Q4 | 2019

SIMON | ANDERSON TEAM MARKET UPDATE

MULTIFAMILY LENDING MARKET UPDATE

2019 Market Study
Puget Sound Region

Kidder Mathews

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INTRODUCTION

OCTOBER 2019

In this study, we aim to answer several key questions for investors.

Who are the top multifamily lenders in the Puget Sound Region?

To answer this question, we meticulously compiled and sorted data on more than 1,400 multifamily loans. Top lenders by volume in 2018 can be found in the next section along with additional insights from our research. We found that banks and life insurance companies have an outsized presence in King County, while agency lenders remain dominant in the outlying counties.

What will likely happen with interest rates in the near-term?

Interest rates have seen a volatile summer and early fall. Sharp movements in underlying indices and fallout from the Q3 agency pullback continue to affect the markets. The Fed is expected to continue lowering rates through early next year.

What do investors need to know about the financial markets to make effective decisions in 2020?

Investors should consider refinancing in Q1 to take advantage of limited competition, shop around to use disparate pricing to their advantage, and consider borrowing long to take advantage of discounted long-term rates.

We hope this study is a useful starting point as you start thinking about multifamily lending in 2020. Contact us for further insights and recommendations, and to learn more about how we use these insights to deliver best-in-class results for our clients.

ALEX MUNDY
Debt Finance

ALEX MUNDY

Alex leads mortgage brokerage for the Simon | Anderson Team, specializing in loan origination and financial underwriting.

Alex joined the team in 2018, bringing a decade of industry experience including more than six years as a multifamily lender.

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MEET THE TEAM

Dylan Simon

Executive Vice President

Dylan is a market-leading apartment broker in the Puget Sound region, specializing in the sale of apartment buildings and development land. He has deep expertise in marketing, sales, market analysis, and industry trends.

Jerrid Anderson

Executive Vice President

Jerrid is an apartment broker specializing in micro apartment, urban apartment, and development land sales. He is passionate about marketing and video content.

Matt Laird

Senior Associate

Matt is an apartment broker specializing in 5–30 unit urban and suburban apartment sales, underwriting, valuations, and market research.

Brandon Lawler

Associate

Brandon is an apartment broker specializing in business development, market research, and off-market transactions.

Tyler Blaikie

Financial Analyst

Tyler specializes in financial underwriting, apartment and development land valuations, market research, and data analysis.

Cate Chase

Senior Marketing Specialist

Cate manages promotion and design for both team and property marketing, specializing in writing, branding, digital strategy, PR, and events.

01

MULTIFAMILY LENDING

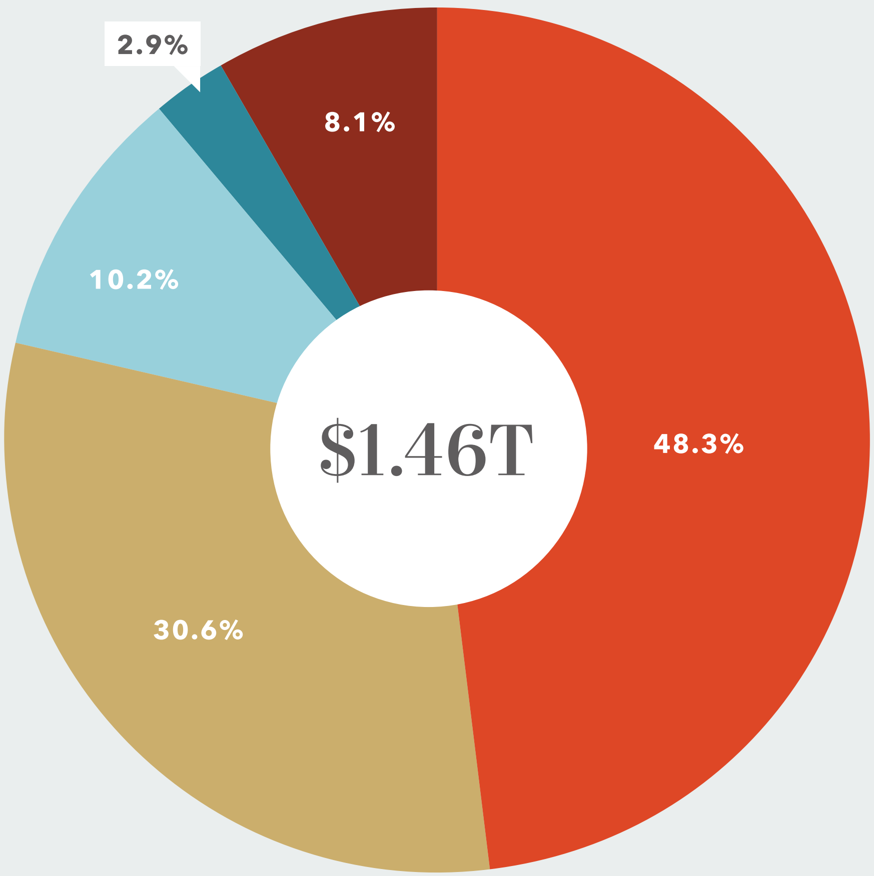
Kidder Mathews

NATIONAL MULTIFAMILY DEBT

The chart breaks down the $1.46 trillion in outstanding multifamily loan debt in the United States as of 2Q 2019.

The multifamily lending market is dominated by the agencies (Fannie Mae & Freddie Mac), which account for nearly half of all outstanding loan balances. Next in line are banking institutions, which range from small credit unions to international behemoths like JPMorgan Chase. These companies provide everything from construction lending to take-out financing and account for just over 30% of outstanding loan balances. Life insurance companies and pension funds make up a notable and expanding share of the market at 10%, which mostly consists of permanent debt on high-quality assets in core markets. Smaller categories include CMBS lenders, direct government lending, debt funds, and private notes.

