

CONVERSATIONS
WITH THE ST. LOUIS FED



FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL TO AMERICA'S ECONOMY®

September 11, 2018

11:00AM to 12:00PM CST

Commercial Real Estate: 2007 déjà vu?

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 - **Via webinar chat:** You can submit a question via the **Q&A Panel** in the webinar tool. Your question will only be seen by our presenters.
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Today's Presenters

- **Julie Stackhouse**
Executive Vice President
Federal Reserve Bank of St. Louis
- **Brian D. Bailey, CRE, CCIM**
Subject Matter Expert, Commercial Real Estate
Federal Reserve Bank of Atlanta



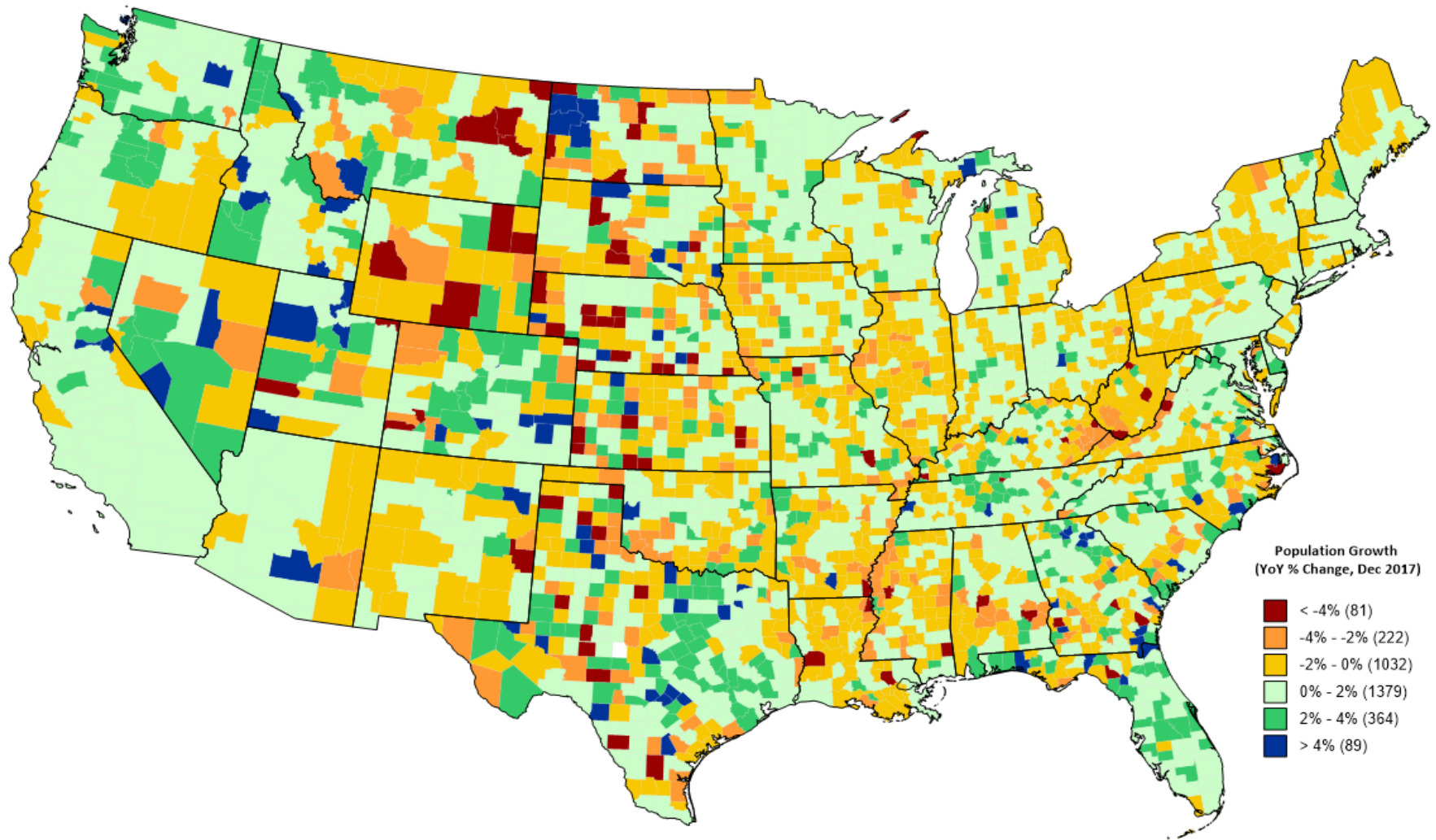
Disclaimer

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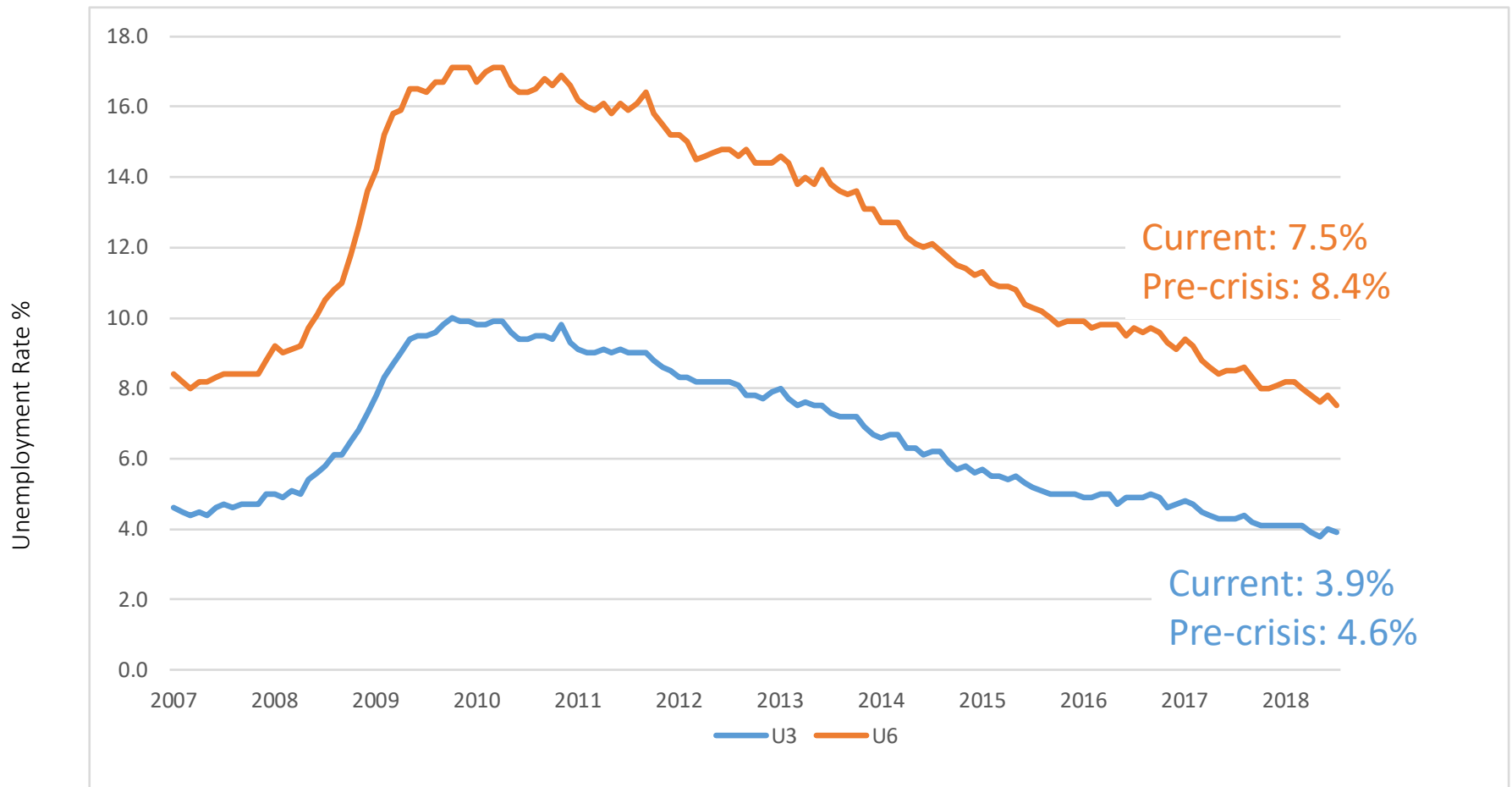
Commercial Real Estate...2007 déjà vu?

