AVISON YOUNG

Third Quarter 2019 / New York City

Office Leasing

Market Facts

$82.97 PSF
Overall Manhattan average asking rent at a historical high

$90.81
New high for Midtown overall average asking rent

150%
Year-over-year growth in Midtown South leasing volume for 3Q19

9.8%
Third quarter vacancy rate; Manhattan overall in equilibrium

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

TAMI Dominates Third Quarter Leasing Activity and Bodes Well for Midtown South; Record Rents Achieved for Manhattan Overall

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 August, the city posted 2.1 percent year-over-year private sector job growth in comparison to 1.3 percent for the state and 1.5 percent nationally. The greatest office-using employment gains were again seen in the education and health services sectors, while continued job increases were also noted in professional and business services, as well as information and technology activities. These consistent employment gains have translated into office leasing demand that has helped boost leasing volume across parts of the Manhattan office market, particularly in Midtown South. This was evidenced by the top two largest leases executed in the third quarter by technology/advertising/media/information (TAMI) tenants in Midtown South, which totaled 2.26 million square feet. In contrast, this strong third quarter activity offset quarterly softness in leasing velocity experienced in Midtown. Although the two largest TAMI transactions referenced above solely accounted for nearly a third of the total quarterly leasing volume, the overall Manhattan office leasing market remains in equilibrium.

For the third quarter, total office leasing volume of 8.5 million square feet ended relatively on par with the same period in 2018. Through the end of September, year-to-date office leasing volume of 27.4 million square feet for the city was greater than the 26.9 million square feet executed for the same period last year and represented a 2.0 percent annual increase.

The Manhattan vacancy rate by the end of the third quarter declined by 30 basis points year-over-year to 9.8 percent. A flight

MARKET DATA POINTS

Manhattan Overall

Indicator	3Q19	3Q18
Vacancy	9.80%	10.20%
Rent	$82.97	$78.71
Absorption	(178,828) SF	884,032 SF

Midtown Overall

Indicator	3Q19	3Q18
Vacancy	10.20%	9.70%
Rent	$90.81	$85.92
Absorption	(1,268,387) SF	708,477 SF

Midtown South Overall

Indicator	3Q19	3Q18
Vacancy	7.40%	8.80%
Rent	$80.28	$79.75
Absorption	684,963 SF	247,659 SF

Downtown Overall

Indicator	3Q19	3Q18
Vacancy	10.80%	12.80%
Rent	$63.40	$63.35
Absorption	404,596 SF	(72,104) SF

Data as of 10/2/2019

to quality for new development and renovated product primarily preferred by financial services, TAMI and legal tenants continued to drive average asking rents up 5.0 percent to a new historical high of $82.97 per square feet compared to $78.71 a year ago. Expect near-term deliveries over the next 12 months of additional new product (e.g. One Vanderbilt Avenue, the Farley Building and 425 Park Avenue), which are being offered at triple-digit rates on a square foot basis to further drive up average asking rents. Such product comes with the latest amenities and, in the case of One Vanderbilt and the Farley Building, within close proximity to a major transit hub.

Midtown: Fewer and Smaller Large Block Transactions Result in Lower Leasing Volume; Average Asking Rents Hit New High

Leasing

Midtown third quarter leasing activity of 4.0 million square feet is down 38.0 percent from a year ago. Typically a market with a significant number of closed large block transactions, there were only eight in Midtown during the quarter totaling 1.6 million square feet, the largest just under 400,000 square feet. This compares to 10 for the same period a year ago totaling 3.2 million square feet, with the largest being 855,000 square feet.

- Four of the eight large block leases were renewals, the largest executed by the law firm of Shearman & Sterling at 599 Lexington Avenue in the Plaza District for 397,150 square feet.
- Two of the remaining four large block leases executed during the quarter were for renovated or soon to be upgraded properties. These respectively include WeWork (362,197 square feet at 437 Madison Avenue in the Plaza District), and Israel Discount Bank (123,000 square feet at 1114 Avenue of the Americas in the Sixth Avenue/Rockefeller Center submarket).

Vacancy

Overall vacancy increased 50 basis points year-over-year to 10.2 percent from 9.7 percent, the result of softer leasing, as well as direct and sublease space put on the market during the quarter.

- Class A vacancy increased 70 basis points year-over-year to 10.7 percent, partly due to 390 Ninth Avenue, the Farley Building (740,000 square feet of direct space) coming online, as well as sublease space made available by Publicis Groupe (601,242 square feet at 1675 Broadway in Times Square/ West Side) and DZ Bank and its affiliate DVB Bank (35,000 square feet at One Vanderbilt in Grand Central put back on the market).
- Class B vacancy declined 70 basis points year-over-year from 8.5 percent to 7.8 percent. Strong leasing in the Penn Plaza/Garment District submarket for deals under 30,000 square feet helped drive this trend.

Rents

Overall Midtown average asking rents ended the third quarter at $90.81, up 6.0 percent year-over-year from $85.92, representing a new historic high.

- Class A average asking rents ended the quarter at $96.02 for a record high, up 6.0 percent year-over-year from $90.59. New development in Hudson Yards (390 Ninth Avenue, the Farley Building) came to market at a high average asking rent level at $145.00 per square feet.
- Class B average asking rents ended the quarter at $59.68, down 2.0 percent year-over-year from $60.91, due in part to more lower priced sublease space made available (e.g. 70,000 square feet

by LF Americas, Inc. and others to total 113,000 square feet at 1359 Broadway).

