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The Harrison at 205 West 76th Street

LOOKING BACK, LOOKING AHEAD

BY JOSEPH DOBRIAN

Rumor has it that 2008 was a challenging year for New York City's real estate industry, and 2009 isn't likely to be much better. True, no breakthrough transactions or momentous decisions were made last year with regard to the city's infrastructure—and certainly no events occurred that might have led to increased demand for commercial space. But several positive developments did take place—some of which will probably soften the impact of the current downturn.

Probably the best news came in the residential area. Several attractive residential developments went into the ground in 2008, and demand for them is expected to stay high despite current economic woes. In terms of actual building, Steven Spinola, president of the Real Estate Board of New York (REBNY), points to the commencement of more than 30,000 housing units in 2008 as proof of consumers' commitment to New York City—and of the efficacy of incentives such as the Section 421a tax abatement program.

"That program spurred major movement through June of 2008, when it expired," he says. "Because of the recent economic hit, some of those units will come onto the market as rentals rather than condos, but traditional developers will be able to keep their projects going.

"As for the office market, the good news out of 2008 is that we did not overbuild as we did in the early 1990s. Back then, when we had a downturn, office vacancy reached 15%—as much as 30% in Lower Manhattan—and we recovered."

Still, the outlook for office development, sales and leasing is gloomy for 2009, probably for 2010 as well. Although debt will be available for purchases of smaller buildings (albeit at a much lower loan-to-value than in recent years), it will be difficult to put together a multi-party debt structure, which in the current climate would be necessary for a large building to be sold. Moreover, billions of dollars' worth of commercial real estate will come up for refinancing this year and next—and few if any borrowers will find terms comparable to the original financing. Assets where leases are locked in at 2007 or 2008 rates may survive, but some buildings are facing considerable rent rollover at a time when rental rates are likely to plummet. Consequently, quite a few sets of keys may go back to the bank this year. Many observers believe that those assets will end up in the hands of traditional investor/owners—high-equity players who had largely been shut out of the market while debt was abundant and are now ready to make opportunistic buys.

Some asset types will probably still perform well this year. Rent-stabilized residential, with its modest but guaranteed rent increases, will be popular. Tourists are still going to come in, so hotels generally should hold their own. But we're likely to see very little commercial development, save for projects that are already well under way.

In this environment, look for strong performances by leasing brokers who understand a building's financial underpinnings and who can thus ensure a strong concessions package to the tenant while ensuring the owner's continued solvency.

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INDUSTRY LUMINARIES LOOK AHEAD:

What Can We Expect in 2009?

CAPITAL MARKETS

"I've been a contrarian all my life, and I don't believe all the doom and gloom that everyone else sees. We've taken a steep fall, but the rise will be just as steep. The developers who are still standing will be so because they will have maintained the strategies that have always kept them around. Those who didn't have a good strategy going in, who were overleveraged, are the ones in trouble. Some buildings were financed based on 10% compounded rent growth, and this created huge leverage. Those buildings themselves are sound—but the debt on them in many cases is too high for the owners to fight their way out, and banks will have to take some loss." *—Douglas D. Durst, president of The Durst Organization*

"We need to unfreeze the credit markets. To do that, we need a structure that will lend credibility to these loans, so people will buy them. They need backing similar to what the government is providing for auto, student and small business loans. The industry must make the case that there'll be systemic risk to the economy if credit is not made available—then we have to work with the mayor and the governor to ensure we have shovel-ready projects that have a long-term ability to stimulate the economy." *—William C. Rudin, president of Rudin Management Co., Inc.*

"In 2009 about $400 billion in real estate loans—commercial, including multifamily—will come up for refinancing. Most commercial buildings are financed by five- to seven-year mortgages with very little amortization, so at the end of the term you'll have to borrow the same amount again, and who's going to lend it to you? We hope to see a consortium of banks backing these loans, and some backing from the government with Troubled Asset Relief Program money. Also, REBNY will do what it can to persuade the state legislature not to push companies out of the city by raising their taxes—which would be the worst possible long-term decision." *—Steven Spinola, president of REBNY*

INVESTMENT OPPORTUNITIES

"It's unlikely we'll see a lot of acquisition in 2009. There will be some in the third and fourth quarters, but for now there's a lot of sorting-out to be done. The following 30 to 48 months will present many good acquisition opportunities that we could not have taken when the market was too rich, too flush. I see opportunities to place our senior preferred equity and mezzanine debt: not buying loans, but originating them with our own capital, raised from credit investors—and we still syndicate, as my grandfather did in 1934. Pricing will adjust downward, which means opportunity for those who are prepared to commit capital. You'll have to have guts to play in this market, though." *—Anthony E. Malkin, president of Wien & Malkin*

