Northern Manhattan's multifamily market made big strides in 2011

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The multifamily asset class continues to dominate investor interest in Northern Manhattan, accounting for 80% of the commercial real estate transactions uptown.

Investors today are looking at four variables when pricing multifamily assetsâ€”price per s/f, price per unit, cap rate, and gross rent multiples.

Since 2007, capitalization rates have been going up and gross rent multiples have been going down, trends that imply an overall lower valuation for the multifamily asset class. That said, in the first half of 2011, for the first time in four years, we have seen that the average price per s/f and price per unit are going up.

The question is why? The main reason is the sample size's location. In 2009 and 2010, the vast majority of multifamily buildings sold in Washington Heights and Inwood, where rents and building values are typically lower. Much of this was driven by institutions that amassed large portfolios from 2004 to 2007 that now need to liquidate. In 2011, we saw a significant number of buildings sell in East, West and Central Harlem below 135th St. where higher rental levels translate to higher average pricing metrics.

With strong market fundamentals, low interest rates and a lack of returns from alternative investments, investors realize the excellent opportunity uptown multifamily investments present.

Buildings that sell today offer tremendous upside potential and trade at a lower premium compared to 2005, 2006, and 2007. Northern Manhattan has more regulated units than average, which explains the implied upside of the area. When we study the rental market of multifamily buildings in Northern Manhattan, we consistently see most apartments renting at roughly 50% of their free market value.

A higher proportion of rent regulated units also limits the downside to investors. Since the buildings are already operating below market, owners of stabilized buildings uptown are somewhat sheltered from potentially large declines in rents that can accompany buildings with predominantly free market rents.

Banks are also playing an integral role in this market's recovery. Historically low interest rates for this asset class and, with vacancy now contained, lower debt coverage ratios give buyers the flexibility to pay higher prices. For a value-add investor who understands rental upside and is comfortable with lower short-term returns, these dynamics create unique incentives to buy.

Other sectors of Northern Manhattan's real estate market are also either improving or stable.

The free market residential rental market, like the rest of the Manhattan rental market, has shown tremendous strength with rental prices bouncing back to 2008 levels of $30 per s/f.

The free market condominium market is relatively new in Northern Manhattanâ€”less than 10 years old. After falling from 2007 peaks, the average price per square foot of condominiums has held steady around $535. Recent absorption of condominiums has been continuously steady while select offerings and locations can reach prices well over $600 per s/f.

Challenges remain in the retail market but improvement has been occurring particularly in small spaces with low absolute rents.

The development market in Northern Manhattan improved significantly in 2011 compared to 2008, 2009, and 2010 as developers looked to buy land at a discount with plans to build today and sell condominiums in two years when they expect tight residential supply to result in higher sell out values.

Ariel Property Advisors currently has more than 120,000 buildable s/f in contract that is scheduled to close sometime in 2012, and close to 200,000 buildable s/f on the market.

Barring some dramatic economic shock, we believe stronger market fundamentals and the tremendous ongoing investment in the area by large institutions like Columbia University and Hunter College mean that Northern Manhattan real estate has already seen the worst parts of this recession.

This article was adapted from a presentation Shkury made on Upper Manhattan Trends at the NYC Real Estate Expo, which nearly 2,000 real estate professionals attended on November 15, 2011 at Columbia University. Copies of his presentation are available here http://arielpa.com/download/ArielPA-NYCREExpo2011.pdf.

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