Marcus & Millichap

Retail Research Market Report

New York City

Third Quarter 2016

Supply Growth Emerges; Buyers Stay Active for Deals

Builders expand delivery slate with focus on premier product in Brooklyn and Manhattan. Broad-based growth in the labor market, underpinned by multiple large Fortune 500 companies, is continuing to foster positive net migration and household formation, providing opportunities for retailers. Throughout the cycle, vacancy rates have fallen considerably in the five boroughs, buoying local property operations as additional retailers enter the market. Recent deliveries of mixed-use and other retail projects have been more subdued than earlier years in the cycle, yet they will reverse in 2016 as builders refocus on marquee neighborhoods in Manhattan and Brooklyn. Meanwhile, interest outside the boroughs will also remain significant, accounting for nearly 1 million square feet of this year's construction. Highlighted developments include the new World Trade Center building in Lower Manhattan and City Point in Brooklyn. Containing over a million square feet between the two projects, the sites will remake the boroughs over time. While vacancy is likely to tick up as these offerings are delivered, rent growth will still exceed inflation over the coming months.

Buyer volume shifting to outer suburbs in search of higher yields; institutions stick to Manhattan. While valuations have continued to escalate, historically low interest rates are motivating investors to deploy capital into retail properties at higher rates of return. Large institutions remain active mostly in the Manhattan suburbs. However, the vast majority of metro capital sources have shifted their allocation strategies toward the outer boroughs, with Brooklyn and Queens making up the majority of transaction volumes. Cap rates are typically in the mid- to low-5 percent range metrowide, with assets in the Bronx and Staten Island providing more robust returns than average. While value-add properties can still be located, the vast majority of these assets require capital intensive improvements and remain highly appealing to investors, increasing the cost of acquisitions and reducing returns. Volatility in other asset classes is likely to leak over into commercial real estate as uncertainty increases, bringing more sellers to the table. As a result, deal volume is likely to expand over the coming year as buyers seek opportunities.

2016 Retail Forecast

2.1% increase
in total employment

Employment:

A slower pace of global growth will weigh on metro hiring, leading organizations to hire 90,000 new workers over the course of 2016. Last year, employers created 101,000 jobs.

3.1 million sq. ft.
will be completed

Construction:

Builders will complete 3.1 million square feet of retail space in 2016, representing an acceleration in deliveries from the prior year when 1.3 million square feet was delivered. More than two-thirds of new supply will come online in Manhattan and Brooklyn.

2.7% increase
in retail sales

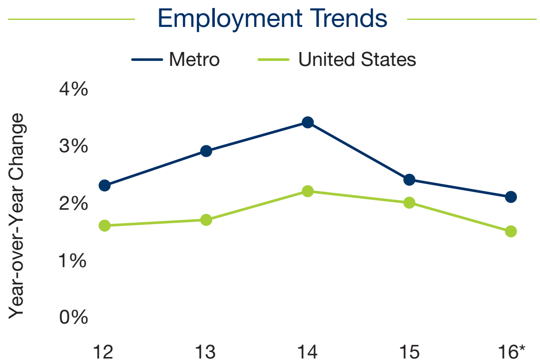
Retail Sales:

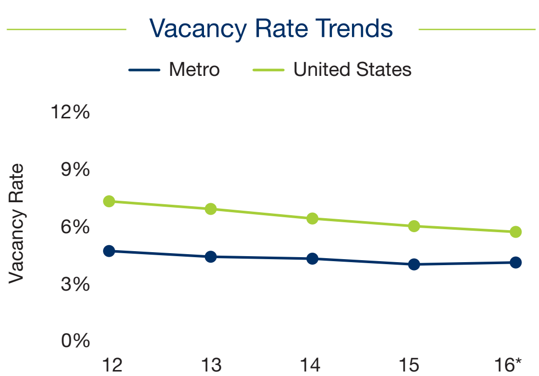
Robust tourism spending and continued job growth boosted retail sales in the New York City metro by 2.7 percent to more than $3.3 billion. This follows a 5.9 percent acceleration recorded in the previous year.

