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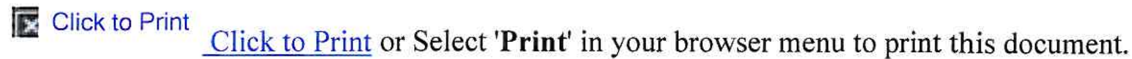

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Rising Rates: What Multifamily Investors Should Know

By Kurt Stuart
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With the Federal Reserve's recent 25 basis point increase to the federal funds rate, and its intention to raise rates twice more in 2018, commercial real estate investors face questions on how best to approach rate resets and loan maturities. Here's what multifamily investors should be thinking about today.

The Federal Reserve's interest rate normalization process continued in June with the Federal Open Market Committee's (FOMC) announcement that it raised the federal funds rate by 25 basis points, to a target range of 1.75% to 2.0%. This is the second rate hike in 2018 and the seventh since normalization began in December 2015. As normalization progresses, multifamily investors should consider how a higher rate

environment might affect their portfolios, and perhaps more importantly, determine the proactive steps they can take to best position them for the future.

Economic Strength Supporting Continued Normalization

Since the first 2018 rate increase in March, economic data has been largely in step with the Fed's outlook. In May, the national unemployment rate fell to an 18-year low of 3.8%, and the four-week rolling average for weekly jobless claims fell to 216,000, which is the lowest the average has been since December 1969.

In New York City specifically, the seasonally-adjusted unemployment rate in May was just 4.2%, a 0.4 percentage point decrease from a year earlier. This comes alongside the city's private sector growth rate of 2.1%, which is greater than the state-wide rate of 1.4% and the national rate of 1.9%. And in March, the US Bureau of Labor Statistics reported that the New York metropolitan area saw a 2.8% increase in total compensation costs for private sector employees.

Nationwide, the tighter labor market has not fueled a commensurate amount of wage growth, but inflation is closer to the Fed's long-term inflation target of 2% than it has been since the beginning of the recovery. The Fed has indicated that being slightly over its inflation target is no more alarming than being slightly under, which should help calm concerns that it will accelerate interest rate hikes if inflation exceeds the target. Rate hikes in 2018 and beyond should remain gradual—despite somewhat hawkish comments coming out of the Fed's June meeting—with the FOMC's statements indicating it now expects two additional increases in 2018 and three or four hikes in 2019.

Preparing Your Balance Sheet for Rate Hikes

If economic growth continues to accelerate and the economy moves closer to operating at its full potential, the Fed's rate normalization is likely to proceed. As such, investors should prepare for a higher interest rate environment and structure their portfolios to withstand rate increases. When considering an investment, we encourage clients to think 200-to-300 basis points higher.

Looking Ahead to Rising Rates and Maturing Loans

Investors can prepare by taking action to protect their portfolios from unforeseen challenges down the line. During the financial crisis, investors who were faced with maturing loans—when interest rates were higher, valuations were lower and liquidity was below normal levels—found themselves in situations that were not ideal.

For commercial real estate investors, we believe it is important to consider where rates may be in one year, two years and even 10 years. Taking into account this longer term view, we encourage our clients to review their maturity and rollover dates with a strategic and proactive mindset.

No one knows what the future will hold, but investors can take steps to position themselves for success in any market environment. Our recommendation to investors continues to be to structure their businesses and balance sheets so that they are well positioned to capitalize on opportunities, irrespective of where we are in the real estate cycle.

Kurt Stuart is Head of Northeast Commercial Term Lending (CTL) at JPMorgan Chase. He leads a team of over 150 people covering New York, Boston and Washington, DC, and is responsible for loan originations, strategic direction and the financial performance of CTL's Northeast Region Multifamily loan business. The views expressed in this article are the author's own and not those of ALM's Real Estate Media Group.