Commercial Market Insights Report

October 2022

National Association of REALTORS®
Research Group

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Summary

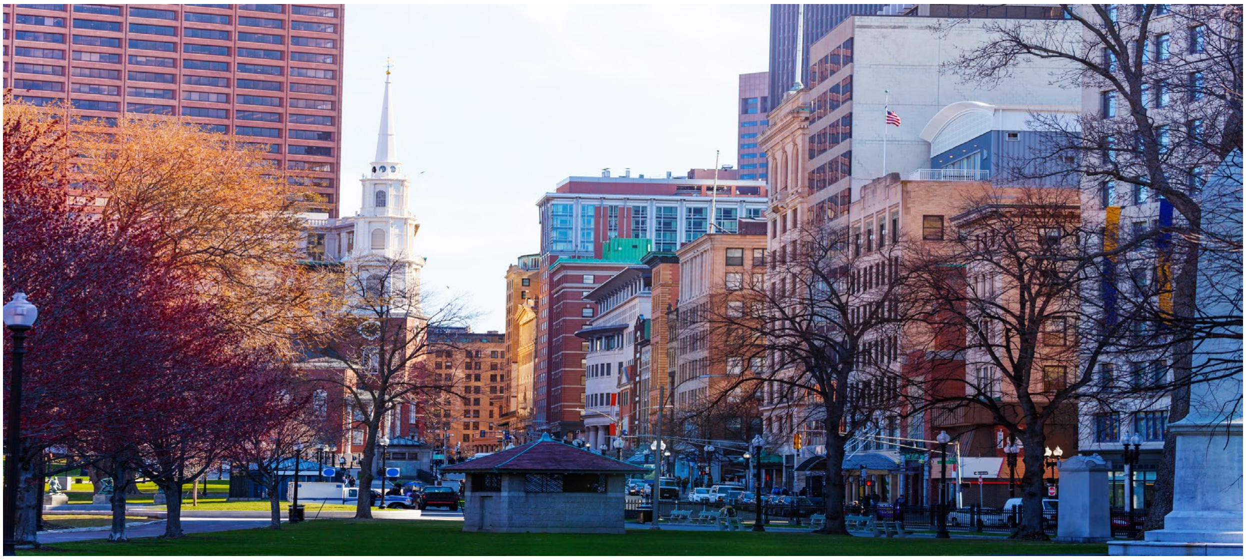
After the strong rebound for the US economy in 2021, growth in 2022 has slowed in the face of rising inflation, the household incomes squeeze, and geopolitical events. While the economy continues to deal with elevated inflation, there is a slowdown in the growth of Commercial Real Estate.

Multifamily and **industrial** properties were the leading sectors in 2022. With healthy balance sheets, consumer demand boosted retail, multifamily, and industrial asset classes. While the industrial boom continues to show no signs of stopping, multifamily absorption and rent growth are decelerating. Multifamily absorption in the last four quarters was below the pre-pandemic levels, in the range of 60,000-70,000 units. In the meantime, rents rose year-over-year at a slower pace, by less than a double-digit percentage. However, multifamily housing demand remains relatively strong. Considering rising mortgage rates and home prices, people may be forced to rent for longer due to decreasing affordability.

Although consumers cut back on spending due to elevated inflation, the net absorption of retail store space advanced to 23 million sq. ft. in the third quarter of the year. Meanwhile, neighborhood retail that offers in-person services continues to advance. Net absorption for neighborhood centers rose by 35 percentage points compared to the second quarter of the year.

As the country navigates hybrid work, the **office** sector continues to struggle. Although more people return to their offices, after four quarters with positive net absorption, demand for office space dropped as net absorption turned negative again.

Inflation, interest rates, supply chain, and geopolitical events are the main factors that will determine how Commercial Real Estate will perform in the following months. The National Association of REALTORS® will keep you informed monthly about the developments in Commercial Real Estate.



