Three reasons to buy and three reasons to sell investment property in New York City - by Cole Kinney Leonhardt

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Buying Investment Property

Historically high cap rates

From 2010 up until 2019, investors wondered how low cap rates in New York City could realistically go. With both sizzling demand and a timeless outlook on New York City investment property, the average cap rate got as low as 3.2% in Manhattan. In the post pandemic environment, brokers are underwriting properties in Manhattan at higher cap rates ranging from 5%-6%.

Strong Repositioning Opportunities

The impact of COVID-19 on the real estate industry has caused many previously occupied buildings to go vacant. The largest increase in vacancy is seen in both the hotel and office markets. In Q1 of 2021, New York City recorded the largest office vacancy rate in 30 years at 16.3%. Hotel occupancy rate in June of 2021 was 60%, lower than summer 2018 and 2019 levels of 90%. A lot of vacancy will allow for buildings to be repurposed and have value added.

Low Cost of Capital

Interest rates remain at a historically low level, making it more affordable for purchasers to borrow capital. From 2016-2019 the Federal Funds Rate increased from .5% to 2.5%. This in turn pushed interest rates to higher levels. Currently, the Federal Funds Rate is down to .25%. This allows lender interest rates for conventional commercial loans to be as low as 2%-5%.

Selling Investment Property

Uncertainty of 1031 exchange legislation

The 1031 exchange, also known as the like-kind exchange, allows property owners to exchange properties that are similar. The exchange defers capital gains and has been in the tax code since 1921. Although there was talk about getting rid of this tax code, it did not appear in the House Ways and Means Reconciliation Bill released on September 15, 2021. Real estate investors were relieved it was not included this time—but it doesn't mean it won't come up again in negotiation.

Capital Gains Tax Increase

The "American Families Plan" is a congressional bill proposed by President Biden in April of 2021. It includes raising the top marginal income tax bracket by 19.6% for individuals earning above $452,700 and married couples earning above $509,300. Those earning over $1 million would have both long-term and short-term capital gains taxes also raised from 20% to 39.6%. Many investors are looking to sell off assets before the tax increases apply to all 2022 income.

Property Taxes/Regulation

Although property taxes vary by property type and location in Manhattan, owners have realized that 20%-40% of their revenue goes toward just the property tax. In the last couple of years, owners in New York City have seen tax expenses increase as the financial health of the city has decreased. This has been coupled with new landlord regulations that limit the ability to raise rents. These regulations, such as both rent stabilization law and good cause eviction, make it difficult to keep up with growing expenses. Most New York City landlords have an extremely small profit margin and some only realize a profit when they sell.

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