

CBRE

SPECIAL REPORT

**NYC Tech 2012:
Implications for Real Estate**



CBRE

Summer 2012



INTRODUCTION

New York City, the longstanding global capital for finance, is rapidly emerging as the fastest-growing hub for tech companies in the United States.¹ In the past five years, nearly 1,000 tech start-ups have been created in New York City, while tech giants such as Google, Facebook, eBay and Twitter have significantly expanded their presence. In 2011 alone, venture capitalists invested \$2.7 billion in 379 deals in the New York metro area, bringing the New York region into the company of such established tech hubs as Silicon Valley and Greater Boston in terms of attracting venture capital investment.² This has led to a marked increase in information technology jobs, with employment rising by 28.7% from 2007 to 2012, according to the non-profit Center for an Urban Future.³

Furthermore, government agencies, as part of a campaign to diversify an economy that has historically been heavily dependent on Wall Street, have made strategic investments to lure tech companies to the city, including \$1.8 million to establish 10 incubator spaces that house 550 start-ups; \$100 million for Cornell University—in partnership with Technion—to establish a top-tier engineering school in the city; and \$15 million for New York University's new applied sciences center in Brooklyn.^{4,5}

Tech's growth is clearly impacting New York's commercial real estate market. There has been a marked increase in leasing activity from established tech companies expanding their footprints in the city as well as growing start-ups graduating from incubator spaces. Midtown South, New York's tech epicenter, boasts the

lowest office vacancy rate in the United States and has seen average asking rents steadily rise, with 21.3% growth from year-end 2009 to May 2012. By comparison, during the same period, Midtown average asking rents grew by 13.7% and Downtown rents remained relatively stable, with a 4.5% increase.

However, in light of the 2000 dot-com bubble, many critics question whether the city's tech sector growth is sustainable. A key difference is that many tech companies in the 2000 boom-and-bust were funded despite nonexistent profits and thin business plans. Today, start-ups must clearly provide investors with viable—and ultimately profitable—business models before they are funded. In addition, the present wave of tech start-ups is less about building new technology than applying it to industries such as advertising, media, fashion, and finance—areas in which New York already excels. Making New York their home allows tech companies to more easily access and collaborate with potential customers and partners from these industries, many of which don't have a presence in Silicon Valley. Finally, unlike a decade ago, the city now has an established and growing tech community of experienced engineers, entrepreneurs and venture capitalists—a proliferating talent pool that will continue to drive the growth of the industry in coming years.

1. "New Tech City," Center for an Urban Future. 2012.

2. Includes Metropolitan NY area, northern New Jersey, and Fairfield County, Connecticut. PWC Moneytree. 2011.

3. "New Tech City," Center for an Urban Future. 2012.

4. New York Economic Development Corporation. <http://www.nycedc.com>

5. "Digital Media and Cleantech Incubator on Varick Street Nurture 22 grads." New York Daily News. 28 Mar 2012.

WHY NEW YORK?

From Gilt Groupe to Google to foursquare to Tumblr, a growing number of well-established tech companies and budding start-ups are putting down roots in New York City. These firms benefit from a presence in New York because of the quality of talent available, the proximity to clients, and the quality of life New York has to offer—especially for a younger workforce. Additionally, the tech sector in New York has continued to gain momentum as these companies see more and more of their peers setting up a New York presence.

Home to a diverse and highly educated workforce—where 57% of the population has at least a Bachelor's degree, and 27% has a graduate or professional degree—many firms are particularly drawn to New York because of the quality of the labor pool.⁶ Entrepreneurs are attracted not only because of the talent they can hire, but also because of the city's high-caliber ancillary resources—such as marketing, advertising, and public relations—that they need to grow their businesses.

Based on the venture capital dollars awarded in the New York Metropolitan Area in Q4 2011, tech companies funded in New York are concentrated in three main sectors: media and entertainment (20.9%), software (19.9%), and IT services (14%).⁷ By establishing themselves in New York, these companies are able to directly interface with clients that they otherwise might not have access to. New York already has existing support systems for industries like advertising, fashion, media and finance, so start-ups have the opportunity to develop strong relationships with partners and customers in many of the industries they seek to enter. These core industries have become reliant on the services that tech companies provide, and must continue to adapt to new technologies to be successful.

