



FEDERAL
RESERVE
BANK
of ATLANTA

Commercial Real Estate and the Next Downturn

2018 Atlanta Fed
Banking Outlook Conference

Presented By:

Brian D. Bailey, CCIM, CRE

Subject Matter Expert – CRE

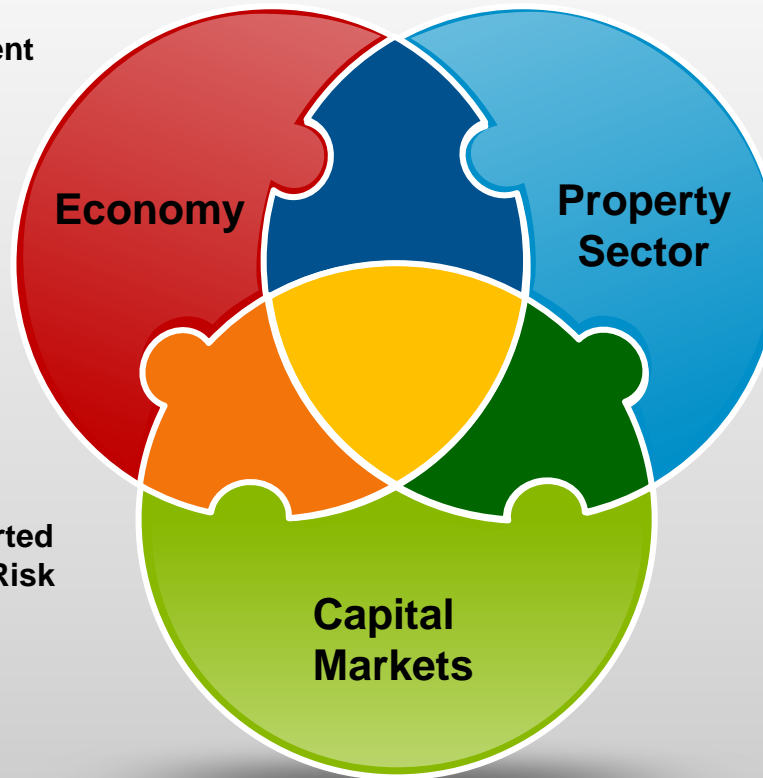
The views and opinions expressed are those of the presenter and are not necessarily those of the Federal Reserve Bank of Atlanta or the Board of Governors of the Federal Reserve System.

