Oral Statement
Before The House Oversight and Accountability Subcommittee on Health Care and Financial Services
April 30, 2024

"Health of the Commercial Real Estate Markets and Removing Regulatory Hurdles to Ensure Continued Strength."

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Good afternoon.

Thank you for holding this important hearing regarding the health of commercial real estate markets.

Because the health of commercial real estate is so intertwined with the overall economy, sometimes it is forgotten that commercial real estate markets:

- directly support more than 15 million jobs in the economy,

- real estate asset values and transaction volume provide the principal source of tax revenue for local government budgets that fund essential services including education, road construction, law enforcement, and emergency planning

- provide pension fund investment returns to build the retirement nest eggs for millions;

To be clear, the commercial real estate industry is not seeking a bailout of any sort.

To the contrary we believe all public and private stakeholders must work together to advance sound regulatory and legislative policy with the goal of making sure that commercial real estate is able to continue its position as a leading driver of the economy and a prime way in which cities grow, business needs are met and housing challenges are beaten.

I want to focus my comments on the two sectors of real estate markets that are at the top of everyone's minds: the office market and housing.

Regarding the office market, “stress” began to elevate in 2023 as the uncertainties of post pandemic office space use, combined with higher, inflation induced operating costs, and higher inflation fighting financing costs.

These factors have created a perfect storm of significant challenges for office markets.

But even in the office market there are notable differences.

Some individual owners are facing considerable pressure, potentially leading to increases in mortgage defaults, foreclosures and large losses of equity.

At the same time, many top tier modern office buildings, with strong ownership and workspace amenities, currently are weathering the storm.

Most commercial real estate bank loans are 8-10 year terms, frequently interest-only, and many times originated with floating interest rates.

An environment of government-mandated artificially low interest rates began in earnest in late 2008.

Although interest rates increased marginally over the next decade they remained historically low.

During this time period, commercial real estate markets were in relative balance (e.g. office vacancy averaging below 12%;).

It is easy to forget that the Fed was holding the federal funds rate at around zero as recently as the first quarter of 2022.

Moreover, commercial real estate loans from the era generally were characterized by conservative underwriting with loan to values of 50%-60%, strong debt service coverage ratios of greater than 2.0x.

The Fed started hiking interest rates in the first half of 2022 and in a span of roughly 18 months raised rates 11 times bringing the key federal funds rate to a target range of 5.25 - 5.5%, the highest since early 2001. Not since the 1980s has the FED hiked rates at this speed.

As concerns about a recession increased, regulators for banks, began calling for increased loan loss reserves on commercial real-estate lending and reduction in commercial real estate portfolio concentration.

In other words, not only were financing costs rising rapidly but financing availability was shrinking . . . liquidity began to contract substantially in commercial real estate markets, particularly office.

In the second quarter of 2023, the overall commercial property debt market, including banks, commercial mortgage securities and nonbank lenders, rose less than 1%, resulting in U.S. commercial property purchases totaling $89.2 billion in the third quarter of 2023, down 53% from the year-ago quarter.

Diminished market liquidity and the drop in transaction value in turn increased pressure further on property valuations.

It is in that environment that nearly half of the $4.7 trillion property debt market, originated during

this government mandated low interest rate period, is scheduled to mature by 2027 . . . in an environment where base interest rates have risen nearly 500 basis points in 24 months-time and one in which lenders are urged to reduce their commercial real estate portfolios.

There has been some helpful policy actions, principally last year's regulatory guidance providing banks with flexibility to restructure maturing existing commercial real estate loans.

But giving flexibility to lenders is not enough.

Banks need to be encouraged to restructure existing loans with new equity and these new loans should be classified as "performing" if the borrower is creditworthy and demonstrates an ability to "transition" the building to a higher rate of occupancy.

I also want to mention office space use.

During the pandemic, authorities ordered widespread closures of places where people gather, including office buildings. These shutdowns were appropriate, and the commercial real estate industry

worked diligently to create safe work environments that would accelerate the reopening of economic activity. Today, returning to in-person work is critical for the health of our cities, local economies, tax bases, and small businesses.

While private sector office occupancy is slowly picking up, the Federal office workforce is behaving as if the pandemic still exists. This is despite President Biden's call for agencies to return to pre-pandemic workplace practices.

We applaud Chairman Comer and this Committee's work in authoring the Stopping Home Office Work's Unproductive Problems (SHOW UP) Act (H.R. 139), a bill that requires each executive agency to reinstate the pre-pandemic telework policies. This bill passed the House over a year ago and should be enacted into law.

In summary, this self-reinforcing cycle of higher financing costs, less credit availability and fewer transactions, must be broken, and it certainly should not be made worse by adopting pro-cyclical measures such as the Basel III Endgame and other regulatory measures that will restrict credit and

capital formation. And the Federal government should lead by example by highlighting the value of in office work.

Regarding housing, yesterday a coalition that we are part of sent a letter to Congress cataloging a host of pending legislative and regulatory actions that we believe would help provide housing to more Americans including: stimulating the conversion of obsolete buildings into housing; increasing the low income housing tax credit volume caps; incentivizing local zoning and permitting reforms; increasing efficiency in the Section 8 housing voucher program and more.

And finally regarding housing, I must note that rent control and eviction moratoriums may be appealing concepts but they have proved time and again that they are counterproductive to addressing the housing shortfall.

Thank you for your time.