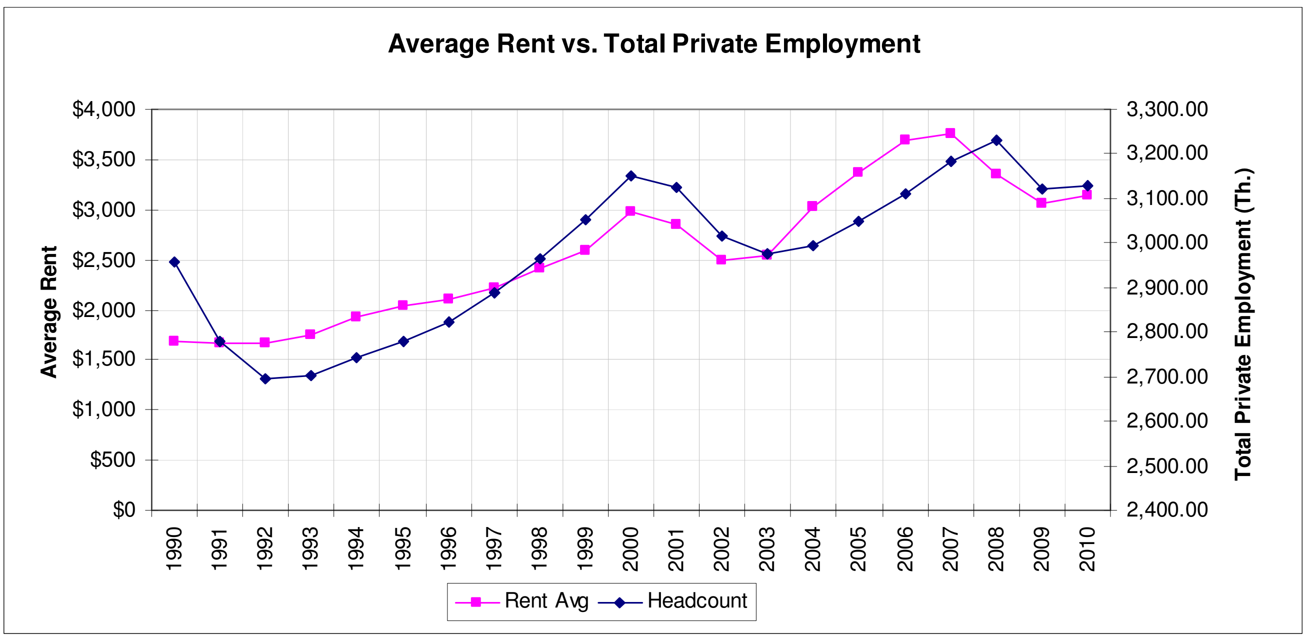
2010 Manhattan Rental Report

Rent Levels

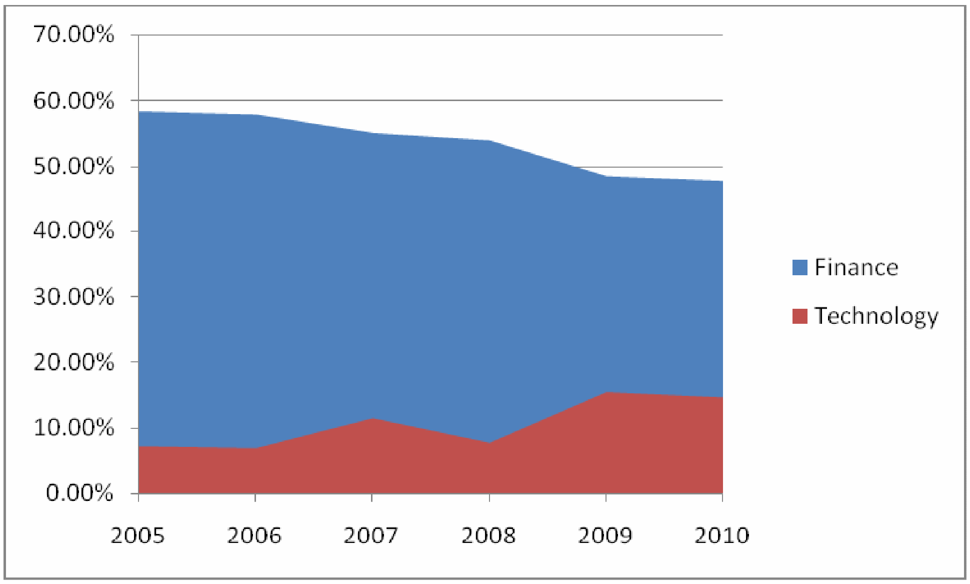
Rents rose in 2010, reversing the trend of decline that began in the third quarter of 2008. In comparing the relationship between supply and demand in the Manhattan rental market, demand has been deemed most responsible for moving prices. The details of supply during the past year will be discussed below. The real story behind rising rents is about demand.



