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MylesTitle's 4th Quarter 2016
Advisory Council Breakfast & Seminar

Solutions to Key Maryland Real Estate Issues:

THE COMMERCIAL REAL ESTATE (CRE) CRYSTAL BALL -- 2017 & BEYOND: THE GOOD, THE BAD, THE UGLY: DISCOVER OPPORTUNITIES!!

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Hayfields Country Club
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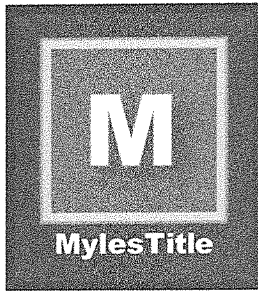

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OUTLINE FOR MYLES LICHTENBERG
OCTOBER 20, 2016 MYLESTITLE ADVISORY COUNCIL BREAKFAST & SEMINAR

A. Introduction and History of Advisory Council
B. Introduction of Speakers
   1. Michael G. Gallerizzo, Esquire
      Gebhardt & Smith LLP
   2. Thomas A. Sychuk
      BB&T Commercial Real Estate
   3. T. Courtenay Jenkins, III
      Cushman Wakefield
   4. Thomas H. Maddux
      KLNB
C. The "Storm Brewing" in the CRE Market – PIMCO Article by John Murray and Anthony Clarke
   1. Volatility in Public Markets
      a. Steady increase primarily due to capital flows (overall office prices have doubled since 4Q 2009 yet rents only risen 15%)
      b. Capital flows grown unstable over past year due to interest rate hikes, political and economic uncertainty in China
      c. REIT's trading below net asset value (NAV) turning REIT's to sellers
      d. Opportunity – Attractive entry point for capital that understands public CRE debt (CMBS), CMBS structure and underlying assets; and on the public equities side sell-off's create opportunity for investment in CRE
   2. Post Financial Crisis Regulations
      a. Dodd-Frank Act
      b. Federal Reserve's Comprehensive Capital Analysis and Review (CCAR)
      c. Bank's reduced their balance sheet inventory by nearly ½ in last 2 years
      d. Hedge funds selling subordinate CMBS positions
      e. Opportunity – Regulatory pressures on CMBS should create financing gaps that could be filled by non-bank capital
   3. Loans Maturity
      a. $200 billion of 10-year CMBS loan will mature over next 3 years
      b. $50 billion of 10-year CRE debt and equity funds winding down in next 3 years
      c. 'Extend and Pretend' vs. investors rights to force liquidation
      d. Opportunity – Alternatives to Foreclosure (Deeds in Lieu, Note Sales), Foreclosures
   4. Foreign investors in CRE market – Centered on major markets
      a. Combination of negative interest rates in Europe and Japan, fears of currency devaluation in Latin America and Asia and desire for a "safe yield" have inspired long term investment by foreigners
      b. Ballooned from $22 billion in 2012 (8% of total volume) to $84 billion in 2015 (16% of total transactions volume)
      c. Sovereign wealth funds (Norway $17 billion, China $35 billion)
      d. President Obama signed Protecting American From Tax Hikes (PATH) Act of 2015 reduces taxes on U.S. CRE for many foreign pension funds

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FEATURED SOLUTION

PIMCO Alternatives

U.S. Real Estate: A Storm Is Brewing

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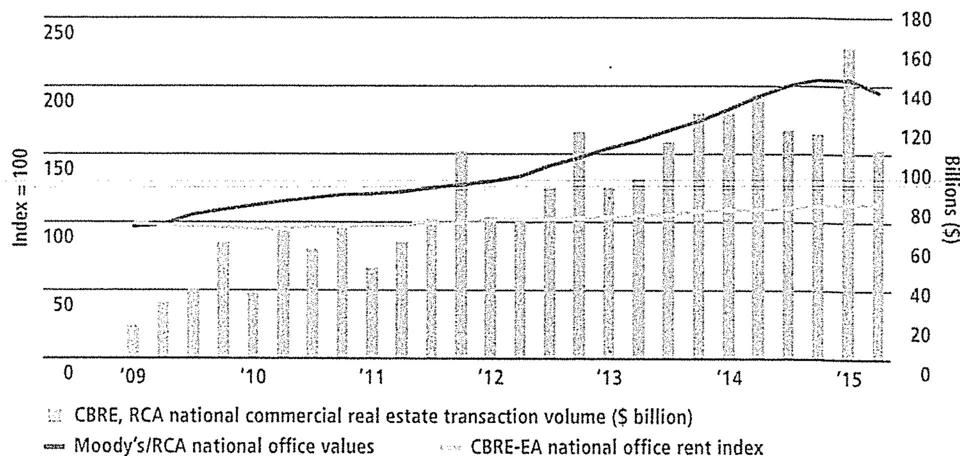
Storms form when moisture, unstable air and updrafts interact. Similarly, a confluence of factors – volatility in public markets, tightened regulations, maturing loans and uncertain foreign capital flows – is creating a blast of volatility for U.S. commercial real estate (CRE) that we anticipate could lower overall private U.S. CRE prices by as much as 5% over the next 12 months. For nimble investment platforms, however, these swirling winds should create attractive opportunities over the secular horizon.

After the financial crisis, which sent prices sharply lower, commercial real estate in the U.S. has enjoyed growth with solid fundamentals. Rents have steadily increased and demand generally continues to exceed supply. Improving fundamentals, though, have not been the primary driver of higher CRE prices. Consider this: Since the fourth quarter of 2009, overall office prices have doubled (as have general CRE prices), yet national office rents have risen only about 15% (see Figure 1). The primary price driver for U.S. CRE assets instead has been capital flows.

