Widespread Uncertainty Is Helping Commercial Real Estate

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If 2015 was the unofficial peak of the commercial real estate cycle, and 2016 was defined by political upheaval, 2017 could be called The Year of Stable Uncertainty.

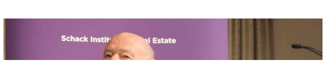
ACORE Capital co-founder Warren de Haan, whose two-year-old company did $5B in real estate financing deals last year, said most people are asking the same questions in his daily conversations with borrowers, but no one knows the answers.

"Not just us, but all our competitors, our friends, equity guys, everyone is focused on the same issues," said de Haan, who will be speaking at *Bisnow*'s National Finance Summit in New York City on June 22. "Where are we in the cycle? What are our risks? Why does the stock market keep going up? What's going to happen with interest rates? What's going to happen with our president? And what's going to unravel us?"

The current economic cycle, the recovery from the Great Recession, is one of the longest periods of economic growth in modern U.S. history. In response to the recession, partly caused by overaggressive lending and borrowing, lenders have become far more conservative in what terms they will accept, often seeking borrowers to put in at least 30% of funding for a deal in equity.

With lenders requiring more skin in the game, borrowers have become more conservative and deliberate, and with sellers not dropping their prices, this has created a capital markets stalemate in some sectors and cities.

"The markets are disciplined," de Haan said. "We don't see craziness in the market that we did in 2007 ... It's been a long time since I've seen real estate people broadly be this measured and thoughtful about each deal."



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While some experts, including Equity Commonwealth CEO Sam Zell, have been predicting a looming recession for more than a year, macroeconomic indicators do not suggest any recession in the near future. Deal volume was down slightly in 2016, and way down in the first quarter of 2017 while the market waited to see how President Donald Trump's election would affect the markets.

But other than a big, brief stock market dip amid increasing scrutiny over the White House's potential ties to Russia, key economic indicators point to a strong, stable economy. Investors have raised $1.7 trillion with the goal of investing in real estate, but that money is sitting on the sidelines as buyers wait for prices to go down.

"I remember after the election, asking 'now what?' and it was a head-scratcher. The only thing I felt confident in was the uncertainty," de Haan said. "A lot of the private equity guys were going, 'Let’s wait and see.' If you fast-forward, I think some guys sitting on the sidelines say, 'It feels decent, it feels OK,' and if the fiscal policies start to get any legs, we’re going to get a Trump Bump."

There is an abundance of multifamily supply and a record-setting number of retailers going bankrupt — both of which could be attributed more to changing realities of how people live and shop than broader economic issues. But the factors lenders look at that could point to a coming recession remain strong.

"Undisciplined markets, lack of liquidity and owners rushing for the door would be bellwethers [to a recession], but we’re not seeing that," Starwood Property Trust president Jeff DiModica said. "We will watch rents for trends. Construction debt is expensive, so supply will eventually be down. As long as the broader economy is not significantly weaker in the next few years, rolling, below-market leases should mean rents can hold in.”

As a result, the slowdown in commercial real estate transactions that started the year should start to pick up, de Haan said. He said he expects ACORE to do another $5B in deals this year.

"People are looking for hope," he said. "Volume has picked up, borrowers are being more active. I'm staring at my office whiteboard with the deals we have coming, and my whiteboard is full again."

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