NOVEMBER 2024

The Commercial Market: What is in store for 2025?

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Introduction

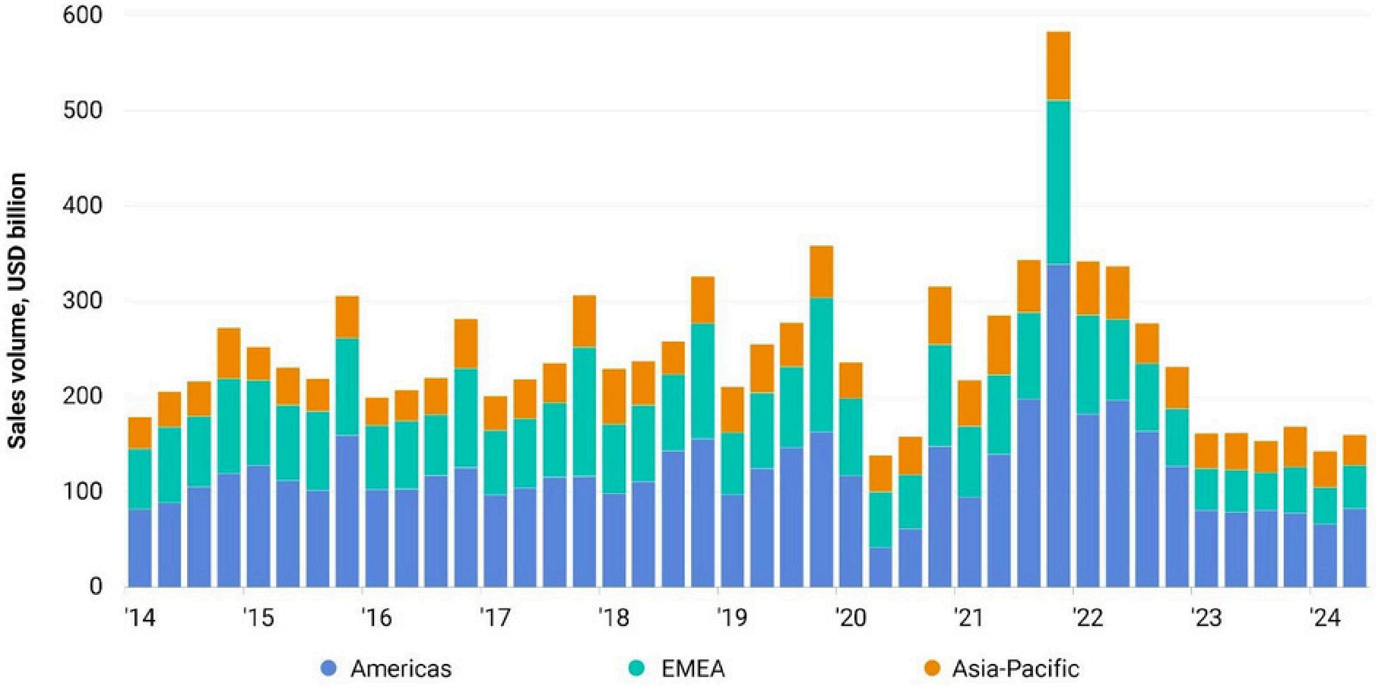
The commercial real estate (CRE) market seems to be experiencing a prolonged case of "long COVID."

While the residential market boomed during and after the pandemic, with home prices surging until mortgage rates doubled in 2022, CRE didn't see the same gains. Residential sales volumes have dropped by about a million units annually since 2021, though prices have continued to climb nationally. In contrast, CRE sales peaked in late 2021 and have declined steadily, with prices falling 6.5% overall since then – though results vary widely across sectors.

The Industrial sector saw prices rise nearly 19% over the past three years, while the Office sector experienced a 21% drop, with Central Business District office values plunging over 50%.

Recent data suggests a slight improvement in prices and sales volume. But does this signal a recovery? The answer is more complex. To better understand these dynamics, we'll examine overall CRE trends and the performance of its key sectors.

Sales Volume Dropped in 2022, Shows Signs of Recovery



- Global CRE sales soared to nearly $600 billion in Q4 2021, driven by historically low financing costs – almost double the sales volume of Q4 2020. The U.S. contributed more than half of this total.
- Sales volume dropped in 2022, with Q4 sales at less than half of the volume of the previous year, and continued to decline on a year-over-year basis throughout 2023.
- The decline in sales was most pronounced in the Americas, but the European and Asian markets also saw weaker sales.
- Q2 2024 sales came in just barely above Q2 2023 sales, the first yearly increase since Q2 2022.

