

# CONSTRUCTION INSTITUTE: CAPITAL MARKETS UPDATE

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*Sources: Cornerstone Real Estate Advisors; Commercial Mortgage Alert; Morgan Stanley Research; Trepp Loan System; Uconn School of Business;*

## Mortgage Bankers Association Commercial Real Estate Conference (2/1-2/4/10):

- Major themes of 2010 Conference: very upbeat but still cautious (as opposed to the sky is falling pall over '09 conference); nearly all insurance co's have money to lend and are open for business (as opposed to half in '09); hybrid lenders forming/are formed to fill specific sections of capital stack (higher leverage 70-75% LTV, bridge market, mezz & pref equity); regional banks still having their pick of deals but competitiveness is more keen; major banks (Wells Fargo, BofA, Deutsche, JP Morgan, CIBC etc.) are forming/have formed origination groups to leverage off of TALF money for new, higher leverage, non-recourse, first mortgages (up to 75%);
- Hybrid lenders – such as Starwood mortgage REIT, RCG Longview, Loan Cor Capital, ORIX Capital, JP Morgan – conduit, Marathon Capital, are or have assembled loan operations to originate capital to fill in various niches in capital stack;

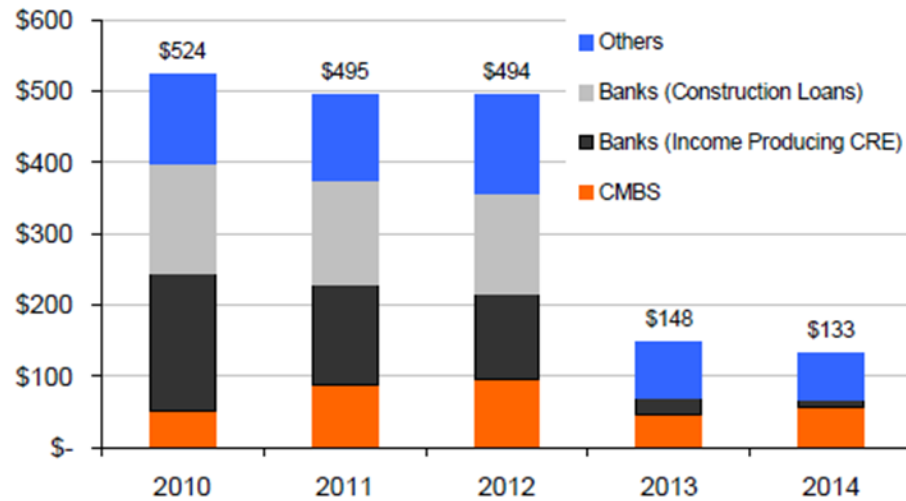
## Mortgage Bankers Association Commercial Real Estate Conference (2/1-2/4/10):

- GSE/Agencies activity has not slowed and is continuing to provide leverage not found in other market segments at rates and leverage levels sizably beyond other sources; some GSE underwriters sponsored by major banks are poised to launch bridge programs for product that doesn't qualify for agency loans and incubator business on their balance sheet:
- Life company appetite for loans has increased sizably due to the delta between corporate bond yields/spreads over Treasuries and spreads attainable by mortgages; most life co's equate a commercial mortgage with a BBB (low investment grade) rated bond whose yield has come in to about 125 bp over comparable US Treasury while mortgages are still 250-275 over, creating a "relative value" play that has CIO's pushing for "prudent" mortgage origination;
- Some Insurance companies considering higher leverage of 70-75% for the "right" deals under the "proper" circumstances and seeking to do JV/equity investments or some type of higher yield hybrid i.e. preferred equity/mezzanine behind their own senior loan;

