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Manhattan Office Insight Report

Q2 2021

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Key Manhattan office takeaways

Economic conditions

- Reopening efforts and higher vaccination rates have allowed the Manhattan unemployment rate to rebound from a high of 16.3 percent to **8.3 percent** as of April 2021.
- Office-using job losses in the New York metropolitan statistical area (MSA) have totaled **4.7 percent** compared with 11.8 percent for other industries' job losses, underscoring the disproportionate impact the pandemic had on the discretionary segments of the local economy (namely retail, hospitality and construction).

Recovery rate

- The overall post-COVID rate of recovery based on extrapolated cell phone data is just **34.3 percent** as a result of limited return-to-work efforts, hesitancy to take mass transit and recuperating tourism.
- Manhattan office occupiers have navigated their return-to-work strategies differently, with banking and law firms returning more quickly than tech and media firms. The overall rate of recovery is just **12.3 percent**, though bellwether companies are beginning to mandate that their employees return to the office after Labor Day.

Office demand

- Post-COVID leasing activity decreased by annualized rate of **46.9 percent** versus the prior 20-year average.
- Renewals have accounted for **41.6 percent** of post-COVID activity compared with **18.2 percent** of 2018 to March 2020 activity.
- Tenants are starting to navigate the market with more conviction as indicated by lease term lengths that have increased by **7.2 percent** since January 2021.
- 'Flight to quality' persists, with Class A and Trophy properties accounting for **82.8 percent** of post-COVID demand.

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Key Manhattan office takeaways

Office supply

- The total vacancy rate has achieved a post-2000 high, reaching **12.7 percent** in Q2 2021.
- The sublease market continues to drag aggregate fundamentals, accounting for **24.1 msf** of available space.
- However, some prospective sublandlords have pulled their space from the market after reassessing their occupancy plans and/or failing to capture subtenant commitments. To date, more than **1.5 msf** of sublease availabilities posted since the onset of the pandemic have been withdrawn from the market.

Pricing trends

- Net effective rents decreased by **10.8 percent** from April 2020 to June 2021 as landlords induced tenant commitments through record-setting concessions packages and favorable lease provisions while keeping base rents relatively steady.
- Concessions packages have shown signs of stabilizing, decreasing by **2.5 percent** after reaching record levels in April 2021. This could be an indication that higher demand has started to offset gains in supply in select segments of the market, specifically well-located Class A and Trophy properties.

Capital markets

- The pandemic caused a risk-pricing crises and resultant investor hesitancy that stalled the market. Just **$7.0B** has been sold since the start of 2020, an annualized decrease of **78.6 percent** compared with the trailing five-year average.
- Cap rates have stabilized at **4.6 percent**, representing a sizable spread from benchmark interest rates.
- Weaker occupier fundamentals have contributed to a decline in asset pricing of **20.5 percent** since December 2019. However, a rebound appears imminent due to increased investor interest.

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Economic and demographic trends

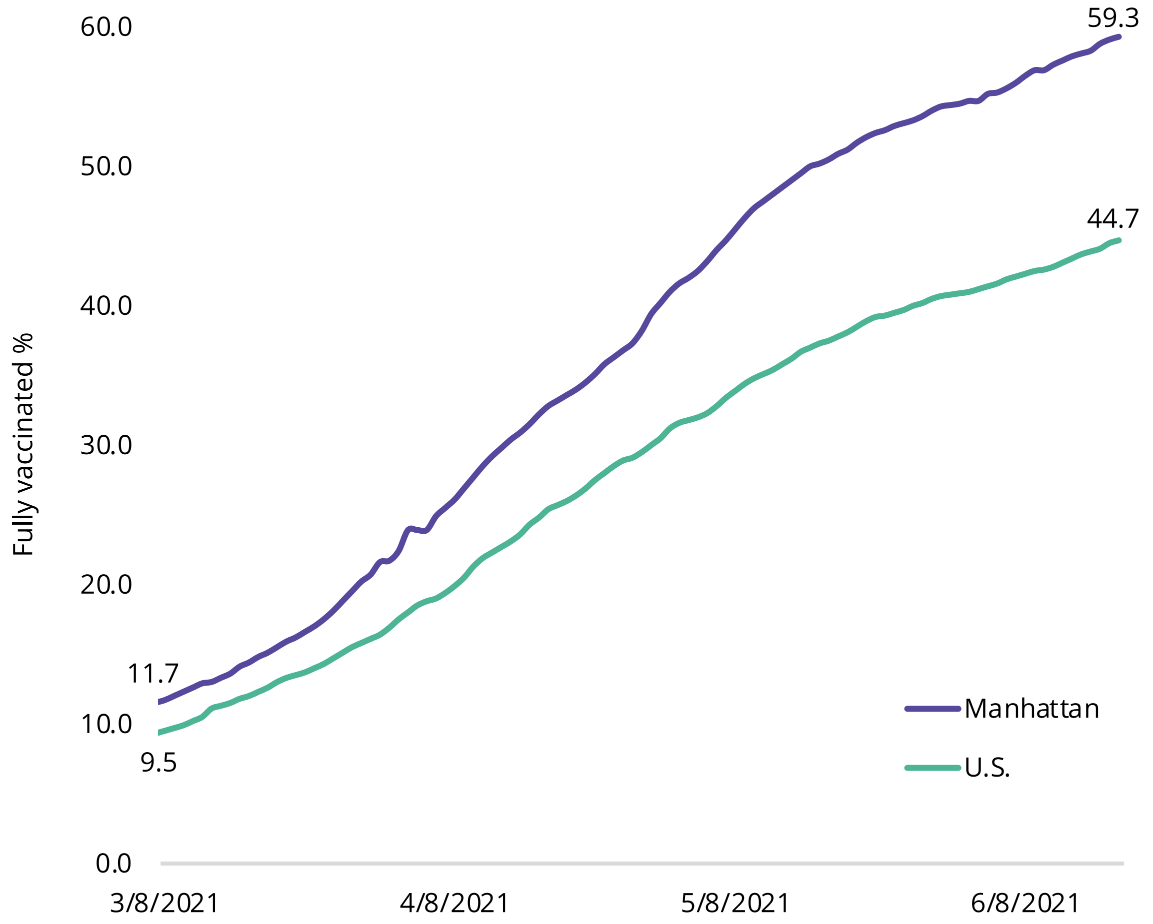
The pandemic immediately shocked the Manhattan economy, though there have been incremental signs of a recovery as the city reopens.

Vaccination rates

59.3%

Share of the total Manhattan population that is fully vaccinated

Governor Cuomo announced on June 15 that 70% of New York State adults were vaccinated, permitting looser COVID-19 restrictions. Businesses no longer require temperature checks, restaurant patrons can sit closer than six feet apart and some indoor mask requirements have been lifted, among other factors.



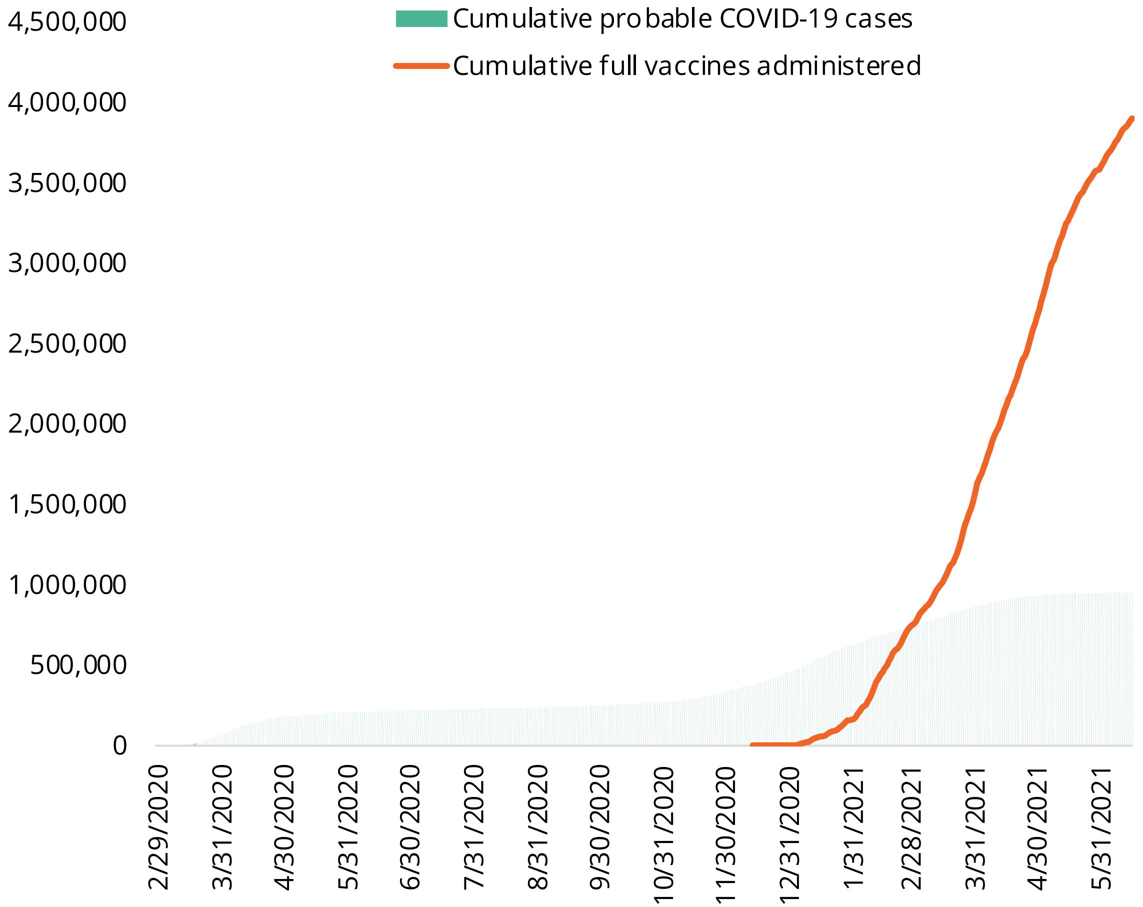
Source: CDC

New York City vaccinations vs COVID-19 cases

4.1x

New York City full vaccinations administered vs. probable COVID-19 cases since the pandemic

Vaccination rates have accelerated as eligibility has expanded to people aged 12 or older, stemming the spread of the coronavirus in New York City. This serves as an important first step for a broader economic recovery and an accelerated return to normalcy.



Source: NYC Health, New York State

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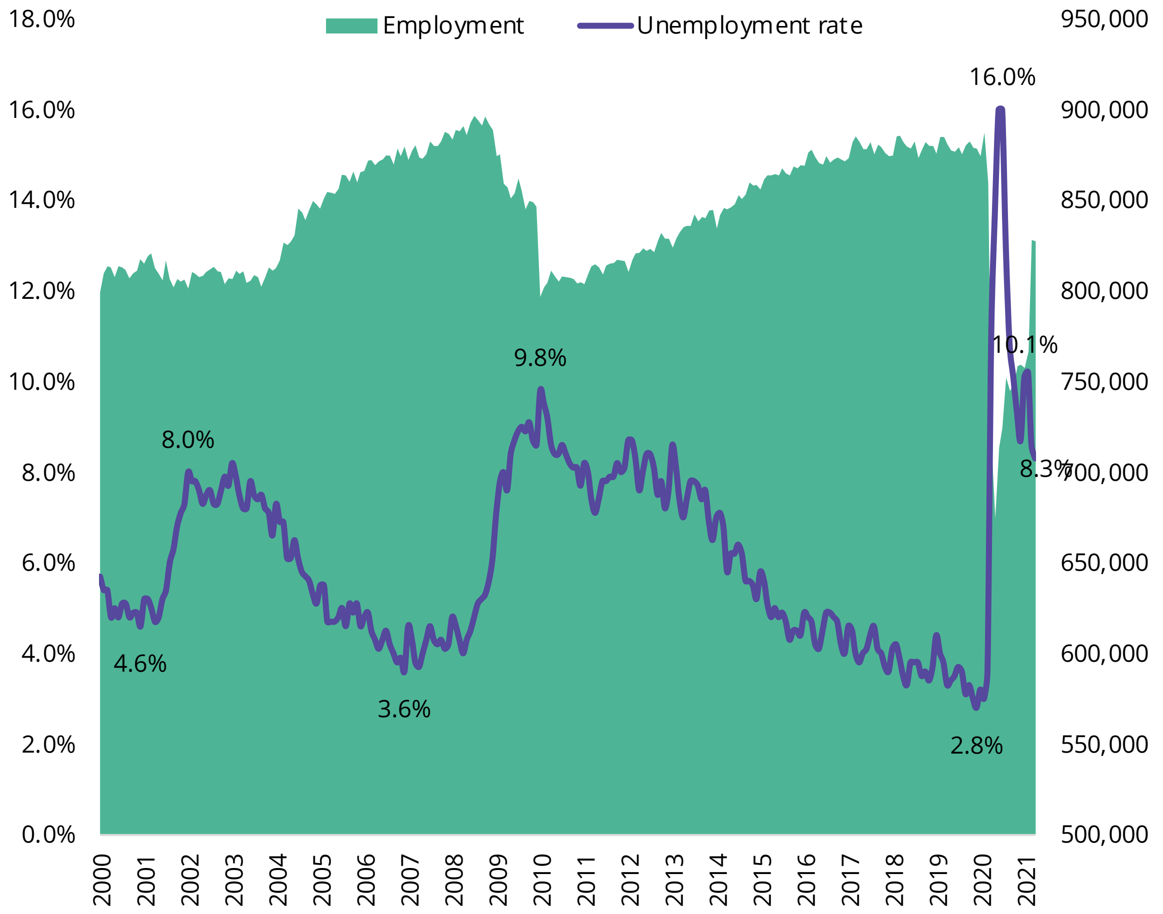
Manhattan employment and unemployment

8.3%

Manhattan unemployment rate as of April 2021, dipping below the height of the financial crisis

Historically tightened labor market conditions were halted by the pandemic, which caused nearly 213,000 job losses by May 2020. However, reopening efforts enabled the local economy to recapture more than 110,000 jobs year-over-year, an increase of 15.4% of the labor force.



