CURRENT STATE OF THE DEBT MARKET

JANUARY, 2023

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The Real Estate Debt Market is the aggregate of all available financial capital that is used to leverage investor returns when acquiring, developing, and repositioning commercial properties. While many conservative institutional and high-net worth investors fund these operations with their own cash, a vast majority are either cash-constrained and/or want and need this leverage to match their perceived risk-reward targets in their real estate ventures. Types of capital providers, or lenders, include Life Insurance Companies, Banks, Conduit (CMBS) and Specialty Lenders/Debt Funds.

- Life Insurance Companies generally focus on the highest quality assets in major population centers around the country. They offer the most aggressive pricing at low to moderate leverage, and can offer non-recourse financing, which is attractive to experienced and institutional borrowers. Most traditional loans are fixed-rate, priced as a spread on US Treasuries, and can be locked 60-90 days before closing to remove interest rate risk. Many Life Companies do offer non-traditional floating-rate and higher yielding options for high-quality, value-add investments.

- Banks provide a wide variety of financing solutions for both permanent financing and construction. They tend to focus mostly within their own limited footprint and are very relationship focused. Terms can vary but they can be flexible on structure and offer competitive loan pricing for lower to moderate leverage. Non-Recourse financing is available for top borrowers, top quality assets, and lower leverage requests.

- Conduit (CMBS) lenders provide the most aggressive pricing and leverage, and can offer non-recourse financing for assets that are outside of core markets, but are stabilized and generally produce good cash flow. They are the least flexible in terms of prepayment and structure, and they price based on the US Treasury swap market and corporate bond spreads, which are susceptible to volatility in the broader capital markets.

- Specialty Lenders/Debt funds focus on heavy renovation and value-add opportunities. They generally offer shorter-term, non-recourse financing and are the most aggressive in leverage and most flexible in terms of structure. They are the most expensive capital and are subject to floating-rate interest (SOFR) fluctuations.

	Life Companies	Banks	CMBS	Specialty
Quality	High	Mid to High	Mid	Lower
Leverage	Low to Moderate	Moderate	High	High
Pricing	Most Aggressive	Varies	Aggressive	High
Pricing Index	US Treasuries	US Treasuries/Swaps/Cost of Funds	US Treasury Swaps	SOFR
Type	Fixed	Fixed or Floating	Fixed	Floating
Structure	Minimal	Somewhat Flexible	Very Minimal	Most Flexible
Fees	Minimal	0.25-1.0%	Minimal	2.0%+
Recourse	Non-Recourse	Mostly Recourse	Non-Recourse	Non-Recourse
Lenders	AIG	Wells Fargo	Citigroup	Blackstone
	New York Life	Suntrust	Barclays	Ladder Capital
	Lincoln Financial	M&T Bank	Goldman Sachs	Prime Finance
	MetLife	Truist Bank	Deutsche Bank	Mesa West

US TREASURY MARKET & THE FED

After a long and fairly consistent climb that began in December 2021, the 10-year Treasury yields peaked at nearly 4.34% during the third week in October 2022 - but have since retreated to the 3.4-3.5% range as of early December 2022. Twelve months ago, the yield averaged around 1.50%. The 2- and 5-year yields have generally followed suit, albeit at levels above the 10-year. A closely watched metric is the spread of 2-year vs. 10-year, which turned negative in April 2022 and has continued to widen.

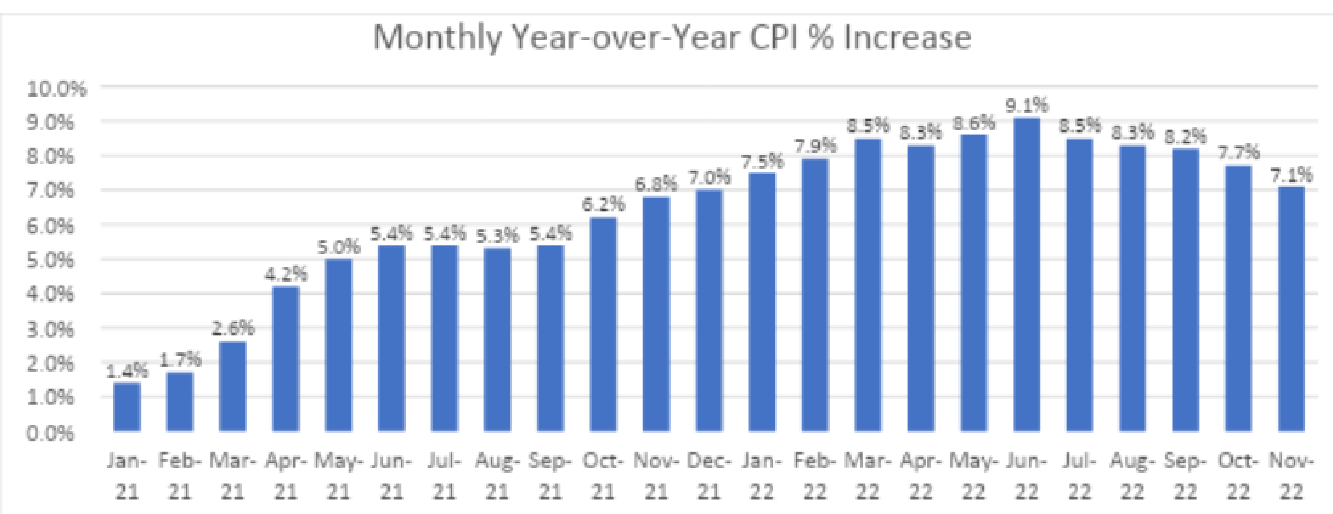
This spread is now at -0.74% as of December 13th, indicative of a steeply inverted yield curve and generally seen as an indicator of future recession. Future rate movements will depend heavily on upcoming actions by the Federal Open Market Committee, which raised short-term rates by 50 bps at its December 14th meeting and stated its target peak rate of 5.1% later in 2023.

