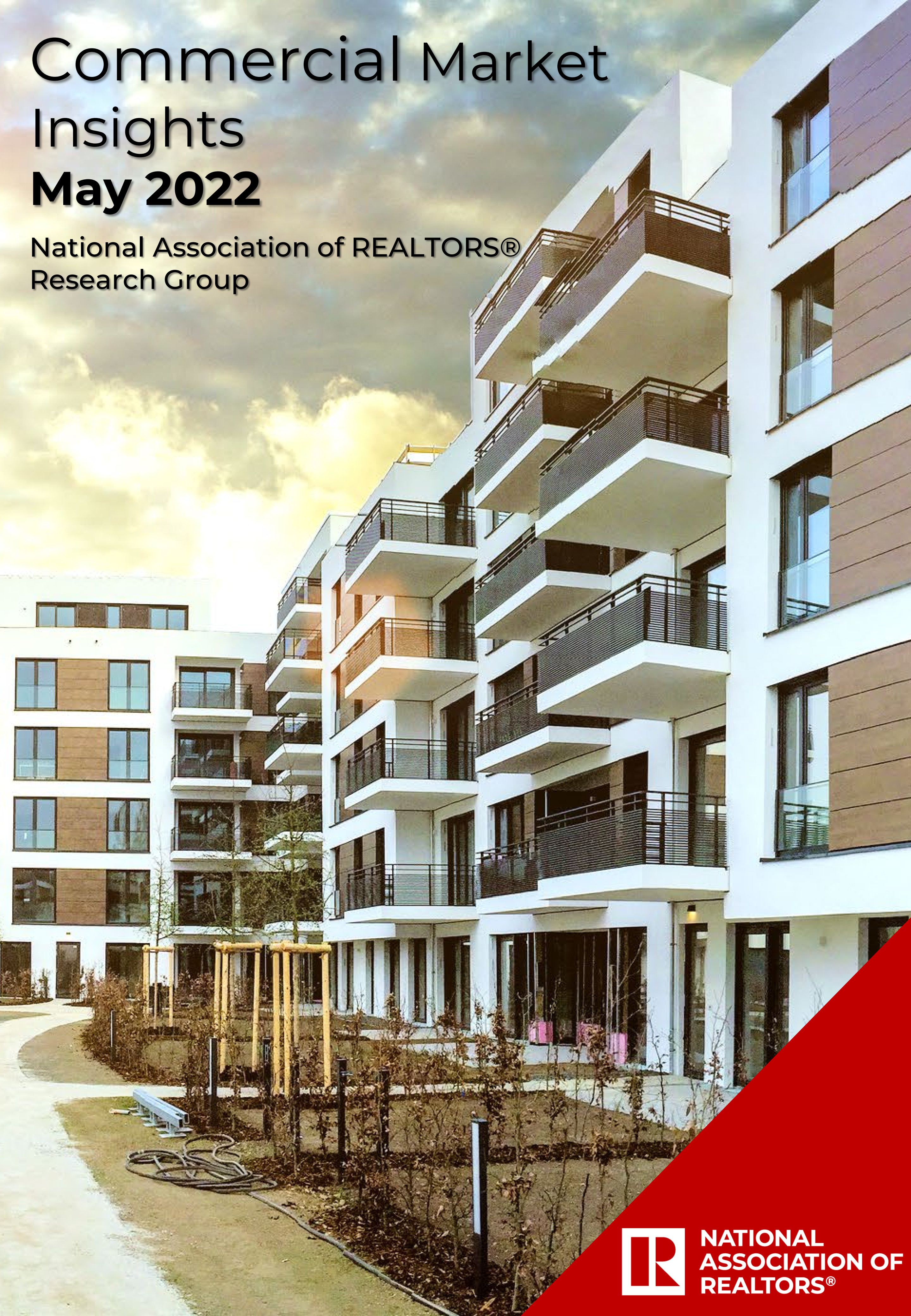
Commercial Market Insights
May 2022

National Association of REALTORS®
Research Group



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Overview

Mixed effect of higher interest rates and inflation on CRE market

Higher interest rates and inflation are having a mixed impact on the demand for commercial real estate. The pace of absorption has slowed in the industrial and retail markets as consumers cut back on spending amid high inflation. Meanwhile higher mortgage rates and continuing return of workers to the office have increased the pace of absorption of multifamily units and office space.

As rising mortgage rates make a home purchase less affordable, occupancy of multifamily units in the past three months as of May 2022 rose to about 75,600 units, an increase from 62,000 units in 2022 Q1.

While workers continue to return to the office and with sustained job growth, 13 million square feet (MSF) of office space was absorbed on a net basis in the past three months as of May, up from just 3.4 MSF in 2022 Q1.

As consumers pare back on spending, net absorption of retail store space decreased to 20.4 MSF in the past three months ended May 2022, slightly lower than the 22.6 MSF net absorption in 2022 Q1. General retail and strip centers, which provide basic goods and services compared to malls, have driven the demand, accounting for 80% of the net absorption.

Net absorption of industrial space also slowed to 83 MSF in the past three months as of May 2022. In the industrial property market, logistics (warehouse, distribution, fulfillment centers) have been the growth driver, accounting for nearly 90% of net absorption.

On a positive note, the big cities continue to come back to life. After the New York metro area suffered a decline in occupancy in the second quarter of 2020, the New York metro area absorbed 30,778 apartment units, the largest increase in net absorption of apartment units in the 12 months ended May 2022, surpassing Dallas-Forth Worth. New York, Los Angeles, Chicago, Boston, Washington DC, and San Francisco also saw positive net absorption of retail space over the past 12 months ended 2022 Q2. However, the office market is slower to recover. Since 2020 Q2, New York has the largest loss in occupancy of 28.3 MSF, followed by Los Angeles (10.9 MSF), San Francisco (10.2 MSF), Chicago (9.6 MSF), and Washington DC (8.6 MSF), as well as Boston though the loss is smaller (-1.9 MSF).

The impact of higher interest rates on the economy is causing some heightened risk aversion among investors. Investor acquisitions over the 12 months ended May 2022 have waned somewhat compared to the 12-month acquisitions ended 2022 Q1, although the investment volume is still above the pre-pandemic level. Total acquisitions for multifamily, office, industrial, and retail properties totaled $582 billion in the 12 months ended May 31, or 7% below the $628 billion of acquisitions in the 12 months ended March 2022.

On the whole, the commercial real estate market is still poised to do well despite higher interest rates and inflation. Mortgage rates are boosting rental demand while e-commerce continues to boost the demand for logistics space. Retail rent growth is still below the rate of inflation which means positive gross margins for retail tenants. The continuing return of workers to the office, even If some return on a hybrid model, is lifting demand for office space.

Enjoy this month's issue!

