RESEARCH BRIEF

Marcus & Millichap

FINANCIAL MARKETS

MAY 2023

Fed Shifts to a Reactive Stance; Greater Lending Consistency May Be Coming

Federal funds rate pushed to 16-year high. On May 3, the Federal Open Market Committee lifted the overnight lending rate to a lower bound of 5.0 percent, a 25-basis-point shift. The FOMC has raised the federal funds rate a combined 75 basis points so far in 2023, just one-sixth of last year's total shift. Going forward, the path is more open. Chairman Powell stated that the FOMC will take a meeting-by-meeting approach to any further monetary policy tightening. If inflation pressures continue to ease and economic growth tapers, the Fed may elect to keep rates flat for the near future. Part of this expectation is tied to recent disruptions in the banking sector, which are expected to have their own cooling influence.

Third banking collapse in two months sustains caution. Unable to recover from over $100 billion in withdrawals made in the first quarter, First Republic Bank was seized by California regulators on May 1. The FDIC was appointed as receiver, who then sold a majority of First Republic's assets to JPMorgan Chase. While the prompt sale helped limit the broader impact of the collapse, general concern from some market participants has continued to weigh on equity values of smaller depository institutions. PacWest Bancorp and Western Alliance Bancorp both reported substantial drops in stock prices in the days after the First Republic sale. Reduced market valuations, paired with ongoing pressure on deposits from higher interest rates, will likely sustain or even possibly enhance tighter lending conditions.

More consistent capital markets environment on the horizon. While the First Republic closure removes another capital source for commercial real estate borrowers, only about 19 percent of the bank's loan portfolio was tied to commercial properties. This most recent seizure may nevertheless elicit further lender scrutiny beyond changes already adopted after the March failures, continuing to constrain lending in the near-term. In the longer run, however, the outlook may be improving. If additional bank closures can be avoided, or addressed as rapidly as First Republic, and the Fed holds interest rates flat, the consistency would help financiers and investors more readily calibrate their underwriting — the first step toward narrowing the buyer/seller expectations gap.

Commercial Real Estate Implications

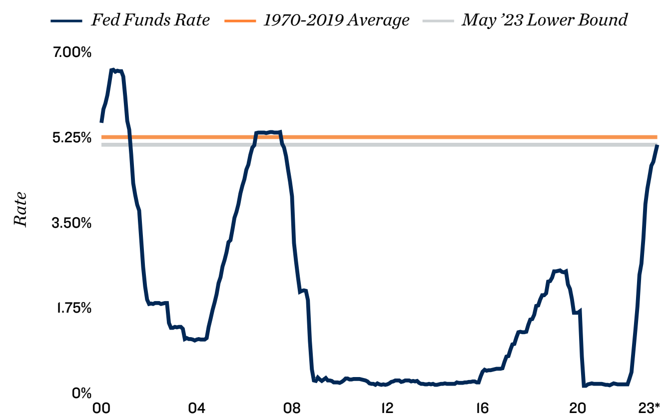
Multifamily capital landscape liquid. While not immune to tighter credit conditions from banks, such as lower loan-to-value ratios, multifamily properties continue to appeal to a wide array of lenders. Borrowers can benefit from access to government sponsored agencies as well. While the multifamily sector encountered headwinds in 2022, with more rentals vacated than newly occupied, the opposite has been true so far this year. Positive net absorption led to a modest quarterly rise in vacancy, despite one of the most sizable delivery slates on record.

Single-tenant stability bolsters retail lending. While local and regional banks have taken on a larger share of lending on retail properties since the pandemic began, capital is still available. Single-tenant spaces net-leased to necessity vendors and dining places, in particular, are benefiting from still-climbing consumer spending in both categories. The overall single-tenant net-lease vacancy rate held flat in the first quarter and is below pre-pandemic levels. The long-term structure of such leases also provides more stability in a dynamic time.

5.00% *Lower Bound of Federal Funds Target*

5.16% *1970-2019 Average Federal Funds Rate*

Fed Lifts Rate to 16-Year High, In-Line with Average



** As of May 3*

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve; Real Capital Analytics; RealPage, Inc.

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