

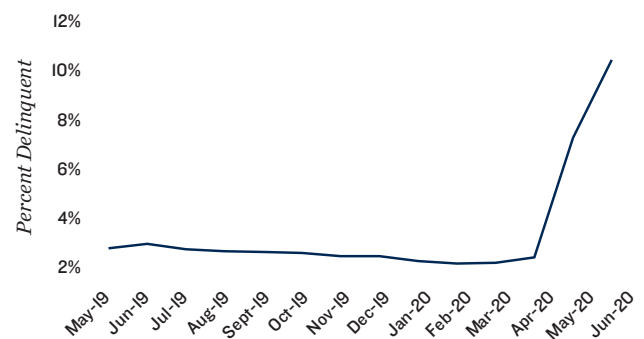
## Investors Eagerly Await Potential for Distressed Assets; Financial Institutions Reopen Familiar Playbook

**Discounting similar to the global financial crisis not anticipated.** The prospects of acquiring real estate at deeply reduced prices has buyers lining up capital in preparation of a wave of distressed assets becoming available. However, investors may be disappointed by the volume of distress this cycle. For properties not financed through CMBS, most financial institutions are committed to delaying foreclosure, following a trend established during the global financial crisis. CMBS may also take longer to become available as Congress considers legislation to prevent automatic foreclosure triggers that tie the hands of the loan servicers when considering forbearance. Furthermore, prompt action by the Fed and Congress could dampen this downturn, limiting the amount of distress that comes to market as a result.

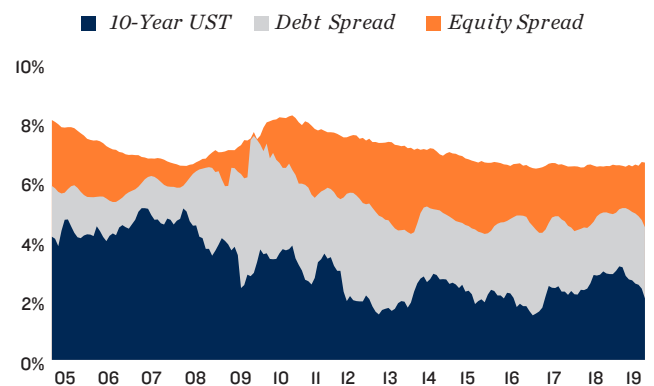
**Distressed properties will be concentrated in a few sectors.** As the world's largest economy adjusts to a post-pandemic world, entire sections of investment real estate may need to be altered. Hotel and retail properties could go into receivership if travel fails to resume and a permanent shift away from dining out emerges. Additionally, less traffic in large office districts will soften demand for retailers that cater to commuters, potentially forcing those assets to shutter permanently and be foreclosed. Investors with a penchant for repositioning real estate may be able to acquire these properties for below-replacement costs. However, most distressed transactions are not expected to be based on relative price. Low interest rates will make deals attractive based on the property's underlying operating fundamentals.

**Billions amassed in opportunity funds.** Several groups have already gathered capital to target distressed properties when they become available. During the last downturn, the sluggish receivership process along with much more stress in the financial sector generated a delayed reaction from opportunistic investors. This time, the shutdown of the nation's economy and obvious implications to the hospitality sector generated significant demand for groups to seize on distress. Although much of the capital is searching for deeply discounted properties, demand is anticipated to range throughout the quality spectrum as the national economic outlook comes into focus. Some funds may need to deploy well ahead of the most significant distress as government intervention and flexibility by financial institutions delays sending properties into foreclosure.

### 30-Day CMBS Delinquency Surpasses 10% in June



### Spreads Favorable Relative to Global Financial Crisis



### States With 30-Plus Day Delinquent Properties Financed by CMBS\*

State	Number of Properties	Percent of CMBS Loans
California	3,406	17.6%
Texas	3,266	24.2%
Florida	2,331	20.8%
New York	1,445	24.1%
Illinois	1,428	26.0%
Ohio	1,227	25.6%
Pennsylvania	1,216	27.2%
Georgia	1,184	21.8%
North Carolina	1,002	23.0%
Virginia	967	19.9%

\*Lodging, office and retail properties with delinquency through May 2020  
Sources: Real Capital Analytics; Trepp

## CMBS Hopes to Avoid a Repeat of the Global Financial Crisis Fallout; Debt Funds May Create Distressed Opportunities

**CMBS could avoid significant distress.** The total amount of outstanding commercial and multifamily mortgage debt stood at \$3.7 trillion in the first quarter. Approximately 14 percent, or \$516 billion, was held by CMBS borrowers. Nearly \$800 billion of CMBS mortgage debt was present at the peak of the previous cycle, which accounted for 40 percent of outstanding debt. Although financial institutions that service CMBS loans generally have little leeway when addressing delinquency from borrowers, Congress is encouraging the Treasury and Federal Reserve to help relieve pressure on borrowers with a CMBS loan. The Fed could loosen rules for special servicers to work with mortgage holders by providing some leeway with the automatic foreclosure triggers. Furthermore, it can inject liquidity into the market by making the Main Street Lending Program available to CMBS borrowers, who are currently barred due to multiparty state law contracts.

