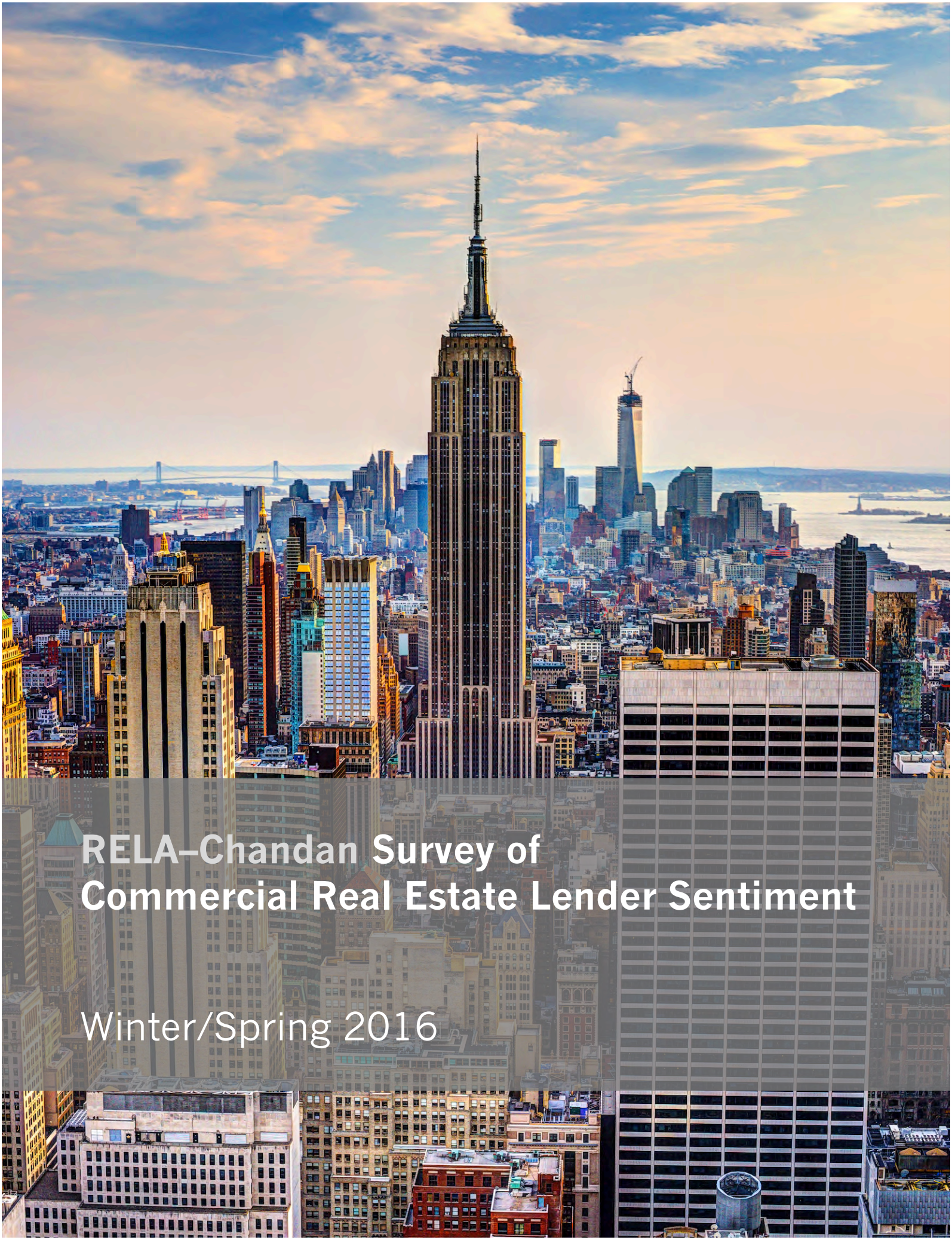


RELA–Chandan Survey of Commercial Real Estate Lender Sentiment

Winter/Spring 2016

WITH A PEAK IN SIGHT, LENDERS PLAN FOR SLOWER GROWTH, TIGHTER STANDARDS, AND HIGHER PRICING

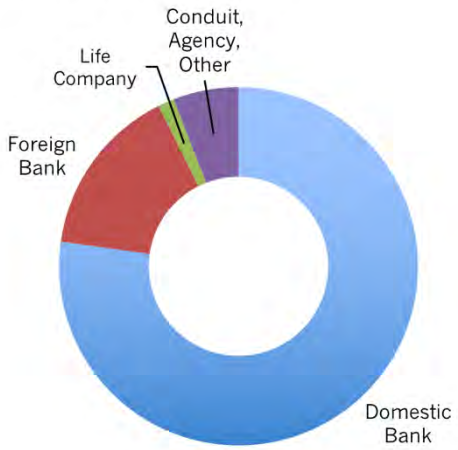
Multifamily and commercial real estate lenders overwhelmingly expect a peak in the market cycle in 2016 or 2017, according to the Winter/Spring 2016 RELA-Chandan Survey of Commercial Real Estate Lender Sentiment. Taking a more cautious view than in prior surveys, fewer lenders expect growth in the volume of their originations in 2016. Instead, the survey results point to weaker growth in new lending, a reversal of the recent easing in underwriting standards, and increases in loan pricing.

- The share of lenders expecting to grow their institution's volume of multifamily and commercial real estate originations declined for all property types between the Spring 2015 and Winter/Spring 2016 surveys. Demand for term loans is projected to increase slightly during 2016, in part reflecting a rise in CMBS refinancing, but construction loan financing is expected to weaken.
- Lenders expressed concerns about the impact of competition on loan quality and the direction of underwriting standards. In sharp contrast with the Spring 2015 survey, more lenders now expect that underwriting standards are set to tighten for all core property types except industrial.
- There is an increasing consensus among survey participants that multifamily and commercial real estate lending will peak either in 2016 or in 2017. Less than 10 percent of lenders expect the market peak to come after 2017.
- As compared to the Spring 2015 survey, a sizable minority of lenders expect the peak will occur earlier than previously anticipated. The most commonly cited reason for the change in expectations was the current trajectory of property prices, which may be softening. Conditions in the domestic and global economies and the outlook for interest rates were cited less frequently as reasons for an earlier peak in lending volume.

About the RELA-Chandan Survey of Commercial Real Estate Lender Sentiment

The RELA—Chandan Survey of Commercial Real Estate Lender Sentiment reports on lenders' expectations for mortgage origination volume, underwriting standards, and loan pricing in the US multifamily and commercial property sectors†. The survey is administered on a semi-annual basis to the membership of the Real Estate Lenders Association (RELA), including domestic and foreign banks, life companies, agency lenders, CMBS conduit lenders, and private and other non-bank lenders. Over the life of the survey, approximately 70 percent of respondents identify as domestic bank lenders. Approximately 20 percent of respondents identify as foreign bank lenders; 10 percent, as agency or conduit lenders or another lender type. In terms of geographic focus, 70 percent of respondents identify as national lenders while 30 percent are focused on a particular region of the United States. Following the formal survey data collection period, Chandan Economics conducts informal interviews with lenders. Comments from those interviews appear in this report's discussion of findings.

