FLIGHT TO QUALITY

NEW YORK CITY | YEAR-END 2022

CUSHMAN & WAKEFIELD

NEW YORK CITY
FLIGHT TO QUALITY

The flight to quality phenomenon gained momentum years prior to the global pandemic as tenants favored new construction over older properties, focusing on building features such as more efficient floor plates, natural light, collaborative spaces, and high ceilings. Companies traded up for better quality space, typically reducing their footprint as the densification trend gained popularity.

Since the pandemic, flight to quality has evolved to a broader scope as employee work patterns shifted to an unprecedented hybrid-remote work model that employees quickly adapted to enjoy for its flexibility. In the post-pandemic era, employees could leverage terms of a work-life balance as employers established back-to-work policies, leading to the period of the Great Resignation. To address the challenge of drawing occupiers back to the office, employers needed to maximize the employee office experience by creating a destination filled with an abundance of high-end modern amenities. Buildings in prime locations with proximity to transportation, including but not limited to newly constructed and renovated assets, have the greatest edge in recruiting and retaining top-tier talent. In the future, tenants occupying space will depend on additional factors, such as neighborhood vibrancy, industry clusters, and more unique top-of-the-line amenities, often resulting in a reduced footprint in exchange for higher-quality space.

This report highlights movements through trend data centered around flight to quality as occupiers look to create a culture with the best workplace experience as they compete for the finest talent.

30 Hudson Yards: The Edge

NOTABLE MARKET STATISTICS

22.8 msf of new and renovated construction in 2022-2023

TAMI and financial services drive **63.2%** of demand

Development properties were the **only sector to record positive absorption** in 2022

Midtown direct vacancy in New Development vs. other Class A: **9.4% vs 16.6%**

Midtown direct net effective rents in New Development vs. other Class A: **$100.77 psf vs. $57.82 psf**

UPSCALED BUILDING AMENITIES

Building amenities have become increasingly popular as a means to draw workers back into the office. A growing number of Manhattan office buildings offer a wide range of amenities, while others are slowly amenitizing their space.

A survey of 74 office buildings with amenities uncovered the following (see next page):

CLASS A
BUILDING AMENITIES

MORE THAN HALF OF THE 74 BUILDINGS SURVEYED OFFER THESE FOUR

62.2%
Conference Center/ Auditorium

58.1%
Lounge/Soft Seating

55.4%
Grab & Go Food

54.1%
Gym/Wellness

47.3%
Restaurant

39.2%
Outdoor Space

33.8%
Locker Room

32.4%
Bike Storage

32.4%
Garage

8.1%
Ancillary Activities (Basketball, Squash, Golf Simulator, etc.)

4.1%
Pool

KEY TAKEAWAYS

- Direct vacancy was **440 basis points (bps) lower** compared to Class A (12.3% vs. 16.7%)
- Of the 11.0 million square feet (msf) of new 50,000 sf and greater leases signed from 2021-2022, **50% occurred in 21 of the 74 amenitized properties**
- **Two-thirds of the buildings** have been built or renovated since 1990, 39% since 2010

