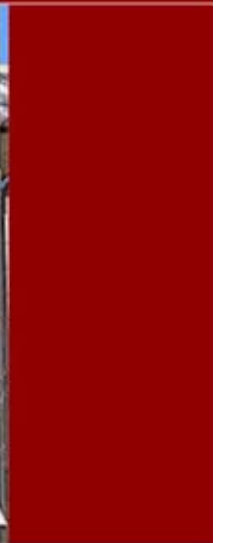




Trends in Commercial Real Estate Finance

Brian S. Andrews, CMB – Andrews Commercial Mortgage





Overview

General Comments

Interest Rates

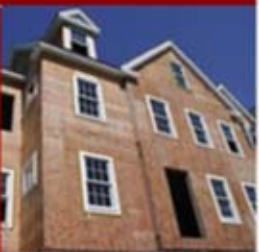
- Floating Rates
- Fixed Rate Indices
- Permanent Loan Rates

Property Types

Loan Programs

- Mezzanine Debt
- Fannie Mae

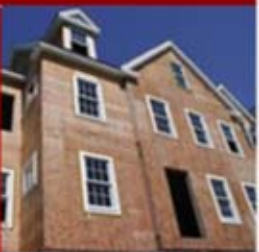
Assumption Dilemma



In General ...

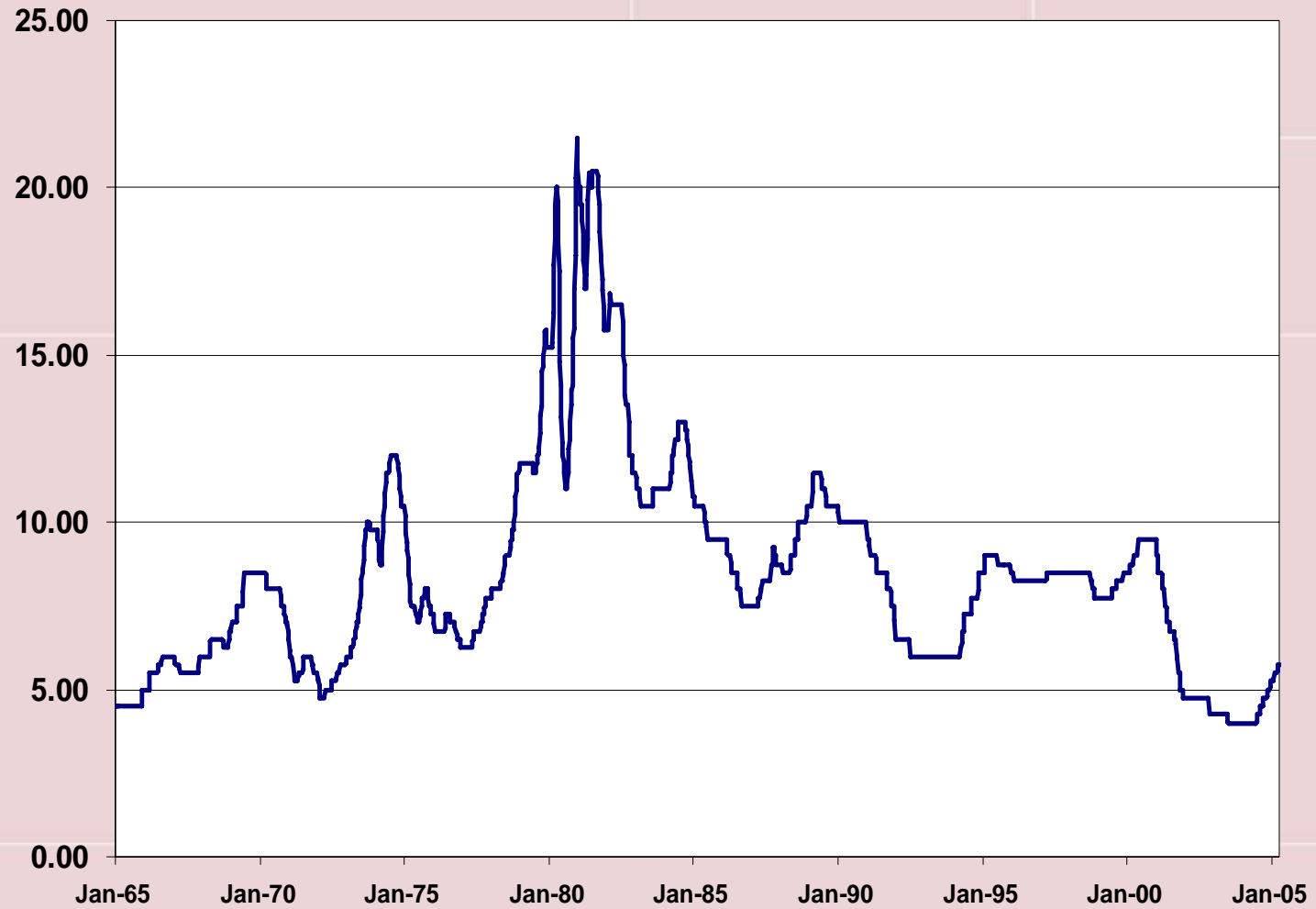
Interest Rates – “Get Your Motor Running”

- Where are interest rates?
- Will interest rates continue to move?
- So What?



