Commercial Real Estate: 2007 déjà vu?
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Todays Presenters

• Julie Stackhouse
  Executive Vice President
  Federal Reserve Bank of St. Louis

• Brian D. Bailey, CRE, CCIM
  Subject Matter Expert, Commercial Real Estate
  Federal Reserve Bank of Atlanta
The opinions expressed in the presentations are intended for informational purposes, and are not formal opinions of, nor binding on the Federal Reserve Bank of St. Louis or the Board of Governors of the Federal Reserve System.
Commercial Real Estate...2007 déjà vu?

- Macroeconomic Conditions
  - Population Growth
  - Unemployment/Job Growth
  - Home Mortgages/Appreciation

- Commercial Real Estate (CRE) Conditions
  - Good/Solid Fundamentals
  - Change Will Do You Good

- CRE Finance Conditions

- Why It Matters
Unemployment Rates

Current: 7.5%
Pre-crisis: 8.4%

Current: 3.9%
Pre-crisis: 4.6%

Data Through Q2 2018 (August 2018)

Source: Bureau of Labor Statistics, STL FRB FRED
Seriously Delinquent Mortgages

Data: July 2018
Home Mortgages 90+ days past due

Source: McDash Analytics, LLC, a wholly owned subsidiary of Black Knight Financial Services
Seriously Delinquent Mortgages, YOY%

Data: July 2018
Home Mortgages 90+ days past due

Source: McDash Analytics, LLC, a wholly owned subsidiary of Black Knight Financial Services
Home Price Appreciation

Data: June 2018

Source: Corelogic; Risk Analysis Unit/Federal Reserve Bank of Atlanta
Home Price Appreciation (from 2007 Peak)

Source: Corelogic; Risk Analysis Unit/Federal Reserve Bank of Atlanta

Data: June 2018

House Price Index (Percent Change)
- < -10% (78)
- -10% - -5% (28)
- -5% - 0% (36)
- 0% - 3% (18)
- 3% - 6% (14)
- 6% - 10% (25)
- 10% - 15% (24)
- 15% - 25% (34)
- > 25% (54)
Commercial Real Estate
2018 Outlook

Note: Depending upon economic conditions, indicators can remain stable or move in reverse.

Source: AXIOmetrics, CBRE-EA, Mueller, Risk Analysis Unit/Federal Reserve Bank of Atlanta
National New Supply vs. Long-Term Average

20-Year Averages vs. 2017, 2018F, 2019F Supply

Source: AXIOMetrics, CBRE-EA, Risk Analysis Unit/Federal Reserve Bank of Atlanta
Based on traditional analytics, most markets are experiencing robust dynamics; however, there are some nuances:

- Hotel markets have struggled with overbuilding recently.
- Except for luxury apartments, the rate of new construction does not indicate that overbuilding is likely.
- Efficiency is having a greater impact on office and retail and could lead to higher vacancy rates.
- New trends could lead to greater rates of change.

Source: Risk Analysis Unit/Federal Reserve Bank of Atlanta
Office Densification

Total Occupied Office Square Feet Per Worker (U.S.)

Source: CoStar Portfolio Strategy
Coworking Growth

Millions SF Occupied By Coworking Tenants

As of Q1 2018

Source: CoStar Portfolio Strategy
Retail Bankruptcies

Retail bankruptcies timeline
A timeline of select retail bankruptcies from 2015 to 2018 YTD (3/19/2018)

www.cbinsights.com
Increasing Targeted Retail Risks

Major retailers are evaluating store closures across a good portion of the spectrum. Is the industry prepared if they begin closing stores at B-, B or even B+ locations?
Grocery-Anchored Retail

- Change is accelerating in the grocery-anchored segment.
- Several grocery chains are under pressure.
- Walmart plans to expand delivery to markets serving 40% of the population by the end of 2018.
- Amazon purchased Pillpack which allows prescriptions to be delivered to your front door.
- Consumer demand for home delivery has big implications for retailers. This means more consumer options, a lower number of impulse buys, and declining margins in an already margin-challenged business.
While other areas are growing, the number of conventional supermarkets has declined in the last five years.
Non-major Market CRE Price Indices

Q42006 = 100

Source: Real Capital Analytics, Risk Analysis Unit/Federal Reserve Bank of Atlanta

Data: 2Q 2018

Source: Real Capital Analytics, Risk Analysis Unit/Federal Reserve Bank of Atlanta
Is CRE Pricing Risk Increasing?

Spread above 10-yr Treasury

[Data through 2Q 2018]

Basis Points

Office | Industrial | Retail | Apartments | Hotel
---|---|---|---|---
Current | 377 | 351 | 361 | 259 | 590
18 Yr Average | 411 | 431 | 394 | 324 | 556
Difference | -34 | -80 | -33 | -65 | 34

Office | Industrial | Retail | Apartments | Hotel
---|---|---|---|---
Low (Q2 2007) | 151 | 177 | 143 | 126 | 361
Difference | 226 | 174 | 217 | 133 | 229

10-year T Yield = 2.91%
Data through 2Q 2018

Source: Real Capital Analytics, Risk Analysis Unit/Federal Reserve Bank of Atlanta
CRE Finance
Lending Sentiment

Source: Federal Reserve (SLOOS) Risk Analysis Unit/Federal Reserve Bank of Atlanta
CRE Loans Outstanding at Banks

$ billions, peak balances shown

Source: Call Report

Data: Q2 2018

Source: Risk Analysis Unit/Federal Reserve Bank of Atlanta

Data through 2018Q2
Borrower-Friendly Financing?

**CRE CLO Originations ($, Billions)**

**CMBS Originations (% Interest-Only, Partial Interest-Only)**

*Source: Kroll*

*Data: Q2 2018*

Changes in Cap Rates May Impact Leverage Levels...

All else remaining equal, a 150 basis point increase in CRE Cap Rates moves the LTV upward notably in both scenarios.

The implications may be greater for smaller markets when CRE Cap Rates experience greater movements.

Source: Risk Analysis Unit/Federal Reserve Bank of Atlanta
Why Does It Matter?

Greater availability of capital may lead to enhanced levels of risk

- Heightened CRE price levels
- Market preferences... (today more debt than equity)
- More originators and greater lending competition
- Loosening underwriting
- Declining spreads
- Increasing friendly borrower terms
- Heightened rates of change in some property types
Summary

- Good macroeconomic fundamentals, robust capital availability and increasing debt dynamics are producing conditions with some similarities to the conditions in the mid-2000s.

However...

- Greater efficiency will continue to have a more pronounced effect for CRE.
- CRE dynamics appear solid today; however, the rate of change appears to be accelerating.
- Capital availability, levels of pricing and competition in the lending environment appears robust and could translate into enriched levels of risk.
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