Blog Post

The Line Reports from Andrews Kurth's Mid-Year Real Estate Roundtable - Part III: Vuvuzelas

Posted on **June 28, 2010** by Charles T. Marshall

In most soccer games there comes a moment, usually around the 60 minute mark, when tired legs and passionate fans recommit and reenergize for the final push. Depending on the country or stadium, that's when the cheering, flare burning, singing, flag waving, or blowing of vuvuzelas intensifies and the teams rally.

The Mid-Year Real Estate Roundtable sponsored by our law firm last week was no different. After an hour of lively discussion of distressed assets, special servicing strategies and relative values, however, flares or vuvuzelas from the Dallas audience were not necessary. The sophisticated panelists sensed the need to turn the talk to liquidity and the return of CMBS.

The panelists agreed that with looming real estate loan maturities and limited or shrinking allocations by banks and life companies, CMBS lending was necessary. (The Fitch Ratings U.S. CMBS Maturity Bulletin released June 24 confirms their views: beginning the wave of maturities, an average of 160 commercial real estate loans in CMBS pools rated by Fitch will mature each month from July through December, 2010, representing $9.8 billion.)

Trey Morsbach's a believer. In his view, securitization is logical and makes too much sense. He notes that many of the investment banks who were major players in CMBS 1.0 are back and are actively bidding on new origination. "They're doing it just on the margin of where the life insurance community wants to lend at a remarkable cost of capital and very disciplined underwriting." Such strict underwriting standards would justify an interest rate higher than the 5% ten-year debt that's being quoted. Strictly from a mortgage banking perspective, he likes the reliability and relational aspect of life company lending, but acknowledges that there is limited capacity. "Proceeds and rate—you can call it greed—and/or necessity are going to drive the average borrower back to CMBS."

Pat Sargent agrees, of course. He notes, however, that a big challenge is the impact of the steep valuation drop and the huge equity gap for 2005-07 vintage assets. The loans at the height of the market "got a little loosey goosey," according to Pat. The 10-year debt maturing now should not be a problem; those loans were originated with tighter standards and loan to values and have had the benefit of amortization. As Lindsey Wright noted, 90% of the recently maturing 10-year debt in her portfolio has been refinanced.

The panelists agree that additional methodology and "plumbing" changes will need to be made for CMBS' return. Investment grade bondholder concerns, concerns by borrowers about disclosure of confidential property information, and streamlining approval processes and the master servicer-special servicer hand off all need to be addressed.

And then there's regulatory reform. Risk retention, restrictions on hedging, mandated transparency, and new accounting standards, to name a few of the issues, will impact whether and how much capital will be committed to lending. Carried interest changes will adversely impact real estate investors.

The House and Senate conferees reached agreement on the financial reform legislation last Friday. We'll discuss in future posts how these legislative changes affect real estate finance and who the winners and losers are.

So get the vuvuzelas out. The game is on.