FIGURE 1: CAPITAL FLOWS AND ROBUST TRANSACTION VOLUMES HAVE LIFTED U.S. CRE PRICES MORE THAN RISING RENTS



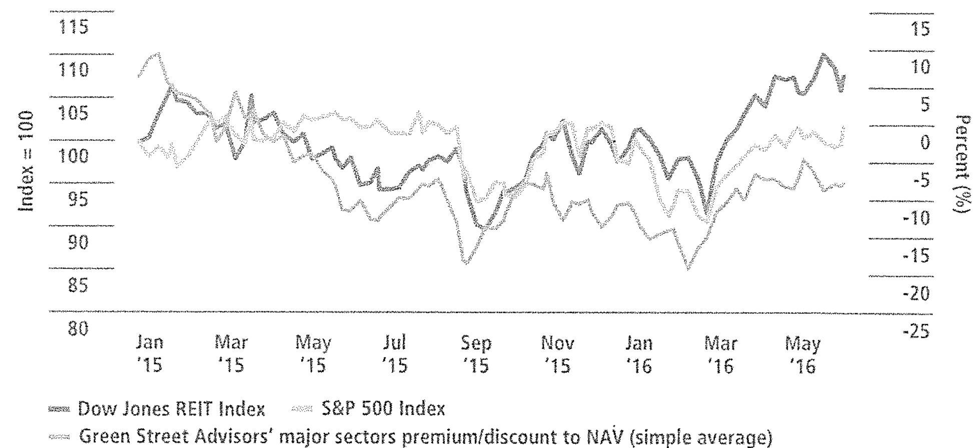
Source: CBRE and Moody's/RCA Commercial Property Price Indices as of March 2016

But capital flows have grown unstable over the past year due to fears over interest rate hikes and, more recently, events such as political and economic uncertainty in China. While this instability began in the public CRE markets, it has blown in to private CRE as well, particularly in non-major markets.

CHANGING DIRECTIONS: REIT DEMAND HIT BY MARKET VOLATILITY

Real estate investment trusts (REITs) are generally registered with the SEC and publicly traded on a stock exchange. But they're classified and often move in tandem with financial stocks, which have been buffeted recently by global financial market volatility. Much to the dismay of REIT CEOs, daily returns of REITs have had a 71% correlation to the broader S&P Index since the beginning of 2015. The result: Despite private CRE price indexes such as Moody's/RCA Index increasing over 7% since 2014, REIT prices have been essentially flat, and dropped as much as 10% on multiple occasions over the same period (see Figure 2). As a result, REITs have generally traded below their net asset value (NAV) for the majority of the past 18 months. As capital efficiency textbooks would dictate, this persistent discount to NAV has turned many REITs from net buyers to net sellers of U.S. CRE, suppressing a major buyer within the market.

FIGURE 2: REITS AND STOCKS – HIGHLY CORRELATED



Dow Jones REIT Index
S&P 500 Index
Green Street Advisors' major sectors premium/discount to NAV (simple average)

Source: Bloomberg as of 3 June 2016

To put this into perspective, REITs acquired about $54 billion annually of private CRE from 2012 to 2014 (some 15% of total transaction volume), according to Real Capital Analytics. However, in the second half of 2015 acquisitions plunged to $17 billion (less than 8% of total transaction volume) due to heightened volatility.

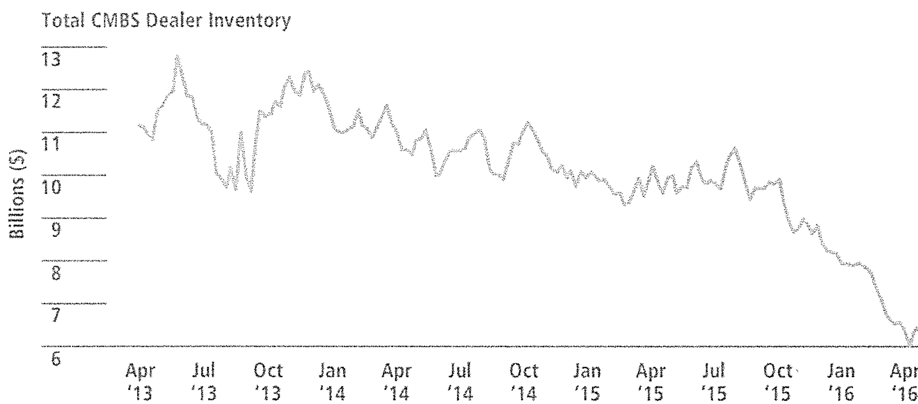
In August of 2016, REITs will be reclassified as their own sector within the Global Industry Classification Standard, which could partly account for recent outperformance. While a more specific benchmark should result in increased flows to REITs from index-conscious equity funds, REITs could still be exposed to highly correlated and volatile global capital markets.

REGULATION – MORE CLOUDS AHEAD

CRE liquidity has declined in recent years, driven by post-financial crisis regulations such as Dodd-Frank and the Federal Reserve's Comprehensive Capital Analysis and Review (CCAR). This has intensified volatility for the sector during periods of broader public market sell-offs. In February, for instance, oil-induced fears in the broader high yield debt markets led to redemptions that forced several hedge funds to unload positions, including subordinate U.S. commercial mortgage-backed securities (CMBS).

Here again, the sell-off had little to do with actual CRE fundamentals. Instead, it highlighted an increasingly important headwind to U.S. CRE finance broadly – reduced bank dealer inventories. As with other areas of fixed income, banks have traditionally served as market makers in CMBS. However, in response to a variety of regulatory pressures, banks have reduced their balance sheet inventory by nearly half in the last two years (see Figure 3). The impact of this inventory reduction is clear – hedge funds hold about 40% of subordinate U.S. CMBS positions, and as they began selling to meet redemptions in February banks were unable to provide liquidity (or make a market). As a result, prices for these subordinate CMBS positions fell by as much as 20% in a matter of weeks.

