# Commercial Real Estate Market Insights

## February 2024

National Association of REALTORS®
Research Group

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# Commercial Real Estate in January 2024; An Overview

Despite the advent of a new year, the commercial real estate (CRE) market continues to be shaped by enduring trends and challenges that persist over time. High interest rates, economic uncertainty, and hybrid work impact on office spaces are some factors that do not simply disappear or change significantly with the turn of a calendar year. While the U.S. economy remains resilient, the commercial real estate market's performance during the first month of 2024 shows a nuanced landscape with sector–specific challenges and opportunities. The normalization of hybrid working arrangements continues to negatively impact office demand, increasing the market's unoccupied office spaces. However, the fundamentals of the multifamily, retail, and industrial sectors remain robust, indicating a varied performance across the CRE market.

Below is a summary of the performance across various commercial real estate sectors at the outset of 2024:

The amount of unoccupied **office** space continues to rise, pushing the vacancy rate further up to 13.7%. Specifically, there are twice as many unoccupied office square feet as occupied compared to a year ago. With many businesses reevaluating their need for physical office space, vacancy rates will continue to increase in this sector, especially in the urban centers. However, the anticipated lower inflation and interest rates later this year may make rehabilitation or conversion of underperforming office buildings more viable.

Mortgage rates remaining near 7% are strengthening the demand for apartment buildings. This trend stems from the fact that higher mortgage rates make home buying less accessible for many, leading people to seek rental options instead, thereby increasing the demand for rental apartments. The past year has seen a 120% jump in net absorption relative to the year before. Nevertheless, the effect is not visible in the vacancy rates due to the increased number of apartment units completed and delivered to the market. An influx of new housing supply could absorb the stronger demand, keeping the vacancy rates from declining. Specifically, the **multifamily** sector's vacancy rate was 7.6% in the first month of the year.

At the onset of 2024, the **retail** sector has experienced a slowdown in demand. Compared to the early months of 2023, net absorption has seen a significant reduction, falling by approximately 30 percentage points. Despite lower absorption rates, the scarcity of retail spaces has contributed to maintaining low vacancy rates, which hover around 4%. With fewer new construction deliveries, the fundamentals of this sector will remain solid in 2024. When new supply is constrained, it can lead to tighter market conditions, potentially supporting rental rates and occupancy levels, key components of the commercial real estate sector.

The **industrial** sector continues to maintain its health, but there are emerging signs of a slowdown, with net absorption falling beneath levels seen before the pandemic. While online shopping and e-commerce pushed up the activity to record high levels at the end of 2021 and the beginning of 2022, net absorption is currently nearly 70% lower than a year ago. Nevertheless, rent growth continues to be the fastest among any other sector of the commercial real estate market. Specifically, rents for industrial spaces are nearly 6% higher than a year ago. The long-term outlook for the industrial real estate market remains positive, buoyed by factors such as the lasting impact of e-commerce and increased construction spending.

# Economy

## Job growth (compared to March 2020): 4.5%
## Inflation (January 2024): 3.1%
## Gross Domestic Product (GDP) Q4 2023: 3.3%

At the outset of the year, the U.S. economy demonstrated its resilience and growth. January witnessed substantial gains in employment, earnings, and consumer expenditures.

### A STRONG START TO THE YEAR FOR THE LABOR MARKET

The U.S. job market demonstrated significant expansion, holding the unemployment rate steady at 3.7%. This sustained growth in job creation is key to boosting consumer spending and driving demand for goods and services, contributing to the U.S. economy's performance exceeding expectations.

Specifically, the total number of job positions climbed to 158 million. By January, the economy had welcomed over 350,000 new jobs in just the first month of the year. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 6.8 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** |
| January 2023 | **154.8 million** |
| January 2024 | **157.7 million** |

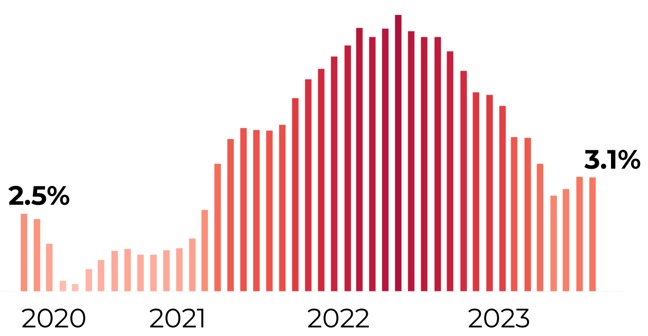
Source: NAR analysis of U.S Bureau of Labor Statistics data

### INFLATION CONTINUES TO EASE

Inflation may not have yet reached the Federal Reserve's goal of 2%, but it's considerably lower than the previous year. As of January 2024, consumer prices were 3.1% higher than the previous year. A year ago, the inflation rate stood at 6.4%.