- **Macroeconomic Conditions**
 - **Population Growth**
 - **Unemployment/Job Growth**
 - **Home Mortgages/Appreciation**
- **Commercial Real Estate (CRE) Conditions**
 - **Good/Solid Fundamentals**
 - **Change Will Do You Good**
- **CRE Finance Conditions**
- **Why It Matters**

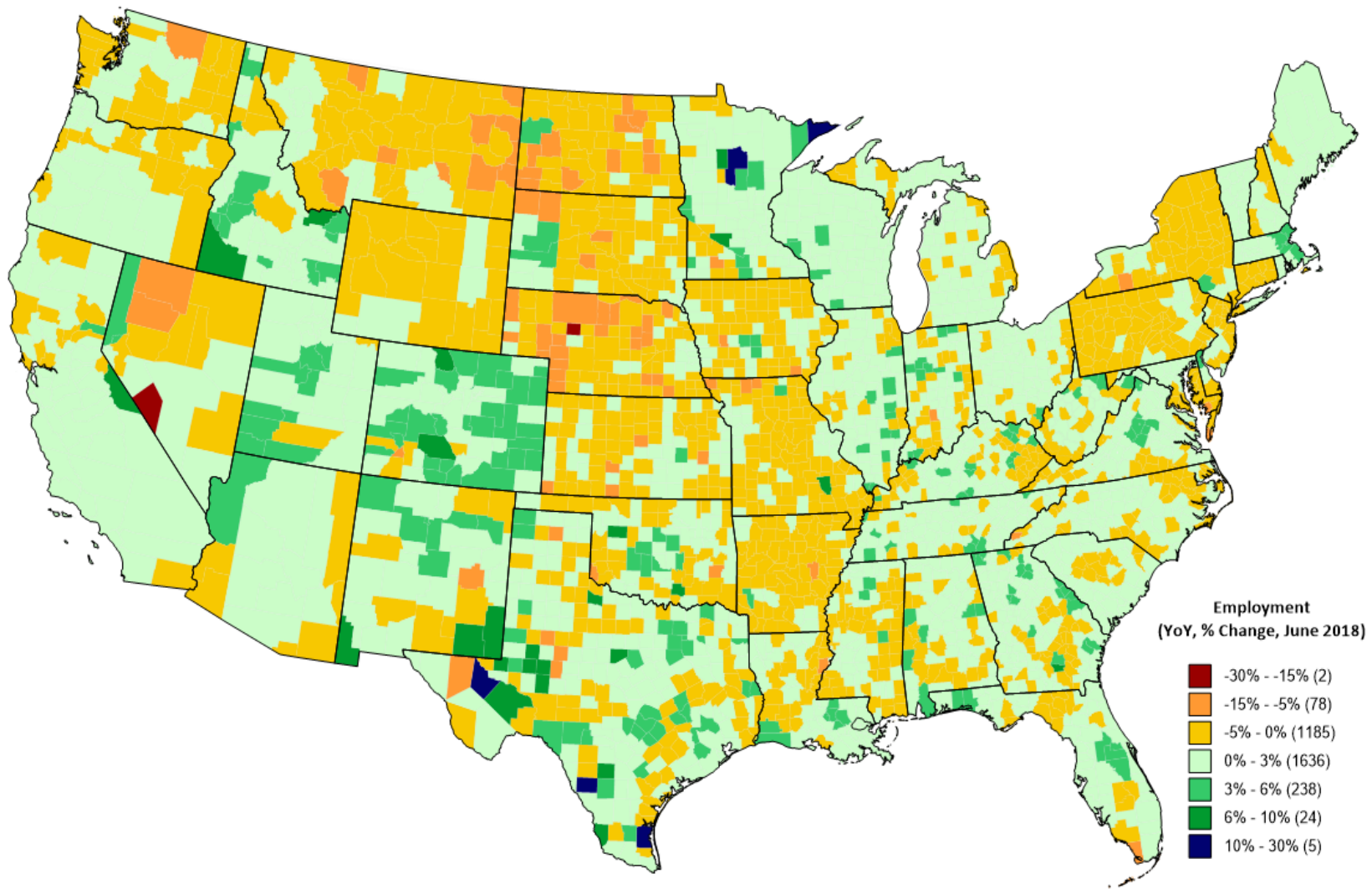
Population Growth, 2017 YOY%



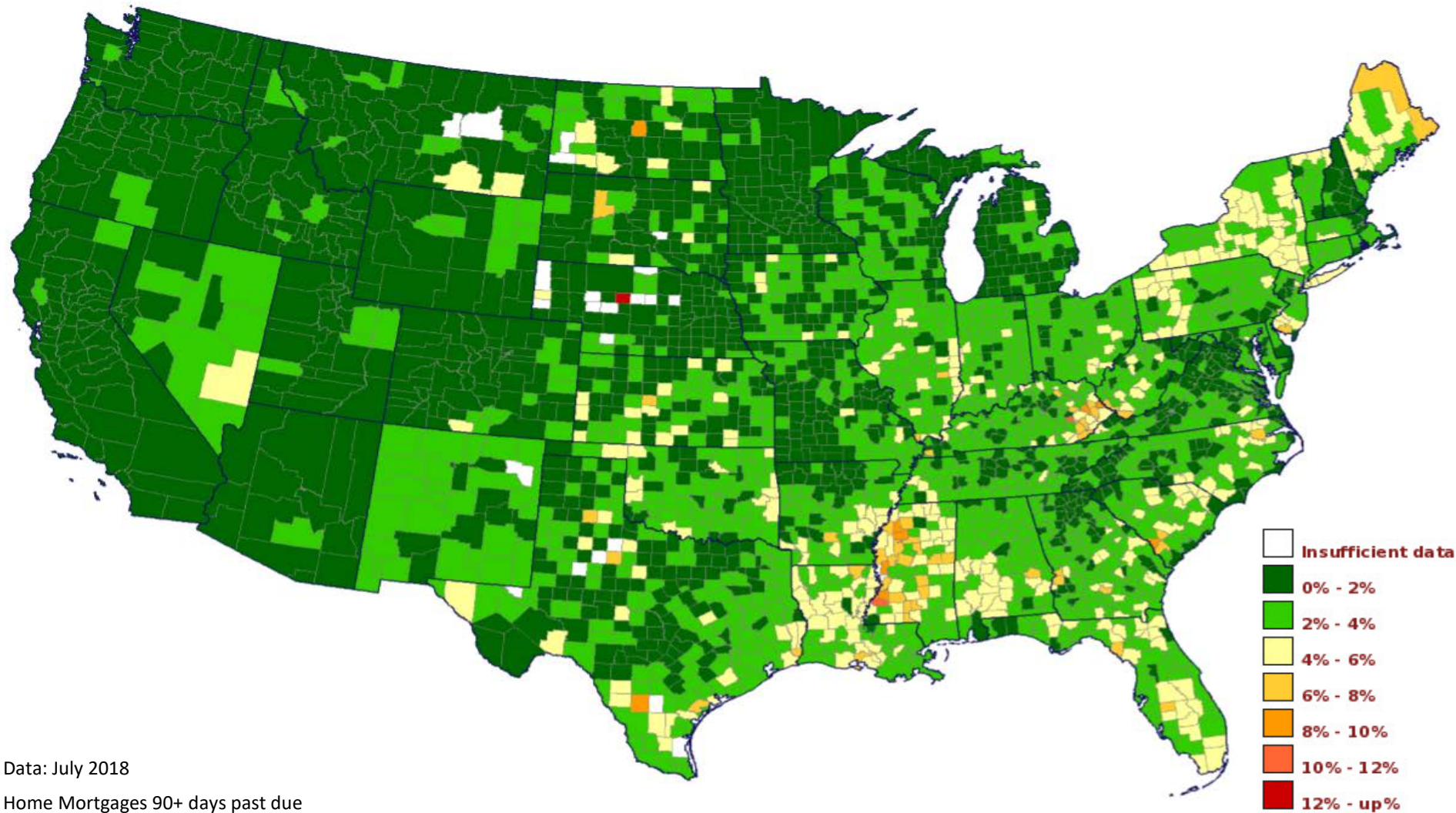
