Commercial Real Estate Market Insights Report

April 2024

National Association of REALTORS®
Research Group

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Commercial Real Estate in the first quarter of 2024; An Overview

The commercial real estate (CRE) market has seen few changes during the year's first quarter. Vacancy rates were on the rise, and rent growth continued to decelerate across all market sectors. Specifically, the office vacancy rate reached new record highs, reaching almost 14%, while fundamentals in both the retail and industrial sectors decelerated. These trends reflect the persistent trends and challenges from the previous year that continue to influence the market. Interest rates remain steady at 5.5%, and the effects of hybrid work impact on office spaces are factors that are not going away overnight. In the meantime, the U.S. economy started to slow down after previously exceeding expectations. Nonetheless, consumers continue to spend, helping to keep the economy resilient.

Below is a summary of the performance across the major commercial real estate sectors during the first quarter of 2024:

Activity in the **office** sector dropped further in the first three months of the year. While office availability and delinquencies rose during this period, construction levels remained nearly unchanged. This further increased the office vacancy rate, reaching a new high of 13.7% in March. Specifically, there is more than double the amount of unoccupied office square footage compared to a year ago. Looking ahead, the forecast suggests a persistent increase in available office spaces. Leasing activity, which helps to gauge the level of demand and interest from potential tenants, is about 30 percentage points below the pre-pandemic levels.

On the other hand, persistently high mortgage rates, hovering around 7%, have spurred demand for apartment buildings. The **multifamily** sector not only rebounded from the lows it experienced last year but also saw net absorption in the first quarter of this year, which more than doubled the activity of the same period a year ago. However, despite the stronger demand, the vacancy rate increased to 7.8% in March. This rise is mainly due to the influx of new housing supply, which has absorbed the increased demand and prevented vacancy rates from decreasing.

Demand for **retail** spaces fell below pre-pandemic levels during the first quarter. Over the past year, net absorption has significantly decreased, dropping by approximately 30 percentage points. But, despite these lower absorption rates, the limited availability of retail spaces has kept vacancy rates low, hovering around 4%, the lowest rate among any other sector in the commercial real estate market. In the meantime, the fundamentals of this sector will remain solid in 2024 as new construction deliveries are likely to diminish. This reduction in new supply can lead to tighter market conditions, potentially supporting rental rates and occupancy levels, essential components of the commercial real estate sector.

Respectively, the **industrial** sector has also slowed during the first quarter of the year, with net absorption falling to levels not seen in over a decade. While online shopping and e-commerce pushed activity to record high levels at the end of 2021 and beginning of 2022, net absorption is currently nearly 66% lower than a year ago and 45% below the pre-pandemic level. Nevertheless, rent growth continued to be the fastest among any other sector of the commercial real estate market. Specifically, rents for industrial spaces are 5.3% higher than a year ago. The outlook for the industrial real estate market remains positive, driven by factors such as the lasting impact of e-commerce and robust construction spending.

Economy

Job growth (compared to March 2020): 4.8%
Inflation (March 2024): 3.5%
Gross Domestic Product (GDP) Q1 2024: 1.6%

During the first quarter of the year, U.S. economic growth decelerated to 1.6%, marking the lowest rate of expansion in the past two years. Persistent high-interest rates, geopolitical tensions, and a rise in imports contributed to slower economic growth. Nevertheless, compared to other countries, the U.S. economy continues to outperform. Despite higher interest rates, consumer spending has advanced, buoyed by substantial gains in employment and earnings during the first quarter.

Strong start to the year for the labor market

The U.S. labor market remained strong, with significant job additions in the first three months of 2024, maintaining the unemployment rate below 4% despite an increase from the previous month.

Specifically, the total number of job positions climbed to 158.1 million in March. In the first quarter of the year, the economy had welcomed about 830,000 new jobs. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 7.2 million jobs in the last 4 years. This robust labor market activity underscores the resilience and dynamic nature of the U.S. economy.

