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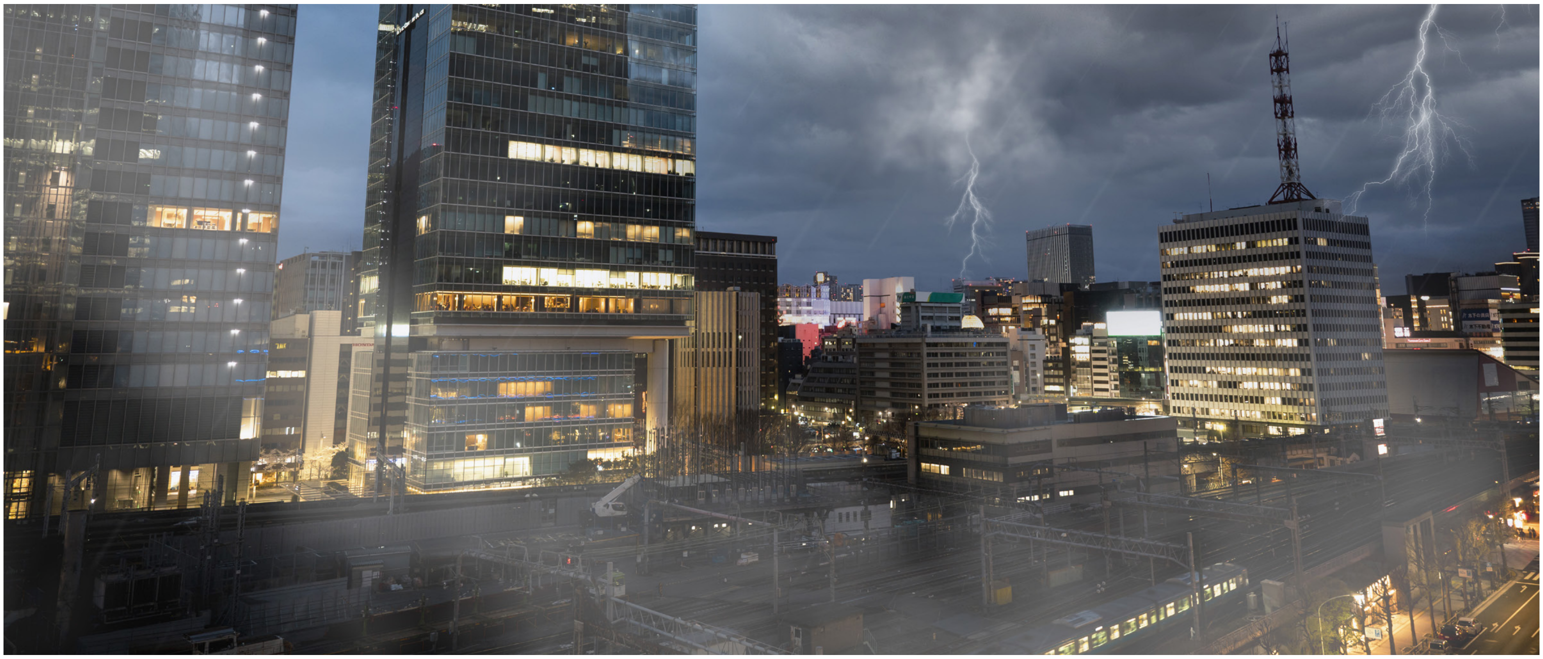
# Market Insight: Distressed Assets on the Horizon for 2024



For many working in commercial real estate (CRE) and investments, 2023 has already been a challenging year. Since the middle of last year, interest rates have risen at an alarming pace, with no asset class immune to the impact, though some have certainly been hit harder than others.

The narrative we've seen from news outlets and analysts alike has focused on the potential for a wave of loan defaults, along with the potential for a financial crash as office and other CRE loans come up for refinancing under tighter conditions. A scenario Morgan Stanley has referred to as a "refinancing wall."

Given the economic forces in play, two questions that are naturally top of mind for a lot of CRE professionals are: How soon should we expect to see a wave of distressed assets hitting the market? And how long will it last?

## Signs of Distress

As a starting point to answering those questions, it's worth recapping the signs of distress currently visible in the market. Arthur Milston, a Senior Managing Director with NAI Global and co-head of the Capital Markets Group, summarizes several key indicators.

First, there's the fact that CMBS (Commercial Mortgage-Backed Securities) delinquency rates are rising, as evidenced by the recent data from Fitch Ratings pointing out that: "The U.S. CMBS delinquency rate rose by 15 basis points (bps) to 1.85% in May from 1.70% in April. This marks the largest month-over-month increase since October 2020 and reverses three consecutive months of declines."

Also important to note: "Approximately 3.1% of the Fitch-rated U.S. CMBS universe ($16.9 billion) was in special servicing as of the May remittance, an increase from April (3.0%; $16.7 billion)."

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CRE loan losses amongst banks and other lending institutions are another red flag, as is the escalating trend of investors "giving properties back to lenders."

A recent report by YardiMatrix, for example, highlights the increasing prevalence of defaults by large, well-capitalized firms that, despite having the resources to avoid doing so, choose to walk away from properties when the outstanding debt exceeds the properties' current market value.

## Rates and Loans

Milston adds: "No asset class has been immune from the Fed raising interest rates at an accelerated rate beginning in mid-2022, although office is the clear loser based on current market conditions.

This is exacerbated by the fact that CRE lending volume reached a nine-year low last year and there is a wave of debt maturities occurring in the next few years of over $1 trillion of outstanding commercial loans.

Many of these expiring loans are interest-only and will not be able to be refinanced in the current lending market, leading to more distress throughout the remainder of 2023 and into the foreseeable future. In addition, a significant decline in transaction volume and large disconnect on valuations between buyers and sellers yields little price discovery, which further inhibits sellers' willingness to enter the market at this time."

## Delayed Effects

What all of that adds up to is a delayed wave of distressed assets poised to hit the market in the medium to long term, rather than the immediate future.

Milston notes: "Since most distressed assets take anywhere between 6 to 18 months to move through the workout process, we expect an increase in distressed sales to start to occur in 2024 and continue for at least 24 months absent a significant change in the availability of debt capital and an increase in property values, both of which appear unlikely at this time."