National Association of REALTORS®

COMMERCIAL REAL ESTATE MARKET TRENDS: Q3.2015

COMMERCIAL Real Estate
REALTOR®
NATIONAL ASSOCIATION of REALTORS®

Commercial Real Estate Market Trends: Q3.2015

Download: www.realtor.org/research-and-statistics/commercial-real-estate-market-survey

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Introduction

The REALTORS® Commercial Real Estate Market Trends measures quarterly activity in the commercial real estate markets, as reported in a national survey. The survey collects data from REALTORS® engaged in commercial real estate transactions. The survey is designed to provide an overview of market performance, sales and rental transactions, along with information on current economic challenges and future expectations.

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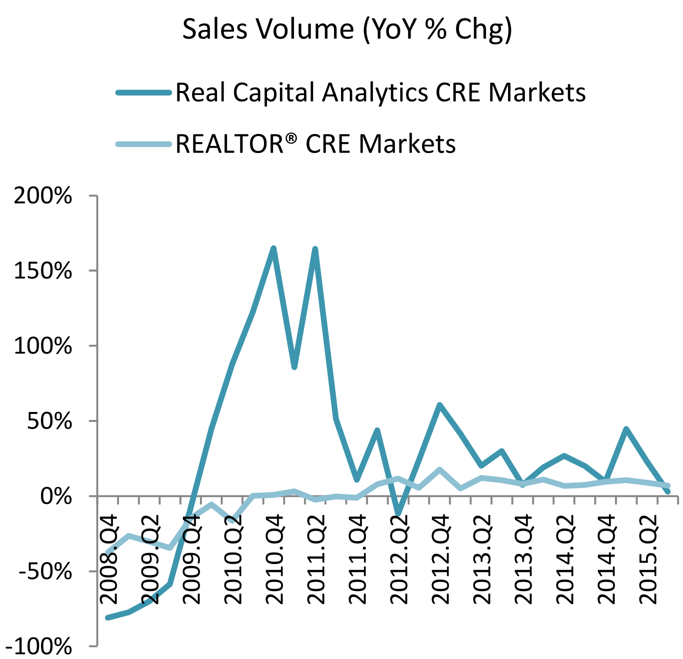
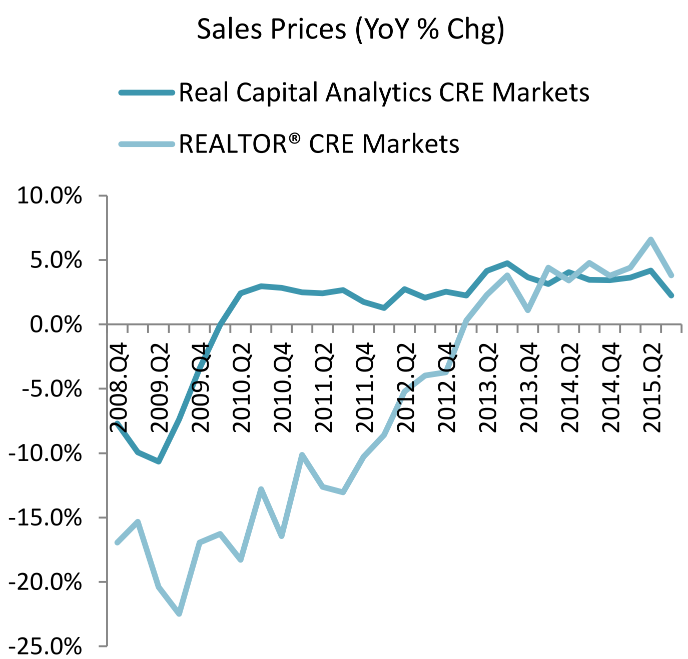
Commercial space is heavily concentrated in large buildings, but large buildings are a relatively small number of the overall stock of commercial buildings. In terms of inventory, commercial real estate markets are bifurcated, with the majority of buildings (81 percent) being relatively small (SCRE), while the bulk of commercial space (71 percent) is concentrated in larger buildings (LCRE).

