

The **CRITTENDEN**  **REPORT**[®] Real Estate Financing

The Nation's Leading Newsletter on Real Estate Finance

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LENDING PICKS UP STEAM

Lenders will get more aggressive on debt coverage and take some market risk. All lender types are expected to be pretty active for the larger deals as they try to reach allocation goals for the year. The increase in product coming to the market will generate a hefty pick up in investment activity in the next couple quarters, which should also spur a boost in acquisition financing. This could pump up bridge lending as borrowers look for three- to five-year money. Most lenders will want a borrower's net worth equal to the loan amount and liquidity of six months of principal interest or 10% of loan amount. Banks want six months principal and interest and conduits shoot for 10% of the loan amount.

Transaction activity will post a vast increase in the second half of the year as we head into the positive part of the cycle. Plenty of capital is available but the lack of viable lending opportunities will limit the amount

LENDING PICKS UP STEAM...

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Expect most life companies to reach or exceed their target allocations this year. They will snatch the best 10-year-plus deals that the conduits cannot compete on. Underwriting should be 150 bps over swap and 60% LTV. Don't expect them to work on any smaller deals. It looks like the majority of LCs will hit their target origination goals but some are still short staffed and will be aggressive to reach the allocation for the year. It is rumored that a few LCs could dip their toes back into construction perm financing in 2012.

Banks

Predictions call for some of the bigger banks to be more active in the next few quarters. Although it remains to be seen exactly who will be the busiest, **Union Bank, JP Morgan Chase, Wells Fargo and Morgan Stanley** will put money to work before the year is through. The local banks will pick up the backyard deals under \$5M and typically underwrite the borrower before the property. Some banks say they are lending but many have not jumped back into the game just yet.

Banks will find a shortage of available loans if they solely target multifamily, so watch for them to expand to the other product types, especially retail, in the next few quarters. Anticipate the most perm loans for apartments and industrial. Bankers have seen a trough in the multifamily market in both rents and occupancies and currently have a higher degree of confidence that these positive trends are going to stick in the future. Some retail and office loans are also possible as the year progresses, however, many will remain cautious as they clean up balance sheets.

Count on banks to get aggressive in underwriting and increase LTVs up to 75% for apartments and decrease DSC to 1.15x. They may open up a bit more for bridge loans on cash flowing properties. Bankers will stick to their bread and butter of four- or five-year money and do not expect them to compete on loans with terms for more than five years. Some of the bigger banks will look for product on a recourse basis. Construction loans will significantly increase for multifamily in the coming quarters.

CMBS DEALMAKERS WILL BREAK FOR SMALLER DEALS

Bankers begin to reach further and CMBS small-balance deals under \$10M will increase during the remainder of the year. There is a disconnect between what people are saying and what people are doing. While chatter in the industry claims there is no institutional money for loans less than \$10M; a handful of CMBS deals at \$3M to \$10M have already been inked this year. Office, multifamily and retail have dominated the small-balance space thus far, but expect these deals to expand to select-service hotels and self storage by Q4. **Cantor Fitzgerald** stuck to the \$5M to \$10M range during the first half of the year, so odds are the company will start to entertain deals under \$5M going forward. **Wells Fargo** inked a handful of \$3M to \$5M loans already this year. It's likely that Wells will increase the presence of this loan size in future tranches. Until more lenders jump in, Wells controls the scene and can cherry pick the best deals. It's only a matter of time before the other conduits enter to compete on the smaller deals. By year's end, it

HOTEL EQUITY FUNDS MAKE DIVERSITY PLAY

Private-equity funds will increase activity in the mezzanine space during the second half of this year to help fill the funding void left behind by conservative banks. **KSL Capital, Starwood Capital and The Blackstone Group** look to originate mezz loans in the hotel sector this year. At the moment, traditional lenders ignore projections and choose to solely lend based on the trailing NOI. These groups see more opportunity than the market is willing to acknowledge and are encouraged by the wider spreads these loans can reach. Since these private equity firms are experts on the hotel industry, they feel comfortable making mezz loans as they believe the industry is on an ascent. Hotel values will further stabilize this year and should settle out at roughly 20% to 30% less than the peak. Typical rates run from 10% to 12% with LTVs in the 80% range.

SOME LENDERS LOOK TOWARD GREEN

Many lenders revise underwriting standards to better analyze green buildings with retrofitting being the focus for the rest of the year. **Wells Fargo, BofA, Comerica, Union Bank, Umpqua Bank, New Resource Bank, Berkadia Commercial and CW Capital** will consider loans for green buildings this year. BofA announces a \$55M program to encourage energy-efficient improvements to older buildings and will select up to 12 CDFIs with the most effective solutions for funding to scale on a national level as part of its new program. However, some lenders could be concerned about the risk related to the cost and eventual performance of sustainable properties.

