Real estate crash has already begun

A 20 percent collapse of New York commercial holdings is only the beginning, investors say.

Asking—not bidding—prices for top-quality New York City office buildings have already dropped 20 percent over the past three months, in the first phase of a property-value crash that will make the 1974 wipeout look small by comparison, according to top New York City real-estate sources. Former high-flyers in the New York market, including the Helmsley organization and the secretive Canadian Olympia and York, are expected to be bankrupt before the end of the year, among a half-dozen top names.

"The Reichmans [the family that controls Olympia and York—L.J.] were in my office twice in the past month trying to sell us parts of their properties," said the president of a large New York real-estate concern, who represents substantial foreign and pension investment in the metropolitan-area property market. "They think their portfolio is worth $3 billion. Our people looked at it and said, '$1.8 billion, maybe $2 billion, tops.' But we wouldn't touch it even at this price."

O&Y's troubles have been the subject of rumors for weeks, and a top consultant to the Canadian private concern, Gary Stamm, has warned friends that his client may have to file for bankruptcy. But what is not known is the extent of the market collapse.

In the past 90 days, the rental cost of top-quality commercial office space has collapsed, partly because new construction is adding the equivalent of a whole World Trade Center tower to supply per year; partly because corporations are canceling expansion plans.

On June 13, a major East Side office tower signed a lease for 40,000 square feet at only $19 per square foot, a rental which implies a loss for the building's owners, according to sources involved in the transaction. "Three months ago, that space would have gone for $32 per square foot, plus a cost-of-living adjustment," said one source.

Among the big Canadian companies speculating in New York City real estate, the only one able to stabilize its position is Cadillac Fairview, sources say. A liquidator for the Bronfman family, Leo Colberg, arranged the sale of two Cadillac Fairview shopping centers to American investors last month, and has taken other measures to contain the company's liabilities.

O&Y has few chances. It has made the rounds of New York investors unsuccessfully and a last-ditch attempt to put together a group to realize cash from their properties mounted by Goldman, Sachs investment banker Claude Ballard is reported to have fallen through.

"No one will go into this market for the next three to five years," said a top industry executive. Asked what discount of real-estate values would lure investors back into the market, he answered, "Asking prices are already down 20 percent from the peak level. But you could knock the price down to nothing, and people still wouldn't buy it. If you can't get the rentals, it costs you money to carry the properties."

A final thump on the coffin lid may well come from Senate Finance Committee Chairman Robert Dole, who is now studying proposals to revoke tax breaks favoring real-estate investment, especially the 15-year straight-line depreciation of non-user commercial office properties. These provisions have permitted investment banks to market tax-shelter packages which permit investors to put up $1 of equity for $2 of debt, and take the entire tax break on the $3. Through participations in office buildings, investors in a 30 percent tax bracket can earn back triple their original investment in eight years. Goldman Sachs, Merrill Lynch, Winthrop Financial, Paine Webber, and other investment houses have already marketed more than $1 billion of such participations. Senate Finance staffers are reportedly incensed at the revenue loss and acting to eliminate it.

Although the investor-participation deals represent a small margin of total real-estate investment, the tax subsidy has permitted sellers to push up the prices of buildings marketed in this fashion. One $90 million property was reportedly sold for $120 million; the investors make so much from the tax break that the inflated price is of little consequence.

Ironically, Dole's move took the normally alert real-estate lobby by surprise because certain prominent real-estate interests, incensed at the price pattern, called the Senator's attention to the tax maneuver.