

# SOUTHEAST REAL ESTATE BUSINESS®



The Southeast's Real Estate Source



Lenders say that life sciences facilities have been an emerging product type in the past 12 months. Trinity Capital Advisors and its partners are investing \$160 million to transform Park Point in Raleigh-Durham into a life sciences hub (rendering above).

## LENDERS CHASE CERTAINTY IN 2021

MBA's Woodwell says real estate categories with the fewest question marks will have capital available.

Interview by John Nelson

**L**oan originations for commercial and multifamily properties fell by 18 percent year-over-year in the fourth quarter of 2020, according to preliminary data from the Mortgage Bankers Association (MBA). The Washington, D.C.-based organization reported that for the year, volume was down by 30 percent as a result of the COVID-19 pandemic, economic recession and changing consumer patterns.

These disruptions overall caused investors and lenders alike to largely pump the brakes and to approach new acquisitions and developments with more caution than they might otherwise have before the pandemic. Jamie Woodwell, the MBA's vice president of commercial real estate research, says that the slowdown in activity wasn't uniform across the various real estate categories.

"One of the most striking characteristics of the pandemic and this recession is how differently it has affected different property types," says Woodwell. "You see that with property fundamentals and in terms of demand for borrowing and supply of lending taking place. In 2020, we saw that significant differentiation with industrial and

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see **MBA**, page 30

## DEBT PROVIDERS FIND THEIR WAY

Pent-up demand, COVID-19 clarity give lenders hope for a productive 2021.

By John Nelson

**T**he prevailing sentiment from lenders for their loan origination volume for 2021 is that they plan to do more business than 2020, a year that will live in infamy for all commercial real estate professionals. Lenders and financial intermediaries are confident that last year will be remembered as an outlier and 2021 will serve as a market correction of sorts.

Investment sales for commercial real estate properties slowed down significantly in 2020 as buyers, sellers and lenders took stock of the COVID-19 pandemic and the ensuing recession. According to research from Real Capital Analytics, investment sales for office, retail, industrial, hotel, multifamily and development sites totaled \$405 billion in 2020, a year-over-year decline

of 32 percent. (See chart on page 28.) Similarly the Mortgage Bankers Association (MBA) found in its preliminary data that commercial and multifamily loan originations experienced a 30 percent decline year-over-year in 2020.

Michael Berman, president and CEO of M&T Realty Capital Corp., says that a net result of the slowdown in acquisitions last year is a pent-up demand from both buyers and sellers in the early months of 2021.

"We're coming to a time when uncertainty from COVID-19 is diminishing," says Berman, who served as the chairman of the MBA in 2010 and 2011. "We have more than 1,400 loans in our portfolio and only a handful are in forbearance. There's light at the end of the tunnel now, but we're not there yet."

There are several macro-economic tailwinds that should help commercial real estate investment sales rebound this year. For starters, the U.S. economy is actively recovering from the downturn. The U.S. gross domestic product grew at an annualized rate of 4.1 percent in the fourth quarter following the 33.4 percent annualized growth in third-quarter 2020.

Retail sales for goods and services also saw an uptick in 2020. Preliminary data from the National Retail Federation (NRF) shows sales surpassed \$4 trillion last year, despite the pandemic. The 6.7 percent increase from 2019 is nearly double the trade organization's forecast of 3.5 percent growth that it

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# DEBT PROVIDERS FIND THEIR WAY

## CAPITAL MARKETS from page 1

predicted prior to the COVID-19 outbreak.

Additionally, pharmaceutical giants Moderna and Pfizer continue the rollout of their COVID-19 vaccines. In late February, the U.S. Food and Drug Administration (FDA) issued an emergency use authorization for Johnson & Johnson's vaccine as well.

The mass vaccination of the U.S. population over the next several months should serve as a godsend for beleaguered property owners. As of this writing, the governors of Texas and Mississippi have announced that they are lifting all restrictions on businesses and facilities in their home states effective mid-March.

