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Property Income Advisors, Inc. is a real estate advisory firm with professional expertise and a focused niche exclusively assisting Gulf-based clients in the investment and management of United States commercial real estate.

We provide a turnkey real estate investment management platform for acquisitions, financing and sales, as well as comprehensive asset management capabilities.

Our career experience includes the successful asset management of more than 13 million square feet of United States commercial real estate valued in excess of $2 billion. In addition, we have directed property acquisitions, dispositions, financings and lease transactions totaling more than $3 billion.

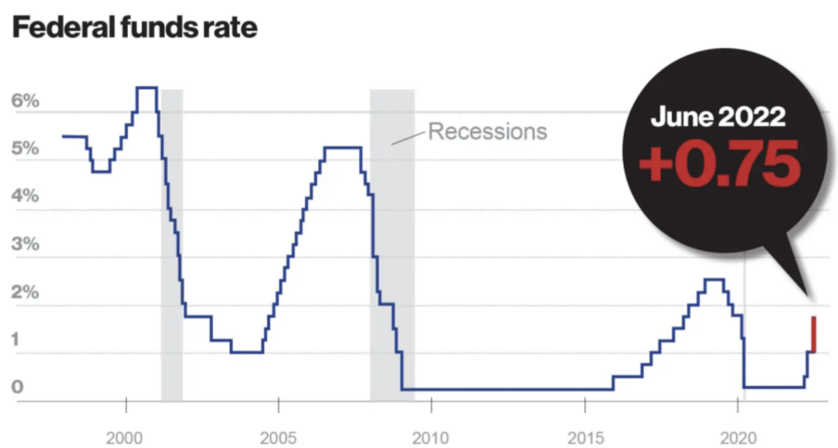
Property Income Advisors, Inc. has nationwide experience and maintains strong national relationships to insure success in all of the major markets in the United States. Our clients consist of Gulf-based high net-worth investors, family offices, private banks and institutions.

State of the Market

U.S. Commercial Real Estate Feeling the Effects of Rising Interest Rates Amid Recession Fears

Buyers Cautious as Property Pricing Starts to Decline

The U.S. commercial real estate sector is finally feeling the effects of the recent actions of the Federal Reserve – three rounds of interest rate hikes totaling 150 basis points since March 2022, plus quantitative tightening to restrict the flow of money, in an attempt to tamp down the decades-high rate of inflation. Last month the Federal Reserve hiked its benchmark interest rate by 75 basis points, the biggest rate increase since 1994.



The upward movement of interest rates and fears of a recession are affecting buyer behavior, with more buyers sitting on the sidelines waiting for the right deal with realistic pricing. Buyers under contract prior to the latest interest rate hikes have also cancelled contracts or have attempted to re-trade for lower prices. The market is much less frenzied with many properties taking longer to market with sellers beginning to lower their lofty pricing expectations. As a result, nationwide commercial real estate prices have dropped by 4.9% since March 2022 according to the *Green Street Commercial Property Price Index.*

Negative Leverage Becomes a Concern

Buyers fear entering into a position of negative leverage – a situation where the interest rate on debt actually exceeds the capitalization rate of the investment. For example, last year a transaction might have commanded a 3.5% interest rate on the debt and a 5% capitalization rate on the purchase price resulting in positive leverage which enhances the return on the investment. This year with the rate hikes, that same transaction with a 5% capitalization rate could face an interest rate on the debt of 5.5% which creates negative leverage causing the return on the investment to actually erode.

Ample Capital for Deals – Underwriting More Conservative

Despite the increase in caution, the demand for U.S. commercial real estate remains very strong. Private and institutional investors, both domestic and non-U.S., have plenty of capital ready to be deployed. Expect this capital to be invested at a slower rate than most recently. Buyers should focus on properly priced, stable, high-quality real estate without leasing risk. Triple-net properties, where the tenants pay all operating expenses, have increased desire during times of high inflation. More than ever, cash flow is king.

While the commercial real estate market as a whole cools down, multifamily and industrial properties are still expected to perform better than other sectors despite the prospect for more interest rate hikes, high inflation and the possibility of a recession. Operating expenses rise with inflation but so do rental rates on in-demand property classes, and the demand for multifamily and industrial leasing remains relatively strong overall although rental rate growth in these sectors has started to slow down.

Anticipate real estate underwriting to get more conservative as lenders and buyers do their best to price recession conditions into their risk models in anticipation of the 10-year treasury possibly exceeding 4% by year-end. Tighter lender underwriting means the potential for less leverage, as lenders commit to lower loan to values. In addition to dealing with higher interest rates, investors will have to invest more capital into an acquisition, resulting in additional yield compression on that capital while still trying to stay away from a negative leverage situation.

The Federal Reserve Isn't Done Yet

Expect to see additional interest rate hikes from the Federal Reserve. The current consensus is for two more rate hikes this year – in the range of 50 to 75 basis points each. Fed officials expect the benchmark interest rate to hit a range of 3.25% to 3.5% by the end of this year. The Federal Reserve also began the process of quantitative tightening in June, beginning to reduce the assets on its $8.9 trillion balance sheet which includes treasury bonds, agency debt and mortgage-backed securities. Beginning in September 2022 the targeted asset reduction will total $95 billion per month. Both the interest rate increases and quantitative tightening are the Federal Reserve's prescription to quell record inflation in the face of a strong U.S. labor market while attempting to not tip the country into a recession.

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