Survey Respondents by Lender Class, Life of Survey

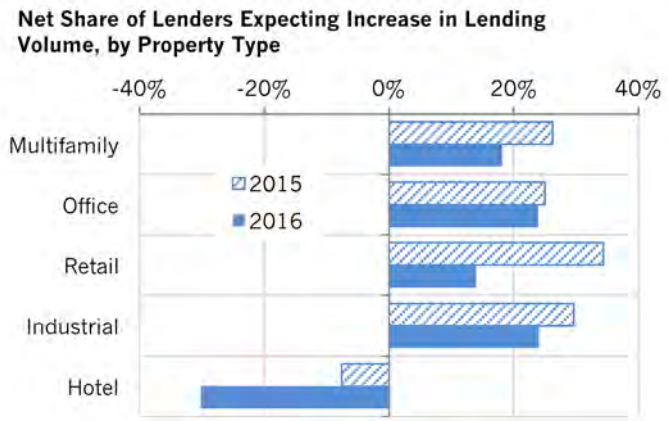


†Apartment, Office, Retail, Industrial, and Hotel

Survey responses are reported as net fractions, consistent with reporting by the Federal Reserve Board in the quarterly Senior Loan Officer Opinion Survey on Bank Lending Practices.

OUTLOOK FOR **LENDING VOLUME**

As compared to the last 12 months, do you expect the dollar volume of new loan commitments made by your institution (excluding extending or restructuring any loans currently included in the portfolio) will increase, decrease, or remain unchanged over the next 12 months?



The share of lenders expecting to grow their institution's volume of commercial real estate originations declined for all property types between the Spring 2015 and Winter/Spring 2016 Sentiment Surveys.

W/S 2016 Survey **Expecting Increase in Lending Volume**	Increase	Unchanged	Decrease	Net Increase
Multifamily	40%	38%	22%	18%
Office	35%	55%	11%	24%
Retail	27%	61%	13%	14%
Industrial	33%	58%	9%	24%
Hotel	16%	39%	46%	-30%
All Property Types	**30%**	**51%**	**19%**	**11%**

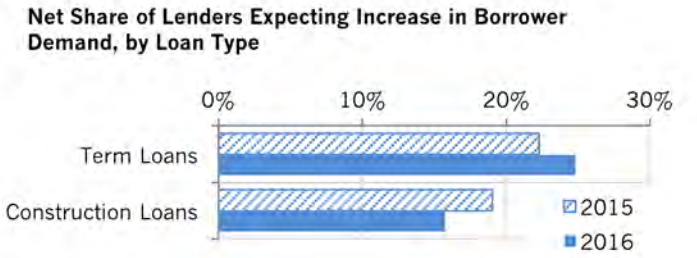
While a slight majority of respondents expects that their institution's origination volume will be unchanged in 2016, the net share projecting an increase in originations in the current survey declined to 11 percent, down from 23 percent a year earlier. In spite of a projected increase in refinancing demand from CMBS maturities, the result is consistent with the survey's special questions relating to the market cycle that show an overwhelming majority of lenders projecting a cyclical peak in real estate markets either 2016 or 2017.

The largest decline in the outlook for lending volume was for the hotel sector, where 46 percent of respondents anticipate an outright drop in volume during 2016. At the other extreme, just 9 percent of lenders expect a decline in lending against industrial properties. That is consistent with several lenders' comments regarding a shift in new investment momentum favoring the industrial sector and away from other assets in 2016.

Lenders appear split in their assessments of the multifamily lending outlook. 40 percent of respondents project an increase in apartment lending volume during 2016, higher than for any of the other property types. At the same time, 22 percent expect a decrease in volume, second only to the hotel sector. Only 38 percent believe that volume will be unchanged. Based on comments from different classes of multifamily lenders, the split may reflect differences in their competitive positions. Some anticipate a positive impact from the lending caps on the government-sponsored enterprises, which they believe may drag on growth opportunities for the agencies' lending partners. On the other hand, several lenders cited the potential for growth in small balance apartment lending as an avenue of growth in 2016.

Outlook for **Borrower Demand**

Across all property types and as compared to the last 12 months, do you expect borrower demand for loans that meet your institution's credit risk profile to increase, remain unchanged, or decrease over the next 12 months?



