Long-term investors should always be interested in needs-based hard asset like apartments

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After rising to near 5% and falling back down to 3.6% in the last year the ten-year treasury note has stabilized in a range around 4% even with the recent turmoil over new import tariffs, significantly higher than four years ago. More interest rate cuts look to be unlikely this year and more predictable mortgage interest rates help with the higher leverage underwriting real estate investors need as lenders are more comfortable with the certainty that this brings. Typical bank lending here has a five-year term and this year will be the last year for mortgage renewals since rates began rising in 2020. In the last five years those with maturing mortgages have found new financing at the new higher rates, the defaults expected from overleveraged properties, those where the net operating income couldn't cover the new higher debt service, haven't occurred. The industry is adapting to the new market reality; the gap between cap rates and mortgage rates is decreasing and values are more easily determined and agreed upon by buyers, sellers, and lenders with stable interest rates making sales and financing easier and expect deal activity to pick up in the Buffalo apartment market in 2025 over 2024. Total sales in 2024 were $118 million, below $200 million for the first time in three years.

Insurance costs and property taxes, the two largest operating expense items, rose faster than rents last year. Insurance increases reflect the nationwide surge in material and construction costs that started with the end of COVID. The New York state lead-safe renovation, repair and painting act pending in the Assembly will force insurers to the cover costs of lead paint remediation which will raise rates further for multifamily owners. Property tax increases are the result of overspending at all levels of government. The assessor's offices here send requests for annual income and expense figures, although a response is voluntary, in New York City building owners must submit annual income and expense reports to the assessor's office subject to a fine if late. Expect the same level of intrusive mandatory government reporting to start happening here with the expectation that the information will be used to set the property tax levies at levels, as a percentage of the potential rental income, that extract the maximum amount of tax revenue possible from income property owners. This, along with the Good Cause Eviction Bill, will further the regulation of the profitability of apartment investments. The Good Cause Eviction Bill, law in New York City, essentially prohibits eviction and limits rent increases and will spread across the state as municipalities opt in. A high profit margin is what attracts investment in new apartment construction and creates the additional supply that's needed, this is how economics works. Prospective tenants outnumber vacancies and rents are expected to keep rising and as always building managers need to keep their rents at market at all times, lost rents are never recovered, and higher operating costs cut the net income available for cash flow and debt service and reduce resale values. Management should always be focused on growing net operating income to insulate property values from the inevitable tax, insurance, and operating expense increases.

Property values here fluctuate less than in more speculative markets in the country allowing lenders to feel more comfortable with high leverage mortgages. Higher interest rates and cash buyers have frozen tenants out of the home ownership market and most tenants renew their lease and historically the Buffalo market has seen high occupancy in the apartment market. Leveraging against this income stream using mortgage financing can produce double digit returns on a small 20-25% equity down payment. There are few investments available with such leverage and returns over the long term. Short-term residential lease contracts inflation proofs the investment, the ability to raise rents annually in response to changing market conditions, as compared to other classes of commercial real estate investment with longer lease terms. There is optimism in the multifamily industry and long-term investors should always be interested in needs-based hard assets like apartments.

Brian Heine is a licensed real estate broker in New York state.