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Spotlight on CMBS — November 2016

The commercial mortgage backed securities (CMBS) market has yet to return to its pre-recession heyday. Market volatility, contraction, and regulation have caused the 10% gains of the 1990s to fall to 2% or less. As the new risk-retention rules will be implemented on December 24, 2016, the market continues to be unstable. The rules require the issuer to have some "skin in the game" by holding 5% of new deals or designating an interested B-piece buyer to assume that risk. Until the market stabilizes after this regulatory change, a risk premium of approximately 15 bps will be added to market spreads. Although only accounting for an approximate 7% of commercial real estate financing executions, CMBS continues to fill a niche for non-recourse financing at 65-75% LTV.

Highlights

- While CMBS can compete with life companies, CMBS lenders execute loans that life companies will not (due to location, asset class, age of asset, etc.)
- Territory for this product is nationwide in primary, secondary, and tertiary markets
- Most all-income property types are financed including office, multifamily, retail, industrial/flex, hospitality, self-storage, senior care facilities, and mobile home parks
- Pricing is a spread above a swap rate or Treasury rate that corresponds to the loan term
- Current pricing is 250-260 bps over the 10-year swap
- Terms are five or 10 years and have identical pricing
- Minimum debt yields for best-in-class real estate:
  - 7.5% for apartments
  - 9% for office
  - 10.5% for limited-service hotels
- Maximum loan-to-value ratio for best-in-class real estate is 75%; however, 65% is the maximum for limited-service hotels
- Loans are non-recourse with standard "bad boy" carve-outs
- Since the loan is non-recourse, the lender will require liquidity at the property level, so escrows will be set up for lease rolls and capital expenditures; this is the borrower's money to be used for the stated purpose any unused funds are returned to the borrower at loan expiry

Hints for Execution

- The process should begin 10 to 12 months in advance of the loan expiry
- Lock in low rates for as long as possible and ensure there is an assumption provision to give flexibility to sell without incurring the prepayment penalty
- Strive to bring delinquencies down and occupancies up; properties need to be at least 85% occupied and preferably 90% or greater for the new loan
- Act on any maintenance/deferred maintenance to help the property show, and ultimately, appraise well
- Staggered leases throughout the new loan term is the best strategy
- Utilize an attorney who is familiar with CMBS executions and documentation

Recent Greysteel Debt & Structured Finance Transactions

ROYAL TERRACE
Euless, TX

Permanent Financing	
Close Date:	November 2016
Units:	120

KALORAMA
Washington, D.C.

Acquisition & Construction Financing	
Close Date:	October 2016
Units:	48

Rates Comparison Chart

	Current November 2016	Year Ago November 2015
3-Month LIBOR	0.88%	0.34%
5-Year Treasury	1.29%	1.67%
10-Year Treasury	1.83%	2.36%
5-Year Swap	1.24%	1.56%
10-Year Swap	1.61%	2.09%

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