April 2023

Commercial Market Insights Report

National Association of REALTORS®
Research Group

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Summary

The first quarter of the year was anything but boring for commercial real estate. The recent developments in the banking sector added concerns about lending activity in the market. While commercial real estate relies heavily on the banking industry for capital, there were rising concerns that the recent bank failures would make it harder to get a commercial real estate loan. Nevertheless, according to the Federal Reserve, commercial real estate loans of small, domestically commercial banks remained unchanged during February and March despite the bank failures. Meanwhile, in April, lending activity is picking up week by week.

In addition, most commercial real estate sectors continue to experience slower rent price gains and higher vacancy rates compared to the previous year. While the Office sector is still struggling to recover from the pandemic, vacancy rates have reached new record highs. With multifamily construction overperforming in the last couple of years, apartment rent growth slowed down further from the record highs during the pandemic. But, although leasing activity is slower, the Retail sector was able to keep vacancy rates near 4%. And rent prices for industrial spaces grew more than 10%, significantly faster than pre-pandemic.

Here is how each commercial real estate sector performed in the first quarter of 2023.

The **Multifamily** sector continues to slow down from its record highs in 2021. Net absorption is 82% lower than the previous year, and the vacancy rate has increased to 6.7% from 5.0% the previous year. As a result, rent growth has decreased by over 8 percentage points in one year, reaching its lowest level since the start of 2021. Nevertheless, apartment rent growth returned to what it was considered normal before the pandemic. In the meantime, the multifamily sector will still perform better than pre-pandemic levels, owing to favorable demographics and a strong job market that promotes household formation.

Despite some employers mandating in-person work and the decline of remote jobs, the **Office** sector is still facing challenges. The downward trend of office space demand has continued throughout the year, resulting in a record-high vacancy rate of 12.9% compared to the previous year's 12.0%. The future of the traditional office space is unclear due to the ongoing impact of COVID-19, with many businesses adopting hybrid work arrangements that allow for a mix of in-person and remote work. However, many universities have recently shown interest in leasing office spaces in their effort to attract more students back to the classes.

The **Industrial** sector of commercial real estate has continued to show strength this year. As e-commerce sales and supply chain disruptions continue to drive demand for warehouse and distribution space, the industrial vacancy rate remains low at 4.3%. Furthermore, the industrial rent growth rate is remaining high at 10.3%, with warehouses having remarkable 11.7% rent growth.

The **Retail** sector of commercial real estate had the lowest vacancy rate among all the sectors in March 2023. Despite higher prices, consumer spending remains strong. As a result, this sector continues to perform better than pre-pandemic. With inflation easing further and interest rates to stabilize later this year, the demand for retail space is expected to remain robust.

The **hospitality** sector saw a further increase in hotel revenue, which was previously affected by COVID-19 restrictions and quarantine measures. The revenue per available room (RevPAR) is now over 10% higher than it was before the pandemic. As both business and leisure travel picks up, the demand for hospitality spaces is expected to keep increasing throughout 2023.

Economy

Job growth (compared to March 2020): 3.1%
Inflation: 6.0%

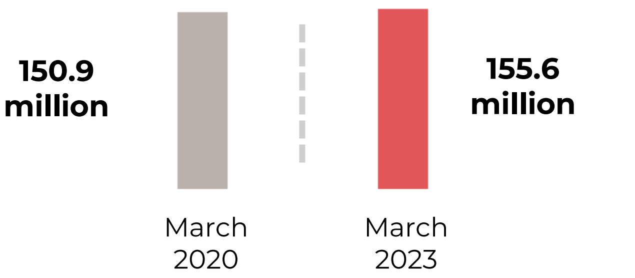
Record high number of jobs

The labor market continues to grow with a record-high number of jobs available in the market. As of March 2023, there are about 3% more jobs than 3 years ago when the pandemic hit our country. In addition, the unemployment rate is at record lows at 3.5%.

In March of 2023, there were 4.6 million more jobs compared to March of 2020 and 236,000 more than the previous month.

