nerej

What is hot and what is not in re-financing commercial real estate loans in 2010 and beyond?

October 27, 2009 - Spotlights

The problem of re-financing commercial real estate loans maturing over the next eight years has been well documented throughout the media. Deteriorating economic conditions related to a worldwide recession have negatively impacted occupancy rates and rents of property types across the board. The result is a universal reduction in the value of commercial real estate.

The good news is that more banks and insurance companies are re-entering the market and have mortgage money available to lend. The not so good news is that these lenders are very selective and the underwriting criteria have tightened significantly. The process from application to commitment and closing is more demanding. Today, a loan quote from a bank or insurance company at a 65% LTV will seem more like a 50% LTV loan to the owner. Vacancy rates are assumed to be higher, rental rates are frequently determined to be lower, capitalization rates have increased by 150-250 basis points and the maximum loan to value is settling in at 65%. Rents are underwritten to market and all leases, expiring during term of loan, are carefully evaluated with the goal of mitigating turnover risk. Loan terms, particularly amortization, are structured to minimize the risk of repayment of principal at maturity.

It is reported that there is a significant amount of new capital being raised by REITs and other debt type funds for investment in commercial real estate. Judging from the inquiries directed to our mortgage banking network and to our correspondent lenders as to the availability of individual loan(s), or foreclosed properties, it is clear that this capital is seeking to acquire the assets at a deep discount to par. While delinquencies and foreclosures are on the rise, as yet, there is no sign that owners or lenders are desperate to the point of liquidating assets at any price.

What strategy is an owner to follow over the next eight to ten years? Understanding the aforementioned reality of financing in today's real estate market, prudence dictates that the owner critically evaluate each loan in his portfolio, no matter when it is due to mature, to determine the potential for refinance. A preemptive move to refinance may prove to be an effective course of action.

Far more attractive options exist for the multi-family property owner, namely, the Government Sponsored Enterprises (GSEs), i.e., Fannie Mae and Freddie Mac as well as HUD FHA insured mortgage programs. Last year, as US mortgage problems deepened, regulators put Fannie Mae and Freddie Mac under government conservatorship. This doesn't mean Fannie Mae or Freddie Mac will go out of business. On the contrary, the expectation is that these two entities will play an important role in the recovery of the troubled housing market.

In fact, it is business as usual. Both GSEs are committing and funding loans at historically attractive terms for the acquisition and refinance of multi-family properties. Today, the typical loan terms look like the following: Amount (maximum) - 75% LTV for a re-finance, 80% LTV for an acquisition; Rate -

currently at a range of 5.4% - 5.7% per annum fixed for the term; Term - 10 years; Amortization - 30 years; Debt Coverage Ratio - 1.25 x maximum. As is the case with other lenders, the underwriting has tightened. It would be difficult to support a capitalization rate less than 7%. Most importantly, historical actual financials must support pro forma projections going forward. For example, great emphasis is placed on the trend of the trailing 12 month cash collections as they relate to the trailing 6 and trailing 3 months actual results.

For the multi-family owner, the best advice might be "to get it while its hot!"

NorthMarq is an authorized seller/servicer for Freddie Mac and, through its affiliate, Amerisphere, is a licensed Fannie Mae DUS lender as well as a HUD lender offering FHA insured construction (221(d)(4)) and permanent (223(f)) financing for all types of multifamily and healthcare facilities.

Joseph Hegenbart is the managing director of NorthMarq Capital, Boston.