

Real Estate Forefront

Emerging Developments in the NYC Marketplace, #17

Office Property Report Mid-Year 2011

Manhattan Office Property Market Soars in the Second Quarter

July 2011

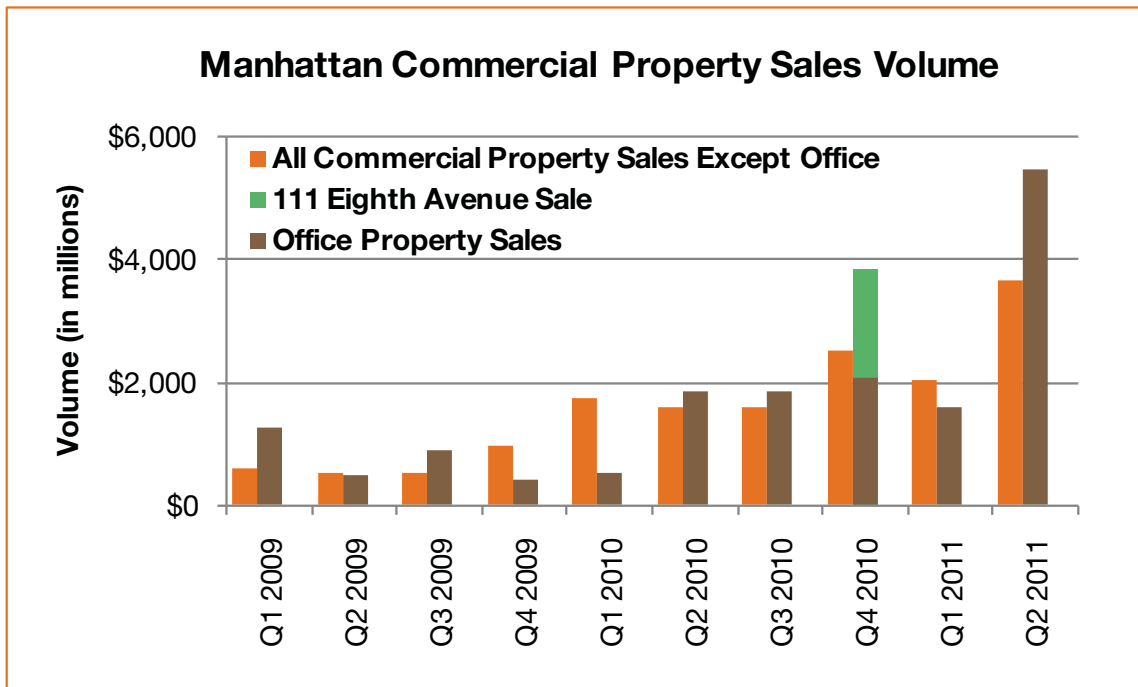
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Real estate investment services

After lagging the rest of the commercial property sales market in 2010 and the first quarter of 2011, the volume of Manhattan office property sales more than doubled in the second quarter to \$5.5 billion¹.

“At some point we knew office sales had to trend upwards,” said Peter Hauspurg, CEO of Eastern Consolidated. “Investor demand for Manhattan office assets has far outstripped supply for several years, and as a result, cap rates have dropped to historic lows for this class, that is 4% - 6%, which has finally drawn sellers into the market.”



Source: Eastern Consolidated, CoStar, Property Shark and NYC Department of Finance

These preliminary second quarter results far outpaced the fourth quarter of 2010 when 111 Eighth Avenue traded for \$1.77 billion which was 46% of the volume that quarter (\$3.85 billion).

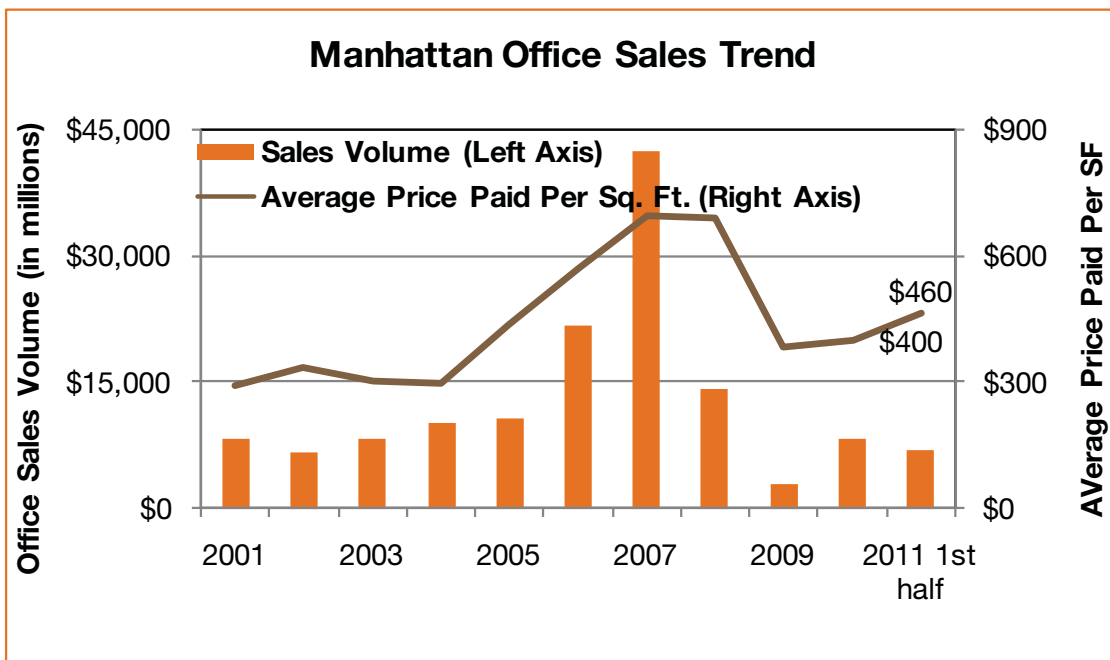
There are a number of possible reasons why sales volume jumped. The analysis herein reviews the trends in leasing, asking rents, employment, interest rates and office inventory trends to show that:

