

New York City Building Sales Market Shows Some Positive Signs... Relatively Speaking

Now I know that some of you will jump down my throat and accuse me of wearing my rose colored glasses and laying some broker BS on you just based on the title of this installment. So let me first acknowledge that, looking at the financial sector as a whole, we are in troubled times and in uncharted territory. Our entire "free market" philosophy is being challenged, 158 year old financial giants are going bankrupt and the Government has seized the country's largest insurance company. Inflation is high, credit is tight, mortgage delinquencies are rising, foreclosures are rapidly increasing, consumer spending is slowing, consumer confidence is in the toilet and people are liquidating money market accounts based upon fear and these accounts have always generally been considered as good as cash. Budget deficits on the City, State and Federal level are ballooning and not too many people are talking about how to address them. The Misery Index, which is calculated by adding the rate of inflation to the rate of unemployment, is being referenced in the Wall Street Journal. This index hasn't been discussed since Jimmy Carter was in the White House. The future of the entire investment banking industry is in question. So, do I see what is going on out there? I do.

When addressing the investment sales market in New York City, the level of activity in the market is almost always conveyed as an aggregation of total sales prices for all property types and sizes. The reports I have read recently show investment sales activity down by as little as 59% (by Cushman and Wakefield) and by as much as 85% (by Jones Lang). Without knowing the parameters of their studies it is not possible to explain the very large discrepancy in these numbers. We do not put as much significance on this measurement as a few transactions can greatly skew these figures (the sales of Peter Cooper Village/Stuyvesant Town for \$5.4 billion or the purchase of the EOP portfolio for \$7.0 billion for example).

At Massey Knakal, we think it is important to segment the market and address the sector which affects the overwhelming majority of our clients. That is the sector of income producing properties (both commercial and multifamily residential) with sale prices below \$100 million. We recently completed our study of the first half of 2008 (the report is prepared by the appraisal firm Miller Cicero) and were pleasantly surprised by the results. The number of transactions was down only 31%, the aggregate sales price was down 35% and prices were off their peak by only 5% down to \$222 per square foot (this price per square foot based on a consolidated median basis). Capitalization rates have inched up from 5.5% to 5.8%. All of these metrics were compared to the first half of 2007 which will, undoubtedly, be viewed on as the absolute top of our recent cycle. The question is, why has this segment performed so much better than larger properties? Here are some reasons:



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

The midsize property sale market has been a significant beneficiary of the recent financing environment. Most of the lending that has occurred has emanated from portfolio lenders which make loans and keep them on their balance sheets (or in their portfolios, hence the name). This is opposed to lenders that made loans and sold them to the secondary market in order for them to be securitized and sold to investors. As the buyers for these securities evaporated, so did the entire commercial mortgage backed securities (CMBS) business. CMBS transactions were down by 90% in the first half of 2008. Portfolio lenders have stepped into the void and are providing debt for our clients and their view of the current lending market is positive, provided they have capital to lend. If you look at the banking business, the spreads, or profits, lenders make on each loan is now as much as ten times as large as they were 16 months ago. Spreads had been as low as 35 or 40 basis points and today they can be as much as 400 basis points. Some lenders are looking for even higher spreads and will likely get takers for that expensive money based upon the lack of capital at some banks, which limits the choices borrowers have.

While these loans are more profitable for the lender, the loans are also accompanied by less risk as loan to value ratios have gone from 75% to 85% 16 months ago to 60% to 65% today. From the lenders perspective, they are making more profit with less risk so the motivation to make loans is very high. The caveat is that the lender must have the capital to lend. It is anticipated that the proposal made



During Mr. Knakal's 24-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.

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last week by Treasury Secretary Henry Paulson and Fed Chairman Ben Bernanke to Congress will, if passed, loosen credit by creating more capital availability for banks. Net interest income for local and regional banks is high and this dynamic will assist the banking system in recapitalizing itself.

The midsize property sales market has also benefited from the amount of equity that is available and the relatively low actual dollar amounts that are needed to close transactions. Even with only a 60% loan, a \$10 million transaction can close with approximately \$4 million of equity. There are hundreds of investors with \$4 million dollars available for an acquisition. If we examine a \$250 million transaction the same way, \$100 million of equity would be required. The number of investors who have that kind of equity is significantly lower and this pool is reduced even further by the reluctance of those who have that amount of equity to invest it in one transaction. This dynamic bodes well for the smaller property segment.

If we look at sales activity in Manhattan (south of 96th street on the east side and 110th on the Westside), Northern Manhattan, Brooklyn, Queens and the Bronx, we see that the largest reductions in sales activity have occurred in Northern Manhattan and the Bronx. In the Bronx sales activity is down by 42% and in Northern Manhattan the reduction was 63%. We believe this is due to the fact that these markets benefited the most, in relative terms, during the last 7 years as institutional investors showed a strong appetite for multifamily properties here for the first time in any significant way. This new demand segment compressed cap rates and raised gross rent multiples. As turnover of regulated apartments was not meeting projections, these institutional investors began to question aggressive proformas and their hunger for product has abated. **Prices in Northern Manhattan are down by 35% but, surprisingly, prices in the Bronx have remained fairly consistent. Sales activity in Brooklyn and Queens has been the least adversely affected as volume was off by 22.5% and 17.6% respectively. Manhattan experienced a reduction of 36%.**

The overall volume of sales in the first half of 2008 was approximately 2.2% (annualized) of the total stock of properties. This compares favorably to our market baseline of 1.6% which was the minimum level of activity from non-discretionary sellers that we saw in 1990 and 1991 when the only people who were selling, had no choice. **This means that 27% of sellers who sold properties during the first half of the year, chose to.** We believe this number would have been significantly higher if potential sellers were aware that pricing in this sector had some fairly positive inertia.

In terms of returns (cap rates), walk up apartment properties are a good reflection of investor sentiment as the statistical sample is significant in all boroughs. In Northern Manhattan investors are now seeking an average yield of 6.1% as opposed to the 5.4% that satisfied them in the first half of 2007. In the Bronx, the yield requirement remained the highest at 7.4% with Brooklyn and Queens investors requiring 6.6% and 6.2% respectively. Cap rates in Manhattan remained below 5% at 4.8%, which was up from 4.0% in first half 2007.

Since the period covered by the report (ending June 30), the market has softened, but not significantly. We expect that prices may have fallen another 5% or so and volume appears to be steady as we get the word out about the relative health of prices. Is there a reason to be optimistic? Notwithstanding my first paragraph today, I think so. Let's see if Congress can pass the proposal before them which, we hope, will free up capital for the banking system to pump back into our market. It will be a long road but each day we get closer to a recovery.

Have a great week,

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