Occupier Outlook

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

Cresa Research | Q4, 2024

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COMMERCIAL REAL ESTATE MARKET AT CROSSROADS:
BALANCING RECOVERY, HIGH RATES, AND EVOLVING WORK TRENDS

OCCUPIER OUTLOOK

Executive Summary

Macro Economic View

- Inflation drifts higher after cooling in the first half of 2024, which may slow anticipated rate cuts to start 2025.
- Job creation picks up steam in November and December, particularly in healthcare and education. Knowledge worker job growth has stalled while the government sector is expected to reverse gains with the new administration stressing efficiencies.
- Consumer spending has remained robust, but rising debt costs may slow spending in the mid-term.
- Rising tariffs and other restrictive policies are putting mid- to long-term demand for consumer goods, particularly non-durable goods, less clear and may slow decision making for companies.

Office Market

- Although vacancy drifts higher, availability has now decreased for three straight quarters, indicating an improved outlook for the overall office market.
- Improved office demand varies greatly in markets, with markets like New York making positive strides while others continue to stagnate.
- Leasing velocity has picked up steam, but deal sizes remain around 15 to 20 percent below historic levels.

Industrial Market

- Asking rents stall and retreat in some industrial markets as supply is outweighing demand.
- Construction starts are at a decade low, providing tenants with a window of leverage to negotiate better terms.
- US imports, business inventories, and real goods spending remain strong, signaling a limited opportunity for tenant leverage.

Economic Overview

The US Economy Expands as Optimism Improves

The US economy has outperformed for the past several quarters, particularly against other global advanced economies. Real GDP grew 3.1 percent in the third quarter, following 3.0 percent growth in the second quarter, highlighting the resiliency of the economy, driven by robust consumer spending. Inflation-adjusted spending rose 3 percent year-over-year as of November. As borrowing costs have increased, attention will be focused on delinquency rates of credit cad balances and personal loans.

The labor market rebounded in November and December after job gains were negatively impacted by hurricane-related activity in the southeast, exceeding expectations. The healthcare and education sectors experienced the most growth, while knowledge worker jobs have considerably slowed. As inflation remains stubbornly elevated, further interest rate cuts may be delayed and negatively affect future job growth, particularly in the manufacturing sectors.

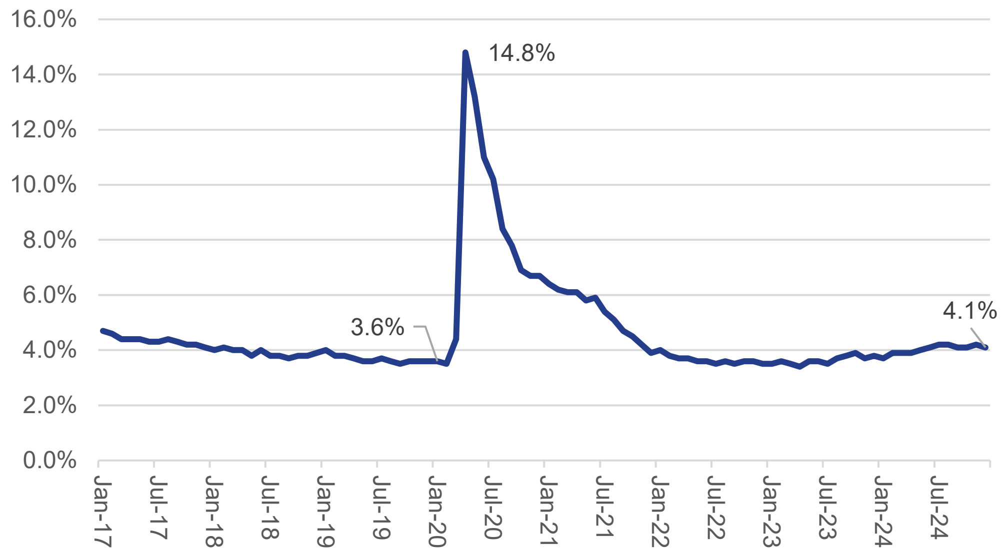
The longer-term outlook is trending more optimistically as the incoming administration implements an expansionary fiscal policy. However, the anticipated imposition of broad and elevated tariffs on imports and restrictive immigration measures are unclear and may weigh on growth further down the road.

Unemployment

Unemployment Steadies After Drifting Higher

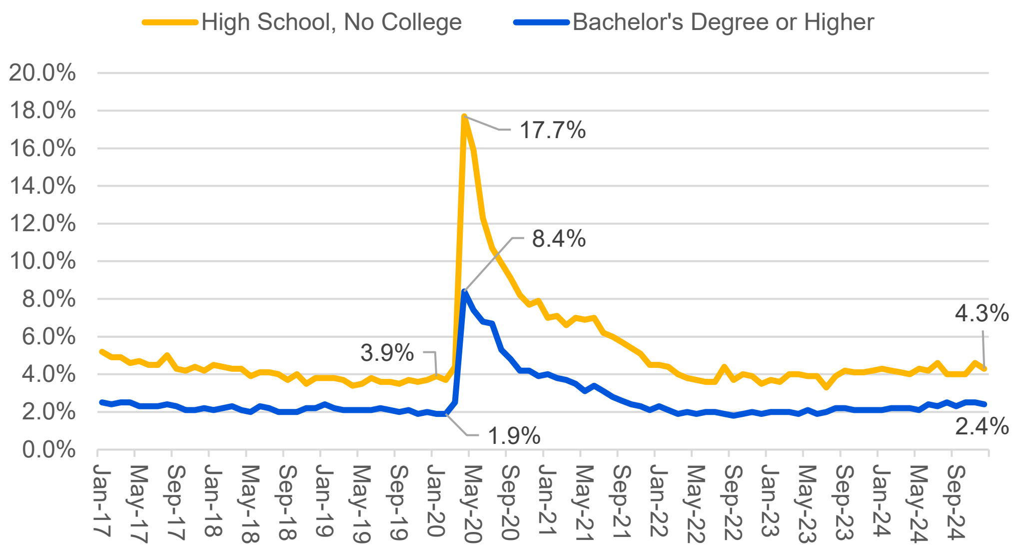
Unemployment has course corrected after ticking higher this past summer. The market is closely watching for additional Fed rate reductions, but volatile inflation is making the timing murkier. College-educated employees remain near full-employment despite recently announced layoffs in the tech industry. Additionally, lower-skilled service-oriented jobs along with the healthcare sector are the main drivers of job growth.

Total Unemployment: (United States)



Source: U.S. Bureau of Labor Statistics, https://bls.gov; Seasonally adjusted

High School Only vs. Bachelor's Degree or Higher



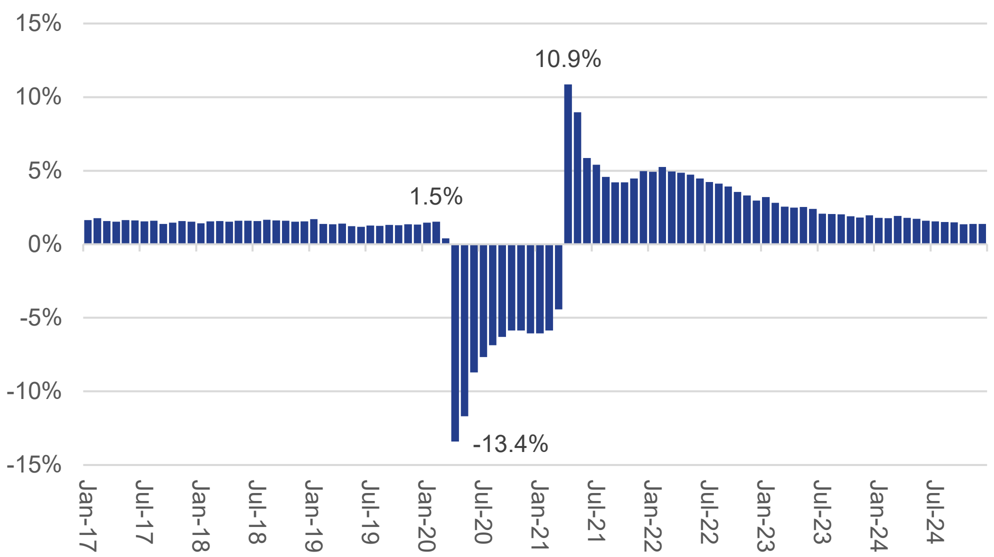
Source: U.S. Bureau of Labor Statistics, https://bls.gov, Seasonally adjusted

Employment

Job Creation Slows to Pre-Pandemic Levels

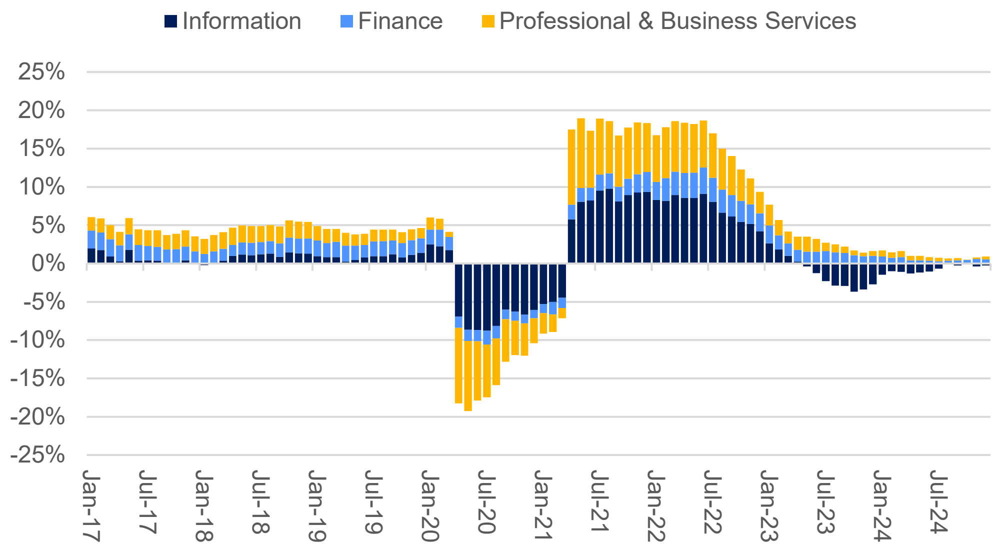
Total nonfarm employment rose by 256,000 in December, surpassing expectations and representing the largest gain since March 2024. Gains occurred in government, and healthcare jobs underpinned the growth. Office-occupying job creation has essentially come to a halt with anemic increases in finance and professional and business service sectors, while the information sector continues to shed jobs.

All Job Sectors (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov, Not seasonally adjusted

Office-Occupying Jobs (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov, Not seasonally adjusted

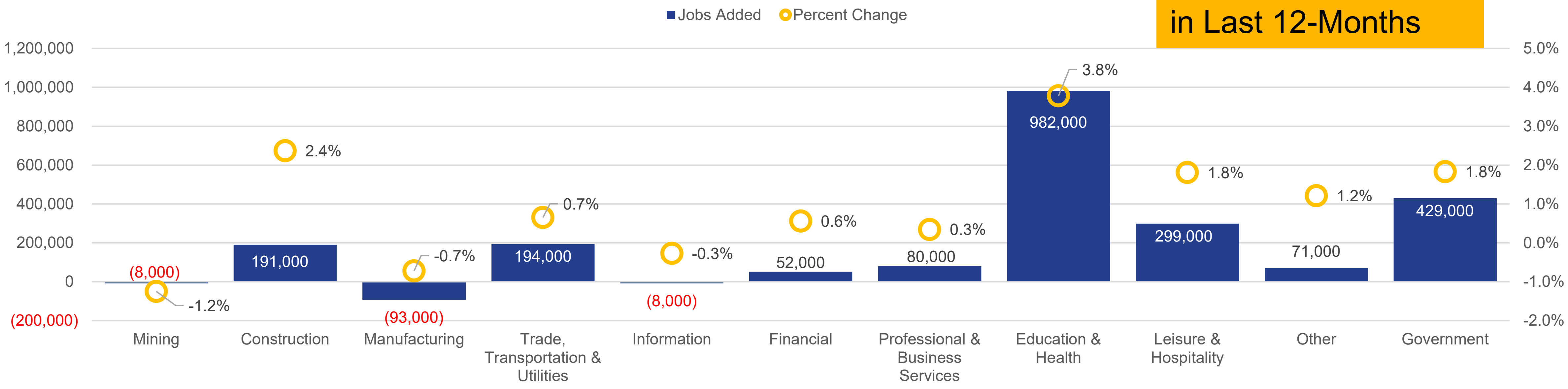
Employment

Education and Healthcare Sectors Lead the Way

Pent-up demand leads to increases in health services sector jobs, with nearly one million jobs added in the past year. The jobs being added are not concentrated in office-occupying sectors. The manufacturing sector pulled back over the past year, while the construction and trade, transportation, and utilities sectors added approximately 385,000 jobs.

Job Creation by Sector (12-Month Change)

2.19M Jobs Added in Last 12-Months



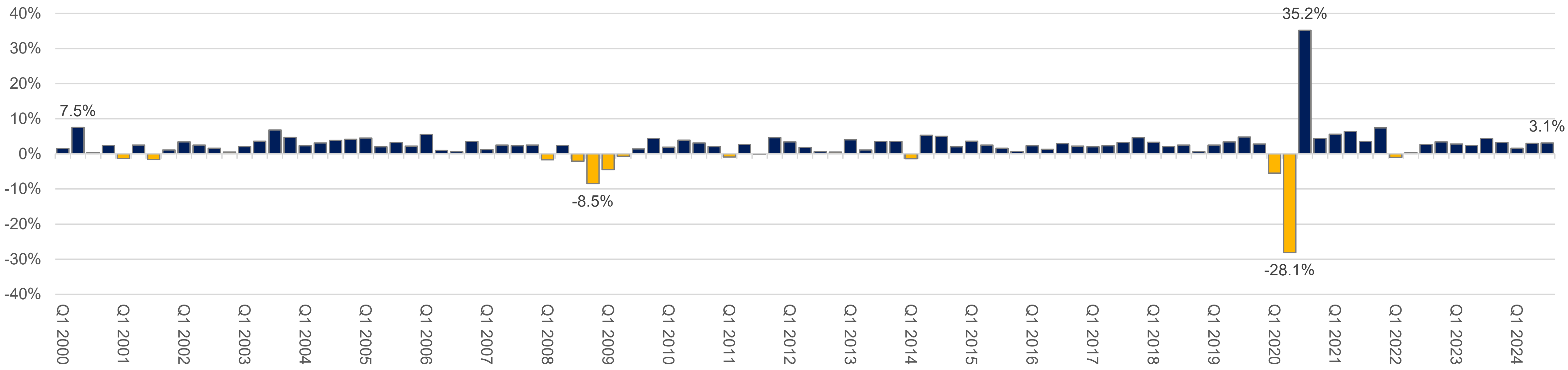
Source: U.S. Bureau of Labor Statistics, https://bls.gov

GDP

Gross Domestic Product Posts Ninth Consecutive Quarter of Growth

The GDP has expanded for the past 10 quarters, remaining remarkably consistent over that time despite much debate about the health of the broader economy. According the Bureau of Economic Analysis, the most recent quarter showed GDP increasing at a 3.1 percent rate, which outpaced the first quarter GDP increase of 1.6 percent. Compared to the first quarter, the acceleration in the second and third quarter real GDP reflected an upturn in private inventory investment and robust consumer spending.

