Global Capital Outlook for 2023

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Commercial real estate investors were on a roller coaster ride in 2022. Given the lag effect of reported investment sales, US volume peaked at an all-time high in the second quarter on a four-quarter rolling average. In addition, borrowing costs soared in many countries, sending capital to the sidelines and cooling investment sales activity. This was the environment investors found themselves in when Colliers surveyed them for the third *Global Investor Outlook Report*. Although investors showed concern in several areas, the broad expectation is for a rebound in activity in the second half of 2023. Investor sentiment revealed similarities and differences across major global regions, including Asia-Pacific (APAC), the Americas, and Europe, the Middle East, and Africa (EMEA).

Also readily apparent was the strength of commercial real estate fundamentals. The current scenario is not one in which vacancies are rising and rents are plummeting; instead, it's the opposite. The real estate sector, by and large, is not overbuilt. Today's market stall is a math problem. Simply put, the higher cost of capital means that 2021's pricing is no longer supported. Owners are choosing to hold onto their assets and ride out this uncertain time. Remember, this is the first bout of sustained inflation and rising interest rates in the US in decades and is new for most real estate investment professionals.

Several key themes emerged after analyzing the record number of responses to the Colliers survey and collaborating with global market experts. They include uncertainty over interest rates and currency volatility, asset pricing, debt availability, a shift in investor focus to debt strategies, and the importance of ESG in investment decision-making. In addition, supply chain disruption remained a widespread focal point, and deglobalization and energy supply and costs were more substantial concerns in APAC and EMEA than in the Americas (Exhibit 1).

As we approach the midpoint of the first quarter, investors remain sitting on near-record amounts of uninvested capital. Although the beginning of the year is anticipated to be slow, the back half has the potential for a sizable rebound.

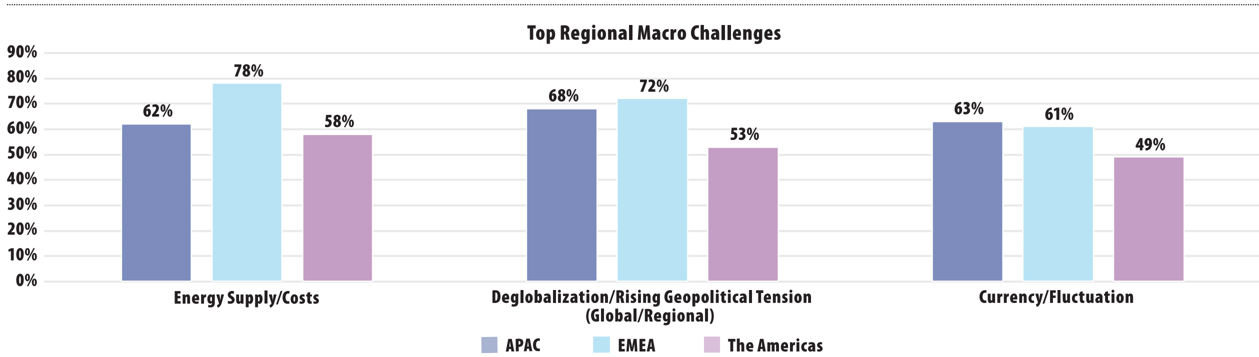
Exhibit 1: Global Challenges: Key Downside Risks

Average % of Investors That Cited the Following As the Top Three Negative Challenges That Will Affect Their Real Estate Strategies in 2023

