Office Sector Faces Growing Foreclosure Threat as Mortgages Become Harder to Obtain

November 21, 2023 - Commercial building landlords are grappling with a looming threat of foreclosures, surpassing levels seen during the 2008 financial crisis, according to a recent analysis. The problem is being caused by broad economic issues affecting the lending market for office spaces. Many office owners are finding it increasingly difficult to pay back their existing loans, mainly because obtaining new mortgages has become difficult. Issues that include more people working remotely, more vacant office spaces, and lower profits making it harder to meet interest payments. At the same time, lenders are trying to reduce their risk exposure to the sector so as loans are becoming due, they are often refusing to refinance.

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While homeowners normally obtain a 30-year mortgage when they purchase a new home, landlords donâ€™t have that luxury. In most cases, loans for commercial property need to be refinanced every few years. And when lenders refuse to refinance, landlords wind up with financial difficulties.

According to a report this week in the Wall Street Journal, only one in three office mortgages managed to get paid off during the first nine months of 2023. Compare that to the first nine months of 2019 when 88% of office loans were successfully paid off when they matured, according to Moodyâ€™s Analytics.

The report indicates a threefold increase in the share of office loans facing delinquency over the past year, reaching 5.75% of all outstanding office mortgages. This means that more office owners are struggling to meet their mortgage obligations.

There are still alternative loans available but even they have become harder to come by. And when borrowers use alternative lending sources that normally means higher costs associated with the loan. Adding to the misery of landlords is the fact that selling their properties, even when they have equity in them, is also difficult right now. Again, this is because many lenders are not willing to issue new mortgages to potential buyers. The bottom line here is that commercial landlords are being squeezed on all sides.

To remedy the situation, some landlords are turning to their existing lenders and asking for loan modifications. This usually means negotiating extensions at a higher cost than what was originally agreed upon. But even this is only a short-term solution. Such extensions may only buy the landlord a few months to find a new lender.

If the trend continues, there are several things that are likely to happen.

Lenders donâ€™t want to become landlords. Because of this they will face increased internal pressure to make more and better loan modifications. Once they foreclose, they have the real problem of disposing of any assets they have acquired. And when they dispose of them, they have to write those assets down on their books. This scenario led to a number of bank failures starting in 2008.

Short sales of some properties are also likely to occur. Again, lenders will be forced to write off some losses when this happens but those losses are usually less than in a foreclosure.

If interest rates do begin to drop, many of these issues will self-alleviate. But if that doesnâ€™t happen soon, then the outlook for commercial real estate could become very bleak.
by Jim Malmberg
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