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## Inflated expectations: Analysis of Manhattan office rents

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Recent reports about the Manhattan office leasing market since the crash of 2008 have offered a cautiously optimistic picture of growth. Indeed, at first glance, Manhattan office rents appear to have climbed a healthy percentage since the economic crisis. But how is this analysis affected once inflation is plugged into the effective rent calculation? An examination of inflation-adjusted\* lease comp data spanning the past 10 years provides an informed representation, and reflects the "flight from quality" that has been visible across submarkets since rents hit bottom in 2010.

### Sluggish A

Adjusted for inflation, Manhattan class A office rents over the past four years show a slow upward movement. While the nominal class A effective rents have grown 13.76% since the crisis, inflation-adjusted rents have increased only 7.36%. A similar trend is observable in Manhattan's Downtown and Midtown, which experienced 3.9% and 8.39% inflation-adjusted increases in effective rent, respectively. This is not surprising, as these submarkets both offer a majority of the class A inventory in Manhattan, which has decelerated along with the financial services sector.

### Rise of Classes B and C

Class B and C buildings have fared better than class A following the downturn, with class C in particular having shown significant increases in inflation-adjusted effective rent. Over the past five years, the gap between class B and C rents has narrowed to only \$4.74 per s/f, compared with \$8.34 in 2009. The growth of class C nominal effective rent since 2010 is 19.53%, and just under 14% when adjusting for inflation, exceeding that of both A and B. Indeed, while current class A and B office rent can be most closely compared to the inflation-adjusted levels of 2006, class C space has risen to near the prices of 2008. This trend can be connected to the post-recession booming technology sector, with tenants like Google favoring class B and C buildings in Midtown South over the corporate quality and higher rents of class A buildings in Midtown.

### Class C wins; Moderate growth for class A and B

Investors may be surprised to learn that the growth of inflation-adjusted effective rent is quite far from the nominal rent growth. While it's clear that class C office space is a hot commodity, and that Midtown and class A are still working on regaining stability, class B's growth has been overrated.

Although growth has not been robust for classes A and B, rents have outpaced inflation and returned to their 2006 levels. The lively leasing activity across Manhattan and an increasing number of leases above \$100 per s/f may lead some to assume that the market is preparing for another bubble. However, when compared to the period of 2003 through 2006, rental rates for classes A and B in the past five years appear almost flat. While it is probable that rents across classes and submarkets will grow as the market continues to recover, this will likely be a slow and steady rise as opposed to a giant leap.

\*Inflation rate for this article was calculated using month by month CPI data from 2003 through present.

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