Three Ways Tech-savvy Real Estate Development Firms Have Met Capital Needs During COVID-19

Despite market uncertainty, CRE project delivery teams have continued to secure necessary capital by embracing and implementing modern technology

The pandemic has caused business to boom in some sectors and grind to a halt in others. Commercial real estate development is no exception, having experienced highs and lows throughout 2020. Many teams faced stop work orders or paused projects amidst general market anxiety. However, once the country endured through the first wave, it became clear that there was a path forward for those previously paused projects as well as potential new development projects. The critical component making all the difference? Capital and financial support were more available and attainable for real estate development teams that were organized, tech-forward and innovative.

Capital for real estate is available and the Federal Funds Rate - the benchmark interest rate for commercial banks - has been very attractive at nearly zero (0-0.25% since March 15), and will remain there for the foreseeable future. To help combat the fallout from COVID-19, the federal government stepped in this spring to create new financing programs like the Paycheck Protection Program (PPP) as well as adjustments to regulations such as eviction moratoria. But many real estate companies have experienced challenges either accessing capital, or have not been nimble enough to apply for funding in a timely manner, impacting their ability to get back on track.

For commercial real estate, the impact of this economic downturn has been measurably different than that of the Great Recession of 2008-2009. This is due in part to fundamental differences in the overall landscape. For one, the capital markets ground to a halt in the last recession, whereas capital is generally available today. Also, perhaps more interestingly, PropTech and CREtech were not a major part of the operating toolkit for owners in the last recession. Today, these products and services are much more mature and deployed widely, with the potential to quickly reinforce and stabilize business.

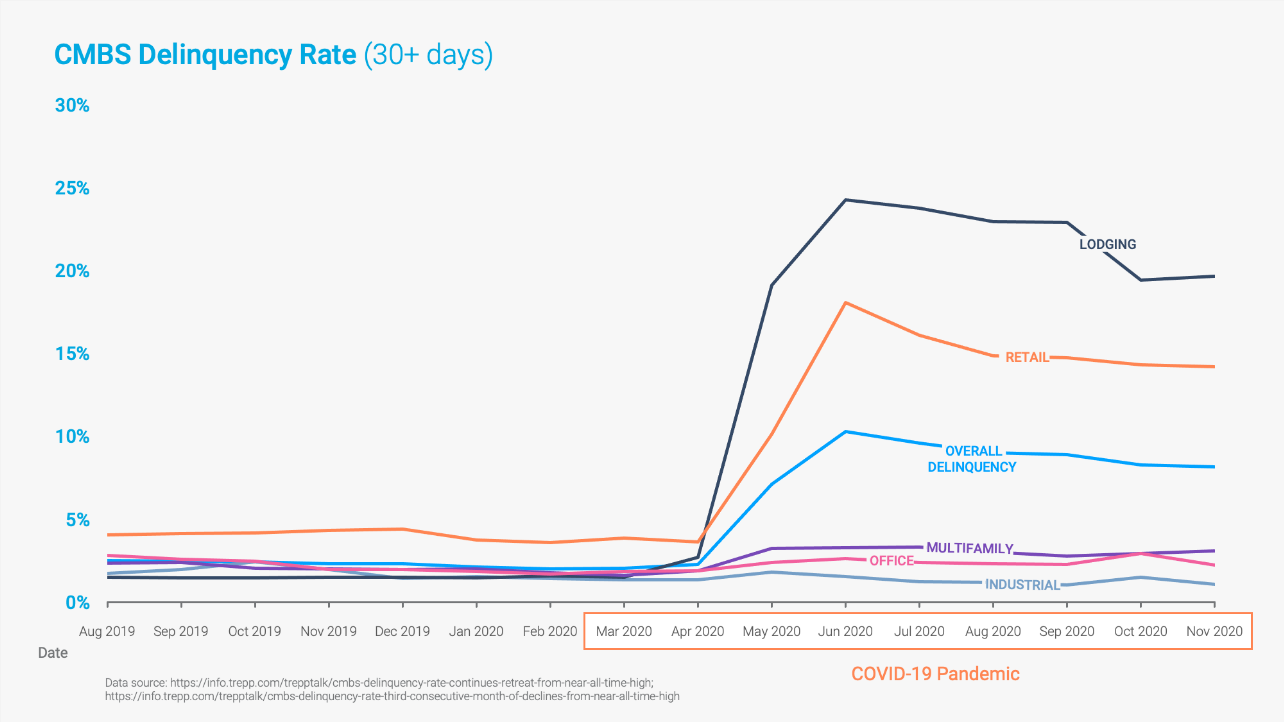
Modern, integrated software and solutions have helped real estate teams navigate this choppy, fast-moving environment. Real estate owners and developers have been better positioned during this downturn than in any prior slump, as they are better capitalized; and the banks have generally healthier levels of risk and capitalization as well[1]. Northspyre has identified three trends in the lending and capital markets space, which illustrate the competitive advantages of using modern technology and frame the current environment for why some owners and developers are thriving while others are stumbling.