The bifurcation continues along transaction volumes as well, with deals at the higher end—$2.5 million and above—comprising a large share of investment sales, while transactions at the lower end make up a smaller piece of the pie.

Data are readily available for transactions in excess of $2.5 million from several sources, including Real Capital Analytics (RCA). However, in general, data for smaller transactions—many of which are handled by REALTORS®—are less widely available. NAR's Commercial Real Estate Market Trends gathers market information for SCRE properties and transactions, mostly valued below $2.5 million





Sources: NAR, Real Capital Analytics

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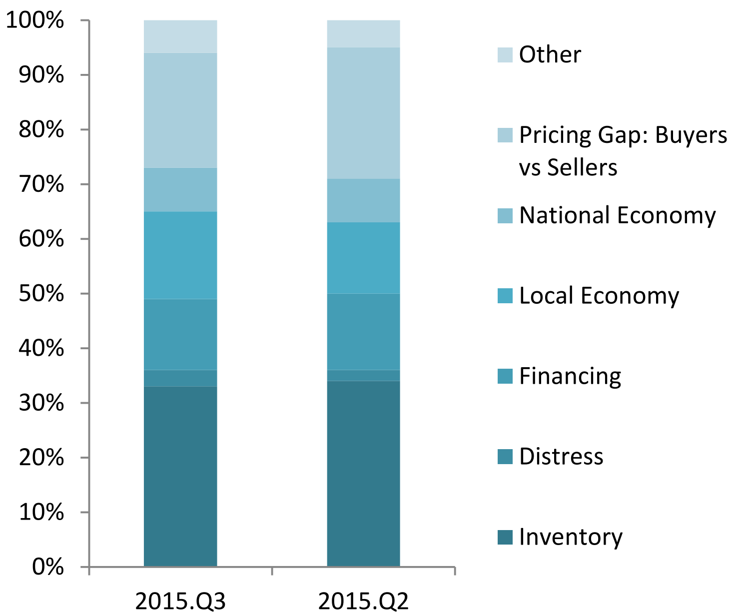
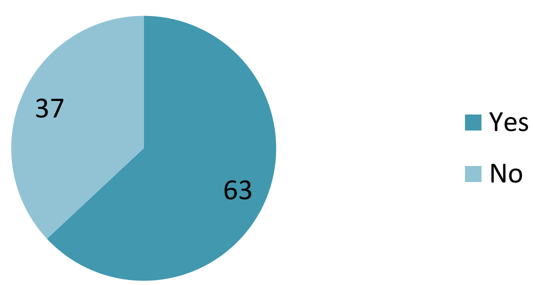
Survey Highlights

- Sixty-three percent of commercial REALTORS® closed a sale.
- Sales volume rose 7.2 percent from a year ago.
- Sales prices increased 3.8 percent year-over-year.
- Cap rates averaged 7.9 percent during Q2.2015
- The average estimated transaction value slid from $2.0 million in Q2.2015 to $1.9 million in Q3.2015.
- Sixty-three percent of members completed a lease transaction
- Leasing volume advanced 3.8 percent from previous quarter.
- Leasing rates increased 2.5 percent over previous quarter.
- Concession levels declined 4.5 percent on a quarterly basis.
- Inventory shortage topped the list of current challenges, followed by buyer-seller pricing gap and local economies.

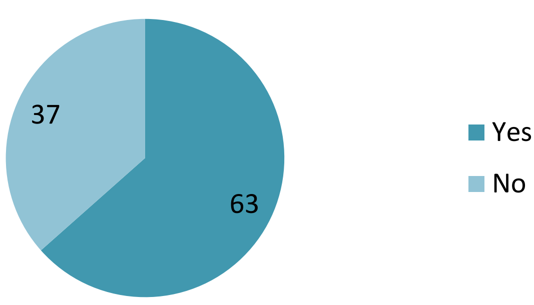
REALTORS®' Most Pressing Challenges



Lease transaction (%)



Sales transaction (%)



NOTE:

