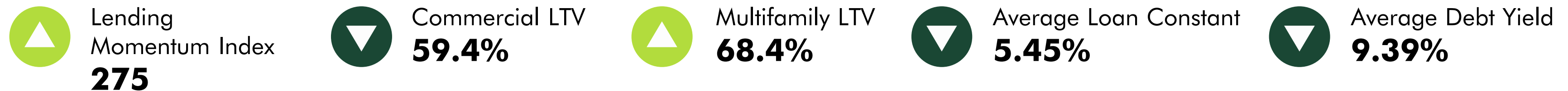
U.S. LENDING FIGURES

CBRE

Q1 2020 U.S. LENDING FIGURES – EXECUTIVE SUMMARY

COMMERCIAL LENDING MARKETS: NAVIGATING THE INITIAL SHOCK OF COVID-19

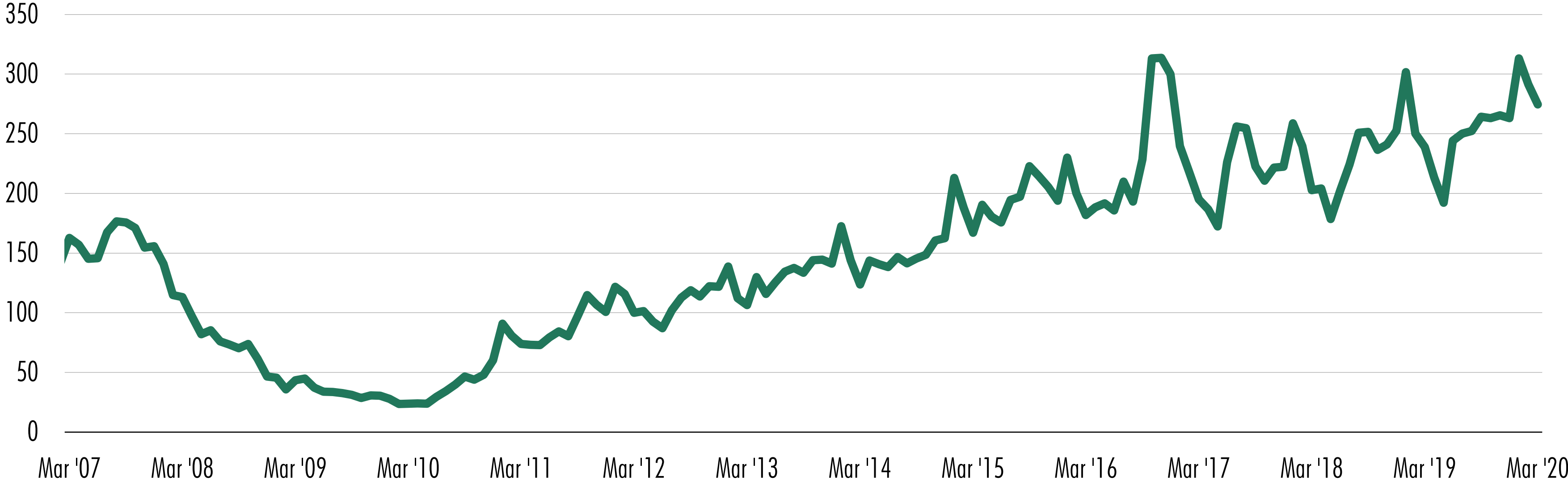


Arrows indicate change in growth rate from the same quarter in the previous year.
Source: CBRE Capital Markets, Q1 2020.

- The economic fallout from COVID-19 that began in mid-March has caused capital markets volatility not seen since the Global Financial Crisis (GFC). In response, the Federal Reserve reduced the federal funds rate to a range of 0% to 0.25%, provided a new round of quantitative easing measures and opened short-term lending facilities to provide liquidity for the repurchase agreement and commercial paper markets.
- Commercial mortgage markets are in a period of price discovery, with certain lenders remaining active. Interest rate floors have become commonplace, while underwriting and property-type criteria are more stringent due to tenant credit, property cashflow and valuation concerns.
- Commercial whole loan spreads for 55%-to-65% LTV loans are some 100 to 140 basis points (bps) wider than Q1 average levels on closed loans. However, conditions have improved in recent weeks. The impact of wider spreads on mortgage rates has been partially offset by the decline in benchmark interest rates.
- Although loan closings remained active in Q1, the March level of CBRE's Lending Momentum Index was down 12% from the high point achieved in January—a harbinger of lower loan closings anticipated in Q2.
- Banks accounted for 32.6% and alternative lenders for 30.3% of loan closings in Q1, leading the non-agency lending groups.
- Balance sheet lenders such as banks and life companies, along with the agencies, are expected to continue offering loan quotes on a selective basis. However, some alternative lenders have liquidity issues. The underwriting of construction and transitional loans likely will remain challenging over the next few months.
- New CMBS conduit originations were curtailed in mid-March, as market volatility caused bond spreads to widen significantly. However, the Fed's resumption of the Term Asset-Backed Lending Facility (TALF), combined with a decline in distressed selling, has since caused spreads to tighten. After reaching a peak of swaps +330 bps in late March, spreads on 10-year AAA CMBS fell to swaps +175 bps by late April. This has generated optimism that shelved deals may soon return to the market, paving the way for new loan originations.
- Most of CBRE's broad loan underwriting measures were unchanged in Q1. While underwriting has become more aggressive in recent years, it remains more conservative than in the period leading up to the GFC. Therefore, current originations should withstand higher levels of stress.