1. The market was ripe for more office sales even if the fundamentals were less than convincing
2. Office inventory growth as well as office-based employment growth since 1989 is negligible
3. The ratio of office sales prices to office rents has climbed and is near equilibrium in most markets

Office Market Fundamentals are Improving but at a Slow and Steady Rate

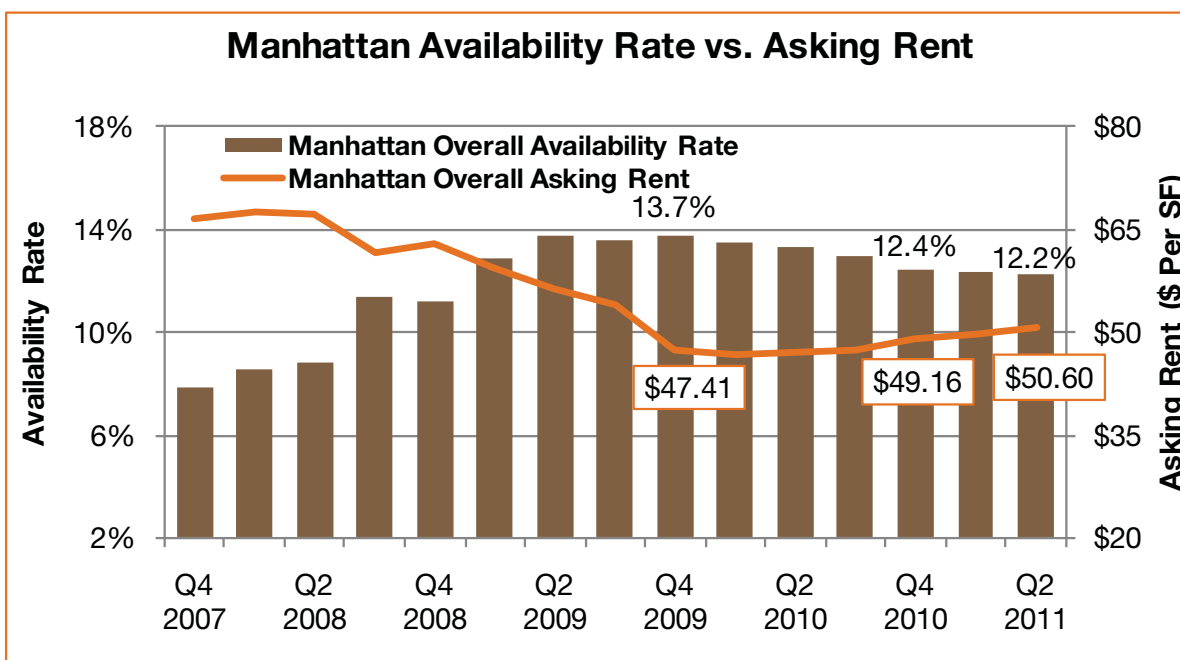
As shown below, after bottoming in 2009, office sales volume more than doubled in 2010 to \$8.3 billion. This volume still pales in comparison to 2007 and even 2008 when volume topped \$14 billion. Currently in 2011, it has increased 75% over 2010 on an annualized basis. But more significant than the increase in volume is the increase in the price paid per square foot. The average increased 15% to \$460 per square foot from approximately \$400 per square foot at the end of 2010.

¹Does not include the recapitalization of 280 Park Avenue.



