



Construction Lenders Risk Management Roundtable

January 24, 2019



PARTNER CLRM 2019 MARKET UPDATE: 8 Trends to Watch in the New Year

Presented by: Dianne Crocker, Principal Analyst, EDR Insight
January 24, 2019





TAILWINDS	HEADWINDS
Rising corporate profits, optimism	Rising interest rates
2 nd longest economic expansion in history	Slowing appreciation rates on commercial properties
Labor market continued to fuel CRE	Moderating property sales
Federal tax reform, spending stimulus	Less abundant opportunities, most inventory has already traded
Strength in CRE fundamentals	Growing geo-political, trade tensions
Abundant debt and equity targeted commercial real estate	Uncertainty about market's endurance



1.

A NEW NORMAL:

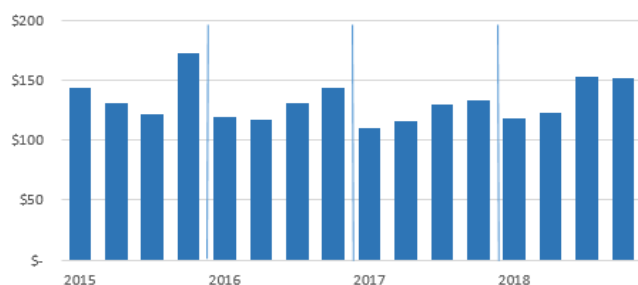
Rate of growth in property deals is decelerating.



