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Outlook for commercial real estate finance - Plenty of capital still available in 2019 - by Michael Chase

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Investors and borrowers in U.S. commercial real estate have enjoyed a long run of economic growth, healthy fundamentals, rising values, and low interest rates. During this run, a new year is typically marked with lenders armed with fresh allocations eager to begin investing in mortgages. While there is still expected to be plenty of capital available in 2019, some lenders have been a bit more cautious out of the gate. Global economic concerns, a partial government shutdown, and general market volatility have resulted in lenders trying to seek out where debt pricing should be to start the year. However, uncertainty provides opportunities for borrowers able to take advantage of the recent dip in U.S. Treasuries along with a relatively flat yield curve.

Plenty of Capital Still Available

The Mortgage Bankers Association recently published its Commercial Real Estate Outlook Survey 2019. The report notes, "A majority of respondents expect lenders' and borrowers' appetites to remain strong in 2019." Amongst the various lender groups, the report states, "The greatest growth is expected from alternative lenders like mortgage REITs and debt funds." The bridge-loan market remains a crowded field with Commercial Mortgage Alert currently tracking no less than 150 firms originating bridge loans of at least \$10 million, with many more below that threshold.

The soft spot for commercial mortgages to start the year appears to be the CMBS (Commercial Mortgage-Backed Securities) and CLO (Collateralized Loan Obligations) markets. Domestic CMBS volume tailed off in the fourth quarter, resulting in total issuance of \$76.1 billion for 2018, which was below the \$86.4 billion placed in 2017. Recent volatility in the bond markets has resulted in a significant widening of spreads, making new originations more costly for borrowers and less profitable for originators. Commercial Mortgage Alert recently reported how an inadvertent European Union risk-retention rule is adding to near-term uncertainty. While regulators work to resolve this issue, the securitized debt market is hoping a new year with new investor demand will help to tighten spreads.

Commercial banks and thrifts have seen their balance sheets swell with commercial mortgages. While regulators continue to keep an eye on institutions with rapid growth in their commercial mortgage portfolios, banks and thrifts are expected to remain active in 2019. A rollback of Dodd Frank was passed in mid-2018; however, regulators have yet to provide banks with clear guidelines on the reform of HVCRE rules. The lack of guidance, along with where we are in the current market cycle, will likely result in continued caution in underwriting construction financing requests.

Life companies and other institutional lenders remain active. They tend to cherry-pick the best deals but will price accordingly with some of the most competitive rates amongst the various lender types. However, it would be incorrect to pigeonhole all life companies together. Many firms augment their typical loan programs with bridge, construction-perm, joint venture and participating debt programs, just to name a few. Meanwhile, they remain the primary option for borrowers seeking to manage interest rate risk with either forward commitments to lock in interest rates up to 12 months in advance of a closing, or long-term, fixed-rate financing out to as far as 30 years.

As always, Fannie Mae, Freddie Mac and FHA will remain a key source of capital for multifamily transactions. The agencies continue to make adjustments to existing programs as well as introduce new initiatives, particularly those designed to support workforce and affordable housing.

Preferred Assets

While there are some concerns of valuations hitting their peaks in some property types, multifamily and industrial have remained the assets of choice throughout 2018 and heading into 2019. Retail continues to evolve with lenders maintaining a preference for grocery-anchored and service-related centers. Office and hospitality loan volumes grew in 2018. Lenders continue to keep an eye on re-leasing costs and capital improvement programs, which impact these assets classes more than others. While near-term rollover is always looked at, lenders will be particularly focused on transactions that involve potential cash flow disruptions over the next 18-24 months given the current uncertainty for 2020. Meanwhile, capital for Opportunity Zone Investments and assets with ties to a growing marijuana industry will likely continue to grab headlines throughout the upcoming year.

Interest Rates

Few predicted where rates ended at the close of 2018. The 10-year U.S. Treasury started the year at 2.46%, and after hitting a peak of 3.24% in early November, declined to finish 2018 at 2.69%. Global economic concerns and an eye toward a potential domestic downturn in 2020 have conspired to hold long-term Treasury rates in check. The Fed said it will take a more cautious approach to raising the benchmark interest rate during the coming year while continuing to shrink the Fed's balance sheet. As of this writing, there have been signs of a turnaround in oil markets and potential progress on a U.S./China trade agreement. If a compromise is reached to reopen the partial governmental shutdown, rates may once again begin to climb modestly.

Meanwhile, the spread between the 2-year and 10-year Treasuries has been hovering around 15 basis points, and the spread between the 2-year and 30-year Treasuries is about 50 basis points. For long-term investors, fixed-rate terms well beyond 10 years are available for relatively little

additional rate.

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