

THE REAL DEAL

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Playing by a new set of rules for condo conversions

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Developers converting the landmark Aphorp apartment building on Manhattan's Upper West Side must follow a new playbook that takes into account both a changed real estate market and a spate of court rulings that could bolster the resolve of tenants battling the shift to condos.

After buying the 163-unit rental complex for a record \$425 million in March, Maurice Mann and Lev Leviev became the latest investors to ride a wave of massive deals in a Manhattan real estate market that many deemed unstoppable.

But recent court fights waged by rental tenants at Sheffield57 and Manhattan House could mean Mann and Leviev face a highly charged regulatory environment where tenants, lawyers and legislators will fight them at every turn. In late November, a housing court judge dismissed eviction proceedings against a group of tenants at Manhattan House, one of a pair of decisions that could make it harder to convert market-rate rental buildings to condos.

Mann and Leviev will also be operating in a more risk-averse financial climate, which could mean trouble if their plans are delayed.

"The climate politically for condo conversions is a complicated one," said Kent Swig, president of Swig Equities, a Manhattan-based developer, who is also an owner and co-chairman of Terra Holdings, which owns and operates the brokerages Halstead Property and Brown Harris Stevens. "And the appetite from banks for pure condo conversions that have any risk attached to them is not what it was just six months ago."

Swig knows better than most. Prior to the subprime debacle in 2007, the market for luxury condo conversions was red hot. From 1997 to 2006, the average price for condos and cooperative apartments tripled from \$430,000 to a record \$1.3 million, according to appraisal firm Miller Samuel. In 2006, the number of condo and co-op conversions filed with the New York State Attorney General more than tripled from 2002, from 299 to 929.

But even during the boom, the hazards were apparent. A 2005 report by Fitch Ratings said investors nationwide spent about \$13.5 billion to buy rental apartments in 2004, an astounding 350 percent one-year jump. More importantly, analyst Deana Treanor predicted that 10 percent of the conversion loans taken out in 2005 would default over the next three to five years.

It was an early comment on a market that was moving more out of control.

"Projects requiring significant construction or in the early stages of the conversion approval process are more likely to be delayed, as evidenced by condo-conversion projects in markets such as New York, Las Vegas and Florida," the report noted. "The lure of a quick profit is also attracting inexperienced

developers, which increases the probability of defaults on condo-conversion loans, especially in an overheated market.”

The Sheffield story

In 2005, Swig led an investor group that acquired the Sheffield, an 845-unit luxury rental tower located near Columbus Circle, from Rose Associates for a record \$418 million. Before entering the New York real estate market, Swig had lost a \$173 million conversion project in San Francisco after he defaulted on payments. Prudential Insurance Co. foreclosed on that project in April 2001, after Swig was unable to secure construction financing.

The Sheffield57 project, which included 109,000 square feet of office space and 6,900 square feet of retail, seemed perfect for a condo conversion. More than 80 percent of the building consisted of market-rate apartments.

However, relations quickly soured between Swig and the Sheffield tenants, who filed numerous complaints with the New York City Buildings Department about hallways being stripped of fixtures, wallpaper and carpeting, asbestos contamination and frequent shutdowns of heat, hot water and elevator service. Hundreds of tenants have either been forced out or abandoned their apartments in frustration over conditions at the building, which critics charge were horrific.

“The developer thus far has not been responsive and has been completely antagonistic,” said Micah Lasher, an aide to Rep. Jerry Nadler, whose congressional district includes the Sheffield. “Whatever the motivation, the developer has shown a clear lack of concern for the quality of life.”

Swig emphatically denies that the building has any asbestos problem and says that weekend construction has only taken place on lower floors where the building has commercial office space.

Court rulings

Further compounding Swig’s problems are a couple of rulings issued last year by Housing Court Judge David Cohen. In a mid-March decision, Judge Cohen ruled that Swig could not force 23 market-rate rental tenants to vacate the Sheffield57 condo conversion.

Judge Cohen said that even though the tenants paid market-rate rents and were not covered by rent-stabilization laws, they were protected against eviction by the state’s 1982 Martin Act, a New York law that regulates the conversion of residential rental buildings into condominiums.

In his Nov. 28 ruling, the judge said that the 31 market-rate tenants at Manhattan House, the landmark 583-unit luxury tower on East 66th Street, were also protected from eviction under the Martin Act and could not be evicted unless a tenant refuses to pay rent or violates a lease agreement.

The ruling bucks a two-decade old interpretation of the state’s Martin Act, which was formerly interpreted to mean that market-rate tenants had virtually no rights to prevent evictions due to a condo conversion.

“Market-rate tenants are ordinarily protected only to the extent of their lease,” said City Councilman David Garodnick, who is sponsoring a bill that would punish landlords who harass tenants into leaving their apartments.

Since the initial March 2007 ruling in the Sheffield⁵⁷ case, Swig has refused to accept rent payments from his 23 remaining market-rate tenants, and many of the building's 90 rent-stabilized tenants have stopped paying rent due to frustration over living conditions, according to Rovelli.

Swig has sold six commercial floors to Hearst for \$93 million and 53 condo apartments at prices ranging from \$635,000 to \$1.4 million, according to city records. However, due to the extensive complaints about the renovation, he had been unable to move many tenants into renovated units, despite gaining approval for the offering plan in March 2007.

