Commercial Market Insights Report

February 2023

National Association of REALTORS®
Research Group

NATIONAL ASSOCIATION OF REALTORS®

Summary

Commercial real estate started the new year on a slow note with lower demand, smaller rent price gains, and higher vacancy rates. Office and multifamily are the two sectors that face additional headwinds this year. In these two sectors, vacancy rates are more than 0.8 percentage points higher than a year ago. Net absorption – another indicator of demand – was significantly lower in January compared to a year ago in all four main sectors of Commercial Real Estate. In fact, office space net absorption went back to negative territory. This means that more office space was vacated/available in the market than what was leased or absorbed by commercial tenants.

Here is how each commercial real estate sector performed in January 2023.

After its recent record-breaking year in 2021, the **multifamily** sector continues to slow down. With net absorption down 80% from a year ago, the vacancy rate rose to 6.8% from 5.0% the previous year. As a result, rent growth dropped by more than 8 percentage points within a year to its lowest level since the beginning of 2021. However, the multifamily sector will continue to perform better than pre-pandemic due to favorable demographics and a strong job market that encourages household formation.

Although many employers are requiring employees to return to the office and remote jobs are fading, the **office** sector continues to struggle. Demand for office space declined in the first month of the year, returning to negative territory. With more office spaces vacant and available than leased, the vacancy rate rose to 12.8% from 12.0%. The future of office space is ambiguous. COVID-19 has disrupted the idea of the “traditional office” work environment. Hybrid work is now a reality for many people.

Demand for **industrial** space has slowed down, but it’s still stronger than pre-pandemic. Net absorption is more than 50% higher than it was at the beginning of 2019. Although the vacancy rate has increased by 6 percentage points within the last year, rent growth continues to increase by a double-digit number due to low supply in this sector. Data shows that the industrial sector will continue to be one of the bright spots of commercial real estate in 2023.

The **retail** sector was the commercial real estate sector with the lowest vacancy rate in January 2023. While consumers keep spending despite higher costs, this sector continues to perform better than pre-pandemic. With inflation moving down further and interest rates to stabilize later this year, demand for retail space will remain strong.

Hotel revenue continued to increase in January. After dipping in 2020 due to the COVID-19 travel restrictions and self-quarantine orders, the hospitality sector has experienced significant gains. In fact, the revenue per available room (RevPAR) is more than 10 percent higher than the pre-pandemic level. With business and leisure time increasing, the demand for **hospitality** spaces will continue to grow in 2023.

The year is still young. Inflation, interest rates, supply chain, and geopolitical events are the main factors that will determine how commercial real estate will perform in the following months. The National Association of REALTORS® will keep you informed monthly about the developments in commercial real estate.

Economy

Job growth (compared to March 2020): 2.7%
Inflation: 6.4%

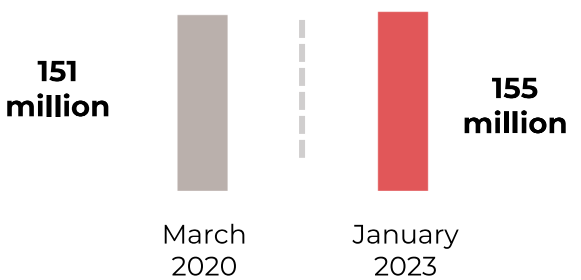
Record high number of jobs

The U.S. labor market started the new year with a record-high number of jobs and historic low unemployment rate.

As of January 2023, there are 4.1 million more jobs compared to pre-pandemic in March of 2020. Within a year, the economy was able to create nearly 5 million new jobs.

Meanwhile, the unemployment rate is at record lows – 3.4 percent - indicating how strong the labor market is since it shows how many people who want a job and are available for work can find one. In fact, there are two jobs for every unemployed person. Thus, job market recovery after the pandemic has been remarkably rapid compared to other notable recoveries in recent history.

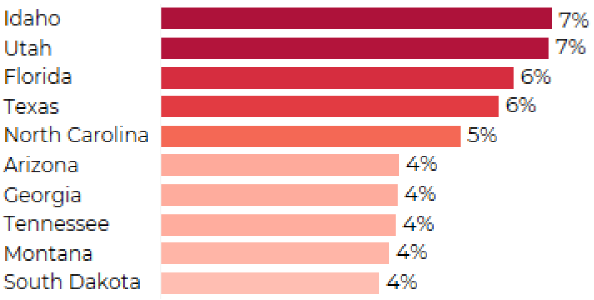
Number of Jobs



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

At the local level, Utah and Idaho continued to be the two states experiencing the fastest employment growth across the country. In fact, these two states were able to recover all the jobs that were lost at the beginning of the pandemic by the end of 2020. As of December 2022, there are more than 100,000 additional jobs in Utah compared to March 2020. Idaho has created more than 55,000 jobs during the same timeframe. However, Hawaii is still missing nearly 36,000 jobs in order to be back to pre-pandemic levels.

