2019 COMMERCIAL LENDING REPORT

The Voice for Real Estate®

COMMERCIAL Real Estate REALTOR® NATIONAL ASSOCIATION of REALTORS®

Commercial Lending Report 2019

Cover photo: Joel Filipe

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1 INTRODUCTION

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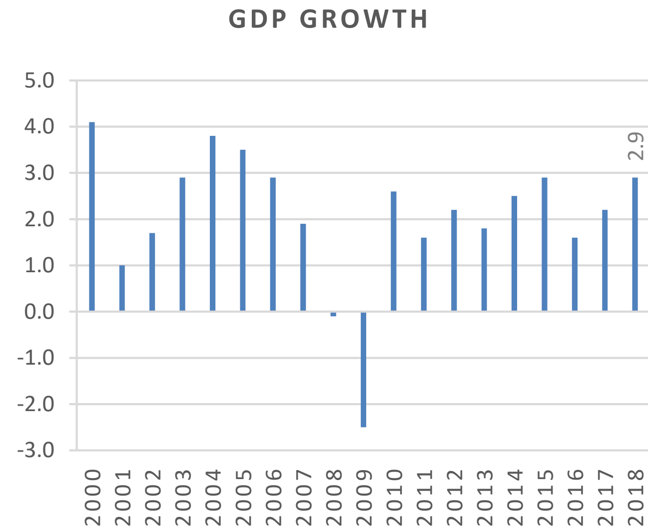
ECONOMIC ENVIRONMENT

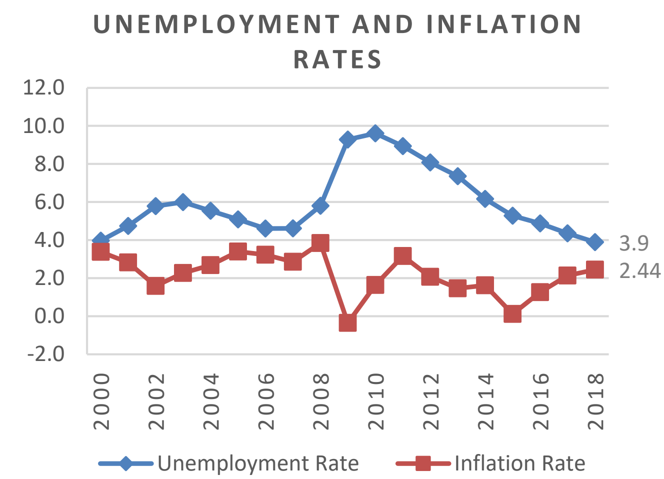
The U.S. economy continued to expand at a strong pace of 2.9 percent in 2018 from 2.2 percent in 2017 as private consumption, investment spending, net exports, and government spending all rose at a faster pace.

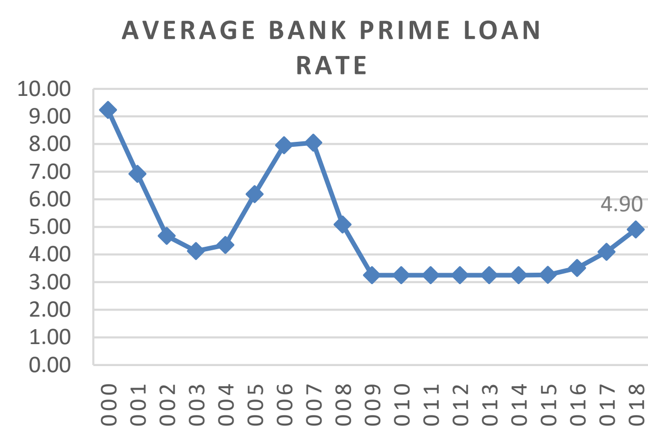
The unemployment rate continued to trend down to 3.9 percent, while inflation mildly rose to 2.4 percent.

Amid the solid economic growth and job creation and the slight uptick in inflation, the U.S. Federal Operations Market Committee raised the benchmark federal funds rate target four times in 2018 by a total of 1 percentage point, to a range of 2.25 to 2.5 percent at the end of 2018. The average bank prime loan rate rose to 4.9 percent in 2018, from 4.1 percent in 2017.

The 2019 survey on commercial lending takes place in this economic environment marked by slightly higher interest rates and a lower level of bank reserves held by depository institutions that underpin the level of lending.







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2 SURVEY HIGHLIGHTS

Photo by Verne Ho

- 56% of respondents reported an **increase in net operating income** in 2018, a decrease from 65 percent in the previous year's survey.
- 38% of respondents reported **tighter lending conditions** in 2018, up from 35 percent in 2017, with a higher fraction for retail stores.
- 65% of respondents reported the client used **debt financing** to purchase a property, with higher reliance on debt financing for suburban offices and retail malls.
- 5% to 7% was the **average interest rate** on loans.
- 10 years was the **median loan term**, except for loans by life insurance companies, at 15 years, and the Small Business Administration, at 20 years.
- 75 to 80 **loan-to-value** ratios were common, especially for suburban offices, multi-family properties, and industrial properties.
- 1.25 was the **median debt service coverage ratio**, with higher DSCR for retail malls.
- 54% of respondents cited **local/community banks and regional banks** as the most active sources of financing in commercial deals.