## **Debt Issues – Maturities, New Capital/Liquidity**

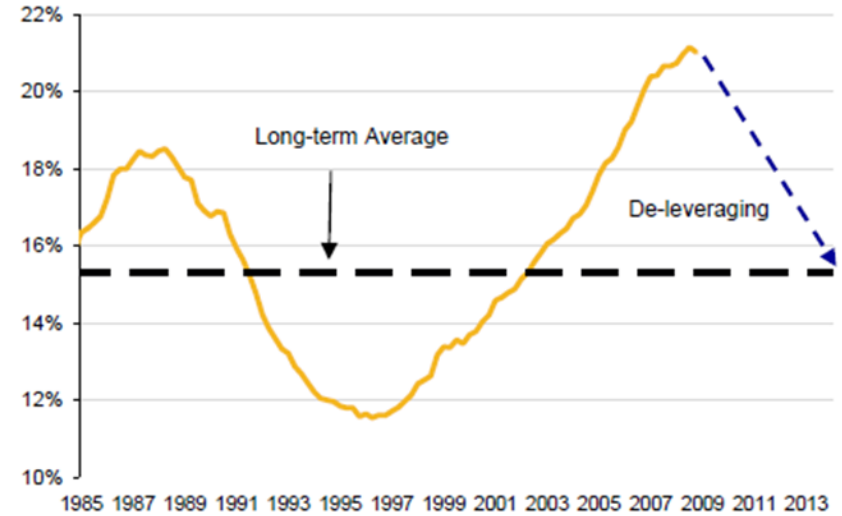
# The Evolving CRE Debt Conundrum – ‘Amend & Extend’ Will Still Dominate in 2010

Commercial Real Estate Debt Maturities (\$Bn)



Source: Federal Reserve, FDIC, FFIEC, MBA, Trepp, Morgan Stanley Research

Ratio of Commercial Real Estate Debt to Nominal U.S. GDP

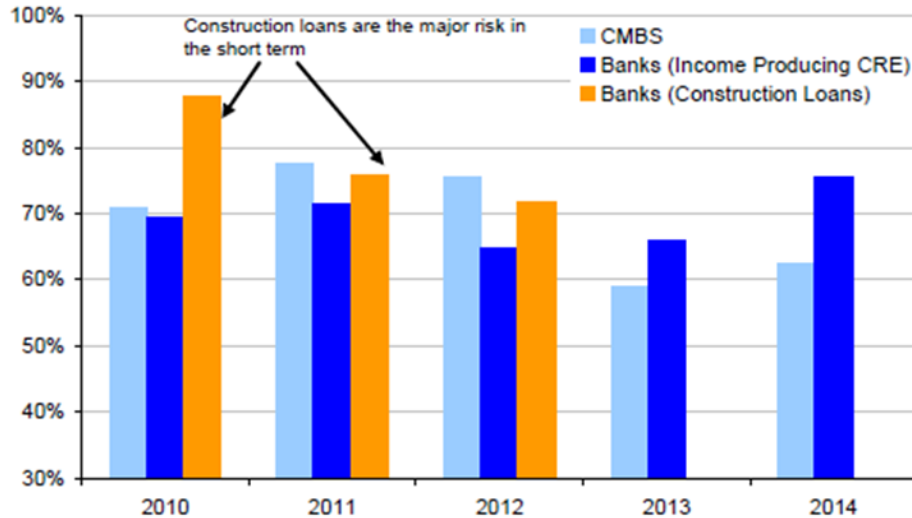


Source: Federal Reserve Board, BEA, Morgan Stanley Research

- Ratio of CRE debt to GDP is at an all time high of 21% and well above the long term average of 15.5% thereby requiring the huge de-leveraging that is occurring now;

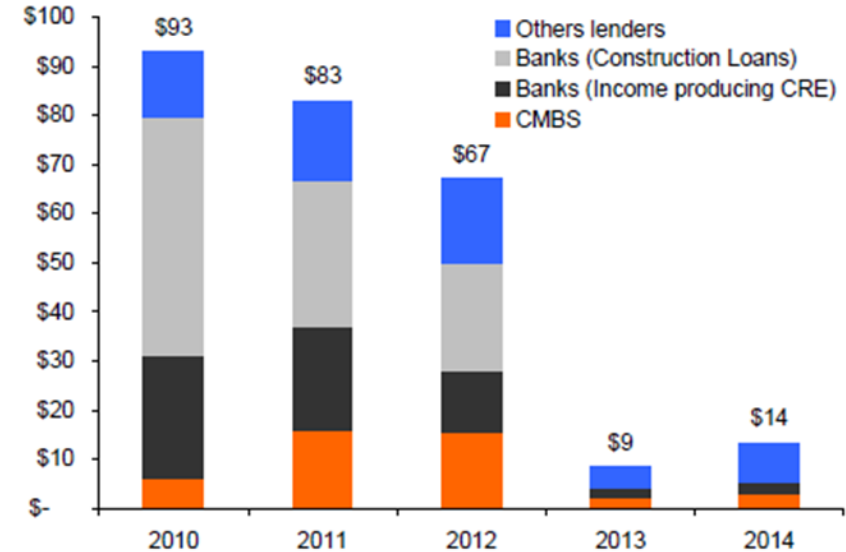
# The CRE Equity Shortfall Creates Distressed Opportunities