Source: Eastern Consolidated, CoStar, Property Shark and NYC Department of Finance

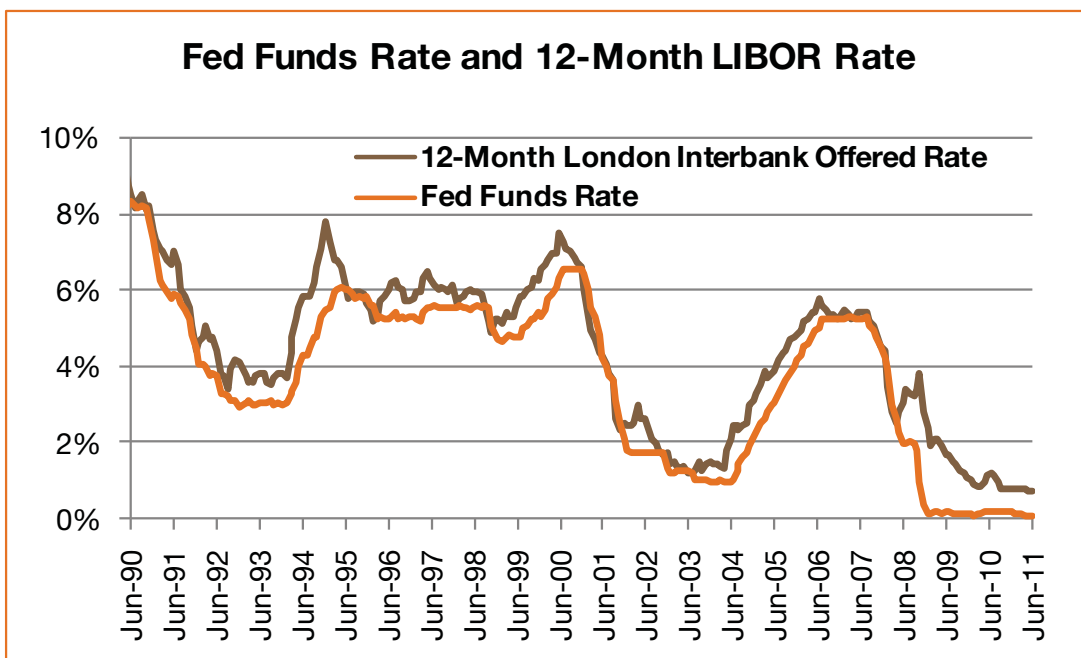
This contrasts sharply with the tepid increase in asking rents. The average overall asking rent in Manhattan has climbed 3% since the end of 2010 and just 7% since the bottom of 2009. Asking rents have increased slowly just as availability has declined slowly. There had been an uptick in leasing activity at the end of 2010 but that too slowed in 2011. More recently, a number of new and very prominent leases have been announced -- Condé Nast closed on a 1-million-square-foot lease at 1 World Trade Center and law firm Morrison & Foerster signed a Letter of Intent for 200,000 square feet at 250 West 55th Street. But both of these leases are in new buildings that have not opened yet so they will not make a dent on the availability rate.



Source: Eastern Consolidated, CoStar, Property Shark and NYC Department of Finance

New York City’s economy has added 75,100 jobs (2.0%) since the bottom of September 2009, **but only 42,400 of these are office-based jobs**. Moreover, the increase in office employment since the end of the last recession has not lowered the office availability rate by much because many of the added office jobs (one-fifth) are in “temporary services” that generally fill already occupied space.

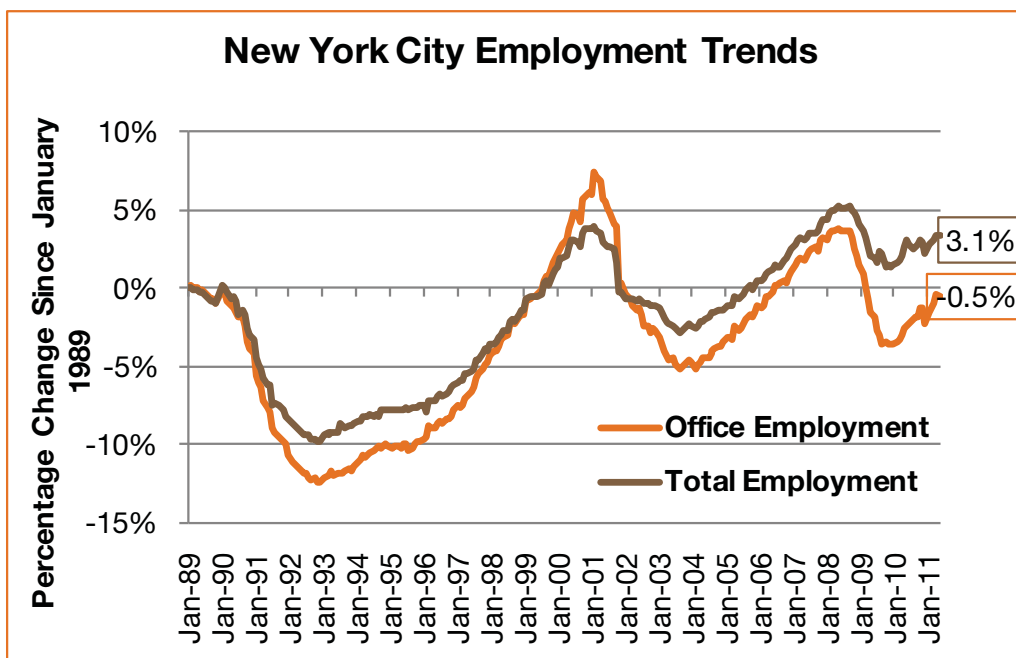
Another significant influence on the investment sales market is the finance environment; that is, recent low interest rates and a more relaxed finance environment have peaked investors interest. Not only have interest rates sank to an all-time low and stayed there all year, as shown below, but investors have found that lenders are loosening their purse strings. A number of anecdotal reports have found that banks are bidding to be the top lender on some property sales which represents a sharp reversal to the tight lending market in 2009 and early 2010.



