Marcus & Millichap Capital Corporation

Retail Market Commentary

May 4, 2023

- The Fed announced a 0.25% increase in the Federal Funds rate at the FOMC meeting on May 3rd, pushing the Target Rate to 5.00% - 5.25%. The move was widely expected by the market as inflation has been moving in the right direction, hitting 5.0% in March compared to 6.0% in April and down from 9.0% at its peak in June 2022. In its announcement, the Fed softened its language regarding potential future increases, leading the market to believe we may have reached a peak for the Federal Funds rate for the near term.
- 1-Month term SOFR, which closely follows the Federal Funds rate, is currently at 5.05%. We are now essentially at the peak of the SOFR forward curve, with rates projected to drop as low as 4.46% by year end 2023. This would bring some rate relief for value-add and construction financing, which are heavily reliant on floating rate debt. It would also substantially reduce the cost to purchase interest rate caps, helping to bring overall borrowing costs down.
- The most recent victim within the banking world of the rapid increases in interest rates was First Republic Bank, which was seized by Federal regulators the weekend of April 28th and sold via an auction to JP Morgan on May 1st. JPM received $50BB in financing from the FDIC and will acquire the bank subject to a loss sharing arrangement with the government. First Republic followed Silicon Valley Bank and Signature Bank, as the third major bank to be seized by regulators this year.
- First quarter earnings were net positive for the major money center banks including JP Morgan, Citi, Wells Fargo and other systematically important financial institutions that have been beneficiaries of the flight to safety of deposits flowing from smaller banks. In the meantime, Moody's downgraded eleven regional banks, including First Republic before it failed, Western Alliance Bancorp, Zions Bancorp, US Bancorp, Comerica and several other banks that are active commercial real estate lenders and whose stocks have been under significant pressure.
- The impact on liquidity in the real estate capital markets is being felt as the regional banks and credit unions have tightened underwriting standards (45% of domestic banks tightened underwriting standards in Q1 according to the Fed) as they move to protect their balance sheets, increase loan loss reserves and prepare for the potential impact of a slowing economy on their loan portfolios. Despite this, we continue to see banks, credit unions and lifecos actively bidding on deals in the market, with certain players sitting on the sidelines or being extremely conservative.
- The 5-year treasury currently sits at 3.39%, having been as low as 3.34% and as high as 3.72% in the last thirty days. The 10-year treasury currently sits at 3.39% and ranged between 3.29% and 3.60% in the last thirty days. The yield curve, which has been inverted all year, is close to flipping as the yield on the 5-year has been dropping quickly. The recent volatility in treasury rates reflects the turmoil in the banking sector and uncertainty associated with the direction of the economy in light of rate increases, but with continued signs of strength in employment and corporate earnings.
- Bank and Credit Union borrowing rates range from 5.50% - 6.50% for most properties with leverage in the 60% - 70% LTV range, assuming at least 1.25x DSCR. Lifeco rates continue to hold in the 5.25% - 6.00% range with typical leverage in the 50% - 60% range. There is an active market bidding on financing opportunities for retail properties as they have become a bright spot in the market with defaults declining and an attractive alternative to office.
- CMBS New Issuance Volume of $5.8BB for Q1 was the lowest since 2012 when it hit $5.1BB. Retail financings represented the largest category of new issuance in Q1 at $1.52BB or 25.6% of the total. Q2 has seen a handful of new deals priced as CMBS steps in to fill the void left by the banks, but overall volume remains low. CMBS rates remains wide as spreads hover at +/-300 bps for most product types, putting all-in borrowing costs at 6.00% - 6.75% and leverage in the 60% - 70% range.

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Stabilized Retail Financing - Market Terms*

						Product Types				
	LTV	Interest Rate	Term	Fixed/Floating	Recourse	Mall	Power Centers	Grocery Center	Strip	NNN
Life Co	50-60%	5.25-6.25%	5-20 years	Fixed (over Treasuries)	Non-Recourse			✓	✓	
CMBS	60-70%	6.00%-6.75%	10 years	Fixed (over SOFR swaps)	Non-Recourse	✓	✓	✓	✓	✓
Bank	60-70%	5.50%-6.50%	3-10 years	Fixed (index varies)	Varies			✓	✓	✓
Debt Fund	65-75%	7.75-9.50%	2-5 years	Floating (over SOFR)	Non-Recourse	✓	✓	✓	✓	
Credit Union	60-70%	5.50%-6.50%	5-10 years	Fixed (index varies)	Varies				✓	✓

* Other terms such as prepay penalty, amortization and future funding vary widely by lender, property and borrower; rates change daily

Recently Closed Transactions

$10,750,000

Norcross, GA

Retail | Bank

$8,846,749

Glendale, AZ

Retail | Credit Union

$4,400,000

East Northport, NY

Net Lease | Bank

$3,850,000

Fullerton, CA

Retail | Credit Union

$3,500,000

Daytona Beach, FL

Net Lease | Credit Union

$2,688,800

Belleville, MI

Net Lease | Bank