Real GDP Percent Change from Preceding Quarter



Source [Real Gross Domestic Product (A191RL1Q225SBEA) | FRED | St. Louis Fed (stlouisfed.org)]
Note January 13, 2024. Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/A191RL1Q225SBEA, January 13, 2024.

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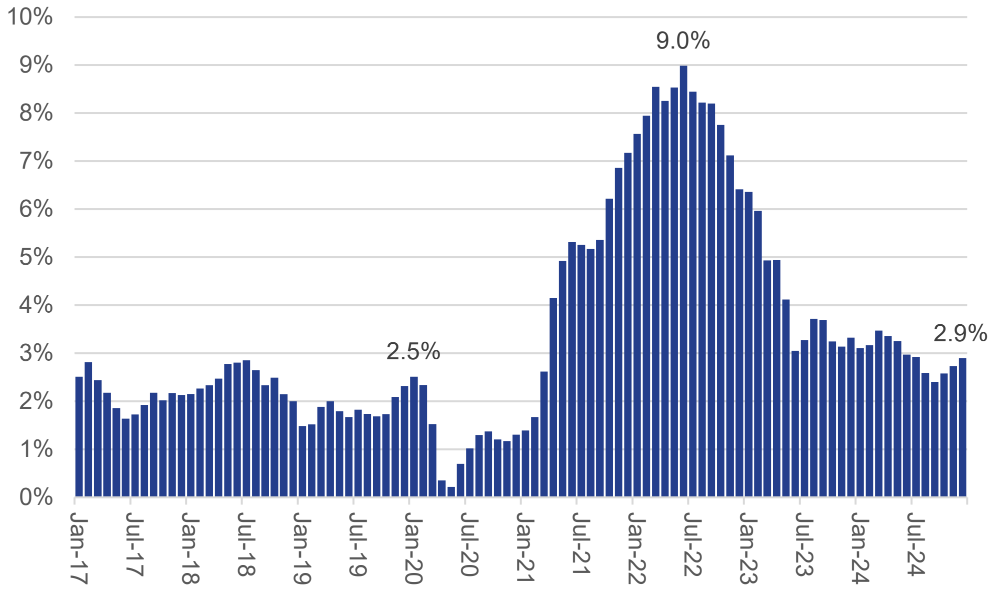
Inflation

Inflation Remains Elevated

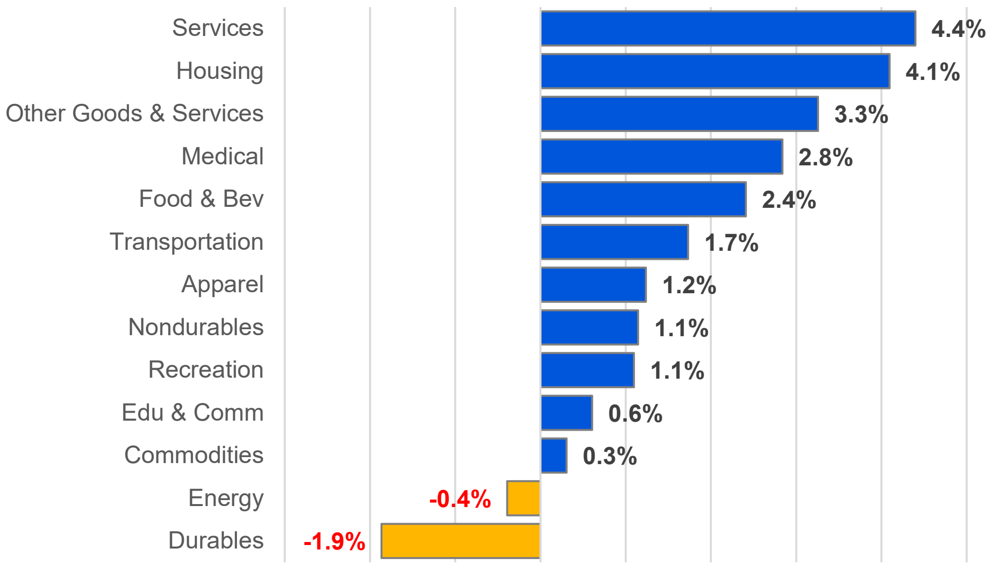
The December 2024 Consumer Price Index (CPI) from the Bureau of Labor Statistics reported inflation has moved higher for three consecutive months after falling for the first half of 2024. Pre-covid rates were typically 2-3 percent annual increases, indicating the US economy has stabilized. Indexes that increased in December include shelter, airline fares, used cars and trucks, new vehicles, motor vehicle insurance, and medical care.

Consumer Price Index (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov
Note: Seasonally adjusted, Data pulled January 2025.

Consumer Price Index by Sector (12-Month Change)



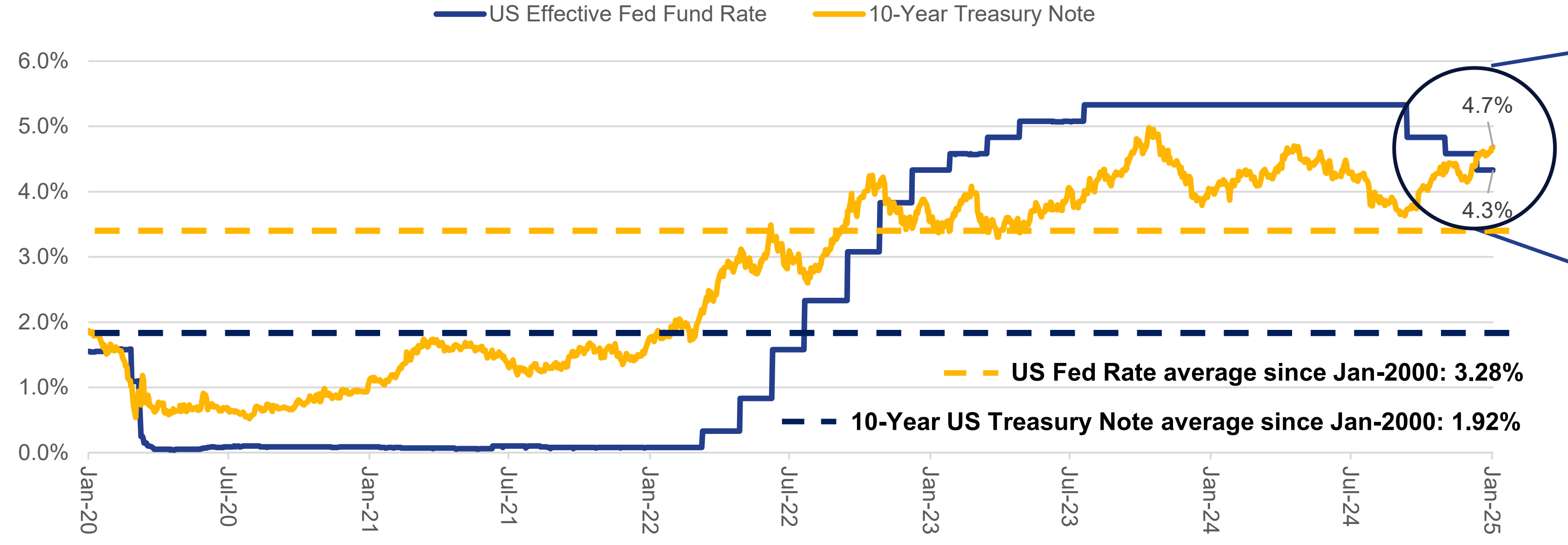
Source: U.S. Bureau of Labor Statistics, https://bls.gov
Note: Seasonally adjusted, Data pulled January 2025

Monetary Policy

The Fed Lowers Rates for First Time in Four Years

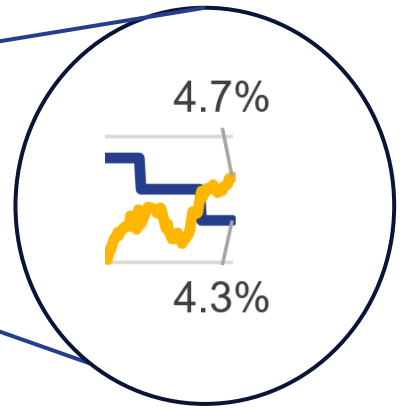
On November 7, 2024, the Federal Reserve cut rates an additional 25 basis points, after lowering interest rates by 50-basis points in September, the first decrease in more than four years. The decision was due to progress in cooling inflation and help support economic growth and stabilize a softening labor market. Further cuts to the interest rate are anticipated. The 10-year treasury rate has been moving higher, above the the long-term average of 4.50 percent and well-above the 1.92 percent average since 2000.

US Effective Fed Fund Rate & 10-Year Treasury Note



Source: Federal Reserve Economic Data, https://fred.stlouisfed.org; Data is through January 13, 2025
Wall Street Journal; Data is through January 13, 2025

10-Year Treasury Passes US Fed Fund Rate



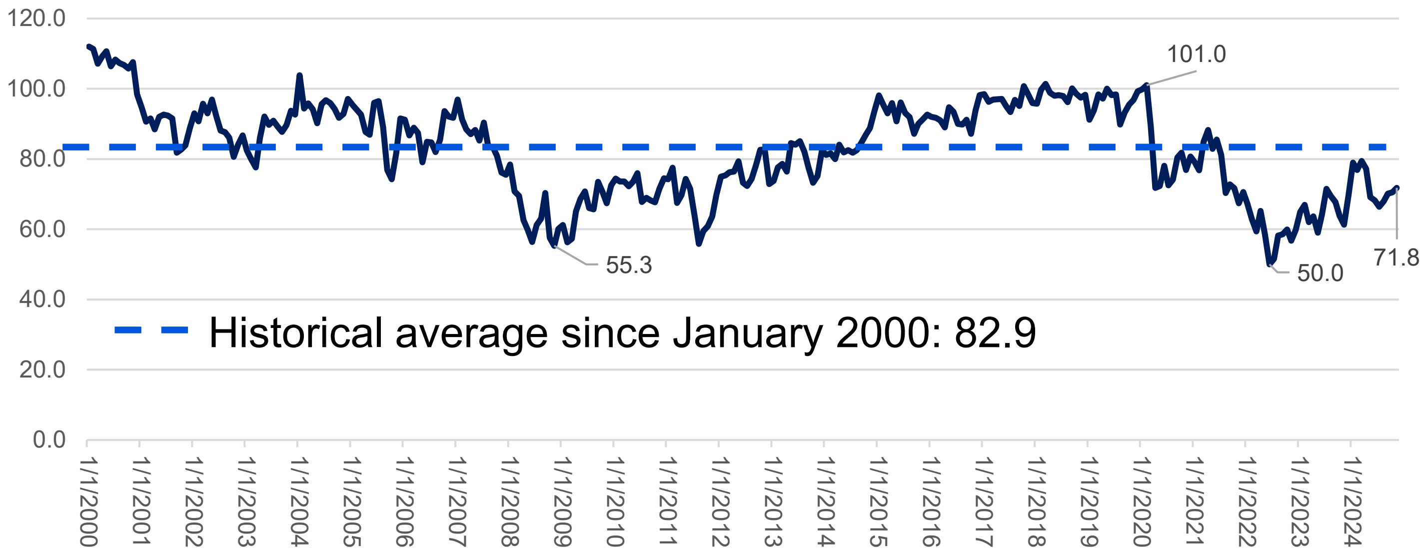
When the 10-year treasury note yield is higher than the US effective rate, it indicates that investors are demanding higher returns on longer-term bonds. The result is typically higher mortgage rates and higher interest rates on other debt like credit cards.

