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# Jones Lang LaSalle Lenders' Expectations Report 2010

The views of major financial institutions on the outlook for commercial property lending from this year's Mortgage Bankers Association Convention & Expo held in Las Vegas

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Event Date: February 1-4, 2010

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## 2010 Lenders' Expectations Report

More than 1,700 commercial/multifamily professionals gathered at the MBA's annual CREF/Multifamily Housing Convention & Expo in Las Vegas to gain access to key industry leaders and share critical strategies to succeed in today's dynamically shifting market. In this update report, Jones Lang LaSalle presents the prevalent themes discussed directly with lenders at the conference and shares detailed findings of the firm's annual Lenders' Expectations Survey that was completed by 60 of the industry's top mortgage originators.

### Key themes

The mortgage banker: reassured

The general sense or mood of the mortgage bankers is that 2010 will be an overall better year than 2009 – a year of minimal new financing activity.

The life company lender: cautious yet optimistic

A clear message is coming from the life company lenders given corporate compressed credit spreads compared to a year ago: they will be lending this year en masse. Life companies plan to target the strongest sponsors on the best performing properties and continue to dedicate a portion of their production capacity toward refinancing loans in their current portfolios.

The domestic bank: easing

Banks reveal credit standards are easing for commercial real estate loans. One lender suggested that the net percentage of domestic banks reporting tightening standards for CRE loans (including construction and development loans) was 27 percent, down from a peak of more than 80 percent in late 2008.

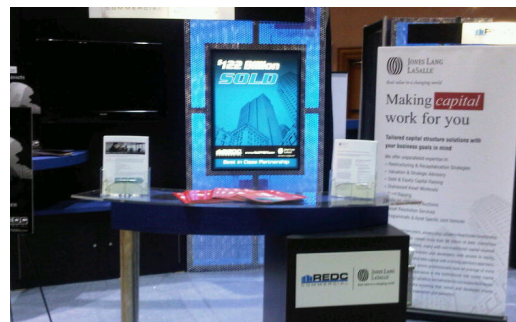
The CMBS platform: emergent

New CMBS platforms are forming and those that exist now are hopeful that strong demand will continue. The word on the street is that major lenders are again ramping up efforts and hiring in order to re-establish CMBS as a primary lending source. While new CMBS issuance has been limited to single-borrower issuance, a number of CMBS dealers are starting to aggregate loans with the expectation of multi-borrower conduit issuance in 2010.

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### MBA Convention & Expo 2010



The joint JLL/REDC booth



Noble Carpenter at the joint JLL/REDC booth



Convention floor

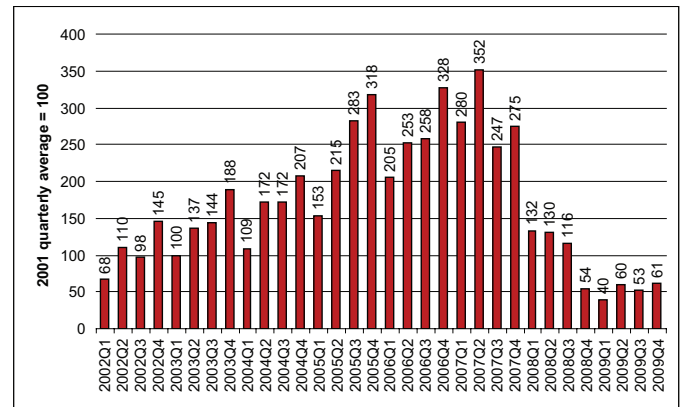
The mortgage REITS and private equity players: filling the gap  
 Newly capitalized mortgage REITS and core equity funds, which have limited, if any, regulatory constraints, are stepping in to fill the leverage gap caused by tighter lending standards. With a lack of inhibition to owning the real estate, this source of capital is reaching further out on the risk spectrum and still offering full term interest only and non-recourse loans for speculative real estate at attractive risk adjusted interest rates.

