BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *Austin Metro Area*

2H/20

Steady Inbound Population Migration and Business Move-Ins Support Long-Term Outlook; Investors Set Sights on Affluent Northern Suburbs

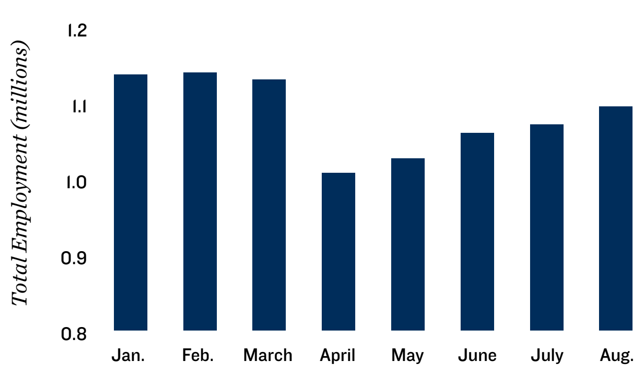
Labor market resilience reiterates metro performance. Entering this year the unemployment rate was 2.6 percent, a nearly 20-year low for the metro. Job losses induced by the health crisis pushed the rate up to 12.6 percent in April, but it has since settled back down to 4.8 percent as of August. Austin has been able to recover jobs more quickly due to Texas' comparatively short lockdown period and early reopening. Several sectors, such as financial activities and manufacturing, have actually grown year over year ended in August. However, the leisure and hospitality sector remains down 32,100 jobs over this same time period. The long-term outlook for Austin's labor market remains strong, though, as robust in-migration will continue to lure firms. Defense contractor BAE Systems recently announced plans to hire 1,400 employees upon completion of its campus in north Austin.

The University area faces challenges amid the health crisis. While the University of Texas brought students back for the fall semester, a surge in COVID-19 cases could lead the school to reverse course. Additionally, the football stadium that typically has nearly 100,000 attendees per game will only accommodate 25 percent capacity this year. Store owners in the area will face burdens with fewer students on campus and less activity on football weekends. Retail vacancy in the area rose 60 basis points in the second quarter to 5.2 percent, and it will likely face additional pressure in the short term. Students choosing to learn virtually and staff layoffs are also weighing on apartment fundamentals, with vacancy rising 230 basis points and the average rent dropping 4.5 percent in the second quarter.

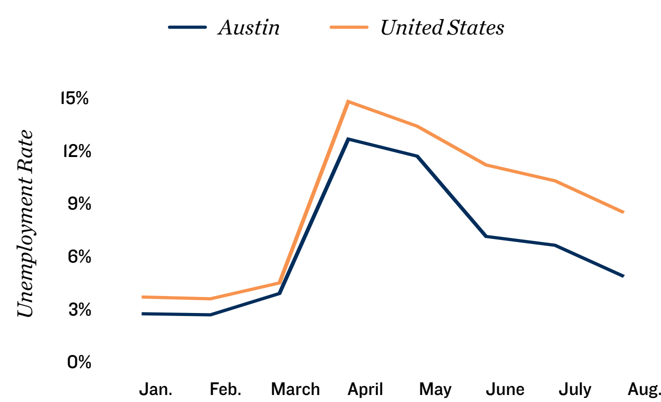
Tesla gigafactory could turn investors' eyes to Southeast Austin. The electric car manufacturer is building a plant near Hornsby Bend that will employ 5,000 people upon completion in 2021. This should fuel household formation in the area, benefiting retail and multifamily owners. The retail segment in Southeast Austin has already responded to the news, with vacancy falling 130 basis points in the first half of this year to 1.8 percent, pushing the average asking rent up 12.7 percent in just a six-month span. Tesla's move-in could also draw employers to the Southeast submarket, where fundamentals had already been improving. Office vacancy is down 730 basis points over the trailing 24 months ended in the second quarter to 7.5 percent, and the average rent grew 33.8 percent over that span.

Robust demographics keep buyers focused on Austin assets. In the second quarter, well-capitalized apartment investors focused on affluent suburbs in Williamson County, such as Round Rock and Georgetown. Investors seeking comparatively lower entry costs in the urban core preferred pre-1990 builds in east Austin neighborhoods. Industrial investors sought assets near Interstate 35, primarily targeting San Marcos and Round Rock for warehouse space with efficient access to population hubs. Single-tenant retail investors also looked south to San Marcos and Buda, finding assets in the $1 million to $5 million range. Meanwhile strip and power centers most frequently traded in northern suburbs such as Cedar Park and Round Rock. Office transactions were few and far between in the second quarter; however, the deals that were completed revealed a preference for smaller floor plans below 40,000 square feet.

