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Summertime...the living is easy? - by Bill Pastuszek

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Here it is, more than halfway through July. Commercial real estate (CRE) markets are scraping by, volumes are down, rates are still up, and there are few transactions. There is no clear trend from quarter to quarter. The most noteworthy part of the summer so far has been a long – but incredibly hot – Fourth of July weekend. The temperatures seemed to be in direct opposition to the coolness of CRE markets and that coolness provides little solace for those working in those markets.

What follows consists of observations collected from a variety of comments on how various property sectors are being viewed by market observers. A particular goal in this research undertaking was to find “common threads” among the sectors reviewed. One immediate takeaway was that while specific markets perform differently depending on their location and amenities, it is possible to draw meaningful conclusions from this type of “macro” level information.

Industrial. While the U.S. industrial market continues a deceleration, overall markets continue to perform positively. Net demand is reported to be stable if not positive, asking rental rate growth persisted, and absorption was generally positive. Vacancies were modestly higher, rental growth rates were slower, and the construction pipeline showed a slowing.

Multi-Family. Job and wage growth affect multi-family markets. With jobs added earlier in 2024, there is demand for units. Construction has been affected by high interest rates. However, absorption indicates demand for units in many, but not all, markets. Declines in vacancies reportedly occur at the expense of rent growth.

Office. Office demand continues to be negative. This has been the case for a couple of years and this trend is likely to continue. The best that one commentator was able to say was that the rate of negative absorption in office seemed to be slowing. As would be expected, construction demand was way off, given the lack of demand and high interest rates. Lenders are busy with workouts with borrowers with troubled office properties. Also, as would be expected, there is a flight toward quality by investors, tenants, and occupiers, both in terms of locations and building amenities, layouts, and age.

The Challenges of Down Markets. For anyone engaged in real estate valuation, the great challenge is to understand pricing, values, and cap rates when there isn't a lot of transactional activity. This is true for brokers, owners, managers, lenders, investors, and appraisers, among others.

Limited transactions make the job of understanding already complicated market activity even harder. Sometimes the answers lie in what is not happening, what's not selling or renting, or what is not getting developed. It helps to spend some time having conversations with peers and market movers and makers.

Conclusions. Common threads in the articles and surveys reviewed include:

a: challenges in capital market environments exist with downturns in construction across sector;

b: the cost of money continues to be a reality;

c: recognition that the overall economy is performing “well enough” with job creation taking place: real estate has its own unique set of challenges;

d: there is no rapid CRE recovery on the horizon; and

e: continued cautious, or, non-existent, investor behavior.

For investors and analysts of investor behavior, it's not completely doom and gloom. There are opportunities for properties even in the down environments of current markets. For appraisers, it may be necessary to go back in time to find relevant comparisons and that must be done with care in order to replicate today's conditions as an adjustment to an older comparable. Not relating today's market to a two-year old sale can result in distorted, unrealistic, if not outright incorrect, value conclusions!

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