1. *In October 2015, NAR invited a random sample of 51,362 REALTORS® with an interest in commercial real estate to fill an on-line survey. A total of 384 complete responses were received, for an overall response rate of 0.7 percent.*

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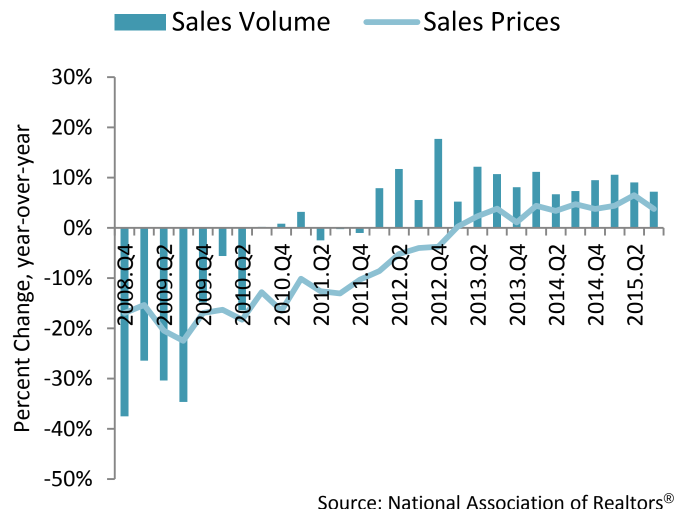
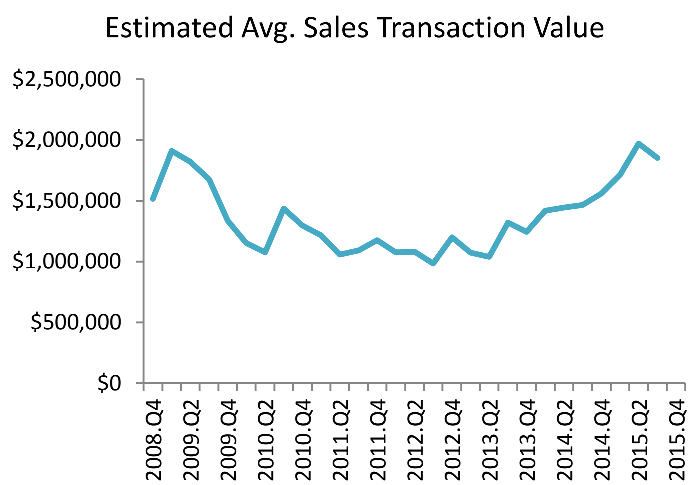
Investment Sales

Commercial real estate continued on a positive trend during the third quarter, with REALTORS® reporting continued improvement in fundamentals and investment sales. However, REALTORS® indicated a deceleration in momentum. The direction of commercial business opportunities during the third quarter 2015 rose three percent, slightly lower than the second quarter's six percent.

A higher proportion of members closed deals in the third quarter 2015—63 percent. Sales volume rose seven percent from the third quarter of 2014.

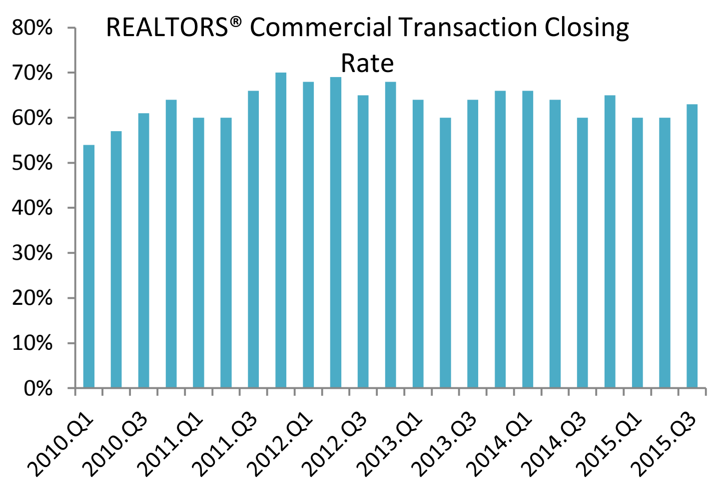
With the shortage of available inventory remaining the number one concern for NAR members, price growth continued upward, with properties trading at average prices four percent higher compared with the same period in 2014. The average transaction price slid from $2.0 million in the second quarter 2015 to $1.9 million in the third quarter 2015. A perceived pricing gap between sellers and buyers remained the second highest ranked concern.





