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MEZZ LENDERS FOLLOW ACQUISITIONS

Count on an increase in demand for mezzanine debt behind acquisition loans, DPOs and notes sales going into next year. Look for a greater willingness from senior lenders to accept DPOs. Senior lenders will not provide enough leverage to cover these deals, which will lead to more creative subordinate debt needs. Buyers will turn to mezz to fill the shortfall of proceeds. Mezz lenders will be attracted to the acquisitions arena thanks to the amount of meaningful new skin in the game that comes with transactions. Leverage will push up to 85% on acquisition deals. Look for mezz lenders to target low double-digit returns around 12% to 15%.

Going forward, expect thicker mezz tranches instead of the thinner multi-tier mezz structures seen in the past. The mezz space will provide attractive risk-adjusted returns to investors willing to get involved in high-leverage deals. Mezz will obtain high-yield interest rates, while first position debt will see increased competition as more balance sheet and CMBS lenders return to the market. Expect mezz activity to slow down once real estate values increase and existing debt can be refinanced for greater proceeds.

Look for **WestRiver Capital Management, Malkin Properties, PREI, CPP Investment Board (CPPIB), Fisher Brothers** and **Blackstone Group** to be active with mezz debt for acquisitions. REITs such as **Redwood Trust, PAC REIT, Colony Capital LLC** and **Invesco Mortgage Capital** will consider mezz for the right deals. **Pembrook Capital Management** will work with multifamily, anchored retail, multitenant office and medical office buildings.

Hotels will see a healthy supply of mezz financing opportunities going into 2013. **Pearlmark Real Estate Partners** and **Canyon Capital** will consider hotel mezz loans. **Lowe Enterprises** will work with urban and suburban limited service hotels in established markets, including underperforming assets in need of new management and renovation dollars. Colony Capital provides mezz loans between $10M and $200M, with a $25M to $75M sweet spot.

Expect mezz lenders to want borrowers with experience, collateral and successful track records. Borrowers that demonstrated positive behavior through previous defaults will also be preferred. Count on demand from transitional assets going through lease-up periods or coming off significant repositioning.

HOTELIERS SEE UNDERWRITING SETTLE

As more lenders begin to warm to hospitality, don't expect underwriting to further improve this year. In the foreseeable future, expect leverage to top out at 70% to 75% for the most favorable assets. An average deal will come in at 60% to 70%. Hoteliers looking for higher leverage will need to select a blended first mortgage/mezz piece to obtain up to 80%. Fixed-rate senior mortgages will see rates from the high 4% to low 6% range. CMBS will be the most abundant avenue for hotel lending going into 2013. Fixed-rate deals with 10-year terms and 25-year amortization will be the most common.

Geographic location will no longer be paramount to closing a loan. Going into next year, look for conduits to favor flagged hotels in nearly any market nationwide that boasts improving fundamentals and/or demand drivers. Conduits such as **Citi** and **Cantor Fitzgerald** will begin to look at smaller hotels, with around 100 keys, in a wider variety of markets. Look for more deals to occur in the Southeast, including Alabama, Mississippi, Georgia and Tennessee.

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"SMALL" DEAL OF THE WEEK

Property Type: Industrial Park in Fountain Valley, Calif.
Loan: $2.5M non-recourse refi
Lender: **Ameriprise Financial**
Leverage: Sub-50%
Rate: Mid-4%

The borrower wanted to lock the rate back in March, even though the loan was not set to close until September. Ameriprise offered a forward commitment and locked the rate in advance, which many other lenders would not have considered. The 10-year loan with 30-year amortization was favorable for a property built in 1969. Ameriprise was comfortable with the non-recourse element due to the low leverage. Loan proceeds will go toward paying off an existing conduit loan.

The deal faced a major hurdle because 22 of the 23 tenants, making up 75% of the space, have leases set to roll within the first two years of the loan. Sauerman and Magoffin attracted the lender thanks to the property's location in a strong market and close freeway proximity. The market boasts one of the lowest vacancy rates in Orange County, Calif., and sees high demand for industrial space. Many of the long-term tenants will most likely renew.

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HOTELIERS SEE UNDERWRITING SETTLE...