FIGURE 1

LENDING MOMENTUM FAVORABLE IN Q1; LIMITED WEAKNESS APPARENT IN MARCH

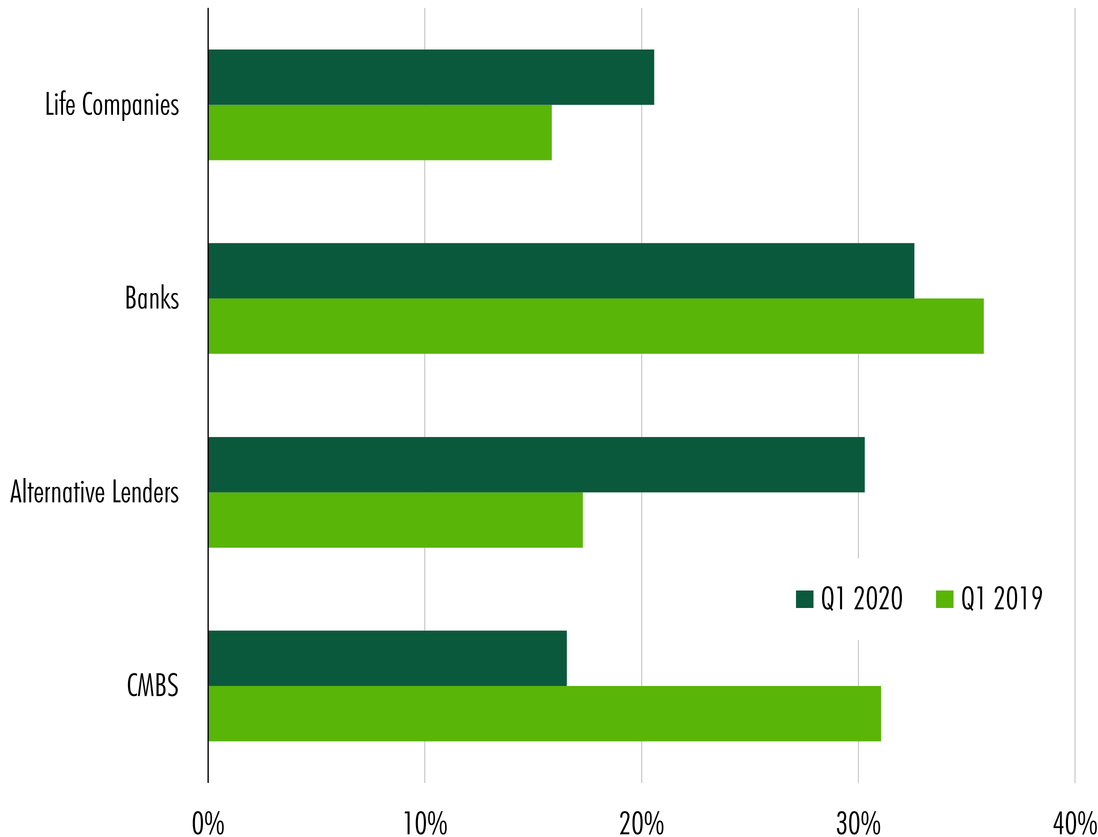


Source: CBRE Capital Markets and CBRE Research, Q1 2020.

- The CBRE Lending Momentum Index level of 275 in March was up 4.5% from December and 15% from a year ago but down 12% from the high point achieved in January of 313.
- The index tracks closed loans originated or brokered by CBRE Capital Markets and has a base value of 100, which represents average activity for 2005.

