Commercial Real Estate Market Insights Report

July 2024

National Association of REALTORS®
Research Group

NATIONAL ASSOCIATION OF REALTORS®

Commercial Real Estate in Q2 2024

An Overview

While the market awaits the interest rate cuts from the Federal Reserve, commercial real estate is also on hold. The office sector ended the second quarter with a record-high vacancy rate of 13.8%, though the increase in unoccupied spaces has slowed down. The retail sector continues to have the lowest vacancy rate among all sectors, but demand for retail spaces has further decreased. The industrial sector's fundamentals also softened in the second quarter, with net absorption hovering at levels not seen since 2012. However, demand for apartments continued to surge as seven percent mortgage rates hurt housing affordability.

Below is a summary of the performance across the major commercial real estate sectors during the second quarter of 2024:

While net absorption for the **office** sector remains negative, with more spaces being vacated than occupied, the second quarter saw fewer additional unoccupied spaces. The surplus of unoccupied office spaces exceeded 61 million square feet at the end of last year and the beginning of 2024. However, in the second quarter, net absorption improved to -42 million square feet, a 1% decrease from a year ago. This indicates that there is a slight increase in demand for office space. Nevertheless, the outlook suggests that net absorption in this sector will remain negative. Leasing activity, an indicator of demand and interest from potential tenants, is currently near pandemic levels and about 40 percentage points below pre-pandemic levels.

In contrast, the **multifamily** sector continued to gain momentum with mortgage rates remaining near 7%. In the second quarter, net absorption was 2.4 times higher than a year ago, with an additional 260,890 more multifamily units leased than vacated. Demand was also 44% higher than the pre-pandemic level. However, despite this strong demand, the record high number of new multifamily units delivered to the market kept the vacancy rate steady compared to the previous quarter and higher than it was a year ago.

In the meantime, availability conditions in the **retail** sector have remained tight. Since the end of last year, only 4.7% of retail space is currently available for lease, marking the lowest level on record. This limited availability of retail spaces has kept the vacancy rate near 4%, despite the slowdown in demand. Specifically, in the last 12 months, demand for retail spaces has increased by nearly 41 million square feet compared to 56 million square feet a year earlier. With new construction deliveries decreasing further, the fundamentals of this sector are expected to remain tight in 2024.

Fundamentals for the **industrial** sector further weakened in the second quarter. Net absorption continued to lose steam, falling to 41 million square feet. While demand for industrial space reached record-high levels at the end of 2021 and the beginning of 2022 - driven by the demand for warehouse space to support online shopping and e-commerce - net absorption is now 64% lower than a year ago and 53% below the pre-pandemic average level. The outlook suggests additional softening in this sector. With consumer spending shifting away from goods to services due to high borrowing costs, demand for industrial spaces is expected to ease further in the coming months.

Economy

Job growth (June 2024 compared to March 2020): 5.1%
Inflation (June 2024): 3.0%
Gross Domestic Product (GDP) Q2 2024: 2.8%

In the second quarter of the year, the U.S. economy demonstrated resilience, particularly in areas like the labor market and consumer spending. However, certain areas continued to face persistent challenges. Although Inflation has eased, it remains a significant concern due to high borrowing costs.

Slower job growth in June

In June, the market added over 200,000 new jobs, which was below the average monthly gain of 218,000 over the past 12 months. Consequently, the unemployment rate rose to 4.1% after remaining below this level for the past 30 months. This slower pace of job creation might encourage the Federal Reserve to consider cutting interest rates in the second half of the year.

Specifically, the total number of job positions increased to 158.6 million in June. In the first half of the year, the economy had welcomed about 1.33 million new jobs. Since the onset of the pandemic in March 2020, the U.S. has successfully generated over 7.7 million jobs in the last 4 years. This robust labor market activity underscores the resilience and dynamic nature of the U.S. economy.

