Research

USAA Real Estate Company

Commercial Real Estate Update

U.S. Economy

Encouraging data in April has soothed fears of another spring slowdown …

- The rebound in April's economic data has calmed most concerns that the economy is experiencing another Spring slowdown
- GDP growth in the first quarter jumped to a 2.5% annualized rate, an impressive feat given the unprecedented fiscal squeeze, and much better than the anemic 0.4% growth in the final quarter of last year
- Looking forward, we expect 2nd quarter growth to be around a more modest 2.0% due to the economic weakness earlier in March
- April's employment numbers were better than expected, with 165,000 jobs added for the month plus a 114,000 upward revision to the gains for the preceding two months
- Unemployment edged down to 7.5% in April, a four-year low, dropping another 10 basis points from the previous month; a noteworthy item in the labor report was the large increase in temporary employment, a promising sign for permanent employment in the months ahead
- Inflation dropped to an annual rate of 1.1% in April, a much larger drop than the consensus forecast, and leading to speculation that the Fed might become concerned about a very low inflation environment, or even deflation
- Retail sales in April were solid across the board, up 0.1% from the month earlier, and providing the strongest sign yet that households have largely shrugged off January's tax hikes
- Consumer confidence increased sharply in the preliminary May reading to nearly a six-year-high of 83.7, largely driven by lower gasoline prices and the stock market continuing to touch record highs

National Commercial Real Estate

Property markets continue to edge further into recovery …

- Real estate markets are continuing to strengthen—we expect the first half of 2013 to follow a similar growth trajectory as in 2012

- Real estate investment remains attractive relative to other asset classes as yield spreads to 10-year treasuries are still historically high; periods of high real estate spreads are typically followed by several years of outperformance
- New construction activity remains low in all but a few key markets, allowing property fundamentals to continue improving while demand gradually recovers
- Major markets continue to outperform the non-major markets; pricing has improved by 45.1% since the trough for assets in major markets, nearly double the gain of the non-major markets (according to the Moody's/RCA CPPI)
- Capitalization rate compression will likely give way to income growth as a source of excess returns during the upcoming five years

Apartments

Fundamentals continued to improve in the first quarter …

- The national vacancy rate continued its march downward during the first quarter, dropping another 20 basis points to 4.3%, and marking the lowest rate since late 2001
- New York remained the tightest market in the country with a 1.9% vacancy rate, followed by eight other markets with vacancies under 3%
- Demand remained strong as the sector absorbed over 36,000 units during the quarter, driven by a healthy rate of leasing activity
- Supply growth took a brief pause, with only 15,000 units delivered in the first quarter, as compared to the 27,000 units that were completed in the fourth quarter
- Deliveries of new supply will continue to ramp up—over 150,000 units are expected to enter the market this year, with the majority opening their doors in the latter part of the year
- Asking and effective rents both grew by 0.5% during the first quarter, a respectable gain, but the slowest rate of rent growth since Q4 2011
- The next few quarters will test the robustness of the apartment sector with respect to rising supply and the sustainability of rent growth

Office

The office market eked out another quarter of small gains …

- The national vacancy rate decreased 10 basis points to 15.3% in the first quarter, roughly the same pace of improvement as the last four quarters
- Net absorption declined to a positive 3.5 million square feet for the quarter, less than half of the 8.3 million square feet absorbed during the fourth quarter, but positive absorption nonetheless
- Construction activity also slowed during the first quarter with only 1.7 million square feet delivered—high vacancy rates and lackluster tenant demand continue to make it tough to justify breaking ground for new office projects

- Behind the all-encompassing national numbers, market-level figures are roughly split in half, with some markets showing improvement in market fundamentals while others are showing declines
- San Francisco, New York, San Jose, Austin, Dallas, Houston, and San Antonio continue to lead the way in the recovery, which is no real surprise given the out-performance of the technology and energy sectors
- With only a smattering of markets performing strongly, the office recovery is still not yet widespread and still stuck in the early to mid-stage of the recovery cycle
- For the office sector, 2013 is shaping up to be a repeat of the last two years, but the good news is that NOI growth should start to improve later this year

Industrial

Industrial sector recovery gains momentum …

- The national availability rate dropped to 12.3% for the first quarter, a 50 basis points decline from the previous quarter, and more importantly, the largest quarterly drop since 2010
- Net absorption was a positive 63 million square feet for the quarter, and increase from the 56 million square feet during the fourth quarter, and the highest amount since Q2 2006
- The gap between supply and demand widened even further during the quarter as the amount of construction deliveries dropped to 10.8 million square feet, almost half of the previous quarter
- Construction activity will gradually ramp up over the next few years—growing obsolescence of older stock will fuel some near term replacement supply, as will a shortage of large state-of-the-art bulk warehouses
- Market rent growth has been strongest for the larger, modern properties in the major metro areas, especially in the leading coastal markets
- It will take several more years of above average rent growth until market rents in most markets recover to the levels seen prior to the peak
- The industrial sector is currently attracting more attention from investors, and as a result, values are increasing in anticipation of higher growth, but core investors should still be able to find investment opportunities in 2013