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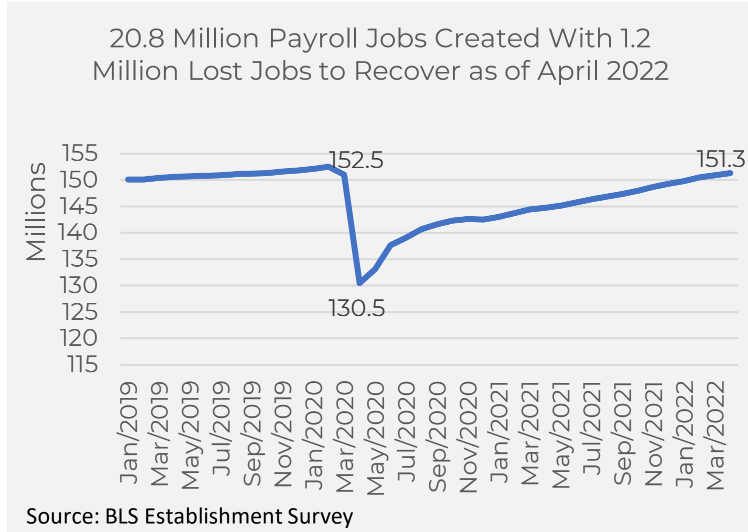
Economic Conditions

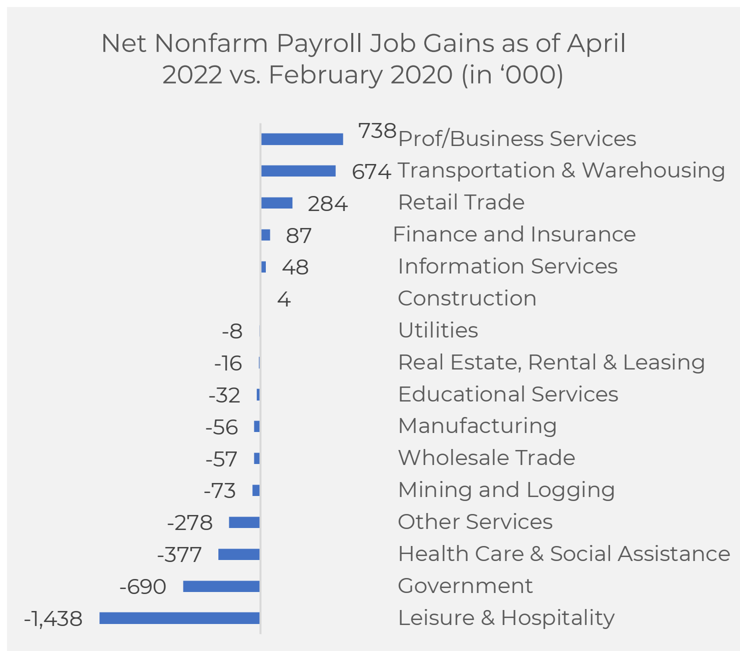
Job growth still solid amid rising inflation and interest rates

20.8 million jobs as of April 2022

Non-farm payroll employment increased by 428,000 jobs in April, with 20.8 million net jobs created relative to February 2020, or 95% of the 22.4 million jobs lost during March and April 2020. There are just 1.2 million nonfarm payroll jobs still to be recovered. The unemployment rate held at 3.6%, just a tad over the 3.5% rate in February 2020. The largest net job creation is in professional/business services (+738,000) followed by transportation and warehousing (+674,000), which bode well for the recovery of demand for office space and sustained demand for industrial space. Even retail trade jobs were up (+284,000). Jobs in the finance and insurance industry increased (+87,000) while real estate, rental, and leasing jobs have still not recovered (-16,000).

As of April 2022, non-farm employment in 33% of 401 metro areas has surpassed the level of nonfarm employment in February 2022. The largest job gains are mainly in the South and West (Mountain Division), led by Dallas, Austin, Atlanta, Riverside, ad Nashville. The largest job losses are in the primary markets like New York, Los Angeles, San Francisco, Washington DC, Chicago, Boston, Minneapolis, Philadelphia, and Pittsburgh.





132 of 401 metro areas and submarkets (33%) have net job gains as of April 2022 compared to pre-pandemic peak employment (February 2020)

Highest net job gains ('000)	
Dallas-Fort Worth-Arlington, TX	181.1
Austin-Round Rock, TX	80.2
Atlanta-Sandy Springs-Roswell, GA	67.3
Riverside-San Bernardino-Ontario, CA	46.4
Nashville-Davidson-Murfreesboro-Franklin, TN	37.7
Tampa-St. Petersburg-Clearwater, FL	36.9
Phoenix-Mesa-Scottsdale, AZ	35.6
Provo-Orem, UT	31.0
Jacksonville, FL	29.6
Raleigh, NC	28.2
Charlotte-Concord-Gastonia, NC-SC	25.9
Indianapolis-Carmel-Anderson, IN	22.8
Salt Lake City, UT	22.0
Lakeland-Winter Haven, FL	21.6
Boise City, ID	20.1
North Port-Sarasota-Bradenton, FL	16.0
Denver-Aurora-Lakewood, CO	14.0
Elkhart-Goshen, IN	13.1
Fayetteville-Springdale-Rogers, AR-MO	12.9
Knoxville, TN	12.8

Highest net job losses ('000)	
New York-Newark-Jersey City, NY-NJ-PA	-395.9
New York City NY	-258.2
Los Angeles-Long Beach-Anaheim, CA	-192.4
San Francisco-Oakland-Hayward, CA	-88.0
Washington-Arlington-Alexandria, DC-VA-MD-WV	-87.7
Chicago-Naperville-Elgin, IL-IN-WI	-86.7
Minneapolis-St. Paul-Bloomington, MN-WI	-77.1
Boston-Cambridge-Nashua, MA-NH Metro NECTA	-74.4
Pittsburgh, PA	-53.4
Philadelphia-Camden-Wilmington, PA-NJ-DE-MD	-52.3
Detroit-Warren-Dearborn, MI	-46.0
Urban Honolulu, HI	-44.6
Putnam-Rockland-Westchester, NY	-41.3
New Orleans-Metairie, LA	-40.6
Seattle-Tacoma-Bellevue, WA	-39.2
Philadelphia City, PA	-33.0
St. Louis, MO-IL	-32.8
Milwaukee-Waukesha-West Allis, WI	-31.8
Bergen-Hudson-Passaic, NJ	-30.2
Houston-The Woodlands-Sugar Land, TX	-28.0
Cleveland-Elyria, OH	-27.7