Economy

- National Unemployment
- State Unemployment

Property Sector

- Vacancy/Occupancy
- Apartment Effective Rent Growth
- Supply

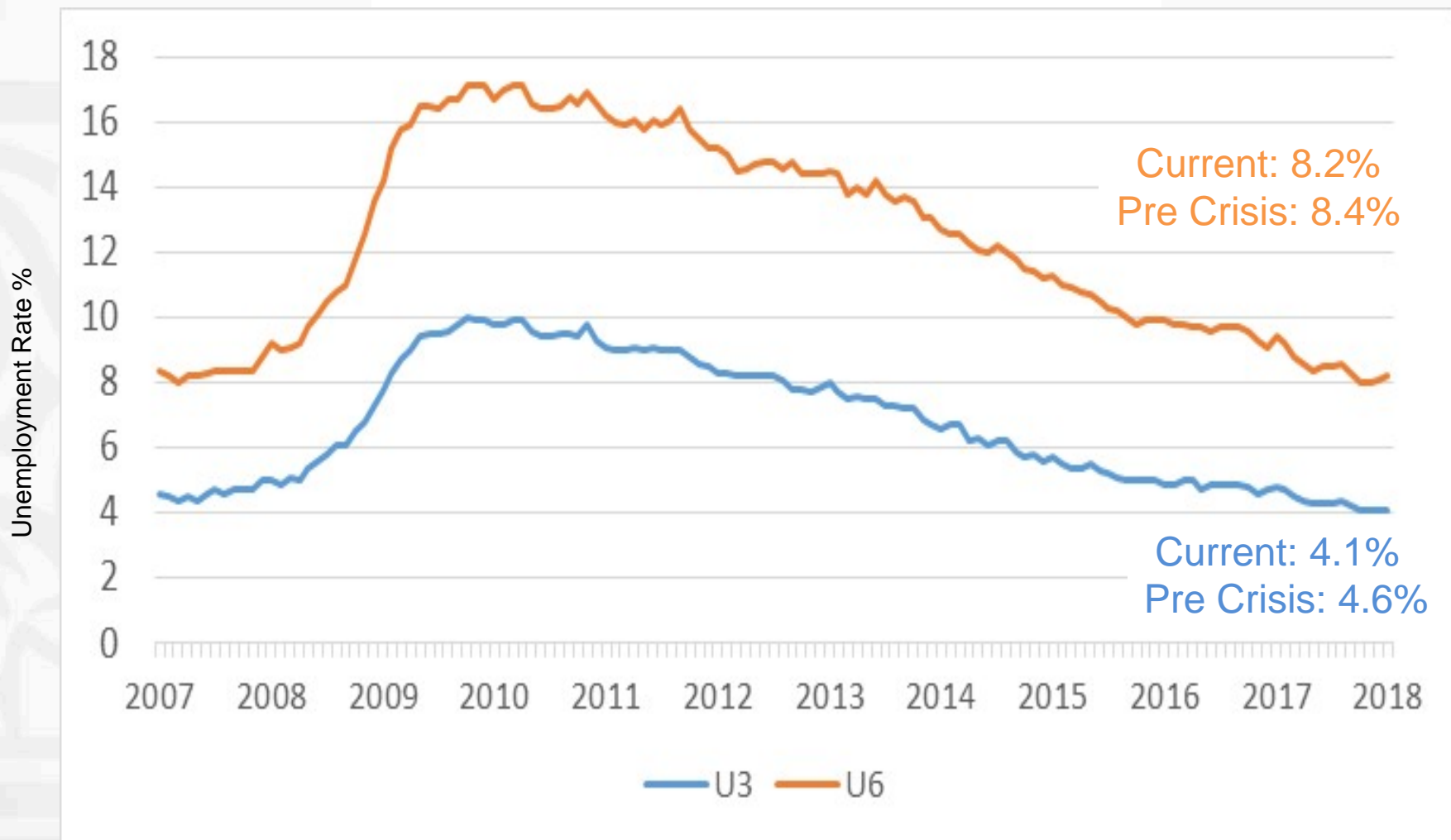


- Has The Downturn Started
- Cyclical/Idiosyncratic Risk

Capital Markets

- Transactions
- Cap Rates
- Risk Premiums

UNEMPLOYMENT RATES

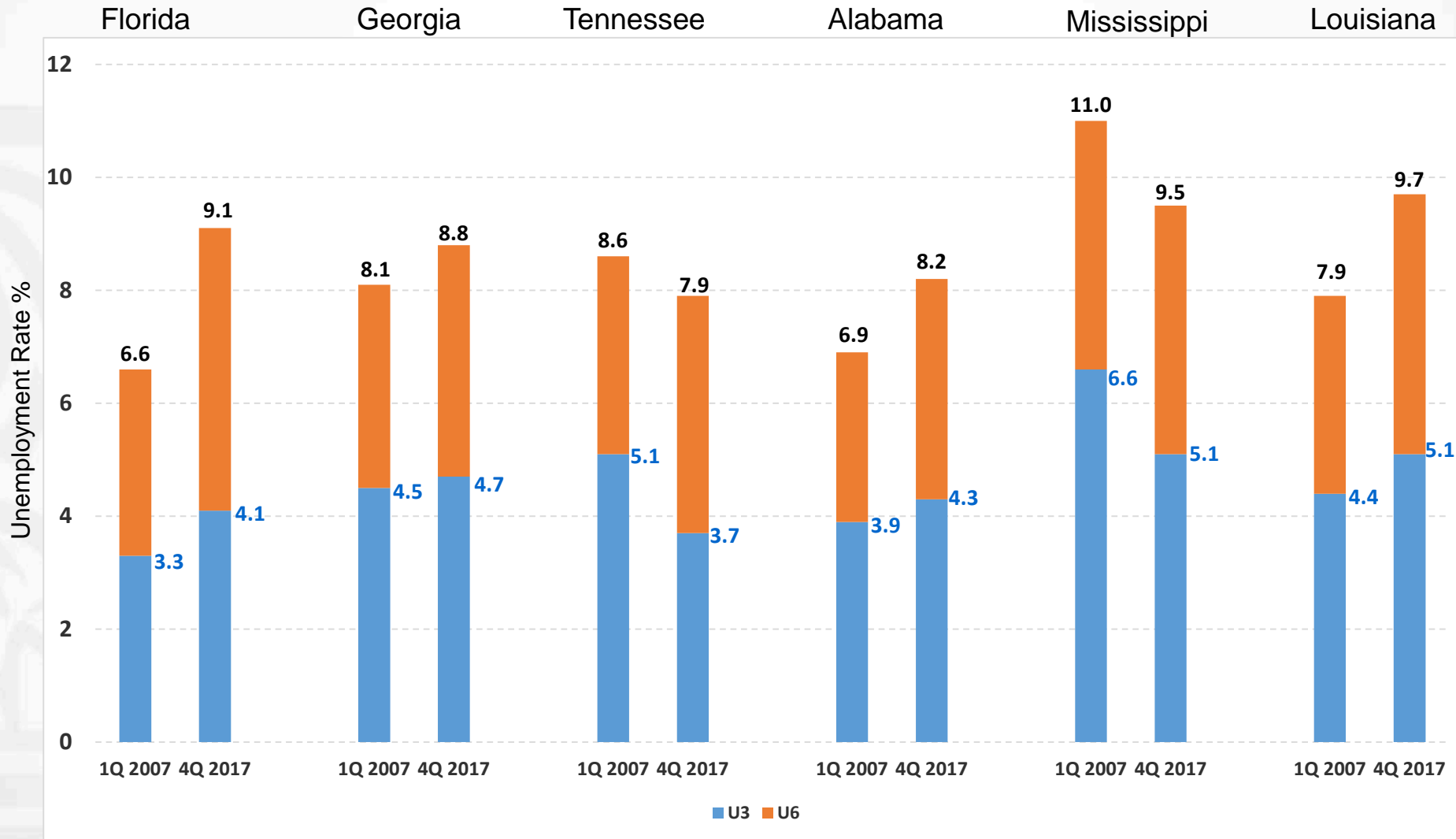


Current: As of 1/2018

Source: Bureau of Labor Statistics, STL FRB FRED

STATE UNEMPLOYMENT RATES

1Q 2007 – 4Q 2017 (%)



Data 4Q/2017

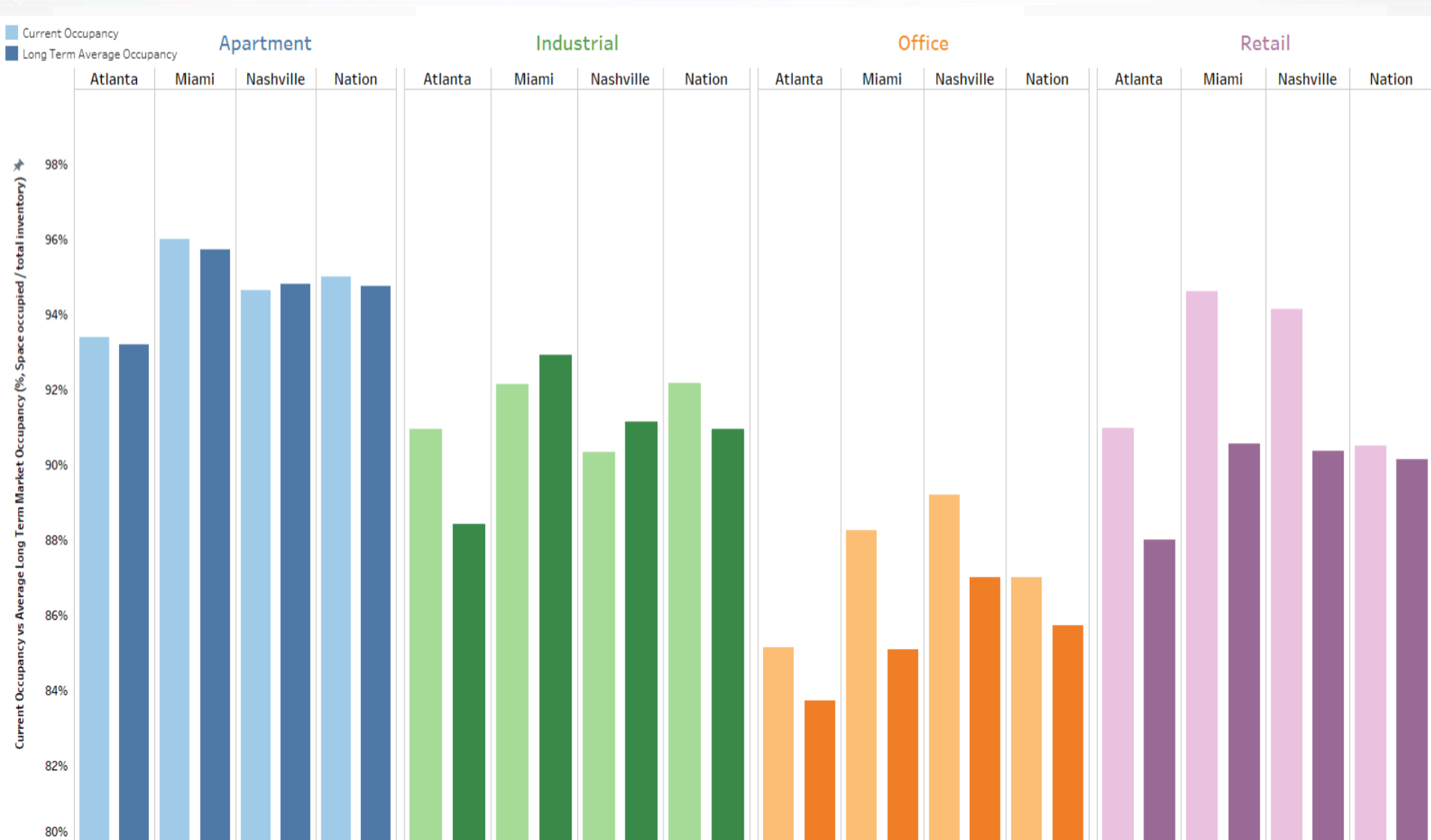
Source: Bureau of Labor Statistics, STL FRB FRED

A charcoal and pastel sketch of a city street scene. The image features several tall, dark buildings with vertical lines representing windows or structural elements. The buildings are rendered in a sketchy, expressive style. In the center of the image, there is a bright, glowing area with soft, pinkish-orange pastel strokes, suggesting a light source or a central figure. The overall composition is dynamic, with the buildings framing the central light. The text "COMMERCIAL REAL ESTATE" is centered over the image.

