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Manhattan Office Insight Report

Q3 2021

AVANT
by AVISON YOUNG

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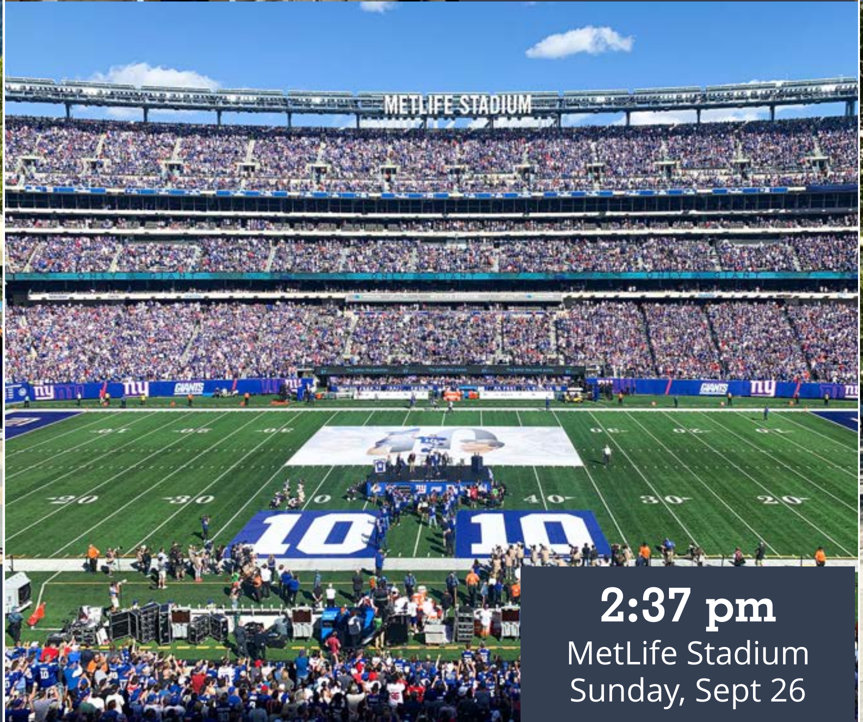
5:32 pm
Moynihan Station
Monday, Sept 27

8:56 am
Grand Central Terminal
Tuesday, Sept 28

11:48 am
Times Square
Sunday, Sept 26

12:27 pm
Bryant Park
Monday, Sept 27



2:37 pm
MetLife Stadium
Sunday, Sept 26

2:49 pm
Madison Square Park
Saturday, Sept 25

Key Manhattan office takeaways

Economic conditions

- The Manhattan unemployment rate of **7.8 percent** nearly equals the average unemployment rate for the five-year period following the Great Recession.
- Pandemic-induced Financial Activities job losses of **4.8 percent** and Professional and Business Services job losses of **3.3 percent** are less severe than these sectors' job losses during the Great Recession (8.5 percent and 7.1 percent, respectively) in the New York MSA. This indicates that underlying office employment fundamentals are comparatively strong.

Recovery rate

- There is a significant dichotomy between Manhattan return-to-work efforts and activity levels across other representative areas of interest. Office visitor volumes are **-70.9 percent** while healthcare (**-3.3 percent**) and education (**-11.6 percent**) have largely returned to pre-COVID levels versus the same period in 2019.
- Manhattan-based banking and finance firms have adopted hybrid work models (**-42.2 percent** visitor volume since Labor Day 2019), though flexible office providers have comparatively struggled (**-64.4 percent**).

Office demand

- Leasing activity improved during the summer months after a slow first half of 2021. Closed deals totaled **7.0 msf** in Q3 2021, up from a quarterly average of 5.6 msf in Q1 and Q2 2021.
- A leading indicator of future demand, tenants increasingly committed to longer-term leases. The average office lease term length has increased by **16.8 percent** since January 2021.
- The flight-to-quality trend has persisted – **all 34 relocations** greater than 50,000 sf have been to the same or higher quality properties compared with their original office locations since April 2020.

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Key Manhattan office takeaways

Office supply

- Availability rates remain at recent historical highs. The total availability rate of **18.2 percent** represents an increase of **220 basis points** compared with year-end 2020.
- Sublease withdrawals continued through the third quarter, partially abating additional supply risk. These removals have totaled **2.5 msf** since the start of 2021; however, the aggregate amount of sublease space of **22.7 msf** is still a post-2005 high.

Pricing trends

- Steady base rents and heightened concessions have caused net effective rents to soften, especially in the commodity sector of the market. Class A net effective rents decreased by **9.2 percent**, or from $66.62 psf to $60.51 psf, from 2020 to Q3 2021.
- Concessions packages have become more generous in recent months, indicating continued tenant-favorable market conditions. Tenant improvement allowances average **$106 psf**, representing an increase of **32.9 percent** since 2019.

Capital markets

- Asset pricing has dipped by **16.2 percent** since 2019, reflecting investors' more conservative underwriting assumptions, an elevated proportionate share of Class B and Class C trades and more leasehold transactions.
- Year-to-date investment volume is **$2.6B**, which is the weakest office investment activity reported since the credit crisis in 2009.
- The spread between cap rates and 10-year Treasury rates, measuring **298 basis points**, remains attractive for prospective core investors assessing cash-flowing assets.

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01.

Economic and demographic trends

Office visitor volumes have lagged those of other representative areas of interest, despite steady underlying employment fundamentals.

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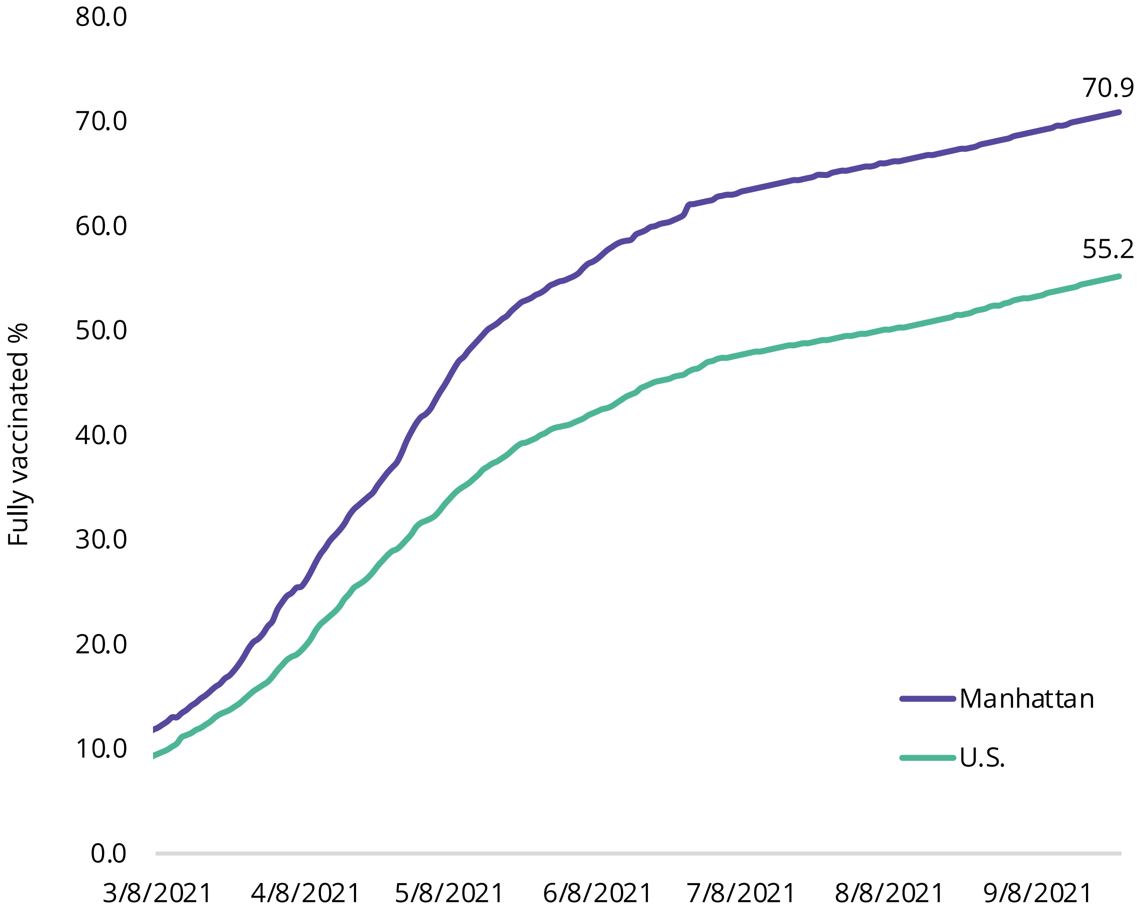
Vaccination rates

70.9%

Share of the total Manhattan population that is fully vaccinated

The City of New York announced the Key to NYC program to stem the spread of the delta variant. People who are aged 12 or above must show proof of vaccination before entering most indoor establishments.



Source: CDC

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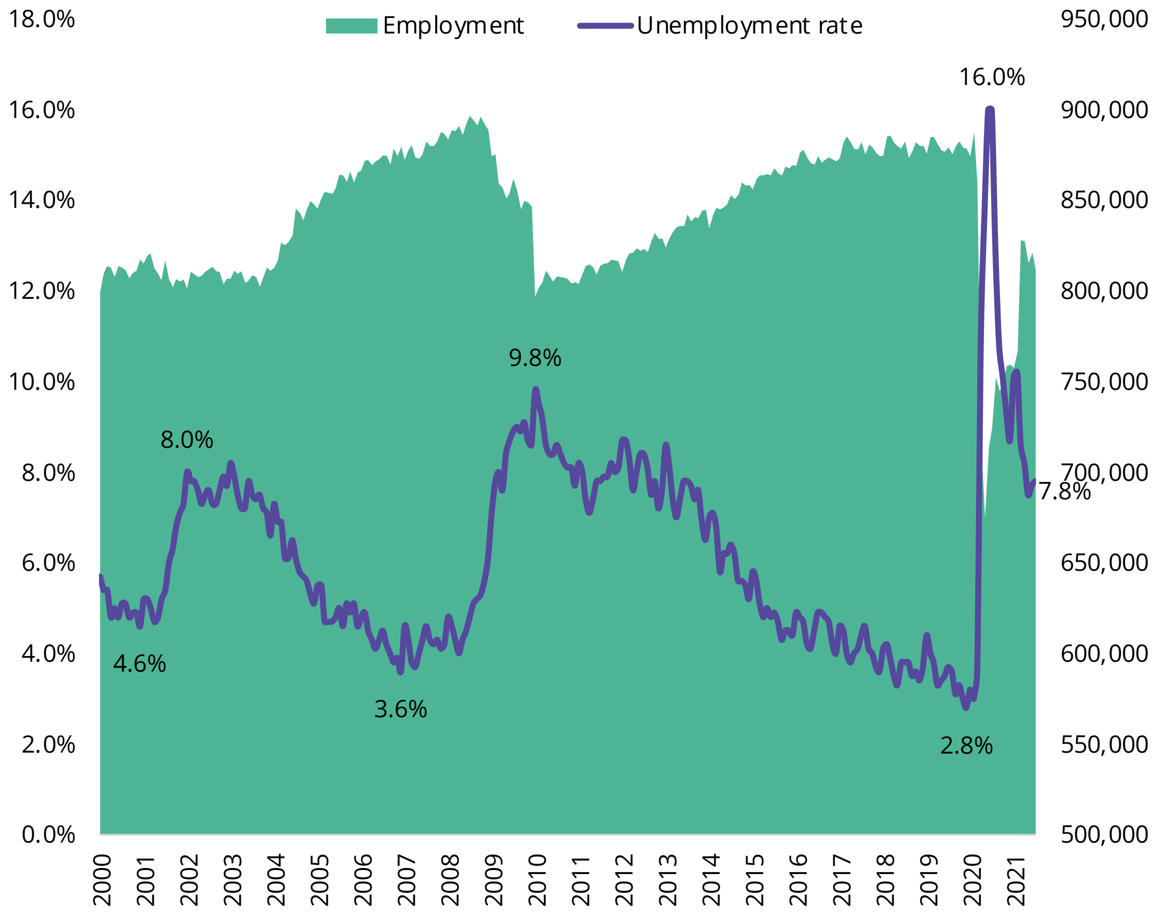
Employment and unemployment

7.8%

Manhattan unemployment rate as of July 2021, dipping below the height of the Global Financial Crisis

Reopening efforts have enabled job additions that have totaled 20.3% since the pandemic low in May 2020. The unemployment rate compressed by 820bp since the pandemic-high of 16.0% reported in June and July 2020, and the July 2021 unemployment rate of 7.8% is nearly equal to the average of 7.9% reported during the five-year period following the Global Financial Crisis.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

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Office-using job gains and losses

-5.3%

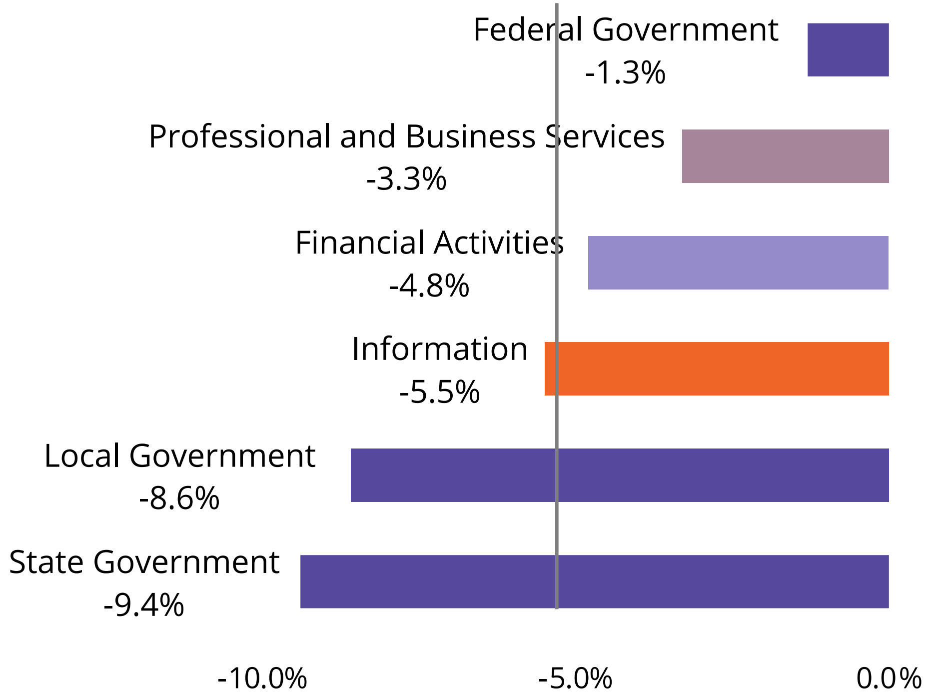
Change in office-using employment from February 2020 to July 2021

Pandemic-induced job losses in two leading office private sector industries have been less severe than the preceding recession: Financial Activities jobs contracted by 8.5% and Professional and Business Services jobs contracted by 7.1% in the Global Financial Crisis.

