# Commercial Real Estate Quarterly

***A Quarterly Review and Forecast of Property Performance and Economic Issues Affecting Commercial Markets****

**THIRD QUARTER 2002**

CONTENTS


**Forecast** .................... 2
**Office..** ..................... 7
**Warehouse**............... 10
**Retail**....................... 13
**Multifamily**............... 16


12-MONTH FORECAST

**Vacancy**
- Office ↓
- Warehouse ↓
- Retail ↓
- Multifamily ↓

**Net Absorption**
- Office ↑
- Warehouse ↑
- Retail ↑
- Multifamily ↑

**Starts**
- Office ↓
- Warehouse ↓
- Retail ↓
- Multifamily ↓

**Completions**
- Office ↓
- Warehouse ↓
- Retail ↓
- Multifamily ↓

## A Cautious Recovery

**The economic growth in the third quarter showed surprising strength…**

Strong increases in consumer spending and federal government outlays -- particularly those related to national defense -- aided in the 4.0 percent economic growth. Overall consumer spending rose 4.1 percent, largely due to zero-interest financing on auto sales. Spending for motor vehicles and parts surged 49 percent on an annualized basis as 17.6 million new autos were snapped up in the third quarter compared to 16.3 million in the second.

**Leasing activity picked up modestly in the third quarter…**

Thanks to better-than-expected economic growth, most of the 54 markets registered modest increases in non-farm employment from the second quarter. This allowed demand for office, warehouse, retail, and apartments to expand moderately in most markets tracked. However, construction of new space continued to outpace absorption, driving down or keeping rents flat while pushing up vacancy rates -- particularly in warehouse properties and apartments -- close to their highest levels recorded in1991. Fortunately, the deterioration in occupancies and rents was less severe compared to the second quarter.

**Expect stronger economic growth in the second half of 2003…**

Look for middling GDP growth in the next two quarters. Consumers have little left to continue to push the economy. A good chunk of stock market wealth has evaporated, debt levels have risen, and job growth has been minimal. With only a slight push coming from consumers, businesses will have to step up to the plate. Fortunately, conditions are developing for increased business spending. Inventory levels are very low, worker productivity has been rising strongly as more production is being squeezed out from same number of workers, and very low borrowing costs should allow businesses to move up their capital spending. The momentum will build to push the economy to its full potential in the latter half of 2003 -- and allow jobs to be created in healthy doses.

**Leasing activity to gain momentum, but rebound is likely to be modest…**

The return of healthy job growth in the second half of 2003 is likely to translate into increased leasing activity. However, demand for commercial real estate is not likely to replicate its robust growth seen in 1999 and 2000. Taken together with slowing construction, occupancy and rent gains for all property types will be gradual over the next two years. Still, the recovery in demand should help pave the way for more solid gains in occupancy and pricing after 2004.

**Based on 54 markets tracked; see back for details*

# *Forecast Summary*

| | 2002 | 2003 | | | | 2004 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | IV | I | II | III | IV | I | II | III | 2002 | 2003 | 2004 |
| **U.S. Economy** | | | | | | | | | | | |
| *Annual Growth Rate* | | | | | | | | | | | |
| Real GDP | 1.2 | 2.7 | 3.0 | 3.6 | 3.2 | 3.3 | 3.6 | 3.8 | 2.4 | 2.7 | 3.5 |
| Nonfarm Employment | 0.7 | 0.3 | 1.9 | 1.7 | 1.9 | 1.7 | 1.7 | 2.0 | -0.8 | 0.9 | 1.8 |
| Consumer Prices | 1.4 | 2.6 | 2.4 | 2.4 | 2.4 | 2.4 | 2.3 | 2.4 | 1.5 | 2.2 | 2.4 |
| Real Disposable Income | 3.1 | 3.7 | 3.8 | 3.6 | 3.2 | 3.6 | 2.9 | 2.9 | 4.4 | 3.4 | 3.3 |
| Personal Consumption Expenditures | 6641.4 | 6668.1 | 6715.3 | 6766.3 | 6815.4 | 6860.0 | 6905.9 | 6955.5 | 6576.7 | 6741.3 | 6931.3 |
| Consumer Confidence | 85.0 | 98.0 | 104.0 | 107.0 | 109.0 | 109.0 | 111.0 | 114.2 | 98.0 | 104.0 | 112.8 |
| Unemployment (percent) | 5.9 | 5.8 | 5.6 | 5.5 | 5.4 | 5.4 | 5.3 | 5.2 | 5.8 | 5.6 | 5.3 |
| *Interest Rates (percent)* | | | | | | | | | | | |
| Fed Funds Rate | 1.4 | 1.3 | 1.5 | 1.8 | 2.3 | 2.5 | 2.8 | 3.0 | 1.7 | 1.7 | 2.8 |
| 3-Month T-bill Rate | 1.2 | 1.2 | 1.4 | 1.7 | 2.1 | 2.3 | 2.6 | 2.8 | 1.6 | 1.6 | 2.6 |
| Prime Rate | 4.4 | 4.3 | 4.5 | 4.8 | 5.3 | 5.5 | 5.8 | 6.0 | 4.7 | 4.7 | 5.8 |
| Discount Rate | 0.9 | 0.8 | 1.0 | 1.3 | 1.8 | 2.0 | 2.3 | 2.5 | 1.2 | 1.2 | 2.3 |
| Corporate Aaa Bond Yield | 6.3 | 6.3 | 6.4 | 6.4 | 6.6 | 6.5 | 6.5 | 6.7 | 6.5 | 6.4 | 6.6 |
| 10-Year Government Bond | 4.1 | 4.3 | 4.4 | 4.6 | 4.7 | 4.8 | 4.8 | 4.9 | 4.7 | 4.5 | 4.8 |
| 30-Year Government Bond | 5.2 | 5.2 | 5.3 | 5.5 | 5.6 | 5.6 | 5.6 | 5.7 | 5.4 | 5.4 | 5.6 |
| **Office** | | | | | | | | | | | |
| Vacancy Rate | 16.6% | 16.5% | 16.2% | 15.9% | 15.4% | 14.9% | 14.5% | 14.1% | 16.6% | 15.4% | 13.9% |
| Net Absorption (Million sq. ft.) | 14.1 | 21.3 | 27.2 | 32.7 | 37.7 | 40.5 | 37.5 | 32.5 | -18.0 | 118.8 | 137.8 |
| Starts (Million sq. ft.) | 20.4 | 19.2 | 18.5 | 19.2 | 19.7 | 20.4 | 21.1 | 21.4 | 96.2 | 76.5 | 84.8 |
| Completions (Million sq. ft.) | 24.5 | 20.0 | 16.8 | 14.7 | 13.9 | 14.1 | 14.8 | 15.7 | 116.5 | 65.3 | 61.1 |
| Inventory (Million sq. ft.) | 5583.7 | 5603.7 | 5620.4 | 5635.1 | 5649.0 | 5663.1 | 5677.9 | 5693.6 | 5583.7 | 5649.0 | 5710.2 |
| Rent Growth | -7.2% | -7.4% | -5.8% | -3.6% | -2.3% | -0.7% | 0.5% | 1.6% | -7.2% | -2.3% | 2.5% |
| **Warehouse** | | | | | | | | | | | |
| Vacancy Rate | 10.5% | 10.6% | 10.5% | 10.2% | 9.8% | 9.3% | 8.9% | 8.5% | 10.5% | 9.8% | 8.2% |
| Net Absorption (Million sq. ft.) | 10.4 | 13.4 | 19.1 | 25.8 | 33.0 | 35.0 | 34.4 | 29.0 | 24.4 | 91.4 | 123.1 |
| Starts (Million sq. ft.) | 18.7 | 16.8 | 14.8 | 12.7 | 11.7 | 11.4 | 11.6 | 12.2 | 107.0 | 56.0 | 48.5 |
| Completions (Million sq. ft.) | 19.3 | 17.4 | 16.2 | 14.5 | 12.7 | 11.1 | 10.7 | 10.7 | 98.9 | 60.8 | 43.6 |
| Inventory (Million sq. ft.) | 5174.5 | 5191.9 | 5208.1 | 5222.6 | 5235.3 | 5246.4 | 5257.1 | 5267.8 | 5174.5 | 5235.3 | 5278.9 |
| Rent Growth | -3.8% | -4.0% | -3.6% | -2.9% | -2.5% | -1.9% | -1.1% | -0.2% | -3.8% | -2.5% | 0.7% |
| **Retail** | | | | | | | | | | | |
| Vacancy Rate | 12.9% | 12.9% | 12.7% | 12.5% | 12.2% | 12.0% | 11.8% | 11.8% | 12.9% | 12.2% | 11.8% |
| Net Absorption (Million sq. ft.) | 16.6 | 19.9 | 24.0 | 27.6 | 28.4 | 27.0 | 22.3 | 16.3 | 42.1 | 99.9 | 80.5 |
| Starts (Million sq. ft.) | 19.3 | 19.5 | 20.0 | 20.0 | 20.7 | 22.0 | 22.9 | 24.0 | 127.4 | 80.2 | 93.7 |
| Completions (Million sq. ft.) | 24.2 | 19.7 | 17.8 | 17.2 | 16.1 | 15.6 | 15.9 | 16.5 | 106.7 | 70.7 | 65.7 |
| Inventory (Million sq. ft.) | 5503.9 | 5523.6 | 5541.4 | 5558.5 | 5574.6 | 5590.2 | 5606.1 | 5622.7 | 5503.9 | 5574.6 | 5640.3 |
| Rent Growth | -0.7% | -1.2% | -0.9% | 0.1% | 0.5% | 1.0% | 1.5% | 1.6% | -0.7% | 0.5% | 1.6% |
| **Multifamily** | | | | | | | | | | | |
| Vacancy Rate | 7.0% | 7.0% | 6.9% | 6.8% | 6.6% | 6.5% | 6.4% | 6.3% | 7.0% | 6.6% | 6.2% |
| Net Absorption ('000 units) | 27.5 | 36.0 | 40.6 | 41.0 | 38.0 | 34.3 | 31.4 | 29.6 | 37.8 | 155.7 | 124.4 |
| Starts ('000 units) | 39.2 | 33.6 | 30.4 | 27.4 | 25.5 | 24.6 | 24.4 | 25.0 | 215.0 | 116.8 | 100.2 |
| Completions ('000 units) | 37.8 | 32.2 | 29.1 | 26.1 | 23.2 | 21.1 | 19.9 | 19.5 | 169.7 | 110.6 | 80.0 |
| Inventory ('000 units) | 12589.9 | 12622.2 | 12651.2 | 12677.4 | 12700.6 | 12721.6 | 12741.6 | 12761.0 | 12589.9 | 12700.6 | 12780.6 |
| Rent Growth | -1.1% | -1.2% | -0.9% | -0.9% | -0.2% | 0.7% | 1.4% | 2.0% | -1.1% | -0.2% | 2.5% |

