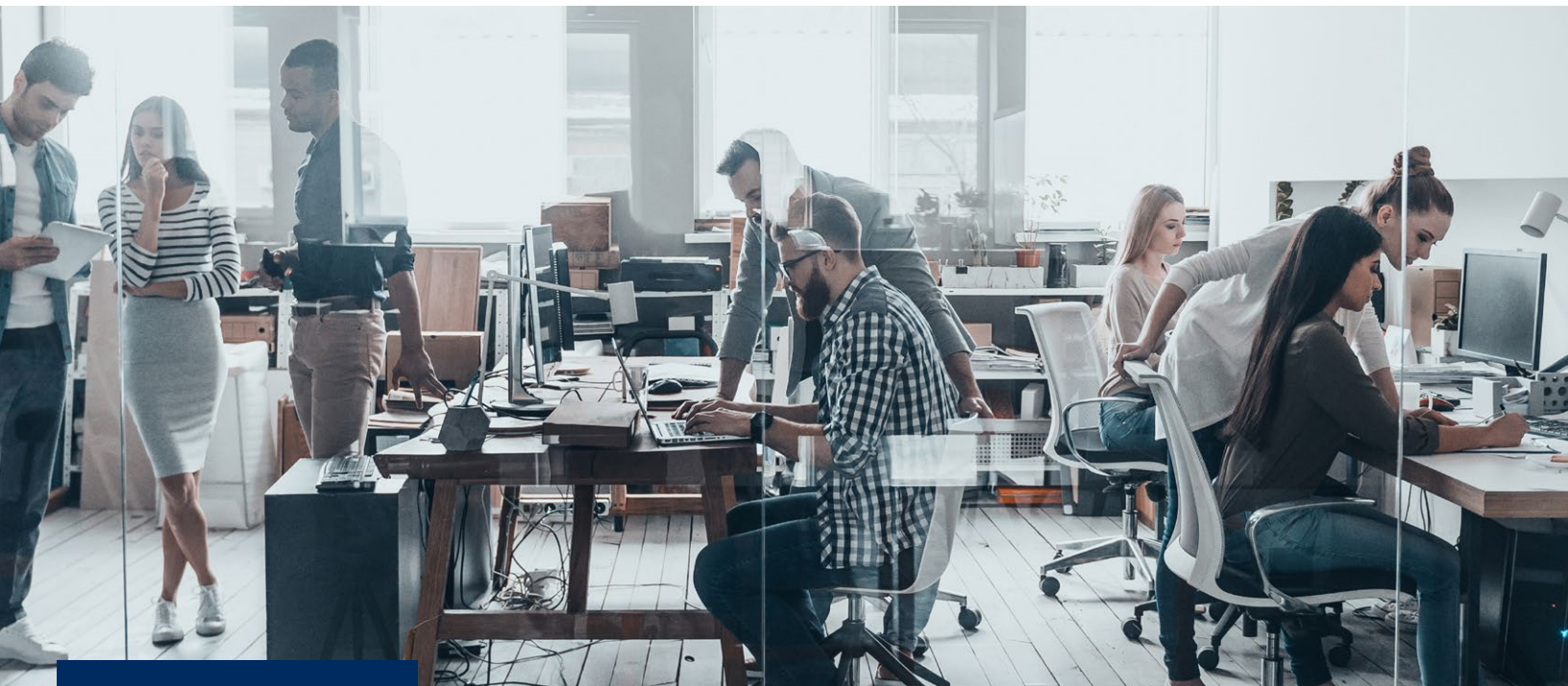


# Office Leasing



## Market Facts

**\$80.36 PSF**

Overall Manhattan asking rent now above \$80.00 for first time ever

**\$81.78**

Record high for Midtown South overall asking rent

**125%**

Year-over-year growth in Downtown leasing volume for 1Q19

**9.8%**

First quarter vacancy rate; Manhattan overall in equilibrium

\*At Avison Young, we track office properties that are 20,000 square feet and greater

## First Quarter Leasing Softens; Manhattan Asking Rents Climb to New Historic High

First quarter 2019 leasing volume of 8.4 million square feet in Manhattan ended lower than the 8.6 million square feet of activity in the first quarter of 2018 (2.0 percent down). Weaker leasing activity in Midtown and Midtown South offset strong leasing velocity Downtown. Despite the overall softness in leasing, the Manhattan vacancy rate declined by 60 basis points year-over-year to 9.8 percent as the result of less space coming online during the first quarter this year. Meanwhile, new development and renovated product in areas such as Hudson Yards, Sixth Avenue and Chelsea helped to drive asking rents up 3.5 percent to \$80.36 per square foot from \$77.67 a year ago, pushing the overall Manhattan rent level above \$80.00 for the first time ever.

## Midtown: Fewer Large Block Transactions Weigh on Leasing Velocity; Asking Rents Hit New High

### Leasing

First quarter leasing activity of 5.0 million square feet is down 15.0 percent from a year ago, partly as the result of fewer closed large block transactions (above 100,000 square feet).

- Ten large block leases (over 100,000 square feet) were executed in the first quarter, compared to 12 a year ago.
- Four of the top five large block leases were renewals, with the law firm of Akin Gump Strauss Hauer & Feld LLP's 280,000 square-foot deal at 1 Bryant Park being the largest.

### Vacancy

Overall vacancy of 9.7 percent decreased 60 basis points year-over-year from 10.3 percent, as the result of less space coming online this quarter.

- Class A vacancy of 10.2 percent declined 30 basis points year-over-year from 10.5

## MARKET DATA POINTS

### Manhattan Overall

Indicator	1Q19	1Q18
Vacancy	9.80%	10.40%
Rent	\$80.36	\$77.67
Absorption	(403,504) SF	(1,487,005) SF

### Midtown Overall

Indicator	1Q19	1Q18
Vacancy	9.70%	10.30%
Rent	\$87.64	\$83.49
Absorption	(631,925) SF	(633,650) SF

### Midtown South Overall

Indicator	1Q19	1Q18
Vacancy	8.20%	8.30%
Rent	\$81.78	\$78.00
Absorption	(401,468) SF	(578,576) SF

### Downtown Overall

Indicator	1Q19	1Q18
Vacancy	11.20%	12.30%
Rent	\$62.13	\$64.28
Absorption	629,889 SF	(274,779) SF

Data as of 4/3/2019

percent, rising back above the 10.0 percent level from 9.8 percent in 4Q18.