Job growth is crucial for a healthy economy, as it increases consumer spending and demand for goods and services, which can lead to growing businesses and demand for commercial real estate.

Number of Jobs



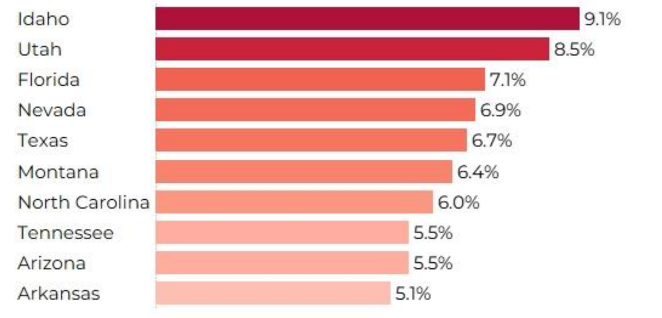
Source: NAR analysis of U.S Bureau of Labor Statistics data

At the local level, Idaho and Utah lead the nation in job growth, with 9.1% and 8.5%, respectively.

Texas is the clear leader in terms of absolute job creation, adding 931,000 jobs since March 2020. Florida and California are not far behind, adding 688,000 and 488,000 jobs, respectively.

Unfortunately, Hawaii and the District of Columbia continue to have nearly 3% fewer jobs than in March of 2020.

Top 10 states with strongest job growth since March 2020



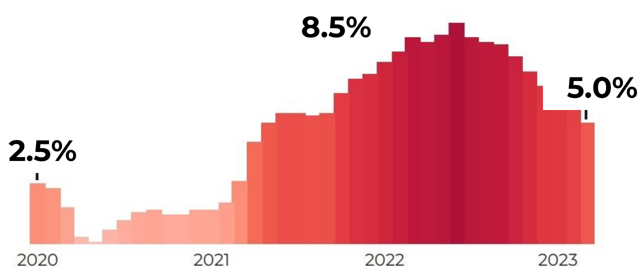
Source: NAR analysis of U.S Bureau of Labor Statistics data

Better-than-expected inflation

In March, inflation eased faster than expected, and the inflation rate is significantly lower than that of the previous year. This means that consumer prices continue to be higher, but they rise at a slower pace than a year ago.

The inflation rate will likely drop further later this year as government data will start reflecting the decelerating trend of rent growth. Starting from the second quarter of 2022, the private sector indicates that rent growth has slowed down. However, rent changes take several months to be shown in government data. The U.S. Bureau of Labor Statistics (BLS) reported that rent prices increased 8.8% in March 2023. But, according to CoStar, rent prices are only 2.5% higher than a year ago.

Inflation



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

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Economy

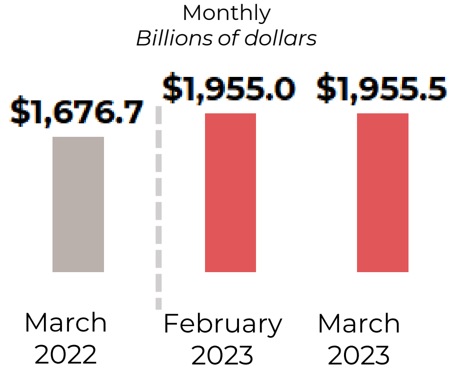
Interest rates: 5.00%
Gross Domestic Product (GDP) Q1 2023: 1.1%

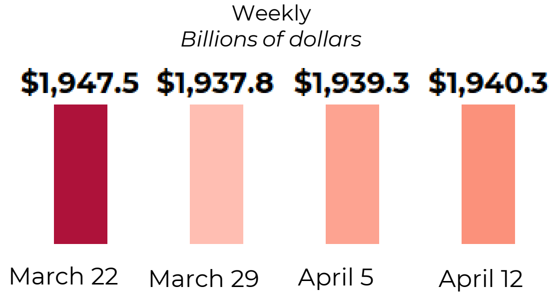
Uncertainty in the banking sector

In March, three regional banks unexpectedly collapsed. In the meantime, regional lenders tend to support the majority of commercial loans because national banks such as Wells Fargo and Bank of America are less likely to provide funds to the average commercial practitioner. Thus, the recent banking developments could have an impact on commercial real estate and the ability to get a commercial loan.

