REAL ESTATE LENDERS TURN MORE OPTIMISTIC

A More Sanguine Outlook for Lending Even as Expectations Grow for a Property Price Decline in 2019

The outlook for multifamily and commercial real estate lending has improved. That's according to participants in the most recent RELA—Chandan Survey of Commercial Real Estate Lender Sentiment, including more than 100 domestic and foreign banks, life companies, conduit and agency lenders, and other non-bank market participants. Surveyed at mid-year 2018, lenders project that origination volume will rise over the next year as underwriting standards adjust to a more favorable near-term economic outlook, offsetting limited growth in borrower demand as investment sales edge lower.

Among the key findings of the mid-year 2018 survey:

- The net share of lenders expecting an increase in origination volume over the next twelve months increased to 9 percent, up from a net share of 12 percent projecting a decline in volume when surveyed in 2017. Expectations for lending growth varied substantially across property types. Lenders are most bullish on the industrial sector, with nearly two-thirds of respondents projecting growth in lending volume. The outlook for the multifamily and office sectors improved as well. Lenders are most reserved in their expectations for the retail and hotel sectors.

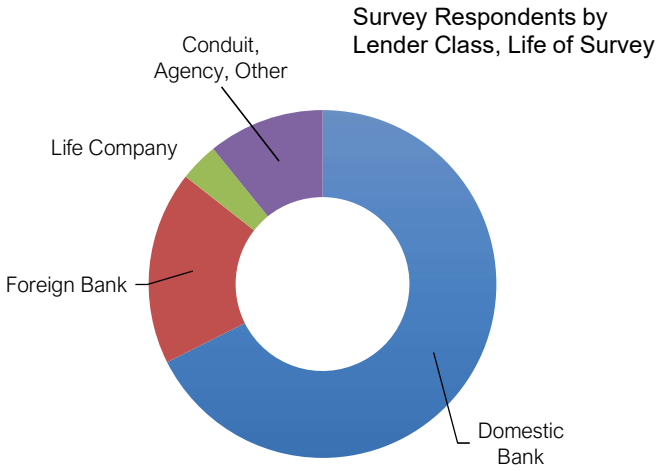
- Contributing to expectations of growth in lending activity, survey respondents anticipate that overall underwriting standards will ease over the next year, reflecting more favorable terms for multifamily, office, and industrial borrowers. This is a departure from 2016 and 2017, when lenders reported that underwriting standards, in general, would tighten.

- The shift in expectations is largely attributable to lenders' improved assessments of the near-term macroeconomic outlook and property income trends. Notwithstanding apprehensions about the policy environment in areas such as international trade, fewer respondents cited concerns about the longevity of the macroeconomic cycle this year.

- Across term and construction loans, the net share of respondents expecting an increase in loan demand was just 10 percent, on par with last year's survey. While demand from investment sales is expected to soften, stronger demand for maturity refinancing–particularly in the multifamily sector–is projected to support growth in lending even as rising interest rates undercut opportunistic refinancing.

- The survey once again included a special question on lender expectations for commercial real estate prices. 34 percent of lenders expect that prices will decline year-over-year in 2018. That share rises to 66 percent for 2019. Only 15 percent of respondents expect price appreciation in 2019.

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



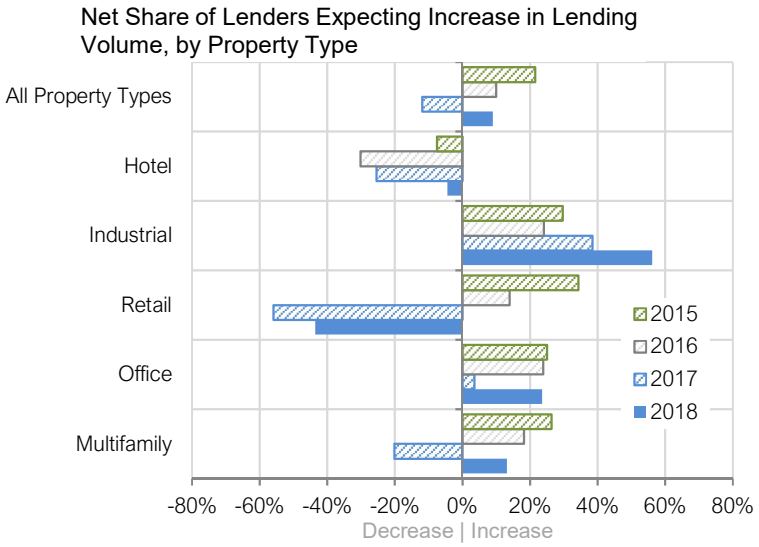
The RELA—Chandan Survey of Commercial Real Estate Lender Sentiment reports on lenders' expectations for mortgage origination volume, underwriting standards, and loan pricing in the US multifamily and commercial property sectors†. The survey is administered on a semi-annual basis to the membership of 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. As compared to the Federal Reserve Board's Senior Loan Officer Opinion Survey on Bank Lending Practices, the RELA—Chandan Survey results incorporate a larger number of responses representing a larger share of total commercial real estate lending activity. Respondents are responsible for various aspects of their institutions' commercial real estate lending activities rather than bank lending practices generally.

