Supply and Demand in Today's Investment Sales Market

As the end of the second quarter of 2017 rapidly approaches, many participants in the market are complaining about and feeling the effects of a significant slowdown in the volume of sales. This week we will take a look at current supply-demand dynamics within the New York City investment sales market.

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New York City sales volumes hit all-time highs in 2014 and 2015. In 2014, there were 5,534 properties sold citywide, a record by more than 10 percent. That was followed up in 2015 by $77.1 billion in sales. These were, undoubtedly, the two best back-to-back years I have seen in the over three decades of brokering here.

Because neither of those metrics has ever experienced consecutive record years, we fully anticipated reductions in both of these statistics heading into 2016. The forecast was further substantiated by the softness in land and hotel values, which first appeared as we entered the fourth quarter of 2015.

In 2016, the volume of sales dropped 25 percent from 2015 and annualizing first-quarter 2017 volume, the market is on pace for a 51 percent drop from last year. Most of the comments I have heard and read put the responsibility for this on the fact that buyers are cautious today.

Buyer perspective impacts demand, but demand is not mainly responsible for activity. Supply is much more highly correlated to sales volume. Since 1984, demand has greatly exceeded supply in every year with the exception of 1992 when the Resolution Trust Corporation was dumping properties from failed banks at a breakneck pace.

The fact is that it is the extraordinarily low supply of product that is impacting this tangible pullback in sales. Discretionary sellers, who normally make up two-thirds to three-quarters of the market, have been reluctant to sell given the downward pressure being exerted on property values. This trend has occurred due to underlying fundamentals, particularly rents in the three major food groups: residential, retail and office.

Along with this limited supply is a bid-ask spread that has had more inertia than is justified within the current market. This spread is a key reason why a much lower than usual percent of the available supply is actually selling today. However, sellers are starting to become acclimated to the new realities of the market that is narrowing the spread. Additionally, we have been in this correcting market for over 20 months, and it usually takes at least 18 months before new realities are generally accepted. There is no doubt that there is pent up seller demand in the market, and we anticipate a healthy increase in supply in the second half of 2017. The number of valuations we are doing for potential sellers is now triple to quadruple the rate we have observed over the past year or so. This metric is highly predictive of supply flow.

At the same time, demand drivers remain excellent. Indeed, some buyers have adopted a wait-and-see attitude, but this is not widespread enough to impact volume. Institutional capital is flowing, high-net-worth buyers are active, and family offices are aggressively looking to deploy capital. Foreign capital continues to be attracted to our relative political and economic stability, notwithstanding some of the reports that have surfaced recently.

Additionally, a recent trend is that we are seeing savvy user buyers looking at today's market as an opportune time to purchase assets for their own occupancy. For example, recently, at 204 Fifth Avenue, two of these user buyers engaged in a bidding war driving the selling price up 15 percent above the ask. There are users aggressively bidding on several other of our offerings, and this is having an impact on execution.

It very well could be our correction was mild, and we are emerging from that slowdown only to gain traction and grow again. Supply will increase in the near term and strong demand exists to meet this increased supply. A favorable outlook moving forward could very well be in the cards.

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