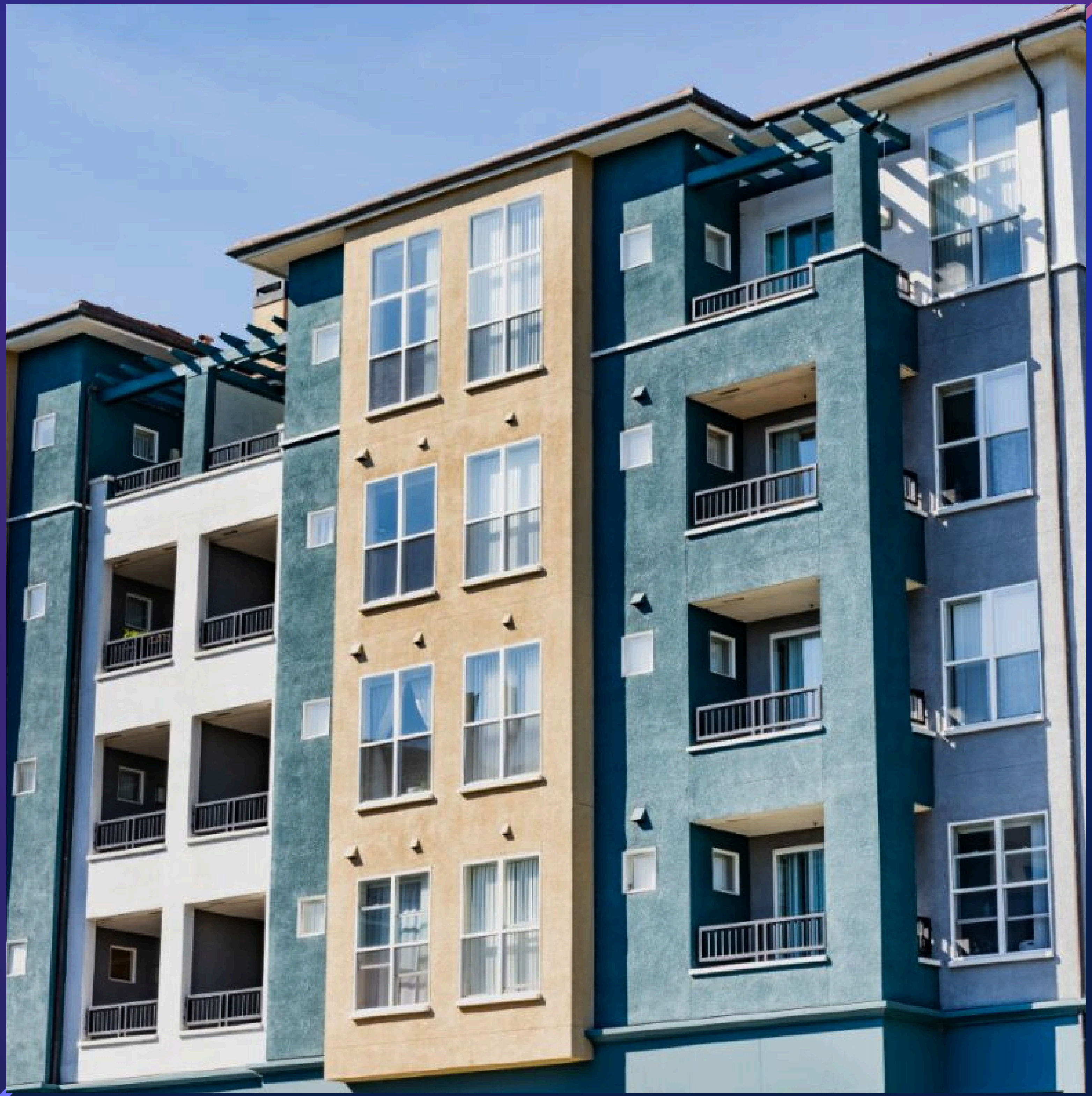
SitusAMC Insights

5 Commercial Real Estate Sectors Ranked By Investors

1Q 2024



INTRODUCTION

Retail was the belle of the ball in first quarter, earning the highest ranking for investor preference. In the latest survey, SitusAMC Insights asked institutional and regional investors what they believe will be the best-performing property sectors over the next year, and which should be avoided. Investors cite the benefit of triple net leases, which limit landlord exposure to increasing expenses, as a major boost to the segment. Investors also believe that retail occupancy levels will be relatively high over the holding period.