- Class B vacancy of 7.5 percent declined 180 basis points year-over-year from 9.3 percent, dropping below the 9.0 percent level for the first time since 2017. Strong leasing, primarily in the Penn Plaza/Garment District submarket, drove this trend.

#### Rents

Overall Midtown asking rents ended the first quarter at \$87.64, up 5.0 percent year-over-year from \$83.49, representing a new high since \$87.30 in 3Q17.

- Class A asking rents are \$92.33, for a record high, up close to 6.0 percent year-over-year from \$87.41, as new development in Hudson Yards and renovated product along Sixth Avenue came to market at higher rents.
- Class B asking rents are \$59.92, down 2.0 percent year-over-year from \$60.92, in part due to rent reductions by some building owners of less competitive product.

#### Midtown South: Overall Leasing Volume Softens, But New Development Drives Asking Rents to a Record High

##### Leasing

First quarter leasing activity of 1.1 million square feet is down 37.0 percent from a year ago.

- There were no large-block closed deals (over 100,000 square feet), compared to three a year ago.
- Tech companies executed 24.0 percent of the leasing during the quarter.
- The largest lease in Midtown South was executed by Google with its 62,448 square-foot expansion at 345 Hudson Street.

- Co-working represented the second largest sector of leasing activity, with such tenants accounting for 20.0 percent of the volume.
- There were no large renewals in Midtown South during the first quarter.

#### Vacancy

Overall vacancy of 8.2 percent declined modestly year-over-year from 8.3 percent.

- Class A vacancy of 11.5 percent increased 220 basis points year-over-year from 9.3 percent due to new supply being added to the market at 540 West 26th Street, as well as 380,000 square feet of direct space coming to the market at 63 Madison Avenue.
- Class B vacancy of 6.5 percent declined 140 basis points year-over-year from 7.9 percent, dropping below 7.0 percent for the first time since 2001.

#### Rents

Overall asking rents ended the first quarter at \$81.78, up close to 5.0 percent year-over-year from \$78.00. This represents a record high for the Midtown South market.

- Class A asking rents are \$100.40, up from \$99.27 last year. Much of the new development is priced in the triple-digits (e.g. 412 West 15th Street and 40 Tenth Avenue).
- Class B asking rents are \$60.97, down 6.0 percent year-over-year from \$64.90 due to higher-priced space being leased, leaving lower-priced inventory currently on the market.

#### Downtown: Increase in Larger-Size Transactions Helps Push Leasing Velocity Up Year-Over-Year

##### Leasing

Strong first quarter leasing activity of 2.3 MSF is up 125.0 percent from a year ago.

- Three large-block leases totaling 864,000 square feet were executed Downtown compared to two totaling 477,000 square feet a year ago.
- NYC Health and Hospitals closed on the largest lease for the Downtown market, and for Manhattan overall, with its 526,552 square foot new lease at 7 Hanover Square.
- The next largest tranche of deals for the Downtown market fell in the 50,000 to 100,000 square-foot range. This quarter, there were seven deals in this range totaling 494,000 square feet compared to only one 50,000 square-foot deal a year ago.
- Of the total 58 leases executed Downtown during the first quarter, 7.0 percent or 4 were renewals.

## Vacancy

Overall vacancy of 11.2 percent declined by 110 basis points from 12.3 percent, back below the 12.0 percent level at year-end 2016.

- Class A vacancy of 11.7 percent declined 60 basis points year-over-year from 12.3 percent, also below the 12.0 percent level at year-end 2016.

- Class B vacancy of 9.2 percent increased 10 basis points year-over-year from 9.1 percent due to an uptick in direct space available.

## Rents

Overall asking rents for the first quarter are at \$62.13, down 3.0 percent year-over-year from \$64.28 PSF.

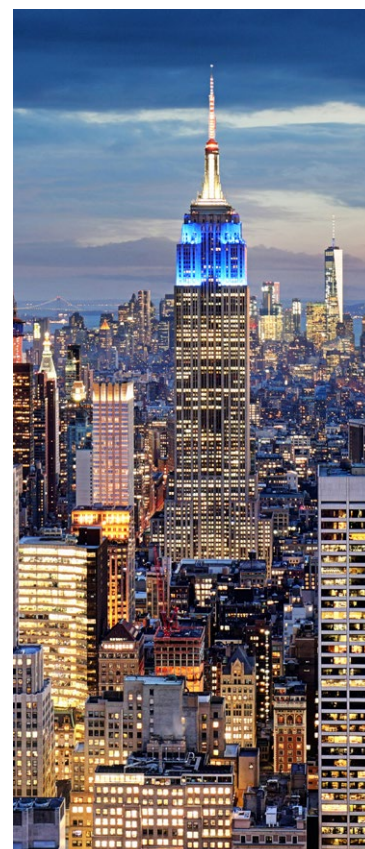
- Class A asking rents are \$63.78, down 4.0 percent year-over-year from \$66.27 due to higher-priced space being leased.
- Class B asking rents are \$53.14, up 4.0 percent year-over-year to \$51.03.

