BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *San Antonio Metro Area*

2H/20

San Antonio's Economic Recovery Hinges on the Uncertain Tourism Revival, Yet the Quick Reopening Mitigated the Initial Damage

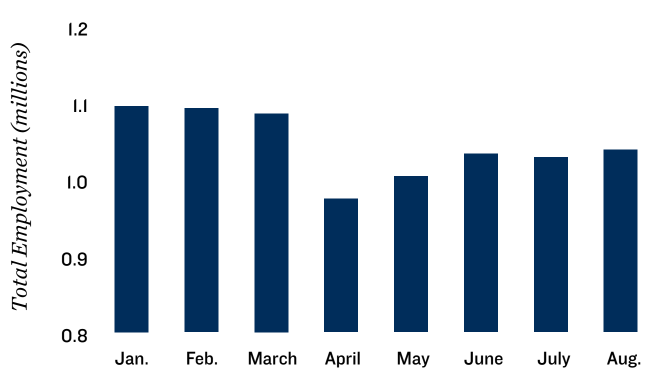
Service sectors recover some jobs after massive hit in spring. Prior to the health crisis, the unemployment rate stood 50 basis points below the national average at 3 percent in February. However, like much of the country, San Antonio's labor force contracted sharply in the months of March and April as the metro shed 118,000 jobs, pushing the unemployment rate up to 13.7 percent. During those two months, the bulk of jobs were lost in the leisure and hospitality sector, and the education and health services sector, which posted losses of 64,000 and 22,000 personnel, respectively. The state's quick reopening helped those two sectors regain positive momentum, combining to add 48,000 jobs back to the workforce from May through August. At the end of August, the unemployment rate was down to 6.1 percent; nevertheless, recovering the rest of the jobs lost will be more difficult as many employers remain financially burdened.

Challenges facing major attractions weigh on the Northwest Corridor. Home to Six Flags and SeaWorld, two of San Antonio's largest entertainment venues, the Northwest Corridor faces more distinct obstacles than other areas. Both of these attractions were closed for nearly three months before reopening in mid-June, and a return to normal foot traffic seems unlikely in 2020. As many of the workers at these parks were laid off amid the downturn, apartment vacancy in the Northwest Corridor rose 50 basis points in the second quarter to its highest rate since 2011. Additionally, fewer people visiting the area burdened store owners. Retail vacancy in the locale rose to a five-year high of 5.9 percent in the second quarter.

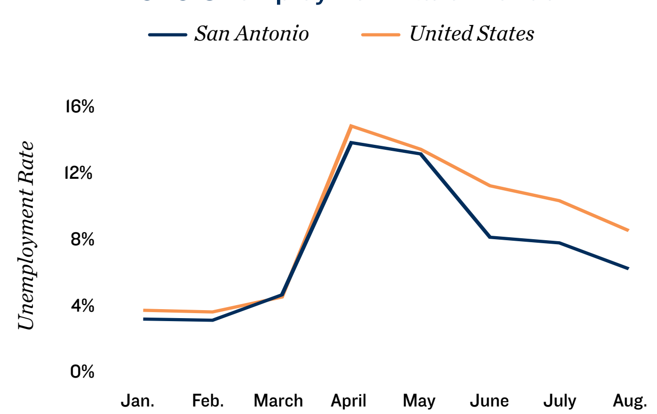
Innovation center at Port San Antonio could lure firms. In August it was announced that a $60 million project totaling 130,000 square feet would be added to Port San Antonio. Scheduled for 2022 completion, the new facility will feature an e-sports arena, a food hall, a museum, as well as a research and development lab. South San Antonio is already rich with technology firms, particularly in the fields of aerospace, cybersecurity and robotics. The innovation center could draw additional technology companies to the area via modern amenities. Prior to the announcement, south San Antonio office fundamentals had positive momentum in the second quarter. The location's vacancy rate plummeted 180 basis points from April through June to a decade low, which fueled a 8.7 percent asking rent hike.

