commercial investment

2015 hampton roads real estate market review

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General Overview

Overall conditions remained outstanding for commercial real estate investment in 2014, with low interest rates and low levels of new construction, combined with significant increases in job growth and investor allocations to commercial properties. Commercial real estate fundamentals also showed continued recovery, led by multi-family with vacancy rate below five percent.

Lenders have shown heightened confidence in commercial real estate with low-cost and flexible offerings to facilitate investments. In addition to attractive longer term, fixed-rate financing, lenders today can also offer creative and compelling shorter-term structures.

NATIONAL OVERVIEW

National sales transactions of significant commercial property increased by 17 percent in 2014, and returned volume to 2006 levels. The chart below shows that sales volume exceeded $420 billion in 2014. While the 2014 volume was lower than the historical peak volume of 2007, the non-portfolio volume in 2014 was actually higher than that of 2007.

INVESTMENTS PROSPECTS

Within the 2014 sales volume, the property sectors with the highest volume were office ($118.6 billion) and multi-family ($112 billion), both which also had substantial year-over-year increases in volume. The other major property sectors of industrial and retail also experienced strong year-over-year growth.

Even with this strong evidence of broad-based market recovery, investors remain selective about market risks within each property type. According to the PWC/Urban Land Institute Emerging Trends survey, investors continue to prioritize industrial and multi-family property types highest, as indicated in the chart below.

To analyze why investors assign the highest prospects to the industrial and multi-family property types, it is helpful to review how each of the major property types have recovered since the peak vacancy experienced during the recession. For each of the property types, the table below indicates that the peak vacancy rate occurred between 2009 and 2011. According to CBRE Research, the industrial and multi-family property types have experienced the greatest decline in vacancy, which investors would interpret as a driver of stronger performance ahead including support for increasing occupancy and rental rates.

<table>
<thead>
<tr>
<th>Product Type</th>
<th>Vacancy Rate as of Q3 2014</th>
<th>Peak Vacancy Rate during last recession</th>
<th>% Change since the peak</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial</td>
<td>6.7%</td>
<td>14.5% (Q4 2010)</td>
<td>-7.8%</td>
</tr>
<tr>
<td>Multi-family</td>
<td>4.7%</td>
<td>7.5% (Q4 2009)</td>
<td>-2.8%</td>
</tr>
<tr>
<td>Office</td>
<td>14.1%</td>
<td>16.6% (Q1 2010)</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Retail</td>
<td>11.5%</td>
<td>13.2% (Q2 2011)</td>
<td>-1.7%</td>
</tr>
</tbody>
</table>

Source: CBRE Research, Q3 2014
The preceding statistics on overall volume and relative property type rankings represent overall national performance, not all markets across the country are perceived equally. A high concentration of overall investment volume, and the year-over-year increases, still favor the six major metro markets of the U.S. These major markets are New York, Washington D.C., Boston, Chicago, Los Angeles, and San Francisco. With higher demand, major markets have also seen a disproportionately higher increase in pricing. In fact, according to the Real Capital Analytics and Moody’s Commercial Pricing Index, average pricing in major markets is currently over 50 percent higher than average pricing in non-major markets.

Outside of major markets, investors continue to use pace of job growth as a critical measure of markets in which they should invest. The below chart shows that seven of the top 10 fastest-growing job markets are in Texas and Florida. The other three are Nashville, Salt Lake Cit, and Raleigh.

Based on this national CBRE Research, it is reasonable to expect that these 10 secondary markets will attract a disproportionate level of investment volume of non-major markets, which should also lead to higher price increases as well.

2015 begins with a continuation of great optimism for conditions supporting commercial real estate investment. That optimism is balanced with a watchful eye on interest rates and the primary economic indicators of job and wage growth. Investors should continue to be attracted to the overall income returns and diversification benefits of commercial real estate, yet volumes and pricing will continue to vary by property type and market area.
The top investment sales story of 2014 was the continued strong investor demand for multi-family assets. CBRE Research tracked 12 multi-family assets of $20 million or more sold in 2014 including three sales of $40 million or more. National demographic trends continue to support increased apartment absorption, and we expect continued frothy interest in multi-family sales in 2015.

A second top investment sales story of 2014 was the inclusion of major Hampton Roads assets in national portfolio sales. MacArthur Center in Norfolk was acquired by Starwood as part of a national $1.4 billion portfolio sale. Similarly, Landstown Commons in Virginia Beach changed hands with Kite Realty Group merging with Inland Diversified Realty Trust in a $2.1 billion transaction. The largest such national transaction with Hampton Roads assets included a large portfolio of industrial and office/flex assets throughout the region which were part of the $8.1 billion national portfolio sale from Blackstone to GIC, Singapore’s sovereign wealth fund.

Outside of the vibrant multi-family sector and the assets sold as part of national portfolio, Hampton Roads investment sales of office, industrial, and retail assets was extremely modest during 2014. No industrial assets of $5 million or more traded in 2014. On the office front, only two sales of $10 million or more occurred in 2014 led by the sale of Town Point Center in downtown Norfolk. Similarly, on the retail front, only two sales of $10 million or more occurred in 2014, although one of them was a major sale with Tabani Group acquiring Peninsula Town Center in Hampton.

CBRE expects a significant increase in regional investment sales within the office, industrial, and retail property types in Hampton Roads in 2015. Interest rates remain historically low, and local market fundamentals continue to improve with increased absorption and minimal new speculative construction. National investment interest is particularly strong for class A industrial properties with expectations of accelerating growth for the Port of Virginia with the Panama Canal expansion project expected to be completed within the next two years. We are also seeing increased interest for office and retail investment sales locally, particularly as pricing for similar assets in higher growth secondary markets increases beyond the return expectation of many private investors.