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## Notable First Quarter Leasing by Market

Tenant Industry	New Address Market	Size (SF) Lease Type
<b>Akin Gump Strauss Hauer &amp; Feld LLP</b> Legal Services	<b>1 Bryant Park</b> Midtown	<b>280,000</b> Renewal
<b>Sumitomo Mitsui Banking Corporation</b> Financial Services	<b>277 Park Avenue</b> Midtown	<b>266,000</b> Renewal/Expansion
<b>BMO Capital Markets</b> Financial Services	<b>4 Times Square (151 West 42nd Street)</b> Midtown	<b>215,000</b> New Lease
<b>Google Inc.</b> TAMI	<b>345 Hudson Street</b> Midtown South	<b>62,448</b> Renewal
<b>Johnson &amp; Johnson</b> Health Services	<b>601 West 26th Street</b> Midtown South	<b>61,526</b> New Lease
<b>Deloitte</b> Business Services	<b>330 Hudson Street</b> Midtown South	<b>58,110</b> Sublease
<b>NYC Health + Hospitals</b> Legal Services	<b>7 Hanover Square</b> Downtown	<b>526,552</b> New Lease
<b>WeWork</b> Real Estate	<b>199 Water Street</b> Downtown	<b>201,231</b> New Lease
<b>Hudson River Trading</b> Financial Services	<b>3 World Trade Center</b> Downtown	<b>135,921</b> New Lease

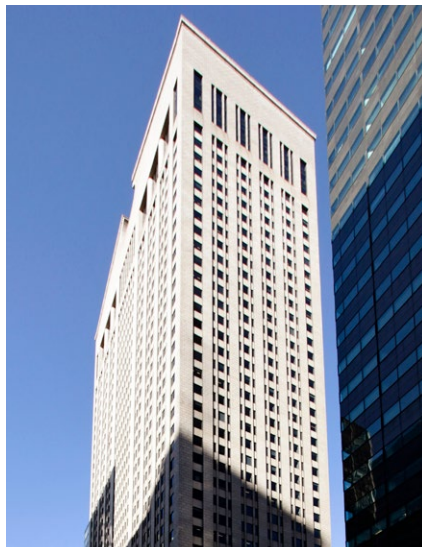




## Largest Blocks of Contiguous Space Currently Available



3 World Trade Center  
World Trade Center | 1,001,008 RSF



550 Madison Avenue  
Plaza District | 797,505 RSF



11 Penn Plaza  
Penn Plaza/Garment | 638,921 RSF



151 West 42nd Street  
Times Square/West Side | 435,142 RSF



63 Madison Avenue  
Gramercy Park | 380,716 RSF



625 Madison Avenue  
Plaza District | 336,057 RSF

## Trends to Watch



Expect additional new product being delivered over the next 12 months in and around Hudson Yards (e.g. 55 Hudson Yards, One Manhattan West and 441 Ninth Avenue) and Chelsea (e.g. 40 Tenth Avenue) to continue to drive asking rents higher.



Based on our analysis of tenants in the market as of the end of Q1 2019, expect more tech companies in the pipeline to increase their commitment to Midtown South, adding a boost to leasing volume.



Expect continued healthy leasing Downtown to reduce the overall vacancy rate even further for that market. We expect the Downtown market to be in a relative state of equilibrium by the end of 2019.

## Market By The Numbers

Submarket	Inventory (SF)	Direct Vacant (SF)	Sublet Vacant (SF)	1st Quarter 2019 Overall Vacancy Rate	1st Quarter 2019 Net Absorption (SF)	Current Under Construction* (SF)	Overall Average Asking Rent Class A	Overall Average Asking Rent Class B
<b>Midtown</b>								
Grand Central	54,819,358	4,273,118	1,133,893	9.9%	454,596	1,733,000	\$73.76	\$60.85
Penn Plaza/ Garment	19,969,798	646,862	1,137,336	8.9%	(28,285)	0	\$63.61	\$57.74
Hudson Yards/ Manhattan West	11,035,904	721,336	85,572	7.3%	63,311	5,517,000	\$126.61	\$0.00
Plaza District	76,861,806	7,135,549	1,684,342	11.5%	(1,170,689)	705,244	\$106.47	\$60.79
Sixth Avenue/ Rockefeller Center	55,985,260	4,176,609	814,971	8.9%	(517,696)	0	\$89.12	\$64.53
Times Square South	24,964,930	1,635,100	664,775	9.2%	(67,934)	0	\$70.76	\$57.82
Times Square/West Side	37,362,312	2,407,553	684,550	8.3%	634,772	0	\$79.59	\$62.16
<b>Total</b>	<b>280,999,368</b>	<b>20,996,127</b>	<b>6,205,439</b>	<b>9.7%</b>	<b>(631,925)</b>	<b>7,955,244</b>	<b>\$92.33</b>	<b>\$59.92</b>
<b>Midtown South</b>								
Chelsea	23,161,279	979,668	856,836	7.8%	(193,759)	0	\$151.64	\$58.18
Hudson Square	14,134,729	525,532	490,670	7.4%	(1,299)	0	\$91.82	\$53.20
Gramercy Park	30,808,894	2,426,331	488,010	9.5%	(138,034)	115,000	\$84.90	\$62.79
SoHo/NoHo	8,859,381	394,195	131,648	5.9%	(68,376)	335,263	\$129.91	\$66.91
<b>Total</b>	<b>76,964,283</b>	<b>4,325,726</b>	<b>1,967,164</b>	<b>8.2%</b>	<b>(401,468)</b>	<b>450,263</b>	<b>\$100.40</b>	<b>\$60.97</b>
<b>Downtown</b>								
TriBeCa/City Hall	18,957,427	1,701,042	160,097	9.5%	(548,599)	0	\$64.54	\$57.03
Financial District	53,199,740	4,207,184	1,117,932	10.0%	691,193	0	\$58.31	\$53.72
World Trade Center	25,849,284	2,918,028	931,225	14.9%	487,295	310,000	\$70.88	\$47.46
<b>Downtown Total</b>	<b>98,006,451</b>	<b>8,826,254</b>	<b>2,209,254</b>	<b>11.2%</b>	<b>629,889</b>	<b>310,000</b>	<b>\$63.78</b>	<b>\$53.14</b>
<b>Manhattan Overall Total</b>								
<b>Manhattan Overall Total</b>	<b>455,970,102</b>	<b>34,148,107</b>	<b>10,381,857</b>	<b>9.8%</b>	<b>(403,504)</b>	<b>8,715,507</b>	<b>\$85.22</b>	<b>\$58.84</b>

Data as of 4/3/2019

\* Excludes 7.7 MSF coming online within the next 12 months.