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Mezz, preferred equity and B notes will all be tapped by hoteliers to reach the highest leverage. Expect **Morgan Stanley, JP Morgan Chase, Wells Fargo** and **Ladder Capital** to favor B notes. **KeyBank** will consider inking mezz on its balance sheet with plans to sell it off after closing. Many borrowers will prefer the structure of mezz and preferred equity over B notes because it gives them more control. **CIBC** favors preferred equity over mezz. The lender often works with **Blackstone Group** for preferred equity pieces behind its first mortgages.

Look for **BofA, Archetype Mortgage Capital, RBS, UBS, Deutsche, PNC Real Estate, Basis Investment Group**, Wells Fargo, Morgan Stanley, JP Morgan Chase and Ladder Capital to become interested in flagged select-service assets. KeyBank will prefer flagged assets with leverage around 60%. IHG brands, including Holiday Inn, will gain popularity from conduits. Marriott flags such as Residence Inn and SpringHill Suites will also be favored in the New Year. CIBC prefers Marriott, Hilton and Hyatt branded assets but will selectively look at boutique hotels with solid sponsorship and location. Don't expect the lender to underwrite deals for Choice or Super 8 brands in the near future.

CONDUITS BECOME MORE COMPETITIVE

As CMBS bond spreads compress, conduits will begin to more aggressively battle with LCs and balance-sheet lenders on rates. Look for rates to be in the low to mid-4% range going forward. Expect more CMBS lenders to start offering 80% on senior mortgages in the next few quarters. Many conduits will team up with mezz lenders to push higher up the capital stack. Typical leverage will be between 70% and 75% on most deals. Cash-out loans will see lower leverage. Conduits will swoop up a vast amount of deals in Q4, as life companies fill allocations and put lending on hold until January.

Debt yield will be between 9% and 10%, but could fall as low as 8.5% as demand increases. Keep an eye out for conduits to move away from debt yield numbers next year and focus on DSC ratios, especially if rates rise. Anticipate conduits to be active in major markets not dominated by institutional lenders such as Dallas and Atlanta. Other markets in Texas, Arizona, Colorado, California, Nevada and Florida will also see activity, especially in the office and retail sectors.

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BANKS & LENDERS

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CONDUITS BECOME MORE COMPETITIVE...

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Count on a pickup in CMBS activity next year, leading to around $60B in allocations, higher than the $35B to $40B expected by year's end. CMBS will be a favorable source of financing on loans coming due in the next couple years. **ING Investment Management** forms a new partnership with **Barclays** and offers $10M to $50M loans with leverage up to 75%. **Prudential** will also be active in CMBS. Other life companies could follow suit and enter the CMBS space next year.

Large players, including **Wells Fargo, Morgan Stanley, Citi, BofA, Goldman Sachs, Deutsche Bank, Natixis Real Estate Capital** and **JP Morgan Chase** will be active on large $10M-plus deals. **Basis Investment Group, Ladder Capital, C-III Capital Partners, Archetype Commercial Mortgage** and **Cantor Fitzgerald** look at deals starting at $4M and consider Class B assets in second-tier markets. **UBS** will originate loans under $5M and balance-sheet lender **CIBC** will also be busy in the CMBS space.

Retail, office, industrial and self-storage will make up the majority of the CMBS deals in Q4. Expect to see a few Class B- and C+ multifamily deals, which don't qualify for agency loans, emerge as CMBS deals. Retail properties with increasing year-over-year sales will see plenty of interested lenders. CMBS lenders will prefer borrowers with experience in both ownership and management. Hotels will see a major boost in CMBS activity going into next year. Properties with strong historical occupancies and increasing rents will be highly sought after.

LCs TURN TOWARD UNANCHORED RETAIL

Life companies will be a reliable source of capital for unanchored retail centers, but expect conservative underwriting. Leverage will be between 50% and 65%. LCs will want borrowers to have significant skin in the game with 35% to 50% equity. New cash ahead of the loans will be preferred, which means acquisitions will be the most attractive. Count on life companies to target 12% debt yield based on the underwritten NOI. Cash-out proceeds will be tough to come by for unanchored retail. Expect tighter amortization at 25 years and below. Interest rates will land from 4% to 5%. DSC will be 1.40x to 1.50x. Lenders will require some level of recourse on loans under $3M.

