



Occupier Outlook

United States Overview:
The Economy and its Impact on Commercial Real Estate



Executive Summary

Macro Economic View

- Labor market defies expectations, keeping unemployment rates near record lows, BUT there are caveats
- Preliminary GDP records the biggest expansion in Q4 seen in seven quarters
- Inflation falls, but remains higher than pre-pandemic levels
- Fed likely to conservatively raise rates in 2024, as 10-year treasury notes remain above past 20-year historical average
- Consumer spending surpasses expectations in Q4, sentiment is low
- Housing starts slow, sale prices creep higher

Office Market Fog Begins to Clear

- Remote work trends appear to be holding steady
- Negative net office absorption continues, but sublease space retreats
- Office deals are getting done, but pace slows and deal size shrinks
- Trophy and other top-end office properties remain competitive, following a flight-to quality

Industrial Cools and Retreats to Mean

- Rates push higher, but annual increases slow to under four percent
- Construction starts fall by nearly 50 percent in 2023, with new deliveries, vacancy, availabilities, and sublease space increases

**Resilient Economy Pushes Forward,
While Commercial Real Estate Faces Challenges**



Mixed Signals Indicate Caution Ahead

The predicted 2023 recession never materialized as consumers and businesses continued to spend despite increased borrowing costs. Economic expansion blew past expectations, growing by 4.9 percent in the third quarter with households spending down their excess savings on pent-up demand for recreation and entertainment activities.

Still, there has been a slowdown in some areas, with manufacturers reporting that new orders for products have fallen, leading to a contraction in factory activity.

The housing market has seen a decrease in sales velocity as rate increases have stalled new listings due to the benefit of remaining in a low fixed-mortgage rate. Further, home prices have dipped as the momentum of steep increases over the past few years have stalled.

Despite tightening financial conditions and higher business costs, the labor market has remained resilient. However, scratching the surface deeper shows job openings retreating and increasing layoff announcements indicate a slowdown. Further, a large percentage of jobs being created are in the service and healthcare sectors, while traditional higher-paying office-occupying jobs have slowed or decreased.

Economy Exceeds Expectations and Eyes a Soft Landing

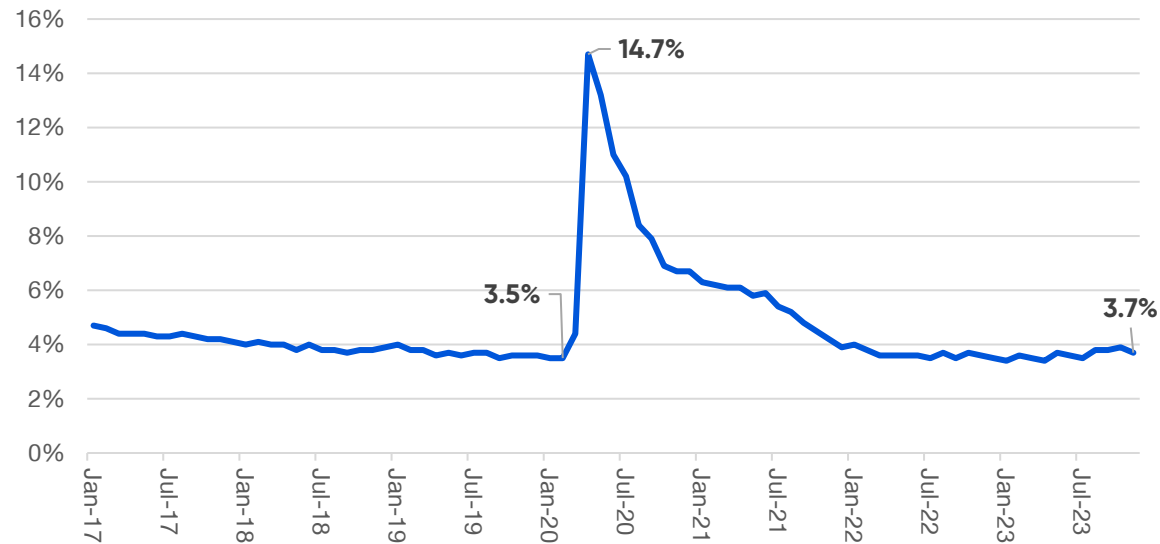


Unemployment

Unemployment Remains Low

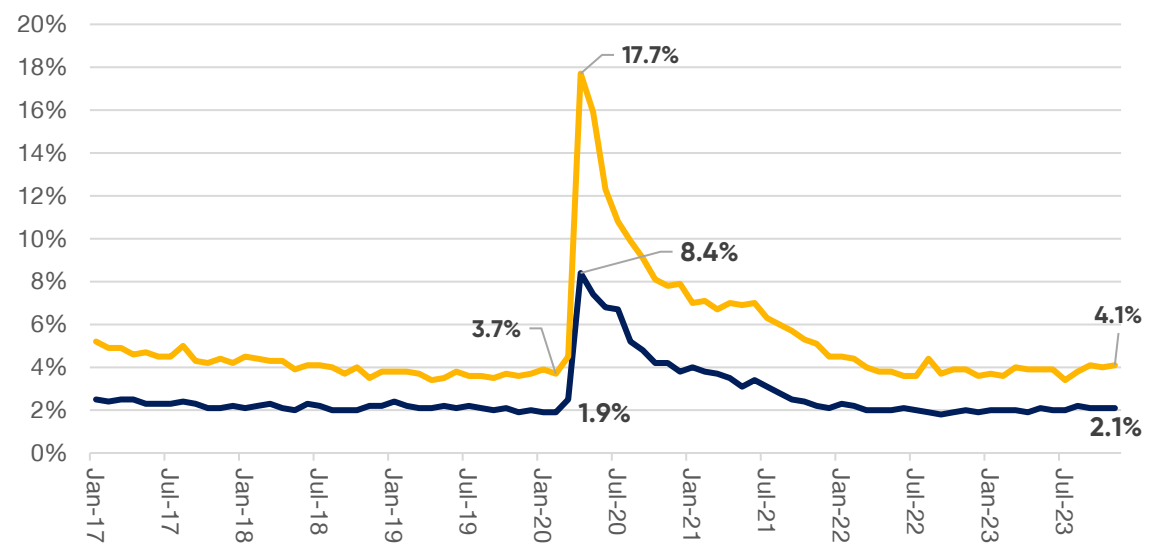
Unemployment remains near historic lows. Fed rate increases are expected to slow as inflation has fallen. College educated employees remain near full-employment despite recently announced layoffs in the tech industry. Additionally, lower-skilled service-oriented jobs are the main driver of job growth.

Total Unemployment: (United States)



Source: U.S. Bureau of Labor Statistics, <https://bls.gov>

High School Only vs. Bachelor's Degree or Higher



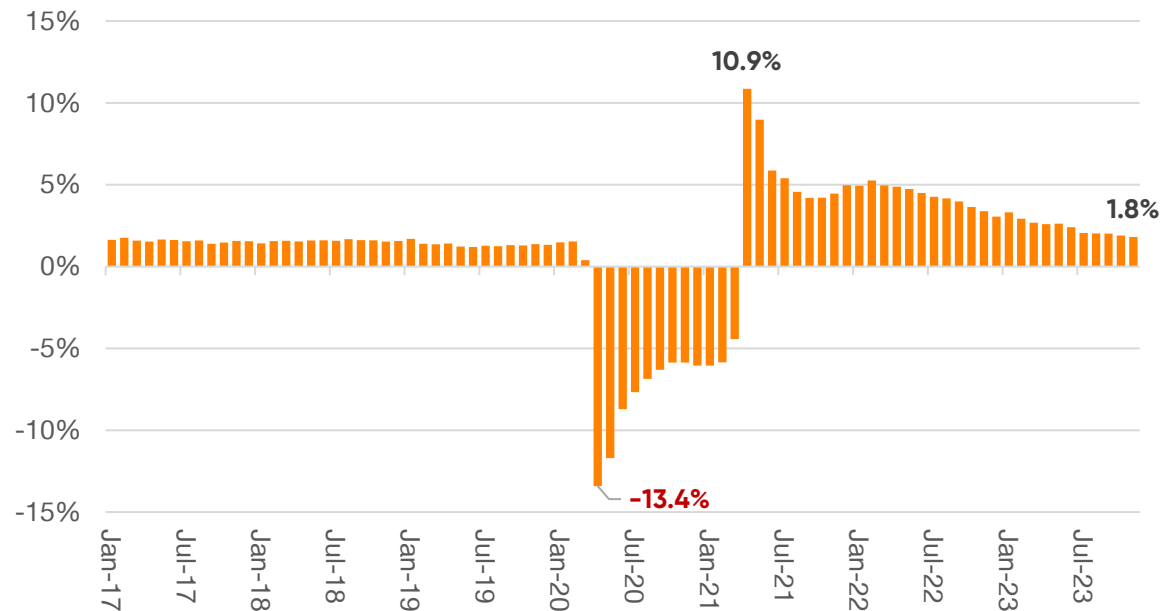
Source: U.S. Bureau of Labor Statistics, <https://bls.gov>

Employment

Job Creation Defies Expectations With Continued Strong Gains

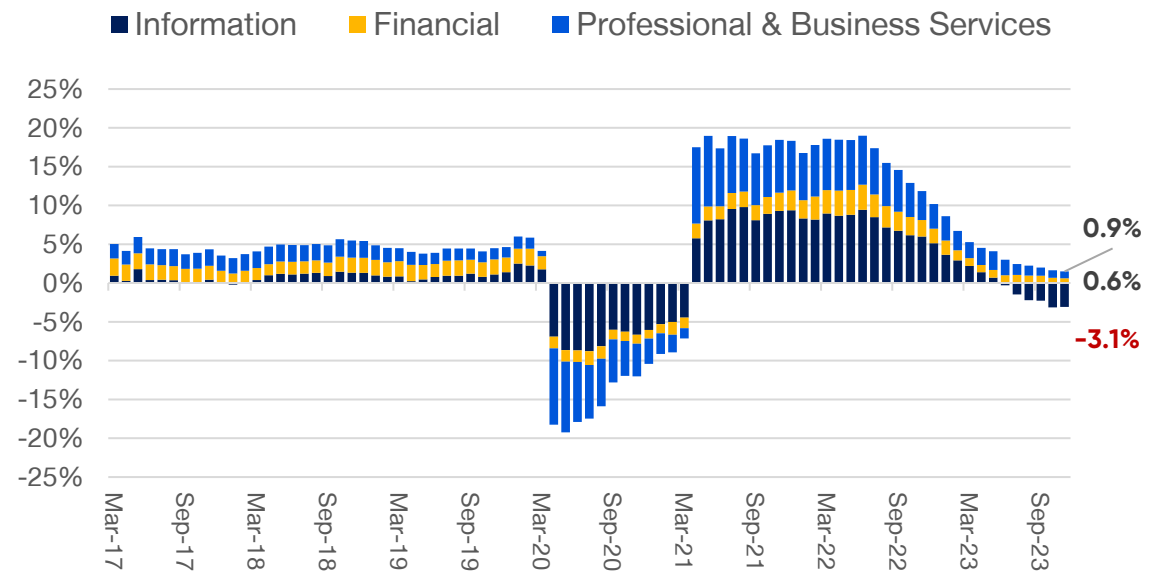
Total nonfarm payroll employment rose by 216,000 in December, surpassing expectations. Job gains occurred in government and healthcare jobs underpinned the growth. Office-occupying job creation is slowing, with information sector jobs down 3.1 percent from a year earlier.