Beyond that, markets are uncertain – but there is an expectation for the FED to pause and hold rates steady for at least the next 12 months, before initiating a slow decline toward a neutral rate once economic indicators show evidence of inflation approaching a target of 2%.

Future policy will be dictated most heavily by upcoming CPI and Unemployment Rate trends. The CPI released on December 13th indicated a year-over-year inflation rate of 7.1% for November, which beat consensus estimates, and was down from 7.7% in October and 8.2% in September.

The capital markets for real estate lending are likely to be somewhat constrained in the first half of 2023, but we can expect a slow thawing of liquidity as corporate bond spreads begin to tighten and CMBS debt becomes more attractive again. It is likely that spreads have peaked and there are some positive trends, but all-in rates still remain well above 6%, even for the preferred asset classes.

Bank lenders initially were the beneficiary of widening spreads in the bond markets, and were able to capture many lending opportunities on transactions that they previously weren't competing on, but after a rush of business in Q3-2022 for fixed-rate debt, many are now in the process of recycling construction capital on loans that are maturing in an uncertain valuation environment, and they have been pulling back somewhat as of the last few months on higher leverage and somewhat riskier deals.



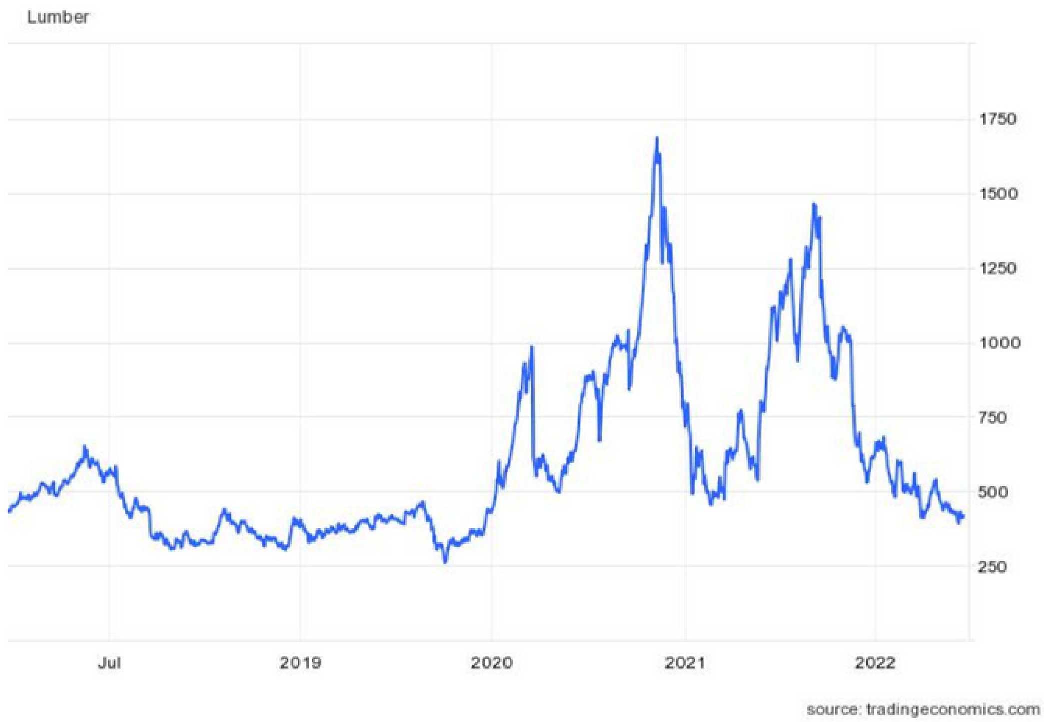
***SOURCE: BUREAU OF LABOR AND STATISTICS**

Bank debt currently ranges in the 5.25-6.0% range, with 30 year Amortization available for preferred asset classes, and 20-25 year for secondary classes – usually with some amount of recourse required.