# Investment Sales



## First Quarter 2019 Summary

Based on the first quarter Manhattan sales figures, it appears the market is taking a “wait-and-see” approach. With political uncertainty in both City Hall and Albany, the \$3.7 billion in sales over 79 investment-grade transactions dropped 13.0 percent and 25.0 percent respectively, compared to the first quarter of 2018. If annualized to \$15 billion and 316 sales, the result is a respective 38.0 percent and 19.0 percent decline versus 2018.

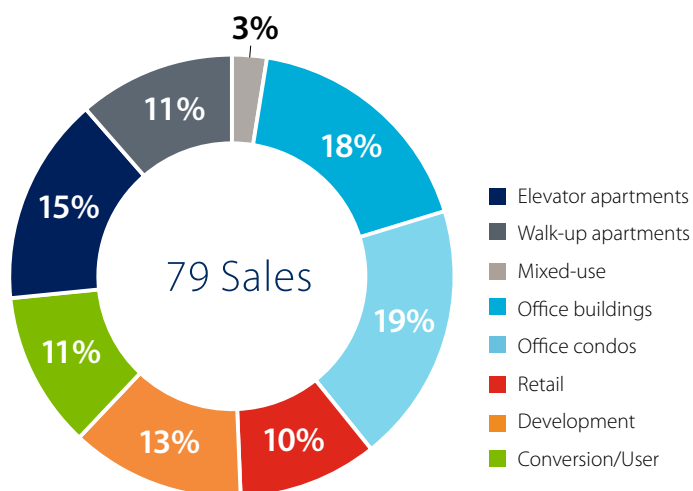
The positive news is, with the exception of land sales, values in the first quarter increased across the board with multi-family up 13 percent to \$1,121 per square foot; retail up 23.0 percent to \$2,637 per square foot; office and office condos up a respective 13.0 percent and 24.0 percent to \$1,098 per rentable square foot and \$1,078 per rentable square foot; and conversion/user sales rising 16.0 percent to \$1,381 per square foot. Cap rates expanded for multi-family properties to 4.5 percent and office to 4.6 percent. Only land sales dropped slightly by 3.0 percent to \$638 per buildable square foot.

## Multi-Family

The 31 multi-family sales for a combined \$677 million represent a slight uptick relative to the first quarter of 2018, but a lower

annualized total than 2018. Expanding the picture, asset pricing told two different stories, cap rates expanded significantly by 83 basis to 4.5 percent, while pricing per square foot actually climbed from \$995 to \$1,121, on average.

## Number of Sales by Asset Class



## Retail

Retail trades took a step back, with only \$185 million in trades across nine investment-grade properties that took place in the first quarter. Relative to 2018's numbers, the first quarter of 2019 brought in \$500 million less than the first quarter of 2018 and an annualized total of almost a billion dollars less than in 2018. Importantly, this steep decline must consider that 2018 represented retail's five-year high in transaction volume. Relative to our 2018 totals, cap rates actually compressed 19 basis points from 4.8 percent to 4.7 percent in the first quarter.

## Office Buildings and Office Condo

Office and office condos / co-ops continued to lead the total dollar volume category with 63.0 percent of Manhattan's dollar volume, up from 58.0 percent of total transactions in 2018. Similar to other asset classes, office building pricing grew on a per square foot basis from \$969 to \$1,098, though cap rates did expand by 26 basis points to 4.6 percent.

## Development

The 12 development sites that transacted for \$286 million during the first quarter amounted to under half a million buildable square feet at an average of \$638 per buildable square foot. Development site pricing is still heavily dependent on location, with pricing ranging from the \$400 to over \$800 per buildable square foot.

## Conclusion

The takeaway from these opposing factors—declining sales and increased pricing—is that core stabilized assets are selling. For the

multi-family asset class, this means renovated fair-market buildings are changing hands, and in retail, the majority of investors are seeking leased spaces. This trend also indicates a flight to quality as the best locations are still trading, especially in the office market where more than half of the top trades were over \$100 million in the first quarter.

## Ethan Bidna

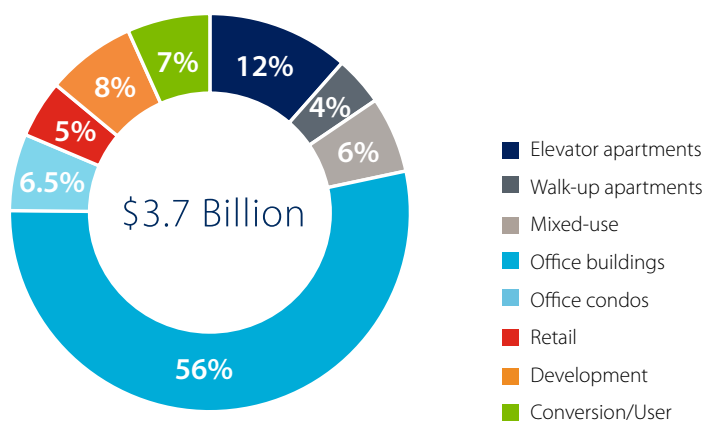
Analyst

Capital Markets Group, Investment Sales

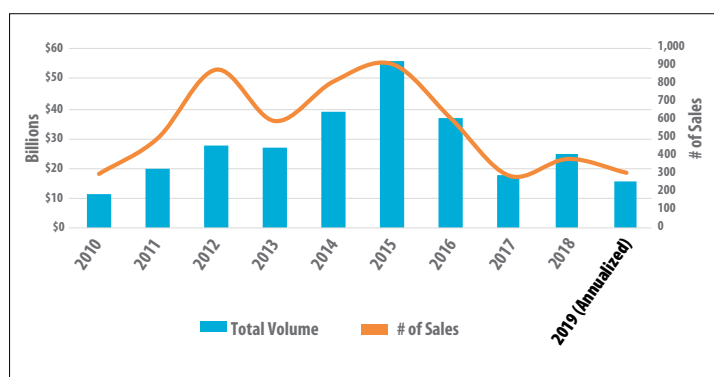
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*Avison Young's Tri-State Investment Sales group tracks confirmed transactions above \$5 million (\$1 for retail properties and office condominiums) sold in Manhattan below 96th Street.*

