



Reengagement and Risk-Taking in the CRE Lending Market

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A Few Thought on Hurricane Sandy

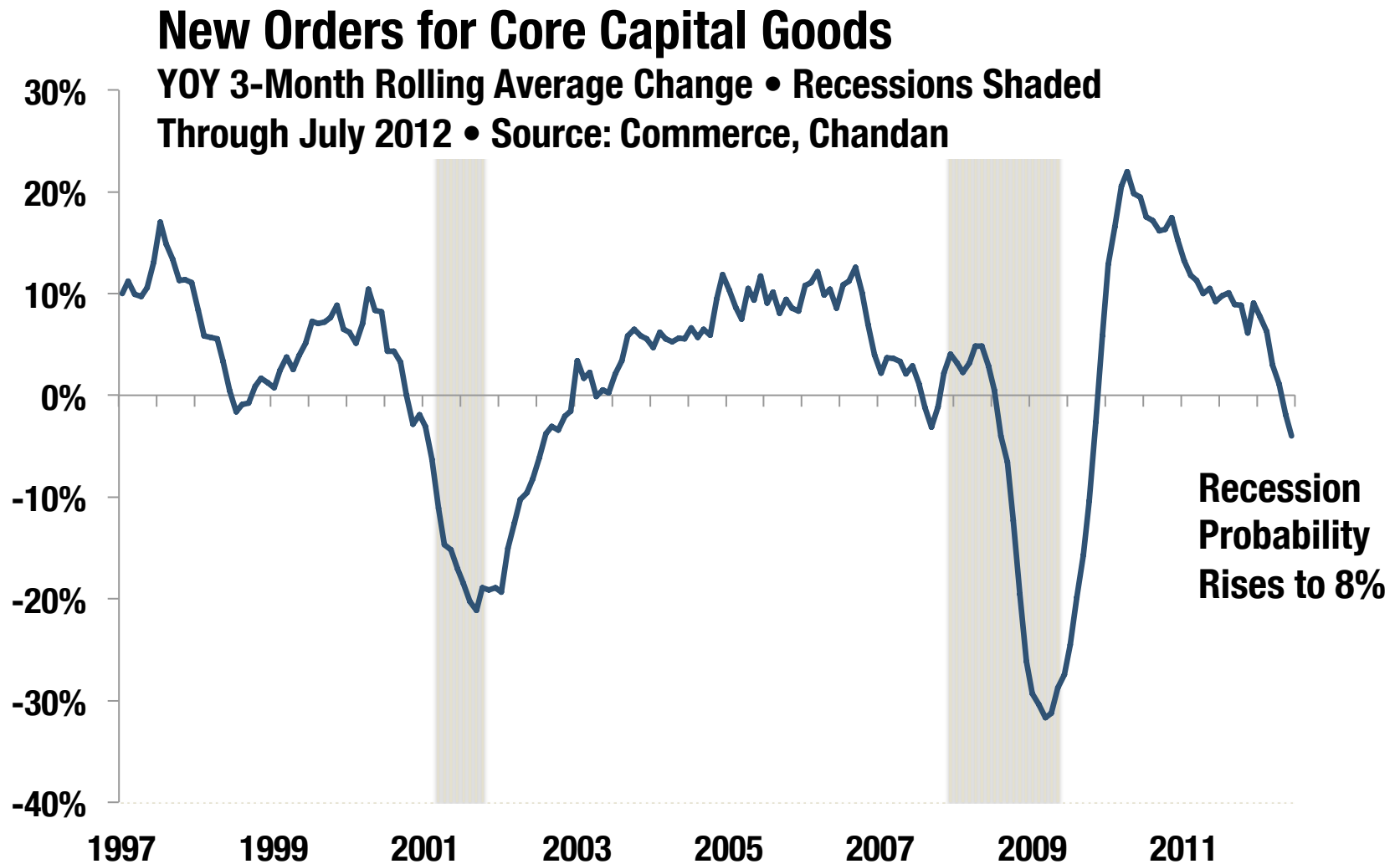
ECONOMIC IMPACT OF HURRICANE SANDY

- **Immediate impact is strongly negative, reflecting sharp drop in trade and commerce, financial markets**
- **Early cost estimates range from \$40B to \$60B**
- **Activity has or will normalize for most large businesses over the next week**
- **Small businesses especially vulnerable to disruptions in operating cash flow**

