with Bob Knakal

Did we really sell more this year?

Q: As we approach the end of the year, it seems the investment sales market in New York was significantly better in 2010, than it was in 2009. How large has the increase in sales volume been?

A: It is too early to know the exact magnitude of the increase in investment sales volume in 2010 over 2009 levels.

Through the first three-quarters of this year, the dollar volume of sales on a citywide basis was approximately $9.1 billion, reflecting about a 150% increase over the $6.25 billion realized in all of 2009.

If we annualized the activity over the first three-quarters, we should see investment sales volume at double the level that was achieved last year.

I believe, however, that this projection grossly underestimates the true level of activity in 2010's investment sales sector. There are two main reasons why this is the case.

We expect the dollar volume of sales in 4Q10 to be the highest quarterly total in quite a while, as many discretionary sellers made the decision to sell based upon the anticipated increase in the capital gains tax rate on January 1, 2011 when Bush tax cuts were set to expire.

While this tax increase is now in question (at least at the time of this writing), sellers of investment properties cannot make the decision to sell, and effectuate that sale, in a matter of days as the sale process takes months.

Therefore, many of these tax-driven transactions have already closed and dozens of others are under contract without an escape clause if the capital gains rates are not changed. Many of the properties being sold for tax purposes were placed on the market in the summer or early fall in order to allow enough time to close prior to year-end. Additionally, many banks and lenders, which have fiscal years running parallel to the calendar year, are rushing to close asset sales prior to year-end in order to clean up their balance sheets. These two factors should lead to very robust sales volume in the fourth quarter.

However, this sales volume alone does not really tell the story of the 2010 investment sales market. There is "shadow activity" in the form of note sales, which has become the predominant transaction type in the distressed asset arena.

Given the length of time for a lender to foreclose on a property in New York, we have seen banks and special servicers much more willing to sell notes than go through a protracted and cumbersome foreclosure process.

This is particularly true when realizing the relatively high recovery rates, relative to collateral value, that note sales are producing.

It is important to remember that if a lender goes through the foreclosure process, and subsequently sells the asset, the best they can do is recovered 94 percent of a property's value. This is because there is a 3 percent transfer tax paid by the lender at the foreclosure sale when they "take in" the property, and a 3 percent transfer tax they pay when the property is resold.

Most of the recoveries we have seen on note sales collateralized by Manhattan (south of 96th Street) buildings have been at 90 percent or more of collateral value. Recovery rates are lower in northern Manhattan and the outer boroughs, however, they are still compelling.

The growing popularity of this type of transaction leads me to believe that this sector could be as large as 25% to 50% of the traditional sales market.

In 2010, I have brokered the sale of over $300 million in notes with several transactions pending for closure before year-end. There are many sales brokers who are taking advantage of this healthy activity which will not be adequately reflected in sales data. This is why I refer to this note sale activity as "shadow activity."

When notes are sold, there is no public recording of the transaction required and, consequently, no formal way to track sales volume.

Therefore, while the 2010 totals for investment sales activity (which will be reported in January) will show significant gains off of the miniscule totals of 2009, they will not be truly indicative of how busy the investment sales brokerage community has been, nor the real amount of transaction volume the market has experienced.

Fortunatley, from the brokerage perspective, this note sale activity is likely to be a prevalent component of our market for another couple of years.