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The Impact of Rising Interest Rates on Commercial Real Estate Investments

Greetings!

The Federal Reserve reaffirmed its view in late July that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation. The potential increased cost of money has had many in a panic, as we have been swimming in unsustainable cheap debt since the recession. Consider that in August 1981 the 30-year fixed mortgage rate was 17.28% (gentle reader....this is not a typo) which steadily declined to a bottom of 2.70% in December 2012. Despite the drama associated around Yellen and the Fed, interest rates have been steadily increasing since 2012. The mortgage rate today for a 30-year fixed is approximately 3.75% or a 1.05% BP increase from the floor. What do we anticipate the impact in the Commercial Real Estate markets? Here are some perspectives to consider:

1. Health of the Economy - if the economy is doing well, it can absorb the impact of the increase in the cost of borrowing. The Fed is only going to make such a move cautiously to prevent the slowing of the economy and return the credit markets to a degree of normalcy. Though inflation may not be in full force, individual wages are trending at an annual 4.2% increase, thus the Fed's move is warranted to keep the pace of the growth in check. In commercial real estate, rents that have been artificially low are increasing in almost every sector so the increase in rates can be absorbed.

2. Fed. Funds Rate is a Short Term Rate - for overnight borrowing between banks. This will have minimum effect directly on cap. rates and respective values in the near future. As future Fed. Rate increases occur, it will likely impact the longer term interest which will result in higher cap. rates. However the spread between the Ten Year Treasury and the Cap Rates should allow for more compression to minimize the impact of any increases in long term rates.

3.Buying Opportunities - we are seeing sellers acting in advance of the interest rate move. If there is an impact on borrowing brought about by increases in the cost of debt, the selling market will have to recognize the impact and quell their pricing expectations. In a more drastic situation, if the rates increase dramatically, there will be an increase in cap rates down the road and prices come down. This means yields go up for the buyer! There is always a silver lining somewhere in every market move.

4.Reality of Risk - the reality is that rates have been increasing for the last 2 ½ years despite the Fed's moves. As discussed above, the rates bottomed in December 2012 and have been steadily trending upwards. Lending money is risky and the lender needs to be compensated for this risk. Furthermore, an increase in rates is a positive for a small segment of the investor market - people living on their pensions and savings.

In summary, we have been investing in properties that are positioned for the inevitable increase in interest rates. We are locking in fixed rates long-term and purchasing properties where the rents are artificially low which can be increased to absorb the impact of rate increases. We have also targeted properties with lease structures that allow expense increases to be passed through to the tenants.

Please see our TriStar Professional of the Month:

Professional of the Month

Jeff Enck with the Shane Company



At Tristar, we work with so many quality professionals that embody our principles of ***Trust, Transparency and Timing***. The timing is right to recognize a quality professional in Jeff Enck. As Vice President of Shane, Jeff Enck's focus is handling acquisitions and dispositions of retail and office properties on behalf of private equity, developers, lenders/CMBS special services and REIT's. Mr. Enck is a consistent top performer with closings ranging \$4 million to \$40 million. His efforts have been continuously recognized, and Mr. Enck is a four time recipient of the Double Black Diamond Award for outstanding performance. Thank you Jeff for your professionalism.

Please Review TriStar's Investment Profile of the Month:

Investment Profile of the Month



22,000 RSF Office Building
Florida Panhandle
96% leased, National Credit Tenants with renewals pending

Double Digit % Returns

TriStar is seeking investors. If you are interested in investing with TriStar, call us at 404-698-3535 or email us at dgibbs@tristarinvest.com. Or visit us on line at www.tristarinvest.com .

Sincerely,

TriStar Partners

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