Hedging Costs & US Real Estate's Post-Virus Recovery

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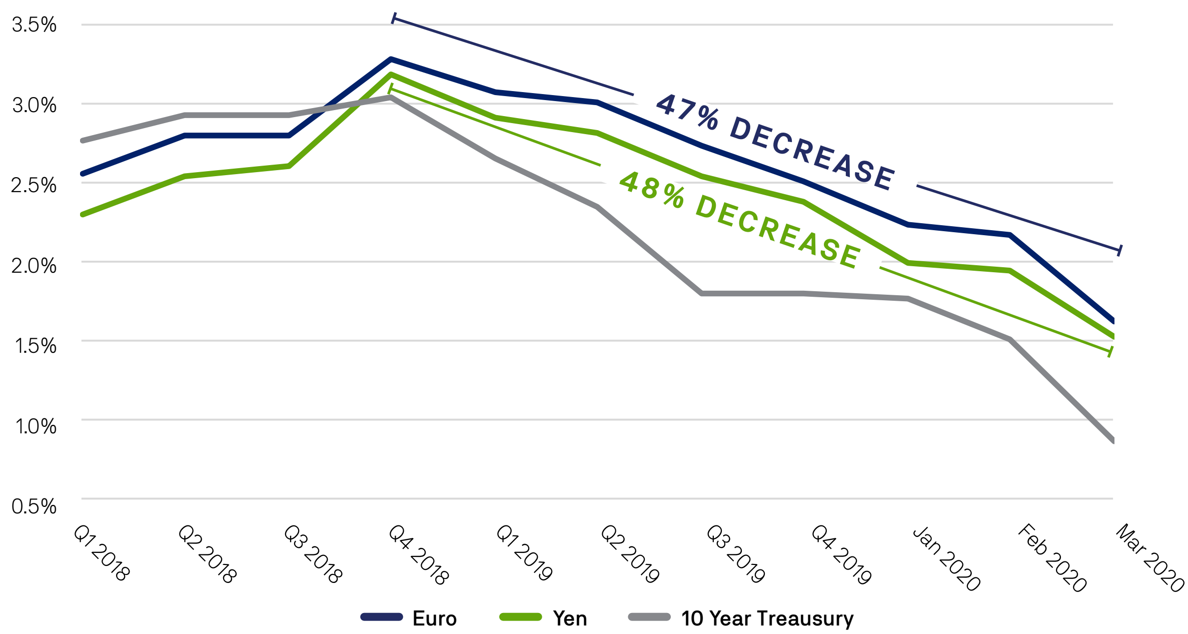
Like most of the world, we are all making the adjustment to the "new normal", digesting the copious amount of coronavirus related news and how it will affect our personal and professional lives, and the overall economy.

In the coming weeks, HWE will be analyzing the various pieces of incoming data to assist with finding interesting information in today's environment that will aid in identifying the opportunities of tomorrow.

Reduced Hedging Costs Could Spur an Increase in Global Investment in US Real Estate in a Post-Virus Recovery

The Federal Bank's emergency reduction of the Fed Funds rate has materially reduced long term interest rates in the US. The US 10 Year Treasury rate is now hovering around 0.8%, a decline in excess of 65% when compared to the 2.4% rate observed just one year ago. This is now much more closely in line with the yields witnessed in Germany, Japan and the UK. Furthermore, the government aid package should help minimize the financial impact of the virus and stabilize the economy more swiftly.

SAMPLE SET OF OFFSHORE HEDGING COSTS (2018-PRESENT)



- While global investors sought yield during 2018 and 2019, hedging costs during those years were prohibitively expensive, despite the decrease witnessed in the second half of 2019.
- NYC cap rates traded at a 150bp – 200bp premium during that time period to comparable global gateway cities...hedging costs eroded any benefit.
- Comparing March 2020 hedging costs to the average levels witnessed in the peak of Q4 2018, they are now nearly 50% less for Japanese and Eurozone investors.
- Similar percentage drops have been witnessed for other regions of the world seeking US asset exposure.
- US real estate can now provide a more attractive risk adjusted cash flow profile after hedging costs, which will become increasingly important as the world seeks stability.

As dislocation in any market results in a flight to quality, HWE believes US real estate will be the beneficiary of this arbitrage. Additionally, the historic lows in the US benchmark risk free rates should eventually work their way through the credit markets in the form of lower borrowing rates, which will further add to the attractiveness of US gateway markets, including NYC. Lastly, the narrowing of the gap in interest rates between the US and other major global economies (from which a majority of offshore investment in US real estate is derived) means the cost to hedge currency risk for these investors will be greatly diminished and could spur further investment as markets stabilize.