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What Dealmakers are Doing as They Wait for Fed to Lower Rates

Borrowers are still concerned given volatility could creep back into the market.

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As the market waits for the Fed to lower interest rates, deals are slowly getting done in the CRE capital markets.

Market participants, nonetheless, are navigating a still tumultuous transaction environment.

If you are fortunate enough to have a lower leverage deal, insurance companies, agencies, and banks provide certainty of execution, Richard Gorsky, Managing Director, Private Real Estate Debt at CenterSquare Investment Management, tells GlobeSt.com.

Debt funds, meanwhile, **have a lot of capital** but also elevated return expectations that stretch beyond what most borrowers want to pay, so unless they have to transact, many debt fund borrowers continue to be on the sidelines, especially given the recent increase in treasury rates, Gorsky reports.

Then there is CMBS, whose spreads have compressed, but borrowers are still concerned given volatility could creep back into the market and certainty of execution at the originally quoted terms is always questioned, Gorsky says. “In other words, it’s not closed until the money has been wired.”

That said, it should be pointed out that CMBS originations in Q4 increased substantially in the industrial, retail, and hospitality sectors compared to the same period last year.

When pitted against Q4 2022, CMBS originations in the industrial sector were up 165%, while the retail and hospitality sectors also gained, expanding by 80% and 50%, respectively, Chad Littell, national director of U.S. capital markets analytics at CoStar Group, tells GlobeSt.com.

“Meanwhile, the origination volume in the office sector continued to slump compared to the prior year. The beleaguered sector witnessed CMBS origination declines of 26% compared to Q4 2022.”

Littell said Q4 2022 origination volumes were very low historically, so while the percentage increase year over year is strong, they are still well below the levels we saw in 2021, and early 2022 before the Federal Reserve began hiking interest rates.

Agreeing is Newmark Global Head of Research David Bitner, who tells GlobeSt.com there seems to have been at least some translation into better activity in Q4.

For example, the MBA’s origination index increased 13% quarter-over-quarter in Q4 2023 and was down just 25% year-over-year compared to being down 47% for all of 2023, he said.

Notwithstanding the recent increases in rates, Bitner thinks that this positive momentum has translated into greater activity in the first quarter. “Insurance lenders and government-sponsored enterprises have fresh allocations, and we have also seen a pickup in CMBS issuance,” he said.

Sources also report that some local and regional lenders have been willing to sit down and discuss deals.

Scott Hensley, CCIM, SIOR, Principal/Broker, Piedmont Properties/CORFAC International in Charlotte, NC, tells GlobeSt.com that most of his transactions involve local and regional lenders, “and if you are an existing customer with a long-term relationship with the lender and you have the right product, then [conversations can be had].

“The favored product in our market remains industrial, some retail, and of course end user loans,” Hensley said. “What submarket the asset is in also affects the lender’s appetite. Speculative land or office will not get a returned phone call.”

While lending remains sparser than pre-pandemic levels due to cautious banking practices, activity is taking place in the Florida markets, particularly in South Florida, where the real estate landscape is notably active compared to Central and Northern Florida, according to David Druey, Florida Regional President at Centennial Bank.

He tells GlobeSt.com that Tampa, Bradenton, and Sarasota are highlighted as strong markets for commercial real estate lending.

“Within southeast Florida, condo development has experienced a notable surge,” Druey said. “In line with the overall positive momentum is the general stabilization of construction costs, encompassing labor and steel, with concrete being the exception with slightly elevated costs.”

On the other end of the spectrum lies the office market, which is facing clear challenges. Ben Kadish, president and founder, Maverick Commercial Mortgage Inc., reports office property refinancing is very difficult in virtually every market, as the massive shift in work behavior continues and the future of office work is still taking shape.

“Leases signed pre-COVID pandemic are now starting to terminate, and 10-year leases signed in 2014 to 2017 have all experienced rent bumps,” he said.

“Those leases are either going to be renegotiated or simply left to expire if they are no longer utilizing the same office footprints as before the pandemic. Obviously, tenants are changing the office environments, with some shrinking dramatically and no one knows whether that will continue indefinitely.”

For many borrowers, though, nothing will happen until there is interest rate stabilization. With interest rate decreases looming on the horizon, it should not only result in a significant amount of stability but also help increase acquisition volume, Pierre Debbas, Managing Partner, Romer Debbas, tells GlobeSt.com.

The question is when this will happen, or worse case scenario, if.

Some borrowers are simply not budging until they see tangible action by the Fed. For instance, while some thawing became visible toward the end of December, Wil Ward, Partner at TwinFocus Real Estate Partners, tells GlobeSt.com, since then he has not re-entered the market as 10-year Treasuries have "blown out" by 30 bps to 40 bps.

"If spreads hold, overall costs are increasing, and I would expect borrowers are drying up," Ward said. "We have seen an increase in bridge lending, but the bid-ask remains too high for much deployment."

Lisa Flicker, Managing Partner, Head of Real Estate, Jackson Lucas, tells GlobeSt.com that of those leaders she speaks to, they are optimistic about the future, but disappointment continues to muddle decisions regarding expansion, investment, and workforce management.

"You can get whiplash watching the optimism and disappointment seesaw," Flicker said.