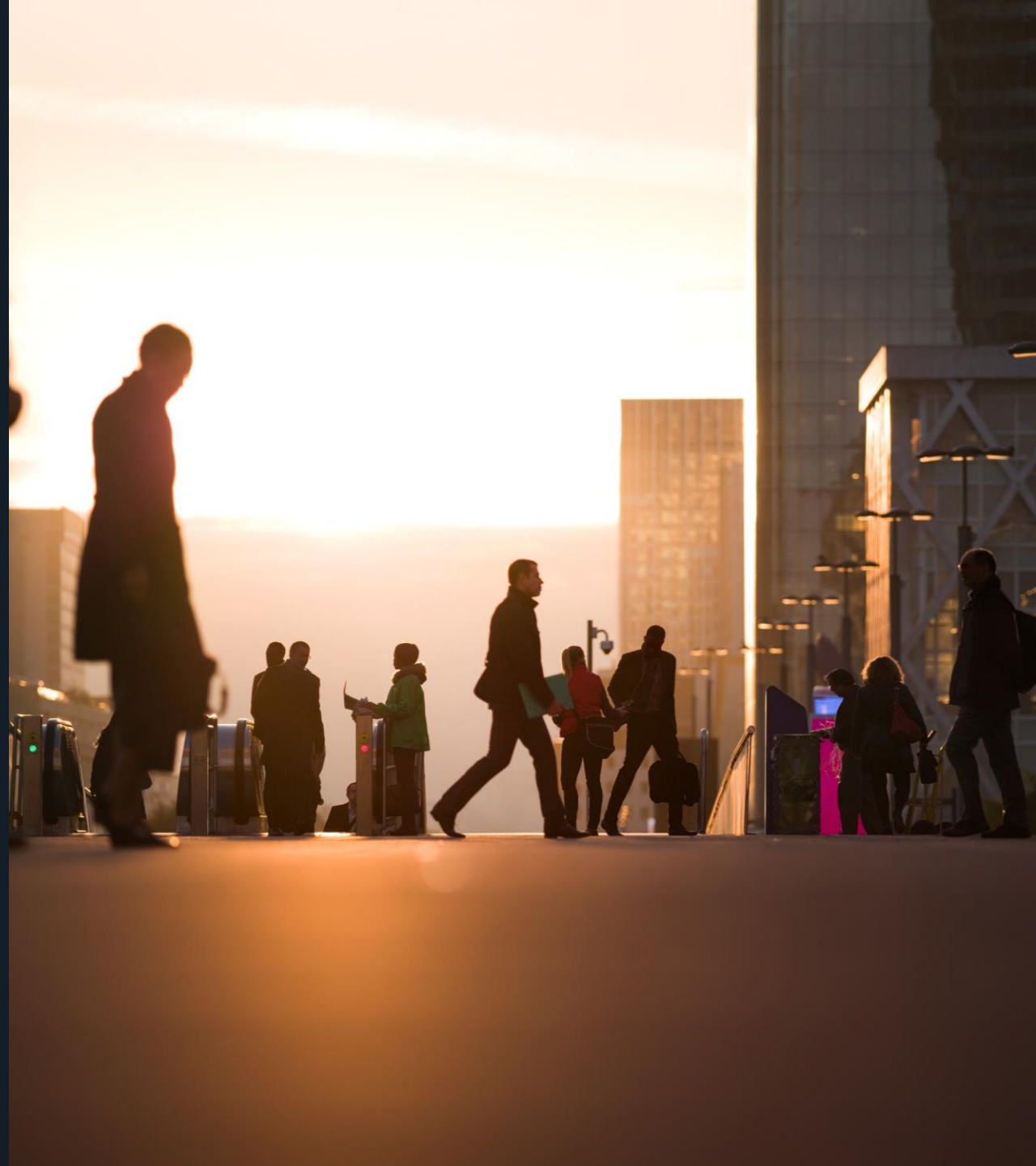
Banking Crisis Meets CRE

Industry insights

May 2023
BOMA Pacific Southwest Region

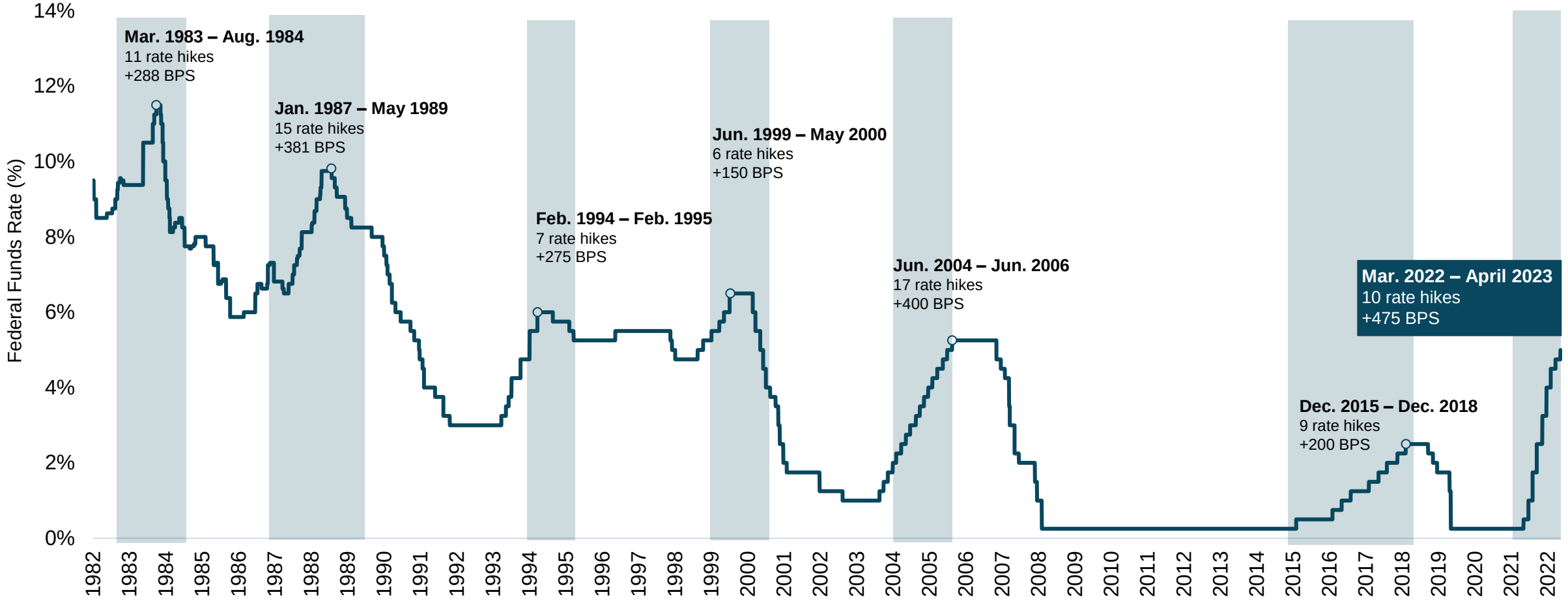
JLL SEE A BRIGHTER WAY



Macro overview

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The Federal Reserve is employing its most aggressive rate increases in over 40 years to combat inflation

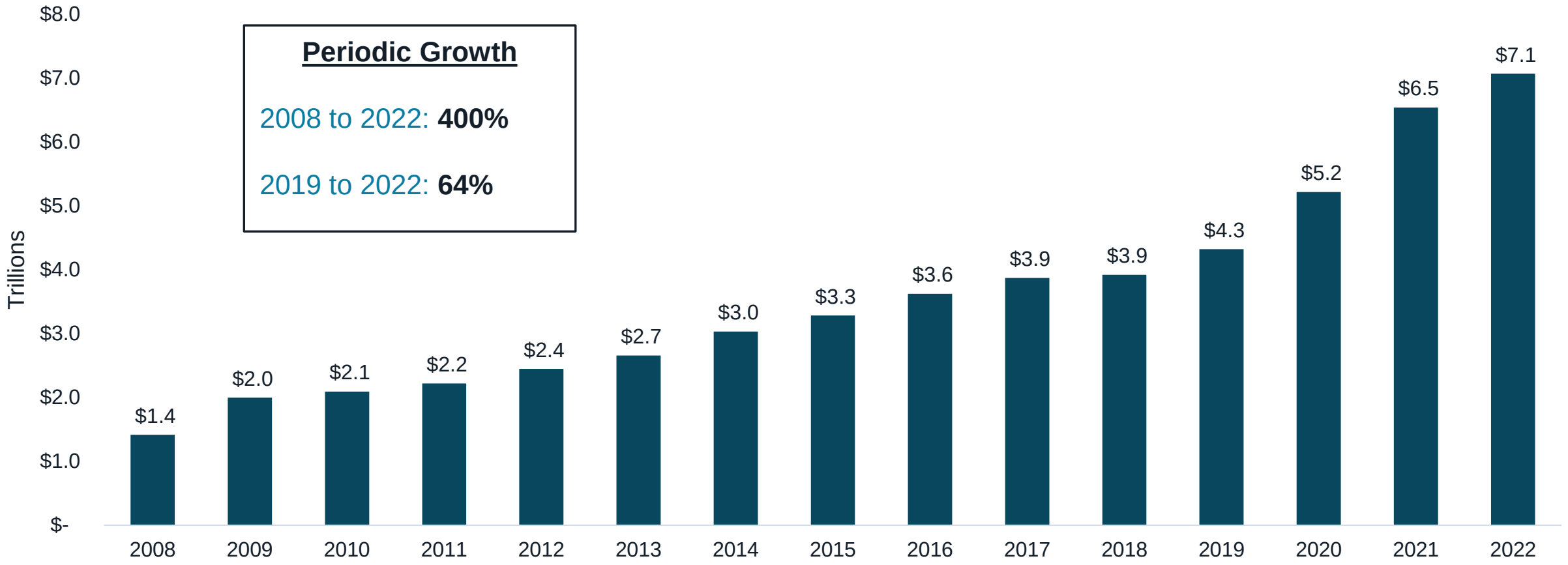


Source: JLL Research, St. Louis Federal Reserve
Note: Figures reflect upper bound of federal funds target range beginning on December 16, 2008 as the Federal Reserve transitioned to range-based policy rates.

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Local and regional banks accumulated significant deposits post-pandemic

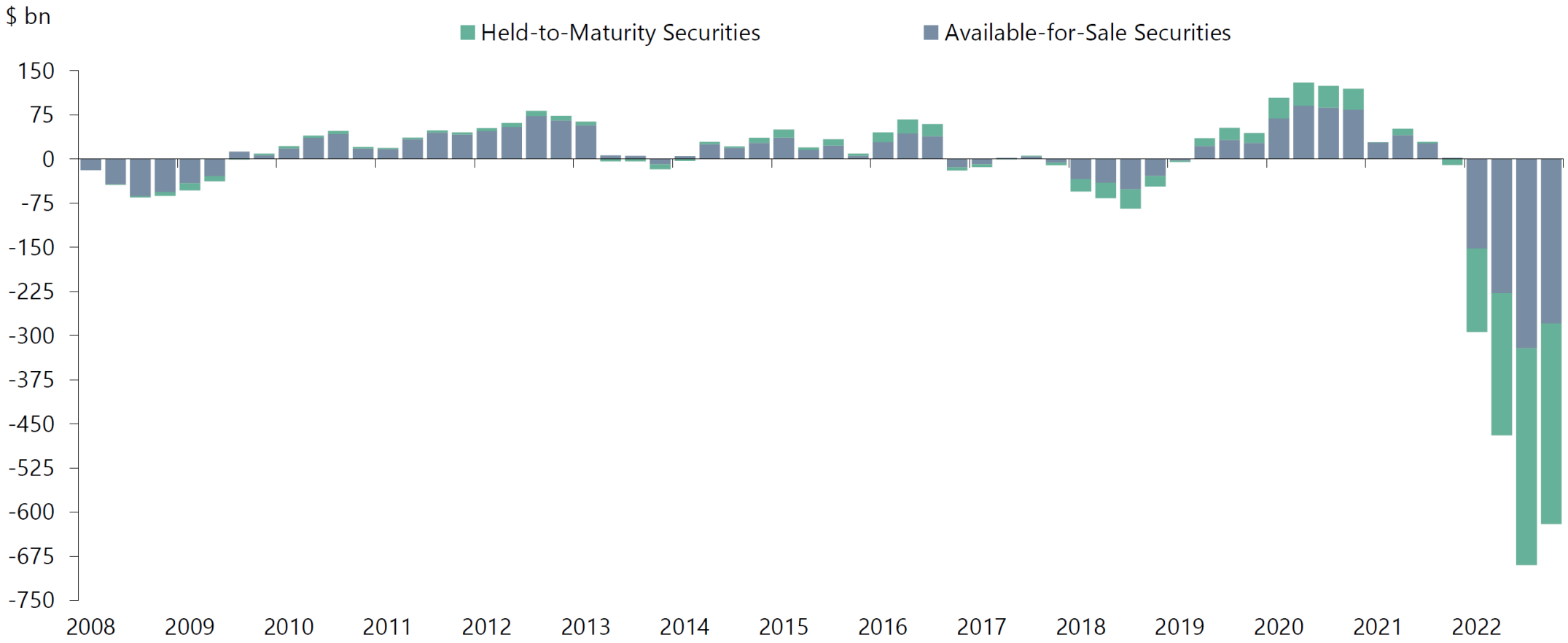
Total customer deposits at select large regional US banks



Source: JLL Research, Bloomberg Finance, L.P., company filings

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Unrealized gains / losses on investment securities for banks accelerated upon Fed rate hikes



Source: JLL Research, Bloomberg Finance, L.P., company filings

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Recent bank failures, acquisitions, and what to watch

- On 3/10/23, Silicon Valley Bank was taken over by the FDIC after a run on deposits that forced the bank into failure
- On March 27, 2023, First Citizens acquired SVB and assumed its assets of $110.1 billion, deposits of $56.5 billion and loans of $72.1 billion. As part of the deal, First Citizens acquired the deposits without a premium and the assets were acquired at a discount of approximately $16.45 billion

- On 3/12/23, Signature Bank, New York, NY, was taken over by the FDIC after regulator concern of contagion after depositors became nervous about the bank's health due to its high amount of uninsured deposits as well as its exposure to crypto and other tech-focused lending
- Roughly one-third of Signature's assets ($36bn of $110bn) were real estate-focused and 94% of its CRE loan originations were focused on the NY-NJ-CT Tri-State Area.
- New York Community bank declined to purchase approximately $60 billion in multifamily CRE loans, these will likely sell at a discount.

- Credit Suisse had been losing investor and customer confidence for years, recording its worst loss since the global financial crisis in 2022. Mounting concern over its stability prompted depositors to pull their funds from the bank, leading to fears that the bank would become insolvent.
- On 3/19/23, UBS Group AG agreed to buy Credit Suisse in the form of a merger for $3.2 billion in an all-stock deal brokered by the government of Switzerland and the Swiss Financial Market Supervisory Authority.
- The deal will create a bank with an $80B commercial real estate loan book and more than $160B of real estate assets under management — making it the fourth-largest CRE lender in the world

- In part due and similar to SVB's failure, First Republic Bank realized an injection of deposits in 2020 and 2021. After SVB's failure, FRB saw considerable bank transfers out of its bank, especially amongst those accounts with over $250,000 in deposits.
- As scrutiny increased, a number of unrealized loses were further identified.
- By last weekend, the FDIC took over and brokered FRB's sales to JPMC. FRB has approximately $34 billion in in outstanding CRE loans according to RCA.

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What’s going on with Silicon Valley Bank?

How did we get here?

Major clients generated a ton of cash that led to a surge in deposits.

SVB’s deposit ↑ 233% ($60B in 2020 vs. $200B in 2022)

What did the bank do?

