Lenders Tighten CRE Borrowing Standards

The Upside: Increased Quality of Newly Issued CMBS Loans

By **Mark Heschmeyer**

Bank and CMBS loan originators tightened their lending standards for all types of commercial real estate loans during the first quarter, a marked reversal from the previous few years.

A significant number of U.S. banks reported tightening standards for construction and land development loans and loans secured by multifamily properties, according to the latest Federal Reserve Senior Loan Officer Opinion Survey released this week. Additionally, a moderate number of U.S. banks reported tightening standards for loans secured by office, industrial, retail and hotel properties.

While lenders were tightening their underwriting standards, demands for all three types of CRE loans continued to grow.

In particular, the Fed's survey of senior loan officers found a moderate net fraction of U.S. banks reported increasing maximum loan size but tightening of their loan-to-value ratios. Another modest net fraction reported tightening debt-service coverage ratios. Survey respondents indicated that other loan terms remained basically unchanged, on net, over the past year.

The Fed also asked bank loan officers about their responses to conditions in the CMBS markets over the past six months. A moderate net fraction of banks reported moderately increasing the volume of origination of CRE loans; while a significant fraction reported moderately decreasing the volume of CRE loan securitization.

When asked about the anticipated large amount of CRE loans originated in 2006 and currently held in CMBS that will need to be refinanced over the next six months, a moderate net fraction of banks noted they expect standards for these refinancings to be somewhat tighter than standards they expect to apply to other CRE loans.

The results of the survey, “were both important and largely inconclusive in most ways,” said Christina Zausner, vice president, industry and policy analysis at CRE Finance Council. “After the Fed’s warning to the market on Dec. 18, 2015, it is interesting to see that the survey results largely suggested that CRE bank lenders are reacting to a changing environment in a moderate fashion - many holding, some taking new cards and some folding.”

The upside to the tighter lending conditions has been an increase in the quality of newly issued CMBS loans, according to Morgan Stanley Research.

“We believe this may lead to the outperformance of 2016 vintage deals relative to 2014 and 2015 vintages,” Morgan Stanley Research analysts wrote. “We expect the collateral performance of 2016 vintage loans to be better than those securitized in 2015 and 2014 vintage deals.”

Originators are becoming more selective, the firm noted. The average size of conduit deals has declined by 16% in the first quarter. The weighted average LTVs declined by 3.3 percentage points to the lowest level since 2011, driven by an increase in the percentage of loans with LTVs less than 60%.