BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *Salt Lake City Metro Area*

2H/20

Hiring Resumes After Limited Shutdown; Comparatively Strong Economy Draws Investor Attention

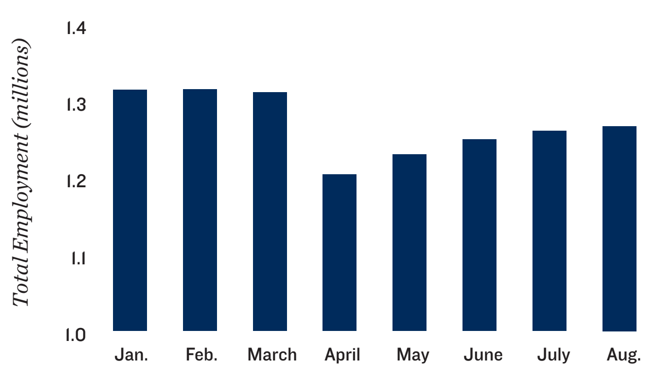
Employment losses quickly replaced. Following a short shutdown during the health crisis, job growth rebounded at a fast clip, maintaining one of the strongest economies in the nation. Roughly 111,200 positions were cut in the metro during the lockdown with all sectors except construction posting a decline. Between May and August, 63,300 employees returned to work, cutting unemployment from a high of 10.2 percent at the end of April to 3.1 percent in August. The unemployment rate remains one of the lowest in the country and rests just 70 basis points above the rate in January. As expected, the greatest worker reduction was in leisure and hospitality, dropping by 51,400 positions in March and April. The sector has since regained almost half of the positions as hotel occupancy in the state rose from 20.9 percent in April to 54.6 percent in August.

Favorable demographic trends bolster housing demand. Salt Lake City has benefited from an increased desire for open space during the health crisis, attracting new residents from more densely populated cities. During 2020, net migration is forecast to top 14,900 people, the highest level in three years, generating the need for additional housing options. While some households will choose to own a home, the median home price of $371,500 in June sits above the national rate, which places homeownership beyond the means of many renters. This bodes well for the multiple apartment projects being built, especially in the suburbs where 6,500 units are underway.

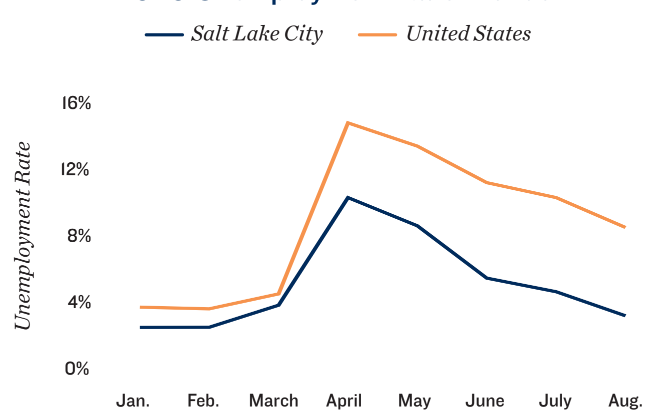
Upgrades to transportation infrastructure prepare metro for growth. The first portion of the Salt Lake City International Airport redevelopment will debut in the third quarter of 2020. A new terminal, concourse and parking garage will open in September, allowing the demolition of existing facilities and the construction of the remainder of the airport in time for a 2024 completion. The new facilities are expected to contribute roughly $5.5 billion to the local economy and increase passenger volume. The region's transportation infrastructure could further be enhanced if the proposed Utah Inland Port comes to fruition. Plans call for an industrial multimodal hub to be built on 16,000 acres west of the airport in the northwestern quadrant of Salt Lake City. The development would bolster the metro's logistics and distribution capabilities and generate demand for additional industrial inventory.

Strong economic performance, favorable long-term outlook capture investor attention. Buyers remained active in the Salt Lake City metro, although transaction volume eased quarter over quarter in June due to difficulty in viewing properties. Other due diligence steps also took longer to complete and closing times were extended. In addition, robust activity in the prior quarters limited for-sale listings in some product types. Investors most often targeted smaller industrial assets near major interstates or population centers that may be used for last-mile delivery space as e-commerce sales surge.

