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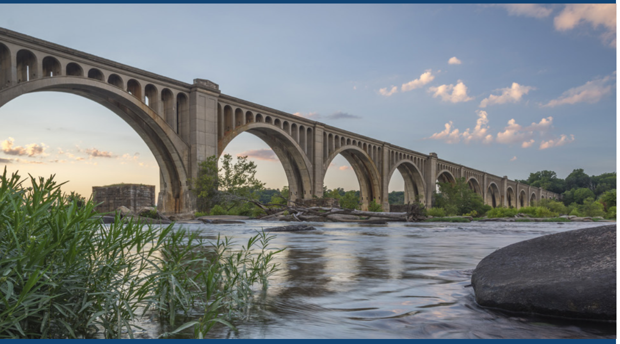
MARKET UPDATE

Greater Richmond
Commercial Real Estate

Commercial Real Estate has a 'muted' outlook after a near-death in 2023.



Commercial real estate has a 'muted' outlook after a near-death experience in 2023, Moody's economist says—and 'office will continue to face the most strain'

The commercial real estate market is still reeling from the aftermath of the pandemic—and 2023 was aparticularly bad year for the sector. Last fall, Julie Whelan, CBRE's global head of occupier research, told Fortune that it was no secret how bad office vacancies were: a 30-year high at around 18%. At the same time, there was a dramatic undersupply of multifamily properties. Could this crucial sector, so pivotal for the recovery of downtown office districts, be facing better odds in 2024? The Magic 8 Ball has a cloudy outlook.

In a report released Thursday, the National Association of Realtors (NAR) said inflation and mortgage rates were the "twin pillars steering the economic landscape and, consequently, the dynamics of the commercial real estate sector." There is optimism here, as inflation rates started at 6.4% in January 2023, and dropped to 3.1% by the end of the year, while mortgage rates peaked at a whopping 8% in October and then also came down slightly. But even though the current 30-year fixed mortgage rate has dropped to 6.76%, that's not enough juice for the troubled commercial real estate space.

"The overall outlook for commercial real estate in 2024 is muted," Ermengarde Jabir, senior economist with Moody's Analytics, tells Fortune. "Across all sectors, there will be a continued recalibration of sorts." This includes office, multifamily, industrial and retail properties. And one thing is clear, she added: "Office will continue to face the most strain in 2024."

Office sector outlook

During and in the aftermath of the pandemic, many companies shed office footprint, opting for more remote or hybrid work options. For example, Neiman Marcus Group drastically downsized and now only has about 20% of the corporate office space it had going into the pandemic—just about 100,000 square feet at its Dallas headquarters. Plus, the coworking office space took a major hit in late 2023 with WeWork's $18 billion bankruptcy, shedding dozens of leases across the country, with 35 in New York City alone. In turn, the office sector was the "most significantly affected segment within commercial real estate, enduring the biggest losses in 2023," NAR reports, adding that "it's unfortunate" 2024 is projected to be another challenging year for the segment.

In fact, the appetite for offices is so low that there may be as much as 1 billion square feet of unused U.S. office space by the end of the decade, according to a 2023 report by Cushman & Wakefield. That's nearly 1.5 times the amount of office vacancies at the end of 2019.

“Despite stricter return-to-office mandates set to take hold in 2024,” Jabir said, “there is an expectation that companies will further reduce their office footprints, pushing vacancy rates up slightly.” Moody’s Analytics even predicts that office vacancies will reach a new high in 2024.

For the companies that do value in-person interaction, though, quality will become more of a concern in 2024, experts agree. This means that there will be more competition for Class A office space as opposed to Class B or Class C properties.

The director of Northeast regional research with commercial real estate brokerage firm Savills, tells Fortune. “Many landlords are unable to renegotiate terms with lenders, leading to the potential loss of buildings,” she says. “This has made investors cautious, focusing more on distressed assets rather than actively seeking value-add opportunities.”

It’s possible that these unused Class B and Class C office buildings, however, could end up being converted into residential properties, Jabir says. “As the office’s woes continue, a flight to quality becomes increasingly within reach for more companies, creating obsolescence in some older, less desirable class B/C space,” she says. “This creates opportunities for converting office space in [central business districts] to other uses such as apartments or data centers which, while not a cure-all, gives new life to some properties.” Other real estate experts and investors, though, are less optimistic about such conversions happening at scale, often because they end up being too expensive and can actually take longer than new-builds. Plus, only about 10% of office buildings are even suitable for office-to-residential conversion projects, according to Stijn Van Nieuwerburgh, a professor of real estate and finance at Columbia Business School.

