GROWTH IN ECONOMY LIFTS SIOR MARKETS TO HIGHEST POST-RECESSION LEVELS

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NAR ECONOMIC OVERVIEW

The economy closed 2014 on a positive note, even accounting for the fourth quarter's slower growth rate. The Bureau of Economic Analysis's first estimate of gross domestic product came in at $16.3 trillion for the fourth quarter, indicating a 2.6 percent annual growth rate. While it certainly seems lower than the second and third quarters' 4.6 percent and 5.0 percent, respectively, the fourth quarter remains subject to at least two more revisions. The second and third quarter figures were also lower in the initial estimates.

The slowdown in the fourth quarter GDP came from a significant decline in government spending at the federal level. Federal defense spending dropped 12.6 percent during the quarter. Federal nondefense spending rose at an annual rate of 1.7 percent. Meanwhile, benefiting from rising property tax revenues, state and local governments increased spending 1.3 percent on an annual basis.

The main boost to GDP growth came from consumer spending, which accounts for two thirds of economic activity. Consumer expenditures gained during 2014 with each successive quarter, from an annual rate of 1.2 percent in the first quarter to 4.3 percent in the fourth quarter. Encouraged by rising employment trends and higher household wealth, consumers spent more on both goods and services. The fourth quarter's 7.5 percent increase in spending on durable goods was driven by higher purchases of vehicles and auto parts (up 6.4 percent), furniture and household appliances (up 5.7 percent), as well as recreational vehicles and equipment (up 9.8 percent). As the fourth quarter included the holiday season, consumers benefitted from noticeably lower gasoline prices. With colder weather and increased holiday travel, spending on gasoline rose 12.3 percent. However, lower gas prices also meant consumers found room in their budgets to spend more on clothing and shoes (up 13.4 percent).

Consumer spending on services rose at the strongest rate of 2014, 3.7 percent in the fourth quarter. With the start of the winter holiday season, consumers upped their expenditures of recreation 5.9 percent, while increasing spending at hotels and restaurants 6.0 percent. Spending on financial services and insurance increased at an annual rate of 6.4 percent.

The pace of business investments in the last quarter of 2014 throttled back from the accelerated pace of the previous two quarters. Nonresidential fixed investment advanced at a slower annual rate of 1.9 percent in the fourth quarter, as companies cut back on equipment spending. Double-digit cuts in purchases of industrial and transportation equipment led to a 1.9 percent decline in overall equipment investment. Spending on information processing equipment—computers and peripherals—was the only bright spot, advancing 15.8 percent.

Business investments in commercial real estate rose 2.6 percent in the fourth quarter, the slowest pace of the year. Companies did up their investment of intellectual property products—software, R&D, along with entertainment, literary and artistic works—at a 7.2 percent annual growth rate.

With declining global economic growth pushing the U.S. dollar's parity higher, imports of goods and services rose 8.9 percent in the last quarter of 2014. Export growth moderated, advancing 2.8 percent, leading to a negative balance of trade of $471.5 billion.

The fourth quarter offered positive news on employment. Payroll employment rose at the strongest pace in the last stretch of the year, adding 850,000 new jobs. The figure closed the year with a total net gain of 2.6 million employees. The unemployment rate dropped to 5.7 percent for the fourth quarter, the lowest of 2014.

