Commercial Real Estate

Divergent Performance in Commercial Real Estate

Office properties continue to suffer, but all other sectors see positive price growth.

In the first half of 2024, only the industrial and apartment sectors had cumulative price growth that exceeded the average loss rate. Conversely, the office sector sustained losses that significantly outweighed price growth. We expect performance across asset classes to diverge for the next couple of years while the market adjusts to post-pandemic tenant preferences.

Sector Commentary

- Following the severe impact of COVID pandemic shutdowns on hotel and retail properties, both asset classes have displayed resilience and maintained positive price growth.
- While loss numbers appear elevated, the retail loss numbers include malls, which accounted for half of the top six retail trades.
- Office properties continue to face weak demand as hybrid work schedules remain sticky post-pandemic. Tenants also continue to favor newer offices with better amenities over older properties that require significant capital improvements.

Investment Themes

- We expect continued losses on office properties for the near term as borrowers face a mountain of upcoming loan maturities.
- Low levels of new supply, coupled with interest rate declines, should support real estate prices.
- Loan maturities remain a pressure point. Even performing loans may face refinancing challenges as commercial banks remain largely on the sidelines.
- This situation with banks may not lead to payment defaults by cash flowing loans but will require patience as lenders weigh the risks of extending maturity versus loan enforcement.

By Jennifer A. Marler and Karen Karwoski

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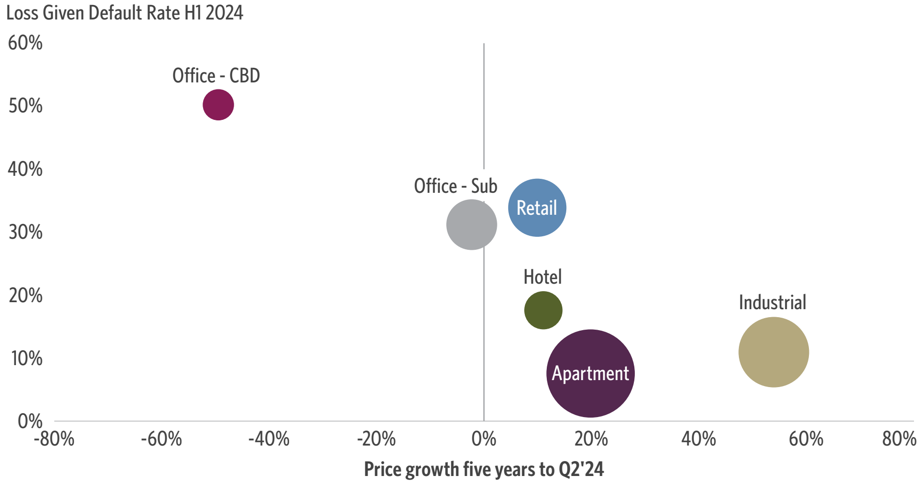
Property Price Growth and Loan Loss Rates Vary Materially by Sector



Source: Guggenheim Investments, RCA Analytics. Data as of 6.30.2024.