March 8, 2009

Looking for Bottom in N.Y. Real Estate

By TERI KARUSH ROGERS

WITH sales prices of Manhattan apartments having tumbled by perhaps a quarter in just the past few months, pinpointing the bottom has become a top priority for anyone eager to buy, sell or broker a deal on a home in New York.

Some industry observers foresee market drops of 40 percent, while others think that is too extreme and suggest that price reductions of 25 percent will more be likely the new norm.

There's no question, though, that the boom-or-bust experience has arrived in Manhattan, which had seemed to be avoiding the fate of Las Vegas and Florida.

"It's almost surreal," said Dottie Herman, the president of Prudential Douglas Elliman, referring to the abrupt turnabout after the collapse of Lehman Brothers last fall. Until then, prices had been marching upward, with the median price of an apartment more than tripling in a decade.

To some degree, the rise in prices was logical in New York, where a string of outsized Wall Street bonuses lined the pockets of many buyers. That wasn't the case in other parts of the country, which suffered from speculation and a large number of subprime mortgages.

No one has any hard numbers yet on New York because first-quarter reports, reflecting closing prices of deals struck last fall, will not be available for a few weeks.

Looking ahead, however, some believe it is possible that the average slide from peak values could reach 40 percent by the end of 2010, with variation by neighborhood and market segment. That would put values back to levels last seen around 2002.

Others are more optimistic. "I'm not disagreeing with you that values are coming down," said Pamela Liebman, the president of the Corcoran Group. But, she said, "there's no way the Manhattan market is dropping to those levels that are being talked about. Certain apartments might, but as a whole it will not happen."

Hall F. Willkie, the president of Brown Harris Stevens, said he, too, would be surprised by a decline that large.

"A lot of negative things would have to happen in the general economy," he said. He is seeing sales prices 15 to 25 percent below those of last summer, with renters making up an ever-increasing percentage of buyers. And he saw a positive sign in the fact that, despite all of the bad economic news, sales volume is about half what it was this time last year.

Jonathan J. Miller, the president of Miller Samuel, a Manhattan research and appraisal company, estimates that contract prices have declined by about 25 percent since last summer.

Just how much further prices will dive may depend more on how soon and how generously banks resume lending than on the recovery of Wall Street or the end of the recession.

Ms. Herman said she expected the brunt of the pain to be borne within the next six months. Others expected the downward drift to last for a year to 18 months, until credit markets regain their equilibrium.

When will we know when the market has reached the bottom?

Frederick Peters, the president of Warburg Realty, noted that some deals his firm had brokered lately were nearing the lows being predicted by others. “Even if the New York market were to end up being 35 to 45 percent down,” he said, “to the degree we’re seeing deals done at 30 to 32 percent down anyway, it’s not very far away.”

Mr. Miller says sales activity needs to stabilize first. “You’re approaching bottom when you start to see sales activity stop declining and level off,” he said. “Pricing begins to push up when you have an extended period, like a year, when sales activity doesn’t decline anymore.”

One measure of just how anorectic sales have become is the bloated state of inventory.

“It’s right now the highest since I started tracking in 1999,” Mr. Miller said. Inventory levels in Manhattan have averaged 7,021 a month for the last decade, he said, and there were 10,243 co-ops and condominiums for sale at the end of February — 38 percent more than a year ago.

Many expect that the million-dollar segment will stabilize first because it is powered by first-timers who are drawn by falling prices and don’t have to sell before they buy. The process is being helped along by federal efforts to increase mortgage lending: The latest stimulus package enables Fannie Mae and Freddie Mac to extend loan guarantees to New York City mortgages originated this year for up to $729,750.

Mr. Peters predicted that larger apartments, in the three-bedroom-and-up category, would stabilize over the next six months. Those buyers, he said, tend to have an easier time obtaining mortgages through private banking relationships and will become more active once sellers trim prices.

Large drops in prices are not new in the city. The last decade-long increase in prices was followed by about seven years of falling prices starting in the early 1990s, said Ingrid Gould Ellen, the co-director of the Furman Center for Real Estate and Urban Policy at New York University School of Law. Prices fell about 29 percent.

“But there’s no rule that a downturn has to be six or seven years,” she said. “It’s possible that rather than seeing price declines spread out over a six-year period, this time it could be concentrated in a two-year period.”

Indeed, both Ms. Herman and Ms. Liebman note that this recession differs from previous ones in that there are buyers on the sidelines this time.

“We see a real increase in traffic and a lot more buyers out there,” Ms. Liebman said. “The fish are circling and they will eventually get hungry and start biting. What we’re seeing is a big disconnect — sellers need to get more realistic, but buyers don’t even think it’s enough. Buyers are not hesitating to walk in and bid 40 percent off the price, but sellers aren’t taking it.”

Recovery, when it arrives, is predicted to be modest. Lenders aren’t expected to return to the open-valve position of the boom years.

Ms. Herman said she anticipated a return to annual appreciation rates of 5 to 7 percent. At 6 percent annual appreciation (should that occur after the market stabilized), it would take about nine years for an apartment worth $1 million at peak — and about $600,000 at bottom — to regain its value, according to calculations by Mr. Miller.

The degree and rate of recovery will be influenced by various factors. A Goldman Sachs analysis of the New York City condo market published in early January addressed the possibility that pay cuts in the financial industry or a significant departure of affluent residents could reduce incomes to their pre-Wall Street boom levels of two decades ago. If per-capita incomes were to revert to twice the national average (versus more recent measures of three times the national average), condo prices would need to fall by 58 percent to match the price-to-income ratios of the late 1990s, before the run-up in the real estate market, according to the analysis.

The leveling of the boom may strike condos and co-ops differently.

As prices head south, Mr. Miller said that he expected condos to be more volatile. New construction, including condo conversions, seems likely to suffer the most. “Contract activity on new development has been much harder hit than co-op resales because of credit,” Mr. Miller said.

Co-op boards, however, could damage themselves, he said, if they become too picky with buyers.

“The danger they face is that co-op boards are in denial about the change in the market,” Mr. Miller said. “They’ve been even more conservative with this downturn in terms of financial qualifications — if you work on Wall Street now that’s like a liability — and they’ve been killing sales that they feel are low, to protect values in the building.”

That sort of behavior only depresses values within a building. “It gets a reputation in the brokerage community of being unrealistic about market conditions and that makes it much more difficult to attract buyers,” Mr. Miller said. “I’m not saying they shouldn’t be prudent, but by overreacting they are doing what lenders are doing, which is damaging the collateral they are trying to protect.”

Mr. Peters said his firm had negotiated some co-op deals “dramatically below where prices have been.”

“What we see is that boards are scrutinizing the purchases carefully but not striking down the deal because the price isn’t high enough,” Mr. Peters said. “I definitely agree that in the current environment, that would be profoundly foolish, because the world is a different place.”

A different place and possibly a better one, said Ms. Liebman, who like many brokers manages to see the positive in any environment that comes along. “Why should an average one-bedroom with nothing special

to offer cost well over a million? The market got ahead of itself, and this correction is good for New York because it brings the affordability back in line.”