Commercial Real Estate Market Insights Report

June 2024

National Association of REALTORS®
Research Group

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Commercial Real Estate in May 2024 Overview

The Commercial real estate (CRE) market continued to experience the same trends in May: office vacancy rates remained at a record high of nearly 14%, fundamentals for both retail and industrial sectors weakened, and demand for apartment buildings grew further due to low affordability. However, there are signs that demand for office space has likely already seen the bottom.

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

Net absorption for the **office** sector remains negative, with more vacant spaces than occupied. However, data indicates that the gap between vacated and occupied spaces is narrowing. As of May 2024, nearly 49 million square feet of office space were vacated more than leased, down from 57 million square feet in the first quarter and 59 million square feet at the end of the previous year. Although there may be a slight increase in demand for office space in 2024, the outlook suggests that net absorption for this sector will remain in negative territory. Leasing activity, an indicator of demand and interest from potential tenants, is currently near pandemic levels and about 40 percentage points below pre-pandemic levels.

Conversely, the **multifamily** sector continues to gain momentum with mortgage rates remaining near 7%. Net absorption is 2.5 times higher than a year ago, with an additional 265,000 more multifamily units leased than vacated. Even though a rising number of multifamily units are delivered in the market, the vacancy rate slightly eased in May to 7.7% due to this strong demand. In fact, the multifamily vacancy rate declined for the first time since Q3 2021.

The **retail** sector continues to have the tightest availability conditions in the commercial real estate market. Only 4.7% of retail space is currently available for lease, the lowest level on record. Due to limited availability, the vacancy rate is still near 4%, even though net absorption has slowed down further in May. Specifically, in the last 12 months, demand for retail spaces has increased by nearly 39 million square feet compared to 57 million square feet a year earlier. With new construction deliveries diminishing further, the fundamentals of this sector are expected to remain tight in 2024.

Fundamentals for the **industrial** sector have further weakened in May. Net absorption has fallen to levels not seen in over a decade. After reaching record-high levels at the end of 2021 and the beginning of 2022, driven by the demand for warehouse space to support online shopping and e-commerce, net absorption is currently 68% lower than a year ago and 60% below the pre-pandemic average level. The outlook suggests further softening in this sector. High borrowing costs have shifted consumer spending away from goods towards services, which can impact the demand for industrial spaces in the coming months.

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Economy

Job growth (May 2024 compared to March 2020): 5.1%
Inflation (May 2024): 3.3%
Gross Domestic Product (GDP) Q1 2024: 1.4%

In May, the U.S. economy demonstrated resilience, particularly in areas like the labor market and consumer spending. However, certain areas continued to face persistent challenges. Although Inflation has slightly eased, it remains a significant concern due to high borrowing costs.

Robust job growth in May

The U.S. labor market rose faster than the average monthly gain of 232,000 over the past 12 months, adding 272,000 new jobs. However, the unemployment rate rose 4% after staying below that threshold for 27 months. This uptick in the unemployment rate is not considered a threat to the economy. The increase was primarily due to seasonal trends in the labor market during the summer months, a period when teenagers and college students look for jobs.

Specifically, the total number of job positions increased to 158.5 million in May. In the first five months of the year, the economy had welcomed about 1.24 million new jobs. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 7.6 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

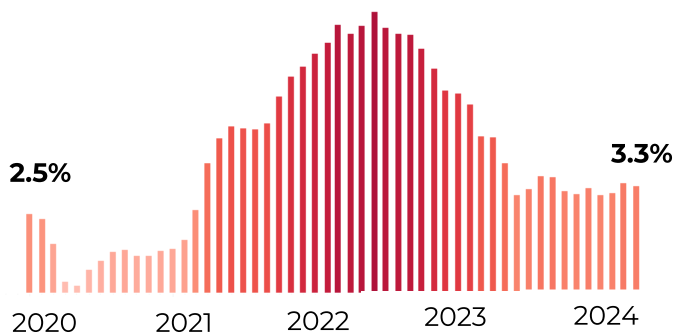
March 2020	**150.9 million**
May 2023	**155.8 million**
May 2024	**158.5 million**

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

Inflation continued to ease in May

Inflation fell in May, even if only slightly. However, it hasn't yet reached the Federal Reserve's goal of 2%, mostly due to higher cost of rent. While these higher rates increase borrowing costs, lingering inflation continues to be one of the economy's main concerns. 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 further.