“Not all conversion projects make economic sense,” he warned in an October 2023 Goldman Sachs report. He’s also called the demise of the office sector as a “train wreck in slow motion.”

Multifamily sector outlook

The National Multifamily Housing Council estimates that the U.S. needs to build 4.3 million more multifamily units by 2035 to meet the demand for rental housing, which includes 600,000 units to fill the shortage from underbuilding after the 2008 financial crisis. Current estimates show that nearly 730,000 units are under construction, according to an August 2023 Fannie Mae report.

With such high demand for these properties, rental prices have grown during the past several years. Plus, the shortage of affordable units has left renters "no choise" but to seek Class B and Class C apartments (typicallt older apartments with lower rental costs), "only placing further pressure on housing affordability," Jabir says. However, he predicts that multifamily properties will continue to undergo a price correction this year.

Multifamily construction has been stronger in certain regions, though, including the Mountain and Sunbelt markets, Jason Sorens, an economist with the American Institute for Economic Research, tells Fortune, which is expected to continue this year based on building permit data.

“That does mean, however, that values and rents will slow in growth, or even fall, and vacancy rates will rise,” he says. “But in Northeastern and Pacific Coast markets that haven’t been building, rents look set to continue their upward trajectory.”

Retail sector outlook

Even with a rise in e-commerce, Jabir predicts that retail “perhaps oddly, will emerge as the stalwart in 2024.”

Her reasoning is that retail has already faced its big decline during the past two decades, so it’s better positioned to have a steadier performance with “unchanging vacancy rates and moderately positive rent growth for neighborhood and community shopping centers.”

The NAR report also shows slower rent growth in the retail sector and low vacancy rates that remained at a 10- year low of 4.1%. However, success will vary by retail space type. Malls will continue to underperform, NAR predicts, but neighborhood and strip centers “are expected to experience steady performance, with the strongest rent growth among all types of retail spaces in 2024.”

“Consumer spending remains resilient, and despite a significant amount of speculative development, a slowdown in construction due to higher interest rates is expected to prevent excessive vacancy rates,” Clinton says. “This sector’s solid long-term fundamentals and minimal distress are attracting investors, indicating a stronger position going into 2024.”

Lake, Sydney. (2024, January 4. Commercial real estate has a ‘muted’ outlook after a near-death experience in 2023, Moody’s economist says—and ‘office will continue to face the most strain’. Fortune.)

https://fortune.com/2024/01/04/commercial-real-estate-office-buildings-muted-outlook-2024-moodys-analytics/a3ef009e?mod=Searchresults_pos12&page=2

SOLD/LEASED IN Q4 2023

See all our listings at: JoynerCommercial.net/Property-Search

Recently Sold:

- 2,930 SF of office space located at 6203 Lakeside Avenue in Henrico for $450,000. Joyner Commercial represented the seller.

Recently Leased:

- 4,000 SF of retail space located at 7123 Staples Mill Road in Henrico. Zachary Robbins represented the tenant.
- 3,228 SF of office space located at 4794 Finlay Street in Henrico. Joyner Commercial represented the landlord.
- 1,500 SF of office space located at 2821 N Parham Road in Henrico. Joyner Commercial represented the landlord.
- 868 SF of office space located at 10001 Patterson Avenue in Henrico. Bill Phillips represented the tenant.
- 783 SF of retail space located at 306 N. 29th Street in Richmond. Joyner Commercial represented the tenant.
- 650 SF of office space located at 7277 Hanover Green Drive in Mechanicsville. Joyner Commercial represented the landlord.
- 400 SF of office space located at 7277 Hanover Green Drive in Mechanicsville. Joyner Commercial represented the landlord.

What's New in RVA

Redevelopment at Patterson - Libbie corner

A four-story commercial building is planned to replace the Westhampton Pastry Shop building at 5728 Patterson Avenue. The 73-year-old bakery is likely to be part of the new project and continue to operate there. The new structure would include three stories of office space above ground-floor retail space.

Plotting the redevelopment are the building's landlord, the Robins family, and Tyler Currie, a local real estate investor.