Number of Jobs

March 2020	**150.9 million**
March 2023	**155.2 million**
March 2024	**158.1 million**

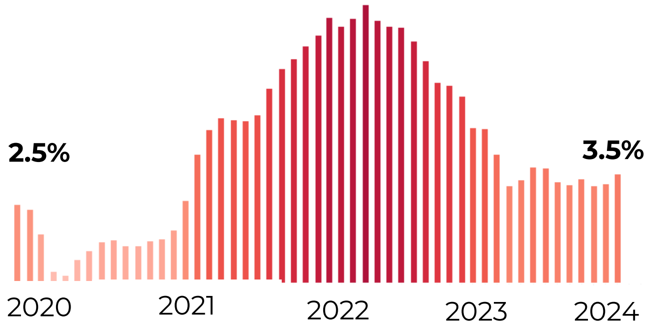
Source: NAR analysis of U.S Bureau of Labor Statistics data

Inflation rose, making it harder for the Fed to cut the rates soon

While inflation hasn't yet reached the Federal Reserve's goal of 2%, it rose in March for the second straight month to 3.5%, driven mostly by the higher cost of rents.

These recent increases have sparked concerns about when the Federal Reserve will feel confident that price pressures are subdued and it can begin cutting interest rates. However, data from the private sector suggests that rent growth included in the CPI basket will decelerate further in the upcoming months, which should help bring down the inflation rate.

Inflation



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

The interest rate remained unchanged

The Federal Reserve kept unchanged its interest rates at 5.5% during the first quarter. With rate hikes over, the Federal Reserve has announced its intention to initiate rate cuts later this year. While interest rates set the foundation for borrowing costs, these lower interest rates are expected to stimulate investment activity in commercial real estate. However, recent increases of the inflation rate delays this decision.

The economy grew slower in Q1 2024

After exceeding all expectations with its rapid expansion, the U.S. economy experienced a slowdown in the first quarter of the year. According to the Bureau of Economic Analysis (BEA), the GDP grew 1.6%, down from a 3.4% increase in the final quarter of 2023. In fact, this is the lowest rate of expansion in the past two years. Persistent high-interest rates, geopolitical tensions, and a rise in imports contributed to slower economic growth. Nevertheless, despite grappling with high-interest rates and inflation, Americans maintained a persistent spending momentum.

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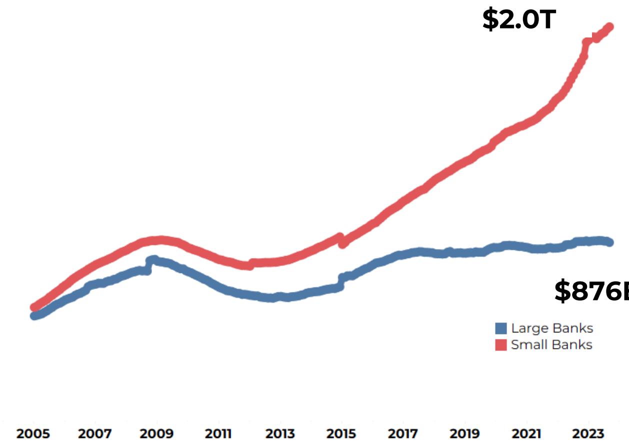
Commercial Real Estate Lending

CRE loans (March 2024): $2.99 trillion
Delinquency rate of CRE loans (Q4 2023): 1.2%

CRE debt increased in Q1 2024

Despite higher interest rates, commercial real estate debt is still on the rise this year. Specifically, within small, domestically chartered commercial banks, the volume of CRE loans has surpassed $2.0 trillion. This is an increase from the $1.9 trillion in April of 2023, following the collapse of the two regional banks. Within large domestically chartered banks, the volume of CRE loans was lower than the year-end figures, hovering around $876 billion.

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

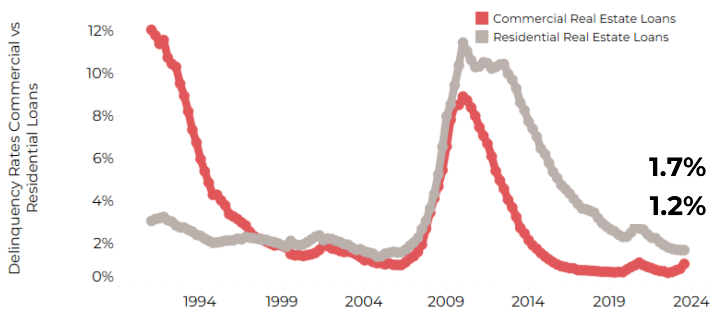


Source Federal Reserve

Rising CRE delinquency rates but still historically low

The Federal Reserve also provides data on delinquency rates for both commercial real estate (CRE) and residential loans. According to the latest data, commercial loans consistently maintain lower delinquency rates compared to residential loans. However, while the delinquency rate for residential loans is decreasing, there is an upward trend in delinquent commercial real estate loans since the last quarter of the previous year. Specifically, the CRE delinquency rate was 0.69% in Q4 2022, and currently, it stands at 1.17%. 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 (Q4 2023)