Source: NATIONAL ASSOCIATION OF REALTORS®, Property and Portfolio Research

## Estimated Change in Demand and Supply by Metro Market: 2002Q4-2004Q3

**Market Conditions Indicator** signifies the future direction of the commercial real estate sector in a particular metropolitan area for the next two years. Specifically, this measure reflects the impact of the *cumulative* change in demand and supply on vacancy, rent, and asset prices:

| | |
|---|---|
| > 20 basis points (bps) | Demand growth far in excess of supply |
| ≤ 20 bps and ≥ -20 bps | Balance between demand and supply growth |
| < -20 bps | Supply growth in excess of demand |

| MSA Name | OFFICE | | | WAREHOUSE | | | RETAIL | | | MULTIFAMILY | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cumulative | | Market | Cumulative | | Market | Cumulative | | Market | Cumulative | | Market |
| | Demand Growth (percent) (1) | Supply Growth (percent) (2) | Conditions Indicator* (bps) (1)-(2) | Demand Growth (percent) (1) | Supply Growth (percent) (2) | Conditions Indicator* (bps) (1)-(2) | Demand Growth (percent) (1) | Supply Growth (percent) (2) | Conditions Indicator* (bps) (1)-(2) | Demand Growth (percent) (1) | Supply Growth (percent) (2) | Conditions Indicator* (bps) (1)-(2) |
| Atlanta, GA | 3.3 | 1.6 | 170 | 2.8 | 1.2 | 160 | 2.3 | 1.4 | 90 | 3.5 | 1.9 | 160 |
| Austin, TX | 4.8 | 1.3 | 350 | 2.8 | 1.0 | 180 | 3.2 | 1.8 | 140 | 3.2 | 1.9 | 120 |
| Baltimore, MD | 2.3 | 1.4 | 90 | 2.7 | 1.2 | 140 | 1.6 | 1.3 | 20 | 0.8 | 0.8 | 0 |
| Boston, MA | 3.1 | 1.2 | 190 | 2.5 | 1.6 | 90 | 1.7 | 1.2 | 50 | 0.8 | 0.5 | 30 |
| Charlotte, NC-SC | 3.5 | 1.6 | 190 | 3.5 | 1.7 | 180 | 2.0 | 1.7 | 30 | 3.6 | 2.0 | 160 |
| Chicago, IL | 2.2 | 1.0 | 130 | 2.5 | 1.4 | 110 | 1.6 | 1.0 | 70 | 0.4 | 0.3 | 10 |
| Cincinnati, OH-KY-IN | 2.4 | 0.9 | 150 | 2.5 | 1.0 | 150 | 1.7 | 1.0 | 70 | 1.2 | 0.9 | 30 |
| Cleveland, OH | 2.2 | 0.6 | 160 | 1.1 | 0.6 | 50 | 1.5 | 1.6 | -10 | 0.3 | 0.2 | 20 |
| Columbus, OH | 2.4 | 1.0 | 140 | 2.9 | 1.3 | 150 | 2.2 | 1.2 | 100 | 2.0 | 0.9 | 110 |
| Dallas - Fort Worth, TX | 3.6 | 0.5 | 310 | 3.4 | 1.6 | 180 | 3.0 | 1.5 | 150 | 2.2 | 1.2 | 100 |
| Denver, CO | 2.8 | 0.9 | 200 | 2.1 | 1.1 | 100 | 1.9 | 2.1 | -10 | 1.6 | 1.3 | 30 |
| Detroit, MI | 2.1 | 1.1 | 100 | 1.5 | 0.5 | 110 | 1.1 | 1.0 | 10 | 0.3 | 0.5 | -20 |
| East Bay, CA | 2.7 | 1.2 | 160 | 1.9 | 0.5 | 130 | 1.8 | 0.9 | 90 | 0.9 | 0.4 | 50 |
| Fort Lauderdale, FL | 3.8 | 0.9 | 290 | 2.9 | 1.2 | 160 | 1.3 | 1.1 | 30 | 1.4 | 1.2 | 10 |
| Hartford, CT | 1.5 | 0.7 | 80 | 1.1 | 0.5 | 60 | 1.2 | 1.2 | 0 | 0.5 | 0.3 | 20 |
| Honolulu, HI | 1.1 | 0.5 | 50 | 1.0 | 0.2 | 70 | 0.9 | 1.4 | -60 | 0.7 | 0.1 | 60 |
| Houston, TX | 2.2 | 1.1 | 110 | 1.2 | 0.9 | 40 | 2.2 | 1.1 | 100 | 1.1 | 1.0 | 10 |
| Indianapolis, IN | 2.3 | 0.6 | 170 | 2.8 | 1.2 | 160 | 1.5 | 0.7 | 80 | 1.7 | 0.7 | 100 |
| Inland Empire, CA | 4.0 | 2.8 | 120 | 3.1 | 2.5 | 60 | 3.1 | 2.7 | 40 | 1.3 | 1.3 | 0 |
| Jacksonville, FL | 2.5 | 0.8 | 170 | 2.0 | 0.9 | 110 | 2.1 | 2.0 | 20 | 2.2 | 1.9 | 20 |
| Kansas City, MO-KS | 2.2 | 1.2 | 110 | 1.3 | 0.4 | 90 | 1.3 | 1.5 | -20 | 1.8 | 1.0 | 80 |
| Las Vegas, NV | 4.9 | 3.0 | 190 | 4.3 | 2.7 | 170 | 4.0 | 2.4 | 150 | 3.4 | 2.1 | 140 |
| Long Island, NY | 1.8 | 0.8 | 90 | 0.8 | 0.5 | 30 | 2.0 | 1.2 | 70 | 0.4 | 0.4 | 10 |
| Los Angeles, CA | 2.4 | 0.9 | 150 | 2.1 | 1.0 | 110 | 1.9 | 1.3 | 60 | 0.8 | 0.8 | 0 |

* Rounded off to the nearest tenth

Source: NATIONAL ASSOCATION OF REALTORS®

## Estimated Change in Demand and Supply by Metro Market: 2002Q4-2004Q3

| MSA Name | OFFICE Cumulative Demand Growth (percent) (1) | OFFICE Cumulative Supply Growth (percent) (2) | OFFICE Market Conditions Indicator* (bps) (1)-(2) | WAREHOUSE Cumulative Demand Growth (percent) (1) | WAREHOUSE Cumulative Supply Growth (percent) (2) | WAREHOUSE Market Conditions Indicator* (bps) (1)-(2) | RETAIL Cumulative Demand Growth (percent) (1) | RETAIL Cumulative Supply Growth (percent) (2) | RETAIL Market Conditions Indicator* (bps) (1)-(2) | MULTIFAMILY Cumulative Demand Growth (percent) (1) | MULTIFAMILY Cumulative Supply Growth (percent) (2) | MULTIFAMILY Market Conditions Indicator* (bps) (1)-(2) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Memphis, TN | 2.9 | 1.6 | 130 | 3.2 | 1.3 | 190 | 2.4 | 1.1 | 130 | 1.9 | 0.6 | 130 |
| Miami, FL | 2.8 | 0.9 | 190 | 2.4 | 0.7 | 170 | 1.3 | 0.8 | 50 | 1.4 | 1.2 | 10 |
| Milwaukee, WI | 1.9 | 1.4 | 50 | 1.3 | 0.8 | 50 | 1.0 | 0.6 | 40 | 0.7 | 0.3 | 40 |
| Minneapolis, MN-WI | 2.3 | 1.8 | 40 | 2.1 | 0.7 | 140 | 1.5 | 1.5 | 0 | 1.4 | 1.0 | 30 |
| Nashville, TN | 2.9 | 1.5 | 150 | 3.1 | 1.4 | 170 | 2.5 | 1.4 | 110 | 2.2 | 1.2 | 100 |
| New Orleans, LA | 1.1 | 0.4 | 70 | 1.3 | 0.5 | 70 | 1.1 | 0.8 | 30 | 0.6 | 0.2 | 40 |
| New York, NY | 1.7 | 1.4 | 40 | 1.2 | 0.9 | 30 | 1.2 | 0.8 | 40 | 0.3 | 0.2 | 0 |
| Norfolk, VA | 2.3 | 1.6 | 70 | 2.9 | 2.8 | 10 | 1.2 | 1.1 | 10 | 0.9 | 1.1 | -30 |
| Northern New Jersey, NJ | 2.4 | 1.7 | 80 | 1.1 | 0.6 | 50 | 1.8 | 1.5 | 30 | 0.8 | 0.8 | 0 |
| Oklahoma City, OK | 1.5 | 0.8 | 70 | 1.5 | 0.6 | 90 | 1.4 | 0.8 | 70 | 0.7 | 0.4 | 30 |
| Orange County, CA | 3.5 | 1.2 | 220 | 2.1 | 1.1 | 100 | 2.5 | 1.5 | 100 | 1.2 | 0.7 | 50 |
| Orlando, FL | 2.7 | 1.3 | 140 | 2.9 | 1.2 | 180 | 2.2 | 2.1 | 10 | 4.3 | 3.2 | 110 |
| Palm Beach County, FL | 2.7 | 0.9 | 180 | 1.8 | 1.4 | 40 | 2.0 | 1.1 | 100 | 3.3 | 4.3 | -100 |
| Philadelphia, PA-NJ | 1.7 | 1.2 | 50 | 1.2 | 0.6 | 60 | 1.4 | 1.0 | 40 | 0.4 | 0.3 | 10 |
| Phoenix, AZ | 3.3 | 1.4 | 190 | 3.0 | 1.7 | 130 | 2.6 | 1.4 | 110 | 2.1 | 1.3 | 80 |
| Pittsburgh, PA | 2.0 | 1.3 | 70 | 0.6 | 0.5 | 10 | 1.3 | 1.0 | 30 | 0.6 | 0.6 | 10 |
| Portland, OR | 2.9 | 1.4 | 150 | 2.1 | 1.2 | 90 | 1.9 | 0.8 | 100 | 1.7 | 0.6 | 110 |
| Raleigh, NC | 3.6 | 1.3 | 230 | 3.5 | 0.5 | 310 | 3.3 | 2.5 | 70 | 4.0 | 2.2 | 180 |
| Richmond, VA | 3.1 | 1.6 | 150 | 2.4 | 0.7 | 170 | 1.9 | 3.3 | -140 | 1.1 | 1.1 | 0 |
| Sacramento, CA | 3.6 | 2.5 | 110 | 1.9 | 0.7 | 120 | 2.8 | 1.6 | 130 | 1.6 | 1.4 | 30 |
| St. Louis, MO-IL | 2.2 | 1.0 | 120 | 1.7 | 0.9 | 80 | 1.3 | 1.5 | -10 | 0.8 | 0.6 | 20 |
| Salt Lake City, UT | 2.9 | 1.1 | 180 | 1.5 | 0.4 | 110 | 2.1 | 1.1 | 100 | 1.4 | 0.6 | 90 |
| San Antonio, TX | 3.1 | 1.5 | 160 | 1.4 | 0.2 | 110 | 2.4 | 1.3 | 110 | 1.4 | 1.2 | 30 |
| San Diego, CA | 3.4 | 1.2 | 220 | 2.0 | 1.6 | 40 | 2.7 | 1.3 | 130 | 1.0 | 1.2 | -20 |
| San Francisco, CA | 2.6 | 1.2 | 140 | 0.6 | 0.3 | 40 | 1.4 | 0.5 | 80 | 1.0 | 0.4 | 60 |
| San Jose, CA | 3.5 | 1.1 | 240 | 1.1 | 0.2 | 90 | 2.2 | 0.9 | 130 | 1.7 | 0.7 | 110 |
| Seattle, WA | 3.7 | 1.5 | 220 | 2.2 | 1.1 | 110 | 1.7 | 1.3 | 40 | 1.4 | 0.5 | 80 |
| Stamford, CT | 2.4 | 1.0 | 140 | 1.3 | 0.6 | 70 | 1.2 | 0.9 | 30 | 0.6 | 0.4 | 10 |
| Tampa, FL | 2.8 | 0.9 | 200 | 1.1 | 0.4 | 70 | 1.6 | 0.8 | 80 | 2.1 | 1.4 | 70 |
| Washington, DC-NoVA-MD | 2.2 | 1.3 | 80 | 1.6 | 1.2 | 40 | 1.7 | 1.4 | 30 | 1.5 | 0.9 | 60 |
| All 54 Markets | 2.6 | 1.2 | 140 | 2.1 | 1.1 | 110 | 1.9 | 1.3 | 60 | 1.2 | 0.8 | 40 |

