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Interest Rates: Ingredients for a Successful 2013-14

Remember that historical lows, in any sector, never last and most things revert back to their mean and so will interest rates, says Daneshrad.

BEVERLY HILLS, CA-As we near the close of 2013, many wonder what the future of **interest rates** will hold in the months ahead. As interest rates rise—and they most likely will in the coming months—it will be a result of an improving economy that should also result in increased demand for real estate. The rise of interest rates will create **cap rate inflation**, some of that inflation, or loss of value, will be offset by the increase in rental rates. The unfortunate bottom line is that we will undoubtedly see more loss of value as interest rates rise than we will see an increase in value from rental rates or improving operating fundamentals.

Hence, for 2013-14, investor uncertainty can be daunting and many wonder what will happen to their real estate investments when interest rates rise. There are three keys for investors to remember as we near the end of the year:

1. The Fed can influence interest rates, but the market ultimately controls them
If we look at the Fed statements over the last two meetings, they have made the decision to avoid increasing rates until the unemployment rate comes down and the overall economy improves. However, even though the Fed hasn't moved rates, interest rates over the last six months have increased 100 basis points due to the market alone. The Fed can influence the rates, but obviously cannot completely control them. At the end of the day, the markets are going to control and react based on the Fed's temperament. So listen to the Fed but watch the markets. Remember that historical lows, in any sector, never last and most things revert back to their mean and so will interest rates.

2. Capital strategies must correlate with business strategies

In 2014, investors must be careful to ensure their capital strategies are synergistic with their asset strategies. In an environment where interest rates are at 60-year lows and are likely to rise, you have to make sure that if you're buying a real estate asset today and you plan to sell it three years down the line, as you're underwriting and modeling your exit strategy, you make sure to price higher interest rates (Cap rates) into your model. Those professionals who ignore this risk factor may regret the purchases they make today as interest rates may be upwards of 200 basis points higher than they are today.

3. Multifamily will remain the strongest sector as single family is hit hardest

As always, interest rates will have a disproportionate impact on different property sectors and certain markets will be hit much harder than others. The multifamily market is hot everywhere in the country, with the exception of a few pockets that are struggling, and will remain the strongest as interest rates rise. By the same token, as interest rates rise and single family affordability decreases, demand will decrease along with single family property values. Additionally, the consumer will be hit by higher credit card and mortgage rates which will not bode well for retail.

Paul Daneshrad *is the president & CEO of Beverly Hills-based StarPoint Properties LLC. The views expressed in this column are the author's own.*