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## On Barren Ground

By Elaine Misonzhnik



It's been a slow few months in the world of real estate lending. For example, Steven J. Lurie, partner in the real estate practice group of Greenberg Glusker, a Los Angeles-based law firm, has handled only one retail financing since Sept. 15, when the investment banking giant Lehman Brothers filed for bankruptcy, taking with it whatever was left of the scant confidence in the global credit markets. The deal, which funded a \$65 million purchase of the 173,000-square-foot Larkspur Landing Shopping Center in Marin County, Calif., was arranged through City National Bank and featured a five-year term, an interest rate in the 6 percent range, a loan-to-value ratio of 50 percent and a recourse requirement. Plus, the bank felt comfortable with the borrower, James Rosenfield, principal of J.S.

Rosenfield & Co., with whom it has been doing business for the past 20 years.

Considering current market conditions, if the terms were any less stringent or if the lender did not have absolute faith in the borrower, it would be unlikely for even that deal to go through, Lurie notes.

“Certain banks are being very difficult with their customers: trying to get loans paid off, not making new loans, not renewing loans,” Lurie says. “Senior debt is not available on terms anything like what was available before the meltdown, except when you have very low loan-to-value and very good credit behind the guarantee.”

In fact, in the fourth quarter of 2008, real estate lending activity on commercial/multifamily transactions by commercial banks fell 86 percent compared to the same period in 2007. On an index where 100 equals the 2001 quarterly average, origination volume by commercial banks on all commercial/multifamily loans in the fourth quarter of 2008 fell to 74—down from 521 during the fourth quarter of 2007, reports the Mortgage Bankers Association (MBA), an industry trade group. On retail properties, the index fell to 47, down from 264 a year ago. For all lenders, the index fell to 54 down from 275 a year ago.

Since the beginning of the year, the average loan size contracted by more than 46 percent, to just \$6.0 million from \$11.2 million. Lending activity by life insurance companies fell 27 percent year-over-year, to 163 deals from 222, though the average loan size increased by approximately 6.9 percent, to \$13.9

million from \$13.0 million. Originations for all of 2008 were down approximately 60 percent from 2007 levels, according to the MBA.

“In a normal market you have a run-off, where people can refinance [with new lenders] so there is always money turning,” says Andrew Oliver, executive vice president and principal with Cushman & Wakefield Sonnenblick Goldman, a global real estate financial services firm. “Now, there is just stagnation.”

Here and there, it’s still possible to get loans, notes Oliver. But those loans tend to be small in size, are granted only to good credit existing customers and feature very tight underwriting standards. What’s more, retail properties tend to be out of favor because of the high potential for tenant bankruptcy, he adds.

“Lenders are very cautious on retail,” Oliver says. “If it’s a grocery-anchored center in a prime location, there is money for it. But if it’s a power center, the tenancy is very important because some of those tenants are having financial problems, so the underwriting is very conservative.”

### **Size matters**

Part of the difficulty is that the profile of the senior lenders active in the market has changed. As recently as June 2008, the bank with the highest profile of mortgage servicing transactions was Wachovia Securities, which had more than \$434 million in mortgage collateral, according to MBA data. But in October of last year, Wachovia had to agree to a takeover by Wells Fargo when it became clear that the bank’s \$312 million mortgage portfolio could destroy the company.

Many of the larger commercial banks are in a similar position, still trying to work through the losses they incurred in their exposure to sub-prime mortgages. As a result, they will likely not take any new risky bets on commercial real estate lending for a while, notes David Akeman, director of capital markets with Stan Johnson Co., a Tulsa, Okla.-based commercial real estate investment firm.

Lurie, for example, recalls a recent conversation with a retail broker who told him his client managed to line up eight different bids for a refinancing loan in the summer of 2008. But by the time the owner made a decision, all eight offers disappeared in the wake of the Lehman Brothers bankruptcy and the subsequent market meltdown.

Meanwhile, many life insurance companies, which serve as another major source of senior debt, have not yet finalized their allocations to real estate for the 2009 fiscal year, according to Oliver. When they do, the amount they lend might turn out to be significantly below the 2008 commercial mortgage allocations, according to Ryan Krauch, principal with Mesa West Capital, a Los Angeles-based institutional commercial real estate lender. “Their balance sheets had so badly deteriorated that they just don’t have money right now,” he says.

Life insurers’ mortgage commitments fell 26 percent from the first to the third quarter of 2008, according to the MBA, to approximately \$7.0 billion, from \$9.7 billion. By contrast, during the third quarter of 2006, at the height of the commercial real estate boom, their commercial mortgage commitments totaled almost \$34.0 billion. As a result, most of the senior lenders active in the market right now happen to be smaller regional banks, according to Akeman.

But since the smaller banks’ lending capacity is limited, that means that the loans getting closed today tend to be relatively small—typically, under \$5 million. Recently, for example, Akeman closed loans in that range on two Walgreens-anchored properties. The biggest deal he is working on right now is an \$11 million loan for a BJ’s Wholesale Club.

“It’s the larger loans that are hard,” says Oliver. “Lenders don’t want a larger loan on their books. They want to diversify.”

**Good credit a must**

Current deals are also getting done under much tighter underwriting terms. Loans on properties in secondary and tertiary markets, where most of the distress is expected to occur, have become virtually nonexistent, says Oliver. The lenders want a top quality asset in an urban location and, in many cases, they will lend only to existing clients, he notes.

But even then, with scant new transactions happening in the investment sales sector, it's extremely difficult to assess the true value of a given property, so lenders tend to be conservative, says Craig Carbrey, president and chief credit officer with EnviroFinance Group, LLC, a Sacramento, Calif.-based brownfield lending specialist. In November, the most recent month for which data is available, investment sales in the retail sector totaled \$600 million and involved fewer than 50 properties, according to Real Capital Analytics, a New York City-based real estate information provider. The volume was 83 percent below that of November 2007, when roughly \$2.6 billion in significant retail transactions closed.

To get a mortgage closed now loan-to-value ratios on retail transactions have to range between 50 percent and 70 percent, according to Oliver and Krauch, with interest rates of 7.5 percent to 9.5 percent. Securing financing from senior lenders will continue to be difficult for a while, says Akeman, as it will take at least until the second quarter of this year for the U.S. financial system to recover from the shocks it had received in 2008.

"To date, we have seen absolutely no movement [in the credit markets]," says Krauch. "It was bad six months ago, even worse two or three months ago, and it continues to be bad. The banks are having their own issues right now in terms of mergers and their balance sheets, so they are not going to be playing any time soon. There are very, very few lenders that are looking at deals today."