Has 2023 Really Been That Bad for CRE?

Maybe the problem is that conditions are returning to an old mean.

By Erik Sherman

When looking at trends in any market, there is often folly in focusing on immediate changes in data. Up-and-down data movement over a short horizon usually creates chatter that can cause whiplash and clouds the vision of investors.

But the issue of chatter isn't one only for an hourly or daily or even weekly fixation. It can happen in a year over year comparison because the aggregation leaves you with only two data points that feed into either concern or euphoria and may seem more important than they are.

A new Green Street report by Managing Director and Co-Head of Strategic Research, Daniel Ismail and Harsh Hemnan, analyst on the net lease and ground lease sector teams, looked at the Q2 CRE transaction results for 2023 as well as the first half roll-up.

The results are probably not surprising given all the news that has come out about industry trends: activity was down 50% year over year.

But dig into the report in greater detail and the results start to look different. It may be more that 2022 created unusually large expectations rather than 2023 exhibiting lackluster performance.

Start with total U.S. transaction volume on a year-to-date basis. Sales for the first half of 2023 were $137 billion. Compare that to the first half of 2022 — $306 billion. That would make 2023 a drop of $169 billion, or 55.2%, from 2022. It seems like a complete disaster.

But now look at the same year-to-date transaction volume across the 10-year average. That figure is $130 billion. In that context, 2023 is a 5.4% increase over the average, but certainly within the range of returning to that 10-year mean.

The change seems like a statistical regression to the mean, in which one data point that is unusually extreme. At least in the first half of 2022, there were very heavy sales and high valuations. Why wouldn't subsequent samples the following year move back toward the mean?

Looking across transaction volumes, including M&A, over time, values for whole years were $212 billion (2013), $259 billion (2014), $356 billion (2015), $314 billion (2016), $313 billion (2017), $395 billion (2018), $409 billion (2019), $276 billion (2020), $685 billion (2021), and $526 billion (2022).

If anything, 2022 was a move closer to the mean than 2021. And now, 2023 is even closer.

CRE, as well as the rest of the economy, has faced conditions that have driven results to extreme, first down, then up. Now down again as inflation cools and markets shift.

Now the question is whether interest rates will come down to where they were right before the pandemic, which was the end of abnormally low interest rates set by the Federal Reserve to stimulate the economy, or if they revert to a longer mean that would mean higher interest rates, but perhaps more predictable markets, going forward.