Manhattan Office Market Topics & Trends – Q1 2021

The Manhattan Class A & B Office market has witnessed a sharp decrease in demand since the onset of COVID-19. Health concerns have shifted demand from urban office as users seek remote working or suburban locations that offer more safety. The Manhattan office market has seen a sharp decline in investment sales volume, higher vacancy rates, lower rents, and higher cap rates over the last year. Furthermore, the PWC Real Estate Investor Survey projects a recession in the Manhattan office market over the next three years, suggesting the current trends will likely continue.

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

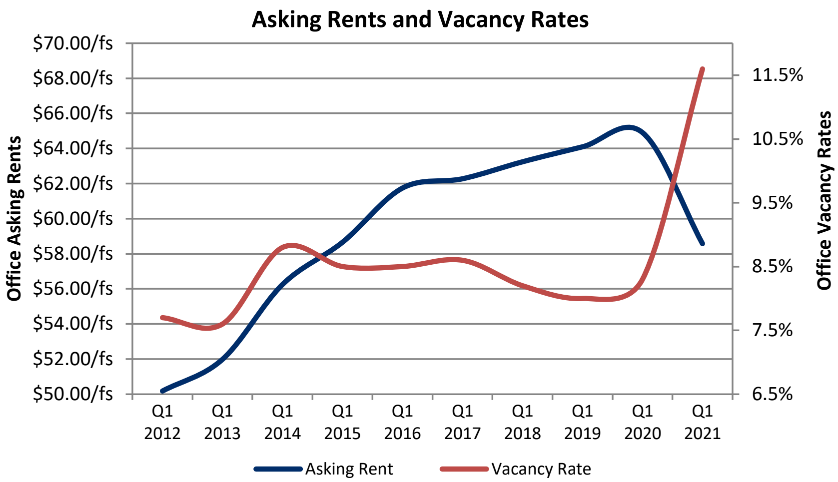
In Mid-March 2020, the Global COVID-19 Pandemic brought much of the world and New York City to a halt. The spread of the virus was so rapid, that nations, states, and local municipalities were forced to take drastic measures. Conditions improved in the summer months, but a second surge in the fall brought about new restrictions and further economic hardship for individuals and businesses alike. On the forefront as we close out Q1 2021 is the rollout of the three approved vaccines to the public and the short and long-term effects this has on the performance of different asset classes.

