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Picking up the pieces

Price cuts, switch to rentals help to restart emerging markets

By **Andrew Marks**

In the time it takes to say “Lehman Brothers,” developers' remaining hopes of making a killing in three emerging neighborhoods—Harlem; Long Island City, Queens; and Williamsburg, Brooklyn—crashed to earth in late 2008, as buyers and lenders raced each other to the exits.

This year, many of those same developers are seeing signs that both buyers and lenders are edging back into action. Most developers hung on last year by eating into their cash reserves and relying on their creditors to “amend and extend” their financing rather than foreclose—and get, say, 50 cents on the dollar in a fire sale.

“We're seeing some encouraging signs of stabilization,” says Jonathan Miller, president of residential appraisal firm Miller Samuel. “But with so much new-inventory overhang, it's too early to say the worst is over in the emerging neighborhoods.”

Harlem condo kings now rental mavens

Three years after developer Luca Capin bought an apartment building on West 145th Street and converted it into a 32-unit luxury condominium, the building is 95% occupied. The killer was getting there.

After selling only four units in four months, Mr. Capin, president of Capin & Associates, switched in 2008 from selling them for $700 per square foot to renting them for $30 per square foot. Eighteen months later, he slashed that rent by 25%.

“We all wanted to be kings of Harlem,” Mr. Capin says of himself and his peers. “But for now, we all do what we have to do to survive until conditions improve.”

The coronation was cancelled by a market rout that pushed down the average apartment sale price in Harlem to $667,000 in fourth-quarter 2009, from $944,000 at the peak in first-quarter 2007, according to Miller Samuel data. The number of sales last year fell to just 212, versus 397 in 2007.

“It's been a painful struggle,” says Arthur Fefferman, president of AFC Realty Capital.

Since commencing sales in July 2008 at Rhapsody on Fifth at $750 per square foot—with 11 out of the 22 units presold—Mr. Fefferman has slashed prices by a third. He's now losing money on every unit he sells at the property, located on Fifth Avenue at West 127th Street.

“But reflective of all of Harlem, we've done what we had to do to respond to market forces and generate sales, and in the past few months, it's been paying off,” Mr. Fefferman says.

After logging just three sales from the middle of 2008 through 2009, he has sold five apartments this year, bringing Rhapsody on Fifth to 85% occupancy.

The prospect of such slow progress has moved many other developers to convert their properties to rentals. Rentals don't bring in nearly as much cash, but at least they keep the door open for sales down the road.

Fortunately, vacancy rates have remained stable in Harlem since 2007—below 5%—and average rents have dipped only 17%, Massey Knakal Realty Services says.

The 90-unit building known as 119th & Third was one of three new East Harlem luxury developments that switched from a condo to a rental in the past year. Toby Klein, director of marketing for 119 Third Avenue Associates, was selling condos priced as high as $1.3 million as recently as last April, when the owners decided to make the building a rental.

“It wasn't the way the building was conceived, but we had to adjust to the market,” she says.

She notes that the property's gym, private rooftop cabanas and garage—meant to entice high-end buyers who can't quite afford the $2 million to $3 million price tags south of 96th Street—are being offered as freebies to renters for up to 12 months. The building is now 85% occupied.

Market conditions remain tough in Harlem, and the number of stalled projects there shows it. There were five last year, up from just one a year earlier, according to New York University's Furman Center for Real Estate and Urban Policy. In addition, one luxury building, 46-unit Dafina at 2130 Adam Clayton Powell Jr. Blvd., was pulled from the market this year.

OVER AT SOHA 118, on West 118th Street, developer Yoav Haron of Artimus Construction has reduced prices by just 10% to 15%; they range up to $1.65 million. The 91-unit luxury condo opened in late 2007, and the firm had sold 67 units by mid-2008. Mr. Haron has inked only seven deals since then—two within the past month.

“Southern and central Harlem have held up pretty well,” says Mr. Haron. “It's a more established submarket, and we've got the retail around here that people coming from the Upper West Side need to see before they spend $1 million on an apartment.”

Mr. Haron points to the Best Yet supermarket that just opened in his building, along with a Starbucks and a Chase branch.

Projects sell in LIC when price is right

More so than Williamsburg or Harlem, Long Island City depended on an ample supply of value-priced housing to attract home buyers. According to veteran developers and brokers, when it comes to emerging neighborhoods, Long Island City is a great idea at $600 to $650 per square foot.

Unfortunately, “it's a terrible one at $800 per square foot,” says William Procida, who developed several projects there when he was head of real estate investment firm Palisades Financial. “The problem is, so much of the new development that's gone up there in the past three years was projected closer to $800 or even $850.”

New York University's Furman Center for Real Estate and Urban Policy says it has records of seven stalled construction sites in Long Island City, and John Reinertsen, senior vice president of brokerage services at the local office of CB Richard Ellis, doubts the neighborhood has hit bottom yet.

“Even the financially healthy developers are on the five- to 10-year plan here,” he says. “There is still lots of blood to be spilled for the next few years before some of this excess inventory is absorbed.”

He points to stalled sales even at established luxury developments, like 237-unit Arris Lofts: The Andalex Group has 18 unsold units, most of them priced above $750,000. After selling 100 units at The PowerHouse, CGS Builders is quietly leasing out many of the remaining 80.

