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The gradual inclusion of recourse into standard loans

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While the commercial real estate community continues to wait to witness the evolution of the CMBS market, changes to its lending platform and how it will re-cast itself going forward we anticipate significant alterations to what was the 'standard' commercial real estate loan as we know it today. With loan volume estimated to be running through CMBS lenders at 10% of volume last year, what is getting written has been impacted by changes in underwriting.

An already apparent change has been the cutback in loan to values, which has put constraints on the loan amounts available to borrowers. Underwriting has become more intense, as a result of the 'spin' surrounding residential mortgage underwriting. Aside from dealing with these elements, the market is also contending with the increase in expenses due to costs and the slow increase in capitalization rates.

But of all the actual or anticipated changes to the current financing marketplace, the most daunting is the gradual inclusion of personal recourse into standard loans. The Wall Street Journal, The New York Times, the internet commercial real estate news outlets and real estate blogs are filled with the mourning of the passing of once standard non-recourse commercial real estate lending.

Recourse, an relatively standard component of bank commercial real estate loans in the past, and an factor rarely seen in CMBS financings up until last year, had been abandoned with the inclusion of funded reserves and less stringent underwriting. Today, personal recourse can be included into the terms of some of the most mundane of loans, which are by no means riskier or concerning than those of the recent past.

Banks are unwilling to further expose their balance sheets to the risk. Life Companies often offer the 'higher caliber' property non-recourse terms, but the loan to values on these transactions is quite conservative. Mezzanine loans are carrying recourse with them and construction loans are adding recourse to completion guarantees. If cash out financing is obtainable, and it is for the loan requests with a good narrative, then recourse is often an constituent of the deal, due to the fact that it is a cash-out situation.

CMBS lending has ground to a halt, and the lenders filling the gap, most especially banks, are holding to the traditional loan platforms which include recourse, either fully or for levels of financing above a certain threshold loan to value. For those needing to re-finance debt coming due now, sometimes the only answer is to accept a loan which has a level of recourse to it. Two scenarios which can limit the impact of taking a recourse loan are; to shorten the term of the loan, and/or negotiating the prepayment terms and penalties. Each of these alternatives anticipate the eventual change in the financial marketplace and an easing of the liquidity crisis.

Non-recourse loans are available, but not on the generous terms of loans of yesteryear. But sights and aspirations of the Borrower have to be curbed to incorporate the reality of what can be accomplished today.

An alternative for the Borrower who has cash and must make a deal is to personally add to equity in the transaction prior to financing (thereby limiting the personal guaranty) to bring down the loan to value ratio to a level that the lender will consider it conservative enough to negate the necessity of recourse.

The fact is that personal recourse, a thing of the past generally, may now be an element of the present and near future. The bottom line remains that the commercial real estate market awaits the regeneration of commercial real estate financing facilities which will be non-recourse in nature.

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