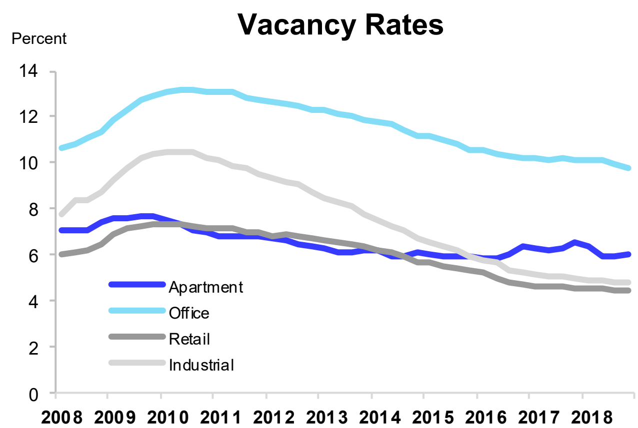
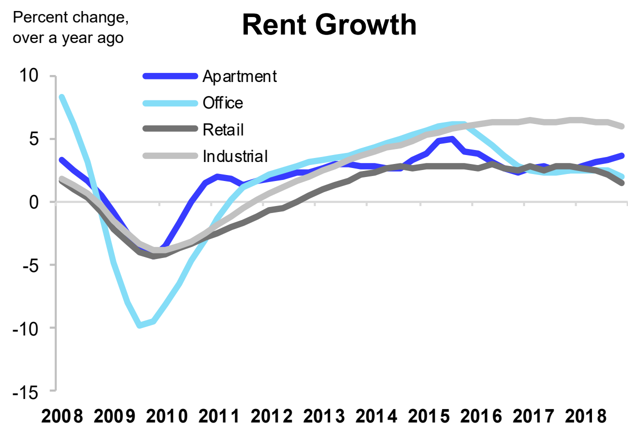
Nareit Commercial Property Update

2018: Q4

No sign of slowing for Commercial Real Estate demand





Apartment

Apartment markets had a strong year in 2018, enjoying the highest net absorption on record. Over 350 thousand units were absorbed in 2018, compared to almost 300 thousand units in 2017. Construction activity slowed a bit, as units completed fell by 54 thousand units, generating excess demand across the country. Vacancy rates stood at 6.0 percent, slightly lower than one year ago, and rent growth accelerated to 3.6 percent over the prior year. Demand for rental housing continues to push through despite the increasing homeownership rate.

Office

The office sector tightened a bit in the latter half of the year with rising demand and modest growth of supply. Net absorption outpaced completions 2-to-1 in Q4, pushing vacancy rates to a new low for this expansion. Rent growth decelerated, however, to 2.0 percent over the prior year. Demand for office space has been weak in 2018 relative to employment growth. At some point these two should realign, but how soon remains uncertain.

Retail

Demand for leased retail space firmed a bit the fourth quarter, to 17.6 million square feet. Given the extremely low levels of construction of shopping centers and malls, net absorption was almost double the rate of completions, and vacancy rates edged lower as a result. Rent growth decelerated, however, to 1.5 percent over one year ago. Retail property owners have re-leased much of the space that had been vacated by store closures and bankruptcies in 2017 and 2018.

Industrial

The industrial sector continues to sit on solid ground, and demand shows no signs of slowing. Construction has ramped up, however, and demand for space was in line with supply for the fourth quarter, keeping vacancy rates unchanged, at 4.8 percent. Rent growth continues to outpace other sectors, at 5.9 percent over the prior year. Heading into 2019, the industrial boom appears far from over, especially as online purchases that are shipped through industrial/logistics facilities continue to rise.

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Source: Data from CoStar and Nareit 2019.

