The Sky May Be the Limit As Interest Rate Caps Keep Rising

Developers and investors have to find different ways to swing finances.

By Erik Sherman

Interest rate hikes have been taking a toll on commercial real estate, especially as interest rate caps become expensive enough to kill deals. Grant Cardone, CEO of Cardone Capital, told GlobeSt.com a month ago, “In the last 18 days, I had about a billion dollars of real estate I was trying to buy [fall through]” because of the financing realities.

But what’s happened since? More of the same, when it comes to financial conditions, and it’s frustrating for many.

The Fed has over-corrected when it comes to raising rates,” Meg Epstein, CEO and founder of CA South in Nashville, says. “They could raise them to 8% tomorrow and it wouldn’t make the next set of inflation numbers come in any lower because inflation is a lagging indicator. They’ve already tightened enough to dramatically reduce demand and dampen prices. It will just take time for it to show up in their numbers. Meanwhile, the Fed will continue to tighten and inevitably will over-correct, just like they over-stimulated after the economy was already well underway to recovering.”

“Rates have moved up over the past 30 days, impacting cap prices and we continue to see interest rate fluctuation,” Sean Burton, CEO of Cityview, tells GlobeSt.com. “In light of current uncertainty, we like many others have tightened our underwriting and are being that much more selective with our deals.” There are still “select attractive buying opportunities” but they need “strong projected risk-adjusted returns.”

“The interest rate cap costs have escalated sharply over the last couple months and the trend continues,” says Adil Hasan, director of real estate at Yieldstreet. “We are seeing a significant slowdown in deal volume as potential buyers can’t justify the prices in the face of higher interest rates and cap costs, while the sellers are slow to accept the price reduction.”

“Everyone is waiting for the cap rates to go up and the prices to go down,” says Joshua Mogin, a partner with Thompson Coburn. “I had a couple of deals go down because the buyers said you have to come down in price and the sellers said no.”

Many lenders Joshua Mogin deals with are adjusting their plans. “It’s kind of like a smorgasbord of what different lenders are doing,” he says. “A lot of the debt fund lenders are incorporating programs with some sort of intervals of rate adjustment, and those are bridge loans.” Rather than a straight 7% or 8% arrangement, they will agree to 7% but then look for an adjustment in six months to a year. “Some big borrowers in the last month were buying large amounts of hedges, but those are significant players that can afford to do that and are willing to spend that money.”

And then there are the banks. "A lot of banks put out so much money in the first six months have already done what they did last year, or in the neighborhood," Mogin says. "Nobody feels pressure to keep making loans at necessarily that level."