Between Q1 and Q2, multifamily balances grew in all categories except government lending and CMBS.



$703B
Agency

$445B
Banks

$148B
Life Insurance

$42B
CMBS

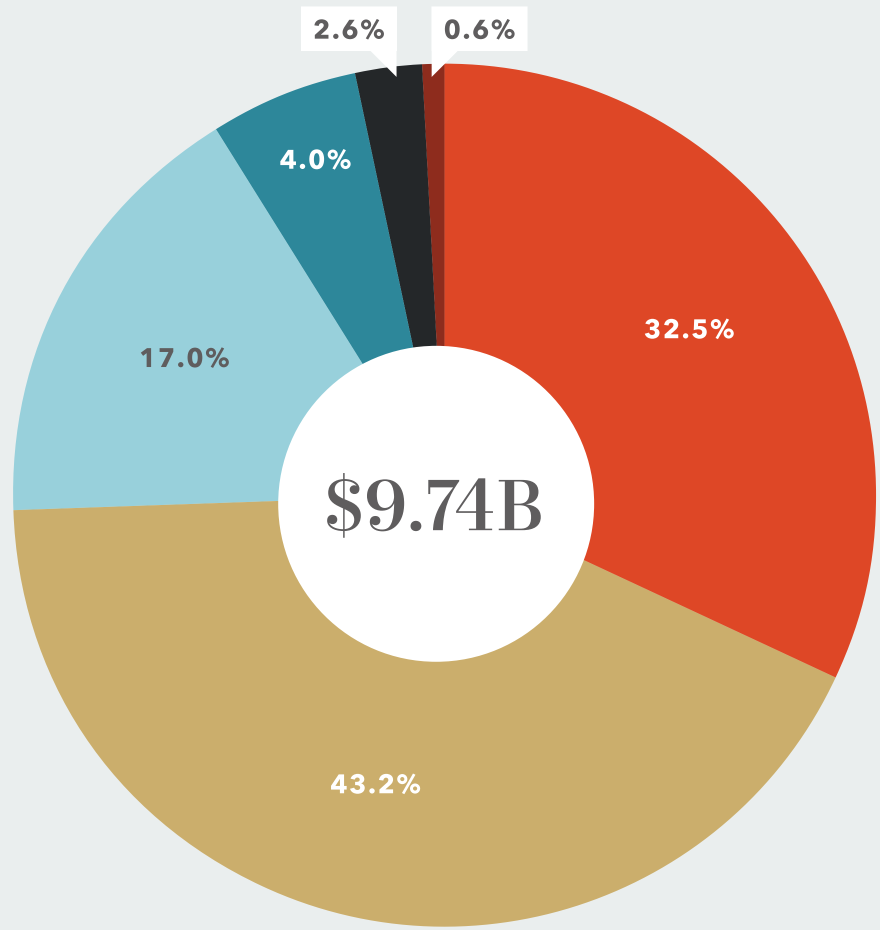
$118B
Other

2018 PUGET SOUND MULTIFAMILY LOAN ORIGINATIONS

Our survey includes all multifamily loans over $1 million originated in King, Pierce, Snohomish, and Kitsap.

While the agencies have nearly 50% national market share, they only account for one-third of originations in our region. The high concentration of bank and insurance company lending reflects the Puget Sound's desirability as a global investment center, but their competition for assets is primarily focused on "core" areas. As shown on the Originations by County exhibit in this section, Fannie Mae and Freddie Mac have more than 50% market share in Pierce, Snohomish, and Kitsap Counties, with significantly less competition from other lenders in those markets.

IMPORTANT NOTE: PUGET SOUND DATA IN THIS STUDY COVERS NEW LOAN ORIGINATIONS, WHEREAS THE NATIONAL DATA COVERS TOTAL LOAN BALANCES.



$3.17B
Agency

$4.21B
Banks

$1.66B
Life Insurance

$392M
CMBS

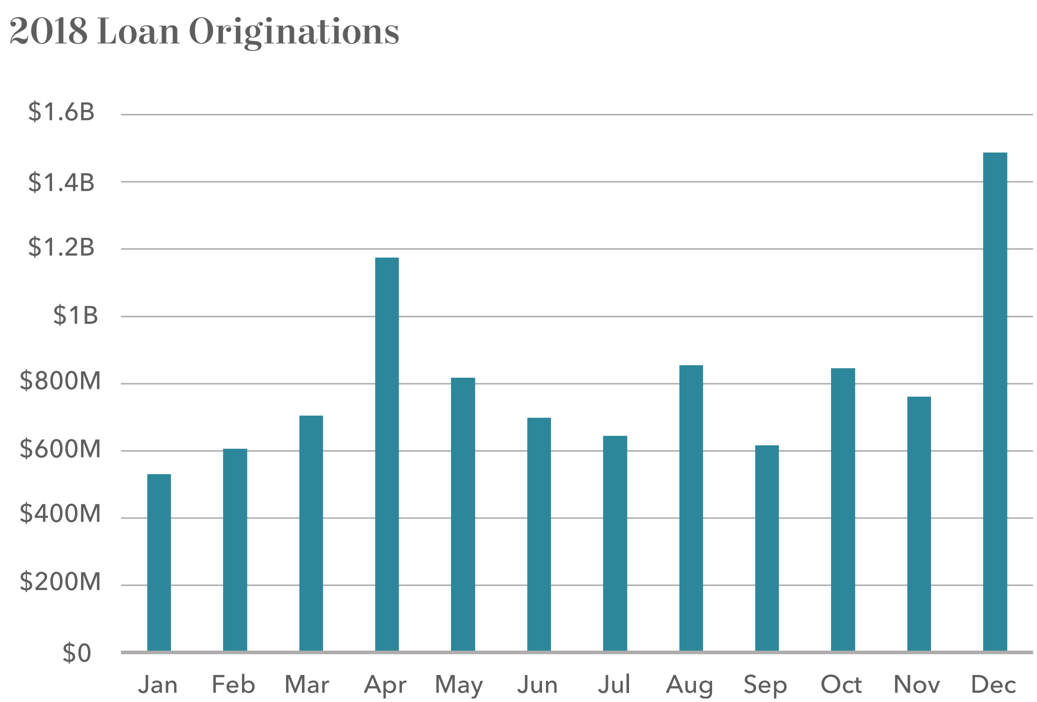
$254M
Debt Fund

$63M
Other

2018 PUGET SOUND MULTIFAMILY LOAN ORIGINATIONS BY TIME OF YEAR

As in 2018, originations tend to ramp up at the end of the year and fall off in Q1.

