Bigger pack of CMBS originators chases up US issuance – and risk

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Real Estate Capital **profiles eight CMBS players birthed in the post-recession environment who are poised to help drive US volumes above $100bn this year. We'll let you decide which ones are best suited to thrive amid the crowd.**

The US CMBS market hit a post-recession issuance record last year and is due for another in 2015, with most industry insiders predicting volume well above $100bn. While it's not the $230bn seen at the 2007 peak, the market is growing fast enough to bring about significant changes: some exciting and others concerning.

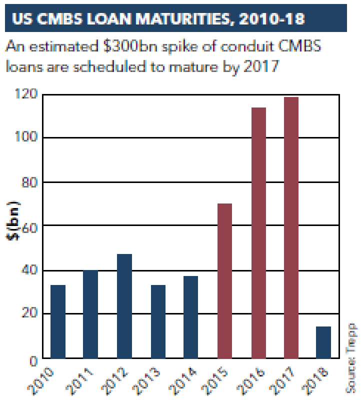
There is much talk about the influx of new originators. The number '40' is thrown around quite a bit, but some haven't done much business yet, so the number of significant originators might be closer to 30.

Somerville

Nevertheless, there are definitely more originators than there were a year ago, with many more preparing to enter the market, as an estimated $300bn wave of 10-year vintage loans comes due and will need refinancing (see chart).

On one hand, stringent regulation has forced many banks to walk away from CMBS origination. One of the biggest was the UK's Royal Bank of Scotland, which last November announced its securities arm would exit US mortgages as part of a scaling down of its global banking activities.

But on the other hand, these changes have opened the door to a flood of speciality finance firms – some old, some new. Some of the pre-recession CMBS loan originating powerhouses have also rejoined the game via joint ventures.



This has spurred aggressive competition, which gives some industry participants pause as trends emerge that are perhaps too reminiscent of the last CMBS boom.

"Competition is a prime reason why underwriting standards are declining," according to Huxley Somerville, head of the US CMBS group at Fitch Ratings. "With this level of competition, if you're not willing to make an aggressive loan, there's always someone else who will.

"Originators have to maintain a business plan and in many ways they get more legitimacy the more loans they make. The concern is that they will cut corners to maintain market share and lending velocity."

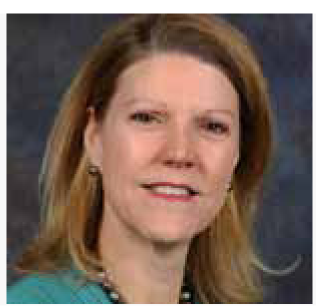
Research and data firm Trepp put last year's issuance at $94.1bn. If the expected jump from that figure happens this year, the ratings agencies are keen to counteract any lack of lending discipline by taking measures such as raising credit enhancement.

Fitch, for example, is offsetting a fall in underwriting metrics with credit enhancement that today averages well above 23% on 'AAA'-rated CMBS tranches, compared to 21.875% at the end of 2013.

New players will be equally wise to nimbly straddle the line between boosting volume and maintaining underwriting discipline, not only to succeed, but to prevent another CMBS market implosion.

While many CMBS originators continue to push the envelope, as interest-only loans proliferate and leverage metrics deteriorate, "other originators are showing a higher level of discipline", notes Fitch managing director Stephanie Petosa.

FREEDOM COMMERCIAL



Davenport

In April 2013, Freedom Mortgage Corporation, one of the largest residential mortgage origination and servicing companies in the US, servicing more than $50bn of residential mortgages, launched a commercial real estate lending division.

“When I met with the company at the start of 2013, we knew we really needed to sit and think about the story,” says Mary Davenport, head of Freedom Commercial. “We knew it wouldn’t make sense jumping in and trying to do $100m loans. It wasn’t right for the risk profile of a company of this size and reputation.”

Ultimately, it was decided that the business would target loans between $2m and $10m. Davenport says: “We knew that we could serve [this sector] appropriately and we are tailored to meet the needs of regional and local borrowers.” These include family trusts and smaller real estate developers.

By May 2014, after taking a year to methodically build in- house systems, hire staff, secure warehouse lines and make other preparations, the business started originating loans.

Davenport aims to originate between $500m and $750m of loans this year and the company is about 30% of the way to this target. In March, Freedom contributed seven loans, with a $30m balance, to Citigroup Commercial Mortgage Trust 2015-GC29.