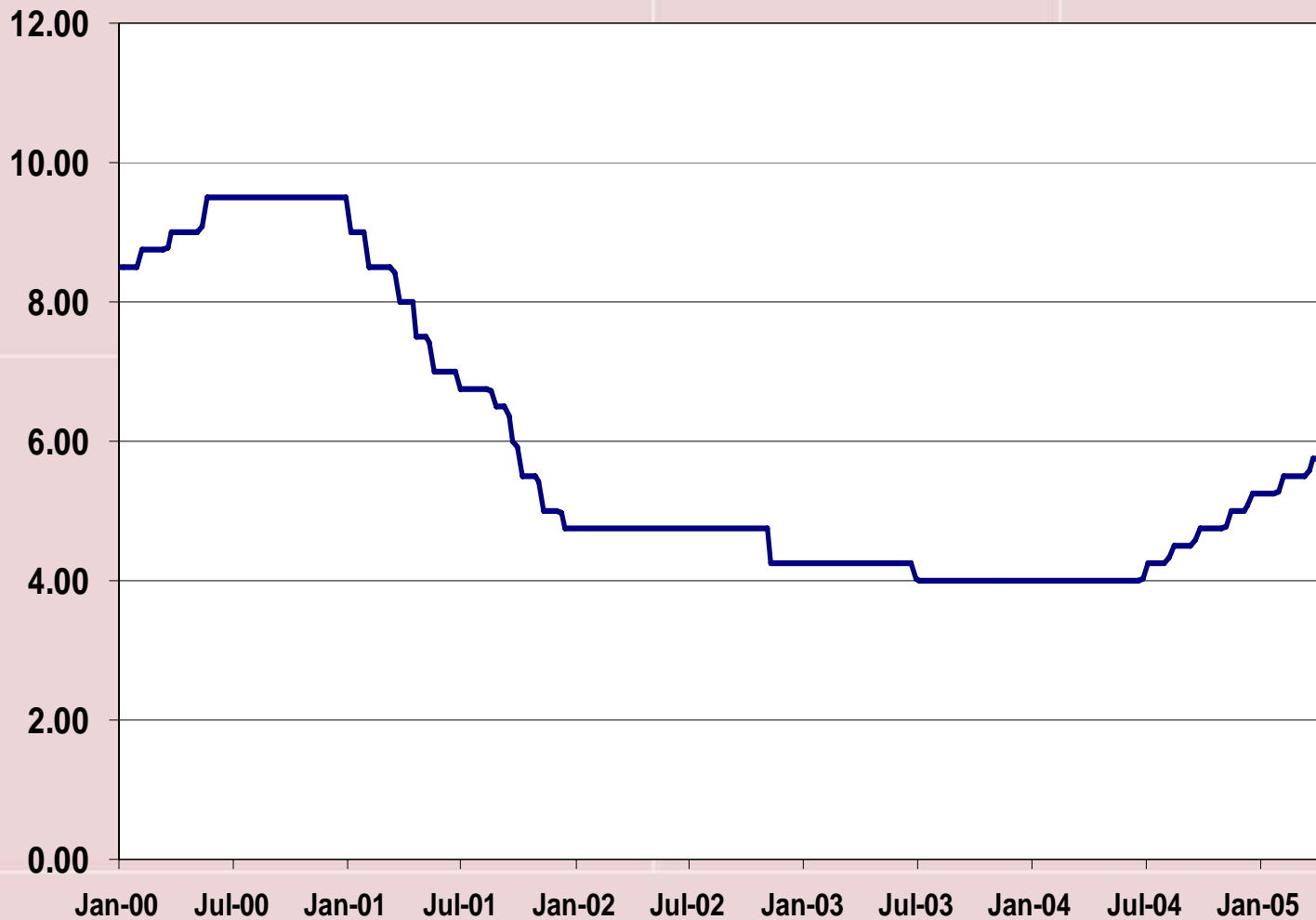
4/29/2005

Prime Rate: January 1965 through current



4/29/2005

Prime Rate: January 2000 through current



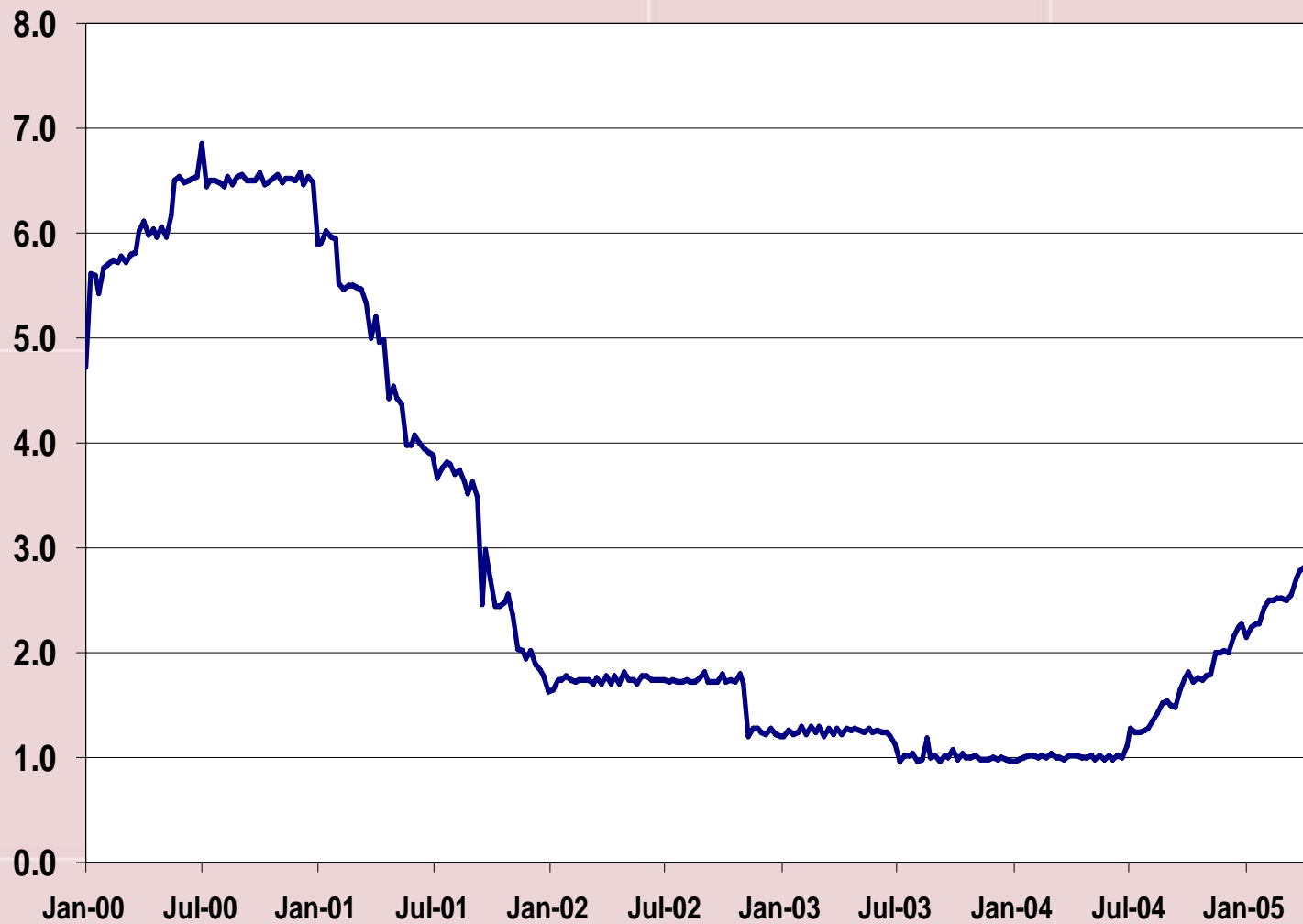
4/29/2005

Fed Funds Rate: January 1965 through current