W/S 2016 Survey **Expecting Increase in Borrower Demand**	Increase	Unchanged	Decrease	Net Increase
Term Loans	36%	53%	11%	25%
Construction Loans	36%	43%	20%	16%
All Loan Types	**36%**	**48%**	**16%**	**20%**

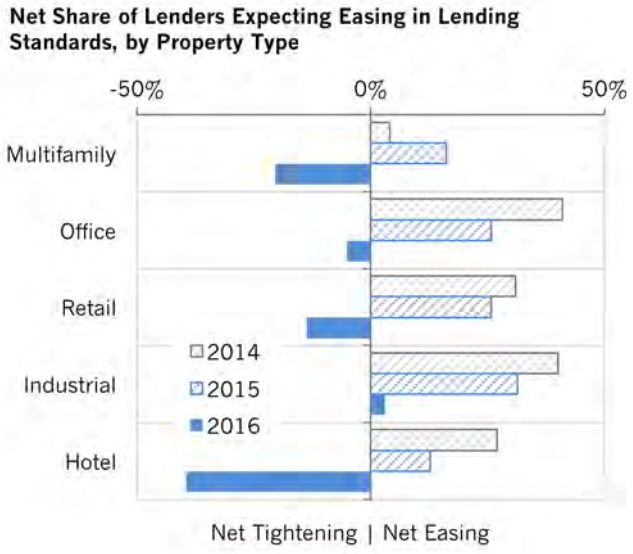
The overall demand outlook for term loans—including stabilized, income-producing assets across all core property types—improved slightly between the Spring 2015 and Winter/Spring 2016 Sentiment Survey. While a majority of respondents expect no change in term loan demand, lenders projecting an increase outnumber those who see a decline more than three-to-one. Overall, the net share of lenders projecting an increase in term loan demand increased to 25 percent, up from 22 percent a year earlier. Several lenders commented that pending CMBS loan maturities will be a source of significant growth in loan demand but that many of these refinancing opportunities will not meet their institution's credit risk profile.

In contrast with expectations for term lending, the outlook for construction loan demand softened in the Winter/Spring 2016 survey. 20 percent of respondents anticipate a decline in borrower demand, compared with 36 percent projecting an increase. As compared to previous expansions, construction loan growth has remained subdued over the current cycle. Discussions with lenders point to two important factors. First, relatively weak property fundamentals over the length of the recovery have limited opportunities for new inventory outside of the multifamily sector and a small number of well-performing metropolitan areas. More recently, the Basel III treatment of high volatility commercial real estate (HVCRE) has impacted banks' incentives to make construction loans. Where specific criteria are not met, banks' Acquisition, Development, and Construction (ADC) loans are assigned a 150 percent risk weight under the new regulatory framework.

Outlook for **Lending Standards**

As compared to the last 12 months, do you expect market underwriting standards to ease, remain unchanged, or tighten over the next 12 months?

Citing the impact of increasing competition on loan quality, lenders expect to pull back on underwriting standards in 2016. The annecdotal evidence from interviews with market participants is supported by the results of the Winter/Spring 2016 survery, which show a major shift in the outlook for lending standards. In both the Spring 2014 and Spring 2015 surveys, lenders were responding to rising prices, an improving outlook for property fundamentals, and heightened competiton across classes of lenders by easing standards. For all but industrial properties, lenders now expect net tighening in standards over the next year.



W/S 2016 Survey **Expecting Easing in Lending Standards**	Easing	Unchanged	Tightening	Net Easing
Multifamily	18%	45%	38%	-20%
Office	17%	60%	22%	-5%
Retail	12%	62%	26%	-14%
Industrial	18%	66%	15%	3%
Hotel	10%	40%	50%	-39%
All Property Types	**15%**	**55%**	**30%**	**-15%**