FIGURE 2

BANKS & ALTERNATIVE LENDERS DOMINATE LENDING IN Q1

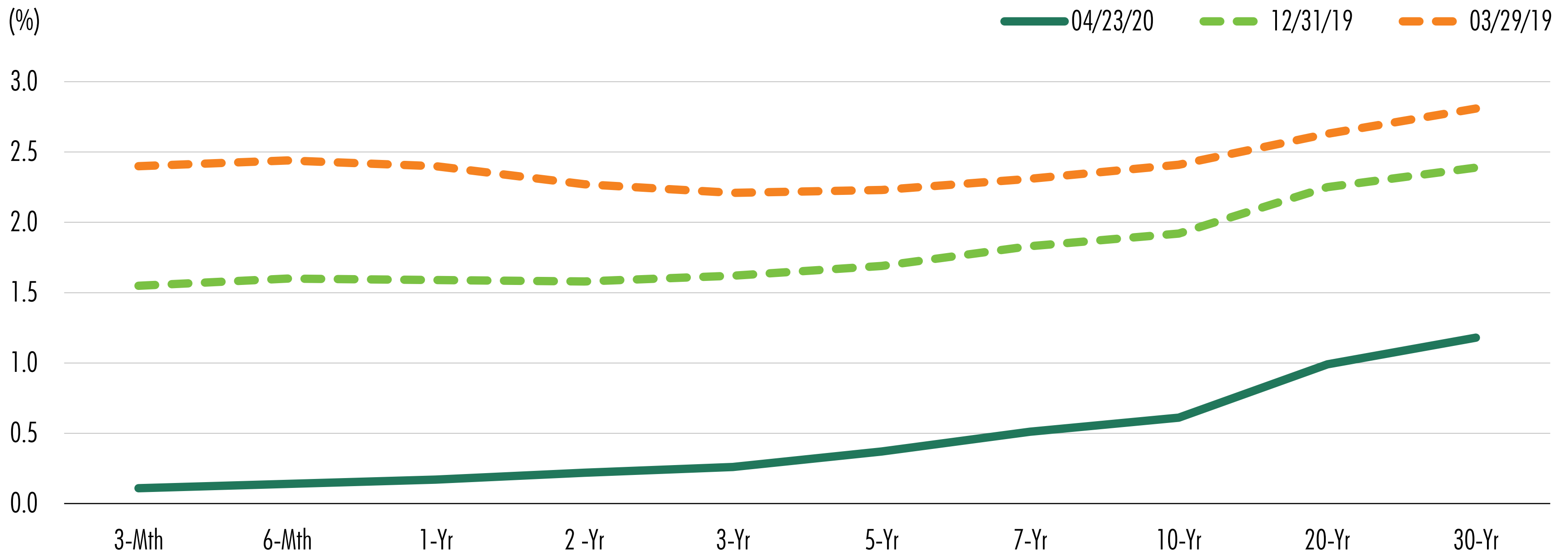


Source: CBRE Capital Markets and CBRE Research, Q1 2020.
Reflects non-agency commercial/multifamily loans.

- Banks led the four major non-agency commercial lender groups in Q1 with a 32.6% share of total lending volume, up from their 25.1% average share in the second half of 2019. Other than the large money center banks, regional and local community banks and credit unions should remain a source of liquidity in the coming months.
- Alternative lenders, which include REITS, finance companies and debt funds, took a 30.3% share of Q1 lending volume, down from more than 40% in Q4 2019. While many private debt funds have substantial equity to deploy, some may struggle with liquidity issues over the near term. In addition, the ability to underwrite value-added and construction deals may be challenging, while opportunistic deals will increase.
- Life companies were the third most active lending group in Q1, accounting for 20.6% of volume—on par with their Q4 2019 share and up from their 15.9% share of a year ago. While many life companies remain active in the commercial mortgage market, they are selective in underwriting new deals.
- CMBS conduits accounted for 16.5% of lending volume in Q1, down from 31% a year ago. The CMBS market came to a standstill in late March, as spreads widened sharply amid market volatility. However, the Fed's inclusion of senior CMBS bonds as eligible collateral in its reactivated TALF program tightened bond spreads and improved the outlook for the resumption of CMBS loan originations in coming months.

