Glad 2017 Is Behind Us. 2018 Will Hopefully Be Better.

In 2017, the New York City investment sales market continued its downward trend, both in terms of the volume of sales and property values. The correction in this market segment is now in its 28th month, and the biggest questions moving forward is whether the recent tax reform package, implemented by Washington, will be enough to pull this market out of its downward spiral.

"Downward spiral" may be a bit harsh, but there is no doubt that for the past two to three years the market has been falling from its 2014/2015 cyclical peak in volume and value.

As is normally the case when a correction in the investment sales market occurs, volume is the first metric to fall, and that trend has held in this correction.

In 2017, there were 3,604 properties sold citywide, an 18 percent drop from 2016, 31 percent below 2015 and 35 percent below the peak in 2014. The 806 properties sold in the fourth quarter of 2017 represented the lowest quarterly total for the entire city since the first quarter of 2013 (20 quarters).

If we look at Manhattan, we see the number of properties sold is even more adversely impacted by the current correction. In 2017, there were 602 properties sold, which was 45 percent below the 1,092 sales in 2015 and 50 percent below 2012's peak of 1,200 sales.

Robert Knakal.

If those numbers weren't depressing enough, the dollar-volume metric was off even more.

In 2017, the dollar volume of sales was $34.9 billion, 40 percent below 2016's $57.8 billion and 57 percent below 2015's record of $80.4 billion. (One of the few positive notes was that in fourth quarter of 2017, there was $10.5 billion in sales, the year's best quarterly total.) In Manhattan, 2017 saw $21.6 billion of sales activity which was 45 percent below 2016's total and 66 percent below the all-time record achieved in 2015 of $63.2 billion.

For the year, 2017 saw an increase in property value citywide by 2 percent, increasing from a 2016 average of $532 per square foot to a 2017 average of $544 per square foot. Digging into these numbers a little further does not bode well for the direction of future values: In 3Q17, property values in Manhattan turned negative across all property types for the first time in this cycle, and this trend continued through the fourth quarter. For the year, Manhattan values dropped by an average of 4 percent from $1,449 per square foot in 2016, to $1,386 per square foot in 2017.

Reductions in Manhattan property values in 2017 were relatively modest with mostly single-digit drops. The exceptions were in the land market and the retail property markets. Land values per buildable square foot dropped by 18 percent from 2016's average of $681 per square foot, down to $558 last year. Retail property values dropped by 11 percent to an average of $3,092 per square foot. Office buildings saw values drop by 9 percent while mixed-use asset's values fell by 8 percent. Multifamily properties held up the best with value reductions of just 3 percent in the walk-up sector and 2 percent for elevator properties.

For the seven major property types in each of the four geographic submarkets outside of Manhattan, values dropped in just seven of these 28 sectors. On a net basis, the outer boroughs showed increases in value of 7 percent last year, increasing from an average of $379 per square foot in 2016, to an average of $406 per square foot in 2017. However, given that values were in red territory in all product segments in Manhattan, and just 25 percent of outer-borough product segments were negative, we would typically expect that this negative pressure would continue to be exerted on values in the outer boroughs in 2018.

Historically, volume drops for four or five years in a row after the beginning of a correction. Given that we are two to three years into volume reductions in this downturn, we would typically expect to see sales volumes drop for another couple of years. Additionally, the 3,604 properties that sold last year represented 2.2 percent of the total market, just 0.1 percent below the long-term average of 2.3 percent turnover. As this turnover average has been consistent over the past 34 years, it would not be surprising to see volumes drop even further in order to maintain this long-term average.

In the absence of tax reform, we would fully expect volume to drop for another year or two, at least, and value to fall modestly in Manhattan and also in the outer boroughs throughout 2018 and perhaps into 2019.

However, tax reform makes owning real estate more profitable for pass-through entities and that profitability could be passed along to sellers in the form of higher prices for their assets. Plus, the additional profits that corporations will make should be very accretive to the underlying fundamentals of real estate as these companies could be taking more space and making more investments based on their effective doubling of profits under the new tax code. This could buoy values when downward pressure might otherwise push them down further. Additionally, any upward pressure on values would lead to higher volumes as potential sellers decide to take advantage. Time will tell but there is reason to be cautiously optimistic. This would not be the case in the absence of tax reform.

Robert Knakal is the chairman of New York investment sales for Cushman & Wakefield.