

Third Down

Investment sales have dropped from the second quarter, but fear not: the numbers behind the story are rosier than they appear

The investment sales market in New York City continues to trend positively, as third quarter 2011 statistics show. This may not seem so apparent when looking at the data in isolation, but drilling further down reveals a far more telling message.

In 3Q11, there was \$6.5 billion in investment sales activity citywide, which was down from the \$8.7 billion that occurred in 2Q11. On face value, it might appear that this slowdown in activity is a negative signal for the market. But, when we look at the numbers more carefully, we see that the medium-term trend is positive. Notwithstanding the \$2.2 billion reduction in dollar volume in the third quarter, with the exception of 2Q11 results, the \$6.5 billion in sales in 3Q11 was the highest quarterly total the market has experienced going all the way back to 3Q08.

The slowdown in the dollar volume of sales is representative of two main factors. First, the supply of available larger, institutional-

quality properties was reduced in the second quarter of the year, leading to less activity in the third quarter. Second, stresses in the C.M.B.S. market created difficulty in obtaining financing for larger assets. It is important to note that the dollar volume of sales has more to do with these factors (supply and debt availability) than anything else, as demand is almost always excessive in New York City. In fact, going back to 1984, the only year in which this was not the case was in 1992, during the post-S.&L. crisis recession.

Annualizing the \$19.2 billion of transaction activity that occurred in the first three quarters of 2011, the market is on pace for approximately \$25.6 billion for the year, which would result in an increase of nearly 80 percent over the \$14.2 billion of sales in 2010. It would also be approximately four times

the 2009 total of \$6.9 billion.

Interestingly, while the dollar volume has quadrupled since 2009, we still remain 60 percent below the \$62.2 billion in sales that occurred at the market's peak in 2007.

Based on the reduction in the dollar volume of sales between the second and third quarters of 2011, it wouldn't be surprising if fourth-quarter dollar volume came in below third-quarter totals. Notwithstanding a second consecutive quarterly drop, we're still expecting total dollar volume to be no less than \$24 billion. Regardless of fourth-quarter totals, 2011 will show a tangible improvement over 2010.

The submarket with the largest increase in dollar volume activity, in 2011 versus 2010, was the Manhattan submarket (south of 96th Street on the East Side and south of 110th Street on the West



Robert Knakal

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Side), where an impressive \$16.8 billion sales tally is on pace to be up 44 percent over the \$11.6 billion through 2010. The submarket that has performed the weakest is in Northern Manhattan, where year-to-date sales volume has slumped to just \$263 million. Annualized, Northern Manhattan is on track to finish 51 percent below the \$534 total the submarket tallied back in 2010.

While the dollar volume of sales usually grabs the headlines, it is always the case that we look at the number of buildings sold as being more representative of the real pulse of activity in the marketplace. This is due to the fact

that a few very large transactions can skew the dollar volume metric significantly. For instance, the transaction for Stuyvesant Town at \$5.4 billion can have a significant impact on market statistics, just as Google's \$1.8 billion purchase of 111 Eighth Avenue last year represented approximately 12.5 percent of the total \$14.5 billion in 2010.

With regard to the number of buildings sold citywide, there were 548 buildings sold in the third quarter, the highest total since the fourth quarter of 2008. Thus far this year, 1,548 properties have sold in New York City, setting pace for an annual total of 2,064. This figure would be 22 percent higher than the 1,690 that sold last year and 46 percent higher than the 1,410 that sold at the market's nadir in 2009.

