Commercial Real Estate Market Insights Report

August 2024

National Association of REALTORS®
Research Group

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Commercial Real Estate in July

An Overview

With inflation and the labor market continuing to ease in July, the Federal Reserve's rate cuts aren't far off. Among all sectors in commercial real estate, the office sector, in particular, is eagerly awaiting these cuts. Office vacancy rates remained at a record high of 13.8% in July, underscoring the sector's ongoing challenges. Meanwhile, both retail and industrial fundaments softened further in July, with net absorption falling by 40% and 68% compared to a year ago in these two sectors, respectively. On the other hand, demand for apartments continued to surge as elevated mortgage rates hurt housing affordability.

Below is a summary of how the major commercial real estate sectors have performed as we entered the second half of the year:

Office vacancy rate remained at record highs, with vacated office spaces still outpacing those being occupied. The outlook suggests that the vacancy rate will likely rise further with negative net absorption, which is expected to persist at least through the remainder of the year and the year after. Leasing activity, an indicator of demand and interest from potential tenants, has declined even more, now sitting 63 percentage points below the pre-pandemic average. But, on a positive note, the pace of additional vacancies has slowed down. The surplus of unoccupied office space has reduced from nearly 58 million square feet a year ago to 44 million square feet in July 2024.

By contrast, the **multifamily** sector benefited from elevated mortgage rates in July. Net absorption was 90% higher than a year ago, sitting at 470,000 units. Another sign of strong demand in the sector is that landlords are offering fewer discounts on their initial asking rents compared to the pre-pandemic average. However, despite this robust demand for rental units, elevated completions and units under construction have kept the multifamily vacancy rate near 8% and rent growth at around 1% year-over-year.

Availability conditions in the **retail** sector remained tight in July. Since the end of last year, only 4.7% of retail space is available for lease, the lowest level on record. This limited availability of retail spaces is the primary reason why the retail vacancy rate has stayed near 4% since the end of 2022, despite the slowdown in demand for retail spaces. Specifically, retail net absorption is down by 40 percentage points compared to a year earlier. With fewer retail spaces under construction, the fundamentals of this sector are expected to remain tight for the rest of the year.

The **industrial** sector continued to lose momentum in July. Net absorption was nearly 70 percentage points lower than a year ago, while rent growth decelerated significantly, dropping to 3.6% from 8.1%. The vacancy rate also rose to over 6.5% from 5.1%. With inventory levels at record highs, the outlook suggests further softening in this sector for the remainder of the year. However, easing inflation in the coming months may boost demand for goods. This usually creates a ripple effect, increasing the need for industrial spaces to manage production, storage, and distribution.

Economy

Job growth (July 2024 compared to March 2020): 5.2%
Inflation (July 2024): 2.9%
Gross Domestic Product (GDP) Q2 2024: 2.8%

Both primary factors influencing the Fed's upcoming policy decisions showed signs of easing in July. Inflation fell below 3% to the lowest year-over-year rate since March of 2021. Meanwhile, job creation decelerated further in July, 47% below the average level of the past 12 months. Thus, the economy indicates that it may no longer need the cooling effects of high interest rates.

Slower job growth in July

In July, the market added 114,000 new jobs, 47% below the average monthly gain of 215,000 over the past 12 months. Consequently, the unemployment rate rose to 4.3% after remaining below this level since November 2021.

Specifically, the total number of job positions increased to 158.7 million in July. In the first seven months of the year, the economy had welcomed about 1.42 million new jobs. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 7.8 million jobs. This robust labor market activity underscores the resilience and dynamic nature of the U.S. economy.

