BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *Austin Metro Area*

4Q/20

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

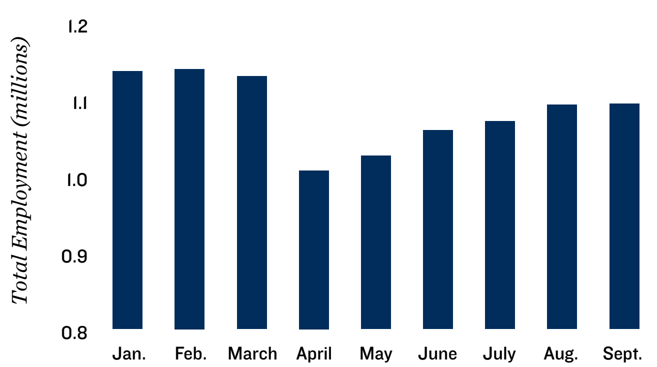
Tesla gigafactory could turn investors' eyes to Southeast Austin. The electric car manufacturer is building a plant near Hornsby Bend that will employ 5,000 people upon completion in 2021. This should fuel household formation in the area, benefiting property owners. The retail segment in Southeast Austin has already responded to the news with vacancy tightening to 2.0 percent in September, down 120 basis points from the beginning of the year. Tesla's move-in could draw additional employers to the area as well, where office vacancy is down 450 basis points over the trailing two years ended in the third quarter. Multifamily availability in the locale also rests below the market rate at 4.8 percent, which could fuel rent gains, particularly within the Class C segment, as the local workforces grow.

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 4.5 percent as of September. 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 as well as professional and business services, have actually grown year over year ended in September. However, the leisure and hospitality sector remains down 32,000 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.

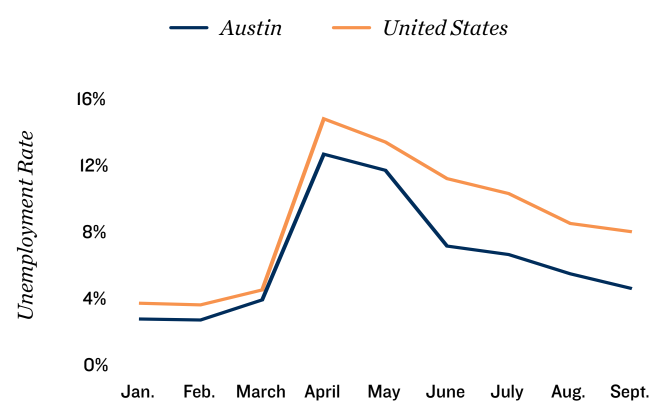
The Downtown and University area face greater challenges. Students at the University of Texas learning remotely and downtown employers allowing personnel to work from home are headwinds for the locale. Apartment vacancy here reached a 16-year high of 7.2 percent in the third quarter after rising 200 basis points year over year, which curtailed average effective rent by nearly 12 percent. Office availability in the central busines district also jumped 450 basis points from April through September to 16.1 percent, and uncertainty regarding a return to crowded high-rises will continue to weigh on fundamentals. Retail vacancy has held more stable, though difficult conditions are forcing operators to lower rates, as the average asking rent dropped almost 10 percent in the third quarter.

Robust demographics keep buyers active in Austin. In the first three quarters of 2020, 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 during the spring and summer months; 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



