Supply and Demand in the Current Sales Market

At the beginning of 2016, our forecast for the investment sales market in New York City was rather bearish. Coming off two years with all-time records, we felt that both sales volumes and values had to correct given how values had gotten so far ahead of fundamentals. We projected that the dollar volume of sales this year would fall by 10 percent to 20 percent, and the number of properties sold could be down as much as 30 percent to 40 percent from last year's totals. In addition, we believed that property values would also decline this year relative to last year's all-time record levels.

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We are currently a bit more than halfway through the first quarter of the year, and it appears our forecast is on track.

The supply of available properties for sale appears to be lower this year than last year. This is likely in response to downward pressure that has been exerted on property values based upon market conditions. Thus far, different property types are performing in different ways. Land values are off by double-digit percentages with the magnitude of these reductions varying based on location, mostly because of the perceived softness of the residential condominium market. The hotel sector is facing headwinds as capitalization rates are up and many of the properties that have been put on the market have not sold. These conditions are not surprising as the land and hotel markets are the two market sectors that react earliest to changes in market conditions.

Office buildings and multifamily properties are still hanging in very well with excessive demand continuing to keep values at elevated levels. Retail properties are somewhere in the middle. They are still trading at expected price levels, but there are fewer buyers who are competing at the aggressive end of the pricing spectrum.

Given the cracks that are appearing on the property value side of the equation, sellers are not putting as many properties on the market as we saw last year. This reduction in supply has a profound impact on the sales market. In the supply/demand relationship, supply has always been the dominant factor in terms of how the New York City market performs. This is because the demand almost always exceeds supply given the attractiveness of New York as a destination for both foreign and domestic capital (the notable recent exception was 1992 when supply ballooned as the Resolution Trust Corporation—RTC—was dumping thousands of properties from failed banks). Therefore, as values rise, supply rises as discretionary sellers take advantage of increased values. The greater the supply, the more properties sell. With values falling, these potential sellers decide not to act (provided they don't have to), deciding to wait until values rise again to sell.

Demand for real estate assets here is still extraordinarily strong but not quite as robust as we have seen over the past several years. The big motivating factors in markets are fear and greed. It appears that fear is starting to become more prominent among market participants and has forced some buyers temporarily to the sidelines. There is still very significant widespread demand from local investors, investors from across the United States as well as tremendous demand from international buyers. Notwithstanding economic challenges seen across most of the world (as evidenced by the negative interest rate policy being adopted by many countries), we still have tremendous demand from foreign buyers.

So with downward pressure on values, supply is edging downward. Coupled with less robust demand, it would appear that our forecast could hold. Clearly, it is far too early to judge how the entire year will play out, but to say that 2016 will be a transitional (and interesting) year, from an investment sales perspective, is an understatement.

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