National Association of REALTORS®

COMMERCIAL REAL ESTATE MARKET TRENDS: Q2.2015

COMMERCIAL Real Estate

NATIONAL ASSOCIATION of REALTORS®

Commercial Real Estate Market Trends: Q2.2015

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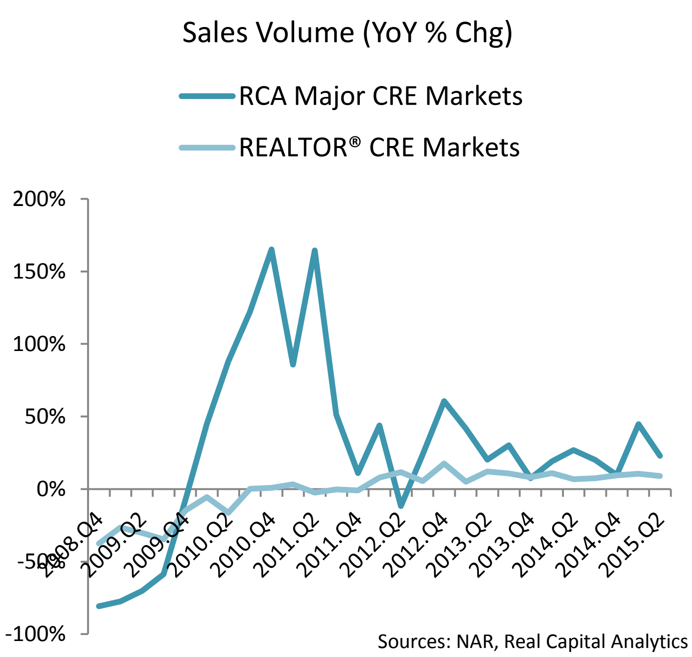
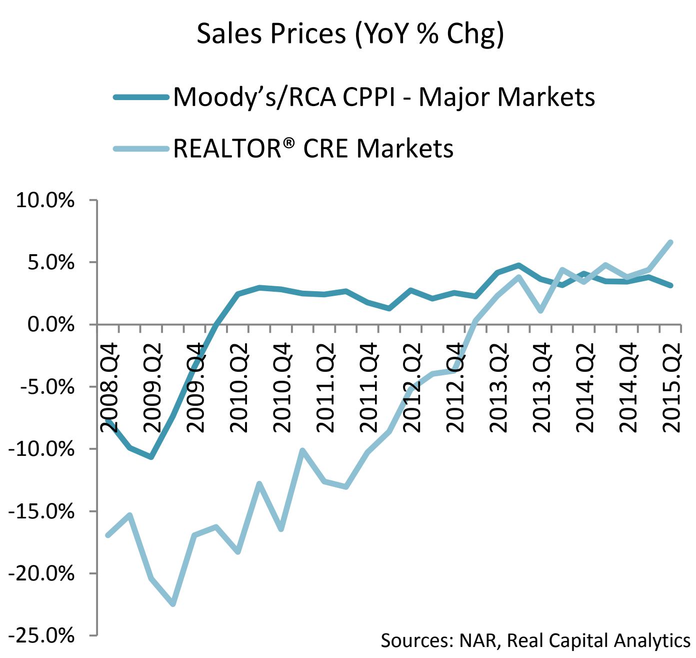
Commercial space is heavily concentrated in large buildings, but large buildings are a relatively small number of the overall stock of commercial buildings. In terms of inventory, commercial real estate markets are bifurcated, with the majority of buildings (81 percent) being relatively small (SCRE),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





