COMMERCIAL REAL ESTATE TRENDS & OUTLOOK 2019.Q3

National Association of REALTORS® Research Group

COMMERCIAL Real Estate

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COMMERCIAL REAL ESTATE TRENDS & OUTLOOK 2019.Q3

NAR RESEARCH GROUP Lead Team

Research and Analysis

LAWRENCE YUN, PhD
Chief Economist & Senior Vice President for Research

GAY CORORATON
Senior Economist & Director of Housing and Commercial Research

Survey Deployment and Editing

MEREDITH DUNN
Research Communications Manager

ANNA SCHNERRE
Research Assistant

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COMMERCIAL REAL ESTATE TRENDS & OUTLOOK

The *2019 Q3 Commercial Real Estate Trends & Outlook Report* discusses the latest development in the small commercial market (transactions that are typically less than $2.5 million) based on a survey of commercial REALTORS® and economic data.

According to respondents, commercial transactions are still modestly up compared to a year ago: development (4%), sales (3%), and leasing (2%).

In both large and small commercial markets, commercial prices continued to ratchet up as of 2019Q2, with price gains from one year ago, based on price indices reported by the National Council of Real Estate Investment Fiduciaries (8%), Federal Reserve Board (4%), and Green Street Advisors Price Index(2%).

The going-in cap rates reported by respondents indicate cap rates are still trending downwards, with the lowest going-in cap rates in multifamily (5.9%) and industrial-warehouse (6.5%). Commercial activity for retail malls remains depressed; as of August 2019, there were 69,300 fewer payroll jobs in the retail industry compared to one year ago.

Multi-family properties continue to be attractive to developers and investors given the tight rental conditions: the national rental vacancy rate stood at 6.8% in 2019 Q2,well below the 9% rate in 2012. The sustained growth in e-commerce sales continues to buoy the demand industrial –warehouse properties.

Amid concerns about an economic slowdown, 48% of respondents reported they expect business conditions to improve in the next 12 months, a lower fraction compared to 53% in the 2019 Q2 survey.

Respondents identified several market opportunities, such as the construction of affordable housing, industrial-flex office, repurposing and rehabilitation of closed retail malls, and senior housing, among others.

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1 | ECONOMIC CONDITIONS

Economic Growth Slowed in 2019 Q2

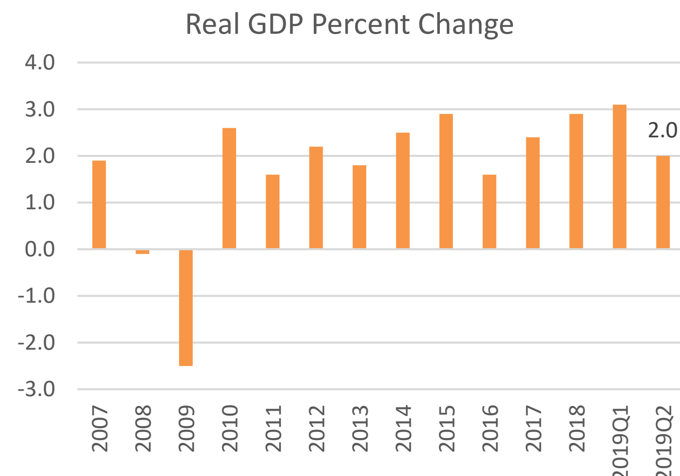
The economy expanded at a slower pace of 2% in 2019 Q2, breaking the pattern of accelerating growth since 2016. Amid increasing apprehension about a significant slowdown or even a recession, private investment spending contracted (-6.3%) in both non-residential (-1%) and residential sectors (-3%). Meanwhile, the escalation of tariffs between US and China has been followed by a contraction in exports of goods and services (-3%). Government spending was unchanged.

The sole engine of growth is personal consumption spending (4.6%) as consumers increased their spending across all broad consumer goods, with the largest spending increase for gasoline, fuel, and other energy goods (38.8%), motor vehicles and parts (16.1%), and transportation services (11%). Sustained job creation and real wage gains have supported consumer confidence and spending.

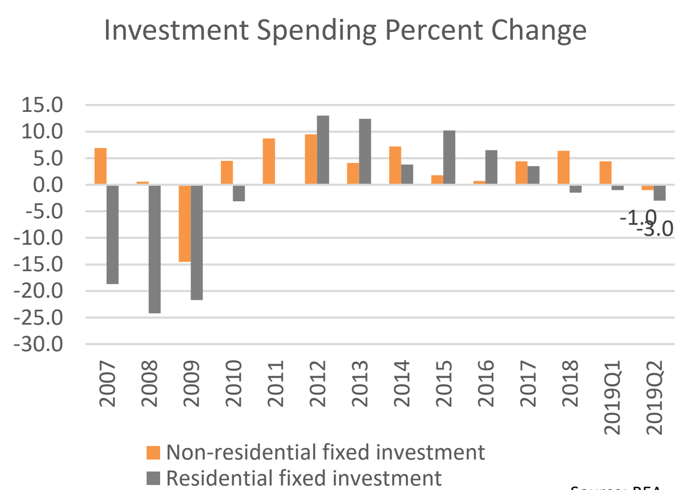
Strong Job Growth; Fewer Unemployed

Net job creation remains positive, although hiring has slowed with fewer people looking for work. As of September 2019, there were 2.1 million net new payroll jobs, below the 2.9 million annual job gains in January 2019. The unemployment rate dipped to 3.5%, at par with 50 years ago, with 5.8 million of 16+ year-olds unemployed, the lowest level since 2000.

Payroll jobs rose in all sectors during the 12-months that ended September 2019 except for retail (-69,300) and utilities (-2,400). The construction industry created 155,000 net new jobs, which is just about half of the 342,000 annual jobs created in January 2019.



