Dear Client:

The outlook for commercial real estate: Some hot sectors will continue to thrive. And some recent laggards are coming back as the damage from COVID-19 finally starts to wane.

Warehouse space is in particular demand, as the e-commerce boom COVID unleashed keeps going and retailers scramble for the storage they need to keep the flow of goods moving smoothly. The national vacancy rate is down to 6.6%, vs. 9%-10% rates for warehouses before the pandemic. Rents are soaring. They'll be up 8% this year due to record demand and capacity constraints.

Some regional markets are even tighter. In Charlotte, N.C., the vacancy rate is down to 3%. Other tight markets: Atlanta, Chicago, Northern N.J., Fort Worth, Texas, Indianapolis, Memphis, Tenn. It's a similar story with industrial space, which competes with warehouses for land. Supply of industrial and manufacturing facilities is tight and renters are experiencing some sticker shock.

For apartments, the hot housing market means continuing strength in rents, though they'll slow this year after last year's surge. Figure on a 5% nationwide gain after 2021's record 13.5% jump. Many renters' budgets are getting stretched tight. Growing Sun Belt metro areas will attract the most tenants and see rapid rent growth. Apartment construction figures to keep booming this year, adding supply that is badly needed in some places. Look for Dallas to see the most building activity, along with Houston and Austin, Texas; Phoenix; Miami; Los Angeles; and New York.

As for the sectors that struggled the most during the pandemic, there's hope. Office space is in for better days as more workers return to in-person work, partially reversing the trend that emptied out so many offices in 2020 and 2021. Rents will creep up about 0.5% on a national basis, with faster increases in markets that were hit hardest by the downturn, like Dallas, Chicago, Manhattan and Seattle. Still, look for the national vacancy rate, now at 15%, to stay high, ending 2022 at 15.5%. A good deal of new office space has been added recently, much of it in a few markets, such as Austin, Dallas, Miami and the San Francisco area (where office renovations are driving construction, rather than an increase in space needs). Smaller markets in the Sun Belt figure to see faster rent gains than big metros like Washington, D.C.

The retail market has turned the corner after demand for space contracted when consumers flocked to e-commerce during the pandemic. The return of foot traffic this year should bring the national vacancy rate for retail space to more normal levels and give rents a slight boost. Figure on average rents rising 1% this year...not much, but a turnaround from the past couple of years, which were brutal for landlords.
When it comes to the economies of the mid-South, Texas is the best. The state will see the biggest employment growth in the region this year, at 3.4%, causing the unemployment rate to fall from 5.0% to 4.0%. Texas has added the most jobs of any state since the start of the pandemic. Moreover, its labor force is one of the few that has already returned to pre-pandemic levels.

While the booming price of oil has been a boon for the Lone Star State, particularly Houston, where much of the oil and gas industry is concentrated... Texas is more than just oil. Austin is already an established tech hub. Tesla will build a massive battery manufacturing facility near the state capital to supply a similarly massive electric vehicle factory. The company’s HQ has moved to Austin, too. Dallas has long been a top destination for firms looking to relocate, with over 100 companies considering such a move in 2022. Many of the relocators are from Calif. Between Jan. and June of last year, nearly two dozen companies moved from Calif. to Texas, the vast majority to either Austin (11) or Dallas (8).

New Mexico has also been blessed by the rising price of oil. The number of rigs operating in the state is now 80% of its pre-pandemic total, more than in Texas. But the state’s future is high tech. The Land of Enchantment appears to be betting big on hydrogen as a source of clean energy. Companies like BayoTech and Pajarito Powder represent an early flowering of this industry. Plus, the state is angling to become one of four $2 billion hydrogen hubs that Uncle Sam will create, using money from the recent infrastructure bill. At the same time, chipmaker Intel is upgrading its operations in Rio Rancho, part of the Albuquerque metro area.

