After Bank Meltdowns, Real Estate Lending Gets Even Tighter

Three Failures Are Expected To Affect the Property Industry and Broader Economy, Professionals Say

The collapse of Silicon Valley Bank will lead to further tightening of lending standards, real estate professionals say. (Getty Images)

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The collapse of three U.S. banks means that one of the toughest real estate lending environments in decades is about to get even tighter, adding a new hurdle to an already challenging time for dealmaking.

Since last summer, rising interest rates, inflation and worries of a recession already have been slowing the pace of deals, pushing down sale prices and making developments

more difficult to finance.

Failures of Silicon Valley Bank, Signature Bank and Silvergate Bank will lead to further tightening of lending standards, according to real estate professionals, which could have far-reaching effects on property owners, the supply of housing and the broader economy.

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The latest jolt comes three years into a near-constant state of flux in the world of real estate, starting with the arrival of COVID-19 in early 2020. The pandemic and other factors, including Russia's invasion of Ukraine last year, also have contributed to supply-chain challenges and shortages of items including construction materials.

There are signs that lenders already are ramping up their due diligence in the wake of banking regulators taking over the shuttered banks, raising rates on new debt.

"This could exacerbate an already-extant expectations gap between buyers and sellers that is impeding transactions," brokerage Marcus & Millichap said in a message to clients. "Smaller banks will be under particular scrutiny, which may generate additional headwinds for investors reliant on financing from smaller institutions."

On the bright side, over the long term some say the bank failures could lead the Federal Reserve to shift monetary policy and slow or even reverse rate cuts, which would bring some relief to the credit crunch.

"Counterintuitively, it's possible that the isolated collapse of these banks may lower the outlook for interest rates for remainder of the year, because the added uncertainty might help to tighten financial market conditions, ease macroeconomic momentum and thereby do a bit of the Fed's job for it," the brokerage Cushman & Wakefield said in new report.

At the Mipim real estate conference this week in France, industry executives speculated over the idea of cheaper debt to buy real estate, even as Credit Suisse lost capital support from one of its principal investors, Saudi National Bank.

“To be honest people at Mipim seem to be walking around talking about the SVBs and Credit Suisses with smiles on their faces thinking it will mean lower interest rates,” said Mark Dixon, founder and CEO of flexible office giant IWG Group.

Apartment Sector at Risk

One sector that could be vulnerable is multifamily, which is shifting from boom times in recent years to a slowdown in demand, according to Marcel Arsenault, CEO of Denver-based real estate investor Real Capital Solutions.

While apartment developers and brokers already acknowledge 2023 will be a weak year, “based on our analysis, we don’t think they have a clue how bad it could get,” Arsenault said in an email to CoStar News.

“The same factors that just caught SVB and Signature with suddenly spiking interest rates will be catching up with the apartment developers who won’t be able to obtain permanent financing,” Arsenault wrote. “Those 1 million-plus units that CoStar data shows currently in the pipeline will be hitting the market at exactly the wrong time, too — deliveries will overwhelm already slowing demand.

He added that “private equity funds are only thinking values will drop 10% to 15%, but we see a far deeper decline in values. This could affect construction lenders, especially those with a large portion of their loan book in apartment construction.”

Builders of single-family homes also are bracing for changes.

“Even as builders continue to deal with stubbornly high construction costs and material supply chain disruptions, they continue to report strong pent-up demand as buyers are waiting for interest rates to drop and turning more to the new home market due to a

shortage of existing inventory," National Home Builders Association Chairman Alicia Huey said Wednesday in a statement.

"But given recent instability concerns in the banking system and volatility in interest rates, builders are highly uncertain about the near- and medium-term outlook," said Huey, a custom home builder and developer from Birmingham, Alabama.

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Some affordable housing construction housing projects financed by Santa Clara, California-based Silicon Valley Bank may wind up delayed or put on hold, CoStar Senior Director of Market Analytics Nigel Hughes said. Biotech projects already have been slowing in recent months because of higher interest rates and a drop in venture capital funding, Hughes said in an email.

