Bright Lights, Big City

As is always the case, Manhattan is destined to lead New York City out of the market downturn

In last week's column, we looked at the third-quarter 2011 investment sales market on a citywide basis and noted that the dollar volume of sales dropped from $8.68 billion in the second quarter to $6.5 billion, a 25 percent decline. This would appear to indicate that the investment sales market is slowing. However, a closer look tells a different story.

If we discount the second-quarter total, the $6.5 billion volume observed this time around was the highest since the third quarter of 2008.

In fact, the number of properties sold citywide reached 548, up 8.5 percent from the 505 sales reported in the past quarter. That number marked the highest quarterly total since the fourth quarter of 2008.

Both of these metrics reflect positive trends in the building sales market, although a further decline in the dollar volume of sales in the next quarter would take some steam out of these positive trends. This decline would not be surprising given current market conditions.

Robert Knakal

As is always the case, the Manhattan submarket leads New York City out of market downturns, and this recovery is no different.

The Manhattan submarket (defined as south of 96th Street on the East Side and south of 110th Street on the West Side) has seen a significant comeback from the 2009 nadir.

In the third quarter, there was $5.7 billion worth of investment sales transactions in Manhattan. This figure, when added to 1H11 totals, brings the 1-3Q11 total to nearly $16.8 billion. Annualized, the Manhattan submarket should see about $22.3 billion of investment sales activity this year, remarkably close to the 2005 total of $24.5 billion.

On the present course, 2011 totals will rise 93 percent from the $11.6 billion that occurred in 2010. The projected total of $22.3 billion will also increase by more than five times the $4.1 billion of investment sales transactions that occurred in 2009. To provide some relative perspective, in 2007 there were $52.5 billion of sales transactions in Manhattan. So, while the dollar volume is up more than five-fold from 2009 levels, activity remains 57 percent below the levels observed at the peak of the market.

Looking at third-quarter totals, the charts show that the $5.75 billion in sales represents a 27 percent drop from the $7.9 billion that occurred in

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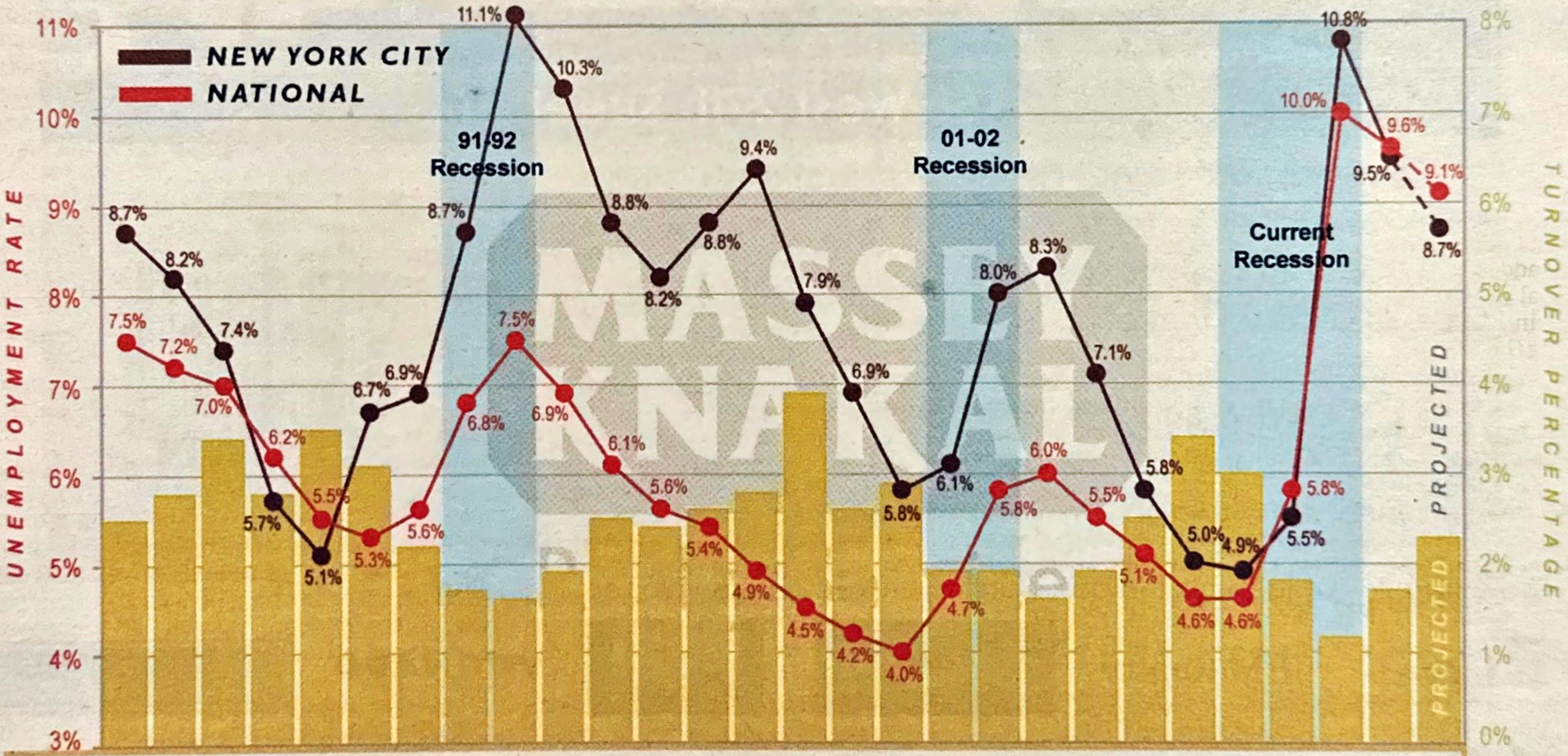
the second quarter. While this may seem like a negative trend, similar to the dynamics we have seen in the citywide data, it is important to be mindful that the $5.75 billion quarterly total is the highest total going all the way back to the third quarter of 2008, with the exception of the second quarter of 2011. The long-term trend is positive. In fact, the $15.7 billion of sales that has occurred so far this year is already well above the $11.6 billion that occurred in all of last year.