SVB bought tens of billions of dollars on U.S. Treasurys and government-backed mortgage securities.

SVB’s securities portfolio ↑ 374% ($27B vs. $128B in 2021)

Why is that a problem?

Mortgage securities pay fixed interest rates, but market interest rates have moved so much higher. Those securities are suddenly worth less on the open market than they are valued at on the bank’s books

SVB’s gap between the cost of the investments vs. fair value ≥ $17B

What else went wrong?

SVB’s deposit inflows turned to outflows – clients burned cash and stopped getting new funds

Attracting new deposits also became far more expensive

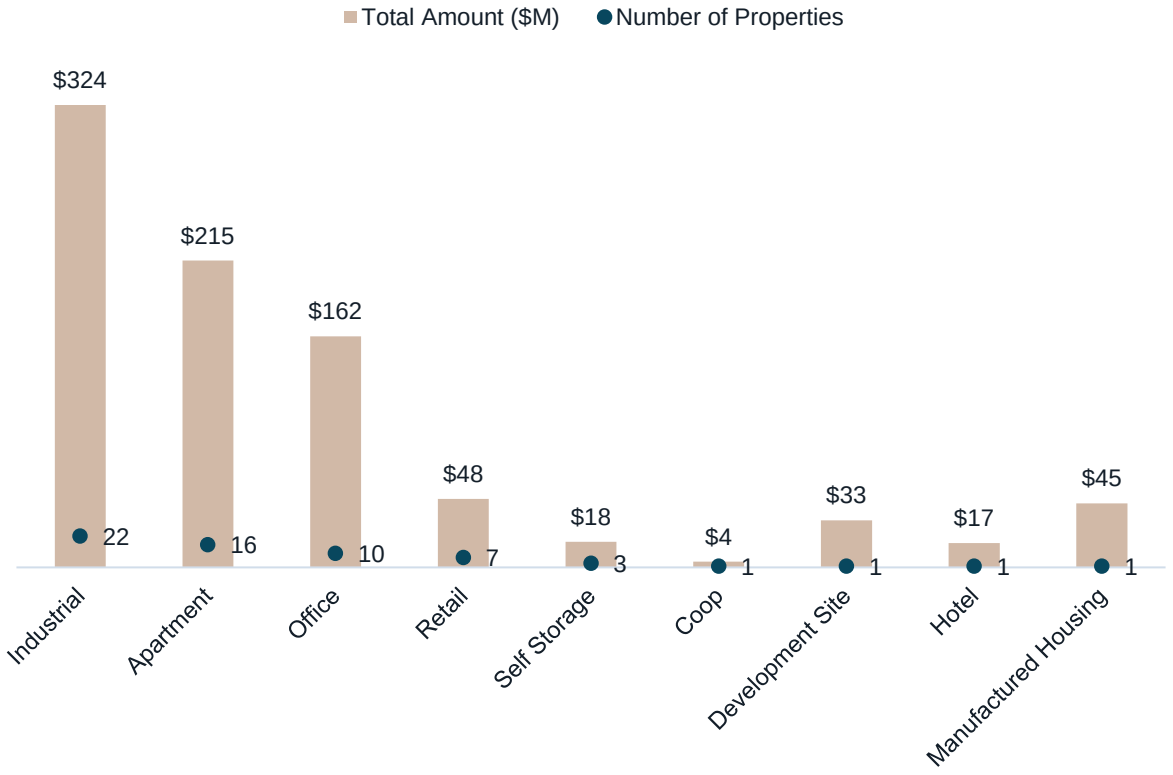
SVB’s deposits ↓ 15% ($200B at 3/2022 vs. $173B at 12/2022)

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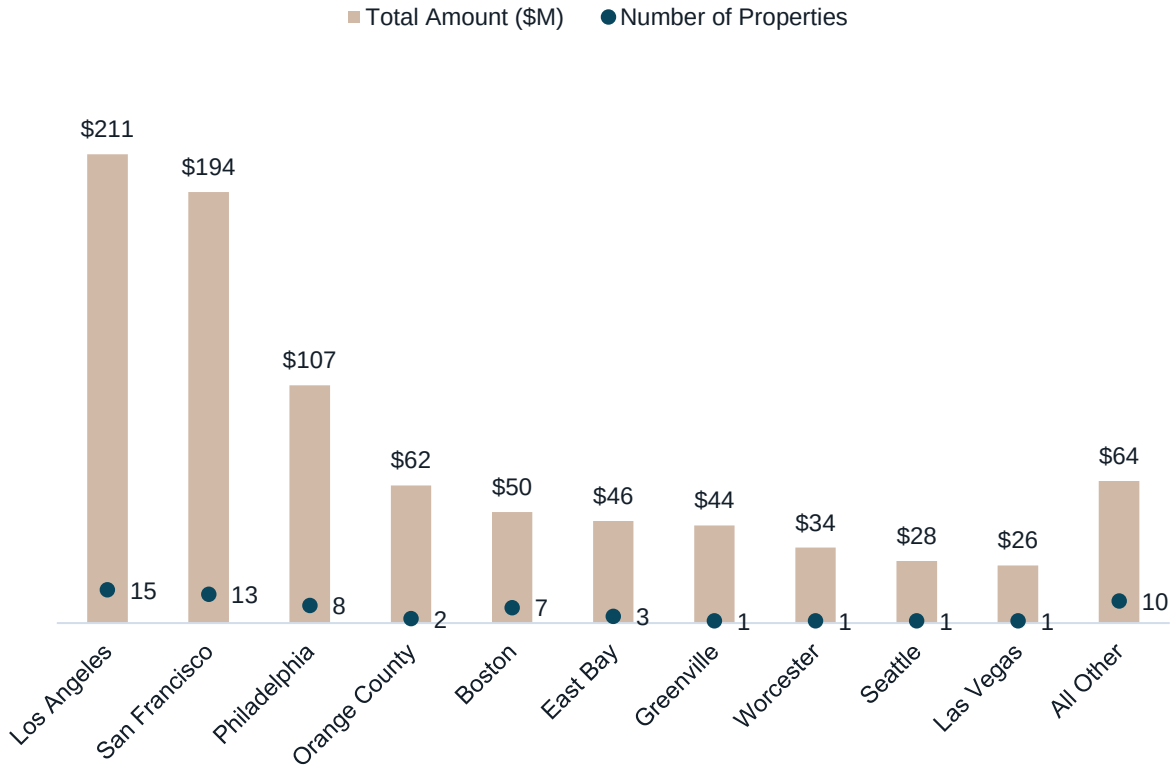
Real Estate Portfolio Loans – Silicon Valley Bank

According to Real Capital Analytics, RCA holds approximately $866 million in active real estate loans with a large share in industrial and multifamily assets with concentrations in the San Francisco Bay Area and Los Angeles.

SVB Real Estate Loans by Property Type ($M)



SVB Real Estate Loans by Market ($M)

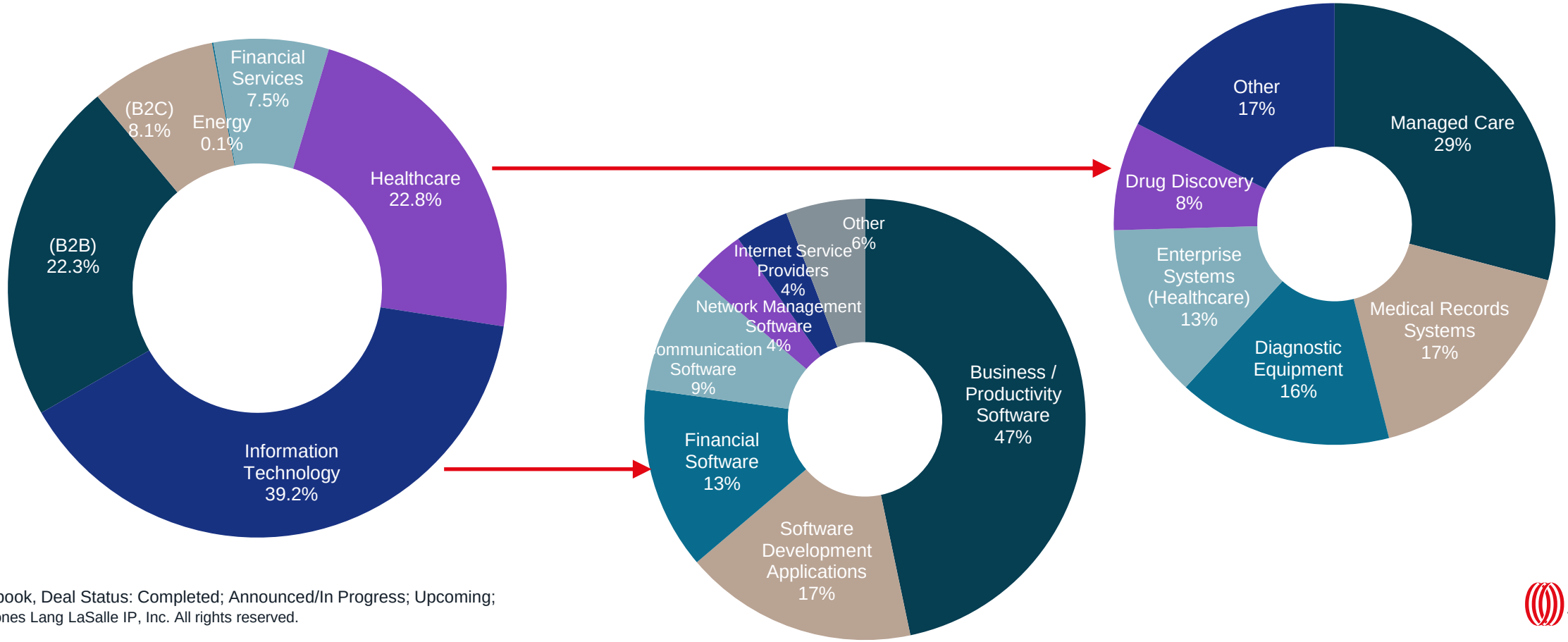


Source: Real Capital Analytics, March 2023.

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Impact on revolving lines of credit

- SVB focused on the startup community, offering more favorable rates than found elsewhere. When these companies renegotiate these loans, they may have to do so at higher rates that could change their financial position.
- The majority of companies with revolving lines of credit at SVB were in the information technology industry, followed closely by healthcare and B2B companies.

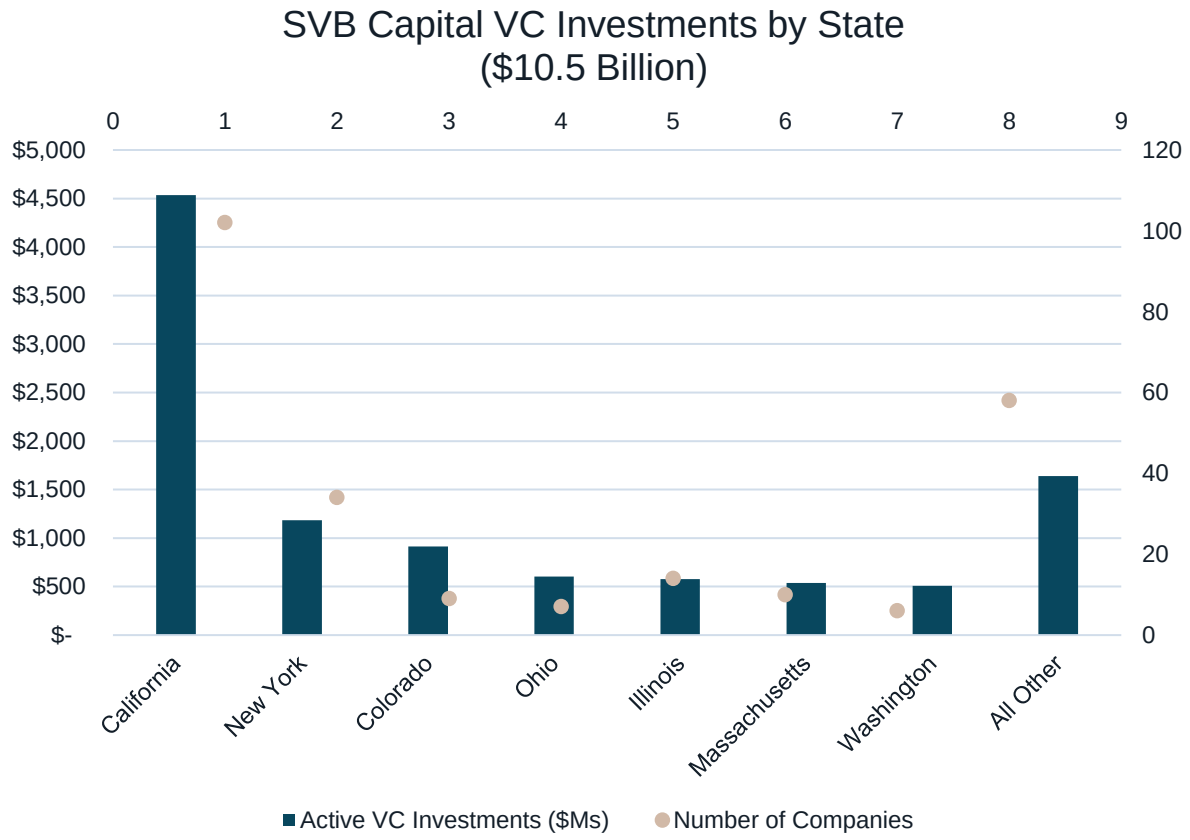


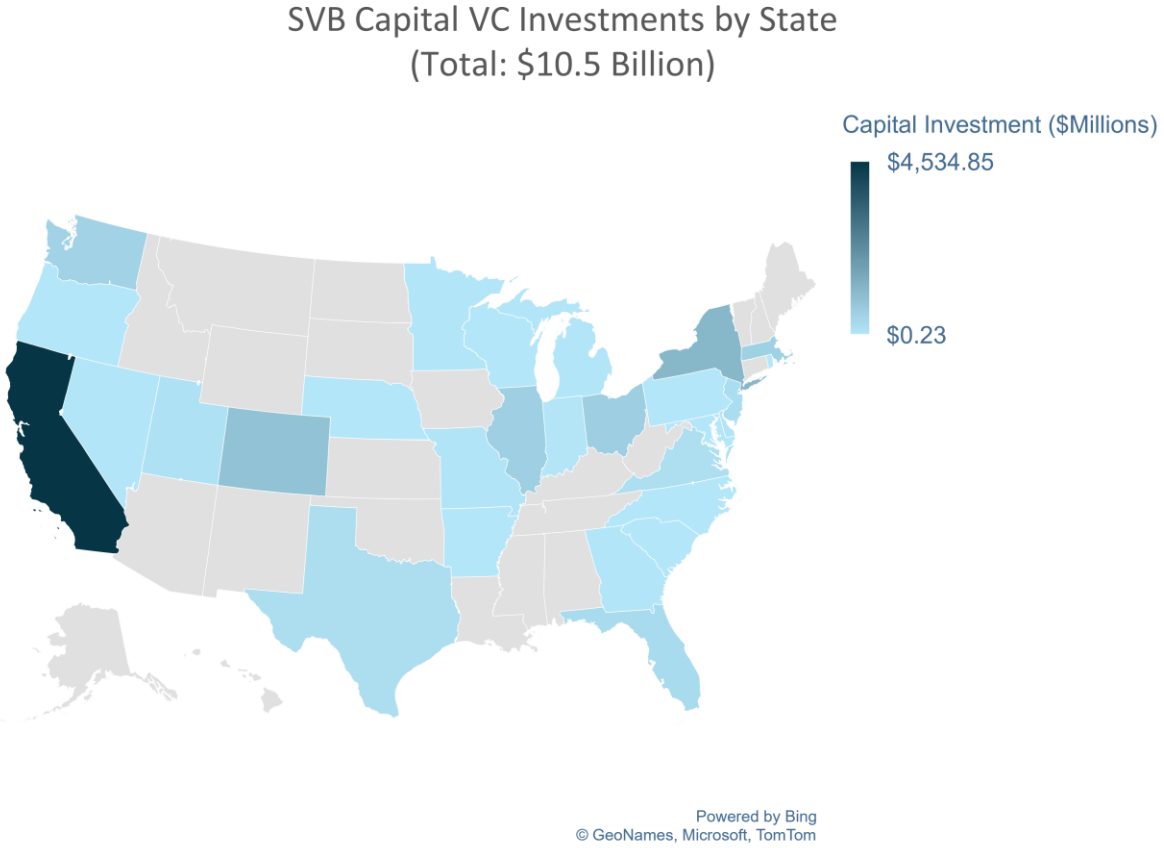
Source: Pitchbook, Deal Status: Completed; Announced/In Progress; Upcoming;

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SVB Capital has an estimated $10.5 billion active venture capital investments with a high concentration in California but also in New York and Colorado.