Number of Jobs

March 2020	**150.9 million**
July 2023	**156.2 million**
July 2024	**158.7 million**

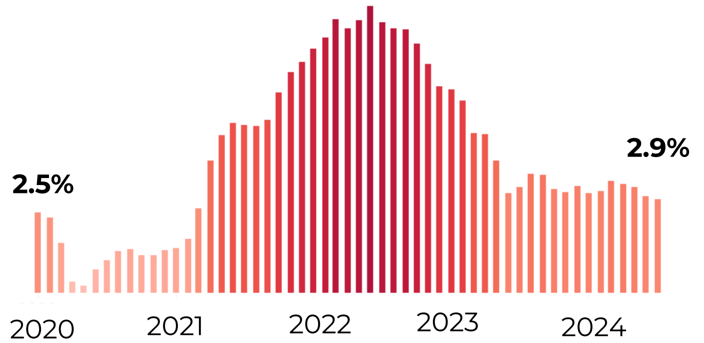
Source: NAR analysis of U.S Bureau of Labor Statistics data

Inflation fell below 3% in July

Inflation decreased further to 2.9% in July, a level last seen in March 2021. Although inflation hasn't yet reached the Fed's 2% target, it has shown consistent signs of easing, which may allow the Fed to start cutting rates as soon as September.

Meanwhile, data from the private sector suggests that rent growth, which usually represents 40% of the CPI basket, will decelerate further in the coming months. This will help to further reduce the inflation rate.

Inflation



Source: NAR analysis of U.S Bureau of Labor Statistics data

The interest rate remained unchanged

The Federal Reserve kept its interest rates unchanged at 5.5% in July. However, with slower inflation and job creation, the Federal Reserve is expected to begin reducing interest rates in its September meeting. While interest rates set the foundation for borrowing costs, these lower interest rates are expected to stimulate investment activity in commercial real estate.

The economy grew faster in Q2 2024

Surprisingly, the economy grew at a 2.8% pace in Q2 2024, faster than a 1.4% increase in the first quarter. The economy's growth picked up in the second quarter as cooling inflation and a strong labor market allowed consumers to keep spending despite high interest rates. Compared to other countries, the U.S. economy continues to outperform.

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Commercial Real Estate Lending

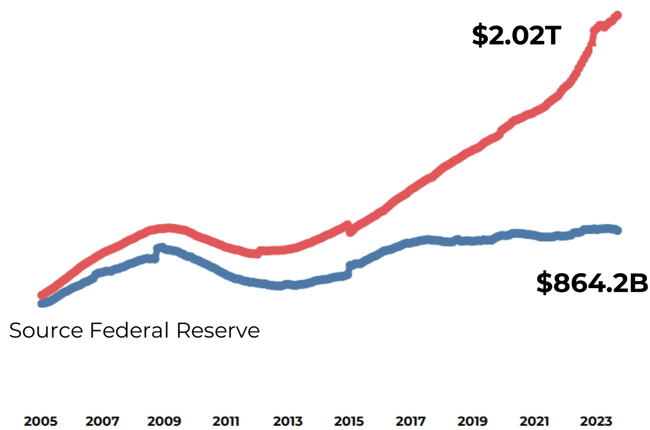
CRE loans (July 2024): $3.00 trillion
Delinquency rate of CRE loans (Q2 2024): 1.42%

CRE debt rose to $3.0 trillion in July

The volume of CRE loans increased in July, reaching $3.0 trillion. Generally, an increase in CRE debt signals stronger investor confidence, indicating that investors and developers have access to capital to finance new projects, improve existing properties, and more. However, this rise in debt also comes with challenges, as property valuations continue to be under pressure, especially in sectors like office.

By bank size, the volume of CRE loans within large domestically chartered banks fell to $864.2 million from $887.8 a year earlier. Nevertheless, the CRE loans of small domestically chartered banks continued to increase in July.

Commercial Real Estate Debt for Small and Large Banks (July 2024)