Photo by Jesse Orico

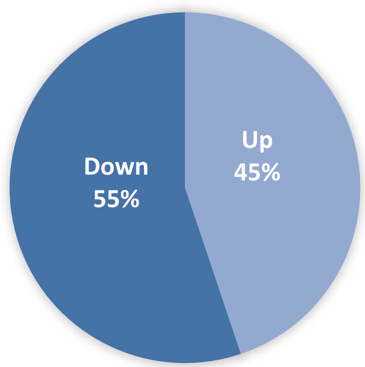
3 SURVEY RESULTS

Photo by Joe Beck

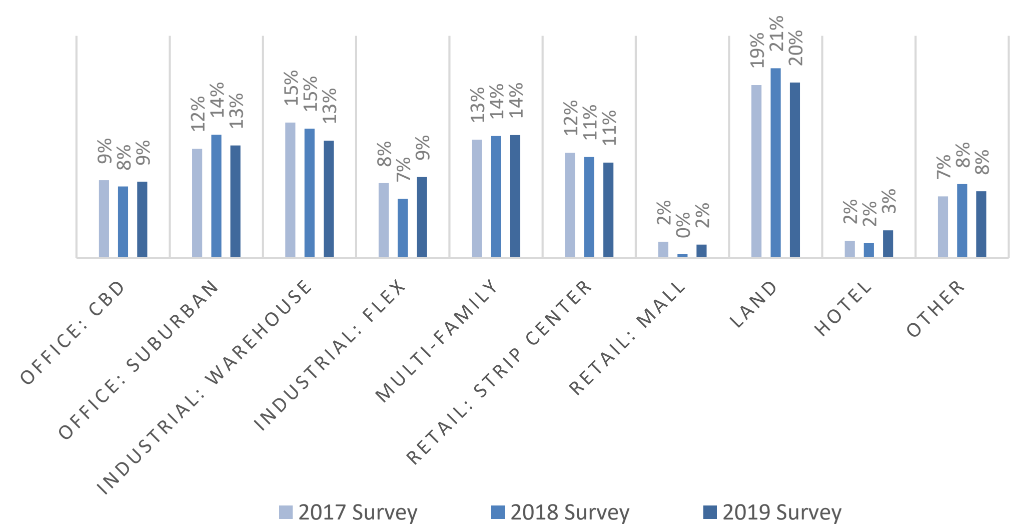
Sales in the Past 12 Months

- 55 percent of respondents reported a decrease in their for sale or for lease inventory in 2018 compared to 2017.
- Land made up 20 percent of properties clients bought or sold, followed by multi-family (14 percent), suburban offices (13 percent) and industrial warehouses (13 percent). Hotels and retail malls made up the lowest share at two percent each.