Davenport, who has more than 30 years of commercial real estate and securities industries experience, was previously a senior credit specialist at RBS Securities and before that was with Capmark Investments and Vertical Capital.

The company’s other top executives include senior vice-presidents Nichole Kim and Shawn Townsend.

Townsend previously held senior origination, capital markets and portfolio management positions for commercial real estate investments at Gramercy Capital, Velocity Advisors, Oasis Real Estate Partners, JP Morgan, Taconic Investment Partners and Nomura Securities.

Kim is a former vice-president at Rialto Capital, where she mainly focused on CMBS B-piece and non-performing loan acquisitions.

Russell

GREYSTONE

In 2014, its first full year as a CMBS originator, investor and adviser Greystone completed $700m of loans.

This year, the firm plans to pass the $1bn mark, Robert Russell, head of CMBS production, says. As part of that push Greystone is unlocking opportunities in the central US states, which have many apartment communities with significant upside potential.

Russell says government-sponsored enterprises like Fannie Mae and Freddie Mac “are in a deep state of flux, pulling back on leverage and increasing pricing”. They financed just 30% of US multi-family housing loans in 2014, compared with around 70% in 2008 and 2009.

A main target is 1980s-1990s class B assets in good condition “but allowing an operator to put in some capital expenditure and receive rent increases”.

In April, Russell originated a $96m, 10-year CMBS loan for the acquisition of six multi-family housing properties partly in the Dallas, Texas area.

In the same month, Greystone originated its first CMBS loan in the self-storage sector, for the purchase of 23 facilities in Ohio and Kentucky. The $26.25m, 10-year loan has a 9% debt yield, a 205bps spread over 10-year swaps and three years of interest-only payments, followed by a 30-year amortisation schedule. The loan-to-value ratio was 75%.

“We are looking to expand our reach into additional asset classes, and are excited to have closed our first self-storage deal,” Russell says. “Appetite for CMBS is ripe for a number of asset classes, so we are likely to see an increase in this type of loan throughout the year.”

The firm recently hired Ted Nasca, a former Guggenheim Commercial Real Estate executive, and Steve Cho, formerly at Royal Bank of Scotland, as managing directors.

With growing US opportunities and a $300bn wave of 10-year loans set to mature between 2015 and 2017, Russell is intent on surpassing his $1bn goal, saying: “This is going to be a big year and we will have our fair share.”

LIBERTY ISLAND GROUP

Prudential Mortgage Capital Company (PMCC) discontinued its CMBS business in 2007, only to re-enter the sector after the recession in a joint venture with Perella Weinberg Partners (PWP), called Liberty Island Group.

Before 2007 Prudential held its CMBS business on its balance sheet. However, in the new set-up, which was forged in late 2011, PWP provides most of the capital, giving Prudential a comparatively minor economic stake and taking away much of the risk.

PMCC is fully responsible for the origination, due diligence and closing process, working closely with PWP to ensure committee approval.

Fitch Ratings conducted an originator review of Liberty Island Group in March 2014. Fitch managing director Robert Vrchota says: “This is another way to offer a product to existing borrowers who might not qualify for balance-sheet lending.”

In the report, Fitch pointed to the high level of CMBS experience among Liberty Island Group’s senior management, its origination and underwriting teams, who have 23, 17 and 10.5 years in the sector respectively, on average.

PMCC also has the benefit of a national origination team of 50 loan officers that participate in the origination of CMBS and non-CMBS financing, Fitch noted.

However, the rating agency also raised two general concerns it has about Liberty Island Group, in common with other CMBS originators. Firstly, it was concerned about the company’s “ability to maintain quality underwriting discipline while origination competition increases”; and secondly “the fact that there is no substantial loan performance track record since the CMBS market re-opened”.

As of last December, Liberty Island Group had a portfolio of 14 loans, a total balance of $188m and average balance of $13.1m. The majority of the loans (41.4%) were secured by office properties and most of the properties (66.5%) were located in secondary markets.

PWP is a global advisory and asset management company with more than $11bn of commitments from institutional and private investors.

PRINCIPAL REAL ESTATE INVESTORS/MACQUARIE

Principal Real Estate Investors and Macquarie Group joined forces in September to launch a CMBS lending business.

