Commercial Real Estate Market Insights Report

May 2024

National Association of REALTORS®
Research Group

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Commercial Real Estate in April 2024; An Overview

The commercial real estate (CRE) market entered the second quarter of the year with persistently rising vacancy rates and slowing rent growth across most market sectors. Specifically, the office vacancy rate reached new record highs, approaching nearly 14%, while fundamentals in retail and industrial sectors decelerated. High interest rates and the effects of hybrid work on office spaces are the main factors that continue to hamper this sector. In the meantime, the U.S. economy started to slow down after previously exceeding expectations, reflecting the impact of inflation pressures on consumers.

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

At the beginning of the year's second quarter, fewer additional office spaces were vacated than occupied for the first time since the end of 2022. Even though net absorption remains negative with more vacated than occupied office spaces, this is the first time the gap between vacated and occupied office spaces has narrowed. However, the vacancy rate rose even further to 13.8% in April 2024. 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, high mortgage rates, hovering around 7%, continue to keep strong demand for apartment buildings. The **multifamily** sector not only rebounded from the lows it experienced last year, but net absorption is more than double that of the same period a year ago. This translates to more than twice of the additional occupied rental units than vacated compared to last April. Nevertheless, even with this strong demand, the vacancy rate remained at 7.8%. This is mainly due to the influx of new rental housing supply entering the market after the record highs in apartment construction over the past couple of years. The completion of these additional rental units has absorbed the higher demand and prevented vacancy rates from easing.

Demand for **retail** spaces remained below the pre-pandemic levels as net absorption slowed further in April. Compared to a year ago, net absorption is significantly lower by approximately 30 percentage points. However, the limited availability of retail spaces keeps vacancy rates low, hovering around 4%, the lowest rate among any other sector in the commercial real estate market. With new construction deliveries likely to diminish even further, the fundamentals of this sector are expected to remain solid in 2024.

The **industrial** sector couldn't escape the impact, with demand for industrial spaces also decelerating. Net absorption has dropped to levels not seen in over a decade. After reaching record-high levels at the end of 2021 and the beginning of 2022, fueled by the need for warehouse spaces to accommodate online shopping and e-commerce demands, net absorption is 63% lower than a year ago and 52% below the pre-pandemic average level. However, this sector continues to experience the fastest rent growth compared to any other sector in the commercial real estate market. Specifically, rents for industrial spaces are 4.7% 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.

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Economy

Job growth (April 2024 compared to March 2020): 4.9%
Inflation (April 2024): 3.4%
Gross Domestic Product (GDP) Q1 2024: 1.3%

Lingering inflation pressures have impacted consumers during the first quarter of the year. According to the updated estimate, the U.S. economic growth decelerated even further to 1.3% in Q1 2024. 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.

Slower job growth in April

The growth of the U.S. labor market slowed down in April – the smallest gain in six months – while the unemployment rate rose to 3.9%. If this cooling in the job market continues in the following months, it could enable the Federal Reserve to lower its interest rates.

Specifically, the total number of job positions increased to 158.3 million in April. In the first four months of the year, the economy had welcomed about 980,000 new jobs. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 7.4 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**
April 2023	**155.5 million**
April 2024	**158.3 million**

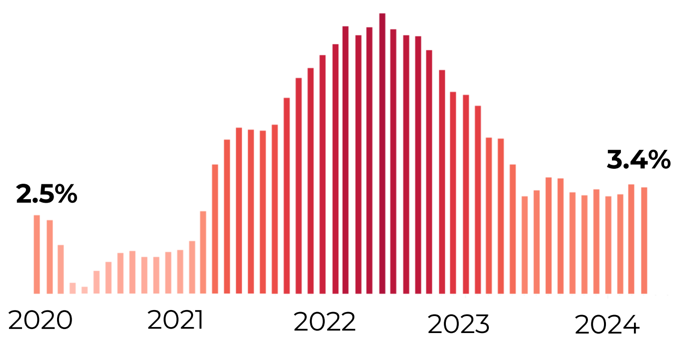
Source: NAR analysis of U.S Bureau of Labor Statistics data

Inflation cooled slightly in April

Inflation fell in April, even if only slightly. However, it hasn't yet reached the Federal Reserve's goal of 2%, mostly due to the higher cost of rents.

