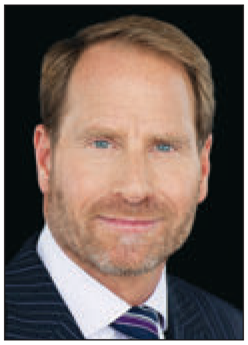
# Real Estate Cycles

**An Interview with Kent M. Swig,**
**Co-Chairman, Terra Holdings, LLC; President, Swig Equities, LLC; and President, Helmsley Spear LLC**


Kent M. Swig

**EDITORS' NOTE** *In addition to his ownership of and responsibilities at Swig Equities and Helmsley Spear, Kent Swig is an owner and Co-Chairman of Terra Holdings, LLC, a company that owns and operates several real estate service firms, including Brown Harris Stevens and Halstead Property. Swig is also a principal in The Swig Company, a family-owned real estate and hotel company based in San Francisco and New York. Swig earned a degree in Chinese history from Brown University and attended UC Hastings College of the Law (San Francisco).*

**How strong is the New York City market and can it be sustained?**

On the residential side, the market is extraordinary, and also strong on the commercial side.

One of the contributing factors to this strength is New York's growing population, which has finally recovered from the economic catastrophe of the 1970s where over 768,000 jobs were lost resulting in more than 1.1 million people leaving the city. It took us until 2003 to gain back our population.

We are now living in a city of 8.3 million people and on its way up to 9 million. The population growth is a mitigating circumstance during the economic downturns and it's an enhancement during the economic upturns. This demographic is one of the most important to recognize.

New York City has also been able to attract 55 million tourists annually, which brings in a lot of business.

If both of these numbers continue to increase, this bodes well for New York City and softens the negative impact of any down markets.

On the residential side, we are at a point now where the inventory of available opportunities to buy is as low as it has been over the past 15 years, and demand is very strong. In fact, the market is so strong that the peak of pricing during the irrational exuberance of 2006/2007 looks inexpensive by comparison.

The question is, how much can New York sustain price increases before it hits a point where people can't afford to live here or refuse to pay these high prices? So far, neither has occurred.

**Will a large percentage of the population be priced out of the market?**

We certainly have a housing issue in New York City. We never regained the growth in the housing supply that we had between 1952 and 1973. During this period, we were adding almost 55,000 units per year until the late 1970s downturn occurred. In 2007, we added approximately 28,000 units. Even during the irrational exuberance of 2006/2007, New York City only added about 50 percent of what we used to do annually. So, supply is really not a factor of the market and demand is the key factor to watch.

New York is very land constrained and an expensive place to build, so I don't see the supply side growing to such an extent that the market will be oversupplied with apartments. In fact, I would suggest that the supply is almost an irrelevant factor in the marketplace – it is all about demand.

The middle market segment makes up the vast majority of the supply, and this segment is getting squeezed, and it is a concern for the workforce in New York City. Socially, some say we're turning into an elitist city, and we could end up with a large low-end sector and a large high-end sector, and little in the middle. So we need to be able to build affordable housing on both a rental basis and on a for-purchase basis.

To accomplish this, we need to incentivize people to build for the middle market.

**What is a healthy vacancy rate for the commercial sector?**

Well, at a 5 percent vacancy rate I would suggest that it is an unhealthy relationship between landlords and tenants because there is not enough available space and prices will go up too drastically, and you don't want to price people out of Manhattan.

At a vacancy rate in the teens, I would say that is unhealthy because there isn't leasing activity going on to sustain the landlords on that side. So a healthy vacancy rate is somewhere in between 8 and 10 percent.

**How does the market look on the commercial side?**

On the commercial side, there has been a discipline added to the marketplace resulting from the economic downturn between 1989 and 1991, when the banks learned a great deal, and those lessons are still applied today.

Prior to 1987, one could go to a bank to build a commercial office building and borrow 110 percent of the entire cost to build a speculative office building. If leasing didn't occur, the banks got stuck with the product, and there was no recourse on the developer side.

After the financial decline of the late 1980s, the banking industry adjusted their lending practices to where they would lend maybe 70 percent on a first mortgage basis for new projects or acquisitions, and the banks maintained this discipline through the present.

Today, one doesn't see a lot of speculative office development without a significant portion of pre-leasing. The result is that the commercial market has been extremely disciplined in its approach to adding new product in the marketplace, which creates stability.

The Downtown office market lost 17 million square feet of office space as a result of conversions from commercial to residential use, comprising some 80 buildings. On top of that, the market lost 13 million square feet, tragically, as a result of 9/11.

With the loss of 30 million square feet, the Downtown market needs to add back office space as one cannot grow a city economically if its office base is shrinking. At present, the World Trade Center development is adding back only 10 million square feet. So the office space of Downtown has significantly declined, even with the addition of the World Trade Center. I don't think supply is an issue in the commercial marketplace and, particularly for Downtown, new office space is needed, especially with an aging inventory.

In other areas, you have a lot of new development and specifically in the new neighborhood known as Hudson Yards. There too, there is pre-leasing involved, but this is a brand new neighborhood and it will take 10 years-plus to solidify itself. The residential development going on in the Hudson Yards area will help greatly as well.

Unless everybody starts building, I think we have a healthy relationship between the supply and demand on the commercial side, and it is more disciplined than the residential side, although as I said previously, I don't think supply is an issue in the residential segment as one could not really build enough product quickly enough to dramatically affect pricing.

**Where does your passion for the industry come from?**

I think that real estate is a "people business," which I very much like, and I enjoy working with tenants and my colleagues in this business. ●