†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?



Measured across all property types, the share of lenders expecting to grow their institution's volume of commercial real estate originations over the next twelve months increased between the mid-2017 and mid-2018 surveys. 34 percent expect growth in lending, the strongest result since 2015, while 25 percent expect a decline.

Share of Respondents Expecting Loan Volume Will Increase, Remain Unchanged, or Decrease

Property Type	Increase	Unchanged	Decrease	Net Increase
Multifamily	38%	38%	25%	13%
Office	38%	48%	14%	24%
Retail	11%	34%	55%	-44%
Industrial	64%	29%	8%	56%
Hotel	20%	56%	24%	-4%
All Property Types (2018)	**34%**	**40%**	**25%**	**9%**
(2017)	27%	35%	39%	-12%
(2016)	30%	51%	19%	11%
(2015)	42%	39%	19%	23%

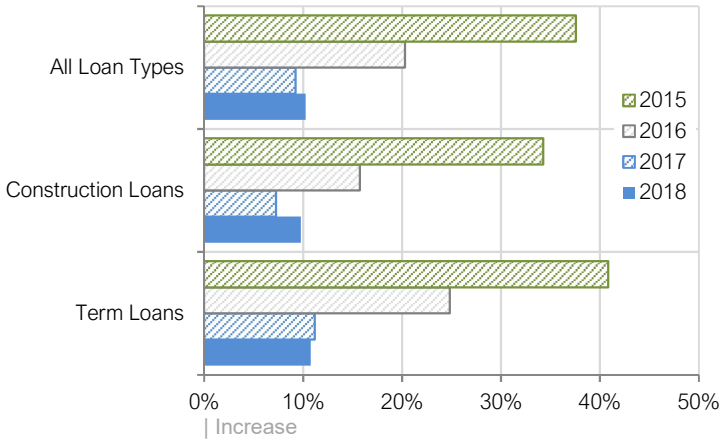
Lenders were most optimistic in their outlook of the industrial sector, consistent with highly favorable investor sentiment. Almost two-thirds of lenders expect to increase their industrial property lending volume, compared with less than 8 percent anticipating a decline.

Once again in 2018, lenders were most reserved in their expectations for retail property lending, with 55 percent projecting a decline in lending volume and just 11 percent projecting an increase. In comparison, the outlook for the hotel sector is relatively balanced, with the net share of lenders expecting a decline in lending at 4 percent.

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?

Net Share of Lenders Expecting Increase in Borrower Demand, by Loan Type



The overall demand outlook for term loans—including stabilized, income-producing assets across all core property types—was essentially unchanged from mid-year 2017 to mid-year 2018. The net share of lenders expecting an increase in term loan demand in the most recent survey was 39 percent, compared to 28 percent expecting a decline. The net share of lenders expecting an increase in demand was 11 percent.

Share of Respondents Expecting Borrower Demand Will Increase, Remain Unchanged, or

Loan Type	Increase	Unchanged	Decrease	Net Increase
Term Loans	39%	32%	28%	11%
Construction Loans	37%	36%	27%	10%
All Loan Types	**38%**	**34%**	**28%**	**10%**

