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### Thank Heaven for Little Rates

In the first quarter of 2012, low lending rates have fueled a jump in property values. So what does it mean for equities markets?

Perhaps the most notable trend observed in the investment sales market in the first quarter of 2012 has been surprisingly shrinking capitalization rates on all types of investment properties. There are several reasons why this has occurred.

In late 2010, lending rates for commercial properties had fallen into the 5 percent range and several of our clients decided to refinance properties and lock in these low rates for as long as they possibly could. Who could blame them? After all, we have been in a low-interest-rate environment for so long that we forget that, over the past 25 years, the average commercial mortgage rate has been 7.9 percent. A rate of 5 percent, locked in on a fixed basis, seemed like a smart move. Remarkably, rates continued to fall through 2011 and, during 1Q12, several lenders announced five-year fixed products at rates around 4 percent and a few, who are very active, are lending at 3.5 percent or less.

Fixed-rate loans at these rates are highly attractive. However, if you are willing to float, rates fall into a tantalizing range below 3 percent. If you believe that rates are going to stay low for a long period of time (a risky bet), this strategy might work well.

With rates this low, investors have been lowering their yield expectations, which has exerted downward pressure on cap rates and, consequently, upward pressure on property prices. In fact, we have seen, within the past eight weeks alone, a drop of 75 to 100 basis points in cap rates across the city. Most notably, we have seen this trend in the multifamily market. However, cap rates have been compressing in the retail, office and hotel sectors as well. This trend is tangible and there are dozens of examples of properties on the market today that attracted offers only at a certain level months ago but now are attracting offers that are much higher or are under contract for sale at much higher prices than could have been obtained previously.

History has shown us that commercial lending rates and cap rates are highly correlated; however, while historically low lending rates are the main driver of this recent cap rate compression trend, they are by no means solely responsible for this dynamic.

The acute supply / demand imbalance continues to exert upward pressure on property prices. Demand drivers are all full-speed-ahead, with institutional capi-

tal demonstrating a dramatic resurgence. These investors join the many domestic high-net-worth individuals and New York families who purchase properties for the long-term for their own accounts.

Additionally, we have seen a surge in the number of foreign investors who are looking to deploy capital into New York's investment property market. The number of buyers looking to acquire properties today greatly exceeds the very limited supply of available properties.

These varied and numerous investors are thrilled with very low yields on investment properties due to the lower yields available today on alternative investments. CD rates are at historic lows and, while you can find CD rates around 1 percent, if you search hard enough and long enough, most banks are offering rates on CDs well below 1 percent.

Even lower are Treasury rates. Clearly the Fed has implemented a strategy of wanting to control rates, keeping them low in an attempt to stimulate the sluggish U.S. housing market and the broader economy in general. At the end of January, the 10-year Treasury was trading at a yield of 1.83 percent. Since then, the rate has risen to last Friday's close of 2.23 percent, still a miniscule rate by historic standards. Remarkably, the two-year is 33 basis points and the one-month Treasury yields only 7 basis points. Taking inflation into consideration, which the government obviously does not measure accurately, Treasuries have negative real interest rates, meaning that those who purchase these bonds are actually paying the government to hold onto their money.

For these reasons, the equities markets have shown strong gains and our real estate market has been a beneficiary. The downside risks of rising interest rates are substantial and there are many sound arguments for why rates should rise as well as rise quickly and to a greater extent than many economists estimate. But, for now, low rates are fueling a boom in commercial real estate prices.

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