Commercial Real Estate Easing in Economic Slowdown

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Commercial real estate vacancies are trending up modestly, while investment has dropped sharply in the wake of the credit crunch, according to preliminary information for the latest *COMMERCIAL REAL ESTATE OUTLOOK** of the National Association of Realtors®.

NAR Chief Economist Lawrence Yun said economic weakness is impacting commercial real estate. “Although the supply-demand fundamentals are broadly favorable in most commercial real estate markets, vacancy rates are rising modestly and rent gains are slowing,” he said. “Slow economic growth is lowering demand for commercial space, mostly in the office and industrial sectors. Despite the slowdown, the commercial real estate market is in much better shape compared to conditions during the 2001 recession.”

Patricia Nooney of St. Louis, chair of the Realtors® Commercial Alliance Committee, said credit has been a problem. “Tight credit availability has significantly slowed the volume of commercial real estate transactions,” she said. “Even so, institutional investors, along with foreign investors who are encouraged by the drop in the dollar, remain active in the current market. Because conditions are so varied across the country, we recommend investors or businesses looking for space consult with Realtors® in their area who specialize in commercial real estate.”

Investment in commercial real estate during the first four months of 2008 was $48.2 billion, down 69.5 percent from $157.8 billion during the same period in 2007 when the credit markets were functioning normally; those totals do not include transactions valued at less than $5 million or investments in the hospitality sector.

The NAR forecast in four major commercial sectors analyzes quarterly data for various tracked metro areas. The sectors are the office, industrial, retail and multifamily markets. Historic data were provided by Torto Wheaton Research and Real Capital Analytics.

Office Market

With a growth in inventory, office vacancy rates are projected to increase to 13.7 percent in the fourth quarter of this year from 12.5 percent in the fourth quarter of 2007. As a result, annual rent growth in the office sector is expected to be 3.0 percent this year, following an 8.0 percent jump in 2007.

Estimates for the second quarter show vacancies rising sharply in Phoenix and West Palm Beach, Fla., to nearly 20 percent, double the levels of a year ago. Other central business districts in Florida have shown notable increases. The housing market downturn is having a spillover effect on commercial real estate in some local areas.

Net absorption of office space in 57 markets tracked, which includes the leasing of new space coming on the market as well as space in existing properties, is likely to total 31.3 million square feet this year, about half of the 60.0 million absorbed in 2007. “Part of the slowdown in office absorption results from new space coming online and the challenge of back-filling older class B and class C buildings," Yun said.

Office building transaction volume has dropped significantly. In the first four months of 2008, a total of only $18.5 billion in office buildings traded hands, compared with $95.0 billion during the same timeframe in 2007. The greatest decline was in suburban markets.

Industrial Market

Warehouse demand has fallen because of the economic slowdown, although the demand for light manufacturing space has risen slightly. "The drop in the dollar is favoring American goods, stimulating some manufacturing with a solid pickup in exports," Yun said.

Even so, overall vacancy rates in the industrial sector are forecast to rise to 9.9 percent in the fourth quarter of this year, up from 9.4 percent in the same period of 2007. Annual rent growth should be 1.2 percent by the end of the year, down from 3.6 percent in the fourth quarter of 2007.

Markets in the West and Florida have been most impacted by the economic slowdown. Industrial markets with rising availability include Orlando, Fla.; Phoenix; Tampa, Fla.; and West Palm Beach.

Net absorption of industrial space in 58 markets tracked is estimated at 68.8 million square feet this year, down from 158.3 million in 2007. Most of the new industrial completions have been built-to-suit, leaving many obsolete or nearly obsolete structures on the market.

Secondary markets have become most attractive to institutional investors and users. Industrial transaction volume during the first four months of 2008 was $8.5 billion, down from $11.9 billion in same period of 2007. The biggest slowdown is in the mid-Atlantic and the Midwest.

Retail Market

Retail spending has been hurt by high oil prices with consumers throttling back on their spending habits, even in the retailing hotbed of Southern California. "Fortunately, the construction of retail space has slowed, which is helping preserve some balance in the market," Yun said.

Vacancy rates in the retail sector will probably edge up to 9.3 percent in the fourth quarter from 9.2 percent in the fourth quarter of 2007. Average retail rent is expected to rise 1.3 percent in 2008, compared with a 2.9 percent gain last year.

Net absorption of retail space in 53 tracked markets is projected to grow to 18.2 million square feet in 2008 from 12.9 million last year.

Retail transaction volume during the first four months of 2008 totaled $7.5 billion, significantly below the $27.7 billion in the same period last year. Markets like Cincinnati and Detroit have seen a 100 percent decline in investment activity so far this year. Only Sacramento, Calif., is showing a gain, up 47 percent.

Foreign buyers are focused on retail strip centers in Southern California, Chicago, the Northeast and the Southeast. Even so, strip center transaction volume is down 77 percent from a year ago.

Multifamily Market

The apartment rental market – multifamily housing – could see less demand during the second half of the year as some first-time home buyers jump off the fence and into the market.

Multifamily vacancy rates are likely to rise to 5.7 percent in the fourth quarter from 4.8 percent in the fourth quarter of 2007. Average rent is forecast to rise 4.0 percent in 2008, up from a 3.1 percent increase last year.

Multifamily net absorption is seen at 219,900 units in 59 tracked metro areas this year, up from 230,900 in 2007.

Transaction volume in the multifamily market so far this year is only $13.7 billion, compared with $23.2 billion in the first four months of 2007. Even so, some markets have seen increasing sales including San Francisco; San Jose, Calif.; Tampa; Portland, Ore.; and Raleigh, N.C.

The *COMMERCIAL REAL ESTATE OUTLOOK** is published by the NAR Research Division for the Realtors® Commercial Alliance. The RCA, formed by NAR in 1999, serves the needs of the commercial market and the commercial constituency within NAR, including commercial members; commercial committees, subcommittees and forums; commercial real estate boards and structures; and NAR affiliate organizations.

Organizations in the RCA include the CCIM Institute, the Institute of Real Estate Management, the Realtors® Land Institute, the Society of Industrial and Office Realtors®, and the Counselors of Real Estate. The RCA also provides commercial products and services.

More than 80,000 NAR members offer commercial services, and 60,000 of those are currently members of the RCA.

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