## Dollar Volume by Asset Class



## Transaction Volume & Number of Sales by Year



## Top First Quarter 2019 Sales

Buyer/Address/Seller	Size (SF)/Type	Price and Price/SF
WeWork / Rhone Capital <b>424-434 Fifth Avenue</b> Hudson's Bay Company	615,782 SF Office	\$850.0 million/ \$1,380
Rockpoint Group LLC <b>885 Second Avenue</b> Ruben Companies	815,000 SF Office	\$565.7million/ \$694
Chetrit Organization <b>850 Third Avenue</b> HNA Group Co., Ltd.	617,000 SF Office	\$422.0 million/ \$684
The Related Companies <b>34 Desbrosses Street</b> The Jack Parker Corporation	222,055 SF Multi-Family	\$260.0 million/ \$1,171
60 Guilders / RCG Longview <b>1760 Third Avenue</b> Chetrit Group	263,000 SF Specialty	\$212.5 million/ \$808

## Trends to Watch



How will new laws affecting multi-family property ownership coming from Albany this summer affect the trading and management of multi-family properties?



How will the shift from Chinese dominated foreign capital to Canadian and European sources of funds change the composition of major real estate asset purchases in the United States?



What will the new interest rate environment mean for the rate of asset acquisitions in the next year?

# Retail Leasing

## State of the Retail Market

The revolving retail door persists with more closures and new openings as the sector continues to reinvent itself. While America is “over-stored,” many more retailers now see it complementary to grow their businesses with an online presence in addition to having a physical store. In February, for the first time ever, “clicks” have overtaken “bricks” as non-store retail sales accounted for 11.813 percent of the retail spending pie compared to 11.807 percent for general merchandise (e.g. in department stores, warehouse clubs and big-box chains, excluding clothing and accessories). While asking rents continue to decline and supply still outweighs demand, there has been an uptick in traditional retail leasing activity, particularly along the high trafficked areas such as the Madison Avenue corridor in Manhattan.

## Madison Avenue Spotlight

The Madison Avenue corridor saw its seventh straight year-over-year drop in asking rents to \$1,160 a square foot (for average ground floor retail spaces) for a 14.0 percent year-over-year decline according to the Real Estate Board of New York (REBNY) Fall 2018 report. Retailers remain committed to the area given the heavy foot traffic by both locals and tourists. Luxury retailer

Hermes will remain on Madison Avenue, opening a new flagship at 706 Madison Avenue in 2022, while high-end shoe designer Balenciaga also re-committed to 620 Madison Avenue for the same reason. In addition, while the trend in the current retail environment has been for some retailers to execute shorter-term leases of one to three years, French handmade footwear company Mephisto committed to new space for 10 years further down on Madison Avenue (at 488 Madison Avenue) to also capitalize on tremendous amounts of foot traffic close to Rockefeller Center.

We also observe that some retailers, new and existing, are making the decision to shrink their overall real estate footprint. In recent news, it was announced that long-time retailer Barneys is potentially in talks with the owner of 660 Madison Avenue to give back five of the nine floors it occupies. If accepted by the landlord, the move would cut back on Barney’s \$30 million in annual rent, which doubled last year. Also at the 660 Madison Avenue location, regardless of Barney’s ultimate occupancy, the restaurant on the 9th floor, Freds Madison Avenue, will remain open. This makes logical sense, as food, fitness and now flexible workspace tenants remain viable options to keep retail space occupied throughout Manhattan.

## Notable First Quarter Retail Transactions

Tenant	Building	Size (SF)	Lease Type
Life Time	1 Wall Street	74,000	New Lease (second Manhattan location)
Convene (Flexible Workspace)	230 Vesey Street	73,000	New Lease (replaces Saks at Brookfield Place)
Museum of the Dog	101 Park Avenue	60,000	New Lease
Hard Rock Café	1501 Broadway	46,410	Renewal/Expansion (expansion of 1,335 SF)
Hermes	706 Madison Avenue	40,000	New Lease (new flagship will open in 2022)
Crunch (Gym)	1385 Broadway	27,450	Renewal
Lululemon	592 Fifth Avenue	20,000	New Lease (relocation from 597 Fifth Avenue)
The North Face	584 Broadway	13,000	New Lease (relocation from 139 Wooster Street)
Urbanspace (Food Hall)	787 Seventh Avenue	10,850	New Lease (replacing Bobby Flay’s Bar Americain)
CVS	387 Park Avenue South	10,500	New Lease
Poggenpohl	138 Greene Street	6,050	New Lease (flagship store)
Balenciaga	620 Madison Avenue	5,781	New Lease
Amaffi	432 Park Avenue	4,000	New Lease
Mephisto	488 Madison Avenue	1,854	New Lease
Mack Weldon	20 Hudson Yards	850	New Lease (first brick & mortar)



## National and Local Score Card

For Q1 2019, store closures are close to surpassing last year's total. Year-to-date, the number of U.S. store closure announcements stood at 5,399 compared to 5,726 for all of 2018, according to the latest Coresight Research store tracker. For store openings, there have been 2,396 announced year-to-date compared to 3,243 for all of 2018 across the country.

The increase in the number of store closures can be partly attributed to the number of brand names that have announced closures at multiple locations around the country. These include clothing retailer Charlotte Russe's closure of its entire network of at least 500 stores, Dollar Tree's closure of nearly 390 stores and Gap, as it plans to close another 230 stores over two years. Also contributing to the increase in the number of store closures is the continued growth in online shopping and the growth of creative customer experiences.

As to Manhattan closures, Tommy Hilfiger announced that it will shutter the doors of its global flagship based at 681 Fifth Avenue. In doing so, the company will focus on next generation retail experiences and partnerships to stay ahead of changing shopping habits and preferences. According to the CEO, the company will leverage its store-of-the-future concepts to be rolled out in the global retail landscape. This news comes on the heels of Calvin Klein's announcement to shutter its 654 Madison Avenue store this spring as part of a new strategy to bring digital operations into focus while streamlining its North America division. As part of its strategy the company will unveil new consumer experiences both online and offline.