Midtown South: TAMI Drives Record Quarterly Leasing Velocity Up 150.0 Percent Year-Over-Year, While Financial Services Take on More New Development and Higher Rent

Leasing

Record third quarter leasing activity of 3.2 million square feet for Midtown South is up 150.0 percent from a year ago as the market remains dominated by TAMI tenant leasing activity.

- TAMI companies executed 80.0 percent of the leasing volume in Midtown South for the third quarter, with the top two largest transactions representing two of the three large-block closed deals (over 100,000 square feet). A year ago, there were two large-block closed deals in total during the same period.
- For 3Q19, the largest deal was Google's 1,300,000-square-feet new lease at 550 Washington Street (aka St. John's Terminal), which is part of the company's 1.7 million square feet campus ("Google Hudson Square" and also includes parcels at 315 and 345 Hudson Street). The second large-block transaction was executed by advertising and public relations company, Publicis Groupe, where the firm closed on a 960,222-square-feet renewal/expansion deal at 375 Hudson Street and plans to relocate all of its agencies from 1675 Broadway in Times Square/West Side.
- Co-working represented just 4.0 percent of leasing activity in Midtown South during the third quarter, compared to 22.0 percent in the prior quarter and 48.0 percent a year ago. However, WeWork had the third large-block closed deal this quarter with its 107,785 square feet new lease at 16 East 34th Street in Gramercy Park.
- Financial services tenants represented the second largest sector of third quarter leasing activity in Midtown South, with some tenants paying triple-digit rent on a per square foot basis to be within close proximity to innovative resources and tech clients.

Vacancy

Overall vacancy declined 140 basis points year-over-year from 8.8 percent to 7.4 percent.

- Class A vacancy decreased 310 basis points year-over-year from 12.4 percent to 9.3 percent due partly to the further lease-up of newer space (e.g. 40 10th Avenue and 412 West 15th Street).
- Class B vacancy declined 70 basis points year-over-year from 7.1 percent to 6.4 percent as the result of continued co-working activity, as well as the greater lease-up of office space by retail/wholesale tenants for Class B product within Midtown South.

Rents

Overall average asking rents for Midtown South ended the third quarter at $80.28, virtually in-line from $79.75 a year ago.

Notable Third Quarter Leasing by Market

Tenant Industry	New Address Submarket	Size (SF) Lease Type
Midtown		
Shearman & Sterling Legal Services	**599 Lexington Avenue** Plaza District	**397,150** New Lease
WeWork Real Estate	**437 Madison Avenue** Plaza District	**362,197** New Lease
Macquarie Group Financial Services	**125 West 55th Street** Sixth Avenue/Rockefeller	**262,087** New Lease
Midtown South		
Google Technology/Advertising/Media/Information	**550 Washington Street** Hudson Square	**1,300,000** New Lease
Publicis Groupe Technology/Advertising/Media/Information	**375 Hudson Street** Hudson Square	**960,222** Renewal/Expansion
WeWork Real Estate	**16 East 34th Street** Gramercy Park	**107,785** New Lease
Downtown		
District Council 37 Government/Public Administration	**55 Water Street** Financial District	**130,449** Sublease
Kelly Drye & Warren LLP Legal Services	**3 World Trade Center** World Trade Center	**103,082** New Lease
Spotify Technology/Advertising/Media/Information	**4 World Trade Center** World Trade Center	**85,666** Expansion

Data as of 10/2//2019

- Class A average asking rents ended the quarter at $98.27, down 3.0 percent from $101.54 last year. We note that while much of the new development remains priced in the triple digits (e.g. 40 Tenth Avenue at $165.00 per square foot and 412 West 15th Street at $150.00 per square foot), relatively lower-priced floors remain on the market.
- For the third quarter, financial services tenants have opted for newer space at 40 Tenth Avenue (innovation-focused firm RTW Investments - 14,082 square feet) and 412 West 15th Street (Untitled Investments – 6,092 square feet) in Chelsea, as well as 809 Broadway in SoHo/NoHo (technology-focused firm Inspired Capital Partners - 3,612 square feet) and (Tolis Advisors - 2,508 square feet), which remains under construction. Each of these transactions have taking rents starting in the triple digits.
- Class B average asking rents ended the quarter at $65.03, up almost 4.0 percent year-over-year from $62.78. We attribute the increase to limited availability of such product, particularly in Hudson Square, given expansions by Oscar Health (80,500 square feet at 1 Hudson Square) and ROKT (33,820 square feet at 175 Varick Street).

Downtown: Diverse Tenant Mix Drives Leasing Activity Up 50.0 Percent Year-Over-Year

Leasing

Downtown leasing activity of 1.3 million square feet is up 50.0 percent from a year ago due to heavy activity in the Financial District and the World Trade Center submarkets.

- Two large-block leases (above 100,000 square feet) totaling over 233,000 square feet were executed Downtown compared to none a year ago. The District Council 37 took a 130,449 square foot sublease at 55 Water Street in the Financial District and the law firm of Kelley Drye & Warren LLP signed for 103,082 square feet at 3 World Trade Center.

Vacancy

As a result of strong leasing activity Downtown, overall vacancy declined by 200 basis points from 12.8 percent a year ago to 10.8 percent at the end of the third quarter, and remains below the 12.0 percent level first reached at year-end 2016.

- Class A vacancy of 11.5 percent declined 190 basis points year-over-year from 13.4 percent, and also remains 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 651,000 square feet during the quarter, compared to 416,000 during the same period a year ago.
- Class B vacancy of 8.1 percent decreased 240 basis points year-over-year from 10.5 percent due to a decline in direct space available, primarily in the Tribeca/City Hall submarket.

Rents

Overall average asking rents for the third quarter ended at $63.40 per square foot, virtually in-line with the $63.35 a year ago.