Source: Federal Reserve

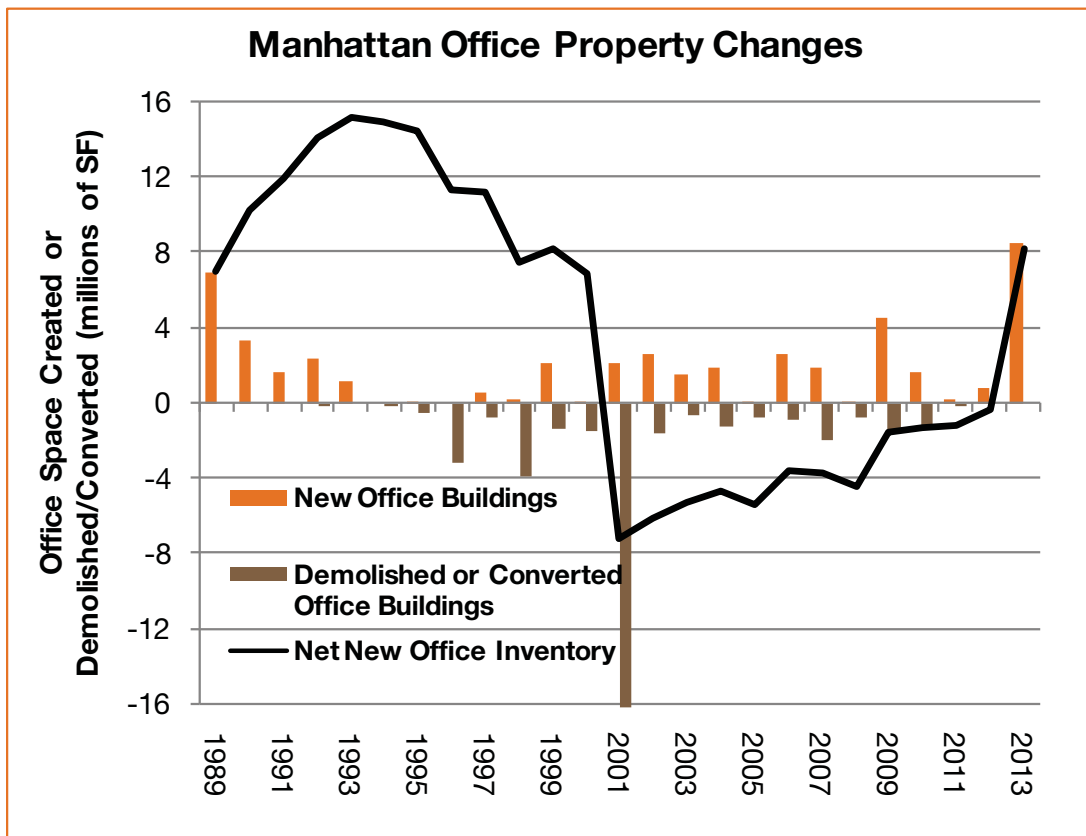
The Net Gain in Office-based Jobs and Office Inventory Since 1989: 0

New York City’s economy has always been cyclical. However, a look at employment trends over the last 20 years shows that not only has office-based employment come full circle – more than once – but the net change in total Manhattan office inventory over the same timeframe is near 0 as well.