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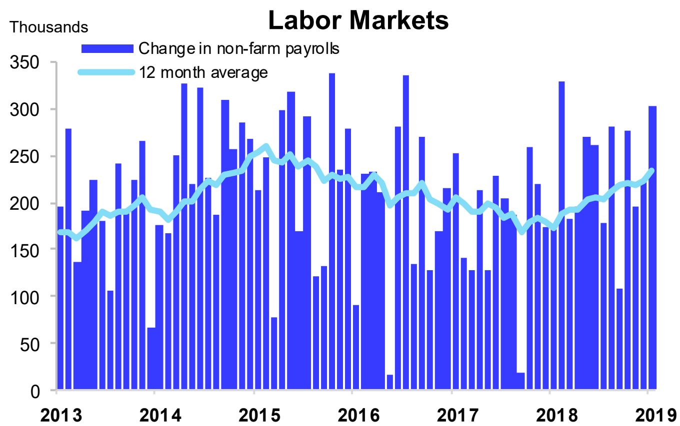
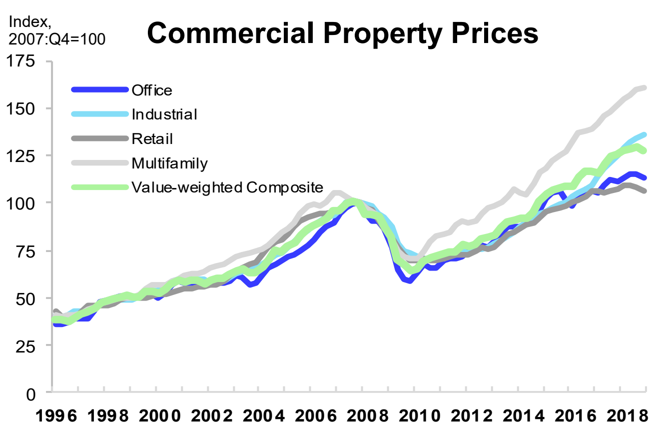
Economic activity supports CRE fundamentals



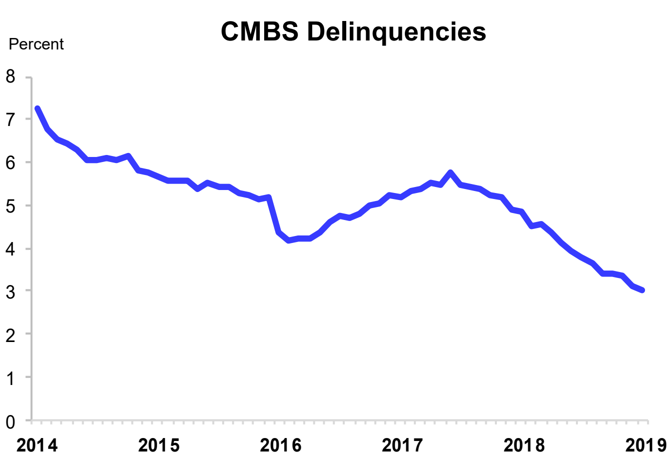
Jobs rise, but crystal ball is cloudy

The government shutdown has delayed some but not all of the main reports on economic activity. One key report that was not delayed was January employment. Nonfarm payrolls rose a robust 304,000 in January. The unemployment rate increased to 4.0 percent, in part due to furloughed federal employees. Other key reports on GDP, retail sales and housing activity, however, are unavailable as of this writing. A strong job market suggests that economic growth remains robust.



Commercial property prices rise

Commercial property prices edged higher in 2018, although gains early in the year slowed or reversed in the second half. Industrial and multifamily properties stood out from the pack, with prices increasing 8.5 and 6.0 percent, respectively, over the prior year. Both property types are well supported by demand fundamentals going into 2019. Office and retail properties lagged the broader market with values for office properties increasing 1.3 percent and values for retail declining 1.4 percent in 2018.



CMBS delinquencies decline

CMBS delinquencies continued to decline in January, to 3.02 percent. Delinquencies had been above 7 percent in the aftermath of the financial crisis, but declined both as tenant cash flows increased and also bad mortgages were written off. The delinquency rate moved back up in 2016-2017 as the $200 billion “Wall of Maturities” of 10-year notes written prior to the crisis came due, reaching a peak delinquency rate of 5.75 percent. The steady decline since then reflects sound underwriting practices, lower leverage on property transactions and higher cash flows of tenants.

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Source: Data from BEA, BLS, U.S. Census Bureau and Nareit 2019.