Inflation



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

Interest rates remained unchanged

The Federal Reserve kept unchanged its interest rates at 5.5% in May. If inflation continues to slow down in the following months, the Federal Reserve might begin reducing interest rates as early as after the summer. 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 third estimate of the Bureau of Economic Analysis (BEA), the GDP grew 1.4%, 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.

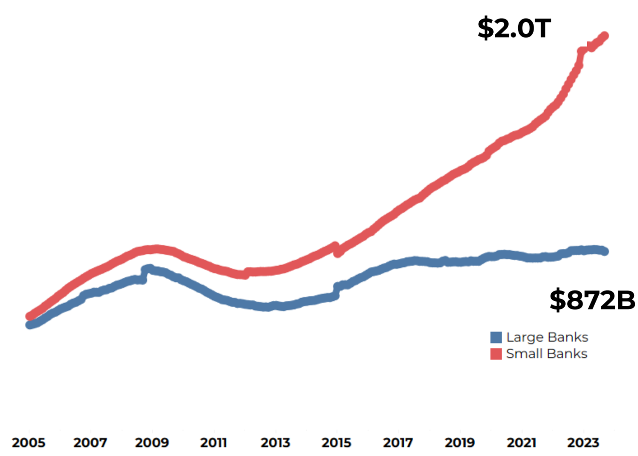
Commercial Real Estate Lending

CRE loans (May 2024): $3.00 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 $872 billion.

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

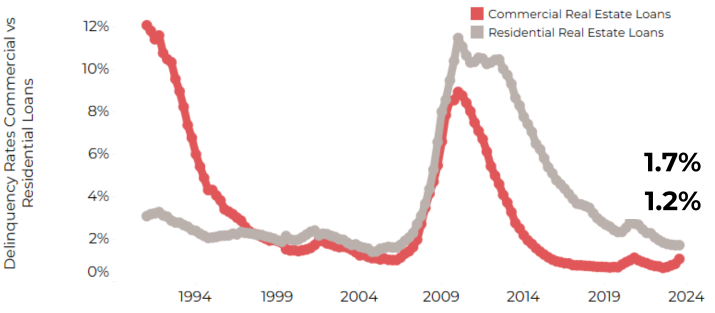


Source Federal Reserve

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)

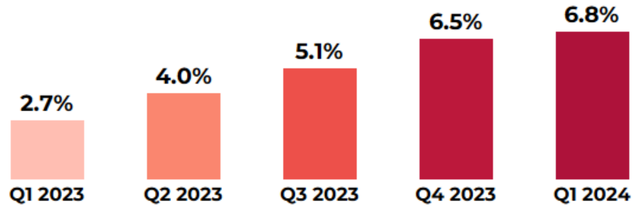


Source Federal Reserve

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: -48.9 million sq.ft.
Rent growth in the last 12 months: 0.7%
Cap rate: 8.6%

