

Brooklyn Returns to Earth, but Still Has Room to Grow

The investment sales market in Brooklyn has been gaining momentum over the past decade. For a long time (think the opening credits of *Welcome Back, Kotter*), Brooklyn was America's fourth-largest city. The growing allure of different neighborhoods has caused the local population to surge, making Brooklyn what would be the third largest city in the U.S. today. Notwithstanding this growth and the chic nature of many neighborhoods, the borough is not impervious to shifts in the broader market. Today, we will take a look at the recent performance of the investment sales market in Kings County.

For context, let's review the performance of the broader investment sales market first. In the first quarter of 2017 (1Q17), there were \$7.1 billion of investment sales transactions in the city. If annualized, the \$28.2 billion pace would result in a total of 51 percent below the \$57.9 billion in 2016 and 63 percent below the all-time record of \$77.1 billion in 2015.

Citywide, the number of properties sold in 1Q17 was 846, on pace for 3,384 for the year. This total would be 23 percent below last year and 39 percent below 2014's all-time record of 5,534. It is interesting to note that 2017 is on track to be the third consecutive year during which the number of properties sold in the city fell.

Simultaneously, property values hit new record heights with a 1Q17 citywide average price of \$570 per square foot. This figure is 7 percent above the 2016 average of \$533. Capitalization rates remained relatively flat at 4.57 percent, up 9 basis points from last year. This upward trend in cap rates is more pronounced when we look at specific property types.

Investment sales activity in Brooklyn in 1Q17 closely mirrored activity in the broader market. The dollar volume of sales was just \$1.3 billion, on pace for \$5.2 billion for the year, which would be 37 percent below

2016's \$8.2 billion (the record year was 2015 with \$8.4 billion). The number of properties sold was 332, set to reach 1,328 if annualized. This total would be 22 percent below 2016 and 39 percent below the cyclical peak of 2,173 in 2014.

Values in 1Q17 hit another new all-time record for Brooklyn at \$433 per square foot. While a new record, this average is up only 2 percent from last year's average. Upward pressure on cap rates was more significant than observed in the broader market. Cap rates averaged 5.18 percent in 1Q17, up 43 basis points from

2016. This was a trend seen across the outer boroughs. On a quarter-over-quarter basis, values in Manhattan, which always transition before values elsewhere in the city, dropped in all four quarters last year, leading to forecasts of headwinds for the outer boroughs. Thus far, values have been stubborn and have not moved into negative



territory outside Manhattan.

One thing we know for sure is that the commercial real estate market in Brooklyn has undergone a "Manhattanization" where demand has greatly exceeded supply and new construction is evident in every neighborhood. To me, Brooklyn today, with many neighborhoods thriving beyond anyone's imagination and some still facing some challenges, reminds me of Manhattan in the 1980s. As hard as it is to imagine, there were neighborhoods in Manhattan south of 96th Street that were dangerous back in the 1980s but became thriving destinations during the Giuliani and Bloomberg administrations. The same thing is very likely to happen to Brooklyn.

One thing is for sure, if Brooklyn continues on its current trajectory, in 10 or 20 years, it will be an even more compelling place to live, work and shop than it already is today!

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