2020 Employment Trends

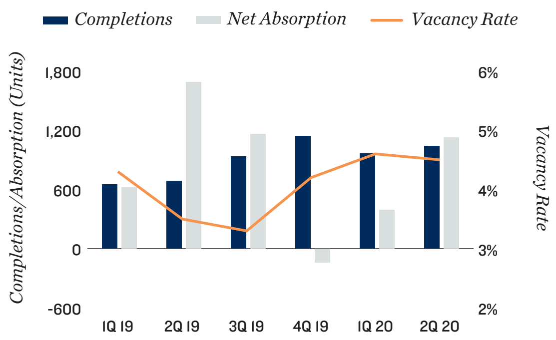


2020 Unemployment Rate Trends

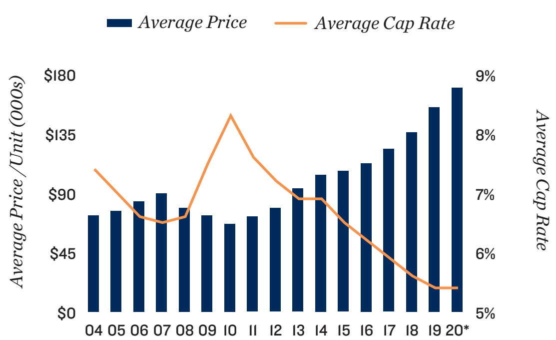


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

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

APARTMENT

Elevated Deliveries Hold Vacancy Above Five-Year Average As Rent Growth Diminishes; Out-of-State Buyers Active

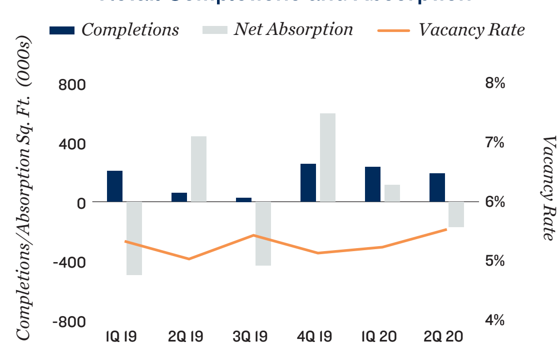
- During the first half of 2020, roughly 2,000 apartments were finalized, up from 1,300 one year earlier. Builders also have 8,900 market rate rentals underway with completions into 2022. Of these units, up to 1,700 could be delivered in 2020, marking the sixth consecutive year that inventory rises by more than 3,400 units.
- After advancing 40 basis points in the opening three months, vacancy dipped 10 basis points in the second quarter to 4.6 percent. New units contributed to Class A vacancy climbing 20 basis points during the April to June period to a metro high of 5.7 percent. The rate in Class C rests at 3.4 percent, up a quarterly 40 basis points.
- Average effective rent dipped slightly quarter over quarter to $1,174 per month at midyear. The rate is less than 1 percent below the recent peak reached in 2019. Class A vacancy retreated 1.1 percent to $1,415 per month on average while Class C rent jumped 2.6 percent to a new high of $1,000 per month.
- Many investors stepped to the sidelines during the second quarter, limiting transaction activity. Out-of-state buyers dominated the light trading volume.
- Over the past four quarters, the average sale price surged 16.7 percent to $169,700 per unit, boosted by a new Class A asset trading. The average cap rate, meanwhile, dipped 10 basis points but remained in the mid-5 percent bracket.

RETAIL

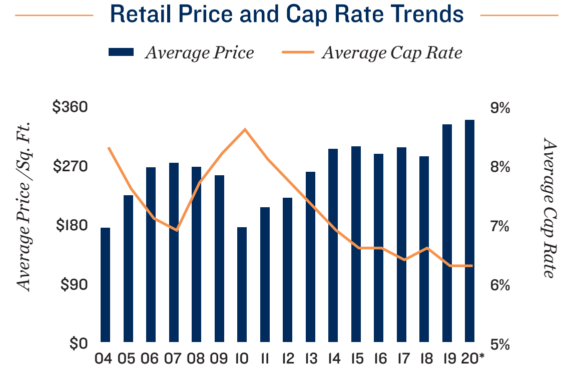
Development Focused in Southwest Valley; Hike in Vacancy Dampens Rent Gains as Investors Pause

