Midtown South Manhattan Office, Q2 2020

COVID-19 curtails leasing activity to its lowest quarterly total since the Financial Crisis

Leasing Activity	Net Absorption	Availability Rate	Vacancy Rate	Average Asking Rent
0.34 MSF	0.11 MSF	10.6%	7.6%	$86.04 PSF

*Arrows indicate change from previous quarter.

- Leasing activity totaled 344,000 sq. ft. in Q2 2020, a 59% decrease from Q1 2020, and 74% behind its five-year quarterly average.
- Renewals totaled 25,000 sq. ft. in Q2 2020, pushing the year-to-date total 263,000 sq. ft.
- The availability rate decreased 10 basis points (bps) from the previous quarter to 10.6% in Q2 2020 but remains up 60 bps from a year earlier.
- Net absorption improved from the prior quarter at positive 110,000 sq. ft. in Q2 2020, bringing the year-to-date total to negative 743,000 sq. ft.
- The average asking rent was virtually unchanged from the prior quarter at $86.34 per sq. ft. but was up 4% year-over-year.
- The COVID-19 lockdowns that extended throughout Q2 2020 led to a sudden collapse in leasing activity, while the lack of new space additions and minimal repricing activity resulted in a stagnant average asking rent that remains near its all-time high.

MARKET OVERVIEW

Virology, not the business cycle, has dictated the course of the world's economy this year. COVID-19 forced a nationwide shutdown of most economic activity in March, with the largest economic centers, especially the Northeast and Pacific coast, facing the strictest lockdowns. The economic fallout proved severe, pushing unemployment to over 14% and likely causing the economy to contract by more than 30% per annum in the second quarter.

New York City was the epicenter of the global COVID-19 pandemic for much of Q2, and the local economy and real estate market felt the full brunt of the crisis' impact. With respect to the office market, the situation manifested most noticeably in a steep decline in leasing, as the lockdown and stay at home orders kept all but essential workers at home and out of offices.

Figure 1: Top Lease Transactions

Size (Sq. Ft.)	Tenant	Address
46,764	SKIP of New York	601 West 26th Street
40,569	Match.com	60-70 Gansevoort Street
34,400	Twitch Interactive, Inc.	315 Park Avenue South
19,647 (E)	BlueRock Therapeutics	430 East 29th Street
17,078	ExelaTechnologies	601 West 26th Street

Renewal (R), Expansion (E), Renewal and Expansion (RE)

Source: CBRE Research, Q2 2020.

In Midtown South, Q2 2020's leasing activity fell to just 344,000 sq. ft., its second lowest quarterly total on record. Despite the overwhelming wait-and-see sentiment of the market, a handful of new, mid-sized deals provided some much-needed positivity during an otherwise challenging quarter. While historically recessions tend to induce an uptick in renewal activity in lieu of new leases or expansions, so far Midtown South saw just 25,000 sq. ft. of recommitments in Q2 2020. Other key fundamentals, which on the surface saw some positive movement, are masking a market otherwise at relative standstill. Q2 2020's net absorption totaled positive 110,000 sq. ft., resulting in a 10-bp dip in the availability rate quarter-over-quarter to 10.6%. However, this was almost exclusively due to a tremendous pullback in space coming to market. Meanwhile, the average asking rent continues to stand on par with the record high at roughly $86 per sq. ft., as asking rents have yet to respond to the drop in market demand. CBRE-Econometric Advisors' Q1 rent forecast shows rents declining between 10 and 16% by Q1 2021 before beginning to recover.

LEASING ACTIVITY

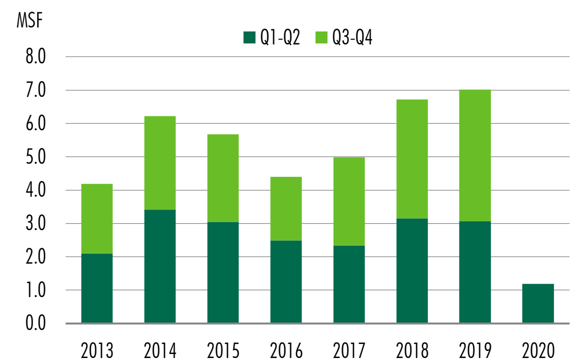
Leasing activity in Q2 2020 totaled 344,000 sq. ft., a 59% drop from the already weak start in Q1 2020, and 74% behind the five-year quarterly average of 1.35 million sq. ft. This marks the second lowest quarterly leasing activity total on record, only higher than Q1 2009's 261,000 sq. ft. at the height of the Financial Crisis. Q2 2020's leasing activity total was comprised of a collection of small-to-mid sized deals, with no new leases or expansions over 50,000 sq. ft.

