INVESTMENT SALES IN 2016 AND THE OUTLOOK FOR 2017

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In PowerPoint presentations that I have prepared for speeches that I have given over the past six months or so, I started out with a quote from the great American business writer, Tom Peters, who once said, "If you're not confused, you're not paying attention".

What prompted that quote, and led to the confusion, was that we were in a market with degrading underlying fundamentals, upward pressure on interest rates and simultaneously values were rising. This goes completely against everything we have learned about the way the commercial real estate sales market functions.

If we look more closely at fundamentals, we see that for nine or ten months now, residential rentals have been dropping. This downward pressure on residential rents was caused, in part, by the significant supply of rental units created by the nearly 40% of condominiums that were purchased by investors. After investors purchased these units, they were put on the market for rent, adding to the stock of rental units.

Simultaneously, we have seen downward pressure in the retail sector caused by the significant store vacancies seen around the city. Cushman and Wakefield tracks about 11 different major retail pockets and midway through 2016, four of these pockets showed a decrease in retail rents. By the end of the year, rents were down in all 11 of these retail pockets ranging from -1.1% to -13.2%. The average drop across all pockets was -8.2%. Concurrently, retail space availability has swelled to 18.2%.

And in the office market, base rents have not yet dropped, however, concession packages seem to be increasing significantly which is generally a precursor to drops in base rent levels.

While these underlying fundamentals are facing challenges, there has also been upward pressure on interest rates, which have risen over the past six months.

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In turn, lending rates have inched up. The combination of downward pressure on rents and increasing lending rates should result in downward pressure on property values. However, this did not appear to be the case.

Throughout 2016, it appeared that property values were continuing to rise. In fact, by the end of the year, the average price per square foot for the major property

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CUSHMAN & WAKEFIELD

YEAR-END 2016 MARKET UPDATE

NEW YORK CITY INVESTMENT SALES

categories citywide had hit an all-time record of $534 per square foot, a 9% increase over the 2015 average of $491. In the Manhattan sub market, which is always the trend setter for the broader market, the average price per square foot in 2016 hit a new record of $1,450 per square foot, also a 9% increase over the 2015 average of $1,332. *(see graphs 1 & 4 on next pages)*

Based on the fact set above, it is understandable that confusion about where the market was headed prevailed. However, now that the final numbers for 2016 are in, we have taken a deeper dive into the numbers to gain deeper insight into market conditions. That deeper dive has presented a very different picture of what is happening with respect to property values.

> "Throughout 2016, it appeared that property values were continuing to rise. In fact, by the end of the year, the average price per square foot for the major property categories citywide **had hit an all-time record of $534 per square foot, a 9% increase over the 2015 average of $491.**"

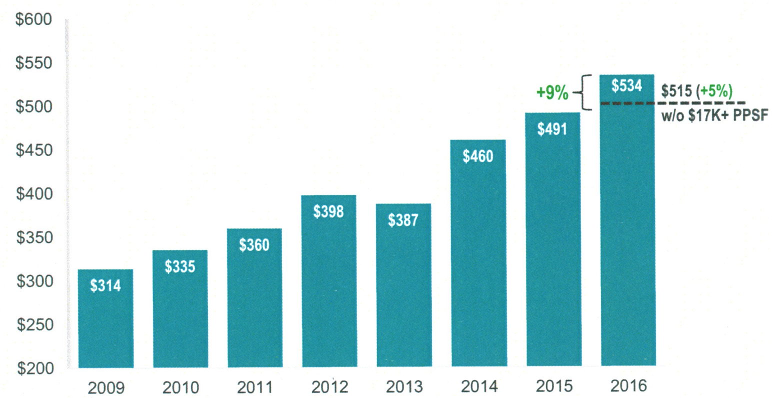
The most important submarket to look at is Manhattan (defined as south of 96th Street on the east side and south of 110th Street on the west side). Manhattan is the submarket that always leads changes in market direction. If values are rising, they will first rise in Manhattan and then the boroughs follow. If values are falling, they will fall in Manhattan first and then will fall in the boroughs.

