GUGGENHEIM

Commercial Real Estate

Cash Is King

With property values under stress, prepared real estate investors can find opportunity.

Increases in interest rates have caused the pace of commercial real estate sales to fall sharply because it has led to higher cost of capital, tighter credit standards from lenders, and increases in operating costs. For borrowers of floating rate mortgages, the cost to hedge against the risk of further interest rate increases can be prohibitive. But certain credit metrics, like loan-to-value ratios on newly originated commercial loans, are now near the conservative levels last seen during the Global Financial Crisis.

Investors who do not have to sell real estate or refinance mortgage loans are generally on the sidelines. But market stress often leads to opportunity, as some investors may be forced to sell or refinance in the current environment. This means investors with dry powder may be able to acquire properties at lower prices, and lenders will see opportunities to improve their position when borrowers seek short-term extensions with hopes of a bridge to a better rate environment. Investors and lenders have used these requests to require borrowers to pay down loans, increase coupons to market rates, establish new covenants or cash sweep protections, and provide credit enhancement for operating and capital shortfalls. Because we see the current environment as driven primarily by the rising cost of capital and not by a fundamental supply/demand disconnect in commercial real estate, we expect these opportunities will wane as interest rates begin to moderate.

In both real estate debt and equity investments, we are focused on defensive strategies in the current market. We look for properties with strong cash flows backed by sponsors that have the liquidity needed to cover potential operating shortfalls and capital needs. These sponsors typically have the ability to be patient and defer a sale or refinance until a more favorable market returns. Our focus continues to be on sectors with strong demand drivers: multifamily, logistics/warehouse, neighborhood retail, and hospitality in undersupplied markets. We continue to be cautious on office investment, where tenant demands for rent concessions and costly improvements are high.

By Jennifer A. Marler and Farris Hughes

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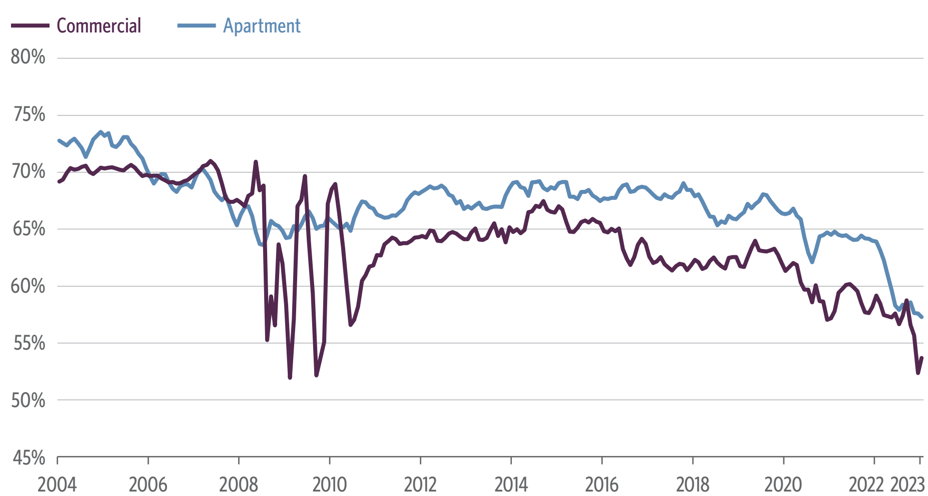
Mortgage Lending Standards Have Tightened to GFC Levels



Source: Real Capital Analytics. Data as of 1.31.2023. Note: chart represents newly originated commercial property loan LTV ratios.