VIEW DASHBOARD

Total change in New York MSA* job gains/(losses)

February 2020 to July 2021



Note: Not seasonally adjusted data. Metropolitan statistical area includes New York City, Northern New Jersey, Long Island and southeast New York.
Source: Bureau of Labor Statistics

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U.S. return-to-work rates since start of COVID

-72.3%

Average office visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Return-to-work efforts across cities have been influenced by governmental regulations (informed by infection and vaccination rates), office-using industry composition and employees’ reliance on mass transit.

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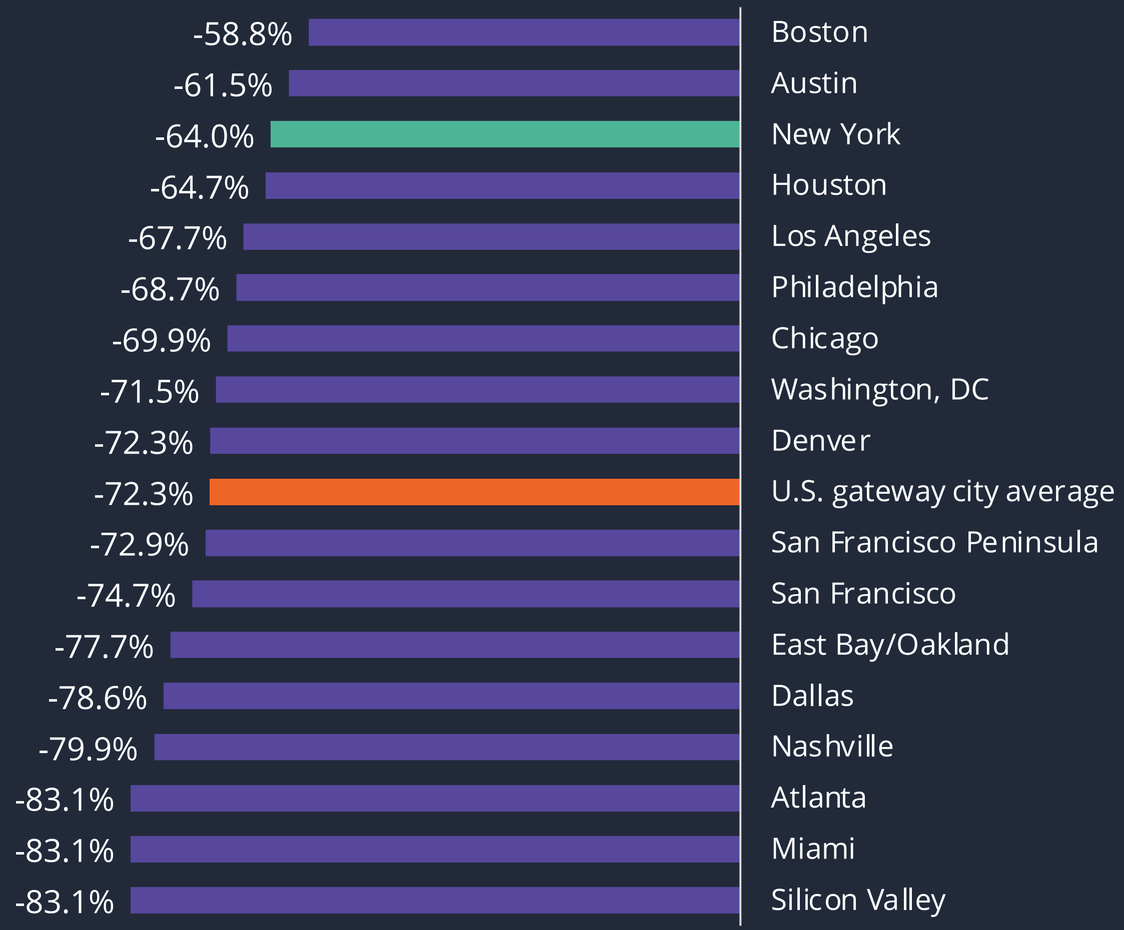

Note: Based on cell phone data for representative full-building office occupiers only. Weekdays only. March 2, 2020 is the week preceding the quarantine. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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U.S. return-to-work rates since start of COVID

-76.9%

Average tech office visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Tech companies have adopted remote work strategies more than most major office-occupying industries, while life sciences and real estate companies have embraced flexible in-office and remote working arrangements.

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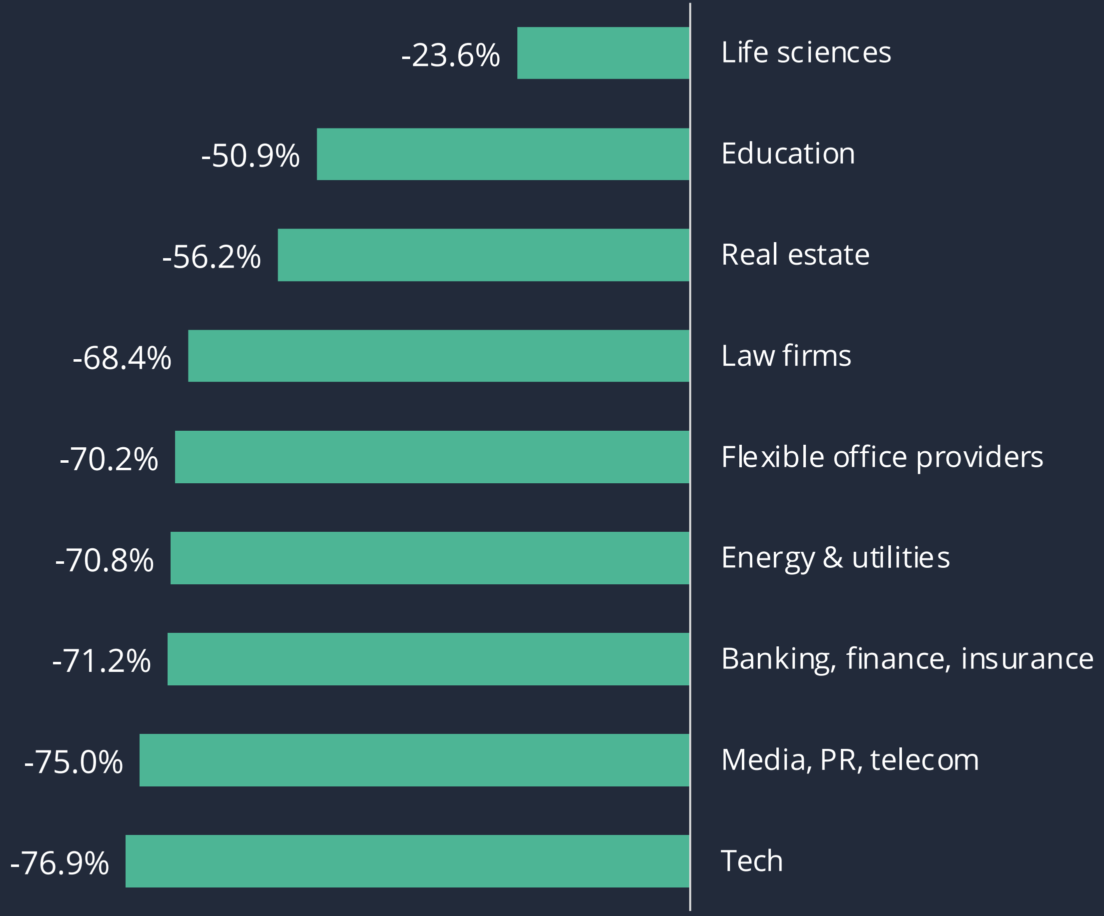

Note: Based on cell phone data for representative full-building office occupiers only. Weekdays only. March 2, 2020 is the week preceding the quarantine. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Local historical visitor volumes

-29.1%

Total visitor volume, September 16, 2019 vs. September 13, 2021

Healthcare (-3.3%) and education (-11.6%) have nearly returned to pre-COVID visitor volumes, while office (-70.9%) has lagged all other major areas of interest.

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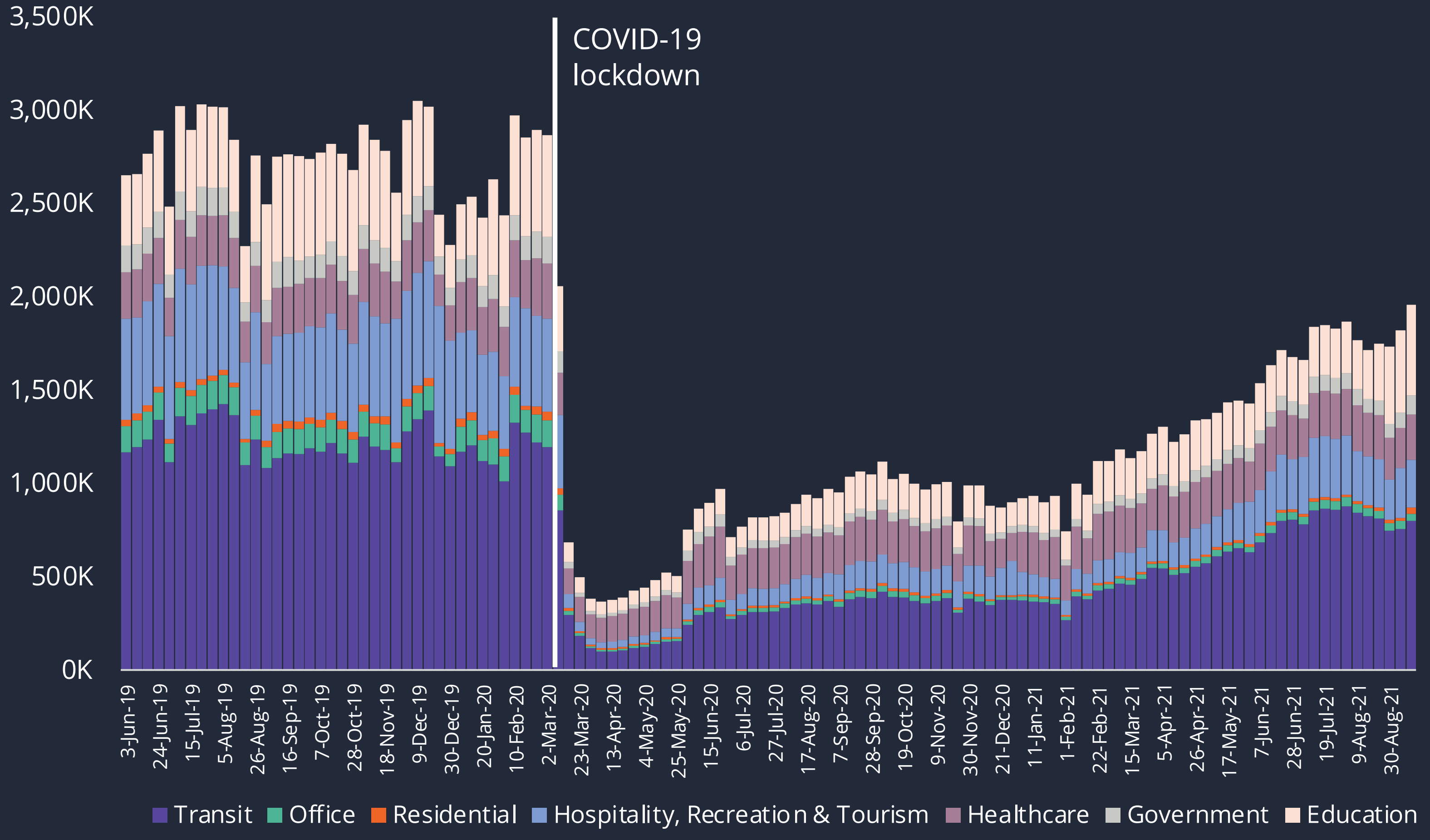

Note: Based on cell phone data for representative areas of interest. Weekdays only.
Weekly visitor volumes referenced above.
Source: Orbital Insight, AVANT by Avison Young

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Change in local activity levels, 2019 vs. 2021

-70.9% Office	**-39.1%** Retail	**-31.1%** Transit	**-3.3%** Healthcare
-11.6% Education	**-34.8%** Government	**-22.9%** Residential	**-47.6%** Hospitality & Tourism

Note: Based on cell phone data for representative areas of interest only. Weekdays only.
Week of September 16, 2019 vs. week of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Local return to work efforts by industry

-42.2%

Combined banking and finance office visitor volumes, September 20, 2021 vs. Labor Day 2019

Manhattan financial services firms have enforced hybrid remote/ in-person work schedules, though creative companies have largely adopted remote work strategies.