4/29/2005

Fed Funds Rate: 2000 through current



4/29/2005

10-Year Treasury: 1965 through current

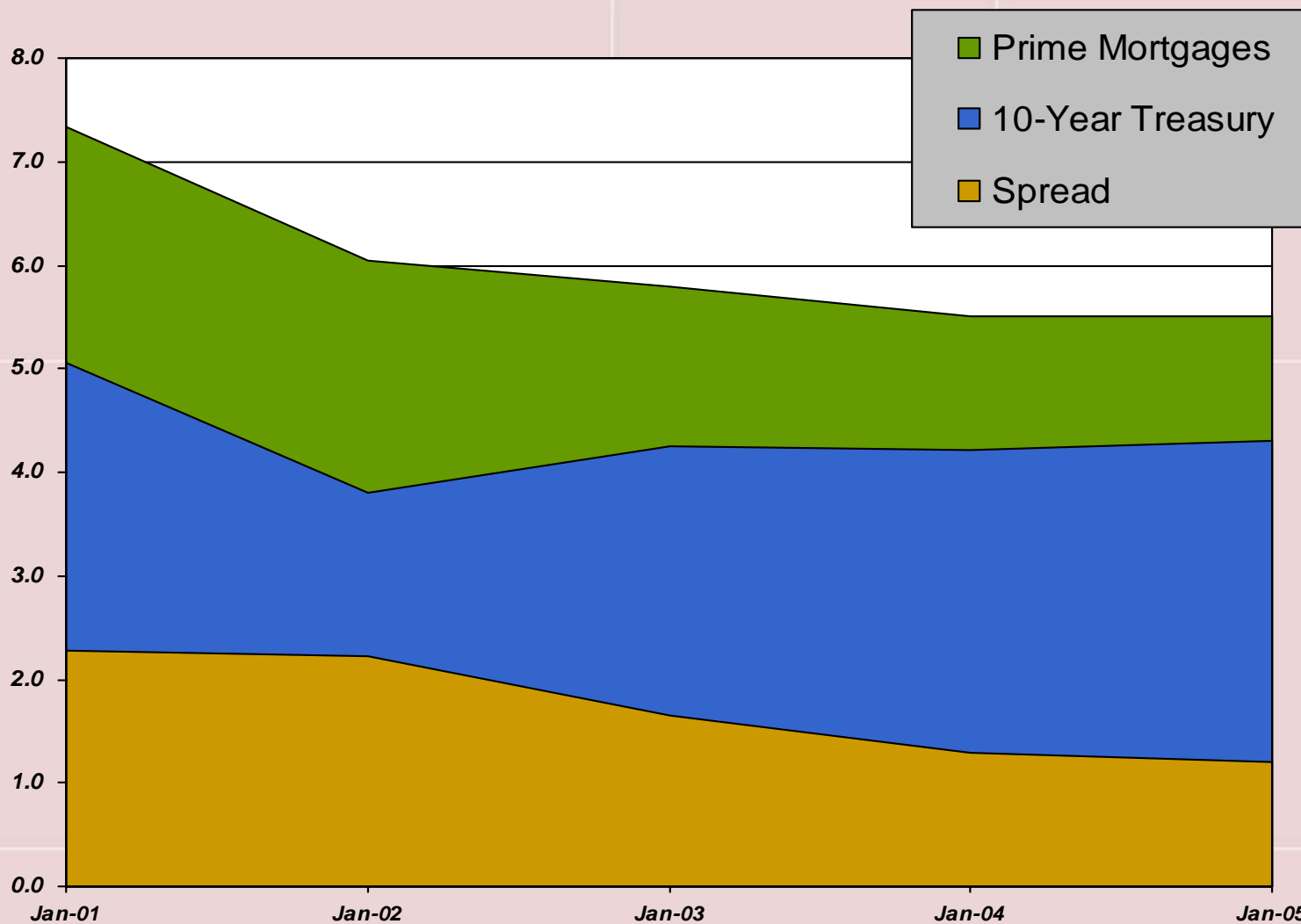


10-Year Treasury: 2000 through current



4/29/2005

Private Real Estate Mortgage Capital Markets