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 further 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% in April. If job growth and inflation continue to slow down in the following months, the Federal Reserve may start cutting its interest rates during the second half of the year. 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 even 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 updated second estimate of the Bureau of Economic Analysis (BEA), the GDP grew 1.3%, down from a 3.4% increase in the final quarter of 2023. Persistent high interest rates, geopolitical tensions, and a rise in imports contributed to slower economic growth. It also seems that consumers struggle with lingering inflation pressures.

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Commercial Real Estate Lending

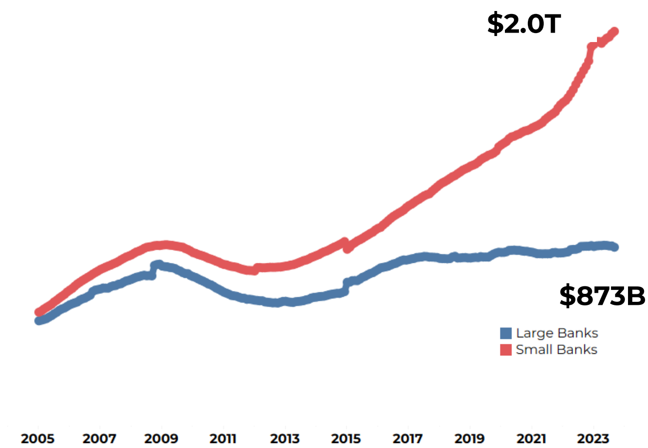
CRE loans (April 2024): $2.99 trillion

Delinquency rate of CRE loans (Q1 2024): 1.18%

CRE debt continues to increase

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. However, within large domestically chartered banks, the volume of CRE loans continues to drop, hovering currently around $873 billion.

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

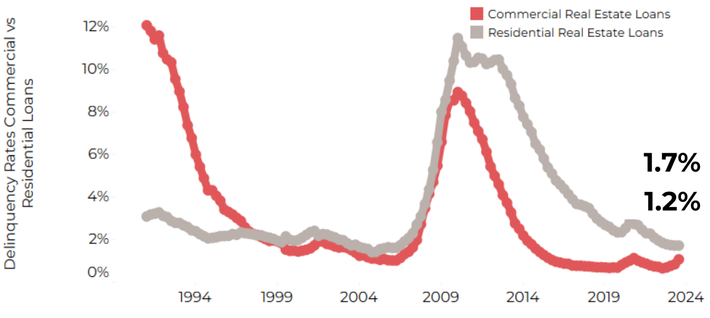


Source Federal Reserve

Increasing 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. Specifically, the CRE delinquency rate was 0.77% in Q1 2023, and currently, it stands at 1.18%. 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 (Q1 2024)

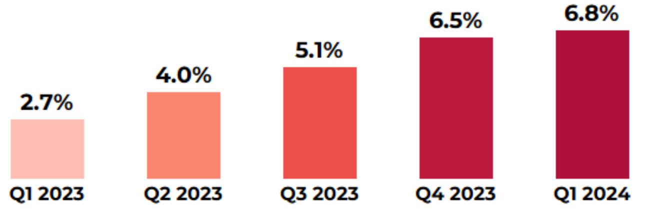


Source Federal Reserve

Office delinquency rates rise again

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 6.8% of the balance of office property loan balances were 30 days or more days delinquent during the first quarter of the year, surpassing those of loans backed by retail and hotel properties. This is an increase from the 6.5% recorded at the end of last year and a substantial jump from the 2.7% reported a year ago (Q1 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 (Q1 2024)



Source Mortgage Bankers Association (MBA)

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Office

Net absorption in the last 12 months: -54.0 million sq.ft.
Rent growth in the last 12 months: 0.8%
Cap rate: 8.6%

