July 2023

Commercial Real Estate Market Insights Report

National Association of REALTORS®
Research Group

NATIONAL
ASSOCIATION OF
REALTORS®

Summary

Leasing velocity slowed down in commercial real estate during the year's second quarter. While there is still much uncertainty about the total impact of the bank failures earlier in the year, there are rising concerns and speculation about where commercial real estate is headed. Since commercial real estate relies heavily on small banks for capital, a pullback in lending among these banks could further impact commercial real estate. However, data shows that commercial real estate lending activity is increasing weekly. Meanwhile, delinquency rates for commercial loans have increased since the end of 2022, but they remain below 1%. Nevertheless, delinquencies are expected to rise further in the year's second half.

As a result, most commercial real estate sectors continue to experience slower rent growth and higher vacancy rates compared to the previous year. In the office sector, there are more available spaces for lease than ever. Despite multiple efforts to repurpose unused office spaces, the slow return-to-office movement continues to hurt this sector. In the multifamily sector, rent growth has slowed even further compared to the beginning of the year, but the vacancy rate remained virtually the same in the second quarter compared to the previous quarter. Although leasing activity continues to slow down in the retail sector, the vacancy rate remains near 4%, the lowest rate in any other sector in commercial real estate. Finally, the performance of the industrial sector has eased from the 2022 record highs, but rent prices for industrial spaces grew more than 8%, significantly faster than pre-pandemic.

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

With multifamily construction overperforming in the last couple of years, the completion of these additional units has increased the vacancy rate in the **multifamily sector**. In the meantime, in the last 12 months, net absorption of apartments was half of last year's level, while 22% more units were delivered during that same timeframe. Thus, this demand-supply mismatch has increased the vacancy rate to 6.9% from 5.3% a year ago. Consequently, rent growth has dropped to 1.1%, below the pre-pandemic level. Nevertheless, the multifamily sector will remain strong compared to the other CRE sectors, owing to favorable demographics, a strong job market, and low housing affordability due to higher mortgage rates.

Even though more people are going to their offices more often, the **office sector** still faces challenges. The office vacancy rate reached a new record high at 13.1% at the end of the year's first half. With hybrid work arrangements allowing for a mix of in-person and remote work, a lot of office space is left empty. Meanwhile, in their effort to reduce their occupancy cost, tenants have decreased the average square footage per person leading to lower demand for space. The office sector is transforming to adapt to changing working arrangements and needs.

Summary

The **industrial sector** of commercial real estate has slowed down this year from record highs during the pandemic, but it continues to be stronger than the pre-pandemic level. Net absorption was nearly 40% lower at the end of the year’s first half compared to the previous year. But, along with lower demand, significantly more industrial spaces were delivered in the market. As a result, the industrial vacancy rate rose to 4.7%, and rent growth eased to 8.9%. However, rents for industrial spaces continue to increase faster than before the pandemic.

Due to the emergence of e-commerce, the “traditional” **retail sector** has been challenged over the past decade, with the pandemic decreasing activity even further. However, the retail sector was able to remain stronger than pre-pandemic. The vacancy rate has been unchanged for the last three quarters at 4.2%, the lowest vacancy rate among all the sectors. With inflation easing further and interest rates to stabilize later this year, the demand for retail space is expected to remain robust.

Hotel demand advanced even further, increasing occupancy and encouraging higher-priced room rates. 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 13% higher than it was before the pandemic. As both business and leisure travel pick up, the demand for hospitality spaces is expected to keep increasing throughout 2023.

Economy

Job growth (compared to March 2020): 3.5%
Inflation: 3.0%

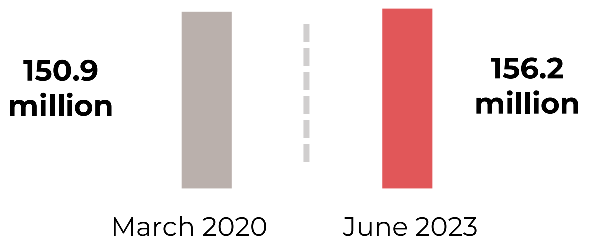
Record high number of jobs

The labor market continues to grow with a record-high number of jobs available in the market. As of June 2023, there are about 3.5% more jobs than about three years ago when the pandemic hit. In addition, the unemployment rate is at a record low of 3.6%.