Click through to see the latest expectations for office, multifamily, industrial, retail and hotel properties in the year ahead, and trends driving investor interest. All figures refer to first quarter 2024 activity, and comparisons are quarter over quarter (QoQ) unless otherwise noted.

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#1 Retail

Retail surged to first place among the property types, favored by 40% of investors, a 12-percentage-point jump QoQ. Retail returns were in the black for the first time in a year at 0.6%, an increase of more than 175 bps from last quarter, per NCREIF's Classic NPI. Retail had the second-highest returns among the major property types, lagging only that of hotel. Retail returns were the highest in almost two years. Though income returns were the highest since mid-2014, appreciation was almost 180 bps below the most recent peak in 1Q 2022. One-year trailing returns were -0.8%.

#1 Retail

FUNDAMENTALS

- Retail demand was relatively stable in first quarter with the occupancy rate unchanged and net absorption increasing just 0.7%, according to Reis. Over the past year, retail occupancy has remained at the highest level since the early pandemic. Still, first-quarter occupancy was about 110 bps below the long-term average (LTA). Retail completions fell to the lowest on record in the first quarter. This will likely boost the segment's stagnant rent growth, which has stayed at 0.2% for the past four quarters.

- Executives at the May International Council of Shopping Centers (ICSC) convention were bullish on retail, according to Commercial Property Executive. Limited new development over the past decade has supported existing space fundamentals. Investors are finding opportunities in converting anchor tenant space into urgent care centers and educational uses, such as community colleges and charter schools.

1Q 2024 STATISTICS

NPI Total Return	Occupancy Change	Effective Rent Growth Change
+0.6%	0 bps	+0.2%

Sources: NCREIF, Reis, SitusAMC Insights, 1Q 2024.

#2 Industrial

Industrial took the number 2 spot in our rankings, favored by 29% of survey respondents, down from 41% last quarter. Returns in the Classic NPI jumped 240 bps to 0.1%. It was the first positive return for the segment in six quarters. Industrial returns have fallen precipitously from their peak of 13.3% in 4Q 2021 and are currently more than 250 bps below their LTA. One-year trailing returns were -3.1%, among the lowest since the GFC.

#2 Industrial

FUNDAMENTALS

- Warehouse occupancy declined for the sixth consecutive quarter, to the lowest level in over two years, according to Reis. Still, occupancy was about 400 bps above pre-pandemic levels and the LTA. Net absorption slowed to the lowest level since 2010, though it remained positive. First-quarter completions were the lowest since 2015. Declining new supply may help boost rent growth, which grew at the slowest pace since the onset of the pandemic.

- Census Bureau data show that the pace of e-commerce growth is decelerating from its early pandemic boom. Preliminary first-quarter data show a 2.1% increase for e-commerce sales, about half the LTA. Moody's projects that e-commerce's share of total retail sales will moderate over the next decade, resulting in slower price and rent appreciation than the previous decade.

