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Where are the CRE Debt Markets?

September 17, 2020

In our recent webinar, *Where are the Commercial Real Estate Debt Markets?,* Zev Gewurz moderated an interactive panel of industry leaders featuring:

- Richard Flohr - Managing Director, CrossHarbor Capital Partners
- Marisol Franco - Senior Vice President, Santander Bank
- David Mark - Managing Director, Tricon Residential

The panelists shared their viewpoints on a range of topics, including:

- parallels between the 2007-09 global financial crisis (GFC) and the ongoing COVID-19 recession;
- whether and under what circumstances lenders are allocating capital;
- changes in loan terms, including pricing, covenants, execution;
- distress and whether we have seen it already or will see it in the near future;
- the property types, geographies and other characteristics of deals getting done or in distress; and
- key considerations regarding the acceleration, disruption and reversal of pre-COVID market trends.

Lending, but still conservatively

The experts generally agreed that—largely due to fundamental differences between the GFC and today's downturn—we are in a better economic position in 2020 than we were in 2007-09, and there are viable opportunities for lending and borrowing capital in the commercial real estate industry. As part of this conversation, the experts analyzed not only the central differences between the GFC and today, but also the implications of current regulatory and market forces. For example, the federal government's credit and liquidity measures have enabled banks to lend more actively during this downturn than the GFC by lowering minimal capital requirements. Panelists also shared their insights on the manner in which deals have progressed over the course of the pandemic and analyzed some of the market forces driving this progression. For example, they discussed the implications of the huge amount of dry powder that is currently sidelined waiting to enter (or renter) the market, as well as how steep competition for deals in a crowded marketplace has impacted the sector both before and during the pandemic.

FOR MORE INFORMATION

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Featuring special guests:

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They also shared thoughts on values and valuation, noting that we still don't have comps on office rents or even multifamily rents. While real estate appears to be a very attractive investment asset class when compared to alternatives, especially the 'risk free rate', they pointed out that the recent downward activity in the REIT market may not be best barometer to measure value activity or in the private real estate market.

Changes in Loan Terms

The panelists—two lenders (a bank and a debt fund) and one borrower (a rental housing company)— then discussed current loan terms and whether terms have changed due to the pandemic and challenges with valuation. While most panelists shared the view that loan terms have not changed drastically, all agreed that loan-to-values continue to trend down. They also are seeing more covenants, especially around cash management and springing cash traps. Panelists highlighted the tendency of both lenders and borrowers to migrate towards "relationship" lending to mitigate against increased risk of execution. One panelist pointed out that deals take longer to diligence and close in this environment, while another claimed to still be able to execute quickly.

Distressed beckons opportunistic buyers

Finally, the panel turned to a high-level discussion of distress in the commercial real estate market, including whether and in what areas we could see a wave of forced sales. While we are seeing some deals getting done, it appears that many investors are still waiting on the sidelines. Similarly, owners and borrowers are trying to avoid fire sales. Some of the key levers for distress will likely include: lease lengths and renewals, susceptible geographic areas, vulnerable property types, construction delays and challenges resulting from longer-term implications of the pandemic.

In sum, we don't yet know how the pandemic will impact intermediate and long-term consumer preferences, ranging from asset class and property type to geography and density. This pervasive uncertainty has put us in a period of price discovery in which the delta between buyers and sellers has prevented deal activity from ramping up significantly beyond deals that (a) were on the screen pre-COVID; and/or (b) have highly compelling strategies with credit-worthy borrowers, strong tenants, longstanding lender relationships, defensible geographies and cyclical and secular advantages. Until we have greater clarity regarding the contours of the recovery and the resilience of certain mechanisms in our economy, it will continue to be challenging to ascertain net operating income and value (and therefore capitalization rates) in a way that makes transactions more attainable.

For More

Have additional questions about this topic or other COVID-19-related guidance? Please contact your Goulston & Storrs attorney contact.
Click here to view the recording of the webinar.

FOR MORE INFORMATION

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