

What the 'User Premium' Means for New York City Building Sales

Across the United States, occupied commercial real estate assets have more value than vacant buildings. When buildings are vacant, they are almost never placed on the market for sale, unless there is some level of distress associated with them. When the vacant building is leased, it might be placed on the market for sale as the value has gone up considerably when it is full of tenants.

In New York City, and especially in Manhattan, this dynamic does not apply and is, in fact, reversed. Here, vacant properties are worth more than leased properties, and this is particularly true for properties less than 100,000 square feet.

Why is it that vacant buildings are worth more than occupied buildings in Manhattan? The answer is simple: vacant buildings in Manhattan are almost always purchased by a "user," which is a buyer that is going to occupy all or a portion of the building for their own use. And the difference between what they pay and what an investor is willing to pay for the property is the "user premium."

Many participants in the market credit my previous partner and best friend, Paul Massey, and myself with coining the phrase "user premium." This is, because, at the beginning of

our careers in 1984, most of the properties we sold were small, vacant commercial buildings for which we found user buyers who paid significant premiums above what investors were willing to pay.

In fact, our first two transactions were user deals. Our first sale in 1985 was of 1421 Third

Avenue, a vacant, 14,400-square-foot furniture showroom building that we sold to American Medical International for the first MRI facility in New York City. AMI paid \$3.18 million, or \$220 per square foot. The offers from investors at that time were maxing out at \$2.6 million, or about \$180 per square foot. The user paid a 22 percent premium above what investors were willing to pay.

Our second deal was the sale of 36 East 61st Street, a 12,000-square-foot, vacant, five-story commercial townhouse that was part of the development site purchased by Leonard Stern for the construction of 667 Madison Avenue. Mr. Stern wanted to spin the property off and we were retained to market the property. We sold that building to the Ebel watch company for \$3.625 million, which was \$302 per square foot. The investor offers there topped out at \$2.85 million, which was \$237 per square foot. This sale reflected a 27 percent user premium.



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After these two transactions, the "user premium" was born. We started to impute a user premium in our broker opinion of values, which was a percentage above what the investment value was, in order to determine what a user would likely be willing to pay for a vacant building in Manhattan.

Not long ago, I mentioned in these pages that one of the things the pandemic afforded me the opportunity to do was to walk and/or drive every block in Manhattan to look at all of the properties that were under construction, and also to log every potential development site in Manhattan.

I have since broken that data down into how many office buildings are under construction and how many square feet they contain, how many hotels are being constructed and how many hotel rooms, how many rental apartments and how many condos. This information has been invaluable in terms of determining what future supply looks like, and how this is going to impact land values and asset values moving forward.

In the same way, the pandemic afforded me the opportunity to take a deep dive into one of the most misunderstood market sectors in the market today: user building sales. I have reviewed the comparable sales books going back to 1984 and have studied the 969 user property sales that have closed during the past

36 years. These user properties have fallen into different buckets: retail properties, including retail condos and co-ops; residential properties; and commercial/office properties.

All of the user sales were placed into one of those three buckets, and then the average price per square foot of the user sales in the bucket were compared to the average prices per square foot of the non-user sales within those buckets. This is how the user premiums for each year were derived. While the user premium has varied year to year, the average user premium paid over the past 36 years has been 16 percent.

Additionally, we analyzed the buyer pool for these user sales. We looked at corporations, educational groups, retailers, nonprofits, religious organizations, health care-related groups, foreign governments, cultural organizations, family offices, private clubs and unions. Clearly, each of these groups was more prominent within different buckets within our study.

Considering the opaqueness of the user market in New York City, the value of these insights is tremendous and will allow for market participants to more fully understand the user market dynamics.

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