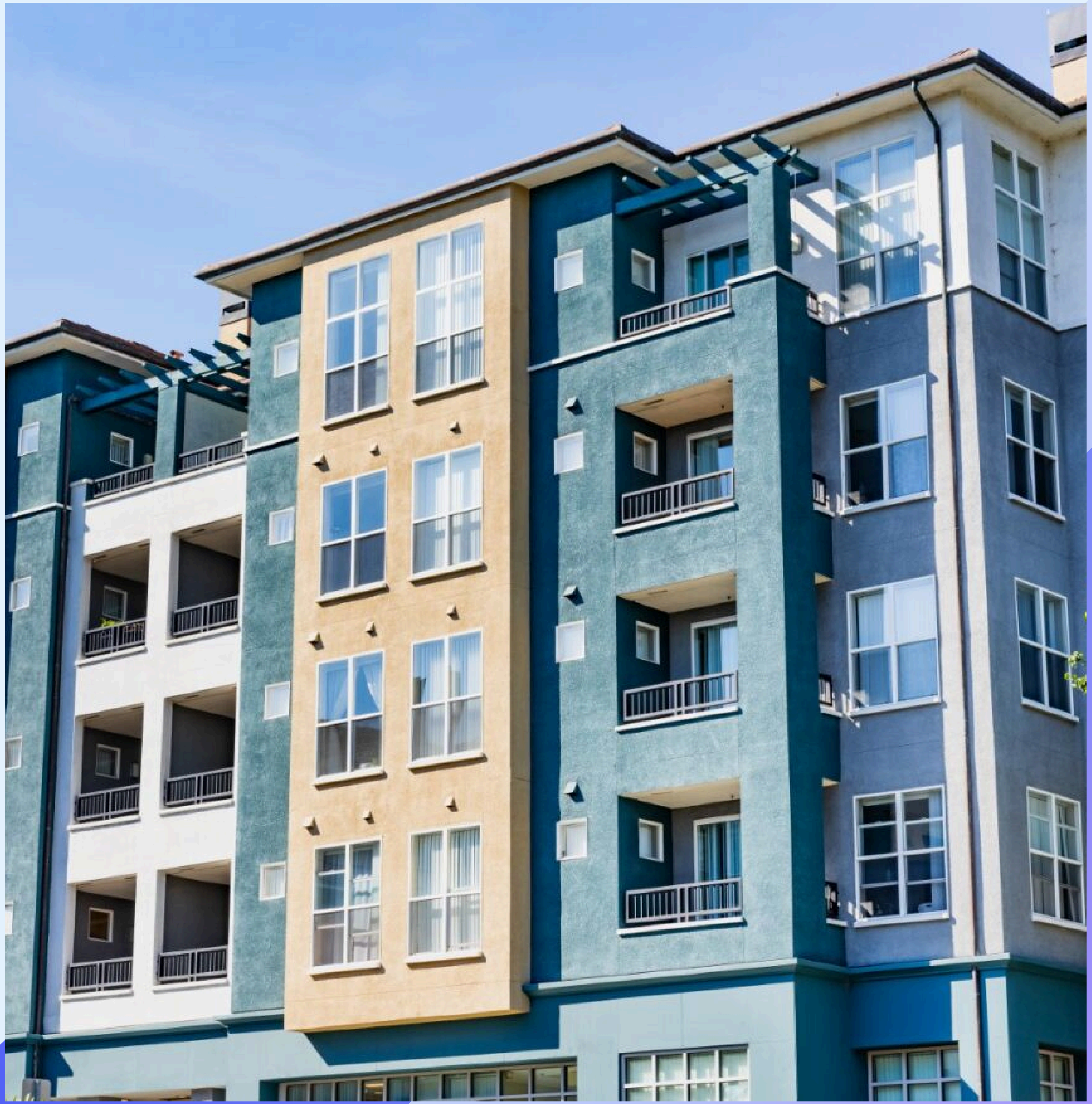
1Q 2024 STATISTICS

NPI Total Return	Warehouse Occupancy Change	Effective Rent Growth
+0.1%	-20bps	+0.3%

Sources: NCREIF, Reis, SitusAMC Insights, 1Q 2024.

#3 Apartment

Apartment sentiment soured with 33% favoring the sector, down from 26% last quarter. Returns were negative for the sixth consecutive quarter, per the Classic NPI, falling 200 bps to -1.0%. It was the second-worst performance among the major property types, behind office. Similar to the industrial segment, a large drop in returns has ensued following the significant run-up in 2021. Returns were about 780 bps below their 4Q 2021 peak and almost 300 bp below the LTA. One-year trailing returns were -6.3%, among the lowest since the Global Financial Crisis (GFC).



#3 Apartment

FUNDAMENTALS

- Apartment demand remained relatively weak in first quarter, per Reis. The occupancy rate remained unchanged QoQ, but was among the lowest since 2011. Net absorption improved slightly QoQ, yet was half of the LTA. Effective rent growth was slightly negative in first quarter, with rents at their lowest since 2Q 2022. Much of the weakness in apartment fundamentals has been due to strong supply during the COVID-19 era. However, completions fell by 53% QoQ to the lowest level since 2014, boding well for an improving investment environment in the medium- to long-term.

