Second Quarter 2019 / New York City

Office Leasing

Market Facts

$80.76 PSF
Overall Manhattan average asking rent now at a historical high

$88.85
New high for Midtown overall average asking rent

21%
Year-over-year growth in Downtown leasing volume for 2Q19

9.8%
Second quarter vacancy rate; Manhattan overall in equilibrium

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

Favorable Employment Trends and a Continued Flight to Quality Help Second Quarter Leasing Finish Strong

The New York City economy continues to outpace both the state and nation in terms of private-sector job growth. As of the latest read in May, the city posted 2.4 percent year-over-year private sector job growth in comparison to 1.1 percent for the state and 1.7 percent nationally. The greatest employment gains were seen in the educational and health services sectors, while continued job increases were also noted in professional and business services, information and financial activities. These gains have translated into strong office leasing velocity across the Manhattan market.

For the second quarter (with April being the highest volume month so far this year), office leasing volume of 10.3 million square feet ended up 6.0 percent year-over-year from 9.7 million square feet for the same period in 2018. Renewals accounted for a third of the activity. Through mid-year, year-to-date office leasing volume of 18.7 million square feet for the city was greater than the 18.3 million square feet executed for the same period last year. Employment growth has been forecasted to remain positive in Manhattan over the next 18 to 24 months. This, in turn, should bode well for the office leasing market for the near term.

By the end of the second quarter, the Manhattan vacancy rate declined by 80 basis points year-over-year to 9.8 percent. A flight to quality for new development and renovated product being offered continued to drive average asking rents up 5.0 percent to $80.76 per square foot from $76.80 a year ago, keeping the pricing level at a historical high. Expect near-term deliveries of additional new product, which come with the latest amenities, and, in some cases,

MARKET DATA POINTS

Manhattan Overall

Indicator	2Q19	2Q18
Vacancy	9.80%	10.60%
Rent	$80.76	$76.80
Absorption	(867,511) SF	(664,573) SF

Midtown Overall

Indicator	2Q19	2Q18
Vacancy	9.70%	10.20%
Rent	$88.85	$83.09
Absorption	(609,000) SF	370,290 SF

Midtown South Overall

Indicator	2Q19	2Q18
Vacancy	8.30%	9.10%
Rent	$78.88	$78.03
Absorption	(142,606) SF	(604,078) SF

Downtown Overall

Indicator	2Q19	2Q18
Vacancy	11.20%	12.80%
Rent	$62.39	$62.71
Absorption	(115,905) SF	(430,785) SF

Data as of 7/2/2019

within close proximity to a major transit hub (e.g. Grand Central or Penn Station), to continue to be sought after by large, less price sensitive tenants and those looking for efficient floor plates.

Midtown: Large Block Deals Propel Leasing Velocity; Average Asking Rents Hit New High

Leasing

Second quarter leasing activity of 6.5 million square feet is up 8.0 percent from a year ago, partly as the result of a greater number of closed large block transactions (above 100,000 square feet), which included WarnerMedia's 1.5 million square foot sale-leaseback at 30 Hudson Yards.

- Twelve large block leases (over 100,000 square feet) were executed in the second quarter, compared to nine a year ago.
- Seven of the 12 large block leases were renewals, the largest being executed by global marketing and advertising firm McCann Worldgroup's renewal at 622 Third Avenue, which gives them over 460,000 square feet of space.
- The remaining five of the 12 large block leases were for new, or soon to be upgraded properties (the latter includes 460 West 34th Street – First Republic Bank for 211,521 square feet), in Hudson Yards/Manhattan West, with one deal also at recently renovated 1271 Avenue of the Americas (AIG for 320,237 square feet) in the Sixth Avenue/Rockefeller Center submarket.

Vacancy

Overall vacancy of 9.7 percent decreased 50 basis points year-over-year from 10.2 percent, as the result of strong leasing that helped to offset space coming online this quarter.

- Class A vacancy of 10.2 percent was in-line with last year and last quarter, due in part to the large block lease transactions previously referenced (including Colgate-Palmolive's 241,657-square-foot renewal at 300 Park Avenue), which also helped to offset the 462,152 square feet of direct space at 1301-1315 Avenue of the Americas from Barclays Capital that came on the market during the quarter in the Sixth Avenue/ Rockefeller Center submarket.
- Class B vacancy of 7.5 percent declined 270 basis points year-over-year from 10.2 percent, and remains below the 9.0 percent level as it did last quarter for the first time since 2017. Strong leasing in the Times Square South submarket for deals 60,000 square feet and less primarily drove this trend.

Rents

Overall Midtown average asking rents ended the second quarter at $88.85, up 7.0 percent year-over-year from $83.09, representing a new high since rents were at $88.05 in 1Q17.

- Class A average asking rents ended the quarter at $93.74, for a record high, up 6.0 percent year-over-year from $88.10. New development in Hudson Yards and renovated product along Sixth Avenue came to market at higher rents.
- Class B average asking rents ended the quarter at $59.56, down 1.0 percent year-over-year from $59.95, due in part to rent reductions by some building owners of less competitive product.