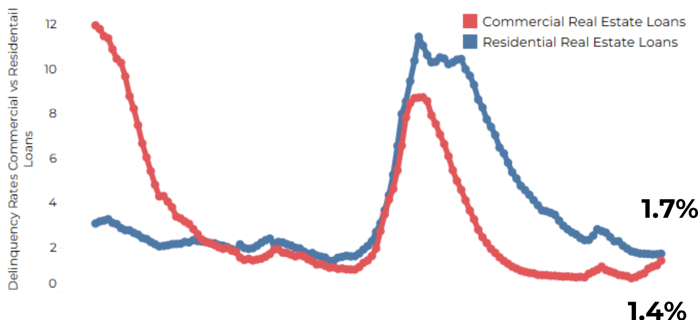


Source Federal Reserve

CRE delinquency rates significantly increased in Q2 2024

The Federal Reserve also provides data on delinquency rates for both commercial real estate (CRE) and residential loans. According to the latest data, delinquency rates for commercial loans significantly rose in Q2 2024. However, these loans maintained lower delinquency rates compared to residential loans. Specifically, the CRE delinquency rate was 0.85% in Q2 2023, which currently stands at 1.42%. Nonetheless, when delving into historical records, the delinquency rate for CRE loans consistently stays historically low, below 3.5%.

Delinquency rates Commercial vs Residential loans (Q2 2024)

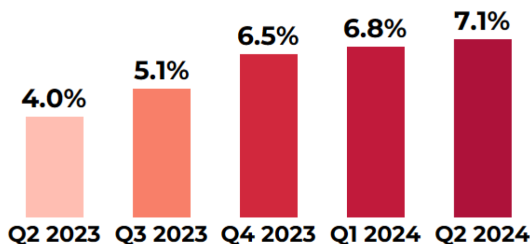


Source Federal Reserve

Office delinquency rates rose again in Q2 2024

According to the Mortgage Bankers Association, 7.1% of the balance of office property loan balances were 30 days or more days delinquent during the second quarter of the year, surpassing those of loans backed by retail and hotel properties. This is an increase from the 6.8% recorded at the end of the first quarter and a substantial jump from the 4.0% reported a year ago (Q2 2023). While the number of vacant office spaces continues to increase, concerns grow regarding the health of these commercial loans. Given that delinquent loans backed by office properties represent nearly 30% of the Commercial Mortgage-Backed Securities (CMBS) outstanding, the condition of these office loans has a large impact on the outlook of this sector.

Delinquency rates for loans backed by office properties (Q2 2024)



Source Mortgage Bankers Association (MBA)

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Office

Net absorption in the last 12 months: -44.0 million sq.ft.
Rent growth in the last 12 months: 0.9%
Cap rate: 8.8%

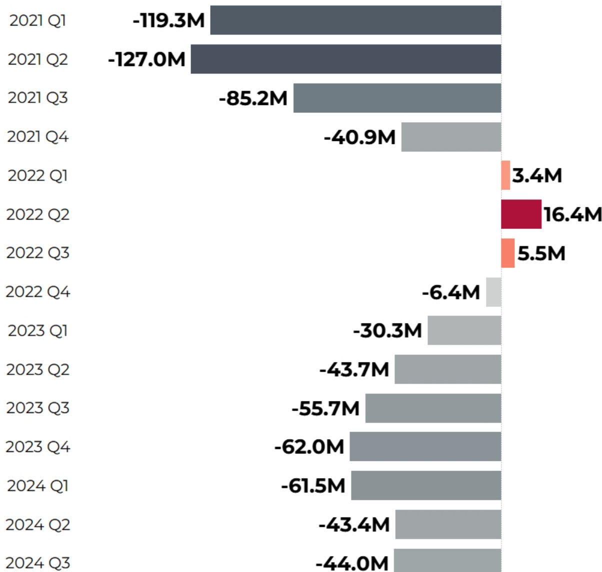
The widespread adoption of hybrid work models, a lasting effect of the pandemic on work culture, has led to a continued decline in demand for traditional office spaces.

Although negative absorption is seen across all office classes, Class A spaces are most impacted, with vacancy rates increasing by 1% over the past year, now standing at 19.7%. In contrast, Class B office spaces have experienced less negative absorption than Class A for the fourth consecutive quarter, currently showing a 12.5% vacancy rate, while Class C spaces have only a 5.1% vacancy rate as companies navigate economic challenges and focus on cost-cutting measures. Despite this, annual office deliveries have halved since last year, contributing to a modest rent growth of 0.2%, now at 0.9%.