Unemployment Rates



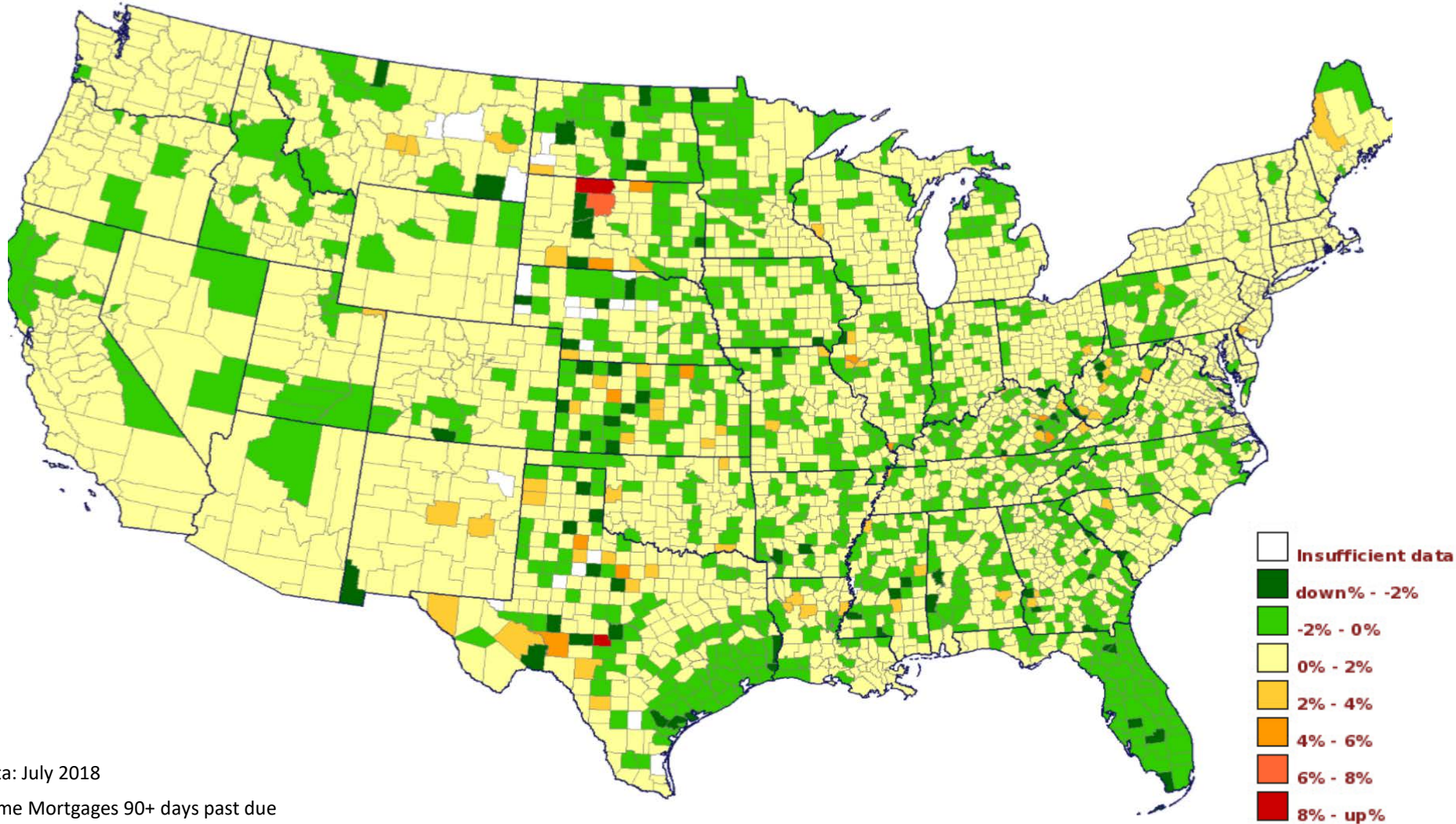
Job Growth by County, YOY%



Seriously Delinquent Mortgages

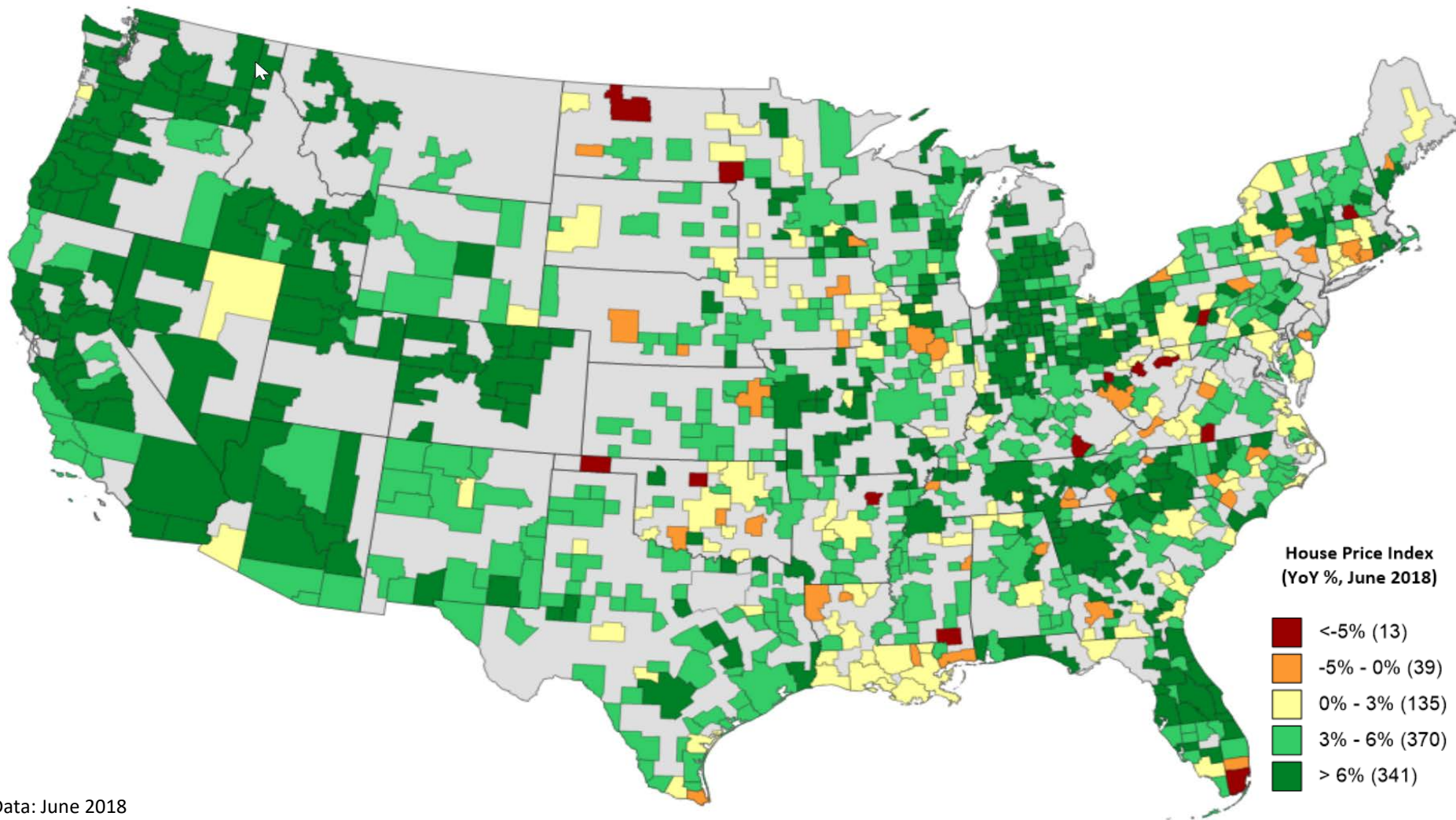


Seriously Delinquent Mortgages, YOY%

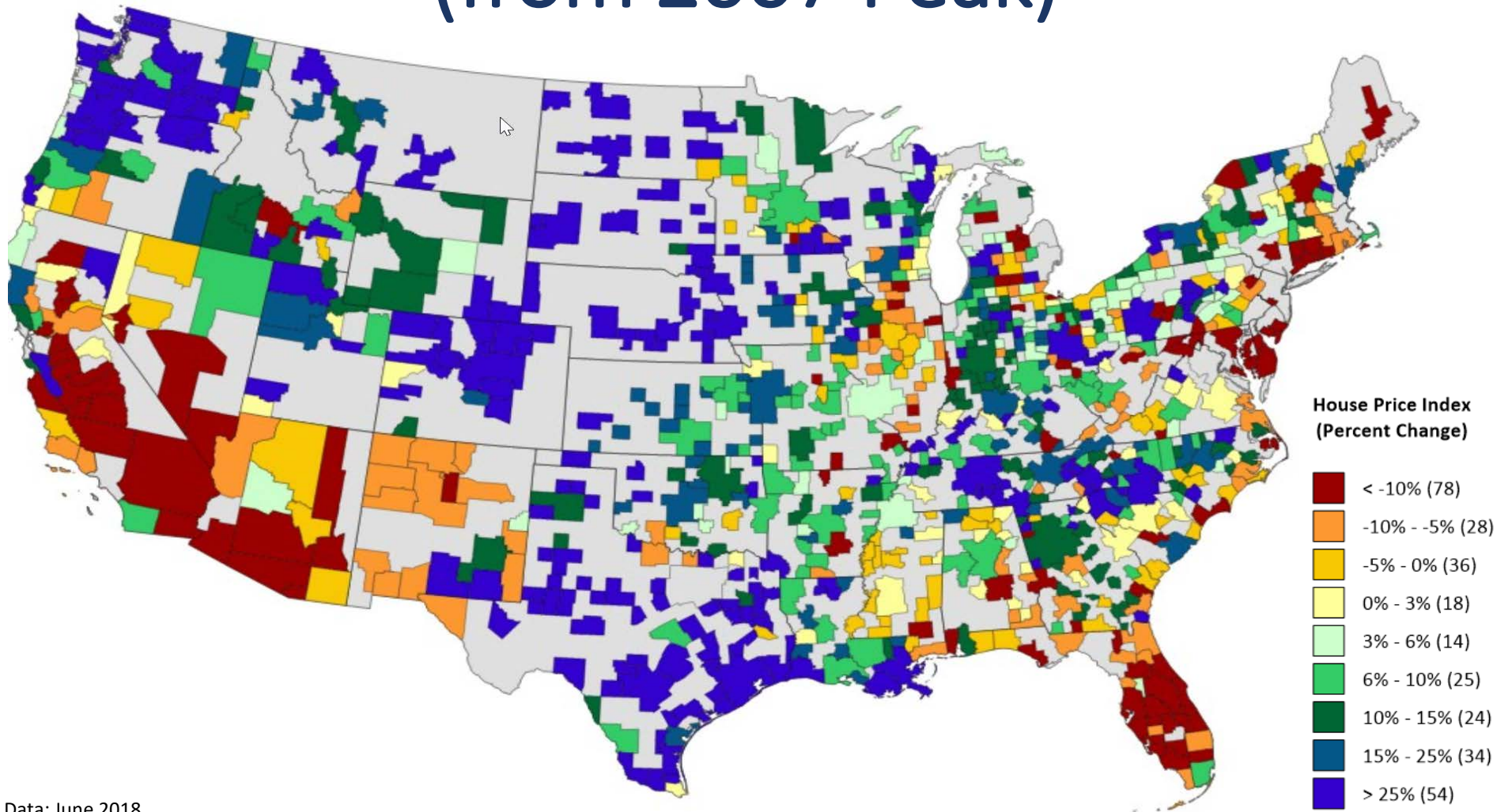


Data: July 2018
Home Mortgages 90+ days past due

Home Price Appreciation



Home Price Appreciation (from 2007 Peak)

