



TRISTAR

REAL ESTATE INVESTMENT

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INCREASING INTEREST RATES: HOW IT AFFECTS BUYERS OF REAL ESTATE INVESTMENTS

Greetings!

The cost of borrowing money to purchase real estate investments is usually determined by what is known as a "spread" to a certain monetary index. The spread is the lenders' interpretation of the risk for the asset on which they are lending money. As an example, the spread on a net leased Walmart Building with 15-years on the lease will be very small (say 100 points) relative to the spread on Class C apartment building on the wrong side of the tracks (say 225 points) that you may be purchasing to renovate.

The key index many lenders use to apply the spread is the ten (10) year treasury bill. If you had a lender quoting a 200 basis point spread to the ten (10) year treasury at 3.0%, your interest rate would be 5.0%.

Over the last few months, the ten (10) year treasury bill has increased from 2.8% to around 3.2%. In this example if all things remain the same, your cost of debt went from 5.0% to 5.4%. This seems small, but what does it mean to the buyer? In simple terms, this increase on a \$10.0 million loan equates to an increase in your annual debt by \$40,000.

Competitive Market:

It is still a sellers' market, with many purchasers competing for attractive real estate opportunities. Each property offering for sale usually has several offers, and usually the top price will win. An average offering may have fifteen (15) or more bidders, then three (3) on the short list and hopefully your bid will be the one that wins the deal.

Denial, Compromises and Lost Deals Ahead:

With interest rates increasing real borrowing costs to the deal, you want to keep the market return to your investors, who typically want an 8-15% return. Increased lending costs requires you to either increase rental income or reduce expenses to equate to your return to your investors. Careful underwriting is important here to avoid the temptation of chasing a proforma that can't be achieved. More than likely, landlords will take the position to increase rents which increases the risk of tenant displacement.

Savvy sellers recognize that interest rates will potentially push up capitalization rates which determine value. This is a difficult realization to accept. As buyers themselves, they realize if the price doesn't change, then when the contract is dropped on their property, the next buyer will have the same cost considerations in this increasing interest rate environment. However, the market is full of sellers who want to hold out for their price expectations. What will occur in the coming months is a Mexican standoff where the failure to recognize the fundamentals will lead to stalled deals as everyone seeks to readjust expectations. This happens with the change in every market cycle.

Increased interest rates are a huge factor in investment real estate, and the effects are only starting to be felt. Our forecast in the next year will be slowed deal activity and failed deals as Sellers and Buyers seek to readjust expectations in the face of true rising costs.

See our Deal Profile of the Month.

Deal Profile of the Month:

HouseATL and Mayor Bottoms \$1 Billion Affordable Housing Pledge

<https://houseatl.org/recommendations/>



In an important announcement, Mayor Keisha Lance-Bottoms shared this month the appointment of Terri Lee as the new "Affordable Housing Czar" for the City of Atlanta. This came after recognizing the leadership of HouseATL for their tireless efforts to create a blue print on the implementation of the Mayor is pledge to put \$1 Billion into affordable housing in Atlanta. The recommendation link above summarizes the thought leadership of the best and brightest from the public and private sectors. This pledge will be the deal of the decade if implemented.

Are You an Investor?

We are in pursuit of several investments. If you are an accredited investor and want to be considered for one of these offerings, please reach out to us. Call us today to learn more at 404-698-3535 or dgibbs@tristarinvest.com.

Sincerely,

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