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Economic Conditions

Teleworking due to the pandemic continues to decline

The fraction of workers who teleworked due to the pandemic decreased to 8%

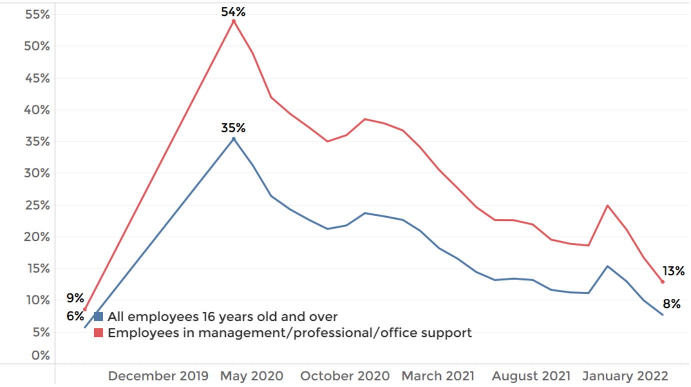
Workers continue to head back to the office. As of April 2022, just 8% of employed workers 16 years old or over teleworked because of the pandemic, down from a peak of 35%, but still twice the 6% rate prior to the pandemic. The fraction of workers working from home could be higher because of a permanent shift toward a full-time remote or hybrid work schedule. Google Trends tracks the number of visitors to workplaces relative to the pre-pandemic level. In the District of Columbia, visits to workplaces are still down 39% compared to the pre-pandemic level, and down by close to 20% in New York, New Jersey, Massachusetts, California, and Colorado.

Inflation still elevated at 8.3% in April

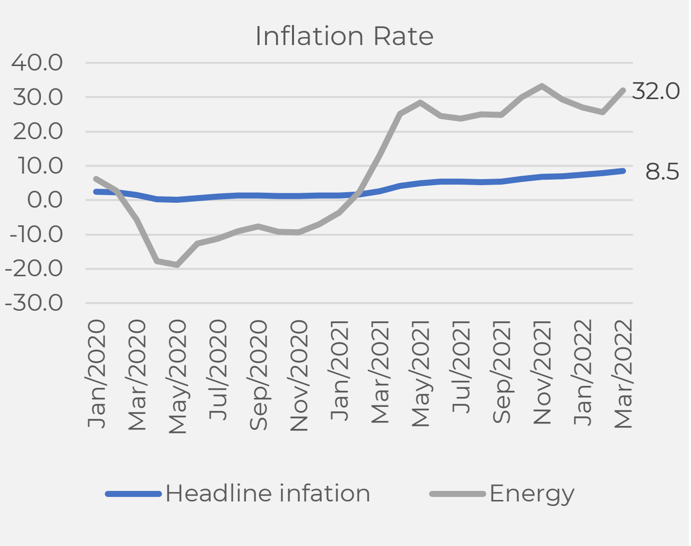
The inflation rate measured using the consumer basket (CPI) ticked down to 8.3% in April, but that is still way up than the Fed's target of 2%, so the Fed will continue to raise interest rates and reduce the level of money supply until inflation cools down. Inflation may be hard to control as it is arising from supply-side pressures. Oil prices have climbed down somewhat after surging to about $120 in the wake of the Russian invasion of Ukraine, but the price of oil is still over $100/barrel and gas prices are still at over $4/gallon.

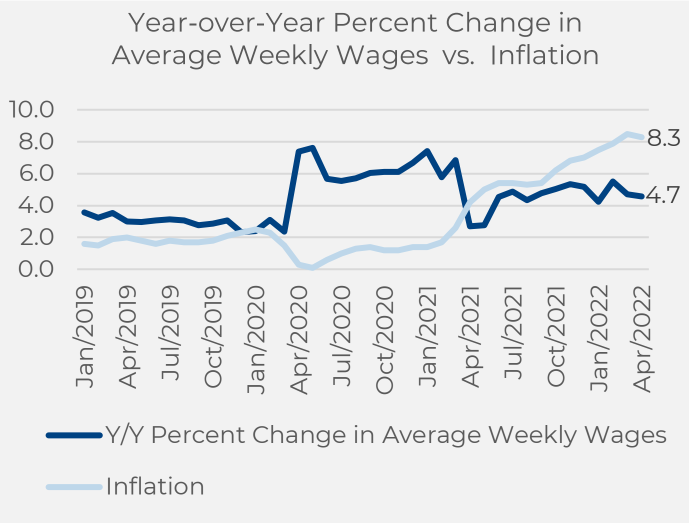
The good news is that even with a tight labor market, wage growth has been tame at 4.7%. This is a good sign that there is no wage-price spiral, but negative income growth will tend to reduce consumer spending.

Percent of employed 16 years old and over who teleworked because of the coronavirus pandemic as of April 2022



Source: Bureau of Labor Statistics COVID Supplement and 2019 American Community Survey. Office-using occupations are management, professional and related occupations and office administrative support workers.





Source: US Census Bureau

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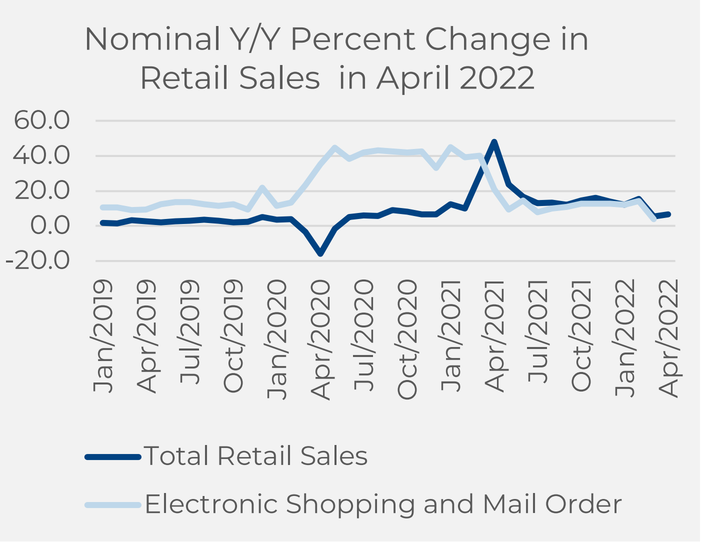
Source: US Census Bureau

Economic Conditions

Rising inflation and interest rates are slowing down spending

Retail sales growth decelerates

With rising inflation, consumers are pulling back on spending. Total retail sales rose at a slower year-over-year pace of 6.7% in April, down from 48% one year ago. Electronic and mail-order shopping also slowed to 3.9% year-over-year, down from 21% one year ago.