"The credit markets, while still relatively frozen, are thawing slightly around the edges. There's plenty of debt available for assets under $50 million, and new banks are being formed with the purpose of making loans in that space. People are going to find much more allure in hard, transparent, income-producing assets now, in the wake of the scandals involving Bernard Madoff, Fredric Dryer and others. Current uncertainties, coupled with low interest rates, will make real estate look attractive. In the 1970s, real estate was a game for maverick investors; today it's relatively safe." *—Robert A. Knakal, chairman of Massey Knakal Realty Services*

"There's still financing available for commercial income-producing properties priced under $50 million—although at lower loan-to-value, and with more stringent underwriting of current net operating income. Most transactions in that price range are with private investors, who tend to act entrepreneurially, and we still see a fair amount of activity from them, since after all they've been waiting for this very opportunity. Private entrepreneurial investors have always evaluated investment real estate on income/expense analysis, and thus they were less competitive when the market belonged to the more speculative, leveraged investor who was looking for future growth." *—Edward M. Jordan, Northeast regional director of the special assets services group of Marcus & Millichap*

A LOOK AHEAD: 2009

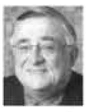
RESIDENTIAL SALES AND DEVELOPMENT

"Price-wise, big apartments are taking the biggest hits. Historically, in the past 20 years, the upper end of the market has been the most insulated, but now, with the financial world the hardest hit, buyers are shying away from larger units. In markets like this you tend to see a flight to the familiar. Buyers feel more secure investing in more established neighborhoods. Therefore we anticipate that as in other downturns, the Upper East and West Sides, the West Village, and the most established areas of TriBeCa will remain strong." *—Frederick W. Peters, president of Warburg Realty Partnership*

"With the expiry of the Section 421a tax abatement, we'll see a huge slowdown of development in general. The end of 421a was good for the market because it slowed development before the crisis became evident, and therefore current developments that have not yet sold out still have a chance to sell. In this slower market, we'll have to show our brokers how to operate, how to negotiate. REBNY has been helping agents with market-centric educational efforts, teaching them how to build long-term relationships and how to price in this market." *—Diane M. Ramirez, president of Halstead Property*

COMMERCIAL LEASING

"Last year we saw many major retail brands coming in at all-time-high rents. Apple, Hugo Boss and others put the Meatpacking District on the map, and revitalized SoHo and Bleecker Street. We won't see that kind of activity in 2009, but we might see an influx of bowling alleys, movie theaters and retailers that had been priced out of Manhattan: national discount chains like Marshall's and Costco, whose sales have remained strong." *—Robin Abrams, executive vice president, The Lansco Corp.*



"Commercial rents will come down as much as 30%. A saving grace is that there hasn't been overbuilding in the core urban areas as there was in the early 1990s, and since relocation costs money, tenants will want to stay put if rents are reasonable. There won't be buildings standing empty, but there will be significant sublet space available. As for commercial mortgages coming up for refinancing, the markets will be sufficient for responsible borrowers. For owners who are overleveraged, the situation will be catastrophic." *—John E. Zuccotti, chairman of Brookfield Properties*

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NEW YORK REAL ESTATE:
Looking For Opportunities

There's no pretending that, going into 2009, New York City's overall real estate picture isn't grim, and most observers expect the situation to worsen considerably before it mends. Still, as in any down cycle, plenty of opportunities await the entrepreneurial developer or investor, as well as users of space who are willing to commit to a large lease or purchase while prices are dropping. With patient money and steel nerves, the contrarian player could do very well in New York City for the next couple of years.

Many observers feel that this isn't the time for speculative development, although of course the market may well have recovered by the time a new project is completed. A few projects already in the works are likely to open in 2009. Jeff T. Blau, president of The Related Companies, reports that The Gateway Center at Bronx Terminal Market is set to open midyear, bringing with it more than one million square feet of big-box retail and restored public access to the Harlem River waterfront. In Manhattan, Related has teamed up with architect Robert A.M. Stern to develop three new residential buildings that will come online in 2009: Superior Ink at 400 West 12th Street; The Harrison at 205 West 76th Street; and The Brompton at 205 East 85th Street.

"I'm not worried about those products, because they're almost all sold," Mr. Blau says, "but for the future I'm being cautious."

Still, Mr. Blau hopes to go ahead this year on the Hudson Yards, a massive linear park and transportation center that's planned for Manhattan's West Side from 28th to 42nd Streets, which will include 12.5 million square feet of new office, retail, residential and hotel properties, plus a school and a cultural center.

"In the meantime," he notes, "we have capital available with which to buy distressed assets, and we'll have lots of opportunities to buy property that we were unable to acquire in the past few years due to unrealistic prices."

