Multi-Family Buildings Become A Focal Point For Investors In 2012

By Pierre E. Debbas, Romer Debbas, LLP

While the volume of co-op/condominium transactions has increased significantly in 2012, banks are still imposing stringent lending regulations that are forcing many people to shift to renting instead of buying.

This trend has caused averages rents in Manhattan to surpass levels seen during the peak of the market in 2007. Due to the increase in rents, consumers are starting to look to arrears surrounding Manhattan and multi-family apartment buildings as opposed to luxury rental buildings.

Currently the vacancy rate in New York City for multi-family properties is at a historic low of only 1.8%.

We saw a surge in multi-family acquisitions in the first quarter of the year and the momentum for this product continues to move forward. Multi-family building transactions differ significantly from regular residential or commercial transactions. The following are the main factors that we look for in our due diligence for a multi-family building:

1. Cash Flow/Leases

When assessing the value of the building, an investor is relying upon the advertised cash flow. The seller should release all of the leases for the building, audited financial statements (if any) and the tax returns for the building. This will enable the attorney performing due diligence to be able to confirm the advertised rent roll, approximately how long the advertised rent roll will be in place and the duration of the leases.

2. Review of the Records at the Division of Housing & Community Renewal (DHCR)

One of the most important aspects to due diligence for multi-family buildings is the review of the records contained at the DHCR. Most buildings are registered with the DHCR and will state whether the building is subject to rent stabilized, rent controlled or single-room occupancy (SRO) laws. Additionally, if the tenant has logged any complaints against the landlord, they should also be with the DHCR. The buyer of any building steps into the shoes of the landlord/seller and assumes all liability from any complaints that the tenants may have filed and any violation of the leases. Therefore, it is important to confirm that no such complaints exist and that the current leases are not in violation of any laws.

3. Zoning/Permitted Use

The City considers 1-3 unit multi-family buildings to be residential transactions where the "Mansion Tax" of 1% would be applicable and buildings with four or more units to be commercial transactions where the Mansion Tax is not applicable. A review of the certificate of occupancy is mandatory to confirm what the permitted use of the building is and what the permitted use of each floor is. We want to ensure that the building's current use and the leases appurtenant the building are not prohibited by the certificate of occupancy.

4. Engineer's Report

An engineer's inspection either takes place prior to signing a contract or post-contract signing so long as a due diligence period is contained in the contract. The engineer's report will reveal any structural issues, cost of upcoming repairs, environmental issues, etc. The report will demonstrate if the current use of the property potentially violates any City laws or codes. Additionally, the report will reveal any current violations on the building and enable us to negotiate in the contract for how the violations will be addressed prior to closing.

5. Survey/Title Report

We always want to receive a copy of the seller's survey and title report from when they purchased the building to see if there were any existing title issues or survey issues prior to their ownership. Then we can draft certain representations in our contract to protect the buyer for any title or survey defects that the seller may have caused during its ownership of the building (keep in mind the buyer does not conduct a title search until the contract is signed). This will also notify us of any potential title defects that our client may have to take title subject to.

6. Assignment of Mortgage

It is important for us to know the outstanding principal of the seller's mortgage and who the lender is. This will enable us to reach out to the lender and see if we can effectuate an assignment of mortgage from the seller's lender to the buyer's lender. This is commonly referred to as a consolidation, extension and modification agreement (CEMA). A CEMA enables the outstanding principal on the mortgage to be assigned from the current lender to the buyer's lender and thus avoid paying mortgage recoding tax on the sum being assigned. An example of this is if the seller currently has a principal balance of $1,000,000 on their mortgage and the buyer is taking out a mortgage of $1,500,000 with the assignment taking place, then the buyer will only have to pay the mortgage recording tax on the new money which is $500,000. The NYS mortgage recording tax rate on a building of 4 or more units is 2.8% of the principal sum of the mortgage. Under this example, the CEMA would save the buyer approximately $28,000 in mortgage recording tax.

Romer Debbas, LLP
183 Madison Avenue, Suite 904
New York, NY 10016
Tel: 212-888-3100
info@romerdebbas.com