Source: BEA



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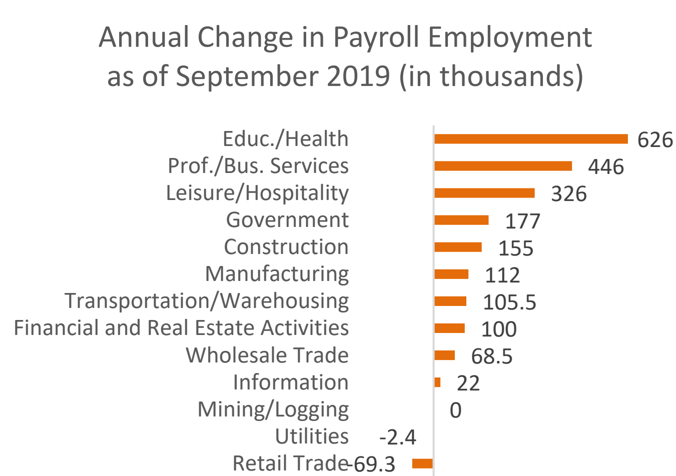
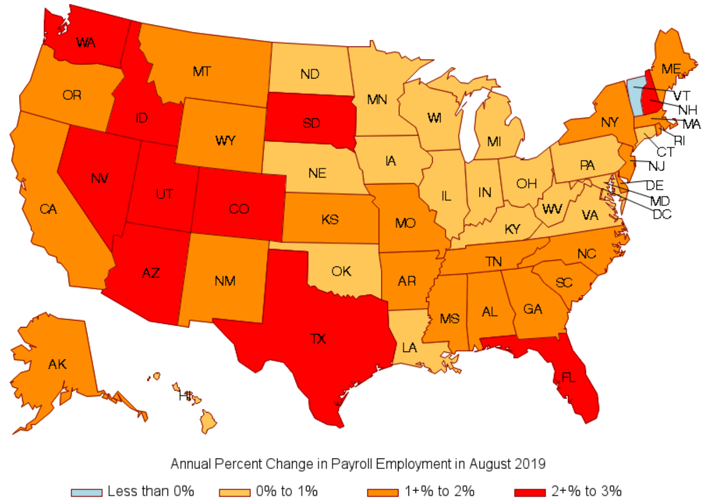


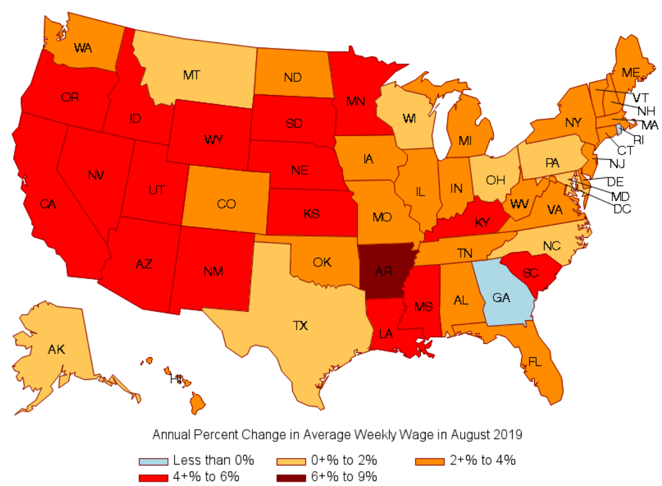
Source: BLS

1 | ECONOMIC CONDITIONS

Except for Vermont, payroll jobs increased in all states and in the District of Columbia, with the strongest gains in Utah (3.0%), Nevada (3.0%), Washington (2.5%), Arizona (2.5%), Florida (2.5%), Texas (2.3%), Idaho (2.2%), New Hampshire (2.2%), South Dakota (2.2%), and Colorado (2.1%).



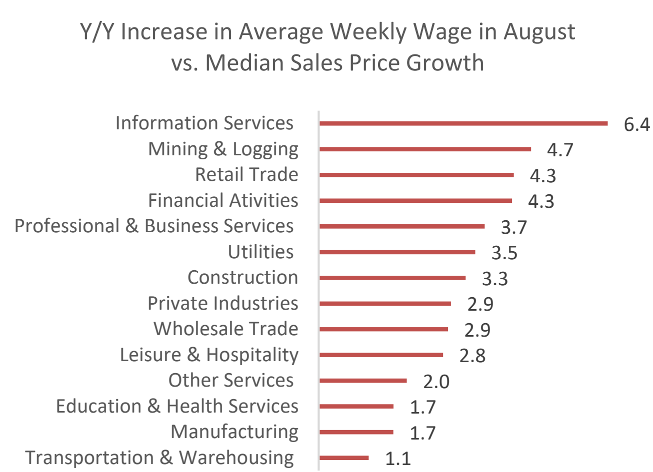
Average weekly wages rose in all states, except in Georgia, with the strongest wage growth in Arkansas (9%).

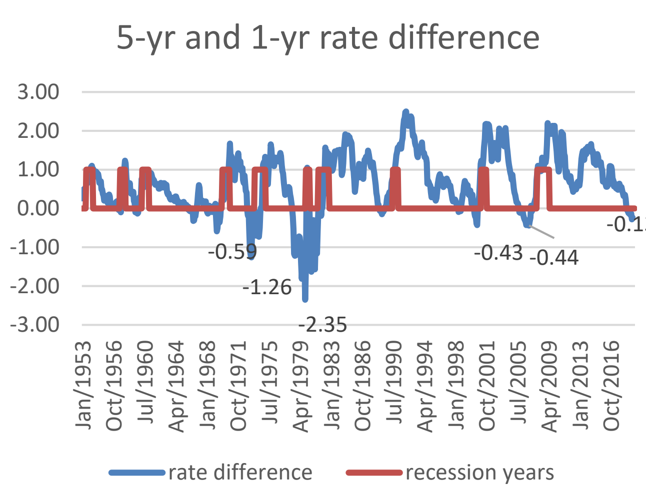


Average weekly wages among those employed in private industry rose 2.9%, ahead of the all-consumer basked inflation rate of 1.7%. However, workers in education and health services industry, manufacturing, and transportation and warehousing had wage growths below the inflation rate.

Interest Rates Trending Down with Yield Curve Still Inverted

Last September 18, the Federal Operations Market Committee lowered the federal funds rate target for the second time in 2019, to a range of 1.75% to 2% given uncertainties in sustaining the economic expansion. The yield curve remains inverted for the 1-year and 5-year T-notes, an indication that many investors foresee an impending significant economic slowdown or even a recession.



