A Strong U.S. Dollar Could Mean A Lot — And Not So Much — For Commercial Property Investment

By Olivia Lueckemeyer

A strong U.S. dollar could propel foreign interest in commercial real estate stateside as investors flee weakening economies and geopolitical conflicts abroad.

But the strength of U.S. currency is just one piece of a complex puzzle that dictates global investment activity, and it won't necessarily translate into billions of dollars pouring in from overseas.

As of July 29, the value of the dollar was outpacing the euro and the pound by 2 cents and 18 cents, respectively. That could signal an even greater investment opportunity in the U.S. among foreign buyers, though it is far from the only factor at play, FTI Consulting Senior Managing Director Josh Herrenkohl said.

“The value of the investment will always trump the value of currency,” he said. “While the value of the U.S. dollar certainly plays into some of the decision-making, at the end of the day, institutional investors are looking to acquire assets that are going to appreciate and will continue to be strong on a go-forward basis, regardless of what currency they’re paying.”

Long seen as a safe haven for assets, overseas investment in U.S. commercial properties made a triumphant return in 2021 when foreign institutions purchased close to $71B of domestic CRE. That was double 2020’s volume and marked the greatest foreign investment in the U.S. since a total of $94.6B was invested in 2018, according to Real Capital Analytics.

If history repeats itself, foreign interest could break down along national lines, Herrenkohl said.

In 2015, when the strength of the dollar outweighed most world currencies, countries with economies similar to the U.S., like Canada, chose to keep their money close to home. But countries with more volatile economies, like Brazil and Argentina, chose to level up their U.S. investments.

“You think we have it bad, many countries have seen 20%, 25%, 30% inflation,” he said. “Even if you are paying a little bit more because of the U.S. denomination, you’re less subject to many of those fluctuations that South American investors might traditionally be faced with.”

In other parts of the world, geopolitical conflicts could dissuade certain countries from investing in the States, Herrenkohl said. China, for example, put a significant amount of money into U.S. commercial real estate in 2015, but that is less likely this time around.

“I don’t think we are going to see a lot of investment in the near term from China, and the same could be said for Russia, for obvious reasons,” he said.

Asian investors have so far this year been more cautious with their investments in the U.S. and Europe, said Harry Tan, head of Asia Pacific research at Nuveen Real Estate. This hesitancy is motivated more by elevated recessionary risks and higher borrowing costs than changes to currency value, he said.

“Investors backed by dollar funding may take the opportunity to accelerate their investments into markets where they already have an existing interest to invest into,” Tan said in an email. “However, institutional investors invest into CRE based on fundamentals; they do not speculate on currency movements.”

The relative strength or weakness of the dollar against the euro makes little difference in investment decisions made by Commerz Real AG, a German investment firm, because the company is legally required to hedge foreign currencies, which protects its assets from future fluctuations, Head of Fund Management Timo Lutz said.

“It doesn’t really matter if the exchange rate is 1-to-1 — as it is more or less nowadays — or 1-to-20 or 1-to-40,” he said. “You have to bear the costs … but you are more or less protected in the long run.”

Commerz Real considers many factors when choosing where to invest, and the cost of currency is just one part of that equation. Investments in U.S. real estate come at a premium when there is a strong dollar, but that added cost is outweighed by other factors, such as the market’s unprecedented demand and distance from the Russia-Ukraine War, Lutz said.

“It’s always the big picture for us from a research point of view,” he said. “We are of the opinion that the U.S. economy is slightly stronger, and they will most likely be able to manage a recession more quickly than the eurozone.”

Commerz Real could choose to redirect funds away from the U.S. if the cost of hedging decimates returns, though Lutz said that is unlikely. The company has $3.19B of assets under management in the U.S., including hotels, offices and retail properties.

“The expectation is that the European Central Bank will increase interest rates, meaning hedging costs will get cheaper and cheaper,” he said. “Nowadays, it’s quite high due to the fact that there is a huge gap, but that will narrow the gap.”

American investors in European CRE flocked to the continent in the first quarter of this year, but cross-border investment volume slowed in Q2, in part due to economic impacts from the Russia-Ukraine War, said Judith Fischer, an associate at Knight Frank, a UK-based real estate consulting firm.

The weak outlook for the European economy, fueled by rising interest rates and inflation, a softening of commercial property prices and a waning occupier market, are all factors behind the dip, Fischer said.

“They are probably worried of what is still to come in Europe,” she said. “That’s why you’re not seeing so much of an influx of institutional investors. At the moment, they may be more hesitant.”

The decision of whether or not to invest in the U.S. could also come down to how much confidence a buyer has in the Federal Reserve. The Fed has thus far responded to volatility in the market by raising interest rates, which could deter some investors, said William Edward Spriggs, a Howard University professor of economics and chief economist for the AFL-CIO.

“The U.S. economy continues to be strong, but it faces clear headwinds,” he said. “The Fed is one of those threats because the Fed is mischaracterizing what it needs to slow down. We’ve already seen the slowdown in the U.S. from fixed investment, which would include commercial real estate.”

Despite economic turmoil in the U.S. and the Fed’s aggressive — or, in Spriggs’ view, misguided — attempts to tamp down inflation, overseas investors will continue to view the U.S. dollar as a safe and stable currency.

To explain this phenomenon, Spriggs referenced a moment in history when Alexander Hamilton solidified America’s reputation as a reliable economy by promising to pay off its debts from the Revolutionary War.

“The commitment that Hamilton made has forever marked the United States as the most stable government in the world,” he said. “The United States always pays its debts — and that’s why they revere the dollar.”