However, the inflation rate will further ease in the following months, driven by a continued slowdown in rent growth. The National Association of REALTORS® forecasts inflation to drop to 2.7% in 2024.

**Inflation**




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

### RATE CUTS TO FOLLOW IN 2024

The Federal Reserve kept its interest rates unchanged at 5.5% in January. With rate hikes likely done, 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. The National Association of REALTORS® forecasts interest rates to fall below 4.5% by the end of the year.

### THE ECONOMY GREW FASTER THAN EXPECTED

The U.S. economy was not anticipated to expand to this extent in 2023, especially following the multiple rate hikes by the Fed. Against all expectations, the economy grew more than 3% in the last quarter of 2023. Despite grappling with high interest rates and inflation, Americans maintained a persistent spending spree, contributing to the advancement of economic growth throughout 2023. The prospect of lower interest rates signals optimism for continued economic expansion in 2024.

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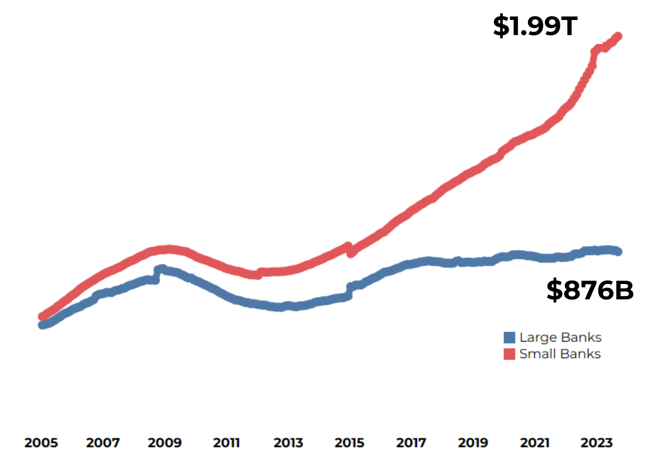
# Commercial Real Estate Lending

## CRE loans (January 2024): $2.96 trillion
## Delinquency rate of CRE loans (Q4 2023): 1.2%

### CRE DEBT IS INCREASING

Despite reports of more stringent lending standards, commercial real estate debt continues to grow this year. Specifically, within small, domestically chartered commercial banks, the volume of CRE loans rose to $1.99 trillion. This is an increase from the $1.88 trillion in April of 2023, following the collapse of the two regional banks. However, within large domestically chartered banks, the volume of CRE loans is declining to nearly $876 billion.

### Commercial Real Estate Debt for Small Banks (January 2024)

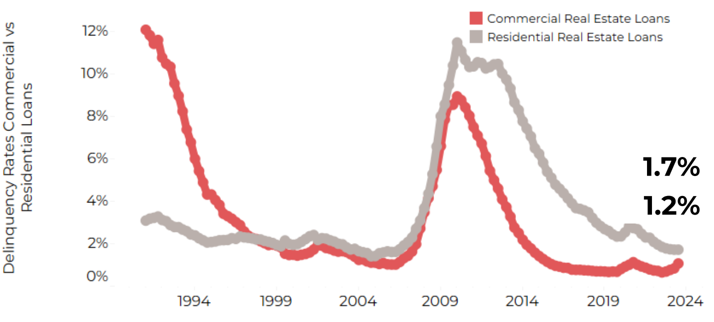



Source Federal Reserve

### INCREASING CRE DELINQUENCY RATES BUT STILL HISTORICALLY LOW

The Federal Reserve also provides data on delinquency rates for 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, which currently 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)

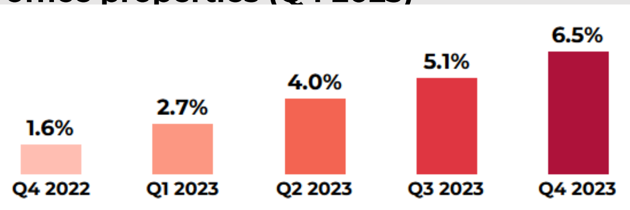



Source Federal Reserve

### 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 office property loan balances were 30 days or more 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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# Multifamily

