2024 Q3 MARKET COMMENTARY

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ECONOMIC OVERVIEW [1]

The U.S. economy continued to expand at a strong pace in the third quarter of 2024. U.S. real gross domestic product ("GDP") grew at a 2.8% annualized pace in the third quarter, stronger than the 2.4% growth rate during the last economic expansion in 2010-2019 and well above estimated potential growth. Consumer spending, which accounts for more than two-thirds of the economy, was a key driver of growth. U.S. households picked up spending at an aggressive 3.7% annualized rate, the fastest pace in six quarters. Spending was broad-based across categories—real spending on goods rose at a 6.0% annualized clip while services consumption rose at a steady pace of 2.6%. In addition, business investment posted double-digit growth as firms purchased new equipment and restocked inventories. U.S. companies also upped investment in intellectual property, such as artificial intelligence, which bodes well for future productivity growth. The U.S. economy's strong pace of growth adds to the possibility that the Federal Reserve's ("Fed") efforts to return inflation to the 2.0% target without triggering a recession have been successful.

The labor market showed signs of gradual softening but was a major support for economic growth. 186,000 jobs per month were added in the third quarter. While lower than the 203,000 average jobs added over the prior 12 months, this rate is in-line with pre-pandemic (2015-2019) norms. With continued healthy demand for workers, the unemployment rate ticked down to 4.1%. Signs that labor market conditions are stabilizing extended to income growth as well. Average hourly earnings rose 4.0% over the past year, a rate reflecting some of the strongest U.S. labor market conditions since the late 1960s.

The growth in real wages, coupled with strong household balance sheets, suggests that consumers will continue to spend at a healthy rate. However, there are signs of weakness for U.S. households. The personal saving rate dipped to 4.6% in September, the lowest in nearly a year and the third consecutive monthly drop. After a period of high inflation, some households are trading down and seeking cheaper alternatives, as evident in earnings reports from major retailers and manufacturers.

The rate of inflation has fallen rapidly over the past year and continued to ease through the third quarter. The Personal Consumption Expenditures ("PCE") Price Index fell to 2.1% annualized, a three-and-a-half-year low. The Core PCE Price Index, which excludes food and energy, increased by 2.7%, down from 2.8% in the second quarter and near the Fed's 2.0% target.

Against this backdrop, the Fed moved to lower the benchmark federal funds rate by 50 basis points ("bps") in September to a range of 4.75%-5%. The first cut since March 2020, this decision reflects the Fed's confidence that inflation is moving sustainably toward the 2.0% target and its intent to prevent further labor market softness. Consensus forecasts anticipate a cumulative decline in the federal funds rate of 100 bps in 2024 and that the Fed will proceed with a measured pace of rate cuts through 2025 and, potentially, into 2026. The U.S. 10-year Treasury rate fluctuated from 4.4% at the start of the quarter to 3.8% near the end. Solid economic growth is expected to keep the 10-year Treasury yield modestly above 4.0% over the near term then drift down to the upper-3% range in 2025.

The U.S. economy is heading toward the end of 2024 with solid momentum supported by strong consumer spending and a resilient labor market. However, risks to the economic outlook remain. Near-term issues, such as the temporary pause in the September worker's strike at U.S. East and Gulf ports, the rise in geopolitical conflicts, and the outcome of the November election, all pose risks that could hinder positive momentum for real estate activity throughout the fourth quarter. However, the outlook for the U.S. real estate market is positive. Sustained economic growth combined with more accommodative interest rates will likely serve as a foundation for strong fundamentals performance, increased investment activity and property values in 2025.

REAL ESTATE FUNDAMENTALS [2]

The U.S. real estate market ended the third quarter of 2024 with solid fundamentals in the industrial, multifamily, and retail sectors, although the office sector remains weak. Nonetheless, there are pockets of weakness in some multifamily and industrial submarkets experiencing elevated levels of new supply. High construction costs and tighter financing conditions led to a significant drop in new construction starts with levels dropping to ten-year lows across sectors. The decline in supply should pave the way for a reacceleration in fundamentals by 2025.

