

By Ernest DesRochers - Commercial real estate lending and the human species

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The English essayist Charles Lamb once said "The human species, according to the best theory I can form of it, is composed of two distinct races, the men who borrow and the men who lend"! He also said wryly "I always arrive late at the office, but I make up for it by leaving early".

Those quotes made some 200 years ago have never been truer than they have been during 2011. After three years of little or no new lending activity the availability of commercial real estate loans increased in all lending sectors in 2011. According to the Mortgage Bankers Association's (MBA) Quarterly Survey of Commercial/Multifamily Mortgage Bankers Originations, second quarter 2011 commercial and multifamily mortgage loan originations were 107% higher than during the same period last year and 52% higher than the revised figures for the first quarter of 2011. More importantly overall increase in commercial/multifamily lending activity during the second quarter of 2011 was driven by increases in originations for all property types. Health care, hotel, retail, and multi-family lending were all up over 100%. Office lending was up over 50% and industrial lending was up over 30%. Among investor types, loans for CMBS conduits saw an increase of 638% compared to the second quarter of 2010. There was also a 150% increase in loans for commercial bank portfolios, an 87% increase in loans for life insurance companies, and a 58% increase in loans for Fannie Mae and Freddie Mac.

Our own experience at NorthMarq reflects these statistics pretty closely. Our correspondent lending programs for the first half of the year were relatively disciplined as institutions focused on high quality underwriting using market rents and capitalization rates that reflected long term averages. These resulted in quality lower leveraged loans across all property types. Unlike the past three years money started to flow to high quality middle market locations like Austin, Tex. and Minneapolis, Minn., and Phoenix, Ariz. Core cities like New York, Boston, and Washington, D.C. still benefited from lenders' desire to be in secure high barrier to entry markets.

With the fourth quarter about to commence there is a large yellow caution light in the commercial real estate sector. While the first six months of 2011 was all good news, dark clouds began forming in July and August. Economic activity in the U.S. and globally has ground to a screeching halt exemplified by no new net jobs being added to the economy in August. The CMBS market has pulled back because of volatile conditions in the bond market. CMBS spreads widened out dramatically during August due to investor and rating agency concerns on new issues. In fact the investor pullback over the past 30 days looks like the new-issue market for CMBS is going to end 2011 like 2010, very quietly. In addition, risk taking by lenders is still measured in that they are increasingly worried about downside risk on account of lease rollover as the economy flirts with potentially another recession.

For borrowers and lenders, the fourth quarter will provide for some interesting opportunities and

challenges. It is very likely that lending volume will be down in both the third and fourth quarters of 2011 as lenders react to a slowing economy and become more selective. One may find folks arriving late and leaving early!

Lenders have expanded their geographic reach this year especially in the multifamily sector as 80% sub 4.5% loans have been available throughout the year. For the balance of the commercial sector expanded geographic lending is evident. But so is the conservative underwriting reflecting the deleveraging of the economy that began three years ago. This continues to be the norm and will continue to be that way for the foreseeable future. Life companies generally will provide leverage of 70% and less with generic pricing for 5-10 year term mortgages ranging from 4.25% to 5.25% with amortization of 25 years and in some cases 30 years for newer product. Values this year have been generally determined using direct capitalization with capitalization rates of 7% or greater for most non-CBD properties. There is a general sense that even though capitalization rates have compressed below 7% banks and insurance companies are reluctant to value properties beneath that except for core locations such as mid-town Manhattan and Washington, D.C. Banks will provide greater leverage though they still often insist on some percentage of recourse.

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 32 offices have the lending resources to help our clients meet these challenges daily.

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