Suburban assets on buyers' radars. The rapid growth of online shopping boosted the prospects of industrial space in north San Antonio suburbs. Guadalupe and Comal counties serve as a middle ground between San Antonio and Austin, and buyers targeted distribution facilities with convenient access to Interstate 35. Retail assets also frequently traded in outer suburbs, with properties near the state Route 1604 loop garnering the most interest from buyers seeking space built within the past 20 years. Multifamily investors, on the other hand, looked farther inward, primarily targeting Class B and C rentals in north central neighborhoods such as Alamo Heights and Terrell Hills. While transaction velocity in the office segment was muted compared with other property types, a handful of properties traded in far west suburbs beyond the Interstate 410 loop.

2020 Employment Trends



2020 Unemployment Rate Trends



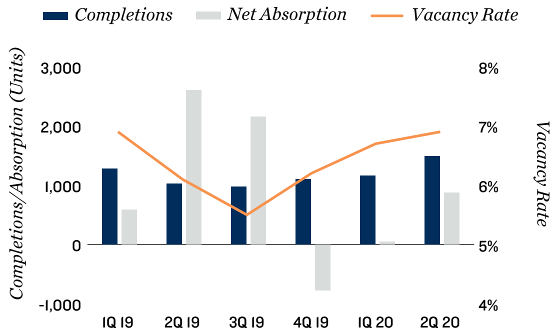
Source: BLS

APARTMENT

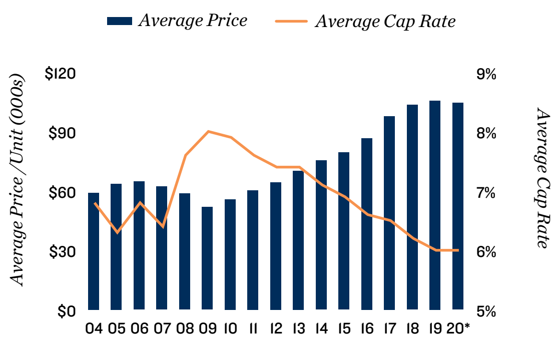
Fundamentals Regress as Job Losses Burden Renters; Lower-Tier Complexes Still Attracting Buyers

- Roughly 1,500 units were completed in the second quarter, which was the largest quarterly delivery in nearly two years. The central, south and far north submarkets each gained more than 400 units in the first half of this year.
- The vacancy rate inched up 20 basis points in the second quarter to 6.9 percent after rising 50 basis points in the previous quarter. Central San Antonio had the greatest regression amongst submarkets as the rate moved up 90 basis points from April through June.
- In the second quarter, the average effective rent dropped 0.7 percent to $1,005 per month. The Class A segment pulled down on the average as rent fell 1.2 percent quarter over quarter while the Class C tier posted a 1.1 percent gain.
- As of June, the trailing-12-month average sale price stayed relatively flat year over year at $104,300 per unit, while the average cap rate dipped 10 basis points to 6.0 percent. Class C complexes traded at a below-market average of $61,000 per unit.
- Private investors seeking assets in the $1 million to $10 million range targeted Class C apartments in northeast and southeast San Antonio. The Highland Hills, Windcrest and Longhorn neighborhoods were among the most favored.

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

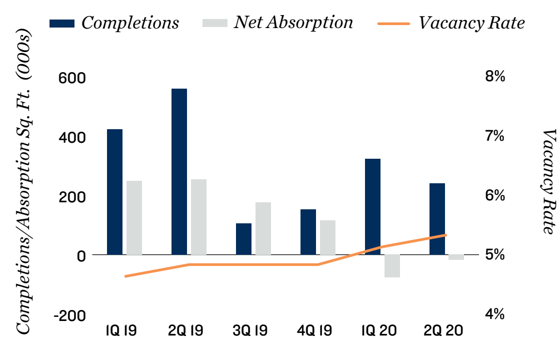
Sources: Real Page Inc.; CoStar Group, Inc.; Real Capital Analytics

RETAIL

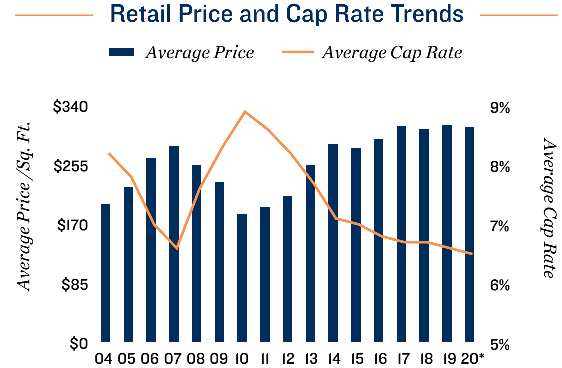
Single-Tenant Segment Posts Strong Rent Growth as Asset Class Gains Favor With Tenants and Investors