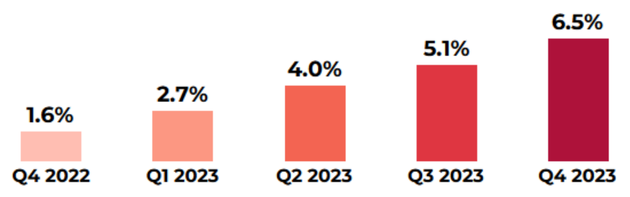


Source Federal Reserve

Rising delinquent loans backed by office properties

While delinquency rates for commercial loans are rising, another source – the Mortgage Bankers Association – provides information on delinquency rates by property type. The data reveals that 6.5% of the balance of office property loan balances were 30 days or more days delinquent, as of the end of the year, surpassing those of loans backed by retail and hotel properties. This is an increase from the 5.1% recorded in the previous quarter (Q3 2023) and a substantial jump from the 1.6% reported a year ago (Q4 2022). 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 (Q4 2023)



Source Mortgage Bankers Association (MBA)

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Office

Net absorption in the last 12 months: -57.9 million sq.ft.
Rent growth in the last 12 months: 0.7%
Cap rate: 8.4%

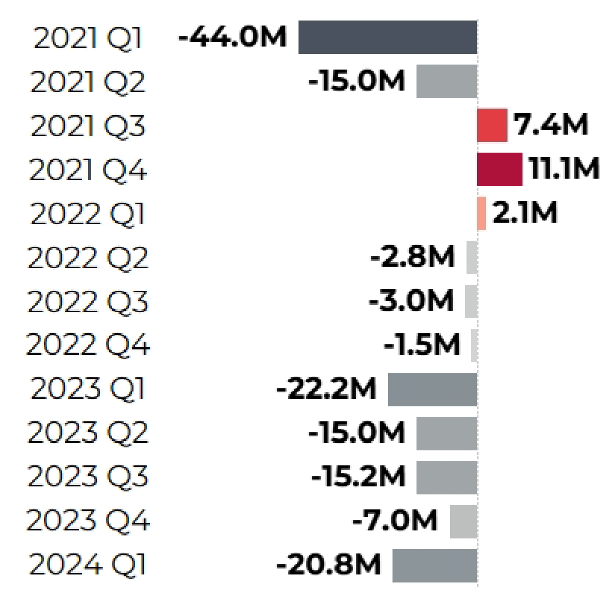
With the establishment of hybrid work models as a legacy of the pandemic's impact on work culture, the demand for traditional office spaces has continued to decline.

Over a year ending March, the amount of vacated office space surged by 97% over the previous year, with the vacancy rate hitting a decade-high of 13.7%—up by 1.1% from the prior year. In a notable shift, the withdrawal from office spaces has predominantly impacted Class A buildings this year ending in March, which now account for 49% of all vacated space, compared to the previous year when Class B spaces took the majority hit at 70% of all negative absorption.

On a regional level, significant surges in unoccupied office space have been most notable in key tech hubs, including San Francisco, Houston, Dallas-Fort Worth, Austin, and Chicago, IL. This uptick has been influenced by the exodus of many businesses and professionals seeking regions with lower operational costs.

Meanwhile, this month, all five of the top five performers in the category have a vacancy rate under 2%, with Wilmington, NC, and Savannah, GA, outperforming the others.

Net Absorption in sq. ft



Top 10 areas with the largest vacancy rates

	2024 Q1	2023 Q1
San Francisco, CA	21.69%	17.14%
Houston, TX	18.64%	18.28%
Dallas-Fort Worth, TX	17.97%	17.58%
Washington, DC	16.74%	15.84%
Austin, TX	16.68%	14.88%
Chicago, IL	16.64%	15.36%
Denver, CO	16.39%	15.21%
Phoenix, AZ	16.09%	14.69%
Los Angeles, CA	16.03%	14.60%
San Jose, CA	15.65%	12.18%

