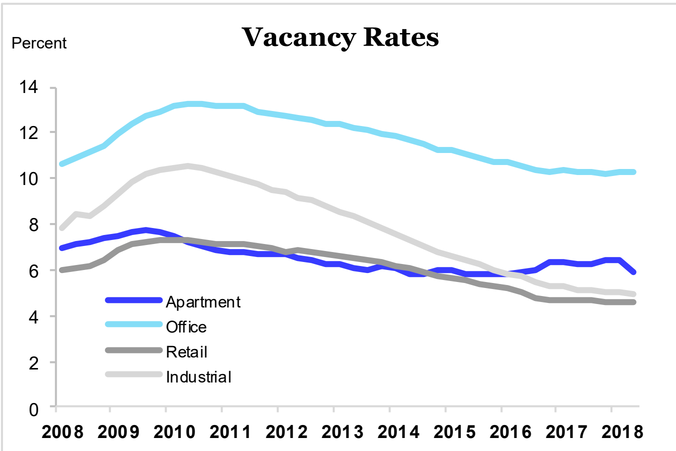
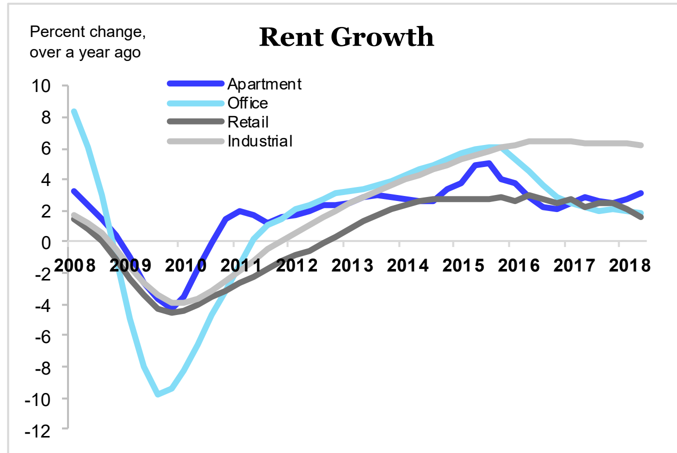
Commercial Property Update

2018: Q2

Strong demand growth keeps vacancy rates low, rents rising





Apartment

Apartment markets firmed in the second quarter of 2018, as rental demand surged during the spring leasing season. Meanwhile, new construction has tapered off a bit, alleviating some of the market worries about a wave of new supply. Vacancy rates dropped 50 basis points as a result, to 5.9 percent, the lowest average vacancy rate in two years. Solid demand helped lift rent growth to 3.1 percent over the past four quarters. The latest news suggests that the latent demand for apartments in the long aftermath of the mortgage crisis provides a deep reservoir of support for the apartment sector.

Retail

Demand for retail space remains sluggish. Net absorption softened to 65.7 million square feet over the past four quarters, less than half the pace in 2016, which saw 125.5 million square feet of net new leases. There is little new construction, however, keeping vacancy rates flat at 4.6 percent. Rents rose 1.6 percent over the past four quarters. Recent performance was depressed by a spate of tenant bankruptcies in late 2017 and early 2018, but landlords are optimistic about progress in re-leasing the vacant space.

Office

Both supply and demand are growing slowly in the office sector. Net absorption has trended lower, to 54.7 million square feet over the past four quarters, compared to 70.3 million square feet a year earlier. Supply, however, remains in balance with demand, keeping vacancy rates unchanged at 10.2 percent. Rents continued to increase, but at a slightly slower pace, rising 1.8 percent over year-ago.

Industrial

The industrial sector continues full speed ahead with 55.9 million square feet of net new leases in Q2. New construction has caught up with the strong demand for space, which is riding the wave of E-Commerce shipments, but markets remain firm. Vacancy rates edged 10 basis points lower to 4.9 percent. Rents rose 6.2 percent over the past four quarters, well ahead of the other major property sectors.

Source: Data from CoStar and Nareit 2018.