Anticipate a steady increase in lending for green apartment properties as Fannie Mae and HUD recently announced enhancements to the Fannie Mae/FHA Risk-Share program, "Green Refinance Plus," giving owners of rental housing properties refi options, with additional debt going toward energy- and water-saving upgrades. The program estimates around \$100M in refi volume, with an average loan amount of \$3.5M to \$5M. FHA also insures up to an additional 4% to 5% of the loan amount, which provides for further energy-efficient improvements. The government has been steadfast in urging the industry to invest wisely, adding incentives such as the Property Assessed Clean Energy (PACE) program and Section 179D, which allows taxpayers to take an automatic expense for energy-efficient improvements that reduce total annual energy and power costs by 50%.

Strip away all the hype that comes with the world of eco-conscious and the lending industry is left with a plethora of research that points to green buildings as a safe bet. Lenders need to concern themselves with problems that come with a building that *isn't* energy efficient. Even properties that aren't LEED-certified can have features that increase the numbers on their pro-forma statements, which can amount to a difference of up to 25 bps. As buildings become more sophisticated, the valuation community may need to rely on dedicated reports from energy experts that use emerging data standards. Engineering reports about building energy performance are required in some SBA 504 loan programs. Responsible development should be very important to lenders because debt service coverage metric rates and building LTVs will be affected by environmental performance. Also, there is systematic evidence that rents for green offices are about 2% higher than those of comparable buildings in the same location.

Retrofit loan opportunities could be few and far between, since only around 25% of owners with a smaller real estate property (50,000 s.f. or less) are expecting energy-efficiency improvements during the next 12 months. Major retrofit loans are a bit out of the box for most lenders, being a combination of an existing property loan and construction loan. Add on the lower profitability due to the smaller size and relative complexity of underwriting and it is understandable that most lenders have moved slowly. The result has been that sustainability investment has generally been limited to that which can be justified by energy cost savings alone over a short one- to three-year time span. Look for a trend toward the inclusion of more and more green components in construction going forward, which means financing dollars for sustainable buildings should increase in the next couple years.

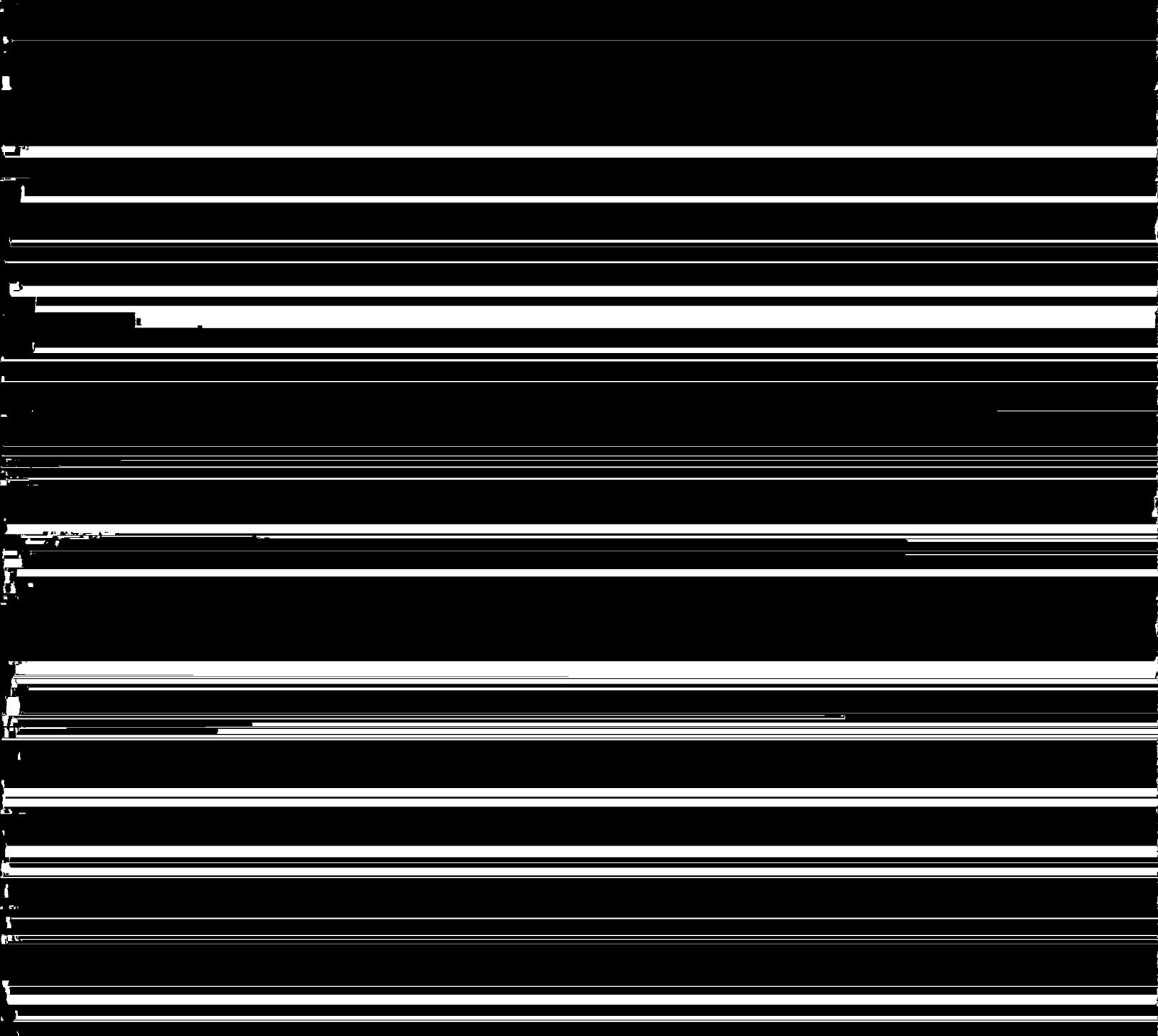
One of the key issues facing the larger commercial property market is the depth of investment. Increasing the depth of investment involves the improved recognition of revenue implications (rents, occupancies, absorption, tenant retention, etc.) but also a focus on risk mitigation. For example, obviously lenders are still scared of what they think green financing will cost and are pricing the risks quite high: A two- to three-year payback requirement implies a simple return of 30% to 50%. But the risk of properly executed projects should be no greater (and perhaps less than) non-sustainable projects.

