Sky's the Limit

REBNY Recap: The Year in Review

Given the hotly contested presidential election in November, 2016 was an eventful one for the country. The mood of the nation during the campaign affected New York City's real estate market, by many accounts in the industry. Coupled with what some see as an oversupply of condos, co-ops and hotel rooms in the city, the market saw a slowdown in some areas, according to REBNY's Statistical Abstract for 2016. Here are some highlights.

The hotel sector

The number of visitors, both from within the U.S. and overseas, has inched up since last year. That has made for a hotel sector where inventory has ticked up to accommodate increased tourism. REBNY's Statistical Abstract found that upscale and mid-priced hotels are averaging the highest occupancy rates, however, with luxury hotels seeing a decline from 2015. The average daily room rate for luxury hotels was just over $400, with room rates for upscale hotels averaging over $200 and for mid-price hotels just under $200.

Jerry Swartz, the senior partner and founder of HKS Capital Partners, a real estate capital advisory firm, has found financing for hotel deals scarce. "Hotels are on the low end of the wish list of lenders right now," said Swartz. "It's very difficult to get them done."

For completed hotels that have been operating for less than a year, the sources of financing tend to be hedge funds, equity funds or opportunity funds, he said. When hotels have been operating for at least a year, conventional lenders are an option, he says.

Swartz isn't alone. "In New York City, we are definitely seeing fewer hotel financings," said Ari Hirt, managing director of debt and equity financing for Mission Capital Advisors, a diversified real estate capital markets solutions firm headquartered in New York City.

One reason is the law of supply and demand. "There was concern about the supply of hotel rooms in New York and about the number of hotels coming online," said Hirt. "While lenders are concerned about [supply] in New York. I don't believe they need to be as concerned. New York has always absorbed whatever it has built—apartments, hotels."

Hotels being built today tend to be affordable hotels, such as Holiday Inns and Hampton Inns, said Slattery. "We're not building more Waldorf Astorias," said Slattery.

Eric Margules, president of real estate investment firm Margules Properties in Manhattan, has found that banks are getting stricter with their lending requirements for his multifamily, office and retail projects.

"Things that were not a problem a year or two ago are all of a sudden problems," said Margules, whose deals are typically in the $10-$20 million dollar range. "Banks are looking for deposit relationships, security accounts, any kind of money they can get deposited. They are much more insistent than they used to be."

Margules is not alone in finding that New York City's real estate market is changing. Many in the development and financing realms are finding their projects affected by the recent interest-rate hike by the Federal Reserve, which raised its federal funds range by .5% to .75% in a unanimous vote Dec. 14. The hike has given rise to an increase in nonbank lending and a slowdown in construction lending. But many anticipate that the recent election of Donald Trump as president may counterbalance this, ushering in a more relaxed regulatory climate and increased mortgage lending.

At the moment, the interest-rate hike is already affecting many in both residential and commercial real estate, with the boroughs outside of Manhattan hit hardest.

Manhattan has in recent years dominated housing starts in New York City and was home to 68% of the value of new construction starts in New York City in the first nine months of 2016, according to a New York Building Congress analysis of construction data from Dodge Data & Analytics. For the five-year period spanning 2011-2015, Brooklyn and Queens were each home to 16% of the value of new construction starts — and the percentages were about the same in 2016. The Bronx accounted for 6% of the value and Staten Island 4%.

David Shorenstein, principal of Silvershore Properties, which invests in multifamily buildings in Brooklyn, Manhattan and Queens, has seen deals taking an extra month to six weeks to close since the increase.

"It's definitely slower," said Shorenstein. "Everything is moving at a slower pace. Sometimes the rate will go up in the middle of a deal and delay it."

To finance acquisitions of vacant buildings in Brooklyn, Manhattan and Queens, Shorenstein has been turning to hard-money lenders, rather than banks, securing financing in the 9% to 12% interest rate range. "The only loans you get are high-interest-rate loans where you have to fund the entire business plan at acquisition," he said.

Similarly, Ari Hirt, managing director of debt and equity financing at Mission Capital Advisors, a diversified real estate capital markets solutions firm headquartered in New York City, has found that on both short-term, floating-rate deals and long-term deals, there has been an increase in interest rates. That has had implications for projects in the area.

"In New York City, we're seeing a pullback in construction financing," said Hirt. "There aren't as many lenders that are lending for new construction. Particularly on the bank side, there has been a reduction in leverage due to regulations but nonbank lenders are filling in some of that space, especially for well-conceived projects with good sponsors."

The pullback is particularly pronounced, he said, in the construction of higher-end condos. "There is concern about how many buyers there are for high-ticket luxury condos," said Hirt.

Ayush Kapahi, principal and founding partner of real estate finance firm HKS Capital, has also turned to nonbank lenders, paring them with banks, in the current climate.

"We just closed out a very large construction loan when everyone has been saying over the last 12 months [construction is] dead," said Kapahi. The $150 million, nonrecourse loan was made to the private developer of a 467-unit, multifamily rental building in Long Island City. It was one of a number of such loans closed in recent months, he said.

However, the lender, in this case, was not a bank. It was an insurance company—and not the only one active in the market.

"Debt funds are effectively filling the gap where other institutions are having a tough time swallowing a leverage level or when banks believe they have too much exposure in a specific asset class," said Kapahi.

In what has proved to be a very liquid environment "you don't know who is going to win what deal, based on their appetite for risk," Kapahi said.

Not all developers are finding their situation changing, however. "I just closed a $3 million loan at 3.25%. It wasn't too complicated," said Mitchel Maidman, president of Townhouse Management, which owns 70 residential and commercial buildings in New York City. The deal was for a 17-unit walkup on the Upper East Side.

And some players on the local real estate market, like Leonard Strindberg, are optimistic about what rising interest rates bode for the city's real estate market. Strindberg is president of Compass, a Manhattan firm that specializes in the marketing of high-end New York real estate.

"When interest rates rise, they usually indicate a strengthening economy," said Strindberg. "When you look at the average interest rates, the interest rate for a 30-year mortgage is the equivalent of April 2014—a very strong real estate market. We know real estate markets have done very well with this level of interest rates."

Strindberg and other observers are also optimistic about what Trump's policies will mean for New York City real estate. Trump's transition team has said it will work to dismantle the Dodd-Frank Act, which has been blamed by critics for stifling lending. "Regulation may be reduced," said Strindberg.

According to Strindberg, some of the Dodd-Frank Act have imposed cumbersome requirements that don't make sense in obtaining a mortgage. "If you open up the ability for people to get mortgages that could be spectacularly effective in boosting first-time home buyers," he said. "Easing the Dodd-Frank regulations will be a mammoth injection in the real estate market." Right now, however, many will be waiting to see what Trump does in his first 100 days before predicting what is to come.