# BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *San Antonio Metro Area*

4Q/20

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

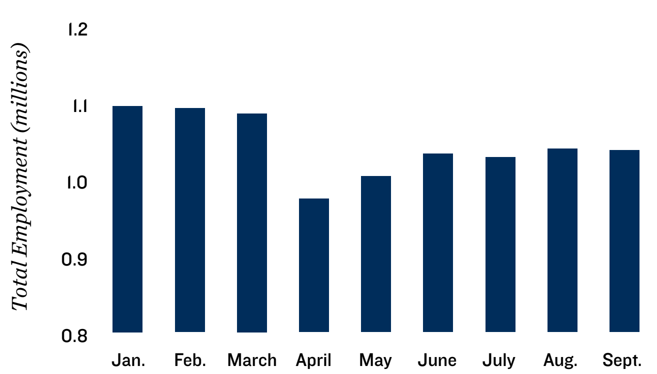
**Service sectors recover some jobs after hit in spring.** Prior to the health crisis, the unemployment rate stood 50 basis points below the national average at 3 percent in February. However, like much of the country, San Antonio's labor force contracted sharply in the months of March and April as the metro shed 118,500 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 64,200 and 22,200 personnel, respectively. The state's quick reopening helped those two sectors regain positive momentum, combining to add 52,700 jobs back to the workforce from May through September. At the end of the third quarter, the unemployment rate was down to 5.7 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 the near future. Fewer people visiting the area burdened store owners, with retail vacancy in the locale rising to a eight-year high of 6.4 percent in the third quarter. Apartment vacancy here also jumped 50 basis points during the second quarter but recovered from July through September as the workforces at these local venues returned.

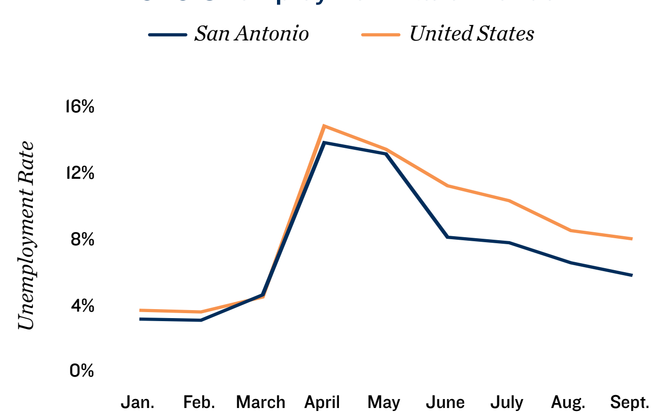
**Innovation center at Port San Antonio could lure firms.** In August it was announced that a $60 million project totaling 130,000 square feet would be added to Port San Antonio. Scheduled for 2022 completion, the new facility will feature an e-sports arena, a food hall, a museum, as well as a research 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 already had positive momentum. The location's vacancy rate plummeted 220 basis points from April through September to a decade low, which fueled a 9.3 percent year-over-year 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

