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Contact:
Alexis Fermanis,
SIOR Director of Communications
afermanis@sior.com

Index Value Continues on Upward Trajectory in the Third Quarter 2015

October, 2015—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 third quarter of 2015. The responses, given by 286 SIOR members, compiled by SIOR in association with the National Association of REALTORS® (NAR), present an accurate depiction of the current industry for the middle of 2015.

Office and industrial markets continued on an upward trajectory in the third quarter; with the SIOR Commercial Real Estate Index increasing 2.3 points (1.9 percent), moving to 120.0 from 118.6, putting the CREI over what is considered the balanced market threshold at 100 points for the sixth consecutive quarter since the last recession, and the highest CREI value since the third quarter of 2007. The SIOR Index measures ten variables pertinent to the performance of U.S. industrial and office markets (see methodology).

Leasing showed a slight improvement in the third quarter of 2015; 56 percent of respondents felt that leasing activity in their market is higher than historic levels; 24 percent found leasing in line with averages, while 20 percent found leasing below normal (compared with 23 percent last quarter).

Rents stay consistent; 4 percent of respondents felt that asking rents are below where they were one year ago; 96 percent feel that asking rents are in line with, or slightly above long-term averages.

Vacancies also stay consistent as 9 percent of respondents thought that vacancy rates are higher than a year ago, 15 percent contend they are the same, and 76 percent say they are lower (compared with 75 percent last quarter).

Subleasing availability continues to decline this quarter. Only 4 percent felt that there is ample sublease space available, compared with 6 percent last quarter; 67 percent considered subleasing to have a small influence on the market.

In terms of tenant concessions—22 percent of respondents felt that tenants were benefiting from moderate concessions to deep discounts to rents (compared with 26 percent last quarter); 34 percent of respondents found a market in normal negotiating balance; 44 percent thought the market favored the landlord.

However, construction activity indicated a rise in new construction; 35 percent indicated rising new construction; 20 percent found development close to historical averages; 20 percent of respondents indicated levels lower than normal, and 25 percent mentioned that there is no new commercial construction in their market.

In terms of development acquisitions, it was a buyer's market according to 15 percent of respondents (18 percent last quarter); 35 percent found it a balanced market, while 50 percent experienced a seller's market (47 percent last quarter). On the investment side, prices were below replacement costs in 4 percent of the markets, compared with 43 percent last quarter; prices were above costs in 37 percent of the markets.

Local economies are impacting real estate markets at a receding pace—13 percent of respondents feel that their local economy is slowing or contracting, compared with the 18 percent from last quarter. Meanwhile, 55 percent considered that the local economy is strong and improving (53 percent last quarter).

The national economy continue to impact local economies —19 percent of respondents felt that the national economy is having a negative impact on their local market (19 percent last quarter); 41 percent felt that the national economy was having a positive impact on their markets.

When asked about the outlook for the next three months, participants pointed to a slightly improving market—6 percent indicated that business was going to be down from current levels, 28 percent of respondents felt the market will be maintaining the current level during the next three months, and 66 percent pointed to expected improvement in the market.

Office Market

The office index rose 7.3 points, to a value of 114 from 106.7 last quarter; the office index has been positively above the 100-point threshold for the past five quarters, the most consecutive quarters for the office market since Fall 2006.

Industrial Market

The industrial sector's improvement slowed, gaining 1.3 points to a value of 126.8; the industrial index has been positively above the 100-point threshold for the past six quarters.

Regional Breakdown

Geographically, all regions increased, except the West. The South posted the highest index value of 125.4 – showing a 5.3 point increase from last quarter; followed by the West, although it had the second highest index with 124.7, it showed a 1.5 point decrease. The Midwest had an index value of 123.5, and finally, the Northeast had the lowest index of 111.3, the result of a 4.5 point advance in market conditions.

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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SIOR
Society of Industrial and Office Realtors ®
1201 New York Ave. NW, Ste 350
Washington, DC 20005-6126
202.449.8200