FOR SALE OR FOR LEASE INVENTORY IN 2018 COMPARED WITH 2017

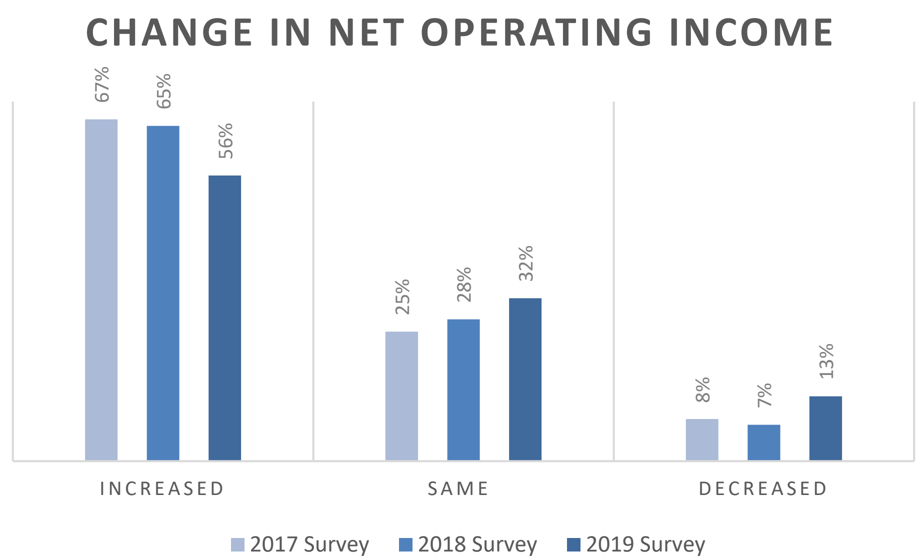


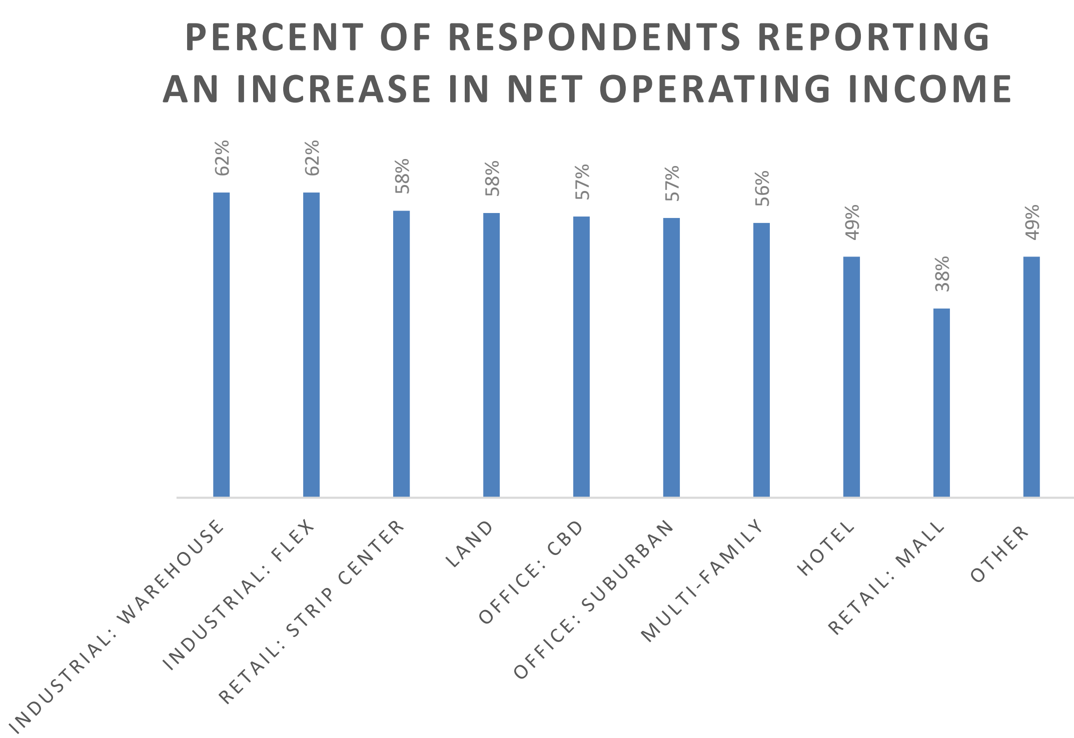
COMMERCIAL PROPERTY TYPES CLIENTS BOUGHT OR SOLD



Net Operating Income

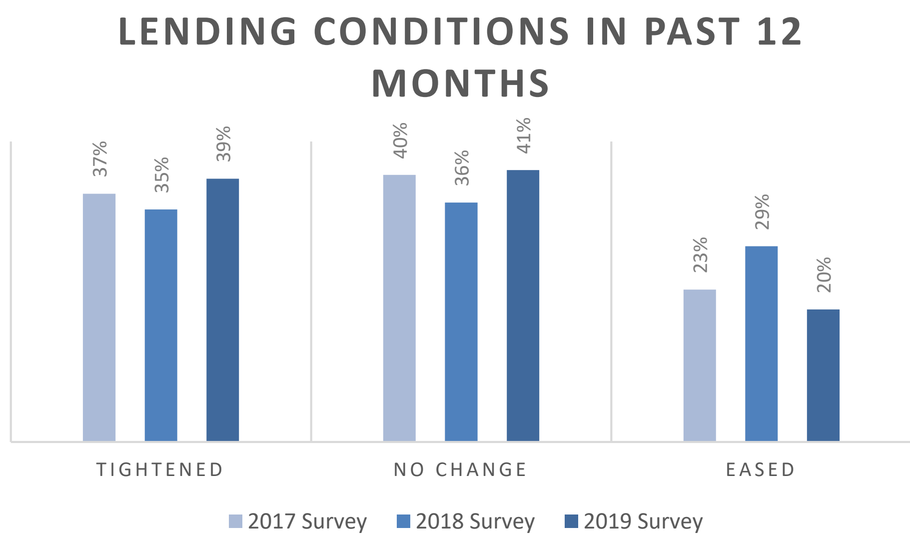
- 56 percent of respondents reported an increase in net operating income (NOI) in 2018 from the level in 2017, a decrease from 65 percent of respondents who reported an increase in NOI in 2017 compared to 2016.
- By type of property, industrial properties had the highest fraction of respondents who reported an increase in NOI, while hotel and retail mall transactions had the lowest fraction of respondents who reported an increase in NOI.

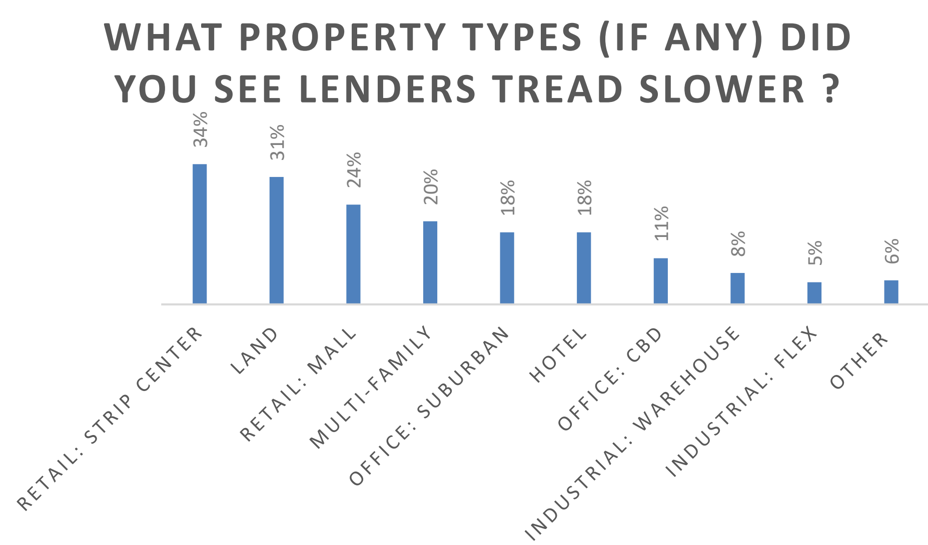




Lending Conditions

- 38 percent of respondents reported tighter lending conditions in 2018, up from 35 percent in 2017.
- 58 percent of respondents reported that lending conditions tightened for retail stores (34 percent for retail strip centers; 24 percent for retail malls). Industrial property had the smallest share of respondents that reported tighter lending conditions, at 13 percent (8 percent, warehouse; 5, percent flex). The survey findings are indicative of the challenges faced by the retail sector and the strong demand for industrial properties on account of the robust expansion of e-commerce sales.