COMMERCIAL REAL ESTATE

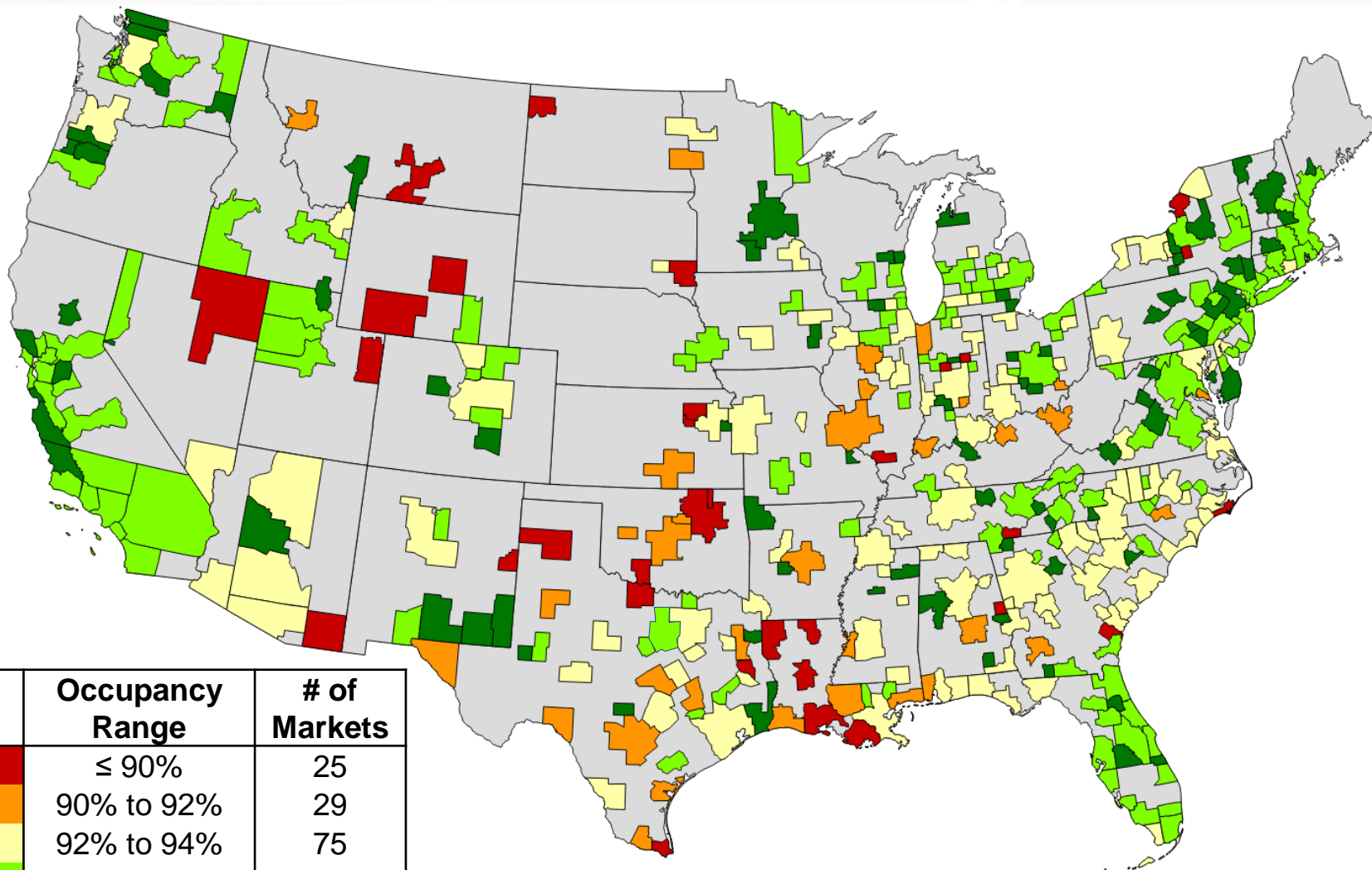
OCCUPANCY RATES

CURRENT VS. 20-YEAR AVERAGE (ATL, MIAMI, NASHVILLE, NATION)



Source: AXIOMetrics, CBRE-EA, Risk Analysis Unit/Federal Reserve Bank of Atlanta

APARTMENT OCCUPANCY RATES

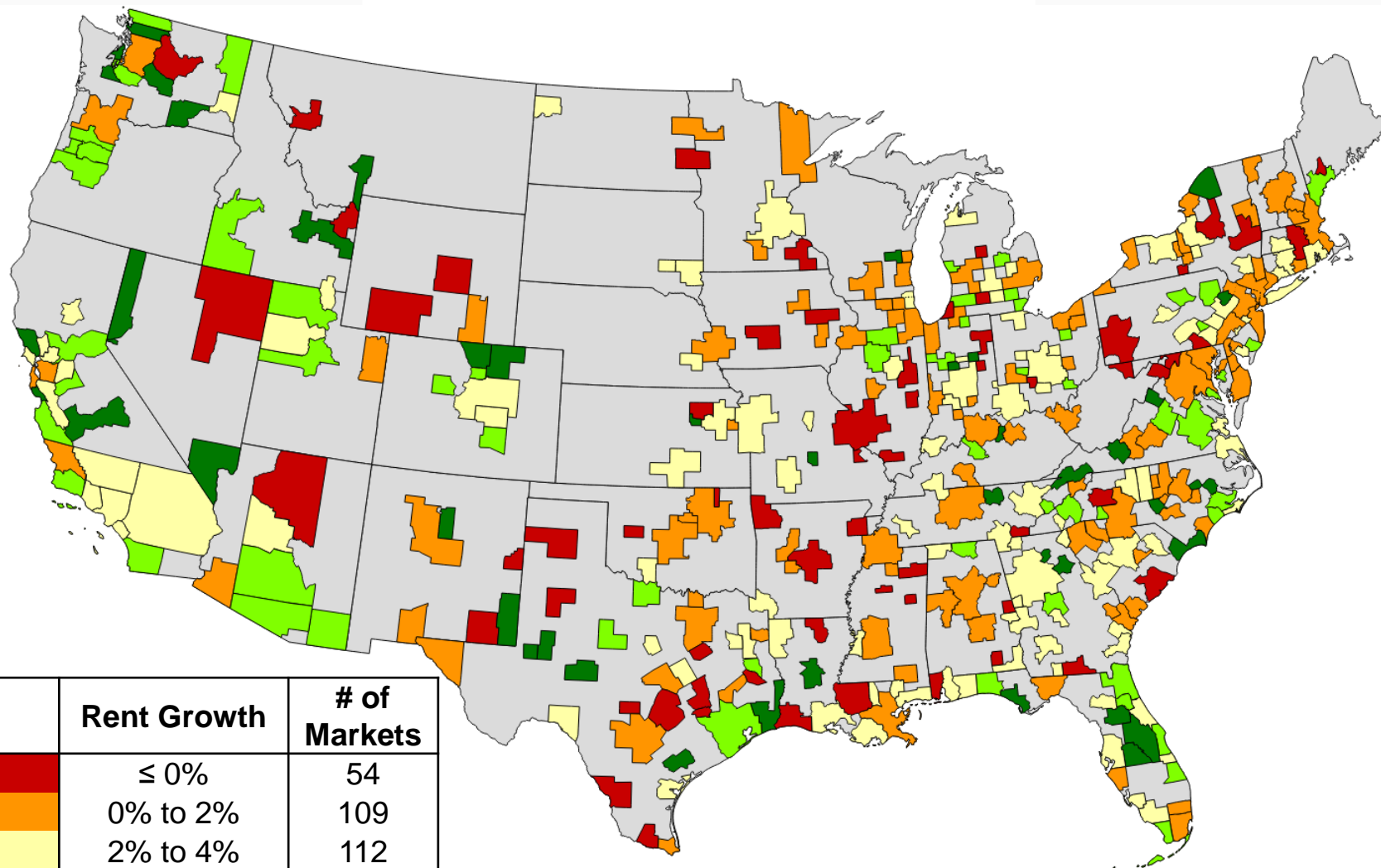


	Occupancy Range	# of Markets
	≤ 90%	25
	90% to 92%	29
	92% to 94%	75
	94% to 96%	153
	≥ 96%	106