REALTORS® 2015.Q3 Prices	
Office Class A($/SF)	$117
Office Class BC ($/SF)	$84
Industrial Class A ($/SF)	$55
Industrial Class BC ($/SF)	$45
Retail Class A ($/SF)	$122
Retail Class BC ($/SF)	$88
Apartment Class A ($/Unit)	$89,342
Apartment Class BC ($/Unit)	$50,928

Source: NAR



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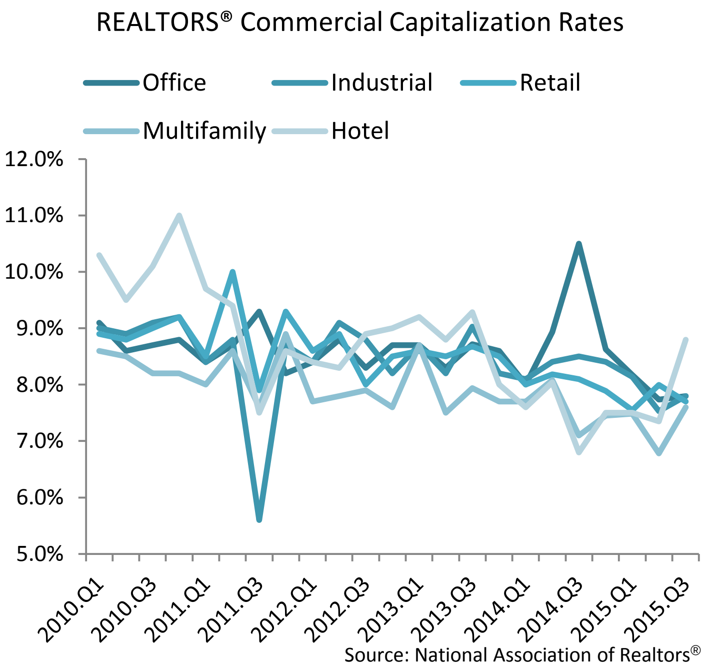
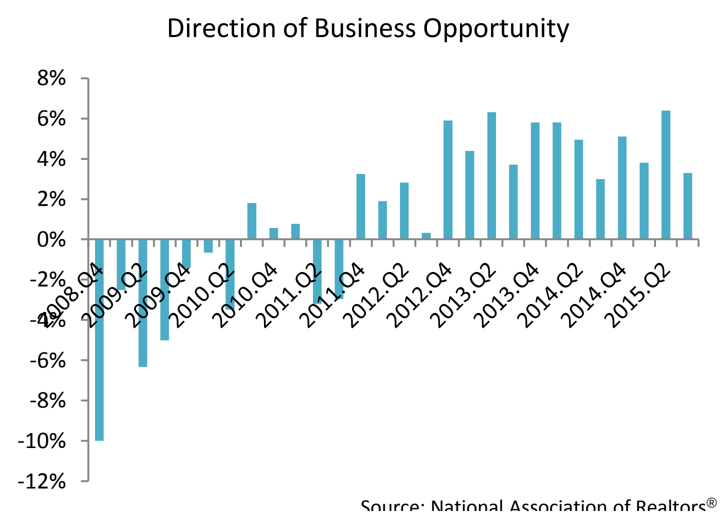


2015.Q3 Cap Rates	
Office	7.8%
Industrial	7.8%
Retail	7.7%
Multifamily	7.6%
Hotel	8.8%



Investment Sales - continued

Average capitalization rates moved up to an average 7.9 percent across all property types, a 26 basis point decline on a yearly basis. Apartments posted the lowest cap rate, at 7.6 percent, followed by retail properties with average cap rates at 7.7 percent. Office and industrial spaces posted identical cap rates of 7.8 percent. Hotel transactions reported the highest comparative cap rates—8.8 percent.