All Job Sectors (12-Month Change)



Source: U.S. Bureau of Labor Statistics, <https://bls.gov>

Office-Occupying Jobs (12-Month Change)



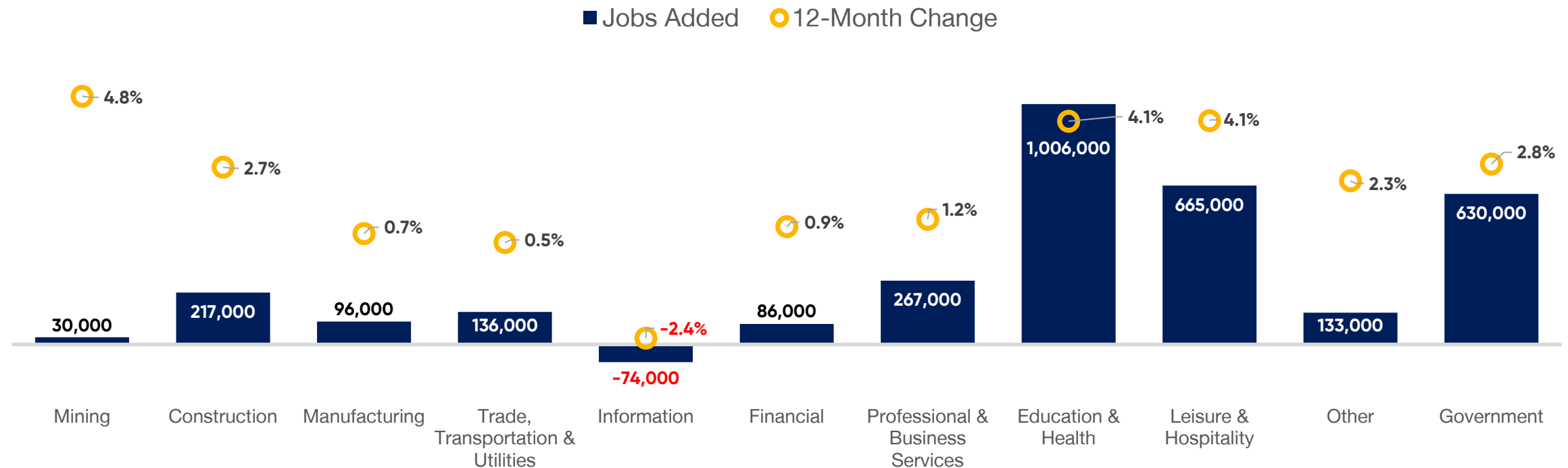
Source: U.S. Bureau of Labor Statistics, <https://bls.gov>

Employment

Education/Health and Leisure/Hospitality Lead the Way

Pent-up demand leads to increases in leisure and health services sector jobs. The jobs being added are not concentrated in office-occupying sectors, meanwhile nearly 450,000 jobs were created in the industrial sector last year, highlighted by the construction sector.

Job Creation by Sector (12-Month Change)

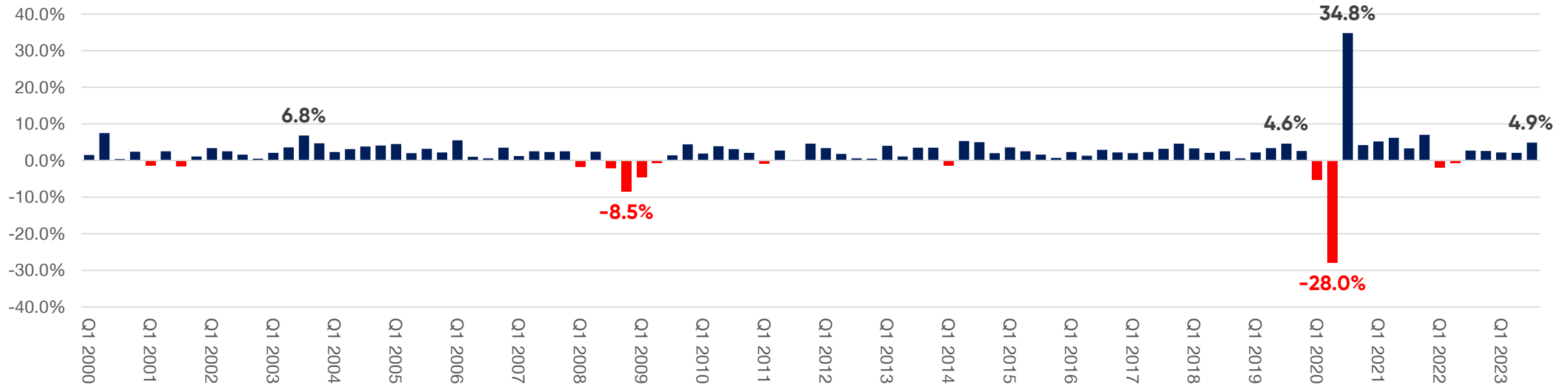


GDP

Gross Domestic Product Posts Fourth Consecutive Quarter of Growth

The GDP has expanded for the past five quarters. According to the *Bureau of Economic Analysis*, the increase in the third quarter primarily reflected increases in consumer spending and inventory investment. Profits increased 3.4 percent in the third quarter after increasing 0.2 percent in the second quarter.

Real GDP Percent Change from Preceding Quarter



Source [Real Gross Domestic Product \(A191RL1Q225SBEA\)](#) | FRED | [St. Louis Fed \(stlouisfed.org\)](#)

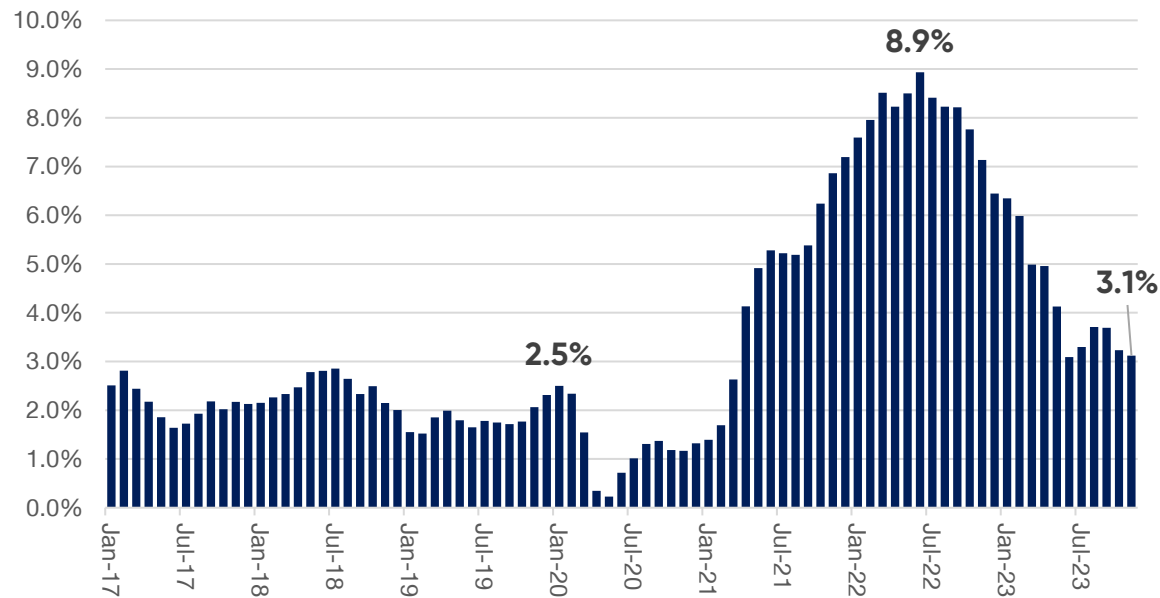
Note: Seasonally adjusted at annual rates, Bureau of Economic Analysis date published December 21, 2023 (third estimate).

Inflation

Inflation Ticks Lower for the Past Two Months After Brief Spike

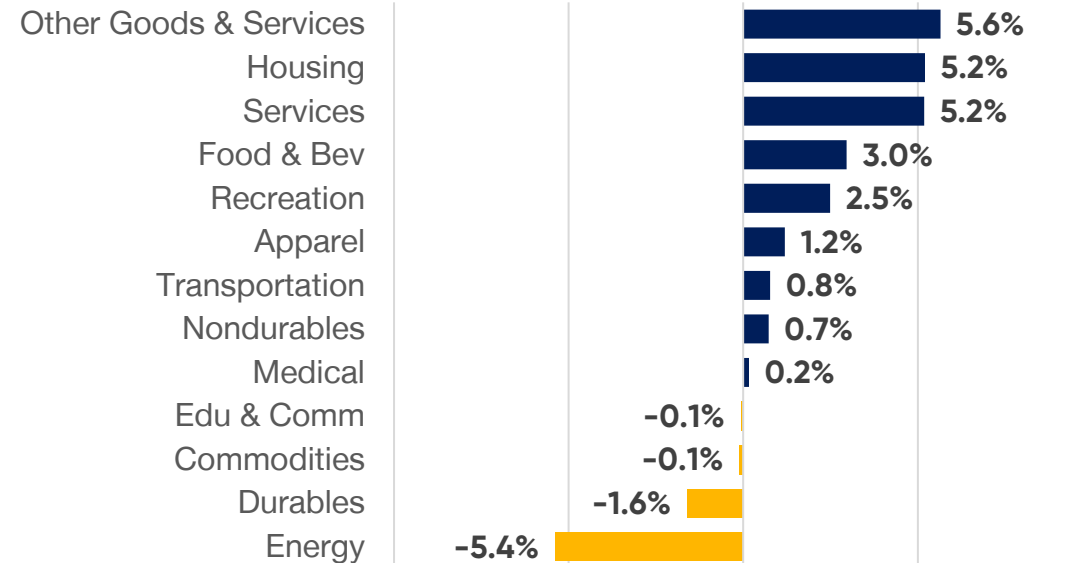
Driven by consumer demand, supply chain disruptions and a tight labor market, inflation pushed prices higher, peaking in June 2022. Inflation growth had slowed for 12 consecutive months, before ticking higher in mid-2023. Overall, inflation has slowed the past two months, led by energy and durable goods. The drop in durable goods means demand for big-ticket items like vehicles, household goods and electronics are slowing.

Consumer Price Index (12-Month Change)



Source: U.S. Bureau of Labor Statistics, <https://bls.gov>
Note: Seasonally adjusted, Data pulled January 2024.

Consumer Price Index by Sector (12-Month Change)



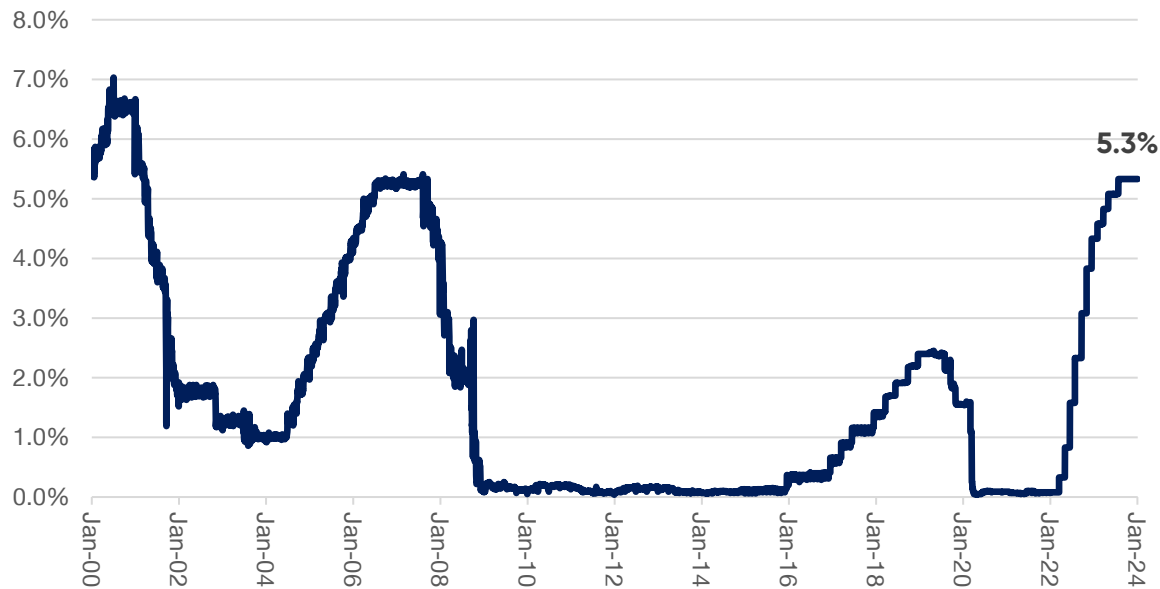
Source: U.S. Bureau of Labor Statistics, <https://bls.gov>

Monetary Policy

Rate Increases Pause as Fed Attempts to Control Inflation

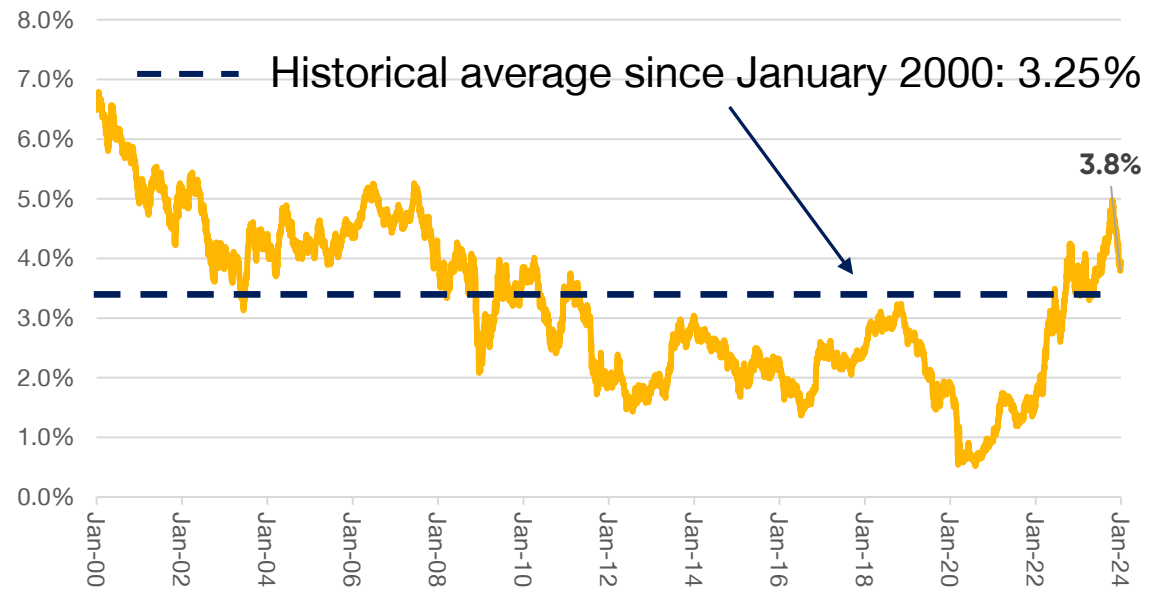
A series of increases in the Fed rate, including three 75bps increases in 2022, has bumped the range to 5.25% to 5.50%, the highest level in more than 20 years. The Fed has held rates steady after a 25-basis point increase in July. Rates are expected to increase only modestly heading into 2024. Meanwhile, the 10-year US treasury note, an indicator for broader investment confidence, has slowed, falling to 3.8 percent in late December.

