Upstate

Commentary on the 2015 Upstate apartment market

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Large class B and C multifamily transactions dominated the upstate New York apartment market this last year. Major buyer focus is on these class B/C units; values are well established and apartment rental growth rates tend to be higher in these apartments than in class A units.

In the city of Buffalo two large class C portfolios traded; the 295-unit low income Braco portfolio sold for $16.5 million, the total cost including extensive renovations will be $42.4 million and the properties will remain as HUD subsidized affordable housing, and the 600-unit Horizon portfolio including brokerage and commercial space sold for $35 million. The combined average per apartment price of over $50,000 before renovation costs is far above levels seen before. Five years ago city of Buffalo sale prices were closer to $25,000 average per unit. The potential for rising apartment rental rates in the downtown central business district and employment growth at the Buffalo Medical Campus are supporting higher nearby class C pricing.

Morgan Management purchased the Grecian Gardens and the Northgate Manor Apartments for a combined $22.5 million or $46,000 per apartment for the total 491 units. This is a current indication of the market for class B suburban brick garden apartments with good locations, good layouts and unit mixes that favor two-bedroom apartments, the vast majority of the demand from upstate multifamily investment buyers. Both properties are in the Rochester suburb of Greece. The seller, Houlihan Parnes from Westchester County, paid $18.8 million for the properties seven and ten years ago.

Capitalization rates for well managed investment grade properties are in the 8-9% range with complexes with upside regularly coming in under 8%. The opportunity to take well located properties and reposition them with higher rents is a large part of the investment process here, the value add component provides the risk premium. Even going in low on the cap-rate rent growth can produce superior future results. Many of the apartment complexes built in the 1960's and 1970's, state of the art at the time they were built, but now showing accumulated deferred maintenance and obsolete finishes. Those with below market rents present the best opportunity. The upgrades necessary are cosmetic and do not require expensive structural changes. Private owners may be reluctant to raise rents as self managers or lack the funding to undertake the capital improvement programs themselves; few have tested the market with bathroom and kitchen upgrades, leaving the investment community to identify the appropriate property and create the added value.

Multifamily is now seen as a small risk investment offering a far higher yield (an 8% capitalization rate is equivalent to the first year un-leveraged yield) than the no risk Treasury Bond or Bank CD investments. This perception has evolved over time as even the smallest owners are able to effectively manage their operations with easily available accounting programs, online payments, and internet advertising. Larger firms have the full range options available including revenue management software and sophisticated property management programs. A realistic handle on the financial performance and forecast helps take the risk out of the equation.

There is a lack of available apartment inventory for sale in all price ranges to satisfy the amount of demand that now exists. Retiring owners long provided a pipeline of new availabilities. Owners are reluctant to put their properties on the market lacking viable 1031 exchange properties to reinvest the full proceeds in larger properties while deferring capital gains taxes or alternate investments such as bank CD's in the case of retiring sellers where the returns are near 1%. Rising interest rates will impact mortgage financing underwriting but should also motivate more owners to market their apartment complexes.

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