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Is it time to take advantage of this market's rates?

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We are all aware that the current real estate market is challenging but some wonder whether or not it is time to take advantage of this market's rising cap rates and increasing rates of return. Many investors are still patiently waiting on the sidelines for the market to stabilize however some are actively buying into the market taking advantage of some favorable conditions. While the most successful of these investors are also among the most well capitalized, they too are not without obstacles.

These obstacles include obtaining financing for the acquisition, refinance, or reposition of an asset. The fall of Wall Street, the consolidation of lending institutions and the fallout from the government placing GSE's Fannie Mae and Freddie Mac into conservatorship have led to tremendous uncertainty in the financial markets. As someone who pays close attention to the multifamily asset class, I think many of you would agree that this sector of commercial real estate has been an oasis in the desert, exhibiting far more stability than other asset classes. Still, we have experienced tremendous interest rate volatility from local and institutional lenders who continue to place debt on these multifamily properties.

The month of November saw a sharp decline in treasury yields, yet ended with rates for fully leveraged, 10 year fixed rate mortgages on stabilized multifamily assets in excess of 6.5%, almost the same rate with which the month opened. On November 3rd the yield on the 10 year U.S. Treasury was 3.96% and on November 28th that yield had decreased to 2.92%. How can the yield on such a benchmark fall 104 basis points inside a month yet no reduction in rates be visible? Well, there were points last month where 10 year rates did fall as low as 6%, however lender spreads over the same period of time increased which essentially offset the fall in the Treasury's yield.

Despite the widening of spreads, there are local lenders who remain aggressive in today's market. These lenders can provide advantages such as providing a fixed rate up front, taking the risk of market volatility out of the equation. For investors who are focused more on working with Fannie Mae and Freddie Mac, being in a position to rate lock when the underlying rate index is at a favorable level can be a way to make the volatility in today's interest rates work to your advantage.

Some of the most attractive multifamily financing in today's environment is still coming from Fannie Mae and Freddie Mac. For investors looking to finance multifamily assets at $5 million or less in the Boston MSA, Fannie Mae has a fixed rate program still underwriting to a 1.20x debt service coverage ratio, 80% loan-to-value, and is non-recourse. Investors looking for loan proceeds in excess of $5 million might be interested in Freddie's capped ARM product. This is a floating rate structure with current rates in the 5% range, coupled with a rate "cap" or maximum interest rate. This means the debt is structured such that your payment fluctuates based on the change in the index plus a predefined spread but in no event will your rate exceed the "cap." The current rate caps are in the 7% - 7.25% range making this an attractive product with relatively low interest rate risk given the increase in market spreads.

Whether or not it is time to take advantage of this market's rising cap rates and increasing rates of return will remain to be seen. However, for those investors seeking financing, viable options are still available and attractive rates and underwriting can be achieved.

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