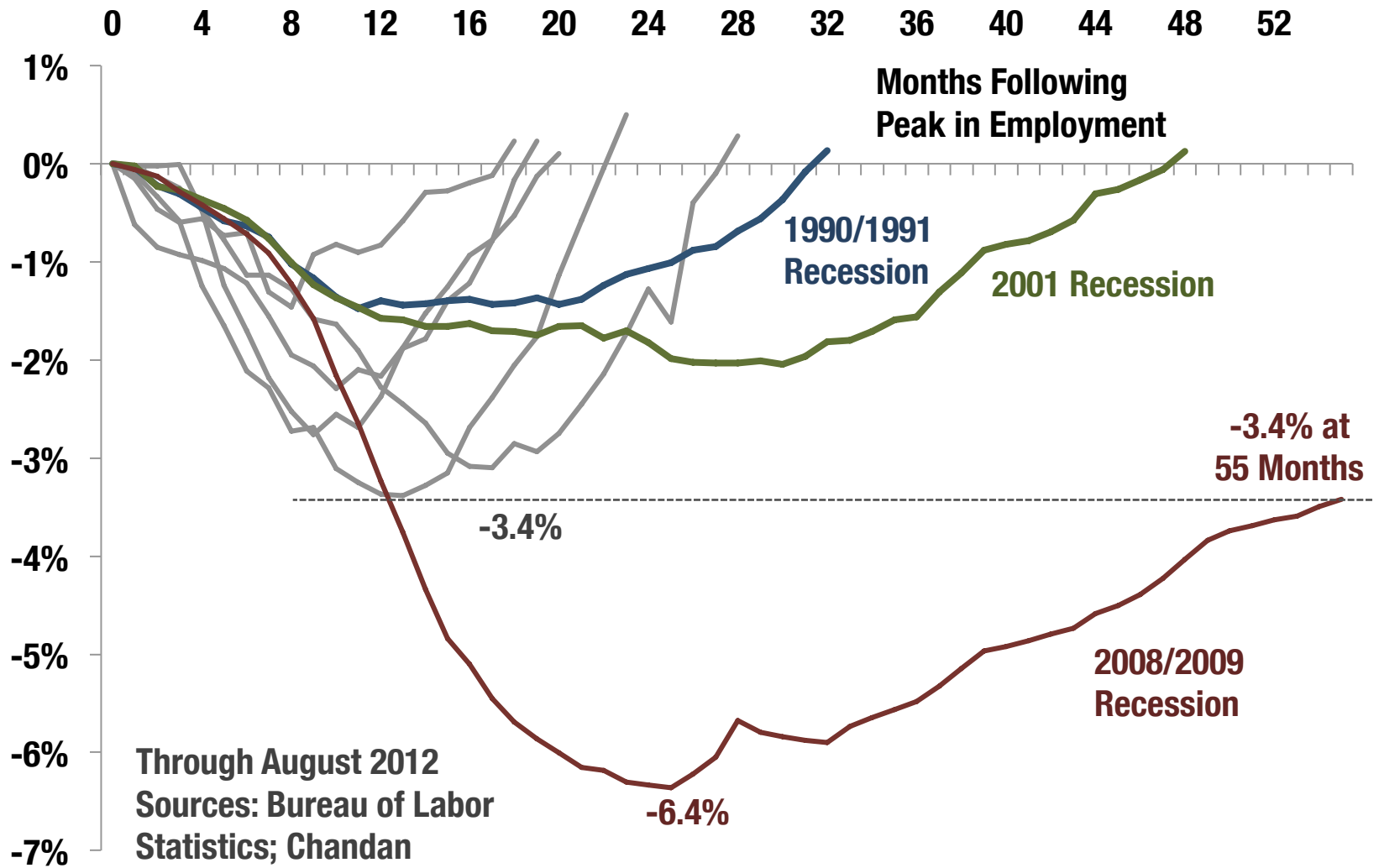
ECONOMIC IMPACT OF HURRICANE SANDY

- **Productivity will remain impaired where there is damage to infrastructure**
 - **Subways, airports, seaports, roads, and rail lines**
- **Higher property and infrastructure losses have the perverse effect of lifting the medium-term outlook**
- **Long-term growth projections for the Mid-Atlantic economy are unchanged**
- **Changing view of event risk along the East Coast**

BAD TIMING FOR THE ECONOMY



THE ECONOMY EMPLOYMENT



FOUNDATIONS OF INSTABILITY

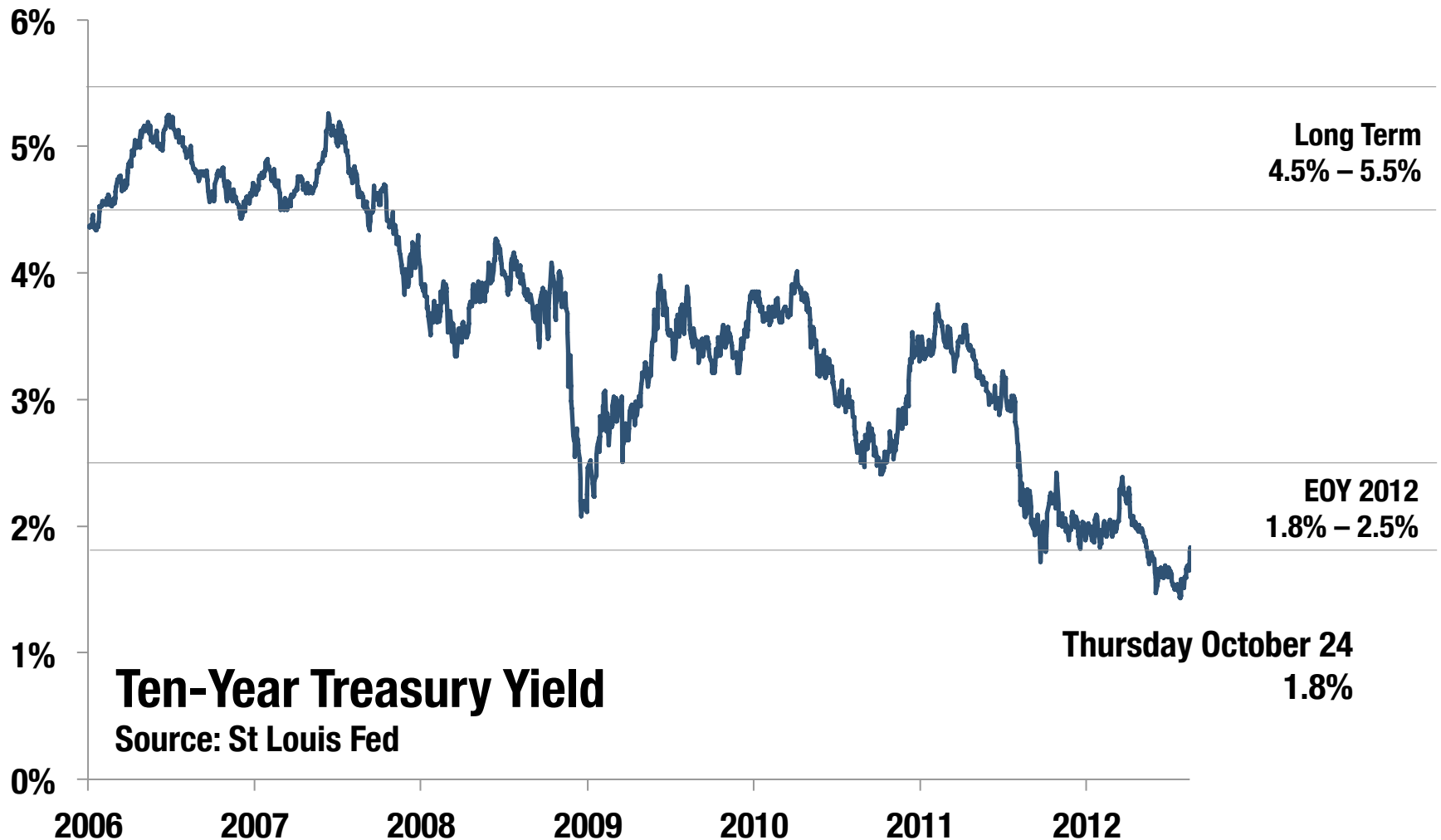
Global Event Risk

**Eurozone Crisis,
the US Fiscal Cliff,
Agency Reform, and
the Era of Policy Dysfunction**



National Lending Trends

DISTORTIONS DEFINE THE RECOVERY



BROAD OBSERVATIONS FROM Q3 2012

- **4,200 transactions recorded during Q3**
- **Q4 sale transactions are up significantly**
- **Historically low borrowing costs, reflecting lower benchmark rates**
- **Moderate easing in underwriting standards**
 - Increase in initial interest-only periods
 - Increase in cash-out refinancings
 - In recent CMBS, higher stressed LTVs, lower DSCRs
 - Smaller negative appraisal bias[†]
 - In the apartment sector, further compression in risk pricing

[†]Limited Sample

COMMERCIAL PROPERTY FINANCING TRENDS

Q3 2012	Interest Rate Fixed-Rate Permanent	Change from Q2 2012 In BPS	Debt Yield	Change from Q2 2012 In BPS
Office	4.8%	-20	11.0%	+10
Retail • Malls & Anchored	4.8%	-20	10.9%	-10
Retail • Unanchored Centers	4.9%	-30	11.3%	-20
Industrial	5.0%	-20	11.9%	-20

