How Rising Interest Is Affecting Floating Rate Refis

And that's before considering the effect of rising Treasurys yields.

By Erik Sherman

The CRE refi market is tough as anyone in the business knows at this point. But the dual explanation of interest rates being high and many lenders — banks in particular — tightening standards and even pulling back from the markets is still fuzzy.

CRED iQ did some data analysis to get a better numeric understanding of at least one mechanism in place based on the Secured Overnight Financing Rate (SOFR). Rather than looking at a rate range the Federal Reserve sets for the federal funds rate, this is "a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities," as the Federal Reserve Bank of New York explains. Unlike the old LIBOR measure, the data is based on collected transaction costs and not self-reported numbers that banks could manipulate for gain.

The firm mentioned that floating rate CRE loans are a challenge when interest rates are rising, which makes sense. Unless an investor, developer, owner, or operator has planned ahead, the increasing rate tide means a good chance that whatever floating rate a plan has anticipated won't be enough.

"CRED iQ's report on Floating loans revealed that ~44% of floating rate loans with near term expirations will see rate cap agreements expiring before those loans mature," the firm said. "Based on SOFR data posted by the Federal Reserve Bank of New York, its apparent the rise in SOFR is having a dramatic effect on pending floating rate loan maturities."

A reminder that correlations aren't the same as causations. Two sets of data can trend in the same direction and still not entirely or even partially cause one another's movements. CRED iQ did find many apparent relationships in lending and SOFR. They found "effects of the rising interest rate environment when analyzing Fannie Mae floating rate issuance, including the aggregate Average Original Note Rate, Average Loan Scheduled Interest Due, and how these metrics vary by Seller."

"When analyzing the trailing twelve-month (TTM) data, it's evident that the average interest due on Fannie Mae loans has surged by over 280%," CRED iQ wrote. "This surge is exerting substantial pressure on Debt Service Coverage Ratio (DSCR) and Loan-to-Value (LTV) ratios for these properties." If rates jump on a floating rate loan, then more money goes into rent-taking with less available to improve DSCR and lower property values increasing LTV.

Keep in mind that there are other influences, like rising yields for Treasurys. They serve as gauges for safe returns to help determine risk-adjusted management. The short end of the Treasurys are over 5.5% yields. A 1-year on Monday, September 25 is 5.46% The 10-year is 4.44. Investors want a substantial return to walk away from a safe investment. And BlackRock, the largest asset manager, thinks that rates will continue high and could keep climbing from 16-year highs.