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Three factors that impact commercial real estate in New England - by Peter Brockelman

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The commercial real estate industry displayed healthy signs last year, but a number of risks and influencing factors remain. According to a report by TD Economics, the research arm of TD Bank, rapidly rising property values, a supply shock to the apartment pipeline, weakness in office demand and a softening for retail space may impact the industry. However, some of these dynamics have a bigger impact on New England than others.

For starters, banks are beginning to be more cautious, especially within the multifamily sector. Now more than ever before, there's a need to diversify portfolios across property types, geographies and even sponsorships. Every market in New England has a different set of demand generators. In Boston, for example, there's a large amount of development, with a primary focus on multifamily and technology properties, being driven by job growth and migration into urban areas. In Cambridge, it's a hot market for office and lab space. Burlington has a strong need for retail space and office development continues at a solid pace. Portland has been seeing office, multifamily and residential activity, which is bringing in new lenders. Hospitality owners in the greater Maine area have pulled back in financing. Finally, many in Connecticut are focused on job rate growth and incomes as there have been several company mergers and relocations.

Overall, the greater New England commercial real estate market remains very competitive and there's a need for lending across all property types including multifamily, office, retail and industrial. Here are three factors to pay close attention to in the year ahead.

Interest Rates: The rising of the federal funds rate back in December signals the strength of an improving economy. In fact, it was not unexpected and future moves have become more likely. TD Economics predicts these increases will happen gradually and will not be more than 20 to 40 basis points each year. Even with these anticipated hikes, the 10-year Treasury rate will remain historically lower than the four to five percent range, which we saw prior to the financial crisis. These increases will not significantly impact lending activity, but will certainly spur refinancing and keep the marketplace competitive. For example, borrowers will be incentivized to refinance their maturing loans to lock in lower rates, and meet their end-of-term agreements. Furthermore, along with Treasury rates, capitalization (cap) rates continue to maintain their lows and spreads over Treasuries are in-line with historical marks. The concerns over an unexpected jump in cap rates are tied more to a black-swan event rather than predictable and foreseeable short-term impacts; beyond impacts from recent administrative changes.

Political Landscape: As we enter into a new administration, many are wondering what the future holds for commercial real estate lending. There are a number of potential regulatory changes that could have significant economic implications that would extend to the CRE market. If passed, the current proposals for tax reform and the new administration’s plans to lower the corporate income tax rate would mean a decrease in the value of tax credits. The lower the tax rate, the lower the value of the credits - which would decrease the value of tax credits for investors. Changes to the mortgage interest deduction, amortization and carried interest would also change the approach of investors and owners and may impact commercial real estate versus alternative investments. On the other hand, many proposed policies are pro-growth initiatives that could be beneficial to the CRE market, with infrastructure improvements and more. Owners and investors are closely monitoring these potential changes, and are waiting to see how the politics, policies and regulations play out during the next several months.

Demographic Shifts: Demographic shifts will remain an issue for the industry as a large number of retiring Baby Boomers merge with the wave of Millennials starting careers and buying houses. Millennials continue to seek amenity-based housing within close proximity to work, stores, transportation and restaurants. Urbanization has fueled a major impact on the retail real estate industry in both suburban and metro markets in New England. Within the suburban market retailers may be at a risk of having too much brick-and-mortar space since many young families are opting to live in urban areas. In contrast, retailers within urban markets are experiencing the need to expand aggressively to meet increased demand for this growing population. As this trend continues among Millennials, it creates a shifting demand for almost all sectors within CRE including retail, multifamily and office space. But many see this demographic shift and demand as just that; a shift. And as Millennials age it would not surprise many if the pendulum swings back the other way and suburban markets rebound; to what extent there are few who are willing to bet at this time in the cycle.

Ultimately, the signs point to a healthy financial landscape throughout New England as we transition into 2017, with many capitalizing on the low cap- and interest-rate environment through refinancing and maintaining a patiently-persistent approach to long-term strategic thinking. The availability of capital remains strong, favorable interest rates will continue and fundamentals in the commercial real estate market will drive strong lending activity in the year ahead.

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