- Class A average asking rents ended the quarter at $65.24, up just 1.0 percent year-over-year from $64.76.
- Class B average asking rents ended the quarter at $52.12, down 7.0 percent year-over-year from $55.90 due to higher-priced space being leased, leaving lower-priced floors on the market.

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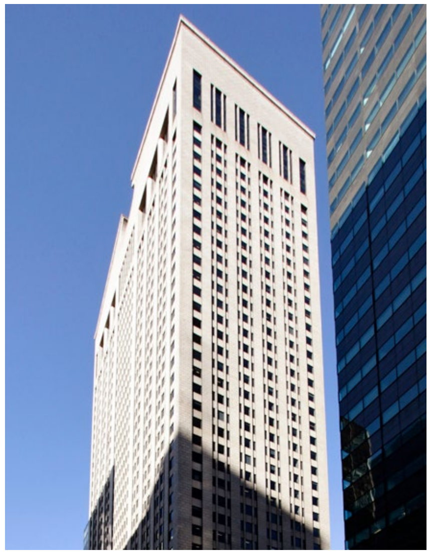
Largest Blocks of Contiguous Space Currently Available

3 World Trade Center
World Trade Center | 887,491 RSF



550 Madison Avenue
Plaza District | 797,505 RSF

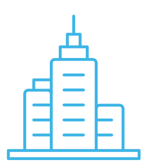
11 Penn Plaza
Penn Plaza/Garment | 638,921 RSF

390 Ninth Avenue
Hudson Yards/Manhattan West | 740,000 RSF

1675 Broadway
Times Square/West Side | 601,242 RSF

Trends to Watch

Watch for potentially more leasing activity in Midtown South by smaller tech-related financial services tenants who wish to be in close proximity to larger TAMI companies, including those with business innovations that these tenants find appealing.



Over the next 12 months, expect near-term deliveries of additional new product being offered at triple-digit rents on a per square foot basis (e.g. One Vanderbilt Avenue with $145.00 per square foot, the Farley Building with $145.00 per square foot and 425 Park Avenue with $230.00 per square foot) to further drive up average asking rents.

Based on our analysis of tenants in the market as of the end of 3Q19, expect significant TAMI activity in the pipeline (Uber, Facebook and Dentsu with requirements totaling in excess of 1.5 million square feet) to weigh positively on overall leasing velocity for the Manhattan office market, and to potentially absorb some of the newer development.

Market by the Numbers

Submarket	Inventory (SF)	Direct Vacant (SF)	Sublet Vacant (SF)	3rd Quarter 2019 Overall Vacancy Rate	3rd 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	56,785,198	4,161,187	973,873	9.0%	306,390	726,547	0	$77.19	$60.69
Penn Plaza/ Garment	20,023,898	689,303	1,433,027	10.6%	(92,328)	(366,417)	0	$65.55	$55.48
Hudson Yards/ Manhattan West	11,356,905	1,410,936	98,416	13.3%	(674,786)	(639,133)	7,762,278	$142.14	$0.00
Plaza District	78,060,045	7,786,431	1,756,921	12.2%	(100,561)	(1,894,150)	0	$108.62	$60.15
Sixth Avenue/ Rockefeller Center	56,543,539	3,989,958	1,036,363	8.9%	(43,636)	(552,437)	0	$88.34	$56.83
Times Square South	25,151,115	1,651,942	797,685	9.7%	(303,727)	(217,686)	0	$69.83	$58.51
Times Square/ West Side	37,826,242	2,143,003	1,152,812	8.7%	(359,739)	433,964	0	$77.29	$66.04
Total	**285,746,942**	**21,832,760**	**7,249,097**	**10.2%**	**(1,268,387)**	**(2,509,312)**	**7,762,278**	**$96.02**	**$59.68**
Midtown South									
Chelsea	23,390,460	959,297	611,622	6.7%	32,809	60,524	900,000	$145.06	$66.56
Hudson Square	14,257,845	354,909	177,976	3.7%	329,621	514,061	0	$95.28	$61.18
Gramercy Park	31,206,525	1,985,176	696,906	8.6%	681,408	94,225	1,500,000	$85.70	$62.05
SoHo/NoHo	9,447,096	800,761	184,627	10.4%	(358,875)	(527,921)	0	$99.97	$70.97
Total	**78,301,926**	**4,100,143**	**1,671,131**	**7.4%**	**684,963**	**140,889**	**2,400,000**	**$98.27**	**$65.03**
Downtown									
TriBeCa/City Hall	19,271,567	1,232,724	141,179	7.1%	173,819	(61,363)	0	$64.05	$53.42
Financial District	53,594,426	4,443,496	1,097,532	10.3%	12,871	479,355	0	$60.02	$52.02
World Trade Center	26,137,946	2,772,134	1,063,826	14.7%	217,906	500,588	410,000	$72.40	$50.83
Total	**99,003,939**	**8,448,354**	**2,302,537**	**10.8%**	**404,596**	**918,580**	**410,000**	**$65.24**	**$52.12**
Manhattan Overall Total	463,052,807	34,381,257	11,222,765	9.8%	(178,828)	(1,449,843)	10,572,278	$88.11	$60.17

Data as of 10/2//2019
* Excludes 7.2 MSF coming online within the next 12 months.