**Buzz in the market**

The overall market sentiment has improved although concerns about weakening commercial real estate fundamentals and looming maturity defaults still remain. Plenty of investors are re-entering the markets and rebuilding their mortgage origination platforms. MBA's Chief Economist, Jamie Woodwell, commented that fourth quarter 2009 commercial real estate loan originations were up 12 percent from the

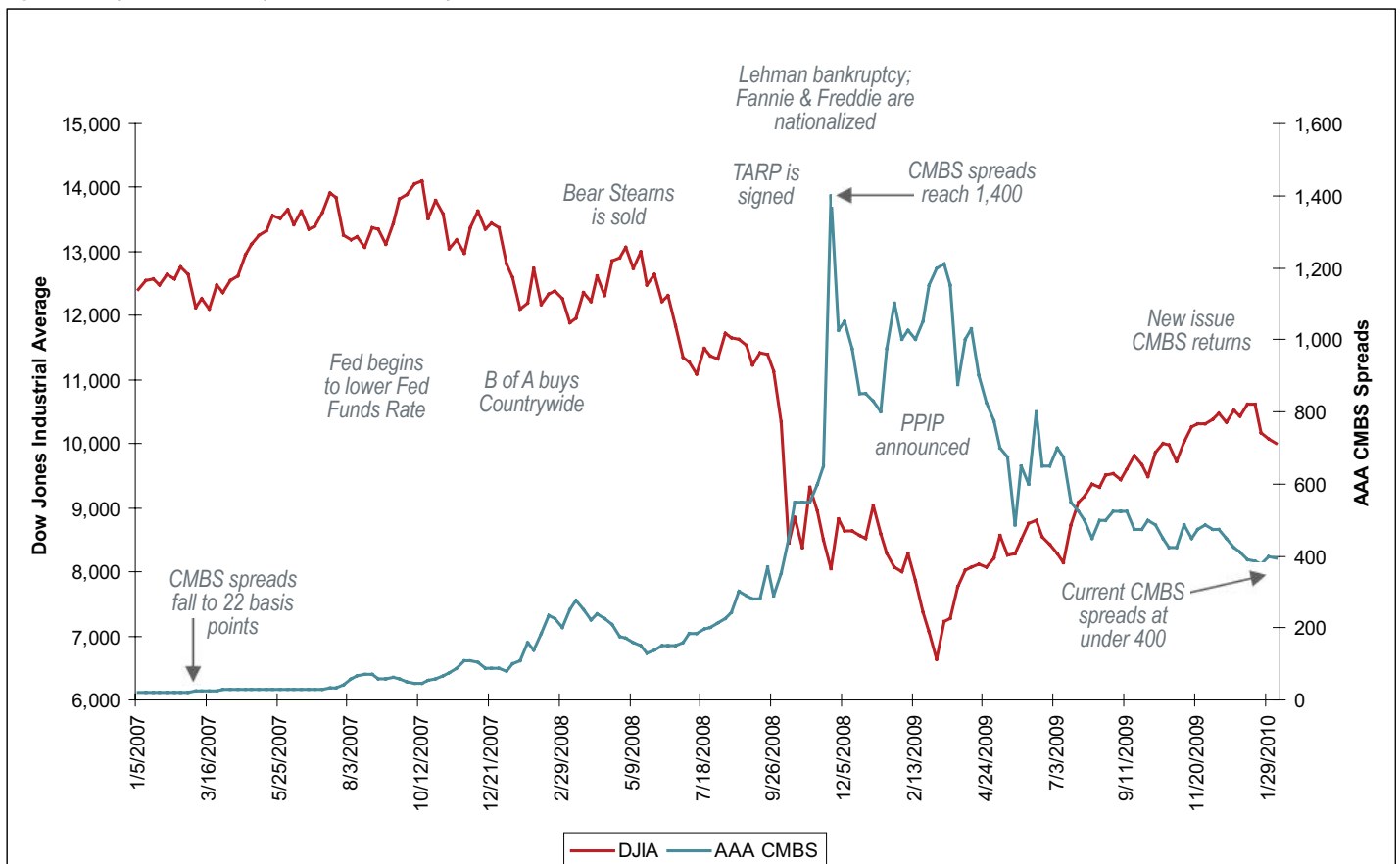
same period last year and 15 percent higher than the third quarter, though still near historic lows.

