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Profimex Market Research Update – May 19, 2020

Capital Markets Loosen Up Enough to Allow Some Multifamily Refinancing

Two months ago, when the Fed decreased the rates to close to zero, the market anticipated a wave of refinancings for commercial real estate. However, as the full extent of the pandemic paralysed much the economy, those voices came to a halt. However, now that the market can quantify the extent of the downturn and has a better understand of the long-term perspective of asset classes, traditional lending sources are coming back to the table to discuss refinancings. Especially, well-positioned multifamily assets are likely to receive favourable debt instruments. Freddie and Fannie are now issuing loans with all-in, fixed rates at 3% and lower. Experts believe that the rates could decrease even further to some extent, but this does not justify waiting any longer to refinance. Considering the tenant uncertainties and the length of the crisis, the spread between the interest rates and the yield on Treasury bonds is relatively thin. Further reason to believe that refinancing will continue is that lenders are unlikely to reach the limits set on their lending by the Federal Housing Finance Agency, as lending for acquisitions came to a halt in April and early May. With regards to the lending source, smaller banks and regional banks are still considering long-term loans on multifamily projects and loan requests from existing customers are handled well. Larger banks and life companies on the contrary are not expected to continue their lending practices any time soon for different reasons. Larger banks, on the one hand, are currently busy with their larger loans to parts of the economy that have been hit hard by the pandemic, such as the airline and energy industry and life companies, on the other side, have reached their interest rate floor. Lending from their balance sheet is not feasible at such low spreads to Treasury bonds.

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How to Get to a Reasonably Accurate Property Valuation Amid the Coronavirus

We are increasingly hearing about tenants not being able to pay their rental obligations. The affected properties range from multifamily assets with 90% collection rates, to offices with smaller and medium size tenants who got into financial distress, caused by the pandemic. Investment professionals find it difficult to quantify the impact of COVID-19 on property cash flows and the resulting values of their own portfolios and/or investments in their pipeline. Institutional investors must address their real estate value's quarterly for financial publications and real estate sponsors must report their investment's performance to their investors. Ross Prindle, managing director and global head of the Real Estate Advisory Group at Duff & Phelps, advises its clients to predict their next 12 months and come up with realistic cash flows. Operators and owners must conduct a thorough analysis on the tenant's cash flow stability and make decisions on how to proceed with those tenants. One can distinguish a portfolio in 3 different branches, those properties with businesses that are not affected by the pandemic, such as many industrial properties; those properties with businesses that will probably recover but are going to have short-term issues; and those properties with difficult businesses where many tenants may have been struggling even before the pandemic started and are likely to go out of business. One of the main assessments should be the second group to understand which business will recover and which ones do not.

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Scarred and Scared, the Reshaping of American Consumers Begins

A recent Bloomberg article summarizes the findings by HSBC and the Washington Centre for Equitable Growth. Their finding suggests that even under the consideration that the COVID-19 virus will be contained in the coming weeks, the US economy will have a slow and lasting struggle back form the health crisis. In the US, 70% of the GDP is driven by consumers and with more than 33 million Americans having lost their jobs in the seven weeks since the outbreak, consumer spending may be limited for some time. The report continues to talk about the impact on the younger generation, which has now experienced the second recession within 12 years that is considered the worst since the Great Depression. This may have a psychological effect on millennials, just as the devasting impact in the 1930s influenced the psychological state of Americans. Economists look to Data from China, where the virus appeared first and where many restrictions have been relaxed. The data suggests a slow recovery consumer spending. When looking to other countries, such as

Sweden, where bars and restaurants have remained open during the contagion, customers have stayed away from such places even when it was legal. This may suggest that consumer may continue to stay away from certain activities and visits even after the government releases restrictions. Some companies will have difficulties to reassure people because risks trigger an emotional response in consumers. HSBC notes that "the psychological impact of risk aversion setting in cannot be understated" and that "until people feel safe returning to places where large crowds are prevalent -- such as public transport, bars, restaurants and many recreational venues -- consumer spending in this part of the economy is likely to remain subdued." However, industry groups are coming together to boost confidence, such as the National Restaurant Association and the government, who are offering guidelines to restaurants and customers.

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