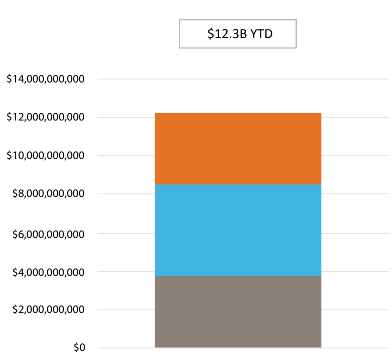
Investment Sales

Third Quarter 2019 Summary

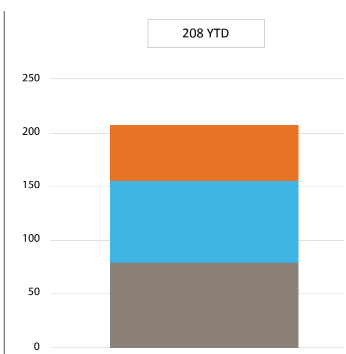
Manhattan's commercial real estate transactions totaled $3.7 billion in the third quarter, which is 28 percent below the trailing four-quarter average of $5.2 billion. By annualizing the first three quarters, 2019 in on pace for sales totaling $16.3 billion, 32.7 percent below the $24.3 billion recorded in 2018.

With large trades dominating the third quarter, transactions fell to 53 from 76 in the previous quarter and declined by 36 percent from the four-quarter average. Based on the first three quarters, total trades for 2019 are projected to be 277, which is 8 percent below the previously recorded 10-year low of 300 sales in 2017.

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

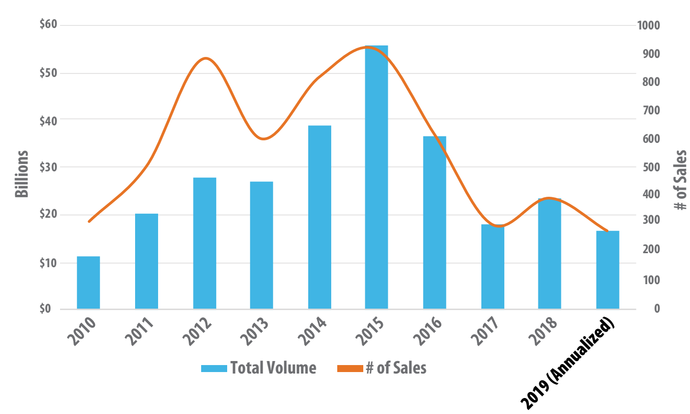


Total Dollar Volume Year-to-Date



Total Number of Sales Year-to-Date

Transaction Volume and Number of Sales by Year



Multi-Family

Manhattan saw $664 million in multi-family sales across 20 transactions in the third quarter, as investors continued their flight to quality. Major transactions for the quarter included 220 East 72nd Street, which traded for $159.5 million, or $1,021 per square foot, 60 East 12th Street, which traded for $106.5 million, or $823 per square foot, and 25 East 67th Street, which sold for $70 million, or $1,810 per square foot. Cap rates averaged 4.34 percent, 31 basis points above the trailing four-quarter average, while the weighted average price per square foot of $929 was 6 percent higher than the four-quarter average.

Retail

The retail sector in the third quarter recorded six transactions totaling $175 million, which is higher than the $153 million closed in the second quarter, but 38 percent lower than the trailing four-quarter average. Significant sales included 196 Orchard Street with tenants CVS, Marshall's and Equinox, which traded for $88.8 million, or $1,464 per square foot, and 47-49 Greene Street with tenant Theory, which traded for $24.8 million, or $3,397 per square foot. Cap rates averaged 5.20 percent, 25 basis points higher than the trailing four-quarter average, and the price per square foot averaged $1,449, which was 39 percent lower than the four-quarter average.

Office Buildings and Office Condo

In the office sector, there were nine office building transactions in the third quarter totaling $2.1 billion, and four office condo/co-op transactions totaling $88 million. The Coca Cola office building at 711 Fifth Avenue sold for $907 million, or $2,563 per square foot, which helped push the average price per square foot for office buildings to $1,322 per square foot, a jump of 71 percent from the four-quarter average. It was reported that 711 Fifth Avenue will be resold for $955 million, which along with several other major sales announced, should result in strong volume in coming quarters. The largest office condo/co-op transaction was the sale of the entire sixth floor of 866 United Nations Plaza for $59.2 million, or $800 per square foot.

Development

In a particularly slow quarter, there were only four development sales totaling $321 million, a 51 percent decline from the trailing four-quarter average. A total of 520,000 buildable square feet traded during the quarter, which represented an 86 percent decline from the four-quarter average, while the weighted average price per buildable square foot was $618, an 11 percent decline from the four-quarter average. Significant sales included 1461-1469 Third Avenue and 204 East 83rd Street for $167 million, or $668 per buildable square foot, and a development site at Lexington and 56th Street, which sold for $103.7 million, or $593 per buildable square foot. Development volume is projected to end the year at $1 billion, the lowest level of any year since 2010 when development sales totaled $802 million.

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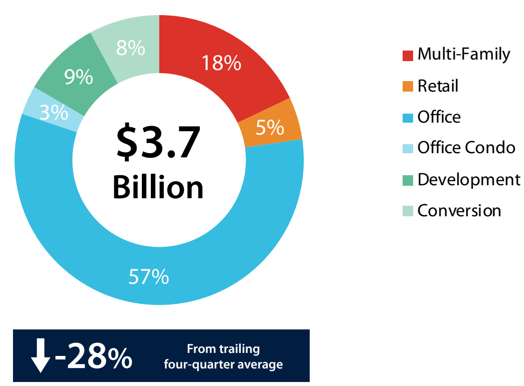
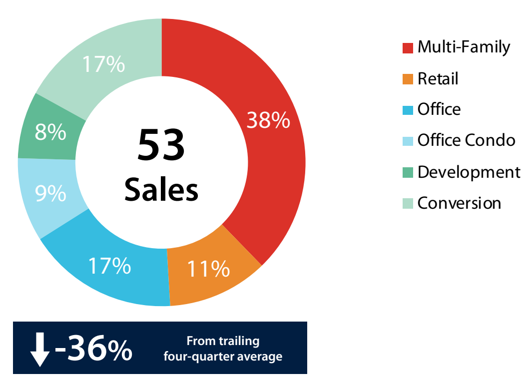
Avison Young's Tri-State Investment Sales group tracks confirmed transactions above $5 million ($1 for retail properties and office condominiums) sold in Manhattan below 96th Street.