Workouts and Loan Restructuring Remain Active

The current environment has created a collective willingness from both lenders and CRE professionals to come to the negotiating table to find agreeable financing solutions. For developers and owners to be as prepared as possible to take advantage of this market situation, teams should be highly organized and have financial documentation in place, well before any debt service problem arises.

Existing capital stacks are being renegotiated due to COVID-19 disrupting business plans, with Moody's reporting that the amount of Commercial Mortgage-Backed Securities (CMBS) loans in distress, or special servicing, had risen 320% from the start of the pandemic to the beginning of the fall. In fact, the volume and speed of CMBS loans being transferred to special servicing is greater and faster compared to prior recessions[2]. Unsurprisingly, both sides of the table are getting creative in how to reach a favorable path forward, with lenders very open to entering workouts.

Exhibit 1, TREPP



1 https://www.cnbc.com/2020/03/17/banks-nearly-took-down-the-economy-in-2008-now-the-industry.html

2 https://www.bisnow.com/national/news/capital-markets/cmbs-loans-have-gone-to-special-servicing-this-year-faster-than-ever-before-106672

CMBS delinquencies shot up to a spike in June and tapered down slightly since, but have remained at historic highs, as reported by Trepp. Many owners have been unable to make payments, or proactively began conversations with lenders and investors upon facing consecutive months of diminished cash flow. The data shows active loan workouts occurring throughout the summer and early fall. As Trepp noted, some of the delinquent loans became “current” because of lenders granting forbearances (paused or lowered mortgage payments) and/or borrowers being authorized to use reserves to bring payments up-to-date, which is typically not allowed. An estimated $20 billion of CMBS[3] loans have been granted forbearances to date during the pandemic (thus bringing them current).

Loan restructuring services are very much in demand, as seen by the number of consulting teams staffing up–and even some new specialty real estate companies that have just been launched. For example, banking veterans Wendy Silverstein and Ed Adler formed Silver Eagle Advisory Group to consult on debt restructuring and single-asset loan workouts for borrowers and lenders. While there is no direct way to quantify the amount of workout activity aside from inferences from the CMBS delinquency rate, anecdotes abound of successful loan renegotiations. Owners recently shared in a Bisnow panel that they have successfully renegotiated terms such as skipping three months of principal payments, or changing the required levels of reserves or debt service coverage ratios[4].

There is a lesson to be learned here for every owner and borrower, regardless of property status: having documents digitized, accessible, and organized will be key to modeling out different scenarios, and help owners be proactive about coming up with reasonable proposals for the loan term’s renegotiation. Having cloud-based software is the best solution. To be as prepared as possible for managing any conversation with a lender, developers and owners need to have rigorous and real-time documentation in place, which comes from having a robust software and technology strategy.

