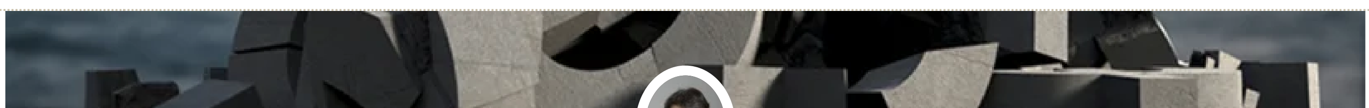

By: Amy Wolff Sorter

Anticipating the Debt Maturity Onslaught

Note: This is the first in a series of Weekender articles about debt maturities and their impact on commercial real estate. Over the next few weeks, experts will discuss other information related to this topic.

In recent days, the finance/banking headlines centered around the Silicon Valley Bank and Signature Bank collapses, and their impact on markets. But a quieter, more assiduous problem will have its own impact on commercial real estate lending and borrowing. This problem involves upcoming debt maturities.


Ben Kadish

Just how bad is it? How bad will it likely be? Experts told Connect CRE that the level of maturities coming due in 2023 is problematic enough. Adding to the issue is the wave of maturing loans in 2024 – and beyond. If interest rates remain high, the industry could face challenges when it comes to capital.

Where We Are Now


David Kidder

The number commonly tossed around concerning CRE debt maturities is $447 billion at least, according to data from Trepp. However, "this total is actually just the tip of a major wave of maturing loans between now and 2027," said Brian Good, iBorrow CEO. He said that $486 billion in loans is anticipated to mature in 2024. Beyond that, more than $500 billion in loans are scheduled to come due in 2025, 2026 and 2027. And these are just estimates, Good explained. The numbers don't include the debt originated by private lenders.

And Scott Morse, Citadel Partners Managing Director indicated even higher numbers. "According to some reports, corporate debt coming due could likely peak at more than $1 trillion, higher than the $900 billion peak in 2012," he commented.


Brian Kenny

And while traditional lenders might have been willing to offer help with refits, that might not now be the case. "Lenders have minimum debt service coverage ratios, so with higher rates they are limited in the loan proceeds they can offer," explained Bryan Kenny, principal with Bandon Capital Advisors.

This has led to what David Kidder dubbed a longer-term issue. "It all comes down to interest rates," said Kidder, director, business and corporate development with Newport

Capital. "If rates stay high and values stay low, borrowers won't be able to refinance their debt."

How We Got Here

Brian Good

While CRE debt maturities seem to be just now showing up in headlines, they actually trace their roots back to the Great Financial Crisis aftermath. In an attempt to goose the economy and boost spending, the Federal Reserve maintained its Effective Federal Funds Rate at close to zero. This generated to cheap capital and a high volume of CRE loans through the very early 2020s.

"Between 2018 and 2022, there was a significant amount of floating rate loans funded with 3- to 5-year loan terms based on cap rates being in the 4% to 5% range," said Ben Kadish, president and founder, Maverick Commercial Mortgage. "Many of those loans were priced at Libor/SOFR plus 300 basis points."

In the early years of those loans, he said, the general calculation was .10% plus 3.0% = 3.10%, with a likely floor of 3.75-4%. But today? Because of ongoing EFFR increases, "the interest rate has more than doubled since those loans were first originated," Kadish said. "Lenders were underwriting with a 1.20 debt coverage ratio. Under today's interest rates, unless the net cash flow of the properties has doubled, the current loan underwriting will not provide loan amounts large enough to refinance the old loan amounts."

Juan Ramirez

Furthermore, unhedged loans have led to a significant reduction in cash flow. "That's because a higher percentage of the rent is going to debt service costs or in the event of non-stabilized deals the interest reserves are depleting earlier than underwritten," said Jon Pharris, CapRock Partners President and Co-Founder. "That will result in a re-balance by way of additional equity. Either scenario is not ideal for a borrower."

Another factor under the "why we're here today" category was the COVID-19 pandemic and its impact on commercial real estate. "CRE owners had to deal with business closures, social distancing, and remote working conditions to name a few," said Juan Ramirez, senior processor with Tauro Capital Advisors. "These conditions have impacted sectors such as retail, hospitality, and office space as they have seen rental and occupancy rates drop significantly."

Scott Morse

Adding to the issue are the Silicon Valley Bank and Signature Bank collapses. This added wrinkle means debt is even more challenging. "Interest rates have been highly volatile in the immediate wake of the bank failures, as the real estate industry tries to figure out where loan terms need to be," said Kadish. This could mean a more complex capital stack, especially if one lender won't or can't refinance in full. This could lead to "a need for more preferred equity, or borrowers simply taking on a higher debt-service coverage ratio," Kadish noted.

The other SVB/Signature wrinkle is that of the regional banks. Pharris explained that beginning in 2022, the nation's banks pulled back on CRE lending, in an effort to reduce industry exposure. Regional banks stepped in. "Unfortunately, with the collapse of Silicon Valley Bank and days later Signature Bank, it is probable that regional lenders, which will now be under more scrutiny, will also reduce their lending levels," he said.

The Crystal Ball

The experts all agreed that this problem isn't going away after 2023. "With a large trough of loans coming due between now and 2027 across all lender platforms, and an uncertainty about where interest rates will level off and—if ever—returning to such low levels of the past decade, maturing loans will continue to be problematic," said iBorrow's Good.

Jon Pharis

On top of that, "given the Federal Reserve's stated position of increasing interest rates to contain inflation coupled with the largest bank failure since 2008, my bet is that asset values will decline before we return to a more typical capital market environment," Pharr noted.

If there is any good news it's that institutional correspondent lenders are still interested in real estate loans. "Most have even increased their allocations to the real estate sector for 2023," remarked Kenny.

Additionally, both borrowers and lenders learned many lessons from the GFC. Citadel Partners' Morse said this could mean a more manageable fallout. "While debt loads are high," he added, “we should weather the storm in a more manageable manner.”

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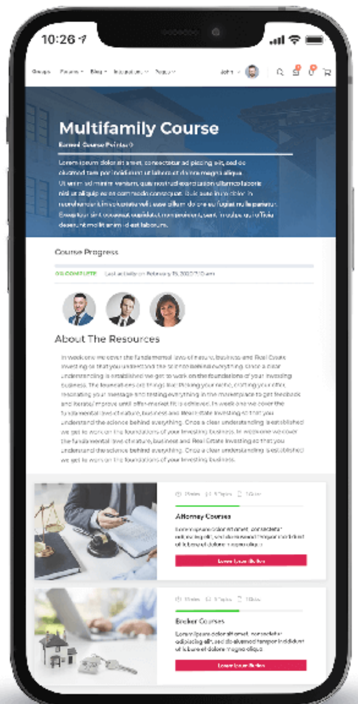

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