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Building owners enjoy robust lending options

In the first quarter of 2015, I wrote an article for Colorado Real Estate Journal highlighting how different types of commercial real estate lenders had unique lending appetites for retail properties. The retail market can be tricky, especially in an environment where online sales are cutting into brick-and-mortar revenues. According to a December Bloomberg report, brick-and-mortar retail sales fell 10 percent compared to the prior year. Despite the headwind of online sales, the capital markets remain robust, and lenders have plenty of capital available for retail real estate.

Over the course of the 2015 calendar year, I closed over $200 million of retail loans, here in Colorado and out of state. These loans were arranged through a wide variety of capital sources including life companies, commercial mortgage-backed securities lenders, banks and credit unions. Lenders are continuing to offer extremely competitive terms, sustaining a favorable environment for borrowers. I'd like to highlight a few trends that I expect will carry forward into 2016.

Life Companies

There are a few notable ways life companies will continue to compete for retail business. First, their continued willingness to offer forward commitments, which allow borrowers to rate-lock far in advance of closing, will be a perfect cure for the anxiety some property owners have about interest rates. Even though the Fed's decision to begin tightening monetary policy doesn't necessarily mean mortgage rates will increase – in most cases, mortgage rates are derived from market Treasury yields, not the discount rate or federal funds rate – many investors are considering refinancing early. They are considering this even if it means paying a prepayment penalty in order to lock a current market mortgage rate.

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The forward-commitment option offered by many life companies eliminates the need for this trade-off altogether, as borrowers have the option to lock their mortgage rate up to 12 months prior to closing, allowing the prepayment penalty associated with their existing debt to burn off. This is an attractive strategy for borrowers. Forward commitments were made on approximately half of the life company loans I originated last year.

Another way life companies will continue to win retail business is by offering longer-term, fixed-rate financing – loans with rates fixed longer than 10 years. Many life companies can offer mortgage rates fixed for 15 to 30 years with negotiable amortization schedules. This is powerful for retail owners who plan to hold assets long term since, for the most part, the only other commercial real estate lenders who can offer longer-term fixed rates are agency lenders in the multifamily space.

There are a few ways life companies may become more aggressive in 2016. In my aforementioned article, I noted that life companies often were sensitive to leverage points where the loan-per-square-foot exceeded $200. The CMBS market won many of the loan requests falling into this category last year; consequently, many life companies' portfolios are underweight retail.

Moving forward, there's a good chance some life companies will warm up to higher loans per foot for select retail assets, especially grocery-anchored centers and properties located in strong urban-infill areas. Life companies also might seek transitional assets more aggressively. Last year, a few insurance companies began offering nonrecourse bridge loans for assets with short-term business problems that could be solved in the near term, but might not be ready for a traditional permanent loan. These debt offerings come with competitive rates compared with the traditional nonrecourse bridge lending market. Investors should keep an eye out for expansion of these programs in 2016.

CMBS Lenders

Since CMBS lenders typically are willing to lend up to 75 percent loan-to-value on stabilized assets, they've been a common source for high-leverage nonrecourse loans. But for the past few years, a handful of CMBS lenders have become more aggressive. For select properties, 80 to 85 percent leverage now is attainable via the addition of on-book mezzanine debt, where CMBS lenders make higher-interest-bearing second-position loans on their own balance sheet (behind their own first mortgage). While the first loan is securitized, the mezzanine debt is not sold in the bond market and is available in sizes of $2 million and up. This eliminates the need to go to a separate mezzanine debt lender and makes smaller "mezz pieces" available. Historically, traditional mezzanine debt lenders haven't offered loans this small.

The availability of mezzanine debt could meaningfully benefit retail real estate, because many of the loans maturing this year were arranged 10 years ago, in 2006-2007 at prerecession valuations. For retail assets in markets where cap rate compression has not been enough to counteract decreasing rental rates, mezzanine financing will prevent borrowers from having to bring cash to the closing table to refinance their asset. Mezzanine financing also adds flexibility for transactions with moving pieces.

For example, I arranged a CMBS loan to refinance a retail asset where a large big-box lease renewal was pending, and its execution was uncertain. In order to provide the borrower comfort that the existing debt would be refinanced by the maturity date, regardless of whether the pending big-box lease was renewed, we negotiated a loan application stipulating that if the lease was not renewed in time for closing, the borrower had an option to add a mezzanine piece in lieu of reduced loan proceeds.

Credit Unions

Historically, we haven't spent much time discussing credit unions in the commercial mortgage banking world. However, they're becoming an increasingly relevant source of capital for some commercial real estate borrowers who seek prepayment flexibility and aren't afraid to provide a recourse guaranty. Furthermore, a select few credit unions recently started making large loans.

For example, I placed a $27 million loan with a credit union for a Colorado retail asset. Even though the asset was considered stabilized, it had enough uncertainty in its rent roll to cause heartburn for life companies and CMBS lenders. Since the borrower was confident enough to provide a recourse guaranty, I arranged a seven-year credit union loan, which involved participation from a second credit union on the West Coast that could be prepaid in full without penalty starting from day one. This provided ample time for the borrower to solidify the rent roll as well as the flexibility to refinance to nonrecourse permanent financing at any time.

Overall, the lending environment remains favorable for commercial real estate borrowers. There's plenty of capital available for acquisitions and refinances – even some of the tougher ones.▲