Starting the loan process at the beginning of the year can be a good way to limit competition. More detail on 2018 originations is shown on the chart below. Of note are loan counts and average loan sizes. Banks and agency lenders are the deal factories, while life insurance companies and CMBS focus on large loans.



2018 MULTIFAMILY LENDING IN THE PUGET SOUND REGION

Lender Type	Loan Volume	% of Total	Loan Count	Average Loan Size
Banks	$4.21B	43.2%	537	$7.8M
Agency	$3.17B	32.5%	215	$14.7M
Life Insurance	$1.66B	17.0%	51	$32.5M
CMBS	$392M	4.0%	24	$16.3M
Debt Fund	$254M	2.6%	35	$7.3M
Other	$63M	0.6%	24	$2.6M
Total / Average	**$9.74B**		**886**	**$11.0M**

LENDER TYPES

AGENCY | BANKS | LIFE INSURANCE | CMBS | DEBT FUNDS

AGENCY

This category refers to licensed correspondents that facilitate loans through Fannie Mae, Freddie Mac, and Ginnie Mae. They are the dominant lenders in Pierce, Snohomish, and Kitsap, but they take the #2 spot in King.

The agencies excel at providing competitive long-term financing, with standard features being non-recourse and partial to full-term interest-only. In low cap rate markets like the Seattle area, interest-only is a "make or break" feature for cashflow-oriented investors. Small balance lending (less than $7.5 million for Freddie Mac and $6 million for Fannie Mae) makes up 50% of total agency loan count.

2019 UPDATE

Fannie Mae and Freddie Mac have a combined lending cap of $70 billion per year, but exclusions for "green" and "affordable" buildings enabled them to lend more than $140 billion in 2017 and $142 billion in 2018. New loan requests skyrocketed as interest rates dropped in summer 2019, and the agencies increased pricing in Q3 to keep market share from rising to a point that created additional political risks.

Uncertainty about the agencies' future was put to rest in September, at least temporarily, when the Federal Housing Finance Administration (FHFA) announced that the combined annual lending cap would increase from $70 billion in 2019 to $160 billion in 2020. There are no exclusions from the new lending cap, but at least 37.5% of new loans must be on "affordable" properties. Notable takeaways are that Fannie Mae and Freddie Mac will continue to be the dominant force in multifamily finance for the foreseeable future, properties considered "affordable" will continue to receive pricing discounts, and pricing incentives for green improvements will change as they're no longer excluded from lending caps.

CBRE — 2018 Top Agency Lender

PUGET SOUND AGENCY STATS 2018-2019

27	Total No. Active Lenders
$15.2M	Average Loan Size
↑ 24%	YOY Change (Jan - Jul)

BANKS

This category refers to loans originated to hold in bank portfolios.

Banks and credit unions were the largest originators of new multifamily debt in the region in both 2018 and 2019. Despite a year-over-year decline in originations through July, they were still the largest category by market share.

Banks and credit unions offer a diverse array of commercial real estate lending products, with some organizations having multiple lines of business offering different services. Although banks dominate new construction financing, some institutions focus exclusively on permanent debt and compete aggressively with the agencies. Loan amounts are typically constrained by debt service coverage (DSC) with a minimum range of 1.20–1.25 DSC being the standard requirement for all loan types.

WELLS FARGO — 2018 Top Bank Lender

PUGET SOUND BANK STATS 2018-2019

78	Total No. Active Lenders
$7.3M	Average Loan Size
↓ 13%	YOY Change (Jan - Jul)

LIFE INSURANCE

This category refers to loans originated to hold on life company and pension fund balance sheets.

Life insurance companies generally focus on long-term debt for Class A assets in core markets. Minimum loan sizes are typically $10–$20 million, yet some life companies compete in the $5 million to $10 million space. Offerings also include bridge financing, construction financing, participation loans, and equity investment. 2019 originations through the first seven months of the year grew by an impressive 43% vs 2018. Growth in originations has been driven by aggressive take-out financing on new Class A apartment buildings.

Pension funds, which make up a small portion of the multifamily lending market, are included in this category.

PGIM — 2018 Top Life Insurance Lender

PUGET SOUND LIFE INSURANCE STATS 2018-2019

32	Total No. Active Lenders
$38.3M	Average Loan Size
↑ 43%	YOY Change (Jan - Jul)

citibank

2018 Top CMBS Lender

PUGET SOUND CMBS STATS 2018-2019

10	Total No. Active Lenders
$21.0M	Average Loan Size
↑ 164%	YOY Change (Jan - Jul)

CMBS

This category is comprised of non-agency lenders that pool and sell multifamily mortgage-backed securities without a government guarantee.

Characteristics include competitive 10-year terms, high leverage, non-recourse, and aggressive interest-only periods.

As of the end of July 2019, CMBS lending increased 164% year-over-year in multifamily originations. We expect this trend to continue at least through Q3 2019. CMBS lending exploded in 2019 because of the GSE pullback in Q3 and a sharp decline in rates. Unlike the competition, many CMBS lenders avoided rate floors and were able to maintain interest rate spreads as benchmarks fell. We saw conservative 10-year deals being done at less than 3% when benchmarks hit bottom in early September.

