COMMERCIAL REAL ESTATE TRENDS & OUTLOOK 2019.Q2

National Association of REALTORS® Research Group

COMMERCIAL Real Estate
REALTOR®
NATIONAL ASSOCIATION of REALTORS®

COMMERCIAL REAL ESTATE TRENDS & OUTLOOK 2019.Q2
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Download report at: https://www.nar.realtor/commercial-real-estate-market-survey

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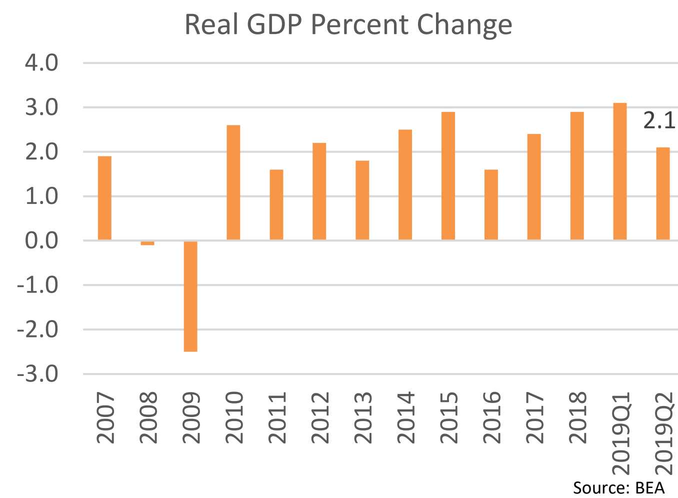
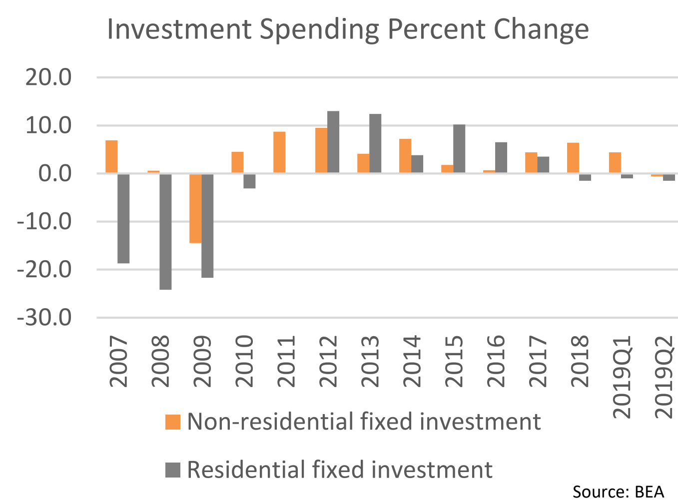
1 | ECONOMIC CONDITIONS

Economic Growth Slowed in 2019 Q2

The economy expanded at a slower pace of 2.1 percent in 2019 Q2, breaking the pattern of accelerating growth since 2016. Amid the tariffs imposed by both the United States and China and the threat of further tariff increases, gross domestic private investment contracted by 5.5 percent while exports decreased by 5.2 percent. Non-residential investment spending contracted by 0.6 percent while residential investment spending slid by 1.6 percent.

On the bright side, personal consumption spending surged to 4.3 percent as consumers increased their spending across broad consumer goods, with the strongest increases in gasoline, fuel, and other energy goods (38.5 percent), motor vehicles and parts (16.4 percent), financial services and insurance (8.9 percent), recreational goods and vehicles (8.5 percent), other durable goods (8.9 percent), and food services & accommodations (8.5 percent). Government spending also rose by 5 percent on account of higher spending at the federal level (7.9 percent) and state and local level (3.2 percent).

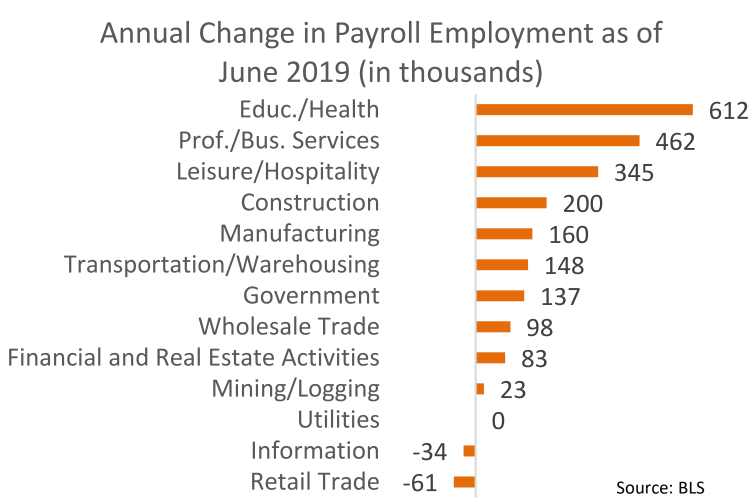




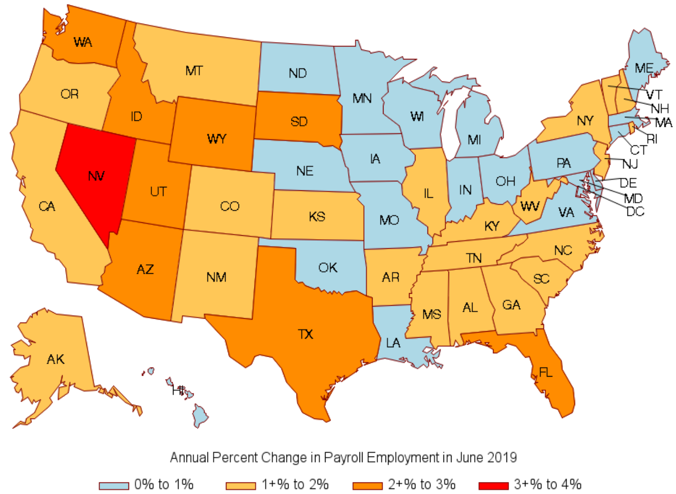
2.3 M Annual Payroll Job Gains in June 2019

Job growth remains strong at over 2 million annually, although job creation has slowed somewhat with fewer workers looking for work, at 3.7 percent of the labor force.

