The CRITTENDEN REPORT® Real Estate Financing

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LENDERS BOOK SMALL HOTELS

Anticipate new lenders, higher leverage and lower pricing for hotel loans under $5M next year, as fundamentals improve and competition increases. Borrowers will see leverage up to 80% from private lenders and 65% to 70% from banks and conduits. Rates will be 5.5% to 11%. SBA loans will see leverage up to 85% and rates around 6%. Debt yield will be 10% to 12% on small hotel loans. DSC starts at 1.30x with 25-year amortizations. Secondary and tertiary market DSC will be around 1.60x. Keep an eye out for private lenders to underwrite stabilized projections, while banks will stick to trailing performances.

Watch for **Wells Fargo, PNC Bank, KeyBank** and **BBVA Compass** to be active providing 10-year loans and 15- to 25-year amortizations with 5.5% rates. Count on banks to require full recourse. **Fidelity Bank** originates $2M to $5M deals. Select-service properties with fewer than 100 keys and mid- to upper tier flags will be desired. Leverage will reach 80%. Rates will be 5% to 6% with 1.25x DSC. Fidelity requires full recourse and personal guarantees. Conduits such as **Starwood, Wells Fargo, Ladder Capital, Morgan Stanley** and **Cantor Fitzgerald** will deploy hotels loans below $5M.

Access Point Financial will allocate bridge loans for renovations and acquisitions, as well as repositioning deals. Loans start at $250K for CapEx with 75% LTC. The lender targets both branded and independent select-service properties with 80 to 200 keys in secondary or tertiary markets. Count on 7% to 10% rates. DSC will be 1.25x in year two of projections. Access Point requires full personal or corporate guarantees. **Edgewood Capital Advisors** boasts a $1.5M loan minimum and 80% leverage for hotels. Rates will be 8% to 12% and non-recourse money will be available. Edgewood targets 120-key luxury hotels in primary and secondary markets, built after 2000.

UC Funding originates hotel mezz and equity starting at $2.5M and bridge loans from $3.5M. Leverage will reach 85% for bridge loans and 90% with mezz. UC Funding provides non-recourse loans with 7% minimum pricing. **Thorofare Capital** starts hotel loans at $2M with up to 80% LTC. Transitional deals and acquisitions with new sponsors and management will be desired. Select-service, interior-corridor properties with first or second tier flags will be preferred. Rates will be 8% to 11%. Bridge loans will offer one- to three-year terms. **Forman Capital** will originate loans as low as $4M for hotels. Leverage will max at 75% with rates around 10%. Flagged select-service properties with 80 to 120 keys will be desired.

Select-service properties with Holiday Inn, Best Western, Comfort Inn and Residence Inn flags will see plenty of interested lenders. Strong management companies will also be sought after. Lenders will look for franchise agreements to run beyond the loan term and low CapEx and PIP requirements. Borrowers must demonstrate property cash flow or owner liquidity for assets with upcoming PIPS. Lenders will look for a diversity of demand generators.

CMBS SHIFTS TOWARD OFFICE

Conduits will grab more office loan market share with higher leverage and attractive three- to five-year, interest-only terms. Anticipate CMBS to enter new secondary and tertiary locales by year's end. Conduits also begin underwriting market vacancy and providing substantial TI reserves. CMBS will beat LCs on office leverage but with higher rates, while banks will play it safe with lower leverage and recourse. Conduits leverage will reach 75%.

Borrowers will see 4.75% to 5.25% rates. Count on a 25 basis point shift up and down in rates going forward. Debt yield will be between 9% and 10.5%. Major cities such as Los Angeles, Chicago, Boston, San Francisco and New York City will see debt yield as low as 8%. DSC will start at 1.25x.

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CMBS SHIFTS TOWARD OFFICE...

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Look for **Cantor Fitzgerald**, **Starwood**, **Rialto Capital**, **Redwood Trust**, **Basis Investment** and **RAIT Financial Trust** to be bullish on non-trophy assets and smaller deals under $10M. **Natixis** provides both floating- and fixed-rate loans for office. Larger players, including **JP Morgan Chase**, **BofA**, **Deutsche Bank**, **Wells Fargo**, **Citi**, **CIBC**, **RBS** and **Goldman Sachs** will be active with office loans.

CMBS lenders will target suburban properties and Class B assets with strong cash flow. Class C properties will be considered in favorable markets, along with Class A assets in tertiary cities. Conduits seek office buildings with at least 85% occupancy. Properties with recent leasing will be sought after as they show viability in the market. Lenders look closely at tenant mix, location, supply and demand dynamics, and tenant lease roll.

Gateway cities with year-over-year absorption and strong secondary cities such as Austin, Texas, and Raleigh, N.C., as well as Jacksonville and Palm Beach, Fla., will see the most conduit attention. Buildings with short-term leases will have a harder time obtaining financing. Pricing and reserves will be adjusted to handle rollover risk.