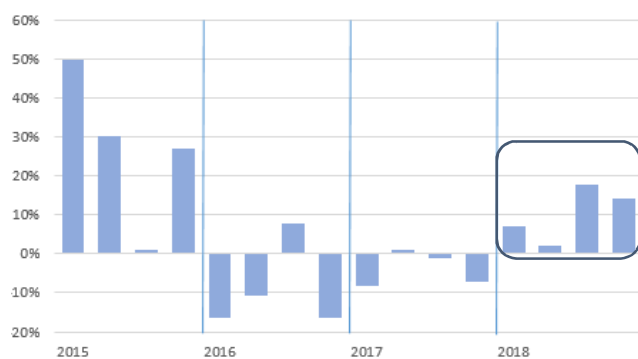
2018's REVERSAL IN CRE TRANSACTIONS

QUARTERLY

U.S. COMMERCIAL REAL ESTATE TRANSACTIONS:
Billion Dollars by Quarter

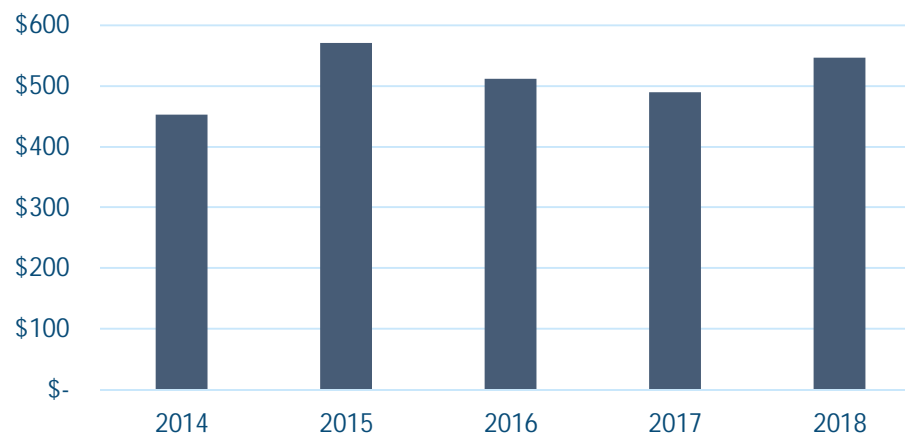


Year on Year Change



ANNUAL

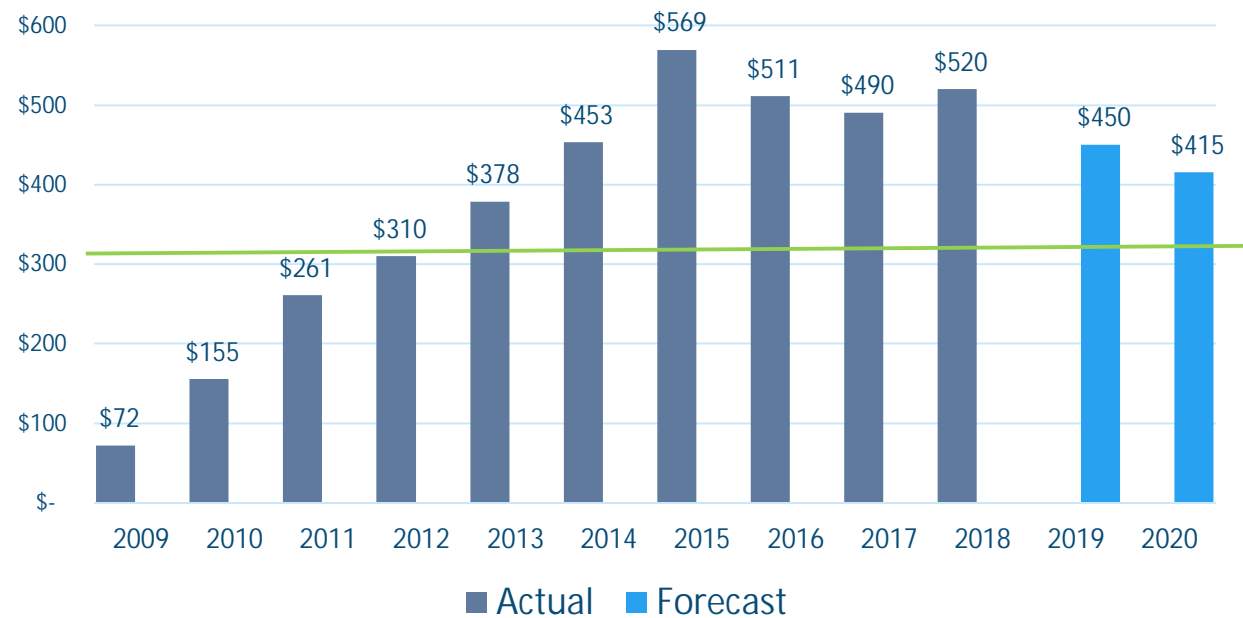
U.S. COMMERCIAL REAL ESTATE TRANSACTIONS
(Billion \$, preliminary data as of Jan. 17)



Development Site Sales Rebounded in 2018

	Q4 '18		2018	
	Vol (\$b)	YOY	Vol (\$b)	YOY
Office	41.3	11%	134.6	1%
Retail	17.4	12%	84.5	32%
Industrial	27.2	44%	92.4	25%
Hotel	14.2	125%	42.0	50%
Apartment	50.9	9%	172.6	12%
Seniors Housing & Care	3.5	14%	14.1	-14%
Dev Site	5.4	-2%	21.8	9%
Total	160.0	20%	562.1	15%
Major Metros	65.9	35%	214.6	16%
Secondary Mkts	70.4	10%	253.4	12%
Tertiary Mkts	22.0	9%	89.9	18%
Portfolio & Entity	53.7	83%	174.5	41%
Single Asset	106.2	2%	387.5	6%

The CRE Forecast: Is 2018 As Good As It Gets?



13-year average
(\$313B)

2.