MACQUARIE Under the agreement, Principal Real Estate Investors sources, underwrites, closes and services the loans, while Macquarie provides funding and capital markets expertise.

The venture focuses on all major property types across the US, with loan terms typically in the five- to 10-year range and deal sizes between $5m and $100m.

A conduit lending operation launched in February marked its first foray into the business, when it contributed nine loans with a balance of $153.2m to the Wells Fargo Commercial Mortgage Trust 2015-C27 CMBS conduit deal.

These nine loans account for 14.6% of the $1bn of finance that serves as collateral for the transaction. The deal also included loans contributed by Wells Fargo and Rialto Mortgage Finance.

Principal has a track record as a CMBS loan originator and seller, having contributed almost 2,000 loans totaling $16bn to more than 50 securitisations.

The firm also manages or sub-advises on $52.6bn of commercial real estate.

As it prepared for the new venture, Macquarie hired a team of CMBS veterans, led by managing director Timothy Gallagher, to expand its presence in the US commercial real estate market.

A global provider of banking, financial, advisory, investment and funds management services, it is focused on generating returns for institutional, corporate and retail clients. It has $396bn in assets under management.

One source familiar with the company's operations says: "Because Principal has a deep base of real estate people originating and underwriting, sometimes they will get too concentrated on balance sheet.

"So rather than turn borrowers away, this venture gives them another source to fund these deals," the source says.

RIALTO MORTGAGE FINANCE

Rialto Mortgage Finance, a wholly-owned subsidiary of eight-year-old Rialto Capital Management, was launched in May 2013 to originate non-recourse, permanent loans for CMBS exit.

RIALTO Its staff includes 26 professionals in New York City and Los Angeles. In a review of the business, Fitch Ratings noted that a significant portion of the platform's loans were sourced from existing relationships.

At the end of last year, Rialto Mortgage Finance's portfolio consisted of 53 CMBS loans with a $450.8m total balance and an average loan balance of $8.5m.

Most of these loans were secured by retail assets (44.3%) in secondary markets (69.1%).

So far this year, the company has contributed additional loans to Wells Fargo Commercial Mortgage Trust 2015-C26, in February, and to Citigroup Commercial Mortgage Trust series 2015-GC29, in April.

Rialto Mortgage Finance's management team includes Brett Ersoff, who joined in 2013 as president. He was previously co-head of UBS's commercial mortgage business and before that was co-head of Credit Suisse's commercial conduit group.

Ersoff was at Lehman Brothers from 1996 to 2008, where he was co-head of the bank's commercial mortgage conduit program, responsible for the creation of the business and implementing its strategy.

Ersoff oversaw the origination of more than $34bn of senior loans, mezzanine loans, and equity transactions across 4,000 deals.

John Herman joined Rialto Mortgage Finance in 2013 and serves as chief operating officer and chief investment officer.

Herman has 27 years of experience in the commercial real estate industry, most recently serving as global co-head of real estate finance at UBS Securities and as the group's acting chief operating officer.

He held previous roles at Credit Suisse, Round Hill Capital Advisors and Lehman Brothers. During his tenure at the latter, Herman approved more than 4,000 securitised loans totalling more than $40bn.

Tiesi

SILVERPEAK REAL ESTATE FINANCE

In November 2013, backed by commitments from parent Silverpeak Real Estate Partners and Elliott Management Corporation, Silverpeak Real Estate Finance set out to originate loans across the capital stack and the US, with a focus on offices, hotels, retail, industrial and multi-family housing.

The day-to-day operations are led by CEO Douglas Tiesi and COO Peter Tzelios, who both joined in January 2014. Tiesi says the firm is "ahead of schedule" on its 2015 target to originate around $2bn in CMBS loans. "We've been able to ramp up quickly, based on the quality of existing relationships," he says.

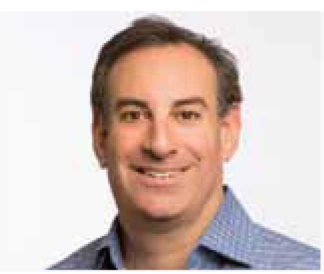
The firm contributed $355m of loans to two Q1 2015 Wells Fargo CMBS deals, including a $270m contribution to the $830m Wells Fargo Commercial Mortgage Trust 2015-LC20, consisting of 68 mortgage loans secured by 122 commercial properties.

