Newmark Knight Frank

The Pandemic and the Manhattan Office Market

Impact and Projections

SEPTEMBER 2020

As New York City continues its slow, steady progress to reopen, new trends have emerged regarding how the office market is reacting to the effects of the pandemic. Among them,

- Rent collection remains strong in Class A assets, though weaker in Class B and C.
- Some large requirements are being put on hold.
- Short-term renewals are replacing long-planned relocations, creating pent-up demand.
- Sublease space has surged as companies rethink business models and adjust office needs.
- Social distancing has changed the demand for co-working and flex office space.

These new trends combined with those of past recessions offer insight as to where the market will be in a year. However, there are meaningful distinctions between them, which hint that the current crisis may not be as severe as the last two for office properties.

- First, the pandemic was preceded by a strong market, following a record year of leasing. Rents were also consistently rising each year, surpassing $80.00/SF.
- Second, the financial services industry, which serves as the bedrock of New York's office market, remains strong. The sector has seen minimal job losses when compared to the prior two downturns, Global Financial Crisis and Dot-com/September 11, which began amidst a weak economy.

Newmark Knight Frank expects total availability to rise by 430 basis points, from 11.9% in 2Q20 to 16.2% at the trough. While it is too early to forecast asking rents, the drop is expected to be shallower than past cycles, which saw decreases of 24% to 33%.

Economic Environment

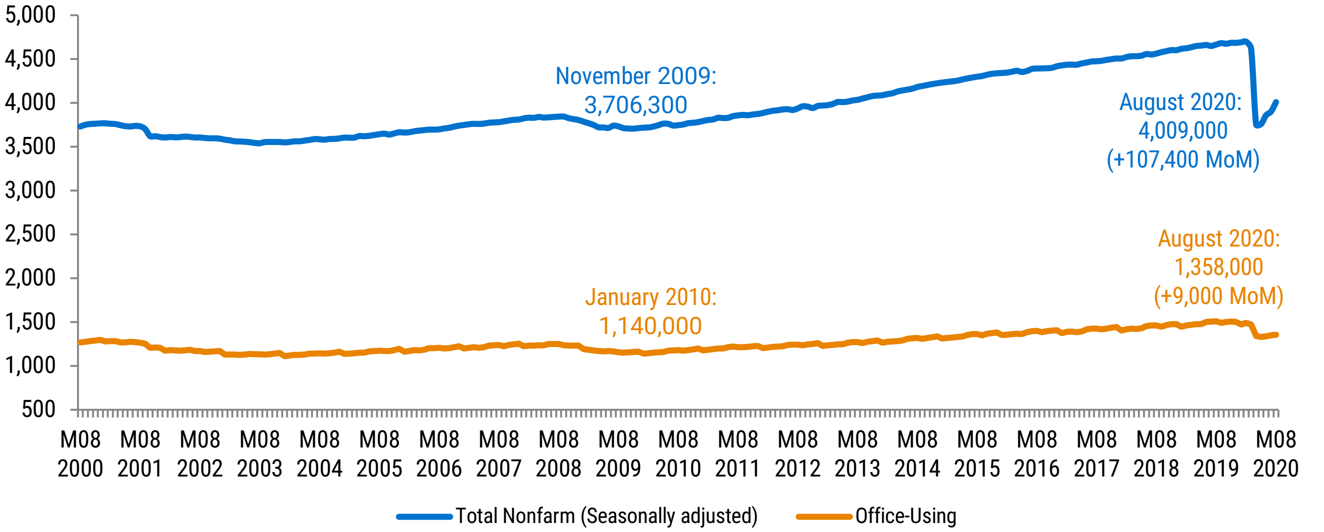
In just six months, COVID-19 has altered an economy with previously strong fundamentals. New York City office-using employment declined by 132,200 jobs from February to August to a total of 1.4 million jobs. On a national level, the economy has shed 2.0 million office-using jobs since the start of the pandemic. There have been 61.0 million unemployment claims through September 12, surpassing the 37.1 million claims from the Great Recession. However, the national unemployment rate was recorded at 8.4% in August, a 6.3 percentage point decline from April's peak of 14.7%. These conditions are expected to improve as employees return to the office through phased recovery plans.

In New York City, financial services as well as the technology and media sectors[1] saw less of an impact from COVID-19 than other industries, with year-over-year employment declines of just 6.5% and 7.2%, respectively.

[1] "Technology and media sectors" include Information and Computer Systems Design and Related Services.

