



Investing In Commercial Real Estate: Why It's All About The Interest Rate

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As an investor in commercial real estate, if you secure a loan for 80% of the purchase price, the return on investment hinges on the eventual sale of the property. Interest rates will make or break the deal.

Why is that? Well, for you CFOs out there, a commercial real estate purchase is really a leveraged buyout – once you've agreed to exit. This may have occurred to you already, but it wasn't until I worked on a recent transaction that it really crystalized for me. Just like a leveraged buyout, the return on investment depends on the terminal value.

What You Can Control

As a buyer, you can negotiate a lower purchase price, using rising interest rates to justify your position. If you succeed, the lower purchase price results in less equity required and less debt. Good for you. That means you can make your loan payments, and bring home some cash. Of course, anything can happen along the way: you might lose one or more good tenants, or you might be able to increase your occupancy rates or upon renewal, increase rents. These all affect the performance of your investment.

What You Can't Control

At the end of the day, though, if you bought a property at historically low interest rates and want or need to sell when interest rates are rising – well, good luck getting a good return on investment in the short term, no matter how well you ran the property. It doesn't take much: 50 basis points in the wrong direction can torpedo your five-year hold performance, despite your hard work to increase rents and ratchet up occupancy rates.

To make a commercial real estate purchase pay out, you have to have a long-term view. Ensure you have the resources to buy and hold, so that you can exit when interest rates maximize your return on investment. In that recent transaction I mentioned, the property our client acquired was solid – but, they had family and financial matters that needed to be resolved, and they had to sell at a specific time. We got them a great deal, but not as much as we could have, had they been able to wait another year or two for interest rates to level off. Selling when interest rates are stable or declining has a positive impact on exit value and return on investment.