Consumers

Consumer Sentiment Moves Higher

After generally increasing since early 2022, the Consumer Index fell during the first half of this year before recovering in the fall. The Index continues to linger below historic averages since 2000, standing at 71.8 to end November. While consumer spending remains strong, durable goods are still lagging, representing a reluctancy to spend money on higher ticket items. **Consumers opinions have shifting to a more optimistic outlook, led by a brightening outlook of the incoming administration lessening government oversight.**

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 November 2024 (UMCSENT)

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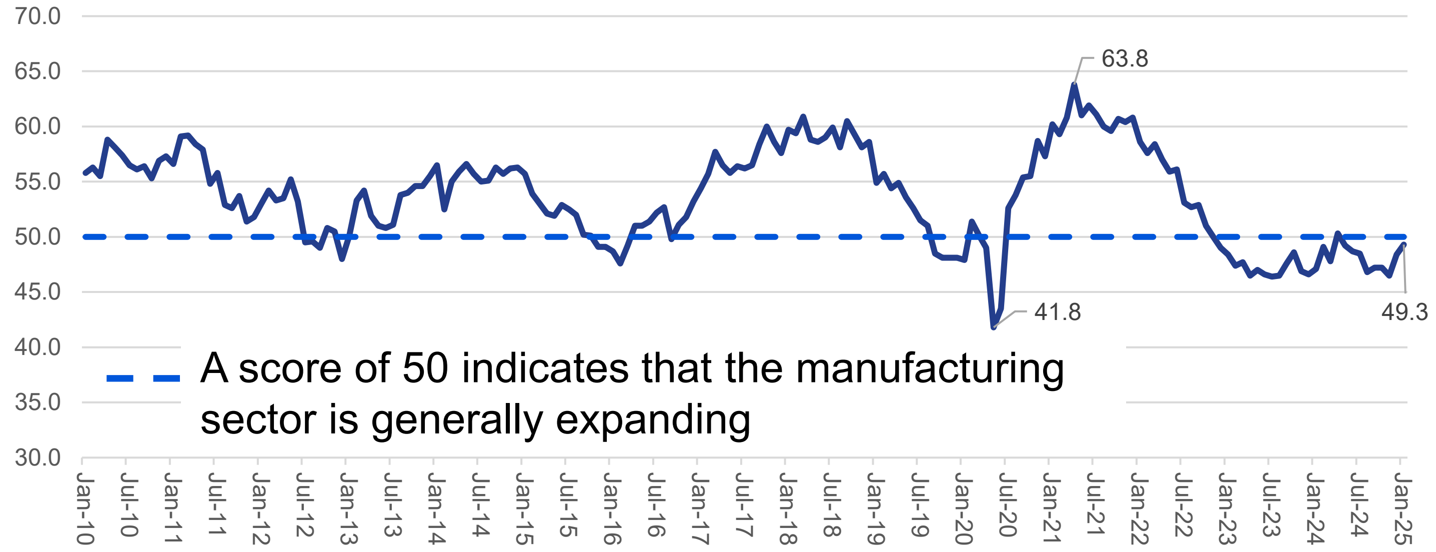
Consumers

ISM Manufacturing PMI Trails After Peaking in May

The Institute for Supply Management (ISM) Manufacturing PMI (Purchasing Managers Index) for December 2024 was 49.3. Economic activity in the **manufacturing sector contracted in December for the ninth consecutive month and the 25th time in the last 26 months.**

ISM Manufacturing Index: (United States Total)



Source: Institute of Supply Management
Note: Data thru December 2024

ISM Manufacturing PMI

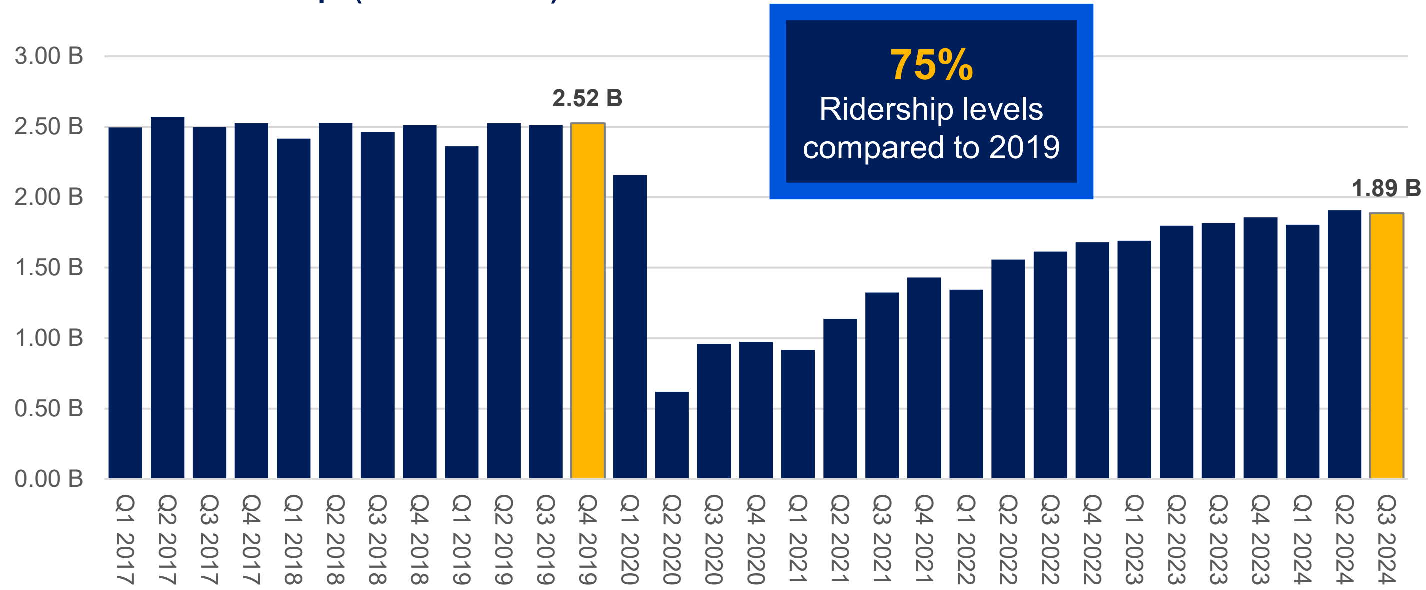
The ISM Manufacturing Index is a key economic indicator that measures the level of demand for products by surveying purchasing managers at manufacturing companies. The PMI is based on five major components: new orders, production, employment, supplier deliveries, and inventories. The index is seasonally adjusted to account for differences in weather, holidays, and other factors. A reading above 50 percent indicates that the manufacturing sector is generally expanding; below 50 percent indicates that it is generally contracting.

Public Transit

Public Transit Levels Off

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 jumped to 1.9 billion in the second quarter before falling slightly in the third quarter. Still, public transit is at the highest rate since the start of the pandemic. Based on several additional indicators, return-to-office momentum has appeared to stabilize, but given the new administration's view on return-to-the office, it may shift in the future.

Public Transit Ridership: (United States)



Source: American Public Transportation Association Quarterly Ridership Report. Ridership Report - American Public Transportation Association (apta.com)

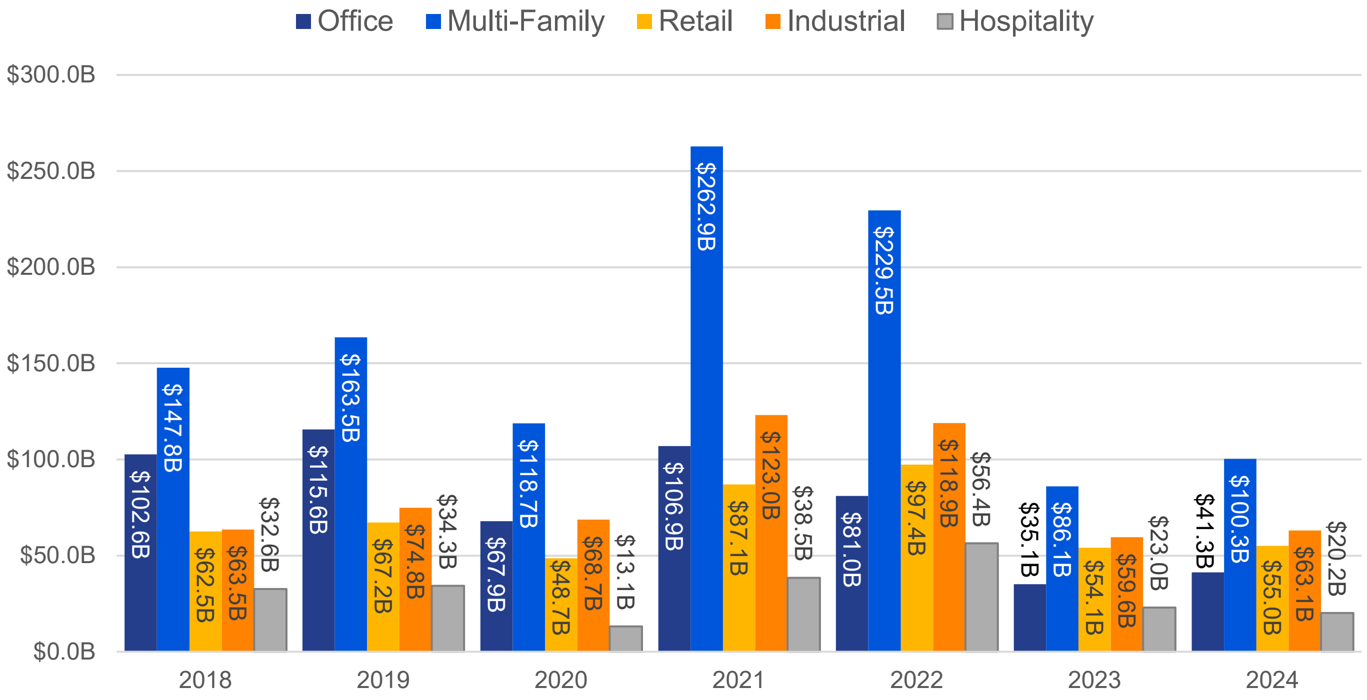
A Fare to Remember

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 2024 at 75 percent of the average ridership of 2019, the last full-year before the start of the pandemic.

Capital Markets

All Asset Types Recover From Down 2023

Sales Volume By Asset Type (United States)



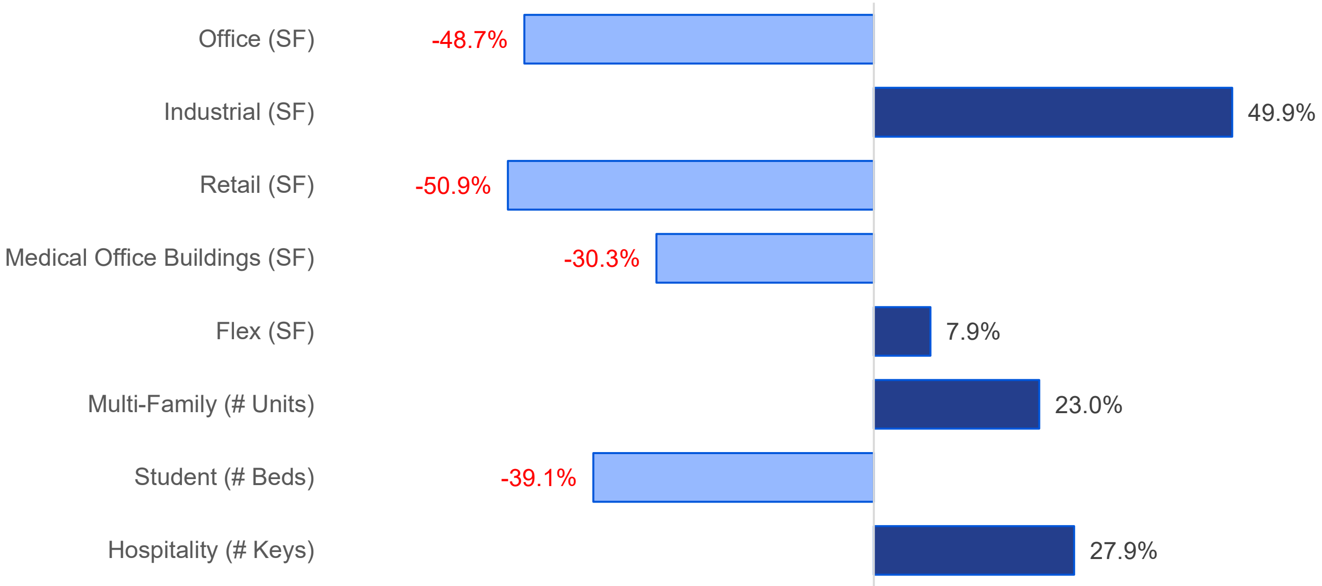
Source: CoStar and Cresa; thru Q4 2024

After peaking in 2021, the sales volume for all asset types have quickly fallen. Demand within the office space asset type has led to a steep decrease in sales volume, but higher interest rates, rising costs, and a cloudy economic landscape have hindered capital markets across all asset types. The least volatile asset type has been retail, which has remained remarkably stable. Both multi-family and industrial asset types quickly fell after peaking in 2021 and 2022. Sales volume in 2024 for all asset types – except for hospitality – has passed totals from 2023.

Capital Markets

Construction starts for industrial properties, despite falling sharply in the past year, are still well-above levels from 2015 through 2019. Not surprisingly, office and retail asset types are far below pre-Covid levels.

Average Construction Starts Per Quarter By Asset Type (United States)
(Q1 2015 – Q4 2019) vs. (Q1 2020 – Q4 2024)



Source: Real Capital Analytics and Cresa; thru Q4 2024

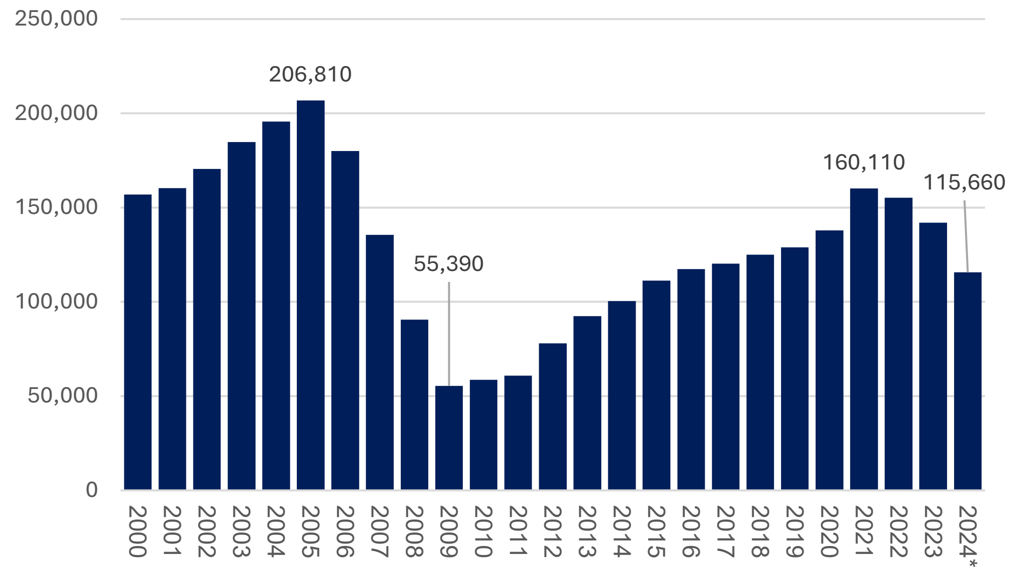
New office space has generally halted, with the number of demolitions nearly equal to new office deliveries. Industrial and flex space projects under construction are above historic averages. While multi-family starts are still above averages compared to pre-Covid, the number of starts for new units is quickly slowing. Meanwhile, the student housing boom of the 2010s has lessened in 2024.

