US Commercial Property Prices Inch Up, but Vacancy Threat Looms
Tentative Increase Comes With Potential for a Decline, CoStar Report Finds

By Mark Heschmeyer

U.S. commercial property prices bounced back in May after a sustained decline, potentially signaling the start of a bottoming market that property professionals have said they are looking for in the next year.

The uptick in property sale prices would have to overcome an increase in vacancy rates to achieve such a leveling of price declines, according to CoStar Group's Commercial Repeat-Sale Indices. The indicator tracks when a previously sold property trades hands again in a process called a repeat sale.

The U.S. composite price indices report showed a significant increase in repeat sales, jumping from 1,041 in April to 1,207 in May. Transaction activity also rose for the third consecutive month, reaching $8.4 billion in May, a 0.6% increase over April. The increases may signal that investors seem to be more willing to buy at current prices rather than wait for further declines.

Slowing demand for commercial real estate space comes as newly completed properties are arriving on the market. Some companies have kept spending low at a time of higher interest rates, leading executives at major brokerages to say they are looking for a rebound in sales at some point in the next year. At the same time, capitalization rates have been rising as higher financing costs and lower rent revenues have eaten into returns.

"While it's entirely possible that we could be in the process of finding a bottom in pricing, in past cycles we typically didn't see prices level out until vacancy and cap rates peaked at about the same time," said Chad Littell, national director of U.S. capital markets analytics for CoStar and the author of the report.

Littell said vacancy rates could continue climbing through 2025 because a significant pipeline of new construction is coming on line. The completion of newly constructed properties across the office, retail and industrial sectors is projected to reach 136.3 million square feet in the second quarter of 2024, he added.

Distressed Sales

The report highlighted a decrease in sales of distressed properties. Only 2.2% of repeat sales in May were classified as experiencing financial problems, such as being acquired through foreclosure or court-appointed sales, compared to double that rate in April. That's another positive sign that investors are finding other properties to acquire than those experiencing financial distress.

There were positive signs in both the high and low ends of the commercial property market. On the pricing front, the value-weighted U.S. Composite Index, more heavily influenced by high-dollar trades common in major markets, saw its first increase in nine months, rising 1.3%.

And the equal-weighted U.S. composite index, which tracks sales in smaller markets, also rose slightly in May, up 0.2% and remaining near its all-time high, suggesting some resilience in these areas.

Even so, the report overall paints a cautious picture for the U.S. commercial property market. Tenants have been leasing less space than they have been vacating through the first two quarters of the year. The difference in net absorption, or the difference between move-ins and move-outs, is projected to total 19.2 million square feet in the second quarter of 2024 across office, industrial and retail properties.

For the 12 months ended in June, tenants were expected to have emptied 28.9 million square feet more of total space than they had occupied, according to the report.