Number of Jobs

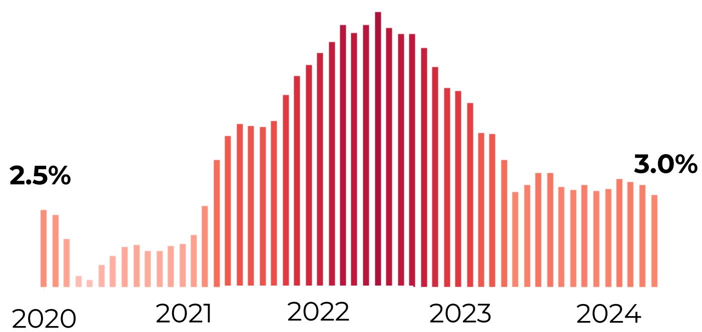
March 2020	**150.9 million**
June 2023	**156.0 million**
June 2024	**158.6 million**

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

Inflation fell to 3% in June

Inflation decreased further to 3% in June, a level last seen in March 2021. However, it hasn't yet reached the Federal Reserve's goal of 2%, mostly due to the higher cost of rents. While these higher rates increase borrowing costs, lingering inflation continues to be one of the economy's main concerns and the main determinant of the Federal Reserve's anticipated rate cuts. However, data from the private sector suggests that rent growth included in the CPI basket will decelerate further in the upcoming months, which should help bring down the inflation rate further.

Inflation



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

The interest rate remained unchanged

The Federal Reserve kept unchanged its interest rates at 5.5% in June. If inflation continues to slow down in the following months, the Federal Reserve might begin reducing interest rates as early as after the summer. While interest rates set the foundation for borrowing costs, these lower interest rates are expected to stimulate investment activity in commercial real estate.

The economy grew faster in Q2 2024

Surprisingly, the economy grew at a 2.8% pace in Q2 2024, faster than a 1.4% increase in the first quarter. The economy's growth picked up in the second quarter as cooling inflation and a strong labor market allowed consumers to keep spending despite high interest rates. Compared to other countries, the U.S. economy continues to outperform.

Commercial Real Estate Lending

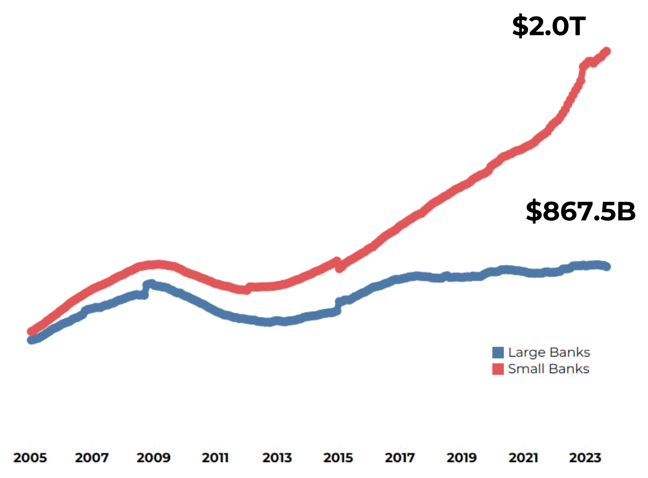
CRE loans (June 2024): $2.99 trillion
Delinquency rate of CRE loans (Q1 2024): 1.18%

CRE debt fell below $3.0 trillion in June

While the volume of CRE loans consistently increased for over a year, it fell below $3.0 trillion in June. This decrease was primarily due to the slowdown of CRE loans reported from large banks. Specifically, within large domestically chartered banks, the volume of CRE loans fell to $867.5 million from $872.5 in May 2024.

Nevertheless, the CRE loans of small domestically chartered banks continued to increase in June.

