

# The State of the **Commercial Real Estate Market**

Copyright G-Squared 2023 All Rights Reserved

# Contents

Key Trends in Commercial Real Estate for Investors to Be Aware Of	4
Reacting to Market Trends: 6 Steps for CRE Investors To Take Right Now	8
Get Assistance from a Specialized Real Estate Accounting Firm	12
Specialized Real Estate Accountant vs. General Accountant: Key Distinctions	13
8 Reasons Investors Hire Specialized Outsourced Real Estate Accounting Teams	15
G-Squared Partners: Comprehensive Financial Solutions for Real Estate Operators	20



It's been an uncertain few years for Commercial Real Estate (CRE) investors. Following the Great Recession in 2008, the industry generally experienced a solid decade of strong growth, fueled by low interest rates and a strong economy.

However, the pandemic rocked many CRE assets. Office workers stopped coming to work every day – and don't appear to be coming back to the office at anywhere near their pre-pandemic rates. At the same time, interest rates have shot up, with the Federal Reserve raising base rates from close to zero in the first quarter of 2022, to [north of 5% today](#).

In tandem, these two issues have had a major impact on the CRE market, triggering a variety of new trends that CRE investors have to be aware of. Understanding these trends, but also how to react to them, is key to your continued success as a commercial real estate investor.

In this guide to the state of the commercial real estate market, we open up the hood of the industry to explore what these latest developments look like, but also exactly what investors should do in response.

## About Us

G-Squared Partners offers [outsourced CFO](#), accounting, and bookkeeping services to investors and operators across the CRE industry. Our team brings experience in areas such as due diligence, long-term forecasting, and more. [Contact us today](#) to learn more about how we can support your business.

# Key Trends in Commercial Real Estate for Investors to Be Aware Of

The CRE industry is fast-moving – now more so than ever. With relentless rate increases, economic uncertainty, and constantly shifting consumer behaviors, it's never been more important for investors to stay up to date on current market trends.

Below, we review four of the most impactful trends that should be top of mind for CRE investors in 2023 and beyond. As you read through these summaries, consider how they affect your own portfolio. While, clearly, there are negative impacts associated with these trends, they also present new opportunities for savvy investors to capitalize on.



**Vacancy Challenges Are More Complex Than They Appear**



**Power is Shifting from Landlords to Tenants**



**Borrowing Costs Continue to Rise**



**New CRE Growth Verticals Are Emerging**

Let's take a closer look at each of these trends and explore how they might affect your portfolio.

## 1. Vacancy Challenges Are More Complex Than They Appear

Two of the CRE asset classes that were hardest hit by the pandemic were office space and retail. Thanks to long leases, many landlords may still be collecting lease payments, but with many office buildings still at least partly empty, renegotiating leases may come with challenges.

Ancillary revenue sources have been hard-hit too. While rent payments may continue to be made, when employees don't come into the office,

they cancel monthly parking passes – a reliable, profitable source of revenue for many office building owners. While more companies are now requiring employees to come into the office at least a few days a week, these incremental revenues are far from where they were pre-pandemic.

In response, some investors may be looking to exit their office space holdings. There have even been instances of large, institutional investors admitting defeat and [handing struggling assets over to their lenders](#). But it's not always this simple. Banks may not be willing to accept these assets, instead preferring to work with owners to adjust loan terms.

## 2. Power is Shifting From Landlords to Tenants

With high levels of vacancies, particularly in the office space sector, the balance of power has shifted. Tenants now find themselves with more leverage than perhaps ever before when it comes time to renegotiate their lease.

Many tenants are shifting to smaller office spaces while also seeking to lower the price per square foot they pay to landlords. Landlords, especially those that hold Class B or C office real estate, have little leverage in these negotiations, and the combination of lower rates and less need for office space significantly handicaps investment returns.

Compounding this further is the changing role of the office in the American workplace. Employees no longer want to commute downtown to sit in their cubicle all day – they can do that just as well at home. Instead, teams come into offices to collaborate and work together. For businesses to do that effectively, their office space often needs a total rethink.

For CRE investors looking to retain current tenants or attract new ones, these trends might necessitate upgrades. It can often be difficult to

make an investment case for these renovations, which could easily cost tens of thousands of dollars, but without them, investors will likely continue to bleed tenants. Besides the ROI of these investments, investors also face the question of how to finance them.