- Approximately 425,000 square feet of space was completed in the first half of 2020, well above the total from the same period last year. Construction activity is slowing, however, as developers have roughly 270,000 square feet of mainly single-tenant buildings underway, with deliveries scheduled into 2021. Academy Village in Herriman will account for the majority of new inventory.
- Following a 10-basis-point rise in vacancy during the first three months of 2020, store closures contributed to vacancy jumping 30 basis points to 5.5 percent in the second quarter. This is the highest rate since 2011. Multi-tenant vacancy held steady at 6.1 percent in the April through June period.
- Rising vacancy halted rent growth. After a 4.0 percent advance in the first three months of 2020, the average asking rent declined 1.5 percent in the second quarter to $16.28 per square foot. The drop was mainly due to a 2.5 percent decrease in multi-tenant marketed rent.
- Single-tenant properties and small strip centers dominated sparse transaction volume during the second quarter. Trading activity is up year over year, however.
- The average sales price leapt 10.2 percent to $337 per square foot during the past four quarters boosted by prime single-tenant assets changing hands. During this time, the average cap rate dipped 10 basis points to the low-6 percent span.

Retail Completions and Absorption



Retail Price and Cap Rate Trends

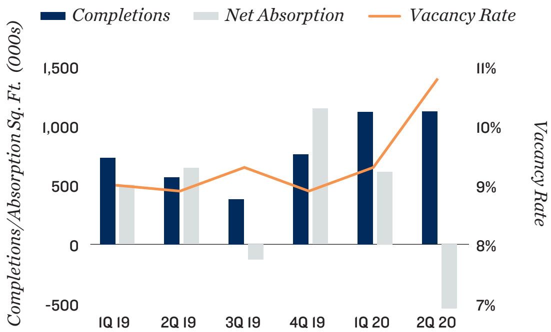


** Through second quarter*

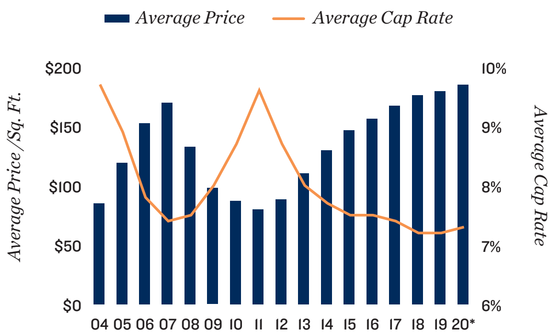
Sources: CoStar Group, Inc.; Real Capital Analytics

OFFICE

Office Completions and Absorption



Office Price and Cap Rate Trends



** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

Supply Additions Push Vacancy Up Yet Rent Still Climbs to New High; Average Price Sets Record

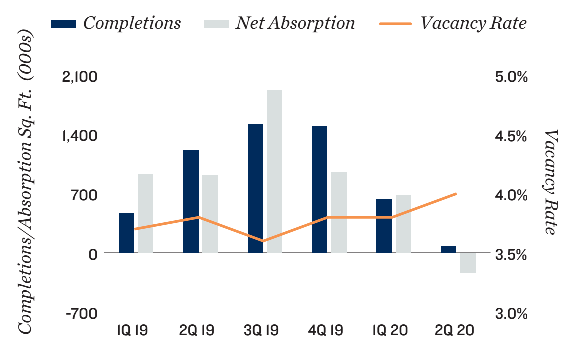
- More than 1.1 million square feet was completed in each of the first two quarters of 2020, the highest three-month sums since 2016. The South Valley has received more than 700,000 square feet during this period. Developers have another 3.7 million square feet underway with completions scheduled into 2021.
- Deliveries outpaced absorption sending metrowide vacancy up 150 basis points in the second quarter to 10.8 percent, the highest rate since 2017. New units in Utah County and the South Valley pushed vacancy in these areas up 310 and 200 basis points in the past three months to 16.9 percent and 9.3 percent, respectively.
- The rise in vacancy dampened rent growth. Following a 1.6 percent gain in the opening quarter, the average asking rent advanced 1.1 percent in the second quarter to an average of $22.51 per square foot, setting a new high.
- Trading volume fell markedly during the second quarter as economic uncertainty had many investors pausing, although the metro's large supply of suburban offices should draw investor interest moving forward.
- In the past four quarters, the average price rose 3.9 percent to $185 per square foot, establishing a record high as out-of-state buyers targeted well-located assets. The average cap rate ticked up 10 basis points but remained in the low-7 percent span.

