

Office Buildings Continue on Their Roll....

In recent columns about the New York City investment sales market, I mentioned that distinct product type sectors have been performing very differently. The land and hotel segments are currently facing challenges with downward pressure being exerted on values; retail properties are trading at the same prices they were six months ago, but there are fewer buyers making offers at the upper end of the value spectrum; multifamily assets and office buildings have held up the best thus far in this, likely to be, transitional year.

The dynamics we have seen in the broader sales market for the last six months or so have looked like the quintessential beginning of a market correction. Under these conditions it is not surprising to see multifamily properties holding up very well. They are always the last asset class to correct because New York's rent regulation system keeps rents artificially low, limiting the downside risk of apartment buildings.

What has been surprising this time around is the relative strength of the office sector. Normally, at this point in the cycle, we would start to see some softness in office values, but that has not been the case, yet. Office buildings in New York City have been the beneficiary of an unprecedented period of job growth. Since 2009, we have seen 630,000 jobs added in the city. That has provided a tremendous shot in the arm to the underlying fundamentals of office buildings. This is probably the main reason why these properties are doing so well.



Robert Knakal

This week, let's take a closer look at the office market and how it is performing thus far in 2016.

When considering the metrics of volume and value in the office sector, we will examine particularly the Manhattan submarket as it is overwhelmingly the leading indicator within the city.

With regard to the number of office buildings sold, last year there were 188

office properties traded citywide, and 102 of them, or 54 percent, were in Manhattan. In the first quarter of this year, there were 30 office buildings sold in the city. If annualized, the 120 property pace would represent a 36 percent drop from last year. Of the 30, 14 of the sales were in Manhattan representing 47 percent of all transactions.

It is noteworthy to point out that the 14 Manhattan office building sales in 1Q16 is the lowest quarterly total going back to second-quarter 2013 and the annualized pace of 56 for Manhattan would be the lowest annual total since 2010.

On the dollar volume front, Manhattan's dominance is much more pronounced. From January to March, there were \$3.92 billion in office building sales citywide, \$3.8 billion of which were in the Manhattan submarket, representing 97 percent of the total dollar volume. If annualized, the \$15.69 billion total reflects a pace, which would be 33 percent below last year's \$23.5 billion.

With regard to office building values, cap rates citywide were 4.63 percent, essentially flat compared with last year. Manhattan

cap rates averaged 3.73 percent, also about where they were last year. On a price-per-square-foot basis, however, the numbers look much more compelling for office investors. Citywide average price per square foot hit an all-time high of \$780. This was up 14 percent from last year's average.

In the Manhattan submarket, the 1Q16 average was a whopping \$1,265 per square foot, also an all-time record. This figure is up 21 percent from 2015.

So, for the time being office buildings are performing very well. Given that cap rates are flat and prices per square foot are up strongly, rising rents are accounting for the value increases. Can rents continue to climb? And what will happen to net absorption? Answers to these questions will likely determine how the sector looks at the end of the year. The traction the sector has right now creates a great opportunity for potential sellers to take advantage of current conditions.

Robert Knakal is the chairman of New York investment sales for Cushman & Wakefield.