REDNews' Texas Capital Markets Virtual Summit

BY RAY HANKAMER

Emerging Trends in Logistics and Commercial Real Estate

Moderator: Reid Wilson, Wilson Cribbs, Goren Panelists: Lillian Fahr, Wells Fargo; Rhonda Sands, Veritex Bank; Rob LaRue, Grandbridge

- We can't be angry about the COVID pandemic and its interruptions of our business lives, and we have to accept where we are and move forward; some sectors are down, some are flat, and some are way up
- The multifamily and industrial sectors for example are way up, and are very attractive to lenders, although underwriting is more careful and conservative than before; some trophy office buildings are able to secure financing as well; lower LTVs, some non-recourse loans still, but also loans with initial recourse that burns off as the project reaches stabilization; some lenders prefer Texas loans
- There are lenders in the market still willing to look at all property types, and now that many have worked through their forbearance requests from earlier in the year, they are looking to put out money through new builds and acquisitions and refinancing...although much more conservatively than pre-COVID; new development loans tend to favor multifamily; some of the big national banks have dropped out of the construction loan market
- Loans in the retail sector tend to favor grocer-anchored centers, although LTV may be 50 to 65 percent, down from pre-COVID 70 percent range; lenders favor entertaining loan requests from established borrower-customers
- Local and regional community banks are looking for openings to move in to capture borrowers for whom big banks' requirements are now too restrictive; community bank loans are sometimes closed to pre-payment in first two years, or pre-payable with a penalty
- Specialized new build projects such as over-55, high-end multifamily and workforce housing for mid-income tenants are being financed
- These are unprecedented times BUT, development has not stalled like it did in '08-'09, although it has slowed a bit
- Interest rates start in the low 3 percent range, with 3-5-7 year terms preferred by some banks, i.e. shorter loans; banks are really digging down on borrowers' portfolios when they contain properties in sectors that are under heavy stress; debt service coverage ratios are ranging from 1.25 to 1.30
- Medical office is attractive to lenders in this market
- Permanent loans are now advertised online by conventional/traditional lenders, and by non-conventional ones; life companies are sometimes requiring 6-month debt service escrow reserves up front at closing; 60 to 65 percent LTV permanent loans with non-recourse are still being made, at 2.5 to 4 percent interest rates, provided the sponsorship is very strong; financing is shifting back to normal after the initial first shock of the pandemic in the early spring; there is a lot of capital out there seeking yield, now that lenders are seeing a lot fewer delinquencies than originally anticipated
- Debt funds are considered by many as lenders of last resort, but there is still demand for their deals, although they can charge up to double-digit rates with 1 to 3 points on the front end; the pandemic has weeded out a lot of debt funds, however; "loan to own" is a term sometimes applied to this lender category
- Credit unions are doing deals, often non-recourse and similar to life companies in their loan structures
- Some hospitality loans are being done, but property and borrower must have an exceptional story
- CMBS lenders are still active, although some borrowers avoid them because of the difficulty of any loan modification once these loans are in place; the CMBS servicer has a first fiduciary duty to the investor and not the borrower; but CMBS lenders are the only ones who would consider an interest only loan or 30 year amortization at 75 percent LTV; "love to hate" CMBS: attractive pricing with inflexibility; CMBS lending pools are shrinking and many lenders in this sector have left the market
- The Federal Reserve's position on keeping interest rates low for a long time in the future is definitely good for commercial real estate!

Commercial Real Estate Equity Investor Requirements & Investment Deal Flow

Moderator: Ed Nwokedi Panelists: Ari Rastegar, Rastegar Property Company; Dalton Skach, GoldGate; Jonathan Paine, Walker & Dunlop

- Churchill was quoted: "Never let a good crisis go to waste"...