**Absorption of units in the last 12 months: 325,208 units**
**Rent growth in the last 12 months: 0.8%**
**Cap rate: 5.9%**

Entering 2024, the Multifamily sector has observed a robust 120% year-over-year increase in absorption, with figures slightly exceeding the 10-year median at 325 thousand units, indicating a market recalibration towards stability. Interestingly, renters' preferences have shifted towards Class B properties, with the Class A share of 12-month absorption decreasing from 61 to 47%, while the Class B share increased from 39 to 53%. The net delivery of units experienced a 19% year-over-year escalation, propelling vacancy rates to a 10-year peak of 7.6%. Consequently, this surge in vacancy rates has directly impacted rent growth, now at 0.8%, marking it as one of the slowest rates of increase in over a decade, reflecting the market's adjustment to the increased supply.

Amidst a nationwide deceleration in rent growth, Ocala, FL, Fort Myers, FL, and Austin, TX, stand out with even bigger challenges. In these areas, rent declines surpassing 5% year-over-year. On the bright side, while many areas are experiencing slowed rent increases, cities such as Rockford, IL, Kingsport, TN, Anchorage, AK, and Youngstown, OH, are defying this pattern, each registering a robust rent growth exceeding 5%.

The appetite for apartment living remains strong in key metropolitan areas such as New York, NY, Washington, DC, Dallas-Fort Worth, and Houston, TX. Throughout the year ending in January, these regions have filled over 10,000 multi-family homes. Despite elevated mortgage rates diminishing the buying capacity of numerous prospective purchasers, the rental sector in many expensive regions across the nation is expected to continue its robust performance.

### Top 10 areas with fastest rent growth

| | 2024 Q1 | 2023 Q1 |
|---|---|---|
| Rockford, IL | 6.16% | 6.04% |
| Kingsport, TN | 5.33% | 8.42% |
| Anchorage, AK | 5.07% | 5.85% |
| Youngstown, OH | 5.01% | 6.31% |
| Providence, RI | 4.66% | 5.34% |
| Rochester, NY | 4.50% | 5.48% |
| Lexington, KY | 4.47% | 5.17% |
| Syracuse, NY | 4.44% | 5.59% |
| Salinas, CA | 4.36% | 2.26% |
| Huntington, WV | 4.22% | 3.04% |

### Top 10 areas with the strongest 12-month absorption

| | 2024 Q1 | 2023 Q1 |
|---|---|---|
| New York, NY | 19,796 | 23,536 |
| Washington, DC | 13,131 | 7,695 |
| Dallas-Fort Worth, TX | 12,715 | 2,987 |
| Houston, TX | 11,682 | 4,409 |
| Minneapolis, MN | 9,528 | 6,336 |
| Phoenix, AZ | 9,518 | 4,934 |
| Austin, TX | 8,951 | 6,575 |
| Denver, CO | 8,572 | 6,720 |
| Chicago, IL | 8,144 | 7,286 |
| Atlanta, GA | 7,779 | -539 |

Source: NAR analysis of CoStar data

# Office

**Net absorption in the last 12 months: -69.9 million sq.ft.**
**Rent growth in the last 12 months: 0.8%**
**Cap rate: 8.3%**

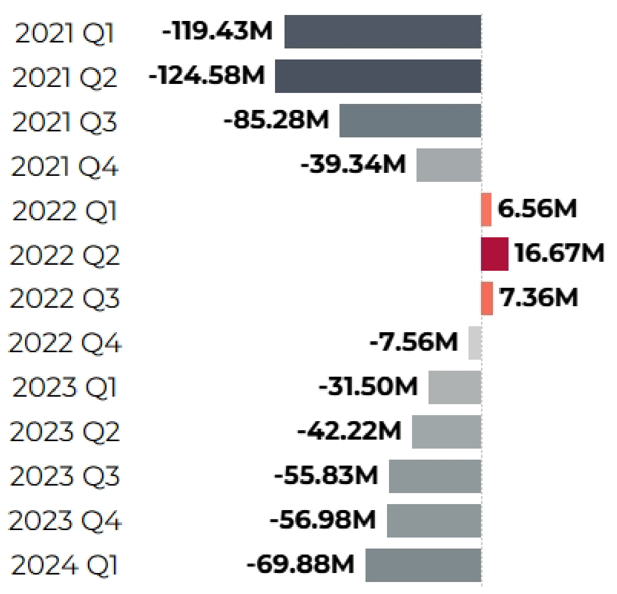
With the establishment of hybrid work models as a legacy of the pandemic's impact on work culture, the demand for traditional office spaces continued to decline.