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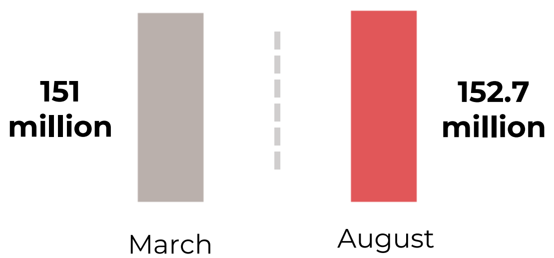
Economy

Job growth (compared to March 2020): 1.2%
Inflation: 8.3%
Interest rates: 3.25%

The job market continues to be very strong

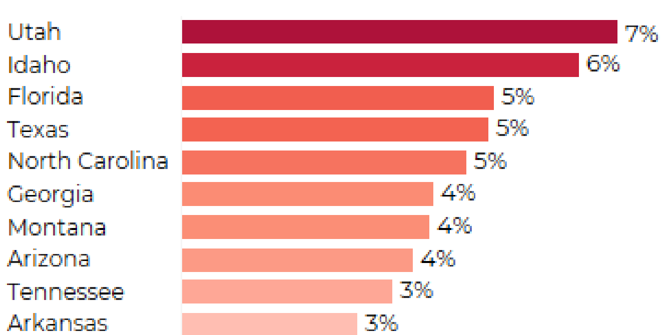
The economy was able to recover all the jobs that were lost at the beginning of the pandemic. There are more jobs now than in March 2020, when the pandemic hit our country. Specifically, there are about 1.7 million more jobs as of August 2022 than in March 2020. Meanwhile, the unemployment rate is near record lows – 3.7 percent - which indicates how strong the labor market is since it shows how many people who want a job and are available for work can find a job. In fact, there are two jobs for every unemployed person. Thus, the job market recovery after the pandemic has been remarkably rapid compared to other notable recoveries in recent history.

Number of Jobs



At the local level, Utah (7 percent) and Idaho (6.3 percent) are the two states with the fastest employment growth across the country.

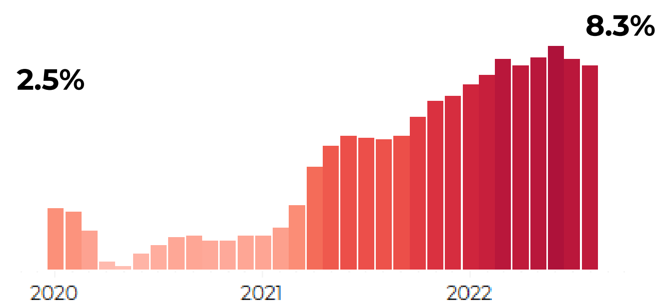
Top 10 states with strongest job growth since March 2020



Inflation remains elevated

Although prices eased slightly in August, inflation continued to rise very fast. It is not the 9.1% or 8.5% seen in the past two months, but this number is higher than expected. A significant contributor to inflation was rapidly rising rents, which rose 6.7% from a year ago — the fastest growth in the last four decades.

Inflation



Interest rates rose by 1.5 percentage points in the third quarter.

The Federal Reserve raised the short-term interest rates twice by 0.75 of a percentage point during the third quarter of 2022. The current Fed's fund rate is 3.25 percent, three percentage points higher than the previous year. While this is not the rate that consumers pay, a higher rate for banks makes borrowing more expensive for consumers, eventually also affecting long-term interest rates such as the 10-year Treasury yield. While inflation continues to remain elevated, the Federal Reserve will need to take additional rate hikes. Interest rates may reach 4.6% in 2023 before the central bank stops its fight against soaring inflation.

