(239) 850-6845

- About
- Services
- Funding
- Newsroom
- Contact

Select Page

Rushing to a wall of uncertainty in 2016

We find 2016 is upon us beginning with a historic decline in the stock market, crude oil at record lows, the dollar strengthening with domestic employment growing in an election year certain to change US leadership. Globally most industrialized countries' growth has slowed most notably China and currency valuations have been used to improve export growth to the US. Concurrently we have had multiple year growth in CRE market with most segments growing and exceeding 2007 activity levels with abundant debt and capital available. The wealth of this country has been confidently spending and investing during this recovery and the global wealth increasingly finds the US CRE market as a safe and an appreciating market. What could be of concern?

Demographics

Demographics – Aging "Boomers" have either accumulated wealth and security which they are investing or spending but more than anticipated where permanently negatively affected and will need social service support for the remainder of their life. The all be it smaller in number the "Xers" are busy attempting to save and provide for later retirement but have not had the previous generations wage growth and now realize as the first generation that will not do as well financially as their parents did. The newest Millennial generation is quickly growing into purchasers and now exceeds in number the "Boomers". Every type of real estate product is now becoming influenced by them.

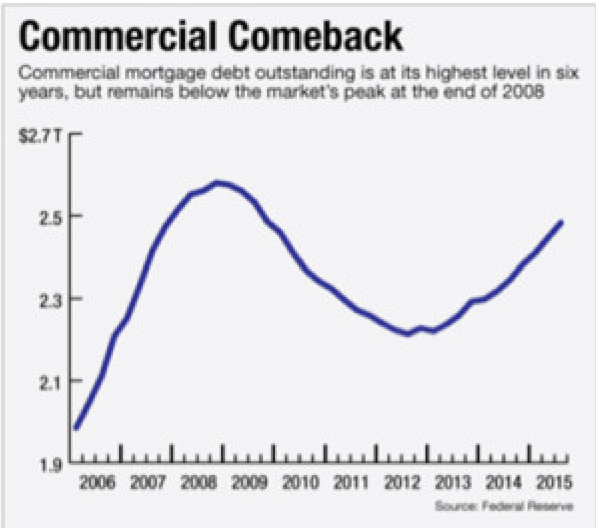
Interest Rates

Interest Rates – The Federal Reserve has increased interest rates the 1st time since 2007. So far this has not affected CRE but flattened the cure leaving long term rates with little change but the fed and others forecast up to 3 more increases during the year. Will the interest rate continue to flatten? What effect will this have on cap rates, values and available financing?

Regulation

Regulation – Federal Bank and SEC Regulators with examination, new regulation, and enforcement are implementing constraints to CRE growth affecting the two largest providers of CRE debt, Banks and CMBS. Without going into detail all the following are announced and in some form of implementation:

- BASAL III (Banks and CMBS)
- Fed CRE Concentration guidance (Banks)
- SEC Regulation AB (CMBS)
- FASB / CECL (Banks)
- FASB / Investments 825-10 (Banks)
- FASB Multi-year lease treatment (All companies)
- Money Market Rules (Banks)



In spite of the concerns above the underlying demand drivers of job growth, consistent retail sales growth and strong demographic trends are encouraging commercial real estate investments. Vacancies have tightened for all property types and in most markets demand has outstripped new supply. Resulting increasing rent growth will remain a positive driver as investors consider future yields. This will result in increasing transaction activity supported by increasing debt throughout 2016.

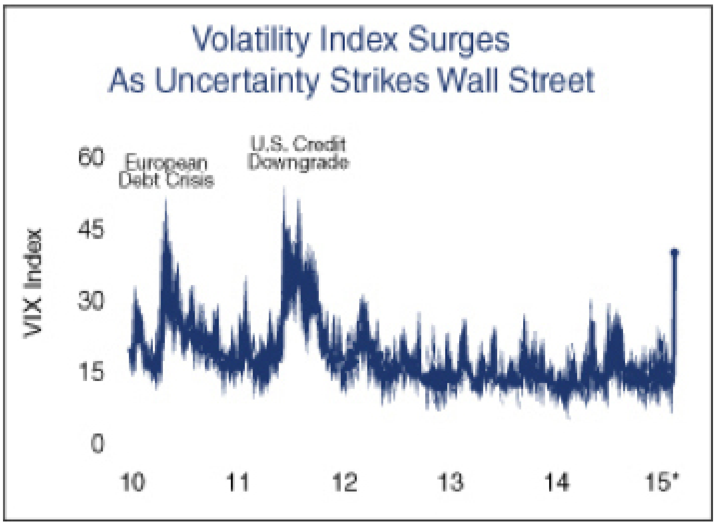
---

(239) 850-6845

CRE to the rescue!