US Effective Fed Fund Rate



Source: Federal Reserve Economic Data, <https://fred.stlouisfed.org>
Data is through December 2023

10-Year US Treasury Note



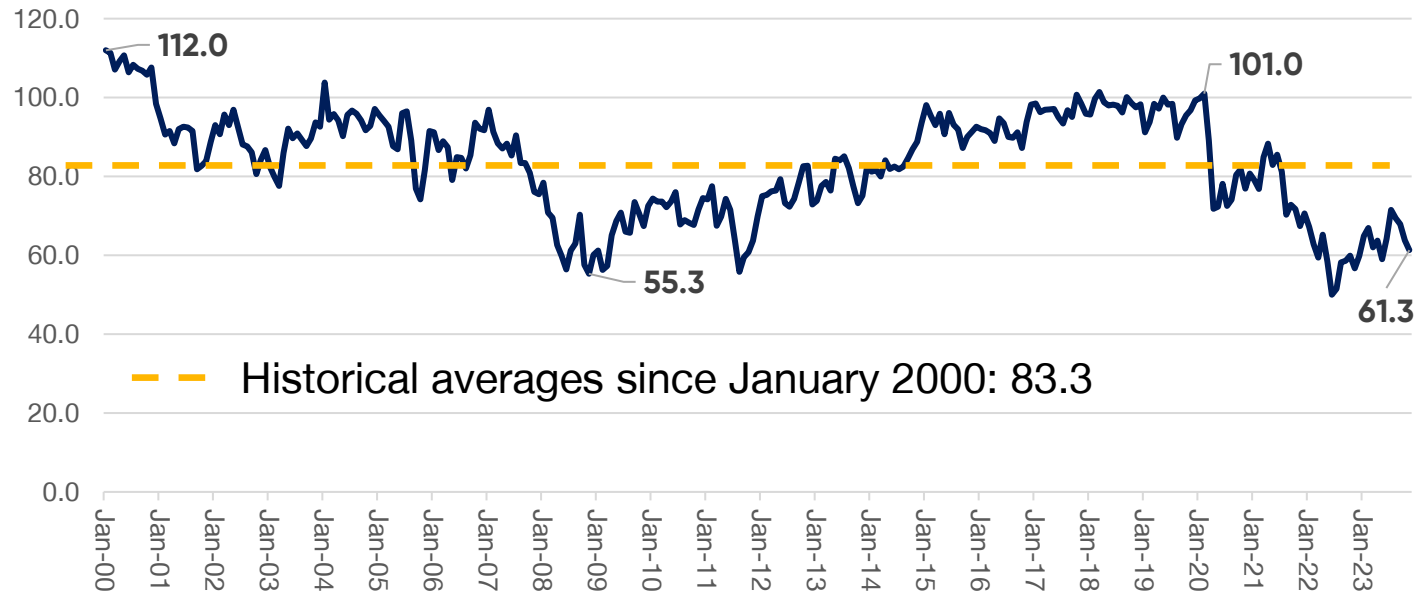
Source: Wall Street Journal
Data is through December, 2023

Consumers

Consumer Sentiment Remains Near Decade Low

Despite strong consumer spending related to pent-up demand, the consumer sentiment index has dropped precipitously since the beginning of the pandemic. The index is now (61.3) near levels following the end of the Great Recession in 2011 before going on a near decade long trend of increases leading up to the start of the Covid-19 pandemic. Moving into 2024, consumer sentiment is still well-below historical averages.

Consumer Sentiment Index: (United States Total)



Consumer Sentiment Index

Consumer sentiment is a statistical measurement of the overall health of the economy as determined by consumer opinion. It considers people's feelings toward their current financial health, the health of the economy in the short-term, and the prospects for longer-term economic growth.

Source: Federal Reserve Economic Data, <https://fred.stlouisfed.org>;

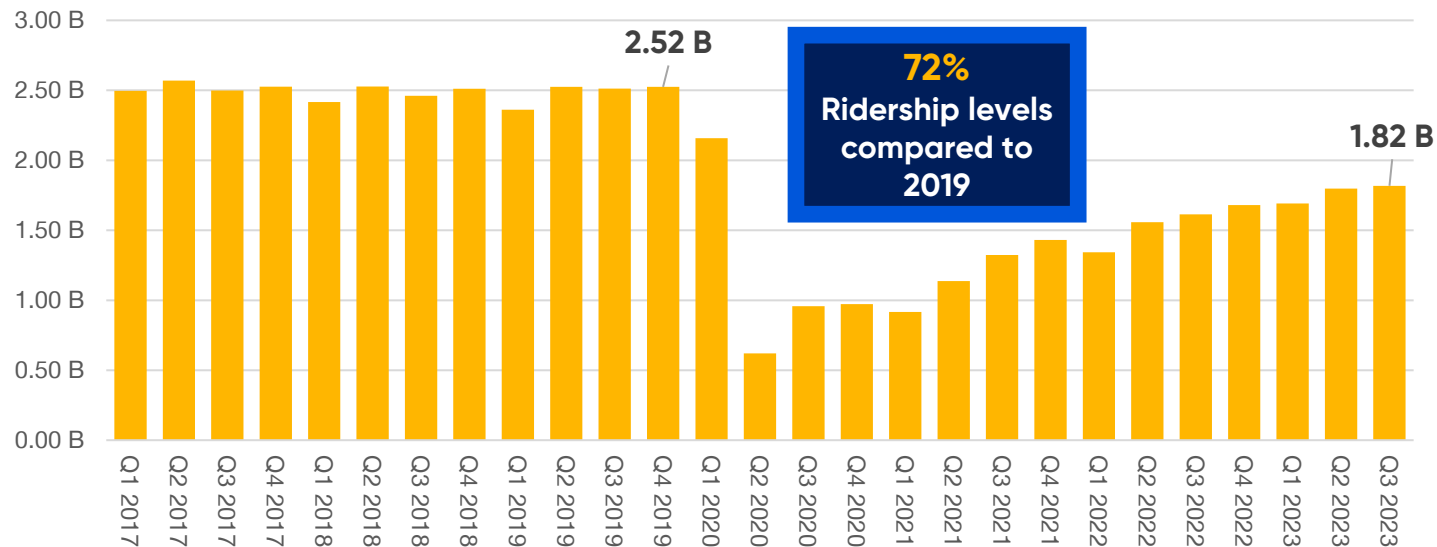
Note: Data thru August 2023

Public Transit

Public Transit Slowly Gains Momentum as Return-to-Work Ticks Higher

A good indicator of the health of an urban core, and by extension the downtown office market, is the use of public transportation. Public transit ridership increased for the past six quarters, experiencing a 35.8 percent increase since the start of 2022. As more workers return to the office, these increases are expected to continue. However, as return-to-work continues to stabilize, ridership levels will likely see only moderate gains.

Public Transit Ridership: (United States)



Ticket to Ride

Public transportation has been reliably consistent since the turn of the century. Sky-rocketing gas prices temporarily encouraged public ridership in 2008, but quickly dropped back to historic levels. During the first year of the declared pandemic, ridership was cut in half (52.8% decrease). The economy opened wider in 2021, but ridership still only increased 3.1 percent from the previous year. The beginning of 2022 marked the beginning of the economy opening back to near pre-pandemic levels, yet ridership on public transportation ended the third quarter of 2023 at 72 percent of the average ridership of 2019, the last full-year before the start of the pandemic.

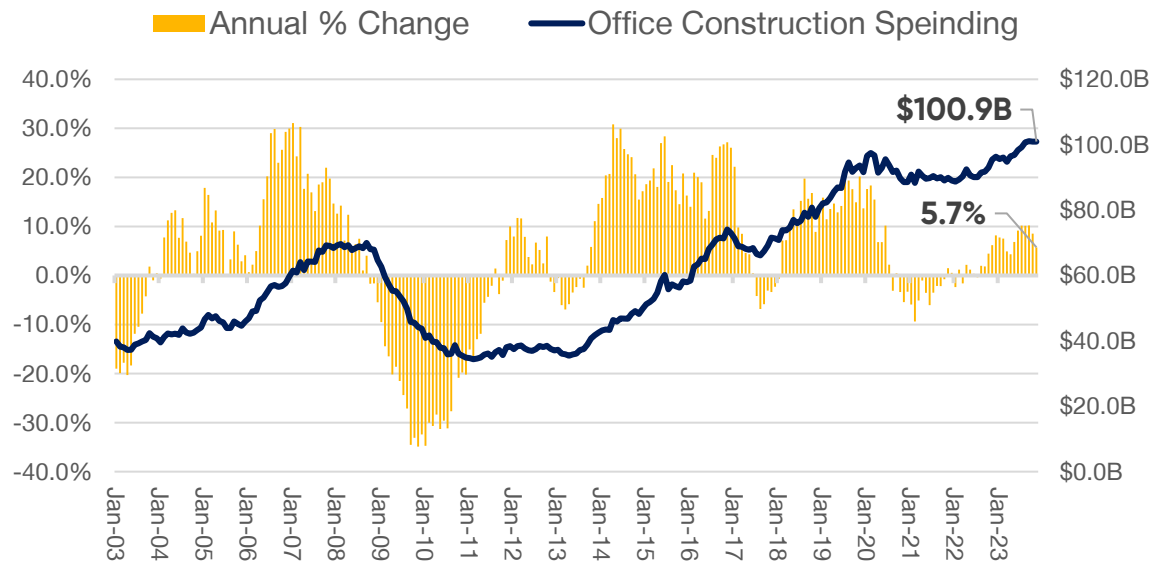
Construction

Office Construction Spending Slows, While Industrial Spending Peaks

Perhaps surprisingly, the amount spent on office construction has not fallen below pre-pandemic levels. New, well-located office construction with plentiful amenities are drawing interest from occupiers as they look to entice people to the office.

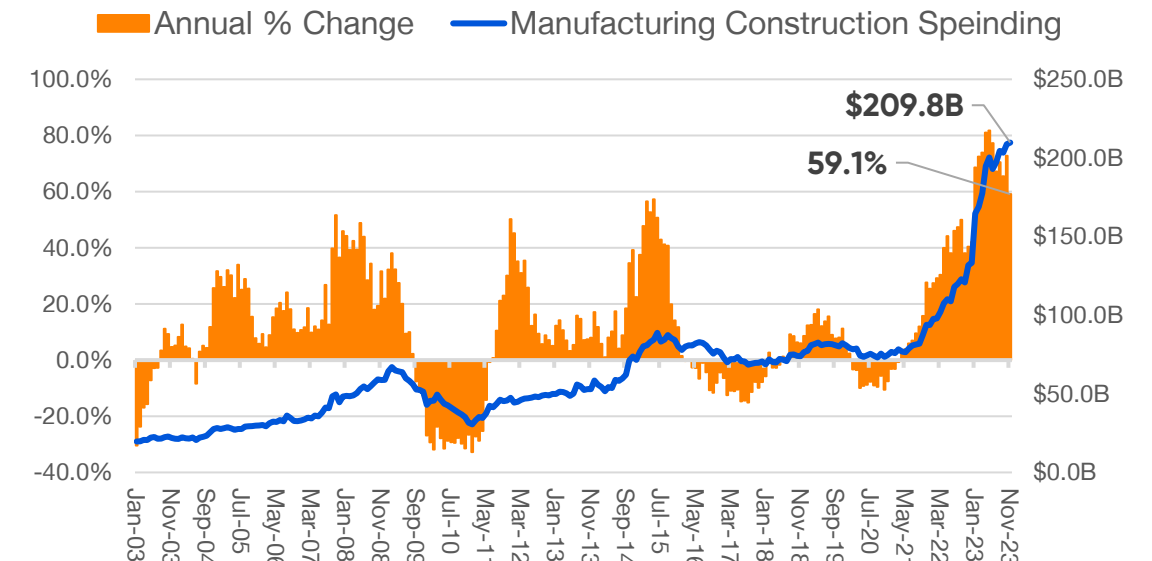
After sky-rocketing for the past three plus years, spending in the industrial sector has begun slowing from prior years. While still near record highs, spending will likely decelerate as investors/ developers wait to test demand as new products deliver.

