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CRE Ponders \$250B Liquidity Dump Implications

By Erika Morphy

Almost lost in the furor of Tuesday's news that the government is injecting \$250 billion into the banking system was the announcement on Wednesday that Bank of New York Mellon will serve as custodian for the Troubled Asset Relief Program, serving as bid manager and conducting reverse auctions for the troubled assets.

To be sure, it had been expected that the government would announce a contractor for this piece of its rescue plan--that is, a vehicle through which it would buy toxic debt. Still, the announcement provides a touchstone of sorts for the commercial real estate industry, which has been whipsawed watching the government try out various approaches to stem the crisis. Indeed, it had been unclear initially whether TARP would remain in place after the \$250-billion partial bank nationalization was announced. Wednesday's announcement provides a small slice of certainty in a larger plan that is unprecedented in scope and action and economic philosophy--at least for the US.

This uncertainty, though, has not stopped lenders and borrowers and brokers from trying to make sense of what this development will mean for the industry. It is true that the market--and the government--is feeling its way through uncharted territory, Ray Torto, chief global economist at CB Richard Ellis, tells GlobeSt.com--but it is important to remember the fundamentals. "Banks have to start lending again, whether it is to businesses looking to make payroll or finance inventory or buy an office building. This plan will make that happen."

Buying up toxic assets on a large scale would have been more cumbersome, he says. "The government buys up the securities, the bank gets the capital and then it starts lending. That is a three-step process. With this model banks should be able to start lending right away," Torto says.

"Effectively, what has happened is that the US government has picked nine banks to make the initial infusion, purposefully and deliberately picking those banks to permit further investments without stigma," Adam Weissburg, partner in the Los Angeles office of Cox Castle & Nicholson, tells GlobeSt.com. "So, what does that tell us? That the nine banks picked are those banks that the government thinks will ride out the storm."

"That inspires confidence. It will allow investors to breathe a bit easier and force the sellers to rethink whether divestiture of stocks in those banks really makes sense. It will also inspire those banks to both lend to borrowers and to engage in inter-bank lending operations," Weissburg says.

A direct infusion of capital will have a multiplier effect, Gary D. Chamblee, a partner with Womble Carlyle Sandridge & Rice, in Charlotte, NC, agrees. "Banks will lend more money this way, instead of waiting to divest themselves of their bad debt," he tells GlobeSt.com. "A direct infusion also avoids the difficult valuation issues that are bound to come up in buying these assets."

Others, though, express doubts as to how much liquidity will reach thirsty borrowers. The banks are not legally obliged to lend the money--although the government is sure to pressure them to do so. Even under the best of circumstances, "it is going to take months, not weeks, for the capital to trickle down to CRE," Cassidy & Pinkard Colliers' David Webb, senior managing director, tells GlobeSt.com. "The problem is not a matter of lending perimeters. For a lot of banks, they have too high a percent of their loans in real estate." Webb thinks it will take until at least the beginning of 2009 for any measurable effects to be felt in the commercial real estate space.

Stuart Eisenberg, the New York City-based partner and managing director of the Real Estate Group at BDO Seidman, doesn't foresee any significant changes in the capital markets or lending policies until after the presidential election. Even, then, he tells GlobeSt.com, the benefits of the capital infusion will be counterbalanced with problems in the sector that are more dependent on overall economic performance, such as rising vacancy rates and retail performance.

One problem that Ed Elanjian, CFO of EnviroFinance Group, a brownfield lending specialist in Sacramento, CA foresees is the uneven distribution of the funding. The nine banks are receiving the first \$125 billion; a slew of commercial and regional banks will be receiving the second tranche. "There is not going to be an equal sharing of the resources, and many of these regional banks are burdened with bad debts as well," he tells GlobeSt.com.

Nonetheless, the consensus is that at least some capital will make its way to waiting deals. "The fact that the government is backstopping a lot of the paper is very important," Paul Arena, president of the New York City-based Venturi Capital Advisors, tells GlobeSt.com. "In the short term I think private equity will be loosened and core-plus-type deals that are conservatively levered will have a chance of getting done."

David Akeman, director of capital markets for Stan Johnson Co. counts himself among the optimists. "I think within 30 to 45 days, liquidity will open up in general, and commercial real estate will get its fair share," he tells GlobeSt.com. The banks will no doubt continue to cherry-pick transactions and maintain tight underwriting, he adds --- but at least they will start lending again.

Residential housing will be a primary beneficiary and "we should expect to see lending on the commercial side as well," says Elizabeth Kulik, a senior managing director of the Schonbraun McCann Group, an FTI company headquartered in New York City. "But the real estate market is plagued with various pricing and cap rate issues that were underway even as the credit crisis began," she tells GlobeSt.com.

There is, in fact, a good amount of liquidity in the marketplace even now, as evidenced by the dollars that have been on the sidelines for quite some time, she notes. "For these equity dollars and consequently mortgage dollars to move, pricing has to come into line so there are deals to be made. Most buyers believe that the non-distressed commercial real estate market is overvalued, and the distressed assets have not reached the bottom in terms of pricing expectations."