Spreads between cap rates in REALTOR® markets and 10-year Treasury notes widened in the third quarter, reaching 573 basis points.

Members indicated that the following areas presented the greatest opportunities:

- Redevelopment/Repositioning
- Industrial
- New Development/Construction
- Apartments/Multifamily
- Land
- Retail
- Capital Availability/Interest Rates
- International Investors
- Small Business
- Office
- Regional/Local Growth
- Agriculture
- Distressed Properties
- Senior Housing
- NNN Properties

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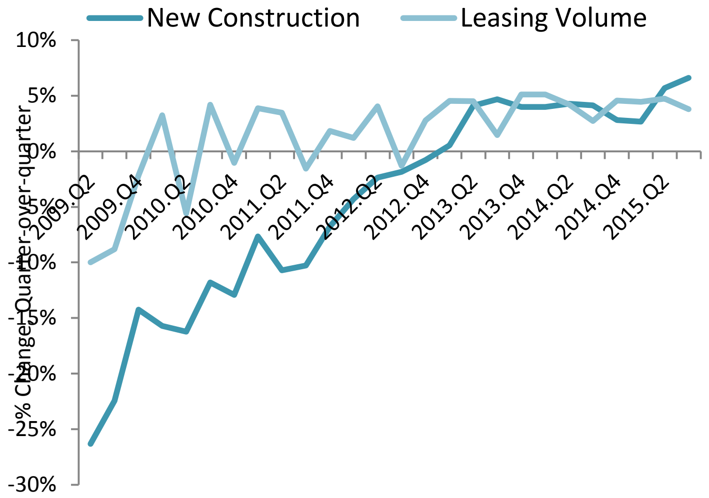
Leasing Fundamentals

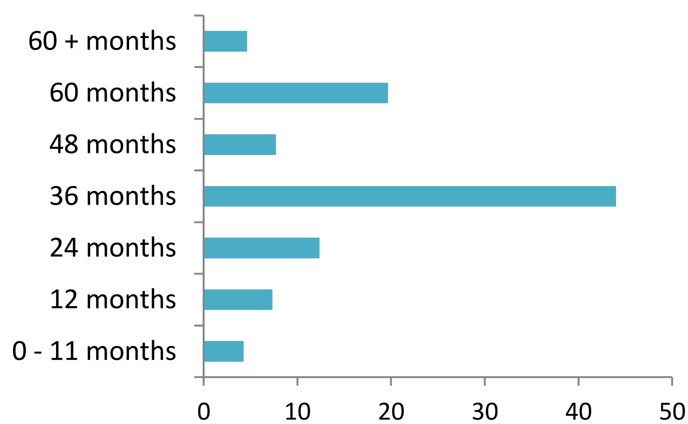
Commercial fundamentals continued improving during the third quarter 2015. Leasing volume during the second quarter rose 3.8 percent compared with the second quarter 2015. Leasing rates advanced at a steady pace, rising 2.5 percent in the third quarter, compared with the 2.7 percent advance in the previous quarter.

NAR members' average gross lease volume for the quarter was $567,257, 9.8 percent lower than the previous period. New construction accelerated, posting a 6.6 percent gain from the second quarter of this year.

