

APRIL 2009

## Maturing CMBS Loans Present Challenges & Opportunities in the DC Region

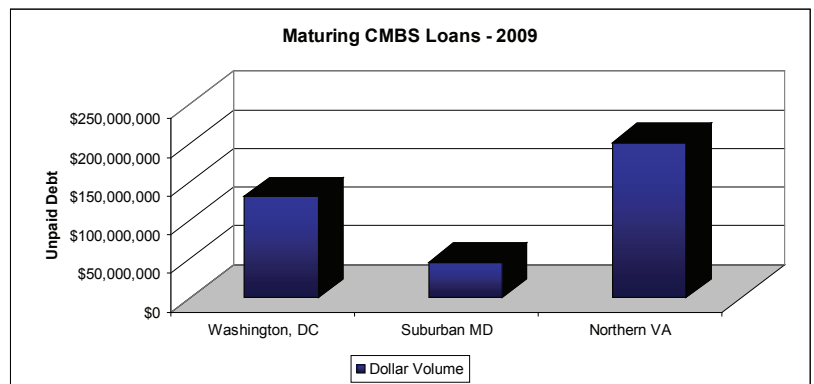
From 2001 to 2007, the commercial mortgage-backed securities (CMBS) market emerged as a dominant source of capital for real estate lending. During this boom period, the CMBS market was able to connect the global financial system to real estate, which resulted in lower interest rates for borrowers and attractive yields for investors. By the end of 2007, the CMBS universe had grown to account for approximately 25 percent of the \$3.1 trillion of outstanding commercial mortgages. However, at this point the subprime crisis had spread to the commercial real estate sector and CMBS issuance diminished rapidly. Several CMBS office loans that originated during this real estate boom are now scheduled to mature in 2009. Given the current lack of credit flow, these maturing CMBS loans could have a significant impact on the global real estate market. In this paper, the DC region's office market exposure to CMBS is examined.

In 2009, the current debt capital shortfall will make it extremely difficult for property owners to refinance maturing loans. Exacerbating the problem, new issuances of CMBS loans, once a \$230 billion-a-year financing vehicle, were down to \$12.1 billion in 2008, creating a severe undersupply of fresh debt capital. Therefore, faced with an illiquid CMBS market, owners looking to refinance securitized mortgages will have to rely on alternative options. If available, these debt sources will require tighter loan standards, which present a significant challenge to

owners with increasing vacancy rates and decreasing cash flows. Nationally, 518 CMBS office loans with unpaid balances totaling \$17.2 billion are coming due in the final nine months of 2009. In comparison, the Washington, DC region must sort through just 29 loans comprising \$378.2 million of unpaid debt<sup>1</sup>, just 2 percent of all outstanding CMBS debt in the region.

Recently named the most attractive market for real estate investment in 2009 by AFIRE<sup>2</sup>, the DC region will benefit as the top focus of global investment in the US. Subsequently, regional owners with maturing CMBS loans are likely to have more refinancing options. As of April 2009, the average CMBS office loan in the DC region has a 58 percent loan-to-value ratio and a debt-service coverage ratio of 1.62. In other words, borrowers who used the CMBS market as a loan vehicle are easily covering their debt payments with net operating income, thus lenders will be more willing to refinance these well-performing assets. In addition, mortgage payments hold a median coupon rate of 7.7 percent, a healthy return that will help attract refinancing. Finally, the height restrictions on buildings in the District make deals more feasible by capping total transaction size.

### CMBS Office Loans – Washington, DC MSA: 2009 Maturities



Source: Cassidy & Pinkard Colliers Research – Data as of April, 2009

\*Excludes national portfolio loans

<sup>1</sup> This estimate excludes national portfolio loans. Given data limitations, we can not accurately estimate the value of assets located in the DC region

<sup>2</sup> Association of Foreign Investors in Real Estate

CONTACT INFORMATION

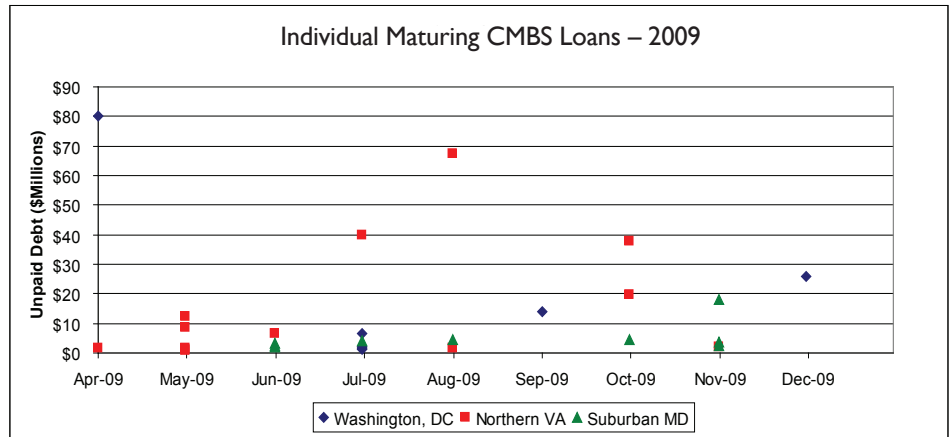
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CMBS Office Loans – Washington, DC MSA: 2009 Maturities



Source: Cassidy & Pinkard Colliers Research – Data as of April, 2009

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Looking forward, with vacancy relatively low, CMBS loans in the DC region will continue to perform. Moreover, only 7 percent of all office loans in the DC region are securitized in the CMBS market, thus exposure is minimal. In 2009, the majority of maturities occur in the second half of the year when the effects of the Public-Private Investment Program may have improved the debt markets. Ultimately, in this financial climate, any maturing loan will be a challenge to refinance, but relatively healthy economic and office market fundamentals in the DC region should lessen this obstacle.

**Owners with maturing CMBS loans have the following options:**

- **Sell property**

*Pro: Opportunistic buyers are in the market*

*Con: Unloading assets in down market may not cover principal payment*

- **Arrange a short-term extension using loan’s master servicer or special servicer**

*Pro: Short-term extensions allow borrower to restructure loan*

*Con: Viewed as a last resort and servicer will require increased reserve requirements, recourse provisions or a higher interest rate*

- **Refinance to deleverage capital stack with increased equity stake or new mezzanine piece**

*Pro: Enables borrower to hold onto assets and deleverage*

*Con: Raise an additional 25-30 percent of equity or pay increased coupon on mezzanine piece*

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