Heavy Multifamily Trading, 'Lender Fatigue,' More Mass Timber: How DFW's Market Will Shape Up In 2024

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After spending the last 18 months shrouded in uncertainty, many real estate professionals in North Texas were reluctant to predict how the market would perform in the new year.

But given strong signals of rate cuts from the Federal Reserve (https://www.bisnow.com/tags/federal-reserve), a deep reservoir of built-in Texas enthusiasm and a stronger baseline performance than nearly every one of its peer cities, commercial real estate stakeholders predict the Metroplex will remain one of the best CRE markets in the nation, buoyed by strong job growth and continued in-migration.

Deal volume fell precipitously in 2023, yet Dallas-Fort Worth remained the top U.S. metro (https://www.bisnow.com/dallas-ft-worth/news/investment/dallas-holds-no-1-spot-for-cre-investment-despite-deal-volume-falling-64-annually-121257) for commercial property investment. Sources told *Bisnow* that despite economic bumps along the road, that's not likely to change in 2024.

"DFW will be one of the first markets to come out of this slower environment that we are currently in," CBRE First Vice President Patrick Benoist (https://www.bisnow.com/tags/patrick-benoist) said. "But I think that will occur more in the back half of the year than the first."

The mere possibility of interest rate cuts should get things moving again, though those queried by *Bisnow* were split on how quickly changes to monetary policy would occur. In the meantime, though, the past year's economic turmoil is slated to create once-in-a-generation opportunities for buyers ready to capitalize on distress.

In that regard, experts say 2024 could be a landmark year for some.

"The Federal Reserve doesn't want to make the same mistakes that were made in the late '70s or early '80s and cut too soon," co-founder and President of CapRock Partners Jon Pharris said. "As investors and developers, we always want to believe the optimistic viewpoint, but I think the cutting will take longer and be slower than most people want."

Bisnow spoke to a handful of CRE leaders in DFW to forecast the year ahead. Here's what stood out.

PREDICTION 1: Renting Remains More Economical Than Owning

A dearth of housing inventory and elevated mortgage rates have kept homeownership out of reach for many North Texans over the past few years. While there is reason to hope for lower prices in the coming months, it will likely still be cheaper to rent than to buy in 2024, said Michelle King, vice president of operations at JPI.

"With higher home prices and record-level interest rates, the spread between homeownership and rental costs continues to make renting significantly more economical than owning," King told *Bisnow* in an email. "Even with the near-term inventory growth, housing is likely to tighten in the future as permitting slows because of more limited access to capital."

A deluge of new apartments coming online in Texas has already begun to dampen pricing power at DFW-area apartments, with January data from MRI Software showing rental rate growth declining by 1.2% over the last 12 months.

More than 44,000 units (https://www.bisnow.com/dallas-ft-worth/news/multifamily/year-end-multifamily-dallas-supply-demand-122192) are slated to deliver over the next two years. That trend is expected to continue, which should provide some relief for cost-burdened tenants. This is especially true in the Class-A market, which will comprise the bulk of new deliveries, said RR Living CEO Melanie French (https://www.bisnow.com/tags/melanie-french).

"When you have a lot coming on board at one time, you'll see that temporary drop in rates and heavy specials," she said. "Those that get built want to cross that 90% occupancy and get stabilized, so all of the sudden they are giving two months free."

PREDICTION 2: Lender Fatigue And More Office Foreclosures

The volume of office foreclosures will increase in DFW as lenders tire of trying to save troubled properties, Benoist said. Borrowers with loan maturities on the horizon may have a more difficult time negotiating workouts, especially if the loan has already been modified.

"They've been able to extend with their sponsors over the last few years … but notes have been due for some time, and we need to work through some of these legacy portfolio issues and then move on with it," he said.

More than $1.4B in DFW commercial property loans were estimated to be in distress as of Q3 2023, with another $8.8B at risk of becoming distressed, according to data from MSCI Real Assets.

Office continued to be the driving force behind growing distress in DFW. As a result, lenders moved to foreclose (https://therealdeal.com/texas/dallas/2023/11/17/lenders-foreclose-on-two-suburban-dallas-office-buildings/) on a number of Dallas-area office buildings toward the end of last year, though one Uptown property owner narrowly avoided (https://www.bisnow.com/houston/news/office/bankruptcy-filing-averts-foreclosure-uptown-dallas-building-but-battle-between-houston-reits-drags-on-121944) that fate by filing for bankruptcy.

Benoist predicts more borrowers will voluntarily hand keys back to lenders in 2024. But despite ongoing turmoil in the office market, the majority of owners will fight to save their buildings:

“I don’t think it’s anyone’s desire to allow their asset to fall into foreclosure proceedings, but unfortunately that will be the case in certain instances,” he said.

PREDICTION 3: Less Office-To-Resi, More Alternate-Use Conversions

Developers came out in droves in 2023 with plans to create new apartments by converting defunct office space. But the office-to-resi trend may have reached its peak, especially in conversion-heavy submarkets like Downtown Dallas.

"We are kind of oversaturated right now with apartment dwellings in the Dallas-Fort Worth market," said Will Pender, regional president at Adolfson & Peterson Construction. "I do see a slowdown; I don't see a sudden stop to it, but we've got to fill some of these existing units."

Fewer apartment conversion requests have come across Pender's desk in the past few weeks, signaling a recognition among developers that the moment for office-to-resi may have passed, at least for now, he said.