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

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New York MSA office-using job losses

-4.7%

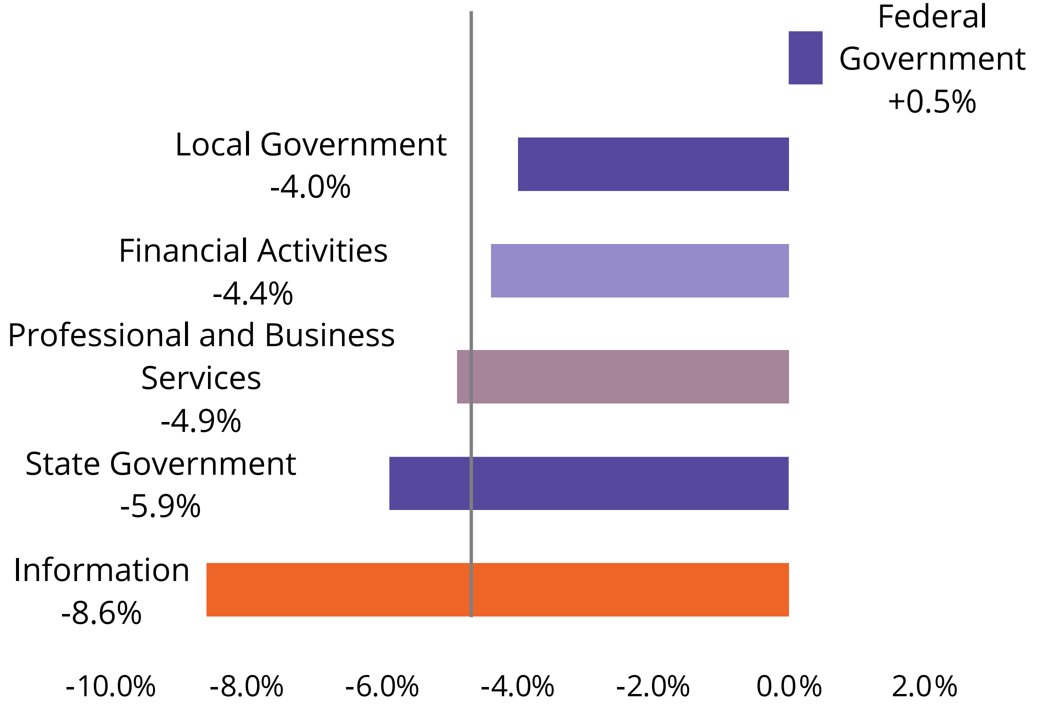
Change in office-using employment from February 2020 to April 2021

New York MSA job losses totaled -9.3% since the pandemic, though office-using jobs contracted by just 4.7%. This recession's impact on the office-using labor market has been less severe than the 2008 financial crisis, when Financial Activities job losses totaled 7.5%.

VIEW DASHBOARD

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

February 2020 to April 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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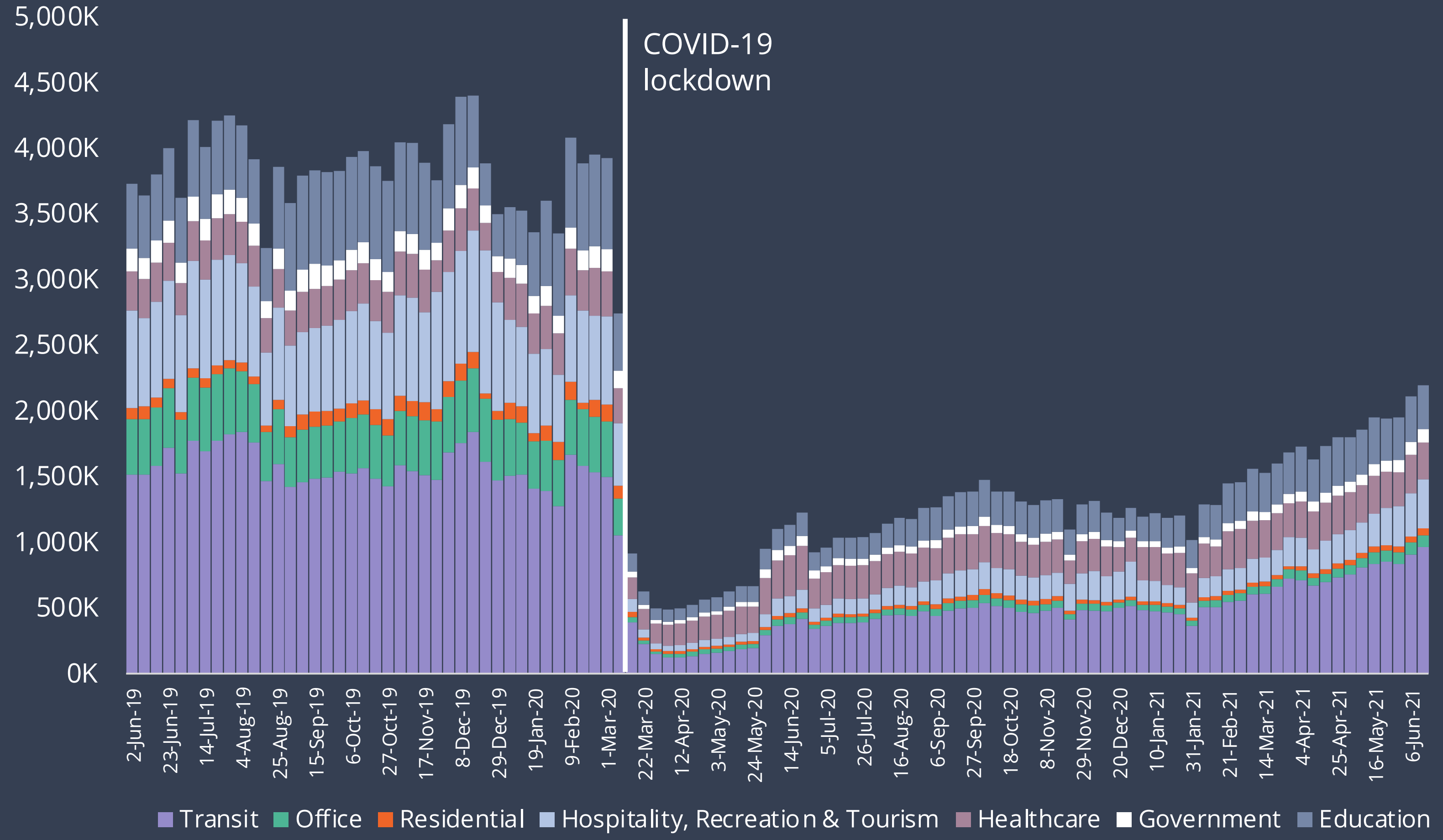
Manhattan recovery index

34.3%

Post-COVID rate of recovery based on representative locations through 6/20/2021

Foot traffic, as evidenced by smartphone data, decreased by 87.6% from the week of 3/8/2020 to the trough on the week of 4/5/2020. Activity has increased dramatically since, rising by 352.1%.



Note: Representative areas of interest.
Pre-COVID period measured as 6/1/2019 to 3/8/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insight, AVANT by Avison Young

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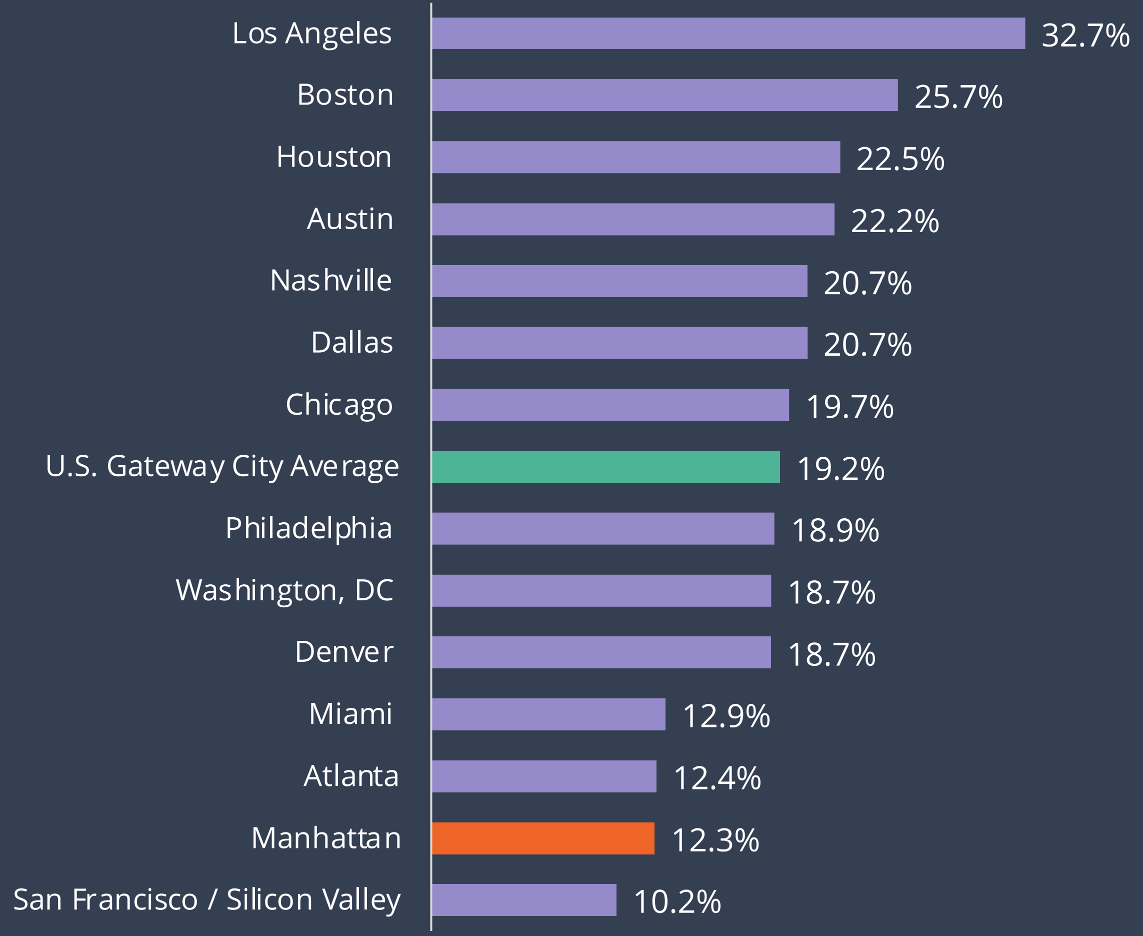
Office recoveries across U.S. gateway cities

19.2%

Average post-COVID rate of recovery for representative office employers across U.S. gateway cities

Manhattan office employers have been comparatively hesitant to return to the office, as measured by the second-lowest recovery rate of 12.3% among U.S. gateway cities. One of the leading roadblocks has been employees' usage of mass transit systems, though elevated vaccination rates are easing these hesitations.