- In multifamily, rent collections remain high: 92 to 99 percent; Fed financing smoothed over the initial shock of the pandemic, and now employment is returning

- "This is the greatest buying opportunity since 1986;" in Manhattan vacant apartments have gone from 4,200 to 15,000 almost overnight; people—and investors—are rapidly moving from high-tax states to low-tax states, such as California to Texas and New York to Florida, although when the dust settles from COVID, many may go back; people are more price/value conscious than ever

- Austin has become the tenth-largest city in the U.S., and has recently surpassed San Jose in size

- Capital markets are still wary and cautious, but all categories of lenders are getting back into the game

- Unique/classic properties are starting to be available for purchase, off- and on-market, but not necessarily at distressed prices

- Block chain/crypto currency is beginning to offer an alternative to conventional financing, while conventional equity capital providers are coming more aggressively back into the market; various crypto currency products offer fractional ownership in commercial real estate, and the possibility to trade fractional shares in and out of various real estate deals as if they were stock—the investor does not have to wait years down the road to get out of his equity investment as in conventional cash equity + loan financing, and investor can receive dividends in crypto currency which he can covert to cash; this new vehicle appeals to young investors who do not like to be locked in for long investment periods; crypto is gaining a place in the capital stack

- In Houston there has been some disruption and it may continue in certain areas, but overall our low regulatory structure is attractive to investors, who are looking mid- and long-term down the road at rental and occupancy growth; markets such as Nashville, Raleigh, Atlanta and Denver are immediately more attractive right now than Houston,

Continued on Page 42>

CAPITAL MARKETS

< Continued from Page 37

which is slowly recovering from a six-year slide in oil and gas; jet fuel and gasoline demand will return with vaccine and so will Houston; rent collection here has held up surprisingly well

- As a basic rule, if a property in any sector has cash flow, it can find financing; much of the inventory of potential value-add multifamily has been picked over in Houston; and although expensive, bridge financing can be obtained to close deals in these uncertain times

- Capital markets are good if developer can find good value-add deals, and has a talented team in place to do meaningful, higher rent-commanding upgrades

Biggest Missed Opportunities with 1031s and Other Transactions

Moderator: Todd Phillips, REDNews Panelists: Cindy Pham, Asset Preservation, Inc.; Duane Lund, NAI Legacy; David Wheeler, Hartman REIT

- The industrial sector is now far stronger than pre-COVID

- CMBS financing is happening in hotel, office and some retail, as lenders wait to see how borrowers' overall multi-sector portfolios shake out after the shock earlier in 2020; it is a challenge for lenders to underwrite right now

- 1031 exchanges and reverse exchanges are as popular as ever, and probably will stay with us, even if/when there is a change in Washington, since the exchange tax deferrals are popular with Democrat and Republican investors alike; there is much flexibility in the 1031 law, and leases, oil and gas interests, and fractional ownerships can all qualify for like-kind exchange; 1031s have been around for over 100 years, and they generate lots of revenue for title companies, brokers and mortgage brokers, lawyers, advisers, surveyors, etc.

- The "Delaware Statutory Trust" or "DST" is a non-1031 tax deferral program that is not as well-known, but under it exchanges can be made in beneficial interests in trusts, which can be classified as real property and therefore qualify; DST is a $7 billion industry and is becoming increasingly popular, with currently 30 to 40 DST sponsors active in the market; currently multifamily dominates the DST sector, but all CRE sectors are eligible; DST gives investment opportunities to non-management active investors in smaller increments, as low as $25,000, and these increments are sold as securities in public DST offerings; DST can be used in family succession planning, from a retiring patriarch down to heirs, and DST involves tax deferment; DST offers an alternative to 1031 for someone who does not want to own and manage an actual asset; cost segregation of the elements in a building can give further first year write-offs

- 1031 buyers are looking for value-add properties and also for passive deals, where not too much effort will be needed, and they are looking in low tax states; 1031 buyers often seek to leave California

- March to June 1031s slowed down, but last two months have seen return to busy activity

- Panelists feel strongly offensive on CRE's future in the state: "the bulls are running" and we will ride out this crisis, this "Black Swan" and business will be better than ever; predictions are that by EOY 2021 we will be back to where we were pre-COVID

- The Fed has done an incredible job during this crisis and by mid-year 2021 we should be back to 5 percent unemployment, almost where it was pre-COVID; workers are ready to go back to the office and collaborate, attend events and resume business travel; there is a lot of liquidity in this market as high-end net worth individuals swing into commercial real estate, seeking the good tax benefits in the industry; this was a weird year but buying opportunities are robust and Houston and Texas are good places to be

- "2021 to '22 may see in Houston the hottest real estate market on the planet"...

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