Changing Interest Rates 2022:

What this means for Corporate Property

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Fed Announcement

At the December meeting of the Federal Open Market Committee, the Committee made announcements targeted at fighting inflation. The imminent move is a monetary tightening policy in which the Fed will double the pull back of its monthly bond buying from $30 billion to $15 billion. This will conclude the tapering process in March, three months earlier than the previously targeted month of June.

Following the Fed's meeting in late January 2022, more prognosticators and analysts believe the speed of rate hikes will accelerate, to as much as four or five rate hikes in 2022. Historically, the Fed has implemented rate hikes in 25bp increments.

The Federal Reserve will implement its first interest rate hike in March 2022.

What This Means

These moves are targeted to get inflation back under control and near the Fed's long-term target of 2.00% annual inflation. The tapering of bond buying reduces monetary supply while an increase in borrowing rates can slow economic growth and trim asset values.

Most prognosticators believe the Fed's moves, specifically the anticipated rate hikes, will have the greatest impact on short-term interest rates with less impact on long-term rates. From an overview perspective rates remain in a historically low range. Accordingly, the yield curve has "flattened" to bring short and long-term rates closer to each other.

Corporate Properties

For Corporate owners of real estate, the market values for assets, particularly Industrial, remain near all-time highs. As Investors begin to underwrite with higher cap rates you can expect some devaluing of these assets as we come to the later half of 2022.

For companies who have higher costs of borrowing for direct long-term debt (such as BBB and lower grades of debt), sale & leasebacks are increasingly attractive on a comparative basis as a way to secure long-term financing in this rising rate environment.

Key Takeaways

The Federal Reserve announced they will implement several rate hikes in 2022 to combat inflation.

In this rising rate environment, Corporate owners of real estate can take advantage of high asset values and hedge against inflation through long-term sale & leasebacks with fixed terms.

Rampant inflation will continue to put upward pressure on lease rates in renewals and annual escalations

Rising rates and uncertainty in the office sector is leading to higher cap rates for this product.

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Impact to Corporate Users

Industrial Properties: Nationally, industrial markets are tight, prime sites are scarce, and creation costs are high. Consequently, industrial users should expect continued upward pressure on rental rates. Not only is low vacancy driving rents up, but also the cost of materials and labor for any sort of construction. Industry forecasters and investors have clear vision that industrial rental rates will increase for several more years.

Tenant Improvement dollars will not go as far as they have in the past and occupiers should be prepared to deploy more capital on improvement projects than they have historically. Additionally, escalations have been quickly rising with most lease deals starting negotiations at 4.00% - up significantly from the prior 2.5%-3% range. Investors in Industrial real estate are beginning to underwrite with slightly higher cap rates, particularly when evaluating transactions that may occur in Q3 or Q4 of this year.

Office Properties: This market has high uncertainty. Tenant's should benefit from softer market conditions and landlords eager to generate income in their properties. While rental rates have dropped in secondary markets and class B/C products, class A product rental rates are holding steady from a broad stroke view. However, concessions have been increasing across the board with free rent and Tenant Improvement Allowances exceeding pre-pandemic levels.

The number of office investors is currently substantially lower as many investors are on the sideline, waiting to see how this market shakes out. Investors in the office sector have begun underwriting with higher residual cap rates, and by a significantly greater margin than Industrial buyers.

Impact on Commercial Real Estate

- The majority of commercial real estate debt for investors is long-term in nature.
- Long money rates will continue to increase from 2021 levels but remain relatively low through 2022.
- The increase in short-term rates will impact developers more than passive holders.
- Global and national markets currently have increasing uncertainty and nervousness.
- Investors are increasing risk premiums and there is a steady "flight to quality" in financial markets.

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