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DEAL OF THE WEEK

Uptown Maintains Upside

Property Values Soar in Harlem, Other Once-Bleak Neighborhoods

Two Harlem buildings, including the one above on West 116th Street, just sold for $15.4 million. *ARIEL PROPERTY ADVISORS*

By MAX TAVES
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Soaring property values in New York neighborhoods once associated with crime and poverty are producing healthy profits for developers who jumped in early.

Consider this recent deal: Springhouse Partners' Adam Verner just purchased two Harlem apartment buildings with 59 mostly-rent-regulated units and seven retail spaces for $15.4 million. The seller was Treetop Development, a New Jersey investment company that bought them for $8.8 million in 2012.

The payoff was even bigger for an earlier investor in the properties. Treetop bought the buildings—one on West 116th, the other on West 125th—from Hosford & Poteat Realty, which paid just $1 for them through a city program in 1991. Back then the area was bleak and few thought multimillion-dollar price tags were a possibility.

"Nothing was trading in Harlem in 1991. It was a war zone," said Matthew Sparks of broker Eastern Consolidated. Now, Mr. Sparks says, "people definitely believe in this market."

The eye-popping prices being paid for residential buildings in neighborhoods such as Harlem, the South Bronx and Bedford Stuyvesant in Brooklyn are partly a reflection of New York's success at boosting employment and its appeal as a place to live. Rents and occupancy rates have been steadily rising in these areas.

But the widening of the city's real-estate boom also is a sign of the growing demand for investment properties throughout the world. With interest rates at historically low levels, yield-hungry investors are bidding up prices globally, particularly in the most desirable cities like New York, London and Paris.

Between 2011 and 2013, the value of multifamily properties sold in northern Manhattan rose nearly fourfold, from $440 million to $1.65 billion, according to broker Ariel Property Advisors, which represented Treetop in its recent sale and tracks properties in Morningside Heights, Harlem, Washington Heights and Inwood.

And prices there for multifamily apartments topped $257 a square foot in the first half of 2014—the highest they have been since their prerecession high of $239 in 2007.

Real-estate experts also measure rising values in terms of the yields that buyers get from properties' incomes. These yields, or capitalization rates, fall as prices rise.

The cap rate of the two buildings Springhouse just purchased is 4.5%, compared with 6% in 2012, according to Treetop.

Mr. Verner, a prolific New York residential investor, believes he will be able to boost the properties' income because the area is steadily improving. Columbia University is building more than 6.8 million square feet of new teaching, research and administration space, among other uses, on a 17-acre, four-block site between 129th and 133rd Streets.

"We acquired this portfolio at 12 times rent," Mr. Verner said. "So from a value perspective, we feel very good because most deals in the area are trading around 13.5 times rent."

Retail also is flourishing. Whole Foods began building a 39,000-square-foot store from the ground up nearby last December. It is scheduled to open next summer.

"It used to be...mom-and-pop-type stores," says Adam Mermelstein, a Treetop principal. "We're now seeing more chain-type restaurants like Chipotle but also boutiques, trendier ones."

For residential property owners, these demographic changes are important for obvious reasons: The new tenants can afford higher rents.

Many apartments in New York's emerging neighborhoods are subject to the city's rent regulations, limiting landlords' ability to increase revenue. But over the years, these rules have eased, enabling owners to charge market rates for an increasing number of units.

All but seven of the 59 units Treetop bought in the two buildings in 2012 were rent-stabilized. But Treetop was able to bring 15 of its three-bedroom units up to market rate by renovating them with new stainless-steel appliances, tiled bathrooms and other features. The average rent of the units rose from $1,500 a month to $2,600, allowing Treetop to increase the buildings' net operating income to $700,000 from $500,000 a year.

Treetop has no plan to stop buying property in the area. In fact, it is poised to complete a $95 million deal next month for 400 more apartments in Inwood.

Says Mr. Mermelstein: "We walk that line between adding value and being sensitive to current tenants."