Top 10 areas with the lowest vacancy rates

	2024 Q1	2023 Q1
Wilmington, NC	1.46%	1.74%
Savannah, GA	1.71%	1.93%
Myrtle Beach, SC	1.86%	2.19%
Hickory, NC	2.01%	3.19%
Asheville, NC	2.17%	2.28%
Pensacola, FL	2.18%	2.78%
Huntington, WV	2.22%	1.74%
Davenport, IA	2.23%	2.28%
Gulfport-Biloxi, MS	2.27%	3.59%
Olympia, WA	2.53%	2.17%

Source: NAR analysis of CoStar data

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Multifamily

Absorption of units in the last 12 months: 356,984 units
Rent growth in the last 12 months: 0.7%
Cap rate: 5.9%

As the first quarter of 2024 wrapped up, the multifamily sector is adjusting to a landscape where an increasing number of individuals are opting to rent, driven by high-interest rates that make homebuying less attainable. This shift is accentuated by a 141% surge in 12-month absorption. Despite that, vacancy rates reached a new 10-year high of 7.8% as a direct result of unit deliveries outpacing absorption by 74% in the past 12 months. The Class A multifamily bears the brunt of it, with vacancy rates reaching 10.6% and a decline in rent growth to -0.2% this quarter. This contrasts with Class B properties, where the vacancy rate stands at 8.7%, providing a comparative perspective on the market's tilt. Additionally, a return to positive quarterly rent growth after previous declines hints at a tentative positive rent trajectory despite the subdued annual increase of 0.7%.

While rent growth is slowing down across the country, certain locales like Ocala and Fort Myer, FL, along with Austin, TX, are grappling with particularly steep rent reductions, with rents dropping over 5% from the previous year. Conversely, a few cities are bucking this trend and witnessing considerable rent increases. Rockford, IL; Kingsport, TN; Salinas, CA; and Anchorage, AK, are all observing rent hikes that surpass 5%, signaling strong growth in these markets.

Major urban centers such as New York, NY, Dallas-Fort Worth, TX, Washington, DC, Phoenix, AZ, and Austin, TX, have not only filled over 10,000 multifamily units in the year up to March but have also significantly improved their occupancy rates from the previous year. This robust demand for apartments persists even as high mortgage rates constrain the buying options for many potential homeowners, signaling a continued strong performance of the rental market in these higher-cost areas of the country.

Top 10 areas with fastest rent growth

	2024 Q1	2023 Q1
Rockford, IL	6.64%	6.12%
Kingsport, TN	5.78%	7.49%
Salinas, CA	5.09%	2.36%
Anchorage, AK	5.04%	5.99%
Evansville, IN	4.97%	3.99%
Syracuse, NY	4.93%	5.75%
Youngstown, OH	4.86%	6.28%
Lexington, KY	4.83%	5.50%
Rochester, NY	4.74%	5.57%
Providence, RI	4.44%	5.42%

Top 10 areas with the strongest 12-month absorption

	2024 Q1	2023 Q1
New York, NY	20,436	23,163
Dallas-Fort Worth, TX	15,691	3,166
Washington, DC	12,698	7,752
Phoenix, AZ	12,115	4,919
Austin, TX	10,232	6,536
Houston, TX	9,904	4,552
Atlanta, GA	9,850	-844
Minneapolis, MN	9,270	6,345
Chicago, IL	9,011	7,402
Orlando, FL	8,291	3,363

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 45.8 million sq. ft.
Rent growth in the last 12 months: 3.1%
Cap rate: 6.8%

In the retail real estate market, while absorption has dropped by 31% compared to a year ago, it's also lower than the pre-pandemic levels. Meanwhile, this year has also seen a 29% uptick in the delivery of new retail spaces. This interplay between absorption and new supply has contributed to a 1.1% decline in rent growth from last year.

Nevertheless, the sector has been maintaining a record-low vacancy rate of 4.1% for the fourth quarter in a row, the lowest among all commercial real estate sectors, indicating a strong undercurrent of demand within the retail space market.

Focusing on retail categories, General Retail spaces and Neighborhood Centers have been instrumental, accounting for approximately 86% of the net absorption as of March 2024.

