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LEPATNER & ASSOCIATES HOSTS REAL ESTATE FORECAST CONFERENCE

You might not expect to hear a discussion of global fertility rates at a conference focused on the state of the American real estate industry. But Stuart Varney, the world-renowned economic trends watcher and contributor to Fox New Channel, didn't presume to preach about regional real estate dynamics to more than 200 of New York City's top industry executives when he appeared at an executive forum at the University Club in Manhattan in April.

The breakfast forum – titled "Real Estate Outlook: Is the Rebound for Real?" – was sponsored by LePatner & Associates LLP, The Rampart Group Insurance Associates, Sterling National Bank and Berdon LLP CPAs and Advisors.

Instead, Varney – an economist educated at the London School of Economics – told listeners what he saw going on in the global socio-economic climate so that they could use his insight to determine how the real estate landscape might pan out in the Big Apple and elsewhere around the country.

At the heart of Varney's commentary was his observation that America had enjoyed the world's strongest-performing economy for more than a decade. More important, this great economic engine will remain at the center of an emerging global economic paradigm where Europe and Japan will play increasingly smaller roles – and the US-Chinese relationship will emerge as "the most important economic relationship on the planet."

The implication?

There will continue to be a positive investment environment for U.S. real estate over the long term.

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Stuart Varney Brings Global Perspective to LePatner Forum

The conference panel, right to left: Stuart Varney, Barry B. LePatner, Esq., Steven Spinola, and Michael T. Cohen. The conference was sponsored by The Rampart Group, Sterling National Bank, Berdon LLP, and LePatner & Associates LLP. All photos © Steve Friedman.

SAVE THE DATE

Join us as we celebrate LePatner & Associates LLP's 25th Anniversary on November 9, 2005. Location, special guests, and presentations to be announced shortly.

BROKEN BUILDING:
FOREVER OVER-BUDGET, FOREVER OVERDUE

This article is excerpted from the forthcoming book ***Broken Building*** *by Barry B. LePatner, Esq. and Tim Jacobson which will be published in 2006.*

Build anything anywhere in America, or pretty much anywhere else, and the rule often is *caveat emptor.*

In construction, owners don't seem to have a choice. It always costs more and always takes longer than they thought. And almost always, if they want their building finished, owners are told they better put up and pay up. That hurts productivity, and these slowdowns, in turn, hurt the overall economy.

In absolute terms, construction is the largest industry in the world and is an enormously important part of most economies. In the U.S., it accounts for at least five percent of GDP. Since 1998, the industry has employed between 5.8 and 6.6 million Americans annually. That adds up to big bucks. The construction industry is now a trillion-dollar-per-year enterprise.

Yet the industry sits at the bottom of the productivity scale in the U.S. Higher construction productivity would mean more, better, or less costly construction projects. Lower prices would stimu-

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Varney supported his theory with information on the unexpected topic of fertility rates, which he said would be a driving factor in determining future economic performance. So much so that countries like Germany, Spain, Italy, Russia, all of Eastern Europe, Scandinavia and nearly every developed economy is poised to experience absolute population *decline* over the next few decades. That, in turn, will have dramatic effects on economies, particularly in areas like social policy, healthcare benefits and pension plans.

But while the rest of the developed world becomes less populous, U.S. fertility rates hover close to the magic number of 2.1 lives births per 1,000 women of childbearing age, a figure that allows for a near stasis in population growth. Moreover, the U.S. continues to accept a massive influx of immigrants -- immigrants, in fact, like Varney himself, an Englishman who has lived in the U.S. for 30 years and has six children. These new arrivals will continue to allow Americans to support their relatively high standard of living.

Varney did not ignore more traditional economic data like numbers on job growth, inflation, or unemployment. "Now, you look today at any economic barometer," he told forum attendees. "Out of almost every single one, America leads the pack." Indeed, unemployment in America today stands at 5.2 percent. "Any European government would kill for a 5.2 percent unemployment rate."

And though inflation is rising here, it is still at a historically low rate of three percent. Further, the American economy spawned 2.2 million new jobs last year and 60 percent of them were "managerial, technical, professional, middle-American jobs."

He compared and contrasted Western Europe, which created only one million net new jobs over the last five years. The United States does that roughly every six to seven months, he said.

America has a "firm grip" on the key industries of today and tomorrow. Varney asked if anyone in the room had bought a French or German computer in the last 15 years. Or could anyone even *name* one foreign brand? He noted that the world's top five computing companies all are American, all except NEC of Japan. Yet even NEC computers have American microprocessors from Intel.

Stuart Varney fielded audience questions with Spinola and Cohen.

It's the same story, he said, for software, pharmaceuticals, medical equipment, optical equipment, strategic materials, communications, and nanotechnology, the extreme miniaturization of computing power. "So we have America pulling away from the rest of the pack in terms of efficiency and size."

But the emerging counterbalance is China, which he called "the workshop of the world."

