

Fear's Silver Lining—Increasing Opportunities in Real Estate

By **Alfonso Munk** | HINES

We've seen this story play out before: while inflation and tightening credit conditions can't help but contribute to the current slowdown in real estate transactions, skilled investment managers with resources are able to take advantage. We encourage you to look past the alarmist rhetoric and consider that business cycles have always been a byproduct of capitalism. By unexpectedly derailing what is expected, these cycles can create opportunities for outperformance. Here are a few metrics we believe should be watched closely as we dive deeper into 2023.

Transaction volume

During a repricing, the first question is always, "When will conditions improve?" We have tested multiple indicators over multiple business cycles, and our data show transaction volume as highly correlated with future price growth¹. For example, when U.S. annual transaction volume has fallen by more than 50%, average forward price growth was negative. If it increased by 50% or more, average forward 1-year price growth was around 6%. Perhaps even more reassuring, when volume rose by 70% or more, there was a greater than 90% chance of price growth the following year.

The risk multiplier

This is a proprietary composite metric that quantifies the probability of a permanent capital loss over a five-year hold period. The data indicates over 55% of U.S. submarkets² are in the high to very high-risk categories. This can be useful information for investors, as risky submarkets tended to have more distressed sales over time which led to strong returns. For example, our data show³ the median discount for distressed U.S. apartment sales (2005-2022) was over 26%. These same properties later resold for a median gain exceeding double the purchase price.

Distressed sales on the increase

Based on the transaction volume and risk multiplier described above, we believe we are in the early innings of an increase in distressed sale opportunities in the apartment, office and warehouse sectors. We project distressed sales to more than double this year and double again in 2024 before peaking in 2025. For larger, well-capitalized investment managers, these conditions may



allow for picking assets believed most likely to deliver strong returns going forward.

Déjà vu all over again

Of course, we have experienced this cycle before and have the benefit of hindsight. While past performance may not be repeated, our research has shown how rising transaction volume can lead to rising prices, how risky submarkets can recover, and how both metrics can be predictive of a rise in distressed sales with the possibility of outperformance. And no matter where we are in the business cycle, real estate has historically provided tax advantages, diversification benefits and has acted as a hedge against inflation. Rather than run for the exits, our suggestion is to view current conditions as a rare opportunity to acquire high-quality assets at market-beating prices. ■

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1. NCREIF, Real Capital Analytics, Hines Research. As of 2022Q4
2. Bureau of Labor Statistics, CoStar; Hines Research; as of March 2023; The Hines Risk Multiplier is a proprietary composite metric designed to indicate the probability of loss over a five-year hold period. The six Multiplier components are pricing risk, liquidity risk, construction risk, fundamentals risk, economic risk, and global market risk.
3. CoStar, Hines Research; as of March 2023; Chart details repeat sales of multifamily properties greater than \$10 million from 2005-2022 where CoStar had identified a distressed sales condition in one trade and no distress condition in a prior or subsequent trade. Distress sales are defined as transactions flagged by CoStar as a distress sale, REO sale, or short sale.

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