Estimated Loan-to-Value Ratios at Maturity



Source: MIT, PPR, Morgan Stanley Research

CRE Equity Gap (\$Bn)

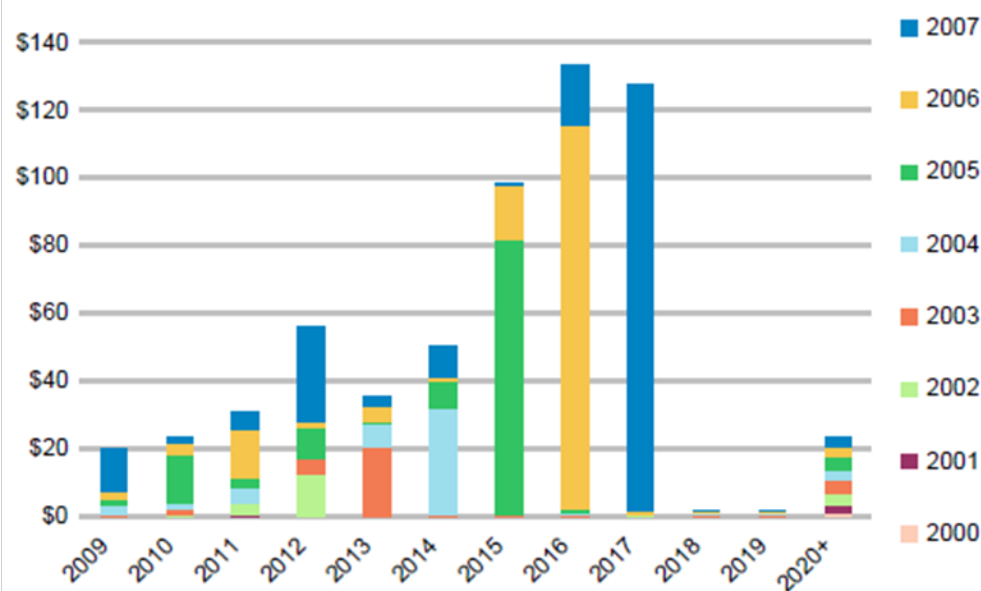


Source: Morgan Stanley Research

- CRE loans (including construction loans) maturing by year end 2012 are estimated to total \$1.5 trillion forcing CRE loans to contract by about \$340 billion/year until 2014 to restore the long term average equilibrium; However, only about \$50-\$60 billion per year is CMBS the others are mostly GSE/Agency, Bank, Life Company debt;

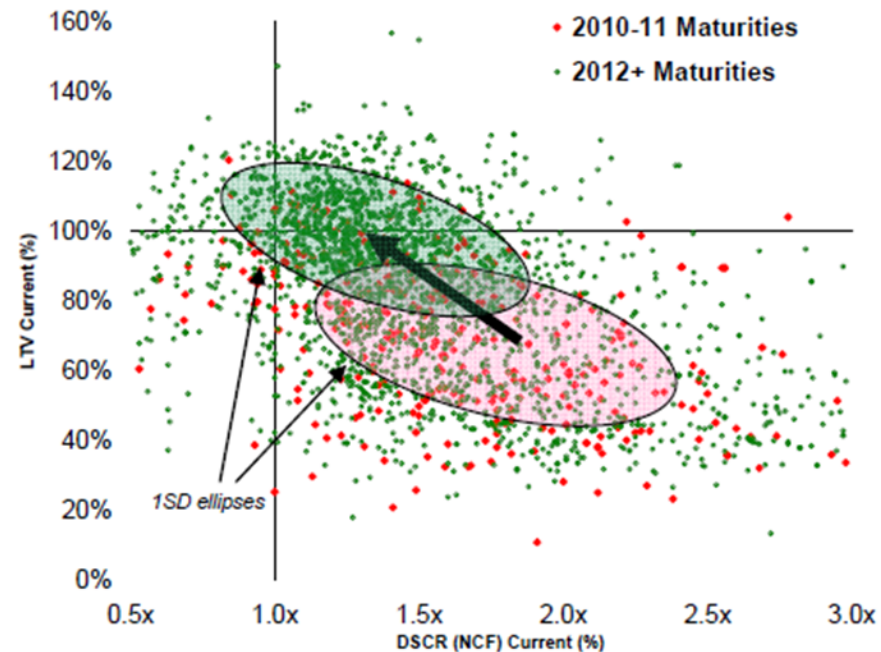
# CMBS Refinancing Needs Are Challenging