Even when renewals are included, Midtown South's Q2 2020 performance was subdued, with only 25,000 sq. ft. of extensions. This brought the market's year-to-date renewal total to 263,000 sq. ft., a level 29% behind its five-year year-to-date average of 373,000 sq. ft. Moreover, of the six renewals completed in 2020, only two saw terms of less than 10 years and none below five years. Thus, unlike Manhattan's other major markets, Midtown South has yet to see any meaningful shift to short-term renewals.

All told – when accounting for new leases, expansions and renewals – Midtown South's total leasing velocity through the first half of 2020 stood at 1.45 million sq. ft., a substantial 65% drop from last year through the same period, and a level trailing the five-year year-to-date average by nearly 50%.

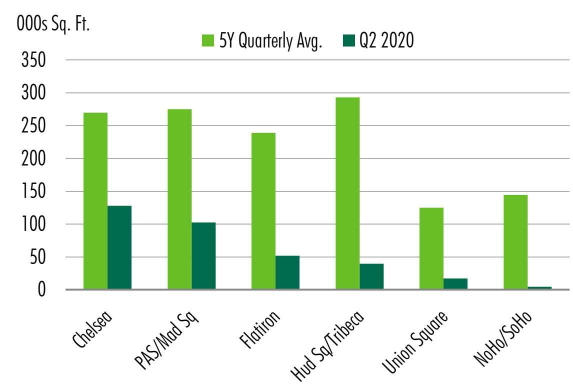
Of the few new leases and expansions that got done in Q2 2020, the tech sector claimed the largest share of the activity at 43%. This was led by Match.com's 41,000 sq. ft. lease at 60-70 Gansevoort Street, the two-building office

Figure 2: Leasing Activity | Historical



Source: CBRE Research, Q2 2020.

Figure 3: Leasing Activity | By Submarket



Source: CBRE Research, Q2 2020.

portion of the high-end redevelopment in Chelsea known as Gansevoort Row. It also included ExelaTechnologies' 17,000 sq. ft. lease at the Starrett Lehigh Building in Chelsea and Unqork's 9,200 sq. ft. lease at 19 Union Square West. The Starrett Lehigh Building also notched Midtown South's largest deal of the quarter, with the non-profit organization SKIP of New York subleasing 47,000 sq. ft.

Additionally, Q2 2020 saw the notable, albeit small, expansion of life science company BlueRock Therapeutics at the Alexandria Center's west tower at 430 East 29th Street. Amid the otherwise downbeat trends seen in the Manhattan office market throughout the COVID-19 crisis, the life science sector has emerged as a bright spot, with tenant interest in the sector surging and continuing unabated in recent months at projects like Midtown South's 345 Park Avenue South and other life science outposts throughout NYC.

Unsurprisingly, leasing activity in all of Midtown South's submarkets declined from the prior quarter and trailed their five-year quarterly averages in Q2 2020. Nevertheless, Chelsea amassed the highest total for the quarter at 128,000 sq. ft. Park Avenue South/Madison Square followed at 102,000 sq. ft., led by Twitch Interactive, Inc.'s 34,000 sq. ft. lease at 315 Park Avenue South. On the opposite end of the spectrum, NoHo/SoHo performed the worst, seeing a mere 4,700 sq. ft. leasing activity.