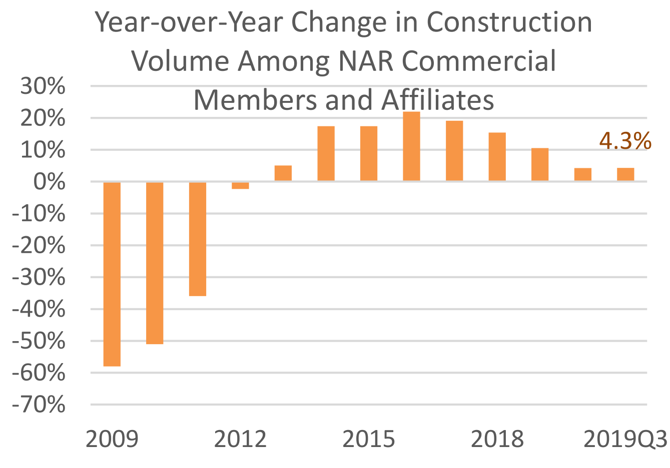


Construction Activity Tapers

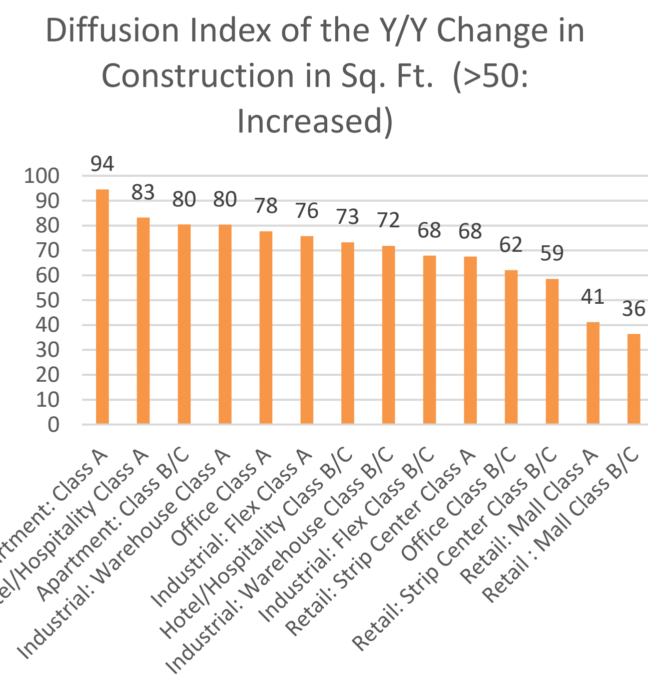
According to REALTOR® members of affiliate organizations who responded to the *2019 Q3 Commercial Real Estate Quarterly Market Survey,* construction increased on average by about 4% percent in 2019 Q3 from year ago levels. The pace of construction activity peaked in 2016 and has tapered since then.

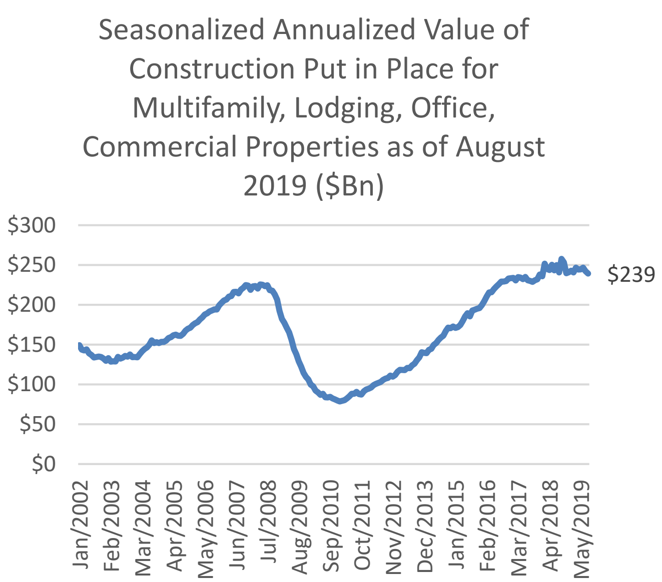
By property type, respondents reported the strongest annual increase Class A apartment properties, Class A hotels/hospitality, Class B/C apartments, and Class A industrial warehouses. Respondents reported a decline in construction activity for retail malls.

As of August 2019, the U.S. Census Bureau reported that the seasonalized annual value of construction put in place for office, lodging, and multifamily structures increased compared to one year ago, but it decreased for commercial properties ((buildings for wholesale, retail, and selected service industries).



Source: National Association of Realtors®





Value of construction put in place (SAAR, in millions)

	Aug-19	Aug-18	% change
New Multi-family	62,028	57,757	7%
Lodging	32,660	31,081	5%
Office	68,839	64,791	6%
Commercial	75,830	87,165	-13%
Source: U.S. Census Bureau			

3 | COMMERCIAL SALES

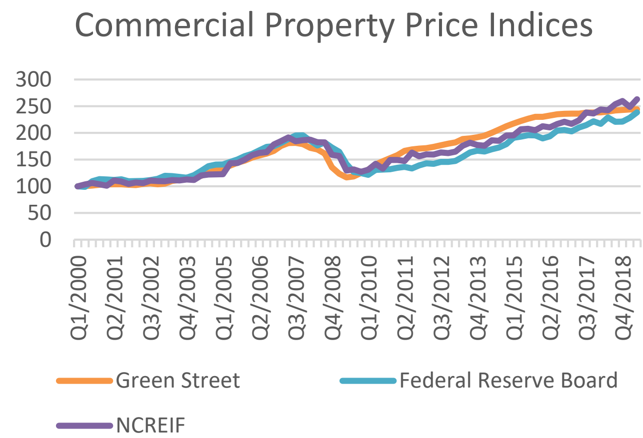
Commercial Property Prices Still Rising

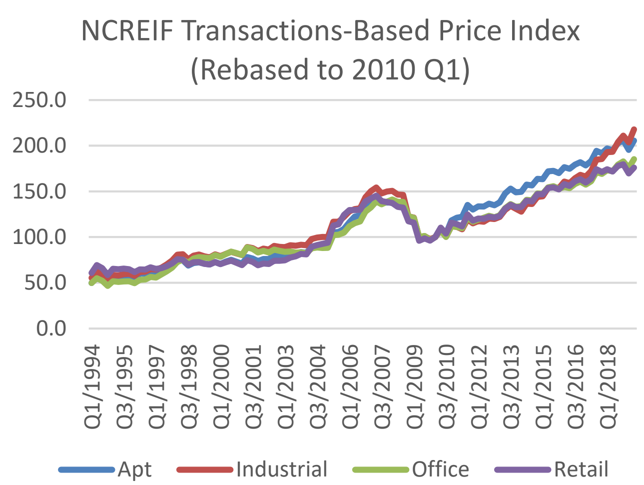
Property indices show commercial prices continued to ratchet up as of 2019Q2, with price gains from one year ago reported by the National Council of Real Estate Investment Fiduciaries (8%), Federal Reserve Board (4%), and Green Street Advisors Price Index(2%).

