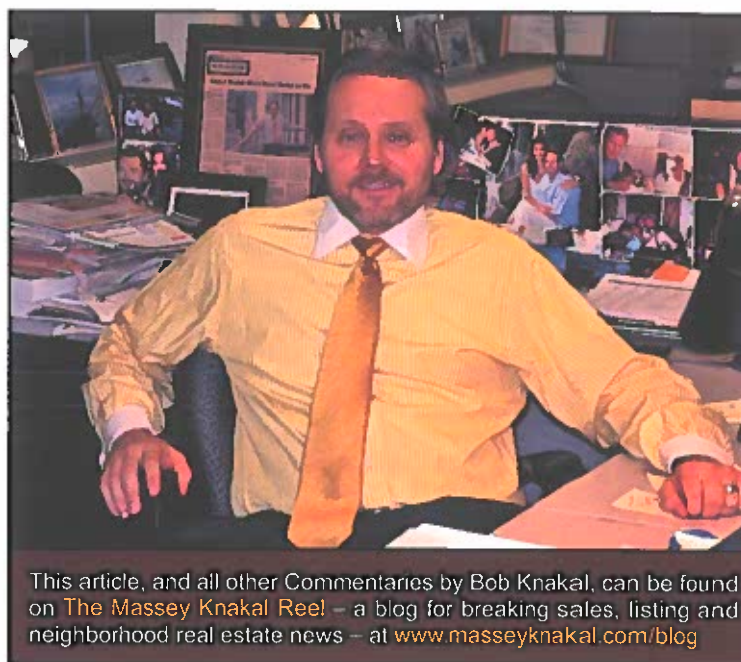


Worst Unemployment Rate Since 1974 is Not Creating High Returns for Buyers

At least five times a day I receive calls from investors looking to buy distressed assets at good yields in New York City. The result of these conversations often leaves buyers frustrated with my answer that, to date, the distress that some over leveraged owners and extended lenders are experiencing is not being translated into buying opportunities at yields buyers would expect. **The activity in the market has also been a pleasant surprise based upon the prices that we are achieving for income producing assets.** As I have stated in many commentaries before, it is very important to differentiate the segment of the market that we are addressing. Clearly, larger institutional quality assets sales have ground to a halt which has created significant difficulty trying to determine value. Nine figure loans are extremely challenging to secure today which is the single biggest obstacle for larger property sales. **In the under \$50 million dollar market, activity continues to be relatively good as debt remains available from portfolio lenders.**

This is particularly surprising given the unemployment data released by the Government last Friday. **I remain very focused on unemployment as it is the single most important economic metric affecting the fundamentals of our real estate market. The U.S. lost 533,000 jobs in November, the largest one month drop since 1974. As employers brace for a continuing recession, job losses are expected to last through much of 2009.** Thus far in 2008, we have lost over 1.9 million jobs signaling that the current downturn could be the worst since the years immediately following World War II. That being said, the unemployment rate of 6.7% is somewhat misleading in a positive way. While it is the highest rate we have experienced in the last 15 years, this jobless rate, which is based on the number of people looking for work, was muted by the ranks of discouraged job seekers who are no longer looking for work as these people are no longer considered "unemployed." This is the result of a fundamental change in the calculation implemented during the Clinton administration to make the numbers look more benign. Because of this, during the last two decades the jobless rate has become a significantly less useful measure of the country's economic health. **A broader and more accurate government measure of unemployment, which includes those who want to work but are no longer actively seeking positions and part time workers who are seeking full time employment, jumped to 12.5% in November.**



This article, and all other Commentaries by Bob Knakal, can be found on [The Massey Knakal Reel](http://www.masseyknakal.com/blog) – a blog for breaking sales, listing and neighborhood real estate news – at www.masseyknakal.com/blog

Most economists believe that payroll reductions will continue at least, through mid 2009 and it is interesting to examine the total number of U.S. jobs lost from peak to trough during the last five recessions. This decline was approximately 2%. In this downturn, a loss of that scale would translate into a decline of about 2.8 million jobs or an additional 900,000 people that will lose their jobs. This is clearly having a significant impact on consumer spending and last Thursday, U.S. retailers reported the worst same store sales declines for November since at least 1969 when the data began being tracked. **Our economy is contracting sharply in the current quarter and the latest job reports indicate that the decline in output could be worse than the expected annualized drop of 4%.** Also last Friday, the Mortgage Bankers Association said that one in ten homeowner with a mortgage is either in foreclosure or is delinquent.

