**Where is CRE and Where is it Going?**
**The Good, The Bad, and the Funny**

**By Richard Benson**

**Based On Our Remarks**
**For the IMN CRE Conference**
**May 15, 2024**
**At the Union League Club**

- **<u>What is Happening on CRE Occupancy levels?</u>**

**<u>Big general trends in progress and coming….. Really Funny Stories</u>**
We followed and learned from a Master Sam Zell, who in 2007 sold to Blackstone for $39 Billion, and knew "When to hold them and When to fold them" when it came to CRE. So, back when the Fed first raised rates the first ¼ point Sam Zell was selling CRE into an up market and we were screaming at banks like SVB to dump their $100 Billion MBS portfolio before it ate them alive. When the $100 Billion was only worth $70 Billion and SVB was down $30,000,000,000 on the trade SBV failed.

Next up, we were trying to move the management team from PacWest to an Insurance company but Ares bought the portfolio that was all good and let the bankers "go walk about". Without dumb banks Vulture hedge funds would have nothing to eat! Banks are really funny in how stupid they always are.

Next what has left us stunned, giddy and giggling is Delinquencies on Floating - Rate Office CMBS loans just hit 20%. We haven't had so much fun since we were working with Rick Trepp, at Trepp Financial doing securitization, and we had worked with Rick at Chase when we were the Trading Desk economist when Paul Volker who worked at Chase twice….. had just become the Chairmen of the Fed.

***We can share some astounding***
***Funny stories about those time with the firms that have engaged us..***

Now at a current 20% delinquency rate on floating, CRE loans you might think the bottom is in, but the sad fact is the Interest Rate CAPs on the floating rate debt are just now running off, so loans at 3.75% are getting marked up another 5.50% for SOFR to 9.25%, and the joke is on both the borrower and lender of course.
How will they pay? Well Spell the word "way" without using the letter F, and you will see there is "No F in Way" they can pay. Not with rent roles down, down, down.

**<u>Inflation is Driving The Fed on Interest Rates</u>**

41% of Americans put inflation number one as the Greatest risk to their families. *<u>"Americans Continue to Name Inflation As Top financial Problem : Gallup Pole."</u>* Inflation has put interest rates on hold and no cuts, from the Fed, so where is inflation headed? Weather – International Situation risks, like the cold but warming up war with Russia and China is well underway.

Let's look at Gas prices first. The Saudis, Mideast Arabs and Iran all want to get paid in Gold and China that has no oil but is taking control of the gold market as they have a $Trillion is US Treasuries to spend want raw materials like oil and food. So, what are we going to do? Just grab China's US Treasuries like we did with 'Russia"? Not before they invade Taiwan is my guess, and we are selling more arms to Taiwan, South Korea, and now Saudi Arabia. The US used most of its Strategic Petroleum Reserve to hold down oil prices earlier and now would be restocking at much higher prices.

The Ukraine and Russia are using drowns to bomb each other's oil refineries, and each other's grain storage silos, so that the cost of shipping grain will be lower than normal I suppose? <u>No, they want to damage each others economies</u> **but that can contribute to world starvation.** With war in the Gulf, Oil can spike anytime even if we sell the Saudis a lot of nasty Arms, that they could turn on ……..who? Well, who in the area do all the Arabs hate? Perhaps Trukiye is a tell..

Turkiye just embargoed trade with Israel. Gas is going to not going to be cheap as we go into summer driving season. You might have noticed that the Permian Basin in Texas and New Mexico that produces more oil than Kuwait and put the United States oil production “on top in the world” is causing the ground to shrink massively where it is pumped and bulge where the water is pumped back in causing fun roller coaster but un-expected earth quakes that make sleeping through the night hard if you go to bed sober. Exxon is buying up the biggest shale producer so drivers can pay more for gas.  Go Giant Exxon! Go USA!

Grain prices around the world are a big problem.  India that exports enough to be 40% of world rice trade has embargoed rice to feed their own people, while massive flooding may have just destroyed 13% of the Chinese rice crop. Meanwhile the temperatures in Vietnam, Thailand and Burma that grow rice have been setting records as which as 120 degrees and summer is just starting.  Brazil just had massive floods, and the West in the US looks to have a dry summer. You know how much the cattle like no water and no hay when they hear they are on the early list to do to the feed lot and then the “hamburger chop shop”. The us Cattle herd is already low, as cows only have one calf a year. Chickens well can make hundreds of eggs and new Chickens.