* Rounded off to the nearest tenth

Source: NATIONAL ASSOCIATION OF REALTORS®

## Metro Market Outlook for Next Two Years

### OFFICE SECTOR

| | <60 million sq. ft. | >60 million sq. ft. and <110 million sq. ft. | >110 million sq. ft. | Likely Direction Over the Next 24 Months |
|---|---|---|---|---|
| ***Markets with Current Occupancy Above/Equal to the Average of 54 MSAs*** | Richmond, VA<br>Inland Empire, CA<br>Cincinnati, OH-KY-IN<br>Jacksonville, FL<br>Norfolk, VA<br>Palm Beach County, FL<br>Honolulu, HI<br>Las Vegas, NV<br>Indianapolis, IN<br>Salt Lake City, UT<br>Milwaukee, WI | San Diego, CA<br>Sacramento, CA<br>Seattle, WA<br>Charlotte, NC-SC<br>Miami, FL<br>Baltimore, MD<br>St. Louis, MO-IL<br>Long Island, NY<br>Columbus, OH<br>Stamford, CT | Washington, DC-NoVA-MD<br>New York, NY<br>Los Angeles, CA<br>Detroit, MI<br>Chicago, IL<br>Philadelphia, PA-NJ<br>Minneapolis, MN-WI | ⇧ |
| ***Markets with Current Occupancy Below the Average of 54 MSAs*** | Fort Lauderdale, FL<br>Raleigh, NC<br>Nashville, TN<br>Memphis, TN<br>San Antonio, TX<br>Hartford, CT<br>New Orleans, LA<br>Austin, TX<br>Oklahoma City, OK | East Bay, CA<br>Cleveland, OH<br>Kansas City, MO-KS<br>Portland, OR<br>Orlando, FL<br>Tampa, FL<br>Pittsburgh, PA<br>San Jose, CA<br>San Francisco, CA | Orange County, CA<br>Houston, TX<br>Northern New Jersey, NJ<br>Denver, CO<br>Phoenix, AZ<br>Boston, MA<br>Atlanta, GA<br>Dallas - Fort Worth, TX | ⇧ |

### WAREHOUSE SECTOR

| | <60 million sq. ft. | >60 million sq. ft. and <110 million sq. ft. | >110 million sq. ft. | Likely Direction Over the Next 24 Months |
|---|---|---|---|---|
| ***Markets with Current Occupancy Above/Equal to the Average of 54 MSAs*** | Palm Beach County, FL<br>Milwaukee, WI<br>Oklahoma City, OK<br>San Francisco, CA<br>Honolulu, HI<br>New York, NY | Seattle, WA<br>Jacksonville, FL<br>Kansas City, MO-KS<br>Denver, CO<br>Fort Lauderdale, FL<br>Cincinnati, OH-KY-IN<br>Miami, FL<br>Detroit, MI<br>Orange County, CA<br>Indianapolis, IN<br>Tampa, FL<br>Salt Lake City, UT<br>San Diego, CA<br>Phoenix, AZ<br>Washington, DC-NoVA-MD | Los Angeles, CA<br>St. Louis, MO-IL<br>East Bay, CA<br>Chicago, IL<br>Houston, TX<br>Northern New Jersey, NJ<br>Inland Empire, CA | ⇧ |
| | Norfolk, VA<br>Pittsburgh, PA | | | ⇔ |
| ***Markets with Current Occupancy Below the Average of 54 MSAs*** | Orlando, FL<br>Nashville, TN<br>New Orleans, LA<br>Portland, OR<br>San Antonio, TX<br>San Jose, CA<br>Austin, TX<br>Charlotte, NC-SC<br>Hartford, CT<br>Stamford, CT<br>Richmond, VA<br>Raleigh, NC<br>Long Island, NY | Las Vegas, NV<br>Sacramento, CA<br>Cleveland, OH<br>Baltimore, MD<br>Columbus, OH<br>Minneapolis, MN-WI<br>Boston, MA | Dallas - Fort Worth, TX<br>Philadelphia, PA-NJ<br>Atlanta, GA<br>Memphis, TN | ⇧ |

Source: NATIONAL ASSOCIATION OF REALTORS®

## Metro Market Outlook for Next Two Years

### RETAIL SECTOR

| | <60 million sq. ft. | >60 million sq. ft. and <110 million sq. ft. | >110 million sq. ft. | Likely Direction Over the Next 24 Months |
|---|---|---|---|---|
| ***Markets with Current Occupancy Above/Equal to the Average of 54 MSAs*** | Salt Lake City, UT<br>Stamford, CT<br>Milwaukee, WI | East Bay, CA<br>San Francisco, CA<br>Long Island, NY<br>Sacramento, CA<br>Seattle, WA<br>Fort Lauderdale, FL<br>Portland, OR<br>Charlotte, NC-SC<br>Pittsburgh, PA | San Diego, CA<br>New York, NY<br>Boston, MA<br>Orange County, CA<br>Washington, DC-NoVA-MD<br>Chicago, IL<br>Los Angeles, CA | ⇧ |
| | | Minneapolis, MN-WI<br>Denver, CO | | ⇔ |
| ***Markets with Current Occupancy Below the Average of 54 MSAs*** | Austin, TX<br>Palm Beach County, FL<br>Oklahoma City, OK<br>Raleigh, NC<br>Nashville, TN<br>Memphis, TN<br>New Orleans, LA | San Jose, CA<br>San Antonio, TX<br>Miami, FL<br>Indianapolis, IN<br>Columbus, OH<br>Cincinnati, OH-KY-IN<br>Las Vegas, NV | Phoenix, AZ<br>Tampa, FL<br>Dallas - Fort Worth, TX<br>Inland Empire, CA<br>Philadelphia, PA-NJ<br>Houston, TX<br>Northern New Jersey, NJ<br>Atlanta, GA | ⇧ |
| | Hartford, CT<br>Jacksonville, FL | St. Louis, MO-IL<br>Kansas City, MO-KS<br>Norfolk, VA<br>Baltimore, MD<br>Orlando, FL | Cleveland, OH<br>Detroit, MI | ⇔ |
| | Honolulu, HI<br>Richmond, VA | | | ⇩ |

### MULTIFAMILY SECTOR

| | <110,000 units | >110,000 units and < 200,000 units | > 200,000 units | Likely Direction Over the Next 24 Months |
|---|---|---|---|---|
| ***Markets with Current Occupancy Above/Equal to the Average of 54 MSAs*** | | Portland, OR<br>Sacramento, CA | Minneapolis, MN-WI<br>Boston, MA<br>San Francisco, CA<br>East Bay, CA<br>Orange County, CA | ⇧ |
| | Long Island, NY<br>Richmond, VA | Inland Empire, CA<br>Pittsburgh, PA<br>Fort Lauderdale, FL<br>St. Louis, MO-IL<br>Baltimore, MD | Chicago, IL<br>Northern New Jersey, NJ<br>New York, NY<br>San Diego, CA<br>Los Angeles, CA<br>Detroit, MI | ⇔ |
| | Norfolk, VA<br>Palm Beach County, FL | | | ⇩ |
| ***Markets with Current Occupancy Below the Average of 54 MSAs*** | Nashville, TN<br>Honolulu, HI<br>Salt Lake City, UT<br>New Orleans, LA<br>Oklahoma City, OK<br>Memphis, TN<br>Raleigh, NC<br>Charlotte, NC-SC | San Jose, CA<br>Las Vegas, NV<br>Columbus, OH<br>Milwaukee, WI<br>San Antonio, TX<br>Cincinnati, OH-KY-IN<br>Indianapolis, IN<br>Kansas City, MO-KS<br>Tampa, FL<br>Orlando, FL<br>Austin, TX | Seattle, WA<br>Dallas - Fort Worth, TX<br>Washington, DC-NoVA-MD<br>Denver, CO<br>Phoenix, AZ<br>Atlanta, GA | ⇧ |
| | Hartford, CT<br>Jacksonville, FL | Cleveland, OH<br>Miami, FL<br>Stamford, CT | Philadelphia, PA-NJ<br>Houston, TX | ⇔ |

Source: NATIONAL ASSOCIATION OF REALTORS®

## State of the National Office Market: Third Quarter 2002

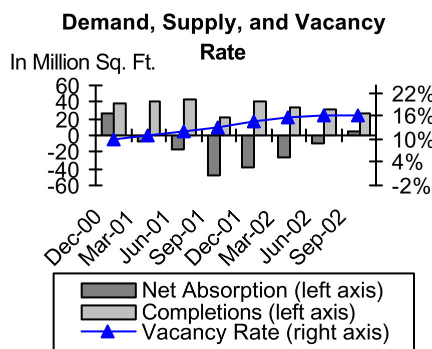
***Vacancy***. Solid economic growth in the third quarter of 2002 allowed labor markets to stabilize. That is good news for the office sector. Even though manufacturing continued to bear the brunt of job cuts, employment in the service sector grew for two quarters in a row. The quarterly gain in office-based jobs of 44,000 was widespread: 47 of the 54 markets tracked experienced increases in office employment from the second quarter 2002. Washington, DC and Dallas-Fort Worth again led the 54 markets in office job gains, generating 6,000 and 4,000 new jobs in the third quarter. Despite this modest job growth, office employment in the 54 markets was still lower compared to that in the third quarter 2001.

