

ADVANCE IN MARKETS SOFTENS IN THIRD QUARTER

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NAR Economic Overview

Mirroring the warm summer temperatures, the U.S. economy rebounded in the third quarter from the weak activity of the chilly first half of 2016. Based on the second estimate from the Bureau of Economic Analysis, real gross domestic product (GDP) rose at an annual rate of 3.2 percent, a stronger pace than initially expected. Third quarter GDP growth was higher than the average 2.1 percent

typical of third-quarter growth over the past 16 years. However, all indications point toward a retreat in GDP growth to around 2.0 percent in the fourth quarter 2016.

The third quarter uptick in economic activity was driven by a continued increase in consumer spending, also boosted by a double-digit jump in exports and higher federal government expenditures. Personal consumption reflected the

traditional summer vacation season, with an annual rate advance of 2.8 percent in the third quarter. The gain came from a stand-out 20.1 percent hike in auto purchases and a 9.5 percent rise in recreational vehicles and goods. Nondurable goods also posted growth, with an annual increase of 2.3 percent, as consumers spent more on food and beverages in grocery stores. Spending on services rose 2.5 percent on an annual basis, with recreation, housing,

SIOR INDEX BY INDUSTRY



Source: SIOR, NAR

transportation, as well as hotel stays and restaurants driving expenditures.

With consumers keeping an upbeat outlook, corporations reported positive quarterly earnings. However, companies remained cautious, as evidenced by the 0.2 percent increase in nonresidential fixed investment. Businesses continued to cut back investments in equipment for the fourth consecutive quarter—especially industrial and transportation equipment. Investment in commercial real estate picked up noticeably during the quarter, with a 10.1 percent annual rate of growth, as developers moved to meet rising demand for warehouses and office spaces. Spending on intellectual property products—software, R&D—increased by 1.0 percent. Investments in residential real estate declined at a 4.4 percent annual rate.

Continuing on an upward trend, international trade accelerated in the third quarter. Exports increased by 10.1 percent, as manufacturers and commodities producers found favorable markets. Imports advanced with a 2.1 percent annual rate of growth.

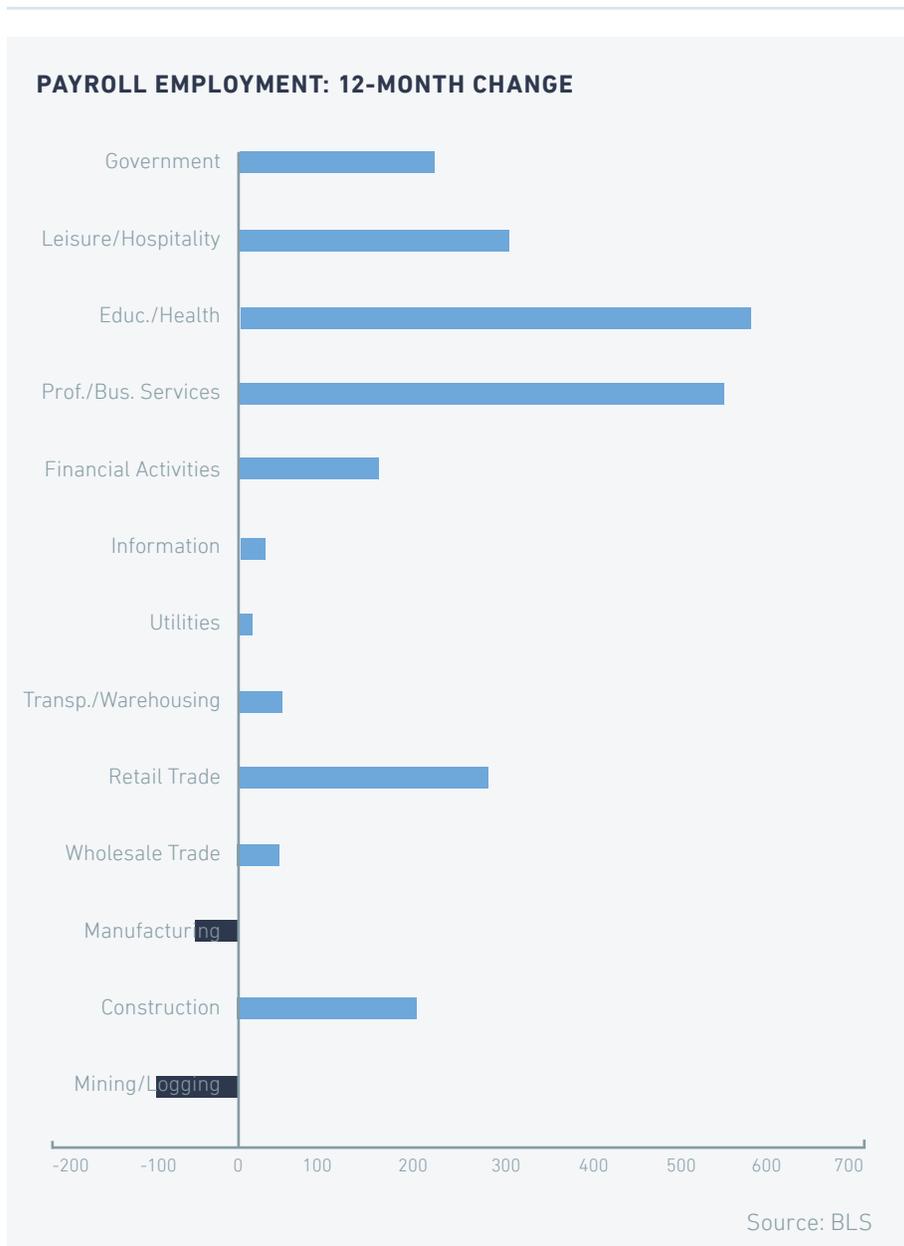
Adding wind in the economy's sails, government spending rose at a 0.3 percent annual growth rate, as the federal government increased spending, with a 3.1 percent rise in nondefense spending, accompanied by a 2.1 percent boost in defense expenditures. State and local governments cut back spending at a 1.1 percent annual rate, due to cuts in infrastructure investments (down 12.4 percent).

