Will the Fed Raise Rates This Time?

By Jordana Rothberg
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Experts weigh in on whether another hike is coming tomorrow—and how it would affect multifamily.

As the impact of the **Federal Reserve**'**s** prior interest rate hikes continues to be felt, there is little certainty as to what the central bank will do this Wednesday.

Conventional wisdom heading into March had been that the Fed would copy its February 25 basis-point interest rate hike this month before easing up on the increases. However, the macroeconomic factors at play this time are significantly different, with economic uncertainty spreading.

In prepared remarks, Lawrence Yun, chief economist at the **National Association of Realtors**, said that recent bank failures mean that the Fed has to be less aggressive in pursuing short-term interest rate hikes. The central bank implemented the first of eight interest rate hikes in March 2022, with rates rising a total of 4.5 percentage points in the past year.

"The range of options available are different this time around," Elie Rieder, founder and CEO of **Castle Lanterra,** told *Multi-Housing News*. "Not only may the Fed be at an inflection point in its rate hike, but the financial market upheaval gives it a broader economic stability question to digest."

Monetary tightening aimed at combating inflation has contributed to the recent failure of key players in the financial sector, most notably the collapse of **Silicon Valley Bank** and **Signature Bank**. As a heavy investor in the multifamily industry, Signature Bank's failure has led to both fears that the fallout may spread to the real estate industry and to pleas for a halt in rate hikes. The bank's multifamily lending portfolio was some $19.5 billion at the end of last year, according to its 2022 annual report. On the other hand, inflationary measures per the consumer price index are not falling where the Fed had hoped. The current 6 percent is well above the Fed's goal of a 2 percent annual rate, and pausing now could do more harm than good.

Uncertainty about what lies ahead

"There will be more increased rate hikes, but I doubt we will see 75 basis-points, at least for the rest of 2023, or that we will see interest rate hikes for at least the next quarter until the banking system is stronger," said Stuart M. Saft, partner and real estate practice group leader at **Holland & Knight LLP.** "One more rate increase or bank failure in the next 3 to 6 months and the Fed will lose control of the situation and there will be a repeat of 2008."

It is essential, at this point, to ensure strength in banks, said Saft, noting that only once the banking system is in check can the Fed continue to move ahead with rate hikes. Another inflationary measure to consider is that the U.S. does not have enough money to fund all the banks that could fail.

Contrarily, Morris Kaplan, president of **Kaplan Residential**, said that while the bank failures play a role in the Fed's decision, we will still likely see further rate hikes. "If not for the recent bank failures, I believe the rate hike would be higher this week, however, the Federal Reserve was forced to be more conservative," said Kaplan.

Rieder also believes the Fed will likely continue to press on with rate hikes this week. "The Fed, and Powell in particular, has generally tried quite hard to telegraph future rate expectations," said Rieder. "Previously, they had opened the window for a 50 basis-point hike but the financial market upheaval has vastly reduced the likelihood of that. Given the Fed's mandate, and current inflation and employment levels—both relatively high—it is possible that they opt for a 25 basis-point increase instead of 50 basis-points."

A core reason for continued bank hikes, Rieder said, is the data the Fed uses. Despite recent bank failures, indicators from the labor market and other inflation metrics will, in his opinion, likely lead to continued interest rate increases.

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Another increase's impacts on multifamily

Should the Fed choose to move forward with another rate hike, there would be both positive and negative impacts on the multifamily market, Saft argues. "On the positive side, real estate, like all hard assets, is the best protection in an inflationary cycle because the property gets more expensive and the outstanding mortgage is less expensive because it is being repaid with cheaper dollars," he said. However, as the economy weakens and the price of construction, maintenance, repairs and replacements become more expensive, few people or businesses can really afford multifamily properties.

Brian Foley, chief investment officer at **Procida Funding & Advisors** said that one of the biggest impacts on multifamily of a rate increase stems from floating rate construction loans. "The 80 percent loan-to-cost ratio, low-rate loans of 2021 to 2022 will be coming due in the next year to two years," said Foley. "Unfortunately, the increased rate environment has drastically cut into the back-end values and will make it near impossible to refinance, leaving the only option as a sale for some borrowers."

Impacts on borrowers in multifamily has a trickle-down effect to every aspect of the industry, including units currently under construction.

Karlin Conklin, co-president and COO of **Investors Management Group**, told *MHN* that if developers go pencils down on units currently in the design and development phase, multifamily deliveries four to five years from now would see the results.

Could we be witness to further slow downs?

"Rate hikes and softening market conditions present challenging conditions for developers," said Conklin. "Assumptions for rents, occupancy and resale value are lower today, so new projects are tougher to pencil out. We expect that as rates go higher, construction activity will slow and some projects will be put on hold as development becomes higher risk and less profitable."

Further contributing towards a potential slow in the market is the difficulty of obtaining financing in the first place. "I believe the biggest slowdown in the development [and] investment landscape has already started and is directly correlated to the banks not lending at all," Foley told *MHN*. "It is very difficult to get construction financing at any level today."

The lending landscape, according to Kaplan, is absolutely feeling the impact of interest rate hikes as banks and private equity firms become less active. “The few [banks and private equity firms] not on the sidelines are creating risk-averse lending by adjusting the loan-to-cost ratio,” Kaplan explained. “Previously you could get a 65% loan-to-cost construction from a bank. Today, if a bank would even entertain it, you would close it at 50% at minimum.”

Difficulty acquiring financing, despite being a small or large company, is posing as a challenge for almost all multifamily players. Therefore, Kaplan believes there will be a slowdown of sales as well as apartment developments.

However, contrary to Foley, Conklin and Kaplan’s thoughts on the multifamily landscape, Rieder believes the slow in multifamily investment and development activity is already being felt. Multifamily investment and development activity will not further lessen as a result of the anticipated 25 basis point interest rate hike, said Rieder. However, he did conceded that, should the Fed choose to raise interest rates more than the general markets are anticipating, the industry could see further slowing.

“The market slowed dramatically from quarter four 2021, and a further rate hike won’t slow it any further,” said Rieder. “Any further slowdown is a result of general uncertainty and bank lenders pulling out of the market to assess the situation and hold onto cash.”

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