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DEBT YIELD: PREFERRED METRIC FOR HOSPITALITY LOANS

The quality of the sponsor will dictate which hotel deals lenders look at and the debt yield will determine which deals get done. Expect to see hotel debt yield at around 11% to 13% for the next three to six months, with 12% being the norm. Although, by year's end count on it to ease slightly with a few deals surfacing at 10%. **Morgan Stanley, JP Morgan Chase, Wells Fargo, RBS, Goldman Sachs** and **UBS** look to include hotels in their CMBS tranches, with most targeting hospitality to comprise roughly 10% of their pools.

Every few years, a new and more significant metric to gauge loans emerges. During the economic recovery, many conduit lenders will use debt yield as the foremost financial ratio to determine the maximum size of their commercial real estate loans. Cash flow is king for inking a CMBS hotel loan this year. Many lenders are beginning to discount 2009 operations altogether and choose to size the loan based solely on the trailing-12, which is good news for the hotel borrower because 2010 was a significantly stronger year operationally. Watch for lenders to get more aggressive and take the better times into account. Some conduits will even start to use the trailing-six, as well as the projected-six.

At this time last year, the hospitality segment was seeing debt yield in the 12% to 14% range. Between November 2010 and early Q1 2011, the lending industry started feeling much better about the hospitality segment when they realized operations had bottomed out. Suddenly, conduits were hot on hotels and wanted hospitality to encompass a minimum of 5% to 10% of the tranches.

As properties continue to improve operationally, many conduits will start to consider 10% debt yield. And with NOIs on the rise, this number will become very compelling to borrowers.

LENDERS THIRST FOR PHARMACY DEALS

All the major lenders are happy to loan on pharmacy properties, specifically Walgreens and CVS stores, but expect conduits and life companies to win what little product is available. Notice firms such as **JP Morgan, Morgan Stanley, Goldman Sachs, Deutsche, UBS, Wells Fargo, Citi, RBS, BofA** and **Ladder Capital**, as well as life companies **Western & Southern, Thrivent, StanCorp** and **Symetra** to lend on this top-tier asset.

Now the conduits are back and are competitively bidding for available drug stores on the shorter-term and fixed-rate deals. Also keep an eye out for the big banks to be drug thirsty. Life companies were pretty much the only game in town for all commercial real estate financing, which explains why most of them

CONSTRUCTION ACTIVITY BUILDS

All of the national banks are back and active in construction lending, while only about half of the regional and community banks are putting together development deals. Anticipate the big players such as **Wells Fargo, RBC and BB&T** to go after the larger \$10M-and-up construction deals, while the smaller deals should go to regional and community banks such as **Bank of Arizona, The Provident Bank and First Colony Bank**. Don't be surprised if life companies stay away from development deals for the time being, except for choice pre-leased properties or large apartment projects. The market has seen an increase in the number of non-recourse lenders, which could be a sign that we are nearing the end of the cycle.

In today's environment, it can be difficult to put together construction deals outside of multifamily. Many lenders believe development will continue to flounder until employment rates pick up further and consumer confidence improves. Yet banks across the board are balancing their books and making their way out of the shadows, so don't be surprised if competition on construction deals revs up as more and more investment capital becomes available to lenders.

Lenders will look for financially strong borrowers with proven track records in developing a particular product type when putting together construction money. Deals today require a quality infill location or significant pre-leasing. Borrowers must contribute substantial equity and have a guarantor with sufficient liquidity. Most lenders require a guarantor with a net worth equal to the loan amount and liquidity equal to 20% and 25% of the loan amount. Watch for interest rates to land between 5% and 7%, with LTC around 65% to 75% and 24- to 36-month terms. Regional banks are currently pricing construction deals at prime-plus 1% with a 5% to 6% floor. Borrowers with strong equity and a feasible project can likely find short-term financing through big national banks, regional banks and possibly private money, but chances are they will be recourse loans with a fairly low LTC.

Most lenders avoid projects without pre-leasing, unless they are small or in an excellent location. During the next few years, expect to see most developers opting to acquire existing assets until vacancy rates improve. A buyer in today's market can acquire a building for as low as 30% to 50% below replacement costs. Office and retail are overbuilt and vacancies are high, so any activity in those sectors will likely involve retrofits or value-adds, rather than ground-up construction.

Multifamily remains the darling of the construction world and you can bet this asset will receive the lion's share of development deals in the coming months. The sector has seen concessions burn off, rent and occupancy rates increase and low 4% to 5% cap rates on sales, which leads to a need for new construction. Meanwhile, the rest of the core food groups should remain in the cellar for the time being, as retail, office and industrial are all saturated with a wealth of unoccupied properties.

