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CBRE Survey: There Will Be a Significant Reduction in Buying and Lending This Year

Multifamily and industrial sectors are most preferred by investors and lenders.

Buying and lending expectations are in flux in most commercial real estate sectors as investors and lenders plan to significantly reduce their activity in 2023 due to rising interest rates, economic uncertainty, and associated impacts on values, according to a new report from CBRE.

The report senses a cautious mood, and CBRE believes “pessimism may have reached its nadir” when its most recent survey was taken in December.

So much is contingent on inflation and the Federal Reserve’s activity.

It cites the multifamily and industrial sectors as the most preferred by investors and lenders and dynamic secondary markets, particularly in the Sun Belt, are where many are focused.

Lenders rate the industrial and logistics sectors as the most favorable with multifamily second best. Investors flip those two as their top preferred sectors. Both groups were more pessimistic about the office and retail assets.

Nearly 60% of respondents expect to purchase less real estate in 2023, while only 15% expect to purchase more. All are waiting for the Federal Reserve to stabilize rates, which could take well into the year or even into the next.

Inflation & Interest Rate Expectations
The key considerations for buying and lending expectations this year are when inflation will peak and where interest rates will end up, CBRE writes.

“About 50% of investors believe inflation will peak in Q1 or Q2, while 35% believe it has already peaked,” according to the survey.

“Along with high inflation, most investors expect higher borrowing costs. More than 70% of surveyed investors believe the 10-year Treasury rate will exceed 3.75% at year-end 2023.”

Brokerage Firms are Reducing Costs

The next 18 months will show a continued slowdown of capital markets until inflation slows and interest rates come down, Doug Ressler, Yardi Matrix, tells GlobeSt.com “Major brokerage firms are reducing costs and FHFA has reduced the GSE debt cap limits with increased affordability goals,” he said.

Joe Iacono, CEO of Crescit Capital Strategies, tells GlobeSt.com that he expects to see the 10-year rate in the mid-3s by Q4.

“If that happens, borrowing costs will come down a bit from today as the market regains some stability due to the feeling that the fed’s position will be more predictable,” Iacono said.

Waiting for Markets to Stabilize

Adam Weissburg, Partner, Cox Castle, tells GlobeSt.com that regardless of what the peak is, lender activity will be constrained until there is some general agreement as to how many rate increases are on the table.

“The issue for lenders is sizing the loan, which goes to the value of the collateral and needed equity,” he said. “Until rates are stabilized, the market doesn’t know what cap rates to use and how to value collateral. Without that, lenders cannot in turn calculate their loan amount. One would hope the activity will pick up as the Fed makes it clear exactly how many raises, we can all expect.”

PCEP is Key Data Indicator

Kyle E. Scheiner, a partner at Romer Debbas, tells GlobeSt.com that after some premature optimism over microdata presented in January, the truth about inflation still being a concern was highlighted by the release of the January Personal Consumption Expenditures Price index.

This is the Fed’s preferred method of measuring inflation, and it came in at .2% above economists’ expectations.

“While this shows that inflation has not yet peaked, the relatively small miss on expectations shows more of a plateauing of the rate of inflation,” Scheiner said. “This is an encouraging sign for the long-term strategy the Fed is employing, though the inability to solve the issue rapidly will continue to wreak havoc on markets. When this storm passes and we look back to analyze this period, I think we will come to consider Q1 as the overall peak of inflation.

“Unfortunately, the housing market will continue to bear the brunt of the Fed’s policies as a 50-basis point raise is all but virtually certain for the next Fed meeting scheduled in March. Future hikes are also being signaled by the Fed.

Scheiner said that with the 10-year treasury already exceeding 3.75%, it’s hard to envision a scenario in which 2023 does not end with the Note at or higher than the 3.75% level given the appetite amongst the Fed Governors and board to continue rate hikes to get inflation at or below its 2% mandate.

“You could see the 10-year UST rate hitting 4.15% before gradually working its way down as inflation comes down off the plateau, but anything under 3.75% in 2023 will be hard to predict at this stage,” he said.

