Manhattan Office Market Topics and Trends – Q3 2020

With uncertainty abound in the Manhattan Class A and B office market, performance in the year ending Q3 2020 indicates that sales volume is down considerably compared to recent years and fundamentals are currently being heavily watched as the COVID-19 crisis develops. Total dollar volume in the year ending Q3 2020 is down over 66% from year ending Q3 2016, with decreases seen over the past three years. This report analyzes the trends in market fundamentals and investment sales in the Manhattan Class A and B office market, including the Midtown, Midtown South, and Downtown submarkets.

FEATURE: COVID-19 and its Impact on the Market

In Mid-March 2020, the Global COVID-19 Pandemic brought much of the world and New York City to a halt. The spread of the virus was so rapid, that nations, states, and local municipalities were forced to take drastic measures. In addition to the health risk itself, there is ongoing societal angst with most US citizens living under state mandated lockdown orders. Some offices have begun to resume occupancy, but at limited capacities, and the return of full-time occupancy is still uncertain.

For the commercial real estate market, this crisis will have both short-term impacts that are now becoming obvious. It will also have long-term impacts that will unfold over time.

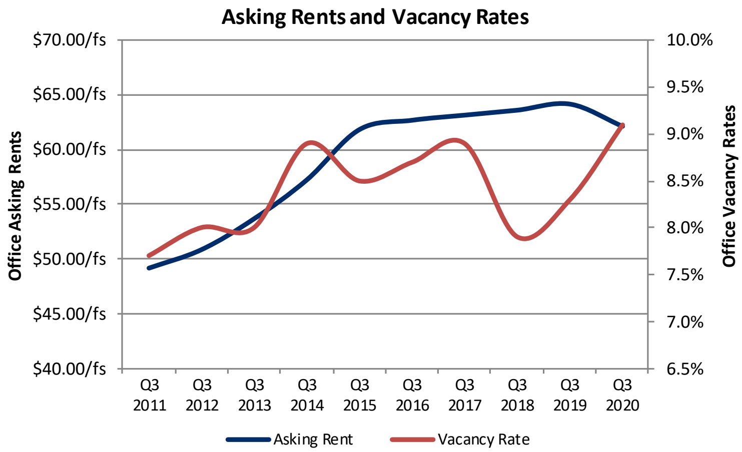
Short Term Impact

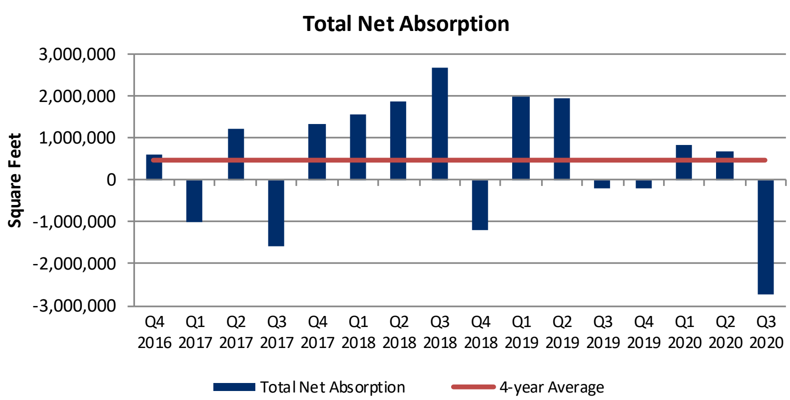
Previously, Labor Day was supposed to mark a return to the office for many businesses; however, most companies are still operating under work from home orders. As stated by CBRE Vice Chair Paul Amrich "…the conversations and the Zoom calls are now more specifically deal-oriented, rather than just where the market is and where the market is headed. It's more of a sign that folks are ready to re-engage to consider a transaction". There has not been a rush to deal making over the summer months, and September marked a month with zero transactions.