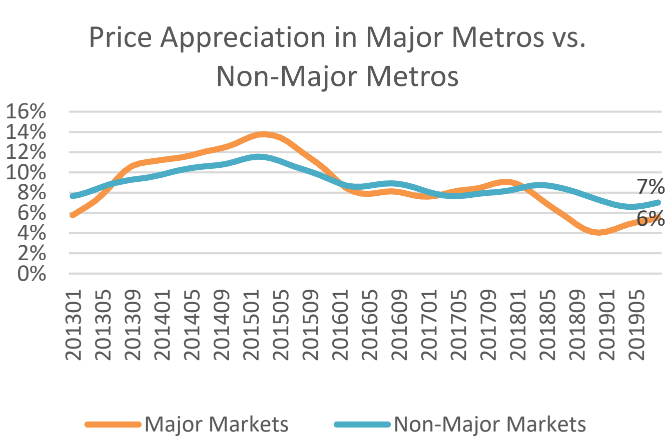
The NCREIF transactions-based price index for apartments, industrial, office, and retail rose in 2019 Q2 from a year ago and in the prior month, indicating that institutional investors (e.g., pension funds) continue to have positive returns on their holdings of commercial properties.

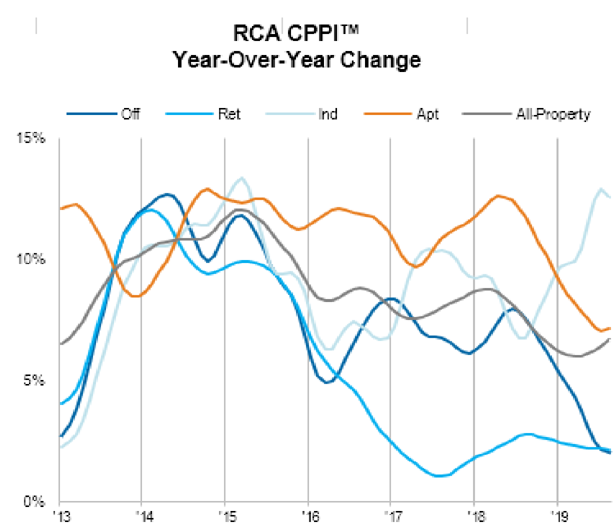
Real Capital Analytics, which tracks sales of at least $2.5 million, reported overall annual price gains of 6.7% in August 2019 from one year ago, with the strongest gain in industrial properties (12.5%), apartment (7.1%), and office-CBD (7.0%).

Based on transactions worth at least $2.5M, commercial price rose in the aggregate in both major and non-major markets, with stronger appreciation in non-major markets (since February 2018). Real Capital Analytics defines the major markets as Boston, New York City, Washington DC, Chicago, San Francisco, and Los Angeles.









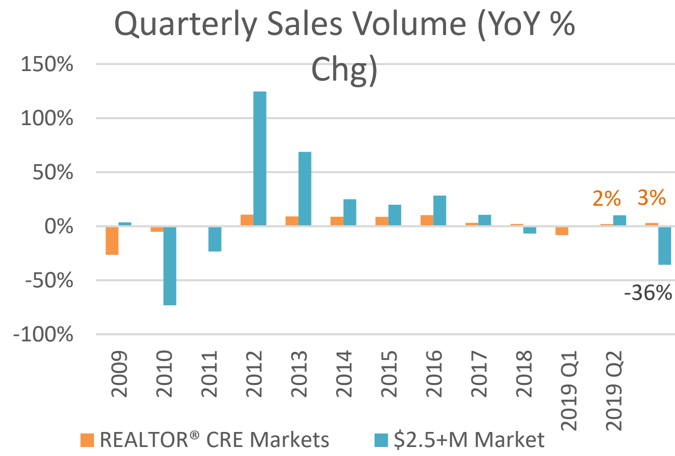
Source: for $2.5M transactions reported by Real Capital Analytics

3 | COMMERCIAL SALES

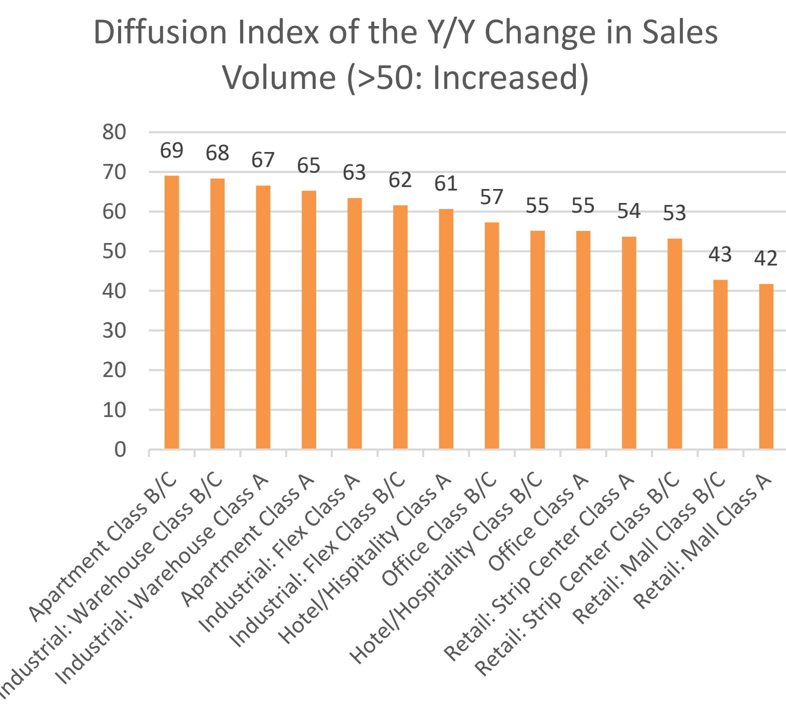
In the small commercial real estate market (below $2.5 million), total sales volume in 2019 Q3 rose at a modest pace of 3% from a year ago, according to REALTORS® and members affiliate organizations who responded to NAR's *2019 Q3 Commercial Real Estate Quarterly Market Survey.* Sales growth has moderated since 2017 compared to the almost 10 percent growth per year since 2012 through 2016.

