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Mult-Housing: Increased real estate market value offsets significant financing pre-payment penalties

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The New England multi-family market continued to experience an increase in market value in 2014. The combination of high investor demand, limited inventory, and low interest rates has continued to fuel rapid appreciation in the region. While multi-family sales were driven by the fear of these new taxes in 2012, a sense of general acceptance has grown over investors that these taxes will be here for some time and business must go on. Fortunately for building owners the surge in multi-family property value has trumped the rise in taxes and has created a strong seller's market. The result is an increase in transactions from 124 in 2013 to 153 this past year for buildings with nine units or more and a sale price greater than a half million.

In the Greater Boston market with the limited inventory of mid-level deals (10-100 units) for sale, investors are still acquiring smaller 4 to 8 unit multi-family properties. In 2014 there were 920 of these transactions statewide compared to 829 the previous year resulting in a 9% increase. Many of these 4 to 8 unit properties were purchased during the last market's peak from 2004 to 2007. Only a couple years ago many of these properties would have been lucky to sell for the debt owed. Today they are now selling at prices higher than paid during the last boom.

In addition to smaller buildings, investors are looking towards secondary markets to capture increased rates of returns. With lesser returns found in the Greater Boston and New York City market, investors are migrating to the Southeastern Mass.-Rhode Island and Connecticut markets. A transaction recently closed by UMF on 114 units in Fall River resulted in a CAP rate to the investor at 9%. For the most part these secondary markets can earn investors double digit returns on their investment with Hartford and Springfield as examples.

UMF recently opened an office in New York City and have become heavily involved in the Conn. market attracting NYC investors to the properties we represent. The sale of class B-C buildings with 24 units or more in Conn. increased in both transactions (37%) and market value (4%) statewide in 2014 as compared to the previous year. The number of Larger class A property transactions increased dramatically by 72% due to improvement of the local rental market and signs of the economy improving.

Besides capital gains an even greater issue for many owners is the heavy pre-payment on the financing they obtained back in 2007. These loans were very popular at the time since an investor could lock the rate for ten years. The problem for many owners is the significant prepayment penalty factored by yield maintenance or defeasance which could eradicate any potential profit or create a loss upon sale. The only way to avoid the penalty is if the buyer would be willing to assume the existing debt typically at a much higher interest rate and lower loan-to-value (LTV) as compared to today's financing. Today a buyer can obtain financing in the 4% range whereas the interest rates back in 2007 were as high as 6.5%. In addition today's loan-to-values are as high as 80% where in

many cases the LTV could be in the 50% to 60% range for the assumable debt. These are just two factors that adversely affect the value of the property if the buyer had to assume the existing debt. Not to mention that the existing debt is coming due soon and it is difficult to forecast where interest rates will be at that time. The good news is that many of these loans are maturing soon making the penalty somewhat palatable for the sellers who do decide to pay it. Our experience is that most investors are willing to pay more for a property where they are able to take advantage of today's low interest rates as opposed to assuming existing debt at a higher rate. The end result is the increase in value significantly offsets the penalty a seller would have to pay.

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