Development increases will most likely follow areas with the lowest cap rates and the strongest job growth. These should typically be major markets on both coasts — especially in the Northeast — and in big inland cities such as Austin, Texas, and Chicago. Moving away from the coasts to Las Vegas and other overdeveloped regions, don't be surprised if construction demand is almost non-existent until vacancy rates improve.

Bank of Arizona SVP **Jennifer Pescatore** envisions higher construction volume for the bank this year. The lender looks for potential income-producing assets with strong fundamentals, primarily in the Phoenix area for development financing. These deals range from \$2M to \$20M and require a stabilized DSC of 1.50x to 1.60x with full recourse. LTV and LTC fall between 50% and 75%. The bank lends across the four food groups and offers fixed-rate, adjustable-rate, acquisition, refi and construction loans.

“L” IS FOR LENDING ON STUDENT HOUSING

Lenders understand well-located student housing is one of the savviest of all assets, which even outperformed regular housing during the downturn. When all other property classes fell, only student housing stayed firm — and even increased. Count on **KeyBank Real Estate Capital, Wrightwood Capital, Arbor Commercial Funding and Mutual of Omaha Bank** to finance as many of these assets as they can get their hands on. **Walker & Dunlop** put 10% to 15% of its overall originations toward student housing last year and shoots for the same in 2011.

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Universities don't want to give away any more campus land for student housing, as they'd like to put those acres toward other academic buildings, which means development is increasing in this sector as well. Life companies are hungry for multifamily, but their 65% LTVs are not good enough to compete with the agencies. A few big banks and conduits, however, are writing LTVs as high as 80% to 85% in order to win deals. Some lenders will even complete a loan as low as \$1M, just to get in on this asset.

Another way for lenders to get their foot in the door with student housing is to first finance the construction loan with their company's bank side and then turn around and ask the life company portion of their firm to finance the long-term refi. Fannie Mae recently announced it was going to drop its enrollment stipulation from 20,000 students to 10,000, allowing lenders to get even more aggressive by snatching up housing at smaller colleges. Since Freddie did \$800M in student housing loans last year and Fannie only tallied \$200M, obviously the GSE had to relax some of its restrictions. Still, Fannie's typical underwriting requirements of 75% LTV and 1.30x DSC fall a bit short of Freddie's 80% and 1.25x.

KeyBank Real Estate Capital is KeyBank's multifamily lending arm, specializing in perm lending, Fannie Mae, CMBS and non-recourse perm loans. The multifamily projection for 2011 is \$2.5B, with approximately 10% to 15% of that going to student housing. **Todd Goulet**, SVP and production manager, points out that underwriting requirements vary, but that LTV is typically 85% to 80% with a 1.25x DSC.

Wrightwood Capital plans to invest around \$130M in preferred equity, joint-venture equity and mezzanine loans in 2011, with approximately 15% to 20% of this going to student housing. Managing Director of Investments **Jason Choulochas** seeks to invest only in major markets and on Class B assets or better.

VACANCIES DOWN, OFFICE LENDING UP

From a dollar-on-dollar perspective the biggest category in CRE lending is office, so count on it being one of the lead horses in today's race to put out loans. Demand for office deals has been high for some time now, but lenders have lacked the capital to finance loans until recently. Expect **Berkadia Commercial Mortgage**, **PNC Bank** and **Natixis** to be busy with office financing this year and now that the big guys have balanced their books, they will be looking for high-profile office deals.

LCs and CMBS lenders have the most capital to deploy and will be increasingly more active as the top 20 markets heat up. Life companies will offer the most attractive loans, so anticipate big players such as **Met Life** and **Prudential** to pick off premium office deals in the top 10 to 15 markets. Look for CMBS firms such as **Goldman Sachs** and **JP Morgan Chase** to generate the second biggest source of office originations. The sector is also seeing more medium-sized banks, those just below the major guys, becoming progressively more active in addition to the big players.

Office sales saw a vast increase this year, up 180% compared to the same period last year. Interestingly, the market sees a spike in all-cash acquisitions for office properties lately. This does not mean borrowers are having a difficult time securing financing, but rather a reflection of the borrower in today's market. For the most part, active borrowers are solid financially, unlike in 2006 and 2007, when the market was saturated with more speculative borrowing and lending. However, don't be surprised if some buyers seek financing after their purchase.

