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Commercial Mortgage Backed Securities heats up in capital markets: reprinted from appraisalinstitute.org

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With the April 17 due date looming for finalization of the risk retention rule mandated by the Dodd-Frank Act, the Commercial Mortgage Backed Securities (CMBS) market has become tumultuous as issuances grow and the regulatory environment continues to be uncertain.

While debate amongst rule makers has mostly centered on the definition of a qualified residential mortgage, there has been less said about the impact of the forthcoming risk-retention provision on the rapidly recovering CMBS market. According to a March 15 story in the Bureau of National Affairs' (BNA) Banking Report, about \$10 billion in CMBS was issued in 2010, with more than 60% of that total priced in the fourth quarter, and several more CMBS issuances have reached the market early in 2011 or are in the Wall Street pipeline.

Tom Deutsch, executive director of the American Securitization Forum, told BNA that the influx of new CMBS issuances may be because the Dodd-Frank deadline is not yet in effect and many investors may be trying to get those deals done before they will be impacted by the provisions of the act. Improved confidence in the market, however, may be attributable to the fact that there are "highly sophisticated parties doing an extreme amount of due diligence on the underlying assets in those transactions," he added.

Additionally, "there is a demand for product in the commercial sector, and investors feel very comfortable with that, given that there is an increased level of disclosure and an ability to perform more due diligence on assets," Brendan Reilly, senior vice president for government relations at the Commercial Real Estate Finance Council, told BNA's Banking Report.

While recovery was initially founded on conservative loans, more recent deals have quickly turned toward the less conservative according to Standard & Poor analysts who warn that "the caution flag is out for CMBS" in the Feb. 24 report, "CMBS 2.0." According to the report, increased competition, steady cash flow underwriting and some aggressive appraisals is driving the trend toward less conservative deals.

Specifically, S&P analysts warned investors to be on the lookout for appraisals that appear to be "reaching," counseling that "value per square foot is a good way to compare properties within (and even across) markets. It's also good to evaluate whether a loan's total debt has come down as much as one would expect it to when it comes up for refinancing, especially loans from the 2005-2007 period. Also, relatively low appraisal cap rates may indicate that the appraiser is building in cash flow upside and that the lender is (ultimately) lending on it."

The precise impact of Dodd-Frank on the current state of the CMBS market remains uncertain as debate about its specifics and definitions continues among policy makers. According to BNA, agencies such as the Commercial Real Estate Finance Council have been working to inform the regulatory process, offering best practices to guide criteria for underwriting standards and controls

and representation and warranties that would obviate the need for originators, issuers, or investors to hold part of the risk in a CMBS. These best practices are expected to be released at the same time as the risk-retention proposal and will be available during the ensuing comment period, noted BNA.

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