Top 10 states with strongest job growth since March 2020



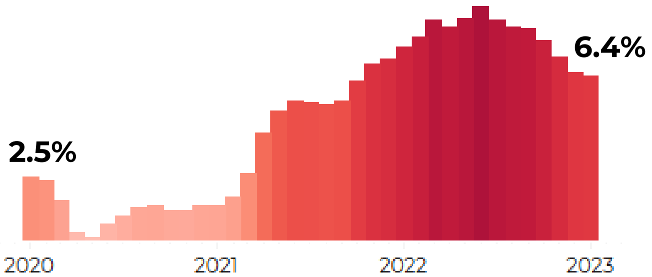
Source: NAR analysis of U.S Bureau of Labor Statistics data

Inflation remains above expectations

Although inflation eased in the first month of the year, it's still rising faster than expected. Fast-rising rents continue to put upward pressure on inflation.

Nevertheless, the inflation rate will 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 8.6% in January 2023. But, according to CoStar, rent prices are only 2.6% higher than a year ago.

Inflation



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

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Economy

Interest rates: 4.75%
Gross Domestic Product (GDP): 2.7%

The Federal Reserve to take a couple of additional rate hikes in 2023

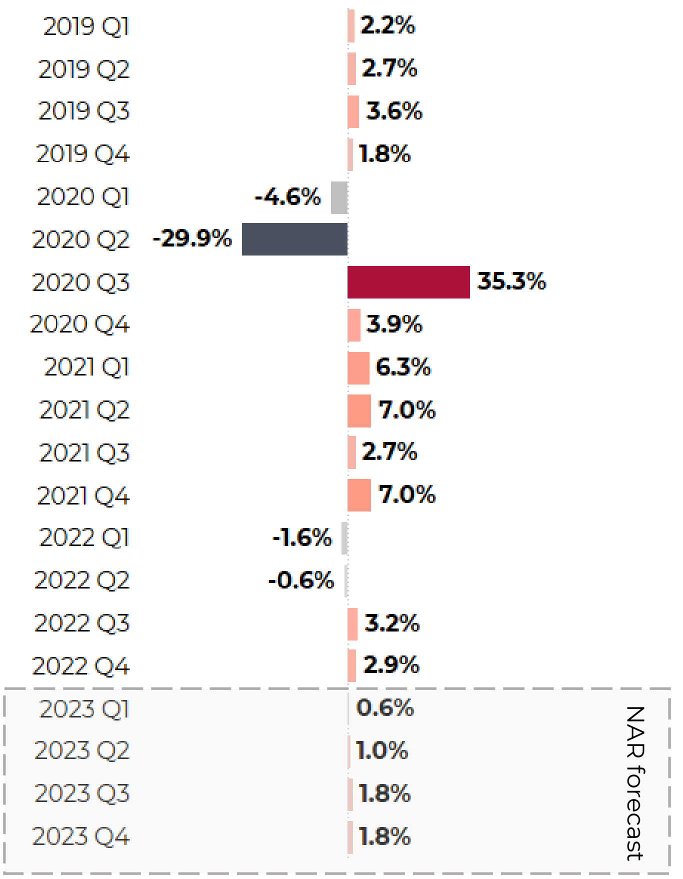
The Federal Reserve has recently switched to smaller interest rate hikes as inflation is moving down. However, the latest data showed that inflation still runs above expectations. Thus, the Federal Reserve may need to raise its short-term interest rates during its fight against inflation. Meanwhile, the current Fed's fund rate is already 4.5 percentage points higher than a year ago.

The National Association of REALTORS® expects the Fed funds rate to reach 5% in early 2023 and remain near that level through the second quarter of 2023. However, 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 will 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 3% growth at the end of 2022. Looking into 2023, although economic growth is expected to decelerate further due to the restrictive monetary policy, the U.S. economy may skirt a 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, real income and 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 1.1% in 2023.