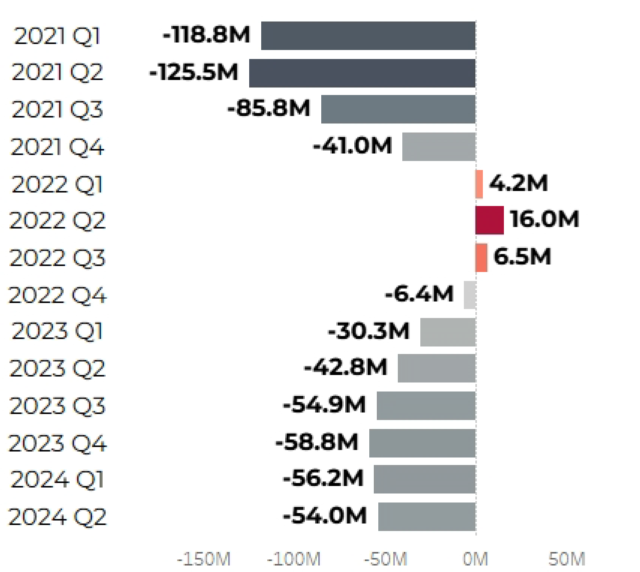
With the establishment of hybrid work models as a legacy of the pandemic's impact on work culture, the demand for traditional office spaces has continued to decline.

Offices are still being vacated, but the rate has slowed. The number of vacated offices increased by 26% over the year ending in April, compared to 97% in the year ending in March 2024. The vacancy rate, however, continued to rise, reaching a decade-high of 13.8%, up 0.8% from a year ago. This trend has primarily affected Class A buildings, with vacancy rates increasing by 1.3% to 19.6%, compared to Class B buildings, which saw a smaller increase of 0.6%, now at 12.4%.

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, TX, Denver, CO, and Washington, DC. This uptick has been influenced by the exodus of many businesses and professionals seeking regions with lower operational costs.

Meanwhile, this month, all the top 5 performers of the category have a vacancy rate under 2%, with Hickory, NC, and Savannah, GA, outperforming the others.

Net Absorption 12 Mo in sq. ft



Top 10 areas with the largest vacancy rates

	2024 Q2	2023 Q2
San Francisco, CA	22.65%	18.71%
Houston, TX	18.63%	18.16%
Dallas-Fort Worth, TX	17.93%	17.66%
Denver, CO	17.03%	15.41%
Washington, DC	16.90%	15.85%
Austin, TX	16.77%	15.82%
Chicago, IL	16.42%	15.88%
Phoenix, AZ	16.21%	15.24%
Los Angeles, CA	15.95%	14.80%
Atlanta, GA	15.87%	15.03%

Top 10 areas with the lowest vacancy rates

	2024 Q2	2023 Q2
Hickory, NC	1.08%	2.30%
Savannah, GA	1.42%	1.80%
Wilmington, NC	1.66%	1.53%
Myrtle Beach, SC	1.92%	2.21%
Gulfport-Biloxi, MS	2.05%	3.20%
Huntington, WV	2.15%	1.94%
Davenport, IA	2.17%	2.39%
Olympia, WA	2.39%	2.16%
Pensacola, FL	2.55%	2.92%
Asheville, NC	2.59%	2.51%

Source: NAR analysis of CoStar data

Multifamily

Absorption of units in the last 12 months: 385,043 units
Rent growth in the last 12 months: 1.0%
Cap rate: 6.1%

As the second quarter of 2024 unfolds, the multifamily sector is adapting to a scenario where more individuals are choosing to rent, driven by high interest rates that make buying a home less feasible. This trend is highlighted by a 102% increase in 12-month absorption. However, vacancy rates remain at a 10-year high of 7.8%, with unit deliveries surpassing absorption by 57% over the past year.

Class A multifamily properties are the most affected, with vacancy rates climbing to 10.8% and an annual rent growth of 0.1%. In contrast, Class C properties are in higher demand, boasting a lower vacancy rate of 5.6% and a 2% rent growth over the past year. This situation underscores the economic reality where many are feeling the financial pinch, and increasingly, more people are opting for affordable living options as high interest rates persist, and inflation has yet to hit the target of 2%.

