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REAL ESTATE NEWS

Demand for Commercial Space Growing

(December 14, 2004) -- Growth of the U.S. economy and a rise in exports will boost demand for commercial real estate space over the next two years, with increases in various commercial sectors already seen this year, according to the NATIONAL ASSOCIATION OF REALTORS® *Commercial Real Estate Quarterly*.

David Lereah, NAR's chief economist, says the commercial real estate market is responding to improvements in the overall economy.

"New jobs are filling office and industrial space, and vacancies will generally decline in the commercial real estate market," he says. "A silver lining to the recent slide of the U.S. dollar on foreign currency markets is an expected boost to U.S. exports that also could stimulate foreign purchase of U.S. commercial property."

Lereah says changing currency values have numerous effects. "On one hand, the higher cost of foreign products will rein in some consumer spending," he says. "On the other, rising exports will help the economy to grow in 2005, which will create new jobs." He projects the Gross Domestic Product to grow 4.0 percent next year, leading to the creation of 2.5 to 3.0 million new jobs.

The growth in federal budget deficits is the primary factor in the dollar's decline. "Even with the expected benefit for exports, high budget deficits do raise a yellow flag," Lereah says. "Long term, if the deficit becomes large enough, the government would compete with the private sector for available funds and that would cause interest rates to rise. Too much of a rate increase would be detrimental for the U.S. economy, but we do not see that occurring in the foreseeable future—the dollar should improve, and right now we're in pretty good shape."

NAR President Al Mansell, CEO of Coldwell Banker Residential Brokerage in Salt Lake City, says investment returns are showing a positive performance in all of the commercial real estate sectors. "One sign of a healthy commercial market is that many of the largest pension funds have started to increase the share of their investment in this asset class," he says. "That underscores the importance of real estate in a diversified portfolio."

The NAR forecast for four major commercial sectors is based on analysis of data in 57 metro areas tracked, including the office, retail, industrial and multifamily markets. The forecast was produced with data provided by Torto Wheaton Research and Real Capital Analytics.

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Net absorption of office space, which includes leasing of new space coming on the market as well as space in existing properties, is performing exceptionally well. With a decline in sublet and unused space, net absorption will nearly triple to 55.9 million square feet this year in contrast with only 20.0 million in 2003. An additional 50.4 million square feet are expected to be absorbed in 2005, with 59.7 million in 2006.

Office vacancy rates in the 57 markets tracked are likely to decline to 15.3 percent in 2005 and 14.1 percent in 2006 from 16.2 percent this year. Office rents for 2004 will be up about 1.0 percent, and then should rise 2.8 percent next year and another 3.3 percent in 2006.

In the retail sector, net absorption in the 57 metro areas tracked is estimated at 27.5 million square feet in 2004, more than double the 11.8 million last year; 33.6 million square feet are forecast for 2005 with 27.0 million in 2006. The most popular retail properties for investors are centers anchored by a grocery store.

The average vacancy rate for retail space should be 7.5 percent this year, down from 8.1 percent in 2003. Vacancies are projected at 6.8 percent next year and 7.5 percent in 2006. Retail rent growth is seen at 3.3 percent this year, with a rise of 4.4 percent in 2005 and 3.6 percent in 2006.

The industrial market varies greatly around the country but is experiencing a level of net absorption not seen since 2000, much of it build-to-suit, forecast at 144.4 million square feet in 2004 in the 57 markets tracked, up greatly from only 16.5 million last year. Net absorption should be at 110.5 million square feet next year and 132.1 million in 2006.

The national vacancy rate is expected to decline to 11.0 percent this year from 11.6 percent in 2003, with projections for 11.1 percent next year and 10.8 percent in 2006. After slipping 0.7 percent this year, industrial rents are projected to rise 0.6 percent in 2005 and another 1.7 percent in 2006.

The apartment rental market—multifamily housing—should experience a net absorption of 243,400 units in the 57 markets tracked this year, up from 159,400 in 2003. Net absorption is projected at 226,700 in 2005 and 225,900 in 2006. The average vacancy rate should rise to 6.8 percent this year from 6.4 percent in 2003, and is projected to drop to 6.6 percent in 2005 and 6.2 percent in 2006. Average rent is forecast to rise 1.3 percent for 2004, 1.8 percent in 2005 and 2.6 percent in 2006.

The *Commercial Real Estate Quarterly* is published by the NAR Research Division for the REALTORS® Commercial Alliance (RCA). The RCA, formed by NAR in 1999, serves the needs of the commercial market and the commercial constituency within NAR, including commercial members; commercial committees, subcommittees and forums; commercial real estate boards and structures; and NAR affiliate organizations.

These organizations include the CCIM Institute, the Institute of Real Estate Management, the REALTORS® Land Institute, the Society of Industrial and Office REALTORS®, and the Counselors of Real Estate. The RCA also provides commercial products and services.

Editor's Note: For more real estate market statistics, visit NAR's Economic Research Division.

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