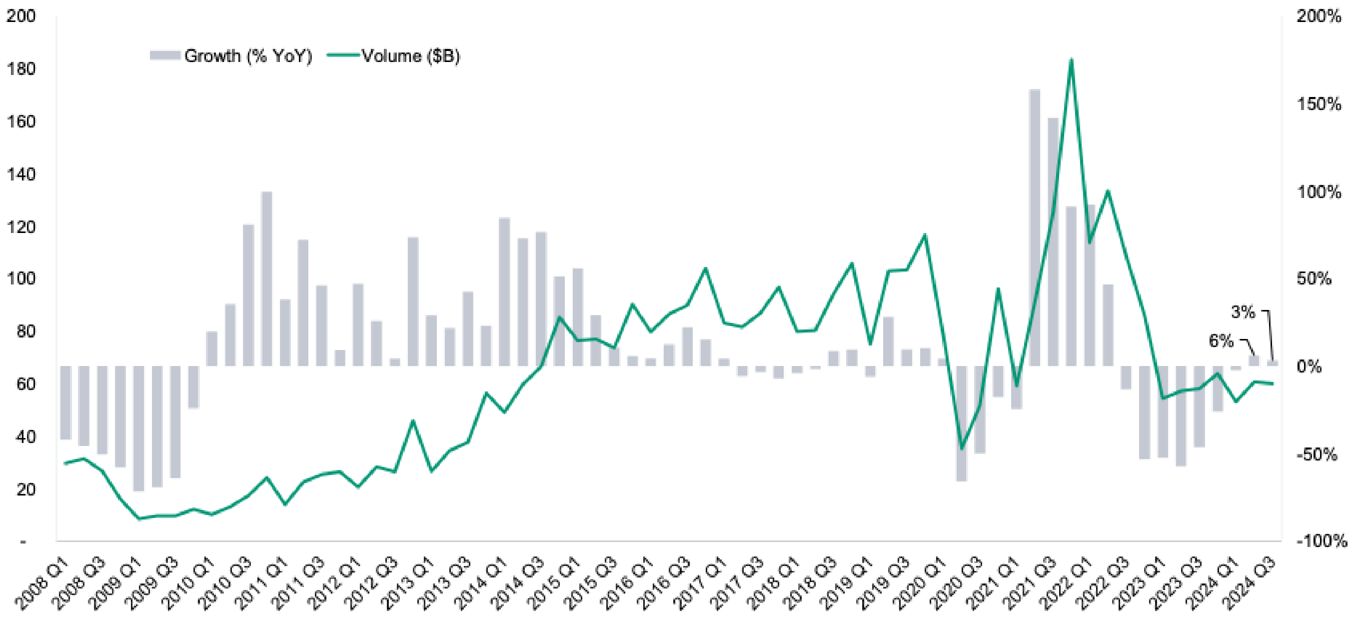
BOTTOM LINE

Global commercial real estate is showing signs of recovery from the slowdown sparked by higher interest rates.

Source: MSCI

Early Q3 2024
Sales Numbers Show Promise

Core Four Property Type Sales Volume and Annual Growth Rate

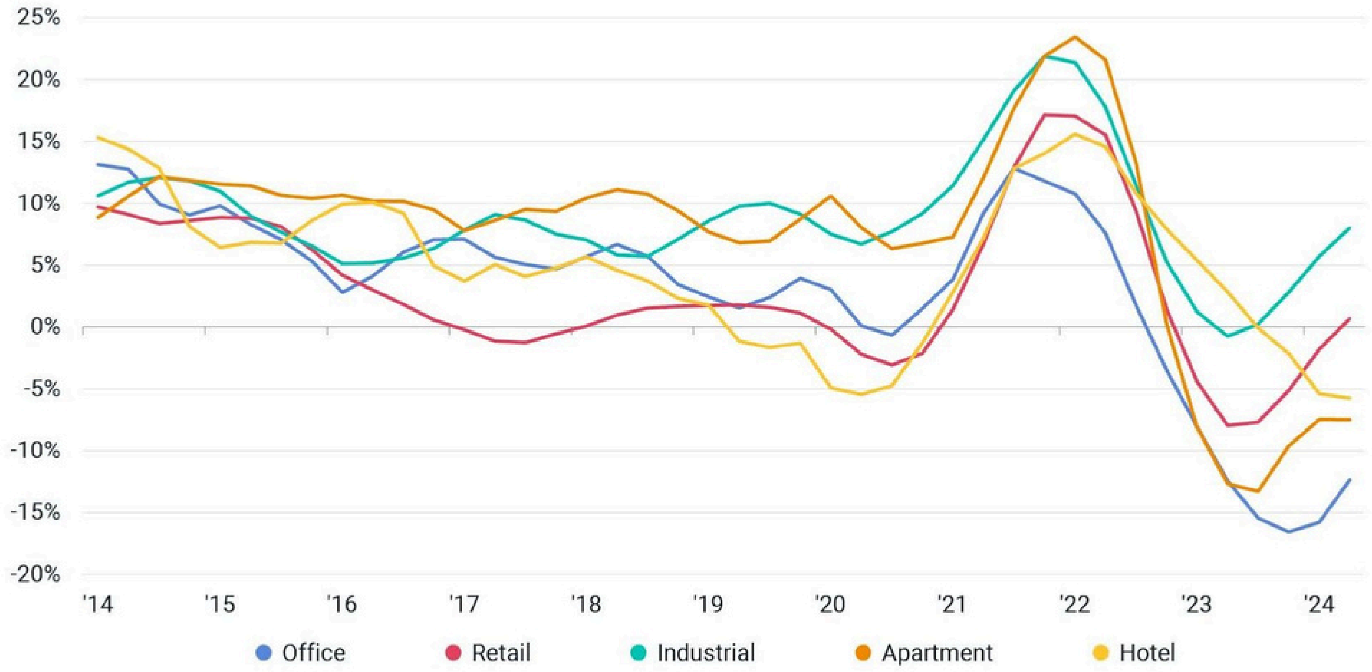


- Preliminary reports suggest that Q3 sales volume will be at least on par with prior year sales, marking two consecutive quarters where year-over-year volume did not decline.
- Seasonal patterns of quarter-over-quarter increases from Q1-Q4 have not returned, as the market continues to adjust to multiple shocks since the onset of COVID.

BOTTOM LINE Even with recent improvements in sales, overall volume is still well below the pre-pandemic Q3 average of just over $136 billion.

Source: Moody's

Property Price Declines in the U.S. CRE Market Have Moderated



- In most of the major CRE sectors, sales prices appear to be beginning to recover – only the Hotel sector continues to see year-over-year price declines, and even there the rate of decline appears to be slowing.
- It's important to note that even though the rate of decline is slowing down, prices generally are still lower than they were a year ago in most sectors.
- Both the Retail and Industrial sectors are showing annual price increases, while the Office and Apartment sectors are still in negative territory, but improving from recent market bottoms.

BOTTOM LINE

It appears that pricing for commercial properties in most sectors in the U.S. has bottomed out and is in the early stages of recovery.

