

Commercial Real Estate Activity: “Stable to Improving”

July 13, 2016

The Beige Book report for July, which summarizes comments received from businesses and other contacts outside the Federal Reserve, suggested that economic growth during the most recent period was “modest.” However, unlike prior months, **no District described growth as slowing or flat**. Just two Districts noted any impact from the **Brexit vote**; **Boston** suggested that while Brexit presented downside risks to aggregate economic growth, those with direct exposure “did not expect severe negative impacts on their own firms’ outcomes” while **Dallas** noted as with the upcoming presidential election, Brexit served as a source of overall uncertainty.

Construction and real estate activity generally remained stable, with “improving” industrial markets in **New York, Richmond and Dallas**. **Office market conditions, however, were described as “mixed,”** with contacts in **Boston** reporting a modest slowdown in office leasing “especially for high-rent space” and “limited” office construction in light of high building costs. Demand for **Houston** office space was still weak, and “spiking” sublease space continued to weigh on rents. In **Manhattan**, office availability rates edged up; despite a pick-up in leasing activity, a large amount of new office construction is underway and has yet to be absorbed.

Economic Growth Characterization by District

	June Beige Book Report (through May 23, 2016)	July Beige Book Report (through July 1, 2016)
“Moderate” Growth:	San Francisco	Minneapolis, San Francisco
“Modest” Growth:	Atlanta, Cleveland, Philadelphia, St. Louis, Minneapolis	Boston, Chicago, Kansas City, Philadelphia, Richmond, St. Louis,
“Other” (positive)	Boston (“generally improving”) Richmond (“continued to expand”)	Atlanta and Dallas (“expanded slightly”) Cleveland (“steady level of activity”) New York (“picked up”)
“Other” (neutral/negative)	Chicago and Kansas City (“pace of growth slowed”) Dallas (“activity grew marginally”) New York (“generally flat”)	n/a

Source: Federal Reserve **Bold** = change from prior report.

WAGES/EMPLOYMENT: Employment continued to grow “modestly” since June’s report. While contacts in several Districts reported strong demand for skilled labor (with challenges filling positions in fields such as IT, biotechnology, and healthcare services) certain segments, such as retail employment, were characterized as “weak.” Hiring in both **Boston** and **Atlanta** was characterized as “cautious.”

Wage pressures remained “modest to moderate” in most Districts, with the strongest pressures linked to skilled workers and difficult-to-fill positions. Contacts in **Cleveland, Chicago and San Francisco** reported increased wages for entry-level employees. Wage pressures picked up in **Richmond** and **San Francisco**, with a staffing contact in Richmond noting that firms that have not increased their wages have been left with the least-skilled employees. **Wage pressures in the construction** industry were highlighted in the **Philadelphia, Cleveland and San Francisco Districts**.

Price pressures remain slight, with contacts generally reporting **no movement in selling prices and increases in input prices, suggesting a reduction in operating margins**. Contacts in **New York, Philadelphia, Cleveland, Atlanta, Chicago and St. Louis** all reported little to no change in selling prices. Most Districts cited upward pressure on input prices, with the exception of San Francisco, which reported a decrease.

Below, we detail specific comments by District on commercial real estate.

Heidi Learner, Chief Economist
hlearner@savills-studley.com 212-326-8648



District	Comments on Commercial Real Estate
Atlanta	<p>“Commercial real estate contacts continued to report improvement in demand resulting in increased rents and increased absorption across property types, but cautioned that the rate of improvement varied by metropolitan area, submarket, and property type. Most commercial contractors indicated that the pace of nonresidential construction activity increased from one year ago, with many reporting backlogs of one to two years. Amid ongoing concern about the overbuilding of apartments, District multifamily contacts indicated a slight deceleration in the pace of rent growth as well as a pullback in the availability of credit for new development. Half of District contacts indicated that the pace of multifamily construction continued to increase from the year earlier level, while the other half indicated that the pace of activity was flat to down. Looking forward, most District commercial real estate contacts expect the pace of nonresidential construction activity to increase slightly over the next quarter.”</p>
Boston	<p>“On balance commercial real estate markets appear stable or improving in the First District. In greater Boston, a modest slowdown in office leasing is reported, especially for high-rent space, but rents are steady amid low vacancy rates. Office leasing activity held steady at a moderate pace in Portland and Providence, but in Hartford activity remains light and some firms gave up space. Investment sales activity is down in Boston from last year's brisk pace. However, industrial sales activity picked up recently in Boston and parts of Connecticut, and a Portland contact sees a strong industrial property market with potential for new construction. Throughout the District, office construction remains limited in light of high building costs...a regional lender to commercial real estate reports an uptick in loan demand at his firm amid reduced competition from other lenders...a Boston contact expects the Brexit vote to exert downward pressure on economic activity in the U.S. and the region, but notes that the vote should also boost foreign investment in Boston's commercial real estate market. Elsewhere in the District contacts are cautiously optimistic for commercial real estate but see risks as tilted to the downside based on global economic and political uncertainty.”</p>
Chicago	<p>“Demand for nonresidential construction increased slightly, with growth concentrated in industrial construction. One contact reported a pickup in the number of large projects entering the bidding process. Commercial real estate activity rose modestly across market segments, with healthy gains reported in the for-lease market. Commercial rents were little changed, while vacancy rates and availability of sublease space decreased somewhat over the reporting period.”</p>
Dallas	<p>“Demand for office space was healthy in Dallas-Fort Worth, but dampened further in Houston where sublease space continued to spike, putting pressure on office rents. Industrial leasing was active in both metros.”</p>
New York	<p>“Commercial real estate markets have been stable to somewhat stronger through mid-year. Office availability rates edged up in Manhattan; despite a pickup in leasing activity, a large amount of space coming onto the market was not fully absorbed. Elsewhere, office availability rates were steady to down slightly; across upstate New York, they were at multi-year lows. New office construction has picked up in New York City but remains sluggish across the rest of the District. Industrial real estate markets strengthened further--particularly across the New York City metro region--with asking rents continuing to climb briskly and vacancy rates falling to their lowest levels since before the recession. New factory and warehouse construction picked up in the second quarter.”</p>
Philadelphia	<p>“Nonresidential real estate contacts, predominately in the Greater Philadelphia area, reported little change in the ongoing modest gains in construction activity and in leasing activity. A developer noted that demand for Lehigh Valley industrial/warehouse space is as great as it's ever been. Driven by e-commerce, these projects bring hundreds of new jobs and are creating upward pressure on \$14 to \$15 per hour wages. The City of Philadelphia office market also continues to tighten as vacancy rates continue to drop.”</p>
Richmond	<p>“On the commercial side, leasing activity increased moderately overall, with a few reports of strong growth; commercial construction varied across submarket and region...a commercial Realtor in Richmond reported solid leasing activity, particularly for small retail spaces. Additionally, commercial brokers in Frederick, Maryland indicated that the retail leasing market was robust. In some areas of Maryland there were reports that commercial and industrial leasing was strong and that a few speculative industrial buildings had leased at 100 percent capacity...commercial real estate activity in Charleston, West Virginia remained sluggish. Rental rates and vacancy rates varied across submarkets and locales.”</p>
San Francisco	<p>“Real estate market activity expanded further in general, although it slowed for commercial properties in some areas...shortages of skilled labor and available land constrained growth in some regions...Demand for commercial real estate continued to expand in most areas. Contacts in the San Francisco Bay Area, however, noted that tighter financial conditions have undermined expansion in the technology sector, causing slower demand growth for commercial space and pushing up the volume of properties available for sublease.”</p>