Source: AXIOMetrics, Risk Analysis Unit/Federal Reserve Bank of Atlanta

ANNUAL EFFECTIVE RENT GROWTH

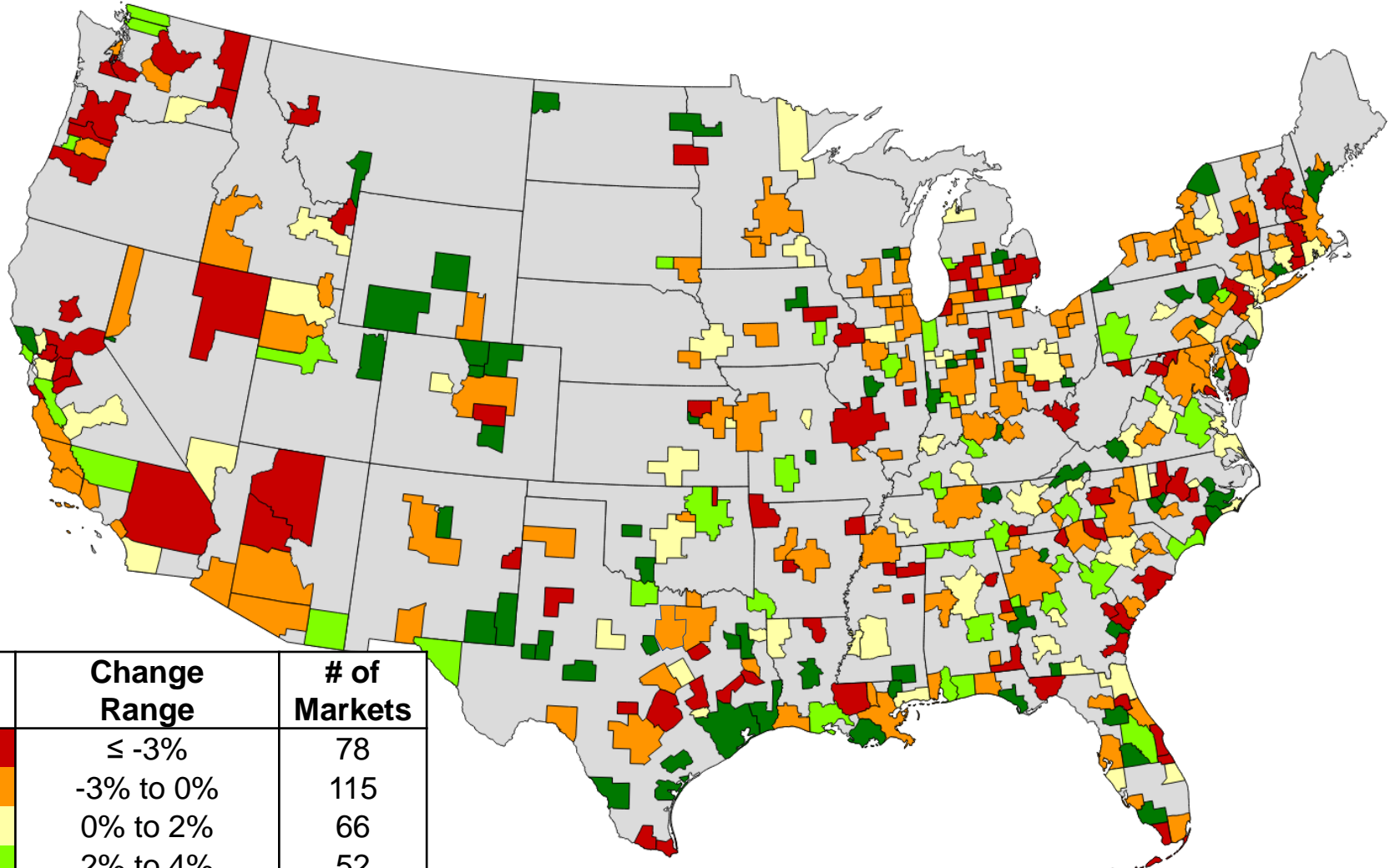
ASKING RENTS & CONCESSIONS



	Rent Growth	# of Markets
	$\leq 0\%$	54
	0% to 2%	109
	2% to 4%	112
	4% to 6%	65
	$\geq 6\%$	48

Source: AXIOMetrics, Analysis Unit/Federal Reserve Bank of Atlanta

APARTMENT EFFECTIVE RENT GROWTH & OCCUPANCY COMBINED CHANGE



**Change
Range**

**# of
Markets**

≤ -3%

78

-3% to 0%

115

0% to 2%

66

2% to 4%

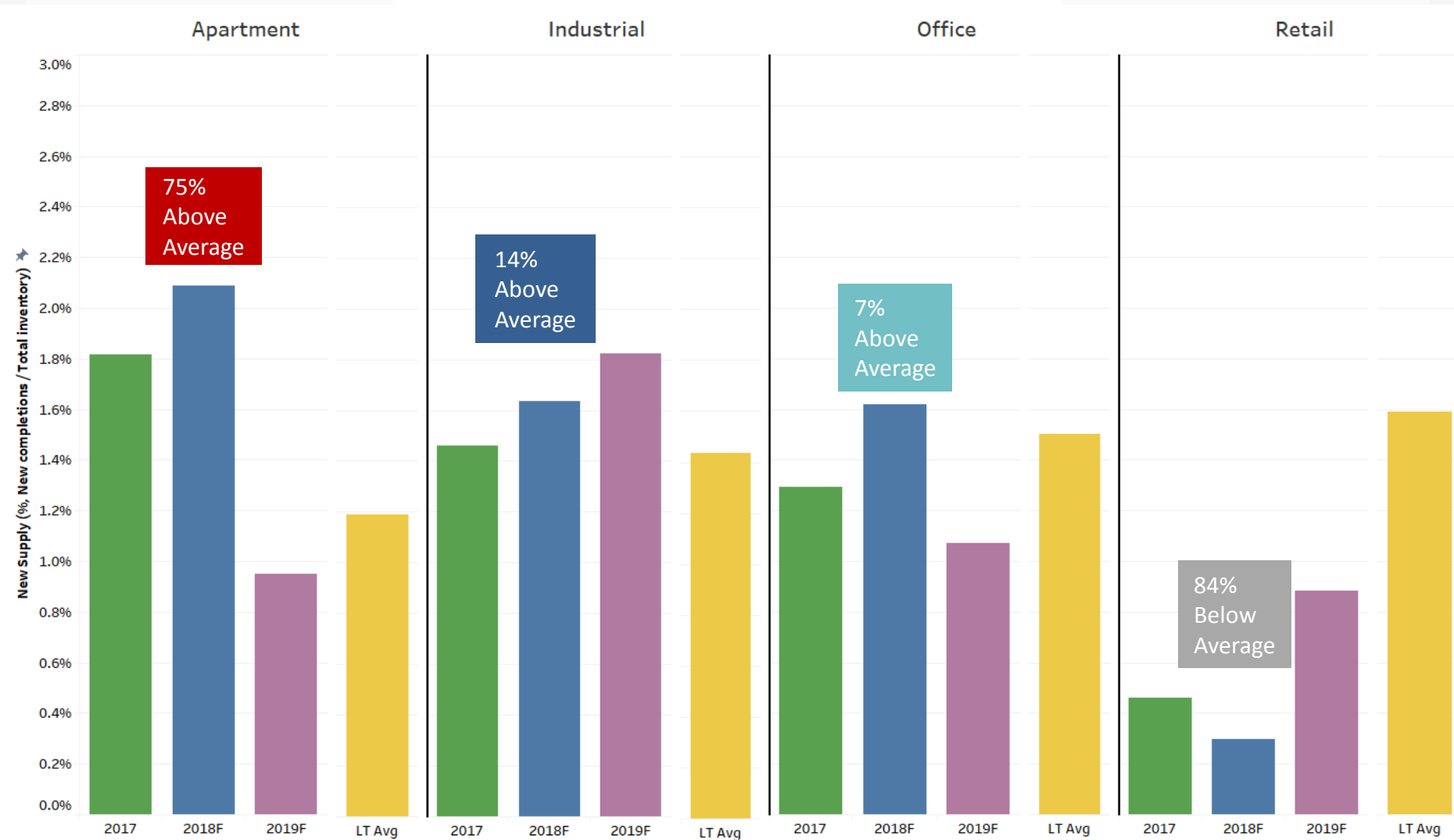
52

≥ 4%

77

NATIONAL NEW SUPPLY VS. LONG-TERM AVERAGE

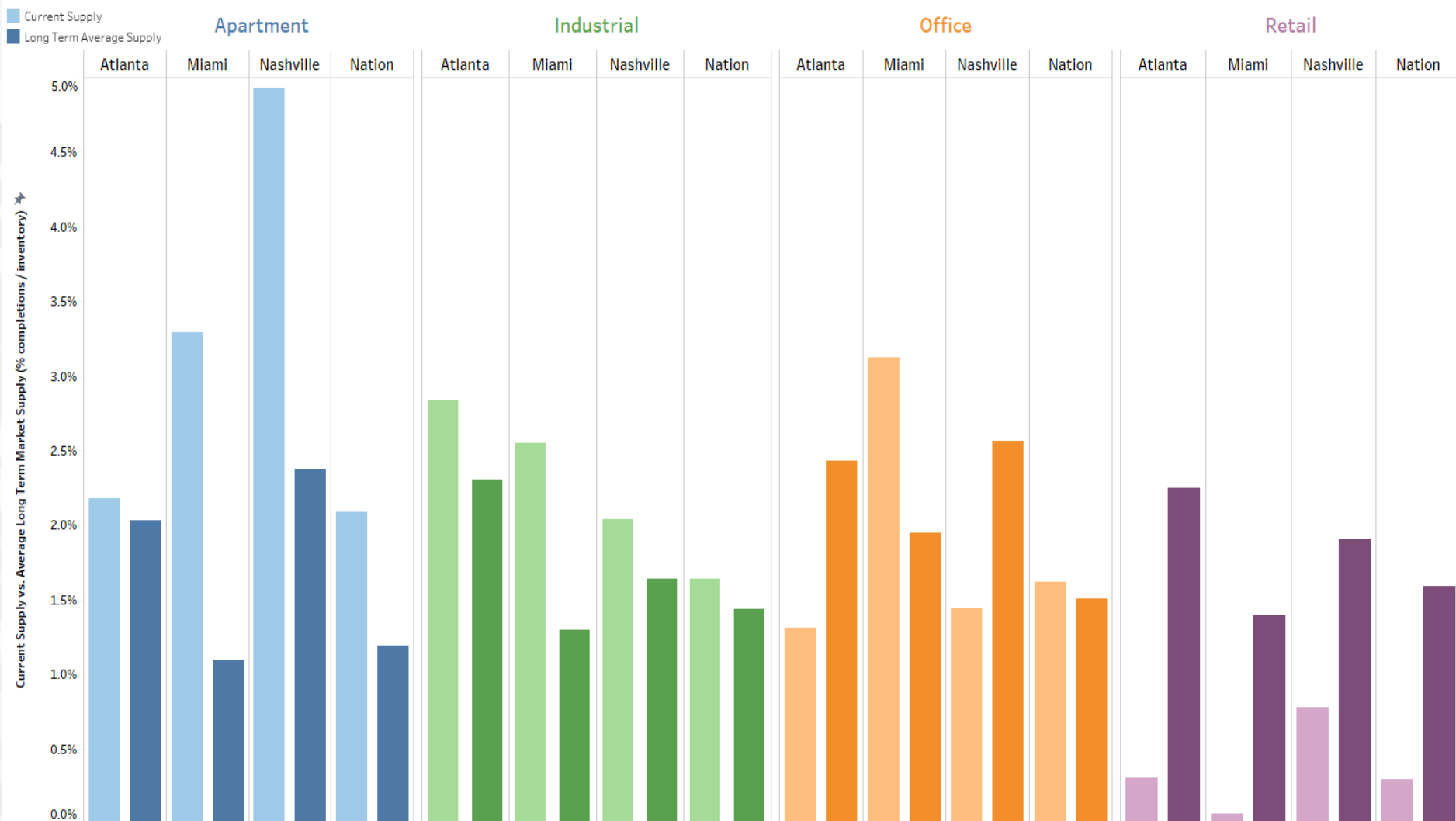
20-YEAR AVERAGES VS. 2015, 2016, 2017 SUPPLY