Gross Domestic Product (GDP) 2019-2023



Source: Bureau of Economic Analysis (BEA) and NAR Forecast

Multifamily

Absorption of units in the last 12 months: 108,109
Rent growth in the last 12 months: 2.6%
Cap rate: 4.9%

Rent prices are still higher than they were a year ago, but the gains have returned to more normal levels. Rent growth dropped to the lowest level since the first quarter of 2021. Rents rose 2.6% year-over-year in January compared to 3.7% and 5.6% in the last two quarters of 2022.

As elevated prices continue to hurt consumers, fewer people can afford to cover their rent expenses, decreasing the demand for apartments. After reaching all-time lows in 2021, the vacancy rate rose significantly in January to 6.8%. A year ago, the vacancy rate was 1.8 percentage points lower. But, vacancy rates increased even more in Provo, UT, Wilmington, NC, and Colorado Springs, CO.

While rents have jumped up in nearly all the metro areas across the county, Sun Belt areas have experienced an even faster rent growth, including Knoxville and Kingsport, TN, Fayetteville, NC, and Charleston, SC. In contrast, rent prices have dropped by 2 percentage points compared to the previous year in Phoenix, AZ, and Las Vegas, NV as there are relatively more apartment units available for lease. Both of the areas had a 10% vacancy rate.

Respectively, demand for apartments remains strong in big city centers such as New York and Washington, DC. In these two areas, more than 7,000 multifamily units have been absorbed in the last 12 months ending in January. 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

	Q1 2023	Q1 2022
Peoria, IL	9.02%	8.96%
Knoxville, TN	8.79%	14.75%
Fayetteville, NC	7.80%	12.95%
Kingsport, TN	7.39%	9.23%
Charleston, SC	7.36%	16.09%
Madison, WI	6.99%	5.19%
Gulfport-Biloxi-Pascagoula, MS	6.78%	10.45%
Omaha, NE	6.69%	7.47%
El Paso, TX	6.62%	11.68%
Fort Myers, FL	6.58%	26.92%

Top 10 areas with the strongest 12-month absorption

	Q1 2023	Q1 2022
New York, NY	21,362	35,834
Washington, DC	7,095	22,199
Austin, TX	6,544	17,240
Chicago, IL	5,957	17,718
Minneapolis, MN	5,415	12,492
Denver, CO	5,124	10,097
Phoenix, AZ	4,315	7,912
Charlotte, NC	4,292	10,855
Boston, MA	4,104	14,251
Miami, FL	3,533	10,683

Source: NAR analysis of CoStar data

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Office

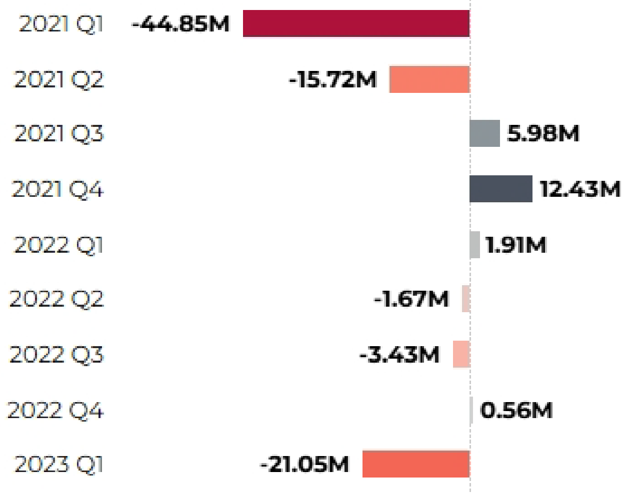
Net absorption in the last 12 months: -25.6 million sq.ft.
Rent growth in the last 12 months: 0.9%
Cap rate: 6.8%

With hybrid work arrangements being the new normal for many companies, the demand for office spaces decreased and became negative again in January after a brief increase in the last quarter of 2022. This means that more office space was available for lease on the market than occupied.

The office sector has been steadily declining for the past 3 years. Currently, the amount of office space leased in the U.S. in the three months ending in January was nearly 60% down from Q1 2019. As a result, the vacancy rate continues to be significantly higher than pre-pandemic at 12.8%.

While office vacancy rates started to rise even before the pandemic, remote and hybrid work, layoffs, and higher interest rates further increased office space availability in the market. Overall, the office vacancy rate has risen by 3% since 2019. At the local level, the most significant increase in vacancy rates was spotted in main tech hubs like San Francisco, Portland, Seattle, and Denver, as many companies and people migrated to more affordable places.