Source: Chandan; Loans of \$2 Million and Greater; Unweighted Averages

APARTMENT FINANCING TRENDS

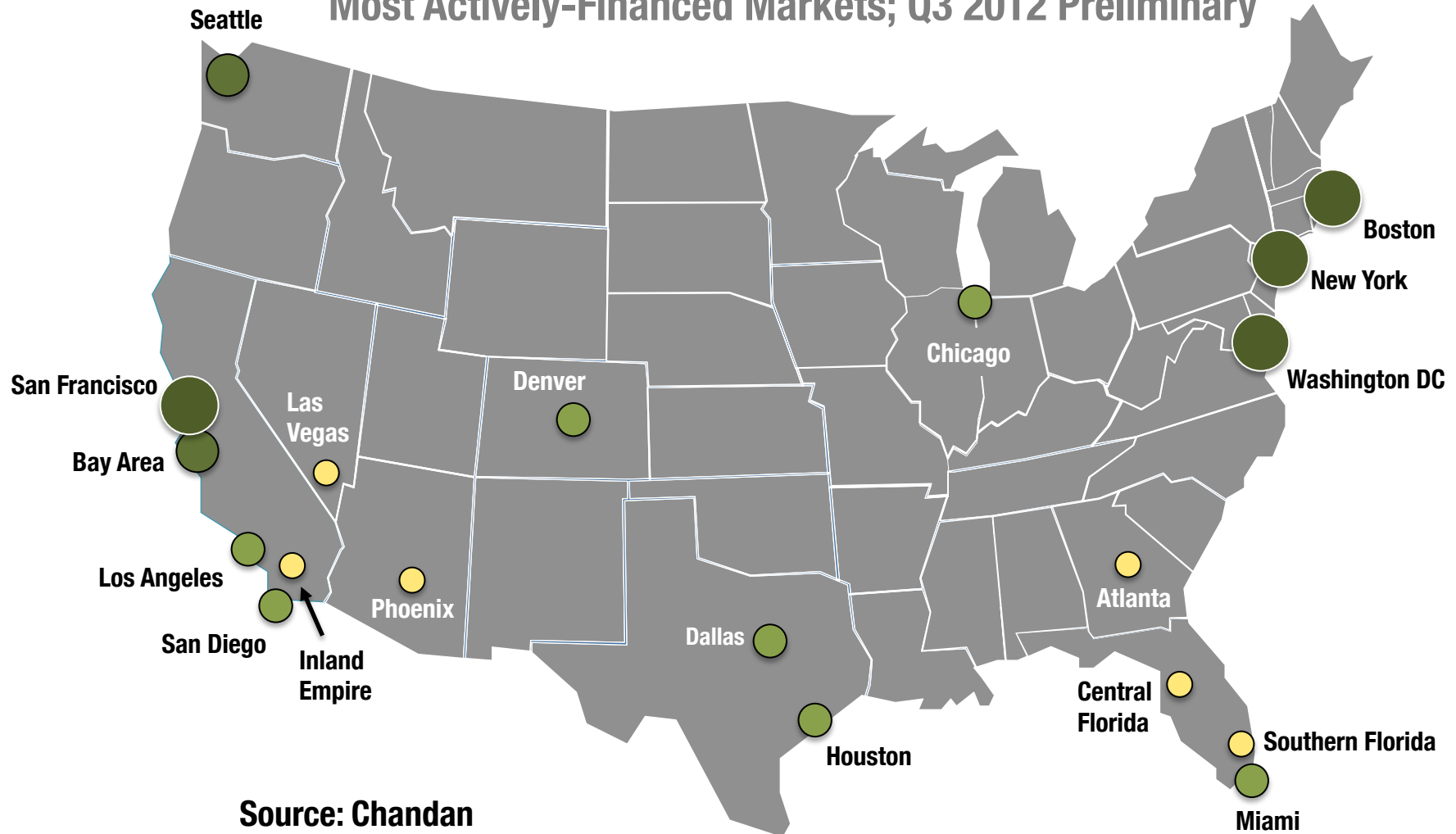
Q3 2012 Originations

Origination Balance	Interest Rate	Rate Spread	Debt Yield	Cap Rate	Occupancy Rate	Expense Ratio
Less Than \$5M	4.0%	216	10.3%	6.9%	95.2%	53.0%
\$5M to \$10M	3.8%	198	10.3%	6.9%	94.2%	50.7%
\$10M to \$25M	3.8%	190	8.8%	6.3%	94.7%	46.7%
\$25M +	3.7%	184	8.1%	5.7%	94.9%	42.1%

Source: Chandan; Loans of \$2 Million and Greater; Unweighted Averages

UNEVEN RECOVERY IN REFI VALUES

Commercial Property Valuations Relative to Pre-Crisis Peak Most Actively-Financed Markets; Q3 2012 Preliminary