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

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Economy

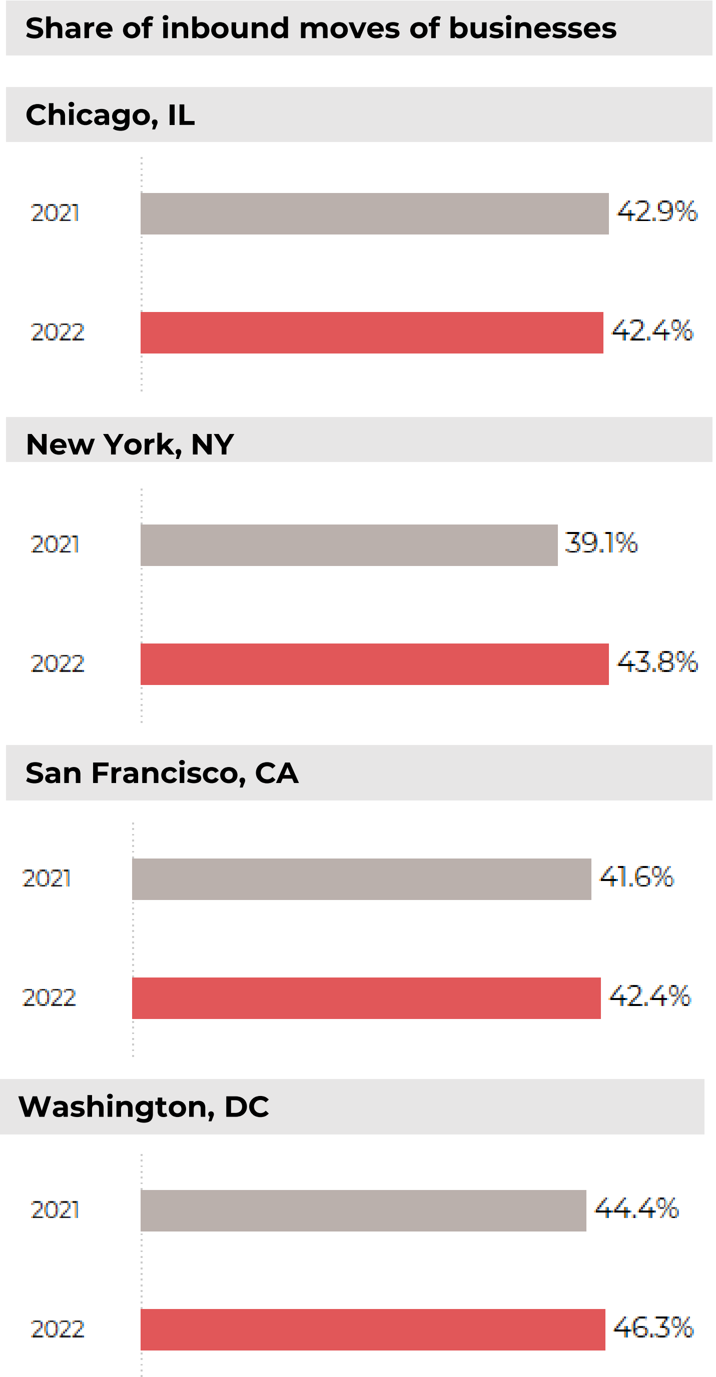
Big city centers lose fewer people and businesses

Fewer Businesses moved away from big city centers

As many people move back to big cities, businesses do too. Although big metro areas continue to lose people and businesses, fewer businesses decided to move away from these areas so far in 2022 compared to 2021. The United States Postal Service® (USPS) publishes monthly change-of-address data for households and businesses. Since people who want to forward their mail from their old business to a new location file a change of address request to the USPS®, this dataset is a good proxy for how many businesses relocated throughout the year.

After comparing inbound and outbound moves for businesses, the share of inbound moves has increased in many big city centers. For instance, in New York, the share of inbound relocations of businesses was 44 percent during January and August of 2022 compared to 39 percent a year ago. Respectively, in San Francisco, the share of businesses that moved to the area rose to 42.4 percent in January-August 2022 from 41.6 percent during the same timeframe in 2021.

However, these areas continue to lose businesses. A share below 50% indicates that more businesses relocate away from an area than those that move in.



Source: NAR analysis of USPS data

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Multifamily

Absorption of units in the last 12 months: 268,629
Rent growth in the last 12 months: 5.7%
Cap rate: 4.9%

There has been a gradual deceleration of rent prices. Rents grew 5.7% year-over-year in Q3 2022 compared to 9.4% and 11.3% in the previous two quarters. However, government data shows that rent growth is accelerating. Why don't private and government data align?

The Consumer Price Index (CPI), which provides information about rent inflation, uses data from the Consumer Expenditure Survey (CES) to determine the level of prices for goods and services. While this is a survey, most renters report the rent they have locked in earlier. This means that rent changes may take months to be reflected in government data. In contrast, the private sector publishes the listed rents – current rent prices. Thus, government data will likely show a decelerating trend in rent prices after several months.

No matter the source, **rent growth will remain strong** as many buyers are forced out of the market. Due to fast-rising mortgage rates, buyers need to earn more than $100,000 to afford to buy the median-priced home.

While rents have increased in nearly all the metro areas across the county, Sun Belt areas have experienced an even faster rent growth, including Knoxville, TN, Miami, FL, Charleston, SC, and Orlando, FL.

Although demand for apartments has eased compared to a year ago, it remains strong in New York, NY, Dallas-Fort Worth, TX, Los Angeles, CA, Washington, DC, and Houston, TX metro areas. More than 11,000 apartments have been absorbed in these areas in the last 12 months ending in the third quarter of 2022.