The most significant increases in vacant office spaces are in major tech hubs like San Francisco, Houston, Dallas-Fort Worth, Denver, and Washington, DC, largely due to companies and workers relocating to regions with lower operational costs.

Conversely, the top-performing markets in this sector, such as Hickory, NC, Savannah, GA, and Wilmington, NC, boast vacancy rates below 3%.

Net Absorption 12 Mo in sq. ft



Top 10 areas with the largest vacancy rates

	2024 Q3	2023 Q3
San Francisco, CA	22.56%	20.39%
Houston, TX	18.74%	18.64%
Dallas-Fort Worth, TX	18.20%	17.62%
Washington, DC	17.19%	16.02%
Denver, CO	17.02%	15.95%
Phoenix, AZ	16.88%	15.68%
Austin, TX	16.77%	16.23%
Atlanta, GA	16.56%	15.76%
Chicago, IL	16.32%	16.10%
Los Angeles, CA	16.24%	15.06%

Top 10 areas with the lowest vacancy rates

	2024 Q3	2023 Q3
Wilmington, NC	1.44%	1.91%
Gulfport-Biloxi, MS	1.73%	2.10%
Savannah, GA	1.79%	1.73%
Hickory, NC	1.81%	2.17%
Myrtle Beach, SC	1.96%	2.21%
Huntington, WV	2.07%	1.86%
Davenport, IA	2.17%	2.18%
Olympia, WA	2.41%	2.38%
Asheville, NC	2.46%	2.49%
Pensacola, FL	2.88%	1.92%

Source: NAR analysis of CoStar data

Multifamily

Absorption of units in the last 12 months: 470,644 units
Rent growth in the last 12 months: 1.3%
Cap rate: 6.1%

As the third quarter of 2024 progresses, the multifamily housing market is adjusting to an increasing trend of people choosing to rent due to high interest rates making homeownership less attainable. This shift is highlighted by a 90% increase in 12-month absorption totaling around 470,000 units. Although the supply of new units still outpaces absorption by 37%, annual rents have risen by 0.3%, marking the first significant increase since the 1st quarter of 2022.

While the vacancy rate for Class A multifamily properties has declined by 0.2%, it remains the highest among multifamily categories at 10.7%, with annual rent growth at 0.6%. In contrast, Class B properties, which have traditionally had lower absorption rates over the past year, are now seeing increased demand for the 5th consecutive quarter. These properties have a lower vacancy rate of 8.8% and have experienced rent growth of 1.2% over the past year. This trend underscores the financial pressures many are facing, driving more people toward more affordable housing options as inflation continues to exceed the 2% target.

While rent growth is sluggish nationwide, some Sun Belt metro areas are actually seeing a decline due to an oversupply of properties. Austin, TX, and Fort Myers, FL, witness rent decreases of over 5%. On the other hand, Lancaster, PA, Evansville, IN, and Springfield, MA, are bucking this trend, with rent increases exceeding 6%, significantly above the national average of 1.3%.

In major urban areas like Dallas-Fort Worth, TX, New York, NY, Houston, TX, and Atlanta, GA, more than 16,000 multifamily units were absorbed over the year ending in July. This surge in demand underscores the strong performance of the rental market in these high-cost regions.

Top 10 areas with the strongest 12-month absorption

	2024 Q3	2023 Q3
Dallas-Fort Worth, TX	23,372	8,956
New York, NY	21,550	18,831
Houston, TX	16,655	8,651
Atlanta, GA	16,469	3,471
Phoenix, AZ	15,649	8,895
Austin, TX	15,595	7,141
Washington, DC	14,976	9,083
Orlando, FL	11,798	4,750
Charlotte, NC	11,211	4,894
Seattle, WA	10,865	5,492

Top 10 areas with steepest 12 Mo rent declines

	2024 Q3	2023 Q3
Fort Myers, FL	-5.62%	-0.24%
Austin, TX	-5.02%	-4.02%
Naples, FL	-4.10%	-0.66%
Raleigh, NC	-2.67%	-1.88%
Jacksonville, FL	-2.59%	-1.80%
Killeen, TX	-2.37%	2.19%
Sarasota, FL	-2.05%	-2.49%
Lakeland, FL	-1.96%	-0.01%
Port St. Lucie, FL	-1.93%	0.02%
Huntsville, AL	-1.90%	-0.95%

