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INSIGHTS & INSPIRATIONS

Economic Forecast Event Digs into Urban Myths; Finds a Few Bright Spots
Seven Takeaways

November's star billing went to **Rebecca Rockey** of Cushman & Wakefield and **Marc Norman** of NYU Schack. Rebecca, deputy chief economist and global head of forecasting at the global real estate firm, went beyond the macro to push back on omnipresent headlines while pointing to a few opportunities in one of the world's most gloomy markets. (See Rebecca's presentation here). Sure, a recession is on the horizon, she said. Leading indicators such as a softening economy, credit access and the cost of capital show the way. "Demand is still too strong, and the labor market is too hot," she cautioned. But by slicing and dicing the data, pockets of value emerge, namely in the industrials segment like logistics and data centers, and select retail. Marc, associate dean of NYU's Schack Institute of Real Estate, underscored the importance of policy levers and people movements that will push urban real estate beyond its post-pandemic malaise, as unprecedented work and lifestyle changes settle. Below follow a few of their takeaways:

1. **Things in Manhattan are not as bad as people think**

   Market watchers are wrongly painting a broad strokes doom picture over all of New York City real estate. This *does* apply to a small, concentrated portion of the market, namely class B and C buildings that cannot easily or affordably be converted to residential, Rebecca noted. But, elsewhere, signs of revival include the lowest levels of retail vacancies ever recorded on Third Avenue, and recovering foot traffic in many neighborhoods—though not to pre-pandemic levels.

This suggests the worst is baked in. According to Rebecca, nearly half of the city's 1,400 office buildings have had no change in occupancy since the pandemic while one-third are fully leased. "There is an extreme concentration of weakness," she explained. "106 of those 1,400 buildings South of Central Park have a vacancy rate of 72% which is contributing to a 22% vacancy rate in Manhattan as a whole. If you take out those 106 buildings, there is a 15% vacancy rate. The nuance of the market has never been greater."

2. **Smaller cities are also facing challenges**

   Rebecca singled out Austin, Salt Lake City, Charlotte, Raleigh-Durham and Nashville as cities where different drivers are eroding prior office market gains. "Austin, on average, relative to its size has shed more office space than the U.S. as a whole;" some of the largest vacancy rate increases have been in high-growth secondary markets like those in Sunbelt cities and the Western Mountain region, Rebecca noted.

3. **The Doom loop impact on the economy is overplayed in New York, at least for tax revenues**

   Yes, as in other cities, the 'maturity wall' will lead to ongoing issues with loans reaching maturity, Rebecca noted. A projected $120B in loans due will drive distress in New York City. This will spark a negative wealth effect, starts will stall, and valuations will decline. However, digging into tax revenues shows that those for New York City from real estate are 27% of total revenue. Total local tax revenue is 55% of total revenues, she explained. New York City relies less on Corporate Real Estate (CRE) property taxes than do Washington, D.C., Austin, Atlanta, Dallas, and Boston. "Right now, given the methodology for assessing values, taxable real estate values are about 3% off from 2019," said Rebecca.

4. **Some class B space will be snapped up by small businesses and non-profits, perhaps when prices drop for buildings that can't easily or affordably be converted.**

   "Tech firms took advantage of the soft market and were active lessors of high-quality office during the pandemic," Rebecca said, noting that top tier Class A buildings make up only 15% of New York's market. "Demand for non-top-tier office will take time to recover, but even this segment of the market will see occupancy gains in the future," Rebecca noted.

5. **Among commercial property sectors, industrial will likely soften in the short-term as consumer spending weakens. But current prices reflect value and could be a good bet for investors.** "We're still dealing with the legacy of pandemic largesse correcting. The demand slowdown has consumers reverting back to spending on services," Rebecca explained. Demand for industrial space benefitted from companies building out networks sooner and faster than they otherwise would have—and demand was pulled forward. "We're actually seeing materially lower leasing (compared to the last two years), and it's impacting certain markets with some reporting negative demand." For those with money on the sidelines, Rockey said the industrial sector remains favorable as vacancy rises from obscenely low levels (sub-3%) to still-tight levels (of 6%), which are still consistent with positive rent growth."

6. **Only policy changes and neighborhood movements will help solve housing affordability issues in supply-constrained cities like New York, which has historically led on this front. Will the city step up again?**

   "Zoning policies enacted decades ago for residential and commercial districts hamper conversions that might bring buildings back to life," Rebecca noted, adding that many owners lack resources for their buildings and to modernize systems, especially if current rent regulations cap increases. "If we, as a city are really serious about office conversions and new supply, policy has to make it feasible through bonuses, abatements or subsidies. New York in the past has been a leader; it has the ability to set the example for the rest of the country," she said. For Marc, neighborhood movements have played a larger role in jump-starting conversions than policy in New York City's prior inner-city recoveries. Artists and creatives filled the gap in prior periods of distress in Soho, Williamsburg, DUMBO and Tribeca. "They far outpaced policy changes," he said. But today, bigger, more complex changes are needed due to the scattered nature of unoccupied office buildings and the hefty upgrade costs required. "The 106 buildings targeted for conversion are dispersed throughout Manhattan, and thus very different from those in earlier crises following deindustrialization," Marc explained. The complexities of this recovery may require more neighborhood leadership, he added. "New York is resilient," he said. "But it might not always be top-down. Sometimes it's bottom-up."

7. **Retail's more diversified nature may help drive its recovery.**

   "The e-commerce apocalypse is pretty much over. If you survived it, you are in a pretty good situation," Rebecca said, noting a diversification of retail tenants over the last eight or so years, led by healthcare, fitness/wellness, restaurants and several other categories. "That diversification is really important because it creates resilience across the sector. Retail was also the least overpriced in the recent ultra-low interest rate environment. Even next year, we're expecting quite a bit of resilience in retail."

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