Industrial

The U.S. industrial market showed signs of normalization from the extremely strong market conditions of recent years in the third quarter of 2024. Although vacancy rates continued to trend upward, the increase slowed notably, rising by just 15 bps to end the quarter at 7%, suggesting the market may be approaching stabilization. Net absorption for the quarter remained at the lowest level since 2012, but held steady compared to earlier in the year, reflecting a tentative recovery as tenant demand slowly rebounds. Leasing activity picked up in the third quarter, fueled by Amazon's recent expansions in key markets in California and Arizona. Consumer goods spending, which has been rising for over a year, coupled with growing warehousing employment are further evidence of a strengthening in demand for industrial space.

A rapid slowdown in new deliveries signals that the industrial market has moved past the historic development wave. After a record-setting 550 million square feet ("msf") delivered in 2023, the 370 msf expected in 2024 is a 33% drop. In the third quarter, 63 msf were delivered, a 40% drop from the second quarter. Additionally, new construction starts have sharply declined, with only 43 msf of space breaking ground in the third quarter, a 57% drop from the same period in 2023. Rent growth, which decelerated over the past two years to an annual rate of 3%, may see renewed upward pressure as the improving supply-demand balance takes hold; particularly in the smaller sized segment of the market or undersupplied submarkets, positioning the sector for a stronger recovery in 2025.

The industrial market is poised for gradual recovery as the underlying drivers of demand improve. Cargo volumes through the port of Los Angeles marked the busiest quarter on record in the third quarter, a 27% increase from 2023, which should bolster the need for industrial space in Los Angeles and the nearby Inland Empire markets. Increased investment in U.S. manufacturing from the CHIPS and Science Act and the Inflation Reduction Act is likely to be a boon nationally while near-shoring supply chains is likely to be drivers of demand, especially in key Sun Belt markets. These trends, combined with increasing supply chain risks and rising transportation costs, are expected to continue to drive demand for warehouse space, particularly in prime markets with large consumption bases and near integral ports of entry.

Multifamily

The U.S. multifamily market saw a continued rebalancing of supply and demand dynamics, indicating a healthier and more stable market, in the third quarter of 2024. With over 170,000 units absorbed during the quarter, total demand over the last 12 months reached 530,000 units, a record level excluding the unique post-pandemic period in 2021. This robust demand held the national vacancy rate steady at 8% for the second consecutive quarter. New supply slowed from the cyclical peak reached in the second quarter, but still narrowly outpaced demand with a high volume of new deliveries—179,000 units in Q3 and 680,000 units in the last 12 months. Significantly, the gap between supply and demand moved closer to equilibrium and the delta between the two was at the lowest point in two years. The supply-demand balance should improve further with construction starts in the third quarter, which are down nearly 70% compared to two years prior.

Multifamily rent growth, after the rapid escalation of 2021 and 2022, has also stabilized. The third quarter saw annual rent growth remain near 1% for the fifth consecutive quarter, reflecting the market's transition from overheated to more sustainable conditions. Gateway markets and smaller Midwestern cities, which have seen limited new supply, have led rent growth, while some Sun Belt markets with elevated levels of new construction have faced some near-term rent deceleration.

The broader outlook for the multifamily sector remains positive. With a tapering of new deliveries expected in the coming quarters and demand projected to stay strong — supported by high single-family housing costs and demographic trends — the stage is set for a potential reacceleration in rent growth. Long-term fundamentals are forecasted to remain strong, bolstered by the chronic housing undersupply that has persisted since the Global Financial Crisis.

Office

The U.S. office market continued to face significant challenges and saw a return to negative demand trends in the third quarter of 2024, reversing the slight recovery in the second quarter. However, the negative absorption of 2.7 msf was a much smaller setback than the average occupancy losses seen since 2022. Overall vacancy rates continued to tick up and reached a new record of 14%. Meanwhile, the office sublease market showed some improvement, with available sublease space decreasing to 190 msf — a continuation of a year-long trend of shrinking sublease inventory from a peak of 210 msf in 2023.

