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Leaders react: Investors compel tighter underwriting

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*Volatility in the Debt Markets *Are CMBS Delinquencies Too High? *Quiet Market but Plenty of Tension *Has Lending Peaked? *How Credit Got So Easy and Why It's Tightening *Complacency, Panic Whipsaw Credit Markets *Credit Crunch Takes Its Toll *Toxic Debt

How many headlines can the public digest? How much more educated are we about the 'credit crunch' now than 6 months ago? To what degree are we much more in tune with the concept of market liquidity? To what level are we willing to investigate the importance of the credit?

It has been a long summer of banner titles that cry out to the market about the delicate balances between credit, underwriting and the liquidity of the market. Those of us in commercial real estate finance have been aware that the underwriting, in commercial mortgage backed securities, of earlier this year could not continue. The abrupt changes to interest only loans and debt service coverages based on those interest rates only were bound, given reason, to have a rebound effect in the market. Fashioning the underwriting on prospective, future, proforma rents was too aggressive. But the pools continued to get sold on Wall Street, that is until March and April.

How long were the A and B piece buyers going to swallow the methods of underwriting being used in the CMBS financial world? It was only for a matter of time, and yet these less and less rigorous elements of commercial real estate finance underwriting prevailed for the better portion of the first six months of this year.

Those days and those means of underwriting have come to a screeching halt. And why not?

Wouldn't the manners and standards of CMBS underwriting commercial real estate loans, have lead to their comeuppance in somewhat the same fashion as the residential sub prime loans? Non-amortizing loans in ten years could be the subject of their own "crisis" if cap rates increased along with rates.

After all, the pragmatics of underwriting in the subprime loans was relaxed. Another culprit in the subprime crisis was the push to increase product.

Commerical Real Estate CMBS Lenders/Originators were repeatedly bemoaning the fact that they were losing product to their competition. If they did not lose product because of aggressive quoting, they were hard-pressed to understand how any Lender could make any money with the rates and terms in the marketplace.

The secondary market has now put a stop to it all.

Quote spreads are increasing daily without any true internal understanding/knowledge of where the spreads would be the next day or for how long a quote would be good. The best indicator of the market is witnessing the success and failure of various pools as they went to market.

The debt service coverage ratio has increased, going back to the familiar 1.15x to 1.25x and then increased to be over amortizing constants. Now quotes are pretty much only immediately accurate with CMBS Lenders making clear that the MAC clauses (material adverse change) are in full use.

Rate locks do not necessarily mean what they say.

Comforting news is that CMBS underwriting is getting back to more of the market "basics"; and, the other sources of financing are becoming attractive and competitive again. Many Borrowers are seeking shorter term, i.e. five year financing, from non CMBS financing sources that use the five year Treasury as an index. Doing this now, before any significant erosion in cap rates, will preserve the most loan dollars, while providing comfort to the Borrower who needs to refinance or finance during these tumultuous times.

Another positive is the reduction in the most common indexes for rates, the five and ten year Treasuries, that have fallen considerably (about 75 bps) since the CMBS spreads have widened, taking some of the sting out of the spreads that have increased as much as 120bps over what they were just months ago.

All this being said, I have secured several sub 6% quotes. Interest only is still available for the lower leveraged transaction that has good bells and whistles.

Finance has not come to a halt. The market is not dead. It has just gone "back to the future" in some respects. Good luck at keeping-up with all the news in the industry. These are exciting times!

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