

A Tale of Two Cities

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While the macroeconomic environments of Moscow and New York differ greatly, the ups and downs of the real estate markets in the two cities have displayed surprising and interesting similarities.

The Moscow and New York real estate markets showed remarkable similarities both in the way real estate prices reacted to the financial crisis and the timing of the events. This is surprising, considering how different these markets' macroeconomic environments are. While the fundamentals behind the recovery that both markets are currently seeing are different, it is interesting to compare and contrast real estate developments in these changing property markets.

How It Has Played Out

Both New York and Moscow seemed immune to the real estate market meltdown until the summer of 2008, when both markets peaked. Long after the pain hit London, Spain and other markets that were popular among investors and lenders, Moscow and New York were still selling at high prices. Last fall both markets stalled, neither sellers nor buyers were willing to act in the face of uncertainty. While prices didn't move much, the transaction volume was so low that it was hard to believe that prices would hold. By the beginning of December, both cities saw bargain hunters, who viewed many properties and made low, often 'insulting' offers of 50 percent below the asking price, but most sellers responded with cold disdain. Winter brought despair, with lost incomes, slashed bonuses and very limited financing options for commercial loans and developers.

With despair came price correction, and prices moved some 30 to 35 percent down. In both cities, supply increased, as unsold apartments joined new inventory, but by the end of the first quarter of 2009 many properties had been taken off the market as their sellers decided to tough out the bad market and try their luck later.

Other sellers, those who really needed cash or had to urgently get rid of mortgage obligations, entertained offers that no longer sounded insulting. Still, the deal volume left much to be desired and was much lower than in the good times of summer 2008.

Moscow saw an increased number of viewings in the spring, but the number of transactions remained low — buyers were testing waters, but not ready to move ahead with purchases. In New York, first quarter statistics broke a number of the city's records, all of them negative — the least sales closed, the greatest price declines, the highest number of vacancies.

In New York, change for the better became apparent when the second quarter statistics came out. According to a New York State Association of Realtors (NYSAR) report, the number of contracts signed almost doubled, and the statewide home price index increased by about 1.5 percent. No matter how tiny this may seem, it was the first positive trend in the market. In addition to these mostly local, statewide numbers, the appreciation of the euro to the dollar revitalized European investors' interest in the New York market. Lower prices and the attractive euro-dollar exchange rate, as well as the tax authorities' ever-tightening control over Swiss banks, motivated many to look at New York real estate as an alternative to keeping cash in Europe. As a result, since July there has been both a price stabilization and an increase in deal volumes.

Moscow lagged slightly behind. Buyers' increased activity, which has been apparent since the spring, was finally converted into deals in September. While it is too early to quote any figures, the city's inventory is moving faster and the deal volume doubled from August to September. Today, it is difficult to book a bank deposit location for a deal closing. This is something

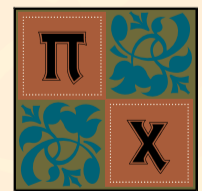
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the market has not seen since the summer of 2008. Sellers have regained confidence and do not see every offer they receive as the one and only chance to sell their property, but are open to reasonable negotiation. Still, the number of well-priced and discounted properties on the market remains quite high, and it is definitely still a buyer's market.

Bulk Sales by Developers

Developers, who usually depend on financing more than other market players, found themselves in the most difficult situation. Slow sales, lower prices, expensive loans, difficulties in re-financing loans and banks' often non-cooperative behavior are all unpleasant factors pushing various developers into bankruptcy. In New York, partially sold buildings, where occupancy was already permitted, created new financial pressure on the developers: they had to pay the unsold apartments' utility charges.

To speed up sales, developers in Moscow and New York are currently offering bulk sales — special, considerably discounted prices for buyers who purchase several apartments. For those with access to financing, it might be a great opportunity, especially in New York, as the risk of losing investments or of major delays to the completion of construction is lower than in Moscow. Even if a developer is not able to complete the construction, the investors' money is held in an escrow account and is not used to finance the actual work, so if the project is not taken over by another developer quickly and there are delays, investors are still assured of being able to withdraw their investment.

Once the building is completed and the ownership documents are issued, however, new developments in Moscow might become a surer bet. As the cost of main-



Both cities were late to feel the onset of the housing market collapse, posted poor first-quarter statistics, and saw an increase in deal volume by the third quarter.

taining buildings is lower, there is almost no chance of an actual building — not its developer — going into bankruptcy. In New York, especially in the financial district, where the number of unsold apartments in many completed and partially occupied developments is high, there are various examples of buildings going into bankruptcy and not being able to maintain their services — pay building staff salaries or bills for gas and water services. Such situations, however, especially when caused by the developer's failure to pay utility charges on unsold units, are quickly resolved through the courts.

Investors, looking into bulk purchases, should focus on careful due diligence

and background checks of the developer. In spite of the many risks, the possible returns are promising — a high yield from rent and a likely hefty profit on resale, once the current inventory of new developments is completely sold. With limited financing and almost no new projects in the pipeline, the supply of newly developed housing is likely to decrease, while the demand is likely to grow as the market recovers, allowing resellers to command a higher price.