Source: CBRE EA, Risk Analysis Unit/Federal Reserve Bank of Atlanta

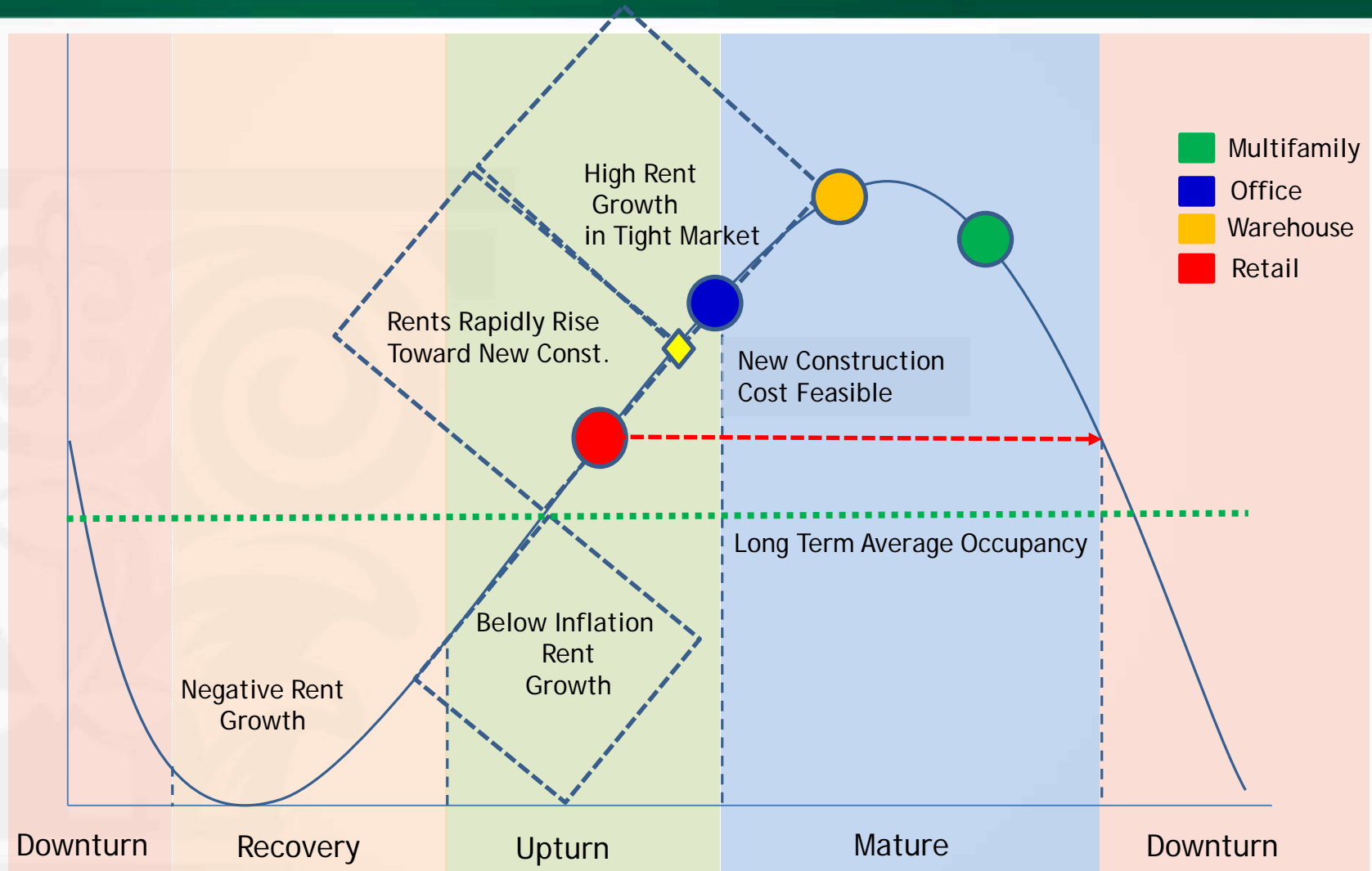
NEW SUPPLY VS. LONG-TERM AVERAGE

CURRENT UNDER CONSTRUCTION VS. 20-YEAR AVERAGE



Source: AXIOMetrics, CBRE-EA, Mueller, Risk Analysis Unit/Federal Reserve Bank of Atlanta

OUTLOOK

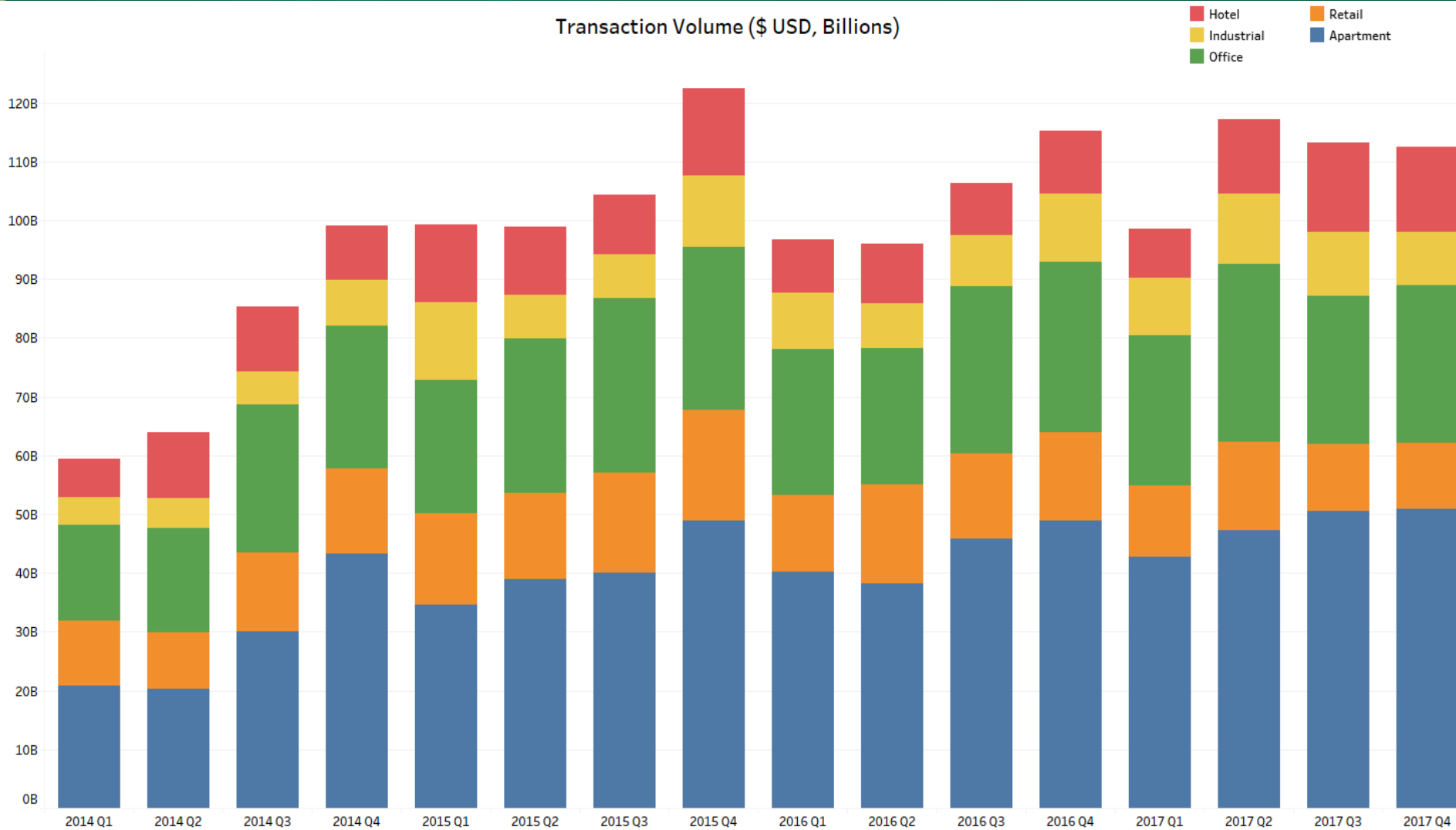


Note: Depending upon economic conditions, indicators can remain stable or reverse