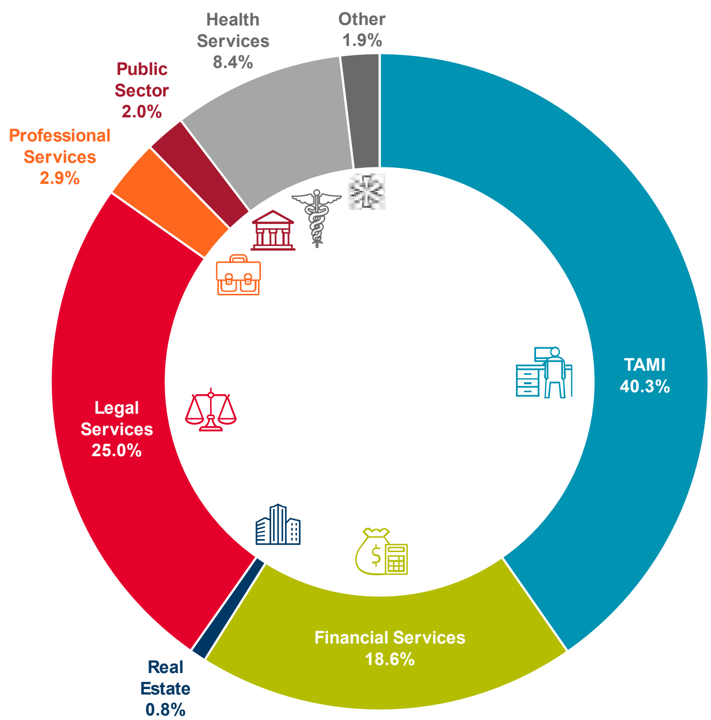
SECTORS DRIVING DEMAND

In recent years, the financial services and TAMI sectors have been leading pillars of demand in New York, as well as the driving forces of leasing newly constructed buildings. While TAMI was the largest contributor of demand between 2018 and 2020, it has been supplanted by financial services in the past two years. The trend has become especially pronounced in 2022, fueled by several major leases in upcoming developments by financial firms such as HSBC, Franklin Templeton, and Macquarie Group.