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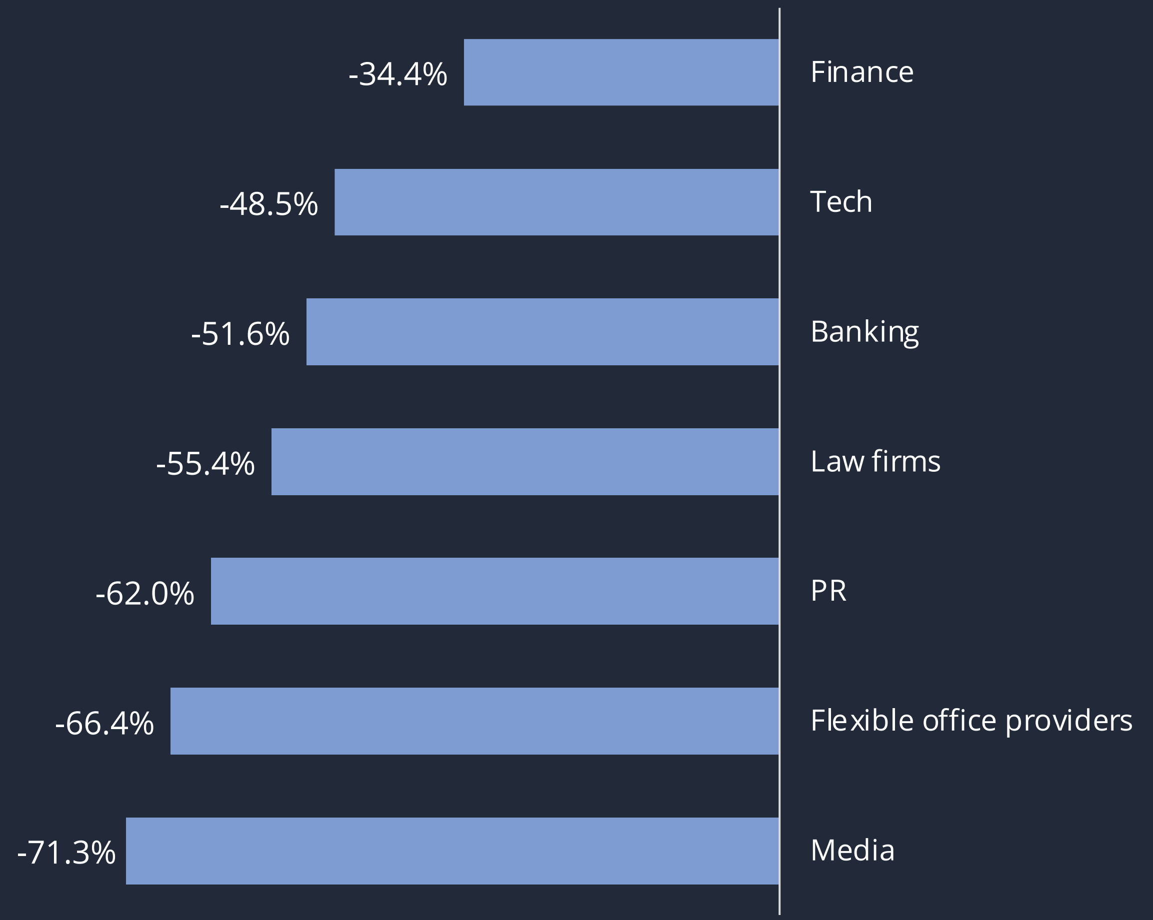

Note: Based on cell phone data for representative full-building office occupiers only. Weekdays only. March 2, 2020 is the week preceding the quarantine.
Source: Orbital Insight, AVANT by Avison Young

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Employers are embracing hybrid work models

According to an August 2021 survey conducted by Partnership for New York City, most New York City employers are allowing their workforce to work on rotating or hybrid work shifts. The survey also found that the delta variant caused 44% of New York City office employers to delay their return-to-work plans.

70%	26%	5%
Hybrid work model	Full-time in office	Return to office not required

Note: Total is greater than 100% due to rounding
Source: Partnership for New York City (August 2021)

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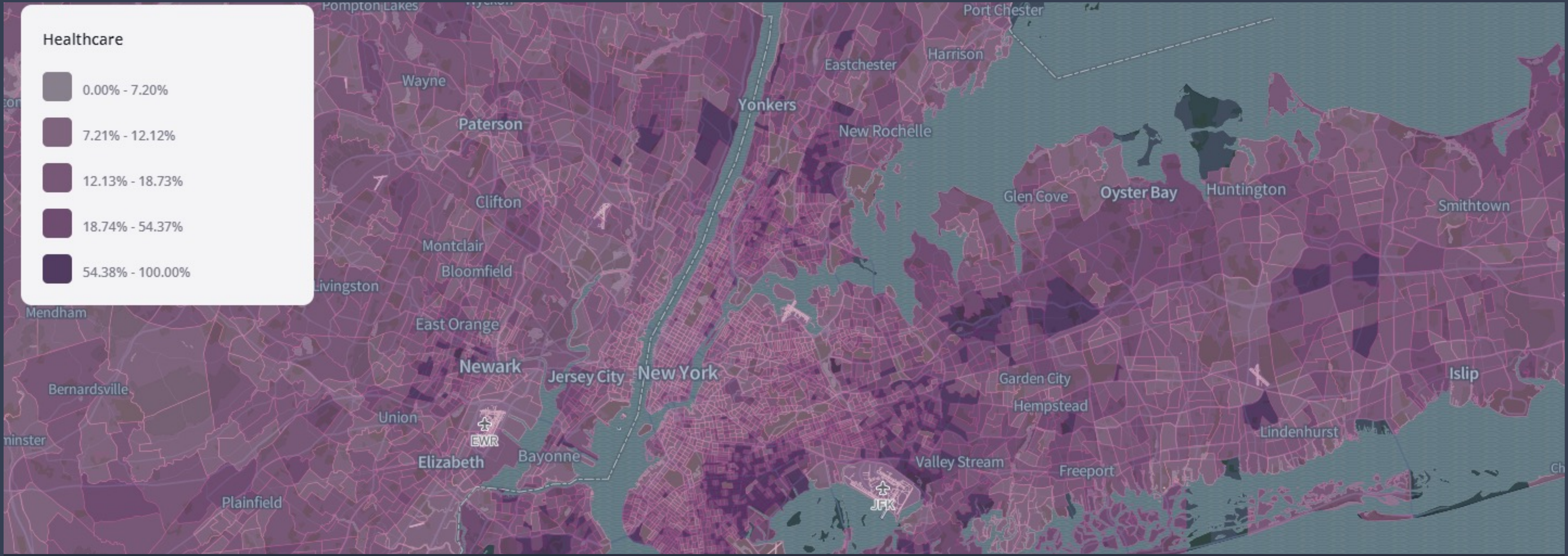
Healthcare worker heat map



Healthcare is one of a few sectors that has returned to pre-COVID activity levels, reigniting the war for talent in that industry.

Source: AVANT by Avison Young
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Office occupier conditions

Leasing activity improved modestly in the third quarter from a slow first half of 2021. Heightened concessions that are being offered to induce tenant commitments have caused net effective rents to continue to soften.

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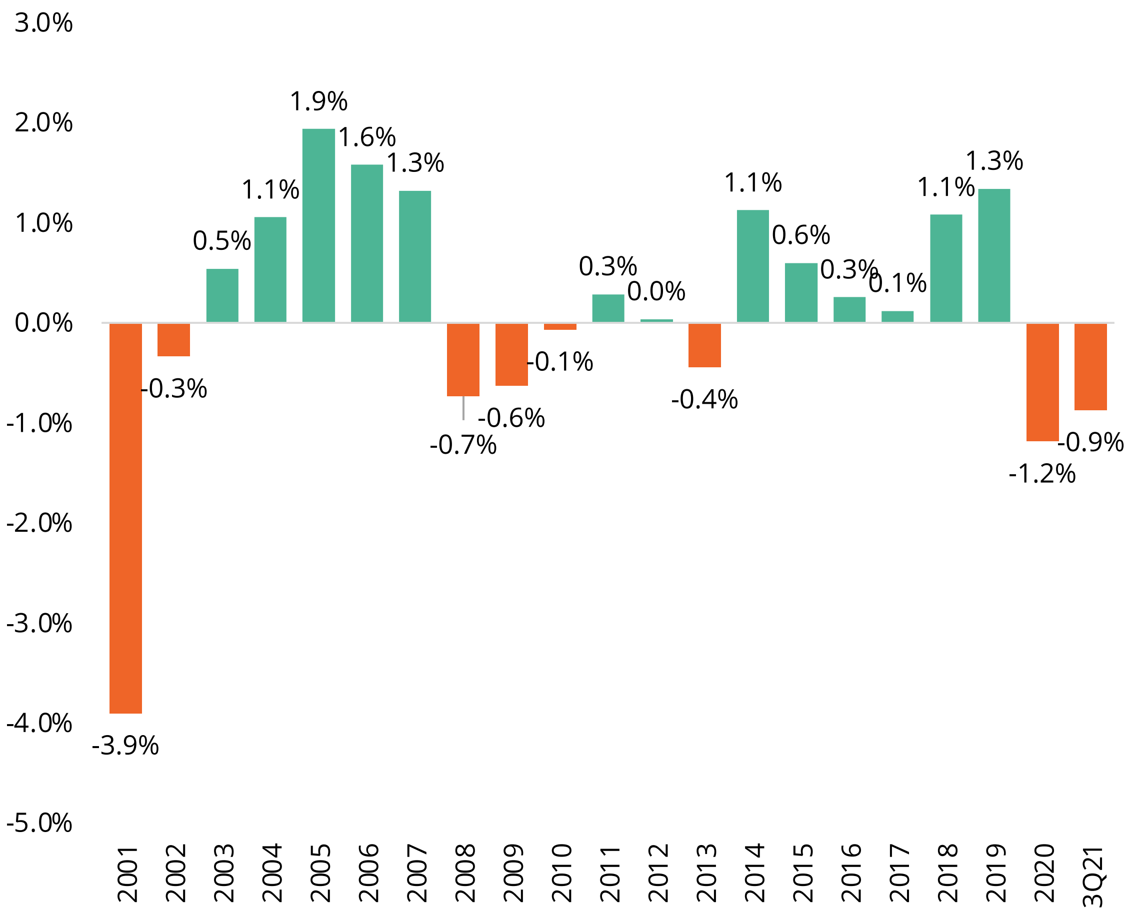
Absorption

-2.1%

Net absorption as a percentage of inventory, 2020 through Q3 2021

Net absorption continued to trend negatively, totaling -4.5 msf year-to-date in 2021 after totaling -6.1 msf in 2020. Positive absorption is unlikely until more office occupiers begin to navigate their medium- and long-term space needs with more conviction, with return-to-office efforts serving as one of the first steps in that process.



Note: Absorption is measured as the year-over-year change in occupied square feet.
Source: CoStar, AVANT by Avison Young

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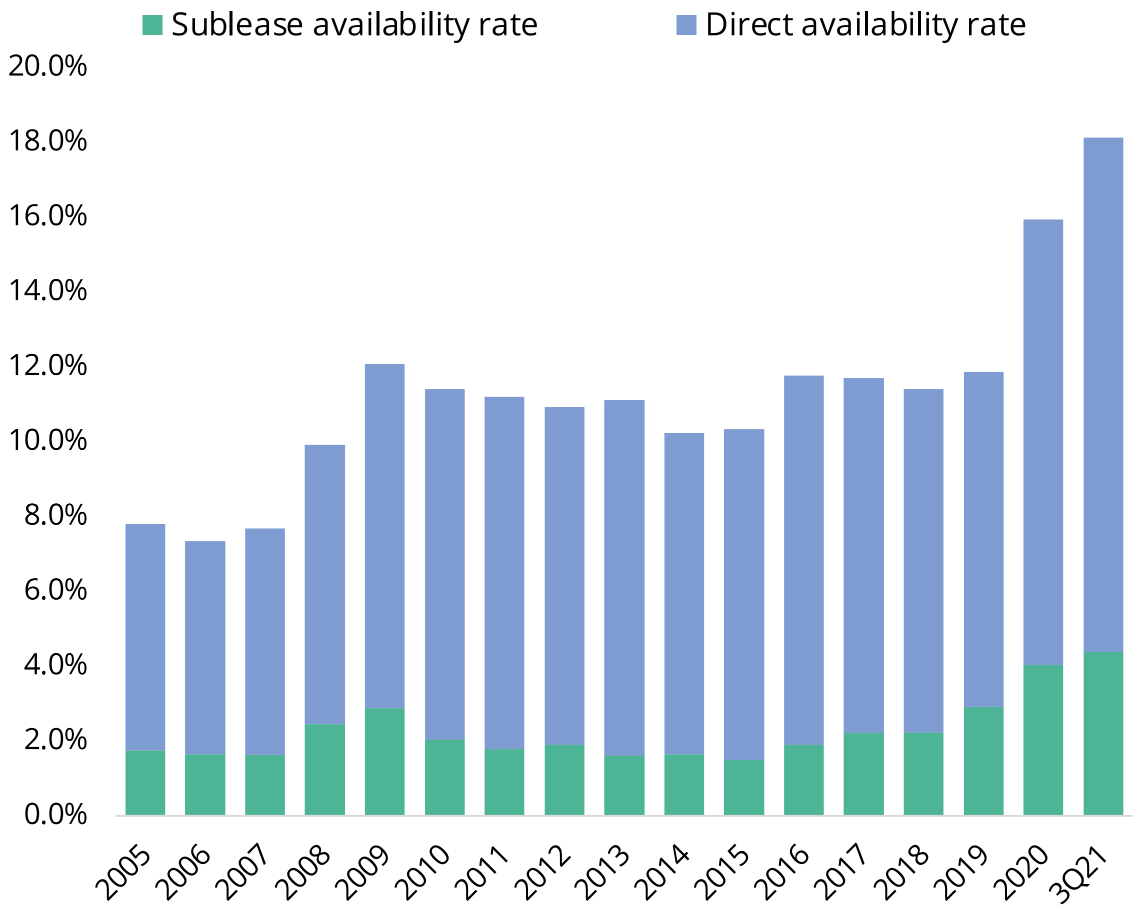
Availability rate

18.2%

Post-2005 high Manhattan availability as of Q3 2021

Direct and sublease availability rates remain elevated despite an uptick in demand in recent months. At 13.8% and 4.4%, direct and sublease availability rates remain at the highest levels observed since at least 2005, respectively. There is more acute supply risk in the Class B and C market segments, which posted an availability rate that has increased by 290bp year-to-date to 19.2%.



