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ABSTRACT

We examine data on over 40,000 commercial mortgages to study the cross-sectional and time-series determinants of credit spreads. Consistent with theory, our empirical evidence indicates that mortgages on property types that tend to be riskier and have greater investment flexibility exhibit higher spreads. Spreads also tend to be higher for properties that have higher ratios of net operating income to value. The evidence, however, indicates that loan to value (LTV) ratios are negatively associated with spreads, which is inconsistent with predictions from theory. This empirical result is likely due to the endogeneity of LTV choice by lenders. We are able to partially resolve this endogeneity problem by introducing a variable accounting for average LTV ratio for each lender, and obtain a positive relation between average LTV ratio per lender and credit spreads. In addition, we provide time-series evidence that spreads decrease with the level of interest rates, and that, after a period of poor performance of the real estate market, spreads increase and LTV ratios decrease.