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Due date

By David Jacobs (Contact)

Monday, September 21, 2009

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The tension in the conference room at Juban's restaurant is palpable, but mostly below the surface. The well-dressed crowd of more than 150 has come not for the trout amandine or the seafood crepes, unfortunately, but for a panel discussion on the state of real estate financing in Louisiana. And as you may have heard, the state of real estate financing is not very good.

This being Baton Rouge, most everyone in the room knows everyone else; some might golf together or sit next to each other at soccer games. So any frustration the developers might be feeling toward the bankers [or vice versa] is subsumed beneath the banter. One banking executive jokes that he "asked the girls in front to check you for torches and pitchforks," drawing a round of chuckles.

Most attendees are old enough to remember the last serious downturn in the late 1980s, when the federal government formed the Resolution Trust Corporation to clean up the mess after the savings and loan meltdown. The RTC acquired troubled assets from the S&Ls and bundled them together into mortgage-backed securities that were sold off to investors. Private interests, including some of the nation's largest financial institutions, created conduit lenders to make a buck on the same principle. By the late 1990s and early 2000s, the conduit market was booming and threatened to overshadow traditional lending.

But many investors didn't understand the securities they were buying. As long as real estate values kept rising, everything was fine. But when the bottom fell out in late 2007 and investors stopped buying securities, the conduits evaporated. Robert Stuart, Louisiana state president with Capital One Bank, breaks the bad news to his audience at Juban's: Until the secondary market comes back, real estate financing probably isn't going to get any easier. Hopefully, none of his listeners will go bankrupt before that happens.

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while making fewer of them. Stuart acknowledges that lenders are getting wider spreads on the loans they make, but argues banks need to make more money to build up their capital and get the engine going again. Narrow spreads in the core lending business helped nudge the banks into more risky products in the first place.

Developer Stephen Keller went to the conduit market several years ago to get a permanent loan for Towne Center. He says he interviewed several mortgage brokers before getting a forward commitment on a 30-year loan at a favorable rate with a 10-year call.



A MATTER OF TIMING: Stephen Keller doubts he could secure a loan to finish the Towne Center if he were trying in today's market.

"We got into the position of so many banks, particularly the bigger banks, who were looking at loans almost as a loss leader, and really trying to drive everything through the investment bank for fee incomes," Stuart says. "That's how you really got the wheel going for all the mortgage-backed securities and trying to sell things off and generate fees, because there had gotten to be a general understanding that you couldn't make money just lending money." In Capital One's portfolio, about 80% of principal reduction came from refinances or developers moving projects into the secondary market, with only 20% from monthly repayments, Stuart says.

Now that the conduits have disappeared, those loans have nowhere to go. A bank might have as many real estate loans on the books now as it did 18 months ago, even

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"Thank the Lord I did it then," Keller says. "Today if I was finishing Towne Center, I don't think I could get a loan. All these bankers that you talk to, they all say they have money to loan. The problem is the conditions that they'll loan you the money on aren't exactly the conditions that we built the projects on." Keller wonders what happened to all that TARP money the banks got last year, although Stuart says TARP was meant to restore confidence in the banks, not spur lending to developers.

Stirling Properties financed three buildings it owns in United Plaza about 10 years ago, two with the same conduit lender; one with a separate conduit. All three loans were slated to mature in June of this year, and **Stirling's Chip Songy** says they went through the "entire spectrum of financing sources" before making three separate deals to refinance the three buildings. A life insurer backed one at 25 years, non-recourse, another insurer did the second at five years, 25% recourse, and two local banks pitched in on the third at five years and 50% recourse. Each building needed a new appraisal, of course, and each came in with a loan-to-value ratio in the range of 43% to 47%.

"We are very concerned because all of our projects aren't going to come in at 43% loan-to-value," Songy says. "We're very fortunate these were the only significant ones to come up this year...Next time that comes up, we're probably not going to be able to do that."

Brian Andrews of Andrews Commercial Mortgage sees a "tidal wave" of conduit loans coming due in the next few years. If Stirling Properties, a well-established company with an impeccable reputation, has trouble financing fully-leased Class A buildings in one of the city's most appealing locations, how much of a chance does everyone else have? At least with a traditional lender, a borrower with a healthy project might be able to go to his loan officer and get a renewal.

"You can't do that now with the conduits because they're all gone," Andrews says. "I don't know of a single one out there right now." Unlike your friendly neighborhood banker, the special servicers who work for investors that hold the securities often don't have an incentive to work with a troubled borrower.

So when your conduit loan matures, what do you do? You pretty much have to go to a bank, or maybe an insurance company. But many banks are busy trying to get the old real estate loans off their books, not write new ones, and local banks may not have the capacity to take on a big project. The insurance companies have the luxury to sit back and pick the best deals at the most favorable rates.

A recent analysis by Deutsche Bank found that 15% to 20% of commercial mortgage-backed security loans are expected to default before maturity. The report says most that survive to maturity, perhaps 65% or more, won't qualify for refinancing without major equity infusions. Andrews fears all this could lead to waves of foreclosures in the near future. Throughout the national financial crisis, property values in Baton Rouge have held up pretty well. But if the project next door to yours is foreclosed upon because the owner couldn't make his payments, then sold at a lowball price, that could affect your next appraisal, which makes it harder to get a new loan at the terms you need. The potential exists for a vicious cycle not seen here since the 1980s.

The economy does appear to be making a recovery, and the stock market is coming back. But a lot of money is still sitting on the sidelines. That money will be available at some point, but to whom? And at what price?

"What they're waiting for is for you to go bankrupt," says Omer Davis, regional president with Whitney National Bank. "Or, they've got to believe that you're not going to go bankrupt, and this is the time that the lowest price can be had. ...Until they realize the recession is over, and they better go put this money out, we're going to have a problem."

"Even if the economy recovers, that problem is still out there haunting all of us," Songy says. He suggests some kind of government backing for troubled commercial mortgages, similar to efforts on the residential side. But taxpayers are already suffering from bailout fatigue, and a recent *Wall Street Journal* report suggests the Federal Housing Administration might need help soon thanks to mortgage-related losses.

"The markets are going to recover," Stuart says. Just don't expect the same terms borrowers were getting in 2006 and 2007, he warns, because "those won't repeat for a generation, when there's more people who didn't live through this right here."

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Posted by Being_Stupid on September 25, 2009 at 10:17 p.m. (Suggest removal)

This economy is a result of the Community Reinvestment Act and all the loans given to people who could never pay back these loans guaranteed by the Democrats in our government.

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