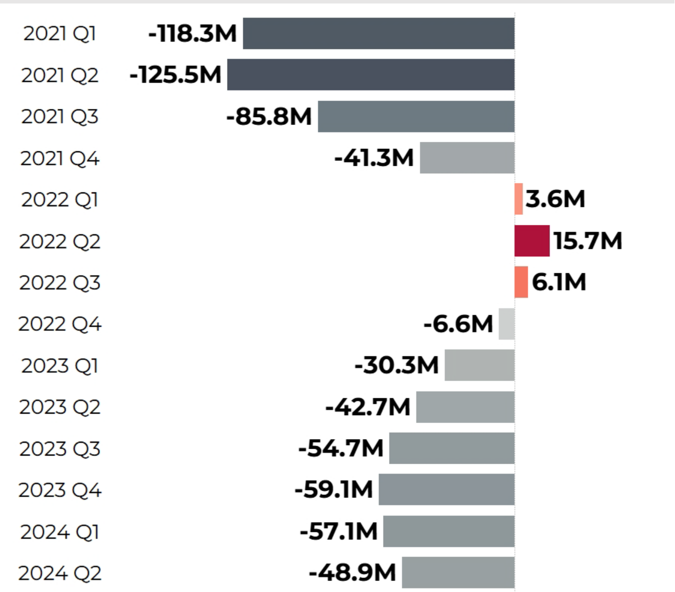
With the establishment of hybrid work models as a legacy of the pandemic's impact on work culture, the demand for traditional office spaces has continued to decline.

Offices are still being vacated, but the rate has slowed down. The amount of additional vacated office spaces year-over-year ending in May decreased by 14%, compared to only 3% decrease over the year ending Q1 2024 and previous increases in vacated space. 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 1.4% to 19.7%, compared to Class B buildings, which saw a smaller increase of 0.6%, now at 12.4%.

Significant surges in unoccupied office space have been most notable in key tech hubs like San Francisco, Houston, Dallas-Fort Worth, Denver, and Washington, DC, influenced by businesses and professionals seeking regions with lower operational costs.

Meanwhile, the top 5 performers in the category have vacancy rates under 2%, with Hickory, NC, and Savannah, GA, leading the way.

Net Absorption 12 Mo in sq. ft



Top 10 areas with the largest vacancy rates

	2024 Q2	2023 Q2
San Francisco, CA	22.40%	18.64%
Houston, TX	18.65%	18.16%
Dallas-Fort Worth, TX	18.27%	17.70%
Denver, CO	17.06%	15.41%
Washington, DC	16.97%	15.87%
Austin, TX	16.83%	15.88%
Phoenix, AZ	16.38%	15.23%
Chicago, IL	16.38%	15.86%
Los Angeles, CA	16.13%	14.77%
Atlanta, GA	15.90%	15.08%

Top 10 areas with the lowest vacancy rates

	2024 Q2	2023 Q2
Hickory, NC	1.00%	2.30%
Savannah, GA	1.54%	1.80%
Wilmington, NC	1.81%	1.71%
Myrtle Beach, SC	1.98%	2.21%
Huntington, WV	2.05%	1.94%
Gulfport-Biloxi, MS	2.10%	3.20%
Davenport, IA	2.17%	2.39%
Olympia, WA	2.32%	2.16%
Asheville, NC	2.57%	2.50%
Youngstown, OH	2.81%	2.08%

Source: NAR analysis of CoStar data

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Multifamily

Absorption of units in the last 12 months: 429,824 units
Rent growth in the last 12 months: 1.1%
Cap rate: 6.0%

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 135% increase in 12-month absorption, now at roughly 430,000 units. Despite deliveries outpacing absorption by 42%, vacancy rates, which had been rising for almost three years, have now started to decline, with a 0.1% decrease from the previous quarter.

Class A multifamily properties are experiencing the greatest impact, with vacancy rates rising to 10.8% and an annual rent growth of only 0.3%. Conversely, Class B properties, which have historically had lower 12-month absorption rates, are now seeing higher demand for the third consecutive quarter, with a lower vacancy rate of 8.5% and a rent growth of 1% over the past year. This scenario highlights the economic reality where many people are feeling financial pressure, leading more individuals to choose affordable living options as inflation remains above the 2% target.

