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Will Investment Sales Recover in 2023?

Investment volume should bottom in Q1, as eyes focus on Fed Funds rate.

By **Paul Bergeron (/author/profile/Paul-Bergeron/)** | December 19, 2022 at 08:25 AM

CBRE forecasts a 15% year-over-year drop in U.S. commercial real estate investment volume in 2023, although it will exceed the pre-pandemic record annual total in 2019.

Investment activity likely will bottom out in the first quarter and then gradually improve, it said. Then, by Q2 2023, a clearer picture should emerge about the terminal (max) federal funds rate and the overall economic outlook.

“Long-term yields and spreads should help reduce capital cost and allow for more sound underwriting. As a result, we expect quarter-over-quarter improvements in capital markets activity starting in Q2,” according to its report.

An informal survey of CRE pros by GlobeSt.com finds that, much like CBRE, while many are expecting a downturn in deals there still will be activity, whether it is from distress or maturing debt. Here are some of their views with more coming tomorrow.

Capital Remains Available

Patrick Nutt, Executive Vice President, NNLG/Market Leader South Florida, SRS Real Estate Partners, tells GlobeSt.com that capital remains readily available.

“However, investors are hoping to be patient and not ‘catch a falling knife’ by making acquisition decisions before reaching peak terminal rates.

“Volatility will continue as we read every Fed note with granular detail and observe how the economy adjusts as growth slows, inflation cools and labor markets ease. The fundamentals thus far have remained exceptionally strong (tenant demand, consumer behavior, etc.) but we anticipate some secular softness but likely not a widespread pull back across all retail.”

An Increase in Recapitalization Requests

Brian Murphy, managing partner, CEO, Veleta Capital, Los Angeles, tells GlobeSt.com that following the recent rate hike, he is more confident in his firm’s near-term projections and anticipates an increase in regular-way transaction volume in Q2.

"We have observed an increase in recapitalization requests and have proactively provided rescue capital to some apartment sponsors," Murphy said.

"We expect this trend to continue throughout the next year. Overall, we remain optimistic about the market opportunities in 2023 and will continue to closely monitor and adapt to market trends."

Good Signs for a 'Healthy' Real Estate Market

Tomas Sulichin, President of Commercial Division at RelatedISG Realty tells GlobeSt.com that buyers and sellers will encounter a more stable market prone to give buyers more options such as through a slight increase in inventory.

In the past years, he said, "buyers and tenants have been at the hands of owners and landlords, and we will soon see a market stabilization. These are all good signs of a healthy real estate market, which is cyclical."

$1 Trillion in Loans Coming Due in Next Two Years

Eric Brody, managing partner, ANAX Real Estate Partners, tells GlobeSt.com that, especially come Q1, expect to see a plethora of investment opportunities in commercial real estate due to the unprecedented amount of senior debt that will be maturing.

"Newmark recently reported that over $1 trillion in loans are coming due in the next two years, and due to rising interest rates, it is expected that repayment conditions will become more challenging, with bridge financing, office, and retail loans being the most at risk," Brody said.

"In addition to the rising rates because of increased construction costs, rent growth, and political headwinds, real estate (particularly in NYC) will need an infusion of capital to either refinance assets at a lower rate, pay down existing debt, or complete current projects."

Some Having 'Uncomfortable Conversations'

Sean Rawson, co-founder, co-founder, Waterford Property Company, tells GlobeSt.com that by the end of Q1 "we will begin to see price discovery in the market. Right now, we are in a period where there is a significant delta between the bid/ask spread between buyers and sellers.

"But due to the distress that is building in the market, it will begin to correct itself by the end of the first quarter.

"There are owners with high-leverage, short-term floating rate debt that are currently having uncomfortable conversations with their lenders going into 2023. Furthermore, we are concerned about the leasing demand for office properties and the supply picture for both multifamily and industrial assets in many markets which could impact property fundamentals in the short term. We believe that will have a large impact on Investment volume in 2023."

"By Q2, a clearer picture should emerge about the terminal (max) federal funds rate and the overall economic outlook. Long-term yields and spreads should help reduce capital cost and allow for more sound underwriting. As a result, we expect quarter-over-quarter improvements in capital markets activity starting in Q2."

Needing 'Clearer Picture' on Trajectory of Rates

Matthew Mousavi, managing principal, National Net Lease Group, SRS Real Estate Partners, tells GlobeSt.com that he expects a bottom by around Q2 when “we will have a clearer picture [illegible] and the capital markets environment going forward.

“However, the inverted yield curve of investment grade bonds and treasuries exceeding certain cap rate yields, along with the negatively leveraged environment based on lending rates relative to seller pricing expectations, has resulted in a marked activity drop in the current environment.”

Waiting for Fed to Stop Raising

Uma Moriarity, Global ESG Lead & Senior investment strategist at CenterSquare Investment Management, tells GlobeSt.com that more clarity and stability in the debt markets will occur once the Fed Funds rate stops rising.

“But at that point, we’re basically going to be in a recession,” Moriarity said. “So the price discovery will be not only from a value perspective, but also from a growth perspective.”

We’re tracking this more real-time in the public markets that had priced in the impact of higher rates earlier in the year and are now looking at recession impacts on cash flow growth.

Net, we’re expecting real estate values to fall in the mid-high single digits by the end of all this but likely we don’t see that really settle out until 2024 in the private markets.

Construction Financing Demand Expected to Rebound

Stephen D. Stein, co-founder/president, Tauro Capital Advisors, Los Angeles, tells GlobeSt.com that he expects sale activity to rebound in early 2023 as sellers, investors and developers grasp the “new normal” of interest rates and cap rates.

“Our forecast of an expected drop in the financial markets is not as severe as the forecast for investment sales,” Stein said. “Pending loan maturities, refinances for cash-out utilized for maintenance obligations and needed repairs or partnership buy-outs, and sale activity to name a few, will all contribute to the continued demand for capital.

“Equity is sitting on the sidelines until the end of Q1 or Q2, demand for construction financing is expected to rebound next year as lenders consider limited new construction projects that will be shovel-ready mid-2023, pricing will remain in flux, loan-to-cost is expected to max out between 50% to 65% and sponsor experience will be paramount.”

Some Loans Need to Be Off Balance Sheets

Stephen Bittel, CEO of Terranova Corporation, tells GlobeSt.com that the lending market will continue to tighten with only banks and life insurance companies lending off their balance sheets.

“Loan sales from existing lenders will accelerate and non- and under-performing loans will need to be moved off balance sheets,” he said. “It will be a tale of two cities with Miami and Austin continuing to outperform the nation, while NYC, Chicago and San Francisco will continue to suffer population and business out flows.”

Bittel also said that unemployment will jump higher and corporate earnings reported in January will be down.

Paul Bergeron

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