A Message from the Chairman: Robert A. Knakal

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3rd Quarter 2011

(Reprinted from The Commercial Observer)

The investment sales market in New York City continues to trend positively as third quarter 2011 (3Q11) statistics show. This may not seem so apparent when looking at the data in isolation, but drilling down into the numbers reveals a more telling message.

In 3Q11, there was $6.5 billion in investments sales activity citywide which was down from the $8.7 billion which occurred in 2Q11. On face value, it might appear that this slow down in activity is a negative signal for the market. But, when we look at the numbers more carefully, we see that the medium-term trend is positive. Notwithstanding the $2.2 billion reduction in dollar volume in the third quarter, with the exception of 2Q11 results, the $6.5 billion in sales in 3Q11 was the highest quarterly total the market has experienced going all the way back to 3Q08.

We believe that the slow down in the dollar volume of sales is representative of two main factors. The first being that the supply of available larger, institutional quality, properties was reduced in the second quarter of the year leading to less activity in the third quarter and, secondly, the fact that stresses in the CMBS market created difficulty in obtaining financing for larger assets during this period. It is important to note that the dollar volume of sales has more to do with these two factors (supply and debt availability) than anything else as demand is almost always excessive in New York City. In fact, going back to 1984, I believe the only year in which this was not the case was in 1992 during the post S & L crisis recession.

If we annualize the $19.2 billion of transaction activity that occurred in the first three quarters of this year, the market is on pace for approximately $25.6 billion for the year which would result an increase of nearly 80 percent over the $14.2 billion of sales which occurred in 2010. It would also be approximately 4 times the 2009 total of $6.9 billion.

Interestingly, while the dollar volume has quadrupled since 2009, we still remain 60 percent below the $62.2 billion in sales which occurred at the peak of the market in 2007.

Based upon the reduction in the dollar volume of sales from 2Q11 to 3Q11, we would not be surprised if the dollar volume in 4Q11 came in below third quarter totals. Notwithstanding a potential second consecutive quarterly drop in this metric, we are still expecting total dollar volume for the year to be no less than $24 billion. Regardless of 4Q11 totals, 2011 will show a tangible improvement over 2010 in this measurement.

The submarket with the largest increase in dollar volume activity, in 2011 versus 2010, was the Manhattan submarket in which we have already had $16.8 billion of sales, which is on pace to be up 93 percent over the $11.6 billion that occurred in all of 2010. The submarket that has performed the weakest is the Northern Manhattan submarket in which there has only been $263 million in sales volume year-to-date. If we annualized this figure, this submarket is on pace to be 51 percent below the $534 total seen in 2010.

While the dollar volume of sales usually grabs the headlines, it is always the case that we look at the number of buildings sold as being more representative of the real pulse of activity in the marketplace. This is due to the fact that a few very large transactions can skew the dollar volume metric significantly. For instance, the transaction for Stuyvesant Town at $5.4 billion can have a significant impact on market statistics just as Google's $1.8 billion purchase of 111 Eighth Avenue last year represented approximately 12.5 percent of the total $14.5 billion in 2010.

If we look at the number of buildings sold citywide, there were 548 buildings sold in 3Q11, the highest quarterly total going back to 4Q08. Thus far this year, there have been 1,548 properties sold in New York City and we are on pace for an annual total of 2,064. This figure would be 22 percent higher than the 1,690 sales which occurred last year. It would also be 46 percent higher than the 1,410 sales that occurred at the bottom of the market in 2009.

While the number of properties sold was up 46 percent from the trough, if the pace of sales continues, and we achieve the 2,064 sales that we anticipate, this total will still remain 60 percent below the 5,018 sales which occurred at the peak of the market in 2007.

It is interesting to note that even with a 46 percent increase in the number of properties sold and the nearly quadrupling of the

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dollar volume of sales, both of these metrics will fall 60 percent below 2007 peak levels.

The average price of a property sold citywide thus far in 2011 has been $12.3 million, remarkably just slightly below the all time peak of $12.9 million achieved in 2007. This city wide average had fallen to a measly $4.3 million in 2009 at the bottom of the market.

We also like to look at what we call the "turnover ratio", which is the number of properties sold out of the total stock of properties that make up the market. If we look at our annualized potential of 2,064 sales for the year, the citywide market place is running at a turnover rate of about 1.25 percent of the approximately 165,000 properties that we track.

This figure is up significantly from the 0.87 percent turnover achieved in 2009, which was a historical low. The marketplace with the lowest turnover was the Queens submarket with 0.82 percent turnover. The submarket with the highest turnover was Manhattan with 2.3 percent. While the Manhattan submarket has been performing extremely well, and is up significantly from the 1.17 percent turnover achieved in 2009, the 2.3 turnover is still well below the long-term average of 2.6 percent going back to 1984. There are 27,649 properties in the Manhattan submarket (south of 96th Street on the east side and south of 110Th street on the west side) and the 630 projected sales for this year would result in a turnover ratio of approximately 2.28 percent.

Several questions have been asked about recent occurrences in the broader markets and their potential impact on commercial real estate capital markets. These include the S & P downgrade, economic turmoil in Europe, and the debt-ceiling debate. An argument could be made that these events have negatively impacted the dollar volume of sales. But, again, further analysis is necessary.

Interestingly, the S&P downgrade has both hurt and helped the market. It has helped the market because, counterintiutively, the U.S. long-term debt downgrade caused a flight to quality which increased demand for U.S. Treasuries, driving the yield down. This was a very positive result for portfolio lenders, mainly the community banks and small regional banks, who lend at spreads above treasury rates. This has created a positive impact on the financing market from these portfolio lenders. However, the flight to quality, as a result of increased risk aversion, created stresses in the CMBS market. This, therefore, hurt the financing market for larger loans which impacted dollar volume.

Moving forward, there are five factors that we will be watching very carefully to try to determine how the sales market will react. They include employment, supply, demand, inflation and interest rates. Clearly, employment is well below where we would like to see it given the tremendous impact that employment has on real estate fundamentals (see last week's Concrete Thoughts column for an overview of our current jobs picture).

As discussed in this column two weeks ago, supply and demand dynamics dictate that demand far exceeds supply and we do not anticipate that changing anytime soon. Supply has been scaled back slightly as the broader economy is creating uncertainty for many participants.

Inflation appears to be rising as the recent CPI calculation has pegged inflation at about 3.8 percent, well above the Fed's comfort zone. This increase in CPI combined with our unemployment rate yields a metric called the "Misery Index". The misery index today, at 12.9 percent, is the highest it has been since 1982.

Interest rate increases also pose a deep threat to the marketplace. While Fed Chair Bernanke has indicated that rates will stay low through, at least, the middle of 2013, it would not be at all surprising to see rates rise before that. To the extent that interest rates stay too low for too long, it would create a concern for the marketplace as low interest rates for an extended period create asset bubbles. This has some investors contemplating whether the market is overheated currently. Others feet that with inflation right around the corner, hard assets, like commercial real estate, are favorable and their aggressiveness is reflective of this perspective.

All things considered, the market is trending very positively and we expect these conditions to continue in the short-term.