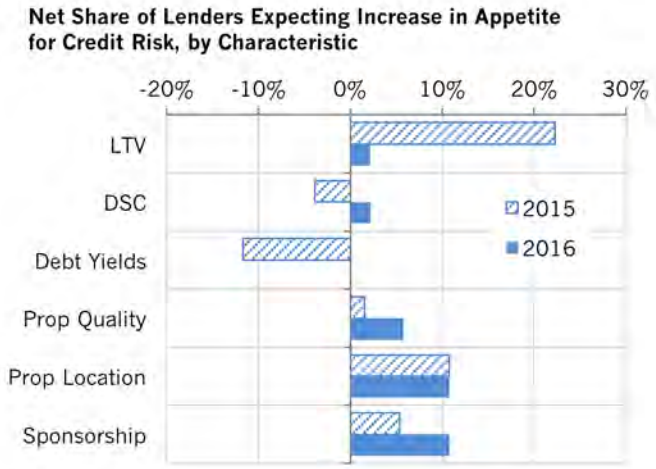
While a majority of lenders in the all-property type metric anticipate that standards will remain unchanged, the number expecting to tighten outnumber lenders expecting to ease two-to-one. Expectations of tightening are strongest in the hotel and multifamily sectors. Lenders indicate that standards may ease for industrial properties but even in this case the net share projecting easing standard is just 3 percent.

Outlook for **Risk Appetite**

Across all property types and as compared to the last 12 months, do you expect your institution's appetite for credit risk to increase, remain unchanged, or decrease over the next 12 months?

When asked about the specific dimensions along which underwriting standards might adjust in 2016, lenders expressed little tolerance for greater risk-taking in any of the core measures. A majority of lenders anticipate no change in their institution's appetite for credit risk. In comments following the survey period, several lenders expressed that underwriting along these dimensions was generally appropriate but left no room for further easing.

In part reflecting fierce competition for high-quality assets in gateway and primary markets, a net share of 11 percent of respondents indicated a greater willingness to lend in secondary and tertiary markets in 2016. Similarly, the net share of respondents projecting an increase in credit risk appetite along the dimension of loan sponsorship was also 11 percent.

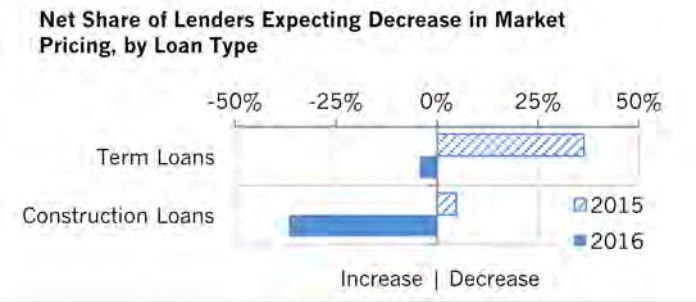


Expecting Increase in Appetite for Credit Risk	Increase	Unchanged	Decrease	Net Increase
Loan to Value Ratios	11%	80%	9%	2%
Debt Service Coverage	13%	77%	10%	2%
Debt Yields	12%	77%	12%	0%
Property Quality	15%	76%	9%	6%
Property Location	19%	73%	8%	11%
Loan Sponsorship	16%	79%	5%	11%
All Characteristics	**14%**	**77%**	**9%**	**5%**

In the Spring 2015 survey, a significant net share of lenders expressed a willingness to make loans at higher leverage. That was not the case for he Winter/Spring 2016 survey. Based on conversations with market participants following the survey data collection period, the finding reflects concerns about current pricing conditions, which several lenders described as "frothy."

Outlook for **Market Pricing**

Across all property types and as compared to the last 12 months, do you expect market pricing for loans to increase, remain unchanged, or decrease over the next 12 months?

