

APARTMENT BUILDINGS REMAIN “GOLD STANDARD” FOR LENDERS IN NEW JERSEY
With Year-End Tax Changes Looming, Building Owners Should Evaluate Portfolios

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We continue to hear about the poor economy, high jobless rates and strict regulatory constraints, which have created substantial cutbacks in the commercial real estate-based lending market. Office vacancies remain high, industrial building sales remain weak, and the entire retail sector continues to plod along with no discernible “light at the end of the tunnel.” Accordingly, commercial lending in these segments of the real estate industry continues to be weak and lending standards continue to be constrained. Thus, commercial real estate owners of these property types are required to show substantial cash flow, low vacancy factors and long-term tenants. Even at that, lenders require borrowers to have substantial “skin in the game.” The days of 80% and 90% loan-to-value (LTV) ratios are gone and in their place LTV’s of 60%, 65%, and 70% are more commonplace.

Fortunately, one segment of the real estate industry remains constant and for lenders, reflects the “gold standard” for lending purposes; that is, the apartment building industry. That this industry is so strong, is not surprising. In a study commissioned by the New Jersey Apartment Association, the Edward J. Bloustein School of Planning and Public Policy at Rutgers University determined that the multi-family industry, directly or indirectly, supports about 44,000 jobs in New Jersey and contributes more than \$5.7 billion to New Jersey’s Gross Domestic Product, while generating more than \$1 billion in local tax revenues.

Lenders across the board from small local banks, commercial regional banks, and life insurance companies are now in a bidding war to attract owners of apartment buildings. Because money is now so “cheap”, in part due to the fiscal monetary easing policies of the federal government, lending rates have reached an all-time low. For example, one prominent real estate developer and owner of multi-family properties, Andrew Abramson of Value Companies, headquartered in Clifton, New Jersey, has indicated that loans as high as \$20 million are being made by regional banks, such as Valley National Bank, at interest rates at or below 4%, with loan terms of 5 to 10 years.

Just a scant two years ago, multi-family loans were averaging 200 basis points above these rates, which reflects the strength of the industry and the competition among lenders to make loans to this segment of the real estate market. Strong local players include Columbia Bank, Valley National Bank, Lakeland Bank, and Union Center National Bank.

How long the strength of the multi-family industry will continue remains to be seen. In this economic cycle, the industry could be labeled in its “middle age”. There is still some support for higher rents and possibly lower cap rates, but this varies from one geographic region to another. Nevertheless, the door is rapidly closing. Some developers who would have built condominiums four years ago, are opting today for apartments. As greater supply of apartments becomes available in the marketplace, coupled with an improving economy, demand for apartments could drop off with a consequential reduction in rents and pricing.

As we move perilously close to the fiscal cliff at the end of 2012 given the real possibility of termination of the Bush tax cuts, which will mean substantial increases in the capital gains tax rate, as well as the corporate income

tax rate, many multi-family apartment building owners are looking to sell their properties this year and either pay the lower capital gains tax or transition their gains into 1031 tax-free exchange properties, once they stabilize their cash flow with low interest rate, long term mortgages. Indeed, Jose Cruz, Senior Managing Director of HFF, one of the nation's largest commercial real estate financing companies, recently stated that multi-family "A" properties were selling for cap rates in the 4.75 – 5.5 range, well below cap rates in other market sectors in the real estate industry. With a high level of activity, both in the refinancing and sales areas in the multi-family industry, it is clear that this is where the action is. Ken Uranowitz, Managing Director of Gebroe-Hammer Associates, with corporate offices located in Livingston, New Jersey, recently indicated that his firm had one of its most active years in the sale and purchase of multi-family properties, consistent with the preeminence of the multi-family industry as a whole.

In conclusion, multi-family property owners should be taking immediate steps: (1) to evaluate their portfolios in determining whether refinancing can result in a better stabilized fiscal position with a higher cash return and (2) to determine whether the sale and/or purchase of multi-family properties prior to the end of 2012 makes sense for them.

If you would like to discuss this client advisory or a related matter, please contact Arnold D. Litt, Chair of the Real Estate/Banking Practice of the North Jersey office of Archer & Greiner, P.C., a regional law firm with offices in New Jersey, Pennsylvania, Delaware and New York. Mr. Litt can be reached in Hackensack at 201-498-8520 or at Alitt@archerlaw.com.

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