Lending remains promising amid rate cuts

As easing interest rates raise hopes of stabilization in the lending market, the industrial sector could benefit more than other asset classes, reports Aisha Kapoor

In recent years, the logistics and industrial sector has faced a raft of challenges that have impacted occupancy, fundraising, transaction volumes and valuations. The ongoing recalibration of monetary policy in many parts of the world could help alleviate some of the concerns.

Industry participants say the extent to which rate cuts could boost lending is somewhat nuanced. While short-term interest rates in the US have lowered, the future direction of long-term interest rates set in global bond markets continues to remain uncertain.

Dave Link, executive vice-president and regional managing director at commercial real estate lending firm Northmarq, says: "It is tough to predict that long-term interest rates are coming down, given they have trended mostly upward, post-election.

"The threat of tariffs and escalating consumer prices have kept long-term treasuries artificially high. We believe the 10-year treasury hovering around 4 percent or below will push owners to transact. The challenge we have had in 2024 is the 10-year treasury has gotten to that 4 percent level, but borrowers have been slow to react. By the time borrowers make decisions to move, the 10-year Treasury jumped, and deals fizzled away.

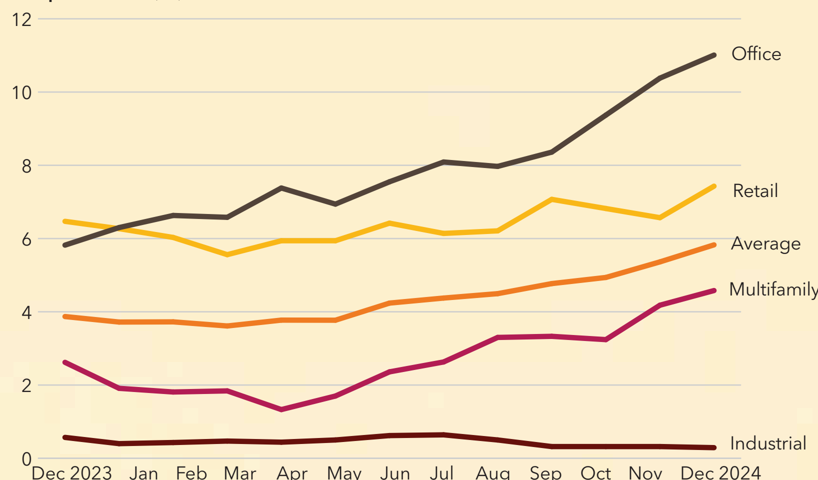
"We need both consistency in long-term rates and borrowers willing to move quickly. Until we see that, transactions will continue to be stuck in the muck."

The case for logistics lending

Notwithstanding the ambiguity over long-term rates, lending is expected to remain buoyant. There are two key reasons why appetite for industrial and logistics property financing is likely to remain strong in 2025: underweight lending allocations of some of the most active lending groups, and relative outperformance of the sector compared to other sectors.

John Rose, senior managing director at JLL Capital Markets, says industrial and logistics properties continue to be an asset type that lenders prefer and investors desire to acquire.

"Lenders cannot find enough product to lend. There are several lenders, specifically life insurance companies, who did not meet their targeted lending allocations in 2024 that will be in pursuit of lending opportunities for



Source: Trepp, 2024

industrial and logistics properties in 2025.

"Overall, this is about as deep of a lending pool that we have seen for industrial and logistics properties – both fixed rate and floating rate. The drop in short-term interest rates has led borrowers to contemplate their borrowing strategy, whereas in early 2024, borrowers gravitated more to fixed-rate loans due to the lower cost of capital."

Link adds: "The life companies have had a tougher time being competitive with agency apartment lending in 2024. To compensate for missing on the apartment business, they have been highly competitive in pursuit of industrial lending."

Even though logistics has experienced value erosion in recent years due to higher interest rates and increasing cap rates, private real estate managers have continued to deploy capital.

Alistair Calvert, chief executive officer of Clarion Partners Europe, says the repricing of real estate in Europe has helped stabilize the investment markets. "With continued uncertainty around the office investment market and softness across large parts of the retail investment market, lenders are looking to increase exposure to the residential and logistics sectors. Key logistics markets have been stable from a yield perspective for the last few quarters, and with the re-emergence of core capital, we are now seeing marginal yield compression."

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JOHN ROSE
JLL Capital Markets

Active players in the market

In addition to life insurance companies, other types of lenders are also re-engaging with the sector, including regional banks, debt funds, commercial mortgage-backed securities and even national banks.

