Greg Michaud

CMLs in 2024: A repriced market with attractive opportunities?

GUEST Q & A

Stewart: Welcome to another edition of the InsuranceAUM.com Podcast. My name's Stewart Foley, I'll be your host. Welcome back. It's so nice to have you and thanks for joining us. Today's topic is CMLs in 2024: A Repriced Market with Attractive Opportunities? And that's being posed by Greg Michaud, who's the head of real estate finance at Voya. Greg, thanks for being on, man. I appreciate it. Thanks for taking the time.

Greg: Yep, thank you.

Stewart: So we're going to start this off the way we always do, which is what town did you grow up in? What was your first job? Not the fancy one. And what makes insurance asset management so cool?

Greg: Sure. I grew up in Jacksonville, Florida, and the first real job I had, I took the vocational track in high school and I was a draftsman, so I worked in big pools of people drawing plans and specs. So that's really where I got my love and started in real estate.

Stewart: Wow, that's cool. I actually had a guy, there was a guy named L.G. Sinclair who was our shop teacher and he taught us drafting and it was with a drawing board and we had the T squares in the whole deal and it was really cool. I just thought it was super cool, I was so into it. What makes insurance asset management so cool in your mind?

Greg: I've been in an insurance company for almost my entire career and to see how it's evolved and how commercial mortgage loans have become a really good part of the investment thesis for insurance companies. It's been really amazing to see how that's transformed and how it's developed over time. What's exciting to me is watching the development of this asset class becoming a really mainstay asset class for a lot of investors out there, especially insurance companies.

Stewart: Yeah, it's really interesting. I mean, I've had a couple of people say to me that the insurance industry has changed more in the last 3 years than it has in the last 30, and I think there's something to that. And I want people to know really that your background is quite varied. I mean, you've been at this for 30 years. I mean, you mentioned most of it's with an insurance company, but you're responsible for the sourcing and underwriting management of all commercial real estate loans on the platform. You're also on the executive leadership team for proprietary assets and the US Credit Committee, you also chair the CMBS Steering Committee. You were a real estate analyst and I also believe you started your career as an appraiser on the commercial side. So you're involved in a number of industry groups. I think you've got your chops well-earned here.

So I think it's important for people to know that your background is well beyond just CMLs, but today it's the topic we're on. So let's talk about it. And I think that I'm pretty sure you agree that there's a lot of stress in the office sector. I mean, the reasons are obvious, although it does seem like there's some return to work going on, and I'm keen to get your view on that. But some cities are busier than others. There seems to be a lack of liquidity oversupply, and this is a well-worn topic and we've covered it elsewhere. But do you think the worst is behind us at this point? Can you give me your review or help educate me on the difference between urban office and suburban office properties as an example?

Greg: Yeah, sure. I do believe we've hit the trough in valuations in office. We're starting to see some deals clear. I was an appraiser so I can talk about them, you're always getting a backward-looking value when you're getting an appraisal, and so I think that's starting to work its way through right now. And I do think that's why we're kind of near hitting the trough. However, I think it's going to be a really long trough. When you saw what happened to retail during COVID, it's almost the same kind of thing except it happened really quick during COVID. All the bad retail deals got wiped out, re-gentrified moved on office is going to be a different story, and it's going to be, I think this trough could be a long trough.

And it kind of gets to where we break it out, as you mentioned in the suburban urban markets. In a suburban market, that's kind of where we focused on anyway, at least you have a second way home where it might be a five office building complex. The developers coming in, they're re-entitling some of the property for multifamily, maybe a little bit of retail. So you're starting to see that mixed-use come into play, which you can do on a large office campus. I saw one large office campus in Chicago, about your neck of the woods get torn down and turned into an industrial park. So with the suburban stuff, you have a couple of second way home. It's not still a panacea. However, you could kind of figure your way out.

You get into the urban market, you get into New York City, you're on a poached stamp site. There's not much you can do with it. Perhaps you can turn it into residential, but I'm sure you've talked to people about that. It's very expensive. Not everything can be converted because of windows, how deep the floor plates are. And so I think when you start looking at how long this trough's going to be, it might be longer in the urban stuff as opposed to the suburban. Now when you look at One Vanderbilt in New York City, that thing's going to be fine, class A, quality asset, no problem with that. It's probably going to be more in that B urban office building that just doesn't have a lot of land to it.

Stewart: And so there are other markets that you think there's stress in terms of the collateral type or in terms of the market geography that maybe isn't as well known or as well worn?

Greg: In the real estate circles we've been talking about this for a while, but multifamily, we always figure multifamily would be the next shoe to drop. You have a lot of those, and I'm talking about the B apartment complexes where a developer's going in renovating the property, new bathrooms, new kitchens, he hopes to move the rents from, call it, $800 a month to $1,000 a month. Those deals are all floating rate. They had rate caps and things like that. But with SOFR increasing, you're seeing stress there. And then they had a double whammy on that also, the expenses on apartments are just going through the roof.