While rent growth is slowing down across the country, metro areas in Florida constitute 7 out of the ten bottom performers, each with annual rent growth below -2%. Conversely, a few cities are bucking this trend and witnessing considerable rent increases. Rockford, IL, Kingsport, TN, Lancaster, PA, and Evansville, IN all observe rent hikes surpassing 5%, signaling robust growth in these markets.

Major urban centers such as New York, NY, Dallas-Fort Worth, TX, Phoenix, AZ, and Washington, DC, have filled over 12,000 multifamily units up to April, significantly improving their occupancy rates. This robust demand persists as high mortgage rates limit homebuying options, highlighting the strong performance of the rental market in these higher-cost areas.

Top 10 areas with fastest rent growth

	2024 Q2	2023 Q2
Rockford, IL	5.71%	6.40%
Kingsport, TN	5.49%	6.30%
Lancaster, PA	5.36%	5.17%
Evansville, IN	5.10%	2.46%
Youngstown, OH	5.07%	5.73%
Springfield, MA	4.79%	4.35%
Syracuse, NY	4.78%	5.04%
Louisville, KY	4.67%	2.91%
Lexington, KY	4.64%	4.39%
Montgomery, AL	4.61%	3.20%

Top 10 areas with the strongest 12-month absorption

	2024 Q2	2023 Q2
New York, NY	19,046	20,040
Dallas-Fort Worth, TX	17,805	5,236
Phoenix, AZ	12,951	6,529
Washington, DC	12,686	7,634
Houston, TX	11,884	4,937
Atlanta, GA	11,741	348
Austin, TX	11,215	7,516
Chicago, IL	10,054	6,930
Nashville, TN	9,359	4,447
Minneapolis, MN	9,308	7,188

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 41.8 million sq. ft.
Rent growth in the last 12 months: 2.8%
Cap rate: 6.8%

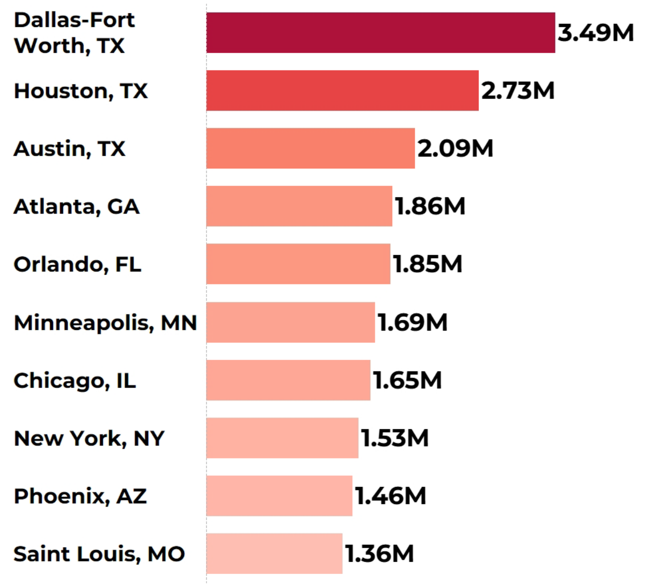
Retail real estate saw a notable rise in net absorption from 2014 to 2017, peaking before the e-commerce boom impacted the market. The growth of online shopping led to a decline in retail space absorption even before the pandemic. COVID-19 exacerbated this trend, causing a significant drop in retail absorption as lockdowns pushed consumers towards online shopping. Net absorption has since dropped 28% over the last 12 months ending in April compared to the previous year, and rent growth fell 1.2%, now at 2.8%. As a result, the retail market continues to transition towards e-commerce, with less physical space being occupied.

Focusing on retail categories, General Retail spaces, and Neighborhood Centers have been instrumental, accounting for approximately 85% of the net absorption as of April 2024.

The overall retail vacancy rate has stayed at a record low of 4.1% for the fifth consecutive quarter. General Retail has the lowest vacancy rate at 2.6%, followed by Power Centers at 4.3%, while Malls have the highest vacancy rate at 8.6%.

Neighborhood Centers and Power Centers experienced the highest increases in rent at 3.5% and 3.3%, respectively.