Explaining the reduction in the dollar volume of sales in the third quarter versus the second is straightforward, as there are two main factors we see for this pullback. The first is that the market is severely supply constrained. Discretionary sellers are returning to market, though cautiously, and the pace of distressed sales has slowed. Our extraordinarily low-interest-rate environment is creating hundreds of "zombie properties," which, while having significant negative equity, still have positive cash flow. The flow of these distressed assets coming to market is more measured, as mortgage matu-

Manhattan Investment Property Turnover Ratio



TURNOVER RATE	2.5%	2.8%	3.4%	2.8%	3.5%	3.1%	2.2%	1.7%	1.6%	1.9%	2.5%	2.4%	2.6%	2.8%	3.9%	2.6%	2.9%	1.9%	1.9%	1.6%	1.9%	2.5%	3.4%	3.0%	1.8%	1.2%	1.7%	2.3%
YEAR	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11

Source: Massey Knakal Realty Services

Number of Properties Sold - Manhattan

Manhattan	2005	2006	2007	2008	2009	2010	2011
Q1	175	255	270	210	42	125	140
Q2	224	213	327	165	85	127	143
Q3	276	175	232	153	84	113	190
Q4	185	173	170	108	94	123	
Total	**860**	**816**	**999**	**636**	**305**	**488**	**473**
***Annualized**							**631***

source: Massey Knakal Realty Services

Dollar Volume of Sales (in Billions) - Manhattan

Manhattan	2005	2006	2007	2008	2009	2010	2011
Q1	$2.83	$6.25	$17.22	$4.21	$1.47	$2.22	$3.09
Q2	$7.77	$8.13	$13.58	$6.86	$0.47	$2.75	$7.94
Q3	$5.56	$6.13	$9.14	$6.93	$1.20	$2.17	$5.73
Q4	$8.31	$14.30	$12.53	$1.79	$1.00	$4.46	
Total	**$24.47**	**$34.80**	**$52.47**	**$19.79**	**$4.14**	**$11.60**	**$16.76**
***Annualized**							**$22.35***

source: Massey Knakal Realty Services

rity is the most impactful variable determining the timing of lenders and borrowers facing these walking-dead assets.

While the dollar volume of sales is telling, the number of properties sold is more indicative of the true activity level in the marketplace, given the ability for very large transactions—particularly in Manhattan—to skew the dollar volume. For instance, last year the $1.8 billion acquisition by Google of 111 Eighth Avenue provided about 12.6 percent of the total dollar volume of sales for the year.