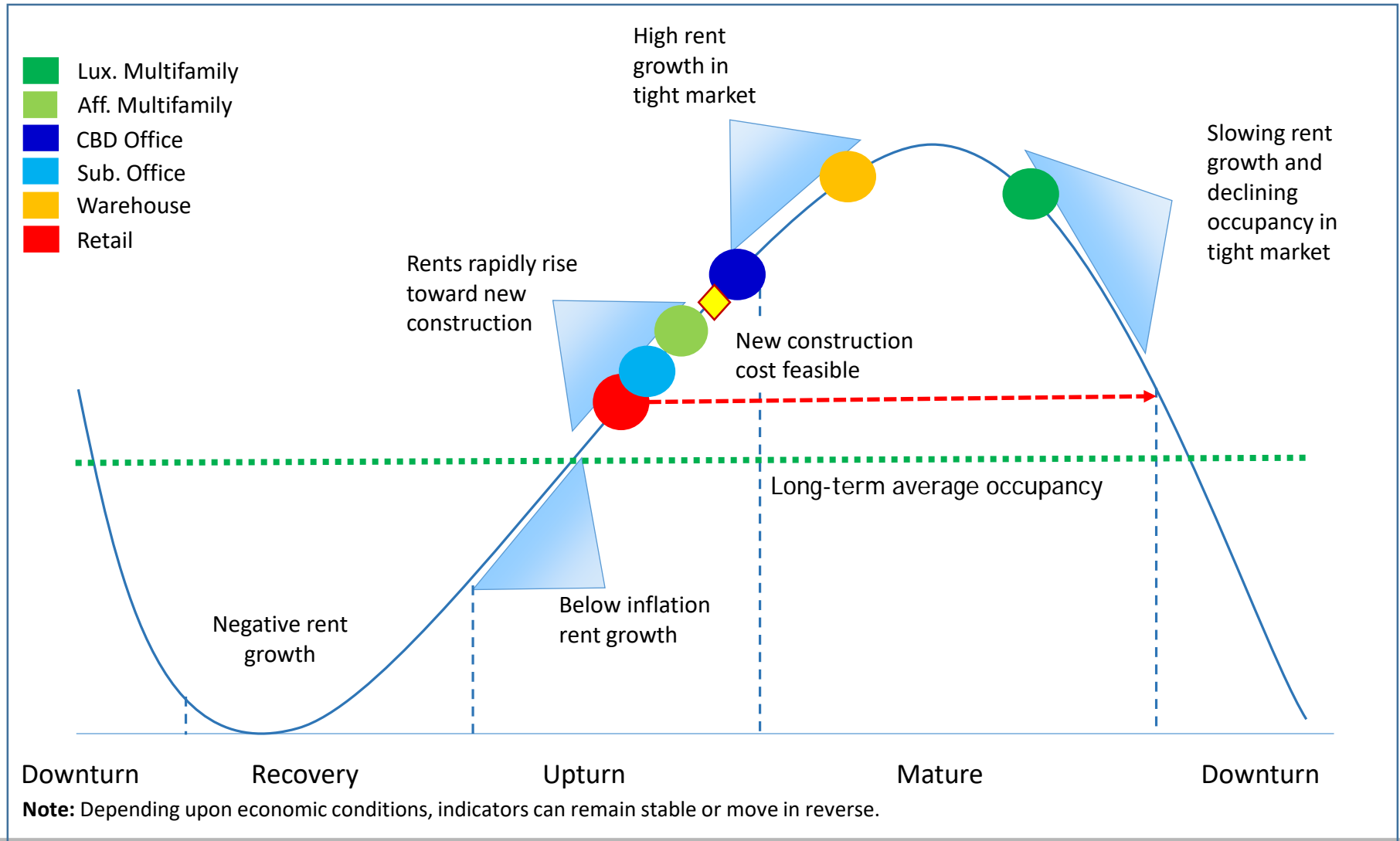


Data: June 2018



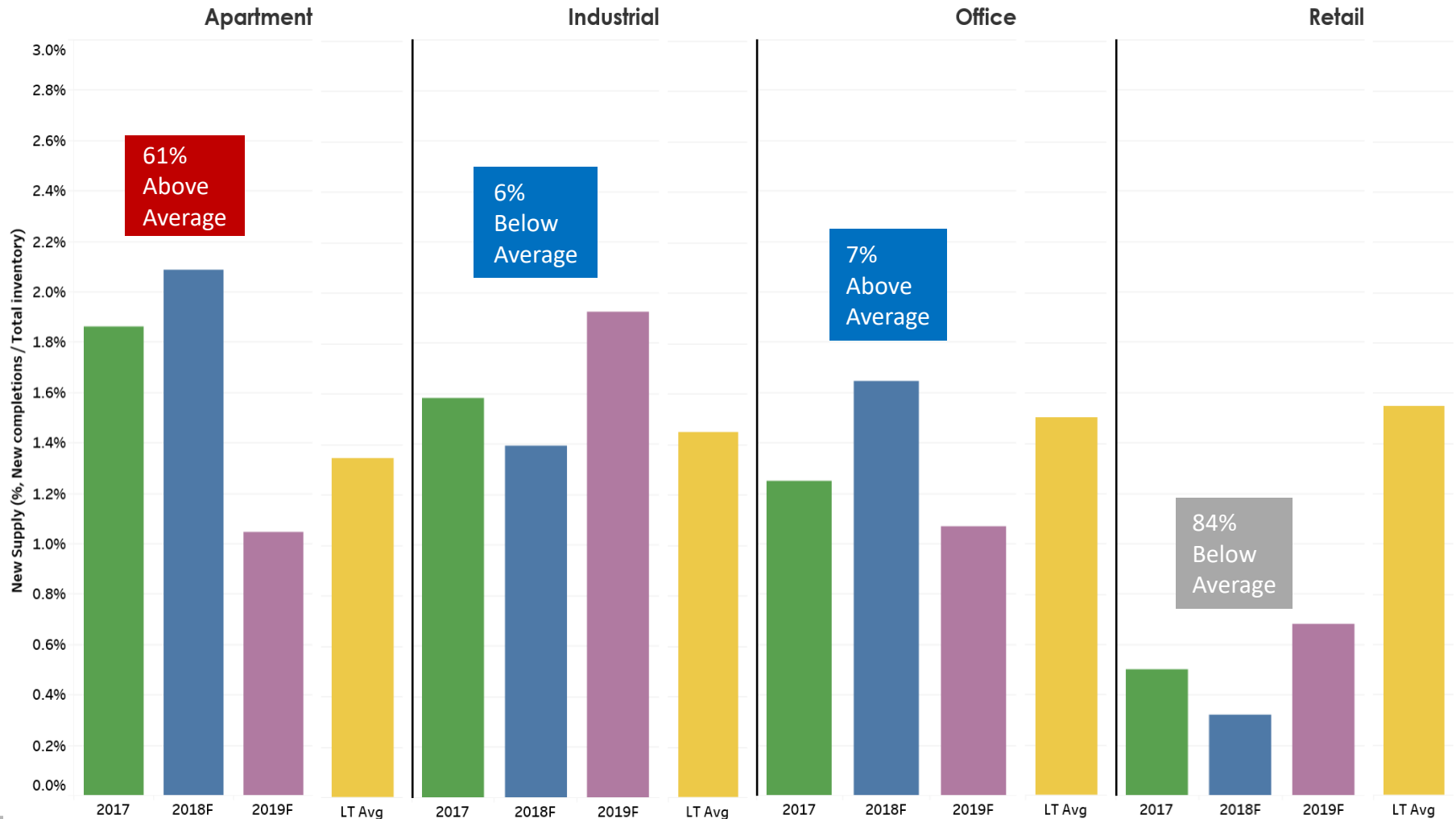
Commercial Real Estate

2018 Outlook



National New Supply vs. Long-Term Average

20-Year Averages vs. 2017, 2018F, 2019F Supply



Strong Market Dynamics?