Source: MSCI

Price Recovery Varies Significantly by Sector

Change in RCA CPPI October 2024

	1-mth	3-mth	1-yr	3-yr	5-yr	10-yr
Office	-0.1%	0.1%	-6.4%	-21.2%	-11.7%	13.6%
Office - CBD	-0.2%	-1.1%	-18.7%	-50.7%	-49.2%	-33.9%
Office - Sub	0.2%	1.1%	-1.6%	-13.9%	-2.6%	25.6%
Industrial	0.6%	1.8%	7.6%	18.9%	53.9%	119.4%
Retail	-0.1%	-0.3%	-1.9%	-2.5%	8.4%	20.0%
Commercial	0.0%	-0.1%	0.2%	-2.6%	13.6%	41.2%
Apartment	-0.3%	-0.8%	-6.1%	-10.2%	13.8%	78.9%
All Types	-0.1%	-0.1%	-1.5%	-6.5%	13.2%	54.3%
6 Major Metros All Types	-0.4%	-0.8%	-2.9%	-11.5%	0.7%	36.5%
Non-Major Metros All Types	0.2%	0.3%	-0.8%	-3.8%	18.9%	62.5%

- According to the RCA Commercial Property Price Index (CPPI), sales prices stabilized – down 1.5% from a year ago, and by 0.1% from a month ago.
- The Industrial sector, driven by increasing demand for warehouse space, light manufacturing, cloud computing, and cannabis production, is the only segment boasting annual price increases, up 7.6% from 2023.
- Both the Office sector (-6.4%) and Apartment sector (-6.1%) had annual declines of over six percent. Office prices were particularly hard hit in the Central Business District category, where prices fell by 18.7% from the prior year.

BOTTOM LINE

CRE prices continue to decline in most sectors, but the pace is slowing, with the Industrial sector seeing more gradual price growth.

Source: MSCI

Property Values are Also Lower

All Sectors Down from Peak Pricing, Most Lower than in Q2 2023

	Index Value	Change in Commercial Property Values		
		Past Month	Past 12 Mos	From '22 Peak
All Property	125.5	0.0%	0%	-19%
Core Sector	125.9	0.0%	2%	-21%
Apartment	152.3	0.0%	12%	-20%
Industrial	213.7	0.0%	0%	-16%
Mall	85.3	0.0%	5%	-13%
Office	71.6	0.0%	-8%	-37%
Strip Retail	114.3	0.0%	3%	-13%
Data Center	108.6	0.0%	-4%	-16%
Health Care	123.6	0.0%	0%	-18%
Lodging	103.0	0.0%	-4%	-9%
Manufactured Home Park	278.5	0.0%	-3%	-14%
Net Lease	94.3	0.0%	-3%	-19%
Self-Storage	246.8	0.0%	-8%	-21%

- According to the Green Street Commercial Property Price Index (CPPI), all commercial sectors have seen property values decline by double digit percentages from their 2022 peaks, with only the Lodging sector experiencing a single-digit drop of 9%.
- Estimated values in the Office sector have fallen by 37%, contributing heavily to the overall market's decline of 19%, and to the Core Sector (Office, Industrial, Retail, and Apartment) decline of 21%.
- The severe decline in property values is likely one of the reasons that sales volume is off by as much as it is: owners in many sectors would have to take enormous losses to sell their properties at these prices.

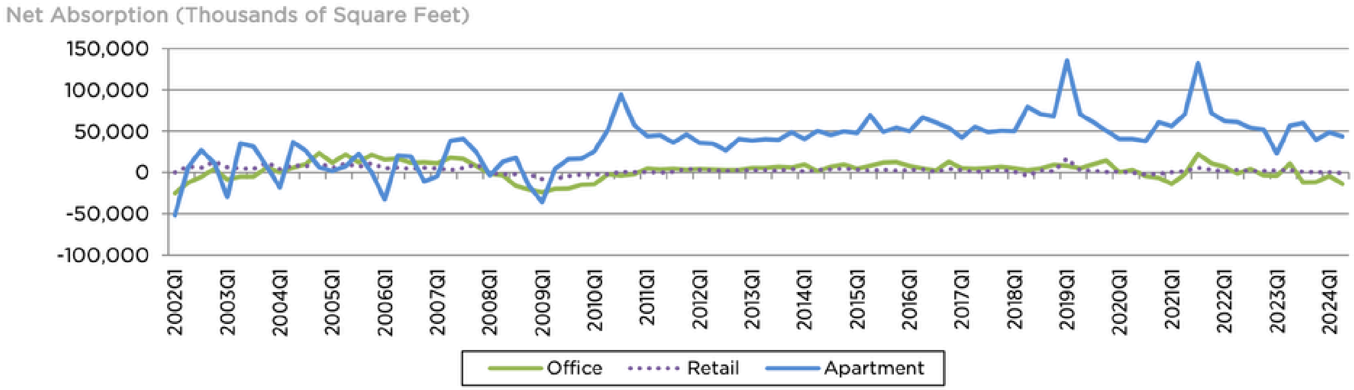
BOTTOM LINE

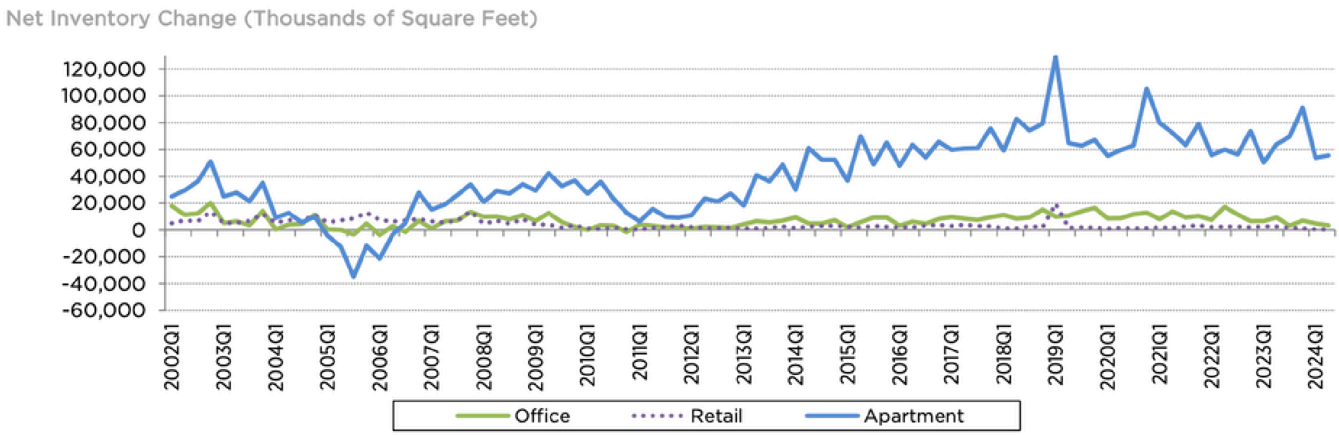
Sales prices have declined 6.5% since 2022, far less than the 21% drop in property values, prompting many owners to delay selling in hopes of a recovery.