Note: References available spaces at existing, under construction and under renovation properties with an indefinite horizon.
Source: CoStar, AVANT by Avison Young

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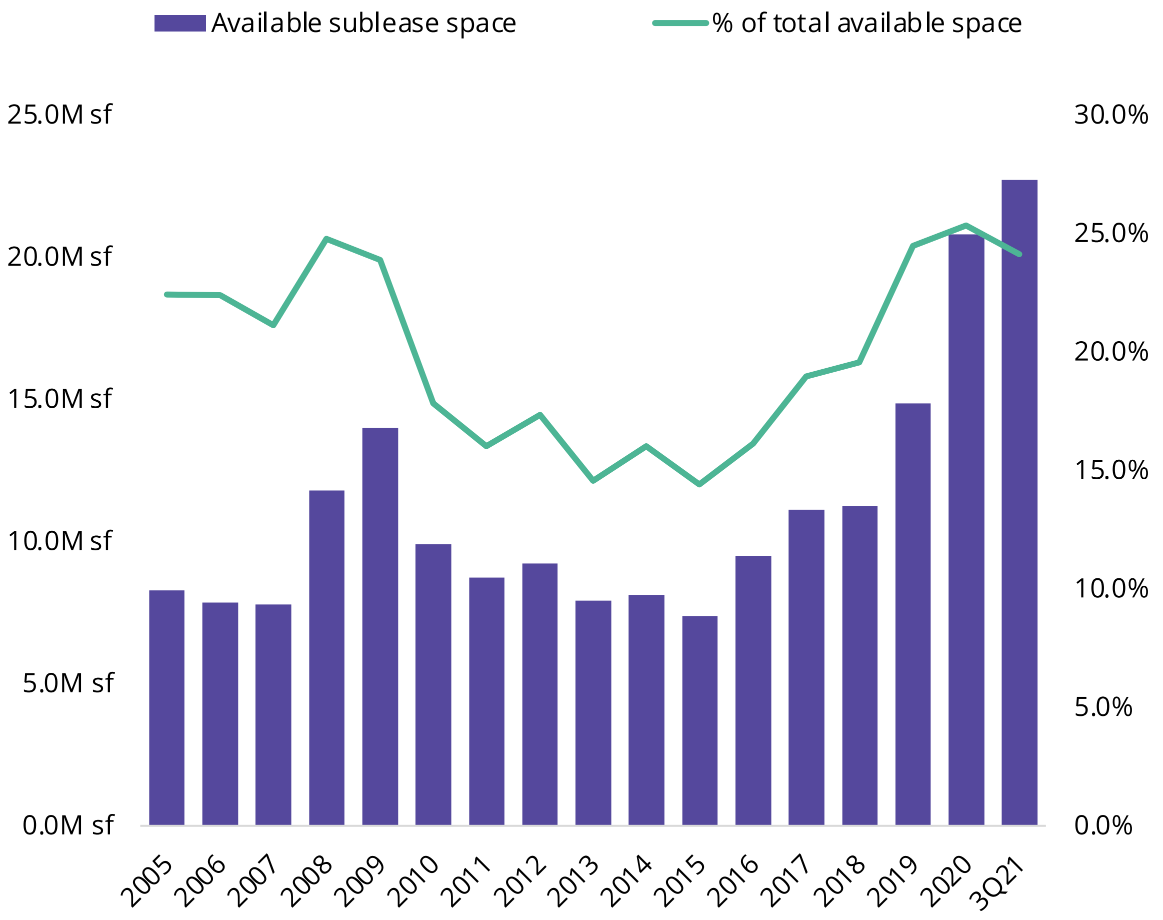
Available sublease space

22.7 msf

Post-2005 high available sublease space as of Q3 2021

Tenants have more sublease optionality in the current environment compared with the Global Financial Crisis. The scale of sublease (22.7 msf) and direct (71.5 msf) availabilities has no modern precedent; however, the proportionate share of sublease-to-total availabilities of 24.1% is slightly lower than 2019 levels of 24.5%.



Note: References available spaces at existing, under construction and under renovation properties with an indefinite horizon.
Source: CoStar, AVANT by Avison Young

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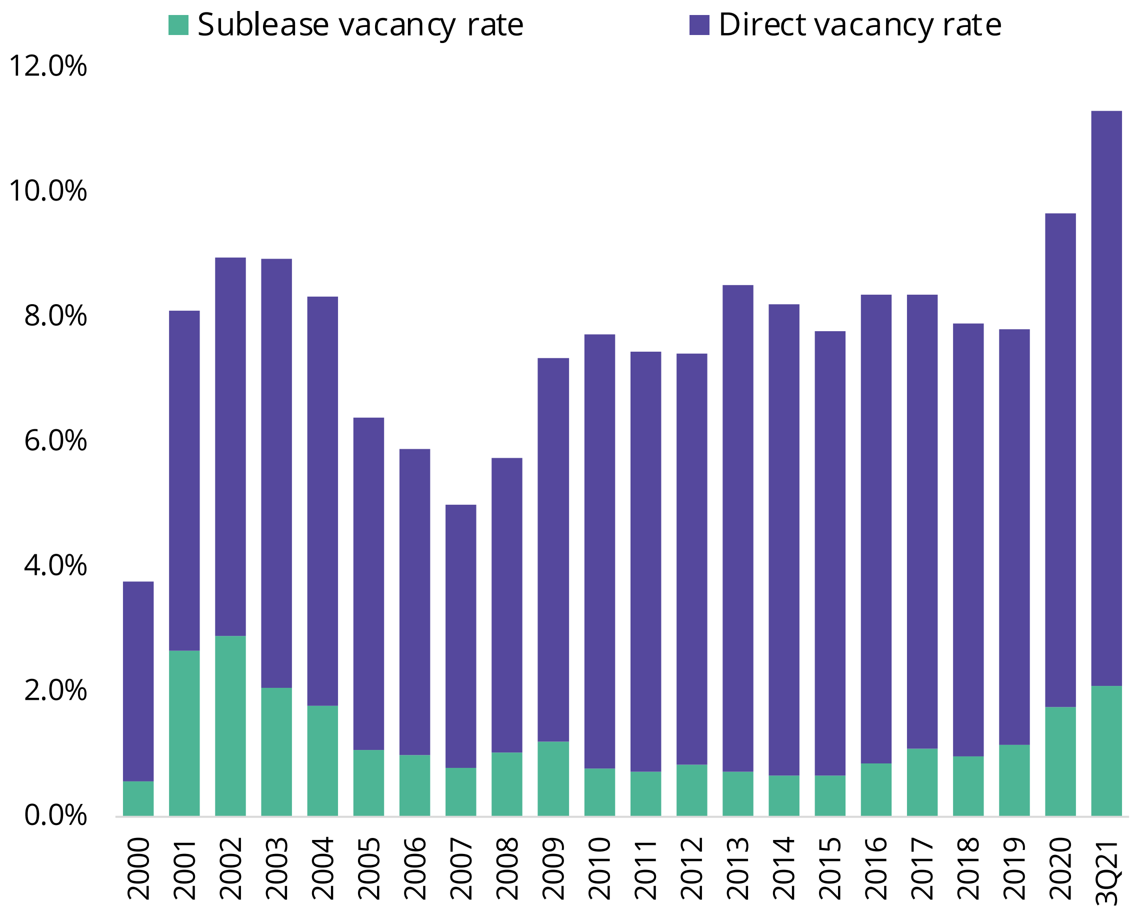
Vacancy rate

11.3%

Post-2000 high Manhattan vacancy as of Q3 2021

The direct vacancy rate of 9.2% in Q3 2021 remained at a post-2000 peak. The current sublease vacancy rate of 2.1% represents a post-2003 peak but has not reached 2001 (2.7%) nor 2002 (2.9%) levels.



Note: References vacant, ready-to-occupy space.
Source: CoStar, AVANT by Avison Young

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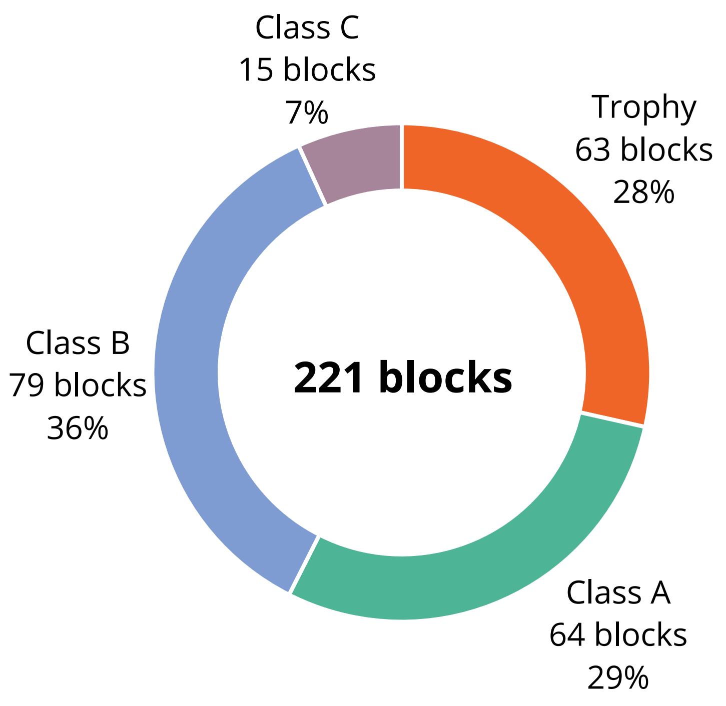
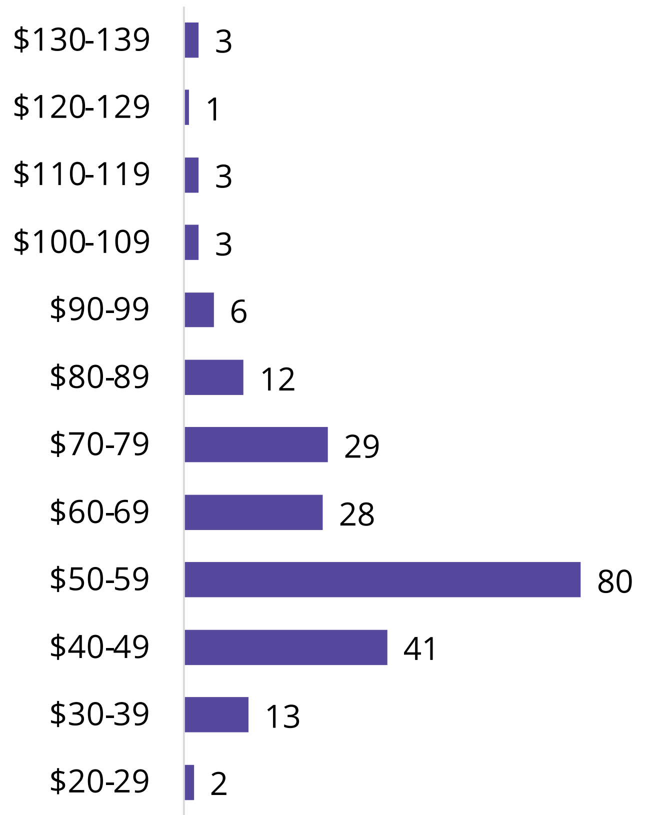
Sublease supply pipeline

Building classification



Asking rent per square foot



Note: 20,000 sf and greater blocks
Source: AVANT by Avison Young

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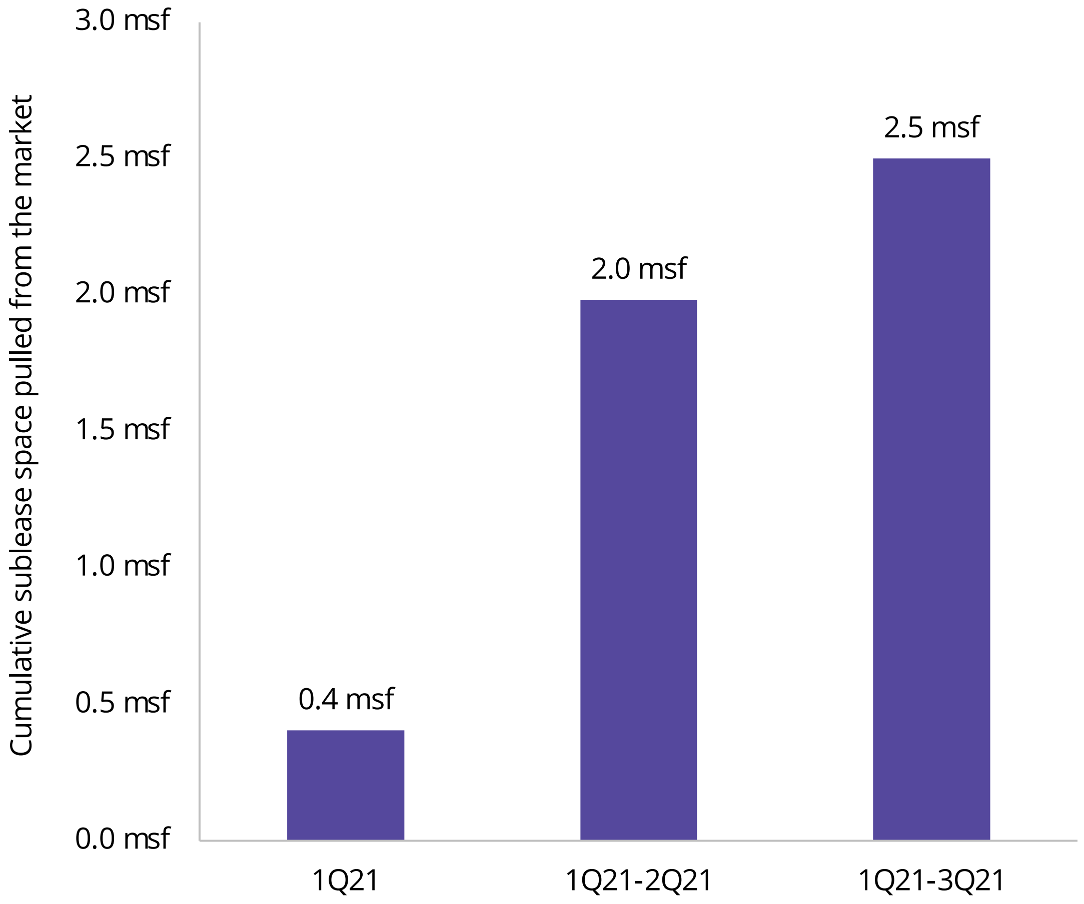
Sublease availabilities pulled from the market

2.5 msf

Post-COVID sublease space withdrawn from the market

Some prospective sublandlords have pulled their availabilities from the market as return-to-work milestones near and limited demand recalibrates sublease recovery rates. These sublease withdrawals have averaged 53,201 sf with remaining lease term lengths of 7.1 years.