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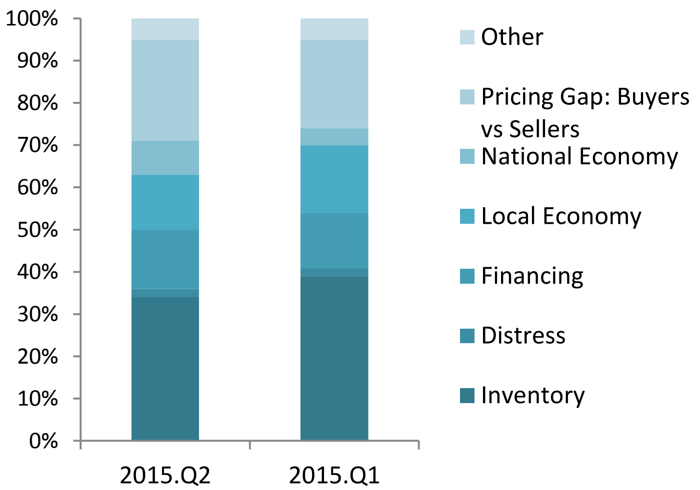
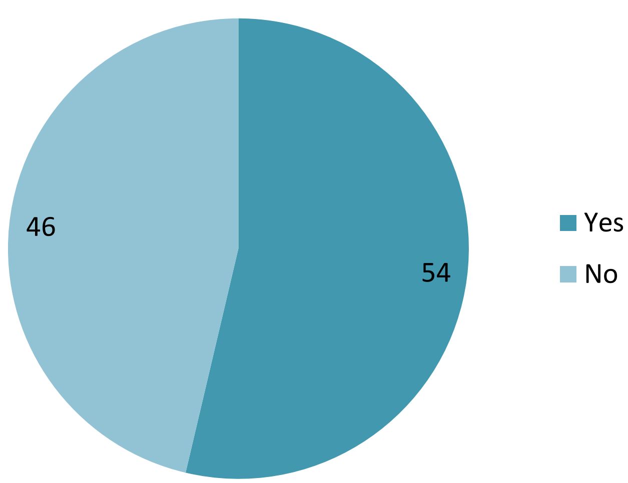
Survey Highlights

- Sixty percent of commercial REALTORS® closed a sale.
- Sales volume rose 9 percent from a year ago.
- Sales prices increased 7 percent year-over-year.
- Cap rates averaged 7.5 percent during Q2.2015
- The average estimated transaction value increased from $1.7 million in Q1.2015 to $2.0 million in Q2.2015.
- Fifty-four percent of members completed a lease transaction
- Leasing volume advanced 5 percent from previous quarter.
- Leasing rates increased 3 percent over previous quarter.
- Concession levels declined 8 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 (%)



NOTES:

1. *Vacancy rate data in this report come from a national survey of REALTORS® who identify themselves as commercial practitioners. The data do not match the historical data which underlie NAR's Commercial Real Estate Outlook (CREO). The CREO vacancy data were sourced from Reis, Inc.*

2. *In July 2015, NAR invited a random sample of 51,580 REALTORS® with an interest in commercial real estate to fill an on-line survey. A total of 372 complete responses were received, for an overall response rate of 0.7 percent.*

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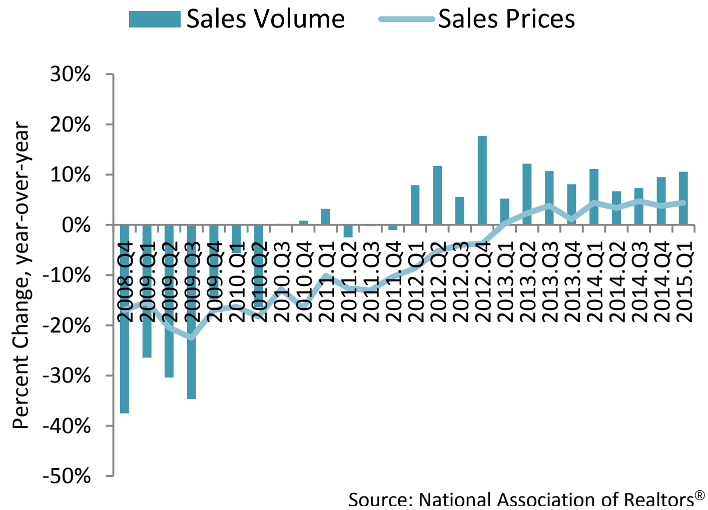
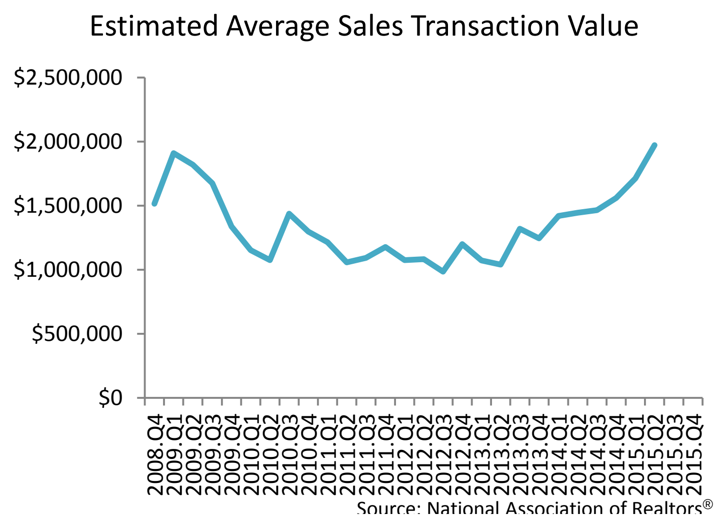
Investment Sales