2020 Employment Trends

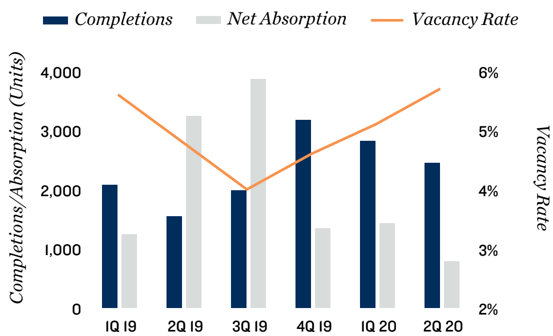


2020 Unemployment Rate Trends

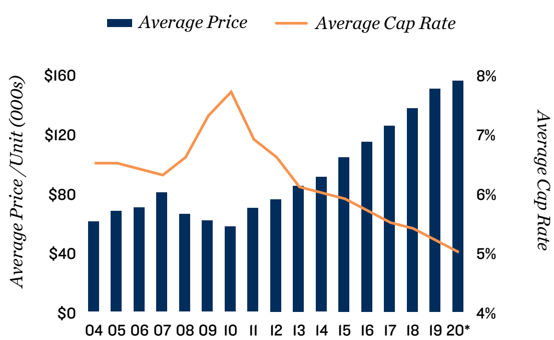


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

Sources: Real Page Inc.; CoStar Group, Inc.; Real Capital Analytics

APARTMENT

Supply Additions Amid Slow Leasing Push Up Vacancy, Weighing on Rent Growth in the Short Term

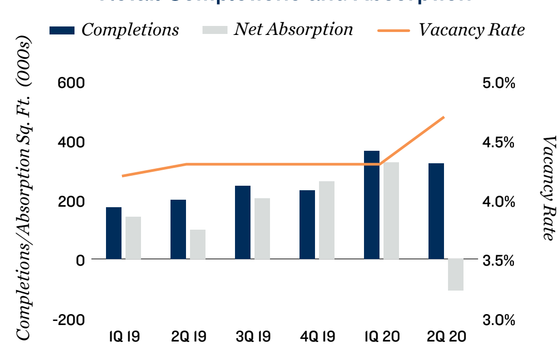
- In the second quarter, roughly 2,450 units were completed. Over the past 12 months ended in June, inventory has grown by 4.2 percent, which is the fastest pace in the nation.
- The vacancy rate rose 60 basis points in the second quarter to 5.7 percent, with the Downtown/University area posting a 230-basis-point jump. However, vacancy fell 10 basis points in the Pflugerville/Wells Branch locale.
- The average effective rent dropped 2.0 percent in the second quarter to $1,285 per unit. One bright spot in the market was the Round Rock/Georgetown area, where rent grew 0.7 percent in the quarter.
- The trailing-12-month average sale price reached $155,000 per unit in June, as the average cap rate dropped 30 basis points year over year to 5.0 percent. Upper-tier space built after 2000 traded well above the metro average at $250,000 per unit.
- Investors with strong buying power continued to scour north Austin despite the economic disruption, with a handful of assets trading with prices exceeding $50 million. Most often these deals were for 300-plus unit Class A complexes in Round Rock and Pflugerville.

RETAIL

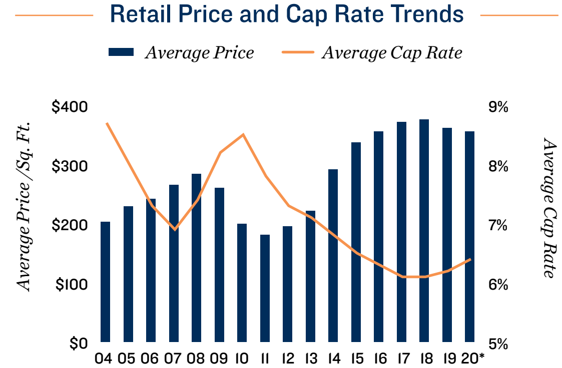
Net Absorption Dips Negative for the First Time in Nearly a Decade; More Challenges on the Horizon

- Roughly 323,000 square feet of space was added in the second quarter, significantly more than the 199,000 square feet delivered in the period one year prior. Of the space completed, more than 90 percent was single-tenant.
- The vacancy rate rose 40 basis points to 4.7 percent in the second quarter as net absorption dipped negative for the first time since 2011. South Austin had the largest adjustment as the location's vacancy rate rose 60 basis points in the quarter.
- The average asking rent rose 1.0 percent in the second quarter to $22.11 per square foot, with the multi-tenant segment posting a 1.4 percent growth between April and June. The single-tenant segment posted a 0.8 percent gain in the second quarter.
- In the second quarter, the trailing-12-month average sale price was $355 per square foot, down 3.6 percent year over year. Meanwhile, the average multi-tenant cap rate was 6.7 percent, up 10 basis points over the past four quarters, and the average single-tenant cap rate was 6.1 percent, up 30 basis points year over year.
- In March and April amid the peak of the retail shutdown, 1031-exchange buyers favored triple-net deals. Single-tenant assets near the Domain and in the central business district were most frequently targeted.

