March 28, 2016

Wider Spreads Create Speedbump for CMBS Defeasance

CMBS defeasance hit a record high in 2015 with $21.2 billion and a total of 1,431 loans that were either defeased or replaced by government securities. That volume was up 11.5 percent over the $19 billion in defeasance that occurred in 2014, according to research firm Trepp. The spike in defeasance activity over the past two years has helped to reduce the wall of looming loan maturities expected to hit the market in 2016 and 2017. The balance of CMBS loans scheduled to mature throughout 2017 continues to shrink, with $67.85 billion scheduled to mature in 2016, followed by $100.59 billion in 2017, for a two-year total of $168.44 billion, according to Morningstar. That volume is down from $222.48 billion at the beginning of 2015. Key drivers behind the 2015 defeasance activity included the recovery in property values, still low interest rates and access to capital. However, volatility and wider spreads in the CMBS market have many borrowers putting defeasance plans on hold. “If you had asked me before the end of last year, I would have said that this is not a high water mark and that it could remain high in 2016,” says Joe McBride, an associate at Trepp. Recent volatility in new issuance spreads has changed the lending atmosphere and has, at least for now, taken away some of the incentive to resolve loans in advance of maturity dates. Spreads started to widen at the end of last year and have expanded further in 2016. For example, AAA conduit spreads that were around 90 basis points last June are now in the 165 to 175 range. Spreads in the BBB- tranches have moved from 375 to 400 basis points six months ago to 750 to 900. Some of the challenges that persist in the global economy, along with the drop in oil prices, have impacted fixed income vehicles, which has trickled down to hit CMBS spreads, notes McBride. The dramatic widening of spreads over the past six months has had an impact on new CMBS issuance. As of early March, U.S. issuance was at $13.6 billion, which is down more than 30 percent compared to the $20 billion in issuance that occurred during the same period of 2015, according to Commercial Mortgage Alert, an industry newsletter. The wider spreads are being passed on to borrowers in terms of higher rates for new issuance. There is also greater pricing uncertainty as B-piece buyers in the CMBS market have become more selective about the loans that they allow into CMBS deals. As such, CMBS lenders are building more “wiggle room” into deals related to the rate in order to account for the diminished appetite and the volatility in the market, says McBride. Last year was a booming year of defeasances, and activity has definitely slowed in 2016, agrees Paul Cairns, senior vice president and managing director, capital services, with debt and equity provider NorthMarq. Cairns also heads the defeasance services team for NorthMarq. “Because there is more volatility in the marketplace, people are taking more of a wait-and-see approach,” says Cairns. Defeasance, or the early resolution to outstanding debt, is commonly done in the last two years of a loan. On the commercial side, borrowers are likely to wait until closer to the end of their loan to defease with the hope that things stabilize in the bond market and spreads narrow, says Cairns. On the multifamily side, borrowers are still defeasing early as they can refinance at attractive rates through Fannie and Freddie with rates that are still below 4.5 percent, he adds. Borrowers that defease loans often roll into a new CMBS loan, and the higher costs of new issuance has certainly been a deterrent. CMBS rates that were hovering at 4.0 to 4.25 percent last May were a powerful incentive. Rates have since jumped 100-plus basis points to about 5.25 percent. “There is really no reason to do a defeasance, unless of course they think they market is going to be a lot worse when the loan becomes open for pre-pay,” says Ory Schwartz, a senior vice president and managing director at NorthMarq. In addition, the majority of the new CMBS loans being done are not locking rates until the time of close. So, it is a little like a game of musical chairs, notes Schwartz. "The best thing that we can do is to manage our client's expectations and keep our finger on the pulse of the market to make sure that whatever the lender says they can do is in line with what is going on in the market," he adds. The defeasance activity that has occurred in the past two years has lightened the load of CMBS loan maturities that are set to expire in 2016 and 2017. "It has chipped away for sure, but there is still a ton that needs to be refinanced or purchased or whatever happens," says McBride. So far, the market has been digesting those maturing loans fairly well. In 2012, for example, there was a mini-wave of five-year loans that came due that had no adverse effect in terms of higher delinquencies. However, the wider spreads, coupled with new CMBS regulations and what appears to be a diminishing appetite among B-piece buyers, could create some added challenges ahead, notes McBride. Some of the marginal loans could have trouble, he adds. **(National Real Estate Investor/Beth Mattson-Teig)**

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Colorado's Jobless Rate Drops, Monthly Employment Gains Continue

Colorado added 2,500 jobs in February, continuing an employment growth streak that is nearing record levels, according to preliminary state Department of Labor data released Friday. Including the February non-farm payroll growth — consisting of 900 private-sector and 1,600 public and government jobs — Colorado has recorded 52 consecutive months of employment gains. The consistent monthly employment additions haven't been seen since the 1990s. Colorado added payroll jobs 58 months in a row from September 1991 to June 1996, labor department officials said. The state's unemployment rate also is approaching historic lows. Colorado's seasonally adjusted jobless rate declined 0.2 percentage points to 3 percent, a statewide rate not seen since March 2001. Nationally, the unemployment level remained unchanged at 4.9 percent. Colorado's lowest seasonally adjusted rate in the past 40 years was 2.7 percent, which was notched during seven months in 2000, according to U.S. Bureau of Labor Statistics data. Since February of last year, Colorado's payroll jobs are up by 63,000. Unemployment has dropped 1.1 percentage points. The number of residents in the labor force has increased by 40,900 people to above 2.86 million. The largest job gains have occurred in the leisure and hospitality sector as well as education and health services. Oil and gas employment in February was down 600 jobs from January and 6,600 from a year before, according to labor force data. The monthly labor estimates are based on two surveys — one of businesses and government agencies, which measures jobs by work site; and the household survey, which measures employment by household. The data are often revised as new information becomes available. **(Denver Post)**

