NATIONAL ASSOCIATION OF REALTORS® | RESEARCH DIVISION

AUGUST 2013

COMMERCIAL REAL ESTATE OUTLOOK

ECONOMIC OVERVIEW

Growing Economy Boosts Commercial Sales 24 Percent in 2013.H1

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As the traditional summer vacation season wrapped up, it became easier to focus on the economic performance over the first half of the year. However, the task became an exercise in reading fortune cookies given the many changes in the economy, the markets, and the legislative environment.

The main measure of economic activity—gross domestic product—has been redefined and revised by the Bureau of Economic Analysis during the second quarter. It has been redefined to include business investments in intellectual property, such as research & development, software, and entertainment and original artistic work. GDP has also been revised, as it normally is at regular intervals.

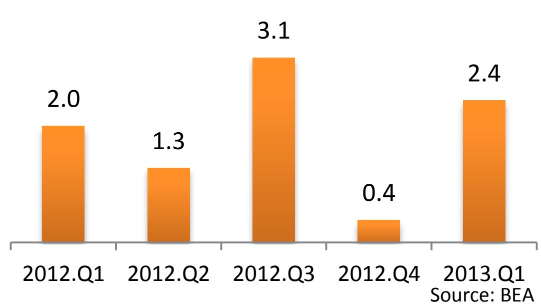
The results point to an economy that nominally is much stronger than it was a quarter ago, by almost $2.0 trillion. At the same time, the revised annual rate of growth for first quarter GDP dropped from 2.7 to 1.2 percent. However, the estimate for the second quarter growth rate is 1.7 percent, indicating an accelerating economy. Of course, given the pace of acceleration, we should not expect any whiplash, as there is no hurry in the macro advance.

After GDP revisions, business spending shows growing confidence in the first half of the year. The first quarter spending was down 4.6 percent, with a decline driven by a 25.7 percent drop in spending on commercial structures.

However, the second quarter posted a much better performance, with an annual growth rate of 4.6 percent. Spending on commercial buildings rose 6.8 percent. Businesses also increased their spending on information processing and transportation equipment by 11.4 percent and 5.5 percent, respectively. The new component of business spending—intellectual property products—rose 3.9 percent in the second quarter, boosted by software and R&D.

Despite slowing global economies, international trade remained brisk. Exports rose 5.4 percent in the second quarter, after a 1.3 percent decline in the first quarter. Imports increased 9.5 percent in the second quarter, leading to a widening balance of trade.

GDP (% Annual Chg.)



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ECONOMIC OVERVIEW

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The looming costs and uncertainty of the coming Patient Protection and Affordable Care Act are certainly keeping businesses cautious. Business savings—cash in reserves—reached a record $3.5 trillion in the first quarter, as corporate real profits after tax posted $1.7 trillion in the first quarter. Businesses continue to stockpile cash reserves as a hedge against uncertainty and increased costs.

That uncertainty is also illustrated in the employment numbers. Payroll employment in the second quarter gained 563,000 jobs, a lower figure than the first quarter's 622,000. July's employment figure of 162,000 disappointed expectations and indicated a slowdown in hiring during the first month of the third quarter. On the flip side, employment remained positive and the economy is making progress toward closing the post-recession gap. The unemployment rate declined from 7.7 percent in the first quarter to 7.6 percent in the second, and then to 7.4 in July. However, part of the decline is attributable to a lowering of the labor force participation rate.

Consumers maintained a moderate spending pace, although at a weaker rate of growth in the second quarter—1.8 percent compared with 2.3 percent in the first quarter. The cutbacks came in several areas—motor vehicles and parts, housing and utilities, and food services and accommodations. However, consumers upped their spending for furnishings, recreation and recreational goods, transportation and health care. Interestingly, consumer spending on recreational vehicles and goods rose at a 12.3 percent annual rate, signaling renewed interest in leisure travel.

Government spending—another major component of GDP—shrank 0.4 percent in the second quarter, as the "sequestration" took effect. At the federal level, spending declined 1.5 percent. Following three years of cuts, spending at the state and local levels is showing signs of stabilization, posting a 0.3 percent increase in the second quarter.