The 2,396 store openings announced year-to-date include Paris Baguette's plan to open 1,000 U.S. stores. In addition, Dollar General will open 975 stores this year and fitness company Peloton will reportedly open 100 stores. Peloton

has already established a presence at Brookfield Properties' Five Manhattan West where last year it signed a 20-year lease for a 35,000 square-foot production studio and consumer-facing space. The opening of 100 stores nationwide is part of the company's commitment to growing its presence and overall consumer experience.

## Looking Ahead to the Future of Retail

Customization and enhancing the user experience with the right balance of online and offline concepts will continue to benefit those retailers that get it right. In addition, some retailers are setting up shop in new developments that are expected to serve as a destination playground where people live, work, shop and dine. As an example, The Shops & Restaurants at Hudson Yards (located at 20 Hudson Yards in the new Hudson Yards neighborhood) includes anchor tenant Neiman Marcus with its three-floor footprint spanning 720,000 square feet. Neiman Marcus has also established The Zodiac Room restaurant with signature dishes as part of its footprint there. The company is banking on a new and exciting destination strategy in order to boost revenue. Other new restaurants that will offer exciting food concepts include Belcampo, Citarella and Hudson Yards Grill, which have all opted to have a presence at 20 Hudson Yards. In an environment where the biggest challenge is a slowdown in economic growth, those restaurants and stores located in the right location with the right concepts should come out ahead.

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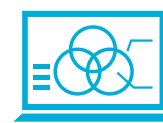
## Trends to Watch



This year will continue with more retail closures, but we will also see new and exciting concepts hitting the streets.



Consumers still want to shop in a different way and today's retailer must cater to them in a multi-channel fashion. Accordingly, we expect more online shopping concepts and unique user experiences to complement more brick-and-mortar strategies and vice versa.



The use of technology and AI (artificial intelligence) is now on every retailer's mind. Expect more retailers to increase customization and come up with ways to implement the use of such tools into their online and physical platforms.

# Debt & Equity



## Low Cost of Interest Rate Caps Likely Indicate Flat Interest Rate Movement For Remainder of 2019

During 2018, we saw interest rate volatility due to the Fed raising interest rates. Long-term interest rates rose in anticipation and then subsequently fell as the market became used to the “new normal” of the Fed slowly raising interest rates. In the first quarter of 2019, interest rates remained in an extremely tight range at lower levels. Off-the-shelf CMBS pricing for moderate leverage is roughly 200 basis points over like maturity swaps – or sub-5 percent for a 10-year loan. In some cases, lender demand could push pricing down to 150 basis points or in the low 4 percent range. The cost of interest rate caps is at record lows. Historically, the cost of caps is a good indicator of future interest rate movements. As such, the current low cost indicates that interest rates are likely to stay at these lower levels for the remainder of 2019. Of course, an extraneous shock could always upset that status quo.

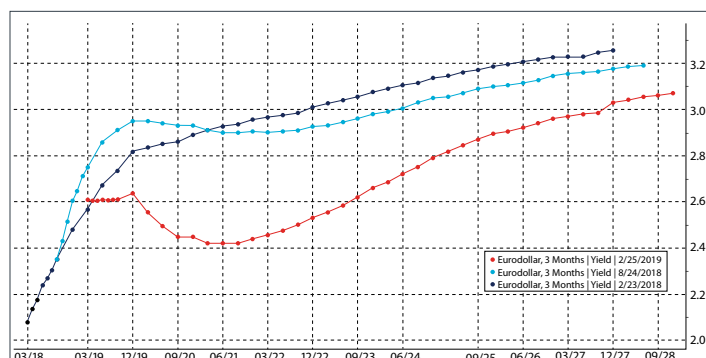
## The Role of LIBOR, No More After 2021

Lenders are starting to prepare for the end of using LIBOR as an index for benchmarking floating rate loans. While it hasn’t been officially decided, it appears likely that SOFR will be the approved index beginning in 2022.

LIBOR (the London Interbank Offering Rate) is the interest rate banks offer to lend funds to each other in the international market for short-term loans. It is the index primarily utilized worldwide as a benchmark for financial instruments including floating-rate loans on real estate mortgages.

There are over \$350 trillion of global financial products that use LIBOR as an interest rate. Daily trading volume of LIBOR is less than \$1 billion a day, with LIBOR being manually set by using an average of the daily submissions of 18 member banks to the Intercontinental Exchange. This daily submission has become

### LIBOR Expectations Chart



Source:  Derivative Logic®

subject to manipulation, and has also been the subject of lawsuits and rigging by banks to enhance their books. After 2021, about one-half of the member banks will not be required to submit LIBOR rates daily. In anticipation of this change, the Alternative Refinance Rate Committee (ARRC) was formed in 2014 and is recommending alternatives to LIBOR being used at the end of 2021. This change has widespread implications that have only been scantily reported on despite the wide-reaching ramifications for real estate owners, among others.

### SOFR and Other Alternatives

While SOFR (Secured Overnight Financing Rate) hasn't officially been chosen as LIBOR's replacement, ARRC has focused on this index. It is liquid (nearly \$800 billion of daily trading) and is secured by Treasury securities. Accordingly, SOFR is effectively a risk-free trade that is overnight (for now). The rate has essentially mirrored LIBOR over the past couple of years (though it is consistently a few basis points lower than LIBOR) with fewer of the gyrations that LIBOR experiences during exogenous shocks. Note, however, that the changeover from LIBOR to SOFR is not yet a done deal. Critics state that the collateral price of even a secure instrument like SOFR could fail in a crisis and that it should incorporate the credit quality of the Treasury collateral pledged,

and not the price of that collateral. Meanwhile, some banks could resist and use the Prime Rate or the Federal Home Loan Advance Rate as an alternative.

