Big Brokerages Prepare for Rocky Recovery in Real Estate Activity

Rebound in Property Markets Is Likely To Take Years

The apartment industry could be among the first to see deal activity, as construction has stayed strong in 2023, including such projects as The Lex, a 247-unit project finished this year in Tacoma, Washington. (CoStar)

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Executives at the largest property brokerages had been hoping that deal activity might pick up in the second half of this year. But most now say they don't expect a major recovery until the second half of 2024, especially for real estate sales.

CEOs for CBRE, JLL, Cushman & Wakefield, Colliers and Newmark lowered their outlooks for the rest of 2023 and made it clear during recent earnings presentations that investment sales and lending probably won't pick up until the Federal Reserve Bank signals that its interest rate increases to curb inflation are over. Only then, they predicted, would investors have the certainty they need about property pricing and debt availability to start making deals again.

But inflation has proven tough to tame, and there is a lively debate over whether the Federal Reserve will have to hold interest rates higher for longer to gain the upper hand on price increases. Many market watchers, for instance, assumed higher rates would push the economy into recession. Now, they aren't so sure.

"One thing that has become clear to us in the past quarter is that if we're going to have a recession, it's been delayed," Bob Sulentic, CEO of CBRE, the world's largest commercial real estate brokerage, told investors during the company's earnings presentation. "Of course, the recovery related to that would then be delayed."

The longer the lull lasts, the choppier a recovery will likely be. Rising concerns over weakening rent growth and higher vacancy rates across all property types, especially the beleaguered office market, and the looming mountain in commercial real estate debt scheduled to come due this year and next year could force owners to capitulate sooner to sales terms that may not be as lucrative as they had hoped.

Waiting for a Thaw

Opinions vary across the industry about when transactions will pick up.

“I do not expect the transaction markets to pick up in a meaningful way until next year at the earliest,” Joseph Gyourko, economist and professor of real estate and finance at Wharton School at the University of Pennsylvania, said in an email. "For the moment, I think money is content to wait until they are sure the Fed is done raising. Once investors know, or think they know, what long interest rates will be, things will change."

Cushman & Wakefield CEO Michelle MacKay sounded a similar note, saying she thought capital markets might thaw by late this year into early next year.

"And at that point, then it's just a discussion around how the dam breaks, if you will; if it breaks in small pieces or breaks all at once," she said, responding to a question from an analyst about when and how transaction activity might rebound.

Even if interest rates stabilize by the end of this year, property prices may continue to fall, Chad Littell, CoStar's national director of U.S. capital markets analytics, said in an email.

"Simply put, space needs are slowing down while new supply continues to hit the market," Littell said. "Consequently, vacancy rates are rising across all property types, rental rate growth projections are decelerating and rents are sliding. These challenges should result in further value declines and a continued lull in the pace of sales activity into 2024."

The property types to watch for a turn in the market are likely to be multifamily and industrial, the two strongest commercial real estate areas since the onset of the pandemic, Rich Ortiz, managing director with Hudson Realty Capital, a private-equity fund manager based in New York, said in an interview.

"Rental rate growth is good, and while there are supply issues in some markets, the multifamily market in general seems to be doing fairly well," Ortiz said. "I'd argue the same for industrial. Although there’s a little bit of weakening now, demand is still healthy and supply has been fairly consistent with demand."

Debt Coming Due

Overall, though, a complete rebound is likely to take time. Similar to the period after the Great Recession, it could take several years to unwind up to $2 trillion in commercial real estate debt slated to mature over the next two to three years, said Littell.

CMBS delinquencies hovered at less than 1% for more than a year into the real estate downturn that started in December 2007 and delinquency rates didn’t peak until the back half of 2012 for most property types, he added.

"Lenders will do what they can to work out troubled situations because they have neither the manpower nor the expertise to see an asset to stabilization," Littell said. "Most lenders just aren't equipped to take properties back."

While many lenders will provide short-term extensions or loan modifications to support the borrower, they will only do it for so long, he said.

"The takeaway is that it is a slow process that will take several years," Littell said. "Despite the maturity schedule that would lead you to believe that mass defaults will create a panic-like wave of distress, it just hasn't played out that way in past cycles."

Lenders also are likely to remain cautious even though loans made in the past decade are nowhere near the extremely high leverage or toxicity of those made in the economic downturn 15 years ago, Alexander Goldfarb, a Piper Sandler analyst who covers Newmark and big office landlords such as SL Green and Vornado Realty, said in an interview.

"Everyone fears the end of the world," Goldfarb said. "After the Great Financial Crisis, the banks got a ton of religion and were only underwriting up to 65% to 70% loan to value."