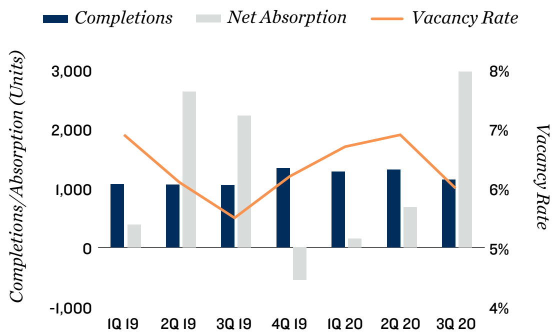



### 2020 Unemployment Rate Trends

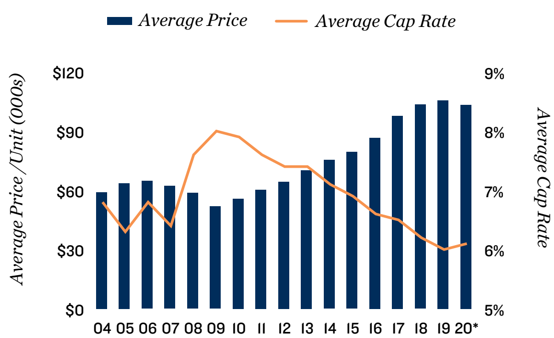



Source: BLS

Apartment Completions and Absorption




Apartment Price and Cap Rate Trends




* Through third quarter

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

# APARTMENT

## Fundamentals Quickly Recovered in the Third Quarter; Lower-Tier Complexes Attracting Buyers

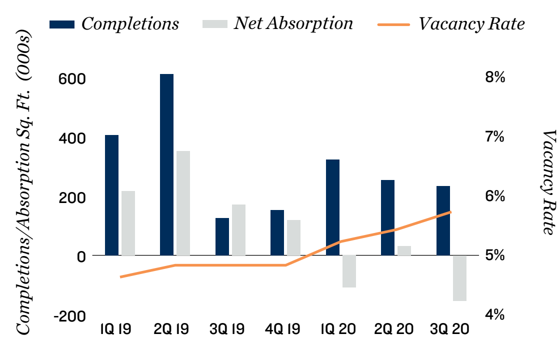
- Roughly 3,700 units were completed in the first nine months of 2020, which increased metro inventory by 1.7 percent. The Central and Far North submarkets each gained more than 600 units during that stretch.
- The vacancy rate dropped 90 basis points in the third quarter to 6.0 percent after rising 70 basis points over the previous two quarters. Momentum was widespread from July through September as 13 of the metro's 14 submarkets noted lower availability. Alamo Heights was the only area to post a vacancy jump.
- In the third quarter, the average effective rent rose 0.7 percent to $1,012 per month. Despite an overall market gain, the Class A segment is more beleaguered with the average rent falling 2.5 percent from the beginning of the year.
- As of September, the trailing-12-month average sale price remained near $103,000 per unit and the average cap rate held in the low-6 percent range. 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.

# RETAIL

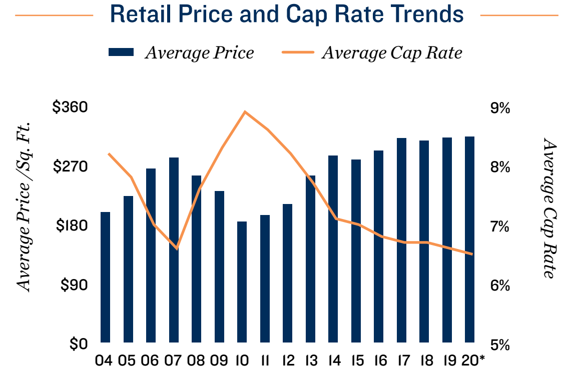
## Rising Vacancy is Pressing on Rent; Single-Tenant Segment Driving Deal Flow

- After roughly 576,000 square feet was completed in the first half, the delivery pace slowed a tick in the third quarter. Almost 460,000 square feet was finalized in the Northwest submarket from January through September.
- The vacancy rate rose 30 basis points in the third quarter to 5.7 percent, the highest level since 2014. However, Comal County was a bright spot in the market, as vacancy dropped 40 basis points in the three-month period.
- From July through September, the average asking rent fell 2.2 percent to $16.64 per square foot. The single-tenant segment posted a 2.1 percent quarterly decline, while the multi-tenant segment noted a 2.6 percent subtraction.
- The average sale price for the 12-month period ended in September was $312 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



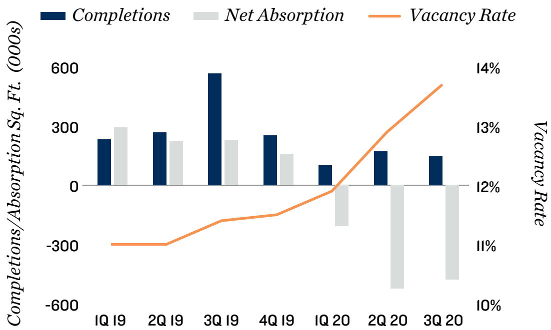

Retail Price and Cap Rate Trends



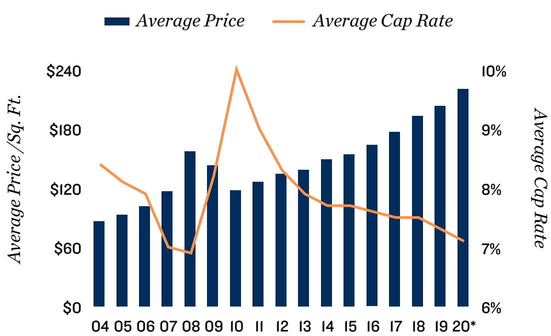

* Through third quarter

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 Despite Fewer Additions; Smaller Suburban Floor Plans a Priority for Buyers