Source: NAR analysis of CoStar data

Retail

Net absorption in the last 12 months: 34.1 million sq. ft.
Rent growth in the last 12 months: 2.4%
Cap rate: 6.9%

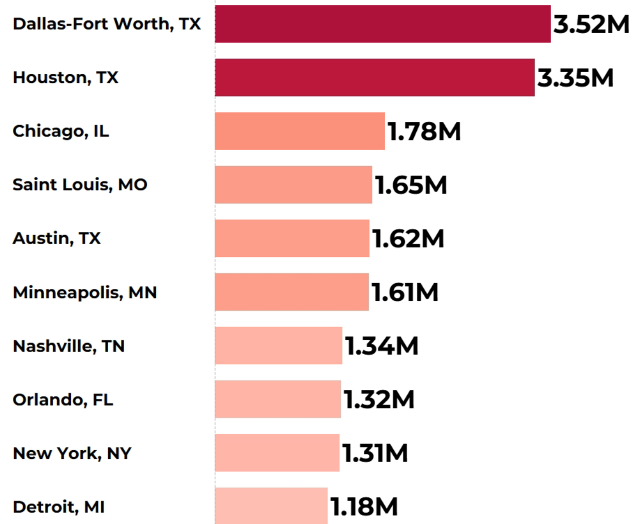
Retail real estate experienced significant net absorption growth from 2014 to 2017, peaking before the e-commerce boom began to impact the market. The rise of online shopping led to a decline in retail space absorption even before the pandemic. COVID-19 intensified this trend, causing a sharp drop in retail absorption as lockdowns shifted consumer behavior toward online shopping. Over the past year, net absorption has fallen by 40%, and rent growth decreased by 1.5% to 2.4%. Consequently, the retail market continues to shift towards e-commerce, with less physical space being utilized.

General Retail spaces and Neighborhood Centers have been key players, contributing to about 86% of the positive net absorption as of July 2024. Conversely, malls vacated 1.8 million square feet of space, increasing their vacancy rate to a new high of 8.8%.

The overall retail vacancy rate has remained at a record low of 4.1% for the seventh consecutive quarter, with deliveries only slightly surpassing absorption.

General Retail maintains the lowest vacancy rate at 2.6%. Neighborhood Centers and Power Centers recorded the highest rent increases, at 3.3% and 3.1%, respectively

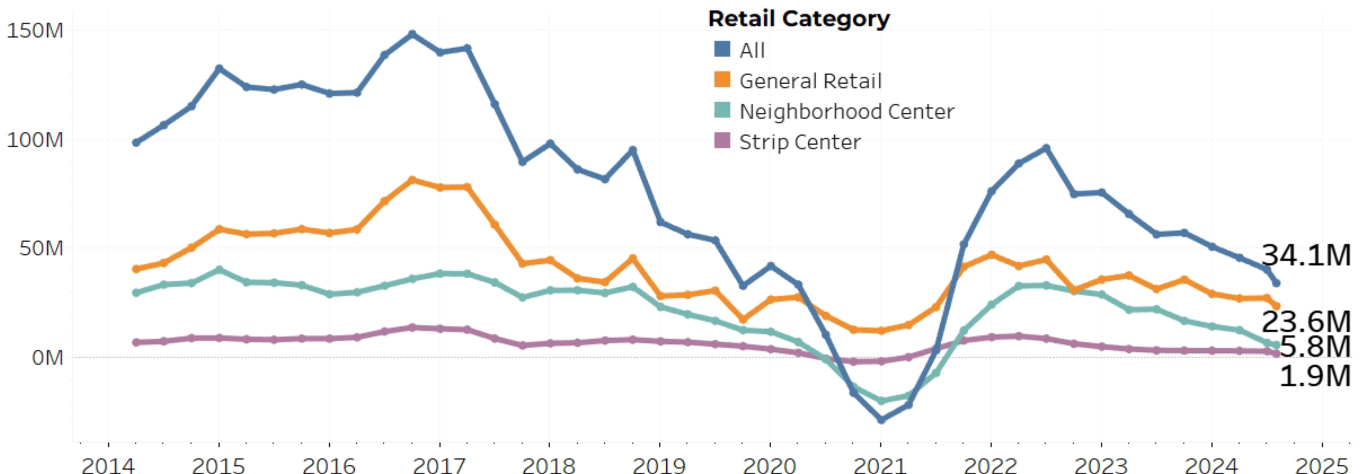
Top 10 areas with the strongest net absorption in the last 12 months



