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Commercial Real Estate

Finding Value in the Post-Pandemic Market

Assessing the effect of secular trends on commercial real estate values.

In the first half of 2023, commercial real estate prices declined by 11.2 percent year over year, according to Real Capital Analytics' (RCA) national all-property price index, the first retracement since the Global Financial Crisis (GFC). The apartment sector experienced the largest decline at 12.5 percent, down from highly elevated levels, while the industrial sector declined only 2 percent, buoyed by continued demand for warehouse and logistics properties to support the realignment of supply chain networks post-pandemic. Despite the near-term pressure on real estate values, prices for all sectors remain above pre-pandemic 2019 levels.

The two primary drivers of the stress on prices are higher debt costs and reduced availability of capital. Stress in the commercial banking sector is limiting new loan originations from one of the largest capital sources, challenging refinances of maturing loans. Real estate transaction volumes are at the lowest level in the past decade, according to RCA data, as sellers and buyers are unable to close the bid-ask gap. The apartment sector is experiencing a supply-demand imbalance in some cities following robust levels of new construction, causing vacancy rates to rise. The office sector continues to undergo a fundamental shift as the stickiness of hybrid work schedules forces companies to rethink how and where they use office space. Although retail fundamentals remain strong and vacancies are at their lowest level ever reported, weakening of consumer spending in an economic slowdown may cause retail demand to cool.

Despite these challenges, we believe that some of the secular trends accelerated by the pandemic around how and where people choose to live, work, travel, and shop are achieving some permanency and will drive the need for capital reallocation and investment—not in the buildings of yesterday, but a new generation of hard assets necessitated by the evolution of onshoring and re-shoring, population migration, demographic changes, and advancements in technology. Our real estate investment strategy is focused on mission-critical industrial assets, such as logistics properties and warehouses, as well as multifamily properties in undersupplied markets, and other sectors where we see sustainable demand drivers that support long-term value and capital appreciation.

By Jennifer A. Marler and Farris Hughes

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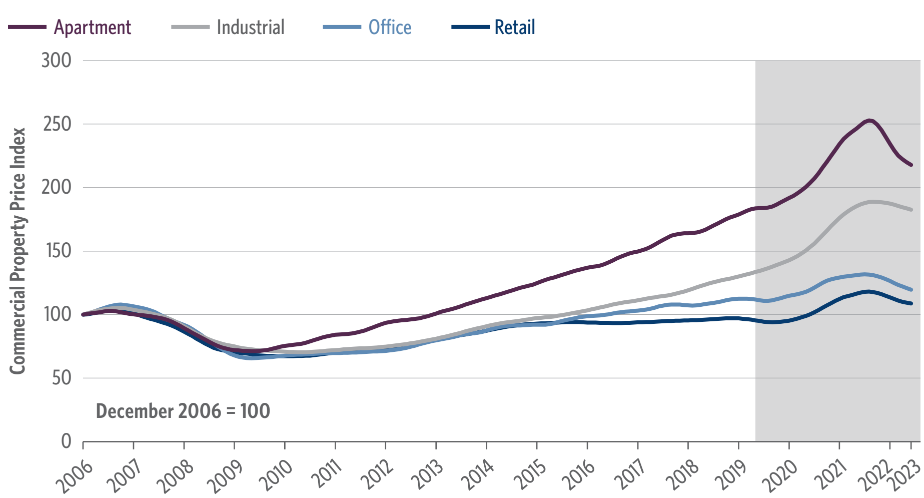
Declining Fundamentals Apply Downward Pressure to CRE Valuations

Commercial Real Estate Value Price Index



Source: Guggenheim Investments, Real Capital Analytics. Data as of 5.30.2023.

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