### 3. Borrowing Costs Continue to Rise

Compared to much of the previous decade, borrowing costs are now sky-high for CRE investors. In an effort to battle inflation, the [Federal Reserve](#) has overseen ten consecutive interest rate increases, and while they paused in June 2023, it's likely more will come later this year.

With borrowing costs not expected to drop anytime soon, investors are having to leverage creative strategies to fund new capital investments. Some investors are funding acquisition costs out of their own pockets, while others are leveraging their wider portfolio to seek more favorable terms from creditors.

Closely monitoring [cash flow](#), budgets, and performance against long-term forecasts on a routine basis is now non-negotiable for CRE investors. This demands a higher standard of financial record-keeping – an area where many CRE investors could benefit from the support of an [outsourced CRE accounting team](#).

### 4. The Emergence of New CRE Growth Verticals

While many of the trends currently impacting the CRE industry have negative implications for investors, there are still plenty of opportunities out there. Many areas of CRE have remained strong: the industrial sector continues to grow strongly, and many regional markets continue to flourish.

It can be valuable for investors to broaden their focus into additional CRE growth verticals. At G-Squared Partners, we're seeing significant

growth opportunities in areas including self-storage facilities, student accommodation, and multifamily. Exploring these opportunities, remaining disciplined, and continuing to keep track of macro trends is a vital step for CRE investors to ensure they stay abreast of new opportunities to grow their portfolio.



# Reacting to Market Trends: 6 Steps for CRE Investors To Take Right Now

Understanding these trends is one thing, but knowing how to react to them is quite another. It might seem like a tough environment right now, but there are plenty of opportunities out there for savvy investors.

Whether your aim is to play defense, batten down the hatches, and ride out the storm, or to go on the offense and acquire new assets, consider the six below steps a strong starting point.



**Work Closely with Lenders**



**Form Lasting Relationships with Tenants**



**Tightly Manage Cash Flow**



**Conduct Comprehensive Due Diligence on New Opportunities**



**Stay Disciplined on New Investments**



**Explore Alternative CRE Asset Classes**

Here's an in-depth overview of each of these steps.

## 1. Work Closely with Lenders

As investors face challenges across their portfolios, a [strong relationship with bankers](#) is crucial. Focus on building strong partnerships with



lenders that are willing to work with you. If tenants demand significant renovations to their office space before signing a new lease, it's important to have access to a line of credit that comes with affordable borrowing costs.

If the financial performance of an asset is extremely challenging, as is the case for many Class B and C commercial office space assets, it's especially important to have a strong relationship with your lender. Many lenders would rather work with you to renegotiate the terms of your debt financing than take outright ownership of the asset. Strong relationships also play an important role when it comes time to refinance debt.

## 2. Form Lasting Partnerships with Tenants

A constructive working relationship with tenants is vital to the success of your CRE portfolio. This is especially important at a time when many tenants, particularly in office space, are considering downsizing to smaller footprints or moving to a different building entirely.

Acting in good faith and being responsive to any issues gives tenants less cause to look around for a new office to call home at the end of their current lease. Retaining in-place tenants is often preferable to having to source new tenants, eliminating turnover costs including renovations, marketing, and broker fees. In many cases, that holds true even if landlords have to accept new lease agreements that are less profitable than the previous contract.

## 3. Tightly Manage Cash Flow

Closely tracking the [cash flow](#) of your real estate business is vital to your long-term success. For many investors, interest expense is higher now than they have been at any point in the previous decade. It's crucial that your business has enough cash flow to support these commitments

while also dealing with the other capital-intensive issues that owning real estate often throws up.

In today's highly inflationary environment, operating costs may be rising faster than rental income. This demands that investors focus more on the monthly and weekly cash flow of their portfolios, and tightly manage both costs and rental income to ensure their portfolio remains sustainable.

#### 4. Conduct Comprehensive Due Diligence on New Opportunities

Due diligence has always been an important part of investing in commercial real estate, but the recent turbulence in the market has made this process even more important. By conducting a comprehensive due diligence process, you can be sure that the economics of an investment make sense for your portfolio.

For fund managers, it's particularly important to conduct this analysis to ensure the fund is able to deliver a return to Limited Partners while also making a profit. There are several steps involved in due diligence, including:

- **Analyze Historical Numbers:** verify that existing [financial statements](#) are correct and normalize these for any anomalies that will not be included going forward, such as add-backs and exclusions.
- **Look at Trends:** a seller may claim to have made a 20% annual return on a property over the past ten years, but it could be the case that in the past two years, they only made 2%. Validate how assets have performed over both the short and the long term.
- **Forecast Growth Potential:** make sure that the deal makes sense i.e. that the pro forma financial statements you produce show a tangible path to your desired ROI for the investment.