FIGURE 3: DEALER INVENTORIES OF CMBS HAVE FALLEN BY NEARLY HALF



Source: Federal Reserve Bank of New York as of 4 May 2016

CMBS loan origination platforms also have been crushed by the plunge in prices, as banks and originators found their recently originated loans, intended for securitization, to be underwater based on CMBS pricing. According to Bank of America, CMBS issuance in the first quarter of 2016 tumbled by over 30%.

"CMBS loan origination platforms have been crushed by the plunge in prices, as banks and originators found their recently originated loans, intended for securitization, to be underwater based on CMBS pricing."

Not surprisingly, with CMBS representing over 20% of the debt origination market in 2015, the February fallout in CMBS had a notable impact on private CRE as well. CMBS lenders increased rates on their debt quotes by 50–100 basis points and buyers reduced property bids to maintain target returns. Indeed, broker transaction volume affirms this dynamic – first quarter transactions dropped 11% compared with the same period in 2015, according to CBRE Group.

Hardest hit were non-major markets, where CMBS represents over 35% of the non-multifamily debt origination volume. Many deals fell out of contract or re-priced down by as much as 10% to 15%.

Regulation will remain a headwind for CMBS and CRE for the foreseeable future. Later this year, another reform – new risk retention rules – will be implemented. These will require CMBS originators (or a long-term holder) to retain at least 5% of a new securitization. In essence, bank originators will have to go from a "moving business" model to a costlier "storage business" model, which in turn means lower volumes and higher rates for CRE borrowers.

Finally, recent regulations are taking a toll on another significant sector of U.S. CRE – non-traded REITs. Enacted by the Financial Industry Regulatory Authority with an implementation grace period that ended in April 2016, the rules require non-traded REITS to disclose asset-based valuations of their securities. This requirement has already revealed significant impairments to the NAV of many of these platforms.

This has dramatically affected fundraising for U.S. non-traded REITs, which fell to $9 billion in the year ending January 2016, a 30% decline from the 2013–2015 average according to HFF. Furthermore, it's likely the numbers will continue to trend down. Similar to CMBS lending, the negative impact will likely fall disproportionately on non-major markets, as non-traded REITs were relatively more aggressive in these markets.

THE WALL OF MATURITY – ROLLING THUNDER

Interestingly, the confluence of these forces comes as the U.S. CRE market is set to experience a surge in forced liquidations. As is well known, more than $200 billion of 10-year CMBS loans will mature over the next three years. Also, over the same period more than $50 billion of 10-year CRE debt and equity funds will wind down. In many cases, these legacy funds have held on to sub-performing assets to retain fees; however, at the 10-12 year point, investors typically have the right to force liquidation.

SWIRLING WINDS OF FOREIGN CAPITAL

Somewhat counterintuitively, the global public market volatility that has hurt REITs and CMBS has arguably had the opposite effect in the direct CRE investment space. Here, the combination of negative interest rates in Europe and Japan, fears of currency devaluation in Latin America and Asia and a continued thirst for "safe yield" has increasingly inspired long-term investments in U.S. CRE. As such, foreign private investment volume ballooned from $22 billion in 2012 (8% of total volume) to $84 billion in 2015 (16% of total transaction volume), according to Real Capital Analytics. Importantly, the impact has centered on major markets.

Prospectively, continued volatility could support additional foreign investment, as sovereign wealth funds remain underallocated to CRE, according to Preqin. In fact, several sovereign wealth funds have recently announced significant increases in their planned CRE investments. For example, Norway's Government Pension Fund announced plans to increase its global real estate allocation by some $17 billion; the China Investment Corporation plans to double exposure by about $35 billion.

To put this in perspective, these plans alone equated to over 10% of the total transaction volume in U.S. CRE in 2015. In addition, last December President Obama signed the Protecting Americans From Tax Hikes (PATH) Act of 2015. The law reduces taxes on U.S. CRE for many foreign pension funds and could prompt an additional $10 billion to $30 billion of cross-border investment into U.S. CRE, according to the National Association of Realtors.

That said, increasing dependence on foreign demand creates even more uncertainty for U.S. CRE, as capital flows are far from guaranteed: China has hinted at increased controls on capital outflows; lower oil prices could curtail investment from the Middle East and Canada; and even certain U.S. presidential outcomes could influence foreign investors' confidence in U.S. CRE assets.

WEATHERING THE STORM: UNCERTAINTY AND VOLATILITY CREATE OPPORTUNITY

The pressure from volatility, regulations, maturing loans and uncertainty over foreign capital flows suggests prices could slump by as much as 5% over the next 12 months, with a disproportionate impact on secondary and tertiary markets.

However, this dynamic could create opportunities across U.S. CRE debt and equity markets, both public and private. In public CRE debt (CMBS), reduced dealer inventories and the 10-year maturity wall will quickly alter underlying credit profiles in CMBS and could create attractive entry points for nimble capital that understands CMBS structure and the underlying CRE assets. Similarly, on the public equities side, broad sell-offs like those in January and February will likely create opportunities to invest in CRE at potentially cheaper levels than the underlying private assets, with potentially even better liquidity. On the private side, regulatory pressures in CMBS should create financing gaps that could be filled by non-bank capital through subordinate debt or preferred equity. Finally, sustained periods of public market volatility, as well as disproportionate foreign capital demand for core assets, could create attractive arbitrage opportunities for larger platforms that can acquire mixed portfolios from forced sellers.

For flexible capital, this storm might be a welcome one indeed.