SHIFT TO EXIT RISK

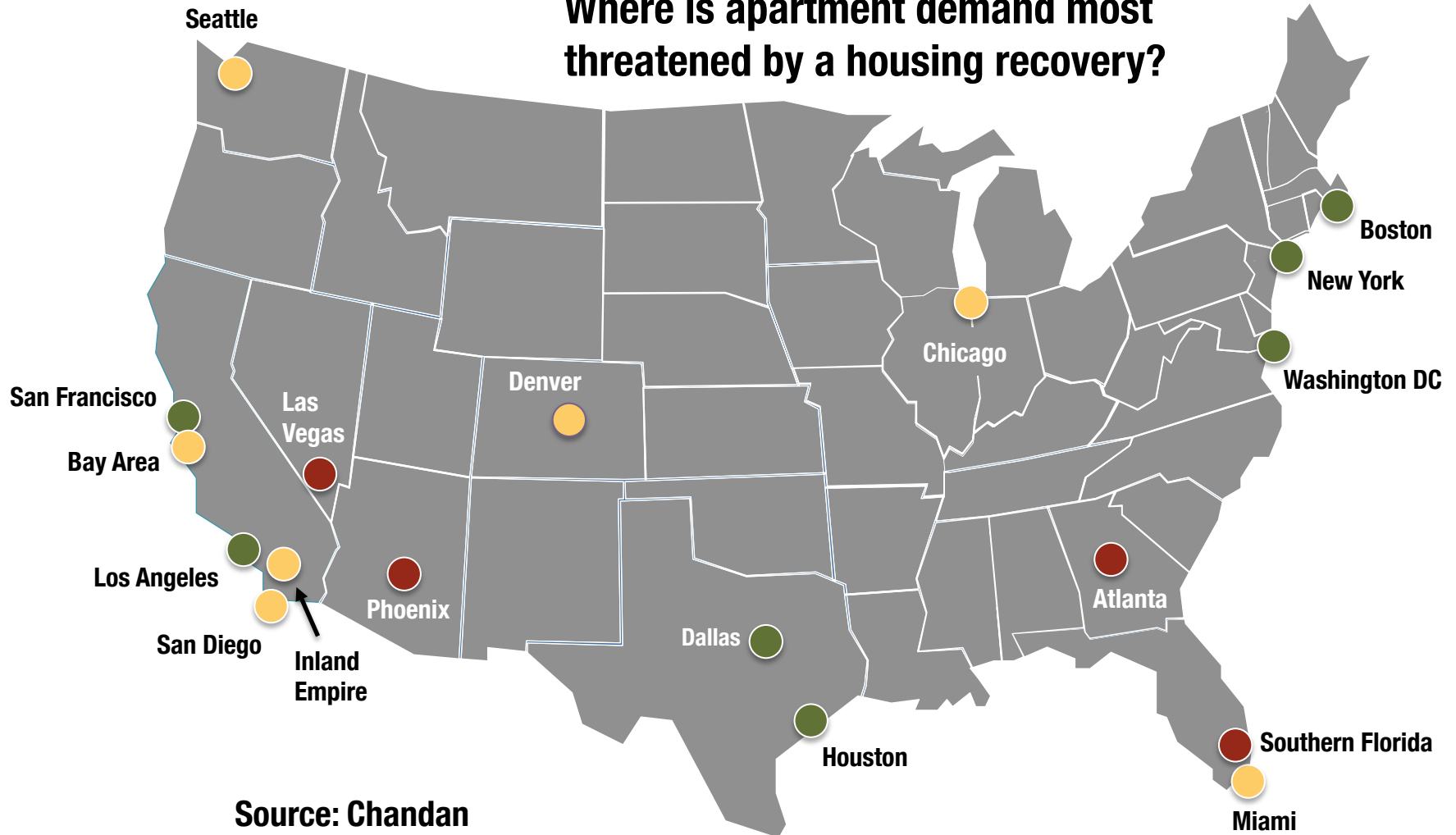
	Scenario 1 Constant Spreads		Scenario 2 Spreads Narrow Sharply	
	Q3 2012	Q3 2019	Q3 2012	Q3 2019
Treasury	1.7%	4.5%	1.7%	4.5%
Cap Rate Spread BPS	330	330	330	200
Cap Rate	5.0%	7.8%	5.0%	6.5%
Annual NOI Growth to Hold Value		6.6%		3.8%

For modeling purposes, assumes marked to 10-year Treasury. Source: Chandan

SHIFT TO REBALANCING RISK FROM HOUSING

Q3 2012 Preliminary

Where is apartment demand most threatened by a housing recovery?



THIRD QUARTER'S MOST FINANCABLE METROS

1 New York

2 San Francisco

3 Seattle

4 Washington DC

5 Dallas

6 Denver

7 Austin

8 Houston

9 Atlanta

10 Chicago

**Indexed Across Core
Property Types by:**

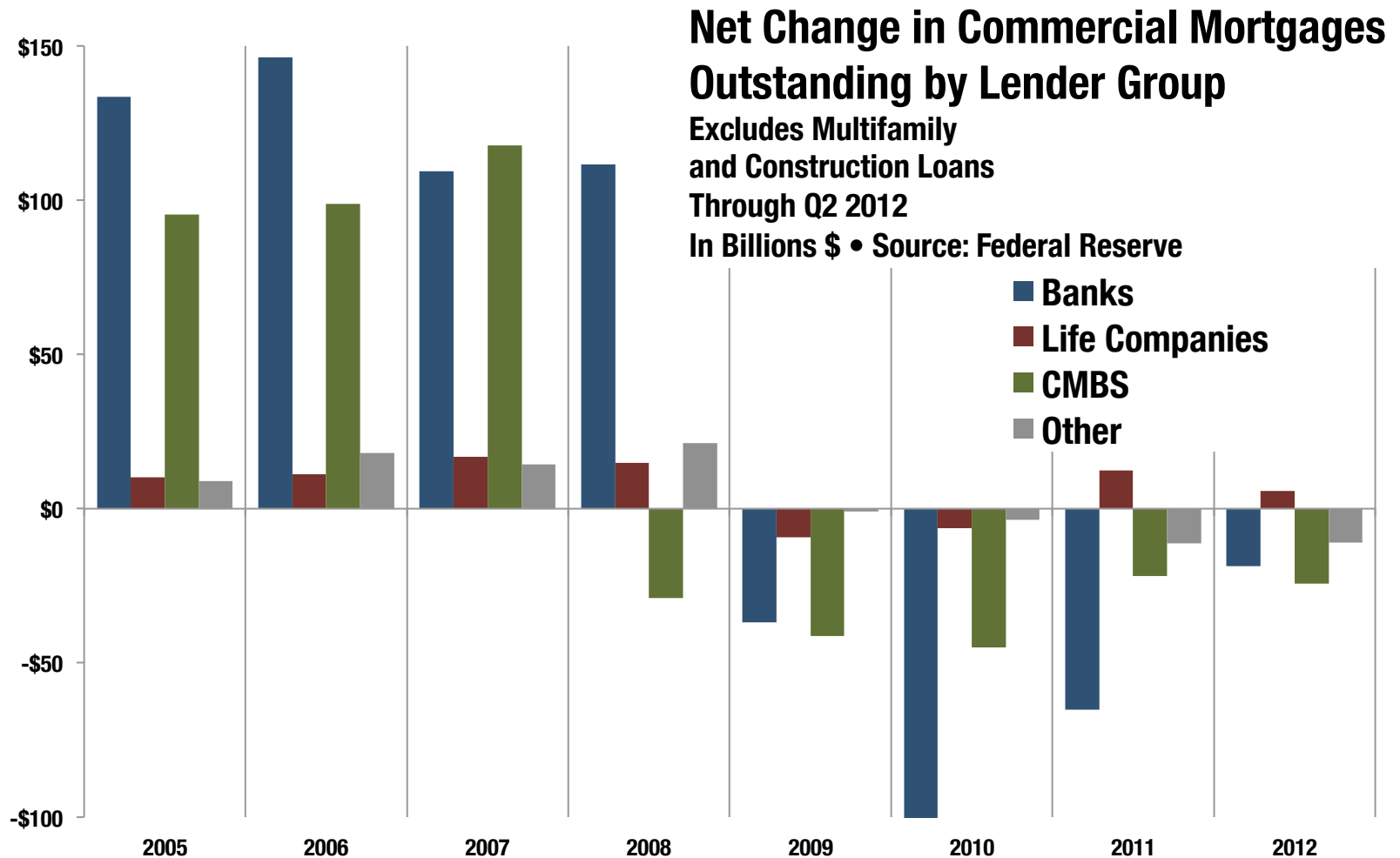
- **Volume of Lending**
- **Volume Relative to
Proxy for Inventory**
- **Lender Concentration**
- **Weighted Average
Debt Yields**