Construction Spending: Office (\$ Millions)



Source: U.S. Census Bureau, <https://census.gov/construction>
Note: Data thru November 2023

Construction Spending: Manufacturing



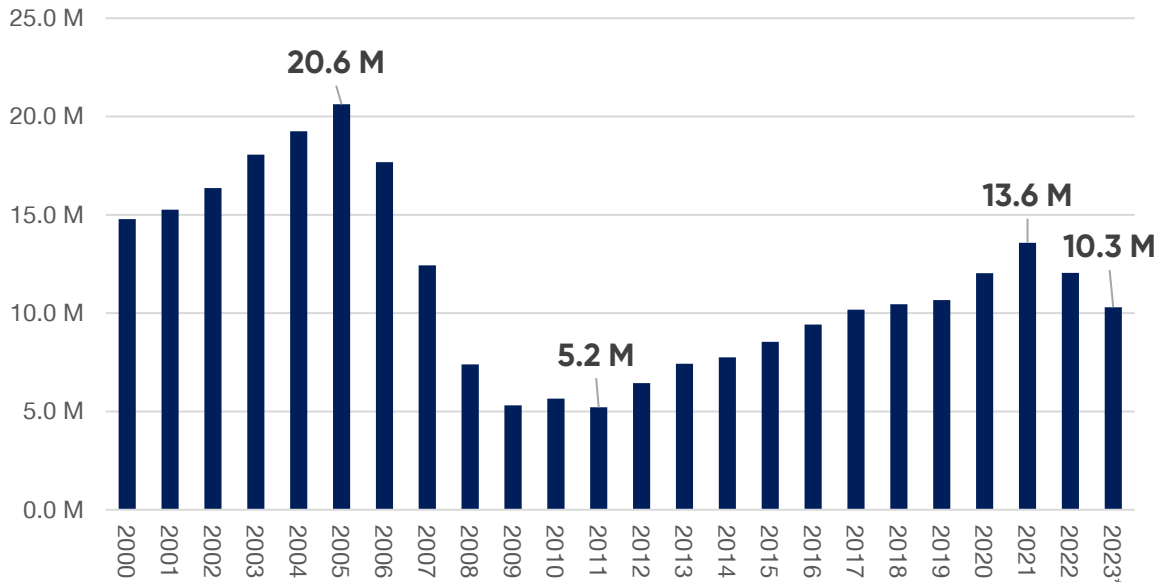
Source: U.S. Census Bureau, <https://census.gov/construction>
Note: Data thru November 2023

Housing

Housing Starts Contract, as Rising Interest Rates Slow the Market

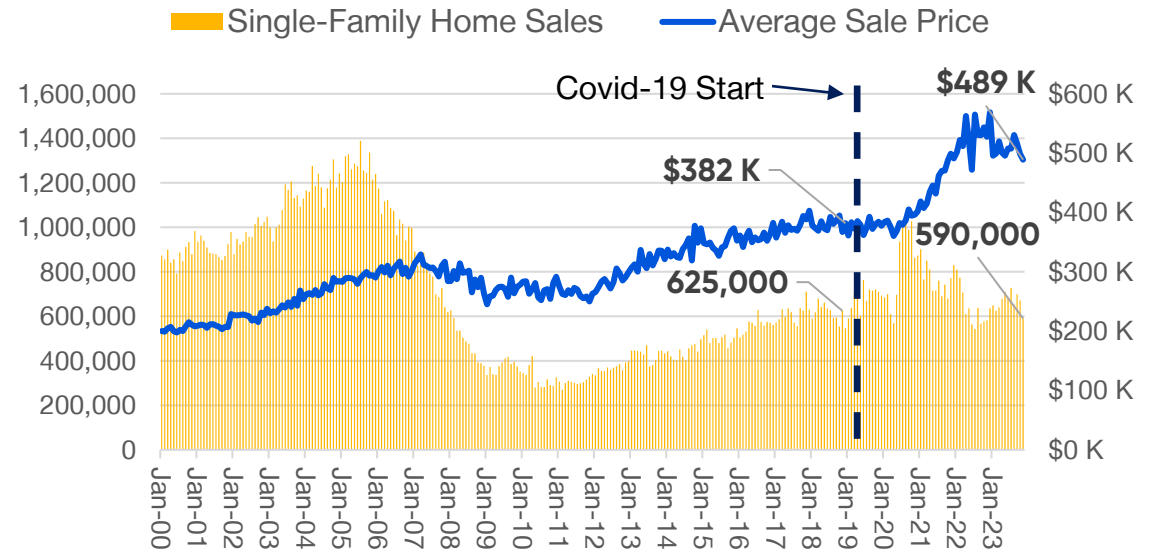
The number of residential housing starts soared at the start of the pandemic, while sale prices reached record highs in both 2020 and 2021. This growth is being tempered as mortgage rates increase, labor costs rise, and supplies remain scarce. The second half of 2023 is on track to match home starts closer to pre-pandemic levels. Meanwhile, prices have begun to fall as demand softens. After passing an average sale price of over \$569,000 to end 2022, prices have fallen 14.1 percent through November.

Residential Housing Starts



Source: U.S. Census Bureau, <https://census.gov/construction>
*Note: Data thru November 2023

Single-Family Homes: No. of Sales (Thousands) vs. Price



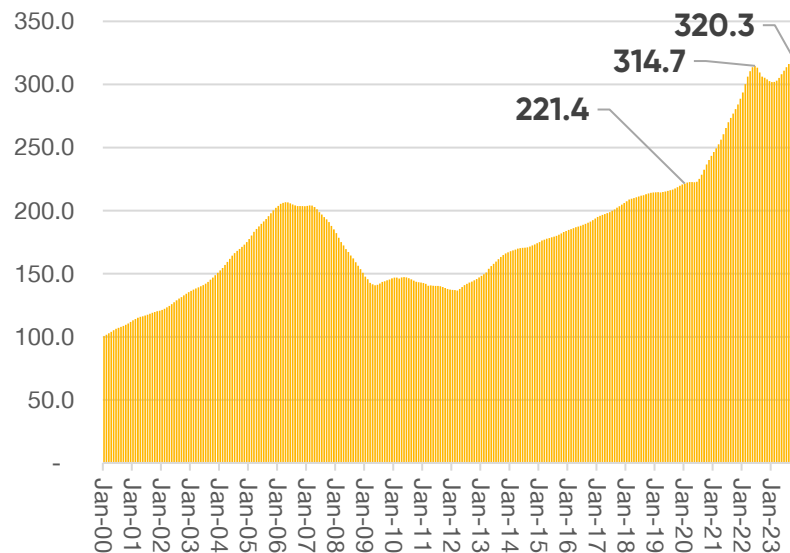
Source: U.S. Census Bureau, <https://census.gov/construction>
Note: Data thru November 2023

Home Price Index

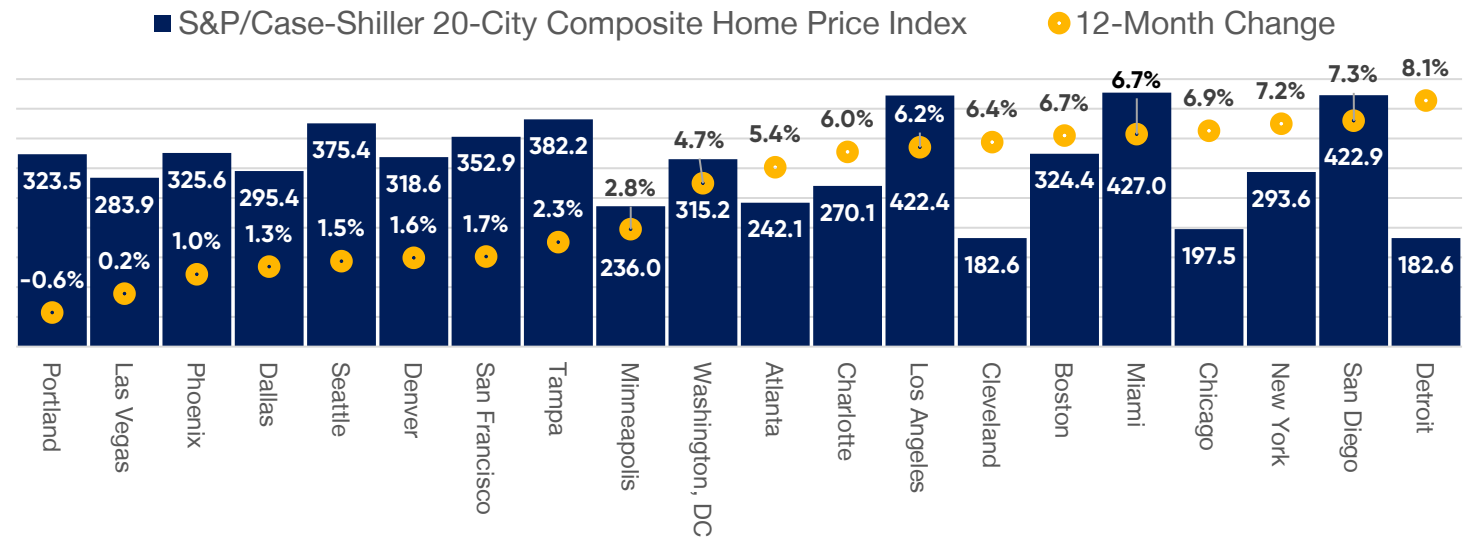
Case-Schiller Home Price Index Reclaims Recent Drops to Reach Record High

The Case-Schiller Index is an economic indicator that measures the monthly change in the value of the U.S. single-family home market. The 20-City Home Price Index peaked in June 2022 and dropped for 8-straight months, before ticking higher for the past five months closing October at a record high. Miami holds the highest Home Price Index, followed closely by Los Angeles and San Diego. Portland and Las Vegas have dropped the most in the past 12-months, while Detroit jumped the highest.

Home Price Index: 20-City Average



S&P/Case-Schiller Home Price Index: November 2023





Industrial Trends

The industrial market continues to downshift moving into 2024. Although the vacancy rate is drifting higher, it is not expected to rise above the 20-year average of 7.5 percent. As a record number of deliveries will be made in the next 12- months, landlords will likely have to work harder to either find tenants to both move into newly delivered space or backfill second generation space. A drop in home sales has caused disruptions in retail with stores like Bed, Bath, & Beyond and Ashley Furniture closing distribution centers. The slowdown in new construction will likely stabilize the market in the longer-term. Regardless, the outlook is still positive as consumer spending remains strong and the pull-back of new construction looks to stabilize the broader industrial market.

Industrial Tenant View

- Sublease space is increasing in the market as it has crossed pre-pandemic levels in terms of a percentage of total inventory.
- Second generation space is now becoming more readily available as occupiers move into new space .
- Emerging markets with lower costs such as labor and real estate are becoming increasingly desirable.

