COMMERCIAL REAL ESTATE TRENDS & OUTLOOK

February 2020

National Association of REALTORS® Research Group

COMMERCIAL
Real Estate

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NATIONAL ASSOCIATION *of* REALTORS®

COMMERCIAL REAL ESTATE TRENDS & OUTLOOK
February 2020

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COMMERCIAL REAL ESTATE TRENDS & OUTLOOK
February 2020 Report

This latest *Commercial Real Estate Trends & Outlook Report* discusses trends in the small commercial market (transactions that are typically less than $2.5 million) based on a survey of commercial REALTORS® about their 2019 Q4 transactions and the latest publicly available data.

Respondents reported commercial dollar sales volume rose 4% in 2019 Q4 from one year ago, new leasing dollar volume rose 3%, and commercial development (in square feet) rose 5%.

Among respondents, the median commercial sales price growth in 2019 Q4 from one year ago was 3%. Apartment, industrial warehouse and flex, and office class A properties had the lowest cap rates, with a median of 6.5%. Among respondents, the median cap rate for retail mall properties was also 6.5%. The retail trade industry appears to be adapting to the challenge coming from robust e-commerce sales. In November 2019, the retail trade industry gained 15,300 net new jobs from one year ago, in contrast to the job losses in past months.

Respondents reported that vacancy rates were still trending downwards. Among respondents, the average commercial vacancy rate across commercial types (multi-family, industrial, retail, and hotel) was 7.3% in 2019 Q4. The lowest rental vacancy rates were in multi-family, at 4%, followed by industrial, at 5%. The highest vacancy rates were in office, at 10%, followed by retail, at 9%.

Respondents reported that construction activity (in square feet) was up 5% in 2019 Q4 from one year ago. Given the low level of interest rates, majority of respondents reported an improvement in conditions related to obtaining debt (60%) and equity financing (57%). However, only a small fraction reported an improvement pertaining to zoning regulations (33%), hiring and cost of labor (23%), and obtaining and cost of raw materials (21%).

Majority of respondents reported observing an increase in construction activity outside the central business district (73%), repurposing of retail malls (71%), senior housing (68%), transit-oriented development (67%), co-working spaces (62%), apartments with smart home technologies (58%), and Opportunity Zone Fund investments (53%).

GDP growth is likely to pick up to 2.4% in 2020 given the de-escalation of trade tensions between the United States and China. With a pickup in growth, we expect commercial sales transactions to increase 3% in 2020 and commercial prices to increases to 2%. Slightly more than half (53%) of respondents expect more commercial business transactions in the next 12 months. Vacancy rates for apartment and industrial will range between 6% to 7% while vacancy rates for office, retail, and hotel hover at 10%.

Enjoy reading this latest report!

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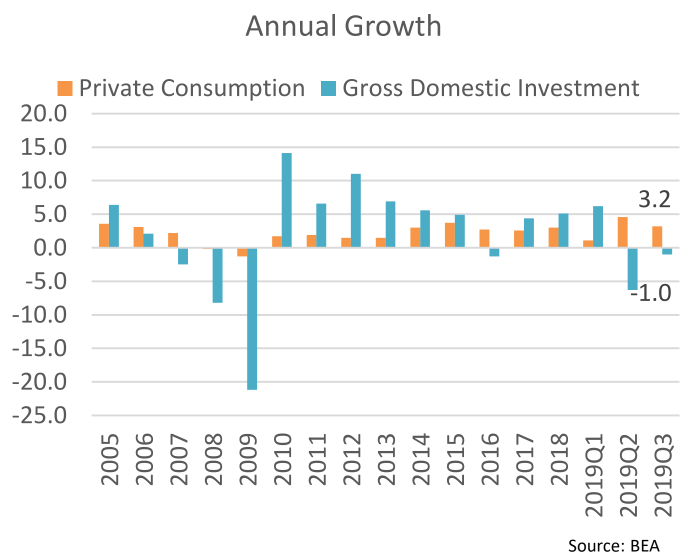
1 | ECONOMIC CONDITIONS

Economic Growth Slowed in 2019 Q3

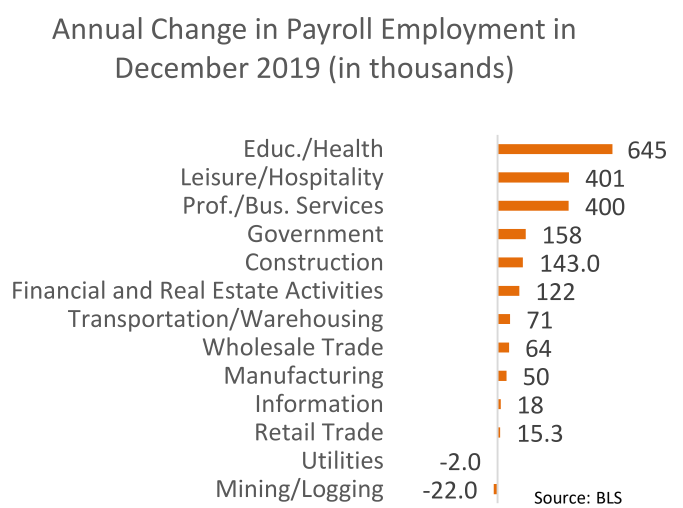
As the U.S.-China tariff war escalated in 2019 and investors became more concerned about the economy's long-term prospects, GDP growth slowed to 2.1% in 2019 Q3. Private investment spending contracted for the second straight quarter by 1% as non-residential investment spending dropped by 2.3%, although residential investment spending rose 4.6%, buoyed by low mortgage rates. The pullback in business spending as somewhat offset by the expansion in private consumer spending that rose 3.2%, amid strong job growth. Net exports rose a modest 1% after contracting in the prior quarter, while imports increased 2% after a flat growth in the prior quarter. Government spending rose 4.8% due to the strong growth in federal spending of 8.3%.



