The U.S. recovery has weathered the recent plunge in oil prices, in part thanks to expansion by technology and media firms. Office demand is surging in the cities popular with “TAMI” (Technology, Advertising, Media and Information) by technology and media firms. Office demand has changed the fortunes of particular cities and districts.

The TAMI sector (Technology, Advertising, Media and Information) is surging in the cities popular with “TAMI” employment, particularly in sectors that have grown by technology-driven submarkets. As asking rents are rising in the low- to mid-single digits across most markets and property owners have been remarkably disciplined due to increased asset protection, the occupancy rates are improving. Developers and construction lenders have traditionally been more cautious than in previous cycles – a huge boon for owners of existing properties. Another recession will happen eventually, but property investors remain optimistic about the near term. A recession is unlikely in the next 12 to 18 months.

MARKET FORECAST

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GDP GROWTH BY SECTOR

The GDP growth by sector is shown in the chart below. The sectors are color-coded by percentage growth, with red indicating sectors with high GDP growth and blue indicating sectors with low GDP growth. The chart includes a legend that explains the color coding and a key that identifies the sectors by name. The chart is a useful tool for understanding the economic growth of different sectors in the United States.

U.S. DASHBOARD

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The Bay Area economy has been outperforming most other markets in the U.S., largely due to the strength of the technology industry. Of the 100+ companies on the Fortune list of “unicorns” (companies with a valuation of $1 billion or greater, based on fundraising), 41 are located in either San Francisco or Silicon Valley, including Uber, Airbnb, Pinterest and Square. Venture capital interest in this market remains strong: investments in Bay Area companies in the first half of 2015 totalled more than $13 billion, or about 49% of all investment nationwide. While the technology industry is centered on the city of San Francisco and Silicon Valley (South Bay), the entire region has benefited from the robust job market these companies have created.

A San Francisco address can give a company an edge in recruiting, and many have moved at least part of their operations here. As a result, increased demand and dwindling supply have driven up asking rents. Annual Class A asking rents in SoMa, the most desirable location for tech tenants, are nearly $75 per sq ft, having inched up by 15% since the beginning of 2010. Santa Clara County has seen the most significant increases, with those in the neighboring San Jose area of San Jose having risen by nearly 16% in the past year to an average of more than $3.400 per month. Median home prices in San Francisco have also increased sharply, to $2.250,000 – 37% above their peak before the city’s present housing crisis.

While housing in much of the rest of the Bay Area is less expensive, prices have risen sharply across the region.

In response, Facebook is building a 274-unit residential development for its employees in Menlo Park in Silicon Valley, while corporate housing companies are reserving certain percentages of their units for tech clients under contract. For the past few years, many big tech firms in Silicon Valley have provided commuter buses for their employees living in San Francisco. Now, many San Francisco-based tech companies are following suit, providing commuter buses for their employees living elsewhere in the Bay Area.

Los Angeles County would rank as the 21st largest economy in the world if it were an independent country. More than 244,000 businesses drive the local economy, concentrated in technology, tourism, international trade, manufacturing and creative industries, including media, entertainment and advertising. However, technology and trade industries in particular are having a significant impact on the economy and the real estate market. Los Angeles has become one of the nation’s leading tech centers.

Mirroring the high demand for office space, residential space is also in short supply. Young tech workers have long favored life in the city over the suburbs, and San Francisco apartment rents have increased by nearly 16% in the past year to an average of more than $3,400 per month. Median home prices in San Francisco have increased by nearly 15% in the past year to an average of more than $1,450 per month. Median home prices in San Francisco have increased by more than 140% since the beginning of 2010. Scarce supply has driven up asking rents. Annual Class A asking rents in SoMa, the most desirable location for tech tenants, are nearly $75 per sq ft, having inched up by 15% since the beginning of 2010. Santa Clara County has seen the most significant increases, with those in the neighboring San Jose area of San Jose having risen by nearly 16% in the past year to an average of more than $3.400 per month. Median home prices in San Francisco have also increased sharply, to $2.250,000 – 37% above their peak before the city’s present housing crisis.

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Government cuts have impacted the market, but increased hiring by private firms offers cause for optimism

The Washington, DC metropolitan area continues to struggle towards a sustained recovery from the effects of federal austerity programs. Each of the region’s three jurisdictions is experiencing a period of light demand for additional office space, resulting in record high leasing concession packages and an investment sales market at times out of sync with leasing fundamentals. Close examination shows that the market is bifurcated, with the Class A market – especially trophy assets – outperforming the rest. Declining office absorption by class, data shows that Class A properties have continued to attract interest, whereas Class B and Class C properties no longer appeal to the needs of many tenants - a reality that is driving the bifurcation of the market. Simply put, demand is present for top of the market space, but largely absent for properties at lesser locations or without robust amenities. Bigger tenants continue to tour the market well ahead of their lease expirations, as large blocks of high quality space remain rare. This has led to discussions with owners and developers about the redevelopement and additional development potential of their existing properties, particularly in the East End and Central Business District, where many older buildings are awaiting significant pre-leasing before renovations to modernize them can begin. These renovations will add floors, new amenities and upgrades to heating, ventilation and air-conditioning systems.

