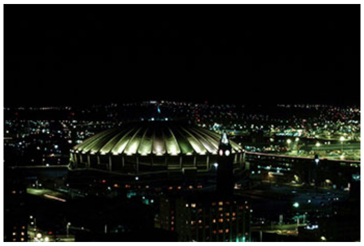

A Look Back In 2021 - Lending & CRE (Part 2)

lending pandemic CRE

Summary: In this second part of our review of 2021, we look at how lending was shaped and specifically address the shifts in the commercial real estate sector. While lending remained low across the board throughout the year, a recovery appears to be in the cards. Meanwhile, commercial real estate seems to have undergone a likely permanent transformation.

Built in 1976, the Seattle Kingdome held its fair share of sports spectaculars over the years before being demolished in 2000. But it wasn't until 15Ys after its 25,000-ton roof came crashing down during the demolition that the stadium's debt was fully paid off.

Let's hope that your loans get paid off a little faster than the Kingdome, but some loans definitely take longer and have divergent pathways to maturity. With that in mind, in today's second part and final review of 2021, we look at the pathways of lending and commercial real estate for this year. Feel free to review part one on the regulations and cyber risk from 2021, in case you missed it.

Lending - slowly moving towards recovery

Loan demand has remained low. The continued influence of the pandemic has resulted in ongoing changes in banking, borrowing, and spending patterns throughout the year. Reduced consumer spending and increased deposits have dampened the need for credit, while constraints on supply chains and labor have limited business expansion. The Delta variant has further hampered the expected return to a level of normalcy. All of these factors have contributed to low demand for loans throughout 2021.

Easing of lending standards. With the economic recovery sluggishly underway, competition between lenders has steadily increased. According to the latest Federal Reserve Senior Loan Officer Opinion Survey (SLOOS), many financial institutions (FIs) indicated that they eased their lending standards for all levels of businesses during Q3, in an attempt to boost demand. For some FIs, loan demand increased from large or medium-sized businesses, while small businesses remained essentially unchanged with only 20% seeing moderately stronger loan demand in Q3.

Signs of recovery… The SLOOS further revealed that various lending categories picked up during Q3, while others stagnated. Survey respondents noted greater demand for multifamily loans and those secured by nonfarm nonresidential properties. Meanwhile, demand for construction and land development loans generally stayed the same.

… But results are still mixed. Q3 results from a number of large Wall Street banks reveal a mixed bag, with only some reporting QoQ loan growth. This most likely reflects the continued increase in loan pay-downs and ongoing economic uncertainty. But despite lackluster growth, the industry remained cautiously optimistic for Q4.

Notwithstanding the currently tepid lending market, all the signs suggest that the economy will continue to recover throughout the rest of this year and into 2022. This will encourage further business investments and lending opportunities.

CRE changes zig and zag

Big tech is moving in. If big tech activity is anything to go by, the CRE office sector might soon experience an upswing. Google recently bought a $2.1B office building in Manhattan, while earlier this year Amazon started developing a $2.5B office and retail complex in Northern Virginia. Many other businesses appeared to be following suit — research by JLL shows that leasing activity was on the rise during Q3.

Hybrid work is here to stay. On the flip side, a survey by EY found that 75% of 500 US corporate executives are not planning on having a headquarters in the long run and only 13% of the respondents plan on having most employees back at the office post-COVID. With these expectations from corporate leaders, it's highly possible that occupancy rates may never fully recover to pre-pandemic levels.

Repurposing spaces. Trying to make sense of all the shifts in CRE, some commercial real estate owners repurposed spaces. As hybrid work expanded, not only office space was affected. Retail businesses reliant on those office spaces also dried up. Once the dust settled from widespread employee geographic relocating, opportunities for repurposing many of these retail properties arose.

According to the April 2021 CRE Trends & Outlook report from the National Association of Realtors (NAR) Research Group, 39% of NAR commercial members were turning vacant malls into mixed-use properties. Turning them into industrial warehouses or self-storage areas was the second most popular reuse of vacant retail areas. Effectively using vacant commercial real estate, while diversifying risk and providing the potential for long-term revenue through mixed-use properties resonated with investors. If office space vacancies continue to stay stubbornly low, repurposing through mixed-use could provide value for investors and bankers.

Although CFIs are generally well placed to serve their CRE customers, these changes have caused uncertainties in numerous ways. Make sure to review your portfolios carefully. Keep talking to your customers and assessing their businesses. Then, you can look back and say that both you and your customers successfully finished out 2021.

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ECONOMY & RATES

Rates As Of: 11/24/2021 06:05AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.06	0.01	-0.03
6M	0.07	0.00	-0.02
1Y	0.21	0.06	0.10
2Y	0.61	0.11	0.49
5Y	1.34	0.15	0.97
10Y	1.66	0.10	0.74
30Y	2.01	0.08	0.37

FF Market	FF Disc	IORB
0.08	0.25	0.15

SOFR	Prime	OBFR
0.05	3.25	0.07