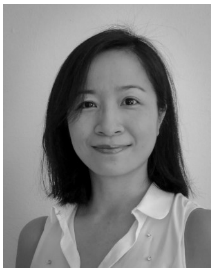
Construction First Glance 2016 Quarter 3

Pre-Release Analysis of Third Quarter 2016 Reis Findings for Construction Activity

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New York — October 14, 2016

(Note: It is my pleasure to introduce Dr Hsiao-shan Yang and Dr Tom LaSalvia as co-authors of this quarter's Construction First Glance report. Hsiao-shan and Tom are in charge of Reis's Acquisition, Development and Construction model, having analyzed over a decade of unique internal data on projects in various stages of completion (and associated delays) across property types. Their insights about where supply growth in various markets are likely to be headed are unrivaled. Enjoy! – Victor Calanog PhD)

New Construction at the Cusp of Economic Change

The third quarter of 2016 was marked by a somewhat consistent trend – a pronounced pullback in new completions, relative to recent quarters. This is readily apparent in the apartment and office sectors, but less so in neighborhood and community shopping centers where supply growth has been anemic for several years anyway. What caused this pullback – especially in multifamily where we were expecting a deluge in new supply?

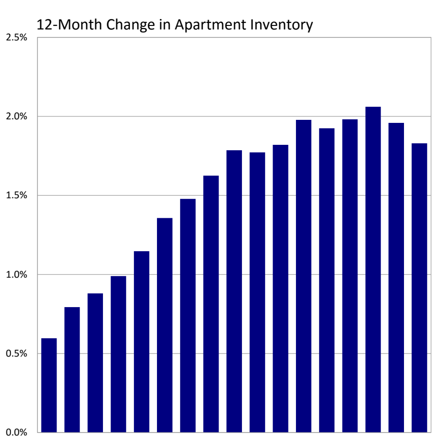
Third Quarter 2016 Completions

	Apartment (units)	Office (square feet)	Retail (square feet)
Q3 2016	38,010	7,226,000	2,552,000
Q2 2016	53,587	8,951,000	1,989,000
Q1 2016	45,975	7,815,000	2,074,000
Q4 2015	56,354	11,129,000	2,427,000

Apartment and office figures are based on 82 metros; retail on 80 metros

Apartment Sector: Consider Lagged Variables

Anemic GDP growth in the first quarter of 2016 accounts for much of the apparent slowdown this quarter; consumer spending and household income growth has been healthy, but firms appear to be postponing long-term decisions on capital investment till domestic uncertainties around the November elections settle down.



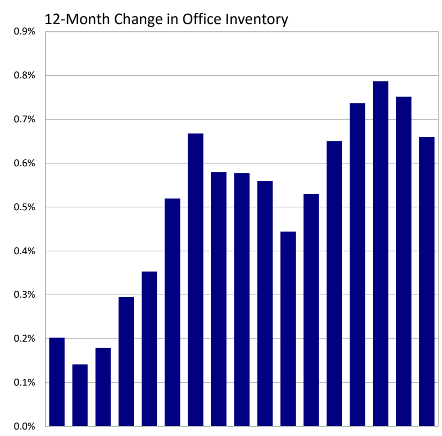
While third quarter figures for multifamily completions also seem to be a step down relative to the preceding three quarters, it should also be noted that there is a lag when it comes to confirming the status of newly completed projects. Because of the volume of new apartment projects in the pipeline, Reis has had to restate quarterly trends *upwards* over the last couple of years, balancing the need to report only what has been confirmed at publication date (one month after the calendar quarter ends) – and being inclusive about what project information is confirmed afterwards. Expect multifamily figures to shift upwards with updated data.

Top Apartment Metros by Completions

Metro	Units	% of Inv.	Inv. growth (q/q)	Inv. growth (y/y)
Houston	4,245	0.78%	0.70%	2.60%
Los Angeles	1,915	0.24%	0.24%	0.96%
Seattle	1,583	0.71%	0.72%	3.67%
San Antonio	1,463	0.86%	0.87%	3.52%
Northern New Jersey	1,304	0.58%	0.58%	2.40%

Houston leads the list for the highest number of new completions for the third quarter, with 4,245 units coming online – and all this even as the metro suffers from depressed energy prices. Vacancies have been rising as a result, from a cyclical low of 5.6% in mid-2014 to its current 6.7% (in the third quarter alone, vacancies spiked by 30 basis points). Los Angeles came in second, and is expected to deliver close to 10,000 units in total by the end of the year – a figure unseen in 25 years.

