CREXI

National Trends Report

Q2 2023

INTRODUCTION

The first half of 2023 displayed mixed economic signals, with both headwinds and beacons of opportunity clouding a clear view of commercial real estate's performance. The reality is far from black and white. However, some would claim it as such: signs like general economic soundness, signs of softening inflation, growth in secondary and tertiary market opportunities, and overall investment activity suggest a healthy sector. Others claim that the sky will soon fall, citing several trillion in CRE debt coming due with murky ends to the Fed's hawkish interest rate hikes.

While there's little doubt that commercial real estate is making its way through hurdles, the worst of doomsayers' claims have failed to materialize, and many trends are reverting to a post-pandemic mean. In reality, many deals and developments are still occurring, and commercial real estate continues to benefit from its built-in diversification across operators, asset classes, sub-types, and market locations. Q2 2023 presented only slightly constricting valuations, while investment capital deployed at a healthy clip with double-digit gains in offer activity from the previous quarter.

As always, comprehensive, data-powered information is essential in investor and broker arsenals. Our quarterly overview report aims to provide valuable insights and trends, and shed light on the undercurrents of commercial real estate activity. This report examines CRE activity on Crexi throughout Q2 2023, considering quarterly metrics and year-over-year data, enabling stakeholders to make informed strategic decisions when navigating the potentially complicated waters ahead.

WHAT HAPPENED IN Q2 2023

CRE loans became a high priority for the Fed.

Some recent high-profile CRE loan defaults and a looming $1.5 trillion in commercial property debt coming due by 2025 - with many loans held by regional banks - have turned the Fed's hawkish eye towards the sector. It should be noted, sometimes a default - though it makes for good headlines - is strategic as most lenders won't discuss relief or restructure negotiation while a loan is current.

The Federal Reserve's tough crackdown on inflation has many in the CRE sector eyeing the fallout of renegotiated debt structures once these loans come due. A cooling labor market added 209,000 jobs in June, below economists' expectations of 225,000 jobs. This provided a hopeful sign that the Fed may slow down its streak of interest rate hikes, rapidly scaling from near-zero to a 5.5% benchmark federal funds rate, with one to two further interest rate hikes looking likely later in 2023.

> **Some slack-tide conditions have emerged as buyers hold firm to their underwriting at higher costs of capital, while sellers remain slow to budge off last cycle's highs. As a result, deal velocity has cooled.**
>
> **Despite the stalemate, we remain long-term commercial real estate bulls. There are some headwinds to navigate and sensationalized headlines, but brick-and-mortar remains extremely relevant and we believe a crisis will be averted. Today's resilience will fuel tomorrow's growth."**
>
> *- Eli Randel, COO, Crexi*