FIGURE 3

TREASURY YIELD CURVE DROPS DUE TO AGGRESSIVE POLICY MEASURES

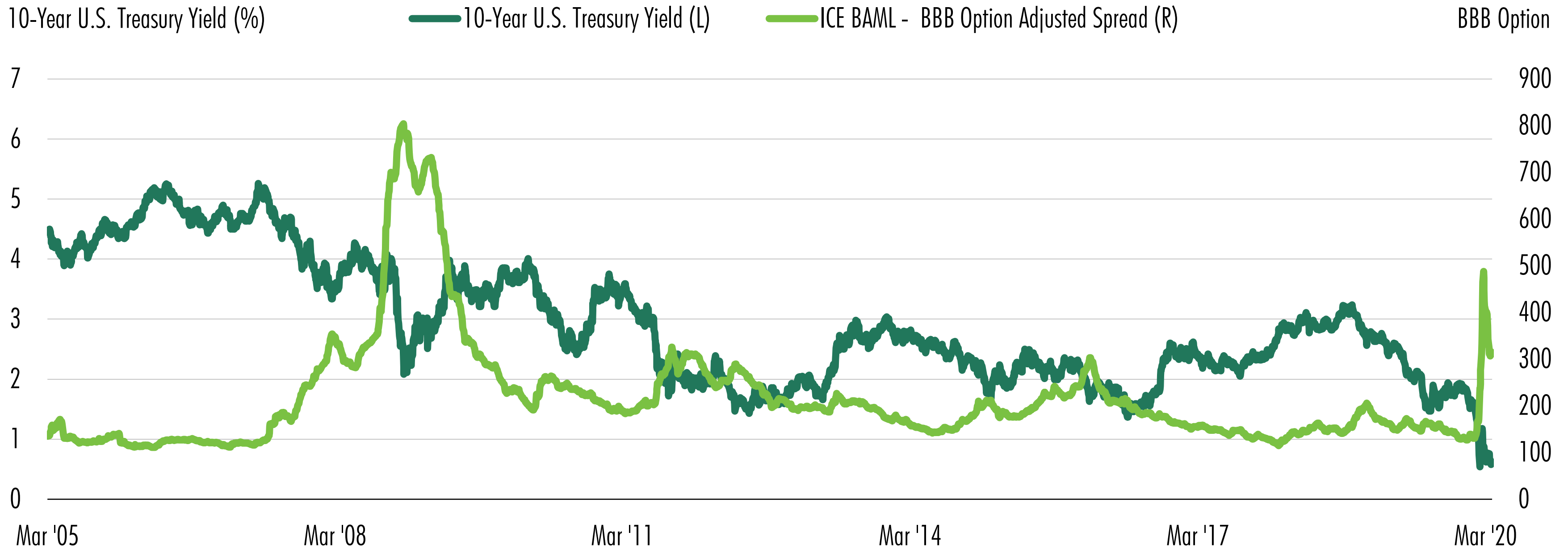


Source: Federal Reserve Bank, April 2020.

- In response to the economic fallout from COVID-19, the Fed reduced the federal funds rate to a range of 0% to 0.25% and reintroduced quantitative easing measures to include up to $700 billion in Treasury bond and Agency MBS purchases. The Fed also established several lending facilities to provide liquidity for short-term repurchase agreement and commercial paper markets.
- With the Fed actions, the Treasury yield curve fell dramatically. On April 23, yields on three-month Treasury bills were only 0.11%, down from 1.55% at the end of 2019. The benchmark 10-year Treasury bond yield declined to 0.61% from 1.92% over this period.