Figure 1: Commercial/multifamily mortgage bankers originations index



Source: Mortgage Bankers Association

Figure 2: Unprecedented capital markets volatility



Source: Jones Lang LaSalle

### What a difference a year makes

The New Year has started on entirely different footing than 2009 with positive sentiment at January's CMSA conference continued at MBA. While bankers were self-reflective and keen on not repeating past mistakes, there was a strong focus on what the next steps will be to help reignite the market. Several key topics dominated the discussions:

1. **Lack of deals.** Lenders, led by life companies are entering the market with double or triple their allocations for new product. However, they are currently restricted to stabilized properties in strong markets, lenders said that the few deals that are hitting the market are seeing fierce competition for financing. This competition has seen debt yields on some loans slide to 10 percent. Lenders also mentioned that quality deals that should be refinanced are being restructured with existing lenders. They feel that once borrowers realize that their current lender is not always their best lender, financing volume should increase. Encouragingly, loan rates are now in the 6 percent to low 7 percent range, allowing property buyers to achieve positive leverage and thus encouraging new trades.

2. **Securitization.** Nearly every participant wants to see securitization come back; however, a great deal of uncertainty hovers around government regulation and potential accounting changes. Without confidence on future regulation, issuers may be less aggressive in aggregating the loans needed to launch securitizations. Risk retention, or "skin in the game," requirements as required by the FDIC are directing future bank-issued structured products to remain on issuer's balance sheets. The FDIC has requested comments from the market but has issued an outline which includes a rule requiring the issuer to retain 5 percent or more of the asset pool's credit risk, which may not be transferred or hedged during the term of the securitization. The implications of this appear to be negative as they remove the economic incentives to securitize and, by extension, lead

to a smaller securitization market. The House and Senate; however, are working on their own financial reforms which may require similar risk retention but may also allow the transfer of this risk to third parties. In one additional layer of complexity, the president has asked for two provisions to be added to the ongoing financial reform legislation: a ban on proprietary trading at banks and a limit on the size of non-deposit liabilities of large financial institutions.

3. **Property values.** While nearly every participant felt that property fundamentals will remain under pressure through 2010, there was debate on whether this would translate to property values that are already down over 40 percent from their peak. Some felt that investors are recognizing this dislocation leading to capital inflows that will produce competitive bidding and rising asset prices. They felt that ample amount of both debt and equity capital waiting on the sidelines will serve as a hedge to further weakening in property-level trends. Indeed, commercial real estate sales transaction volume data for fourth quarter 2009 confirm that property markets are in fact thawing. Total transaction volume was up 74 percent in fourth quarter 2009 versus first quarter 2009, with most property types experiencing successive quarterly gains in volume throughout 2009<sup>1</sup>.

4. **Treasury rates.** So far, the increase in risk premium required by lenders has largely been accomplished by the rally in the 10-year Treasury. A low Treasury has also allowed for the launch of 3 new CMBS deals in November and December of 2009. Many participants worry that a fragile and recovering commercial real estate market could be hurt if the 10-year yield increases – and this will be based largely on the actions of the Federal Reserve.

The issue that dominates most discussions seems to be the fate of commercial real estate debt scheduled to mature over the next few years.

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- Bart Steinfeld, Jones Lang LaSalle

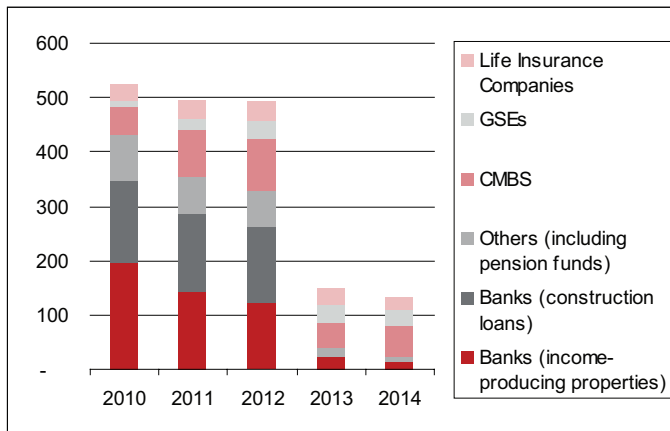
“Lenders we spoke with say they’ll be giving borrowers 24+ month extensions in order to avoid foreclosure on high quality, well-located assets,” said Bart Steinfeld, Jones Lang LaSalle’s Managing Director of the real estate investment banking practice. “With more than \$1.5 trillion worth of commercial real estate loans expected to mature between now and 2013, it’s no surprise that a majority of borrowers are placing significant importance on restructuring those loans. However, many financial institutions don’t want to hold on to assets and now

