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A BUSY YEAR OF REFINANCING AHEAD IN 2015

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In a post-recession environment of increased regulatory governance and a tighter credit climate, adopting proactive risk management policies will ensure lenders remain compliant and adequately protected against liabilities and losses.

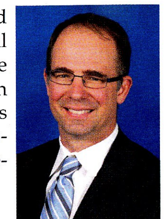
Many recent commercial real estate industry forecasts predict several more years of strong growth, followed by a possible downturn in 2017. New construction and transaction rates have increased, and an estimated $1.4 trillion in maturing commercial mortgage loans are up for renewal by 2017. This provides great opportunity for the broader commercial real estate industry in the coming years, but could it also present challenges for lenders to adequately protect against risk, while keeping up with this flood of activity. What will lenders do over the next 12 months to capitalize on the strength of the market, and to better protect against a possible crash?

Hot Markets, Protecting Against Risk

Construction: Cranes are back in the sky. The American Institute of Architects semi-annual *Consensus Construction Forecast* projects construction spending will increase by 8 percent in the next year, while Dodge Analytics estimates an even greater increase. Construction lenders are aiming to manage risks post-recession, while remaining competitive and also compliant with regulatory pressures. Incorporating proactive construction review and monitoring practices — such as feasibility analysis, plan and cost review and construction progress monitoring — into loan underwriting and administration policies and procedures will allow lenders to proactively manage risks.

Commercial Mortgage Backed Securities: CMBS loans comprise an estimated 25 percent of the loans up for renewal over the next three years — with huge potential for lenders to increase their books. Fortunately, improving markets are expected to support the refinancing of a majority of CMBS debt. Unfortunately, loans due to be refinanced were aggressively underwritten during the peak of CMBS activity. Though credit markets are improving, current requirements for net operating income and debt service coverage ratios may create challenges for some properties. Others may face obstacles resulting from revised regulations and due diligence requirements, or from deferred expenses associated with property upkeep.

Multifamily: The multifamily market continues to perform well, thanks to demographic trends that create high demand in the apartment market. The Small Loan Space — which is estimated to comprise almost 30 percent of the multifamily market — is particularly hot. Agency lenders are launching new initiatives to remain competitive in this space and to further support affordable housing. Freddie Mac's Small Balance Loan program is designed to increase activity in the multifamily and affordable housing markets through more competitive pricing and streamlined deal cycles. It mirrors the increased focus on small balance loans in Fannie Mae's upcoming 2.0 guidelines.



Derhake

A Busy Year Ahead

Activity across these hot markets is set to keep commercial real estate lenders and supporting industries very busy in 2015. Lenders should adopt underwriting practices that are appropriate for the size, nature and scope of their lending operations and that reflect their internal risk tolerance levels to meet demand and remain competitive. In a post-recession environment of increased regulatory governance and a tighter credit climate, adopting proactive risk management policies will ensure lenders remain compliant and adequately protected against liabilities and losses. However, banks should not let regulators drive their policy. Banks profit by taking risks, and the most successful lenders take steps to understand and mitigate risks in order to maximize profitability. Because of this, lenders' policies must balance competitiveness with risk management. ■