BIOGRAPHIES

John Murray

Mr. Murray is a managing director and a portfolio manager in the Newport Beach office, and is co-head of U.S. commercial real estate. Prior to joining PIMCO in 2009, he structured real estate transactions throughout the U.S. at JER Partners. Before JER Partners, Mr.Murray was in commercial real estate development and construction and also served as a combat engineer officer with the U.S. Army. He has 15 years of investment experience and holds an MBA from the Wharton School of the University of Pennsylvania. He also holds a master's degree in civil engineering from MIT and a bachelor's degree from Lehigh University.

Anthony Clarke

Mr. Clarke is a vice president and commercial real estate portfolio manager in the Newport Beach office. Prior to joining PIMCO in 2014, he focused on real estate acquisitions throughout the United States at Walton Street Capital. He has four years of investment experience and holds graduate and undergraduate degrees in civil engineering from Stanford University.

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MYLES TITLE
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The Commercial Real Estate Crystal Ball – 2017 & Beyond….

OCTOBER 20, 2016

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OUTLOOK FOR RETAIL SHOPPING CENTERS

Maryland, D.C. & Virginia

- **Market conditions look favorable for Class A and Trophy Malls for next several years. Market conditions are also favorable for Class B Malls in the Baltimore Metropolitan area.**

- **Class B and Class C Malls and stand-alone retail centers in other parts of the country and the Mid-Atlantic region will struggle.**

- **Looming problems with CMBS Loan maturities in 2017**

  - **Approximately 112 Billion in CMBS Loans are scheduled to mature in 2017, including 30.4 Billion of retail loans.**

  - **It is predicted that many of these loans will not be paid at maturity.**

  - **Loans secured by retail properties with high loan-to-value ratios, questionable tenants, high vacancy rates, etc. will be difficult to refinance.**

OUTLOOK FOR RETAIL SHOPPING CENTERS

Maryland, D.C. & Virginia

What will happen to retail shopping center loans where borrowers are unable to refinance at maturity?

Legal options available to borrowers and lenders include:

- Friendly Foreclosure
- Deed in Lieu of Foreclosure
- Loan Modification
- Loan Sale
- Bankruptcy
- Receivership

OUTLOOK FOR RETAIL SHOPPING CENTERS

Maryland, D.C. & Virginia

There is also a general decline with respect to in-store sales for large and small retailers.

Increased preference for online shopping (and home delivery) by millennials and others.

Amazon and internet shopping are here to stay and will continue to cause problems for large and small retailers in Class B and Class C Malls and stand-alone retail centers.

Potential bankruptcies loom for large retailers / chain restaurants

Walmart, Sears, Macys, etc. are closing stores around the country including in the Mid-Atlantic region, and some large retailers (i.e., Sports Authority, Aeropostale) have filed or may be filing bankruptcies.

There has also been a rise in restaurant chain bankruptcies (i.e., Logan's Roadhouse, Garden Fresh, Cosi), further adding to the stress on Class B and C Malls and stand-alone retail centers.

Outlook for Multi-Family Rental Housing and Single Family Housing Projects

Maryland, D.C. & Virginia

Multi-Family Rental Housing

The outlook for multi-family rental housing in the Mid-Atlantic Region is good for at least the next several years.

However, there are concerns about (1) the saturation of multi-family rental housing, (2) the number of multi-family projects under construction, (3) the potential for a future preference change in the multi-family rental housing market, and (4) whether renters will continue to have an appetite for higher/rising rents.

Residential Homes

The outlook for residential home sales in the Mid-Atlantic region for the next several years is not positive. There are a number of factors causing this negative outlook.

OCTOBER 20, 2016

MYLES TITLE BREAKFAST SEMINAR

DISCUSSION TOPICS TO BE COVERED BY MICHAEL G. GALLERIZZO, ESQUIRE

I) Outlook for retail shopping centers in 2017 and beyond (Maryland, DC and Virginia)

A. The market looks good for Class A and Trophy Malls for the next several years. The market for Class B Malls in the Baltimore Metropolitan area should also be good for the next several years.

B. For the rest of the Country and the Mid-Atlantic region, Class B and C Malls and stand-alone retail centers will struggle and experience a general decline in value and a variety of problems over the next several years.

1. Looming problems with CMBS Loan Maturities in 2017
   - (a) Approximately 112 Billion in CMBS Loans are scheduled to mature in 2017, including 30.4 Billion of retail loans. It is predicted that many of these loans will not be paid at maturity
   - (b) Loans secured by retail properties with high loan-to-value ratios and questionable tenants, high vacancy rates, etc. will be difficult to refinance.

(c) In some instances, the keys to retail centers are already being handed over to special servicers where the retail properties are cash flowing but the lenders have decided not to invest additional equity towards a refinancing due to high loan-to-value ratios.

(d) What will happen to retail shopping center loans where borrowers are not able to refinance at maturity?

  (i) Options available to Borrowers and Lenders

    (a) Friendly foreclosure
    (b) Deed in Lieu of Foreclosure
    (c) Modification of Loan
    (d) Sale of Loans
    (e) Bankruptcy
    (f) Receiverships

2. There is also a general decline with respect to in-store sales for large and small retailers. This factor is especially stressful for Class B and C Malls and stand-alone retail centers

   (a) Increased preference for on-line shopping by millennials and others
   (b) Rapid decline with respect to in-store sales for large and small retailers

3. Potential bankruptcies of large retailers and chain restaurants

   (a) Large retailers such as Walmart, Sears, Macys, Sports Authority, etc. are closing stores around the country including in the Mid-Atlantic

region, and some of them (ie, Sports Authority, Aeropostale) have filed or may be filing bankruptcies. Some of these bankruptcies may end-up as liquidations where all or a major portion of the store locations are closed. All of these occurrences have had and will continue to have a serious negative impact on Class B and C Malls and stand-alone retail centers around the Country and in the Mid-Atlantic region.