The outlook for the remainder of 2013 is for GDP to grow at a 1.6 percent annual rate. Payroll employment is expected to rise 1.5 percent, leading to a net 2.4 million new jobs for the year.

Commercial Real Estate

Sales of major properties (over $2M) advanced 24 percent on a yearly basis during the first half of this year, totaling $145.3 billion, based on Real Capital Analytics (RCA) data. Most property types registered double-digit growth rates, signaling strong investor interest in commercial assets. Based on National Association of REALTORS® data, sales of properties at the lower end of the price range (mostly below $2 million) increased 12 percent on a yearly basis.

Portfolio sales made up a significant part of transactions in the first half of the year, with Archstone's sale of apartment properties accounting for over $14 billion of the total. Hotels were another major component of the top portfolio transactions. On the individual property side, the General Motors building in New York ranked at the top, selling for $1.3 billion, at $1,766 per square foot. Office properties made up the top three, with Sony Plaza and 425 Lexington Avenue, both in New York, coming in second and third place.

In line with growing demand for properties, prices rose 8 percent on a yearly basis, according to RCA's Commercial Property Price Index. Prices rose the most for apartments (15%) and retail buildings (13%). The average apartment unit price reached $108.347. Retail spaces commanded $166 per square foot. Office buildings traded for an average of $212 per square foot, up 7 percent year-over-year. Industrial properties posted average prices of $63 per square foot, a 5 percent decline from a year ago. Cap rates inched up 17 basis points, to an average 7 percent nationally across all property types. For lower priced properties (below $2M), prices increased 2 percent year-over-year, based on survey data from the National Association of REALTORS®.

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ECONOMIC OVERVIEW AND FORECAST

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Investor interest in secondary and tertiary markets continued in the first half of the year. Markets like Jacksonville, Long Island, Philadelphia, Las Vegas posted triple-digit growth rates in sales volume. By the year's midpoint, 31 markets exceeded the $1 billion mark. In terms of dollar volume, Manhattan, Los Angeles and DC's Northern Virginia suburbs rank at the top of the list. However, Dallas and Houston move in the top five, surpassing Atlanta, Chicago and Boston.

Distressed properties accounted for $118 billion across all property types, with office making up $36.5 billion of the total. The workout rates have been steadily climbing, reaching 66% in the first half of the year. Apartments and hotels recorded the highest workout rates, at 68% and 67%, respectively.

New commercial distress is on a downward trend, as asset values continue to rise. CMBS continues to hold the largest proportion of outstanding distress—45%. U.S. banks are the second largest holder of distressed properties, accounting for 25%.

Several markets stand out for their rates of distress workouts. Las Vegas retains the top spot in terms of total current outstanding distress--$11.4 billion. Its workout rate is 43%, a fairly low figure. Manhattan posted the second highest current outstanding distress volume, totaling $8.4 billion. However, its workout rate reached 77% in the first half of the year. Other markets with high distress workout rates were DC (82), San Francisco (87%), Pittsburgh (79%) and San Jose (76%).

U.S. Economic Outlook: August 2013

	2011	2012	2013	2014
Annual Growth Rate, %				
Real GDP	1.8	2.1	1.6	2.6
Nonfarm Payroll Employment	1.2	1.4	1.5	1.7
Consumer Prices	3.1	2.1	2.0	3.3
Level				
Consumer Confidence	58	69	73	82
Percent				
Unemployment	8.9	8.1	7.6	7.1
Fed Funds Rate	0.1	0.1	0.1	0.1
3-Month T-bill Rate	0.1	0.1	0.1	0.2
Corporate Aaa Bond Yield	4.6	3.7	4.3	5.0
10-Year Gov't Bond	2.8	1.8	2.4	3.1
30-Year Gov't Bond	3.9	2.9	3.5	4.2