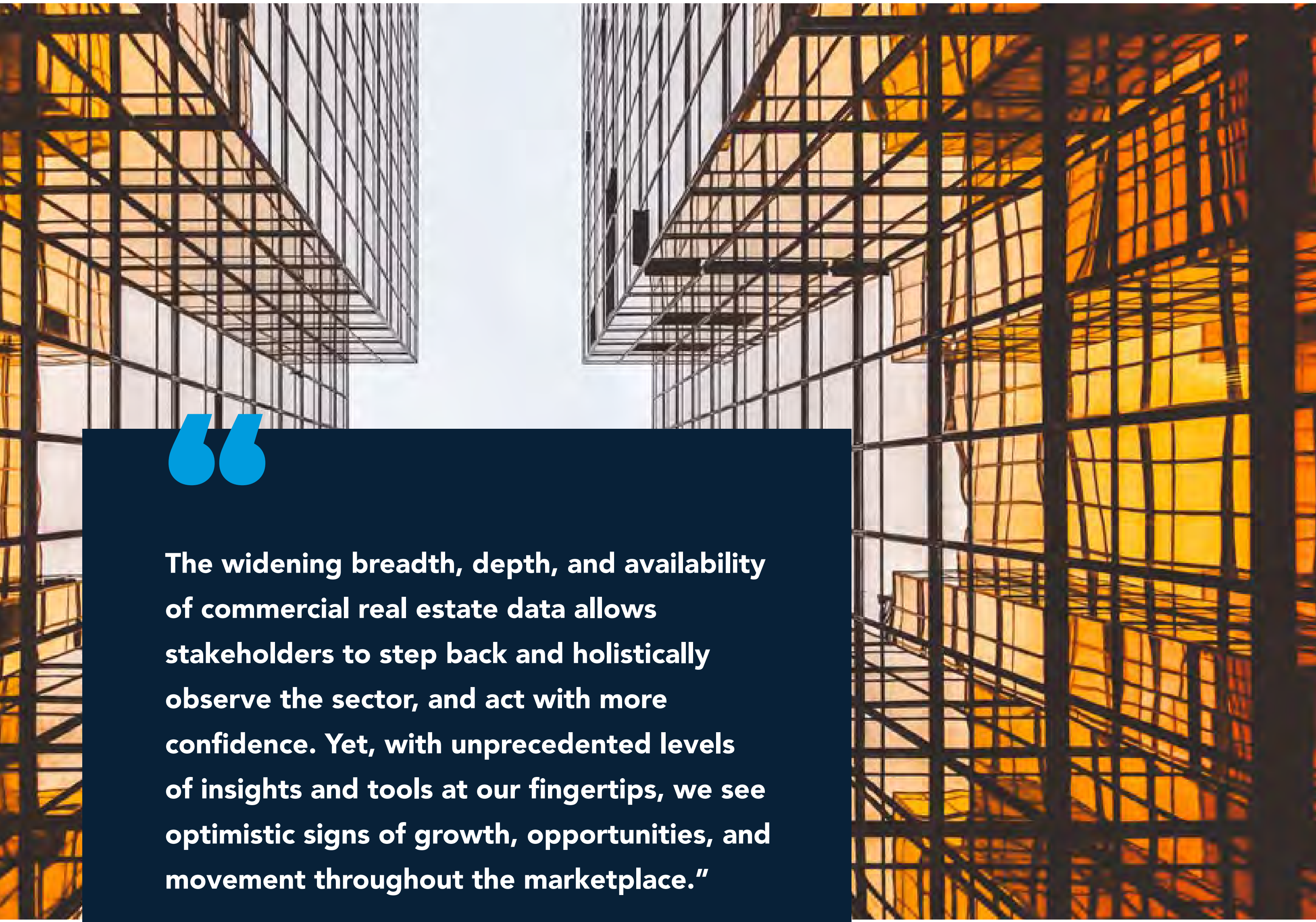
As these loans approach maturity, borrowers have three options: refinance at a much higher rate, sell their properties, or restructure the loan with the lender. In response, financial regulators updated guidance for lenders to work with credit-worthy borrowers, providing examples of how to work with short-term loans, partial repayments, and other stop-gaps to ease potential stress. The government's awareness of CRE's positioning means it's taking proactive steps to address possible concerns, a far cry from the blind-sidedness of the Great Financial Crisis.

While the government's moves may be worrisome to some, they come amid many promising metrics within CRE's different asset classes and regions. Mixed signals and reports muddled the waters of macroeconomic conditions in the last half-year. Still, the good signs and the implementation of so many guard rails may mean CRE is clear from the worst outcomes, primed for clearer skies ahead.

Commercial real estate's inherent diversity showcased varying performance across sectors.

Despite headlines painting woeful pictures of distress and doom, many fail to consider commercial real estate's sheer, inherent diversity across asset classes, operators, and markets. There are certainly salient concerns about looming debt and rising costs of capital that stakeholders should keep an active eye on, but the CRE ecosystem is far from falling apart. Behaviors and fundamentals in specific asset classes and markets affect each category's performance; while some (like office) faced stress in Q2, there were certainly still opportunities to be found.

Retail has positioned itself well for the long haul, thanks to promising consumer spending habits and a flourishing return to in-store visits. Not all subsectors are growing equally, however. By the nature of its diverse operators and longer-hold leases, retail has proven a reliable profit generator for owners, particularly in quick-service dining with drive-throughs and luxury shopping.



"The widening breadth, depth, and availability of commercial real estate data allows stakeholders to step back and holistically observe the sector, and act with more confidence. Yet, with unprecedented levels of insights and tools at our fingertips, we see optimistic signs of growth, opportunities, and movement throughout the marketplace."

- Mike DeGiorgio, CEO, Crexi

Multifamily, as another example of success, can't be built fast enough. While certain hurdles to meeting the exponential demand for affordable housing exist, surging home prices and a general trend towards renting versus buying have sent multifamily demand soaring in the last half-year.

Interestingly, even while offices have continued their glacial trudge towards recovery, creative developers are converting vacant units into industrial or multifamily space, seeking to meet a serious lack of logistics vacancies and growing demand from e-commerce and manufacturing.

