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A bright spot in today's commercial building sales market in Manhattan

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Today's commercial building sales market is a completely different animal than what it was prior to six or seven years ago. We've all been hearing negative press about the subprime/CMBS markets and how drastically it has been affecting financing. But how bad is the current market place for Manhattan income-producing properties? Are there any bright spots in today's market? In actuality the correction in the financing markets has led to many positive trends for those who are in the market today and planning to be in it tomorrow.

There is no doubt that the unprecedented growth from 2002 into 2007 was the greatest real estate market we have experienced. Early in 2002, after the market had come to a screeching halt because the September 11th terrorist attacks, the market catapulted into action. Fueled by a strong stable economy and historically low interest rates that kept getting lower at almost every Fed meeting, the demand for housing skyrocketed. Values of properties took off like never before. Like all hot investments of the day, people who really had no business in the real estate game jumped in for this "sure thing" investment.

They started overpaying for properties, getting close to 90% financing (sometimes on projected incomes), refinancing a year later at even more inflated numbers or selling for a profit. It was too easy and too good to be true and, eventually, the music stopped. When it did, many were left without a seat. When the sub-prime borrowers started doing what they do best-not make payments on time-the lenders began to tighten their belts. So, now the rookie investors who thought they could just buy anything, hold it for a year and flip or refinance got caught in a bit of a pickle. Those who purchased development sites, shells, and condo conversion properties felt the squeeze the most.

However, there are those that did find a seat and are still playing the game. The long-term residential multifamily owner has seemed to have weathered the storm quite well. They have been the beneficiary of a strong rental market in Manhattan that continues to remain extremely stable. This has led them to strong profits as they achieve free market rents higher than they ever thought could have been achieved.

Banks are in the business of lending and in today's market it seems that they have found one asset they still want to lend on-NYC, multifamily, residential, rent regulated product (with a preference on Manhattan and strong neighborhoods). However, the days of 90% financing are gone and banks are back to lending 65% to70% on actual income. This is how business should be done, was done in the past and we are returning back to basic fundamentals. The long-term owner has seen these times before and is used to putting down 30% to 40% equity to get into a deal. In comparison to the previous cycle, today's interest rates are significantly lower and much more attractive to these buyers.

Values have not dropped for this specific product type and have been trading on a relatively flat basis in 2008. There is still demand and there are still sellers. Although all of the negative news has created a shortage of supply as discretionary sellers have not put their properties on the market. The buyer in today's marketplace has a different profile than in our recent past. Today's buyer is the type of organization that has other properties and has benefited from the strong increase in free market rents. They are often family-run businesses that have seen the good times and the bad. They saved up some cash in the piggy bank over the past couple of years, while paying down a large portion of their debt on the properties they own. They are in a perfect buying mode. NYC has plenty of these families and there are definitely enough of them to create a competitive bidding environment.

Sellers in today's market are motivated by many typical reasons including the sharp increase in costs. These cost increases have led them to not being able to achieve the bottom line they would like to with all the same headaches of owning a multifamily property. They have seen their water bills rise 13.5% this year, taxes increase significantly and fuel costs spike. Fuel has been a major concern in 2008. Even though today a barrel of light sweet crude is down about 28% off its July 11th high of $147, it is still about 60% higher than 2006 and 2007 levels. A stabilization in the oil market will help reassure our marketplace.

So a bright spot in today's market is in the multifamily asset class. Because of the rent regulated status and significant upside banks are willing to lend and even compete to lend on these properties. They are lending at still historically low interest rates but at loan to value levels of 65% to70% (1.15 - 1.30 debt service coverage ratio). The buyers are long-time owners who have the capital because of the strength in the rental market and their long-term outlook to justify prices sellers are motivated to sell at. Sellers are motivated by many reasons including the recent uptick in expenses, which are making their bottom lines dwindle.

Looking forward to 2009 really depends on the lending environment. If banks will continue to lend on this asset class I expect a relatively flat and stable market. If the large banks can finish all their write-downs, raise new capital and begin pushing more money to the street for other assets, I expect the market to trend upwards as development options come back into play. Many vulture funds (including Black Rock) are out there now looking to purchase bad debt from the larger financial institutions. Albeit at a significant discount, the influx of any capital and the capability to raise new capital will eventually trickle down and financing restrictions will ease. Interest rates will trend upwards and banks will become profitable again. This ease will lead to the return of financing additional product types.

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