Capital is Readily Available, Even if Developers Are Hesitant

The bullish commercial real estate market pre-pandemic was awash with capital readily available to support new development projects[5]. Now, following paused or closed construction sites, shifts in strategy to accommodate different asset classes, and overall market volatility, owners and developers are rightfully more cautious, which has led to an imbalance of available capital and projects breaking ground. Capital sources that would have passed on construction

3 Excluding Government Sponsored Enterprises (GSE) CMBS. Trepp Talk, October 1, 2020. https://info.trepp.com/trepptalk/cmbs-delinquency-rate-third-consecutive-month-of-declines-from-near-all-time-high
4 https://www.bisnow.com/national/news/commercial-real-estate/loan-workout-post-webinar-105991

5 https://docs.preqin.com/reports/2019-EisnerAmper-Private-Equity-Real-Estate-Market-Outlook.pdf

lending pre-pandemic (because of the abundance of competitive lenders quoting low rates) are attracted by the higher yields now that some lenders have pulled away from the market.
However, as market confidence is slowly being restored, there are several positive signs in the real estate capital markets for developers who are ready to access capital for new projects. Commercial loan originations in Q3 showed a solid rebound of 12% in loan volume from a choppy second quarter, as reported by the Mortgage Bankers Association[6]. On a quarterly basis, all property types except Retail and Hotel showed increased lending activity, a dramatic difference from many lenders putting on the brakes in their immediate response to COVID in Q2.

Exhibit 2, Mortgage Bankers Association

Property Type	Percent Change in Origination Volume, Q2 to Q3 2020
Total	+12%
Multifamily	+4%
Office	+35%
Retail	-27%
Industrial	+67%
Hotel	-45%
Health Care	+32%

Other favorable economic signals for developers who are ready to access capital include the uptick in Opportunity Zone dealmaking[7], and the competitive bid environment from contractors. Developers continue to build new projects in Opportunity Zones, even in the midst of the pandemic: there are now 186 projects, since the founding of the program, that have used opportunity zone financing, which allows investors to defer capital gains for placing equity investments in underinvested and low-income areas[8]. Construction industry analysts and consultants have observed as of this fall that architects, contractors, and subcontractors are lowering their expected profit margins and submitting highly competitive bids for the small number of projects intrepid enough to move forward[9]. These conditions can help developers who are ready to move forward, because of lower project costs.

