CRE Predictions For 2023: Distress, Opportunity And Another 'Roller Coaster' Year

By Miriam Hall

After the last three years, there are few real estate professionals brave enough to make confident predictions about what will happen in 2023 — other than to say once again to expect the unexpected.

“We expect 2023 to herald a whole lot more of the same relative to 2022, and by that, I mean it's likely to be a similar roller coaster ride,” Moody’s Analytics Head of Commercial Real Estate Economics Victor Calanog said. “It's not all downs, it's a lot of ups and downs.”

Commercial real estate enters 2023 pointing in the opposite direction as it did a year ago. The Federal Reserve has pushed its benchmark rate to 4.5% after starting 2022 near zero, a rapid change in the state of affairs that has ground sales volume to a standstill and killed deals around the country.

Rents at multifamily and industrial properties have soared this year, but amid the Fed's aggressive campaign to rein in inflation, demand for both has started to come down. More significantly, demand for office space has never approached pre-pandemic levels, and office occupancy is still below 50% of what it was in most large markets.

Meanwhile, predictions of a recession next year — and whether the overheated recovery will end with a hard or soft landing — have intensified. Nothing is predictable these days but something of general consensus is taking place on apartment rents, the U.S. economy, return to office and how the Fed may behave in 2023.

It might not turn into a nightmare year along the lines of 2008 — but it certainly "won't be pleasant," CBRE predicted — and it will likely be defined by what doesn’t happen more than what actually does.

“I think we're in for a tough road,” said Andrew Steiker-Epstein, the vice president of sales, leasing and marketing at New York developer Charney Cos. “I think you are going to see just very low transaction volume, and not a lot of things happening.”

Bisnow spoke to nearly a dozen industry leaders to gather predictions for the year ahead in CRE. Here is what stood out:

The Housing Crisis Won't Abate, Even As Rents Stabilize

Eye-watering rent increases are expected to keep slowing down this year after posting records in 2021 and the beginning of 2022.

The last of the Covid-era discounts will expire in 2023, bringing even more inventory to market, said

Diane Ramirez, the chief strategy officer of Berkshire Hathaway HomeServices New York Properties.

"I think there's going to be a lot of turnover of apartments," she said. "That's going to help with supply, and with supply, you might get a little bit of an easing with prices, so I think the rental market is going to just become a little more normalized."

Shimon Shkury, founder of multifamily sales brokerage Ariel Property Advisors, said rental growth will no longer see a rapid ascent, but he doesn't expect it to start coming down because "there's not a tremendous amount of new product that is opening up."

That spells bad news for the tens of millions of Americans who are paying more than 30% of their income on rent. The housing crisis isn't going away next year — and it will likely get worse, Nuveen Impact Investing Senior Portfolio Manager Pamela West said.

“I've seen a ton of numbers quoted from different sources, but we’re somewhere between 6 and 7 million units in deficit of housing,” she said. “If we were to build 100,000 units per year of affordable housing, it would still take us 20 years to catch up to what we need. It's just a ridiculous statistic and the needle moves every year, and so in 2023, it's going to move again, and it's going to move away from us.”

She said housing is a "purple" political issue and is on governments' agendas more than in previous years, but the required urgency is not yet there, and it's unlikely to show up in 2023.

“I don't think we'll go backwards on any policies, but my concern is that we're not really going to move forward either,” she said.

Recession? Maybe. But Distress Is Coming

The predictions on the style of recession vary wildly, from deep to shallow to not coming at all.

“The market really hasn't given up on the possibility that there will be a soft landing, that we're going to avoid a recession,” Calanog said. “We think that the probability of a recession in the United States now lies between 55% to 65% over the next 12 months.”

Goldman Sachs, for its part, has put the chances of a recession at 35%. Almost uniformly, real estate players have arrived at the conclusion that some form of correction will come next year, particularly for deals made at the top of the market last year.

"We're heading to what you refer to as a liquid recession," said Ran Eliasaf, the founder of real estate private equity firm Northwind Group, which has $3B in assets under management. "It's hard to say if we're gonna hit a full-blown recession, or it's just gonna be a milder one, but there's definitely a big correction in pricing as well as valuation. That has to happen.”

Marx Realty CEO Craig Deitelzweig is predicting a “shallow” recession, characterized by companies shedding employees following the hiring spree in 2021. His company has been lying in wait for opportunities to pounce on assets whose owners aren't able to withstand the current market conditions.

Those opportunities have presented themselves in Washington, D.C., he said, but in New York, the “come to Jesus” moment hasn't yet arrived.

“I thought we would see more in New York, but I'm hearing quarter one is when we'll really start to see more of those opportunities," he said, adding the firm will continue to look for assets in New York, and in other parts of the country like Atlanta and Austin.

