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OP-ED: Commercial real estate's appeal still great

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Ever since the Great Recession of 2008, investors have been patiently waiting for secondary markets to rebound while so many private-equity real estate funds have plummeted. Fast-forward to today and Portland is a rising star with a robust local economy. Consistent job gains and low mortgage rates lifted home sales for most of 2015, despite the fact that skyrocketing home values and limited inventories have temporarily stalled growth as we enter 2016.

Nationally, current economic conditions like low interest rates and ever-increasing uncertainty abroad have made commercial mortgages a prudent investment. Though interest rates have increased this month for the first time in almost a decade, Federal Reserve Chairwoman Janet Yellen has cautioned against any aggressive increase in rates, citing that doing so would undermine economic expansion and necessitate a lasting return to low interest rates. As such, banks wanting to make fees are especially motivated to take advantage of low interest rates right now. Life companies, which make loans as stocks and bonds alternatives, are also proactive in the market because commercial mortgages are relatively stable in comparison to volatile foreign markets and geopolitical turmoil.

Over the past 18 months in particular, institutional investors have flocked to Portland, making the market flush with capital. Lenders are busy too, financing a myriad of assets and future projects. Since the city's healthy economy is further supported by the rebounding national economy, Portland isn't slowing down anytime soon. These conspiring, favorable conditions suggest that 2016 is looking more and more likely to surpass 2015's impressive volume of commercial real estate activity.

In the initial wake of the Great Recession, many underwater commercial assets or transitional properties were recapitalized through private-lending sources with the long-term strategy of attaining conventional financing after stabilization. Transitional properties are loosely defined as having capital, maintenance or location issues, and these properties most definitely bore the brunt of the economic downturn.

Over the past few years, however, the strengthening economy has created increasing opportunities for these distressed properties to secure financing. As such, private lenders are ready to work with building owners to regain the true value of these types of properties. Cash-out refinances can help existing properties compete in today's market, and there is equity available for solid construction projects too.

Yet, not all transitional property types are out of the woods. A massive number of loans underlying commercial mortgage-backed securities (CMBS) will mature over the next few years and spur tremendous refinancing demand. CMBS issues peaked prior to the Great Recession between 2005 and 2007. According to a report by Trepp LLC, a provider of information and analytics to the CMBS, commercial real estate and banking markets, 10-year balloon terms were attached to a majority of these loans, thus causing a domino effect of maturities set to begin in 2016 and carry through 2017. Trepp LLC also reported that an excess of $300 billion in CMBS loan balances are scheduled to mature, which is more than double the amount that matured between 2012 and 2014.

Transitional properties that have maturing CMBS loans may not qualify for refinancing or a permanent loan due to the asset's risk in the market. As a possible solution, bridge loans are short-term loans that bridge the gap between loan types, and are particularly useful for transitional properties. As such, bridge loans are expected to increase steadily over the next three years.

Local forecast

With only a couple of weeks remaining in 2015, it's safe to say that this has been a banner year for Portland's commercial real estate industry. Leasing and sales activity remains strong for all property types, driving price appreciation to near record highs. Demand continues to outpace Portland's limited supply, but citywide construction is also on the rise. New construction across all sectors is motivated by low vacancy rates, which in turn enables consistent higher rents.

Though multifamily assets have led rental growth for both urban and suburban markets, all property types have experienced significant increases, which has sparked considerable development across the metro area. Current development and proposals are also fueled by Portland's rapid ascension as a prime West Coast destination, both as an enviable lifestyle attraction as well as an employment epicenter rich in talent and culture. The combined population and employment growth of late is a credit to millennial and baby boomer transplants and major employers opting to relocate or expand in the Pacific Northwest. As a result, this tremendous, dual momentum of in-state migration and employer growth has thrust Portland into the global spotlight.

Capitalization rates for core assets and markets remain at historical lows, but will likely taper off and slowly increase in 2016. As cap rates edge up, the main driver for valuation growth will be increased rents. Portland's frothy multifamily market is testament to this fact. Deterred by steep down payments for single-family homes in conjunction with paying higher multifamily rents, potential homebuyers, particularly would-be first-timers, are delaying purchases. As a result, the multifamily market shows no signs of slowing and investors who are chasing yields are eyeing Portland as a viable alternative to top-tier markets.

Overall, the commercial real estate lending market is anticipated to have another strong year in 2016. I do believe that interest rates will increase over the duration of 2016, but barring any unforeseen macroeconomic event, I believe it will be a modest increase. Underwriting standards have relaxed a little over the past few years, but will continue to be guided by the fundamentals of a specific asset. If nothing else for 2016, both lenders and investors are sure to keep a strong appetite for commercial real estate, especially for Portland's seemingly unstoppable tour de force.

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