

## *Support for Foreign Investment in our Real Estate Market*

About a month ago, I read a great article in the Real Estate Weekly titled, “America’s fire sale gets some hot and bothered.” The article highlighted comments by US Congressional Rep. Marcy Kaptur, of Ohio, calling for America to distance itself from foreign interests. She made a case against Abu Dhabi Investment Council’s investment in the Chrysler Building. She made a case against sovereign wealth funds claiming that transparency is lacking. **“America cannot afford to sell off any more of our country,”** Kaptur said. The article went on to say that those in the industry are at odds with her position. I was quoted in the article and felt it was important to reiterate some of the points I made and expand on them. **Ms. Kaptur’s position could not be more off base. Here is why I think so:**

In the 25 years I have been selling properties in New York, I have seen wave after wave of new demand segments and new sources of foreign capital. Most notably the tremendous demand exhibited by Japanese investors in the 80s which created significant sentiment of unease in political circles, particularly after their acquisition of Rockefeller Center. **Waves of foreign investors have continued to pour into our market as countries changed their guidelines regarding foreign investment.** The primary origins of this capital vary from cycle to cycle. **Recently, we have seen the largest global economic expansion in history with tremendous amounts of capital being created in nations all over the world.** Much of this newly generated capital was earmarked towards US investments. A large percentage of this capital was earmarked for real estate and, particularly, New York real estate. An interesting observation about foreign investment in the under \$100 million market is that, while the most prominent origin of capital changes from cycle to cycle, the most consistent source of capital, year after year, comes from countries which are the United States’ most significant trading partners. Does this say something about the importance of free trade agreements on our economy?

Foreign demand for real estate has come from private individuals, corporations, banks, hedge funds and sovereign wealth funds. There are presently approximately 55 sovereign wealth funds in 38 countries which control an estimated \$4 trillion. The most prominent funds include Abu Dhabi Investment Authority, the Government of Singapore Investments Corp. and Norway’s Government Pension Fund. Other significant funds originate in Kuwait, Saudi Arabia, Canada, Libya, Algeria, Australia, Brunei and Russia. They have been making headlines in recent years.



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](http://www.masseyknakal.com/blog)

Investments in the GM Building, Chrysler Building, Flatiron Building, 450 Lexington Avenue, 230 Park Avenue, 280 Park Avenue and the Mandarin Oriental Hotel at the Time Warner Center have drawn great attention.

With all of the foreign investment in our market, I have never seen a foreign investor pick up a building and move it to their country. Have you? **Foreign investors are rarely long term holders. With all of the buying and selling that occurs aren’t local business people beneficiaries of this activity?** The brokers who sell the buildings, the lawyers who represent the buyer and seller, the title closer, the mortgage broker, the engineers and environmental inspectors are all benefiting from this activity. (Did I mention the brokers?) All of this economic activity is generated and it is likely that the property will end up back in the hands of domestic owners at some point.

Many participants in the market will say that this demand was exacerbated by the weak US dollar. I do not agree with this premise, specifically with respect to our investment sales market. A low US dollar does indeed have some benefits to our real estate market. The weak dollar fills our hotels with foreign travelers who find it cheap to shop and dine here and also keeps occupancy rates up because domestic travelers find it cost prohibitive to travel abroad and frequently choose our city as a vacation destination. The



During Mr. Knakal's 24-year career, he has sold over 974 buildings having an aggregate market value of over \$5.6 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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weak dollar also makes our for-sale housing stock enticing for foreign buyers, and they have helped to keep activity in our condo and coop market at reasonable levels. When it comes to our investment property market, this argument does not hold water. Consider this; why would a foreign investor purchase a property because of a weak local currency, when the cash flow they receive on that property will be in the same weak currency and when the property is sold, their profit (if there is one) will be in the same weak currency? **The weak dollar only motivates foreigners to buy if their investment strategy includes currency arbitrage, meaning that they believe our dollar will increase in value during the holding period relative to their currency.**

An argument can be made that now that the dollar is getting stronger, more foreign dollars should be flowing into our market. Investment dollars seek assets in markets where interest rates are expected to increase. As economies in the UK, the Euro zone and Japan head toward recession, it is expected their interest rates will be lowered and as the dollars strengthens, it is anticipated that at some point (probably in the first half of 2009) our interest rates will increase. This dynamic should spur additional foreign investment in US assets. And that is a good thing.

**So why is there so much demand for our investment properties? For one, the real estate market has become increasingly globalized and New York has been a big beneficiary of this. Secondly, New York holds a rare combination of attractive investment ingredients including a constantly low supply of available properties for sale, high barriers to entry, unparalleled demand generators which create tremendous competition for assets, and, most importantly, political stability.** While every market has its cyclical ups and downs, our market fundamentals are generally not very volatile relative to other countries.

In the over \$100 million property market, foreign capital plays a large role representing approximately 25% of total investment dollars. In the under \$100 million market, foreign capital plays a less significant role representing 10%-15% on an annual basis. Moreover, the investment in larger institutional office properties is much more transparent as these deals are headline makers. **Much of the investment in the mid-sized market, particularly in the multifamily market, is in the form of equity financing for local operators who understand rent regulation.** These guidelines are so complicated that foreign investors rarely attempt to navigate their way through their implementation.

In addition to investment in real estate, foreign investors also play a vital role in domestic capital markets. Recent investments by GIC and Temasek have pumped billions of dollars into Merrill Lynch and Citigroup. They are also major buyers of Fannie Mae and Freddie Mac debt and hold a significant percentage of government issued Treasury Bills. **Globalization has created a reliance and capital interdependence among industrialized nations. The thought of cutting off or limiting this capital is absurd. We should continue to encourage foreign investment in the US and in our local real estate market.** Let's hope that our capital gains rates do not go up after the November elections as this will make the US a less desirable investment option for those foreign dollars.

*- Bob*