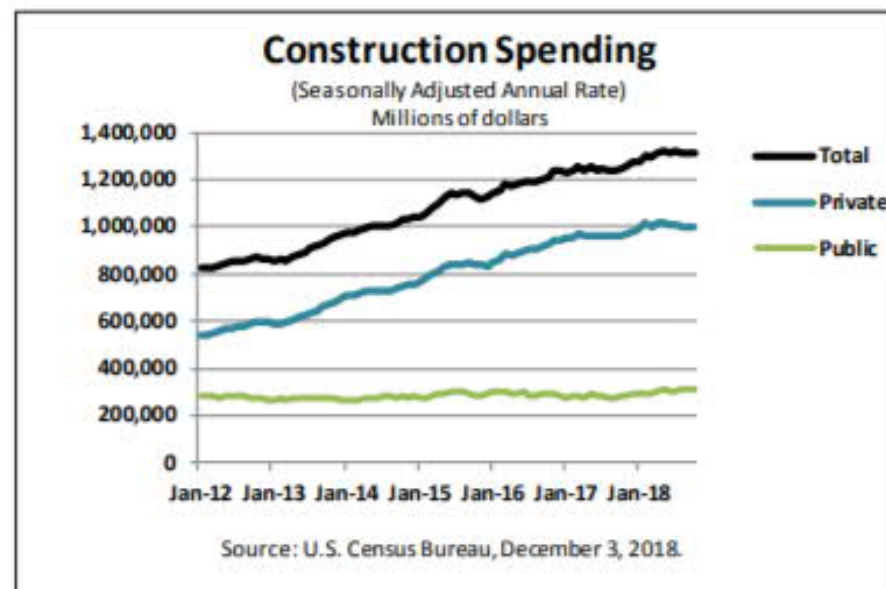
CONSTRUCTION SPENDING AND LENDING:

Will remain active amid stiff competition
from the unregulated



U.S. Construction Spending On the Rise

Through October 2018, construction spending up 5.1% above the same period of 2017.