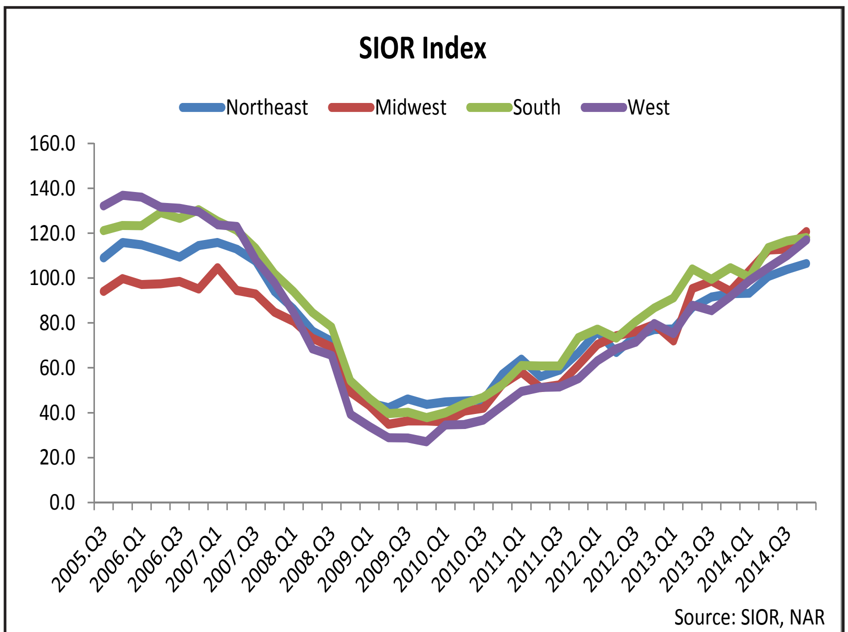
The fourth quarter also registered an improvement in wages and salaries, which advanced 4.6 percent year-over-year. Wages and salaries for all of 2014 rose 4.3 percent compared with their levels in 2013. The largest gains came for private industries, where wages increased 5.0 percent compared with 1.2 percent gain for government workers. These figures were not adjusted for inflation.

Consumer confidence—as measured by the Conference Board—picked up toward the tail end of last year, rising to 92.7 in the fourth quarter, from 80.5 in the first quarter 2014. Meanwhile, the University of Michigan's Consumer Sentiment Index also rose, to its highest value since the first quarter 2007, reaching 89.8 in the fourth quarter.

SIOR INDEX RESULTS

Office and industrial markets reflected the positive economic environment in the fourth quarter. The SIOR Commercial Real Estate Index, representing fourth quarter 2014 data, gained 3.9 points. The national index, based on 10 variables pertinent to the performance of U.S. industrial and office markets, closed at 116.3, the highest value since the first quarter of 2007. An index value of 100 shows a balanced market, meaning that the national index has surpassed its historical average, and is pointing to growing conditions. The figure represents the third quarter with a value above the 100-point threshold since the Great Recession.

With professional and business services employment rising, SIOR office markets registered strong advance. The office index rose 6.3 points, to a value of 106.9. The industrial sector maintained its upward trajectory, with the index rising 1.2 points, to a value of 120.0. The industrial index has been over the 100-point value for the past five quarters, indicating strong demand for space.



Source: SIOR, NAR

SIOR members reported rising fundamentals, with positive developments in leasing and sales.

- Leasing activity exceeded historical levels for half of SIORs who responded to a market survey.
- Rents were flat for office and industrial properties—only 4 percent of SIORs considered that asking rents were below those of one year ago. Meanwhile, 96 percent ascertained that rents were in line with or above long-term averages.
- Vacancies continued declining, with 76 percent reporting lower availability rates.
- Subleasing availability has become marginal, with less than 30 percent of SIORs feeling that tenants benefitted from concessions.
- New construction of office and industrial spaces improved, with almost a third of markets reporting new construction during the quarter.
- Development conditions continued shifting in favor of sellers during the period, with 40 percent of SIORs rating it a seller's market. Investment prices stayed level, with 50 percent of markets being below construction costs.

Improving local economies boosted real estate markets. Only 17 percent of SIORs felt that their local economy was slowing or contracting, while 51 percent considered their economy to be strong and improving. Meanwhile, a strengthening national economy translated into almost half of SIORs feeling that it provided a positive impact upon their markets. In contrast only 14 percent of SIORs experienced negative impact upon their markets from the national economic conditions (the remainder was neutral). Regionally, all four main regions posted gains, with index values above 100, signifying market expansion.

The Midwest overtook the South during the fourth quarter, as the strongest region, with an index which reached a value of 120.7—the highest of all regions. The South had the second highest index value—118.1. The West region experienced the second fastest growth pace during the quarter, with a 6.9 point advance, reaching an index value of 117.0. The Northeast closed the quarter with an index value of 106.5.

Looking ahead at the first quarter of 2015, SIOR members expect the outlook to improve—83 percent of respondents indicated growth in the 1-15 percent range, while 12 percent felt the market will maintain current levels. Only 5 percent of SIORs expected conditions to decline. ■