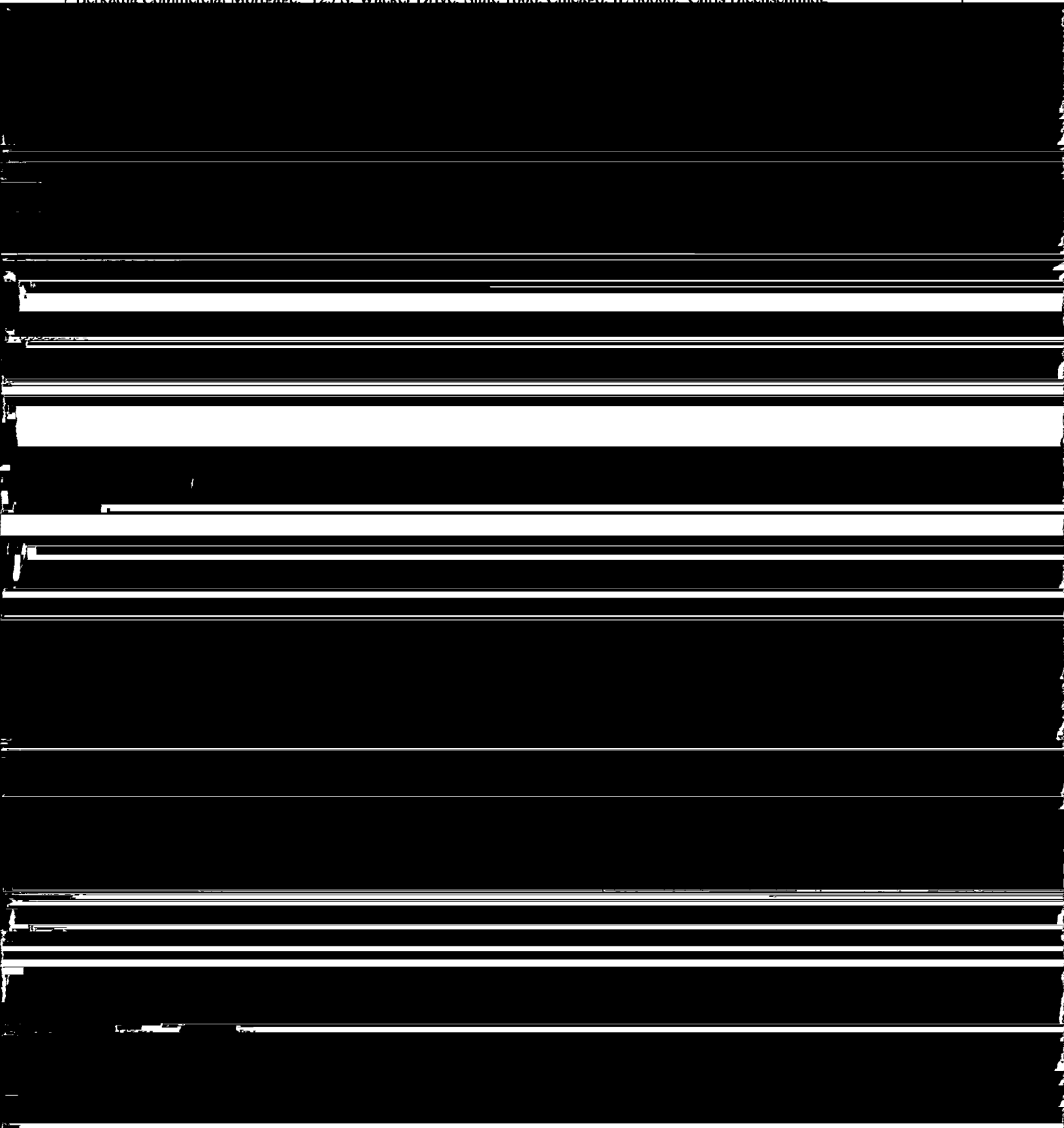
The busiest office markets will be the big cities on both coasts due to their larger populations and urban centers. Expect New York City, Washington, D.C., Boston, Los Angeles and San Francisco to see a large

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RECENT LOAN ROUND-UP

KeyBank doles out a recent loan with correspondent client, investor Kayne Anderson, for \$58M on eight stabilized student housing properties, located throughout the Southeastern states. KeyBank also provided a \$3.85M bridge loan for a ninth unstabilized building.

The Provident Bank doles out \$15.47M to a joint venture between Normandy Real Estate Partners and investor Mark Yeager for the acquisition, renovation and construction of Summit Executive Center in Summit, N.J. The Class A, 65,518-s.f. office property will be completed in March 2012. The loan carries a 36-month term. The lender was attracted to the location, the best-in-class sponsorship and the fact that the building is already about 50% pre-leased.

Walker & Dunlop provides \$12.7M refi dollars to Breckenridge Group's Aspen Heights, a fully-leased student housing community at the University of Texas at San Antonio. The 10-year loan was structured with a 30-year amortization. The LTV was 70% and the DSC was 1.30x. Walker's VP **Brendan Coleman** notes his company values Breckenridge's knowledge as it has done an exhaustive amount of research on student housing.

