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Industrial Growth Boosts SIOR Markets in First Quarter 2014

April, 2014—WASHINGTON, DC— Members of the Society of Industrial and Office REALTORS® (SIOR) participated in the Commercial Real Estate Index survey, supplying their knowledge of the industrial and office market conditions in the United States for the first quarter of 2014. The responses, compiled by SIOR in association with the National Association of REALTORS® (NAR), present an accurate depiction of the current industry for the start of 2014.

Office and industrial sectors advanced in the first quarter; with the SIOR Commercial Real Estate Index increasing 2.2 points, moving from 96.4 to 98.6. A balanced market is signified by 100 points—something the U.S. has not experienced since third quarter 2007. The SIOR Index measures ten variables pertinent to the performance of U.S. industrial and office markets (see methodology).

The broad markets showed improvement. The office markets rebounded, rising 3.4 points during the quarter, to 89.1, up from 85.7 in December. The industrial sector continued its steady advance, gaining 2.2 points, and moving positively about the 100-point threshold, signifying an expanding market.

SIORs expectations for the next three months were slightly better this quarter, with 80 percent of respondents expecting an improving market for the next quarter; compared to the 77 percent last quarter. Two percent predicted that business was going to be down from current levels, whereas 14 percent of respondents felt the market will be maintaining the current level during the next three months.

Construction activity is still low, with 28 percent of respondents indicating lower levels than normal, and 42 percent mentioning that there is no new commercial construction in their market. However, there are signs of a rebound with 17 percent reporting growing new construction, up from 15 percent last quarter.

National economy continues to impact local economies, but at a diminishing marginal rate than prior quarters – 43 percent of respondents feel that the national economy is having a negative impact on their local market (48 percent last quarter).

Fundamentals continued to improve – vacancies continued declining for SIORs, leasing levels improved, and rents continued to rise.

Industrial Market

The SIOR Index for industrial markets show a value of 105.2 for the quarter, past the 100-point equilibrium. The industrial sector notched above-equilibrium values on six of the 10 variables underpinning the index. In addition, industrial markets continue to outperform office markets on nine of the 10 index variables.

Office Market

The office markets improved with the index value reaching 89.1, a 3.4 point advance over last quarter. However, by most variables, office markets lag the broader commercial markets. Office spaces continue to wrestle with weak demand as employment in office-using industries has yet to make significant inroads.

Regional Breakdown

The West (98.8, up from 91.8 in December) posted a 7-point advance in the first quarter, inching closer toward equilibrium.

The South

The South (100.4, down from 104.6 in December) recorded a decline of 4.2 points during the quarter, to an index value of 100.4, which may have been caused by the harsh winter weather. Despite the decline, the region remains the second strongest in terms of fundamentals and investments.

The Northeast

The Northeast (93.2, up from 93.0 in December) had a small 0.2 point gain, placing it at the end of the growth rate. The northeast is still shy of long-term equilibrium with an index value of 93.2.

The Midwest

The Midwest (103.2 up from 94.2 in December) moved past the 100-point equilibrium in the first quarter, indicating that the region is moving toward expansion. Nine point advancement gave the region the strongest gain of the first quarter. The Midwest took the top spot from the South, as the region with the strongest fundamentals with an index value of 103.2.

Methodology

The SIOR Commercial Real Estate Index is constructed as a "diffusion index," a very common and familiar indexing technique for economic measures. Other examples of diffusion indexes include the Index of Leading Economic Indicators, the Consumer Confidence Index, and the Institute of Supply Management's Purchasing Managers' Index. In the SIOR Commercial Real Estate Index, a value of 100 represents a well-balanced market for industrial and office property. Values significantly lower than 100 indicate weak market conditions; values significantly higher than 100 indicate strong market conditions. The theoretical limits of this Index are a low of zero, and a high of 200, though it is unlikely that such limits would be approached as long as the property markets are operating efficiently.

The Index is based on a survey questionnaire with ten topics. The topics covered are (1) recent leasing activity; (2) trends in asking rents; (3) trends in vacancy rates; (4) subleasing conditions; (5) levels of concession packages in leases; (6) development activity; (7) site acquisition activity; (8) investment pricing levels; (9) the impact of the local economy on the property market; and, (10) the effect of the national economy on the property market. Survey respondents are given five choices. For each topic, five choices are provided, corresponding to conditions that are very weak, moderately weak, well-balanced, moderately strong, or very strong.

For each question, answers are tallied and the percentage of responses for each of the five choices is calculated. If survey panelists indicate "very weak" conditions (the "a" choices in the questionnaire), the answer is assigned 0 (zero) points; "moderately weak" ("b" answers) earn 5 points; an indication of "market balance" ("c") receives 10 points; "moderately strong" indications ("d") score 15 points; and "very strong" ("e") responses receive a maximum 20 points. Thus a score of 10 for a given question can be

earned if responses are evenly distributed across all five choices, if all responses were “c”, or if the answers form a “bell-shaped curve” centered around the “c” choice. The total index value is derived by summing the scores for all ten questions. Index values for each of the two property types are similarly calculated.

The survey was developed by Hugh F. Kelly, CRE, clinical professor at New York University, who worked with SIOR on research projects since 1989.

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