Yes there is so much uncertainty with almost everything.   Global economies, political strife, global environmental practices now affect our domestic investment decisions.   Many of these and other factors seem to be beyond our control. Slowly commercial real estate has been building a solid story of predictability. But consider the following concurrent issues creating uncertainty:

- The stock market volatility index (VIX) continues to forecast investor’s lack of confidence even after the market (DJI) lost 1300 points in two weeks.
- China’s growth has slowed; their currency devalued causing disruption in commercial trade.
- Oil and commodity prices are down lead by $45 / barrel oil.
- The Federal Reserve is hesitant to increase short term rates as promised.
- CRE has outpaced S&P returns to date with lending, investing and selling real estate increasing year over year.



As we begin September 2015 institutional-quality real estate pricing continues to rise with cap rates remaining historically low. Recently however lower quality smaller properties have been selling in increased numbers and averaging 14% annual increased price appreciation according to CoStar Commercial Repeat Sales Indices. In fact net absorption across all asset classes totaled 575.5 million square feet over the past 12 months and was the highest on record since 2008.

This good news for investors hasn't been unnoticed. Watching for another real estate "bubble" the Federal Reserve Bank's Semiannual Monetary Report to Congress reported concern for commercial property's rapidly increasing prices and the deterioration of CMBS activity reported by Moody's investment services. Mitigating concern by the regulatory agencies is the increased capital required by banks for construction and development loans. Current bank construction loans outstanding are down from 2008 levels of $630 billion to $236 billion and growing slowly. Private lenders some referred to as "Shadow Banks" firms act like lenders (but don't have depositors, federal regulators or access to the Federal Reserve bank discount window) have expanded their market share and now account for $150 billion of $500 billion of total 2014 commercial mortgage activity with considerable growth in construction activity. The Fed seems pleased risk has been reduced in the banking system but they have been seeking greater regulatory oversight of this activity by the SEC. The Federal Reserve expects to dampen this increased real estate activity by increasing short term rates at future Fed meetings.

Mortgage Bankers Association has reported commercial mortgage activity increased 29% year over year for the first 6 months of this year. Borrowing increases were broad based across most types of CRE except health care. (-50%) (Multifamily (+58%), industrial property (+32%), office (+22%), retail (+17%) and hotel (+16%)

All commercial mortgage originators increased activity year over year. Leading all originators were agencies Fannie Mae and Freddie Mac with 113% increased originations. Banks increased volume by 64% taking greater interest rate risk and insurance companies continued their growth trend now increasing volume by 14%. Banks had the highest quarterly volume in the last 5 years while they try to offset margin decline with volume. 2015 CMBS activity totaled more than $49.6 billion in six months which supports the $100 billion forecasted this year but swap spreads continue to widen and liquidity moderated in August with economic uncertainty. Individually institution volume was led by Deutsch Bank and Wells Fargo but collectively 56% of CMBS volume was originated by conduits. The lodging sector has seen the largest increase of issuance ($13B) now exceeding any time in the last 3 years and loan to values are increasing to now 70.19% depending on property type.

Commercial mortgage real estate investment trusts (mREITs) are playing an increasing role in the commercial real estate lending market. mREITs predominately originate commercial mortgages to hold on their balance sheet but they also originate conduit loans securitizing for sale and they invest in commercial mortgage-backed securities. Collectively 13 Mortgage REITS hold $32.2 billion in assets and are up 52% since 2010. Since mREITs are less regulated than banks they have become a significant competitor for banks and are expected to take an increasing share of the $350 billion maturing CMBS loans maturing in the next 2 years.

In summary investors have found commercial real estate investment returns to be rewarding and perhaps a more certain return than other asset alternatives. Most assuredly if absorption is finally dramatically increasing you can be sure rental rates and increased construction will follow. Existing and new private lenders are aggressively providing low cost financing and if rental rates increase with absorption even increased rates won't necessarily slow down the momentum.   With current uncertainty in other investible assets CRE is here offering what can't be found elsewhere.

