LIKE A BROKEN RECORD: 100 YEARS OF BUSTS

While 'Great Recession' has been painful, other real estate downturns have hit New York City much harder

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By Sarah Ryley

Economists have determined that this recession, nationally, was the longest and deepest since the Great Depression. So it was only logical to expect that Manhattan, the epicenter of this financial crisis, would ultimately bear its worst brunt.

So far, that hasn't happened. Job losses and declines in housing values have been less severe than predicted, and most observers believe the recession to be officially over, with economic indicators across the board showing signs of a recovery.

In fact, *The Real Deal*'s analysis of 100 years of statistics, editorial content, and interviews with real estate professionals who have spent decades in the business suggests that the "Great Recession" likely ranks as only the fourth-worst over the past century in terms of its overall impact on Manhattan (click here or see below for a chart of the average transaction price for a Manhattan building from 1910 to 2009).

Although the worst could still be yet to come, Manhattan has struggled more during the Great Depression, the 1970s downturn and the savings-and-loan crisis of the late 1980s and early 1990s.

Like a broken record, building booms fueled by wildly optimistic speculation and reckless overleveraging preceded each of these busts. In each case, Manhattan eventually came back stronger -- until the next crash.

As part of its research into how the most recent downturn compared to its predecessors, *The Real Deal* created the first-ever graph showing the average transaction price of a Manhattan building over the past 100 years, adjusted for inflation (see spread on following page). The data was culled from the dusty volumes of the now-defunct Real Estate Record and Builders' Guide -- once the city's preeminent real estate weekly -- and from the Real Estate Board of New York.

Because the "average transaction price" combines all buildings, from townhouses to towers, versus a median price for one property class, the graph provides an overall economic picture of the borough, reflecting the rental, single-family home, and office markets, as well as, to a large extent, the availability of credit.

For example, the 67 percent drop in the average transaction price between 2007 and 2009 was the second-sharpest decline over the past century (behind a 72 percent drop during the Depression). But it should be noted that there were a record nine transactions exceeding $1 billion recorded during the credit-happy days of 2007, versus last year, when there were only $5.5 billion worth of total building sales and only five above $100 million, according to REBNY data.

That shriveling of sales last year was largely the result of banks' refusal to lend money. When debt is easy to come by, even the most amateur developer can get enough financing to make a record-breaking purchase and start demolition for a 22-story hotel, as was the case with the site of a former church near Madison Square Garden, and hundreds of other plots like it. But when credit is tight, sales grind to a halt, prices diminish, and construction sites lay fallow as they await financing.

Today there are more than 100 stalled construction sites in Manhattan, and unfortunately no historic count to provide a means of comparison.

But the sky has not fallen.

Taken together, indicators that measure employment, economic activity, housing prices and the office market show the city has (so far) fared better during this past recession than it did during those three aforementioned downturns. And on some levels it's performed even better than during the downturn spurred by the dot-com bust and Sept. 11 attacks.

Those indicators don't even take into account other quality-of-life factors and cultural shifts that have recently benefited New York. For example, unlike in past decades, today the city's real estate market is bolstered by a record-low crime rate, scores of television shows and movies depicting life here in a charmed light, and a national period of urban renaissance.

"Real estate is a behavioral business. We tend to define real estate as bricks and mortar, but you're building things because society needs to use them," said James Stuckey, a former developer and city official who now heads NYU's Schack Institute of Real Estate.

Stuckey, best known as a former Forest City Ratner executive who oversaw the Atlantic Yards project (he worked for the company from 1994 until 2007), started working for the city's economic development corporation at the tail end of the decade-long 1970s downturn, and eventually rose to become its president.

He said that downturn -- touched off by the stock market collapse and oil crisis, and during which the state Labor Department shows the city lost 623,400 jobs at its worst -- wouldn't have been as severe if not for "sociological factors," like the race riots and nationwide suburbanization movement that had companies and middle-class families fleeing for the hinterlands.

Of course, Manhattan is not out of the woods yet. The borough could easily see another dip -- it saw false "recoveries" three or four years after the real estate market first took a plunge during the 1930s, 1970s and 1990s.

Stuckey noted that Manhattan's stubborn 17 percent office vacancy rate during the savings-and-loan crisis -- which was only exceeded during the Great Depression, according to research from commercial firm Grubb & Ellis -- didn't let up until then-Mayor Rudy Giuliani passed laws in 1996 encouraging the residential conversion of older commercial buildings in Lower Manhattan.

"Overnight, you took the vacancy rate down to like 8 or 9 percent," he said.

Fewer job losses

As economists have repeatedly noted over the last two years, job losses are one of the economic indicators most closely tied to the real estate market. People with jobs fill apartments, and also need office space at the rate of roughly 250 square feet a person.

