nerej

# Lending in a rising real estate environment - by Mark Zink

August 10, 2018 - Front Section

Mark Zink, Melrose Bank

During its June 2018 meeting, the Federal Open Market Committee raised rates for the seventh time since the Great Recession in 2008, and the fifth time since the beginning of 2017. In May, the unemployment rate fell to 3.8%, a level reached only twice before in the past 50 years. While unemployment has since increased to 3.9%, the strong job market, coupled with rising inflation, has paved the way for continued rate hikes, two more of which are expected to occur in 2018. Understanding how these macroeconomic factors may impact your local real estate buying decision will be key in your ultimate rate of return.

Impact on Property Values: The multifamily asset class is becoming a more pricey investment than in years past. The continued lack of inventory coupled with a rising interest rate environment have inflated sale prices beyond historic norms. To compound this, due to higher borrowing costs and stagnant wage growth, first time home-buyers are opting to rent rather than buy. While this may provide for a more robust tenant market allowing existing owners to increase their rents, it has also had the effect of artificially increasing property values.

In theory, this speaks to a strong investment market. Increased rents coupled with higher credit-quality tenants results in less payment issues and low vacancy. That said, when buying an investment with these characteristics, you will likely have to pay a premium.

Is Premium-Priced Real Estate Worth It? In a few instances, it may make sense to buy real estate at a premium. If the buyer has confidence in the asset class and the strength of the market the real estate resides in, they can treat the investment as a bond: low annual returns are acceptable due to the quality of the underlying asset.

However, in the case of making a quick or significant return on real estate through renovation or ground-up construction, present market data reveals the investor should be cautious as borrowing costs are now higher than they were in years past. In addition, in the Greater Boston market, there is an abundance of new inventory that will become available in the next 12 – 24 months, increasing choices for the consumer. Finally, due to the recently imposed tariffs on steel coupled with the red hot real estate market, the cost of both supplies and contractors are at the high point of this current cycle.

This is not to say that you can't earn a return on real estate in this market. Having a sense of costs and the end market demand are crucial in making sure the investment will provide you with a respectable return. Making sure you have a banker who can act as a trusted advisor, and not just a sales representative, is imperative to making the right decision.

Mark Zink is vice president, commercial lending at Melrose Bank, Melrose, Mass.