THE COMMERCIAL REAL ESTATE ENVIRONMENT KEEPS GETTING BETTER

RESEARCH REPORT - WEEKLY ECONOMIC UPDATE

A Cushman & Wakefield Research Publication

AUGUST 10, 2015

- The economic environment for commercial real estate keeps getting better. The U.S. economy is on pace to add more than 2.5 million jobs in 2015, boosting demand for all kinds of commercial real estate, and setting the stage for tightening markets and rising rents.
- Employment in the three main office-using sectors (financial, professional and business services, and information) grew by 59,000 jobs, indicating continuing strong demand growth for office space across the U.S.
- The July U.S. employment report virtually guarantees that the Federal Reserve's Open Market Committee will raise short term interest rates at their next meeting in September.
- Wages continue to increase, but at a moderate pace. Average hourly earnings rose 0.2% in July and were up 2.1% from a year ago, the seventh consecutive month that earnings were up 2.0% or more from a year earlier.
- Labor markets continue to tighten. The unemployment rate held steady at 5.3% and the underemployment rate (unemployment plus discouraged workers and others) dropped to 10.4%, the lowest level since June 2008.
- Signs point to faster wage growth in the second half of 2015, which should boost income and spending at a faster clip during the third and fourth quarters.

U.S. commercial real estate markets across the U.S. continued to improve in the second quarter. One important reason for this has been rising employment driving higher demand. That trend continued in July.

The U.S. economy continues to add jobs at a healthy pace, indicating that businesses are confident that demand for their products is rising and they need to increase output. In July, the economy added 215,000 jobs, the third consecutive month that nonfarm payroll employment increased by more than 200,000 jobs. Since winter ended in March, employment has increased an average of 223,000 jobs per month, up from 195,000 in the first three months of the year. Job growth in both May and June was revised slightly higher. Compared to a year ago, there are 2.9 million more people on payrolls, continuing the trend of strong job growth that emerged in the second quarter of 2014.

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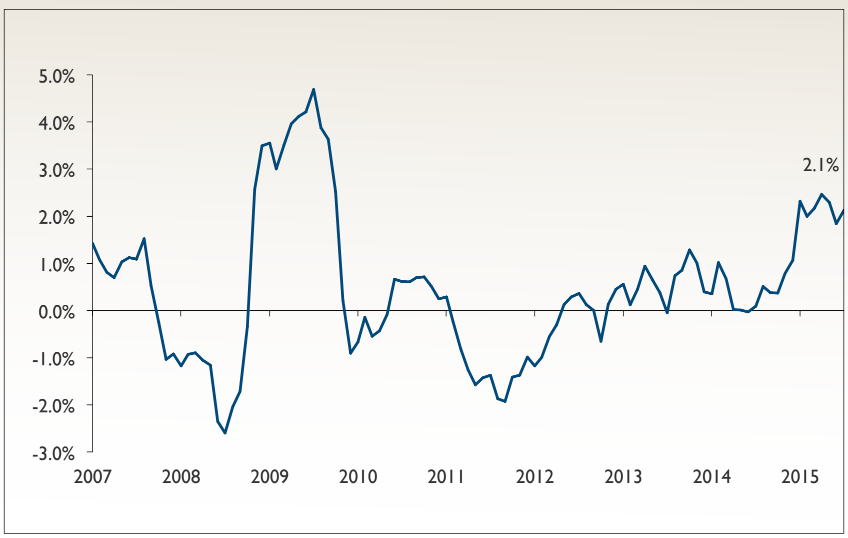
INFLATION ADJUSTED EARNINGS GROWTH PERCENT CHANGE FROM A YEAR AGO



Source: U.S. Bureau of Labor Statistics

The details of the July employment report were for the most part positive.

- Job growth was broad-based in July, with 64.4% of the industries tracked by the labor department reporting higher employment in July than June, the highest percentage since last December.
- The unemployment rate remained stable at 5.3%, the lowest level since early 2008.
- Employment in manufacturing increased by 15,000 jobs, the fastest pace since January. Over the past 12 months, the economy has added 159,000 manufacturing jobs, bringing employment in this important sector to its highest level since February 2009.
- Office-using employment – the sum of financial services, information and professional and business services – rose by 59,000 jobs as all three sectors grew. Financial services employment has accelerated, and over the past 12 months has increased by 156,000 jobs – marking the fifth consecutive month that annual growth has exceeded 155,000. We have not seen that kind of growth in financial services since 2006.

INDUSTRIES ADDING JOBS

OFFICE-USING EMPLOYMENT

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> Employment in the three main office-using sectors (financial, professional and business services, and information) grew by 59,000 jobs, indicating continuing strong demand growth for office space across the U.S.

The lack of growth in wages has been one of the biggest disappointments of the current economic expansion, and while this employment report had some positive signs on the earnings front, we need to see more growth before we can say wages are growing strongly. In July, average hourly earnings increased 0.2% after a small decline in June.

Compared to a year ago, earnings were up 2.1%. The good news is that the increase in earnings is a true increase in spending power because there is no inflation. In June, the consumer price index stood 0.1% above its year-earlier level. With no inflation, higher earnings equals more spending power.

Currently, inflation-adjusted earnings are growing at their fastest pace since 2009, however, the overall pace of wage growth is still low by historical standards. In 2007 and 2008 earnings were rising 3.0% to 3.5%.

Last week we discussed the drivers of Federal Reserve monetary policy, noting that in the FOMC's announcement after its latest meeting, the focus was clearly on labor markets. As long as employment continues to grow at a healthy pace, there is no need to hold interest rates as low as they are. Today's report supports the expectation that the FOMC will raise the Federal funds rate at the next meeting in September. Unless something disastrous happens over the next five weeks, we expect the Fed to start increasing interest rates in September and most probably raise rates again in the fourth quarter.

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The economy is in solid growth mode. The only missing component is stronger wage growth to support more consumer spending. All the data point to faster wage growth, but it is not happening yet.

The current environment is a great one for commercial real estate.

- Job growth is boosting demand for space in all types of commercial real estate. Office space demand is rising because of rising employment in office-using industries.
- Demand for retail and industrial space is also benefiting from strong job growth. More people working means more income in the economy which is increasing consumer spending. Although U.S. GDP growth in the second quarter was a disappointing 2.3% annual rate, consumer spending increased at a 2.9% annual rate on the back of rising employment. Consumers are spending more in stores and online.
- Hotel and multifamily demand also receive a boost from strong job growth. In the hotel sector, more travel for business and pleasure will boost room demand. For the multifamily sector, as more people get jobs there should be more household formations and more demand for apartments.

A strong labor market will lead to higher interest rates and is a great environment for the commercial real estate industry. That is where we are today and expect to be through the second half of 2015.

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