In June of 2023, there were 5.3 million more jobs compared to March 2020 and 209,000 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



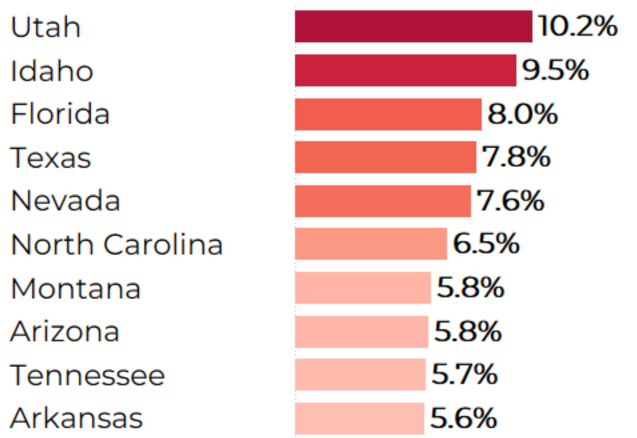
Source: NAR analysis of U.S Bureau of Labor Statistics data

At the local level, Utah and Idaho lead the nation in job growth, with 10.2% and 9.5%, respectively.

Texas is the clear leader in terms of absolute job creation, adding 1 million jobs since March 2020. Florida and California are not far behind, adding 722,000 and 608,200 jobs, respectively.

Unfortunately, Hawaii and the District of Columbia continue to have nearly 3.4% fewer jobs than in March of 2020.

Top 10 states with strongest job growth since March 2020



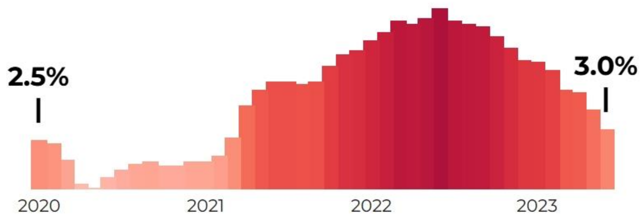
Source: NAR analysis of U.S Bureau of Labor Statistics data

Better-than-expected inflation

In June, inflation dropped sharply to 3% approaching the 2% Federal Reserve's target. That was the lowest point in more than two years. Parsing out by expenditure category, rent growth continues to ease. In June, rent prices - representing 40% of the CPI basket – rose 8.3% compared to the previous year. This is a decrease from 8.7% and 8.8% in May and April, respectively.

With rent growth decelerating even further in the following months, inflation is headed in the right direction to meet its benchmark target rate. It seems that the second half of the year can be a turning point for the Federal Reserve. Although the Federal Reserve may raise interest rates in its July meeting, this rate hike could be the last for quite a while.

Inflation



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

NATIONAL ASSOCIATION OF REALTORS®

Economy

Interest rates: 5.25%
Gross Domestic Product (GDP) Q1 2023: 2.0%

Banking Sector and Commercial Real Estate Lending

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 the volume of commercial real estate loans of small domestically commercial banks continue to advance in the second quarter of the year. In June, the volume of these loans rose to $1.92 trillion from $1.90 trillion in March.

Commercial real estate loans in small domestically chartered commercial banks

Monthly
Billions of dollars

February	March	April	May	June
$1,905.0	$1,902.7	$1,900.5	$1,914.1	$1,922.7

Weekly
Billions of dollars

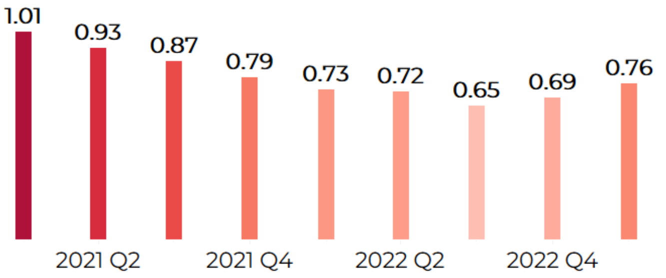
14-Jun	21-Jun	28-Jun	5-Jul
$1,921.1	$1,923.1	$1,924.2	$1,926.9

Source: Federal Reserve

While there is still a lot of uncertainty and speculations about rising defaults of commercial real estate loans, data also shows that more borrowers of commercial real estate loans were delinquent on their loans in the first quarter of the year compared to the end of 2022.

