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The commercial mortgage landscape as winter approaches - by Michael Chase

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It may only be the end of October, but for commercial mortgage borrowers and practitioners it might as well already be year-end. With a few rare exceptions, most new loan requests are likely to fund in 2023. Even during a time of rate volatility, many commercial real estate (CRE) lenders have already met or exceeded their origination goals. There are a few lenders already working on their new fiscal year; meanwhile, many others are taking their foot off the gas for now and looking towards what the new year will bring.

What can CRE borrowers expect as we head towards 2023? We are certainly in a higher interest rate environment and market conditions continue to push the likelihood of the next interest rate cut further out. Underwriting can be expected to be tighter with lenders focusing on exit strategies and refinance risk. The good news is there should still be plenty of capital available, and a new year may bring some renewed competitiveness from lenders looking to fill fresh allocations.

Banks and Credit Unions

Banks and credit unions remain the largest holders of CRE mortgages. This group includes multinational banks to local savings and loan institutions. The large money center banks are currently on the sidelines and not actively lending in the CRE marketplace. This is for a host of reasons, including regulatory pressure combined with exposure to consumer credit and warehouse facilities. The most competitive spaces for borrowers are the banks and credit unions who occupy the middle market. Even though the Fed Funds Rate has been aggressively increased to stamp out inflation, this has yet to fully translate into increased capital costs for these lenders. Many of them are in price discovery mode and they can be selectively aggressive for the right opportunity. Some loan requests can be enhanced with a significant deposit relationship or an opportunity that qualifies for Community Reinvestment Act (CRA) credit.

Life Insurance Companies

Institutional lenders can be expected to remain active. While they represent a modest portion of the overall commercial mortgage debt market, they can still offer attractive terms for conservative borrowers seeking long-term fixed-rate capital without personal guarantees. The inverted yield curve is providing some relative value for those who are long-term holders.

Agency Lenders (Fannie Mae, Freddie Mac & FHA)

Multifamily continues to perform well and benefits from the willingness of agency lenders to provide liquidity to this space even during a downturn. Apartment demand will likely persist as higher residential mortgage rates limit the housing market. Owners of properties that provide affordability and meet the mission-driven goals of the agencies can expect to see a discount of thirty to sixty basis points inside of normal market rates.

Alternative Lenders

Private debt funds, mortgage REITs and other sources of alternative capital can be expected to fill some of the voids left by other lenders. There will likely be a need for these lenders to finance some construction loans and for certain assets, which may find difficulty getting done by more traditional lenders. The alternative lending space has certainly grown during the past several years; however, there could be some fall out from those groups lacking a strong balance sheet or who are too reliant on warehouse lines.

A Positive Note

It's not all doom and gloom out there. Borrowers with make-whole prepayment structures such as SWAPs, defeasance or yield maintenance are finding the higher short-term rates allow them to pay off their existing loans with a minimal penalty or in some cases with a financial benefit. Loans with assumption clauses may be accretive to deals when favorable terms can be passed along to a new borrower. Difficulties for some may lead to opportunities for others.

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