**Industrial Market Slows But
Fundamentals Point Higher**

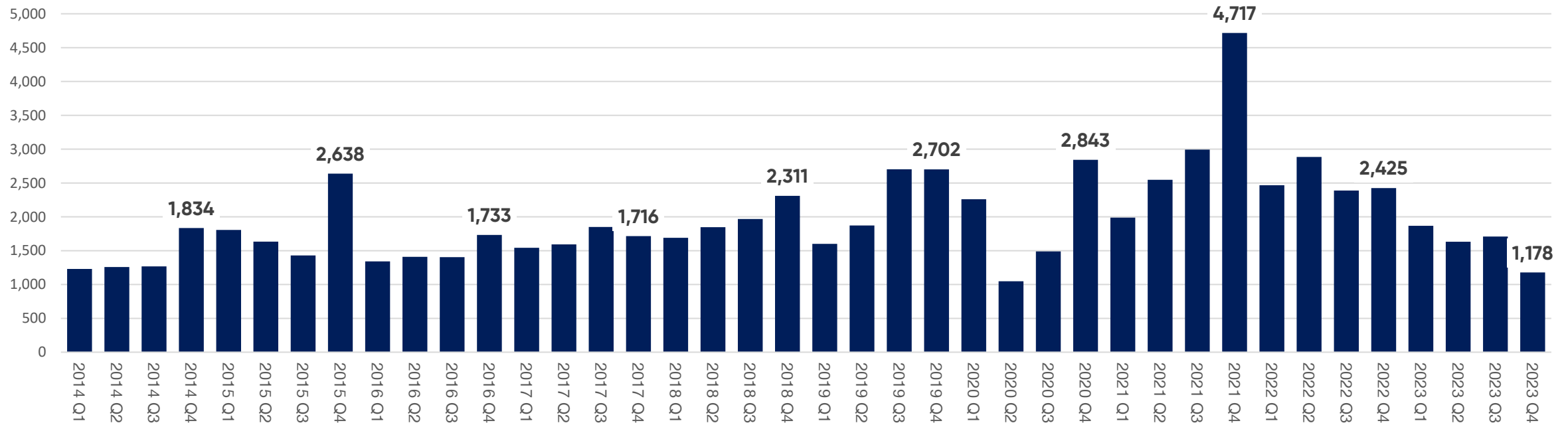
Q4, 2023

Capital Markets

Industrial Sales Velocity Decelerates

Strong demand has caused industrial sales velocity (number of sales) to nearly double in the year following the Covid lockdown. Warehouse/distribution spaces consist of nearly 70 percent of the sales volume in 2022. Higher interest rates, lack of available buildings for sale, and broad economic volatility have all contributed to the slower pace of sales in 2023.

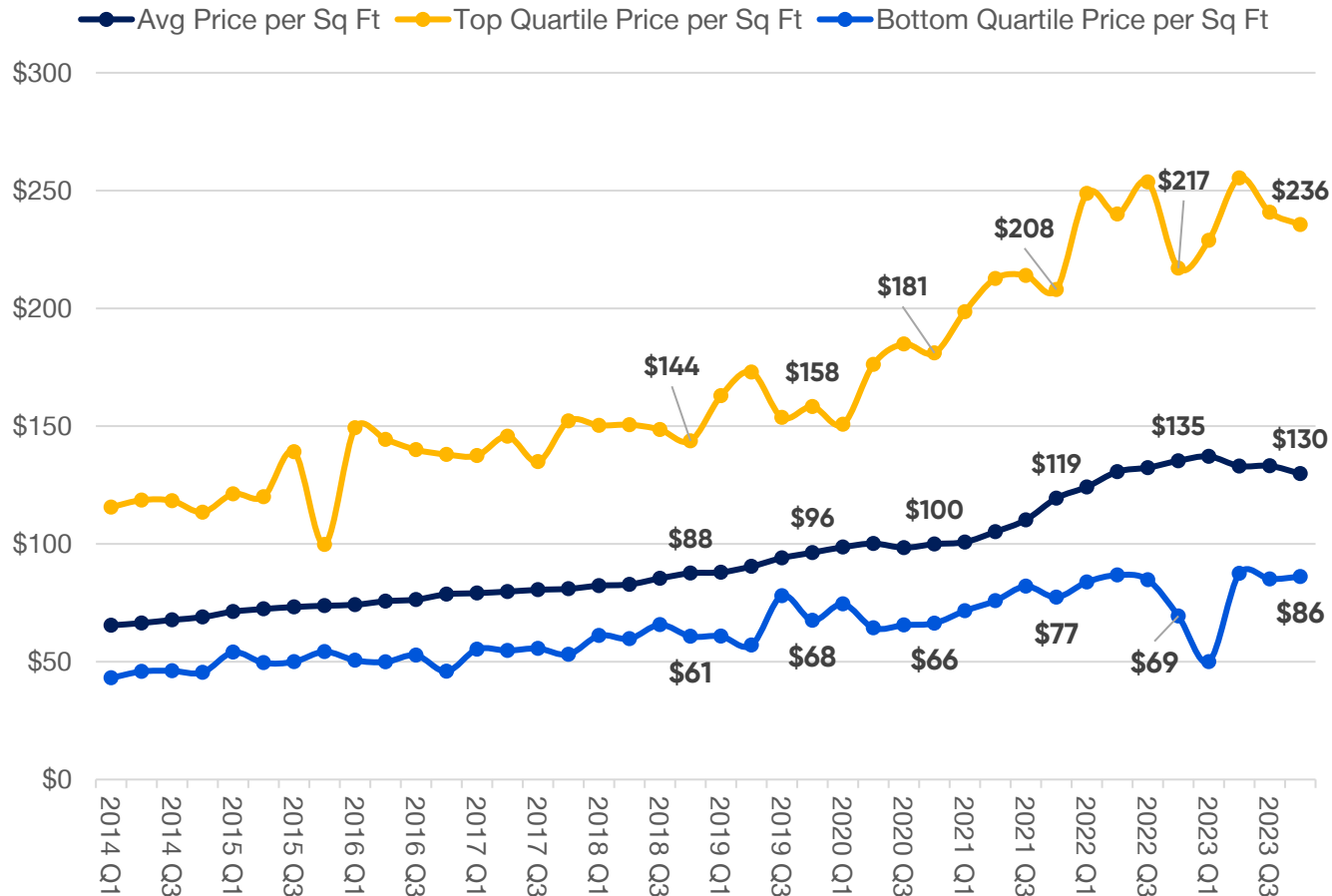
Industrial Sales Velocity: (United States)



Capital Markets

Industrial Sale Prices Per Square Foot Levels Off After Tremendous Increase

Average Industrial Sale Price/SF (United States)

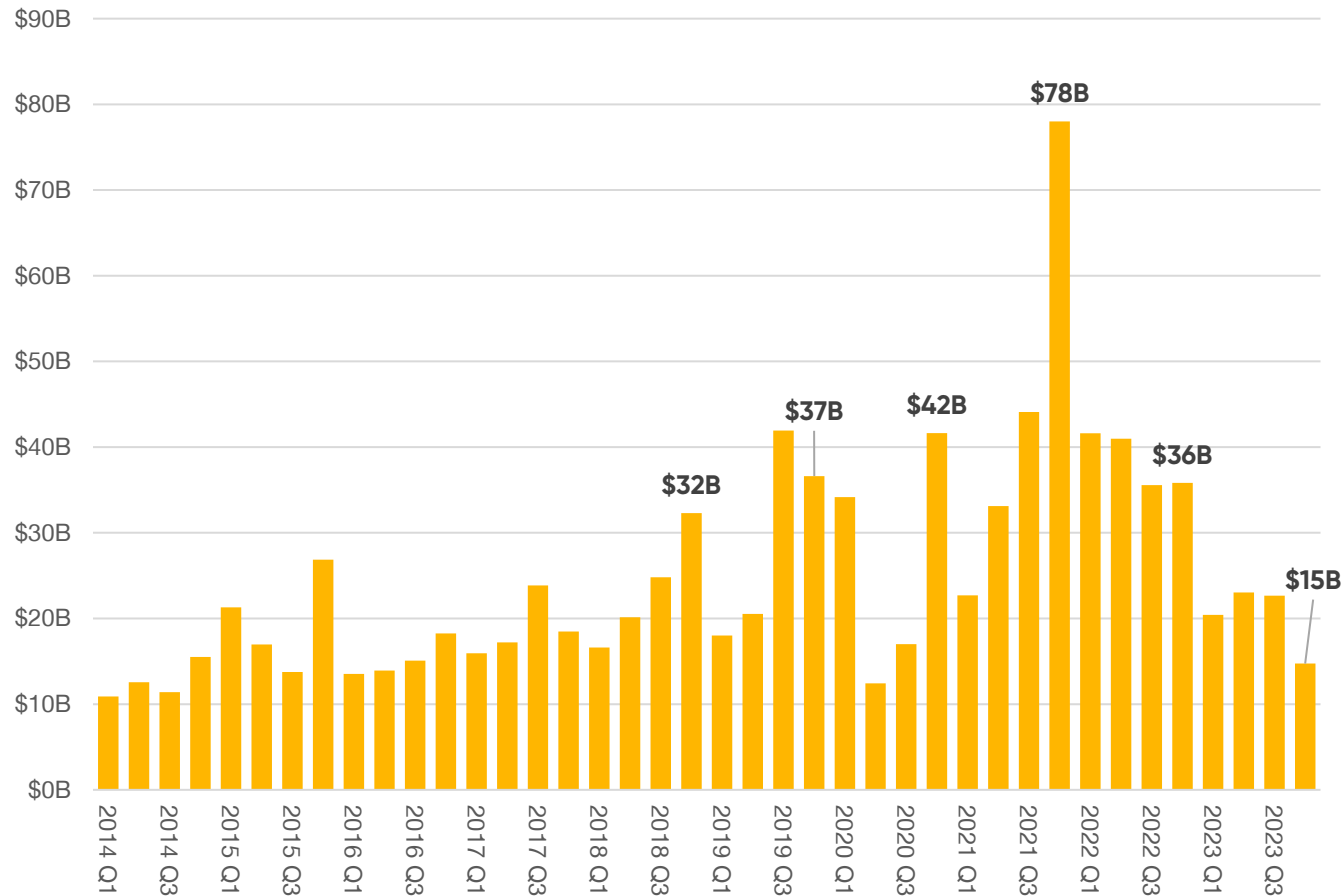


The average sales price per square foot of industrial properties has dropped slightly two of the past three quarters. Nevertheless, the average sale price of \$130 per square foot has still increased 35 percent over prices realized since before the start of the pandemic (fourth quarter of 2019). With the high volume of sales in the past four years, the pool of available properties, particularly newer, class A buildings, on the market is considerably down, potentially skewing numbers for the most recent quarter. Still, prices are trending flatter on a per square foot basis.

Capital Markets

Industrial Sales Volume Drops Off Record Highs

Industrial Sales Volume: (United States)

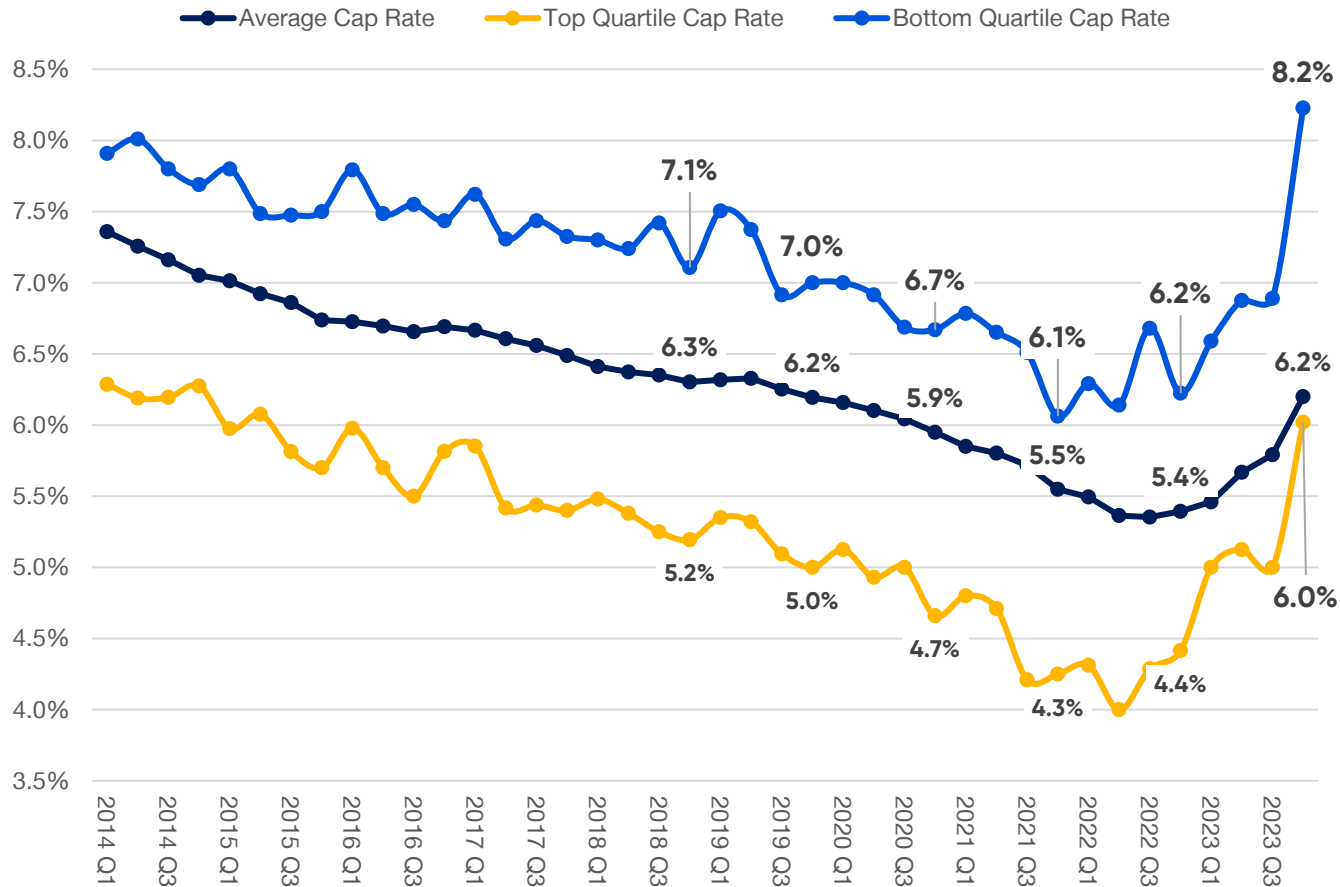


Sales volume, while trailing 2021 and 2022 levels, is still on pace to end the year at or near pre-pandemic levels. Higher prices have pushed volume higher, despite the number of total sales declining from prior years.