### Potential Exposure to New Risks

Until very recently, there was no fallback language within current loan documents for loans that have maturities after 2021. For those that have any language at all, banks commonly state that any LIBOR replacement will be "determined by Lender in its sole judgement" and "If there is any ambiguity, Lender's judgement will be dispositive." This could expose borrowers to unanticipated interest rate spikes. Preferable language would be similar to what Fannie Mae recently used on documents that specifically recognized the end of LIBOR. It stated that if LIBOR "is no longer widely accepted or has been replaced as the Floating Rate Option for similar financial instruments," they will "use a new Floating Rate Option taking into account general compatibility."

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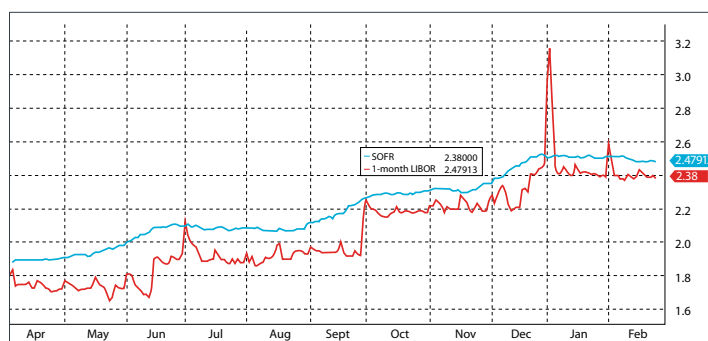
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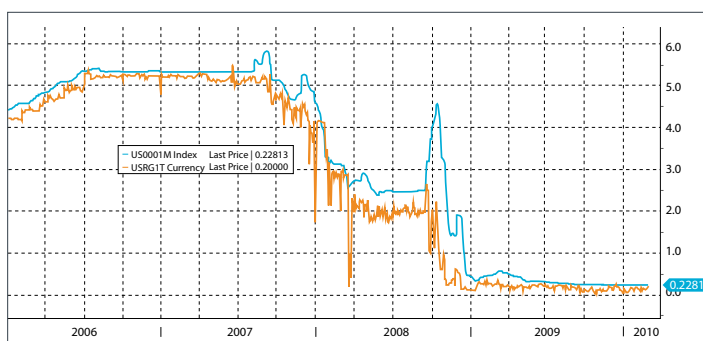
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### SOFR May Expose Lenders/Borrowers to New Risk Chart

### LIBOR vs SOFR Volatility Chart



Source: Derivative Logic®



Source: Derivative Logic®

### Trends to Watch



Interest Rates have stayed relatively flat over the past quarter and the cheap cost of caps indicates that the market expects them to stay flat over the balance of the year.



CMBS lenders continue to stay aggressive with spreads staying at or below 200 basis points over the maturity of the same term. Retail is the lone exception where lenders remain cautious.



Lenders are starting to prepare for the end of using LIBOR as an index for benchmarking floating rate loans. While it hasn't been officially decided, it appears likely that SOFR will be the approved index beginning in 2022.



# Valuation & Advisory



## Industrial Market Overview

Over the past five years the national industrial market has seen a significant increase in investor demand. This heightened interest in U.S. industrial product has been fueled by the nation's substantial uptick in online purchases, resulting in e-commerce tenants and businesses seeking distribution centers and warehouses to house their products. At a more microregional level, this phenomenon has carried over to large cities such as New York. In recent months, the New York metropolitan area has seen a large influx of industrial demand, as investors believe it will continue to provide solid future returns. Through examining general industrial valuation trends and leasing related activity at the national and local level, one is able to see how robust this asset class is.

## High Valuations and Compressed Discount/Cap Rates

Industrial assets are among the hottest property types to own in the U.S., which is due, in part, to the large growth of the e-commerce market. This increased demand has resulted in spikes in asset valuations and considerable compressions of overall cap rates, discount rates and residual cap rates.

Industrial properties are forecasted to experience positive value changes of up to 12.0 percent over the next 12 months, with an estimated average increase of 4.5 percent, according to PwC. Moreover, the national industrial market has seen the average overall cap rate for industrial product decrease by 152 basis points over the past five years to 4.64 percent, as of Q1 2019.

Over the same time period, this market has experienced a compression of discount rates by 129 basis points to an average rate of 6.21 percent. Similarly, the national industrial market has seen residual cap rates decrease by 119 basis points over the past five years to an average rate of 5.46 percent.

New industrial tenants are concentrating more in urban city cores as tenants need to be located closer to major transportation systems, according to Real Estate Business Online. As a result, the aforementioned valuation trends are expected to hold true for the Manhattan industrial market, as large industrial neighborhoods within the city, such as Chelsea and Hudson Square, provide investors with urban property locations that will appeal to new industrial tenants seeking centralized space within New York City.

### High Leasing Demand and Growth in Rental Rates Nationally; Vacancy Remains Low

As reported by the Bureau of Labor Statistics (BLS), the United States has seen an increase in over 200,000 new jobs related to manufacturing. From a leasing perspective, this increased job supply has flooded the market with prospective tenants for industrial space, making warehouses and distribution centers increasingly more attractive assets to own.

This high leasing demand has also fostered the continued growth of industrial rental rates. PwC reports that as of Q1 2019, the national industrial market is seeing market rent changes up to 7.00 percent with an average of 2.78 percent. This current average represents a 30-basis point increase from the average growth rate of 2.48 percent five years ago.

Moreover, the RERC Q4 2018 Real Estate Report stated the national warehouse market's average rent growth rate was 2.90 percent, the highest average of all listed asset types. This information highlights that the current demand to lease industrial space on a national level is quite strong. Moreover, industrial vacancies remain low nationally. PwC reports Q1 2019 underlying vacancy and collection loss allowances of up to 6.0 percent, with the majority of the vacancy estimates around 3.0 percent.