Total Dollar Volume by Asset Class



Number of Sales by Asset Class



Trends to Watch

How will the Housing Stability and Tenant Protection Act of 2019 continue to affect the overall multi-family transactions for the year?

Will institutional investor confidence remain strong for trophy assets?

Can development sales regain steam without a luxury condominium sales recovery?

AVISON YOUNG

Third Quarter 2019 / New York City

Retail Leasing

State of the Retail Market

Retail leasing activity picked up in several Manhattan submarkets in the third quarter. Overall, however, the supply of retail spaces continued to exceed demand.

In the Penn Plaza/Garment District, SL Green successfully renewed a 95,000-square-foot lease for AMC Theatres at 312 West 34th Street, and replaced H&M at 2 Herald Square with a 12,000-square-foot lease for Ulta Beauty. Educational tenants, Lightbridge Academy and Hopscotch Montessori School, signed new leases in Hell's Kitchen. Food retailers also remained active with new lease signings across Manhattan including Whole Foods in NoMad, Korean Food Hall in the Garment District and Burgerim in Penn Plaza.

Year-over-year, REBNY's recent Manhattan Retail Report shows that asking retail rents declined more than 20.0 percent in some areas, as landlords adjusted pricing in an effort to move their spaces.

The high-profile corridors catering to luxury tenants have experienced the steepest declines, according to REBNY's data. These include Fifth Avenue, between 49th and 59th streets where asking rents have fallen from $3,900 per square foot to around $3,000 per square foot, still the highest in Manhattan, and the upper part of Madison Avenue, between 57th and 72nd streets, where asking rents have dropped to around $1,000 per square foot from $1,390 per square foot.

Some new owners, or those who purchased their retail properties at the peak of the market, have waited to lower their rents and, as a result, are having more difficulty filling vacant spaces. Long-time landlords and owners, however, remain flexible, participating in store build-outs and creating alternative uses of space, which has helped drive leasing velocity.

Spotlight on Experiential Retail

In this challenging environment, various retailers are creating "experimental" pop up shops or short-term stores to test the market or a retail strategy, while others are creating "experiential" stores where consumers buy an experience rather than just an item or service.

For example, Warner Brothers leased the former home of Restoration Hardware, a 35,000-square-foot three-level space at 935 Broadway in the Flatiron District, for a Harry Potter-themed exhibit that will allow fans to experience the enchanted world of the blockbuster film and book series. The exhibit is expected to attract a significant number of tourists and local visitors.

In addition, Nordstrom opened its first product-free mini store on the Upper East Side. Called Nordstrom Local, the 1,800-square-foot "neighborhood hub" is located at 1273 Third Avenue. Instead of selling clothing or goods directly, customers can pick up an online order, make a return, get an item altered or have a gift wrapped. This location also offers stroller cleaning services, and hosts networking and other events, many targeted at families. A second Nordstrom Local opened at 13 Seventh Avenue in the West Village in September.

Whether a way to complement existing brick-and-mortar stores or online shopping, or to serve as an alternative use of space, these new unique retail spaces create a "win-win" for both occupiers and owners. Retailers are able to adapt to changing consumer behavior, while landlords fill their vacant spaces.

Notable Third Quarter Retail Transactions

Tenant	Building	Submarket	Size (SF)	Lease Type
AMC Theaters	312 West 34th Street	Penn Plaza	95,341	Renewal
Whole Foods	63 Madison Avenue	NoMad (Gramercy Park)	60,000	New Lease
Museum of Ice Cream	558 Broadway	Soho	25,000	New Lease (replaces H&M)
KFF (Korean Food Hall)	218 West 40th Street	Garment District	22,927	New Lease (First Manhattan location)
Tourneau	601 Madison Avenue	Plaza District	12,050	New Lease (replaces Armani; temporary site while it renovates its store on 12 East 57th Street)
Ultra Beauty	2 Herald Square	Penn Plaza	12,040	New Lease (replaces flagship; replaces H&M)
First Republic Bank	1 Grand Central Place (60 East 42nd Street)	Grand Central	14,491	New Lease (replaces Bank of America)
Lightbridge Academy	606 West 57th Street	Hell's Kitchen (Times Square/West Side)	11,491	New Lease
Hopscotch Montessori School	624 West 57th Street	Hell's Kitchen (Times Square/West Side)	6,855	New Lease (second NYC location)
Burgerim	485 Seventh Avenue	Penn Plaza	1,408	New Lease (First Manhattan location for the gourmet burger chain)

Local Score Card

Several long-time, iconic New York City retail institutions, however, have faltered in the transition to this new environment. Barneys filed for reorganization under Chapter 11 of the Bankruptcy Code in August, and could announce a buyer as early as October 11. The 660 Madison Avenue flagship store, which was reportedly paying about $45 million a year in rent including taxes, the 101 Seventh Avenue location and Barneys' online platforms will remain open. Up to 15 stores nationwide will close.