"China at this moment is sucking in every last barrel of oil, every ton of steel, every dollop of copper, lead, and cadmium. Every natural resource you can name, China is sucking it in and turning it into high-quality, low-priced products for export," Varney said. "That's why we're paying so much for oil, steel, and lumber." In his view, America is established as the center of the global economy and China as "the great maker of things."

"They make them. We buy them. It's the dynamism of China matched by the import market of the United States of America."

Barry LePatner delivered the opening remarks and introduced the expert panelists.

Panelists from **Real Estate Outlook: Is the Rebound for Real?** *From left to right, Michael T. Cohen, GVA Williams; Steven Spinola, President REBNY; Barry B. LePatner, Esq. Founder, LePatner & Associates LLP; and Stuart Varney, Economist and Commentator for Fox News.*

EXCERPTS from the EXPERTS

To read the entire conference transcript, go to **www.lepatner.com**

Steven Spinola,

President, Real Estate Board of New York

When it comes to real estate, you can't get a better investment than the city of New York.

This economy is doing extremely well because of tough decisions made by the previous and current administrations.

Can anyone remember fifteen to twenty years ago when crime rates were up? Then rates started to come down, thanks to a terrific job by our police department. Today, crime rates continue to decline. We remain the safest, large city in the country. That clearly means that people are willing to invest in this city.

We have has taken on dramatic zoning changes, opening up opportunities throughout the five boroughs. In the Hudson Rail Yards, the opportunity has been created for 38 million square feet of new development: 14 million square feet of residential, and twenty-four million square feet of commercial, a million of which is expected to be retail. This has already spurred major development and major purchasing of property on the West Side.

Since 2000, we're averaging more than 19,000 units of new residential permits a year, compared to an average of close to 7,000 in the 1990's.

Brooklyn is setting records in terms of housing production. A major downtown Brooklyn rezoning will permit four-and-a-half million square feet of new, Class A office space. Add that to the plan to bring the Jersey Nets back to New York and create a new environment there, and we have an opportunity to generate thousands of affordable housing units.

Along the Brooklyn waterfront between Williamsburg and Greenpoint, the City Council will adopt a plan permitting high-rises looking over the East River onto Manhattan. The best views will not be from tall Manhattan buildings, but from 35-story structures in Greenpoint and Williamsburg.

The first response to 9/11 was, "How do we create temporary office space to solve the problem of the people pushed out of their lower Manhattan offices?" We quickly realized there was a lot of office space available and people took that opportunity to put space on the sublet market. Rents continue to move up gradually, and vacancy rates have declined.

There is a major commitment for rebuilding the infrastructure downtown, including a new tunnel connecting downtown Brooklyn to lower Manhattan and bringing Long Island Railroad and JFK access directly into lower Manhattan, a $6 billion project.

Real estate taxes are at a dangerous tipping point. Office buildings in Manhattan pay 63% more taxes today than in 2000. Rental apartment buildings pay 83% more today in real estate taxes than in 2000.

I don't see a bubble in Manhattan or in the five boroughs. We're hitting numbers that maybe are stretching the point. Maybe we'll see a slowdown, but foreign money is continuing to come into the city. As the economy grows and jobs continue to grow, New York City will continue to be the home for businesses and for the financial sector.

Michael T. Cohen,

President and CEO, Williams Real Estate Co.
and Chairman, GVA Williams

U.S. cities fall into one of two categories. In "supply-constrained" cities, adding to the office or residential stock is difficult because of geographical, political, legal or capital obstructions. New York City is the quintessential supply-constrained city

In a "360 degree" city, by contrast, land is cheap and regulations are not an obstacle. Investment requires a relatively low level of capital. Buildings can spring up in response to market forces.

The stage is set for a classic recovery of New York's office market. When availability rates -- the percentage of office stock available -- dip below roughly ten percent, we start to see hyper-inflation of office rents.

Manhattan real estate sector comprises nearly 400 million square feet of office space. So remember that a ten percent availability rate here exceeds the total square footage in most U.S. cities.

Let's look at Manhattan's three key markets:

This last quarter, Midtown North office availability dipped below 10 percent for the first time in about a dozen quarters. A rental spike seems to be looming, possibly by 2006. The spike, already anticipated by investors, is probably no more than twelve to twenty-four months away.

By GVA Williams's definition, the heart of Midtown South starts somewhere north of where the numbered streets begin and stops just south of Grand Central. Its look and rhythm is similar to that of Midtown North. It's the classic "overflow" market where service businesses went 20 years ago. Space commonly rented for $30 to $40 a foot. After 9/11, as supply increased, rents declined. Its availability rate is 9.3 percent -- also below 10 percent. Thus much of what I said about Midtown North applies to this market too.

There's no place left to convert Manhattan industrial space to office space. We cannot manufacture B class office space, which is sort of the "sweet spot" in the marketplace for service companies.

In those Midtown South neighborhoods that have become friendly and classy, many office buildings that rented for $25 to $45 dollars now generate $800 to $1,200 dollars a foot as condominiums. Investors are buying them for $300 or more per square foot and turning them into residential buildings and condominiums.