By asset class, respondents reported strong sales in apartment and industrial markets. An index above 50 means sales activity broadly increased in these markets. Only the retail sector had values below 50,

In the large CRE market (at least $2.5M), the dollar sales volume was down by 36% in July–August 2019 from one year ago. Over the period January–August 2019, sales transactions ($321.4 B) were down by 11% compared to the same period one year ago ($360.3 billion) on account of a decline in acquisitions by non-individual investors.



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 Q3 survey, the median total sales transaction volume among respondents was $1.4 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.

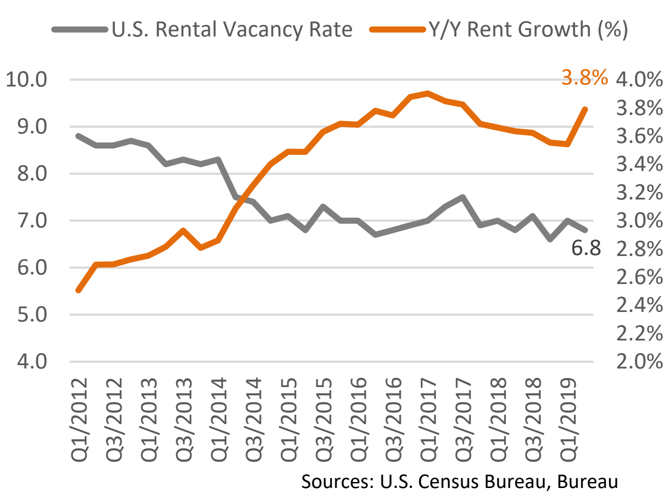
3 | COMMERCIAL SALES

Apartment and Industrial Assets Still Most Favored Assets

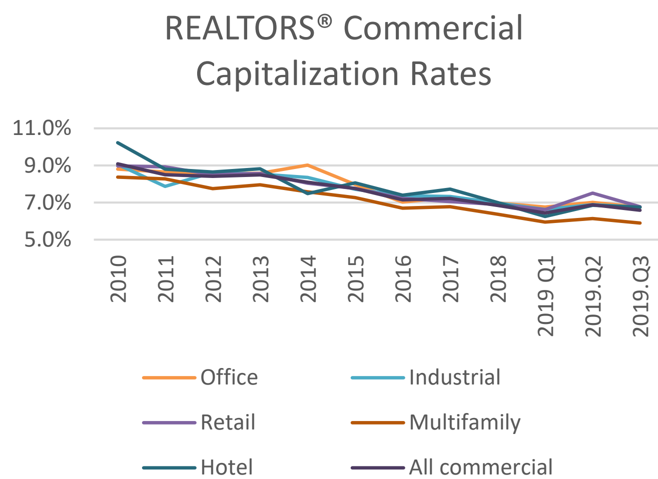
In 2019 Q3, the median* going-in cap rates among survey respondents was 6.6%. In the $2.5+M market reported by Real Capital Analytics, cap rates averaged 6.1% in July and August 2019.

In the small CRE market, apartment properties had the lowest median cap rate, at 5.9%, followed by industrial warehouse, at 6.5%. Retail strip centers had the highest cap rate, at 7.1%.

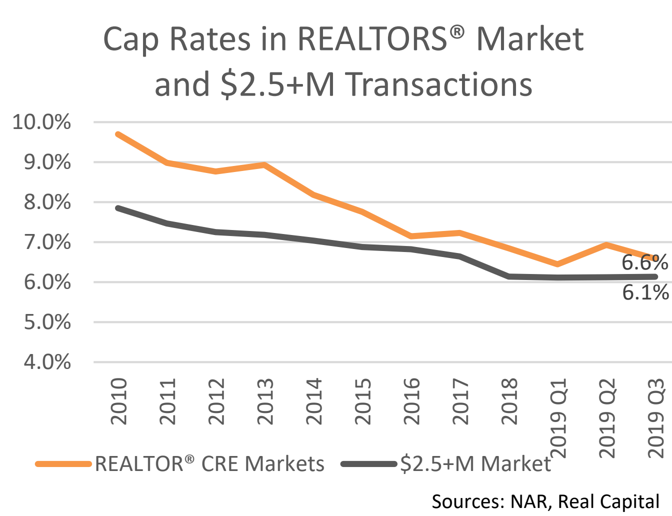
Cap rates continue to decline, especially for apartments and industrial properties given the demand for these types of properties (falling cap rates = rising prices). In the apartment sector, the national rental vacancy rate was 6.8% in 2019 Q2,well below the 9% rate in 2012. With low vacancy rates, rents rose on average by 3.8% in 2019 Q2 from one year ago.
Rising rent growth can only be tamed by more construction of and preservation of rental units.



Note: starting in 2019 Q3, the median cap rate is reported while in previous quarters, the average was reported. The median is less sensitive to outliers.