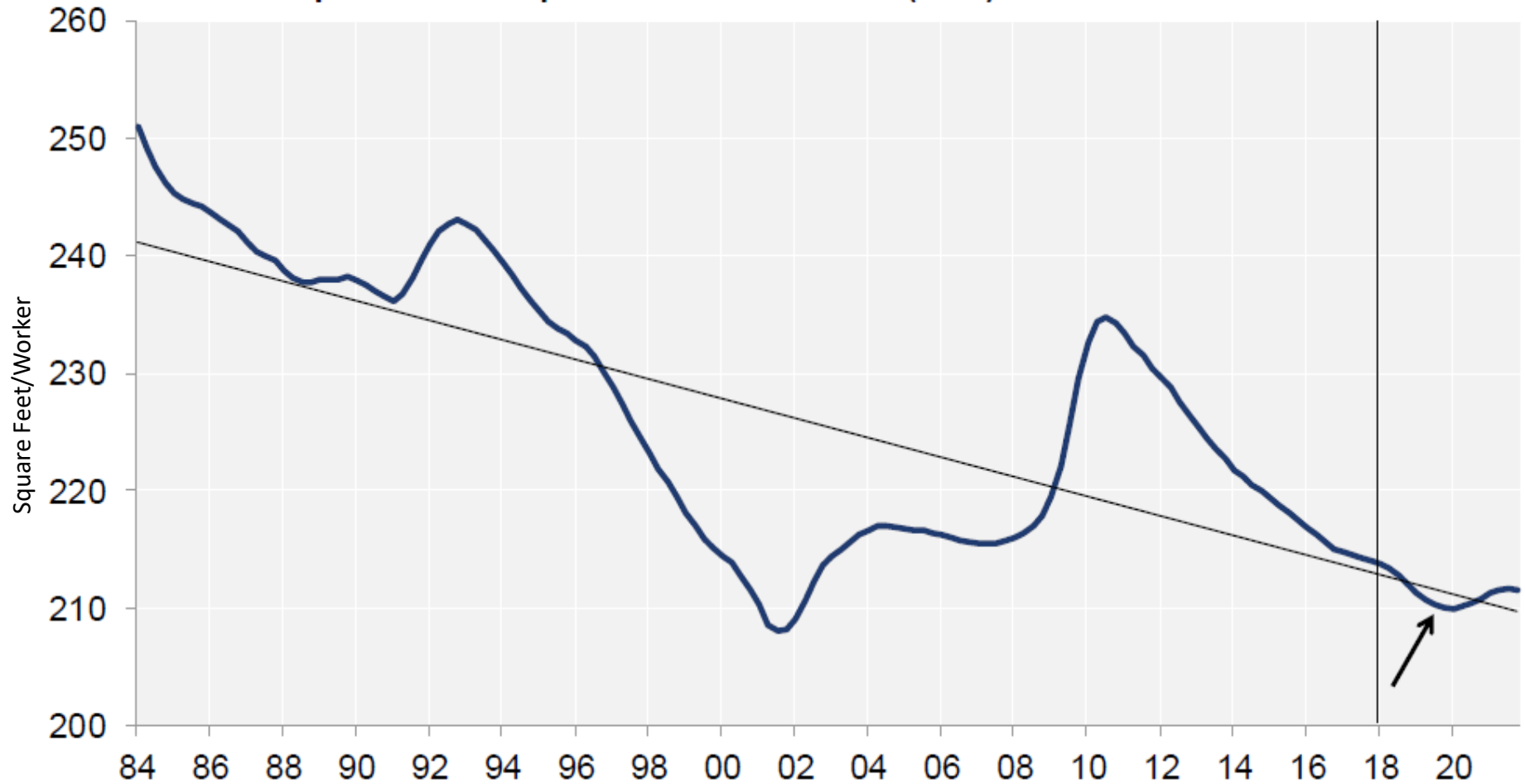
	Apartment	Hotel	Industrial	Office	Retail
High risk		7%			
Moderate risk	9%	69%	5%	3%	5%
Low-moderate risk	6%	11%	6%	3%	3%
Low risk	85%	13%	89%	94%	92%

Based on traditional analytics, most markets are experiencing robust dynamics; however, there are some nuances:

- Hotel markets have struggled with overbuilding recently.
- Except for luxury apartments, the rate of new construction does not indicate that overbuilding is likely.
- Efficiency is having a greater impact on office and retail and could lead to higher vacancy rates.
- New trends could lead to greater rates of change.

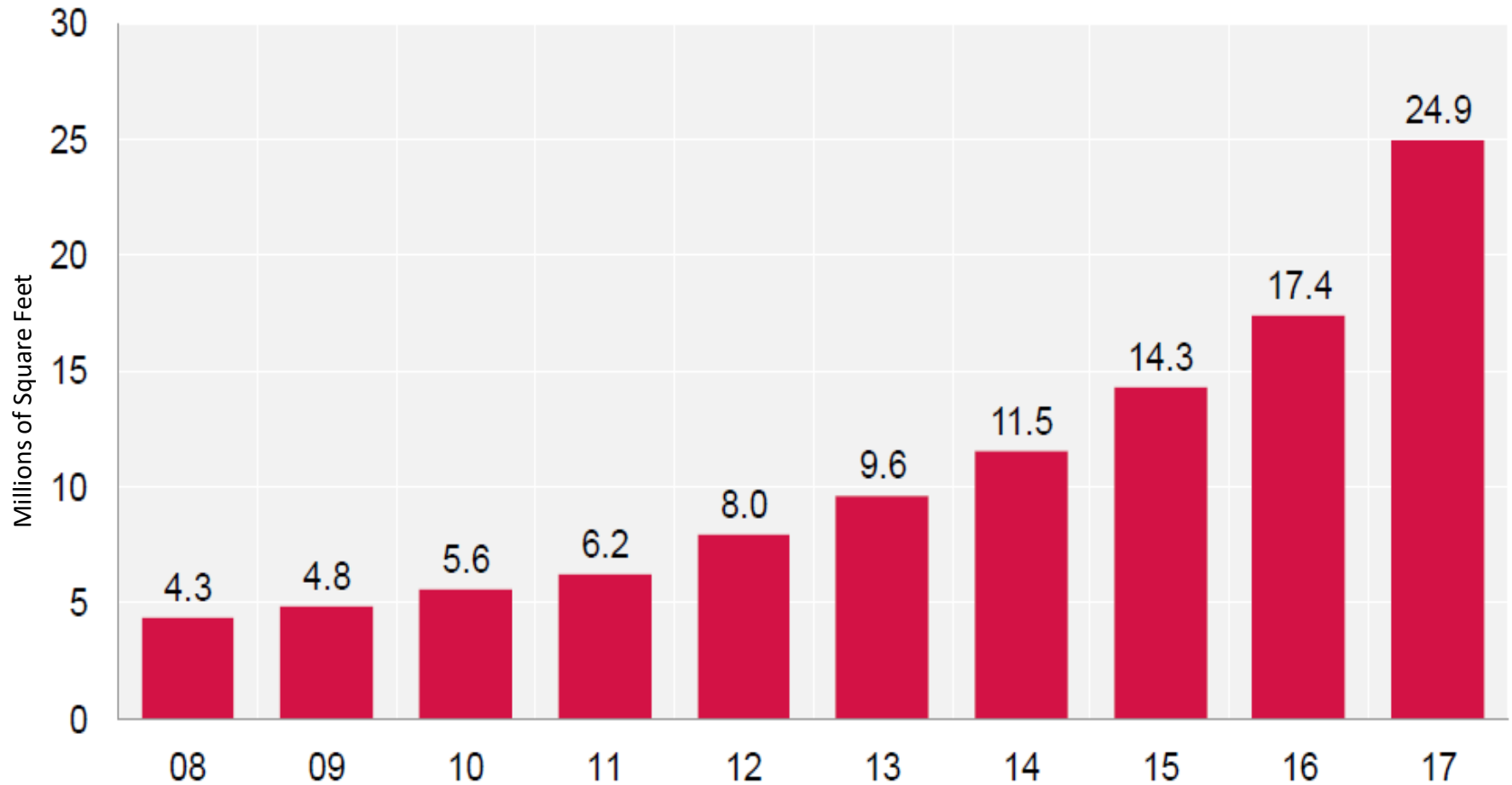
Office Densification

Total Occupied Office Square Feet Per Worker (U.S.)