Sources of Credit

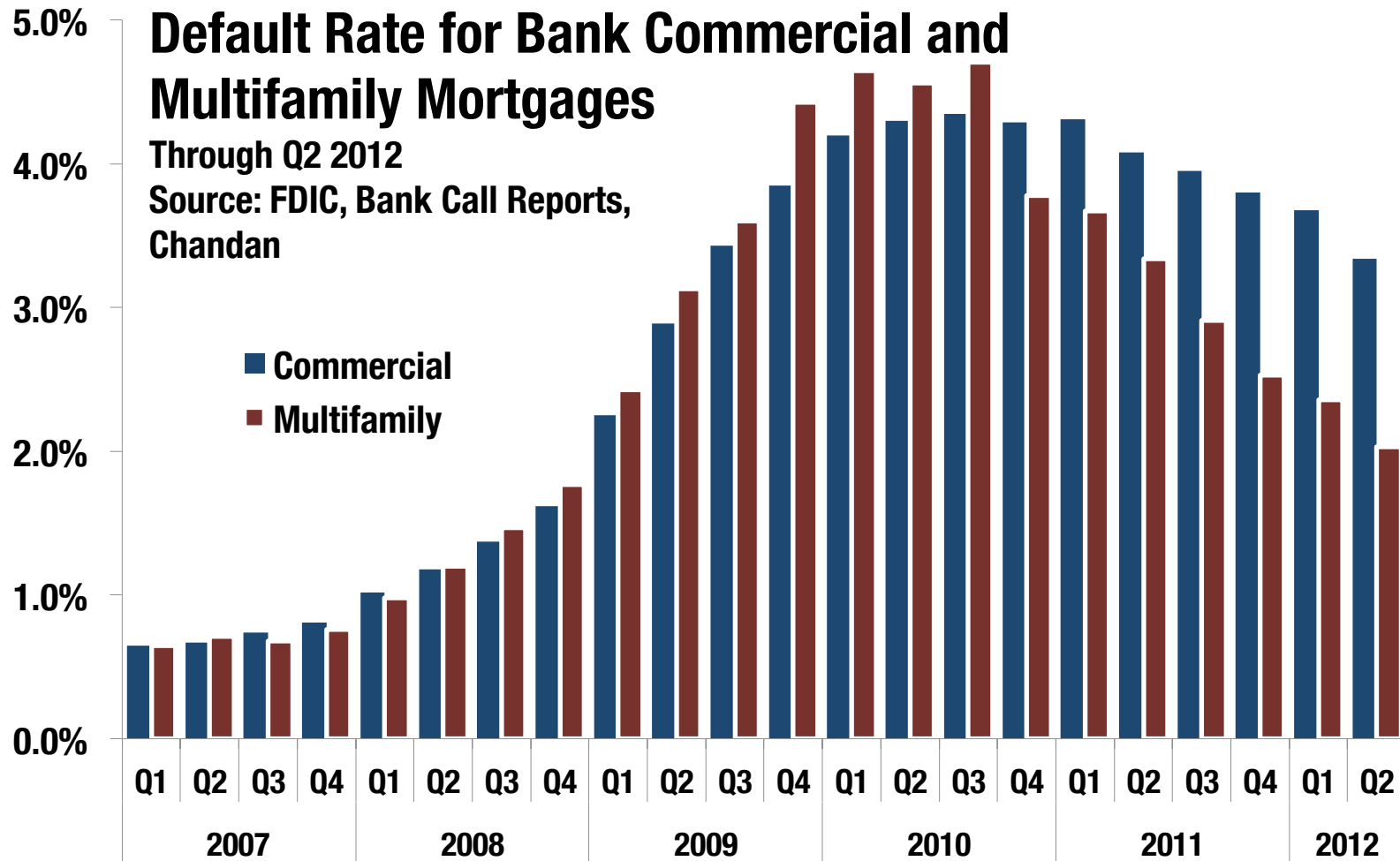
BROAD OBSERVATIONS FROM Q3 2012

- **Minority of banks increasing their net exposure, mostly in multifamily**
 - **Tend to be larger institutions, located in major markets where price recovery is stronger**
- **CMBS share of the market growing**
 - **Supporting smaller office transactions in secondary and tertiary markets**
- **Life companies seeing more competition from international banks, CMBS alternatives**
- **Agency lending holding strong, driving capital into smaller markets**