Cap Rates in 2019 Q3	
Office	6.8
Industrial: Warehouse	6.5
Industrial: Flex	7.0
Retail: Strip Center	7.1
Retail: Mall	6.5
Apartment	5.9
Hotel/Hospitality	6.8
Source: 2019 Q3 NAR CRE Market Survey	
For $2.5 million or less properties	



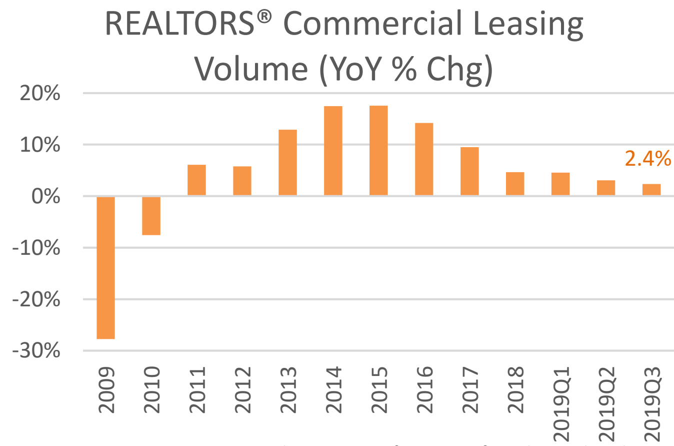
4 | COMMERCIAL LEASING

Strong Leasing Activity in Apartment and Industrial Market

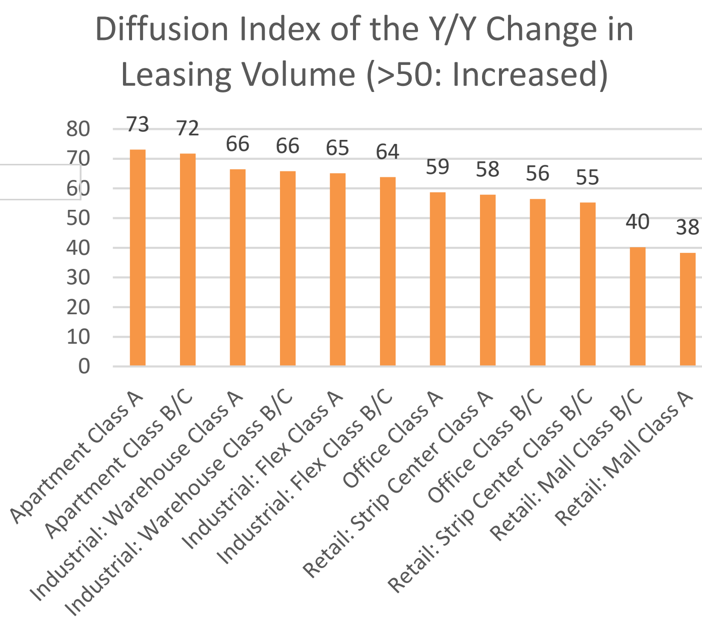
REALTORS® and commercial affiliate members reported a modest annual gain of 2.4% in leasing volume in 2019 Q2. Leasing activity increased most strongly for apartment properties, followed by industrial warehouse and flex properties. Office leasing rose modestly (with the diffusion index hovering near 50). Leasing activity increased in retail strip centers but decreased in retail malls.

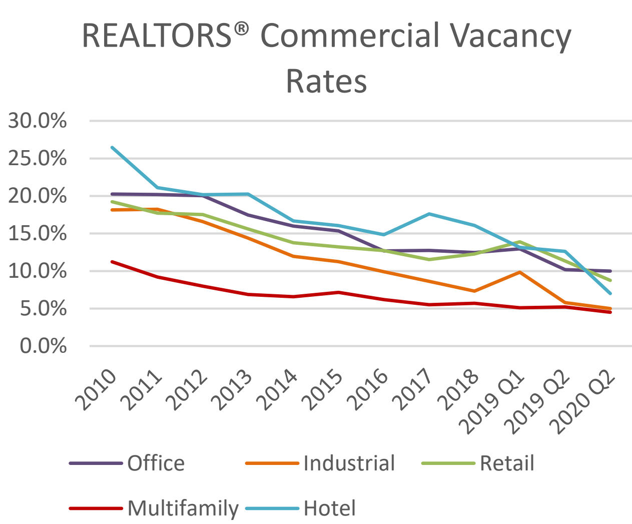
Vacancy rates in the small commercial real estate market continued to trend down in 2019 Q3. The lowest median vacancy rates were in apartment and industrial properties, at 5%. REALTORS® reported high vacancy rates in retail properties, at 9%, and office properties, at 10%.

In the 75 largest metro areas, 38 metros had multifamily rental vacancy rates below 7%, including California metros of San Jose-Sunnyvale (2%), Riverside-San Bernardino (3.7%), Los Angeles-Long Beach-Anaheim (4.5%), and San Francisco-Oakland (4.7%).



Sources: National Association of REALTORS®, Real Capital Analytics





Median Vacancy Rates in 2019 Q3	
Multifamily	5%
Industrial	5%
Retail	9%
Office	10%
Source: 2019 Q3 NAR CRE Market Survey	
For $2.5 million or less properties	

4 | COMMERCIAL LEASING

Multifamily Rental Vacancy Rates

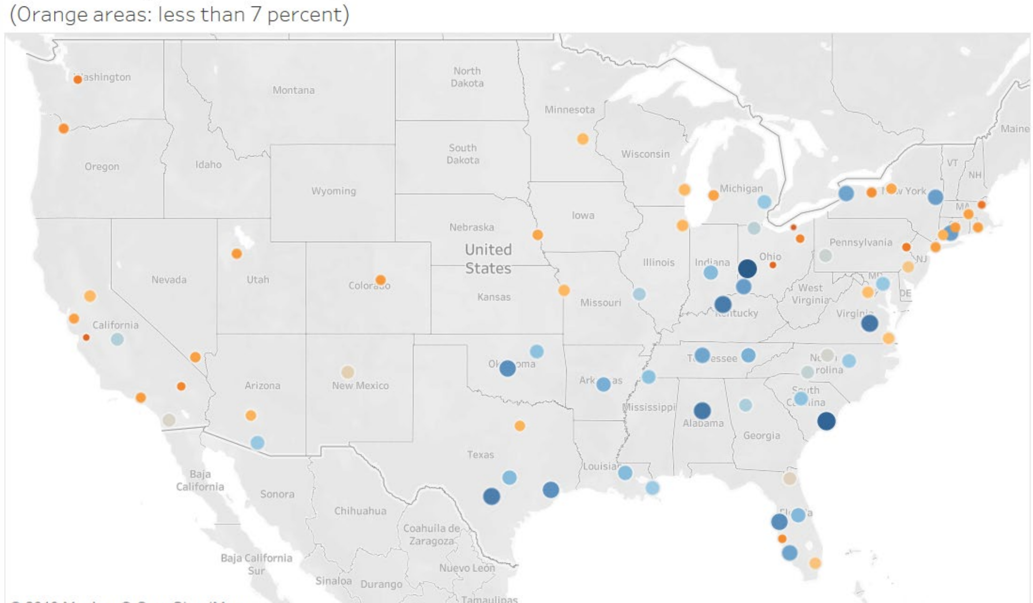
Rental vacancy rates as of 2019 Q2
(Orange areas: less than 7 percent)