“Cumulatively, this will continue to have chilling effects on a stale housing market with a perfect storm of factors working against a recovery—homebuyers, especially first-timers, being priced out of the market; sellers locked into mortgages with incredibly low-interest rates who are unwilling to sell and pay 2x-3x the borrowing costs they currently pay; overall higher originating borrowing costs for individuals and investors alike and; the declining value of investments, savings and retirement accounts."

Fed Will Raise Rates 'A Quarter Point at Each of Next Two Meetings

Larry Jacobson, president and CEO of Jacobson Equities, tells GlobeSt.com that while inflation appeared to have flattened out on a monthly basis in late 2022, monthly inflation in January jumped 1.8%.

"That surprising increase, coupled with a surge in hiring in January, should put to rest any notion the Fed is done raising rates at this point. It is clear neither the Fed nor economists have a clear picture of when inflation will go down nor when the Fed's past rate increases will cause the economy to go into recession.

"Economists who track money supply are convinced inflation is headed down, yet even if they are correct that inflation was, in fact, transitory (as a result of excessive government stimulus), tight labor markets could still cause inflation to pick back up again."

Jacobson said the Fed would likely raise rates a quarter point at each of their next two meetings, but no one should be surprised if one of those meetings results in a half-point bump. It's conceivable a third-quarter point bump will be in the offing. Rates will continue to rise through 2023 to at least the Fed's target of 5.25 % to 5.50%.

"The CRE market will continue to be moribund until inflation not only levels off, but begins to fall, and the Fed signals a stop in rate increases," he said.

Date to Reach Goals Keeps Moving Out Further

Patrick Nutt, executive vice president, SRS Real Estate Partners, National Net Lease Group, Market Leader, South Florida, tells GlobeSt.com, "Regarding inflation peaking, there's a difference between saying inflation has peaked, i.e. when inflation will fall to 0% or below the target rate for the Fed of under 2%, compared to when the rate of inflation will peak.

"I believe we have already seen that figure peak last year when it was running 9%+ and now stands at 6.4%. I'm expecting inflation to slow as the economy continues to digest the higher rate environment that we are in."

Nutt said on the interest rate front, "the only consistent thing we have seen is that every time a forecast comes out to predict terminal rates, the rate has moved higher and the date to reach that rate has moved out longer in the year.

"The 10-year treasury is more of a forward-looking rate compared to the 2-year T-bill, so I do expect that to be sub-4% at year-end, but likely still above 3.75%."

Northmarq Sees Renewed Buyer Engagement

Will Harvey, Northmarq senior vice president, investment sales, tells GlobeSt.com that following a quiet Q4 2022, 2023 has brought renewed buyer engagement to the market.

"With internal capital allocations reset, yield-seeking investors are hunting for accretive opportunities and getting creative on their business plans.

The majority of buyers are willing to underwrite 12 to 18 months of negative leverage for the right deal, as long as there is a path forward to positive returns and a strong residual.

“Investment opportunities with favorable in-place debt (remaining IO, extended term, 60%+ LTV) are being priced well inside of free and clear deals – essentially overpaying for the equity.”

Harvey said that the 50bps runup in rates during February has not deterred buyers from chasing deals but rather adjusted their return threshold. “We’re seeing an uptick in buyer activity on the deal level, coupled with a wider spread in pricing,” he said.

“All cash/generational buyers looking for distress have not been successful given the strong fundamentals and organic property level performance in the multifamily market.

“We’re seeing an uptick in interest in development following the thesis that we’re currently in a suppressed capital markets environment.”

Inflation Likely to Weaken Buying Power

Brad Tisdahl, CEO of Tenant Risk Assessment, tells GlobeSt.com that the better question is how long inflation will remain above the Fed’s long-term target of 2%.

“In that instance, inflation will likely remain a factor even if it’s easing into 2024 as prices are demonstrating a stickiness,” Tisdahl said. “Inflation may have peaked in terms of growth compared to the same period last year, but it is likely to continue to weaken buying power and pressure rates to remain elevated.

“As for 10-year treasury rates, TRA falls in the camp of rates exceeding 3.75% at year-end 2023.”

https://www.globest.com/2023/02/27/%E2%80%8Bcbre-survey-there-will-be-a-significant-reduction-in-buying-and-lending-this-year/