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Top 6 Takeaways from the Allen Matkins/ULI Capital Markets Roundtable

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Allen Matkins and Urban Land Institute (ULI) recently held a Capital Markets Roundtable discussion, in two parts, that featured several industry leaders. They shared insights regarding the effect that COVID-19 has had on capital markets, mainly in real estate, as well as their forecasts for 2021. Which sectors of the market are strong, and which should you avoid? What are the thoughts and strategies of some of the major players in real estate financing and investing?

The following are six takeaways from the discussion:

1. NON-REAL ESTATE CAPITAL MARKETS HAVE PERFORMED WELL

Despite the overall negative economic impact that COVID-19 has had, equity and credit markets have shown surprising strength and resilience. Although April unemployment rates were hovering around 15% and equity and credit markets plummeted, policymakers threw trillions of dollars at the problem in the form of aid programs, loans, additional unemployment insurance, and lower interest rates. The markets generally recovered at a good pace, with the Nasdaq up 20% and the S&P 500 up 5%. Issuances in August (typically a slow period) were $44 billion; it is on pace to be the biggest year in at least 10 years. Many companies have been able to refinance their balance sheet to extend maturities in order to create liquidity. True, the current default rate is over 6%, but that is nowhere near the double-digit default rates predicted a few months ago.

2. REAL ESTATE MARKETS AREN'T THRIVING, BUT THEY'RE STAYING AFLOAT

Although CMBS volumes are down about 50%, debt in the multi-family space has remained more or less flat and with very attractive rates. Additionally, government stimulus and aid have allowed people to continue to pay their rents and mortgages. Overall volumes are down, of course, and lenders are mainly trying to figure out how to support their existing clients. The numbers show that real estate markets did not directly benefit as much from government stimulus as corporate markets. But there was a "trickle-down" effect that made them indirect beneficiaries of these programs. There will likely not be any additions for real estate in any future government stimulus.

3. THE RETAIL AND HOTEL MARKETS WILL TAKE A LONG TIME TO RECOVER

John Brady, Head of Global Real Estate at Oaktree Capital Management, L.P. (Oaktree), estimates that this may take "four to six years." "Nobody wants to finance retail and hotels right now," he said. Pre-COVID, hotel loans were at about 3%; now they are hovering around 7% to 8%. Retail and hotels have generally represented a third or more of most issuances on the securitization side; now, it is less than 10%. When asked if that will turn around anytime soon, Brady stated, "I don't see the catalyst for that." Lower-end hotels and drive-to hotels are doing okay. But until businesses start thriving again, lenders will be very hesitant when it comes to hotels that mainly depend on business travelers, meetings, and conventions. The retail space is more difficult to predict because it has many more variables and moving parts, but until people are back to work and confident in the economy, the recovery will be difficult.

4. NO ONE QUITE KNOWS WHAT THE FUTURE HOLDS FOR OFFICE SPACE

Nationwide, office space is less than 20% occupied right now. And while some companies are eager to get back to a fully-staffed office, space requirements will no doubt be different because of COVID-19; appropriate distancing between workers — whatever form that may take — will certainly be a major consideration for years to come. Scott Stafford, a Founding Partner of Strada Investment Group, believes that people will be "avoiding density" for at least the next 12-18 months, so returning to an urban working environment could be slow in coming. Thus, urban markets will take a hit, at least in the short term. The net result is that lenders and investors are a bit hesitant to get involved in office space at the moment. Both Stafford and Terrence Daly, Vice Chairman at Cushman & Wakefield, believe that office space won't start to see a significant recovery until 2022. And right now, given the uncertainty of the next year or two, companies themselves are very hesitant to sign leases for a new term.

5. THE FUTURE OF REMOTE WORK IS YET TO BE SEEN

Since the pandemic began this past spring, many workers have been working at home — some by choice, and some not. What is the future of the home office and its consequent effect on needed office space? Some of that depends on the market. High-density areas, where people are shoulder-to-shoulder on public transportation on their way to work, are likely to see a slower return to a traditional office environment. Other markets, where there is more space and most people can drive their own car to work, may see a faster return. However, John Frank, Vice Chairman of Oaktree, believes that many businesses will adopt a hybrid model, with workers splitting their working hours between the office and home. And since many people have gotten used to working from home — and they like it — they may be more likely to look for future work with a company that allows them to do so. Additionally, hiring remote workers enables companies to access a much larger field of skill and talent than might be available in the immediate geographical area.

6. COVID-19 ACCELERATES JOB MIGRATION TRENDS

Not every region or property is going to behave the same way. COVID-19 has accelerated the trend of population and job migration to places where homes are more affordable, taxes are lower, and it is easier to commute to work. These areas generally have more space, which is extremely attractive during a pandemic. Many millennials are moving to the suburbs, and a growing number of businesses prefer a suburban location that provides space for light manufacturing as well as R&D. So when it comes to investing, location plays a role, but so does the industry itself. The panelists generally agreed that the short-term future of real estate looks good in the industrial, multi-family, and single-tenant long-term credit leases.

While the pandemic didn’t deal as harsh a blow to the real estate space as it did to other sectors and industries, investors should proceed with caution. No one quite knows what the fallout from COVID-19 or the economic landscape will be in a year or two. It’s good to remember that real estate looked pretty grim in the wake of the 2008 crisis but came back nicely. It will again. Nevertheless, a patient and conservative approach is, at the moment, the best course to take.

Watch the full webinar replay.

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