Executive summary | September 14, 2023

Wipfli Real Estate Leaders Exchange

Host: Cory Bultinck | National real estate leader at Wipfli

Facilitator: Austin Evans | Profitable Ideas Exchange

Introduction

Nine chief financial officers (CFOs) and leaders of finance from the real estate industry met by video to share leading practices and discuss topics of mutual interest based on an agenda created through a series of pre-interviews.

From Wipfli, Cory Bultinck, national real estate leader, hosted the exchange and Austin Evans of Profitable Ideas Exchange facilitated. The focus of the discussion covered the following topics over the course of the hour:

- Market trends
- The high-rate environment and lending

Market trends

Cory Bultinck of Wipfli opened the conversation around the heightened risk environment as interest rates continue to reach unprecedented levels.

- With the current market indicating a crash on the horizon, real estate leaders were eager to hear responses to the extreme risk exposure found in certain asset classes.
- Leasing for multifamily homes has slowed despite economic drivers like high interest rates that typically contribute to a strong renters' market.
- In some cases, executives have seen applicants who initially considered renting withdraw their applications and opt to stay put instead.
- Within the last month, real estate leaders have noticed a slowdown, with less applicants and higher levels of vacancies in multifamily units. This was attributed in part to higher levels of supply becoming available.

On a local level, the real estate leaders haven't noticed large amounts of relocation happening based on job opportunities, which could be at least partly attributed to the high interest rates of 7.5% for a 30-year fixed mortgage.

- However, rent growth is not rising at the expected 10% growth, falling closer to 2% instead. As a result, one organization anticipates a potential opportunity when borrowers with high levels of debt find that they can't pay due to lower growth.

Market trends

Market concerns extend beyond high-growth markets, though those are seeing impacts.

- In cities like New York, real estate purchases made in 2021 with fixed-rate loans now face rate adjustments and may pose challenges when rents no longer align with initial projections.
- On the West Coast, prices relied on a 10% rent growth curve, but the current market does not reflect such growth. Banking mandates have also forced bankers to provide relief, which may impact projections.

While office space has seen dramatic downturns since the pandemic and the shift to remote work, some geographies still incentivize investment in offices.

- One executive noted that Memphis and the state of Tennessee have many ongoing office projects due to state incentives to attract business to the region.
- However, similar incentives are not offered to other initiatives, such as creative repurposing of vacant retail.

Market trends

While many areas of real estate face headwinds, retail has seen an uptick since the pandemic.

- There seems to be a demand for outdoor space as public opinion sways in favor for physical shopping experiences. The move away from malls has also contributed to a vacuum in retail shopping, creating opportunities for new projects.

- While some states offer incentives for retail and office construction, rising interest rates have impacted asset investors, and obtaining financing has become a challenge as regional banks reduce lending activity. Office financing since the pandemic has gotten increasingly expensive and hasn't experienced the same level of rejuvenation retail has encountered.

- While suburbs are improving for smaller retail spaces, the surplus of office spaces are leading to high vacancy rates.

The high-rate environment and lending

The fallout from the Silicon Valley Bank and First American banking crises may still be rippling throughout the market.

- One executive speculates that future refinancing regulations will lead to a shadow banking industry reminiscent of 2019. The lending business however is not experiencing the same challenges. In the case of a hard money lender, they shared that they are seeing opportunities with 8% loans for borrowers where traditional financing options were not favorable.

- Another executive shared the example of a $70 million multifamily home project wherein they were expected to keep a $4 million dollar deposit with the lending bank.

As banks continue to adjust deposit requirements and become more selective with their loans, even to investors with strong balance sheets, smaller banks seem the most receptive to finding a deal.

- One executive noted they were able to find a workaround for more stringent deposit requirements by utilizing a certificate of deposit (CD) that combines a brokered CD to avoid parking money in one bank. However, having some ex-bankers on board can help secure capital.

- Extended hold periods allow an opportunity to gain value from existing financing in markets where expectations have shifted. To adapt, one leader is looking into utilizing income funds and asset pooling to optimize their investments.

The high-rate environment and lending

One real estate executive wondered about the implications that different loan terms could have on property values, portfolio management and cash flow.

- Despite the hesitancies held by bankers, the executive suggested a proactive approach to stimulate some confidence in the real estate sector.
- Rationalizing property prices and securing financing for new investments are top of mind for investors as a recession seems imminent.

One real estate executive noted that insurance costs have significantly exceeded their budget, totaling 2.5 times their original estimates.

- Another member shared that insurance rates in their city went up 125% this past year.
- Pooling insurance for both affordable and multifamily properties faces high premiums that don't correspond to the actual level of risk given based on a specific location. However, as insurance companies continue to pull out, premiums are expected to continue to rise.

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