By Charles H. Green
Managing director
Small Business Finance Institute

Will Your Deals See Daylight in 2014?

The outlook for commercial real estate lending is bright despite lingering concerns

As this year unfolds, there has been an unmistakable positive sentiment among mortgage professionals and lenders in the commercial real estate finance market. This sentiment echoes the results of a survey that Scotsman Guide Media and the Small Business Finance Institute conducted this past December.

In a bid to gauge the outlook for commercial real estate lending in 2014, the organizations' 10-question survey sought mortgage professionals' evaluation of their business volume in 2013 as well as their views of the prospects that 2014 might have in store. Surprisingly, the results demonstrated a stark contrast between the two years in the eyes of mortgage professionals and lenders. Although only 29 percent of respondents said they were satisfied with their dollar loan volume in 2013, a whopping 82 percent expected this year to bring an increased dollar volume, and 81 percent expected a higher number of clients. In addition, 64 percent said they expected the ratio of funded loans to applications to increase this year, as well.

Will 2014 live up to these high expectations? By taking a close look at the survey respondents' answers, several market trends can be seen as indicators of where commercial real estate lending may be headed this year.

Despite the apparent optimism about this year's prospects, respondents expressed various concerns about a number of issues that could represent barriers to funding commercial real estate loans. Given five choices, the majority of responses were split between:

- **Restrictive lender-credit policies** (38 percent), and
- **All of the above** (35 percent).

The latter included depressed borrower demand for capital and real estate appraised values, in addition to restrictive lender-credit policies.

The survey also asked respondents to elaborate on their outlook for lending in 2014 by answering the following two

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Illustration: Dennis Wunsch

Charles H. Green is managing director of the Small Business Finance Institute. Previously, he founded and served as president and CEO of Sunrise Bank of Atlanta. Green authored several finance books, including the bestselling *The SBA Loan Book 3rd Edition* and *Get Financing Now*. He earned a bachelor's degree in finance from the University of Alabama and completed the Stonier National Graduate School of Banking. Reach Green at Director@SBFI.org.

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questions:

1. **What conditions, terms or incentives** could motivate more users/investors to acquire, construct or refinance commercial real estate loans in 2014?
2. **What conditions, terms or incentives** could motivate commercial real estate lenders to extend more loans to property users/investors in 2014?

More than two-thirds of survey respondents answered these two questions, with more than 40 percent of the responses pointing to the market's need for less restrictive lender-credit policies. The next most common concern of survey respondents related to either regulatory or government policies, which dominated 22 percent of the answers. These two major concerns were followed by concerns about real estate values (11 percent), borrower issues (10 percent), interest rates (9 percent) and the overall economy (7 percent).

Let's take a closer look at each of these concerns and their potential impact on commercial real estate lending this year.

Restrictive lender-credit policies

Concerning possible changes in industry-wide credit policy, survey respondents recommended almost every conceivable solution — from subtle tweaks to major changes. The responses ranged from urging lenders to ease borrower-credit standards to removing onerous lending regulations. Many respondents even demanded higher loan-to-value leverage, a request that likely will fall on deaf ears.

Respondents still suggested some valid points that sound plausible or even possible, however, given the regulatory environment and the slow climb to recover lost real estate values. Some of these suggestions included:

- **Faster loan processing**. With available technology and human resources, lenders should be able to provide quick turnaround times, which will give them a competitive benefit.
- **Restoring the U.S. Small Business Administration 504 loan-refinancing program**. This program expired in 2012, and there has been a strong lobby to restore it.
- **Offering differentiated products for purchasing and refinancing commercial real estate.** Borrowers with a track record in a particular property type should be seen as representing lower risks than new buyers.
- **Returning to common-sense underwriting.** This is one of the most repeated expressions of frustration with lender policies.

The government

Many respondents laid the blame for soft borrower demand at the feet of poor confidence in the U.S. economy and the uncertainty fueled by government gridlock in Washington, D.C. Racked with low economic growth, an elongated high unemployment rate and anxiety about future interest rates, many business owners have been hesitant to invest in expansion, which limits opportunities for lenders and mortgage professionals alike.