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

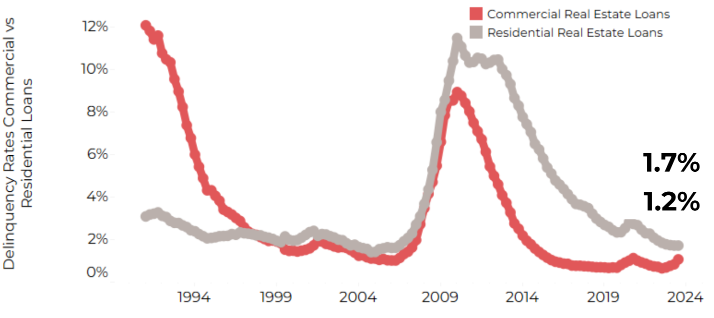


Source Federal Reserve

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. Specifically, the CRE delinquency rate was 0.77% in Q1 2023, and currently, it stands at 1.18%. 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 (Q1 2024)

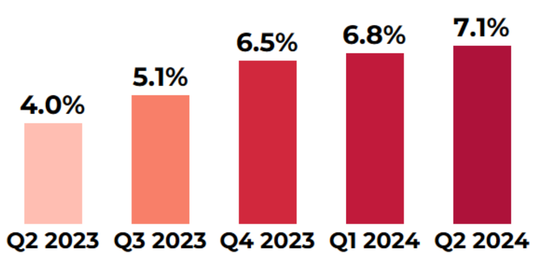


Source Federal Reserve

Office delinquency rates rose again in Q2 2024

According to the Mortgage Bankers Association, 7.1% of the balance of office property loan balances were 30 days or more days delinquent during the second quarter of the year, surpassing those of loans backed by retail and hotel properties. This is an increase from the 6.8% recorded at the end of the first quarter and a substantial jump from the 4.0% reported a year ago (Q2 2023). 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 (Q2 2024)



Source Mortgage Bankers Association (MBA)

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Office

Net absorption in the last 12 months: -42.2 million sq.ft.
Rent growth in the last 12 months: 0.7%
Cap rate: 8.6%

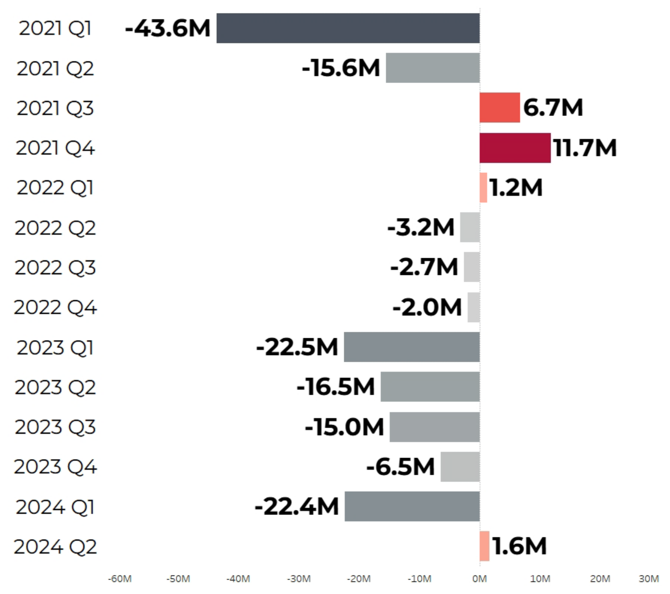
With the establishment of hybrid work models as a legacy of the pandemic's impact on work culture, the demand for traditional office spaces has continued to decline.

Quarterly net absorption of office spaces turned positive for the first time in over two years, driven by a renewed interest in Class A office spaces, which added 4.8 million square feet this quarter. Class B offices still have negative absorption, but the amount of square footage vacated this quarter shrank significantly, to nearly one-fifth of the previous quarter's rate, while Class C vacancies halved. Nonetheless, as the amount of delivered space rose 30%, vacancy rates continued to grow by 0.1%, and rent only increased by 0.1% this quarter.

Major increases in vacant office space are most evident in prominent tech cities such as San Francisco, Houston, Dallas-Fort Worth, Denver, and Washington, DC, driven by companies and workers relocating to areas with lower operational costs.

Meanwhile, the top performers in the category have vacancy rates under 3%, with Hickory, NC, Savannah, GA, and Wilmington, NC, leading the way.