Specifically, according to the Federal Reserve, the delinquency rate on commercial real estate loans has increased to 0.76% in the first quarter of 2023 from 0.69% in the last quarter of 2022. Nevertheless, even with this increase, the delinquency rate continues to remain low, below 1%. But, delinquency rates are expected to increase in the following months surpassing the 1% threshold.

Delinquency rates on commercial real estate loans (excluding farmland)



Source: Federal Reserve

The economy to grow slower in 2023 but no recession is expected

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 2.0% growth at the beginning of the year. Looking into 2023, the U.S. may skirt recession. 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. The National Association of REALTORS® is expected the GDP to increase by about 1.2% in 2023 and 1.7% in 2024 as volatility in the U.S. economy is expected to diminish.

NATIONAL ASSOCIATION OF REALTORS®

Multifamily

Absorption of units in the last 12 months: 177,839 units
Rent growth in the last 12 months: 1.1%
Cap rate: 5.4%

The multifamily sector, after achieving record-breaking results in 2021, is slowing down. On a national scale, the absorption of units experienced a significant increase of 25.4 percentage points compared to the previous quarter. However, the national vacancy rate rose to 6.9% in the second quarter of 2023, a notable increase from 5.3% in the first quarter of 2022.

Although rent prices have risen compared to the previous year, the rate of growth has decelerated. In the second quarter of 2023, rents saw a year-over-year increase of 1.1%, which is lower than the 2.8% growth observed in the preceding quarter. Overall, the multifamily sector is gradually returning to its pre-pandemic state.

While rent growth is easing in more areas across the county, the Sun Belt region continues to experience strong rent growth, notably in Gulfport-Biloxi-Pascagoula, MS, Knoxville, and Kingsport, TN, Brownsville-Harlingen, TX

Meanwhile, the Midwest also saw strong rent growth, with Peoria and Rockford, IL, and Lincoln, NE, ranking among the top ten metro areas with the highest rent growth rates. In contrast, Ft Walton Beach, FL, Austin, TX, and Las Vegas, NV, have experienced over a 3% year-over-year rent decline.

In major urban hubs like New York, Austin (TX), Dallas-Fort Worth (TX), Phoenix (AZ), and Washington DC, there continues to be a robust demand for apartments. Over the past 12 months, ending in June, these areas have witnessed the absorption of over 7,000 multifamily units. Due to the impact of increased mortgage rates on affordability, leading to the exclusion of many potential buyers from the market, the demand for rental properties is expected to remain strong in numerous expensive regions nationwide.

Top 10 areas with fastest rent growth

	2023 Q2	2022 Q2
Peoria, IL	9.07%	8.50%
Gulfport-Biloxi-Pascagoula, MS	7.17%	7.63%
Trenton, NJ	6.65%	9.20%
Rockford, IL	6.62%	4.56%
Knoxville, TN	6.25%	14.36%
Madison, WI	6.20%	5.95%
Lincoln, NE	6.08%	7.40%
Brownsville-Harlingen, TX	5.96%	8.12%
Kingsport, TN	5.74%	9.81%
Columbus, GA	5.70%	6.26%

Top 10 areas with the strongest 12-month absorption

	2023 Q2	2022 Q2
New York, NY	18,894	33,778
Austin, TX	8,350	12,346
Dallas-Fort Worth, TX	7,874	24,823
Phoenix, AZ	7,715	2,656
Washington, DC	7,048	17,121
Chicago, IL	6,673	12,213
Minneapolis, MN	6,535	9,777
Denver, CO	6,524	10,255
Boston, MA	5,386	9,666
Houston, TX	5,246	18,098

Source: NAR analysis of CoStar data

NATIONAL ASSOCIATION OF REALTORS®

Office

Net absorption in the last 12 months: -39.7 million sq.ft.
Rent growth in the last 12 months: 0.8%
Cap rate: 7.9%

With hybrid work arrangements being the new normal for many companies, the office sector continues to struggle.

