Wall of Maturities Becomes Low Hurdle; Bridge Lenders Chomp at the Bit

By Orest Mandzy

The wall of maturities has been part of the commercial real estate vernacular for at least two years. The worry was that a large percentage of the volume of loans originated during the market's peak, when underwriting practices were at their frothiest, wouldn't qualify for refinancing as they matured and would drive a huge increase in delinquency.

So far, the wall hasn't been the issue that was feared.

In fact, more than three-quarters of the $126.8 billion of loans that came due last year were paid off. And while delinquency volumes increased slightly during the year's waning months, they didn't increase to panic-inducing levels.

"We haven't seen much distress," explained Gerard Sansosti, executive managing director of HFF. Many thanks ought to be given to historically low interest rates and the abundant liquidity in the commercial real estate sector.

"I don't expect there will be a void," Sansosti said, in addressing the maturities. Indeed, the Mortgage Bankers Association expects mortgage origination volume this year to climb to $537 billion, from the $515 billion of volume it had expected for all of 2016.

But it won't all be smooth sailing. Banks and thrifts, which historically have held roughly 40 percent of the country's commercial real estate loans, are facing regulatory pressure to ease their exposure to the sector. And CMBS, which was hobbled during the first half of last year as market volatility took its toll, will be dealing with newly implemented risk-retention rules. Those rules are expected to limit origination volumes, keeping the sector's contribution to the overall mortgage universe to less than $80 billion. Many expect volumes to range between $55 billion and $75 billion.

The two other big investor groups that fund mortgages are life insurance companies and the housing-finance agencies. Any increases in their volumes will be marginal.

The MBA calculates that $208 billion of mortgages held by all investor types will be coming due this year. A total of $117.2 billion of that is held by CMBS trusts. When most of those securitized loans were written, many didn't amortize, so their balances could be at the inflated levels they were a decade ago. Meanwhile, their collateral very well could be tired and in need of updating. Of course, some of the best loans that were coming due already have been refinanced—many have been defeased, the process of replacing a loan's collateral with government securities. As a result, a large chunk could face challenges getting taken out.

"The remaining (loans) isn't the highest quality," noted Patrick C. Sargent, an attorney with Alston & Bird, who was president of the Commercial Real Estate Finance Council between 2009 and 2010. He noted that much of what's left likely will need help, either in the form of additional equity or other capital that could be used to fund the redevelopment or improvement of their collateral.

Those loans are what Tad Philipp, director of commercial real estate research at Moody's Investors Service, called "zombie loans." They're performing well enough to remain current with their payments, but not well enough to get refinanced.

That's where the growing number of bridge lenders come in.

"The great thing about commercial real estate finance is the diversification of capital sources," explained Thomas Kim, head of the MBA's commercial/multifamily group. Any regulatory tamping of capital flow is picked up by others. Seeing the potential opportunity among the securitized loans coming due, A10 Capital in 2015 started funding permanent loans. The Boise, Idaho, non-bank lender, which also focuses on bridge loans, is backed by a number of significant capital partners and keeps its originations on its balance sheet.

"There will be an opportunity for alternative, stable capital," explained John Spengler, A10's chief strategy officer. "There will be a real desire" among borrowers not to tap securitized lenders because of the restrictions CMBS loans bear. "We also think it's difficult to do business with banks."

In part that's because of the regulations they face, as well as their ambiguity. One need look no further than the rules that govern capital set-asides for loans considered high volatility commercial real estate, or HVCRE, loans that could have a profound impact on the availability of construction financing.

So it's no surprise that there's been substantial growth in the alternative lending space. That growth, however, could result in a squeeze on existing bridge lenders.

"Lenders aren't capital constrained," noted John Wilcox, managing director and head of lending at Ten-X, an online auction platform. But they will, however, be cautious when lending against certain property types or areas.

That abundance of capital has changed the dynamics in the bridge-lending business. "Two and three years ago, it was much easier and lower-risk to be a bridge lender," said Larry Grantham, managing director of Calmwater Capital of Los Angeles. "The margin for error has decreased and not everyone will be a winner."

Most bridge lenders were created to help facilitate acquisitions—they would provide short-term debt capital to fund a property's purchase and subsequent improvements, to enhance its value and allow for a take-out by a larger permanent loan. However, many are finding their businesses shifting to refinancings.

Last year, for instance, JCR Capital saw roughly a quarter of its bridge-lending business involve refinancings. That's going to grow this year, according to Jay Rollins, co-founder of the Denver investment manager. Borrowers "who thought they'd get permanent loans will turn to bridge loans," he predicted.

The timing would be uncanny. The bridge loans would start coming due just when the CMBS market would be facing a dearth of maturities and could be scouring for opportunities.

Only $17.6 billion of CMBS loans come due in 2018. Subsequent years will see subdued maturities as a result of the low issuance volumes 10 years prior. So the bridge loans that are written this year should find plenty of permanent mortgage liquidity. ■