PNC Bank lends \$35M to refinance two office buildings in Waltham, Mass., totaling 200,928 s.f. The buildings are fully leased to Verizon Laboratories. Loan proceeds were used to replace a maturing loan. The combination of credit quality, prime location and strong sponsorship makes this an attractive deal to PNC. The properties include a Class A building completed in late 2010 and a two-story office/research and development building that was recently renovated. Waltham is one of the top suburban office locations in New England. The asset is located near Route 128, where fundamental vacancy rates and absorption are strong.

Natixis lends \$60M to LaSalle Investment Management (LIM) to finance the acquisition of the iconic Miami Tower in Florida. The 47-story, Class A tower has 600,959 s.f. of rentable space and is one of the most well-known assets in Miami. The non-recourse, floating-rate mortgage had a relatively low LTV and the deal was put together fairly quickly after LIM purchased the property in an all-cash transaction in December 2010.

BMC Capital closes \$1.6M on a refi for a CVS in Brownsburg, Ind. The 10-year, fixed-rate loan has a 50% LTV and a 25-year amortization schedule. Count on BMC to lend about \$25M to \$45M to pharmacy properties alone this year. **Keith Van Arsdale**, BMC's president and CEO, explains that the quality of borrowers who buy pharmacy, or rather *get* to buy pharmacy, are in the top percentage of their class.

Mutual of Omaha Bank shells out \$16M to fund a 36-month construction loan for student housing located at the University of Kansas in Lawrence, Kan. SVP of Commercial Real Estate **TJ Heither** explains that people always knew student housing was a good bet, but now they realize it's a safe one as well. The Bank has recently financed several student housing developments at the major state schools in Texas, Nevada and Colorado, just to name a few.

Wrightwood Capital finances \$4.96M in mezzanine dollars for a mixed-use student housing development at the University of Southern California in Los Angeles. The borrower acquired the site and was able to obtain all the necessary entitlements in order to build the project — which was a very lengthy and expensive process. LTV was underwritten to approximately 75%, and the underwriting debt yield was about 10% to the mezzanine position. The interest rate was fixed in the low teens.

First Colony Bank lends \$1.3M to finance the development of Dollar General in Kissimmee, Fla. The 9,100-s.f., Class B single-tenant retail property should be completed in June of this year. LTV is 75%, LTC is 80% and the rate is floating over prime. The community bank was attracted to the deal because the borrower was financially sound and the tenant signed into a 15-year lease.

Arbor Commercial Funding doles out a \$6M loan under the Fannie Mae DUS Dedicated Student Housing Loan product for a housing complex near Michigan State University in East Lansing, Mich. The developer converted two-bedroom units into four, increasing the income about 150%. The 10-year loan amortizes on a 30-year schedule. **Michael Jehle**, Midwest regional director, believes the distance from campus must be taken into consideration when evaluating a student housing property for a loan.

RETAIL LTVs HIT 70%

Solid retail product is achieving 70% LTVs in today's market, a huge improvement from the 50% they were getting two years ago. The market has shifted and the entire lending community is getting more interested in retail deals as consumer confidence grows and retail sales pick back up. The days during the downturn when lenders would not go anywhere near retail are starting to seem like a distant bad dream. Grocery-anchored centers were the only assets getting any attention those days, but now most attractive retail centers can get more than two dozen bids, including offers from CMBS.

Mid-level properties are leveraging at 65% to 70%, although some could go up to 75% if the metrics are in place and the tenant is strong, such as a brand new Walgreens with a 25-year lease. If borrowers choose to go the conduit route and the deal is more than \$5M, LTV can go up to 75%. The real quality assets will get 30-year amortization, up from 25 years. CMBS picks off more of the slightly outside the box loans the life companies will not touch.

Expect the life companies to average out at 70% on retail unless it is a single, non-credit tenant — then the LTV will surely drop. The deals under \$5M should see 70% and count on big LCs such as **StanCorp** and **Symetra** to be the most aggressive since they like the middle of the road assets. Typically these loans will have a 10-year term, with a 25-year amortization. Cap rates should be 8.25% to 8.5% and they will underwrite accordingly. The B- and C deals in tertiary markets will continue to have a tough time obtaining financing from any lender. In order to ensure a borrower can withstand another downturn, LCs need the borrower's net worth to be three times of the loan amount and eight months worth of mortgage payments in the form of liquidity, as a rule of thumb.

If you look at retail in general, food- and drug-anchored centers have always been at the top of the pile, followed by power- and shadow-anchored centers, with strip and single-tenant centers filling the gaps. On deals with one or two tenants, the credit worthiness of the tenant and the lease term are both paramount because if the tenant moves out, the whole center is in deep trouble. Deals in strip shopping centers with 10 or more tenants are more sought after, because one tenant leaving will not affect the whole center. Some lenders look toward mom-and-pop tenants over the big national anchors because big anchors can command low rent rates and CAMs, which leads to downward pressure on the other infill tenants in the center. These are hard to finance.

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