Source: Green Street CPPI - November 6, 2024

Inventory Levels and Absorption Rates Soften

Net Inventory Change / Net Absorption Commercial / Multifamily Properties





- As demand for commercial properties weakened in the post-pandemic period, very little new inventory has been added to the market. Both the Retail and Office sector had virtually no change to the amount of available inventory, and the latter showed a modest decline over the past year.
- Normally, limited inventory would lead to higher absorption rates and higher rents, but that hasn't been the case in today's market, where Retail absorption rates are flat; Office absorption rates actually ventured into negative territory.
- The Apartment sector bucked the trend and will have added about 740,000 new units by the end of 2025; absorption rates in this sector are also higher than other sectors, but aren't high enough to prevent vacancy rates from increasing.

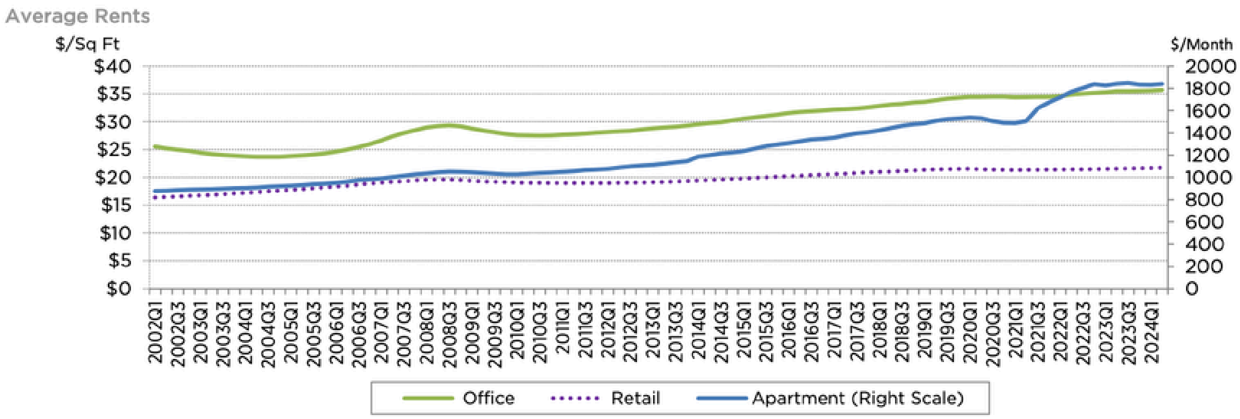
BOTTOM LINE

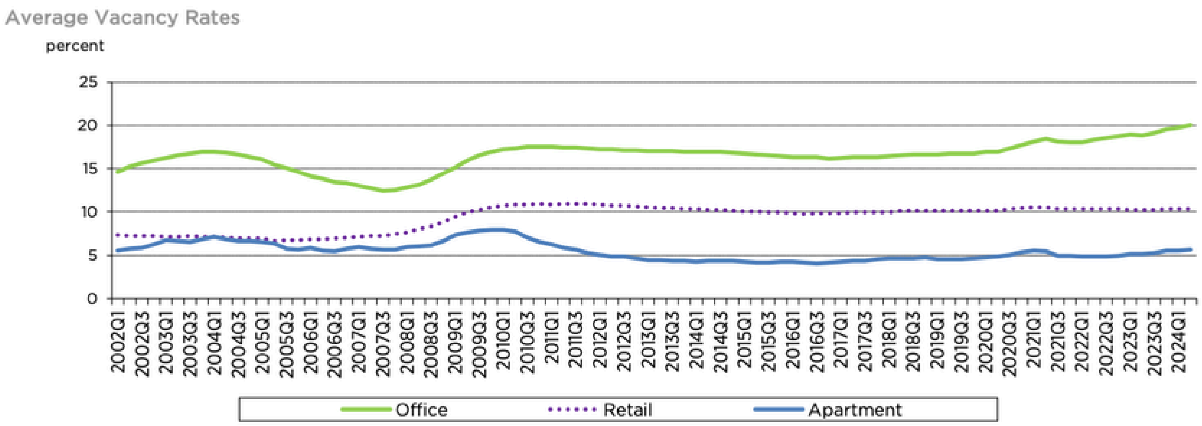
Very little new inventory is coming to market in 2024, with the exception of a boom in apartment units. Even with the limited amount of new supply, absorption rates continue to be sluggish.

Source: Mortgage Bankers Association and Moody's Analytics

As Vacancy Rates Increase, Rental Increases Decline

Average Rents and Vacancy Rates at Commercial / Multifamily Properties





- Vacancy rates have increased in all sectors, led by a 20% vacancy rate in the Office sector – the highest vacancy rate for that part of the market in many years. Vacancy rates in the Retail sector are at 10.4%, which is up just slightly from Q2 2023. The Apartment sector vacancy rate is 5.7%, which is almost a full point higher than the rate in 2022, when there was a post-COVID flood of tenants.
- As vacancy rates have risen, rental rates have slowed down: Retail rents are basically flat from a year ago; Apartment rents, after rising by 17.5% in Q2 2022 and 4.1% in Q2 2023, are down 0.1% this year through Q2.
- Office rents are up 0.6%, compared to annual increases of 1.7% in Q2 2023 and 1.2% the prior year. But it's important to note that the majority of office leases were initiated prior to the pandemic; we likely haven't seen 100% of the fall out from COVID in this sector's leasing prices yet.

