



# COLORADO REAL ESTATE JOURNAL

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## Road is leading to recovery

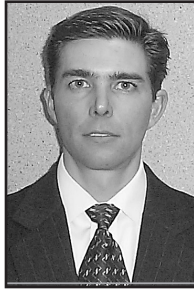
If only we could tap our red ruby slippers together and take ourselves out of this bizarre dream and return to the comfort of "home." We're not in 2006 anymore, Toto.

Of course it's been some time since 2006, the peak year, but mentally it seems to be taking us a long while to adjust from those days. Mid-2007 saw the initial stumbles of the debt market and there was quite a bit of adjustment and volatility in 2008. I'm predicting increased stability in 2009.

Mortgage rate indexes such as prime, LIBOR and U.S. Treasuries all have fallen greatly compared with 12 months ago. The most common index for long-term loans is the 10-year U.S. Treasury Bill. Jan. 1, 2008, it was 3.91 percent. Between January and October, the Treasury fluctuated between 3.5 percent and 4.25 percent. Day-to-day swings of 20 basis points or more was not uncommon. However, since Oct. 31, when the Treasury was 4.01 percent, there has been a downward trend. On Dec. 30, 2008, the Treasury was 2.11 percent; however, as of Jan. 6, 2009, it had increased to 2.47 percent. LIBOR has been largely decreasing, save for a spike in October. The 30-day LIBOR rate in January 2008 was 4.41 percent. One month ago it was 1.64 percent and today (Jan. 6) it is a mere 0.45 percent. Prime has fallen from 7.25 percent in January 2008 (it was reduced to 6.5 percent later in the month) to 3.25 percent today.

Last year started with most lenders still trying to do loans. The commercial mortgage-backed securities (conduit) lenders were hanging on, hoping the market would return. Within a few months, with virtually nobody buying the bonds, they started to disappear. Today, while a couple still try to hang on and wait it out, a handful of others are surviving by making Fannie Mae and Freddie Mac loans or funding loans with general account money. But by and large, the CMBS lenders are nonexistent today – a far cry from the dominating \$250 billion performance they tallied in 2006.

The burden has fallen on the banks, life companies and governments-backed agencies (Freddie Mac, Fannie Mae and Federal Housing Authority) to fill the void. In the beginning of 2008, most of the life companies were active and offering



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loans on well-performing stabilized properties with strong sponsorship. In the last few months the alternative investments to mortgages have impacted investment allocations. With corporate bonds returning relatively strong yields, around 8 percent these days, they are attractive to institutional investors. This negatively affects money available to make loans. As investors flock to these corporate bonds, pricing should come down, increasing funds available to make mortgage loans.

Also, 2008 brought some spectacular bank and corporate failures. Some of the biggest names in corporate America – Lehman Brothers, Bear Sterns, Washington Mutual, IndyMac Bank, Wachovia, AIG – are either gone, have been taken over or have been greatly helped by the government. The rumor mills remain active regarding who will take over whom next, or that is in trouble. But these failures have also created some opportunities for other institutions who were either very conservative in the past years and find themselves in a strong position today, or are new lenders without troubled assets dragging them down.

Overall, we saw our list of lenders, those that are actually closing loans, shrink to less than half the number we worked with in 2007. This fact alone affects things greatly. It is simply supply and demand. The number of lenders today is smaller than one year ago. Each lender has a greater number of loans to choose from. Thus begins the financial version of "natural selection" – only the strong survive – or get funded.

very competitive 10-year fixed rate money in the 6 percent to 6.25 percent range – certainly the best in the market at the time, and better than what we are typically seeing as I write this. As the year progressed they became more selective, funding primarily lower-leverage

Under these simple economics, it is only natural that each loan request will undergo greater scrutiny as lenders search for the best (safest) opportunities.

In a strong economy with great competition to put out loan dollars, as we saw up until mid-2007, lending can get sloppy because there is a mentality that the expanding economy will make up for any short-term deficiencies such as under-market rents or vacancy. Today, lenders are nervous about the economy and they know they are not competing as heavily for loans. Loan requests with perceived weakness in either the real estate or borrower strength may find the market challenging.

To get a loan closed in 2009 there are several things to keep in mind. Lenders are underwriting the real estate much more thoroughly. They want to see actual, in-place cash flow that meets debt-coverage ratio requirements, which still are generally 1.25 but we are seeing a range of 1.2 to 1.3. Lenders are not as open to "stories" about temporary vacancies or under-market rents. Lenders also are looking at the leasing strength of the property. What does the rollover look like? How likely are the tenants to be negatively affected (i.e., out of business) in this slow economy? Lenders may want to see financials on any major tenants. These factors are relevant to the takeover risk. Lenders want to feel comfortable that if they do a five-year loan, the property will be financeable at the end of the term.

Lenders are spending more time evaluating borrowers' financial strength as well. They are looking at global cash flow. They want to see that the borrowers have good income. They want to see if the borrower has any other properties that are draining cash flow and/or liquidity. Cash out has become much more difficult to obtain. Lenders do not want to use "their" cash for other lenders' "problems." Borrower liquidity has become even more important. More than any time in the last 10 years, having large amounts of liquidity is one factor, probably the biggest factor, that can help to overcome weaknesses in a financing request.

Interest rates seem almost to have taken a back seat to whether a loan can even get approved. Despite extremely low Treasuries and other

indexes mentioned above, rates in general have not followed. But that said rates are very reasonable these days. Lenders are pricing loans based on perceived risk, a specific desired yield regardless of where the Treasuries are, and/or supply and demand of money. In 2008 the majority of loans we closed were between 6 percent and 7 percent fixed for five to 10 years. I think 2009 will be the same.

Keep in mind there are always exceptions, even in this market. These are general rules of thumb and now – more than ever – every deal is being considered on a case-by-case basis. Particularly strong requests, for one reason or another, may be able to get better financing terms whereas "B" and "C" requests may need to make some compromises on loan terms compared with what they could get two years ago.

It likely will require more work to get financing in the next year. We need to work together to provide more information to lenders on the front end to get good quotes. We will need to provide full financials including liquidity verifications, three years' worth of complete tax returns, two to three years worth of property financials, and maybe more, in order to get lenders interested in the deal and provide accurate quotes. However, the important thing to remember is that loans are getting closed. Financing is available for high-quality, well-performing properties and strong borrowers. Loan committees are not getting easier yet – so using our relationships and providing good information will be of utmost importance. We will have to work with more lenders on each request to find the best fit. As mortgage bankers we will also have to work harder to keep our clients educated about the changing market because it is changing – in hopes of keeping expectations realistic.

We may not be in Kansas, err, 2006 anymore, but we're on a road. And I think it's leading to "Recovery," wherever that is. I don't know how long the road is. Frankly I don't care. What I do know is that business is getting done. And that will help our journey.▲