Sustained Job Creation in 2019

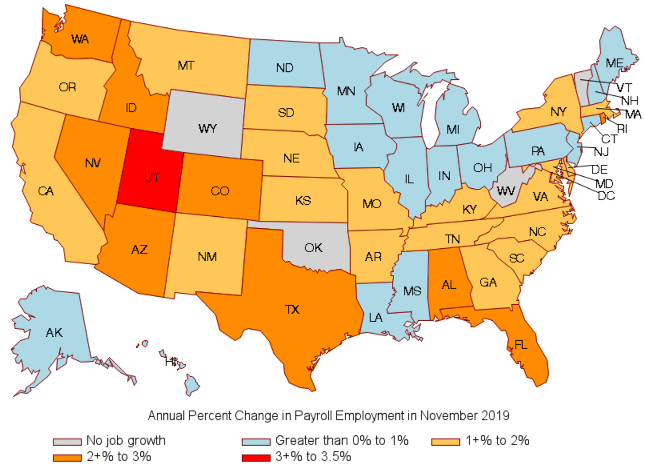
Job creation remained strong in 2019, with 2.1 million net new payroll jobs created as of December 2019 compared to one year ago. Payroll jobs rose in all sectors except in utilities and mining/logging. The retail trade industry, which had been losing jobs in past months, created net new jobs (15,300). The construction industry created 143,000 net new jobs, although this is about half of the 342,000 annual jobs created in January 2019.

The unemployment rate dipped to 3.5%, at par with 50 years ago. The number of 16+ year-old unemployed workers trended downwards to 5.75 million, near the level in 2000 (5.69 million).



1 | ECONOMIC CONDITIONS

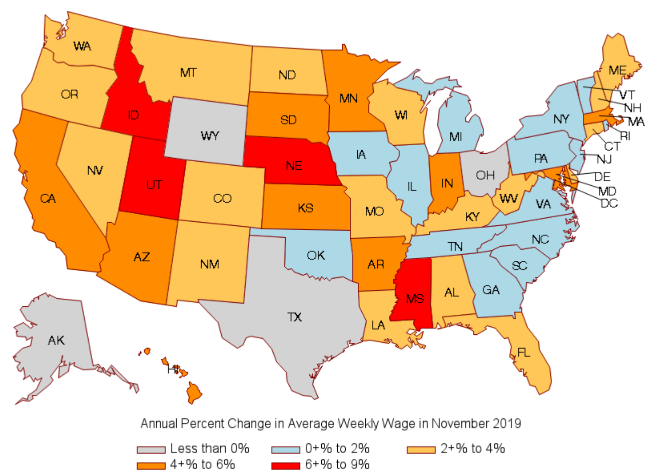
Nonfarm payroll jobs increased in all states, except Wyoming, Oklahoma, and West Virginia. The states with the strongest job growth were Utah (3.0%), Texas (2.7%), Nevada (2.7%), Idaho (2.6%), Washington (2.5%), Florida (2.5%), Alabama (2.4%), Arizona (2.4%), Rhode Island (2.2%), and Colorado (2.1%).



Annual Percent Change in Payroll Employment in November 2019

Wage Growth Tapers as Inflation Picks Up

Even as the unemployment rate continues to fall, average weekly wage growth has tapered. In December 2019, average weekly rose 2.3% from one year ago, about the same pace as the inflation rate. Wages have been rising at slower pace since January 2019 while inflation has picked up, resulting in no real wage gains for workers. Meanwhile, CPI-Shelter, an indicator for the price of housing services (e.g., rent) rose 3.2%. Rent growth has generally outpaced inflation and wage growth since 2012, an indication that housing supply remains low relative to demand.

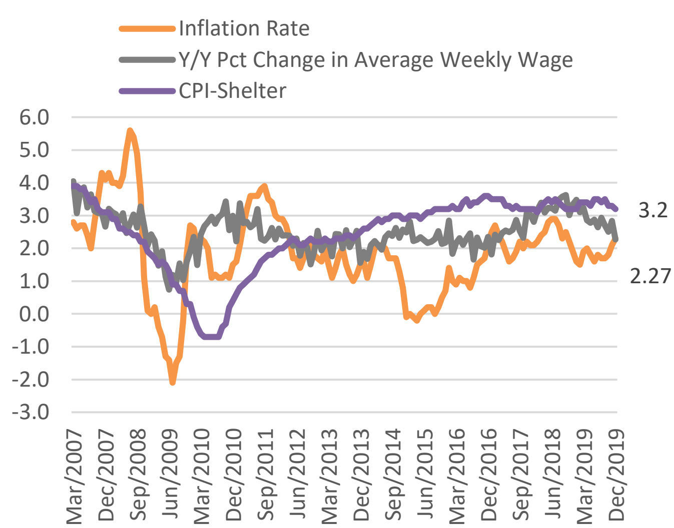


Annual Percent Change in Average Weekly Wage in November 2019

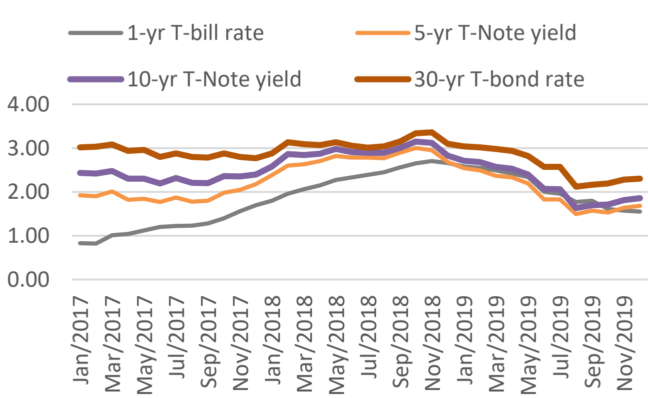
Average weekly wages rose in all states, except in Wyoming, Ohio, Alaska, and Texas (this may just be a statistical fluke given Texas' strong job growth.

Yield Curve Normalized in November 2019

The Federal Open Market Committee lowered the federal funds rate three times in 2019 by a total of 0.75%, to the current range of 1.5% to 1.75%. The yield curve normalized in November 2019 after it inverted in January 2019 when the 5-year T-note yield fell below the 1-yr T-bill rate.



