

## Investment Sales: What Just Happened, What Lies Ahead

Did somebody say optimism? Signs from late 2010 point to more sales, more value, more turnover; what to watch and why

The performance of the 2010 investment sales market in New York City was indicative of a market still trying to find solid ground. Not surprisingly, the volume of sales showed significant improvement over 2009 levels. Very surprisingly, on the other hand, is the fact that values, on a price-per-square-foot basis, were lower in 2010 than in the prior year. Given quarterly volatility within each of these metrics, the investment sales market is clearly still trying to establish firm footing and gain traction for a tangible recovery.

In 2010, sales volume reached \$14.5 billion, up 131 percent from the abysmal \$6.3 billion achieved in 2009. To illustrate just how bad the performance was in 2009, the \$6.3 billion in sales reflected a drop of about 90 percent from the \$62.2 billion at the peak of the market in

2007. The \$14.5 billion in sales recorded in 2010 was also less than half of the \$32.6 billion recorded back in 2005. Therefore, while the 131 percent increase over 2009 levels seems encouraging, we are still well below the medium-term trend line.



**Robert Knakal**  
Columnist

Manhattan was the submarket that performed the best, showing a 187 percent increase over 2009 levels; Queens continued its slide, with a 6 percent drop compared to the prior year.

The 2010 numbers were helped immensely by an extraordinary fourth quarter, in which there was \$5.6 billion in sales volume. This was the highest quarterly total in more than nine quarters, going back to 3Q08. The tremendous activity in the fourth quarter was reflective of two very strong factors: that banks and special servicers were aggres-

sively trying to clean up balance sheets before the end of the year; and that many sellers, motivated to dispose of assets due to the anticipated increase in capital gains tax rates, had already closed on their sales or executed binding contracts prior to Congress agreeing to extend the then-current rates. These two forces created many long days and nights in December for market participants who are involved on the transactional side of the business. I can't remember a time during my 27-year career when simultaneous contract/closings or contract periods of less than two weeks were more prevalent.

While the trend within the volume of sales is clearly upward, there has been significant quarterly volatility in the numbers. After the second quarter of 2010, we had seen several consecutive quarters of volume growth in Manhattan and northern Manhattan. Volume trends in Brooklyn and Queens had also become positive for the first time

in this cycle, and it was anticipated that the Bronx would turn positive in 3Q10. With the exception of the Bronx, which did see an increase in sales volume, 3Q10 results were disappointing, as volume dropped in all submarkets. These third-quarter setbacks were followed by dramatic increases in the fourth quarter. Given the external stimulus of lender balance sheet considerations and, more importantly, tax considerations, we expect that this bloated activity in 4Q10 will have "stolen," or accelerated, some of the expected activity from 1Q11.

This is something that we would expect to see and is common after externalities impact a marketplace. We saw similar dynamics with the cash-for-clunkers program and the tax credit for first-time home buyers. As soon as these programs ended, auto sales and home sales plunged. We expect to see similar declines in volume in the first quarter of this year.

Something that has been unex-

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pected, and is very positive, is that, thus far in January, we have seen an incredible number of potential discretionary sellers inquiring as to the value of their properties as they consider potential sales. This was unexpected, and is very encouraging relative to our projected sales volume for 2011.

Even though the dollar volume of sales increased 131 percent in 2010, we always look more closely at the volume based on the number of properties sold, as we believe this is a better indication of market activity. After all, a few very large transactions can skew the dollar volume significantly.

In 2010, 1,667 properties were sold in New York City, up just 16 percent from the 1,436 properties sold in 2009. At the peak of the market in 2007, 5,018 properties were sold. In fact, during the period from 2005 to 2007, an average of approximately 4,750 properties sold each year. Therefore, 2010 activity was only about a third of the medium-term trend line.

The 1,667 properties sold represented a turnover ratio of approximately 1.01 percent of the 165,000 properties in our statistical sample. This is up from a 0.87 percent turnover rate experienced in 2009, and is significantly less than the approximate 3 percent turnover experienced in 2005, 2006 and 2007. An interesting way to look at this turnover percentage is that a 1 percent turnover ratio means that the average property would only sell once every 100 years!

