PCCP Market Commentary

Condos, Condos Everywhere

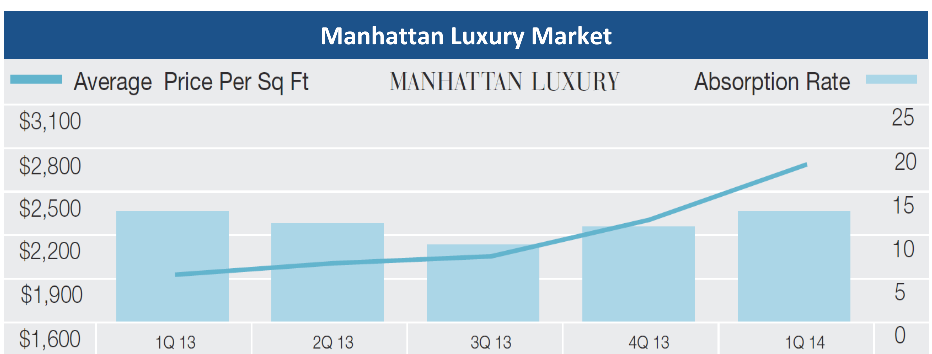
Third Quarter 2014

We're continuing our exploration of supply and demand this quarter, but this time we are taking a look at condominiums, which was the one sector of real estate that had substantial new development and unsold inventory during the last cycle. Today, almost six years later, much of the inventory has been absorbed – largely at lower prices – or converted to rental units.

Let's first take a look at Manhattan and Miami, the two most active condo markets in the U.S. It seems that every other day there is another news story about a record-breaking condo sale or another ultra-luxury condo building breaking ground in these cities. What's interesting about the market fundamentals in Manhattan and Miami is how this current demand is interacting with supply.

The wave of demand for luxury condos in both Manhattan and Miami is being driven by foreign investment. High net-worth individuals from Russia, the Middle East, Southeast Asia, and Latin America are buying up condos as a way to park capital in tangible, relatively liquid assets in the U.S., where markets are more stable and systemic risk is relatively low.[1] Developers report that the majority of buyers in the Miami market are still from Latin America, along with more activity coming from Russia, which is different than Manhattan, which sees buyers from across the globe. This influx of foreign capital combined with some pent up demand from residents in each respective city is driving the record sales volume and pricing.

In Manhattan, the condo market is on fire and prices are breaking records. The number of sales in Q1 was 35% above the same period last year, while the average sale price increased 31% year-over-year and the average price per square foot reached a record $1,363, a 24% increase over 2013.[2] In the luxury market (which is considered the top 10% of sales), the average price is up 40% year-over-year to $2,700 per square foot.



Source: Elliman Report, *Manhattan Sales*, 1Q-2014.

Upward pressure on prices can be attributed to high demand as discussed above, as well as a shortage of supply. Condo inventory on the market is down 17% from Q1 last year and 56% from its peak in Q1 2009.[3] An overheated market for land is causing land for residential development to trade for $800 per square foot and above. Because of this increased cost of land and development, sponsors are only bringing super-high end units to market, and in limited quantities.

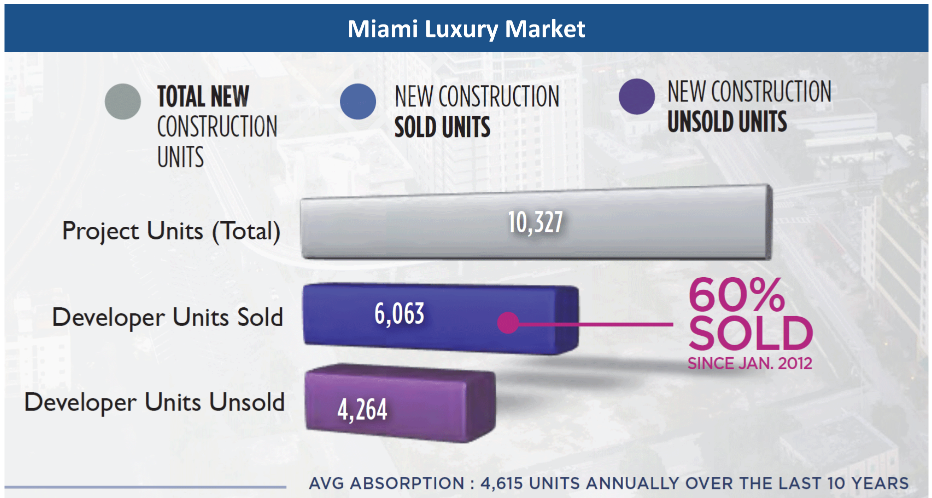
[1] ISG World, *Miami Report*, http://planbinternational.com/docs/MiamiMarketReport.pdf, February 2014.

[2] Elliman Report, *Manhattan Sales*, http://www.millersamuel.com/files/2014/04/Manhattan_1Q_2014.pdf, 1Q-2014.

[3] The Corcoran Report, *Manhattan*, http://media.corcoran.com/pdf/reports/2014_Q1/Manhattan_Q12014.pdf, 1st Quarter 2014.

In Miami, the situation is a bit different. Over 10,000 new condo units have been delivered since 2012 or are currently in the construction pipeline, of which about 60% are sold.[4] Foreign investors looking to invest capital in real estate in the U.S. have increasingly been looking to Miami, because prices per square foot are significantly lower than in Manhattan, especially in the luxury condo market where the average price per square foot is $804[5], compared to $2,700 in Manhattan.[6]

To capitalize this glut of new construction in Miami, developers are turning to the buyers. Developers in Miami, who are still risk averse from the downturn, are requiring deposits of 50% or more on these units which are being used to fund construction costs. While it may seem imprudent for buyers to put down such high deposits, keep in mind that the majority of the buyers are coming from markets where high deposits are typical and the majority of real estate is owned all equity.



Source: ISG World, *Miami Report*, February 2014.

The type of movement we are seeing in Manhattan and Miami is unique, but construction is picking up in other markets. Places like Los Angeles and San Francisco are experiencing moderate numbers of new condo deliveries and growth in the construction pipeline due to job growth and general economic growth, along with some secondary foreign investment. As the economy continues to recover, condo construction is starting to spread into other top markets, with new developments breaking ground in Boston, Seattle, and Washington DC.

The strong absorption to date in Miami and New York appears to justify the supply in the pipeline, and the initial wave of projects in other top markets (San Francisco, Los Angeles, Boston, Seattle, and Washington DC) has been selling very well. At this point in the cycle, lenders are broadly sticking to the major markets where the demand supports the new construction. But we are starting to see signs of new projects seeking capital in secondary locations, because developers know that capital seeking higher returns is getting priced out of the top markets. Investors and lenders should keep an eye on demand for condos outside of the top markets before getting aggressive.

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[4] ISG World, *Miami Report*.
[5] Elliman Report, *Manhattan Sales*.
[6] Elliman Report, *Manhattan Sales*.