Not all offices are created equal, either: Apple in June acquired over 161K square feet of office space in Cupertino, and other corporations continued championing a return to work, citing higher productivity. The office is also a means of attracting talent: amenities and value-add space provide a competitive edge to tenants. Providing those perks has become key on the landlords' side.

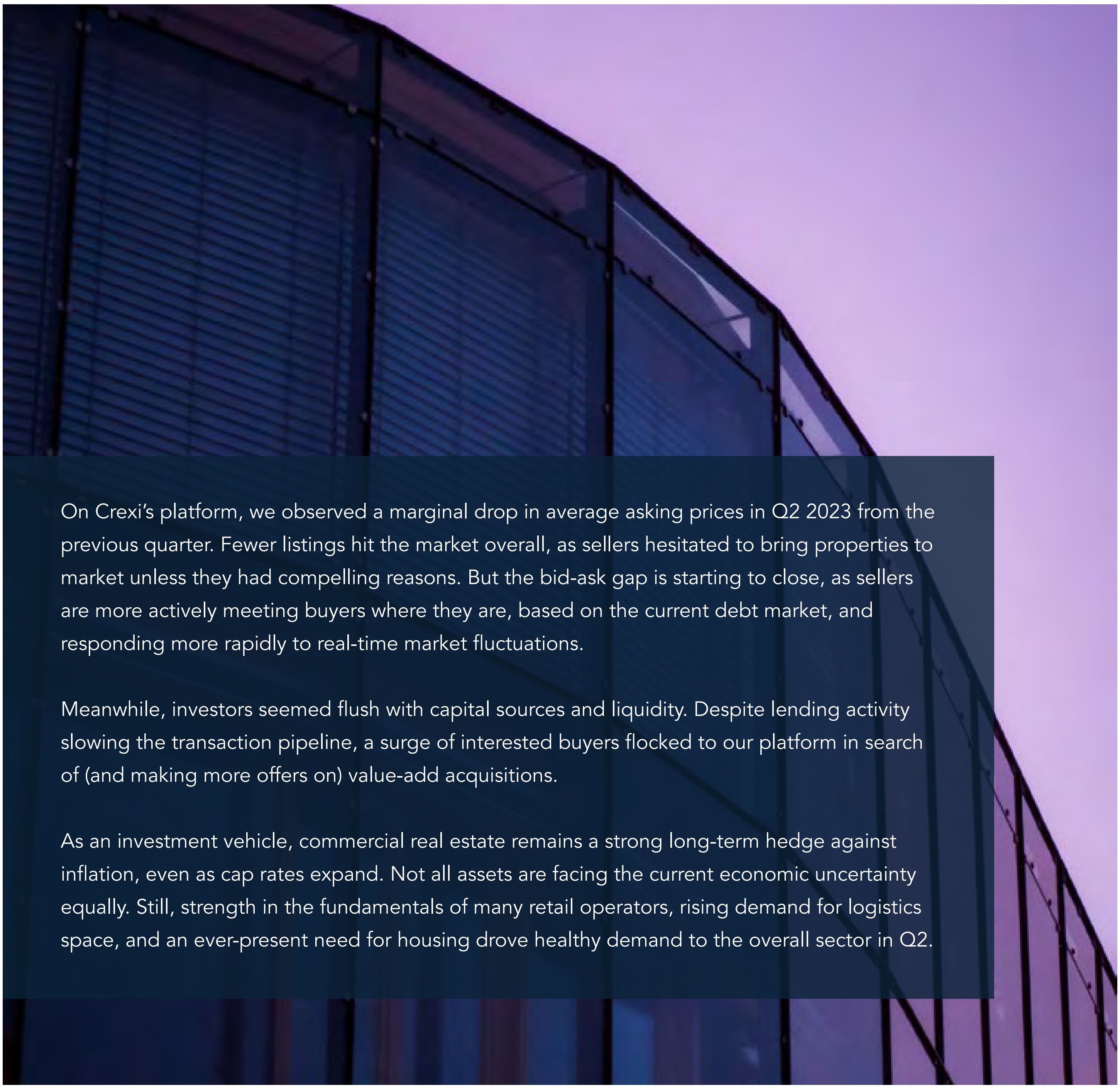
These signs and others displayed a side less cited in the current commercial property conversation. It's important to explore all elements, fundamentals, and trends of a particular market, asset class, and subsector: in Q2, several diamonds were waiting in the property investment rough.

