Research

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Commercial Real Estate Update
September 2013

U.S. Economy

Employment growth remains low, but fading fiscal drag should boost GDP growth…

- Even though the labor market seems to be stuck in low gear, economic growth should continue to rebound through the end of the year as the current fiscal tightening fades and the external environment improves
- GDP growth in the second quarter was revised upward to a 2.5% annualized rate, much higher than the initial estimate of 1.7%, and largely driven by upward revisions in net external trade
- We expect third quarter GDP growth will come in around 2.5%, with the potential for a slight acceleration in the fourth quarter
- The employment report for August was a mixed bag with a gain of 169,000 new jobs, slightly below the consensus of 180,000, but more significantly, the gains in the previous two months were pared back by a cumulative 74,000, signaling a clear slowdown in the six-month average of monthly payroll gains
- The national unemployment rate edged down to 7.3% in August, from 7.4% in July, but some of that decline has been attributed to a dwindling labor force participation rate, which has dropped to a 35-year low of 63.2%
- Inflation decreased to an annual rate of 1.5% in August from 2.0% in July. A small rise in gas prices is likely to have been offset by a further fall in electricity and gas prices. Food prices may have risen by just 0.1%. Core inflation remained at approximately 1.7%
- August retails sales weren't as good as expected, only achieving a 0.2% increase from the previous month and suggesting that this year's back to school shopping season wasn't very strong, but nevertheless, the fact that underlying consumption continues to grow is an encouraging sign
- Consumer confidence declined to a five-month low of 76.8 in the preliminary September reading, reflecting the recent surge in interest rates and last month's stumble in the stock market
- Despite the recent rise in long term interest rates, the housing recovery should continue, providing a boost to the economy, with rising house prices supporting consumption via the wealth effect

National Commercial Real Estate

Market fundamentals continue to strengthen across all property types …

- Investors continue to be attracted to the income yield, diversification, and potential inflation hedge that real estate can offer
- Although demand for some property types has lagged, market fundamentals continue to improve in general, driven by the improving economy and low level of new supply
- Increased demand for commercial real estate continues to drive prices higher and cap rates lower—interestingly enough, even as treasury yields have increased, cap rates have continued to fall in popular markets with strong growth potential
- Energy and technology markets provide consistent areas of growth and investment opportunity
- Transaction volume continues to increase—the first half of 2013 experienced transaction volume that exceeded $145 billion, 24% higher than the same period last year
- Investors are increasing their appetite for risk as the level of interest in secondary geographic locations and non-traditional property types has picked up significantly
- Although recent interest rate movement has caused a handful of deals to get re-traded or not completed at all, overall investment activity and pricing continues to climb upwards

Apartments

Although the rapid pace of growth has eased, market fundamentals continue to be robust…

- The national vacancy rate remained unchanged at 4.3% in the second quarter, ending the run of thirteen consecutive quarters of declines in the vacancy rate
- New York remains the tightest market in the country with a 2.0% vacancy rate, although it did experience a 10 basis point (bps) increase in its vacancy rate from the previous quarter
- Absorption remains strong as 31,973 units were absorbed during the second quarter, down slightly from the pace in the first quarter
- Supply growth was up in the second quarter—26,584 units were delivered to the market—a jump from the 16,578 units completed in the first quarter
- Asking and effective rents grew by 0.6% and 0.7%, respectively, during the second quarter, resulting in a marginal increase of 10 bps from the previous quarter
- Technology and energy markets continue to perform well and represent 7 of the top 10 markets when ranked by year-over-year effective rent growth
- The outlook for the rest of 2013 remains healthy, but market fundamentals should continue to decelerate to a more normal level of growth, especially as the gap between supply and demand narrows

Office

The office market is faring well despite uncertainty…

- The national office vacancy rate declined by 20 bps to 15.3% in the second quarter, and is 70 bps lower than 2012's second quarter rate
- CBD office vacancy rates declined by 10 bps during the quarter to 12.3% while the suburban office rate fell 20 bps to 16.8%
- Net absorption for the second quarter resulted in a positive 9.8 million square feet, a sharp increase from the 3.8 million square feet absorbed in the first quarter