This July, Salt Lake City, UT, and Toledo, OH, experienced the highest year-over-year rent growth at 8.8% and 8.0%, respectively. On the flipside, Pittsburgh, PA, and San Francisco, CA, had rent declines of more than 2%.

Moreover, Texas is excelling in retail real estate, with cities like Dallas-Fort Worth and Houston recording the highest year-over-year retail space absorption rates in the nation, surpassing 3 million sq. ft. as of July 2024.

Net Absorption 12 Mo by type (Q1 2014 – Q3 2024)



Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 83.4 million sq. ft.
Rent growth in the last 12 months: 3.6%
Cap rate: 7.3%

The industrial real estate sector, which flourished in 2022, is now grappling with an oversupply of properties and declining absorption rates. Over the past year ending in July 2024, net absorption has dropped by 68%, hitting a decade-low of 83.4 million square feet. Also, with deliveries outpacing absorption at a 5.6 to 1 ratio, the vacancy rate climbed by 1.6% to 6.7%, while rent growth has slowed to 3.6%, though it still outperforms other commercial real estate segments.

Logistics spaces remain the only industrial category with positive absorption, totaling nearly 93.5 million square feet in the year ending July. In contrast, Flex and Specialized spaces had 6.6 million and 3.6 million more vacated square feet than occupied, respectively. Logistics spaces also lead in rent growth, with a 4.1% increase, while Specialized spaces saw a 3.0% rise and Flex spaces grew by 2.8%.

Dallas-Fort Worth, TX, recorded the highest industrial space absorption in the last 12 months, followed by Houston, TX, and Phoenix, AZ, each absorbing over 15 million square feet by July 2024.

As the third quarter unfolds, Reno, NV, and Memphis, TN, along with Los Angeles, CA, have dropped from the top 10 in 2023 to the bottom 10 in 12-month industrial absorption. The strong market interest seen in 2022 and early 2023 has waned, leading to slower rent growth. However, Los Angeles still maintains a vacancy rate of 5.6%, which is below the national average of 6.7%.

Richmond, VA, Orlando, FL, and Columbus, OH, have seen the highest rent increases. Due to strong warehouse demand, industrial rents in these cities have risen by over 8% in the past year. This trend highlights the economic growth and competitive nature of these regions' industrial markets.

Top 10 areas with the strongest 12-month absorption

	2024 Q3	2023 Q3
Dallas-Fort Worth, TX	20.34M	37.09M
Houston, TX	18.28M	24.08M
Phoenix, AZ	15.01M	19.43M
Savannah, GA	9.04M	10.59M
Austin, TX	7.50M	3.60M
Chicago, IL	7.12M	26.71M
Minneapolis, MN	6.12M	3.83M
Philadelphia, PA	6.04M	7.27M
Nashville, TN	5.98M	5.82M
Atlanta, GA	5.64M	10.22M

Top 10 areas with the weakest 12-month absorption

	2024 Q3	2023 Q3
Los Angeles, CA	-12.50M	-14.59M
Reno, NV	-4.24M	4.27M
Portland, OR	-4.20M	1.92M
New York, NY	-3.36M	-1.12M
Seattle, WA	-3.25M	0.53M
Memphis, TN	-2.83M	7.75M
Harrisburg, PA	-2.63M	2.72M
Winston-Salem, NC	-2.57M	-0.14M
San Diego, CA	-2.55M	-1.84M
San Francisco, CA	-2.03M	-1.61M

