What to Make of Investment Sales

As tumultuous 2010 ends, searching for trends, planning for busy December

EXECUTIVE SUMMARY:

- → The third quarter of 2010 delivered declines in sales and dollar volume versus second quarter.
- → The declines are surprising because they reversed the trends of the year's first half
- → Still, the first three quarters of 2010 were much more positive than the same ones in 2009.
- → Expect a busy end of the year because of uncertainty over taxes and government policy.

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In the third quarter of 2010 (3Q10), the investment sales market in New York City suffered a surprising setback, with a reduction in sales volume from trends established in 2009 that continued into the first half of this year. This is true if we look at total dollar volume as well as number of buildings sold.

In 3Q10, the total dollar volume of sales was $2.65 billion. This figure represented a 30 percent drop from the $3.76 billion in sales volume in 2Q10. In terms of the number of properties sold, there were 377 properties sold in 3Q10, representing a 23 percent reduction from the 488 properties sold in 2Q10.

The reason these reductions are surprising is that they were not expected based upon recent trend analysis.

In the Manhattan marketplace (defined as south of 96th Street on the East Side and south of 110th Street on the West Side), we had seen six consecutive quarters of positive volume increases. Northern Manhattan also experienced a positive volume trend for many quarters running. In 2Q10, we saw transaction volume turn from negative to positive for the first time in this cycle, both in Brooklyn and Queens. The Bronx was the only submarket in which volume did not change course from its consistent slide in transaction volume. Our expectation was that transaction volume would turn positive in the Bronx in 3Q10 and that we would have positive volume trends marketwide.

In actuality, the dollar volume of sales increased in the Bronx in 3Q10, increasing from $125 million in 2Q10 to $136 million, but the dollar volume dropped in all other submarkets. The increase in the Bronx represented a 9 percent increase. In the other submarkets, Manhattan showed a 26 percent reduction, to $2.15 billion; Queens dropped 37 percent, to $88.3 million; and the Brooklyn and northern Manhattan submarkets each dropped by more 50 percent, with Brooklyn falling by 51 percent, to $172 million, and Northern Manhattan falling by 53 percent, to $107 million.

An explanation for these setbacks could be that 2Q10 was a particularly strong quarter; however, the halt in momentum was disturbing nonetheless.

While the above comparison shows the disappointing results of 3Q10 versus 2Q10, the comparison of the first three quarters of 2010 (1-3Q10) to the first three quarters of 2009 (1-3Q09) tells a different story.

The total dollar volume sales in 1-3Q10 hit $9.11 billion, an increase of 98 percent over the same period in 2009. The majority of this increase was due to activity in the Manhattan submarket, where $7.3 billion of transaction volume occurred. This figure was up 130 percent over 2009 levels. The northern Manhattan submarket followed closely behind with $451 million in 1-3Q10, a 105 percent increase over the same period in 2009. The Brooklyn submarket saw activity of $688 million, an increase of 32 percent over 2009 levels; activity in the Bronx remained essentially unchanged with $329 million of sales activity, up just 1 percent from 2009. The dollar volume of sales in Queens, at $369 million, was down 2 percent from the same period last year.

The percentage increases coming off 2009 totals are clearly substantial, however, we must keep in mind that 2009 totals were well below the volume seen at the peak of the market. The $9.11 billion in 1-3Q10 remains a whopping 81 percent below the totals observed in the first three quarters of 2007, when there was $47.7 billion in transaction volume.

In 1-3Q10, the number of buildings sold in New York City showed similar trends to dollar volume. On a marketwide basis, the 377 properties sold in 3Q10 represented a 23 percent reduction from the 488 properties sold in 2Q10. Each submarket registered a reduction in the number of buildings sold from 2Q10 to 3Q10, with the exception of northern Manhattan, in which there were 37 properties sold, versus 35 in 2Q10. The smallest reductions in volume were in Manhattan and the Bronx, dropping 18 percent and 22 percent, respectively. The reduction in Brooklyn was 27 percent. Queens suffered the largest drop, from 88 properties sold in 2Q10, to 58 in 3Q10, a reduction of 34 percent.

Similar to the dynamics seen in dollar volume trends, the buildings-sold totals for 1-3Q10 are significantly better than those seen in 1-3Q09 with 1,237 properties sold this year, versus 1,038 sold last year, an increase of 19 percent. The largest increase in sales volume, when comparing these two periods, occurred in Northern Manhattan, with a 75 percent increase in number of buildings sold versus last year. The Manhattan submarket showed a 69 percent increase, and the Brooklyn market was up 15 percent. Remarkably, the number of buildings sold in Queens was 8 percent lower this year and, in the Bronx, the total sold in 1-3Q10 was 16 percent lower than the same period in 2009.

The average transaction levels in 3Q10 also showed a drop from where they were at the end of the first half of the year.

