RESEARCH BRIEF

Marcus & Millichap

CAPITAL MARKETS

AUGUST 2024

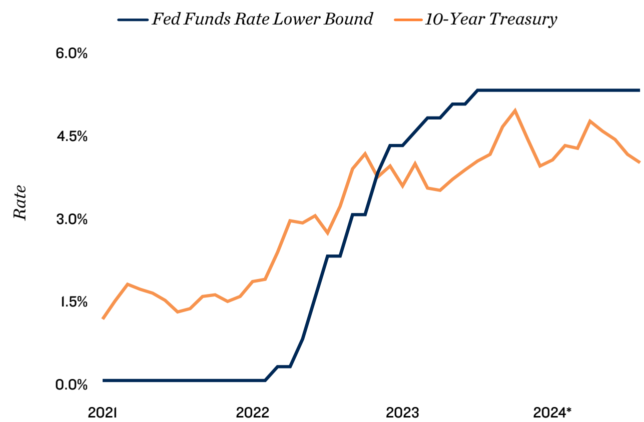
Interest Rates Trend Lower, Paving Way for Invigorated Commercial Property Investment

Treasuries decrease amid softening market conditions. In the 90 days ended Aug. 9, the 10-year Treasury fell 50 basis points to the 3.9 percent range, its lowest level since a brief point in February of this year. This decline manifested as the prospects for upcoming interest rate cuts by the Federal Reserve gained momentum amid lower inflation readings and loosening labor market conditions. July's slowdown in hiring, and resulting 20-basis-point increase in unemployment to a 33-month high of 4.3 percent, in particular prompted a short-term drop in the 10-year to 3.8 percent earlier this month. Rising unemployment, paired with a change in the Federal Reserve's messaging at its last meeting, have convinced Wall Street that the Fed will cut its overnight lending rate in September. The possibility it will be a 50-basis-point reduction has also garnered more support.

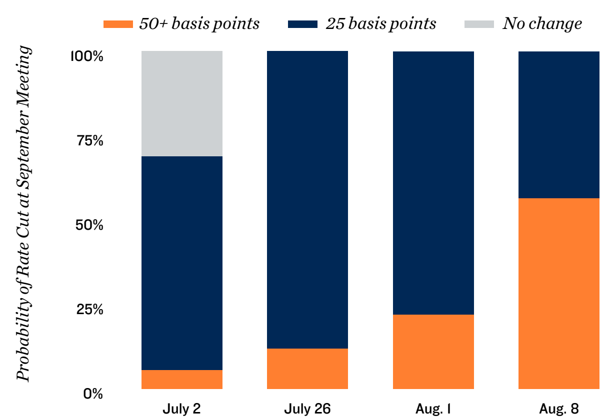
Borrowing costs on downward path. The emerging clarity surrounding interest rates has begun to convince select lenders to narrow their spreads over the underlying interest rate basis. That tightening, combined with drops in the benchmarks themselves, is reducing the cost of debt. Since early May, commercial mortgage rates have fallen approximately 50 basis points to the 6.25 percent-to-6.75 percent range. Multifamily rates have declined to the 5.25 percent-to-5.75 percent band, down approximately 95 basis points in that span for conventional agency financing. For comparison, the average cap rate across all commercial properties traded over the 12-month period ended in June was 6.7 percent. For multifamily properties, the measure was lower, at 5.8 percent. As lenders' spreads move closer in line with cap rates, investment sales activity is likely to heat up.

Lower rates pave way for renewed investment enthusiasm. These rate reductions will materially lower a borrower's cost of capital. On a $10 million seven-year loan, the annual payments could be reduced by as much as $50,000 on just the rate reduction alone. Over the course of the last 10 quarters, since the Federal Reserve began increasing interest rates, commercial real estate transaction flow has moderated. As interest rates approached or exceeded cap rates, the expectations gap between buyers and sellers expanded. The upcoming decline of interest rates should help alleviate the buyer/seller expectations gap and help the large pool of investors who have been on the sidelines reengage with the transaction market.

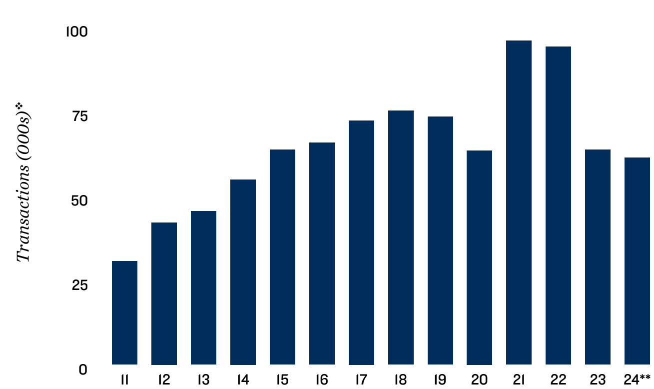
Treasury Yields Dipping as Rate Cut Anticipation Builds



Market's Expectations of Fed Policy Quickly Shifted



Sales Activity Down from Peak, In-Line Historically



* As of Aug. 9 ** T-12 months through 2Q * Sales $1M+ for multifamily, retail, office & industrial
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; CME Group; Federal Reserve; Real Capital Analytics