These companies will likely be revalued under any transition/buyout. Recent increases in discount rates as well as a less favorable IPO environment will likely result in a reduction in the associated companies' valuations. These investments are often commingled with other venture capital investments from other venture firms who would also see a correction in their portfolio value.





Source: Pitchbook, Active Venture Capital Investments, March 2023.

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Fallout from the banking crisis

- Bank stocks saw the third-largest weekly decline since the GFC (during the week of March 13th), following news of SVB's failure, before recovering some losses.
- Banks have $12bn in credit from the new Bank Term Funding Program (BTFP)
- The Fed extended $143bn to support the FDIC's guarantee of all depositors in SVB and Signature.
- Banks continue to hold significant unrealized losses in Treasury, MBS and CRE loan portfolios. Concerns also remain over mark-to-market values on CRE portfolios.
- Continued volatility and risk raises the possibility that additional federal backing may be necessary, in the form of additional support for banks and depositors.
- Stricter lending standards (fewer loans and wider spreads) could have implications for the monetary policy and economic cycle and potential recession in the back half of this year.
- Fed rate peak likely lower and shorter.

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Implications to CRE

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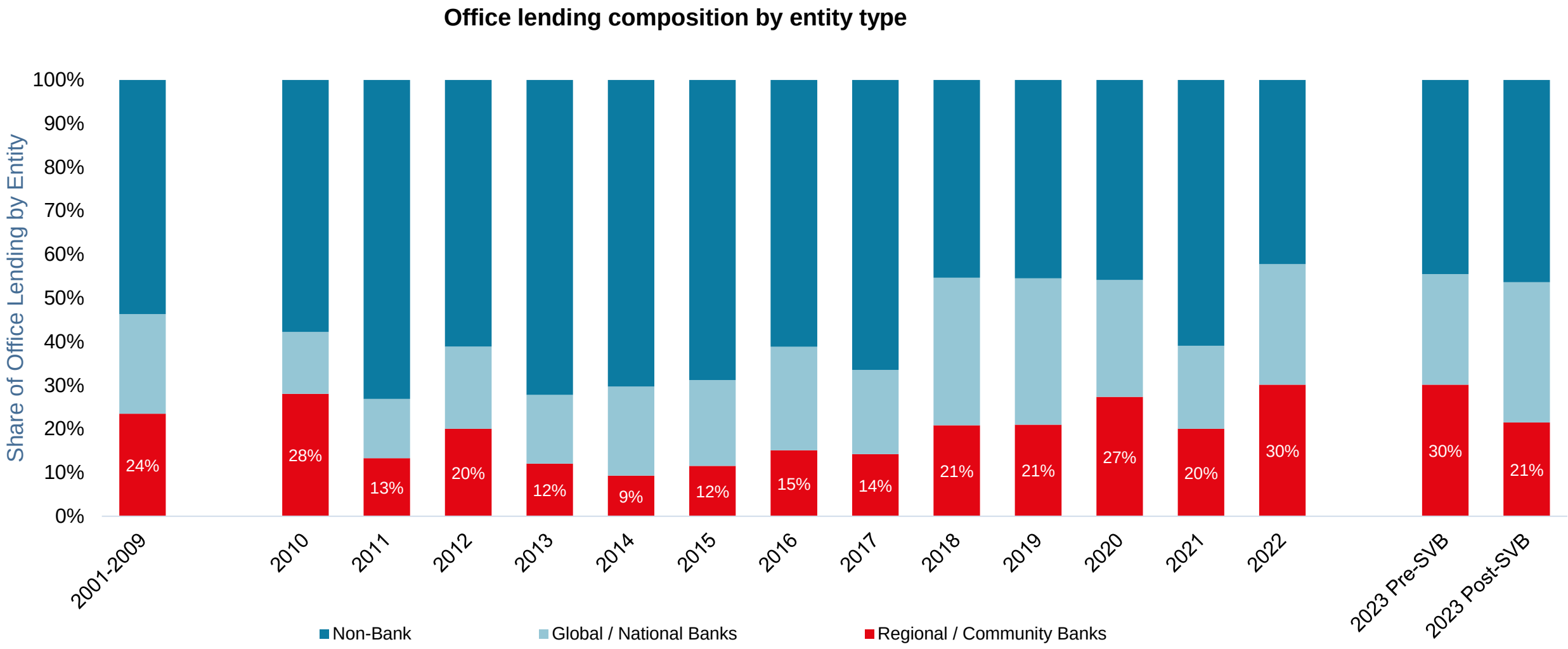
Small domestic banks commercial real estate loans share



Source: Federal Reserve Board, Haver Analytics, Apollo Chief Economist. Represents the views and opinions of Apollo's Chief Economist.

INST-20230315-2794774-8868576

Regional banks cut office lending after bank failures



Source: JLL Research, Real Capital Analytics
Note: Excludes data centers, life science and medical office.

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“Debt costs are up 40% to 50% for some owners whose loans are maturing, causing a seismic shift to underwriting and turning some buildings with a healthy cash flow into risks.”

Stephen Buschbom, Trepp

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Current state of the capital markets

01

Investor sentiment impacted by recent bank failures; CRE lending community working to assess broader impacts

02

Investors are shifting from underwriting **interest rate risk and inflation risk** to focusing more heavily on **recession risk**

03

More stability in rates/spreads is needed to establish pricing and catalyze transactions, but **trend of lower index rates should prove beneficial**

04

Investors anchoring to more realistic pricing benchmarks (2018/2019 – pre-pandemic and pre stimulus)

05

Bid-ask gap persists; core funds' quarterly appraisal methodology still lagging and does not yet reflect actual value resets

06

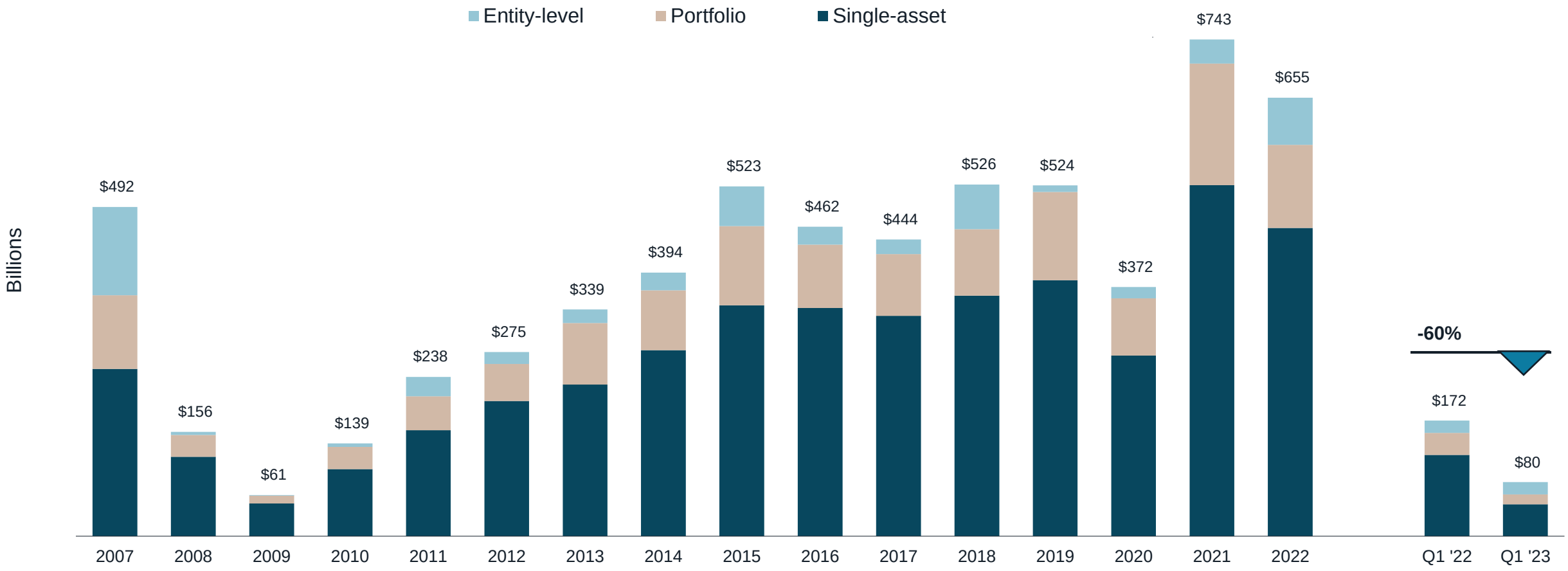
While lending has been more conservative this cycle, **various factors will lead to increased distress, particularly for commodity office**

07

Potential for strong H2: Some owners capitulating more quickly and selling assets/loans "at market" to avoid carrying through a potential recession

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Liquidity slowed precipitously in late 2022 and early 2023 as debt market volatility challenged dealmaking

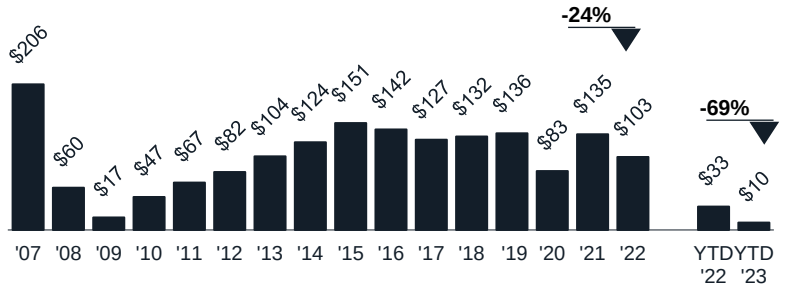


Source: JLL Research, Real Capital Analytics (transactions over $5 million, includes entity-level transactions), includes: office, industrial, multi-housing, retail, hotels and seniors housing. Includes recaps; excludes refinances

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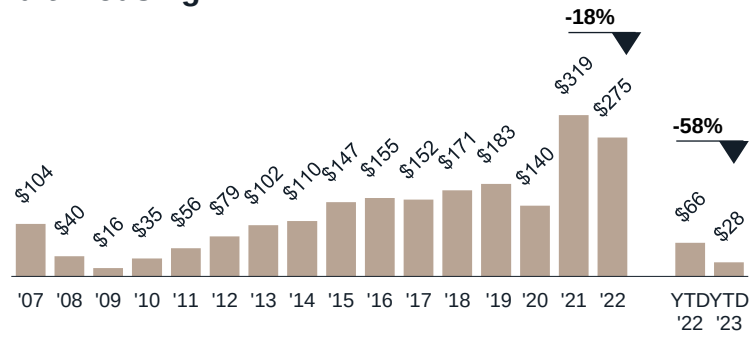
Transaction velocity by property type

Office



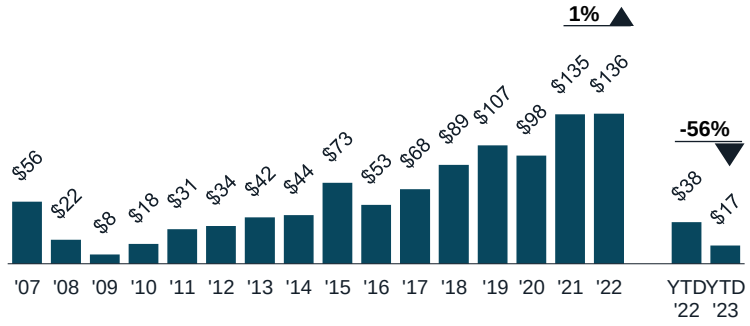
Blackstone | Q3 '22 | $7.6B

Multi-housing



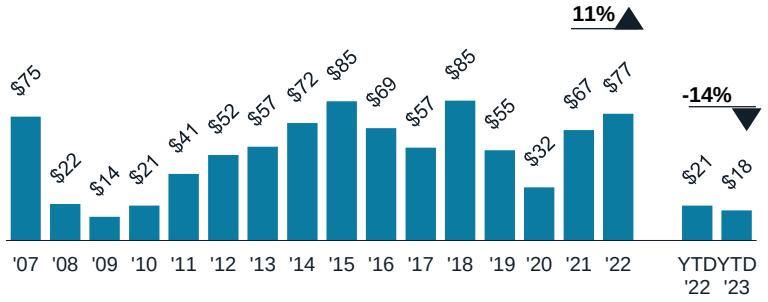
Blackstone | PAC Preferred Apartment Communities | Q1 '22 | $5.8B

Industrial



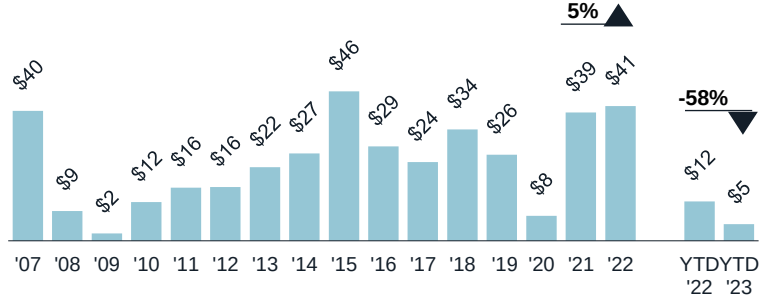
PROLOGIS | Duke Realty | Q4 '22 | $23.0B