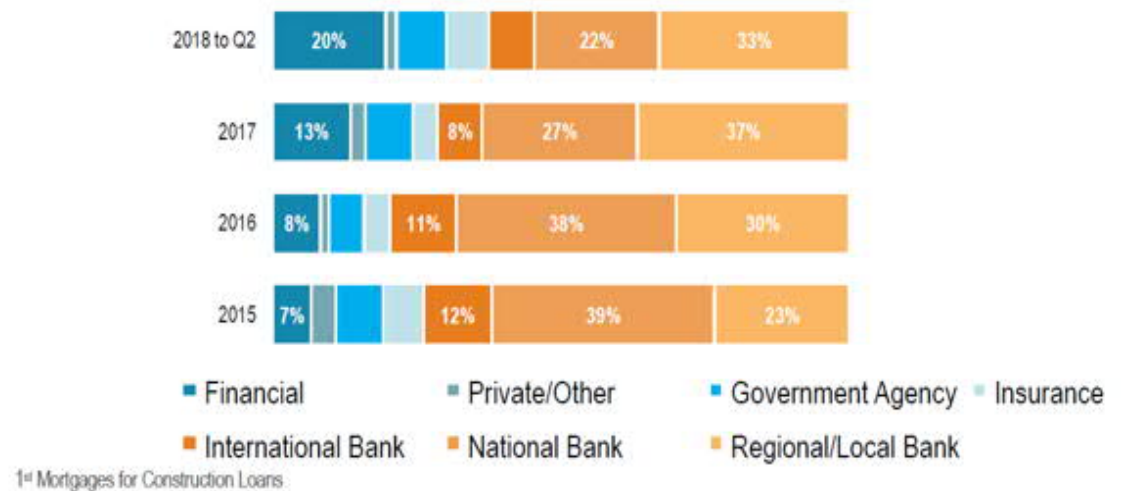


Most Commercial Lenders in U.S.
Expect Originations to Increase in 2019

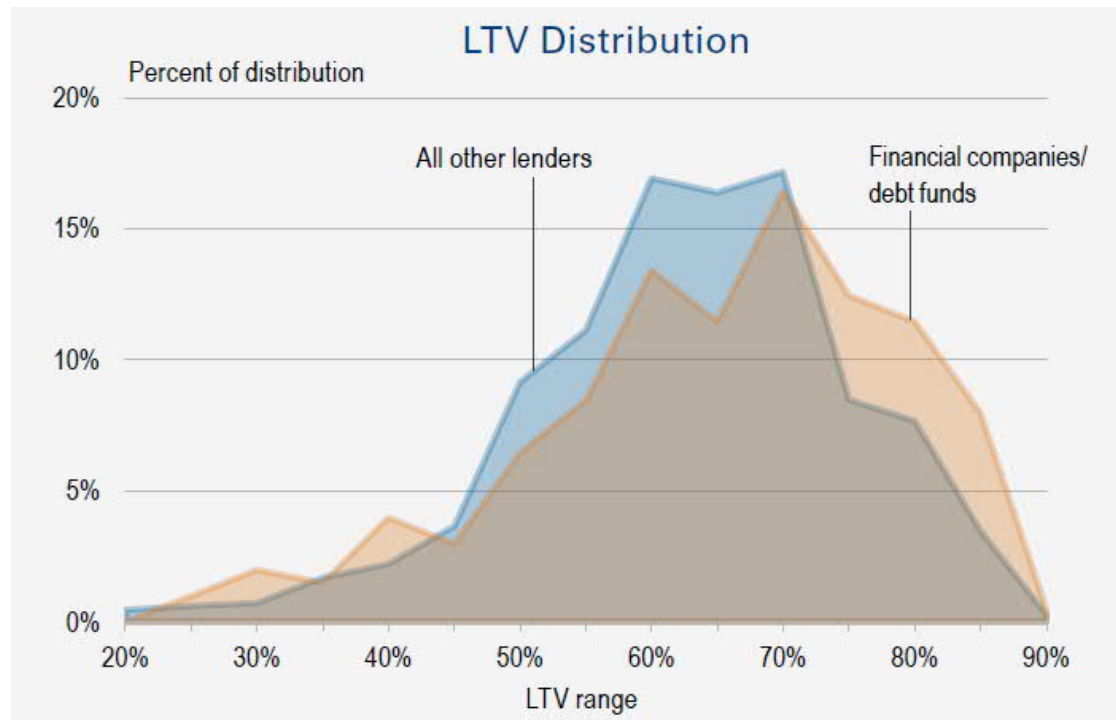
SHIFTS IN THE DISTRIBUTION OF CONSTRUCTION LENDERS

- Debt funds stepped into the gap left when 2015 HVCRE regulations led big banks to curtail construction lending.
- Local/regional banks still lend more, but debt funds have posted a sharp increase for their market share.
- Uber-competitive playing field:
6 out of 8 classes had at least 10% of the market in 1H18

Financial includes debt funds which might be viewed as a shadow banking sector.



...Debt Funds' Lending Skewed to Higher LTVs



TOP ORIGINATORS IN CONSTRUCTION LENDING

TOP CONSTRUCTION LENDERS, 1H2018	
1. Wells Fargo	11. Otera Capital
2. Blackstone Mortgage Trust	12. CIBC
3. Bank OZK	13. Comerica Bank
4. Bank of America	14. BMO Financial Group
5. JP Morgan	15. Dougherty & Company
6. US Bancorp	16. Madison Realty Capital
7. SunTrust	17. Goldman Sachs
8. PNC Fin'l Services	18. Bank of the West
9. M&T Bank	19. Starwood Property Trust
10. Fifth Third Bank	20. MassMutual Life



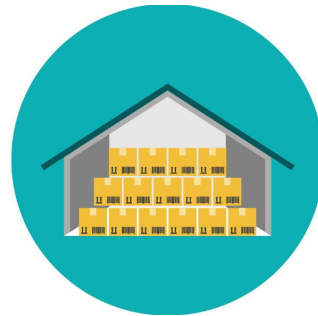
3.

RETAIL'S PAIN IS INDUSTRIAL'S GAIN:
Industrial will win the asset war





EVERY \$1B IN
E-COMMERCE
SALES



THE NEED FOR
1.25MSF OF
WAREHOUSE SPACE



AVAILABLE
WAREHOUSE SPACE
AT LOWEST LEVEL
SINCE 2000

MEANWHILE IN THE OTHER ACTIVE ASSET CLASSES:

MULTIFAMILY:

- Still strong in areas with constrained development
- Benefits from dynamics that favor renting over homebuying

RETAIL:

- Strong demand for adaptive reuse and repurposing of vacant, underutilized or obsolete properties

OFFICE:

- Relatively moderate construction, benefits from strong job growth
- Demand for energy efficiency improvements

4.

