DEVELOPMENTS

A LOOK AT PROJECTS AND TRENDS

Commercial Real Estate Lenders Riled Up

Regulators' plan to raise capital requirements would curtail lending, say industry leaders.

A proposal by federal regulators to more closely scrutinize banks with large concentrations of commercial real estate (CRE) loans and raise capital requirements threatens to choke a lucrative lending sector, industry leaders say.

"By using blanket industry-wide guidance to address concentrations that the regulators are seeing at some banks, the regulators risk choking off the flow of credit from banks that are engaging in CRE lending in a safe, sound, and profitable manner," banker Harris Simmons told members of the House Subcommittee on Financial Institutions and Consumer Credit on Sept. 14. Simmons is CEO of Zions Bancorporation in Salt Lake City and chairman of the American Bankers Association (ABA).

The new rules would set thresholds that call for enhanced risk management programs and greater capital requirements when a bank's concentration of construction lending grows larger than 100% of its total assets, or when all CRE loans exceed 300% of capital.

While the proposed thresholds are intended to alert banks to the need for rigorous risk management programs to monitor high loan concentrations, lenders and real estate industry experts say that analysts and bank examiners could interpret the 100% and 300% thresholds as lending caps.

Several agencies, including the Office of the Comptroller of the Currency (OCC), proffered the rule change in January in response to a rapid increase in real estate lending. Commercial loans made in 2005 totaled $1.3 trillion, up 16% from the previous year, reports the OCC. Regulators fear a repeat of the widespread commercial real estate failures that led to bank and savings-and-loan failures two decades ago.

Approximately 35% of U.S. banks today have CRE loans equal to more than 300% of their capital. That's nearly double the 169% CRE loan concentration for community banks in 1989, according to the comptroller's office.

"One bank has commercial real estate loans that represent 750%, or 7.5 times, its capital," Rep. Maxine Waters, D-Calif., told the subcommittee. "Is this prudent banking practice, or is it inherently risky?" Waters' example was intended to show the potential for overexposure to real estate, yet it lends equal weight to the lending industry's main complaint about the proposed regulations — that banks with risk management programs inadequate for their CRE loan concentrations are best dealt with on a case-by-case basis, rather than via industry-wide regulations.

"The regulators have an ample supply of supervisory and enforcement tools at their disposal to address any bank that is failing to manage adequately the risks presented by a CRE concentration," says Simmons of the ABA. "If, in fact, the regulators are seeing concentrations at only some banks, then the supervisory response should be tailored to fit the particular facts of a given bank."

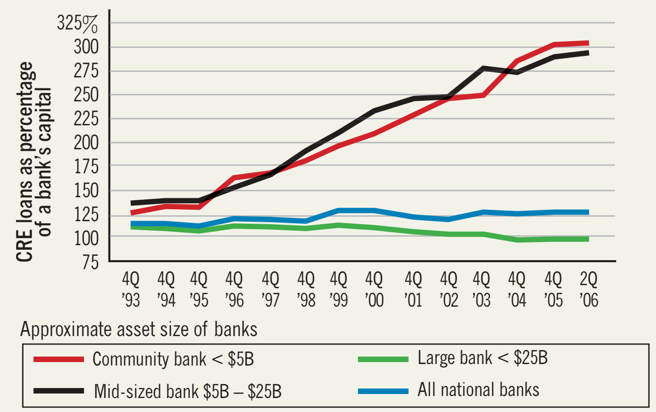
Opponents of the new regulations say the broad-brush approach is too simplistic for a market sector that employs a spectrum of diversification strategies by geography, product type and other factors. Today's commercial real estate market benefits from greater transparency, increased scrutiny and more timely information than in years past due to the influence of public REITs and the creation of the commercial mortgage-backed securities market, says Bob White, president of Real Capital Analytics.

"The information feedback loop that is now in place should help prevent large boom-bust cycles in the future," White told subcommittee members. If the rules are adopted, real estate and banking leaders worry that even those lenders that do meet enhanced risk-management guidelines will see their share prices suffer, if they exceed the new thresholds for CRE loan concentrations.

— Matt Hudgins

ARE SMALLER LENDERS OVEREXPOSED?