Rent growth remained stagnant at 1% while the broader market continued to feel the pressure of high vacancy rates and a cautious tenant base. Landlords, especially in non-prime locations, continue to rely on concessions like free rent and significant tenant improvement allowances to attract tenants. On the other hand, premium office buildings in highly amenitized areas remained relatively resilient, maintaining effective rent growth and stronger leasing activity.

Near-term, the office market is expected to weaken further, as the expiration of pre-pandemic leases drives additional vacancies. However, with 2024 construction starts slowing to 25-year lows and future office supply limited, premium office space is poised to outperform. By 2026, once many firms complete their downsizing in response to hybrid work, the relationship between employment growth and office demand may stabilize, potentially laying the groundwork for a slow recovery in the sector.

Retail

The U.S. retail market remained tight through the third quarter of 2024 although momentum slowed. Limited new construction has kept available space at near record lows of 4%, unchanged for the fifth consecutive quarter. However, demand has weakened significantly, with only 16 msf of space absorbed year-to-date, just half of the amount absorbed by this time in 2023. Rent growth decelerated, slowing to 2.4% year-over-year. However, neighborhood and power centers saw stronger rent growth, exceeding 3%. Sun Belt market rent growth continued to outperform.

Construction activity remained at historically low levels with just under 6 msf delivered in the third quarter, bringing the year-to-date total to 24 msf — 25% less than the first three quarters of 2023. Only 5 msf of new retail space began construction this quarter and future supply is expected to remain scarce, with new space delivered primarily through mixed-use projects and property renovations.

With strong household balance sheets, easing interest rates, and continued job growth, the retail market remains well-supported by a resilient consumer base. These economic factors are expected to drive steady demand, particularly in grocery-anchored centers across the Sun Belt, where population growth and consumer spending remain robust.

CAPITAL MARKETS [3,4]

U.S. real estate capital markets moved further down a path to recovery in the third quarter. Since 2022, real estate has undergone significant repricing, as higher interest rates slowed investment activity and created pockets of distress. The Fed's announcement of a 50 bps interest rate cut in late September, and the expectation of more cuts ahead, provided a signal that the real estate capital markets had turned a corner. Investment activity saw modest improvements as debt market conditions improved, showing better pricing and liquidity. U.S. real estate sales volume totaled $97 billion for the quarter, unchanged from third quarter 2023, but following a 6% year-over-year growth in the second quarter.

Pricing continued to trend toward stabilization. The MSCI Commercial Property Price Index ("CPPI") held relatively steady over the quarter and capitalization rates ("cap rates") overall have seen minimal expansion since the first quarter. Signs of compression in multifamily and industrial cap rates have emerged but with segments of the market still in a phase of price discovery, notable variations within property types are expected - even within the highly challenged office sector.

The industrial sector continued to lead in pricing growth through the third quarter, with prices up 7% year-over-year. Transaction volume for warehouse assets alone reached $20 billion, reflecting a 2% rise compared to the same period last year. Notably, industrial transaction volume was in line with historical levels, coming in at near the average third-quarter volume from 2015 to 2019. The sector's stable income generation and the appeal of assets offering near-term lease rollovers, allowing for mark-to-market adjustments, should continue to attract deep investor interest across markets.

The multifamily sector remained the most active in transaction volume, with $36 billion in sales, marking a 9% increase from a year prior. Although the volume is still 15% below the pre-pandemic average the sector has taken further steps toward equilibrium. Multifamily pricing decreased by 6% year-over-year, a slowdown in the pace of declines, suggesting that pricing may be approaching stability. Despite supply-side challenges in high-growth Sun Belt markets, demographic trends, high single-family home costs, and the U.S. housing shortage are expected to sustain investment in the sector long-term.

The office sector saw early signals that the market has found a bottom in terms of volume and pricing in the third quarter. After seven consecutive quarters of annual declines (excluding a first-quarter 2024 increase driven by a large entity-level transaction), the office sector saw a 13% rise in transaction volume in the third quarter, totaling $13 billion. Although this remains 63% below pre-pandemic levels, the uptick suggests that office assets may be approaching a pricing floor. Cap rates for the office sector have stabilized just above 7% for five straight quarters, reinforcing signs of possible stabilization. The office sector remains challenged while credit is extremely limited for investment. As the office market moves through this period of pricing adjustment, there may be strategic opportunities for office deals.