CMBS Annual Maturities (\$Billion)



Source: Trepp, MIT, Morgan Stanley Research. Includes Conduit and Floating Rate CMBS Transactions

LTV and DSCR Ratios for Large CMBS Loans



- It is estimated that 15-20% of all 2010-2011 maturing CMBS loans are either delinquent or have negative cash flow to debt service;

## Debt Issues – Maturities, New Capital/Liquidity

- Delta between recourse and non-recourse for riskier bridge type senior loans is at its peak of approximately 600-800 basis points; there are signs that the differential is narrowing but there is no expectation of cheap non-recourse bridge debt appearing in 2010. Only clear economic recovery and better market fundamentals will bring this segment of capital back;
- Massive pools of capital (\$100-\$200 billion) raised to buy distressed assets and mortgages; Multiple IPO's registered with SEC to capitalize on real estate issues
- Transactions flow is still very weak at \$44 billion in 2009 down from \$500 billion in 2007; Too much money chasing too few deals – market is bifurcated into hot and cold with no in between; High quality assets with lower risk are going for a premium while lesser assets with risk associated see little demand and are seriously discounted;

# Massive Blind Pools on the Sidelines

- \$100 - \$200 billion raised to buy distressed assets and mortgages
- Multiple “Blank Check” IPO’s registered with SEC
- Weak transactions flow continues \$44 billion in 2009 down from \$500 billion in 2007
- REITs have lowered debt burden to 60%
- A familiar refrain.....

## A Familiar Refrain

- Too much money chasing too few deals!
- Bidders are already reaching
- So far only the FDIC is offering huge bargains
- The floor is in, let the fun begin!

## Construction Institute: Q & A

**Q: Where's the money?**

**A:** Smaller and medium sized regional banks (in the Northeast) have been very active. Some of the larger national and international banks are ramping up as are the insurance companies and pension funds.

## Construction Institute: Q & A

**Q: How have the criteria for financing changed over the past two years?**

**A:** Much stricter underwriting standards are employed taking into account current market rents, market vacancies, operating expense increases, re-leasing costs and concerns; credit quality of tenants; lease structures; higher debt coverage ratios (was 1.15-1.20x now 1.25-1.30x min); lower LTV's now 65% for non-recourse or 75% for recourse vs. 80% plus for both; Risk is looked at extremely carefully and no "leaps of faith" are utilized;

## Construction Institute: Q & A

**Q: What new sources of funding are becoming available?**

**A:** There are several new mortgage REIT's (Starwood, Ladder Capital etc.) and several investment funds sponsored by hedge funds, real estate operators, public and private REITs, institutional investors including pension funds and private investment companies.

## Construction Institute: Q & A

**Q: To what extent are financing challenges holding back otherwise viable development projects?**

**A:** The hurdles for new development are great but due mostly to the heightened concern over risk based on the status of the economy. Market rents are down, vacancies are up, unemployment is up substantially and jobs drive real estate; construction costs while down from 2007 are still higher than generally can be supported by the current market rents making new construction in most areas unfeasible. Due to the increased concern over risk, equity capital is priced very high especially for projects with leasing risk. Debt capital is available for well designed, well located projects with solid, experienced sponsors AND sizable leasing (i.e Whole Foods in Fairfield).