The Patina Restaurant Group announced it will be closing the Sea Grill, Rock Center Café and Cucina at Rockefeller Center, restaurants that have been Midtown fixtures since the 1980s. The current leases, which were renewed in 1999, will expire at the end of this year. Adapting to the times, the landlord Tishman Speyer said in a statement that it is "now exploring other partners and concepts in food and beverage. This is a unique moment to develop new ideas for the iconic spaces at Rockefeller Center."

National Score Card – The Retail Correction Continues

Year-to-date through September, the number of U.S. store closures stood at 8,558, well over the 5,844 total store closures for all of 2018, according to the latest Coresight Research store tracker. In contrast, store openings year-to-date increased nationwide, totaling 3,446 compared to 3,258 in 2018.

Previously, 2017 held the record for store closures, with 8,139 store shutterings that included all Toys 'R' Us stores, as well as hundreds of Sears and Kmart locations. At this pace, store closings in 2019 could reach 12,000 by year-end, Coresight reports.

Major national chain stores closing this year include Payless, which is shuttering its remaining 2,100 U.S. locations this summer, Gymboree, with 749 store closures and Dressbarn, which could close up to 650 stores. Dressbarn is currently in negotiations with its landlords to get out of its existing leases or face paying $302 million in rent obligations.

Forever 21 could soon be one of the latest fatalities, as it is currently seeking to restructure debt, shed unprofitable stores and recapitalize the business. If unsuccessful, Forever 21 store closures could be problematic for the country's major mall owners.

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Trends to Watch

Expect more retailers to open "experiential" brick and mortar stores to complement their existing retail strategies. In doing so, the overall user experience will be enhanced as more concepts are created. The key is to find the optimal click and brick balance.

As the holiday season approaches, watch for more short-term pop-up shops. In addition, we could see more online deals and multi-hour sales such as Amazon's Prime Day, which lasted for 48 hours and was more successful than both Black Friday and Cyber Monday in 2018.

Be on the lookout for higher tariffs on December 15 on some electronics, footwear and apparel imported from China. For now, lower interest rates are putting more disposable income in consumer's pockets, but we must be mindful of potential price increases for such goods.

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Debt & Equity

Fannie and Freddie pulling back could have consequences for multi-family

While it's not unusual for Fannie Mae and Freddie Mac to run out of funds at the end of their fiscal year, the Agencies hit their lending cap on Labor Day this year, which caused significant uncertainty in the market.

After announcing new caps beginning October 1, 2019, however, Fannie and Freddie are back in the market. Talk is that they will be more conservative going forward in terms of both leverage and interest rate, and suddenly will no longer be the de facto cheapest lender in the marketplace. This could adversely affect cap rates in the multi-family space, which will only be exacerbated if interest rates spike. Compounding the situation for New York City, the Treasury released its Housing Finance Reform Plan during September. Buried in the text is a mandate for the Agencies to curb lending in markets where there is rent control. Thus, the latest multi-family rent regulation laws adopted in New York City in June may still result in aftershocks in the market. Conversely, Fannie and Freddie mandated that 37.5 percent of all multi-family business be "mission-driven affordable housing," a change that is likely to strengthen pricing incentives for affordable projects.

Inverted Yield Curve Could Impact Cap Rates

The 10-Year Treasury rates dipped below 1.5 percent in late August before rising above 1.7 percent currently. An inverted yield curve like we have now has correctly foreshadowed the last seven recessions. If correct, a recession could slow growth in rents and subsequently temporarily depress real estate values.

Trouble in the Repo Markets

Overnight lending rates spiked to 10.0 percent in September. There is a debate as to why this happened and if there are any long-lasting ramifications. The Federal Reserve responded by injecting $105 billion into the overnight market which temporarily quelled the market fears. In 2020, the Fed will have to boost its reserves by $400 billion. The question is, will this have carryover effects to the longer-term interest rate market?

Converging Factors Affecting Cap Rates

IIf interest rates do rise as a result of either the Repo market or other factors, will this affect cap rates? There is a definite correlation between them. Using office as an example, cap rates on Class A product were approximately 350-450 bps (nationally) over the 10-year Treasury as of October 9, 2019. This spread was violated in the peak of 2005 when cap rates were only 100 bps over the 10-year UST Bond, as investors bid up prices to unsustainable levels. The 2009 downturn then caused the gap to widen with spreads peaking at 5+ percent in 2012. Today, we are back to the normal gap as Treasury Bond yields have plummeted. Cap rates certainly vary by property type too. Class A apartments in rent regulated buildings were at 3.0 percent cap rates, but that was prior to the recent rent regulation changes, which will limit their upside. They likely rose almost 2.0 percent overnight though there haven't been any notable trades.

The accompanying chart shows the historical correlation between interest rates and cap rates.

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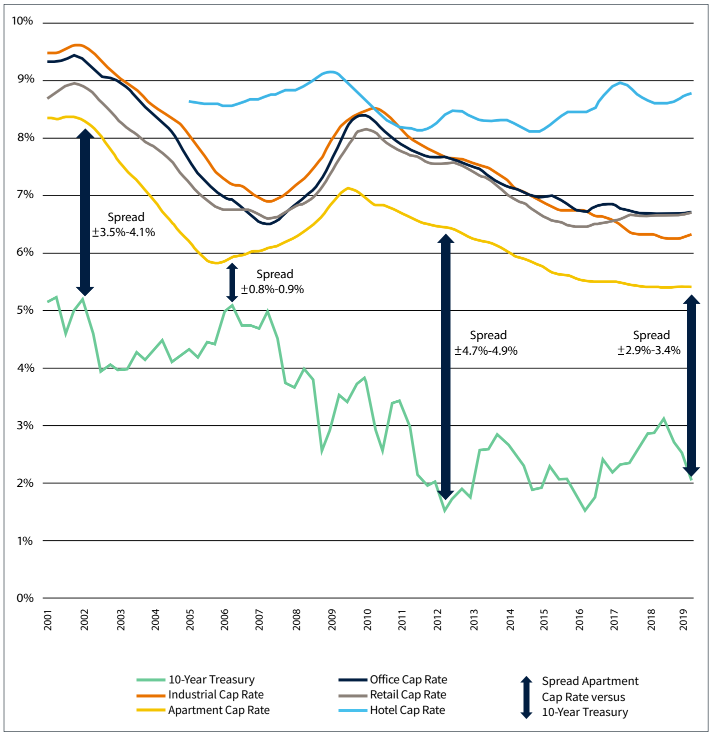
Cap Rate vs. 10-Year Treasury Chart