Capital Markets

Industrial cap rates float higher

Industrial Cap Rates (United States)



Economic volatility, increasing borrowing rates, and rising construction costs have pushed cap rates for industrial properties higher in the past 18 months. This higher risk has slowed overall sales and leveled prices paid for industrial assets. While there is still money available for investment in a stable asset class, the lack of available top-quality properties with modern amenities is causing hesitation in capital markets. The industrial market will likely adjust as economic conditions stabilize and the market better understands demand after buildings are delivered in the current robust industrial pipeline.

Leasing Trends

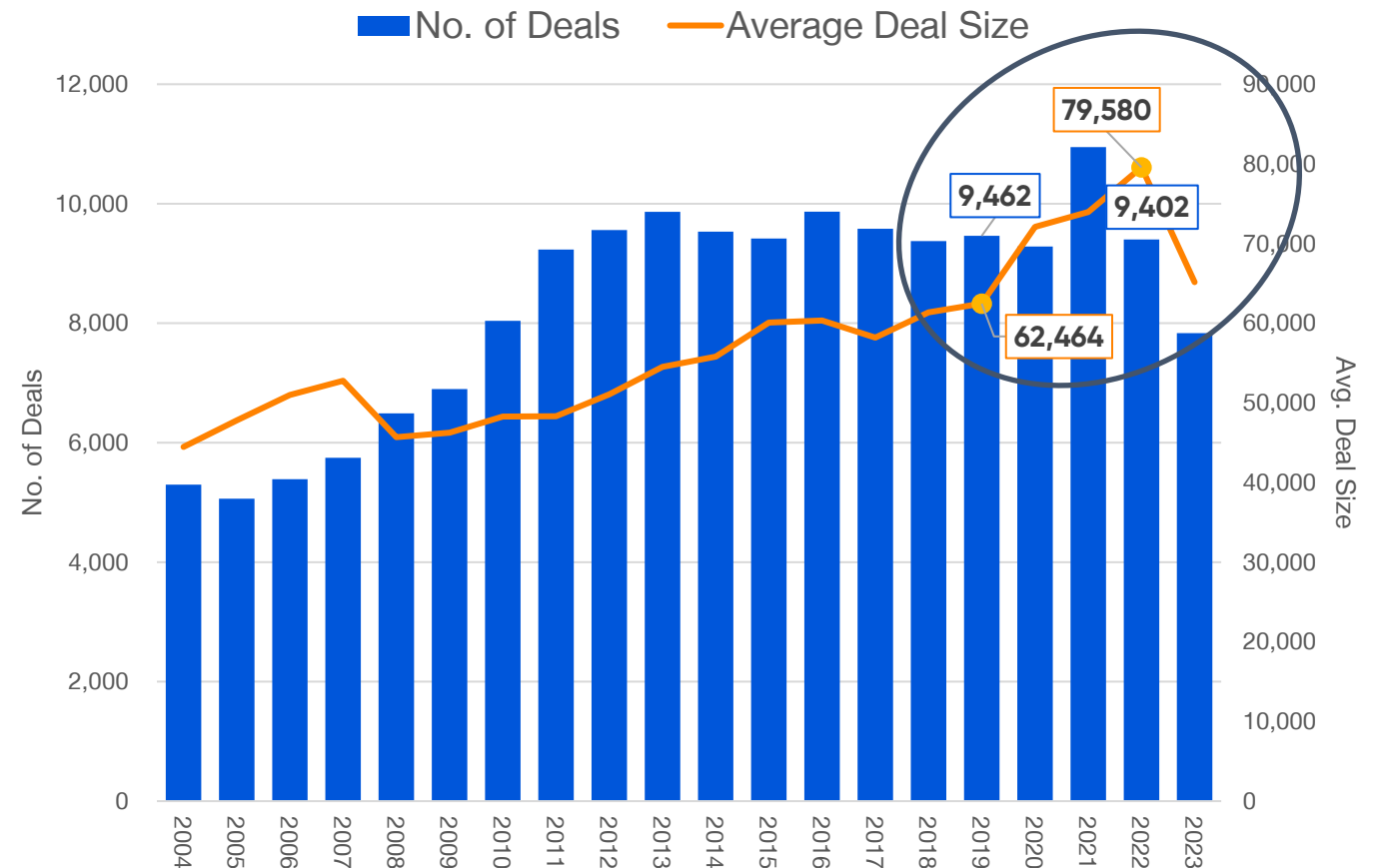
Transaction Size is Smaller Than 2019

Lease deal sizes in 2022 were **27.4 percent** larger compared to 2019.

While lease deals in the 2023 are smaller compared to 2022, lease deals have historically taken time to be recorded in CoStar.

The number of deals between 2022 and 2019 have stayed relatively flat, with deals peaking in 2021.

Historic Industrial Leasing Activity – Average Deal Size

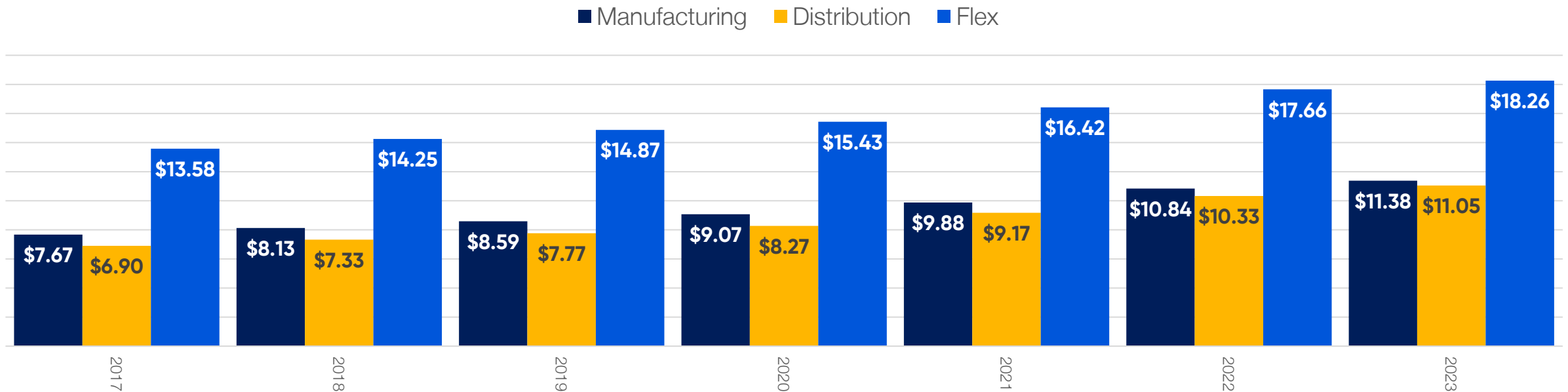


Market Rent

Industrial Rents Hit Historic Highs... But Rate of Growth Slows

Industrial rates have steeply increased since the end of 2020, particularly distribution space, which has increased by 20.5 percent in the past two years. Logistics asking rates have increased every quarter since 2017. While rates continue to rise, quarterly increases have begun to slow, with rates jumping just 0.8 percent last quarter, the smallest quarterly increase since before the pandemic.

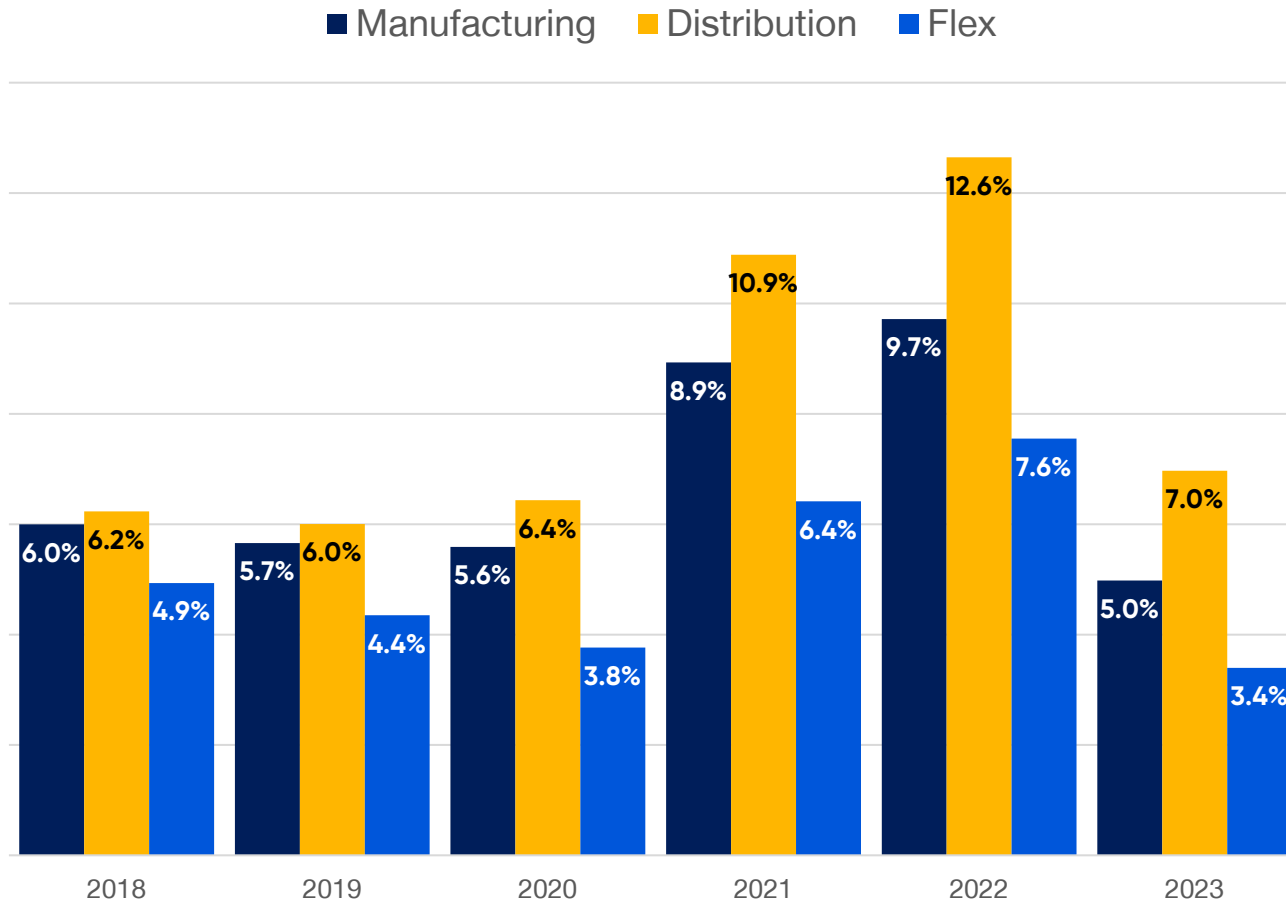
Industrial Lease Asking Rates (\$/SF): (United States)



Market Rent

Direct Asking Rent Growth Reverts to Pre-Pandemic Levels

Industrial Asking Rent Annual Increase: (United States)