FIGURE 4

10-YEAR TREASURY YIELD & BBB OPTION ADJUSTED CORPORATE BOND SPREAD

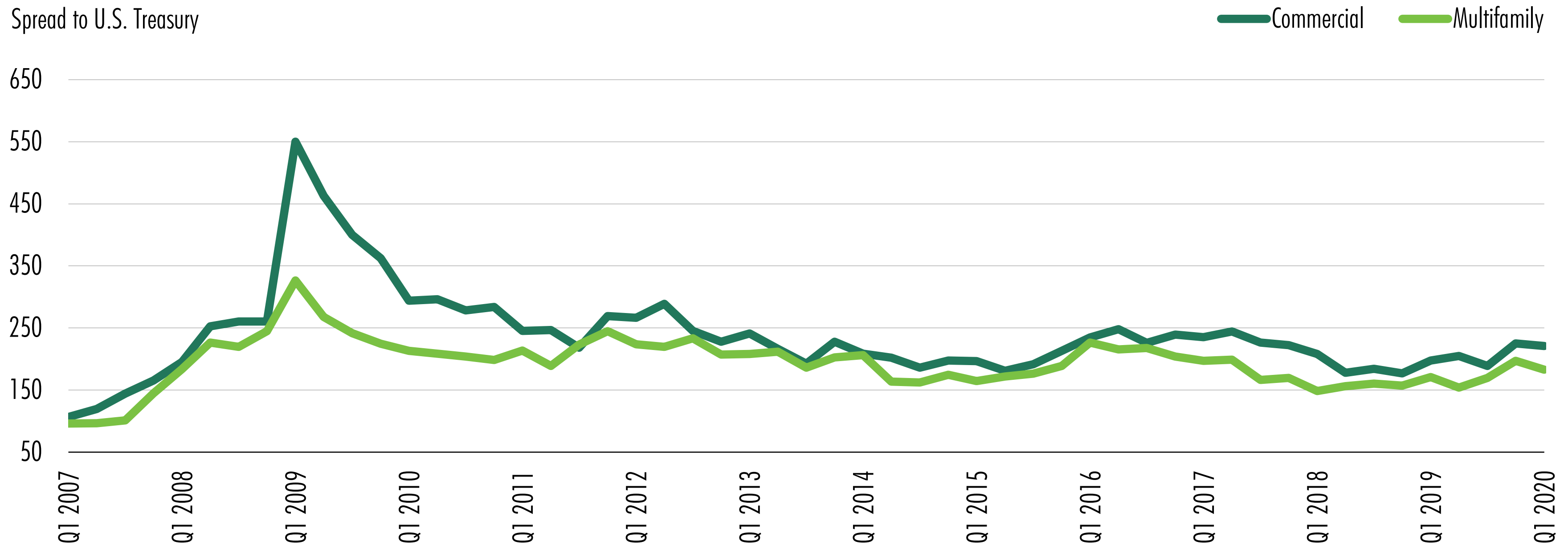


Source: ICE Bank of America/Merrill Lynch, Federal Reserve and CBRE Research, April 2020. Reflects data through 4/24/2020.

- Since the onset of COVID-19 in mid-March, market volatility has risen to levels not seen since the GFC. After reaching a peak of 3,386 on Feb. 19, the S&P 500 Index reached a low of 2,237 on March 23. However, the Fed's action helped to stabilize equity and credit markets. By April 24, the S&P 500 index had rebounded to 2,836.
- Credit markets have followed a similar pattern. As short-term corporate liquidity and cash funding issues emerged in March, corporate bond spreads reached their widest levels since the GFC. According to the ICE Bank of America/Merrill Lynch U.S. Corporate BBB Index, spreads reached a high of 488 bps in late March. As markets stabilized, however, spreads tightened to 311 bps by April 24.

FIGURE 5

COMMERCIAL & MULTIFAMILY MORTGAGE LOAN SPREADS REMAIN TIGHT IN Q1

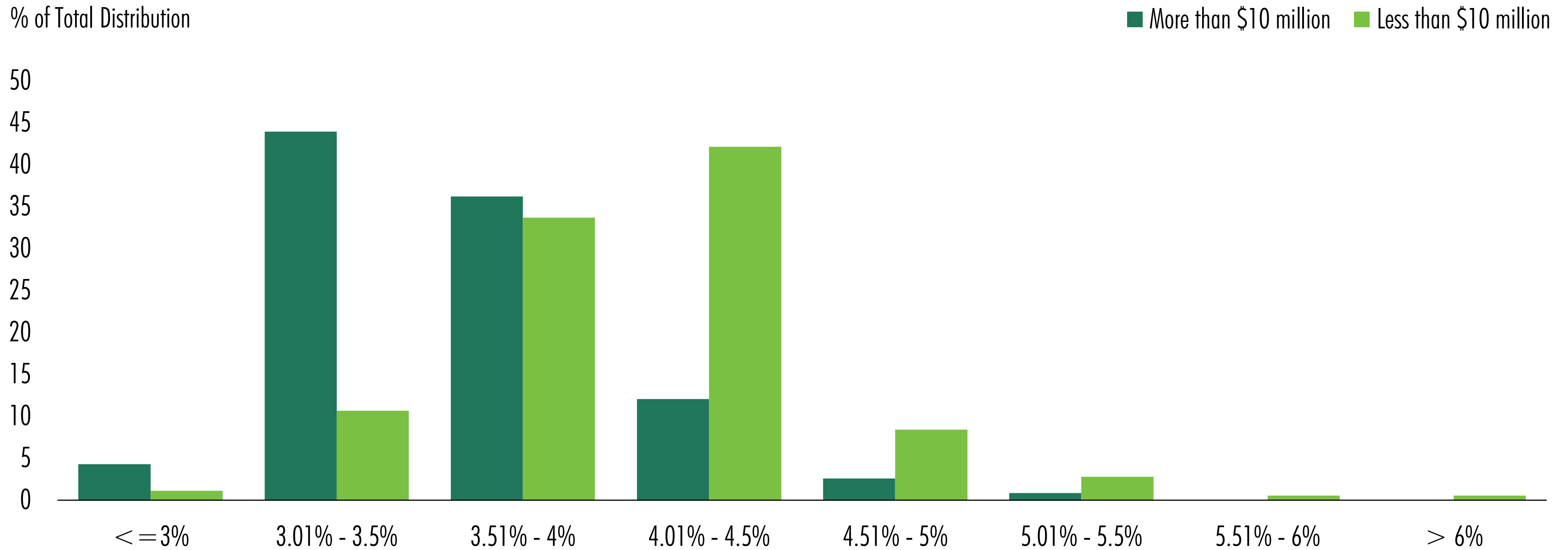


Source: CBRE Capital Markets and CBRE Research, Q1 2020.
Note: Reflects average spreads on 7-10 year, 55%-65% LTV, permanent fixed-rate loans closed by CBRE Capital Markets.