The New York tech center's uniqueness is particularly evident when comparing the industries that receive venture capital awards in each market. In Silicon Valley, the industries that led venture capital funding in Q4 2011 were software (35.6%), industrial/energy (17.1%),

Figure 1: Tech Sector Office Growth 2008–2012

Tenant	2008 Occupied RSF	2012 Occupied RSF	Percent Change
Adobe Systems	10,000	30,000	200%
Apple	10,000	55,000	450%
Buddy Media	10,000	65,000	550%
Cisco Systems	60,000	60,000	0%
Facebook	10,000	40,000	300%
Google	650,000	930,000	43%
Hewlett-Packard	50,000	85,000	70%
IBM	200,000	200,000	0%
Microsoft	175,000	175,000	0%
Orade	70,000	70,000	0%
Wireless Generation	58,000	80,000	28%
Yahoo!	50,000	55,000	10%
Total	1,353,000	1,845,000	36%

Source: CBRE Research.

biotechnology (12.9%) and semiconductors (8.1%). In Boston, biotechnology (49.1%) and software (23.9%) companies captured the dominant share of funding in the market.⁸

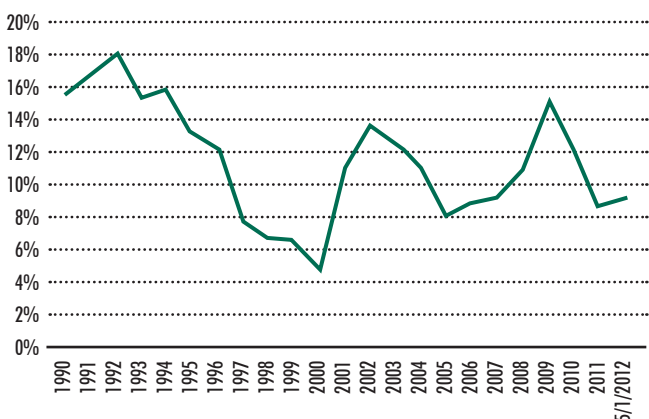
New York's popularity with tech companies is evident by a few key players' commitment to the city. Google, in particular, drew attention to the growing tech culture in New York with the purchase of 111 Eighth Avenue, a 2.9 million-sq.-ft. building in Chelsea. After Google dramatically increased its New York presence, other tech giants such as HP, eBay and Apple, also expanded their New York footprints, often more than quadrupling in size, or entered the New York market for the first time (See Figure 1).

This new focus on New York is driven by both cachet and the struggle among tech firms to attract the best talent. Because of competition among these firms, when Google planted its flag in New York and Facebook announced plans to open an office that will employ 1,000 engineers, New York quickly became a priority for other firms. For companies like eBay, HP, Salesforce.com and Apple, it's not about choosing New York over Silicon Valley, but about having a presence in both markets so

6. "2006-2010 American Community Survey 5-Year Estimates for New York County," U.S. Census Bureau. 2010.

7. PWC Moneytree.

8. "2006-2010 American Community Survey 5-Year Estimates for New York County," U.S. Census Bureau. 2010.

Figure 2: Historical Midtown South Availability

Source: CBRE Research.

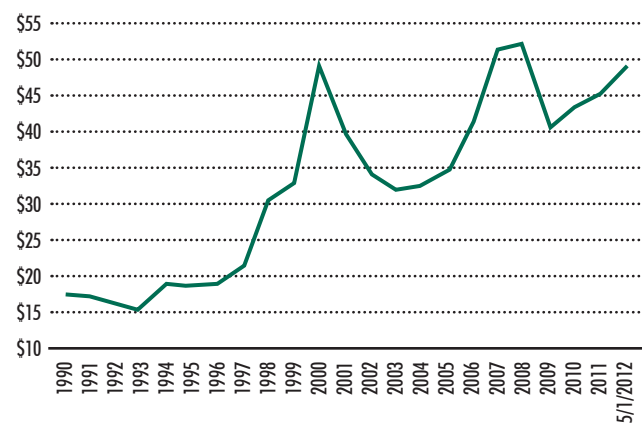
that the firms can capitalize on each market's respective strengths.