88%
Interest Rates

74%
Inflation

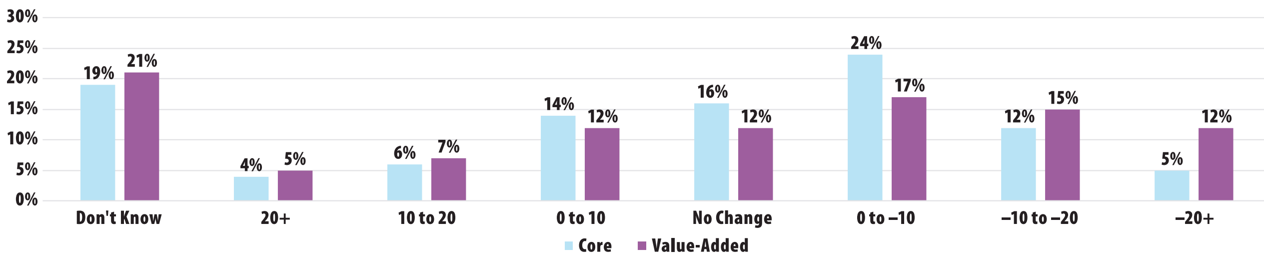
68%
Supply Chain Disruption



Source: Colliers, 2023 Global Investor Survey

Exhibit 2: Global Capital Values: % Change in 2023 for All Asset Classes

% of Investors Deciding What the Capital Values Will Be for Core and Value-Added Across All Asset Classes



Source: Colliers, 2023 Global Investor Survey

Pricing Discovery Is Underway

Pricing adjustments have not been equal across global markets. The first markets to react were the US and the UK, with yields moving out 100 basis points or more in many asset classes across cities and regions. This movement was noticeable in the second half of 2022. Market performance will continue to vary. How markets reprice and recover and which sectors will be the focus will differ from region to region.

Uncertainty remained a key theme in the survey, with investors unsure how long the market would take to rebound. They reported paying close attention to additional geopolitical challenges and economic shocks, concerned that the market could move backward just as easily as it moves forward. Many investors are working through today's conditions, managing assets and cash flow and watching for signs of market recovery. Interest rates have been volatile, and debt sources have changed. Sentiment differs across asset classes, meaning investors will implement various strategies.

Survey results reflect a significant variance in how and when markets will land. Overall, investors' consensus was that a further correction in core asset values of –10% would be likely by the end of 2023. In addition, value-added assets would be prone to an additional drop (Exhibit 2).

That said, almost 20% of investors stated that they "don't know" where values will land in 2023. This figure was above 30% for retail, hospitality, and multifamily value-added assets. Multiple factors were driving pricing change and the timing and velocity of that change across markets. The Global Investor Survey took place between Oct. 3 and Nov. 3, 2022, during which some markets were experiencing significant changes in values. It is difficult to be certain whether all the views expressed by investors accounted for this price adjustment or whether they represented the expectation of further price changes in 2023. Either way, the results confirm that the price discovery journey still has some way to go.

The view on value change also differed by region. It was far more bearish for North American core office, with 13% of investors believing values would decline by more than 20% in 2023. Less than 5% thought this would be the case in APAC and EMEA.

Opportunity Will Present Itself

Unlike prior crises, the current environment is different—it is not a repeat of the global financial crisis. Liquidity remains broadly available, leverage is lower, and capital and liquidity are still available, even if more expensive. Still, the higher interest rate environment has negatively impacted capital values, resulting in the emergence of distress in 2023. Commercial mortgage-backed securities delinquency rates remain low, although they rose in 4Q2022, and watch lists are being closely monitored. Investors in a liquidity event, such as a refinance or loan maturity, may find injecting additional equity into their deals necessary. This situation will not be confined to late-cycle investors or those in high-risk assets. Occupier turnover can quickly turn a performing asset into a challenged one.

Investors are gearing up for these opportunities, raising funds, and looking at assets that must trade, which will help set pricing clarity. Meanwhile, privatization plays will emerge. Publicly listed investors are trading at discounts to net asset value, making them targets for risk-on private-equity and other cash-rich investors, including those