INDUSTRIAL

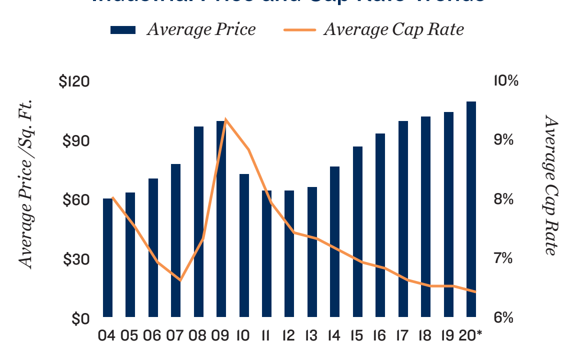
After Brief Pause, Construction Resumes as Vacancy Trends Higher; Coronavirus Extends Time to Close, Slowing Trading

- Roughly 83,500 square feet was finalized in the April to June period, the lowest quarterly completion rate since 2013. The downturn should be short lived, however, as builders have more than 5 million square feet underway with deliveries expected into 2021.
- Net absorption lagged completions in the second quarter, moving vacancy up 20 basis points to 4.0 percent, the highest rate since 2017. Vacancy is also up 20 basis points annually. Demand for industrial space is robust in Toole County. At midyear, the rate rested at 4.6 percent down 200 basis points quarter over quarter and 570 basis points annually.
- During the second quarter, the average asking rent rose 2.0 percent to $6.50 per square foot, resting slightly below the cyclical peak reached in early 2019 . On an annual basis the rate is up 2.8 percent.
- Trading activity declined in the second quarter as the coronavirus delayed some closings but transactions were up on a year-over-year basis.
- The average price soared 6.3 percent over the past four quarters to $109 per square foot, setting a new high even as older Class B/C assets were sought. The average cap rate, meanwhile, declined 30 basis points into the low-6 percent range.

Industrial Completions and Absorption



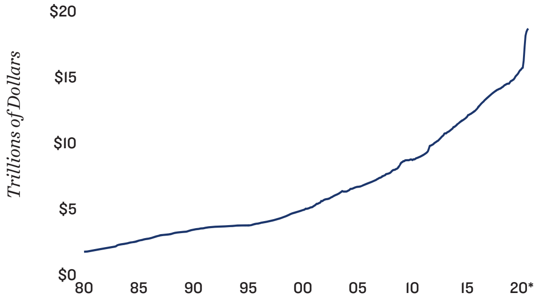
Industrial Price and Cap Rate Trends



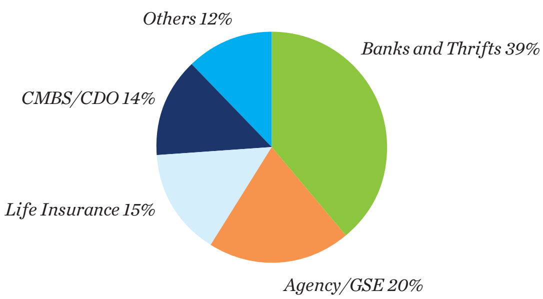
** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

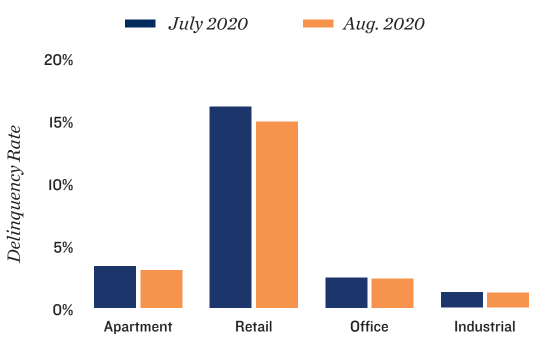
Fed Sharply Increases Money Supply During Health Crisis



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