Inflation and Recession Fears are affecting Commercial Mortgage Rates and the Commercial Real Estate Industry

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NEW YORK CITY, NEW YORK, US, February 27, 2023 /EINPresswire.com/ -- 2023 is starting off as a very challenging year for the commercial real estate industry. Commercial mortgage rates keep rising, investors are confused, and many property types are facing cash flow and occupancy issues. The two questions we hear most often are, “What’s going on with commercial mortgage rates?” and “What type of commercial property is the best choice for investment today?” Hopefully, we can shed some light on these issues.

In May 2022, the Open Markets Committee of the Federal Reserve started raising the Federal Funds rate in order to slow the rampant rate of inflation. The Federal Reserve continued raising short term rates aggressively throughout 2022. In 2023, the Fed announced that it would continue with rate increases, although at a slower pace. These increases in short term rates have caused long term US Treasury rates to climb as well. At the start of 2022 the 5 year Treasury rate stood at 1.37% and the 10 year Treasury stood at 1.66%. Today, the 5 year Treasury is at 4.19% and the 10 year is at 3.95%. Most commercial mortgage loans are priced based on one of these two indices. Even more shocking, the Prime Rate has jumped from 3.50% to 7.75% over the same time period. Many consumer and small business loans are based on the Prime Rate. These higher rates are making borrowing much more costly for individuals, small businesses, and commercial real estate investors. With more and more of their cash flow being eaten up by higher commercial mortgage payments, investors are finding it difficult to turn a profit. Most retail and office properties are subject to longer leases, making rental rate increases difficult. With the exception of apartment properties in highly desirable areas, most properties are facing intense pressure to stay cash positive. Billions of dollars of commercial mortgage debt are set to mature in 2023 and owners are facing very difficult times refinancing this debt at today’s much higher rates. We are already seeing some investors turn in the keys, and we expect to see the foreclosure rate increase as more and more investors are unable to refinance maturing debt.

Worries about inflation, higher interest rates, and the fear of recession have slowed the pace of the market considerably. Some property types are faring better than others. Multifamily buildings in desirable neighborhoods are doing well, as owners have been able to pass through rental increases to keep up with rising interest rates. Apartments in smaller and less desirable markets, or markets where unemployment is rising, are not doing as well, as rental rate increases are harder to implement. In the office sector, only medical office buildings are doing well. General office properties have taken a huge hit as a result of the work from home policies established during the Covid-19 pandemic. Office demand is unlikely to return to pre-Covid levels making the office sector extremely hard to navigate right now. When it comes to retail, essential service businesses, such as grocery stores and pharmacies, are doing well, while traditional retailers are still reeling from the effects of Covid-19 and the competition from online retailers. Many malls are experiencing record level vacancy levels and some are being repositioned for other uses. In the industrial sector, we are seeing strong demand for warehouse and distribution space to accommodate the online retailers. Industrial space in urban markets and close to transportation are doing very well.

Economists are divided. Some predict a recession. Others predict declining rates by the end of the year. Until we have some certainty in the market, we can expect some tough times in the commercial real estate and commercial mortgage lending markets.

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