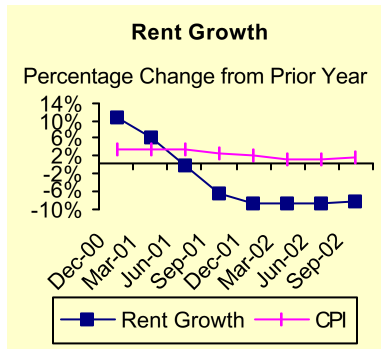
The slight pickup in employment was still good enough to reverse the downward trend in leasing activity in the 54 markets. Net absorption jumped to 4.7 million sq. ft. (msf) in the third quarter of 2002, the first positive quarterly increase in demand since the dot-com implosion in early 2001. This is largely attributed to 39 markets posting positive absorption rates in the third quarter, compared to 21 in the previous quarter. Washington DC was the most active office market, absorbing 1.2 msf in the third quarter. While net absorption in the 54 markets for the first nine months of 2002 remained negative at -32.1 msf, it was an improvement from -72.6 msf in the same period in 2001.

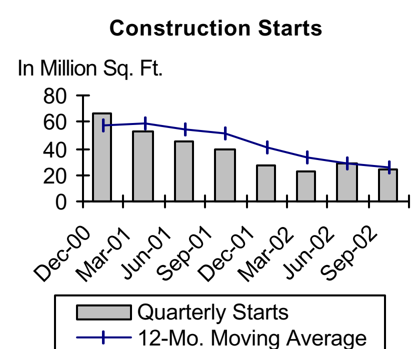
Subdued demand over the past 8 quarters stifled construction activity, and translated into a fourth consecutive quarter of decline for completions of new office projects. Approximately 26.6 msf of new properties came on stream in the 54 markets during the third quarter of 2002, bringing the year-to-date total to 91.9 msf, 10 percent lower than the level reported in the same period in 2001. Although office completions slowed, the supply of office space grew more rapidly than demand. As a result, occupancies contracted once again in all 54 markets except Inland Empire. The average office vacancy rate was 16.4 percent, up from 16.1 percent recorded at midyear and up 13.1 percent from the third quarter 2001. The modest uptick in office vacancies (+30 basis points) since midyear seems to indicate that the influx of sublease space has begun to ease.

***Rent***. Inspite of labor market stability, an abundance of sublease space and soaring vacancies required landlords to sweeten deals, yielding to tenants' demands in order to keep properties occupied. As a result, the average rent for office space in the 54 markets decreased 8.2 percent from the third quarter 2001, the sixth consecutive quarter of decline. While rent reduction was pervasive across the 54 markets, once again it was steepest in tech and telecom heavy markets including San Francisco, San Jose, Austin, East Bay, Denver, Seattle, Boston, and Atlanta. Rent cuts in these markets were in the double-digits, ranging from 10.8 percent to 30.4 percent.

***Construction Starts***. Current market conditions discouraged developers, resulting in only 24.7 msf breaking ground or under construction in the third quarter of 2002. This represents a 14 percent drop in construction starts posted at midyear, and is nearly 40 percent off from the same period in 2001. Once again, the decline in construction pace was broad-based, with nearly two thirds of the 54 markets experiencing decreased activity from the third quarter 2001 and in the second quarter of 2002. On year-to-date, construction starts totaled 75.8 msf, substantially down from 136.2 msf reported in the first nine months of 2001.




Source: Property and Porfolio Research, Bureau of Labor Statistics

# KEY MARKET TRENDS: THIRD QUARTER 2002

### Markets with Highest Occupancy

| Market | Vacancy Rate | Change from Prior Year |
|---|---|---|
| Washington, DC-NoVA-MD | 11.1% | 280 bps |
| New York, NY | 11.2% | 250 bps |
| Sacramento, CA | 12.0% | 260 bps |
| San Diego, CA | 13.0% | 310 bps |
| Inland Empire, CA | 14.2% | -30 bps |
| Richmond, VA | 14.4% | 190 bps |
| Baltimore, MD | 14.5% | 190 bps |
| Norfolk, VA | 14.5% | 330 bps |
| Honolulu, HI | 14.6% | 180 bps |
| Cincinnati, OH-KY-IN | 14.8% | 280 bps |

Source: Property & Portfolio Research

A high absorption rate allowed Washington DC to remain the tightest market in the third quarter of 2002. Strength from government spending and related activity has sustained employment, and offset job losses in the suburbs particularly in Northern Virginia. Regionally, the Northeast posted the lowest vacancy rate (15.1 percent) in the third quarter, even after increasing from 12.1 percent in the same period in 2001. The Midwest followed with an average vacancy rate of 16 percent –- up from 12.8 percent in the third quarter 2001. The South and the West, saddled with a glut of new office space, lagged with an average vacancy rate of 16.9 percent and 17.2 percent, respectively.

### Markets with Highest Rent Growth

| Market | Rent Growth |
|---|---|
| Inland Empire, CA | 2.8% |
| Long Island, NY | -1.3% |
| Washington, DC-NoVA-MD | -1.8% |
| Sacramento, CA | -2.4% |
| Philadelphia, PA-NJ | -2.6% |
| Stamford, CT | -2.8% |
| Los Angeles, CA | -2.9% |
| Jacksonville, FL | -3.0% |
| Oklahoma City, OK | -3.0% |
| New Orleans, LA | -3.4% |

Source: Property & Portfolio Research

Most landlords continued to cut rents –- a trend that began late in 2000 –- so that the average rent in the 54 markets has fallen 15 percent from its peak rate for all years tracked. In San Francisco and nearby Silicon Valley, rents have tumbled more than 50 percent since 2000's peak. Only the Inland Empire sustained high rents, with rent appreciation averaging one percent every quarter since late 2000. Rising occupancy was a driving force for propelling rents in this market. Other markets that continue to have high rents –- albeit slightly off from their peak are Washington DC, Richmond, Oklahoma City, and San Diego.

### Markets with Highest Construction Starts

| Market | Percentage of Total U.S. Starts |
|---|---|
| Washington, DC-NoVA-MD | 11.0% |
| Las Vegas, NV | 4.7% |
| Los Angeles, CA | 4.3% |
| Phoenix, AZ | 3.9% |
| Milwaukee, WI | 3.8% |
| San Diego, CA | 3.8% |
| Atlanta, GA | 3.7% |
| Chicago, IL | 3.6% |
| Philadelphia, PA-NJ | 3.6% |
| Dallas - Fort Worth, TX | 3.2% |

Source: Property & Portfolio Research

The South was the construction leader in the third quarter of 2002. The region experienced robust construction activity, particularly in Washington DC, with starts of 2.7 msf in the third quarter of 2002, boosting year-to-date volume to 8.7 msf. The West followed with 7.4 msf in its construction pipeline in the third quarter, with nearly 60 percent concentrated in four markets: Las Vegas, Los Angeles, Phoenix, and San Diego. Interestingly, the Northeast and Midwest, both of which reported above-average occupancies, had modest pipelines. The Northeast posted starts of 3.0 msf and the Midwest recorded 4.3 msf in new office projects in the third quarter of 2002.

## THE OFFICE OUTLOOK

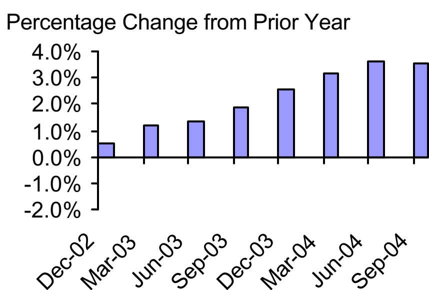
Although the economy is unlikely to repeat the strong third-quarter advance, the expected annual growth of 1.2 percent in the fourth quarter should be sufficient to create jobs in the service sector in the 54 markets tracked. Approximately 78,000 office-based jobs are likely to be added in the fourth quarter. Though the expected job gains are still slim compared to losses in previous quarters, they should help drive up net absorption in all 54 markets, except San Francisco, San Jose, and Hartford, to 14.1 msf in the fourth quarter –– the best quarterly showing in nearly two years. The aggregate decline in demand should thus be contained to –18 msf by year-end, a dramatic improvement from the –111 msf in 2001. Northern New Jersey and Washington DC are expected to lead the 26 markets likely to record positive absorption rates this year.

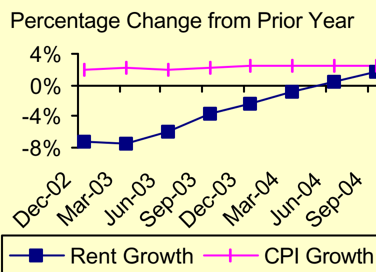
Modest construction will continue to fuel office completions in the 54 markets tracked. An estimated 24.5 msf of new office space will be delivered in the fourth quarter, and boost annual completions to 116.5 msf in 2002. Expect the average vacancy rate to creep up from 14.4 percent in 2001 to 16.6 percent by year-end. Though vacancies will still be far below their peak rate of 18.7 percent posted in 1991, some markets are still reeling from slumping demand or a major construction buildup. Boston, Pittsburgh, San Francisco, and Atlanta are expected to record vacancies close to or at their peaks of 20 percent-plus by year-end. Higher vacancies should continue to translate into attractive lease deals for tenants –– with landlords likely to continue to offer a variety of enticements. The average rent in the 54 markets is thus expected to be down 7.2 percent from 2001. Only Inland Empire is likely to continue to report rent gains by year-end.

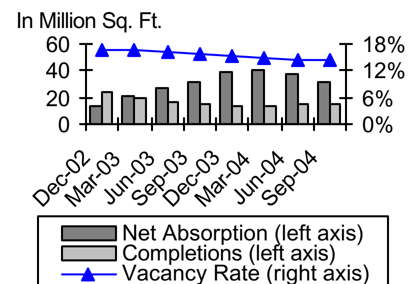
Solid consumer spending and improving business outlays, plus the extra insurance from the Federal Reserve in the form of the historically low federal funds rate, argue that the economy will likely strengthen in 2003 and 2004. However, the U.S. continues to face an unprecedented period of uncertainty. The war on terrorism, imminent invasion of Iraq, and news of corporate fraud have deepened worries. Hence, a big concern for the outlook is that widespread dread could heighten business caution and possibly hold back the growth of capital spending and delay hiring plans. This could derail the recovery in the office sector.