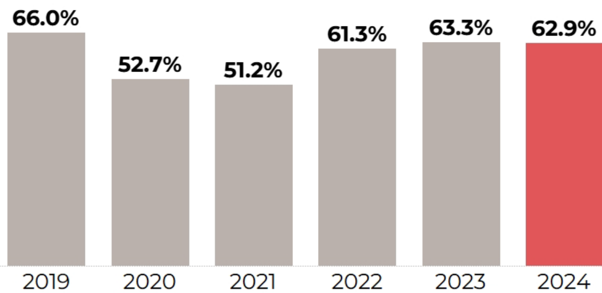
Source: NAR analysis of CoStar data

Hotel

Occupancy rate in the last 12 months: 62.9%
Average daily rate in the last 12 months: $157/room
Revenue per available room in the last 12 months: $99/room

As we start Q3 2024, the hospitality sector is maintaining stability. Hotel occupancy rates have leveled off at around 63%, remaining roughly 3% below pre-pandemic figures, which suggests that a complete recovery may be elusive due to the prevalence of remote work. Nevertheless, average daily rates and revenue per available room have now exceeded pre-pandemic benchmarks.

12-month Occupancy Rate in July



Specifically, in July 2024, the average daily rate (ADR) per room rose to $157/room, up 20% from July of 2019. The revenue per available room (RevPAR) also increased to $99/room, up 15% compared to the same period in 2019.

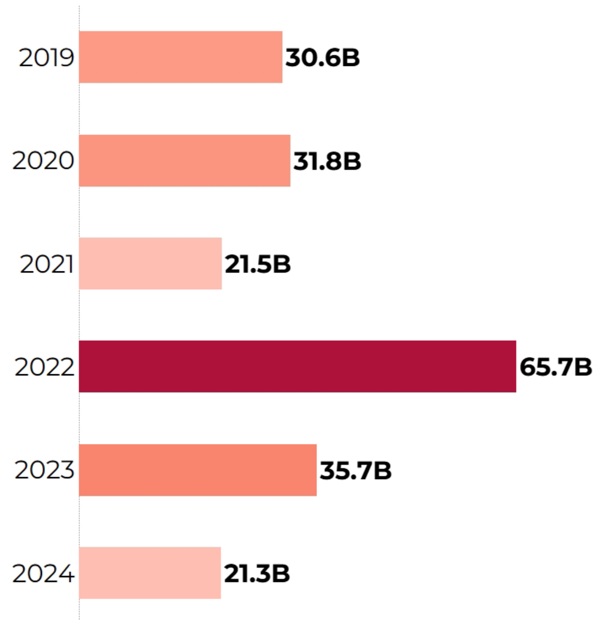
12-month ADR and RevPAR in July

	Average daily rate	Revenue per available room
2019	$131	$86
2020	$120	$63
2021	$110	$56
2022	$142	$87
2023	$154	$97
2024	$157	$99

ADR is the total revenue/number of rooms.
RevPAR is ADR x occupancy rate.

Sales acquisitions have declined since the last year. In July 2024, the 12-month sales volume dropped to $21.3 billion, from $35.7 billion in the previous year.

12-month Sales Volume as of July



Source: NAR analysis of CoStar data

At the local level, the hospitality sector on Hawaii's Kauai Island is flourishing, with the Average Daily Rate (ADR) increasing by 60%, Revenue per Available Room (RevPAR) rising by 56% from pre-pandemic levels, and an impressive occupancy rate of 70%. Maui Island leads the nation with outstanding figures, with an ADR of $556 and a RevPAR of $364. Meanwhile, New York City holds the highest hotel occupancy rate at 83%.

Conversely, regions in California, especially San Francisco/San Mateo and San Jose/Santa Cruz, are still facing significant challenges. RevPAR remains 24% and 27% below pre-pandemic levels, respectively, indicating ongoing recovery difficulties.

COMMERCIAL REAL ESTATE REPORT
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