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Capital supply will be more expensive, but plentiful in 2006

sh Steve Henderson



**Tremont
Realty
Capital**

As we approach the end of another year, many people involved in commercial real estate financing are focused on trying to get that last deal closed before year end. Overall, it has been another good year for all parties involved in our industry. One of our greatest concerns is where interest rates will go in the coming year. In 2005, the market continued to be ripe with plenty of capital, low interest rates and an ever expanding laundry list of lenders, which seemed to be multiplying on a monthly basis. Each year, for the past three years, there have been predictions that "rates will jump this year." Is 2006 the year this will occur? If so, how will it affect the supply of capital for specific types of real estate financing?

Anchored retail still appears to be a favorite of most lenders. Low spreads even for full lever-

age loans, should continue, but we expect to see a tightening of underwriting. Be aware of some of the grocery anchors such as Royal Ahold (Stop and Shop, Giant Foods) whose credit ratings are not investment grade. Some lenders are now underwriting a vacancy factor for their tenancy. More portfolio lenders are willing to offer long term fixed rates (10-year terms) with 30-year amortizations and no reserves in order to compete with the conduits.

Office and industrial properties are still market specific, because vacancy rates will differ depending on the sub-market and lease rates. Lenders will look closely at how each specific market is performing and the length of each property's remaining leases. Financing for single tenant properties, a more prevalent need in the office and industrial market (particularly with non-credit tenants), is an area where some lenders are looking to add to their portfolio.

Apartments and condominiums appear to be headed in different directions. Condominiums, a word lenders had forgotten until it re-appeared three

years ago, look as if they have started to downturn in some areas. Condo-conversions and ground-up construction projects are still being proposed by developers. While many are still viable, lenders are taking a more cautious approach particularly if the project is primarily second homes. Apartments are still selling at historically low cap rates, but the breadth of lenders in this arena means continued competition for this loan product, which keeps low cost capital available in abundance.

Financing for real estate deals on hotels, self storage, and manufactured housing communities will continue to be "niche" products meant only for certain lenders. Location and the operator of the asset continue to be key elements in lenders decision making. Availability for construction monies for hotels and self storage specifically have a defined list of lenders seeking these products on a national basis.

For those borrowers seeking higher leverage on any type of real estate project, there may never have been more opportunities to get those dollars. The availability of mezzanine fi-

ancing, that part of the capital stack above 75 to 80% loan-to-value, is at an all time high. Lenders are willing to provide up to, and in some instances, in excess of 90% of costs on projects. This type of financing is typically funded on a non-recourse basis. The trade-off is usually a premium on the loan spreads, but it enables the developer to avoid an equity partner who usually requires a piece of the deal versus a higher interest cost.

The upcoming year will continue to provide plenty of options for borrowers. Capital, even if a little more expensive, will be plentiful. Borrowers should recognize the availability of the increasing number of lenders, particularly those who are national in scope and who are providing certain lending products not always available in the local marketplace. Accessing these lenders and providing the borrower with multiple options will be the key to a successful 2006

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