As of June 2019, there were 2.25 million payroll jobs added from one year ago. Although this is a strong pace, this is lower than the 2.48 million annual jobs created in June 2018. Payroll employment increased in all sectors, except for retail trade, information services, and utilities. The strongest job gains were in the education and health, professional and business services, and leisure & hospitality industries.



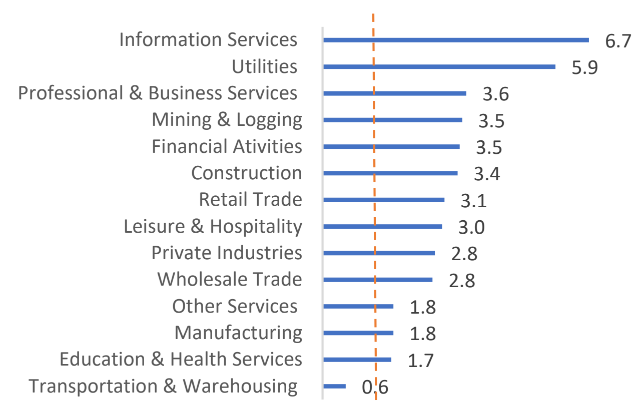
States in the South and West posted the highest annual job gains as of June 2019, led by Nevada (3.4%), Utah (3.0%), Arizona (2.8%), South Dakota (2.7%), Florida (2.6%), Washington (2.6%), Texas (2.5%), Idaho (2.4%), Wyoming (2.3%), and Colorado (2.0%).



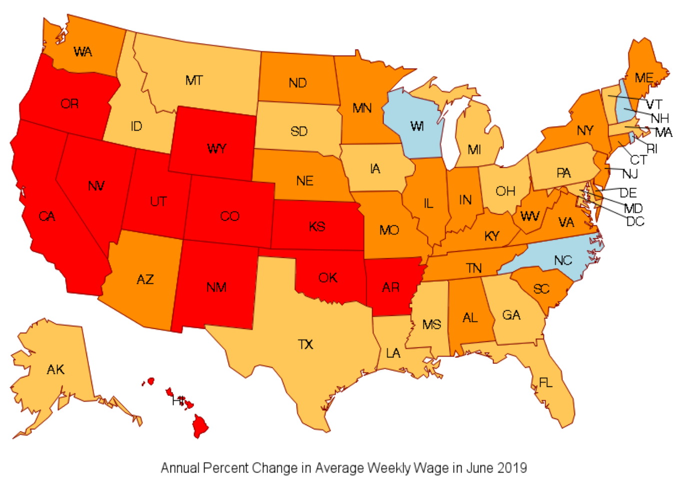
Annual Percent Change in Payroll Employment in June 2019

Average weekly wages among those employed in private industry rose by 2.8 percent, a real gain given the inflation rate of 1.6 percent. Average weekly wages rose in real terms in all industries (2-digit NAICS level) except in transportation and warehousing.

Y/Y Increase in Average Weekly Wage in June 2019 vs. Inflation Rate



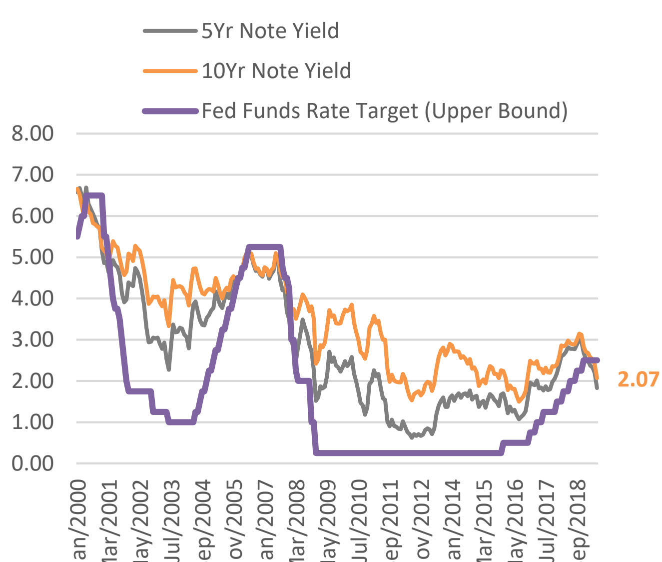
Nominal wages rose in all states led by Washington, DC (14.0%), Wyoming (8.7%), Nevada (8.2%), Utah (8.1%), Kansas (8.0%), Arkansas (7.4%), California (7.3%), Colorado (6.7%), Oklahoma (6.7%), New Mexico (6.2%), and Oregon (6.2%).



Annual Percent Change in Average Weekly Wage in June 2019

Interest Rates Have Trended Down

Interest rates have trended down in 2019 as the Federal Operations Market Committee held off any increase in the fed funds rate in 2019. The yield curve remains inverted for the 1-year and 5-year note: as of June 2019, the 5-year Treasury Note yield was 1.83 percent while the 1-year Note yield was 2.0 percent.



