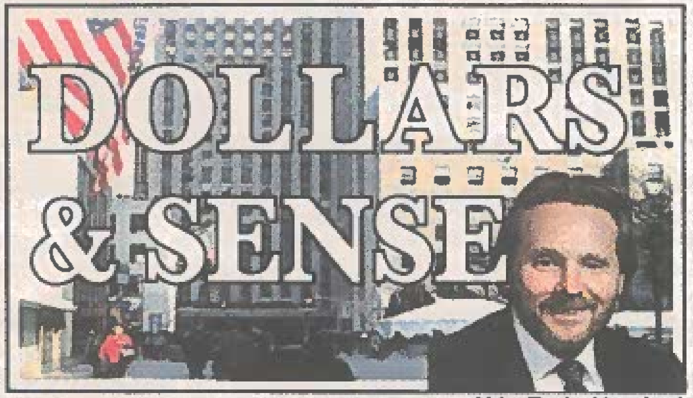
# History about to repeat itself




with Bob Knakal

*Q. Given the results of the election last week, do you anticipate capital gains taxes increasing and therefore sales volume decreasing in New York City next year?*

A. Given the rhetoric coming out of this administration, it was clear that if they won another four years that they would push very hard for tax rate increases, particularly capital gains tax.

It is expected that if the Bush tax cuts are allowed to sunset, capital gains will go from 15 to 20 percent and, as healthcare in now unlikely to be repealed, an additional 3.8 percent capital gains rate increase will go into effect.

Therefore, if Congress does nothing, which they happen to be excellent at, the capital gains rate will increase from 15 percent to 23.8 percent.

On top of this, the president has indicated that he would like to see a 30 percent capital gains rate which we are sure does not include the 3.8 percent covert capital gains tax in the healthcare. Therefore, the rate could be as high as 33.8 percent by the end of next year. Typically these tax increases, if passed anytime during the year, are retroactive back to January 1.

The looming threat of these increases has brought many properties to market this year, many of which may have come to market prematurely based upon the impact this increase would have.

It has created a significant volume of sales this year which is almost certainly going to lead to a reduction in volume next year.

The Bush tax cuts were set to sunset at the end of 2010 and there was a lot of discussion about letting the tax cuts expire. This created tremendous sales activity in 2010 as sellers tried to beat a potential increase at that time.

We were expecting volume to fall at the beginning of 2011. Volume did, drop but not by as much as we anticipated because a deal was made to extend the Bush tax rates.

Given the recent election results, we have had many clients say properties they have on the market need to be sold by year end.

Other clients wantr to put properties on the market in the hopes of selling by year end.

But, unfortunately, the overwhelming majority of these late arrivals will not be able to be sold by year end without taking a significant haircut in order to effectuate a quick sale. This, in all likelihood, would eliminate the savings, or benefit received, from paying the lower cap gains rate.

Another consideration when looking at sales volume projections for 2013 is that 2012 has been an extremely active year in terms of sales volume.

Through the first three quarters of the year, on an annualized basis, the turnover of sales in the Manhattan submarket (which is a good barometer of the entire New York City market) is running at about 3.3 percent of the total stock. We analyze a stock of buildings in the borough of 27,649 properties.

Going back to 1984, the turnover ratio has only exceeded three percent on four occasions, 1986, 1988, 1998 and 2006. These levels were peaks during each respective cycle. On average, after these peaks were attained, the reduction in volume the following year has been 18.5 percent.

We believe the reduction in volume in 2013 could be more pronounced and could be as much as 30 percent (from 1998 to 1999 we saw the biggest drop in volume as the highest volume achieved was in 1998 at 3.9 percent and in 1999 volume dropped 33 percent to 2.6 percent of the total stock).

We expect to see a similar reduction in the volume of sales next year, particularly if the capital gains tax rates do indeed increase as we anticipate. We are on pace for about 913 properties to sell this year in Manhattan and, based upon the year end push, the number could challenge the 999 sold in 2007. 1,078 is the highest total Manhattan has had since at lease 1984.

Next year, we believe these numbers could be as low as 600 to 650 which would be below the long-term average of 2.6% of the total stock, or 719 properties sold.

We certainly hope cap gains rates don't go up and that volume continues to chug along at its current healthy pace, however, we think that history, and dysfunction in Washington D.C., make the likelihood of that happening slim.