- Through the first half of 2020 roughly 563,000 square feet has been completed, increasing metro inventory by 0.5 percent. The Northwest Corridor received the bulk of deliveries, with 356,000 square feet coming online in the first half of the year.
- The vacancy rate rose 20 basis points in the second quarter to 5.3 percent, the highest level since 2015. However, Comal County was a bright spot in the market, as vacancy dropped 60 basis points in the quarter.
- From April through June, the average asking rent grew 1.7 percent to $17.08 per square foot. The single-tenant segment posted a 2.0 percent quarterly hike, while the multi-tenant segment noted a 1.0 percent gain.
- The average sale price for the 12-month period ended in June was $309 per square foot with an average cap rate of 6.5 percent, down 20 basis points year over year. Shops smaller than 10,000 square feet traded above the metro average in first half of this year, at roughly $340 per square foot.
- Investors seeking single-tenant, triple-net assets favored Comal County suburbs such as New Braunfels, Canyon Lake and Boerne. Multi-tenant centers traded more frequently in north central San Antonio within the I-410 loop.

Retail Completions and Absorption



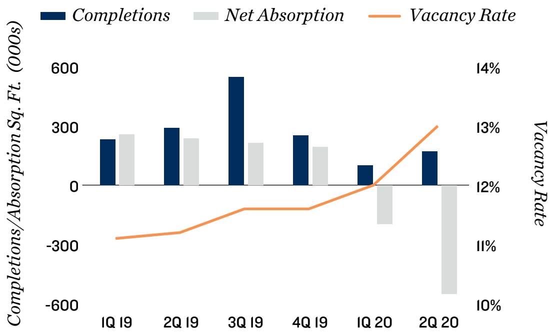
Retail Price and Cap Rate Trends



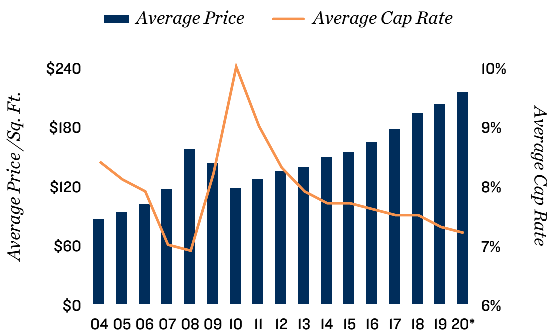
** Through second quarter*

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 and Rents Fall Despite Minimal Additions, Smaller Suburban Floorplans a Priority for Buyers

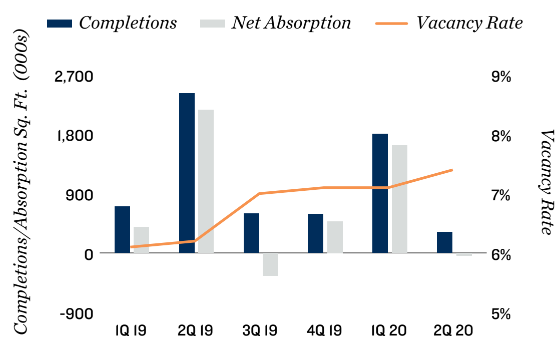
- Completions totaled roughly 270,000 square feet in the first half of the year, which was the smallest delivery volume over a six-month span since 2014. However, more additions are on the horizon as nearly 2 million square feet is under construction.
- In the second quarter, the vacancy rate jumped 100 basis points to 13.0 percent. The Class A tier was particularly impacted by the economic disruption, as vacancy rose 180 basis points quarter-over-quarter to 16.6 percent.
- The average asking rent inched up 0.2 percent in the second quarter to $22.75 per square foot. San Antonio's average asking rent in the CBD grew 0.3 percent from April through June, while nationwide the average CBD rent fell 0.7 percent.
- Ending in June, the trailing-12-month average sale price grew 8.5 percent year-over-year to $214 per square foot, driven by a spike in Class A deal flow in the first quarter. The average cap rate dropped 20 basis points over that span to 7.2 percent.
- Buyers' preferences shifted in the second quarter, as the median property that traded hands was 20,000 square feet compared to 32,000 square feet in the previous period. This coincides with the transition to remote working, as more firms could downsize their footprints as they allow some employees to work from home.