Over a year ending January, the amount of vacated office space surged by 122% over the previous year, with the vacancy rate hitting a decade-high of 13.7%—up by 1% from the prior year. In a notable shift, the exodus from office spaces has predominantly impacted Class A buildings, which now account for 52% of all vacated space, compared to the previous year when Class B spaces took the majority hit at 65% 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, the Southern U.S. has seen more promising office space occupancy numbers. Cities like Savannah, GA, and Wilmington, NC, are outperforming others, boasting vacancy rates below 2%.

### 12-month Net Absorption in sq. ft




### Top 10 areas with the largest vacancy rates

| | 2024 Q1 | 2023 Q1 |
|---|---|---|
| San Francisco, CA | 22.02% | 17.15% |
| Houston, TX | 18.95% | 18.38% |
| Dallas-Fort Worth, TX | 17.92% | 17.66% |
| Austin, TX | 17.14% | 15.16% |
| Chicago, IL | 16.61% | 15.44% |
| Washington, DC | 16.51% | 15.92% |
| Denver, CO | 16.31% | 15.25% |
| Phoenix, AZ | 16.16% | 14.75% |
| Los Angeles, CA | 15.88% | 14.73% |
| Atlanta, GA | 15.70% | 14.06% |

### Top 10 areas with the lowest vacancy rates

| | 2024 Q1 | 2023 Q1 |
|---|---|---|
| Wilmington, NC | 1.58% | 1.74% |
| Savannah, GA | 1.68% | 1.97% |
| Davenport, IA | 1.89% | 2.30% |
| Hickory, NC | 1.94% | 3.18% |
| Huntington, WV | 1.96% | 1.75% |
| Gulfport-Biloxi, MS | 2.10% | 3.61% |
| Myrtle Beach, SC | 2.15% | 2.19% |
| Pensacola, FL | 2.16% | 2.84% |
| Asheville, NC | 2.25% | 2.26% |
| Olympia, WA | 2.39% | 2.18% |

Source: NAR analysis of CoStar data

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# Industrial

## Net absorption in the last 12 months: 117.7 million sq. ft.
## Rent growth in the last 12 months: 5.9%
## Cap rate: 7.4%

The industrial market is experiencing a slowdown as net absorption year-over-year has plunged by 69% to 117.7 million square feet, along with the decade's second-highest volume of new space entering the market. These dynamics have led to an increase in the vacancy rate, climbing to 6.0% from 4.2% just last year, while rent increases have moderated to 5.9% annually, down from 10.0% a year ago. Even with this slowdown, the industrial domain continues to outperform all other commercial property categories regarding rent growth, maintaining a pace consistent with its pre-pandemic level.

By branch of the industrial sector, logistics spaces lead with a 6.9% rent increase. Meanwhile, flex spaces have seen a rise of 3.4%, and specialized spaces are growing at a rate of 4.5%.

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 11 million square feet over the past 12 months ending in January 2024.

Conversely, Los Angeles, CA, experienced a decline, with over 16 million square feet of industrial space being vacated. Despite robust interest in early 2022, the market's vigor has diminished with a minor uptick in unoccupied space. Nonetheless, Los Angeles maintains a vacancy rate of 4.6%, which remains under the national average of 6.0%.

Furthermore, cities like Orlando and Jacksonville, FL, and Minneapolis, MN, saw the most significant increases in rent. In these locations, industrial space rents have surged more than 11 percent from the previous year, driven by the unwavering demand for warehouse areas.

