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2019 fall outlook: Finding a chair before the music stops - by Michael Chase

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2019 has been an active year so far for U.S. commercial and multifamily real estate. There appears to be a consensus among fellow practitioners that this summer lacked the typical seasonal slowdown, particularly here in Boston. Refinance activity remains high, even with limited maturing debt originated during the depth of the last recession in 2009. This is partly due to mortgage rates still being attractive enough to refinance more recently originated loans. In addition, the inverted yield curve allowed many borrowers to benefit from breaking swaps that were in the money, especially before the Federal Reserve made their first of multiple rate cuts so far this year. The Mortgage Bankers Association (MBA) supported the anecdotal feeling on the street by recently revising their forecast of annual originations by commercial and multifamily mortgage bankers up to \$652 billion. According to the MBA, this would be a new record volume and an increase of 14% over last year's record.

Potential global headwinds seem to dominate economic news reports. A recent headline from Bloomberg Economics read, "U.S. Recession Chances Hit 27% Within Next 12 Months." Interestingly, they chose not to say that there was still a 73% chance of avoiding recession. While global concerns should not be ignored, it seems one of the biggest risks is talking ourselves into a recession.

The local story does not appear as dire as international headlines might suggest. The Federal Reserve Bank of Boston reports the August unemployment rate is 3% in New England and 2.9% in Massachusetts, both below the national rate of 3.7%. As most seasoned practitioners know, commercial real estate is about jobs, which are still being created here in New England. The strong local economy is helping to support the 2019 delivery of more than 5,300 multifamily units in Boston, Cambridge, and Newton, according to RentCafé. Additional multifamily units will be mixed with life science space, commercial, and retail uses within major upcoming developments in Somerville, Cambridge, Charlestown, the Seaport District, South Boston, Watertown, and Allston.

Capital Outlook for the Remainder of 2019

Commercial banks and thrifts continue to close the majority of commercial and multifamily loans. This is a function of the large number of banks and thrifts competing in the space; however, it is important not to lump them all together. Large banks can offer an almost unlimited capacity but have to deal with higher regulatory scrutiny. Smaller banks may offer more flexibility, but larger borrowers can quickly find themselves running up against lending limits. Many banks are currently offering competitive fixed rates for five, seven, or ten years, particularly with the use of a SWAP. Floating rate loans may also be advantageous in the current rate environment for short-term holders. Borrowers entering into either a SWAP or floating rate debt with LIBOR-based pricing will want to pay particular attention to the language on how their loan will be managed with LIBOR set to expire at the end of 2021, which is within the loan term for many loans being originated today.

Life companies and other institutional lenders remain the primary option for borrowers seeking long-term, fixed-rate financing out to as far as 30 years. This is typically the time of year when some life companies become less aggressive as they approach their annual allocation goals for commercial mortgages; however, there are still others with capital to put to work in the fourth quarter. Borrowers can take advantage of the current rate environment with forward commitments to lock in their mortgage rate up to 12 months in advance of a closing.

In mid-September, the Federal Housing Finance Agency (FHFA) made a highly anticipated announcement regarding the multifamily lending caps for Fannie Mae and Freddie Mac. The new structure sets a \$100 billion ceiling for each agency and includes a directive requiring 37.5% of their respective business consist of mission-driven affordable housing. The new limits remove exclusions used in prior years. While affordable housing will remain a central focus, the financing of green initiatives will most likely be deemphasized. Another interesting twist is the lending caps are for five quarters instead of four. Uncertainly leading up to FHFA's announcement caused spreads from Fannie and Freddie to widen earlier this year. While both groups are now back lending, they are each still working to manage their new lending caps over the next 15 months.

CMBS (Commercial Mortgage Backed Securities) moved aggressively towards the end of the summer to pick up the slack from Fannie and Freddie when they widened spreads. Boosted by a strong third quarter, Commercial Mortgage Alert reported total U.S. CMBS volume through the end of September stood at \$56.1 billion. This is still slightly below last year's pace with total volume for the year expected to fall just short of the volume in 2018 and down further from the post-recession high set in 2017.

While CMBS may not exceed last year's volume, Kroll Bond Rating Agency expects CLO (Collateralized Loan Obligations) issuance to reach \$19.3 billion.

This would be a 40% increase over 2018 volume. Commercial real estate CLO pools are typically made up of floating-rate bridge loans. The strength of the CLO market is indicative of the highly active and competitive bridge lending space. The relative affordability of interest rate caps in the current rate environment is also benefiting this space. One of the recent trends for floating rate loans is lenders attempting to set index floors. It is something Borrowers should be aware of as they are

being asked to limit their benefits if rates decline further.

Outlook Going Forward

Few predicted where rates are today. The 10-year U.S. Treasury started the year at 2.69% with many predicting it would not be long before it reached 3% with an upward climb from there. Along the way, global economic concerns and fears of a domestic downturn conspired to hold long-term Treasury rates in check. As of October 15, the 10-year U.S. Treasury sits at 1.71%. For much of the year borrowers have been able to benefit from favorable index rates, without a significant widening of spreads. The lone exception came in August when index rates fell to a point where some lenders set floors to their mortgage rates. It was around this time in 2018 when volatility in the corporate bond market caused spreads to widen even as treasury rates started to decline. Could 2019 end in a similar fashion? The bottom line: it is still a good time to be a borrower with attractive rates available for either floating or long-term, fixed-rate loans. We don't know when the music will stop, so be sure to grab your chair now.

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