Here’s What Property Pros Learned in the First Half of 2024 — and Expect in Coming Months

They See More Data Center Developments, Retailer Compromises, Subdued Hospitality Growth

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For commercial real estate professionals who began the year saying they need to survive until 2025, they're halfway there. But property executives also point out that this year has taught them there's no guarantee conditions will improve soon.

So far in 2024, high interest rates that have gone unchanged longer than some real estate executives had hoped in January affected many aspects of the nation's property market, from housing sales and inventory to office transactions and valuations. Until things change, property professionals have said they're holding on, hoping market conditions improve next year and learning from the first half that some conditions could stay the same.

Here's a look at five things the first half of 2024 taught the industry and what they might portend for the second half.

Office Valuations Fall

On the national office front, the market has struggled to work through a panoply of uncertainties since the start of the year. But if there is one thing most stakeholders can agree upon, it’s that a decline in property valuations has reset the stage for investors.

Trophy office towers in cities such as Los Angeles, Chicago, New York and Philadelphia have sold in recent months for just a fraction of their previous price tags, a phenomenon fueled by a shrinking pool of interested buyers and an eagerness among some sellers to offload properties, regardless of price.

Office sales nationally fell more than 55% over the past year to $35 billion, a nearly 15-year low, according to CoStar data. What’s more, among the deals that have closed, high vacancy rates and declining rents have helped to push pricing further downward.

For older, lower-tier properties, valuations have fallen as much as 40% since 2021, according to CoStar data. That drop essentially matches the decline reported throughout the Great Recession.

Yet more smaller, privately managed investors are proving themselves willing to make the bet. After leveling off last year, sales volume nationally ticked up in the early months of 2024 as significant discounts pushed an expanding group of investors to take advantage of more deals.

"We've seen the worst from a capital markets perspective, and while we might not be at the bottom just yet, we're close to it," said Kevin Shannon, Newmark's co-head of U.S. capital markets, told CoStar News. "Rates went up so fast that you didn't know how high was high or what your cost of capital was, and that's scary. People have a better understanding now, and while the impacts from the pandemic mean the healing process will take longer, there are more signs of certainty and we can at least now see the bottom and rebuild from there."

Housing Supply Improves

When it comes to housing, one of the biggest hold-ups has been the chronic shortage of inventory, specifically among existing single-family houses, condos and co-ops.

Analysts largely blame that undersupply on homeowners who opted to stay in place and keep their historically low, pandemic-era mortgage rates. It's a trend known as the "lock-in effect" or "golden handcuffs," and it's a result of the rapid rise of mortgage rates over the past year, currently near 7%.

Real estate analysts are watching Federal Reserve Chairman Jerome Powell in anticipation that the central bank will make at least one Fed interest rate cut by year end. Of course as 2023 ended, the Fed seemed poised to make three cuts this year, so some executives say they now know there's no guarantee this half will hold a cut.

But there are hints of optimism: for the first time in months, some analysts say new housing supply data looks promising.

In May, the supply of existing homes for sale in the U.S. reached its highest level in four years, according to a report from the National Association of Realtors. Other data has found that in some metropolitan areas, especially in Texas and Florida, the housing supply has even returned to its pre-pandemic levels.

Sure, part of the recent rebound is due to the low starting point, but some economists have signaled the increase in supply could continue, pushing the market further into recovery.

"Eventually, more inventory will help boost home sales and tame home price gains in the upcoming months," the Realtors association's chief economist, Lawrence Yun, said in a statement. "Increased housing supply spells good news for consumers who want to see more properties before making purchasing decisions."

Fierce Retail Competition

While the office market has stumbled and housing shows some positive signs, retail properties emerged as the apple of many investors' eyes while tenant demand has fueled heightened competition for space.

Vacancy rates at historic lows and a stagnant construction pipeline combined to create a market where tenants are often forced to be less choosy in what space they take in order to open additional locations. This trend may not end anytime soon as retailers remain bullish on expanding their real estate portfolios, industry analysts predict.

With retail property, however, even the companies that once dictated leasing terms have been forced to become more flexible as the amount of available space has edged lower.

Across the United States, the average retail vacancy rate has fallen to about 4%, one of its tightest positions on record, according to CoStar data.

The demand for retail space jumped nearly 42 million square feet over the past year and by more than 200 million square feet since the start of 2021, according to CoStar data. Tenant move-outs have dropped by nearly 20% over the past three years.

"There is a dearth of retail space in the market," said Tabassum Zalotrawala, McDonald's senior vice president and chief development officer, recently during a panel at the ICSC annual conference. "This is the truth. There's not a lot of new shopping centers going out there, and so one of the things that's going to be top of mind, for my team, is creativity. We've got to become innovative."

More Data Center Space

Real estate professionals say they are looking for more space in data centers to come online in the third and fourth quarters as artificial intelligence leads to dramatic design changes in this industrial property niche.

Architects and engineers are designing the new breed of AI-enabled data centers with higher ceilings and wider corridors to accommodate the next-level cooling equipment needed to prevent AI servers from overheating, according to Tom Earp, principal engineering director at Page, an architecture firm in San Francisco.

Developers also are searching for regions and cities where both land and electric power are cheaper for AI-enabled facilities, according to a JLL North American Data Center report. Salt Lake City has seen the fastest acceleration in data center construction for those reasons, the report noted.

The total space under construction in primary and secondary markets exceeds 5.3 gigawatts, with one gigawatt being enough to power about 750,000 houses, and most of that is preleased as demand jumps due to the "accelerating ... volume of data we create," according to the JLL report.

In addition, nearly 12.3 gigawatts of data center power capacity is in the planning stages, JLL said, for property typically powered by electricity, gas or a combination of both.

Hotels Raising Rates

When it comes to hospitality properties, overall hotel performance has remained robust, and forecasts call for a strong second half of the year that could help boost valuations.

Still, hoteliers across the U.S. continue to cope with a drop in demand at economy and midscale hotels as low-end consumers grow more cost conscious. At the same time, more international travel continues to leave U.S. shores than arrive as affluent travelers are drawn to destinations, particularly in Europe.

That weakness at midscale and economy hotels drove the first drop in hotel operating metrics in March since the depths of the COVID-19 pandemic. In fact, the stratification between the high end and low end has since only grown more pronounced. Conversely, affluent travelers are feeling more confident in their purchasing power as they see their net worths increase.

All of this adds up to a projection for a 2% full-year increase in revenue per available room, driven exclusively by rate increases as demand remains flat to slightly down.

Meanwhile, hoteliers came into 2024 with the expectation that international travel patterns would normalize and support U.S. hotel performance. But the strength of the U.S. dollar has kept overseas travelers away and driven up the desirability of destinations from Italy to Japan.

Some analysts are concerned the U.S. is on a path toward a long-term loss of international travel share if it doesn't make a concerted effort to simplify the travel process and cut down on such things as visa wait times.