- Construction completions for the second quarter also picked up—3.9 million square feet was delivered during the quarter, over double the amount of completions from the previous quarter
- Technology and energy markets continue to do exceptionally well in the wake of slow recovery
- As a sign of the recovery becoming more entrenched, markets that were severely affected by the housing crash have been among the top performers in the first half of 2013
- With respect to demand, the addition of 57,000 jobs in office–using employment during the month of May was further encouragement that employment is poised to surpass pre-recession peaks early next year
- Overall, the national office market has been remarkably resilient during the first half of the year, especially when faced with the headwinds of sequestration and a weak employment picture

Industrial

Industrial sector availability continues to decline…

- The national availability rate decreased by 30 bps to 12.0% in the second quarter, decelerating slightly from the previous quarter, yet still showing strong growth
- Of the 48 markets that showed a decline in their availability rate, half of those markets fell by an impressive 50 bps or more
- Net absorption was a positive 46.5 million square feet for the second quarter, a slight decrease from the 63 million square feet absorbed in the first quarter
- New construction deliveries increased to 14.5 million square feet during the quarter, up from 10.9 million square feet delivered in the first quarter—the gap between supply and demand is expected to continue to narrow over the near term
- The industrial market has seen 12 consecutive quarters of recovery, with the strongest recovery occurring in the three most recent quarters
- Market rent growth continues to remain strongest for larger, modern warehouse properties in major metro areas, especially in the leading coastal markets

Retail

Retail recovery remains slow…

- The national vacancy rate declined to 10.5% in the second quarter, down 10 bps from the previous quarter, marking the sixth occurrence in the last seven quarters that vacancy has fallen by only 10 bps or less
- Net absorption for the second quarter was 2.5 million square feet, a decline from the 2.9 million square feet absorbed in the first quarter of the year
- Asking and effective rents both grew by 0.3% during the quarter, a pace on par with the first quarter growth
- High levels of vacant stock and lackluster net absorption have created an environment fostering slower-than-normal rent growth
- Older retail space has become increasingly obsolete as newer, higher quality construction is preferred by tenants
- E-Commerce continues to play a significant role in the space usage of retail tenants
- Looking forward, the growth of the retail sector remains muted for the rest of 2013, but should continue to trend slowly in the right direction

Texas Economy

The Texas economy continues to expand…

- The Texas economy continued to expand at a moderate pace over the past six weeks, with almost all industries reporting improved demand
- Texas added approximately 19,900 jobs in July, maintaining the 2.7% annual growth rate from the previous month
- Five of the 11 major industries showed employment increases over the month of July, led by gains of 9,000 jobs in the Financial Activities sector and 8,000 positions in the Mining and Logging sector
- The unemployment rate in Texas remained flat at 6.5% for July, but is still 80 bps lower than the current national unemployment rate of 7.3%
- Sales grew for firms in residential construction, retail, and durable goods. Energy sector activity experienced some flattening, but continued at high levels

Residential housing activity posts another strong month…

- Sales of existing single-family homes in July rose to 29,374 units, a 26% increase over a year ago, and the highest monthly total since June 2006
- The current inventory of unsold existing homes relative to sales decreased to 4.1 months in July, down from 4.2 months in June, and continuing the trend of tight inventory
- The median sales price for an existing single-family home inched downward to $179,900 in July, slightly off the $181,000 mark set in June, but still representing a 9.8% increase from a year ago
- Single-family construction permits trended higher in July, reversing the slight drop in June
- Construction activity continues to ramp up as the number of permits issued in July was 19.9% higher than a year ago

The San Antonio Economy

The San Antonio economy has transitioned from recovery to expansion …

- Payroll employment in San Antonio has grown faster than the national average over the past year, though not as rapidly as Dallas, Houston or Austin
- All major industries have contributed to the gains in payrolls, though manufacturing has been weak at times
- The unemployment rate has fallen to 6.3%, though some of the decline was caused by a drop in the size of the labor force
- Home sales and prices are rising and the amount of available inventory has declined, although more slowly when compared to other Texas metro areas
- Among the major Texas metro areas, San Antonio faces the greatest threat from the automatic federal spending cuts (sequestration); about one-fifth of the state’s military jobs are in San Antonio; many associated civilian workers could face furloughs, including the private sector work that is generated by the Air Force
- As a major destination for Mexican tourists, the San Antonio economy should continue to enjoy support from leisure/hospitality which was the fastest growing industry in 2012; San Antonio is the seventh most visited U.S. city by Hispanic travelers and the most visited in Texas
- Air traffic to and from Mexico quadrupled over the past year
- Longer-term above average population growth in the Hispanic demographic segment will contribute to further industry gains
- San Antonio should benefit from expanding solar panel manufacturing