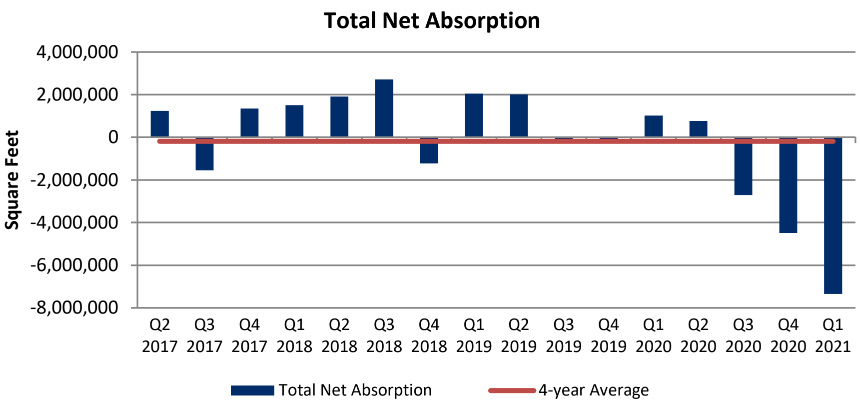
Short Term Impact

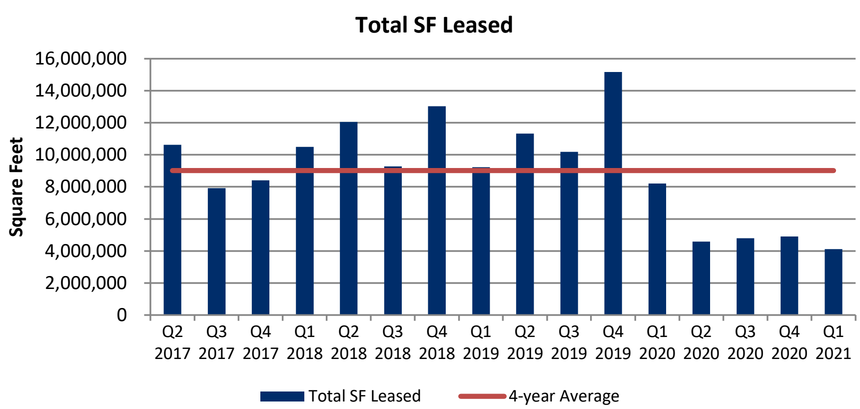
Most companies have operated virtually since March 2020 with the safety of their employees in mind. Many companies that have returned to work have implemented safety measures, like rotational shifts. Work from home measures have proven to be both cost effective and equally productive for most companies. One of the most alarming trends in the Manhattan Class A & B office market has been net absorption, which registered at negative 7.35 million square feet as of Q1 2021.

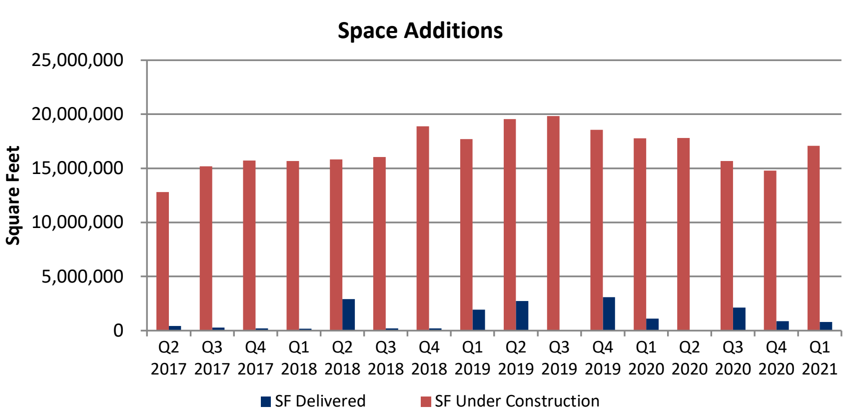
Long Term Impact

Given its reliance on public transit for commuters coming from the NYC outer boroughs and nearby suburbs, Manhattan remains more of a high-risk office setting. Suburban locations that can effectively space workers and eliminate the need for public transportation are becoming more feasible alternatives. We can expect greater concession packages and lower effective rents in this market going forward.









MARKET FUNDAMENTALS: Average Asking Rents & Vacancy

Between Q1 2012 and Q1 2020, vacancy rates fluctuated between a low of 7.7% (Q1 2012) and a high of 11.6% (Q1 2021). Over the past year, vacancy rates have increased sharply from 8.3% to 11.6%. Asking rents declined by over $6 per square foot from Q1 2020 to Q1 2021, exhibiting the lowest asking rent figure ($58.58) since Q1 2014 ($56.25). The pandemic has caused a notable decline in office demand. We are currently in a tenant's market, with vacancy rising and rents falling.

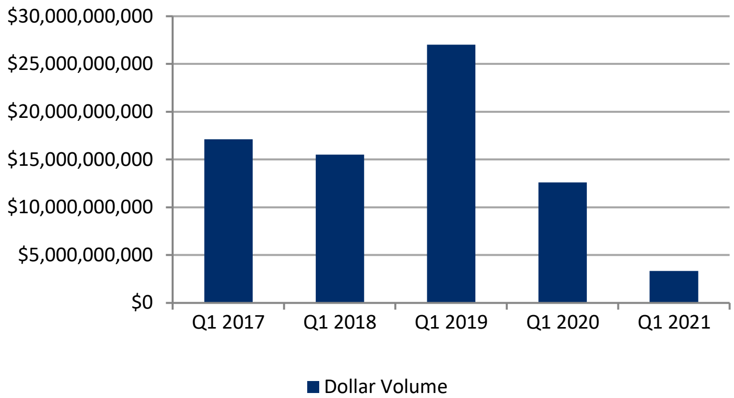
Net Absorption and Leasing Activity

Total net absorption in the Manhattan market has decreased significantly over the last year. Q3 2020 saw negative absorption of 2.7 million square feet, whereas Q4 2020 saw negative absorption of nearly 4.5 million square feet, and Q1 2021 saw negative absorption of over 7.3 million square feet. Leasing activity remains well below the average and has not shown any signs of rebounding. While work from home orders may no longer be mandated, many companies have shifted their business model to encourage working remotely.

