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Has the subprime crisis affected comm'l. and investment R.E?

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Is the subprime mortgage crisis affecting commercial real estate? To answer that let's first look at the residential real estate markets where there has been a very visual effect to the mortgage industries problems. Most notably in house sales time on the market has increased dramatically and in many areas prices are being adjusted. Plus, we must consider in the residential, as opposed to the commercial market, there were many "creative" mortgage programs and in many cases very low down payments were required thus fueling the "meltdown." Now, adjustable mortgages are another area of concern for many and unfortunately the tightening of credit lines may cause problems for these owners and lenders.

Commercial real estate seems to get affected after residential impact and we are now seeing a slow down in this sector. All of these economic events have business owners thinking "Do I really need to move or expand now?" We have heard of some commercial lenders pulling commitments and hiking interest rates and consequently deals dying. But, this was more likely a temporary reaction to the subprime issues. Then the Fed lowered the interest rates half a point.

Time to let the smoke clear! Where are we going from here?

Wish I had a crystal ball, but I don't, however a few observations. Historically in commercial lending there is less creativity of mortgages, consequently there has been less impact from the subprime crisis. On investment properties, in particular, generally down payment requirements are 25-30%, and the lending is based on the actual cash flows. The lender evaluates the sources of the income, the building's expense and from what remains, how much of that "cash flow" can be used to repay the loan. A formula (debt service ratio) is used to keep a reserve of that cash flow, just in case it is interrupted by vacancy or repairs. With investments properties loans based upon the properties financial performance are usually considered stable. Using that cash flow methodology to determine value is also considered conservative and realistic. I see a strong investment market. On the commercial side perhaps less consequences from the sub-prime events, but resulting market changes now and in the future.

Supply and demand: slowing activity (currently occurring) usually causes an increase in inventory (properties on the market) and with that come a decrease in pricing. As costs decrease, the percentage of profit (CAP rate) on investments increases, sparking a return to more activity.

We have already seen a tightening up on appraised values, stricter reviews of financial pro formas, and enforcement of debt service ratios; but there is plenty of money available for those who have the down payments and meet the lending criteria. The interest rates have gone up a little, but we have yet to see the full impact of the Feds cut. I would expect some ups and downs on interest rates between now and the end of the years as lenders "get back to normal."

As we start to put this "crisis" behind us, business will again start moving!

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