Source: BLS



Source: FRB

2 | COMMERCIAL SALES

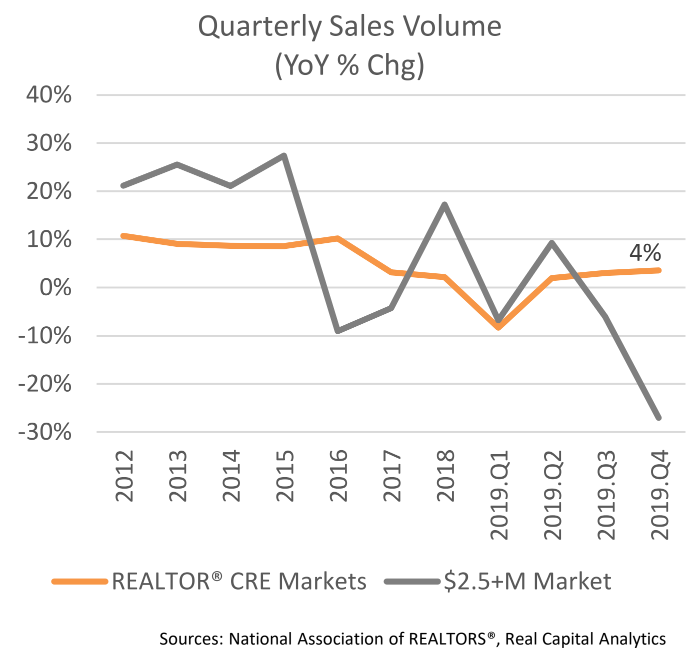
Sustained Growth in Small Market Commercial Sales Transactions in 2019 Q4

In the small commercial real estate market (below $2.5 million average sales volume), sales volume rose 4% in 2019 Q4 from one year ago, according to commercial members of the National Association of REALTORS® who responded to NAR's *2019 Q4 Commercial Real Estate Quarterly Market Survey.*

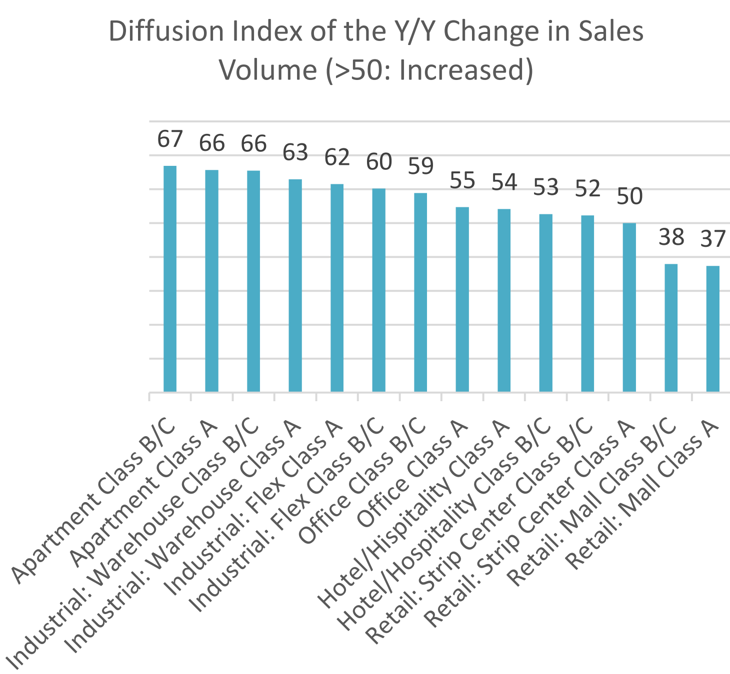
Notwithstanding the slowdown in growth in 2019, respondents reported no change in the pace of sales during 2019. The majority of respondents also reported an improvement in local economic conditions in 2019 Q4 from one year ago (78%) and national economic conditions (75%). Majority also reported they saw an improvement in obtaining debt (60%) and equity financing (57%), given the low level of interest rates.

Based on the diffusion index* for each asset class, sales transactions for apartment and industrial properties had the strongest gains compared to other asset classes (above 50). Transactions in the office market were almost stable (hovering around 50) while sales transactions for retail properties were weaker compared to one year ago (below 50).

In the large CRE market (at least $2.5M), the dollar sales volume was down by 27% year-over-year in October–November 2019, as the dollar volume of transactions fell to $73.3 billion from $100.4 billion during the same period one year ago, according to Real Capital Analytics. Investors in the large commercial real estate market ($2.5 million or more) were more likely impacted by the heightened economic and global tensions in 2019 than small investors.



Sources: National Association of REALTORS®, Real Capital Analytics



** A diffusion index above 50 means more respondents reported an increase in sales activity in the reference quarter compared to one year ago than the number of respondents who reported a decrease, indicating that the market is broadly "stronger" compared to one year ago. A value of 50 means a "stable" market, while an index below 50 means a '"weaker" market.*

2 | COMMERCIAL SALES

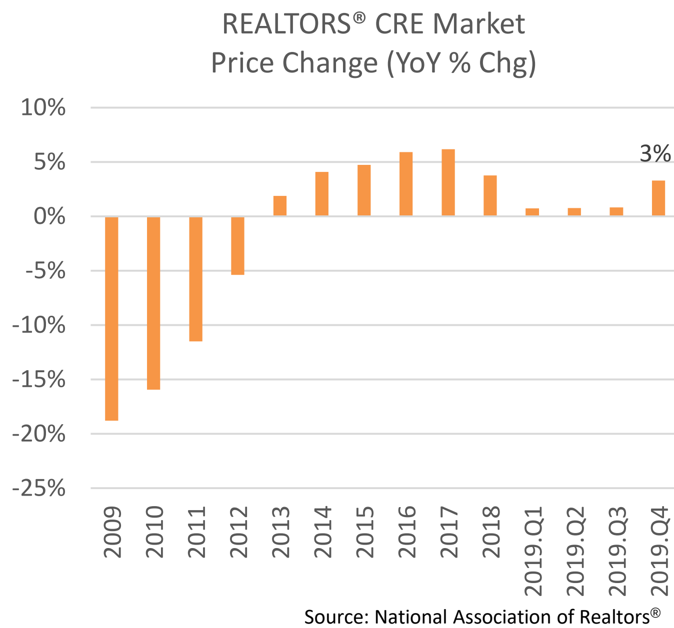
Strong Price Growth in the West Region and in Industrial Property Transactions

