CONCRETE THOUGHTS

Down, Down, Down

First Quarter Investment Sales Slump Marks Third Consecutive Drop

In a conversation with a good client last week, I told him that the investment sales market was just kind of slogging along without any substantial traction at this point in the recovery. He was surprised by my comments and pointed out that he felt the market was "great" because values were rising so the value of his portfolio was way up.

I pointed out that, as an intermediary, action and activity was much more indicative of the "health" of the market, as sales brokers, attorneys, title closers, mortgage brokers, bankers and operating promoters are primarily dependent upon market activity for their livelihoods. Therefore, for most of us, our perspective on the market is dependent upon the volume of sales, not the direction of property values.

Robert Knakal

In the first quarter of 2012 (1Q12), the property sales market in New York City continued to perform at essentially the same modest levels seen in the fourth quarter of 2011. The results were disappointingly-not-better, and, simultaneously happily-not-worse.

They were disappointing because we expected a natural gravitation toward long-term trends that should have pulled all markets up from the relatively low levels the market had plummeted to. However, we were happy that things weren't worse because both the dollar volume of sales and the number of properties sold had been trending lower in recent quarters. That trend is apparently slowing, which is very positive.

In 1Q12, there was $6.9 billion of investment sales transactions, down slightly from the $7 billion in 4Q11. This marked the third consecutive quarterly drop from $8.1 billion in 2Q11. If we annualize 2012's performance, we're on track for $27.6 billion in sales for the year, up very slightly from 2011's $27.4 billion.

Looking at these numbers from a macro perspective, the annualized total would be up 353 percent, or more than four times, from the $6.1 billion in sales we saw in 2009, but remains 56 percent below the market's $62.2 billion peak in 2007.

The best performing submarket was northern Manhattan, in which 1Q12 totals were $155 million, up 71 percent from 2011 totals, if annualized. This remains 58 percent lower than 2007 peak levels. The Brooklyn market also performed very well in 1Q12 with $684 million in sales, up 61 percent from 2011. The Brooklyn market volume is only 29 percent below the 2007 peak, which is the best performing submarket in the entire city, including Manhattan.

The poorest performing submarket was the Bronx, in which there were only $151 million in sales in 1Q12. If annualized, this total would be down 20 percent from 2011 levels. This annualized total reflects a 72 percent drop from the 2007 peak of $2.2 billion. That is the worst performing submarket in terms of the extent to which it has recovered.

While the dollar volume of sales is widely quoted, we believe that the number of properties sold is much more indicative of market activity as a few very large transactions can have a profound impact on the dollar volume metric.

With regard to the number of properties sold, citywide in 1Q12, there were 547 properties sold, down 10 percent from the 606 sales in 4Q11. If annualized, 2012 is running at about 2,188 properties sold, 2 percent less than the 2,222 in all of 2011. This figure is up 55 percent from the 1,410 in 2009 and 56 percent below 2007's peak of 5,018.

The best performing submarket in terms of number of properties sold was northern Manhattan, in which there were 34 sales and, if annualized, the 136 total would be up 10 percent from the 124 properties sold in 2011. Here, sales volume would remain 58 percent below the 2007 peak total. Manhattan is also very strong in terms of number of buildings sold, with 191 properties trading in 1Q12. This was the second consecutive quarterly drop for Manhattan from the 194 sales in 4Q11 and 213 in 3Q11. If we annualize the 191 sales, the total would, however, be up 9 percent from 2011. Manhattan has had the strongest recovery in terms of number of properties sold, as we are presently running at just 27 percent below 2007 peak levels.

The poorest performing submarket in terms of the number of properties sold was Queens, in which there were only 67 sales in 1Q12. This figure is 28 percent lower than the 93 sales seen in 4Q11. If annualized, the 268 sales would be 28 percent below the 373 sales in all of 2011. The Queens market continues to be the poorest performing in terms of number of buildings sold, where this year's total is running at 76 percent of the 1,116 properties sold in 2007.

In terms of turnover ratio, which is the number of buildings sold relative to the entire marketplace (there are 165,000 properties in our statistical sample), citywide turnover in 1Q12 was 1.33 percent. This is up significantly from the 0.86 percent turnover ratio in 2009 but remains well below 2007's peak performance of 3.04 percent.

Using Manhattan as a microcosm, we see that turnover in 1Q12 hit 2.76 percent, the first time this turnover ratio has been above the 2.6 percent long-term average, since 2009. For some historical perspective, the highest turnover we have ever seen in Manhattan was 3.9 percent in 1998 and the lowest was a miniscule 1.17 percent in 2009.

In terms of the average price of a property sold in New York City in 1Q12, we have, remarkably, seen the highest average ever recorded in N.Y.C. at $12.6 million. This is up from 2011's average sale price of $12.3 million and even exceeds the 2007 average of $12.4 million. The average price of a property sold in New York City had fallen to as low as $4.3 million in 2009.

In the Manhattan submarket, we see an average sales price in 1Q12 of $29.9 million, down about 10 percent from 2011's average of $33 million. In 2009, the average had fallen to as low as $13.6 million. This was a significant reduction from Manhattan's all-time peak average, achieved in 2007, of $50.5 million.

So the question becomes, why is volume meandering at this relatively low level? At the end of 2Q11, it appeared that the recovery had great traction and we were headed on a sharply increasing ascent back to 2005-07 levels. But the sales market's trajectory has temporarily plateaued (I am hopeful that adverb is correct). Why is this happening?

The acute supply/demand imbalance addresses this dynamic. There is an extraordinarily low supply of available properties on the market today. This has been created mainly by discretionary sellers who routinely ask the question, "If I sell, what do I do with the money?" The rates of return on alternative investments are near historic lows and, while the equities market is performing well, uncertainty surrounding the economy has investors leery about equities. Bond yields are at or near all-time lows with the 10-year Treasury dipping below 2 percent once again in recent weeks. Bank CD rates were as high as 5.5 percent as recently as 2007. Today these same investments are yielding maybe 20 or 30 basis points of return.

Simultaneously, the demand side is excessive, with high-net-worth individuals and families establishing strong footholds since the institutional capital left the market in the 2007-09 period. This institutional capital has, however, regained traction and is a prominent player in the marketplace today, being joined by tremendous traditional foreign buyer demand and, increasingly, we are seeing first-time buyers in the New York City market who are domestic and foreign.

While volume is relatively slow but steady, we expect values to rise significantly this year. Just within the past six to eight weeks, we have seen significant cap rate compression as lending rates have dropped, exerting downward pressure on caps, which have fallen by 75 to 100 basis points just in the past two months. First-quarter results do not show this increase in value but, based upon the contracts signed recently, we expect to see sharp increases in value in 2Q12. So, from my client's perspective (and all other property owners), the market is indeed great. But if you are someone who relies on transaction volume for your compensation, leave the cork in the Champaign for now.

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