So with all this negative news, why are Manhattan's small to midsized income producing properties still performing relatively well? Rent regulation, which artificially reduce average rent levels and is prevalent in many multifamily and mixed-use properties, is one reason. Interest rates hover around historic lows and it is expected that when the Fed meets on



During Mr. Knakal's almost 25-year career, he has sold over 1,000 buildings having an aggregate market value of over \$5.8 billion. He was the top salesman, with partner Paul Massey, at Coldwell Banker Commercial (now CB Richard Ellis) in New York in 1986, 1987, and 1988 prior to forming Massey Knakal. 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. In 2001, Mr. Knakal was named one of "The Top Dealmakers" by Real Estate New York Magazine. 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. First in 2002, for the assemblage of the easterly blockfront of Second Avenue between 54th and 55th Streets. Then again in 2004 for the sale of the historic Gotham Book Mart at 41 West 47th Street.

Please give a call if you have questions about your property or the market in general.

212.696.2500 x7777

**ROBERT KNAKAL'S
TRANSACTIONAL SUPPORT TEAM**



JONATHAN HAGEMAN
SALES TEAM MANAGER
212.696.2500 x7773
JHAGEMAN@MASSEYKNAKAL.COM



ELYSA BERLIN
ASSOCIATE
212.696.2500 x7764
EBERLIN@MASSEYKNAKAL.COM



J.J. STANTON
ASSOCIATE
212.696.2500 x7775
JSTANTON@MASSEYKNAKAL.COM



THOMAS WILLOUGHBY
ASSOCIATE
212.696.2500 x7730
TWILLOUGHBY@MASSEYKNAKAL.COM



KEVIN GLEASON
ASSOCIATE
212.696.2500 x7750
KGLEASON@MASSEYKNAKAL.COM

December 16th, they will cut the Federal Funds Rate to a quarter of a point or zero. This should have a positive impact on credit availability as it will widen spreads even further making loans even more profitable for the lender. Banks that have capital have tremendous incentive to lend the funds and while spreads are high, risk is relatively low as loan to value ratios are down to 60-65%.

We find, in many of the transactions that we are doing current buyers are financing only 50-60% of their acquisitions. We are using these signed contracts as a basis for determining value today as comparable sales do not provide nearly the insight that they historically have. The reason for this is that we see an inflection point in the market as of September 30th which can arguably be depicted as the point in time when the credit markets were the most frozen. That was the day the overnight LIBOR rate jumped to 6.88% and the commercial paper market had completely evaporated. Any transactions that have closed through today had contracts which were, very likely, signed before this time period. (Subsequent to September 30th, the realignment of the implementation of the TARP Program and additional stimulus that the Fed and the Treasury have announced have gone into effect. Therefore, we are looking very carefully at the contracts that we have signed since September 30th and while these transactions have not closed yet, they are more indicative of value today than those transactions which are closing with the pre-September 30 contract dates. Remarkably, the cap rates on the transactions which have gone to contract remain in the 5-6% range with some transactions in the below 5% cap rate range.

We have also seen a tangible shift in the type of buyer that we are seeing. Over the past few years, the majority of buyers in the marketplace were operators who had partnered with institutional capital. **Today, we see the overwhelming majority of buyers are private individuals and families which invest their own equity and do not rely on external equity sources to complete their transactions.** These are typical buyers with extensive portfolios who have been active in the market for decades and have remained active throughout the peaks and valleys of our market.

So the question is, "When will the buying opportunities come?" and we are defining buying opportunities as the ability to get returns on equity that are approaching the high single digits or double digits or at least a yield above the cost of debt. Clients will often tell me that they recall buying properties in the early '90s at 8% and 9% returns. What some don't remember is that mortgage rates were 9% or 10% back in those days and even though cap rates had increased, they were still buying with negative leverage. **Will the days of the 10% cap rate return? It is difficult to say "no" to that question based upon all the negative indicators in our marketplace, the state of our economy and the common prediction that the turmoil in 2009 will make 2008 look like a walk in the park. However, to date, we have not seen any evidence that this condition may return despite what "opportunistic investors" would like to think.**

Have a great week!

275 Madison Avenue, Third Floor
New York, NY 10016
Phone: 212.696.2500 • Fax: 212.696.0333