

## Any Port in A Storm

AMID MASSIVE LENDER CONSOLIDATION,  
BORROWERS FIND SAFE HAVEN IN THE AGENCIES

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### THE TOP LENDERS AREN'T WHAT THEY USED TO BE.

The competitive landscape of the lending industry has been altered, as some of the most prolific multifamily lenders failed and were ushered into acquisitions in the final months of 2008.

This high-stakes game of musical chairs saw the nation's top two multifamily lenders, Wachovia and Washington Mutual, acquired by Wells Fargo and JPMorgan Chase, respectively. What's more, Merrill Lynch is now property of Bank of America, Red Mortgage Capital is being integrated into PNC, and Column Guaranteed is part of Walker & Dunlop.

Borrowers also are looking for a haven, and they've found two in the last year: Fannie Mae and Freddie Mac. In a market where many lenders are unable or unwilling to lend, the government-sponsored enterprises (GSEs) are serving as fountains of liquidity.

The GSEs will continue to shepherd the multifamily industry through a deepening credit crisis throughout 2009, even as their underwriting standards grow more conservative. And the lack of viable construction financing has forced many developers to turn to another agency lender, the Federal Housing Administration (FHA).

"Freddie and Fannie gained more market share in 2008 than they have

ever had in the past," says John Cannon, head of agency lending at Capmark Finance. "And our FHA pipeline has never been higher."

Underwriting standards from all lenders grew more conservative in 2008, a trend that will continue this year. Loan-to-value ratios will continue to inch down, and debt-service coverage ratios will rise as the mounting unemployment numbers force higher vacancies and lower rents.

The gathering storm clouds have forced many lenders to closely eye their "watch lists," or their roster of loans in danger of default. "It's going to be a year in which we have to pay more attention to risk than ever before," says Steve Wendel, managing director of Deutsche Bank Berkshire Mortgage.

Most banks are scaling back their balance sheets and prioritizing only the best new construction deals by the strongest sponsors with whom they have a relationship.

In 2006 and 2007, many financial institutions aggressively offered balance-sheet loans in an effort to grow volume and keep up with the competition. Now, the flow of construction capital, as well as bridge and mezzanine loans, has slowed to a drip.

"The balance sheet is valued more appropriately now," says Wendel. "It's not a commodity anymore."

Lenders are increasingly steering borrowers instead to FHA programs

like the Sec. 221(d)(4) program for construction financing. "All banks are delivering, and most of them are focused on real estate risk," says Dan Walsh, head of multifamily production at KeyBank. "As they focus on managing their portfolio of real estate loans, there's not much room for new loans but for only their very best clients."

The GSEs have kept rates on 10-year deals stable in the 6 percent to 6.5 percent range for the last six months, and most lenders don't expect much rate fluctuation through 2009.

But the GSEs are transforming. Under current guidelines, the GSEs will reduce their portfolio by 10 percent annually starting next year. So the companies have placed more emphasis on securitized programs, which are not held on the company's books but sold to investors as securities.

Investor interest in Fannie Mae's Mortgage-Backed Securities (MBS) program began to heat up in January, and as of early February, Fannie Mae had a pricing advantage over Freddie Mac, by as much as 25 to 50 basis points (bps) on some 10-year deals.

That advantage may not last long, as Freddie Mac continues to build out its Capital Markets Execution (CME) program. Borrowers routinely get a 25-bp reduction in pricing through the CME program compared with the more standard portfolio execution. Borrowers can also access supplemental financing through the program, unlike most securitized offerings.

The emergence of CME and MBS is a significant change. Securitized offerings work very well for standard, plain vanilla deals for stabilized properties, but the loan documents are often inflexible. But stabilized assets are having a much easier time getting financing these days, as lenders shy away from transitional assets.

#### SCALING THE RANKS

A rash of bank failures in 2008 accelerated the banking industry's consolidation trend. In all, 25 U.S. banks failed in 2008, and more failures are expected in 2009.

Wells Fargo acquired the multifamily industry's top lender, Wachovia, for \$15.1 billion in October 2008. And JPMorgan Chase acquired Washington Mutual, the No. 2 lender, after federal regulators seized WaMu in September.

PNC rocketed up the rankings from No. 23 to No. 9 thanks to its

acquisition of ARCS Commercial Mortgage in 2007. And PNC should continue to climb: It acquired National City Corp. for \$5.2 billion in October, including its subsidiary, Red Mortgage Capital.

Walker & Dunlop, the parent company of Green Park Financial, acquired Column Guaranteed from Credit Suisse at the end of January.

The rankings are based on the Mortgage Bankers Association's 2007 Annual Report on Multifamily Lending, the most recent numbers available.

#### ON THE HORIZON

The mass consolidations have presented opportunities to those lenders that have best weathered the current credit crisis.

"It has opened up the opportunity to expand existing relationships that may

have been shared with other multifamily lenders," says Tim White, president of PNC ARCS. "And it's also opened up a chance to develop new relationships."

But lenders expect the economy to continue its downward spiral, with a possible bottoming out toward the end of 2009. Cap rates will continue to rise, apartment values will fall in most if not all markets, and the feeling among lenders is that the worst is yet to come.

"There really is a coming storm in terms of asset performance," says David Durning, senior managing director of Prudential Mortgage Capital Co. "And so in 2009, it's going to get worse before it gets better."

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| <b>The Multifamily Industry's Top 10 Lenders</b> | <b>Volume (\$ millions)</b> | <b>Loans</b> | <b>Avg. size (\$ millions)</b> |
|--|-----------------------------|--------------|--------------------------------|
| <b>1</b> Wachovia                                | \$20,602.5                  | 1,673        | \$12.3                         |
| <b>2</b> Washington Mutual Bank                  | \$10,749.5                  | 7,632        | \$1.4                          |
| <b>3</b> Deutsche Bank Commercial Real Estate    | \$8,064.0                   | 3,401        | \$20.1                         |
| <b>4</b> Capmark Financial Group, Inc.           | \$8,001.7                   | 729          | \$11.0                         |
| <b>5</b> Wells Fargo Bank, N.A.                  | \$6,236.0                   | 3,367        | \$1.9                          |
| <b>6</b> Credit Suisse                           | \$6,130.3                   | 368          | \$16.7                         |
| <b>7</b> Prudential Mortgage Capital Co.         | \$4,457.0                   | 366          | \$12.2                         |
| <b>8</b> KeyBank Real Estate Capital             | \$3,876.6                   | 293          | \$13.2                         |
| <b>9</b> PNC Real Estate Finance                 | \$3,470.0                   | 521          | \$6.7                          |
| <b>10</b> GE Real Estate                         | \$3,317.0                   | 86           | \$38.6                         |

*According to the Mortgage Bankers Association 2007 Annual Report on Multifamily Lending*