CONCRETE THOUGHTS

The Straw That Stirs the Market

Positive signs in Manhattan's building sales market augurs well for city

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In 1977, baseball slugger Reggie Jackson responded to a question about his importance to the New York Yankees by saying that he was "the straw that stirred the drink." Similarly, the Manhattan building sales market is the straw that stirs the New York City building sales market, and we have been seeing many positive signs in the market of late. Just as Mr. October led my beloved Yankees to back-to-back championships in 1977 and 1978 after a 15-year drought, Manhattan is poised to lead the New York City market out of its malaise.

At face value, the Manhattan numbers in first-quarter 2010 (1Q10) wouldn't excite anyone, as they seem to be relatively flat from the first quarter of 2009. However, upon deeper inspection, we see positive trends emerging.

In 1Q10, there were $1.539 billion in investment sales transactions closed in Manhattan (defined as south of 96th street on the East Side and south of 110th Street on the West Side). This level is almost unchanged from the $1.536 billion in sale transactions closed in 1Q09. This figure, however, represents an increase of 51 percent from the $1.019 billion in sales in 4Q09.

If we annualize the $1.539 billion in sales in 1Q10, the marketplace is on pace for approximately $6.16 billion in sales volume this year. If that occurred, it would represent a 47 percent increase in activity from the $4.2 billion total in 2009. This significant increase would be due to the fact that 1Q10 activity significantly exceeded sale volume in 2Q09, 3Q09 and 4Q09, so the traditional comparison, of quarter to quarter, shows its flaws.

Sales activity, expressed in terms of aggregate dollar volume, can be a misleading indicator of true market activity because several large transactions can greatly impact these totals. For example, the $5.4 billion sale of Stuyvesant Town–Peter Cooper Village exceeded, in one transaction, the entire $4.2 billion in sales in 2009 by a significant margin. In 1Q10, the top six transactions represented nearly half (48 percent) of the total dollar volume of sales activity in the quarter. Because of this lopsided dynamic, we focus greater attention on the total number of buildings sold than we do on the aggregate dollar volume.

In Manhattan in 1Q10, there were 99 properties sold. This represented a 98 percent increase above the 50 properties sold in 1Q09. To give some perspective to this activity level, we should take a look at how the volume of sales, in terms of the number of buildings sold, has performed over the long term.

In the Manhattan marketplace, there are 27,649 buildings in our statistical sample. Over a 26-year history, the average turnover within this stock has been 2.6 percent annually. The lowest volume of sales we ever saw occurred in 1992 and 2003, both of which were years at the end of recessionary periods and were also both years in which New York City hit peaks in cyclical unemployment. (The chart nearby shows the 26-year history of building sales volume since 1984.)

We had always assumed that the 1.6 percent turnover was a base line below which volume would never fall. This assumption was based on the fact that in 1992 and 2003, the only people who were selling were those who had no choice. Properties were sold due to death, divorce, taxes, insolvency, partnership disputes, etc. This assumption was obliterated in 2009, as there were only 322 properties sold in the entire Manhattan marketplace. These 322 sales represented a turnover of 1.17 percent, 27 percent below the 1.6 percent previous low.

Notwithstanding this new record low, there was some good news in the 2009 numbers, as throughout the year, on a quarter-over-quarter basis, we saw an increase in volume. (The chart nearby shows that if you annualize the sales that occurred in 1Q09, turnover runs at 0.7 percent.) If we annualize the 123 sales in the first half of last year, turnover rises to 0.9 percent. Annualizing the first three quarters of sales brought us to a turnover of 1 percent, and when we incorporate fourth-quarter sales, the annual volume rises to the 1.17 percent level. If we annualize the 99 sales in 1Q10, sales volume in Manhattan increases to 1.4 percent. This quarterly increase was the fifth consecutive such quarterly increase.

We anticipate turnover for 2010 to finish in the range of 1.6 to 1.7 percent, which would be an increase of 40 to 45 percent above 2009 levels. While still at previous historic lows, the 40 to 45 percent increase in activity would certainly be welcomed by participants in the marketplace.

With regard to pricing, as usual, the multifamily sector has performed best. In 1Q10, the average capitalization rate on elevator properties rose just 3 basis points from the 2009 average, to an average of 4.55 percent. Walk-up apartment buildings performed well also, with cap rates dropping 5 basis points to an average of 5.0 percent from a 2009 average of 5.05 percent. Interestingly, the average price per square foot for walk-ups continued its 2009 trend of remaining higher than the price per square foot attained for elevator properties. Walk-ups averaged $540 per square foot; elevator buildings averaged just $386.

In the mixed-use sector (properties where the retail component represents at least 20 percent of the building's square footage), 1Q10 saw cap rates rise 52 basis point, from a 2009 average of 5.58 percent to 6.1 percent. This cap-rate expansion moved in tandem with a reduction in value per square foot, as it fell from a 2009 average of $599 to a 1Q10 average of $564, a 5.8 percent reduction.

The retail sector, which we had indicated had overshot to the downside, with nearly a 50 percent drop in value from the peak of the market, saw an increase in the average price per square foot, moving from the 2009 average of $1,071 to a 1Q10 average of $1,246. This figure represents a 16 percent increase in value.