(b) There has also been a rise in restaurant chain bankruptcies (ie., Logan's Roadhouse, Garden Fresh, Cosi), further adding to the stress on Class B and C Malls and stand-alone retail centers.

II) Outlook for Multi-Family Rental Housing and Single Family Housing Projects in 2017 and Beyond (Maryland, DÇ and Virginia)

A. Multi-Family Rental Housing

1. The outlook in the Mid-Atlantic Region for Multi-Family Rental Housing is good for the next several years.
2. The growth in employment in the Mid-Atlantic Region, coupled with a growing preference to rent residential housing as opposed to purchasing the same, favors well for the multi-family rental housing market in the Mid-Atlantic Region and other parts of the Country for the next several years. Also, the amount of new construction for multi-family rental housing is currently being out paced by the demand for such housing. All of these factors should lead to

a rise in rental rates for multi-family rental housing and for a very favorable market for multi-family rental housing for at least the next several years.

3. However, some experts are concerned about the saturation of multi-family rental housing and the number of multi-family projects under construction
4. Some experts are also concerned about the potential for a future preference change to purchase as opposed to renting residential housing which could seriously diminish the available renters for the multi-family rental housing market
5. Other experts are also concerned about rental pricing and whether renters will continue to have an appetite for higher rents
6. All of these concerns could result in a decline of available renters and demand falling significantly short of supply for multi-family rental housing.
7. We don't believe, however, that any of these concerns will result in a significant decline in the demand for multi-family rental housing for at least the next several years.

C. Residential Homes

1. The outlook for residential home sales for the Mid-Atlantic Region for the next several years is not positive. Home sales are currently on the decline and it appears that homes sales will continue in that direction for the next couple of years. There are a number of factors causing this negative outlook.
2. Current sales of both new and existing homes are on the decline and have been for at least the past

couple of months.

3. New home inventories are restrained by a more cumbersome and expensive development process. Developed lots are becoming in short supply
4. Existing homeowners are reluctant to sell their homes due to the low supply of newer homes to purchase in exchange.
5. Many homeowners are also reluctant to sell their homes because they recently refinance their mortgages at exceptionally low interest rates and are happy to wait and build equity in their homes and purchase at a later point in time. This reaction is particularly prevalent amongst baby boomers, many of whom have grown children who have yet to firmly establish themselves.
6. All of these factors have resulted in an increase in housing prices, further stressing the outlook on home sales for the next couple of years. The recent price increases for residential housing in the Mid-Atlantic Region are at their highest level since 2008. These price increases, coupled with the decreased supply of new and existing homes on the market and the other factors discussed above, are all leading existing homeowners to the decision to sit tight and sell their homes after they have reaped the equity gains resulting from these price increases and home prices in general have stabilized.

7. The greater preference for multi-family rental housing will also have a negative impact on residential home sales for the next several years.
8. For all of these reasons, the outlook for residential home sales in the Mid-Atlantic Region for the next several years is not positive.

Myles Title Advisory Panel Discussion
Banking
October 20, 2016

- Traditional Bank organizations and how they operate in the community
- Commercial real estate product and loan types
- The move out of the Great Recession
- Improving Bank balance sheets
- Interest rates continue to go lower...how low can they go?
- Low interest rates, improved balance sheets and the desire to lend result in bank loan growth
- Commercial real estate loan growth nearing all-time highs
- CRE loan growth triggers regulator concerns and scrutiny
- Examinations, concentrations and concerns cause some lending challenges
- On top of it all regulation continues to cause CRE headwinds
- HVCRE and its confusion for borrowers and Banks
- Potential impact of HVCRE rules and interpretations
- Political landscape...is there help on the way?
- Challenges and change should result in opportunities

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High Volatility Commercial Real Estate (HVCRE) Exposures[4]

1. If a borrower contributes additional capital to an existing HVCRE loan to meet the 15 percent contributed capital requirement after the banking organization has already advanced funds to the borrower, can the loan be excluded from the definition of HVCRE as a loan to a commercial real estate (CRE) project that meets specified criteria?

The loan remains an HVCRE loan because any contribution of cash or land must be contributed to the project before a banking organization advances funds for a loan to be considered a CRE loan, rather than an HVCRE loan.

2. Are acquisition, development or construction (ADC) loans made prior to the effective date of the regulatory capital rule exempted from the HVCRE definition?

The regulatory capital rule does not provide for the grandfathering of existing loans. Therefore, ADC loans made before the effective date of the regulatory capital rule are not automatically exempted from the definition of HVCRE. Unless such loans meet the criteria for exemption provided in the definition of HVCRE, they must be treated as HVCRE loans.

3. If a borrower owns real estate (and has no mortgages or liens on that real estate) that is unrelated to a project, can the borrower pledge this real estate to the project as collateral and count the value of the real estate toward the 15 percent borrower contributed capital requirement and avoid the HVCRE classification?

No, the definition of HVCRE requires that capital be contributed by the borrower to the project in the form of cash or unencumbered readily marketable assets. To the extent that an asset is merely pledged as collateral, it would not be considered to have been contributed to the project.

4. For the purpose of determining whether a loan meets the definition of HVCRE, would various purchasers' deposits on units in a condominium project (that does not qualify as a one- to four-family property that is excluded from the definition of HVCRE) count toward the borrower's contributed capital?

No. Purchasers' deposits on units in a condominium project do not qualify as capital contributed by the borrower. The purpose of contributed capital, or equity, is to ensure that the borrower maintains a sufficient economic interest in the property and to provide a margin between the loan amount and the value of the project to provide protection to the lender against loss due to overruns or an incomplete or otherwise failed project. Typically, a purchaser's deposit is not able to absorb losses on the project because the deposit must be returned to the purchaser in the event that the project is not completed.