- Despite its long history of military aerospace, the metro area has a surprisingly small pool of aerospace, mechanical and electrical engineers; further the workforce is not as well-educated as other competing metro areas
- San Antonio's economy should grow at an above average rate in 2013, supported by a variety of industries such as tourism, housing, manufacturing, local government, and those associated with the oil & gas production in the Eagle Ford shale
- Domestic federal spending cuts pose a significant downside risk
- Long-term, the concentration of military cyber-security and medical activity, growth in commercial aerospace, and above-average population gains should enable San Antonio to outperform the nation by a significant margin

San Antonio Commercial Real Estate

San Antonio Apartment Market

The San Antonio apartment market leveled off in the second quarter…

- The vacancy rate for the second quarter remained flat at 5.7%, no change from the first quarter and ending the impressive run of consecutive decreases in the vacancy rate
- Net absorption was a positive 876 units in the second quarter, a slight uptick from the 518 units absorbed in the first quarter, but further evidence that supply and demand have become more balanced
- Asking rent increased to an average of $770 per month in the second quarter, an increase of 0.7% over the previous quarter, and marking a 2.8% gain over the past four quarters
- Effective rents also advanced 0.7% in the quarter, mirroring the asking rent increase, and suggesting that landlords have been able to raise rents without having to sweeten the relative value of concession packages used to attract new renters
- New construction activity is expected to deliver 3,674 units by the end of the year, of which only 3,140 units are expected to be absorbed, resulting in excess supply, which will likely increase the vacancy rate by 20 bps to 5.9% by year end

San Antonio Office Market

The San Antonio office market recovery starting to gain traction...

- The office vacancy rate dropped to 18.6% for the second quarter, down from the 19.8% in the first quarter
- Net absorption was a positive 239,397 square feet during the quarter, almost double the 120,762 square feet absorbed during the first quarter, and a further testament that the local office market has turned the corner
- Citywide Class A vacancy has tightened to 10.6%, but conditions remain soft for Class B and Class C properties with vacancy rates of 22.3% and 25.7%, respectively
- Several developers have announced plans for speculative projects, but which projects actually move forward have yet to be seen
- Two new office projects scheduled for delivery next quarter include The Oaks at University Business Park and Shavano Center IV, which have pre-leased a significant amount of space to tenants Univision and Armadillo Homes, respectively

San Antonio Industrial Market

The San Antonio industrial market continues to strengthen at a robust pace …

- The vacancy rate declined an impressive 100 bps in the second quarter, dropping to 8.1% from the 9.1% registered in the first quarter
- New leases and expansions generated 564,220 square feet of positive net absorption for the quarter, bringing the year-to-date total to more than 850,000 square feet
- Distribution and warehouse properties continue to lead the pack, but service center and flex properties also recorded healthy gains
- Demand for industrial space continues to be supported by the growing oil production in the Eagle Ford shale
- As a result, demand for rail-based logistics has prompted the development of two new rail parks in Southeast Bexar County
- With limited amounts of speculative development and vacancy at near all-time lows, the industrial market is positioned to continue to outperform over the near term

San Antonio Retail Market

San Antonio retail market improved slightly during the second quarter...

- The overall vacancy rate declined to 10.6% during the second quarter, an improvement over the 11.0% rate in the first quarter, reflecting the continued backfilling of vacant anchor space
- Net absorption also turned positive during the quarter with 118,705 square feet absorbed, reversing the negative trend over the past few quarters, and bringing the YTD total back into positive territory
- Power centers continue to be the healthiest of all retail product types – boasting a citywide vacancy rate of 5.3%
- Although community and neighborhood centers continue to struggle with double-digit vacancy rates, all product types demonstrated slight improvement in the second quarter
- Major lease transactions during the quarter include Gander Mountain backfilling the darkened Sportsman's Warehouse at Westover Marketplace (48,663 sf) and Burke's Outlet leasing space at the Wonderland of the Americas mall (24,150 sf)

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