Source: US Census Bureau

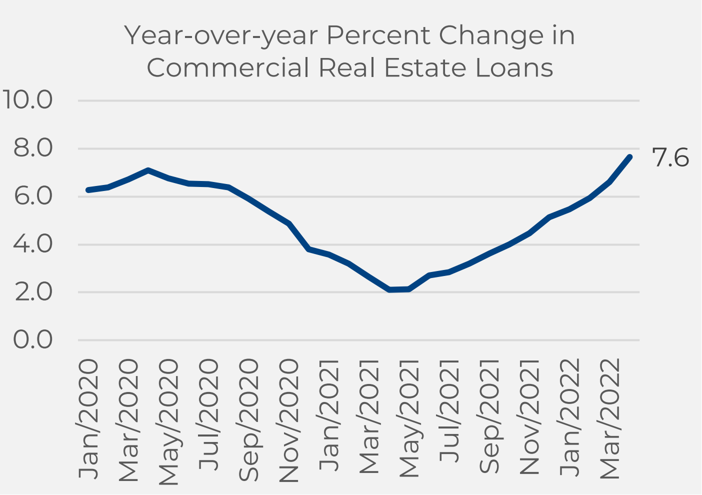
New orders and production slowing

New orders of manufactured goods and the production of goods has slowed in April. The new orders index is down to 53.5 from 64.3 one year ago. An index of 50 means production is still broadly increasing but at a weaker pace compared to one year ago. \

Source: Institute of Supply Management

CRE loans up 7.6% year-over-year in March 2022

Despite rising interest rates that is casting a pall on the economic outlook, banks continue to increase their commercial real estate (CRE) lending, with CRE loans up 7.6% year-over-year as of April 2022. CRE loans are loans for the purchase of commercial real estate, like mortgage loans for personal real estate. Rising loan volume indicates that lenders still hold a positive commercial real estate outlook. This is because of the strong underlying demand fundamentals of the multifamily and industrial market, retail asset types such as neighborhood and power centers, and the office market in Sunbelt states.



Source: Federal Reserve Bank

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Commercial Market Overview

Slower absorption in industrial and retail as consumers cut back on spending

All commercial sectors experienced net positive absorption in the last three months through May 2022. However, the pace of absorption has slowed in the industrial and retail markets as consumers cut back on spending amid high inflation. Meanwhile, net absorption increased in the multifamily market and in the office sector.

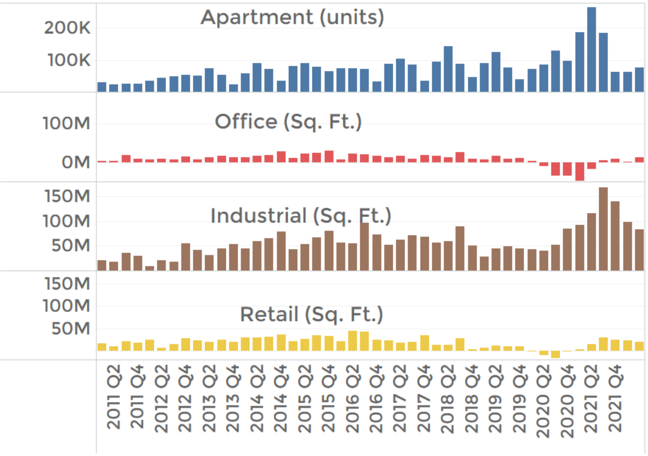
As rising mortgage rates make a home purchase less affordable, occupancy of multifamily units in the past three months as of May 2022 rose to about 75,600 units, an increase from 62,000 units in 2022 Q1. Deliveries over the past 12 months of 426,000 units outpaced absorption of 383,000, leading to a slight uptick in the vacancy rate to 5.3%. Rent growth moderated to 9.7% after rising at a double-digit pace in the second half of 2021.

As workers continue to return to the office and with sustained job growth, 13 million square feet (MSF) of office space was absorbed on a net basis in the past three months as of May, up from just 3.4 MSF in 2022 Q1. However, there is still about 100 MSF returned to the market since 2020 Q2, pushing up the vacancy rate to 12.2%, from 9.7% in 2020 Q1. Asking rents are now rising at over 1% year-over-year.

As consumers cut back on spending, absorption of industrial space also slowed to 83 MSF in the past three months as of May 2022, a slight decrease from 98.5 MSF in 2022 Q1. However, the industrial sector still has the lowest vacancy rate among the core property markets, at 4%, and the strongest rent growth, at 11.8% year-over-year.

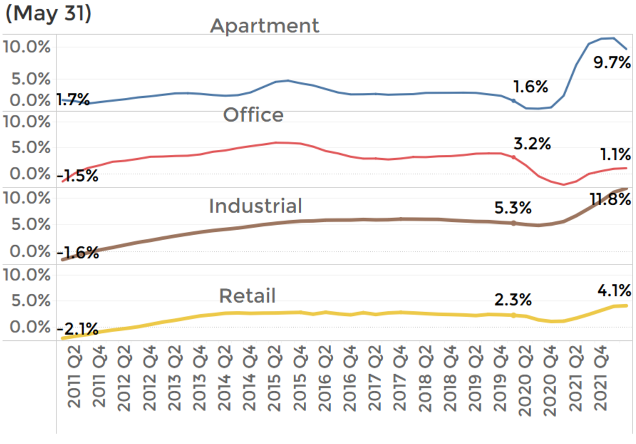
Net absorption of retail store space also decreased to 20.4 MSF in the past three months ended May 2022, slightly lower than the 22.6 MSF net absorption in 2022 Q1. Net absorption in the past 12 months totaled 97 MSF compared to just 18 MSF in net deliveries, pushing down the vacancy rate to 4.4% and propping up rent growth to 4.1%.

3-Month Net Absorption as of 2022 Q2 (May 31)



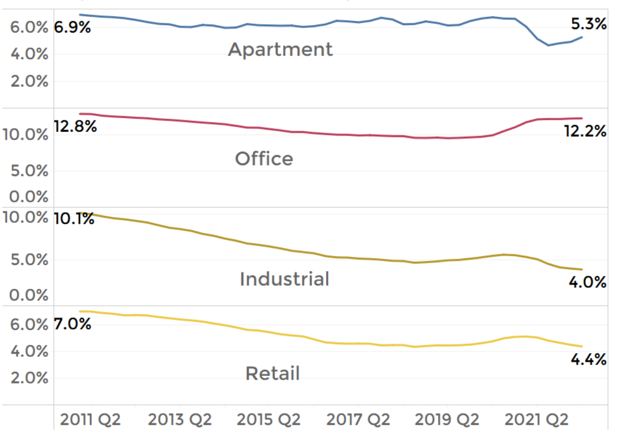
Source: CoStar

Y/Y Percent Change in Asking Rents as of 2022 Q2 (May 31)



Source: CoStar

Vacancy Rates as of 2022 Q2 (May 31)



Source: CoStar

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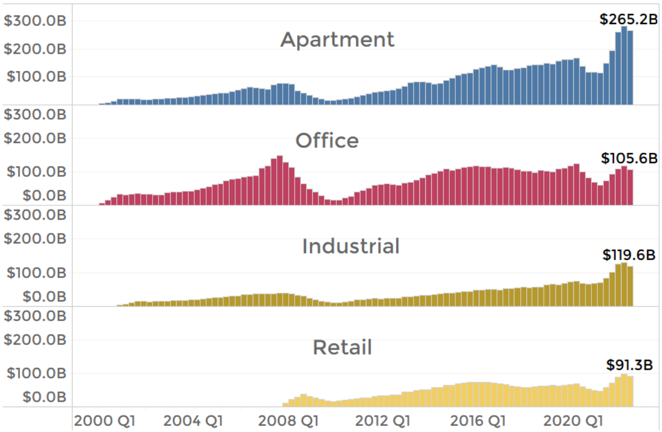
Commercial Market Overview