THE QUEST FOR YIELD: Casting a Wider Net to Secondary Metros



CONTINUED MIGRATION TO SMALLER METROS

HIGH-GROWTH DUE DILIGENCE MARKETS

1. San Francisco (19%)
2. Orlando (16%)
3. San Diego (15%)
4. Tampa (15%)
5. Indianapolis (14%)
6. Columbus (14%)
7. Houston (13%)
8. Stamford (12%)
9. Charlotte (11%)
10. Detroit (10%)

THIS YEAR'S TOP CRE MARKETS

1. Dallas/Fort Worth
2. New York-Brooklyn
3. Raleigh/Durham
4. Orlando
5. Nashville
6. Austin
7. Boston
8. Denver
9. Charlotte
10. Tampa

Sources: EDR ScoreKeeper model; Urban Land Institute-PricewaterhouseCoopers Emerging Trends in Real Estate, 2019.



An aerial photograph showing a coastal urban area. In the foreground, several weathered wooden pilings stand in the water. The middle ground features a dense cluster of modern high-rise buildings, including a prominent one with a 'LONG ISLAND' sign. The background shows a vast expanse of water and distant land. Overlaid on the image is the text 'Amazon's HQ2 Impact On Crystal City And Long Island City' in white.

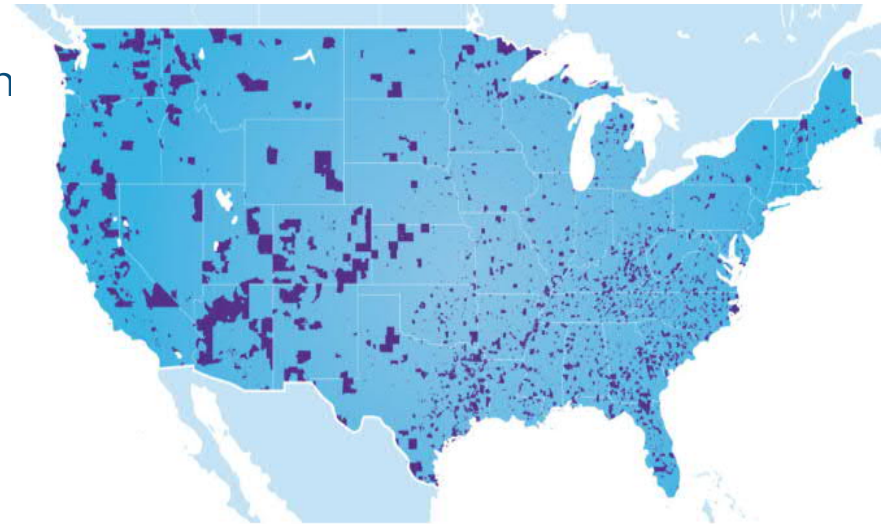
Amazon's HQ2 Impact On Crystal City And Long Island City

5.

OPPORTUNITY IN OPPORTUNITY ZONES:
Tax incentives lure investment capital

Opportunity Zones: Tax Breaks Drive Reuse, Renovation

- Nearly 9,000 opportunity zones across the U.S.
- One of the most attractive tax incentives in years.
- Emphasis is on reinvestment into new construction or major rehabilitation
- Already seeing an increase in:
 - Interest from banks and insurance companies to lend in these areas
 - New funds deploying capital
 - State/local incentives added as icing on the cake
 - Broad interest from investors, developers...