3% increase
in transactions 2Q15-2Q16

Sales Velocity:

Transaction velocity increased 3 percent over the past year as a lack of listings limited investors' ability to deploy capital. Closed deals proliferated in the Bronx and Queens, while transactions were largely unchanged in Manhattan and Brooklyn.





* Forecast

Economy

- During the first six months of the year, New York City organizations hired 33,600 new workers, bringing payroll additions over the past year to 80,900, a 1.9 percent growth rate. In the previous 12 months, companies added 127,400 staffers, an annual expansion of 3.1 percent.
- Job growth continues to be propelled by the education and health services and professional and business services sectors, leading to the hiring of 42,100 and 10,000 workers, respectively. The leisure and hospitality sector also swelled, adding 18,000 positions, as more tourism spending prompted organizations to hire.
- Over the past four quarters, retail sales in the five boroughs rose 5.7 percent to above $4.5 billion, propelled by domestic strength in the labor market and the continued flow of inbound tourism. In addition, household and population growth are also supporting this trend, with each category growing 2.4 percent and 3.4 percent, respectively.
- The financial activities and trade work sectors recorded small contractions in headcounts of 5,200 and 1,900 workers, respectively, as slower global growth weighed on metro hiring activity.

Outlook: A slower pace of global growth will lead organizations to hire 90,000 staffers this year, a 2.1 percent rate of expansion. In the prior four quarters, 101,000 jobs were added, a 3.1 percent rise.

Construction

- During the first six months of the year, developers completed 372,000 square feet of retail and mixed-use space. As a result, deliveries over the past year reached nearly 1.1 million square feet. Builders were most active in the Brooklyn and Manhattan boroughs.
- Development in Brooklyn is widespread, with 26 projects slated for delivery this year. The biggest site is known as City Point and will be located at 1 Dekalb Avenue. The project will contain 675,000 square feet of retail and apartments, one of the largest deliveries in Brooklyn in several years.
- Although less active than Brooklyn, Manhattan builders are still planning to complete 17 different sites in 2016. The World Trade Center is set to contain 335,000 square feet of retail space upon delivery, the largest project underway this year. Meanwhile, 100 W. 125th St. and 5 W. 125th St. in Harlem will contain roughly 161,200 square feet and 101,400 square feet, respectively.
- Developer interest outside of Brooklyn and Manhattan is slowing somewhat, with nearly a million square feet of space expected to be brought to market across the Bronx, Queens and Staten Island. The bulk of the projects are small single-tenant spaces, while the largest floor plate will be at 5740 Broadway in the Bronx. Plans call for 85,200 square feet of retail space at the site.
- Despite the largest supply injection of the current cycle, robust pre-leasing will reduce the amount of new space available for lease to less than a half a million square feet. The majority of unleased space will come to market in Brooklyn.

Outlook: Builders will complete 3.1 million square feet of retail space this year, representing the quickest pace of deliveries since 2006.

Rents and Vacancy

- Over the past four quarters, the average asking rent climbed 7 percent to $57.25 per square foot, far exceeding the 0.1 percent decline recorded in the previous yearlong period. Gains were witnessed in both multi-tenant and single-tenant structures, particularly in Manhattan, Brooklyn and Queens.
- Single-tenant spaces outperformed multi-tenant floor plates over the past year, recording a 7.0 percent rise to $59.84 per square foot, while multi-tenant product advanced 6.2 percent to $37.91 per square foot. Spaces in the Queens and Manhattan boroughs recorded significant increases, up 9.2 percent to $48.12 per square foot and 10.8 percent to $110.44 per square foot, respectively.
- A slower pace of development fostered a 60-basis-point decline in vacancy to 3.5 percent by the close of the second quarter. Brooklyn and Queens registered the largest declines in vacancy, falling 110 basis points to 3.0 percent and 110 basis points to 2.8 percent, respectively.
- Vacancy in net-leased properties has continued to decline over the past 12 months, reaching 3.5 percent by the end of June. Robust net absorption in Brooklyn and Queens led vacancy to fall 110 basis points to 3.4 percent and 140 basis points to 2.7 percent, respectively. Staten Island assets saw less demand, with vacancy rising 140 basis points to 4.8 percent.