Retail



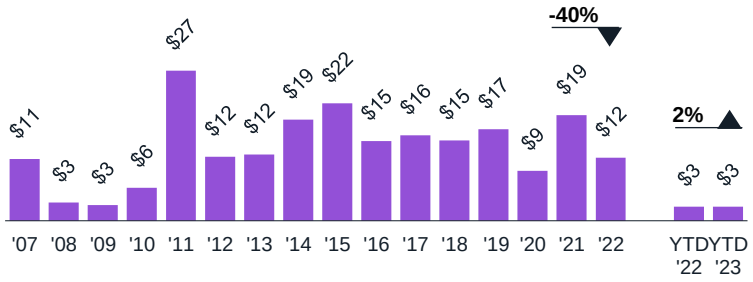
GIC | STORE capital | Q1 '23 | $15B

Hotels



Brookfield | WLT Watermark Lodging Trust | Q2 '22 | $3.8B

Seniors housing

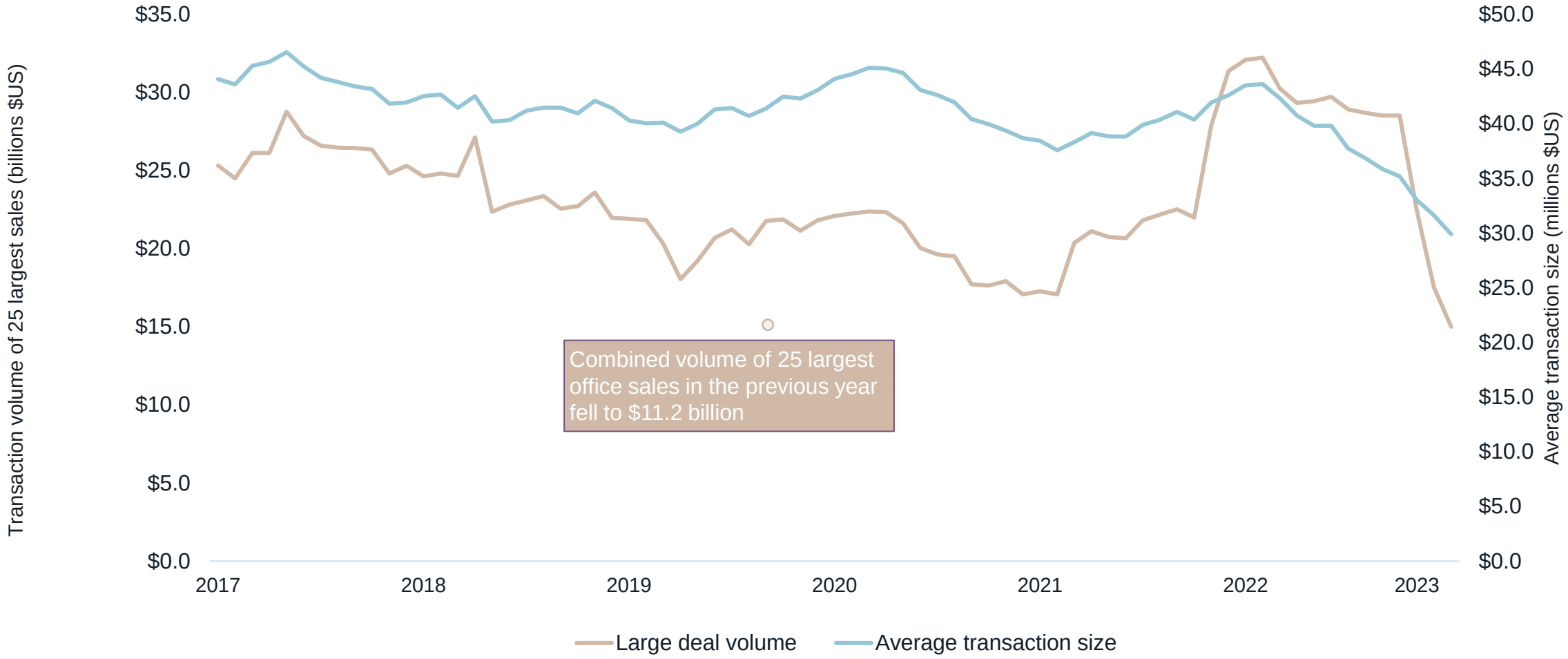


VENTAS | New Senior Investment Group | Q4 '21 | $2.3B

Note: Logos beneath each bar chart pertain to a recent notable transaction (buyer | seller | close date | transaction value)
Source: JLL Research, Real Capital Analytics (transactions over $5 million, includes entity-level transactions); industrial includes Flex-R&D; includes recaps, excludes refinances

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Large-scale transactions have declined sharply due to difficulty financing

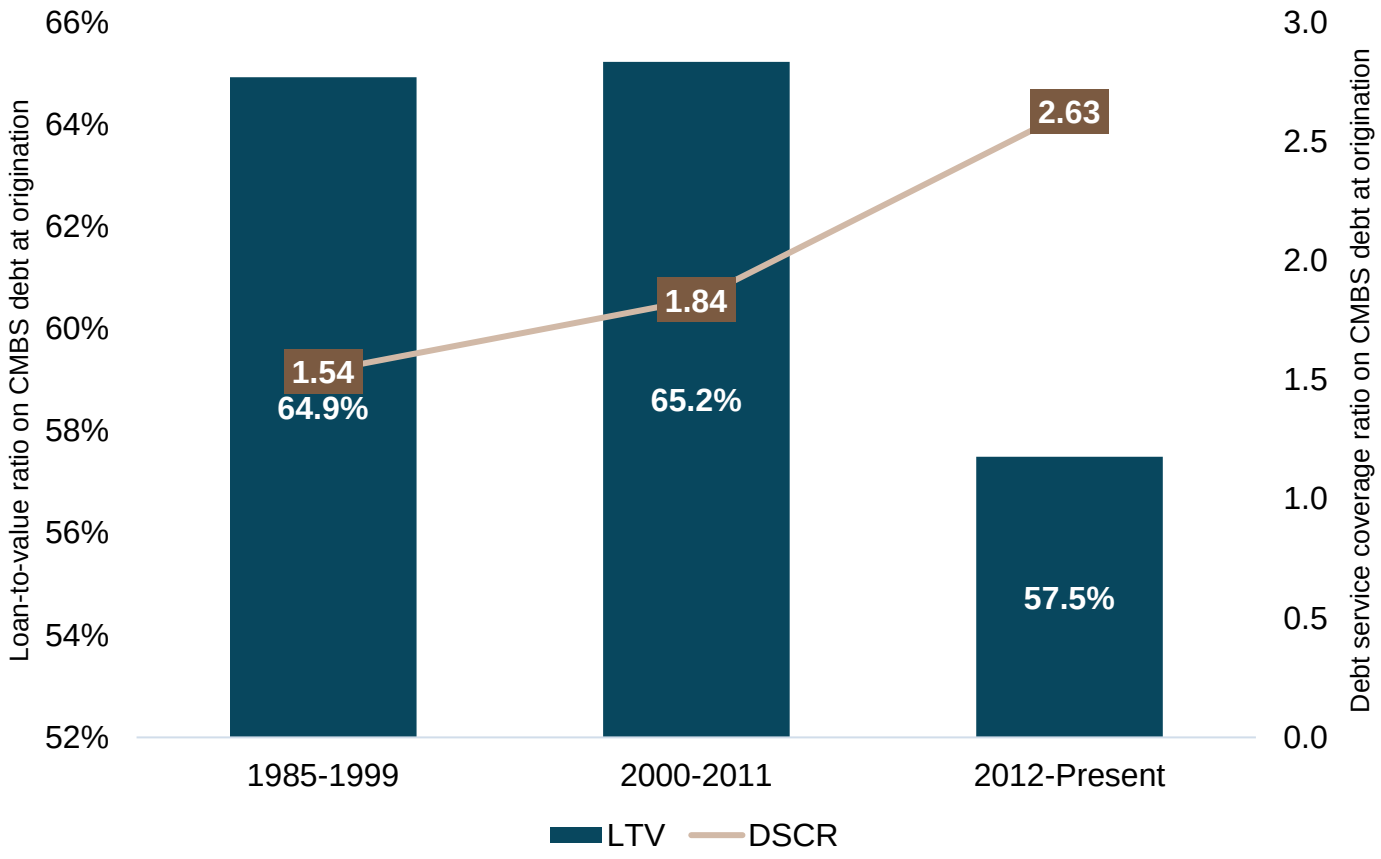


Source: JLL Research

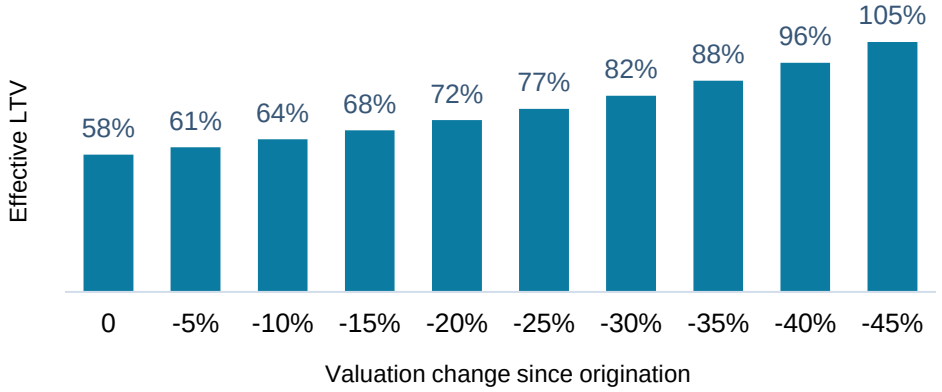
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Lending standards trended more conservatively in the current cycle, but sharp value declines may nullify risk mitigation

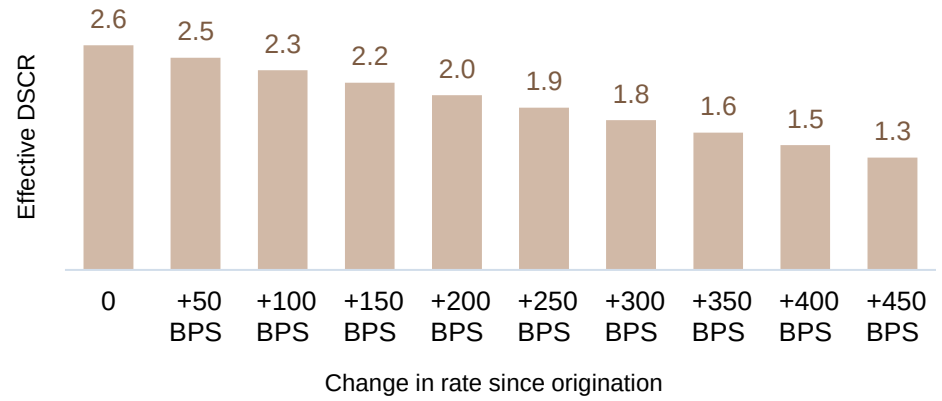
Weighted average leverage and debt coverage ratios



Value declines drive effective LTV higher



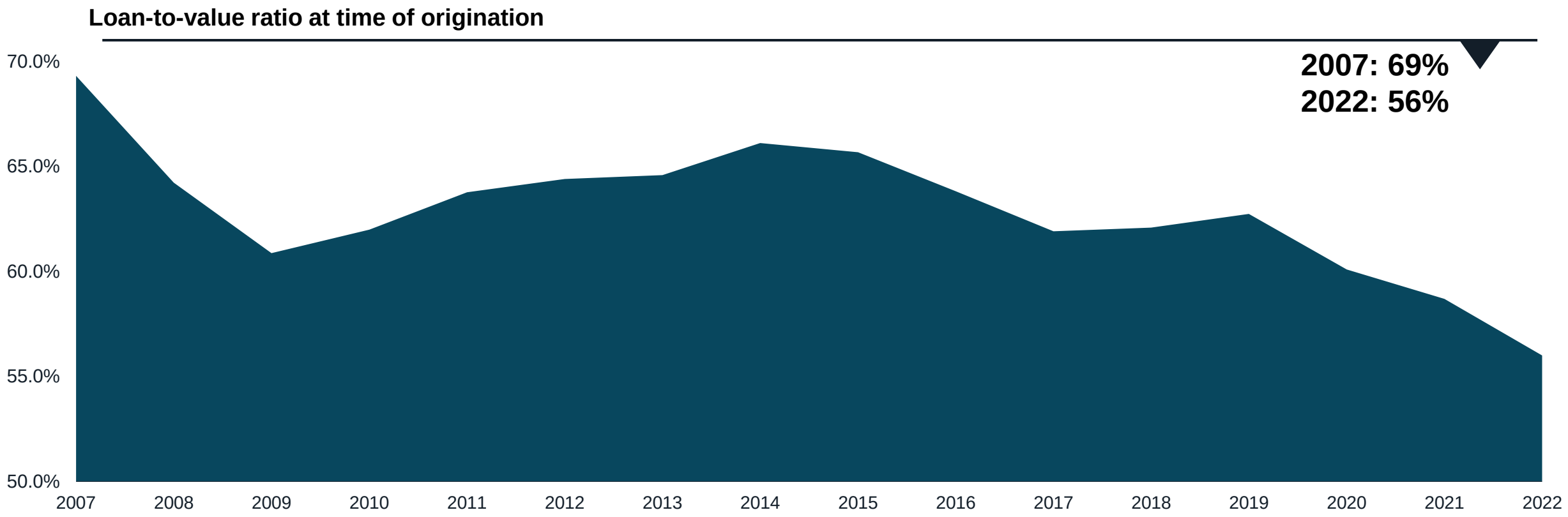
Floating-rate debt is vulnerable to rate increases



Source: JLL Research, Trepp

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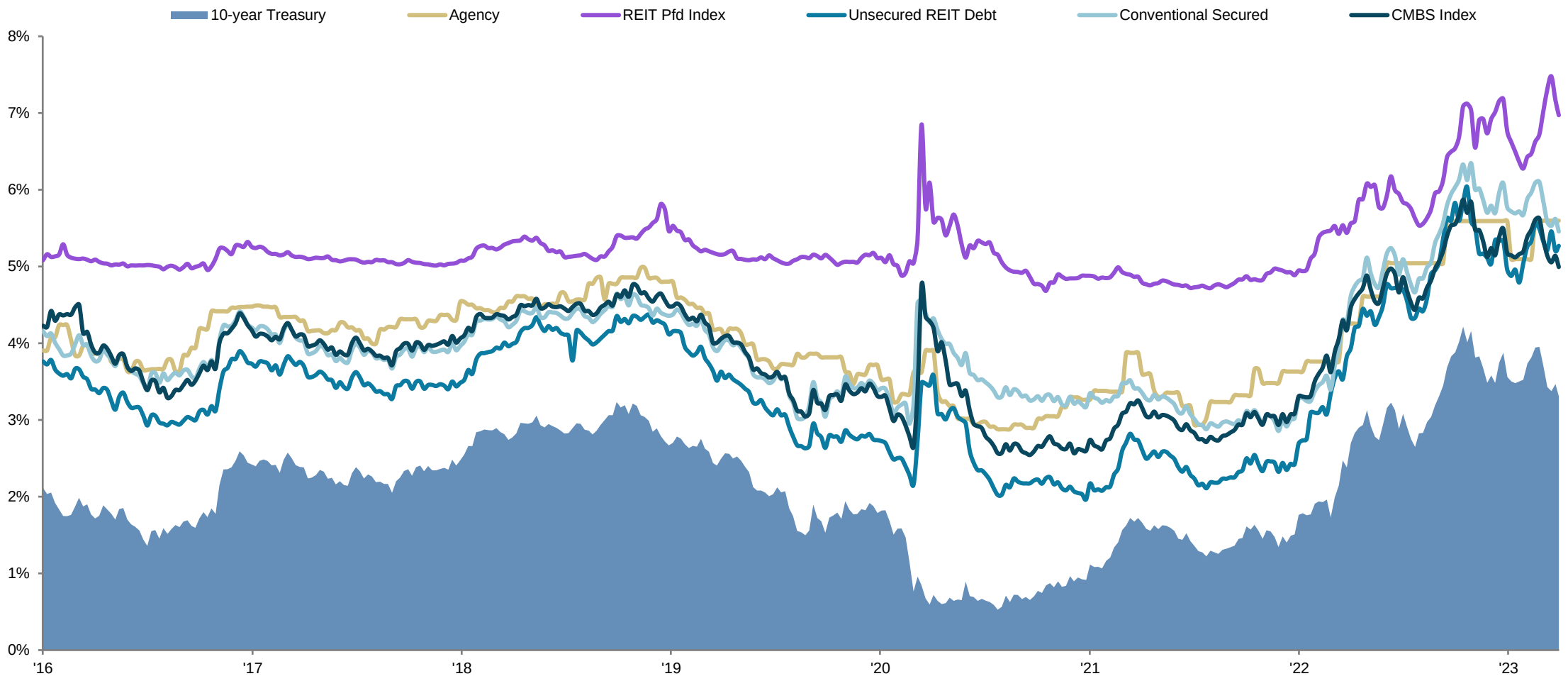
Lending standards notably more conservative than leading up to GFC; but asset value erosion will nonetheless drive distress in 2023+



