Marcus & Millichap
Capital Corporation

Cap Alert

LATEST DEBT MARKET INFORMATION

June 5, 2020

Moderation in the Face of New Challenges

This has been an enormously painful and difficult week for a nation already wrestling with the shock of COVID-19. The death of George Floyd in police custody led to widespread anger and peaceful protests, as well as violence and destruction in multiple cities. Businesses that were just beginning to open after the pandemic lockdowns may not recover.

It will take time to move forward. It's human nature to think the chaos convulsing the country will become a permanent reality. This is a cognitive bias that psychologists call "exaggerated expectation" – a tendency to predict more extreme outcomes than actually happen. Other observers tend toward an "optimism bias" – they think the future will be great, forever. But past experience with difficult events such as 9/11 and the Great Recession have taught us that for better or worse, change is constant. Conditions are generally never as good or bad as we think they are, so the sage advice is moderation. Don't overdo it when things are good, don't go to pieces when things are bad.

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We do know that COVID-19 is likely to alter the mindset and behaviors of the consumer. One analyst called it "a Darwinian moment for trends" -- only the fittest will survive. In the case of retail, a new Marcus & Millichap research report suggests a best-case scenario in which the sector will see a short downturn and a strong recovery; stores reopen by summer and pent-up demand will jump-start activity. The personal savings rate soared 33 percent in April as Americans limited purchases to essentials, which bodes well for future spending activity. A worst-case scenario would see an extended downturn coupled with a weak recovery, leading to higher vacancies, falling rents and more defaults and bankruptcies. Essential and discount retailers, and stores with a strong omnichannel presence, will outperform.

Prior to the pandemic, online sales accounted for about 15 percent of retail transactions. That figure has now grown to 25 percent, according to UBS. It's worth noting that despite shelter-in-place orders, three-quarters of consumers still walked into a physical store to do business. Things changed – but not as radically as some expected.

Corporate office space is quickly shifting as well, with occupiers looking at suburban satellite locations to complement big city headquarters and planning for more employees to work from home. Safety is paramount and space planning and new technologies will be key for navigating offices. We will see a strong focus on the quality of cleaning, air quality, touchless devices; individual versus open/shared spaces; and staggered attendance to reduce crowding in elevators and other common areas. A UBS report found new inventory and slower new leasing activity drove the office sector's vacancy rate to 12.3 percent in the first quarter.

Lenders are inching off the sidelines and bidding on deals. Pricing is tighter. Agencies are looking more closely at sponsors' historical performance and track records, and softening upfront reserve requirements for certain transactions, with the recognition that requirements will be loosened once the crisis is over. Banks, credit unions and life companies are originating loans and we are seeing green shoots in CMBS lending, though an estimated 7 percent of CMBS loans across asset classes have gone into special servicing, according to one report. Financing for hotels remains very challenging.

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Many of the initial due diligence challenges such as appraisal, environmental inspections and even title that have emerged over the past 60 to 90 days are starting to abate, as lenders and third parties have adjusted “new practices” to the “new normal,” and are executing those processes faster than before.

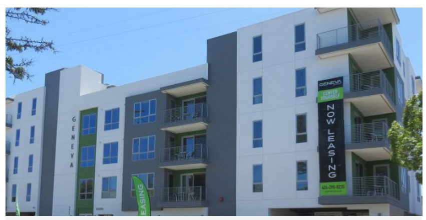
Meanwhile, transactions are muted as market participants await better price discovery. The New York Times reports that investors are sitting on $300 billion in equity, awaiting distressed sale opportunities. We are keeping an eye on the Federal Reserve, which has purchased $2.2 trillion in Treasurys and mortgage bonds since mid-March. The Fed meets June 9 and 10 to consider its next moves.

These tumultuous times call for expertise and creativity to execute capital solutions. Please reach out to your MMCC Capital Advisor for guidance.

RECENT TRANSACTIONS

MULTIFAMILY, OFFICE & RETAIL

Boston, MA
$16,500,000
3.55% Fixed for 7 yrs
14-yr term/30-yr amort.
No prepayment fee



MULTIFAMILY

Los Angeles, CA
$10,725,000
3.60% Fixed for 5 yrs
3 yrs I.O.
30-yr term/30-yr amort.
Used market vacancy of 5%
Allowed all Debt Service Reserve payments

INDUSTRIAL

Randolph, NJ
$2,000,000
4.25% Fixed
3 yrs I.O.
3-yr term
Locked rate at application

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