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R.I. finance forecast remains optimistic for 2021 - by Alan Doyle

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More than ever, Bob Dylan's 1964 song "Times, They are a-Changin" best describes our current times. After almost a year of historic economic and personal loss, we finally see "the light at the end of this tunnel". It's truly amazing what companies such as Pizer, Moderna, AstraZeneca and Johnson and Johnson have achieved in a matter of months which previously took years to accomplish. Fortunately, we live in an era where quantum computing and advanced medical technologies have joined forces and leveraged off of decades of AIDS research to create these vaccines.

COVID has taken the lives of over 2.1 million people globally and in the U.S. the number (413,000) of lives lost to this virus has exceed the total number of U.S. casualties (405,399) in World War II. While some countries such as Taiwan and Australia have managed to keep their COVID mortality rates low (Taiwan .03/1,000, Australia 3.6/1,000) the U.S. has not been as fortunate, with 123 deaths per 1,000 COVID cases which is only slightly better than Italy and the UK.

The financial cost of fighting COVID and keeping our economy afloat has exceeded $2.9 trillion dollars thus far, which does not include an additional $1.9 trillion in funding supported by President Biden. Incoming treasury secretary Janet Yellen has also urged Congress and the Senate to "Go Big" on its next proposed round of funding to help revive our economy. The Federal Reserve has also pitched in by dropping their Fed Funds Rate to near zero and have committed "to do whatever it takes" to fight off the economic impact of this pandemic.

While the Federal Reserve can exercise significant control over short term rates, it's the private capital markets which have the major hand in dictating longer term bond yields. At the beginning of 2020 the 10 year U.S. Treasury yield started at 1.88%. By April 24th it dropped to its low point of 0.6% before recovering some of its loss over the summer. The index currently stands at slightly over 1% .

Although lending indices took a steep dive last year lenders interest rates did not follow them down. Instead, almost all lenders instituted interest rate floors of between 3.5% - 4.25% for 5 – 10 year loans. In March and April most lenders stepped back from lending entirely to assess the lending environment and COVID's impact on their existing portfolio, a portion of which required significant loan modifications. Banks had the additional task of processing mountains of PPP applications.

What is lesser known is the critical role bank and insurance company auditors (FDIC & OCC for banks and NAIC for insurance companies) have played in minimizing COVID's impact on the commercial real estate industry. Instead of requiring banks and insurance companies to write down their real estate collateral values to current market ("mark to market"), they've been very lenient in response to banks and life companies' loan extensions and modifications. Loan modifications typically comprised waiving interest payments and in many cases accruing principal for up to six months or more. Had these bank and insurance company auditors used the same heavy handed approach they employed in 2008, it would have forced lenders to incur massive loan write downs, precipitating the subsequent sale of multibillion dollar non-performing loan portfolios which would have significantly delayed the recovery of the commercial real estate industry in the U.S.

When lenders returned to the market last summer they were understandably conservative in their underwriting (lower Loan/Value margins) and aggressively wider on rate spreads (3.5% - 4.5% rates) in order to compete with corporate bond yields. Several bank lenders initially chose not to lend outside of their existing customer base, though for the most part that changed by the 4th quarter last year. For a while many bank lenders even required escrows of +/- 6 months of principal and interest to be established at time of loan funding. In addition to wider margins and higher rates, lender appetite for financing certain property types evaporated within a matter of weeks in early 2020. Most all lenders have ceased (or dramatically curtailed) lending on hotels and unanchored retail centers and, to a lesser degree have become much more conservative lending on urban and suburban office property.

Because the pandemic forced many of us to master Zoom and other multi-media platforms in order to work remotely, the obvious question is "do we need as much office space going forward"? While many of us may not return to the office five days/week we will work from our offices part of each week if only for the social interaction with our colleagues, which has been sorely missed. Also, business owners and managers will always prefer "seeing" their employees work rather than "hoping" they're working productively from home.

Fortunately, as a nation we continue to show resilience in the face of economic adversity. Our government has taken significant steps to support the economy through programs such as the CARES Act and PPP in addition to the Federal Reserve's continuing to hold short term interest rates to near zero while vaccines are being distributed.

The WSJ recently reported that executives from companies such as Honeywell International, Atrium Health Care Systems, Starbucks, Amazon and others have already reached out to President Biden offering the use of their facilities, logistic and communications capabilities to assist in reaching his immunization goals. Therefore, the expansion of a public - private initiative to improve immunization rates looks very promising.

We remain very optimistic that 2021 will usher in continued improvement in lender and investor confidence which will correlate to more aggressive loan pricing and a broadening in lender appetite within asset classes.

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