Nancy Ferrell, executive vice president and regional managing director of NorthMarq, says that as business activity picks up at the property level, acquisition demand should follow in lockstep.

"Once investors and debt providers see rent collections and occupancies begin to improve as the pandemic wanes, we should see a spike in transactions," says Ferrell.

For 2021, the MBA is predicting that commercial and multifamily loan originations will increase by 11 percent compared to 2020. Faron Thompson, regional managing director of NorthMarq's Atlanta office, says that a major driver in the capital markets are the debt funds and other vehicles that are looking to execute on their capital allocations before their investment horizons sunset.

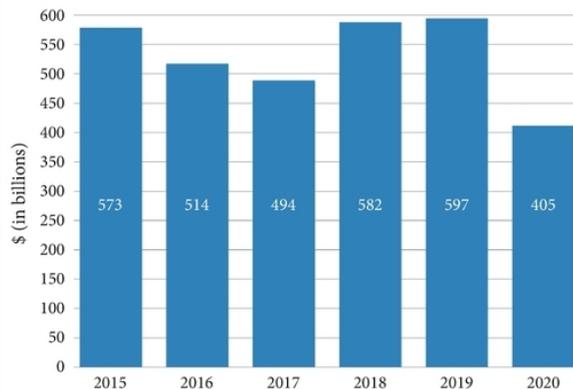
"There is a lot of fun money that was raised, and there is a limited amount of time to place that acquisition," says Thompson. "2019 in particular was a big year to raise that money. If they had a three-year window, they lost a big chunk of 2020 because of the pandemic."

This year is also shaping up to be aligned when so many loans are coming due. The MBA reported that \$222.5 billion of the \$2.3 trillion (roughly 10 percent) of outstanding commercial and multifamily mortgages held by non-bank lenders and investors will mature in 2021, a 36 percent increase from the \$163.2 billion that matured in 2020.

In addition to opportune timing, lenders are also increasing their level of competition to win deals, with banks looking to enter the fray more in 2021. Hugh Allen, senior vice president of TD Bank and head of the bank's commercial real estate South division, says that his firm is getting aggressive on deals after slowing financing volume last year to improve its capital position.

"Coming into 2021, we have better clarity on rent collections across all property types, the vaccines give folks more comfort and there is a lot of money sitting on the sidelines waiting for

## U.S. Property and Portfolio Sales Across Property Types, 2015-2020\*



\*includes hotel, industrial, multifamily, office and retail sectors

Source: Real Capital Analytics

the pandemic to resolve itself," says Allen. "We've seen borrower demand and loan volume increase significantly."

### The haves and the have nots

While overall lenders and financial intermediaries are expecting a bounce back year across all real estate sectors, they caution it won't be an even uptick across each property type. Allen says TD Bank's loan offerings have been mostly for acquisition and construction financing for multifamily properties in the Sun Belt, as well as for industrial acquisitions.

"In the South, we're always building, so there are more construction financing requests than there are in the northern part of our footprint," says Allen.

Thompson says that owners and developers are motivated to increase their land holdings and begin to break ground because of the favorable returns they can achieve building relative to trading.

"There is probably as big a gap in the development versus sell cap rates than I've seen in my career," says Thompson. "Multifamily developers can still find a way to build to 6.5 percent return on cost fairly routinely. Now they are looking to sell at a sub-4 percent cap rate, which is a huge gap."

The hotel sector was coined as a "speed bump" property type by MBA's vice president of commercial real estate research Jamie Woodwell (see page 30), meaning that the industry was performing well before the pandemic and will again once it subsides. Berman agrees but is dubious on when hoteliers can expect tourism and business travel to return to pre-pandemic norms.

"There is so much uncertainty in the hospitality sector that it is hard to see

the timing of that reemerge," says Berman. "I'm confident that it will, but it is much less immediate than in the multifamily sector where we are already starting to see green shoots and more acquisition buy-in."

