Could A Change With Fannie, Freddie Be CRE's Black Swan Event?

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Jeffrey Erxleben

DALLAS, TEXAS–The commercial real estate environment is so strong, not only for Texas, but the rest of the nation, that observers can't help but wonder, what don't see that we should be worried about? In other words, there is nothing obviously alarming on the horizon, so only an event now lurking in the shadows could bring the industry down. That question — what lies in the shadows? — was on the minds of panelists at **RealShare Dallas**, held earlier this week.

There were a handful of possibilities tossed about including rising energy costs and a prolonged tariff war — which for a state like Texas would be a serious and sobering affair — but one in particular grabbed our attention. During the capital markets panel discussion, which was moderated by **Steve Pumper**, executive managing partner of Transwestern, the question of Fannie Mae and Freddie Mac came up.

What if a change in policy caused Fannie Mae and Freddie Mac to pull back on lending, particularly their interest only loan components? That would have a massive impact on the multifamily market if they eliminated their IO component, **Andrew Van Tuyle**, senior managing director, Investments of BH Properties said. It is a possibility, he added. "I've heard the GSEs talk about it occasionally."

After the session, GlobeSt.com asked another panelist, **Jeffrey Erxleben**, executive vice president and regional managing director of NorthMarq Capital, to elaborate.

"A change in the GSEs and their outlook would affect the market overnight," he told us.

This would be due to a change in regulation, which at this point appears to be highly unlikely. "I don't foresee this happening," Erxleben said.

"The general consensus is that the Trump Administration has enough to tackle right now and that massive reform within GSEs is not going to happen any time soon." Another problem for proponents of GSE reform: There are a number of suggestions floating around on how to change the agencies but there isn't a prevailing theory.

Still, the possibility does remain and if a change in mandate requires GSEs to either pull back on IO financing or worse, to completely wind down, "it would have a substantial change in the liquidity environment, Erxleben said. The GSEs provide "north of 50% of financing available for multifamily."

Not only would finance be affected but so would property valuations, development and deal flow, he added. "There isn't a viable private sector source that could step up."

"In the past people have talked about CMBS filling the void but that product is not fully functioning in that market now. Life could fill some of the gap but that bucket is finite."

The cost of financing would rise significantly, Erxleben also said. "Right now there is a healthy competition between life and the agencies and, as with everything, if a major competitor is taken out, the pricing will clearly go up."

Other Black Swan Events

There are other Black Swan possibilities, although none as frightening as a change in the GSEs.

One could be an erosion in property values, Erxleben said. For example, rental rates are already showing signs of flattening for multifamily but ongoing strong demand is still shoring up the asset class. But multifamily is still jobs-driven at the end of the day. If job growth were to drop that could significantly affect fundamentals for multifamily, Erxleben said. "No one seems to be looking at that right now, given how strong job growth is."

Another Black Swan scenario: an economic downturn that is led by corporate defaults. That would impact market liquidity, Erxleben said.

But CRE could well come out ahead in this case, because it represents hard assets to investors. "Real estate could do better in that scenario," Erxleben said.

Rising costs — perhaps due to the tariff increases — is another worrisome event to watch. "Nothing is getting cheaper to build and margins are decreasing," Erxleben said.

So are rising rates. "In the short term there is enough liquidity that the industry won't see that much of an impact but in the long term there could be an impact on large deals."
