Cobblestone Management LLC
RISK & CREDIT CONSULTANTS TO FINANCIAL INSTITUTIONS

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The CMBS Market: Lessons from the Great Financial Crisis

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October 1, 2019 – It has been widely reported in recent weeks that the presence of an Inverted Yield Curve has preceded the onset of recessions by an average of 22 months during the last several economic cycles. Whether the inverted yield curve present today turns out to be an accurate predictor of recession in the current economic cycle or not, it's a worthy exercise to compare the CRE markets and lending environments today with those in the months preceding the onset of the last recession - The Great Recession of 2008. In particular, data from the Commercial Mortgage Back Securities ("CMBS") market preceding 2008 – and the period since – is informative to Banks and risk managers on several levels.

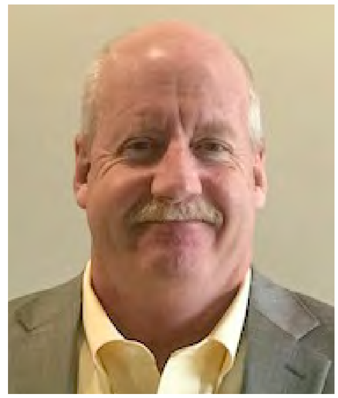
CMBS Market Overview

The CMBS market is not a perfect proxy for bank CRE loan portfolios. However, with a 30 year history and approximately $1.9 trillion in originations, it is the most transparent CRE loan market in the world. As a result, it provides excellent time series data on individual property types, underwriting metrics, delinquency and loan losses and reminders of market volatility and other valuable information to CRE risk managers and credit professionals. In particular, the data is valuable and informative as it relates to the loss severity of different property types and loan pools and how differing underwriting standards and securitization timing have contributed to loss rates.

Comparison of Pre-2008 Period and 2019

Some similarities exist in the state of CRE lending and property markets leading up to 2008 and those observed today (in addition to the inverted yield curve). A few are listed below.

Aggressive Underwriting: Today many CRE lenders are willing to lend at higher loan-to-value ratios and at lower debt service coverage ratios than at any time in the past 7 years. In addition, loan terms frequently include extended interest only periods and partial and non-recourse terms.



Jeffrey Nolan joined Cobblestone Management in 2016. He has thirty years of experience in commercial banking, loan servicing, real estate finance and hospitality consulting, and worked at Bank of New England and Fleet Bank. Jeff is a graduate of Colby College and the Center for Real Estate at Massachusetts Institute of Technology.

Historical Increases in Property Values: To compare the increase in property values during the two time periods, we compared the increases in commercial property value index appreciation during the five year period preceding 2008 and today. The CoStar Commercial Repeat Sales Index indicated that U.S. General Commercial property values increased by 54% during the 60 month period ending February 28, 2008. In comparison, the Index indicates that property values have increased by 58% during the 60 month period ending July 31, 2019.

Capitalization Rate Compression: During the 5 year period preceding the Great Recession, core commercial property capitalization rates fell dramatically. Over that period, the RCA composite weighted capitalization rate index fell by 170 basis points (21%). That Index indicates that Cap rates have fallen an additional 105 basis points over the past 60 months.

To learn more about Cobblestone visit **www.cobblestonerisk.com**, or contact us at **508-583-7005** to schedule an appointment.

More about Cobblestone Management

Cobblestone Management has assisted financial institutions with their risk management practices for over thirty years. We assist financial institutions in their risk management practices with high quality, market-leading products and services delivered through experienced and independent professionals. These include but are not limited to loan review, stress testing, credit underwriting support, Merger & Acquisition Due Diligence and consulting, and special credit projects.