

YEAR-END 2017

2017 CONTINUED TO SLIDE... WHERE WILL IT GO? TAX REFORM SHOULD HELP...

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In 2017, the New York City investment sales market continued its downward trend, both in terms of the volume of sales as well as property values. The correction in this market segment is now in its 28th month and the biggest questions moving forward is whether the recent tax reform package implemented by Washington will be enough to pull this market out of its downward spiral.

“Downward spiral” may be a bit harsh but there is no doubt that for the past 2 to 3 years the market has been falling from its 2014/2015 cyclical peak. This is both in volume and, recently, value.

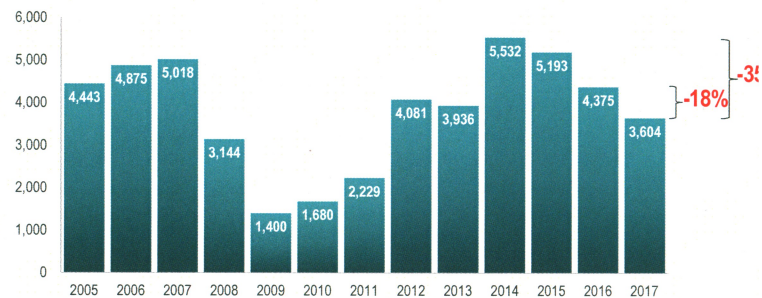
As is normally the case when a correction in the investment sales market occurs, volume is the first metric to fall and during this correction that long-term trend has held. The reason that volume falls first is that as negative pressure is exerted on underlying fundamentals, real values fall. As real values fall, sellers who don't get their price simply do not transact. Those who do get their price, do sell so values appear to be healthier than they really are. It generally takes 18 months to two years for the new reality to set in, take hold, and impact a seller's decision making process. The cyclical peaks in our volume metrics occurred in 2014 in terms of number of properties sold and 2015 in terms of dollar volume.

In 2014, there were 5,532 properties sold, and all-time record for New York City by more than 10 percent. Since this cyclical peak, the performance of the market has been severely challenged. In 2017, there were 3,604 properties sold citywide, an 18 percent drop from 2016, 31 percent below 2015 and 35 percent below the peak in 2014. The 806 properties sold in 4Q17 represented the lowest quarterly total for the entire city since 1Q13 (20 quarters). (see graph 1 and 2)

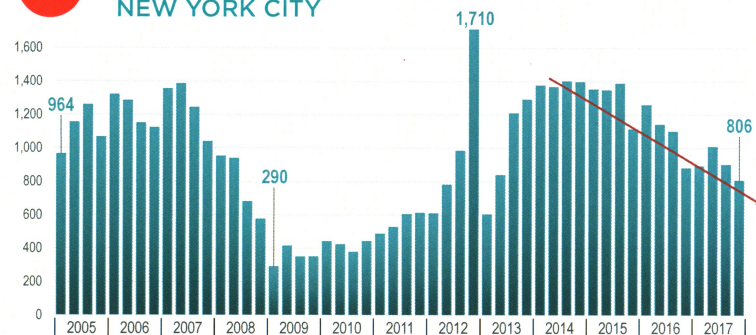
If we look at the Manhattan submarket, which is important to look at because what happens in New York City happens in Manhattan first, we see the number of properties sold metric is even more adversely

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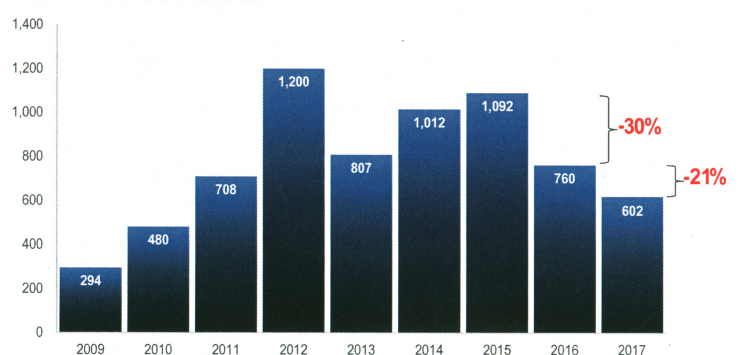
GRAPH 1 Properties Sold NEW YORK CITY



