TO: Terence Cho
FROM: BJH Advisors
DATE: November 1, 2021
SUBJECT: Office and Hotel Market Prospects – Penn Station/Manhattan

As the planned Penn Station redevelopment advances through the approval process, questions may be raised by decision makers, local elected officials, or the media about the demand for, and economics of, new office and hotel product in Manhattan generally and the Penn Station area more specifically. This memorandum briefly summarizes the findings of a highly relevant recent study, along with providing some select additional indicators for the office and hotel markets (retail can be evaluated should that be of interest).

The City's Hudson Yards Infrastructure Corporation (HYIC) recently closed on about $450 million in new debt to refinance a portion of its existing debt, and the offering contemplated future issuances to fund additional public improvements in the area, primarily the second phase of Bella Abzug Park. The HYIC debt is backed by real estate tax and related revenues from a defined geography comprising 45 city blocks, the Hudson Yards Financing District (HYFD), that includes the Penn Station and Moynihan Station superblocks and the area immediately to the west of the Penn Station area. As part of the financing package, Cushman & Wakefield, Inc. (C&W) performed a new development and real estate study, which directly addressed questions about the future demand for, and viability of, new office and hotel development. The study found that notwithstanding the severe effects of the COVID-19 pandemic and resultant economic crisis, the office market in this area held up well, and is likely to thrive and attract new development in the near and medium term. Similarly, the study opined that the hotel market, which was much more negatively impacted, will return to health over the next few years.

Office Market

- Prior to COVID-19, the Manhattan office market was performing strongly. Office-using employment increased by 19,100 in 2019 and new office construction totaled 4.7 MSF of completions in 2018 and 5.8 MSF in 2019. A significant portion of this office construction was located in the Hudson Yards/Penn Station area (Manhattan West is located both in the HYFD and the Penn Station office submarket). Since the rezoning of Hudson Yards in 2005, nearly 17.8 MSF of office space has been completed or is nearing construction completion within the HYFD.

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- The economic and real estate impacts of the COVID-19 pandemic on the Manhattan office market are assumed to be temporary. **The C&W report concludes that corporations and other highly productive employers may level off at a 5 - 10% decline in workers physically present within offices in comparison to pre-pandemic levels, but such losses will be offset by increased space standards and office-using employment growth in the long term.**

- Positive signs include surging office tenant tour activity (C&W), and a dramatic increase in the number of tenants in the market, with 397 tenants looking for 24.2 MSF of space, which is greater than the pre-COVID-19 peak in 2019/2020 (Newmark Q3 Manhattan Office Report).

- Other positive indicators are the continued development of new office properties post-COVID-19, including JPMorgan Chase's new headquarters at 270 Park Avenue (2.5 MSF), Disney's East Coast headquarters at 4 Hudson Square (1.2 MSF), and Google's purchase upon completion of the totally redeveloped and expanded St. John's Terminal/550 Washington Street (1.7 MSF) in September 2021.

- The office market in Hudson Yards has fared quite well in comparison to that of Manhattan at large. Asking rents in 2021 for Class A space in Hudson Yards range from $105-$200/SF which is 27% greater than asking rents in Midtown. Comparatively, asking rents in the Hudson Yards area averaged at $80/SF in 2011. This corresponds to a 4.01% increase annually.

- The desirability of Hudson Yards office spaces can be linked to flight to quality (Class A and trophy assets) amongst companies. Class A and trophy office spaces have lower vacancy than Class B and C buildings in part due to stronger and more financially resilient tenant rosters. Work from home / work remotely policies are likely to affect absorption primarily in Class B and C buildings in the long term, which may lead to increased conversion of this stock to other uses.

- Other factors of desirability include Hudson Yards' proximity to transportation, entertainment, dining options, cultural amenities (the High Line Park, Shed, West Chelsea arts district), and LEED certified and green office buildings. These factors will likely apply to the Penn Station redevelopment with its even stronger mass transportation access and entertainment assets. The Penn Station office market is already benefiting from having the thriving Hudson Yards commercial and residential district to its immediate west.

Hotel Market

- Prior to COVID-19, tourism in New York City was one of its most important sectors. In 2019, the City boasted 66.9 million visitors in comparison to 22.3 million in 2020. The pandemic has thus greatly impacted the demand for and success of hospitality services in the city. The GOPAR (gross operating profit divided by available hotel rooms) in NYC fell by 203% in March 2020 with respect to 2019, and occupancies fell to an all-time low of 28.5%.

- Many hotels closed due to negative cash flow during the pandemic and the C&W report held that experts estimate that it will not be feasible for 20-30% of offline hotels to resume service.

- Hotels within the HYFD, which comprise about 8,500 keys developed since the rezoning in 2005, have fared better than the hotel market of NYC. **The C&W report states that new hotels within Hudson Yards maintain occupancies within the 90 - 95% of capacity range, solidly ahead of the Manhattan hotel market at large at 52% (2Q 2021)**. New hotels planned within the Penn Station area would benefit from its superior transportation network and entertainment assets.

- The NYC visitor's bureau anticipates that domestic travel rates will return to pre-pandemic levels by 2023, but that corporate travel will take longer to recuperate. Per the C&W report the hospitality industry has reported talent sourcing issues leading to a shortage of workers. Until hotel profitability recovers and wage growth increases, this could be a challenge for years to come. Meanwhile, hotels are incorporating new strategies to reduce operating costs while maintaining quality of service by leveraging contactless services.

- The C&W report also notes that the City's Hotel Special Permit zoning amendment that is in the final stage of ULURP, if passed, will likely restrict new hotel supply, which may over time lend support for hotel construction in projects like the Penn Station redevelopment that would not be subject to the Special Permit.