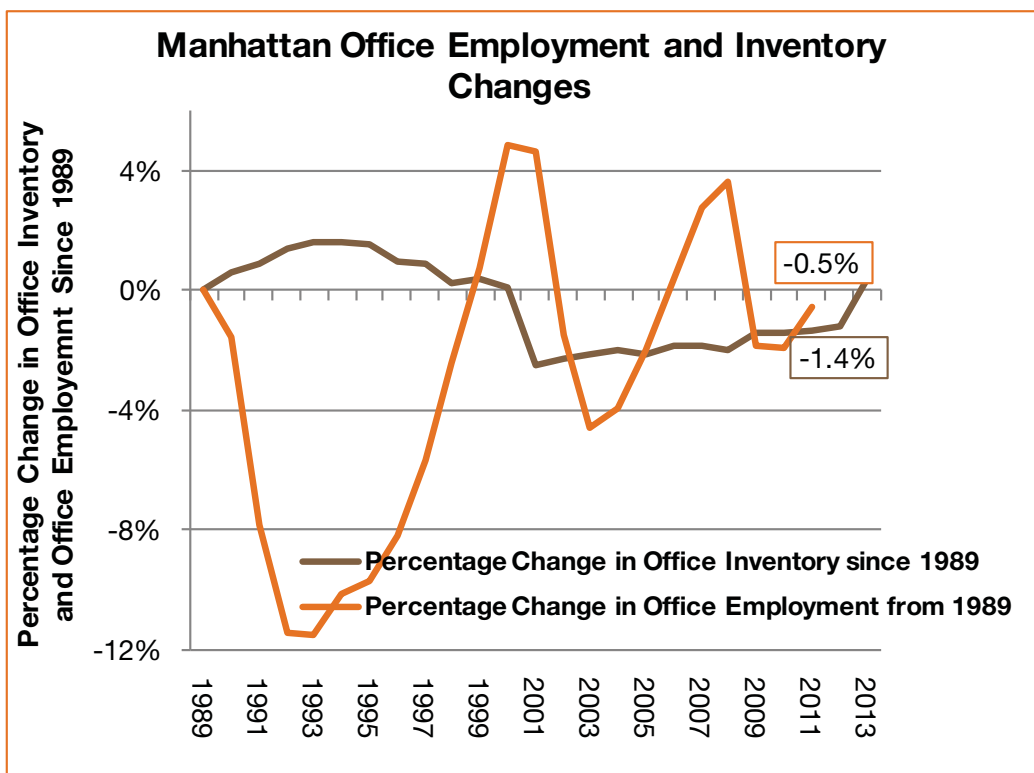
Source: Eastern Consolidated and NYS Department of Labor

While 90 new office buildings have been introduced to the market since 1989, either in the form of new construction or conversions, close to 250 office buildings have been demolished or converted from office to another use. *Netting all the new buildings with those demolished or converted from 1989 through 2012 yields 0 new office space.*



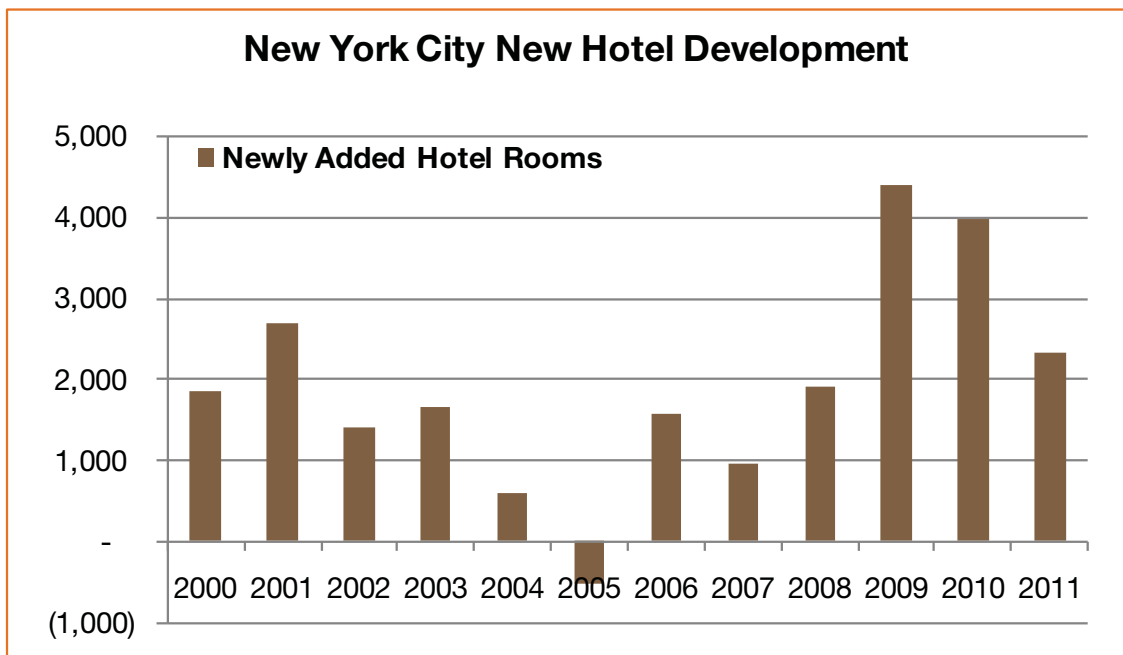
Source: Eastern Consolidated, CoStar and Property Shark

The fact that these two trend lines shown below -- office employment and office net inventory – both yield no growth over a 22-year horizon is striking.