GRAPH 2 Properties Sold (Quarterly) NEW YORK CITY



GRAPH 3 Properties Sold MANHATTAN



Source: Cushman & Wakefield Research

impacted by the current correction. In 2017, there were 602 properties sold which was 45 percent below the 1,092 sales in 2015 and 50 percent below 2012's peak of 1,200 sales. The 2012 total was produced by the rush to sell based upon the perceived, and actual, increases in capital gains tax rates. The 145 trades in 4Q17 represented the lowest total going back to 1Q11 (28 quarters). (see graph 3 and 4)

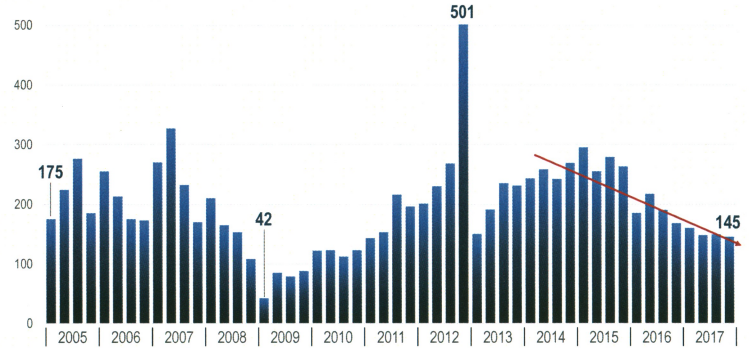
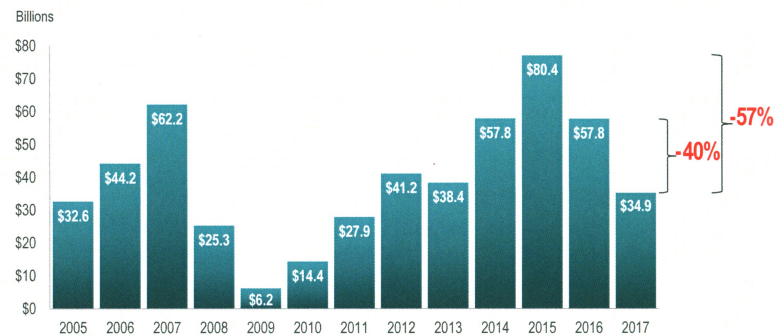
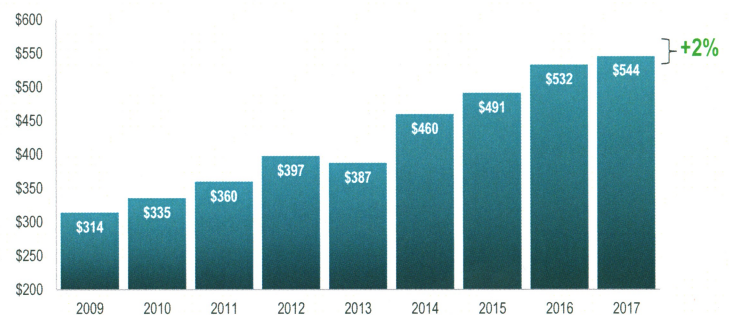
If those numbers weren't depressing enough, the dollar volume metric was off even further.

In 2017, the dollar volume of sales was \$34.9 billion, 40 percent below 2016's \$57.8 billion and 57 percent below 2015's record of \$80.4 billion. One of the few positive notes was that in 4Q17, there was \$10.5 billion in sales, the year's best quarterly total. In the Manhattan submarket, 2017 saw \$21.6 billion of sales activity which was 45 percent below 2016's total and 66 percent below the all-time record achieved in 2015 of \$63.2 billion. The \$7.2 billion of sales in 4Q17 was also the highest quarterly total for 2017. (see graph 5)

For the year, 2017 saw an increase in property value citywide by 2 percent.