THE SURGE IN MIDTOWN SOUTH

The tech boom has been good news for commercial real estate, helping to mitigate the negative effects of the financial crisis. CBRE estimates that the tech sector fueled 159 real estate deals in 2011, in comparison to just 74 in 2008.⁹ Midtown South, the submarket that currently has the lowest availability in the country at 9.0% (See Figure 2), has become New York City's tech hub.

Midtown South was originally attractive to tech tenants because of low rents, but the neighborhood has also become desirable because of its 24/7 environment and trendy, creative culture, as well as the unique attributes of the buildings in the area.

Tech entrepreneurs are especially eager to settle in Midtown South because of the opportunity for networking and collaboration with others in the industry. At 568 Broadway, for instance, Thrillist, 10gen, ZocDoc and foursquare regularly host happy hours and other after-work social events to encourage employee camaraderie. This would be hard to replicate in neighborhoods that lack a critical mass of techies.¹⁰ Because of the competitive market to attract and retain the best personnel, companies use these events to create an

Figure 3: Historical Midtown South Asking Rents

Source: CBRE Research.

environment and community that is attractive to the talent they need.

Tech companies prefer space with open layouts that encourage collaboration. With their large floor plates, high, loft-like ceilings, and exposed brick walls, Midtown South's plethora of Class B buildings offer the atmosphere, layout and rental rate that typical tech tenants are looking for. Given the high demand and low supply of Midtown South office space, however, average asking rents have increased 18.5% from May 2010 to May 2012 (see Figure 3). For some of the most desirable buildings in Midtown South, asking rents have been in the \$60s and \$70s per-sq.-ft., numbers that were historically only seen in Midtown.

CHALLENGES OF MIDTOWN SOUTH BUILDINGS

Despite Midtown South's popularity, a growing number of large tech companies are having difficulty finding buildings within the submarket that meet their needs. In comparison to Midtown, where buildings are controlled by large institutional owners and the top 10 landlords own 44% of the office stock¹¹, many buildings in Midtown South are held by "one-off" family owners who each have their own ways of handling leases and managing their real estate. While these loft buildings with family owners may be fine for fledging tech startups, companies start running into problems once their

9. CBRE Research. 2012.

10. "Digital Jobs Central."Crain's New York. March 2012.

11. Calculation based on square footage. CBRE Research. 2012.

size or structure dictates the need for a long-term lease or a large block of space, because these leases often have more complex requirements that current owners are not sophisticated enough to meet. Brokers seeking office space for larger, more institutional tech clients often have to look beyond Midtown South to meet their clients' needs.

Given the scarcity of buildings capable of offering the services that larger tech firms require, companies like Facebook, LinkedIn, Twitter and Amazon.com are opting for more traditional office space in Midtown.

Due to the high demand for office space in Midtown South, CBRE anticipates that certain Midtown South buildings with the potential to become Class A properties will be acquired by institutional landlords. In fact, a few of the city's largest landlords have already begun testing the waters in the Midtown South market. In 2011, RXR Realty acquired 620 Avenue of the Americas and the Starrett-Lehigh Building, 601 West 26th Street, which they are positioning as high-quality assets for technology and creative users. Similarly, Related closed on 511-541 West 25th Street at the tail end of 2011. With the property currently 25.5% vacant, Related plans to make significant upgrades to the building's lobby, common areas, restrooms and building systems to attract creative tenants that want Class A loft space in Midtown South. The flip side of the argument for a higher class of loft buildings, however, is the potential for smaller technology companies to be priced out of Midtown South.

THE NEEDS OF TECH COMPANIES

For tech companies, the focus on their search for office space is not merely about large floor plates and high ceilings, but about finding buildings where landlords are amenable to certain lease conditions. Flexibility is the single most important factor to tech companies. Because many of them do not know what their business and operational needs might be in just a couple of years, a short-term lease commitment with early termination and expansion options is often required. In

a recent deal for Fab.com, this translated into signing a five-year lease for the entire 8th floor, comprised of 23,500 sq. ft., at 95 Morton Street that gave the tenant generous expansion options to grow in the building. For many companies, however, finding such flexible terms can be a challenge. With very little "plug-and-play" space on the market, many tech companies still require a full build-out for a two- or three-year lease. Landlords are rarely willing to offer tenant improvement allowances for such short-term leases.