Top 10 areas with fastest rent growth

	Q3 2022	Q3 2021
Knoxville , TN	11.7%	13.8%
Miami , FL	10.6%	14.1%
Charleston , SC	10.1%	16.4%
Orlando , FL	9.4%	20.1%
Greenville , SC	9.3%	12.6%
Fort Lauderdale , FL	9.2%	19.4%
Indianapolis , IN	8.9%	10.9%
Salt Lake City , UT	8.9%	15.3%
Greensboro , NC	8.8%	15.1%
Charlotte , NC	8.7%	16.1%

Top 10 areas with the strongest 12-month absorption

	Q3 2022	Q3 2021
New York, NY	29,348	33,699
Dallas-Fort Worth,TX	13,436	47,696
Los Angeles, CA	13,133	31,103
Washington, DC	13,055	21,708
Houston, TX	11,420	37,419
Chicago, IL	10,322	19,738
Austin, TX	10,029	20,327
Minneapolis, MN	9,754	11,259
Seattle, WA	8,415	17,524
Boston, MA	6,667	16,158

Source: NAR analysis of CoStar data

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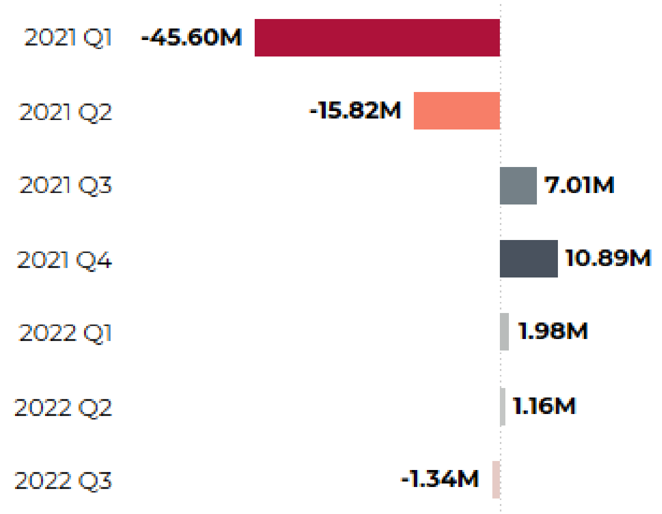
Office

Net absorption in the last 12 months: 12.7 million sq.ft.
Rent growth in the last 12 months: 1.1%
Cap rate: 6.9%

Although more people are returning to their offices, the office sector continues to struggle. In August 2022, 6.5 percent of employed persons teleworked because of the coronavirus pandemic, down from 7.1 percent in the prior month. However, after four quarters with positive net absorption, demand for office space dropped as net absorption turned negative again. As a result, more office spaces are vacant as the vacancy rate rose to 12.4% in Q3 2022 from 12.1% a year earlier.

Net Absorption by quarter in sq. ft



At the local level, Boston, MA, San Jose, CA, Dallas-Fort Worth, TX, Austin, TX, and Atlanta, GA experienced the most robust demand for office space in the last 12 months ending in Q3 2022.

In contrast, net absorption was negative in the last 12 months ending in Q3 2022 in the following areas: New York NY, San Francisco, CA, St. Louis, MO, Chicago, IL, and Minneapolis, MN. Office occupancy dropped by more than 1 million square feet in these areas.

Top 10 areas with the strongest 12-month absorption

	Q3 2022	Q3 2021
Boston, MA	4.57M	-4.98M
San Jose, CA	3.74M	-0.96M
Dallas-Fort Worth, TX	3.51M	-0.91M
Austin, TX	2.41M	1.35M
Atlanta, GA	2.03M	-2.65M
Charlotte, NC	1.70M	-0.83M
Las Vegas, NV	1.46M	0.02M
San Diego, CA	1.42M	0.00M
Raleigh, NC	1.18M	-0.21M
Miami, FL	1.14M	0.78M

Top 10 areas with the slowest 12-month absorption

	Q3 2022	Q3 2021
New York - NY	-2.52M	-22.84M
San Francisco - CA	-2.26M	-4.61M
Saint Louis - MO	-2.12M	-1.52M
Chicago - IL	-1.79M	-6.79M
Minneapolis - MN	-1.03M	-2.33M
Philadelphia - PA	-0.95M	-3.56M
Portland - OR	-0.91M	-1.41M
Hartford - CT	-0.89M	-0.31M
Richmond - VA	-0.82M	-0.03M
Baltimore - MD	-0.70M	-1.37M

Source: NAR analysis of CoStar data

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Industrial

Net absorption in the last 12 months: 425 million sq. ft.
Rent growth in the last 12 months: 11.8%
Cap rate: 6.1%

The industrial sector continued to outperform. Demand is very strong as net absorption was nearly 425 million SF in the last 12 months ending in Q3 2022. Although demand may have tapered, the volume of industrial space absorbed continues to be double that of pre-pandemic times. As a result, this sector had the lowest vacancy rate at 4% of any other sector in the commercial real estate market.