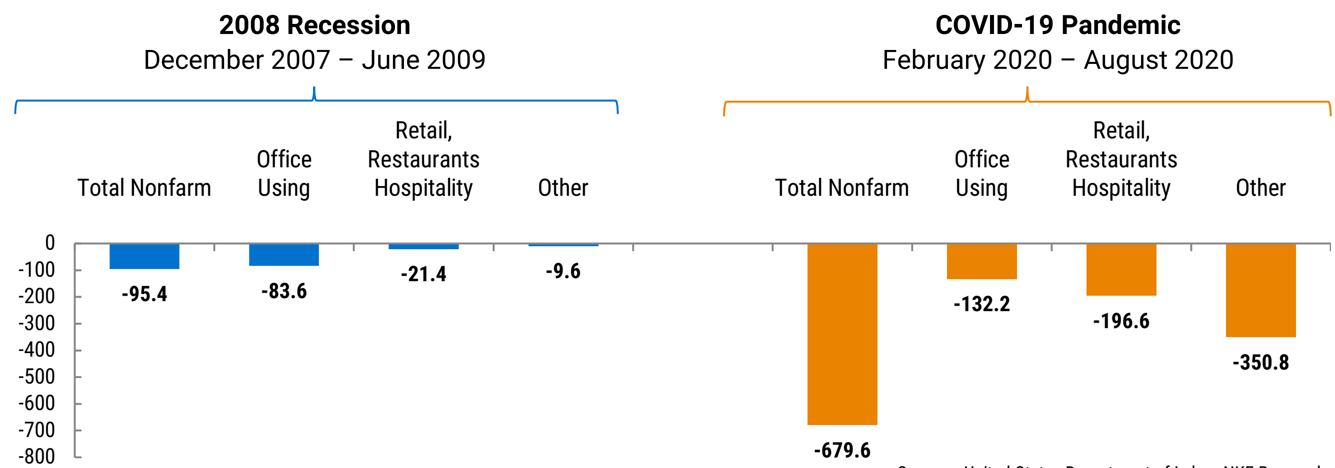
These are far less than the hospitality and food industry, which has suffered the most severe job losses, with a 45.3% decrease in employment from August 2019. Retail saw similar difficulties, with year-over-year job losses of 11.4%.

NYC Employment, Total Nonfarm and Office-Using, 2000-August 2020



Sources: United States Bureau of Labor Statistics, NKF Research

Change in NYC Employment, Financial Crisis Vs. COVID-19 Pandemic



Sources: United States Department of Labor, NKF Research

Rent Collection Varies by Class

When rent collection data first captured the pandemic's impact in April, Class A office REITS with New York properties, a bellwether for all Class A landlords, collected between 90% and 95% of payments. Meanwhile, Class B landlords reportedly collected between 69% and 96%. The variability in Class B properties can be attributed to a broader spectrum of tenants, while Class A buildings attract more established, well-capitalized tenants. Rent collection in Class A properties in July was consistent with April figures, as collection rates remained above 90%, while improvement was seen in Class B properties. Going forward, Class A buildings, including 16 million square feet under construction across Manhattan, will be able to more easily reconfigure spaces to accommodate changing office layouts and desirable building updates, such as contactless entry and improved air quality.

