CONCRETE THOUGHTS

Sales Brokers: Get Ready for a Wild Ride 09/04/12

Low rates and high demand will lead to volume increases between now and December

It is hard to believe that the summer is over, but here we are, getting ready to finish off what has been, thus far, a fantastic year in New York's commercial real estate sales market. There are several issues we are going to watch as the year concludes, and today's column will review a few of them.

One thing to be sure of, many of the city's top investment sales brokers will likely see the most productive year yet in their careers in 2012. This may seem counterintuitive as the total sales volume will likely top out at $30 billion to $34 billion this year, a far cry from the $63 billion at the peak of the market in 2007. However, the dollar volume of sales was a mere $6.2 billion in 2009, so this year's volume is very uplifting to those brokers who are still around. Many sales brokers left the industry after the recession turned the market downright ugly in 2009 and 2010, leaving seasoned pros and a few others left to handle the 3,000 or so sales that will close this year (there were over 5,000 sales in 2007). The relative increase in activity and the reduced competition is creating a windfall for those competing in our market.

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As this year has unfolded, a few things have been obvious to participants in the market. The extraordinarily low interest rate environment, coupled with the very sharp supply/demand imbalance, has exerted tremendous upward pressure on property values. The market statistics in the first half of the year showed only very minimal increases in property values, but these statistics are indicative of a market that was in the process of transitioning. In March and April, many of the active lenders in the market unveiled five-year fixed-rate loan programs for commercial properties at rates well below 4 percent. Many of the sale contracts signed in the second quarter of 2012 will close in the third quarter and beyond, so the spike in value will be observed clearly in second-half numbers.

Within a few weeks of these low interest rate loans being made available, we saw capitalization rates across all product types, and within all geographic submarkets, compress by more than 100 basis points. These low interest rates have allowed the sales market to attain healthy traction just as they are allowing the stock market to perform well and are allowing the broader economy to at least show positive growth (some would argue that GDP growth of less than 2 percent still leaves us feeling like we are in a recession). But how long will these low rates be with us? With a tripling of the U.S. money supply and a tripling of the Fed's balance sheet, inflationary pressures are on the horizon. Last week, Fed Chairman Ben Bernanke alluded to QE3 at some point, which would be implemented to keep rates low and stimulate a scarily weak economic recovery. Notwithstanding this position by the Fed, whether rates will rise significantly is not a question of if, but when. The impact of rising interest rates will be tangibly negative for property values.

Additionally, the supply/demand imbalance has been as sharp as I have ever seen in nearly 30 years of selling properties in New York City. The supply of buildings for sale is always low here, as evidenced by the long-term average turnover rate in the Manhattan submarket (the highest in NYC) of 2.6 percent of the total supply of existing properties. This means that, on average, properties are purchased and held for 40 years before they are sold. In the outer boroughs, the turnover rate is even lower.

Simultaneously, the number of buyers in the market is at an all-time high, as high-net-worth individuals, families, institutional investors and foreign buyers are all competing feverishly for offerings.

The combination of low rates and excessive demand has created an extraordinary seller's market. We expect more properties to be brought to market in the coming weeks, and these additional offerings will be scooped up quickly by buyers looking hungrily for product. We expect these conditions to continue through the balance of the year, which will mean a very busy fall, and early winter, for sales brokers across the city.

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