The remaining $85m of loans went towards the $962m Wells Fargo Commercial Mortgage Trust 2015-C26, which includes 102 loans secured by 116 commercial properties.

Tiesi, a 20-year industry veteran, was most recently MD and head of RBS's US commercial real estate arm, and previously led the European real estate finance businesses for RBS, ABN Amro and Credit Suisse. Tzelios most recently served as a principal of commercial real estate lender and investor Full Stack Capital.

The firm has 24 employees in New York, Chicago and Los Angeles. John Burke, former head of RBS's CMBS originations team, was hired in Chicago to run the central US origination operation. Alex Ovalle, a former managing director with Jefferies LoanCore, heads operations in LA.

"There is a wide range of new non-bank lenders, but three or four shops are pulling away from the pack," Tiesi says. "We have an ability to deal with risks in a smart way. We will only move up the risk curve when underwriting supports it. When it makes sense, we'll add mezzanine to retain on our balance sheet."



Potters

Société Générale

Société Générale closed its CMBS business in 2008, at the height of the financial crisis; last year, RBS confirmed its securities arm would exit US mortgages amid new regulations, planning to focus on its UK consumer and business bank.

So it was "very good timing for people at RBS", as one industry source says, when SocGen in January launched a US CMBS business, taking on at least 11 key CMBS executives from RBS.

SocGen's expansion contrasts with a retreat from US capital markets by foreign banks such as RBS and Barclays.

When the venture was announced, the French bank said: "This CMBS development is part of a global initiative headed in the US by Hatem Mustapha [global head of the special situations group] to develop asset-backed products."

The initiative expands a push into the US government-backed mortgage securities market that the lender started in 2013.

The former RBS executives hired include head of CMBS Wayne Potters, previously head of RBS's Commercial Real Estate Group since 2013 and with the bank since 2010. Adam Ansaldi, head of CMBS securitisation, was previously RBS's head of distribution and securitisation within the bank's CMBS group.

Additional key team members include Gary Swon, Joey Petras, Chris Kramer and Peter Lewicki, driving origination; Stewart Whitman, managing REITs origination; David Goodwin, managing CMBS credit; Jim Barnard and Justin Cappuccino, in CMBS securitisation; and underwriter Marty Black.

The bank says its new CMBS arm will "take advantage of a trend towards increased securitisation to finance the economy, at a time when many banks' capacity to hold assets on their balance sheets is limited.

"The addition of a CMBS product also shows a commitment to providing world-class capabilities in structured finance, as well as innovative investment opportunities in challenging and changing markets."

The competitive landscape today is a very different to that of 2008, Potters has said, noting that there are now far fewer banks and more specialist finance firms.

Walker

WALKER & DUNLOP COMMERCIAL PROPERTY FUNDING

In November 2013, Walker & Dunlop, and an affiliate of a fund managed by Fortress Investment Group, formed Walker & Dunlop Commercial Property Funding, a CMBS lending business providing first mortgage loans, high-yield whole loans, mezzanine debt and preferred equity on commercial assets across the US.

The joint venture is headquartered in New York and overseen by Tim Koltermann, a 25-year industry veteran in commercial loan originations, CMBS trading, loan pricing and structuring, and CMBS securitisation.

Willy Walker, Walker & Dunlop's chairman and CEO, says that the venture "allows us to leverage our scaled origination, underwriting, servicing and asset management infrastructure to offer an alternative capital source for all commercial real estate asset classes."

Walker & Dunlop Commercial Property Funding contributed the first $58m of collateral, including multi-family housing and retail loans, for the $962m Wells Fargo Commercial Mortgage Trust 2015-C26, a securitisation that includes 102 loans secured by 116 commercial properties.

In September, the firm hired three originators to lead the Walker & Dunlop Commercial Property Funding team. Geoff Smith joined as managing director and head of origination for Walker & Dunlop's conduit and high-yield operation, based out of Walker & Dunlop's New York office.

Paul Jankovsky, who has 29 years of industry experience and an extensive background in real estate lending, joined the team as senior vice-president based in Dallas, Texas, while Kimberly Riordan joined the group as vice- president in New York.

"They are relatively new to commercial but have done a lot of Freddie Mac," one source says about the firm. "There are some ex-[Bank of America] credit risk people there… a lot of people with a lot of experience and tenure who are now getting into the commercial side of things."