5 THINGS YOU NEED TO KNOW ABOUT DEBT AND LOANS IN 2016

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Many are still debating how 2016 is going to fare for commercial real estate and the economy at large. While some believe 2016 will **remain strong** despite initial market volatility, others, like Blackstone vice chairman **Byron Wien**, aren't as optimistic. With so many opinions and predictions flying around, we wanted to see if we could get some **more balanced insight** on what we can expect. That's why we sat down with Hunt Mortgage Group capital markets managing director **Barry Polen**. Known as a "CMBS Pro," Barry's insight is highly trusted among the Hunt staff. After a long discussion, Barry gave five things that he's currently thinking about.

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Long Live Longer Loans!

Barry says one of the biggest market influences will be the Fed's potential rate hikes. While he doesn't believe they'll **raise rates** four to six times—especially when you consider the market's volatility—Barry tells *Bisnow* even the **expectation** of a rate hike can raise the short end of the **yield curve**, flattening or even inverting the curve. Either case, Barry explains, can motivate borrowers to migrate to **longer-term loans**—such as 10-year CMBS loans—that will be **securitized.**

Barry says **refinance opportunities** will also be a huge factor in 2016. "2006 was a year of large CMBS production and many of those 10-year loans are coming due in 2016. That will be a **natural source** of product as CMBS borrowers often refinance with CMBS lenders."

While market size for US CMBS deals was around **$230B** in 2006, the amount due this year won't be that large. Since some loans were **pre-paid**, others **defaulted** or had different term lengths, Barry says the amount of CMBS actually due for refinancing in 2016 is closer to **$90B**, which can be easily managed and even built upon.

There's A Ton Of Cooks In The CMBS Kitchen

As the market came out **hibernation** in the **post-correction era**, Barry notes, the CMBS market has seen a huge influx of lenders.

"At the end of 2015, we had **47 different lenders** for CMBS deals, while five years ago it was only a handful."

In order for a **new lender** to compete, one has to offer lower interest rates or **offer more proceeds**. As a result, the deals brought to the CMBS market have increasingly become more **levered**, and the investor base has begun **refusing to buy deals** unless offered a greater spread or yield. While this phenomenon has largely been an issue with **lower-rated bonds**, the top of the credit curve has been affected as well. Even **AAA bonds** have fallen victim to **wider spreads** and underperfomance when compared to other fixed-income products.

Barry believes people will eventually realize the relative value of highly credit enhanced CMBS and the spreads will shrink, making CMBS loans the "**biggest pocket of opportunity**."

China Is A Big Question Mark

Barry says there's the potential for increase in **foreign investment**, but the dollar's value has to stay strong.

"China can be a large source of **CMBS purchases**, however it's dependent on the **allure** of the dollar," Barry explains. "If monetary policy in China continues to **devalue the yuan** to stimulate their economy, Chinese investors may find a safe home in **US dollar-denominated** CMBS bonds and that may be an impetus for a spread tightening."

The best way to capitalize on that? Buying into US real estate deals that appeal to Chinese investors. Easily underwritable fixed-rate **single asset deals** on **trophy properties** will likely hold the most appeal to Chinese investors.

Fannie And Freddie To Be A Formidable Force

Hunt does a ton of work with both agencies, but reports of the two's recent status have been muddled. Both agencies gave out more than their quotas last year, but Freddie also reported a loss in Q3 '15, its **first** in four years. Barry is optimistic, however, and expects the two will increase their **overall market share** and continue to grow in 2016, since they offer **cheaper debt** relative to other financing sources.

"If the first couple of weeks is any indication as to how the rest of the year will go," he says, "people are in a **risk-off mode**, and when you're in a risk-off mode, you want bonds that have belts and suspenders. In the last week or so, spreads on Fannie and Freddie's multifamily bonds have **tightened**, when the rest of the world has done anything but."

In The Worst-Case Scenario, Multifamily Will Stand Strong

When asked about what would happen in the case of a total recession, Barry believes the asset class that will take the **biggest hit** will be retail, due to the simple decrease in **consumer confidence** and, therefore, retail spending. **Office properties**, however, could also take a hit.

"If the economy is in a recession or even heading that way, companies will be quick to slash payroll, which means less required office space. Without tenants to pay the rent, the mortgagee won't be able to make his mortgage payment with a result being bonds that aren't getting interest and principal payments that are due."

But the asset class that will always prevail in a recession will be **multifamily**. While many will be inclined to cut spending on retail, only the truly desperate would cut their monthly rent. In addition, as people tighten their belts, consumers are less likely to put down money on a home, giving multifamily a huge boost.