Source: Real Capital Analytics, US Treasury, International Valuation & Advisory and RJM Worldwide, https://www.rjm-worldwide.com/articles/cap-rates

Trends to Watch

Fannie Mae and Freddie Mac are changing their lending guidelines and this could affect multi-family interest rates and, thus, cap rates.

The inverted yield curve continues which usually portends a recession.

The Repo market has overnight lending rates spiking towards 10.0 percent, which could imply some market instability.

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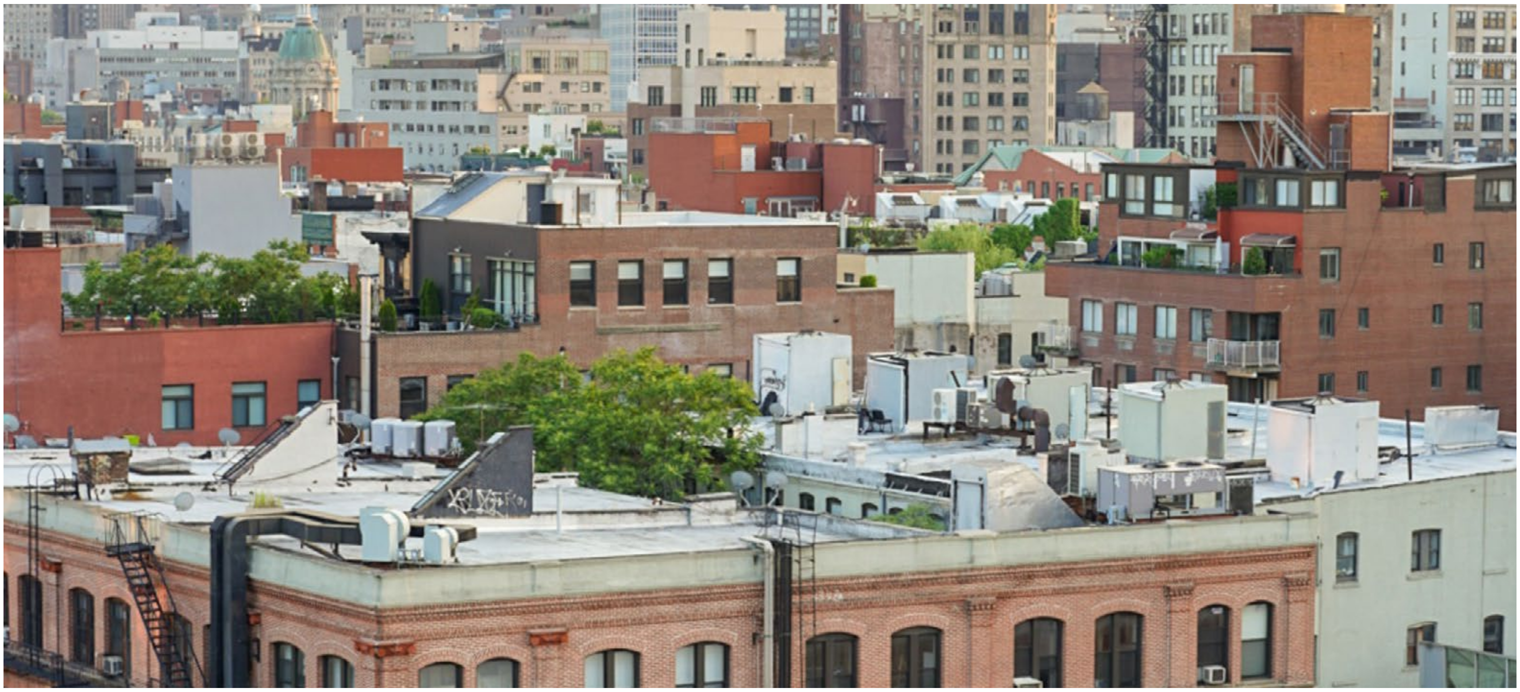

Housing Stability and Tenant Protection Act of 2019

Since June 14, 2019, the date Governor Andrew Cuomo signed off on the Housing Stability and Tenant Protection Act of 2019, there has been no shortage of news articles, panel discussions, and expert opinions that have speculated about the impact of the new legislation on the housing market in New York City. The comprehensive legislation introduces significant changes to the laws governing the city's rent-regulated housing stock. The following is a brief overview of the major changes that impact the ability to increase rents to cover operating expenses or improvements:

- New York rent regulation laws are made permanent, including the Emergency Tenant Protection Act of 1974 (ETPA). Previously, rent regulation laws expired every four to eight years.
- Repeals high-rent vacancy and high-income deregulation statutes.
- Repeals statutory vacancy and longevity bonuses.
- Prohibits owners who offer tenants a preferential rent, or rent below the legal regulated rent, from raising the rent to the full legal amount upon lease renewal. Landlords may charge up to the full legal regulated rent once the tenant vacates the unit.
- Limits the use of the owner-use provision to a single unit. The owner must also use the unit as their primary residence.
- Sets the maximum collectible rent increase to a five-year average of Rent Guidelines Board increases.
- Caps the annual Major Capital Improvement rent increase at two percent.
- Caps the amount of reimbursable Individual Apartment Improvement (IAI) spending at $15,000 over a 15-year period, for up to three separate IAIs.