JLL's Rose says the money center banks, which were mostly on the sidelines the past 18-24 months, are increasing their lending activity. "Large loan executions through the SASB market have created efficient access to liquidity for borrowers. Given the demand from bond investors for industrial product, credit spreads have compressed significantly since the beginning of the year. An increase in acquisition activity over the last two quarters has also created more lending opportunities. These factors collectively indicate a positive trend in logistics and industrial real estate lending activity."

The uptick in lending activity is reflected in the number of notable transactions recently announced around the world. In October 2023, New York-based private equity firm Blackstone announced it had secured $930 million for a sustainability-linked loan representing the largest of its kind in Australia's industrial sector.

Last September, JLL Capital Markets arranged a $577.6 million CMBS single-asset, single-borrower financing for an industrial portfolio comprising 25 properties totaling seven million square feet across 10 US states. Soon after, Invesco Real Estate reportedly provided €272 million for a portfolio of prime logistics assets located across three countries.

As more players become active, lending terms are also evolving.

Clarion's Calvert says the big change in the all-in cost of debt is being driven by the reduction in expectation of long-term interest rates. "The

increased lender appetite for logistics is also putting downward pressure on margins. We are seeing lenders increasingly willing to offer higher LTVs and more bespoke structures for development or refurbishment projects. The rise of green-loan lending, for example, is also providing cheaper debt to borrowers who are able to provide sustainable buildings as collateral or a business plan to achieve certain environmental milestones during the loan period."

Melissa Rose, senior managing director at JLL Capital Markets, says: "Regional and local banks have notably re-entered the construction lending space, with certain banks offering compelling leverage and pricing on speculative industrial non-recourse financing. The increased competition among a larger pool of capital sources has materially improved terms on development loans."

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>
> **MELISSA ROSE**
> **JLL Capital Markets**

Constraints to growth

While the industry is hopeful of an imminent stabilization, commercial real estate continues to grapple with cyclical challenges.

The looming maturity wall remains a key issue. Rate hikes since March 2022 have led to burgeoning refinancing challenges for borrowers whose loans are due soon. S&P Global estimates that around $1 trillion in commercial real estate mortgages could mature in 2025, and peak at $1.26 trillion by 2027. That said, executives largely agree the logistics and industrial sector faces less of a refinancing risk compared to other sectors.

Trepp's December 2024 *Delinquency Report* shows average delinquency rates rose again at the end of the year, with the overall rate climbing 17 basis points to 6.57 percent. The office delinquency rate surpassed the 11 percent mark in December, representing more than $2 billion in office loans that became newly delinquent that month and beating the previous high of 10.34 percent set back in 2012. Meanwhile, delinquency in the industrial CMBS sector fell to just 0.29 percent in December, continuing its downward trend since July.

Northmarq's Link explains: "The real problem we see is lenders who have had maturities in 2023 or 2024 and have kicked the can down the road with short-term loan extensions. At some point, this refinance wave will have caught up to the reality of the market and there will be some refinance challenges. That said, I don't see issues refinancing industrial as the appetite for that product type remains high with no reason to see change any time soon.

"Current rates are higher on refinances than rates you had locked in on when borrowers originated loans years back. The true challenge I see for industrial is the potential need to bring additional equity to the table on the refinance. This could happen if borrowers haven't amortized their loans during the loan term or if the owner has a challenging rent roll."

The refinancing pressure on logistics assets could also present acquisition opportunities, notes Melissa Rose. "Industrial and logistics properties have not experienced the level of distress compared to other asset types. Pending maturities will cause borrowers to make decisions, which we believe will result in opportunities. There is ample liquidity from different lender types resulting in a capital solution for any situation. The primary consideration in these cases is the cost of capital."

However, the sector is not immune from other challenges. Global brokerage JLL estimates that in Q3 2024, US industrial leasing volumes were 26 percent lower year-on-year, despite greater touring activity in many markets as transaction timelines remain lengthy. Similarly, leasing activity declined by 19 percent over the year across European markets, while in Asia-Pacific, net absorption was 22 percent below 2023 levels.

The sector is also burdened with aging supply around the world that is ill-suited for today's technology and sustainability requirements. CBRE Investment Management found that more than 72 percent of logistics assets in the US were built prior to 2000, with over a quarter being more than 50 years old. The mismatch in supply and demand for more modern logistics facilities is also leading to a financing gap in the sector.

While short-term rate cuts could encourage investors and lenders waiting on the sidelines to re-engage with the sector, addressing these broader economic challenges remains crucial for long-term performance. ■