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Move Aside, RiNo: Denver's Uptown is on the Up-and-Up

LoDo. RiNo. LoHi. Conversations about commercial real estate in Denver these days can quickly turn into alphabet soup due to the overwhelming popularity and pervasive reach of abbreviation-friendly neighborhoods that have been hotspots of activity in recent years. But what about neighborhoods on the other end of the 16th Street Mall? Places like Uptown, Capitol Hill and Golden Triangle? Containing city hall, the Capitol and institutions like the Denver Public Library, as well as millions of square feet of office space inhabited by some of Denver's most influential companies, these neighborhoods have long served as the guts of the city's central business district. And while its flashier cousins to the north are, deservedly, the current darlings of Denver real estate, neighborhoods in the half of downtown from Arapahoe Street south should not be discounted for their economic might and contributions to Denver as a whole, both in the past and going forward, said Greg Holm, senior vice present of occupier and advisory services at CBRE Group Inc. (NYSE: CBG) The core central business district (CBD), identified by CBRE as the area between Arapahoe and the southern border of Golden Triangle, which is the intersection of Lincoln Street and Colfax Avenue, contains the downtown's four largest office buildings, Holm said. Wells Fargo Center, Republic Plaza, 1801 California and Denver Place are all located in that area and contain a total of 4.9 million square feet of office space, according to CBRE. That number is equal to the entire LoDo office market, which also includes 4.9 million square feet of office. The office vacancy rate in the core CBD is 13.2 percent, while new construction in LoDo has driven the vacancy rate there to 16.2 percent. At the same time, the average lease rate for office space in LoDo is 24 percent higher, at $40.43 per square foot, compared with $32.50 in the core central business district. Buildings in LoDo are newer and include more modern amenities, meaning their owners can charge a premium. Uptown owners are aware of this, Holm said, and are working to bring their own buildings up-to-date. Brookfield Property Partners, owner of 1801 California, in 2014 spent $58 million on the building's lobby alone and have been steadily increasing occupancy ever since. "1801 California is not the only building in the core CBD investing in renovations," Holm said. "Republic Plaza and Wells Fargo Center both just added new amenities centers, and City Center, 1001 17th St. and Denver Place all recently complete extensive renovation projects. Owners of older buildings in the core CBD understand they have to invest to compete with trendy areas like LoDo and RiNo." As developers buy up more property near Union Station, economic development efforts will increasingly have to shift south, Holm said. "With the Central Platte Valley almost fully developed, and with only a few sites left in LoDo, the future direction of development for both residential and office development is likely to shift toward the core central business district, particularly toward sites along 14th and 15th streets and at the upper end of the CBD with access from Broadway and Lincoln Street, and Colfax and Park avenues," Holm said. Beyond office, retail along the southern end of the 16th Street Mall has long been quieter than the active restaurant and bar scene in LoDo, but more restaurants are beginning to creep toward the Capitol. The Golden Triangle is the beneficiary of new apartment complexes, including the 22-story luxury development Eviva Cherokee, and the ART Hotel, which has exceeded expectations since opening in 2015. Golden Triangle is one neighborhood that has been targeted by the city of Denver for renewal, and has already seen some signs of change beyond commercial development. The city in 2014 passed a Golden Triangle plan, outlining improvements to transportation, pedestrian access and the area's arts and culture institutions. Since the plan's passage, the city has added bike lanes on 11th Avenue, said Sarah Showalter, senior city planner working on the Golden Triangle plan. Two neighborhood groups have been combined into one nonprofit, Showalter said, uniting the neighborhood's voice and allowing stakeholders there to find ways to leverage funding for improvements. That organization plans to hire an executive director position soon, she said. "They've laid the groundwork to have a more cohesive voice so they can start working together and making changes," Showalter said. Denver Public Works is working on a transportation study in the area as well, Showalter said. The first phase of the study will be complete next month, with phase two set to launch later this year. One of the ideas on the table would remove one lane of Broadway and turn it into a two-lane bike corridor, said Nancy Kuhn with public works. Also still in the works is a previously announced upgrade to Civic Center Station, the three-decades-old bus station at 16th and Broadway. A Regional Transportation District's Board of Directors committee this week approved a proposal for the upgrade, which sends it to the full board, said Julia Marvin, a RTD spokesperson. If the full board passes the proposal, RTD expects that construction will begin this summer and take 12 to 14 months. The renovation of Civic Center Station is seen as a bookend to the redevelopment of Union Station, which was finished in 2014."Just as the transformation of Union Station helped jumpstart LoDo, we anticipate the renovation of Civic Center Station to have a profound impact on the east side of Downtown's revitalization," said Holm. "Between Civic Center Station and the D, F and H lines, almost every building in the CBD is within three blocks of rapid transit. As the RTD adds more lines over the next year, including access to the airport, it has the potential to more than double its capacity." **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.50	.50	.25
3 MONTH LIBOR	.62	.63	.27
PRIME RATE	3.50	3.50	3.25
10 YEAR TREASURY	1.91	1.74	2.00
30 YEAR TREASURY	2.67	2.60	2.59