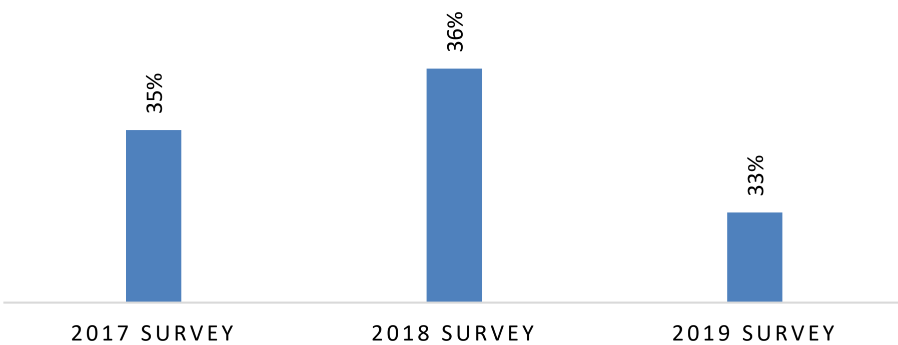




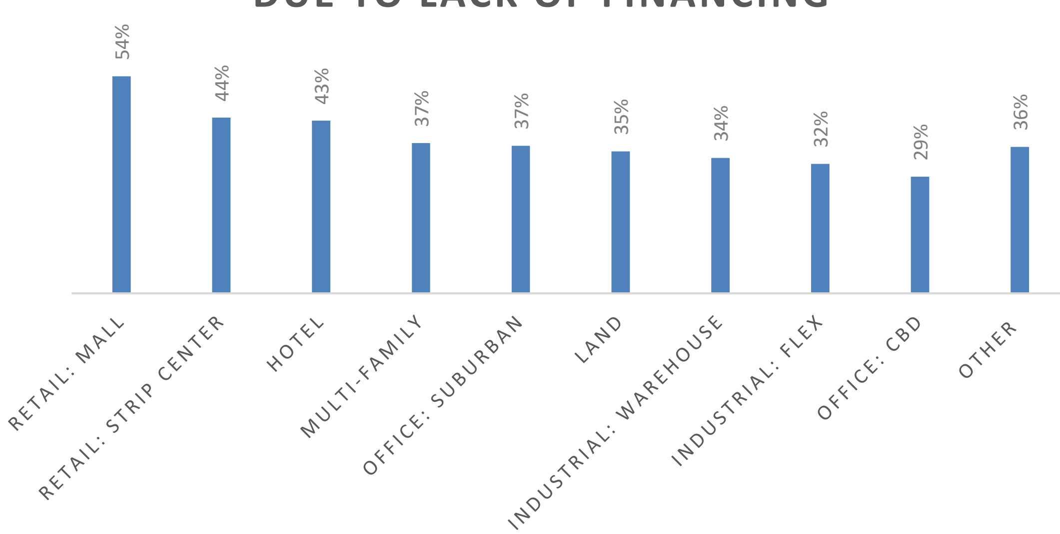
Lending Conditions

- 33 percent of respondents reported they had a failed transaction due to lack of financing.
- 54 percent of those who reported a failed sale transaction reported retail mall transactions, and 44 percent reported retail strip center transactions. The smallest fraction of reported failed sales transactions were CBD offices, at 29 percent. Multiple responses are allowed so the shares won't sum up to 100 percent.
- Loan/underwriting requirements was cited by 54 percent of the respondents as the reason for the failure, followed by financing availability (18 percent), appraisal (15 percent), and other reasons (10 percent).

PERCENT OF RESPONDENTS WITH A FAILED SALES TRANSACTION DUE TO LACK OF FINANCING

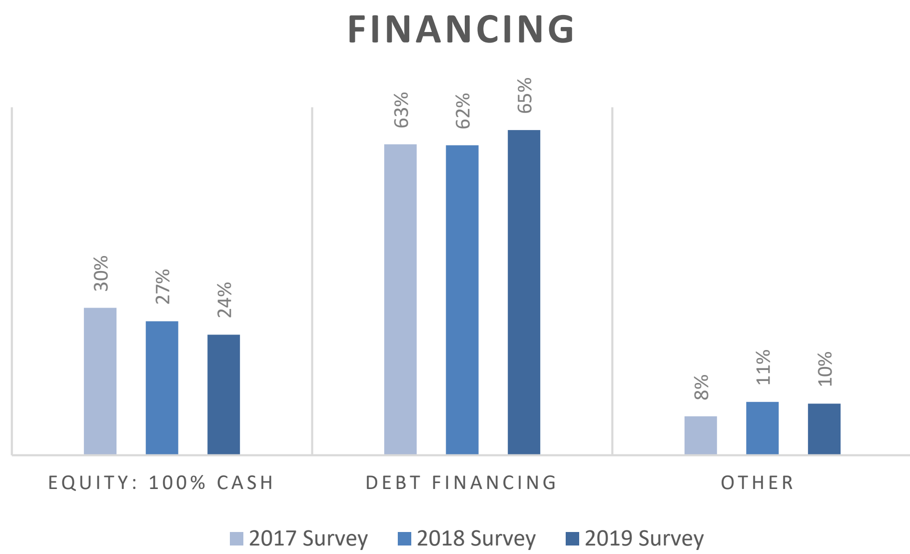


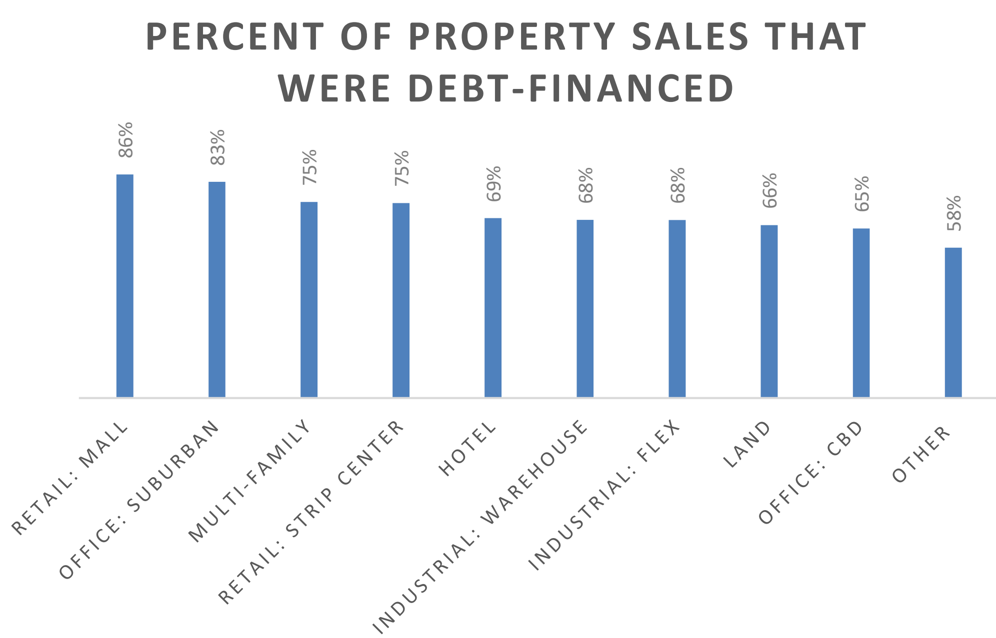
PERCENT OF RESPONDENTS WHO REPORTED A FAILED SALE TRANSACTION DUE TO LACK OF FINANCING