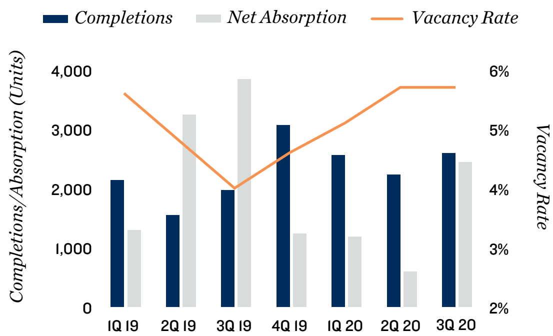
Source: BLS

APARTMENT

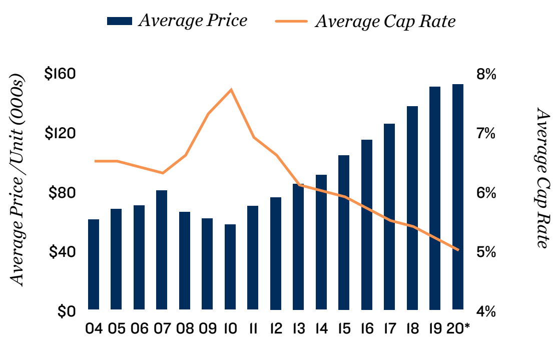
Elevated Supply Additions Push Up Vacancy, Weighing on Rent Growth in the Short Term

- In the third quarter roughly 2,600 units were completed, bringing annual additions to exceed 10,000 rentals. Over the past 12 months ended in September, inventory has grown by 4.2 percent, which is the fastest pace in the nation.
- The vacancy rate rose 110 basis points in the first nine months of 2020 to 5.7 percent. During that stretch, the Riverside submarket posted a 290-basis-point jump, while vacancy fell 40 basis points in the Pflugerville/Wells Branch locale.
- The average effective rent dropped 3.9 percent year over year ended in the third quarter to $1,270 per month. One bright spot in the market has been the Round Rock/Georgetown area, where rent grew 1.0 percent over that time frame.
- The trailing-12-month average sale price was $152,000 per unit ended in September. The average cap rate dropped 30 basis points year over year to 5.0 percent. Luxury complexes built post-2000 traded at an average of $250,000 per unit.
- Investors with strong buying power continued to scour suburbs in north Austin experiencing rapid household growth. A handful of 300-plus unit Class A complexes in Round Rock and Pflugerville traded with prices exceeding $50 million. A population shift outside of the core may further strengthen underlying demand here.

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



* Through third quarter

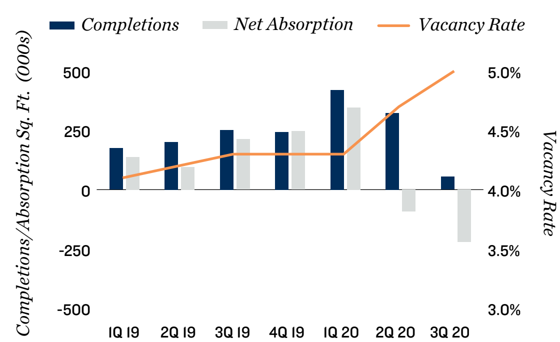
Sources: Real Page Inc.; CoStar Group, Inc.; Real Capital Analytics

RETAIL

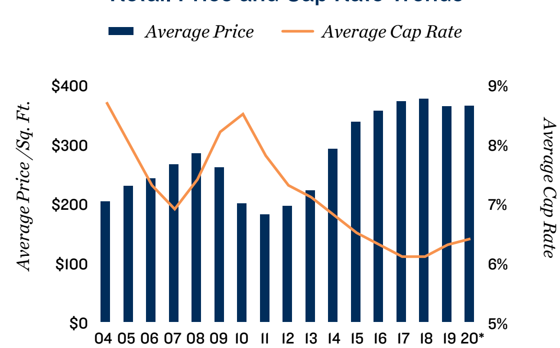
Net Absorption Dips Negative for the First Time in Nearly a Decade; More Challenges on the Horizon

- Only 55,000 square feet of space was added in the third quarter as developers eased up to reevaluate the market. The 744,000 square feet delivered in the first six months, amid unexpectedly difficult retail conditions, strained fundamentals.
- Negative 312,000 square feet of net absorption from April through September pushed the vacancy rate up 70 basis points to 5.0 percent. Cedar Park and Far Northwest Austin noted the greatest vacancy rises over that span.
- The average asking rent remained flat in the third quarter at $22.23 per square foot. Average multi-tenant rent is down 2.8 percent on an annual basis, while the single-tenant segment posted a 0.8 percent increase.
- In the third quarter, the trailing-12-month average sale price was $364 per square foot, down 0.7 percent year over year. Meanwhile, the average multi-tenant cap rate was 6.9 percent, up 20 basis points over the past four quarters, and the average single-tenant cap rate was 6.0 percent, up 10 basis points year over year.
- Over the spring and summer months, 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