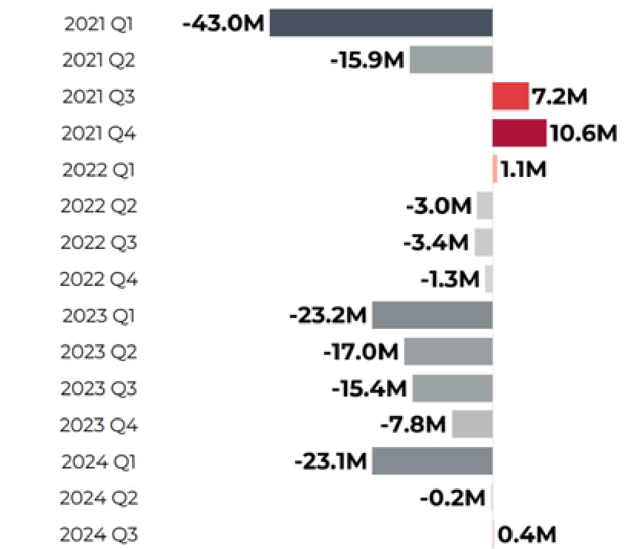
BOTTOM LINE

Inventory and rental rates are still adjusting to market changes caused by the pandemic, and vary significantly between each sector.

Source: Mortgage Bankers Association, Moody's Analytics

Office Absorption Rates: Have We Turned the Corner?

Quarterly Net Absorption in sq. ft



Top 10 areas with the largest quarterly absorption

	2024 Q3	2023 Q3
Dallas-Fort Worth, TX	1.98M	0.84M
New York, NY	1.38M	-1.75M
Detroit, MI	0.81M	0.23M
Columbia, SC	0.64M	0.25M
Kansas City, MO	0.61M	0.02M
Jacksonville, FL	0.51M	-0.20M
Houston, TX	0.48M	-0.54M
Las Vegas, NV	0.45M	-0.02M
Little Rock, AR	0.44M	-0.16M
Memphis, TN	0.39M	-0.24M

- A more granular review of the Office sector shows some signs of hope as Q3 data starts to come in. For the first time since Q1 2022, before finance rates skyrocketed, Office absorption rates were in positive territory, albeit just barely.
- New York City, one of the largest office markets in the country, experienced a massive turnaround, going from a net negative absorption rate of 1.75 million square feet to a positive rate of 1.38 million square feet, which is the second-largest rate in the country, behind only the Dallas Fort Worth Metroplex.
- San Francisco, while still in negative territory, saw absorption rates improve from -3.05 million square feet in Q3 2023 to -0.5% in Q3 2024.
- Worth noting that the less expensive types of offices across the country are experiencing the highest levels of absorption; Class A properties in general have lower absorption rates than Class B and Class C offices.

BOTTOM LINE

As more companies begin requiring workers to “return to office,” we may have begun to see a recovery in the Office sector, based on preliminary Q3 data. Limited post-pandemic construction may be a factor in this recovery as well.

Source: NAR Analysis of CoStar Data

Multifamily Rent Growth Strongest in Midwest and Northeast

Top 10 areas with steepest 12 Mo rent rises	2024 Q3	2023 Q3
Evansville, IN	6.82%	2.08%
South Bend, IN	5.83%	-0.23%
Rockford, IL	5.30%	7.82%
Lancaster, PA	5.16%	5.25%
Youngstown, OH	4.79%	5.21%
Montgomery, AL	4.79%	1.87%
Lexington, KY	4.57%	4.65%
Providence, RI	4.56%	5.48%
Poughkeepsie, NY	4.53%	2.56%
Hartford, CT	4.46%	4.10%

Top 10 areas with the strongest 12-month absorption	2024 Q3	2023 Q3
Dallas-Fort Worth, TX	25,136	8,697
New York, NY	24,248	19,243
Houston, TX	19,215	8,720
Atlanta, GA	19,163	3,360
Austin, TX	18,681	6,972
Phoenix, AZ	18,255	8,973
Washington, DC	15,294	9,083
Orlando, FL	13,831	4,679
Seattle, WA	11,858	5,534
Nashville, TN	11,588	5,731

- Secondary markets – mid-sized cities – across the Northeastern and Midwestern parts of the country experienced rental rate increases significantly higher than the national average of 1.1% in preliminary Q3 2024 data, led by two Indiana cities – Evansville and South Bend – where rates rose by 6.8% and 5.8% respectively.
- Absorption rates of apartment inventory mirrored the geography of the Office sector, with Dallas-Fort Worth and New York City as the two metros with the largest increases.
- Some markets, such as Austin, Naples, and Fort Myers, experienced annual declines in rental rates, likely due what could be a short-term oversupply of rental units.

