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Influx of former city-owned properties on market as compliance period ends

April 11, 2011 - Spotlights

A New York City housing policy initiated during the Koch Administration has resulted in an influx of formerly city-owned buildings coming on the market because owners have reached the end of their compliance period or have expiring benefits.

These buildings are unique because they were among the thousands transferred during New York City's Department of Housing Preservation and Development's Vacant Buildings Program, in which partnerships agreed to completely renovate the properties and enter into regulatory agreements, in exchange for low-interest financing or low-income housing tax credits.

At Ariel Property Advisors, we're evaluating more of these buildings because the initial 15-year compliance period has been met or the J-51 benefits have expired. While many of the buildings will continue to be subject to rent stabilization guidelines or tenancy restrictions for anywhere from 5 to 20 more years, they present investors with a unique opportunity to purchase properties at a significant discount compared to similar, unregulated ones.

For example, we recently closed on a portfolio of eight buildings with more than 200 units located in Upper Manhattan, Brooklyn, and the Bronx that sold for a total of $12 million. The price roughly represents a 6% cap rate with a tremendous upside in the rents. However, the discount is apparent when one looks at the substantially discounted price per s/f and price per unit, which equates to approximately $77 per s/f and $68,000 per unit.

The returns are so low and so restricted, that many investors indicated that they are interested merely in buying the cheap bricks for their grandchildren and great-grandchildren, not themselves.

While it may be difficult to envision, the modern, rapidly developing Upper Manhattan of today was once one of the hardest hit by disinvestment and housing abandonment.

In the 1970s and 1980s, New York City became the "the landlord of last resort" as it seized control of thousands of vacant, dilapidated multifamily buildings in neighborhoods throughout the city for nonpayment of taxes. By the mid-1980s, the city had foreclosed on so many buildings that it found itself owning about 100,000 housing units that it didn't have the financial resources or capacity to manage, depriving residents of much needed housing stock and blighting communities throughout the boroughs.

Mayor Ed Koch took steps to combat this crisis with an ambitious 10-year, $5 billion capital program that offered the assets and financing to responsible owners, developers, tenant cooperatives, and community development groups. Subsequent administrations continued the 10-year plan and also created new initiatives to transfer city-owned buildings to new owners. Northern Manhattan was one of the greatest beneficiaries of these programs, though Bedford-Stuyvesant, the South Bronx, East New York, Bushwick, and Jamaica also received significant resources.

In exchange, new landlords entered into agreements with the city that set and stabilized rents at moderate levels. Some programs required the units only be rented to tenants that fell within certain restricted income requirements. After 15 to 30 years, the units would revert to rent stabilization laws or provide an option for converting to co-ops.

We expect more buildings in these programs to come to market in the next few years for several reasons. First, many major landlords have large holdings of these properties and now wish to deploy the significant equity they have accumulated to more growth-oriented assets. Second, partnerships formed in the 1980s and 1990s may no longer be relevant to the goals of the principals, leading to an eventual sale. Finally, after several decades of managing these assets, some owners simply want to retire.

While we advise all buyers to thoroughly review the regulatory agreements and be prepared for the long haul, properties exiting their compliance period will continue to present an excellent opportunity to acquire relatively inexpensive, well-maintained, long-term real estate investments.

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