Real estate lawyer Jamie Heiberger-Jacobsen said that she believes the rulings are erroneous and will be overturned on appeal.

"If people are in these apartments and their lease is up prior to the time that the conversion plan is accepted, they do not have any rights," she said. She conceded that if the decision is upheld, it could force landlords to make a choice between selling an apartment on the open market and accepting market-rate rents.

Manhattan House headache

After settling a bitter legal dispute with former co-owner Richard Kalikow, developer Jerry O'Connor put together an ambitious plan to convert Manhattan House into a hotel-quality luxury residence, with spa facilities, a resident manager with 65 on-site concierge staff, valet parking, a children's play center and a 10,000-square-foot rooftop lounge.

But that conversion isn't moving as smoothly as the developer would like, due in part to tenant complaints. Manhattan House tenants complain that the building suffers from extensive flooding, asbestos contamination, rodents and other problems that the management is trying to cover up. In an amended filing, Manhattan House officials boosted the insider discount to tenants by 10 points to 25 percent. Only three of the first 15 sales came from insiders, according to the tenants' group.

Prudential Douglas Elliman placed about 90 of Manhattan House's 584 apartments, or 15 percent of its units, on the condo market with asking prices ranging from \$722,000 for a studio to more than \$6 million for a five-bedroom, five-bath apartment.

According to Manhattan House's amended conversion plan, the building must sell 15 percent of its units by June 1, 2008, under the terms of a \$750 million loan from HSH Nordbank AG of Germany.

Howard Margolis, executive vice president and director of sales at Prudential Douglas Elliman, said Manhattan House has 15 executed contracts and another 35 signed offers for apartments that range from about \$600,000 for a studio to \$7.5 million for a 3,300 square foot penthouse.

Margolis, who is directing sales for both Manhattan House and the Apthorp, said that sales are averaging about \$1,600 per square foot, but he expects sales to "do much better" as the conversion moves forward.

Market watchers are skeptical, said Susan Hewitt, a principal at the Cheshire Group, a real estate investor.

"Purchasers are far less panic-stricken, from the standpoint of 'Oh my God, I have to buy this apartment

tomorrow,” she said.

“It’s not where it was three years ago when you could build anything and it would sell,” said Elan Padeh, president and chief executive of the Developers Group, a Brooklyn-based marketing firm. “Developers have to realize that buyers are very savvy today.”

Tenants at the Apthorp fear that the same tactics allegedly used on Sheffield and Manhattan House tenants will force many of them out of their homes. Nearly 100 tenants at the Apthorp are either in rent-stabilized or rent-controlled units. However, tenant leaders claim that the developers are using a variety of tactics to harass people into giving up their apartments.

Angst at the Apthorp

Paul Nickolatos, co-chairman of the Apthorp Tenants Association, says residents have been offered hundreds of thousands of dollars to give up their units, while other tenants are being asked to pay monthly rents exceeding \$50,000 or being hauled into court over eviction notices.

When Mann bought the Apthorp, he paid about \$2.4 million per apartment, which means condo prices must average about \$2,500 a square foot just to ensure he recoups his costs.

Mann said the Apthorp isn’t a speculative market play and insists that he considers this property a long-term asset.

“Most people felt we were very fair in terms of our initial offering price,” said Mann. “We are very long-term holders.”

Sam Merrin, who moved his family into a 3,000-square-foot apartment at the Apthorp in mid-2007 as a rental tenant, said he looks forward to the conversion and hopes to buy a new apartment.

“Mann bought this building to make a big profit, and everybody knows it,” he said. “That’s just business. It’s also a question of whether the rents will hold up.”

Landmark status

Details of the conversion are limited, but one provision allows the new owners to exercise air rights, which would allow the construction of new penthouse apartments. However, due to the Apthorp’s landmark status, such construction would require approval of the Landmarks Preservation Commission.

Apthorp officials did confirm that the building’s second entranceway on West End Avenue will be restored and that all individual apartments will be renovated, but would give no further details on the timeline, except to say they are aiming for the 100th anniversary celebration in September 2008.

Streamlining condo conversion plans

Nearly all parties in the real estate industry agree that a major problem in converting condos has been a lack of responsiveness by government regulators, whether it involves tenants complaining about the harassment and repair problems, or developers complaining about red tape from regulators.

Last month, Attorney General Andrew Cuomo announced a bill to streamline approval of condo-conversion plans and give his office more tools to respond to complaints. The bill would raise the cap on conversion plan filing fees to \$30,000 from \$20,000, which would cover additional staffing for the Real Estate Finance Bureau, led by Assistant AG Kenneth Demario.

Demario's office has already begun taking steps to address the enforcement problem. At an extraordinary November meeting between Swig, local political officials and residents of the Sheffield, Demario hammered out an agreement to resolve the health and safety concerns brought on by the conversion.

The AG's office was not available for comment; however, Nancy Rovelli, president of the tenants association, says the parties will have to agree on an arbitrator to negotiate protocols for any future construction inside the building.

"Let's hope that Mr. Cuomo will more vigorously prosecute developers that are harming tenants," said Kevin McConnell, lawyer for the Sheffield and Manhattan House tenants.

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