### Top 10 areas with the strongest 12-month absorption

| | 2024 Q1 | 2023 Q1 |
|---|---|---|
| Dallas-Fort Worth, TX | 28.08M | 41.10M |
| Houston, TX | 18.37M | 32.44M |
| Chicago, IL | 17.25M | 29.63M |
| Phoenix, AZ | 11.45M | 22.62M |
| Savannah, GA | 9.65M | 12.35M |
| Philadelphia, PA | 7.70M | 9.78M |
| Columbus, OH | 6.39M | 9.44M |
| Austin, TX | 5.82M | 6.92M |
| Richmond, VA | 5.51M | 9.64M |
| Las Vegas, NV | 5.37M | 6.37M |

### Top 10 areas with the weakest 12-month absorption

| | 2024 Q1 | 2023 Q1 |
|---|---|---|
| Los Angeles, CA | -16.05M | -9.55M |
| New York, NY | -3.37M | 0.75M |
| San Diego, CA | -3.12M | 0.22M |
| Seattle, WA | -3.10M | 6.22M |
| Shreveport, LA | -2.80M | 0.58M |
| San Francisco, C.. | -1.94M | -0.39M |
| Winston-Salem,.. | -1.86M | 0.93M |
| Buffalo, NY | -1.83M | 1.02M |
| South Bend, IN | -1.27M | 1.38M |
| San Jose, CA | -1.27M | 0.43M |

Source: NAR analysis of CoStar data

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# Retail

## Net absorption in the last 12 months: 46.2 million sq. ft.
## Rent growth in the last 12 months: 3.2%
## Cap rate: 6.8%

Enthusiasm for retail property continues to be robust. The figures are still strong despite a 31% dip in absorption compared to the previous year. The industry is observing the most minimal vacancy rates in ten years. Presently, at 4.1%, the retail sector boasts the record for the lowest vacancy rate among all categories of commercial real estate.

Focusing on retail categories, General Retail spaces, and Neighborhood Centers have been instrumental, accounting for approximately 84% of the net absorption as of January 2024.

**Net Absorption by type (January 2016, 2020, and 2024)**

| | 2016 Q1 | 2020 Q1 | 2024 Q1 |
|---|---|---|---|
| General Retail | 57.40M | 27.81M | 26.59M |
| Mall | 11.15M | -6.18M | 2.45M |
| Neighborhood Center | 29.77M | 7.40M | 12.06M |
| Other | 3.18M | 0.07M | 0.53M |
| Power Center | 9.31M | 1.91M | 2.01M |
| Strip Center | 9.02M | 2.19M | 2.29M |
| **All** | **119.83M** | **33.20M** | **45.93M** |

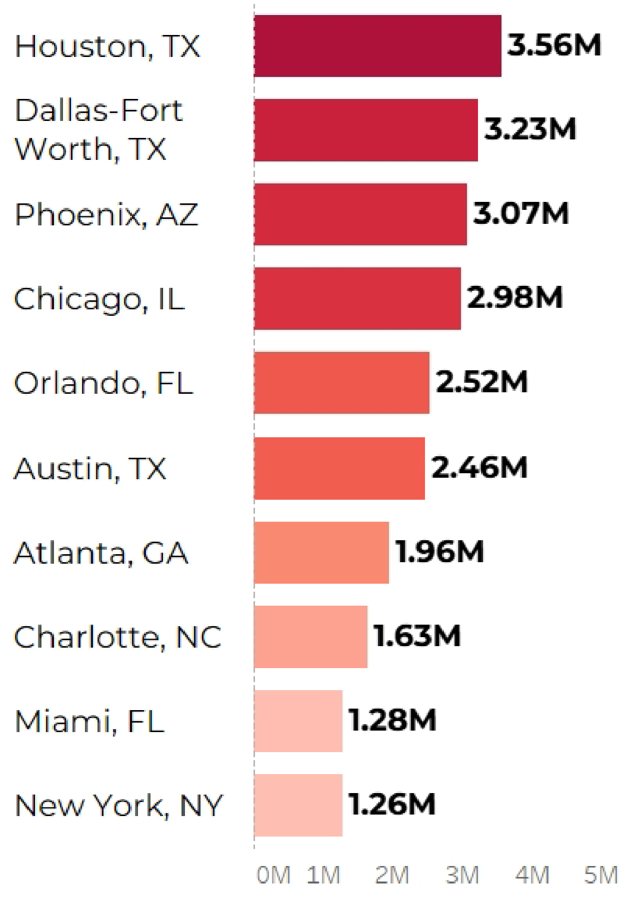
Retail space rents are still higher than last year, but the growth pace has eased, perhaps as consumers become wary amid climbing expenses. Retail asking rents have risen by 3.2% nationally, less than the previous year's peak of 4.2% but still higher than before the pandemic.