Source: Barron's/John B. Levy and Company Survey

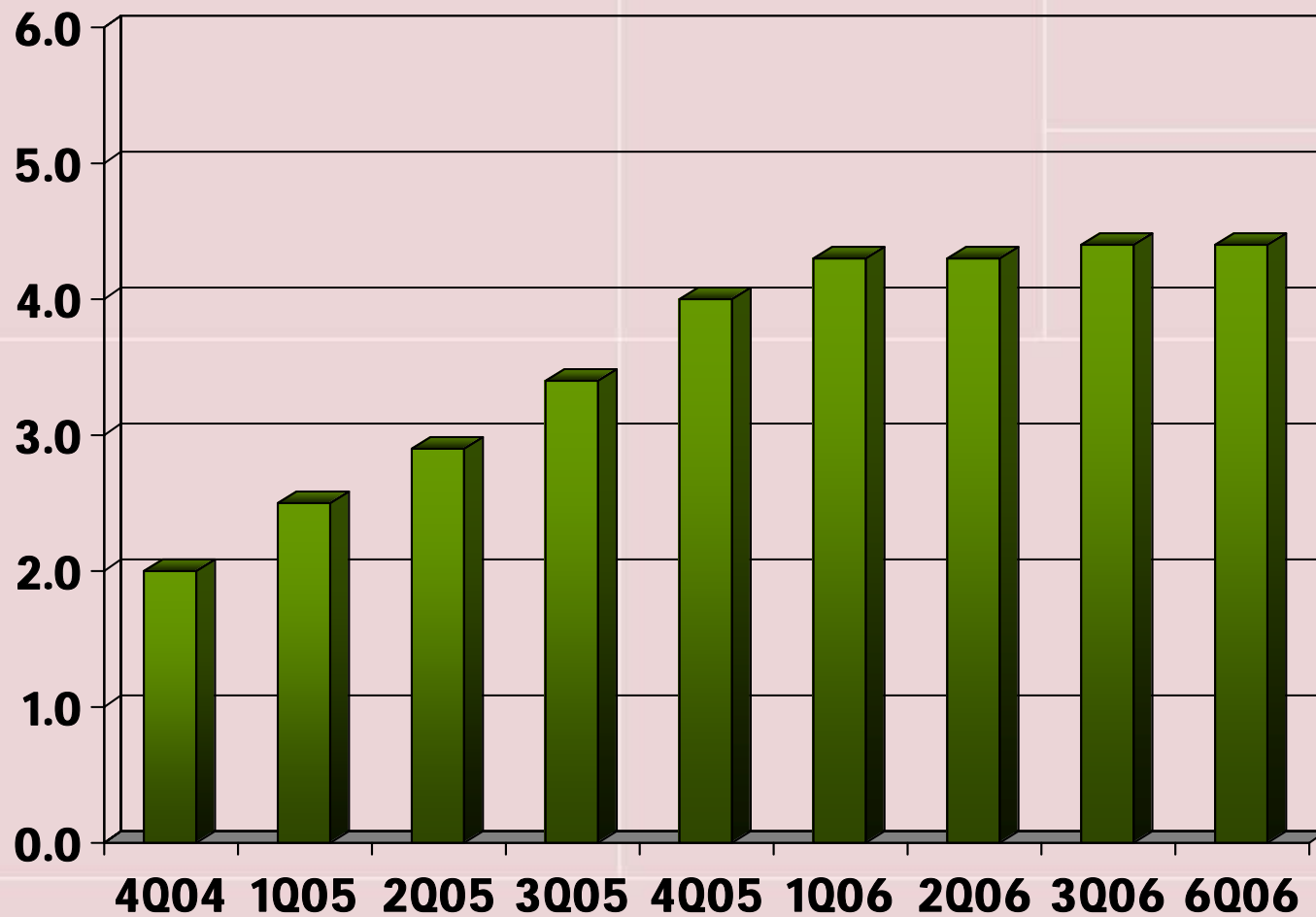
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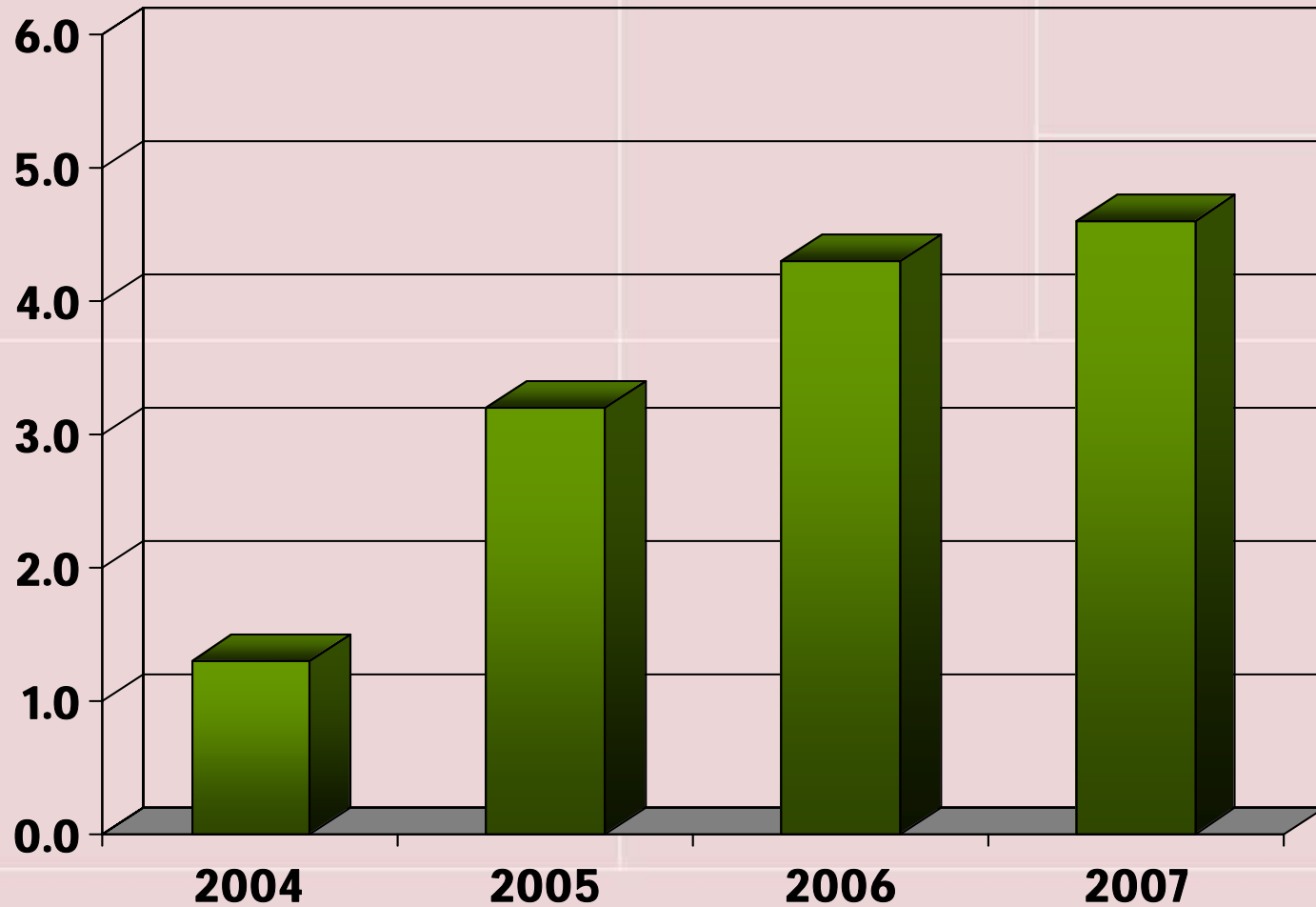
Interest Rates – Will They Continue to Move?

