Commercial Real Estate Market Insights Report

March 2024

National Association of REALTORS®
Research Group

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Commercial Real Estate in February 2024: An Overview

During the second month of the year, the Commercial Real Estate (CRE) market presented a mixed picture, with certain sectors showing resilience while others continued to face uncertainties and losses. The office sector has unquestionably borne the brunt of the most severe and persistent challenges than any other CRE category, and its outlook remains uncertain. The industrial sector has slowed down, with demand falling beneath levels seen before the pandemic. However, multifamily and neighborhood retail sectors remain strong. In the meantime, lower interest rates later this year are expected to create a more favorable environment for the CRE market by reducing costs, increasing demand, and stimulating economic activity.

Below is a summary of the performance across various commercial real estate sectors during February 2024:

Troubles continue in the **office** sector. Leasing activity has dropped, office availability and delinquencies have increased, but construction remains nearly at the same levels. As a result, the office vacancy rate reached a new record high last month at 13.8%. Specifically, there are more than twice as many more unoccupied office square feet than occupied compared to a year ago. Looking ahead, the forecast suggests an increase in available office spaces. Leasing activity, which helps to gauge the level of demand and interest from potential tenants, has dropped about 50 percentage points below the pre-pandemic levels.

On the other hand, the **multifamily** sector is progressively rebounding from the lows it experienced last year. Net absorption has surged 120% compared to a year earlier. Persistently elevated mortgage rates, hovering around 7%, continue to boost the demand for apartment buildings. But, despite stronger demand, the vacancy rate increased further in February to 7.7%. The influx of new housing supply to the market has absorbed the stronger demand, preventing vacancy rates from falling.

Demand for **retail** spaces continues to slow down. Compared to the early months of 2023, net absorption has seen a significant reduction, falling by approximately 30 percentage points. But, despite lower absorption rates, the limited availability of retail spaces maintains vacancy rates low, hovering around 4%, the lowest rate among any other sector in the commercial real estate market. With fewer new construction deliveries expected, 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, which are key components of the commercial real estate sector.

In the **industrial** sector, there are emerging signs of a slowdown, with net absorption falling to levels lower than any seen in the past decade. While online shopping and e-commerce pushed up the activity to record high levels at the end of 2021 and beginning of 2022, net absorption is currently nearly 70% lower than a year ago and 35% below the pre-pandemic level. Nevertheless, rent growth continues to be the fastest among any other sector of the commercial real estate market. Specifically, rents for industrial spaces are 5.5% higher than a year ago. The long-term 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 (compared to March 2020): 4.6%
Inflation (February 2024): 3.2%
Gross Domestic Product (GDP) Q4 2023: 3.2%

During the second month of the year, the U.S. economy continued to showcase its resilience and growth, reflecting a positive start to the year. Despite elevated, yet steady, interest rates at 5.5%, consumer spending advanced, buoyed by substantial gains in employment and earnings in February.

Strong start to the year for the labor market

The U.S. labor market remained strong, with significant job additions in February 2024, maintaining the unemployment rate below 4% despite a slight increase from the previous month.

Specifically, the total number of job positions climbed to 158 million. In the first couple of months of the year, the economy had welcomed over half a million new jobs. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 6.9 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**
February 2023	**155.1 million**
February 2024	**157.8 million**

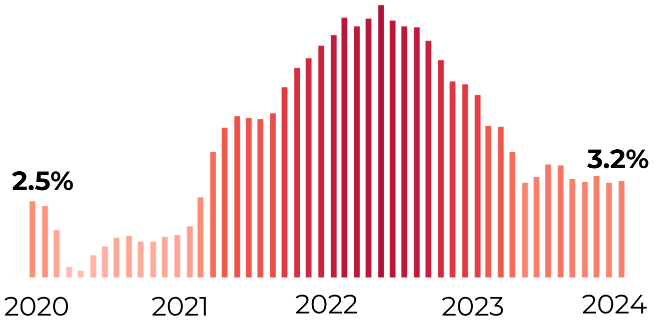
Source: NAR analysis of U.S Bureau of Labor Statistics data

Inflation rose slightly but moving in the right direction

Inflation may not have yet reached the Federal Reserve's goal of 2%, but it's considerably lower than the previous year. As of February 2024, consumer prices were 3.2% higher compared to the previous year. A year ago, the inflation rate stood at 6.0%.