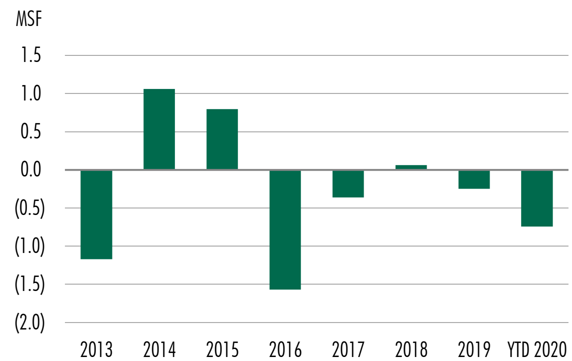
NET ABSORPTION AND AVAILABILITY

Space added to the market in Midtown South followed in lock step with the massive pullback in leasing activity in Q2 2020. The inability to physically tour spaces and pervasive market uncertainty led to a largely wait-and-see approach by both landlords and tenants. As a result, after averaging roughly 1.67 million sq. ft. of quarterly total space additions over the prior four quarters, total space added in Q2 fell to just over 500,000 sq. ft. All of the blocks of space that encompassed this total were below 40,000 sq. ft. This dramatic decline, combined with just enough leasing activity and other space removals throughout the quarter, led to positive 110,000 sq. ft. of net absorption in Q2 2020.

After residing between the 9% to low-10% range for most of 2019, Midtown South's availability rate hovered around the 10.5% mark during the first half of 2020, still maintaining its standing as the tightest among Manhattan's three major markets. The Q2 2020 spurt of positive absorption led to a slight 10-bp drop in Midtown South's availability rate from the previous quarter to 10.6% but remains up 60 bps year-over-year.

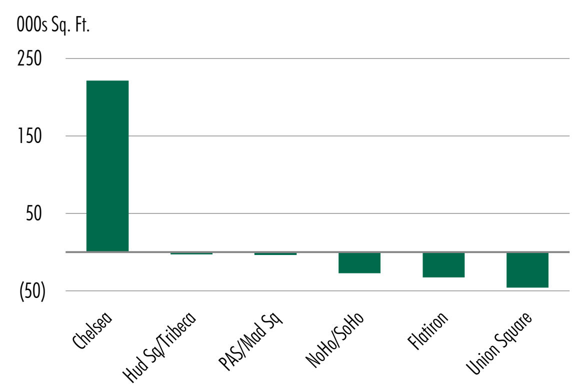
As the COVID crisis continued to unfold in Q2 2020, one of the most closely watched bellwethers of a weakening market, the rise of

Figure 4: Net Absorption | Historical



Source: CBRE Research, Q2 2020.

Figure 5: Quarterly Net Absorption | By Submarket



Source: CBRE Research, Q2 2020.

large quantities sublease space, has yet to materialize in Midtown South. In fact, the opposite trend has occurred. The sublease availability rate fell 10 bps quarter-over-quarter in to 2.6% in Q2 2020, on par with its level of one year ago. Furthermore, the percent of sublease space as a share of total space in the Midtown South market remains at a healthy level and has declined for two consecutive quarters to 24% most recently.

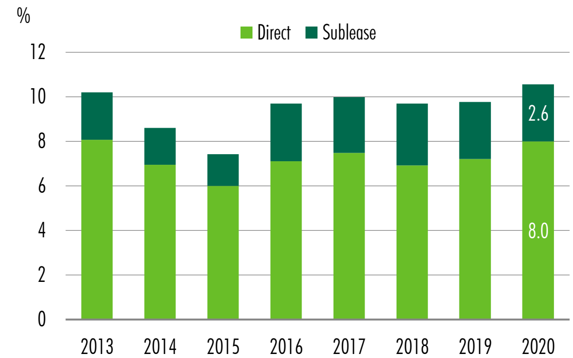
The declines in these sublease metrics in Q2 2020 were the result of two primary factors. First, the majority of sublease spaces that were added were small—all but two were below 30,000 sq. ft. The exceptions included iHeartMedia, Inc.'s 38,000 sq. ft. space at 32 Avenue of the Americas and Eli Lilly & Company's 30,000 sq. ft. space at 430 East 29th Street. Second, several of the spaces that were leased during the quarter were sublease spaces, including the largest of the top five leases: SKIP of New York at the Starrett Lehigh Building.

Chelsea was the only submarket to register positive absorption in Q2 2020 at 222,000 sq. ft., as it claimed three of the five top leases and saw a negligible amount of space being added. This resulted in a 120-bp drop in the availability rate from the previous quarter to 10.4%, its lowest level since year-end 2019. On the other hand, Union Square's negative 46,000 sq. ft. of net absorption was the worst performance among the submarkets, pushing its availability rate up 90 bps to 15.9% from a quarter ago – the highest in Midtown South. This was partially driven by the addition of BuzzFeed, Inc.'s 28,000 sq. ft. space at 225 Park Avenue South.