While it's still early to assess the overall impact of the bank failures on the economy, data from the Federal Reserve shows that commercial real estate loans of small, domestically commercial banks remained unchanged during February and March despite these bank failures. Meanwhile, in April, lending activity is picking up week by week.

Commercial real estate loans in small domestically chartered commercial banks





Source: Federal Reserve

Uncertain if the Fed will continue to raise interest rates

Despite the uncertainty in the banking sector, the Federal Reserve continued to raise its short-term interest rates during its fight against inflation. Meanwhile, the current Fed's fund rate is already 4.75 percentage points higher than a year ago.

The National Association of REALTORS® expects that the Fed will likely cut interest rates back in the last quarter of 2023 as inflation will slow down even further, increasing by 4 percentage points.

The economy to grow slower in 2023 but not a recession

After the strong rebound for the U.S. economy in 2021, with the fastest average growth in nearly 40 years (6%), the U.S. economic growth slowed down with a 2.6% growth at the end of 2022. Looking into 2023, although the economy grew slower than expected in the first quarter of 2023, the U.S. may skirt recession in 2023. Generally, during inflationary periods, people hold less money and thus spend less. However, that's not currently the case. Amid elevated inflation and higher interest rates, both real income and real spending continue to advance. Meanwhile, job growth remains resilient with a record high number of jobs and a record low unemployment rate. Thus, the U.S. economy will likely remain in positive territory throughout this year. GDP is expected to increase by about 1.2% in 2023.

Multifamily

Absorption of units in the last 12 months: 116,037
Rent growth in the last 12 months: 2.5%
Cap rate: 4.9%

The multifamily sector continues to slow down from its record highs in 2021. At the national level, the absorption of units dropped by 18.7 percentage points from the last quarter. The national vacancy rate moved up to 6.7% in the first quarter of 2023, a notable increase from the 5% in the first quarter of 2022, but still on par with the pre-pandemic levels.

Rent prices are still higher than they were a year ago, but the gains have returned to more normal levels. Rents rose 2.5% year-over-year in the first quarter of 2023 compared to 5.6% and 3.8% in the third and fourth quarters of 2022, respectively. Overall, the multifamily sector is returning to its pre-pandemic state.

While rent growth is easing in more areas across the county, the Sun Belt regions continue to experience strong rent growth, notably in Knoxville and Kingsport, TN, Fayetteville, NC, and Fayetteville-Springdale-Rogers, AR.

Meanwhile, the Midwest also saw strong rent growth, with Peoria, IL, Indianapolis, IN, Omaha, and Lincoln, NE, ranking among the top ten metro areas with the highest rent growth rates. In contrast, Phoenix, AZ, and Las Vegas, NV, have experienced a 1.9% year-over-year rent decline.

Respectively, demand for apartments remains strong in the big city centers such as New York, Austin, TX, and Denver, CO. In these areas, more than 6,000 multifamily units have been absorbed in the last 12 months ending in March. While higher mortgage rates continue to hurt affordability, forcing out of the market many buyers, demand for rental properties will likely remain solid in many expensive areas across the country.

