MBA

Lenders Brace for Change

The rise in securitized financing is the tip of the iceberg for an industry in transition. **By Jamie Woodwell**

From tenancy-in-common to environmentally efficient buildings to data standards, the vast array of issues shaping today's real estate finance market are not the same ones on which most of us cut our teeth. The changes facing the industry, and the pace of those changes, are dizzying and are making it harder than ever for industry leaders to keep their businesses tuned to transformations within the market.

In early August, The Council to Shape Change, an independent group of 19 industry leaders representing diverse business models across the single-family, commercial and multifamily real estate finance industry, released a forward-looking report entitled "Outlook for the Real Estate Finance Industry."

The council met monthly from January to June of this year to hear from academic, government and business experts and to discuss the forces shaping change over the next decade. The council was created by the Mortgage Bankers Association (MBA) to provide insights into its strategic planning processes, as well as that of its members.

AGING APARTMENT STOCK*

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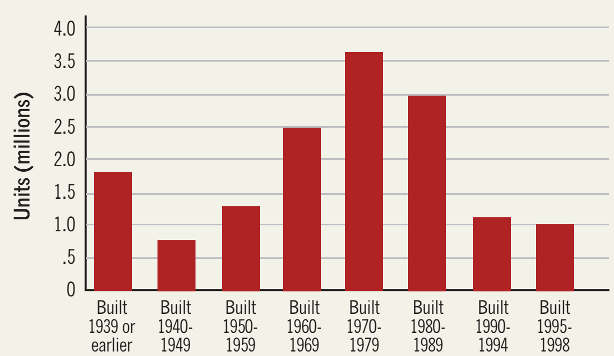

* Renter-occupied units in buildings with five or more units

Source: Decennial Census, MBA

The council's findings are comprehensive, and the book is laid out in a straightforward way. Although the findings of the council do not reflect the opinions of MBA or of the respective companies serving on the council, they do provide a unique view of what may lie ahead for the real estate finance industry.

Required skills for future success

Among its conclusions, the group noted that to be an effective leader in the real estate finance industry 20 years ago, a CEO had to understand sales. A decade later, that executive had to understand the secondary markets. Now, that exec needs to understand accounting and finance.

Tomorrow's finance leaders will need a new set of skills — including an understanding of how to integrate technology into their business; how to attract, train and retain a more diverse workforce; and how to serve a more diverse marketplace. These new demands on leadership are just the tip of the iceberg. Among the council's other conclusions:

• Securitization now dominates as the primary funding source for the real estate finance industry, and structured product credit markets are global. Securitization is increasingly used to disperse credit as well as interest rate risk, particularly through the use of Collateralized Debt Obligations (CDOs) — which tranche and sell security interests in pools of real estate and other debt — and other synthetic securities. This trend will continue.

• Demand for space will grow with the economy, including increased demand for Class-A space in high-quality markets. A large number of existing properties will become functionally obsolete in the coming decade, creating additional demand for construction/rehabilitation financing.

• The threat of increased weather hazards poses a significant — and likely underappreciated — risk to the commercial/multifamily markets.

• There will be a continued blurring of the lines between traditional first-lien mortgages and other secured and unsecured financing. The result will be a more investment, bank-like relationship between large borrowers and lenders.

• The tension between technology as an enabler and technology as an inhibitor is likely to grow as technology development lags behind the continued innovation of real estate finance products.

• The real estate finance industry will be shaped more like a barbell in coming years, with a few very large integrated firms, numerous small specialist firms, and a declining number of mid-sized institutions that will gradually be forced to move to one or the other end of the spectrum. We are likely to see consolidation across both the single-family and commercial/multifamily sides of the industry — as many of the same drivers are pushing consolidation in both sectors along with a healthy group of small players serving distinct market niches.

• Even as large firms gain market share, particularly in retail originations and servicing, consolidation will create opportunities for smaller, more nimble firms. Without the costly infrastructure and bureaucracy of their larger competitors, the best of these firms will quickly act on niche opportunities.

As MBA, real estate finance firms and others consider the council's conclusions in their business activities and strategic planning, we can be certain that the industry will be better prepared to adapt to changes in the years ahead. The council's report is available through the MBA website, www.mortgagebankers.org.

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