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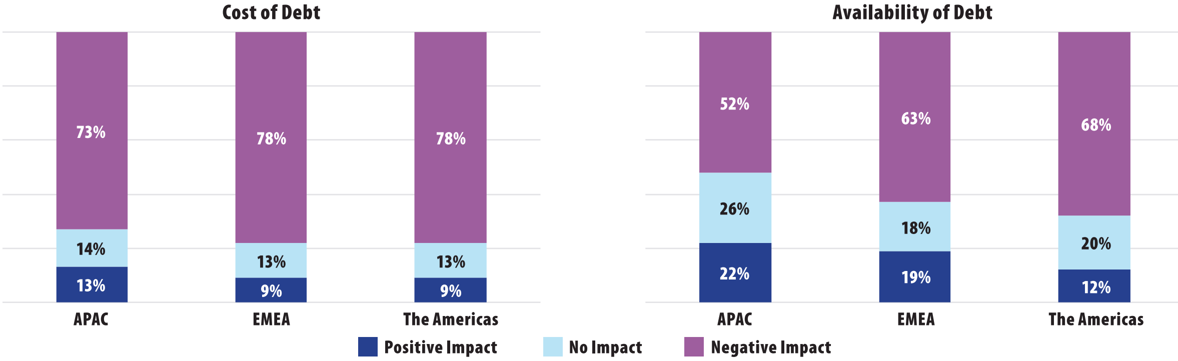
Exhibit 3: Survey Question on Impact of Debt

Please rank the following factors in terms of their influence on your ability to pursue your investment strategy during 2023.

% of Investors That Chose How the Cost and Availability of Debt Will Impact Their Real Estate Strategies in 2023



Source: Colliers, 2023 Global Investor Survey

overseas. Some will take the route of acquiring bonds they can convert to equity. Although these larger go-private deals eased late in 2022, they could emerge in 2023.

Tighter conditions also mean some larger platforms assembled by developers and asset owners will become increasingly expensive to maintain, which has already proved true in APAC. This uptick will lead to large-scale capital placement and direct opportunities, with nonperforming assets and portfolios coming to market to shore up balance sheets.

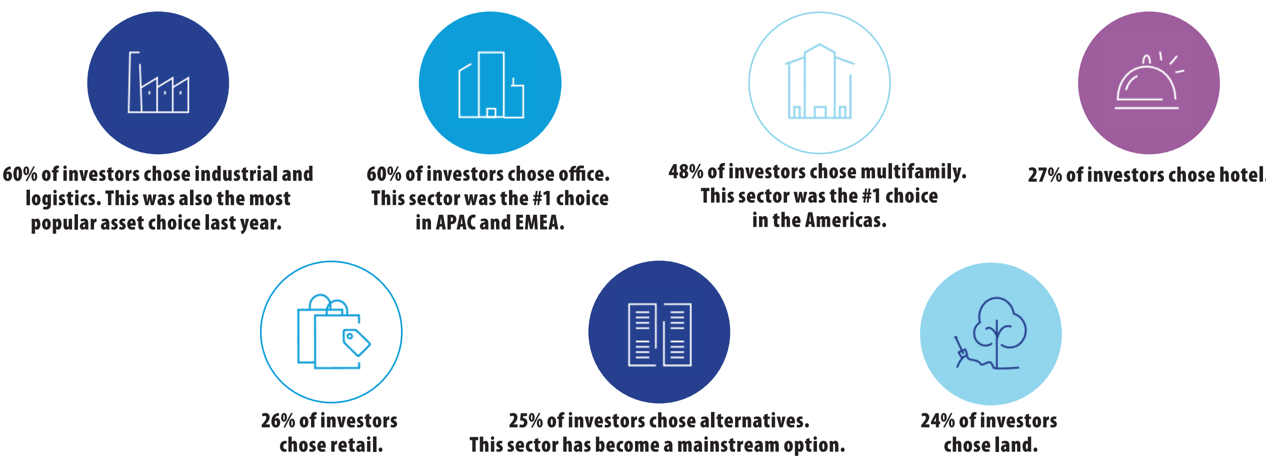
Debt Is the Focus

Responses to the Colliers survey illustrate the immense impact interest rates are having regarding the cost and availability of debt (Exhibit 3). Globally, 76% of investors said the rising cost of debt would negatively impact their real estate strategies in 2023—a sentiment consistent across regions. An additional 60% anticipated that a reduction in the availability of debt would have negative consequences. This view was most apparent in surveys in the Americas, with less concern in APAC.

