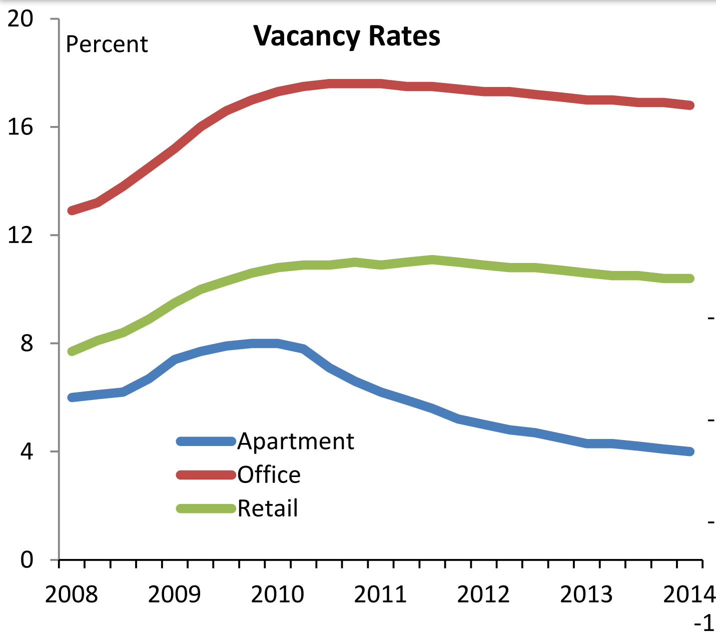
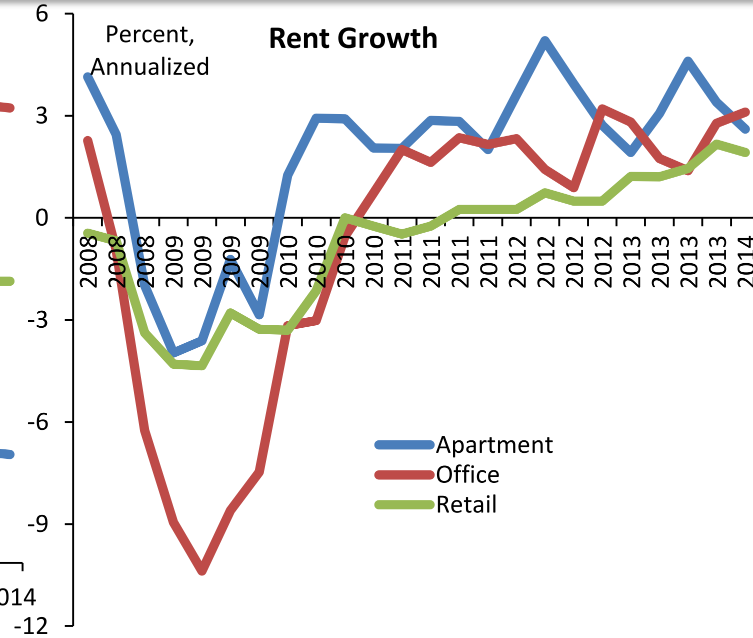
Commercial Property Update 2014:Q1





The apartment sector remains tight despite growing new supply. Vacancy rates edged down 10 basis points to a new cyclical low of 4 percent, while completions were nearly 70 percent higher than one year ago. Weak wage growth has limited landlords' ability to raise rents, however, and rent growth slipped to a 2.6 percent annualized rate. (See opposite page for an update on labor market conditions, including growth of average hourly earnings.)

The office sector continues to recover. Vacancy rates declined 10 basis points despite a rise in deliveries, as absorption rates were 50 percent higher than their quarterly average in 2013. Rent growth jumped to a 3.1 percent annualized rate. The recent acceleration of job growth may boost absorption rates and rent growth even further.

The retail sector lost momentum in early 2014. The vacancy rate was unchanged from the previous quarter, despite a 50 percent decline in completions. Rent growth decelerated by 15 basis points to a 1.9 percent annualized rate. The retail sector has lagged other property types through most of the recovery.