---

(239) 850-6845

WHEELER CAPITAL PARTNERS

- About
- Services
- Funding
- Newsroom
- Contact

Select Page

Full speed ahead for Commercial Real Estate in 2015

Improving rental rates, lower vacancy rates, muted construction with low interest rates caused price appreciation and continued CRE growth in 2014. Although construction was muted overall there was sizable growth of multifamily and hotel construction expected to moderate in 2015. The Urban Land Institute and Ernst and Young forecasts 2015 real estate transaction volume increasing 6% to $425 billion and Dodge's Construction Forecast expects a 9% increase to $612 billion in 2015. Leveraged purchasers and investors are competing fiercely for product requesting lowered underwriting criteria and lower investor IRR. 2015 is expected to be even stronger in dollar volume and transaction count as the same market characteristics are motivating buyers and sellers.

New construction has been slow to gain momentum but will be increasing growth across most real estate types creating greater inventory in major markets. This continued growth is supported by the positive economic environment, construction financing becoming more available, (reflecting some easing of bank lending standards) a greater focus on the real estate by the investment community and more construction bonding available. Dodge Construction Forecast is forecasting the following:

	2015		2014	
	% increase	$ in Billions	% increase	$ in Billions
Commercial	15%	32.3	14%	27.1
Retail	11%	18.9	9%	17.0
Office	19%	32.3	23%	27.1
Institutional	9%	103.6	4%	95.4
Single Family	15%	189.7	11%	165.4
Multifamily	9%	67.2	22%	61.9
Public Works	-9%	118.8	-9%	113.4
Mfg. Plants	-16%	24.4	57%	20.5
Utilities	-9%	20.5	-28%	22.5
Other		4.4		13.7
Total	9%	612	5%	564

The one trillion dollars of real estate sales and new construction will be supported by capital formation and debt. Hedge funds are expected to raise $90 billion, Private Real Estate funds $90 billion, Private Real Estate focusing on debt investing $26 billion, increased REIT investing with total returns in excess of 20% and increased debt funding of $407 billion. All investors are chasing yield and some are funding mezzanine loans up to 90% LTV at rates floating in the 9% to 11% range. Ultimately the need will be greater for the debt / mezzanine funding given the CMBS “wall of maturities”.

Mortgage total debt outstanding grew to $2.57 trillion and 2014 annualized originations were $379 billion according to The Mortgage Bankers Association. The lenders were led by Banks who provided 66% of the increased net outstanding mortgage debt and grew construction and development outstanding year over year for the first time since 2008. CMBS closed volume increased $14 billion year over year but outstanding was flat. Most other debt providers had slight year over year net growth.

Bank, Government Agency, Financial, Insurance, CMBS and Private / Other capital lending sources are all growing in absolute numbers and fighting for share. They are supported by going-on cap rates which compressed nationally across all product types and classes in 2014. The many all-time low cap rates supported sellers, investors and lenders. Commercial real estate cash flow is improving slowly with escalating rental rates and decreasing vacancy while long term interest rates remain low. These projections are causing REIT purchases often unleveraged to compete aggressively with leverage buyers causing CMBS and Bank's to push underwriting criteria to compete with this activity. Much of the valuation and sales price increases of the future will be supported by increasing NOI rather than reducing cap rates.

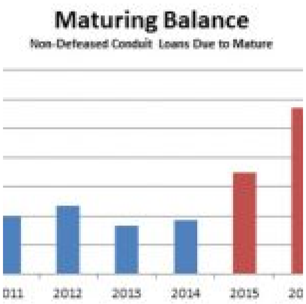
CMBS issuance grew 18% to $94 billion in 2014 and according to Moody's an additional 40 CMBS originator companies were added to the competition. 2015 issuance is expected to grow to $125M with a good % of origination from the maturing CMBS "Wall of Maturities". It is expected $300 billion will mature in the next 3 years originally issued in 2005 thru 2007 with weaker underwriting. Trepp estimates that over 20% of the maturities will require additional capital when the properties are refinanced or sold. New CMBS loan to value and debt yields will continue to be stretched to allow refinancing. Moody's Commercial Property Price Index indicated LTV and debt yield ratios are beginning to resemble 2007 sold transactions. In April 2014 Moody's Investors Service warned CMBS issuers of the "boiling frog syndrome". The metaphor is that a frog put in boiling water will jump out, while one in cold water won't notice the danger if the temperature heats up slowly. Hence lenders are relaxing their standards, will continue to do so in 2015 making it more important to understand "the temperature of the water"

Bank balance sheet lending growth has dwarfed any other lending type of origination according to The Mortgage Association and balances are now in excess of $920 billion or 36% of the entire market. Banks now fund 78 cents of every dollar, on net, of all multifamily loans. GSE make up 21 cents of every multifamily net dollar but they have lost share for the last 18 months. Banks must increase lending in this low rate and spread environment. It is expected product type and secondary / tertiary markets will become acceptable risks in 2015 as overall markets improve. This continued need by the market leader and similar needs by other lenders will provide even greater production and outstanding in 2015.

