A New Day for Commercial Real Estate

Newmark Grubb Knight Frank

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AGENDA

1. Economic Backdrop
2. Leasing Markets
3. Capital Markets
4. Why It’s a New Day
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4. Why It’s a New Day
Gross Domestic Product
GDP Restrained by Govt. Policy, Better in 2014

- Growth is back; we are in year 5 of recovery.
- GDP hit new peak in 2011-Q2, recovering economic output lost in recession.
- But growth remains disappointing by historic standards.
- Another year of substandard growth in 2013 as economy absorbs sequester-mandated spending cuts, tax increases & partial shutdown.
- Better outlook next year as tax effects fade and European recession winds down.

Source: BEA, Moody’s, PNC, Wells Fargo, NGKF
Fed has engineered era of record-low interest rates.

Three rounds of quantitative easing have inflated Fed’s balance sheet above $3 trillion, more than 3 times its pre-crisis level.

Low rates benefit real estate & other interest-sensitive assets.

Low rates have re-ignited the housing market, supporting consumer spending & demand for distribution centers.

Rates are beginning to rise.

10-year yield should be around 4-1/2 to 5% in vigorous recovery cycle.
Payroll Job Change, Annual
Job Growth Will Stay Moderate

- GDP hit new peak in 2011-Q2 but employment still 1.9M jobs shy of prior peak.
- Means that businesses have increased productivity (output per hour).
- Businesses hiring and spending cautiously with an eye toward maintaining healthy balance sheets and filling key positions with the “right” hires.
- Employment likely to hit new peak next year.
- Unemployment remains high overall but demand for skilled, educated workers also is high – mismatch of supply & demand.

Source: BEA, Moody’s, PNC, Wells Fargo, NGKF
**Employment Change Since Start of Recession**

Tulsa vs. OKC vs. U.S.

- Tulsa labor market following trajectory of U.S. recovery.
- Tulsa lost 33,500 jobs peak to trough, still down by 13,200.
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Apartment Market
Vacancy at all-time low; rent up 8.2% from trough in ’09q4

Homeownership Rate
By Quarter, Seasonally Adjusted

Apartment Vacancy & Asking Rent

Source: Census Bureau, Reis, NGKF
Industrial Market
Vacancy near pre-recession low; rent up 4.9% from trough in ’11q4

Source: DOT, NGKF
Office Market
“Densification” restrains recovery; rents up 3.8% since ‘11q3 trough

Payroll Employment Monthly Change (thousands)

Office Vacancy & Asking Rent

Source: BLS, NGKF
Retail Market
Vacancy & rents slow to recover; Class A assets doing much better

Source: Census Bureau, CoStar, NGKF
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Sales Still Growing, Cap Rates Near Bottom

CRE Investment by Quarter
+30% in 2012, +24% 1H 2013

Avg. Quarterly Cap Rates

Source: Real Capital Analytics, NGKF
Avg Cap Rate vs. 10-year Treasury Yield (Monthly)

Spread Still High by Historic Standards

- Rising interest rates will put upward pressure on cap rates.
- Recent jump in 10-year yields reduces spread with cap rates.
- Could still be some cushion for interest rates to rise with little effect on cap rates.
- Rising rates will have least impact on institutional & other all cash/low leverage buyers.
- Lots of debt & equity capital chasing CRE.

Source: Real Capital Analytics, NGKF
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Construction is Minimal

- Office construction = 54M SF, 53% below pre-recession peak
- Industrial construction = 70M SF, 61% below peak
- Retail construction = 37M SF, 80% below peak
- Apartment permits +20% YTD thru Aug. but less than ½ recent peak in 2005
CRE Returns Are Solid, Volatility Is Low

- CRE returns have been stellar for both listed funds and direct ownership with 10-year annual returns beating stocks & bonds.
**Commercial Mortgage Conditions**

**Distress Is Receding**

**Monthly Net Change to Inventory of Distressed Properties**

![Graph showing monthly net change to inventory of distressed properties from 2007 to 2013.](image)

**Delinquency Rates Thru 2013-Q2**

![Graph showing delinquency rates from 2007 to 2013-Q2.](image)

- **CMBS**
- **Life Insurers**
- **Fannie Mae**
- **Freddie Mac**
- **Banks**

Source: Real Capital Analytics, Mortgage Bankers Assoc., NGKF

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What Could Go Wrong?

Unwinding QE, Long Term Budget Accord

Assets on Fed Balance Sheet

Public Debt as % of GDP

Source: Federal Reserve, OMB., NGKF