The strong correlation between demand and pricing is demonstrated in the chart above, comparing average rent with private sector employment. It has been a truism of both the sale and rental markets that the financial services industry is the dominant force in creating demand. In 2010, Google's acquisition of a 3,000,000 square foot office headquarters, of which it currently occupies about 550,000 square feet, prompted us to explore the growth rate of technology sector employment and to compare it to financial services employment growth.

Government databases do not track the technology industry as sufficiently as desired, for both "medium and message" components. To address the question directly, we collaborated with On-Site Marketing, a leading company in credit checking for the Manhattan rental market. On-Site analyzed the representation and growth of key industries as reflected by the employment of Manhattan tenants over the past five years.

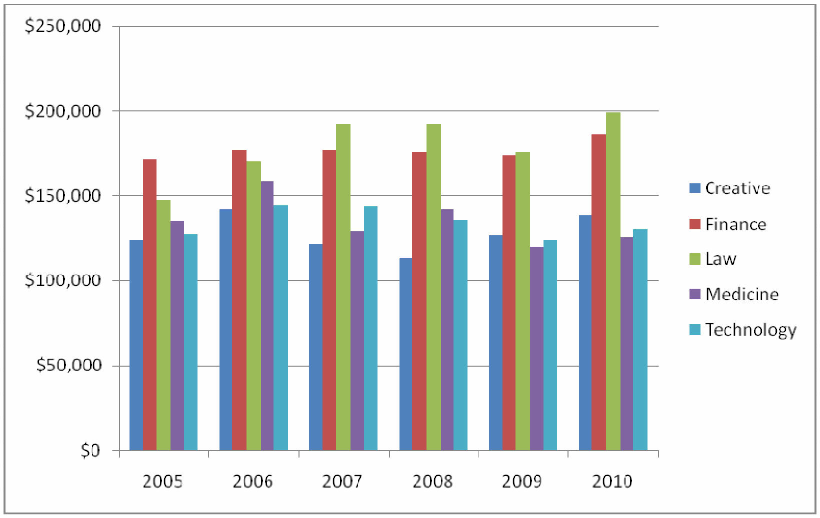
Finance vs. Technology jobs as a percentage – 5 year trend



Industry jobs as a percentage – 5 year trend

	Finance	Technology	Creative	Law	Medicine	Student
2005	58.35%	7.20%	8.57%	10.97%	4.54%	10.37%
2006	57.91%	6.91%	9.14%	11.94%	4.11%	9.99%
2007	55.09%	11.47%	10.69%	10.95%	4.43%	7.36%
2008	53.95%	7.71%	10.39%	9.12%	4.73%	14.10%
2009	48.49%	15.46%	12.27%	10.19%	5.90%	7.70%
2010	47.79%	14.64%	9.13%	7.56%	5.95%	14.93%

Average income by industry – 5 year trend



As these charts demonstrate, the growth rate in technology sector employment has doubled while financial services employment has declined. Of course, financial services employment was deeply affected by the 2008 crisis and has since begun to rebound, but tech sector job acceleration is the more impressive for that as the financial crisis impacted almost all industries. How financial service employment will fare in the future remains to be seen, given regulations aimed at mortgage underwriting and securitization and given new restraints on proprietary trading. By comparison, the tech sector has no visible constraints and Google's choice of Manhattan for a headquarters is extremely promising for the local economy. Also, as the charts show, compensation levels for tech workers are substantially less than for finance and both are less than for law. This will need to be monitored over time to gauge its impact on rental pricing.