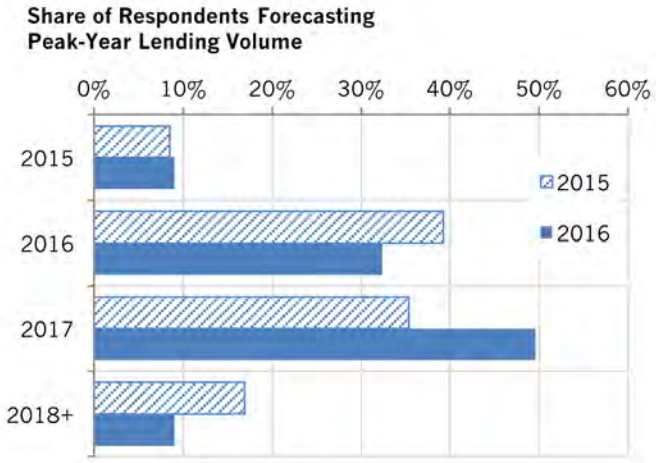


Expecting Decrease in Market Pricing	Increase	Unchanged	Decrease	Net Decrease
Term Loans	34%	36%	30%	-4%
Construction Loans	54%	28%	18%	-37%
All Loan Types	**44%**	**32%**	**24%**	**-20%**

For the first time in the survey's post-crisis history, lenders expect that loan pricing will increase over the next year. The net share of lenders anticipating an increase in term loan prices was only 4 percent. For construction loans, however, the net share was 37 percent, reflecting that 54 percent of survey respondents expect an increase in this category, outnumbering lenders projecting a decline in costs by three-to-one. In conversations following the survey period, several lenders expressed concerns that wider spreads and bond market volatility would persist for CMBS loans and that bank and some life company lending would see price increases as well.

Special Questions on the Market Cycle

Based on your current assessment of the market, when do you believe that new lending volume (excluding modifications and restructurings of 2005, 2006, and 2007 vintage CMBS) will reach its cyclical peak?



The commercial real estate debt market is approaching its cyclical peak according to lenders surveyed for the Winter/Spring 2016 survey. While a minority of lenders (9 percent) believe that 2015 had already marked the peak in origination volume and that 2016 will see lower year-end volume, the overwhelming majority of survey participants anticipate that lending will peak either this year or next. As compared to the Spring 2015 survey, which posed the same question, more lenders now believe that 2017 will mark the peak. Even so, there is now greater consensus regarding timing and the diminishing chances of a protracted expansion. The share of lenders that anticipates a peak in 2018 or later declined to 9 percent, down from 17 percent in the Spring 2015 survey.

Expecting New Lending Cyclical Peak in a Given Year	
2015	9%
2016	32%
2017	50%
2018+	9%

Referring back to your response to the previous question, have your expectations for the timing of the cyclical peak in new lending volume changed over the last six months? If so, what has been the most important factor in your change in expectations?

For Lenders Expecting Tightening Earlier	
Domestic Economy	13%
Global Economy	16%
Investment Conditions	34%
Lending Conditions	11%
Interest Rates	14%
Other	12%

When asked about changes in their expectations about the timing of the market peak, most lenders reported that their views had not changed leading up to the Winter/Spring 2016 survey period. However, a sizable minority (27 percent) did report that they now expect the peak will occur sooner than they previously anticipated. Rather than conditions in the domestic or global economy or an increase in interest rates, more than one-third of lenders cited a change in multifamily and commercial real estate investment condition as the primary reason for their updated view on timing. In conversations with lenders following the survey period, several expressed the view that peak pricing and peak lending would coincide and that pricing will reach its cyclical peak in 2016 or 2017, driving their views on originations and credit risk.

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About the **Real Estate Lenders Association**

The Real Estate Lenders Association, Inc. is a not-for-profit corporation formed in 1991 to provide a forum for real estate lenders and equity investors to advance their knowledge and expertise in their industry. RELA's focus is on education, networking, and opportunity. Membership in RELA is exclusive to institutions with commercial real estate debt and equity under their direct control.

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About **Chandan Economics**

Chandan Economics is a leader in commercial real estate debt market research. Leveraging its database of commercial mortgages originated by balance sheet, agency, and conduit lenders, Chandan reports on lending trends and provides credit risk analytics for banks, life companies, investors in CMBS and agency securities, regulators, and policymakers.

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