Potential Impact on Values in New York City

According to the most recent New York City Housing and Vacancy Survey conducted in 2017, 63.0 percent of the city's housing stock is comprised of rental units, 45.0 percent of which are subject to rent regulation. Based on these figures, the new legislation introduces substantial changes to the operation of approximately 28.0 percent of the total housing stock in New York City. The biggest topic currently up for debate in the industry is the extent of the impact that the new legislation will have on property values. In this profession, we rely on transactional data to inform our conclusions. At this time, that data is practically nonexistent as owners of properties with rent-regulated units are highly reluctant to sell. Similarly, the new legislation has made investors very hesitant to deploy capital for rent-regulated assets with limited rent growth potential. The general sentiment among industry professionals is that the values of properties with a high percentage of rent-regulated units will decline as a result of the new legislation. In the near-term, the decline in sales activity for multifamily assets will likely translate to lower transfer tax revenue for New York City. Over a longer horizon, lower property values could cause a decline in total real estate tax revenue. According to the Office of the New York City Comptroller, real estate taxes accounted for 30.2 percent of New York City's total general revenue in fiscal year 2018 and represent the largest single source of income for the city.

Conversations with investment sales professionals and other market participants indicate that capitalization rates, which express the ratio of net operating income to asset value, are likely to increase for buildings with a high percentage of rent-regulated units as investors see limited upside potential in these assets at this time. Prior to the passing of the June 2019 legislation, capitalization rates for rent-regulated buildings generally reflected a certain degree of perceived upside potential in the ability to increase rents. According to Real Capital Analytics (RCA), in the 12-month period ending in the second quarter of 2019, capitalization rates for multifamily assets have risen in 83.0 percent of the major cities in the United States that have rent control laws. In comparison, RCA data shows that approximately 40.0 percent of cities without rent control have exhibited increasing capitalization rates over the same observation period. However, in the absence of sufficient transactional data, the full impact of the new legislation on capitalization rates for rent-regulated assets in New York City cannot be determined just yet.

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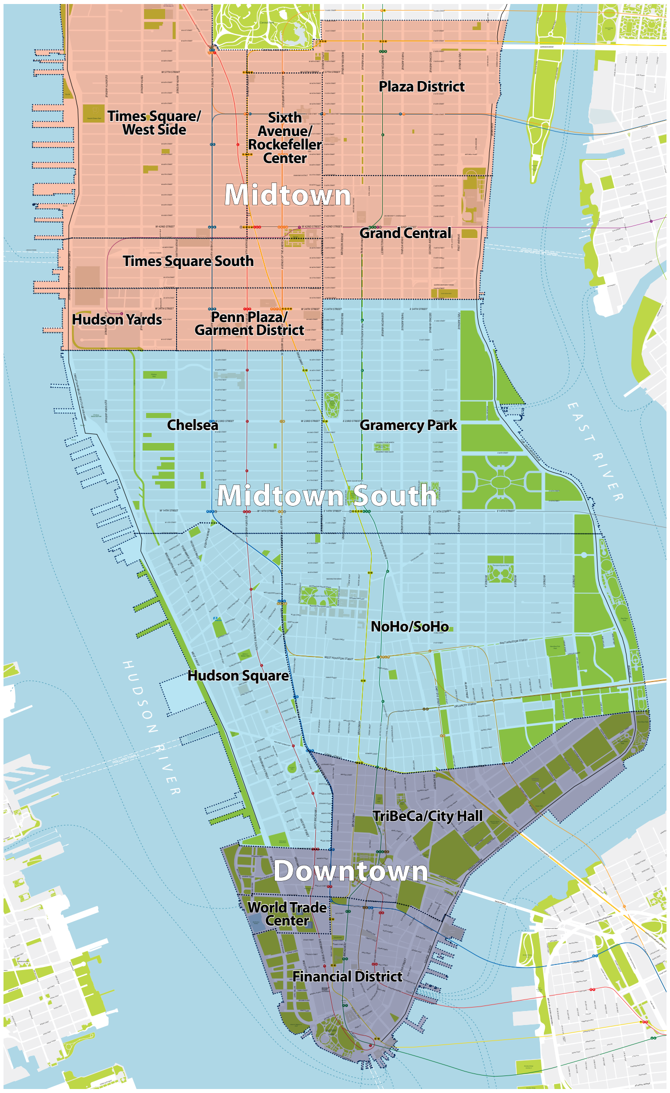
Trends to Watch

Significant sales activity for rent-regulated assets is unlikely in the near term as owners and investors wait on the sidelines to gauge the full impact of the new legislation on the market. The initial sales activity to occur will likely reflect transactions of distressed properties.

With limited ability to increase rents on rent-regulated units, landlords have less economic incentive to invest in renovations and repairs at their properties. This could have a negative impact on the overall maintenance of the city's rent-regulated housing stock.

Demand for buildings with market-rate rental units may increase, as the restrictions placed on rent-regulated units will likely drive more investment activity toward market-rate housing stock within New York City.

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
Third Quarter 2019

avisonyoung.com

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