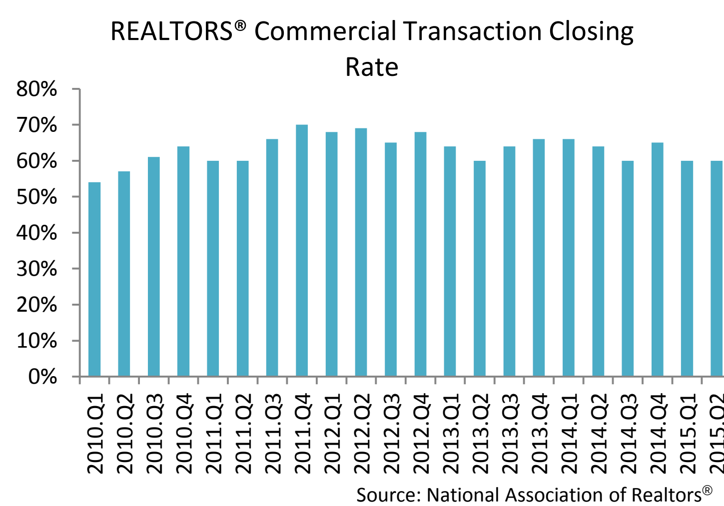
Commercial real estate maintained an upbeat pace of sales during the second quarter, with REALTORS® reporting continued improvement in fundamentals and investment sales. REALTORS® indicated a pick-up in the direction of commercial business opportunities during the second quarter 2015, with a 6.4 percent quarterly increase, following a 3.8 percent rise during the previous quarter. Sales of commercial properties rose 9.1 percent on a year-over-year basis.



With the shortage of available inventory the number one reported concern for NAR members, price growth accelerated, with properties trading at average 6.6 percent higher prices compared with the same period in 2014. The average transaction price increased from $1.7 million in the first quarter 2015 to $2.0 million in the second quarter of 2015. A perceived pricing gap between sellers and buyers remained the second highest ranked concern.

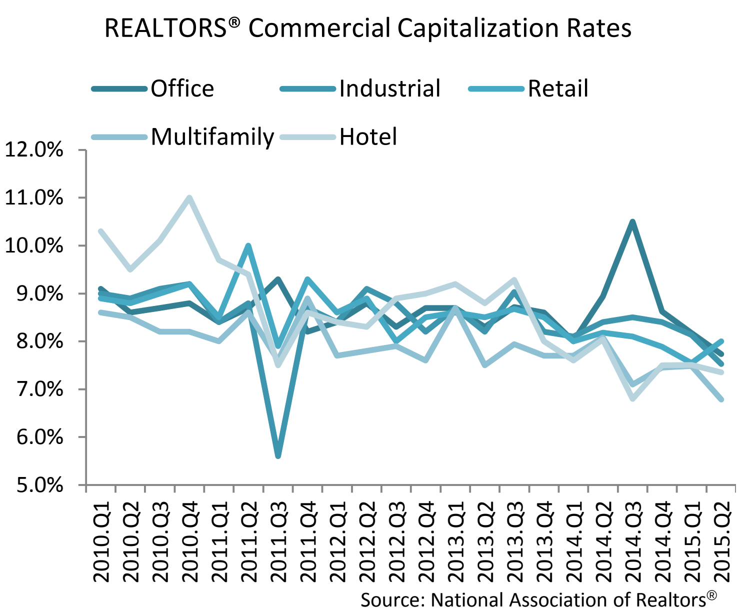
REALTORS® 2015.Q2 Prices	
Office Class A($/SF)	$123
Office Class BC ($/SF)	$80
Industrial Class A ($/SF)	$70
Industrial Class BC ($/SF)	$52
Retail Class A ($/SF)	$142
Retail Class BC ($/SF)	$87
Apartment Class A ($/Unit)	$68,497
Apartment Class BC ($/Unit)	$37,440