Source: Eastern Consolidated, CoStar, Property Shark and NYS Department of Labor

Of the 250 office buildings that were demolished or converted, a number were re-built into hotels. Indeed from 2007 through the end of this year, 82 new hotels will have been built in Manhattan adding 13,650 hotel rooms [See *“If You Build It, They Will Come”*]. Not coincidentally, New York’s tourism industry has added more than 111,000 jobs since 2002.



Source: Eastern Consolidated

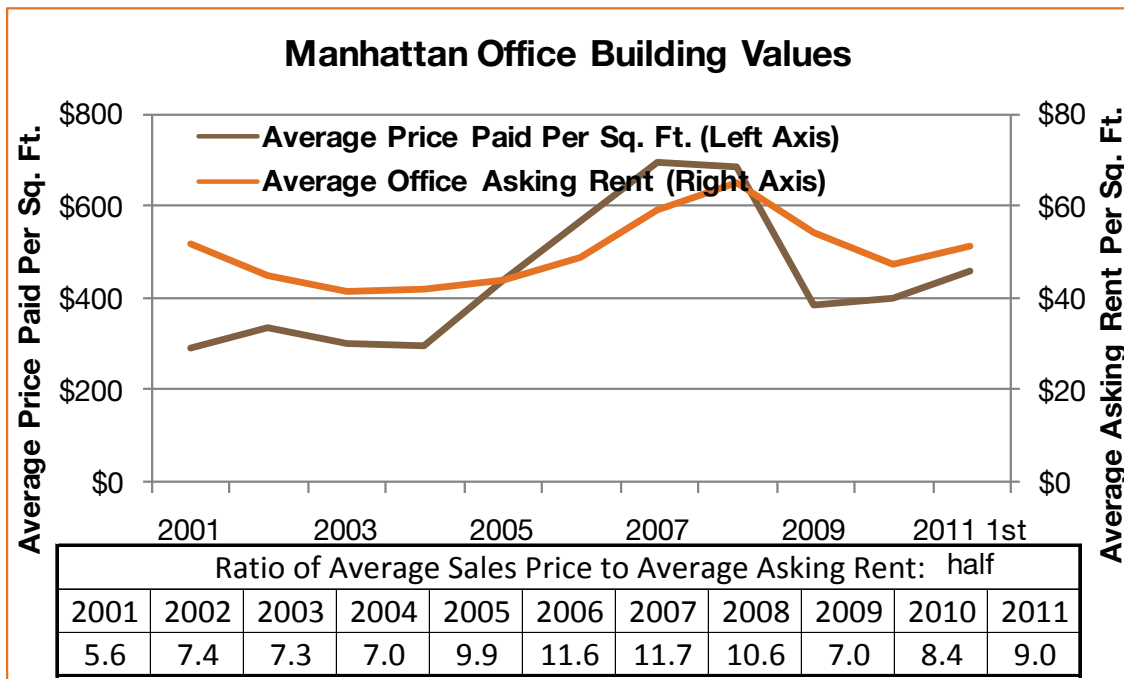
That said, six office buildings are either under construction or are in planning stages that will add 9.25 million square feet by 2013. These include 4 West 47th street, 51 Astor Place, One World Trade Center, 150 Greenwich Street (Tower 4), 130 Liberty Street (Tower 5) and 250 West 55th Street. Using 250 square feet per employee as a rule of thumb, 9.25 million square feet could accommodate 37,000 office jobs. If New York added 42,200 office jobs in the last 20 months, it could easily add another 37,000 office jobs before these new buildings are completed. All of which suggests that the market for office development is ripe for further investment.

The Ratio of Office Sales Prices to Asking Rents is Near Equilibrium

Revisiting an analysis we did 18 months ago showing the ratio of office sales price to asking rents reveals a healthier sales market.

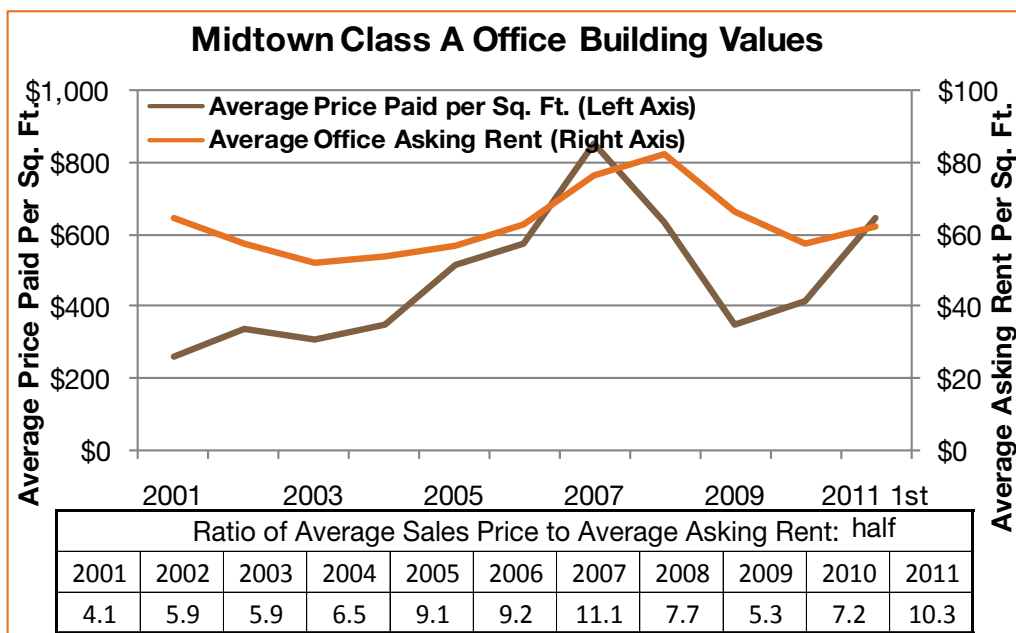
In that first analysis, we showed that if office building values are determined by rents or rent potential, the ratio of average sales prices per square foot to asking rents should hold relatively steady over a period of time. The ten-year Manhattan data showed how the ratio held steady at 7 from 2002 through 2004, but then jumped above 11 in 2006 and 2007, 70% higher than in 2002-2004.