CAPITAL & FINANCE

CRE TRANSACTION VOLUME

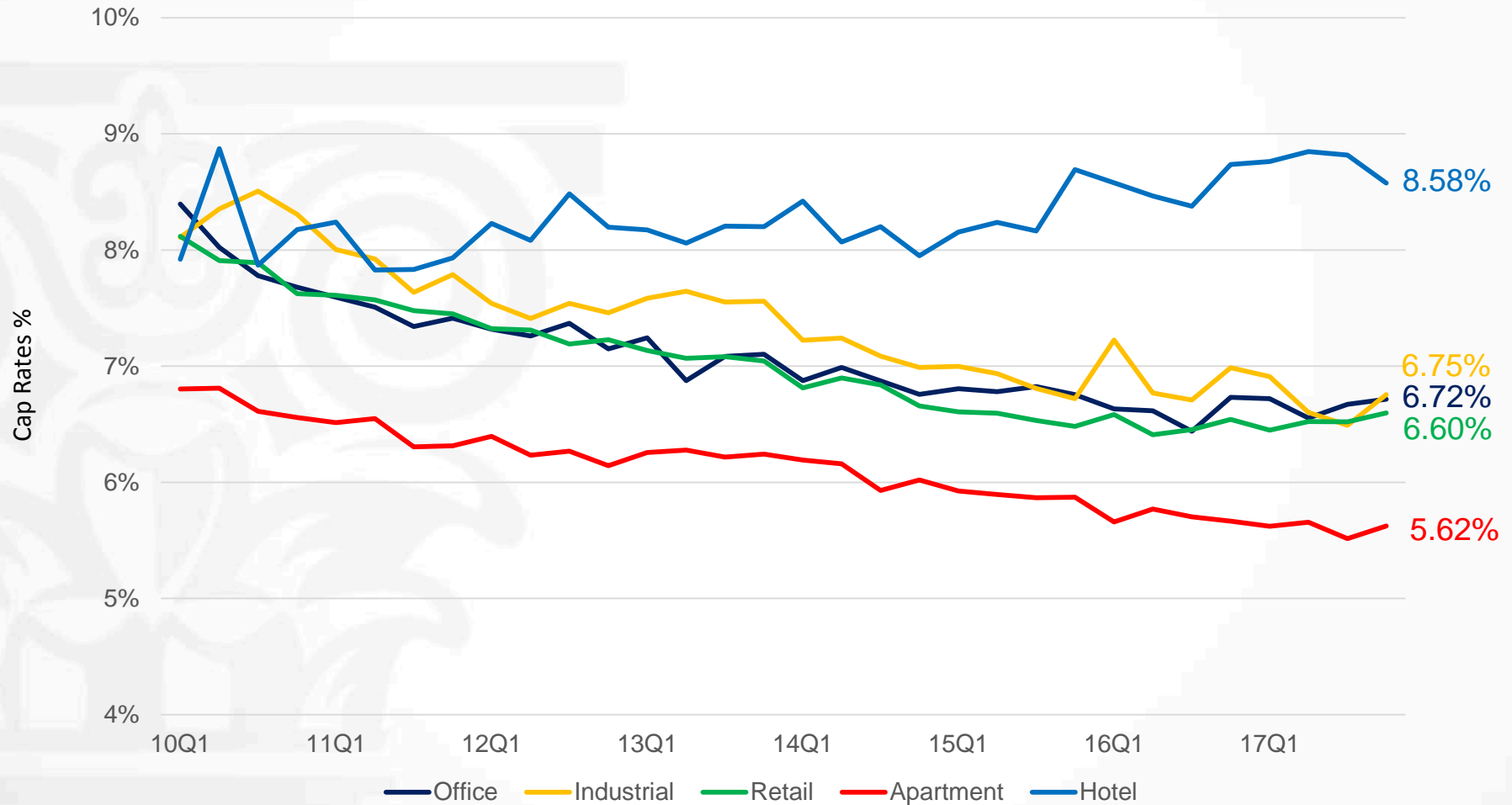


Data: Q4 2017

Source: Real Capital Analytics, Risk Analysis Unit/Federal Reserve Bank of Atlanta

NATIONAL CRE CAP RATES

QUARTERLY AVERAGES 2010-2017



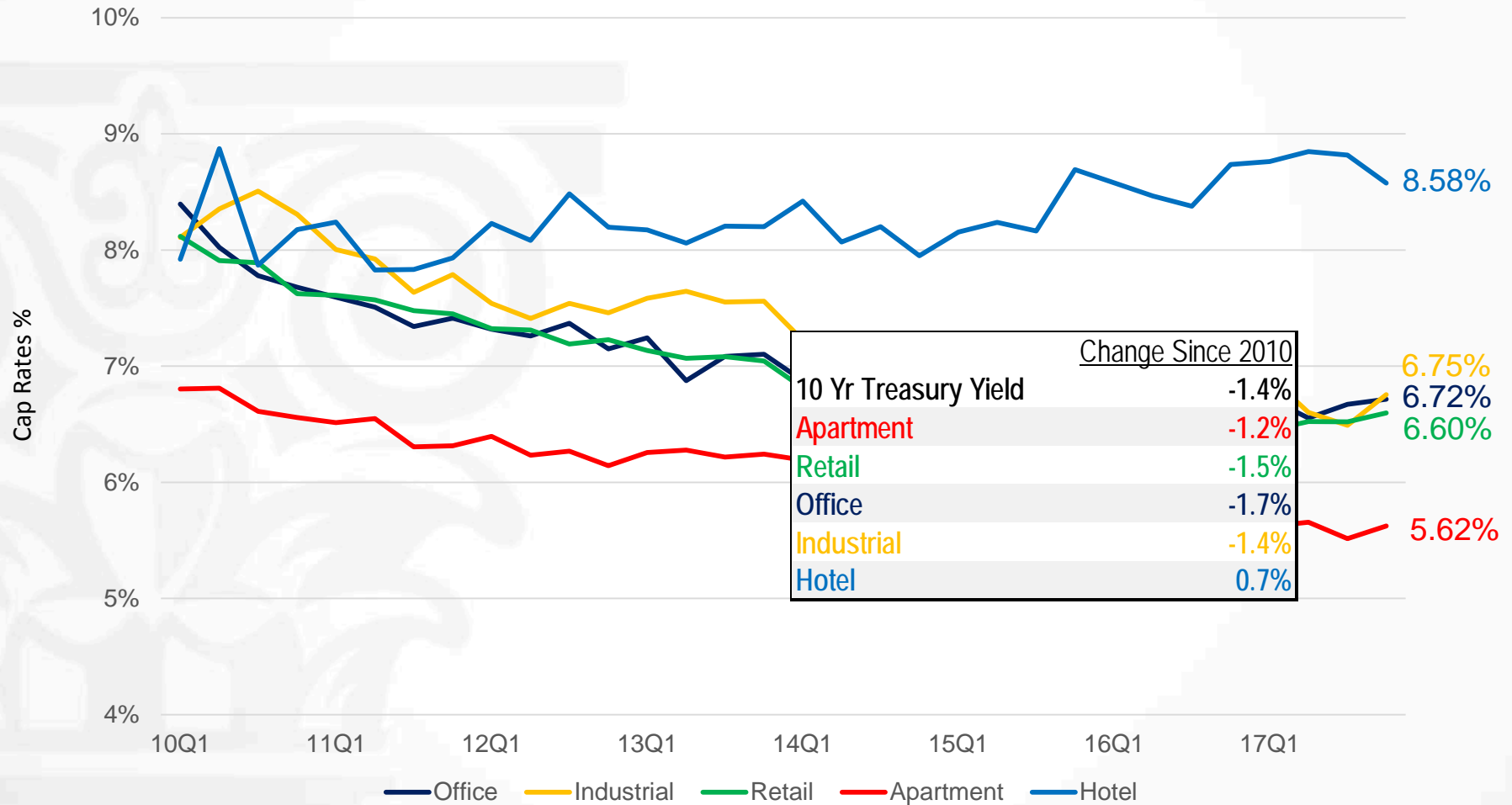
Yield 10 Yr T (10Q1: 3.83%, 174Q: 2.40%)