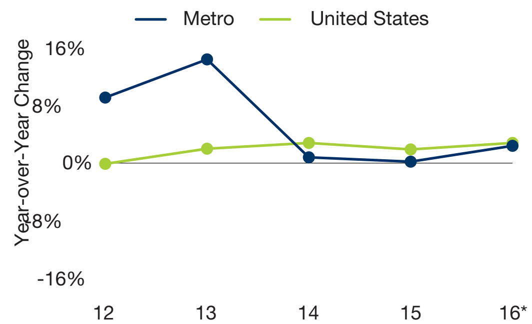
Outlook: The quickest pace of deliveries in the current cycle will foster a 10-basis-point rise in the average vacancy to 4 percent, while the average asking rent increases 6 percent to $56.50 per square foot.

Sales Trends**

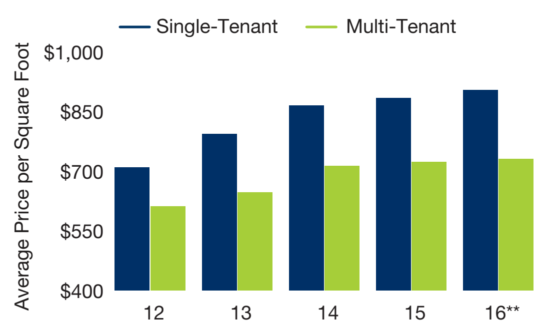
- Over the past year, transaction velocity ticked up marginally as investors continue to deploy capital in New York City. While dollar volume was once again led by properties in Manhattan, transaction velocity in Brooklyn and Queens has picked up substantially.
- Over the past year, metro cap rates have remained in the low- to mid-5 percent range, with suburban assets trading at discounts to core properties in Brooklyn and Queens. These two boroughs will typically exchange ownership near the metro average, while Manhattan offerings will extend into the mid- to high-3 percent range. Cap rates in Manhattan can sink even lower for top-tier assets.
- The vast majority of deal flow was centered around multi-tenant product in mixed-use or retail storefronts, particularly in the outer boroughs. Prices per square foot are typically in the mid- to high-$500 range in the outer boroughs, while rising above $2,200 per square foot in Manhattan.
- Single-tenant buildings are commanding an exceptional premium in the metro across all five boroughs. While average prices per square foot will exceed $800, Brooklyn and Queens assets will exchange ownership at roughly $1,000 and $900, respectively. Offerings in Manhattan can exceed $3,400 per square foot, depending on location and asset quality.

Outlook: While institutional investors will remain active in Manhattan, the vast majority of private buyers and syndicates will continue to deploy capital in the outer boroughs, with a particular emphasis on Brooklyn and Queens.

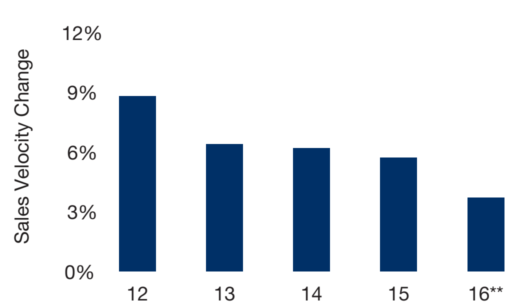
Asking Rent Trends



Sales Trends



Retail Sales Velocity



* Forecast
** Trailing 12-month period through 2Q
Sources: CoStar Group, Inc.; Real Capital Analytics