Source: JLL Research, Real Capital Analytics. Pertains to Commercial LTV at time of origination (data plotted as annual average of dataset)

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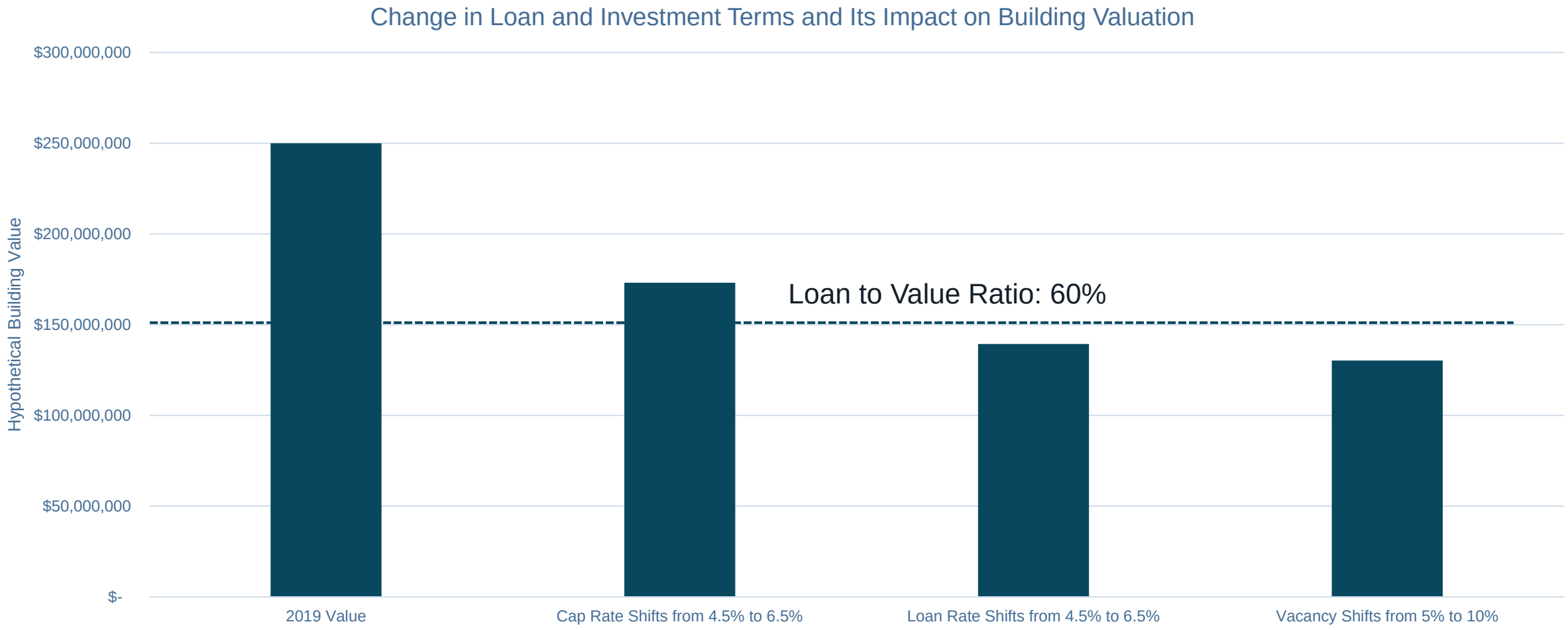
CRE debt costs have settled a bit during the past two weeks



Source: JLL Research, Green Street (as of 04.14.23) Representative of 10-year money

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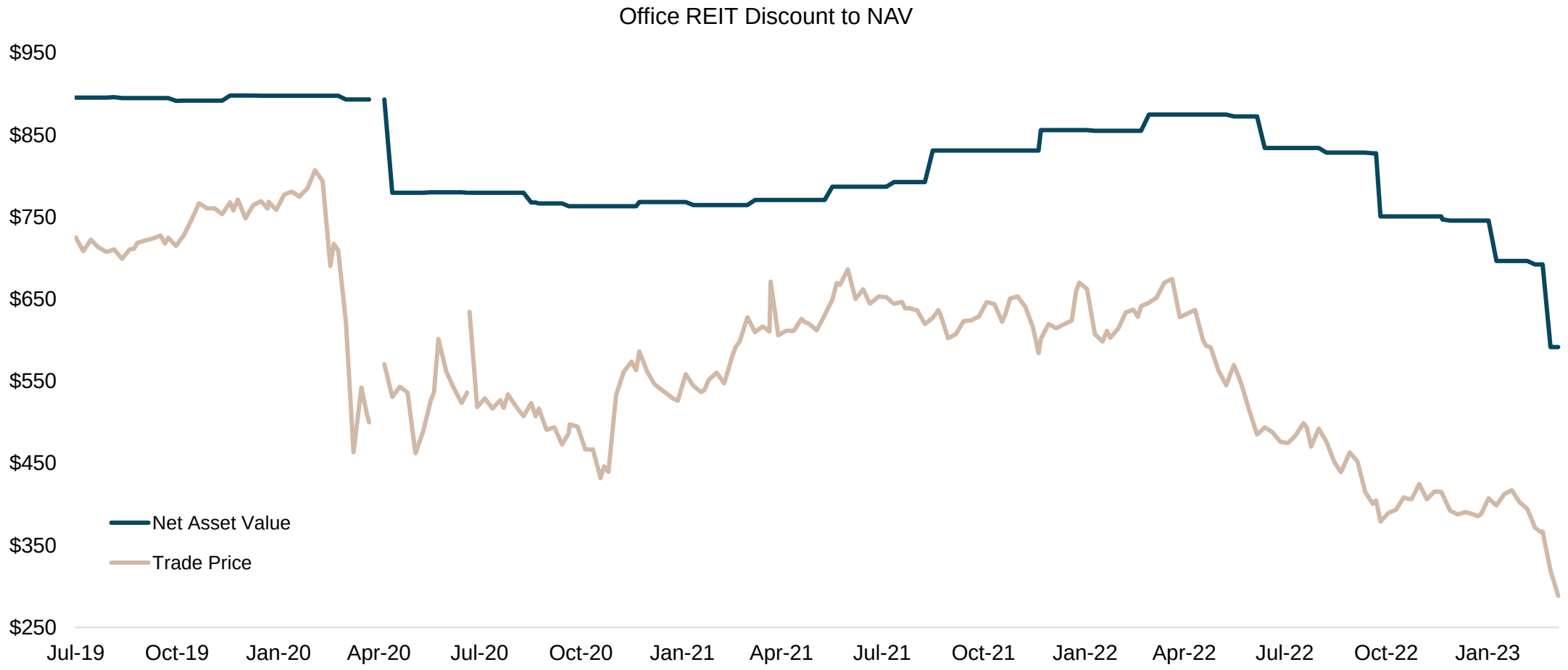
Shifting Financing and Investment Terms Deteriorating Building Values



Source: JLL Research, Hypothetical reassessment of a 250,000 square foot office building purchased in 2019.

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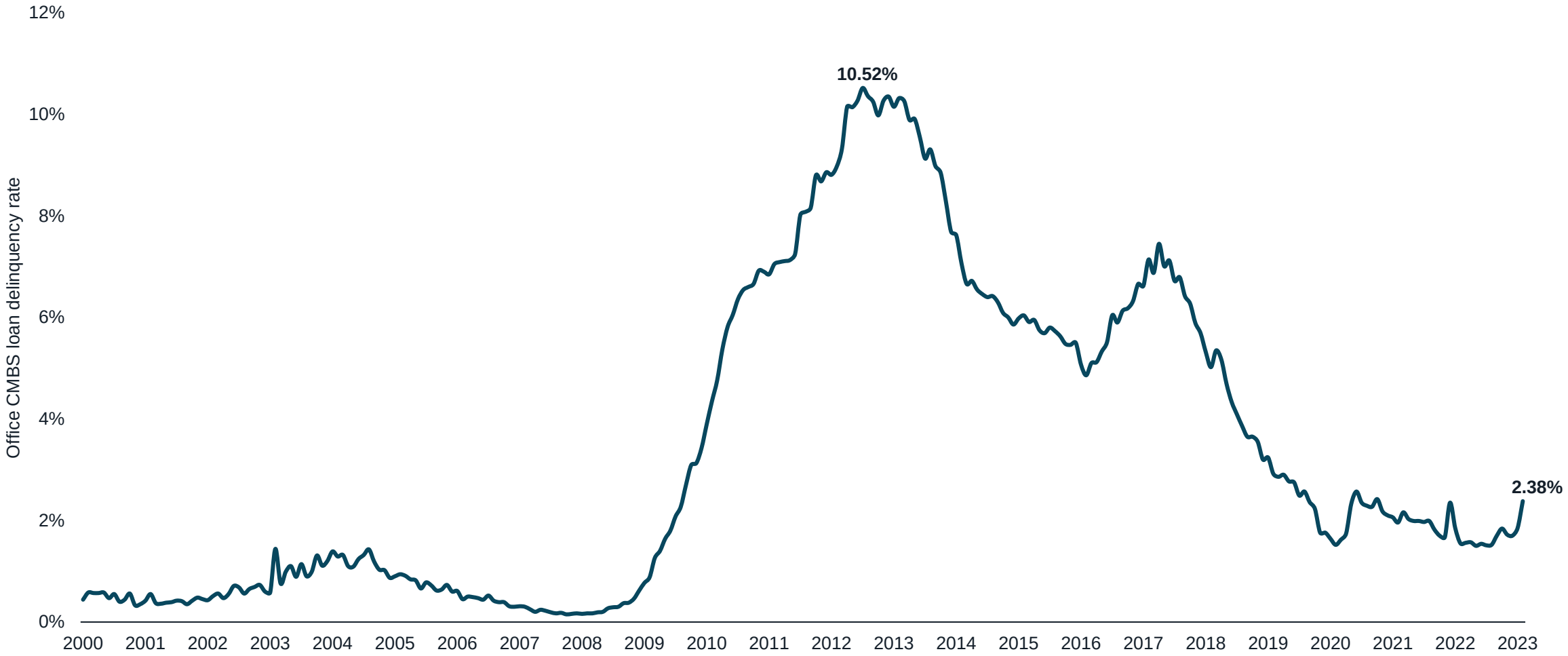
Public REITs trading near record discounts despite almost 35% markdown of NAVs from peak pre-pandemic levels



Source: JLL Research

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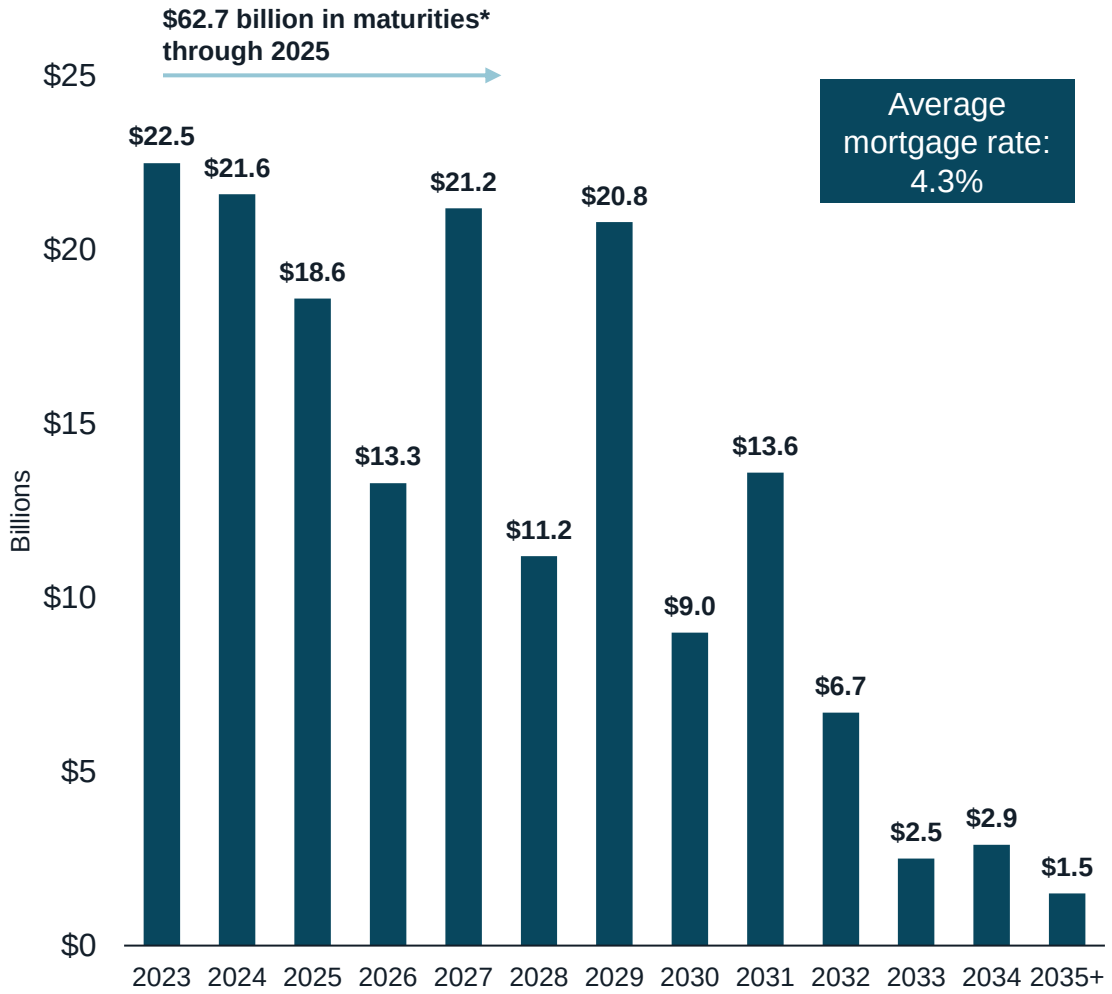
Office loan delinquency rates are still near 10-year lows but have started to move upward