Source: National Association of REALTORS®

NCREIF PROPERTY INDEX RETURNS – 2013.Q2

NATIONAL	2.87%
OFFICE	2.84%
INDUSTRIAL	3.22%
RETAIL	3.21%
APARTMENT	2.50%

Source: National Council of Real Estate Investment Fiduciaries

COMMERCIAL FORECAST

OFFICE	2013 III	2013 IV	2014 I	2014 II	2014 III	2014 IV	2015 I	2013	2014
Vacancy Rate	15.7%	15.6%	15.8%	15.7%	15.5%	15.4%	15.6%	15.7%	15.4%
Net Absorption ('000 sq. ft.)	9,918	8,983	12,256	9,374	10,846	9,098	15,523	30,054	41,575
Completions ('000 sq. ft.)	9,094	7,016	8,573	8,638	7,160	6,524	11,590	25,984	30,894
Inventory ('000,000 sq. ft.)	4,102	4,109	4,118	4,126	4,134	4,140	4,152	4,109	4,140
Rent Growth	0.6%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	2.5%	2.8%

INDUSTRIAL	2013 III	2013 IV	2014 I	2014 II	2014 III	2014 IV	2015 I	2013	2014
Vacancy Rate	9.3%	9.2%	9.0%	8.9%	8.7%	8.6%	8.6%	9.3%	8.8%
Net Absorption ('000 sq. ft.)	26,523	23,463	21,168	19,051	33,868	31,752	21,810	102,013	105,839
Completions ('000 sq. ft.)	9,870	9,392	19,239	20,465	13,372	12,725	20,134	48,568	65,801
Inventory ('000,000 sq. ft.)	8,424	8,433	8,452	8,473	8,486	8,499	8,519	8,433	8,499
Rent Growth	0.6%	0.6%	0.7%	0.6%	0.7%	0.7%	0.6%	2.4%	2.6%

RETAIL	2013 III	2013 IV	2014 I	2014 II	2014 III	2014 IV	2015 I	2013	2014
Vacancy Rate	10.6%	10.4%	10.3%	10.2%	10.0%	9.9%	10.0%	10.5%	10.1%
Net Absorption ('000 sq. ft.)	2,955	3,419	4,175	4,357	4,175	5,446	4,164	11,819	18,154
Completions ('000 sq. ft.)	2,654	1,928	3,510	3,033	3,407	3,479	4,619	6,636	13,429
Inventory ('000,000 sq. ft.)	2,033	2,034	2,035	2,038	2,042	2,045	2,050	2,034	2,045
Rent Growth	0.4%	0.5%	0.5%	0.5%	0.6%	0.7%	0.5%	1.5%	2.3%

MULTI-FAMILY	2013 III	2013 IV	2014 I	2014 II	2014 III	2014 IV	2015 I	2013	2014
Vacancy Rate	3.9%	3.9%	4.0%	4.0%	4.0%	4.0%	4.1%	4.1%	4.0%
Net Absorption (Units)	75,996	79,365	58,363	60,561	69,355	71,553	38,255	266,654	259,833
Completions (Units)	46,943	43,092	36,209	45,992	41,999	44,568	26,166	141,197	168,768
Inventory (Units in millions)	10.0	10.0	10.1	10.1	10.2	10.2	10.3	10.0	10.2
Rent Growth	1.5%	1.4%	1.0%	1.1%	1.0%	1.0%	0.9%	4.2%	4.1%

Source: National Association of REALTORS® / Reis, Inc.

COMMERCIAL FORECAST: METRO VACANCY RATES - 2013.Q3

Source: NAR, Reis, Inc.