All the pieces are in place to continue the 2014 trend of increasing real estate transactions and construction growth. Domestic and foreign investors are seeking yield and the upside of the trend. Lenders, REIT's and Funds are liquid seeking opportunities and in spite of the following unknown risks greater growth is expected in 2015:

- Will the anticipated short term interest rate movement cause excessive long term interest rate movement?
- Will TRIA (Terror Risk Insurance Act) be again supported by congress?
- Will regulatory uncertainty of key regulations FIRPTA and lease accounting standards be determined?
- Will oil prices remain below $50 per barrel and what impact will it have on commercial real estate?
- Will "an event" create geopolitical instability for governments, investors and lenders?

The Wall of Maturities: Something's Gotta Give



Published November 13, 2014

Commercial real estate lenders, borrowers, and CMBS investors alike are looking at the next three years as a true test of the strength of recovering capital markets. Property values have rebounded in many markets, interest rates are low, and foreign investment is boosting US properties in gateway cities. On the other hand, big box retailers continue to close stores at a rapid pace, big banks and law firms are cutting their office footprints, and new construction is slowing down multifamily appreciation. Rising rates and higher relative underwriting standards could lead to volatility both in CMBS prices and commercial real estate values just as more loans than ever before reach maturity.

CMBS issuance volumes were higher than ever in 2005, 2006, and 2007 with a peak volume of about $230 billion in 2007. The far majority of this issuance was made up of ten year balloon loans, creating a wall of maturities from 2015 to 2017. Over the next three years, more than $300 billion in Conduit CMBS loan balance will mature. That's more than 2.5 times the amount that matured from 2012 to 2014.

Office and retail loans make up 63% of the loan balance maturing in the next three years with multifamily in third at 14%.

"Refinancability"

With 2014 issuance set to reach just below $100 billion and 2015 forecasts calling for a marginal increase, the CMBS origination engine will have to pick up the pace to digest the wall of maturities, especially in the heavy 2016 and 2017 years. Headwinds include the threat of rising rates, the end of quantitative easing, and the implementation of new risk retention regulations coming in January of 2017. Currently, multifamily and industrial have the highest rate of maturing delinquent or specially serviced loans at 12.4% and 12.0% respectively. Multifamily delinquency in 2016 maturities comes mainly from the $3 billion StuyTown loan which actually suffers more from risk of extension and litigation than of low valuation. The Schron Industrial Portfolio ($208.5 million) and Bush Terminal ($292.5 million) loans contribute to the high rates in 2015 and 2017 in the Industrial category.

Comparing debt yields, cap rates, LTVs, and DSCRs of loans originated so far this year with those coming due gives us an idea of how easily borrowers will be able to refinance or sell their properties when their balloon payment arrives. Below is a comparison of all conduit loans originated so far in 2014 and the loans coming due in the next three years. Cap rates on average have been lower on new issuance than what's coming due while DSCR on new loans is significantly higher than those coming due. Maturing loan LTV ratios are also higher than what the average lender is doing this year especially in loans coming due in 2016 and 2017. Debt yields on maturing loans are generally lower than what lenders are requiring on new loans so far this year. Highlighted cells show where maturing debt yields, cap rates, and DSCR are lower than current origination as well as where LTV is higher.

	New Origination	Maturing		
	2014 YTD	2015	2016	2017
Cap Rate	6.68%	7.17%	6.75%	6.53%
Debt Yield	11.30%	11.99%	10.89%	9.99%
LTV	59.09%	59.76%	62.01%	65.36%
DSCR	1.82x	1.50x	1.39x	1.37x

For further detail, we break out these measures by property type to find pockets of opportunity for originators to find value in maturing loans as well as sectors where additional capital will be necessary.