Another potential problem for technology tenants is their lack of credit. Many are not yet profitable, requiring them to provide up to 12 or 18 months of security for a landlord to even consider leasing them space.

MOVING BEYOND MIDTOWN SOUTH

Should Midtown South become too pricey or overcrowded, tech companies will have to consider other markets. Although the "Tech Triangle" in Brooklyn, which comprises DUMBO, Downtown Brooklyn and the Brooklyn Navy Yard, was once a viable alternative to Midtown South—rents in the second half of 2011 were just \$24.68 per-sq.-ft.—this office market is also very tight. Given these constraints, CBRE anticipates that tech firms will increasingly expand southward into Downtown Manhattan, as some firms have already begun doing (see Figure 4). Downtown Manhattan average asking rents of \$39.65 per-sq.-ft., as of March

Figure 4: Tech companies are increasingly moving Downtown due to Midtown South's tight supply and rising prices

Tenant	Address
The Knot	195 Broadway
LivIntent	291 Broadway
Priceline.com	100 William Street
RealMatch	90 Broad Street
SinglePlatform	17 Battery Place
Telemetry	7 WTC

Source: CBRE Research.

2012, are attractive to start-ups, as is the edgy cache of the market's abundant Class B space. To help meet the demand in Brooklyn, a study initiated by the DUMBO Improvement District projects the amount of office space in the "Tech Triangle" will increase from its current 1.7 million sq. ft. to 3.1 million sq. ft. by 2015.¹²

WILL IT LAST?

This isn't the first time New York has tried to become a tech haven. At the height of the market in 2000, the availability rate in Midtown South was just 4.9%, with an average asking rent of \$49.28 per-sq.-ft. When the bubble burst, many landlords suddenly found themselves with vacant space and little recourse to hold belly-up tech companies accountable for their remaining lease obligations. By 2002, availability in Midtown South had nearly tripled to 13.7% and asking rents had plummeted to \$34.14 per-sq.-ft. While the dot-com bubble of 2000 was largely fueled by speculation, with little regard for whether or not these tech companies could actually make a profit, technology companies today must demonstrate their potential for profitability from the outset. Furthermore, the market for technology has grown tremendously over the past decade. In 2000, just 43.1% of the U.S. population used the internet. Today, that number has grown to 79.3%.¹³

OUTLOOK FOR THE FUTURE

The wealth of public and private investment in New York's technology sector suggests that technology will be a lasting force in New York. The City government, for one, has proven its commitment to establishing New York as a major driver of innovation in the U.S. economy by identifying the need for top-tier engineering schools in the city. This project lays the groundwork for a more robust and diversified New York economy over the long term, and provides a framework for the continued growth of technology in the city. In addition to this game-changing decision, the New York City Economic Development Corporation (NYCEDC), in partnership with Industrial + Technology Assistance Corporation, the New York City Investment Fund, Empire State

Development's Division of Science, Technology and Innovation (NYSTAR), and the Polytechnic Institute of New York, has established a seed fund to support early stage start-ups. To measure and track New York's technology growth, NYCEDC has begun to publish an "Innovation Index."¹⁴ These measures, in conjunction with the private- and NYCEDC-backed incubator spaces, provide the foundation for continued growth of the tech sector in New York.

Private indicators of New York's long-term success as a technology hub are also evident. Google's purchase of 111 Eighth Avenue in 2011 demonstrated the company's confidence and long-term investment in New York, anchoring Midtown South and encouraging like-minded companies to move there as well. The growing amount of venture capital awarded to New York's technology companies has profoundly affected New York's start-up scene, since this funding gives entrepreneurs the ability to turn ideas into businesses.

Tech will remain a strong force in Midtown South in the short term and increase its footprint in the Downtown and Brooklyn markets over the long term. CBRE expects the technology sector to continue to exert upward pressure on Midtown South rents, especially for the market's most coveted properties.

