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# Skies Are Darkening For Building Loans

## Deal terms tightening as commercial investors react to residential mortgage drought

By Sean O'Leary  
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Yesterday

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The market for commercial real estate in Connecticut and throughout most of New England has been strong and stable. But the perils of the residential mortgage pullback is now threatening the health of the commercial real estate market.

The same major investors who have withdrawn from funding risky consumer loans are also pulling out of commercial real estate lending. That causing some deals to fall apart, and it's forcing sellers to cut prices in order to move their properties.

Kevin Geenty, SIOR, vice president of the Geenty Group, said the past five weeks has been the busiest he's had in decades as broker but he is worried about what could happen in the next five months.



"It's the bankers getting us in trouble again," he said. "They did the same thing in the late 1980s and caused a very severe recession. We're not at that point yet but if you have some other factors, like unemployment going up, and it could be a problem."

The Federal Reserve Board this month said commercial real estate lending in Connecticut and the rest of New England is "experiencing a significant tightening of credit."

The Fed's Beige Book analysis mirrored Geenty's anecdotal comments. "With the stricter requirements lenders have been demanding, sales activity will experience — in one contact's words — 'a major disturbance' in the near future, despite the fact that underlying fundamentals in the region's commercial markets appear relatively robust," the Fed opined. "Some primary lenders... stopped lending

altogether a few weeks back; while they are back in business now, spreads are up sharply.”

## **Fallout**

While residential mortgage-backed securities have been clobbered in recent months, commercial mortgage-backed securities have also been affected, if not as drastically, contends Steven Witten, senior director of the New Haven-based National Multi Housing Group for Marcus & Milichap Investment Real Estate Services.

“The CMBS has been affected because many of these conduit lenders are simply not lending right now,” said Witten. “If you’re an investor, you can still find lenders and it’s not like money isn’t available. There’s just a big difference in rates.”

For the borrower, Witten agreed lenders have become far more conservative, noting that 10-year loan spreads are 20 to 40 basis points greater than they were a few months ago.

“There’s simply a greater level of caution on the part of lenders,” said Witten. “It could end up affecting property values as we move forward.”

The Federal Reserve thinks that’s a foregone conclusion. Its survey of economic conditions resulted in its concluding that “the biggest impact [will] fall on sales of retail buildings and multi-unit apartment buildings. Respondents say there is already evidence of significant downward pressure on prices.”

## **Deals Harder**

It is not to say that commercial mortgage based-securities are on the verge of ruin, but there has been a dramatic sea change when it comes to making deals.

“What happened with residential real estate is not the case with commercial,” said Steven Inglese, principal of New Haven Group, Inc. “It’s not a crisis in the market, it’s a pull back.”

Lenders are still present, but they have reduced how much they are lending and are forcing investors to assume more risk — if they decide to lend at all. In short, lending institutions are no longer simply giving the money away to anyone with a

plan.

“For the long-term health of the commercial investment property market, it’s not a bad thing,” said Inglese. “It’s going to help keep the market’s fundamentals good.”

Inglese asserted that the caution Witten spoke of is more aptly described as nervousness by commercial lenders who have surveyed the damage caused by the problems in residential mortgages.

“What’s happened since early August in the commercial lending environment, to the Wall Street firms that lend to commercial investors, is that they are not doing the same type of lending,” said Inglese. “Often times, they are really dragging investors on deals because they don’t know what they’re going to do.”

Kevin Geenty charged that the mortgage crisis is due to “another case of people using shoddy business practices.”

But the Connecticut market, while feeling some pressure because of the commercial lending pullback, will likely fare better than other areas of the country.

“This marketplace,” said Inglese, “and I’m talking about New Haven and Hartford, is dominated by private investors that are putting more equity into the deal.”

Inglese cautioned that he expected property values to go down slightly, but that changes in interest rates and the economy in general could alter that opinion. His current view, though, is based on a market for commercial real estate that he still characterized as good and sound.

“The fundamentals for the market are still positive,” said Inglese. “In the past year, lease rates rose and vacancy rates declined. It’s unlike the subprime market, where you have people that can’t afford their house and are overburdened.”

Geenty concurred with that outlook. The commercial real estate lending squeeze “hasn’t affected what we do yet and I don’t think it will by itself,” he said. “There are other things out there that could make it worse for commercial properties.”

Witten, who concentrates on deals for apartment complexes, agreed that the commercial market is not faltering.

“If you look at the state of Connecticut, the deals that have sound underwriting will continue to happen,” said Witten. “The financing might cost you a little bit more but there’s no shortage of available properties.”