Symetra, **Stancorp.** and **Industrial Alliance Life Company** will consider smaller deals with strong sponsors and conservative leverage. Immense players, including **Nationwide**, **MetLife**, **New York Life**, **Cornerstone**, **Principal** and **Prudential** will target the best-in-class sponsors and assets. **ING Investment Management, Lincoln Financial, RiverSource (Columbia Management), Sun Life, Thrivent Financial for Lutherans, Aetna, Southern Farm Bureau, American Equity Investment Life Insurance Company** and **Advantus** will also be active.

A rise in leasing activity and rents going forward will make many LCs more comfortable with the product type. Going into 2013, life companies will be optimistic that tenants will not downsize or vacate. Count on LCs to critically analyze the long-term business viability of a wide variety of storefront retailers such as book and electronics stores. LCs will focus on the underlying credit of the tenants, which can be challenging for unanchored centers. These centers will usually contain mom-and-pop tenants, which were hit hard during the downturn and will be slower to recover.

Unanchored retail properties typically see higher tenant turnover and lower tenant creditworthiness, leading to a need for some level of recourse. LCs will seek well-occupied properties in dense, urban locations with favorable historical sales performances. A seasoned property that successfully navigated the downturn will see the best financing terms. Owners that were able to backfill vacant space quickly at reasonable rent abatements will be the most attractive. Borrowers will need favorable reputations, established track records, experience in the sector and financial stability.

Count on lenders to put a higher emphasis on infill markets with favorable demographics. Primary markets, including New York City, Boston, Chicago, Washington, D.C., Dallas, Houston, Miami and Denver will be desirable. Coastal gateway markets, including San Francisco, Los Angeles, San Diego, Orange County, Calif., Seattle and Portland, Ore., will see the most activity, especially in areas with energy or tech jobs.

DEALMAKER DATABANK

EagleBridge Capital 33 Broad St., Suite 800, Boston, MA 02109 [redacted]	EagleBridge closes a $10.8M construction loan with United Bank for Dorset Crossing, a mixed-use [redacted]

[redacted]

CONSTRUCTION LENDERS TO CONSIDER MOST ASSETS

Anticipate a plethora of construction activity across all product types in most major MSAs by Q4 2013. Look for more construction loans for built-to-suit and preleased anchored retail projects next year, as retailers become more comfortable with expansion. Count on office rents to increase in 2013, which should lead to demand for more new product. Lenders will be looking for significant preleasing from creditworthy national tenants and strong local brands that have demonstrated favorable sales. Retail and office projects will need to be 50% to 75% preleased to garner lender attention. Preleasing hurdles will drop for well-located projects.

Leverage will be between 65% and 70% for most deals. A handful of banks will provide leverage above 70%, which could creep up to 75% if the rental market continues to flourish. Borrowers will need 35% of project costs from a source other than the construction lender. Debt yield will be 9% to 10%. Regional banks will provide interest at 5.5% to 6.75%, while big money-center banks will be in the 2.75% to 3.5% range. DSC will be 1.25x to 1.50x based on projected stabilized NOI.

Lenders will be looking for ways to increase origination volume; construction deals will see less competition and receive more favorable yield. The large deals, $50M plus, will go to money-center banks such as **Wells Fargo, Citi, BofA** and **Chase. United Bank, Bank of the West, US Bank, KeyBank** and **PNC Real Estate** will also originate some construction money. Count on regional banks, including **Webster Bank** and **Fulton Bank** to allocate construction lending.

Small to mid-sized developers could have a tougher time, but private lenders, including **Seattle Funding** and **Silo Financial** will provide construction loans under $1M. Seattle Funding will allocate loans from $500K to $5M for spec residential and small infill projects. Silo Financial will consider construction loans under $1M for mixed-use properties.

Spec construction will be tough until meaningful job growth occurs. Capital will be available with favorable interest rates but balance sheets and existing relationships will be key factors. Lenders will look closely at borrowers, product types and locations. Borrowers need to bring track records of similar projects, clean borrowing histories, personal equity and 10% to 20% liquidity to cover any hard cost overruns.

Lenders will favor cities with the lowest inventory and greatest absorption. Construction financing will increase in major cities such as Boston, New York City, Los Angeles and Miami, as well as cities in Texas. Washington, D.C., and Philadelphia will see some office construction activity. Look for activity in West Coast gateway cities such as San Diego, Los Angeles, Orange County, Calif., San Francisco, Seattle and Portland, Ore. Secondary markets such as Lincoln and Omaha, Neb., will see some projects break ground.

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