In terms of submarket performance, Manhattan's increase in number of buildings sold was the strongest, at 47 percent; the number of sales in Queens, meanwhile, was down by 11 percent on a year-over-year basis. If we look at the turnover ratio in each submarket, we see that

**Average Price Per Property Sold**  
(in Millions)

	2005	2006	2007	2008	2009	2010
Manhattan	\$28.5	\$30.4	\$52.5	\$31.1	\$12.9	\$25.3
Northern Manhattan	\$4.2	\$4.8	\$4.5	\$4.6	\$3.2	\$4.0
Bronx	\$2.7	\$2.6	\$3.1	\$2.2	\$2.0	\$3.1
Brooklyn	\$1.8	\$1.9	\$2.1	\$1.8	\$1.7	\$1.8
Queens	\$2.2	\$2.2	\$2.0	\$2.3	\$1.7	\$1.9
<b>TOTAL MARKET</b>	<b>\$7.3</b>	<b>\$9.1</b>	<b>\$12.4</b>	<b>\$8.0</b>	<b>\$4.4</b>	<b>\$7.2</b>

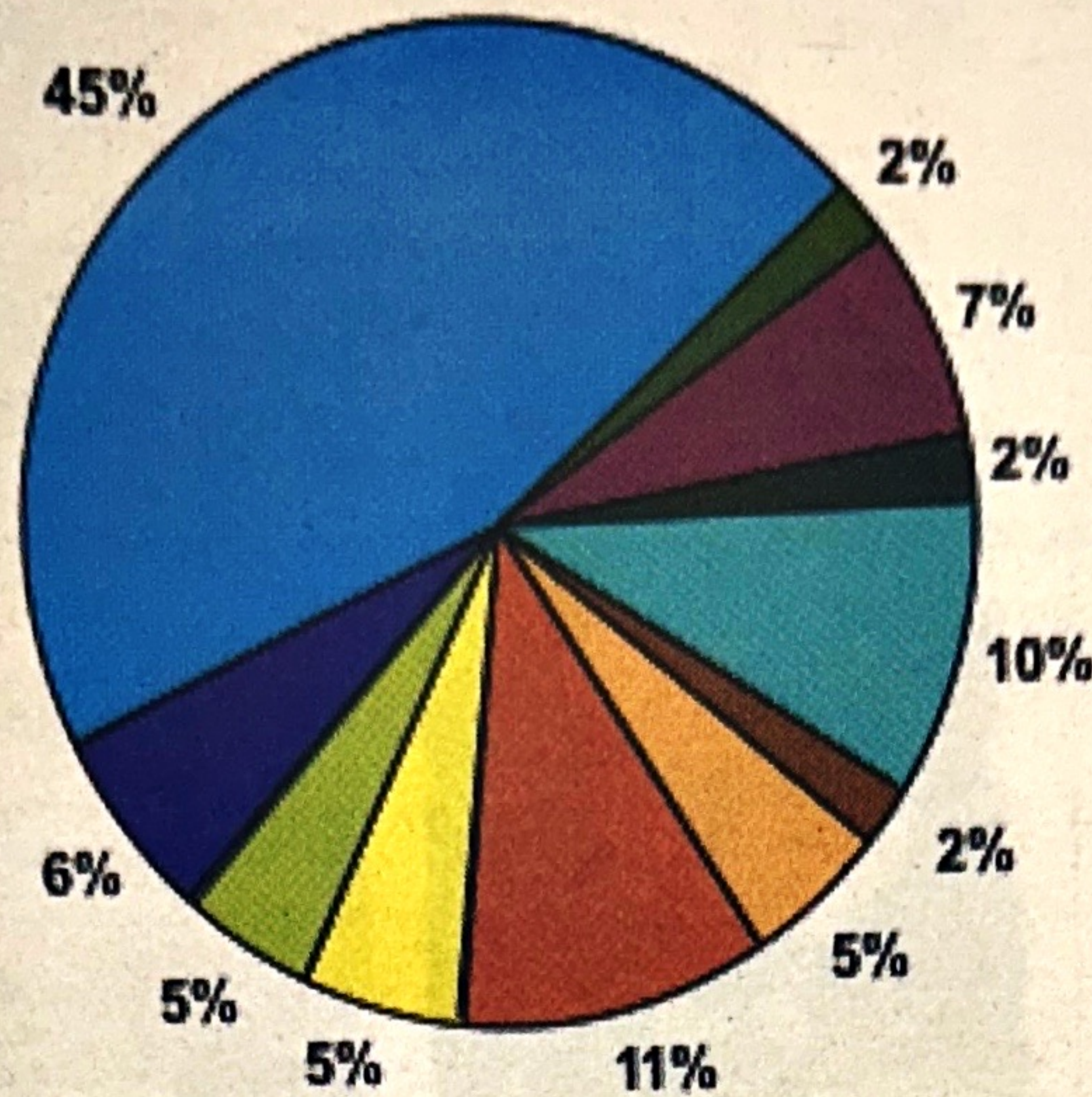
source: Massey Knakal Realty Services

**New York City Total Sale Dollar Volume**  
(in Billions)

Total Market	2005	2006	2007	2008	2009	2010
Q1	\$4.69	\$9.01	\$20.11	\$6.23	\$2.05	\$2.67
Q2	\$9.56	\$10.41	\$15.74	\$8.24	\$0.76	\$3.53
Q3	\$8.25	\$8.27	\$11.80	\$8.14	\$1.80	\$2.67
Q4	\$10.11	\$16.51	\$14.54	\$2.69	\$1.66	\$5.59
<b>TOTAL</b>	<b>\$32.60</b>	<b>\$44.20</b>	<b>\$62.19</b>	<b>\$25.30</b>	<b>\$6.26</b>	<b>\$14.46</b>

source: Massey Knakal Realty Services

## New York City Total Sale Dollar Volume 2010



1-4 Family	\$	720,071,062
Elevator	\$	1,541,834,132
Walk-Up	\$	787,743,237
Mixed-Use	\$	657,130,476
Retail	\$	898,461,050
Office	\$	6,561,859,171
Office Condo	\$	295,233,722
Development	\$	973,939,231
Industrial	\$	333,639,590
Hotel	\$	1,410,581,276
Specialty Use	\$	281,090,470
<b>Total</b>	<b>\$</b>	<b>14,461,583,417</b>

northern Manhattan was the most active, with a 1.82 percent turnover ratio, and Queens was the lowest, with just 0.70 percent of its stock trading in 2010.

To illustrate shifts in certain trends in the sales market, it is interesting to look at the difference in the performance of dollar volume of sales versus the number of properties sold. From the peak of the market in 2007 to 2009, the dollar volume dropped 90 percent; the number of properties sold fell by 74 percent.