AVERAGE ASKING RENT

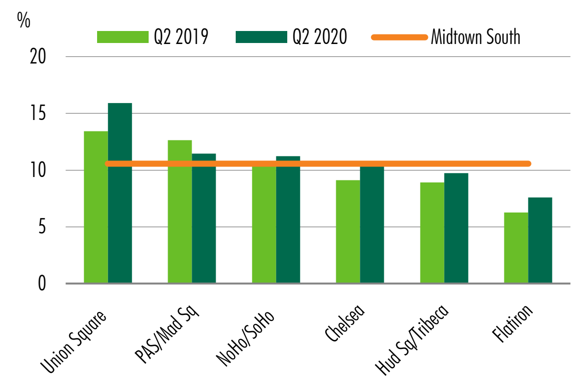
While Midtown South's Q2 2020 average asking rent remains near its all-time high at just over $86 per sq. ft., this stability is purely a reflection of a market on pause. With so little space added and removed throughout the quarter in terms of total footage – and with the space that was added and removed exhibiting a similar blend of low- and high-priced space – the current average asking rent level reflects

Figure 6: Sublease and Direct Availability Rate | Historical



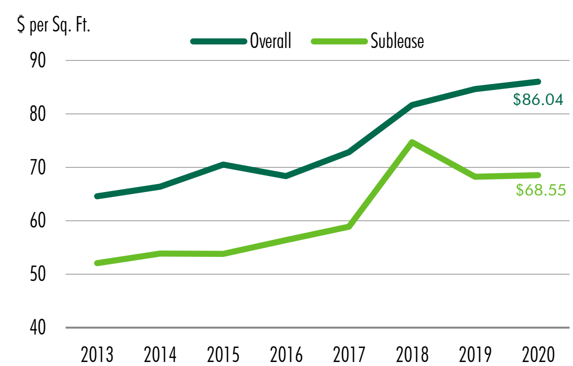
Source: CBRE Research, Q2 2020.

Figure 7: Availability Rate | By Submarket



Source: CBRE Research, Q2 2020.

Figure 8: Average Asking Rent | Historical



Source: CBRE Research, Q2 2020.

where the market was pre-COVID-19. Thus far, the market has provided little evidence of where pricing is headed. Midtown South saw very few spaces repriced downward in Q2 2020.

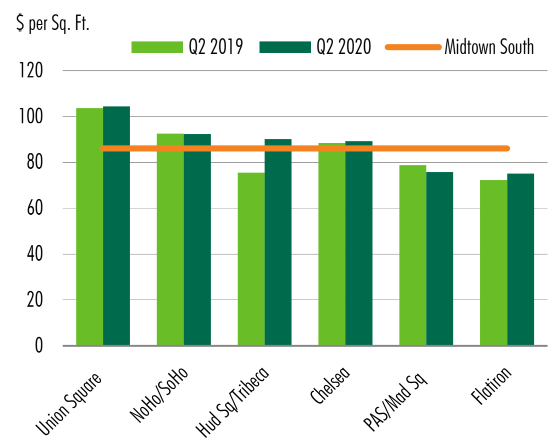
The Q2 2020 average asking rent in Midtown South's submarkets all remained within 2% of their level from a quarter ago. Union Square continues to hold Midtown South's highest average asking rent at $104.34 per sq. ft. The submarket recently added BuzzFeed, Inc.'s built sublease space at recently renovated 225 Park Avenue South into the mix of several other new construction and redevelopment projects commanding premium rents, the largest of which is a 174,000 sq. ft. block at 124 East 14th Street known as Zero Irving. Behind Union Square, NoHo/SoHo continues to boast the next highest average asking rent of $92.41 per sq. ft., similarly buoyed by new construction developments like Essex Crossing and 141 East Houston Street. Conversely, Flatiron's average asking rent remains the lowest, and saw a 2% quarter-over-quarter drop to $75.10 per sq. ft., owing to several below-average priced sublet spaces added in Q2 2020.