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<sup>1</sup> Real Capital Analytics

are coming to terms with the fact that they can no longer 'extend and pretend.' They're now realizing it makes sense to move these assets off their balance sheets to create greater ability to originate loans this year."

Figure 3: Commercial real estate debt maturities



Source: Morgan Stanley, MBA, FDIC, FFIEC, Intex, PPR

### Results from our survey

Jones Lang LaSalle's survey — administered directly to 60 nationwide lenders through an in person questionnaire — included a mix of insurance companies, commercial mortgage-backed securities dealers, private equity lenders, commercial banks and government agencies. The survey reveals that a number of commercial real estate lenders predict loan production will increase this year. Forty-three percent of respondents expect their loan production to range from \$1 to \$3 billion in 2010 — a number that is more than double the rate that lenders surveyed reported sourcing in 2009 (21 percent).

### Loan production

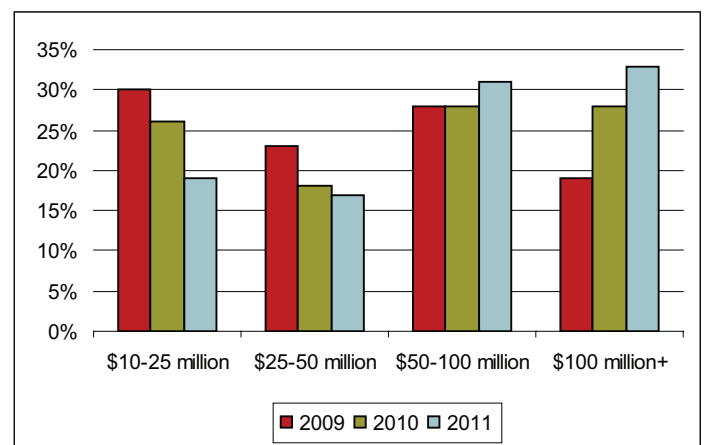
Showing even more future optimism, nearly 70 percent of respondents say their loan production will ramp up to \$1 to \$3 billion in 2011. In another encouraging metric, the number of lenders that expect to lend more than \$4 billion jumped up nearly 6 percentage points from 9.3 percent in 2009 to 15.2 percent in 2010.

The number of lenders willing to lend greater amounts toward single-asset acquisitions is also shifting. In 2009, the majority of respondents indicated they would lend only \$10 to \$25 million on a single asset acquisition. In 2010, the greatest percentage of respondents was split evenly at 28 percent each among those willing to lend \$50 to \$100 million and \$100+ million (hence 56 percent will lend \$50 million and

more for single-asset purchases). In 2011, the number of lenders willing to lend \$50 to 100+ million rises by 8 percent to 64 percent of respondents.

"A few life companies and investment banks we spoke with indicated that they're willing to lend \$150 to \$500 million on large, single asset acquisitions in 2010," said David Hendrickson, managing director of Jones Lang LaSalle's real estate investment banking practice.

Figure 4: Maximum size for single-asset acquisition



Source: Jones Lang LaSalle survey

Approaching maturities will continue to share the stage in 2010, with more than 67 percent of life company respondents acknowledging 40-to-60 percent of their portfolios will be allocated to the refinancing of maturing loans.

While liquidity within the capital markets is expected to turn from a trickle to a slow-but-steady flow in 2010, borrowers can expect the same tightened underwriting standards they experienced from life company lenders in 2009. Loan-to-value ratios in 2010 will fall predominantly in the 50-to-70 percent range, according to more than 74 percent of life company respondents, and that number is expected to remain steady in 2011.