A LOOK AHEAD: 2009

Money Talks—But Debt's Hard To Find

Those who can commit their own capital to an investment are likely to find plenty of opportunities to invest here in 2009. Edward M. Jordan, Northeast regional director of the special assets services group of Marcus & Millichap, says that multifamily rental properties—especially rent-stabilized properties—look like a good investment now because more banks are willing to lend into them. Purchases of other product types, though, will be much more equity-driven, he says—and more chancy.

"In office product, rent growth is trending downwards and cap rates are compressing, and vacancy is becoming an issue," he reports. "Office transactions will be driven by the need to resolve problems. The sellers will be the overleveraged investors—or their lenders—who based their transactions on pro forma net operating income that turned out to be unachievable. Buyers will be well-capitalized private investors who've been waiting for this opportunity."

Those who are looking to invest in real estate companies, rather than hard assets, might find some opportunities this year as well, according to Mary Ann Tighe, CEO of the New York Tri-State region for CB Richard Ellis.

"Some of the larger REITS and C corporations operating in the city, such as Vornado, Boston Properties and Forest City, are strong operators that have acquired carefully and whose properties are well managed and well leased," she observes. "Right now is a great time to invest in such companies. We're also going to see certain businesses expanding, taking more space while rents are lower: law firms, for example, because what's distress for one firm is opportunity for another. But most of the leasing demand this year will come from renewal activity."


The Brompton at 205 East 85th Street

Tenants Look For Best Management

Anthony E. Malkin, president of Wien & Malkin, confirms that owners who are in a good financial position, whose assets are well managed, are still in a strong position in this market. In uncertain times, he explains, tenants look for stable buildings whose ownership won't be in question.

"Leasing brokers are showing greater awareness of an asset's underlying capitalization," he explains. "This is a relationship business, and they don't want to take a tenant to a building on which the mortgage can't be sold and the owner might not be able to fulfill his obligations.

"We also see opportunity this year to provide mezzanine debt and preferred equity to good properties that are having trouble recapitalizing."

But Robert A. Knakal, chairman of Massey Knakal Realty Services, suggests that overall, financing is going to be a challenge for many years to come—particularly on larger transactions. Massive de-leveraging has to take place before lenders can part with large amounts again, he says, "and that will take years because of staggered maturity dates on the various loans."

"Even if a loan is performing now," he adds, "when it matures, it'll be hard to replenish if it were given at maximum proceeds in the past two or three years. Property sales over $50 million won't come back to healthy levels of activity until the public is willing to invest in commercial mortgages—and there's a lot to forget before that happens. To do a nine-figure loan now, you have to get several institutions involved, and that's not easy."

Residential, Retail Show Promise

The housing market too will be negatively affected, with continuing downward pressure on home prices as unemployment rises.

"But there'll always be a flow of residential transactions in New York City," says Diane Levine, brokerage manager at Sotheby's International Realty. "Low interest rates will create more activity."

"New Yorkers have a low tolerance for delayed gratification," adds Frederick W. Peters, president of Warburg Realty Partnership. "People have been waiting for the other shoe to drop, but there have been innumerable shoes, and people want to get on with their lives."

Rising unemployment may also negatively impact retail leasing, notes Joanne Podell, executive director of Cushman & Wakefield. But, she adds, retailers as a group saw this downturn coming before much of the rest of the business community did.

"Retailers have been making their operations more efficient," Podell explains, "and people will have to start shopping again at some point. When that happens, the winners will be those retailers who have reviewed their portfolios and closed stores that aren't doing well."

"Retailers are still taking space in larger-than-life locations," says Faith Hope Consolo, chairman of Prudential Douglas Elliman's retail leasing and sales division. "Despite the high cost and the consumer shift, this is still a serious market."

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'KEEP MOVING FORWARD,'

Industry Leaders Tell Private, Public Sectors

In tax revenue and transfer fees, the real estate industry contributes more than $17 billion to New York City's economy annually. What can the public and private sectors do to ensure that real estate stays prosperous enough to maintain this revenue stream? According to most industry insiders, a fast and minimally painful recovery will require strong displays of confidence by debt and equity investors—plus a little help from federal, state and local governments. At the same time, there's concern that if government help becomes too intrusive—and if taxes have to be raised to pay for governmental services—the real estate industry could be crippled for several years.

A LOOK AHEAD: 2009

According to Steven Spinola, president of the Real Estate Board of New York (REBNY), his organization is currently urging Washington to help get banks lending into real estate again, possibly by using Troubled Asset Relief Program (TARP) funds to guarantee commercial loans.

