Construction and real estate industry: Top issues for 2024

with Greg Ross, Construction & Real Estate National Managing Partner, Grant Thornton

Narrator: Welcome to the Industries podcast series, where Grant Thornton shares information through an industry-specific lens about the most important business issues of the day.

Greg Ross: In the construction and real estate industry, 2024 will be an important year for companies to know how to navigate existing challenges while harnessing new opportunities. My name is Greg Ross, and I lead the Construction & Real Estate industry for Grant Thornton.

In 2023, a lot of folks indicated that we had a dark cloud over our industry, meaning interest rates were rising, the Federal Reserve was consistently raising rates; transactions were at a low — an all-time low as relates to what we've experienced over the last four or five years; there were no comparables, meaning we didn't know and understand what type of value changes were out there people were adopting; the hybrid workforce model, where people were not coming into the office, so it was basically like a dark cloud over our industry for 2023.

Our industry is normally consistent of a macroeconomic principle view, meaning if you have low interest rates, low unemployment, high consumer confidence, then these industries should be performing at a very high level, meaning we should have real estate values that are strong; demand for real estate development, construction to be high. We experienced this at our finest in 2021 and 2022. However, for 2023, rising interest rates have created significant changes and challenges for our industry. The Federal Reserve has raised interest rates 11 times since March of 2022 to try and manage overall inflation in the marketplace, hoping the rate increases will slow down demand, decrease material costs and ease tension in our market. However, the large increase in renters' rates caused bank financing and borrowing costs to skyrocket, while overall demand and material costs stayed very high throughout 2023. So with interest rates being at levels higher than recent decades, the industry in '23 took a major hit. Many real estate markets or sectors were significantly impacted in general, real estate transactions were not-existent, values were decreasing across most asset classes, bank financing was not available, cash flows were limited and consumer confidence was very low.

Let's take a further look at 2023 by asset class and discuss what we observed.

Multifamily remains strong with low vacancy rates but very little rent growth. Multifamily remains strong because high interest rates reduced new home ownership as well as high interest rates reduced available inventory for existing homes.

While multifamily remains strong, the housing market took a significant hit. Retail space or grocery-anchored tenant malls have remained consistent based on location, new home neighborhoods and the fact that people are still getting out. Foot traffic has been decent, and e-commerce continues to be less than 20% of current projections.

Industrial spaces remain consistent in most locations, however, we notice new construction has been limited.

Warehousing continues to be a focus. Any type of warehousing industrial spaces remain strong, and that's primarily due to the increased e-commerce. It's also because the workplace models have changed, more people are working from home, so all that has changed investments.

Office buildings, on the other hand, have not performed so well with vacancy continuing to climb as much as 20% across major metropolitan cities. While we see and hear companies that want to bring back folks to their office after COVID, the numbers have not been there. Values and vacancies continue to be a problem and we really don't expect that to change for 2024. Normalization of hybrid work models continue to gain momentum.

REITs right now are really focused on certain asset classes, meaning most of the REITs identified a single asset class that they want to focus on and get better at. We see a lot of reads that are very interested in the industrial space, the data centers. We also see some that are focused on the multifamily. Those are continuing to be hot, but where you see REITs that are trying to invest in many different asset classes are not gaining any momentum because it's more difficult to manage those investment dollars.

Let's discuss 2024.

The Federal Reserve decided to hold interest rates steady while giving some indications that rate reductions could be ahead in the near-term. Chairman Powell indicated that inflation is down to almost 3%, so there could be a series of rate reductions in ’24. This could mean that most economists will feel that 2024 will have a soft landing or a small uptick for our industry in 2024. Reduced interest rates could change demand. We could see some values climbing. We could see some transactions happening and potentially more investments flowing to most asset classes across the real estate industry. Expect multifamily to remain consistent with more units coming online. Expect industrial and data center investments to climb as most folks start looking to alternative investments besides high-rise office. We expect to see some adjustments or rates. We expect to see some transactions across certain sectors to increase. Demand adjusted as rates change. All this means more construction and better real estate investments for 2024.

I think there's a lot of optimism going into 2024 with the Federal Reserve holding rates steady ending 2023. With potential rate reductions in 2024, there's an opportunity to try to improve with cost optimization projects, increase cash flow, also reduce borrowing costs. So moving into

’24, we could see a lot of changes with the banking community with lending arrangements and therefore see transactions and value increasing across our industry.

Narrator: Thanks for listening. Find out how Grant Thornton goes beyond expectations at gt.com.