Data through 4Q 2017

Source: RCA, Federal Reserve Bank of Atlanta

NATIONAL CRE CAP RATES

QUARTERLY AVERAGES 2010-2017



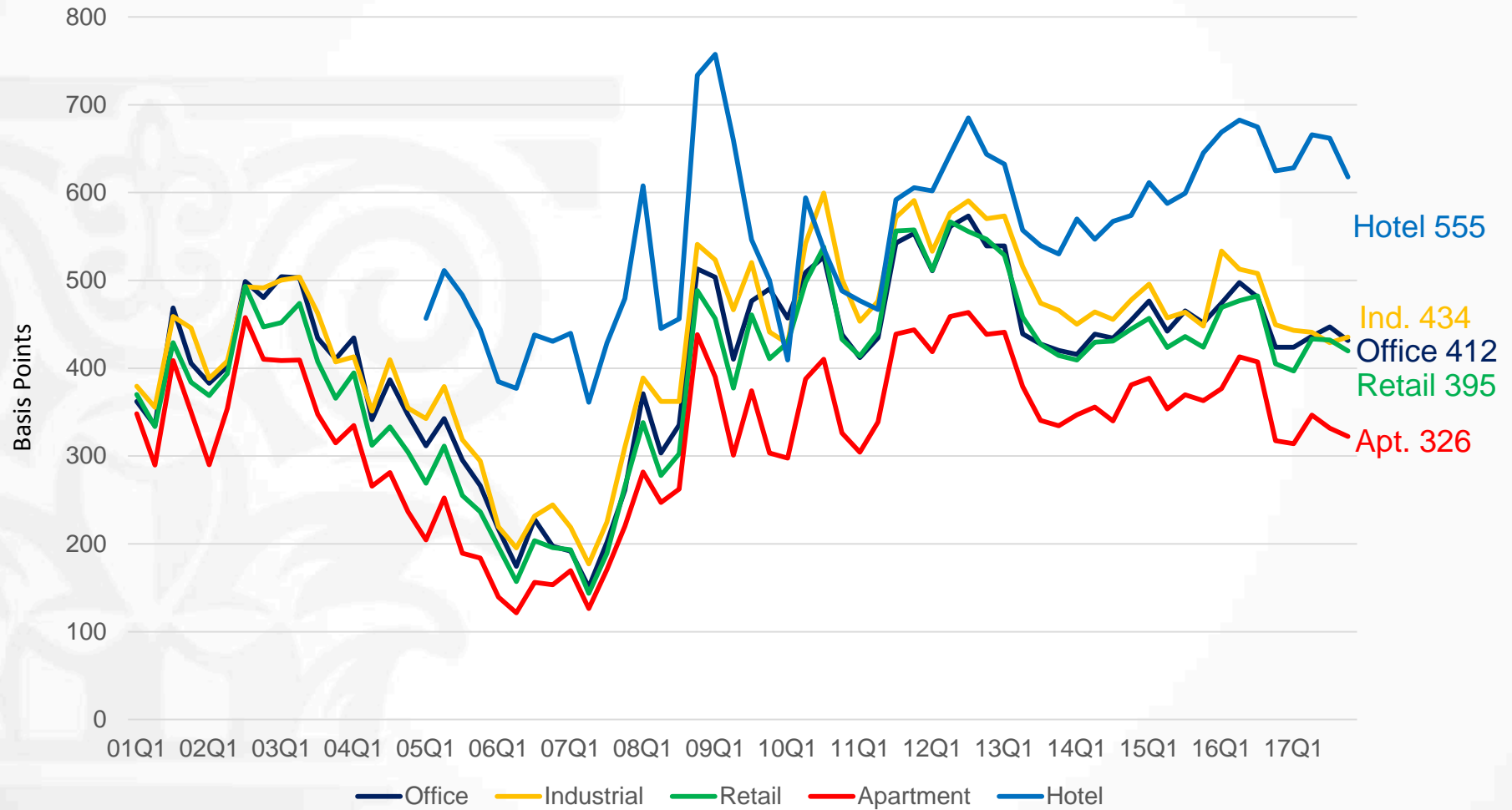
Yield 10 Yr T (10Q1: 3.83%, 174Q: 2.40%)

