Rodney's Take

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Jingle Mail Making a Comeback

In my early teens, I spent a few years living just south of Houston, Texas. After that, in the early 1980s, my family moved to southern Louisiana, about the time the oil market was starting to tank. By the time my family moved back to the Houston area just two years later, chunks of Houston had become a ghost town. Entire neighborhoods were dotted with empty homes. Owners had packed up, driven off, and sent their keys back to their lenders. Hence, the term "jingle mail." We might be on the cusp of another round of defaults, but this time the lenders will have precious little leverage, because there's no one to sue for payment.

The properties in question are commercial buildings, many owned by companies set up for this specific purpose, and the loans are non-recourse. When the buildings become financially unfeasible, the owners metaphorically mail the keys back to their lenders, ridding themselves of the problems. But that's not where the buck stops. Many banks that were already reeling as a result of declining values on long-maturity Treasury bonds and mortgage-backed securities will find themselves underwater, which means their depositors and owners, consumers and investors, will take the pain.

If banks could avoid this trap simply by convincing the Fed to pivot sooner, then we might hold out hope that Chair Powell and his fellow bankers would comply to avoid the meltdown. But it might be that Powell and his compatriots see the situation more clearly than Fed watchers. It's highly unlikely that the Fed would take interest rates anywhere near zero in the year ahead, which will leave banks with long-dated, very-low-coupon bonds in their portfolios sitting on losses. At the same time, their commercial real estate clients who took out variable rate loans are starting to feel the heat from two directions.

As rates rise, these borrowers will fall back on their interest rate hedges to make the higher mortgage payments, but that will last only so long. At some point, the hedges must be renewed, which will happen at much higher rates. While commercial landlords are fretting over rising hedging costs, they also are grappling with falling occupancy rates and declining rents as companies allow employees to work remotely.

Powell might see the situation and understand that even though it's a train wreck in slow motion, it's still a train wreck. It might take months or even years for all of this to play out, because hedging contracts and tenant renewals have their own schedules. But it will play out, because we've fundamentally changed two characteristics of commercial real estate at the same time. Zero interest rates won't be back this year and tenants are drifting away. Regional banks that receive notice that their borrowers are defaulting might not make it, but that's just a way station for the financial pain that eventually will find its way to us, the consumers and investors.

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Got a question or comment? You can contact us at info@hsdent.com.