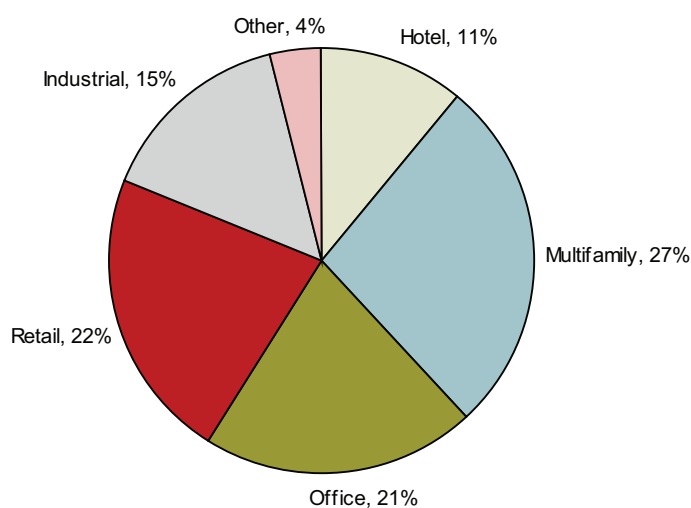
As for new conventional commercial real estate loans in 2010, 59 percent say most loan terms will range five years or greater, with an additional 28 percent indicating a preference for three-to-five year terms.

### Current lending environment

When asked about average debt coverage ratios to help determine loan proceeds industry participants expressed a wide range of opinions. The following is a sampling of offerings for each lending sector (not every respondent actively lends to each industry sector, thus responses vary):

- **Life companies:** One respondent advised that debt coverage ratios would range from 2.25 for hotels, 1.30 for multifamily, 1.40 for office, 1.60 for retail, 1.50 for industrial.
- **CMBS:** One respondent advised debt coverage ratios will range from 1.35 for hotel, 1.25 for office, 1.20-1.25 for retail, and 1.20-1.25 for industrial.
- **Banks:** One respondent advised debt coverage ratios will range from 1.35 for multifamily, 1.50 for office, 1.50 for retail, and 1.50 for mixed-use.
- **Private Equity:** One respondent advised debt coverage ratios will range from 1.15 for multifamily, 1.20 for office, 1.20 for retail, 1.30 for industrial and 1.30 for mixed-use. They're also underwriting debt yields across the sector between 10 and 12 percent.

Figure 5: Preferred asset type



Source: Jones Lang LaSalle survey

As for the sectors that lenders would most prefer to lend, a majority of respondents (27 percent) say they'll single out multifamily for their loan dollars, another 21 percent say they'll focus on the office sector in 2010. While the hotel sector stands out as the sector to which lenders are least likely to lend, a select number of lenders indicated an interest in hotel investments given their belief that the sector is at bottom. The numbers don't appear to change much for 2011, as 25 percent of respondents say they plan to reserve a majority of their lending dollars for the multifamily sector, with 21 percent putting their money into the office sector.

A number of lenders have indicated an interest in bridge loans for speculative development projects while yields are still high and spreads are compressing on the best projects. Thirty percent of respondents say they have already begun or plan to begin lending on speculative projects in 2010, however, (23 percent), stated the risk won't be worth the reward until year-end 2012. One life company and one commercial bank respondent noted that they would never lend on speculative developments again.

### Distressed assets

There is a significant increase in the number of lenders who are selling performing and non-performing loans. In addition, these lenders are prepared to accept significant discounts in 2010 to create liquidity and to rid themselves of these non-core or problem assets. For performing loans, 29 percent of respondents indicated they are selling performing notes at 0.90 cents on the dollar and another 24 percent are selling performing loans between 0.70 cents and 0.80 cents on the dollar.