Cbsaname (Rentalvac)	
Cleveland-Elyria, OH	1.50
San Jose-Sunnyvale-Santa Clara, CA	2.00
Columbus, OH	2.20
Boston-Cambridge-Newton, MA-NH	2.90
Allentown-Bethlehem-Easton, PA-NJ	3.20
Seattle-Tacoma-Bellevue, WA	3.30
Akron, OH	3.60
Riverside-San Bernardino-Ontario, CA	3.70
North Port-Sarasota-Bradenton, FL	3.90
Rochester, NY	4.00
Portland-Vancouver-Hillsboro, OR-WA	4.10
Denver-Aurora-Lakewood, CO	4.40
Salt Lake City, UT	4.40
Hartford-West Hartford-East Hartford, CT	4.50
Los Angeles-Long Beach-Anaheim, CA	4.50
New York-Newark-Jersey City, NY-NJ-PA	4.60
Providence-Warwick, RI-MA	4.60
San Francisco-Oakland-Hayward, CA	4.70
Worcester, MA-CT	4.70
Las Vegas-Henderson-Paradise, NV	4.80
Grand Rapids-Wyoming, MI	4.90
Omaha-Council Bluffs, NE-IA	5.00
Syracuse, NY	5.00
Bridgeport-Stamford-Norwalk, CT	5.50

Rental vacancy rates as of 2019 Q2
(Orange areas: less than 7 percent)

Cbsaname (Rentalvac)	
Dayton, OH	15.80
Charleston-North Charleston, SC	14.90
Richmond, VA	13.60
Birmingham-Hoover, AL	13.50
Louisville/Jefferson County, KY-IN	13.30
San Antonio-New Braunfels, TX	13.10
Tampa-St. Petersburg-Clearwater, FL	12.00
Oklahoma City, OK	11.90
Houston-The Woodlands-Sugar Land, TX	11.80
Cincinnati, OH-KY-IN	10.90
New Haven-Milford, CT	10.80
Albany-Schenectady-Troy, NY	10.80
Cape Coral-Fort Myers, FL	10.50
Nashville-Davidson-Murfreesboro-Franklin, ..	10.40
Buffalo-Cheektowaga-Niagara Falls, NY	10.40
Little Rock-North Little Rock-Conway, AR	9.80
Knoxville, TN	9.70
Orlando-Kissimmee-Sanford, FL	9.20
Indianapolis-Carmel-Anderson, IN	9.10
Austin-Round Rock, TX	9.10
Baton Rouge, LA	9.00
Memphis, TN-MS-AR	8.70
Tulsa, OK	8.60
Columbia, SC	8.60

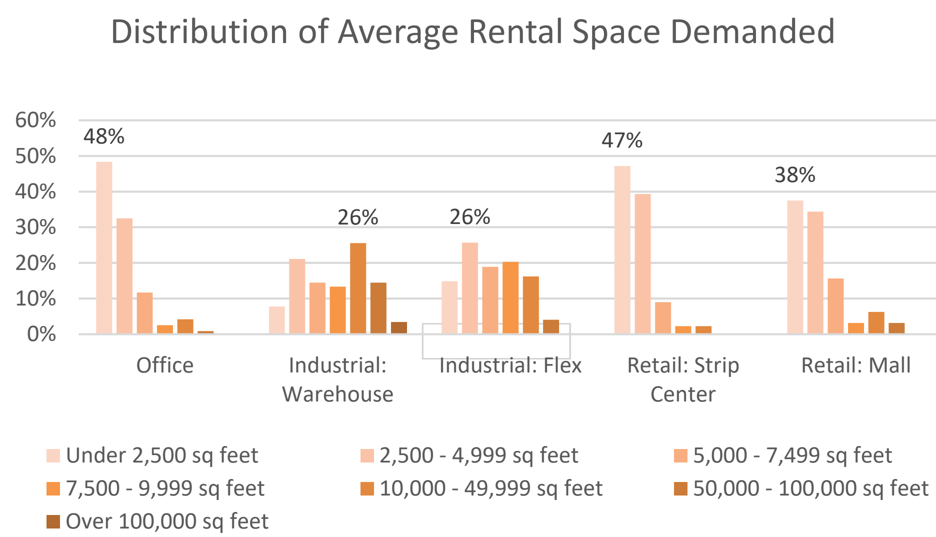
Rental vacancy rates as of 2019 Q2
(Orange areas: less than 7 percent)

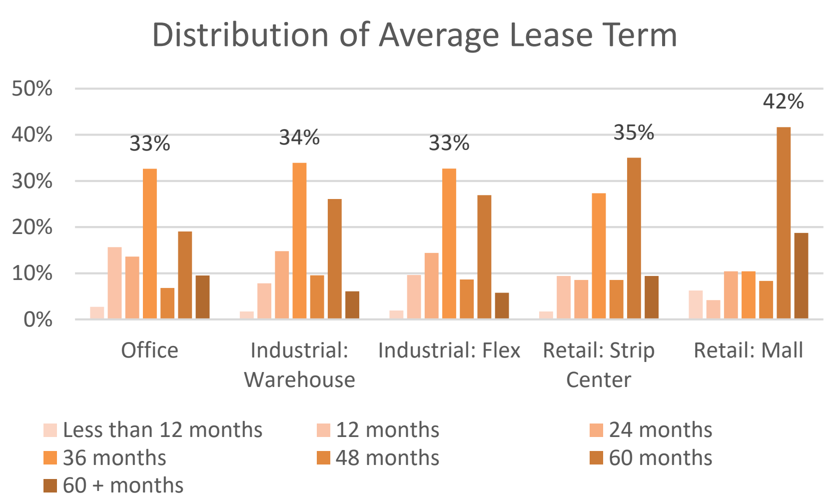


4 | COMMERCIAL LEASING

Median Rents in 2019 Q3		
	Gross	Triple
Office (per sf)	$22	$18
Industrial: Warehouse (per sf)	$8	$6
Industrial: Flex (per sf)	$9	$8
Retail: Strip Center (per sf)	$22	$18
Source: 2019 Q3 NAR CRE Market Survey		
For $2.5 million or less properties		