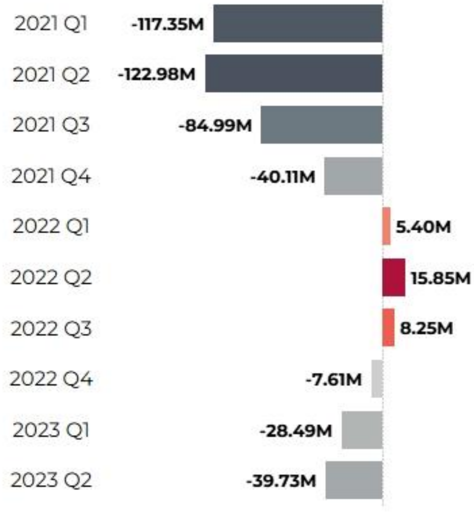
About 102 million more square feet became available for lease in Q2 2023 compared to the same period before the pandemic. As a result, the vacancy rate increased by 3.7% to an all-time high of 13.1%.

Upscale office spaces are taking the biggest hit. Class A is suffering from a 6.1% increase in vacancy rates from Q2 2019 and is currently at the level of 18.2%. Meanwhile, Class B is responsible for 62% of all negative year-over-year absorption this quarter. These figures indicate persistent challenges for the office sector, particularly for top-tier office spaces.

On a local scale, the major rise in vacancy rates occurred in prominent technology centers such as San Francisco, Houston, Dallas-Fort Worth, Austin, and Washington, DC. This shift was driven by relocating numerous companies and individuals to more cost-effective regions.

However, Savannah, GA, and Huntington, WV, emerged as the top areas with the lowest vacancy rates in the past 12 months, boasting a mere 2% of office spaces remaining unoccupied as of July 2023.

12-month Net Absorption in sq. ft



Top 10 areas with the largest vacancy rates

	2023 Q2	2022 Q2
San Francisco, CA	18.85%	14.67%
Houston, TX	18.64%	18.21%
Dallas-Fort Worth, TX	17.93%	17.58%
Austin, TX	16.11%	12.24%
Washington, DC	15.87%	15.41%
Phoenix, AZ	15.78%	14.21%
Chicago, IL	15.62%	15.26%
Denver, CO	15.34%	14.21%
Los Angeles, CA	14.99%	13.67%
Atlanta, GA	14.58%	13.82%

Top 10 areas with the lowest vacancy rates

	2023 Q2	2022 Q2
Savannah, GA	1.95%	2.28%
Huntington, WV	2.02%	1.80%
Youngstown, OH	2.17%	2.70%
Myrtle Beach, SC	2.25%	2.41%
Olympia, WA	2.66%	2.47%
Asheville, NC	2.68%	3.37%
Salisbury, MD	2.74%	2.15%
Davenport, IA	2.80%	3.47%
Hickory, NC	2.86%	2.56%

Source: NAR analysis of CoStar data

NATIONAL ASSOCIATION OF REALTORS®

Industrial

Net absorption in the last 12 months: 288.3 million sq. ft.
Rent growth in the last 12 months: 8.9%
Cap rate: 6.7%

Despite a slowdown in demand compared to the previous year, the industrial sector continues to experience higher levels of absorbed industrial space compared to pre-pandemic times. Over the past 12 months, ending in June, the net absorption reached nearly 288 million square feet. Consequently, the industrial sector now has the lowest vacancy rate at 4.7%, after the retail sector.

Rent prices in the industrial sector are experiencing a more rapid growth rate compared to other sectors. There has been a year-over-year increase of 8.9% due to the limited availability of space. Particularly, the logistics space has witnessed even faster rent growth, with a year-over-year increase of 10.1%. In contrast, flex space saw an increase of 5.5%, while specialized space experienced a growth rate of 7.7%.

Dallas-Fort Worth, TX, had the largest absorption of industrial space in the past 12 months. Chicago, IL, Houston, TX, Phoenix, AZ, and Indianapolis, IN absorbed more than 17 million square feet over the past 12 months ending in June 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, and vacancy levels have slightly increased. However, Los Angeles continues to have a vacancy rate of 3.7%, which is below the national average of 4.7%.

In addition, Fort Lauderdale, Orlando, FL, and Columbus, OH, experienced the largest rent gains. In these areas, rents for industrial space are at least 15 percentage points higher than a year ago as demand for warehouse spaces remains solid.

