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## Commercial real estate lending mid-year 2009: No pain, no gain

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Bill Gates once said that "Success is a lousy teacher. It seduces smart people into thinking they can't lose."

The seduction of success in the real estate community was marked by the peak of market invincibility that occurred in the spring of 2007. Despite bumpy times during the 12 months that followed, "hope and change" was the market psychology during the summer of 2008. Unfortunately in the summer of 2009, hope and change have been replaced by disappointment and loss.

The crisis that now exists in the real estate industry is a result of a perfect economic storm that occurs every generation or so under circumstances that sometimes are more intense than at other times. Unfortunately this is one of those intense times. This perfect storm has been caused by factors such as:

- \* Continued deterioration of national economic conditions where entire industries have been radically changed;
- \* Commercial property fundamentals that continue to decrease as evidenced by increasing vacancy and decreasing rents across all property types;
- \* Declining commercial property sales volume and property prices evidenced by increasing capitalization rates;
- \* A slowdown in commercial property lending; and
- \* Continued increase in commercial mortgage delinquencies.

Complicating the issue is the fact that there are literally thousands of commercial mortgages valued at hundreds of billions of dollars that are approaching a renewal date. Because of the factors described above, two out of every three will no longer meet original loan underwriting and as a consequence will not be able to be refinanced.

For example, the Mortgage Bankers Association of America performed a survey in January 2009 to estimate the amount of commercial/multifamily loans that will be coming due in the next decade. The survey indicated that there was \$1.55 trillion of outstanding mortgages held by non-bank investors (insurance companies, pension funds, etc.). The MBA identified \$171.3 billion (11.0% of the total) that will mature in 2009 and another \$120.0 billion (7.7%) in 2010. Federal Deposit Insurance Corp. data indicates that banks have about \$1 trillion of commercial real estate loans on their books, an amount equal to about half of all outstanding commercial mortgages maturing sometime between now and 2018. Commercial real estate market pundits predict that it will be late 2011 or early 2012 before market conditions start getting back to normal.

For borrowers and lenders, this will provide some interesting opportunities and challenges. Large commercial banks, insurance companies, and Wall Street firms are originating new loans at a small fraction of the loan volume they did at the market peak. New lending volume is non-existent in the

CMBS sector, and many insurance companies have put new lending on hiatus. With the exception of foreign banks and the GSEs, loans in excess of \$25 million are difficult to obtain and most are from regional banks.

Conservative underwriting has become the norm and will continue to be that way for some time. Gone are non-recourse 80% loans with interest-only terms, sub-7% cap rates and sub-100-basis-point spreads. In are 65% and sub-8%-cap rate loans with faster amortization (25 years and less) and higher debt coverage (greater than 1.30x). Generic pricing for recourse loans ranges from 6% to 7% for 5 to 10-year term loans and 7% to 7.5% for 10-year non-recourse loans. Investors with financing needs will have to meet these challenges head-on in order to achieve desired financing levels. NorthMarq Capital, Inc. and its network of 32 offices have the lending resources to help our clients meet these challenges daily.

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