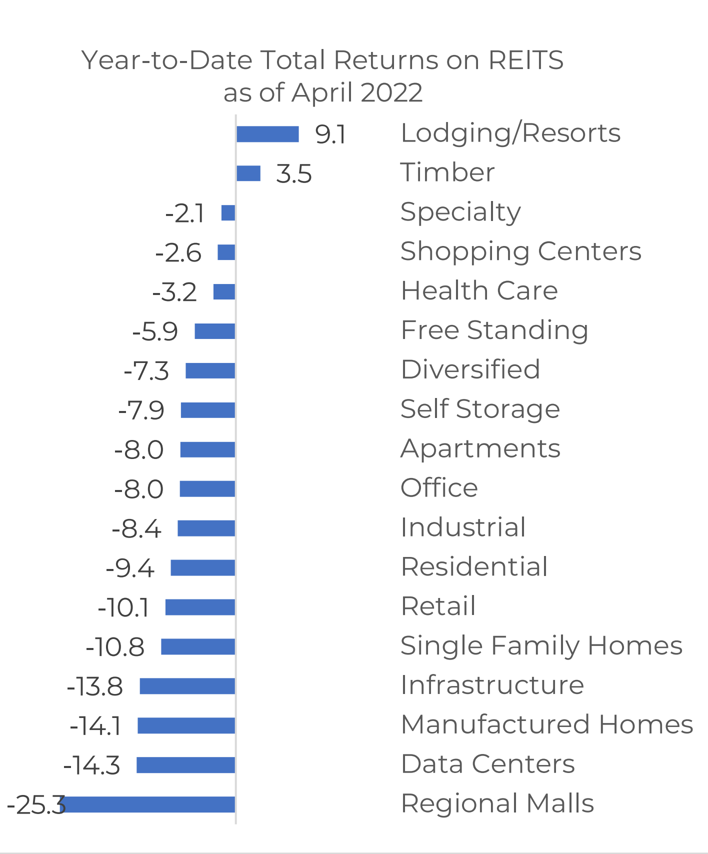
Investors pull back in second quarter

Investor acquisitions over the 12-month period ended May 2022 have weakened compared to the 12-month acquisitions ended 2022 Q1, although the investment volume is still above the pre-pandemic level. Total acquisitions for multifamily, office, industrial, and retail properties totaled $582 billion in the 12-month period ended May 31 or 7% below the $628 billion of acquisitions in the 12-month period ended March 2022. However, the volume is 34% higher than the $434 billion of acquisitions during the 12-month period ended March 2020. Of total 12-month acquisitions ended May 2022, 46% of dollar volume went into multifamily acquisitions.

Despite the favorable fundamentals underpinning commercial real estate, investors have become more risk averse. Year-to-date returns on REIT stocks are negative, except for REITS invested in lodging/resorts and timber. Investors appear to be expecting more personal and business travel as COVID-19 cases have led to fewer deaths even as infections have surged. Investors shied away even from REITS invested in assets that have strong fundamentals like apartments, single-family homes, infrastructure, and data centers. Rent growths for multifamily and industrial assets are outpacing inflation, making these assets a good hedge against inflation.



Source of data: CoStar



Source: Nareit

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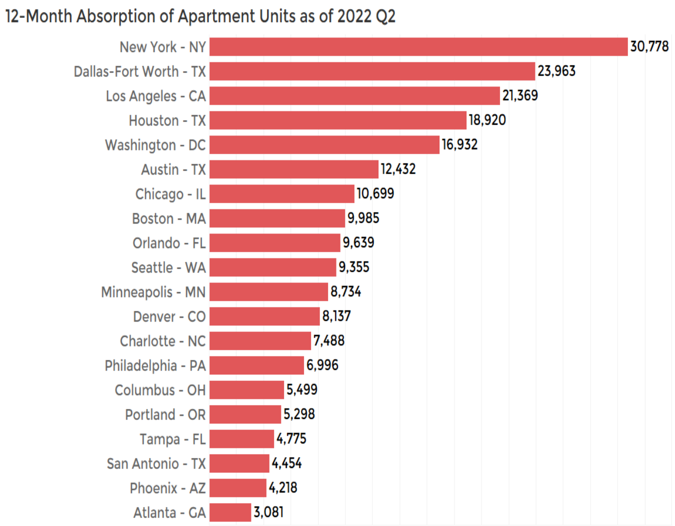
Multifamily

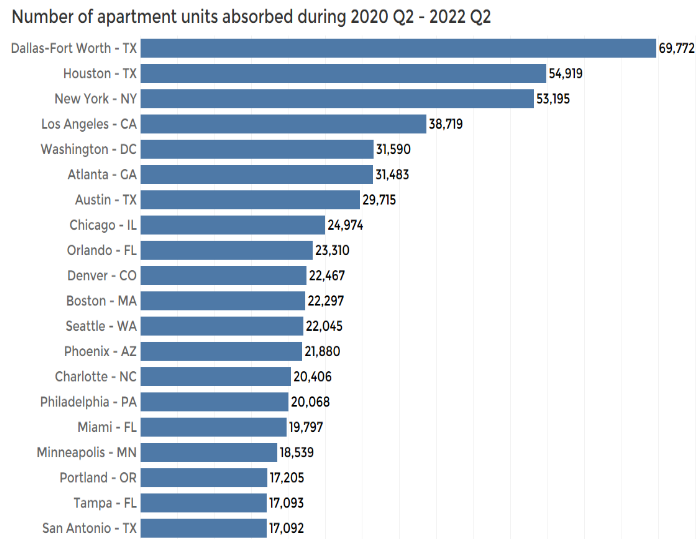
New York is #1 in apartment absorption in past 12 months