The Locus of Development Is Already Shifting to Opportunity Zones



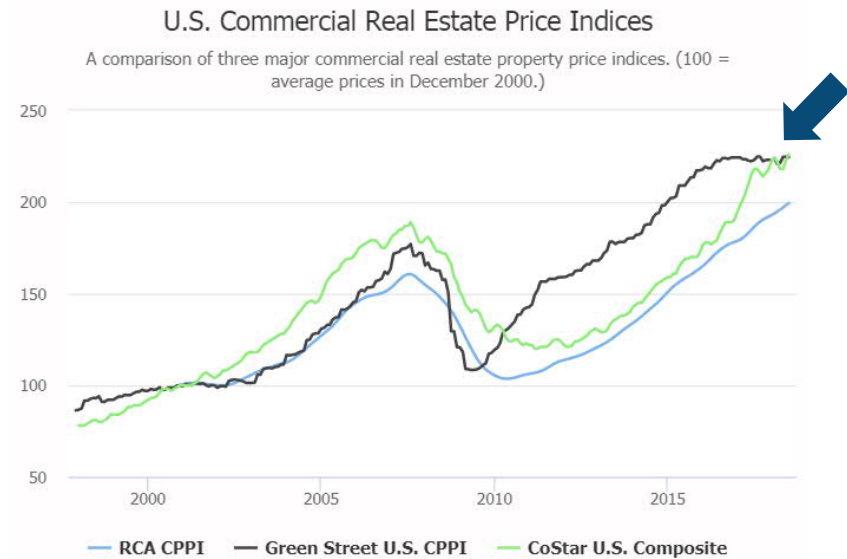
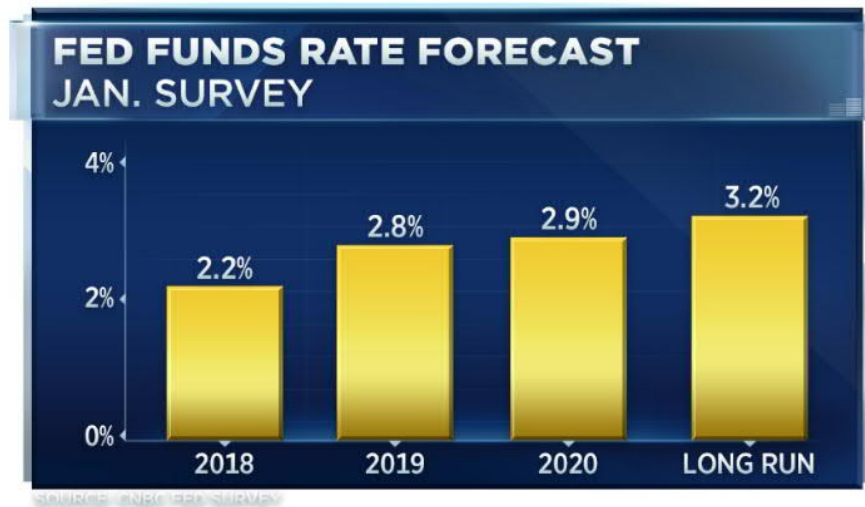
- Since Q4'17, development site sales within opportunity zones have grown at high double-digit rates.
- Value of construction starts within opportunity zones climbed to 18% of the market total by Q3'18.
- Development site sales are clearly a leading indicator of a shift in construction in the coming years to opportunity zones.

6.

DEAL OR NO DEAL?

Rising interest rates/slowing appreciation
will change the equation.