- Average commercial and multifamily spreads remained tight in Q1, reflecting the strong market conditions that existed prior to the late-quarter onset of COVID-19.
- Multifamily mortgage spreads averaged 183 bps in Q1, down from 197 bps in Q4. Spreads were 12 bps wider than their Q1 2019 average.
- The average spread on commercial mortgage loans averaged 221 bps in Q1, close to the 225-bp average for Q4. Spreads were 23 bps wider than a year ago and based on fixed-rate deals with a seven- to 10-year term and 55%-to-65% LTV ratios.
- Active loan quotes and lender pricing indicatives reveal that comparable commercial and multifamily loan spreads have widened by 100 to 140 bps as of late April from the Q1 2020 closed loan averages noted above. However, the increase in overall mortgage rates from higher spreads has been partially offset by a nearly 70-bp decline in 10-year Treasury benchmark rates.

FIGURE 6

MORTGAGE RATE DISTRIBUTION



Source: CBRE Research, Q1 2020.

- Mortgage rates were quite low in Q1, reflecting the combination of tight credit spreads and low benchmark interest rates. Overall, 61% of loans carried a mortgage rate of 4% or less, up from 52% in Q4 2019. The comparable figure for larger loans—those carrying an origination balance of $10 million or more—was 81%, while the percentage for smaller loans was 45%.
- Approximately 51% of smaller loans were originated with a mortgage rate of between 4% and 5%.

FIGURE 7

LOAN UNDERWRITING MEASURES STEADY IN Q1

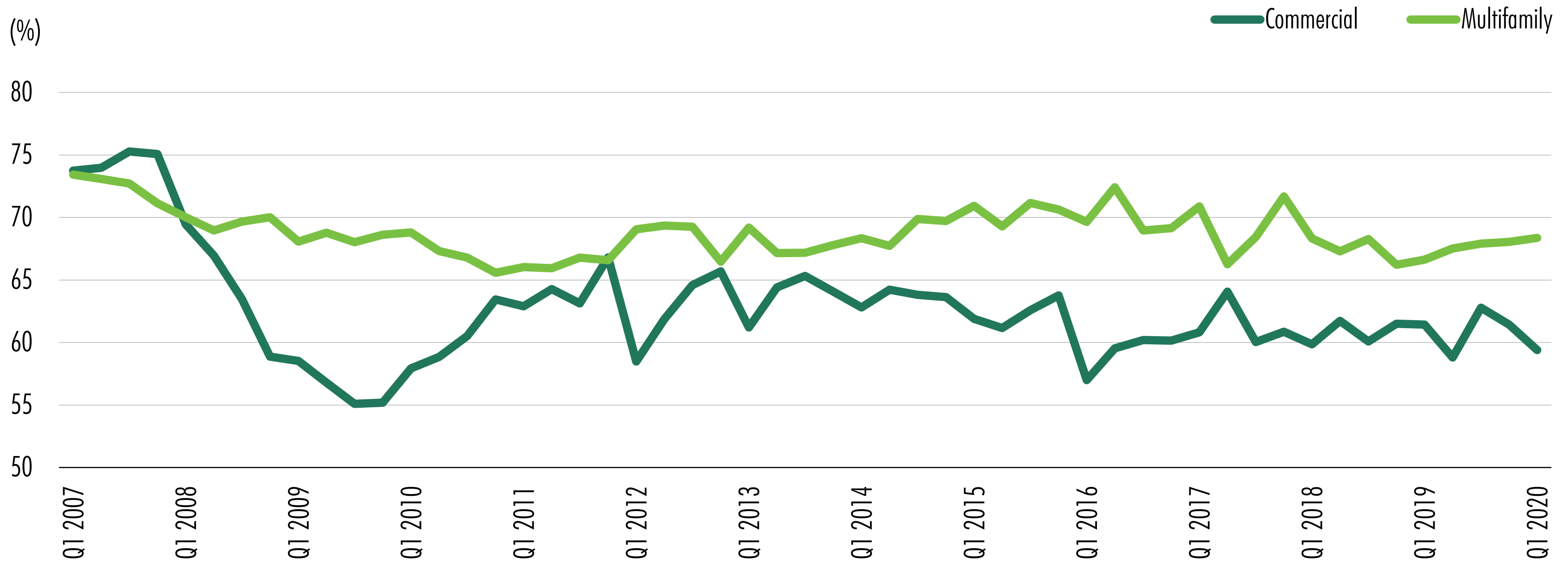
Key Underwriting Measures	Q1 2020	Q4 2019	Q1 2019	Q1 2017
Debt Service Coverage Ratio	1.51	1.51	1.40	1.51
Loan-to-Value (LTV) (%)	65.0	65.8	65.1	65.4
Cap Rate (%)	5.89	5.89	5.90	6.22
Amortization Rate (%)	20.3	22.6	16.8	24.0
Percent Partial or Full Interest-Only	63.3	64.1	67.5	55.6
Percent Full Interest-Only	22.8	19.9	17.9	11.1
Loan Constant (%)	5.45	5.50	6.10	6.23
Interest Rate (%)	3.82	3.89	4.72	4.24
Debt Yield (%)	9.39	9.26	9.34	9.93