Source: AVANT by Avison Young

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Office leasing activity

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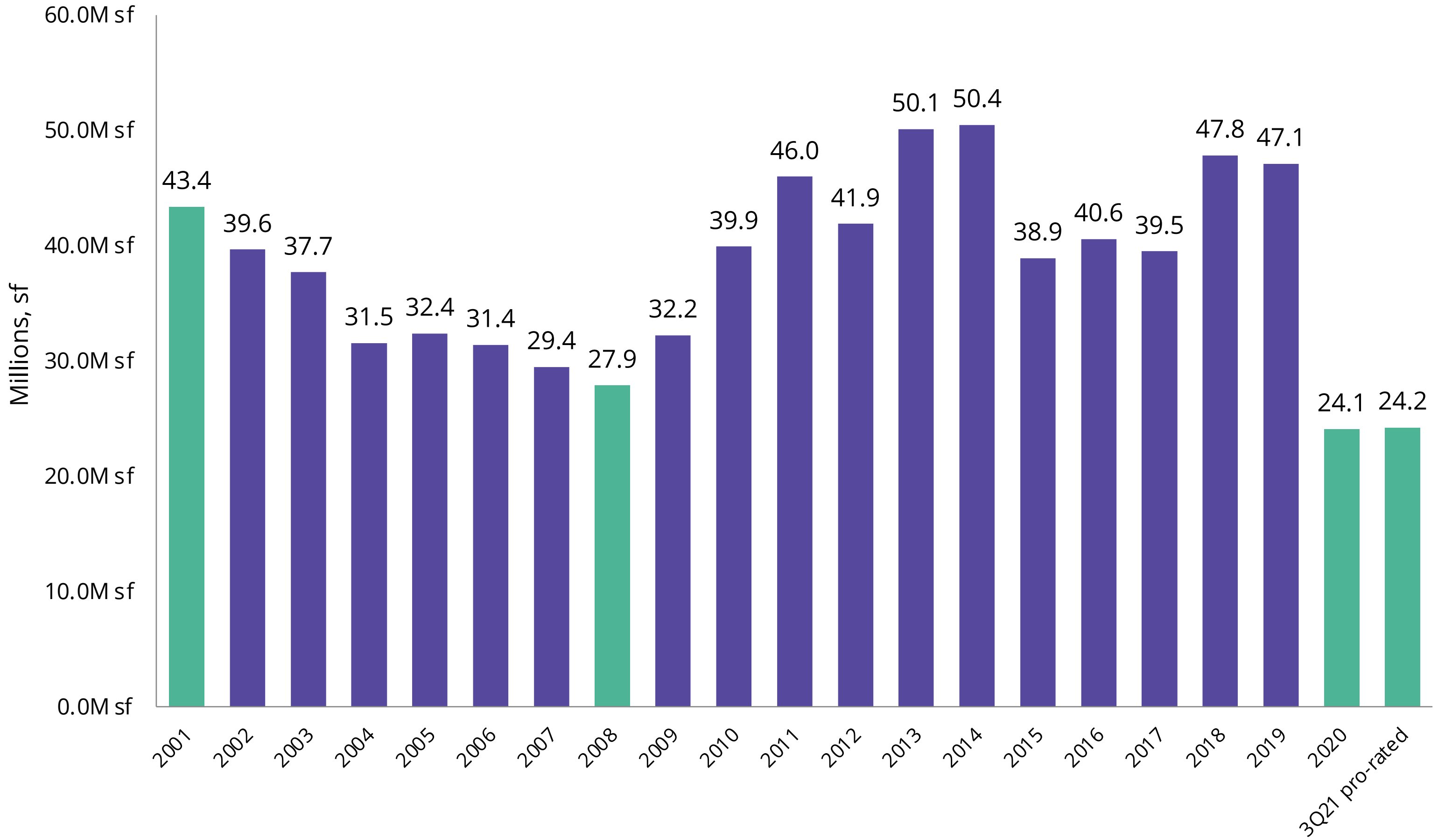
-38.6%

2020-pro-rated 2021 vs. prior 20-year annual average leasing activity

Leasing activity showed signs of improving after a slow first half of 2021, increasing from 4.8 msf in Q1 2021 to 6.4 msf in Q2 2021 to 7.0 msf in Q3 2021. However, the annualized pace of closed deals remains the weakest reported since at least 2001.



Source: CoStar, AVANT by Avison Young

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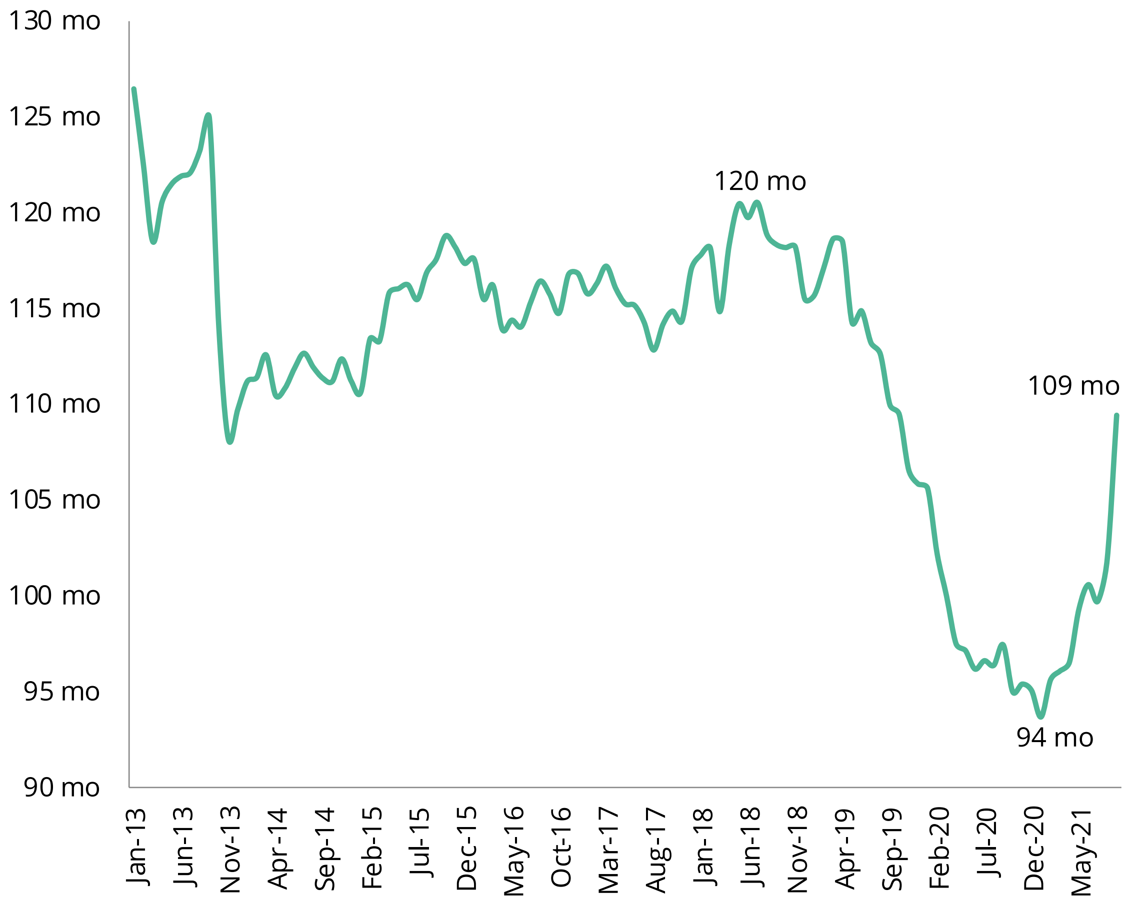
Average office lease term

109 mos

12-month moving average of office lease term lengths

A potential leading indicator of future demand, tenants increasingly committed to longer-term leases in the third quarter. The average office lease term length has increased by 15.8 months or 16.8% since the beginning of 2021. Further, Google announced that it will purchase its Hudson Square headquarters for $2.1B in early 2022.



Source: AVANT by Avison Young

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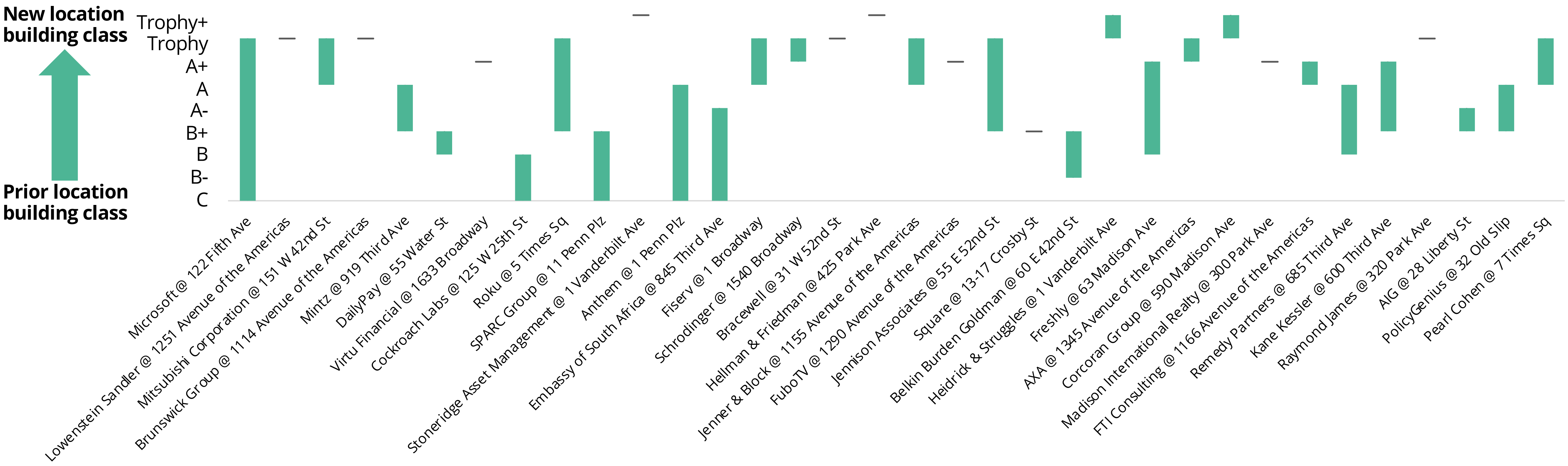
Post-COVID flight to quality trend

34 out of 34

Relocations by 50,000+ sf tenants to the same or higher quality properties



Note: 50,000 sf or greater relocations from April 2020 to September 2021.
Excludes leases signed by net-new market entrants.
Source: AVANT by Avison Young

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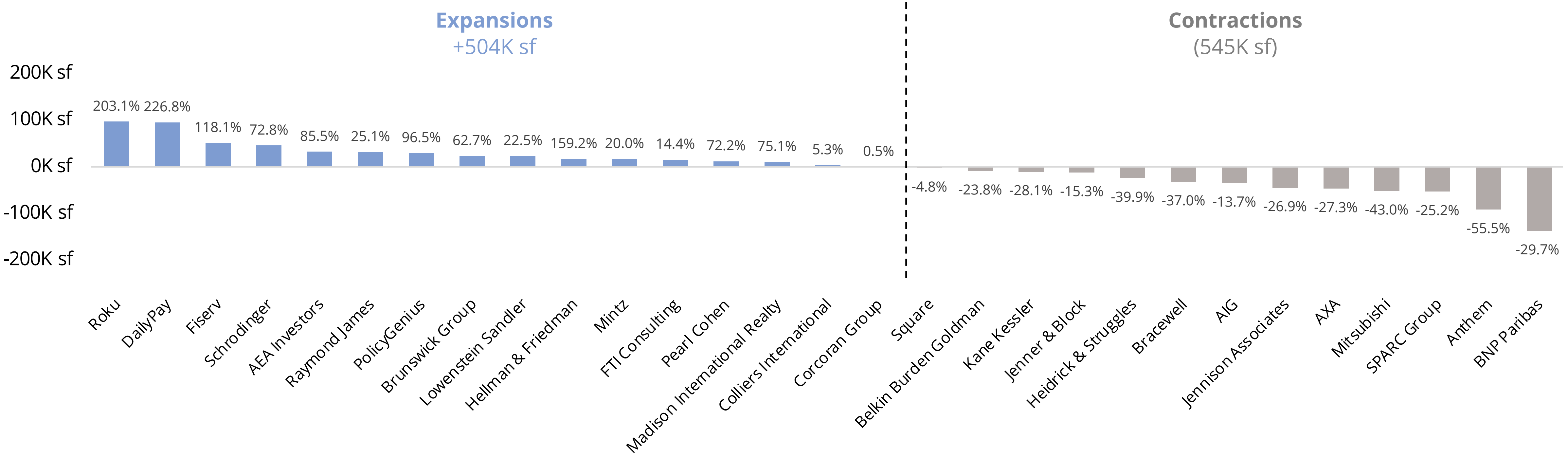
Post-COVID expansions and contractions

78.7% Average expansions by representative 50,000-sf lessees from April 2020 to September 2021

28.5% Average contractions by representative 50,000-sf lessees from April 2020 to September 2021

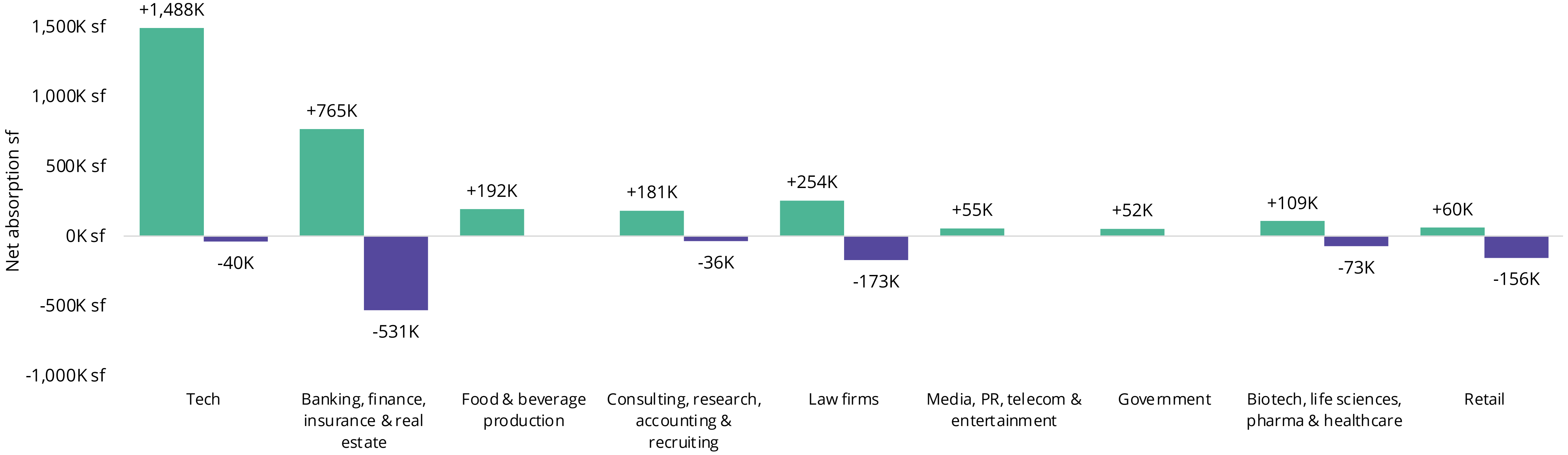


Note: Representative 50,000 sf or greater leases signed from April 2020 to September 2021.
Excludes leases signed by net-new market entrants.
Source: AVANT by Avison Young