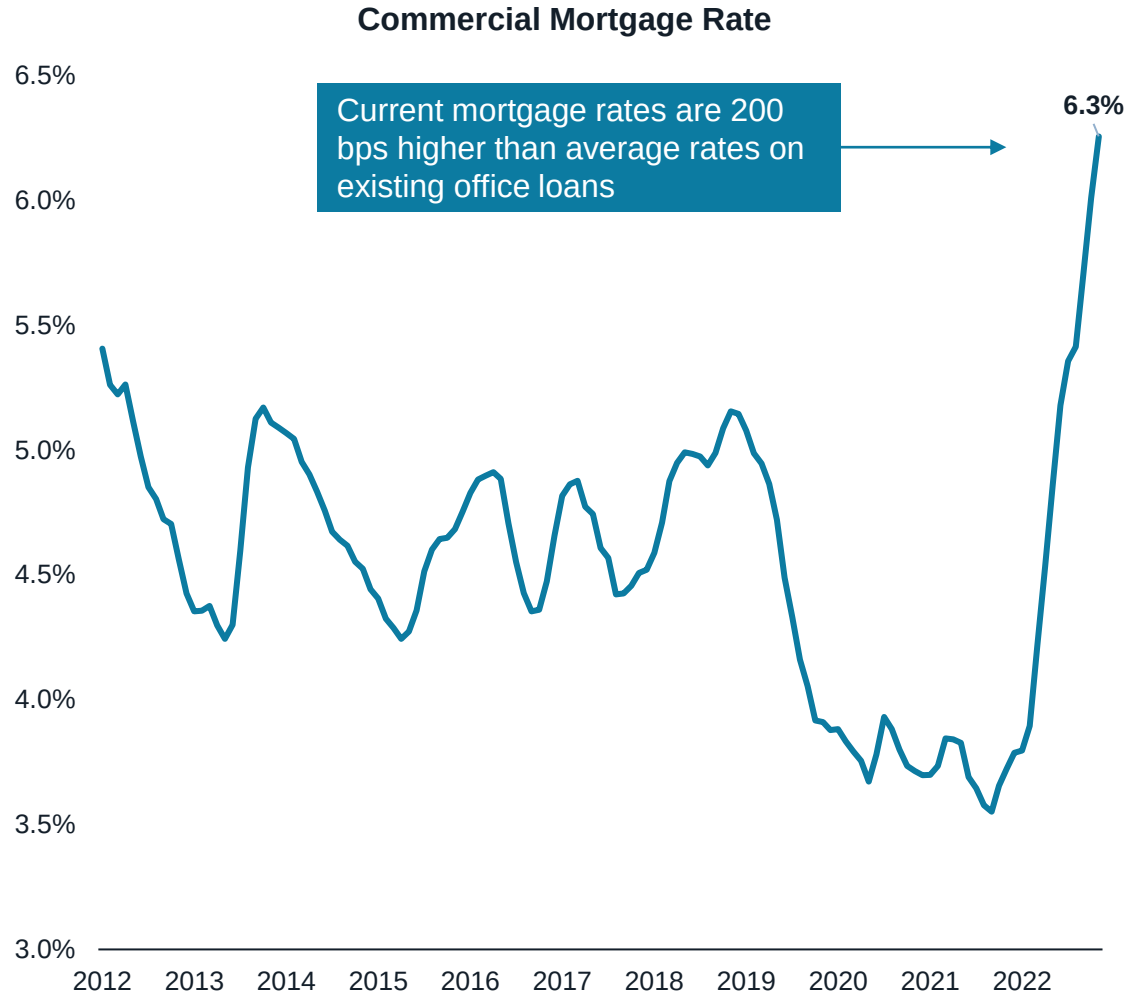


Source: JLL Research, Trepp

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Wave of looming office loan maturities with limited refinancing options will catalyze forced sales and distress





*CMBS Only

Source: JLL Research, Trepp, Real Capital Analytics

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10-year Treasury tends to start to decline slightly before or concurrently with the plateau in interest rates

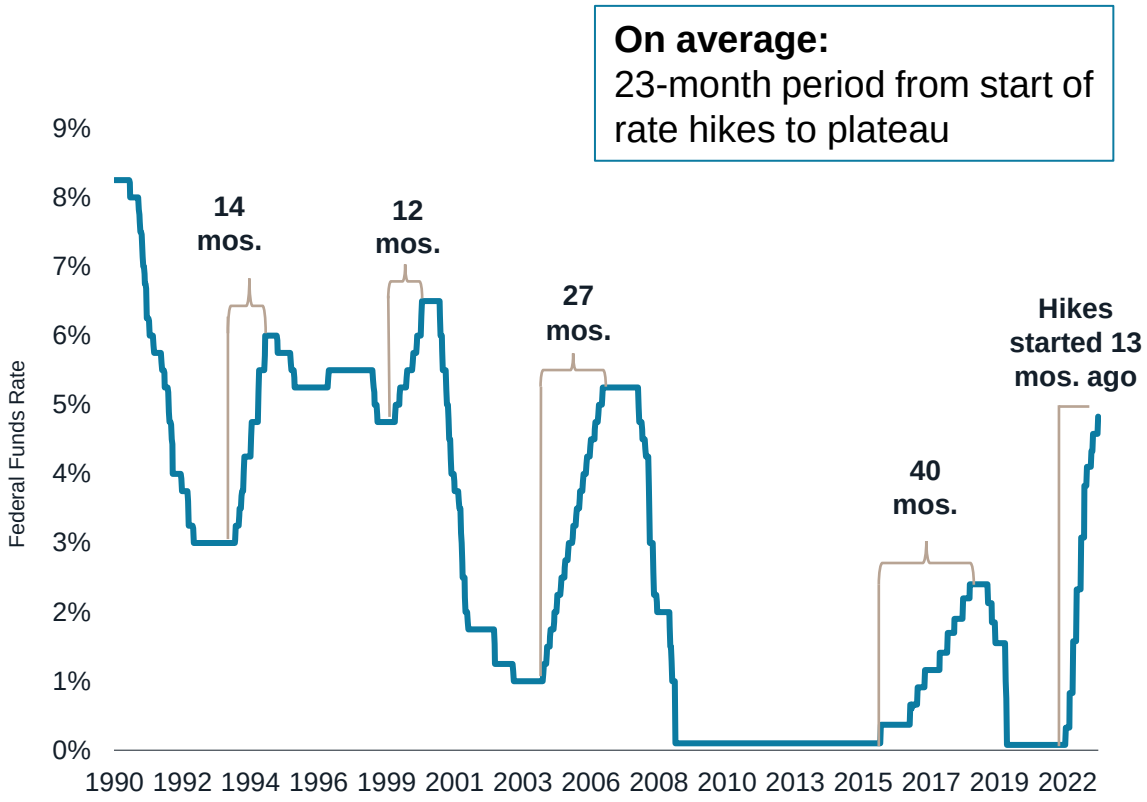


Source: JLL Research, Federal Reserve

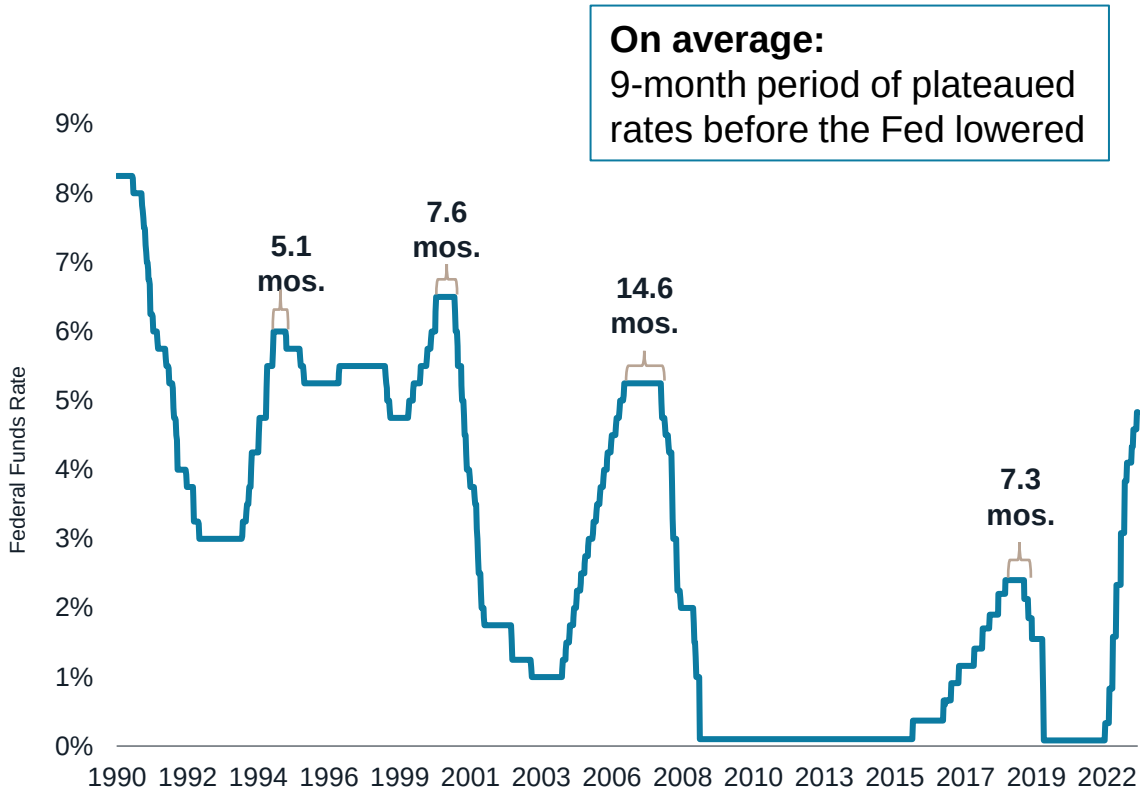
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Fed rate hike cycles are typically followed by brief plateau and relatively rapid subsequent easing of rates

Duration of rate hike cycles



Length of plateau in rates before subsequent easing



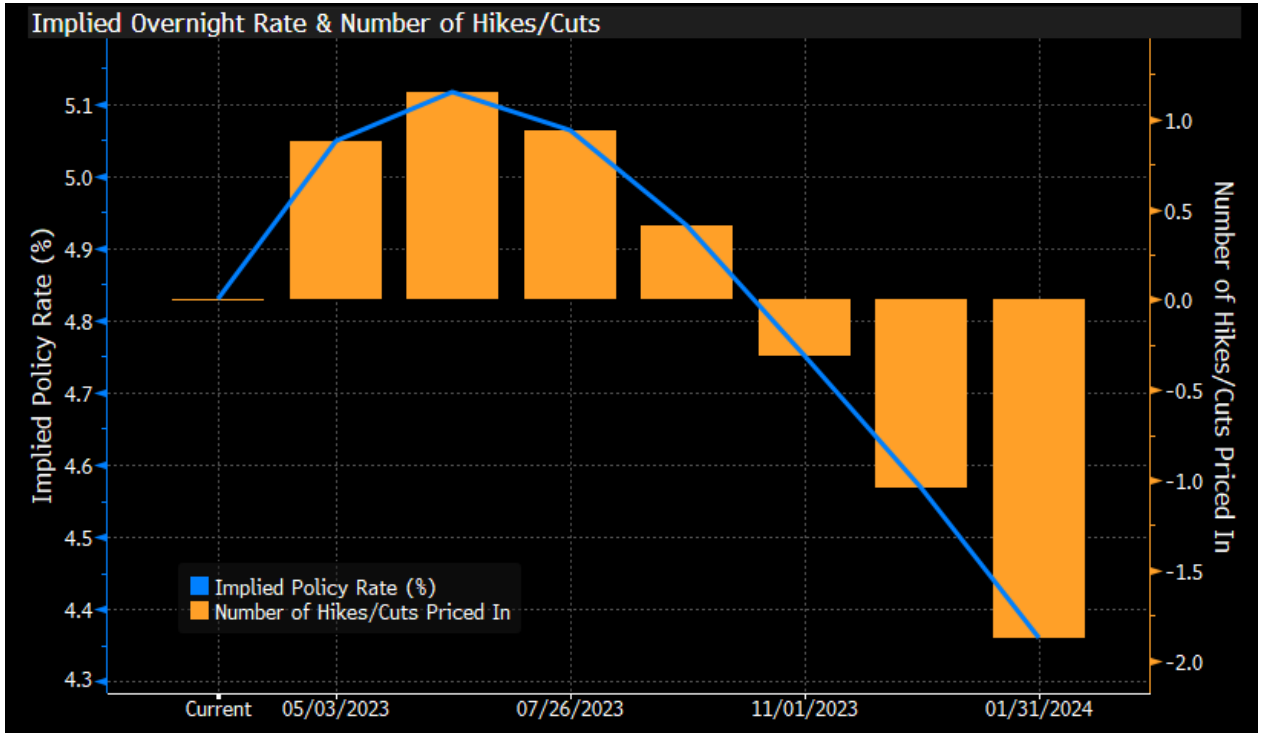
Source: JLL Research, Federal Reserve

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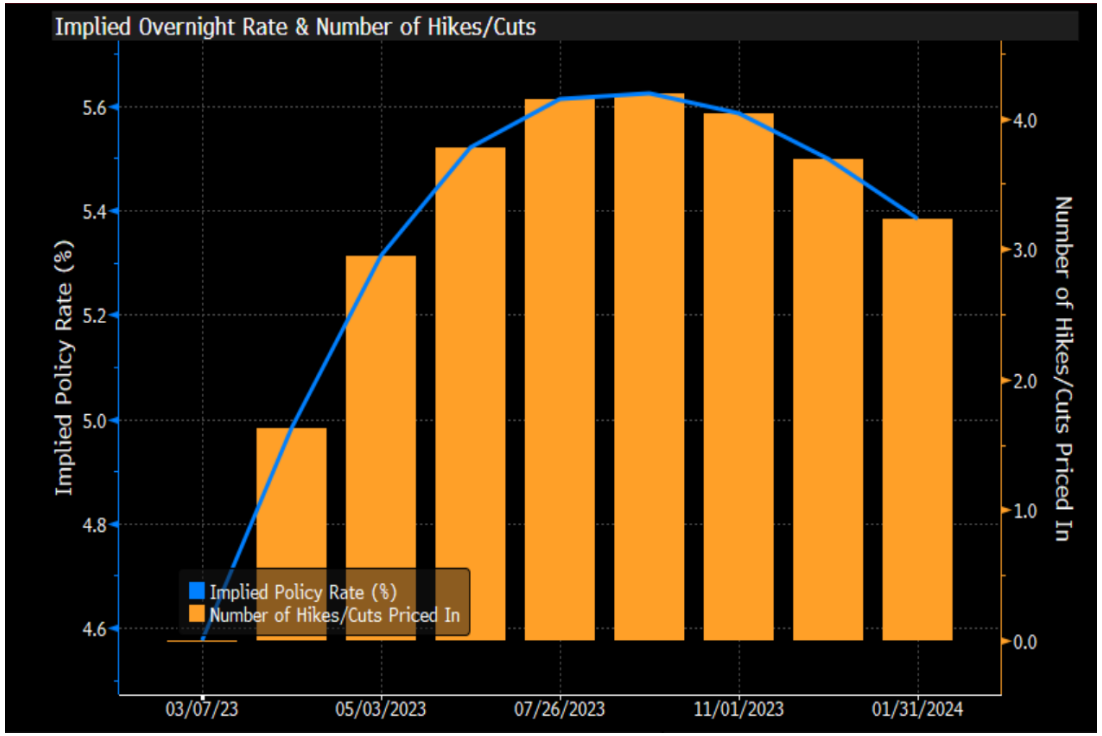
Expectations for Fed actions have shifted drastically

Market-implied Fed rate hikes/cuts

Today (late April)



Pre-SVB



Source: Bloomberg Finance L.P.

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What is needed for a meaningful CRE capital markets recovery to set in?