PYATT/BROADMARK MANAGEMENT, LLC

2018 Top Debt Fund Lender

PUGET SOUND DEBT FUND STATS 2018-2019

35	Total No. Active Lenders
$7.3M	Average Loan Size
↑ 84%	YOY Change (Jan - Jul)

DEBT FUNDS

Debt funds include traditional "hard money" lenders, bridge funds offered by agency correspondents and CMBS lenders, and a variety of leveraged and unleveraged investment pools.

Debt funds make up a relatively small but growing sector of multifamily lending. Most focus on construction and bridge financing, and occasionally provide short-term debt for stabilized properties. Debt funds are typically constrained by loan-to-value instead of debt service coverage, and have relatively low regulatory burdens and efficient processes.

2019 PUGET SOUND MULTIFAMILY LOAN ORIGINATIONS

Our study includes 2019 originations from January to July, which are shown below against the same 2018 period to adjust for seasonality.

Loan count is flat compared with 2018, but dollar volume is up 16%. We expect 2019 to end strong given the late summer interest rate slide and an increase in apartment sales volume driven by the excise tax increase effective January 1, 2020. A notable takeaway from the 2019 data is growth in CMBS and debt funds. CMBS has more effectively competed against the agencies compared to prior years, and the number of active debt funds continues to grow.

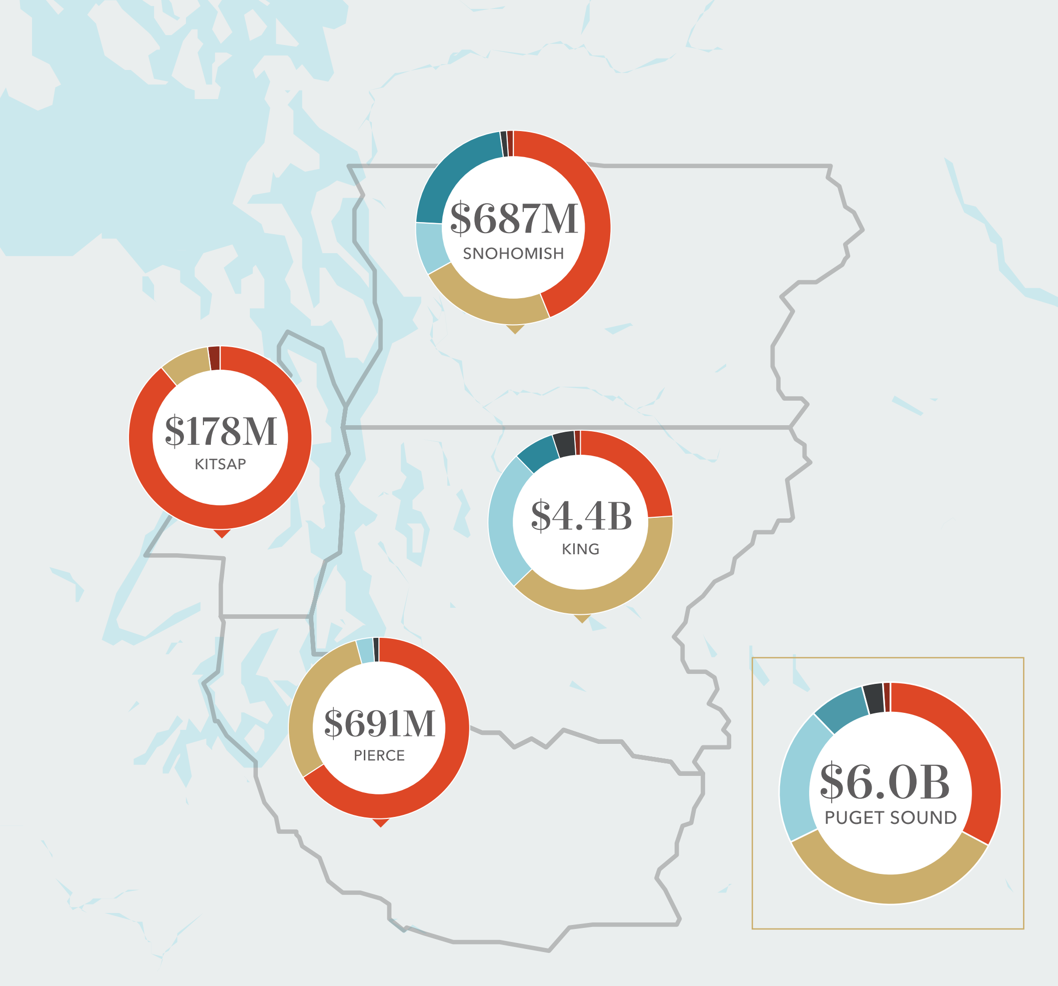
2019 JANUARY TO JULY

Lender Type	Loan Volume	% of Total	Loan Count	Average Loan Size	YOY Change
Banks	$2.10B	35.0%	330	$6.4M	-13%
Agency	$2.00B	33.4%	125	$16.0M	24%
Life Insurance	$1.18B	19.7%	23	$51.2M	43%
CMBS	$472M	7.9%	17	$27.8M	164%
Debt Fund	$212M	3.5%	29	$7.3M	84%
Other	$36M	0.6%	12	$3.0M	-11%
Total / Average	**$5.99B**		**536**	**$11.2M**	**16%**

2018 JANUARY TO JULY

Lender Type	Loan Volume	% of Total	Loan Count	Average Loan Size
Banks	$2.41B	46.5%	338	$7.1M
Agency	$1.61B	31.1%	119	$13.5M
Life Insurance	$827M	16.0%	26	$31.8M
CMBS	$179M	3.4%	15	$11.9M
Debt Fund	$115M	2.2%	18	$6.4M
Other	$41M	0.8%	17	$2.4M
Total / Average	**$5.12B**		**533**	**$9.7M**

2019 ORIGINATIONS BY COUNTY



Loan volumes by county show a stark difference between King County and the rest of the region.

