

Commercial BUZZ

Straight From the Experts: The latest BUZZ in Commercial Real Estate



by Ray Hankamer

Speaking at the Real Estate Resources Alliance (RER Alliance), recent luncheon, experts on commercial real estate lending were **Gary Hough**, Principal, Kinghorn, Driver, Hough & Co.; **Mark B. Fisher**, VP and Managing Director, StanCorp Mortgage Investors, LLC; **Dale E. Helling**, VP of Commercial Mortgages, Aviva Investors; and **Greg McFarland**, Sr. VP, Midland Loan Services. Comments from experts included:

CMBS (Commercial Mortgage Backed Securities / "Conduit") Loans: Approximately \$60 billion per year will be coming due through 2014, then from \$80-140 billion per year through 2017, and after that there will be a sharp falloff. CMBS loans originated between 2004 and 2007 were underwritten more conservatively, so may be a little easier to refinance (Note: average CMBS loan term is ten years). If impossible to move/refinance upon maturity, CMBS loans which conform to current underwriting standards may have a 2-3 year extension available under certain circumstances, until borrower is able to find refinancing on the open market and pay off the CMBS loan. Midland is largest servicer in the U.S., currently servicing 27,000 plus loans totaling over \$282 billion.

The "Primary Servicer" of a loan is usually the loan originator; if the loan becomes troubled, it is passed down to either a "Master

Servicer" (loans with credit issues) or a "Special Servicer" (loans which are delinquent, in default, or which are credit-impaired). Problem loans may be "resolved" in a number of ways: they may be brought into conformance with current standards by pay down, or may be liquidated by sale of asset, by foreclosure, or deed in lieu of foreclosure. Servicers are extremely busy, and even for performing loans, requests for accommodations or modifications of the loans or collateral or terms - in the normal course of business - may take extra time and patience, and may require payment of fees.

The "overhang" of problem CMBS loans will take at least 3-4 years before any type of stabilization will occur, and only perhaps 50% of all CMBS loans will be able to be refinanced - the rest will be funneled to "special servicers." Out of approximately \$3.5 trillion of commercial real estate debt, pay downs to the \$2.8-\$2.9 trillion range must take place before the market can hope to regain equilibrium. Buyers who own assets purchased at low cap rates during the last four years "will be owning the assets a long time" if they hope to sell for what they paid, or...more. A lot of equity has been destroyed by the recent downturn, and to replace it will be "expensive."

Transaction Velocity: We need a lot more transactions, but there is still a large disconnect between buyers and sellers.

Texas Market: We like Texas and the Sunbelt. Texas has a good climate for business, and outsiders are welcome in the market.

made in the past few years will likely need to be seriously paid down or otherwise "sweetened" for lenders to consider them for refinancing. Values and cap rates and appraisals are hard to estimate given the paucity of transactions, but transactions should pick up in coming months and years as CMBS loans mature.

Comments from the O'Connor Apartment Forecast Luncheon:

Todd Marx of Holliday Fenoglio Fowler, L.P.: Most distressed properties in our market are Class C or worse, and there is high competition to acquire top properties, when and if they become available. There is cap rate compression for these quality multi-family deals, and sales are increasing. There is a lot of money out there for high quality assets. Due to buying and selling activity in the multi-family segment, a twenty year old property may have five or six owners over time - great for brokers! A lot of out of state capital is coming to Houston. One property in SW Austin had 36 offers and eventually sold - after a seemingly endless stream of site visits - for a 6.5 cap. The "Texas story" is still very good compared to other states and cities. Houston, however, is now getting very little new supply.

Ed Nwokedi of Cushman & Wakefield of Texas, Inc.: Quite a few apartment foreclosures are about to hit the market, mostly B & C units hit by vacancies. A "tsunami" of commercial real estate is coming to the market. Banks looking to de-leverage means cash calls to mortgagees. And some banks will be going under due to bad real estate loans. New apartment starts will remain low through 2012. There will be more distressed opportunities than stabilized opportunities. Many Bs are being stepped up to As with renovating. Not a lot of As coming to market - why should owner give up good cash flow? About 13% of apartments are distressed in Houston, and 10% statewide. In many cases banks are not taking actual ownership of their distressed properties, but are selling the notes with short due diligence: 15-45 days to closing. Bank decisions and pricing are heavily influenced by what foreclosure does to their reserve requirements. If hundreds of properties hit the market, sellers may resort to auctions, which draw a lot of buyers looking for below-market deals. Cap rates are expanding in this challenged market. 2010-2012 is a perfect time to buy in this segment. Cash is not "king" now, but "emperor." BUT, cash is required not just for purchase but also for rehab.

Let's "buzz" around the business press and see what the pundits are saying about what we can expect in 2010:

Bloomberg News: The worst U.S. employment slump in the post-World War II era may have almost ended in December, signaling the recovery will not be jobless much longer...stimulus-driven gains in global demand mean American companies may need to start boosting payrolls in 2010...businesses are starting to come out of their shells...staffing at temporary employment agencies jumped the most in five years in November...increases in temporary hiring are "a classic part of the recovery"...U.S. stocks rallied in the second half of the year as evidence of an economic recovery mounted...S & P Index climbed 65 percent since sinking to a 12 year low on March 9...U.S. manufacturing expanded in December at the fastest pace in more than three years [manufacturing makes up 12% of our economy]...stocks rallied worldwide as reports showed the

New Commercial Loan Availability and Terms:

Lenders are basically cherry picking the best of the best loans. Loan to value (LTV) is in the 65% range, and can be higher but "borrower will have to pay for it." Treasury rates should go higher over the next months, but spreads should narrow, so actual rates should remain fairly stable with those available today. Debt service coverage ratios (DSC) were said to be averaging about 1.35 x net operating income, but many of the examples shown by the speakers in their slide presentations showed DSCs in the 1.50 to 2.0+ range. (As we said, underwriters are in the driver's seat and are able to make only the "best of the best" loans.) Recourse and non-recourse loans are being made, but again, underwriting standards are far more conservative now than in the last few years.