Coworking Growth

Millions SF Occupied By Coworking Tenants



As of Q1 2018

Retail Bankruptcies



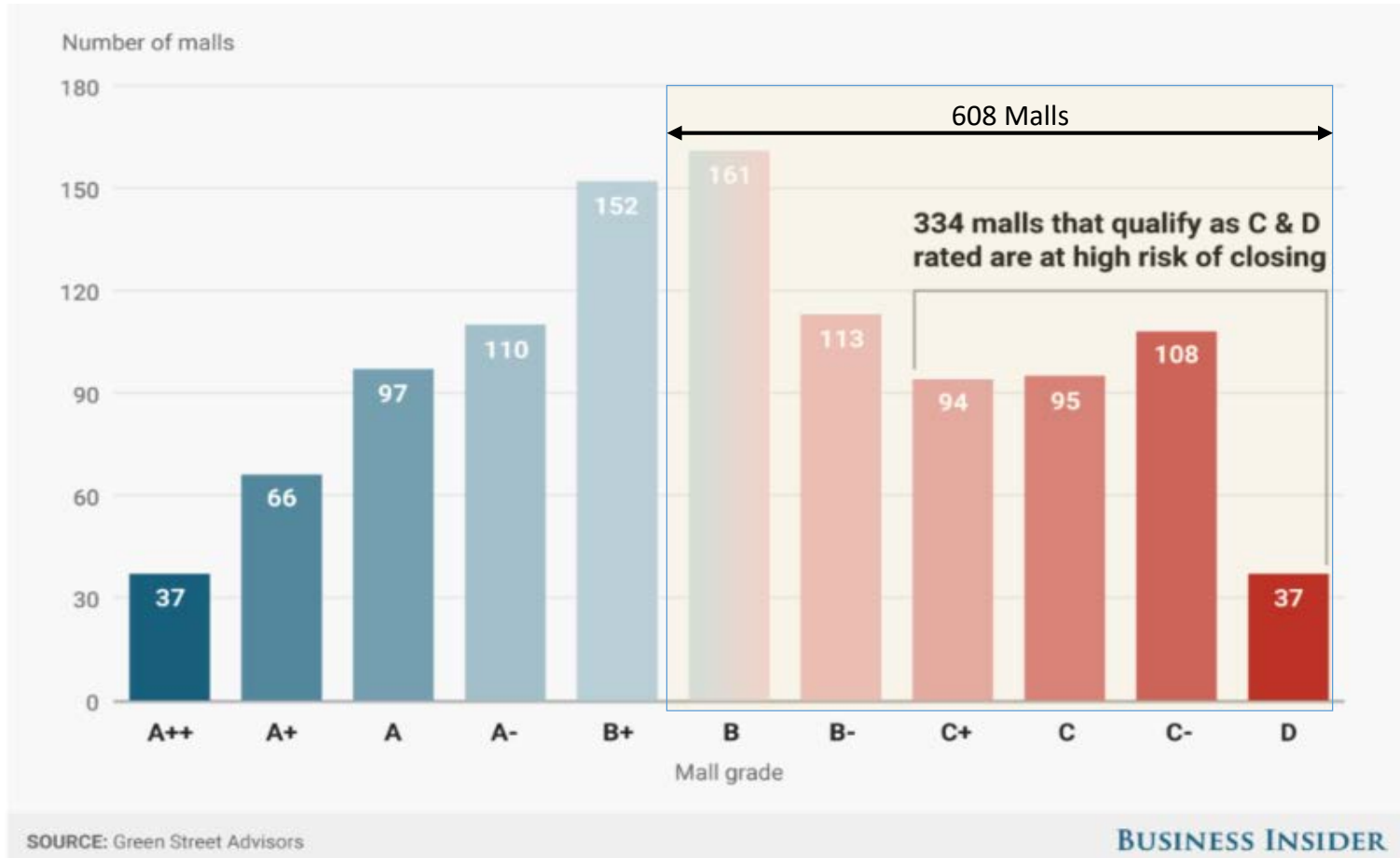
Retail bankruptcies timeline

A timeline of select retail bankruptcies from 2015 to 2018 YTD (3/19/2018)



Increasing Targeted Retail Risks

Major retailers are evaluating store closures across a good portion of the spectrum. Is the industry prepared if they begin closing stores at B-, B or even B+ locations?

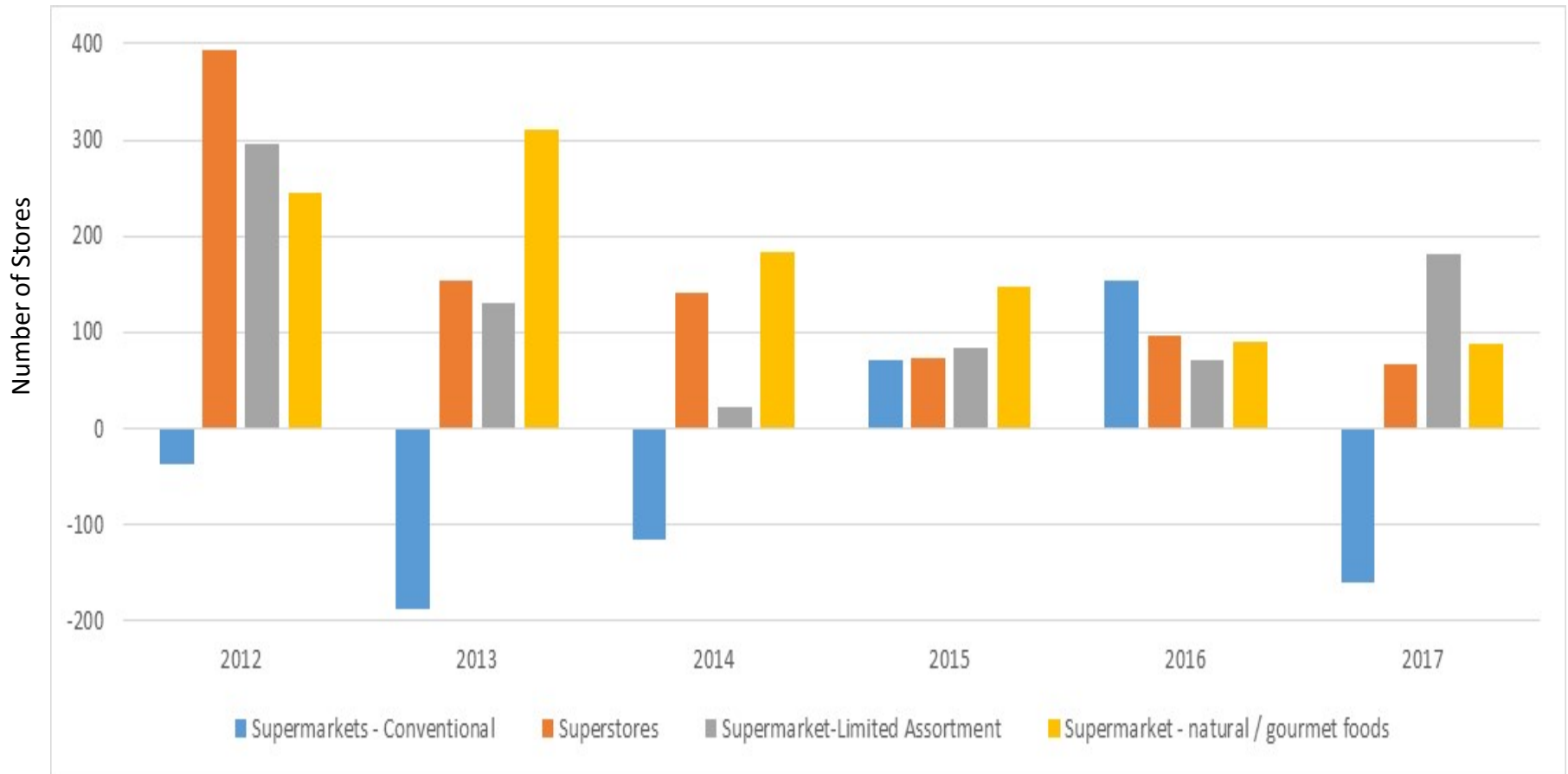


Grocery-Anchored Retail



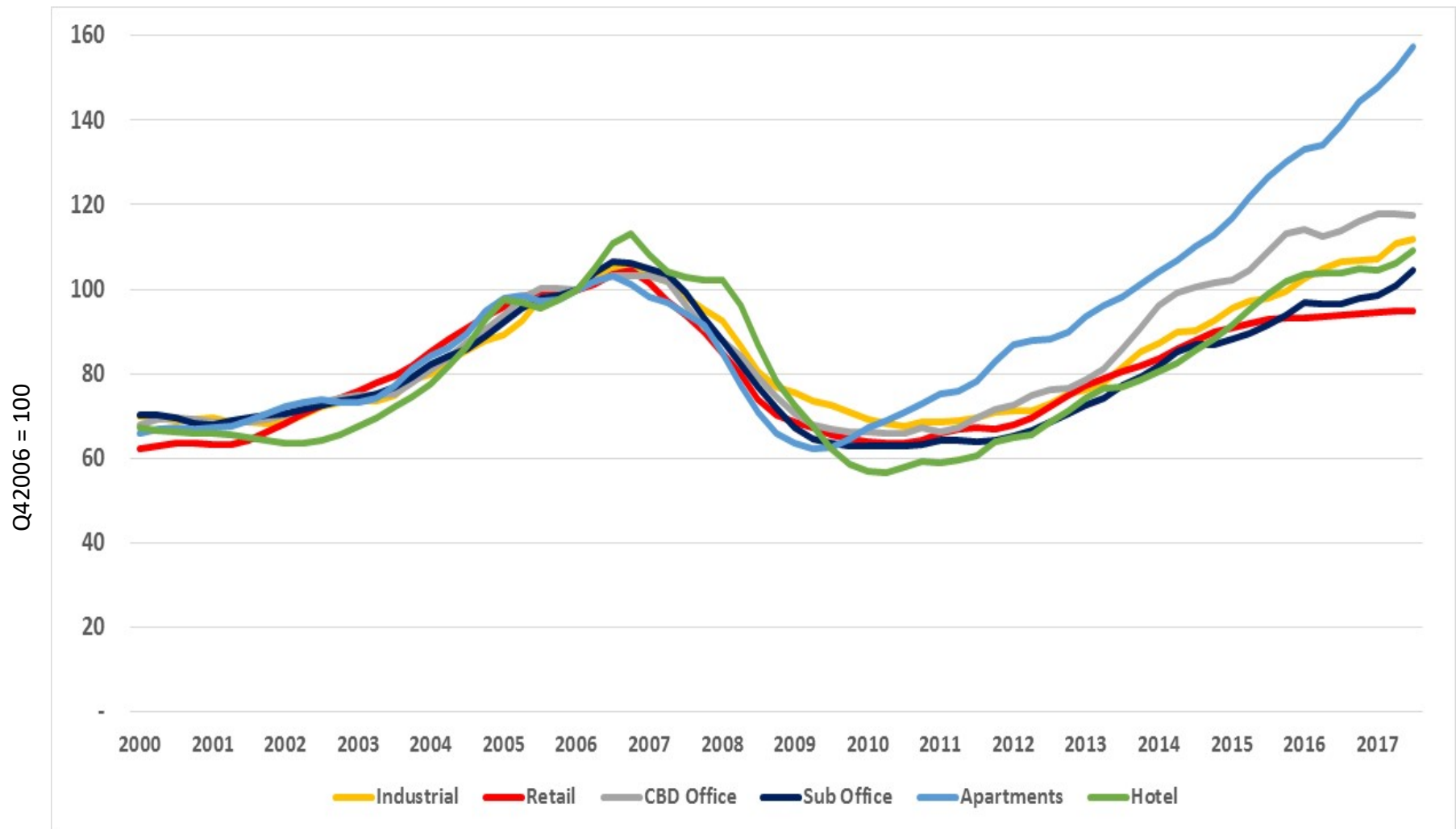
- Change is accelerating in the grocery-anchored segment.
- Several grocery chains are under pressure.
- Walmart plans to expand delivery to markets serving 40% of the population by the end of 2018.
- Amazon purchased Pillpack which allows prescriptions to be delivered to your front door.
- Consumer demand for home delivery has big implications for retailers. This means more consumer options, a lower number of impulse buys, and declining margins in an already margin-challenged business.

