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Midtown South Office Rents Top Midtown

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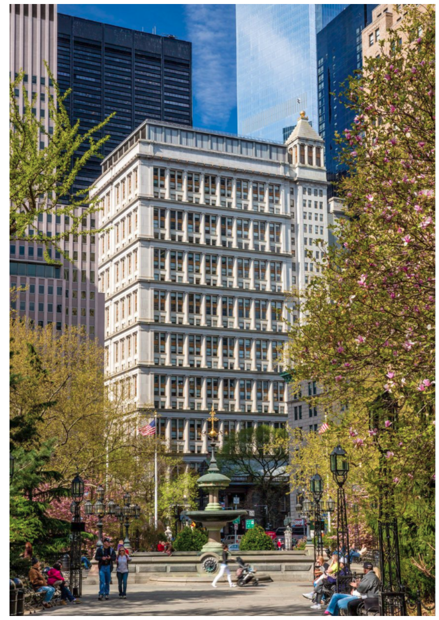

NEW YORK CITY—Manhattan's office leasing slowed in the first quarter with slightly higher availability and negative absorption. But asking rents climbed.

The Overall Office Picture

At 7.57 million square feet, Manhattan's first quarter leasing activity dropped 22.5% from Q4 2017. Year-over-year leasing was down by 17.8%. It fell 18.9% below the five-year first quarter average but was 3.3% above the same 10-year average. However, the average asking rent at $73.05 was up despite lower demand and a growing supply. These results are from the Colliers International Q1 2018 office market reports, analyzing data from a sample set of 517 million square feet of office space.

Colliers International's executive director, Craig Caggiano, and managing director of research, Franklin Wallach, tell GlobeSt.com what's behind these latest numbers.

A greater supply entering the market does not necessarily mean leasing prices will immediately drop. L&L Holding Company placed more than 400,000 square feet at 390 Madison Ave. on the market at above average market rents. This caused office pricing in the area to increase. JPMorgan Chase leased the full 16-floors for the duration of construction of its new headquarters, removing the above average priced offices from the market. As a result, market pricing decreased, says Caggiano.

On the other end, when below average market space is available, this can reduce prices. When removed, this can drive up average market prices. As an example, Wallach points to Tommy Hilfiger's leased space at RXR Realty's Starrett-Lehigh Building at 601 W. 26th St. When Hilfiger moved to RFR Realty's 285 Madison Ave., RFR assumed responsibility for the space. It placed the sublease on the market at a below average price, and market prices decreased. When RXR took back the space and removed it from the market, average prices in the area rose, says Wallach.

In addition to 390 Madison Ave., throughout all of Manhattan, the largest three leases included Simon & Schuster's renewal of 300,150 square feet at 1230 Ave. of the Americas in the Plaza District and Omnicom Group's 287,520 square-foot lease at 195 Broadway in Downtown.

FIRE (financial services, insurance and real estate) tenants led Manhattan leasing with a 45% share. TAMI (technology, advertising, media and information services) held a 23% share. With co-working, WeWork created a splash last quarter signing a 167,000 square-foot lease at 18 W. 18th St., a 122,193 square-foot lease at 154 W. 14th St., and a 112,000 square-foot lease at 750 Lexington Ave. Wallach notes that co-working accounted for slightly over 10% of overall Manhattan leasing, and less than 10% of Midtown leasing.

The Surprise of Midtown South

Who performed the best with pricing and leasing: Midtown, Midtown South or Downtown?

"It was definitely Midtown South for the first quarter of 2018," says Wallach.

Midtown South's asking rent average reached a new record high. "Individual pricing for Class A, B and C buildings in Midtown South was higher than Class A, B and C buildings in Midtown," notes Caggiano. "Yet the overall asking rent in Midtown was higher than in Midtown South." Midtown's average asking rent of $79.20 compared to Midtown South's $71.55. Caggiano explains this was due to the higher proportion of Class A buildings in Midtown compared to Midtown South.

These findings combined with the fact that the average sublet price in Midtown South was higher than in Midtown are a significant aspect of the reports, according to Caggiano. "It is the first time in our records that has ever occurred," he says.

Wallach adds that 10 years ago, right before the 2008 recession, it was the time when the market peaked. Back then, there was a 40% to 45% discount, comparing the average rent of Midtown to Midtown South. "Now it's less than a 10% discount of Midtown South compared to Midtown," he says. "It's the first time on record that has dipped below 10%."

Leasing was up in Midtown South by more than 50% compared to Q1 2017. It jumped to 2.67 million square feet with four separate deals greater than 100,000 square feet. In addition to the two WeWork leases, GMHC signed on for 112,272 square feet at 307 W. 38th St., and Flatiron Health inked a deal for 107,440 square feet at One Soho Square. In addition, Facebook expanded its lease at 770 Broadway to 78,000 square feet.

How is Availability Up But Remaining at an Equilibrium Point?

Availability is defined as the amount of space coming to market also including that which would be ready for tenants to fit out in up to 12 months. Vacancies simply mean vacant spaces. For overall Manhattan, the Q1 2018 availability rate was 10.3%. It showed stability, rising slightly from 10.0% from Q4 2017. Q1 2017 had an availability rate of 10.2%.

Job growth remained strong. From February 2017 to February 2018, New York City added 74,700 private sector jobs, a 2% yearly increase. With the influx of people joining the Manhattan workforce, Caggiano points to the densification of tenants, allocating less square feet per employee. At the height of the last market cycle in Q3 2008, employers typically allocated 230 to 240 square feet per person. "Now the average has dipped below 200 square feet," he says. "Depending upon the industry it can be as low as 120 square feet per person."

He has observed that TAMI tenants in particular seek more open-plan environments. They also prefer new construction where it is easier to reduce the square footage per person. The overall market has also increased from approximately 510 million square feet to 517 million square feet. The densification and new construction has kept pace with high employment numbers and a strong economy. These factors have kept availability close to the equilibrium point at 10%, says Caggiano.