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## LENDERS SHIFT FOCUS TO PREFERRED EQUITY

Expect to see senior lenders push for preferred equity, as opposed to mezz, in the capital stack going forward. Preferred equity deals will increase significantly throughout the rest of this year. Look for many private lenders to allocate both preferred equity and mezz. Leverage from senior lenders will top out at 75% on multifamily; deals with preferred equity or mezz will reach 90%. Industrial, anchored retail, multitenant office and hotels will see leverage up to 70% on senior mortgages and 80% to 85% with subordinate debt. Watch for more lenders to provide preferred equity for hospitality assets in the second half of the year, as this sector will see one of the biggest gaps in capital due to the vast amount of CMBS loans maturing.

The trend toward preferred equity over mezz may be attributed to a few high-profile deals with several layers of mezz underwritten in the peak, which went bad. The layers of mezz became complicated to separate after the deals defaulted. Many lenders will remember those deals and chose preferred equity because it will give them more control. Another benefit for preferred equity will be that lenders do not need to count it as additional debt in the deal. While the preferred equity trend will pick up steam this year, also expect to see a fair amount of lenders further warm to mezz when using the structure of one senior piece and one mezz lender. The majority of mezz debt will see rates of 10% to 13%. Preferred equity deals will be in the mid-teen to mid-20% range.

**Pensam Capital** will consider preferred equity loans under \$10M. Look for the lender to push out from its Florida base by year's end with deals emerging in Texas, the Carolinas and on the Eastern Seaboard. Pensam will underwrite preferred equity at 80% to 85% of the total equity needed. The four main asset types and select-service hotels will be favored. Pensam, a private lender, will be flexible with deal structures and might consider lending up to 90% or 100% of the equity portion for the most attractive loans. Watch for **Foreman Capital** to move further into the preferred equity space this year. Due to the competition for first mortgages, Foreman will begin to look at preferred equity deals from \$3M to \$10M. Deals sized from \$2M to \$3M will increase due to less competition for that size loan. The lender expects to deploy up to \$100M by year's end. All property types will be considered, including hotels.

**Regional Capital Group** underwrites preferred equity for value-add purchases. The lender focuses on multifamily but will also consider student housing, retail and office. Typically, Regional Capital will contribute 90% of the equity or 25% of the total capital stack. Returns run from the mid-teen to mid-20% range. Watch for **Pembrook Capital Management** to underwrite mezz and preferred equity deals from \$5M to \$20M this year. The lender prefers mezz, when given the choice, because it will provide more time to fix problems if a default occurs. Pembrook will do transitional assets at 85% of cost or 75% of the stabilized value. While multifamily will be half the lender's business in 2012, Pembrook will also target anchored retail and office.

**Dominion Corporation** will underwrite preferred equity to reach a total capital stack of 93%. Loans must be \$5M and up. Pricing for preferred equity will be north of 20%. Mezz loans top out at 85%. Terms run three to seven years. Dominion will look at all property sectors, including the four main groups, special purpose, hospitality, gaming, entertainment and parking lots. Primary MSAs and secondary markets will be targeted with tertiary financing reserved for areas with an immediate need for healthcare properties.

**Terra Capital Partners** looks to dole out preferred equity and mezz for cash flowing assets. Multifamily, retail, industrial, office and hotels will be targeted. Deals run \$2M to \$10M with most ranging \$3M to \$7M. Terra will typically provide 5% to 20% of the capital stack. **Hudson Realty Capital** will dabble with mezz but will prefer B notes going forward.

### “SMALLER” DEAL OF THE WEEK

Property Type: Walgreens in Spring Hill, Fla.  
 Loan: \$3M Refi  
 Lender: **BankUnited**  
 Leverage: 50% LTV  
 Rate: Floating +275 over Libor

This non-recourse loan breaks down into a \$2M, 10-year loan and a \$1M, five-year line of credit. The line of credit is interest only and there is a 25-year amortization schedule. This deal was tough to place due to the borrower's desire for a floating-rate loan without recourse. Banks that will do small floating-rate loans usually require recourse. The strength of the borrower and previous relationship with BankUnited helped push this loan through.

Expect to see a decrease in the number of lenders interested in single-tenant, non-recourse loans going forward. Small life companies will reach capacity with drugstore chains and the conduits will target deals at \$5M and up. Credit unions typically prefer higher leveraged assets without cash flow. This property's location in a suburban market, along with a cell tower in back of the property, also created challenges. However, the prime location on an outparcel pad in a Publix-anchored shopping center attracted lender interest. The center also has the ability to add additional outparcels in the future. BankUnited will allow future development without consent, just notice. Walgreens' credit worthiness and conservative loan request made the bank comfortable with the deal.