Note: Select, representative occupiers only. Weekdays only.
Pre-COVID period measured as 6/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insight, AVANT by Avison Young

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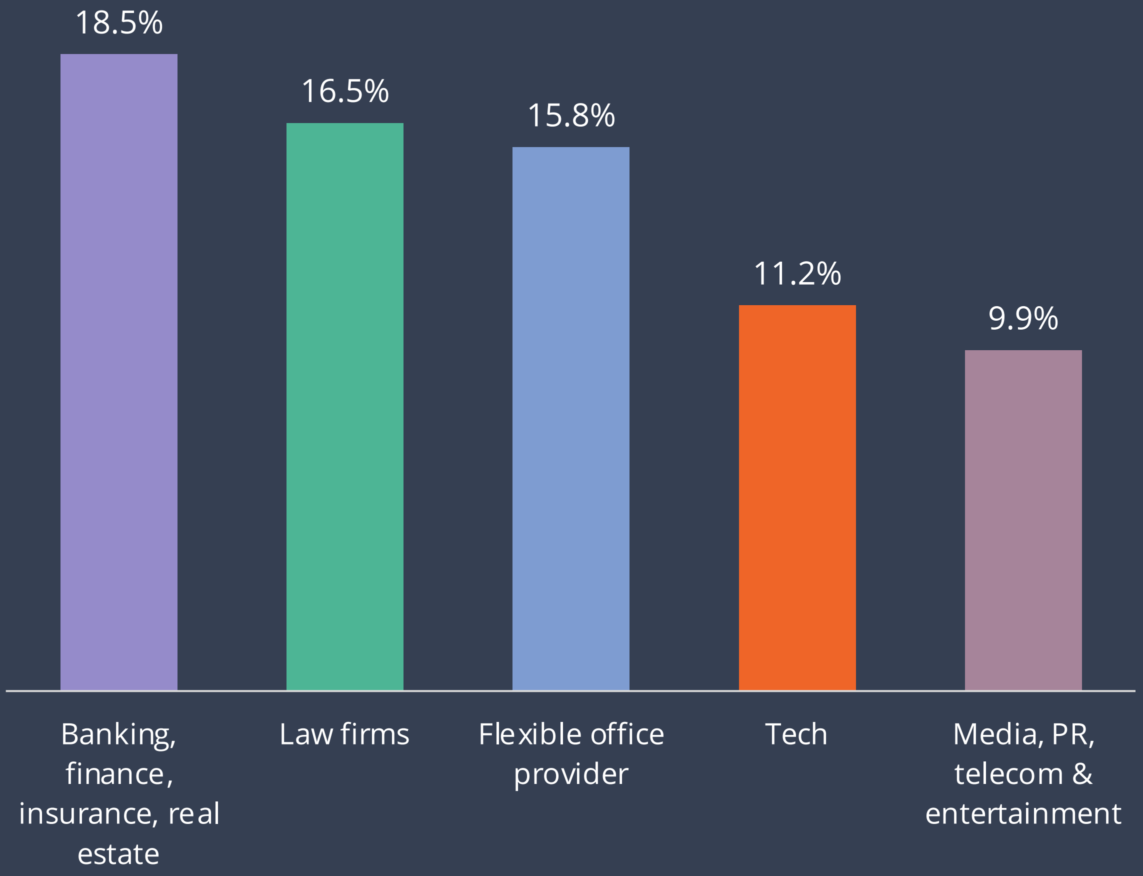
Manhattan office recovery index by industry

12.3%

Post-COVID rate of recovery for representative Manhattan office occupiers through 6/20/2021

Office employers have taken unique approaches in their return-to-work efforts, with financial services returning more quickly than tech and media firms. Bellwether firms, especially banks, are increasingly requesting their employees to return to the office by Labor Day, which should cause this recovery index to rise considerably.



Note: Select, major occupiers only. Weekdays only.
Pre-COVID period measured as 6/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insight, AVANT by Avison Young

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Employers are embracing remote work models

A survey conducted in March 2021 concluded that only 10% of Manhattan office employees had returned to the office as their employers supported remote work. However, several leading banks are mandating their workforces to return to the office from June to September, an indication that return-to-work metrics are poised to rise significantly.

56%

office employees expect to work remotely at least part of the time

66%

hybrid model employers vs. 22% that will return to the office full-time, 9% that will be fully remote, and 4% that will be role-dependent

61%

employers that will enforce their workforces to get vaccinated before returning to the office

Source: Partnership for New York City

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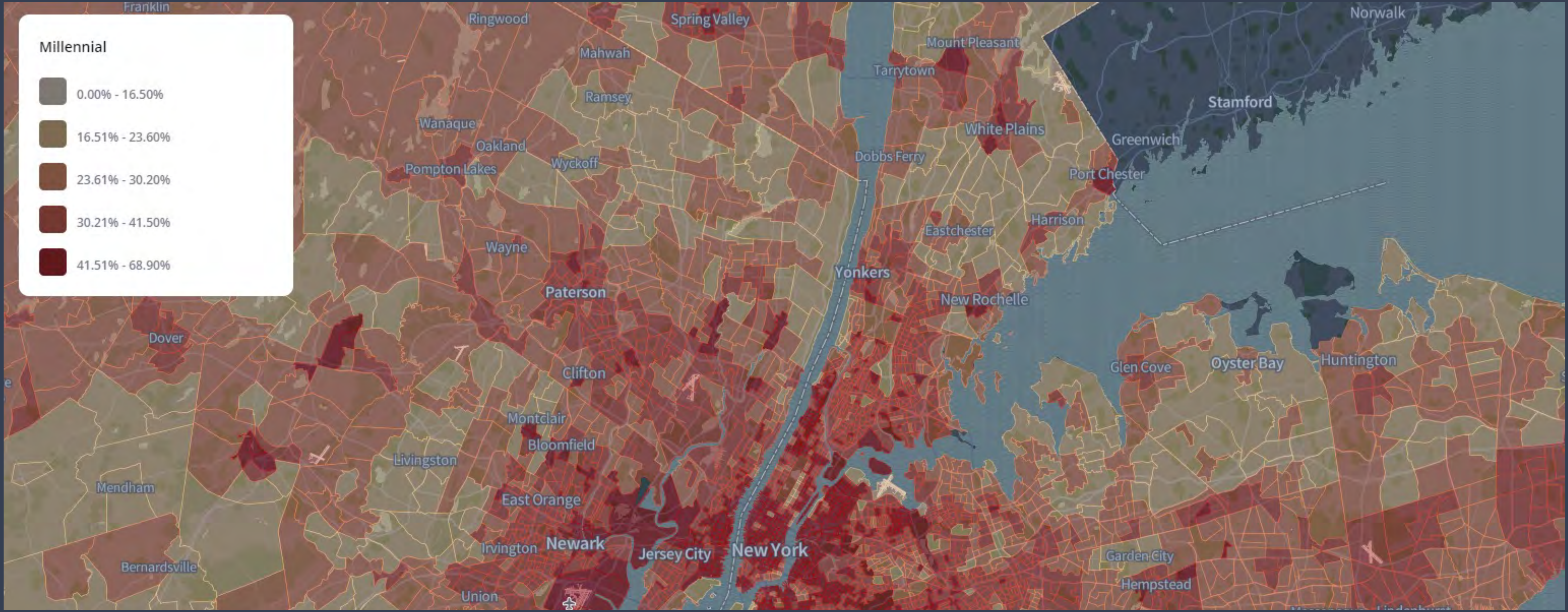
NYC is a hotbed for Millennial talent…



Source: AVANT by Avison Young
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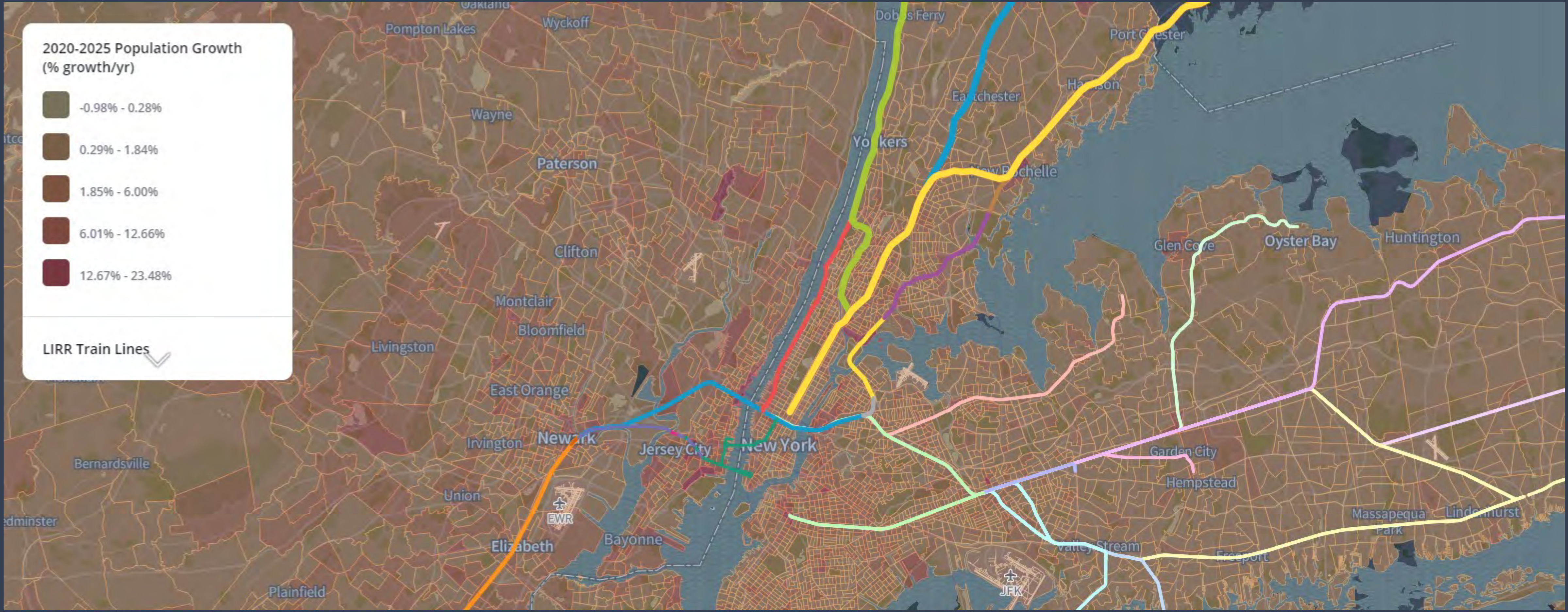
But will they begin to migrate out of the city?



Source: AVANT by Avison Young
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Office occupier conditions

Demand temporarily paused, allowing supply to reach record levels. Tenants are navigating the market with more conviction, indicating a potential recovery in select market segments.

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Manhattan absorption

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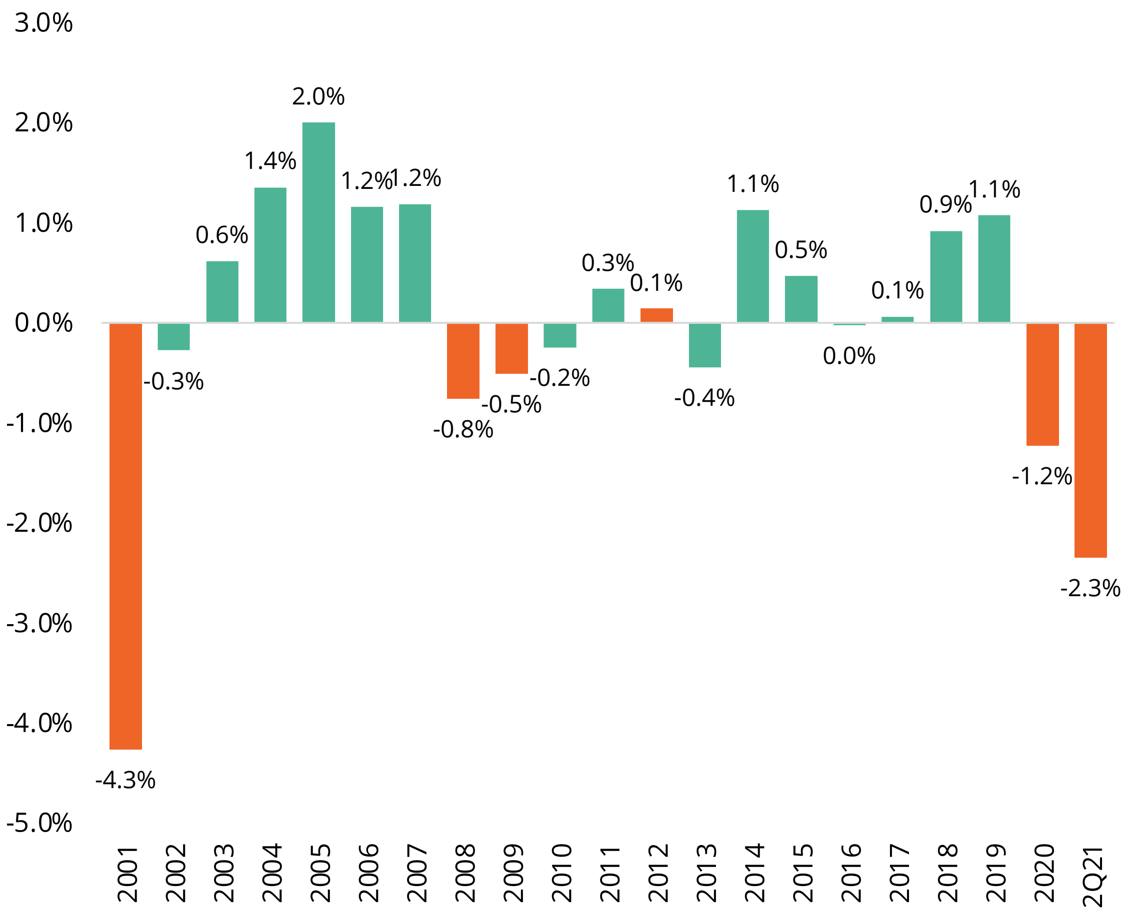
-3.5%

Net absorption as a percentage of inventory, 2020 through Q2 2021

Negative absorption from 2020 to Q2 2021 has totaled 18.8 million sf, representing 3.5% of the existing stock. This negative absorption significantly surpasses global financial crisis levels, which totaled a comparatively muted -1.3%.