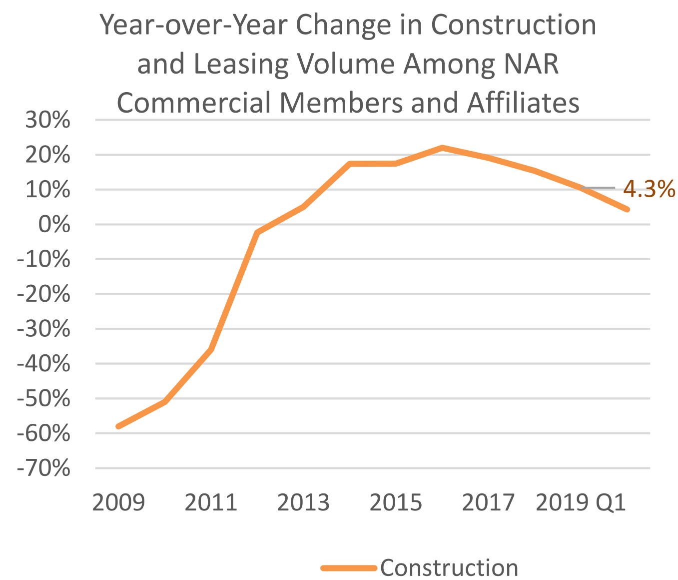
2 | COMMERCIAL CONSTRUCTION

Construction Activity Tapers

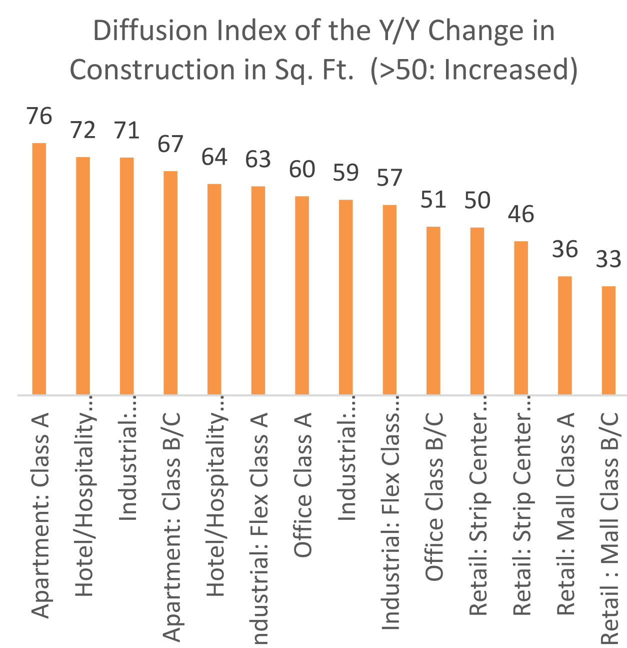
According to NAR's *2019 Q2 Commercial Real Estate Quarterly Market Survey* of commercial REALTOR® members and affiliate organizations, construction increased on average by about four percent in 2019 Q2 from one year ago. The pace of construction activity peaked in 2016 and has tapered since then.

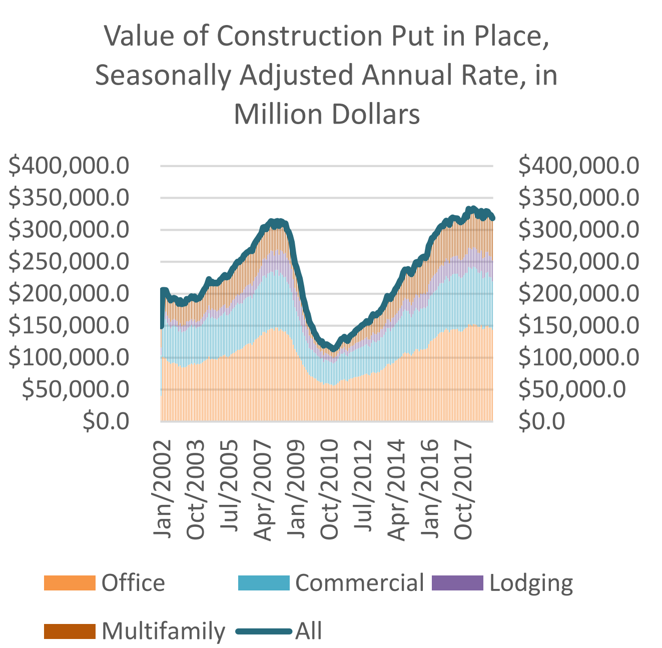
By property type, respondents reported the strongest annual increase in 2019 Q2 in the Class A apartment properties, Class A hotels/hospitality, and industrial warehouse properties. Respondents reported a decline in construction activity for retail strip center Class B/C and retail malls.

The U.S. Census Bureau reported that the seasonalized annual value of construction put in place for office, commercial, lodging, and multifamily structures totaled $318.5 billion in May 2019, a five percent decline from one year ago. By type of structure, lodging and multi-family construction rose while office and commercial structures construction decreased.



Source: National Association of Realtors®





Annual Value of Construction Put in Place, SAAR, May 2019			
	May-18	May-19	% Change
Office	$152,744	$143,597	-6.0%
Commercial*	$89,654.0	$75,886.0	-15.4%
Lodging	$30,535	$32,680	7.0%
Multifamily	$60,682	$66,332	9.3%
Total	$333,615	$318,495	-4.5%
Source: U.S. Census Bureau			

*Commercial includes retail, wholesale and selected service industries.

