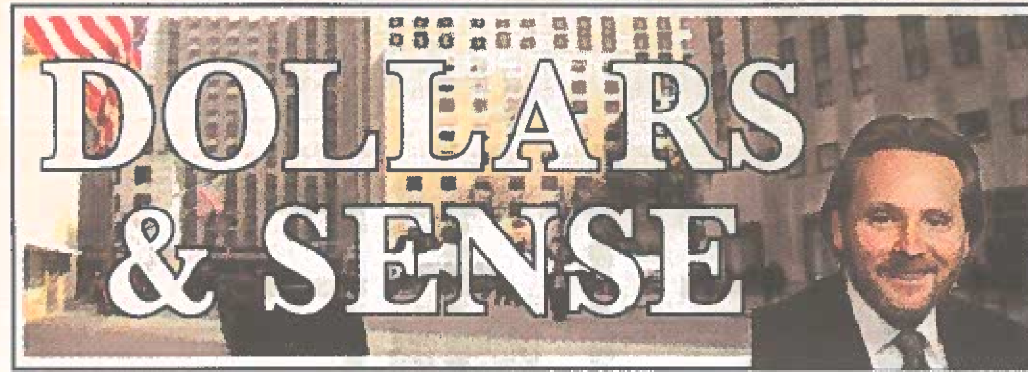

Do interest rates still pose a risk?

Q: In previous Dollars & Sense columns, you mention that one of the biggest risks to the investment sales business is our interest rate environment. Given the Fed's recent announcement that they will keep rates low well into 2013, has this risk been eliminated from the market in the short-term and won't this help the financing of commercial real estate sales?

A: The recent announcement by the Fed, as well as recent events in the economy, have had an interesting impact on commercial real estate sale financing.

impacting our financing markets.

With the downgrade of our debt rating, intuitively, one would think that, given the perception of additional risk, rates on our treasuries would rise. Interestingly, after the downgrade, the rate on treasuries plummeted.

This occurred because while it is apparent that there is a worm in our economic apple, there are far more worms in the economic apples across the globe.

The economic turmoil that is creating such unrest in Europe has created a tangible mercial real estate financing is that portfolio lenders, which primarily lend based upon spreads over treasury rates, are able to continue to set mortgage rates at low levels. These low rates are good in the short run but could have a flip side in the medium and long-term.

The reason for this is that interest rates that are too low for too long generally lead to asset bubbles. It has been said that when Alan Greenspan kept rates too low for too long in the mid 2000s, the housing bubble was inflated.

Today, with the way real still keep lending rates at or near historically low levels.

Economic stresses have created this flight to quality which is keeping rates low, helping portfolio lenders, but is having almost the opposite impact on the CMBS market.

For much of the spring, it appeared that the CMBS market was recovering nicely. Delinquency levels were abating; troubled loan resolutions were occurring more frequently and spreads were tightening. Then in June, as economic indicators visibly began to trend negatively here at home and economic woes in Europe and across the globe became more transparent, the flight to safety that exerted downward pressure on treasury rates began to force CMBS spreads to widen noticeably. T

hen, after the S&P downgrade, the market became so uncertain that two proposed CMBS issuances were pulled from the market.

Therefore, for the past few months obtaining large nine-figure financings were quite a bit more challenging than they had been previously. This dynamic, along with a general concern that job creation has been anemic and economic indicators have been sluggish at best, has created a slowdown in the commercial building sales market.

While we are not close to having all data in for 3Q11, it appears that the dollar volume of sales as well as the number of properties sold in 3Q11 will be lower than the totals we saw in 2Q11.

As all of this occurs, we have seen CMBS delinquencies rising again. In July, according to Trepp, an increase of 51 basis points was observed in the CMBS loan market bringing the delinquency rate up to 9.88 percent, the highest rate ever in CMBS history. Notwithstanding this reality, I appears another CMBS issuance is being teed up presently and, if it comes to market, it will be interesting to see how it is priced and how it is received.

Getting back to your question about whether the interest rate risk is out of the market, I believe we still must be concerned about rates increasing. We must remember that just because the Fed keeps the fed funds rate low, this is not the rate banks charge customers for commercial real estate loans.

Will spreads widen if the economy continues to sputter? Additionally, what happens if inflation kicks in meaningfully? With the amount of money the government has printed and continues to print, inflationary pressures have been pent up.

To the extent inflation seeps into the market at rates above the Fed's comfort level of 1 percent to 2 percent, the Fed will be compelled to increase rates, notwithstanding the announcement to the contrary.

In fact, some Fed presidents have indicated that they thought it was irresponsible to announce an interest rate policy for two years out. For these reasons, I still believe interest rate risk remains a concern for our market.