Employment trends in the third quarter underscored the economic rebound, with the largest quarterly advance of the year so far. Payroll employment recorded a net increase of 636,000 new positions. Average weekly earnings of private employees rose by 2.0 percent

in the third quarter of this year, compared to one year earlier.

Employment in private service-providing industries remained the growth engine during the quarter, with 549,000 net new jobs. Within the service industries, professional and business services posted the highest number of net new employees—199,000—while financial services added 37,000 new

positions, indicating continuing demand for office space. Education and health services added 136,000 net new payroll positions, the second-largest industry advance. As the summer months attracted consumers to vacations, employment in leisure and hospitality advanced by 54,000 new positions, while retail trade added 52,200 new positions. With demand for industrial warehouses positive, transportation



and warehousing employment gained 27,900 new positions, while wholesale trade employment rose by 17,800 jobs. The unemployment rate remained flat in the third quarter, at 4.9 percent, the same level as the first and second quarters of 2016. The average duration of unemployment was level as well, at 27 weeks.

The positive trends in employment were echoed by the consumer confidence figures, with The Conference Board's index advancing to 100.7, the second-highest value since the third quarter of 2007. Separately, the Consumer sentiment index compiled by the University of Michigan slid in the third quarter of the year to 90.3, compared with the 92.4 value from the second quarter.

