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SIOR Commercial R.E. Index shows office market remains strong

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The Summer 2007 Commercial Real Estate Index compiled by the Society of Industrial and Office Realtors (SIOR) of the National Association of Realtors (NAR) posted the steepest quarterly decline since SIOR began its indexation project in late 2005. The national index, which measures 10 variables pertinent to the performance of U.S. industrial and office markets, dropped 4.49 points to a summer reading of just 113.70. This is the weakest score yet seen for SIOR's national index.

The SIOR Commercial Real Estate Index is a diffusion index where a score of 100 indicates markets in balance. Therefore, a score of 113.70 does reflect positive conditions in the commercial real estate industry for landlords and sellers. But it is clear that the strong momentum enjoyed until recently has been broken at least temporarily. The weakness was broad-based, with all 10 components of the index registering lower scores than in the spring. According to SIOR survey respondents, the recent index showed slower leasing activity caused by a softening in the local and national economies. The index was based on replies from 367 SIOR participants who provided their views on market conditions in their respective markets in late July and early August.

The industrial market was hardest hit scoring only 112.34 in the summer survey, a decline of 6.99 points from the spring. Warehouse and distribution centers experienced a significant slowdown in demand, stalling the decline in the vacancy trend it had been enjoying since the economy emerged from recession. While there were signs of modest improvement in rental rates, rental growth moderated. This may have been caused by the contractions in the home-building industry and in durable goods spending.

The office market, dipping less than one point from the spring to 114.95, appeared to fare better. Leasing activity in the office market was actually up slightly, with rent and vacancy measures improving. Investment values were also rated as strengthening. However, local and national economic conditions are weakening the market, setting the stage for a less robust office market later this year.

How Is the Country Faring by Region?

All four major regions of the country saw their index scores slip - West and South reached new lows. However, these two regions remained marginally stronger than the Northeast, and much stronger than the troubled Midwest.

The West led all regions with a score of 122.99, down 0.76 points from the spring and far below the peak of 136.90 it registered in the winter of 2006, when housing markets were booming, retail sales were robust, and international trade was expanding. This quarter marked the sixth consecutive quarter of decline in the West's index score.

After two quarters as the nation's leading regional score, the South saw its index slip to 121.32, a 4.06 point drop in the past quarter and significantly below its excellent 130.45 value just six months

ago. The Sunbelt's reliance on vigorous home-building as a component of its economy turns out to be a two-edged sword, now cutting into its commercial markets in a measurable way.

By contrast, the Northeast index score of 112.95, which fell 2.16 points since the spring, was slightly higher than the mid-point of its historical range. This densely populated quadrant of the country is more demographically mature, and features some of the largest and healthiest office markets in the country. It is comparatively less dependent upon the industrial sector of the commercial real estate market. While sub-prime lending and the resultant credit market turmoil affect financial industry employment, such demand-side effects on the market were not yet evident in the summer 2007 results.

Finally, the Midwest, where the troubled U.S. auto industry is centered, has emerged as one of the most intense housing foreclosure clusters in the nation. This has aborted what appeared to be an encouraging commercial property revival just three months ago. The Midwest, which had scored an index value of 104.58 in the spring, plunged to 94.49, a loss of more than 10 points. Such a precipitous drop is the steepest in any region, whether it is in the industrial or office market, in the eight quarters in which the SIOR Commercial Real Estate Index survey has been conducted. The summer 2007 index for the Midwest is close to the low that this region saw in our first survey in the fall of 2005.

Although quarterly variation is a feature of the SIOR Index, and a rebound later in the year cannot be ruled out, there is obviously cause for concern for landlords and sellers that so many of the regions are at or near their two-year lows, and that the overall index and the industrial property index posted their lowest scores since our survey was initiated. While real estate is less volatile than investment markets like stocks and bonds, commercial property is cyclical and is prone to swings in concert with the national and local economies. The SIOR Commercial Property Index warrants close and careful attention through the remainder of the year.

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