At the end of 1H10, the average property in New York City had a sale price of $7.9 million. Adding third-quarter activity, the average property sold saw its price drop to an average of $7.4 million. Comparing the differences between these two periods, surprisingly, the Bronx was the only submarket in which the average

New York City Total Buildings Sold

Total Market	2005	2006	2007	2008	2009	2010
Q1	964	1,320	1,353	951	363	372
Q2	1,154	1,284	1,385	938	299	488
Q3	1,259	1,149	1,242	680	376	377
Q4	1,066	1,122	1,038	575	398	
TOTAL	**4,443**	**4,875**	**5,018**	**3,144**	**1,436**	**1,237**

source: Massey Knakal Realty Services

Average Price Per Property Sold
(in Millions)

	2005	2006	2007	2008	2009	2010*
Manhattan	$28.5	$30.4	$52.5	$31.1	$12.9	$20.5
Northern Manhattan	$4.2	$4.8	$4.5	$4.6	$3.2	$4.2
Bronx	$2.7	$2.6	$3.1	$2.2	$2.0	$2.4
Brooklyn	$1.8	$1.9	$2.1	$1.8	$1.7	$1.7
Queens	$2.2	$2.2	$2.0	$2.3	$1.7	$1.6
TOTAL MARKET	**$7.3**	**$9.1**	**$12.4**	**$8.0**	**$4.4**	**$7.4**

source: Massey Knakal Realty Services *total dollar volume\properties sold 1Q-3Q

Percentage of Total Stock Sold

Stock		2005	2006	2007	2008	2009	2010*
27,649	Manhattan	3.11	2.95	3.61	2.30	1.17	1.71
6,967	Northern Manhattan	4.52	4.23	4.69	2.08	1.33	2.05
21,376	Bronx	2.45	3.07	3.28	1.91	0.94	0.85
65,119	Brooklyn	2.63	2.94	2.88	1.70	0.73	0.84
43,765	Queens	2.36	2.72	2.55	1.93	0.79	0.70
164,876	**TOTAL MARKET**	**2.69**	**2.96**	**3.04**	**1.91**	**0.87**	**1.00**

source: Massey Knakal Realty Services *annualized transaction price increased, rising from $2.1 million to $2.4 million. The Queens average, which had the lowest average within all submarkets, remained unchanged at $1.6 million.

When comparing the averages to previous totals, we see that our $7.4 million average transaction level compares favorably to 2009's average of just $4.4 million. It is also approximately the same as the $7.3 million average we saw in the market in 2005. At the peak of the market, in 2007, the average property in New York City sold for $12.4 million.

The final metric that we use to analyze building sales volume is to consider the turnover ratio of the number of buildings sold versus the total stock of buildings in the marketplace.

The 1,237 buildings sold in the first three quarters of 2010 represent, on an annualized basis, approximately 1 percent of the total stock of 164,876 properties in our citywide statistical sample. This figure compares favorably with the 0.87 percent turnover rate seen in 2009, when just 1,436 properties were sold. This total is, however, well below the 5,018 properties sold at the peak of the market in 2007, which represented a turnover ratio of 3.04 percent. In 1-3Q10, the submarket with the highest turnover ratio was northern Manhattan, in which 2.05 percent of its 6,967 properties changed hands. The lowest turnover ratio was experienced in the Queens submarket where just 0.7 percent of the borough's 43,765 properties were sold.

I generally address value trends in my column at the end of the half-year, and in my year-end review. Through 3Q10, values have remained volatile, merely bouncing along the apparent bottom that we hit in 2009. We have seen values in different product segments up in some submarkets, and down in others.

December is likely to be a record month and is going to be a very bad time for brokers, attorneys, and title closers to even think about going on vacation.

We have been searching for clear positive trends in value for some time, but the market has failed to deliver them. We had previously taken comfort in the fact that volume trends were all heading in a positive direction, which is why the setback in the third quarter was so disappointing. Now both major fundamentals within our marketplace, volume and value, appear to be meandering along, more or less aimlessly.

This volatility parallels the broader macroeconomic indicators, which show a lack of consistency. The massive amount of uncertainty in today's economy is creating below-trend, slow, sluggish growth in gross domestic product, which, in turn, has created lackluster results in the employment market.

With employment growth anemic, real estate fundamentals face challenges. While rental fundamentals are better than they have been, as owners reduce concessions for both commercial and residential tenants, it will be difficult for rent levels to increase without job creation at levels higher than we have had. The uncertainty created by a lack of clear tax policy is easily remedied if Congress can get its act together after the midterm elections. The uncertainties created by health care reform and financial regulation could take years to be understood and solved given the magnitude of these programs and the complexities embedded within them.

Notwithstanding current economic conditions, we expect the fourth quarter of 2010 to be excellent for the building sales marketplace, particularly on the volume side.

A simple extrapolation of the 1,237 properties sold thus far in 2010 puts us on pace for approximately 1,650 properties sold for the entire year. A simple forecast of dollar volume of sales, based upon the $9.11 billion sold thus far in 2010, would lead to a 2010 year-end forecast of $12.15 billion.

We, however, believe that the actual totals will be significantly higher than both of those numbers based upon the anticipated strong activity in 4Q10. Distressed assets are coming to market in significant numbers from both banks and special servicers, while, simultaneously, discretionary sellers continue to anticipate an increase in the capital gains rate. This fear has motivated sellers to place several properties on the market with the intention of title transferring before the end of the year. In December of 1986, hundreds of properties were rushed to closing prior to the implementation of a new tax structure, which was scheduled to take effect Jan. 1, 1987.

If Congress doesn't act after the midterm elections to keep the existing tax rates in place, this December is likely to be a record month, and is going to be a very bad time for brokers, attorneys and title closers to even think about going on vacation.

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