5. For the purpose of measuring capital contributed by the borrower under the HVCRE definition, if Bank A has a first mortgage secured by the real estate of the project and Bank B has a second mortgage on the same real estate collateral, does the second banking organization's funding count as cash contributed by the borrower?

[4] For HVCRE questions, see the definition of "HVCRE" in section 2 of the regulatory capital rule.

No. A second banking organization's funding of the project is not considered to be capital contributed by the borrower. Rather, it is another loan to the project, and both loans encumber the property.

6. What is the "as completed" value? Can the "as stabilized" value be used for purposes of determining whether the loan is an HVCRE exposure?

No, the "as stabilized" value cannot be used for purposes of determining whether the loan is an HVCRE exposure. The agencies' Interagency Appraisal and Evaluation Guidelines explain both the "as completed" value and "as stabilized" value as follows:

The prospective market value "as completed" reflects the property's market value as of the time that development is expected to be completed. The prospective market value "as stabilized" reflects the property's market value as of the time the property is projected to achieve stabilized occupancy. For an income-producing property, stabilized occupancy is the occupancy level that a property is expected to achieve after the property is exposed to the market for lease over a reasonable period of time and at comparable terms and conditions to other similar properties. (Refer to the interagency guidelines: The Board's SR letter 10-16 at http://www.federalreserve.gov/boarddocs/srletters/2010/sr1016a1.pdf; the OCC Bulletin 2010-42 at http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-42.html; and the FDIC's FIL 82-2010 at https://www.fdic.gov/news/news/financial/2010/fil10082a.pdf.)

Of the three market value scenarios that are generally used by an appraiser (that is, the current ["as is"] market value, the prospective market value "as completed," and the prospective market value "as stabilized"), a banking organization should consider only the prospective market value "as completed" for purposes of determining whether a project is an HVCRE exposure.

7. If cash is used to buy land, and that land is subsequently contributed to a new development, can the land still count as contributed capital? Does the banking organization need to document when and how much the borrower paid for the land?

Yes. If cash is used to purchase land that is subsequently contributed to an ADC project, the cash used to buy the land can count toward the 15 percent contributed capital amount. This 15 percent requirement must be met before the banking organization advances funds. The definition of HVCRE excludes CRE projects in which the borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's "as completed" value. (See definition in question 6.) Consistent with the preamble to the regulatory capital rule, cash used to purchase land is a form of borrower-contributed capital under the HVCRE definition. The banking organization should document the details pertaining to the amount of cash paid for the land.

8. For purposes of determining the amount of a borrower's contributed capital and whether a loan would be classified as an HVCRE loan, would "soft costs" (such as brokerage fees, marketing expenses, or costs of feasibility studies) qualify as "development expenses"?

Under the regulatory capital rule, contributed capital may include out-of-pocket development expenses paid by the borrower. "Soft costs" that contribute to the completion and value of the project can count as development expenses for purposes of the HVCRE definition. Such soft costs include interest and other development costs such as fees and related pre-development

expenses. Project costs paid to related parties such as developer fees, leasing expenses, brokerage commissions, and management fees may be included in the soft costs provided the costs are reasonable in comparison to the cost of similar services from third parties. Acceptable contributed capital includes actual cash expended by a developer for the purchase of a site and initial costs paid, such as engineering or permits related directly to the project.

9. Does an interest-only loan to purchase an existing building under renovation with tenants qualify as HVCRE?

The terms of financing (for example, interest-only loans) are not a relevant criterion for HVCRE determination. Rather, the classification of the loan depends primarily on whether it is permanent financing. A loan cannot be classified as permanent financing if (1) the loan is based on the "as completed" value of the project (i.e., the project has not yet been completed) and (2) there will be any future advances on the loan. Other characteristics of the loan should also be considered in the context of the regulatory capital rule's HVCRE definition.

10. Are Small Business Administration (SBA) 504 loans considered community development loans under the definition of HVCRE and, therefore, not subject to the HVCRE treatment?

SBA 504 loans are used for fixed assets (for example, the purchase of land and buildings, site and building improvements, newly constructed facilities, and long-term machinery and equipment) as well as to refinance existing debt and are not automatically excluded from the definition of HVCRE. SBA 504 loans that meet the criteria in paragraphs (2)(i) and (2)(ii) under the HVCRE definition are exempt from treatment as an HVCRE exposure. SBA 504 loans that are not community development investments may be exempt from the HVCRE treatment if the loan satisfies the other exemption criteria in the definition of HVCRE.

11. Projects may receive cash in the form of grants from nonprofit organizations, municipalities, state agencies, or federal agencies. Can a banking organization providing ADC financing to a project (that does not otherwise qualify as a community development investment with regard to the HVCRE exemption) consider the cash from such grants as part of the 15 percent contributed capital requirement?

No, to the extent a project receives a grant, a banking organization may not consider the cash from the grant as a capital contribution because the cash did not come from the borrower. Although a third-party grant would increase the capital invested in the project, because it does not come from the borrower, it does not affect the borrower's level of investment and therefore does not ensure that the borrower maintains a sufficient economic interest in the project.

12. Is a credit facility used to purchase a commercial lot (land only with no site improvements) an HVCRE exposure? The proceeds are used to acquire the land, however, there is no plan to develop, construct, or make improvements. At this time the borrower intends to hold the land.

An acquisition loan to purchase CRE (including land) would qualify as an HVCRE exposure, unless the loan is permanent financing in accordance with the banking organization's normal lending terms or meets the exemption criteria described in the HVCRE definition.

13. Does an ADC loan on a multipurpose property that will contain both CRE and one- to four-family residential real estate meet the HVCRE definition?