Acquisitions are being made, slowly but steadily.

Historically speaking, commercial real estate has proven a hedge during increased inflation. Fear of market turbulence has allowed savvy, well-capitalized investors to make strategic moves in a highly reliable vehicle. CRE has outperformed its own historical averages and other asset classes during the last several instances of elevated inflation, even despite rents not adjusting as quickly as higher costs, according to a recent McKinsey analysis.

Patient investors know this and continued to deploy capital for good opportunities in Q2– with some deals at discounted prices. Demand remained strong throughout the second quarter of 2023, and plenty of liquidity remains on the sidelines even as lenders tightened their underwriting practices. Additionally, many opportunities exist for current owners to streamline operating costs and add value to their current assets, increasing the likelihood of capturing tenants – who are certainly still seeking space in many sectors – and securing solid, recession-resistant NOI.

COMMERCIAL REAL ESTATE NATIONAL SALES TRENDS

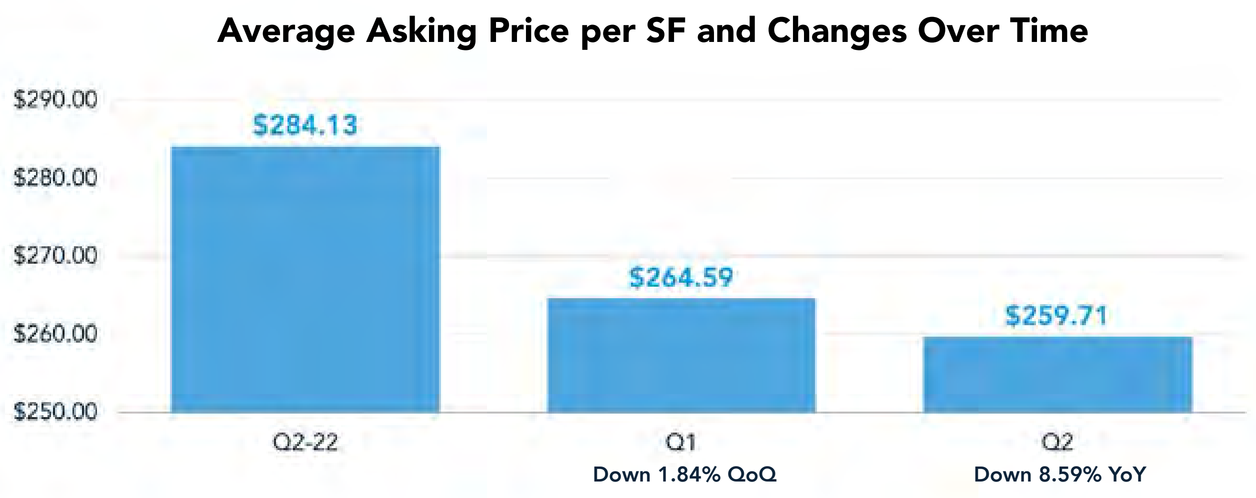


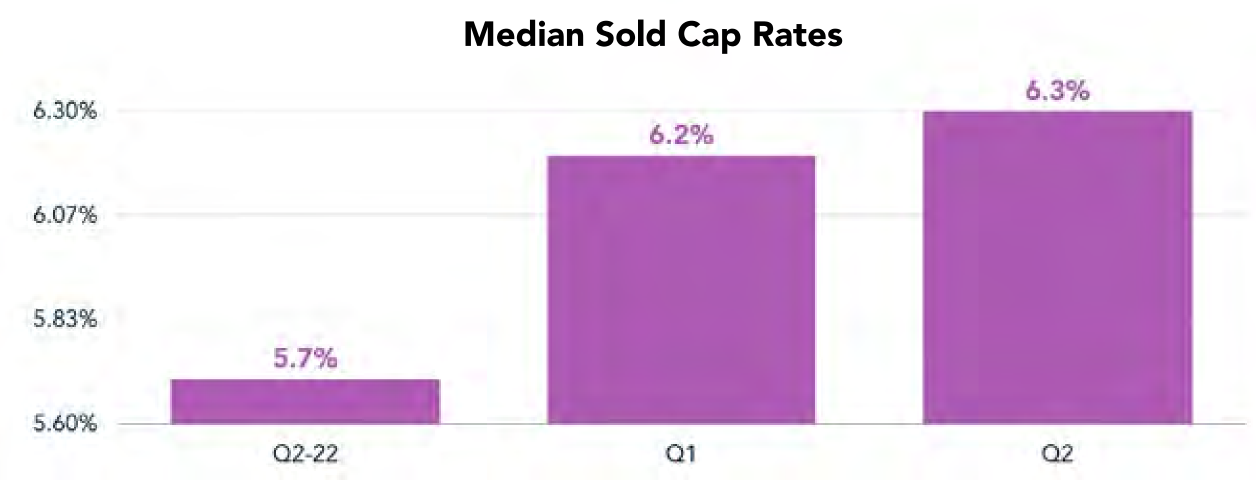
On Crexi's platform, we observed a marginal drop in average asking prices in Q2 2023 from the previous quarter. Fewer listings hit the market overall, as sellers hesitated to bring properties to market unless they had compelling reasons. But the bid-ask gap is starting to close, as sellers are more actively meeting buyers where they are, based on the current debt market, and responding more rapidly to real-time market fluctuations.