- **Verify Existing Leases:** check the length and terms of existing tenant leases to ensure that the property's revenue base will continue to be consistent.

## 5. Stay Disciplined on New Investments

In today's market, many property owners have an unrealistic opinion of the value of their properties. The value of commercial office space in January 2020 is markedly different from the value it commands today. In many cases, this leads to a significant disconnect between buyers and sellers when determining what an asset is worth.

For investors aiming to expand, these misaligned expectations mean many deals might not make sense. Investors must remain disciplined and consider how opportunities fit within their model. Keeping money in the bank, or even returning it to investors, is better than investing in a bad deal that will lose money – even if it feels like you're sitting on the sidelines.

## 6. Explore Alternative CRE Asset Classes

As we've noted throughout this guide, some areas of commercial real estate, particularly office space, have faced a tough time in recent years. However, while the market remains tough across a variety of asset classes, there are many opportunities still out there.

These may require CRE investors to explore alternative asset classes within the CRE space. At G-Squared Partners, we're seeing significant opportunities in areas such as self-storage, industrial, student housing, and multifamily. Identifying these opportunities and capitalizing on them may pay dividends for investors.

# Get Assistance from a Specialized Real Estate Accounting Firm

Commercial real estate (CRE) investors face a complex and ever-changing landscape of accounting standards, evolving tax laws, financial pressures, and interest rates. These demands make managing a portfolio of investments a tightrope walk — where maintaining exact balance is the key to avoiding costly missteps.

While some larger funds staff an in-house accounting team, this isn't feasible or practical for all investors. Unless a fund has significant scale, this strategy doesn't align with the financial realities or strategic goals of most real estate investors.

For many, the smartest choice is partnering with an outsourced real estate accounting service. An accounting partner with expertise in the industry can offer a holistic approach to financial management grounded in a deep understanding of the unique complexities of real estate accounting.

To help you understand how an outsourced real estate accounting service can benefit your business, let's discover some key reasons why so many investors choose this route.



# Specialized Real Estate Accountant vs. General Accountant: Key Distinctions

The world of accounting is quite diverse. While you might understand the role of a general accountant, many specialized accountants cater to unique industry and business needs — specifically, for our purposes, real estate accountants.

Much like you wouldn't trust a general physician to perform open heart surgery, these specialized accountants are the go-to choice for managing complex real estate-specific investments.

So what do these specialized real estate accounts accomplish that a regular CPA won't be able to handle effectively? Let's explore some key distinctions:

- **Industry-Specific Knowledge:** navigating the complex financial landscape of real estate requires a deep understanding of industry-specific regulations and financial practices. A specialized real estate accountant is steeped in this type of industry knowledge and can provide accurate, timely, and tailored strategic advice.
- **More than Bookkeeping:** a specialized real estate accountant takes a much more nuanced approach to managing finances. A generalist, in contrast, will carry a broad understanding of various industry approaches but may lack the specific expertise necessary to manage real estate accounting tasks.
- **Attention to Detail:** real estate accounting has many idiosyncrasies. This includes specific accounting practices, deductions, and

reporting mechanisms specific to the industry. For example, applying the intricacies of property depreciation requires a depth of knowledge a general accountant may lack.

The detailed insights from a specialized real estate accountant can make all the difference. While general accountants are invaluable for many broad financial applications, they simply lack the expertise required to navigate the complexities of real estate accounting successfully.



# 8 Reasons Investors Hire Specialized Outsourced Real Estate Accounting Teams

Real estate investing can be both dynamic and complex. Whether it's keeping up with ever-changing accounting standards, financial pressures, or fluctuating interest rates, getting a handle on all of these financial aspects is mission critical — but often overwhelming to handle alone.

The solution might be to build an in-house accounting team. However, for many investors, especially those still growing their portfolios, this is neither economically feasible nor necessary.

Another solution is to outsource financial management to an expert real estate accounting team. These firms have plenty of experience serving clients in the CRE industry and can offer a more tailored approach to accounting and financial strategy.

To help you understand the value [an outsourced accounting team](#) can provide your CRE business, here are some key reasons why investors choose these specialized teams:

- Anticipating Potential Issues
- Budgeting assistance
- Financial Modeling
- Due Diligence
- Sales Readiness
- Manage Relationships with Tax Experts

- Risk Mitigation
- Operations Support

Let's take a look at each reason in more detail.