In the office building sector, average prices per square foot increased about 10 percent, from the 2009 average of $397 per square foot to $438. Within the office building sector, however, it is important to keep in mind that an office building's exposure to the marketplace has a significant impact on its price level. In 2009, as office building values on a per square foot basis fell by 55 percent from the peak, those that were well leased with low vacancy and little short-term lease rollover had lost only 25 percent of their value. Buildings with very high vacancy, and significant lease rollover in

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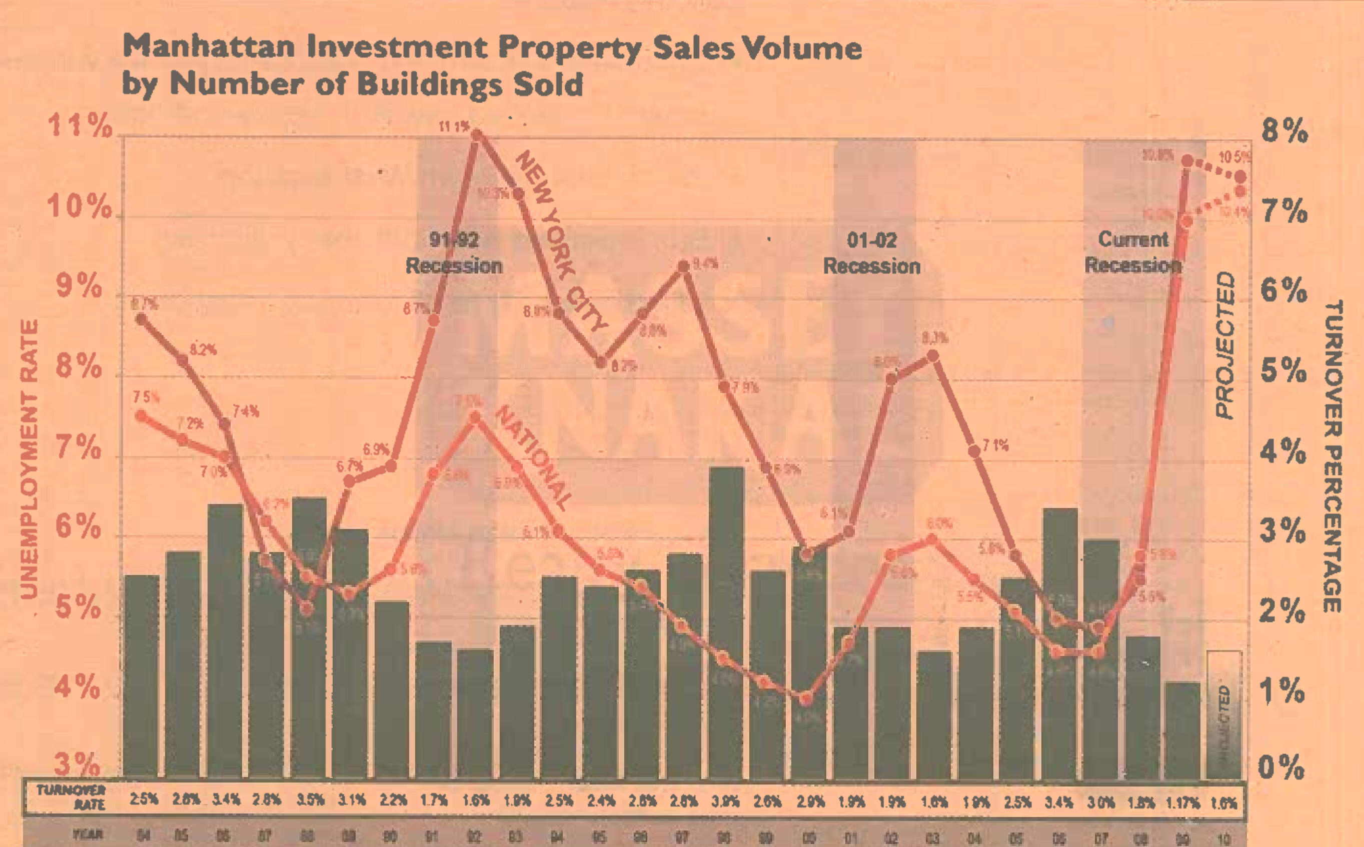

Source: Massey Knakal Realty Services

the short term, lost almost 70 percent of their value. Understanding the composition of the properties being sold is critically important to determining performance within the sector.

Office condominiums showed a similar increase to that seen in the office building sector, with an 11 percent increase in price per square foot, from a 2009 average of $805 to a 1Q10 average of $879.

The development-site, or land, market continued its surprising performance, with four 1Q10 sales averaging $341 per buildable square foot.

Specialty-use properties, those acquired by nonprofit organizations, foundations, foreign governments, religious organizations or schools, continued an upward trend, with a 7 percent increase over the 2009 average of $951 per square foot by reaching $1,015 in 1Q10.

First-quarter sales activity was positive in Manhattan from many perspectives, and an even stronger 2Q10 is anticipated based upon the activity we have seen in the first quarter and, more importantly, based upon the surge in contract executions in the first three months of the year.

The capital that has been sitting on the sidelines has transited to the playing field, as the motivation to deploy capital continues to increase. Fortunately, the supply side is beginning to loosen, creating opportunities for all of that capital. We expect the Manhattan market to lead the way, with the boroughs lagging behind; but they will, eventually, follow the straw that stirs the drink.

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