A look ahead. Loan originations will remain strong, yet less robust than last year - by Alan Doyle

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First things first.
Accurately forecasting the immediate future of loan originations requires reconciliation between 2021 and the conditions on the ground right now.

So let’s begin by backing up.

Categorizing last year’s commercial mortgage loan originations as “strong” would qualify as a gross understatement. More appropriate, certainly, would be the term “record setting,” as lenders surpassed their 2021 loan-origination goals by a margin of 25%-50%.

In the first nine months of 2021, CMBS originations totaled $102 billion, which represents the single highest nine-month loan origination volume recorded since 2007, according to Trepp, LLC. Life-company and bank originations followed suit with their own record years.

Similarly, investment sales activity during the first nine months of 2021 totaled $462.1 billion which was 10% over 2019s high-water mark and, per Real Capital Analytics, the highest three-quarter buying spree ever recorded. Investors flocked to commercial properties in part for their higher yields compared with the bond market.

Dropping loan spreads.
Not surprisingly, loan spreads on construction, mini-perm and long-term non-recourse perm loans dropped precipitously. Life-company loan spreads dropped to 140 bps over Treasury (sub 3% in the first quarter). Bank spreads narrowed to 160 bps -170 bps /FHLBR and CMBS spreads hovered at +/-175 bps/Treasuries. Interest-only periods of three to five years were offered by banks while life companies and CMBS lenders were offering 10-years interest only for low leveraged transactions.

The lows and highs of demand.
While demand for office and retail space was understandably depressed, demand for warehouse and distribution space intensified substantially, as e-commerce flourished and retailers sought more storage capacity to better manage consumer demand. As a result, warehouse and distribution center values increased by nearly 40% relative to pre-COVID levels.

Demand for multi-family rentals remained strong as an overheated (and overpriced) residential home sales market forced many potential first-time homebuyers to continue renting. The result: Occupancies and rental rates increased substantially which correlated to a 20% increase in multi-family property values.

So, what should we expect from the financing markets in 2022?

What is past is most definitely not prologue.
Unlike last January, forecasting loan activity over these next twelve months is considerably more challenging. Last year, it was easy to forecast a rebound in the capital markets after a

COVID-ravaged economy forced most lenders to the sidelines. It was just as easy to assume that 2021 was going to benefit from a year of historic pent-up loan demand, in addition to a significant decline in short- and long-term interest rates and the unprecedented injection of liquidity into the marketplace from the Federal Reserve's aggressive bond buying and Treasury's stimulus programs.

The specter of inflation.

Projecting loan originations over the next twelve months is tricky as well because of the emergence of a rapidly growing inflation rate. While there are various inflation rates being floated, the consensus is that inflation is currently running at an annualized rate of +/- 6.5%.

File under "No good deed goes unpunished."

While the Fed's efforts to soften COVID's devastating impact on 2020s economy was met with success by pushing down borrowing rates and injecting liquidity into the marketplace, too many of these curative measures have since translated into a precarious level of inflation, its highest since 1982.

While the simplified definition of inflation is "too much cash chasing too few goods," we've clearly seen this being manifested in 2021s over-heated and over-priced home sales in addition to a high demand for luxury goods such as new automobiles, boats, and vacation homes, etc.

The potential side effect of too much stimulus was initially downplayed by Treasury secretary Yellen and Fed chairman Powell in 2021. However, statistics have affirmed that our escalating inflation clearly needs to be brought under control or the economy may find its way into another recession.

As a result, the Fed announced three planned increases this year in the Fed Funds Rate. This will immediately push up short-term borrowing costs in addition to coaxing up long-term interest rates and carefully bleeding some of the excess liquidity out of the marketplace through its aggressive curtailment of its bond buying program.

The view from here.

At Larew Doyle & Associates, we believe strongly that chairman Powell's actions will be successful in getting inflation under control, although it will take time to achieve. We are also of the opinion that lending activity and aggressive pricing will remain strong through the first half of 2022 and start to slow as the Fed's activities start to circulate more evenly throughout the financial markets.

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