If the war is quickly resolved and the spate of corporate scandals abates, then businesses could move forward. Hiring could pick up, with 1.7 million net new office-based jobs to be created in the 54 markets in the next two years. This should buoy demand, and cause net absorption to accelerate to 118.8 msf and 137.8 msf in 2003 and 2004, respectively. Slowing development activity will continue to result in decreased annual completions of 60+ msf in the next two years. The average vacancy in the 54 markets is thus likely to continuously slide to 15.4 percent in 2003 and 13.9 percent in 2004. High, albeit declining, vacancies should continue to put pressure on owners to lower rents in 2003: the average rent for the 54 markets is expected to slip modestly (-2.3 percent). But expect owners to regain some pricing power in 2004, with average rent likely to edge up 2.5 percent.

***Hot Markets.*** A total of 25 office markets will outperform the 54 markets as propitious demand and supply trends help sustain above-average occupancies through the next two years: Richmond, Inland Empire, Cincinnati, Jacksonville, Norfolk, Palm Beach County, Honolulu, Las Vegas, Indianapolis, Salt Lake City, and Ft. Lauderdale among markets with less than 60 msf of office space; San Diego, Sacramento, Seattle, Charlotte, Miami, Baltimore, St. Louis, Long Island, Columbus, and Stamford among markets with office space between 60 msf and 100 msf; Washington DC, New York City, Los Angeles, and Orange County among markets with office space in excess of 100 msf.




Source: Property and Portfolio Research, NATIONAL ASSOCIATION OF REALTORS®

## State of the National Warehouse Market: Third Quarter 2002

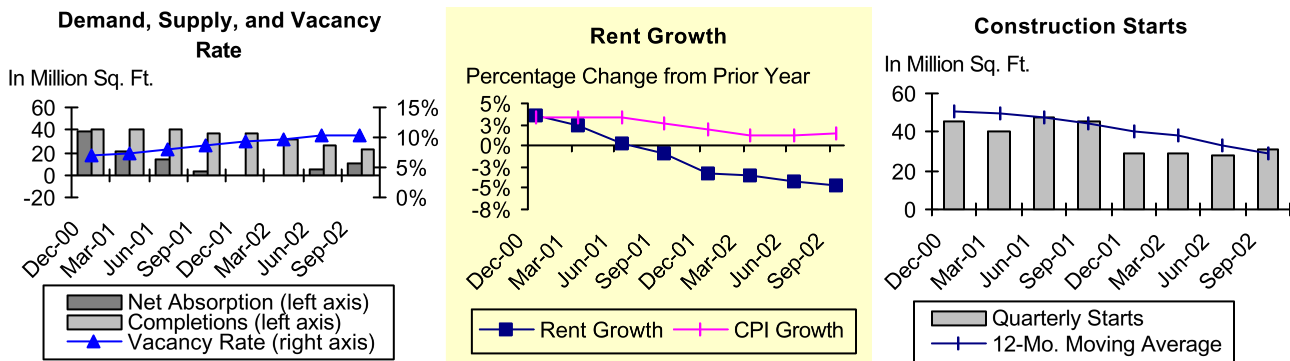
***Vacancy***. Recovery in the warehouse sector continued to advance in the third quarter of 2002. Resilient consumer demand induced retailers and wholesalers to cautiously lift their inventories, and an import buildup provided an unexpected boost to inventories. Factories continued to fill orders from inventories so that industrial production was up at an annual rate of 3.5 percent from the second quarter, and 0.8 percent from the third quarter 2001. Moreover, U.S. companies ordered imports in anticipation of a longshoremen strike –- and some of that import buildup went into inventories, especially at retailers and wholesalers.

Inventory gains allowed leasing activity to expand modestly in the 54 markets tracked in the third quarter of 2002. Though still low compared to the 20-year quarterly average of 23 million sq. ft. (msf), net absorption doubled last quarter's total to 9.9 msf. Super-regional distribution centers including Inland Empire, Dallas-Fort Worth, Los Angeles, Chicago, and Atlanta topped the 45 markets that recorded positive absorption in the third quarter of 2002. Year-to-date, approximately 14 msf has been absorbed in the 54 markets, particularly in Inland Empire, Phoenix, Chicago, Dallas-Fort Worth, Charlotte, Fort Lauderdale, Indianapolis, and Atlanta. Only 24 markets continued to report languishing demand for warehouse space, compared to 31 markets in the previous quarter.

Developers were cautious, and new warehouse space completions declined for a third straight quarter in the 54 markets. Approximately 22.3 msf of new projects were completed in the third quarter of 2002, down from the 26.7 msf posted in the second quarter of 2002 and off from the 37.4 msf posted in the third quarter of 2001. Year-to-date, only 79.6 msf of new warehouse space was added to the 54 markets, compared to 118.3 msf in the same period in 2001. Still, the amount of new and sublease space was copious relative to absorption so that the average vacancy climbed from 8.6 percent in the third quarter 2001 to 10.4 percent in the third quarter of 2002. Palm Beach County was the only market that experienced improvement in occupancy on both a yearly and quarterly basis.

***Rent***. Rising vacancies, coupled with the availability of sublease space, eroded rents of warehouse properties for the fifth consecutive quarter and spruced up leasing incentives in the summer of 2002. Average rent in the 54 markets was down 4.6 percent compared to that of the third quarter of 2001. Still, three markets –- San Diego, Honolulu, and Kansas City –- managed to eke out rent gains of 1-2 percent from the third quarter in 2001. On a quarterly basis, the average rent in the 54 markets was off just 1.3 percent from the previous quarter.

***Construction Starts***. Inventory rebuilding efforts propped up development of new warehouse properties in the 54 markets. Thirty markets reported a pickup in development activity from the second quarter of 2002. Over 31.5 msf of new space broke ground or was under construction in the third quarter compared to 28 msf of building projects underway in the last quarter. Still, aggregate starts remained well below 45.6 msf that was under construction in the third quarter of 2001. Likewise, year-to-date starts of 88.3 msf remained substantially below the 132.9 msf that was in the pipeline for the nine months ending September 2001. Top super-regional distribution centers including Inland Empire, Chicago, Dallas-Fort Worth, Los Angeles, Atlanta, Houston, and Northern New Jersey accounted for half of total year-to-date starts.




Source: Property and Portfolio Research, Bureau of Labor Statistics

## Key Market Trends: Third Quarter 2002

**Markets with Highest Occupancy**

| Market | Vacancy Rate | Change from Prior Year |
|---|---|---|
| Palm Beach County, FL | 5.6% | -30 bps |
| Milwaukee, WI | 7.0% | 120 bps |
| San Francisco, CA | 7.3% | 140 bps |
| Los Angeles, CA | 7.5% | 220 bps |
| Seattle, WA | 8.0% | 190 bps |
| Jacksonville, FL | 8.1% | 90 bps |
| Oklahoma City, OK | 8.2% | 250 bps |
| Kansas City, MO-KS | 8.4% | 230 bps |
| St. Louis, MO-IL | 8.5% | 180 bps |
| Denver, CO | 8.6% | 160 bps |

Source: Property & Portfolio Research

Palm Beach County once again boasted the lowest vacancy rate in the third quarter of 2002, after sustaining positive absorption while the availability of industrial land dwindled. Overall, 29 markets reported above-average occupancies despite significant increases in warehouse space relative to absorption. Among the four regions, the West was tightest with just 9.2 percent of available warehouse space as most major markets reported occupancies higher than the national average. The Midwest followed with a vacancy rate of 10.1 percent; occupancy decline in this region was moderate compared to the rest of the regions. Lackluster demand in the Northeast, and high supply growth in the South pushed down occupancies in these regions. The Northeast posted a vacancy rate of 10.9 percent and the South posted a vacancy rate 11.5 percent.

**Markets with Highest Rent Growth**

| Market | Rent Growth |
|---|---|
| San Diego, CA | 1.9% |
| Honolulu, HI | 1.6% |
| Kansas City, MO -KS | 1.0% |
| Stamford, CT | -0.5% |
| Long Island, NY | -0.9% |
| Oklahoma City, OK | -0.9% |
| Northern New Jersey, NJ | -1.1% |
| Houston, TX | -1.7% |
| Ft. Lauderdale, FL | -1.7% |
| San Antonio, TX | -1.7% |

Source: Property & Portfolio Research

The lack of strong demand for warehouse space made landlords in the 54 markets more willing to continuously lower rents. As a result, average rent growth has been non-existent or marginal at best since the second quarter of 2001. To date, the average rent in the 54 markets is off 6.3 percent from its peak level in 2000. In San Jose, East Bay, and San Francisco, average rents for warehouse space have dipped over 20 percent since 2000. Sizeable declines were also noted in Phoenix, Orange County, Detroit, Jacksonville, Salt Lake City, Philadelphia, Honolulu, St. Louis, Columbus, and Dallas-Fort Worth.

**Markets with Highest Construction Starts**

| Market | Percentage of Total U.S. Starts |
|---|---|
| Inland Empire, CA | 12.3% |
| Dallas - Fort Worth, TX | 10.8% |
| Chicago, IL | 9.0% |
| Los Angeles, CA | 6.8% |
| Northern New Jersey, NJ | 5.0% |
| Houston, TX | 3.8% |
| Atlanta, GA | 3.3% |
| Portland, OR | 2.7% |
| Las Vegas, NV | 2.6% |
| Cleveland, OH | 2.5% |

Source: Property & Portfolio Research

Construction in the third quarter 2002 was once again concentrated in the seven largest warehouse markets –- Los Angeles, Northern New Jersey, Atlanta, Chicago, Dallas-Fort Worth, Inland Empire, and Houston. Those markets accounted for more than 50 percent of new projects in the third quarter. The combination of a large population base and physical accessibility is instrumental in driving development activity in these markets. Regionally, the South and West had the most construction activity, each with 11.4 msf of new warehouse space under construction. The Midwest and Northeast reported construction pipelines of 5.5 msf and 3.2 msf, respectively, in the third quarter of 2002.

## THE WAREHOUSE OUTLOOK

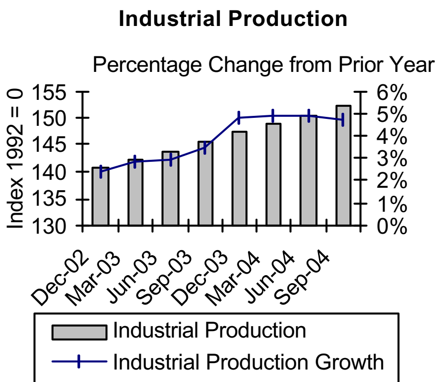
Even though recent data show manufacturing continues to struggle, there are signs of future improvement. Consumer spending on items other than autos has not fallen off. Businesses have also begun to spend a bit more on equipment and other productivity-boosting tools. In addition, the ratio of overall business inventories to sales for September was far below its long-run trend. All these indicate the need to build up inventories and set the manufacturing recovery back on track. However, with the national mood of waiting and worrying about both economic and security issues, a manufacturing upturn is still at risk.