Post-COVID expansions and contractions

1.4 msf

Positive absorption by tech firms from April 2020 to September 2021



Note: Representative 50,000 sf or greater leases signed from April 2020 to September 2021.
Includes leases signed by net-new market entrants.
Source: AVANT by Avison Young

Transaction activity by lease type

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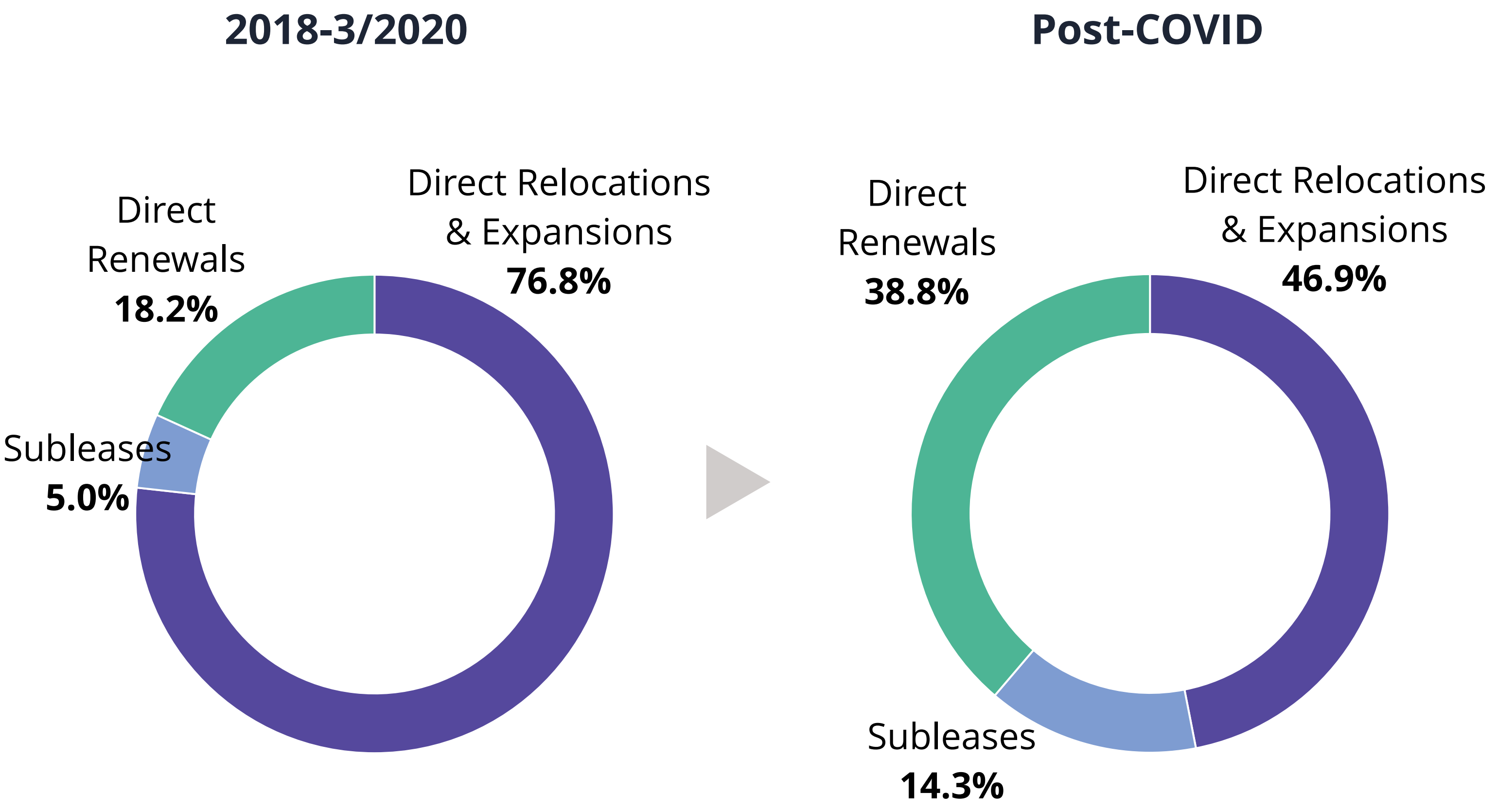
38.8%

Renewals share of total Manhattan post-COVID office leasing activity

Renewals have become more common during the pandemic, but their share has waned since Q2 2021 (41.6% of post-COVID leases from 2020 to Q2 2021). Subleases have been a popular option for occupiers considering new office locations.



Source: AVANT by Avison Young

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Trophy and Class A lease economics

Period	Average base rent	Average free rent period	Average tenant improvement allowance	Average net effective rent
2018 to 03/2020	$75 psf	8 months	$91 psf	$70 psf
04/2020 to 09/2021	$90 psf	11 months	$125 psf	$70 psf

Note: Direct relocations only. Concessions are normalized for 10-year lease terms.
Source: AVANT by Avison Young

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Class B and Class C lease economics

Period	Average base rent	Average free rent period	Average tenant improvement allowance	Average net effective rent
2018 to 03/2020	$61 psf	6 months	$68 psf	$51 psf
04/2020 to 09/2021	$63 psf	9 months	$96 psf	$44 psf

Note: Direct relocations only. Concessions are normalized for 10-year lease terms.
Source: AVANT by Avison Young

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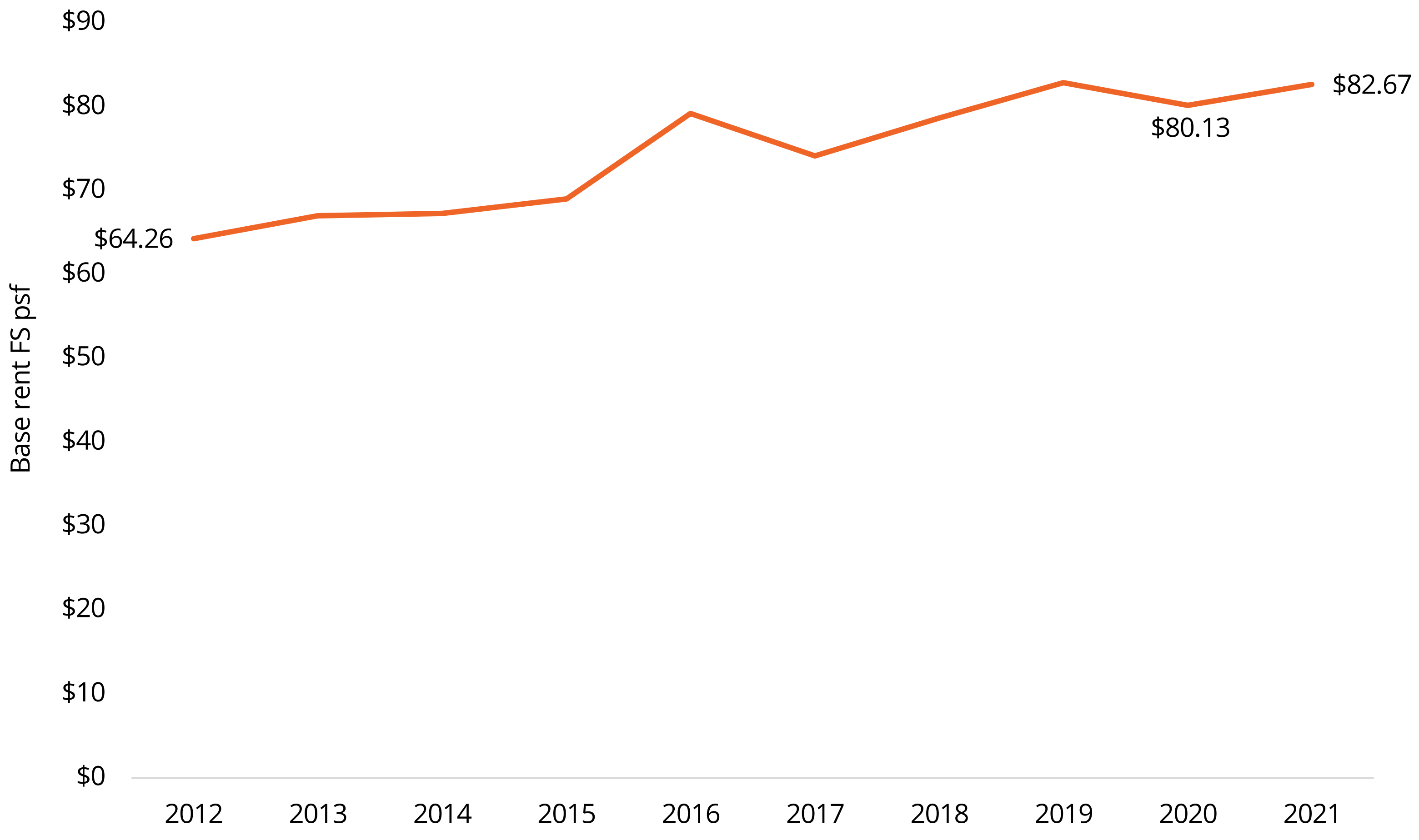
Base rents

-0.2%

Change in base rents, 2019 to 2021

The modest year-to-date increase in base rents of $2.54 psf is reflective of the disproportionate demand at the top of the market, not prevailing landlord-favorable market conditions.



Note: Direct relocations for Trophy, Class A, Class B and Class C properties.
Excludes subleases, expansions and renewals.
Source: AVANT by Avison Young

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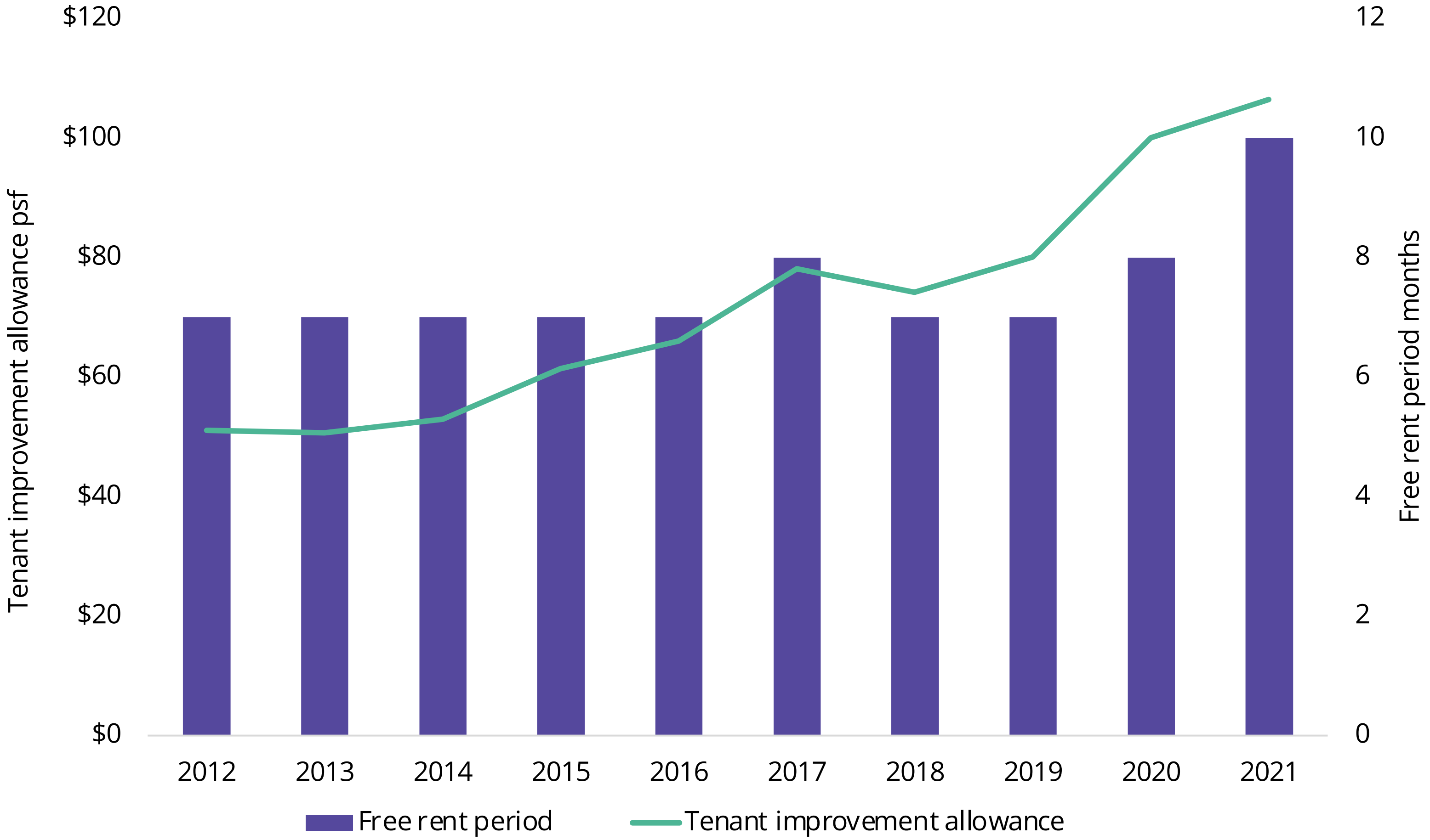
Concessions

+32.9%

Change in tenant improvement allowance amounts, 2019 to 2021

Landlords have offered record levels of concessions packages to induce tenants to make long-term commitments, regardless of building location and quality.