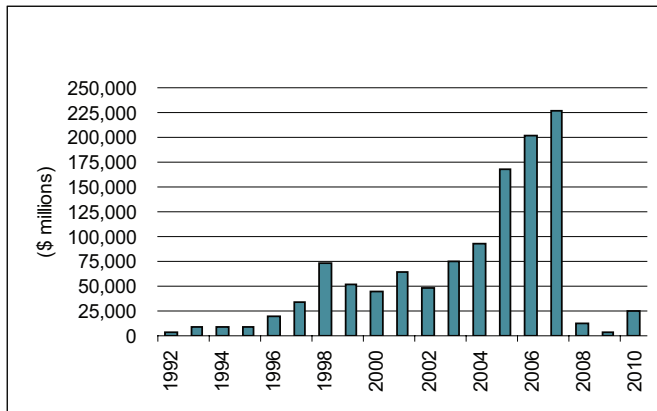
"There is also increased interest in selling sub-performing, or "scratch and dent" loans," said Noble Carpenter, managing director of Jones Lang LaSalle's real estate investment banking practice. "Depending on the remaining term, interest rate, property type and market, over 45 percent of survey respondents indicated a willingness to sell these loans below 0.60 cents on the dollar."

### CMBS

A modicum of securitized lending has returned to the market with the issuance of \$1.6 billion in Commercial Mortgage-Backed Securities in 2009. While 2009 issuance was limited to single-borrower deals, the extreme over-subscription has led to an interest in multiple borrower pools. Forty-eight percent of respondents say they expect CMBS issuance to range from \$0 to \$10 billion in 2010, while 27 percent

predict production of \$10 to \$20 billion and an additional 21 percent with \$20 to \$30 billion expectations. In 2011, the greatest numbers of respondents (38 percent) expect CMBS issuance to land between \$20 to \$30 billion.

Figure 6: Historical and projected CMBS issuance



Source: Commercial Mortgage Alert

#### Auction action

Many special servicers and financial institutions have started or are considering asset, REO and loan sales.

“We’re definitely seeing the bid ask spread between buyer and seller narrow, and in some cases reach equilibrium. That alignment should be the impetus many lenders need to bring large and small balance loans and REO to market,” added Wes Boatwright, managing director of Jones Lang LaSalle’s real estate investment banking team. “One innovative distribution method financial institutions are now seriously considering and using to sell small balance notes and REO is an online auction. Our auction platform provides sellers with efficiency, bid transparency and creates urgency which will help facilitate an

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- Wes Boatwright, Jones Lang LaSalle

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#### Closing comments

It is everyone’s hope that 2010 will be a far different year than 2009. While investors and lenders are hoping for a strong return for the capital markets, a great deal of haziness remains. Will the Federal Reserve tighten the money supply or will they keep rates low? Have property values stabilized or will we see further correction in 2010? Will we continue to see a tale of two cities where there is intense competition for the best deals and limited, if any, capital for everything else? What will happen with the more than \$500 billion in commercial real estate loan maturities in 2010? And perhaps most importantly, will CMBS retake its place as a primary lending force?

Given the volume of maturities the market is facing over the next few years, it is apparent there will need to be concrete solutions to address the second- and third-tier loans scheduled to mature. However, it is also evident that rushing to fix commercial real estate is not the best strategy. The regulatory and legislative changes currently being discussed will have a profound and long-range effect on the markets and, by extension, will affect the capacity to refinance upcoming commercial real estate loan maturities. Therefore any governmental mandates must be well thought out and not driven by politics.

The amount of work that needs to be done to turn around the commercial real estate lending markets is daunting to say the least. Undoubtedly, the market recovery will depend on consumer confidence and employment. What remains impressive is the commitment by all participants in the industry to make sure that the market not only returns strongly but in a form that will be here to stay.



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## About Jones Lang LaSalle

Jones Lang LaSalle (NYSE:JLL) is a financial and professional services firm specializing in real estate. The firm offers integrated services delivered by expert teams worldwide to clients seeking increased value by owning, occupying or investing in real estate. With 2008 global revenue of \$2.7 billion, Jones Lang LaSalle serves clients in 60 countries from 750 locations worldwide, including 180 corporate offices. The firm is an industry leader in property and corporate facility management services, with a portfolio of approximately 1.4 billion square feet worldwide. LaSalle Investment Management, the company's investment management business, is one of the world's largest and most diverse in real estate with more than \$46 billion of assets under management. For further information, please visit our Web site, [www.us.joneslanglasalle.com](http://www.us.joneslanglasalle.com).