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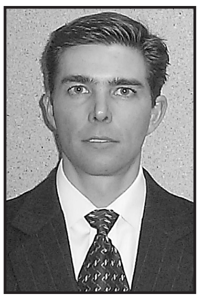
Trying to answer age-old question: Are we there yet?

You know the scene – the kids are in the back seat asking every few minutes, "Are we there yet?" You are driving along, the engine struggling as you climb the mountain passes, passing certain landmarks, and it seems to be taking forever to get anywhere – but, yes, you are getting closer! "Just a little while longer …" you answer.

So, are we there yet? Well, where is "there"? Let's take a quick look at where we were, where we are, and see if we can see where "there" is.

Taking a brief look back at 2008 and 2009, the lending market was, for the most part, dismal. Life companies were looking for perfect loans: low-leverage, Class A assets, strong sponsorship, and on top of that they wanted higher yields. Then, as corporate bond yields rose, most life companies started allocating more investment dollars to bonds instead of mortgages. A few life companies maintained volume by funding some large loans to real estate investment trusts, which historically had been going through the conduits. In 2008 and 2009, the commercial mortgage-backed securities market was virtually nonexistent. It certainly was a nonfactor for anybody but the largest borrowers as the few loans that were funded were gigantic single-borrower securitizations (for example, a $400 million loan to a single borrower on its portfolio of office properties nationwide). Banks were fairly active; however, regulatory pressure put a damper on their lending practices. On one hand, the banks wanted and needed to lend; on the other, government regulators were raising capital requirements, restricting their capacity. Fear played a part, too. Lenders didn't know when the bottom of the market would occur, and how much values would decrease, and these fears made loan committees more conservative. In general, the majority of people getting loans during that time were people who



Brandon Rogers
Vice president, Terrix Financial Corp., Denver

didn't have much choice. The biggest exception was apartments. Interest rates provided by the agency lenders (Fannie Mae, Freddie Mac and the Federal Housing Authority) had been incredibly low. This, combined with little competition from life companies and conduits, and a fairly strong multifamily market (certainly here in Colorado), kept them extremely active – more active than any other type of lending institution.

The turnaround started in late 2009. Corporate bond yields declined, making mortgages a more attractive investment for life companies, and a multiborrower securitization was completed. It is still more difficult to get loans closed, and overall loan volume is still down considerably, but these positive changes have led to 2010 being significantly more productive than 2009. Most of the loan volume has been refinance business but, as the debt market continues to improve, purchase transactions should pick up.

Today, every life company that we represent or work with is in the market and actively lending. They have been all year. Life company loan volume is up from 2009 significantly (some of our life companies blew through their billion-dollar allocation by September), and many life companies anticipate a similar or better 2011. While, in general, the life companies are still limiting leverage to lower levels than during the boom years, it is slowly creeping up. Interest rates are very attractive right now. Ten-year fixed rates start around 5 percent at full leverage (65 percent plus loan to value) and nonrecourse loans are available.

The CMBS world is where the biggest changes are coming. The CMBS market reached volume levels of around $230 billion in 2006; however, volume in 2009 was only about $2 billion and predictions for 2010 (at the time of this writing) are about $5 billion to $7 billion. These are small numbers, but the reason it is big news is the return of multiborrower securitizations, rather than the single-borrower executions that took place in 2009. This is a huge step in the right direction because it is bringing loan sizes down, making them more accessible to more investors. At the time I'm writing this, several lenders are coming out with "small" CMBS loan platforms with minimum sizes of $5 million, down from the $15 million minimums we were seeing for the last year. And already we are hearing about plans to bring the minimum even lower in early 2011. Today's CMBS underwriting standards are similar to those of 2002, more conservative than during the crazy days of 2006-2007. Today we see leverage, realistically, up to about 75 percent, underwriting actual in-place rents instead of future rents and industry standard 1.25 debt-coverage ratios. In exchange for a longer amortization (30 years) and higher proceeds (up to 75 percent, maybe 80 percent vs. 65 percent to 70 percent), the conduit loans likely will have slightly higher rates and larger prepay penalties than life companies. The re-emergence of the CMBS market will be crucial in providing needed capital to the commercial real estate market.

The agency lenders still offer the most competitive terms on apartment loans. They have the lowest rates, highest LTV and nonrecourse. While the agencies have come under quite a bit of criticism, and some politicians have gone so far as to call for them to be dismantled, it is unlikely there will be many significant changes in the next 12 months. Anticipated small changes include elimination of some "prereview" markets and a lowering of the underwriting rate minimums. Fannie Mae and Freddie Mac will continue to compete with each other, keeping them efficient and cost-effective. The agencies, with 10-year fixed rates under 5 percent and leverage up to 80 percent, have been the biggest bright spot for loan production.

The banks were busy during the past couple years, unless they were under cease-and-desist orders. Today, however, while still very active, their volume is down for a few reasons. One reason is competition from life companies. Another reason is a lack of quality loan requests. On the property side, occupancy and collected rents are down and, on the guarantor side, it's not uncommon to see reduced income, net worth and liquidity. These issues make doing some loans very difficult, despite the banks desire to book new loans. The area where banks are most aggressive is owner-user properties because they do not count against their capital reserves as much as investor property loans. Assuming no big changes come from the Office of the Comptroller of the Currency, 2011 should look similar to 2010, in terms of both underwriting standards and loan volume, although the banks will face even more competition.

So if by "there" we are referring to the heyday of 2006, I think we may be on a never-ending road. But if we can accept that we've been re-routed to a new destination, one where underwriting and loan terms are more conservative, yet still evolving, I think that with life companies up and running and conduit lenders coming back, we're almost there. It isn't quite as carefree and crazy as before, but it's probably safer in the long run.▲