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Money for CRE Deals Starting To Flow

Don't Expect a Gush, But Lenders Are Lifting Capital Constraints

Numerous indications over the past few weeks point to an easing of investment capital for real estate deals. Life insurers have become more active lenders; new CMBS offerings are hitting the street; syndicators are starting to assemble new CDO offerings; and bank loan officers are reporting the first easing of lending standards in years.

The ongoing recovery of the capital markets is being aided by an improving U.S. economic recovery. Employment appears to have entered a period of consistently stronger growth, manufacturing output is expanding robustly, and business confidence is up. Corporate profits continue to be a core source of strength for the U.S. economy and corporations are spending more on new technology and new hires, which should reinforce employment growth and bolster consumer confidence, according to Jones Lang LaSalle.

"From nearly every capital segment there are more active participants and the competitiveness among lenders has intensified markedly over the last few quarters," said Tom Fish, executive managing director and co-head of Jones Lang LaSalle's Real Estate Investment Banking team. "The CMBS market has re-emerged and is once again considered a viable component of the market."

Though commercial real estate lending is still down 75% from peak levels, it has rebounded in the past 12 months. It was up 88% in the first quarter of 2011 from the first quarter of 2010, according to CoStar Group.

Leading the charge have been life insurers. Their balance sheets are much further along the recovery path than their counterparts in the banking sector, and issuance since the third quarter of 2010 is running at about 90% of average 2005-2007 issuance in this sector, according to Mark Fitzgerald, a debt strategist for CoStar Group.

However, its composition has changed dramatically over the past two years, Fitzgerald said. Refinance activity averaged 12.8% of total lending volume from 2000 to 2008, but jumped to a little less than 30% in 2010. In addition, risk tolerance remains very low, particularly for new business.

Life insurers are focusing the vast majority of their new lending on large deals. While this has been a longer-term development since the early 1990s (as expected with increases in asset values over this period), this trend has ramped up significantly since 2008, despite sharp declines in CRE values. In 2010, just less than 75% of all new lending volume was on loans greater than $25 million.

The focus on larger assets in core markets has helped to fuel the divergence between pricing on large loans and that of the rest of the market, Fitzgerald said.

Meanwhile, many lenders are still dealing directly with the aftermath of the downturn. Legacy assets continue to restrict new lending availability, he said. For many of those with capital to deploy, the pain of the credit crisis remains front and center. However, history has shown that the most attractive lender returns are earned on the bottom-of-the-cycle vintage loans, Fitzgerald added, which is contributing to the greater availability of funding.

Brian Staffers, president of CBRE Capital Markets reported this week that loans that were virtually impossible to fund at the beginning of 2011, now command multiple lender bids. Loan-to-values are

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higher, debt yields are lower, interest only is coming back and even some special purpose assets and non-credit single tenant properties are receiving substantive lender attention.

"These are all the logical results of a more-competitive environment," Staffers said, adding however, "this does not represent exuberance. We see lenders making rational decisions based on valid inputs and thoughtful consideration."

Banks Easing CRE Lending Standards
Banks are slowly ramping up their commercial real estate lending, according to the Federal Reserve's quarterly Senior Loan Officer Opinion Survey on Bank Lending Practices. In the recently released April survey, 5.5% of respondents said their banks eased standards for CRE loans in the prior three months, the first such loosening of bank credit since the fourth quarter of 2005.

Nearly 35% reported stronger demand for CRE loans from creditworthy borrowers, the largest quarterly jump in 13 years.

BB&T Corp., a major regional bank based in Winston-Salem, NC, is just one example. It has doubled the portfolio lending capacity of its BB&T Real Estate Funding group from $400 million to $800 million.

"We expect 2011 will be a very strong year for us," said Kirk Booher, manager of BB&T Real Estate, which sources all loans through Grandbridge Real Estate Capital. "We are seeing increased transaction activity and improved fundamentals in the marketplace, particularly for multifamily, our preferred property type."

That isn't to imply that all banks are out of the woods yet. For starters, the banks that indicated an increase in demand were almost all large domestic banks, noted Robert Bach, senior vice president, chief economist for Grubb & Ellis. Other domestic and foreign banks reported little change in demand for CRE loans on net, he said in a report this week.

The outstanding volume of bank CRE loans, at levels last seen in late 2006, continues to fall as the increase in REO properties outpaced the issuance of new loans, Bach noted in analyzing the Federal Reserve loan officer survey.

Overall, capital availability is increasing for commercial real estate across most sources of debt and equity, Bach noted. Although prices have moved higher for core assets in primary, supply-constrained markets, pricing for slightly riskier assets (older, more vacant space, secondary location, etc.) remains low, tempting investors and lenders with visions of buying low now and selling high down the road when the market fully recovers, Bach said.

Two Banks Going to Market Again This Year with New CMBS Deals
With liquidity building, the return of the CMBS market is continuing its comeback, too. Through April 2011, $9 billion in CMBS was issued, far exceeding the nominal amount issued in the same period a year earlier, and already more than three-quarters of the total issuance recorded for the whole of 2010. Current estimates for 2011 issuance range between $40 billion and $60 billion.

