

A Glimmer of Light

For almost two years now, the dollar volume in the investment sales market in New York City has been declining—and declining significantly. And for almost three years, the number of properties sold has also been trending downward. Simultaneously, property values, on average, have continued to increase, albeit at a decreasing rate of increase. These dynamics continued on their expected pace through the third quarter of 2017 (3Q17).

In the third quarter of this year, there was \$7.94 billion of investment sales activity, putting the market on pace for an annual total of \$32.7 billion. This would be a 44 percent drop from last year's \$57.9 billion and 59 percent below 2015's \$80.4 billion. The number of properties sold in 3Q17 was 869, putting this metric on pace for 3,701 sales for the year. This total would be 15 percent below last year's 4,377 sales and 33 percent below the cyclical peak of 5,534 in 2014. This quarterly total is the lowest we have seen in 17 quarters.

Property values citywide have achieved a new all-time record thus far in 2017 with an average of \$559 per square foot. However, the 3Q17 average was \$514, down from \$567 and

\$598 in 1Q and 2Q, respectively.

As has been the case for many quarters running, Manhattan has been more adversely impacted than the outer boroughs. Through the first three quarters of the year, dollar volume in Manhattan has been on pace to be 70 percent below its cyclical peak in 2015 while



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the pace in the outer boroughs is 26 percent below its cyclical peak achieved last year. With regard to number of properties sold, Manhattan is slated to be 45 percent below its cyclical peak while the drop in the outer boroughs is 32 percent. Meanwhile, values in Manhattan are expected to be up 1.3 percent this year as opposed to a 7.4 percent appreciation pace in

the outer boroughs.

We are now 25 months into a sales market correction that began in the beginning of the fourth quarter of 2015. Since then, both the dollar volume of sales and the number of properties sold have steadily decreased and the rate of value appreciation has tapered off, indicating that values may be reaching a plateau. These are conditions that are consistent with historical market corrections. As downward pressure is exerted on underlying fundamentals, such as market rents, values begin

to fall, which leads to lower offers coming in on properties that are on the market for sale. In these cases, sellers simply do not capitulate. Sellers who get their price sell which provides the appearance that values are still rising. Over time, however, the negative pressure on values takes hold and the statistics on closed transactions will show that values have indeed dropped.

It is clear that 2014 and 2015 were the cyclical peak in terms of number of properties sold and the dollar volume of sales, respectively. Since then, residential rent and retail rents have fallen and face office rents are starting to exhibit downward pressure after many months of swelling concession packages. Land, hotel and retail property values have dropped while office and multifamily properties have maintained their values with rising average prices per square foot, notwithstanding slight increases in cap rates.

But the news for the future of the investment sales market in New York City is positive. For the first time in two years, there is more positive momentum in the land market than we have seen, as both experienced developers, as well as new entrants to the market, have been aggressively pursuing opportunities. Land values were down 19 percent in the first half of this year, but we

expect these values to rise in the first half of 2018 as current contract activity leads to closings after the new year. Residential property owners are reporting for the first time in quite a while that they are seeing upticks in free market rents. Both of these metrics are important as they are lead indicators for the market. Land normally drops first and rises first as the market moves and the residential market normally moves before the commercial markets. Capital is continuing to flow into the market and supply remains very low. This combination of factors should result in much more positive market dynamics as we head into next year.

There are a host of macro issues that could impact the sales market moving forward. They include tax reform, job creation, interest rates, North Korea, etc. However, provided that externalities do not impact the market significantly, we could be pulled out of this correction fairly soon. If we are indeed coming out of the correction, it will mirror the correction seen in the wake of the recession in the early 2000s where volumes dropped significantly over many years, but average values were never lower.

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