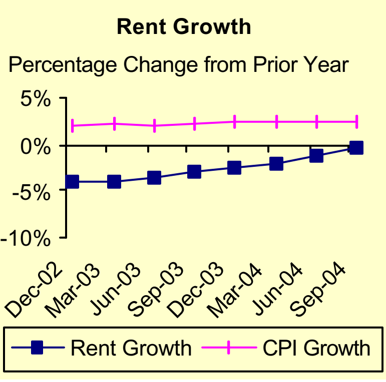
With current inventories exceptionally lean, businesses will inevitably have to expand output –- a situation that bodes well for the warehouse sector. Increased output should spur leasing activity in all 54 markets except San Francisco, Tampa, and San Jose –- and translate into a net absorption of 10.4 msf in the fourth quarter this year. However, net absorption should only reach 24.4 msf for all of 2002, down from the 36.5 msf absorbed in 2001.

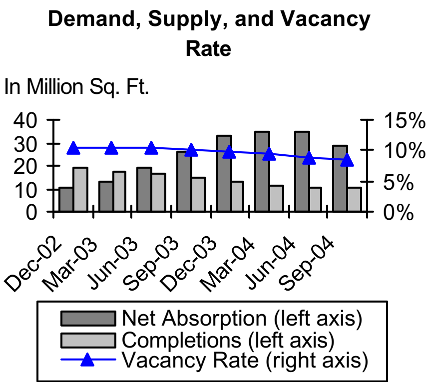
Construction starts of warehouse space have tapered off noticeably from last year in 42 of the 54 markets so that completions are expected to fall from 154.9 msf in 2001 to 98.9 msf for 2002. However, there is more building activity than is warranted so that the average vacancy rate is expected to edge up to 10.5 percent by year-end 2002 from 9.3 percent in 2001. Approximately 26 markets are expected to post vacancies higher than the national average by year-end. Hence, landlords are likely to slash rents to induce tenant renewals and fill up empty warehouse buildings. The average rent in the 54 markets is thus expected to drop 3.8 percent from 2001. Only San Diego and Honolulu are likely to post modest rent appreciation from their 2001 levels.

As long as overall demand keeps growing –- even modestly –- chances are good that businesses will gear up production in the next two years. This should stimulate leasing activity in the 54 markets, and help keep net absorption rising to 91.4 msf and 123.1 msf in 2003 and 2004, respectively. Much of the demand strength is likely to occur in the large warehouse markets of Los Angeles, Northern New Jersey, Atlanta, Chicago, Inland Empire, and Dallas-Fort Worth. Declining construction starts will continue to temper increases in warehouse space across the 54 markets, with completions of 60.8 msf in 2003 and 43.6 msf in 2004. When demand growth picks up beginning in 2003, 41 of the markets could strengthen occupancies. However, sizable advances are more likely to happen in 2004: the average vacancy rate should dip to 8.2 percent in 2004 from 9.8 percent in 2003. With vacancy rates in the 54 markets still higher than the 20-year average, landlords are likely to wield weak pricing power. As a result, the average rent is expected to drop again 2.5 percent in 2003, and level in 2004.

***Hot Markets***. Approximately 26 markets are expected to be the frontrunners as above-average occupancies gain from healthy employment growth and controlled development activity in the next two years. Palm Beach County, Milwaukee, Oklahoma City, San Francisco, and Honolulu will lead those markets with less than 60 msf of warehouse space. Seattle, Jacksonville, Kansas City, Denver, Ft. Lauderdale, Cincinnati, Miami, Detroit, Orange County, Indianapolis, Tampa, Salt Lake City, San Diego, Phoenix, and Las Vegas are poised to recover the fastest among warehouse markets with size ranging from 60 msf to 100 msf, while Los Angeles, St. Louis, East Bay, Chicago, Houston, and Dallas-Fort Worth are expected to dominate those with warehouse space exceeding 100 msf.




Source: Property and Portfolio Research, NATIONAL ASSOCIATION OF REALTORS®

*The Retail Sector*

## STATE OF THE NATIONAL RETAIL MARKET: THIRD QUARTER 2002

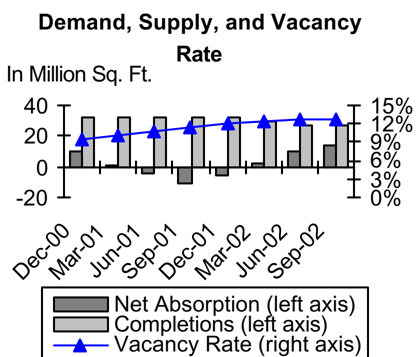
***Vacancy.*** Consumers remain the economy's driving force, despite their somber mood in the third quarter of 2002. Household spending on goods and services grew at an annual rate of 4.1 percent –- the strongest showing of the year. This lifted overall retail sales, excluding autos, 1.9 percent. The housing sector also posted healthy numbers, as consumers continued to commit a sizable portion of their income to the purchase of homes. Why all this spending? Incomes are well above the pace of inflation. Disposable income was up at an annual rate of nearly five percent in the third quarter of 2002, while consumer prices rose marginally (1.8 percent). Consumer buying power is also getting a boost from record refinancing activity. Extra money from liquidating their home equity and lower monthly payments gave consumers additional buying power in the third quarter.

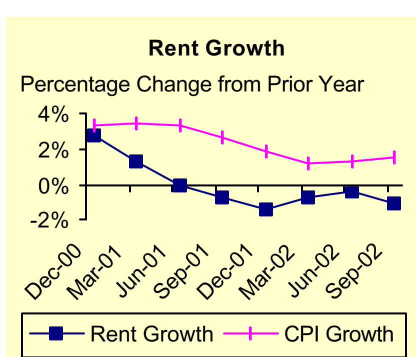
Thanks to the resilience of consumers, demand slowdown in the retail sector was one of the shallowest on record. After four consecutive quarters of negative growth, demand growth finally turned positive (+0.4 percent). Forty-three markets, led by Dallas-Fort Worth, Inland Empire, and Los Angeles, reported healthy absorption rates. Aggregate net absorption in all 54 markets tracked rose from –10.9 million square feet (msf) in the third quarter of 2001 to 13 million msf in the third quarter of 2002. This raised net absorption to 25.6 msf in all 54 markets for the nine months ending September 30, 2002.

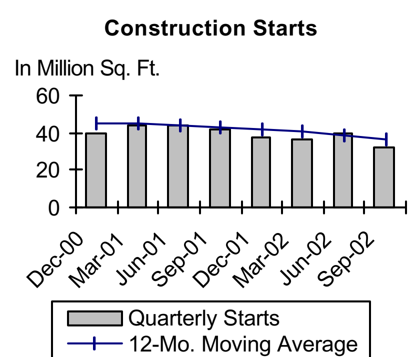
Meanwhile, total stock of retail space in the 54 markets grew 2.3 percent from the third quarter in 2001 –- noticeably faster than the increase in demand. Even though completions of new retail space eased from year-ago levels, they remained high at 27 msf in the third quarter of 2002 as 23 markets reported an increase in deliveries of new retail space compared to the same period in 2001. That brought the year-to-date retail completions in the 54 markets to 82.5 msf. Consequently, the average vacancy rate was 12.8 percent in the third quarter of this year, up 20 basis point from last quarter and 150 basis points from the third quarter of 2001. Only Inland Empire and Richmond bucked the vacancy uptrend, as demand grew more rapidly than supply in these markets. Overall, 20 markets reported vacancy rate that was still below the average for the 54 markets.

***Rent.*** Despite healthy retail sales, particularly among discount retailers, higher vacancies continued to weigh down on the pricing power of retail owners. Average rent for retail properties in the 54 markets dipped 1.1 percent in the third quarter of 2002 from the same period in 2001. Seventeen markets posted rent increases ranging between 0.1 percent and 3.8 percent from the third quarter in 2001. While average rent in the 54 markets has continuously slipped since the second half of 2001, the good news is that it is just 2.1 percent down from its peak rate in 2000.

***Construction Starts.*** Sales of retail properties were brisk in most of the 54 markets, but construction was moderate in the third quarter of 2002. Developers were hesitant to start construction unless properties could be largely pre-leased. As a result, retail starts in the 54 markets trended down to 32 msf, the lowest since the first quarter of 1997. This largely reflects the marked slowdown in construction activity in 34 markets from the third quarter 2001. Year-to-date, construction starts in the 54 markets totaled 108.1 msf, well below the 130.1 msf under construction in the first nine months of 2001. Los Angeles, Dallas-Fort Worth, Houston, and Atlanta accounted for 20 percent of total year-to-date starts.




Source: Property and Portfolio Research, Bureau of Labor Statistics

# KEY MARKET TRENDS: THIRD QUARTER 2002

**Markets with Highest Occupancy**

| Market | Vacancy Rate | Change from Prior Year |
|---|---|---|
| East Bay, CA | 7.7% | 40 bps |
| New York, NY | 7.7% | 50 bps |
| San Francisco, CA | 8.0% | 60 bps |
| Boston, MA | 8.5% | 130 bps |
| Long Island, NY | 8.5% | 80 bps |
| San Diego, CA | 9.2% | 60 bps |
| Washington, DC-NoVA-MD | 10.2% | 70 bps |
| Ft. Lauderdale, FL | 10.4% | 0 bps |
| Orange County, CA | 10.6% | 130 bps |
| Seattle, WA | 10.6% | 100 bps |

Source: Property & Portfolio Research

Tight occupancies in New York City and Boston helped the Northeast retain the top spot among all regions in terms of retail occupancy. Interestingly, rents have been steep in most major markets in this region, yet its vacancy rate of 11.1 percent was still the lowest regional figure in the third quarter of 2002. The West followed with a vacancy rate of only 11.6 percent as most major markets reported vacancy rate that was far below the average for the 54 markets. The Midwest and South trailed as vacancy rates stood at 13.1 percent and 14.5 percent, respectively. Relatively flat demand growth in the Midwest and a surge in new retail space in the South explain vacancy increases in the third quarter of 2002.

**Markets with Highest Rent Growth**

| Market | Rent Growth |
|---|---|
| Inland Empire, CA | 3.8% |
| Norfolk, VA | 2.5% |
| Tampa, FL | 2.2% |
| Kansas City, MO -KS | 1.5% |
| Palm Beach County, FL | 1.4% |
| Northern New Jersey, NJ | 1.2% |
| Long Island, NY | 1.2% |
| San Diego, CA | 1.2% |
| New Orleans, LA | 0.8% |
| St. Louis, MO-IL | 0.7% |

Source: Property & Portfolio Research

Rent growth leaders in the third quarter of 2002 include Inland Empire, Norfolk, and Tampa. Increased defense spending and an improved trade environment is helping prop up employment and consumer spending in these markets. The Northeast and South reported rents basically unchanged from the third quarter 2001. Rents in the Midwest decreased 1.6 percent, reflecting significant erosion in 14 of the markets in this region. The West posted the most significant rent decline (-1.8 percent), as substantial rent cutbacks remained prolific in tech heavy markets including San Francisco, San Jose, East Bay, Portland, and Seattle. Even so, the average rent in this region was still higher than the national average.

