www.REBusinessOnline.com

November/December 2017 · Volume 14, Issue 2

NORTHEAST REAL ESTATE BUSINESS®

Connecting Real Estate in the Northeast

http://northeastrealestatebusiness.epubxp.com/i/904246-nov-dec-2017

FALLING FOREIGN INVESTMENT CONTRIBUTES TO BROAD SALES SLOWDOWN

Limited supply, high prices and export restrictions on Chinese capital are among the influences weighing on Northeast investment sales.

By Joe Gose

The Northeast is absorbing the brunt of cooling foreign demand for commercial real estate in the U.S., part of a broader property investment slowdown that began after sales hit a post-recession peak of around $534 billion in 2015. In general, high prices, a robust refinancing market, and unknowns surrounding interest rates and fundamentals in a cycle that is already long in the tooth are all contributing to the waning activity. Furthermore, China's efforts to control the export of capital have all but removed some of the most aggressive bidders from the market.

"It's not a question of whether there's money available — there's an exorbitant amount of capital out there — but the supply of properties isn't as abundant as we would like," says Samantha Ahuja, a partner with the Morris Manning & Martin law firm in New York, who specializes in commercial property development and financing. "There's also a gap between what buyers and sellers think assets are worth, and investors are waiting to see how other variables will play out."

Through the first three quarters of this year, U.S. commercial real estate investment sales volume of $332 billion represented a 6.7 percent decline from the same period in 2016, according to New York-based commercial real estate researcher Real Capital Analytics (RCA). Among the regions, the Northeast experienced the largest plummet in activity by far: Some $55 billion of sales through third quarter in 2017 represents a year-over-year decline of nearly 27 percent, according to RCA, which tracks transactions of $2.5 million or more.

Foreign investors played a significant role in that pullback, sprinkling $9.1 billion in the region through September 30 this year, which was half of the amount of foreign capital invested over the same period in 2016, according to RCA. What's more, cross-border buyers accounted for 19 percent of all Northeast deals through three quarters of 2017, a decrease of 6 percentage points from last year.

see GLOBAL CAPITAL page 53

INSIDE THIS ISSUE

Fairfield County Office Market Displays Healthy Indicators page 22

The RIDC Puts the 'Development' in Economic Development page 30

Building on Potential in Long Island City page 40

Changes to Immigration Policy Could Impact Commercial Real Estate page 42

only $5.8 billion in cross-border investment through third quarter this year, a year-over-year decline of almost $8 billion.

As evidence of the market's diminished fortunes, investors displayed little interest in bidding on the 47-story Park Lane Hotel on Central Park South, which was seeking $1 billion in a recent auction, according to the *New York Times*. A federal investigation into the possible misappropriation of billions of dollars by Jho Low, a Malaysian financier and majority owner of the property who has gone missing, may have contributed to buyer hesitancy. But the indifference more likely speaks to the softening investment sales market, given the fact that the winning bidder would have inherited the right to build a new residential skyscraper on the lucrative site.

"Prices on a square-foot or cap rate basis are at or are close to their peak," says Heidi Learner, chief economist for Savills Studley in New York. "It could be that there are more attractive investment opportunities given where we are in the cycle in the U.S. I would not expect a big rebound in commercial real estate investment next year."

New Faces

Still, observers note that a number of cross-border buyers are entering the U.S. for the first time. In many cases, new investors such as family offices are most interested in Brooklyn or similar up-and-coming markets that are attracting millennials, notes David Zlotnick, a co-founder and managing partner of The Britannia Group, a New York-based boutique brokerage that specializes in representing foreign investors.

Among other deals, in May Britannia represented a German family that paid $23 million for a 41-unit apartment property in Brooklyn's South Williamsburg neighborhood. The purchase marked the first New York investment by the family, and the price reflected a capitalization rate of 3.3 percent, according to Zlotnick and Jacob Rogosnitzky, the firm's other co-founder.

"There are plenty of buyers that want to bring in fresh capital to the market, but they are new to the process and you have to be very patient with them and do a fair amount of hand-holding," Zlotnick says. "It's a question of whether they can find something that fits their criteria."

For a growing number of foreign buyers, pinpointing assets that fulfill their investment goals is taking them beyond core properties in Manhattan, which are demanding capitalization rates of 4 percent or less, according to Michael O'Callaghan, a senior managing director for Savills Studley in New York. He made the comments during a capital markets panel during the recent 2017 Urban Land Institute Fall Meeting in Los Angeles. O'Callaghan further suggested that the prices and dearth of opportunities in Manhattan are turning off foreign buyers, which are coming to the U.S. looking for better yields than they can find in their home countries.

Some investors, like Koreans, are now focused on providing debt after initially buying offices and then industrial buildings, he said, and Middle Eastern buyers are seeking value-add properties. "We're talking to foreign investors about moving outside of the gateways to other markets where they should be OK on a risk-adjusted basis," O'Callaghan added.