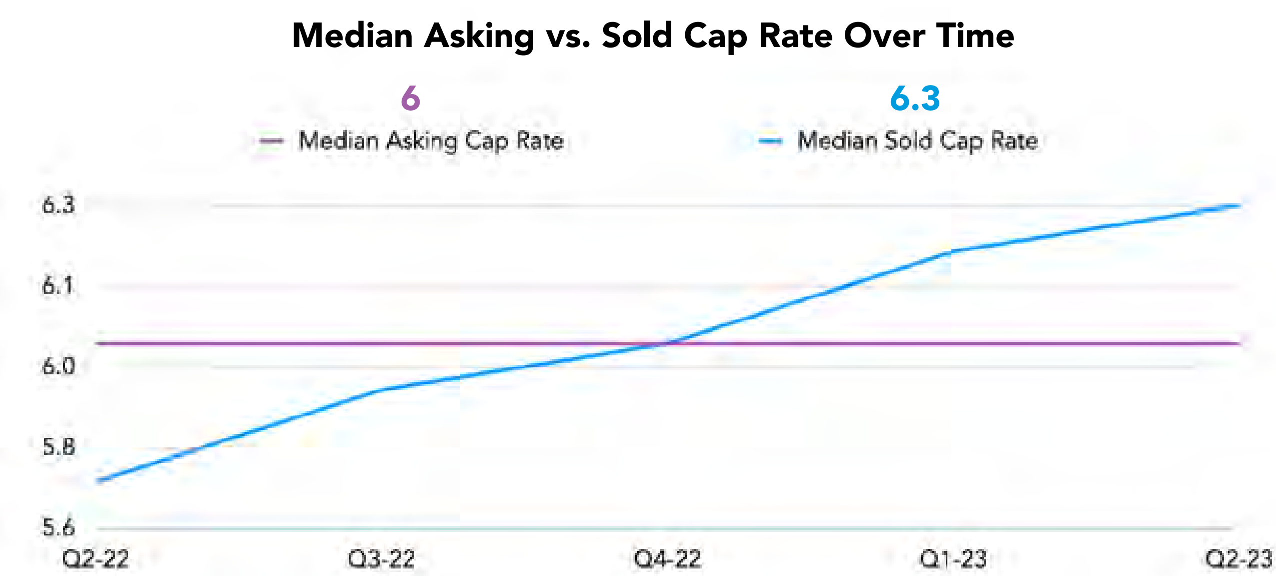
Meanwhile, investors seemed flush with capital sources and liquidity. Despite lending activity slowing the transaction pipeline, a surge of interested buyers flocked to our platform in search of (and making more offers on) value-add acquisitions.

As an investment vehicle, commercial real estate remains a strong long-term hedge against inflation, even as cap rates expand. Not all assets are facing the current economic uncertainty equally. Still, strength in the fundamentals of many retail operators, rising demand for logistics space, and an ever-present need for housing drove healthy demand to the overall sector in Q2.