#### Last-Mile Centers in NYC

The industrial leasing market has also been performing well within New York City, most notably with last-mile delivery centers. These facilities are small warehouses that are proximate to major cities and communities that provide retailers with more seamless and time efficient means of delivering purchased goods. Recently, Amazon leased over 120,000 square feet worth of warehouse space in the Bronx neighborhood of Hunts Point. This site will serve as a major New York City distribution center for the e-commerce giant. Another notable e-commerce company to absorb

industrial space for a last-mile distribution center was Jet.com, which leased approximately 200,000 square feet worth of warehouse space in the South Bronx back in April 2018. Manhattan has seen a major consolidation of its industrial supply over the past years, losing warehouses and factories to residential and office conversions. With large e-commerce firms moving into New York City at an increasing rate, Manhattan's remaining industrial neighborhoods should benefit from the borough's decreased supply and increased leasing activity throughout the metropolitan area.

#### Investor and Tenant Appetite Expected to Grow

Overall, the industrial market is currently one of the top performing asset categories on a national level. Increased investor demand has driven overall capitalization, residual capitalization, and discount rates to their lowest levels over the past five years. Moreover, increased job growth in the manufacturing sector has caused an upward hike in demand from firms seeking industrial space across the county, leading to increased rents and low vacancy rates across the nation. New York City's industrial market has proven to be highly sought after from both the investor and tenant perspective. With strong transportation networks and prominent tenants flooding the city, industrial product is expected to continue to remain hot across the New York metropolitan area. Moreover, Manhattan's industrial market in particular is expected to prosper, as the decrease in the borough's industrial supply over the past years has created a scarcity of highly sought-after product in its urban core.

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## Trends to Watch



Watch out for continued decreases in Manhattan's industrial supply due to conversion



Keep an eye out for the rate at which rents continue to increase and the pace at which overall rates, discount rates, and residual cap rates continue to decrease, in order to better judge if the market is beginning to cool off



As market conditions seem to currently favor sellers over buyers, watch out for shifts in market dynamics that could potentially alter this relationship

## National Industrial Market

	Current	Last Quarter	1 Year Ago	3 Years Ago	5 Years Ago
<b>Discount Rate (IRR)*</b>					
Range	5.25-8.00%	5.25-9.00%	5.50-9.25%	5.50-9.25%	5.75-9.00%
Average	6.21%	6.33%	6.55%	6.94%	7.5%
Change (Basis Points)	-	-12	-34	-73	-129
<b>Overall Cap Rate (OAR)</b>					
Range	3.00-6.25%	1.00-6.50%	3.00-6.50%	3.00-7.00%	5.00-7.50%
Average	4.64%	4.56%	4.95%	5.52%	6.16%
Change (Basis Points)	-	+8	-31	-88	-152
<b>Residual Cap Rate</b>					
Range	4.50-6.75%	4.50-6.75%	4.60-7.25%	4.75-8.50%	5.50-8.50%
Average	5.46%	5.51%	5.83%	6.28%	6.65%
Change (Basis Points)	-	-5	-37	-82	-119
<b>Market Rent Change</b>					
Range	0.00-7.00%	0.00-7.00%	0.00-7.00%	0.00-7.00%	0.00-6.00%
Average	2.78%	2.78%	2.31%	3.05%	2.48%
Change (Basis Points)	-	0	+47	-27	+30
<b>Expense Change</b>					
Range	0.00-3.00%	0.00-3.00%	0.00-3.00%	3.00-3.00%	2.50-3.00%
Average	2.35%	2.35%	2.25%	3.00%	2.95%
Change (Basis Points)	-	0	+10	-65	-60
<b>Expense Change</b>					
Range (months)	1 - 9	1 - 9	1 - 9	1 - 12	2 - 12
Average	3.8	3.8	4.1	4.5	5.8
Change (↓,↑,=)	-	=	=	↓	↓

Source: PwC Q1-2019 Investor Survey

\*Based on unleveraged, all-cash transactions





## About the Market



### Midtown

**Plaza District:** Borders East 62nd and West 59th Streets on the north, Seventh Avenue on the west, East 47th and West 56th streets on the south and the East River on the east (includes prior Park Avenue submarket)

**Grand Central:** Borders East 47th Street on the north, Fifth Avenue on the west, East 35th Street on the south and the East River on the east

**Sixth Avenue/Rockefeller Center:** Carved out section that borders West 56th Street on the north, Seventh Avenue on the west, West 41st Street on the south and Fifth Avenue on the east

**Times Square/West Side:** Borders West 64th Street on the north, the Hudson River on the west, West 41st Street on the south and Fifth Avenue on the east (includes Columbus Circle)

**Times Square South:** Borders West 41st Street on the north, the Hudson River on the west, West 36th Street on the south and Fifth Avenue on the east

**Penn Plaza/Garment District:** Borders West 36th Street on the north, the Hudson River on the west, West 30th Street on the South and Fifth Avenue on the east

**Hudson Yards/Manhattan West:** Carved out section that borders West 36th Street on the north, the Hudson River on the west, West 30th Street on the south and Ninth Avenue on the east

### Midtown South

**Chelsea:** Borders West 30th Street on the north, the Hudson River on the west, West 12th Street on the south and Fifth Avenue on the east (includes prior Flatiron submarket)

**Gramercy Park:** Borders East 35th Street on the north, Fifth Avenue on the west, East 12th Street on the south and the East River on the east (includes prior Union Square/Madison Square/Park Avenue South submarkets)

**Hudson Square:** Borders Morton Street on the north, the Hudson River on the west, Chambers Street on the south and Sixth Avenue/Avenue of the Americas on the east

**SoHo/NoHo:** Borders East 12th Street on the north, Sixth Avenue/Avenue of the Americas on the west, Canal Street/East Broadway on the south and the East River on the east (includes Greenwich Village)

### Downtown

**Tribeca/City Hall:** Borders Canal Street/East Broadway on the north, West Street on the west at Warren Street, Ann Street on the south and the East River on the east (all of upper-lower Manhattan); (includes prior insurance submarket)

**World Trade Center:** Borders Vesey Street on the north, the Hudson River on the west, Albany Street on the south and Church Street/Trinity Place on the east

**Financial District:** Borders Albany and Ann Streets on the north, the Hudson River on the west, South Street on the south and the East River on the east (rest of lower Manhattan)

# New York City

Market Report  
First Quarter 2019



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