Neighborhood Centers and Power Centers experienced the highest increases in rent at 4.0% and 3.8%, respectively. General Retail saw a smaller increase of 2.8% but maintains the lowest vacancy rate at 2.6% across retail subsectors.

Locally, Sun Belt cities, including Phoenix, AZ, Orlando, FL, and Salt Lake City, UT, are experiencing a surge in demand, with rent growth surpassing 8%.

Furthermore, the retail sector is thriving in areas such as Chicago, IL; Phoenix, AZ; Houston; and Dallas-Fort Worth, TX. These locales have seen considerable net absorption, with an occupation of over 3 million square feet in the year leading up to January 2024

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




Source: NAR analysis of CoStar data

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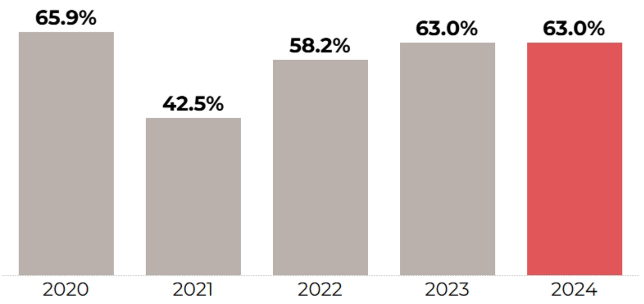
# Hotel

## Occupancy rate in the last 12 months: 62.9%
## Average daily rate in the last 12 months: $156/room
## Revenue per available room in the last 12 months: $98/room

The hospitality sector continued to advance at the beginning of 2024. Yet, despite gains in average daily rates and revenue per available room, hotel occupancy hasn't fully recovered to the figures seen before the pandemic. The 12-month occupancy rate is still lagging by 2.9 percent behind the pre-pandemic benchmark.

### 12-month Occupancy Rate in January




Specifically, in January 2024, the average daily rate (ADR) per room rose to $155/room, up 19% from January 2020. The revenue per available room (RevPAR) also increased to $98/room, up 13% compared to the same period in 2019.

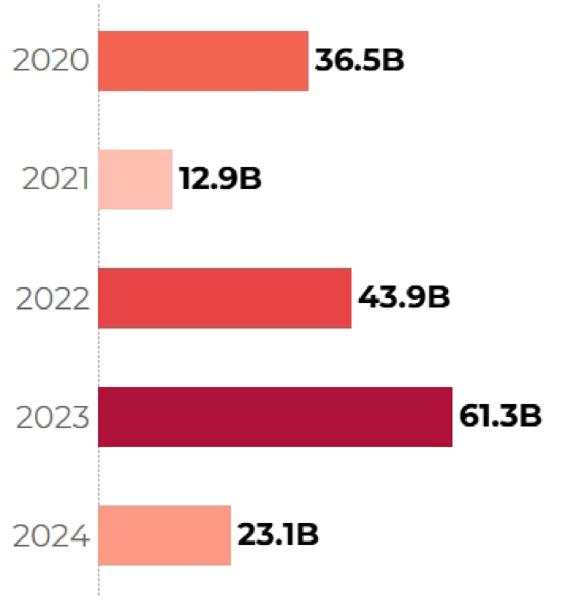
### 12-month ADR and RevPAR in January

| | Average daily rate | Revenue per available room |
|---|---|---|
| 2020 | $132 | $87 |
| 2021 | $99 | $42 |
| 2022 | $126 | $73 |
| 2023 | $150 | $95 |
| 2024 | $156 | $98 |

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

Sales acquisitions have declined since the last year. In January 2024, the 12-month sales volume dropped to $23.1 billion from $66.6 billion in the previous year.

### 12-month Sales Volume as of January




Source: NAR analysis of CoStar data

Locally, Maui Island in Hawaii is a standout in the hospitality industry, boasting a significant ADR hike of 57% from before the pandemic. It also claims the nation's highest ADR and RevPAR, at $587 and $389, respectively. Meanwhile, New York City tops the charts as the busiest hotel hub with an occupancy rate of 82%, and Sarasota, FL has seen an impressive 47% jump in hotel RevPAR.

Conversely, California's San Francisco/San Mateo and San Jose/Santa Cruz areas have not yet overcome the pandemic's impact, with their RevPAR dipping by 27% and 26%, respectively, compared to January 2020.

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# COMMERCIAL REAL ESTATE REPORT
# December 2023

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