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

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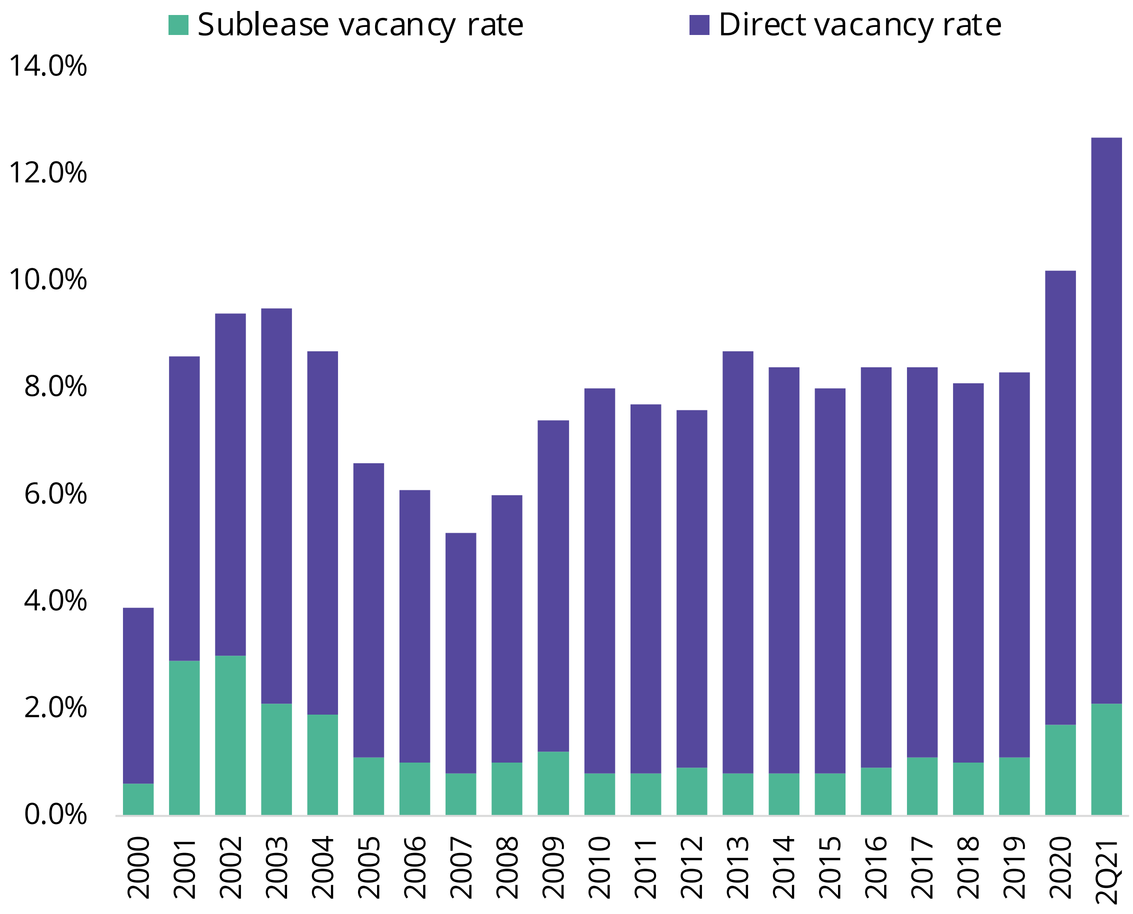
Manhattan vacancy rate

12.7%

Post-2000 high Manhattan vacancy as of Q2 2021

The Q2 2021 vacancy rate represents a post-2000 high in terms of direct (10.6%) and total (12.7%) percentages. These elevated rates are attributable to the temporary pause in demand coupled with cyclical lease rollovers since the onset of the pandemic. Leasing velocity has incrementally risen in 2021, though continued upward supply pressure is anticipated in the near term.



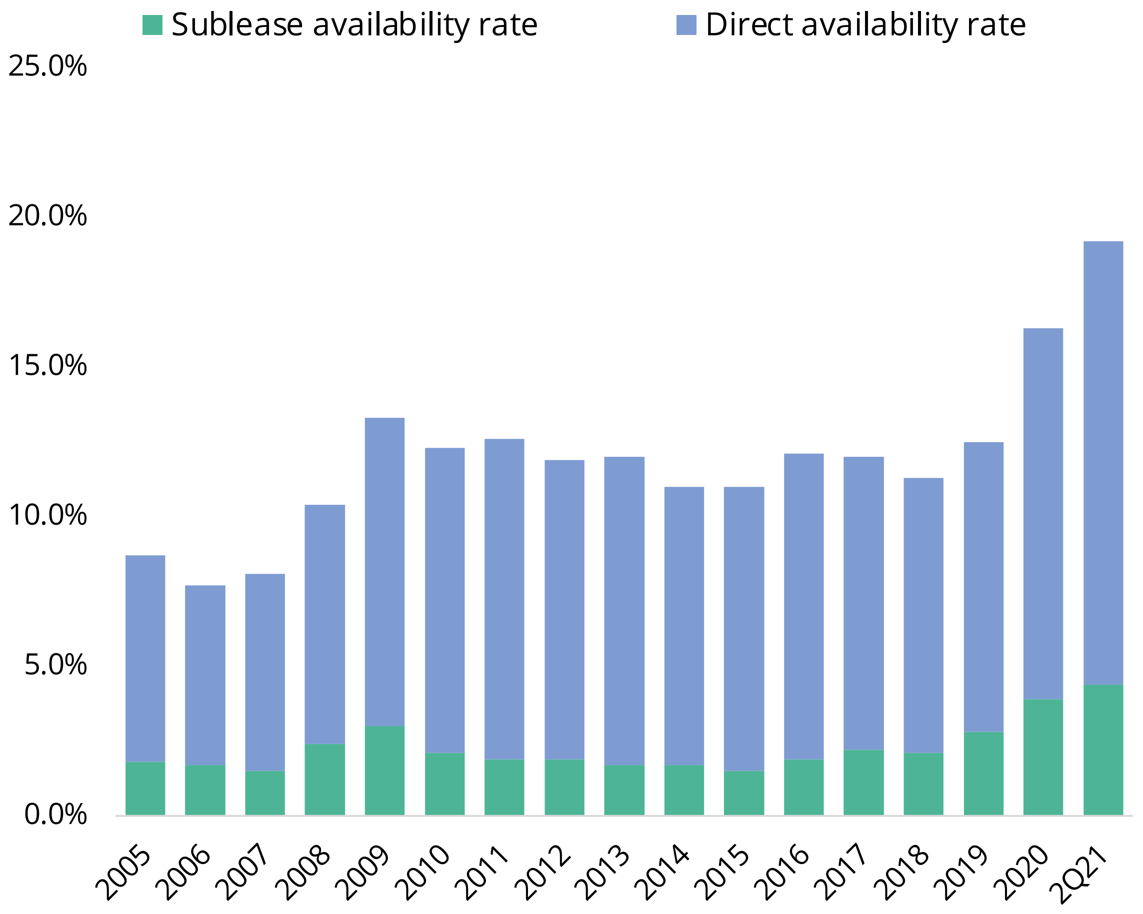
Source: CoStar, AVANT by Avison Young

Manhattan availability rate

19.2%

Post-2005 high Manhattan availability as of Q2 2021

Direct and sublease availability rates spiked following the pandemic, though both rates had been trending upward since 2018 partly due to an influx of new construction deliveries. The sublease availability rate of 4.4% in Q2 2021 is double the sublease availability rate of 2.2% reported in Q4 2017 and represents a 50bp increase from Q4 2020.



Source: CoStar, AVANT by Avison Young

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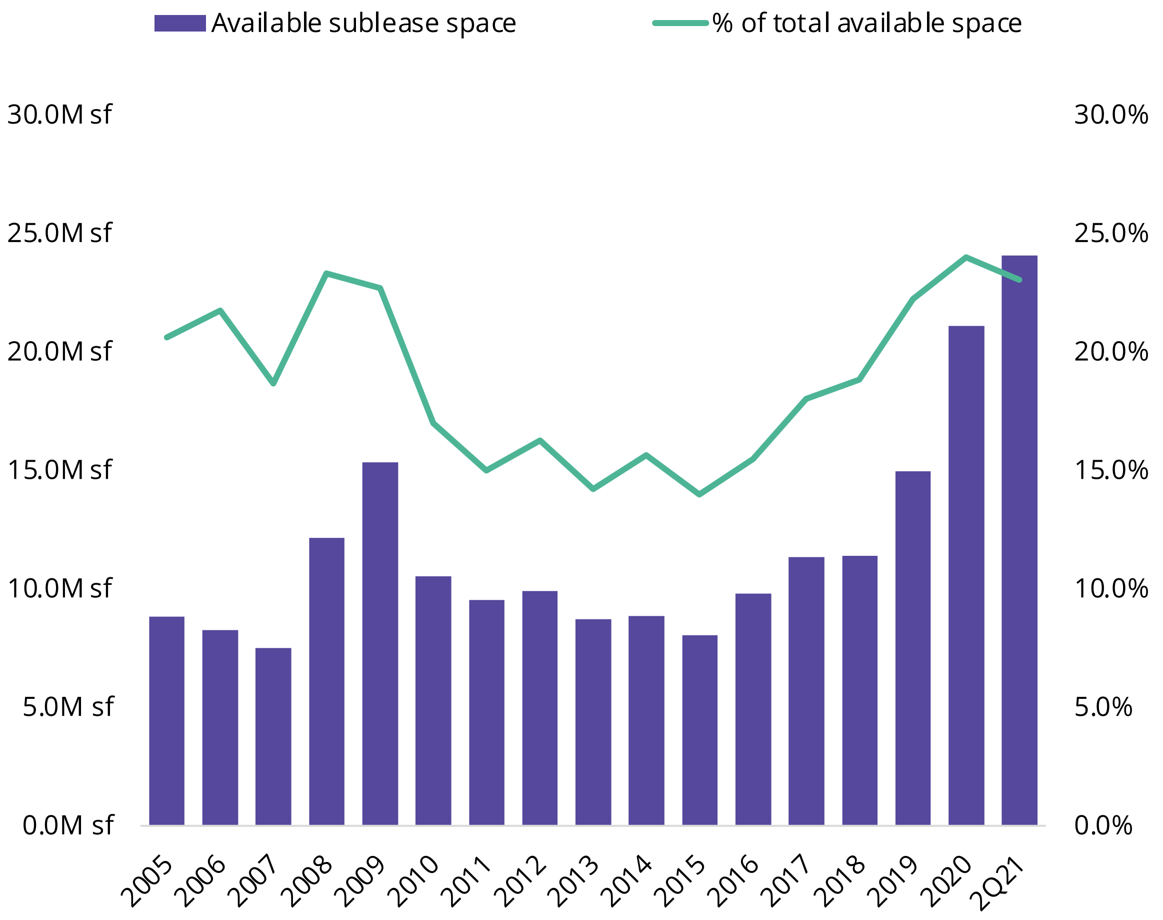
Manhattan available sublease space

24.1 msf

Post-2005 high available sublease space as of Q2 2021

The Q2 2021 share of sublease-to-total available space of 23.1% nearly matches global financial crisis levels of 23.3% in 2008 and 22.7% in 2009, which underscores how commodity properties are positioned to reset their rents to compete with record levels of sublease supply.



Source: CoStar, AVANT by Avison Young

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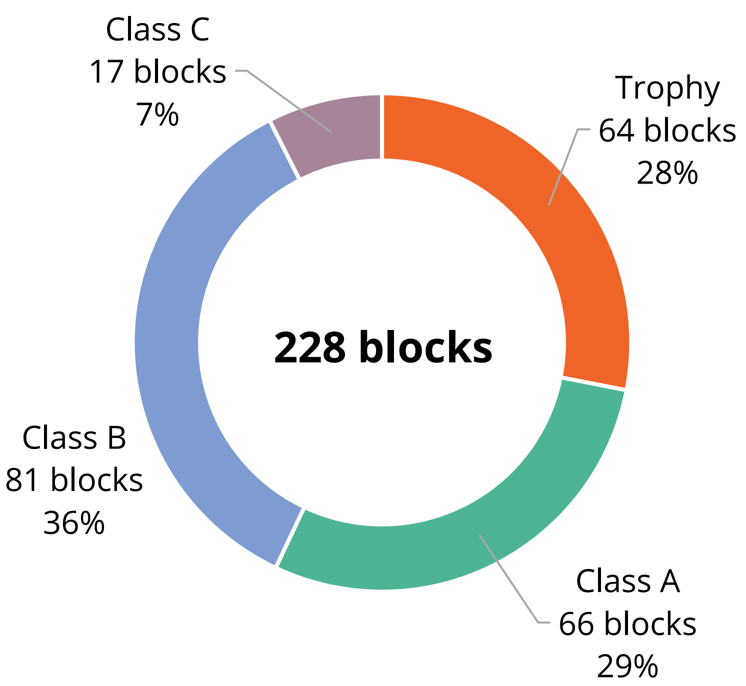
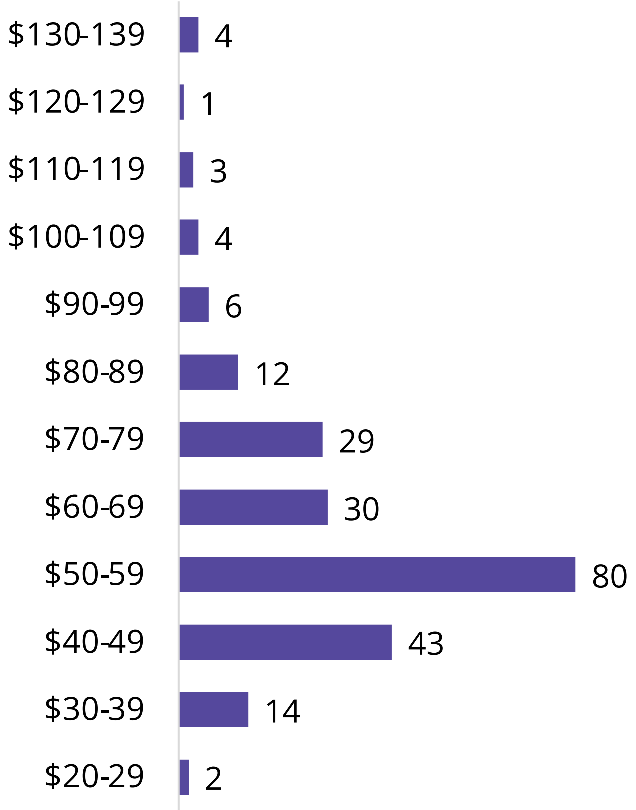
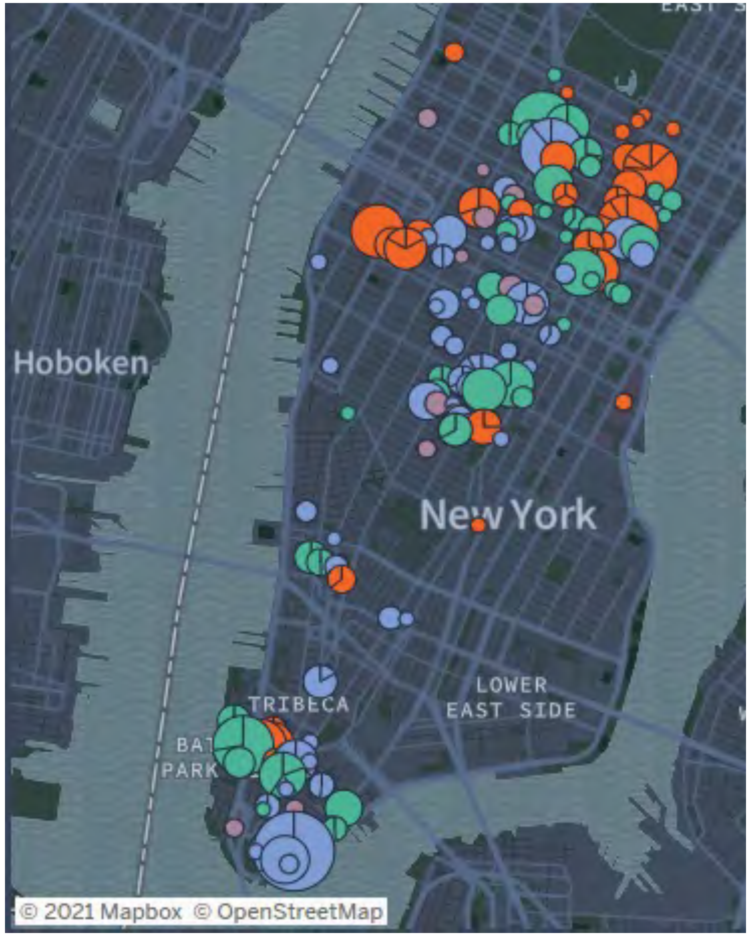
Manhattan sublease supply pipeline