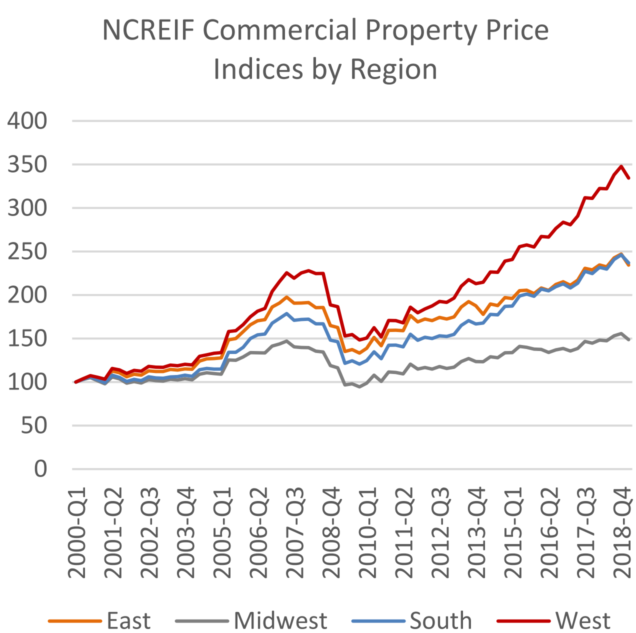
3 | COMMERCIAL SALES

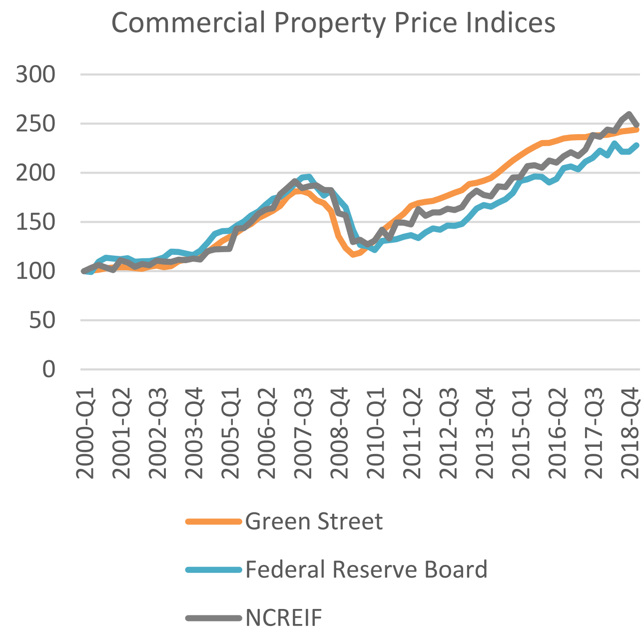
Commercial Property Prices Still Trending Up But at Modest Pace

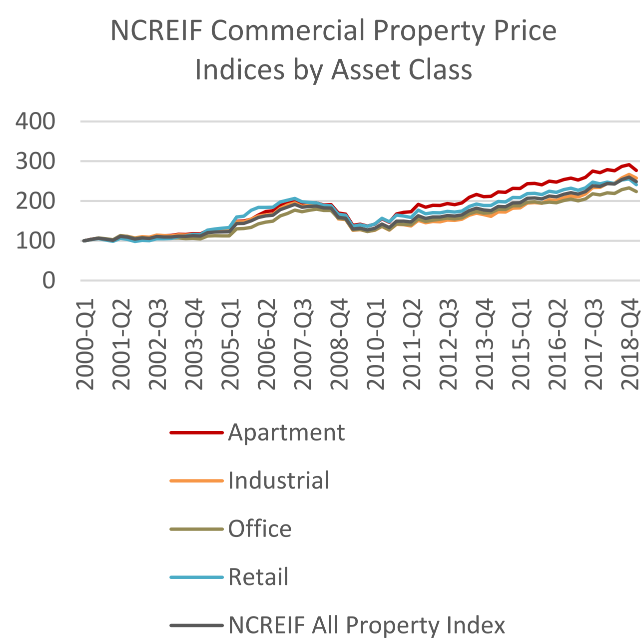
Commercial property prices are still broadly trending upwards, although at a modest pace. As of 2019Q1, the National Council of Real Estate Investment Fiduciaries (NCREIF) Index and the Green Street Advisors Price Index were up by two percent from one year ago, while the NCREIF Index was up by four percent.

Based on the NCREIF transactions-based price indices, sales prices have increased the most in the apartment sector, followed by the industrial sector. However, in 2019 Q1, prices rose at the fastest pace for industrial assets, with an annual price growth of six percent (apartment, -1 percent; office,1 percent; retail, - 3 percent).

By region, the West region has experienced the steepest price increase, followed by the East and South regions, and lastly the Midwest region. In 2019 Q1, the West had the strongest price gain from a year ago, at four percent (South, 2 percent; East, -0.1 percent; Midwest, 0.3 percent).







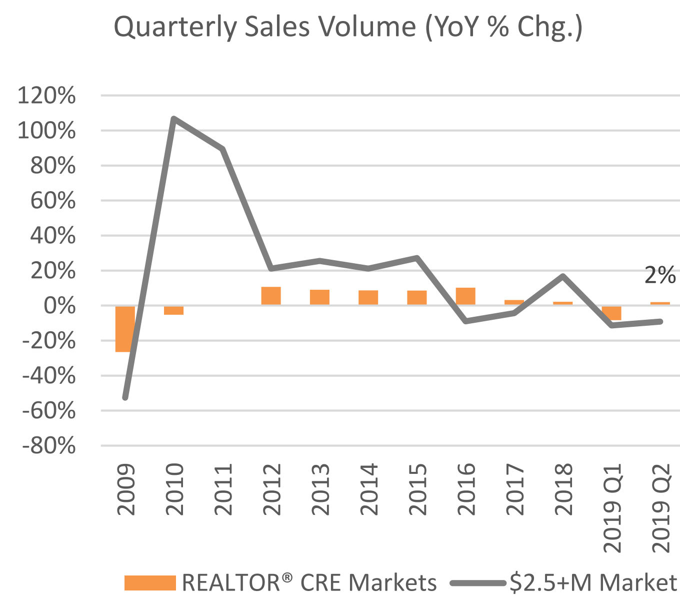
3 | COMMERCIAL SALES

Commercial Sales Growth Tapers

In the small commercial real estate market (typically below $2.5 million), total sales volume in 2019 Q2 rose at a modest pace of two percent compared to one year ago, according to NAR's *2019 Q2 Commercial Real Estate Quarterly Market Survey* of commercial REALTOR® members and affiliate organizations. Sales growth has moderated since 2017 compared to the almost 10 percent growth per year since 2012 through 2016.