Source: NAR



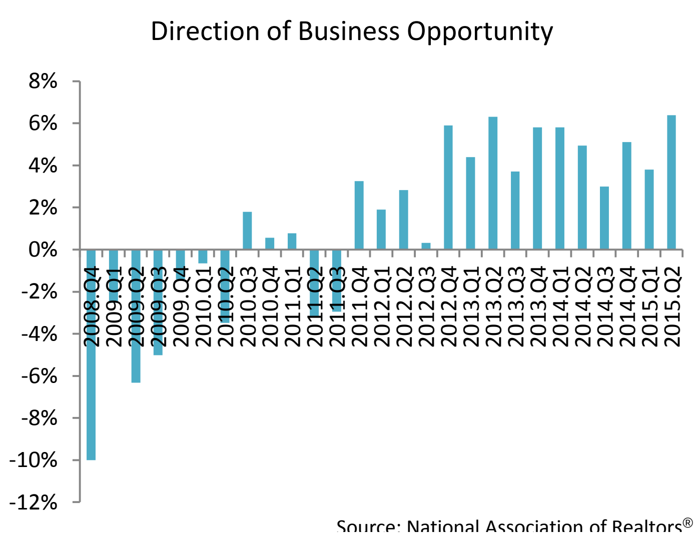
The rate of REALTORS®' sale closings remained even during the quarter at 60 percent.

Investment Sales - continued



Average capitalization rates declined to an average of 7.5 percent across all property types, an 85 basis point decline on a yearly basis. Apartments posted the lowest cap rate, at 6.8 percent, followed by hotel properties with average cap rates at 7.4 percent. Office and industrial spaces posted cap rates of 7.7 percent and 7.5 percent respectively. Retail transactions reported the highest comparative cap rates—8.0 percent.

2015.Q2 Cap Rates	
Office	7.7%
Industrial	7.5%
Retail	8.0%
Multifamily	6.8%
Hotel	7.4%



REALTORS® were positive about the general direction of business opportunity, which is a broad market indicator. NAR members responded that they expect a 6.4 percent increase in general business opportunities.

Members indicated that the following areas presented the greatest opportunities:

- Industrial
- Retail
- New Development/Construction
- Apartments/Multifamily
- Land
- Distressed Properties
- Office
- Redevelopment

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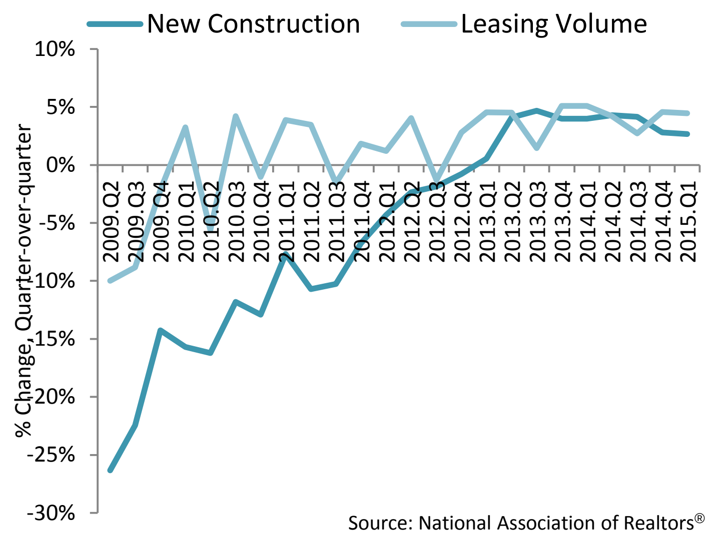
Leasing Fundamentals

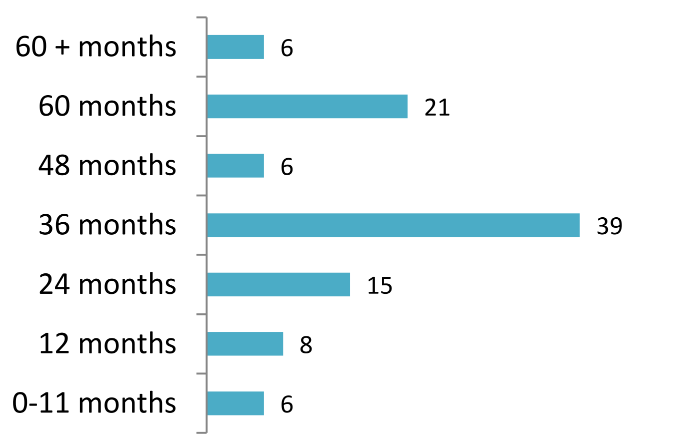
Underpinning investors' confidence, fundamentals improved during the second quarter 2015. Leasing volume during the second quarter rose 4.7 percent compared with the first quarter 2015. Leasing rates advanced at a steady pace, rising 2.7 percent in the second quarter, compared with the 2.8 percent advance in the previous quarter.