Leasing Activity Declines

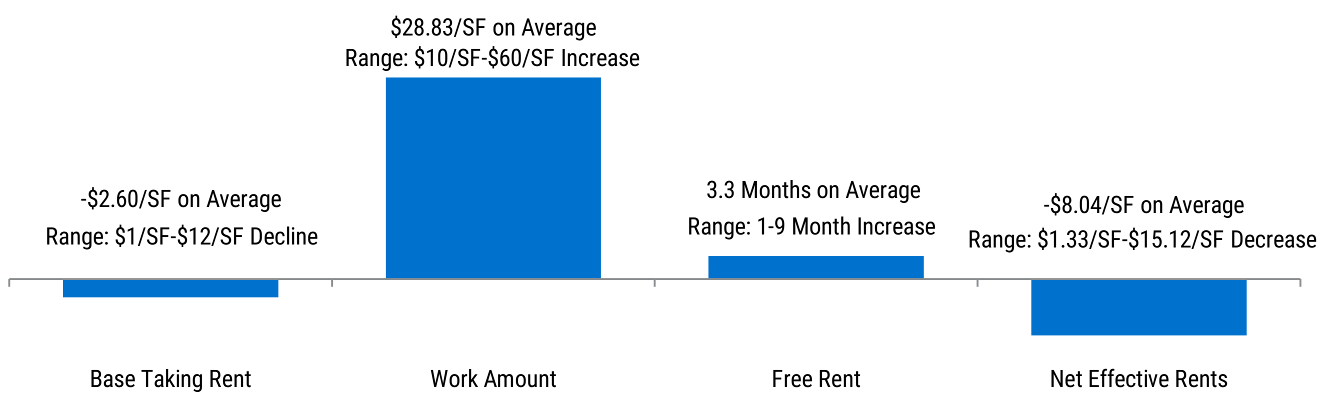
The more than 50 million square feet of leasing activity in 2019 was driven primarily by a surge in relocations and major expansions from TAMI tenants. In 2020, however, new transactions have largely come to a halt. Intra-COVID-19 leasing has totaled just 8.9 million square feet across 621 deals, reflecting declines of 68.3% and 70.3% from last year. Activity began to rebound in July, reaching 2.9 million square feet, before dropping to 1.4 million square feet in August. Of the 155 intra-COVID-19 transactions of at least 10,000 square feet, **63.9% of deals were relocations, down from 72.2% in the same time last year.** As tenants seek greater flexibility, the percentage of short-term leases has increased. **Approximately 48.5% of intra-COVID-19 leases were signed for five years or less**, while just 28.1% of first quarter pre-COVID-19 deals were under five years.

As more tenants sign short-term renewals, delaying activity by up to five years, they are signaling that it could take several years for the current crisis to resolve to the point of renewed confidence. The increased renewal rate will likely last into 2021, and potentially for the duration of the pandemic. From March to September, there was a decline in active requirements by more than 3.0 million square feet, as **at least 36 major tenants put their requirements on hold.** For deals that were completed, **the average re-trade included an additional 3.3 months of free rent and $28.83/SF in work amounts.**

Short-Term Renewals/Extensions Since March 2020

NBC/Comcast 1221 Avenue of the Americas **339,833 SF**	**Goodwin Procter LLP** 620 Eighth Avenue **216,419 SF**	**Stroock & Stroock & Lavan LLP** 180 Maiden Lane **192,816 SF**	**NYC Human Resources Admin.** 260 Eleventh Avenue **174,186 SF**
Quinn Emanuel 51 Madison Avenue **159,562 SF**	**Allen & Overy LLP** 1221 Avenue of the Americas **143,331 SF**	**Mitsubishi International Corp.** 655 Third Avenue **120,075 SF**	**Perella Weinberg** 767 Fifth Avenue **112,461 SF**

Deal Re-trades During The Pandemic | Change In Terms

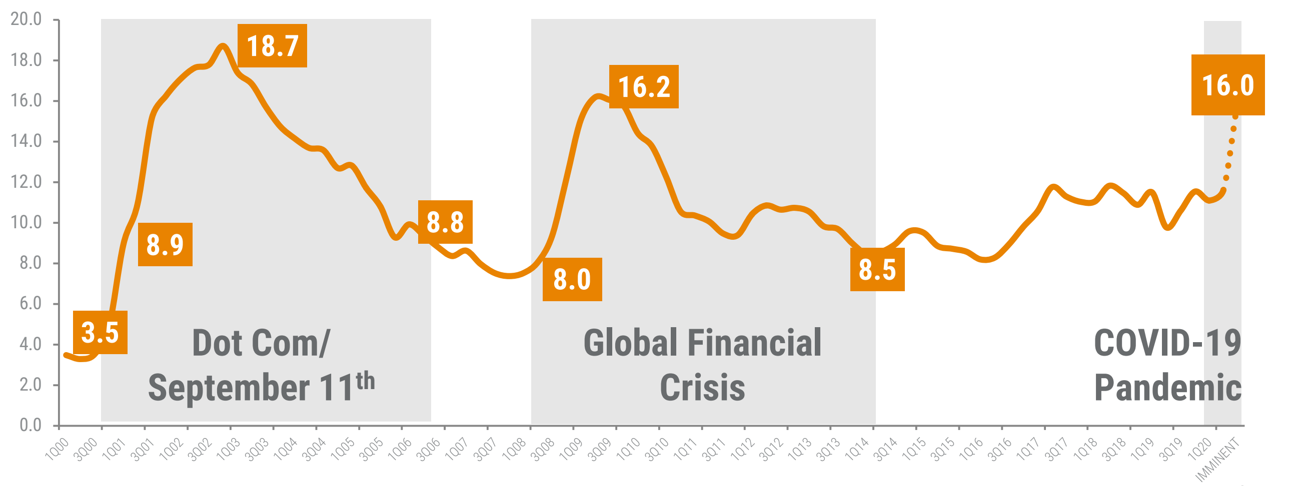


Sublease Space Begins to Rise

Approximately 16.0 million square feet of sublease space is on the market or expected to come to market in the coming months, an increase of 4.9 million square feet since mid-March. Of the space that has come to market, 92.6% is built, indicating companies are primarily shedding occupied space rather than expansion options, or other unused space.