By asset class, sales activity was most robust in the industrial warehouse and apartment markets, based on the diffusion indices for these markets. An index above 50 means sales activity broadly increased in these markets. Only the retail asset class registered values below 50, with the lowest values for retail mall properties.

In the large capital market tracked by Real Capital Analytics ($2.5 million and above), dollar sales volume decreased to $67.6 billion during April – May 2019 from $74.5 billion one year ago, a 9 percent decline.

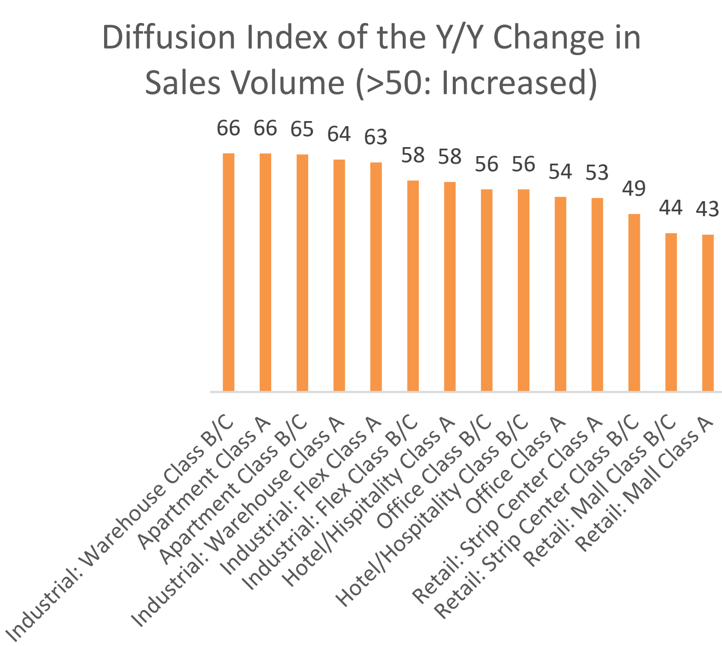


Sources: National Association of REALTORS®, Real Capital Analytics

Commercial sales transactions at the higher end—$2.5 million and above—comprise a large share of investment sales.

Most REALTORS®' are active in serving smaller markets with sale transactions of less than $2.5 million; in the 2019 Q1 survey, the average sales transaction was $1.2 million. These smaller properties (e.g. neighborhood shopping centers, warehouses, small offices, supermarkets, etc.) make possible the conduct of daily economic activity and comprise a larger fraction of total commercial buildings (according the Energy Information Administration 2012 Commercial Buildings Energy Consumption Survey, properties 10,000 square feet or less in size make up 72 percent of all commercial buildings).

Given the different yet equally important roles of both large and small commercial buildings in providing the space where people live, work, and play, this report discusses trends in both markets.