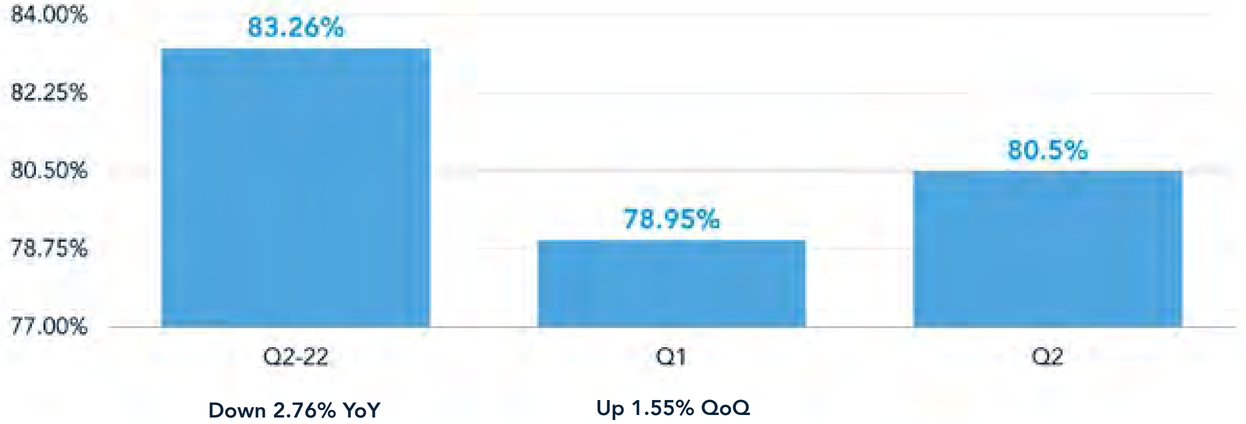
What the Data Says



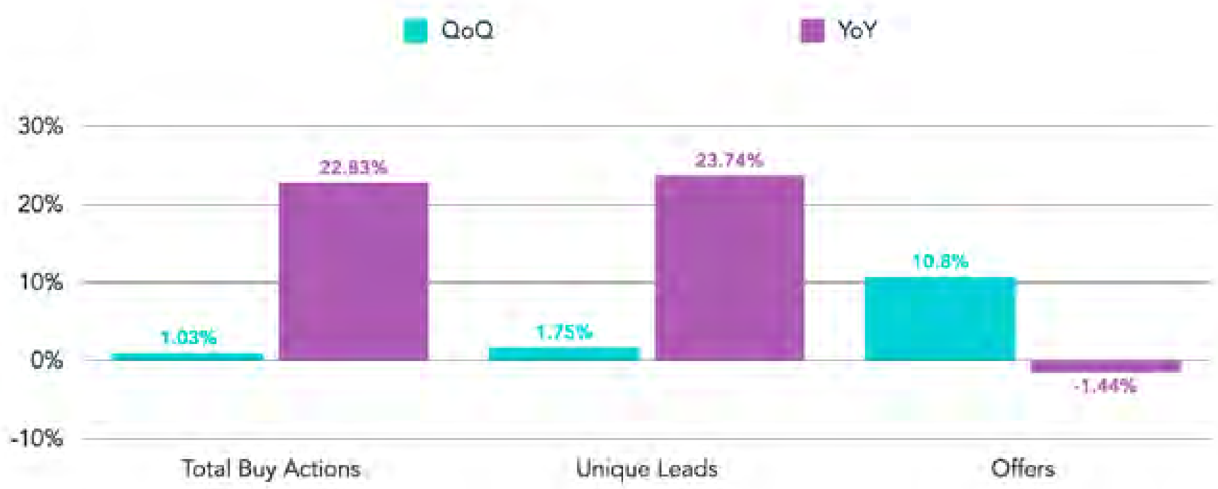




Average Occupancy and Changes Over Time



Buyer Activity, Leads and Changes Over Time



Key Insights

Despite slow dips in valuations, buyers are still clearly on the hunt for good investments. Investment activity has tapered somewhat in the aftermath of the post-COVID acquisition frenzy, when rates were near-zero, before the Fed began its aggressive series of interest rate hikes in March 2022.

However, demand activity on Crexi paints a picture of a deal-seeking market, with overall offers up over 10% quarterly. Additionally, the median sale price of completed deals has only dipped 55 basis points annually, despite an industry slow in transaction velocity. We can attribute the lengthier deal timelines to some lenders' hesitancy and more stringent due diligence processes. However, many financial institutions are still funding deals – deploying $193B in total deal volume Q2 2023, per Crexi's comps data.

Steadily growing occupancy rates also paint a picture of a healthier commercial real estate sector. Retail and multifamily absorption has gained over the year's first half, at 85.1% and 86.5%, respectively. And while office vacancies are still historically high, we saw national occupancy levels rise 94 basis points to 63.9% over the last quarter, especially as operators push for employee returns to in-person work, with office amenities and high-quality working quarters.