Midtown South: Lease-Up of Higher Priced Newer Product Drives Vacancy Lower. Midtown South Remains Favored by Tech, While Health Services Boosts Presence

Leasing

Second quarter leasing activity of 1.8 million square feet for Midtown South is down 10.0 percent from a year ago. The market remains dominated by technology and a growing number of co-working tenants. Health services firms continued to increase their presence in this segment.

- Unlike last quarter when there were no large-block closed deals (over 100,000 square feet), for the second quarter there were four, similar to a year ago. The largest was the renewal/expansion by Flatiron Health, Inc. for 252,452 square feet at newly renovated 161 Avenue of the Americas (aka One SoHo Square East). Here the firm renewed their existing 130,384 square feet of space and took on an additional 122,068 square feet.
- Tech companies executed 40.0 percent of the leasing during the quarter. This activity included Yext (145,741 square feet sublease at 61 Ninth Avenue – former Aetna space) and Microsoft (63,000 square feet for the entire office portion at 300 Lafayette Street). Both opted for new space.
- Co-working represented the second largest sector of leasing activity in Midtown South, with such tenants accounting for 22.0 percent of the volume. WeWork executed its largest lease so far this year during the quarter (212,937 square feet at 620 Avenue of the Americas) and in doing so took over space vacated by Spotify and Mediaocean.
- The one additional large-block renewal was executed by CBS (164,000 square feet at renovated 63 Madison Avenue – rebranded as 28 East 28th Street).

Vacancy

Overall vacancy of 8.3 percent declined 80 basis points year-over-year from 9.1 percent.

- Class A vacancy of 9.8 percent decreased 70 basis points year-over-year from 10.5 percent due partly to the lease-up of newer space that had been put on the market during the past year (e.g. 300 Lafayette Street and 61 Ninth Avenue).

Notable Second Quarter Leasing by Market

Tenant Industry	New Address Submarket	Size (SF) Lease Type
Midtown		
McCann Worldgroup TAMI	**622 Third Avenue** Grand Central	**464,598** Renewal
Cravath Swaine & Moore Legal Services	**2 Manhattan West** Hudson Yards/Manhattan West	**350,000** New Lease
AIG Insurance	**1271 Avenue of the Americas** Sixth Avenue/Rockefeller Center	**320,237** New Lease
Midtown South		
Flatiron Health, Inc. Health Services	**161 Avenue of the Americas** Hudson Square	**252,452** Renewal/Expansion
WeWork Real Estate	**620 Avenue of the Americas** Chelsea	**212,937** New Lease
CBS TAMI	**63 Madison Avenue** (28 East 28th Street) Gramercy Park	**164,000** Renewal
Downtown		
Emblem Health Health Services	**55 Water Street** Financial District	**440,000** Renewal
JustWorks TAMI	**55 Water Street** Financial District	**270,000** New Lease
FINRA Financial Services	**200 Liberty Street** World Trade Center	**208,022** Renewal

Data as of 7/2//2019

- Class B vacancy of 7.5 percent declined 90 basis points year-over-year from 8.4 percent as the result of the strong co-working leasing, executed primarily within Class B product for Midtown South.

Rents

Overall average asking rents for Midtown South ended the second quarter at $78.88, up 1.0 percent year-over-year from $78.03.

- Class A average asking rents ended the quarter at $97.95, down modestly from $99.22 last year. However, note that while much of the new development remains priced in the triple-digits (e.g. 412 West 15th Street and 40 Tenth Avenue), relatively lower-priced floors remain on the market.
- Class B average asking rents ended the quarter at $64.79, down just 1.0 percent year-over-year from $65.60. However, higher-priced space is being leased, leaving lower-priced inventory currently on the market.

Downtown: Diverse Tenant Mix Drives Leasing Activity Up Over 20.0 Percent Year-Over-Year

Leasing

Strong second quarter Downtown leasing activity of 2.0 million square feet is up 21.0 percent from a year ago.

- Three large-block leases totaling 918,000 square feet were executed Downtown compared to the same number of such deals totaling 641,000 square feet a year ago.
- The increased presence of health services firms also continues Downtown with EmblemHealth closing on the largest lease for the market with its 440,000-square-foot renewal at 55 Water Street.
- The next largest tranche of deals for the Downtown market fell in the 50,000 to 100,000-square-foot range, with some leases also executed among health and business services occupiers. This quarter, there were five deals in this range totaling 340,000 square feet compared to the same number a year ago totaling 381,000 square feet.
- Of the total 53 leases executed Downtown during the second quarter, 21.0 percent (11 deals) were renewals/expansions by a diverse mix of value-oriented tenants.

Vacancy

Overall vacancy of 11.2 percent declined by 160 basis points from 12.8 percent by the end of the second quarter, and remains below the 12.0 percent level first reached at year-end 2016 and again last quarter.

