

Real Estate Investor Insights

Lead Story: Observations in Uncertain Markets

While most economists anticipated a market correction, clearly no one could have predicted it would come in the form of a global pandemic. Recognizing that every individual and business is affected and the long-term economic effects are unknown, the following are some general observations of trends and strategies for these fluid market conditions.



Equity for Real Estate Investments:

Many that have had liquidity events over the past few years have continued to maintain that liquidity in the form of cash reserves. Going forward those investors may now elect to allocate even more of that capital into real estate in lieu of the financial markets, and we may actually see the average equity investment increase on a deal by deal basis. While we anticipate that investors will continue to invest in CRE, in the near term they may shift their focus to core *existing cash flowing* real estate with a tenant base deemed more stable in lieu of new, speculative ground-up development.

While many market fundamentals remain unchanged, today's extreme conditions will force investors to change their thinking and strategies to find sustainable opportunities.

Debt:

We continue to see interest rates at historic lows including fixed rate in the upper 2%'s for senior debt, and anticipate a low interest rate environment continuing for some time to come. However we do expect lenders being more conservative overall and in the near term and hesitant to finance assets in certain sectors like retail, land and ground-up speculative development. We also anticipate that lenders will be more restrictive with their loan covenants including requiring more equity (for example – 60% loan to value vs. 70-80%), personal guarantees and increased cash reserves.

Investment Sectors:

A few sectors of investment real estate may emerge stronger including *most multi-family products, industrial, life-science, healthcare and medical manufacturing* while retail and multi-tenant office properties may take much longer to recover. Multi-tenant buildings with companies that are most susceptible to large market swings or who are dependent upon short term cash flow may be most vulnerable. For example, prior to this event, most CRE experts were carefully watching WeWork and other office incubators anticipating that should they financially falter it would have a dramatic downward effect on the Boston office market given they occupy so much space. While WeWork was already experiencing financial and operational challenges, this situation may be the catalyst that causes them and their competitors to close or consolidate leaving many real estate owners financially exposed.

Rental Rates and Real Estate Expenses. Again, depending upon how long and how adversely affected a company's production and income will be, we expect rental rates in most sectors to recede. Even when companies are back to work and fully operational, there will be a need for them to reduce expenses including real estate/rent, employee benefits, and labor going forward in order to regain and maintain profitability.

Ways to Capitalize....

Companies needing liquidity. For businesses that own their real estate, a great way to raise capital going forward will be through a **Sale/Leaseback**. This is a financial engineering exercise whereby a company structures a long-term lease with an investor who will pay a premium for long-term stable cash flow. Also, financing or re-financing owned real estate may be viable options. There are many factors to be considered with each, not the least of which is how either can affect the sale or transfer of a business, but both are worth considering.

Tenants seeking to reduce rent: If a company anticipates cash flow issues over a sustained period, but has a fundamentally sound business there may be an opportunity to restructure the lease and actually reduce the rent. Each situation is different, and is usually dependent on how the debt and equity for that building is structured, but when structured properly can be highly effective.

Investment Opportunities: Real estate, in particular multi-tenant commercial and retail properties, that experience decreased cash can present upside for buyers to acquire at lower prices. While we do not anticipate a substantial increase in foreclosure sales, much investment real estate is owned through closed end funds which have specific dates by which they have to sell regardless of market conditions. Also companies (including CRE investment companies) needing liquidity may present opportunities, and families/trusts that own real estate which also may experience reduced cash flow or require new debt or capital may entertain selling.

Seller-financing: Though we anticipate a sustained and even increased interest to invest in real estate, more conservative lending practices and uncertain market conditions may decrease values in the near term. One way for an owner to address this is by providing seller-financing. This can be structured in a number of ways, and while the tax implications are different then in a conventional sale it may be an effective way to bridge the gap .

While there will always be change in the markets, one thing we have learned that will never change is *that we all need to wash our hands!!!*

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