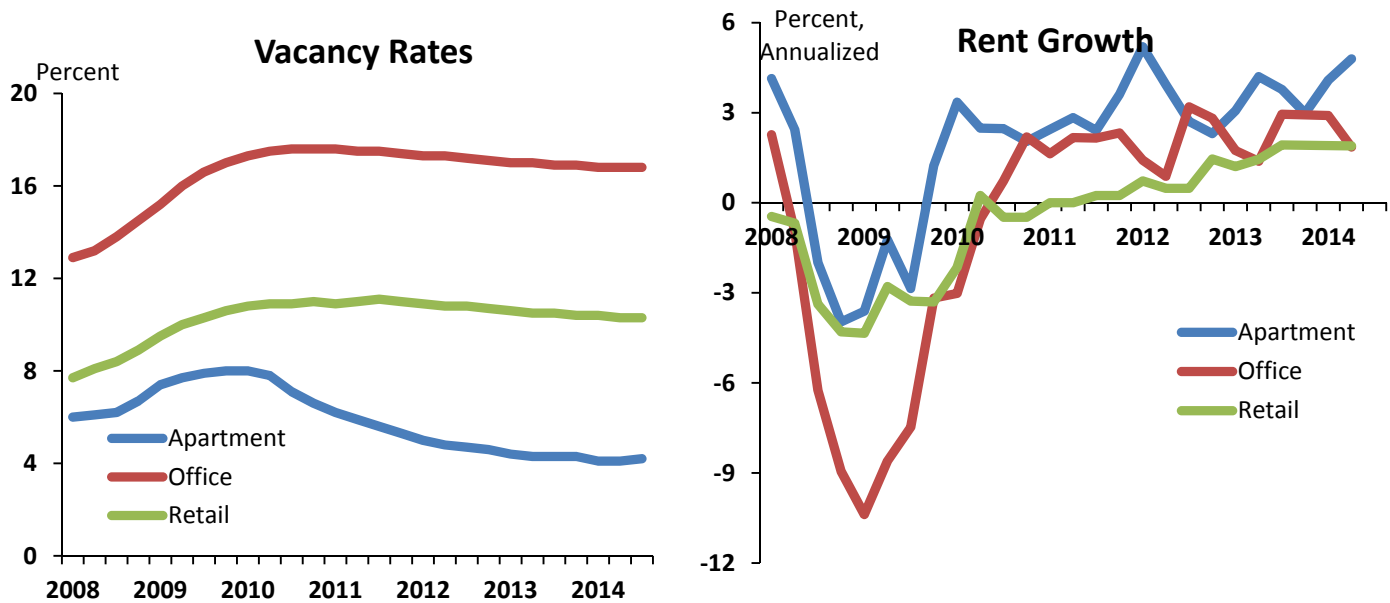


Commercial Property Update 2014:Q3



The apartment sector absorbed a significant increase in new supply with little change in vacancy rates, as demand has remained robust (page 2 has details on overall demand for rental housing). Vacancy rates edged up 10 bps, the first increase since 2010; at 4.2 percent, however, there is little (if any) excess supply, and pricing trends remain in landlords’ favor. Indeed, rent growth accelerated to a 4.7 percent annual rate, the most rapid since 2012.

The office sector was little changed, with vacancy rates flat and a slight slowing in rent growth. Completions over the past four quarters are up nearly 40 percent from a similar period ending 2013:Q3. New construction activity is recovering from the extreme low levels reached in the financial crisis, however, and remains well below normal levels. Net absorption is on a similar uptrend as completions, buoyed by the strengthening job market (see reverse).

The retail sector is consistently sluggish. Net absorption for the year-to-date is running 25 percent behind last year, leaving vacancy rates flat. Rent growth, after turning up in 2012 and 2013, has been little changed this year at an annualized 1.9 percent rate—an improvement from earlier years, but barely keeping pace with inflation.