Net Absorption by quarter in sq. ft



Top 10 areas with the largest vacancy rates

	Q1 2023	Q1 2022
Houston, TX	18.93%	18.25%
Dallas-Fort Worth, TX	17.69%	17.37%
San Francisco, CA	17.43%	13.57%
Washington, DC	15.67%	14.83%
Chicago, IL	15.55%	15.05%
Phoenix, AZ	15.09%	14.18%
Los Angeles, CA	15.01%	13.65%
Denver, CO	14.65%	14.04%
Austin, TX	14.54%	12.48%
Atlanta, GA	14.19%	14.18%

Top 10 areas with the lowest vacancy rates

	Q1 2023	Q1 2022
Huntington, WV	1.96%	1.74%
Savannah, GA	2.14%	2.36%
Myrtle Beach, SC	2.17%	2.33%
Youngstown, OH	2.29%	2.56%
Davenport, IA	2.39%	3.70%
Salisbury, MD	2.46%	2.09%
Clarksville, TN	2.49%	1.98%
Visalia, CA	2.59%	2.52%
Asheville, NC	2.61%	2.87%
Olympia, WA	2.63%	2.48%

Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 352 million sq. ft.
Rent growth in the last 12 months: 10.2%
Cap rate: 6.0%

The industrial sector continues to outperform compared to pre-pandemic. Demand is strong as net absorption was above 350 million SF in the last 12 months ending in January. Although demand may have tapered, the volume of industrial space absorbed continues to be double that of pre-pandemic levels. As a result, this sector had the second lowest vacancy rate at 4.6% after the retail sector.

With less available space, rent prices for industrial spaces grow faster than the other sectors at 10.2% year-over-year. Meanwhile, rents increase even faster for logistics space with 11.5% year-over-year gains compared to 7.2% for flex space and 8.5% 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 January 2023.

In contrast, Los Angeles, CA, and Boston, MA, are 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 low vacancy rate below 3%.

In addition, Fort Lauderdale and Miami, 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

	Q1 2023	Q1 2022
Dallas-Fort Worth, TX	39.69M	39.72M
Chicago, IL	31.83M	39.86M
Houston, TX	30.24M	37.78M
Phoenix, AZ	24.66M	24.60M
Atlanta, GA	16.32M	29.28M
Indianapolis, IN	15.53M	23.85M
Kansas City, MO	12.94M	9.39M
Savannah, GA	12.04M	10.67M
Philadelphia, PA	11.47M	13.65M
Nashville, TN	10.23M	6.95M

Top 10 areas with the slowest 12-month absorption

	Q1 2023	Q1 2022
Los Angeles, CA	-8.33M	11.26M
Boston, MA	-1.51M	3.26M
Springfield, MA	-0.94M	-0.30M
Syracuse, NY	-0.89M	5.07M
New York, NY	-0.79M	13.13M
Chattanooga, TN	-0.76M	2.05M
Santa Rosa, CA	-0.72M	0.72M
Little Rock, AR	-0.69M	6.26M
Asheville, NC	-0.69M	0.96M
Rochester, NY	-0.63M	1.02M

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 66.6 million sq. ft.
Rent growth in the last 12 months: 3.6%
Cap rate: 6.7%

Demand for retail space continues to be strong even though it is lower than the previous year. U.S. retail net absorption remained positive for the last couple of years. In fact, demand for retail space continues to remain double that of pre-pandemic. By type of retail stores, general retail, and neighborhood centers have driven the demand, accounting for nearly 90% of the net absorption in January 2023.

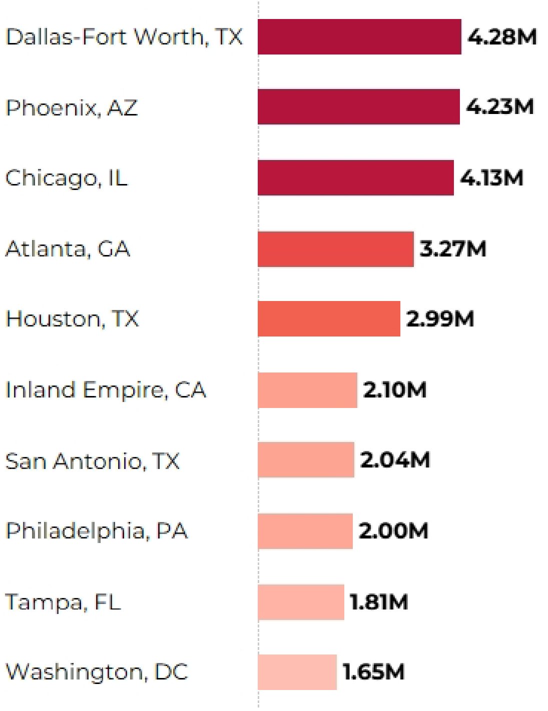
Net Absorption by type (2017, 2020 and January 2023)