In early 2015, the National Institutes of Health (NIH) announced a 20 year master plan to shift all employees now located in space leased off-campus back to the main campus in Bethesda, Maryland. The return to a campus-centric model would substantially impact the market, as NIH leases more than 3.1 million sq ft of office space. The NIH’s announcement comes after federal downsizing and consolidations by the Food and Drug Administration, National Institute of Allergy and Infectious Diseases and NIH in suburban Maryland soured the market. However, despite these headwinds, there are signs of improvement that bode well for the future outlook. New budget proposals suggest an increase in federal spending over the next few years, which would aid the office market’s recovery, especially if additional spending boosts demand among government contractors. This should balance the continued downsizing by the federal government, as it addresses the pending expirations of its leased space over the near-term. Recent increases in hiring within the private sector, especially within the office intensive professional and business services sector, are a cause for optimism in 2016.

As the third largest metropolitan region in the United States after New York and Los Angeles, Chicago is viewed as a ‘gateway market’, one of already defined groups of cities marked by their attractiveness to cross-border investors, corporate occupiers and tourists. Among this elite group of cities, Chicago stands out for its low business and living costs and the higher yields it offers commercial property investors. Chicago is served by an extensive public transportation system consisting of heavy rail (the L), commuter rail (Metra) and buses. This system has supported Chicago’s dense urban core, walkable neighborhoods throughout the city, and mixed-use ‘villages’ around suburban train stations—growth patterns that newer, auto-dependent cites seek to emulate.

Chicago’s growing population of educated Millennials has fostered a robust tech community with companies including Groupon, Gogo and GrubHub progressing from start-up to IPO, and tech giants Google and Facebook opening state-of-the-art offices. The surge in manufacturing has been particularly strong in Chicago, where Goose Island, formerly home to heavy industry, is being transformed into a cutting edge manufacturing and tech district. Recently, the first of its kind UIC Labs Digital Manufacturing and Design Innovation Institute—a start-up hub for modern manufacturers—opened on the island.

Employers including United Airlines, Motorola, Capital One and Hillshire Brands have relocated their offices downtown to gain access to the young and educated workforce living nearby. Both downtown and suburban office vacancy rates are shrinking, while rental rates are rising downtown, but steady in the suburbs. Several new high profile projects are under construction downtown, including two Skyscrapers. As a mid-continent transportation nexus, greater Chicago is home to the nation’s largest industrial market, with more than 1 billion sq ft of space. More than 10.6 million sq ft of new product—an eight year high—is under construction in new, multi-modal logistics parks, high image business parks and infill submarkets.

Chicago’s most famous retail strip, Michigan Avenue, continues to reinvent itself with a diverse mix of upscale retailers; many are establishing anchor or brand house facilities to showcase their offerings to a global audience. Retail districts throughout the city are evolving, as new and renovated residential development transforms neighborhood after neighborhood. The region is not without its challenges: The City of Chicago, Chicago Public Schools and the State of Illinois are struggling under high debt loads, and the city’s lagging neighborhoods need investment. As Chicago tackles these challenges, it will remain a magnet for property investors, occupiers and young workers migrating to the city from across the Midwest and beyond.
Increased trade and investment is supporting growth in Mexico City

WHITTEN BY
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With 80% of its exports flowing to the United States, Mexico offers a sophisticated industrial property sector with state-of-the-art product, occupied by U.S. and multinational manufacturers and distributors. This sector has experienced major growth and development over the past decade, driven by foreign direct investment and a recovering U.S. economy. The vacancy rate for modern industrial space in the country is in the mid-single digits.

The surge of trade and investment is benefiting Mexico City, and in turn Mexico. This sector has experienced some of the highest increase in industrial space in the country, where developers, investors and occupiers.

The flow of investment into Mexico’s retail property sector is expected to top U.S.$3.5 billion by 2017, which will add 100,000 new shopping centers with an additional 36 million sq ft of space. About half of this development will occur in Mexico City and its environs.

Mexico is not without its challenges. The peso has declined by almost 20% against the U.S. dollar over the past year, a trend that favors exporters but could restrain consumer spending and stoke inflation as imports become more expensive. The low price of oil is creating revenue shortfalls for the government, while the simmering problems of government corruption and drug-related violence have yet to be resolved.

Despite these challenges, Mexico City continues to enjoy vibrant growth. Construction activity has remained strong through the recent economic turbulence, and – unlike many emerging markets – demand has kept pace. REITs are competing to gain market share and develop innovative space for increasingly sophisticated occupiers. PwC forecasts that Mexico City will be the seventh richest city in the world by 2025, with a GDP of U.S.$743 billion (after Tokyo at number one, followed by New York, Los Angeles, London, Chicago and São Paulo). This increased wealth and production will create more real estate opportunities for developers, investors and occupiers.

OFFICE MARKET KEY METRICS

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EUROPE DASHBOARD

After years of crisis, the European property market is experiencing an early stage recovery.

COMMERCIAL PROPERTY INVESTMENT VOLUMES 12 MONTHS TO Q2 2015 (U.S.$bn)

PRIME OFFICE RENTS (U.S.$ PER SQ FT PER ANNUM)

YEAR-ON-YEAR CHANGE (%) (LOCAL CURRENCY RATES)

PRIME OFFICE YIELDS (%) (LOCAL CURRENCY RATES)

HOW MUCH PRIME OFFICE SPACE DOES U.S.$100 MILLION BUY (SQ FT)

Source: Knight Frank Research / Real Capital Analytics