So far, New York has lost fewer jobs than expected -- roughly 65,800 between January 2008 and April 2010 (at the peak it was higher, but the city has gained 57,000 jobs since the beginning of the year), versus the 243,000 predicted by the city Independent Budget Office last year. According to the state Department of Labor, a rebound began early this year.

In addition, the number of jobs counted in April, 3.1 million, is higher than almost all of the 1970s, 1980s and 1990s, thanks to record growth during the recent boom.

In fact, the job losses the city has seen this time around pale in comparison to those lost during at least four downturns this past century.

Although the federal government didn't start tallying unemployment until late in the Depression, the first report published by the New York Times in 1938 found that there were 514,327 completely unemployed city residents, and 334,320 employed only part-time or through a government work program.

The number of jobs lost during the 1970s downturn was 551,900. It was 195,700 during the savings-and-loan

crisis, and 113,700 after Sept. 11, according to the Labor Department.

"It appears as if things are better than they had been in the 1990s, and certainly the 1970s," noted Michael Slattery, senior vice president of REBNY. However, he cautioned that while there were more job losses during those downturns, it took several years for them to reach their lowest point, in comparison to the dramatic drop-off that immediately followed the 2008 financial collapse.

"The sizing up of the financial markets, the virtual end to transactions commercial and residential, the dramatic loss of jobs and the paralysis in the local economy was the worst I can recall -- worse than the '90s in the swiftness and steepness of price decline and occupancy," he said. "As for the stock market, the loss of value [today] was probably only matched by the Depression."

However, he noted that "the city, from a quality-of-life point of view and safety, is far superior to the '70s or the '90s."

James Brown, the regional analyst for the state Labor Department, said the length of a downturn is a key factor in determining total job losses, as well as larger tectonic shifts in the way companies do business.

"The decline in the 1970s lasted more than seven years. Also, in 1969, the city still had more than 800,000 manufacturing jobs. Manufacturing alone declined by almost 300,000 between 1969 and 1977," he said.

"The early 1990s downturn saw significant corporate restructuring, which led to heavy losses in office industries [like finance and business services]."

Even though the financial sector still dominates the city's economy, the greatest growth in recent years has been toward the more stable industries of health care and education, which together account for around 18 percent of employment and offer a better buffer for the city during recessions.

Further, when looking at the Federal Reserve Bank of New York's economic activity index, the drop-off in 2008 only ranks fourth in severity since the 1960s. The index, which factors in employment, wages and hours worked, showed a decline of 6.8 percent during this downturn -- compared to 8.9 percent after Sept. 11, 13.8 percent during the early 1990s, and 22.6 percent between 1967 and 1977.

Office vacancy relativity

Manhattan's office market has also so far fared better during this downturn than during the previous four major downturns, "stabilizing" at 10.2 percent vacancy and $50 per square foot, according to Richard Persichetti, research manager at Grubb & Ellis.

That may be cold comfort to the current crop of Manhattan's struggling commercial brokers. But Persichetti said that at the worst point during the savings-and-loan crisis, Manhattan offices had a 16.8 percent vacancy, with rents bottoming at $45 per square foot (adjusted for inflation into today's dollars).

The peak vacancy rate was also higher, and the trough rents lower, during the 1970s and after Sept. 11.

And while it was difficult to pinpoint a peak office vacancy rate during the Depression, the Times archives from the period indicate that it generally exceeded 20 percent.

Perhaps an indicator of the fast and loose lending practices that occur during bubble periods, every major downturn over the past century has been marked by the delivery of an enormous amount of office space, oftentimes including a new tower that ranked as the "world's tallest."

In 1930, a year after the stock market collapsed, 40 Wall Street, and then the Chrysler Building, broke the record for the world's tallest skyscraper -- until the following year, when the Empire State Building was finished. It was soon nicknamed the "Empty State Building," and didn't turn a profit until the 1950s.

Upon realizing the office market had been overbuilt, the head of a national builders' group blamed the overly rosy market statistics released during the 1920s: "This encouraged inexperienced promoters to undertake unsound projects, the financing of which were accomplished because no measuring rods were available to underwriters," he said, according to a speech quoted in the Real Estate Record.

Apparently, lessons from the past didn't stop future developers from overshooting the market. According to Grubb & Ellis, around 53 million square feet of office space, including the World Trade Center, was finished during the early 1970s, and around 60 million square feet was built between 1981 and 1991.

The 60-story Carnegie Hall Tower was one of those ill-fated buildings finished during the height of the savings-and-loan crisis. Thomas Elghanayan, who now runs TF Cornerstone, was one of the developers.

"We were crazy," he said. "We mortgaged everything we had, every building we had, we put mortgages on our houses, everything. And we drummed up all the cash we had and we built that building with our cash and the bank's cash. We had to carry it for three or four years trying to rent it, and it bled us. It was just like a monopoly game."