Thank God we got the BLS to take Food and energy out of the BLS CPI index the Fed Watches as they are not core prices people should care about. But where there is food, the CPI will substitute cheap chicken for expensive beef to hold the line and manipulate the CPI to underreport it but using the BLS Substitution trick.

Back in the US rising food prices are sending shoppers to trade down to Aldi.

Not only Food and Gas are going up in price.  Car insurance has gone vertical on vehicles as the new cars are easy to damage, and hard to fix, and even Tesla is finding out that Tesla’s really can’t drive themselves without running into things or off a cliff.  Car insurance in 2023 had the biggest percentage jump since 1976. Meanwhile why the cost of coco is coming off a sugar high, the price of coffee beans is more than robust as they would say. It is a tragedy. Don’t talk to me, if I can’t get my morning Joe fix.

In many states the ‘kind power companies’ are pushing up the cost of electricity to make it easy for consumers to make a simple decision between 1) not running the air condition and dying quickly; or 2) many Americans with Walrus or Hippo body types, not eating and getting back down to a painful normal healthy European weight **<u>without the new expensive miracle drugs like wegovy.</u>**

Worse yet for inflation and consumer budgets are Articles in the Press expand on the hidden cost of home owning are soaring like insurance, lawn car, gutters, Insurance, taxes sewer, water etc. Then there is 'insurance hell' in FLA. Average home insurance can be $12,000 plus in FLA, not the $2,550 average is some states. In every case, if you have a mortgage you have to have home insurance. Even the people with 3% mortgages are getting stretched out on the housing bills. Now old folks, can't even afford their long time trailer any more as the trailer park just popped up the rent again.

So, looking at family budgets it should be no surprise why Credit card payments are running late and on the way to charge off, just doubled from 2% to 4% and look on track to go north of 8% if the labor market gets crappy. Most new fulltime jobs are just part time gigs, and many people have three jobs and three different workers by the US Government bought and paid for BLS statisticians.

Meanwhile flooding is everywhere along with killer monster tornadoes, and we are just getting ready for a Hurricane season that may be "busy with a lot of named storms". We lived in Palm Beach for 17 years, while running our FINRA BD, and we got hit by three hurricanes none over a Cat 3 in the same year. With power out you have to hang out at a cooling station or get heat stroke. The East Coast of FLA is long overdue for a 'BIG One'. Go Global Warming!. Go Mother Nature! & Gia looks to have Karma going for her!

*The nice thing about a lot of the housing costs is they are not a part of implied rent* **<u>that we helped invented at Harvard to keep the CPI undercounted, and inflation under reported by 50%</u>**

**The news on real estate is not all positive as headlines like….**

<u>" Home sales Clobbered by Mortgage Rates. New listing & Active Listing Surge."</u>
Most Prices Reductions for any March in Years are starting to give Buyer's hope. So is there fact that 20% of condos in San Francisco are selling for less than the buyer paid, and prices are lower than 2021.

**Meanwhile, on the East Coast of the US**

> *"Florida Real Estate sellers slashing home prices as inventory surges to uncomfortable levels" is the new new and refreshing for the senior lenders who have been caught napping, again.*

To wrap up singly family housing on what is likely on the way in the US, is *"The Most Splendid Housing Bubbles in Canada: Home Prices Dip Further, -14% from Peak in March 2022,- Now below Sep 2021."* Don't be shocked if in the Canadian Government is first to nationalize big banks like BMO and CIBC to save their economy.

Finally, "Americans Went All -in on Self Storage. That Demand is Suddenly Cooling." That is good for prices down the road unless you are a Developer with a lot of units just half built that now will never pencil with the bank's bridge loan costs as your interest rates CAPs just expired.

The Spectacular CRE good news is very Local. Example*: "How Hudson Yards Went from Ghost Town to Office Success Story"* as many of the big name 'white shoe law firms' moved over Hudson Yards to follow the giant hedge funds that want their employees to live in an area with nothing to do outside of work. The 'White shoe Law firms fled Midtown, so it was Hudson Yards up, and Midtown down.

> *Meanwhile, retail at Hudson Yards is still dead except for two fancy restaurants for lunch when clients are entertained. We have been there bringing in clients to meet the likes of KKR, and are getting to be on a first name basis with the maître d and cute waitresses.*

Small Businesses can feel good they are not left out of the situation. *"Disaster Loans Provided a Lifeline"* Now 860,000 Small businesses Owe **tens of billions including 30% late Fess curtesy of the US Treasury SBA program.** many of the small business can't afford to pay the 'VIG' on their small CRE loan, OOPs!