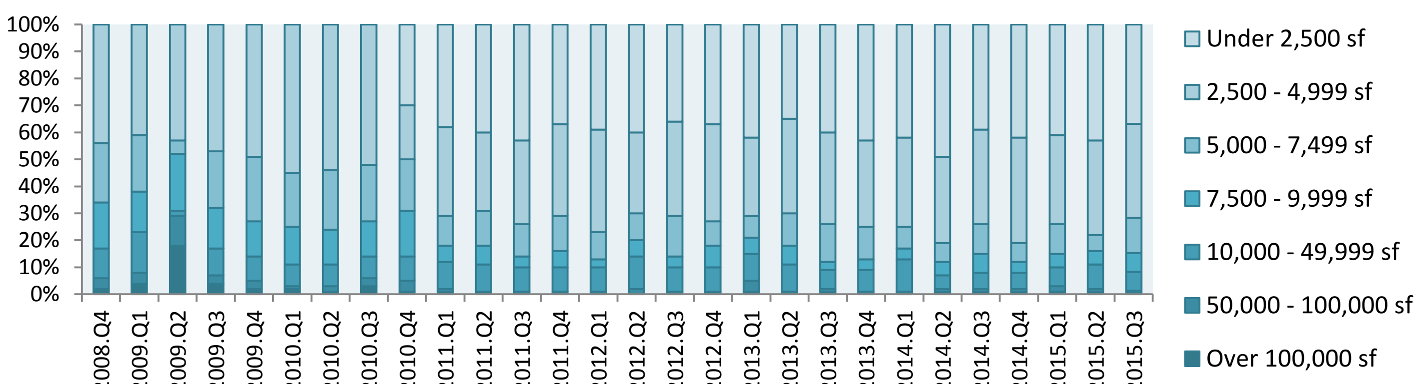
Tenant demand remained strongest in the 5,000 square feet and below, accounting for 72 percent of leased properties. However, demand for space in the 5,000 – 7,499 square feet more than doubled during the third quarter, comprising 13 percent of total. Lease terms remained steady, with 36-month and 60-month leases capturing 64 percent of the market.



Average lease term during last transaction (%)



Average Leased Space by Size, Quarterly*



*Prior to 2010.Q4 "Under 5,000 sf was the lowest category available.

Source: National Association of Realtors®

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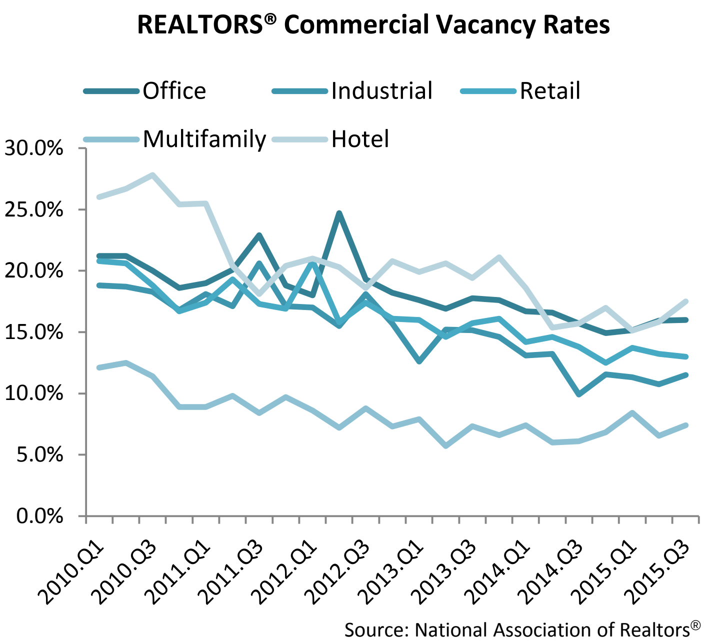

REALTORS® 2015.Q3 Vacancy Rates	
Office	16.0%
Industrial	11.5%
Retail	13.0%
Multifamily	7.4%
Hotel	17.5%

Leasing Fundamentals - continued

Vacancy rates mirrored the regional and product variations REALTORS® markets, ranging from a low of 7.4 percent for apartments to a high of 17.5 percent for hotel properties. With rising new supply, apartments experienced availability increases, as the national average rose from 6.1 percent in the third quarter of 2014 to 7.4 percent in the third quarter of this year.

Office vacancies rose 30 basis points to 16.0 percent compared with a year ago. Industrial availability witnessed a yearly increase of 160 basis points—to 11.5 percent. Retail vacancies declined 80 basis points on a yearly basis, to 13.0 percent.

Lease concessions declined 4.5 percent. Tenant improvement (TI) allowances averaged $30 per square foot per year nationally.

