It’s The End Of 2023. Are We Where Experts Predicted We Would Be?

By Emily Wishingrad

Last December, Bisnow asked economists and real estate experts to predict what we might see in 2023 — what big trends and milestones were likely to shape the coming 12 months in commercial real estate.

The cards were stacked against them.

The last few years have made clear that this is an era in which almost nothing can be predicted. But looking back at experts' guesses from one year ago shows a mixed bag: some predictions panned out while others missed.

In general, the economy seems to have fared better than most expected, Sunny Wong, economist and associate dean at the University of Houston’s Hobby School of Public Affairs, told Bisnow.

“Talking about the general economy — talking about labor markets and talking about the interest rate, everything, I think, is not as bad as I would [have predicted] at the very beginning of the year,” he said.

2023 did not bring a recession as many expected, and while the CRE market has seen distress, it has not been as widespread as some feared. Housing supply and affordability has remained a major issue. But the rapid rate of rental price increases is cooling, as is inflation, with the Federal Reserve keeping interest rates high.

This year also saw remote workers holding firm to their stretchy pants and comfy couches, even as companies became more forceful in their return to office requirements. And in the midst of it all, a surprising trend emerged: the dark horse of artificial intelligence galloped into the universal consciousness, bringing numerous CRE implications with it.

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

The country’s housing and availability and affordability crisis has yet to be resolved.

“From the work that we've done on different affordable housing programs, I think that that panned out as true. The housing crisis did not abate. There's still definitely a shortage of affordable housing,” Jill Naamane, a director of financial markets and community investment for the Government Accountability Office, told Bisnow.

This past year did see a surge in supply following the construction boom in 2021. More than 460,000 units were delivered during the first nine months of 2023, according to RealPage, nearly half of the total deliveries over the past three years.

As a result of all that new supply, the rate of rent increases has slowed this year. In November, asking rents were up 3.3% year-over-year, compared to 8.4% at the same time last year.

However, affordable housing is still a persistent problem and is expected to be in the years ahead, with less construction getting off the ground due to high interest rates and construction costs.

Meanwhile, a GAO report in October found that federal funds for affordable housing aren't going as far as they once did and that the agency needs to examine the implications of the overall economic environment on its programs.

“Even with the same amount of funding, you're getting less for your money in terms of output of production of units. So that is one trend in the last year,” Naamane said.

CORRECT: Industrial Down, Retail Up

Industrial and retail did indeed swap places this year on the commercial real estate favorability scale — and with industrial's pain came retail's gain.

The first few years of the pandemic saw an explosion of new industrial construction, fueled by e-commerce needs. But now, as those projects come online, demand for those spaces can't keep up. As a record 162.4M SF of industrial delivered in the third quarter of the year, Q3 also saw the absorption hit the lowest levels since 2015, according to JLL.

The slow absorption caused the industrial vacancy rate to rise by 70 basis points from the quarter before 4.9%. That number, however, is still well below a decade prior, when the industrial vacancy rate was at 7.7%.

Dollar volume of industrial sales fell by 45% in the third quarter from a year prior, The Wall Street Journal reported, citing MSCI Real Assets.

“It was unsustainable, but no one knew how long this party was going to last,” Green Street Managing Director Vince Tibone told WSJ.

Meanwhile, as shoppers became more eager to return to stores, institutional dollars have poured billions of dollars into the asset class, in a rapid 180-degree turn from the quarantine era that pummeled the sector.

Retail vacancy was at 4.8% during the third quarter, according to CBRE — the lowest rate since the firm began tracking the market in 2005. Luxury retailers are playing their part in those strong fundamentals — luxury brands inked 650K SF of leases as of the end of September, per JLL, compared to 250K SF during the first three quarters of 2022.

“This is the only asset class that currently has positive leverage,” Lincoln Property Co. co-CEO David Binswanger told Bisnow in August. “You can buy a deal at a cap rate and borrow at a rate that is lower than the cap rate you're buying. Currently, you can't really do that in industrial, you can't really do that in multifamily.”

PARTIALLY CORRECT: Recession? Maybe. But Distress Is Coming

Many economists were eyeing a recession in 2023 — a point of economic dread that has yet to come to fruition. And although distress is certainly here — it hasn't reached a level that some say they would have predicted at the beginning of the year.