National and regional banks and life insurance companies are very active in the region's core, with life insurance companies actually holding slightly higher market share than the GSEs. Snohomish also attracts a significant amount of interest from national CMBS lenders, banks, and life insurance companies. Pierce and Kitsap, on the other hand, are dominated by the GSEs.

	KING		PIERCE		SNOHOMISH		KITSAP	
Lender Type	Total	%	Total	%	Total	%	Total	%
Banks	$1.72B	39%	$207M	30%	$157M	23%	$16M	9%
Agency	$1.08B	24%	$458M	66%	$304M	44%	$160M	90%
Life Insurance	$1.10B	25%	$18M	3%	$61M	9%	-	-
CMBS	$319M	7%	-	-	$153M	22%	-	-
Debt Fund	$197M	4%	$8M	1%	$7M	1%	-	-
Other	$29M	1%	-	-	$5M	1%	$3M	2%
Total	**$4.44B**		**$691M**		**$687M**		**$178M**	

02 INTEREST RATES

2018 STEADY CLIMB

2019 RATE ROLLER COASTER

THE EFFECT OF VOLATILITY

YIELD CURVE

2020 OUTLOOK

Kidder Mathews

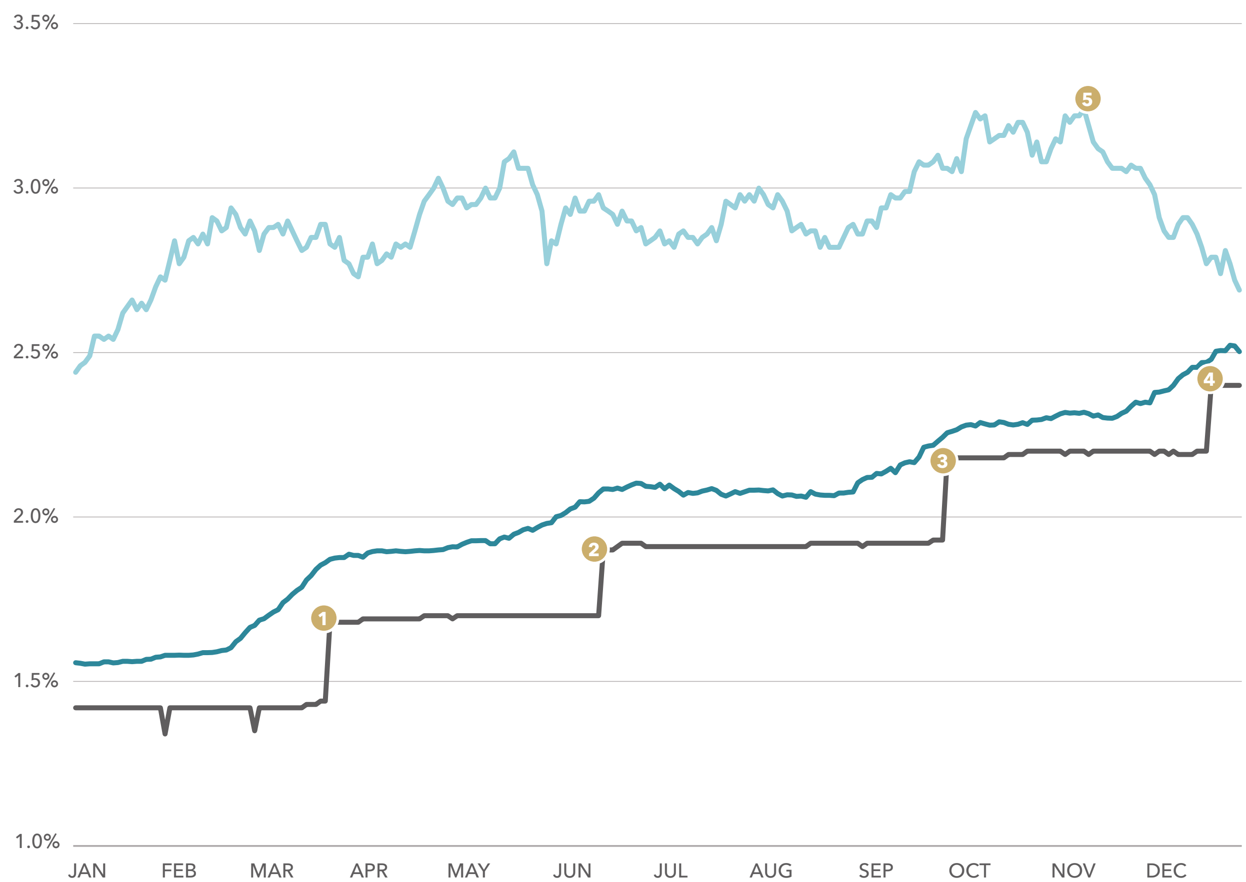
2018 STEADY CLIMB

Despite gradual rate increases, 2018 was a relatively stable year.

The Fed raised its target rate four times, in-line with market expectations, and both short-term and long-term rates followed suit. Economic growth of about 3% in Q1 through Q3 provided logical support for rate increases, and Fed officials expected to keep raising rates in 2019.

The plan changed in Q4. Domestic growth slowed, foreign growth slowed, and the market stopped believing in further rate cuts. After peaking at 3.24% in November, the 10-year treasury fell by more than a half percent by the end of the year.

