



Net Lease in 2023:

Slower Investment Sales Activity
Amidst Higher Interest Rates, but
Will 2024 Be Any Different?

January 2024



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As we look back at 2023, the year's story was one of slower commercial real estate sales activity driven by a high interest rate environment. Despite continued federal funds rate increases in an effort to combat persistent inflation, a softening economy has been buoyed by an employment market that remains strong. At the end of third quarter 2023, net lease investment sales volumes were down roughly 48% year-over-year across all single-tenant property sectors, while available listing inventory on the market continued to grow across all sectors as the wide pricing gap between buyers and sellers persists.

Net Lease Sectors Tell a Mixed Story

Within the net lease industrial sector, market rent growth has continued to be the major highlight, and while it has slowed from the 11.2% rent growth seen in 2022, market rent growth has remained strong and will average 7 to 8% in 2023. We anticipate similar market rent growth to continue into 2024 and forecast an increase in sale-leaseback activity within this sector as owner-user operators explore cheaper alternatives for raising capital to fund future growth projects or improve their balance sheets by paying down higher interest rate debt.

The retail property sector has faced some headwinds as key traditional retailers such as Bed Bath & Beyond, Tuesday Morning, and others have closed their doors. However, overall occupancy rates remain relatively healthy as a lack of new construction has balanced supply and demand. Multi-tenant retail investment sales in 2023 saw a 31% drop year-over-year, as of third quarter, and single-tenant retail transactions also slowed tremendously, as 1031 exchange investors dropped by 65% year-over-year. In 2024, we anticipate much of the same within the retail sector, however there should be continued movement in pricing expectations especially for the more commoditized single-tenant retail assets where "market clearing" pricing tends to be more apparent on a cap rate basis.

Unsurprisingly, the office property sector has experienced the most pain of all commercial real estate sectors. The impact of remote and hybrid work among office workers has led to a significant drop in demand for office space. According to Goldman Sachs, nationwide office utilization is down 51% from pre-pandemic levels and, for certain markets and industries, this will be difficult to reverse course in the near term as the employment markets have remained relatively in favor of the employee. While strong office submarkets continue to exist throughout many major U.S. markets, there are signs of distress and significant valuation swings.

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Curtis Hodges

Regional Managing Director, Commercial

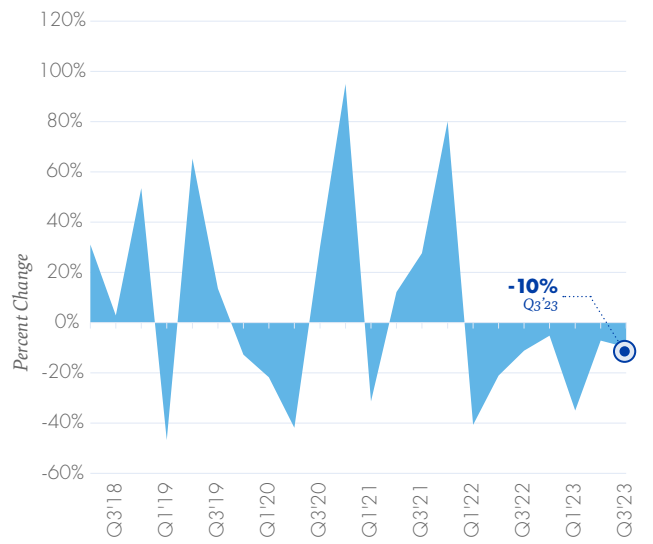




What Needs to Happen to Jumpstart Market Activity in 2024?

Overall, we anticipate 2024 to be similar to 2023 in most ways, as there are few indicators that the next 12 months will be profoundly different than the last 12 months. However, as inflation is tamed closer to 2%, the Fed begins to slowly reverse course, and financing becomes more affordable and accessible, we will begin to see some relief. It is unknown whether that relief will occur in mid- or late 2024 or not until 2025. However, we anticipate that investor motivations to sell net lease assets will continue to unfold for other reasons as time moves along and the market stabilizes. Motivated sellers will ultimately adjust their pricing closer to market clearing and shrink the gap between buyer and seller expectations. This will in turn lead to more transaction activity in the near term and improve future transaction velocity through an increase in 1031 exchange activity.

The overall net lease market has reported seven consecutive quarters of declining investment sales totals, and volume is not expected to rebound significantly in the near term



Overall Single-Tenant Net Lease Investment Sales Volume: Quarterly Change (%)

Source: Northmarq, Real Capital Analytics; analysis includes sales greater than \$2.5m

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