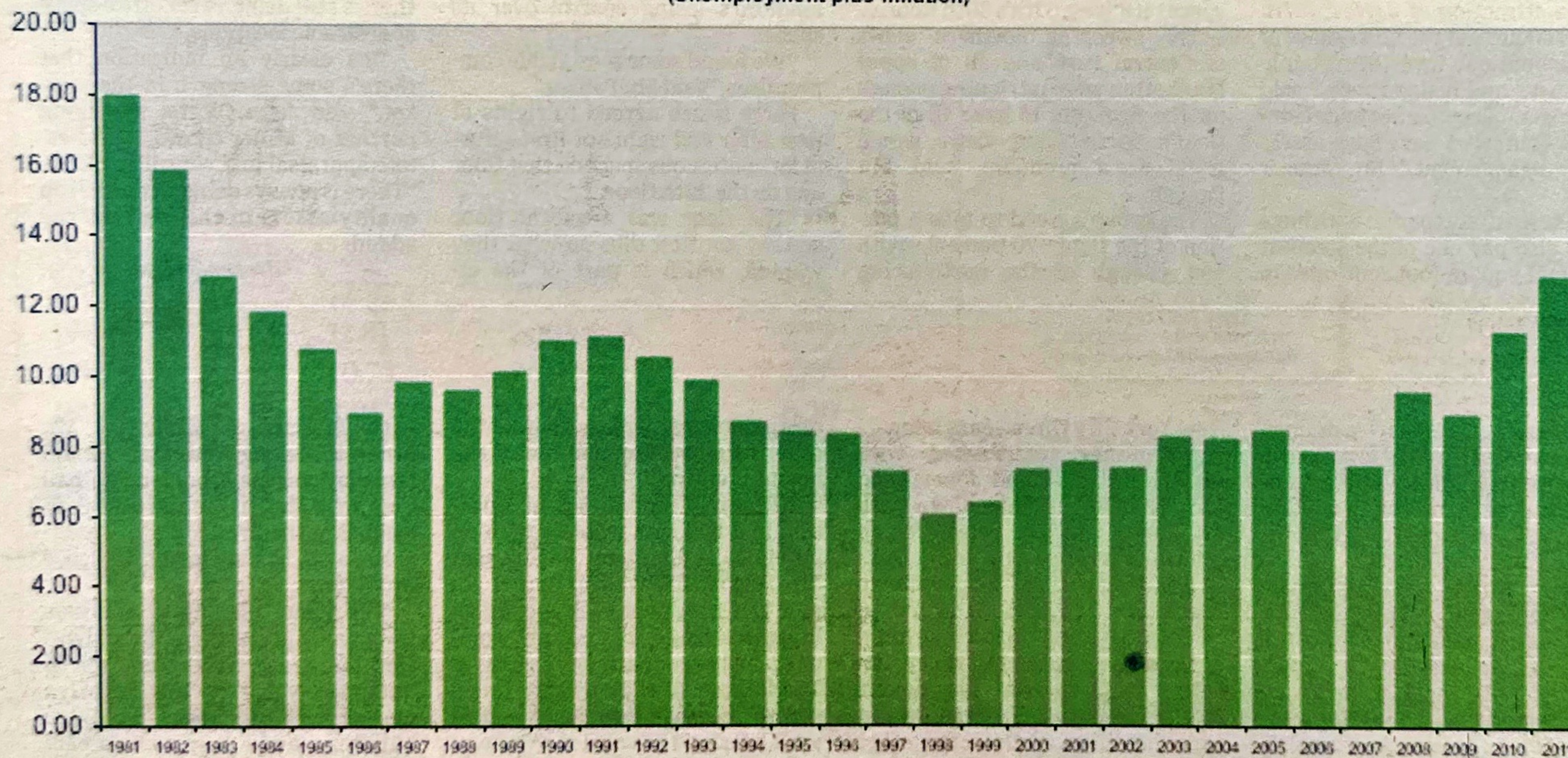
While the number of properties sold was up 46 percent from the trough, if the pace of sales continues, and we achieve the 2,064 sales that we anticipate, this total will still be 60 percent below the 5,018 in sales at the peak of the market in 2007.

It is interesting to note that even with a 46 percent increase in the number of properties sold, and the nearly quadrupling of the dollar volume of sales, both of these metrics will fall 60 percent below 2007 peak levels.

The average price of a property sold citywide in 2011 has been \$12.3 million, remarkably just slightly below the all-time peak of \$12.9 million achieved in 2007. This average had fallen to a measly \$4.3 million in 2009 at the bottom of the market.

Also worth inspecting is the "turnover ratio," which is the number of properties sold out of the total stock of properties across the market. Considering the annualized potential of 2,064 sales this year, the citywide market place is

Misery Index
(Unemployment plus Inflation)



source: The Federal Reserve Bank

running at a turnover rate of about 1.25 percent of the approximately 165,000 properties that are tracked.

This figure is up significantly from the 0.87 percent turnover achieved in 2009, which was a historical low. The marketplace with the lowest turnover was the Queens submarket, with a 0.82 percent turnover. The submarket with the highest turnover was Manhattan, with 2.3 percent. While the Manhattan submarket has been performing extremely well and is up significantly from the 1.17 percent turnover achieved in 2009, the 2.3 turnover is still well below the long-term average of 2.6 percent going back to 1984. There are 27,649 properties in the Manhattan submarket and the 630 projected sales for this year would result in a turnover ratio of approximately 2.28 percent.

Several questions have been asked about recent occurrences in the broader markets and their potential impact on commercial real estate capital markets. These include the S&P. downgrade, economic turmoil in Europe and the debt-ceiling debate. An argument could be made that these events have negatively impacted the dollar volume of sales. But, again, further analysis is necessary.