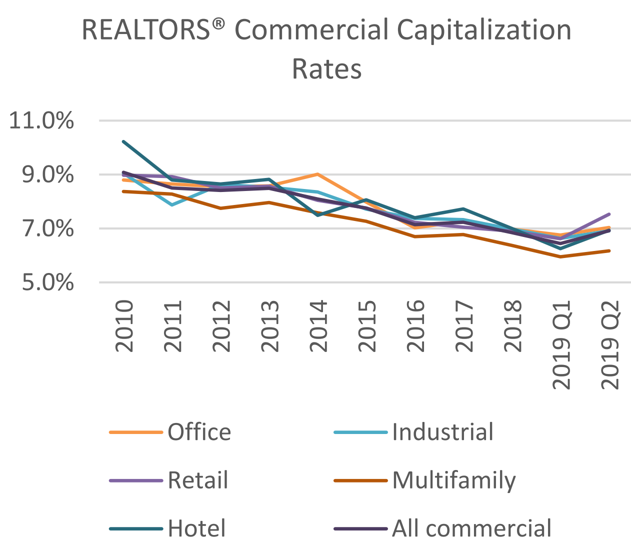


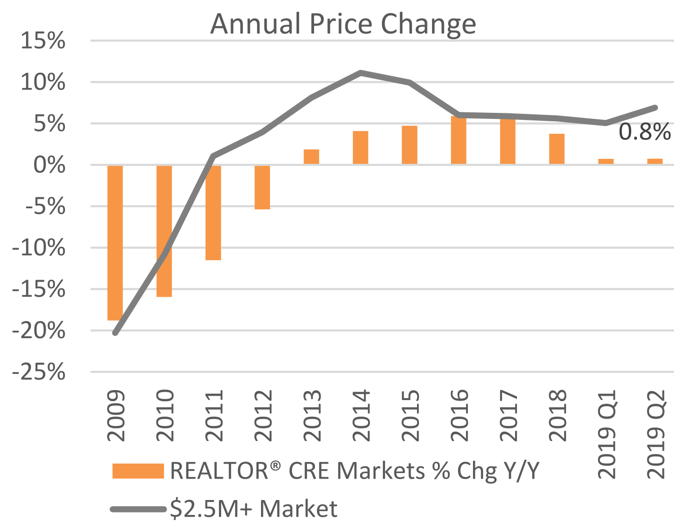
3 | COMMERCIAL SALES

Apartment and Industrial Assets Still Most Favored Assets

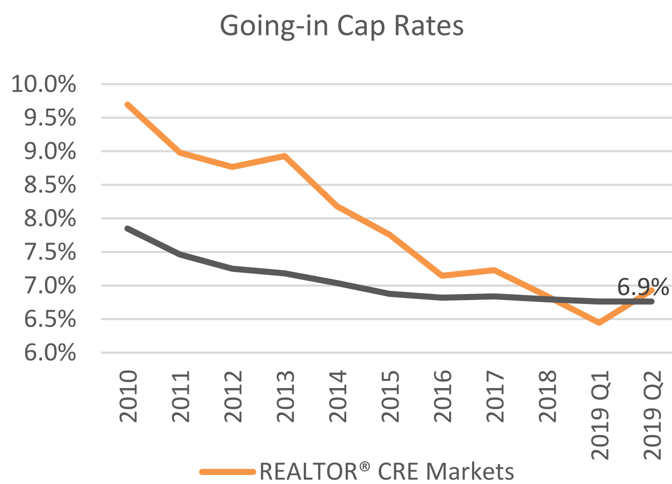
In the small CRE market (less than $2.5M per transaction), REALTORS® reported that on average, commercial sales prices rose by one percent in 2019 Q2 from year-ago levels. Prices rose at stronger pace in the $2.5M+ market tracked by Real Capital Analytics, at nearly seven percent during April–May 2019 from one year ago.

In 2019 Q2, the average going-in cap rates among survey respondents rose slightly to 6.9 percent, with higher cap rates for all asset classes. Cap rates in the small CRE market are about the same as the 6.8 percent cap rate in the $2.5+M market reported by Real Capital Analytics. The apartment asset class had the lowest cap rate at 6.2 percent, followed by industrial warehouse at 6.8 percent.





Source: National Association of REALTORS®, Real Capital Analytics



Source: National Association of REALTORS®, Real Capital Analytics

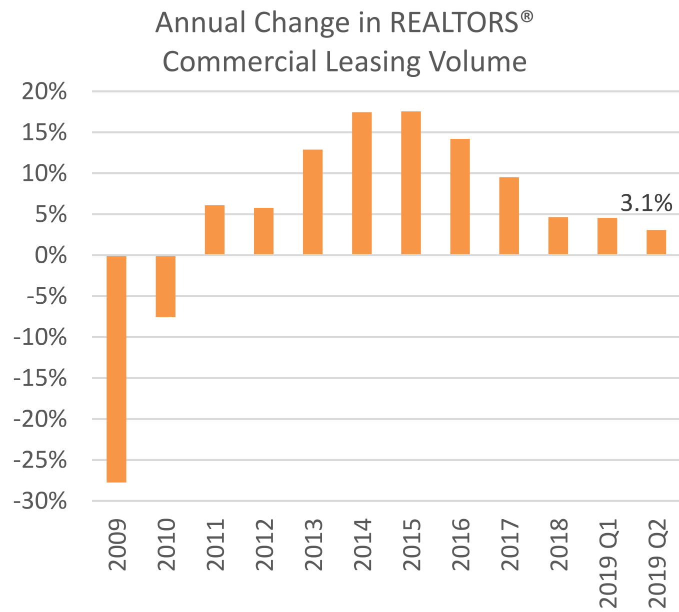
Cap Rates in 2019 Q2	
Office	7.0
Industrial: Warehouse	6.8
Industrial: Flex	7.0
Retail: Strip Center	7.4
Retail: Mall	7.7
Apartment	6.2
Hotel/Hospitality	6.9
Source: 2019 Q2 NAR CRE Market Survey	
For $2.5 million or less properties	

4 | COMMERCIAL LEASING

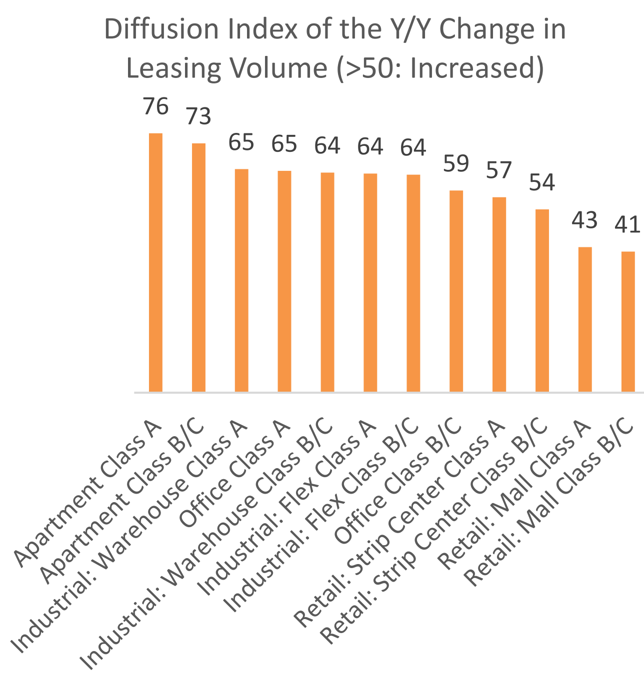
Strong Leasing Activity in Apartment and Industrial Market