Housing

Housing Starts Pick Up, as Interest Rate Cut Encourages Developers

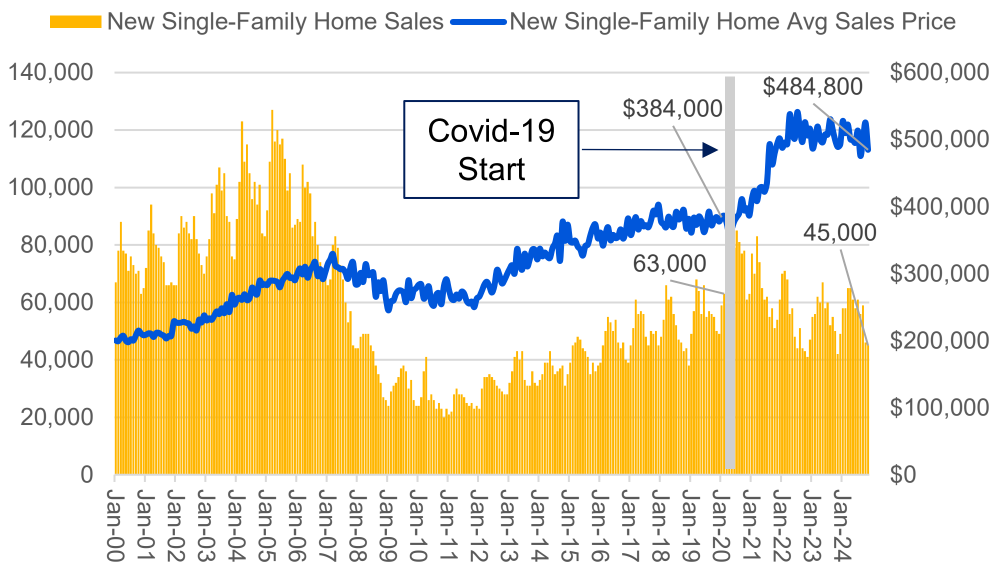
The number of residential housing starts soared at the start of the pandemic, while sale prices reached record highs in 2022. This growth is being tempered as mortgage rates increase, labor and material costs rise, and supplies remain scarce. During 2023, home starts declined from the previous two years but remain near pre-pandemic levels. Meanwhile, prices have begun to fall as demand softens. After passing an average sale price of over $540,000 to end 2022, prices have fallen to $484,800 to close October of 2024, a decrease of approximately 10 percent. Nevertheless, the average sales price for new single-family homes is over $100,000 higher compared to pre-Covid levels.

Residential Housing Starts



Source: U.S. Census Bureau, https://census.gov/construction
*Note: Data thru October 2024

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



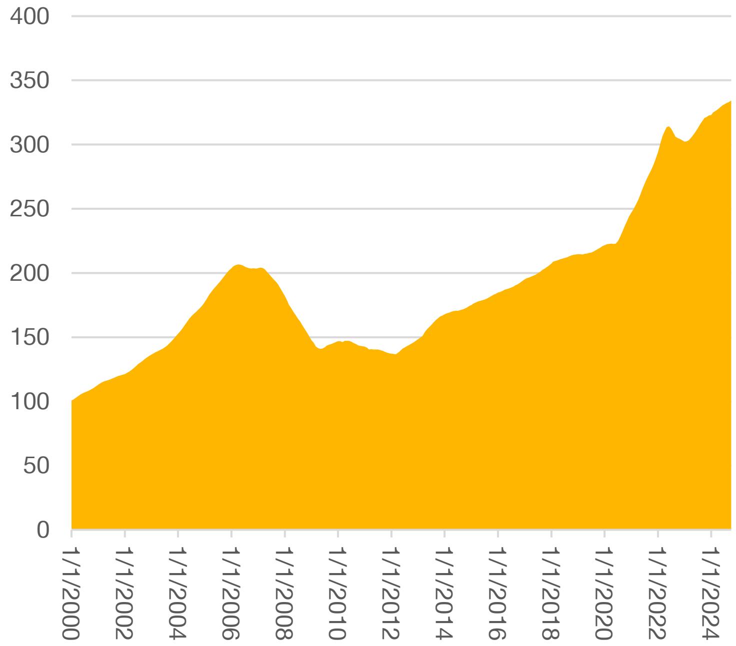
Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru October 2024

Home Price Index

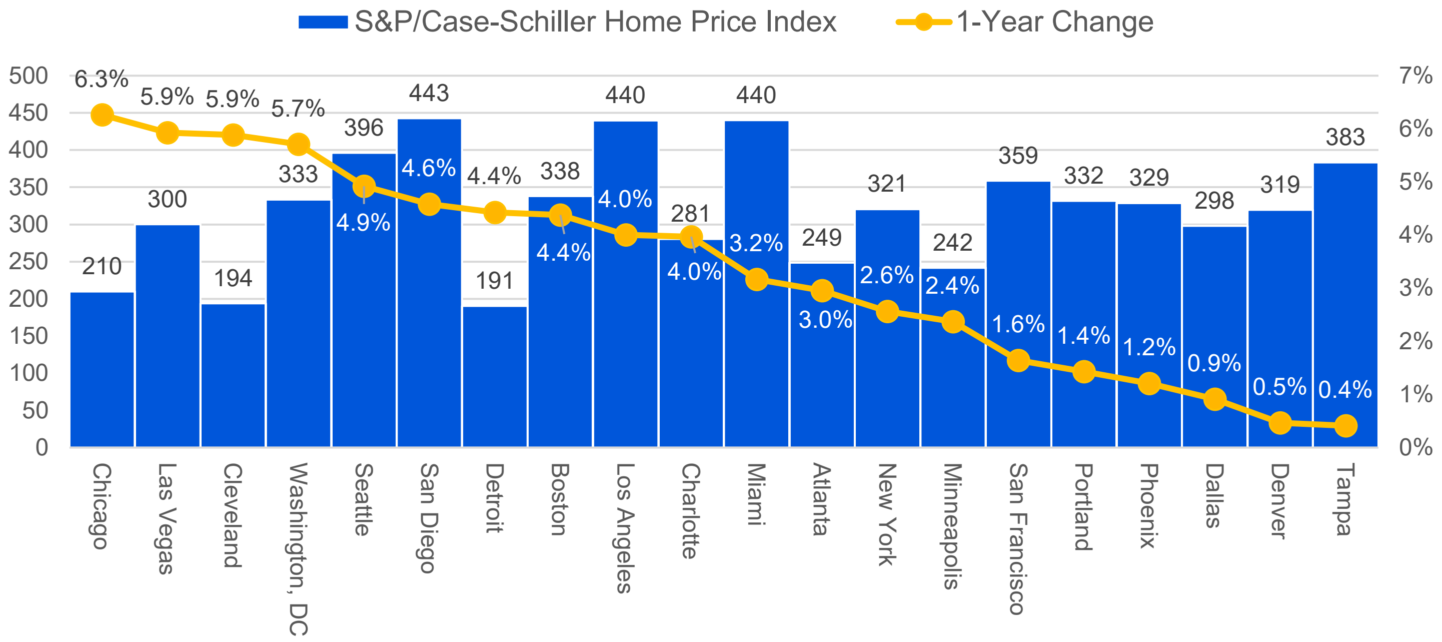
Case-Schiller Home Price Index Keeps Setting Record Highs

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 briefly peaked in June 2022 and dropped for eight straight months, before ticking higher for the past 21 months closing October at a record high. San Diego holds the highest Home Price Index, followed closely by Miami and Los Angeles. Chicago, Las Vegas, and Cleveland increased the most in the past 12-months, while Tampa, Denver, and Dallas each increased less than 1 percent during the same time.

Home Price Index: 20-City Average



S&P/Case-Schiller Home Price Index



Source: S&P Dow Jones Indices LLC, S&P/Case-Shiller U.S. National Home Price Index [CSUSHPINSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CSUSHPINSA, January 2025.

Industrial Trends

The US Industrial Market is in a Holding Pattern, but Positioned for Growth

With the tenth consecutive quarter of rising vacancy, industrial market conditions have shifted in the tenants' favor. While net absorption remained modestly positive during the fourth quarter, demand has slowed as occupiers that jumped into the fray during peak demand in the early stages of the pandemic reassess their future demand. Tenants with space requirements are taking longer to make decisions because of more choices. Additionally, many of the largest US industrial distribution tenants are expressing concerns over how increased tariffs could impact their customers. The lackluster demand has caused asking rates to stall and even retreat in some markets, increasing the willingness of landlords to negotiate terms. However, US imports, business inventories, and real goods spending remains strong, signaling a limited opportunity for tenant leverage.

Industrial Tenant View

- The small bay industrial market is outperforming logistics properties 100,000 square feet or larger, with vacancy below 4 percent.
- Despite slowing asking rates, because of the steep rent increases in 2020 – 2023, tenants are still looking at renewing at over 40 percent of their previous rates.
- New construction starts have dropped to 10-year lows, older less amenitized buildings with lower clear heights and inadequate power supply will likely be more exposed to leasing difficulties.

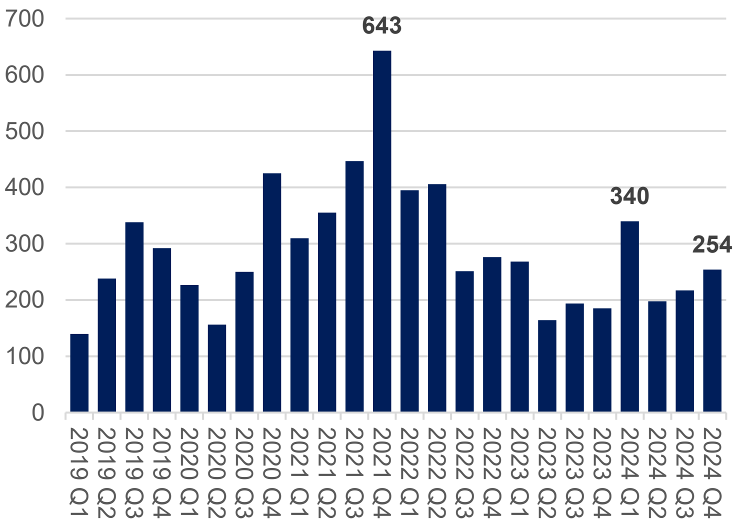
Capital Markets

Industrial Sales Velocity Stabilizes

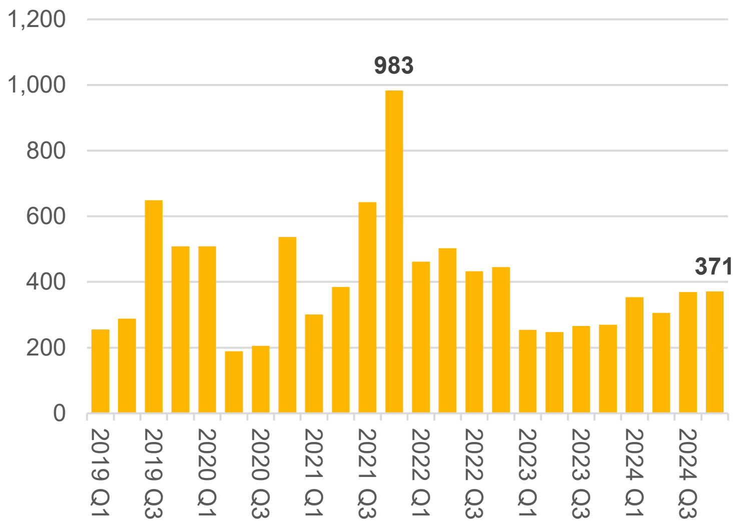
Strong demand caused industrial sales velocity (number of sales) to nearly double in the year following the Covid lockdown. Warehouse/distribution spaces consist of nearly 70 percent of the sales volume in 2023. **Strong demand in manufacturing caused sales to spike in the first quarter of 2024, before falling back to historic levels.** Both warehouse/distribution spaces and flex spaces have leveled off in the past two years.

Industrial Sales Velocity: (United States)

Manufacturing



Distribution



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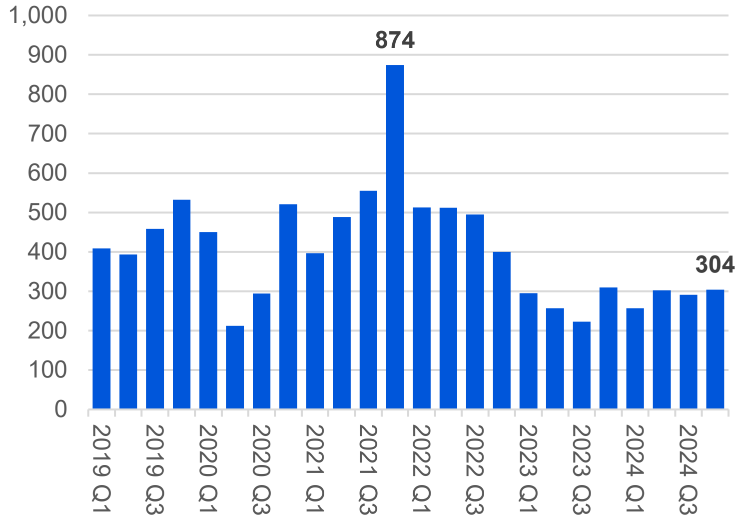


Source: Real Capital Analytics and Cresa; thru Q4 2024

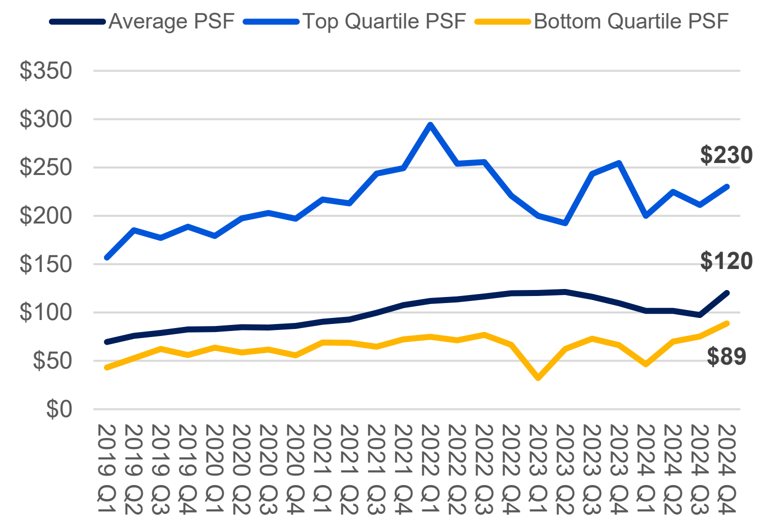
Capital Markets

Sale Prices See Only Moderate Change on a PSF Basis

The average sales price per square foot of industrial properties increased in the fourth quarter. The average price per square foot of manufacturing space peaked during the fourth quarter, after leveling off in 2021 and 2022. Averaged realized prices per square foot for both manufacturing space and distribution space have each increased more than 70 percent compared to the start of 2019, while flex spaces increased 46.1 percent over the same period.

