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Commercial real estate lending in 2016: Risk on, risk off! - by Ernest DesRochers

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William Sloane Coffin once said, “All of life is an exercise in risk.”

The real estate industry is a business where the great optimism of rising markets can be quickly replaced by the pessimism of contracting markets. From the loud crash in 2009 to the extraordinary recovery of the past several years we have been witnesses again to another cycle. My experiences have shown that when commercial property markets recover they are stronger and more dynamic than the previous cycle and much different.

As we begin 2016 the risk on optimism of the previous few years is being replaced by a more conservative risk off sentiment not seen in lending in some time.

There are several takeaways from year-to-date 2016 which support my premise:

• Life insurance company lenders, long the bell weather for market trends are competing aggressively for lower lower-leveraged, higher-quality, best-of-class mortgage loans, eschewing risk for safety. They are eschewing high leveraged deals for fear of refinance risk.

• The CMBS has ground to halt after having a strong year in 2015. Spreads have widened substantially year over year, market volatility has become severe, and there is increased concern about deteriorating credit quality of loans. Very little lending is going on in that space year to date.

• The market for commercial property sales appears to be slowing down as more and more market participants believe prices have peaked nationally and in the Tri-State region.

• Other capital sources who provide fuel to the lending market are the GSEs consisting of Freddie Mac, Fannie Mae, and FHA. They are the most active multifamily lenders in the country however they too have a more measured approach to lending.

• Regional banks and credit unions are tightening underwriting on account of new regulation and economic concern. They will take more risk generally because of their recourse requirements.

Underwriting parameters are now more conservative than in years past. Insurance companies are generally quoting spreads of 175-200 over U.S. Treasuries for sub 65% loans. The minimum debt coverage ratio is generally1.50x assuming a 25 year amortization schedule. Available loan terms are generally 7-10 years with longer fully amortizing loans (up to 30 years) available on a select basis.

In contrast, pricing for conduit loans are generally 300-350 over swaps with loan to value ratios of 70% or less. These loans generally require full leasing reserves. Generally these loans are 10 years in length with 30 year amortization. Some interest only may be available if the property warrants.

Multifamily lenders continue to have strong deal flow but they too have gotten more conservative. Pricing is generally 200-250 over US Treasuries depending on leverage and DSC ratios are a minimum of 1.35x. Loan terms are generally 5-10 years.

In common with all of these lenders is the desire to maintain discipline with respect loan underwriting metrics. As capital continues to chase the best deals, lenders are holding to debt yield, LTV and debt service constraints, and are insisting on getting paid for risk.

With the second quarter about to commence, the optimism that we have seen in the past has been replaced by conservative underwriting as the national economy deals with potential issues that have not been seen in a while. Investors with financing needs will have to meet these challenges head-on in order to achieve desired financing levels. NorthMarq Capital, LLC, and its network of 36 offices, have the lending resources to help our clients meet these challenges daily.

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