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What will 2010 bring for the commercial real estate financing marketplace?

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It has been a year since the U.S. treasury took control of the Government Sponsored Enterprises (GSE) of Freddie Mac and Fannie Mae. At that time, I reported that the GSEs would continue to operate and maintain "Business as Usual." But has this truly been the case with the GSEs? And what about other lending institutions such as life insurance companies, national regional and local banks? How have they fared in 2009 and what will 2010 bring for the commercial real estate financing marketplace?

2009 commercial real estate lending to date has exhibited all of the characteristics of a slowing economy. There has been an increase in the unemployment rate, a decrease in the GDP, a decrease in consumer spending and substantial decreases in property values in many residential and commercial real estate markets. In addition, the stock and equity markets are well off of their 2008 highs. Some of these characteristics of the economic slowdown have effected commercial real estate lending. These include:

1. A reduction in loan volume.
2. Tougher underwriting standards/increased due diligence.
3. Increased capitalization rates (reducing property valuations.)

As the economy has slowed, lending institutions for commercial real estate lending have adjusted their lending characteristics. For example, during the first quarter of 2009, many life insurance companies announced they were refraining from originating new business. As the stock and equity markets hit new lows, many of these institutions simply could not put out new mortgages as their investment portfolios became unbalanced as a result of the low prices in equities. In addition some big name lenders such as GE Capital retreated from the market. The ultimate result has been a reduction in overall commercial real estate origination volumes through the first half of 2009.

For lending institutions remaining in the market, tougher underwriting standards and increased due diligence have became standard. For example some of the GSEs have put limits on "cash-out" refinances not to exceed 75% of a property's value. In addition, the GSEs have placed greater emphasis on trailing actual rental collections. This underwriting technique projects long-term trends based on short term aberrations and has resulted in many apartment loans being turned down by buyers, sellers, and lenders alike as loan proceeds were driven significantly downward.

With commercial property collections trending downward and loan proceeds following in step, commercial real estate sales volumes decreased. These events are partially responsible for inflating capitalization rates as buyers stood on the side-lines. This was most notable with apartment sales, as capitalization rates moved from below 7% to over 8% in many markets.

As 2009 approaches the fourth quarter, all eyes are focused on what the commercial real estate lending community will do next. There is over $200 billion in Commercial Mortgages Backed

Securities (CMBS) coming due by 2012 alone! And over $800 billion in the next 7-10 years! Many organizations have already begun to lobby in congress about this flood of refinancing and it has been reported that New Jersey senator, Robert Menendey has contacted treasury secretary, Timothy Geitner and Federal Reserve chairman, Ben Bernake concerning this. So many of these loans have been secured by properties which have declined in value that refinancing them will be next to impossible. For a public already "bail-out" wary, there is only so much congress can do. Stay tuned for 2010 and beyond. This is going to get very interesting.

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Sam Berns is senior VP/managing director of the upstate office of NorthMarq Capital, Rochester, N.Y.