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This week and the futures market commentary

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Ok, its official we are in a recession, in fact it began, so says the National Bureau of Economic Research, in December of 2007. The economy won't fare much better next year either as the residential lending contagion will make its final manifestation in the commercial markets this spring. The 1973-75 and 1981-82 recessions were this country's longest at 16 months. This time around we should set a new record.

Here's the good news, what began for us last year, began for many six months later so most industry experts actually see a faster correction in the commercial real estate markets than what many fear will be a long and slow recovery on the residential side. However, a commercial real estate recovery ahead of a residential recovery would be counter cyclical to the norm. The difference this time, is that unlike the last down cycle in commercial real estate, most sectors have not been drastically overbuilt and corporate America is already fairly lean having purged much of the payroll bloat earlier this decade. Despite the gloom and doom and rising loan delinquencies we all read in the papers, the fundamentals are still relatively strong.

Value's of course were, and still are, too high and some like Alan Todd, head of commercial mortgage bond research at JPMorgan, feels that prices could drop by as much as 40% from peak to trough. According to Todd, they have already dropped 11% since this time last year. This prognostication might be a little strong, but didn't we all know values were getting ridiculous? Such corrections are actually great for our markets and the heavy doses of fiscal and monetary policy stimulus heading our way are bound to loosen up credit next year. We are already seeing it in the north east where many banks have indicated strong appetites for commercial real estate next year. We see enormous opportunity for all lenders to put out debt capital at spreads that haven't been seen in years.

I think more debt capital would have been put in play already if it wasn't for the fear mongering that has gone on in the CMBS market as of late. The next wave of business press sensationalism has gripped this market which only makes up about 22% of the overall commercial real estate loan market. Triple A CMBS bonds, which make up about 80% of all CMBS that are traded, are currently yielding between 14-16%! It would take approximately two thirds of an entire CMBS issuance to default before eating away at the A tranche principal. Hence, we feel that CMBS yields are a bubble that will pop at some point this spring. When it does, the remaining capital that has been earmarked for commercial real estate debt will be able to cherry pick the refinance opportunities at fantastic spreads. This will give the 36% of the commercial real estate debt market that is made up of non-bank and non-CMBS issuers the opportunity to grab further market share. Some non-bank commercial lenders like GE did that this year and if allocated sufficient corporate capital next year they could do it again.

What does this mean for borrowers? Well borrowers will be served best by focusing on the

economics of their business and relying heavily on commercial real estate debt and equity intermediaries to execute refinances and opportunistic acquisitions. Debt will not be easy to find, but it is and will be available. When debt capital is tight, lenders look to their best relationships in the brokerage community to source the right debt opportunities. Lenders' allocations to product and property types will also be volatile next year so relying on a broker that has a plethora of lending relationships will serve borrowers well in the months and years to come.

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