Type of Financing

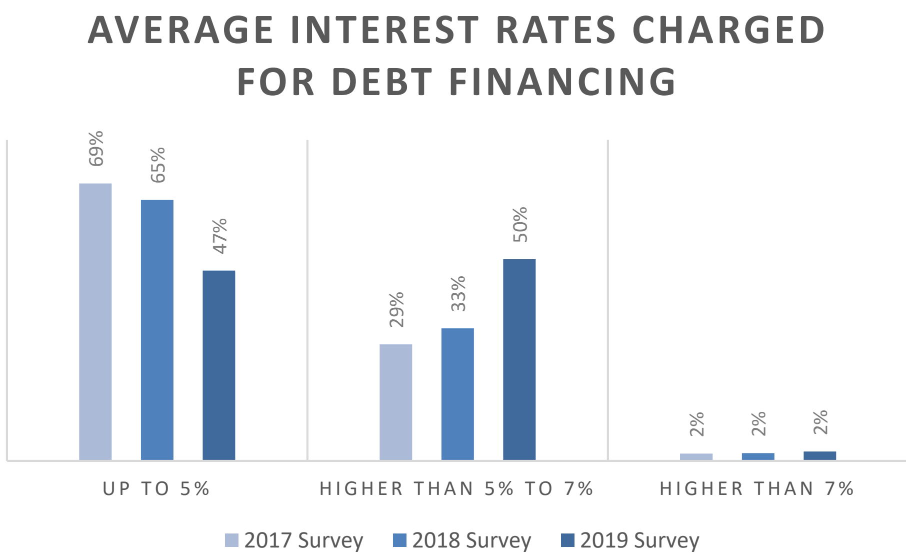
- 65 percent of respondents reported the client used debt financing to purchase a property.
- By property type, over 80 percent of retail malls and suburban office transactions were debt-financed, while only about two-thirds of hotels, industrial properties, land, and CBD offices transactions were debt-financed, with equity (cash) accounting for a larger portion of the financing.

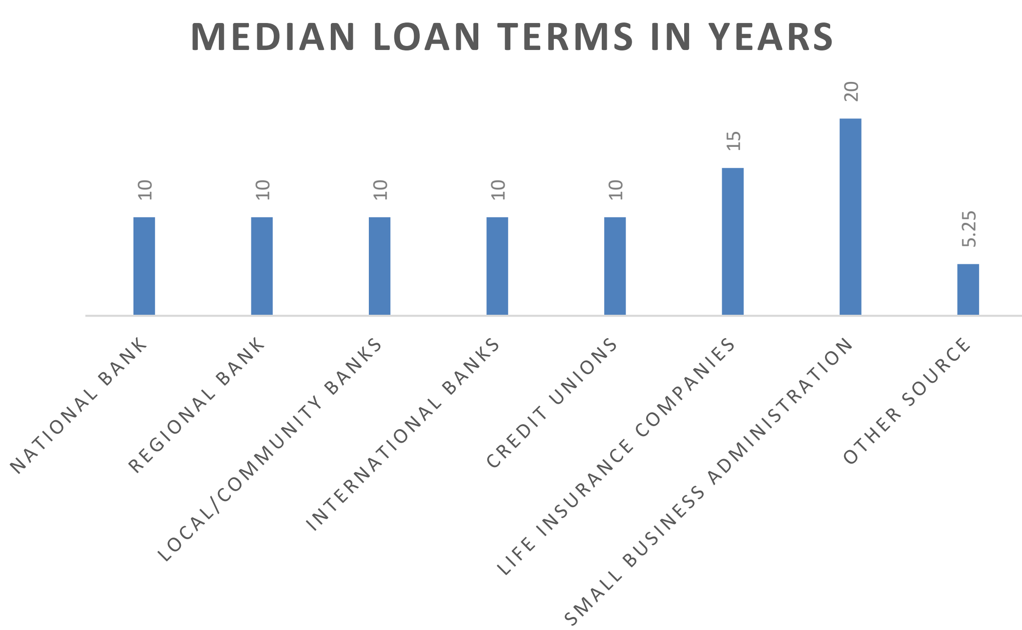




Interest Rate and Loan Term In Years

- 50 percent of debt-financed sales in 2018 had an average interest rate of five to seven percent, up from 33 percent in 2017. This result is consistent with the rising interest rate environment in 2018.
- Respondents reported that the median loan term among lenders was 10 years, except for life insurance companies, 15 years, and the Small Business Administration, 20 years.

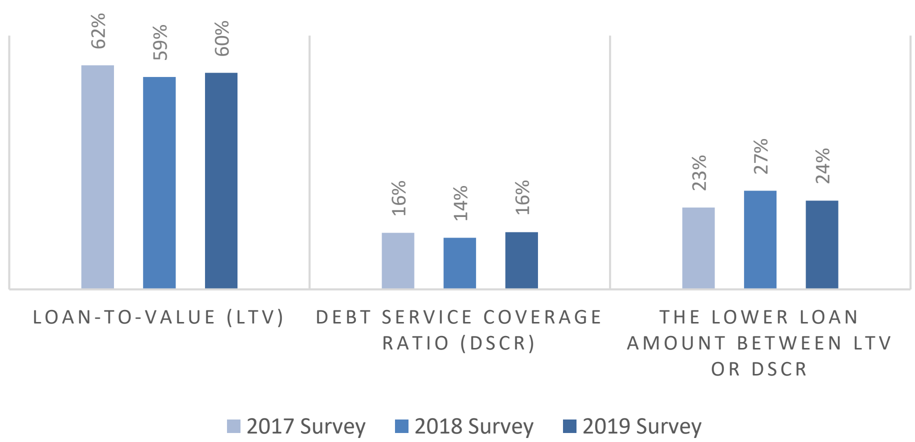




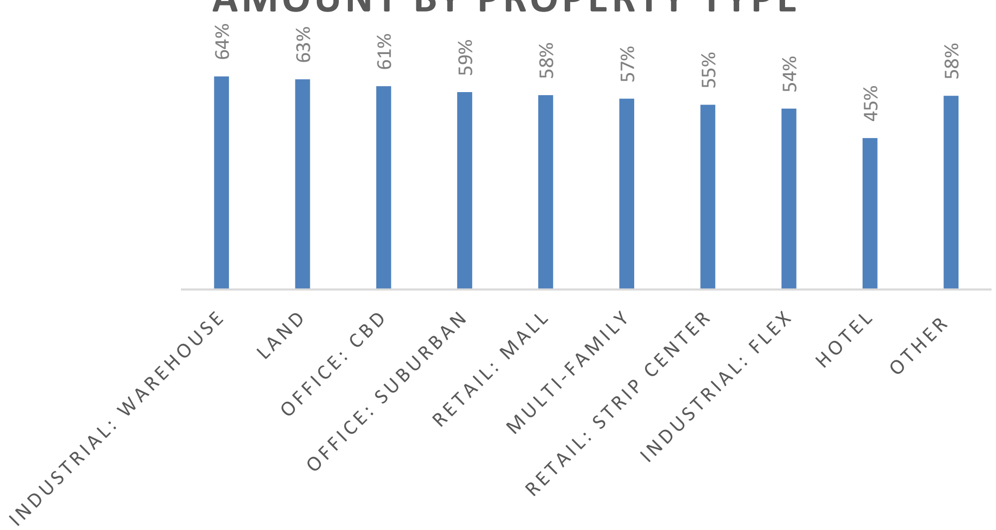
Loan-to-Value Ratio

- 60 percent of respondents reported that lenders used the loan-to-value (LTV) ratio as the criteria for determining the loan amount; the rest used the debt service coverage (DSC) ratio or the smaller of the loan amount using the DSCR or the LTV
- By property type, a higher fraction of loan amounts for industrial warehouses, land, and offices were determined using the LTV criteria compared to other property types