- Class A vacancy of 11.8 percent declined 170 basis points year-over-year from 13.5 percent, also still below the 12.0 percent level first reached at year-end 2016. We attribute the vacancy decline partly to greater leasing in the Financial District of 1.4 million square feet during the quarter, compared to 660,000 during the same period a year ago.
- Class B vacancy of 8.4 percent decreased 150 basis points year-over-year from 9.9 percent due to a decline in direct space available.

Rents

Overall average asking rents for the second quarter were $62.39, down less than 1.0 percent year-over-year from $62.71 PSF.

- Class A average asking rents ended the quarter at $63.92, relatively in line year-over-year from $64.08.
- Class B average asking rents ended the quarter at $53.10, down 3.0 percent year-over-year from $55.00 due to higher-priced space being leased, leaving lower-priced floors on the market.

Marisha Clinton
Senior Director of Research, Tri-State
marisha.clinton@avisonyoung.com
212.729.1193

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

1301-1315 Avenue of the Americas
Sixth Avenue/Rockefeller Center | 462,152 RSF

Trends to Watch

Expect additional new product being delivered over the next 12 to 24 months around major transit hubs such as Grand Central (One Vanderbilt) and Penn Plaza (The Farley Building – 390 Ninth Avenue) to continue to drive average asking rents higher and be sought after by large less price sensitive tenants.

For product delivery beyond 24 months, expect redevelopment around major transit hubs to continue to lure occupiers who remain focused on easy access to transportation in an effort to attract top talent and clients. That said, the transformation of One and Two Penn Plaza will be well-positioned.

Based on our analysis of tenants in the market as of the end of 2Q19, expect more health services tenants in the pipeline to increase their commitments across Manhattan.

Market by the Numbers

Submarket	Inventory (SF)	Direct Vacant (SF)	Sublet Vacant (SF)	2nd Quarter 2019 Overall Vacancy Rate	2nd Quarter 2019 Net Absorption (SF)	Year-to-Date Absorption	Current Under Construction* (SF)	Overall Average Asking Rent Class A	Overall Average Asking Rent Class B
Midtown									
Grand Central	55,054,209	4,444,202	997,248	9.9%	(34,439)	420,157	1,730,989	$76.82	$61.60
Penn Plaza/ Garment	20,023,898	734,159	1,295,843	10.1%	(245,804)	(274,089)	0	$64.50	$58.85
Hudson Yards/ Manhattan West	10,616,904	760,426	74,140	7.9%	(27,658)	35,653	10,452,419	$135.53	$0.00
Plaza District	78,060,045	7,885,584	1,557,207	11.7%	(622,900)	(1,793,589)	0	$106.09	$60.13
Sixth Avenue/ Rockefeller Center	56,543,539	4,086,316	896,369	8.8%	8,895	(508,801)	0	$88.22	$63.01
Times Square South	25,151,115	1,425,549	720,351	8.5%	153,975	86,041	0	$71.20	$55.79
Times Square/ West Side	37,826,242	2,291,652	644,424	7.8%	158,931	793,703	0	$82.23	$64.93
Total	**283,275,952**	**21,627,888**	**6,185,582**	**9.7%**	**(609,000)**	**(1,240,925)**	**12,183,408**	**$93.74**	**$59.56**
Midtown South									
Chelsea	23,390,460	1,001,809	601,919	6.8%	221,474	27,715	600,000	$149.16	$66.03
Hudson Square	14,257,845	699,228	163,278	6.0%	185,739	184,440	0	$87.03	$62.57
Gramercy Park	31,133,202	2,682,599	680,891	10.8%	(449,149)	(587,183)	1,500,000	$82.81	$64.03
SoHo/NoHo	9,197,653	472,110	154,403	6.8%	(100,670)	(169,046)	353,501	$142.69	$66.82
Total	**77,979,160**	**4,855,746**	**1,600,491**	**8.3%**	**(142,606)**	**(544,074)**	**2,453,501**	**$97.95**	**$64.79**
Downtown									
TriBeCa/City Hall	19,271,567	1,390,994	156,728	7.7%	313,417	(235,182)	0	$63.52	$54.08
Financial District	53,594,426	4,200,368	1,353,531	10.4%	(224,709)	466,484	0	$56.92	$53.59
World Trade Center	26,137,946	2,986,225	1,067,641	15.5%	(204,613)	282,682	0	$72.73	$50.65
Downtown Total	**99,003,939**	**8,577,587**	**2,577,900**	**11.2%**	**(115,905)**	**513,984**	**0**	**$63.92**	**$53.10**
Manhattan Overall Total	**460,259,051**	**35,061,221**	**10,363,973**	**9.8%**	**(867,511)**	**(1,271,015)**	**14,636,909**	**$85.71**	**$60.50**

Data as of 7/2//2019
* Excludes 7.8 MSF coming online within the next 12 months.