		Office	Industrial	Retail	Multifamily
Albuquerque	NM	18.0	14.2	11.9	4.0
Atlanta	GA	20.1	11.9	13.9	6.2
Austin	TX	16.7	12.5	6.6	4.1
Baltimore	MD	16.8		6.8	3.4
Birmingham	AL	12.4		14.9	5.4
Boston	MA	14.0	18.7	6.7	3.4
Buffalo	NY	14.8		13.1	2.6
Central New Jersey	NJ	21.7		9.9	2.6
Charleston	SC	16.0		11.0	4.4
Charlotte	NC	17.4	12.9	9.7	5.0
Chattanooga	TN	15.9		15.3	3.4
Chicago	IL	18.3	9.3	10.9	3.4
Cincinnati	OH	20.4	8.5	13.2	3.4
Cleveland	OH	22.4	8.8	15.3	3.1
Colorado Springs	CO	19.9		16.2	3.8
Columbia	SC	17.8		10.8	6.3
Columbus	OH	18.1	9.1	15.6	4.6
Dallas	TX	22.9	12.7	13.4	5.1
Dayton	OH	26.4		16.2	5.3
Denver	CO	17.3	8.3	11.5	3.7
Detroit	MI	26.0	11.9	11.8	3.7
District of Columbia	DC	9.7			3.9
Fairfield County	CT	21.5		4.1	4.2
Fort Lauderdale	FL	19.7	9.3	10.6	3.7
Fort Worth	TX	16.6	11.0	11.7	5.0
Greensboro/Winston-Salem	NC	21.0		11.5	6.1
Greenville	SC	19.5		13.7	4.4
Hartford	CT	21.1		9.5	2.6
Houston	TX	14.2	8.0	11.7	6.5
Indianapolis	IN	19.5	9.7	15.1	5.3
Jacksonville	FL	19.8	8.3	13.5	6.4
Kansas City	MO	17.6	10.3	11.0	4.3
Knoxville	TN	15.3		10.7	4.7
Las Vegas	NV	25.6		12.6	5.2
Lexington	KY	15.0		8.7	5.1
Little Rock	AR	12.1		13.0	6.5
Long Island	NY	13.8		5.0	3.2

COMMERCIAL FORECAST: METRO VACANCY RATES - 2013.Q3

Source: NAR, Reis, Inc.

		Office	Industrial	Retail	Multifamily
Los Angeles	CA	16.0	4.0	6.0	3.0
Louisville	KY	15.1		9.7	4.7
Memphis	TN	24.0	15.0	12.3	7.8
Miami	FL	16.5	5.9	7.2	3.8
Milwaukee	WI	18.6		12.6	3.0
Minneapolis	MN	17.1	7.7	10.8	2.2
Nashville	TN	12.6	8.4	8.4	4.1
New Haven	CT	17.2		12.3	1.9
New Orleans	LA	13.0		11.4	6.0
New York	NY	9.8			2.1
Norfolk/Hampton Roads	VA	15.1		9.9	3.9
Northern New Jersey	NJ	19.0		5.7	3.5
Oakland-East Bay	CA	18.0	9.2	6.4	2.5
Oklahoma City	OK	16.5		13.8	5.3
Omaha	NE	16.1		9.2	2.9
Orange County	CA	17.0	3.8	5.4	2.9
Orlando	FL	18.5	11.6	12.8	5.0
Palm Beach	FL	18.8	6.9	11.8	4.9
Philadelphia	PA	13.8	10.4	9.2	3.4
Phoenix	AZ	25.7	11.2	10.9	5.3
Pittsburgh	PA	15.9	9.4	7.9	2.9
Portland	OR	14.0	8.1	8.2	2.8
Providence	RI	16.0		12.8	2.8
Raleigh-Durham	NC	14.7	15.8	9.1	4.1
Richmond	VA	14.7	14.7	9.7	4.5
Rochester	NY	16.5		12.3	2.8
Sacramento	CA	21.2	12.6	12.9	3.1
Salt Lake City	UT	17.1		12.5	3.6
San Antonio	TX	18.2	7.6	11.5	5.9
San Bernardino/Riverside	CA	23.6	6.9	9.8	3.2
San Diego	CA	16.0	7.0	6.3	2.1
San Francisco	CA	13.3	11.2	3.9	3.1
San Jose	CA	18.6	16.6	6.1	3.0
Seattle	WA	13.9	6.4	6.8	4.0
St. Louis	MO	18.3	6.8	12.4	4.8

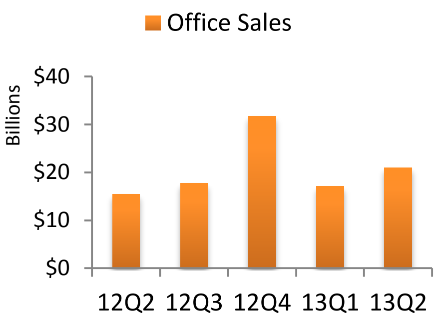
COMMERCIAL FORECAST: METRO VACANCY RATES - 2013.Q3