Higher Cost of Capital As Yields Moderate: Be Diligent

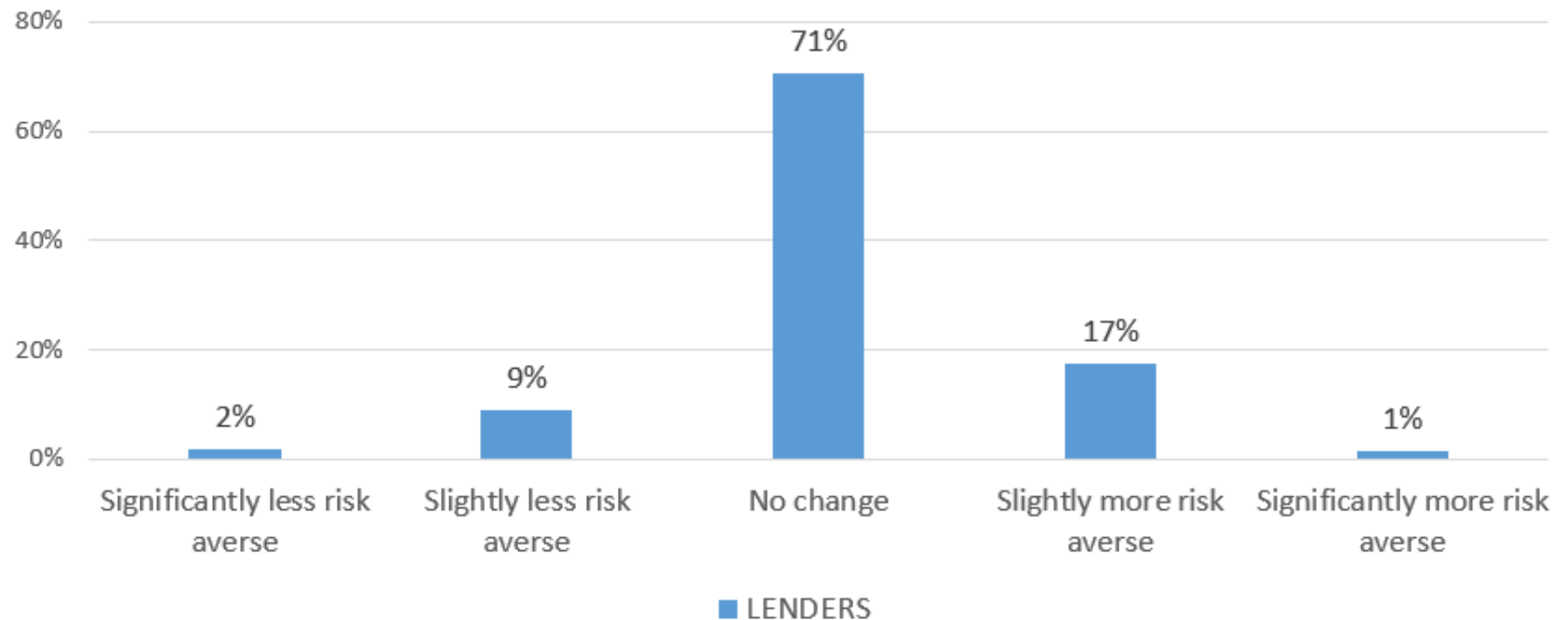


7.

PAY ATTENTION TO THE “R” WORDS:
Prepare for recession, protect from risk



Are your clients more risk averse? or less?



SOURCE: EDR Industry Benchmark Survey of Environmental Professionals, August 2018.
424 responses



How Are Things Different Than Before the GFC?

- Stronger capital buffers
- Smarter risk management
- Greater understanding of environmental risks
- Many economists peg 2020 as the year recessionary conditions take room

“Our banking system’s risk management is the best it’s ever been. Risk used to be stuffed in the legal department, and now it’s been elevated to one of the most senior positions at a financial institution. There’s an elevated status to being a risk officer today. Now CEOs are talking about practices that will or won’t fit within their risk parameters.”

Joseph Otting, Comptroller of the Currency

8.

CONSTRUCTION FORECAST: Labor shortages, rising costs

Rising Construction Costs a Concern

- The #1 real estate and development concern today
- Land costs a close second.
- Margins are going to be squeezed, cost overruns incurred, and values under pressure unless rents and net operating income can be increased to cover the increasing costs of new construction.

“Rising construction costs may be the most undertold story of 2018 that should become a material story in 2019.”

KC Conway, CCIM



CONSTRUCTION FORECAST BY ASSET CLASS

	2019	2020	2021	
Multi-unit housing	-9.2%	-6.9%	2.3%	Despite recent growth, Starts will decline in the near term and into mid-2020.
Office buildings	5.2%	-0.7%	8.8%	Activity will rise through the first half of this year before declining mildly through 2020.
Retail	7.0%	6.5%	-4.4%	Growth will take hold by the end of 2019 and persist through much of 2020.
Warehouse	14.9%	14.6%	9.8%	This market will expand throughout the length of this forecast

QUESTIONS?

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