Average Industrial Sale Price/SF (United States)

Manufacturing



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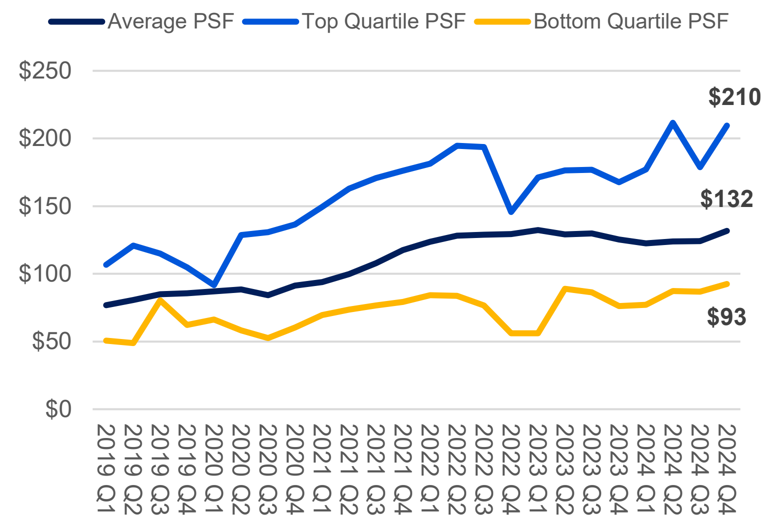

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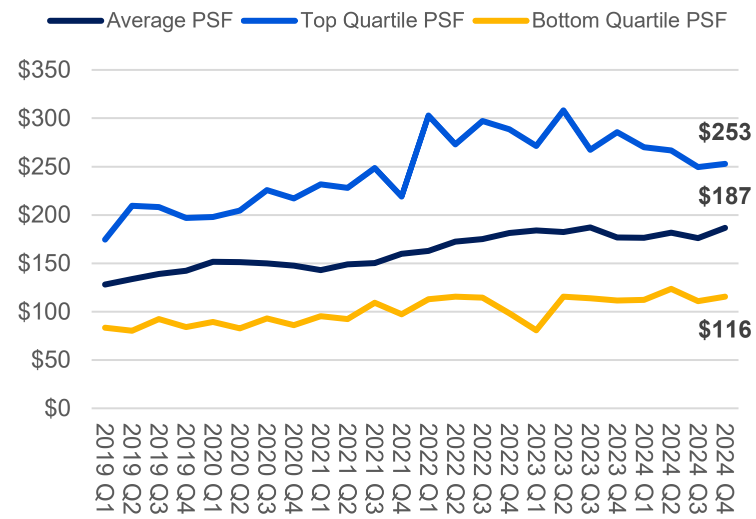


Source: Real Capital Analytics and Cresa; thru Q4 2024

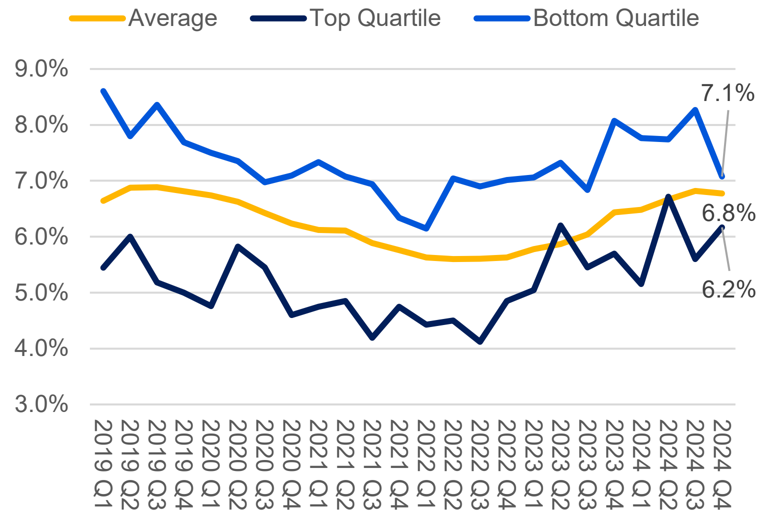
Capital Markets

Industrial Cap Rates Float Higher as Risk Increases

Economic volatility, increasing borrowing rates, and rising construction costs have pushed cap rates for industrial properties higher in the past 24 months. This **higher risk has slowed overall sales as paid for industrial assets increased.** 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 Fed cuts in interest rates may spur additional investment.

Industrial Cap Rates (United States)

Manufacturing



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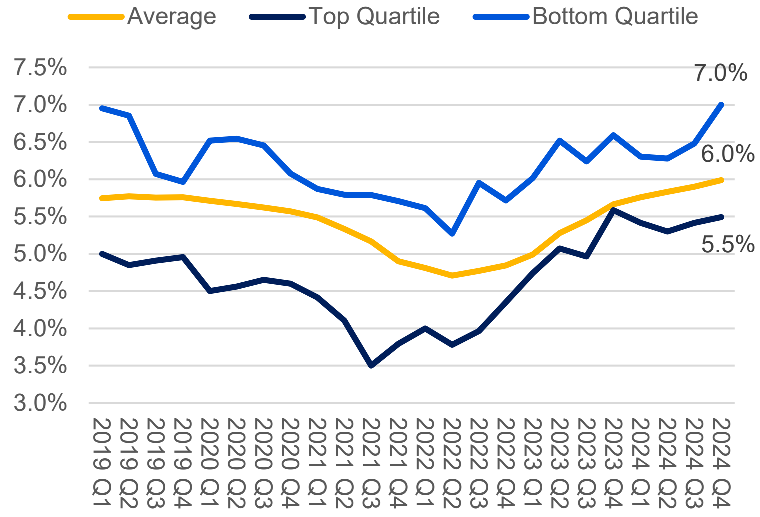

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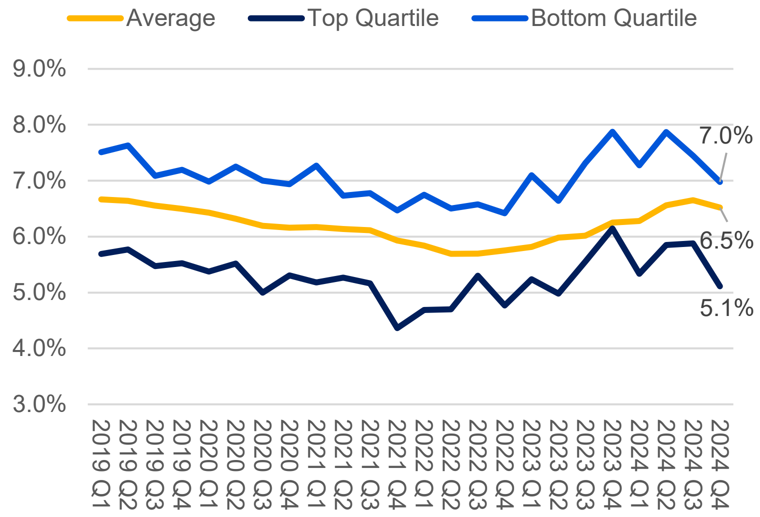


Source: Real Capital Analytics and Cresa; thru Q4 2024

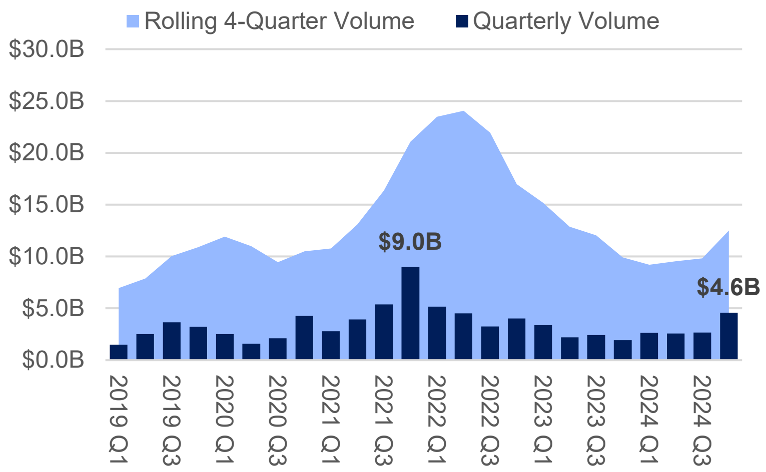
Capital Markets

Industrial Sales Volume Improves

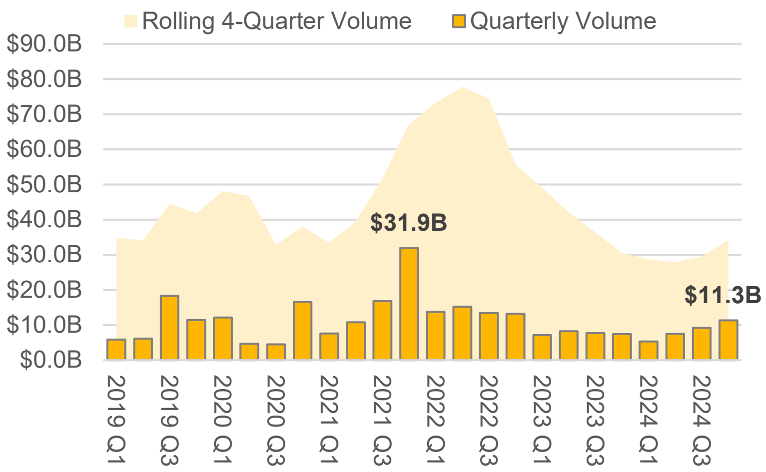
Sales volume in 2024, while trailing 2022 and 2023 levels, is comparable to pre-pandemic levels. Higher prices have pushed volume higher, despite the number of total sales declining from prior years. The sales volume for both manufacturing and distribution properties have been trending higher in the past year, while sales volume for flex properties has been steady.

Industrial Sales Volume: (United States)

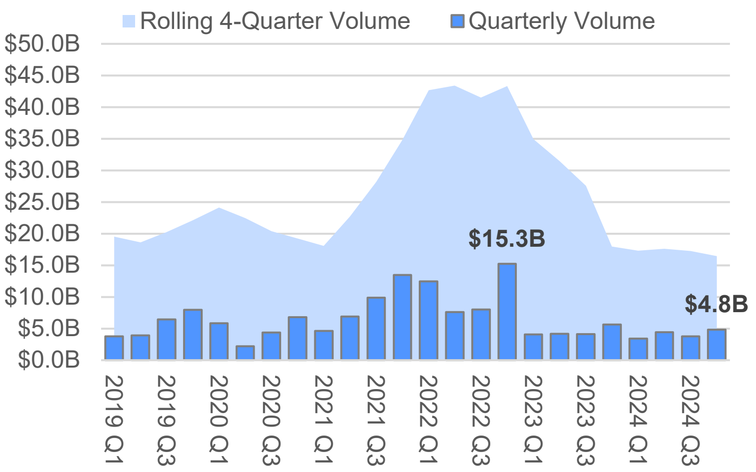
Manufacturing



Distribution



Flex



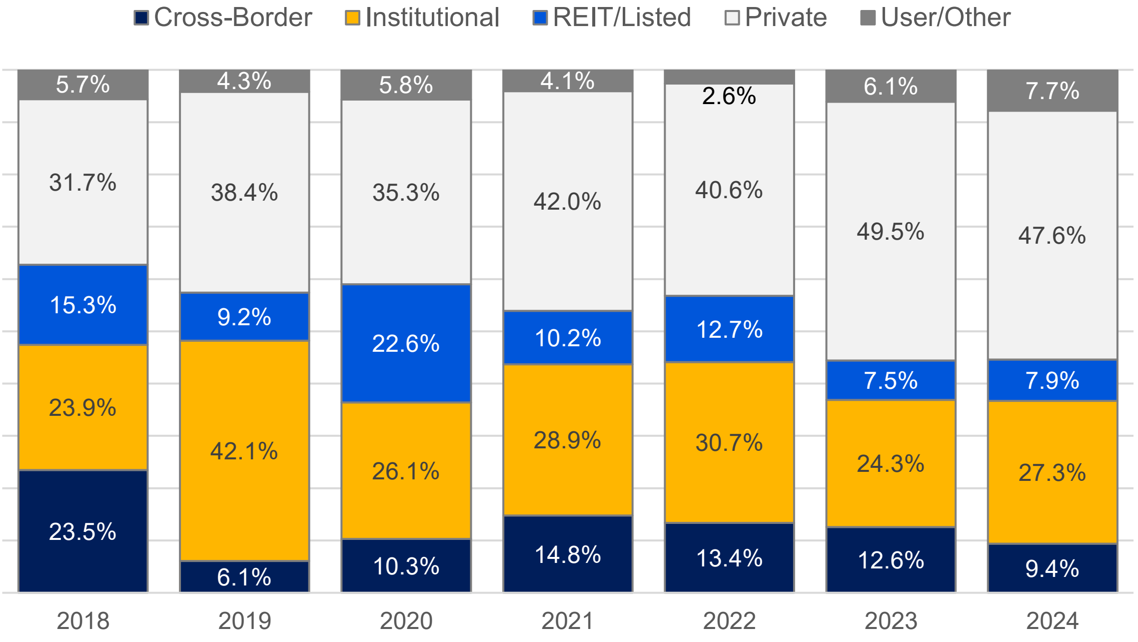
Source: Real Capital Analytics and Cresa; thru Q4 2024