In the wake of this past October's government shutdown, a few survey responses were political in nature, with little direct relation to commercial real estate funding. These responses included complaints about the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Affordable Care Act and the role played by the Consumer Financial Protection Bureau.

Most complaints about the government were general in nature, appealing for lighter regulation and more flexibility from supervising regulators. Respondents' suggestions ranged from getting the U.S. Federal Reserve to taper off bond buying in 12 months — with comments like "let the market stand on its own" — to requesting fewer regulations, lower taxes and more incentives. In this regard, however, "more incentives" may be something of an oxymoron.

Property values

Despite the recent uptick in property values, there was plenty of frustration noted under the topic of property values. In short, respondents requested higher valuations, but they offered scant solutions as to how that can be achieved.

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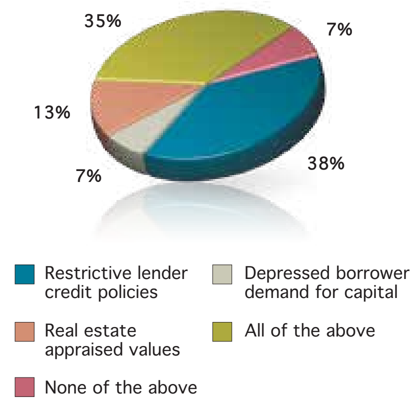
What do you expect will be the most significant barrier to funding commercial real estate loans in 2014?



Were you satisfied with the funded-loan dollar volume that you were involved with during 2013?

Do you expect to increase the funded-loan dollar volume that you will be involved with during 2014?

Visit SBFI.org for a complete review of the survey results.

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One exception was a suggestion that appraisers provide a better accounting of recent value growth rather than defaulting to worst-case scenarios. Another respondent asked lenders to expand the use of commercial evaluations.

Borrower issues

Respondents divided borrower issues into two main points: borrowers' financial conditions and the quality of brokers. Several respondents pined for better borrowers with stronger balance sheets, liquidity, guarantors and solvency.

Other respondents focused on commercial mortgage brokers, tasking them to develop a better understanding of lender programs. Respondents said that brokers wouldn't be able to connect to deals if they didn't know what programs were available. A couple of complaints were aired about brokers' presentation packages, which were described as weak. Respondents said that strong, complete packages are likely to get faster responses from lenders.

Interest rates

It's hard to imagine how to improve on interest rates after the industry witnessed all-time lows for the past five years. Several respondents apparently have grown dependent on this level and voiced concerns about the prospect of increasing interest rates.

Not everyone is a fan of low rates, however. There were a few respondents who called for higher rates, apparently reasoning that a gradual elevation of rates would pressure more potential deals to move faster.

Overall economy

The economy remained a concern for many respondents, who hoped for more growth and a lower unemployment rate. In their view, stronger economic growth and better employment would spill over quickly and help improve commercial real estate values and deal flow.

In answers to a question about the prospects for economic growth this year, respondents were generally positive. Sixty-four percent expected an economic expansion, 25 percent didn't expect an expansion and 11 percent said they didn't know.

Unsurprisingly, this sentiment is associated with the overall optimism about this year, which demonstrated itself in answers to one fundamental question: Does your company plan to hire more people to facilitate commercial real estate business loans in 2014? An encouraging 43 percent indicated that their companies would be hiring more people, while 34 percent said they were not and 23 percent did not know.

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Commercial real estate lending has taken a beating over the past six years. Although some lenders may have set themselves up for the shellacking with too much concentration in vulnerable property classes, the fact is that many prudent lenders were hurt, as well.

Soft loan demand, a plethora of problem loans and flat interest rates have made profitability and loan growth difficult tasks for many lenders. Part of the fallout has been tighter scrutiny of lender performance and the loss of many of good market players who could not develop loans in these conditions.

With that in mind, if the collective commercial real estate finance sector can muster and maintain its overall optimism in the wake of these tough years — and in the face of continued lackluster growth and borrower uncertainty — that's great news. Optimism implies the steadfast faith that things will improve and that a stronger, healthier market is within reach. ●

Visit SBFI.org for the complete survey results.