Source: NAR, Reis, Inc.		Office	Industrial	Retail	Multifamily
Suburban Maryland	MD	14.9	10.8	9.2	3.7
Suburban Virginia	VA	17.1	10.4	6.3	2.9
Syracuse	NY	15.5		14.7	2.0
Tacoma	WA	17.2		11.6	3.8
Tampa-St. Petersburg	FL	21.6	8.0	11.9	4.3
Tucson	AZ	15.5		9.4	4.9
Tulsa	OK	16.7		16.6	5.7
Ventura County	CA	16.3		8.8	2.6
Westchester	NY	19.1		8.3	2.6
Wichita	KS	16.8		12.4	3.9

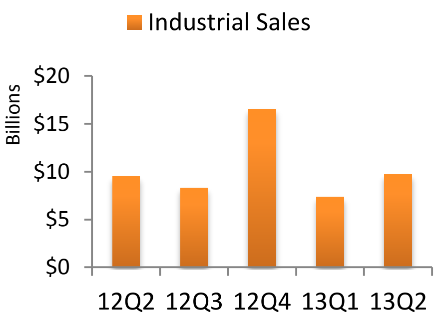
AUGUST

2013

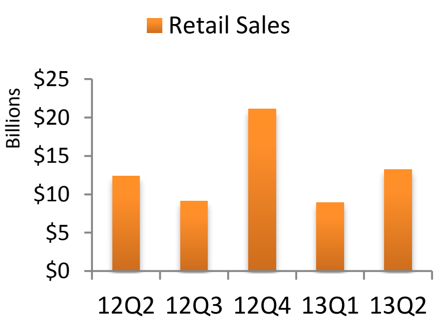
INVESTMENT TRENDS AT A GLANCE



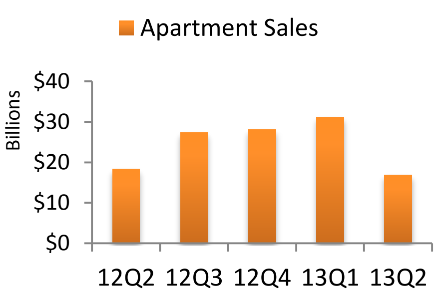
OFFICE		
Region	Average Cap Rate	Average Price ($/Sq. Ft.)
Mid-Atlantic	7.0%	$243
Midwest	7.7%	$136
Northeast	6.3%	$320
Southeast	8.1%	$149
Southwest	7.1%	$189
West	6.5%	$272



INDUSTRIAL		
Region	Average Cap Rate	Average Price ($/Sq. Ft.)
Mid-Atlantic	8.1%	$58
Midwest	8.6%	$34
Northeast	7.1%	$81
Southeast	8.1%	$50
Southwest	7.5%	$74
West	6.7%	$98



RETAIL		
Region	Average Cap Rate	Average Price ($/Sq. Ft.)
Mid-Atlantic	7.3%	$154
Midwest	7.3%	$126
Northeast	6.7%	$257
Southeast	7.6%	$146
Southwest	7.3%	$149
West	6.7%	$224



MULTI-FAMILY		
Region	Average Cap Rate	Average Price ($/Unit)
Mid-Atlantic	7.2%	$132,996
Midwest	7.3%	$77,523
Northeast	5.4%	$201,320
Southeast	7.3%	$73,813
Southwest	7.0%	$87,915
West	5.6%	$145,550

Note: Data as of 7/24/2013
Source: Real Capital Analytics

REALTOR® RESEARCH

The Research Division of the National Association of REALTORS® monitors and analyzes monthly and quarterly economic indicators, including retail sales, industrial production, producer price index, gross domestic product and employment data which impact commercial markets over time. In addition, the Research Division provides several products covering commercial real estate:

- Commercial Real Estate Quarterly Market Survey
- Commercial Real Estate Lending Survey
- Commercial Member Profile

If you have questions or comments regarding this report or any other commercial real estate research, please contact George Ratiu, Manager, Quantitative & Commercial Research, at gratiu@realtors.org.

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