DEALMAKER DATABANK

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DEALMAKER DATABANK

<p>NorthMarq Capital 2330 W. Joppa Road, Suite 200, Lutherville, MD 21093 Bill Libercci, VP (410) 296-0707 Ext. 2307 blibercci@northmarq.com</p>	<p>Goldman Sachs puts together a \$19M refinance for White Marlin Mall in Ocean City, Md. Goldman was comfortable that Prudential is the equity partner in the property and that it had good anchors.</p>
<p>Pacific Life Insurance Co. 700 Newport Center Drive, Newport Beach, CA 92660 Tony Premer, Senior Managing Director-Real Estate Finance (949) 219-5447 tony.premer@pacificlife.com</p>	<p>Will lend nearly \$2.5B by year's end on all property types. For office, the debt yield target starts at 10% and LTV can be anywhere between 50% and 65%. New York, Washington, D.C., and Houston have been the most active markets for the lender this year.</p>
<p>Thomas D. Wood & Company 95 Merrick Way, Suite 360, Coral Gables, FL 33134 Steven Hayes Wood, COO (305) 447-7836 swood@tdwood.com</p>	<p>Stancorp. inks a \$1.5M perm loan for Point East Office Complex in Kissimmee, Fla. Debt yield was 15% and DSC was 1.47x. The 15-year loan is fully amortizing, with interest fixed at 6.5%. LTV was 57.3%.</p>
<p>UC Berkley 2299 Piedmont Ave. Berkeley, CA 94720</p>	<p>Assistant professor in finance and real estate at Maastricht University in the Netherlands, and visiting</p>



CONSTRUCTION LOANS EXPAND

National and regional banks begin to fund development deals that are not preleased. Word on the street is **BofA, Wells Fargo, PNC and U.S. Bank** will be among the first to ink spec construction loans. Lenders' biggest appetite for non-preleased deals will be in the industrial segment. Primary markets in the Northeast will see funding first and northern New Jersey will be a hot market for industrial projects in the next year. Some speculative office projects will also get off the ground in the New York/New Jersey area, likely on the waterfront in markets like Morristown. These construction loans will need extremely strong sponsorship with proven track records, favorable real estate in the right location and economics that make sense for the market.

Preleased construction funding for office, industrial and retail starts to creep into secondary markets. Look for properties that are nearly 100% preleased to begin to see 70% LTC with no recourse. Going forward, debt yield should settle around 9% for preleased assets with LTVs on the way to 75% in the next month or two. While some deals contain recourse, there is a strong trend toward less or no recourse. Bankers will favor single-tenant, credit-tenant office and industrial developments, as well as small multi-tenant retail deals with credit-tenants.

A trend toward limited to no recourse on construction loans at certain leverage levels emerges. Competition with lenders heats up thanks to the active multifamily financing arena coupled with the projected boost in construction next year. Major MSAs are preferred but multifamily development is creeping into select secondary markets where there is solid demand. If multifamily is well thought out with the right sponsorship, a deal can get done just about anywhere. Banks will follow Freddie and Fannie when underwriting and will size to where they are at. At the moment, the GSEs will do 80% at a 1.25x DSC. Construction lenders will do 75% and 1.25x DSC

The multifamily segment will see a vast increase in construction loans this year as well. Based on a cap rate model, many investors begin to find it can be less expensive to build new multifamily than to buy an existing assets. A recent multifamily asset traded at a high 4% cap rate in northern New Jersey. Since then, a slew of transactions hit the market. Pricing has been bid up and is now very expensive. Equity investors can buy a multifamily asset for a 5% cap or build a brand new project for a more favorable 7% return. If the operating partner is best of class, then this is a good risk adjusted return. Last year, a 7% return didn't seem that good, but with cap rates at 5% and falling, many investors will look for other avenues to get into multifamily. Two years ago assets were selling at a 7% or 8% cap rate but those numbers will not be seen during the economic recovery.

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