Data through 4Q 2017

Source: RCA, Federal Reserve Bank of Atlanta

CRE CAP RATES

SPREAD ABOVE 10-YR TREASURY



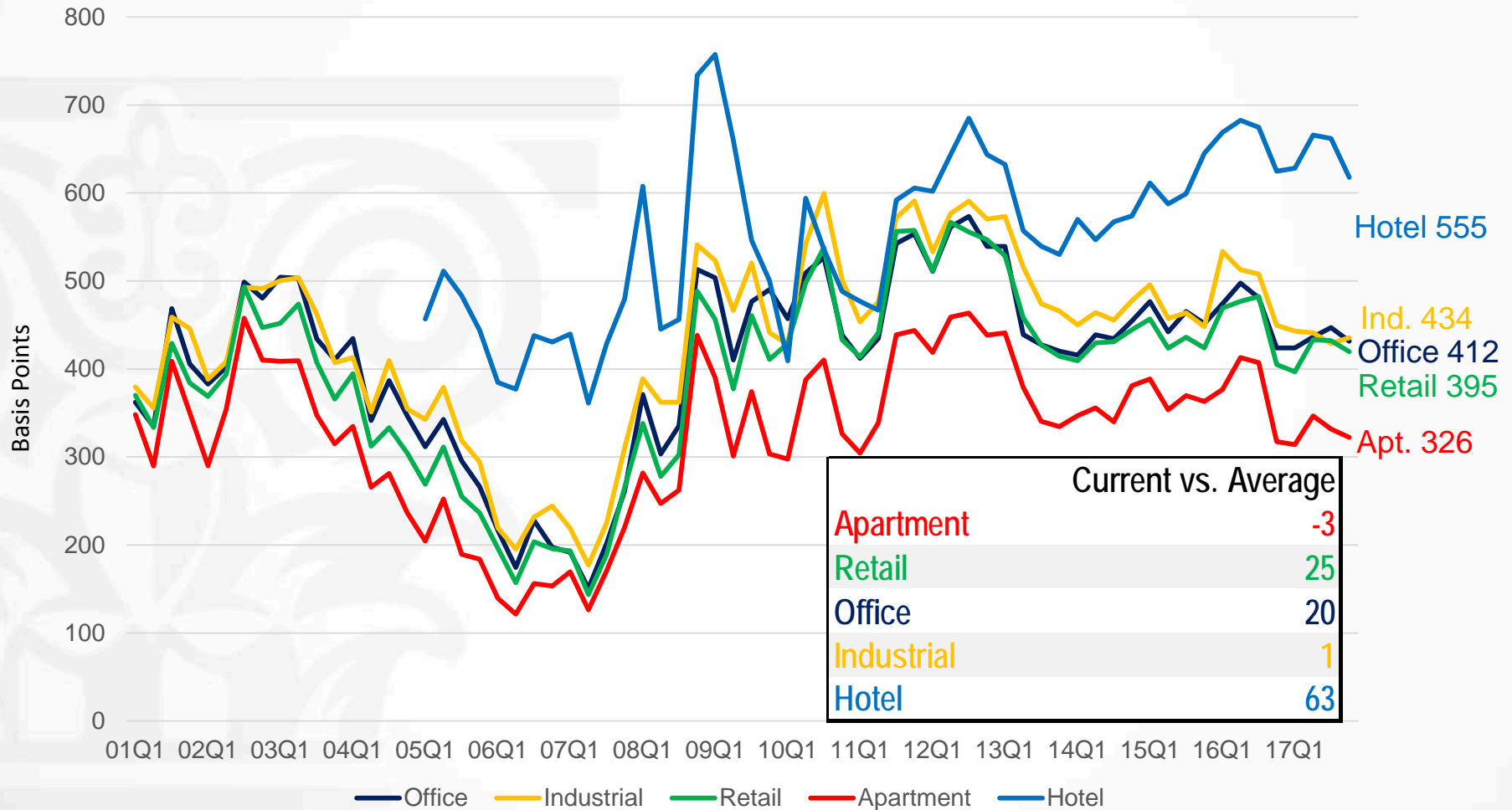
Yield 10 Yr T = 2.4%

Data through 4Q 2017

Source: RCA, Federal Reserve Bank of Atlanta

CRE CAP RATES

SPREAD ABOVE 10-YR TREASURY

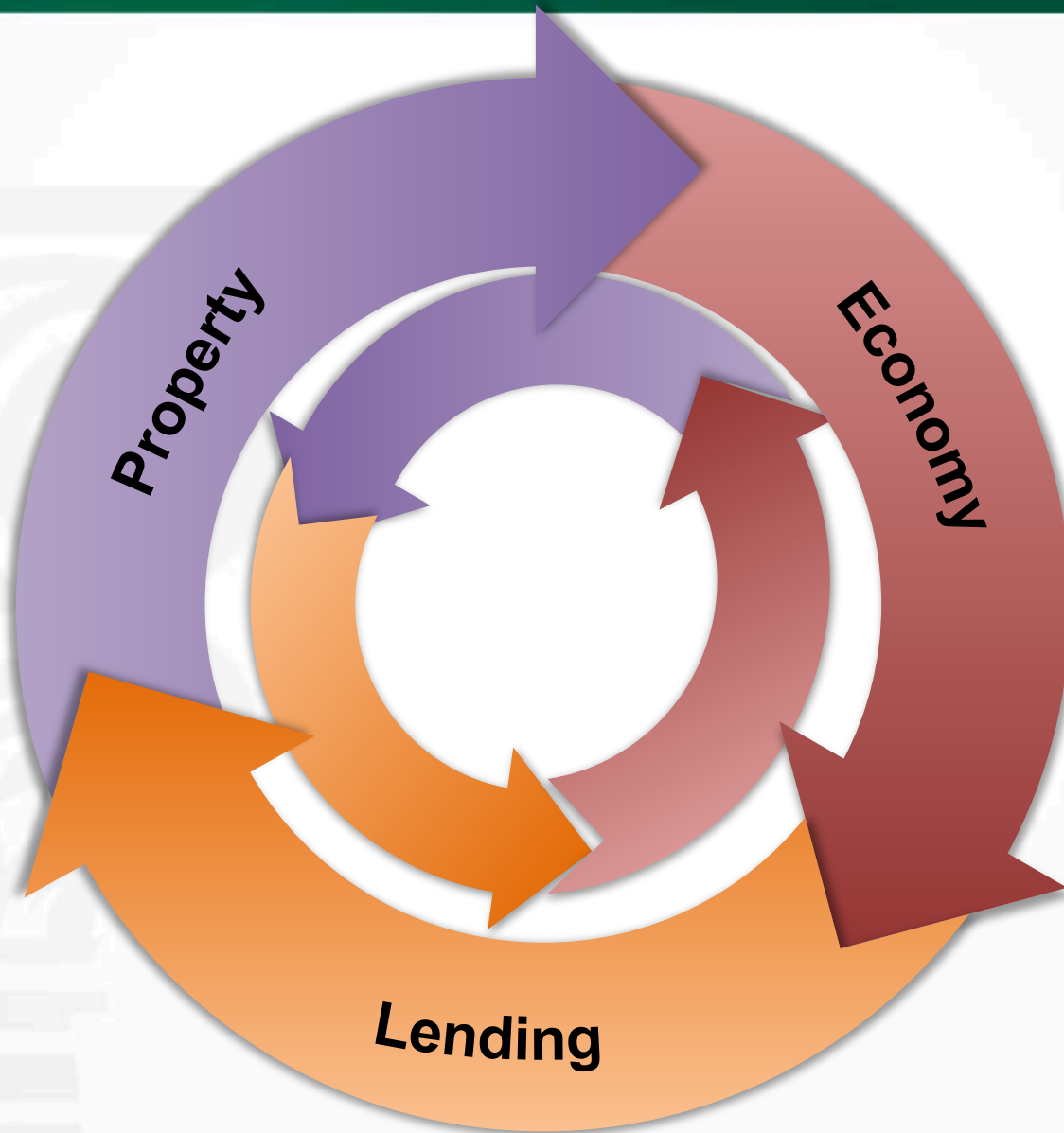


10 Yr T Yield = 2.4%

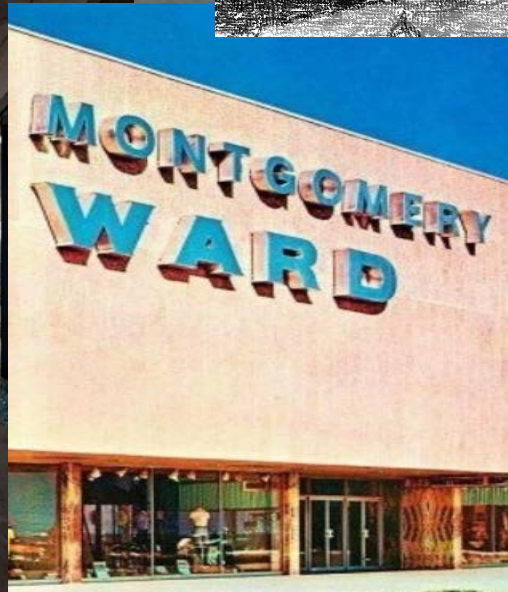
Data through 4Q 2017

Source: RCA, Federal Reserve Bank of Atlanta

THE 2008 DOWNTURN



SHIFT HAPPENS

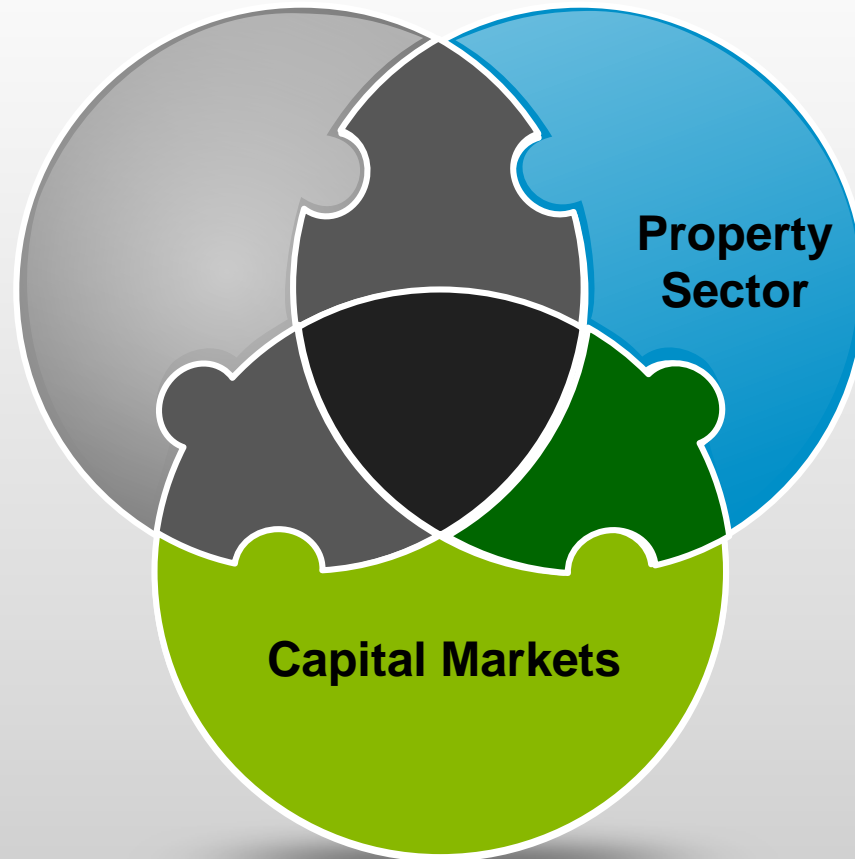


Property Sector

- Overbuilding
- Greater Efficiency
 - Amazon
- Affordability
 - Higher Rents
 - Increased Costs
- Cybersecurity

Capital Markets

- Capital Availability
- Heightened Value Levels
- Rising Cap Rates
- Reduced Regulatory Environment
- Current Prevailing Market Sentiment “What Can Go Wrong”
- Current LTV Environment



CURRENT LEVERAGE LEVELS...

A FALSE SENSE OF SECURITY?

Market participants say: *“Average loan LTV = 58%. A low leverage environment equates to safety and what can go wrong.”*

	Current	Future
NOI	\$100,000	\$100,000
Cap Rate	5.50%	7.00%
Value	\$1,818,182	\$1,428,571 (\$389,610)
Leverage @ 58%	\$1,054,545	\$1,054,545
LTV Based on New Value		74%

	Current	Future
NOI	\$100,000	\$100,000
Cap Rate	4.00%	5.50%
Value	\$2,500,000	\$1,818,182 (\$681,818)
Leverage @ 58%	\$1,450,000	\$1,450,000
LTV Based on New Value		80%

All else remaining equal, a 150 basis point increase in CRE Cap Rates moves the LTV upward notably in both scenarios.

The implications may be greater for smaller markets

Property Sector

- Enhanced Market Knowledge
- Greater Due Diligence
- Monitoring Changing Dynamics
- Actively Monitoring Concentrations
 - Property
 - Geography
 - Tenant

Capital Markets

- Stress Testing Going-In & Exit Cap Rates
- Stress Testing LTVs Against Changing Property Values
- Asking “What Can Go Wrong”