Only the portion of the loan applicable to the property's CRE could be subject to the HVCRE treatment. The banking organization should consider the contribution of the CRE portion of the project to the total "as completed" value of the project when determining the portion of the loan applicable to the property's CRE.

14. Subsequent to loan origination, if an updated appraisal or valuation on an HVCRE exposure results in a loan-to-value (LTV) ratio that no longer exceeds the maximum LTV ratio in the relevant supervisor's real estate lending standards, could the exposure then be removed from the HVCRE classification (if the exposure meets the other exemption criteria in paragraph (4) of the HVCRE definition)?

No. A banking organization must consider the LTV ratio at origination when evaluating a loan against the HVCRE exemption criteria. A loan with an LTV ratio that exceeded the maximum supervisory LTV ratio at origination would remain an HVCRE exposure until it converts to permanent financing. Refer to the agencies' real estate lending standards regulations: 12 CFR part 34, subpart C (OCC); 12 CFR part 208, subpart E (Board); and 12 CFR part 365 (FDIC).

15. The definition of HVCRE includes a provision that "the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project." What does "contractually required" mean in this context?

In order to meet this criterion in paragraph (4)(iii) of the HVCRE definition, the loan documentation must include terms requiring that all contributed or internally generated capital remain in the project throughout the life of the project. The borrower must not have the ability to withdraw either the capital contribution or the capital generated internally by the project prior to obtaining permanent financing, selling the project, or paying the loan in full.

16. If a banking organization lends a borrower 15 percent against the property, independent of the project, can the proceeds from the loan count towards the obligor's 15 percent capital contribution to the project?

No. Proceeds from a loan from the banking organization that is financing the ADC project does not count toward the 15 percent contributed capital amount.

17. Would the issuance of a certificate of occupancy qualify the loan as having reached the stage of permanent financing? There is usually a remaining loan duration extending past the issuance of the certificate of occupancy in either the initial loan term and/or through extension options.

A certificate of occupancy does not transform an HVCRE loan into permanent financing. The HVCRE exposure ceases to be an HVCRE exposure when it is converted to permanent financing in accordance with the banking organization's normal lending terms, or is paid in full. Generally, this would involve a new credit facility in the form of a term loan replacing the ADC facility.

Other Real Estate and Off-Balance Sheet Exposures

1. What is the risk weight under the standardized approach for the on-balance sheet portion of a reverse mortgage?

Reverse mortgages receive the same risk weight treatment as traditional residential mortgages. A 50 percent risk-weight category applies if a reverse mortgage is (1) secured by a property that is either owner-occupied or rented; (2) made in accordance with prudent underwriting standards, including standards relating to the loan amount as a percent of the market value of the property at origination of the mortgage; (3) not 90 days or more past due or in nonaccrual status; and (4) not restructured or modified. A banking organization risk weights a reverse mortgage at 100 percent if the mortgage fails to meet any of the qualifying criteria for a 50 percent risk weight (see section 32(g) of the regulatory capital rule). Any portion of a reverse mortgage exposure that is *conditionally* guaranteed by the U.S. government (for example, Federal Housing Administration (FHA) guarantees) receives a 20 percent risk weight as set forth in section 32(a)(1)(ii) of the regulatory capital rule.

2. For purposes of a reverse mortgage, what is the treatment for the off-balance sheet component of the mortgage?

For available funds committed but not disbursed under the terms of the reverse mortgage contract, a banking organization should apply a credit conversion factor (CCF) of 50 percent to the undisbursed available commitment amount to calculate the exposure amount, given that such commitments are generally in effect for a period greater than one year (see section 33(b)(3) of the regulatory capital rule). The exposure amount would then receive a risk weight consistent with the risk weight treatment for residential mortgages (described above).

3. If a banking organization has a multipurpose facility that could include both financial and performance standby letters of credit, can the banking organization apply the lower of the two applicable CCFs (that is, 50 percent)?

Yes. A banking organization may apply the lower of the two applicable CCFs set forth in section 33 of the regulatory capital rule for commitments to extend letters of credit in the form of a financial or a performance standby letter of credit (that is, 50 percent).

4. Under other multipurpose facilities, a banking organization makes a commitment that could be drawn either as a letter of credit, a revolving loan, or a term loan. What is the correct CCF?

A banking organization may apply the lower of the two applicable CCFs set forth in section 33 of the regulatory capital rule for loan commitments (that is, 20 percent for short-term and 50 percent for long-term commitments) even though such exposures could be drawn as a letter of credit or a term or revolving loan.

5. In order for a residential mortgage to comply with prudent underwriting standards, can private mortgage insurance (PMI) continue to be relied upon for purposes of computing LTV ratios?

Yes. LTV ratios can account for PMI in determining whether a loan is made in accordance with prudent underwriting standards for purposes of section 32(g)(1)(ii) of the regulatory capital rule.

6. May a home equity line of credit (HELOC) be considered unconditionally cancellable?

Yes. A HELOC may be considered unconditionally cancellable to the extent it meets certain requirements. The regulatory capital rule defines unconditionally cancellable in section 2 to mean "a commitment for which a banking organization may, at any time, with or without cause, refuse to extend credit (to the extent permitted under applicable law)." In the case of a residential mortgage exposure that is a line of credit, a banking organization can unconditionally cancel the commitment if, at its option, it may prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by applicable law and the regulations issued pursuant to those laws. This treatment is effectively identical to that under the general risk-based capital rules.

7. What is the proper capital treatment for FHA Title I loans?

FHA Title I loans are secured by junior liens and are insured by the FHA at either a portfolio level or on an individual loan basis. The type of insurance provided by the FHA depends on the type, characteristics, and origination date of the loan.