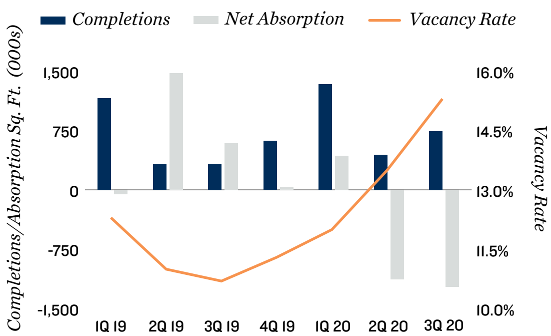
Retail Price and Cap Rate Trends



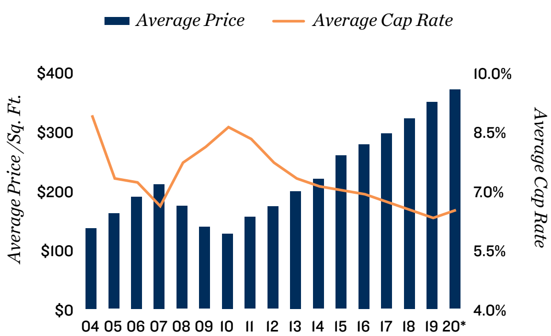
* Through third quarter

Sources: CoStar Group, Inc.; Real Capital Analytics

Office Completions and Absorption



Office Price and Cap Rate Trends



** Through third quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

OFFICE

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

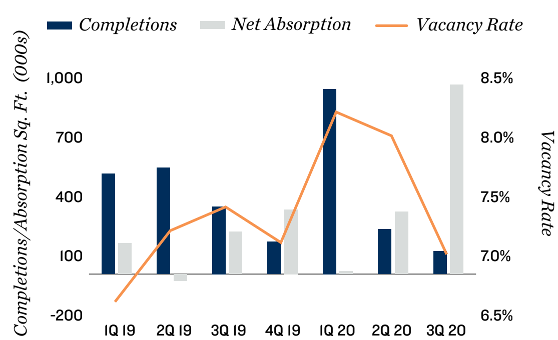
- After more than 1.3 million square feet of space was delivered in just the first quarter, completions totaled 1.2 million square feet over following six months. Developers have been most active in the South and Southeast submarkets.
- In the third quarter, the vacancy rate moved up 180 basis points to 15.3 percent, the highest rate since 2011. Challenges are exacerbated in the Central Austin submarket, where availability jumped 460 basis points from April through September.
- The average asking rent fell 0.9 percent in the third quarter to $26.43 per square foot. Northeast Austin, South Austin and Hays County had the greatest rent reductions in the quarter, with average rates falling 4 percent or more in these areas.
- The trailing-12-month average sale price was $370 per square foot ended in September, up 8 percent year over year. The average cap rate was 6.5 percent, up 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

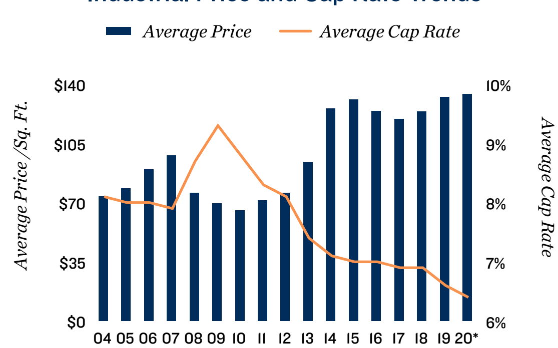
Rent Grew in the Third Quarter as Vacancy Dropped, Supported by the Rise in Online Shopping