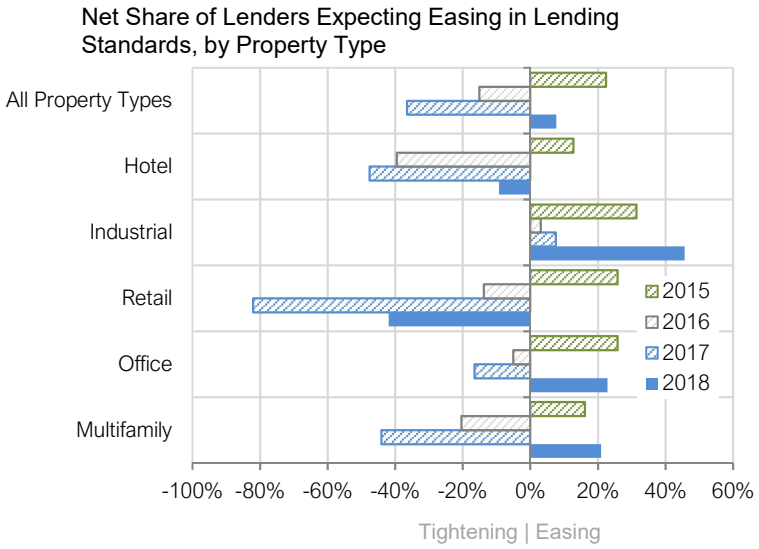
In conversations following the formal data collection period, survey respondents reported expectations of a decline in demand for lending in support of investment sales but an increase in demand for maturity refinancing, particularly in the multifamily sector.

The outlook for construction loan demand is comparable to term loans. Expectations for multifamily construction financing were mixed in discussions with respondents. Several survey participants expect that demand will decline for large urban multifamily construction projects but improve for relatively more suburban workforce multifamily housing. One survey participant cited growth in demand for financing of single-family rental development.

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?

Measured across all property types, the net share of lenders expecting that underwriting standards will ease shifted markedly in the mid-year 2018 survey. In last year's survey, lenders reporting tightening standards outnumbered those reporting easing more than 3-to-1. The net share expecting tightening standards was 37 percent.



What a difference a year makes. The share of lenders projecting that standards will ease tripled between 2017 to 2018, from 11 percent to 33 percent. 25 percent of lenders reported that standards will tighten, down from 48 percent in 2017.

As with other measures of lender sentiment, results varied significantly across property types, with retail scoring the most bearish outlook and industrial the most bullish.

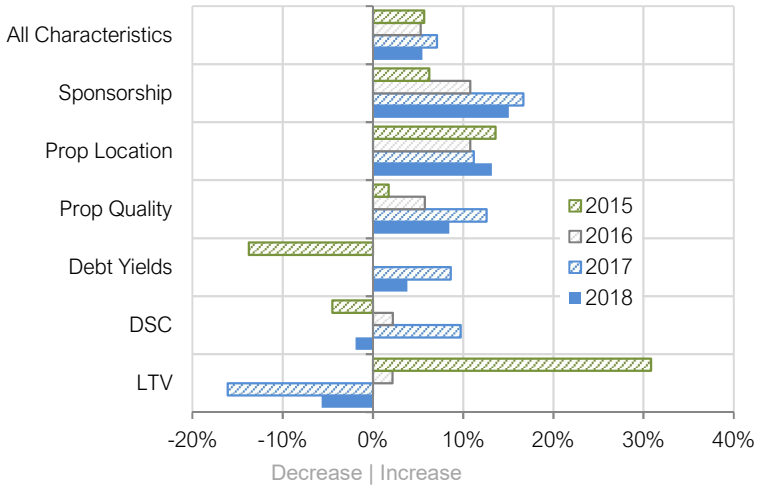
Share of Respondents Expecting Lending Standards Will Tighten, Remain Unchanged, or Ease

Property Type	Ease	Unchanged	Tighten	Net Ease
Multifamily	41%	39%	20%	21%
Office	36%	50%	13%	23%
Retail	16%	26%	58%	-42%
Industrial	54%	37%	9%	46%
Hotel	15%	61%	24%	-9%
All Property Types (2018)	**33%**	**42%**	**25%**	**8%**
(2017)	11%	40%	48%	-37%
(2016)	15%	55%	30%	-15%
(2015)	40%	42%	18%	22%

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?

Net Share of Lenders Expecting Increase in Appetite for Credit Risk, by Characteristic



When asked about the specific dimensions along which underwriting standards might adjust, lenders expressed little tolerance for greater risk-taking in loan-to-value ratios, debt service coverage, or debt yields. In discussions following the formal survey period, respondents expressed concern that each of these metrics would come under pressure in an environment of rising interest rates.