Exhibit 4: Survey Question on Interest in Asset Classes

Please choose the asset classes you are considering investing in during 2023.

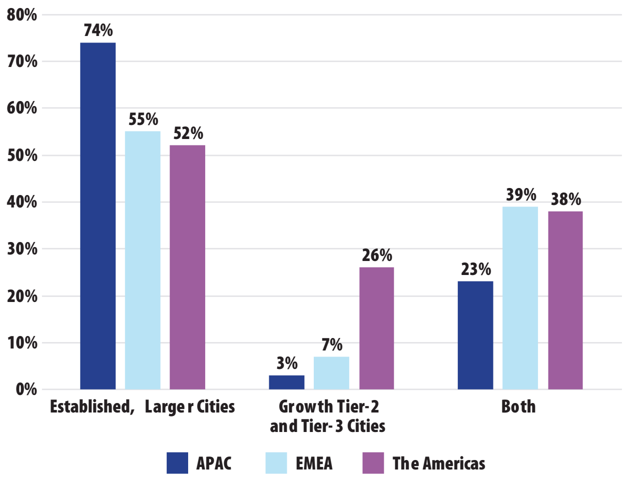
Average % of Investors That Chose Sectors*



Source: Colliers, 2023 Global Investor Survey

* For each selection, the % figure indicates the percentage of investors surveyed that chose this specific selection; each investor could choose multiple answers.

Exhibit 5: Survey Question on City Preference
During 2023, what is your city preference when investing in asset classes?
% of Investors, Split by Region, That Chose Their Preference on City Type



Source: Colliers, 2023 Global Investor Survey

As the cost of capital rises, investors recognize it can be more advantageous to extend their activities into debt than aim for direct equity investment. As a result, there is heightened activity and creativity in the debt space, which is still evolving, as more investors explore solutions such as mezzanine debt, bridge loans, and project financing. These options will help close any liquidity gaps and recalibrate pricing in the process.

Safety Wins Out

Investors made it clear that though they were seeking value-added and opportunistic plays, they were pivoting back to safety (Exhibit 4). Office, industrial & logistics, and multifamily assets continue to top the list of preferences globally. Industrial & logistics was the top asset choice in our previous survey, but the weighting of interest continues to differ by region. For example, multifamily ranked first in the Americas, and office was the top target in APAC and EMEA.

Although core assets in top-tier global cities remain preferred, sectors closely connected to changing demographic and economic realities, such as multifamily, student, and senior housing, are still driving activity away from major cities (Exhibit 5). This trend will continue pushing investors into tier-2 and tier-3 cities, particularly in American and European markets. APAC investors showed very little interest in these locations. Life sciences ranked as the top alternative asset class for the third year running.

Although opportunity plays will have a renewed focus, multifamily and industrial & logistics assets will be most favored as defensive asset strategies persist. Supply and demand fundamentals in both sectors are critical. Undersupplied housing markets and low vacancy rates across industrial assets help underpin capital values and support income growth. Equally, industrial & logistics assets will continue to absorb market share, with investor interest in first-mile assets rising as the nearshoring of foreign direct investment becomes a reality.

For multifamily assets, greater attention needs to be placed on operational expenditure, especially as yields and cap rates are often most resistant to change in this sector. Operational-intensive assets will require closer scrutiny as the cost base rises. This was one of investors' biggest concerns going into 2023, along with the rising cost of creating new assets. In addition, rising insurance costs in the US are a significant area of discussion.

Sustainability Is Driving Decisions

Environmental, social, and governance criteria and ratings are a growing emphasis for investors. This ties in closely with the flight to quality. Investors expect these assets to outperform and command a premium. However, it is more than just regulatory and reputationally driven; occupiers are demanding it, and investment portfolios are adjusting. Noncompliant assets are being disposed of, and stranded assets are becoming an ever-increasing topic of discussion. ■

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