- yes
- up
- maybe way up

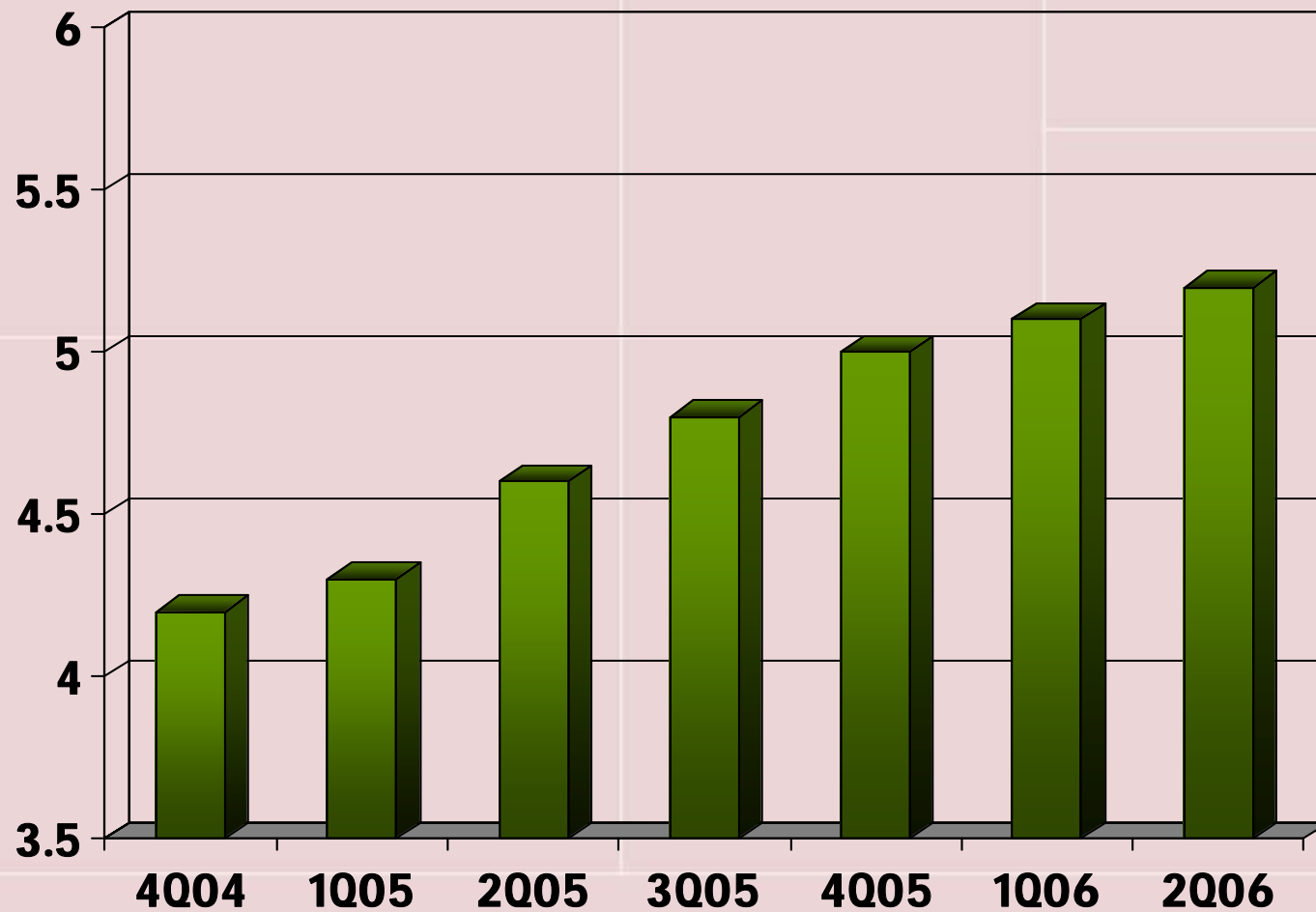
MBA Forecast: Fed Funds Rate



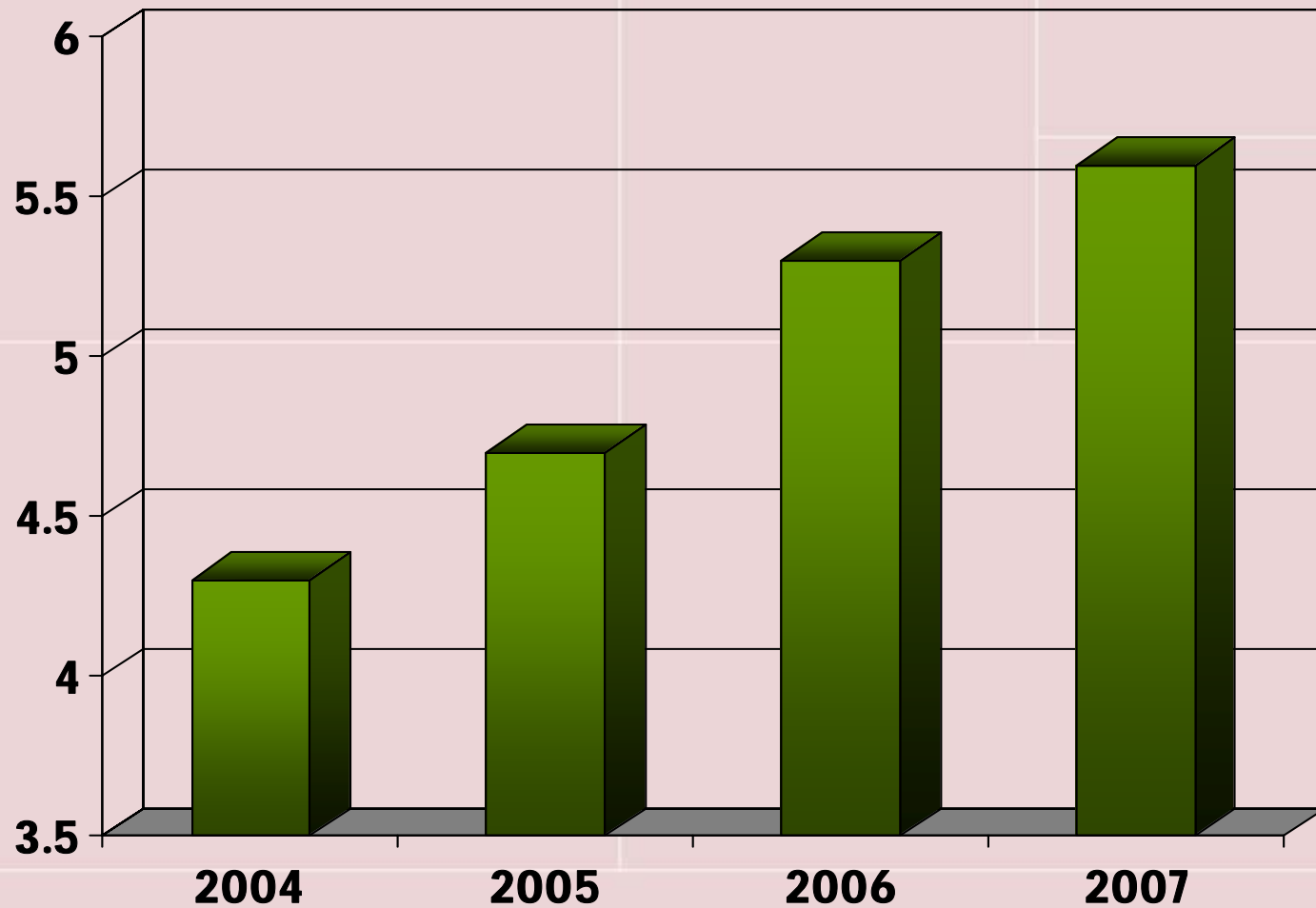
MBA Forecast: Fed Funds Rate



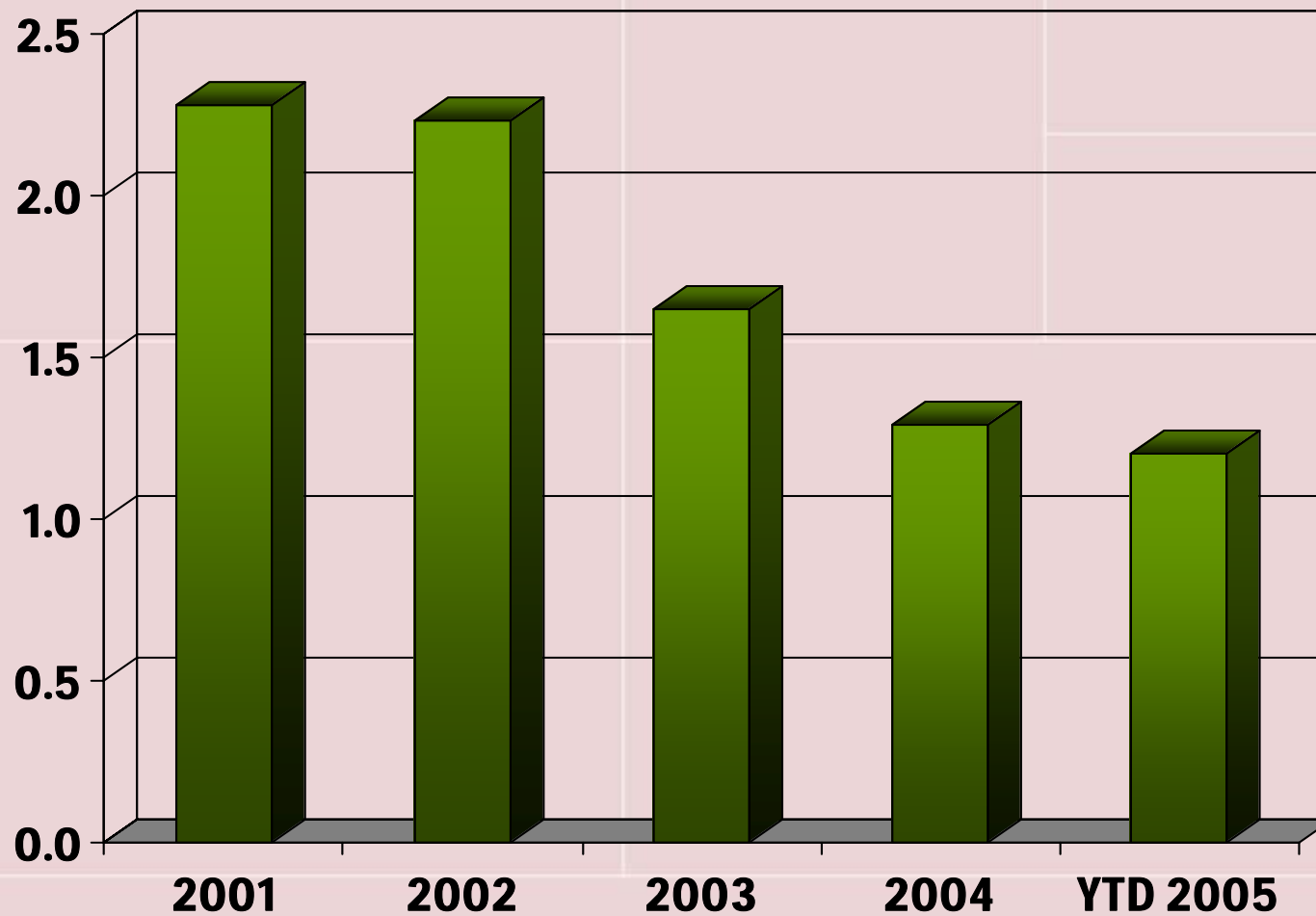
MBA Forecast: 10-Year Treasury



MBA Forecast: 10-Year Treasury



Historical 10-Year "Prime" Mortgage Spreads



Source: Barron's/John B. Levy and Company Survey



Interest Rate Conclusions

- Loan indexes are beginning their rise out of the basement and they have a LOT of room to go up.
- Narrowing spreads kept mortgage rates from rising as fast as the indexes, but that trend is already changing.



So What?

- Increases in rates will decrease the amount that can be borrowed, all other things being held the same.

For Example:

	Base Case	Scenario 1	Scenario 2
NOI	\$241,226	same	same
Index	4.30%	4.80%	4.80%