This bias toward smaller property sales was a clear indication that larger financings were difficult to obtain and it was simply easier to sell smaller properties during that period. The commercial mortgage-backed securities market dried up, falling from \$230 billion in 2007 to just a few billion in 2009. Additionally, large commercial and money-center banks ceased lending on commercial real estate during this period. This reduction in the availability of large-scale debt exerted downward pressure on average transaction levels.

The banks most actively lending during this time period were small regional and community banks. These banks typically had an individual loan threshold of about \$30 million. The 60 percent loan-to-value ratio created a clear line of demarcation at the \$50 million price level. Now we have seen an increase in the dollar volume of sales by 131 percent, but an increase in the number of properties sold at only 16 percent. The market is now clearly demonstrating a bias toward larger transactions, as the financing markets are recovering and investor confidence is encouraging them to deploy large chunks of equity into a single transaction.

**M**arket-wide, the average price for a property sold in 2010 was \$7.2 million. This was up from a 2009 average of just \$4.4 million. In 2007, the average New York City property sold for \$12.4 million. Last year's \$7.2 million average is approximately what it was in 2005, when the average property sold for \$7.3 million. The resurgence of the CMBS market, and the financing markets in general, has

helped this average transaction level increase along with the increase in investor confidence mentioned above.

We see this bias toward larger transactions particularly in Manhattan, where in 2009 there were just nine properties sold with a price in excess of \$100 million. In 2010, this number climbed to 32.