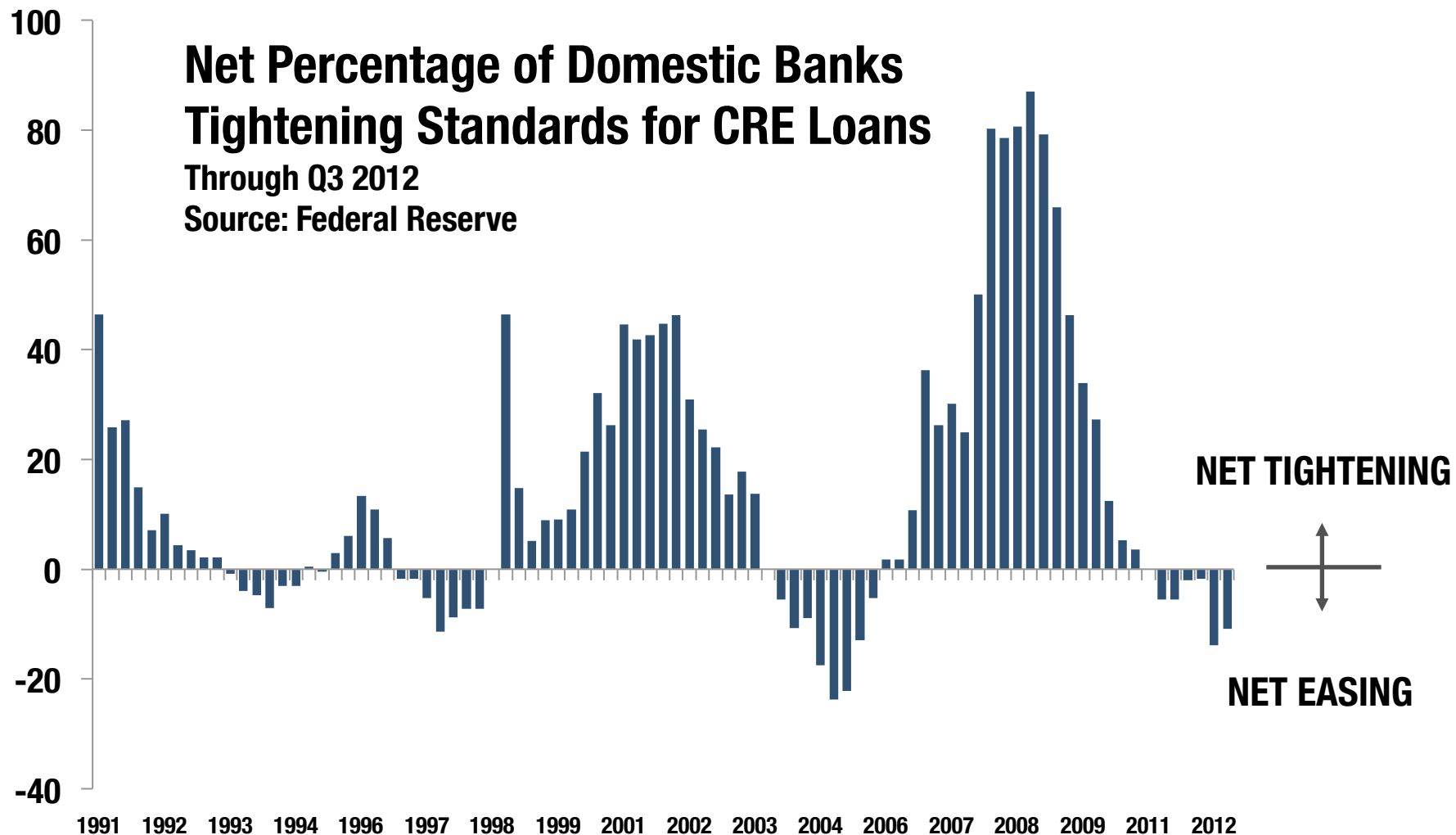
CRE CAPITAL SOURCES



BANKS' LEGACY LOAN PERFORMANCE



BANK LENDING STANDARDS



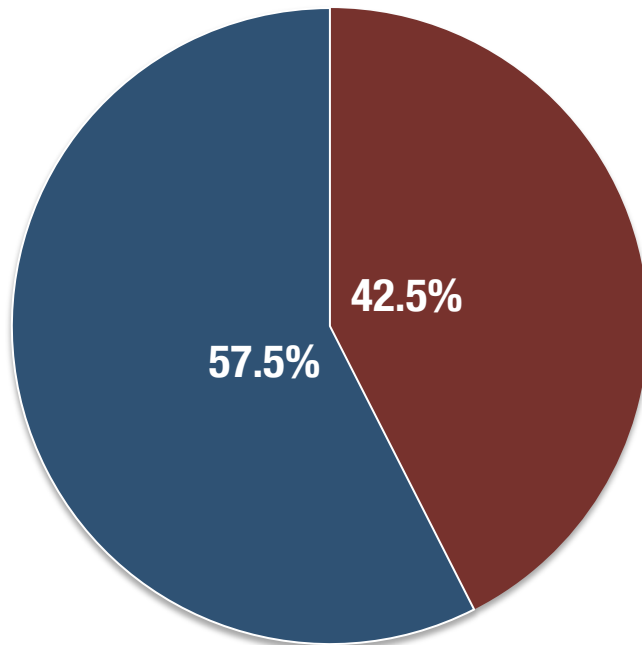
RECIDIVISM AND OTHER DRAGS ON LENDING

Commercial TDR Loans

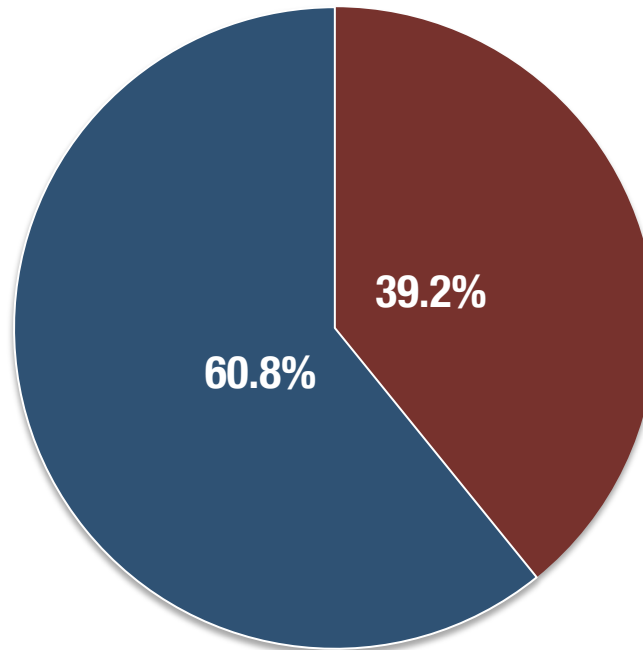
Performing | Non Performing

