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Understanding your loan portfolio can put property owners in an advantageous position

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As the economy continues down its current path and the credit markets continue to tighten, identifying financing sources is becoming increasingly difficult. Banks are becoming more and more conservative, the conduit market remains absent, and insurance companies are finding better returns in the bond market. While the lack of available financing is affecting all asset classes, the multifamily sector still remains among the most attractive to lenders.

Lenders are viewing multifamily assets as the most secure and while still approaching them with relatively conservative lending criteria, this is where borrowers are finding the most aggressive terms. Fixed rates in the sub 6% range are available with leverage points reaching the 80% mark, however, the strength of the borrower and the property are paramount in achieving these terms. While Fannie Mae and Freddie Mac continue to offer attractive loan terms through both their fixed and floating rate products, more and more borrowers are bringing their business to local banks whose lower rates are allowing higher loan proceeds.

Regardless of the lending source from which borrowers are seeking their financing, a more critical issue may be that of value. The same economic drivers that are pushing lenders to become more and more conservative are also having an impact on property values. The impact of decreasing values is more significant than simply a lesser dollar amount. Assume the capitalization rate on a given property rises just 2% from a 7% cap rate to a 9% cap rate; the result is a decrease in value of over 22%. The question borrowers should be asking themselves today is not only where am I going to get financing, but how is the global decrease in property values going to affect my ability to obtain financing.

It is crucial for property owners in this environment to conduct a detailed analysis of their current loan portfolio with a particular focus on loans that are maturing over the next two years. As the example above indicates, a rise in cap rates can have a significant impact on the status of your current loans as well as your ability to refinance that loan at maturity. Most bank loan documents contain a loan to value covenant dictating that the loan amount may never exceed a specified percentage of the property's value. A decrease in value of over 22%, as was the case in the example above, would likely cause that loan to exceed the loan to value covenant and could allow the lender to charge the borrower a default rate of interest until that default is cured by paying down the principal loan balance. A decrease in value can have a similar impact when it comes to refinancing.

Conducting an analysis of their current loan portfolio can put property owners in an advantageous position by giving themselves the opportunity to restructure their existing debt now and take advantage of today's attractive interest rates. As a borrower, understanding the current position of your loan portfolio can also allow you to take a proactive approach with lenders holding debt on properties that may be at risk of default. Here at Cornerstone, we are seeing an increasing number of clients ask us to review their current loan portfolios and assist them in structuring work-outs with existing lenders as well as creating borrowing strategies going forward. By working with clients and offering these services we are able to help them transition their loan portfolios into sustainable, long term positions.

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