INDUSTRIAL

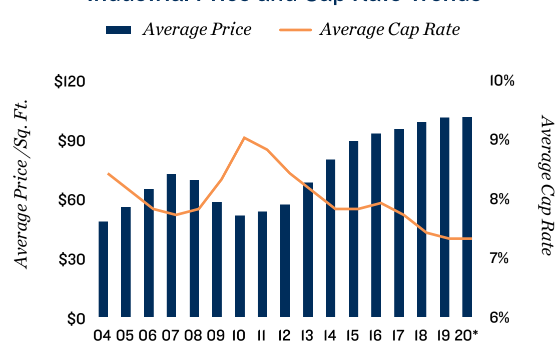
Rent Gains and E-commerce Growth Turn More Private Investor Eyes to San Antonio Industrial Assets

- First-half delivery volume totaled 2.1 million square feet, which increased market inventory by nearly 2 percent. The 1.6 million-square-foot H-E-B super regional warehouse was by far the largest project to reach completion.
- San Antonio's vacancy rate moved up 30 basis points in the second quarter to 7.4 percent. Comal County and the northeast corridor each posted 100-plus basis point vacancy hikes in the three-month period.
- In the second quarter, the average asking rent jumped 3.3 percent to $5.88 per square foot. The Northwest Corridor had one of the strongest performances among submarkets from April through June as average rates grew 11.7 percent.
- The average sale price for the 12-month period ended in June was $101 per square foot, up 1.4 percent year over year. Over that same timespan, the average cap rate stayed flat at 7.3 percent.
- In the first quarter, a handful of $20 million-plus properties changed hands; however, in April through June the majority of trades were for facilities in the $1 million to $10 million range. Private investors had an opportunity to acquire industrial spaces, while institutions were on the sidelines amid the disruption.

Industrial Completions and Absorption



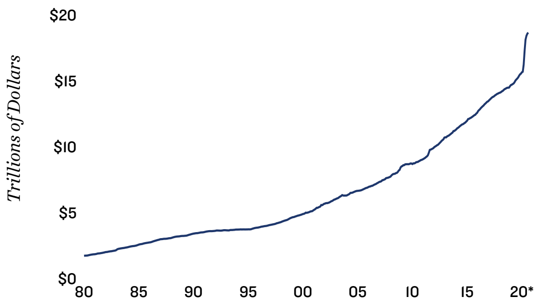
Industrial Price and Cap Rate Trends



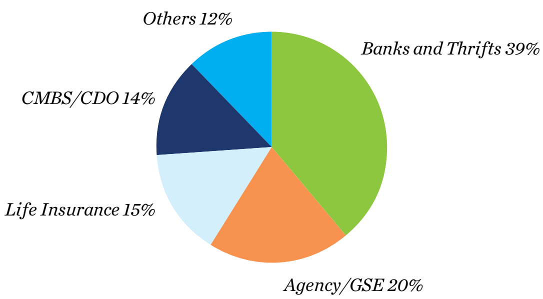
* Through second quarter

Sources: CoStar Group, Inc.; Real Capital Analytics

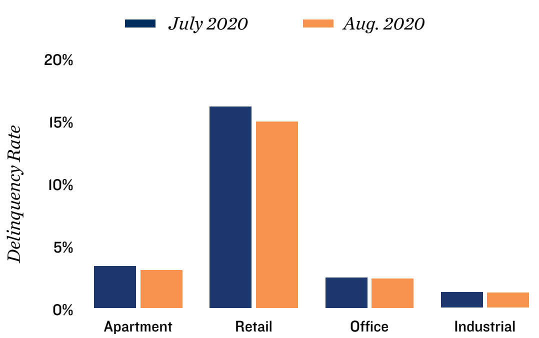
Fed Sharply Increases Money Supply During Health Crisis



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