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Examining the outlook for lending in today's market

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The Counselors of Real Estate held its National Conference in New York City at The Waldorf-Astoria from March 29-31. On March 30, the morning program included a panel of experts who examined the real estate debt market to understand where we went wrong, the magnitude of the problem and the highly correlated implications of real estate pricing both near and long term. The panelists included Jeff Taschler, managing director, UBS; Brian Stoffers, president, CBRE Capital Markets; Ralph Rose, managing director, Citigroup; Mark Wilsmann, managing director, MetLife Real Estate Portfolio Management and Art Pasquarella, CRE as moderator. Here is a summary highlight of the program.

Pasquarella began the program by stating that commercial real estate and the apartment industry did not create the lending mess. New supply was kept in check but money was cheap and easy to obtain and that was the true core of the problem. Capital was frozen instantaneously worldwide. It is now difficult to obtain financing or near impossible. It is a fist fight between lenders and borrowers.

Here is a summary of Stoffers's points:

- * The period we are in no longer looks like the 1990s. Will this recession be like the early 1990's? No, it's worse but it is not anywhere as bad as the Great Depression. Looking back to the 1920s, this recession is deeper than expected but it isn't a depression.
- * The U.S. GDP growth was being driven by consumers and the consumer fell off in the third quarter of 2008. Now business spending has dropped off but government spending is still driving.
- * The personal savings rate has increased dramatically which is not good; the consumer needs to spend.
- * Debt spreads have been 100-150 BP range and in third quarter of 2007, it started to widen.

U.S. Debt Source of Commercial and Multi-Family Outstanding

Stoffers introduced the following stats:

- * There is a total of \$3.5 trillion of debt outstanding
- * 44.3% is from commercial banks
- * CMBS has dried up
- * As of March, 2009, most global banks are far lower in value than 2007
- * Property sales have been down. The second quarter of 2008 really diminished from the first half of 2008 for the remainder of the year. The fourth quarter of 2008 may be more indicative of 2009. Large transactions are history now.
- * In 2009, the debt coming due is not as much as it will be in 2010, '11 and '12. The next three years are potential real problems for the U.S. Mortgage originations have dried up. About a third of life insurance companies are out of lending. Multi-family has been supported by Fannie Mae and Freddie Mac.
- * We are back to the old ways of financing. Recourse loans are "in" along with on-book lending.

* Cap rates will be in the 8% range and properties are now closing in the 8-10% range. Last week (March, 2009) a sale closed in the 10-11% range.

* In the fourth quarter of 2008, the fundamentals were deteriorating. Industrial real estate vacancy is 11.3%; office is 13.9% and retail has a 10.4% vacancy.

* A lot of sellers are paralyzed with low prices but are coming to their senses. We will have more bloodletting in the next year. There is not a wave of equity and less reallocation of investor funds. Fundamentals will perform poorly in 2009 and 2010 without improvement.

Rose then asked the question, "Why has the real estate market frozen?" And he answered his own question by stating that it is because financing and the debt markets have frozen. But we need to look back in the last 10-12 years with the CMBS industry and how it evolved. CMBS started out as a \$1 trillion industry. In 2007, it was \$3 trillion and its immense increase in volume was not due to economic or stock growth. It was absurd growth due to the shadow market.

* No capital at risk and people were lending. Fundamentally there was no transparency on risk and no stability to operate the properties to maturity. As financing dried up, properties were lining up in 2008 to be financed and couldn't. Now, in 2009, there is a glut for refinancing and these expiring debts are on balance sheets with mark to market issues.

* We are at a critical junction with solutions to break the logjam and priming the pump. The UK requires quarterly reappraising of properties and this forces transparency on value. We still need to raise equity to keep up with fair market covenants and that is a good thing.

* Rose stated that mark to market accounting is causing undue financial stress and is overblown because less than 25% of bank assets and less than 10% of life insurance real estate assets are subject to mark to market.

* Rose stated five steps important to restart the real estate debt industry. 1.) Clean up the system and overhang of inventory on balance sheets; 2.) Restore ratings creditability; 3.) Bolster securitized products structure; 4.) Address regularity and accounting uncertainty and 5.) Restore demand.

* Rose concluded by stating that when the market comes back, it will look like the 1990's and there will be approximately 70% leveraging.

Next, Taschler stated to the audience that he has reduced his risk at UBS to \$4 billion of real estate. Swiss National Bank is providing preferred financing which has helped UBS. What has been his volume over the last 3 years?

* In 2007, he had \$13 billion of new originations of which \$7 billion was fixed rate securitized loans and \$6 billion was at a floating rate. In 2008, he had \$500 million of new originations and all were at a floating rate. By the fall of '08, he seized fixed rates and his ability to hedge now becomes critical. Wilsmann concluded the program by giving the life insurance side of the story. At MetLife, the direct side was influenced by rollover in 2005-07 with \$7 billion in loans and owners either selling off or paying off loans. In 2009, he is targeting \$4-5 billion of activity with 50% of the activity dealing with 'in-house" rollover loans on refinancing or re-extending loan terms. The other 50% will be for new loans and he is dealing with each loan on a case by case basis. He doesn't have a lot of term default issues.

* He also stated that if the borrower is committed to the property and investing his own equity into capital improvements then MetLife will work with the borrower

* He gives 7% interest on a 5 year term on his best deals at 75% LTV. But in general they are financing a maximum of 65% and could be as low as 50-55% LTV.

* The DCR is 1.3 minimum on amortized loans and that interest rate might be in the 8-8.4% range.

The program concluded on an up note that we were headed for better times and that in the next few months, the U.S. government was listening to the issues. By the Fall Convention, we will be clearer as the worst of the unknown is behind us.

Tentative 2009 Calendar of Events

- * October 11-13: CRE National Convention, New Orleans
- * December 16: Algonquin Club, Holiday Evening Reception, Boston

2009 Chapter Officers

- * Robert Nahigian, Auburndale Realty Co., chapter chair
- * Emmet Logue, NAI Hunneman, vice president
- * Robert Costello, Capital Crossing Bank, secretary/treasurer
- * William Norton, Norton Asset Management, membership chair

Robert Nahigian, FRICS, CRE, is the 2009 CRE chairman and is president of Auburndale Realty Co., Newton, Mass.

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