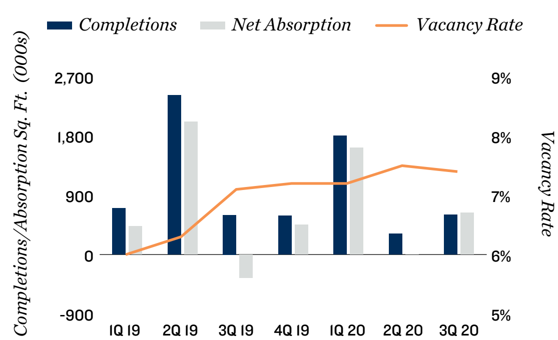
- Completions totaled roughly 670,000 square feet over the trailing four quarters ended in September, just half of the previous yearlong volume. However, more additions are on the horizon as nearly 2.2 million square feet is under construction.
- In the third quarter, the vacancy rate jumped 80 basis points to 13.7 percent. The Class A tier was particularly impacted by the economic disruption as vacancy rose 260 basis points from April through September to 17.4 percent.
- The average asking rent inched up 0.6 percent in the third quarter to $21.20 per square foot. San Antonio's average asking rent in the CBD grew 2.2 percent from July through September, while nationwide the average CBD rent fell 1.2 percent.
- Ending in the third quarter, the trailing-12-month average sale price grew 10 percent to $220 per square foot, driven by a spike in Class A deal flow in early 2020. The average cap rate dropped 30 basis points over that span to 7.1 percent.
- Buyers' preferences shifted amid the health crisis, as the median property that traded hands was 20,000 square feet in the second quarter compared with 32,000 square feet in the previous period. This coincides with the transition to remote working as more firms could downsize their footprints.

# INDUSTRIAL

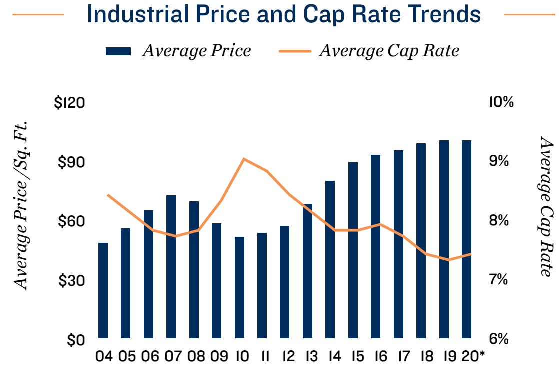
## Rent Gains and E-commerce Growth Turn More Private Investor Eyes to San Antonio Industrial Assets

- Third quarter delivery volume totaled roughly 607,000 square feet, remaining sluggish after a large first quarter pipeline. The 1.6 million-square-foot H-E-B super regional warehouse was by far the largest project to reach completion this year.
- San Antonio's vacancy rate decreased 10 basis points in the third quarter to 7.4 percent. The North Central submarket and Gaudalupe County each posted vacancy contractions of at least 50 basis points in the period.
- From July through September, the average asking rent jumped more than 10 percent to $6.51 per square foot. The Northeast Corridor and the CBD had the strongest performances as greater demand for last-mile delivery buoyed rental gains.
- The average sale price for the 12-month period ended in September was $100 per square foot, up less than 1 percent year over year. Over that same timespan, the average cap rate increased 10 basis points to 7.4 percent.
- In the first quarter, a handful of $20 million-plus properties changed hands; however, in the spring and summer months 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 third quarter

Sources: CoStar Group, Inc.; Real Capital Analytics

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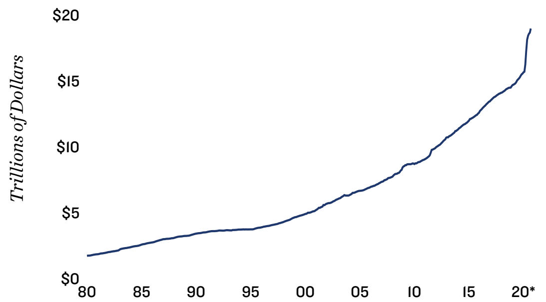
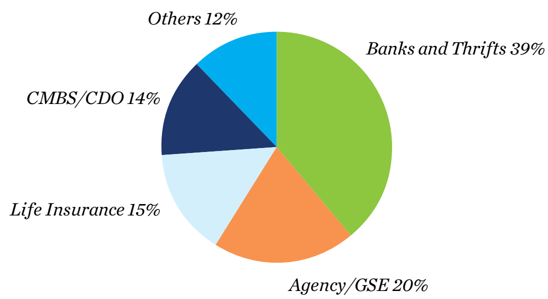
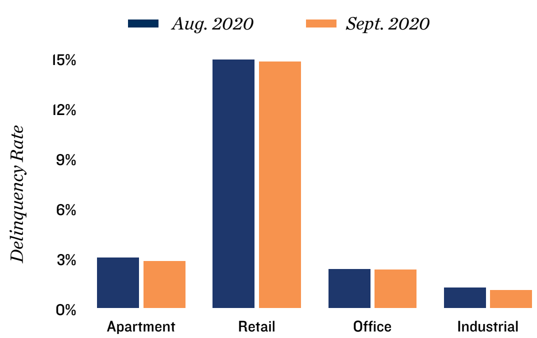
## Fed Sharply Increases Money Supply During Health Crisis




## 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*