Second Quarter 2019 / New York City

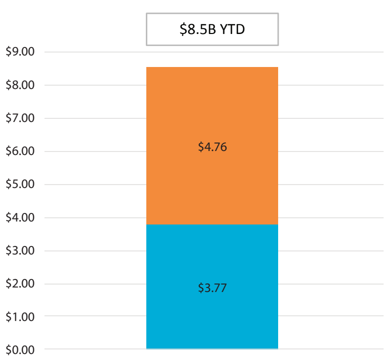
Investment Sales

Second Quarter 2019 Summary

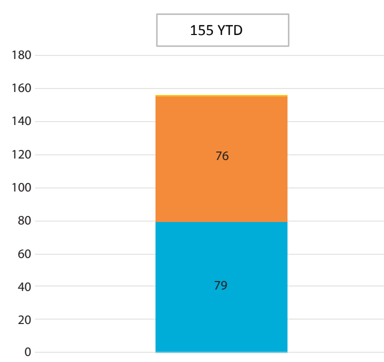
In the second quarter of 2019, dollar volume for all Manhattan sales was $4.8 billion, which is 10.0 percent lower than the trailing four-quarter average. This consisted of 76 sales, which is 17.0 percent less than the trailing four-quarter average. Though the second quarter had the fewest number of trades out of the last four quarters, the dollar volume was higher than the fourth quarter of 2018 and first quarter of 2019. That being said, 46.0 percent was attributed to the single trade at 30 Hudson Yards for $2.2 billion. Without it, the quarterly dollar volume would drop to $2.6 billion, the lowest quarterly average since 2010.

After the sweeping rent regulation law was passed in Albany in June and on the heels of Amazon's departure, the New York City market is at an inflection point. As the market adjusts, it remains to be seen if investors will view this as an opportunity to buy with rates at all-time lows. On a positive note, private sector job growth rose in New York City year-over-year by 2.4 percent, to 4,055,700 jobs in May 2019.

Total Dollar Volume & Total Number of Sales Year-to-Date

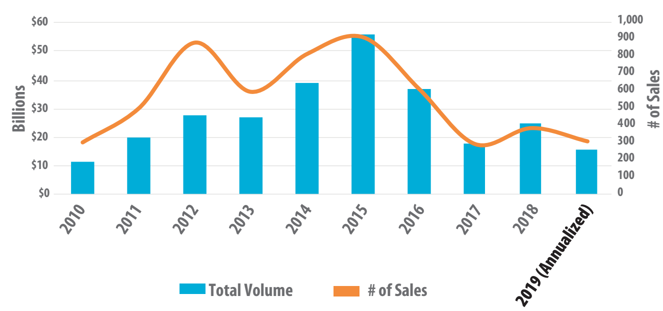


Total Dollar Volume Year-to-Date



Total Number of Sales Year-to-Date

Transaction Volume & Number of Sales by Year



Multi-Family

The 39 multi-family sales for a combined $763 million in the second quarter of 2019, represented a 13.0 percent and 26.0 percent increase, respectively, relative to the first quarter. The first-half annualized total is projected at $2.9 billion which is a 15.0 percent reduction in dollar volume from 2018, while the projected 140 trades remained nearly flat from the 136 recorded last year. Expanding the picture to include pricing, cap rates are at 4.21 percent, a 39 basis point increase from the trailing four-quarter average while the $952 average price per square foot was 17.0 percent lower. Considering the anticipation and eventual severity of the Housing Stability and Tenant Protection Act of 2019, the pricing correction is not a surprise and the market will likely take some time to settle into a new normal.

Retail

As the multi-year retail correction continues, transaction dollar volume and pricing have taken a significant hit. However, the year-over-year number of transactions have held relatively steady. This quarter, the eight investment-grade transactions totaled $153 million dollars, which when combined with a similarly under-performing first quarter, represents the first year since 2013 when total dollar volume dropped below the $1 billion threshold. The relatively small sample size of trades in the quarter averaged a 5.95 percent cap rate and the average price per square foot of $2,006, representing a 108 basis point increase and 14.0 percent decrease, respectively.

Office Buildings and Office Condo

Office building and office condominium sales represented 77.0 percent of the dollar volume in the second quarter, however the $2.2 billion sale-leaseback of the TimeWarner condo at 30 Hudson Yards represented 46.0 percent of the market alone. Cap rates for office buildings held relatively flat at 4.56 percent while the sales of 875 Washington Street and 450 West 15th Street, each over $1,800 per rentable square foot, pushed the average price per square foot up by 23.0 percent to $1,135. This asset class continues to be one of the most sought after by investors, despite a dearth of supply on the market.