**Hotels and full-service restaurants see heightened delinquency.** From April to June, the delinquency rate for all CMBS loans soared from 2.3 percent to 10.3 percent as borrowers stopped receiving revenue from tenants. The lodging sector posted a jump to 24.3 percent as travel shut down, while retail recorded a rate of 18.1 percent. These segments face the greatest risk of going into foreclosure in the future due to the global health crisis. Not only were these industries shuttered to help reduce pressure on the healthcare system, the likelihood of a rapid reopening is doubtful. Multifamily delinquencies ticked up modestly between April and May, though CMBS represented just 3 percent of outstanding debt in the sector.

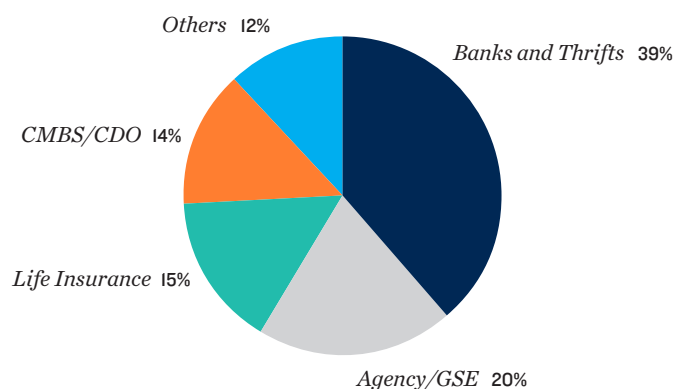
**Debt funds and banks introduce new risk.** Investor-driven lending, which includes debt funds, jumped over the past few years and accounted for 10 percent of originations in 2019. Underwriting for this debt was far more aggressive than CMBS, which facilitated the rapid increase in market share. A large number of these loans were also for construction projects, representing 19 percent of these originations last year. The prevalence of construction loans and elevated interest rates in this category could create some distress in the market for investors more quickly. While banks were more aggressive than CMBS originators during the last cycle and represent more than half of all originations last year, tighter overall underwriting standards and lower loan-to-value ratios could limit distress from banks. Nonetheless, if the financial system comes under renewed stress, the sheer size of bank-originated portfolios could make them the largest source of distressed assets.

**Awaiting deep discounting reduces opportunities.** Investors searching for deals to trade for “pennies on the dollar” could miss out on attractive properties as the economy recovers. In situations where buyers can acquire assets at a fraction of the previous valuation, new considerations will need to be made regarding their future viability. Following the global financial crisis, investors only needed to wait for the economy to recover. After the health crisis, however, fundamental shifts in the economy and real estate are anticipated. Namely, dispersed working could reshape office districts and population density in several areas. Some assets may never recover previous valuations as demand shifts.

Retail and Hospitality 30-Plus Day CMBS Delinquency Soars\*

Property Type	20-June	20-May	20-Apr
Hospitality	24.3%	19.1%	2.7%
Retail	18.1%	10.1%	3.7%
Multifamily	3.3%	3.3%	1.9%
Office	2.7%	2.4%	1.9%
Industrial	1.6%	1.8%	1.4%

Total Outstanding Mortgage Debt\*\*



\*Percent of CMBS loans 30-plus days delinquent \*\*As of 1Q 2020  
Sources: Mortgage Bankers Association; Trepp

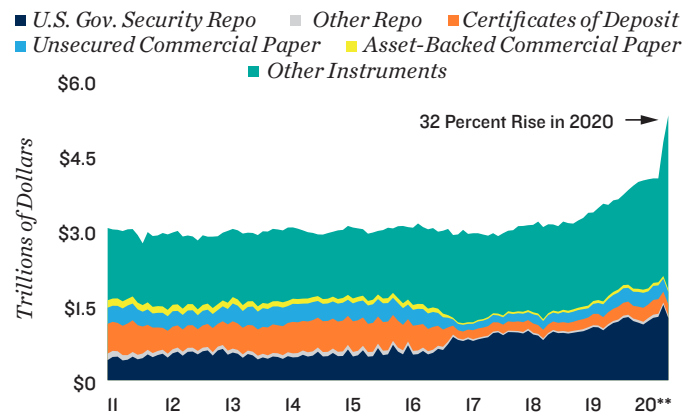
## Liquidity and Sidelined Capital Generate Competition for Distressed Properties; Narrow Opportunistic Acquisition Market