- Bank of America released its Homebuyer Insights Report in May, which found that 80% of Baby Boomer renters prefer renting to buying in the current environment, a substantial increase from last year's 63%. Baby Boomers said they wanted freedom from maintenance and repairs and financial stress, and the ability to easily relocate.

1Q 2024 STATISTICS

NPI Total Return	Warehouse Occupancy Change	Warehouse Effective Rent Growth Change
-1.0%	0 bps	-0.2%
Up 7 bps QoQ		

Sources: NCREIF, Reis, SitusAMC Insights, 1Q 2024.

#4 Office

Investors generally remain pessimistic on the office segment, with only 5% of survey respondents selecting it as the best. Still, this was a slight improvement from last quarter, when no investors chose office as best. Though office returns rose 160 bps, they remained in the red -- the seventh consecutive quarter of negative returns. Office has posted the lowest total returns of all major segments in the NPI for more than two years; returns were almost 525 bps below the LTA. One-year trailing returns were -17.4%, the second worst since the GFC, trailing only last quarter's performance.

#4 Office

FUNDAMENTALS

- Office fundamentals continued to weaken, with occupancy falling 20 bps to a record low, and net absorption remaining negative for the third consecutive quarter. Effective rents were essentially unchanged, declining just 0.04%. However, the Wall Street Journal reports that landlords are using concessions, such as months of free occupancy and expensive interior build-outs, to keep rents steady. The only bright spot for the segment is that new supply should ease, with completions dropping 36% to the lowest levels since 2013.

- According to the Wall Street Journal, $38 billion of U.S. office buildings are facing defaults, foreclosures and other distress, the highest level since the GFC. Over the next year, about $18 billion of securitized office loans will mature. Moody's projects that 73% of loans will be difficult to refinance due to the properties' income, debt levels, vacancy rates and looming lease expirations.

1Q 2024 STATISTICS

NPI Total Return	Occupancy Change	RevPAR Growth
-3.8%	-20 bps	0.0%

Sources: NCREIF, Reis, SitusAMC Insights, 1Q 2024.

#5 Hotel

Though exhibiting the best performance among the major property types on a quarterly and one-year trailing basis, hotel ranked last in our survey, with no investors selecting the segment – down four percentage points from last quarter. Investors say the sector has likely peaked and see little room for future growth. Hotel returns have been positive for the last three years; though following a 100-bps decline, first quarter's return was the lowest since 2Q 2021. Returns were over 50 bps below the LTA. One-year trailing returns were a robust 8.7%, the only segment turning in positive performance.

#5 Hotel

FUNDAMENTALS

- Seasonally adjusted hotel occupancy dropped nearly 240 bps, falling to the lowest rate in almost a year. Still, occupancy was about 345 bps above the LTA. Reis projects that occupancy will rise throughout 2024, reaching near-record levels by year end. Seasonally adjusted room rates increased 2% to the highest rate on record. However, RevPAR declined slightly QoQ owing to the decline in occupancy.

- Hotel conversions last year were the highest on record, according to GlobeSt. Conversions rose 39% YoY in 2023, yielding more than 4,500 new apartment units. About 60% of these conversions came from Class B hotels. Conversions to apartments from hotels are often faster and more cost-effective than those from other types of structures, because the necessary infrastructure is often already in place.

1Q 2024 STATISTICS

NPI Total Return	Occupancy Change	Effective Rent Growth
+0.8%	-240bps	-1.6%
Down 170 bps QoQ		

Sources: NCREIF, Reis, SitusAMC Insights, 1Q 2024.

Ranking Recap

1Q 2024 STATISTICS

		NPI Total Return	Occupancy Change	Rent Growth / RevPAR Change
	#1 Retail	+0.6%	0 bps	+0.2%
	#2 Industrial	+0.1%	-20 bps (Warehouse)	+0.3% (Warehouse)
	#3 Apartment	-1.0%	0 bps	-0.2%
	#4 Office	-3.8%	-20 bps	0.0%
	#5 Hotel	+0.8%	-240 bps	-1.6%

Sources: NCREIF, Reis, SitusAMC Insights, 1Q 2024.

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To learn more about SitusAMC's research, data, and analytic tools, email:

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