To Berman's point, multifamily experienced the smallest dip in origination volume in 2020 versus 2019 — an 8 percent decline, according to MBA data. The government-sponsored enterprises (GSEs) of Fannie Mae and Freddie Mac were vital to the multifamily debt markets as both agencies generated record loan volumes last year. Fannie Mae provided \$76 billion in debt in 2020 and Freddie Mac generated \$83 billion.

"As soon as a crisis hits, the private money retreats to the sidelines," says Thompson about the GSEs' countercyclical activity. "Life companies and banks left the market completely for 120 to 180 days, but Fannie Mae and Freddie Mac kept going."

Thompson expects another big year for the agencies and multifamily financing in general because it is largely viewed as a safe haven since it serves a human need.

"People don't necessarily have to go to an office, shop at stores or stay at hotels, but they need to live somewhere," says Thompson.

The industrial real estate sector was the least-hampered property type by the pandemic and accelerated some thanks in part to surging e-commerce sales that boosted leasing activity at distribution and fulfillment centers nationwide.

The NRF is expecting online sales to have another breakout year and top \$1 trillion for the first time ever. If that comes to fruition, e-commerce will make up a quarter of all retail sales in

the United States, only a few years after comprising less than 10 percent of the overall figure.

While beneficial for industrial developers, it is expected to make the overall retail sector's recovery even more of an uphill climb.

"For the retail sector, it's unclear how it shakes it out due to e-commerce," says Berman. "Retail will re-stabilize but the timelines are less settled, so transaction volume is moving hesitantly."

### Trends in underwriting

Brett Forman, executive managing director of Trez Capital's Eastern U.S. division, says that the biggest hindrance for financing shopping centers in 2021, as well as office buildings, comes down to valuations.

"It's still going to be tough because of the time it takes for price discovery to really figure out what things are worth," says Forman.

Allen says that overall underwriting structures are similar to it was to pre-pandemic, but banks and other lenders are looking a lot closer at property performance during their due diligence period.

"There are a lot of factors that affect where we shake out in underwriting in today's environment. It varies from request to request, but we are asking a different set of questions today than we were pre-pandemic," says Allen. "We want to understand the nature of the tenancy in a commercial property and if they have exposure to COVID-19 relative to the business they are in."

Thompson says that he's been fielding more requests from multifamily borrowers looking to lock in long-term debt to take advantage of low interest rates. As of this writing, the 10-year Treasury yield hovered around 1.42 percent. This is a 50-basis-point uptick from the beginning of the year but is still historically low.

The Federal Reserve has telegraphed that it will keep the federal funds rate low until after the U.S. economy recovers from the pandemic. At the February meeting of the Federal Open Markets Committee (FOMC), which sets monetary policy for the central bank, the committee decided to leave the short-term benchmark rate at 0 to 0.25 percent.

Thompson says the Federal Reserve has plenty of incentive to keep rates low for the foreseeable future.

"The United States is set to owe \$30 trillion, so it doesn't want the interest rate for the national debt to get any higher than it has to be," says Thompson. "Folks are beginning to suggest that we will see more inflation this year, and inflationary environments do cause rates to tick up."

One such event that could cause inflation in the U.S. economy is the

dispersal of the next round of stimulus checks. The House of Representatives recently passed a \$1.9 trillion stimulus bill, and the Democrat-controlled Senate is expected to pass the bill as well. Berman says that interest rates will likely have to increase to stave off inflation in the economy.

"It's hard to imagine that interest rates are going to stay where they are," says Berman. "I foresee a pretty steady rise over the next couple years."

Ferrell of NorthMarq says that the amount of equity required for financing to pencil out now is also a moving target based on many variables, chief among them being the real estate category.

"Leverage has increased a bit due to lower interest rates except for multifamily and industrial properties, which were already being underwritten at aggressive levels," says Ferrell.