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### PRIVATE LENDERS INCREASE VALUE-ADD DEALS

Count on a surge of private lenders to get involved with value-add loans, especially as more multifamily properties come to the market. After multifamily, watch for hotels and office to see a significant amount of activity, while retail and industrial will pick up by year's end. Leverage will land between 55% and 65% on transitional deals. Since lenders will be taking more of a risk on value-add loans, count on a 150 to 250 basis points higher spread on interest. Rates will range 10% to 15%, although some lenders will go lower. Keep an eye out for lenders to underwrite based on the exit cap rate. **Hudson Realty Capital**, **CapitalSource**, **BRT Realty Trust** and debt fund **Latitude** will be active. **Mesa West** will solely underwrite loans for value-add properties this year with rates at 5% to 7%. Loans will run \$10M to \$150M.

Private equity investment fund **Bloomfield Capital** focuses on deals under \$15M. The lender targets markets where there will be less liquidity and fewer capital sources such as Texas, Tennessee, Ohio, Florida, Maryland, Upstate New York, Michigan and Illinois. Equity-based transitional lender **Seattle Funding** will provide loans with rates between 8% and 9%. Loans will be \$500K to \$6M. **Sterling Commercial Capital's** typical loan amount will be \$3M, with a \$2M minimum. Some banks such as **Wells Fargo** and **Chase** will get involved in the high-quality loans with favorable sponsors.

Borrowers will need to contribute about 20% of capital for these deals. Expect investors to fill the gap in the capital stack through seller financing, a mezz piece and/or personal funds. Some borrowers will raise money from personal acquaintances. Large institutional investors will use their own equity. Borrowers could also use additional capital from equity investment firms or private equity firms (although not prevalent for deals under \$10M) or borrow higher up on the capital stack at an elevated price.

As fundamentals improve, look for a flight to quality. Borrowers will want to enhance properties, which will push a need for value-add financing. More multifamily value-add loans will come to the market as owners begin to invest additional capital into improving units when competition heats up in the sector. Look for private lenders to swoop up the deals that fall out of the agencies' box. Private lenders will especially desire properties that have the ability to upgrade from one class to the next. Lower class properties in prime locations will be more desirable.

Borrowers will need to have significant construction and renovation experience. Lenders will be more concerned with the business plan than the property itself. Look for plenty of value-add funding opportunities in West Coast cities, especially those in Southern California. Expect many lenders to seek out loans in Northern California because of the strong tenant demand and positive activity. Denver and Phoenix will also see some action.

**BANKS & LENDERS****Allianz**

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Allianz bets on around \$700M in allocations this year. The LC will be bullish on retail and multifamily. Allianz will participate in club loans as a way to obtain exposure to a specific property, asset class or market.

**Beech Street Capital**

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Beech Street provides \$9.49M through Fannie Mae to refinance Lakewood Estates, a manufactured home community in Denton, Texas. The lender will be active in the MHC space and hopes to beat the \$100M originated in the sector last year.

**Berkeley Point Capital LLC**

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The Irvine, Calif., office of Berkeley Point finances a \$30M refi with Fannie Mae for Paradise Cove Mobile Home Park in Malibu, Calif. Interest was fixed at 3.86%. The lender prefers \$5M and above loans in the space and can go up to 80% leverage.

**Bloomfield Capital**

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Bloomfield Capital plans to loan out \$50M by year's end all on value-add assets. The private equity fund manager is a direct lender and buys loans. States in between the coasts will be targeted. Loans will be \$15M and under have one- to three-year terms.

**Equitable Life**

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Equitable Life loans in the \$500K to \$4M range. Medical office, federal-leased buildings, office, warehouse/distribution, retail, multifamily, mobile homes and self storage will all be considered. Cities from Texas to Colorado and Ohio will be the focus.

**Mesa West Capital**

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Mesa West will originate \$1.5B this year and all loans will be for value-add properties. The lender has an appetite for all asset types. Look for loans on a vacant industrial building in California's Inland Empire and an office building in Dallas to close soon.

**Pacific Life Insurance Company**

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Pacific Life will target around \$2B in commercial mortgage loans by year's end. The LC will consider club loans on the more than \$350M deals. These loans will most likely be for office, regional malls and portfolios.

**Seattle Funding Group**

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Seattle Funding is a transitional lender that focuses on multifamily, office, retail and flex distribution assets. Loans will be between \$500K and \$6M. Markets on the West Coast, including Los Angeles, San Francisco and Seattle will be targeted.

**Security National Capital**

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Security National will participate on 50/50 JVs with other life companies when the loan is over the \$5M maximum, usually falling between \$6M and \$10M. Office, retail, office/warehouse and multifamily will be targeted. The LC does one- to five-year loans.

**Sterling Commercial Capital LLC**

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Sterling Commercial plans for \$80M in commercial loans by year's end. Around \$60M will go toward value-add/distressed properties. The minimum loan amount is \$2M. The lender will work with any income producing real estate.

### DEAL OF THE WEEK

Property Type: Shadow-Anchored Shopping Center in Boca Raton, Fla.  
 Loan: \$5M Refi  
 Lender: **Advantus**  
 Leverage: 60% range  
 Rate: 5.2%

The lender used a conservative cap rate floor of 8.5% in the initial analysis of the property. Higher leverage was achieved thanks to the appraiser's 7% cap rate. The borrower requested a non-recourse loan, a difficult feat in today's market. Many life companies will not provide non-recourse retail loans. Advantus grew comfortable with the well-capitalized borrower that boasts experience in the market. The loan holds a 15-year term, with 20-year amortization. DSC is 1.86x. Proceeds will go toward the refinance of a maturing CMBS loan. The competitive interest rate was locked at application.

