Real Estate Incubator

DUBAI IMPACT ON NYC LIMITED TO DISTRESSED HOTELS, BUT SIGNALS END TO SOVEREIGN WEALTH RESCUE

December 01, 2009 04:00PM

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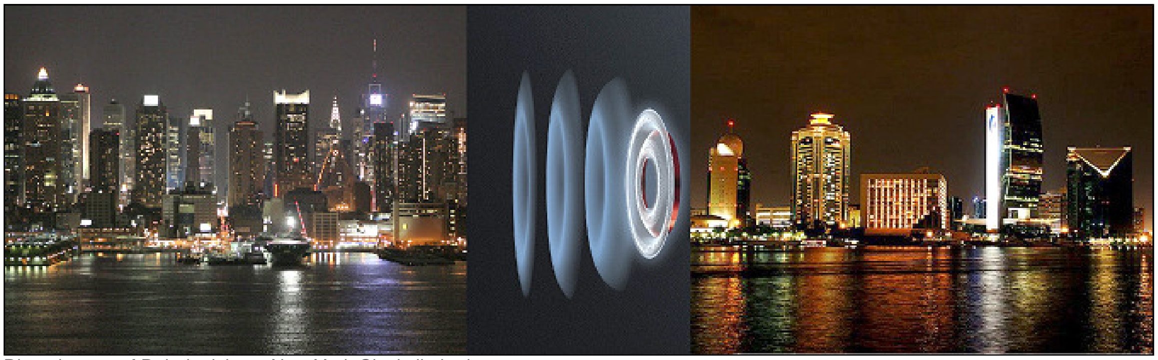

Direct impact of Dubai crisis on New York City is limited, experts say

As the international credit crisis spread into the kingdom of the United Arab Emirates, real estate experts said that while any direct impact on New York would be limited, it may signal the inability of sovereign wealth funds to bail out distressed assets here.

The financial world briefly shuddered last week after Dubai World, the main investment arm of the powerful Gulf region city-state, asked lenders for a six-month suspension of nearly $60 billion in debt payments.

Analysts say the suspension may force Dubai to sell many of their trophy assets around the world, including several high-profile buildings in New York, like the Jumeriah Essex House, the former Knickerbocker Hotel and the flagship W New York-Union Square hotel, whose mezzanine debt is scheduled for a Dec. 8 foreclosure auction.

"Dubai got drunk with debt just like we did here in New York," said Dan Fasulo, managing director of research at Manhattan-based investment research firm Real Capital Analytics. "A lot of people think Dubai [was financing its deals with] oil. In actuality, it was very much of a debt-fueled building boom."

In 2006, the W Union Square, at 201 Park Avenue South, was acquired by Istithmar, the investment arm of the Dubai government, for $285 million. Hotel experts say the W acquisition suffered from over-leveraged debt and high labor costs, while plagued by declining room rates and occupancies.

Ray Cirz, chief executive of Manhattan-based appraisal firm, Integra Realty Resources, said average hotel rates are down 25 percent from a year ago, to below $300 a night, a level not seen since 2004. At the same time, the occupancy rate is down to about 75 percent, also the lowest amount since that year.

Officials at Starwood, the parent company of W Hotels, were not immediately available for comment. The W New York Union Square debt includes $115 million mortgage loan, $60 million A note, $37 million B note and $20 million C note. According to the law firm of Allen & Overy, which is conducting the Dec. 8 auction, the C note will be on the block.

According to documents obtained by *The Real Deal*, the mezzanine debt was held by a firm called LEM Mezzanine, a Philadelphia-based firm with $450 million in private equity funds.

Kurt Hackett, vice president at LEM Mezzanine, was not immediately available for comment.

Within months, the firm acquired the iconic Knickerbocker Hotel at Times Square for $300 million. The firm planned to convert the Knickerbocker, which was being used as an office building, back into a five-star luxury hotel.

By 2007, Istithmar acquired a 73 percent stake in the Mandarin Oriental at the Time Warner Center. Istithmar paid a whopping $340 million for the property, which valued the hotel at more than $1.1 million per room, a price that analysts say was unsustainable.

"You run any kind of metrics on a purchase that high, you would have to have an astronomical room rate," Cirz said. Commercial real estate experts say that Dubai World will take a major hit on the purchase prices of these buildings if it's forced to sell anytime soon. By some estimates, these buildings could trade at 40 percent less than the prior sales prices. This would depend in part on how much cash a buyer could generate, versus financing the deals.

These assets also expose the myth of the sovereign wealth funds as some kind of financial angle for the real estate market. "If you look at what they did, they really leveraged everything up; they didn't spend their own money," said Eric Anton, executive managing director at Manhattan-based commercial brokerage Eastern Consolidated.

Nicholas MacLean, Middle East managing director at CB Richard Ellis, noted in a MSNBC interview that Abu Dhabi and Dubai projects are facing widespread foreclosure.

Commercial Real Estate Fallout

On the residential end in New York City, Jonathan Miller, president of appraisal firm Miller Samuel, said the impact on New York real estate would be limited at best, as a few high-profile developments were looking to sell units with investors from the Middle East.

In late 2008, superbroker Michael Shvo was actively marketing the W New York Downtown Hotel and residences at 123 Washington Street, to the Dubai market. Sales at that property began to stall as signs of the debt crisis began to rear their head earlier this year. Shvo was traveling and not immediately available for comment.

Attorney Ron Kremnitzer, co-chair of the commercial real estate group at Manhattan-based Pryor Cashman, said he was working with some investors who were looking to raise funds in the U.A.E., but wonders if this new financial crisis could put a chill on that deal.

This is yet another safety valve in the real estate community that has been blown away," Kremnitzer said.

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