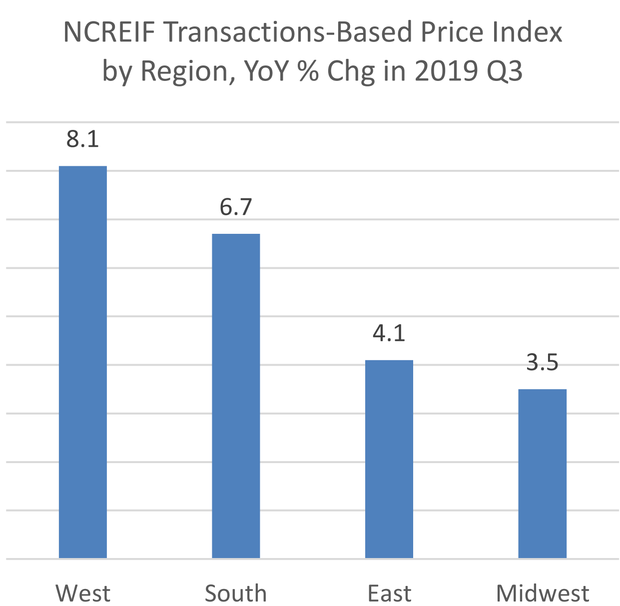
In the small commercial real estate market (sales transactions of less than $2.5 million), commercial property prices were up 3% in 2019 Q4 from one year ago.

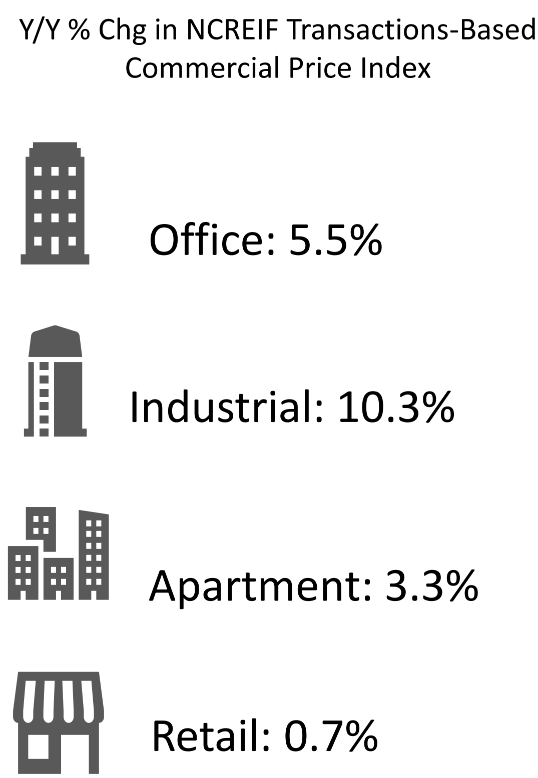
Commercial price indices compiled by other institutions also show that commercial prices are still on the uptrend. The Green Street Commercial Price Index, which tracks REIT investments, rose 2.5% in 2019 Q4.

The National Council of Real Estate Investment Fiduciaries reported a 6% y/y increase in the transactions-based price index in 2019 Q3 from one year ago, with the strongest price gain in the industrial market (10.3%), followed by office (5.5%), apartment (3.3%), and lastly retail (0.7%).

Based on the NCREIF Index, the West region had the strongest commercial price appreciation in 2019 Q3 from one year ago (8.1%), followed by the South (6.7%), the North (4.1%), and lastly, the Midwest (3.5%).







