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Declining interest rate period seems to have come to an end but it's still a borrower's market

dm Daniel Mee



Tremont Realty Capital

The historic declining interest rate period enjoyed over the last four years appears to have come to an end. On June 30, Federal Reserve chairman Allan Greenspan announced a 25 basis point increase in the benchmark Federal Funds Rate, which now stand at 1.25%. The Fed Funds rate is what banks charge each other for overnight loans. It was last changed one year ago, in June 2003, when the Fed lowered it to 1%, a level not seen since 1958! The last time the Fed raised rates was back in May 2000, shortly after the stock market peaked.

The rate hike, which had been widely projected, reflects a major turning point in Fed policy, ending a long cycle of easing that began in early 2001, just as the economy was about to plunge into its first recession in 10 years. Even after the recession ended in November 2001, the Fed continued lowering rates as the economy struggled through a series of challenges, including uncertainty related to the U.S. war on Iraq. Essentially the Fed reacted to a series of crises that

hit the economy including 9/11, the collapse of the dot-com industry along with the various corporate accounting scandals not to

1.1% as recently as January. It appears that the Fed Governors felt with all the good news in the economy; a measured rate bump

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mention the Iraq war. Many economists in fact feel rates have been artificially low to help ease the pain caused by the different crises.

Now that the economy seems to be stronger, the Fed is concerned about inflation risks that can be exasperated with low interest rates. All this is somewhat surprising, in that we are in the middle of an election year, a time when rates typically stay put so as not to have much of an impact on voters. While the economy does not seem in any immediate danger of overheating, nearly 1 million jobs have been added to payrolls over the past three months, ending a long jobless recovery and signaling that the economy has resumed a robust, sustainable expansion, analysts say. However, consumer inflation has picked up some speed this year. Even excluding the volatile food and energy categories, consumer prices in May were up 1.7% over year earlier levels, compared with

would have a negligible impact on the election

In reality most commercial real estate borrowers felt rates tick up over the last several months as US Treasuries moved nearly a full percent with another half percent jump expected by years end. The direct impact of Fed's action was the immediate quarter point jump in the Prime rate. This has an impact on many floating rate borrowers who still have Prime based loans. As noted above, the capital markets have reflected increasing rates for some time and LIBOR based borrowers have seen the jump reflected in the current three month LIBOR at 1.59% up from 1.12% this past January

Still, rates are very attractive from a historic perspective. Many savvy borrowers, who have enjoyed low floating rates over the last several years, are now locking up long term, fixed rate loans before they move further. Of equal

importance to rate is availability; and there continues to be a significant amount of dollars seeking quality real estate project from both a debt and equity perspective. Borrowers who shop around are finding that lenders will compete on many terms for the right deals. Longer amortization periods, flexible pre-payments and, of course,

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additional dollars are often competitive tools used by lenders to win business. Additional dollars should continue to be available despite rising rates due to the emergence of a sophisticated mezzanine-lending environment that can bolt on up to 90% leverage for a marginal increase in overall cost

In summary, as the real estate industry moves into the second half of the year, the upward trend in the cost of capital should not dampen the improving market.

Dan Mee is executive director, Tremont Realty Capital, Boston, Mass.