While the \$14.5 billion in investments transactions in 2010 was very encouraging, it was not indicative of the actual level of activity, which was understated due to the tremendous action in the note-sale market. We estimate that there was approximately \$6 billion to \$7 billion of note-sale transactions last year. As note sales are not publicly reported anywhere, this number is merely an estimate based on extrapolations of Massey Knakal's activities selling and analyzing potential note sales for lenders, on understanding the sheer volume of distressed assets in the marketplace and on speaking to banks and special servicers about the relative level of distressed left on their balance sheets.

If there were indeed \$6 billion to 7 billion in note sales, this would mean that sales activity actually tripled from 2009 to 2010, and would

further substantiate the very positive psychology that exists among participants in the market today.

**W**e always talk about the "two Vs" as the most important metrics when analyzing the investment sales market. We already looked at the positive trends in sales volume, and now we must look at the other V: value.

Perhaps the most surprising statistic coming out of our 2010 study was the fact that prices, on a price-per-square-foot basis, dropped by 8.4 percent in 2010 versus 2009. This data defies the generally held belief that prices were increasing in 2010. It is important, however, to draw a distinction between price trends within the "core" asset market and trends within the balance of the property sample. It is clear that core assets have seen overwhelming demand, and prices for these institutional quality assets did indeed rise in 2010. Unfortunately, these core assets (which make up a disproportionately high percentage of total dollar volume of sales) represent less than 5 percent of the total number of buildings sold. If we aggregate all product types, in all submarkets, we come up

with our average drop of 8.4 percent.

In terms of submarket performance, surprisingly, the Bronx saw an increase in average value per square foot, with a 3 percent increase over 2009 levels. Queens was the most negatively impacted, as prices dropped by 13 percent year-over-year.

This 2010 average value reduction on a price-per-square-foot basis indicates that, on average, properties are trading for approximately 36 percent below where they were trading at the peak of the market. This additional reduction in value will leave distressed assets even more stressed as negative equity positions grow. Furthermore, the extend-and-pretend strategies implemented on a short-term basis will not have provided the anticipated relief, as this tactic is only beneficial in an appreciating market. Fortunately, the pace of the decline in value has slowed significantly, and we expect to see price appreciation sometime before the end of 2011.

If we look at the market from a macro perspective, it is clear that the low point in the volume of sales was the second quarter of 2009. We believe that the bottom in terms of value will occur sometime in 2011. Based upon the relative level of value and volume, we are optimistic that there is room for significant improvement in both these metrics over the short, medium and long terms. Based upon that perspective, we anticipate that the dollar volume of sales will rise into the \$22 billion to \$25 billion range this year, representing a 55 percent increase over 2010 levels. We also anticipate that the turnover ratio in this year's market will be in the 1.2 to 1.3 percent range, representing about a 25 percent increase in the number of buildings sold. We also expect to see price appreciation of 5 to 8 percent citywide as core assets continue to climb and, more importantly, secondary and tertiary markets begin to firm up.

Clearly, there are many reasons for optimism as we progress into 2011. There are, however, many factors that we must monitor that could dampen that optimism. We will take a look at each of these factors next week.

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### New York City Total Buildings Sold

Total Market	2005	2006	2007	2008	2009	2010
Q1	964	1,320	1,353	951	363	363
Q2	1,154	1,284	1,385	938	299	473
Q3	1,259	1,149	1,242	680	376	375
Q4	1,066	1,122	1,038	575	398	456
<b>TOTAL</b>	<b>4,443</b>	<b>4,875</b>	<b>5,018</b>	<b>3,144</b>	<b>1,436</b>	<b>1,667</b>

source: Massey Knakal Realty Services

### Percentage of Total Stock Sold

Stock	2005	2006	2007	2008	2009	2010
27,649	3.11	2.95	3.61	2.30	1.17	1.71
6,967	4.52	4.23	4.69	2.08	1.33	1.82
21,376	2.45	3.07	3.28	1.91	0.94	0.89
65,119	2.63	2.94	2.88	1.70	0.73	0.87
43,765	2.36	2.72	2.55	1.93	0.79	0.70
<b>164,876</b>	<b>2.69</b>	<b>2.96</b>	<b>3.04</b>	<b>1.91</b>	<b>0.87</b>	<b>1.01</b>

source: Massey Knakal Realty Services

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