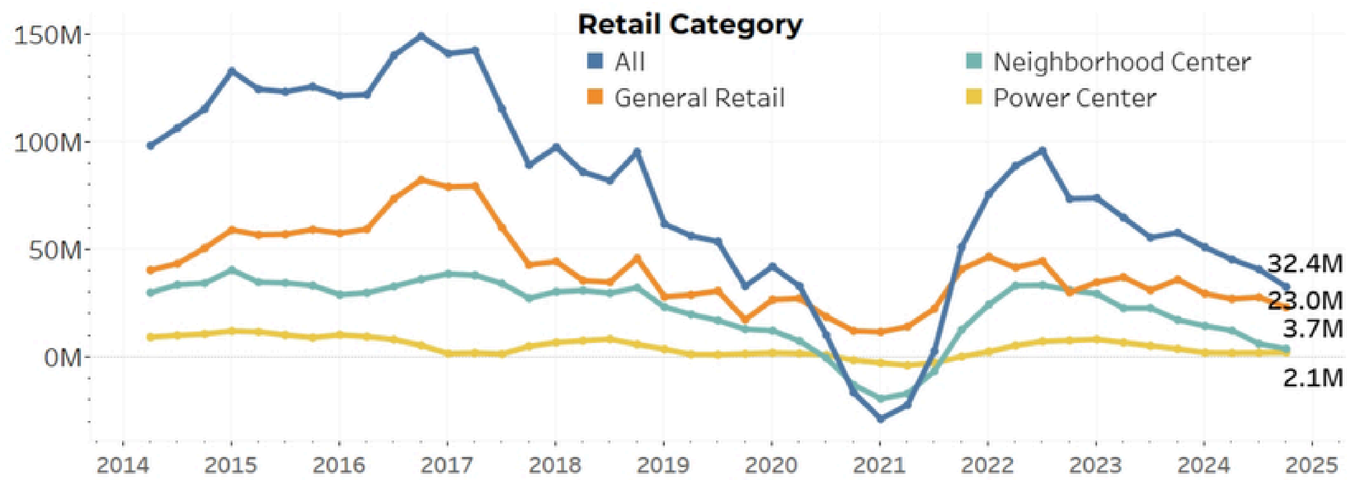
BOTTOM LINE

Rental rate increases nationally were virtually flat at 1.1% in the third quarter. But there's significant regional variability in rate movement – from a high of almost 7% in Evansville, IN, to markets in Florida and Texas where rates were lower than last year.

Source: NAR Analysis of CoStar Data

Retail Absorption Rates Slowing Down, but Vacancy Rates Remain Low

Net Absorption 12 Mo by type (Q1 2014 - Q3 2024)



- Preliminary Q3 2024 data shows that retail net absorption rates have declined by about 44% in the past year, but vacancy rates have held steady at 4.1% as retail construction and development have also slowed.
- Shopping mall vacancy rates are the highest in the category, and are approaching 9%.
- General Retail maintains the lowest vacancy rate at 2.5%. Neighborhood Centers and Strip Centers recorded the highest rent increases, at 5.9% and 4.7%, respectively.
- Three Texas metros – Dallas-Fort Worth, Houston, and Austin – were among the five metros in the country with the highest net absorption rates.

BOTTOM LINE

The Retail sector remains fairly steady, with a balanced amount of new construction and net absorption rates, and stable rents and vacancies. Most of the growth is in general retail and neighborhood centers, and in areas where population is growing.

Source: NAR Analysis of CoStar Data

Industrial Sector Slows Down After Massive COVID-Fueled Boom

Top 10 areas with the strongest quarterly absorption

	2024 Q3	2023 Q3
Dallas-Fort Worth, TX	5.97M	9.35M
Houston, TX	5.96M	6.98M
Savannah, GA	4.10M	2.41M
Indianapolis, IN	3.34M	1.68M
Chicago, IL	2.85M	6.16M
Denver, CO	2.62M	-0.20M
Salt Lake City, UT	2.55M	1.93M
Davenport, IA	2.53M	0.10M
Saint Louis, MO	2.08M	0.48M
Phoenix, AZ	2.07M	4.64M

Top 10 areas with the weakest quarterly absorption

	2024 Q3	2023 Q3
Charlotte, NC	-2.06M	1.22M
Reno, NV	-1.71M	0.70M
Boston, MA	-1.59M	0.47M
Detroit, MI	-1.34M	2.06M
Los Angeles, CA	-1.28M	-1.18M
Inland Empire, CA	-1.00M	-4.52M
Winston-Salem, NC	-0.93M	-0.82M
Milwaukee, WI	-0.86M	0.59M
Spartanburg, SC	-0.68M	0.59M
Greensboro, NC	-0.59M	0.53M

- The Industrial sector had a net absorption rate of 112.3 million square feet from September 2023 to September 2024 – a large number, but a 56% decline from the prior year.
- Preliminary Q3 2024 data shows vacancy rates rising to 6.6% for the sector, with annual rental rate increases of just over 3%, which is among the highest of any sector.
- Similar to findings in the Office, Multifamily, and Retail sectors, the Dallas-Fort Worth and Houston metros had the highest Industrial sector net absorption rates.
- Metros in coastal states struggled in the most recent reports, with cities in North and South Carolina and California among the markets with negative absorption rates, and cities like Los Angeles, Seattle, and Tampa all seeing rents decline by 1.8% annually.

BOTTOM LINE

The COVID-fueled boom in the Industrial sector, which drove immediate demand for warehouse and distribution facilities, appears to have run its course. But opportunities remain for steady growth in logistics, specialized spaces, and flex facilities.

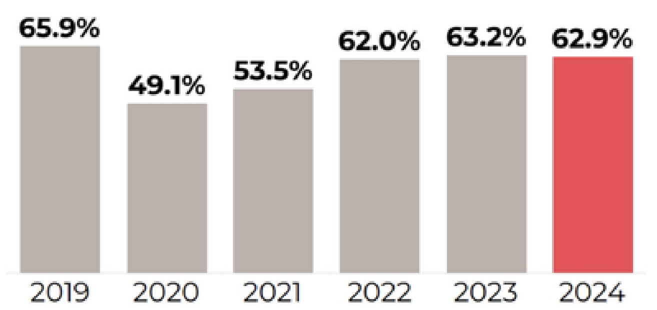
Source: NAR Analysis of CoStar Data

Hotel Sector
Appears to Have Stabilized

12-month ADR and RevPAR in September

	Average daily rate	Revenue per available room
2019	$131	$87
2020	$114	$56
2021	$116	$62
2022	$145	$90
2023	$155	$98
2024	$158	$99

12-month Occupancy Rate in September



- National hotel occupancy rates are slightly lower than in 2023, but offset somewhat by higher prices. The average daily rate (the total revenue/number of rooms) is 20% higher than it was in 2019, and the revenue per room (the average daily rate x the occupancy rate) is up 15% over the same time period.
- Most of the country has recovered from the extreme drop-off in travel during the pandemic: New York City boasts an 84% occupancy rate. The San Francisco Bay Area, however, continues to struggle, with revenue per room rates still 10-12% lower than. in 2019.
- Hotel sales peaked in 2022, with almost $62 billion in sales volume through September of that year. Same period sales declined to $33 billion last year, and again to $22 billion in 2024.