Quarterly Net Absorption in sq. ft



Top 10 areas with the largest vacancy rates

	2024 Q2	2023 Q2
San Francisco, CA	22.29%	18.66%
Houston, TX	18.86%	18.38%
Dallas-Fort Worth, TX	18.16%	17.74%
Denver, CO	16.99%	15.40%
Washington, DC	16.96%	15.79%
Austin, TX	16.81%	15.91%
Phoenix, AZ	16.40%	15.29%
Chicago, IL	16.23%	15.81%
Los Angeles, CA	16.08%	14.77%
Atlanta, GA	16.03%	15.13%

Top 10 areas with the lowest vacancy rates

	2024 Q2	2023 Q2
Hickory, NC	1.70%	2.30%
Savannah, GA	1.77%	1.83%
Wilmington, NC	1.95%	1.71%
Myrtle Beach, SC	2.00%	2.22%
Huntington, WV	2.13%	1.94%
Gulfport-Biloxi, MS	2.22%	3.20%
Davenport, IA	2.26%	2.39%
Olympia, WA	2.37%	2.16%
Asheville, NC	2.59%	2.50%
Pensacola, FL	2.78%	2.90%

Source: NAR analysis of CoStar data

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Multifamily

Absorption of units in the last 12 months: 450,664 units
Rent growth in the last 12 months: 1.0%
Cap rate: 6.0%

As the second quarter of 2024 ended, the multifamily housing market is adjusting to a situation where an increasing number of people are opting to rent due to the high interest rates that make homeownership less attainable. This shift is evident with a 148% rise in 12-month absorption, now approximately 450,000 units. However, since the supply of new units exceeds demand by 45%, quarterly rents have decreased by another 0.2% compared to the previous quarter and are now at 0.9%.

Class A multifamily properties are seeing the most significant effects, with vacancy rates climbing to 10.8% and annual rent growth at just 0.2%. In contrast, Class B properties, which typically have had lower absorption rates over 12 months, are now experiencing higher demand for the fourth consecutive quarter. These properties have a lower vacancy rate of 8.8% and a rent growth of 0.9% over the past year. This situation highlights the financial strain many face, leading more people to choose affordable living as inflation remains above the 2% target.

Although rent growth is sluggish across the country, some Sun Belt metro areas are experiencing a decline, with Austin, TX, and Fort Myers, FL, seeing rent decreases of over 5%. On the other hand, Lancaster, PA, Evansville, IN, and Springfield, MA, are defying this trend with rent increases exceeding 5%, significantly higher than the national average of 0.9%

Major urban areas like Dallas-Fort Worth, TX, New York, NY, and Houston, TX, had absorbed over 15,000 multifamily units by the end of the second quarter. Notably, Dallas-Fort Worth had surpassed New York in 12-month unit absorption after trailing for two years. This surge in demand highlights the robust performance of the rental market in these high-cost regions.

Top 10 areas with fastest rent growth

	2024 Q2	2023 Q2
Lancaster, PA	6.47%	5.21%
Evansville, IN	5.52%	2.42%
Springfield, MA	5.34%	4.48%
Louisville, KY	4.95%	3.02%
Syracuse, NY	4.92%	4.43%
Youngstown, OH	4.85%	5.71%
Rockford, IL	4.40%	6.36%
Providence, RI	4.28%	4.78%
Reading, PA	4.26%	4.43%
Dayton, OH	4.21%	4.07%

Top 10 areas with the strongest 12-month absorption

	2024 Q2	2023 Q2
Dallas-Fort Worth, TX	21,894	5,665
New York, NY	20,999	20,005
Houston, TX	15,165	4,905
Atlanta, GA	14,577	852
Phoenix, AZ	14,272	6,674
Washington, DC	14,234	7,558
Austin, TX	13,480	7,526
Orlando, FL	10,462	3,969
Nashville, TN	10,334	4,444
Seattle, WA	10,091	5,438

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 41.4 million sq. ft.
Rent growth in the last 12 months: 2.6%
Cap rate: 6.9%