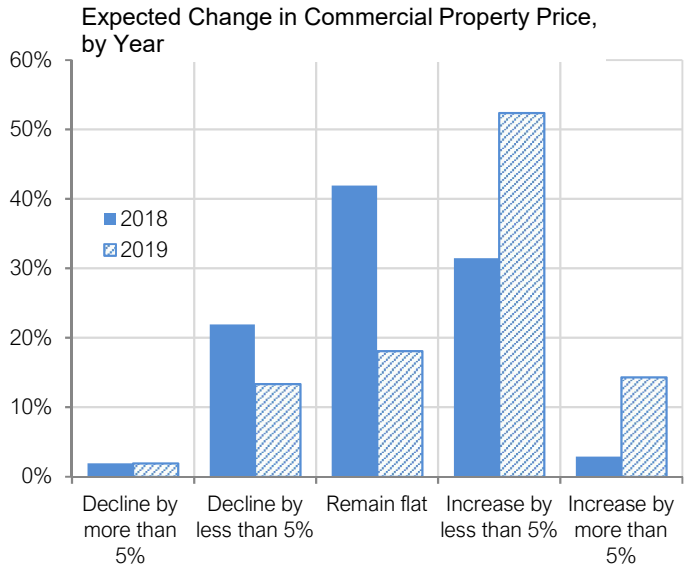
Lenders do anticipate easing standards somewhat in terms of property location, both within and across metropolitan areas, and in terms of sponsorship quality.

Share of Respondents Expecting Risk Appetite Will Increase, Remain Unchanged, or Decrease

Characteristic	Increase	Unchanged	Decrease	Net Increase
Loan to Value Ratios	9%	75%	15%	-6%
Debt Service Coverage	12%	73%	14%	-2%
Debt Yields	16%	71%	13%	4%
Property Quality	15%	78%	7%	8%
Property Location	23%	68%	9%	13%
Loan Sponsorship	24%	68%	8%	15%
All Characteristics	**17%**	**72%**	**11%**	**6%**

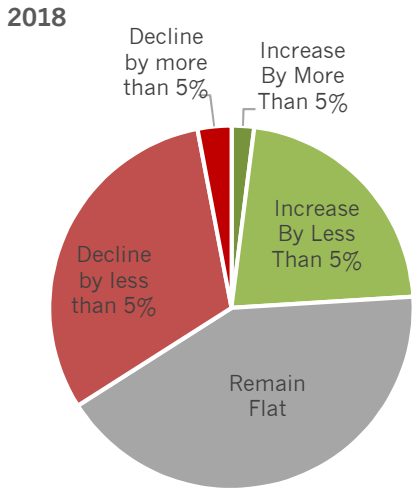
Special Questions on the Market Cycle

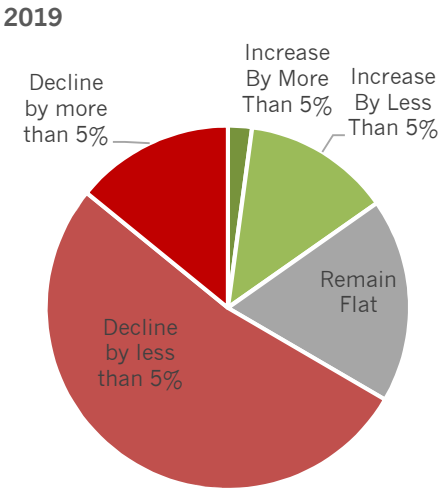
In the 2017 RELA-Chandan survey, 13% of respondents projected a year-over-year decline in commercial real estate prices during 2017. 36% projected an increase in prices, and 51% projected that prices would remain stable. According to the Green Street Commercial Property Price Index, prices fell by 0.55% in 2017. Based on these trends, how do you expect that commercial prices will move in 2018 and 2019, respectively?



The commercial real estate cycle is running long, driving a reassessment of lenders' views on the timing of a slowdown. In last year's survey, the overwhelming majority of participants expected that prices would peak in 2017 or 2018. While pricing momentum has tapered off, lenders' views of current pricing trends are mixed. A plurality of 42 percent see flat prices in 2018. Expectations of a decline in prices are now concentrated on 2019, with two-thirds of lenders anticipating an outright drop in property values. Notably, the share of lenders expecting a decline of more than 5 percent increases to 14 percent. In conversations following the formal survey period, several lenders commented that loan growth in their preferred sector or region will grow modestly even as investment sales decline and refinancing rates rise, reflecting an increase in maturity volume.

Expected Change in Commercial Property Prices in 2018 and 2019 Benchmarked Against Green Street CPPI





Share of Respondents Expecting Property Prices Will Increase, Remain Flat, or Decrease in 2018 and 2019

Year	Increase > 5%	Increase < 5%	Remain Flat	Decrease < 5%	Decrease > 5%
2018	2%	22%	42%	31%	3%
2019	2%	13%	18%	52%	14%