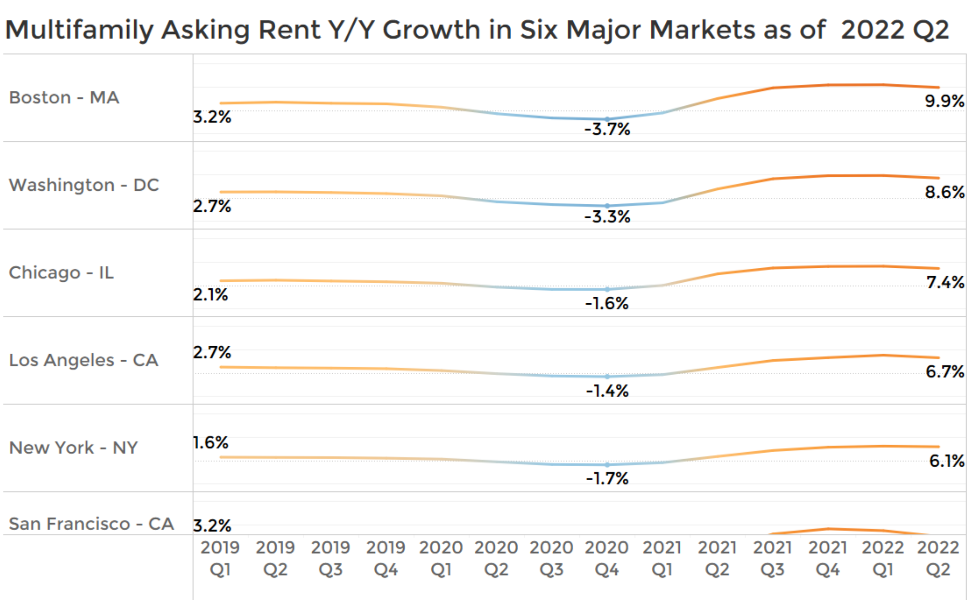
The big cities are clearly coming back to life. After the New York metro area suffered a decline in occupancy in the second quarter of 2020, the New York metro area absorbed 30,778 apartment units, the largest increase in net absorption of apartment units in the 12 months ended May 2022, surpassing Dallas-Forth Worth.

However, relative to units absorbed since the second quarter of 2020, Dallas is still the top metro with the most apartment units absorbed (69,772). But all of the six major cities had net positive absorption of apartment units during 2020 Q2—2022 Q2: New York (53,195), Los Angeles (38,719), Washington DC (31,590), Chicago (24,974), Boston (22,297), and San Francisco (7,625).

With rising absorption, rents are strong, with the highest rent growth in Boston (9.9%), Washington, DC (8.6%), and San Francisco with the least rent growth (5.2%).







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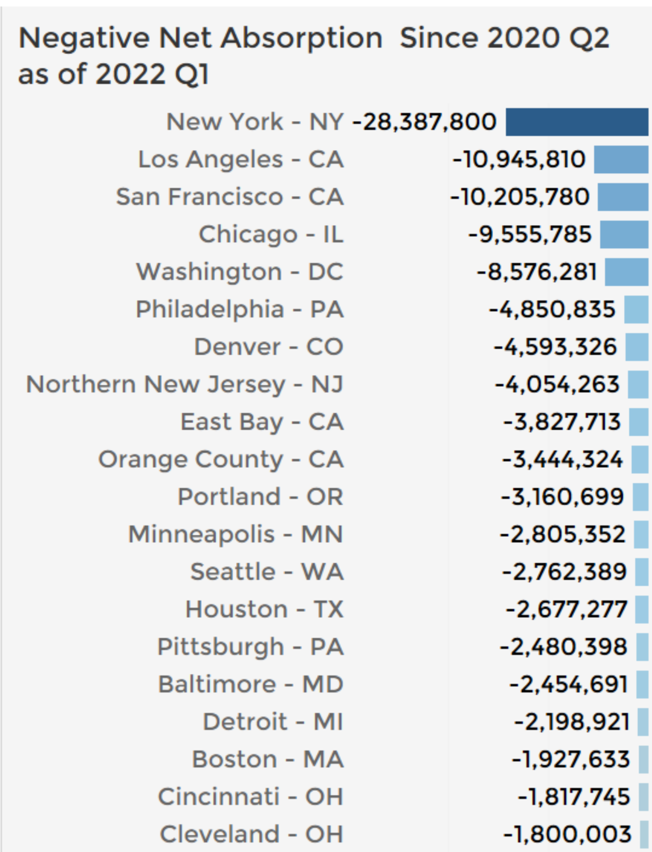
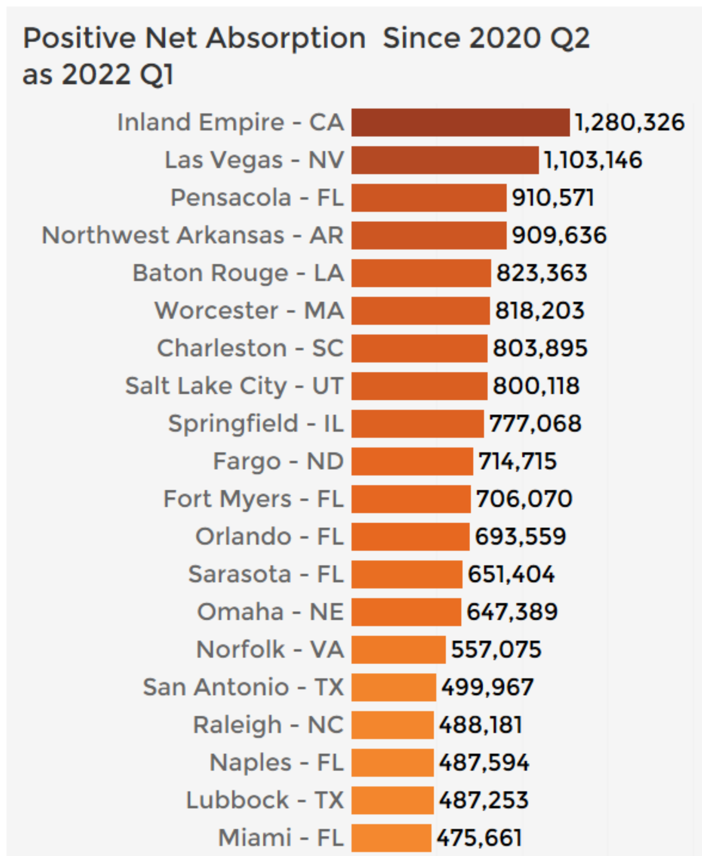
Office

Primary cities still suffering huge occupancy losses

While people are returning to the big cities, the recovery in the office market has been slow. Since 2020 Q2, New York has the largest loss in occupancy of 28.3 MSF, followed by Los Angeles (10.9 MSF), San Francisco (10.2 MSF), Chicago (9.6 MSF), and Washington DC (8.6 MSF), as well as Boston though the loss is smaller (-1.9 MSF).

Meanwhile, it's non-primary markets that have gained more occupants since 2020 Q2, with the largest increase in office occupancy in the Inland Empire (1.3 MSF) and Las Vegas (1.1 MSF), with positive net absorption in markets like Charleston, Salt Lake City, San Antonio, Raleigh, and several Florida metro areas (Pensacola, Fort Myers, Orlando, Sarasota, Naples, and Miami).





