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Commercial real estate lending: Words from a founding father

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Benjamin Franklin once said "If you would know the value of money, go and try to borrow some; for, he that goes a borrowing goes a sorrowing." He also said that "the great part of the miseries of mankind is brought upon them by false estimates they have made of the value of things."

Those quotes made by Poor Richard, Franklin's nom de plume, some 250 years ago have never been truer than in the past two years. The availability of commercial real estate loans has virtually been non-existent as lenders dealt with economic conditions not seen since the 1930s. Severely deteriorated commercial property fundamentals characterized by decreasing rents across all property types; declining property values; and a continued increase in commercial mortgage delinquencies all significantly contributed to a lending market that has been virtually shut down.

With the fourth quarter about to commence, we are finally beginning to witness a nascent recovery in the commercial real estate sector. Through the first half of 2010 the majority of capital available for new mortgage loans has been very much focused on primary markets and on quality low leveraged assets. Property values have declined by 30% to 40% from peak pricing in 2007; however, there is increasing evidence that prices of core Class A assets in coastal cities like New York and Washington D.C. have recovered a significant amount of the value they lost during the Great Recession as both of these cities benefited from a flight-to-quality.

The dollar value of commercial property investment-sales activity in the first half of 2010 was over three times greater than a year ago. Large transactions and portfolio sales, which were few and far between in 2009, have returned. According to the Mortgage Bankers Association, second quarter commercial and multifamily mortgage loan originations were 1% higher than during the same period last year and 35% higher than during the first quarter of this year. At NorthMarq Capital we have seen a steady rise in loan volume over the past two quarters as our new loan activity is up even more. Capital contraction has ended as lenders have begun to return to the marketplace. The vast majority believe that commercial mortgage delinquencies and pricing have finally stabilized. Life insurers, CMBS conduits, Government GSEs and banks are all in the market and lending at rates that are at extremely attractive levels. For property loans of \$3 million and more, borrowers have capital available to them that hasn't been seen since early 2007.

For borrowers and lenders, this will provide some interesting opportunities and challenges. The lending market has become bifurcated especially in the multifamily sector where 80% sub 4.5% loans are available. However, for the balance of the commercial sector, conservative underwriting reflecting the deleveraging of the economy that began three years ago has become the norm and will continue to be that way for the foreseeable future. Life companies generally will provide leverage of 65% and less with generic pricing for 5-10 year term mortgages ranging from 4.5% to 5.5% with amortization of 25 years. Values this year have been generally determined using direct capitalization

with capitalization rates of 8% or greater for most non-CBD or multifamily property types. There is a general sense that as the economy improves capitalization rates will compress further. Banks will provide greater leverage though they often insist on some percentage of recourse. Pricing is generally in the same range as insurance companies.

Investors with financing needs will have to meet these challenges head-on in order to achieve desired financing levels. NorthMarq Capital, Inc. and its network of 32 offices have the lending resources to help our clients meet these challenges daily.

Ernest DesRochers is senior vice president and regional manager, Metro New York regional office, for NorthMarq Capital, Inc.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540