Landlords Offering Incentives

In New York, sellers who were not under pressure to sell opted to rent their apartments out to avoid selling in a low market. Even developers, facing difficulties with moving the large inventory of brand new apartments, especially in less popular locations, decided to convert their new buildings into rental units. This additional supply in the rental sector increased the mounting downward pressure on the rental market caused by lay-offs and salary cuts, and rents continued to slide downward.

As a result, this past summer — a time of year which is usually considered a hot season for rentals in New York — most landlords were pressed to offer concessions to potential tenants, such as paying brokerage fees, offering free rent and other incentives. This did not change the intrusive and difficult procedure of being approved as a tenant, though. Every applicant still has to present tax returns, a letter of employment and go through a credit check when trying to rent accommodation. Some private landlords, however, became less choosy when looking at tenants' profiles and are now willing to accept international tenants with no local credit history with less than a year of prepaid rent.

In Moscow, the rental market has been affected mostly by the devaluation of the ruble, slashed salaries and lay-offs. As some expats were saying goodbye to Moscow, their apartments came on the market and found no potential occupants. Many sellers, not able to sell, also offered their apartments for rent, thus further increasing supply. Mid-range and expensive apartments suffered the most. Cheaper apartments, where tenants were mostly locals, were less affected, although they suffered from the drastic change in the ruble exchange rate, since rent was usually denominated in rubles. Moscow landlords are also feeling market pressures and are starting to offer different concessions — mostly by including additional services, such as parking, cable television, the Internet, and sometimes even cleaning services in the rent.

Government Tax Incentives

Authorities in the United States and Russia are trying to lure their citizens into buying real estate by offering tax incentives. In Russia, the government has doubled the tax credit for homebuyers from 1M to 2M of taxable income, which allows a saving of 260,000 rubles (\$8,600) in cash. This increase applies to any purchases made in 2008 and later. In the U.S., homebuyers can get a tax credit of \$8,000 on their principle residence. In both countries these incentives only help tax residents. Mortgage interest is tax deductible in both countries as well. US taxpayers, including those living outside the country, can benefit from this as well, if they pay interest on a mortgage loan on a property in the United States.

For investors, Moscow does not have much in terms of tax savings to offer. That is, however, balanced by the overall low cost of property ownership in the city. In New York, tax abatement on new developments — a tax incentive offered to all buyers of new developments irrespective of their tax residency that considerably lowers the cost of owning a New York property — is much more attractive in terms of tax savings.

Celebrity and Unique Properties

In both cities, the financial crisis motivated many people, who once had fortunes, to list their properties for sale. As a result, many exciting and unique properties have appeared on the market. In New York, a curious buyer can shop by celebrity name or by the most exclusive address. In Moscow, you can look at apartments in Romanov Pereulok or view mansions with private gardens at the Sokol Artist Compound — options that until recently were likely to change hands quietly in an off-market transaction or remain with the same owner for years. Celebrity hunters can go after Chigirinsky properties, or choose from a long list of others who entered the crisis highly leveraged. For buyers who have managed to hold onto their cash until now, there are many exciting options out there.

In New York views onto Gramercy Park and keys to the only private park in Manhattan are on offer at the most desired new development adjacent to the Gramercy Hotel. Many options are available in such famous and fashionable buildings as the Dakota, where John Lennon once lived, or 15 Central Park West by Central Park. Even Sting has listed his 3-bedroom apartment for sale. Since most wealthy New Yorkers or owners of properties in the city

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While developers' bulk sales, governments' tax incentives and landlords' concessions are common to both markets, the financing options available differ greatly.

were active in the city's financial markets and incurred considerable losses as a result of recent events, the list of properties up for sale in landmark buildings seems to be incredibly long. Buildings that were once registering record prices are now posting the highest price drops.

Financing Options

Of course, not everything unites the two cities. There are important differences as well. One key difference is in financing options available. Unlike Moscow, where there is virtually no financing and the banks that are still offering mortgage loans are charging double-digit interest rates, in

New York both investors and local buyers have a wide choice of financing options. For investors, the loan-to-value ratio — a percentage of the property value that can be borrowed — is 75 percent or less, while local buyers and those who file a US tax return, can finance up to 90 percent of the property value. Even the most expensive properties can be financed, although the loan-to-value ratio goes down for properties over \$2 million. While foreign investors would have to pay about eight percent in interest on a 30-year mortgage, locals get a better deal and can find deals as low as 4.6 percent in interest on a 15-year mortgage. Of course, cash buyers get better deals and smoother negotiations than

those who are borrowing, but tax benefits and the smaller amounts of cash invested increase the overall return on a project.

In Moscow, financing options are extremely limited for tax residents and almost non-existent for foreign investors. Only buyers of inexpensive primary homes can count on financing of up to \$450,000.

In both New York and Moscow, there are many opportunities, and although most people mistrust recommendations to buy, it does look like the worst is over and prices are unlikely to slide further. Of course, nobody is promising a rapid rally in either location tomorrow. But if you were waiting for the markets to hit the bottom, this point has most likely been reached.

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