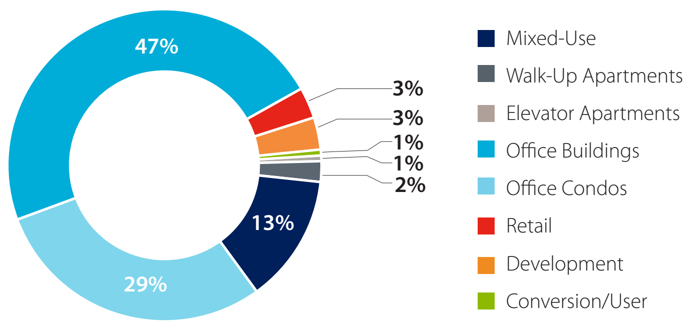
Development

The nine development sites that transacted for $159 million during the second quarter amounted to just over 200,000 buildable square feet at an average of $767 per buildable square foot. Development trades continued to see a focus on condominium developments and end-user scenarios in Manhattan where the land pricing disqualifies rental product. This number obscures the fact that development site pricing is heavily dependent on hyper-location and zoning, with pricing ranging from the just under $400 to over $1,200 per buildable square foot.

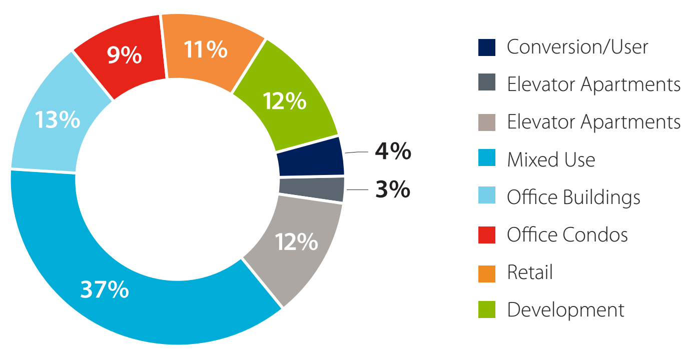
Erik R. Edeen
Director
Tri-State Investment Sales Operations
erik.edeen@avisonyoung.com
212.729.7402

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

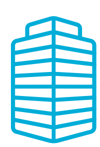


Number of Sales by Asset Class



Trends to Watch

How seriously will pricing be impacted by the Housing Stability and Tenant Protection Act of 2019?



If Albany does not exempt New York City from the proposed new prevailing wage law, how will that affect current and future development projects in the city?

Will there be a financial impact of the new Green initiative? If so, what?

Retail Leasing

Second Quarter 2019 / New York City

AVISON YOUNG

State of the Retail Market

Retail leasing has picked up, but the supply of space still outweighs tenant demand. Although asking rents continue on their descend, with declines as much as 20.0 percent on average in some instances, interest still remains in various parts of Manhattan. The top three areas that saw the most leasing activity during the second quarter are Chelsea, the Upper East Side and SoHo.

Notable Second Quarter Retail Transactions

Tenant	Building	Submarket	Size (SF)	Lease Type
Food Bazaar	201 East 125th Street	Harlem	45,885	New Lease (base of new residential building)
Complete Body Fitness	25 West 14th Street	Chelsea	24,000	New Lease (fourth Manhattan location)
Target	600 West 181st Street	Washington Heights	23,700	New Lease (replaces Rainbow shop)
Norrona	67 Greene Street	SoHo	5,000	New Lease
Krispy Kreme	10 Times Square	Times Square/West Side	4,500	New Lease (first of its kind Flagship location)
Nordstrom	13 Seventh Avenue	Chelsea	2,413	New Lease (sixth location in New York City)
Suit Supply	230 Vesey Street	World Trade Center	2,003	Expansion (expansion of 1,335 SF, now occupies 3,903 SF)
Mephisto Shoes	488 Madison Avenue	Plaza	1,854	New Lease

Midtown East Spotlight

The Midtown East retail corridor spans from Third Avenue to Fifth Avenue between the 16 blocks located from 42nd to 57th Streets. Within this boundary, there is a total of 101 available retail spaces or 521,069 square feet covering the 80-block radius. For Fifth Avenue, this is the most prestigious retail block. However, there are many large multi-level spaces on this avenue and as such, landlords will have to divide the spaces in order to move them. In total, there are 31 available multi-level retail spaces for an approximate 277,594 square feet.

According to the Real Estate Board of New York (REBNY) Spring 2019 Report, Upper Fifth Avenue, between 49th and 57th Streets experienced a 22.0 percent year-over-year drop in average asking rents to \$3,050 from \$3,900 per square foot, while the corridor between 42nd and 49th Streets dipped 20.0 percent to \$800 from \$1,000 per square foot. Note, that retail rents at \$3,050 per square foot remain the highest throughout Manhattan. The rental rate declines are attributed to historically high availability rates and low absorption rates, as many would be tenants have difficulty justifying the high rents. As the rent declines persist, expect to see some owners execute short term leases or participate in the cost of a build-out in order to move the space.

National and Local Scorecard

For 2Q19, store closures have now surpassed last year's total. Year-to-date, the number of U.S. store closure announcements stood at 7,037 compared to 5,864 for all of 2018, according to the latest Coresight Research store tracker. For store openings, there have been 2,992 announced year-to-date compared to 3,251 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 continue to announce the closure of stores at multiple locations around the country. These include Dressbarn, which will shutter 650 stores, CVS (46 stores), Pier 1 (up to 145), the Gap (up to 230 stores), Top Shop (20 U.S. locations), and other chains that have announced closures during the first half of 2019, including some locations in New York City. According to Coresight Research, the number of closures could hit 12,000 by the end of the year. 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.

