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Written by Chris Macke (cmacke@costar.com)

Commercial Real Estate Surges, Needs Corporate Hiring To Continue

First quarter commercial real estate market fundamentals in 2011 continued their improvement over 2010. This will come as no surprise to anyone who understands that commercial real estate demand is derived from activity in the overall economy. As the economy goes, so go commercial real estate fundamentals.

When looking at the change in economic indicators outlined below, the continued improvement makes sense. Consider the following:

This time last year unemployment was at 10.2% versus 8.8% currently
Since the February 2010 employment trough, 1.7 million jobs have now been added
Manufacturing capacity utilization now stands at 74.3%, up from 69.7% in February of 2010
The S&P 500 has doubled from its March 2009 low

Maybe the most important indicator is investor confidence. According to PriceWaterhouseCoopers' First Quarter 2011 Real Estate survey, it's on the rise.

Clearly there has been an improvement in the national economy, which has translated into improved commercial real estate fundamentals. Now let's look at the specific first quarter results:

Office Market

According to CoStar's first quarter reports, the office market saw a positive net absorption of 8.8 million square feet of office space. This marks the fourth consecutive quarter of positive net absorption with almost 48 million square feet added over the last 12 months. For comparison, the previous twelve months saw the market lose 28.8 million square feet.

Office vacancy rates held steady at 12.6 percent, even in the face of a slight rise in new deliveries.

CoStar's quarterly reports also show that office rental rates turned slightly downward after a fourth quarter rise, which was the first in 10 quarters. With office construction at a record 10-year low, there is no denying that an increase in corporate hiring would accelerate the strengthening of office market fundamentals.

Retail Market

CoStar is also showing a positive net absorption of 10.1 million square feet of retail space in the first quarter of this year. A total of 65 million square feet was added during the last 12 months, which is more than four times the amount added in the previous twelve months. Even with major retailers like Borders and K-Mart closing up big box stores around the country, the retail vacancy rates continued their decline, dropping to 7.1 percent, down from the market high of 7.4% in 2009.

Thankfully, retail space deliveries resumed their decline after increasing in the fourth quarter, falling 50 percent from their first quarter 2010 level and rental rates continued their decline albeit at a slower pace.

Industrial Market

CoStar's first quarter 2011 Industrial Market Report shows strong positive net absorption of 32.3 million

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square feet of industrial space in the first quarter of this year. This is the fourth-straight quarter of positive net absorption, with more than 89 million square feet of industrial space being absorbed over the last 12 months. Considering industrial space absorption shrank by 182 million square feet the previous twelve months, this news is a welcome sign that things are picking up in the industrial sector.

CoStar's report also shows that vacancy rates for industrial property continued a slow but steady decline, falling to 9.9 percent, down from their market high of 10.2 percent in 2009. Also industrial deliveries are down 56 percent from their first quarter 2010 level.

The amount of new industrial space delivered has declined in each of the last nine quarters. This is not surprising considering the nature of industrial real estate and its ability to quickly shut off new supply. Rental rates continued their decline albeit at a much slower pace than for the same period last year.

As with office and retail, projects under construction are at a record 10-year low. An increase in corporate spending would accelerate the strengthening of industrial market fundamentals.

Will Momentum Continue?

All of this analysis through CoStar's quarterly reports begs the next logical question: Will this improvement continue, and if so, at what pace?

Both the sustainability of the current recovery, which has been occurring for more than a year in all property types based on net absorption, and future strength of the recovery, depend on the levels of corporate hiring and investment.

If corporations increase their rate of hiring and investment, then the commercial real estate recovery will not only be sustainable but will strengthen. If corporations hold hiring levels steady and do the same with their spending levels, then the sustainability of the recovery will be more dependent on other factors such as the impact of rising oil prices on consumer spending.

Corporations hold the key to the future of commercial real estate's market fundamentals.

Chris Macke is a senior real estate strategist for the CoStar Group and a former vice president with GE Real Estate. He has 20 years experience in commercial real estate development, acquisition, leasing and financing.