CHANGE IN FEDERAL RATE & TREASURY BENCHMARKS



1	**MARCH 21**	Fed target raised to 1.50%
2	**JUNE 13**	Fed target raised to 1.75%
3	**SEPTEMBER 26**	Fed target raised to 2.00%
4	**DECEMBER 19**	Fed target raised to 2.25%
5	**NOVEMBER 8**	10-Year treasury peaks at 3.24%

10-YEAR TREASURY
1-MONTH LIBOR
FED FUNDS RATE

Source: US Treasury Data / Economagic.com

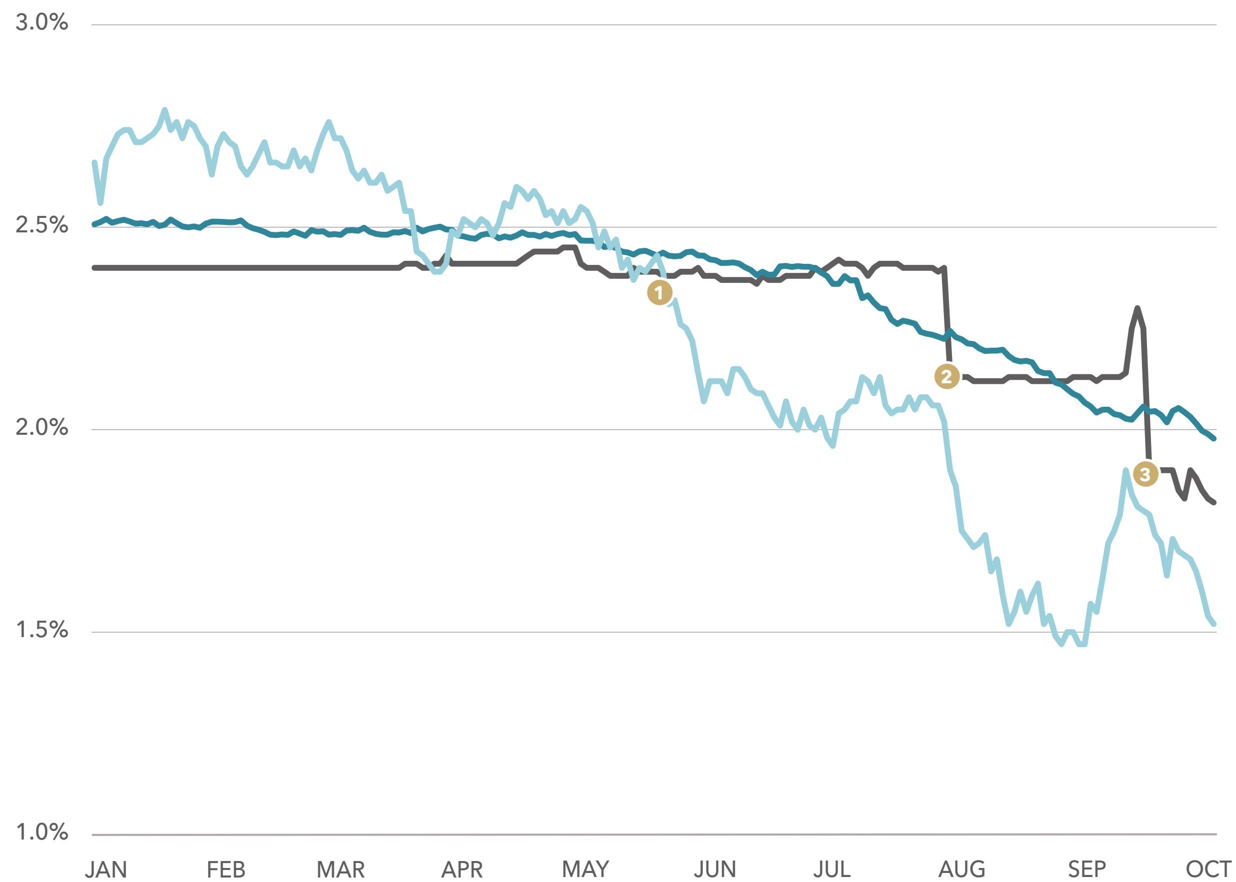
2019 RATE ROLLER COASTER

Fed Chair Jerome Powell softened his stance on further rate increases in early 2019, and rates fell throughout the year in anticipation of easier monetary policy.

Tensions with China, slowing global growth, and a series of high-profile tweets may have contributed to the market's expectations that the Fed would start lowering its rate targets in Q3.

The Fed finally reduced its benchmark rate by 0.25% on July 31, setting off a volatile series of rate swings in late summer and early fall. Between August 1st and this writing, the 10-year treasury yield plunged to 1.47%, jumped to 1.90%, plunged again to 1.53%, and jumped again to 1.80%.

CHANGE IN FEDERAL RATE & TREASURY BENCHMARKS



1	**MAY 23**	10-Year treasury at 2.31% drops below the target Fed Funds rate
2	**JULY 31**	Fed target lowered to 2.00%
3	**SEPTEMBER 18**	Fed target lowered to 1.75%