Grocery-Anchored Retail



While other areas are growing, the number of conventional supermarkets has declined in the last five years.

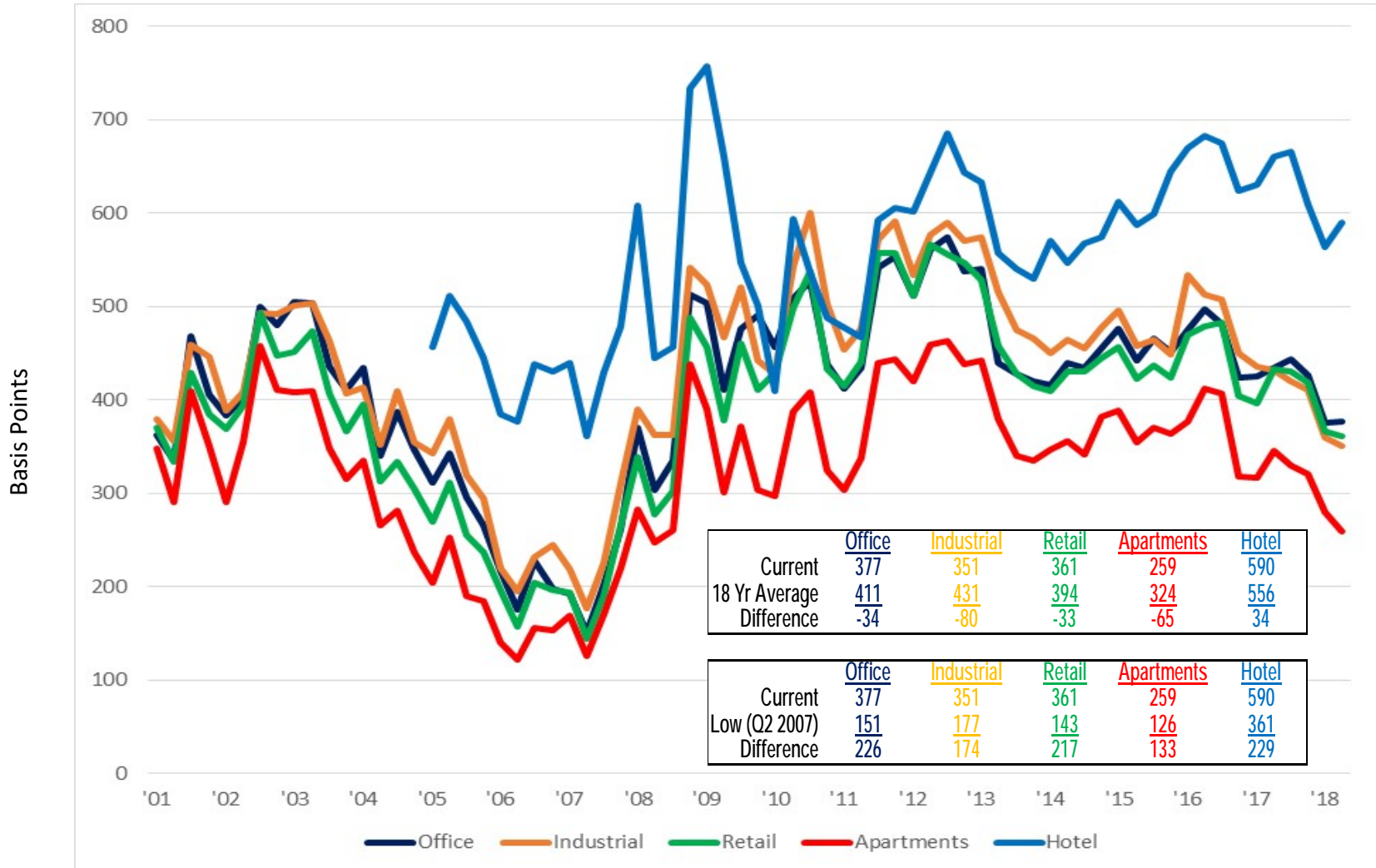
Non-major Market CRE Price Indices



*Non-major markets: All markets except the majors (Boston, Chicago, Los Angeles, New York City, San Francisco, and Washington D.C.)

Is CRE Pricing Risk Increasing?