While rent growth is slow nationwide, some southern metro areas are experiencing a decline in rent. In Florida, 7 out of 10 bottom performers have annual rent growth below -2%. Conversely, 7 metro areas, including Lancaster, PA, and Evansville, IN, are bucking the trend with rent growth of over 5%, well above the national average of 1.1%.

Major urban centers like Dallas-Fort Worth, TX, New York, NY, and Atlanta, GA, have filled over 14,000 multifamily units up to May, boosting occupancy rates. Notably, after two years behind, Dallas-Fort Worth now leads New York in 12-month unit absorption. This demand, driven by high mortgage rates limiting homebuying, underscores the rental market's strong performance in these high-cost areas.

Top 10 areas with fastest rent growth

	2024 Q2	2023 Q2
Lancaster, PA	5.79%	5.30%
Evansville, IN	5.35%	2.43%
Syracuse, NY	5.17%	4.51%
Youngstown, OH	5.11%	5.77%
Springfield, MA	5.11%	4.35%
Rockford, IL	5.10%	6.40%
Louisville, KY	5.03%	2.92%
Kingsport, TN	4.63%	6.30%
Hartford, CT	4.48%	4.24%
Huntington, WV	4.35%	4.09%

Top 10 areas with the strongest 12-month absorption

	2024 Q2	2023 Q2
Dallas-Fort Worth, TX	20,415	5,304
New York, NY	19,685	20,105
Atlanta, GA	14,041	785
Houston, TX	13,957	4,895
Phoenix, AZ	13,688	6,619
Washington, DC	13,475	7,587
Austin, TX	12,310	7,553
Minneapolis, MN	9,932	7,187
Orlando, FL	9,909	4,210
Chicago, IL	9,883	6,843

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 39.0 million sq. ft.
Rent growth in the last 12 months: 2.7%
Cap rate: 6.9%

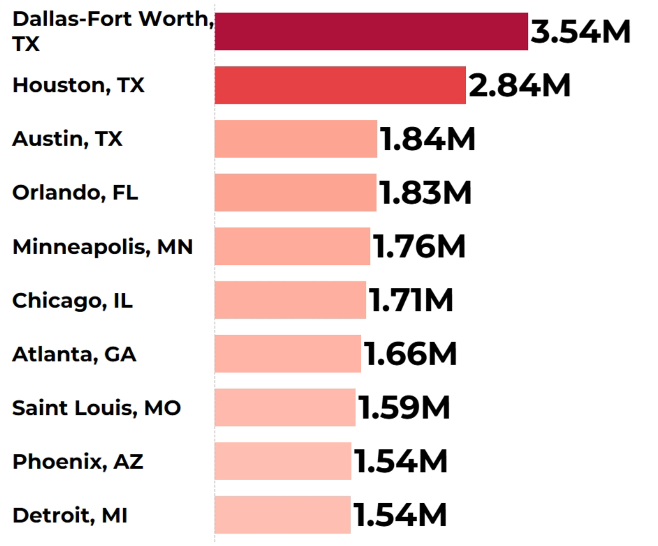
Retail real estate saw a notable rise in net absorption from 2014 to 2017, peaking before the e-commerce boom impacted the market. The growth of online shopping led to a decline in retail space absorption even before the pandemic. COVID-19 exacerbated this trend, causing a significant drop in retail absorption as lockdowns pushed consumers towards online shopping. Net absorption has since dropped 33% over the year ending in May compared to the previous year, and rent growth fell 1.4%, now at 2.7%. 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 86% of the net absorption as of May 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 8.8%.

Neighborhood Centers and Power Centers experienced the highest increases in rent at 3.5% and 3.2%, respectively.