Top 10 areas with the strongest 12-month absorption

	2023 Q2	2022 Q2
Dallas-Fort Worth, TX	37.95M	36.82M
Chicago, IL	25.31M	39.65M
Houston, TX	23.11M	43.62M
Phoenix, AZ	18.13M	25.83M
Indianapolis, IN	17.67M	19.34M
Kansas City, MO	12.70M	11.67M
Atlanta, GA	11.19M	25.91M
Savannah, GA	10.75M	11.76M
Richmond, VA	10.72M	3.25M
Columbus, OH	9.17M	17.44M

Top 10 areas with the slowest 12-month absorption

	2023 Q2	2022 Q2
Los Angeles, CA	-14.39M	6.99M
New York, NY	-1.84M	10.06M
Boston, MA	-1.45M	3.62M
Rochester, NY	-1.01M	1.83M
San Diego, CA	-0.89M	8.27M
Little Rock, AR	-0.79M	5.44M
Ventura, CA	-0.70M	3.44M
Springfield, MA	-0.70M	-0.28M
Birmingham, AL	-0.62M	2.39M
Portland, ME	-0.60M	0.78M

Source: NAR analysis of CoStar data

NATIONAL ASSOCIATION OF REALTORS®

Retail

Net absorption in the last 12 months: 54.5 million sq. ft.
Rent growth in the last 12 months: 3.6%
Cap rate: 6.1%

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 has 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 87% of the net absorption in Q2 2023

Net Absorption by type (June 2015, 2019, and 2023)

	2015 Q2	2019 Q2	2023 Q2
General Retail	52.76M	27.52M	30.88M
Neighborhood Center	34.52M	17.12M	20.96M
Power Center	9.73M	0.55M	4.79M
Strip Center	8.16M	6.27M	3.20M
Other	2.51M	0.89M	-0.12M
Mall	10.18M	-1.32M	-5.76M
All	**117.87M**	**51.03M**	**53.96M**

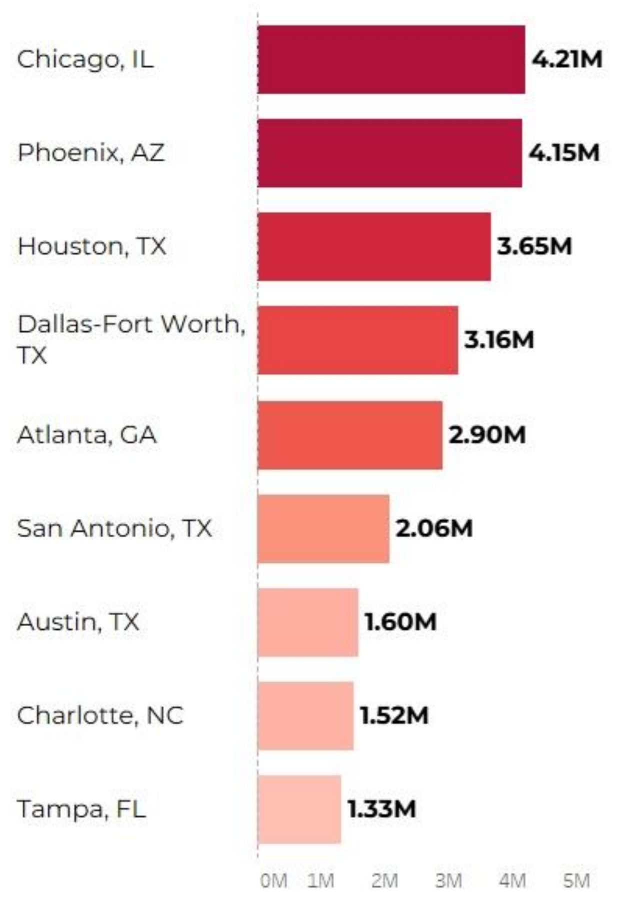
Retail space rents have continued to remain high compared to the previous year, although their growth rate has slowed down, potentially due to consumer sensitivity toward higher prices. At a national level, retail asking rents witnessed a growth rate of 3.6%, which is slower than the previous year but faster than pre-pandemic levels. Among different types of retail stores, neighborhood centers (4.6%) and strip centers (4.3%) observed the largest increases in rent prices.

Conversely, General Retail experienced the smallest growth in rent at 3%, indicating a slower recovery compared to other types of retail stores.

On a local scale, Sun Belt metro areas such as Jacksonville and Fort Lauderdale, FL, are witnessing robust demand, resulting in rent growth exceeding 10%.

Additionally, the retail industry is flourishing in Chicago, IL, Phoenix, AZ, Houston, and Dallas-Fort Worth, TX. These regions have experienced significant net absorption, with over 3 million square feet occupied in the past 12 months as of Q2 2023.