Fed has to signal that interest rate increases are stopping



Loan spreads have to stabilize



Investors' risk premium around inflation risk must not worsen



Large money center banks have to return to the market

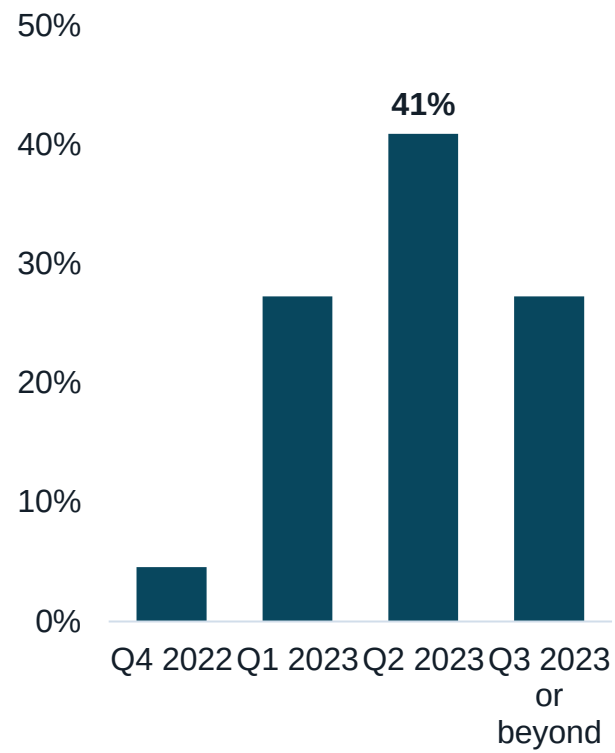


More clarity has to emerge around hybrid work's impact on office demand



Core funds' valuation marks need to reflect reality

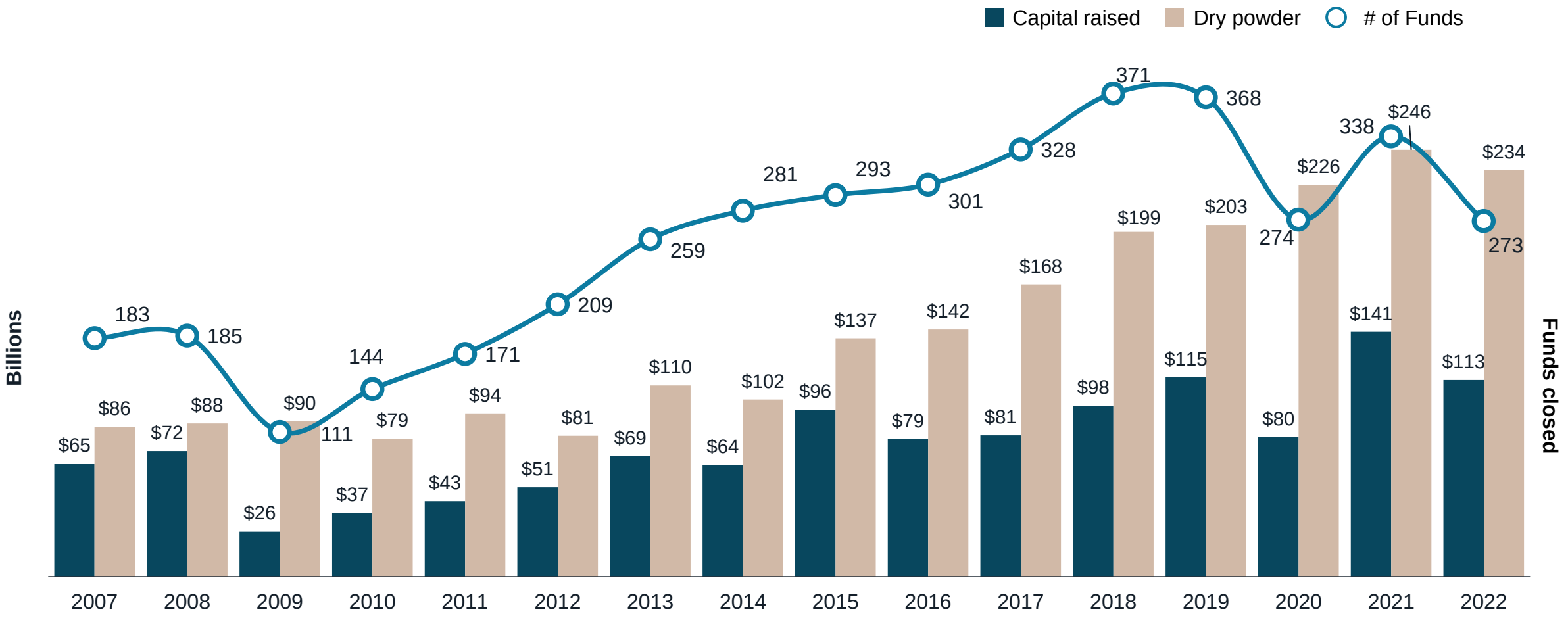
Which quarter will represent the market bottom in terms of closed transaction volumes / investor sentiment?



Source: JLL survey of 25 top LPs and institutional investors – February 2023

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Dry powder near record levels but fundraising facing increased headwinds

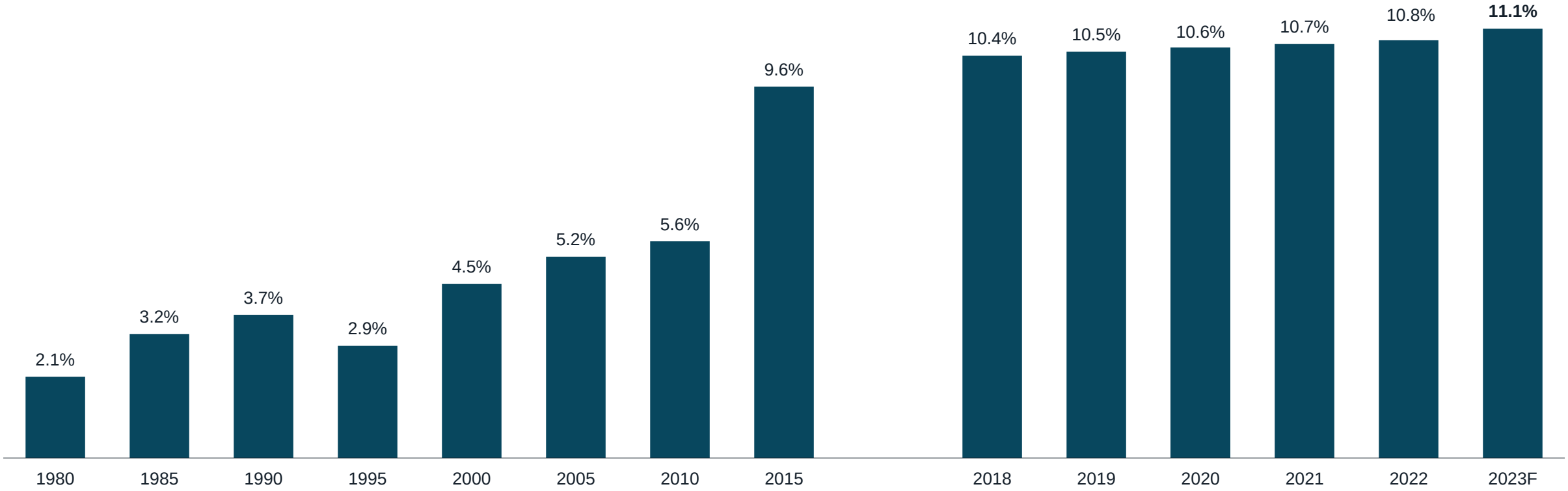


Note: Pertains to closed-end funds
Source: JLL Research, Preqin

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Institutional investors' target allocations to CRE continue to increase

Institutional target allocations to commercial real estate as % of total asset portfolio



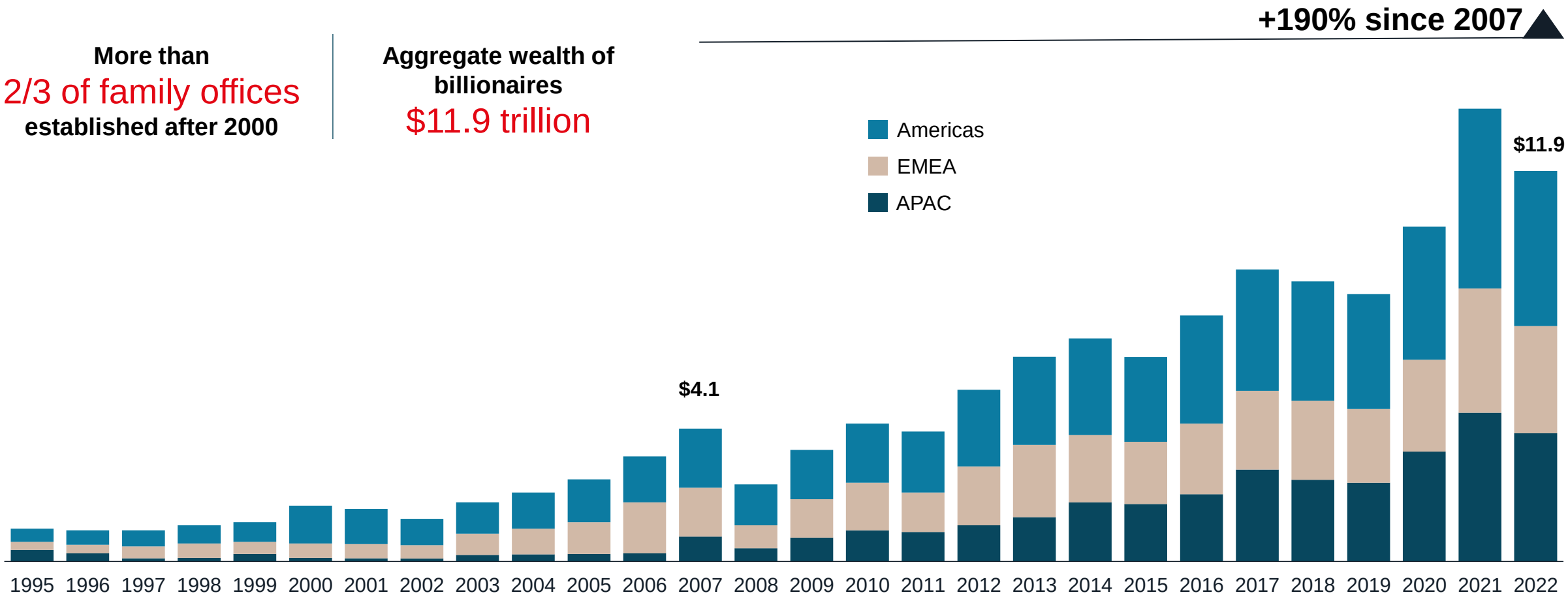
Source: JLL Research, Hodes Weill, Cornell University

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Surge in private wealth globally provides untapped capital for future investment

More than
2/3 of family offices
established after 2000

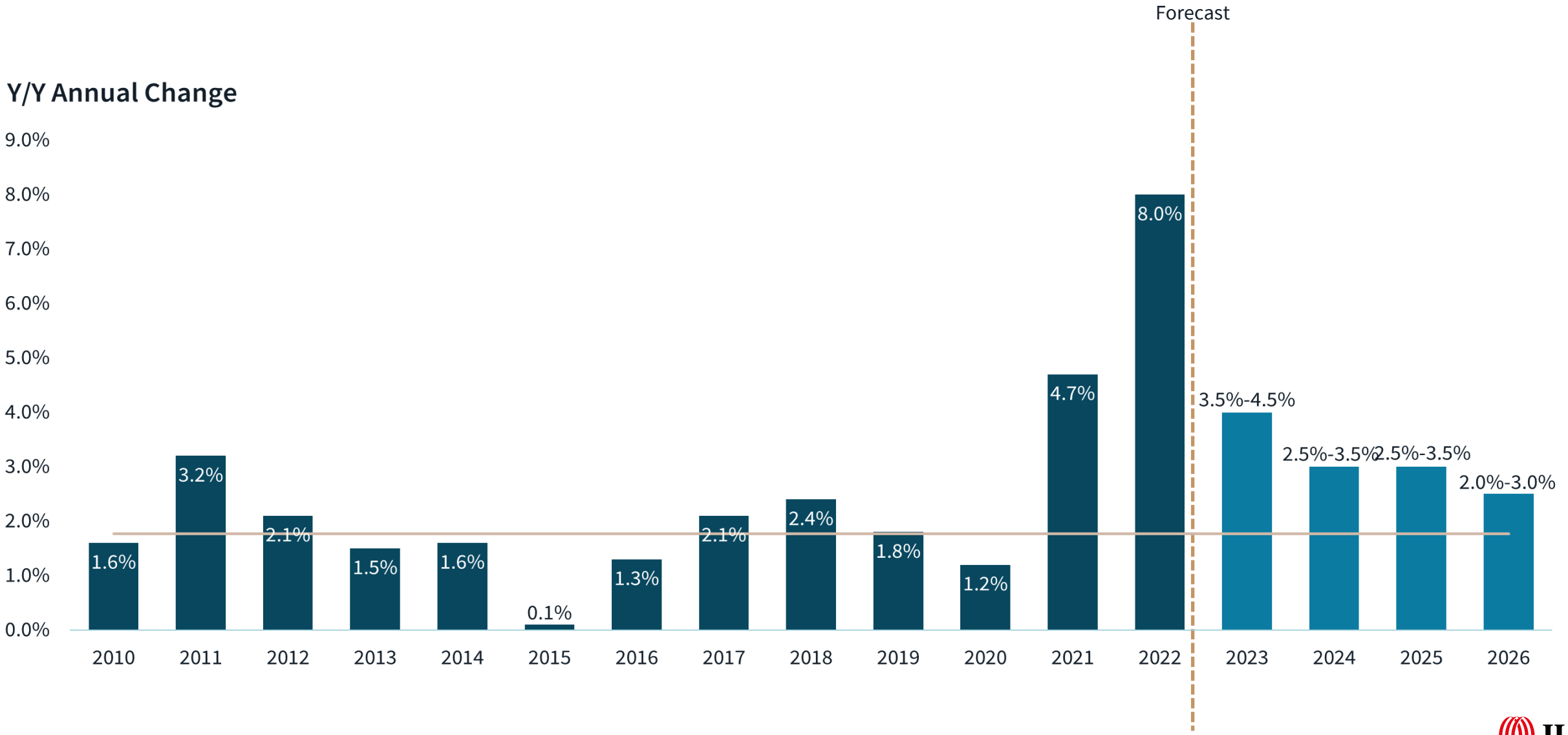
Aggregate wealth of billionaires
$11.9 trillion