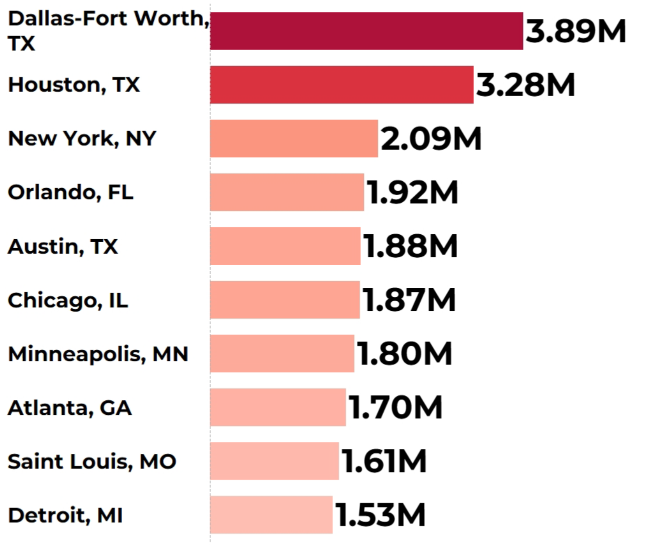
Retail real estate saw a notable rise in net absorption from 2014 to 2017, peaking before the e-commerce boom impacted the market. The growth of online shopping led to a decline in retail space absorption even before the pandemic. COVID-19 exacerbated this trend, causing a significant drop in retail absorption as lockdowns pushed consumers towards online shopping. Net absorption has since dropped 27% over the year ending in June, and rent growth fell 1.4%, now at 2.6%. As a result, the retail market continues to transition towards e-commerce, with less physical space being occupied.

As for retail categories, General Retail spaces and Power Centers have been instrumental, accounting for approximately 92% of all the positive quarterly net absorption as of June 2024. Malls, on the other hand, vacated 0.9 million sq. ft. of space, further increasing their highest vacancy rate to 8.8%

The overall retail vacancy rate has stayed at a record low of 4.1% for the sixth consecutive quarter, thanks to delivery outpacing absorption. General Retail has the lowest vacancy rate at 2.5%.

Neighborhood Centers and Power Centers had the highest rent increases at 3.5% and 3.3%, respectively.

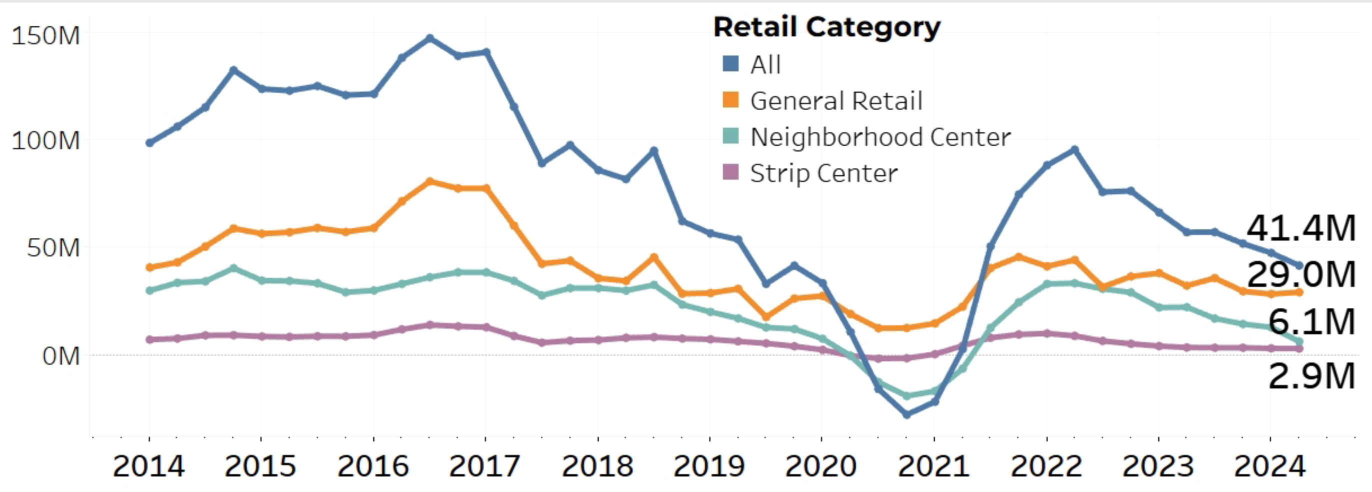
Top 10 areas with the strongest net absorption in the last 12 months