Spread	1.70%	same	2.00%
All-In Rate	6.00%	6.50%	6.80%
Loan Amount	\$2,400,000	\$2,290,150	\$2,227,900
Asset Value	\$3,000,000	same	same
Equity Required	\$600,000	\$709,850	\$772,100
Equity / Value	20%	23.7%	25.7%



So What?

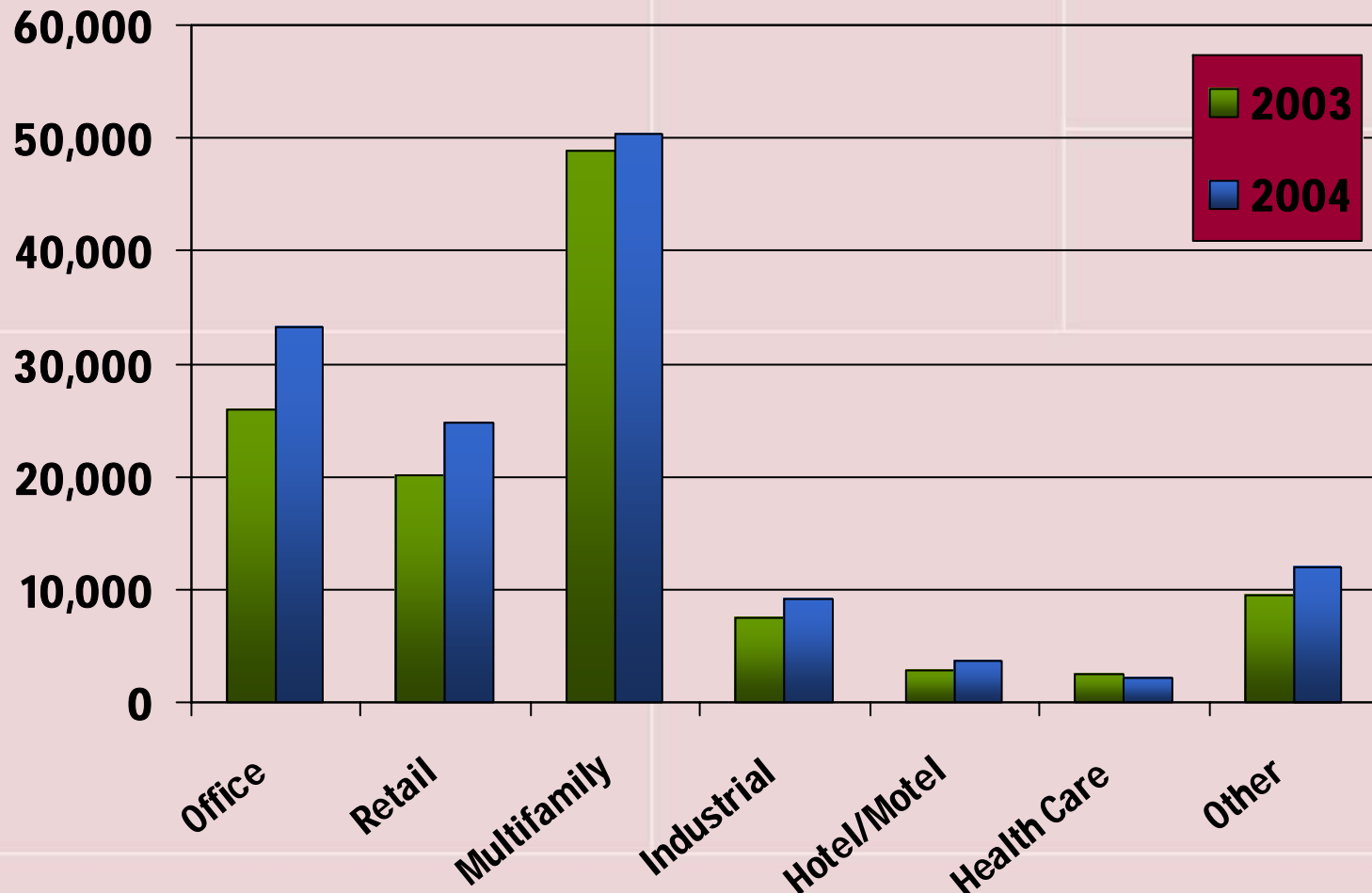
- Increases in rates will decrease the amount that can be borrowed, all other things being held the same.
- Unless there has been a fundamental shift in how cap rates are determined, they should come under upward pressure, also decreasing the amount that borrowed.
- Increases in home mortgage rates will make home ownership less advantageous over apartment living, improving the fundamentals in multifamily.
- Increases in commercial rates will make garden offices for owner-occupants less affordable, improving the fundamentals in the multi-tenant office market.