The current level is below the levels of the last two recessions, which peaked at 16.2 million square feet in 2009 and 18.7 million square feet in 2001. From the second quarter of 2008 to the second quarter of 2009, sublease spaced doubled from 8.0 million square feet to 16.2 million square feet. Direct availability also increased by more than 10 million square feet in that same time frame, and these same trends are expected to contribute to rising availability during the pandemic.

Historical Sublease Space (MSF)



Source: NKF Research

Changes in Density Impact Co-working Providers

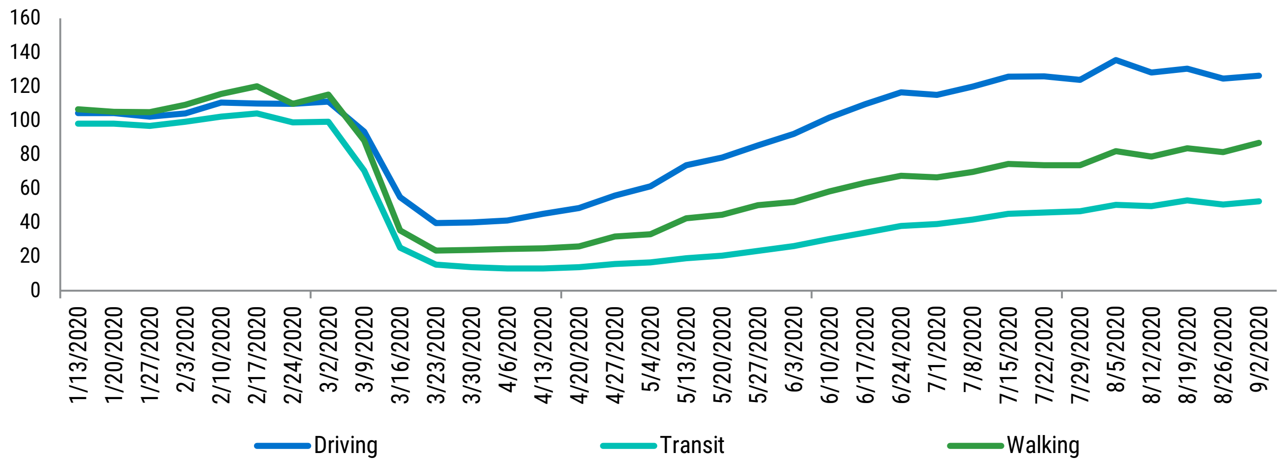
Built around the trend of densification, the co-working and flex space industry faced a sudden and dramatic change in demand as social distancing requirements took effect. There will always be a place for co-working in real estate, and the industry will likely rebound and adapt when the pandemic subsides. Until then, enterprise space is expected to fare better than traditional co-working, as companies in flux will seek increased flexibility throughout the pandemic and beyond.

Co-working companies in Manhattan occupy 17.4 million square feet, with an additional 2.0 million square feet in the outer boroughs. Several major providers have already announced layoffs in the past few months, and the 57 providers with under 100,000 square feet will likely find difficulty surviving following lost revenue after several months of tenants working from home. Others, including Regus, have filed for bankruptcy. More than 900,000 square feet of space are being marketed for sublease or have been returned to building owners. Most of this space has been in Midtown and Midtown South, but providers have also returned space in Tribeca/City Hall, Brooklyn and Long Island City.