Source: National Association of Realtors®

NAR members' average gross lease volume for the quarter was $629,000. New construction accelerated, posting a 5.7 percent gain from the first quarter of this year, a pace which more than doubled the 2.7 percent rise recorded in the first quarter 2015.

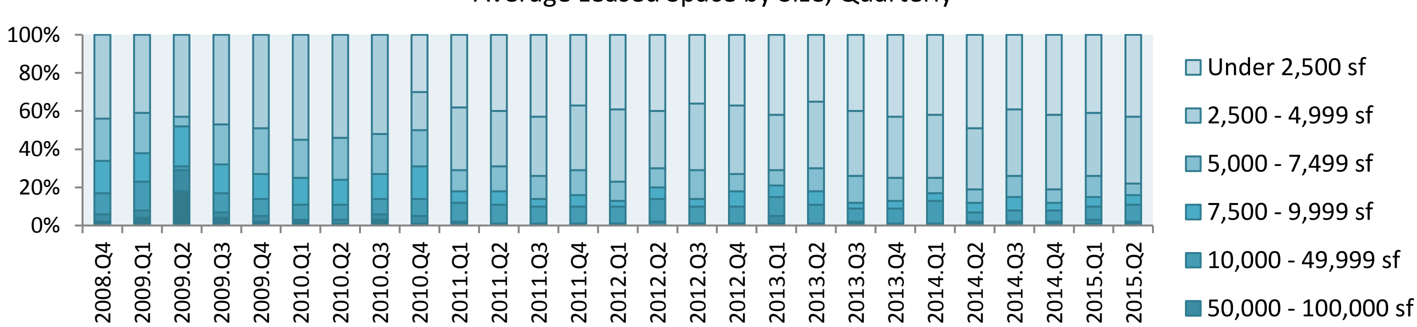
Average Lease Term During Last Transaction (%)



Source: National Association of Realtors®

Tenant demand remained strongest in the 5,000 square feet and below, accounting for 84.0 percent of leased properties. Lease terms remained steady, with 36-month and 60-month leases capturing 60.0 percent of the market.

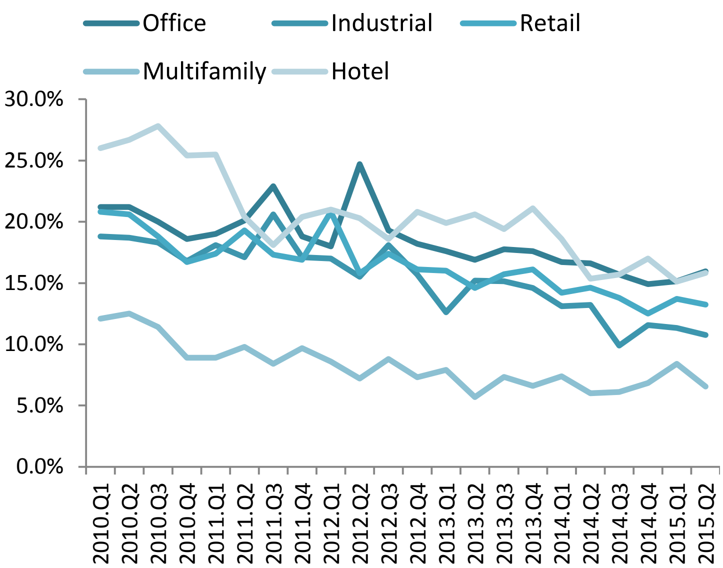
Average Leased Space by Size, Quarterly*



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

Source: National Association of Realtors®

REALTORS® Commercial Vacancy Rates



Source: National Association of Realtors®

REALTORS® 2015.Q2 Vacancy Rates	
Office	15.9%
Industrial	10.8%
Retail	13.2%
Multifamily	6.6%
Hotel	15.8%

Leasing Fundamentals - continued

Vacancy rates mirrored the regional and product variations REALTORS® markets, with most properties posting availability declines. With rising new supply, apartments experienced availability increases, as the national average rose from 6.0 percent in the second quarter of 2014 to 6.6 percent in the second quarter of this year.

Office vacancies declined 65 basis points to 15.9 percent compared with a year ago. Industrial availability posted the largest year-over-year decline—246 basis points—to 10.8 percent. Retail vacancies declined 137 basis points on a yearly basis, to 13.2 percent.

