A Snapshot of Where CRE Debt Markets Stand Right Now

Here is a look at everything from lending momentum to agency finance.

By Clark Finney

The landscape of CRE has undergone significant transformations throughout the year. This CRE market update delves into key trends and insights to help industry professionals understand the current landscape and what to expect for the last quarter of 2023.

Lending Momentum
The market saw a 5% quarter-over-quarter decline in commercial real estate lending momentum between Q1 and Q2, reflecting a substantial 52% year-over-year (YOY) decrease.

Agency Allocations
Government-sponsored entities like Freddie Mac and Fannie Mae are currently operating at less than 75% of their allocated $75 billion each. However, they appear comfortable with this situation, prioritizing profit over volume in a departure from previous cycles.

Liquidity and High Rates
In an unusual twist, the current market stressors are primarily driven by liquidity constraints and high interest rates rather than deterioration in cash flow.

Bridge Financing Dominates
Approximately 75% of the CRE pipeline consists of bridge-to-bridge or bridge refinance requests. Limited partner (LP) equity is in short supply, making it challenging to meet capital calls. Factors such as taxes, insurance costs, and capitalization rates are affecting short-term deals that originated in 2021, even when business plans are executed successfully.

Private Capital Attraction
Institutional investors are showing strong interest in private capital, seeking higher yields. Bridge rates for high-quality projects are at 8.5% or more, while middle-market deals command rates exceeding 10%. In some cases, investors are providing small equity checks, sometimes taking a share of the coupon and general partner (GP) share.

Retail Sector
In the retail sector, credit unions have stepped in to fill the void left by banks, which now require a deposit relationship of over $1 million for liquidity. Credit unions face fewer balance sheet liquidity issues in comparison. One significant advantage they offer is the absence of prepayment penalties for refinancing in a more favorable economic environment. Secondary and tertiary markets can expect prime-based lending with interest rates starting at 8.5% or higher and a 25-year amortization period. Major markets, on the other hand, will see 5-year deals with spreads ranging from approximately 200 to 220 basis points (around 7-7.25%) and a 30-year amortization period. When it comes to non-recourse financing options, Commercial Mortgage-Backed Securities (CMBS) take the lead. These loans often feature interest-only payments and can be sized up to 1.25 times the property's income. However, a drawback is the standard 10-year term with a spread

of around 200 basis points, although this is offset by the availability of a new 5-year product with a spread of about 250 basis points.

For those seeking tighter spreads ranging from 150 to 200 basis points and 1.25 times or higher amortization rate, Life Insurance Companies present a robust financing option.

Multifamily and Industrial Sectors

In the multifamily and industrial real estate sectors, Agency financing remains the preferred choice despite potentially higher interest rates and lower loan proceeds. This preference is due to the predictability of execution and the ability to bridge the leverage gap with preferred equity (up to 75% Loan-to-Value at rates ranging from 12% to 15%, with accrual structures available). A recent trend involves buying down interest rates, a strategy commonly employed for all securitized loans, whether Agency or CMBS. By paying a 1% fee, borrowers can reduce spreads by 25 basis points, with buydown options of up to 2% available and occasionally 3% for CMBS loans. This approach ultimately helps lower rates, improve Debt Coverage Ratios (DCR), enhance cash flow, and increase net proceeds.

Agency spreads typically range from 175 basis points to as high as 245 with prepayment flexibility, while CMBS spreads are in a similar range (180 basis points to 245) but typically come with no prepayment option and feature a 5-year term.

Life Insurance Companies have been gaining a substantial market share in the industrial sector, primarily due to their prepayment flexibility and competitive spreads, with CMBS being a secondary choice primarily driven by leverage considerations.

Looking Ahead

Forward yield curves suggest a decreased probability of the Federal Reserve raising rates again in 2024, thanks in part to U.S. Treasuries doing much of the heavy lifting. There are no expectations for rate cuts until September 2024 at this time, and U.S. Treasuries are expected to remain volatile until the Treasury completes its campaign of auctions to replenish the deficit incurred by COVID-19 stimulus measures.