Building classification



Asking rent per square foot





Source: AVANT by Avison Young

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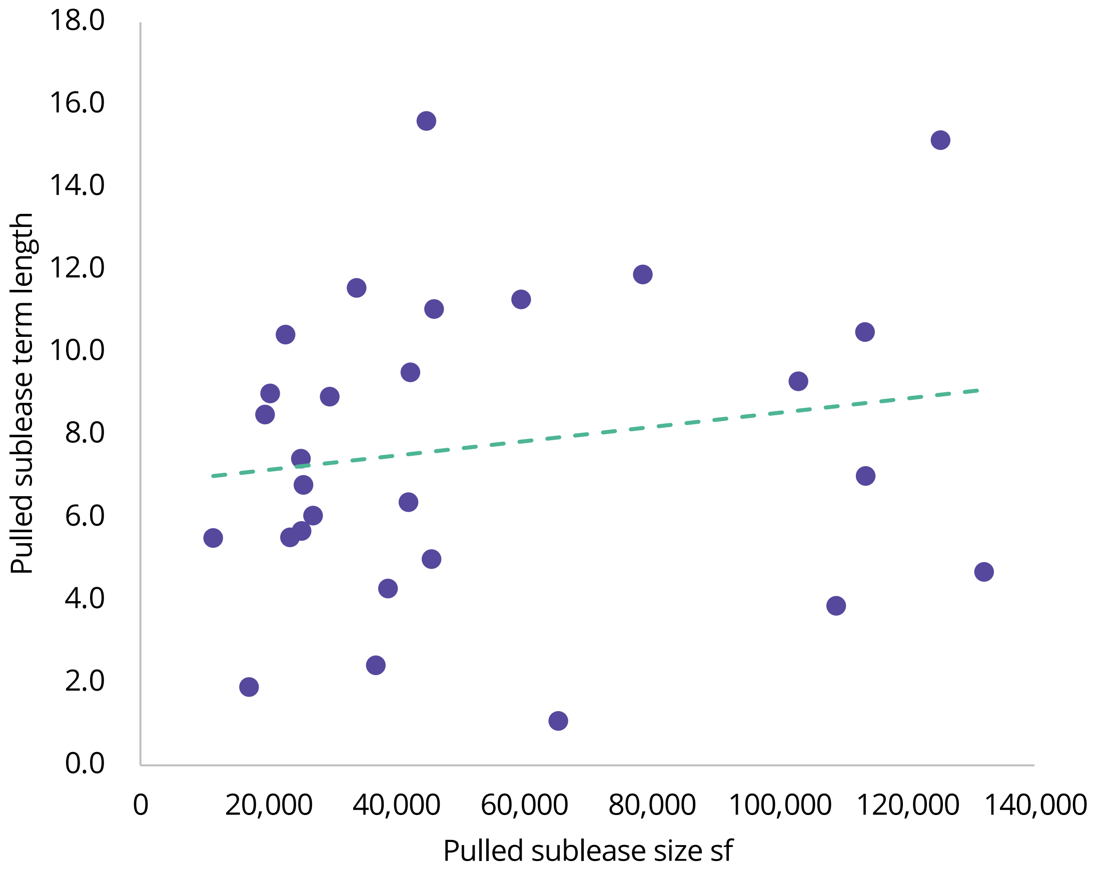
Sublease availabilities pulled from the market

1.5 msf

Post-COVID sublease space withdrawn from the market

Increased competitiveness in the sublease market and different remote working strategies have caused some prospective sublessors to pull their sublease availabilities, especially larger-scale suites and smaller suites with short term lengths. These former sublease options averaged 52,756 sf and 7.7-year remaining term lengths.



Source: AVANT by Avison Young

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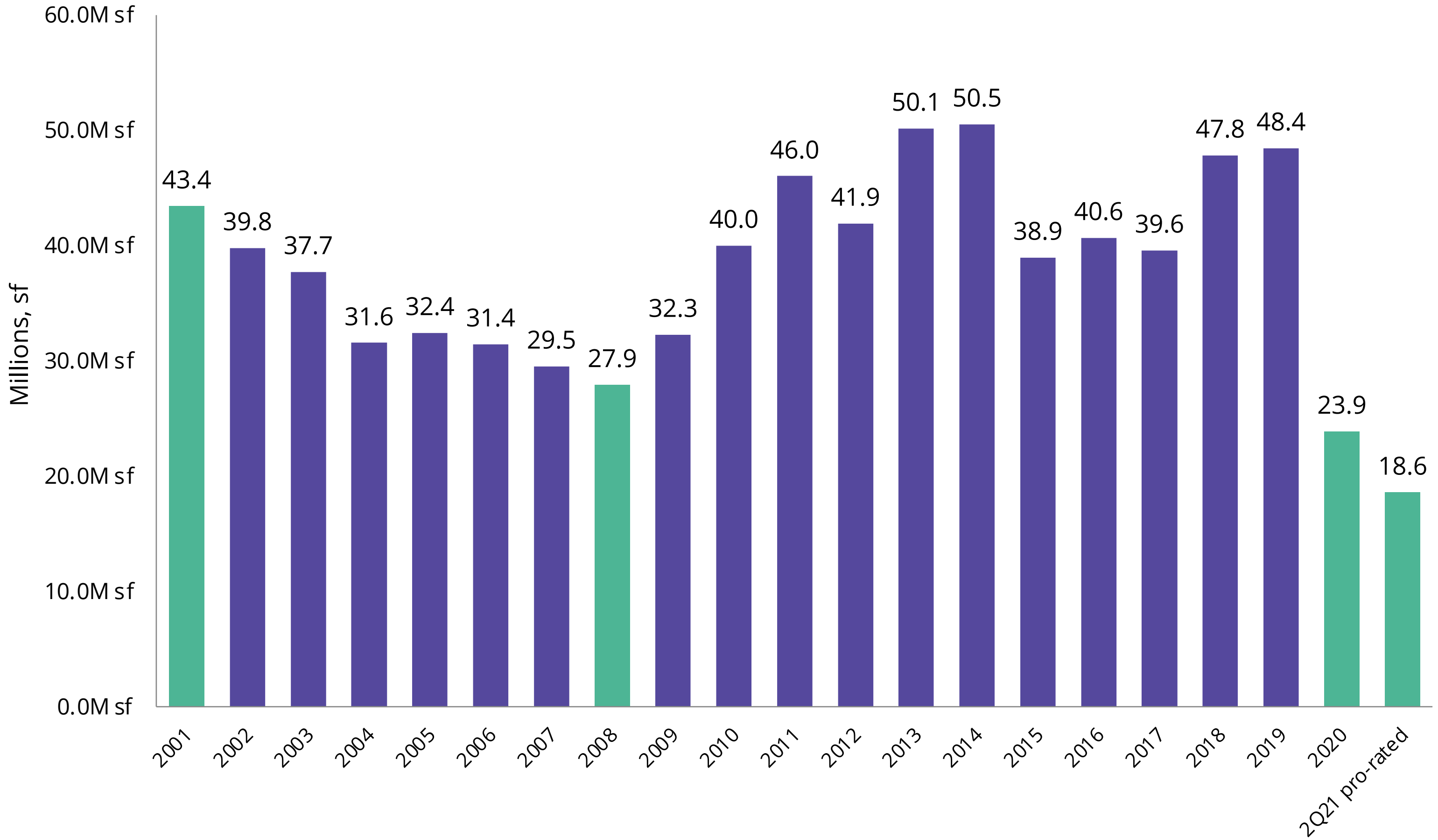
Manhattan office leasing activity

-46.9%

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

There is no modern precedent for the post-COVID slowdown in leasing activity—not 2001 nor 2008—due to the sudden change in office occupiers' future workplace strategies and the 2020 recession.



Source: CoStar, AVANT by Avison Young

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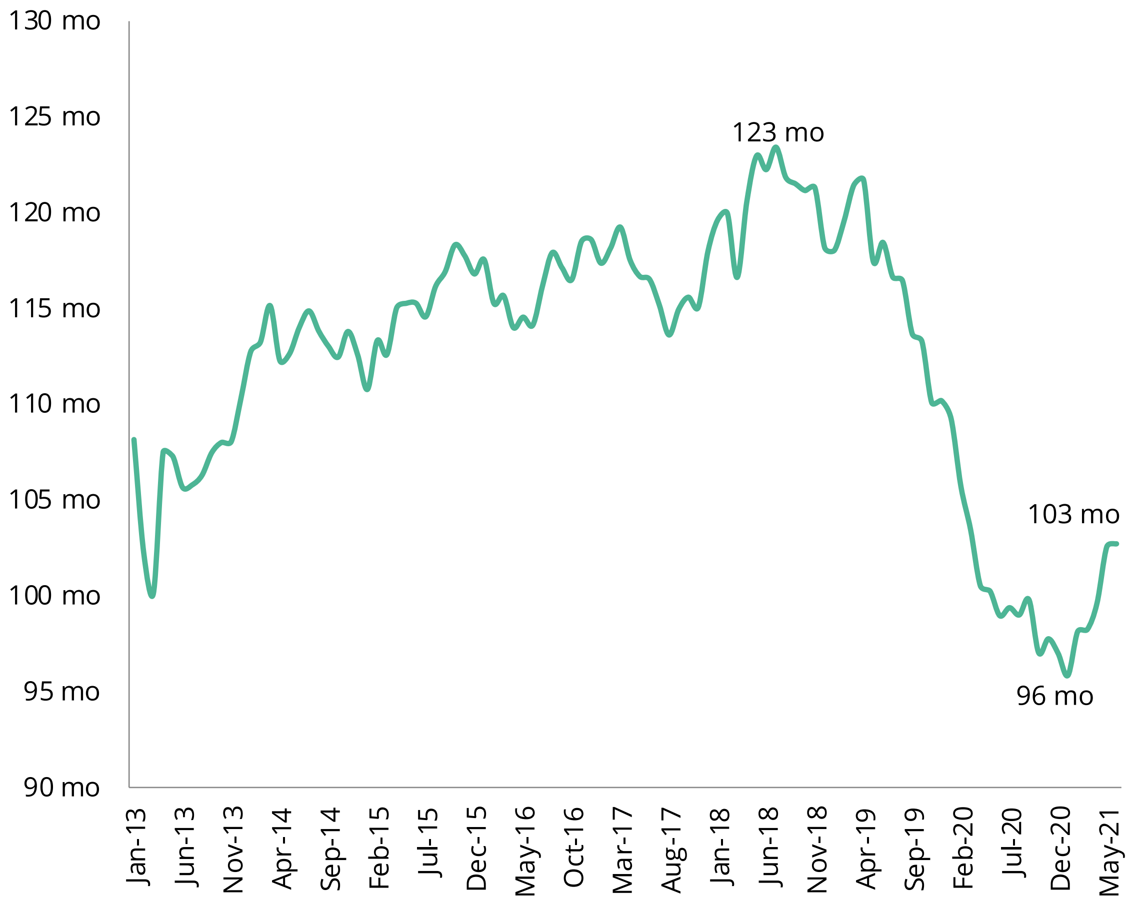
Manhattan average office lease term

103 mos

Current 12-month moving average lease term

Tenants have begun to navigate the current environment with conviction, capitalizing on more favorable lease economics and provisions while recognizing Manhattan's lasting draw from a talent perspective. This change in sentiment has caused a rebound in lease term lengths, which increased by 7.2% from January 2021 to June 2021.