Cap Rates

	New Origination	Maturing		
	2014 YTD	2015	2016	2017
Office	6.62%	6.80%	6.37%	5.98%
Retail	6.62%	7.10%	6.91%	6.59%
Multifamily	6.69%	7.37%	6.60%	6.45%
Lodging	8.15%	8.78%	8.45%	8.52%
Other	5.77%	6.65%	5.95%	6.26%
Industrial	7.15%	7.46%	7.04%	7.28%
Total	**6.68%**	**7.17%**	**6.75%**	**6.53%**

Debt Yield

	New Origination	Maturing		
	2014 YTD	2015	2016	2017
Office	11.20%	11.67%	10.61%	9.48%
Retail	10.96%	11.22%	10.38%	9.64%
Multifamily	9.85%	11.70%	9.96%	9.54%
Lodging	13.54%	15.36%	14.60%	12.78%
Other	11.46%	12.76%	11.38%	10.10%
Industrial	11.29%	11.81%	10.94%	11.35%
Total	**11.30%**	**11.99%**	**10.89%**	**9.99%**

LTV

	New Origination	Maturing		
	2014YTD	2015	2016	2017
Office	59.09%	58.23%	60.07%	63.03%
Retail	60.42%	63.26%	66.52%	68.37%
Multifamily	67.87%	62.97%	66.29%	67.57%
Lodging	60.19%	57.16%	57.92%	66.67%
Other	50.37%	52.11%	52.31%	61.93%
Industrial	63.27%	63.16%	64.38%	64.16%
Total	**59.09%**	**59.76%**	**62.01%**	**65.36%**

DSCR

	New Origination	Maturing		
	2014YTD	2015	2016	2017
Office	1.61x	1.37x	1.30x	1.34x
Retail	1.59x	1.43x	1.32x	1.33x
Multifamily	1.52x	1.55x	1.45x	1.37x
Lodging	1.79x	1.80x	1.59x	1.48x
Other	2.58x	1.70x	1.54x	1.47x
Industrial	1.51x	1.44x	1.37x	1.39x
Total	**1.82x**	**1.50x**	**1.39x**	**1.37x**

So far in 2014, new loan interest rates average 4.94% for all property types with a high of 5.08% in lodging and a low of 4.89% in office. Doing a simple analysis of maturing loans, applying a 5% interest only payment to current loan balances and looking at current Net Cash Flow measures gives a rough estimate of what DSCRs on a refinance loan might be. Assuming lenders require at least a 1.50x DSCR on new loans, 82% of loans maturing between 2015 and 2017 would be eligible for refinance at current debt and income levels. Loans maturing in 2015 have the highest percentage of loans at or above the threshold while 2017 maturities are the lowest.

	Maturing			
New Loan DSCR	2015	2016	2017	All
1.50x+	86.33%	83.13%	78.77%	82.48%
<1.50x	13.67%	16.87%	21.23%	17.52%

Breaking down hypothetical “new loans” by property type shows office properties will have the hardest time refinancing at current debt and income levels and all property types get worse moving into 2017.

	Maturing "New Loan" DSCR >= 1.50x			
	2015	2016	2017	All
Office	77.30%	74.97%	73.12%	74.92%
Retail	87.93%	83.20%	78.96%	83.11%
Multifamily	88.22%	86.67%	78.60%	84.36%
Lodging	89.94%	85.63%	80.67%	84.69%
Other	89.98%	87.77%	83.17%	86.85%
Industrial	84.09%	82.46%	82.52%	82.88%

Going Forward

Looking ahead, the wall of maturities presents an opportunity for originators and a worry for legacy CMBS bondholders. In 2012, a mini-wave of maturities resulting from 5 year loans done in 2007 sent the Trepp delinquency rate to its highest level of all time. Maturing volume that year was 40% of what it will be in both 2016 and 2017. With nearly 60% of the entire CMBS public conduit universe maturing in the next three years, property transaction and origination volumes will have to continue and accelerate their upward trends. Almost 20% of those maturities will also require additional capital either from current borrowers or new buyers when the loan is refinanced or the property is sold. All of this will have to happen in an environment of uncertainty in terms of interest rates, property values, and a shifting landscape in office and retail property usage. CMBS investors are well aware of the risks inherent in the wall of maturities, the question is what will the economy look like in six months, in a year, in two years when the brunt of this wave is set to hit the CRE market. Lower for longer interest rates, continued property value appreciation, and fundamental performance growth would make the wall much easier to scale.

Flexible Rates, Terms, and Conditions

Wheeler Capital Partners is a trusted partner in finding funding sources for its client’s financing needs.

- Follow
- Follow

Contact Us

12645 Race Track Road
Tampa, FL 33626
Office: (239) 850-6845

Hours: Mon-Fri 8am-5pm

©2023 Wheeler Capital Partners | NMLS ID 1008714