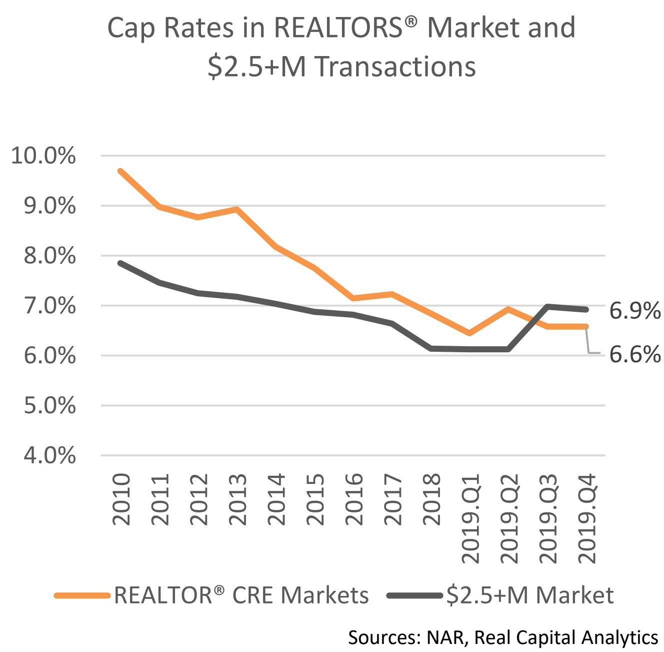
2 | COMMERCIAL SALES

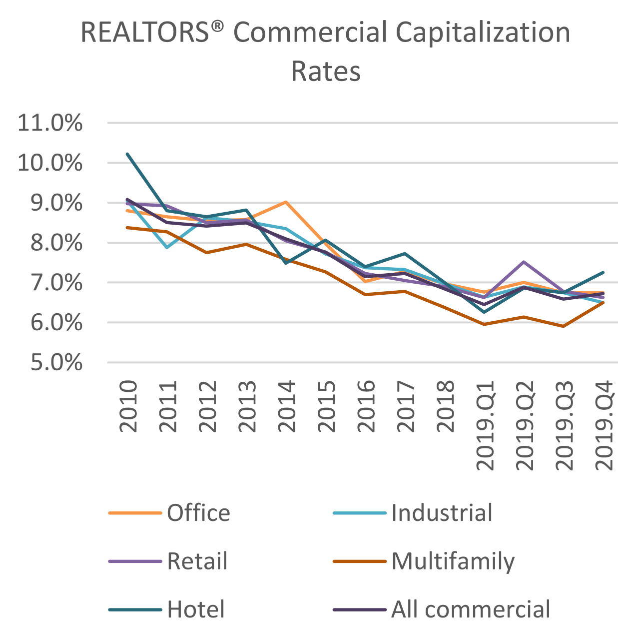
Cap Rates Still Trending Down

Cap rates for transactions in the small commercial real estate market (below $2.5 million) compressed to 6.6% in 2019 Q4 from 6.9% in 2019 Q2. On the other hand, cap rates in the large commercial market ($2.5 million or more transactions) reported by Real Capital Analytics trended up in the second half of 2019, to 6.9% in 2019 Q4 from 6.1% in 2019 Q2. Large commercial real estate investors appeared to have factored in to a greater degree the risks from a potential economic downturn as economic growth slowed during the year, the yield curve inverted, and investment spending contracted.

In the small commercial real estate market, multi-family, industrial warehouse and flex, and office class A properties had the lowest cap rate, at 6.5%. The median cap rate among respondents for retail mall properties was also 6.5%. The retail trade industry appears to be adapting to the challenge coming from robust e-commerce sales. In November 2019, the retail trade industry gained 15,300 net new jobs from one year ago, in contrast to the job losses in past months.

Cap Rates in 2019 Q4	
All Commercial	6.7
Office: Class A	6.5
Office: Class B/C	7.0
Industrial: Warehouse	6.5
Industrial: Flex	6.5
Retail: Strip Center	6.8
Retail: Mall	6.5
Apartment	6.5
Hotel/Hospitality	7.3
Source: 2019 Q4 NAR CRE Market Survey	
For $2.5 million or less properties	





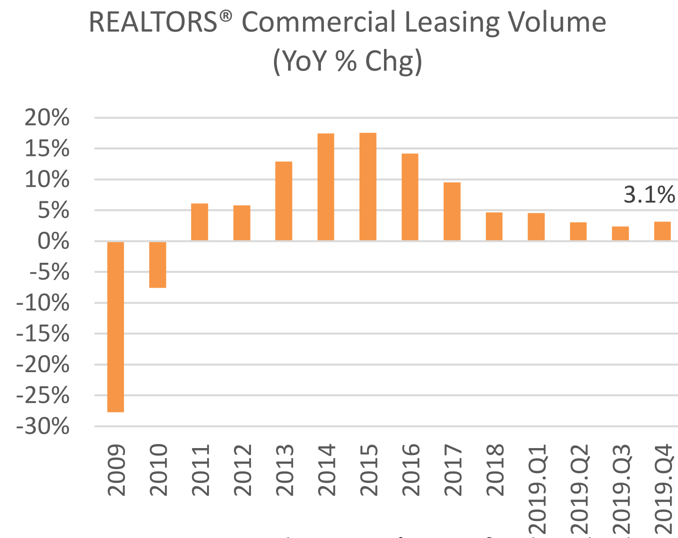
3 | COMMERCIAL LEASING

Strong Leasing Activity in Apartment and Industrial Market

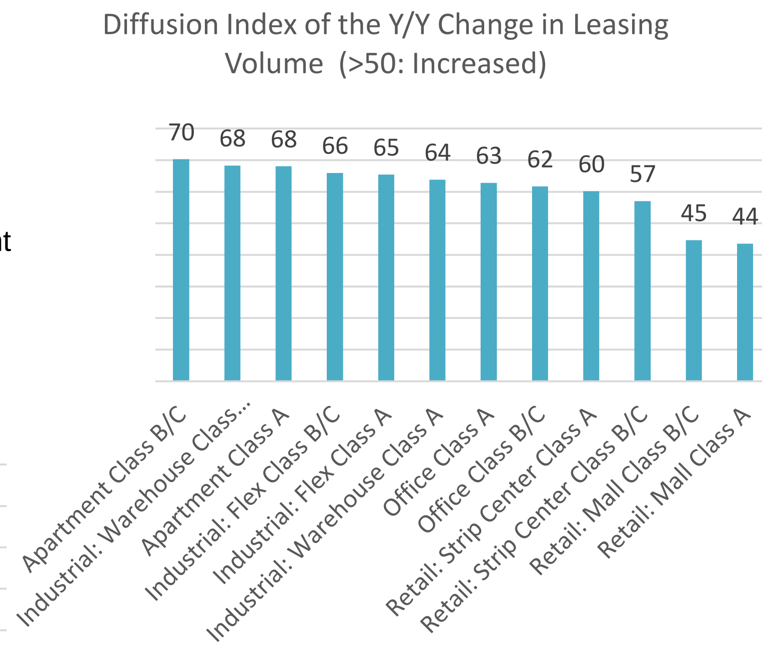
REALTORS® and commercial affiliate members reported a 3.1% increase in new leasing dollar volume in 2019 Q4 compared to one year ago. This is a slower pace of increase compared to the 5% growth in 2018.

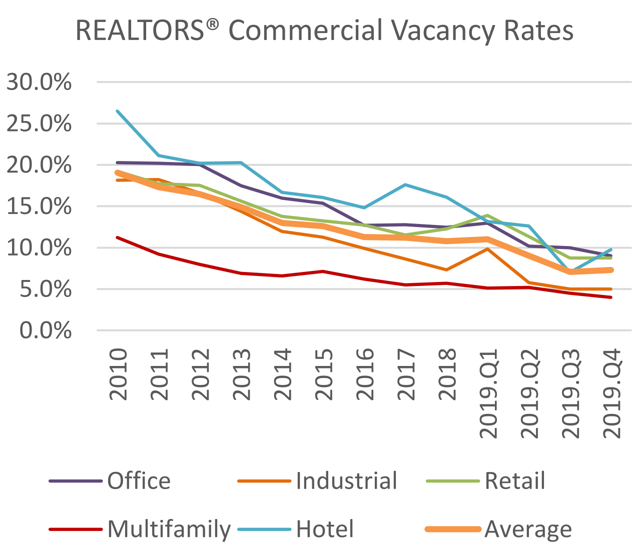
Based on the diffusion index by property type, leasing activity increased most strongly for apartment and industrial warehouse and flex properties. Office leasing activity was also broadly strong, as well as leasing in retail strip centers (above 50). Respondents reported that their new leasing volume in retail malls contracted in 2019 Q4 compared to one year ago.

