MULTI-FAMILY DWELLINGS REMAIN AN ATTRACTIVE & FLEXIBLE ASSET CLASS FOR TODAY'S INVESTOR

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As high-rise new construction condominium buildings continue to alter the city's skyline as well as the real estate market, commercial investors remain focused on finding more traditional income-producing assets, such as multi-family dwellings and mixed-use properties.

Although long-term appreciation is generally the ultimate goal, return on investment continues to drive the popularity and stability of this asset class. The potential for long-term appreciation coupled with the ability to obtain an annual return will attract the attention of domestic and foreign investors alike. Non-U.S. investment in our market has certainly waned due to many economic and political factors. However, a wide majority of surveys indicate that New York City continues to be the most popular city in the U.S. for real estate investments by foreign investors. Although non-U.S. investors are most commonly associated with luxury condominium and large-scale commercial building acquisitions, there has been a noticeable shift as income-producing assets, such as multi-family dwellings and mixed-use buildings, garner increased attention.

Prior to purchasing a multifamily, investors should focus on the following:

Cash Flow/Leases
Review leases to confirm advertised cash flow, lease term, lease type (market/stabilized/controlled), assignment rights and renewal options. Regarding returns, investors must understand the difference between market leases and stabilized/controlled leases where the returns are much smaller but quite stable.

Engineering Inspections
An engineer's report will indicate any structural issues and whether the building is compliant with local building code.

Division of Housing & Community Renewal Records
Often overlooked, it's important to confirm whether the building is registered, subject to stabilization or rent control laws, or whether there are/have been complaints filed by tenants.

Certificate of Occupancy
A review of the CO will indicate the permitted use of the building and each floor. It will also indicate whether the city considers the building to be residential (one to three units) or commercial (four or more units) or whether Single Room Occupancy (SRO) laws apply, resulting in a need for Certificate of Non-Harassment.

For investors focused on finding a stable income-producing asset, it's a basic financial analysis of the cost to acquire, improve and carry the building versus the annual rental income. However, for an investor seeking a potentially greater return, converting the building to a condominium is a viable alternative. In addition to being a conservative income-producing asset, many investors view these buildings as opportunities for condominium conversion, especially in markets such as Queens, Brooklyn and, most recently, the Bronx.

The conversion route generally begins with an analysis of the cost of the project (both hard and soft) versus the projected gross income received from the sale of the converted units. The hard costs boil down to the purchase price of the property plus the projected construction and renovation costs. Soft costs include title insurance, legal and architect fees, lender fees, carrying costs and, typically, a contingency. Projected gross income from unit sales requires a market analysis from an experienced real estate professional. In some cases, we have helped clients realize rates of return in excess of 20% to 30%, which is much higher than the average cap rates, if the property were to be purchased and maintained as an rental building.

If the numbers make sense, the discussion shifts to whether it is possible from a legal, architectural and construction standpoint. A key factor is whether the existing floor area ratio (FAR) is sufficient to complete the project or whether there are available unused air/developments rights attached to that parcel or even a neighboring parcel which could be transferred. Zoning issues are the other main determining factor: namely, what uses are permitted in the district, whether variances are available, and whether the city's Inclusionary Housing Program (IHP) applies which would require a percentage of the dwelling units to be set aside for affordable housing.

There are many factors to consider when determining the best use of a multifamily or mixed-use property. Whether the intent is conversion or buy and hold, the asset class provides investors with flexibility and options.