Sperry Van Ness
Commercial Real Estate Advisors®

REAL ESTATE and the Economy

Five years after the Great Recession reached its conclusion, the American economy is on the cusp of renewed expansion. From the New Economy markets at the heart of American innovation to the Oil and Gas Markets driving renewed energy independence to the slow turnaround in the nation's manufacturing centers, drivers of growth can be found in both large and small markets across the United States. The commercial real estate market has come into its own, not just in the gateway markets that defined the early recovery but with exceptional geographic and industry diversity.

NEW ECONOMY

From the long established hubs of San Jose and the San Francisco Bay area, Boston, Seattle, Portland, and Austin, to the technology clusters and social media hubs emerging in Indianapolis, Salt Lake City and Chattanooga, technology and new media is one of the key sectors driving office absorption in the slow climb back from recession. Major technology markets have posted office vacancy rates significantly lower than the national average, and have outpaced the country rent growth as well. Developers are responding, with nearly half of the office space under construction today occurring in these centers of innovation. The metros able to capture a sizeable share of the high tech industry are also some of the markets enjoying the strongest population and job growth. Software development and delivery of online services can occur in virtually any location with high-speed internet access, which gives many technology employers and skilled workers the freedom to select a home market based on quality of life issues ranging from the cost of living and availability of housing, to climate and access to educational resources, recreation and nightlife. In other words, the mild weather and 24-hour urban lifestyle that attracts highly skilled professionals to San Francisco also attracts employers pursuing those workers. As technology clusters form and exert their own gravity in attracting firms, new employers add job opportunities that bring even more workers in a cycle of economic expansion. Tech workers' education, skill sets and high salaries can lead to economic bifurcation at the local level, however. The herd of investors in technology markets is busy upgrading or developing real estate to serve technology companies and their employees with highly priced office space, apartments, retail, dining and entertainment, in some cases flooding the hot urban core markets with luxury apartments. Not surprisingly, tradespeople and many non-technology service workers in markets like Boston, San Jose, and Austin, will struggle to cope with apartment rents and single-family home prices that have risen with the incomes of the tech workforce. This creates contrarian opportunities to serve existing and increasingly unmet demand for mid-tier apartments, value oriented retail and modern office space in subprime locations.

MARKET CLUSTERS

- ENERGY CENTERS
- FINANCIAL CENTERS
- GOVERNMENT CENTERS
- MANUFACTURING CENTERS
- SUN BELT MARKETS
- NEW ECONOMY

ENERGY CENTERS

The Bakken oil fields of North Dakota join Eagle Ford in Texas and Marcellus across the Appalachian Basin as part of a geographically disparate assemblage of markets that are enjoying robust economic growth fueled by the energy sector. Houston has been riding the energy train for decades, but advancements in drilling technology and alternative energy sources are producing gushers of wealth generation in some unlikely places. In contrast with technology centers, where economic rifts have emerged between sectors of the economy catering to highly paid technology workers and those in lower-paying occupations, energy-centric markets seem to have done a better job of spreading wealth across economic brackets and industries. In Denver, for example, energy firms occupy roughly one third of all office space and as much as a fifth of the local industrial inventory, while the swelling ranks of young workers moving to the metro for tech and energy jobs has helped to push the apartment vacancy rate to cyclical lows. In Houston, retail developers have begun to construct new power centers to serve the expansion needs of mid-priced retailers, bucking the general malaise that has halted expansions by middle market store chains in other markets since the recession. While the potential for increased regulation and excess supply pose contrasting risks, American energy markets are poised for continued economic growth, perhaps with less volatility than in past cycles. Natural gas and oil deposits captured in shale rock formations, previously deemed inaccessible, are yielding massive volumes of fossil fuels and radically changing economists' projections for production. The nation is on track to supplant Russia as the world's leading gas producer, and low prices are driving production for a range of materials produced in gas-powered refineries and plants. The changes have been transformative in many cases, energizing population growth and fueling housing shortages and meteoric rent growth.

GOVERNMENT CENTER

Growth and spending by federal agencies fueled optimism among office investors in and around Washington during the recession, at a time when most state governments were laying off workers and slashing budgets in response to diminished revenue. The scales of prosperity are tipping in the other direction in 2014, however. Leaner state governments are rebuilding their revenue streams as the economy gains momentum, from gradually increasing sales tax volumes to rising property tax collections related to a recovery in real estate values. In the nation's capital, however, federal pay freezes, layoffs and sequestration cuts have highlighted the economic ramifications of political deadlock. Landlords and investors working under the assumption of growing government agency demand for office space in the coming years have been forced to reconsider those projections. In fact, several federal departments are now seeking to implement some of the same strategies of shared workstations, telecommuting and use of contract workers that have reduced per-person space requirements in the private sector. Washington is not down for the count, however. The Beltway economy is more diverse than its base industry, with emerging and established tech companies among the classes of firms helping to pick up the slack from smaller government.