Downtown's long-term outlook is terrific. The city needs it, because trends in Midtown North and Midtown South are going to leave a lot of moderately budgeted office space with no place to turn but downtown.

For tenants, this is probably a good time to wrap up a rental before the spike hits. If you can't do that, find ways to shorten your commitment and catch the next downturn, because, unfortunately I don't think we've rewritten the book on real estate cycles.

BROKEN BUILDING, *continued from p1*

late demand for higher quantities. In turn, there would be more construction work to go around. Thus, the question of productivity is, at its heart, an economic one.

The construction industry in the United States is, and has long been, characterized by many small firms. In 1985, the industry boasted 1.2 million firms and 5.5 million workers. By 1993, the number of construction firms had shrunk to about 600,000, 83 percent of which employed fewer than ten people. Only 59 firms employed more than 1,000 people and not even 900 companies employed more than 250. That's in an industry that in total employed over four million!

...consolidation will occur as soon as the construction market becomes truly competitive, and as soon as the contracts between general contractors and owners become a truly fixed cost.

The industry continues to be extremely fragmented. Though the average construction firm today is larger than it has been in the past, consolidation within the industry has proceeded much more slowly than in the manufacturing and financial services sectors.

Construction projects, even small ones, are complex affairs -- too complex to be left to the vagaries of the market. According to one recent study, at least 2,855 specific problems can arise on any given construction site, almost all related, directly or indirectly, to conflicts between disparate firms.

The solution, consolidation, will occur as soon as the construction market becomes truly competitive, and as soon as the contracts between general contractors and owners become a truly fixed cost. The reality of today's construction world is that a "lump sum" or "fixed price" or "guaranteed maximum price" contract is rarely what it appears to be. Few, if any, contractors are willing to take the full risk of such contracts, and so carefully orchestrated exclusions or "carve outs" open the doors widely to costly "extras," change orders that add on average ten to fifteen or at times 25 percent to the cost of the original contract.

This keeps the construction industry from ever being really competitive. Owners put plans out to bid. Contractors bid, and the lowest bidder (usually) wins. If the winning contractor bid too low, he or she often is faced with the need to do, or retain subcontractors who do, shoddy work, or charge the owner for every change in the plans. And due to architects' often incomplete or uncoordinated drawings or failure to include nitty gritty details, there are always changes in plans, which results in change orders.

Owners cannot easily complain because they know so little about the cost of building materials and labor. Moreover, it is extremely difficult and costly to stop a construction project in mid-stream in order to iron everything out. Once they have begun work, contractors are monopolists in practical terms. So what to do?

Previous attempts to reform the industry have failed because they have not addressed key problems, most notably the lack of knowledgeable representatives on the owner side and the lack of true fixed-cost contracts.

What most owners need is an intermediary, that reduces the information asymmetry by keeping tabs on contractors who successfully perform as contracted for by the terms of their agreements. Such an intermediary might guarantee the price stated in a bid in exchange for a premium paid by the contractor. In other words, construction companies would begin to compete. This would likely drive consolidation, which in turn would bring better management, more R&D, more use of technology and the like.

Second, widespread adoption of truly fixed-cost contracts would enhance industry competition, and hence performance, even without the introduction of intermediaries. And it certainly would help owners to save money. Very few owners or contractors spend much time with contracts, even on projects involving many millions of dollars. But following a few sensible rules can go a long way towards keeping the work moving on time and on budget.

FIRM NEWS

LePatner & Associates is proud to have recently shared its construction expertise with one of the nation's leading financial insitutions, J.P. Morgan Chase. In conjunction with outside counsel Paul Hastings, the firm assisted in the formulation and refinement of comprehensive national construction procurement and management policies prepared by the bank's senior management. LePatner then formulated a complete set of construction and design agreements and forms tailored specifically to J.P. Morgan Chase's exacting standards. Barry B. LePatner joined the bank's team and traveled the country to train its national project management staff on the proper and effective use of these unique tools.

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LePatner & Associates is celebrating its 25th Anniversary this year. To kick off the celebration in June, the firm held two luncheons for its entire staff and key consultants. The first focused on key events in the firm's history and the second examined the unique aspects of the firm's culture.

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LePatner & Associates congratulates Alexander Ferrini on being named a partner of the firm as of August 1, 2005. The firm also welcomes new associate Lee Stumacher, Esq. whose practice areas include construction law and commercial litigation.

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Barry LePatner was featured in two recent articles in the August 2005 issue of *The Real Deal.* The first, "Some Converted Condos Remain Unfinished," discusses warning signs for buyers of converted condominiums. The second, "Construction Costs Going Up," comments on the continued increase of construction costs in New York City. Read the articles at *www.therealdeal.net.*

QUOTE OF THE QUARTER

"Good people are good because they've come to wisdom through failure. We get very little wisdom from success you know."

William Saroyan

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