"We also hope to see a second stimulus bill," Mr. Spinola reports, "from which up to $6 billion in federal money might go to New York, and a good portion of that might go to infrastructure improvement. We're also working on solutions that will allow [developer] Larry Silverstein to go ahead with his efforts in Lower Manhattan, and urging the government to put more emphasis on the completion of Moynihan Station, which will open the door to Manhattan's West Side. Vornado Realty Trust and The Related Companies have the ability to keep things moving there, with state support, as the market recovers."

Refinancings Cause Concern

With hundreds of billions of dollars in commercial mortgages coming due in 2009—in an environment where many buildings' tenancies and cash flows are uncertain—vehicles must be created to accommodate CMBS debt, warns Mary Ann Tighe, CEO of the New York Tri-State region for CB Richard Ellis.

"Government intervention would not be a bailout, just a loosening of credit markets," she argues. "The government, instead of simply creating a pool of dollars, should put money into the hands of people who are tasked with getting it directly to the commercial mortgage sector."

Marcus Rayner, principal of CRESA Partners, also insists that government backing is essential to a recovery of the credit markets.

"The investment and lending markets are on their knees, and landlords are suffering massive downturns," he asserts. "Layoffs will result in tremendous amounts of sublease space. We'll recover because the government will underwrite insurance and financial services companies: You're certainly not going to see them underwriting landlords. But the city had better hope that the landlords, who pay the taxes, don't go out of business."

Higher Taxes? Now?

Speaking of taxes, the New York City Council's recent ratification of a 7% hike in real estate taxes has created an outcry from the ownership community.

"Residential owners will just have to absorb this increase," says Alan H. Weiner, managing director of Wachovia's multifamily capital group. "They can't pass it along to tenants in the current market. On commercial leases you can—but that will make being in the city less attractive to tenants, so there'll be more space available."

REBNY TO HONOR SIX AT ANNUAL BANQUET

The Real Estate Board of New York (REBNY), New York City's foremost real estate industry association, will honor six of its members tomorrow at its 113th annual banquet, to be held in the Hilton New York Hotel.

"These industry veterans are not only professionally successful, but contribute significantly to strengthening the communities they serve," says REBNY President Steven Spinola.

Mary Ann Tighe, CEO of the New York Tri-State region for CB Richard Ellis, will receive The Bernard H. Mendik Lifetime Leadership in Real Estate Award. Ms. Tighe, who has held her current position since 2002, represents several of the city's largest real estate owners and users, including the Archdiocese of New York, CIT, Condé Nast, Crain's, Limited Brands, Medco and The New York Times Co. She has been part of the executive committee of REBNY's board of governors since 2001.

Leonard Litwin, president and CEO of Glenwood Management Corp., will receive The Harry B. Helmsley Distinguished New Yorker Award for his contribution to civic welfare. A 50-year veteran of the industry, Mr. Litwin is known as a builder of low-income housing units as well as owner-builder of luxury high-rise developments in Manhattan. He's also the founder of The Litwin Foundation, which supports various medical research projects.

Earle S. Altman, chairman of ABS Partners Real Estate, will receive The Louis Smadbeck Broker Recognition Award for his work as a commercial broker. Mr. Altman co-founded ABS following a 40-plus-year career at Helmsley-Spear, where he headed the sales and leasing divisions. He's perhaps best known as one of the pioneers in the wave of conversions of industrial lofts into residential condos and co-ops, which led to the gentrification of several Manhattan neighborhoods in the last quarter of the 20th century.

James H. Farley, senior vice president at Stahl Real Estate Co., will receive The George M. Brooker Management Executive of the Year Award. A construction and development specialist, Mr. Farley recently has overseen the renovations of 277 Park Avenue and the Lunt-Fontanne Theatre, the residential conversion of the Apple Bank for Savings Building, and the restoration of the Chanin Building following the Con Ed steam blast.

Diane M. Ramirez, president of Halstead Property, will receive The Kenneth R. Gerrety Humanitarian Award, which recognizes meritorious service to the community by a REBNY member. Ms. Ramirez helped Clark Halstead in the founding of Halstead Property in 1984, and was one of the selling brokers who helped engineer the blossoming of Downtown Manhattan and the West Side in the 1980s. She became president of the firm in 1999, and has served on various REBNY committees.

Joseph A. Grotto Jr., senior managing director and principal of Colliers ABR, will receive The Young Real Estate Man of the Year Award. He has been involved in the real estate industry from the age of 16, co-founded J. Grotto & Associates (along with his father, Joseph Grotto Sr.) in 1986 and took his current position when that company merged with Colliers ABR in 2003. He's a former chairman and vice chairman of the Young Men's/Women's Real Estate Association of New York.

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