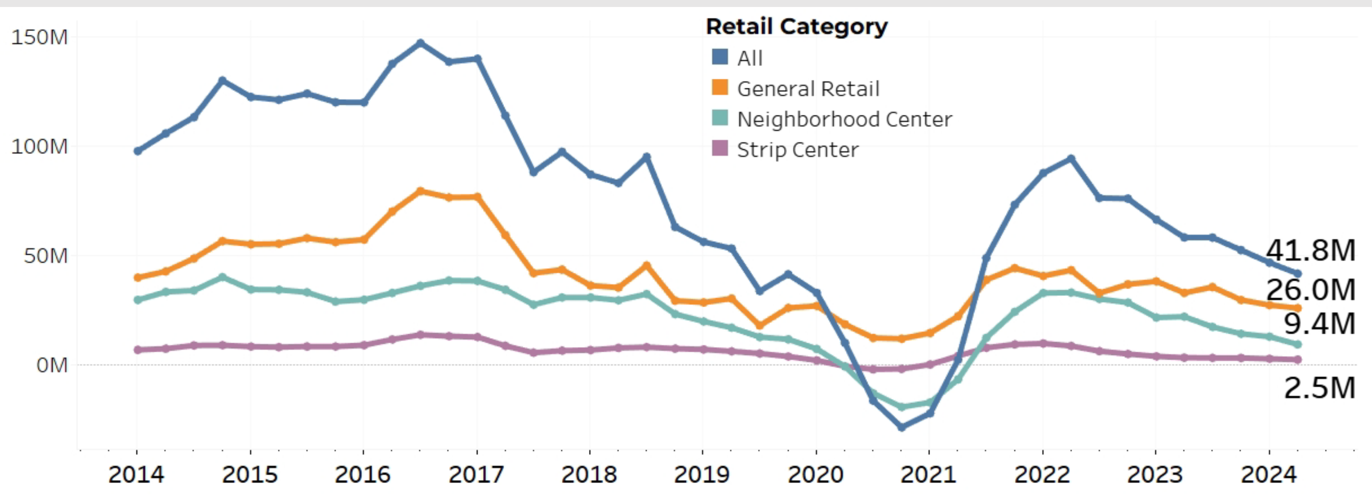
Top 10 areas with the strongest net absorption in the last 12 months



In the Sun Belt, Raleigh, NC, and Greensboro, NC, are setting the pace with an impressive annual rent growth of over 8%. Richmond, VA, closely follows with a notable 7.7% 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 year-over-year retail space absorption rates in the nation as of April 2024, over 2 million sq. ft.

Net Absorption 12 Mo by type (Q1 2014 - Q2 2024)



Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 111.5 million sq. ft.
Rent growth in the last 12 months: 4.7%
Cap rate: 7.4%

The industrial real estate market, which was booming in 2022, is now facing some challenges due to oversaturation with delivered properties and plummeting absorption rates. Net absorption over the past 12 months has fallen by 63%, reaching the lowest level in a decade at 111.5 million square feet. Deliveries are outpacing absorption by a ratio of 4.5 to 1. Consequently, the vacancy rate has risen by 1.7% to 6.4%, and rent growth has declined by 4.3% to 4.7%, though it still outperforms other commercial real estate categories.

Within the industrial sector, logistics spaces lead with a 5.4% rent increase and are the only branch with positive absorption over the past 12 months ending in April. Meanwhile, specialized spaces have seen a moderation in rent rise to 3.8%, and flex spaces are growing at a rate of 3.2%.

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

This April, West Coast cities Seattle, WA, and Portland, OR, followed Los Angeles, CA, moving from the top 10 to the bottom 10 in 12-month industrial absorption. While there was strong market interest in 2022, lasting into early 2023 for some, the momentum has waned with declining rent growth. Still, Los Angeles and Portland maintain vacancy rates of 5.1% and 5.3%, below the national average of 6.4%.

Additionally, Orlando and Tampa, FL, have seen the largest rent increases. Industrial rents in these areas have climbed over 9% since last year, driven by strong demand for warehouse properties. This trend reflects the region's broader economic growth, attracting businesses and fueling a competitive industrial market.