While rent-growth has been a major tailwind for development and value-add projects for the last 24 months, there's ever-growing sentiment that landlords are beginning to lose pricing power (except in extremely constrained markets). And even though there's also evidence that pricing for commodities used in construction are returning to pre-pandemic levels, developer pro-formas that relied on low interest rate permanent financing and a comfortable spread on cap rate vs. return on cost are tightening.

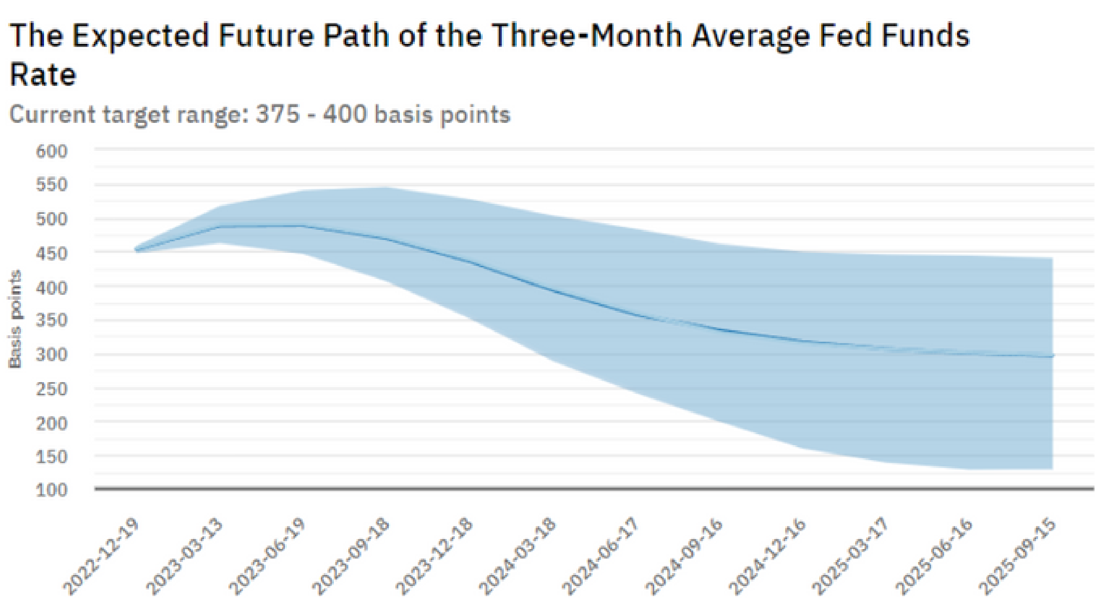
This phenomenon will have both positive and negative implications on future deals. Contractors will lower pricing to be more competitive as their pipelines diminish, but land and future development value will face downward pressure.

	Fed Funds Rate	2 year Treasury	10 year Treasury	Spread	Bank Prime Rate	30 Year Mortage
February 2020	1.58%	1.36%	1.54%	0.18%	4.75%	3.47%
June 2020	0.08%	0.14%	0.66%	0.52%	3.25%	3.13%
December 2021	0.08%	0.56%	1.43%	0.87%	3.25%	3.11%
June 2022	1.21%	2.65%	2.94%	0.29%	4.75%	5.70%
As of December 15, 2022	***3.84%***	***4.24%***	***3.45%***	***-0.79%***	***7.00%***	***6.33%***
**data of 1st business day of month*						



Where interest rates trend over the next 12-24 months is still indeterminate as of now. If inflation is quelled quickly, the FED may pivot to decreasing rates sooner than expected and accelerate the rush of liquidity back into the market for debt capital. Data utilized for monetary policy is mostly trailing, so the market may be closer to returning to normal than the headlines convey.

At least in the near-term, borrowers should pursue flexible financing terms with limited prepayment penalties – which allow refinancing at a potential lower fixed-rate in the future, and even consider floating rate debt if it is economical to yields on investments. Market sellers have shown little willingness to capitulate and accept higher cap rates unless forced to by maturities, other LP fund mandates, or personal issues that are forcing a sale.



***SOURCE: ATLANTA FEDERAL RESERVE**