Through Q2 2012

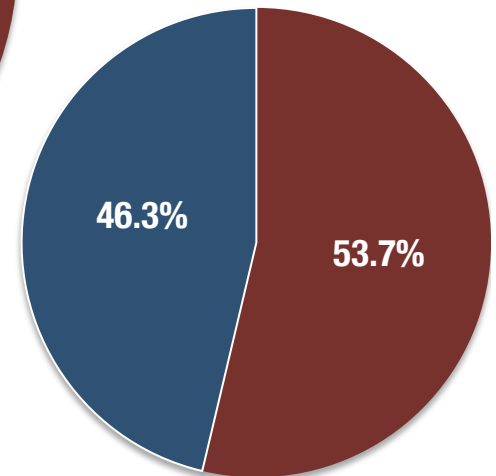
Source: Chandan, FDIC



Multifamily TDR Loans



Construction TDR Loans



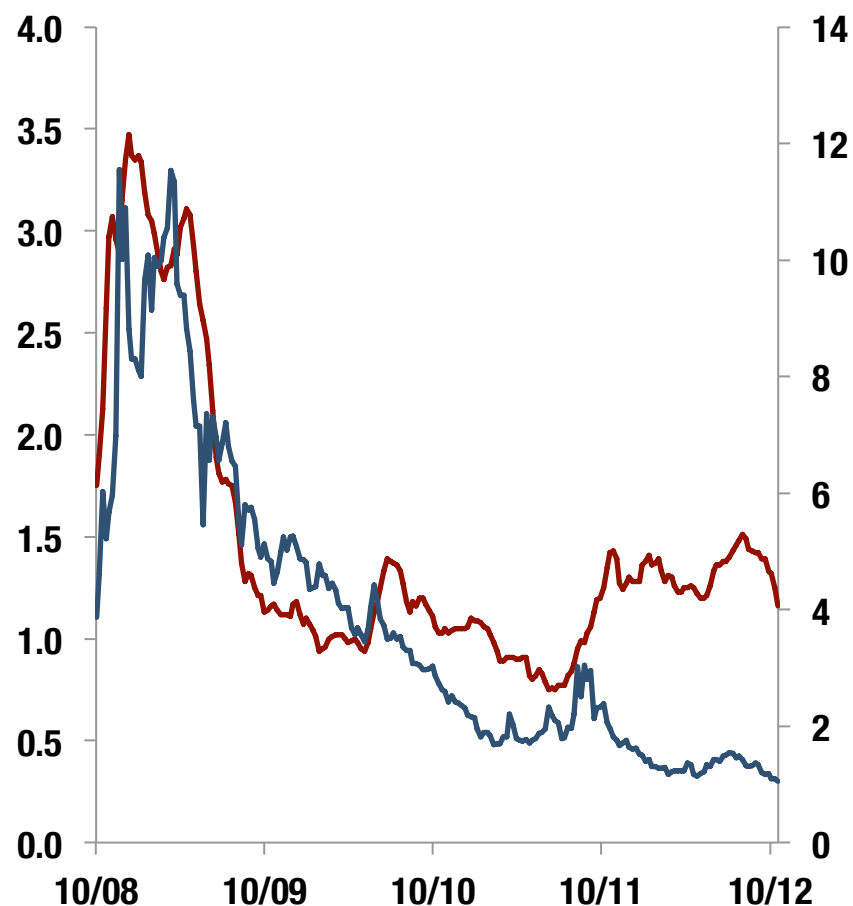
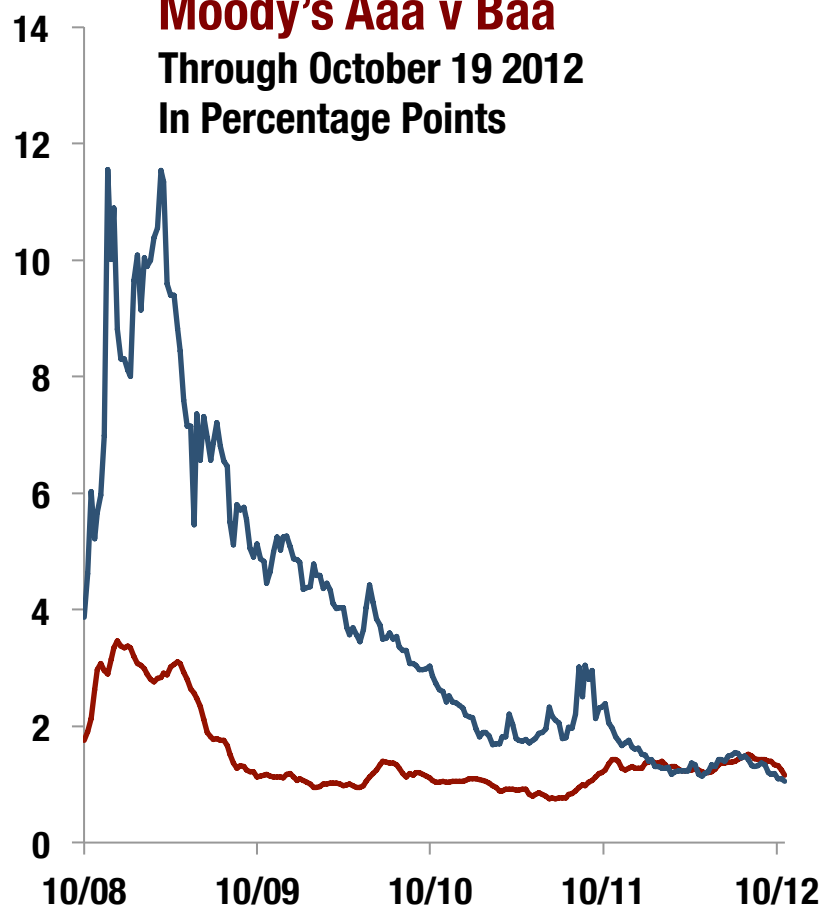
CMBS SPREADS NARROW

CMBS Spreads (10-Year AAA; Source: Morgan Stanley)