FINANCIAL CENTER

There is some wishful thinking in the real estate industry concerning the recovery of the financial services sector. Space demand has largely bounced back in New York City, but the methodical pace of economic growth since the downturn, increased regulation and squeezed profit margins have left financial services providers reluctant to take on additional employees or space. Gone for now is the pre-recessionary urge to warehouse leased space for anticipated, rapid growth. Consolidation aimed at cementing specialized service offerings at large banks and providing the advantages of scale suggests that financial services job gains in one market may come at the expense of jobs lost in other markets. Even so, banking is again producing net employment gains in several markets, from Charlotte (the second-largest financial market after New York City) and Raleigh, to markets less prominent in the sector, including Salt Lake City, Indianapolis and Phoenix. Charlotte in particular suffered a severe contraction in office demand during the Great Recession and is still in the early stages of its recovery. For investors who missed the boat in acquiring a stake in the high tech or energy markets before cap rate compression eroded potential returns, Charlotte and other financial centers still present opportunities to get in on the ground floor, while financial services employers are still finding their footing. After all, expected growth in financial services is one of the reasons Charlotte's population of Millennials is expected to grow by 15 percent over the next five years, or four times the national average. As financial service providers seek to enhance data security, efficiency and customer convenience through improved technology, job creation within the sector may extend to markets, like Raleigh, that offer a large pool of workers with the skills to design and implement those new systems.

MANUFACTURING CENTERS

The trend of offshoring manufacturing operations is beginning to reverse far more rapidly than economists had predicted, as rising wages in China and an appreciating Yuan increase manufacturers' costs. One of the largest examples is General Electric, which has invested more than $1 billion to shift its manufacturing of major appliances back to the United States. At the same time, reduced costs are making marginal American factories profitable again. Advanced drilling technologies have unlocked huge reserves of natural gas and oil in the United States, reducing the need for imported fuel and lowering costs to many of the nation's manufacturers, both for gas-powered industrial operations and for raw materials used in the production of plastics and other petrochemical products. In Detroit, manufacturing output surpassed its pre-recession peak in 2011, and the market's dependence on automakers has been mitigated to some degree by a more diverse manufacturing base that includes expanded textiles and furniture production. Detroit no longer has a monopoly on the auto sector. Automotive manufacturing is also fueling job growth and demand for space in Nashville, San Antonio and other markets. Population growth and retailer efforts to shorten supply chains are driving demand for food production and packaging operations in virtually every large population center. The desire for shorter supply chains to serve U.S. markets extends to foreign-based manufacturers as well: Lenovo Group, the China-based owner of the former IBM Personal Computing Division, in 2013 opened a 240,000-square-foot facility near Greensboro that will produce, service and distribute its PCs.

SUN BELT MARKETS

Sun Belt populations are growing again following a slowdown during the housing crisis, which reduced mobility for many Americans. Mild winters, better infrastructure than the Northeast and Midwest, and a relatively low cost of living have historically fostered migration to the warm states of the south and southwest. Today those same factors are part of the attraction drawing employers and workers to the expanding energy economies of the major Texas metros, to high tech hubs in Research Triangle Park and Austin, and to Las Vegas, Phoenix, and Tucson, where population explosions are driving demand for new apartments and retail space. With a resurgence in manufacturing, some Sun Belt states have stepped up incentives to attract specific industries: for its part, North Carolina has set its sights on aerospace companies. Mississippi is nurturing an automotive cluster that includes manufacturing by Nissan, assembly plants for Toyota, PACCAR and GreenTech Automotive, and planned plants by Yokohama Tire and Feuer Powertrain, a German parts maker. The South Florida metros have worked through the surplus residential condominiums built before the crash and are now experiencing renewed demand for retail space, as well as offices along the state's emerging high tech corridor that stretches from Orlando to Tampa. The pending opening of an expanded Panama Canal is driving intermodal development and infrastructure improvements at several ports in Florida and along the Gulf Coast, as well as distribution center construction along logistics channels.

IT'S A DIFFERENT WORLD OUT THERE.

It requires a different kind of commercial real estate firm working on your behalf in order to be successful. The Lipsey Company has ranked the Sperry Van Ness® organization as one of the most recognized commercial real estate brands in the US for a reason–we know how to deliver a certainty of execution for our clients. Sperry Van Ness International Corporation is one of the largest commercial real estate franchisers with more than 180 locations in 200 markets.

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