An increasing concentration of commercial real estate loans at community and mid-sized banks worries federal regulators. In the second quarter of this year, banks with less than $5 billion in assets had commercial real estate loans outstanding equal to 308% of bank assets, on average.



Sources: U.S. Comptroller of the Currency, Call Reports

HOTEL PROJECT POINTS TO BRIGHTER FUTURE

The first new full-service hotel to rise in Monterey, Calif. since the early 1980s is officially under development. In September, San Mateo, Calif.-based hotel owner and operator Pacific Hotel Management announced plans to develop the 208-room Cannery Row Hotel. The hotel will be constructed on a formerly run-down waterfront parcel located in downtown Monterey. It will consist of two, four-story buildings, a 95-seat restaurant and more than 10,000 sq. ft. of banquet and meeting space. Another 20,000 sq. ft. will be devoted to retail space on the ground floor of both buildings.

Buchanan Street Partners, a real estate investment bank based in Newport Beach, Calif., arranged $59 million in financing for the project. Thomas Sherlock, managing partner of Buchanan Street Partners, believes that the new hotel will help revitalize the run-down waterfront area made famous by John Steinbeck in his 1945 novel.

Previous developers failed in their attempts to build on the site due to environmental lawsuits and limited interest in financing the project. Earlier this year, however, Pacific Hotel Management secured development rights through a ground lease. The 2.7-acre parcel is divided up between various parties (including the City of Monterey), which further complicated past efforts. Hotel construction will be completed by fall 2008.

— Parke M. Chapman

Q&A

David Montross: Public sector work helps Equis expand services for corporate clients

David Montross moved up from COO to CEO of Equis Corp. on July 20, when Australia-based United Group Limited (ASX: UGL) completed its acquisition of the formerly private, 400-person real estate services firm. Now part of a 3,300-employee organization with offices in more than a dozen countries, Montross is poised to grow Equis' multi-faceted real estate services firm. Montross recently spoke with NREI about what corporate real estate users can expect from the new Equis.

NREI: Equis suffered along with the rest of the economy after 9/11, with revenue dropping almost 30% from 2000 to 2001. Since then, the business has more than doubled. How did the company bounce back?

Montross: We went back to our knitting. Most [corporations] were downsizing their internal real estate organizations and needed an outside provider with an integrated set of services. We had a series of service lines offered by people who were used to providing the accountability and performance management that companies were looking for. So the market came to us a little bit. We added several new business lines, which really extended our sales entrées into new business opportunities and new sources of revenue. That really took off, and we've felt its value in the significant growth we've achieved since 2001.

NREI: You were a broker at LaSalle Partners before joining Equis as COO in 2001. How has that experience influenced your work at Equis?

Montross: In 17 years as a transaction advisor, I came to recognize that brokers need a series of services, tools and resources around them to support the ever-expanding business needs of occupier services. When I joined Equis, my passion was to build the other service lines to support and drive brokerage. I had this vision of going beyond transactions and building up the support resources and experts around them. The advisory businesses I thought were necessary to complement brokerage capability included technology services, strategic consulting, incentive services, and strategic planning for facilities management, and that led us into government services, where we're now a prominent player.

NREI: You were instrumental in developing the government services group. Why is this a critical service area for the company?

Montross: It's not a heavily developed sector like corporate services, and it really plays to our strengths of knowing all aspects of occupier services, from facility condition assessments to strategic planning, transaction advisory, project services, data management — all the things that the public sector, with its giant portfolios, really needed help with. Many corporations just don't have a need for strategic advisory services, so many competing brokerage firms don't have that capability on their staff. Our government services practice gives us the opportunity to have a strong, vibrant group of strategic advisory people because they're working in the government sector that has huge demand for their talents. That capability also makes them available for an area like corporate services.

NREI: What are your growth plans?

Montross: United Group has well-known growth targets. It wants to grow at 15.5% per year, and United Group is going to demand that of us. Our growth and success are dependent on getting good people, so we are looking for the best and brightest interested in joining a team with an entrepreneurial, small-firm culture and a global vision and commitment to success. Also, everybody recognizes that some of the smaller real estate players are going to get absorbed by the bigger ones in the coming years. We're well-positioned now to look at those opportunities as another growth vehicle for our company.

— Matt Hudgins