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 February. With rate hikes over, 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 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 grows faster than expectations

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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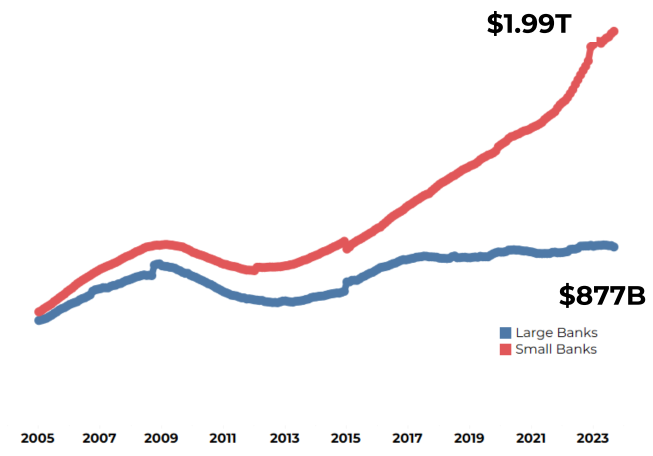
Commercial Real Estate Lending

CRE loans (February 2024): $2.98 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 $1.90 trillion in April of 2023, following the collapse of the two regional banks. Within large domestically chartered banks, the volume of CRE loans also advanced to nearly $877 billion in February after diminishing for over a year.

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

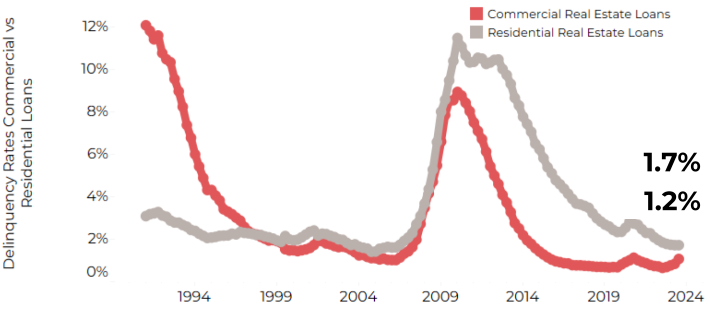


Source Federal Reserve

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. However, while the delinquency rate for residential loans is decreasing, there has been 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, and currently, it 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)

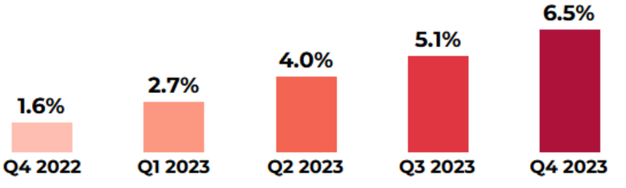


Source Federal Reserve

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 the balance of office property loan balances were 30 days or more days 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: 331,990 units
Rent growth in the last 12 months: 0.7%
Cap rate: 5.9%

As the first quarter of 2024 progresses, the Multifamily sector shows a notable 120% year-over-year surge in absorption, reaching 331 thousand units—marginally above the 10-year median. This uptick is indicative of a market moving towards equilibrium. Renters are increasingly opting for Class B properties, demonstrated by a shift in the 12-month absorption share from 61% to 47% for Class A and an increase from 39% to 53% for Class B. The annual net delivery of units has risen by 20%, causing vacancy rates to hit a 10-year high at 7.7%. This rise in vacancy has consequently subdued rent growth to 0.7%, registering as one of the lowest increases in the past decade as the market responds to the expanded inventory.

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 surpassed 5% year-over-year. On the bright side, while many areas are experiencing slowed rent increases, cities such as Rockford, IL, Kingsport, TN, Salinas, CA, 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; Dallas-Fort Worth, TX; Washington, DC; Phoenix, AZ; and Houston, TX. Throughout the year ending in February, these regions have seen over 10,000 multi-family homes being filled. In view of 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	6.64%	6.19%
Kingsport, TN	6.21%	7.59%
Salinas, CA	5.13%	2.39%
Youngstown, OH	5.01%	6.17%
Rochester, NY	4.64%	5.53%
Syracuse, NY	4.63%	5.61%
Springfield, MA	4.47%	5.67%
Anchorage, AK	4.47%	5.94%
Providence, RI	4.43%	5.36%
Lexington, KY	4.35%	5.32%