The toll that the downturn is taking on developers—and related businesses—is mounting by the day.

“As Long Island City boomed right up through 2007, we picked up seven buildings as clients,” says Robert Francis, chief executive of Planned Cos., a building services firm. “But in the past 18 months, several of those owners have come back to us and asked for more flexibility on their payments; some others have defaulted on payments altogether.”

But demand is still there for well-priced projects. Highlyann Krasnow, executive vice president at The Developers Group, the new development division of The Real Estate Group of New York, says she has a list of more than 100 prospects to draw from when sales launch this spring at Hudson Equities' Murano. The 76-unit condo on Borden Avenue is priced between $550 and $600 per square foot.

Ebbing fears about an economic cataclysm produced an 82% rise in area sales in fourth-quarter 2009 versus the disastrous drought of a year earlier. That rise accompanied a nearly 16% drop in condo prices, bringing the median sale to $468,000, appraiser Miller Samuel says.

“Long Island City is definitely lagging,” says Ms. Krasnow, whose brokerage firm handles the sales for more than 20 residential projects in Long Island City and Williamsburg. “But if you price your building competitively, it will sell.”

Her observation is echoed by Robson Lemos, a senior vice president at The Corcoran Group and a longtime Long Island City broker, who blames the inventory overhang as much on developers mispricing their buildings as on the recession.

“About 70% of what's moving here now is from first-time buyers looking at one or maybe two bedrooms for under $500,000,” Mr. Lemos says. “That's always been the core profile here.”

HIGH MONTHLY FEES and locations that are many blocks from the subway are hampering sales at some properties near Astoria Park, like Pistilli Riverview East and the Piano Factory, says The Corcoran Group's Robson Lemos.

“They're asking common charges of up to $1,000 for a one-bedroom,” he says. “That's what people came here to pay for rentals a few years ago.”

Smaller sells better in Williamsburg

The rumble of jackhammers and heavy construction equipment filling the air in Williamsburg—a neighborhood with more than its share of stalled residential development projects—is music to the ears of David Maundrell.

“Just in the last month or two, I'm seeing—and hearing—construction crews coming back to work,” says Mr. Maundrell, a broker who is the president of Aptsandlofts.com.

He has spotted signs of life at two vacant lots along North Ninth Street, a once-busy strip more recently known for its rising numbers of homeless people and drug users.

“Sales are on the rise again,” Mr. Maundrell adds, “but there's a still a lot of inventory out here to work.”

Indeed, much of the recent progress has come at a high price for developers, who have cut their asking prices and converted some condos to rentals. Brokers estimate that condo prices in Williamsburg have tumbled 30% to 35% below their peaks.

Warehouse 11 on North 11th Street is a case in point. Its owner has sold 70 of the 120 apartments since slashing prices to the mid-$500s per square foot in mid-January, from an average of $770 when the property opened in July 2007.

GFI Development Co., the owner of 100 Engert Ave., took a different approach. GFI bought the land three years ago at the height of the market. But rather than put the Century Vintage development on hold when the economy went downhill, GFI changed its plan for the high-end finishes and appliances typical of new developments in the area. Instead, the company went with what Steven Hurwitz, GFI's vice president of acquisitions and development, calls a “traditional” look, which was much cheaper.

Cheaper paid off. Since the property went on the market in October, half of the 31 units have been sold, at prices ranging from $485,000 to $659,000. But the average price of $635 per square foot is almost $100 below the average for a new North Williamsburg condo.

Broker Highlyann Krasnow, an executive vice president at The Developers Group, is also seeing signs of life in the lower reaches of the market. She closed seven deals in Williamsburg in the last week of January alone, making it her best week there in more than a year.

“Velocity has picked up in Williamsburg since December, but it's mostly in smaller one-bedroom units: apartments that can qualify for FHA loan guarantees,” Ms. Krasnow says.

Condos aren't the only things that are going for less these days. Eastern Consolidated's David Schecht-man last month brokered distressed-mortgage sales on two unfinished Williamsburg luxury condos.

“The discount was about 33% on both deals,” he says.

David Sigman, who heads the New York office of Berwyn, Pa.-based LCOR Inc., was also able to capitalize on another developer's problems. The company acquired 34 Berry St. in 2007 from a condo developer who couldn't get a construction loan; LCOR is now developing the property as a rental. Mr. Sigman expects to ask in the mid- to upper $40s per square foot when leasing begins in mid-March, while offering one month rent-free.

“Williamsburg has great infrastructure to get back on the upswing once the economy fully turns,” Mr. Sigman says. “We're looking for more partially completed projects there that we can take over.”

HEFTY PRICE CUTS may be the order of the day in Williamsburg, but they are not universal. Many developers, including Jeffrey Levine, president of Douglaston Development, are sticking to their guns. Since marketing began in June 2008 for The Edge, a 565-unit waterfront condo development, he's nudged prices down a scant 5%, to $900 per square foot. He sold more than 100 units in the first six months; since then, he has sold only 56.

“Having only 30% sold this far along is obviously far less than we'd anticipated,” says Mr. Levine. “But we'll be OK if we can sell out in another year or two.”