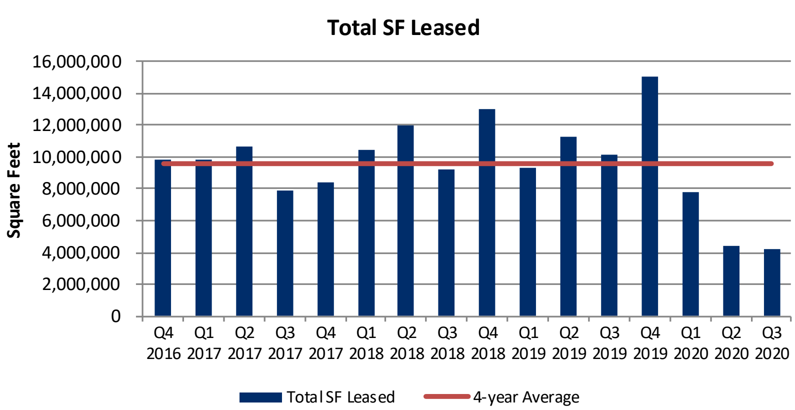
Older office parks in the suburbs have been in relatively high demand recently, due to the ability to space out workers, and the proximity to those who live in suburbs. This brings up the question, will this be a trend that carries into the future?

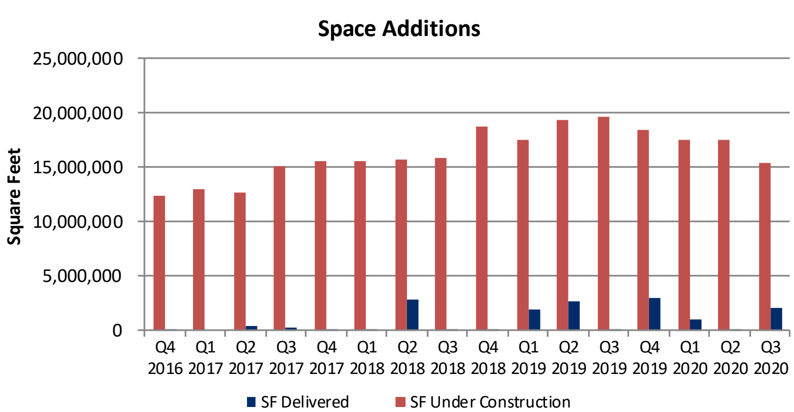
Long Term Impact

With vacancies looming, and revenue loss seen throughout the crisis, transaction figures continue to be grim.









MARKET FUNDAMENTALS: Average Asking Rents & Vacancy

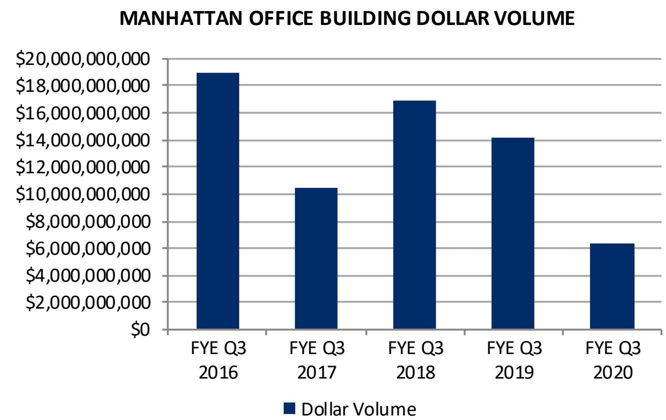
Prior to the pandemic, fundamentals were healthy. Between Q3 2011 and Q3 2020, vacancy rates fluctuated between a low of 7.7% (Q3 2011) and a high of 9.1% (Q3 2020). Over the past year, vacancy rates have increased sharply, in line with the trend that began in Q3 2018. Asking rents have been increasing relatively consistently, ranging from $49.23 per square foot (Q3 2011) to $64.09 per square foot (Q3 2019), until the most recent quarter when there was a decline, down to $62.07 per square foot. The pandemic has caused an extended dip in demand, vacancies are rising, and rent is declining, almost to an inflection point. We are likely heading into a tenant's market.

