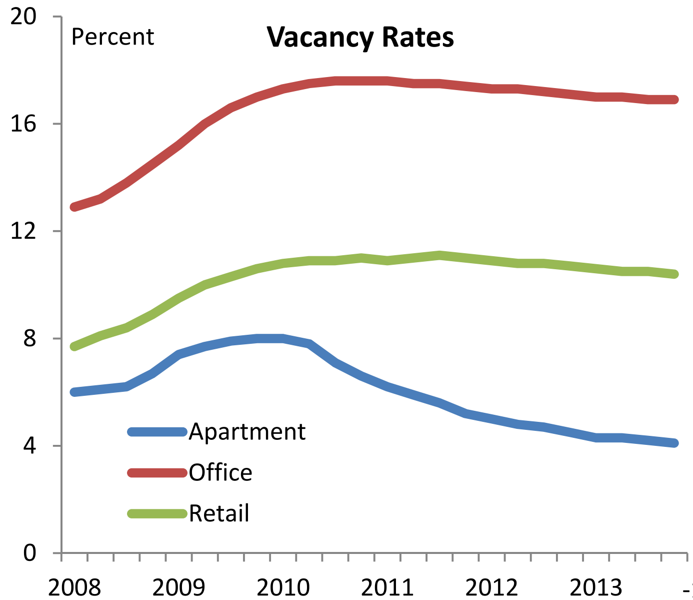
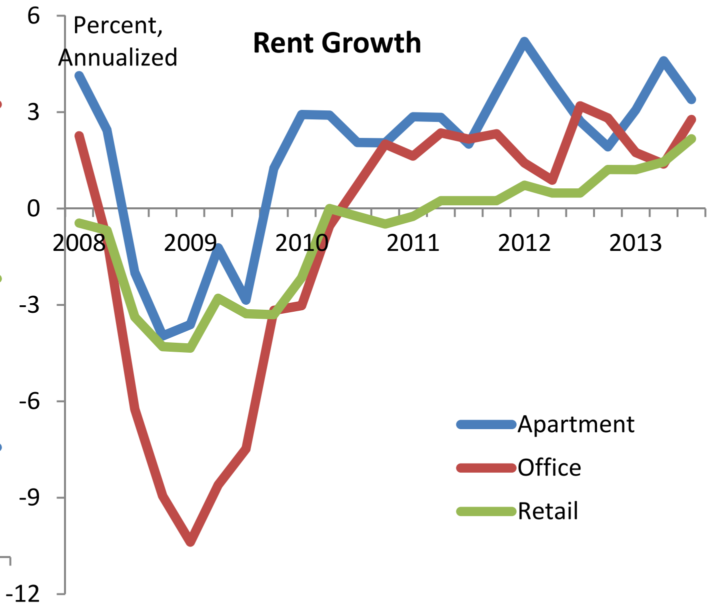
National Association of Real Estate Investment Trusts®

Commercial Property Update 2013:Q4





The apartment sector tightened further, with net absorption 21% higher than a year earlier. Completions also accelerated, however, resulting in a 10 basis point decrease in vacancy rates, a slower decline than the 40 basis point average quarterly drop since 2010. Rent growth eased a bit to 3.4% annualized rate. The pace of household formation, which drives demand for apartments, continues to be subdued, as job gains remain modest (see chart on next page).