Expect employment growth of 2.8%, bringing the jobless rate down to 5.0%. Oklahoma should also have 2.8% job growth this year, as more oil rigs open up. But labor will be tight; the unemployment rate is already low, at 2.3%. Like Texas and N.M., the Sooner State is also branching out into clean energy. Its wide open spaces are well-suited for wind power, now the second-largest source of electricity in the state, after natural gas. Oklahoma is also a likely location for one of the federal government’s four hydrogen hubs, given its abundance of natural gas, essential for the production of hydrogen fuel cells. The city of Pryor is in competition to be the location of a huge electric-vehicle battery factory.

Arkansas and Louisiana will lag the rest of the region in job growth. The Natural State will see employment gains of 1.9% this year, with much of the growth coming in northwest Arkansas, the state’s hottest labor market. Best known as the home of retail giant Walmart, Bentonville was recently selected as the site of electric vehicle start-up Canoo’s corporate headquarters and R&D center. Lowell-based trucking company J.B. Hunt is partnering with Google subsidiary Waymo to bring autonomous trucks to some of the company’s routes in Texas. U.S. Steel is building a $3 billion plant in Osceola, near Memphis, Tenn., to come on line in 2024. The project will create 900 jobs and serve automakers in neighboring Tenn. Figure on 1.7% job growth in the Pelican State, where employment is still 6% below pre-pandemic levels. Rising oil and natural gas prices are good for the state’s energy industry. In addition to drilling, Louisiana is a refining center and a top exporter of liquefied natural gas. Construction of a $30 billion LNG plant south of Lake Charles will begin in April. This will enable the export of 20 million tons of LNG per year. Other such projects are also in the works. The NOLA oil terminal being constructed on the Mississippi River will enable greater access to larger vessels and is the first major new infrastructure this part of region has seen in 40 years.

Ukraine-Russia tensions are driving the price of palladium higher. Russia supplies 35% of the world’s palladium, a precious metal used by automakers in catalytic converters. There is fear that conflict will disrupt supplies of the metal at a time when rebounding vehicle production is expected to boost palladium demand.
Odds are decent Congress will approve a final round of aid for restaurants hit hard by the pandemic. In the Senate, a bipartisan group of lawmakers has proposed $48 billion in additional funding for the Restaurant Revitalization Fund, which is run by the Small Business Admin. and ran out of money last summer. Eligible recipients include restaurants, bars and various other dining establishments. The senators want to attach the funding to a forthcoming federal spending bill.

The restaurant sector continues to struggle with the effects of COVID-19. Thanks to the virus, many customers are still wary about indoor dining. Higher costs and staffing issues are also weighing on the industry. In one recent survey, 40% of restaurant operators said business wouldn’t return to normal for at least a year.

The White House wants to direct more work to unionized construction firms. A recently signed executive order requires so-called project labor agreements on federal construction projects over $35 million. The order will affect $262 billion in federal construction projects and around 200,000 jobs. It will not apply to projects that are funded by grants to nonfederal agencies, including the bulk of those in the bipartisan infrastructure legislation that Congress passed in Nov. of last year. Opponents of the move say it will reduce competition and raise costs. Backers say it will improve access to skilled labor and workforce diversity. The construction sector is a relative bright spot for organized labor, with unionization rates slightly higher (12.6%) than the national average (10.3%).

Some relief may soon be coming to the supertight stainless steel market. But it will depend on the Dept. of Commerce granting a tariff exemption to A&T Stainless, a joint venture between Allegheny Technologies, also known as ATI, and China’s Tsingshan. A&T wants to import semifinished stainless slab from Indonesia, arguing that domestic suppliers can’t keep up with demand. If granted the exemption, A&T would restart a direct-roll anneal and pickle line in Midland, Pa., restoring 20,000 tons of monthly stainless steel sheet output. The company idled the line in June 2020 due to unfavorable tariff policies. However, there is still plenty of opposition to the proposed tariff exemption, in part because ATI produces many proprietary alloys used by the Dept. of Defense. Plus Tsingshan has key ties to the Chinese government and Communist Party. ATI maintains that the exemption wouldn’t adversely affect national security. Meanwhile, stainless steel producers face other short-term difficulties, including a recent spike in the price of nickel, key for many stainless steel alloys. Roughly two-thirds of global nickel output is used in stainless steel production.