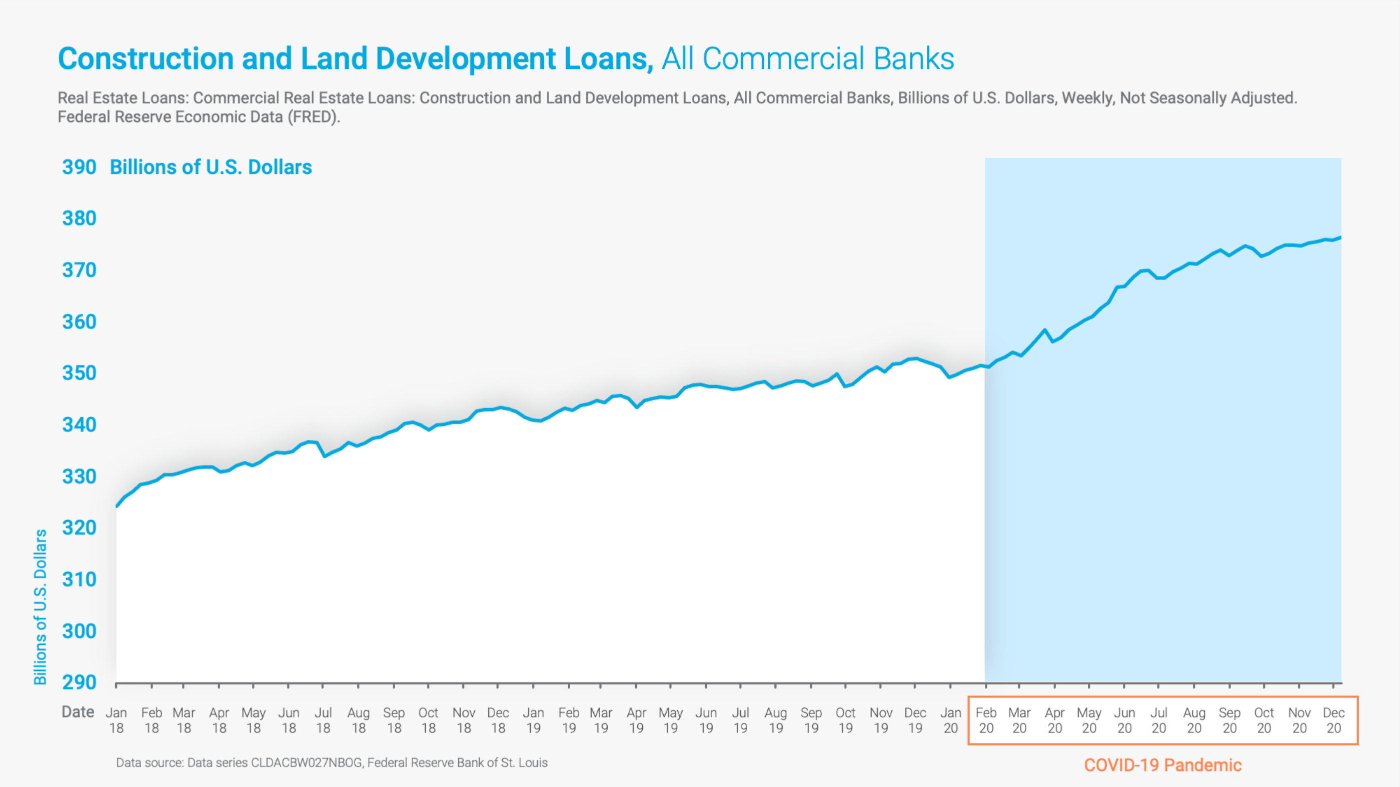
6 https://www.mba.org/news-research-and-resources/research-and-economics/commercial/-multifamily-research/quarterly-commercial/multifamily-mortgage-bankers-originations-index

7 https://www.bisnow.com/national/news/opportunity-zones/investments-in-opportunity-zones-growing-during-pandemic-104437

8 https://www.nytimes.com/2020/11/24/business/opportunity-zones-funding-development.html

9 https://www.constructiondive.com/news/the-covid-19-conundrum-money-is-available-for-new-construction-projects-b/583418/

Exhibit 3, FRED



As seen above, data from the Federal Reserve Bank of St. Louis (FRED) via the Board of Governors of the Federal Reserve System shows real estate construction and land development loan activity has generally been climbing week to week with only a few slight dips since March 2020[10]. Lenders clearly remain active and open to offering capital to developers and owners. The more owners and developers can show that their projects are well-designed and thoughtful, by integrating the latest technology, the more traction they will find with lenders and investors.

Owners and developers who are more willing to adopt new technology are more able to operate in the face of challenges. Despite the general paucity of sales, one developer in Chicago achieved a record price-per-unit sale for a luxury multifamily building in October, by using virtual tours[11]. Virtual tour and floor plan rendering technology also aid with tenant prospecting. Transparency and quick access to reporting increases trust with both tenants and lenders.

10 Board of Governors of the Federal Reserve System (US), Real Estate Loans: Commercial Real Estate Loans: Construction and Land Development Loans, All Commercial Banks [CLDACBW027NBOG], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CLDACBW027NBOG, October 21, 2020.