Source: AVANT by Avison Young

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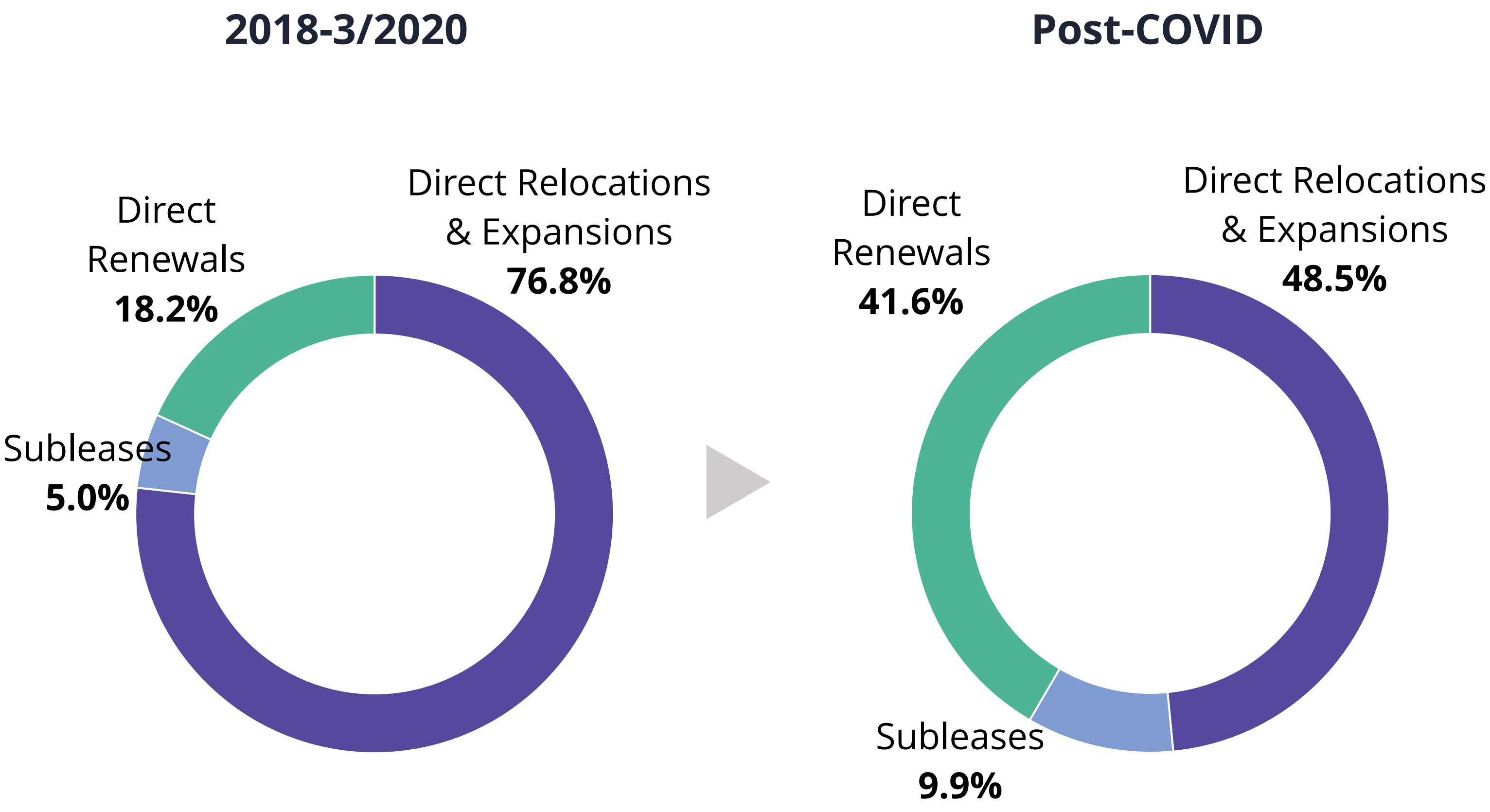
Manhattan transaction activity by lease type

41.6%

Renewals share of total Manhattan post-COVID office leasing activity

Renewals and subleases have become more common since the start of the pandemic, providing tenants more time to navigate an unprecedented workplace environment.



Source: AVANT by Avison Young

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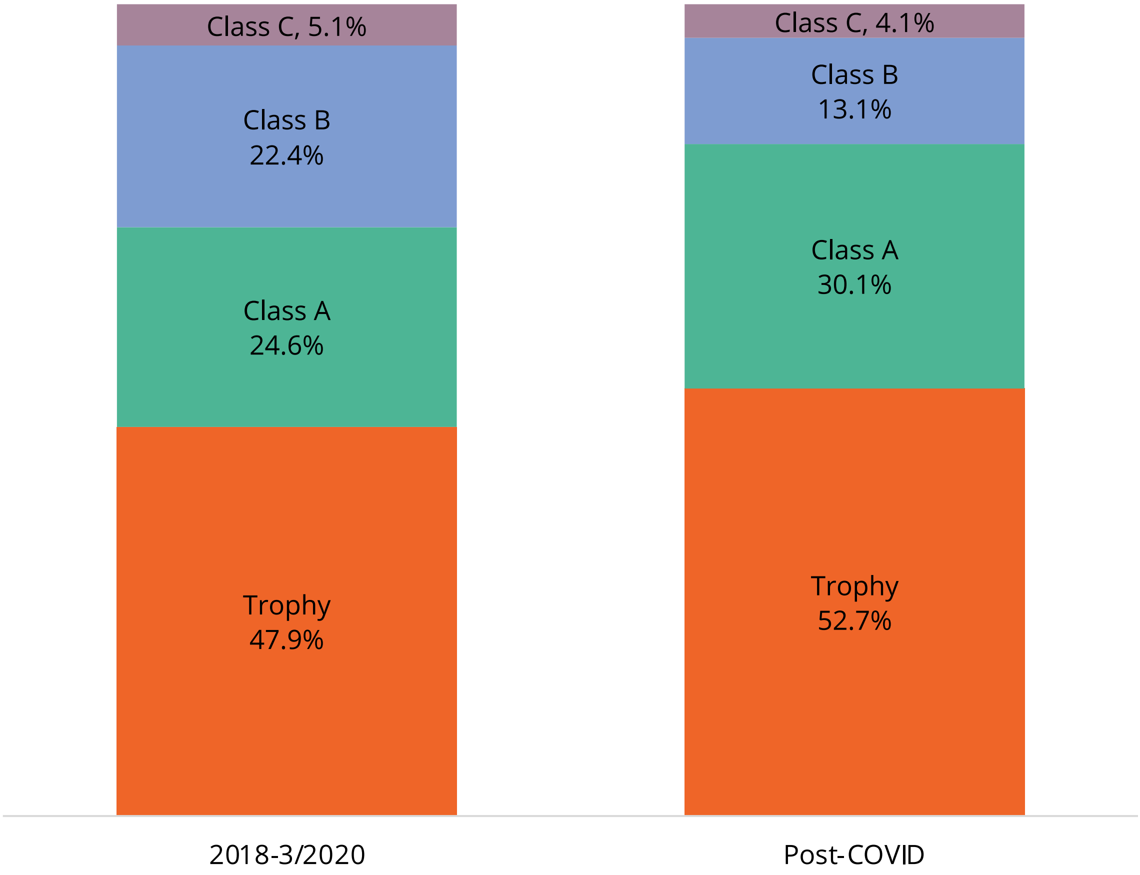
Manhattan flight-to-quality trend

82.8%

Trophy + Class A
office leasing activity post-COVID

The ‘flight-to-quality’ trend that has persisted for several years has been exacerbated as transit-oriented, top-of-market options gain leasing traction while commodity offerings have struggled to attract tenant commitments.



Source: AVANT by Avison Young

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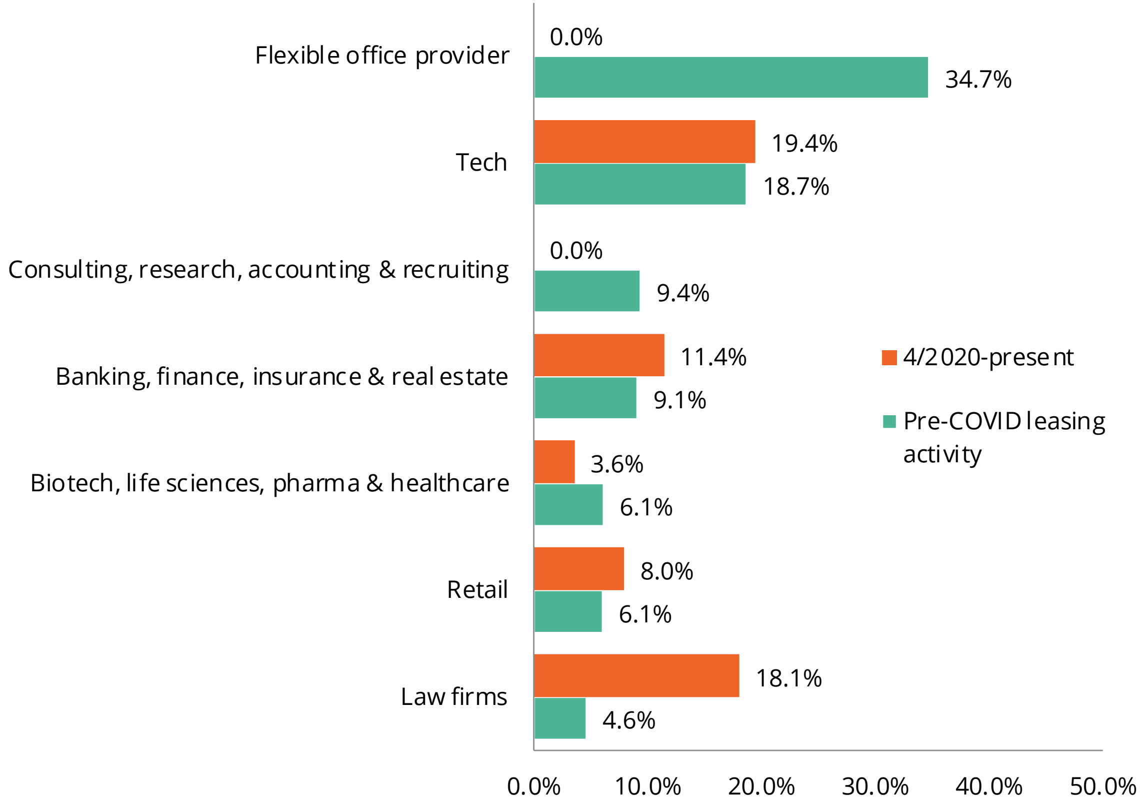
Manhattan Class B and Class C office demand

34.7%

2018-3/2020 Class B and Class C leasing activity by coworking companies

Flexible office providers anchored demand for commodity properties before the pandemic but have since ceased their expansions, intensifying weakening market fundamentals in the Class B and Class C market segments.