More specifically for New York City, while the Lord & Taylor and Henri Bendel flagships have gone by the way wayside, as did the Saks Fifth Avenue women's store downtown, new arrivals include Neiman Marcus and Nordstrom. In addition to these new arrivals, there are some retailers that will always call New York City home. Accordingly, existing stores have invested more than \$500 million to revamp their Manhattan locations. Bergdorf Goodman has unveiled a five-year plan that includes a new first floor and jewelry salon in its historic building. Bloomingdale's is redesigning three fashion floors, the cosmetics department and the shoe area in its own multi-year renovation projects. At the same time, Saks Fifth Avenue is nearing completion of a \$250 million renewal, including a totally revamped main floor to be labeled as a handbag shopper's paradise. Many of these new stores have set out to mature the relationship that they have with New Yorkers.

Jedd Nero
Principal, Executive Managing Director
New York City Retail
jedd.nero@avisonyoung.com
212.729.3019

Trends to Watch

Expect more online retailers to open brick and mortar stores to complement their e-commerce strategies. In doing so, technology will be more visible in stores, particularly as the customer experience is enhanced.

Customer service and customization will continue to be on every retailer's agenda as a way to develop and mature the relationship with consumers.

Although we can expect to see some rent stabilization by the end of the third quarter, for many retailers, world issues including the China trade agreement will continue to cause pause. We can only hope for a favorable resolution in 3Q19.

Second Quarter 2019 / New York City

Debt & Equity

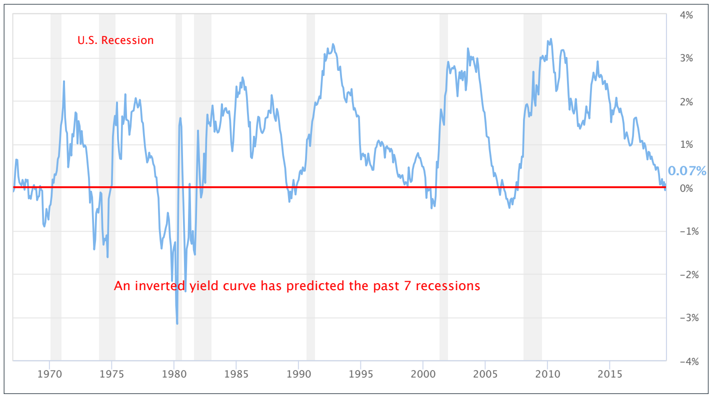
Some Unintended Consequences of the Latest Multi-Family Rent Regulation Laws

The latest multi-family rent regulation laws adopted in New York City in June have sent shockwaves throughout the area. Most of the news is focused on the effect that it will have on landlords who can't move a rent-regulated unit to market-rate apartments. However, the banks financing those properties have encountered an immediate and profound effect. Loan-to-values and cap rates went up immediately in response to the news (in theory, as there have not been any actual trades to point to as of yet). Especially hard hit were full leverage loans on anybody who bought buildings in the last two-three years at a very low cap rate – with the premise that they will make their returns when some of the units roll to market. That future pop is now certain not to happen. In some cases, the loans are now underwater and will need to be modified. Banks that have the most market share in this arena, New York Community Bank, Signature Bank and Dime Community Bank, have lost $2.5 billion in market share in the last quarter. That may be an overreaction considering they are not high leverage lenders, however, it will clearly affect loan volume going forward. As a result, impacted loans could have difficulty refinancing when they come up for maturity.

Interest Rates and the Treasury Yield Curve; What the Pictures Currently Tell Us

Real estate loan volume is up 12.0 percent year-over-year for the first half of 2019. An estimated $110 billion of loans have or will have matured in 2019, fueling the increase, according to the Mortgage Bankers Association. Lower long-term interest rates have also spurred the increase in originations as the 10-year Treasury has dipped below 2.0 percent, even with shorter term interest rates being raised by the Federal Reserve. It certainly is