CBRE Econometric Advisors has issued rent forecasts for the New York City office market, which point toward declining rent in Midtown South over the next three quarters. Based on current forecasts, Midtown South's average asking rent is anticipated to see a decline of between 10 and 16% by Q1 2021. Newer, amenity-rich buildings with stable occupancy levels are expected to fare better than the market overall, while older and unimproved buildings and those with higher levels of tenant roll can be expected to face pressure to drop rents.

TAKING RENT INDEX

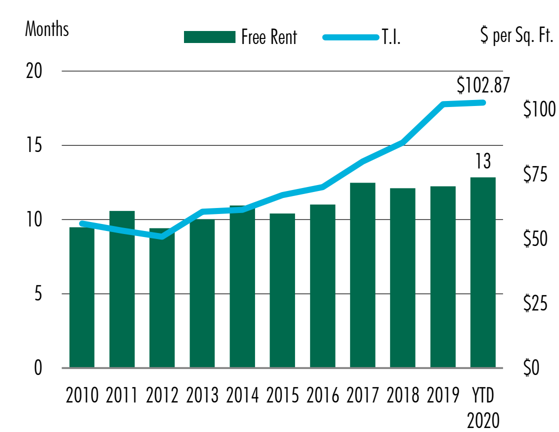
After seeing a sharp drop to 94.9% in Q1 2020, Midtown South's taking rent index continued its decline in Q2, falling to 89.5%. This marks the first time since year-end 2018 that Midtown South does not hold the highest index level among Manhattan's major markets. The weighted average of concession packages for new leases of raw space completed over the past 18 months averaged $102.87 per sq. ft. in tenant improvement allowance, up 18% from year-end 2018, and 13 months of free rent. In order to get deals over the finish line amid the COVID-19 disruption, instances of creative negotiation – such as clauses and options outside of free rent, TI and starting rent terms – are beginning to be reported, though are not yet widespread.

Figure 9: Average Asking Rents | By Submarket



Source: CBRE Research, Q2 2020.

Figure 10: Concession Values | Historical*



*This study examines all direct new leases larger than 25,000 RSF with a term length greater than 10 years (omits renewals and expansions). YTD 2020 figure reflects a blended average of 2019-YTD 2020.

Source: CBRE Research, Q2 2020.

INVENTORY AT A GLANCE

Submarket	Total Size (Mil. Sq. Ft.)	No. of Buildings
Chelsea	17.9	66
Flatiron	12.2	68
Hudson Square / Tribeca	15.4	35
NoHo / SoHo	8.4	58
Park Avenue South / Madison Square	19.9	59
Union Square	5.2	33
TOTAL INVENTORY	**79.0**	**319**

DEFINITIONS

Availability — Space that is being actively marketed and is available for tenant build-out within 12 months. Includes space available for sublease as well as space in buildings under construction.

Asking Rent — Weighted average asking rent.

Concession Values — The combination of rent abatement and T.I. allowance. The graph is for new leases for raw space of 25,000 sq. ft. or greater consummated year-to-date, this excludes expansion and renewal deals.

Leasing Activity — Total amount of sq. ft. leased within a specified period of time, including new deals, expansions, and pre-leasing, but excluding renewals.

Leasing Velocity — Total amount of sq. ft. leased within a specified period of time, including new deals, expansions, and pre-leasing and renewals.

Net Absorption — The change in the amount of committed sq. ft. within a specified period of time, as measured by the change in available sq. ft.

Rent Abatement — The time between lease commencement and rent commencement.

Taking Rent — Actual, initial base rent in a lease agreement.

Taking Rent Index — Initial taking rents as a percentage of asking rents.

T.I. — Tenant Improvements.

Vacancy — Unoccupied space available for lease.

Percentage of Leasing by Industry —The percentage of sq. ft. leased by an industry based on transactions where a tenant and industry have been confirmed.

SURVEY CRITERIA

CBRE's market report analyzes fully modernized office buildings that total 50,000+ sq. ft. in Midtown South, including owner-occupied buildings (except those owned and occupied by a government or government agency). New construction must be available for tenant build-out within 12 months. CBRE assembles all information through telephone canvassing and listings received from owners, tenants and members of the commercial real estate brokerage community.

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