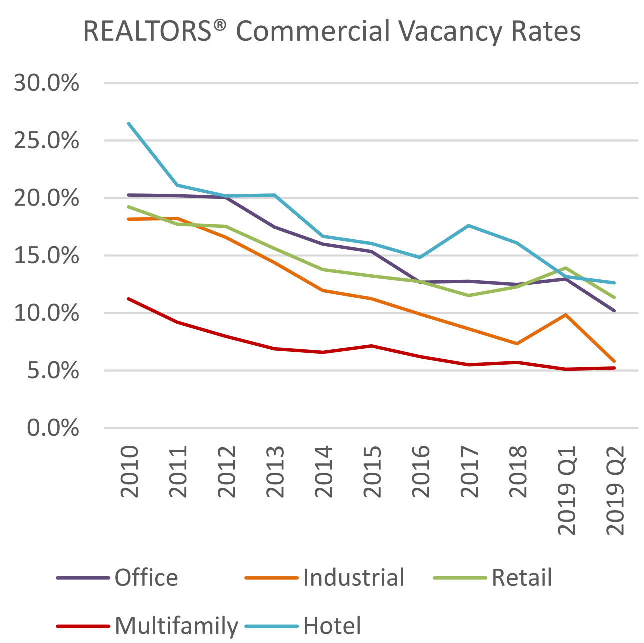
REALTORS® and commercial affiliate members reported a modest annual gain of 3.1 percent in leasing volume in 2019 Q2. Respondents reported an increase in leasing activity in 2019 Q2 from year-ago levels except for retail malls (indicated by diffusion indices of greater than 50). Leasing activity increased most strongly for apartment properties, followed by industrial warehouse and flex properties, as well as Class A office assets. Leasing activity increased in retail strip centers but decreased in retail malls.

Vacancy rates in the small commercial real estate market continued to trend down in 2019 Q2. Respondents reported an average apartment vacancy rate of 5.2 percent, 5.8 percent in industrial properties, 10 percent in office properties, and 13 percent in retail malls and hotels..



Sources: National Association of REALTORS®, Real Capital Analytics





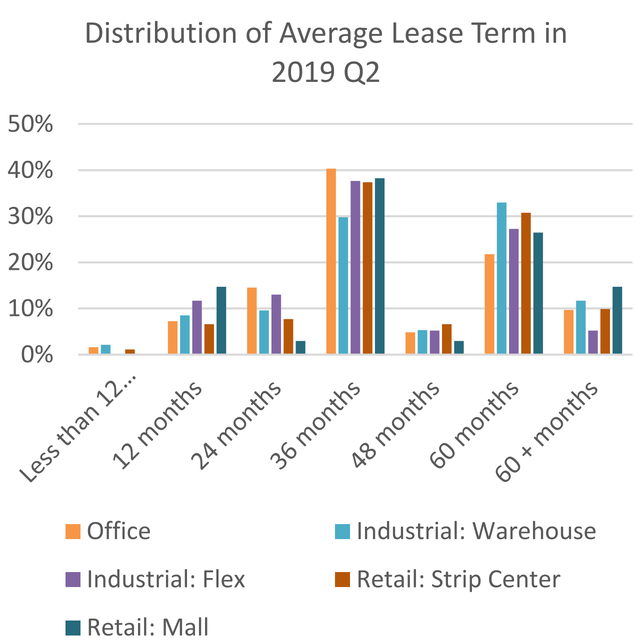
4 | COMMERCIAL LEASING

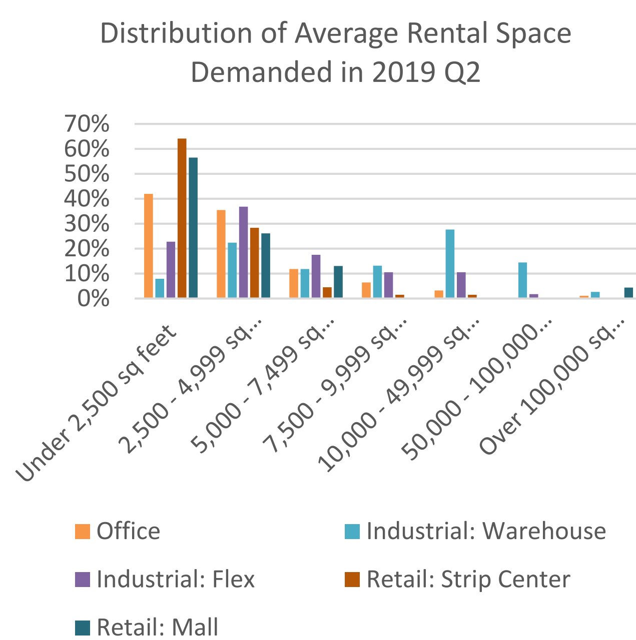
Vacancy Rates in 2019 Q2	
Office	10.2
Industrial: Warehouse	5.8
Industrial: Flex	5.8
Retail: Strip Center	9.8
Retail: Mall	12.9
Apartment	5.2
Hotel/Hospitality	12.6
Source: 2019 Q2 NAR CRE Market Survey	
For $2.5 million or less properties	

Gross Rents in 2019 Q2	
Office (per sf)	$18
Industrial: Warehouse (per sf)	$12
Industrial: Flex (per sf)	$9
Retail: Strip Center (per sf)	$21
Retail: Mall (per sf)	$18
Apartment (per unit)	$1,358
Source: 2019 Q2 NAR CRE Market Survey	
For $2.5 million or less properties	

Tenant Improvement Allowance in 2019 Q2	
Office (per sf)	$25
Industrial: Warehouse (per sf)	$12
Industrial: Flex (per sf)	$11
Retail: Strip Center (per sf)	$52
Retail: Mall (per sf)	$25
Source: 2019 Q2 NAR CRE Market Survey	
For $2.5 million or less properties	

Triple Net Rents in 2019 Q2	
Office (per sf)	$21
Industrial: Warehouse (per sf)	$8
Industrial: Flex (per sf)	$9
Retail: Strip Center (per sf)	$18
Retail: Mall (per sf)	$25
Apartment (per unit)	$1,366
Source: 2019 Q2 NAR CRE Market Survey	
For $2.5 million or less properties	





5 | OUTLOOK

Modest Macroeconomic Outlook

Given the latest trend, NAR projects GDP growth to slow to 2.2 percent in 2019. The growth projections assume no increase in the federal funds rate in 2019, with the Fed policy rates currently at 2.25 to 2.5 percent. The unemployment rate is expected to remain below 4.0 percent in 2019 and 2020, given the current low level of unemployment.