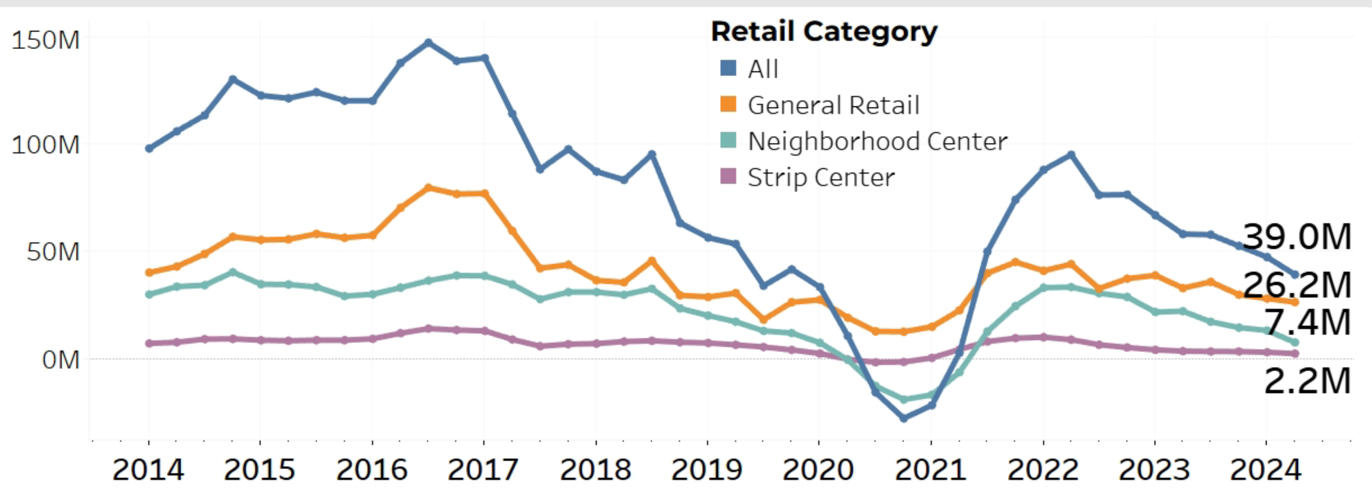
Top 10 areas with the strongest net absorption in the last 12 months



This May, Salt Lake City, UT, experienced the highest year-over-year rent growth at 8.8%. In the Sun Belt, Raleigh, NC, and Greensboro, NC, followed closely with impressive annual rent growths exceeding 8%.

Moreover, Texas is excelling in retail real estate, with cities like Dallas-Fort Worth, Houston, and Austin recording the highest year-over-year retail space absorption rates in the nation, surpassing 2 million sq. ft. as of May 2024.

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: 98.5 million sq. ft.
Rent growth in the last 12 months: 4.4%
Cap rate: 7.2%

The industrial real estate market, which thrived in 2022, now faces challenges due to an oversupply of properties and declining absorption rates. Net absorption over the past 12 months has dropped by 68%, hitting a decade-low of 98.5 million square feet. Deliveries are outpacing absorption at a 4 to 1 ratio. As a result, the vacancy rate has increased by 1.9% to 6.5%, and rent growth has decreased by 4.6% to 4.4%, though it still outperforms other commercial real estate sectors.

In the industrial sector, logistics spaces lead with a 5.0% rent increase and are the only category showing positive absorption over the past 12 months ending in May. Meanwhile, specialized spaces have seen a moderate rent rise to 3.5%, and flex spaces are growing at a rate of 3.1%.

Dallas-Fort Worth, TX, experienced the highest absorption of industrial space in the last 12 months. Houston, TX, and Phoenix, AZ, followed, each absorbing over 14 million square feet during the same period, ending in May 2024.

This May, West Coast cities Reno, NV, 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 5.3% and 5.5%, below the national average of 6.5%.