Class B and Class C leasing activity



Source: AVANT by Avison Young

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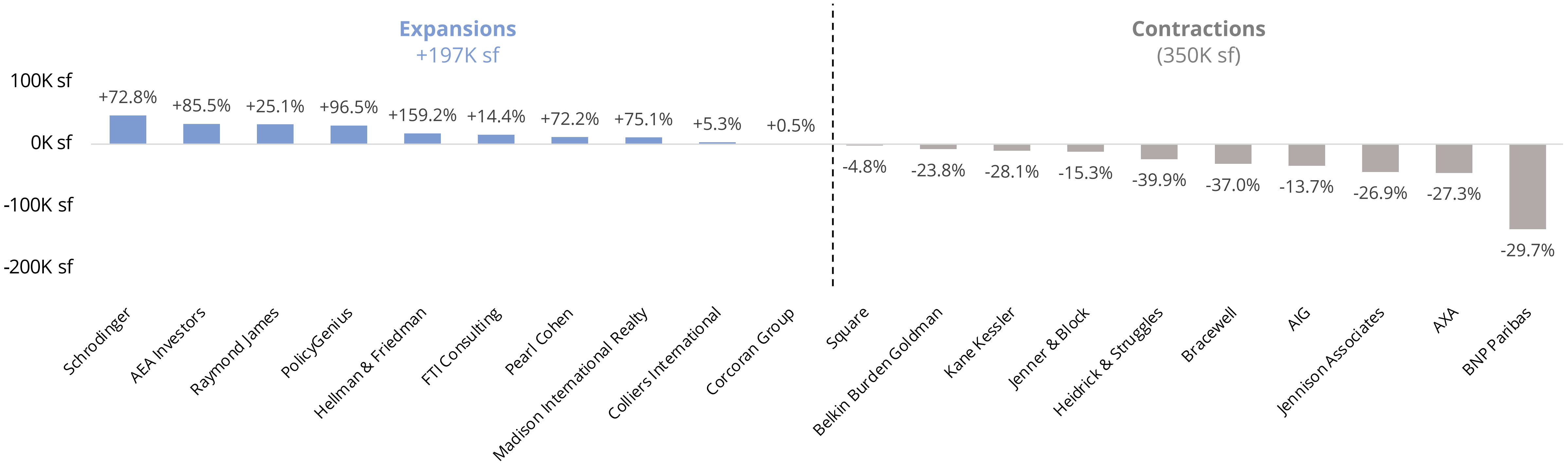
Post-COVID expansions and consolidations

24.6%

Average contractions by representative 50,000-sf commitments from April 2020 to June 2021



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

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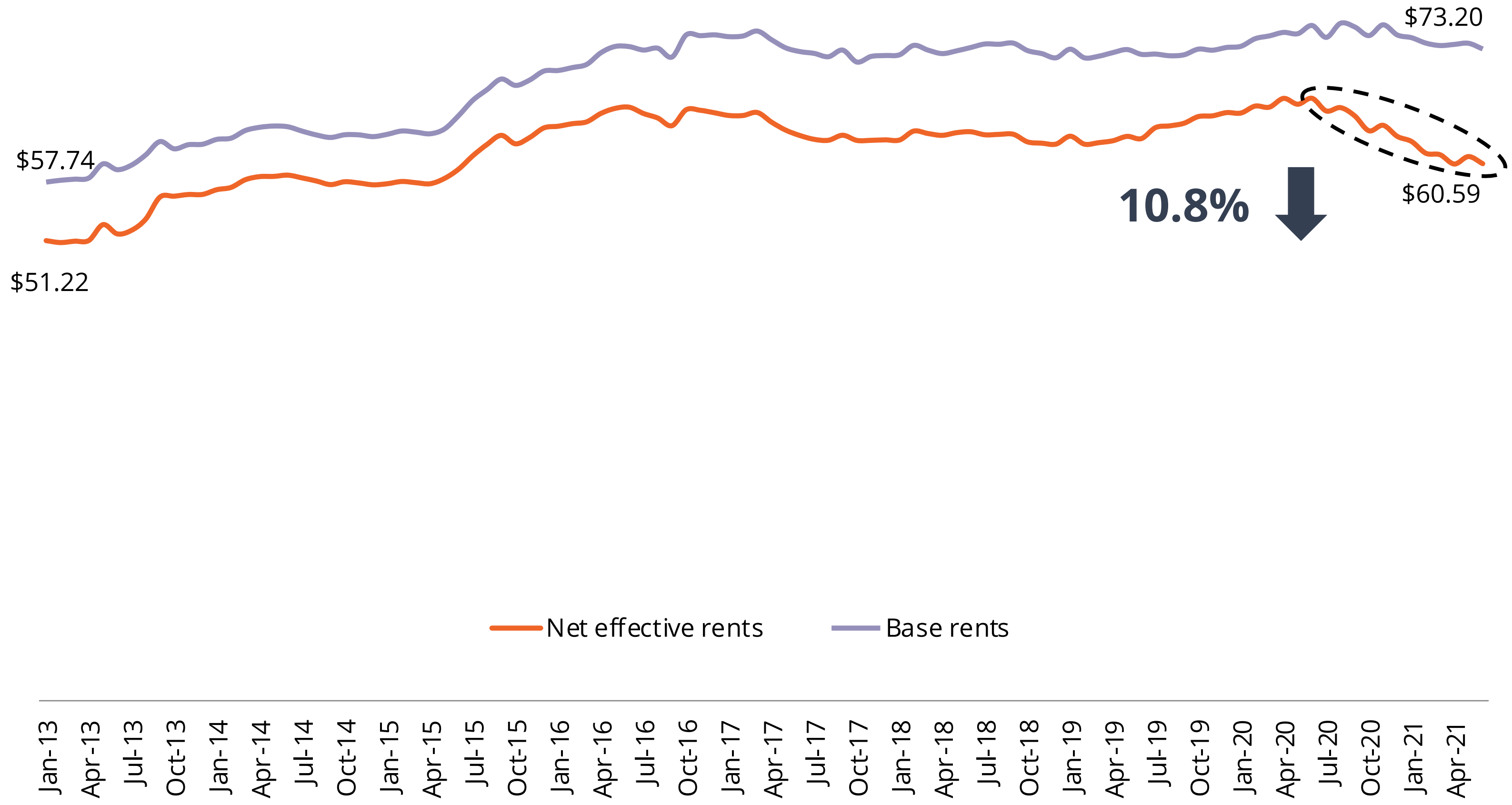
Class A net effective rents and base rents

-10.8%

Change in Manhattan net effective rent from April 2020 to June 2021

Net effective rents have shown signs of stabilizing since March 2021, signaling that demand has risen as office occupiers return to work and tenants that postponed their real estate decisions re-enter the market.



Note: Class A office properties. Trailing 12-month unweighted averages. Excludes subleases, renewals and expansions. Source: AVANT by Avison Young

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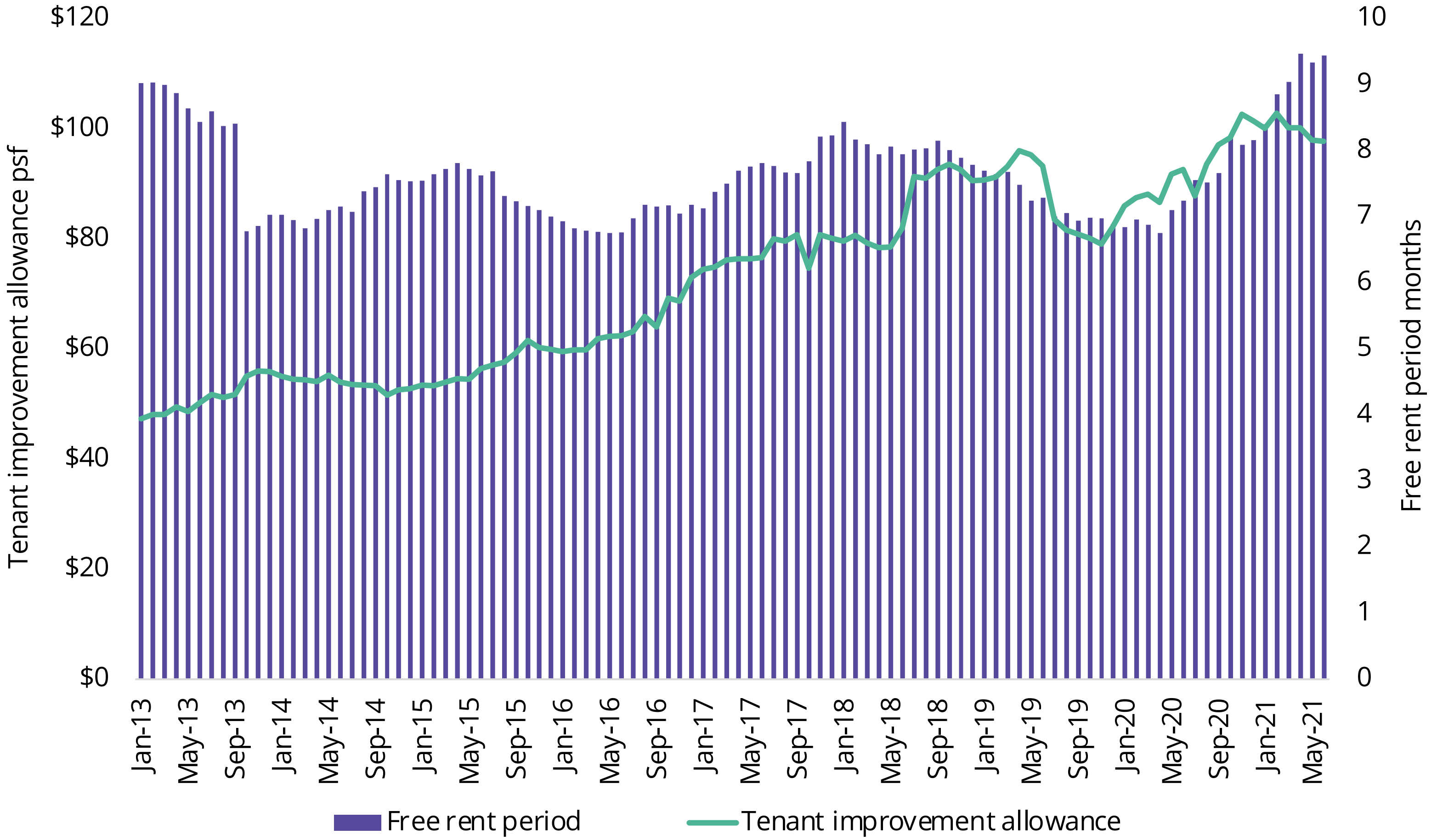
Manhattan concessions

-2.5%

Change in tenant improvement allowance, April 2021 to June 2021

Tenant improvement allowances and free rent periods have begun to level off as activity levels have risen, though both concessions remain near historical highs.



Note: Class A office properties.
Trailing 12-month unweighted averages. Excludes subleases, renewals and expansions.
Normalized to 10-year lease terms. Source: AVANT by Avison Young

Indicative Class B and 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 06/2021	$62 psf	8 months	$88 psf	$43 psf

Note: Class B and C direct relocations only normalized for 10-year lease terms.
Source: AVANT by Avison Young

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Manhattan's aging office inventory

62 properties

proposed or under construction

41.7 msf

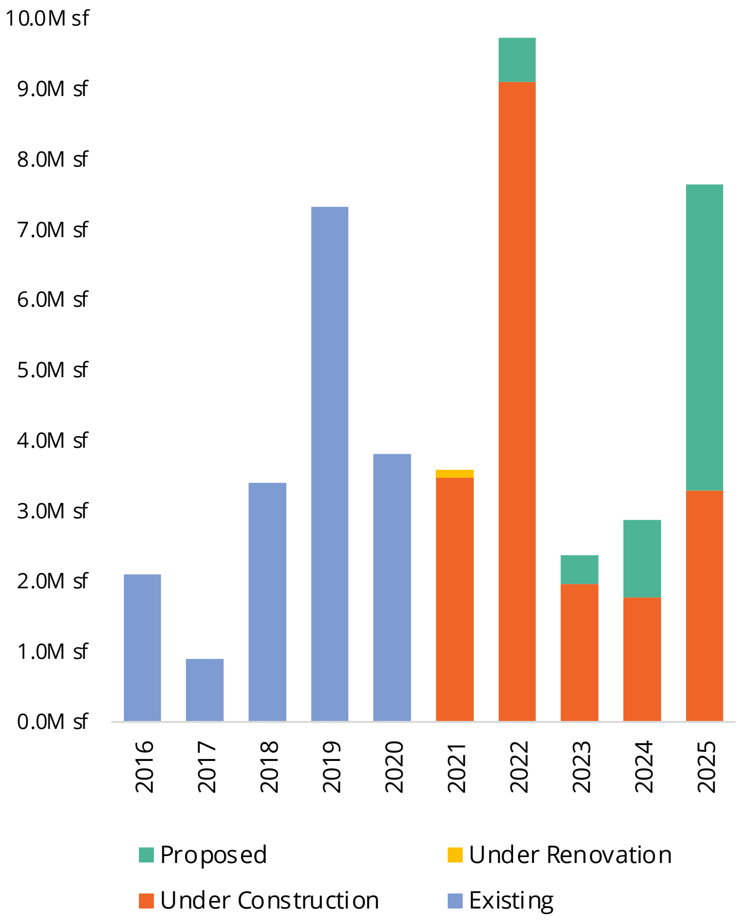
proposed or under construction

7.9%

share of office inventory

1930

average delivery date of existing Manhattan offices



Source: AVANT by Avison Young

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Capital market conditions

Investors have encountered a risk pricing crisis as office occupier conditions became strained, raising the prospect for defaults in the commodity market segment.