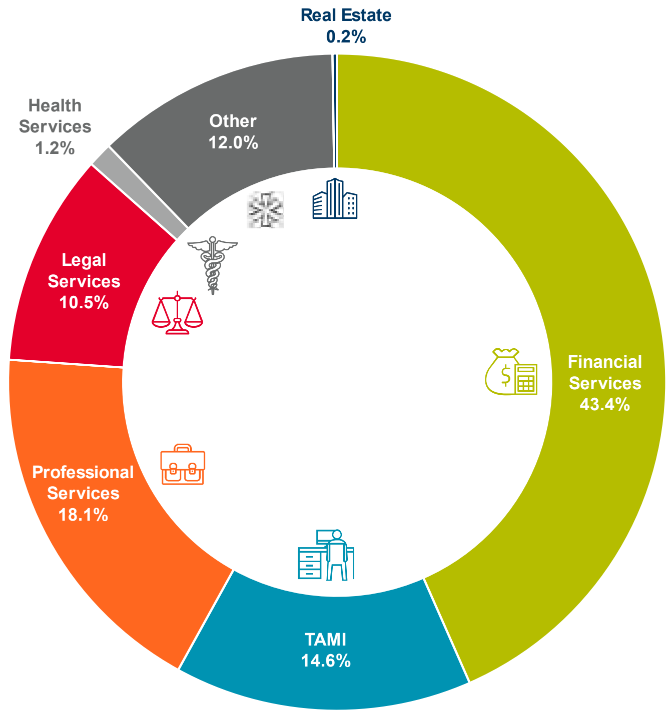
*LEASING BY INDUSTRY

**(AFTER NEW CONSTRUCTION)

2018-2020

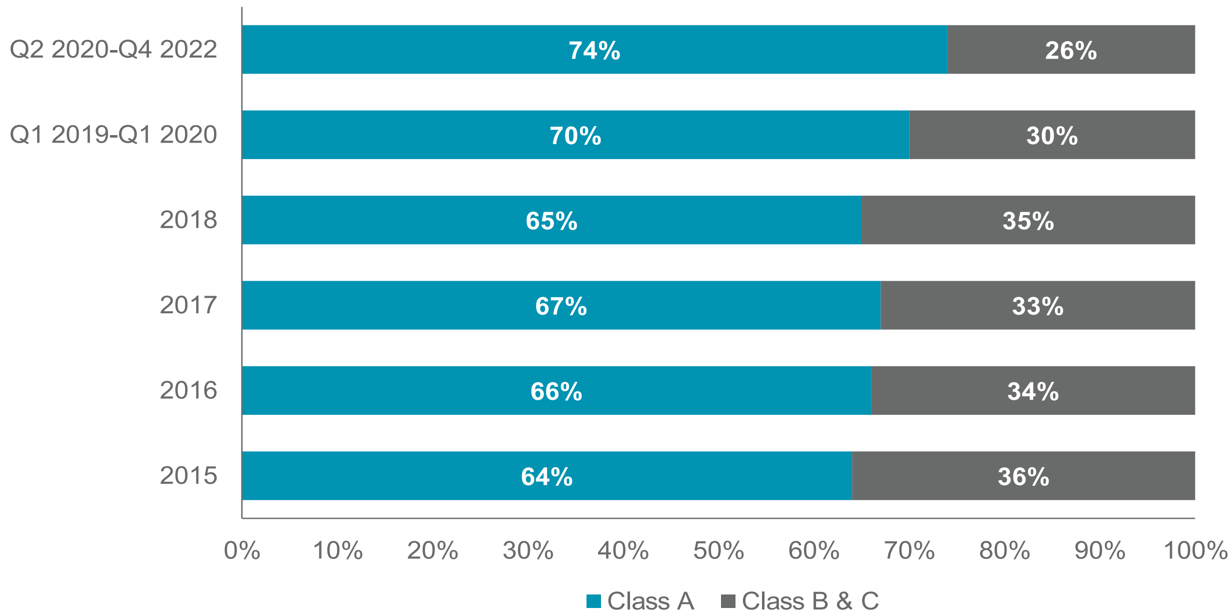


2021-2022



*New leases 10,000+ SF
**New and under construction since 2015

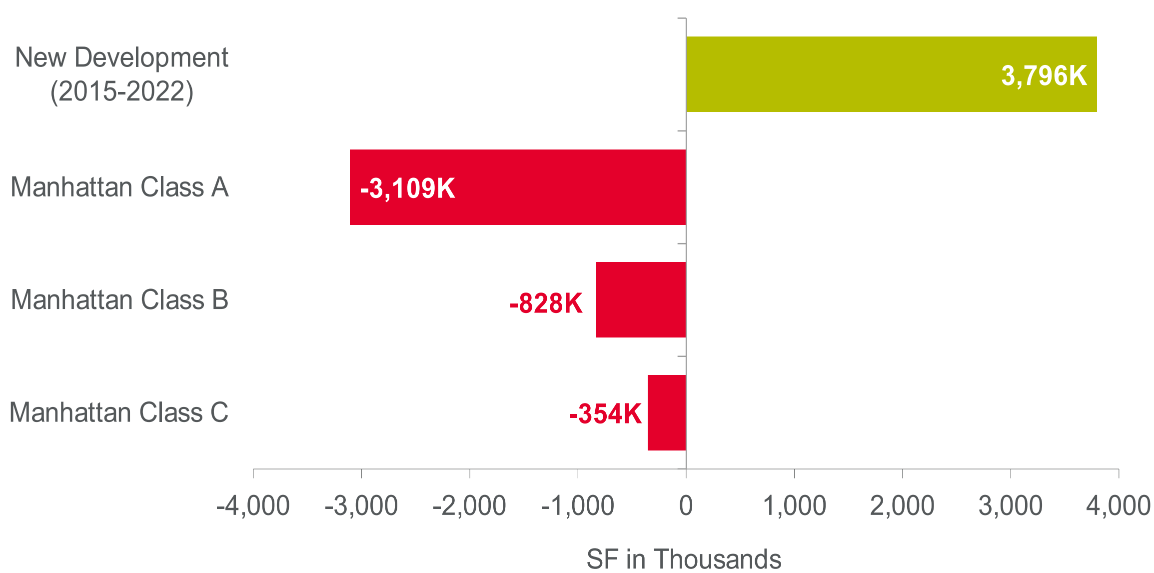
INCREASED DEMAND FOR BETTER QUALITY MANHATTAN ASSETS



Before the pandemic, from 2015 through Q1 2020, Class A assets accounted for an average of 67.0% of total leasing activity. In the post-COVID era, there has been a flight to quality as 74.0% of leases transacted were in Class A assets. The Midtown leasing trend in higher-quality buildings is even more significant, as 84.0% of leasing occurred in Class A assets, compared to 77.0% prior to the pandemic.

MANHATTAN **ABSORPTION** BY BUILDING QUALITY

As companies have gravitated towards higher-quality buildings, space absorption has surged, while the broader market recorded a net reduction in occupied space. In 2022, buildings developed since 2015 were the only segment of the market to record positive absorption.