SIOR Index Results

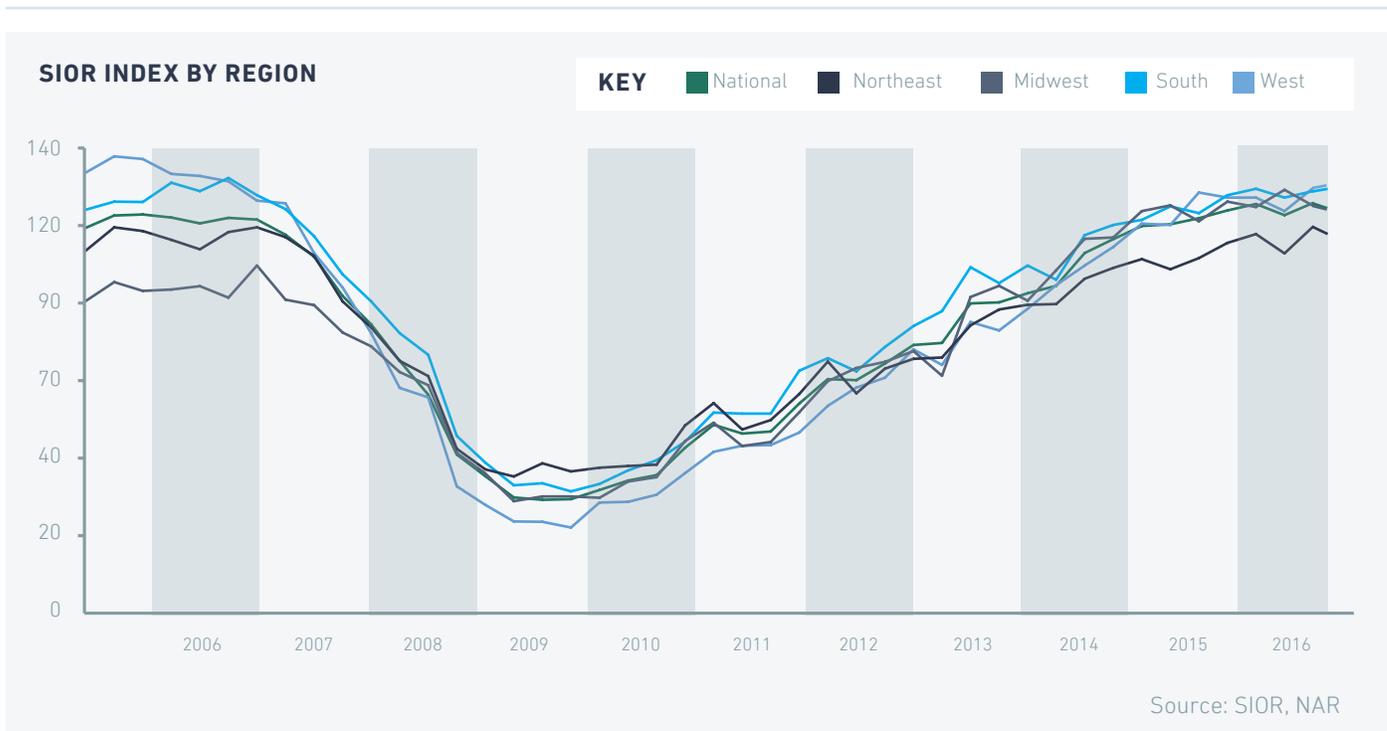
As deal volume in large cap markets continued sliding, commercial real estate markets moderated in the third quarter. The SIOR Commercial Real Estate Index, representing third quarter 2016 data, decreased 4.1 points from the second quarter of 2016. Compared with the prior year, the index declined by 1.6 percent. The national index, based on 10 variables pertinent to the performance of U.S. industrial and office markets, closed at 119.0. An index value of 100 shows a balanced market, meaning that the current value of the national index is pointing to growing conditions, having surpassed its historical average. The figure represents the tenth quarter with a value above the 100-point threshold since the Great Recession.

Market conditions in both the office and industrial sectors registered

slowdowns. The office index reached a value of 105.5, representing a 9.5-point decline from the prior quarter and 8.5 points lower year-over-year. The industrial sector also encountered softening conditions, with the index recording a value of 127.0, a decline of 1.5 points from the prior quarter. However, both property indices remained above the 100-point value for the past nine quarters, indicating solid demand for space.

SIOR members reported rising fundamentals, with positive developments in leasing and sales.

- Leasing activity exceeded historical levels for 54 percent of SIORs who responded to a market survey.
- Rents moved sideways for office and industrial properties—6 percent of SIOR members considered that asking rents were below those of one year ago. Meanwhile, 59 percent indicated



that rents were in line with long-term averages, and 34 percent ascertained that rents were above historical trends.

- Vacancies continued declining, with 71 percent of respondents reporting lower availability rates.
- Subleasing availability picked up slightly, with 9 percent of SIOR respondents feeling that there was ample sublease space in their markets.
- New construction of office and industrial spaces improved, with 41 percent of SIOR members reporting new construction during the quarter, and 18 percent indicating new building development close to historical averages.
- Development conditions continued shifting in favor of sellers during the period, with 52 percent of SIOs rating it a seller's market. Investment prices

posted a slight decline, with 39 percent of markets being below construction costs.

Many local economies performed well during the quarter. Only 12 percent of SIOR respondents felt that their local economy was slowing or contracting, while 52 percent considered their economy to be strong and improving. Meanwhile, with the spry performance of the GDP in the third quarter, the national economy's impact was felt on local markets, with 37 percent of SIOR responses indicating a positive impact upon markets. In contrast, 15 percent of SIOR respondents experienced a negative impact upon their markets from national economic conditions (the remainder was neutral).

Regionally, the survey respondents indicated mixed performance. While all four regions continued with index values

above 100, the Northeast and West declined from the second quarter, with values of 107.3 and 119.7, respectively. The South region regained the top spot with an index value of 126.5, although its performance was flat. The Midwest was the only region to post an increase, with a value of 123.3.

Looking ahead at the last quarter of 2016, SIOR members expect the outlook to improve—56 percent of respondents indicated growth in the 1-15 percent range (compared with 44 percent in the prior quarter), while 36 percent felt the market will maintain current levels. Only 8 percent of SIOR members expected conditions to decline. ♥

For more information on the SIOR Commercial Real Estate Index methodology, visit www.sior.com/resources/commercial-real-estate-index