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



Source: NAR analysis of CoStar data

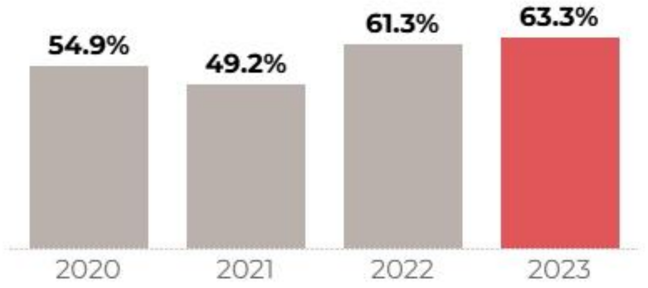
NATIONAL ASSOCIATION OF REALTORS®

Hotel

Occupancy rate in the last 12 months: 63.3%
Average daily rate in the last 12 months: $154/room
Revenue per available room in the last 12 months: $97/room

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

12-month Occupancy Rate in June



Specifically, in June 2023, the average daily rate (ADR) per room rose to $154/room, up 25% from the beginning of 2020. The revenue per available room (RevPAR) also increased to $97/room, up 42% compared to the same period in 2020.

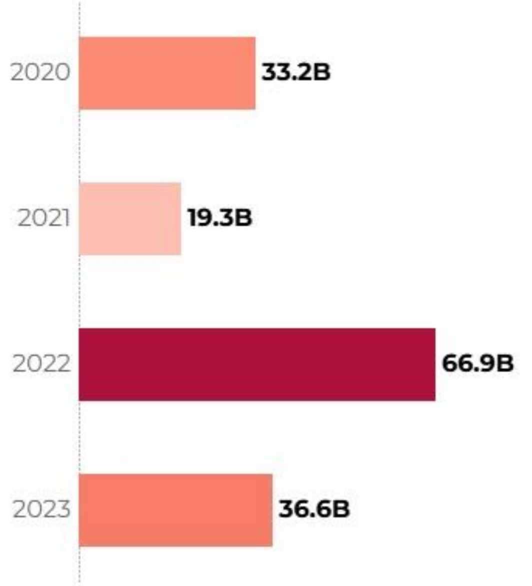
12-month ADR and RevPAR in June

	Average daily rate	Revenue per available room
2020	$123	$68
2021	$105	$51
2022	$141	$86
2023	$154	$97

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

Sales acquisitions have declined since last year. In Q2 2023, the 12-month sales volume dropped to $36.6 billion from $66.9 billion in the previous year.

12-month Sales Volume as of June



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 59% since pre-pandemic, also having the highest ADR and RevPAR nationwide at $614 and $415, respectively. New York's occupancy rate is still 7% lower than the pre-pandemic level, but it is the highest in the US at 79.4%.

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 27% of RevPAR since the second quarter of 2019.

COMMERCIAL REAL ESTATE REPORT
July 2023

LAWRENCE YUN, PhD
Chief Economist & Senior Vice President for Research

MEREDITH DUNN
Research Manager

OLEH SOROKIN
Analyst, Commercial Real Estate

Download report at https://www.nar.realtor/commercial-market-insights

Download other NAR Commercial reports at Commercial Research

For question about this report or reprint information, contact data@nar.realtor.

NATIONAL ASSOCIATION OF REALTORS®

The National Association of REALTORS® is America's largest trade association, representing more than 1.5 million members, including NAR's institutes, societies and councils, involved in all aspects of the real estate industry. NAR membership includes brokers, salespeople, property managers, appraisers, counselors and others engaged in both residential and commercial real estate. The term REALTOR® is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of REALTORS® and subscribes to its strict Code of Ethics. Working for America's property owners, the National Association provides a facility for professional development, research and exchange of information among its members and to the public and government for the purpose of preserving the free enterprise system and the right to own real property.

NATIONAL ASSOCIATION OF REALTORS®
RESEARCH GROUP

The Mission of the NATIONAL ASSOCIATION OF REALTORS® Research Group is to produce timely, data-driven market analysis and authoritative business intelligence to serve members, and inform consumers, policymakers and the media in a professional and accessible manner.

To find out about other products from NAR's Research Group, visit
www.nar.realtor/research-and-statistics

500 New Jersey Avenue, NW
Washington, DC 20001
202.383.1000