Note: Direct relocations for Trophy, Class A, Class B and Class C properties.
Normalized to 10-year lease terms.
Source: AVANT by Avison Young

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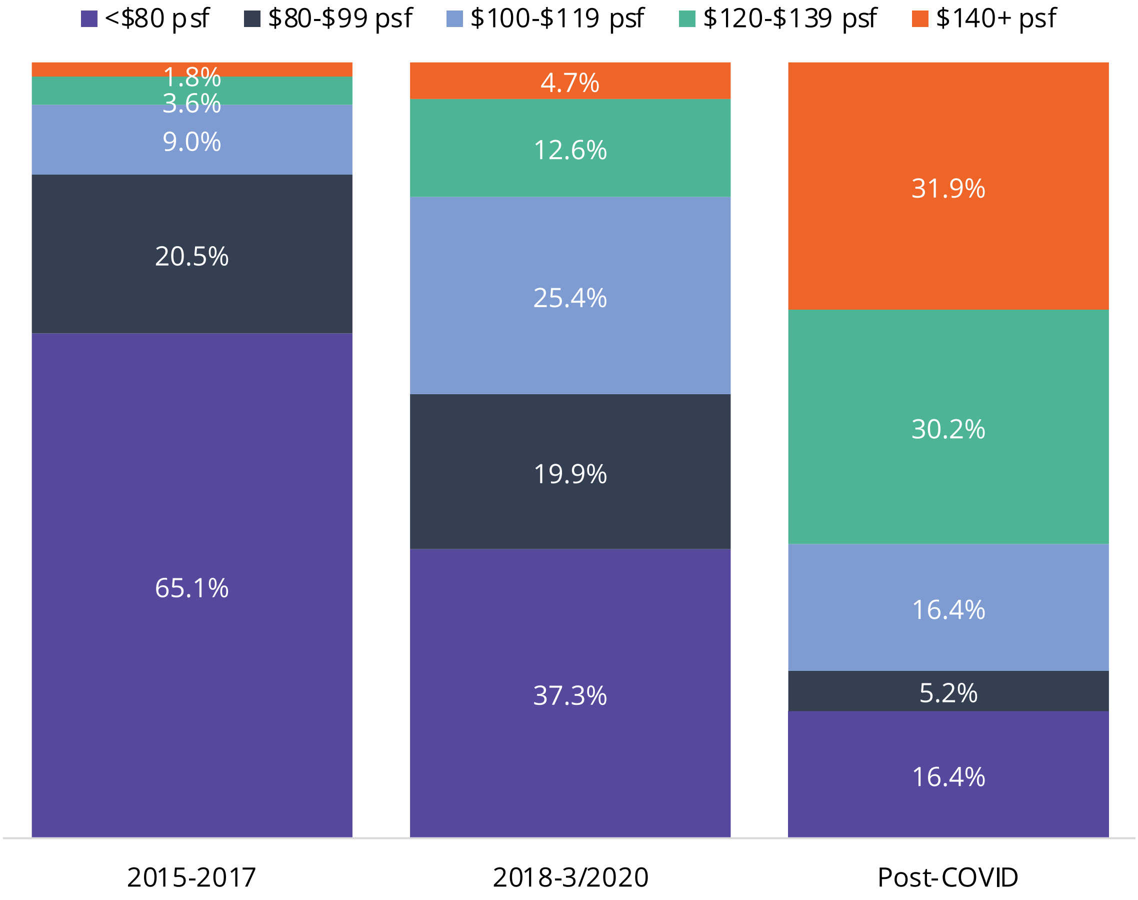
Tenant improvement allowances

78.5%

Manhattan direct relocations receiving $100 psf or greater tenant improvement allowances since 4/2020

Landlords have offered increasingly generous tenant improvement allowances to induce long-term commitments as the leasing cycle matured. The post-COVID concessions packages are partially caused by leasing activity at top-of-market properties, which traditionally provide higher concessions packages.



Note: Tenant improvement allowances for direct relocations with lease terms of 10 years or greater.
Source: AVANT by Avison Young

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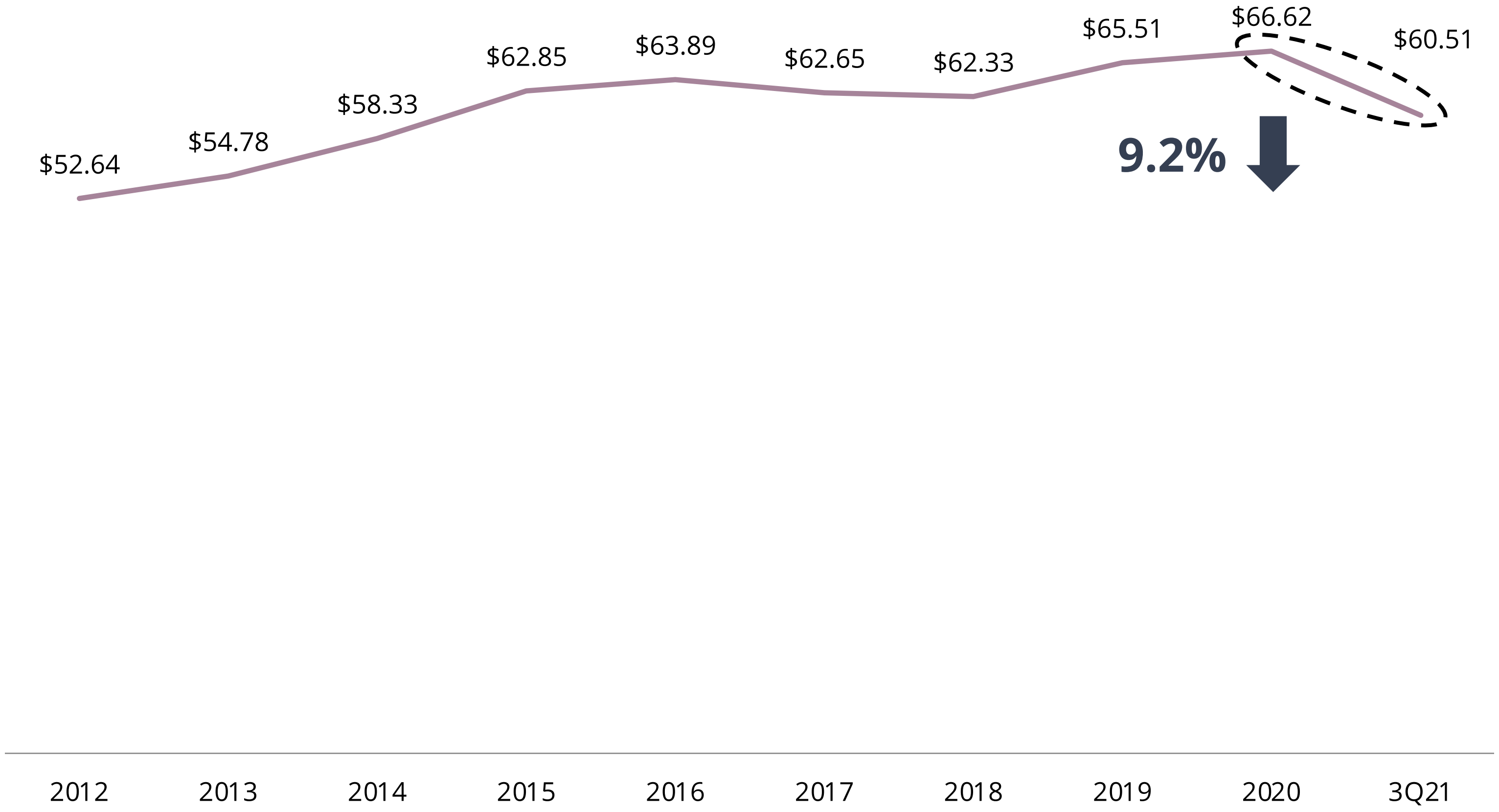
Class A net effective rents

-9.2%

Change in Manhattan net effective rents from 2019 to September 2021

Heightened concessions packages have caused net effective rents to soften throughout 2021. Continued downward momentum is expected as supply is poised to outstrip demand, particularly in the commodity sector.



Note: Class A office properties. Excludes subleases, renewals and expansions.
Source: AVANT by Avison Young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Office development pipeline

61 properties

proposed or under construction

41.6 msf

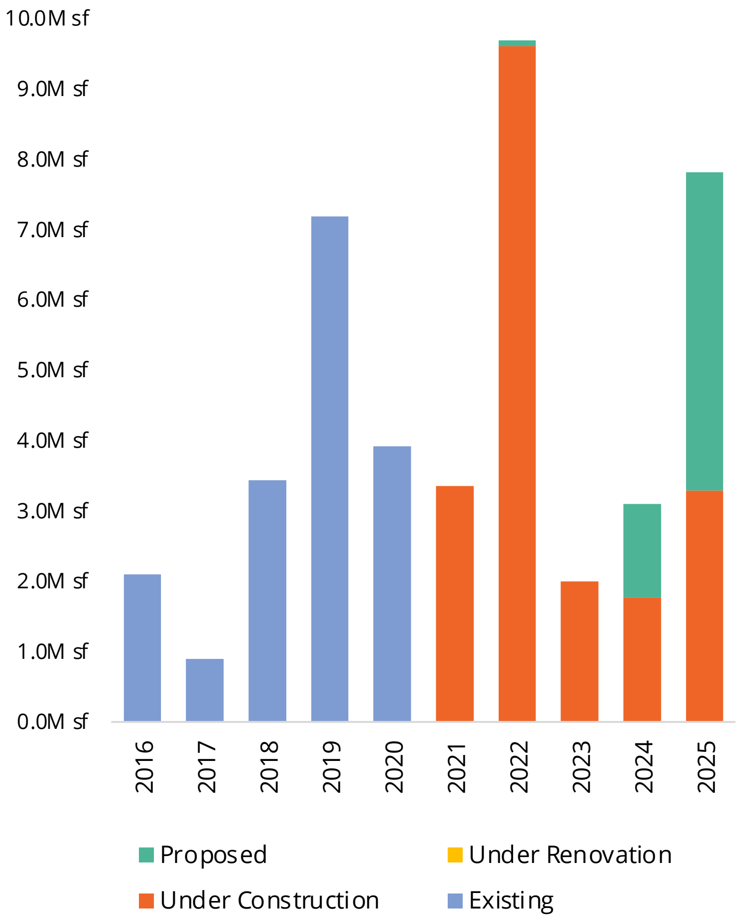
proposed or under construction

7.8%

share of office inventory

1930

average delivery date of existing Manhattan offices



Source: AVANT by Avison Young

03.

Capital market conditions

Pricing trended downward and investment activity continued to lag amidst challenging occupier market conditions.

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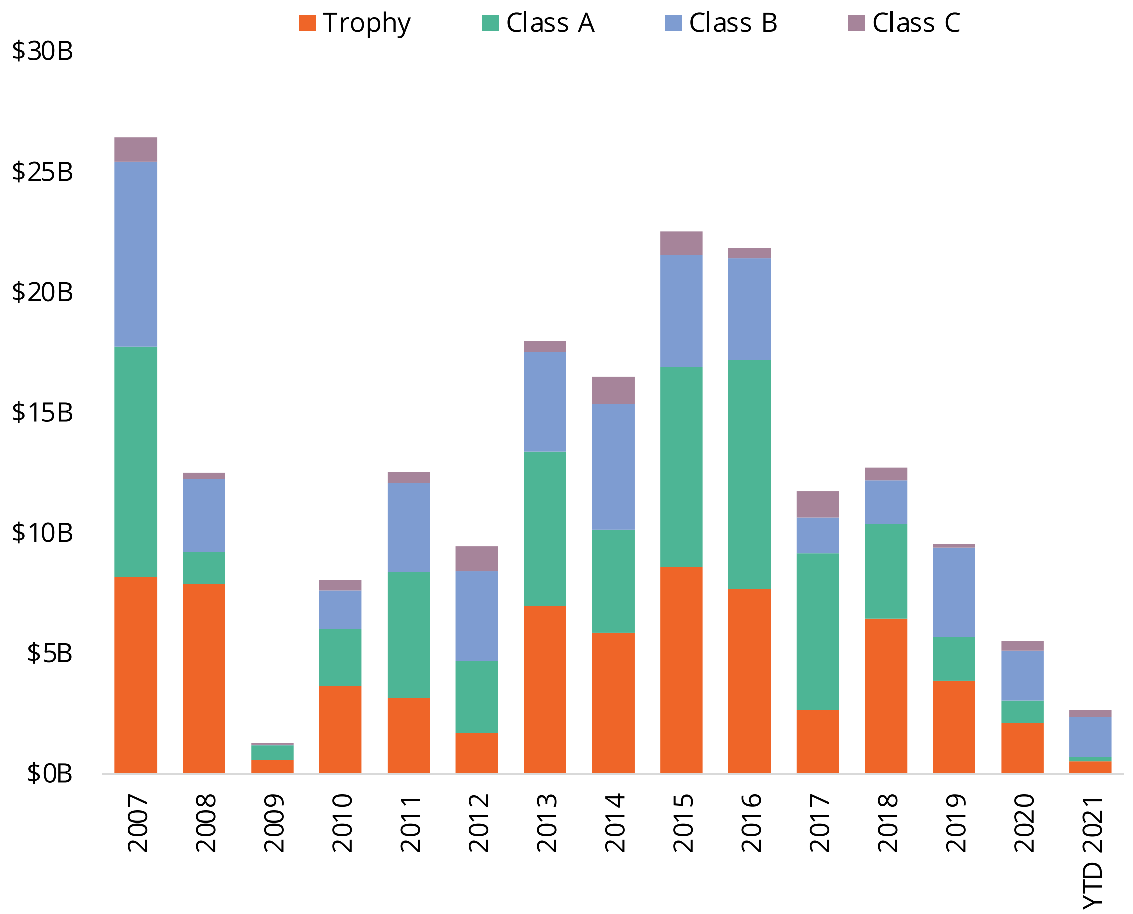
Office investment dollar volume

$8.2B

Manhattan office dollar volume 2020 to September 2021

Seven properties traded totaling $1.6B in the third quarter. The lack of Trophy deals to date has lowered overall transaction dollar volume ($516.2 million); however, Google's pending $2.1B acquisition of 550 Washington Street, its Hudson Square headquarters, should boost dollar volumes in early 2022.