We've seen apartments in Florida, for instance, $3,000 a unit for insurance, whereas back in normal times, wherever that is, it was $700 a unit. So they've been hit by a double hit, high SOFR rates, and then expenses just ratcheting up. And while real estate apartments are a great hedge to inflation, you just can't keep up with that kind of inflation right now. And so we're starting to see some stress in the apartment market right now. We figured we'd start seeing that and now it's starting to come to fruition.

Stewart: I mean, I'm a layman at this and in this market, I mean it's not my jam, but if I crank the lens out and just say in general, what are the key drivers for properties that you think are going to perform well versus struggle? And are there any rules or metrics that you've built? I mean, you've done this for years and years, and I'm sure you've got some tried and true guideposts that you'd stick with.

Greg: And this is not going to be earth-shattering, but you're seeing it really in this market, it's the experience of the borrower. And in the run-up to this, a lot of people quit their jobs and started working on these apartment renovations. I saw brokers, mortgage brokers get into the business. You saw a flood of people get into that apartment business because they saw the money that was being made there. And in most cases, back three or four years ago, you didn't even have to do a renovation at the property, at the apartment to see rents move up in a significant way. So you saw a lot of inexperienced people go into that space. And that's really where we're starting to see the stress is the inexperienced not-well-capitalized investors that they got into the space five, six years ago. You saw these people have YouTube channels, all the nightmares you can think of, and that's really where you're seeing the stress.

And this is when it really matters that you've got some experience because renovating an apartment or any kind of real estate, it's not an easy experience. You have to get a deal with the government. And in the last couple of years, you had to get workers, which has been hard. In some parts of the country, we found our borrowers couldn't find drywall, in other parts of the country they couldn't get windows. So you had all these supply chain disruptions that impacted it, and you're always going to have that in real estate. But if you've got that impact hitting you and then you're not very experienced. You haven't been through the war yet. We're seeing that as a real differentiator in how some of this real estate's performing.

Stewart: That's interesting. I mean, I'm a bond geek, right? And bond geeks, we're contrarians by nature. So, a lot of people are dealing with the challenges in the real estate arena, but it kind of makes my spidey senses perk up a little bit and say, when this is beaten up and everybody kind seems to be on one side of it. Is that the right time to be looking for opportunities? Someone said to me many years ago, well bought is half sold. So where do you see things getting beaten up, where there's opportunities? Is this the right time to start to look? I mean you mentioned the trough's going to be long, but what are some of the best opportunities going forward? And most importantly, why?

Greg: Sure where I'm seeing the smart money, at least in the apartment... And I'm going to move office off to the side because I'm not sure. I think there will be an opportunity in office. I have seen some funds get raised, rescue capital for office, and I think that could be interesting. I'm not sure if they might be a little too soon, but time will tell. Where I've seen a lot of the really smart money is on the preferred equity side, mez side, rescue type capital for apartments. Because you have Freddie and Fannie in the apartment side, the GSEs, they create a fair amount of liquidity in that space, whereas you don't have that in the office side. So I do think with some smart money purchasing some distressed apartments with those borrowers that are struggling, I think that could be very smart money going in right now.

If you're a good operator, you can get financing for it and then you can get the takeout financing either through a sale of the property obviously, or through a Freddie or Fanny takeout. And so I think that's where the opportunity lies. Back on office. I think there will be an opportunity there, and you're starting to see some of the smart money circle around that, but that's a little bit TBD, and that's a much different market obviously than the apartments. And so that will definitely play out differently than what the apartments will play out on now.

Stewart: And in what markets, in your mind, are the most attractive? I mean it's in the primary market, the secondary market. I mean why, and do you see your views on these markets changing down the road?

Greg: Yeah, so full disclosure, we were never big primary market players. Now we'll go into New York City, San Francisco, and those markets were especially attractive after the GFC. You could make a loan in New York City or San Francisco and you knew it was going to be okay. As we've gotten much further away from the GFC, we've kind of definitely pivoted back to the secondary markets. And we like the high growth secondary markets, Charlotte, Nashville, Salt Lake City, we've always been in those markets. And part of the benefit for us has been because we've been in those markets for decades, we kind of see the long-range history of these markets because when the tourists come in, the lenders that spend a lot of time in their primary markets, they're squeezed out and so they kind of go into those secondary markets. Sometimes they're not always aware of what is good relative value. Whereas for us, we kind of know what the relative value is because we've been lending in those markets for a long time.

And a lot of big investors don't like those secondary markets because they don't feel they're as liquid, that's the primary concern. And there's some truth to that. There's much more liquidity in New York City when the markets are going well than in a Salt Lake City. However, we just thought that's been our investment thesis and I think we're really going to track that. For our thinking now we're seeing some nice tertiary markets that are up-and-comers that I might want to be in as opposed to a slow-growing secondary market. You're seeing Santa Fe, you're seeing Albuquerque, New Mexico, Boise, Idaho. All you have to really do is follow where the U-Haul trucks are going. So when it costs the U-Haul truck $300 to go to Boise, Idaho, and $10 to go back to San Francisco kind of tells you all you need to know where the migration's going.