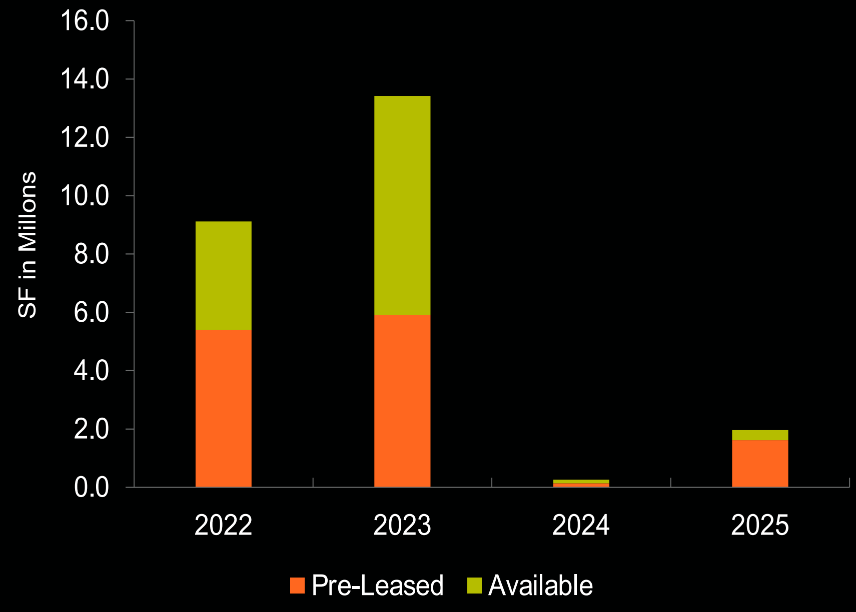


FUTURE SUPPLY

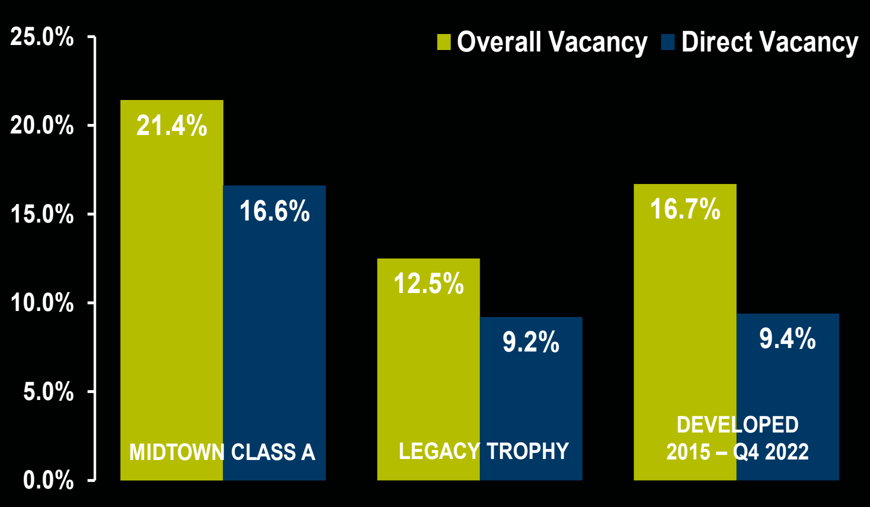
Manhattan is undergoing a surge in new supply, with 22.8 million square feet (msf) of new and renovated office space scheduled for completion in 2022 and 2023—11.9% more than that achieved in the previous five years combined. These properties have benefited from the flight to quality trend, particularly from tenants with large space requirements, typically already limited with options. More than 50.0% of space set for delivery in 2022 and 2023 has been pre-leased, with nearly 3.3 msf pre-leased in 2022. Major transactions included KPMG's 456,518-square-foot (sf) lease in Two Manhattan West and IBM and Franklin Templeton's leases of 356,928 sf and 347,474 sf, respectively, in One Madison Avenue.

However, beyond 2023, the market for large space occupiers seeking newly constructed space is set to become much more challenging. Only 1.6 msf of space is actively under construction for completion in 2024 and 2025; of that, a mere 343,100 sf is set to be made available for lease. While several proposed developments could deliver high-quality space in the longer term, most await an anchor tenant before commencing construction.