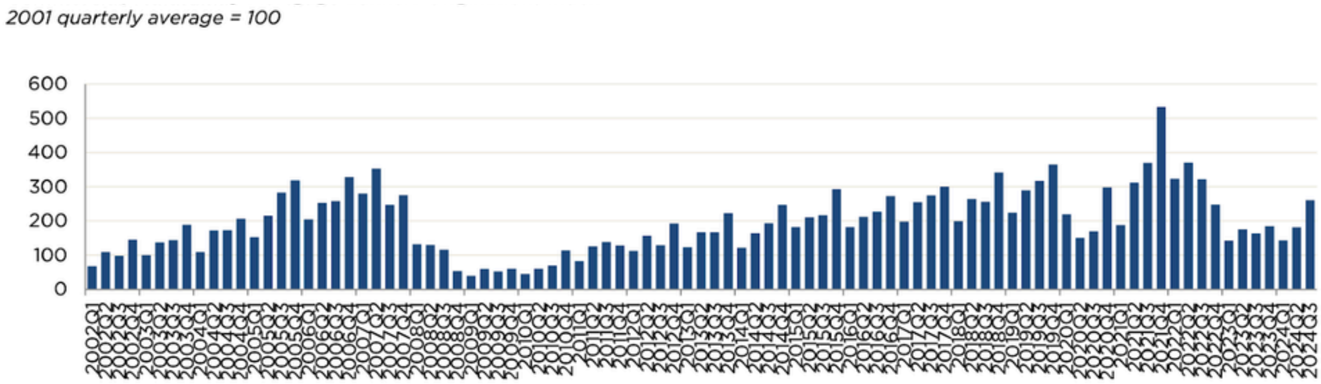
BOTTOM LINE

While the sale of hotel properties has slowed down significantly from its 2022 peak, and occupancy rates are still slightly below pre-pandemic levels, the sector appears to be stable, and has been able to adjust pricing to improve overall revenues and profitability.

Source: NAR Analysis of CoStar Data

Loan Volume Increases by 59% Annually in Q3 2024

Commercial / Multifamily Mortgage Bankers Originations Index



- Commercial loan volume was up 59% compared to Q3 2023 and 44% compared to Q2 2024 in the most recent report from the Mortgage Bankers Association.
- Loans were up in all commercial sectors except the Office sector, where loan volume was down by 3%.
- Loans from all sources increased: depository banks, insurance companies, government-sponsored entities, investor funds, and CMBS.

BOTTOM LINE

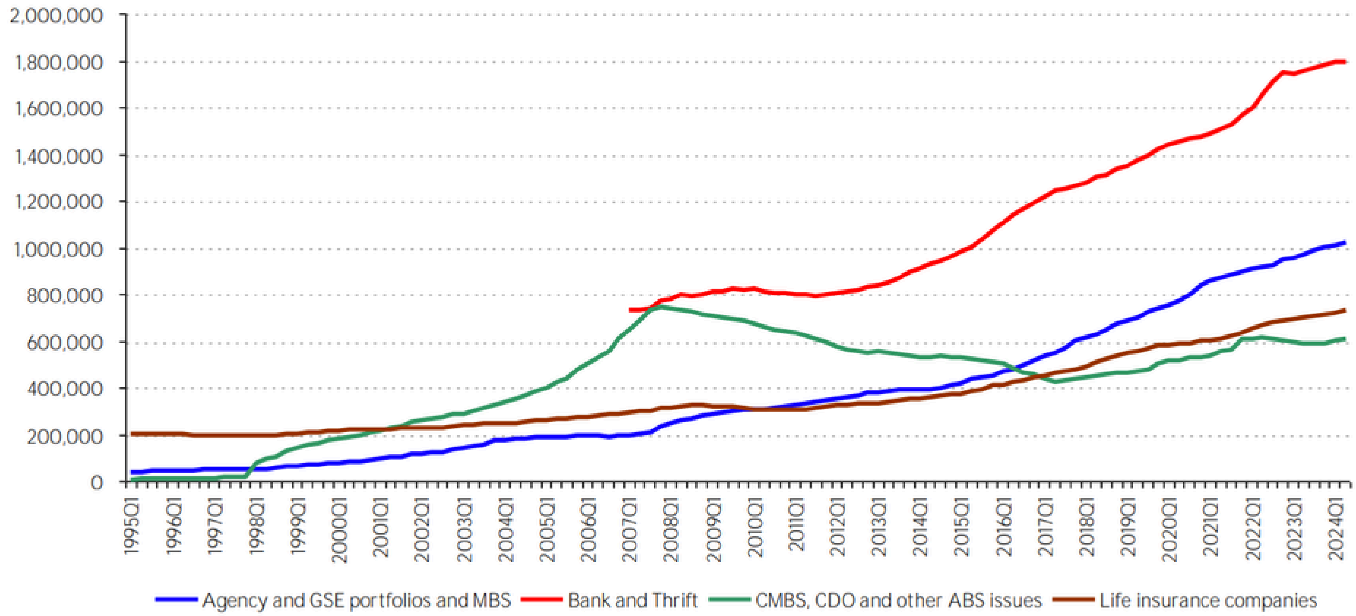
Loan volume secured by commercial properties rose dramatically in the third quarter of 2024. But it's important to remember that interest rates bottomed out in early September and have since risen; this will probably have an impact on Q4 loan volume.

