

Capital Markets Update

In recent years, commercial mortgage-backed securities (CMBS), or conduit, lenders have been a driving force in commercial real estate finance. They have offered highly competitive structures, full leverage and competitive pricing. However, in 2008 there has been limited origination of new conduit loans. Conduit lenders originate mortgage loans on commercial real estate. The cash flows from these loans are pooled to create CMBS for sale in the secondary marketplace. The securities have differing priorities to the cash flows generated from the pool of loans and are typically rated from AAA down to B and below. In 2007, \$230.2 billion of CMBS bonds were issued in the United States¹. During the first half of 2008, this number fell to \$12.1 billion², a drop of 95%. Moreover, many of the loans that were included within the 2008 CMBS numbers were loans that were originated in 2007.

One of the primary reasons for the drop-off in conduit lending is the lack of demand from CMBS bond buyers at pricing levels that translate into competitive lending rates for borrowers. AAA CMBS bonds receive the first cash flows from the loan pools and are the most secure. AAA CMBS bonds are currently trading at approximately Treasuries plus 292 basis points, whereas in early 2007 they traded at Treasuries plus 90 basis points. In addition, the riskier, lower-graded bonds have seen even larger increases. BBB CMBS bonds are currently trading at Treasuries plus 1960 basis points, whereas in early 2007 they were at Treasuries plus 175 basis points. From a borrower's perspective, this has resulted in new loans being offered at significantly higher rates and on more conservative terms. In early 2007, it was common to obtain an 80% loan-to-value (LTV) conduit loan priced at 120 basis points over the 10-year Treasury yield. This would often translate into a 10-year fixed rate in the 5.75% - 6.00% range with a 30-year amortization. Today, the few conduit lenders that are currently quoting are offering deals up to 70% LTV and priced at 375-400 basis points over the 10-year Treasury yield. This equates to a 10-year fixed rate in the 7.75% - 8.00% range. This drop in leverage, coupled with the dramatic increase in loan spread, has resulted in minimal current demand from borrowers for conduit loans.

According to Commercial Mortgage Alert, "the consensus among industry players is that the market won't see anything resembling a normal flow of commercial MBS issuance until a year from now, at the soonest". Most of the conduit lenders who are currently writing loans are holding them on their balance sheet for securitization when the market stabilizes.

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With the conduit lenders on the sidelines, where are deals getting done today? Insurance companies, banks, Fannie Mae and Freddie Mac are continuing to lend at competitive levels. Year to date 2008, Grandbridge Real Estate Capital has closed and committed 337 loans totaling \$2.5 billion. Insurance companies are lending on high-quality real estate developments. While underwriting and loan structures have become more conservative, attractive long-term fixed rate capital is available. Current deal structures from insurance companies include up to 75% LTV with 10-year fixed interest rates in the 6.40% - 7.00% range.

Local and regional banks continue to originate commercial real estate loans, increasing their market share in this area. These lenders can be very competitive for shorter-term loans of three, five or seven years but usually cannot offer non-recourse debt. Recently, local and regional banks, which had not been as exposed to global debt issues as commercial and investment banks, are beginning to experience increased scrutiny from Federal regulators. FDIC officers are reviewing the asset quality of bank holdings and are requiring banks to raise capital in order to boost reserves for construction and condominium loans; this will have the effect of limiting the funds available to write new commercial loans.

[Fannie Mae](#) remains the most active and aggressive lender for multi-family borrowers. Grandbridge Real Estate Capital's Fannie Mae department continues to close transactions at up to 80% LTV with interest rates in the 6.00% - 6.50% range. Fannie Mae has been a stable source of funds for multi-family throughout the recent period of market unpredictability. As a Delegated Underwriting and Servicing (DUS) lender, Grandbridge offices work directly with in-house Fannie Mae department staff to execute quick and efficient transactions.

Grandbridge is also one of a limited number of Freddie Mac Program Plus seller/servicers. Freddie Mac has proven to be a reliable and consistent investor for multi-family loans. Freddie Mac's Early Rate Lock feature enables a borrower to take the interest rate risk out of the deal very early in the process, which is extremely valuable in today's volatile market.

¹ Commercial Mortgage Securities Association: Compendium of Statistics 7/28/08

² Commercial Mortgage Securities Association: Compendium of Statistics 7/28/08

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