Office Sector



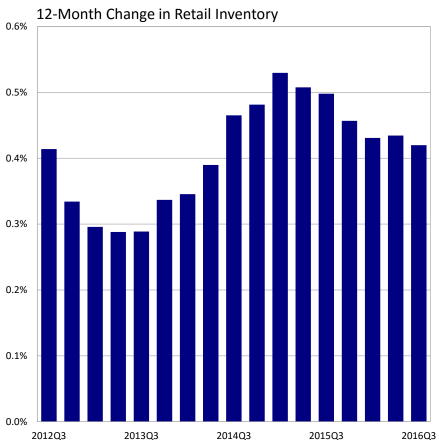
The chart on the right profiling the 12-month change in office inventory mirrors the equivalent chart for the apartment sector. After a hopeful run in late 2015 with three consecutive quarters of more than 9 million square feet of new office space coming online, deliveries have backed off, down to 7.2 million square feet in the third quarter. This is in line with both nonfarm employment and office employment monthly job creation figures falling off this year, relative to 2015.

Top Office Metros by Completions

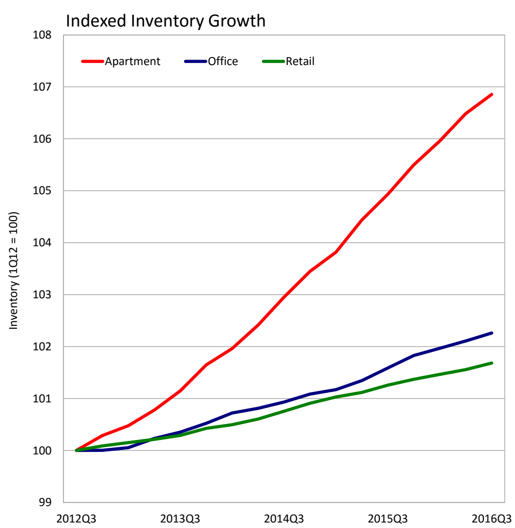
Metro	SF	% of Inv.	Inv. growth (q/q)	Inv. growth (y/y)
Houston	1,526,000	0.85%	0.85%	2.94%
Chicago	783,000	0.32%	0.32%	0.52%
Phoenix	737,000	0.99%	1.00%	2.53%
Boston	693,000	0.53%	0.53%	1.26%
Dallas	487,000	0.30%	0.30%	3.29%

Houston, with its lack of zoning laws, once again leads the top five markets for office completions in the third quarter. It is an unfortunate time to be bringing new office space to the beleaguered market – vacancies now stand at 17.7%, after having risen by 130 basis points in the third quarter alone. The top five markets listed in the table above account for 58.5% of all new office deliveries in Reis's top 82 markets in the third quarter.

Retail Sector



Retail followed the same lackluster trend as in prior quarters, with a scant 2.5 million square feet of new shopping center space coming online in the third quarter. Here the trend has been invariably towards less inventory growth, a pattern that has been operative since late 2014. Unlike multi-family, brick and mortar retail properties do not have the tailwinds of demographics as an advantage. Rather, the threat of e-commerce has been keeping a lid on most new retail developments, except for mixed-use projects that are positioned to deliver experiential value – like the newly opened Kalahari Resorts at the Poconos mountains. Featuring water slides, convention rooms, and hotel rooms, retail space within stands to benefit from a captive market.



Some shopping centers are attempting to pivot to attract tenants offering services that have yet to be disintermediated by the internet, but most are still struggling to find their footing amidst a world where retailers are diverting more of their resources towards online channels. Amazon was recently profiled as planning to build retail brick and mortar stores, offering curbside pickup for online orders,* but those are likely to be freestanding centers that represent even more competition for multi-tenant neighborhood and community centers that are part of our definition of competitive stock.

Top Retail Metros by Completions				
Metro	SF	% of Inv.	Inv. growth (q/q)	Inv. growth (y/y)
Atlanta	299,000	0.36%	0.25%	0.41%
Minneapolis	265,000	0.77%	0.78%	1.21%
Houston	229,000	0.26%	0.26%	1.20%
Dallas	174,000	0.30%	0.30%	0.98%
Phoenix	169,000	0.24%	0.24%	0.33%

With overall figures being so low, the top five markets listed in the table above tend to register new completions that consist only of a few projects.

What Should We Expect in the Near Term?

Any pickup in activity for new completions is likely to be driven by projects that are already in the pipeline, just waiting to come online in what may well be a deluge for the apartment sector in the fourth quarter. Otherwise, developers are likely to pick up the shovel and commence new projects closer to the end of the year or the beginning of 2017 once the dust settles after the US Presidential elections on November 8.

* "Amazon to Expand Grocery Business with New Convenience Stores," Wall Street Journal, October 12, 2016.

Note: History and 2016 inventory addition calculations are for 82 markets for apartment and office; 80 markets for retail.