**Numerous investors await discounted properties.** The pool of capital sitting on the sidelines is at a record level with close to \$5 trillion sitting in money-market funds. Due to the liquidity in the market and access to capital by a broader range of investors, the competition for bank-owned assets will be significant when the time comes for lenders to move properties off their books. Opportunity funds have raised hundreds of billions in anticipation of discounts, and that capital may need to be deployed prior to any significant price cuts as banks kick the proverbial can down the road. As capital does move off the sidelines, it may be focused on property fundamentals rather than replacement cost. Investment real estate that trades at attractive cap rates relative to pre-pandemic levels will be the benchmark for distress during this cycle rather than price discounts.

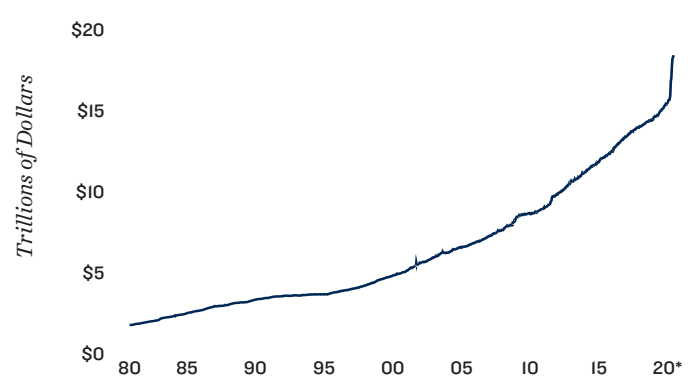
**Relationships and capital limit distress.** Quick action by the Fed to add liquidity into the financial markets will have significant implications on real estate. Since the beginning of the health crisis, the Fed has increased the money supply by 10 percent to \$18.5 trillion. Conversely, M2, which includes cash and investments easily converted to cash, only increased by 4 percent during the duration of the last recession. Liquidity will keep banks from overtightening lending standards, preventing the capital markets from freezing. Another consideration is the banks' larger share of loan originations during the most recent cycle. Existing relationships with borrowers will not only help limit the number of distressed assets as forbearance and other solutions are created, the number of real estate investors in good standing with financial institutions is also elevated. When distress does occur, lenders have a larger pool of existing and viable buyer options.

**Unique distress creates opportunity.** The sheer magnitude of the economic downturn will result in some assets being returned to lenders, namely properties that cannot reopen in their pre-health-crisis format due to a shift in demand. Buyers willing to target these deals may find the discounting that is not expected elsewhere. Adaptive reuse strategies are already in discussion for real estate. Experience-oriented retailers have the greatest likelihood of falling into this category. The other major opportunities will be found in assets where the business and real estate are intrinsically linked, including hotels and seniors housing. A significant share of these properties are owned by business operators and opportunity funds are likely to target more passive real estate, paving the way for private buyers to compete.