PRE-LEASED VS. AVAILABLE SUPPLY (2022-2025)



MIDTOWN **VACANCY** BY BUILDING QUALITY

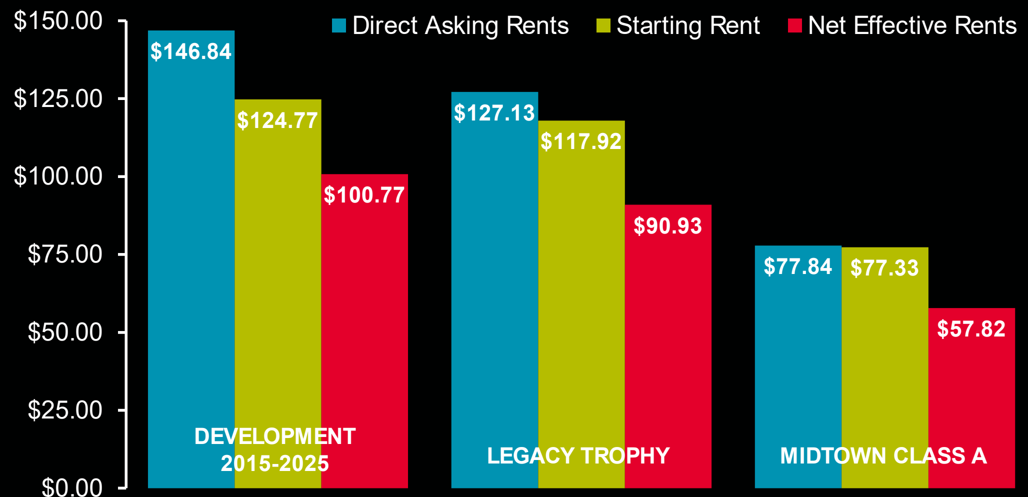


Development Set includes 500k+ sf buildings newly built or redeveloped from 2015-Q4 2022
Legacy Trophy comprises 30 best-in-class office properties in Midtown built prior to 2015

While overall vacancies have trended significantly higher since the onset of the pandemic, the best-quality buildings, particularly in Midtown, have remained relatively low. As of the fourth quarter of 2022, direct vacancies for newly developed product and legacy trophy buildings were more than 700 bps lower than other Class A assets in Midtown.

MIDTOWN **PRICING** BY BUILDING QUALITY

While benefitting from strong demand, the highest-quality buildings have been able to command a substantial rental premium throughout the pandemic. As of the fourth quarter, asking rents and net effective rents for new development in Midtown reached $146.84 per square foot (psf), 88.6% higher than other Class A assets in the market. Meanwhile, net effective rents for those assets topped $100.00 psf, 74.3% above other Class A assets.



Development Set includes 500k+ sf buildings newly built or redeveloped from 2015-2025
Legacy Trophy comprises 28 best-in-class office properties in Midtown built prior to 2015

SHIFTING
OFFICE FOOTPRINTS

Consolidations have driven new lease activity in the post-COVID landscape among some of the largest Manhattan occupiers, many reducing their overall Manhattan footprint between 30.0%-50.0%.

When digging further into post-pandemic leasing, 141 companies across all Manhattan submarkets and industry types signed leases, adjusting their occupancy footprint. Their collective pre-pandemic occupancy totaled 12.9 msf, whereas their current occupancy totals 11.4 msf. Post-pandemic, consolidations and "trading up" have reduced the average Manhattan tenant footprint by 14.8% (>10,000 sf tenants). However, it is essential to highlight the significance of industry type/sector in the discussion.

TENANT FOOTPRINT SECTOR ANALYSIS: Q2 2020 – Q4 2022

The **financial** and **professional services** sectors have consolidated to a far greater extent than any other sector, **down 1.3 msf and 1.5 msf**, respectively.

Legal Services has condensed its office space, **down 859K**.

TAMI has collectively expanded its footprint post-pandemic, **up 379K**.