JP Morgan Chase and Wells Fargo Bank are both going to market this week with $2.9 billion of new commercial mortgage backed securities offerings (CMBS) - the second such offerings from both banks this year.

Wells Fargo Bank's WFRBS Commercial Mortgage Trust 2011-C3 commercial mortgage pass-through certificates are backed by 73 loans secured by 144 commercial properties having an aggregate principal balance of $1.45 billion. The loans were originated by Wells Fargo Bank, The Royal Bank of Scotland, C-III Commercial Mortgage, Basis Real Estate Capital II, RCG LV Debt IV Non-REIT Assets Holdings and RBS Financial Products Inc.

The master and special servicers will be Wells Fargo and Midland Loan Services Inc. respectively.

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Retail properties represent the highest concentration of the pool at 49.5%, including nine of the largest 15 loans. The retail concentration is composed of regional malls, local shopping centers and a few single-tenanted retail portfolios. Three of the four regional malls in the top 15 loans are backed by malls in secondary markets. Office properties represent 20.2%.

The largest loan in the pool at $184.5 million is for the Village of Merrick Park, a 741,229-square-foot regional mall, as well as 116,312 square feet of office space in Coral Gables, FL. The mall anchors, Nordstrom and Neiman Marcus, own their stores and land thus are not part of the collateral. The sponsor is a joint venture between General Growth Properties, JP Morgan Strategic Property Fund and Cigna.

The second largest loan at $99.9 million is for the Hilton Minneapolis, an 821-room full-service hotel in downtown Minneapolis, MN.

The third largest loan at $99.1 million is for the Park Plaza Mall, a 532,149-square-foot regional mall in Little Rock, AR. The mall is anchored by two Dillard's stores, Men's & Children and Women's & Home, which own their stores and thus are not part of the collateral. The sponsor is CBL & Associates Properties.

The JP Morgan Chase Commercial Mortgage Securities Corp. 2011-C4 certificates are backed by 42 loans secured by 84 commercial properties also having an aggregate principal balance of $1.45 billion. The loans were originated by JPMorgan Chase Bank.

Midland Loan Services will be the master servicer and Torchlight Loan Services will be the special servicer.

Retail properties also represent the highest concentration of this pool at 41.6%; with office properties making up 35.6%.

The largest loan in the pool at $199.8 million is for the Newport Centre, a 1.15 million-square-foot (972,484 square feet owned), three-level regional mall in Jersey City, NJ. The property was built in 1987 and is anchored by Macy's, JC Penney, Sears and Kohl's. The loan, which refinances existing debt of $146 million, is sponsored by a joint venture between Melvin Simon & Associates and members of the LeFrak Organization.

The second largest loan at $174.9 million is for the Two Allen Center, a 36-story, 993,356-square-foot office building in downtown Houston, TX. The largest tenant is Devon Energy Production Co., which occupies 64.6% of the net rentable on a lease that expires in January 2020. The property was 97.1% occupied as of January 2011.

The third largest loan at $114.7 million is for a Sun Communities portfolio secured by nine manufactured housing communities and two recreational vehicle resorts across six states. The loan is sponsored by Sun Communities Inc., a self-administered and self-managed real estate investment trust (REIT) that owns, operates and develops MHCs across the Midwest, South and Southeast. The loan is a refinance $105 million of maturing debt.

Freddie Mac Marketing Second CMBS This Month
Just two weeks after completing a new multifamily mortgage backed securities offering, Freddie Mac has the streets with another in its series of structured pass-through certificates (K Certificates). This is its sixth such offering this year.

The company expects to offer $538 million in K Certificates (K-AIV Certificates) that are backed by 19 multifamily properties owned by Apartment Investment & Management Co. affiliates. This is only Freddie Mac's second single-borrower K Certificate; the previous was the March 2010 K-SCT transaction backed by the Starrett City property in Brooklyn, NY.

The K Certificates were expected to price this week.

The largest property backing the offering is for the Fox Chase Apartments, a 2,113-unit complex in

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Alexandria, VA, with a $217.8 million loan issued by Wells Fargo Bank.

As CRE CDO Delinquencies Pile Up, New Offerings Beginning to Re-Emerge
The 3-year plus absence of new U.S. commercial real estate collateralized debt obligations (CRE CDOs) may be coming to an end soon as well, Fitch Ratings reported.

On the heels of the CMBS market revival, Fitch has begun to receive inquiries regarding new CRE CDOs. The collateral contemplated is ranging from seasoned commercial mortgage backed securities (CMBS), newly originated CRE loans to a hodgepodge of CRE debt.

The difference in collateral is also likely to lead to equally different ratings, according to Huxley Somerville, Fitch group managing director.

"New issue CRE CDOs backed by whole loans may look very similar to traditional multi-borrower CMBS and therefore may be able to achieve high investment grade ratings," Somerville said. On the other hand, "CRE CDOs backed by a mix of lower quality loans or bonds may only be able to achieve ratings a notch or two above the level of their average asset rating, if they are even ratable at all."

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