Manhattan Pain, Boston Gain

While Manhattan has seen waning activity, Boston experienced an increase in overall sales volume through the first three quarters of this year, thanks largely to foreign investors that plunked down more than $2.4 billion in the market. That represented a year-over-year increase of $900 million, according to RCA. "Boston, to a certain degree, has been anointed a safe harbor, and there has been a broadening of the types of foreign capital that have come to the market," says Anthony Hayes, a vice president in Colliers International's capital markets group in Boston. "They are looking for capital preservation and see the market as a way to achieve it."

Hayes estimates that capitalization rates for core properties in Boston are around 100 to 150 basis points higher than in Manhattan. Yet many downtown properties are in the hands of long-term owners after trading over the last few years, and foreign investors are looking at industrial properties and Class B offices.

In April, an investment vehicle affiliated with the Susskind & Rokeach family in Berlin paid $41 million for the 64,500-square-foot 148 State Street in Boston. Colliers represented both parties in the deal and arranged roughly $27 million in acquisition financing.

In April, for example, Colliers brokered the $41 million sale of 148 State Street to an investment vehicle affiliated with the Susskind & Rokeach family in Berlin. The Class B, 64,500-square-foot downtown office building is home to Public Consulting Group's headquarters — an affiliate of the firm was the seller — and the price reflected a 5.9 percent cap rate. Colliers represented both parties in the deal and arranged roughly $27 million in acquisition financing.

"Everything that we've brought to market, ranging from downtown and suburban office to industrial, has had a good audience," Hayes adds. "In some cases there have been showdowns on pricing expectations from both sides, but we're not hearing that capital is moving to the sidelines."

Whether more capital moves off the sidelines in the rest of the Northeast will ultimately depend on buyers and sellers reaching an accord on price, a condition that will be influenced by interest rates as well as supply and demand, among other factors. In terms of foreign investors, however, CBRE's Levy argues that the U.S. real estate market will continue to benefit from a glut of global capital seeking returns.

"From a big-picture perspective, I think we're going to see more foreign capital over time, although I don't see anything in particular that's going to cause a spike in the short-term," he says. "The only thing that could change my point of view is if we do something to restrict the flow." ■

RESTRICTING THE FLOW OF FOREIGN MONEY

When Congress reformed the Foreign Investment in Real Property Act (FIRPTA) in late 2015, observers suggested that the flow of international money into U.S. commercial real estate would improve because the changes lessened the tax burden on foreign investors. However, the act still imposes some tax burden that impacts foreign investment — and many observers argue that eliminating FIRPTA is the only way to increase cross-border capital in the U.S. in a meaningful way. But FIRPTA it isn't the only regulation that stymies foreign funds trying to enter the U.S. Here are a few other potentially deal-impeding rules:

- ***China Capital Controls*** – In an effort to tamp down perceived corruption, China late last year introduced measures requiring government regulators to sign off on certain outside investments. (*See page 53.*) The government's focus on commercial real estate became clear when authorities arrested the chairman of Chinese insurance giant Angbang in June and ramped up scrutiny of Chinese conglomerates HNA Group, Dalian Wanda Group and Fosun International. All have been active investors in U.S. commercial properties.

"While there are some deals still taking place, the ability for Chinese investors to export capital has fallen dramatically," says Samantha Ahuja, a partner with the Morris Manning & Martin law firm in New York. "There has been chatter that Chinese institutions may be forced to either dispose of assets or find new ways to hold them."

- ***CFIUS*** – Thanks largely to the wave of Chinese investment across industries in the U.S., the Committee on Foreign Investment in the United States is making news today with more regularity than at any time since it was created during the Ford Administration. An interagency body, CFIUS reviews foreign purchases of U.S. assets for potential national security risks. Commercial real estate deals account for only 10 percent of CFIUS's 200 cases currently, but landlords selling to foreign buyers need to be cognizant of the property's tenants and proximity to sensitive areas like military bases, advises Chris Griner, a partner with the Stroock law firm in Washington, D.C.

Case in point: Angbang's purchase of the Waldorf Astoria in 2015 raised flags because the president and other officials had standing apartments there. To solve the problem, officials stopped using the apartments, Griner says.

- ***FinCEN*** – In 2016, the Financial Crimes Enforcement Network of the U.S. Treasury Department began cracking down on shell companies buying luxury condominiums in Manhattan and Miami for cash to prevent money laundering. The program has spread to other communities, and FinCEN has hinted that it may expand to commercial properties. Why? All-cash buyers could acquire apartment buildings or similar alternatives to residential condos as a way to escape FinCEN detection, says Pierre Debbas, a partner with the Romer Debbas law firm in New York. *— Joe Gose*