*For engaged or prospective clients we can explain how our research at Data Resources at Harvard got used to fudge the BLS price statistics, and why……….*

…….inflation is really double what the government reports. **See John Williams shadowstats.com**.

*For President Johnson, Guns & Butter kicked off over ten years of very high inflation and the need for financial repression to make sure people on Social Security starve and save the budget. In 2024 Federal Budget issue is worse.. far worse.*

*SFG will be creating new price indexes to save investors is going to be "our profitable hobby" in a JV with shadowstats.com*

**-What are the trends for employment as you need jobs to fill CRE?**

Sorry you asked, but a funny lesson for the young workers who have always had multiple offers to work in jobs they did poorly, yet thought the job was beneath them.

Now workers are finding *"Why it's Hard to Get Hired Despite Glowing Job Reports",* like Tesla suddenly laying off 10% of all workers and pulling out on Tesla Charging.

*Currently many job postings are for show. A firm wants to pretend they are hiring not pruning. A firm will say "We are hiring" but they Ghost every applicant, and the job listing are not real. Even 'We Works' did not sell to their toxic founder.*

Now in Office land *"A lack of Job Security: White Collar Job Growth Stalls Hard",* and AI is just getting started working 24.7.365. 120,000 job postings from San Francisco, Los Angles and Chicago combined just vaporized and were deleted.

College Graduates are looking forward to more Beer and Pizza and maybe going to business school as "Class of 2024, It's Not in Your head: The Job market is Tough" (Already). Instead of fine arts perhaps it is time to get another student loan and study accounting that is in great demand but not sexy, but pays well.

Pizza and Starbucks reflect the number of people coming in and working. Both are down in nominal dollar revenue, and Starbucks share price just dropped 18%. Perhaps that is notable as coffee prices are way up, and without a job you don't need to get 'jacked up on Java'.

### -How is the Banking Crisis going to impact the office market?

The question is backwards, as the first part of the banking crisis was their holding money good long duration assets that dropped 30% to 40% in market value in a mark to market world that lets you hold value at original cost.

The second leg is hitting banks as they have to start paying market rates on deposits or watch their bank deposit flow out to a money market fund that buys T-bills at over 5%. Banks ae having to start paying for Deposits to keep them. "*Money market Funds, T-Bills, Large CDs, Small CDs: Americans Learn to Arbitrage the Higher -for-Longer Interest Rates" ,* This can make a bank's NIM or Net Interest Margin turn negative and even the Fed can't help that one much. We have a client that has $75,000,000 on deposit at Wells Fargo, and they told Wells they would take the money out, if Wells Did not pay them SOFR on their deposits. *They got SOFR on their deposits next day.*

The third leg is really scary for the banks scary for the banks as LOAN ARE ALSO Starting to Default. See our pome aspecialtyfinanceCRE.com, and specialtyfinance.com **"The Charge of the Bank Brigade"** for the color and emotion behind that one.

However, as banks fail they are not there to make new loans are they? So, new lenders have to step in from Private Credit, and the smart ones fund in the capital market with tools like REPO to fund assets they can get rated. Indeed, we are starting some new lenders and showing banks how to get assets rated and using the REPO market to replace deposits. **"US Domestic Deposits Tumble $60 BN As Small Bank Loan Volumes Shrank Most Since SVB."**

*The trend is nothing new and as were running E. F. Hutton's securitization effort in the S&L crisis to get assets rated and put our on the REPO DESK right before Hutton got levered out in the 87 crash which was a warm up for the later failures at Lehman Brothers, Bear Sterns and Merrill getting a Bear Hug 'take-under' from BofA.*

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- **What is the latest on office loans maturing and CMBS?**

Well Guys this is just an epic catastrophe in the making. If you sit the defaulted loan is going to get sold to a hedge fund at a song, and the bank and Developer owner are totally wiped out.

*That is why we invented a strategy to save them both with the bank regulators looking on and smiling on what we do to save both the bank and Developer for the 'Vulture Hedge Funds". The term sheet for our deal is at specialtyfianceCRE.com. The costs are pretty reasonable considering there in no other way to save your selves unless you can wait for a government program that will never pass before the November election. The scope of the disaster needs to be hushed up until after the election as 'politics dictate happy optics before the election.'*

**To look at Getting a Distressed Property Fixed**
**Look at the Term Sheet we could offer you at**
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- **Attractive Distressed plays & Reposition for Exits**
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