### Record Capital in Short-Term Investments



### Fed Sharply Increases Money Supply During Health Crisis



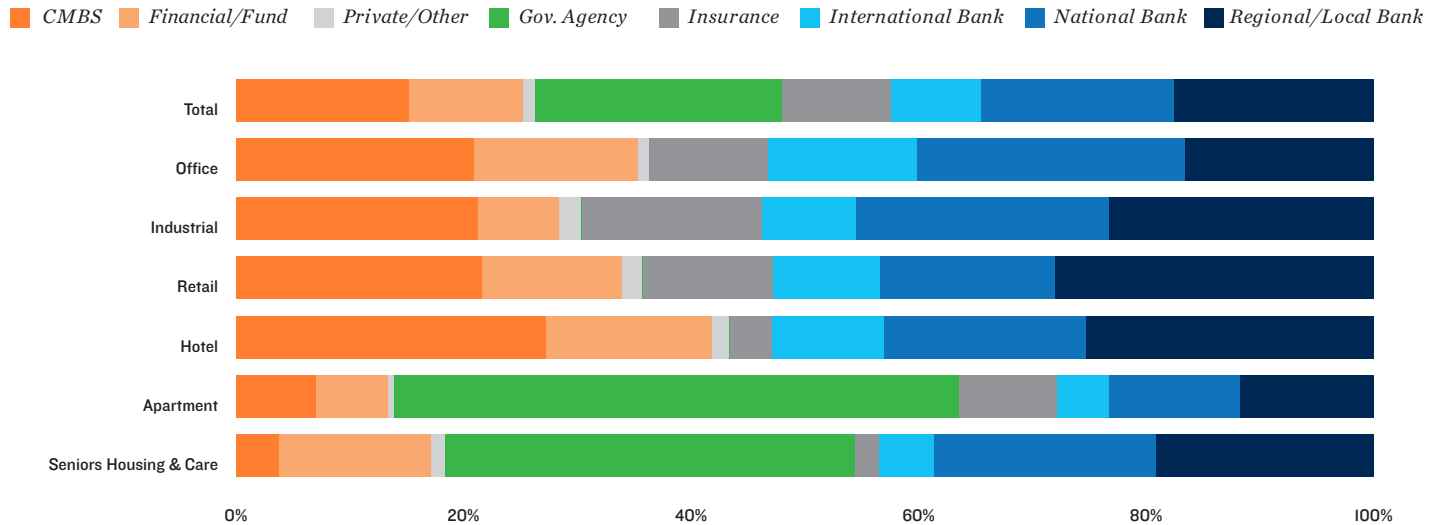
### Markets With High CMBS Distressed Hotel and Retail Properties\*\*\*

Metro	Number of Distressed Hotel Properties	Number of Distressed Retail Properties
Greater New York	228	674
Chicago	206	610
Dallas/Fort Worth	295	412
Los Angeles/Orange County	219	464
Atlanta	227	388
Houston	220	382
Phoenix	155	297
South Florida	198	240
Washington, D.C.	133	251
Detroit	102	277

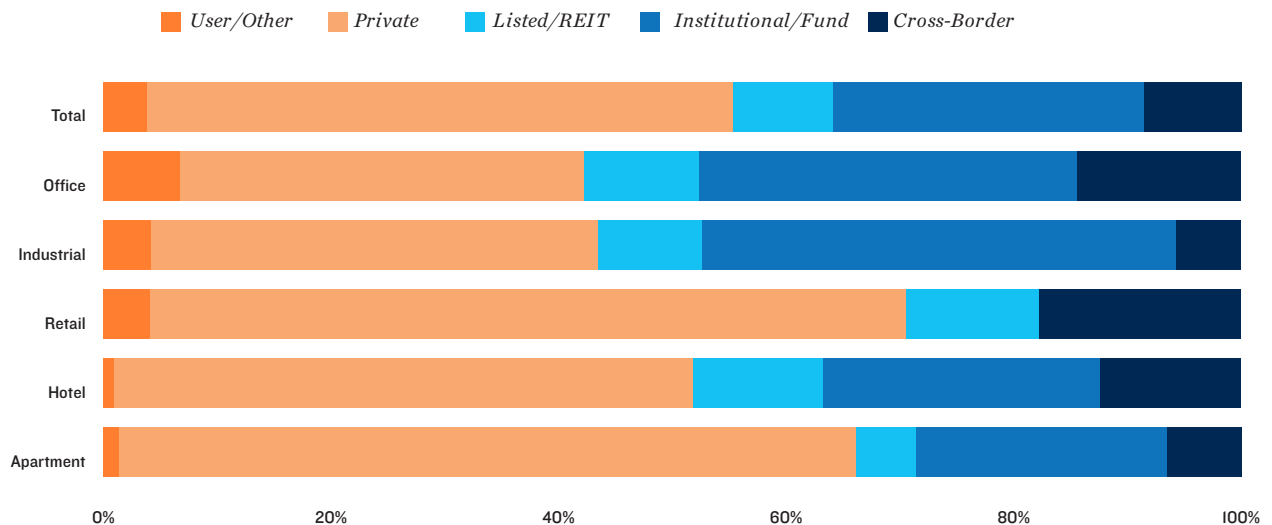
\* Through June 8 \*\* Through April 30 \*\*\* Through May  
Sources: Federal Reserve; Trepp

Privately Held Hotel and Retail Assets Financed With CMBS and Debt Funds Face Outsized Risk of Distress

2019 Loan Origination\*



2019 Buyer Composition\*



\*Percent of dollar volume; includes sales \$2.5 million and greater

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Sources: Marcus & Millichap Research Services; Federal Reserve Bank; Mortgage Bankers Association; Real Capital Analytics; Trepp

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