In 2019, Manhattan’s investment property market faces wild card of rates & rent regulation - by Howard Raber and David Baruch

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Manhattan’s real estate investment market was a mixed-bag last year and there are concerns that rising interest rates and changes to rent regulation may have the potential to suppress activity in 2019. A look back at Manhattan’s investment sales activity in 2018 shows that investors were already anticipating these market shifts; yet total sales volume and pricing remained rather stable compared to 2017. Investors will continue to be active this year as Manhattan will continue to prove to be one of the stronger markets for both national and international buyers.

On a macro level, Manhattan in 2018 saw a total of 501 transactions consisting of 626 properties totaling $24.4 billion in gross consideration, according to preliminary data from Ariel Property Advisors’ Investment Research Division. Compared to 2017, this data shows that while transaction volume remained flat, there was an 8% increase in property volume and a 33% increase in dollars spent. Such an increase in spending may be attributed to the actions of institutional investors versus the rest of the market as large institutional-caliber deals made a comeback with transactions sold between $250 and $500 million doubling year-over-year to 14 sales. Non-institutional investors were more prudent, evidenced by a slight 5% decrease in price per s/f ($891/s/f) while cap rates held stable at 3.71%).

For total transaction volume across Manhattan, Downtown West led all neighborhoods with 114 sales, while the Upper East Side and Midtown East tied for second, with 97 transactions each. Investors spent the most in Midtown West, with $7.549 billion in sales, followed by Midtown East's $7.019 billion. As to be expected, activity in these areas was bolstered by the larger office and commercial deals, such as the joint acquisition of the 500,000 s/f office and retail conversion project at 261-275 11th Ave. by L&L Holding Co. and Normandy Real Estate Partners for $880 million ($769 per s/f), and Vanbarton Group's purchase of the 700,000 s/f tower at 425 Lexington for $700 million. Of note, office properties encompassed nearly 50% of Manhattan's dollar volume, with $11.146 billion in sales, led by Google's $2.4 billion acquisition of Chelsea Market.

Even with various market factors affecting property valuations, a primary focus for many investors is the multifamily asset class, as supported by nearly 20% of total dollars being spent here. Notable multifamily transactions in 2018 include the sale of Equity Residential's 101 West End Ave. to a joint venture of the Dermot Co. and PGGM, the second largest pension fund in the Netherlands, for $416.1 million; and Dalan Management Associates' acquisition of 102-116 8th Ave., a 115,000 s/f mixed-use portfolio from Brodsky Org. for $83 million.

In 2019, investors in the multifamily sector will be keeping an eye on interest rates and changes to rent guidelines. While both factors are wholly independent from each other, they are equally present in investors' analysis of the multifamily market.

First, the U.S. Federal Reserve, which raised its benchmark short-term interest rate four times last year, is poised to continue raising rates in 2019. It is difficult to predict where prices will head this year as the Fed may opt to change the pace of its increases given an increasingly murky economic backdrop. Most forecasters expect growth to decelerate after 2018's pace, which could prompt the central bank to slow or even pause its interest rate increases. The partial effects of these increases are evident in the multifamily pricing metrics, which saw across-the-board softening, with aforementioned average cap rates in Manhattan rising 17 basis points to 3.71%.

More pressing for many investors who are seeking value-add opportunities is the recent shift in NYS' political landscape, which could be one of the biggest drivers of multifamily real estate prices in 2019. The state senate's flip to Democratic control may pave the way for party leaders to implement sweeping reforms to the state's rent laws that govern rent regulation and limit landlords' capacity to command more money from tenants.

Per current regulations, each time a rent-regulated unit becomes vacant or improvements are made, owners may apply for a supplemental boost to the rent. And eventually the state's vacancy decontrol policy lets them remove their apartments from the system altogether once the price reaches $2,733 and the apartment is empty.

While no official proposition has emerged yet, one idea that has been discussed is to end a system under which landlords can raise rents above what the Rent Guidelines Board requires in exchange for implementing capital improvements on regulated apartments. Some legislators have proposed offering tax incentives to landlords or cash from a coffer to replace the current system.

Another proposal includes eliminating a process that enables landlords to raise rent each time a regulated unit becomes vacant, which allows the apartment to become deregulated when monthly rent reaches the above-mentioned price threshold. Some say the removal of the opportunity to make an apartment vacant would decrease tenant harassment cases and evictions. Investors who are seeking value-add opportunities will most likely be required to alter their buying strategies – which in turn, will have an impact on market values.

Regardless of the effects that may result from higher interest rates and rent regulation, strong fundamentals will continue to favor owning real estate in Manhattan, while demand for well-priced, high-quality assets has not dissipated. No matter what happens to the local and national economy, domestic and international investors will likely continue to pour capital into the borough as it remains a global safe-haven and has historically been one of the best bets around.

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