Interestingly, the S&P. downgrade has both hurt and helped the market. It has helped the market because, counterintuitively, the U.S. long-term debt downgrade caused a flight to quality, which increased demand for U.S. Treasuries, driving the yield down. This was a positive result for portfolio lenders—specifically, the community banks and small regional banks—who lend at spreads above Treasury rates. This has created a positive impact on the financing market from these portfolio lenders. However, the flight to quality, as a result of increased risk aversion, created stresses in the C.M.B.S. market. This, therefore, hurt the financing market for larger loans, which impacted dollar volume.

Moving forward, there are five factors worth watching to determine how the sales

market will react: employment, supply, demand, inflation and interest rates. Clearly, employment is well below where we would like to see it given the tremendous impact that it has on real estate fundamentals.

As discussed in this column two weeks ago, supply-and-demand dynamics dictate that demand far exceeds supply and we do not anticipate that changing anytime soon. Supply has been scaled back slightly as the broader economy is creating uncertainty for many participants.

Inflation appears to be rising as the recent C.P.I. calculation has pegged it at about 3.8 percent, well above the Fed's comfort zone. This increase in C.P.I., combined with our unemployment rate, yields a metric called the "Misery Index." At 12.9 percent today, the dreary sounding metric is the highest it has been since 1982.

Interest rate increases also pose a deep threat to the marketplace. While Fed chair Ben Bernanke has indicated that rates will stay low through, at least, the middle of 2013, it would not be at all surprising to see rates rise before that. To the extent that interest rates stay too low for too long, it would create a concern for the marketplace, as low interest rates for an extended period create asset bubbles. This has some investors contemplating whether the market is currently overheated. Others fear that, with inflation right around the corner, hard assets, like commercial real estate, are favorable, and their aggressiveness is reflective of this perspective.

All things considered, the market is trending very positively and we expect these conditions to continue in the short-term.

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Robert Knakal is the chairman and founding partner of Massey Knakal Realty Services and in his career has brokered the sale of more than 1,175 properties, having a market value in excess of \$7.8 billion.

YEAR	MISERY INDEX	1996	8.34
		1997	7.28
1981	17.97	1998	6.05
1982	15.87	1999	6.41
1983	12.82	2000	7.35
1984	11.81	2001	7.59
1985	10.74	2002	7.37
1986	8.91	2003	8.26
1987	9.84	2004	8.21
1988	9.57	2005	8.48
1989	10.09	2006	7.87
1990	11.01	2007	7.46
1991	11.10	2008	9.61
1992	10.52	2009	8.92
1993	9.87	2010	11.29
1994	8.71	2011	12.90
1995	8.40		

Number of Properties Sold

Total Market	2005	2006	2007	2008	2009	2010	2011
Q1	964	1,320	1,353	951	289	443	495
Q2	1,154	1,284	1,385	938	413	428	505
Q3	1,259	1,149	1,242	680	353	377	548
Q4	1,066	1,122	1,038	575	355	442	
Total	4,443	4,875	5,018	3,144	1,410	1,690	1,548
*Annualized							2,064

source: Massey Knakal Realty Services

Dollar Volume of Sales (in Billions)

Total Market	2005	2006	2007	2008	2009	2010	2011
Q1	\$4.69	\$9.01	\$20.11	\$6.23	\$1.88	\$2.87	\$4.01
Q2	\$9.56	\$10.41	\$15.74	\$8.24	\$1.03	\$3.53	\$8.68
Q3	\$8.25	\$8.27	\$11.80	\$8.14	\$1.69	\$2.69	\$6.50
Q4	\$10.11	\$16.51	\$14.54	\$2.69	\$1.50	\$5.14	
Total	\$32.60	\$44.20	\$62.19	\$25.30	\$6.09	\$14.23	\$19.19
*Annualized							\$25.59

source: Massey Knakal Realty Services

THE TAKE AWAY:

1. Third-quarter investment sales were down by \$2.2 billion from the past quarter. But with the exception of 2Q11, the \$6.5 billion in sales this time around is the highest quarterly total since the third quarter of 2008.

2. This year, investment sales are on track to exceed \$25 billion, an 80 percent increase from the \$14.2 billion in 2010. If those figures stick, it would also be approximately four times the activity of the 2009 total of \$6.9 billion.

3. A notable 548 buildings sold in the third quarter, the highest quarterly total since the fourth quarter of 2008. With 2,064 buildings expected to sell in all of 2011, the projected number is 22 percent higher than last year, and 46 percent higher than the 1,410 that sold at the bottom of the market in 2009.

4. The average price of properties sold throughout New York City in 2011 sits at \$12.3 million, just slightly below the all-time peak of \$12.9 million in 2007.

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