## 1. Forecasting Upcoming Challenges

One key reason investors choose to work with outsourced real estate accounting experts is to gain additional insights into potential future challenges. Outsourced financial teams will work closely with clients, functioning as a sort of financial “blind spot” checker.

They don't simply focus on the current financial state but rather take a comprehensive approach to financial management and strategy that sees what lies ahead. By anticipating these potential issues, they help clients devise strategic plans to mitigate risks. This kind of proactivity ensures investors aren't blindsided by unforeseen problems.

## 2. Financial Planning Support

Proper budgeting is essential in CRE investing. An [outsourced accounting service](#) can provide invaluable support in this business-critical area, delivering accurate projections and expense tracking for various types of projects in a portfolio.

These real estate experts will help keep financial decisions on track and provide meticulous budget management support to mitigate the risk of overspend and ensure all projects stay financially viable.

## 3. Economic Projections and Analysis

It should come as no surprise that the real estate market is prone to fluctuations. With ongoing market volatility and borrowing costs at their [highest level since 2007](#), CRE businesses need to understand the value of building and stress-testing financial models.



By partnering with an experienced accounting service, CRE funds can develop tailored models that anticipate and prepare for these fluctuations. By simulating various economic and market conditions, a real estate accounting firm can help determine potential outcomes of various scenarios and provide strategic input to mitigate risk and capitalize on opportunities.

#### **4. Comprehensive Investment Evaluation**

Understanding and evaluating potential acquisitions can be tricky business. A specialized real estate accountant can assist with the critical due diligence necessary to make a determination on the profitability of an investment.

This process will include rigorous research and analysis to assess the viability of potential opportunities before a CRE business makes any commitments. This essential step in the real estate acquisition process becomes much easier with the extensive experience and insights provided by the outsourced real estate accounting team.

#### **5. Pre-Sale Financial Preparation**

A specialized CRE accounting service will assist in the sale preparation process — which includes an in-depth review and cleanup of a property's financial records. They'll work to address any discrepancies, ensuring all transactions are properly documented and align books with standard accounting practices.

By making all financial information accurate and transparent, businesses can build confidence among potential buyers while maximizing a property's appeal. Moreover, an accounting firm will deliver this value while anticipating and addressing potential issues, helping streamline the sales process.

## 6. Manage Relationships with Tax Experts

Navigating tax season can challenge even the most experienced CRE investors. Given the unique tax considerations in the industry, having the right support can make a significant difference in a business's tax liability and overall financial performance.

While specialized accounting firms don't always handle tax filing directly, they do play a critical role in the process. They'll work closely with an investor's tax accountant and provide all the necessary financial information and records in a timely manner. This level of collaboration streamlines the tax process and reduces the risk of potential errors.

## 7. Risk Management Support

An outsourced real estate accounting service will help anticipate upcoming challenges and build strategies to mitigate them. These risks can range from market volatility and regulatory changes to operations issues and financial uncertainties.

Once the accounting team identifies potential or upcoming risks, they can provide solutions like diversifying investments, optimizing debt structures, or setting up financial contingencies. By proactively managing risks alongside expert real estate accountants, businesses can avoid costly pitfalls and safeguard their returns.

## 8. Help with Day-to-Day Management

The daily management of a CRE business involves a multitude of tasks — many of which an outsourced accounting service can manage. This can range from financial record keeping and reporting to tenant billing and collections.

But, these services extend far past [standard bookkeeping](#). A specialized accounting service will help establish efficient organizational practices, recommend and implement accounting software options, and provide ongoing support and troubleshooting. By outsourcing these daily activities, CRE investors can free up time, reduce operational headaches, and focus on more strategic growth opportunities.



# G-Squared Partners: Comprehensive Financial Solutions for Real Estate Operators

Navigating the financial complexities of the real estate market requires a knowledgeable and experienced partner — and that’s exactly what a specialized accounting firm offers.

By choosing to outsource accounting services, businesses can bring industry-specific knowledge and experience to the table while finding comprehensive solutions tailored to their unique needs.

[G-Squared Partners](#) provides service far beyond traditional accounting. This includes adding value through strategic foresight, customized financial modeling, and so much more.

Whether your team is looking for assistance with [accounting and bookkeeping](#), searching for guidance from a high-level [outsourced CFO](#), or anything in between, G-Squared Partners has the expertise and services to meet all your needs. Don’t wait to streamline your financial operations; [connect with a team member today](#) to learn more.