Cushman emphasized that the banking crisis is unlikely to approach the severity of the Great Financial Crisis in 2008, because it appears contained to a small number of banks and since the overall economy is far stronger than it was 15 years ago.

But the implosion of Silicon Valley and Signature banks comes amid what already was the tightest lending market in well over a decade, aside from the early days of the pandemic in 2020, according to the Cushman report. The Fed's Senior Loan Officer Opinion Survey showed that the percentage of banks that say they are tightening lending standards is the highest it has been in 13 years, according to the report.

"We now believe these banks' lending constraints will become greater as they are likely to exercise even greater caution in the wake of these events to evaluate their capital conditions," the Cushman report said. "This comes at an inopportune time given that regional and community banks have stepped up as one of the more active CRE lending sources in recent quarters, all as the large banks, CMBS and life insurance companies have largely taken to the sidelines."

Costlier Debt

Real Capital Solutions' Arsenault said his firm already is seeing interest rates rise and loan-to-value ratios fall in ongoing loan quotes, meaning debt is coming at a higher cost and there's less of it available relative to the percentage of equity investors put into a transaction.

The federal government's stated intent to guarantee deposits over $250,000 could raise insurance costs for all banks, Walker & Dunlop Chairman and CEO Wally Walker said on his webcast Wednesday. He said that "is going to make regional and local banking that much more expensive, which makes it less profitable, which means that you get increased flows back to the money center banks."

It also could increase regulatory oversight, Walker said.

"You know, we're already seeing deposits move from smaller banks to larger banks, even though those smaller bank balance sheets are healthy," Michael Arougheti, CEO of investment manager Ares Management, added on Walker's webcast. "So you're going to continue to see an aggregation of capital. All of these deposits … have to go somewhere and you'll begin to see that they're going to the top five banks."

Shuttered Signature Bank has been one of the largest commercial real estate lenders in New York since 2020. (Robert Gigliotti/CoStar)

Signature Bank has issued about $13.3 billion in loans on New York real estate since 2020, according to a CoStar analysis, citing PincusCo data. During that time, the bank ranked as the third biggest lender in the city by total dollar value and first by number of loans made, with 882 total on its books.

The only banks that have issued a higher volume of real estate loans by dollar amount in that time are Wells Fargo and JPMorgan Chase, according to the data.

Including all markets, New York-based Signature Bank had $33.56 billion in commercial real estate loans at the end of 2022, or 45.1% of its total loans, according to data from the Federal Deposit Insurance Corp. Silicon Valley Bank's exposure to real estate was much lower, making up $2.38 billion, or 3.2% of its loans.

Stifled Startups

The bank failures also could have many indirect effects on the real estate industry.

That could include holding back growth of startups that had been backed by banks such as Silicon Valley Bank, preventing those companies from eventually expanding into larger offices and other real estate.

“It eliminates a major source of capital in the venture capital community,” CoStar Director of Analytics Victor Rodriguez said of Silicon Valley Bank, which he added is reported to have been involved in 50% of all U.S. venture capital-backed startups.

Silvergate Bank’s collapse was a voluntary liquidation not orchestrated by the Fed. The bank was primarily focused on digital assets and cryptocurrency and, according to FDIC data, had only about $267 million in commercial real estate loans

“What you expect to see is a dent in fundraising which typically leads to a rise in startup failures as these companies just run out of cash,” Rodriguez said in an email.

That could lead to a continuation of acceleration of cost-cutting seen over the past year, such as layoffs and cutbacks in real estate, which means there is a “decent chance 2023 is a bloodbath for the startup world,” Rodriguez said.

Smaller local banks are likely to cut back on real estate lending, “but I do not envision the commercial real estate lending landscape completely drying up as it did in 2008 and 2009,” Daniel Palmier, founder and CEO of Boston-based real estate lender UC Funds, said in an email.

“While there will be less capital in the marketplace for the foreseeable future, there is still capital available and there is still appetite from borrowers to get deals done,” Palmier said.