LENDERS' LOAN CRITERIA USED TO DETERMINE LOAN AMOUNT

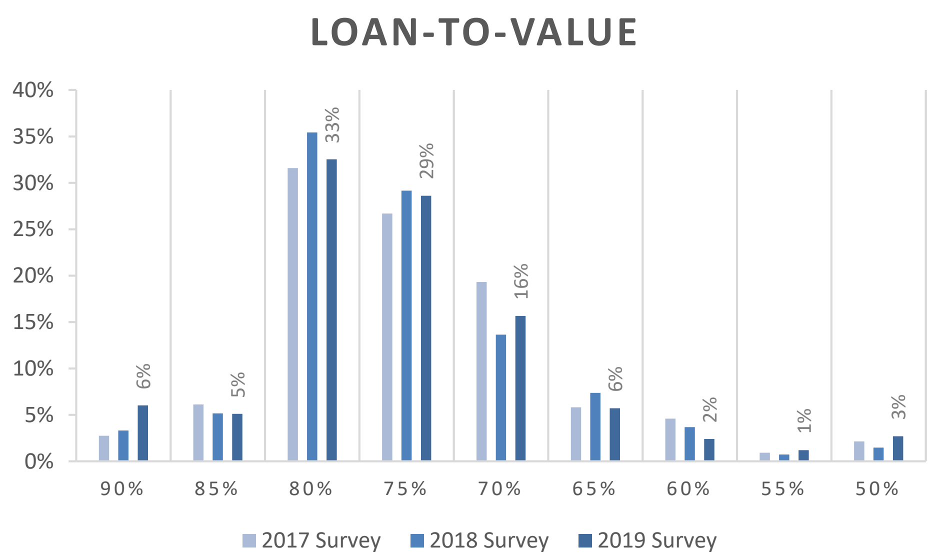


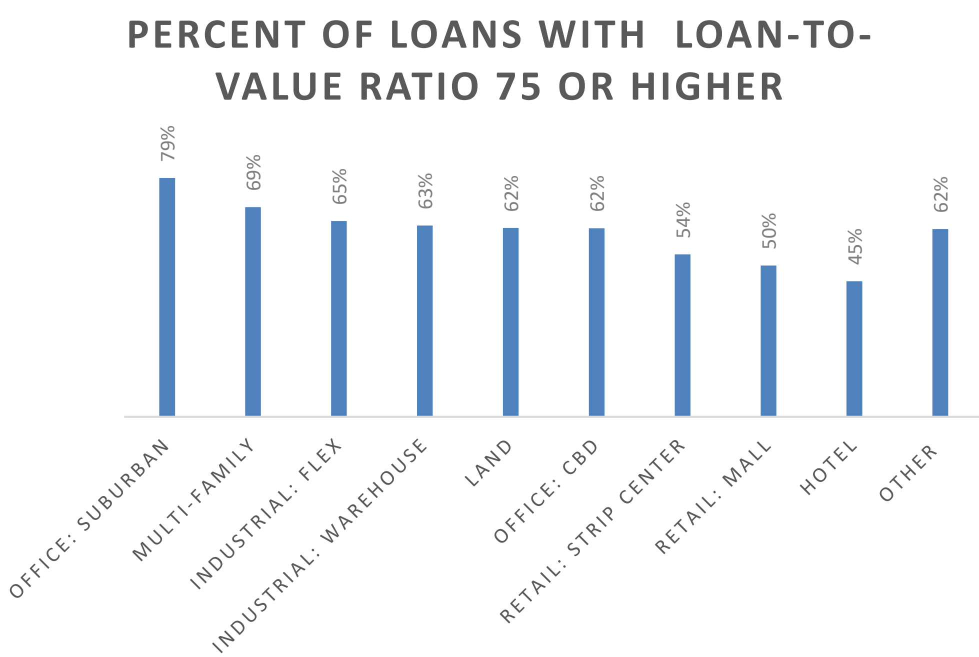
SHARE OF LOANS THAT USED LTV CRITERIA TO DETERMINE LOAN AMOUNT BY PROPERTY TYPE



Loan-to-Value Ratio

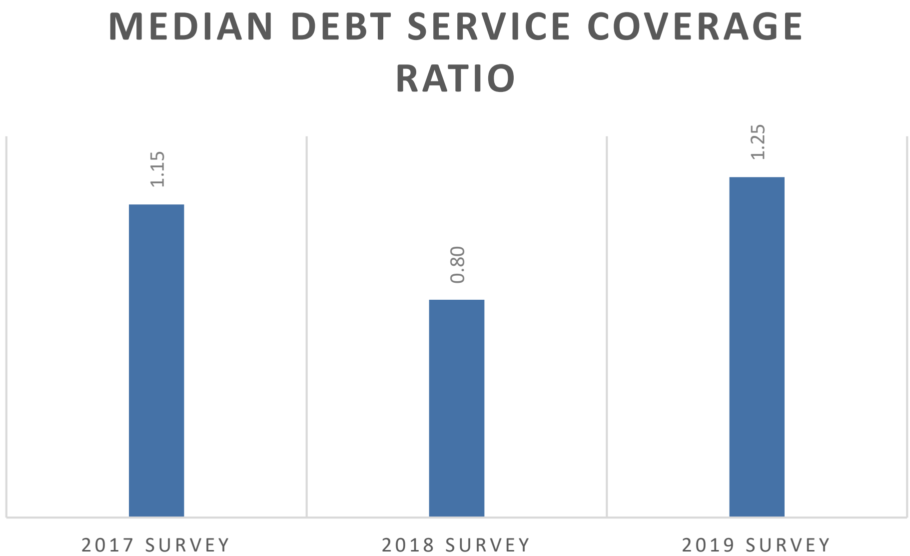
- Of the reported transactions where the loan amounts were determined using the LTV ratio, 62 percent had LTV ratios of 75 percent or 80 percent.
- By property type, suburban office, multi-family, and industrial properties had the highest fraction of loans with LTV ratio of 75 or higher, while at most half of retail stores and hotel loan amounts had an LTV ratio of 75 or higher.