Capital Markets

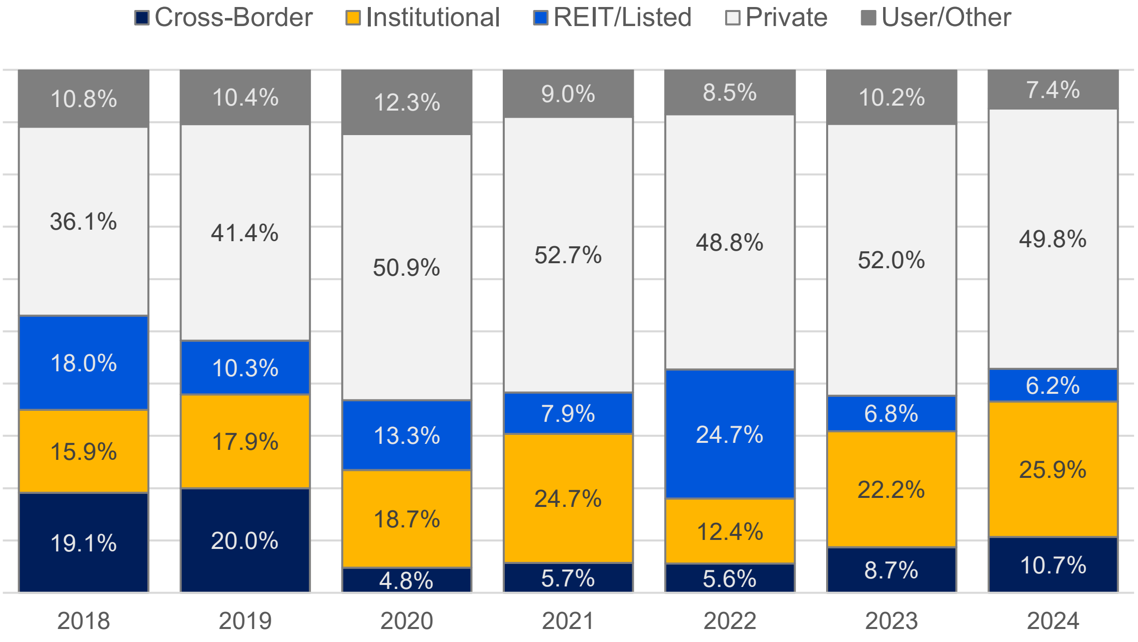
Industrial Capital Composition

Capital markets were very active in 2021 and 2022 before quickly slowing, due to both interest rates and rising costs, but also lack of investment grade industrial supply. Private investors have been active buyers in the industrial market, while REITs have generally been less active. Cross-border investors have trended lower on the sell-side, as they look to hold on to investments and take advantage of aggressive rent increases in many markets across the country. Institutional investors increased their activity on the sell-side in 2024, while REITs decreased their sell-side activity in 2023 and 2024 compared to an active 2022.

Industrial Buyer: (United States)



Industrial Seller: (United States)



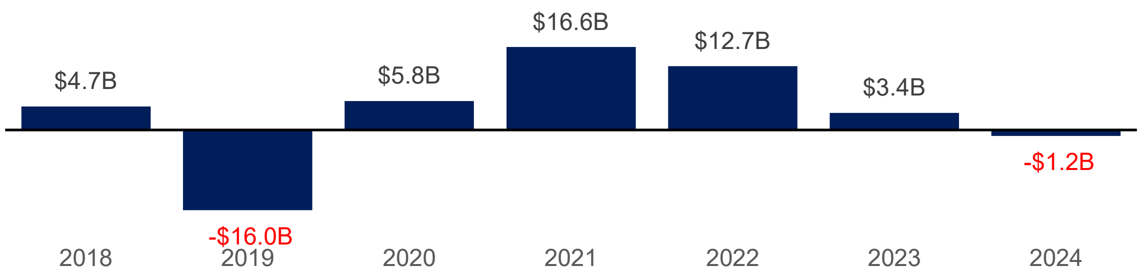
Source: Real Capital Analytics and Cresa; thru Q4 2024

Capital Markets

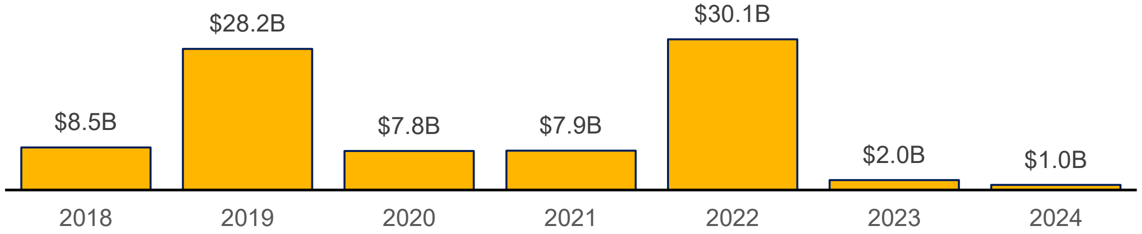
Industrial Capital Flows: Net Acquisitions

While private investors have been more bullish on the investment side, they have generally been more active sellers in the industrial asset type, more actively selling than buying for the past seven years. Meanwhile, institutional investors have made big bets on the buy-side as they have acquired more than disposed of industrial assets in each of the past seven years.

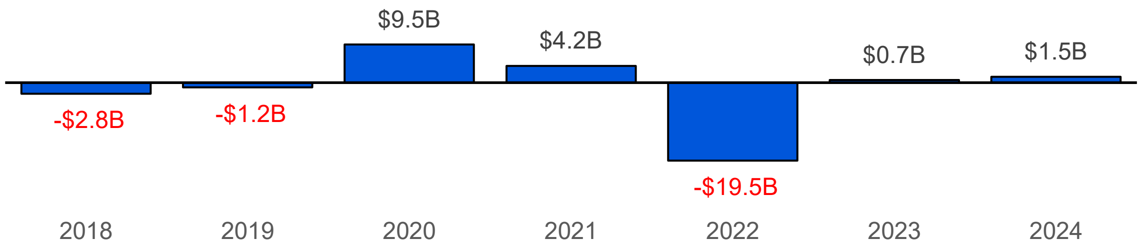
Cross-Border



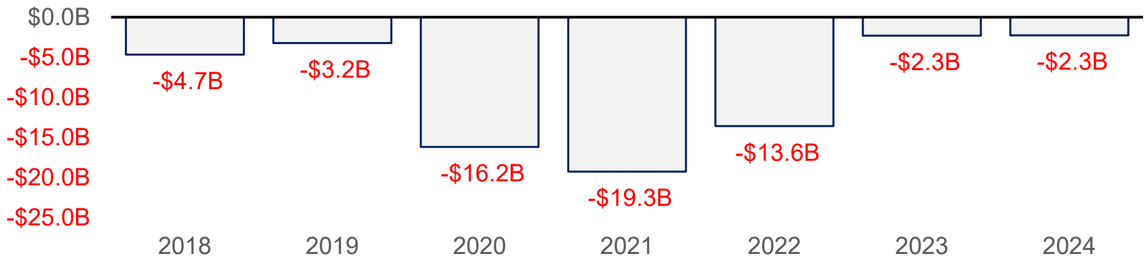
Institutional



REIT/Listed



Private



Source: Real Capital Analytics and Cresa; thru Q4 2024

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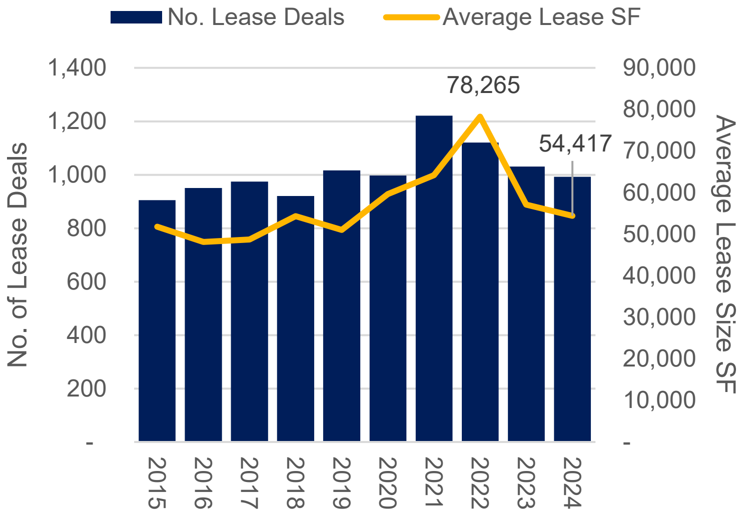
Leasing Trends

Transaction Size is Smaller than 2022, Reverts to Historic Averages

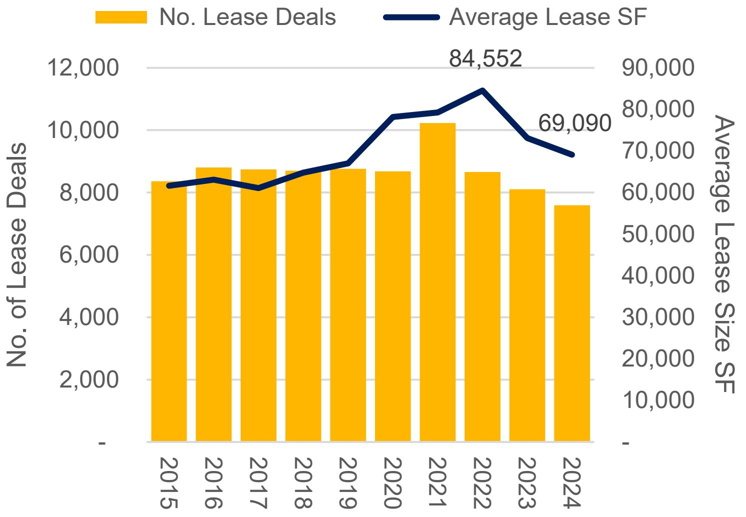
Lease deal sizes in 2022 were higher for all industrial property types compared to 2024. After beginning to spike in 2020, average deal sizes have reverted closer to historic averages. The number of lease deals for manufacturing, distribution, and flex spaces are on track to align with the past two years.

Historic Industrial Activity – Average Deal Size

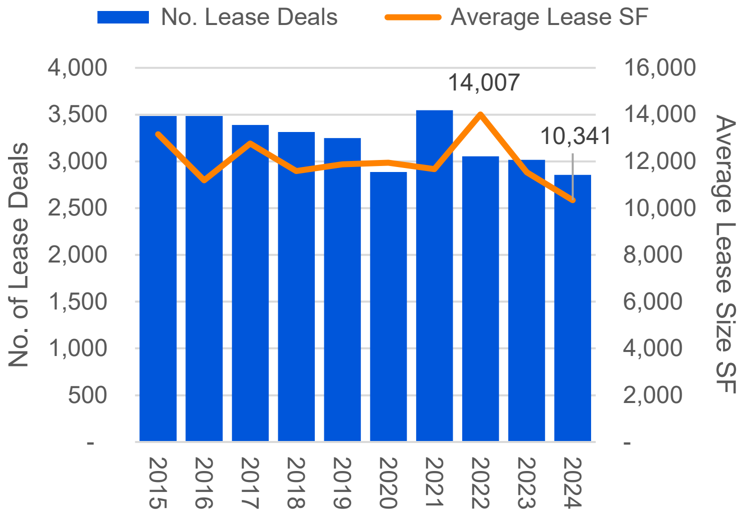
Manufacturing



Distribution



Flex

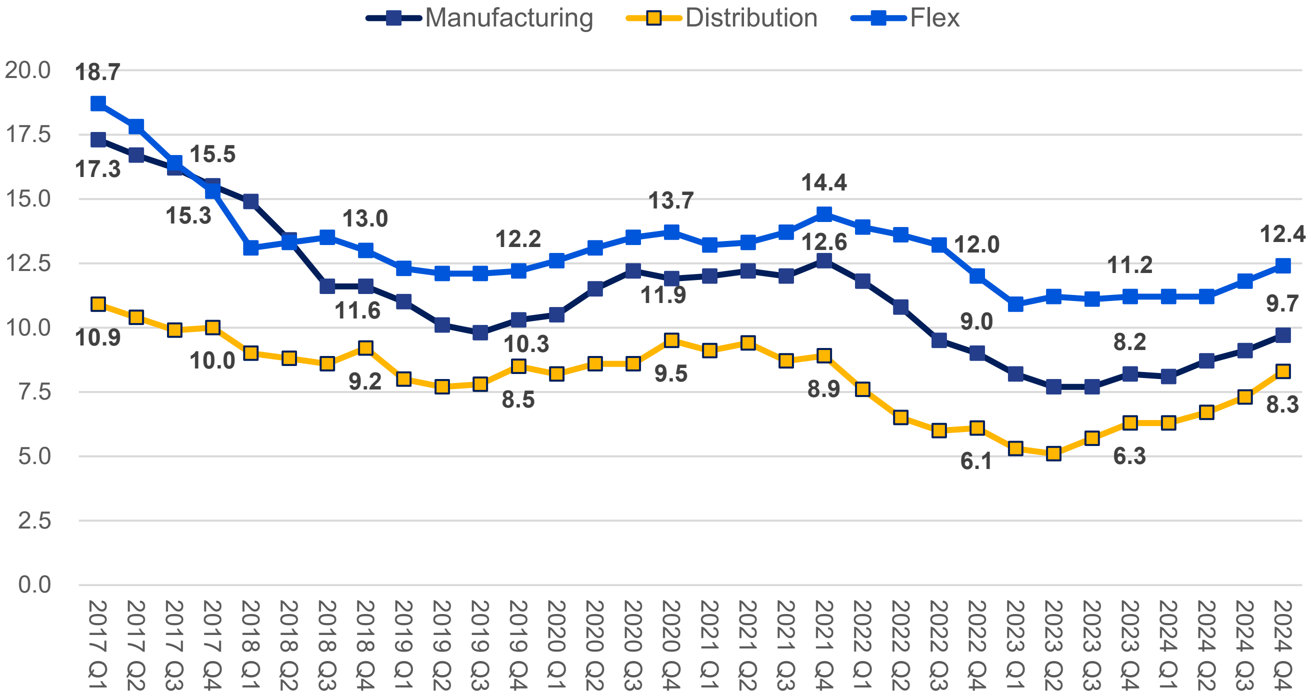


Source: CoStar and Cresa; thru Q4 2024.

Leasing Trends

Months to Lease Properties Generally Declines Over the Past 3 Years

Months-To-Lease



Source: CoStar and Cresa; thru Q4 2024

The number of months to lease industrial properties have generally trended lower in the past seven years, bottoming out in 2023 before moving higher.