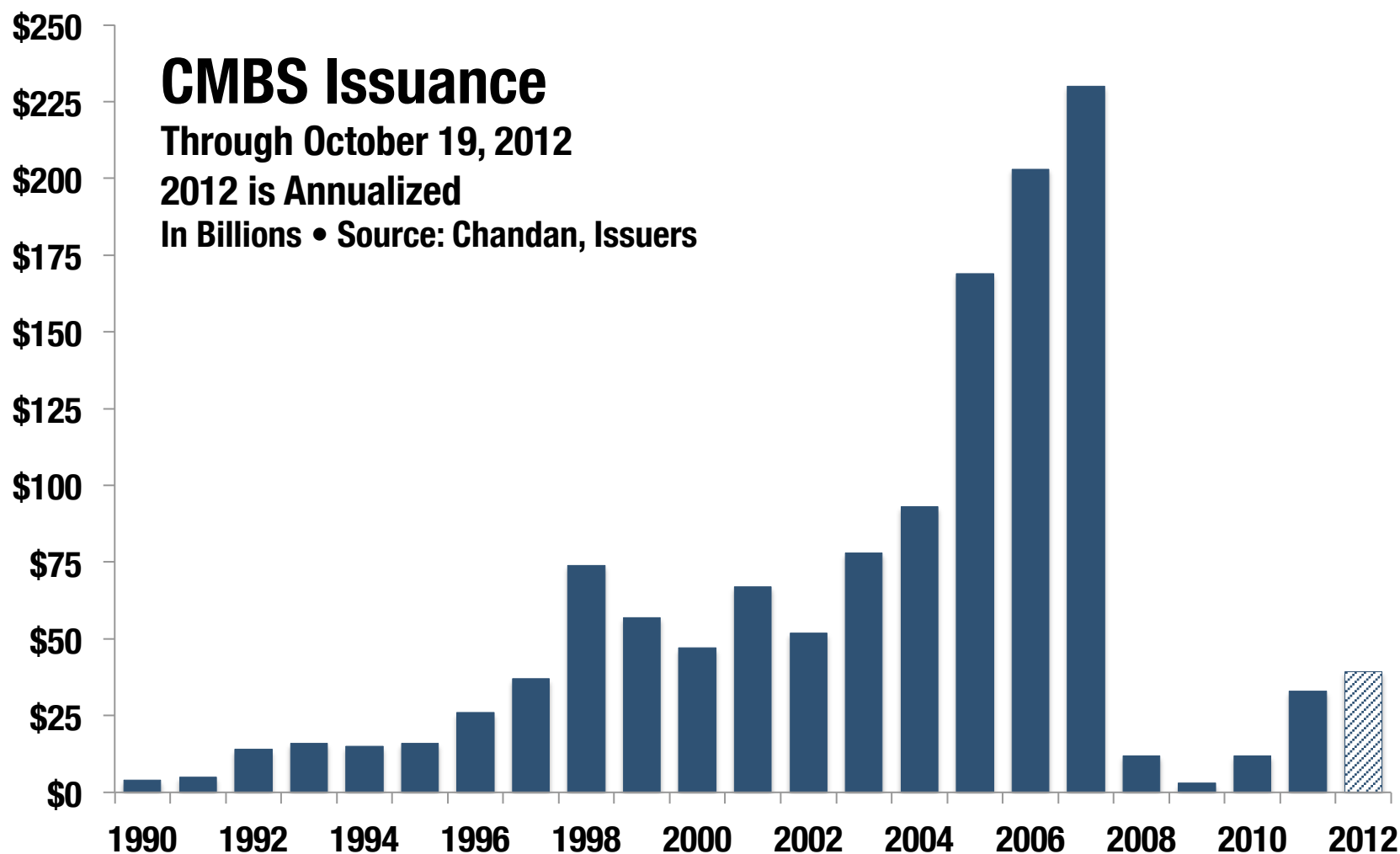
Moody's Aaa v Baa

Through October 19 2012

In Percentage Points



SECURITIZATION ACTIVITY BUILDS MOMENTUM



COMPETITIVENESS OF CMBS IMPROVES

Pricing Date	Apartment	Office	Retail	Industrial	Hotel
July	2%	33%	34%	3%	17%
July	4%	30%	37%	5%	9%
August	11%	52%	23%	3%	6%
September	9%	44%	20%	0%	17%
September	9%	14%	33%	6%	16%
September	19%	22%	42%	4%	14%
September	2%	36%	26%	9%	7%
October	8%	19%	39%	12%	11%
October	2%	26%	34%	3%	22%
November	3%	24%	35%	6%	3%
Average	7%	30%	32%	5%	12%
Median	6%	28%	34%	5%	13%

Source: SEC Filings, Chandan

INTERPRETING THE SPREAD

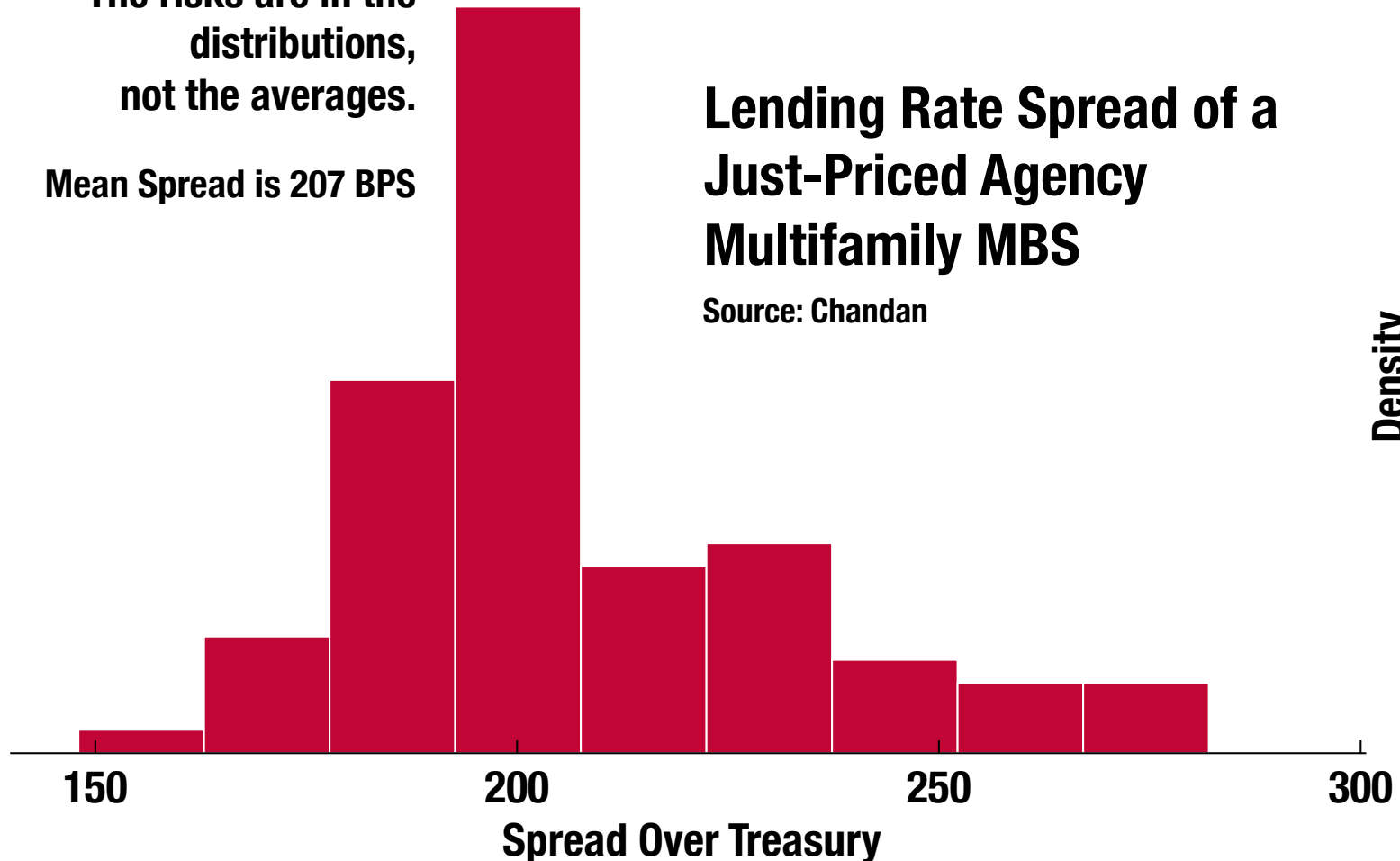
**The risks are in the
distributions,
not the averages.**

Mean Spread is 207 BPS

Lending Rate Spread of a Just-Priced Agency Multifamily MBS

Source: Chandan

Density



OUTLOOK FOR LENDING

- **Slow improvement in bank lending continues**
- **CMBS outlook brightening, sensitive to bond markets**
 - **Concerns about weaker underwriting are reflected in recent rating agency disagreements**
 - **Our credit risk models show an uptick in default probabilities, clustered at maturity**
- **Life companies remain competitive for most desirable lending opportunities, less so in apartment**

OUTLOOK FOR LENDING

- **Value-add financing options show limited improvement**
- **Construction lending commitments rising outside of apartments, not yet showing up in draws**
 - **Manhattan leading resumption of large-scale development**
 - **Anecdotal cases of spec industrial construction**
- **Balloon and interest risks underpriced, to the greatest extent for stabilized apartments**

OUTLOOK FOR LENDING

Key Risks for the Next Year

- **Across property types, exit risk related to interest rate environment**
 - **5- and 7-year loans with initial IO periods**
- **Weaker risk pricing observable in the apartment sector and in some CMBS issuance**
- **Potential for adverse shocks to the economy, missed expectations for jobs and related absorption**
- **Improving housing's impact on select apartment markets**



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