The analysis of Manhattan values shows that if we eliminate just 2 of the 765 sales that occurred in 2016, which are two retail condominium sales which transacted at over $17,000 per square foot, values actually dropped by 1% in the submarket. Further, If we look at the first half of the year versus the second half of the year, we see that in 1H16 the average price per square foot was $1,617. In 2H16, the average fell to $1,263 per square foot, a 22% drop. *(see graph 5 on next page)*

If we break these numbers down on a quarterly basis, we see a very concerning trend. The per square foot average has dropped from $1,754 in 1Q16, to $1,507 in 2Q16, to $1,420 in 3Q16 and finished the year in 4Q16 at $1,084. This fourth-quarter value average brings us back to 2013 value levels. While quarterly data can be skewed, making reliance on a single quarter sketchy, the trend over several quarters is undeniable. *(see graph 6 on next page)*

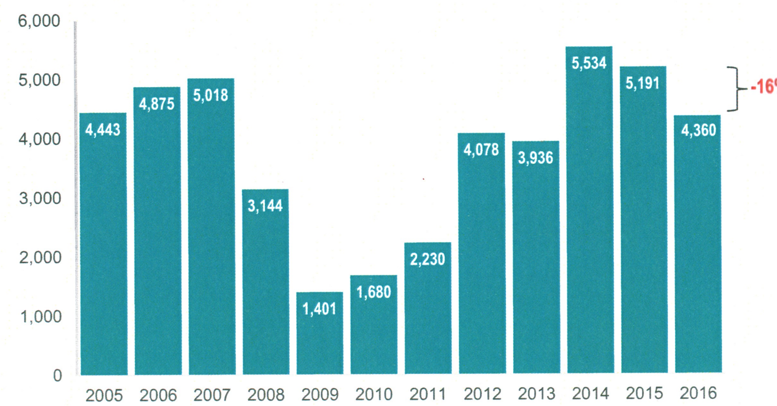
GRAPH 1

Price Per Square Foot | NEW YORK CITY



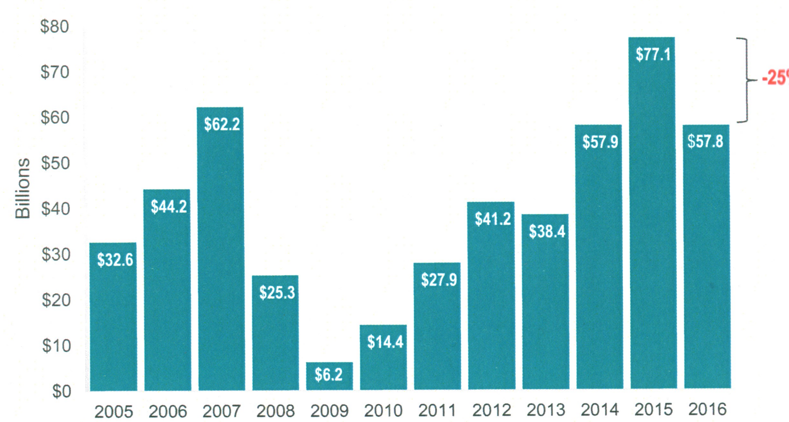
GRAPH 2

Properties Sold | NEW YORK CITY



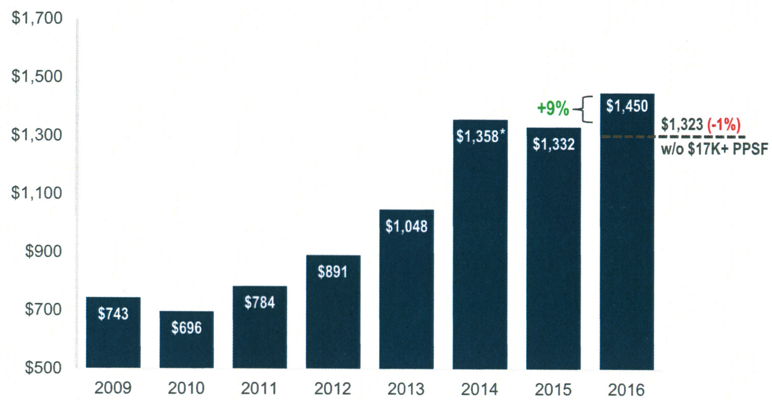
GRAPH 3

Dollar Volume | NEW YORK CITY



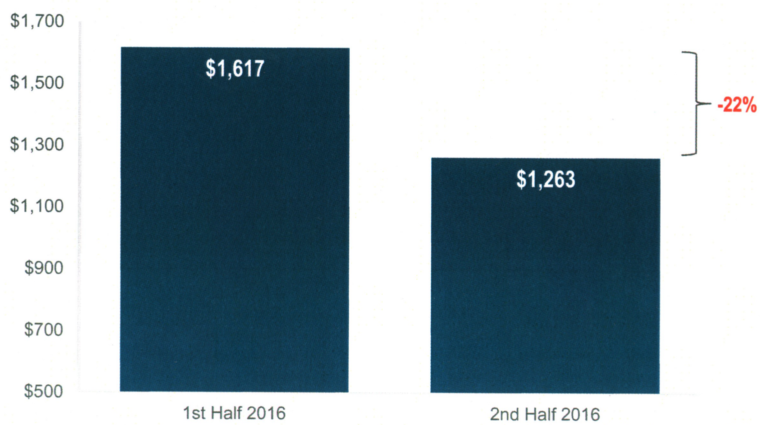
Source: Cushman & Wakefield Research

GRAPH 4
Price Per Square Foot | MANHATTAN

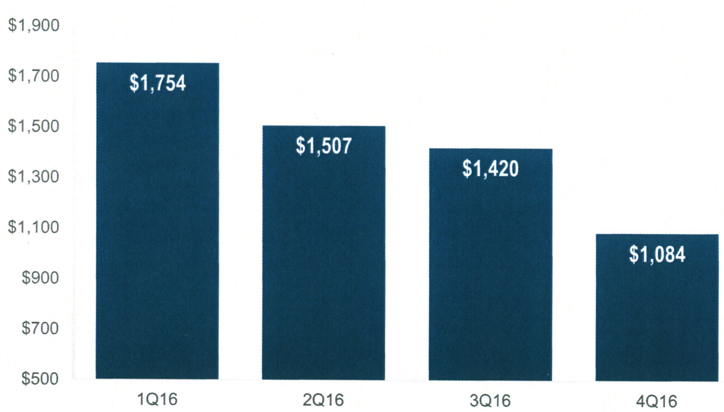


*Adjusted for 737 Madison Ave & 697 Fifth Ave ($1,414 with them)

GRAPH 5
Price Per Square Foot | MANHATTAN



GRAPH 6
Price Per Square Foot | MANHATTAN



Source: Cushman & Wakefield Research

While the Manhattan submarket is feeling stresses, values in the outer boroughs and Northern Manhattan have continued to climb. In fact, in the outer boroughs, values showed a 15% increase as the average price per square foot for major asset classes averaged $381 in 2016, up from the $332 average price per square foot in 2015. Unlike Manhattan, values increase in 2H16 over 1H16. The 1H16 average was $377 while the 2H16 average rose to $385 per square foot.

