

Next for Investment Sales: Up, Down or Sideways?

The cyclical peak in the New York City investment sales market is now clearly in the rear-view mirror. Volumes peaked in 2014 and 2015, and values peaked earlier this year. Volumes have been dropping for years, and now, property values are moderating on a market wide basis and are down in all major property types in Manhattan. Simultaneously, for the past two months, contract execution activity is up sharply, and it is becoming fun to be a sales broker again. But where does the market go from here?

I believe that we are about 26 months into an investment sales market correction. There was no event to catalyze this correction. No stock market crash, no savings and loan crisis, no housing market imploding, nothing—just the natural cyclicity of the market.

As a backdrop, since 5,534 properties traded hands in 2014, the number of properties sold has dipped for three years running. We are presently on pace to end the year about 33 percent below 2014's peak. The drop in Manhattan is even sharper as we are currently on pace for a total that is 45 percent below the cyclical peak.

Also, prices have come down dramatically: There was an all-time record of \$80.4 billion

of sales in 2015, dwarfing the prior record of \$62.2 billion achieved in 2007. This year, we are slated to reach \$32.7 billion, 59 percent below the 2015 peak. In Manhattan, the present pace should get us to \$19.2 billion, 70 percent below 2015's \$63.2 billion record.



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While land was (and almost always is) the first sector to drop, we are now seeing values dropping in Manhattan in all of the major product types. These include elevator and walk-up apartment buildings, mixed-use properties and retail and office buildings. Fortunately, the percentage drops have all been in the single digits. In the outer boroughs, values are also beginning to adjust with some property types seeing reductions

while others are still appreciating, albeit at a slowing rate of increase.

So here are the possible outcomes we may be heading toward from here, and the probability associated with each:

A rising market: Based on contract execution activity, we expect to see volume metrics pick up in early 2018 when the contracts that have been executed over the past two months begin to close. Unfortunately, most of this contract activity will not close soon enough to impact 2017 statistics, which we expect to continue to slide through the end

of the year. However, if sellers continue to adjust to market realities, they'll continue to come to the market, and volumes will rise. We are beginning to hear that residential rents are stabilizing and concession packages are being reduced. If rents in the major property types solidify and begin to rise, values will begin to tick up again. Interest rates remaining low would bolster the argument for an upswing in the market. (Probability 20 percent.)

A falling market: The trends we are seeing are simply early-stage correction dynamics. Manhattan is suffering more than the rest of the city, but changes up or down generally happen in Manhattan first. It would appear that values would continue to experience downward pressure until they drop on a broad basis in the outer boroughs. With regard to the number of properties sold, while market activity is down significantly below peak levels, absolute levels market wide are only at the long-term average of 2.2 percent of the total stock. Given we are at the average, there is plenty of room for the number of sales to slow even further. In Manhattan, the turnover ratio is also 2.2 percent, below the 2.6 percent long-term average. While below the average here, in past cyclical low points, turnover has fallen as low as 1.2 percent to 1.6 percent. Clearly, there is room for this metric to as well. Simultaneously, the Fed has

projected three rate increases for next year, which would exert downward pressure on value unless we have tangible growth in GDP. (Probability 30 percent.)

A relatively stable market: Because there was not a catalytic event that brought about this correction, it should be relatively mild. Corrections in the past have varied in terms of how they impacted the market. During the S&L crisis in the early 1990s, the volume of sales dropped for four years before gaining traction. At the same time, property values fell by 53 percent. During the recession in the early 2000s, volume also dropped for four years before turning. However, during that recession, there was not one year in which average sales values decreased. During the recent Great Recession, volume dropped for three years, and values fell by 38 percent on average. Today, we are in the third year of declining sales volume, and while values in Manhattan are down, market-wide values are still increasing, albeit at a very low rate. This correction could mirror the one in the early 2000s when volume dipped but average values never did. Capital is continuing to flow into the market, and with availability growing, this activity should buoy downward pressures. (Probability 50 percent.)

Clearly, time will tell, and tax reform could upend everything. We will continue to watch the market and keep you posted.