

Economic Pulse

Beige Book I National

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Commercial Real Estate Activity: Sales and Leasing “Expanded Modestly”

September’s Beige Book report, the Federal Reserve’s qualitative assessment of conditions across the country’s 12 Districts, suggested that economic activity expanded at a moderate pace during July and August (Table 1). While **Dallas** reported “relatively brisk growth,” despite a levelling off of drilling activity due to pipeline capacity constraints, **Philadelphia, St. Louis, and Kansas City** indicated somewhat below-average growth. **Consumer spending** continued to grow at a modest pace and **transportation activity** expanded, with a few Districts characterizing growth as “robust.” **Home construction** activity was “mixed but up modestly,” even as home sales were somewhat softer, due to reduced demand in some cases, and due to low inventories in others.

While businesses generally remained optimistic about the near-term outlook, most Districts noted concern and uncertainty about **trade tensions**, particularly among manufacturers. For example, in the **New York District**, a “sizable” number of contacts noted that recent hikes in tariffs have raised their overall input costs, with some having expressed concern about the effects of changes in trade policy on various aspects of their business. (One utility firm noted that tariffs on some construction materials may force them to scale back capital investment slightly.) In **Atlanta**, uncertainty regarding tariffs and trade policy continued to weigh heavily on manufacturers’ sentiment as expectations for future production levels decreased from the previous period; slightly less than one-third of contacts are expecting higher production over the next six months. In **Chicago**, some contacts indicated that they were delaying capital spending decisions until 2019 because of uncertainty over the outcome of international trade negotiations.

With regard to **commercial real estate**, construction was mixed, although both sales and leasing volume expanded modestly. Activity was described as “steady,” “solid” and “strong,” in many areas, but the **Dallas District** highlighted the national trend toward densification as contributing to “a moderation” of net absorption. In **Philadelphia**, office rents continued to rise, although higher rents have been “driven, in part, by outside investors, then partially offset by concessions.” Office vacancy rates “decreased slightly” in some markets in the **Richmond District**; in **Boston**, office and warehouse leasing demand “remained strong.” The market for industrial space “continued to strengthen” in **northern New Jersey**, and in perhaps the first appearance of the word “cannabis” in a Federal Reserve report, leasing demand for retail and warehouse spaces “picked up further” in **Oregon**, “due in part to the growing cannabis industry.” Notably, many Districts highlighted increasing price pressures in the construction segment (**Atlanta, Boston, Chicago and San Francisco**). Construction workers (as well as truck drivers, engineers and other high-skill workers) remained in short supply and “a number of Districts cited steep wage hikes for construction workers. More broadly, businesses’ input costs have generally been rising more rapidly than selling prices, though there have been increased efforts to pass along cost hikes to customers.

Table 1: Economic Growth Characterization by District

Assessment	July Beige Book Report (data through July 9, 2018)	September Beige Book Report (data through August 31, 2018)
“Moderate” growth:	Boston, Cleveland, Kansas City, Minneapolis, New York, Richmond, San Francisco	Atlanta , Boston, Chicago , Cleveland, Minneapolis, New York, Richmond, San Francisco
“Modest” growth:	Atlanta, Chicago, Philadelphia	Kansas City , Philadelphia, St. Louis
Other:	Dallas (“solid”), St. Louis (“improved slightly”)	Dallas (“solid”)

Source: Federal Reserve. **Bold**: change in categorization from prior report.

On the following page, please find additional comments on commercial real estate by District.

District	Comments on Commercial Real Estate
Atlanta	“Many District commercial real estate contacts noted continued strong demand . The majority of commercial contractors indicated that on balance, the pace of nonresidential construction activity at least matched the year-ago level, with the exception of retail construction, which was characterized as unchanged to down . Most contacts reported a healthy pipeline of activity, with backlogs greater than or equal to the previous year. Many contacts expressed concerns that uncertainty over increasing materials prices was making bidding and fulfilling projects more challenging . The outlook for nonresidential and multifamily construction among commercial contractors across the District remained positive, with the majority anticipating activity to match or exceed the current level.”
Boston	“Commercial real estate activity held roughly steady on balance in recent months, although rising construction costs and shortages of construction labor were seen as growing constraints. Office and warehouse leasing demand remained strong in Boston and Portland amid low vacancy rates, resulting in positive but slow net absorption and further upward pressure on rents... The financing environment remained favorable for commercial real estate construction and investment in the First District, and recent loan deals were seen as safe in the sense of involving relatively low amounts of leverage. Construction was stable but mixed across areas and sectors; multifamily housing and hospitality continued to lead. Commercial real estate contacts said that construction costs had increased moderately to steeply in recent months, and the increases were attributed in part to rising materials costs—stemming partly from tariffs on imported goods—and in part to rising wages for scarce construction labor . The tight construction labor market also contributed to delays in project completions. Contacts maintained a mostly favorable outlook.”
Chicago	“Nonresidential construction edged higher from an already solid level, with contacts highlighting growth in the industrial, health and education sectors . Commercial real estate activity increased modestly with growth spread across most segments. That said, one contact indicated that he had started seeing deals fall through because of increases in construction costs . Commercial rents increased slightly, vacancy rates edged down, and sublease space edged up.”
Dallas	“Net absorption of office space moderated in Dallas–Fort Worth and remained weak in Houston in part due to the broader national trend among firms to move out of larger spaces into more efficient, smaller ones .”
New York	“Commercial real estate markets have firmed slightly . Office availability rates declined modestly in northern New Jersey, and Westchester and Fairfield counties. Office markets were steady in Manhattan and upstate New York, but slackened modestly in Long Island. The market for industrial space continued to strengthen, particularly in northern New Jersey , where availability rates fell to multiyear lows and rents continued to climb, posting double-digit percentage gains from a year ago.”
Philadelphia	“Volumes grew moderately in mortgages and in other consumer loans (not elsewhere classified) and grew modestly in commercial real estate lending and in auto loans.... Overall, rents continued to rise in the slowly growing nonresidential real estate market, especially for offices and industrial warehouses. Higher office rents have been driven, in part, by outside investors, then partially offset by concessions , while underlying demand continued to support new construction and rising rates for warehouses. On balance, nonresidential construction activity continued to slowly wane in most markets.”
Richmond	“Commercial real estate leasing activity rose modestly in recent weeks as brokers reported increased demand in the industrial and retail markets. Office leasing activity was mixed across the District. Brokers in... Virginia reported slower office leasing activity in recent weeks, while agents in... the District of Columbia reported modest increases. Vacancy rates decreased slightly in some office markets and were unchanged in the retail and industrial markets. Rental rates for all sub-markets were stable to increasing modestly . On the commercial sales side, brokers reported modest increases in prices and sales. Industrial and retail construction increased modestly, but there were no reports of new office construction projects.”
San Francisco	“Commercial real estate activity was healthy. In line with the residential market, construction in the commercial market was limited only by labor shortages and rising material costs . In Oregon, leasing demand for retail and warehouse spaces picked up further, due in part to the growing cannabis industry . A contact in Southern California noted that commercial leasing rates jumped, spurring some additional construction starts.”

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