I hope that you see an opportunity as it arises by Vin Cannistraro

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As Marvin Gaye famously sang, “What’s Going On.” Indeed, it’s quite a challenge to figure that out in today’s climate, and more importantly, to determine where one should be going. One of the most widely accepted assumptions is that [real estate] investors make all of their decisions based on “facts” while homeowners allow themselves to be governed by emotional responses. If they love the look of a certain home, then they’ll pay more because of how it makes them feel. But this line of reasoning leaves out a very important investor emotion, namely, anxiety. For it is anxiety, and more specifically the level of anxiety relative to confidence, which plays a crucial role in investor behavior. How many times does a broker show the same listing to different investors, and the one who invariably steps up with the crazy high offer is the one with the most confidence in their interpretation of the facts presented. Conversely, how many times does an investor throw a lowball offer on a property, only to say something to the effect of “it’s not what I know.” In other words, the investor’s anxiety about the situation guides their behavior.

The reason this issue is worth mentioning is that today’s world is full of uncertainty, which is eroding investor confidence and increasing anxiety. Further, the relationship is not linear. In other words, when an investor gets to a point where they have too much anxiety over an investment, their behavior can’t be graphed in a straight line and calculated.

Will interest rates come down? Maybe, but maybe not too soon. Will inflation remain stubborn and more persistent into 2024? Maybe. Will the war in Ukraine keep going? Will gas stay above $2.75 per gallon? While the list goes on, the thing to remember when talking about any metric is that there are two issues. The first is the number itself, e.g the current interest rate, the cost per square foot of roof, etc. The second is the certainty that the given number will in fact remain as forecasted long enough to make the contemplated deal succeed. It is my personal experience that investors are generally much more concerned with the second issue. In other words, they need confidence that what is estimated/forecasted will in fact bare out. Nobody likes anxiety.

When I was learning how to drive, the instructor took me on the highway one day, and he noticed that my eyes were focused on the end of my hood. “Look as far down the road as you can. Then look down. You’ll be there before you know it,” he told me. Little did I know then how valuable that advice would later turn out to be. So, as I look down the road now, what do I see?

I see a 42% decrease in commercial/multifamily loan originations for Q1 2023 vs. Q4 2022. I see a 72% decrease in the dollar value of industrial loans over the same period. I see building permit applications falling precipitously nationally and locally. I see failing banks, stubbornly high prices, and plenty of cranes sitting idle. But I also see opportunity. For opportunity has been born out of every single challenge since the beginning of time, and when that ceases there will indeed be no point in reading any journal articles at all.

When anxiety is high, there are two predictable responses from investors. The first is panic, which usually manifests itself in selling assets prematurely or at too low a price. The second is stasis - sitting on the sidelines.

So, where is the opportunity? In the industrial sector, I see it in the sub-100,000 s/f flex space market, and suggest retrofitting existing buildings. The industrial/flex sector in this region, and in the country, is expected to remain strong as COVID, although no longer a public health threat, reminded us that globalization is not perfect and that we need more warehousing and more manufacturing capabilities domestically.

There is also opportunity in investment properties as industrial lease rates remain strong, yet cap rates are rising. I believe that interest rates will come down, likely within 6-12 months. Will new construction come back? Sure it will. When? My guess is 18-24 months, because it is being proven nationally that “out of the ground” projects can’t be viable at the current rates. Will things get worse before they get batter? Likely, which is why low leverage should be key to any investment decision right now.

As for sitting on the sidelines, this is actually not a bad strategy for the next six months or so, especially if you don’t have to deploy cash. No matter what you do, I hope it is not panic-driven, I hope that your leverage is low, and I hope that you see an opportunity as it arises.

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