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## **Individual relationships between intermediary, borrower and lender are our businesses lifeblood**

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Well into the first quarter of 2010, financing provided by life insurance companies and other non-recourse lenders are following a distinct "barbell" shape. On one end of the spectrum, lenders are offering loan-to-values of 65% or less for quality assets, with strong sponsors and cash flow. On the opposite end, for more transitional properties, loan structure and leverage dominates over cheaper pricing. Today higher leverage deals are underwritten to high single digit debt yields, while it is not uncommon to encounter minimum requirements in the 12-15% range. This metric is a direct result of the lack of comparable sales on which to base an opinion of value and distrust in appraisals during underwriting. Similarly, sales of REO or poorly leased assets are settling for prices that are a fraction of replacement cost with almost no recognition of upside potential. In short, cash flow wins over intrinsic or qualitative value, as it represents the only quantitative value.

At this time last year, the 10-year Treasury yielded 2.54% and Corporate Triple B yields, the traditional benchmark for commercial mortgage debt, had blown out to 573 basis points (bps). At the same time, non-recourse first mortgages were priced in the upper 7% range. Today, although the 10-year has risen to 3.64%, Corporate Triple B yields have decrease 349 bps to 224 bps, or 61%. Commercial mortgage credit spreads have followed suit dropping more than 200 bps. The overall effect is a reduction in ten-year rates of approximately 100 bps into the low- to mid-6% range. The reasons behind this movement include a reduction in fear (or increase in risk tolerance), increased competition driven by reallocation of investments and deployment of cash.

The elephant in the room is the overwhelming volume of pending loan maturities that average a billion dollars a day and many are leveraged beyond an amount that may be refinanced on a conventional basis. This, and the earlier barbell analogy, foreshadow two likely developments. First, look for participating debt programs from life companies, pension funds and other non-bank balance sheet lenders to provide one-stop shopping for higher leverage in exchange for a meaningful stake in the equity upside. This, combined with the difficulty in building a multi-layered capital stack, and the compelling rationale for investing in commercial real estate, should lead to participating debt options multiplying in 2010. Nonetheless, the window for lenders to implement this strategy maybe limited if debt markets continue to improve.

Second, expect loan-to-values (LTVs) to push higher with greater competition. Earning pressures are creating more liquidity and as yields on alternative investments such as corporate bonds decline, commercial real estate loans look more attractive. There is already evidence of LTVs pushing higher as life companies face competition from one another for low lying fruit and as they lose solid deals to debt funds offering higher leverage at higher yields. After all, if yesterday's 75% LTV loans are now north of 100 percent, today's 75% LTV deals are likely to become tomorrow's low leverage portfolio loans. Considering the increased supply of permanent money re-entering the market, it's not a bad

time in the market cycle to stretch a little for quality deals and sponsors. It will be interesting to see if the new supply of capital will get utilized with current lending parameters.

Going forward, though CMBS is largely broken, look forward to more CMBS lenders re-entering the market. Our money is on Wall Street to figure out how to re-introduce securitization as a profitable lending vehicle, but it may well follow, rather than lead, the commercial real estate recovery. However, with several single-borrower securitizations under their belts, look for a few multi-borrower and multi-asset securitizations this year.

Also, expect a higher volume of low basis acquisitions as lenders shed real estate owned. The internal formation of REO and asset recovery functions within institutions has led to a shifting of originators and underwriters to work out functions. Some institutions may opt to accept more pain sooner, and where feasible, to position themselves to be relevant to the new originations market coming out of this portion of the cycle. Given the potential for low basis acquisitions to drive market rents lower, don't be surprised if more lenders choose to sell off assets without a clear cut path to resurrection.

Underlying these observations and our view going forward is a renewed sense of importance in our relationships. The relationship between the borrowing community and the lending community has fractured, and as a result, many borrower/lender relationships are broken or torn. However, the individual relationships between intermediary and borrower, and intermediary and lender remain intact and the lifeblood of our business. For Colliers Meredith & Grew, an opportunity has presented itself to leverage these relationships to the bridge both parties' needs.

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