The decommodification of the investment mtge. loan: "Lender uncertainty is all but certain"

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These are undoubtedly unique times to say the least. In my 20+ years as a commercial mortgage broker, never have I seen the level of bewilderment displayed by my associates as I've witnessed during September and October of 2008. The professionals in my business whose daily work days are affected by the credit market meltdown have been walking around in an almost haze-like stupor as headline after headline trumpets horrifying financial news that was unthinkable just days before. These are the times that our grandchildren will be asking about and studying in textbooks for many years to come. Without a doubt, the recent events have been "game changers" as the traditional roles of lender, broker and borrower have been redefined in the commercial real estate arena.

We had a great run. Since the mid 1990s thru mid 2008, I have witnessed a transformation of the perception of the traditional relationship of banker, broker and borrower. I now see that what I was experiencing during these years was a role reversal of sorts where certain lenders acted like brokers and over zealously pursued business from borrowers to feed the insatiable mortgage machine made possible by the securitization of debt. The mortgage loan was being commoditized along with the role of the mortgage professional. Nowhere was this more evident than on Wall St. with the proliferation of the CMBS product (I'm assuming we all know what this is at this point). Hailed at the time as a new lending source that would inject billions of dollars of liquidity into the real estate lending market and create lender competition (competition is good, right?), the CMBS product was indeed the great catalyst that fueled countless transactions to occur at valuation and debt levels that would not have been possible otherwise. In many respects, the commercial mortgage backed security was (and I believe one day will be again, albeit in a much altered form) a good and viable alternative to traditional portfolio borrowing.

We now know what went wrong. risk was grossly mis-priced. Wall St. originators of CMBS aggregated way too much of the stuff before selling off inventory. Competition became so fierce for loan product that underwriting standards were compromised and hence, pricing was not commensurate with risk. When the end users of the CMBS product figured all this out, the music stopped and here we are....in a liquidity crisis due to a monetary system clogged with unsaleable assets.

That brings me to the subject title of this article: "The Decommodification of the Mortgage Loan." Certainly since late 2007 (but much more so in the past few months) I've witnessed an industry-wide change in lender sentiment towards the borrowing community and more specifically, the mid-sized to larger investor of income producing property. As financial institutions consolidate, withdraw, preserve capital or simply go bankrupt, borrowers can no longer rely on established banking relationships they once took for granted. Unfortunately, personnel changes have left relationship voids all over the banking industry and as a result, the role of the established mortgage broker has become much more important to the success of any loan placement. Our service is no longer viewed as a dispensable commodity but has become much more valued while options for the borrowing community have been greatly limited. The potential for a "retrade," as we call it, is a concept that borrowers are becoming painfully familiar with as they now recognize the inherent value of a sound relationship that the seasoned mortgage broker brings to the table. The once forgotten retrade is simply a concept where lenders may offer a set of loan terms including rate, proceeds, term, fees, etc. and then deliver, if at all, something different - often radically different. Any retrade may have major implications for a transaction - especially in the case of acquisition financing where the level of debt and the cost of same will greatly affect investor returns. Although I expect to see the return of the "mortgage contingency" clause as a more standard contract point, many of today's buyers have signed non-contingent contracts and find themselves in a situation with a substantial contract deposit at risk in a shaky debt environment. We have been witnessing an anomaly of sorts with mortgage rates as Treasury Yields have plummeted (due to mass migration of capital from non-government guaranteed investments to federally insured treasury issues) and lender spreads have nearly tripled. For example, take the common rent stabilized apartment house in one of the five boroughs. In early 2007, CMBS spreads for a standard 80% LTV with a 1.15x's debt coverage ratio may have attracted say 90-110 bps over the ten year treasury yield, equaling a 10-year fixed rate of 5.5% (as of 2/07). Today, with only portfolio lenders to choose from (namely the local watered down banking community), this same property could expect to attract only a 5-year fixed rate loan with an interest rate of 6.25%, equating to 3.5% over the corresponding five-year Treasury Note Yield. Oh, and you could forget about interest only for the life of the loan, but you may get a year or two if there is upside in the rent roll. In addition, lender debt coverage ratios have readjusted to a minimum of 1.2xs and even greater for commercial properties. Although loan to values for multifamily residential properties have remained strong, the methods and appraisal assumptions used to value these assets have become much more conservative as fuel and insurance costs have soared.

The lack of aggressive liquidity in the market has had a compounding negative effect on property values as more investor capital is required to consummate transactions and capitalization rates have decompressed. We are starting to see a more logical risk reward analysis in property valuation as lenders pull back on loan proceeds and raise interest rates to match their perceived risk.

The credit markets have dramatically changed at an unprecedented rate, and I can tell you first hand how difficult the banking waters have become to navigate. Without a seasoned captain to steer the ship, any loan transaction will almost certainly run aground. Now more than ever, the good old-fashioned Relationship should be valued as an indispensable asset.

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