The state of commercial real estate debt markets - by Michael Zysman

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Today’s banking environment for commercial real estate can be defined as a period of low liquidity and lingering distress. Much of this distress is due to banks having made aggressive loans in the COVID era, coupled with the functional obsolescence of many buildings due to rapid technological innovation. A large portion of regional and small banks in the U.S. are burdened with underperforming commercial real estate loans that have fixed interest rates at levels less than what they can sell certificates of deposit for in the current market. Many of these banks are staying afloat due to emergency funding from the Federal Reserve. This dynamic puts these banks in a precarious situation that could force them to liquidate loans at losses, that they are not able to cover if there is a swift change in policy. The relative lack of liquidity in banks has pushed many bank borrowers to focus on obtaining stabilized loans from insurance companies and government backed institutions as alternatives.

Commercial real estate market activity could improve if banks start selling assets off or restructuring loans at a quicker pace, due to the continued deterioration and underutilization of many overleveraged properties. Allowing these assets to continue their current path can negatively affect the country’s supply of quality housing and the long-term resiliency of the economy. Taking losses in a thought-out and just way allows the system to fix and learn from its mistakes, and reinvent obsolete real estate. New policy changes could also help improve the health of commercial real estate capital markets and increase activity in commercial real estate ventures.

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