Source: AVANT by Avison Young, New York City Department of Finance, RCA

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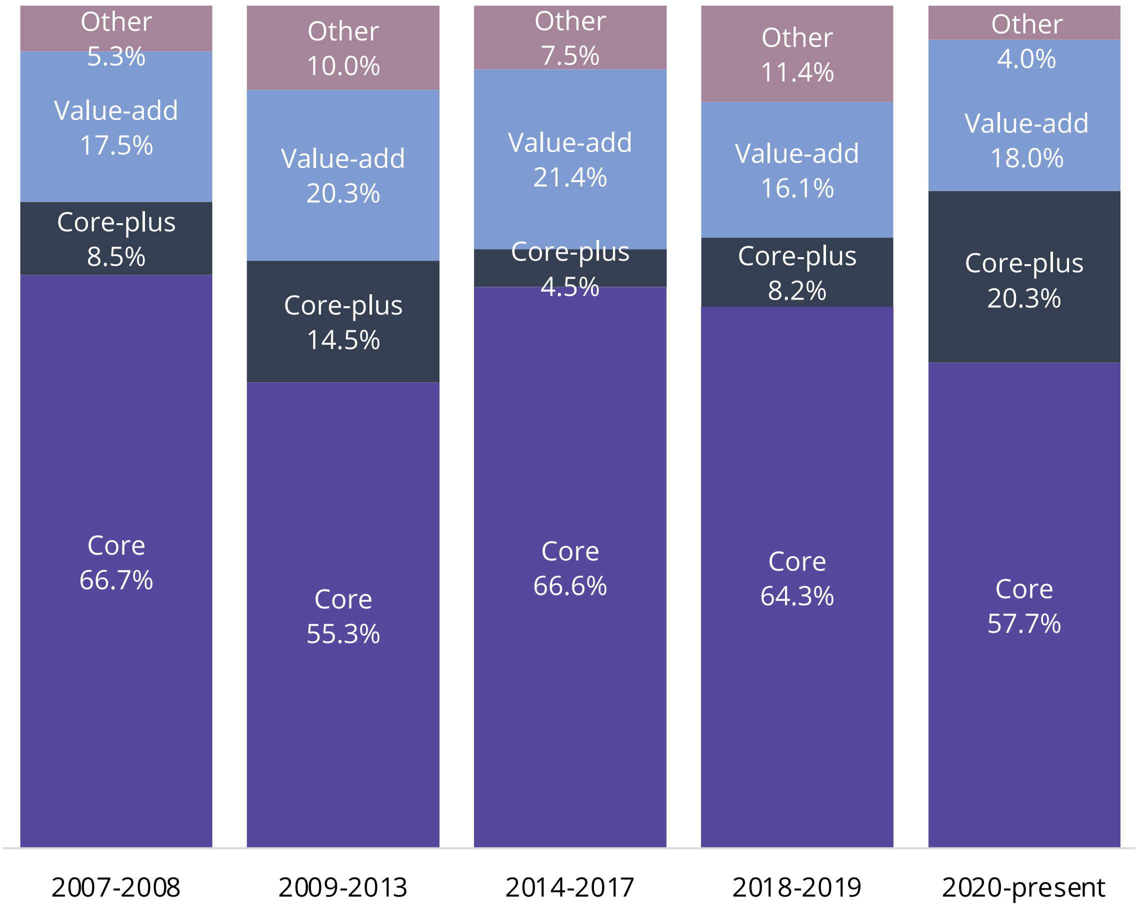
Office investment asset profiles

78.0%

Manhattan core and core-plus investments based on dollar volume since 2020

The share of core-plus and value-add transactions has increased from 24.3% from 2018-2019 to 38.3% from 2020 to present, underscoring some contrarian investors' appetite for more speculative acquisition opportunities.



Note: Other investments include owner-occupied and development transactions.
Source: AVANT by Avison Young, New York City Department of Finance, RCA

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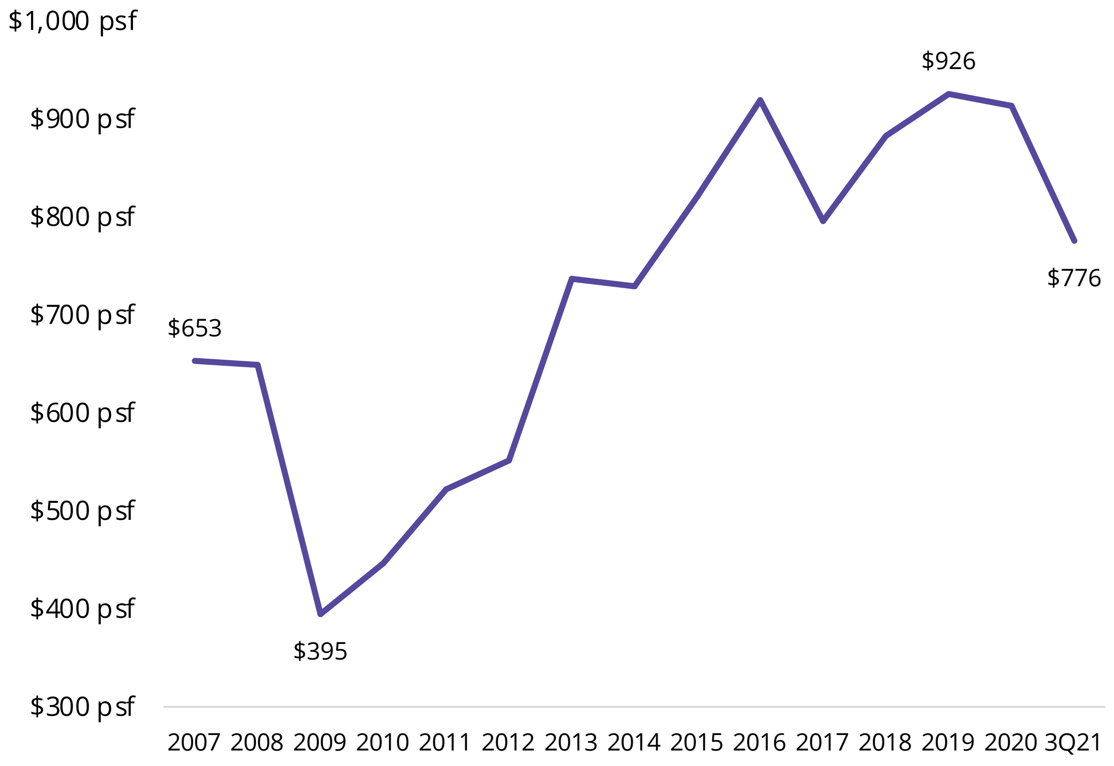
Office asset pricing

-16.2%

Manhattan office pricing from 2019 to September 2021

Manhattan office asset pricing continued to trend downward in Q3 2021, reflecting investors' more conservative underwriting approaches given prevailing office occupier conditions. Class B and C properties have accounted for 62.1% of investment volume since 4/2020, while leasehold transactions also affected asset values.



Source: AVANT by Avison Young
New York City Department of Finance, RCA

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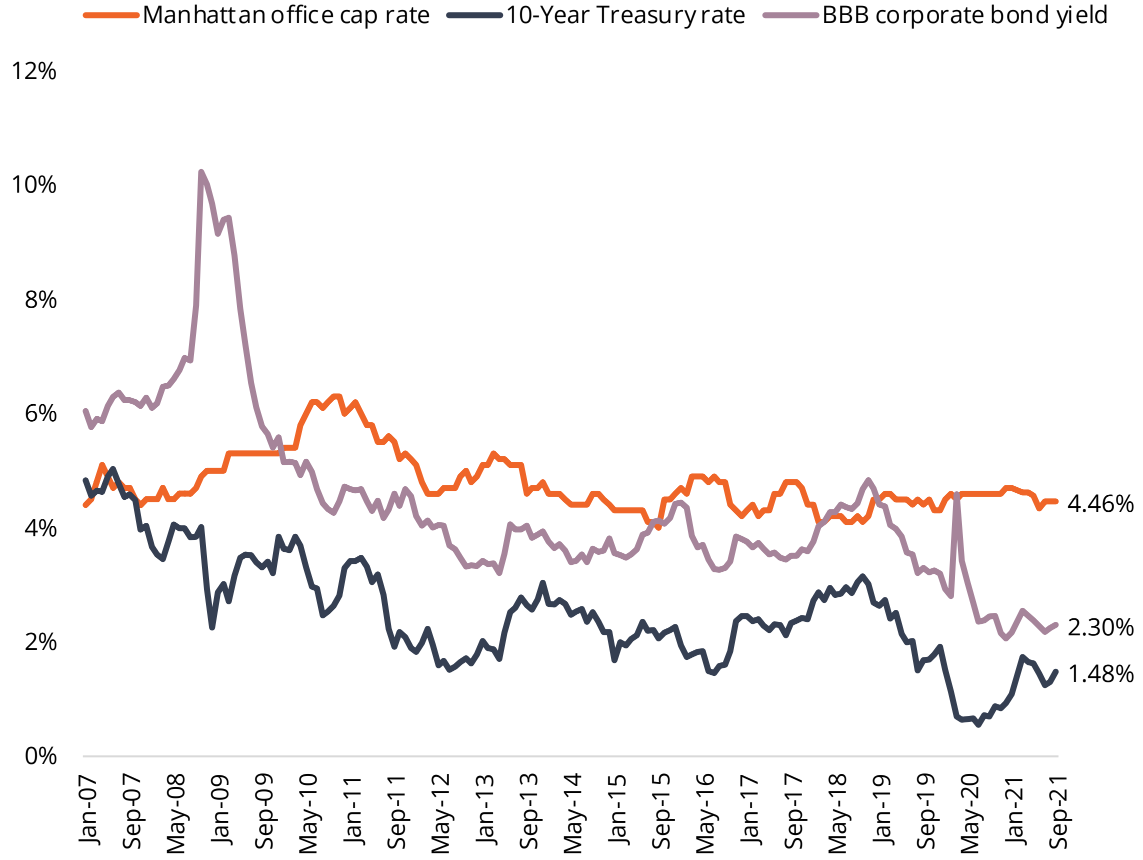
Office cap rates versus benchmark yields

298bp

Manhattan office spread vs. 10-year Treasury rate

The spread between Manhattan office cap rates and 10-year Treasury rates has widened to 298bp, increasing from an average of 216bp from 2014 to 2020, underlining the continued attractiveness of stabilized office transactions with credit tenancy.



Source: AVANT by Avison Young
U.S. Department of the Treasury
Federal Reserve Bank of St. Louis

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Looking forward

Here's what we can expect

- Leasing demand is **unlikely to return to pre-COVID levels** in the near term until office occupiers return to the office en masse through which they can determine their long-term occupancy strategies. Labor Day 2021 was previously one of the goalposts for return-to-work efforts, though the spread of the delta variant largely postponed those efforts. These shifts underscore the prevailing uncertainties facing space occupiers that are navigating an unprecedented change in workplace strategy.
- **Tenants are expected to retain leverage** in most lease negotiations, except for top-of-market properties that have benefitted from flight-to-quality and ease-of-accessibility trends.
- **Office asset pricing is poised to continue to soften**; however, the sizable spread between investment yields and benchmark rates and lower pricing could attract new capital sources, especially for cash-flowing properties.

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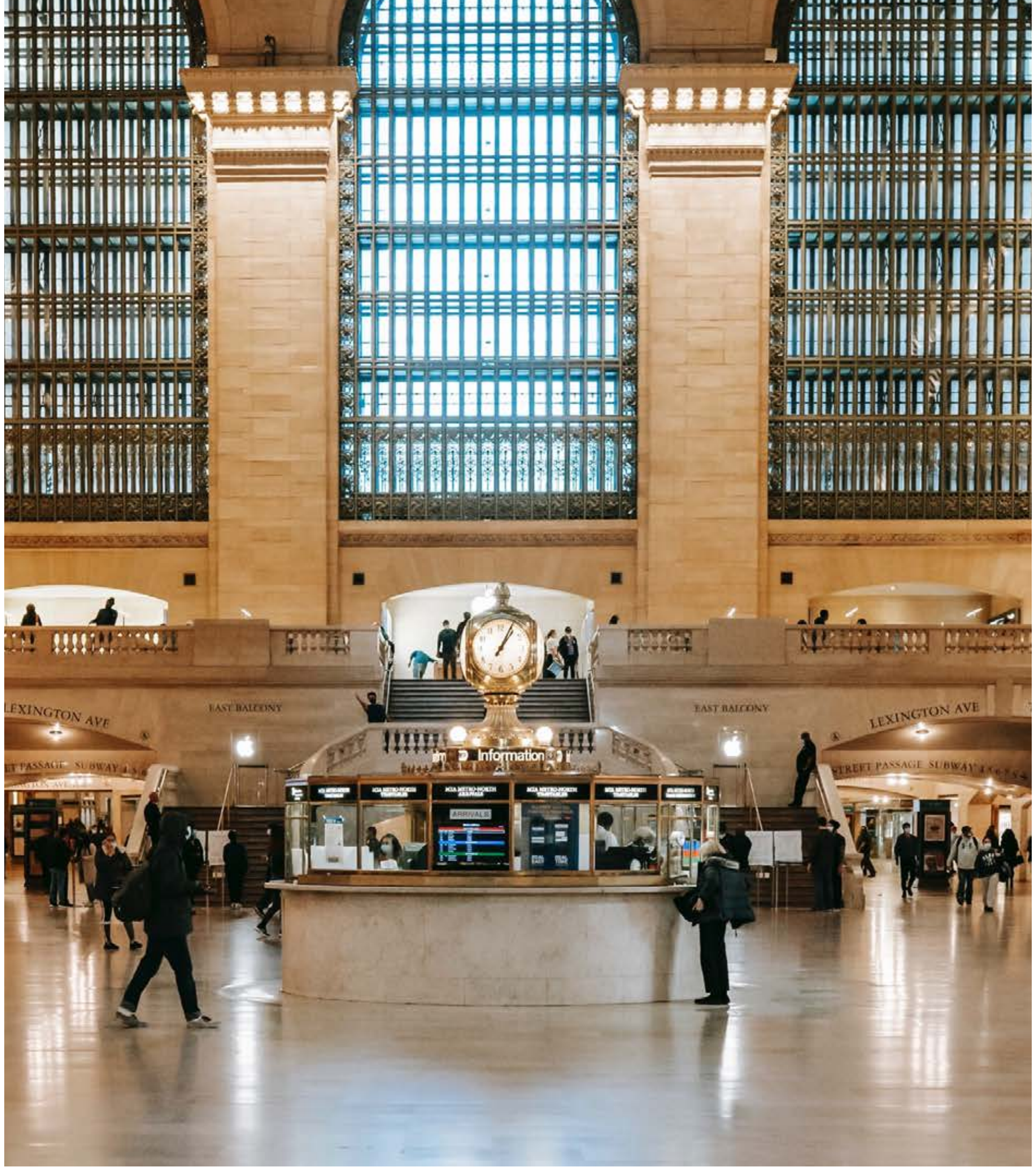

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Let's talk

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