Net Absorption 12 Mo by type (March 2016, 2020, and 2024)

	2016 Q1	2020 Q1	2024 Q1
General Retail	57.32M	26.86M	27.43M
Mall	11.24M	-6.03M	1.23M
Neighborhood Center	29.86M	7.38M	11.90M
Other	2.82M	0.02M	0.36M
Power Center	9.28M	1.99M	1.57M
Strip Center	9.09M	2.17M	2.98M
All	**119.60M**	**32.38M**	**45.48M**

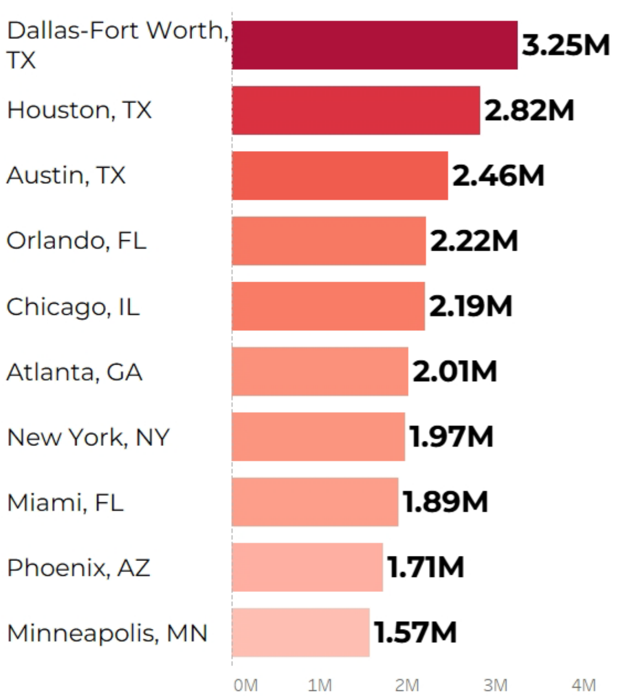
Retail space rents are still higher compared to last year, but the growth pace has eased, perhaps as consumers become wary amid climbing expenses. Retail asking rents have risen by 3.1% nationally, less than the previous year's peak of 4.2%, but still higher than before the pandemic.

Neighborhood Centers and Power Centers experienced the highest increases in rent at 3.8% and 3.7%, respectively. General Retail saw a smaller increase of 2.8% but maintains the lowest vacancy rate at 2.6% across retail subsectors.

In the Sun Belt, Raleigh, NC, and Greensboro, NC, are setting the pace with an impressive annual rent growth hovering around 11%. Phoenix, AZ, closely follows with a notable 9% increase in rental rates.

Moreover, Texas is excelling in retail real estate, particularly in cities like Dallas-Fort Worth, Houston, and Austin, which have recorded the highest retail space absorption rates in the nation as of March 2024.

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



Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 124.1 million sq. ft.
Rent growth in the last 12 months: 5.3%
Cap rate: 7.3%

The industrial market is seeing a notable transformation, with net absorption plummeting by 66% from the prior year to 124.1 million square feet, even as almost the highest volume of new space this decade enters the market. This dynamic has led to an increase in the vacancy rate to 6.2%, a leap from the former 4.3%. In parallel, the pace of rent increases has moderated to 5.3%, down from the previous 9.9%. Nevertheless, the industrial domain continues to outperform other commercial real estate categories in rent growth, maintaining levels similar to those before the pandemic.

By branch of the industrial sector, logistics spaces lead with a 6.2% rent increase. Meanwhile, specialized spaces have seen a rise of 4.0 %, and flex spaces are growing at a rate of 3.1 %.

Dallas-Fort Worth, TX, had the largest absorption of industrial space in the past 12 months. Houston, TX, Chicago, IL, and Phoenix, AZ, absorbed more than 10 million square feet over the past 12 months ending in March 2024.

In a contrasting trend, Los Angeles, CA, saw over 15 million square feet of industrial space emptied. While there was strong market interest in early 2022, the momentum has waned with a slight increase in vacancies. Still, Los Angeles holds onto a vacancy rate of 4.9%, staying below the national average of 6.2%.

Additionally, Orlando, Tampa, FL, and Phoenix, AZ, have experienced the most notable rent escalations. Industrial space rents in these areas have climbed over 10 percent since last year, propelled by a consistent and strong demand for warehouse properties. This trend reflects the broader economic growth in the region, attracting businesses and fueling a competitive industrial market.

