FEATURED ARTICLE

PUSHING THE ENVELOPE ON CREDIT

CREDIT CARD LENDERS, RISKY LOANS, AND THE U.S. REAL ESTATE MARKET

BY RACHEL ANTMAN

The U.S. is experiencing a "credit card crisis." That was a major conclusion of Northwestern Mutual's 2019 Planning and Progress Study[1]. According to the results, credit cards are the main source of debt for 22% of the population. The study also found that 31% of Americans own credit cards with interest rates above 15%.

Statistics on dollar amounts are equally disconcerting. In March 2019, USA Today reported that the average American owes $6,345 on bank-issued credit cards and that, in aggregate, U.S. consumers owe more than a trillion dollars in credit card debt.

Meanwhile, many credit-card companies have added personal loans to their offerings. Some observers view these as a means for borrowers to pay off existing debts and avoid high interest rates—provided, of course, that the borrowers limit their card usage while paying off the loans. Other supporters point out that offerings from well-established banks are generally far safer than those of non-bank lenders, which have lower underwriting standards and fewer reserves.

Critics view the loans as insidious forms of debt traps that could have detrimental effects far beyond the household level. In a 2018 article entitled "Banks flock to personal lending, but at what risk?"[2] Kevin Wack of *American Banker* states that "for now, the U.S. unemployment rate remains low, and industrywide losses on personal loans are manageable. But more of these loans are expected to go bad when the economy inevitably weakens." He adds that "there are signs that, despite its rapid growth, the personal loan market is not chipping away at credit card balances."

Should you be worried about mounting credit card debt? Several experts from the world of real estate weighed in on both sides of this debate.

DANGEROUS DEVELOPMENTS

Consider Andrew H. Baraff, a commercial real estate attorney at New York City-based Reitler Kailas & Rosenblatt, LLC, as among the concerned. He believes that risky credit card lending threatens the overall economy, and, by extension, commercial real estate. "Any time a large sector of the economy has taken on more debt than it can repay, trouble can't be far behind," he says. "At some point, when consumers have too much debt, they stop spending, and that can quickly lead to a significant contraction…commercial real estate is not immune to economic contraction, which is why the real estate market is cyclical."

Landon Williams, SIOR, senior vice president, capital markets at Cushman & Wakefield in Memphis, Tenn., has a similar perspective. He notes that "as credit card debt rises, consumers have fewer dollars to spend in the marketplace. Consequently, the economy may slow or even stall altogether, which almost certainly will have a negative impact on commercial real estate."

REASONS FOR CALM

But some experts are less concerned. For example, Dr. Sam Chandan, associate dean of the New York University School of Professional Studies – Schack Institute of Real Estate, reminds us that credit card debt is "a relatively small slice of the overall household debt universe. It doesn't present the same kinds of systemic risks as if we were experiencing a significant deterioration in the performance of mortgage loans in the United States."

1. https://news.northwesternmutual.com/planning-and-progress-2019

2. https://www.americanbanker.com/news/banks-flock-to-personal-lending-but-at-what-risk

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He also notes that most delinquencies are experienced by the more income-constrained customers, who "represent a relatively smaller share of overall consumer activity."

Furthermore, there are indications that consumers are getting better at controlling their credit card usage. Average FICO scores have reached a record high of 706, which Ethan Dornhelm, vice president, FICO Scores and Predictive Analytics, attributes in large part to improving consumer financial health. In addition, the Northwestern Mutual study revealed that the average total personal debt has decreased from the year before.

POTENTIAL EFFECTS

Nevertheless, the rising rates of credit card debt are worrisome, especially given that many industry insiders are predicting a downturn in the near future. Brokers, in particular, should prepare themselves for potential effects on the real estate market.

What sort of effects should they expect? Decreases in consumer spending pose obvious threats to brick-and-mortar retail. But the industrial sector is also vulnerable since it is so closely tied to e-commerce – the realm of credit card payments. Today, high demand in the sector "is driven in part by double digit growth in e-commerce sales," says Jim Berry, Dallas-based partner at Deloitte & Touche.

The vulnerability of the office market is less apparent, but it becomes clearer upon closer examination. Decreases in consumer demand lead to business contraction in the wider commercial domain, explains Baraff. Such contraction, in turn, leads to higher vacancy rates and lower rents.

PREPARING FOR FLUCTUATIONS

Brokers should prepare not only themselves, but also their clients, for such eventualities. Williams suggests that "as thought leaders, brokers have the opportunity to guide clients in conservative and disciplined underwriting now during the 'feast' in order to be well positioned to capitalize on new opportunities during the 'famine,' whenever a recession finally does come."

The good news? The feast could last a while. "Based on economic data and what I see in the marketplace, I remain hopeful we still have good runway left in the current cycle," says Williams.

When the market eventually does turn, brokers should maintain a long-term perspective. Daniel Evans, managing partner of the financial advisory firm Evans & Company, emphasizes that a recession "is a natural part of the economic cycle, temporary, and won't cause a riot." Chandan also urges brokers to keep in mind that downturns are relatively short-lived compared to the periods of growth that follow them.

CONCLUSION

Although experts disagree on the extent to which credit card debt could affect the economy in general and the real estate market in particular, it's not unreasonable to fear ripple effects from delinquencies and defaults. The best brokers will keep a close eye on the situation. They recognize that when it comes to credit, it's hard to predict just what's in the cards.

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