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There is still significant equity capital available for right deals

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While the real estate lending market has cooled from its peak at the beginning of 2007, there is still plenty of liquidity in the marketplace, especially for cash flowing assets. The players have changed as the decline in CMBS lending (roughly \$250 billion last year domestically and projected to be half that this year) has led to a resurgence of portfolio lenders, particularly life companies and commercial banks. Portfolio lenders have not completely filled the gap left by CMBS, but there is also significant equity capital available for the right deals. This is fortunate, as underwriting standards have tightened, especially loan-to-value and debt service coverage metrics. These tighter standards have effectively caused highly levered buyers to remain on the sidelines for the time being. While typical valuations have dropped 5-10% core property values have remained strong and all cash and low levered buyers are still active.

Many life insurance companies had a record year of production in 2007 as they stepped up to provide liquidity to the market, most notably in the second half of the year. While life companies are just now deciding on their allocations for 2008, all signs point to the life companies continuing to dominate the permanent loan market. Traditionally, life companies lend on a fixed-rate basis for terms of 3 to 30 years, secured by the major property types (office, industrial, retail, apartments and hotels). While life companies will leverage up to 75% loan-to-value, 70% is more the norm in the current market. Minimum debt service coverage ratios are 1.20-1.30x on an amortizing basis. Interest-only is still available, but very selectively. Quoted spreads range from 175 to 250 basis points over the comparable Treasury bond depending on the characteristics of the deal. In addition to making fixed-rate loans, many life companies have broadened their programs to include floating-rate, construction, construction/permanent loans and earnouts. Unlike the majority of the CMBS lenders, life companies service their own portfolios which affords borrowers greater flexibility when issues arise post-closing. Given capital markets uncertainty, many life companies prefer smaller loans at the moment (\$5 to \$30 million), although larger players will lend as much as \$100 million on a single asset and much more when secured by a portfolio of assets.

As the life insurance companies have picked up some of the slack on the fixed-rate side, commercial banks have increased their lending activity, particularly for floating-rate acquisition, redevelopment and construction loans. Banks are typically underwriting to a maximum 75% loan-to-cost/loan-to-value and looking for coverage ratios around 1.25x on an amortizing basis. Loan terms of 3 to 5 years are being priced generally at 175 to 225 over LIBOR. Some banks are offering 10-year fixed-rate deals by swapping from floating to fixed. As CMBS pricing has widened, bank fixed-rates are now competitive with CMBS, but bank loans offer added flexibility and can be prepaid at a lower cost to the borrower. This is due to the fact that the cost to prepay a bank loan does not include the margin, just the cost to break the swap instrument. The current size threshold appears to be about \$100 million. Larger single asset deals are more challenging and require a

combination of more equity/higher pricing/additional structure, as syndication market activity has been curtailed. Large, high quality portfolios are still of interest.

Fannie Mae (FNMA) and Freddie Mac (FHLMC) are back as the major forces in apartment lending, doing huge production in 2007. As with other categories of lenders, agency underwriting criteria has become more conservative. The typical agency program is fixed-rate, up to 80% loan-to-value, 1.15x minimum amortizing debt service coverage with competitive pricing in the mid-to-high 100s (160-190 basis points).

No one knows for sure when the capital markets will stabilize; however, it is clear that there is plenty of capital available to finance good quality commercial real estate projects. Commercial banks, life insurance companies and the agencies are all open for business.

Tagline: Janet Krolman and Greg LaBine are directors in the Boston office of HFF (NYSE: HF), a leading provider of commercial real estate and capital markets services to the U.S. commercial real estate industry operating out of 18 offices nationwide. The firm offers clients a fully integrated national capital markets platform including debt placement, investment sales, structured finance, private equity, note sales and note sale advisory services and commercial loan servicing. HFF is a seller/servicer for FHLMC and a correspondent for numerous life insurance companies.

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