This June, Richmond, VA, and Salt Lake City, UT, experienced the highest year-over-year rent growth at 9.1 and 8.9%, respectively. On the flipside, Pittsburgh, PA, San Francisco, CA, and Louisville, KY, had rent declines of more than 2%.

Moreover, Texas is excelling in retail real estate, with cities like Dallas-Fort Worth and Houston recording the highest year-over-year retail space absorption rates in the nation, surpassing 2 million sq. ft. as of June 2024.

Net Absorption 12 Mo by type (Q1 2014 - Q2 2024)



Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 108.9 million sq. ft.
Rent growth in the last 12 months: 4.1%
Cap rate: 7.3%

The industrial real estate market, which thrived in 2022, now faces challenges due to an oversupply of properties and declining absorption rates. Over the past year, net absorption has plummeted by 64%, reaching a decade-low of 108.9 million square feet. Deliveries are surpassing absorption at a ratio of 4.5 to 1. Consequently, the vacancy rate has risen by 2% to 6.6%, and rent growth has slowed by 4.8% to 4.1%, though it still outperforms other commercial real estate sectors.

In the industrial sector, logistics spaces are the only branch with positive absorption this quarter, absorbing nearly 36 million square feet. In contrast, Flex and Specialized spaces vacated 4.9 and 7.5 million square feet, respectively. Logistics spaces also led with a 4.6% rent increase over the past 12 months, while specialized spaces saw a 3.3% rise and flex spaces grew by 3.2%.

Dallas-Fort Worth, TX, saw the highest industrial space absorption over the past 12 months. Houston, TX, and Phoenix, AZ, also performed strongly, each absorbing over 14 million square feet by the end of June 2024.

By the end of the 2nd quarter, Reno, NV, Seattle, WA, Portland, OR, and Memphis, TN, joined Los Angeles, CA, in dropping from the top 10 to the bottom 10 in 12-month industrial absorption. Strong market interest in 2022 and early 2023 has waned, leading to declining rent growth. However, Los Angeles and Portland maintain vacancy rates of 5.4% and 5.6%, respectively, below the national average of 6.6%.

Richmond, VA, Baltimore, MD, and Orlando, FL, have experienced the highest rent increases. Due to strong warehouse demand, industrial rents in these cities have surged over 9% in the past year. This trend underscores the region's economic growth and competitive industrial market.

Top 10 areas with the strongest 12-month absorption

	2024 Q2	2023 Q2
Dallas-Fort Worth, TX	23.04M	39.45M
Houston, TX	18.38M	25.12M
Phoenix, AZ	14.91M	18.22M
Atlanta, GA	10.16M	11.12M
Chicago, IL	9.45M	25.95M
Savannah, GA	8.30M	11.38M
Nashville, TN	8.03M	6.88M
Austin, TX	7.55M	5.06M
Minneapolis, MN	5.15M	5.95M
Philadelphia, PA	4.86M	7.91M

Top 10 areas with the weakest 12-month absorption

	2024 Q2	2023 Q2
Los Angeles, CA	-12.48M	-15.34M
New York, NY	-4.59M	-0.75M
Portland, OR	-4.04M	4.89M
Winston-Salem, NC	-2.85M	0.81M
San Diego, CA	-2.61M	-1.26M
Harrisburg, PA	-2.40M	3.31M
Seattle, WA	-2.32M	4.76M
San Francisco, CA	-2.30M	-0.61M
Reno, NV	-2.27M	5.22M
Memphis, TN	-2.21M	10.23M