At 11.8% year-over-year, U.S. industrial rent growth remains near historic highs. Rents are rising even faster for logistics space is up on average 13.5% year-over-year compared to 8.6% for flex space and 9.7% for specialized space.

Dallas, TX had the largest absorption of industrial space in the past 12 months. . Chicago, IL, Houston, TX, Atlanta, GA, and Phoenix, AZ, absorbed more than 20 million square feet over the past 12 months ending in Q3 2022.

In contrast, Miami, FL, Inland Empire, CA, Fort Lauderdale, FL Columbus, OH and Phoenix, AZ experienced the largest rent gains.

Top 10 areas with the strongest 12-month absorption

	Q3 2022	Q3 2021
Dallas-Fort Worth, TX	34.31M	41.23M
Chicago , IL	33.65M	35.42M
Houston , TX	29.62M	33.09M
Atlanta , GA	24.81M	30.43M
Phoenix , AZ	23.41M	25.88M
Indianapolis , IN	14.31M	12.92M
Columbus , OH	14.26M	15.76M
Denver , CO	12.74M	3.21M
Memphis , TN	11.47M	14.55M
San Antonio , TX	10.84M	4.49M

Top 10 areas with the slowest 12-month absorption

	Q3 2022	Q3 2021
Columbus , GA	-890.6K	0.09M
Providence , RI	-860.4K	-0.66M
Springfield , MA	-707.4K	0.38M
Colorado Springs , CO	-429.4K	4.76M
Santa Rosa , CA	-411.5K	0.96M
Pine Bluff , AR	-387.0K	-0.03M
Manhattan , KS	-314.0K	0.02M
Chico , CA	-293.2K	0.29M
Utica , NY	-282.1K	2.13M
Yakima , WA	-280.6K	-0.20M

Source: NAR analysis of CoStar data

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Retail

Net absorption in the last 12 months: 87.7M sq. ft.
Rent growth in the last 12 months: 4.4%
Cap rate: 6.8%

Although the spending power of consumers has decreased due to elevated inflation, the retail sector continues to be solid. **Retail sales** – excluding gas, auto, and non-store retailers advanced to $383 billion in August – a 19 percent increase from pre-pandemic levels (August 2019).

As a result, **U.S. net absorption** remained positive for seven straight quarters, increasing in the third quarter of 2022 to 23.3 million square feet – a 22 percent increase from the second quarter. However, over the last 12 months, net absorption slowed to 87.7 million square feet from 94.3 million square feet in the second quarter of the year. By type of retail stores, general retail and neighborhood centers have driven the demand, accounting for nearly 90% of the net absorption.

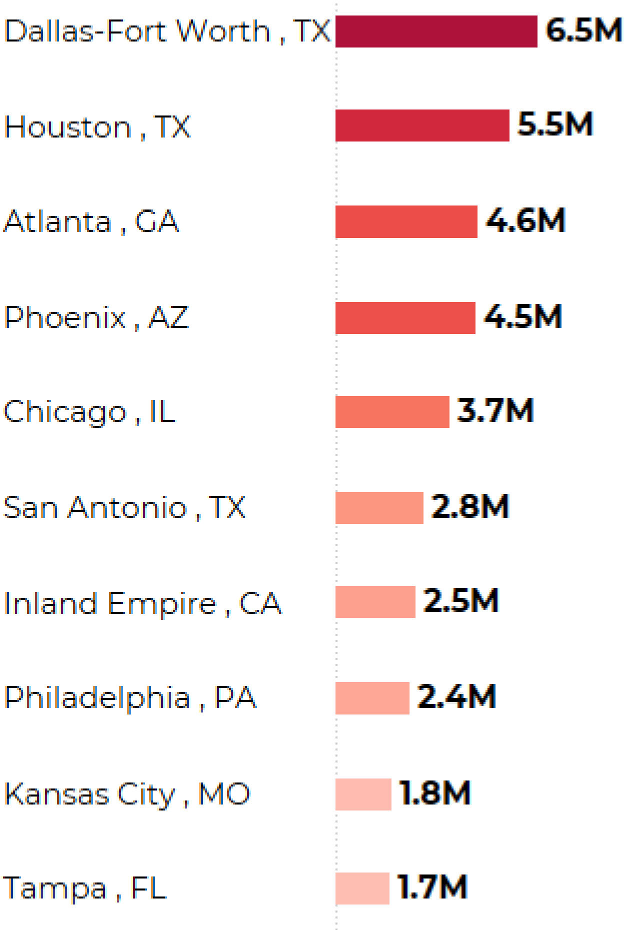
12-month Net Absorption by type (Q3 2016, Q3 2019 and Q3 2022