Property Types and Lender Appetites

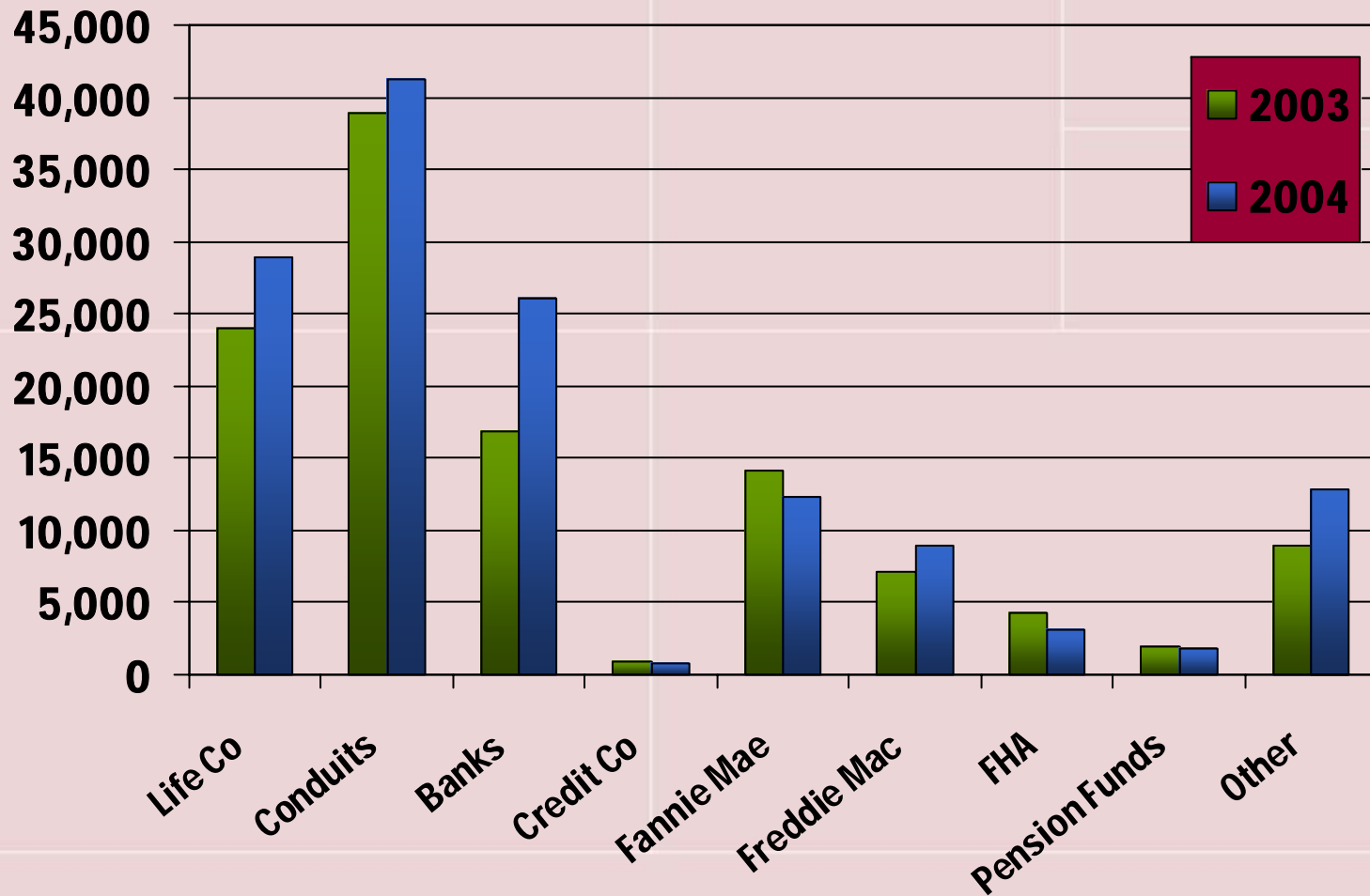
- Apartments are still the most highly sought property type as indicated by permanent financing terms.
- HUD insured apartment construction loans are coming out of the ground and going through stabilization, so look for new HUD financing again.
- Construction and permanent loans for office and retail properties are still available, but ...
- Grocery anchored shopping centers are being looked at more carefully as the anchor credit evolves, and retail will be looked at carefully in Baton Rouge given the large projects that are being developed.
- Hotel financing is making a limited comeback.

Origination by Property Types: 2003/2004



Source: MBA Mortgage Origination Survey

Origination by Lender: 2003/2004



Source: MBA Mortgage Origination Survey



The January 2005 Senior Loan Officer Opinion Survey on Bank Lending Practices

- Demand for commercial real estate loans rose, on net, at both domestic and foreign banks in recent months.
 - The net percentage of domestic banks that reported increased demand for such loans was 16 percent, a modest decline from the 23 percent in the previous survey.
- As was the case throughout 2004, domestic and foreign banks reported in the January 2005 survey that they had eased lending standards and terms for commercial real estate loans.
 - About one-fourth of domestic banks reported a net easing of lending standards on commercial real estate loans over the past three months, a slightly larger fraction than in the October survey.



The January 2005 Senior Loan Officer Opinion Survey on Bank Lending Practices

- Almost half of the respondents, on net, indicated that they had reduced spreads on loans over the past year, compared with a small fraction that reported having tightened spreads in the January 2004 survey.
- About 25 percent of domestic banks also indicated that they had increased the maximum size of loan that they were willing to extend last year, a bit more than had done so during 2003.
- In addition, a modest fraction of domestic banks had eased limits on loan maturity over the past twelve months.
- Domestic banks that had eased terms on commercial real estate loans gave the following reasons: more competition from other lenders (both bank and nonbank), improved conditions in the commercial real estate market, and a more favorable economic outlook.

Over the past year, how have the following terms on commercial real estate loans changed?

	All Rspndnts	Large Banks	Other Banks
	Mean	Mean	Mean
Maximum loan size	3.27	3.33	3.18
Maximum loan maturity	3.15	3.15	3.14
Spreads of loan rates over your bank's cost of funds	3.47	3.48	3.45
Loan-to-value ratios	3.04	3.06	3.00
Requirements for take-out financing	3.04	3.03	3.05
Debt-service coverage ratios	3.07	3.12	3.00

1=tightened considerably / 5=eased considerably

Possible reasons for easing CRE loan terms:

	All Rspndnts	Large Banks	Other Banks
	Mean	Mean	Mean
More favorable economic outlook	1.60	1.80	1.20
Improving CRE in your market	1.73	1.90	1.40
More aggressive competition from other commercial banks	2.61	2.48	2.90
More aggressive competition from nonbank lenders	2.23	2.20	2.30
Increased tolerance for risk	1.45	1.48	1.40
Reduced concern about take-outs	1.17	1.20	1.10
More liquid CMBS market	1.33	1.50	1.00

1=not important, 2=somewhat important, 3=very important

Possible reasons for tightening CRE loan terms:

	All Rspndnts	Large Banks	Other Banks
	Mean	Mean	Mean
Less favorable economic outlook	1.57	1.33	1.75
Worsening CRE in your market	1.71	1.33	2.00
Less aggressive competition from other commercial banks	1.00	1.00	1.00
Less aggressive competition from nonbank lenders	1.14	1.00	1.25
Reduced tolerance for risk	1.86	2.33	1.50
Concern about take-outs	1.43	1.67	1.25
Less liquid CMBS market	1.29	1.33	1.25

1=not important, 2=somewhat important, 3=very important



Bridger Funding Survey

- Bankers plan to increase their commercial real estate lending for the first time since 2003
 - 64 percent of bankers surveyed expect higher CRE loan volume this year, up from 51 percent one year ago. Similarly, nearly every survey respondent (95 percent) reported a mandate to increase their CRE loan portfolios, up from 86 percent last year.



