

Fundamentals Should Get a Boost From the Economy

If you are a regular reader of Concrete Thoughts, you know that my perspective is that the New York City investment sales market peaked in 2014 and 2015 in terms of sales volume while property values hit their peak in 2016.

Since an all-time record of 5,534 property sales in New York City in 2014, we have seen a steady decline in this metric over the past four years. Another all-time record in dollar volume was achieved in 2015 at \$80.1 billion in sales. Similarly, this metric has been sliding for the past three years. Property values tangibly began to decline in 2017, first in Manhattan and then throughout the outer boroughs.

So, in terms of market cycles, I believe that the bull market in New York's commercial real estate sales sector ended at the beginning of fourth-quarter 2015. Since then, we have been in a correcting market, however, based on the tangible traction that the U.S. economy is experiencing, we believe that positive pressures will be exerted on the underlying commercial real estate fundamentals which could bring us out of this correcting

cycle sooner than later.

The broader economy is doing extraordinarily well from any perspective. In August, the economy grew by 201,000 jobs, wages have increased the most since 2009 and new unemployment filings have hit a 49-year low.

The job growth in August (the 95th consecutive month of positive movement) is a continuation of the longest economic expansion ever in U.S. history.

Most market observers point to the tax cuts and significantly reduced regulations as the stimulus for this continued and unprecedented economic expansion. Those two factors are profoundly important. The tax cuts

have effectively doubled the profits of small businesses and large corporations across the nation. The reduction in burdensome regulations has also fueled optimism within the business community. This optimism has also impacted main street as consumer confidence and consumer spending have also been trending positively for quite a while now.

Tax cuts and reductions in regulations are

frequently addressed in the media by market watchers. What is not discussed nearly as much is that while after-tax profits have been boosted by tax cuts, total profits have increased significantly due to what economists are referring to as "synchronized growth" within U.S. businesses. This growth has led to extraordinarily strong top line revenue increases of about 10 percent on a year-over-year basis. Because of this, for over a year now the overwhelming majority of U.S. companies have consistently beaten earnings estimates, which is aiding the rally that we have seen in U.S. equities markets.

It appears that this economic rally will continue for the foreseeable future. Concerns that pessimists discuss include Fed tightening, inflation and the potential results of the mid-term elections. There is also some fear that a trade war could stop the economic growth in its tracks. However, from what the market has demonstrated thus far, it appears that a trade war will have more of a microeconomic impact as opposed to a macroeconomic one.

The strength of the broader U.S. economy should have a positive impact on the underlying fundamentals of commercial real estate.

The more profitable that companies are, the more employees they can hire, the more computers they can purchase, the more investments they can make and, importantly for commercial real estate, the more space they can absorb. This dynamic has already been substantiated by the fact that within the past year business spending on capital goods has increased by about 10 percent in the U.S. meaning that businesses are making more investments than they have in the past.

To the extent these trends continue, positive absorption in the office and retail sectors should be experienced. With wages rising, household creation should increase and with increased household formation, the absorption of for-sale housing and rental housing should continue, providing a needed boost to the residential sector.

We hope that these positive signals from the economy will help to pull us out of what has been nearly a three-year market correction for investment sales in New York. If things continue the way they are, there is no doubt of that.

Robert Knakal is the chairman of New York investment sales at JLL.