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Source: NAR analysis of CoStar data

Industrial

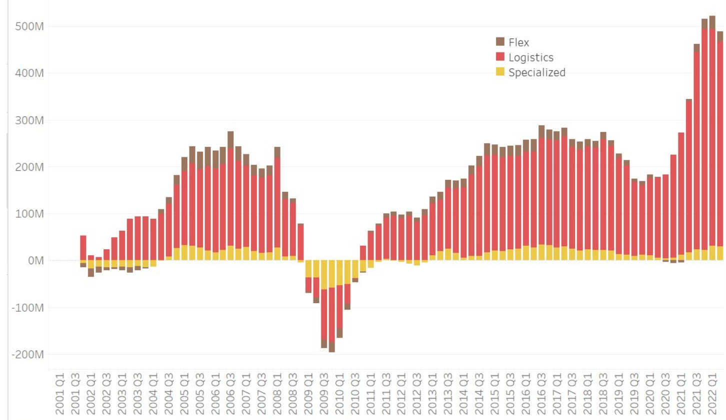
Net absorption is still double the pre-pandemic level

In the industrial property market, logistics (warehouse, distribution, fulfillment centers) have been the growth driver, accounting for nearly 90% of the net absorption of 490 MSF of space. The demand for logistics space continues to be driven by e-commerce sales, which account for 16% of sales, up from 13% before the pandemic. Net absorption for industrial space in the past 12 months as of May has tapered somewhat but the volume of industrial space absorbed is still double the pre-pandemic level.

Asking rents for logistics space is up on average 13.3% year-over-year compared to 8.8% for flex space (which can be used also as a warehouse, showroom, or office space).

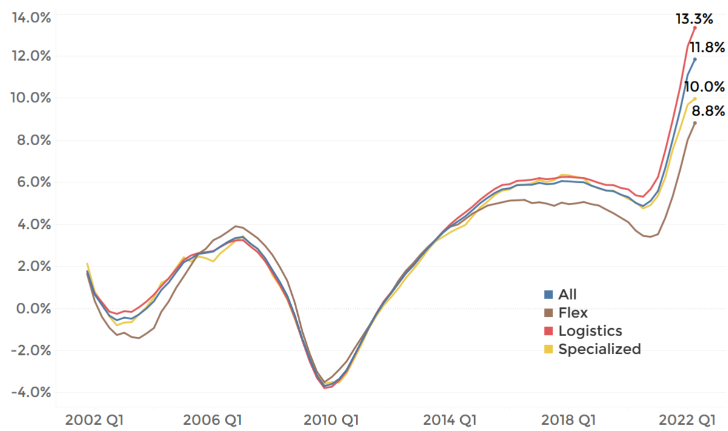
Houston has the largest absorption of industrial space in the past 12 months, driven by the oil industry. Chicago, Dallas, the Inland Empire, Phoenix, and Atlanta are all absorbed over 20 MSF over the past 12 months as of May.

12-Month Net Absorption of Industrial Space



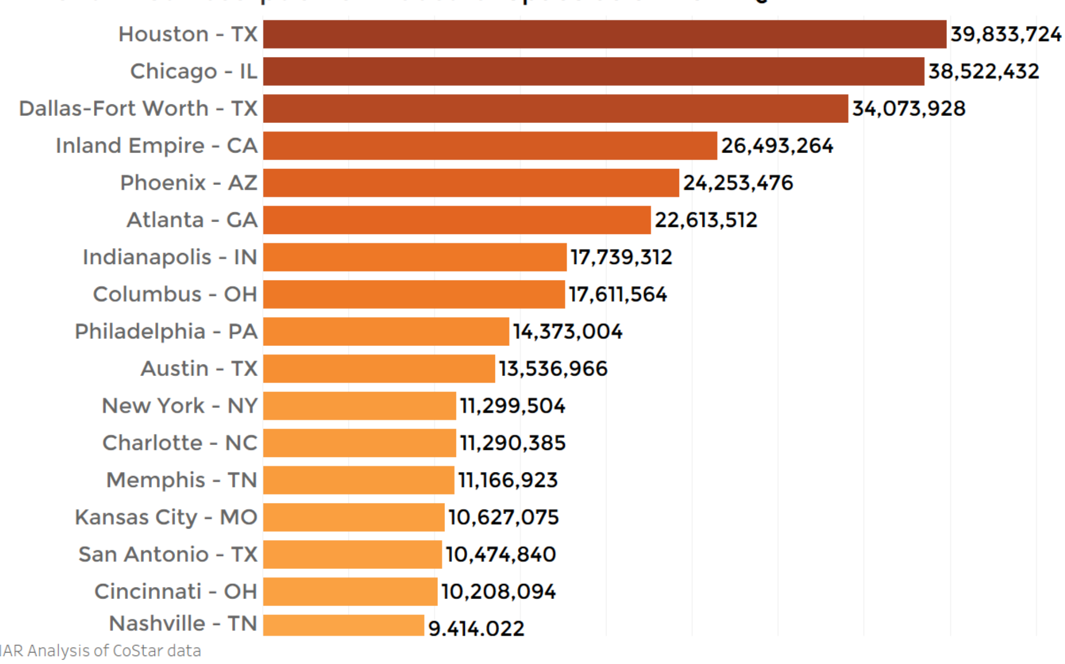
NAR Analysis of CoStar data

Year-over-Year Industrial Rent Growth as of 2022 Q2



NAR Analysis of CoStar data

12-Month Net Absorption of Industrial Space as of 2022 Q2



NAR Analysis of CoStar data

Source: NAR analysis of CoStar data

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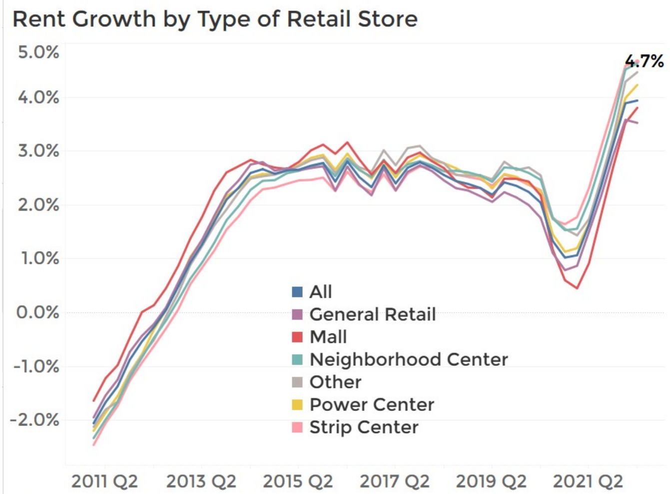
Retail

