

SIOR Index –Commercial Markets Plateau in Third Quarter 2011

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NAR Economic Overview

With a month left in 2011, the economy is looking for some good cheer. While the third quarter brought some positive news, it barely makes for holiday sparkle. With unemployment still high, a bagful of European issues threatening financial markets, and a consumer mood that's more attuned to Grinch than Santa, economic concerns weigh on commercial real estate markets.

Based on the Bureau of Economic Analysis's first estimate, gross domestic product (GDP) rose 2.5 percent in the third quarter. Mirroring second quarter's patterns, all major components advanced, except government spending. Business investments provided a double-digit boost behind the economic advance. Business spending rose 16.3 percent during the quarter. Businesses have accelerated spending with each successive quarter during 2011. Businesses upped their spending on equipment—transportation was up 37.9 percent while industrial equipment rose 33.2 percent. Notably, spending on commercial real estate gained for the second consecutive quarter, advancing 13.3 percent.

The major driver of economic growth by scale, consumer spending remained steady, gaining 2.4 percent during the third quarter. While at modest levels, consumers increased their spending on both goods and services. Spending on furnishings and household equipment was up 4.5 percent, while consumption of recreational goods and vehicles rose 12.1 percent. Cars and auto parts registered a 3.2 percent decline. Consumers also increased their spending on financial services and insurance (3.3%), recreation (3.2%) and health care (5.4%).

International trade, which has proven resilient this year, continued to expand during the quarter. With exports rising by 4.0 percent and imports growing by 1.9 percent, the balance of trade was positive. However, along with growth in trade, prices of exchanged goods also increased. Import prices, in particular, have been growing at double-digit rates for better part of 2011, with September's prices 13.4 percent higher year-over-year. Export prices rose at a much slower pace, with September 2011 figures up 9.5 percent from the prior year.

The other major contributor to economic growth—government spending—was flat. Federal spending increased 2.0 percent, driven by defense expenditures, up 4.9 percent. State and local governments slashed their spending 1.3 percent as they continued to face mounting deficits.

On the employment front, the third quarter witnessed a slowdown. Businesses cite general uncertainty, lack of demand and regulatory concerns as the main reason for modest hiring. The number of payroll jobs rose by 368,000 during the quarter. Manufacturing, construction and mining maintained a steady pace of growth. In a positive sign, professional and business services posted a net 100,000 new jobs during the quarter. The other contributors to employment growth were the education and health sectors.

However, employment conditions remain far from a pace that could support sustainable economic growth. The first-time unemployment insurance claims were stubbornly high at 412,000 per week, during

the third quarter. The figure should fall below 400,000 per week to ensure a meaningful, consistent job creation. In addition, the number of people drawing unemployment benefits rose to 3.73 million in the third quarter, from 3.72 million in the second quarter of the year. Not surprisingly, the unemployment rate spent the third quarter pegged at 9.1 percent. It declined to 9.0 percent in October.

With the large specter of unemployment casting a long shadow across the economy, consumers grew weary. The consumer confidence index compiled by the Conference Board—a measure that considers respondents' general feelings about the job market and their finances—declined to 39.8, a low not seen since the first quarter of 2009, during the recession. More troubling, consumers were pessimistic about both the current economic conditions as well as their expectations.

Looking ahead, GDP growth will likely close the year at an anemic 1.8 percent annual rate. While the holiday season is expected to bring a small jolt of energy, it will not likely provide enough fizz to make everyone's celebration cups full.

SIOR Index Results

Against this economic backdrop, office and industrial spaces found a plateau. The third quarter SIOR survey results reflected an uncertain economy.

The Commercial Real Estate Index, representing third quarter 2011 data, was virtually unchanged, having inched up 0.6 points. The national index, based on 10 variables pertinent to the performance of U.S. industrial and office markets, rose slightly to 55.5 from 54.9 in the second quarter. The office sector declined 1.5 points from an index value of 53.2 to 51.7. In contrast, the industrial sectors rose 1.6 points to 57.9. Looking at most indicators, office space experienced a comparatively more difficult quarter. As of the third quarter, the national economic conditions are taking an increasing toll on local industrial and office markets.

SIOR Commercial Markets

The broad markets were almost flat, in step with the macroeconomic trends. Geographically, all four regions avoided a decline. Commercial markets in the Northeast posted the largest advance during the third quarter—2.8 points to an index value of 58.9. Markets in the Midwest were slightly positive as well, gaining 1.2 points. Markets in the West and South were virtually unchanged from the previous quarter. In terms of nominal index value, the South continues to register the best overall market conditions.

Leasing activity was flat in the third quarter, as practitioners reported unchanged vacancies. While concessions continue to make it a tenant's market, respondents found improving rents—67 percent felt they were below last year's level. In addition, subleasing availability is registering minor improvements, with only 36 percent of SIORs reporting ample sublease space.

Construction of new commercial space is showing signs of life in certain regions, but remains at historically low levels—74 percent of practitioners mentioned there was no new construction in their market. Development conditions remained level, favoring buyers, with acquisition prices lower than construction costs in 83 percent of the markets. While selected local economies witnessed improvements

in the third quarter, national economic conditions worsened. According to 92 percent of SIORs, the national economy had a negative impact upon their markets.

Based on the results of the third quarter survey, commercial markets are following the wider economic trends. SIOR members find a sideways moving market, lacking in the upside potential expected during the first part of the year. Only 47 percent of respondents expect market improvements in the next three months, compared with 94 percent with similar expectations during the first quarter of the year and 62 percent in the second quarter.

SIOR Outlook

In light of the results of the third quarter SIOR Index, commercial real estate markets are stagnant. With economic conditions bouncing along at a modest pace, office and industrial markets continue on a sideways path.