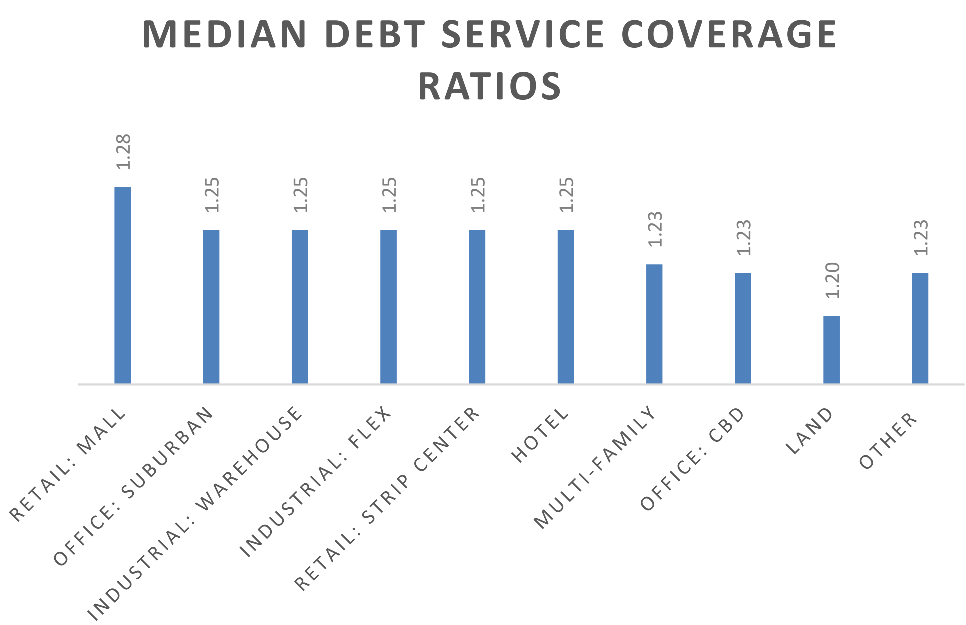




Debt Service Coverage Ratio

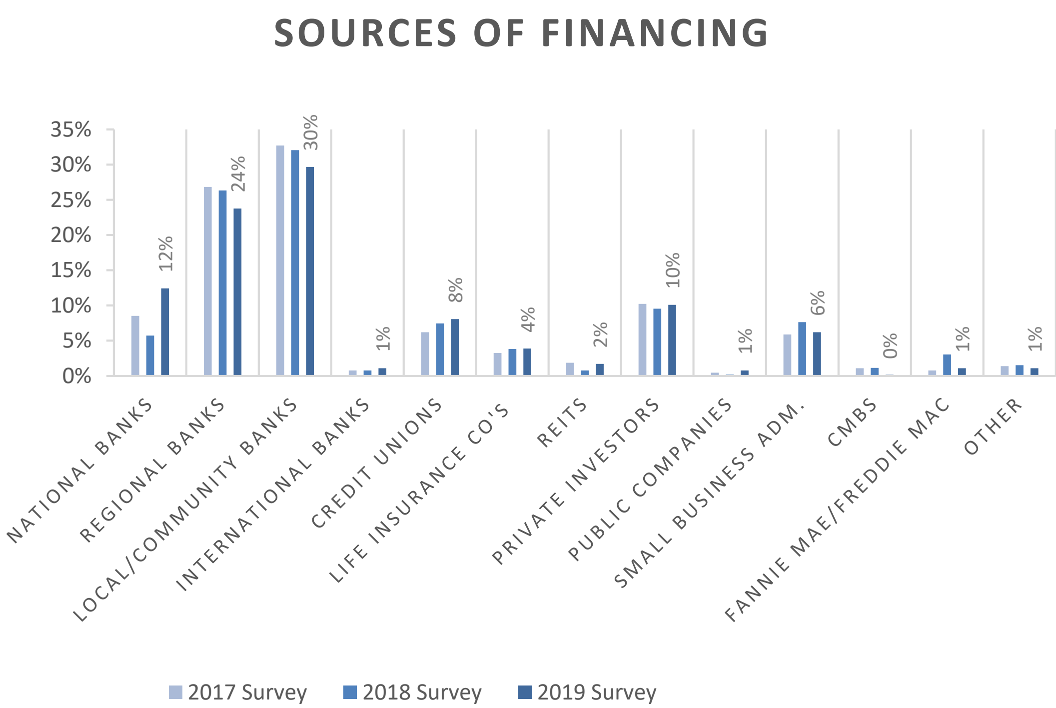
- The median debt service coverage ratio was 1.25.
- By property type, retail malls appeared to have a slightly higher debt service coverage ratio compared to other properties, while land transactions had the lowest debt service coverage ratio.





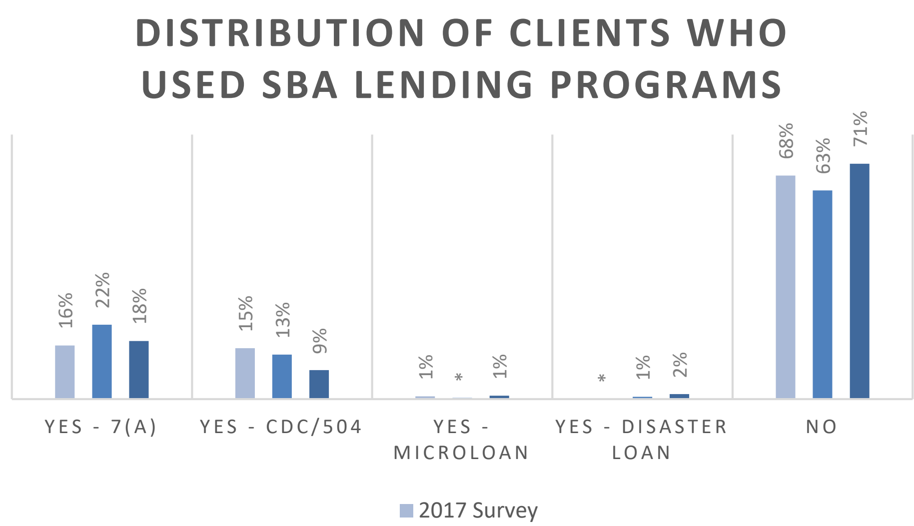
Lenders

- Local/community banks comprised the biggest source of lending, at 30 percent, followed by regional banks, at 24 percent in the 2019 survey (2018 reference year).
- National banks accounted for 12 percent, although the share increased from six percent in the 2018 survey (2017 reference year).
- Private investors made up 10 percent, and credit unions eight percent.
- The Small Business Administration accounted for six percent of reported transactions.

