MARKET REPORT

Office

New York Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

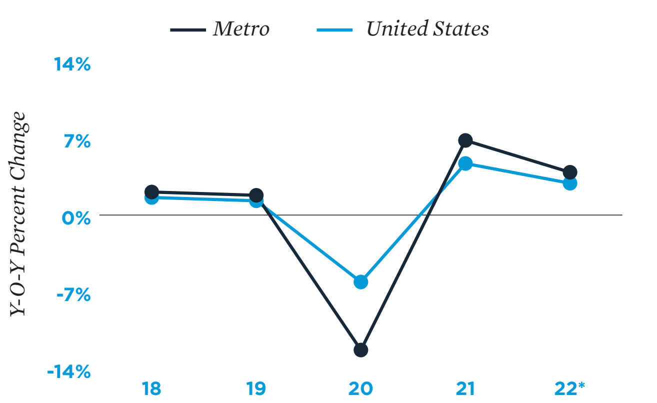
2Q/22

Workers Filter Back into Offices; Wave of New Top-Tier Assets on the Horizon

Having weathered omicron headwinds, recovery back on track. Office usage as of May stood at 38 percent of pre-2020 counts based on a Kastle Systems utilization survey, exceeding pre-omicron figures and the highest measure since the onset of the pandemic. While health concerns are subsiding, changing workplace strategies could reshape leasing moving forward. As of April, 78 percent of the city's traditional office-using employers have plans to implement hybrid workplaces, up from 6 percent before the appearance of COVID-19. With less workers expected to be in the office full time, many tenants may favor smaller floor plans and spaces that offer greater flexibility than a traditional office environment.

Bifurcated performance in marketed rents persists. As New York's largest employers look to entice workers back to the office, performance gaps between property tiers have emerged as tenant preferences increasingly trend toward amenity-rich stock. Newer Class A developments should continue to capture leasing from high-profile tenants, indicated by Meta's 1.2 million-square-foot lease in Hudson Yards, and nearby move-ins by HSBC Bank USA and AllianceBernstein. Marketed rents in this tier have begun to show year-over-year gains as of the first quarter, but the 18 million square feet of Class A space in the pipeline could complicate recovery. Though rents in Class B and C assets are still downward trending, vacancy appears to be stabilizing as owners have increased concessions and adopted more flexible leasing models to attract and retain tenants.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

170,000 JOBS
will be created

EMPLOYMENT:

As recovery continues, New York's employment tally should expand 3.9 percent in 2022. The city's traditionally office-using employers will gain 45,000 personnel, achieving pre-pandemic staffing counts by the end of the year.

10,100,000 SQ. FT.
will be completed

CONSTRUCTION:

Developers will finalize the second-highest amount of square footage since the onset of the financial crisis. This year, over 5.7 million square feet of 2022 deliveries stem from two developments in and adjacent to the Hudson Yards.

40 BASIS POINT
increase in vacancy

VACANCY:

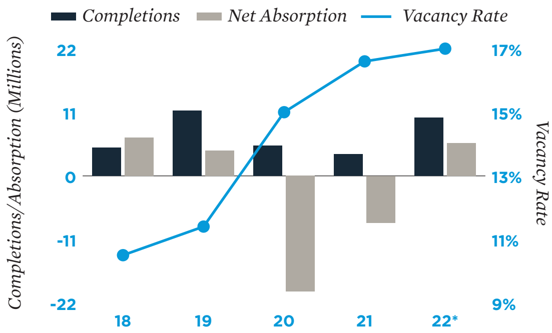
Rapid stock expansion, as office usage remains well under pre-pandemic norms, will translate to a fourth consecutive year of increasing availability, pushing up citywide vacancy to 17.0 percent.

2.0% INCREASE
in asking rent

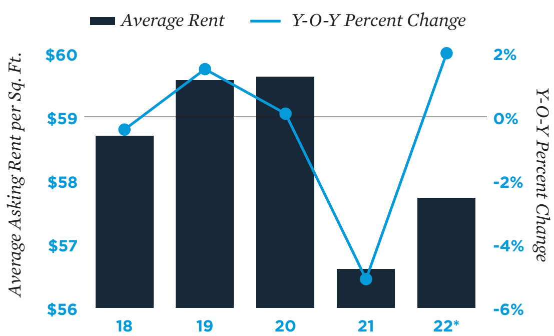
RENT:

Despite robust development, ongoing leasing activity should contribute to the recovery of asking rents that began in mid-2021. The average marketed rate will end this year at $57.73 per square foot.

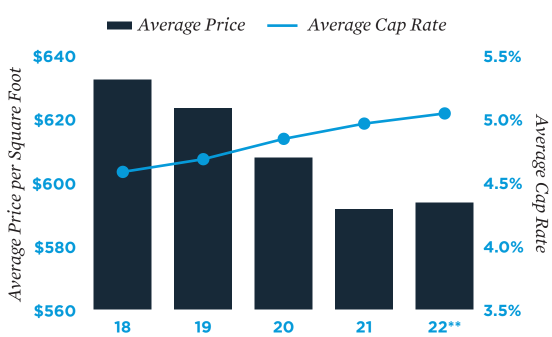
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION

3,942,000 sq. ft. completed

- With over 20 million square feet of space underway, New York retains the weightiest construction pipeline of all metros nationwide.
- More than 2.3 million of the square feet finalized during the yearlong period ended March came online in Midtown, Midtown South and Downtown Brooklyn, as developers focused on the city's central business districts.

VACANCY

30 basis point increase in vacancy Y-O-Y

- While net absorption remained strongly positive during the latter half of 2021, vacancy still ended the first quarter of 2022 perched at 16.8 percent.
- Submarkets where availability increased substantially in 2020 observed significant vacancy compression this period, including Midtown South, North Brooklyn and Northwest Queens.

RENT

1.2% increase in the average asking rent Y-O-Y

- After hitting a pandemic-era low in mid-2021, the mean asking rent rose in recent months to end the first quarter at $56.54 per square foot.
- Preferences for high-quality space have translated to a bifurcated recovery. Class A rents posted a 3.1 percent gain during the yearlong span, while marketed rents on lower-tier assets declined 1.8 percent on average.

Investment Highlights

- Despite the sector's rising vacancy, transaction activity returned to pre-2020 equivalents during the trailing 12-month period ended March, as investors anticipated a forthcoming return to the office. Uncertainty regarding the length of the recovery made underwriting more difficult during this period, contributing to the most significant pricing decline observed since 2017, as the average price per square foot fell to $594. Falling entry costs could make room for new investors in the market moving forward.
- Supported by robust fundamentals in this sector, medical office deals also returned to pre-pandemic levels during the yearlong period. These properties typically changed hands with cap rates in the low-5 to high-6 percent range, though well-located assets in residential zones could trade with yields as low as 4 percent.
- The Long Island boroughs offer a number of lower-tier properties for investors operating in the sub-$10 million zone. Investors in pursuit of assets here may employ value-add strategies, or repurpose traditional office properties for medical uses.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions sold for $1 million or greater unless otherwise noted. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice. Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics; Partnership for New York City

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