Due to a chemical leak from a former dry cleaning facility on the property years ago, there are still contaminants on the site. Most lenders would not consider a deal with environmental contamination issues. Advantus is open minded because the contaminants will most likely go away naturally over time and the property is located in a high-traffic area that boasts favorable rents and low vacancy. There is high tenant demand for this center and very little tenant improvements required at move in.

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### LCs JOIN THE CLUB

Look for more life companies to join forces and syndicate club loans in an effort to tackle larger loan amounts. LC club loans will be a more feasible way to fill the void for sizeable deals left behind by the broken CMBS model. Leverage will be between 50% and 70%. Debt yield will be around 10%, while DSC will come in at 1.35x to 1.50x. Rates will be 4.25% to 4.5%. LCs will prefer to partner with other life companies since they will be alike in underwriting and face similar regulatory issues. Expect club loans to provide conservative underwriting since multiple parties need to agree on the terms and conditions. Watch for **Cornerstone, Prudential, John Hancock and Lincoln National** to consider club loans.

**Allstate, Great-West Life, MetLife, New York Life, Prudential, TIAA-CREF and New York State Teachers Retirement** partner with **Northwestern Mutual** on loans this year. Northwestern will look for a co-lender on any single-asset deal of more than \$250M. Most loans will be for regional malls and large office buildings. New York Life will most likely do more club loans this year, after participating in seven so far in 2012.

**Pacific Life Insurance** will get involved in club loans with one or more LC on deals in excess of \$350M. Most will be for office, regional malls and portfolios of properties in major cities. **Allianz** will team up on club loans with one or more LC to obtain exposure to a specific asset, asset class or market.

Count on smaller life companies such as **Advantus** and **Protective Life** to partner on deals less than \$10M, which will be below many of the major players' minimums. **American National Insurance Company** will consider syndicating on a case-by-case basis. **Security National** prefers traditional 50/50 partnerships for loans more than its' \$5M maximum. The lender provides shorter term bridge products, which makes club loans a challenge. Office, retail, office/warehouse and multifamily will be targeted. **Equitable Life** will team up with other LCs to allocate loans higher than the lender's \$4M minimum.

Club loans help mitigate the risk to the lender. Loans with less participating LCs work better, as deals become complex with more partners. Lenders will look at the quality of the real estate and adequacy of in-place cash flow as an eventual exit strategy. Borrowers will obtain a certainty of execution from the LCs, have post-closing flexibility and favorable pricing.

DEALMAKER DATABANK

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## LCs, BANKS EYE SMALL RETAIL LOANS

Look for increased competition from lenders on retail loans under \$5M. Large lenders will further drop minimums and small lenders will raise maximums. The LCs' typical leverage will be around 70%; banks will reach 75%. Count on loans under \$5M to see 0.25% to 0.5% higher interest rates than larger retail deals. Interest on 10-year money will be around 4.75%, while 20-year loans will see rates in the 5% range. DSC will be between 1.25x and 1.50x. Debt yield will be 10% to 11%. Life companies will use yield maintenance, while banks will offer fixed or no pre-payments. Loans with rapid amortization schedules will receive the most favorable terms.

**Kansas City Life, Summit, Protective Life, Thrivent Financial for Lutherans, Lincoln National, Genworth and Advantus** will fund deals as low as \$3M. **Stancorp** will be one of the most active in the space, with a \$1.5M average loan size. **Symetra** will size loans down to \$1M. **United Farm Family Life, Modern Woodman of the World, Aetna, American National Insurance and RiverSource** will also get involved in smaller retail loans. **Equitable Life** will only look at retail loans with a maximum 50% leverage.

**Wells Fargo** will be bullish through its small loan program. Community banks, including **BankUnited, EverBank, North Shore Bank, Gateway Bank, Park Sterling Bank, TD Bank and Sterns Bank** will step up to fill the need for smaller deals. A handful of credit unions such as **Coastal Federal Credit Union** will also be active in the space.

Borrowers will most likely bring in their own equity by raising capital from personal acquaintances to fill the capital stack, since these smaller deals will not be a big market for mezz or equity players. Borrower net worth will need to be two and a half to three times the loan amount. Lenders will want a credible borrower with a track record of meeting obligations. LCs will look closely to make sure the borrower hasn't given properties back and hasn't fallen underwater on any other assets. Most lenders will underwrite using global cash flow.

Properties need to be well located with a favorable track record of strong leasing for the past three years. Assets at or below market rents and healthy fundamentals will be targeted. Look for lenders to desire 90% occupancy. Lower occupancies will be considered if the borrower plans to add value to the property and fill the empty space. Lenders will prefer grocery- or shadow-anchored centers but the majority of the need will come from unanchored mom-and-pop assets. Co-tenancy clauses will be problematic. Markets such as Washington, D.C., where retail will be strong yet undersupplied, will see plenty of lender attention.

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