Source: US Treasury Data / Economagic.com

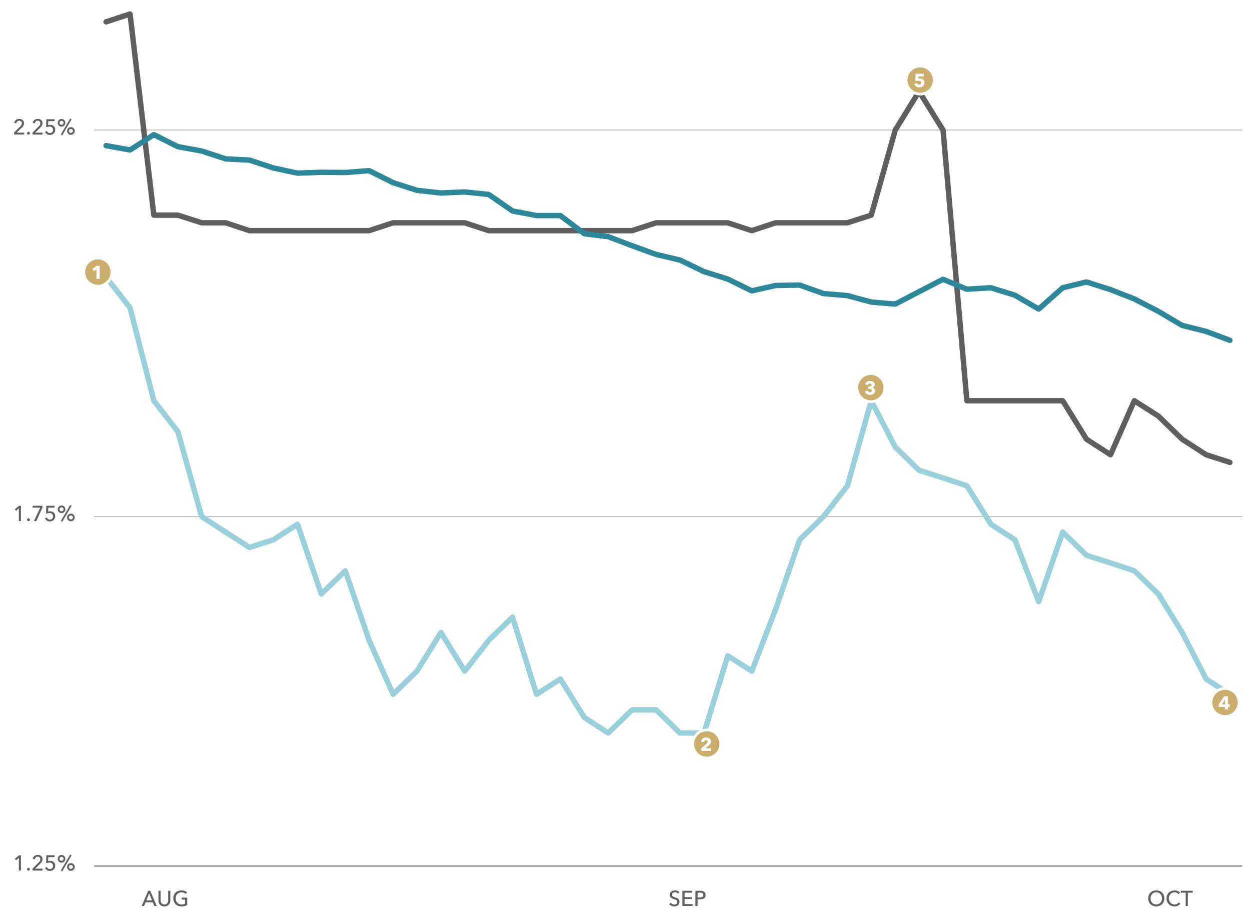
THE EFFECT OF VOLATILITY

A challenge with volatility is that most lenders have trouble reacting quickly to extreme changes.

In a stable market, a gradual 0.10% drop in the 10-year treasury tends to coincide with a 0.10% drop in 10-year interest rates, but the same can't be said of a rapid 0.50% drop. The fast changes in August and September spurred most lenders to implement pricing floors in the mid- to high-3% range rather than continue chasing rates down to the bottom.

Still, apartment rates have improved dramatically since the beginning of the year. A competitive, fully-leveraged 10-year loan with a balance of $5 million or higher was priced at about 4.4% at the start of the year, 3.7% in late July, and in the mid-3% range in September.

CHANGE IN FEDERAL RATE & TREASURY BENCHMARKS | 2019



1	JULY 31	10-Year treasury rate is 2.02%
2	SEPTEMBER 4	10-Year treasury rate is 1.47%
3	SEPTEMBER 13	10-Year treasury rate is 1.90%
4	OCTOBER 4	10-Year treasury rate is 1.52%
5	SEPTEMBER 17	Fed Funds Rate hits 2.30% in pre-meeting spike

10-YEAR TREASURY
1-MONTH LIBOR
FED FUNDS RATE

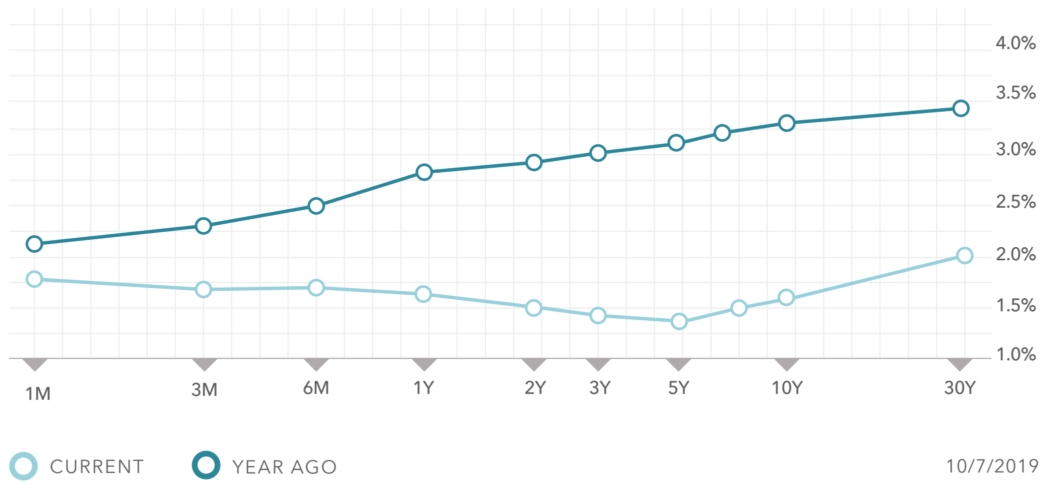
Source: US Treasury Data / Economagic.com

YIELD CURVE

The yield curve was partially inverted most of the year, which reflects market expectations of easy monetary policy and low inflation.

The yield curve is now flattening, but long-term debt remains inexpensive relative to short-term debt. Five-year fixed rates are on par with variable rate debt.

US TREASURIES



2020 OUTLOOK

The CME group publishes probabilities of future rate decreases based on trades in the futures markets.