Source: Mortgage Bankers Association

Commercial Real Estate:
$4.7 Trillion in Debt Outstanding

Commercial and Multifamily Mortgage Debt Outstanding

Total Commercial and Multifamily Mortgage Debt Outstanding, by Selected Sector by Quarter
($millions)



- For anyone still waiting for a commercial market "crash," there's a lot of debt to keep an eye on: just under $4.7 trillion, in fact. Depository banks have the most exposure, at about $1.8 trillion, followed by government-sponsored entities at a little over $1 trillion, insurance companies at $735 billion, and then commercial mortgage backed securities about just over $600 billion.
- The most vulnerable debt is probably the commercial mortgage backed securities, which are typically short-term loans that re-set at current market rates; a high percentage of these loans are backed by properties in the Office and Multifamily sectors, where prices have fallen and rents may not be adequate to compensate for higher finance costs when these loans reset

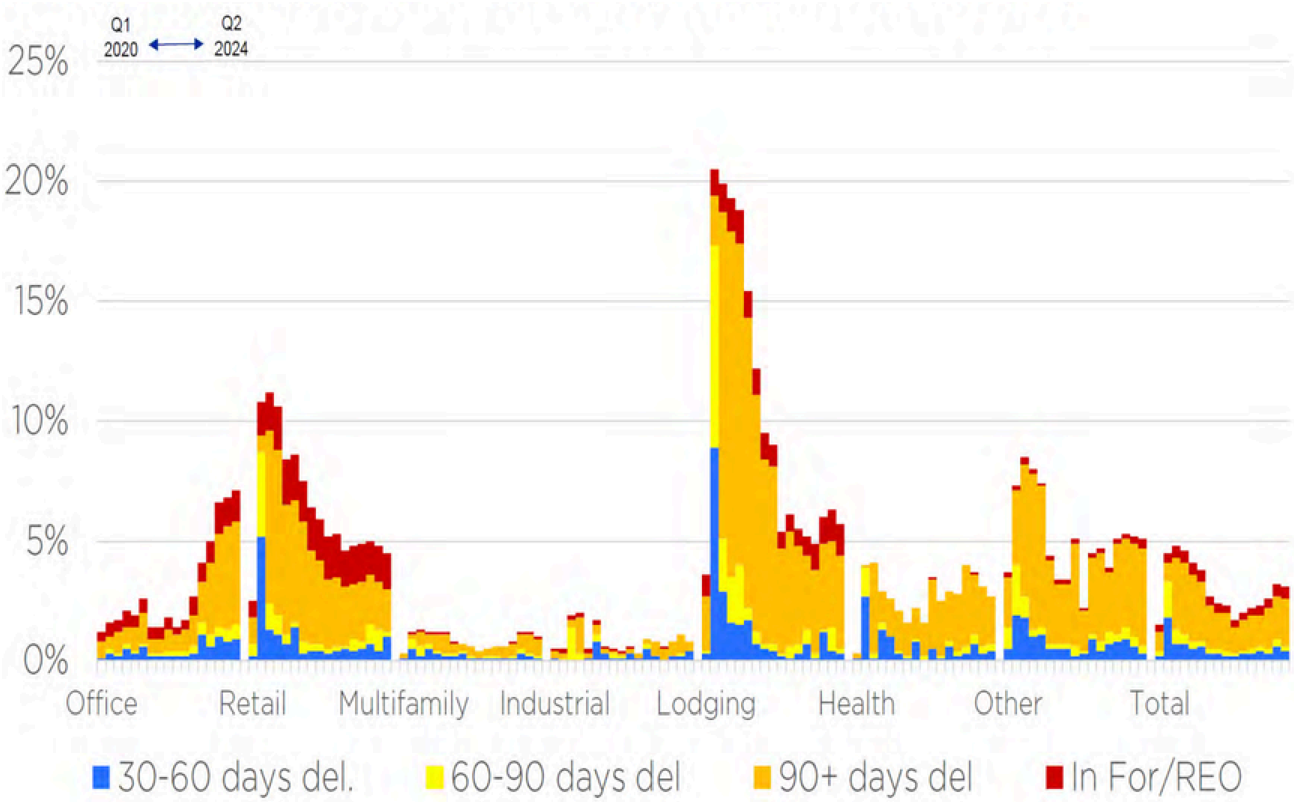
BOTTOM LINE

The amount of debt secured by commercial properties continues to grow, albeit more slowly than in prior years. Most of the debt is held by banks and GSEs, although most of the most volatile debt is probably held in mortgage backed securities or by private lenders.

Source: Mortgage Bankers Association

Loan Delinquencies Slightly Elevated, but Down from Recent Peak

End-of-quarter Delinquency Status by Property Type, Share of Total Unpaid Principal Balance, APR 2020 - Jun 2024 (Note: no data for Q2 2022



- Delinquencies vary by sector and by loan type, but overall appear to be running between 3.5-4.0% of all loans.
- The Office sector has the highest delinquency rates, at around 7%, and accounts for almost $740 billion of the $4.7 trillion in total CRE market debt. Retail, Multifamily, and Industrial are all down from recent peaks.
- No sector has delinquency or foreclosure rates nearly as high as they were in 2008, during the Great Recession.

BOTTOM LINE

Delinquency rates on loans backed by commercial properties are slightly higher than they were prior to the pandemic, but not at worrisome levels overall. There may be some distressed sales, and a higher rate of foreclosure activity as the market resets.

Source: Mortgage Bankers Association

What It Means

The commercial real estate (CRE) market has faced sharp declines in sales volume, prices, and property values in recent years, following a period of rapid growth during and immediately after the COVID-19 pandemic.

While the pandemic initially boosted Industrial property construction and Apartment rental rates with record-low vacancies, it also triggered prolonged declines in Hotel occupancy and revenues, alongside persistent challenges in the Office sector. These shifts have increased delinquency rates on CRE loans and led to more foreclosures. For CRE agents and brokers, this volatility presents both listing and buying opportunities as the market recalibrates.

Current sector trends vary widely. The Industrial sector, once thriving, now risks overbuilding, potentially raising vacancies and pressuring rents. The Apartment sector faces a near-term oversupply, with 740,000 units coming online this year but minimal new construction, which could lead to shortages in the future. Retail is growing in local markets but struggling in shopping malls. Meanwhile, the Office sector remains unstable, with employers navigating return-to-office policies and property owners grappling with $740 billion in loans resetting at higher interest rates.

Recent data suggests the market may have turned a corner, with prices stabilizing or falling at a slower rate and vacancy rates leveling off, though they remain higher than pre-COVID levels, limiting rental rate increases.

For proactive and informed agents, this period of uncertainty and volatility offers significant opportunities to generate both listings and leasing activity in the evolving CRE market.

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