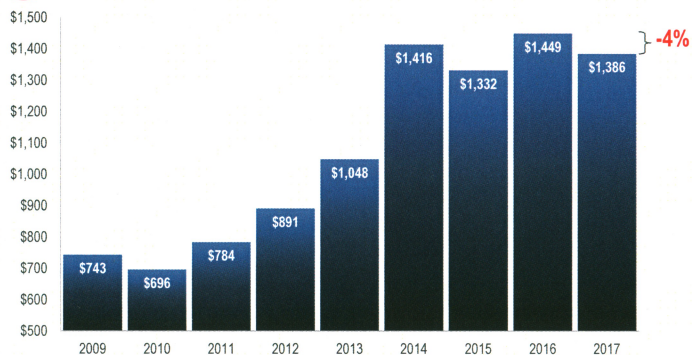
For the year, 2017 saw any increase in property value citywide by 2 percent, increasing from a 2016 average of \$532 per square foot to a 2017 average of \$544 per square foot. Digging into these numbers a little further is much more insightful. As mentioned earlier, trends begin in Manhattan which does not bode well for the direction of future values. In 3Q17, property values in Manhattan turned negative across all property types for the first time in this cycle and this trend continued through the fourth quarter. For the year, Manhattan values dropped by an average of 4 percent on a price per square foot basis from \$1,449 per square foot in 2016, to \$1,386 per square foot in 2017. (see graph 6 and 7)

Reductions in Manhattan property values in 2017 were relatively modest with mostly single digit drops. The exceptions were in the land market and the retail property markets. Land values per buildable square foot dropped by 18 percent from 2016's average of \$681 per square foot, down to \$558 last year. Retail properties dropped by 11 percent to an average of \$3,092 per

GRAPH 4 Properties Sold (Quarterly) MANHATTAN

GRAPH 5 Dollar Volume NEW YORK CITY

GRAPH 6 Price Per Square Foot NEW YORK CITY


Source: Cushman & Wakefield Research

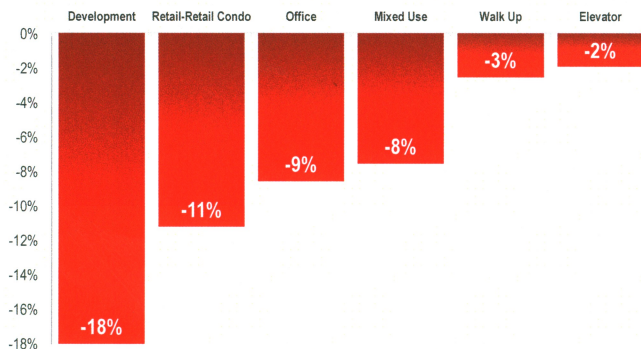
GRAPH 7
Price Per Square Foot
MANHATTAN



square foot. Office buildings saw values drop by 9 percent while mixed-use asset's values fell by 8 percent. Multi-family properties held up the best with value reductions of just 3 percent in the walk-up sector, and 2 percent for elevator properties. (see graph 8)

For the seven major property type categories in the four geographic submarkets outside of Manhattan, values dropped in just seven of these 28 sectors. On a net basis, the outer boroughs showed increases in value of 7 percent last year, increasing from an average of \$379 per square foot in 2016, to an average of \$406 per square foot in 2017. However, given that values were in red territory in all product segments in Manhattan, but just 25 percent of outer borough product segments were negative, we would typically expect that this negative pressure would continue to be exerted on values in the outer boroughs in 2018. (see graph 9 and 10)

GRAPH 8
% Change in Pricing (2016-17)
MANHATTAN



We would fully expect volume to drop for another year or two, at least, and value to fall modestly in Manhattan and also in the outer boroughs throughout 2018 and perhaps into 2019.