Top 10 areas with the strongest 12-month absorption

	2024 Q2	2023 Q2
Dallas-Fort Worth, TX	24.24M	38.78M
Houston, TX	17.33M	25.26M
Phoenix, AZ	11.82M	18.08M
Chicago, IL	11.27M	25.55M
Nashville, TN	8.07M	6.88M
Savannah, GA	6.92M	11.39M
Austin, TX	6.83M	5.05M
Philadelphia, PA	5.61M	7.87M
Detroit, MI	5.52M	6.67M
Atlanta, GA	5.33M	11.16M

Top 10 areas with the weakest 12-month absorption

	2024 Q2	2023 Q2
Los Angeles, CA	-14.17M	-15.12M
Seattle, WA	-4.31M	5.24M
New York, NY	-3.28M	-1.68M
Portland, OR	-2.97M	4.89M
San Diego, CA	-2.95M	-1.41M
Winston-Salem, NC	-2.64M	0.81M
San Francisco, CA	-2.09M	-0.67M
Shreveport, LA	-1.73M	0.73M
San Jose, CA	-1.56M	0.13M
Dayton, OH	-1.24M	2.14M

Source: NAR analysis of CoStar data

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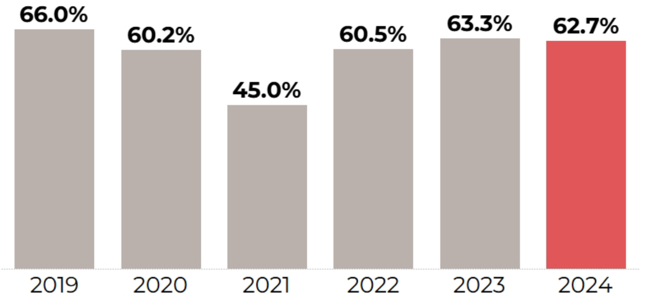
Hotel

Occupancy rate in the last 12 months: 62.7%
Average daily rate in the last 12 months: $157/room
Revenue per available room in the last 12 months: $98/room

As we move further into 2024, the hospitality industry is showing improvement. Hotel occupancy rates have stabilized around 63%, which is still about 3% below pre-pandemic levels. This suggests that full recovery may be elusive due to the rise of remote work tools like Zoom. However, average daily rates (ADR) and revenue per available room (RevPAR) now surpass pre-pandemic levels.

12-month Occupancy Rate in April



Specifically, in April 2024, the average daily rate (ADR) per room rose to $157/room, up 17% from April of 2019. The revenue per available room (RevPAR) also increased to $98/room, up 14% compared to the same period in 2019.

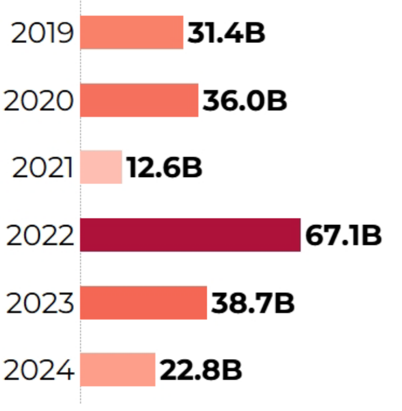
12-month ADR and RevPAR in April

	Average daily rate	Revenue per available room
2019	$131	$86
2020	$129	$78
2021	$98	$44
2022	$136	$82
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 April 2024, the 12-month sales volume dropped to $22.8 billion from $38.7 billion in the previous year.

12-month Sales Volume as of April



Source: NAR analysis of CoStar data

On the local level, Hawaii's Kauai Islands hospitality sector is thriving, with its Average Daily Rate (ADR) soaring 59%, Revenue per Available Room (RevPAR) up 56% from pre-pandemic levels, and an impressive occupancy rate of 72%. Maui Island leads the nation with top figures at $567 for ADR and $377 for RevPAR. Meanwhile, New York City boasts the highest hotel occupancy at 86%.

On the flip side, California's areas, particularly San Francisco/San Mateo and San Jose/Santa Cruz, are grappling with a lingering 27% drop in RevPAR from pre-pandemic figures, reflecting ongoing recovery challenges.

COMMERCIAL REAL ESTATE REPORT
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