Now that tower, which Elghanayan estimated caused the company $150 million in losses, is one of the city's premier office spaces. He said rents at Carnegie Hall Tower today are around $85 per square foot, down from $150 at their peak in 2007.

That type of wild fluctuation is actually typical for Manhattan office space. The Grubb & Ellis report shows that average inflation-adjusted rents have ping-ponged between $41 and $75 per square foot since 1960. And a report coauthored by William Wheaton of the Massachusetts Institute of Technology found that the value of century-old office buildings fluctuated between 20 and 50 percent within each decade, throughout their life spans.

Steve Kaufman, president of the Kaufman Organization, said his firm looks at low-end rents when penciling out the numbers on building deals, which they generally make during down cycles. "We look at it from the perspective of knowing that if we're in a boom period, a bust will come."

In the last boom, it was more popular to build residential than commercial (only around 7 million square feet of new office space have been completed in Manhattan since 2006).

One of the largest towers still underway, besides the new World Trade Center, is the 1.1 million-square-foot 11 Times Square.

"I don't think we're completely out of the woods yet. But I think there was a positive sign with the [law firm] Proskauer Rose signing [for 380,000 square feet] at 11 Times Square," said Slattery. "We're also not building the same kind of office space as we did in the 1980s, so I think that limited supply has made a difference as well."

Residential reality

Manhattan's residential market also hasn't plummeted as far as some experts predicted. Goldman Sachs, in one of the most widely publicized reports during this bust, predicted in January 2009 that Manhattan condo prices would need to drop between 35 and 45 percent before the market stabilized.

While at various points in 2009, market reports from Miller Samuel found that median prices had dropped by more than 18 percent, the overall decline for the year was actually lower. Indeed, NYU's Furman Center found that the median sale price of Manhattan condos only declined 9 percent between 2008 and 2009, and the median sale price of all residential property combined, excluding co-ops, declined 12 percent. (Some of these figures, however, reflect prices that were agreed upon before the market crashed.)

This year's market reports uniformly show signs of an uptick, although sale prices commonly rise incrementally, and then fall again, during downturns -- particularly when the government is pumping money into the market with programs like FHA.

In comparison, Manhattan's median sale price for condos dropped 24 percent between 1985 and 1994, and the overall median price for residential property, excluding condos, dropped 35 percent, according to the Furman Center.

Since Manhattan's economy saw its big drop-off before Furman started collecting data in 1974, there aren't exact comparisons for that downturn.

However, the average price of an elevator apartment building in Manhattan declined about 40 percent

between 1970 and 1975, according to the Times, which cited a REBNY report. (*The Real Deal* found a 28 percent drop in average building sale prices over the span of the entire 1970s downturn.)

During the 1970s, the virtual gutting of real estate values, along with the increased cost of maintenance attributed to the rising costs of labor and fuel, caused landlords across the five boroughs to abandon their buildings by the thousands, making the city its own biggest landlord. This phenomenon, in turn, significantly impaired the city's ability to collect real estate taxes, driving it to the brink of bankruptcy.

Worse still was the Great Depression. Between the market's peak in 1929 and the end of 1932, Manhattan real estate values shrank by a stunning 74 percent, and stayed that way until the start of World War II, according to a Harvard Business School/UC Davis study, which also used data from the Real Estate Record.

Jonathan Miller, president of appraisal firm Miller Samuel, warned that today's market could experience a double dip, particularly as government props to the industry wane. He pointed out that the nation seemed as if it had experienced a full recovery by 1933, only to fall back into an even deeper downturn that lasted until World War II.

"It's important to separate the overall economy from the housing market. I don't believe the former will [experience a double dip], but I won't be surprised if the latter does," said Miller. "The expiration of housing-related stimulus is expected to cause demand to fall over the next few months," he continued. "The question becomes whether there is enough momentum to enable housing to get back on its feet by the end of the year."

Miller pointed out that since thousands of units of "shadow inventory" not yet released by developers still lurk on the market, the city's unemployment rate is still high, and credit remains tight, the city could see some more slippage in prices. "However, we are not anticipating another sharp correction."

While the residential market no doubt took a beating since the start of the credit crisis -- the number of transactions fell by more than 50 percent, according to the Furman Center -- developers and investors who still have money say they're dying to snap up distressed residential projects, at the right price.

"People have money coming out of their noses," said Elghanayan. "I've tried to make a bunch of deals, but what I've found different than prior busts is that [in prior busts], prices had come down significantly. Right now prices have not come down; there are very few transactions."

He said banks are holding on to distressed property, allowing developers to merely pay the debt service to either avoid massive write-downs, or in hopes that a market comeback will decrease their losses.

"What I've learned going through all these cycles is that they're wild swings," said Elghanayan. "If you really analyzed the risk-reward ratio of this business, you wouldn't be in it, because on a purely rational, analytical basis, it wouldn't make sense. It's true you could make some money -- you could make a lot of money in the good times -- but the risks are huge."

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