Distribution spaces have taken 3.0 months more time to lease since the start of 2023.

Both flex and manufacturing spaces have each taken 1.5 months more time to lease since the start of 2023.

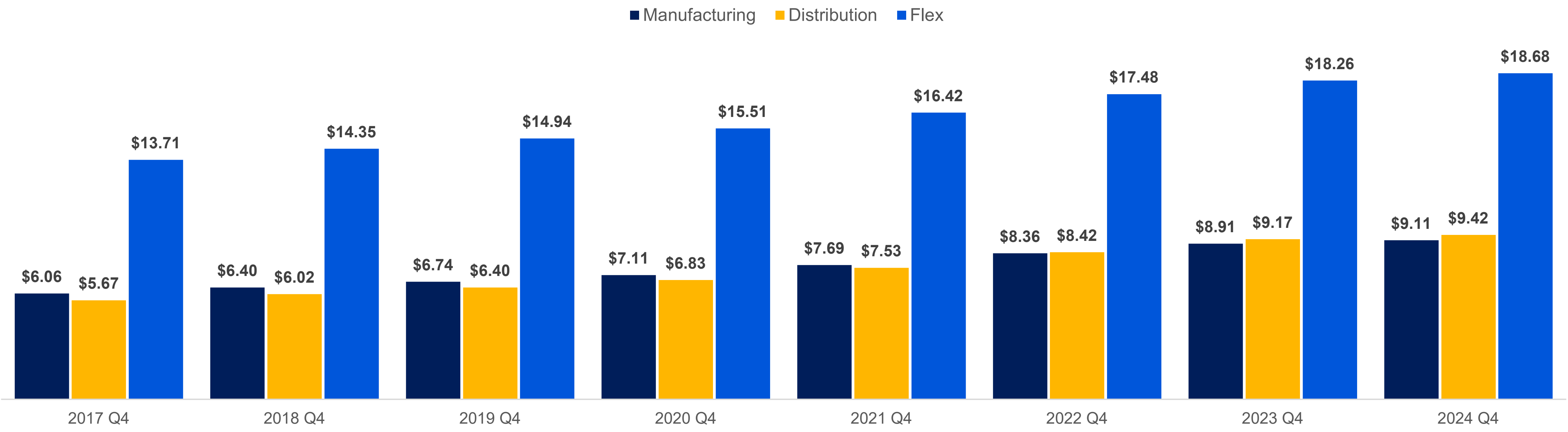
All three industrial asset times are reverting to historical averages.

Market Rent

Industrial Rents Growth Slows

Industrial rates have steeply increased since the end of 2019, particularly distribution space, which has increased by nearly 50 percent in the past five years. Nationwide, average logistics asking rates have increased every quarter since 2017 until this past quarter that saw no increase. It should be noted that some markets that underwent dramatic rate increases have experienced rates moving lower. While rates are generally expected to increase, landlords will need to wait for demand and absorption to catch up before rates see a meaningful increase.

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

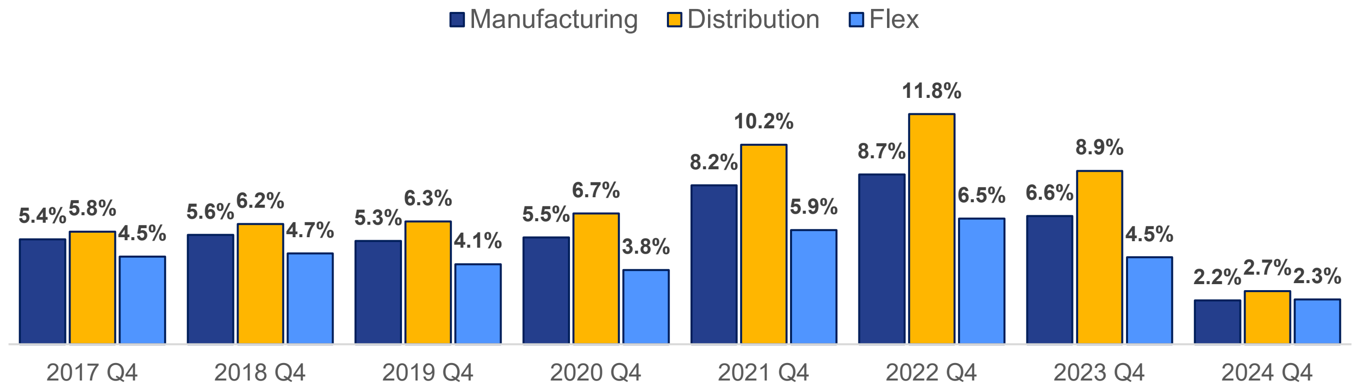


Source: CoStar and Cresa; thru Q4 2024

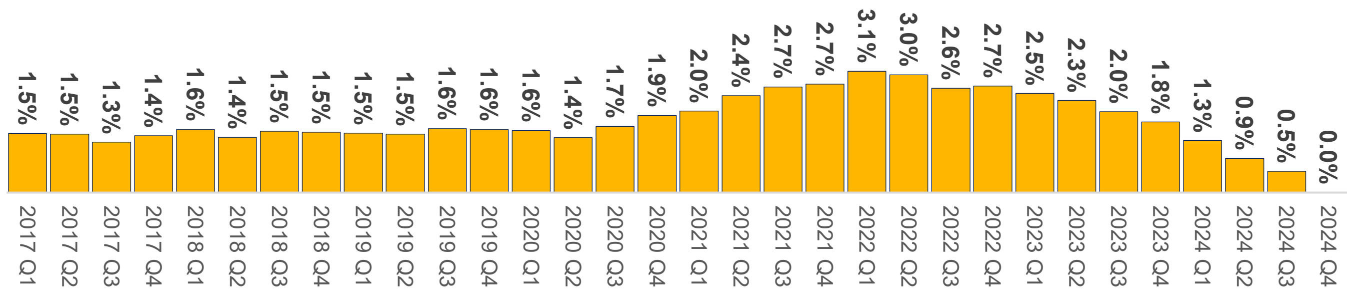
Market Rent

Direct Asking Rent Growth Dips Below Pre-Pandemic Levels

Industrial Asking Rent Annual Increase: (United States)



Distribution Asking Rent Quarterly Increase



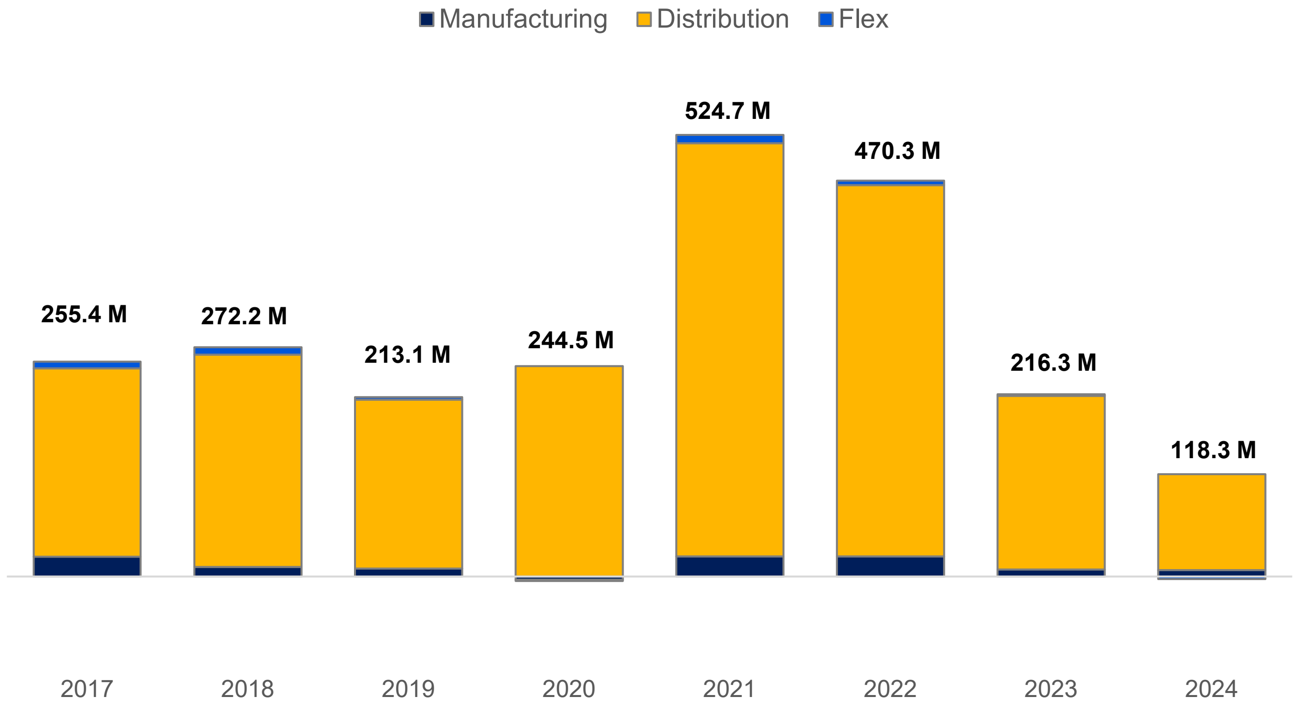
Source: CoStar and Cresa; thru Q4 2024

Industrial lease rates have generally stalled after an extended run of big increases. Still, the compounded annual growth rate (CAGR) for distribution spaces has increased 8.2 percent per year since the start of 2017, while manufacturing spaces have increased 6.6 percent and flex spaces increased 5.0 percent during the same time. While it is unlikely rates will meaningfully decline, other incentives like TIs and abatements may become more negotiable for occupiers.

Absorption

Industrial Absorption Dramatically Slows

Industrial Net Absorption (SF): (United States)

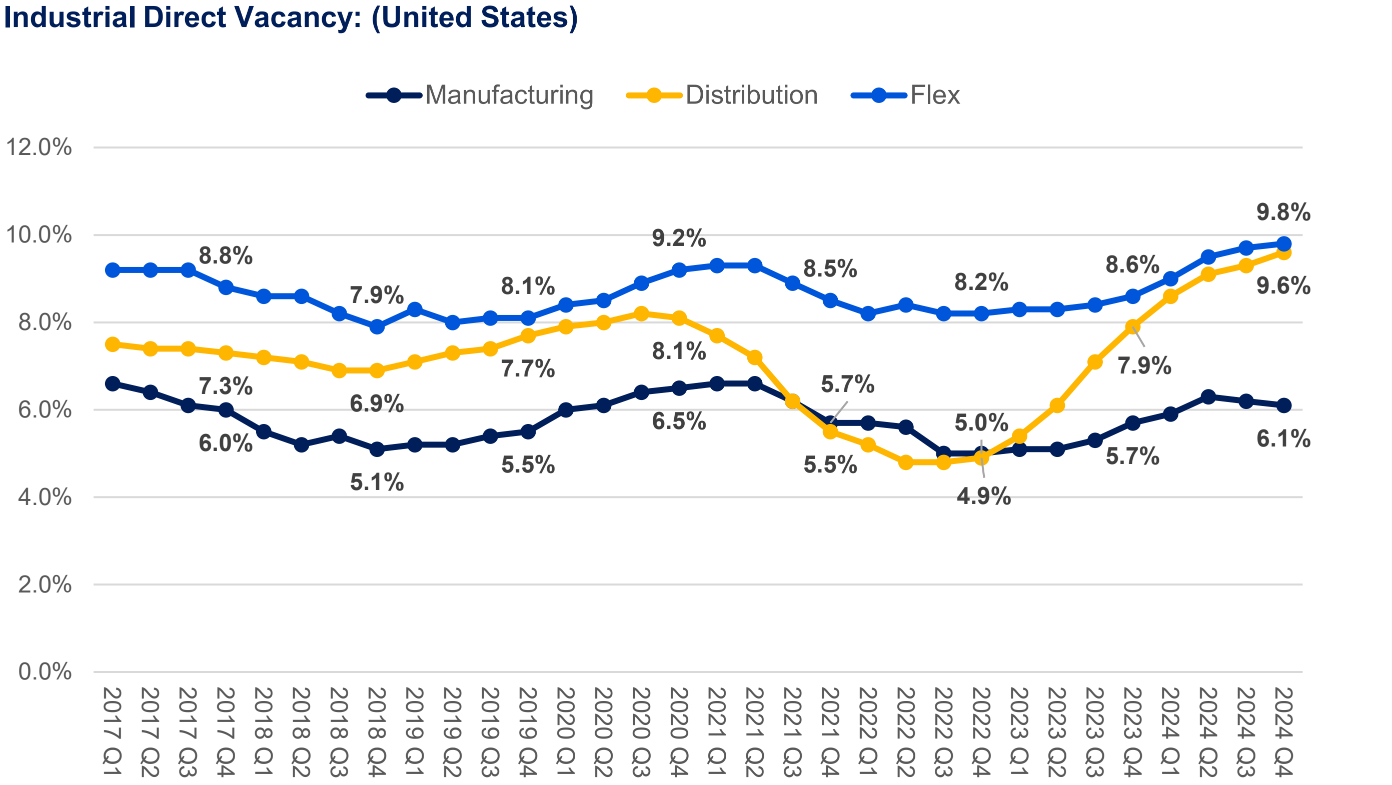


Source: CoStar and Cresa, thru Q4 2024

After a record-breaking 2021, absorption has experienced a slowdown. Some of this can be explained by economic conditions softening with overall imports slowing. Absorption in 2024 was at the lowest level in the past seven years. Nevertheless, with the amount of new construction being delivered and ongoing demand over the next several quarters will likely keep absorption near or above historical averages as occupiers take space.