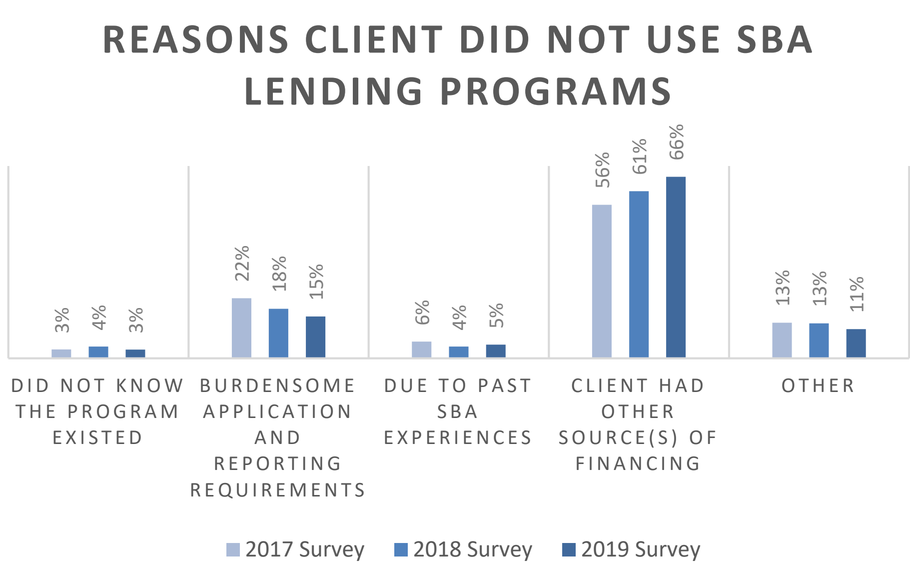


SBA Lending

- 19 percent of respondents reported a client who had used an SBA lending program in 2018: 18 percent, 7(A); 9 percent CDC/504; and 1 percent, microloan
- Among those who reported they did not have a client who used an SBA lending program, 66 percent reported that the client had other sources of financing. Three percent reported the client did not know the SBA program existed.



**less than one percent*



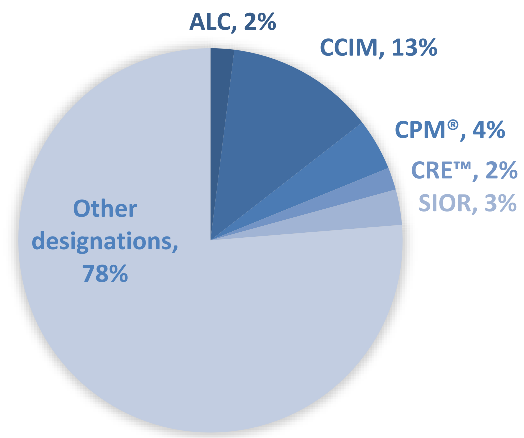
ABOUT THE SURVEY

In March of 2019, NAR sent out the online survey to nearly 70,000 REALTORS® with an interest in commercial real estate. The objective of the survey was to gather information about their commercial transactions with international clients during the period January –December 2018. A total of 1,009 responses were received for an overall response rate of 1.4 percent.

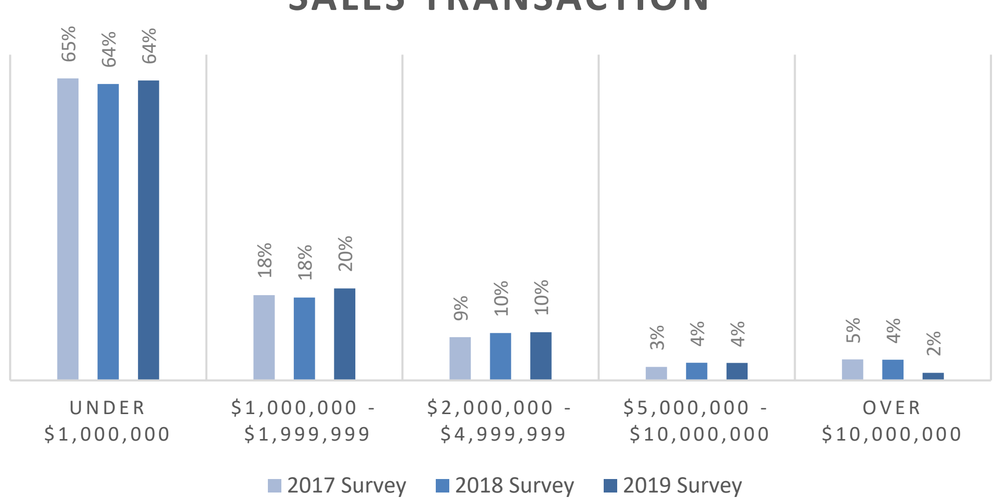
Of the 1,009 respondents, 573 or 57 percent had a sale and were asked questions about their transactions. Respondents had a median of four transactions during the year. The average sales transactions value was less than $ 1 million.

Based on the 573 respondents, the margin of error for estimating proportions (using 50 percent sample estimate) at the 95 percent level of confidence is 4 percent. The margin of error for sub-groups estimates (property types) will be higher.

DESIGNATIONS OF RESPONDENTS IN THE 2019 COMMERCIAL LENDING SURVEY



DISTRIBUTION OF AVERAGE VALUE OF SALES TRANSACTION



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