

## Commercial Real Estate Debt Musical Chairs



**William Bennett**  
Managing Director



**Ted Jung**  
Vice President

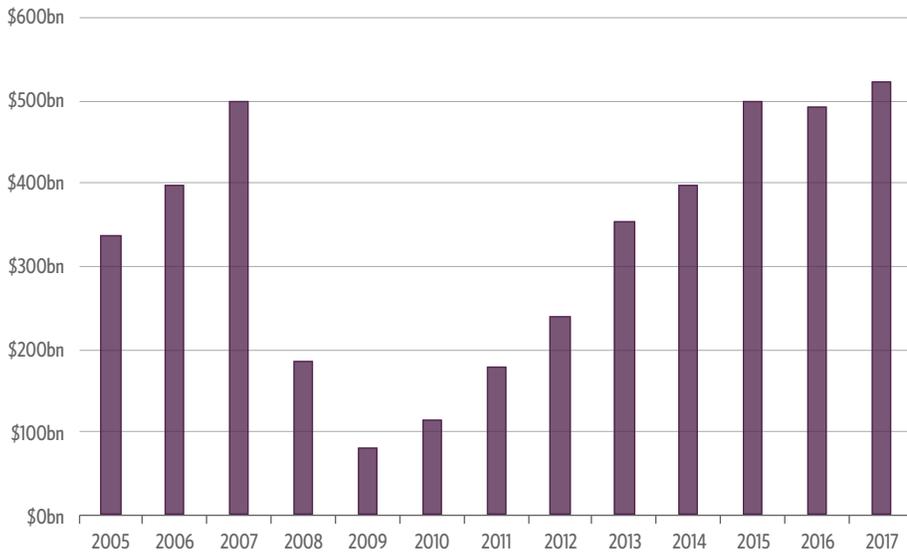
With falling sales volume and normalized maturities, the supply of mortgage loan opportunities will be significantly less this year.

Mortgage origination volumes of \$540 billion in 2017 broke the record set in 2007 (see chart, top right), but we do not believe this trend will continue in 2018. While lender demand remains strong, supply is likely to wane due to declining sales activity and lower new construction completions for most property types. Additionally, most borrowers likely to refinance have already done so, and Agencies have signaled skepticism about the potential for continued origination growth after two years of frenzied activity, particularly in multifamily originations that accounted for 44 percent of new loans.

Our sector has attracted nontraditional lenders to the market, which warrants some attention as it could lead to an oversupply of capital. Private funds have seen a significant increase in lending volume over the past two years, and this is expected to increase again in 2018 (see chart, bottom right). Private funds have raised equity capital faster than they are investing it and have turned to mortgage debt to provide short-term high yields to their investors. These private funds initially tried to fill the void left by banks on first-lien construction loans and have since migrated to bridge financing to deploy funds and provide yield. Banks and life insurance companies have a strong appetite for bridge financing. As with any supply/demand imbalance, spreads have tightened for this product and all product types other than construction loans in the first quarter. We do not expect this trend to change for the rest of the year barring an unforeseen disruption in the markets. Instead, competition for product will put downward pressure on pricing and, perhaps more worrisome, underwriting will get more aggressive to win transactions.

As Libor rates continue to rise, we see opportunities for lenders that can provide fixed-rate coupons for bridge transactions as a way to differentiate from the pack. With the cost of new construction still increasing, we are constructive on the bridge transitional product as a way for borrowers to compete at a lower rental basis. With 10-year Treasury yields near 3 percent, longer-term loans beyond 10 years are becoming more attractive and have less competition than traditional seven- and 10-year terms.

### Mortgage Origination Is Likely to Slow in 2018

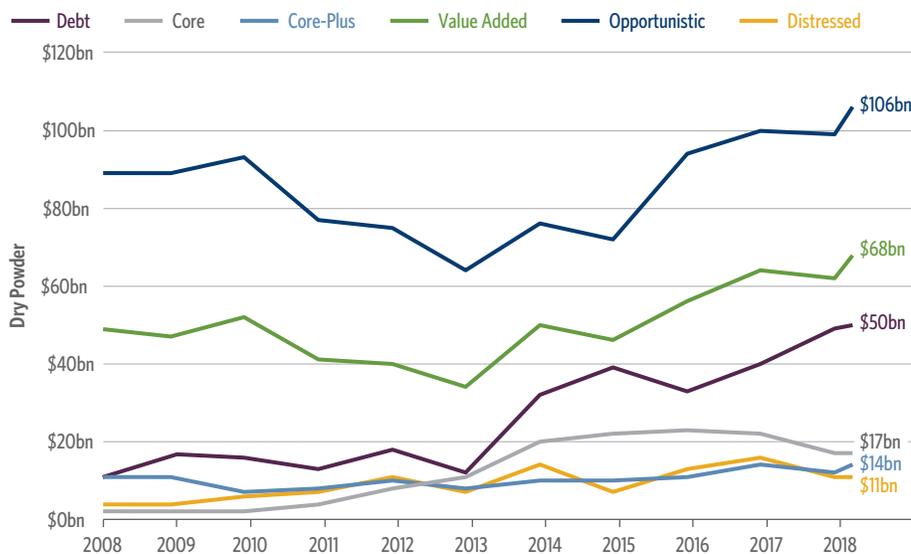


Source: Mortgage Bankers Association CREF Database. Data as of 12.31.2017.

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### Debt Funds Show Signs of Significant Growth

Closed-End Private Real Estate Dry Powder by Fund Type



Source: Preqin, Guggenheim Investments. Data as of 3.31.2018.

Strong demand has attracted nontraditional lenders to the market. Private funds have seen a significant increase in lending volume over the past two years, and this is expected to increase again in 2018 given substantial dry powder. This could result in an oversupply of capital and may lead to further deterioration in underwriting standards.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-backed securities, may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Real Estate, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2018, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.