Top 10 areas with fastest rent growth

	2023 Q1	2022 Q1
Peoria, IL	9.55%	9.02%
Fayetteville, NC	8.98%	12.43%
Kingsport, TN	8.39%	9.45%
Knoxville, TN	8.08%	15.10%
Fayetteville-Springdale-Rogers, AR	7.86%	8.22%
Omaha, NE	7.20%	7.41%
Gulfport-Biloxi-Pascagoula, MS	7.03%	10.31%
Madison, WI	6.93%	5.03%
Lincoln, NE	6.68%	8.22%
Indianapolis, IN	6.60%	12.02%

Top 10 areas with the strongest 12-month absorption

	2023 Q1	2022 Q1
New York, NY	22,761	35,833
Austin, TX	6,323	17,130
Denver, CO	6,072	9,871
Washington, DC	5,975	22,199
Minneapolis, MN	5,682	12,360
Chicago, IL	5,635	17,839
Phoenix, AZ	5,561	7,664
Boston, MA	4,731	14,198
Charlotte, NC	3,774	10,848
Miami, FL	3,603	10,601

Source: NAR analysis of CoStar data

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Office

Net absorption in the last 12 months: -28.8 million sq.ft.
Rent growth in the last 12 months: 0.9%
Cap rate: 6.8%

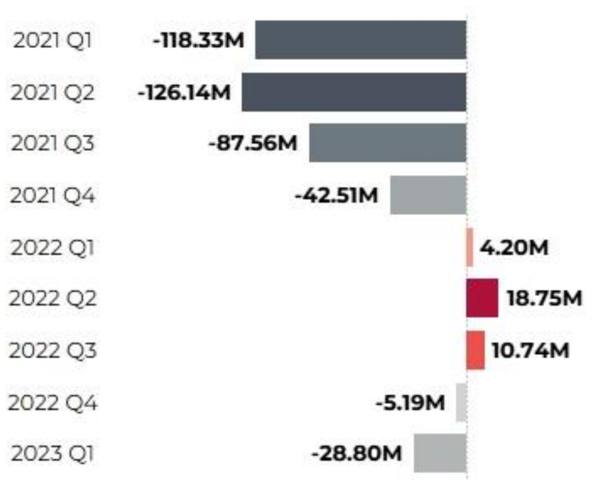
With hybrid work arrangements to be the new normal for many companies, the office sector is continuing to struggle. The demand for office spaces decreased, resulting to more available spaces for lease on the market.

About 72.9 million more square feet became available for lease in Q1 2023 compared to 3 years ago. As a result, the vacancy rate increased by 3.3% to an all-time high of 12.9%. The Class A office spaces took the biggest hit, suffering a 5.6% increase in their vacancy rates from Q1 2020 and now at 17.9%. These figures indicate persistent challenges for the office sector, particularly for Class A office spaces.

At the local level, the most significant increase in vacancy rates was spotted in main tech hubs like Houston, Dallas-Fort Worth, San Francisco, Chicago, Washington, DC, and Austin, as many companies and people migrated to more affordable places.

But, San Jose, CA, Atlanta, GA, and Miami, FL were the top 3 areas with the largest net absorption in the last 12 months with over 1 million sq. ft more leased than vacant as of March 2023.

12-month Net Absorption in sq. ft



Top 10 areas with the largest vacancy rates

	2023 Q1	2022 Q1
Houston, TX	19.09%	18.52%
Dallas-Fort Worth, TX	17.98%	17.49%
San Francisco, CA	17.24%	13.58%
Chicago, IL	15.67%	15.09%
Washington, DC	15.65%	14.83%
Austin, TX	15.26%	12.30%
Denver, CO	15.25%	14.05%
Phoenix, AZ	15.13%	14.16%
Los Angeles, CA	14.98%	13.61%
Atlanta, GA	14.03%	14.11%

Top 10 areas with the lowest vacancy rates

	2023 Q1	2022 Q1
Huntington, WV	1.73%	1.75%
Savannah, GA	2.00%	2.36%
Youngstown, OH	2.15%	2.55%
Myrtle Beach, SC	2.18%	2.32%
Clarksville, TN	2.33%	1.98%
Davenport, IA	2.35%	3.70%
Asheville, NC	2.38%	2.88%
Olympia, WA	2.42%	2.48%
Salisbury, MD	2.70%	2.07%
Visalia, CA	2.71%	2.52%

Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 361.9 million sq. ft.
Rent growth in the last 12 months: 10.3%
Cap rate: 6.0%

Although demand may have slowed in the Industrial sector compared to the previous year, the amount of industrial space absorbed remains twice as high as pre-pandemic levels. In the last 12 months ending in March, net absorption reached almost 362 million SF. As a result, this sector had the second lowest vacancy rate at 4.3% after the retail sector.