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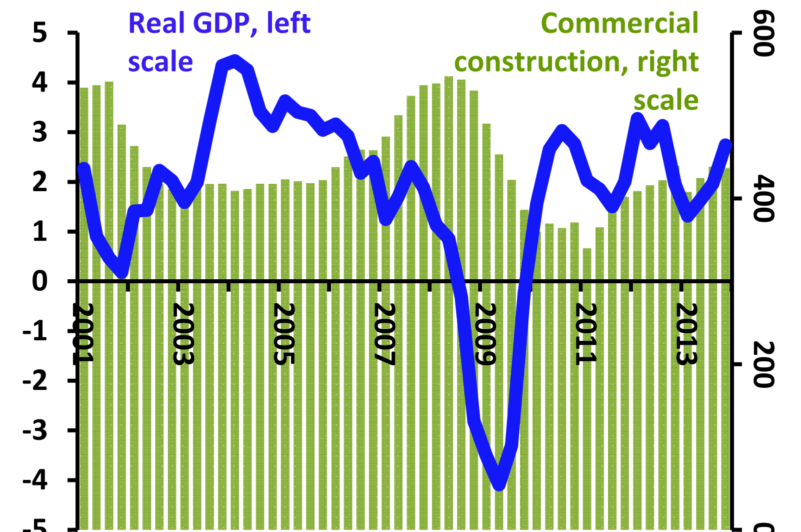
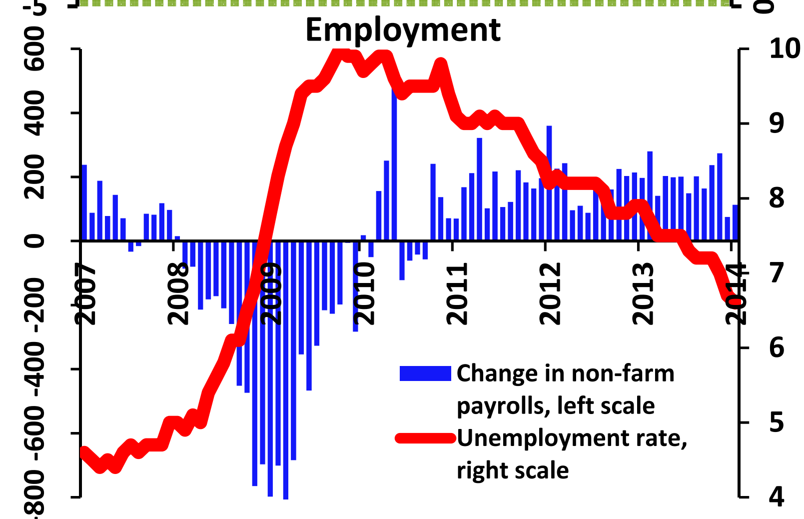
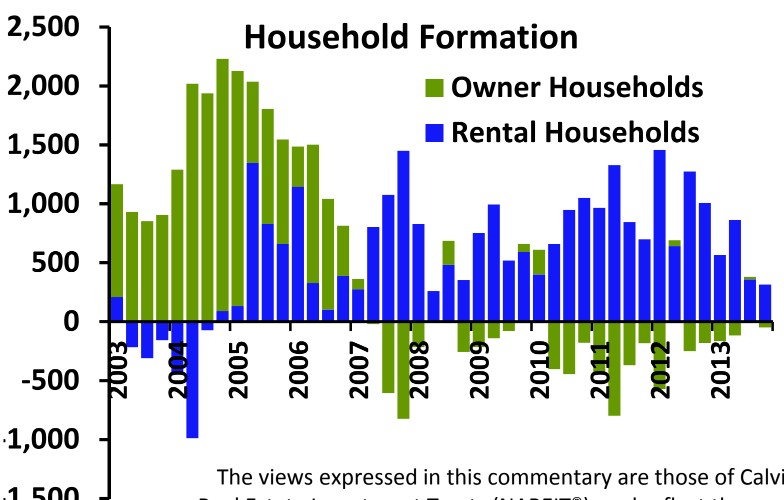
The office sector perked up in the fourth quarter, as rent growth jumped to a 2.8% annual rate. The vacancy rate dropped by 10 basis points and the absorption rate rose to pre-crisis levels. Vacancy rates remain elevated, however, and stronger job growth will be necessary for rents to accelerate further.

The retail sector improved slightly. The vacancy rate fell 10 basis points, while rent growth ticked up to a 1.9% annual rate. The outlook for fundamentals is slowly improving: Consumer spending is firming as unemployment declines and household balance sheets recover, but job and wage growth are still in low gear. High-end malls and luxury retailers report solid results, while community centers and discount stores lag.

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

Job growth remains modest, trending around 200,000 per month. Hiring slowed in December-January; winter storms may have 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 7, 2014. Neither Dr. Schnure nor NAREIT undertakes to advise of any future changes in the views expressed herein.

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