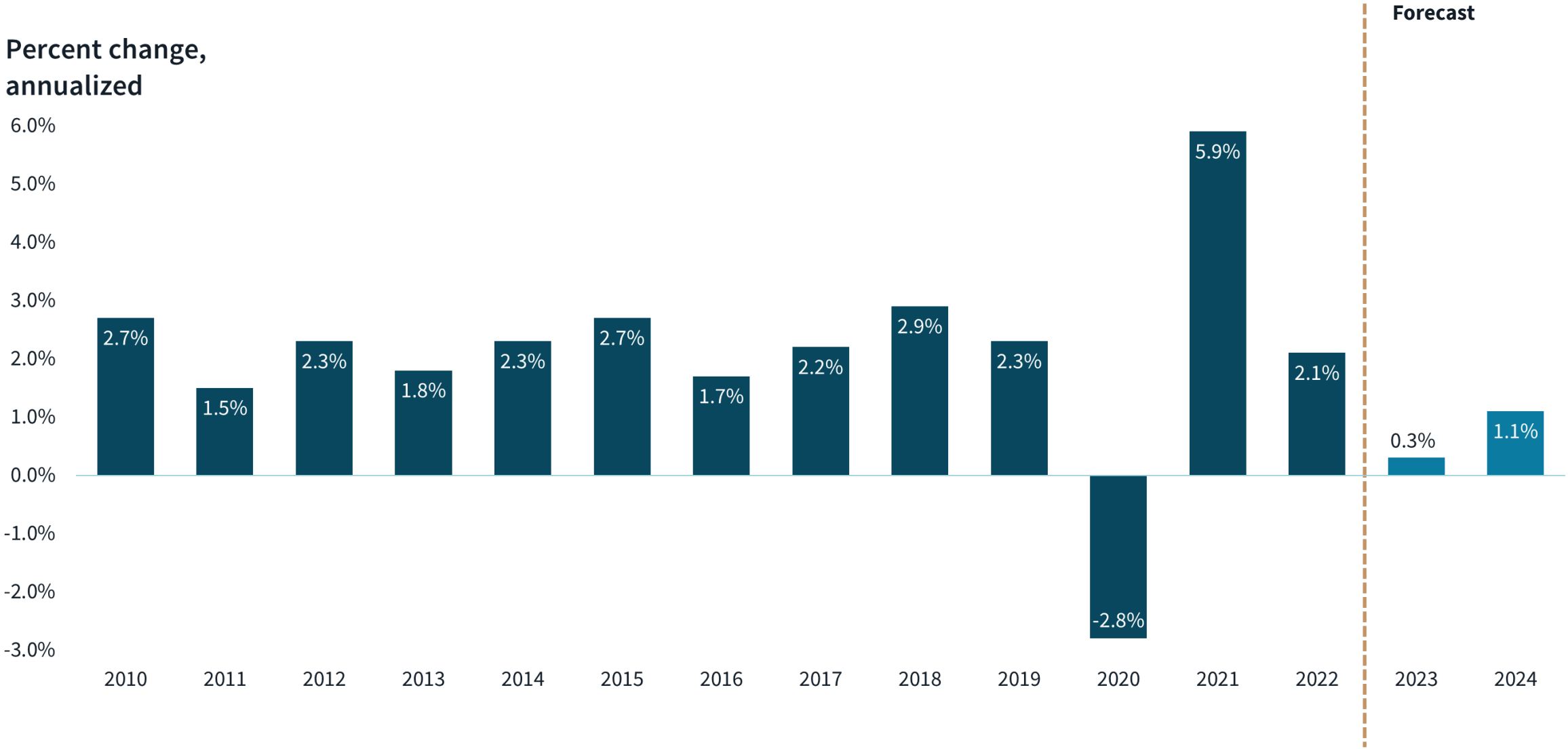
Source: JLL Research, UBS, PwC, Forbes

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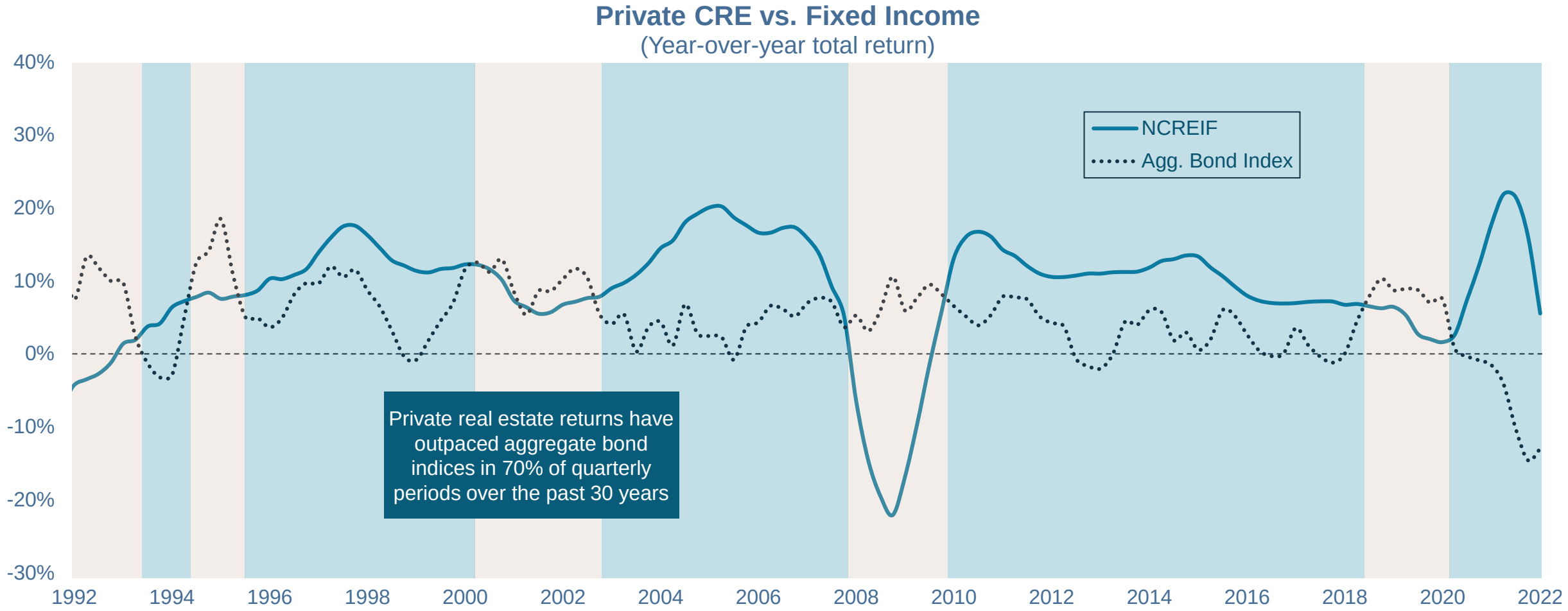
We’ve likely passed peak inflation



Economic growth—slowing, not collapsing



Private real estate returns have consistently outpaced fixed income assets



Source: JLL Research, Hodes Weill, Cornell University

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Thank You

JLL SEE A BRIGHTER WAY

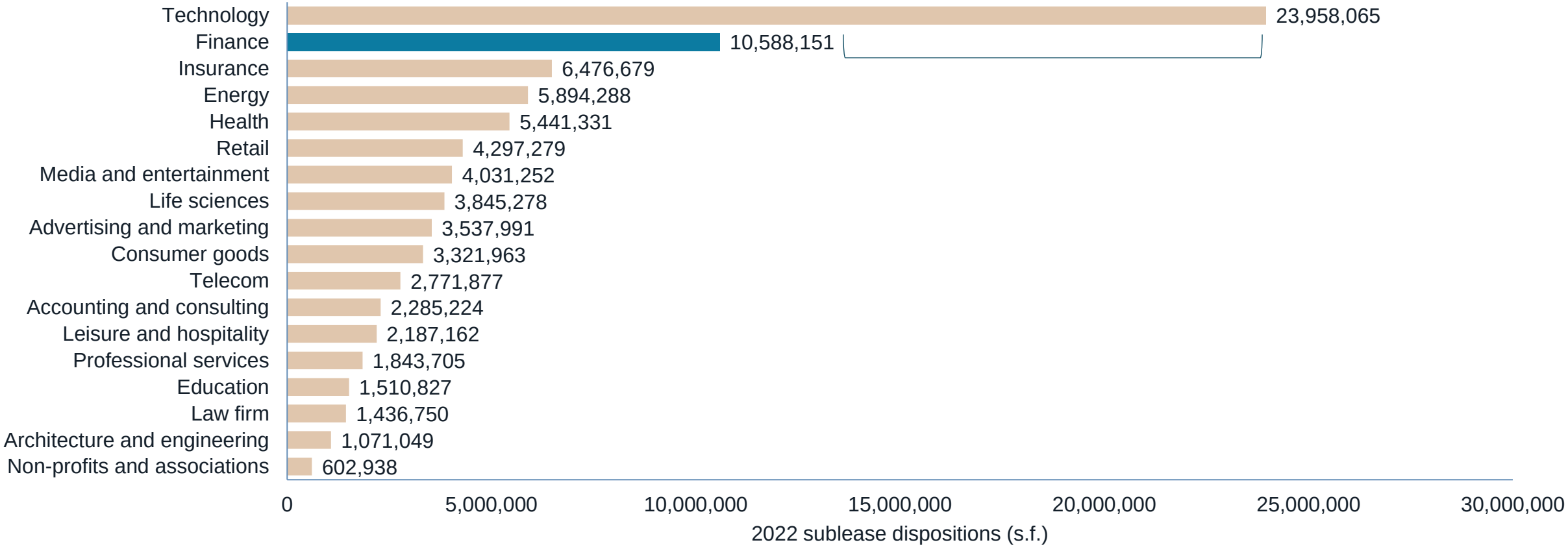
Banking & finance leasing surpasses tech in 2022 amidst widespread correction across the tech sector

2019 Rank	2022 Rank	Industry	2022 leasing activity (m.s.f.)	2022 vs. 2019 change (%)
2	1	Banking and finance	22.5	-16.2%
1	2	Technology	21.9	-47.8%
6	3	Life science	13.4	9.7%
7	4	Government	10.5	-11.5%
4	5	Health	9.7	-34.7%
5	6	Legal services	9.6	-28.6%
11	7	Retail	6.8	-26.9%
9	8	Accounting and consulting	5.6	-43.0%
3	9	Real estate / Coworking	5.0	-74.9%
8	10	Media and entertainment	4.8	-55.3%
11	11	Energy and utilities	4.2	-42.1%
12	12	Architecture and engineering	4.2	-32.2%
15	13	Construction and materials	3.2	-30.9%
13	14	Education	2.4	-54.2%
16	15	Aerospace and defense	2.4	-43.5%
18	16	Nonprofit and associations	2.3	-28.8%
14	17	Advertising and marketing	2.2	-54.3%
22	18	Logistics and distribution	1.6	33.7%
17	19	Leisure and hospitality	1.4	-64.8%

Source: JLL Research
Note: Includes leases over 20,000 s.f.

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Tech remains the largest sublessor industry after a period of sharp expansion, and the gap with other industries is widening

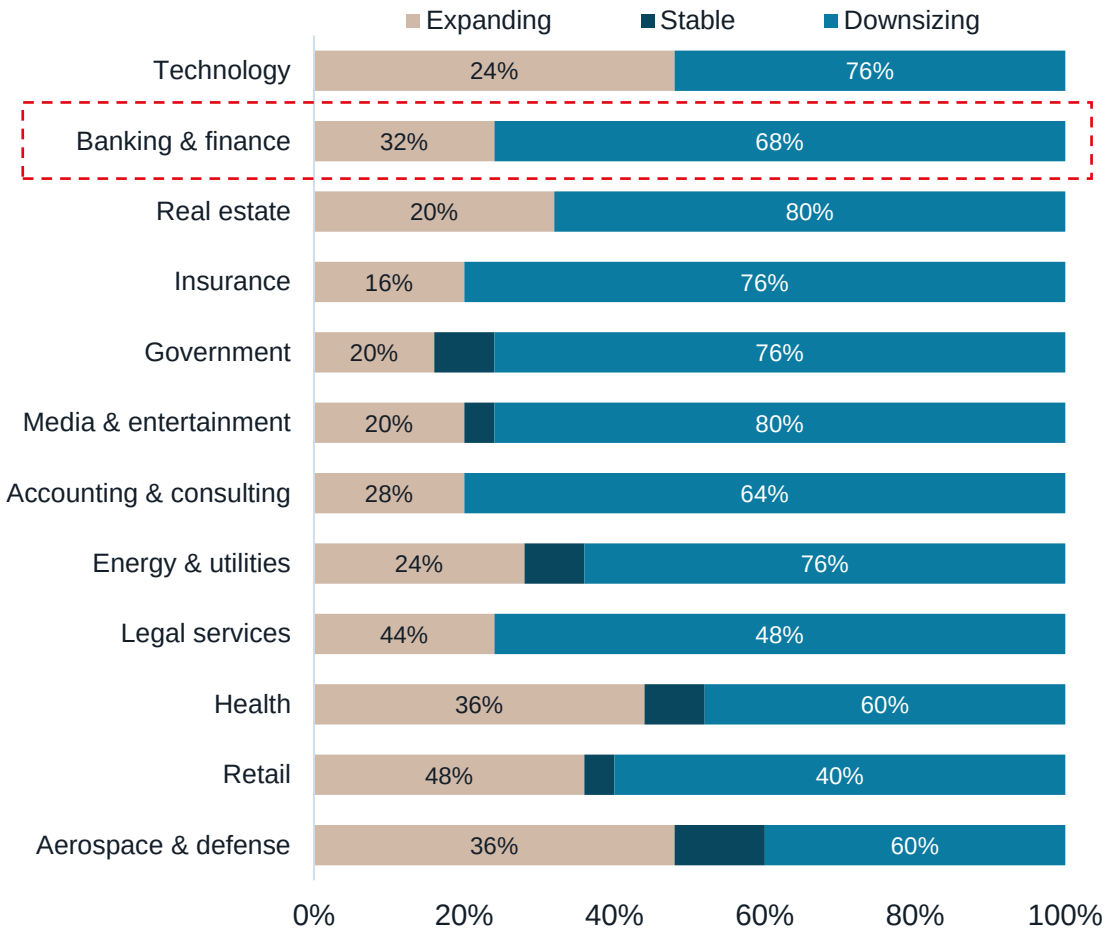


Source: JLL Research – *subleases > 20,000 s.f. only*

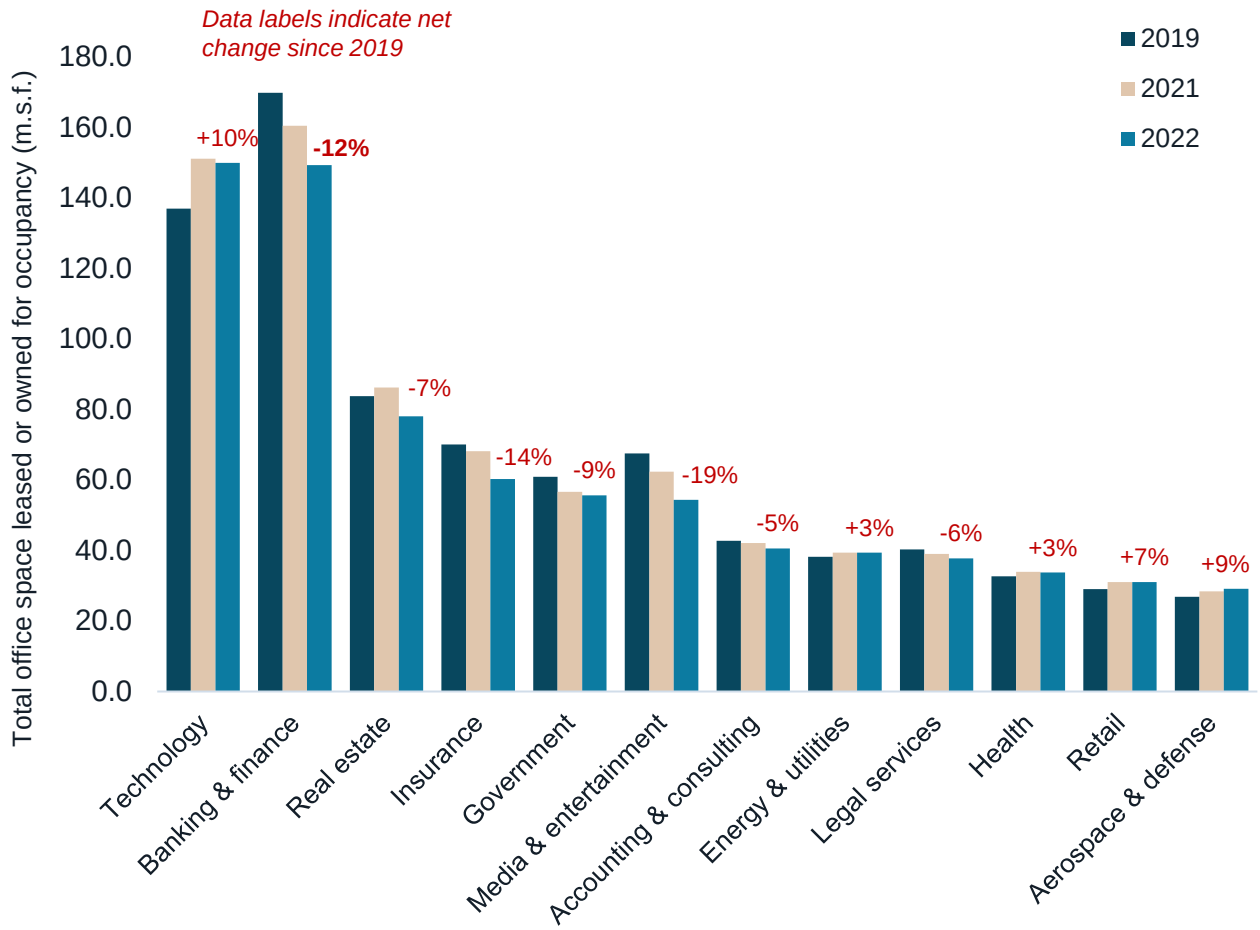
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Most of the largest office tenants in major industries have contracted office footprints since the pandemic

Office footprint changes among 25 largest occupiers



Net change in footprint by industry, top 25 occupiers



Source: JLL Research
Note: Footprint changes are inclusive of owner-occupied office assets.

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