Top 10 areas with the strongest 12-month absorption

	2024 Q1	2023 Q1
Dallas-Fort Worth, TX	23.46M	40.73M
Houston, TX	17.04M	32.73M
Chicago, IL	15.95M	27.90M
Phoenix, AZ	12.15M	22.25M
Savannah, GA	8.25M	12.24M
Austin, TX	6.82M	6.94M
Philadelphia, PA	6.18M	9.27M
Richmond, VA	6.18M	9.63M
Detroit, MI	6.06M	4.83M
Nashville, TN	6.06M	9.98M

Top 10 areas with the weakest 12-month absorption

	2024 Q1	2023 Q1
Los Angeles, CA	-15.29M	-9.68M
Inland Empire, CA	-3.43M	12.22M
San Diego, CA	-2.92M	0.30M
Seattle, WA	-2.79M	6.25M
New York, NY	-2.69M	0.18M
Shreveport, LA	-2.25M	0.58M
San Francisco, CA	-2.08M	-0.37M
San Jose, CA	-2.06M	0.42M
Winston-Salem, NC	-1.96M	1.03M
Portland, OR	-1.60M	5.27M

Source: NAR analysis of CoStar data

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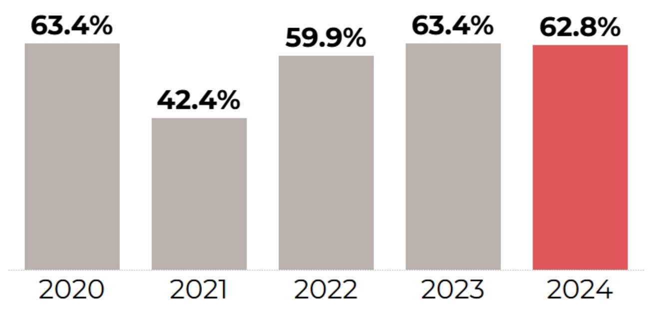
Hotel

Occupancy rate in the last 12 months: 62.7%
Average daily rate in the last 12 months: $156/room
Revenue per available room in the last 12 months: $98/room

At the outset of 2024, the hospitality industry has shown signs of progress. The hotel industry is nearing a full recovery, with occupancy rates now just 0.6% below pre-pandemic levels. Moreover, average daily rates (ADR) and revenue per available room (RevPAR) are now surpassing those seen before the pandemic struck.

12-month Occupancy Rate in March



Specifically, in March 2024, the average daily rate (ADR) per room rose to $157/room, up 19% from March of 2020. The revenue per available room (RevPAR) also increased to $98/room, up 13% compared to the same period in 2020.

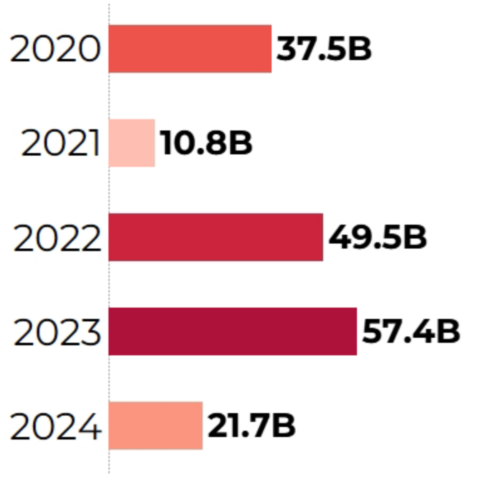
12-month ADR and RevPAR in March

	Average daily rate	Revenue per available room
2020	$131	$83
2021	$96	$41
2022	$132	$79
2023	$153	$97
2024	$157	$98

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

Sales acquisitions have declined since the last year. In March 2024, the 12-month sales volume dropped to $21.7 billion from $57.4 billion in the previous year.

12-month Sales Volume as of March



Source: NAR analysis of CoStar data

Maui Island's hospitality sector is riding high, with its Average Daily Rate (ADR) soaring to 57% more than what it was before the pandemic, marking the nation's top figures at $572 for ADR and $380 for Revenue Per Available Room (RevPAR). Meanwhile, New York City boasts the highest hotel occupancy at 82%. Sarasota, FL, is also on a successful trajectory with a significant 47% surge in hotel RevPAR.

On the flip side, California's areas, particularly San Francisco/San Mateo and San Jose/Santa Cruz, are grappling with a lingering 25% drop in RevPAR from pre-pandemic figures, reflecting ongoing recovery challenges.

COMMERCIAL REAL ESTATE REPORT
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