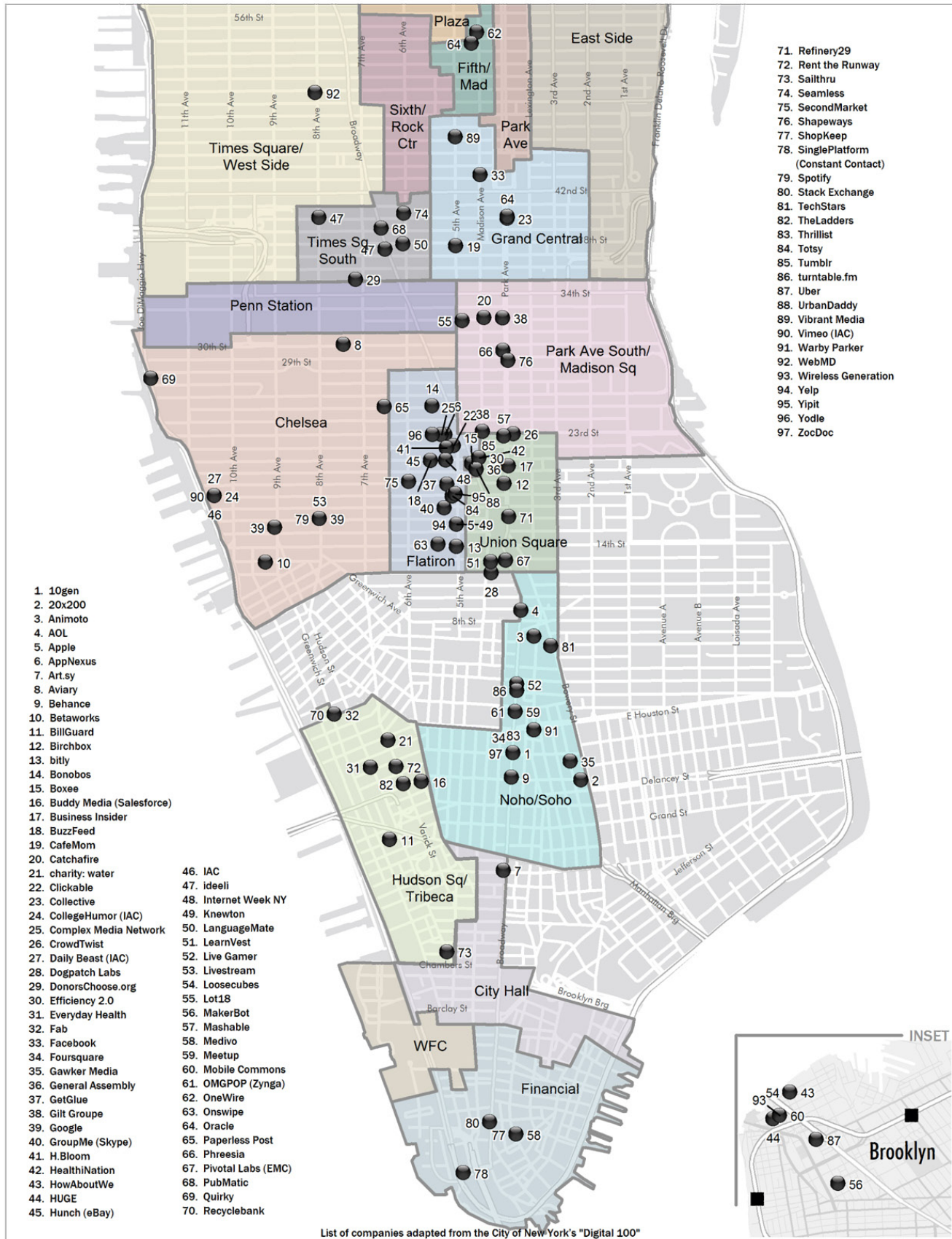


12. "Economic Impacts of the Tech and Creative Sectors." Prepared by Urbanomics for Brooklyn Navy Yard Industrial Park, Downtown Brooklyn Partnership, and the DUMBO Improvement District. April 2012.

13. "Internet Users." The World Bank. Worldbank.org

14. "NYCEDC Innovation Index 2011." Nycedc.com

Technology Firm Locations



List of companies adapted from the City of New York's "Digital 100"

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