Real estate working for you

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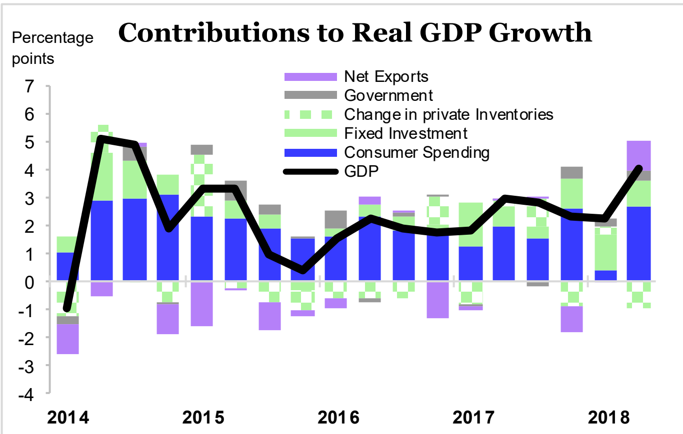
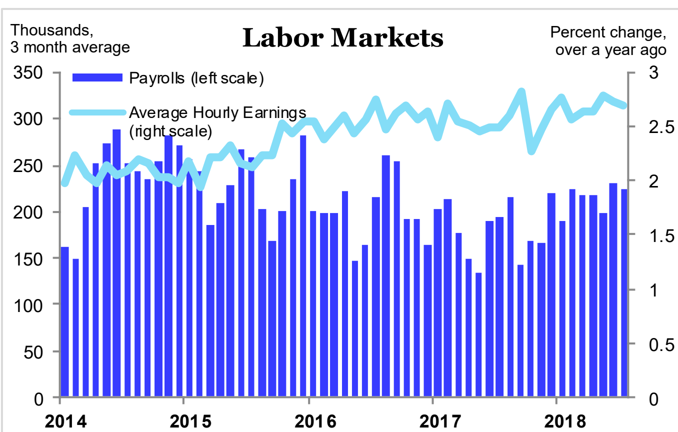
Rising GDP and job growth boost CRE fundamentals



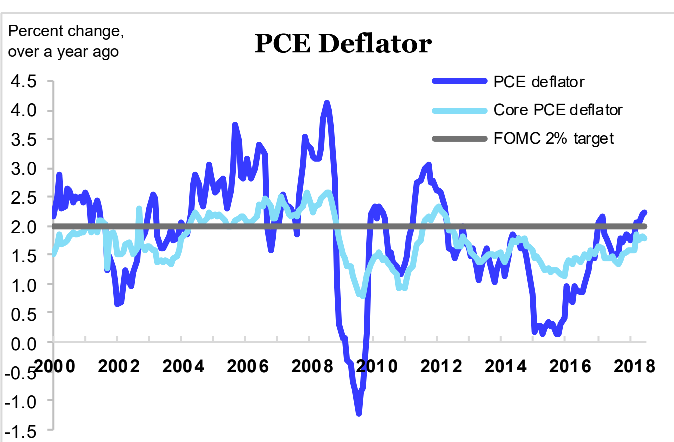
Economic activity accelerated in Q2

The economy had a growth spurt in the second quarter, surging to an annual rate of 4.1 percent. Consumer spending rebounded after a weak Q1, rising 4.0 percent (blue bars show the contribution to total GDP growth, the solid line). Net exports made a significant contribution to overall GDP growth (1.1 ppts, purple bars) offsetting the decrease from private inventories (green checkered bars). The economy is currently enjoying above-trend growth, boosted by last year's tax cuts.



Labor markets continue to tighten

Job growth has been solid through mid-2018, but wage gains have shown little improvement. Payroll employment has risen 215,000 per month, on average, through July, the fastest pace since 2015. The unemployment rate has declined below 4.0 percent for the first time since 2000. The number of people on the sidelines of the labor market remains elevated, however, which damps wage growth: average hourly earnings rose 2.7 percent over the past 12 months, little changed from the prior two years.



Inflation in line with expectations

Inflation trends have moved up to the Fed's target, with the personal consumption expenditure (PCE) deflator, the Fed's preferred inflation measure, rising 2.2 percent over 12 months (1.8 percent excluding food and energy). Increases in June were led by spending on services, specifically food services and accommodations. The Fed's efforts to bring inflation back up to its target have taken five years or more, however, suggesting there is little risk of a sudden inflationary spiral.