One sector that hasn’t seen inflation surge like the rest of the economy: Health care, where price growth has largely stayed in the 2%-3% range since the beginning of the pandemic, according to one estimate. By contrast, overall inflation increased by over 7% last year, the highest figure since 1982. But expect that to change. The sector still faces the same issues... labor shortages, supply chain problems, etc...that are driving up prices in the broader economy. But health care prices are generally slower to respond to such pressures, since they are set by government programs like Medicare or negotiated in advance with private insurers. Some hospitals are signaling that they plan to factor in higher costs in their next round of negotiations with insurers, who will likely raise premiums next year. Meanwhile, Medicare plans to release initial payment rates for 2023 in the spring and summer of this year, an early indicator of just how much inflation is hitting health care. That said, other factors may keep health care inflation lower than that of the rest of the economy, including pressure from D.C. to keep prices in check.
The Dept. of Transportation wants to combat an increase in traffic fatalities. Among the agency’s priorities: Better signage for U.S. roads. Various updates to the New Car Assessment Program, which analyzes auto safety features. New rules related to automatic emergency braking technologies for new cars and trucks. Plus, reassessment of speed limits throughout the country, to ensure that they are safe. And new reporting requirements for crashes involving automated driving systems. DOT will work with state and local governments to implement the plan and use money from the bipartisan infrastructure bill that passed last Nov. to help pay for it.

Through the first nine months of 2021, there were 31,720 traffic fatalities in the U.S., up 12% from the same period in 2020 and the highest number since 2006.

A proposed merger between Frontier and Spirit would be a game-changer, turning the two low-cost carriers into the country’s fifth-largest airline. Combined, they would serve more than 145 destinations across the U.S., Latin America and the Caribbean, including new routes not currently served by either airline...

But only if the $2.9 billion transaction can get past U.S. antitrust officials. Regulators are now exercising greater scrutiny over potential mergers and acquisitions, citing fears that economic concentration will reduce competition and raise prices. Note that America’s four largest airlines...American, Delta, United and Southwest... currently account for 80% of the U.S. air travel market. The Dept. of Justice is even going after partnerships, such as American Airlines’ alliance with JetBlue.

Even so, there’s still a decent chance the merger will go through. Frontier and Spirit would still account for less than 10% of the U.S. air travel market if they merged. Most of the markets they serve are also served by other airlines. And consumers would still have other low-cost options, including Southwest.

People and goods are once again traveling across the Ambassador Bridge, a crucial conduit for cross-border trade between the U.S. and Canada. The bridge was closed off for a week by protest activity in the province of Ontario.

Some supply chains will still feel the pinch. Take automakers, many of whom were forced to slow production on both sides of the border after the bridge shutdown prevented them from getting the parts they needed. The industry is stretched so thin, because of the semiconductor shortage and other issues, that even a minor disruption can represent a significant setback. A return to normal anytime soon seems unlikely.

Another Super Bowl has come and gone. Now, football fans are wondering... Will the Monday after the big game ever become an official holiday? Many Americans already take the day off from work. An estimated 16 million did so in 2021. This year’s Super Bowl is expected to have cost employers $6.5 billion in lost productivity, thanks to a combination of absenteeism and distracted working.

While it’s unlikely Super Bowl Monday will become a federal holiday...

Things could be different at the local level. Cincinnati Public Schools, for example, canceled school the day after the game...no surprise, since the Bengals were one of this year’s Super Bowl participants. But other localities could follow suit.

Another idea: Move the big game to the Sunday before Presidents’ Day, which may happen anyway if the NFL decides to expand its 17-game regular season.

Yours very truly,

Feb. 17, 2022

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