**Markets with Highest Construction Starts**

| Market | Percentage of Total U.S. Starts |
|---|---|
| Houston, TX | 6.9% |
| Los Angeles, CA | 5.8% |
| Atlanta, GA | 4.4% |
| Dallas - Fort Worth, TX | 3.8% |
| Boston, MA | 3.8% |
| Chicago, IL | 3.6% |
| Phoenix, AZ | 3.6% |
| Las Vegas, NV | 3.5% |
| Northern New Jersey, NJ | 3.5% |
| New York, NY | 3.0% |

Source: Property & Portfolio Research

The largest retail markets –- Houston, Los Angeles, Atlanta, Dallas-Fort Worth, Boston, Chicago, and New York City –- dominated the construction pipeline, accounting for 30 percent of starts in the third quarter of 2002. Regionally, the South –- which had the highest vacancy in the third quarter –- recorded the largest volume of retail starts (11.9 msf). It is good news that new construction in most markets in this region already eased from the third quarter of 2001, but there was a notable upturn in development activity among markets characterized by high vacancy rates: Richmond, Memphis, and Jacksonville. The West and Midwest also reported slowing construction, with starts declining 20 percent-plus to 9.9 msf and 4.9 msf, respectively. Only the Northeast experienced increased activity with 5.4 msf of new retail projects.

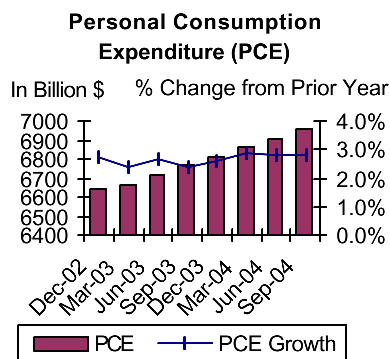
## The Retail Outlook

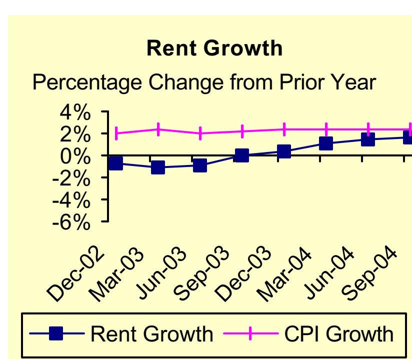
Consumer spending in the fourth quarter is not likely to be as strong as it was in the third, and will just add modestly to economic growth. Why? Retail sales in October were flat, reflecting a plunge in car sales after the summer's generous financing deals were curtailed. Moreover, there are fewer shopping days in the 2002 holiday season compared to 2001. There are also psychological factors such as fear of terrorism that could slam the brakes on spending. Nonetheless, the fourth-quarter consumer outlook has some silver lining. Closer inspection of October retail activity shows that households are still in a buying mood. Excluding cars and gasoline, retail sales were up by a healthy 0.8 percent from September, and the gains were broad-based. In addition, there are factors that could make shoppers loosen their purse strings. Confidence is rebounding. Incomes are growing faster at a faster clip than inflation. Cash from refinancing activity should continue to boost buying power. Also, energy prices have declined.

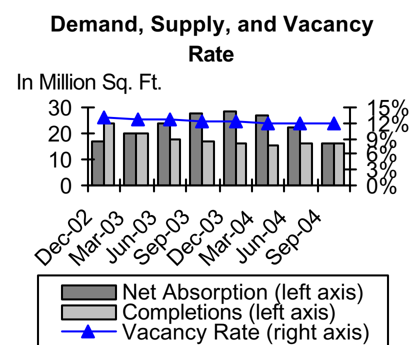
Steadfast consumer spending should help lift demand for retail space in the 54 markets tracked. Net absorption is expected to edge up to 16.6 msf in the fourth quarter, with all 54 markets likely to record positive increases. This should raise the aggregate net absorption to 42.1 msf for all of 2002, a far cry from 19.7 msf that was not absorbed in 2001. Meanwhile, slowing construction over the past year will again translate into fewer retail completions (24.2 msf) in the fourth quarter. However, annual completions will remain uncomfortably high at 106.7 msf, pushing up the average vacancy rate in all 54 markets except Inland Empire, San Diego, Ft. Lauderdale, Richmond, East Bay, New York City, and San Francisco to 12.9 percent by year-end 2002 from 12.0 percent recorded in 2001. There will be little upward movement in rents over the fourth quarter, as owners work to keep space filled. Rents should remain nearly unchanged from 2001 (-0.7 percent).

Beyond the fourth quarter, expect consumer spending to gain momentum, and allow the economy to make solid gains in 2003 and 2004. Improving job prospects will be the main driver of spending: nearly 5 million non-farm jobs are likely to be created in the 54 markets over the next two years. Strength in consumer spending should fuel demand for retail space, with 99.9 msf and 80.5 msf likely to be absorbed in 2003 and 2004, respectively. Likewise, strong consumer spending should spur modest development activity, particularly in those markets with strong absorption rates such as Dallas-Fort Worth, Los Angeles, and Inland Empire. Annual completions in the 54 markets will be lower than their 2002 levels at 70.7 msf and 65.7 msf in 2003 and 2004, respectively, and thus likely to be easily absorbed. Consequently, expect the average vacancy rate to contract to 12.2 percent in 2003 and 11.8 percent in 2004 –- still well above the record low of 9.1 percent in 2000. Only Richmond, Honolulu, Cleveland, St. Louis, and Kansas City are likely to suffer occupancy declines due to an influx of retail space. Though owners would benefit from higher occupancy, they are likely to be hesitant to bump up rents. Average rent in the 54 markets is expected to rise moderately: 0.5 percent in 2003 and 1.6 percent in 2004.

***Hot Markets***. Approximately 21 retail markets tracked should rebound more rapidly in the next two years, as strong demographic and job trends shore up their retail occupancies above the average for the 54 markets. Salt Lake City, Austin, Stamford, and Milwaukee will be the growth leaders among markets with less than 60 msf of retail space. East Bay, San Francisco, Long Island, Sacramento, Seattle, Ft. Lauderdale, Portland, Minneapolis, and San Jose will top markets between 60 msf and 110 msf, while, San Diego, New York City, Boston, Orange County, Washington DC, Chicago, Los Angeles, and Phoenix will lead markets among those with more than 110 msf of retail space.




Source: Property and Portfolio Research, NATIONAL ASSOCIATION OF REALTORS®

## State of the National Multifamily Market: Third Quarter 2002

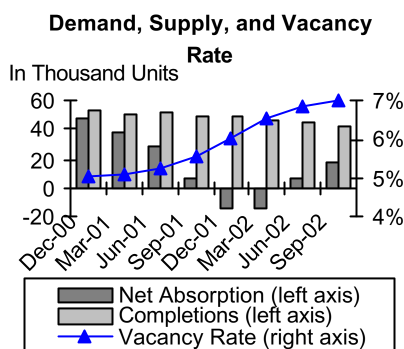
***Vacancy.*** Housing demand showed no sign of abating, and thus continued to constrain demand gains for apartments. Existing single-family home sales were up 1.7 percent from one year ago to a seasonally adjusted annual rate of 5.36 million, while new home sales soared 15.0 percent to an annual rate of 997,000 in the third quarter of 2002. As a result, the homeownership rate remained strong at 68.0 percent. Low mortgage rates, coupled with healthy gains in income, bolstered the demand for housing. The average 30-year fixed mortgage rate dropped 50 basis points from the second quarter to 6.3 percent. After-tax disposable income was up at annual rate of 2.9 percent.

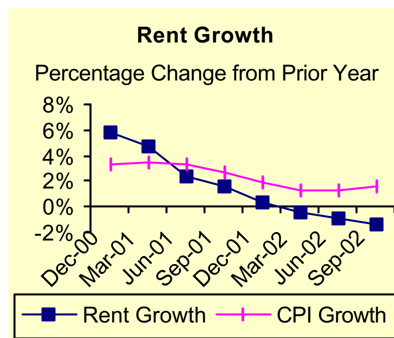
Even with the rampant home buying, leasing activity modestly picked up in all 54 markets except New York City, Chicago, Detroit, Boston, New Orleans, Oklahoma City, Long Island, Hartford, and Stamford in the third quarter of 2002. Net absorption for all 54 markets tracked was thus positive for the second straight quarter at 18,500 units, up from 6,100 units in the previous quarter and in the third quarter in 2001. Why the dichotomy? Buoyant home sales have generally sparked prices –- median prices shot up 6.9 percent for existing homes and 2.1 percent for new homes from the third quarter in 2001. Consequently, rapidly appreciating home prices have put homeownership out of reach for some households. Moreover, layoffs ebbed –- non-farm employment in the 54 markets tracked notched its second straight quarter of gain, adding 62,000 net new jobs in the third quarter of this year. However, year-to-date net absorption was low at 20,900 units, keeping total occupied rental housing almost at par with that in the same period in 2001.

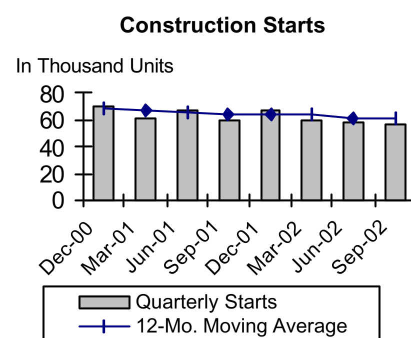
Completions continued to be at healthy levels, although the trend was downwards. A total of 41,500 new apartments came online across the 54 markets tracked –- 10 percent below the 20-year quarterly average of 46,200 units. Year-to-date completions thus remained robust at 131,900 units, moderately down from 150,000 apartments completed in the first nine months of 2001. With the construction of new apartments not slowing sufficiently, the average vacancy rate in the 54 markets ratcheted up to 7 percent in the third quarter this year from 5.6 percent in the same period in 2001. Compared to the previous quarter, the average vacancy rate was just up 20 basis points. Only Norfolk posted modest occupancy gains on both quarterly and yearly basis.

***Rent***. Declining occupancies continued to prompt owners and managers to offer large-scale concessions and rent reductions to lure and keep tenants in the third quarter of 2002. Leasing incentives translated into discounts on rents in the 54 markets for the third straight quarter. The average rent for the 54 markets tracked slipped 1.4 percent in the third quarter of 2002 from the same period one year ago. Even so, 22 markets realized some rent gains. On a quarterly basis, rents were up slightly (0.1 percent) from the second quarter, as 28 markets recorded rent appreciation. Compared to its peak rate in 2001, the average rent was off 1.4 percent.