Lease concessions declined 8.1 percent. Tenant improvement (TI) allowances averaged $10 per square foot per year nationally. In keeping with higher vacancies, office properties recorded the highest TI rates at $17 per square foot per year. Apartments posted the lowest TI rates—$3 per square foot per year.

Photo by Dmytro Sergiyenko, 2007.

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.

Apartment market continues to remain fairly strong!

Appraisals a huge issue still - lack of financing for CRE, lots for owner/occupied but not CRE.

Being a seller market, see very little co-brokerage activity.

Big shortage of inventory under 50,000 sq.ft.

Birmingham is typical of so many other cities in terms of many areas are "under demolished."

Clients more cautious thus slow to commit.

Confidence in the market is weak. Wages are not increasing even though employment has increased.

CT was just ranked in the worst 10 states in the country to do business. Our office has done better than most in the past 3 years.

Degrading infrastructure (Roads & Bridges) is changing target areas for new locations. Expect more before it gets better. Traffic is becoming a major decision item.

Good activity with small businesses that are growing - but still a lot of trepidation because of the economy.

Government rules are holding back some ownership. Lots of liabilities to overcome.

Holding at the present level, strong influx of the need for small office space due to movie business in Atlanta

Illinois is a depressed state and many local companies are relocating or closing due to too much Federal regulation and Illinois over-regulation and taxes.

Industrial market continues to be strong as more and more space is absorbed. We are finally seeing speculative real estate being built for the first time in over 10 years.

Inventory is declining and traffic is improving.

It is a slow recovery with vacancies filling and leasing concessions vanishing. The larger tenant is still consolidated and the smaller tenant cannot afford a partial building risk. It is that moment in the market when recovery turns to boom or fizzles and drifts backward. Given the recent employment statistics, boom is most likely.

It would appear Las Vegas has turned the corner but it is slow.

Lack of availability is driving the prices up, city's building department delays.

Lack of inventory drives prices higher but the number of transactions have slowed tremendously. When these two meet in the middle is anyone's guess in this economic atmosphere.

Lease and sale market for B/C properties are substantially overvalued, which tends to lower serious interests in sales and leases.

Main focus is land - a lot of activity and a lot of cash or non bank financing.

Comments – continued

Market in Atlantic City NJ [has been] very bad in past 2 years: 4 casinos have closed up and the city is in trouble.

Market is in an upward trend that hopefully will continue. Businesses seem to be trying to expand or are seeking better business and tax concessions, friendly environments causing relocations to our area.

New lending rules are an impediment to a robust growth in the real estate market. Also over regulation by cities/counties, state and federal agencies presents a tremendous drag on real estate and business.

New Mexico ranks among the bottom of all states consistently. Reliance on federal spending as its economic engine has contributed to poor policy making and an anti business attitude among the political class. The business class also relies on government contracts which are diminishing. There is no significant manufacturing base and policy decisions have eroded the industrial land supply in favor of other forms of development. We have a diminished and undereducated workforce, 1 out of 2.5 people receiving Medicaid, and no corporate headquarters anywhere in the state. We are in trouble economically and it is reflected in a stagnant marketplace, but for up and coming craft brew and burger places...

Office is slack due to no core jobs. Uptick in industrial for those who made it through recession. Some bounce-back in housing sector from retirees. Apartments are way overvalued.

Our market remains strong mostly due to the continued growth of the University that is in the city. The stability is directly tied more to this than to national trends.

Rural area with growth in nearby counties, but not here yet as no population growth or job creation.

Seattle is experiencing a boom cycle at this moment. How long it will last is the question.

Small markets not getting much attention.

Small town, lots of new startups and more franchises coming to town

[Market is] smoking hot with very limited inventory and no room for growth.

Southeast Florida is doing great with the biggest problem being lack of inventory.

Still feeling the effects of the recession. Slow recovery.

The commercial market in greater Houston is just now seeing more property come on the market including sub leases in office and industrial due to much lower oil pricing. Office absorption was only 560k compared to 2.4 million one year ago. Add huge amount of office construction just now going on the market and consolidation by many oil companies.

The federal budget cutbacks are affecting many facets of the real estate business.

There is still NO primary economic function pushing the market; clients and customers with abundant cash or access to capital are making deals no one else is.

We have an over inflated market with Mayo Clinic and Destination Medical. Mayo Clinic is the largest buyer and real-estate company […] in Minnesota.

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