Historical 10-1 Year Spread on Treasury Yield



Source: gurufocus.com

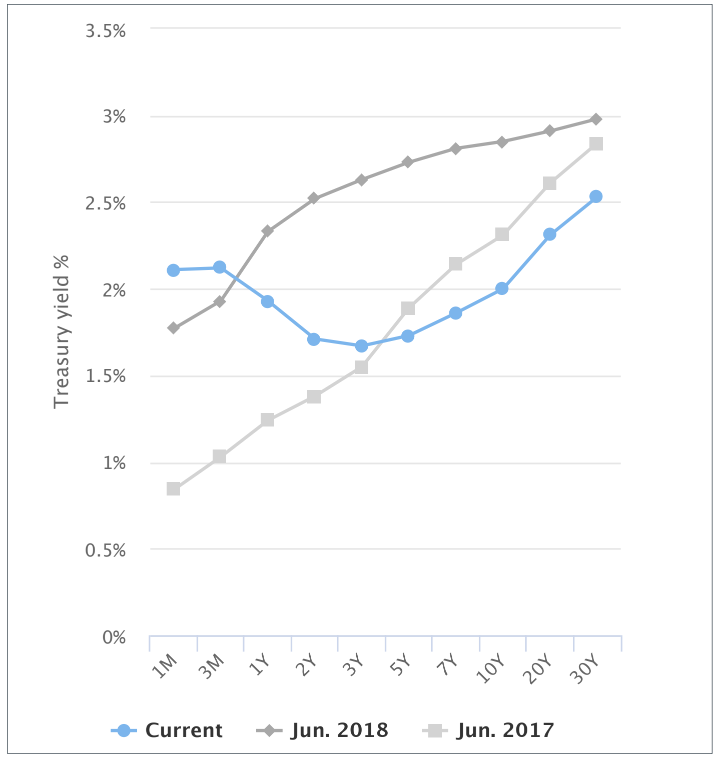
bizarre to see the Prime Rate at 5.5 percent, given where long-term Treasuries are priced. An inverted yield curve like we have now has correctly foreshadowed the last seven recessions. The accompanying chart illustrates the inversion and the timing of the resulting recessions.

Loan Modifications Spurred by Lower Interest Rate Environment

A recent trend this past quarter was prompted by borrowers refinancing their bridge loans to take advantage of decreasing interest rates. Collateralized Loan Obligations (CLOs) are often the method where many of these bridge loans are securitized. Because issuers were losing loans at a brisk pace due to being refinanced out, recent issuers have put provisions into their loans authorizing them to make modifications to performing loans in pools. Previously, the issuers were prohibited from making modifications.

Dan E. Gorczycki
Senior Director
Capital Markets Group, Investment, Investment Management
dan.gorczycki@avisonyoung.com
212.729.7087

Treasury Yield Curve



Source: gurufocus.com

Trends to Watch

New York City banks are already feeling the effects of the new Rent Regulation Laws. Acquisition financing of newer vintage purchases have seen their LTV's spike overnight.

Long-term interest rates continue to go down, even as short-term interest rates were raised by the Federal Reserve. An inverted yield curve is the result.

Recent CLO issuers have added language to authorize them to modify performing loans in collateral pools. This will allow lenders to more easily retain existing loans.

Valuation & Advisory

Real Estate's Role in the Budding Marijuana Industry

Real Estate – The Biggest Barrier to Entry

Real estate is an essential part of success for any cannabis operator. However, real estate has also become the biggest barrier to entry for many cannabis companies. The legal risks associated with the industry, on both the state and federal level, have made real estate extremely expensive for cannabis companies. Because marijuana is still illegal on the federal level, banks and other large corporations will not lend to companies or individuals who operate within the marijuana industry. This has left a huge void in the capital markets space for those looking to buy, lease or build out space intended for the growth and distribution of marijuana. REITs and private equity firms have recently began lending in this space to fill the gap. These specialized lenders can typically charge 12.0 to 16.0 percent due to the lack of available options and the risk they assume. The lack of options and high interest rates makes buying property extremely difficult for smaller marijuana operators. This forces them to start renting.

The High Cost of Renting

However, renting presents its own challenges. For landlords who have a mortgage on their property, leasing space to cannabis operators potentially puts them in violation of specific clauses in their mortgage. Violating clauses in a mortgage can result in the bank demanding repayment of their loan in full at a moment's notice. Landlords have therefore increased rents for cannabis tenants in order to combat this increased risk. Other landlords have simply increased rents because they realize cannabis tenants do not have many alternatives. Cannabis operators are currently singing leases that are two to three times higher than market in specific locations.

Additionally, in some states cannabis operators need to secure property, either through a lease or purchase, before they can be approved for a license. This results in some companies paying hundreds of thousands of dollars in rent while they wait to be approved for a license. These barriers to entry are preventing smaller companies from entering and/or expanding in the industry.

Cap Rate Comparison

Currently, in Denver, industrial grow facilities lease between $12.00 to $14.00 NNN per square foot with no or minimal tenant improvements. This is above the current Denver Metro market rate of $9.79 per square foot, according to CoStar. Additionally, industrial buildings occupied by cannabis companies in Denver saw their sales prices rise more than 17.0 percent between 2014 and 2017, from $98.00 to $115.00 per square foot. Most grow facilities in Denver are currently trading in the 12 percent to 15 percent cap rate range. This is above the market average for industrial properties, which is currently in the 6 percent to 7% percent range. Cap rates in the Denver market have been correlated with how above market the in-place lease is. Properties with leases well above market are typically trading for higher cap rates.

Rising Property Values

Property values have increased not only due to the higher rents, but also because some cannabis companies are investing millions to accommodate large-scale growth operations. Typical buildout costs for grow facilities range between $40.00-$70.00 per square foot, but can reach over $150.00 per square foot in some cases.