With about 80,000 jobs regained to date of the total 200,000 lost, rent levels are up. Rent levels alone, however, do not tell the whole story. Just as significant to income for buildings that are not in their first rent up is the decline in concessions such as free rent and owner paid brokerage commissions. These generally equal one month's free rent or about eight percent of annual rent. Before the market decline in 2008, there were generally no concessions offered except in connection with the rental of new buildings. However, as the market recovers, fewer concessions are being offered and this has resulted in a 4.95% increase in average rent between 2009 and 2010. Coupling this with the 2.8% increase in rental prices for attended buildings results in an overall increase of 7.5% in rental prices.

Time Period	Percentage of Deals Offering Concessions	Average Concession *	Impact on Average Rent
2009	43.06%	2 months	-7.18%
2010	26.88%	1 month	-2.24%
Effective change in rent (2009 – 2010): 4.95%			

* Concession includes one month free rent or Owner Paid broker's fee equal to one month free rent.

Last year many building owners began prohibiting tenant installation of temporary walls that facilitate sharing. This change put downward pressure on demand for one and two bedroom rental units and increased demand for studios. This change will have an ongoing impact on the overall size of units and the mix of units in new rental buildings.

The Effect of Supply on Pricing

2010 saw an average amount of new supply added to the Manhattan rental market.

Time Period	# of Market Rate Units
Average. (1997 – 2009)	3,238
2010 (Actual)	2,803
2011 (Actual YTD)	393
2011 (Projected)	1,714
2012 and later (Projected)	3,069

We have compiled a database of all full service rental buildings in Manhattan. The current total number of buildings is 595 and the total number of units is approximately 119,000. As against this total number of existing units, average annual new supply is too small to affect pricing except where there is concentrated new supply in submarkets. In the future, the development of large rental markets in the outer boroughs and New Jersey will function as additional supply in affecting the Manhattan rental market, but that moment has not yet arrived.

In addition, there has been a constant drain on the supply of rental housing as buildings are converted from rental to condo. Since 2003, when the most recent cycle started up, approximately 5,000 units were converted from rental to condo. Also, in the aftermath of the last cycle, very few condo units converted to rental. In prior cycles that had been the case, but the condo units only stayed in the rental market for a few years. Eventually, planned condo units were sold. A similar motif is played out with individual condo owners who rent for a period of time when the sale cycle is down but eventually sell.

The market has welcomed condo product all over Manhattan, a phenomenon of relatively recent vintage. Over time, that change will drain product from the rental market through conversion and competition for land when the cycle is rising. Lack of construction finance and the use of higher interest rate lending to restart stalled projects have also kept many failed condos in Manhattan from reemerging as rentals. In the outer boroughs, however, where rental prices are rising faster than sale prices, some stalled condos are coming back as rentals.

The Vacancy Factor in the Manhattan Rental Market

A distinct feature of the Manhattan rental market is that it is surrounded by rental markets in the outer boroughs and New Jersey where rental housing is substantially less costly. A large majority of these residents work in Manhattan and choose their residences outside of Manhattan primarily on the basis of price. With one-year lease terms the norm in rentals, substantial demand from the surrounding areas is available for the Manhattan rental market when prices decline as the result of job losses in recessionary periods. Demand from the surrounding areas is a substantial factor buffering declines in the Manhattan rental market.

Any vacancy in the Manhattan rental market is the result of pricing disequilibrium, not lack of demand. Landlords often do not react quickly enough to price drops to eliminate a vacancy. Another form of price disequilibrium causing a vacancy occurs when a resident fails to renew based on an above market renewal offer. Eventually, landlords discover the market price and lease the unit. The time taken in this process is called the vacancy factor. It is not structural, reflecting a lack of demand, and differs from one landlord to another, based on experience and philosophy. By comparison, the office rental market has structural vacancies where loss of jobs and companies and multi-year lease terms create conditions where price cannot easily be adjusted to recognize demand level.

Conclusion

Against the somewhat bleak and stagnant backdrop of the national economy and housing market, Manhattan rebounded in 2010 with about 80,000 new private sector jobs and price increases in both the sale and rental markets. Constraints on new supply in the rental market include the demise of tax benefits, lack of construction finance and competition for land from condominium developments. With the acceleration of job growth in the tech industries, Manhattan seems assured to retain primacy as the place where the world's entrepreneurs and intelligentsia want to be.