The ratio fell in 2009 to 7 but climbed to 8 in 2010 and is currently at 9.0. At a minimum, the increase signals buyers' optimism that rents will not decrease any further, but it also raises the question of is there an equilibrium for this ratio? And has the market reached that equilibrium?



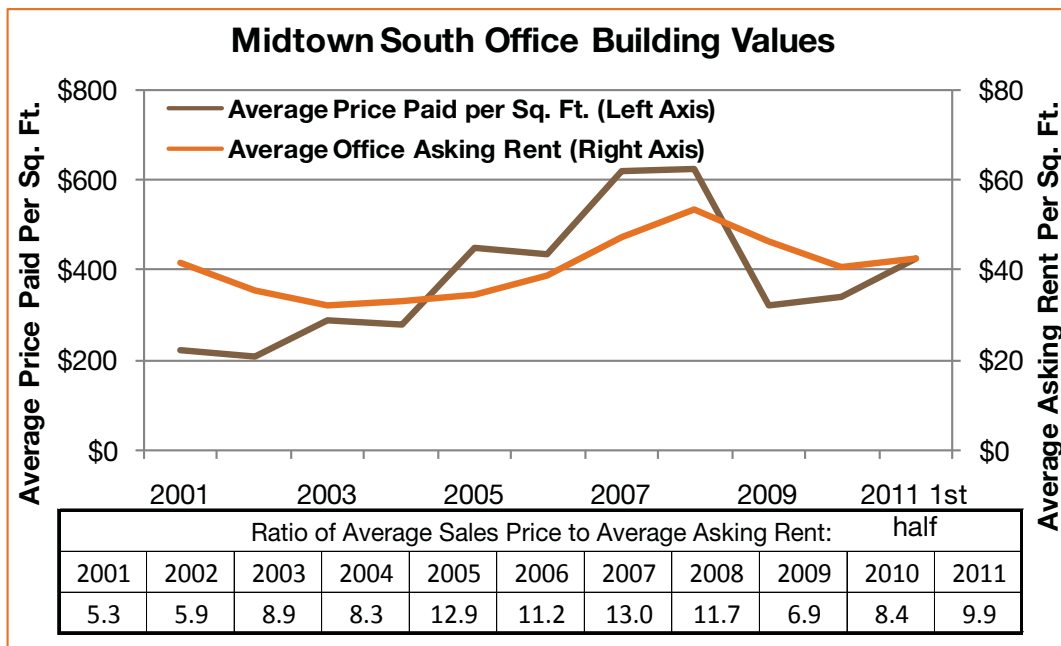
Source: Eastern Consolidated, CoStar, Property Shark and NYS Department of Labor

Judging by historic trends, a ratio of 9 to 10, where the market is now, looks to be “in equilibrium.” That is, in most submarkets (shown below), sales prices per square foot accurately reflect current asking rents. Recent improvements in the office fundamentals show that rents have climbed in line with the drop in availability; that is, at a slow but steady rate. Indeed, office prices have climbed more rapidly since 2009 but this was largely due to the fact that sellers were reluctant to put their buildings on the market for more than two years all while plenty of investors were ready and able to buy. The pent-up demand together with a more favorable interest rate and finance environment has yielded higher sales prices in 2011.