	Q3 2016	Q3 209	Q3 2022
General Retail	74.77M	17.03M	40.05M
Mall	10.20M	-3.56M	1.58M
Neighbor hood Center	35.71M	12.67M	29.74M
Other	2.09M	-0.03M	1.10M
Power Center	5.29M	1.29M	8.11M
Strip Center	13.90M	5.22M	6.58M
All	**142.28M**	**32.90M**	**87.69M**

With both retail sales and inflation rising, **retail asking rents** increased by 4.4% - the second-fastest increase in the last decade. While rents are rising across all types of retail stores, neighborhoods (5.3%) and strip centers (5.1%) experienced the highest rent gains.

At the **local level,** demand for retail space was robust in the Dallas, TX, Houston, TX, and Phoenix, AZ metro areas, as these areas experienced the most significant net absorption in the last 12 months in the retail sector.

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



Source: NAR analysis of CoStar data

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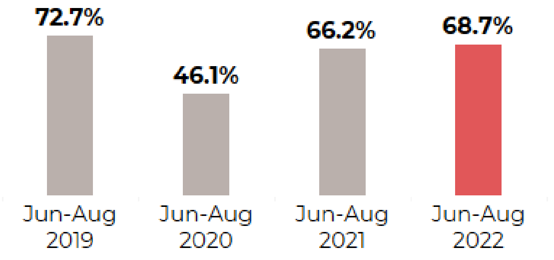
Hotel

Occupancy rate in the last 12 months: 61.7%
Average daily rate in the last 12 months: $143/room
Revenue per available room in the last 12 months: $88/room

During the summer months (June-August), hotel occupancy rose to 68.7% from 66.2% the previous year. However, hotel occupancy remains below the pre-pandemic level as inflation remains elevated.

3-month occupancy rate in August



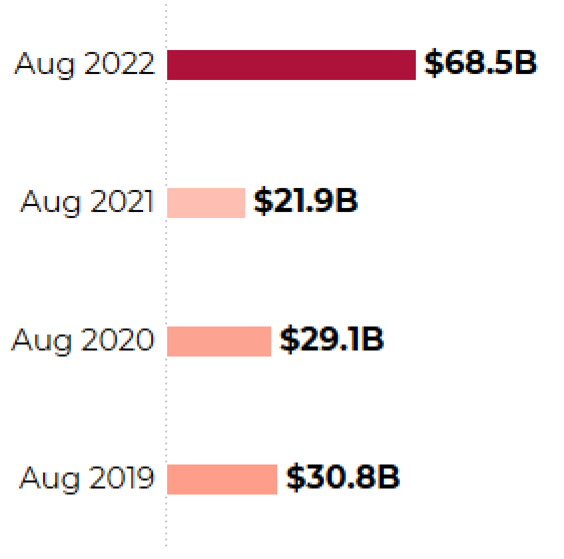
As a result, the 3-month average daily rate (ADR) per room rose to $155/room, up 13% from a year ago. The revenue per available room (RevPAR) also increased to $107/room, up 17% from last year.

3-month ADR and RevPAR in August

	Average daily rate	Revenue per available room
Jun-Aug 2019	$134	$98
Jun-Aug 2020	$100	$46
Jun-Aug 2021	$138	$91
Jun-Aug 2022	$155	$107

Sales acquisitions have been rising since 2021. As of August, the 12-month sales volume rose to $68.5 billion, from $21.9 billion one year ago. Sales data does not provide information if the investors intended to continue operating the hotels as hotels or undertake adaptive reuse, such as for residential purposes. However, most acquisitions were of luxury, upper upscale, and upscale hotels. As of August 2022, occupancy rates in the luxury and upper upscale sectors were below 60%, indicating that the hotels may be converted for other uses.

12-month sales volume as of August



Source: NAR analysis of CoStar data

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

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COMMERCIAL REAL ESTATE REPORT
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