Vacancy rates in the small commercial real estate market generally trended down in 2019, to 7.3% in 2019 Q4, from 11% in 2019 Q1. The lowest median vacancy rates were in apartment (4%) and industrial properties (5%), with the highest vacancy rates in retail and office (9%).



Sources: National Association of REALTORS®, Real Capital Analytics





Median Vacancy Rates in 2019 Q4	
All commercial	7.3%
Multifamily	4.0%
Industrial	5.0%
Retail	8.8%
Office	9.0%

Source: 2019 Q4 NAR CRE Market Survey

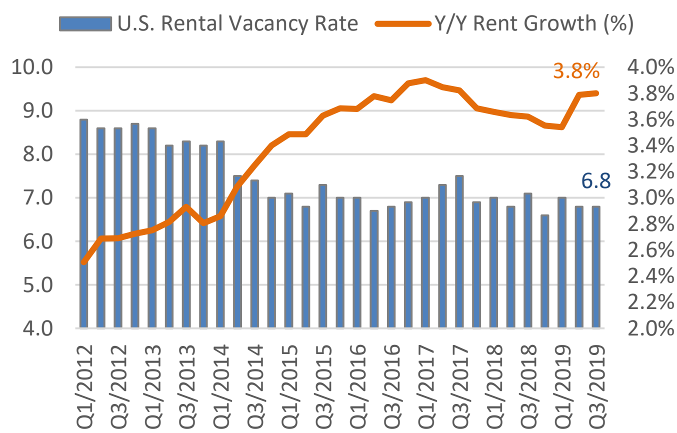
For $2.5 million or less properties

3 | COMMERCIAL LEASING:APARTMENTS

The U.S. rental vacancy rate has mainly been trending downwards since 2012, to 6.8% in 2019 Q3. As rental rates have tightened, rent growth has mainly trended upwards, to 3.8% in 2019 Q3. Rent growth outpaced inflation of 2% and average weekly wage growth of 2.5% during this quarter.

Rental vacancy rates have remained low as housing starts have not kept pace with net household formation. As of 2019 Q3, housing starts fall short of household formation by about 200,000 units.

Among the largest 75 metro areas for which the U.S. Census Bureau produces data on rental vacancy rates, the lowest vacancy rates were in Worcester, MA-CT (1.1%); Minneapolis, MN (2%); Buffalo, NY (2.8%); Grand Rapids, MI (2.8%); San Francisco (3.3%); San Jose (3.7%); and Los Angeles (3.9%).



Sources: U.S. Census Bureau, Bureau

On the other hand, rental vacancy rates were over 11% in the metropolitan areas of Charleston, SC; Albany, NY; Cape Coral, FL; New Haven, CT; Houston, TX; Syracuse, NY; Memphis, TN; Baltimore, MD; and Cincinnati, OH.

Rental Vacancy Rates in 2019 Q3

Worcester, MA-CT	1.1
Minneapolis-St. Paul-Bloomington, MN-WI	2.0
Buffalo-Cheektowaga-Niagara Falls, NY	2.8
Grand Rapids-Wyoming, MI	2.8
San Francisco-Oakland-Hayward, CA	3.3
San Jose-Sunnyvale-Santa Clara, CA	3.7
Los Angeles-Long Beach-Anaheim, CA	3.9
Akron, OH	4.0
New York-Newark-Jersey City, NY-NJ-PA	4.3
Toledo, OH	4.3
Seattle-Tacoma-Bellevue, WA	4.6
Bridgeport-Stamford-Norwalk, CT	4.7
Jacksonville, FL	4.7
Portland-Vancouver-Hillsboro, OR-WA	4.7
Providence-Warwick, RI-MA	4.7
Boston-Cambridge-Newton, MA-NH	4.8
Greensboro-High Point, NC	5.1
Sacramento-Roseville-Arden-Arcade, CA	5.1
Washington-Arlington-Alexandria, DC-VA-MD-WV	5.1
Las Vegas-Henderson-Paradise, NV	5.2
Cleveland-Elyria, OH	5.3
Phoenix-Mesa-Scottsdale, AZ	5.3
Salt Lake City, UT	5.3
Denver-Aurora-Lakewood, CO	5.4
Riverside-San Bernardino-Ontario, CA	5.5
Pittsburgh, PA	5.8
Hartford-West Hartford-East Hartford, CT	5.9
Urban Honolulu, HI	6.0
Chicago-Naperville-Elgin, IL-IN-WI	6.2
Milwaukee-Waukesha-West Allis, WI	6.2

Rental Vacancy Rates in 2019 Q3

Charleston-North Charleston, SC	16.5
Albany-Schenectady-Troy, NY	15.5
Cape Coral-Fort Myers, FL	15.2
New Haven-Milford, CT	13.5
Houston-The Woodlands-Sugar Land, TX	12.4
Syracuse, NY	11.8
Memphis, TN-MS-AR	11.6
Baltimore-Columbia-Towson, MD	11.5
Cincinnati, OH-KY-IN	11.1
Little Rock-North Little Rock-Conway, AR	10.8
Richmond, VA	10.7
St. Louis, MO-IL	10.6
Tulsa, OK	10.3
Baton Rouge, LA	10.2
Knoxville, TN	10.1
Tucson, AZ	10.0
Tampa-St. Petersburg-Clearwater, FL	10.0
Kansas City, MO-KS	9.5
Charlotte-Concord-Gastonia, NC-SC	9.5
Rochester, NY	9.1
San Antonio-New Braunfels, TX	9.0
New Orleans-Metairie, LA	9.0
Raleigh, NC	8.9
Louisville/Jefferson County, KY-IN	8.6
Dallas-Fort Worth-Arlington, TX	8.6
Philadelphia-Camden-Wilmington, PA-NJ-DE-MD	8.0
Albuquerque, NM	7.8
Omaha-Council Bluffs, NE-IA	7.6
Oklahoma City, OK	7.3
Dayton, OH	7.3