Housing starts will increase in 2019 to meet demand from household formation, which is growing at about 1.5 million.

Positive Outlook for Multi-family and Industrial Assets

Multi-family and industrial will continue to be strong commercial asset classes. The multi-family market is expected to remain bright in metros with low vacancy rates and affordable rents. E-commerce will continue to sustain demand for industrial properties, particularly flex properties. Retail brick and mortar will continue to do well in growing metros and in retail niches that require face-to-face customer service. The office market will be sustained by the growth in technology-driven jobs. The Opportunity Zone tax break on capital gains is expected to bolster commercial and residential real estate sales in 2019-2020.

Respondents reported commercial market opportunities in co-working space, adaptive re-use of properties, mixed-use development, transit-oriented development, senior health care, and warehouse and flex spaces.

The primary challenge was rising construction cost that is constraining development, sales, and leasing.

U.S. ECONOMIC OUTLOOK — July 2019

	2017	2018	2019	2020
Real GDP, % Growth	2.2	2.9	2.2	2.0
Unemployment Rate	4.4	3.9	3.7	3.9
Fed Funds Rate	1.0	1.8	2.4	2.4
10-Year Gov't Bond	2.3	2.9	2.3	0.4
30-Year Gov't Bond	2.9	3.1	2.7	2.9
30-Yr Fixed Rate	4.0	4.5	4.1	4.2
Housing Starts ('000)	1,203	1,250	1,270	1,410
% change	2.5%	3.9%	1.6%	11.0%
Single-family	849	876	900	1,020
Multi-family	354	374	370	390
Existing Home Sales ('000)	5,510	5,340	5,350	5,550
% change	1.1%	-3.1%	0.2%	3.7%
Median Existing Home Price ($'000)	$247.0	$259.3	$265.5	$275.0
% change	1.1%	-3.1%	0.2%	3.7%
Median New Home Price ($'000)	$323.1	$326.4	$321.3	$327.8
% change	5.0%	1.0%	-1.6%	2.0%

Source: National Association of REALTORS®

Commercial Market Opportunities

- Adaptive reuse
- Affordable housing
- Climate controlled storage business
- Cannabis/marijuana growing and production
- Construction of warehouse and flex space
- Co-working space development and leasing
- Child care services
- Land for solar farms
- Mixed use properties
- Port development and last-mile properties
- Redevelopment of Class B/C strip centers
- Residential housing
- Senior health care
- Transit-oriented development
- Warehouse leases
- Low interest environment
- Opportunity Zones
- Strong population growth

Commercial Market Challenges

- Low inventory/scarcity constraining sales and leasing
- Rising construction costs
- High rents not sustainable (e.g., South Florida)

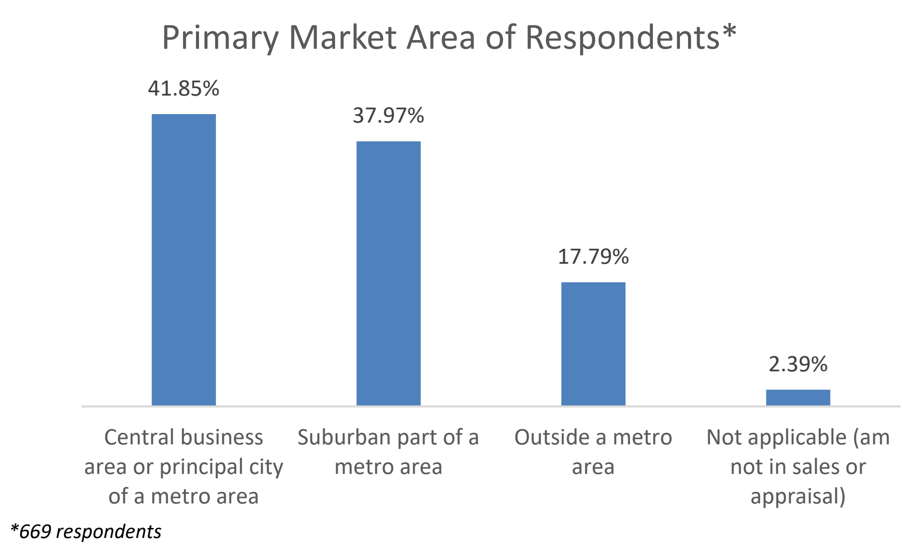
6 | ABOUT THE SURVEY

NAR's Quarterly Market Survey gathers information about the commercial transactions of REALTORS® and members of affiliate organizations (CCIM, SIOR, RLI, IREM, and the Counselors of Real Estate) and the opportunities and challenges facing commercial practitioners.

The 2019 Q2 survey was sent to approximately 64,953 commercial REALTORS® and members of affiliate organizations during July 1–9, 2019, of which 681 responded to the survey.

Among sales agents who had a sale during 2019 Q2, the average sales transaction was $1.9 million, the average total transactions value was $5.3 million, and the average number of transactions 2.8 during the reference quarter.

Forty-percent of respondents primarily conducted their business in the central business area or principal city of a metro, 38 percent in the suburban part of a metro area, and 18 percent outside a metro area. Two percent of respondents reported they wee not engaged in sales or appraisal.



The National Association of REALTORS® is America's largest trade association, representing more than 1.3 million members, including NAR's institutes, societies and councils, involved in all aspects of the real estate industry. NAR membership includes brokers, salespeople, property managers, appraisers, counselors and others engaged in both residential and commercial real estate. The term REALTOR® is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of REALTORS® and subscribes to its strict Code of Ethics. Working for America's property owners, the National Association provides a facility for professional development, research and exchange of information among its members and to the public and government for the purpose of preserving the free enterprise system and the right to own real property.

NATIONAL ASSOCIATION OF REALTORS®
RESEARCH GROUP

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