GRAPH 9
Property Vales (2016 vs. 2017)
MANHATTAN VS. OUTER BOROUGHS

MANHATTAN		OUTER BOROUGHS	
POSITIVE Δ	0	POSITIVE Δ	21
NEGATIVE Δ	6	NEGATIVE Δ	7
TOTAL SEGMENTS	6	TOTAL SEGMENTS	28
100% NEGATIVE Δ		25% NEGATIVE Δ	

If we look at volume trends, historically, we see that typically volume drops for four or five years in a row after the beginning of a correction. Given that we are 2 to 3 years into volume reductions in this downturn, we would typically expect to see sales volumes drop for another couple of years. Additionally, the 3,604 properties that sold last year represented 2.2 percent of the total market, just 1/10 of a percent below the long-term average of 2.3 percent turnover. As this turnover average has been consistent over the past 34 years, it would not be surprising to see another couple of years where sales volumes drop even further in order to maintain this long-term average. (see graph 11)

In the absence of tax reform, we would fully expect volume to drop for another year or two, at least, and value to fall modestly in Manhattan and also in the outer boroughs throughout 2018 and perhaps into 2019.

Source: Cushman & Wakefield Research

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However, tax reform makes owning real estate more profitable for pass-through entities and that additional profitability could be passed along to sellers in the form of higher prices being paid for their assets. Additionally, the additional profits that corporations will make should be very accretive to the underlying fundamentals of real estate as these companies could be taking more space and making more investments based on their effective doubling of profits under the new tax code. This could have the impact of buoying values when downward pressure might otherwise push them down further. Additionally, any upward pressure on values would lead to higher volumes as potential sellers decide to take advantage of any increase in value. Time will tell but there is reason to be cautiously optimistic. This would not be the case in the absence of tax reform. ■

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ROBERT A. KNAKAL

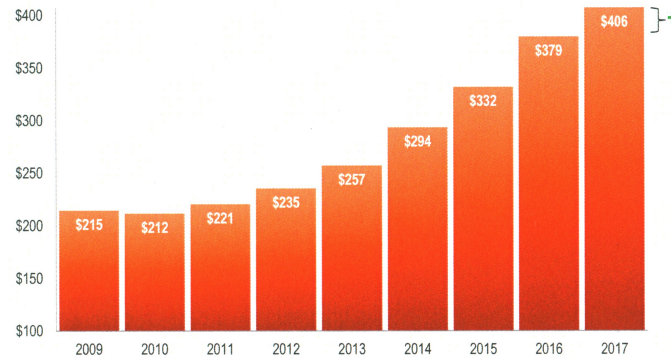
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During Mr. Knakal's 34 year career, he has sold over 1,772 buildings having an aggregate market value of over \$16.5 billion. He is a graduate of The Wharton School at The University of Pennsylvania and formed Massey Knakal with Paul Massey in 1988. In 1999, he was named to Crain's New York Business's Forty Under Forty/New York Rising Stars list for his outstanding achievement in the New York City 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. On December 31, 2014, Cushman & Wakefield acquired Massey Knakal.



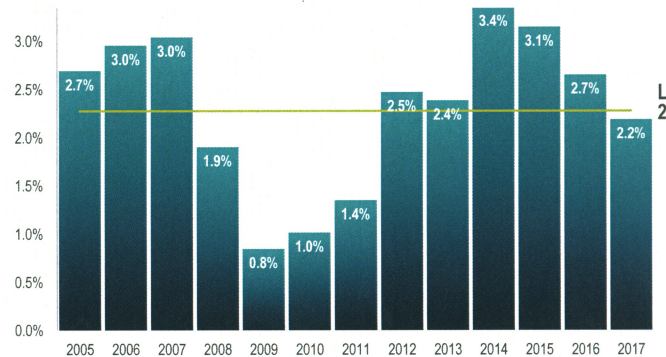
GRAPH 10

Price Per Square Foot OUTER BOROUGHES



GRAPH 11

Annual Turnover NEW YORK CITY



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