Stewart: Are there data providers that show the kind of information, those statistics and those data points that you're referencing?

Greg: Yes. U-Haul is a big borrower of ours, we have a great relationship with them. But I do think that information is out there in the public, but it just kind of tells you where migration's going and that's where we're following the real estate sometimes.

Stewart: Yeah, absolutely. I mean, that's really interesting. We haven't talked about industrial, as it relates to industrial Voya has been overweight in that asset class, according to my notes for over two decades. Why do you think this area is so attractive in the market and how have you seen this space transform over the last two decades?

Greg: Sure. We've always been big on industrial, and it might not be the prettiest industrial, it's just the stuff that pays. At the end of the day, we want to get paid back. And the reason why we liked industrial is it's not a very capital-intensive asset like an office or a hotel. And we saw this in the GFC where we had some loans that were very low leverage, but there were office buildings. And when the GFC hit in order for them to retenant the space, it was very expensive. In fact, the new dollars they were putting in were probably going to give them a negative return, especially if it was in a fund. And so they decided, I'm not going to retenant this office space. I'm just going to give the keys back. You're seeing the same thing go on right now.

Whereas on an industrial deal, it doesn't mean industrial is immune, but when a tenant leaves in a time of stress, pretty much you can sweep out the space and it's ready to tenant. There's not a lot of capital to it. Now, it's not quite that simple, obviously, but that's really the nature of that asset class. When there is a downturn to release it is not as expensive. And we've seen a lot of changes even in that market as we discussed about changes in the market. You're seeing a lot in that space now. Not only are you seeing the big bombers, but we really like the 50,000 square foot portfolios of industrial that might be a bunch of 50,000 square foot buildings in a bunch of different markets. We really like those portfolios quite a bit.

But now we're seeing the infill industrial, the old and ugly stuff that people thought were dead, they're being used now to solve the last mile issue with a lot of the logistics people. And we're seeing a second life for those deals. They don't have the 30 foot clear heights, however they're located, and they have big parking fields that allow the logistics companies to utilize them and solve that last mile problem.

And then finally, the other thing we're seeing in the market is I'm getting a lot of calls on open air storage. 20 years ago I called those parking lots. But we're seeing a lot of those once again to solve that last mile problem. So that's why we like the industrial and it's really kind of morphed and followed along where the opportunities have been in the market. So we just think it's a very flexible asset class that's really shown how well it's performed over the last two decades.

Stewart: That's fantastic. And if we can just wrap it up with, I mean, what are a couple of takeaways that you want our audience to leave here with today about your market and CMLs in particular?

Greg: Yeah, sure. I do think it has definitely hit a trough, I do think there's some good opportunities out there if you're smart about it. And I think these are opportunities that you didn't see outside of COVID. You saw a little bit of outside the GFC. I'm not saying this feels like the late '80s, early '90s, but I do think there could be some really good opportunities in the market based on the dislocation that's been out there. But I think if you stick to the high good quality assets, good operators, I think that area of investments is going to serve you well in the next 12 to 18 months.

And I think now's probably the time to take a little bit extra risk because you're just not seeing the rent growth. You kind of figure out where value is right now. And I think knowing where value is, as an old appraiser, that's really what you want to figure out. If you know where D is now, you can make educated guesses on where you want to invest in the market. And I think this market's kind of settled out where value is a little bit easier to ascertain. It was hard to figure out where value was two three years ago as rents were shooting up. It was hard in the last 12 months as interest rates are going up. But as things start to settle out, I think knowing where the valuations are shaking out will help you invest in this market in the next 12 to 18 months at prices that we haven't seen in a long time.

Stewart: This is fantastic. Thank you so, so much. These are great points and I appreciate it very much. We've got a couple of fun ones for you on the way out the door, you can choose either of them or both. Lots of our guests choose both. No pressure.

So the first one is, what's a good piece of advice that you've gotten along the way in your career that you'd like to pass along to your 21-year-old self? And the second one is, who would you most like to go to lunch with, alive or dead?

Greg: Sure. The first one is from my old boss, my mentor. And he told me when I was very young in my career, would you put your grandmother's money in this deal? And if the answer is yes, it's a good deal. If the answer is no, you probably shouldn't do it. And that was always a guiding principle. And it's even what we do now at Voya. We invest with other clients, we eat our own cooking. But really, would you put your grandmother's money in this investment was how I always thought about whether we want to put money in deals.

History-wise, I'm a history buff for sure. I got a history degree over COVID when I was a little bored. I just saw the Napoleon movie and I'd have to pick Napoleon and just figure out why did you make Waterloo, basically? So that was a good movie, and I would just want to get into Napoleon's head for sure to see what he was thinking and what he saw to go into Waterloo that last time.

Stewart: That's awesome. I really appreciate you being on. We've been joined today by Greg Michaud, who is the head of real estate finance among many other things at Voya. So Greg, thanks for being on. We've had a great time with you today.

Greg: Thank you. Good speaking with you today.

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