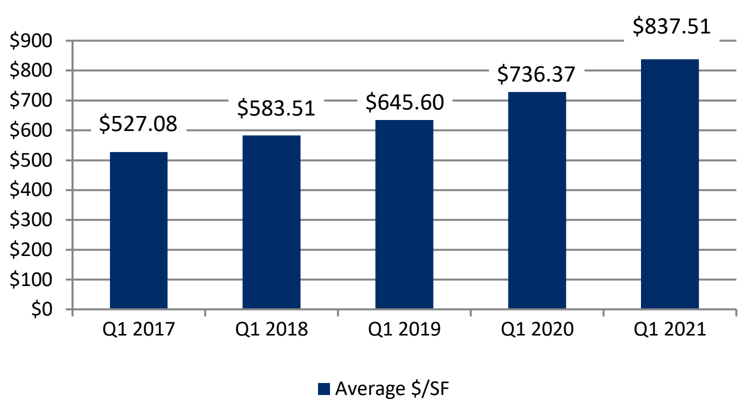
Space Addition Activity

There is still a fairly large amount of space under construction that is waiting to be delivered, indicating an active construction pipeline. 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. The market should see some of these projects delivered to market in upcoming quarters. However, new construction in the Manhattan office market does not seem feasible given current trends in demand.

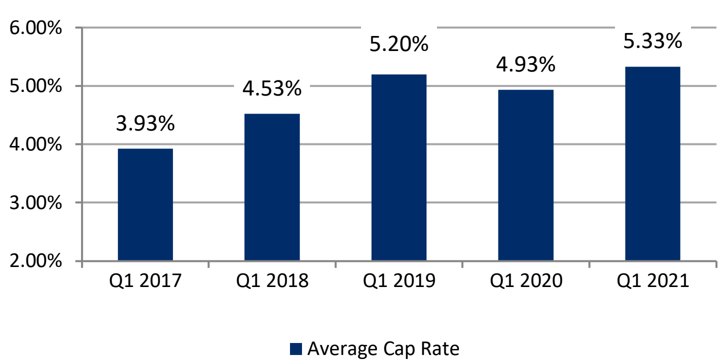
MANHATTAN OFFICE BUILDING DOLLAR VOLUME



MANHATTAN OFFICE BUILDING AVERAGE $/SF



MANHATTAN OFFICE BUILDING AVERAGE CAP RATE



SALES (5 YEAR TREND YE Q1): Volume

Total dollar volume for investment sales of Class A and B office buildings in Manhattan peaked in 2019 and has decreased precipitously since. Average quarterly sales from Q1 2017 to Q1 2019 was roughly $19.8 billion. Quarterly sales in Q1 2020 were $12.6 billion, down roughly 58 percent, and $3.3 billion in Q1 2021, down nearly 500 percent. Investors largely remain on the sidelines for Class A & B office buildings.

Average Pricing Per SF (YE Q1)

Whereas transaction volume has fallen off over the last few years, price per square foot has increased. Price per square foot is at its highest level as of the year ending Q1 2021, although it should be noted that fewer transactions can skew pricing results one way or the other.

Capitalization Rates (YE Q1)

According to PwC Korpacz data, the average cap rate for Class A and B office buildings in Manhattan increased from 4.93% to 5.33% over the last year. As of a Q1 2021 report, PwC placed this market in expansion through 2020, moving into contraction for 2021 and recession for 2022 and 2023. This timeline has shifted due to COVID-19, and the market is now projected to be in a recession from 2021 to 2024. Market participants will be eager to see how cap rates move as more data becomes available.

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

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