- Completions fell to 116,000 square feet in the third quarter after 1.2 million square feet was added in the first half of the year. Hays County received the bulk of deliveries so far in 2020.
- The vacancy rate decreased 100 basis points from July through September to 7.0 percent, erasing the jump recorded earlier in the year. Hays and Bastrop counties each posted third-quarter contractions of at least 150 basis points.
- The average asking rent grew 5.9 percent year over year ended in the third quarter to $10.78 per square foot. Over that time frame, the rapidly growing suburbs of Cedar Park and Round Rock noted the strongest gains. The ability to efficiently service e-commerce orders to nearby households may be a tailwind for demand here.
- At the end of September, the trailing-12-month average sale price was $134 per square foot, with the average cap rate down 30 basis points year over year to 6.4 percent. Warehouses traded below the metro average at $95 per square foot.
- The Northeast Corridor along Interstate 35 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.

Industrial Completions and Absorption



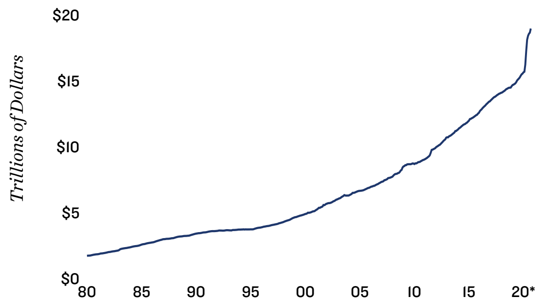
Industrial Price and Cap Rate Trends



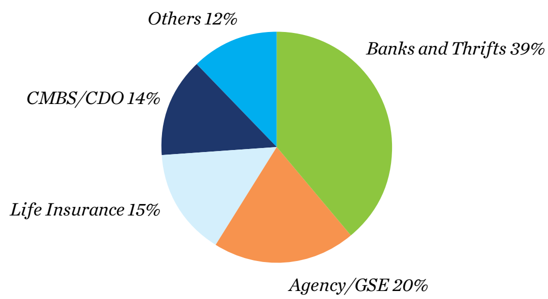
** Through third quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

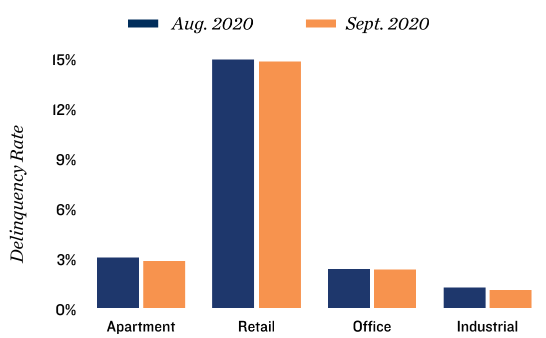
Fed Sharply Increases Money Supply During Health Crisis



Total Outstanding Mortgage Debt**



30+ Day CMBS Delinquency Rate



** Through September*

*** 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.** Most lenders have adapted to the health crisis, and more information on the economic damage of the pandemic is affording buyers, sellers, and lenders price clarity for large swaths of commercial real estate. 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 available for assets that perform at 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 collections are heavily examined, though financing remains available from the agencies. Loans are more readily accessible for suburban office, while core buildings require lower LTVs.
- **Record-low interest rates to encourage investment activity.** Freddie Mac and Fannie Mae are originating loans in the high-2 to low-3 percent range for gateway and secondary markets, while interest rates in smaller markets can reach the mid-3 percent band for well-capitalized buyers. Life insurance companies are offering rates in the 3 to 4 percent range with LTVs of 60 to 70 percent, though some premier properties have been able to achieve rates in the mid- to high-2 percent band. Most banks, credit unions and CMBS lenders are offering debt in the 3.25 to 4.25 percent range, and debt funds start slightly higher in the 3.5 to 4 percent territory. Stricter criteria for CMBS loans have limited options for many borrowers though. The Federal Reserve's commitment to keep the overnight rate near zero through 2023 should support historical low interest rates over the coming quarters, providing investors with compelling risk-adjusted returns in contrast with other asset classes.

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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