Where Are CRE Investors Investing?

lending CRE

Summary: After initially suffering a severe setback as a result of the pandemic, some areas of the commercial real estate (CRE) market are recovering more strongly than others. Notably, offices, multi-family, and certain niche sectors are looking optimistic. The outlook for subsectors like hotels and retail remains less certain.

John F Kennedy once said that the Chinese use two brush strokes to write the word "crisis" — one signifying danger and the other opportunity. While this interpretation may not be totally accurate, the sentiment behind his quote holds true — where there is crisis, there is opportunity.

With the pandemic and subsequent economic crisis, this has shown to be true in some commercial real estate (CRE) sectors more than others. While inflationary pressures could continue along with labor and supply chain shortages, this year points to several positive signs for CRE customers and the community financial institutions (CFIs) that support them.

CRE investment ramping up, but varies geographically

Despite ongoing market pressures, a Trade & Industry Development report indicated a strong appetite for investment in CRE. Private equity funds are raising significant capital for deployment across the CRE sector, although transaction volumes are recovering only slowly.

Most of the highest-ranked real estate markets are now in the faster-growing southern and western regions of the US, away from the coast. Meanwhile, the larger, more expensive cities traditionally favored by investors are slipping, including Los Angeles, Washington DC, and San Francisco. CFIs should watch for growth opportunities for their CRE customers and prepare to support them where needed.

Here is the **latest update on CRE investment in five sectors**.

1. **Office resurgence in niche markets and newer spaces**

Despite the shift in normal working practices and space requirements, there are signs the office market is growing in confidence. Tech-friendly cities like Austin and Nashville are doing well, with technology and financial services firms particularly keen to sign up. Nationally, big tech continues to be the dominant driver for leasing.

Newer buildings are particularly in demand. Nearly 25% of new leasing activity is for properties built after 2015. There is likely to be continued interest in higher quality, modern spaces with excellent facilities and a strong preference for newly delivered or under-construction buildings. Tenants' demand for floorspace largely depends on whether they need more room for social distancing or less due to hybrid working. It's also likely lease terms will continue to be slightly shorter than pre-pandemic. Now is a good time to have follow-up conversations with your CRE customers on tenant quality, lease terms, and expectations for growth.

2. **Urban apartments in demand**

Investors are rushing to buy downtown apartment properties in the largest US cities, along with high-rise and mid-rise apartment properties in urban areas, pushing up rents. This trend is likely to become stronger in 2022. Analysts predict multi-family housing in coastal cities will see a full recovery and sustainable growth across the US. The relatively new real estate model of build-to-rent, consisting of homes in professionally managed communities, could also prove attractive to some investors. This may be an area of opportunity your customers are considering.

3. **Rise in specialized real estate**

Some niche real estate markets could attract continued investment. Higher-end, off-campus student accommodation is booming, driving huge interest from buyers and developers. The continued growth of e-commerce is increasing interest in both dry and cold storage facilities. Meanwhile, properties suitable for use as data centers are highly sought after by cloud services providers to meet growing demand. The pandemic-accelerated growth in streaming services is also driving interest in the production studio market. The development of more specialized CRE will likely depend on certain geographic areas. Watch for growth in these areas in your community.

4. **Mixed picture for hospitality**

Opinions vary on the outlook for the hotel sector. Forbes argues those catering to business travelers will see an accelerating recovery as business travel and conventions start up again. But despite encouraging increases in hotel transactions and loan activity levels, some observers fear investors may be overpaying for hotel real estate that may not deliver the returns hoped for in 2022-23. If you have CRE customers in hospitality, you will want to discuss their plans with them in detail.

5. **Retail not out of the woods**

Following the return of consumers to brick-and-mortar retail, demand for grocery-anchored centers with strong sales and long-term tenants has stabilized. However, some observers foresee B- and C-grade malls continuing to suffer, with a likely increase in business foreclosures and bankruptcies.

Many will need to adopt new strategies, such as converting retail units to industrial space or repurposing them as multi-family properties. The transformation of retail real estate into logistics distribution centers is less likely, but more Apple or AmazonGo stores may appear in optimal positions in A-grade malls. Similar to the hospitality segment, landlords will need to have good plans in place where activity may be less robust.

Overall, the CRE sector is expected to carry on performing strongly in 2022. CFIs are well-positioned to continue to be the dominant financing source. In fact, almost half of community bank leaders expect their profitability this year to be driven by CRE revenue streams. Yet, uncertainty still remains. So, CFIs should review their CRE strategies, including how they price their debt, to come out on top.

EXCESS LIQUIDITY? WANT TO INVEST?

ECONOMY & RATES

Rates As Of: 02/23/2022 03:30PM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.34	0.12	0.28
6M	0.74	0.25	0.55
1Y	1.15	0.36	0.76
2Y	1.60	0.42	0.87
5Y	1.91	0.30	0.64
10Y	1.99	0.21	0.48
30Y	2.30	0.19	0.39

FF Market	FF Disc	IORB
0.08	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.07