Industrial rent prices are growing at a faster pace than other sectors, with a year-over-year increase of 10.3% due to limited availability of space. Logistics space experienced even faster rent growth, with a year-over-year increase of 11.7%, compared to 7.2% for flex space and 8.7% for specialized space.

Dallas-Fort Worth, TX, had the largest absorption of industrial space in the past 12 months. Chicago, IL, Houston, TX, and Phoenix, AZ, absorbed more than 24 million square feet over the past 12 months ending in March 2023.

In contrast, Los Angeles, CA, is experiencing negative net absorption as more industrial spaces are available for lease than occupied. After seeing strong demand in early 2022, market momentum has moderated as vacancy levels have slightly increased. However, Los Angeles continues to have a vacancy rate below the national average at 3.2%.

In addition, Fort Lauderdale, Miami and Orlando, FL, and Columbus, OH, experienced the largest rent gains. In these areas, rents for industrial space are at least 16 percentage points higher than a year ago as demand for warehouse spaces remains solid.

Top 10 areas with the strongest 12-month absorption

	2023 Q1	2022 Q1
Dallas-Fort Worth, TX	41.44M	39.65M
Chicago, IL	31.20M	39.90M
Houston, TX	29.51M	37.55M
Phoenix, AZ	24.82M	24.59M
Indianapolis, IN	17.81M	23.86M
Atlanta, GA	16.41M	29.50M
Kansas City, MO	13.67M	9.41M
Savannah, GA	13.31M	10.68M
Riverside-San Bernardino-Ontario, CA	12.41M	30.85M
Memphis, TN	11.50M	10.22M

Top 10 areas with the slowest 12-month absorption

	2023 Q1	2022 Q1
Los Angeles, CA	-10.55M	11.26M
Springfield, MA	-0.87M	-0.30M
Syracuse, NY	-0.79M	5.07M
Santa Rosa, CA	-0.74M	0.72M
Chattanooga, TN	-0.55M	2.05M
Rochester, NY	-0.54M	1.02M
Lansing, MI	-0.46M	0.43M
Asheville, NC	-0.45M	0.96M
Little Rock, AR	-0.44M	6.26M
Tulsa, OK	-0.37M	1.20M

Source: NAR analysis of CoStar data

Retail

Net absorption in the last 12 months: 63.9 million sq. ft.
Rent growth in the last 12 months: 3.8%
Cap rate: 6.7%

Retail space demand remains strong. Although absorption may have decreased since last year, the current vacancy rates are lower than both last year and pre-pandemic. In fact, Retail currently boasts the lowest vacancy rate among all commercial real estate sectors at 4.2%.
By type of retail stores, General Retail and Neighborhood Centers have driven the demand, accounting for nearly 90% of the net absorption in Q1 2023.

Net Absorption by type (2017, 2020 and March 2023)

	2017 Q1	2020 Q1	2023 Q1
General Retail	74.50M	25.22M	35.00M
Mall	8.35M	-6.15M	-4.06M
Neighborhood Center	38.07M	7.47M	21.66M
Other	1.64M	0.01M	0.12M
Power Center	2.08M	1.81M	6.87M
Strip Center	12.90M	2.14M	3.68M
All	**137.54M**	**30.50M**	**63.27M**

Rents for retail spaces remained elevated compared to the previous year, but their growth rate has decelerated, likely due to consumer sensitivity to higher prices. Nationally, retail asking rents grew by 3.8%, which is slower than the previous year but faster than pre-pandemic levels. Despite rising rents for all types of retail stores, neighborhood centers (4.7%) and strip centers (4.5%) saw the largest increases in rent prices.

On the contrary, General Retail experienced the smallest rent growth at 3.4%, indicating a slower recovery compared to other types of retail stores.