As legal marijuana markets mature and more states legalize recreational use, property valuations and rental rates will come down. In markets such as Denver, which is considered one of the more mature markets in the industry, rental rates have already started to decrease, and cap rates are compressing from their peaks. If, or when, the government legalizes marijuana on the federal level, rental rates and valuations will likely fall back to market levels.

New York State

New York State legalized medical marijuana in 2014. However, attempts to legalize recreational marijuana use have come up short, with the most recent push in June 2019 failing to win enough support before the end of the legislative session. As of June 2019, approximately 55.0 percent of voters supported legalizing recreational marijuana use, versus approximately 40.0 percent who oppose, depending on which poll is referenced. Governor Cuomo and Mayor De Blasio have both publicly supported legalizing recreational marijuana use. New York can next vote on this issue in 2020.

Eric Falvo
Associate
Valuation and Advisory Services
eric.falvo@avisonyoung.com
212.735.8556

States That Have Legalized Medical Marijuana

- Alaska (R)
- Arizona
- Arkansas
- California (R)
- Colorado (R)
- Connecticut
- Delaware
- Florida
- Hawaii
- Illinois (R)
- Louisiana
- Maine (R)
- Maryland
- Massachusetts (R)
- Michigan (R)
- Minnesota
- Montana
- Nevada (R)
- New Hampshire
- New Jersey
- New Mexico
- New York
- North Dakota
- Ohio
- Oklahoma
- Oregon (R)
- Pennsylvania
- Rhode Island
- Utah
- Vermont (R)
- Washington D.C. (R)
- West Virginia

(R) States that have legalized recreational marijuana

States That Will Potentially Legalize Recreational Marijuana in the Near Future

- Arizona
- Connecticut
- Florida
- New Hampshire
- New Jersey
- New Mexico
- New York
- Ohio

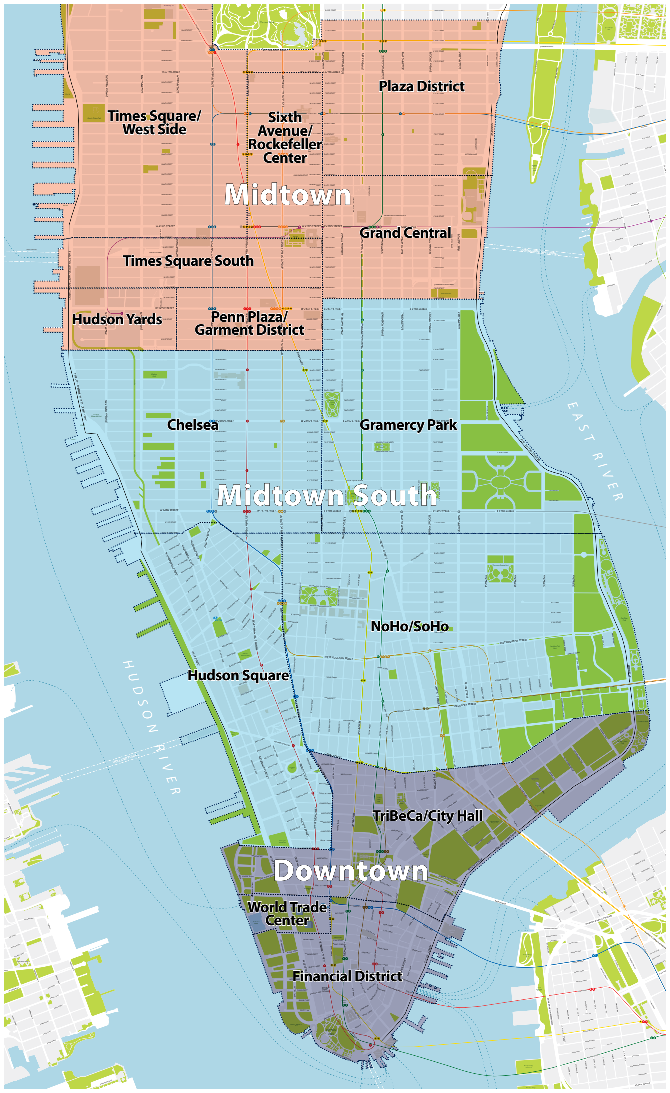
Trends to Watch

Given the lack of financing options, as well as high interest rates, this makes buying property extremely difficult for smaller marijuana operators. Expect more of these operators to rent versus own their cannabis facilities.

Expect cap rates for industrial grow facilities to remain above the market average for non-cannabis industrial properties.

Watch for property valuations and rental rates to come down, more so as legal marijuana markets mature, and more states legalize recreational use.

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
Second Quarter 2019

avisonyoung.com

For more information, please contact:

A. Mitti Liebersohn
President and Managing Director, NYC Operations
212.729.7734
mitti.liebersohn@avisonyoung.com

Corey Deslandes
Research Manager
212.729.6973
corey.deslandes@avisonyoung.com

Marisha Clinton
Senior Director of Research, Tri-State
212.729.1193
marisha.clinton@avisonyoung.com

1166 Avenue of the Americas
15th Floor
New York, NY 10036
212.729.7140