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Addressing the Realities of Residential Real Estate

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The Condo Kicks In

An Alfred Hitchcock Twist

Two recent articles that tracked sales data for co-op and condo transactions in the New York City area, reveal an interesting trend in favor of condos over co-ops. In a June 22, 2010 piece in the Wall Street Journal, entitled "Condos Rule Over Co-ops at High End", citing Miller Samuel data, Brittany Hutson points out that the "absorption rate" for condos at price points above $1.5 million, was significantly faster for condos than for co-ops. In the market under $1.5 million, co-ops fared slightly better than condos. Then on July 1, 2010, Will Alden, in an article for the New York Observer, entitled "We Officially Live in the Age of the Condo" also citing Miller Samuel statistics, pointed out that total condo sales for the quarter just ended, exceeded co-op sales by 12.6% (or 56.3% of total sales). Wait a minute... Co-ops are 75% percent of the ownership housing stock, but condo sales exceeded co-op sales? How could that happen?

Condo as Stepchild

It wasn't until 1964 that Manhattan even had a major condominium development (the St. Tropez on East 64th Street). For generations, co-ops were the primary ownership vehicle for residential real estate in New York City. Then, as now, in order to purchase a co-op (with a few exceptions for condops that act like condos), a purchaser was required to run the gauntlet of "Board approval", with the myriad disclosures, both personal and financial, in "nineplicate". The unspoken truth was that just about "anyone" could purchase a condo, since there was no Board approval. Those buyers with chinks in their financial armor or sloppy personal history, had no choice but to seek the refuge of a condo, safe from the bean counters and social monitors. That flexibility of ownership came at a price, as Hilary Stout points out in her July 8, 2010 New York Times article "The March of the Conversions", with condos selling at ten to twenty percent higher than comparable co-ops.

The Law of Unintended Consequences

Leave it to the worst financial crisis in the past 80 years to rearrange the DNA of New York City real estate transactions. A significant increase in foreign buyers, captains of industry becoming lieutenants of industry, and the biggie, tons of excess condo inventory, have lead to what may be an inevitable development: condo sales are outpacing co-op sales.

Commit this Lingo to Your Lexicon: Shadow Inventory and Absorption

At your next cocktail party, try to throw the phrase “shadow inventory” into the conversation. But what is it? The concept means different things to different real estate professionals, depending upon where they are located in the country. Units in foreclosure, units ninety days or more in arrears, or units owned by the banks, are certainly one measure of shadow inventory. As always, Gotham is a little different and I like Jonathan Miller’s definition: “Those units that are finished or nearly constructed, but not currently offered, including rescinded contracts”. What we really are talking about in New York are the massive number of new condo units, constructed during the housing “boomathon”, that are just sitting there waiting for purchasers. That brings us to “absorption”.

We’re Talking Months, Not Weeks

Real estate economists look at the sales data and try to predict how long it will take, measured in months, to absorb the outstanding housing units presently on the market as well as the so-called shadow inventory. According to a recent report by Standard and Poors, the absorption rate for New York City is now 103 months. So in human speak, there is a backlog of developer units, together with bank-owned real estate, units in foreclosure and other housing stock not yet on the market, that could take over 8 years to absorb. Shadow inventory, plus rate of absorption, speaks volumes as to when the housing market in New York will actually recover. Into this mix is the interesting trend of condo sales outpacing co-op sales.

Is it Financial or Philosophical?

So here’s where we appear to be at the moment. According to the Miller Samuel data, housing sales activity is now at pre-crash levels. That being said, from my anecdotal research, pricing continues to be significantly depressed. There are years of condo inventory available at historically low prices per square foot. Looking out three to five years, and perhaps longer, there doesn’t seem to be any reason why pricing would change until the shadow inventory is dramatically reduced, in part, by increased absorption. To complicate matters for cooperatives, as Stout’s piece points out, a number of well-known pre-war rental buildings are now also converting to condos. If the above assumptions are correct, a question arises, at least in my mind: How long can co-ops continue restrictive purchase and subleasing policies in an economic environment that will favor condos for many, many years to come? At some point in the future, if condo sales continue to outpace co-op sales and possibly dominate the landscape, co-op Boards may be forced to revisit the sacred cow of co-op ownership: restrictions on sales and subleasing. In the world we live in today, the idea that you can't sublet your co-op when you are unable to sell due to market conditions, may no longer be a viable investment strategy. Or to put it in technology terms: are co-ops Betamax and condos Blu ray?

Residential Reality: Have Value and Other Factors Overtaken Location?

We all know the three most important words in real estate. But is the mantra changing due to market conditions? A new era may be upon us, where multiple factors, such as value, flexibility of ownership and timing, are equal in importance with location, amenities and architecture. This change in philosophy is finding its way into what appears to be a buyer's preference to purchase a condo rather than a co-op.

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