At the local level, Sun Belt metro areas are experiencing strong demand, with more than 9% rent growth in Jacksonville and Fort Lauderdale, FL, Greenville, SC, and Greensboro, NC.

The retail industry is also thriving in Phoenix, AZ, Houston, TX, Chicago, IL, Dallas-Fort Worth, TX, and Atlanta, GA, as these areas experienced the largest net absorption as of Q1 2023 with more than 3 million square feet more occupied in the past 12 months.

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

Source: NAR analysis of CoStar data

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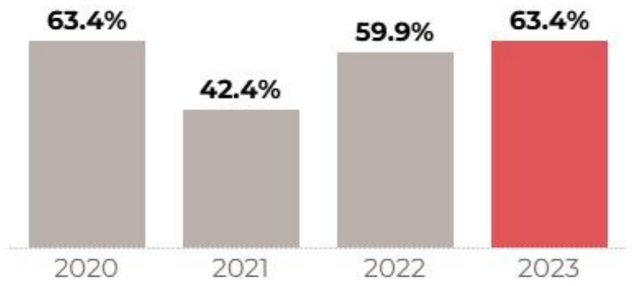
Hotel

Occupancy rate in the last 12 months: 63.4%
Average daily rate in the last 12 months: $152/room
Revenue per available room in the last 12 months: $96/room

The hospitality sector continued to advance at the end of the first quarter of 2023. The hotel occupancy has finally fully recovered from the pre-pandemic level. This concludes the recovery of all three prevailing measures of hotel performance: Average Daily Rate, Revenue Per Available Room, and Occupancy Rate.

12-month Occupancy Rate in March



Specifically, in March 2023, the average daily rate (ADR) per room rose to $152/room, up 16% from the beginning of 2020. The revenue per available room (RevPAR) also increased to $96/room, up 16% compared to the same period in 2020.

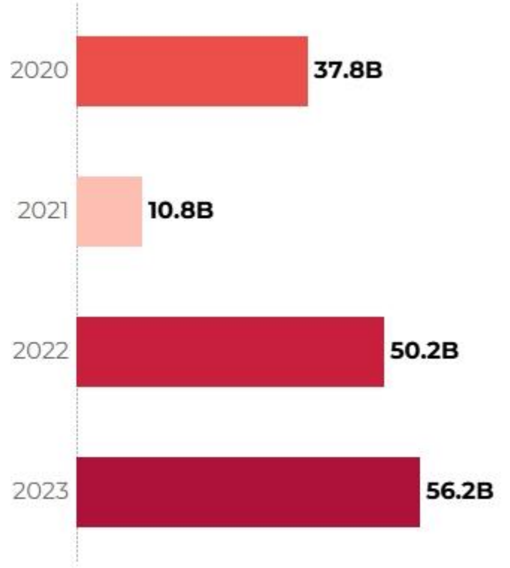
12-month ADR and RevPAR in March

	Average daily rate	Revenue per available room
2020	$131	$83
2021	$95	$40
2022	$132	$79
2023	$152	$96

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

Sales acquisitions have been rising since 2021. In Q1 2023, the 12-month sales volume rose to $56.2 billion from $50.2 billion in the previous year.

12-month Sales Volume as of March



Source: NAR analysis of CoStar data

At the local level, one of the top-performing markets in the hospitality sector is Maui Island, HI, with the biggest ADR increase of 53% since pre-pandemic and the highest ADR and RevPAR nationwide at $618 and $421, respectively. While New York's occupancy rate is still 3.6% lower than pre-pandemic levels, it's still the highest in the US at 78.4%. Meanwhile, Sarasota, FL, experienced a remarkable 68% increase in RevPAR, the fastest growing since pre-pandemic, followed by the Florida Keys with a 56% increase.

On the other hand, the San Jose/Santa Cruz and San Francisco/San Mateo areas in California continue to feel the impact of the pandemic, having lost nearly 20% of RevPAR since the first quarter of 2020.

COMMERCIAL REAL ESTATE REPORT
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