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Comments

The REALTORS® Commercial Real Estate Quarterly Market Survey asks participants to comment on current conditions in their markets. Below are selected remarks about the latest market environment.

Access to financing is our biggest challenge. Buyers are ready yet funding sources prove fruitless.

Any good quality property is in high demand.

Availability of credit is still too limited.

Banks are being way too tough...taking way too long. High taxes are stopping new building projects.

Birmingham, AL has seen more new building in its CBD than it has seen in over 25 years. The outlying areas next to the CBD are benefiting as well with new construction on the east and south sides. There are millions of dollars of foreign investment starting to flood into the Birmingham, AL CBD. Many areas of opportunity are waiting to be demolished and redeveloped.

Commercial construction is increasing nicely here. Our residential market has far surpassed the upside of the last cycle and is rapidly increasing in price as well as volume.

Confidence for business formations is still not as strong as it could be. People are hesitant to take risks.

[There is] Huge discrepancy between sellers and buyers. Sellers are substantially overvaluing their properties. Big Corp & Wall Street news tends to color Main Street realities and set completely unrealistic lease or sale expectations for owners.

Market is on steady rise, hitting some head winds with the State of Illinois.

Industrial inventory is in short supply, not just the properties, but parcels zoned for industrial. Drought conditions have made ag land hard to sell.

Low inventory results in higher sales price with compressed cap rates. [Section] 1031 exchange is not recommended due to low inventory.

Most of the Mom and Pop businesses suffer due to the not-so-affordable advertising requirements needed to attract buyers and sellers. Multi Task is decaying and direct commercial companies push them out.

Mostly flat and more economic uncertainty may continue to push it lower. Business does not feel comfortable to expand or make any long term commitments.

Office market is overbuilt. Drastic drop in Oil prices has slowed employment growth.

Our market has been slow to recover from the meltdown of 2008. We have had to overcome both local and statewide political impediments to our progress. Things are pointing up, but it appears that it will be another couple of years till our market will be robust.

Our market on the western slope of CO is still plagued by lack of businesses and investors moving to the area, unlike the eastern slope.

People are still expecting recession deals, but without the alternatives, so the mind set of beating up on the Landlords is fading.

Comments – continued

Plenty of capital available for well-planned urban area re-development.

Purchasers taking a step back as prices increased earlier this year.

Retail inventory is down enough that retail is being built for the first time in 7 years.

Retailers want the best A class sites and are unwilling to compromise. That drives rents and land prices through the roof.

San Francisco's market is strong.

The Agriculture Market is very active

The energy industry is suffering from low commodity pricing in addition the extreme drought conditions and generally the lack of water are negatively impacting new residential and commercial construction and agricultural land values.

The overall market was making a strong move from March to about July 2015, but the 3rd quarter was good for me because of multiple year leases exercised options to purchase, and one REO sale for a bank on Class A office building. 3rd Quarter was very flat in both residential and commercial. Still getting calls but very picky slow purchases. The 3rd quarter is nowhere close to the activity in 2nd quarter of 2015.   Gas prices are down and interest rates are down, I cannot find a cause for the sudden slow down on showing calls. […] Something has happened in the economy more than regional markets. I cannot explain it to my clients but it is definitely changed late July and early August.

The sequester component of the Federal budget is a huge negative factor for Hampton Roads.

There is a lot of uncertainty mixed with some optimism as to what is going to happen in the future marketplace. Banks are getting a bit more cooperative - appraisers are still being difficult but life moves on...

This is a growth market with several non-spec developments coming online over the next 12 months that will further create additional demands on the other property types.

This market is heavily based on agriculture. The agricultural economy is experiencing lower crop prices, but very good yields. I see steady local market conditions. We have seen approximately a 70% increase in commercial building in the last 5 years.

Very little movement in the market. Marginal increase coming out of the recession.

We are a small rural town, close to reservation. Not many high paying jobs.

We have a lot of office space available but very little warehouse with more demand on warehouse than office.

We have a waiting list, which hasn't happened in the last 15 years.

With the concern of the federal budget, defense spending is stagnant awaiting future direction of Federal Government.

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