Marcus & Millichap

Capital Markets

By WILLIAM E. HUGHES, Senior Vice President | Marcus & Millichap Capital Corporation

- Global capital markets have remained stable over the past few weeks, even as Brexit and the continued devaluation of the Chinese yuan have induced bouts of volatility into stock and bond markets. Meanwhile, U.S. economic data has proved resilient, with increases in retail sales and steady hiring supporting a measured pace of growth. Additionally, higher bond prices have lowered prospective yields, boosting the appeal of commercial real estate.
- As the current economic cycle has continued, retail vacancy descended to 5.8 percent by the end of the second quarter. A focus on net-leased construction for pre-leased tenants and mixed-use developments has limited development activity in relation to prior cycles, supporting robust increases in average asking rents. Builders will deliver 46 million square feet of retail space this year, with more than two-thirds of new supply slated as single-tenant structures. This environment will sponsor a fourth straight year of average asking rent growth, with advancement projected to exceed inflation over the same period.
- Capital markets remain highly competitive, with a broad assortment of fixed-rate products available through commercial banks, life-insurance companies and CMBS lenders. Loans are generally offered at terms up to 10 years at maximum leverage of 65 to 75 percent. For 10-year terms, rates will typically reside in the high-3 to mid-4 percent range, depending on leverage and underwriting criteria. Floating bridge loans and financing for repositionings are typically underwritten with LTVs above 80 percent, while pricing at 300 basis points above Libor for recourse deals and extending to 470 basis points above Libor for non-recourse transactions.

Local Highlights

- After recently completing the purchase of the iconic Waldorf Astoria hotel, China-based Anbang Insurance Group has announced plans to take as many as 1,000 hotel rooms and turn them into luxury condos. The move follows several other similar real estate deals, including the Pierre and Baccarat Residences. The firm's chairman outlined plans for world-class amenities and finishes to be installed in the conversion.
- The city's largest office landlord, SL Green, recently outlined plans for its massive One Vanderbilt office project in Midtown Manhattan. Pegged at more than $3.1 billion in total cost, the firm is outlining financing and joint venture structures while it undergoes leasing conversations.
- The Rheingold brewery site in Bushwick is being envisioned as a massive luxury apartment complex in new design plans rendered by architecture firm ODA New York. Attempting to convey a city-within-a-city concept, plans call for more than 1 million gross square feet of building area that will include a pool, mini-golf course, rock-climbing wall and urban farm where tenants would be able to grow their own food. All of the rental units would be below market rate, keeping with the city's zoning change approval in 2013.
- Thor Equities is planning a 623,000-square-foot office and retail development on the Red Hook waterfront in Brooklyn. The four-story complex will feature more than 600,000 square feet of office space and roughly 23,000 square feet of retail and restaurant space. The project would also contain a waterfront esplanade, coupled with a courtyard and rooftop terraces for tenants.

National Retail Group

Visit www.NationalRetailGroup.com

Bill Rose
First Vice President, National Director
National Retail Group
Tel: (858) 373-3100
bill.rose@marcusmillichap.com

New York City Offices:

Brooklyn Office:
John Horowitz
Vice President, Regional Manager
Tel: (718) 475-4300 | Fax: (718) 475-4310
john.horowitz@marcusmillichap.com

16 Court Street, Floor 2A
Brooklyn, New York 11241

Manhattan Office:
J.D. Parker
Senior Vice President, Division Manager
j.d.parker@marcusmillichap.com

John Krueger
Regional Manager
Tel: (212) 430-5100 | Fax: (212) 430-5110
john.krueger@marcusmillichap.com

260 Madison Avenue, Fifth Floor
New York, New York 10016

Prepared and edited by
Aaron Martens
Research Analyst | Research Services

For information on national retail trends, contact:
John Chang
First Vice President | Research Services
Tel: (602) 687-6700
john.chang@marcusmillichap.com

Price: $250