Regional Trends

Cities with Highest Asking Price per SF in Q2

City	Price per SF	% Change QoQ
New York	$743.27	10.43%
San Jose	$559.14	3.33%
San Francisco	$551.84	0.68%
Miami	$528.77	13.06%
Austin	$525.25	24.14%
San Diego	$516.22	16.45%
Charlotte	$477.86	40.78%
Los Angeles	$463.03	4.14%
Seattle	$439.37	1.21%
Nashville	$422.31	-7.92%

Cities with Most Pricing Growth in Q2

City	Price per SF	% Change QoQ
Detroit	$130.36	68.70%
Atlanta	$349.65	50.54%
Cincinnati	$183.67	46.47%
Charlotte	$477.86	40.78%
Oklahoma City	$204.07	30.75%
Austin	$525.25	24.14%
Philadelphia	$297.96	19.41%
San Diego	$516.22	16.45%
New Orleans	$285.52	15.26%
Fort Myers	$313.86	14.73%

Cities with Highest Cap Rates in Q2

City	Cap Rate
Cleveland	9.72%
Fort Myers	8.86%
Baltimore	8.58%
Chicago	8.41%
Hartford	8.00%
Pittsburgh	7.70%
St. Louis	7.56%
Buffalo	7.48%
New Orleans	7.44%
Oklahoma City	7.34%

COMMERCIAL REAL ESTATE NATIONAL LEASING TRENDS

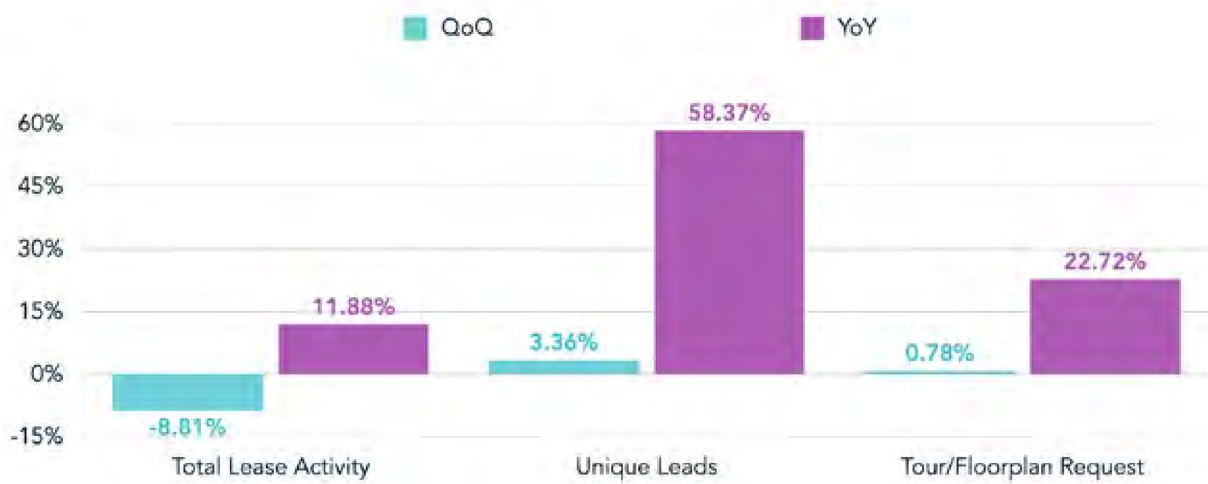
For-lease assets on Crexi saw promising gains in the second quarter, with average asking rents jumping by double-digit percentages. Supply constrictions in highly desirable asset classes, including multifamily, industrial, and some retail sectors, turned up the heat on tenants, who seemed to accept the rising rents across the board. Demand activity climbed more slowly than asking rents, but was still on the upswing, with most asset classes posting increased lead activity in Q2.

However, while job growth and steady wages in Q2 were good for the broader tenant pool, tenant expansion has the potential to falter if rents surpass the threshold of tenants' willingness or ability to pay.

What the Data Says

Average Asking Rate per SF per Month and Changes Over Time

Lease Activity, Unique Leads, Tour/Floor Plan Requests, and Changes Over Time



Key Insights

Asking rents jumped over 10% quarterly, as landlords enjoyed a steady demand surge across asset classes. Taking a closer look, retail leases were the primary driver of rate gains, rising an impressive 26.7% in asking rates, compared to the first quarter of 2023.