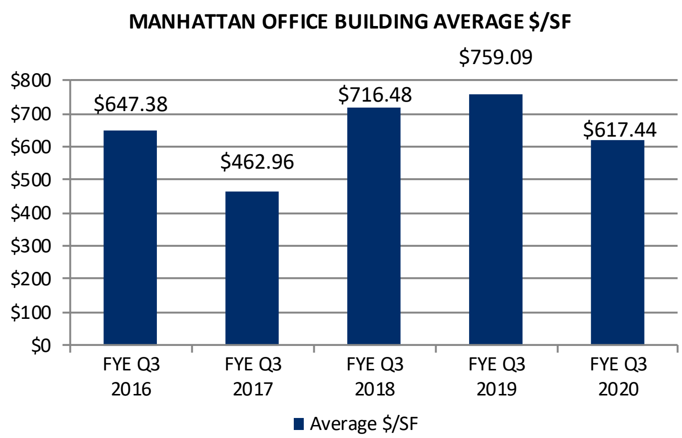
Net Absorption and Leasing Activity

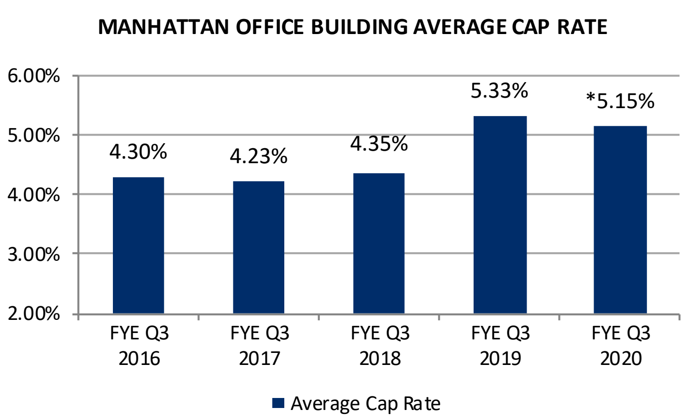
Total net absorption in the Manhattan market has been relatively low since the end of 2019. Q3 2020 demonstrates a concerning net absorption figure, at negative 2.7 million square feet. Total square feet leased is down for the third consecutive quarter. Leasing activity increases are not expected to resume anytime soon, as work from home orders have forced much of the workforce to operate from home.

Space Addition Activity

There is still a fairly large amount of space under construction that is waiting to be delivered, indicating an active construction pipeline prior to the pandemic outbreak. With increased transit connectivity, tenants have shifted their focus from just the Midtown core and are now open to different areas of the metro, like Hudson Yards. All construction activity has resumed, and developers will be excited to deliver on projects.







NOTE: Q3 2020 data from PwC Korpacz Investor Survey

SALES (5 YEAR TREND): Volume

Total dollar volume for investment sales of Class A and B office buildings in Manhattan has been decreasing year over year since Q3 2018. Since 2016, when a surge of Chinese investment capital flowed into the metro, there has been a significant decrease in total dollar volume, down to approximately $14 billion in 2019 compared to $19 billion in 2016. The 2020 results are 67% lower than 2016 and 55% lower than 2019 figures.

Average Pricing Per SF

There was a significant increase in average pricing in Q3 2019. The average as of 2020 was $617 per square foot, which is a 19% decrease compared to the pricing seen in 2019, but still above pricing in 2017. Market participants will be watching this metric carefully for the remainder of 2020.

Capitalization Rates

According to PwC Korpacz data, the average cap rate for Class A and B office buildings in Manhattan decreased slightly in the last year. As of a Q1 2020 report, PwC placed this market in expansion through 2020, moving into contraction for 2021 and recession for 2022 and 2023; however, this timeline has already been shifted due to COVID-19. Price discovery has been an area of difficulty as transaction volume is low, with no transactions in the month of September for this asset class. Market participants will be eager to see how cap rates move as more data becomes available.

SOURCE: CoStar, Bisnow, PwC Korpacz Investor Survey, and Marshall & Stevens

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