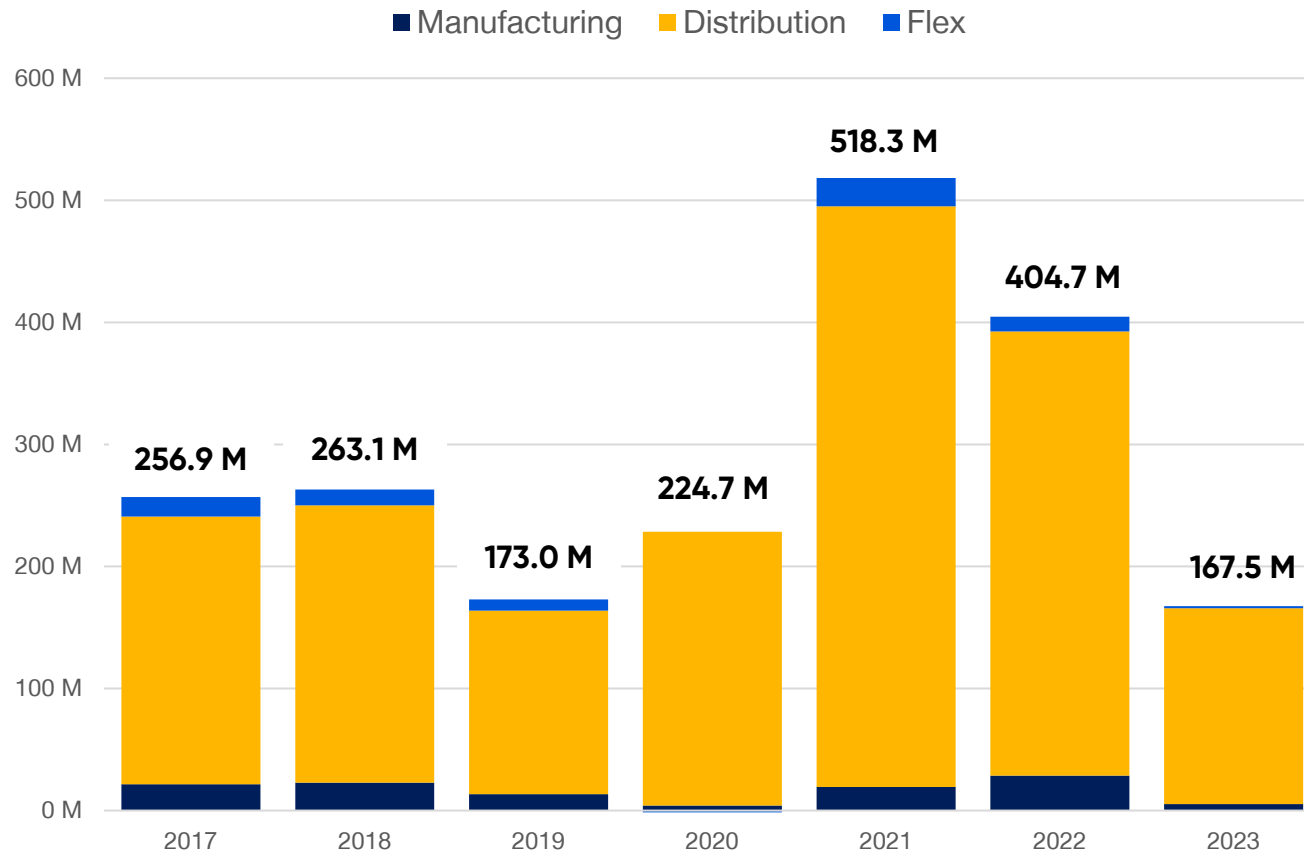


Industrial lease rates continue to set new water marks each quarter. The growth rate is slowing. Still, the compounded annual growth rate (CAGR) for distribution spaces has increased nine percent per year since the start of 2017. With demand remaining firm and vacancy low, rates are expected to grow in line with pre-pandemic levels in the near-term. While it is unlikely rates will correct, other incentives like TI's and abatements may become more negotiable for occupiers.

Absorption

Industrial Absorption Slows After Two Torrid Years

Industrial Net Absorption (SF): (United States)



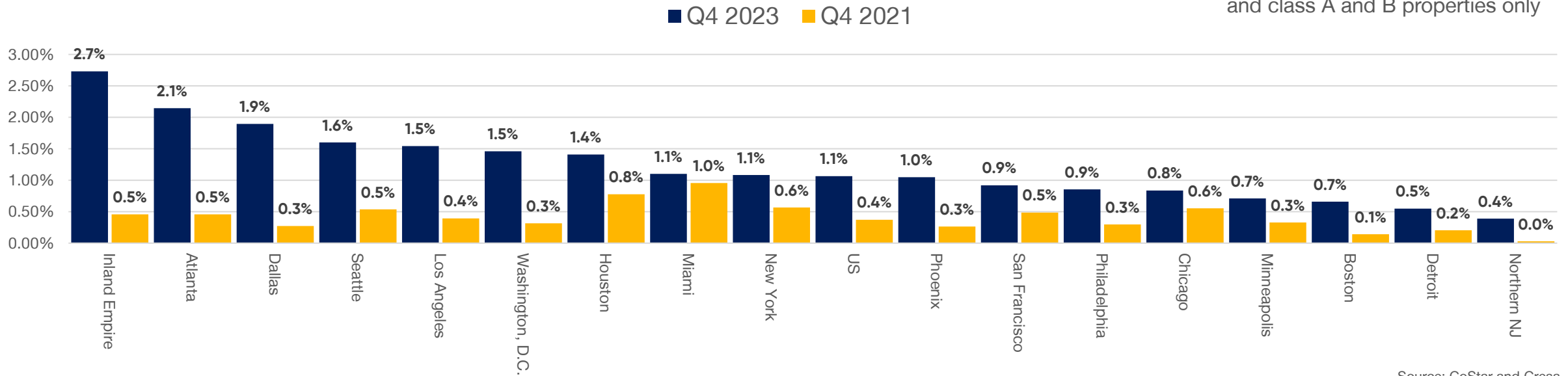
After a record-breaking 2021, absorption has experienced a slowdown. Some of this can be explained by economic conditions softening, but overall imports have been slowing, too. Nevertheless, the amount of new construction being delivered and ongoing demand over the next several quarters will likely keep absorption higher than historical averages.

Sublease Space

Largest US Industrial Markets: Change Since the End of 2021

Industrial: Sublease Space as a Percentage of Total Inventory (United States)

Note: Includes **Sublease Space** for industrial properties over 50,000 SF and class A and B properties only



Source: CoStar and Cresa

264%

Increase in sublease SF on market in largest Metros compared to the end of 2021

71.8 M

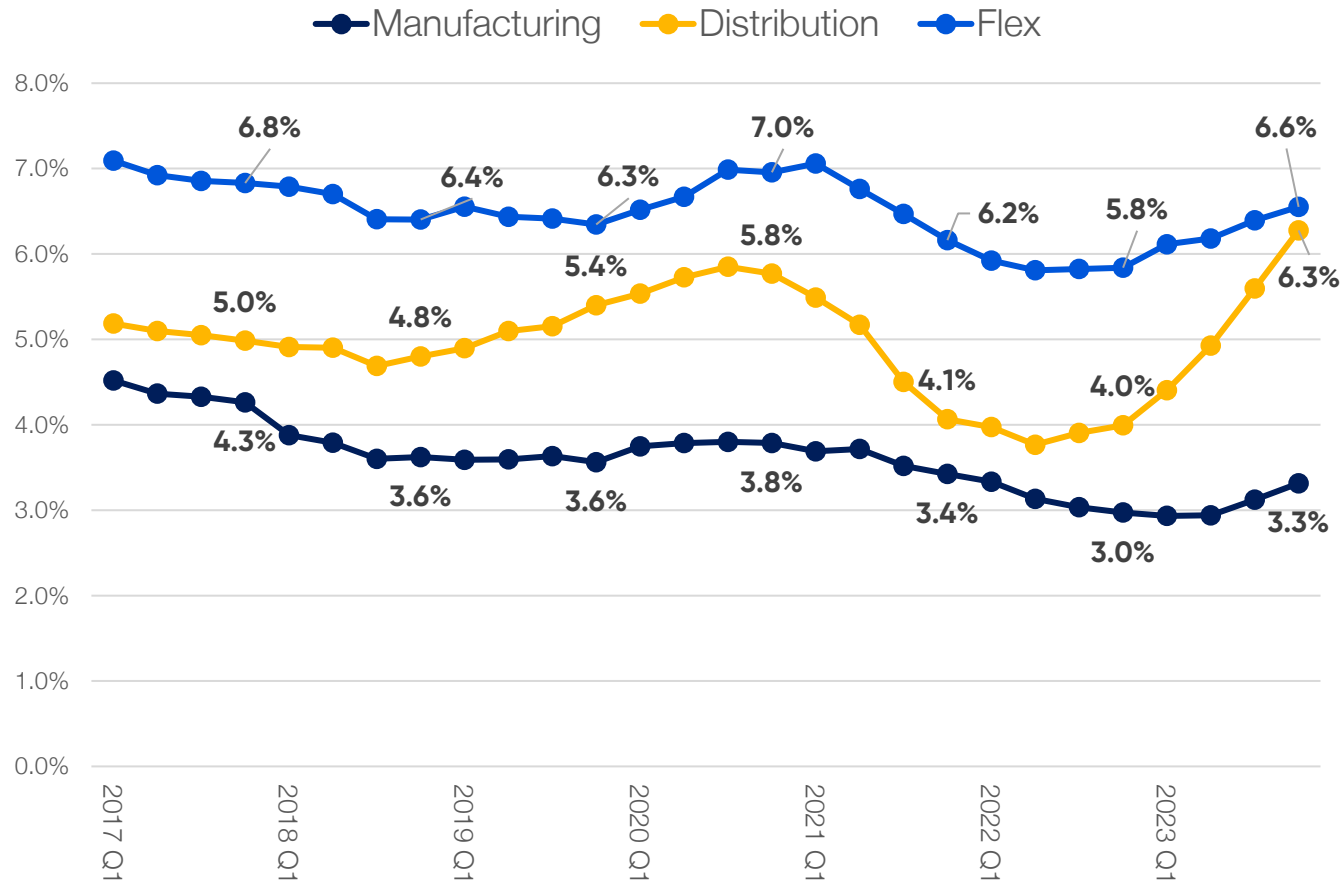
SF of sublease space available in largest Metros in December 2023, compared to **19.7 M** at the end of 2021

Sublease space has moderately increased since the end of 2021. Markets that have experienced tremendous industrial growth have shown the highest amount of sublet space increase as new inventory is delivered. Although sublease space is increasing, rate growth remains strong. It is expected that sublease space will begin to trend lower as space is absorbed. **Current sublease space as a percentage of inventory are generally higher (1.1%) than levels at the end of 2019 (0.6%), before the pandemic.**

Direct Vacancy

Industrial Vacancy Moves Higher

Industrial Direct Vacancy: (United States)

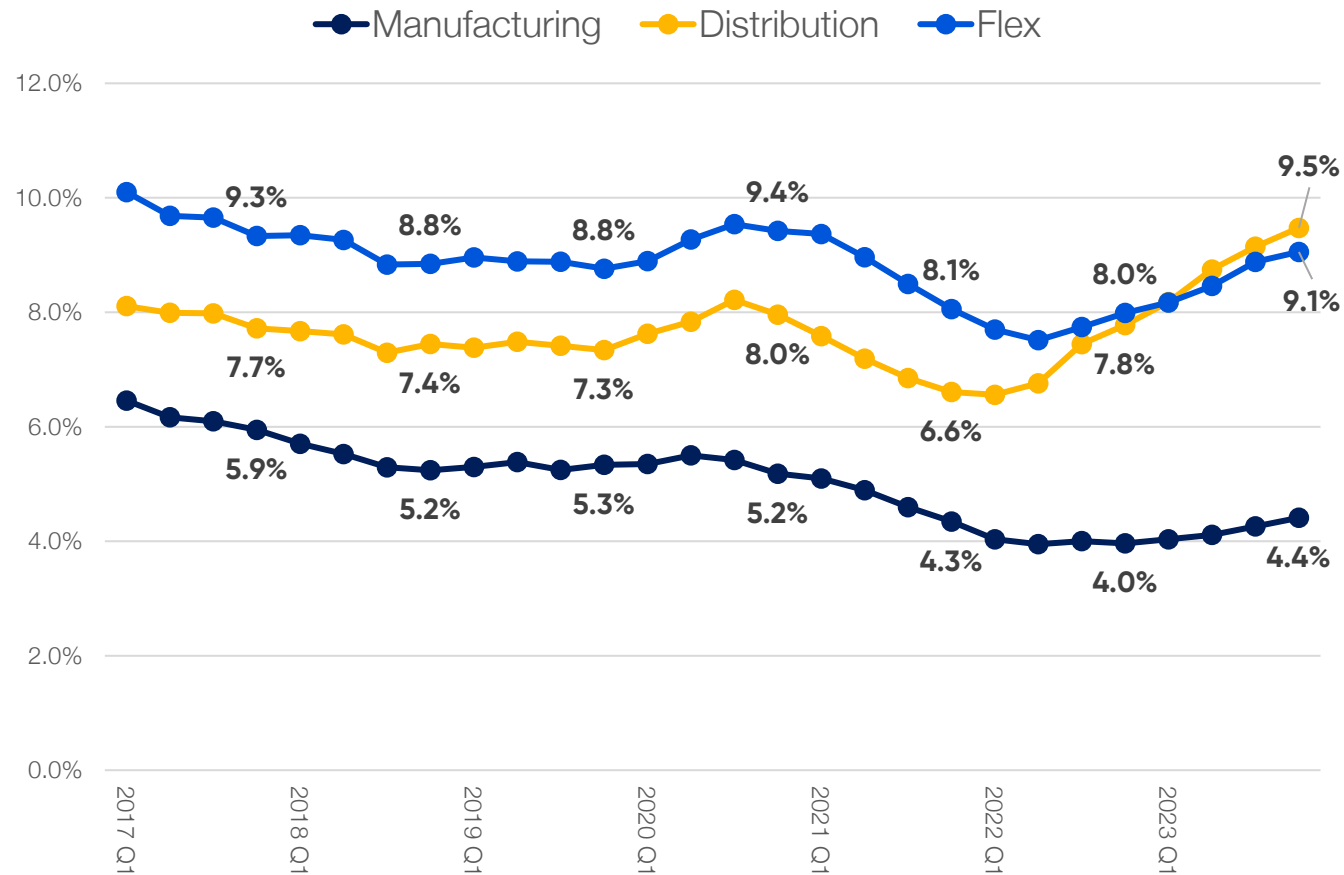


Direct vacancy has remained below historical averages, despite a bump in distribution and flex space vacancy during 2023. It is likely that the large amount of new construction being delivered contributed to the increase. Large occupiers of space like Amazon have also curtailed new commitments as tenants prepare for lessened demand due to volatile economic conditions. Large retailers are still looking to shore up distribution facilities, so they are better positioned for future growth.