FHA Title I loans that are insured on an individual loan basis should receive a 20 percent risk weight for the portion of the loan that is conditionally guaranteed by FHA, typically 90 percent of the outstanding loan balance, as set forth in section 32(a)(1)(ii) of the regulatory capital rule. The remaining, uninsured portion of the loan should be treated as a junior lien residential mortgage exposure for purposes of section 32(g)(2) of the regulatory capital rule.

FHA Title I loans that have portfolio insurance are considered to be securitization exposures because only a portion of the portfolio is covered by insurance and should be risk weighted according to the applicable securitization framework, as set forth in section 41(b) of the regulatory capital rule. Banking organizations also have the option to hold regulatory capital against the underlying exposures as if they are not a tranched guarantee. If this option is selected, these exposures should be treated as junior lien residential mortgage exposures.

8. For purposes of the regulatory capital rule's definition of a statutory multifamily loan, can a multifamily mortgage receive a 50 percent risk weight during an interest-only period when no principal is due to be paid?

Generally, statutory multifamily loans receive a 100 percent risk weight in the first year after origination. If the loan meets all the criteria in the statutory multifamily loan definition set forth in section 2 of the regulatory capital rule, including the timely payment of principal and interest in accordance with the terms of the loan for at least one year and the debt service coverage ratio criteria, the loan will receive a 50 percent risk weight in year two, as set forth in section 32(i) of the regulatory capital rule. For statutory multifamily mortgages with an interest-only period, there are no principal payments due during this period. Therefore, as long as the interest payments are made on a timely basis in accordance with the terms of the loan during year one, the requirement for timely payment is effectively met and the multifamily loan would be eligible to receive a 50 percent risk weight beginning in year two. In addition, the debt service coverage ratio should be calculated using the amortizing payment (principal and interest) that will occur under the terms of the loan. In the case of an adjustable loan, the amortizing payment is based on the fully indexed rate.

An interest-only loan that does not meet the other criteria in the definition of a statutory multifamily loan would generally continue to receive a 100 percent risk weight.

9. For a residential mortgage loan that is not in default, and otherwise meets all the lending requirements for a 50 percent risk weight, what would be the appropriate risk weight for this loan after the banking organization lowers the interest rate for the sole purpose of keeping the borrower as a customer?

Under section 32(g) of the regulatory capital rule, a residential mortgage exposure may be assigned to the 50 percent risk-weight category only if it is not restructured or modified. Lowering the interest rate without any additional underwriting or documentation would constitute a loan modification and would subject the mortgage to a 100 percent risk weight. To continue receiving the preferential 50 percent risk weight, the banking organization would need to perform additional underwriting on the loan to the extent required for the banking organization to ensure that the credit quality of the borrower has not deteriorated. Moreover, in cases where the interest rate change is to prevent any type of payment increase or other change in terms (for example, from the end of a temporary fixed rate to a scheduled floating rate, from interest-only to amortizing payments, or to address an upcoming balloon payment), then the banking organization would need to fully re-underwrite the loan to maintain the 50 percent risk weight.

CUSHMAN & WAKEFIELD

Baltimore Office & Industrial Outlook

Courtenay Jenkins
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October 20, 2016

I. National Perspective

a) Asset classes and what's hot
b) Interest rate prediction
c) Forecast next 18 - 24 months
d) New construction

II. Baltimore Industrial

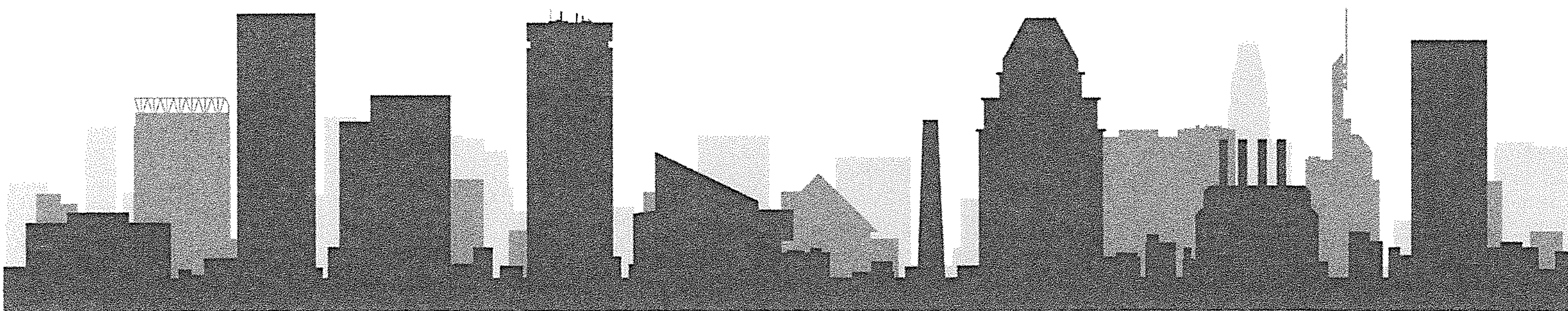
a) Current Market
b) Drivers
c) Forecast

III. Baltimore Office

a) Current Market
b) Drivers
c) Forecast

IV. Workplace Strategies

a) What is it?
b) What it means for real estate
c) Impact on the future
d) WeWork - "the new global workspace"



Myles Title Advisory Panel Discussion
Retail Market

Thomas H. Maddux
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October 20, 2016

- Rapid expansion cycle from about 1988 until the great recession in 2008.

- A&B properties continue to remain strong. C&D properties are challenged.

- The demise of enclosed malls has been created by competition from open air centers and ecommerce and the slow failure of traditional department stores.

- Rental rates remain strong for A&B properties. Cap rates remain low for NNN lease credit backed properties.

- All retailers are under assault by internet shopping, but traditional bricks and mortar retailing will survive.