More so than interest rates and pricing and even term length, lenders today are most concerned about who is sitting across the table when it comes to underwriting debt. For trusted or blue chip borrowers, lenders are making accommodations to win their business.

"We've ratcheted our leverage down a little bit, but more importantly than that, we've tried to stick to borrowers that are more experienced and financially stable," says Forman of Trez Capital.

### Emerging property types

In addition to the proven commodities of industrial and traditional market-rate multifamily, lenders and financial intermediaries are praising two subsectors that have been accelerated by the past year's events: single-family rentals (SFR) and life sciences.

SFRs are quickly becoming a fan favorite for lenders. The properties are purpose-built, contiguous developments that are available for rent, and several built-for-rent (BFR) communities are cropping up around the Southeast. The sector has so much momentum that Walker & Dunlop recently launched a dedicated practice group for financing SFR transactions.

The COVID-19 outbreak has caused millions of renters to stay home more than ever before and a large swath work from home, and will do so indefinitely. The paradigm shift is causing renters of all age groups to look at renting homes that provide ample space and a yard. Allen says that banks and other lender categories are bullish on the product type, though underwriting SFRs isn't down to an exact science since it's not a legacy program for most lenders.

"The challenge on the construction lending side is rent discovery. How do we comp and underwrite rents?" says Allen. "The GSEs are receptive to it, as long as it's contiguous. If it's on the same block they'll treat it like apartments. There is strong institutional equity interest there so it's going to be here to stay at some level."

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Berman says that though demand has accelerated for SFRs in recent months, as an industry it's been a long time coming before stepping into the spotlight thanks to the remote working and learning phenomenon.

"Single-family rentals as an industry has been maturing over the past decade and is now institutionalized as a business," says Berman. "We are seeing it grow in real-time. It has been emerging, but there is a new chapter being written now."

Vaccine makers and therapeutics firms have made national headlines

as they've worked to produce effective treatments for COVID-19 and related illnesses. The result is a heavy investment in research and development and laboratory space, especially in established clusters like Boston and Research Triangle Park (RTP) in Raleigh-Durham, which benefits from institutions like Duke University, University of North Carolina at Chapel Hill and North Carolina State University.

"Life sciences is another sector that has picked up, especially in Raleigh-Durham," says Allen. "Also in Atlanta and Tampa, basically anywhere where

smart people are graduating."

Biotech and pharmaceutical firms are either establishing their own campuses or are converting existing office and industrial buildings into life science centers, and lenders are receptive to financing those deals. JLL recently arranged a \$52.8 million loan through MetLife Investment Management for an adaptive reuse project in RTP. The borrower, Longfellow Real Estate Partners, is using the funds to acquire and reposition an office campus into a research and development campus for life sciences firms. ■

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**WALTON, KENTUCKY**  
\$38,810,630 - Industrial



**LAKE WORTH BEACH, FLORIDA**  
\$35,147,555 - Residential



**NORCROSS, GEORGIA**  
\$8,292,891 - Residential



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### OUR LENDING CRITERIA

**LENDING AREA:**  
U.S. & CANADA

**MIN/MAX LOAN AMOUNT:**  
UP TO \$100M

**TERM:**  
UP TO 3 YEARS

**AMORTIZATION:**  
INTEREST ONLY

**RATE:**  
FLOATING OVER WSJP  
(VARIES BASED ON LOAN TYPE)

**LOAN TO COST:**  
UP TO 80% LTC

**ASSET TYPE:**  
RESIDENTIAL, MULTI-FAMILY,  
INDUSTRIAL, OFFICE,  
MIXED-USE, RETAIL -  
INCLUDING CONSTRUCTION

**LOAN TYPE:**  
BRIDGE, TERM,  
CONSTRUCTION,  
INVENTORY, LAND  
LOT DEVELOPMENT,  
MEZZANINE, AND  
PREFERRED EQUITY

**SECURITY:**  
1ST OR 2ND MORTGAGE,  
NON-RECOURSE AVAILABLE