Virginia Credit Union to merge with Member One FCU

Virginia Credit Union announced on January 11 its plans to merge with Roanoke-based Member One Federal Credit Union.

The merger, which is subject to certain approvals and could close later this year, would create the third-largest credit union in Virginia with $6.8 billion in assets, nearly 500,000 members, 37 branches and 1,100 employees.

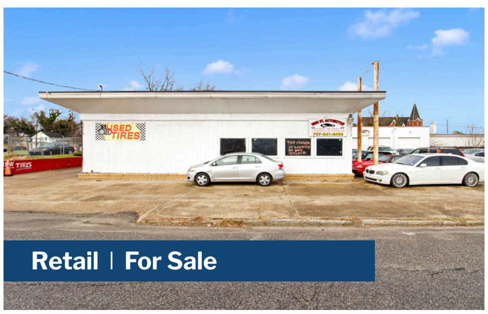
Kinsale looks to transform corner of Staples Mill & Broad

With the help of Marchetti Development, Kinsale Capital Group is planning a $450 million redevelopment of the former Anthem Inc. campus at the northeast corner of West Broad Street and Staples Mill Road.

They're looking to build nearly a million square feet of new construction on the 29-acre plot, with plans for 692 apartments, a 147-room hotel, more than 350,000 square feet of new office space and over 32,000 square feet of street-level retail.

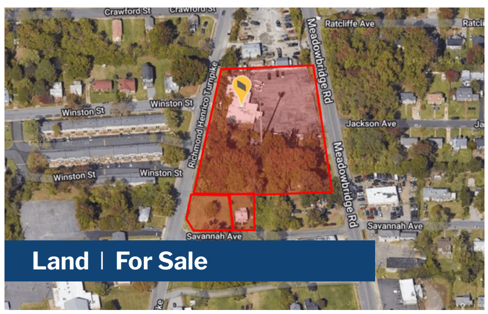
Source: Richmond BizSense I 2023

FEATURED PROPERTIES



2012 HIGH STREET
$650,000 | 7,323 SF
Shawnta Soberanes | (757) 837-1507

Auto service and repair facility that consists of an office, lounge area, and 6 bays located in Portsmouth, Virginia.

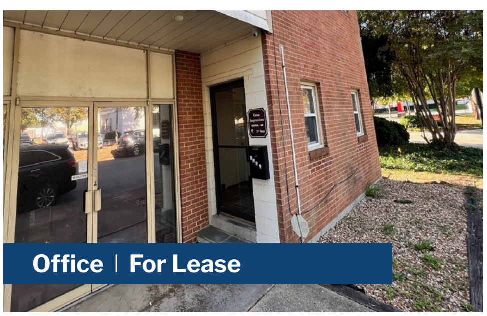


3810 MEADOWBRIDGE ROAD
$225,000 | 2.035 ACRES
Susan Haas | (804) 349-5788

2.035 acres, zoned B-3 in an Opportunity Zone with 370' frontage on Meadowbridge Rd. and Richmond Henrico-Turnpike. Mostly paved with a 6,000 SF building.

1122-1130 W MARSHALL STREET
$1,450,000 | 4 UNITS
Newton Carroll | (804) 967-2624

This development/multi-family opportunity consists of 4 rental properties and 1 buildable lot. Each home has 3 beds, 1.5 baths with a W/D in each home and 2 off-street parking spaces.



2103 LAKE AVENUE
NEGOTIABLE | 650 SF
Zachary Robbins | (804) 854-0508

650 SF of office space located on the first floor. Conveniently located off of West Broad Street near Willow Lawn, close to Libbie Mill.

2545 SOUTH CRATER ROAD
$615,000 | 2,944 SF
Bill Phillips, CCIM | (804) 967-2739

The Mad Italian Restaurant has been a thriving Petersburg landmark for nearly 50 years. A separate fully leased stand alone 1,200 SF building is included for a total 4,144 building SF.

1109 & 1111 W. FRANKLIN STREET
$1,650,000 | 8,008 SF
David Feibish | (804) 399-4514

A generational re-purpose development opportunity within the Fan. This location is a part of the western portal to the original RPI, subsequently VCU campus.

6641 W BROAD STREET, SUITE 101
RICHMOND, VA 23230

Phone: 804-270-9440
JoynerCommercial.net