Retail Completions and Absorption



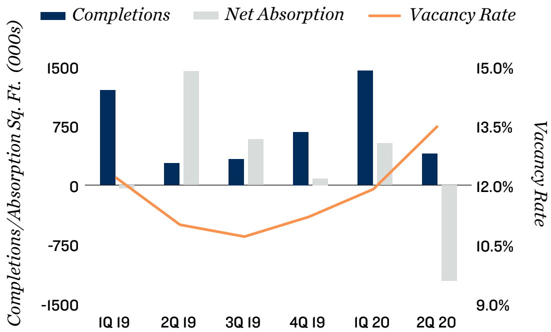
Retail Price and Cap Rate Trends



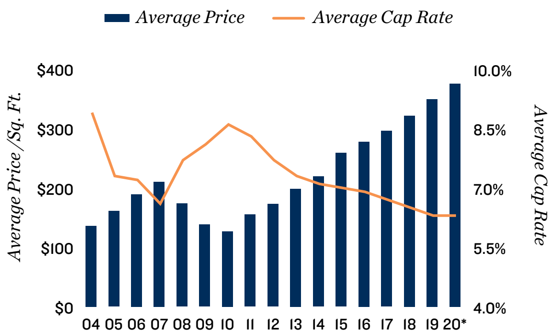
** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

Office Completions and Absorption



Office Price and Cap Rate Trends



** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

OFFICE

Vacancy Jumps to a Five-Year High as New Development Presents Headwinds Amid Shift to Remote Working

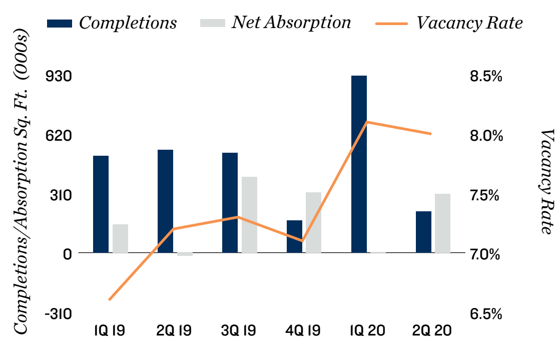
- After nearly 1.5 million square feet of space was delivered in the first quarter, completions fell sharply to 397,000 square feet in the second quarter. Over half of the space added in that span was in south Austin.
- In the second quarter, the vacancy rate moved up 160 basis points to 13.5 percent, the highest rate recorded since 2014. The CBD and Georgetown submarkets each posted vacancy jumps exceeding 250 basis points.
- The average asking rent fell 0.3 percent in the second quarter to $36.42 per square foot. Northeast Austin, East Austin and Georgetown had the greatest rent reductions in the quarter, with average rates falling more than 3 percent in these areas.
- The trailing-12-month average sale price was $375 per square foot ended in June, up nearly 12 percent year over year. The average cap rate was 6.3 percent, down 10 basis points over the past four quarters.
- Class B assets traded most frequently among the three property tiers in the first half of this year. Few Class A deals traded hands as institutions paused acquisitions amid the disruption.

INDUSTRIAL

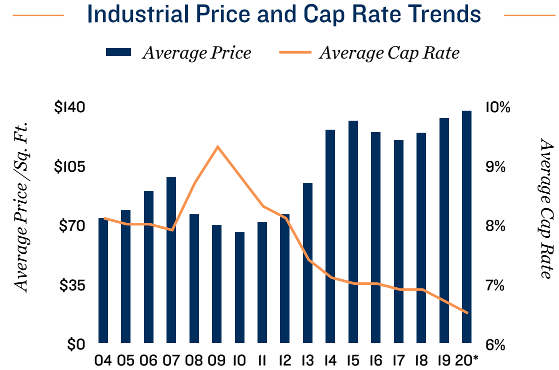
Rent Grew in the Second Quarter as Vacancy Dipped, Supported by the Rise in Online Shopping