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DEAL OF THE WEEK

Property Type: Unanchored Retail in Ocoee, Fla.
Loan: $1.4M Refi
Equity Investor: **Ohio National Life Insurance**
Leverage: 53%
Rate: 4.45%

Ohio National Life was flexible in providing a fully amortizing 15-year loan and closed during a 30-day window to avoid prepayment penalties. The borrower wanted the shortest amortization schedule possible in order to be free of debt in 15 years. Many lenders shy away from unanchored retail but Ohio National Life was comfortable working on this deal because of its relationship with the borrower, along with the location, tenant base, loan size and the age of the 2003 property.

The LC provides rate lock at application, which helped the borrower obtain a favorable low rate. This loan replaces existing bank financing. Ohio National requires full recourse. Originally, the borrower wanted cash-out proceeds but chose Ohio National because of the ease and certainty of execution.

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LEVERAGE ON THE RISE FOR ADJUSTABLE RATES

As acquisition activity spikes in 2014, lenders will increase leverage and decrease DSC/debt yield to compete for adjustable-rate loans. Expect leverage in the 65% to 85% range next year. Floating-rate loans offer the lowest cost of capital and will become more viable across all property types as treasuries increase. Spreads will range from 150 to 550 over Libor with starting rates between 2% and 6%. Anticipate spreads to further compress due to increased competition. Banks and life companies will provide rates of Libor plus 200 to 250 basis points (around 2.2% to 2.7%) with interest-only terms. Borrowers can expect Libor plus 650 for deep value-add hotels or 50% leased buildings.

Adjustable rates will typically be for larger loan amounts than fixed rates and will be attractive for acquisitions and recapitalizations. Interest rate uncertainty will lead to more lenders opting for floating-rate transactions. Watch for banks and debt funds to be the most active in the sector, especially for transitional assets. Banks will provide the most favorable options for rate-driven borrowers, while debt funds offer the best execution for proceed-driven borrowers. Life companies and conduits will also get aggressive in the space next year.

Banks originate five- to 10-year, adjustable-rate loans with swaps. **PNC Bank, US Bank, Chase, Capital One Bank, City National Bank** and **Wells Fargo** will be active. **BofA** and **California Bank & Trust** will provide floating-rate deals for office assets. Banks could push leverage to 70% in 2014. Most deals will be 60% to 65% with non-recourse provisions.

Anticipate pricing compression and leverage up to 85% from debt funds and bridge lenders. Debt funds such as **Starwood, Ares Management, Mesa West** and **Prime Finance** will originate three-year loans with extension options. **GE Capital Real Estate** will provide floating-rate money for hotel loans.

Life companies such as **Cornerstone, Prudential, MetLife, Nationwide, Allstate** and **PPM Finance** will stick to three- to five-year, floating-rate terms and 12 to 18 months of lock out then open prepayment. Expect LCs to become more open to adjustable rates on transitional assets next year. Life companies will max leverage at 65% with 9% to 11% debt yield. Conduits such as **Natixis, Goldman Sachs, C-III Commercial Mortgage, CIBC** and **Jefferies LoanCore** will be active. Debt yield for CMBS loans will be 7.5% to 8%.

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EQUITY INVESTORS TARGET SINGLE FAMILY

Look for a new wave of preferred and JV equity investors to enter the single-family market thanks to home price appreciation and positive fundamentals in the space. This increase in competition will lead to lower pricing and more equity options for small and mid-sized builders. Leverage can reach 90% with equity pieces and many investors will provide up to 100% of the equity. Expect 10% to 20% preferred returns. Equity investors will be drawn to the sector's insufficient supply of housing to support demand and population growth in many markets.

Presidio Residential Capital invests $5M to $25M JV equity pieces for small to mid-size builders. The investor can provide up to 100% of the equity needs with 15%-plus returns. Detached homes and townhomes will be in the cards. Phased projects with at least 15 homes will be desired. Presidio will also get involved in entitlement and development plays. **Partners Capital Solutions** originates the entire capital stack with sponsor co-investment. The investor targets infill properties without land entitlement risk and projects with a total cost of $2.5M to $10M. Count on returns in the low 20% range. Small and local builders with experience in the market will be targeted.

TMC America originates $1M to $10M pref and JV equity slices for small to mid-sized private builders. Returns range from 6% to 12%, which is split with the builder based on a waterfall that accounts for project risks. TMC provides 90% or more of the required equity, usually 15% to 30% of project costs. All housing types from affordable to luxury will be desired and builders with little net worth will be considered on certain deals. The investor finances entitlement opportunities and works with builders that acquire parcels requiring further approvals.

Mountain Real Estate Capital provides pref and JV equity for single-family assets and will also allocate debt on certain deals. The investor originates $5M to $50M equity pieces. Count on 10% to 12% returns. Mountain seeks projects where an opportunity to add value through redesign or repositioning exists. **Resmark Land and Housing, Oak Tree Capital Management, Starwood Land, AEW Capital Management, The Carlyle Group** and **AIG** will also invest equity for single family. Keep an eye out for **HG Capital** to re-enter the single-family JV equity market with $1M to $5M slices and mid-20% returns.

Equity investors target smaller urban-infill communities near transportation, amenities or infrastructure. Homes near marinas or golf courses will also be in demand from the baby boomers. Builders that have done similar projects in the past will see the most equity dollars. Expect builders to need a track record of experience and financial capability to support any required guarantees, inflation or project delays. Builders with limited experience and those lacking exit strategies will keep equity investors at bay.

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