In the third quarter, there were 190 properties sold in the Manhattan submarket, the highest quarterly total going back to 1Q08. This figure, when added to 1H11 totals, reflects a total of 473 properties sold thus far in 1-3Q11. This figure is approaching the 488 properties that sold in the Manhattan submarket in all of 2010.

All projections point to 631 sales this year in all five boroughs, which would be approximately where we were in 2008, when 636 properties traded hands. Expect that 2011 results will be about 29 percent above 2010 totals and more than double the 2009 total of 305 properties sold.

While the number of properties that have sold in Manhattan has doubled since the submarket's low point, if our present pace continues, we will still be about 37 percent below the 999 properties that sold in 2007 at the market peak.

Another indicator worth examining is the turnover ratio, which is the total number of properties sold out of the total stock of properties in the marketplace. In the Manhattan submarket there are 27,649 properties and, with an expectation of 631 properties trading this year, year-end activity should produce a turnover ratio of 2.28 percent.

With the exception of 2009, the lowest turnover ratio we had ever seen occurred in 1992, and again in 2003, at 1.6 percent. Both years marked the end of recessionary periods and were also years in which cyclical unemployment hit a peak. In 2009, market conditions were so bad that the turnover ratio hit 1.17 percent, an all-time low, even below the 1975-'76 totals, when New York City was on the brink of bankruptcy.

The market has made significant strides in terms of a recovery. However, even if the year finishes at a projected 2.28 percent turnover, the market will still not reach the 2.6 percent long-term average that the market has experienced.

With regard to the average transaction size thus far in 2011, the average property sold in the Manhattan submarket has clocked in at $35.44 million. This is up significantly from the 2009 average of $12 million, but well below the $52 million average tallied in 2007.

Perhaps the most interesting aspect of the Manhattan submarket—and what differentiates it from the outer boroughs and northern Manhattan—is its tremendous appeal to foreign investors. While there is some demand outside Manhattan from foreign buyers, this demand is very limited. In Manhattan, foreign capital has flooded the market in significant amounts from high-net-worth individuals, small companies and large institutional investors across the globe. The relative political stability and relative economic stability the U.S. provides is a welcome change to present conditions in many foreign countries.

This foreign demand, coupled with extraordinarily high domestic demand for New York City assets, has exerted upward pressure on property values. The extraordinarily low interest-rate environment has also added to the upward trajectory of property values.

We believe that, years from now, looking back at market average prices per square foot, it will be clear that 2010 was the bottom of the market in the Manhattan submarket, and 2011 was the bottom for northern Manhattan and the outer boroughs. In 2011, average prices in Manhattan have increased nearly 6 percent from 2010 levels.

Each property segment has reacted differently based on differences in underlying fundamentals within each of those property types. Elevator apartment buildings have been the best performers thus far, mainly due to the fact that condo conversion underwriting has returned to the marketplace, exerting significant upward pressure on property values. Office buildings and retail properties have also seen double-digit increases in average price per square foot and hotel properties have also been doing extraordinarily well.

We will get into much more detail with regard to value trends in our year-end synopsis in January.

Meanwhile, we will complete our 3Q11 analysis next week as we dig into the performance of northern Manhattan and the outer boroughs.

THE TAKE AWAY:

1. In the third quarter there was $5.7 billion worth of investment sales transactions in Manhattan. When annualized, the Manhattan submarket is on track to record about $22.3 billion in sales activity, remarkably close to the 2005 total of $24.5 billion.

2. On the present course, 2011 investment sales should rise a whopping 93 percent from the $11.6 billion that occurred in 2010. The projected total of $22.3 billion should also mark an increase by more than five times the $4.1 billion of investment sales deals that occurred in 2009. To put it in perspective, in 2007 there was $52.5 billion in sales throughout Manhattan.

3. The $5.7 billion in sales this quarter represents a 27 percent drop from the $7.9 billion in the second quarter. While that may sound like a negative trend, keep in mind that, with the exception of last quarter, it's the highest quarterly total since the third quarter of 2008

4. In the third quarter, 190 properties changed hands in the Manhattan submarket, the highest quarterly total since the first quarter of 2008. In total this year, 473 properties have changed hands, a figure that approaches the 488 sales in all of 2010.

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