The Fed's Latest Meeting Minutes Offer Details for CRE

There was a big jump in CRE loans on banks' balance sheets.

By Erik Sherman

The minutes from the Federal Reserve's June Federal Open Market Committee (FOMC) meeting were released on Wednesday with some interesting tidbits for the real estate industry.

First was a direct mention of commercial real estate loan activity at banks:

"Commercial and industrial (C&I) and commercial real estate (CRE) loans on banks' balance sheets expanded at a rapid pace in April and May. Issuance of both agency and non-agency commercial mortgage-backed securities (CMBS) stepped down slightly in May from its strong pace earlier in the year. Small business loan originations through April were in line with pre-pandemic levels and indicated that credit appeared to be available."

Through May, residential mortgage credit was "widely available … for most borrowers," although separate from the Fed's observations, ongoing higher rates have been discouraging many borrowers. Since January, there have been twice as many weeks with falling numbers of mortgage applications than with increases, according to Mortgage Bankers Association figures as aggregated by Trading Economics.

"While refinance volumes continued trending lower in April and May amid higher mortgage rates, outstanding balances of home equity lines of credit at commercial banks posted the first significant increase in more than a decade, likely reflecting a substitution by homeowners away from cash-out refinances," the minutes read. Borrowing costs have increased, with yields on non-financial corporate bonds "well above pre-pandemic levels." Also, bank interest rates for C&I and CRE loans are up.

"Commercial real estate has historically been a hedge against inflation, and we continue to see sturdy rent growth in the multifamily and hotel sectors," Alex Killick, managing director at CWCapital, tells GlobeSt.com. "That said, expense inflation, particularly for staffing and insurance, continues to impact NOI margins, especially on office and retail assets where tenants are on long-term fixed rent leases with 2-3% annual escalations, below the rate of expense inflation."

According to Killick, the Fed notes and plateauing trends of some commodity prices suggest that "the biggest near-term risk in CMBS is upcoming fixed rate loan maturities in 2023 and 2024." He said loans face potential refinancing charges between 1 and 2 percentage points higher than existing rates. "Where NOI has also been impacted by rising expenses, could experience a level of distress higher than we have seen outside of the 2020 covid default wave," he adds.

"Interest rate increases will adversely impact financing costs of commercial real estate projects and on margin we anticipate some projects to be canceled," says Al Lord, CEO of Lexerd Capital

Management, which primarily focuses on multifamily, which he says is a current bright spot. "Despite increases in interest costs in financing MF real estate projects, the demand for rental units is so strong that this asset class is expected to perform well through at least 2023."

Dave Nelson, managing director of acquisitions at multifamily-focused investment firm Hamilton Zanze, suggests some caution, even in that sector. "Apartment fundamentals remain strong however apartment returns are under attack," Nelson tells GlobeSt.com. "The wide dislocation between Buyers and Sellers is narrowing but not complete and as the Fed minutes allude to a further rate hike the gap will widen. This is not a time to be feared but a time to evaluate strong geographic market fundamentals with significant job drivers and be choosey as a buyer."