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Economic Outlook

Economic Fundamentals

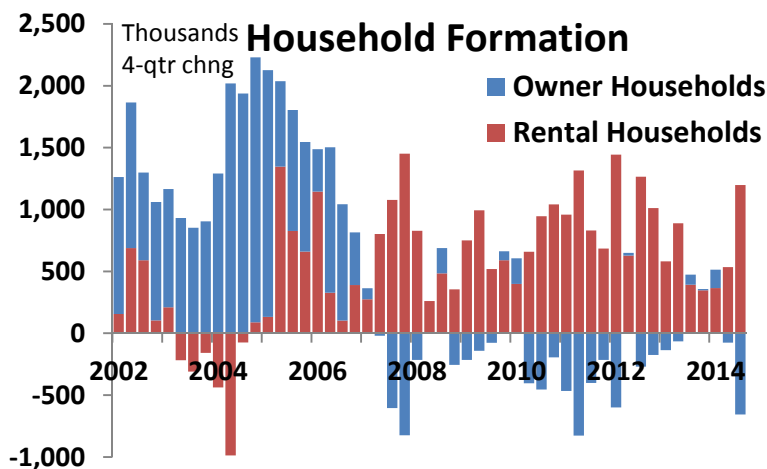
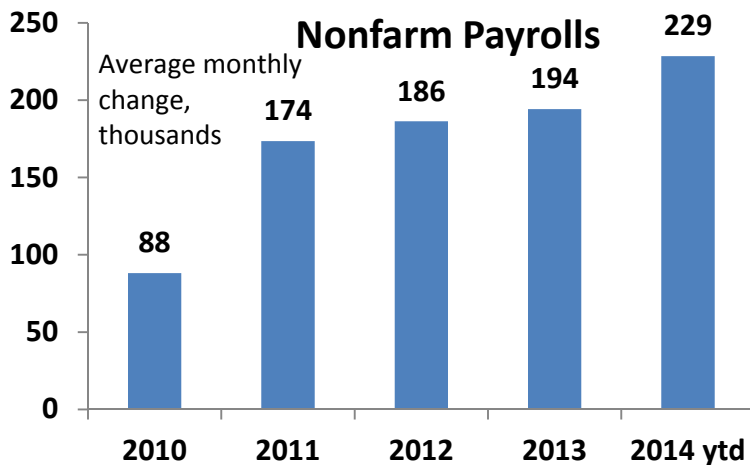
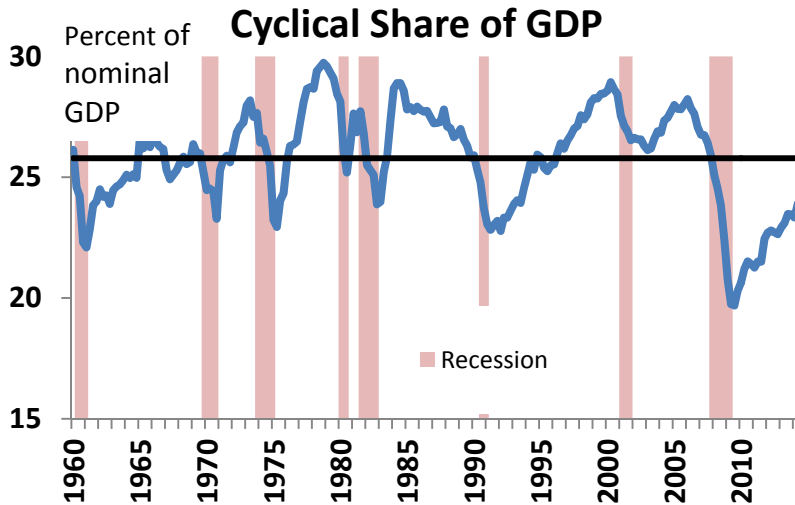
GDP has upside potential even following the recent rebound in growth, according to an analysis of the cyclical components of GDP. The cyclicals (consumer spending on durable goods, plus investment spending) drive most business cycle fluctuations, while non-cyclicals (spending on non-durable goods, services, government spending and net exports) are much less volatile.

Recessions are caused by declines in the cyclical share, while recoveries see a rise. Spending on cyclicals remains two percentage points below the economy's long-run average. Further recovery of durable goods and investment spending will likely boost GDP growth over the medium term.

Nonfarm payrolls appear to have reached "escape velocity". After several years of struggling below 200k per month, payroll gains have exceeded 200k for the past nine months, and are averaging nearly 230k so far this year.

A job market that is firing on all cylinders will have broad impact on the macro economy and commercial real estate: rising incomes fuel consumer spending (retail sector) and demand for housing (apartment REITs and single-family rentals), and, of course, more space for the workers (office REITs).

Growth of rental households continues to surge in 2014, as the home ownership rate fell below 65% in Q2 for the first time since 1995. These trends accelerated in Q3 as a stronger job market bolstered apartment rentals while tight mortgage credit continues to hinder home purchases.



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 November 11, 2014.