	2017 Q1	2020 Q1	2023 Q1
General Retail	74.36M	24.99M	35.38M
Mall	8.36M	-6.27M	-3.18M
Neighborhood Center	37.98M	7.32M	22.91M
Other	1.59M	0.03M	0.00M
Power Center	2.23M	1.77M	7.21M
Strip Center	12.95M	2.16M	4.30M
All	**137.48M**	**30.01M**	**66.61M**

Rents for retail spaces continued to be higher than the previous year, but the pace of the increase has slowed down as consumers still feel the burden of higher prices. Across the country, retail asking rents increased by 3.5%, slower than the previous year but faster than pre-pandemic. While rents rose across all types of retail stores, neighborhoods (4.4%) and strip centers (4.3%) experienced the highest rent gains.

At the local level**,** demand for retail space was very strong in Dallas, TX, Phoenix, AZ, Chicago, IL, and Atlanta, GA, as these areas experienced the largest net absorption in January 2023 with more than 3 million square feet more occupied than available for lease in the retail space.

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



Source: NAR analysis of CoStar data

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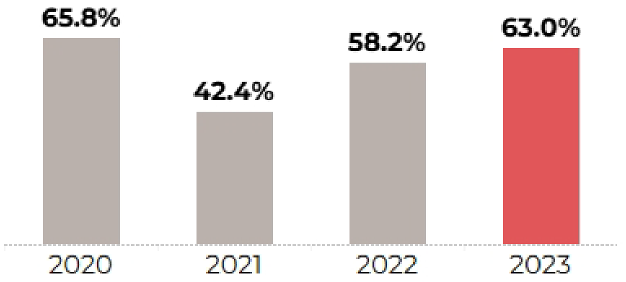
Hotel

Occupancy rate in the last 12 months: 63.0%
Average daily rate in the last 12 months: $150/room
Revenue per available room in the last 12 months: $95/room

The hospitality sector continued to advance in the first month of 2023. Although hotel occupancy hasn't fully recovered yet from the pre-pandemic level, both of the prevailing measures of hotel performance- Average Daily Rate and Revenue Per Available Room – have fully rebounded from pre-pandemic.

12-month occupancy rate in January



Specifically, in January 2023, the average daily rate (ADR) per room rose to $150/room, up 14% from the beginning of 2020. The revenue per available room (RevPAR) also increased to $95/room, up 9% compared to the same period in 2020.

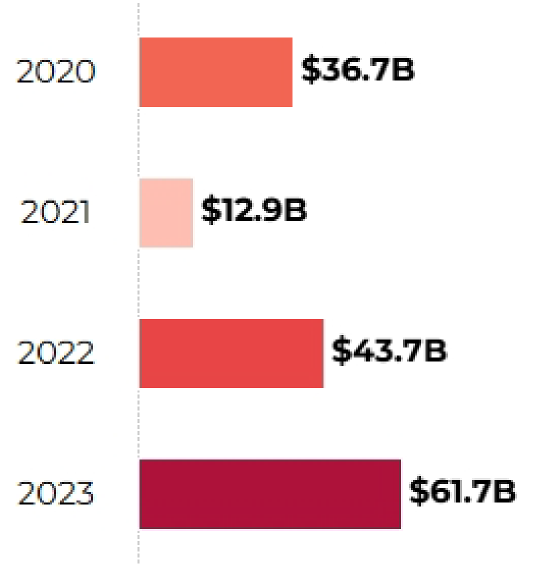
12-month ADR and RevPAR in January

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

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

Sales acquisitions have been rising since 2021. In January 2023, the 12-month sales volume rose to $61.7 billion from $43.7 billion in the previous year.

12-month sales volume as of January



Source: NAR analysis of CoStar data

At the local level, harder-hit markets such as San Francisco, San Jose, and New York still have an occupancy rate significantly lower than pre-pandemic. For example, in San Francisco, the occupancy rate was 82% in 2019 compared to 65% in January 2023. As a result, the revenue per available room is still 27% below the pre-pandemic level. In contrast, in McAllen, TX, Sarasota, FL, Portland, ME, and Knoxville, Tennessee, the occupancy rate is more than 5% higher than in 2019.

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