Top 10 areas with the strongest 12-month absorption

	2024 Q1	2023 Q1
New York, NY	20,161	23,382
Dallas-Fort Worth, TX	13,879	3,124
Washington, DC	12,487	7,692
Phoenix, AZ	10,465	4,958
Houston, TX	10,090	4,437
Minneapolis, MN	9,282	6,295
Austin, TX	8,993	6,569
Chicago, IL	8,738	7,387
Atlanta, GA	8,695	-860
Nashville, TN	7,770	3,259

Source: NAR analysis of CoStar data

Office

Net absorption in the last 12 months: -66.5 million sq.ft.
Rent growth in the last 12 months: 0.7%
Cap rate: 8.3%

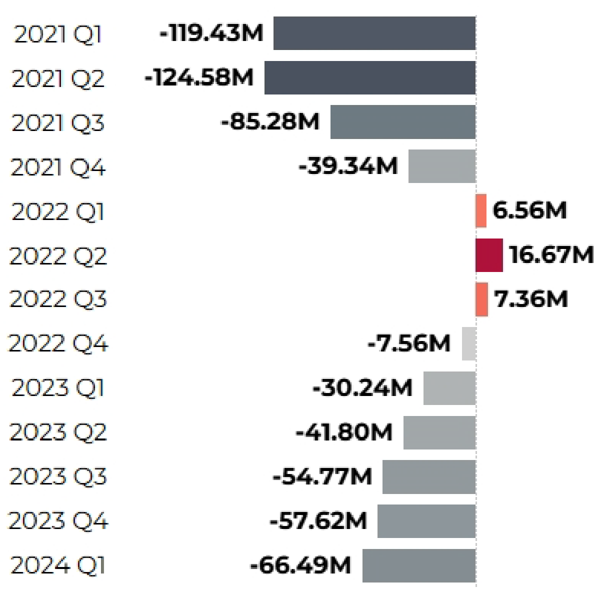
With the establishment of hybrid work models as a legacy of the pandemic's impact on work culture, the demand for traditional office spaces has continued to decline.

Over a year ending February, the amount of vacated office space surged by 119% over the previous year, with the vacancy rate hitting a decade-high of 13.8%—up by 1.1% from the prior year. In a notable shift, the withdrawal from office spaces has predominantly impacted Class A buildings this year ending in February, which now account for 55% of all vacated space, compared to the previous year when Class B spaces took the majority hit at 67% 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, this month, all five of the top five performers in the category have a vacancy rate under 2%, with Wilmington, NC, and Savannah, GA, outperforming the others.

12-month Net Absorption in sq. ft



Top 10 areas with the largest vacancy rates

	2024 Q1	2023 Q1
San Francisco, CA	21.96%	17.08%
Houston, TX	18.73%	18.32%
Dallas-Fort Worth, TX	17.99%	17.62%
Austin, TX	16.93%	15.06%
Chicago, IL	16.79%	15.38%
Washington, DC	16.78%	15.89%
Denver, CO	16.39%	15.19%
Phoenix, AZ	16.02%	14.69%
Los Angeles, CA	15.97%	14.59%
Atlanta, GA	15.55%	14.02%

Top 10 areas with the lowest vacancy rates

	2024 Q1	2023 Q1
Wilmington, NC	1.35%	1.74%
Savannah, GA	1.67%	1.95%
Davenport, IA	1.86%	2.30%
Hickory, NC	1.89%	3.19%
Huntington, WV	1.91%	1.75%
Myrtle Beach, SC	2.04%	2.19%
Asheville, NC	2.15%	2.26%
Gulfport-Biloxi, MS	2.29%	3.59%
Olympia, WA	2.29%	2.17%
Pensacola, FL	2.30%	2.84%

Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 112.6 million sq. ft.
Rent growth in the last 12 months: 5.5%
Cap rate: 7.2%

The industrial sector is undergoing significant change, with net absorption dropping 69% year-over-year to 112.6 million square feet, alongside the introduction of a near-record amount of new space this decade. This shift has resulted in a vacancy rate rise to 6.1%, up from 4.3% the previous year. Concurrently, annual rent growth has eased to 5.5%, a decrease from the previous rate of 10.0%. Despite these changes, the industrial sector's rent growth still surpasses that of all other commercial real estate categories, holding steady with rates seen before the pandemic.

By branch of the industrial sector, logistics spaces lead with a 6.5% rent increase. Meanwhile, flex spaces have seen a rise of 3.0%, and specialized spaces are growing at a rate of 4.4%.

