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Commercial real estate financing outlook 2021 - by Derek Coulombe

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2020 was a year dominated by the global pandemic and 2021 starts off with emotions running high and uncertainty in the market. The outlook for commercial real estate this year is an expected cautious reopening as the vaccine rollout continues and we expect the finance markets will have a similar approach. Although long-term use of commercial real estate, whether it be office space, downtown amenity retail or restaurants, will need to be reevaluated as some modified remote vs in person work approach will be adopted by corporate leadership. The real impact of these decisions will not be felt in 2021.

Commercial real estate has been affected unevenly by the pandemic and the finance markets followed. After a pause in the late spring and early summer, capital became available again for industrial properties, multifamily (especially suburban multifamily) and even some low leverage office properties. Counter to expectations there was even a tightening of cap rates partially fueled by historically low interest rates. This awakening resulted in refinancing activity and ended the year on a strong note carrying momentum into 2021.

Along with this momentum is an anticipated tightening of credit standards with more scrutiny on the underwriting assumptions. However, there is a palpable optimism to 2021. Surveying the life insurance lenders, we learned that the lending goals have been increased, much more inline with the goals that were laid out at the end of 2019 and not the modified goals in Q3/Q4 of 2020.

New England's commercial banks stepped back in 2020 and reduced their goals, placed limits on loan to value while adding more rigorous stress testing. As 2021 starts off there is a real willingness to lend, but under the right conditions, ie. more recourse, lower loan to values and more debt service coverage. Not to be overlooked is the ongoing uncertainty finding a suitable long-term replacement to LIBOR. This transition is underway with LIBOR being phased out of new loans by the end of 2021. Unfortunately, an acceptable replacement index has not been fully ironed out yet and this is causing some additional ripples for floating rate loans. Many banks have already stopped quoting

over LIBOR and the rest will follow suit, and this will get resolved since there is so much at stake, but it will take some time.

The agencies were a bright spot for multifamily lending in 2020 and continue strong as 2021 starts with the full expectations for another strong year. Consistent with the theme from 2020 going to 2021 not being without some complexity, the agencies introduced a new reserve to address the unknown impacts of COVID-19 on the property's collections and net income. Those reserves have release provisions but have not proven to be a major hurdle due to the low-rate environment and strong collections.

The commercial real estate mortgage back securities market had just started to really rebound when the pandemic hit and has suffered the worst. Delinquencies are high and new originations are down, but lenders are optimistic the worst is behind them and new lending will be picking up soon.

Bridge and mezzanine funds have continued to raise capital and financing is abundant. In the Northeast we have historically not had a lot of demand for this product historically but coming out of this pandemic, we may see an uptick.

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