nerej
CELEBRATING 55 YEARS

# A reset in ownership will present an opportunity for structured finance and cash flush buyers

March 28, 2012 - Spotlights

The Mortgage Bankers Association of America finished its annual commercial real estate finance conference. The conference was filled with optimistic lenders from bankers to conduits to life companies. During the course of the four days of meetings, it was clear that every lending sector expects to have more money available to invest in real estate debt (first and second mortgages and mezzanine) and equity (joint ventures, participating debt, fund investment and acquisitions). The optimism was tempered by concern over an impending wave of CMBS refinancing, the economy and lack of job creation, the uncertainty in Europe and the largest expansion of government spending and regulation since the depression.

The concern over the refinancing wave cannot be overstated, as most maturing loans will have difficulty bridging the gap between today's leverage levels and underwriting compared to the undisciplined days of the past. The additional equity required to underwrite those maturities will lead to a restructuring of the capital stack with many borrowers unable to retain ownership. A reset in ownership is unavoidable for those who took advantage of a frothy market to over-leverage. This presents an opportunity for structured finance and cash flush buyers that may not be equaled for years to come.

The competitive return advantage that commercial real estate now enjoys over other investment vehicles is leading most chief investment officers to loosen the reins on real estate professionals. Investment philosophy varies among the professionals with some reluctant to lock in yields that can only be classified as historically low. Others seem concerned only with asset and liability match and are willing to go long. There is mortgage capital available for terms varying from 3 to 25 years and equity investment available for core, core plus and opportunistic deals.

Mortgage spreads declined over the course of the convention by at least 25 basis points and seem headed even lower as competition for the best deals increases. Few seemed concerned over the lack of quality real estate available for financing. While loan to value seems headed north towards 75%, most lenders continue to believe that there will be sufficient product in the 60% to 70% range to allow them to meet their goals. Frankly, that seems unlikely, and loan to value is destined to creep upward over the coming year. Another nuance is the return of the forward commitment with some Life Companies willing to go out as far as twelve months with added spread of between 4 and 9 basis point per month after a free 90 days.

CMBS is attempting a much needed comeback but projections for 2012 remain well below the boom years of the mid 2000s, volume is expected to range between $30 and $60 billion. There were over 20 conduit players in attendance. Rates for new CMBS deals are below 5% and money is available on both a fixed and floating rate basis. While Dodd/Frank continues to hang like the Sword of Damocles over the market, at first blush there seems to be little reason to expect improved discipline on the underwriting front and nothing has yet been mentioned by industry leaders about the now exposed flaws in the servicing of CMBS. "Caveat Emptor" should be the watchwords for borrowers seeking CMBS execution. With all the talk of a rebound, overall levels of CMBS funding remain anemic.

The volume of special servicing is still at a cyclical peak of nearly 10%, and Industry experience is that principal loss ratios of loans in special servicing approach 50%. Any borrower with misfortune to deal with a special servicer understands first-hand how badly the system needs reform, but there is no discussion about what needs fixing.

Q10 New England Realty Resources' merger into NorthMarq Capital is now complete and we are pleased to be on the team. The NorthMarq brand is among the most respected in the industry for ethics, integrity and innovation. Our combination with NorthMarq brings new tools, which will allow us to compete more effectively in the multi-family financing market as we now represent Fannie Mae, Freddie Mac and FHA. In addition, we have added the respected names of John Hancock, Sun Life of Canada and Allstate to our correspondent list. We represent more lending sources than any mortgage banker in the New England market and are confident that we are better able to serve any real estate capital needs.

James Murphy, CRI, CMB, is senior vice president and managing director of NorthMarq Capital, Boston.