An Optimistic Expert Thinks CRE is About to Boom

Prediction: The Fed will lower rates in the second quarter of this year.

By Joseph J. Ori

The CRE industry has been in the doldrums for the last two years due to historic interest rate increases courtesy of the Federal Reserve. The Federal Reserve raised the federal funds rate beginning in March of 2022 from 0.0% to 5.25%, where it stands today. All the pundits who predicted over the last two years that the CRE market would crash, and many community and regional banks would go under from the weight of defaulted CRE loans, have again been proven wrong. I have been steadfast in my writings and analysis that defaulted CRE loans would only be about 2% of total loans of $4.6 trillion or $92 billion and this would not crash the CRE market or banking industry.

Many market watchers are now opining that the Fed will only lower rates two or three times in the later part of 2024 and the same in 2025. I also don’t agree with this prediction and see the Fed lowering rates beginning in the second quarter of this year with the federal funds rate at 4%-4.25% by the end of this year and at 3.0%-3.5% by the end of 2025.

Even though a drop in the funds rate of 1.0%-1.25% is not huge, it will be a significant catalyst for a mini-boom in the CRE industry in the last half of this year. If rates are lowered further in 2025, an even bigger boom will arrive in CRE similar to the market in 2012 and at the tail end of the Great Recession. There is so much pent-up demand right now to do deals and with over $150 billion sitting idle in real estate private equity funds, there is ample capital to buy distressed real estate assets and loans. The entire brokerage community that has made very little money during the last two years will be aggressively doing deals. Since the Fed began raising interest rates, transaction volumes in the CRE industry have dropped 70%. Sales, leasing, and financing transactions in the next two years will skyrocket. Developers will also seek to start the new development projects that were mothballed the last two years and skittish banks, and other regulated lenders will again seek to fill their coffers with new loan applications. The shadow or unregulated lenders who have increased their market share of total loans to about 10% in the last few years will also be aggressively seeking new loan deals and will fill any void left open by the regulated lenders.

Even institutional investors like pension funds, endowments, and sovereign wealth funds with billions in funds earmarked for CRE that have been dormant the last two years will be back in the market seeking to place new funds. The REIT industry which has seen the FTSE-NAREIT All Equity Index fall 24.95% in 2022, increase 11.36% in 2023 and fall 4.86% through January of 2024, will see total returns of 6%-8% in 2024 and 20%+ in 2025. Distressed sales will be a key sector during this boom, especially office assets in high-crime urban cities around the country. Investors should also seek senior housing investments as this sector, which was much aligned during the pandemic, has made a strong comeback in rental rates and occupancy and there is a dearth of capital in this sector. All CRE market participants need to sharpen their pencils and get ready for this upcoming boom as great investing opportunities will abound.