***Construction Starts***. There continued to be a large number of units in the construction pipeline –- indicating that developers and lenders are still optimistic. New multifamily projects totaled 57,400 units in the third quarter of 2002, not too far off from starts of 58,100 units in the second quarter and 60,500 units in the same period in 2001. This brings up the aggregate starts for the nine months of 2002 to 175,800 units –- with 25 percent located at large apartment markets of New York City, Atlanta, Los Angeles, Houston, and Washington DC.




Source: Property and Portfolio Research, Bureau of Labor Statistics

## Key Market Trends: Third Quarter 2002

**Markets with Highest Occupancy**

| Market | Vacancy Rate | Change from Prior Year |
|---|---|---|
| Chicago, IL | 4.0% | 110 bps |
| Minneapolis, MN-WI | 4.1% | 160 bps |
| Northern New Jersey, NJ | 4.1% | 80 bps |
| San Diego, CA | 4.5% | 140 bps |
| Inland Empire, CA | 4.6% | 80 bps |
| Boston, MA | 4.8% | 140 bps |
| New York, NY | 4.8% | 60 bps |
| Los Angeles, CA | 5.1% | 110 bps |
| Norfolk, VA | 5.1% | -20 bps |
| Detroit, MI | 5.3% | 130 bps |

Source: Property & Portfolio Research

All regions posted higher vacancies in the third quarter of 2002, but the rate of increase has noticeably slowed from the second quarter. The Northeast posted an average vacancy rate of 5.5 percent, up 10 basis points from the previous quarter. Sustained high occupancy in this region reflects tight conditions in New York City, Philadelphia, Pittsburgh, Northern New Jersey, Boston, and Long Island. The Midwest and West followed with an average vacancy rate of 5.9 percent and 6.4 percent, respectively –- also up 10 basis points from the second quarter. The South posted the highest vacancy rate of 9.4 percent in the third quarter, a 20-basis-point increase from the last quarter. Even though demand was up, the stock of new apartments grew at a faster clip in this region.

**Markets with Highest Rent Growth**

| Market | Rent Growth |
|---|---|
| Honolulu, HI | 13.6% |
| Norfolk, VA | 6.5% |
| Sacramento, CA | 4.3% |
| Inland Empire, CA | 4.1% |
| Baltimore, MD | 3.7% |
| Long Island, NY | 3.4% |
| Hartford, CT | 3.0% |
| Jacksonville, FL | 2.9% |
| Los Angeles, CA | 2.4% |
| Orange County, CA | 2.4% |

Source: Property & Portfolio Research

Honolulu continued with another double-digit rent increase due to the proliferation of top-tier products in this market. Strong military presence in Norfolk bolstered demand for rental housing –- which boosted rents in this market. In contrast, San Diego, East Bay, and San Francisco suffered the largest drops in rent ranging between –12.1 percent and –17.6 percent. On a regional basis, tight occupancies allowed the Northeast to sustain some modest rent appreciation (0.7 percent) from the third quarter of 2001. Meanwhile, the rest of the regions posted rent declines. The average rent was down 3.7 percent in the Midwest, 2.3 percent in the West, and 1.3 percent in the South from the third quarter of 2001.

**Markets with Highest Construction Starts**

| Market | Percentage of Total U.S. Starts |
|---|---|
| Atlanta, GA | 6.0% |
| Los Angeles, CA | 5.2% |
| Houston, TX | 5.0% |
| Washington, DC-NoVA-MD | 4.4% |
| New York, NY | 4.4% |
| Seattle, WA | 4.1% |
| Boston, MA | 4.0% |
| Minneapolis, MN-WI | 3.7% |
| Portland, OR | 3.3% |
| Denver, CO | 3.2% |

Source: Property & Portfolio Research

Once again, the South reported the most construction activity in third quarter of 2002. Although starts were substantial at 24,200 units, volume has already dropped from the third quarter of 2001–- a welcome change given that vacancy rate was highest in this region. In contrast, low vacancy rates spurred development activity in the West (17,600 units) and Northeast (7,900 units). Compared to the third quarter of 2001, starts were up 3 percent in the West and 20 percent in the Northeast. The Midwest trailed all regions, with 7,800 units of new apartments that broke ground or were under construction. This represents a decline of 20 percent from the third quarter of 2001.

## THE MULTIFAMILY OUTLOOK

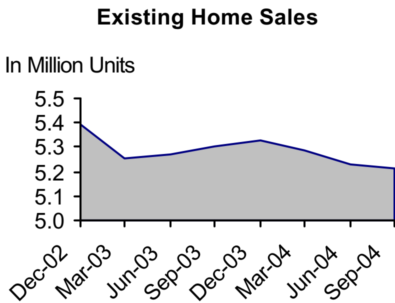
Housing demand is expected to remain brisk through the end of year. By year-end, sales of existing and new homes for all of 2002 will have risen by 4 percent and 6 percent, respectively –- and surpassed their 2001 records. Historical lows in mortgage interest rates should continue to push demand higher in the fourth quarter.

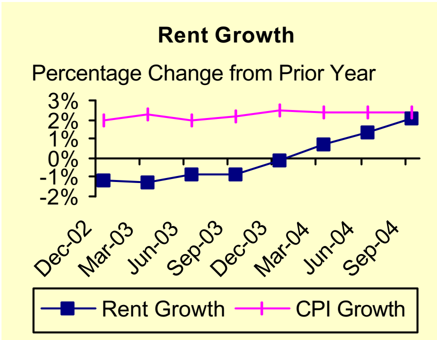
Despite the sustained uptrend in single-family housing demand, expect the apartment sector to post moderate demand gains in the fourth quarter. Leasing activity is expected to pick up in 23 markets, boosting net absorption in the 54 markets tracked to 27,500 units in the fourth quarter. Atlanta, Dallas-Fort Worth, Washington DC, Orlando, and Raleigh are each likely to absorb in excess of 1,000 units. The key to such improvement is the creation of new non-farm jobs in the 54 markets. Some 198,000 net new jobs are likely to be added in the 54 markets in the fourth quarter. However, in the face of uneven economic recovery and geopolitical uncertainties, this magnitude of job additions is still at high risk.

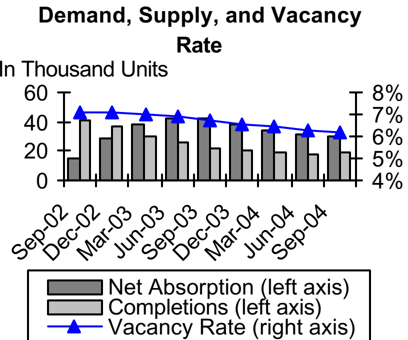
New apartments will continue to proliferate the 54 markets, but the volume should dip modestly to 37,800 units in the fourth quarter. Atlanta and Dallas are expected to have more than 5,000 units delivered, representing 15 percent of aggregate completions. Fortunately, the decline in completions and improved leasing activity should help vacancies stabilize and contain rent declines in the 54 markets in the fourth quarter. The average vacancy rate and rent are expected to be almost unchanged from the third quarter. And the good news is that eight markets are likely to post occupancy and rent gains from the third quarter. Compared to 2001, the average vacancy rate of 7.0 percent by year-end 2002 is likely to be up 100 basis points, while the average rent is likely to be down 1.1 percent.

While the economy heads into 2003 with dogged uncertainty, there are reasons for optimism. Companies are operating with too few workers, so expect non-farm employment in the 54 markets to increase by nearly 5 million net new jobs. Thus, expect stronger apartment trends to emerge. Net absorption is expected to gain momentum and reach 155,700 units and 124,400 units in 2003 and 2004, respectively. Meanwhile, slowing construction will rein in aggregate completions: 110,600 units in 2003 and 80,000 units in 2004. This combination of rising demand and dwindling supply increases should reduce vacancy rates and restore some pricing power of apartments owners and managers in the 54 markets. The average vacancy rate is expected to continuously fall from 6.6 percent in 2003 to 6.2 percent in 2004. Only Norfolk, San Diego, Inland Empire, Los Angeles, Northern New Jersey, New York City, are likely to post flat-to-declining occupancies in the next two years. Meanwhile, the average rent is likely to be unchanged from 2002, and appreciate by 2.5 percent in 2004. Again, the 2-year outlook hinges on the recovery of the labor markets. Low mortgage rates are likely to fuel strong home sales, and cut into the demand for apartments.

***Hot Markets.*** Twenty-two of the 54 markets will record the most favorable demand/supply fundamentals in the next two years. Norfolk, Nashville, Long Island, and Honolulu with less than 110,000 apartment units. Inland Empire, Portland, Sacramento, Pittsburgh, Ft. Lauderdale, and San Jose, will lead those markets with size ranging between 110,000 and 200,00 apartment units, while Minneapolis, Chicago, Boston, Northern New Jersey, San Francisco, New York City, East Bay, Orange County, San Diego, Los Angeles, Detroit, and Seattle will dominate those markets with more than 200,000 apartment units.




Source: Property and Portfolio Research, NATIONAL ASSOCIATION OF REALTORS®

The markets covered in this report include the following:

| | |
|---|---|
| Atlanta, GA | Minneapolis, MN-WI |
| Austin, TX | Nashville, TN |
| Baltimore, MD | New Orleans, LA |
| Boston, MA | New York City, NY |
| Charlotte-Gastonia, NC-SC | Norfolk, VA |
| Chicago, IL | Northern New Jersey |
| Cincinnati, OH-KY-IN | Oklahoma City, OK |
| Cleveland, OH | Orange County, CA |
| Columbus, OH | Orlando, FL |
| Dallas-Fort Worth, TX | Palm Beach County, FL |
| Denver, CO | Philadelphia, PA-NJ |
| Detroit, MI | Phoenix, AZ |
| East Bay, CA (Formerly Oakland) | Pittsburgh, PA |
| Fort Lauderdale, FL | Portland, OR |
| Hartford, CT | Raleigh, NC |
| Honolulu, HI | Richmond, VA |
| Houston, TX | Sacramento, CA |
| Indianapolis, IN | Salt Lake City-Ogden, UT |
| Inland Empire (Formerly Riverside, CA) | San Antonio, TX |
| Jacksonville, FL | San Diego, CA |
| Kansas City, MO-KS | San Francisco, CA |
| Las Vegas, NV | San Jose, CA |
| Long Island, NY | Seattle, WA |
| Los Angeles, CA | Stamford, CT |
| Memphis, TN | St. Louis, MO-IL |
| Miami, FL | Tampa-St. Petersburg, FL |
| Milwaukee, WI | Washington, DC-MD-VA |

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