Direct Vacancy

Industrial Vacancy Moves Higher as New Product Delivers



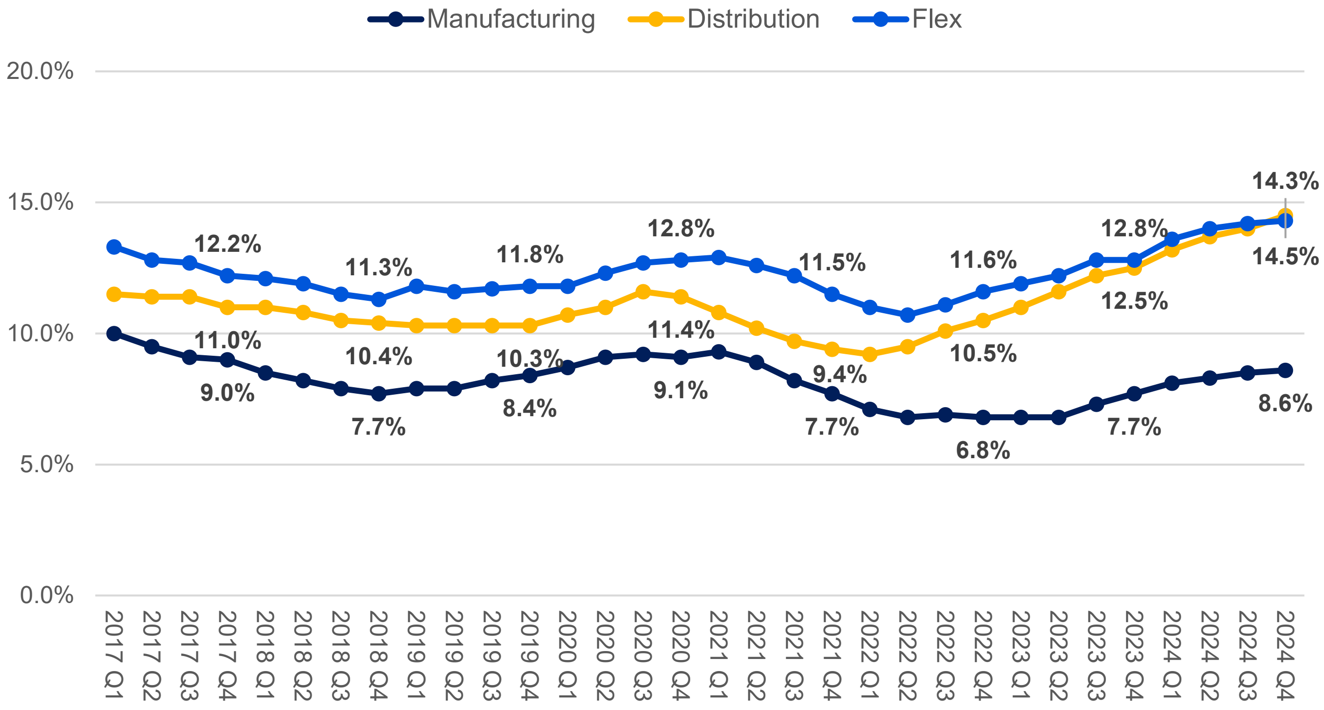
Source: CoStar and Cresa, thru Q4 2024

Direct vacancy is approaching historical averages after spending the past three years near historic lows. It is likely that the large amount of new construction being delivered contributed to the increase. Large retailers are still looking to shore up distribution facilities, so they are better positioned for future growth. Manufacturing space has remained low due to increased demand as more companies move operations back closer to US markets to stabilize supply chains.

Availability

Industrial Availability Drifts Higher

Industrial Availability Rate: (United States)



Source: CoStar and Cresa, thru Q4 2024

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 9.2 percent over the past three years to 14.5 percent to close 2024.**

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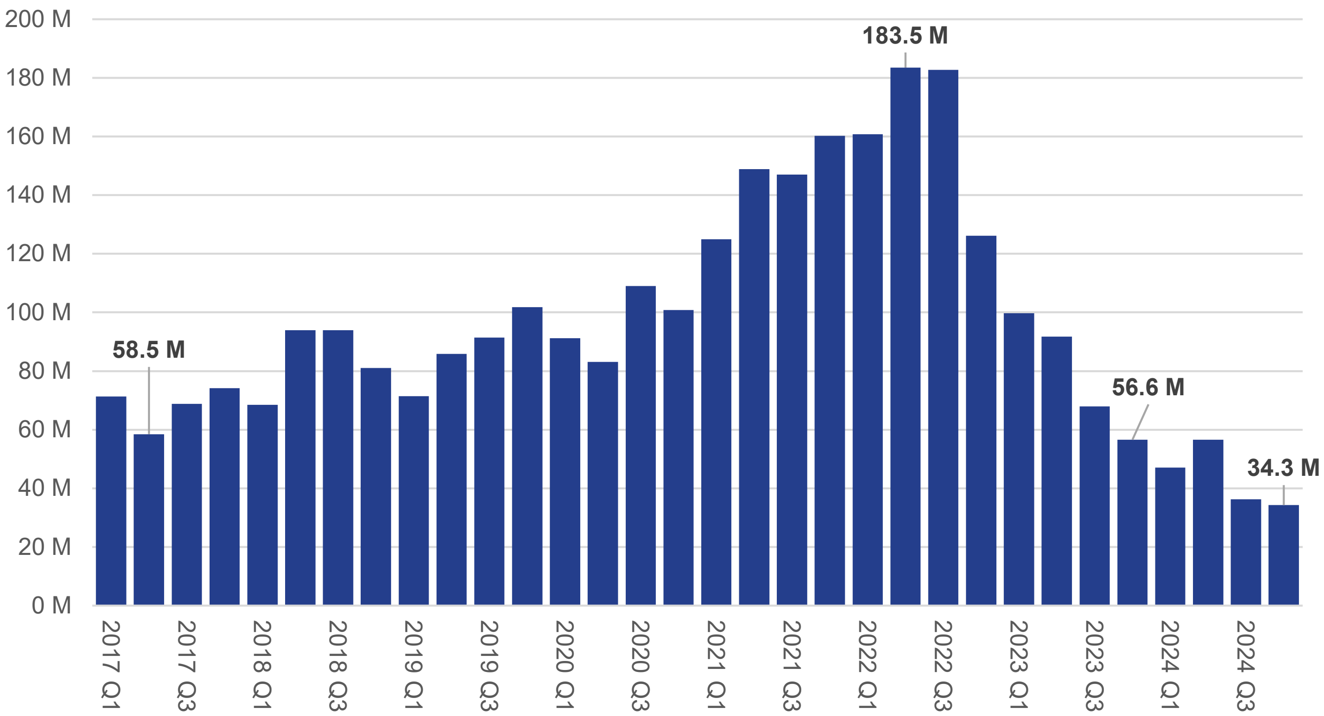
Construction

Industrial Construction Starts Fall Sharply

Industrial Construction Starts: All Types (United States)



Source: CoStar and Cresa; thru Q4 2024

New industrial construction starts topped 183 million square feet in the second quarter of 2022. Starts for 2023 were comparable to pre-pandemic levels. However, given the torrid pace of construction and rising construction costs, elevated interest rates, and supply chain constraints, the number of new industrial starts has dramatically slowed. It is expected that construction starts will dip further in early 2025 before falling back in line with pre-pandemic levels moving forward. **The number of quarterly industrial starts by square footage has dropped for nine of the past 10 quarters.**

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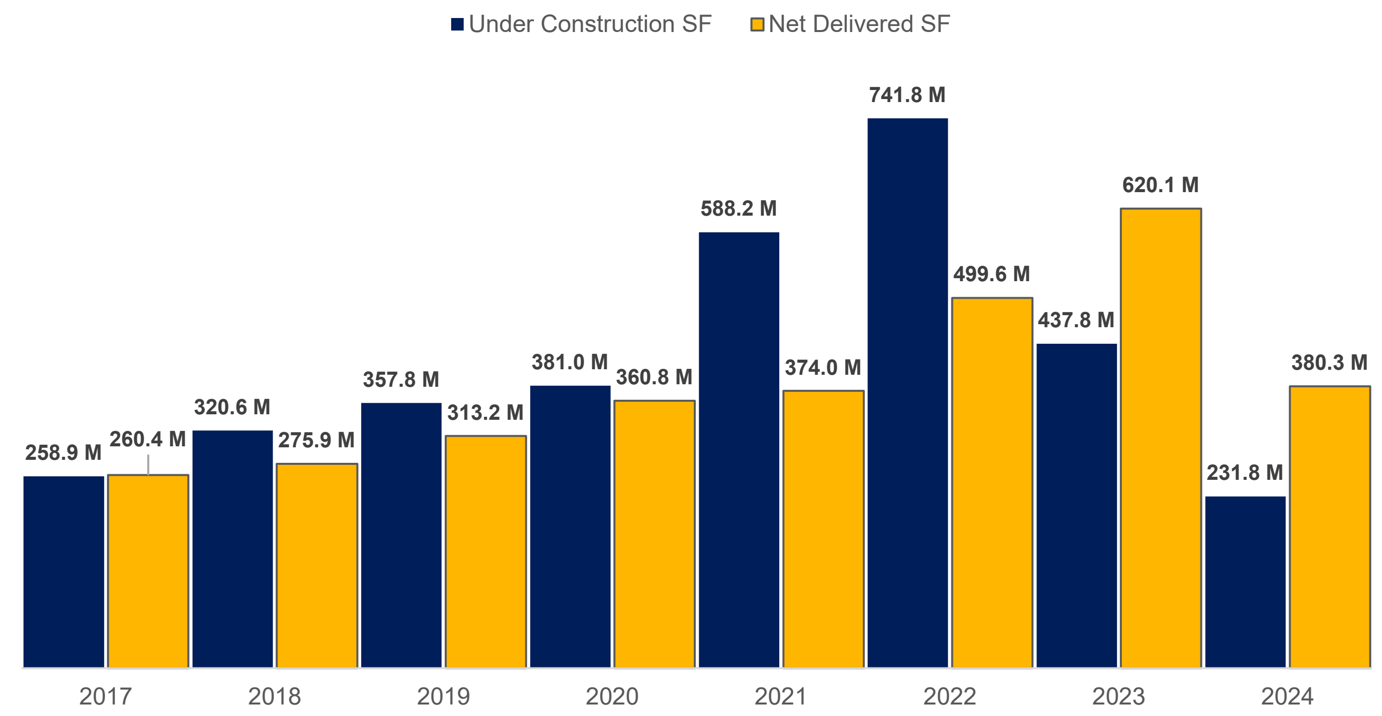
Construction

New Industrial Projects Pump the Brakes

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



Source: CoStar and Cresa; thru Q4 2024

Industrial inventory grew nearly three percent in 2023, an increase not seen in the United States in the past 30 years. The number of industrial starts peaked in 2022, 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 manufacturing and flex spaces remains resilient, likely resulting in a temporary lull in the breakneck speed of new construction starts. **The total industrial space square footage under construction dropped nearly by half (47.1 percent) since the end of 2023.**

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.

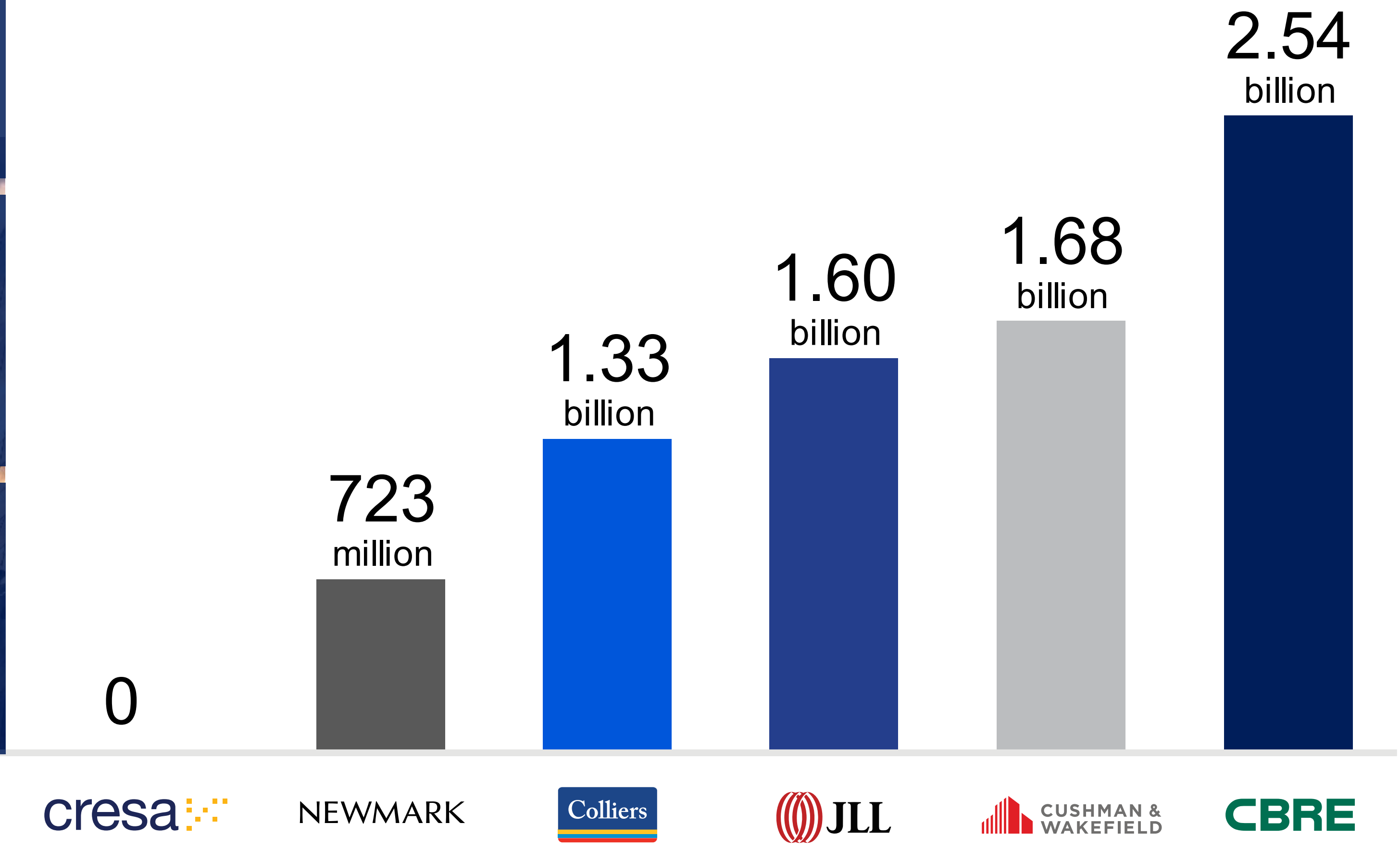
How We're Different

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.



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