The retail sector showed signs of stabilization. With $11.7 billion in transaction volume for the third quarter, retail sales improved by more than 5% compared to the second quarter. The majority of the transactions were made up of single asset trades, signaling the market may be reaching a healthy equilibrium. While cap rates were stable for the fourth straight quarter, retail pricing saw another quarter of slight decline, around 1%. The retail sector's supply and demand dynamics and evolving rental profile position it well for long-term attractive returns and opportunities for growth. High-quality, well-located retail — especially grocery-anchored — is expected to outperform the rest of the sector.

The NCREIF Property Index ("NPI") posted its first positive quarterly return since the third quarter of 2022, pushed by improving net operating income ("NOI") growth and moderating negative appreciation. U.S. real estate achieved a quarterly total return of 0.8% in the third quarter of 2024, supported by a steady income return of 1.2% and a modestly reduced appreciation decline of (0.4)%. This quarter's positive performance highlights the resilience of property fundamentals and indicates growing investor confidence. Rolling twelve-month returns for U.S. real estate also showed improvement, with a total return of (3.5)%, reflecting an (8.1)% appreciation return and a solid 4.6% income return.

For the third straight quarter, all asset types but office posted a positive quarterly return. Retail returns were strongest, totaling 1.9% with a 0.5% appreciation return, and an income return of 1.4%. Multifamily returns totaled 1.1% with an appreciation return just above 0.0% and an income return of 1.1%. Industrial returns similarly posted a 1.1% total return, with an appreciation return of 0.1% and an income return of 1.0%. Office returns continued to be the laggard, though improved from the second quarter — third quarter returns for the sector were (1.1)%, with a (2.5)% appreciation return and a 1.4% income return. As evidenced by strong income returns, property fundamentals remained resilient and showed signs of growth. NOI improved by nearly 1% quarter-over-quarter and almost 3% year-over-year. As a note, NCREIF released an expanded NPI for the third quarter which includes senior housing and self-storage assets in addition to the classic NPI property types. The return for expanded NPI in the third quarter of 2024 was 0.8%.

Outlook

Moving toward the end of 2024, the end of the Fed's aggressive monetary tightening, and the start of a new easing cycle marked a significant turning point for the U.S. economy and suggests that the U.S. real estate market recovery will likely continue to broaden. Overall, the cost of capital has declined, with borrowing spreads and base rates moving lower, while the availability of debt capital has increased. At the same time, supply and demand are coming back into balance particularly in the U.S. industrial and multifamily markets.

The real estate market faces the prospect of further adjustment and potential stresses, but the extreme post-pandemic highs and lows have moderated, and more predictable outcomes support an expected increase in investment activity near the end of the year and a more robust recovery in 2025. Wide differences in fundamental outlooks within real estate subsectors suggests market, submarket, and asset selection will be crucial for driving outsized performance.

While the anticipated recovery plays out over time, the steady income streams from real estate will likely lead to long-term value creation, and the outlook for real estate is positive. As a lower, more stable interest rate environment begins to take hold, it should set the foundation for a new cycle of increasing values in real estate. History has shown that the best returns have often been generated in the aftermath of markets like we are experiencing today.

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SOURCES

[1]Source: U.S. Bureau of Economic Analysis, Gross Domestic Product, Consumer Spending, Third Quarter 2024, Advance Estimate; U.S. Department of Commerce, Congressional Budget Office, September 2024; U.S. Bureau of Economic Analysis, U.S. Personal Income and Outlays, Personal Consumption Expenditures, September 2024; U.S. Bureau of Labor Statistics, Employment Situation, September 2024; U.S. Bureau of Economic Analysis, September 2024; Board of Governors of the Federal Reserve System, September 2024
[2] Source: CoStar, Third Quarter 2024, Property Market Fundamentals Statistics
[3] Source: MSCI CPPI, Hedonic Series Cap Rates, Third Quarter 2024, Capital Markets Statistics
[4] Source: National Association of Commercial Real Estate Investment Fiduciaries, NCREIF NPI, Third Quarter 2024