- Completions fell to 217,000 square feet in the second quarter after 923,000 square feet was added in the first quarter of the year. Round Rock received nearly 85 percent of the space added in the second quarter.
- The vacancy rate fell 10 basis points in the second quarter to 8.0 percent after jumping 100 basis points in the previous three-month span. Cedar Park and Southeast Austin each posted second-quarter contractions of at least 200 basis points.
- In the second quarter, the average asking rent grew 2.6 percent to $10.73 per square foot, with Hays and Bastrop counties both logging double-digit gains. On the other hand, the average asking rent fell substantially in the Northwest Corridor and Central Austin in April through June.
- At the end of June, the trailing-12-month average sale price was $137 per square foot, with the average cap rate down 30 basis points year over year to 6.5 percent. Warehouses traded below the metro average at $95 per square foot.
- The Northeast Corridor was a focal point for buyers seeking distribution space. The rise in online shopping and proximity to population hubs have made these types of assets more appealing in the locale.

Industrial Completions and Absorption



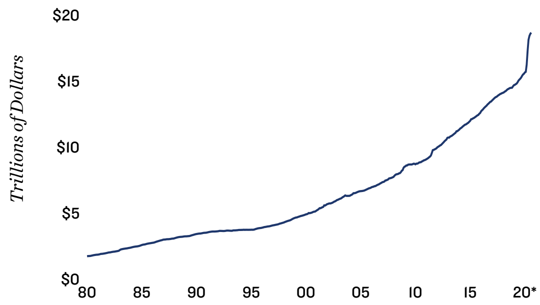
Industrial Price and Cap Rate Trends



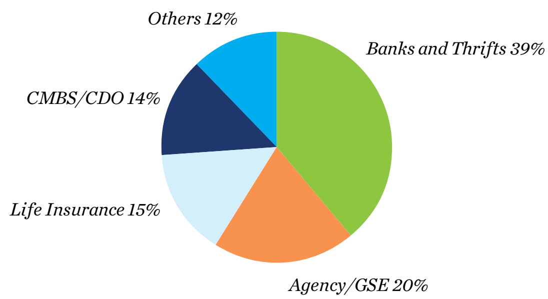
** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

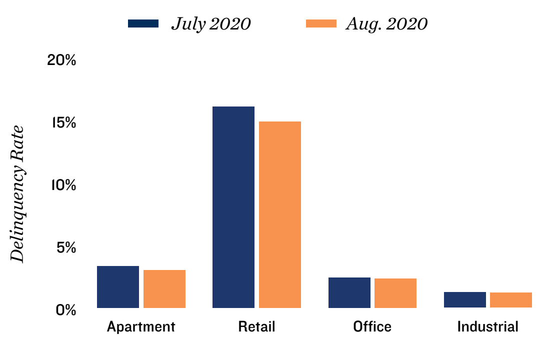
Fed Sharply Increases Money Supply During Health Crisis



Total Outstanding Mortgage Debt**



30+ Day CMBS Delinquency Rate



** Through August*

*** As of second quarter*

Sources: Federal Reserve; Mortgage Bankers Association; Trepp

CAPITAL MARKETS

By TONY SOLOMON, Senior Vice President, Marcus & Millichap Capital Corporation

- **The capital markets are thawing relative to the height of the crisis.** Most lenders have adapted to dispersed working, and more information on the economic damage of the pandemic is affording buyers, sellers, and lenders risk and price clarity for large swaths of the commercial real estate sector. Both property performance and location can impact financing as some areas of the country outperform and the pace of recovery remains in doubt for others. Capital is readily available for assets that perform on or near par with pre-crisis levels, especially industrial assets, which buyers and lenders see as a safe part of their portfolios. Single-tenant retail with national credit tenants are also heavily favored by lenders, followed by grocery-anchored multi-tenant properties. Apartment rent rolls are more heavily examined, though financing remains available from the agencies and banks. Loans are more readily accessible for suburban office, while core buildings are more difficult to leverage. Some lenders continue to operate in the hospitality space, but obtaining financing is challenging.
- **Loan-to-value ratios were already declining prior to the pandemic and average 60 percent.** Freddie Mac is offering rates in the high-2 percent to high-3 percent range for seven-year terms. Debt service coverage is approximately 1.35 times. Life insurance companies will finance below 3 percent for apartments in some cases, and peak at 4 percent for retail. CMBS loans are available, though strict criteria makes deals more difficult to find. Rates bottom in the low-3 percent range for apartment and industrial and rise to 4 percent for office.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Mortgage Bankers Association; Real Capital Analytics; RealPage, Inc.; Trepp

Price: $250