The volume of sales also fell in 2016. The number of properties sold citywide was 4,360, 16% below the 5,191 properties that sold in 2015, and 21% below the 5,534 properties that sold in 2014. The dollar volume of sales was $57.8 billion, 25% below the $77.1 billion that occurred in 2015. *(see graph 2 on previous page)*

While on a relative basis these numbers don't look so good, on an absolute basis they are not bad at all. The $57.8 billion of sales volume ties 2014 for third on the all-time list (The 2015 total was an all-time record for New York City). Additionally, the 4,360 sales that occurred in 2016 represents a 2.6% turnover ratio out of the approximately 165,000 properties in our statistical sample. Over the long term, the average turnover citywide is 2.32%, so 2016 was still an above average year. *(see graph 3 on previous page)*

In these volume metrics, we also see a sharp divergence between what is being observed in the Manhattan submarket versus the other submarkets. In Manhattan, the 2016 dollar volume hit $39.6 million, a 34% drop from the $59.9 million in 2015. The number of properties sold dropped 30% from 1,089 in 2015 to 765 last year. *(see graphs 7 & 8 on next page)*

> "While the Manhattan submarket is feeling stresses, **values in the outer boroughs and Northern Manhattan have continued to climb.**"

Looking at the outer boroughs and Northern Manhattan, we see that the dollar volume actually rose by 6% from $17.2 billion in 2015 to $18.2 billion in 2016. The number of properties sold dropped by 12% from 4,102 in 2015, to 3,595 in 2016.