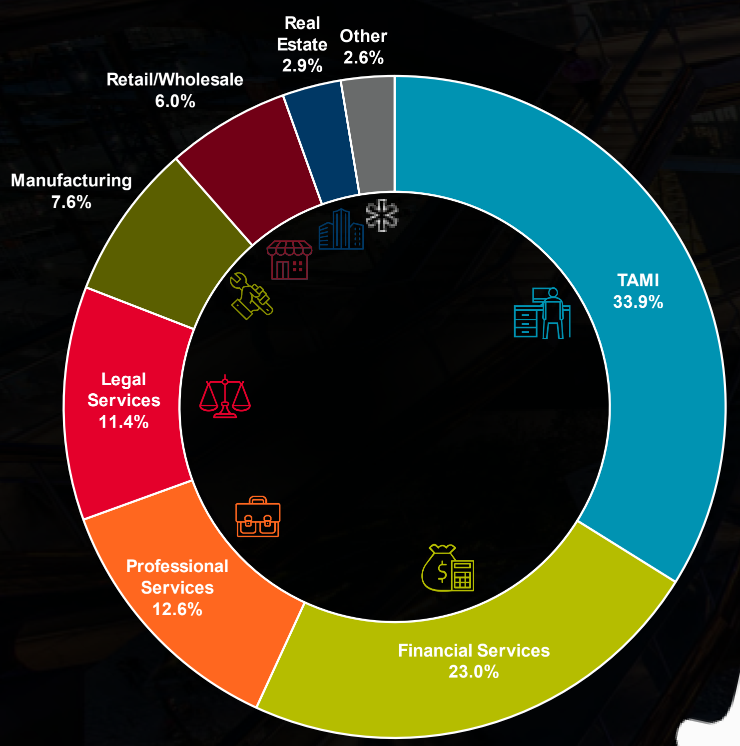
HUDSON YARDS/ MANHATTAN WEST SPOTLIGHT

Hudson Yards is the biggest private real estate development in the history of the United States and the largest development in New York City since Rockefeller Center. Its site comprises more than 18 msf of commercial and residential space, hundreds of retail locations, restaurants, residences, open space, a public school, and a 200-room Equinox-branded luxury hotel. Manhattan West is an eight-acre, six-building mixed-use development located in the Hudson Yards district that includes more than five msf of state-of-the-art Class-A office space, luxury apartments, a boutique hotel, retail amenities, restaurants, and two acres of open space.

Since its groundbreaking in 2012, the Hudson Yards area has rapidly become one of Midtown's hottest master-planned transformations. In 2022 the pace of leasing increased to nearly 2.0 msf—accounting for 12.0% of Midtown's new leasing activity and the highest total since 2019. There were 25 leases transacted in 2022, the highest annual number on record. TAMI, financial services, professional services, and the legal sector are the leading drivers of activity, accounting for nearly 70.0% of new lease transactions since 2013.

The direct vacancy rate in Hudson Yards/Manhattan West registered 15.3%—100 bps lower than the Midtown Class A vacancy rate, while average direct asking rents at $162.44 psf commanded a 82.2% premium over the Midtown Class A direct average of $89.16 psf.

BREAKDOWN OF **HUDSON YARDS/MANHATTAN WEST LEASING BY INDUSTRY***



The **TAMI sector** has **accounted for nearly one third of leasing** in Hudson Yards and Manhattan West since 2013, followed by **financial services comprising nearly a quarter** of activity.

**New leases since 2013*

SINCE APRIL 2013,

70 COMPANIES

HAVE MOVED **TO THE HUDSON YARDS** INTO

15.5 MSF OF SPACE





CONCLUSION

The workplace experience will continue to center around a flight to quality for the foreseeable future as employers create a more inviting and fulfilling working culture that drives the development and retention of top-tier talent. Vibrant neighborhoods and access to transportation will be important factors as to where occupiers want to be. Meanwhile, developers are likely to become even more creative in terms of amenity offerings that will set their building apart and attract top-tier tenants. While activity may be constrained in the short-to-medium-term by economic uncertainty and a slowdown in new completions in 2024, the long-term is bright, with nearly 22.0 msf of potential office space in the proposal stage that will fuel the next chapter in the flight to quality.

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