Availability

Industrial Availability Drifts Higher

Industrial Availability Rate: (United States)

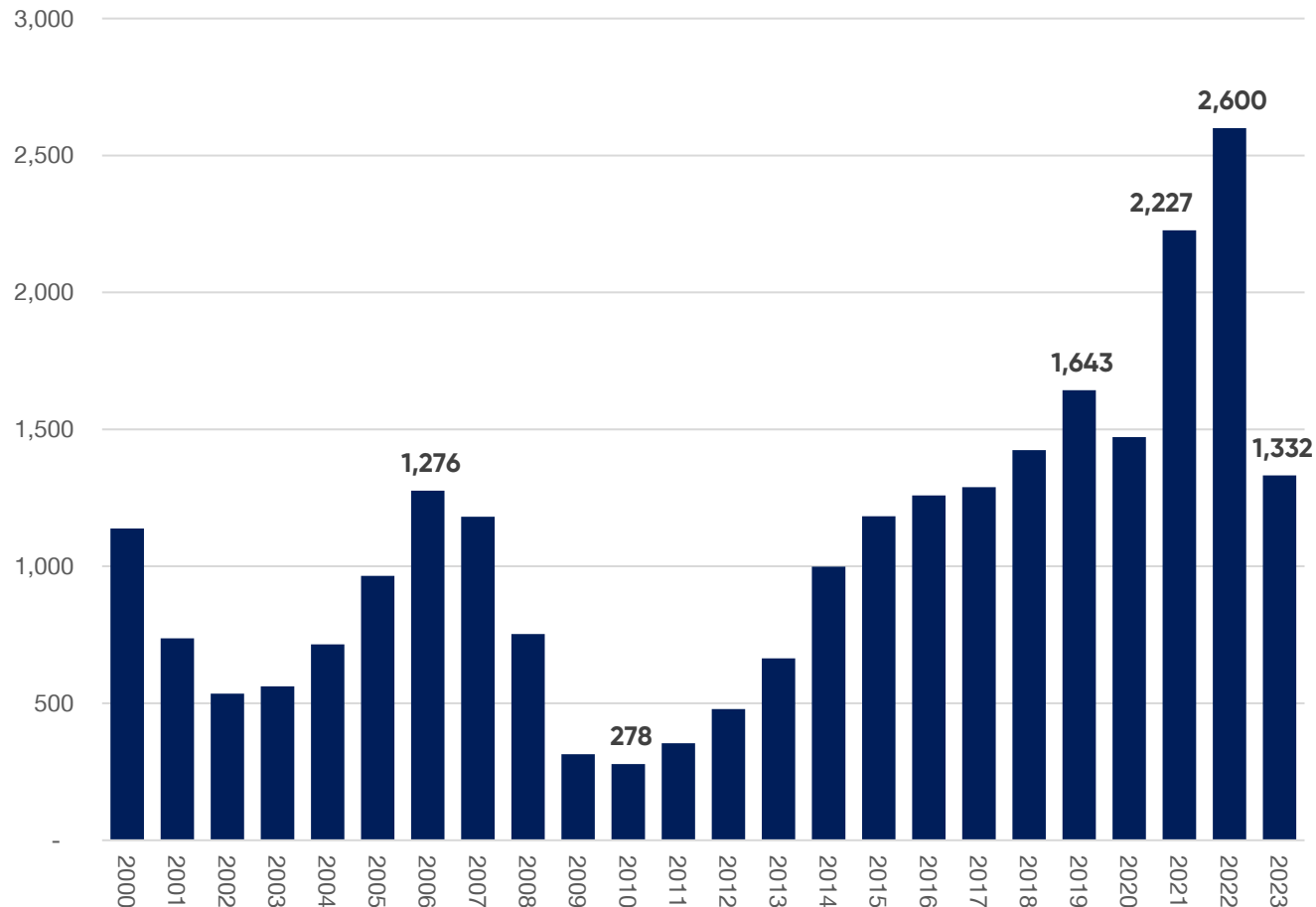


The availability rate includes the amount of space that is being marketed as available for lease, regardless of whether the space is vacant, occupied, available for sublease or available at a future date. Therefore, the availability rate may be a more accurate depiction of the market during this volatile period than the direct vacancy rate. Availability in the distribution asset type jumped from 6.6 percent to 9.5 percent in the fourth quarter of 2023.

Construction

Industrial Construction Starts Fall Sharply

Industrial Construction Starts: All Types (United States)

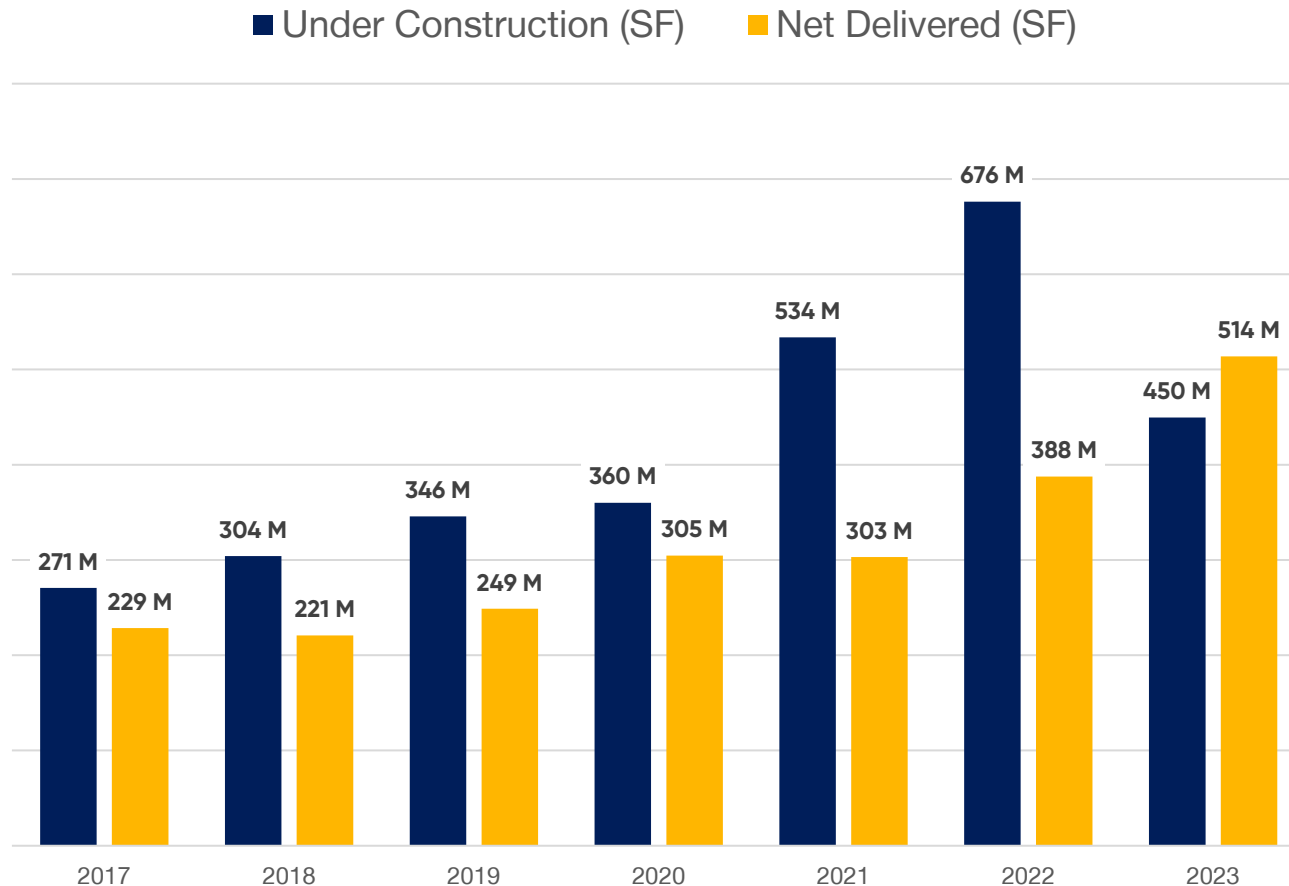


New industrial construction starts topped 2,500 in 2022, after breaking 2,000 for the first time in 2021. Starts for 2023 are on track to be in line with pre-pandemic levels. However, given the torrid pace of construction and rising construction costs, elevated interest rates, supply chain constraints, the number of new industrial starts is robust. It is expected that construction starts will dip further in 2024 before falling back in line with pre-pandemic levels moving forward.

Construction

New Industrial Projects Pump the Brakes

Industrial Under Construction – All Types (SF): (United States)



Industrial inventory is expected to grow nearly four percent in 2023, an increase not seen in the United States in the past 30 years. The number of industrial starts appears to have peaked last year, as developers are taking a more cautious approach as interest rates increase, construction costs rise, and the amount of time to complete a project has lengthened. However, the demand for warehouse/distribution space remains resilient, likely resulting in a temporary lull in the breakneck speed of new construction starts.

The problem with the real estate market is the market itself.

The market
Sees you as
a **target**.

The market
chases the
deal.

The market
is short term
and
reactive.

The system
favors
landlords
not
occupiers.

The stakes are high for occupiers. Real estate is expensive and inflexible. With the pandemic, labor dynamics, and economic instability, all bets are off.

It's time to go beyond the market and uncover how your commercial real estate can drive your goals, not impede them.

How We're Different

As the world's largest corporate real estate provider committed exclusively to serving occupiers, we're in a league of our own. We offer creative solutions, unbiased advisory services and executive leadership on every account. We believe this combination of transparency and executive involvement generates the superior service our clients have come to expect from Cresa.

Billions of square feet are represented on the landlord's behalf nationally. Cresa never does business on behalf of landlords.



An Unbiased Advocate

We're unbiased, uninfluenced by landlords. Everything we do is from an occupier perspective – and to their advantage.

Our Structure

As a privately-owned firm, we can adjust quickly, easily scaling project teams or service offerings to suit client needs.

Our Integrated Platform

Our services, each led by specialists in their field, are interconnected to enrich our clients' businesses and ensure seamless delivery.

Our People

Led by seasoned principals with years of experience, we hire selectively and empower our employees to think innovatively.

Transparency

Transparency is what allows us to foster lasting, meaningful relationships with each other and with our clients.



Visit cresa.com
for more
information.

Cresa is the world's only global commercial real estate advisory firm that exclusively represents occupiers and specializes in the delivery of fully integrated real estate solutions. Our purpose is to think beyond space, strengthening those we serve and enhancing the quality of life for our clients. Delivered across every industry, Cresa's services include Transaction Management, Workplace Solutions, Project Management, Consulting, Lease Administration, Technology, Investment Banking & Capital Markets and Portfolio Solutions. In partnership with London-based Knight Frank, Cresa provides service through 16,000 people, across 380 offices in 51 territories.

About the Author



Craig Van Pelt
Head of Research, Director
cvanpelt@cresa.com