Last December, Moody's Analytics was more confident than not that a recession would occur in the next 12 months, Victor Calanog, the firm's head of commercial real estate economics told Bisnow — putting the chance between 55% and 65%.

Goldman Sachs was a little wearier — putting the chances at 35%, as it predicted the U.S. would "narrowly" escape a recession — an outlook that seems to have played out.

"I was surprised too, honestly," University of Houston's Wong told Bisnow, pointing to the strong labor market as the economy's saving grace.

Commercial real estate distress was at a ten-year high at the end of Q3 after a fifth consecutive quarter of increase. But the wave of distressed property deals hasn't been as big as some foresaw.

As of the end of September, only 205 distressed properties traded hands, well below the volume of transactions during the Great Recession: 309 during the first three quarters of 2009 and close to 1,000 in 2010, according to MSCI Real Assets.

"If you would have asked at the beginning of the year, I would have said we would have been a lot more focused on the distressed opportunities," Harbor Group International Managing Director of Acquisitions Matt Grabler said at Bisnow's Multifamily Annual Conference East last month.

WRONG: Office Usage Will Rise With The Threat Of Layoffs

This year did not bring the return-to-office renaissance that many in the commercial real estate industry were expecting — and hoping for.

Though more companies did start to drill down on enforcing in-office attendance, card swiping data indicated the return on that effort wasn't substantial. Office occupancy has hovered around 50% of pre-pandemic levels throughout most of this year, per Kastle Systems data. Last week, the metric used to determine office occupancy reached a pandemic-era high of 51.6%.

But the sluggish returns come even as nearly 3 million employees were projected to fall under new return-to-office policies throughout 2023, and as 52% of U.S. companies are requiring employees to come in between one and four days per week, Globe Street reported Friday, citing VTS.

Now, nearly four years after the start of the pandemic, the level of usage offices are seeing today may be the trend for the long run, experts say.

"WFH levels have become 'flat as a pancake,'" Stanford Economics Professor Nick Bloom wrote on X, formerly Twitter, in late November. "The latest Census, SWAA and Kastle data all show the same thing. Levels of WFH were falling throughout 2020 to 2022, and office occupancy was rising. That trend ended in 2023, with both now pancake flat. Return to the Office is dead."

WRONG: Interest Rates Could Start Coming Down Before Year-End

It's official: interest rates did not come down during 2023. The Federal Open Markets Committee held rates between 5.25% to 5.5% during the last meeting of the year on Wednesday.

It was the third meeting in a row that the Fed decided to hold the rate, after more than a year of aggressive increases beginning in March 2022. Most FOMC members said they expect rates to come down by at least 50 basis points next year.

"We are seeing strong growth that appears to be moderating," Federal Reserve Chair Jerome Powell said at last week's press conference.

"We're seeing a labor market that is coming back into balance by so many measures, and we're seeing inflation making real progress. These are the things we've been wanting to see. No one is declaring victory. That would be premature and we can't be guaranteed this progress. So we're moving carefully."

The hikes were an attempt to get inflation under control, and they have paid off so far. The Consumer Price Index rose 3.1% year-over-year in November, down from 6.4% at the beginning of the year. Inflation is now well below what it was in June 2022, when CPI increases hit a 40-year high of 9.1%.

SURPRISE: The Rise Of AI And Its Real Estate Applications

This time last year, the phrase artificial intelligence for many people may have sparked an image of a Wall-E-type robot.

Now, it's a technology that millions use daily — to help write emails, create travel itineraries and figure out what to make for dinner.

And the effects on CRE have been wide-ranging — from creating massive demand for data centers to performing leasing and management duties to developing solutions to reduce carbon emissions.

ChatGPT was unveiled in November 2022 and since then, the race has been on to uncover how AI can help the sector save time and money and avoid mistakes. Following investments at the beginning of the year from the biggest players in tech, like Google and Microsoft, real estate giants also got their foot in the virtual door.

JLL's tech venture capital arm put $10M into AI real estate planning platform Qbiq, the brokerage announced in September. That same month, property data company Site Technologies announced it had secured a $10M Series A round, led by Proplogis. This summer, CBRE announced it had started using the AI platform Nexus to gather building operators and usage data for its 1B SF portfolio and JLL launched its own in-house large language model product called JLL GPT.

"For commercial real estate, it's clear that strategically embracing AI could transform the sector," JLL authors wrote in a July report on the sector.