Source: CBRE Research, Q1 2020.
Note: Amortization rate reflects the average percentage of origination balances scheduled to pay down over the loan term.

- CBRE's loan underwriting measures were largely unchanged from the previous quarter. Debt service coverage ratios and underwritten cap rates were stable, while loan constants and the average mortgage rate were down slightly.
- The average amortization rate—the percentage of origination balances that pay down over the loan term—fell in Q1. This reflected a higher average share of loans carrying full-term interest only—22.8% in Q1 vs. 17.9% a year ago.
- Underwriting measures are slightly more aggressive than they were three years ago. With lower underwritten cap rates and debt yields and a higher percentage of interest-only loans, a large share of recently underwritten loans should withstand higher degrees of stress than loans underwritten prior to the GFC.

FIGURE 8

COMMERCIAL LTVS DOWN; MULTIFAMILY LTVS UP SLIGHTLY

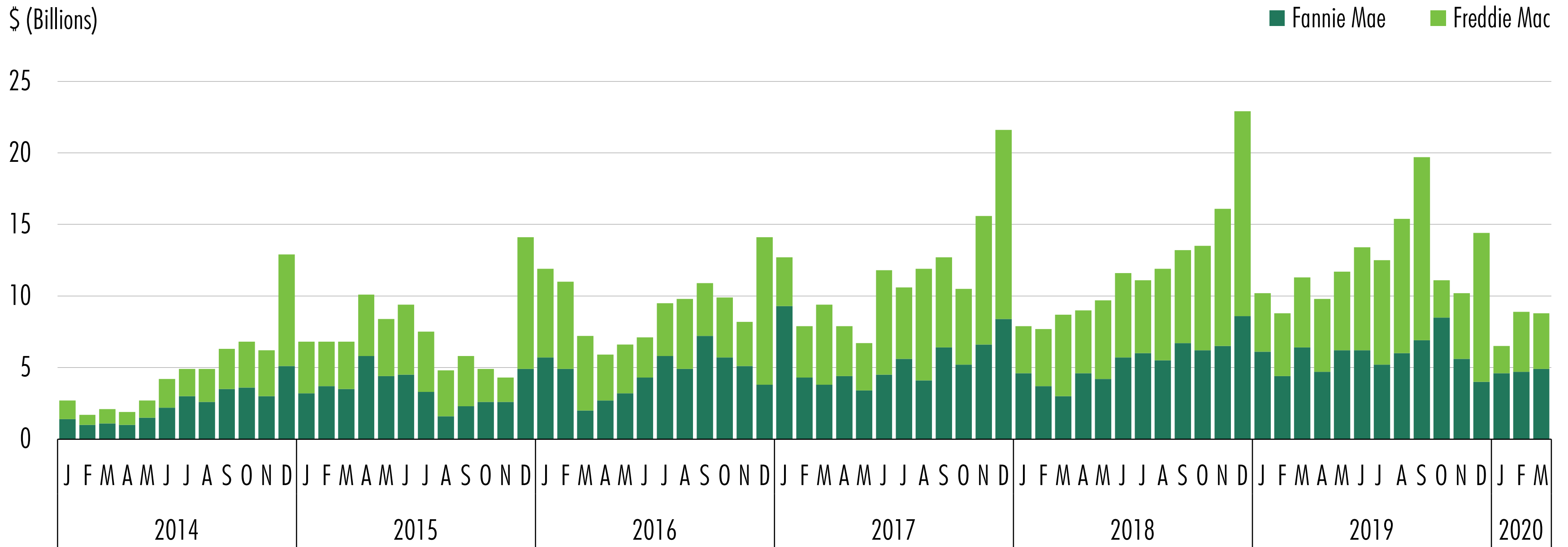


Source: CBRE Research, Q1 2020.