Retail

The recovery of the retail sector remains tepid …

- The national vacancy rate declined to 10.6% for the first quarter, dropping 10 basis points from the previous quarter
- Net absorption was a positive 2.9 million square feet for the quarter, a slight improvement from the 2.7 million square feet absorbed during the previous quarter
- New construction added only 1.1 million square feet during the quarter, a pace similar to the amount delivered in the fourth quarter

- Construction continues at a historically low pace as most owners are investing their capital into improving existing assets rather than funding new construction
- The recovery of the retail sector continues to be decidedly uneven—better properties in higher-income, supply-constrained locations are firmly into recovery, while weaker centers and markets continue to struggle with store closures, elevated vacancies, and rent declines
- The sector is also suffering from the legacy overhang of obsolete retail space that owners are either unwilling or unable to convert to a more productive use
- The gradual recovery will continue over the near term, but the sector should see accelerating gains in the next several years

Source: CBRE EA, Reis, Inc., Real Capital Analytics, Colliers, Deutsche Bank

Texas Economy

The Texas economy expanded robustly in April ...

- Texas added 31,300 jobs in April, after taking a brief pause in March, but continues to add jobs at nearly twice the national rate
- Year to date, Texas has added 87,300 jobs new jobs, representing a 2.4% annualized growth rate thus far this year
- The unemployment rate held steady at 6.4% in April, and continues to trend more than 1% lower than the national unemployment rate of 7.5%
- The regional economy continues to grow at a moderate pace, but the growth has been volatile over the past several months
- Labor shortages and prices pressures have also become slightly more pronounced, but remain mild

Residential housing activity continues to be strong …

- Sales of existing single-family homes picked up in March and were 18% higher as compared to March 2012
- The inventory of unsold existing homes relative to sales edged down to 4.2 months in March, dropping from 4.3 months in February
- The median sales price for an existing single-family home increased to $164,900 in March, more than 6.7% higher than the median sales price in March 2012
- Single-family construction permits jumped significantly in March versus the previous month, and are approximately 18.1% higher when compared to March 2012

San Antonio Commercial Real Estate

San Antonio Apartment Market

San Antonio apartment market on a roll with strong demand …

- The vacancy rate for the first quarter dropped to 5.7%, declining 30 basis points from the 6.0% in the fourth quarter
- Net absorption was a positive 483 units for the quarter, a slowdown from the furious pace of almost 2,000 units absorbed in the fourth quarter, but boosted by an extremely low level of construction deliveries
- Average asking rent increased to $765 per month in the first quarter, an increase of 0.3% over the previous quarter, and marking a 3.4% gain over the past four quarters
- New supply is booming, but the steady demand from new renters should keep the vacancy rate stable at around 6.0% for the next several years to come

San Antonio Office Market

San Antonio office market is off to an optimistic start to 2013 ...

- Although the overall office vacancy rate remained flat at 19.8% in the first quarter, demand for top tier space has tightened the citywide Class A vacancy rate to 12.8%
- Net absorption was a positive 120,762 square feet during the quarter, a slight increase from the 94,890 square feet absorbed in the fourth quarter
- Leasing velocity appears to be on the rise, boosted by a robust health care industry and an emerging energy sector
- As confidence in the direction of the market grows, many landlords are beginning to reign in leasing concessions and test higher rental rates
- The perceived need for additional quality office space has spurred new development activity with several proposed projects: WestRidge at La Cantera (128,700 sf), Monterrey Office Park (120,000 sf), and 13582 IH-10 West (104,500 sf)

San Antonio Industrial Market

Another impressive quarter of performance for the San Antonio industrial market …

- In the first quarter, the vacancy rate declined to 9.1%, dropping 80 basis points from the fourth quarter rate of 9.9%
- Net absorption increased to 318,855 square feet for the quarter, a significant increase from the 207,041 square feet absorbed in the previous quarter
- USAA recently leased 128,354 square feet of flex space at University Park Tech center, which will accommodate the intended addition of 1,000 employees
- The market is also experiencing an elevated amount of development activity from both build-to-suit and owner-occupied facilities
- There are four development projects currently underway: Thousand Oaks Business Center (66,170 sf), Amazon.com (1.26 msf), Glazer's Inc. (518,000 sf), and Maruchan (500,000 sf)
- Nexolon America, producer of high-efficiency solar panels, recently broke ground on their new headquarters/manufacturing plant (240,000 sf) at Brooks City-Base

San Antonio Retail Market

San Antonio retail market off to a slow start in 2013...

- The overall vacancy rate was 11.0% for the first quarter, unchanged from the fourth quarter, but an improvement from the 12.0% recorded in the same quarter last year
- Net absorption registered a negative 4,818 square feet during the quarter, a step backward from the 151,695 square feet absorbed in the previous quarter
- Power Centers continue to dominate the market with a tight vacancy rate of 6.2%, reflecting the recent backfilling of several key big boxes
- Wal-mart is expanding rapidly—opening two new supercenters and has plans for several more supercenters, as well as the smaller neighborhood market concept
- The good news is that as speculative construction activity remains at historic lows, the lack of new product will continue to funnel new and expanding retailers into existing buildings, improving the overall vacancy rate

Sources: CBRE Econometric Advisors; Federal Reserve Bank of Dallas; NAI REOC; Real Capital Analytics; REIS, Inc.

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