Spread above 10-yr Treasury



10-year T Yield = 2.91%

Data through 2Q 2018

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



CRE Finance

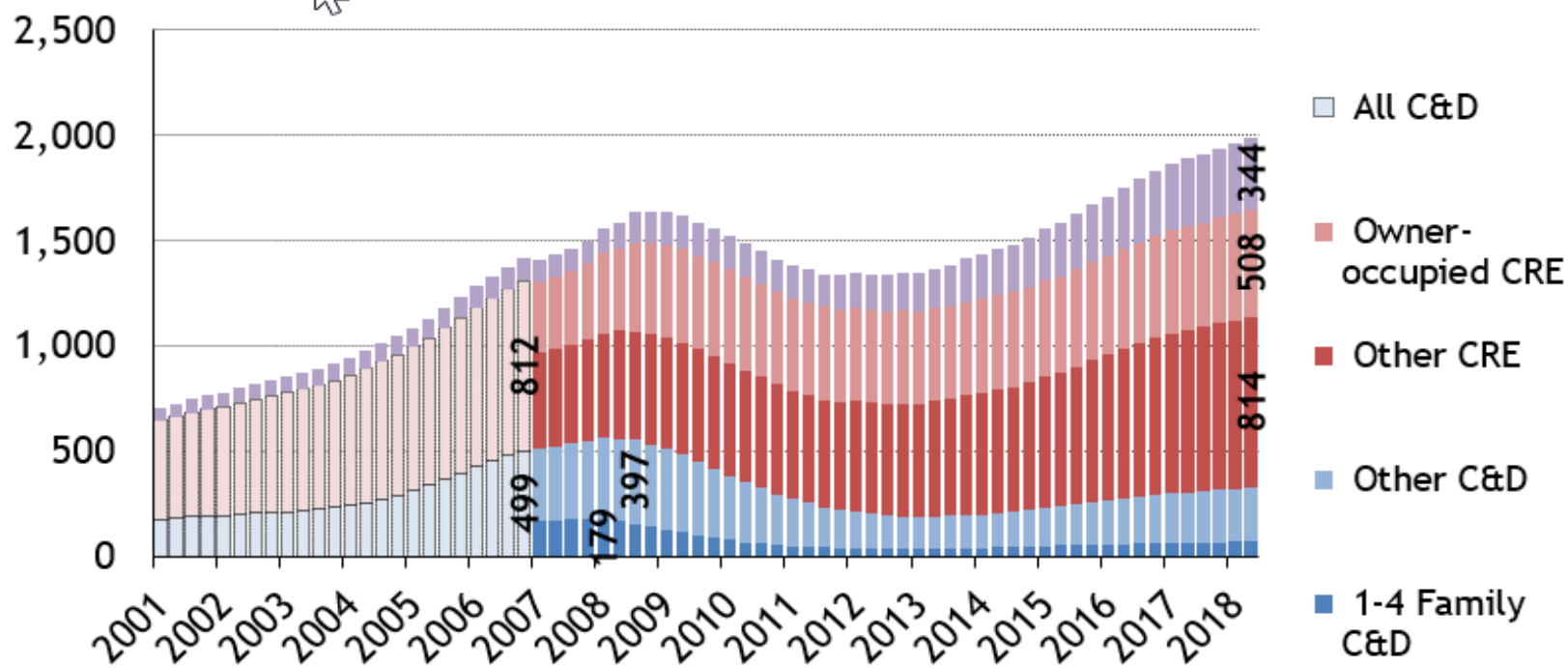
Lending Sentiment



CRE Loans Outstanding at Banks

CRE Loans Outstanding at Banks

\$ billions, peak balances shown

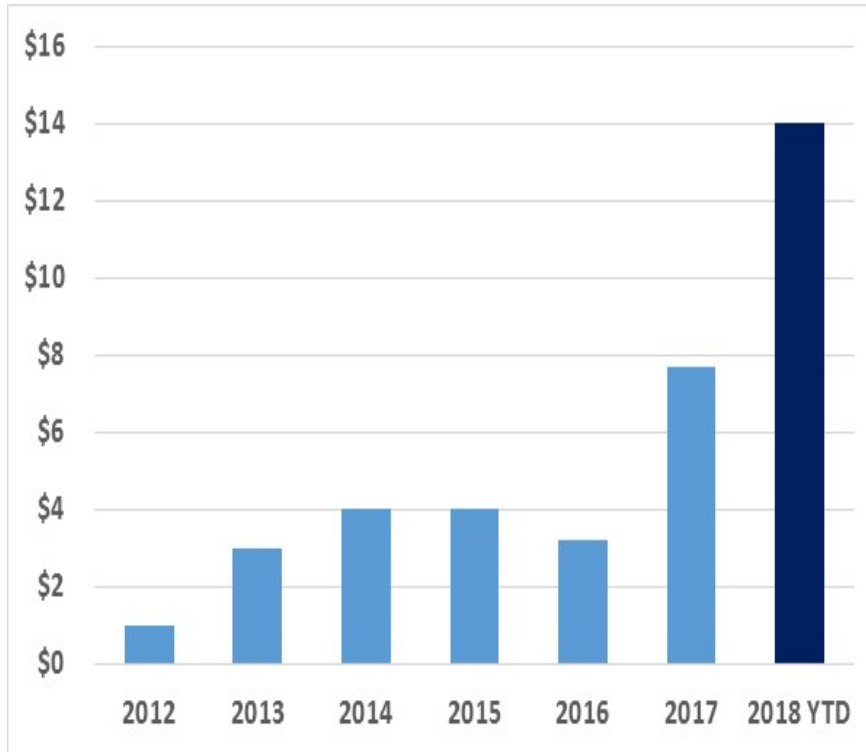


Source: Call Report

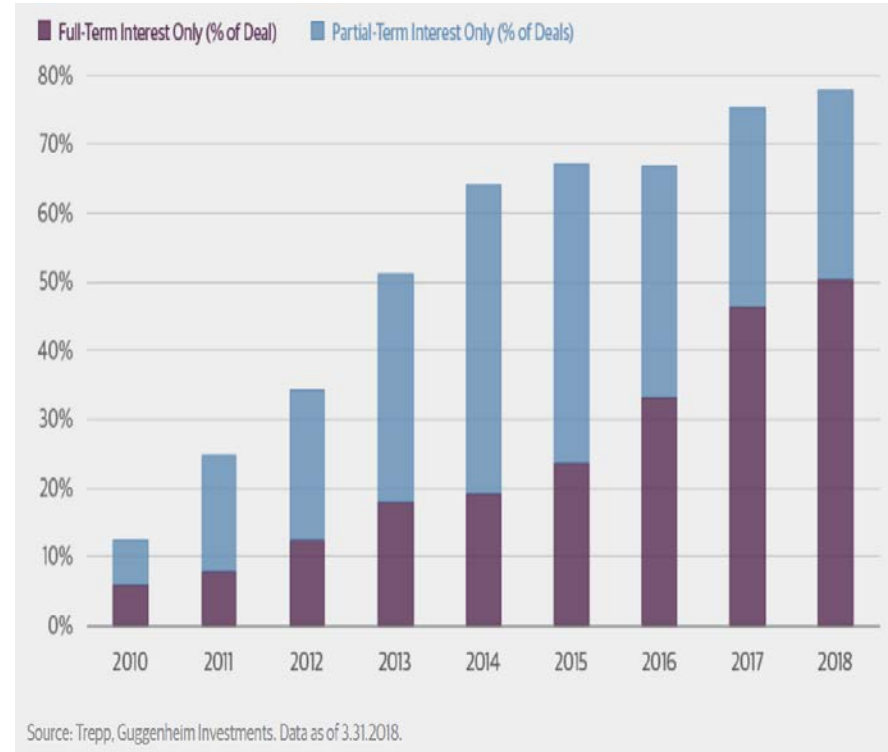
data through 2018Q2

Borrower-Friendly Financing?

CRE CLO Originations (\$, Billions)

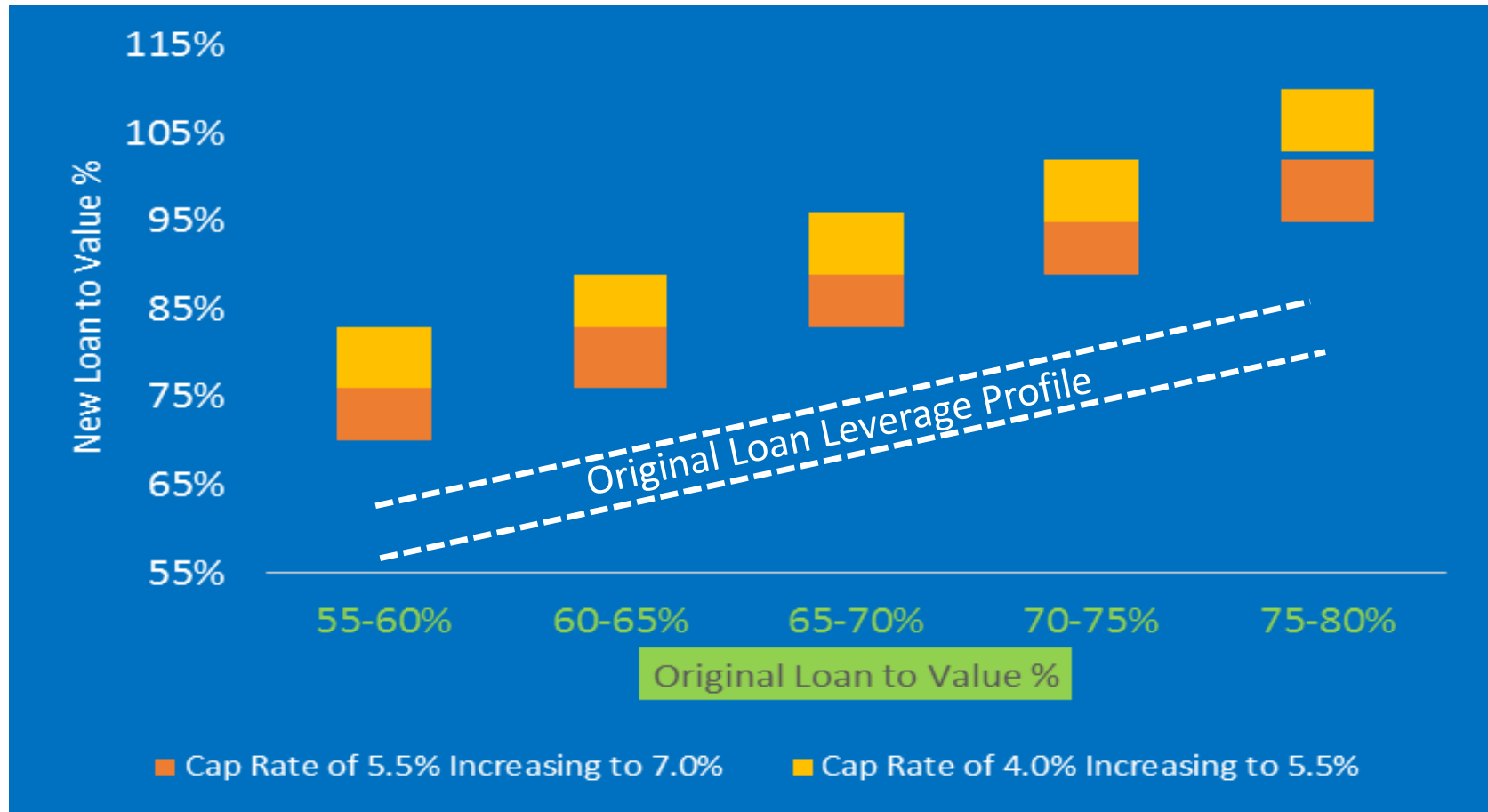


CMBS Originations (% Interest-Only, Partial Interest-Only)



Changes in Cap Rates May Impact Leverage Levels...

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 when CRE Cap Rates experience greater movements.

Why Does It Matter?

Greater availability of capital may lead to enhanced levels of risk

- Heightened CRE price levels
- Market preferences...(today more debt than equity)
- More originators and greater lending competition
- Loosening underwriting
- Declining spreads
- Increasing friendly borrower terms
- Heightened rates of change in some property types

Summary

- Good macroeconomic fundamentals, robust capital availability and increasing debt dynamics are producing conditions with some similarities to the conditions in the mid-2000s.

However...

- Greater efficiency will continue to have a more pronounced effect for CRE.
- CRE dynamics appear solid today; however, the rate of change appears to be accelerating.
- Capital availability, levels of pricing and competition in the lending environment appears robust and could translate into enriched levels of risk.

Questions



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