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New England’s commercial real estate financing outlook 2020 - by Derek Coulombe

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What a difference a decade makes! The great recession ran from late 2007 to the end of 2009 and while 2010 was the beginning of the recovery, it sure didn’t feel like that early on. Retailers were worst hit, hunkering down on what cash they had left while consumer confidence was shaken. Industrial properties in the Northeast had been basically forgotten about and although hospitality was starting to rebound slowly, the future was unclear. Fast forward to 2020 – interest rates are incredible, the 10-year treasury rate, a commonly quoted benchmark index, is well inside of 2.00%. Demand for commercial real estate investments is as high as ever; pushing cap rates continually tighter.

Commercial real estate financing in New England has been and will continue to be led by commercial banks. The large regional banks lead the charge by providing well priced capital on both a recourse and non-recourse basis for the right assets. The community banks continue to fight for market share and provide very aggressive financing for middle market sized transactions and smaller. Many say that the atmosphere of competition created by banks in the Northeast is the most aggressive in the country. In 2019 a slowdown was anticipated but never materialized. Although there have been several mergers and takeovers of banks over the past few years new entrants to the market keep the count high and the loan terms fierce.

Insurance company lenders grew the exposure to their balance sheet in 2019 by doing several large deals but did not make up much ground on middle market or independently owned real estate. For borrowers with strong properties in good locations looking for slightly lower leverage, life insurance company financing should be a great execution in 2020, we are seeing spreads from 100-150 bps over Treasuries at the start of the year. Loan terms and amortization have become more customized with amortizations going from 25 to 35 years.

The agency lenders are a bit of a political football and the long-term structure of Fannie and Freddie are undetermined at the moment, but these lenders still have close to an insatiable appetite for providing non-recourse financing for multifamily properties. The agencies come out with new programs frequently to offer differing levels of incentives; some examples are transit oriented, improvements to decrease energy consumption, affordable, etc.

The conduit or CMBS lenders haven’t had much of a presence in New England over the past few years and are still trying to increase their presence throughout New England. Underwritten debt yields and debt service coverage requirements have constrained the loan proceeds in metro Boston so look for higher leverage further out with B or C quality properties. Although spreads are tighter than they have been in the recent past, it looks like something is going to have to change for them to become a larger player here.

Funds that have been raised to provide bridge, preferred equity and mezzanine loans have risen to a noteworthy level nationally and are now the second or third largest loan type by volume. However, these lenders do not have much of the market share in New England as the banks traditionally offer equally as competitive terms at a better rate, which is not the case nationwide. The product offered, short term flexible, higher priced, higher leverage loans are not in high demand but for the opportunistic investor the options are growing out there.

In summary the outlook for commercial real estate finance in New England continues to be very strong. The New England economy has been buoyed by education, healthcare and innovation. Unemployment is at an all-time low, interest rates are very low and the barriers to entry for commercial real estate development continue to constrain supply resulting in a demand heavy imbalance.

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