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Thrive in '24 or survive till '25 - by Harrison Klein

April 12, 2024 - Front Section



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Tatte, Ogawa, Pressed, or perhaps a simple Dunkin iced coffee. These are where the behind-the-scenes conversations are happening among brokers, investors, and bankers. The rebound, once forecasted to be “two quarters out” for the past six quarters, has become a punchline. As we wait for coffee, we may discuss interest rates staying “higher for longer.” However, once caffeinated, it becomes clear that the details are important.

We are not in a homogeneous market. Newly capitalized funds are behaving very differently from high-net-worth investors. In the industrial sector, the most active buyers at the front of the cycle (pre-2020) seem to be the slowest to chase deals today. Perhaps because they’ve already proven themselves and have earned a respite after providing massive investor returns. In the sub \$10 million world, high-net-worth investors are often supplanting syndicators. The high-net-worth group is able to wait patiently for yields without the demands of a preferred return structure.

In a change of pace, lending has become easier for the private investor over institutional groups. With limited capital to lend, banks are prioritizing existing customers, especially those with significant operating accounts. As we finish our coffee, the conversation shifts to lenders. Who’s actively lending and who’s quietly sitting on the sidelines? Life insurance companies and other non-bank lenders are filling in the gap left by undercapitalized local banks. While nobody is wagering on systemic risks in the banking sector, opportunistic investors are seizing the opportunity to acquire defaulted notes at discounted rates. The availability of debt, particularly for vacant buildings or professional offices, is weighing down segments of the market.

“So, what are your plans for this year?” Everyone aims to thrive in ‘24, instead of survive until ‘25. Deals are getting done, but not at the blistering pace seen in 2021. Tenants are committing to leases, and available space is being occupied. The majority of owners have fixed-rate debt that doesn’t mature until 2025 or later. In 2024, the focus appears to be on refining the business plan. Value-add investors are waiting for lease rollover to increase rents before refinancing or selling. Being a skilled operator has become increasingly important for profitability in real estate.

Coffee ends on a much more optimistic note than it did this time last year. Interest rates have stabilized, rents remain mostly stable in the industrial and suburban office sectors, and expenses are beginning to level out. Market participants are anxious for deal-making conditions to improve, not fearful of a collapse in value. Similar to 2009, Greater Boston is proving to be one of the most resilient markets in the country. Across product types, Boston avoided some of the hysteria seen in places like Phoenix and Austin. Deals were bought at prices commensurate with the fixed-rate debt used to buy them. Buyers were largely well-capitalized groups with rational business plans.

In my world, the sub \$20 million industrial and suburban office prices are more consistent with the current debt markets. Cap rates have increased 50-75 basis points compared to late 2022. Investors can achieve cash-on-cash returns in the 6-8% range, with mid-teen internal rates of return being

modeled. Thriving in '24 will require searching hard for properties, lenders, and, if selling, finding the right buyer for your building. Life isn't about waiting for the storm to pass; it's about mastering the art of dancing in the rain. The best deals are often done during times of uncertainty. Today's environment offers terrific opportunities for both buyers and sellers to make strategic moves that will yield long-term benefits.

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