As of this writing, these notes show an 85% chance that the Fed will reduce rates at least once more in 2019. Predictions about 2020 are murkier, but participants clearly expect continued cuts with a 70% probability of two or more cuts by next April. For apartment investors, signs point to declining short-term rates and continued downward pressure on long-term rates. Global growth has continued to slow, and it's doubtful the Fed will change course in an election year.

NOTE: THE TARGET RATE REPRESENTS THE LOW END OF THE FED'S TARGET RATE RANGE (I.E. 1.75% TARGET INDICATES A TRUE TARGET RANGE OF 1.75% TO 2.00%).

UPCOMING FED MEETINGS

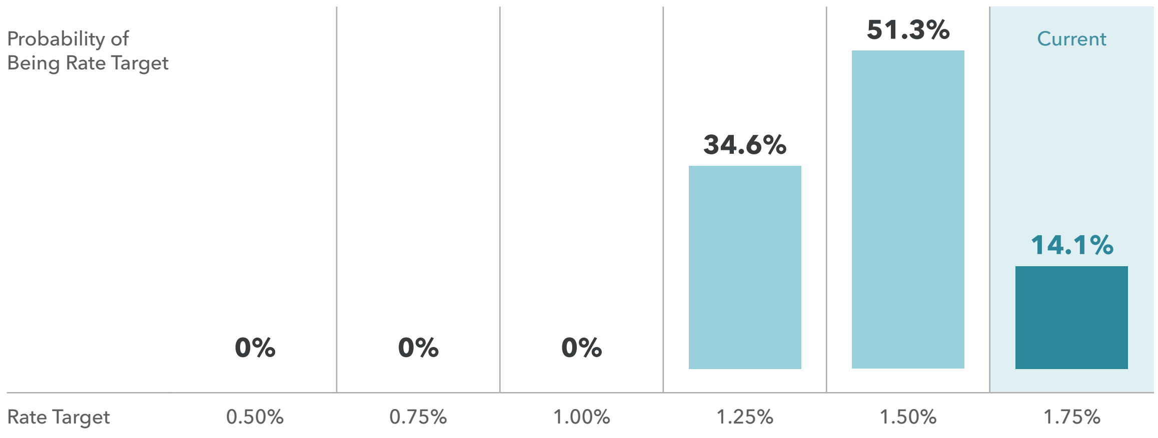
OCTOBER 29-30

75% probability of rate decrease to range of 1.50%-1.75%

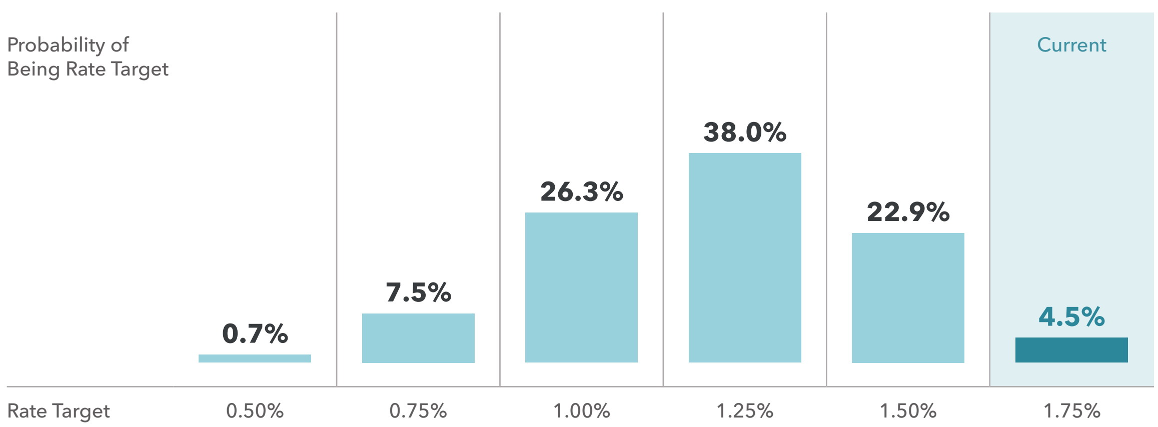
DECEMBER 10-11

50% chance rates hold from prior meeting

TARGET RATE PROBABILITIES FOR DECEMBER 11, 2019 FED MEETING



TARGET RATE PROBABILITIES FOR APRIL 29, 2020 FED MEETING



CURRENT TARGET RATE OF 1.75% TO 2.00%

10/7/2019

Our team is focused on providing absolute best-in-class brokerage services to apartment developers, investors, and owners in Seattle and the broader Puget Sound region.

Although we have brokered hundreds of millions of dollars of apartment transactions over the years, our approach to the brokerage business is modern and dynamic. We perform all of the traditional tasks associated with apartment and loan brokerage, yet our clients gain the advantage of modern advisory practices and services.

We think and act in terms of absolute market expertise, exposing arbitrage opportunities and achieving best-in-class sales results. We inspire trust and confidence in our guidance to the market by leveraging data and information to develop Profitable Insights™ on the market. Our clients excel by having an unfair advantage over the marketplace.

SERVICES OFFERED

LOAN BROKERAGE for construction, bridge, and permanent financing

SALE of stabilized apartment buildings – five units to 500 units

OFF-MARKET pursuits of pre-sale and stabilized apartment buildings

SALE of development land, both apartments and mixed-use

STRATEGIC disposition of apartment portfolios

Let us turn our expertise into your profit!

DATA SOURCES

LOAN ORIGINATIONS

Black Knight Services

RCA Analytics

Trepp

Reonomy

Mortgage Bankers Association

INTEREST RATES

US Treasury

CME Group

Wall Street Journal

Economagic.com

SPECIAL THANKS TO OUR TOP DATA PROVIDER:

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2019 MULTIFAMILY LENDING MARKET UPDATE

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