Source: U.S. Census Bureau

4 | COMMERCIAL CONSTRUCTION

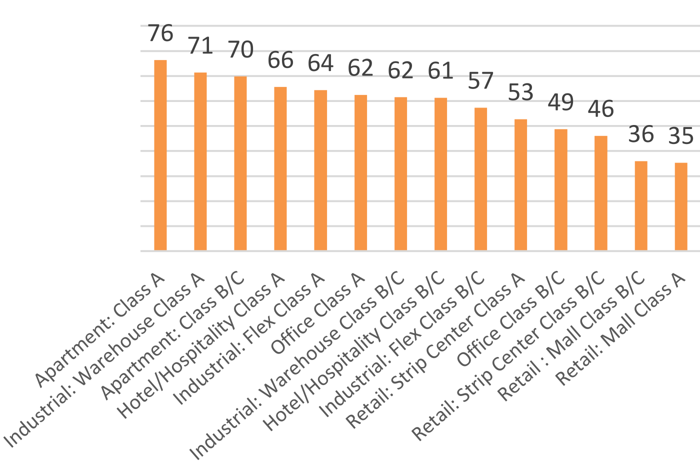
Slight Uptick in Commercial Construction Activity

The construction of commercial space dipped in 2019. The U.S. Census Bureau reported that the seasonalized annual value of construction put in place for commercial properties ((buildings for wholesale, retail, and selected service industries), office, lodging, and multifamily structures decreased to $238 billion as of November 2019, from $246 billion in June 2019.

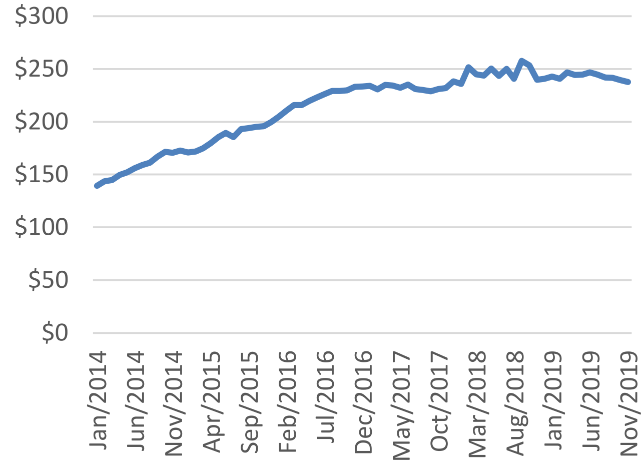
However, commercial members of the National Association of REALTORS® who typically engage in the small commercial real estate market (sales of $2.5 million) reported that construction activity (in square feet) rose 5% in 2019 Q4 from one year ago, about the same pace during the first three quarters of 2019, but slower than the 15% expansion in 2018. The pace of construction activity peaked in 2016 and has tapered since then.

By property type, respondents reported the strongest annual increase for apartment and industrial properties. Respondents reported a decline in construction activity for office class B and malls.

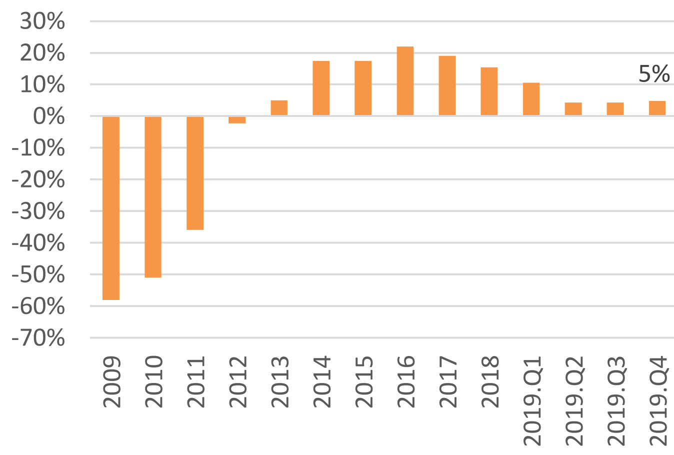
Diffusion Index of the Y/Y Change in Construction in Sq. Ft. (>50: Increased)



Seasonalized Annualized Value of Construction Put in Place for Multifamily, Lodging, Office, Commercial Properties as of November 2019 ($Bn)



Year-over-Year Change in Construction Volume Among NAR Commercial Members and Affiliates



Source: National Association of Realtors®

5 | COMMERCIAL OUTLOOK

Macroeconomic Outlook

We expect GDP growth to pick up to 2.4% in 2020 given the de-escalation of trade tensions between the United States and China, starting with the signing of the Phase One Trade Deal in January 2020. We view this development as having a positive impact on investor confidence and rising business investment. Unemployment rate will further ease to 3.6%,

The Federal Open Market Committee to likely maintain the federal funds rate at the current range of 1.5% to 1.75%. Under an accommodating monetary policy, the 30-year fixed contract mortgage rate is expected to stay below 4%, which will support 5.5 million of existing home sales and 0.75 million of new home sales. Low interest rates will keep debt financing for new home construction low, encouraging the production of more homes. As builders continue to see strong demand for both owner-occupied homes and rentals, we expect builders to increase construction of new housing to 1.37 million, of which 415,000 (30%) will be multi-family units.

2020 OUTLOOK: as of January 2020

	2018	2019	2020F
Economy			
Real GDP, % Growth	2.9%	2.1%	2.4%
Inflation Rate	2.4%	2.0%	2.0%
Unemployment Rate	3.9%	3.7%	3.6%
30-Yr Fixed Rate	4.5%	4.0%	3.8%
Housing Starts (in '0000			
Total	1,250	1,290	1,368
Single-family	876	888	953
Multi-family	374	402	415
Commercial Market*			
Commercial Sales, % change	2.2%	0.1%	3.7%
Commercial Prices, % change	3.8%	1.4%	2.4%
Vacancy Rates*			
Apartment	6.9%	6.9%	6.8%
Industrial	7.3%	6.4%	6.3%
Office	12.5%	11.0%	10.9%
Retail	12.5%	10.5%	10.4%
Hotel	16.1%	10.6%	10.5%

Source: National Association of REALTORS®

** Commercial sales and price forecasts are for commercial market transactions of less than $2.5 million.*

Apartment renta vacancy forecast is based on US Census rental vacancy rates.