Industrial, restaurant, and office asking rates showed more modest increases of no more than 70 basis points, compared to new listings in Q1. However, this holdfast of rates stands strong amid a noticeable rise in actively-seeking tenants. Nearly 58% more unique tenants were on the hunt for available space, compared to Q2 2022.

We may see rates climb in the year's second half, but landlords can better position themselves to attract strong leases and steady NOI by closely working with tenants to create value-add spaces. Luxury retail shops and Class A offices are among the top Q2 lease performers, in terms of occupancy. When landlords improve their offerings, many tenants seem ready to sign higher lease terms for higher quality space.

Regional Trends

Cities with Highest Average Asking Rents in Q2

City	Monthly Rate per SF	% Change QoQ
Raleigh	$1.60	7.30%
San Francisco	$1.57	17.14%
Hartford	$1.56	44.93%
Virginia Beach	$1.53	12.64%
Orlando	$1.51	6.84%
Chicago	$1.48	4.98%
Portland	$1.48	9.41%
Tampa	$1.46	3.44%
Jacksonville	$1.43	9.44%
Atlanta	$1.41	7.89%

Cities with Highest Rent Growth in Q2

City	Monthly Rate per SF	% Change QoQ
Hartford	$1.56	44.93%
Baltimore	$1.34	23.76%
Milwaukee	$1.35	19.33%
Nashville	$1.32	19.27%
San Francisco	$1.57	17.14%
Austin	$1.40	15.85%
Louisville	$1.28	14.95%
Virginia Beach	$1.53	12.64%
Jacksonville	$1.43	9.44%
Portland	$1.48	9.41%

FINAL THOUGHTS

Mixed economic data, naysayers, and contrarians paint a confusing picture of commercial real estate's short-term future. Despite looming continued rate hikes, the job market and inflation are tapering toward a hopeful peak. Regardless of lenders pausing and becoming more particular with their investment partners, many opportunistic investors are getting deals done and deploying from their considerable liquidity.

Commercial real estate is simply too vast to paint as a single entity. Its diversity and reliability as an inflation hedge is precisely what makes it continue as a relatively safe, long-horizon investment vehicle. We believe that many able to proactively keep a finger on the pulse and strike when an opportunity is hot will find long-term success in commercial real estate.

METRICS AND METHODOLOGY

This article relies on data from [Crexi's marketplace](). In particular, to ascertain timely and representative trends in seller sentiment, this article focuses on offering metrics, such as average asking price per square foot, cap rate, and monthly rents, in addition to listed occupancy, tenancy, and square footage. Using these listing-based metrics and changes therein, we can use seller expectations at the time of listing to approximate overall valuation trends.

While these data aggregations may broadly reflect prevailing market conditions, it is essential to note that variations can also be affected by inventory changes, asset size, etc. We pair these data points with internal data from Crexi buyers on search trends and acquisition-related actions performed on Crexi to provide a holistic understanding of where both sides of commercial real estate are headed.

DISCLAIMER

The information in this report is based on Crexi's internal marketplace data and additional external sources that we consider reliable, but we do not represent it is accurate or complete.

Crexi internal marketplace data consists of aggregated property-level data points provided by brokers and reviewed internally by Crexi. While these data aggregations may largely reflect prevailing market conditions, variations can also be affected by inventory changes, asset size and other factors.

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TERMS

Occupancy: The percentage of occupied square feet in a building.

Absorption: A measurement of the net change of the supply of commercial space in a given real estate market over a specific period of time. Total absorption is new square footage leased by tenants minus vacated square footage vacated by tenants and made available on the CRE market.

Asking Price per Square Foot: The asking price per square foot of a building for sale.

Asking Rate per Square Foot: The landlord's asking rent rate per square foot for a building or market.

Asset Type: Also called "Asset Class" or "Property Type," one of four main categories in commercial real estate: retail, industrial, multifamily, and office. Also can refer to smaller categories including land, hospitality, etc.

Asking Cap Rate: Net Operating Income divided by the Asking Price.

Vacancy Rate: The rate of vacancy in the listed property.

Buyer Activity: Acquisition-related actions taken by users on Crexi sales property pages.

Buyer Searches: Internal site searches taken by users on Crexi sales or lease.

Lease Activity: Leasing related actions taken by users on Crexi lease property pages.

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