General and neighborhood stores are growth drivers

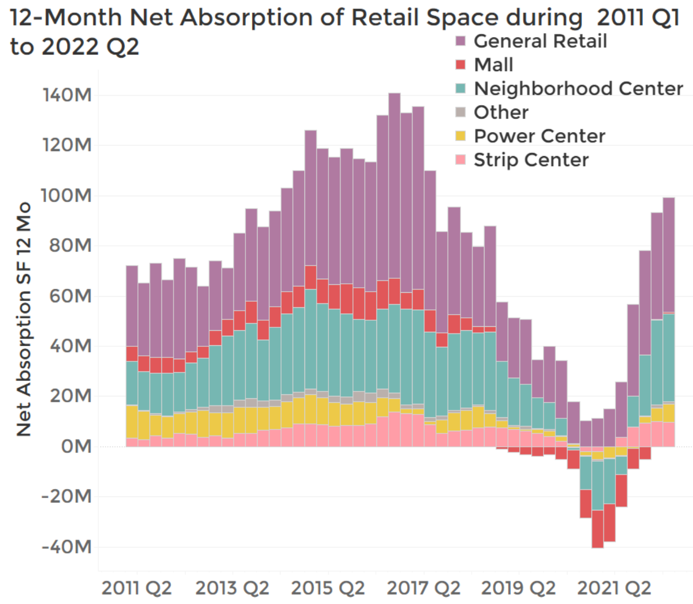
Net absorption of retail space has been rising since the pandemic from about 30 MSF in the 12 months ended 2020 Q1 to about 100 MSF as of 2022 Q2. General retail and strip centers have driven the demand, accounting for 80% of the net absorption. On a positive note, malls have been recovering, with a 12-month net absorption of 638,000 sq. ft, compared to the decline in occupancy of 15 million square feet in the 12 months ended 2020 Q4.

Rents are rising across all types of retail stores. Neighborhood centers and strip centers* which are anchored by grocery stores and businesses that provide personal services (nail salons, diners), had the highest rent growth of 4.7%. Year-over-year. Rent growth for malls rose 3.8% percent. On a positive note, rent is a cost of doing business, so prices of goods and services are still rising faster at 8%, yielding a positive gross margin for businesses leasing retail space.

The demand for retail space appears broad-based, with 342 out of 390 metro areas experiencing positive net absorption in the 12 months ended 2022 Q2. The largest absorption is in areas like Houston, Atlanta, and Phoenix. Worth noting is that the primary metros of New York, Los Angeles, Chicago, Boston, Washington DC, and San Francisco also saw positive net absorption over the past 12 months ended 2022 Q2.



Source: CoStar



NAR analysis of CoStar data

*Strip centers are anchored by convenience/mini-mart stores; neighborhood centers are anchored by supermarkets; power centers or category killers are anchored by home improvement, discount stores, warehouse clubs.

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Hotel

Slower economic growth and inflation stall the hotel recovery

Rising inflation and a slowing economy have taken some wind out of the recovery in the hotel sector. Hotel occupancy slipped to 52,5% in April 2022 after rising to 66% in August last year.

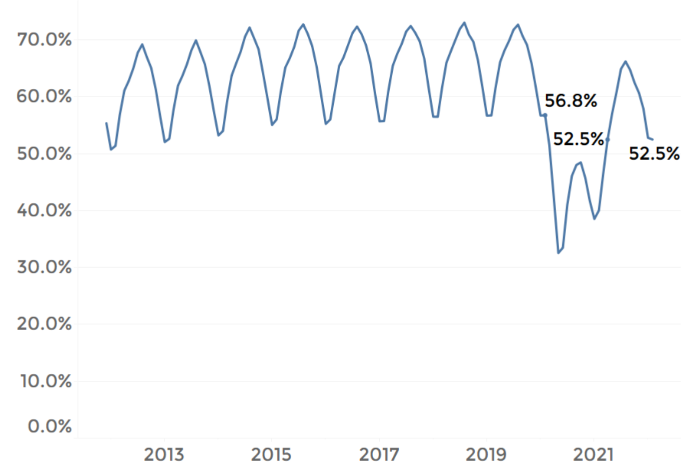
However, the average daily rate per room rose to $143/room, up 35% year-over-year. The revenue per available room (RevPAR) also increased 57% year-over-year to $88/room, an indication of an improving financial position.

Sales acquisitions have been rising since 2021. As of April, the 12-month sales volume rose to $10.5 billion, from just $2.4 billion one year ago. Sales data does not provide information if the investors intended to continue operating the hotels as hotels or undertake an adaptive reuse, such as for residential purposes. However, most acquisitions were of luxury, upper upscale, and upscale hotels. As of April 2022, occupancy rates in the luxury and upper upscale segments were below 60%, which indicates the hotels may end up being converted for other uses.

Outlook for 2022-2023

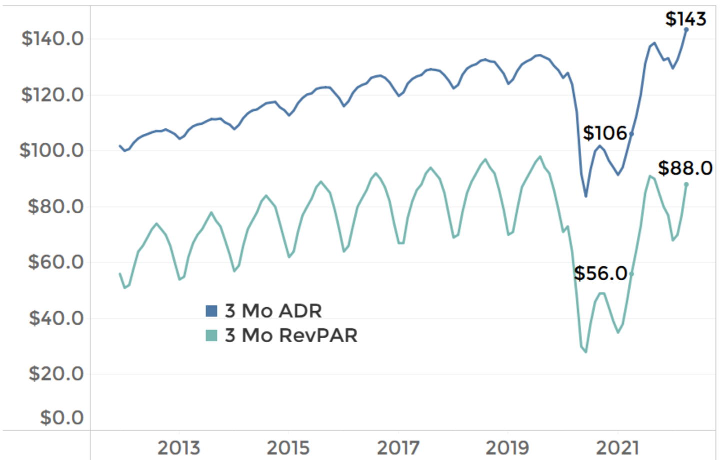
In 2022, rising airfares and gas prices could put a dent in personal travel and therefore demand for lodging. A slowing economy could also lead businesses to cut back on business meetings and conferences.

3-Month Hotel Occupancy Rate as of April 2022



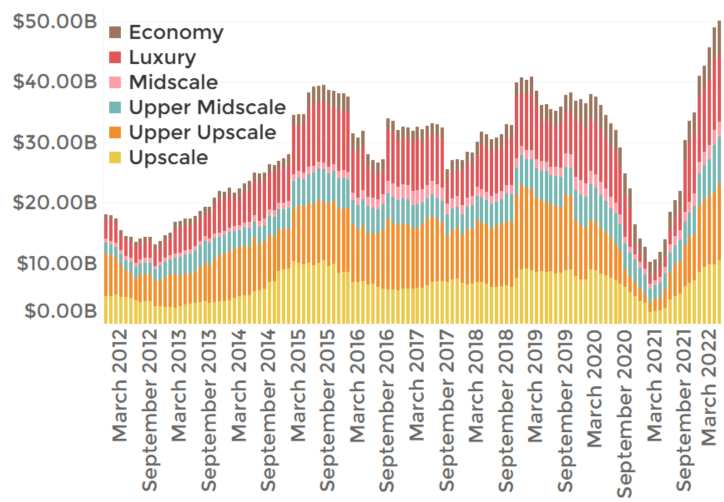
Source: NAR analysis of CoStar data

3-Month Average Daily Revenue and Revenue Per Available Room as of April 2022



Source: NAR analysis of CoStar data

12-Month Sales Volume as of April 2022



Source: NAR analysis of CoStar data

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

COMMERCIAL MONTHLY INSIGHTS REPORT
May 2022

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