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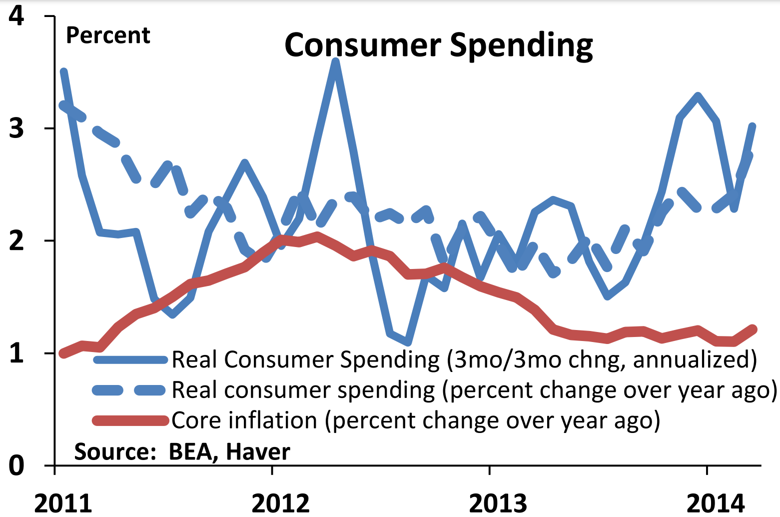
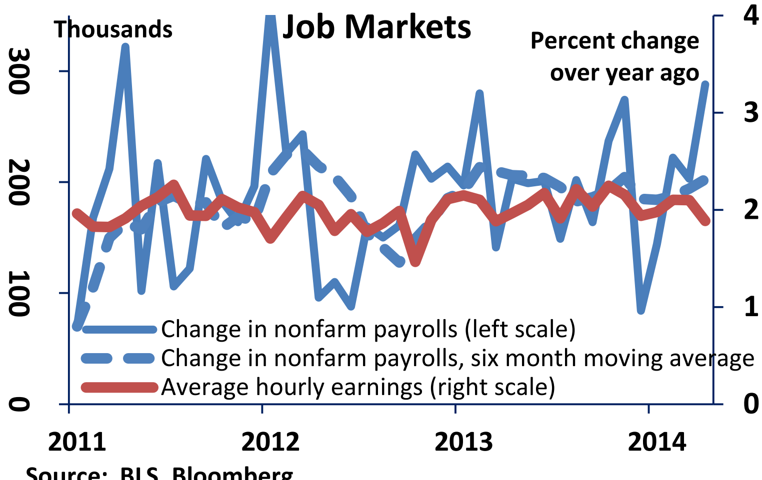
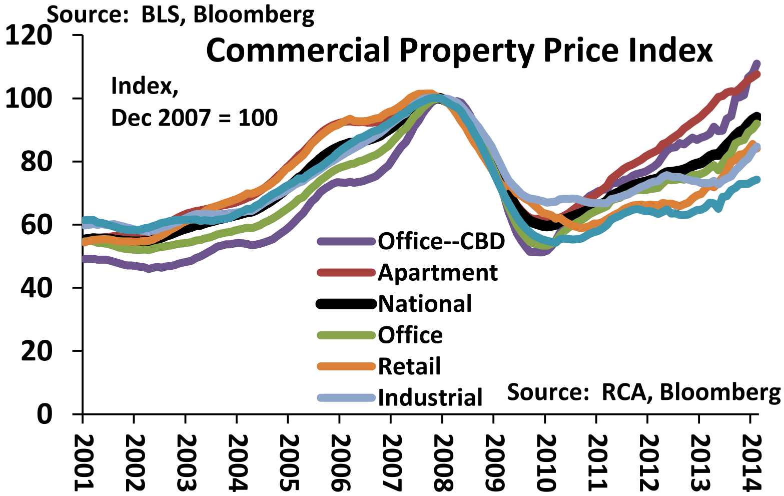
Economic Outlook







Economic Fundamentals

Economic growth accelerated in 2013:H2, with 4.1% GDP growth in Q3 and 3.2% in Q4 (blue line). Private GDP, i.e. excluding the drag from the government shutdown, topped 4% in Q4.

Commercial construction (red bars) is ramping up. Despite this growth, however, real (inflation-adjusted) construction activity is roughly in line with the lows from the early 2000s.

Job growth remains modest, trending around 200,000 per month, although winter storms caused some disruptions. The unemployment rate has fallen largely due to lower labor force participation, reflecting both demographics (retiring Baby Boomers) and discouraged workers. Wage growth remains weak, with average hourly earnings up less than 2% over the past 12 months.

Household formation, when one or more people move out of shared space to rent or buy a place of their own, shows no sign of rebound, rising a scant 0.25% over year-ago. Population growth generates a long-term trend of over 1%, but the modest job market gains to date fall short of what's needed to drive a rebound as in previous business cycles. Like water building behind a dam, however, demand pressures are growing in the need for space, and eventually will generate stronger absorption.

The views expressed in this commentary are those of Calvin Schnure, PhD, of the National Association of Real Estate Investment Trusts (NAREIT®) and reflect the current views of Dr. Schnure as of February 5, 2014. Neither Dr. Schnure nor NAREIT undertakes to advise of any future changes in the views expressed herein.

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