Bridger Funding Survey

- A majority of bankers foresee moderate performance in each major property sector in 2005
 - 96% of bankers surveyed expect *Retail's* performance to outpace all other property types, similar to their 2004 outlook.
 - Substantial positive outlook shifts appeared for *Office*, with 86% favorable now versus 65% favorable one year ago.
 - *Lodging's* continued recovery is evidenced by a doubling of strong expectations for the sector in 2005 versus 2004 (26% versus 12%) and an overall 86% favorable opinion of the hospitality arena, up from 79% last year.



Bridger Funding Survey

- Commercial real estate lending activity will be concentrated in two areas as the sector continues to recover in 2005
 - 58% foresee *construction loan* volume strengthening, up from just 38% in 2004.
 - 76% anticipate more *acquisition financing* opportunities, up substantially from 51% when surveyed a year ago.



Bridger Funding Survey

- For the first time in more than two years, a majority of respondents (51 percent) report bullish sentiments overall on commercial real estate, up from a low of 27 percent two years ago.
- And 60 percent of bankers anticipate strong loan performance (few or no delinquencies and defaults) during 2005, up from 40 percent just a year ago, suggesting that the number of problem loans is declining.



Bridger Funding Survey

- Tightening credit standards at banks could chill the loan growth that bankers anticipate.
 - One-third of bankers surveyed reported that *underwriting standards tightened* last year; one-third also expect standards to tighten in 2005 as well.
 - Ten percent indicated that standards eased in 2004, while just 5% expect them to ease in 2005.



Property Types - Conclusions

- In the permanent market, apartments are king
- Apartment construction in our area will need traditional financing sources for the near term, but HUD 221(d)(4) should be back
- For deals outside of “the box”, a good story still gets a loan from creative lenders at higher pricing
- Office and Retail construction still probably require substantial pre-leasing
- There is a significant amount of competition in the banking arenas leading to easing of lending terms, particularly pricing.

So What?

- Get out and shop the deals
- Don't be afraid to ask for what you want
- The community banks may be able to handle larger loans
- The regional and national banks may have new services to offer



Loan Programs – Mezzanine Debt (2004)

- Fills the gap between what the lenders are willing to lend and what the owners are willing to put in
- On a permanent loan, it can increase the loan-to-value up to 85% in most cases and in some cases up to 95%
- On bank loans, available on a case-by-case basis
- There has to be a good story and serious potential for value creation
- Most mezzanine players have \$5mm minimum, but some go down to \$1mm (some even lower)
- Pricing is in the low teens for lower leverage and high teens for higher leverage, both with exit fees and minimum guaranteed returns



Loan Programs – Mezzanine Debt (2005)

- The industry is maturing and more players understand how the process works
- Many conduits have their own mezzanine programs or have partnered with third parties
- The third party mezzanine providers are lowering their minimums as procedures are more widely accepted and costs come down
- Fannie Mae has instituted it's own mezzanine program



Fannie Mae "DUS Plus"

- Under the DUS (Delegated Underwriting and Servicing) Plus product line, Fannie Mae will offer mezzanine financing in combination with mortgages underwritten under its standard Fannie Mae DUS execution.
- Available for financing conventional, but not seniors or student housing, DUS Plus provides for an additional leverage of up to 5 percent for an overall LTV of up to 85 percent. The mezzanine loan will carry a five-year, fixed-rate term followed by one two-year and three one-year adjustable-rate extensions to match the 10-year term of the underlying loan.
- At present, the cost of the mezzanine loan under DUS Plus is 12.5 percent. This rate is fixed for the first five years of the loan, and then it will fluctuate during the floating-rate extension periods.
- Typical of mezz debt, the mezzanine loan under the Fannie Mae program takes the ownership interest as collateral.
- Prepayment is locked out in the first year, with a 2 percent penalty in year two. In years three to five, the prepayment penalties go down by half a percent each year. The loan is prepayable at par during the last 90 days and is prepayable at par during the floating-rate extension periods.

Source: Multi-Housing News



Similar Mezzanine Programs

- Fannie Mae DUS Plus
- Commercial Bank Tank Top
- HUD PUD
 - FHA 9853(f)(542.9)(iii)-amended and revised until death or you give up, whichever comes blissfully sooner
- Conduit Onto-It
- Freddie Mac Attack



Other Enhancements from Fannie Mae

- ***Extended Maturity Option*** - allows borrowers to extend the term of their loan for up to one year beyond the maturity date; provides a nine-year, fixed-rate term with a floating rate in the 10th year.
- ***Removal of the underwriting floors*** for standard DUS five- seven- and 10-year financing; the floor would be replaced by a stressed refinance test (SRT), similar to that used by many other Fannie Mae competitors.
- ***Lowered lifetime cap*** on DUS adjustable-rate mortgages from 300 to 600 basis points to 200 or 250 basis points over the initial note rate. Additionally, the LTV has been increased from 77.5 percent to 80 percent.



Final Word on Government Sponsored Entities

- Fannie Mae and Freddie Mac have been in the news a lot lately
- Will they be cutting back on multi-family lending?
- No – to the contrary, Fannie and Freddie should be increasing lending on affordable projects



The Assumption Dilemma

- We are getting to the end of a cycle where interest rates have declined and values have increased.
- Savvy investors are trying to sell key assets to the highest bidders.
- What happens when the asset has a permanent loan on it equal to 60% of the new value?
 - Still in the lock-out period
 - High prepayment penalty



The Assumption Dilemma

- What happens when the asset has a permanent loan on it equal to 60% of the new value?
 - Purchaser can assume the loan and put down 40% in cash
 - The old loan can be prepaid and a new loan put on, but who pays the cost?
 - The seller can adjust the purchase price to yield the same returns.



The Assumption Dilemma

- If it is a Fannie Mae loan, there is possibility of a supplemental loan to increase leverage
- If it is a large enough conduit loan, there MAY be a possibility of a mezzanine loan
- If it is a life company loan, there is always the chance to restructure the deal with the LIC
- If it is a HUD deal, there may be a way to increase the balance up to the original loan amount
- In any case, bank support may be possible if the permanent lender allows the pledge of the ownership interest



Commercial Real Estate Finance – Wrap-Up

- Money is still out there for construction projects, acquisitions and permanent refinances
- Interest rates are climbing out of the basement
- There have not been major shifts in appetite for property types, though retail is becoming more popular nationally and hotels are back in favor
- Lenders are hungry
- Fannie Mae is coming out with enhancements to better compete in the market
- An asset purchase involving the assumption of a permanent loan can break the deal BUT possibly can be handled with new products.

