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Positive signs in the commercial real estate sector indicate sound investment and lending will continue

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Chin-Ning Chu, the business author, international lecturer and consultant said, "Without the strength to endure the crisis, one will not see the opportunity within. It is within the process of endurance that opportunity reveals itself."

The current credit crunch, which began in mid 2007, has deepened in response to slumping conditions in the world economy. Large commercial banks and Wall Street firms are originating new loans at a fraction of the loan volume they did from late 2006 to early 2007. According to numerous industry sources, Wall Street investment banks have failed to securitize even a single dollar of collateralized mortgage-backed securities this past summer. Though some firms say they are lending, Wall Street firms have laid off thousands of individuals and are basically shut down.

While portfolio lenders like insurance companies and banks have been very active this year taking advantage of this CMBS dislocation, a lending gap continues to exist that has yet to be filled. Life insurance companies, long known for conservative underwriting standards, are now looking at credit-related losses and impairments of commercial loans. Some are being forced into loan sales to rebalance portfolios and improve credit quality. Others have finished lending programs for 2008 and will have reduced programs in 2009. Freddie Mac and Fannie Mae are under fire with many pundits wondering if they will continue to exist in their current form.

The lending landscape has dramatically changed in the past 12 months as a lending market psychology of a repricing of risk now borders on desperation. According to a report recently published by Goldman Sachs, there continues to be a gap between the pricing of assets, both real and financial. Though conditions have improved somewhat since the start of 2008, buyers and sellers still have some distance to go before pricing efficiency is restored and normalized lending begins.

We believe that market should be of hope - not desperation - as there are positive signs in the commercial real estate sector indicating that sound investment and lending will continue.

* Federal Reserve action finally turned aggressive in March and has continued to be aggressive in terms of accommodative monetary policy and its discount window operations. In addition, the U.S. Treasury is prepared to back stop Fannie and Freddie. These actions will continue to stabilize financial markets and credit spreads in the months ahead.

* Most commercial real estate sectors are generally healthy this year with comparatively low vacancy and several years of healthy rent growth. This has helped in absorbing market turbulence.

* The current environment is best defined as a transition from unsustainable, frothy conditions to a normalized market. Though rising cap rates will affect values, those buyers with reasonable long-term owning strategies will benefit from a dearth of competition for assets as high leverage buyers wait on the sidelines.

* There has been a major deleveraging and repricing of risk in commercial lending. Gone are loans with 80% LTV ratios, sub 100 basis point spreads and interest only payments. Last September all-in spreads were generally 175 to 225 basis points over matching treasuries for loans of 70% of value or less. Today, pricing is 250-300 bps over matching treasuries with floors in place in many instances with amortization of 25 years and less. Ironically because of an improving treasury market, interest rates are still in the 6.25% to 6.75% range - very competitive in historical terms and not much different from last year.

* Debt capital, while constrained, is available and across a wide spectrum of lenders. Transactions are occurring across markets and property types for realistically priced assets. New lending standards are more responsible and sustainable.

* Commercial real estate loan delinquency rates have increased in the past 12 months, but are at less than 0.6% and near all time historical lows.

The rest of this year and into next year will provide some interesting opportunities and challenges for both lenders and borrowers. Unlike the last prolonged credit crunch of the early 1990s that was caused by massive overbuilding, the commercial real estate market today is generally well balanced and well positioned to weather the current economic storm. Conservative lending will continue where lower loan to value ratios, faster amortization and higher debt coverage will likely be the norm. Investors with financing needs will have to meet these challenges head on in order to achieve desired financing levels.

Whether it is a large or small loan, NorthMarq Capital, Inc. and its network of 29 offices has the lending resources to help our clients meet these challenges daily.

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