Conversions at Santander Tower, Bryan Tower (https://www.bisnow.com/tags/bryan-tower), Energy Plaza (https://www.bisnow.com/tags/energy-plaza) and more will remove 2M SF of office space from downtown (https://www.bisnow.com/dallas-ft-worth/news/multifamily/office-conversions-kill-two-birds-with-one-stone-in-dallas-cbd-116050) and expand the submarket's base of apartments by 20%, Partners Senior Vice President of Research and Market Forecasting Steve Triolet (https://www.bisnow.com/tags/steve-triolet) told *Bisnow*.

To justify conversion costs, rents at the newly created units will need to be high, and Triolet doubts there are enough people with that kind of budget willing to live downtown.

"Luxury apartments do not have the level of demand to support those conversions," Triolet said. "There's just not that many people who can pay that kind of rent."

Developers wary of office-to-resi may see an opportunity to convert vacant office space to another use. Already, some office buildings have been tapped (https://www.bisnow.com/dallas-ft-worth/news/industrial/developers-plan-industrial-projects-on-former-office-sites-in-dfw-122175) for industrial conversions, and Pender said even the more niche segments of CRE have entered the chat.

"Some of these Class-B office buildings are prime to convert to warehouses, to public storage and to other amenities," Pender said. "There's even been talk of, if they have the power requirements, converting them to data centers as well."

PREDICTION 4: Institutional Groups And REITs Will Be Active Industrial Real Estate Buyers

Institutional investors took a major step back from commercial real estate in 2023, but trades among those groups are slated to tick up in 2024 as sellers capitulate on pricing and more clarity is gained around values, Pharris said.

"Existing assets that are institutionally owned are going to transact a lot more, because the bid-ask spread is going to narrow and institutions will be more willing to accept the new pricing and the new reality," he said.

Institutional investment volume fell more than 66% (https://www.cbre.com/insights/figures/q3-2023-us-capital-markets-figures) in 2023, as a lack of liquidity and sharp rise in interest rates kept many groups from deploying capital. Owners that have loans coming due and are unable to refinance may be forced to sell, providing opportunities for well-heeled groups to step in and fill the void.

Real estate investment trusts will also be active in DFW's industrial market, Pharris said. After several sluggish quarters, The Dow Jones Equity All REIT Index closed Q4 (https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-reits-close-2023-with-a-strong-q4-outperforming-the-broader-market-79928380) with a 17.9% total return, outperforming the broader market and prompting an 11.3% return for 2023 as a whole.

Pharris expects this trend to continue, which means REITs will have cash to spend on industrial real estate. Some institutional-grade transactions have already begun to occur (https://www.bisnow.com/dallas-ft-worth/news/industrial/blackstone-acquires-14m-sf-dfw-warehouse-portfolio-as-manufacturing-moves-closer-to-home-121978), with Blackstone (https://www.bisnow.com/tags/blackstone) acquiring a 1.4M SF DFW warehouse portfolio in December.

"As 2024 progresses, each month there will be more and more buyers in the marketplace," Pharris said.

PREDICTION 5: Heavy Trading Returns To Apartment Market

After a historic level of investment activity coming out of the pandemic, apartment sales slowed dramatically in 2023 as rising interest rates clouded values and created a vast divide between buyer and seller expectations.

But that could change this year as owners with maturing loans become desperate to sell and a wave of value-add opportunities hit the market, French said.

"That will be good because it will jump-start the whole acquisition process again," she said. "All of that together is good for the market."

Multifamily sales volume declined 61.9% (https://www.bisnow.com/national/news/multifamily/lennar-puts-multifamily-portfolio-up-for-sale-122111) nationwide in the first three quarters of 2023 compared to the same period in 2022. In DFW specifically, investment activity was down 65% (https://www.northmarq.com/insights/dallas-2q23-multifamily-market-insights-report-rents-upswing-sales-prices-trend-higher) in the first half of the year, though the Metroplex still led the nation (https://www.cbre.com/insights/figures/dallas-fort-worth-multifamily-figures-q3-2023) in overall sales at the end of 2023, with $10B trading hands over the previous rolling four quarters.

French said even more transactions will occur as owners with floating rate debt are forced to either sell or hand back the keys to their properties. Multifamily distress began to creep into DFW in 2023 as small-scale developers and syndicators struggled to refinance into more expensive debt.

More distress is likely on the horizon, French said, which should provide an opportunity for well-capitalized investors to snap up properties at bargain prices.

"Over the next six months we could see heavy trading as all of this comes together," she said.

BONUS PREDICTION: Several Mass Timber Projects To Be Announced

The use of mass timber in commercial construction gained significant ground in North Texas in 2023, with several new projects (https://www.bisnow.com/dallas-ft-worth/news/sustainability/mass-timber-branches-out-across-texas-as-developers-look-to-save-time-and-fill-buildings-117582) breaking ground. That trend will continue in 2024 as developers chase demand for sustainability and investors seek to meet environmental, social and governance requirements, Pender said.

"You'll see probably two to three mass timber projects in the Metroplex this year in different uses," Pender said.

At least 134 mass timber projects were in progress or complete (https://www.texastribune.org/2023/10/19/mass-timber-trend-east-texas-forest/) in Texas as of October, according to The Texas Tribune. Several were located in the Dallas area, including The Offices at Southstone Yards, a 235K SF development in Frisco and the first mass timber building of its kind in North Texas.

Globally, the number of mass timber projects is expected to reach more than 24,000 by 2035, per the Tribune.

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