Tenant Improvement Allowance in 2019 Q3	
Office (per sf)	$19
Industrial: Warehouse (per sf)	$8
Industrial: Flex (per sf)	$8
Retail: Strip Center (per sf)	$16
Source: 2019 Q3 NAR CRE Market Survey	
For $2.5 million or less properties	





5 | OUTLOOK

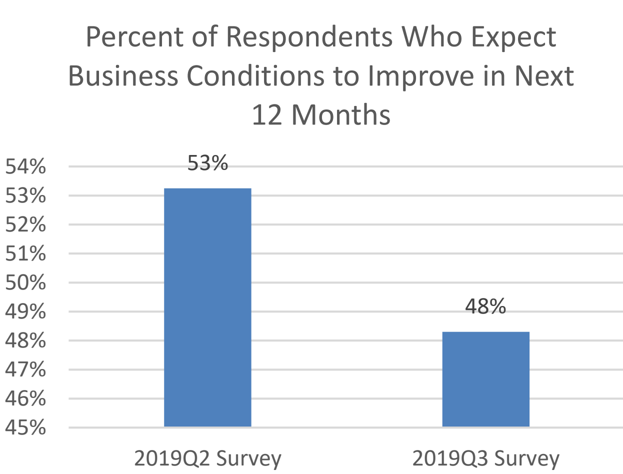
Modest Macroeconomic Outlook

Given the latest trends, NAR projects GDP growth to slow to 2.1% in 2019 and 2% in 2020 (no recession). The unemployment rate is expected to average 3.7% in 2019 and to slightly increase to 4% in 2020 given slower economic growth.

48% of respondents reported they expect business conditions to improve in the next 12 months, a lower fraction compared to 53% in the 2019 Q2 survey.

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.



U.S. ECONOMIC OUTLOOK — October 2019

	2017	2018	2019F	2020F
Real GDP, % Growth	2.4	2.9	2.1	2.0
Unemployment Rate	4.4	3.9	3.7	4.0
Fed Funds Rate	1.0	1.8	2.2	1.5
30-Yr Fixed Rate	4.0	4.5	3.9	3.6
Housing Starts ('000)	1,203	1,250	1,275	1,410
Single-family	849	876	888	1,000
Multi-family	354	374	387	410
Existing Home Sales ('000)	5,510	5,340	5,370	5,550
% change	1.1	-3.1	0.6	3.4
Median Existing Home Price ($'000)	$247.2	$259.3	$270.0	$279.0
% change	5.7	4.9	4.1	3.3

Source: National Association of REALTORS®

Commercial Market Opportunities

- Affordable housing/, including ADUs and micro-apartments
- Expanding small logistics
- Flex offices
- Warehouse distribution
- Rehabilitation /renovation of Class B/C buildings
- Build-to-suit for technology companies
- Re-purposing vacant retail spaces
- Senior housing
- Pedestrian and increased use of biking
- Foreign investors
- Growth in house of worships, medical, dental, food services
- Downtown revitalization
- New businesses, job growth, high population growth
- Opportunity Zones to increase ROI

Commercial Market Challenges

- High land, material, and labor cost
- Low inventory/scarcity constraining sales and leasing

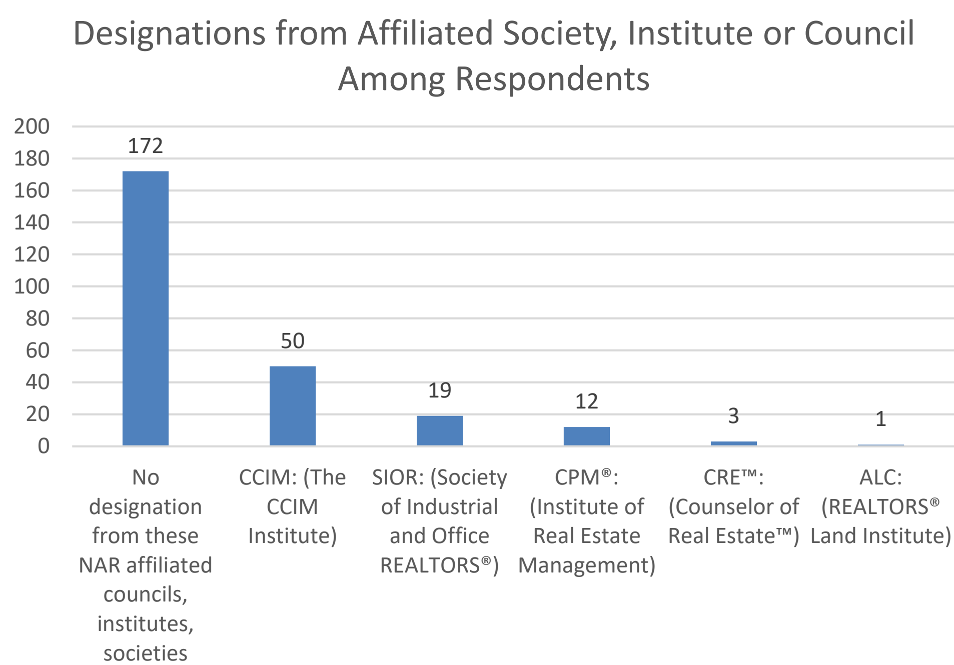
6 | ABOUT THE SURVEY

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 Q3 survey was sent to approximately 69,000 commercial REALTORS® and members of affiliate organizations during October 1–9, 2019, of which 817 responded to the survey.

Among sales agents who had a sale during 2019 Q3, the median total transactions value for the quarter was $1.4 million and the median sales (closed) transactions was 2.

Of the 244 respondents who answered the question about designations held by the respondent, 30% reported holding designations from an affiliated society, institute, or council.



answered by 244 respondents

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500 New Jersey Avenue, NW
Washington, DC 20001
202.383.1000

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