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 10 million square feet over the past 12 months ending in February 2024.

In a contrasting trend, Los Angeles, CA, saw over 17 million square feet of industrial space emptied. While there was strong market interest in early 2022, the momentum has waned with a slight increase in vacancies. Still, Los Angeles holds onto a vacancy rate of 5.0%, staying below the national average of 6.1%.

Additionally, cities in Florida, including Orlando, Jacksonville, and Tampa, have experienced the most notable rent escalations. Industrial space rents in these areas have climbed over 10 percent since last year, propelled by a consistent and strong demand for warehouse properties. This trend reflects the broader economic growth in the region, attracting businesses and fueling a competitive industrial market.

Top 10 areas with the strongest 12-month absorption

	2024 Q1	2023 Q1
Dallas-Fort Worth, TX	25.15M	41.12M
Houston, TX	16.46M	32.38M
Chicago, IL	15.52M	28.24M
Phoenix, AZ	10.78M	22.22M
Savannah, GA	8.15M	12.24M
Philadelphia, PA	7.25M	9.39M
Detroit, MI	6.69M	4.81M
Richmond, VA	6.32M	9.63M
Austin, TX	6.04M	6.93M
Oklahoma City, OK	5.59M	0.98M

Top 10 areas with the weakest 12-month absorption

	2024 Q1	2023 Q1
Los Angeles, CA	-17.69M	-9.21M
New York, NY	-3.87M	0.74M
Inland Empire, CA	-3.53M	11.50M
Seattle, WA	-3.48M	6.31M
San Diego, CA	-3.43M	0.25M
San Francisco, CA	-2.09M	-0.38M
Shreveport, LA	-1.99M	0.58M
Winston-Salem, ..	-1.82M	0.95M
San Jose, CA	-1.66M	0.42M
Buffalo, NY	-1.59M	0.66M

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 44.6 million sq. ft.
Rent growth in the last 12 months: 3.2%
Cap rate: 6.8%

Demand for retail space remains strong. Even though absorption has decreased by 33% from the previous year, it still exceeds levels from before the pandemic. The sector is currently experiencing some of the smallest vacancy rates in a decade, with a current rate of 4.1%. This positions the retail sector as having the lowest vacancy rate compared to all other sectors.

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

Net Absorption by type (February 2016, 2020, and 2024)

	2016 Q1	2020 Q1	2024 Q1
General Retail	57.40M	27.81M	25.43M
Mall	11.15M	-6.18M	1.82M
Neighborhood Center	29.77M	7.40M	12.36M
Other	3.18M	0.07M	0.45M
Power Center	9.31M	1.91M	1.88M
Strip Center	9.02M	2.19M	2.26M
All	**119.83M**	**33.20M**	**44.21M**

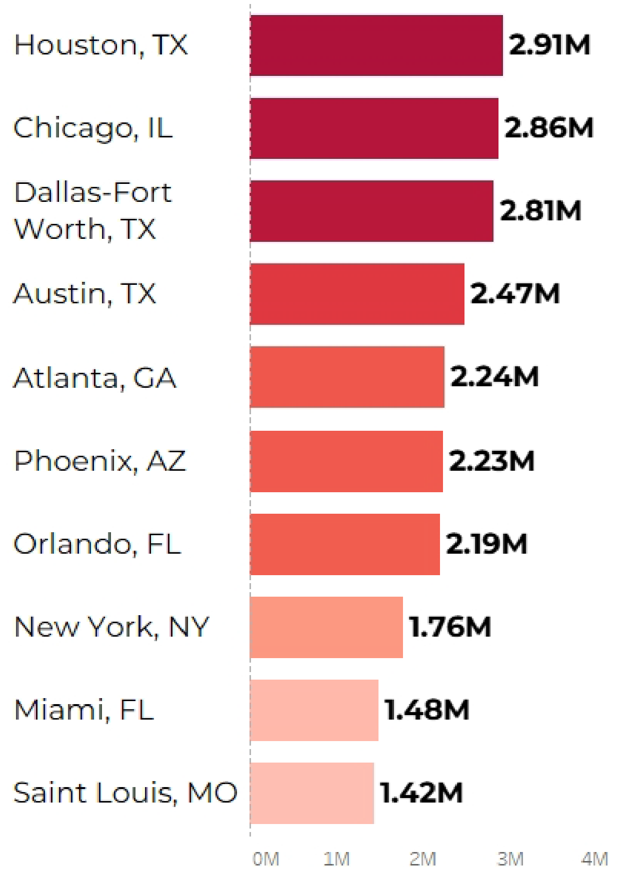
Retail space rents are still higher than last year's, but the growth pace has eased, perhaps as consumers become wary amid climbing expenses. Retail asking rents have risen by 3.2% nationally, less than the previous year's peak of 4.2% but still higher than before the pandemic.