Summary: Lenders are lending. Rates should remain stable. Underwriting of new and refinanced debt is very conservative. Existing loans

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improvement at U.S. factories...boosting orders that will encourage producers to ramp up output and fuel a self-sustaining recovery...employers probably cut fewer jobs in December and may begin to hire after almost two years of job losses...U.S. economy, world's largest, expanded at a 2.2 percent pace from July through September after a yearlong contraction that was the worst since the 1930s...lingering credit constraints are a key reason why...strengthening in economic activity will be gradual...

Business Week: Consumers are opening their wallets again...momentum is most evident in spending for services...job losses are diminishing, allowing income from wages and salaries to stabilize...healthier picture of households also includes greater savings...despite still-heavy debt, consumers are making at least slow progress in repairing their financial positions...green shoots of optimism are sprouting among corporate managers...that could improve prospects for a sustainable rebound...[corporate] gloom

seems to be lifting. That should give legs to the recovery and reduce the risk of relapse into a recession...Behind the revival: a pick up in profits. Earnings surged 11% in the third quarter...Even better times may lie ahead...Rather than focusing solely on cost-cutting, executives are preparing for growth by looking to hire workers, add inventory, and build capacity.

Wells Fargo Securities Economics Group: We are far from an equilibrium point in the economy. We continue to anticipate sub par growth in 2010...disappointing outlook for housing and the slow growth in consumer spending...slow improvement in the labor market...a populace less willing and less able to fund that spending...Real estate markets have seen some modest improvement...much can be attributed to tax rebates...what happens when that support is withdrawn?...rising tide of defaults and foreclosures of residential and commercial properties continue to put stress on the financial system. Supply and demand fundamentals

are still deteriorating...the increasing entitlement imbalance has driven the deficit to new heights...pressures on government spending will become increasingly evident...a quick return to fiscal sustainability is off the table...Outlays [for entitlements] will become the crux of future budgetary challenges...Commercial real estate: storm warning still out...vacancy rates are high and rising and there is still a huge excess of leased but vacant space not included in vacancy rate statistics...retail sales remain subdued...rents are being negotiated lower and property values continue to fall...very little credit is available for new projects...problems will take longer to correct this time...so far REITs and private equity firms have had a difficult time putting their capital to work, because there is still a wide gap between what people are willing to pay for properties and what sellers are willing to take for them...expect construction activity to pull back further over the next 18 months but look for declines to gradually taper off...



SOUTHEAST TEXAS

Study: More Hats Hung in Texas

January 4, 2010 - Houston Business Journal

More people began calling Texas "home sweet home" last year than those who left the state, according to a report by Allied Van Lines.

The Lone Star state led the nation as the No. 1 destination state with 5,364 inbound shipments and was second behind California and Florida in outbound shipments with 3,419, according to the Westmont, Ill.-based moving company's 42nd Annual Magnet States Report, which tracks U.S. migration patterns.

Texas also had the highest net relocation gain, determined by subtracting outbound moves from inbound moves performed by Allied Van Lines, of almost 2,000 in 2009, slightly higher than last year's 1,900.

"We moved a wide variety of people here this year from singles, to families, to retirees and all from various backgrounds," said Ben Hurwitz, president of Westheimer Transfer & Storage in Houston, in a statement. "We also did a lot of corporate relocations this year for some very large companies based in Texas."

Michigan had the biggest net relocation loss, reporting 2,210 outbound shipments compared with 1,019 inbound shipments. In addition, Texas racked up almost 8,800 total shipments, bested only by California, which had almost 11,000 total shipments.

2010 Industrial Outlook

Bob Berry, Jones Lang LaSalle's Houston-based industrial services expert, says there will be "a continued market reaction to the profound deflationary effect of the 2008-09 global recession. Through the first 6-8 months of 2010, there will continue to be significant sublease space brought to the market, and in several areas of town, an overhang of first-generation space due to significant overbuilding in 2005-07. In the 3rd-4th Quarter 2010, there will be a very gradual improvement in the industrial market. We may already be seeing a "bottoming" of packaged goods inventories and a slight improvement in the manufacturing base. Ultimately, these indicators will equate to a very slight but improving industrial market. However, rental rates will not show any increase until some point in 2011."

Why Rural Land is a Good Investment

By Sassy Stanton

The future growth of the Greater West Houston trade area validates "Why rural land is a good investment". The predictions from the West Houston Association of over 2,000,000 people in the 100 square miles outlined on the chart below in 2050 support the wisdom of investing in land in the west, south and north west. A&M's Texas Real Estate Center reinforce this prediction that over 90% of the population in Texas will live in a triangle between Houston, Dallas, San Antonio and Austin by 2040. The I-10 corridors are the backbone for this predicted growth, with both residential and commercial development.

As an investor, the simplicity of buying land in rural counties offers lower taxes through an AG exemption and future lower development cost. The historical appreciation of this type of desirable land (rural, farm/ranch) can be measured in the major growth shown on the diagram west of HWY 6 which in the 1970s was rural farm and ranch land.

The cost of developing and owning land inside the West Houston Association diagram will be more complicated and expensive than it has been in the past with the future governmental controls from state and federal agencies.