Source: NAR analysis of CoStar data

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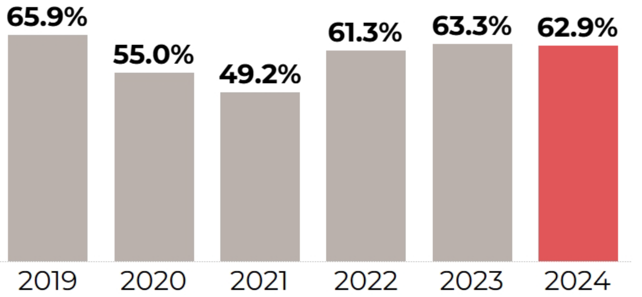
Hotel

Occupancy rate in the last 12 months: 62.9%
Average daily rate in the last 12 months: $157/room
Revenue per available room in the last 12 months: $99/room

As we conclude Q2 2024, the hospitality sector is seeing improvements. Hotel occupancy rates have leveled off at around 63%, remaining roughly 3% below pre-pandemic figures, which suggests that a complete recovery may be elusive due to the prevalence of remote work. Nevertheless, average daily rates and revenue per available room have now exceeded pre-pandemic benchmarks.

12-month Occupancy Rate in June



Specifically, in June 2024, the average daily rate (ADR) per room rose to $157/room, up 20% from June of 2019. The revenue per available room (RevPAR) also increased to $99/room, up 15% compared to the same period in 2019.

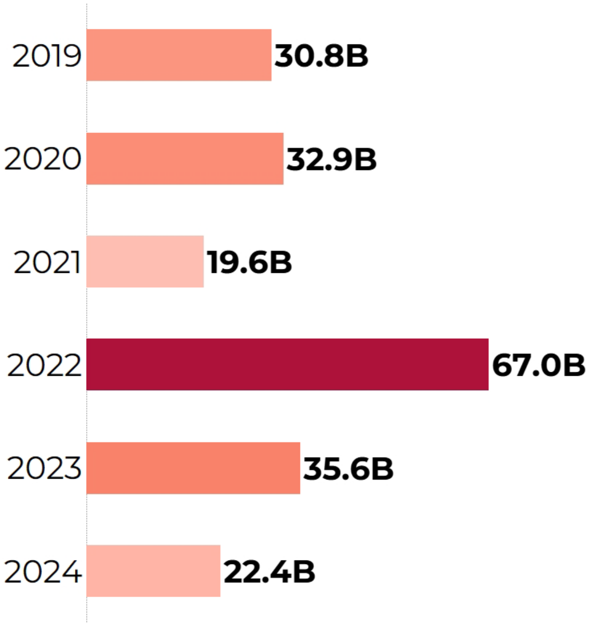
12-month ADR and RevPAR in June

	Average daily rate	Revenue per available room
2019	$131	$86
2020	$123	$68
2021	$105	$52
2022	$141	$86
2023	$154	$97
2024	$157	$99

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

Sales acquisitions have declined since the last year. In June 2024, the 12-month sales volume dropped to $22.4 billion, from $37.1 billion in the previous year.

12-month Sales Volume as of June



Source: NAR analysis of CoStar data

At the local level, the hospitality sector on Hawaii's Kauai Island is flourishing, with the Average Daily Rate (ADR) increasing by 59%, Revenue per Available Room (RevPAR) rising by 57% from pre-pandemic levels, and an impressive occupancy rate of 70%. Maui Island leads the nation with outstanding figures, with an ADR of $564 and a RevPAR of $371. Meanwhile, New York City holds the highest hotel occupancy rate at 86%.

Conversely, regions in California, especially San Francisco/San Mateo and San Jose/Santa Cruz, are still facing significant challenges, with RevPAR remaining 26% and 28% below pre-pandemic levels, respectively, indicating ongoing recovery difficulties.

COMMERCIAL REAL ESTATE REPORT
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