11 https://www.connect.media/lincoln-park-sale-reaches-pricing-high-point/

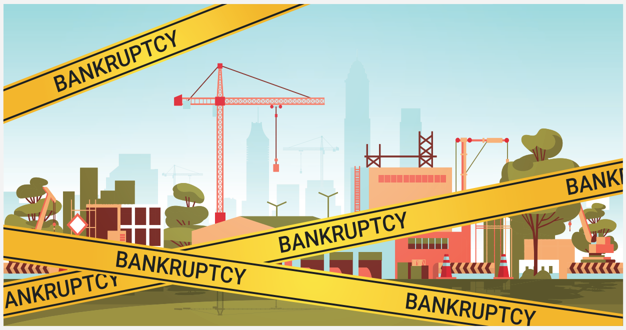
Just as the last recession ushered in new types of real estate products, such as data centers and amenitized multifamily–and geographic revitalizations, such as Austin, Denver, and Nashville's population booms–there will be opportunity for nimble or forward-thinking developers in this cycle. In addition, it is smart for developers to actively plan for construction now because their product will be delivered two to three years out, when the realities of travel and mass gatherings will likely be much different.

Government Programs and Adjusted Regulations Offer Non-Traditional Path Forward

Government programs figure into the current capital markets environment, too. Any new programs and regulatory updates to help support CRE professionals during this time will disproportionately favor owners and borrowers who have already gone digital with their records and internal processes, and have strong relationships with their lenders. Multiple examples support this trend.

This June, a prominent new capital source for maintaining business operations entered the scene: Paycheck Protection Program (PPP) loans. In the rush to implement it, lenders favored the borrowers with whom they had the strongest–meaning, best documented–relationships with.

The mad rush to take advantage of the program favored "sophisticated companies with strong ties to lenders...over those with weaker financial roots," for better or worse[12]. The Small Business Association (SBA), the agency overseeing the program, has been giving updated guidance and clarifications about how the commercial rent and mortgage interest payments can be counted as expenses toward loan forgiveness. In addition, legislators and advocates will likely apply pressure to audit the program, making documentation and transparency more important than ever.



As the Executive Branch changes hands, economic recovery and infrastructure programs may create new opportunities for real estate and construction companies to access project or business operations financing. The Biden Administration has clearly stated it supports green or climate-resilient infrastructure and development going forward. The biggest engine of federally-supported real estate finance is multifamily housing programs. The Biden Housing Plan proposes increasing the Community Development Block Grants (CDBG) and Low-Income Housing Tax Credits (LIHTC) programs by $10 billion each; and a $100 billion Affordable Housing Fund which includes generous allocations ($65 billion) to state and local housing authorities. LIHTC in particular has enjoyed broad bipartisan support in Congress ever since its inception in 1986, and rural states frequently support and want more LIHTC funding. During times of regulatory change

12 https://www.wsj.com/articles/ppp-money-aboundedbut-some-got-it-faster-than-others-11601976601 to a more affordable-housing-friendly administration, multifamily developers with robust documentation will be best positioned to reap the benefits.

With all of the volatility the economy has experienced and the likely uneven recovery ahead, the ability to qualify quickly for loan programs can make the difference between folding and surviving, keeping staff on payroll or reducing headcount. Cloud-based software and a modern technology strategy can help your company be nimble enough to jump on new programs and not lose out on non-traditional capital sources.

Conclusion

In times of volatility, there is often opportunity. But real estate leaders need real-time information at their fingertips to take advantage of such moments. To manage through a recession, executives must make the appropriate judgment calls about deal opportunities that come across their desk, as well as secure necessary capital through traditional or more creative means. And those providing capital need to have confidence in projects and borrowers, through a high level of trust in the relationship or developing trust quickly based on the wow factor of the real estate team's sophisticated abilities.

Northspyre helps real estate teams become more proactive and data-driven, making better, faster, more confident decisions and mitigating risk in the process. A thoughtful technology strategy will help teams achieve more predictable outcomes on real estate projects, and enable companies to fully harness their data for a competitive advantage.

In addition, Northspyre enables teams to maintain institutional knowledge no matter the market dynamics, so that historical project data and expertise is fully retained. With Northspyre, teams can hold steady or rebound from market volatility faster, and hit the ground running to secure financial partners and take on new deals.

Technology strategies will determine whether real estate owners thrive, or get left behind, in this brave new capital markets world. For more information about creating and implementing a cloud-based software solution, contact us at Northspyre.