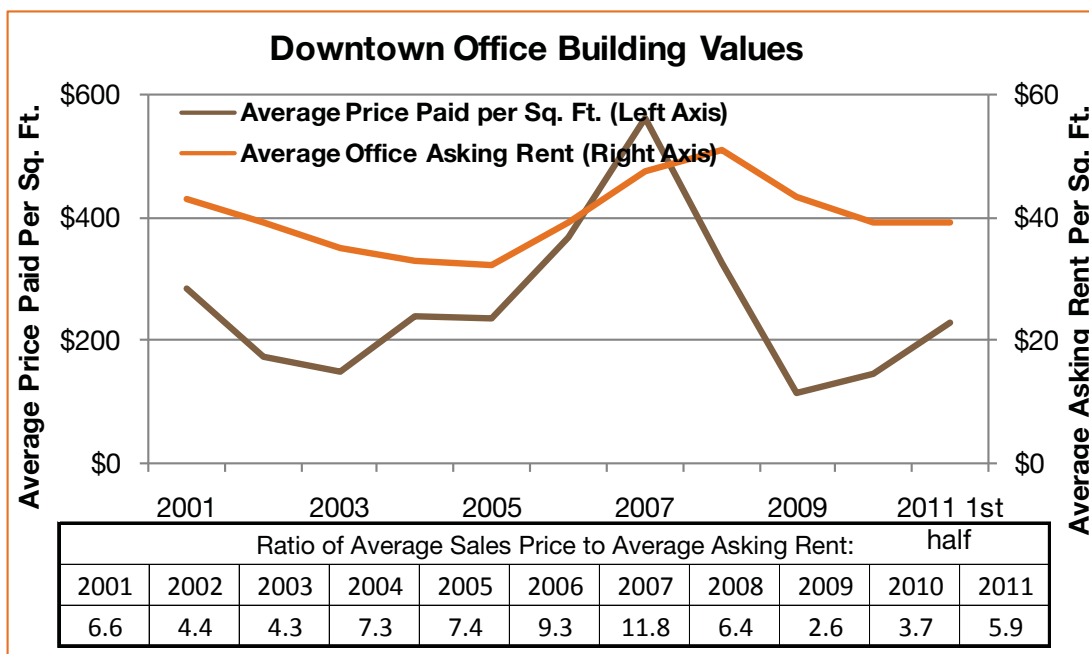
The optimism and/or demand for Class A Midtown properties is quite apparent as the ratio for sales prices to rents climbed to 10.3 this year from 7.2 last year and a low of 5.3 in 2009.

Source: Eastern Consolidated, CoStar, Property Shark and NYS Department of Labor



Optimism is just as high in Midtown South. The ratio jumped to 9.9 in 2011 from 8.4 last year and a low of 6.9 in 2009.

Source: Eastern Consolidated, CoStar, Property Shark and NYS Department of Labor



Finally, while the ratio has nearly doubled in Downtown, it remains well below the ratio in Midtown and Midtown South. This suggests that buyers do not see an appreciable increase in asking rents in the near horizon due to both the current number of large blocks of available space as well as the projected growth in inventory with the construction of the World Trade Center towers.

Source: Eastern Consolidated, CoStar, Property Shark and NYS Department of Labor

Conclusion

After stalling for more than nine quarters, the office sales market sprang to life this quarter including 14 sales for \$100 million or more. The top sales are listed below, note that some only include a partial interest.

Property	Sales Date	Sales Price
1633 Broadway	May-11	\$980,000,000
230 Park Avenue	June-11	\$760,000,000
450 West 33rd Street	May-11	\$553,074,580
1515 Broadway	April-11	\$544,500,000
750 Seventh Avenue	May-11	\$485,000,000
120 Broadway	June-11	\$341,000,000
425 Park Avenue	May-11	\$315,000,000
1180 Avenue of the Americas	May-11	\$259,000,000
1450 Broadway	June-11	\$204,000,000
245 Fifth Avenue	April-11	\$161,500,000
28 West 44th Street	May-11	\$161,000,000
375 Pearl Street	June-11	\$120,000,000
305 East 46th Street	May-11	\$114,000,000
One World Trade Center	May-11	\$100,000,000
1140 Avenue of the Americas	May-11	\$98,250,000

Source: Eastern Consolidated and CoStar

Indeed, many investors have recognized that the current interest rate and economic environments provide an excellent buying opportunity for Manhattan office properties. While some of the office market fundamentals have not been overwhelming, New York City's economy has grown at a faster rate than the national economy over the last two years in nearly every sector outside of manufacturing.

Moreover, with so many office conversions over the last two decades that have canceled out all of the new office construction, New York's constrained supply of office space has kept a lid on office availability and prevented office rents from plummeting. In fact, even the minimal increase in office rents over the last nine months combined with only moderate office leasing and office employment growth demonstrates that the office market fundamentals are on sound footing, again in contrast to many office markets across the country that have a glut of unoccupied office space.

The charts above show the ups and downs of New York City's economy, but it is remarkable that when looking over the last 22 years the net growth in office space is zero. And yet, office developers seem to have moved in line with office-based employers who have added 42,400 jobs over the last 20 months but have not regained all of the lost jobs in previous recessions.

The threat of inflation has eased of late now that the Mideast crisis has settled down and oil prices have dropped. Without this inflation pressure, interest rates are expected to stay favorable. Given the reduced uncertainty, the market is poised to continue to generate sales of this magnitude in the coming quarters.



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