Neighborhood Centers and Power Centers experienced the highest rent increases, at 3.9% and 3.7%, respectively. General Retail saw a smaller increase of 2.8% but maintains the lowest vacancy rate, at 2.6%, across retail subsectors.

In the Sun Belt region, cities like Phoenix, AZ, Orlando, FL, and Salt Lake City, UT, are witnessing a robust increase in demand, with rental rates climbing by over 8%.

Moreover, the retail market is flourishing in Chicago, IL, as well as Houston and Dallas-Fort Worth, TX, where significant space has been filled, marking nearly 3 million square feet of net absorption at the end of February 2024.

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



Source: NAR analysis of CoStar data

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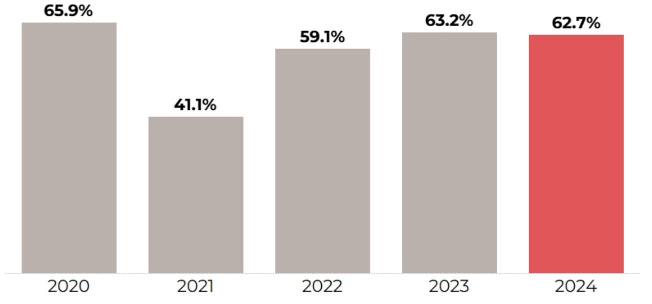
Hotel

Occupancy rate in the last 12 months: 62.7%
Average daily rate in the last 12 months: $156/room
Revenue per available room in the last 12 months: $98/room

The hospitality industry has shown signs of progress at the beginning of 2024. However, hotel occupancy levels have yet to return to pre-pandemic norms, even with the improvement in average daily rates and revenue per available room. Over the past year, the occupancy rate has remained 3.2 percent lower than the levels seen before the pandemic's impact.

12-month Occupancy Rate in February



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

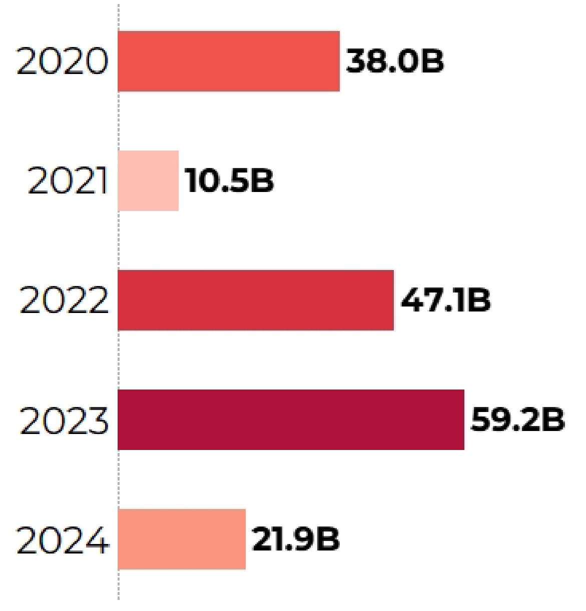
12-month ADR and RevPAR in February

	Average daily rate	Revenue per available room
2020	$132	$87
2021	$95	$39
2022	$129	$76
2023	$151	$96
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 February 2024, the 12-month sales volume dropped to $21.9 billion from $59.2.6 billion in the previous year.

12-month Sales Volume as of February



Source: NAR analysis of CoStar data

Maui Island in Hawaii is making waves in the hospitality market, with its Average Daily Rate (ADR) climbing 57% above pre-pandemic levels, achieving the highest ADR and Revenue Per Available Room (RevPAR) in the country at $579 and $382, respectively. New York City leads as the most occupied hotel location with an 82% occupancy rate, while Sarasota, FL, has experienced a notable 47% increase in hotel RevPAR.

Conversely, in California, the regions of San Francisco/San Mateo and San Jose/Santa Cruz are still facing challenges from the pandemic's aftermath, with both seeing a 25% decline in RevPAR since February 2020.

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