We believe there will be continued downward pressure on sales volumes in 2017 as the supply of available properties is presently relatively low. Based on historical trends, it would appear that values will begin to feel downward pressure in the outer boroughs as contagion from market conditions in Manhattan start to spread. This would occur

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During Mr. Knakal's 33 year career, he has sold over 1,725 properties in New York having an aggregate market value of over $16 Billion. He is a graduate of The Wharton School at The University of Pennsylvania and formed Massey Knakal with Paul Massey in 1988. In 1990, he was awarded Crain's New York Business "40 Under 40" awarded annually to 40 business people under forty years of age for outstanding achievement in the New York business community. He has twice been the recipient of the Robert T. Lawrence Award in the Real Estate Board of New York's Most Ingenious Deal of the Year Contest. In 2010, he won REBNY's Louis Smadbeck Broker Recognition Award for Lifetime Achievement in Commercial Brokerage. In December of 2014, Messers Massey and Knakal sold their firm to Cushman & Wakefield.

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if the market operates in the same fashion it has in past cycles. However, we are living in unprecedented times and with tax reform on the front burner for the new administration, externalities could significantly impact the sales market, disrupting the normal performance.

At this point there are too many possibilities to go into potential policy changes and their potential impacts on our market. Suffice it to say that reducing taxes associated with selling has historically resulted in spikes in property sales. 1986, 1998 and 2012 were three of the four years with the highest total number of properties sold based upon the Tax Reform Act of 1986 (1986), a drop in capital gains taxes from 28% to 20% (1998) and the threat of increased capital gains taxes created by the Affordable Care Act and political rhetoric prior to the presidential election (2012). Other issues, such as modifications to 1031 exchanges, depreciation schedules, interest deductibility and tax treatment of carried interests, could also have a profound impact on our investment sales market.

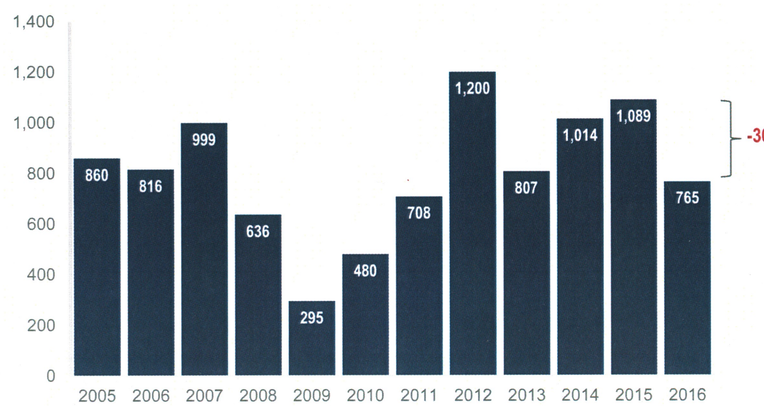
We will be watching underlying fundamentals very closely as well as changes in volumes and value in all geographic submarkets and within all product types. 2017 promises to be a very interesting year. And I will continue to keep you posted on changes in market conditions.

CONCRETE THOUGHTS

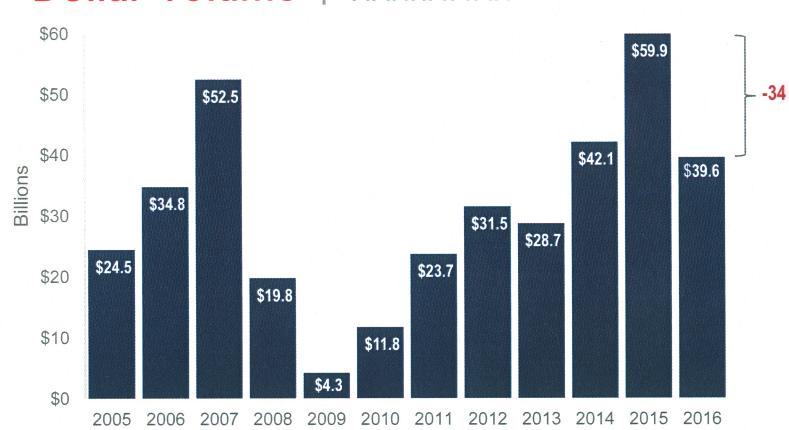
You can read Mr. Knakal's "Concrete Thoughts" - weekly articles for the Commercial Observer at

www.commercialobserver.com/tag/concrete-thoughts

GRAPH 7
Properties Sold | MANHATTAN



GRAPH 8
Dollar Volume | MANHATTAN



Source: Cushman & Wakefield Research