Vacancy rates for other properties are based on REALTOR® transactions of less than $2.5 million

Commercial Outlook

With a pickup in growth, we expect commercial sales transactions to increase 3% in 2020 and commercial prices to increases to 2%. Nearly half (53%) of respondents expect their commercial business to increase in the next 12 months.

With higher demand from stronger economic growth, we expect vacancy rates to tighten in 2020. Multi-family and industrial will continue to be strong commercial asset classes. Vacancy rates for apartment and industrial will range between 6% to 7% while vacancy rates for office, retail, and hotel hover at 10%. The demand for apartment rentals will remain strong in metro areas with low vacancy rates, such as in San Francisco, San Jose, and Los Angeles, Seattle, Salt Lake City, and Washington D.C.

Industrial properties will remain in demand given the sustained growth in e-commerce and as brick-and-mortar retailers continue to attract and retain their customers through online shopping and delivery. The retail trade properties appears to be coming back to life: 71% of respondents reported that they are retail stores being repurposed for other uses.

In the multi-family market, 68% of respondents reported that they are seeing an increase in business for senior housing living and in transit-oriented development projects.

With the finalization of the regulations for Opportunity Zone investments last December 19, 2019, we expect more investments in OZ areas in 2020. Nearly half of respondents reported an increase in investments funded from OZ funds in 2019 Q3 from one year ago.

6 | COMMERCIAL BUSINESS TRENDS

A 2019 Q4 survey of commercial members of the National Association of REALTORS® were asked: *"Did you observe an Increase in the following developments in your primary market compared to one year ago?* The fraction of respondents* who reported **Yes**:

Senior housing: **68%**

Transit-oriented development: **67%**

Apartment with smart home technology: **58%**

Group-living: **48%**

Parking-free apartments: **32%**

Micro-apartments: **32%**

**Respondents answered Yes or No and skipped the question if they did not know. On average, there were 462 respondents who answered each question, +/- 28 respondents.*

6 | COMMERCIAL BUSINESS TRENDS

A 2019 Q4 survey of commercial members of the National Association of REALTORS® were asked: "*Did you observe an increase in the following developments in your primary market compared to one year ago?* The fraction of respondents* who reported **Yes**:

Construction outside Central Business District: **73%**

Repurposing of Retail Malls: **71%**

Co-working/flex spaces: **62%**

Opportunity Zone Fund investments: **53%**

LEED Certification: **43%**

WELL Certification: **19%**

**Respondents answered Yes or No and skipped the question if they did not know. On average, there were 462 respondents who answered each question, +/- 28 respondents.*

6 | COMMERCIAL BUSINESS TRENDS

A 2019 Q4 survey of commercial members of the National Association of REALTORS® were asked: "*Did you see an improvement in these conditions in your primary market area compared to one year ago?* The fraction of respondents* who reported **Yes**:

Local economic conditions: **78%**

National economic conditions: **75%**

Obtaining debt /equity financing: **60% / 57%**

Zoning regulations: **33%**

Hiring and cost of labor : **23%**

Obtaining and cost of raw materials: **21%**

**Respondents answered Yes or No and skipped the question if they did not know. On average, there were 472 respondents who answered each question, +/- 27 respondents.*

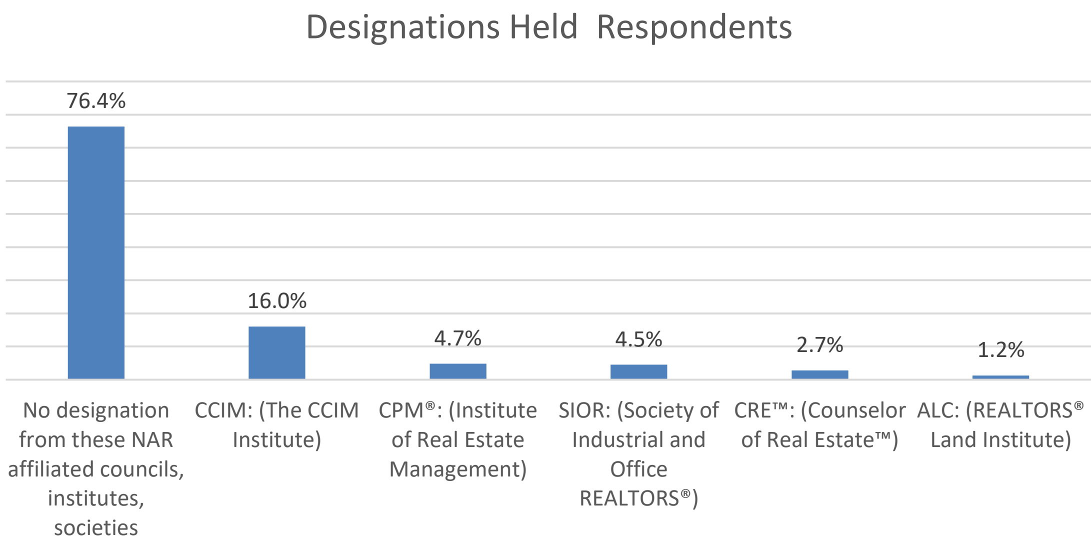
7 | ABOUT THE SURVEY

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 Q4 survey was sent to approximately 69,000 commercial REALTORS® and members of affiliate organizations during January 2–19, 2019, of which 844 responded to the survey. A smaller number of respondents reported their sales (538), leasing (333), and construction (310) activities.

Among sales agents who had a sale during 2019 Q4, the average sales transaction was $598,000.

Of the 844 respondents who answered the question about designations held by the respondent, 24% reported holding designations from an affiliated society, institute, or council.



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