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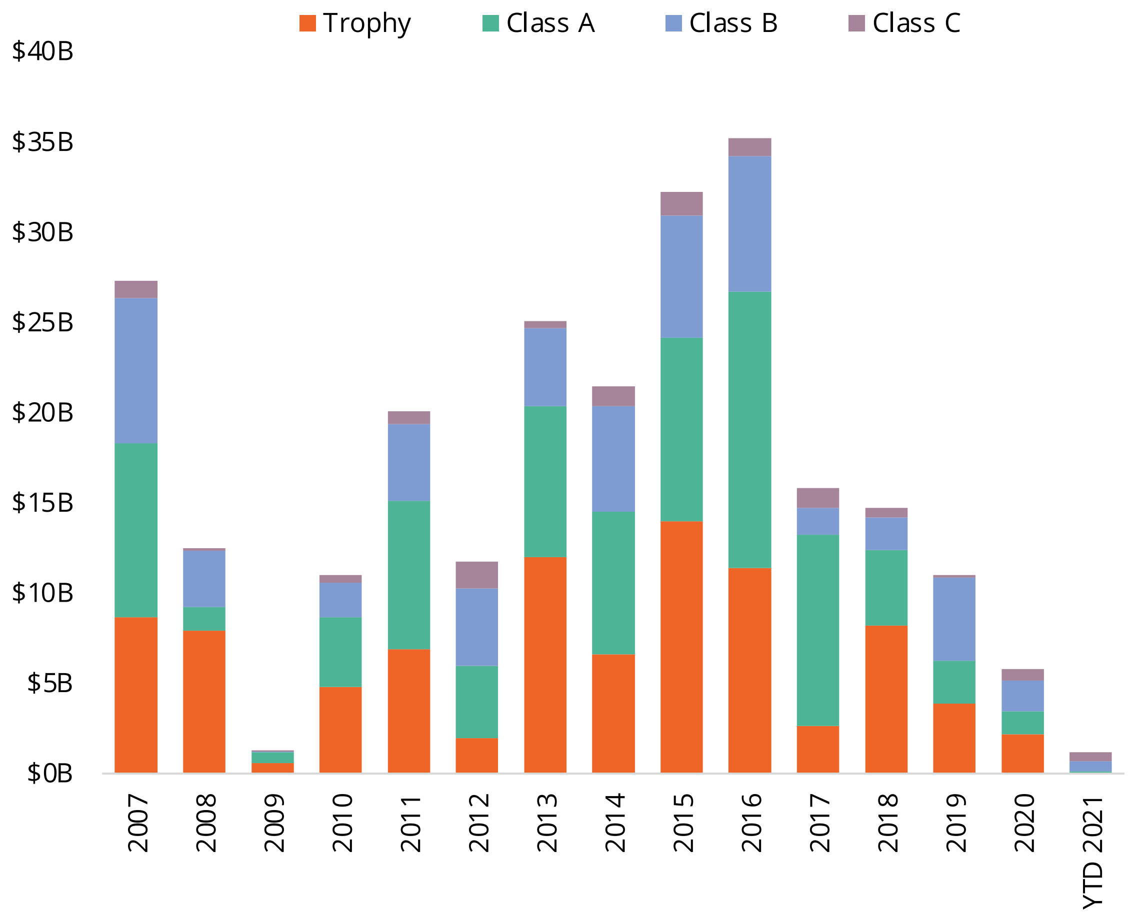
Manhattan office investment dollar volume

$7.0B

Manhattan office dollar volume 2020 to June 2021

Office sales activity has temporarily paused since the beginning of 2020, decreasing by an annualized rate of 78.6% compared with the prior five-year average dollar volume of $21.8B.



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

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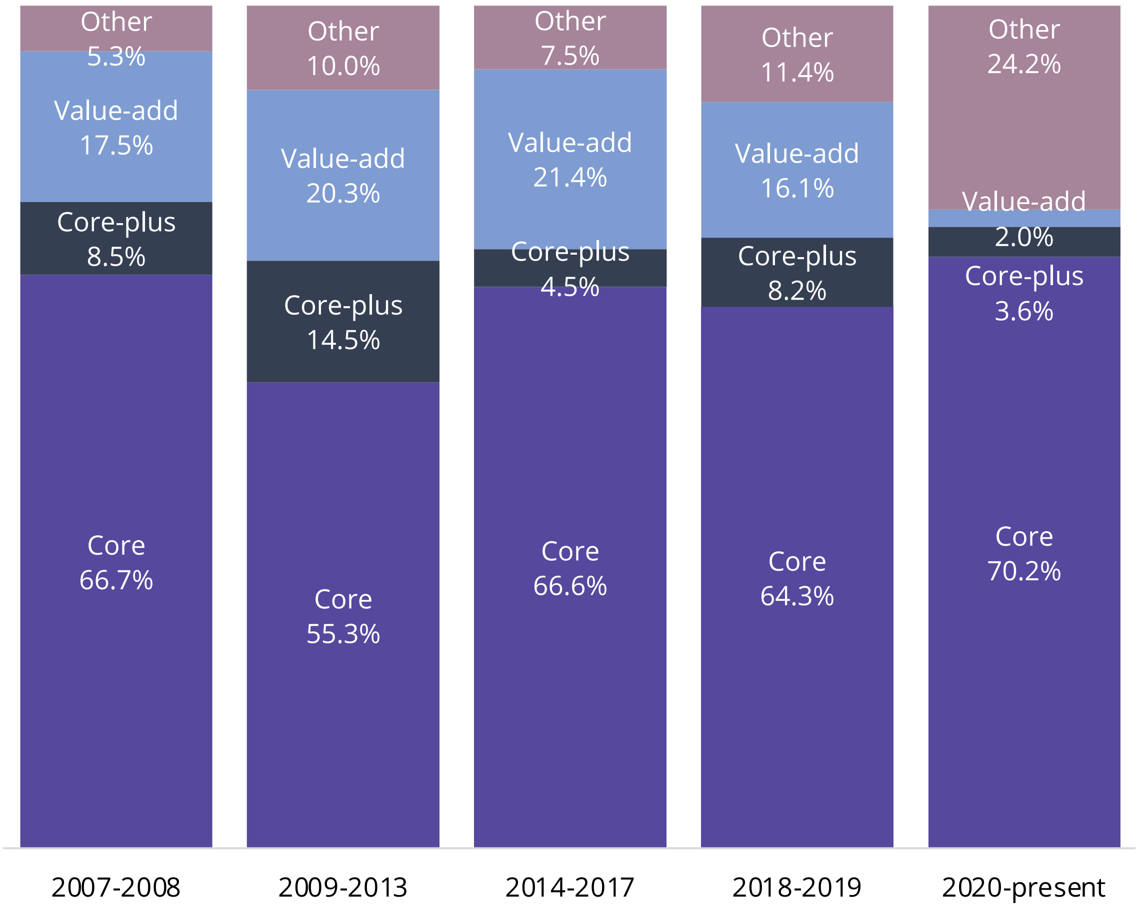
Manhattan office investment asset profiles

70.2%

Manhattan core investments based on dollar volume since 2020

Transactions that fit the profile of the recently-traded 410 Tenth Avenue are likely to become more prevalent as investors prioritize ‘safe-haven’ investments over riskier, transitional opportunities due to prevailing occupier market uncertainties.



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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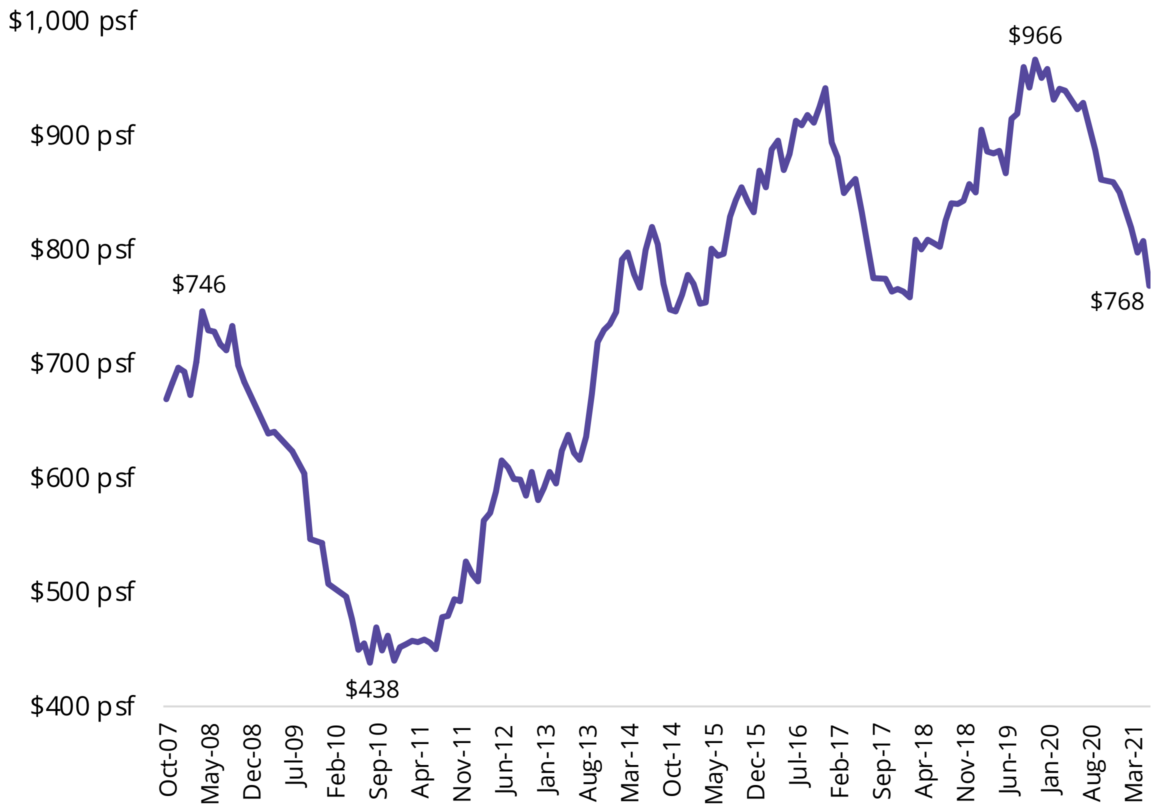
Manhattan office asset pricing

-20.5%

Manhattan office pricing from November 2019 to June 2021

Prices are trending downward but are unlikely to deteriorate to global financial crisis levels (-41.3% peak-to-trough) because investors are facing a risk pricing, not a liquidity, crisis in the current recessionary environment.



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

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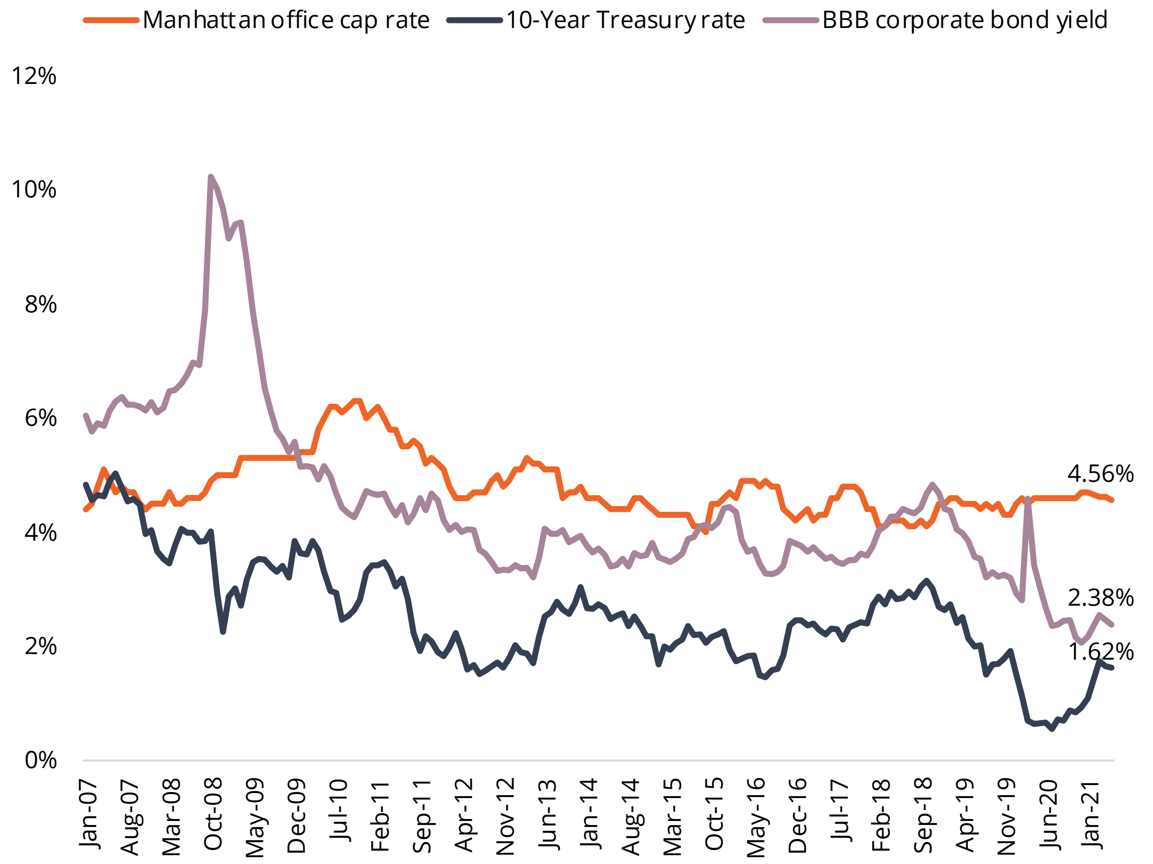
Office cap rates versus benchmark yields

377 bps

Manhattan office spread vs. 10-year Treasury rate

There is an attractive spread between Manhattan office cap rates and benchmark 10-year Treasury and BBB corporate bond yields, underscoring stabilized office properties' favorable risk/return profile.



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

Looking forward

Here's what we can expect

- The **mayoral election**, which began with primaries on June 22 and will conclude with a general election on November 2, **could have significant implications for the New York City office market**. Hot-button issues include public safety, economic recovery efforts and other quality of life concerns.
- Bellwether **companies are beginning to return to the office**, a leading indicator for rejuvenated office demand. Two leading bulge bracket banks, Goldman Sachs and JPMorganChase, began their return-to-work efforts on June 1, which could have a trickle-down effect on other financial services companies and office-using industries.
- **Office leasing demand is incrementally rising** as indicated by increasing term lengths, though continued downward momentum is anticipated on net effective rents for commodity properties.
- **Asset pricing is likely to continue to trend downward**, but risk/return metrics for stabilized office properties remain favorable based on the prevailing spread between cap rates and benchmark yields.

AVANT by AVISON YOUNG

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Let's talk