A SPECIAL FOCUS ON

“TRENDS IN MORTGAGE LENDING”

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Mortgage Lending: It’s all About Jobs and the Economy

By Jonathan Hornik

The trends in mortgage lending historically reflect those of the bigger picture—everything from the state of the economy to, in the 21st Century, the impact of technology on the business transaction and everything in between. Today, the issue at hand is the ongoing rebound from the Great Recession. For the latter, it is the evolution of the “paperless” society, the emergence of social media and their impact on the financial transaction.

To begin with, over the past 12 months, we have noticed a major shift in the private lending/finance markets with more private capital entering the picture as non-traditional lending sources. The traditional lending sources—national and regional banks and thrifts—are now competing with such non-traditional lenders as private equity, hedge funds, opportunity funds and finance companies. This has recently forced such non-traditional lending sources within the past year, to take a closer look at the real estate-based asset classes. The result is that the market has become more competitive—a good thing for borrowers, because they have more options.

The latest trend in real estate secured lending are private lenders, backed by major REITs and hedge funds, that are making portfolio loans secured by single-family and multi-family rentals at prices that would be considered more in line with traditional conventional lenders. The pricing we’re seeing is five and six percent, with one point at the closing versus the typical non-traditional lending sources, coming from hard money/private/finance companies that are in the nine to 11 percent range, and one to six points.

Why is this happening? First, it is an acknowledgement by the finance companies that the real estate market has stabilized and that, in fact, in a number of the major cities such as New York, Miami, Las Vegas, Los Angeles and Dallas the market has actually accelerated. Real estate is transacting again, and when real estate starts transacting, there is increased competition to finance those deals. That exerts downward pressure on finance pricing and upward pressure on loan-to-value and loan-to-costs, that lenders will need to go to close.

With that said, new capital providers are entering the real estate finance world today. There is capital available today and a tolerance to lend against real estate that we haven’t seen since 2002-2006. And that’s a good thing for the market and pricing.

One may ask, however, are we entering the “bubble” stage? Not necessarily, because this current real estate expansion is not being driven in part by the CMBS market, which is a fraction of its pre-recession size. The CMBS market expanded dramatically between 2001 and 2006, with such expansion requiring that mortgages be put into traunches and sold off to secondary markets. This demand and lack of regulatory oversight allowed originators to make loans that should not have been made when considering traditional real estate underwriting. Underwriting loans today is being done on a more traditional basis—requiring more equity, the borrowers or sponsors need a track record of success and the real estate assets need to be in strong rising markets that transact versus raw land located in rural areas with very illiquid markets.

In general, I do not believe we are in a bubble like we were in 2007, but again, we’re starting to see the market heat up from competition. The picture does change depending upon geographic location. A deal priced in South Florida is different than a deal priced in Columbus, Ohio, for example. The market is very regionalized and very market-driven within those regions, and my advice to those lenders who feel that the space in which they have typically operated is becoming too competitive, take a step back and find a new “space.” If you’re having trouble competing in Manhattan, for example, New York’s outer boroughs, (the Bronx, Brooklyn and Queens) may be a better fit.

Overall, capital is available to those lenders who are originating good quality loans. And we’re seeing a shift to ownership—a lot of the smart money wants to lend against occupied and stabilized real estate with long-term rents in order to capture that cash flow.

What’s hot right now in the marketplace is the multifamily apartment sector and single-family rentals. There are a lot of people willing to lend against them—it’s very competitive. Indeed, there are an estimated 21 billion single-family rentals available for investment in this country.

With companies seeking to finance those properties, it’s an exciting time, a shift in the business from the recent past when one could not find a loan. The more competitive, non-traditional lending sources are, the better it is for the market because of the increased number of transactions that occur at better pricing.

We are also seeing a market shift from one dominated by refinancing to purchase-based financing transactions. Refinancing as a general market trend occurs when real estate is not transacting. For many real estate owners, the only real option over the last five years was to find another lender and pay points and fees and a higher interest rate in order to maintain their property.

Now, with prices moving up in many markets, as mentioned, it makes increasing sense to transact. Owners have an opportunity to sell the property at a price above the original purchase and repay their existing lender—and that is driving the increase in purchase-based transactions.

The market has become extremely competitive for private loans, and that is affecting pricing in terms of interest rates and points charged at the closing and the amount of prepaid interest necessary from the borrower at the closing. It also affects the loan-to-value or loan-to-costs, causing them to go up. That’s good for borrowers because they are going to get better deals. It’s not as good for lenders, on the other hand, because they may have to take more risk than they may otherwise be comfortable with.

And technology has also asserted itself into the picture, as it has in many other industries. For example, social media like Facebook, LinkedIn, and e-mail blasts, are all great tools from a marketing perspective. And while paperless origination, processing and closing are an apparent trend, as a practicing attorney I am not signed on to paperless transactions. I’ve always said that the borrower has the best deal in the world, because when you close, he gets cash and a lender gets an IOU signed on a piece of paper.

I don’t support removing that signed piece of paper. A paperless closing—the loans I’m discussing are all secured loans, which means a mortgage, deed or trust, or deed to secure debt, or other security instrument—needs to be filed in the proper land records where the property is located. In that case, you still require signatures and there are still certain rules within each jurisdiction about the form those security entrants need to be in order to create, attach and perfect your security interest.

But beyond that, technology is improving the marketplace for more lenders that “do it right.” These lenders will continue to succeed and do well. And it’s not just about size—there is always a spot for the small- to mid-sized lenders in this business, for example. The personal attention they give is important. Large lenders will enter the space–some won’t want to directly originate smaller loans; some will just want to fund the smaller lenders.

The bottom line in the mortgage financing equation is that real estate really drives the economy. There is nothing that generates more jobs than ground-up construction. Consider the construction of the traditional house and how many people it employs, from the workers who actually build the house, to the appliance and furniture manufacturers who furnish the house, to the bankers and brokers who complete the transaction.

Indeed, once consumer confidence rises to a level where people are comfortable to invest in real estate again, and real estate begins transacting again to historical levels, the economy and the market will really begin to emerge from the after-effects of the deep recession we’ve experienced. We’re very optimistic for 2014.

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