“A lot of debt comes due in 2023, 2024,” he said. “They have debt coming due, and they either don't have the capital to [improve the buildings] or they don't have the wherewithal to do it.”

Northwind's Eliasaf said the bank pullback from CRE lending has already led to some borrowers seeking out debt funds like his for products like condominium inventory loans in New York.

“The quality of borrowers that need financing solutions increased, because they would usually get the solution from the bank and that doesn't exist,” he said. “I think we're going to be very busy 2023 as well.”

A sluggish market makes for a tough time for appraisers, said Grant Norling, a co-founder at Valcre, a software company for appraisal firms, but next year is set to bring more activity for the industry as owners, and their lenders, face challenges with their assets.

“There'll be other aspects of the other sectors of the appraisal industry that start picking up quite a bit,” he said. “Any bank that has troubled assets, or they're looking at pre-foreclosures ... they'll want to be appraising their assets for loan monitoring purposes. So that portion of the industry we anticipate will fire back up.”

Office Usage Will Rise With The Threat Of Layoffs

Office usage is top of mind for 2023 across the board, with some predicting workers will try to ease their fears about the state of the economy by heading into the office more frequently next year.

“I think part of the reason why the sentiment has been weak [on office] is because a lot of companies have had challenges in fully mobilizing their employees back to the office,” Empire State Realty Trust Chief Operating Officer and Chief Financial Officer Christina Chiu said. “Tech layoffs, maybe some of the financial [firms' layoffs] and how that rolls through the system, especially in light of rising interest rates and economic uncertainty ... I think some of that will make it easier for companies to bring people back and get people more confident about the use of office.”

Deitelzweig predicted office occupancy will jump by 10%, while Shkury said he thinks usage “absolutely” is going to go higher. Steiker-Epstein of Charney Cos. said 2023 is more likely the year office owners accept the workplace is fundamentally altered.

“I think there's going to be a slow trend of people coming back,” he said. "It’s never going to be near where it was."

Calanog took another viewpoint: While employers might demand more workers back at their desks — and some are already doing so — that phenomenon might proved short-lived.

“Would you really feel good about working for an employer that uses the potential threat of layoffs to get you to go back?” Calanog asked. “Yeah, you might comply in the short run, and then guess who's gonna be stepping up their résumé?”

Interest Rates Could Start Coming Down Before Year-End

Last week, the Federal Reserve hiked the benchmark interest rate half a percentage point, hitting its highest rate in 15 years. The targeted range reached between 4.25% and 4.5% — and Fed officials are now forecasting raises to be around 5.25% by the end of 2023.

Real estate has a more optimistic take, however.

“I think that we peaked in terms of interest rate growth — I hope so at least ––and I think that there is some likelihood that we'll see a lower interest rate environment in a year from now,” said Shkury, though he said he can’t predict that with any certainty.

“I think we'll see a pause in March and they start dipping in June,” Marx’s Deitelzweig added.

“There are some who are talking about the possibility of rates coming down next year … There's a number of folks in the last few weeks who are entertaining that possibility, giving a greater probability to that happening than they were weeks before,” Trinity Place Holdings CEO Matt Messinger said. "I am certainly more optimistic about the possibility of potentially opportunistically being able to refinance certain debt obligations at the tail end of ‘23.”

Industrial Down, Retail Up

Industrial real estate, long the darling of the industry, could be facing a challenging 2023.

Turnbridge Equities Managing Principal Ryan Nelson said the sector is suffering from lack of available space and limited new construction coming online.

"This stagnation can be attributed to the current and impending capital market dislocation we are seeing and this will further exacerbate supply chain delays as industry players navigate finding space," he wrote in an email. "From a developer’s standpoint, higher interest rate and the potential for a recession will threaten prospective industrial developments."

Speculative construction has been the norm — of the record 700M SF of industrial space under construction in the middle of 2022, just 26% was pre-leased, according to Cushman & Wakefield. But while future development is still needed, construction will be limited "due to capital market dislocation and distress," Nelson said.

But in a complete reversal of fortune, there is a growing sense that the worst is over for the embattled retail market.

“The pessimists all said it would take years for the New York retail market to recover from the pandemic, but the numbers don’t lie," Patrick Smith, who is vice chairman of retail brokerage at JLL in New York, wrote in an email. "By the close of 2022, we expect the number of retail leasing transactions this year to surpass that of 2019 and mark a return to normalcy as we go into the new year."

Sublease space dropped nearly 11% last quarter and leasing velocity was up 7.4% year-over-year in Manhattan, per the brokerage.

"It seems that lenders have become more positive on retail, along with some buyers, under the notion that they've been downside-tested on multiple fronts: Covid-tested, internet-tested, e-commerce tested," Chiu said.