- Commercial LTVs averaged 59.4% in Q1, down 2 percentage points from Q4 2019 and the lowest level since Q2 2019's 58.8%.
- Multifamily LTVs inched up to 68.4% in Q1 from 68.0% in Q4 2019 and have gradually increased since reaching their most recent low of 66.2% in Q4 2018.
- With the current economic uncertainty, recent loan originations have been underwritten more conservatively than during the period leading up to the GFC.

FIGURE 9A

MONTHLY AGENCY MULTIFAMILY MORTGAGE PRODUCTION

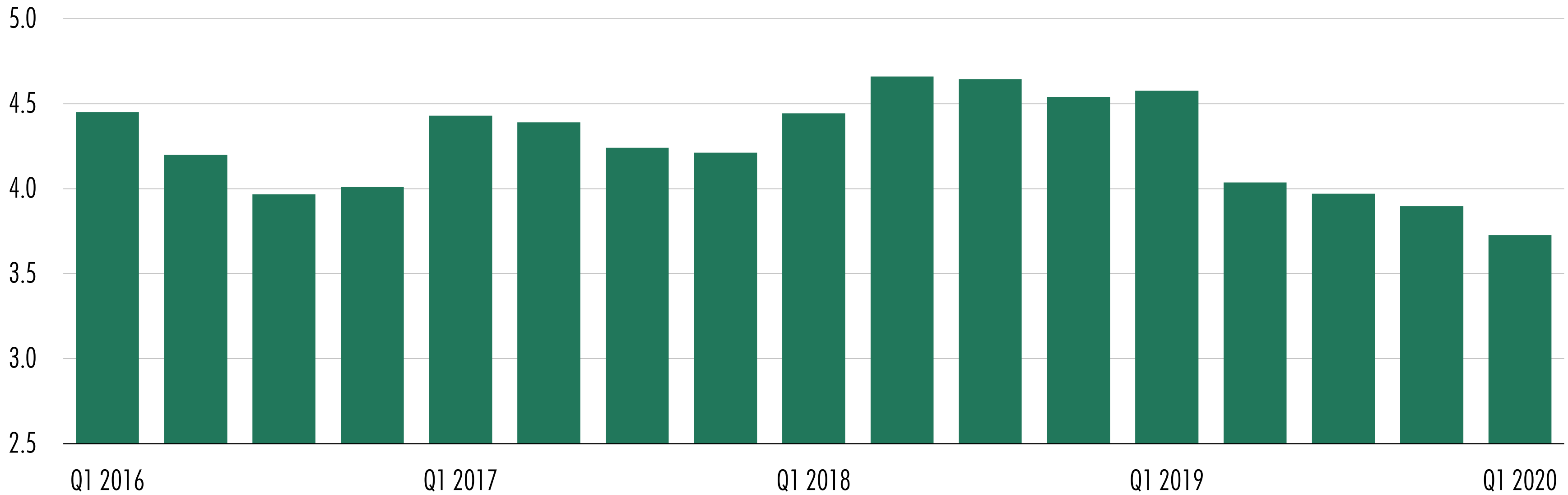


Source: CBRE Capital Markets, Q1 2020.

- Agency loan production totaled $24.2 billion in Q1, down from $30.3 billion in Q1 2019.
- CBRE's Agency Pricing Index, which reflects the average agency fixed-mortgage rates for closed permanent loans with a seven- to 10-year term, fell by 17 bps in Q1 to average 3.73%. Rates were down 85 bps from a year ago.
- The agencies likely will remain a strong source of liquidity during the COVID-19 crisis. They have implemented forbearance programs for existing borrowers, which likely will mitigate the overall rise in loan default rates.

FIGURE 9B

QUARTERLY AVERAGE AGENCY MORTGAGE RATE



Source: CBRE Capital Markets, Q1 2020.
Reflects average closed mortgage rate for 7-10 year permanent fixed-rate agency loans.

FOR MORE INFORMATION, PLEASE CONTACT:

CBRE RESEARCH

RICHARD BARKHAM, PH.D. MRICS
Global Chief Economist &
Head of Americas Research

SPENCER G. LEVY
Chairman of Americas Research
& Senior Economic Advisor

MARK GALLAGHER, CFA
Senior Strategist
Americas Research

CBRE CAPITAL MARKETS

BRIAN STOFFERS
Global President
Debt & Structured Finance

JEFF MAJEWSKI
Executive Managing Director
Debt & Structured Finance

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