US commercial real estate facing "wall of debt."

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While Wall Street has been hitting record highs on the prospect of interest rate cuts by the US Federal Reserve in 2024, at least three and possibly more, a key sector of the US economy with crucial links to the financial system, is being hit by the rise in rates that has taken place since March 2022.

According to data from the Mortgage Bankers Association, reported on by the *Financial Times* (FT), "billions of dollars of debt will fall due this year on hundreds of big US office buildings that their owners are likely to struggle to refinance at current interest rates."

There are $117 billion worth of mortgages based on offices which need to be repaid or refinanced this year. Many of the mortgages were taken out when interest rates were at ultra-low levels because of the quantitative easing police pursued the Fed and other central banks for almost a decade and half after the financial crash of 2008 and the crisis of 2020 when COVID struck.

The FT report cited the comments of a real estate finance lawyer at a major firm who said it would be a problem to get some of the refinancing done.

"We're seeing deals where even sophisticated borrowers are calling it a day and asking their lenders whether they would like to take the keys," he said.

The commercial real estate sector has already been hit with a shock because of the collapse of the Austrian firm Signa in December which has now put up for sale half of the Chrysler building in New York in order to raise cash.

While Signa's owner, the billionaire René Banko assembled what has been characterised as a "financial time bomb"—gorging himself on "cheap financing left, right and centre" as one description put it—his activities were only one of the more extreme examples of a broader process.

Last November it was reported by industry tracker BankRegDate that delinquent commercial real estate loans had reached their highest rate in a decade—the consequence of higher interest rates and the fall on demand for office space as a result of growth of remote working in response to the pandemic.

The volume of loans on which property owners had missed more than one payment jumped by 30 percent, $4 billion, in the September quarter and increased by $10 billion in the past year.

It is expected the delinquencies are going to continue with Bill Moreland of BankRegData telling the FT that commercial real estate lending was "getting ugly fast."

Larger banks have resources to weather the storm, at least so far, but much of lending in the US is carried out by small regional banks. They have already been hit by the rise in interest rates because of the loss of value on the government bonds in which they placed their cash, because it was a "safe" security.

This situation led to the demise of three banks in March, but the problem went across the board with many banks "underwater" where their total liabilities is greater than the book value of their assets.

The FT reported that last month "a group of US economists found that 40 percent of office loans on bank balance sheets were underwater, potentially causing problems for dozens of regional banks holding them."

The problems for commercial real estate are long term. Back in April, Bloomberg reported that a "wall" of commercial and real estate debt worth almost $1.5 trillion would become due for repayment before the end of 2025. The big question facing these borrowers was "who is going to refinance them?"

A note by Morgan Stanley analysts at the time said

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refinancing risks were front and centre as it estimated that office and retail property valuations could fall by as much as 40 percent from peak to trough, increasing the risk of defaults. Things have not improved since then and, as the Bloomberg report noted, would continue to worsen.

It is not only small and regional banks that are being impacted. Problems are emerging as well in the high end of the finance sector and commercial real estate.

Earlier this week, the *Wall Street Journal* reported that one of the "hottest fundraising juggernauts" on Wall Street, nontraded real-estate investment trusts (REITS) that allowed investors to take part in the 2019?2022 property boom, had "run off the rails" last year.

Redemptions from the funds soared last year as investors sought to cash in and on occasions the trusts had to implement rules that limited the rate at which people could get their money back.

Nontraded REITs raised $9.8 billion the year to November compared to $33.2 billion in 2022, as investors pulled out $17.4 billion.

The article said that while the pace of redemptions had slowed to some extent towards the end of last year, outflows were expected to exceed funds raised in 2024. This made "the business a symbol of the worst downturns to hit the commercial-property industry since World War II."

An article in the *New York Times* at the end of last year said the building spree which had reshaped the Manhattan skyline over the past 25 years was over.

"Rising construction costs and interest rates have significantly driven up the price to build. Banks are increasingly reluctant to finance such construction while Manhattan has record office vacancies," it said.

Office developers had been hit by a one-two punch. First the decline in demand because of COVID and then soaring interest rate "kryptonite for an industry built on debt."

At the end of November nearly 18 percent of all office space in Manhattan was available for lease, much of it in older buildings built after World War II.

The average asking rent for office space in Manhattan is $75 per square foot. But with higher construction costs, rates and increased interest rates developers of new buildings would need to charge between $200 to $300 per square foot.

Such figures, coupled with the mounting commercial real estate problems across the country, indicate that the boom of the past quarter century, based on some of the lowest interest rates in history, is over and a financial reckoning is coming.

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