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Disconnect between borrowers and lenders: "This is not a credit of capital issue, this is a liquidity issue"

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By definition, real estate is a cyclical asset. In the current cycle, most if not all will agree that the commercial real estate market is in a downturn despite fundamentals being strong. At the heart of the downturn is the lack of liquidity in the debt market which has caused lenders to revise both their lending parameters and pricing. As a result, this sudden change amongst the lending community has created a disconnect between borrowers and lenders. This disconnect has become increasingly evident in the bridge lending niche as the quality of deals and demand for the product has increased dramatically over the past eight months. As an institutionally backed private commercial bridge lender based in Manhattan, Madison Realty Capital (MRC), sees that those borrowers who need to transact either to take advantage of an opportunity or refinance are having a difficult time securing conventional financing. The market has shifted from conduits, the perpetual money machine, to lenders that have cash, low leverage, liquidity and a balance sheet.

To quote William Mack (founder and senior partner of Apollo Real Estate Advisors, LP), "This is not a credit or capital issue, this is a liquidity issue." There simply is no liquidity in the market and thus the supply of money has shifted from an "infinite" amount of capital in the conduit world to a quantifiable amount with balance sheet lenders. This change in supply (amongst other factors) has been reflected in the structure of the capital stack and pricing. Lenders that were willing to lend in a senior secured position at an 80% LTV have revised their parameters to 60 - 75% LTV. While lenders have adjusted to market conditions, many borrowers are still accustomed to the old parameters, rates and terms prior to the present downturn. Simply, borrowers are not willing to transact on a deal unless they have to and those who have to transact are just beginning to realize the change in lending policy across the board.

The borrower lender disconnect has been particularly apparent in the bridge lending space. The bridge loan, which is Madison Realty Capital's (MRC) core product, has traditionally been used for time of the essence, transitional and/or non-stabilized transactions. However, with the change in the lending environment, the quality of deals and demand for the product has considerably improved. The deals that MRC is funding are deals that were bankable just six months ago, but due to the state of the current market are unable to find a lender willing to do a deal. The borrowers that are going to MRC have traditionally used conventional sources to finance their transactions with longer term floating or fixed rate money. For example, the deals that are falling into our space are those that have an existing mortgage coming due and the lender holding the note is trying to clear debt off of their balance sheet, time of the essence closings and borrowers that have gone hard on a purchase contract. In all of these scenarios, borrowers may have been unaware of the current lending environment and originally come to a bridge lender like MRC as a backup. Due to the current lending environment, they were unable to find a lender with the capital and ability to fund their deal, thus coming full circle to MRC in search of execution. Drawing from this, borrowers need certainty of execution, as many lenders have re-traded or pulled deals altogether. Those lenders that can provide that certainty of execution will flourish, providing borrowers an outlet to get their deals financed.

Invariably, the disconnect between the lender and borrower still remains. What once was the backup plan has become one of the only plans until liquidity and confidence returns to the market.

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