Population Movement Correlates to Leasing Activity

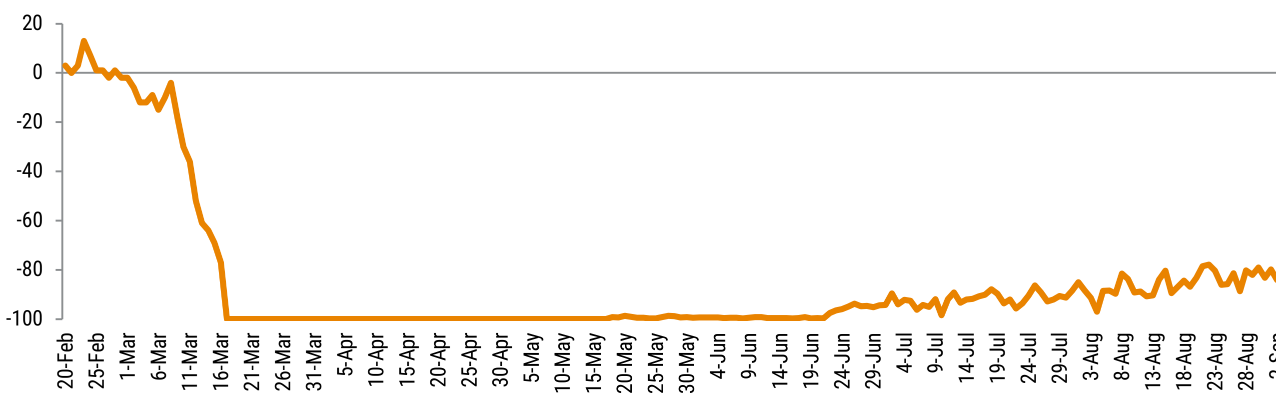
As the city's population began to get moving in June, demonstrated by data from Apple and OpenTable, leasing activity jumped in July, reaching its highest point since the onset of COVID-19. According to mapping data from Apple, New York City showed increased driving in June and July, ahead of walking and transit. The number of restaurant reservations can also serve as an effective indicator of improved circulation of people. According to OpenTable, reservations were down essentially 100% as restaurants were limited to only providing takeout or delivery. However, that number inched up following the beginning of outdoor dining in the third quarter. Newmark Knight Frank expects future improvements in general movement to have a similar effect on leasing activity, particularly for deals driven by lease expirations. More than 100 tenants of at least 50,000 square feet have leases expiring over the next 2 years, for a total of 17.7 million square feet.

Mobility Trends | Percent Change in NYC Routing Requests | 7-Day Average



Source: Apple, NKF Research

Percent Change in NYC Restaurant Reservations on OpenTable



Source: OpenTable, NKF Research

Conclusion and Impact on Availability

Newmark Knight Frank projects the changes outlined in this report to add up to 4.3 percentage points to the availability rate from pre-COVID-19 levels. The severity at which this increase occurs depends on the effectiveness of social distancing measures and the development of a vaccine. The more success that these factors have in minimizing the virus's impact and limiting subsequent business interruptions, the greater likelihood that tenants can resume normal operations and limit the uptick in availability. The market is witnessing a shift to short-term leases, increased renewals, and an overall drop in velocity as tenants employ a wait-and-see approach to the pandemic and the market. **Newmark Knight Frank expects asking rents to drop in the coming quarters, but at a shallower rate than either of the last two downturns.** It remains to be seen when significant demand will return to pre-COVID-19 levels following the development of a vaccine, but pent-up activity will positively impact the market once some level of normalization occurs.

NEW YORK CITY HEADQUARTERS
125 Park Avenue
New York, NY 10017
212.372.2000

Jonathan Mazur
Senior Managing Director
National Research
212.372.2154
jmazur@ngkf.com

Stephanie Jennings
Managing Director
National Research
212.372.2099
stjennings@ngkf.com

Stephen Tsamblakos
Senior Research Analyst
646.441.3734
Stephen.Tsamblakos@ngkf.com

NORTH AMERICA
Canada
United States

LATIN AMERICA
Argentina
Brazil
Chile
Colombia
Costa Rica
Dominican Republic
Mexico
Peru
Puerto Rico

EUROPE
Austria
Belgium
Czech Republic
France
Germany
Ireland
Italy
Netherlands
Poland
Portugal
Romania
Russia
Spain
Switzerland
United Kingdom

ASIA PACIFIC
Australia
Cambodia
China
India
Indonesia
Japan
Malaysia
New Zealand
Philippines
Singapore
South Korea
Taiwan
Thailand

AFRICA
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

MIDDLE EAST
Saudi Arabia
United Arab Emirates

Newmark Knight Frank has implemented a proprietary database and revised its tracking methodology. This expansion and refinement in our data may cause adjustments to historical statistics, including availability, asking rents, absorption and effective rents.

Newmark Knight Frank Research Reports are also available at www.ngkf.com/research

Newmark Knight Frank

ngkf.com