Additionally, Orlando, FL, Baltimore, MD, and Richmond, VA, have seen the largest rent increases. Industrial rents in these areas have climbed over 9% since last year, driven by strong demand for warehouses. This trend reflects the region's 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	23.76M	39.42M
Houston, TX	17.19M	25.12M
Phoenix, AZ	14.58M	18.15M
Chicago, IL	9.52M	26.29M
Nashville, TN	7.61M	6.88M
Austin, TX	7.04M	5.07M
Savannah, GA	6.89M	11.38M
Philadelphia, PA	5.33M	7.87M
Atlanta, GA	5.01M	11.14M
Las Vegas, NV	4.52M	8.18M

Top 10 areas with the weakest 12-month absorption

	2024 Q2	2023 Q2
Los Angeles, CA	-13.76M	-15.20M
New York, NY	-4.09M	-1.96M
Seattle, WA	-3.54M	5.37M
Portland, OR	-3.36M	4.89M
Winston-Salem, NC	-2.87M	0.81M
San Diego, CA	-2.71M	-1.26M
Harrisburg, PA	-2.60M	3.31M
Reno, NV	-2.23M	5.22M
San Francisco, CA	-2.12M	-0.67M
Shreveport, LA	-1.89M	0.73M

Source: NAR analysis of CoStar data

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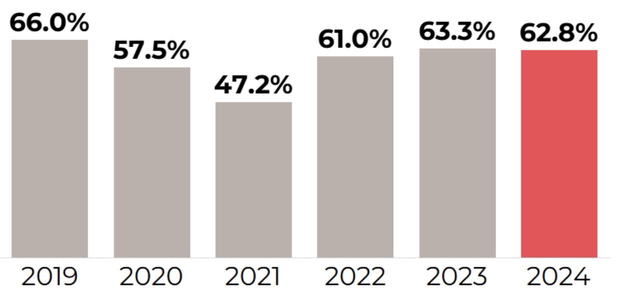
Hotel

Occupancy rate in the last 12 months: 62.8%
Average daily rate in the last 12 months: $157/room
Revenue per available room in the last 12 months: $99/room

As 2024 continues, the hospitality sector is seeing improvements. 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 May



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

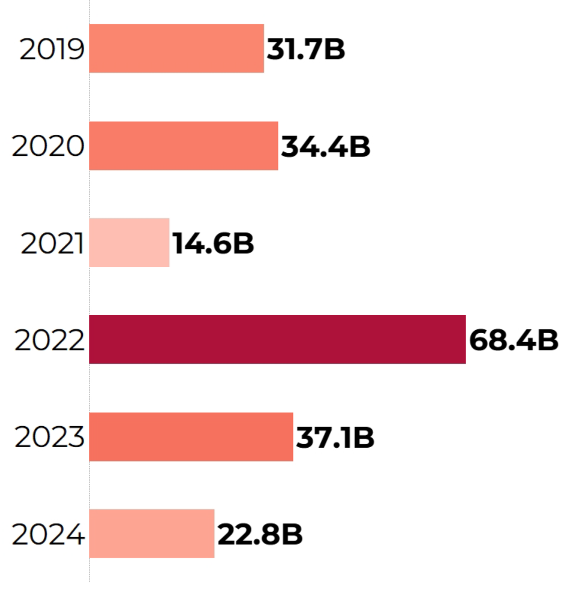
12-month ADR and RevPAR in May

	Average daily rate	Revenue per available room
2019	$131	$86
2020	$126	$73
2021	$101	$48
2022	$138	$84
2023	$153	$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 May 2024, the 12-month sales volume dropped to $22.8 billion from $37.1 billion in the previous year.

12-month Sales Volume as of May



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 59%, Revenue per Available Room (RevPAR) rising by 56% from pre-pandemic levels, and an impressive occupancy rate of 72%. Maui Island leads the nation with outstanding figures, with an ADR of $563 and a RevPAR of $375. Meanwhile, New York City holds the highest hotel occupancy rate at 86%.

Conversely, regions in California, especially San Francisco/San Mateo and San Jose/Santa Cruz, are still facing significant challenges, with RevPAR remaining 26% and 28% below pre-pandemic levels, respectively, indicating ongoing recovery difficulties.

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