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LEADERS IN REAL ESTATE FINANCE TALK ABOUT WHAT'S HAPPENING ON THE FRONT RANGE

Question: Can you discuss the main sources of capital for real estate deals and any prominent trends that you see now in Denver?

TODD BEDINGFIELD, AIG Investments: We are involved in most of the major metropolitan area. We've got approximately $385 billion of invested assets and our commercial real estate mortgage portfolio is a little over $20 billion. In Colorado, we've invested about $500 million in business over the last five years. Predominantly, it has been hotels, apartments, office, and a little bit of retail. We've done a couple hospitality deals; Marriot City Center, Hampton Inn, and Homewood Suites. We've done apartments from Denver all the way down to Colorado Springs. We like the office market in some pocket areas, TOD (Transit-Oriented Development) locations and urban creative office spaces. There's been a fairly strong economy so the retail market has been pretty attractive too, Clayton Lane as a good example.

ERIC TUPLER, HFF: As an intermediary, we have established relationships with all the capital types. The primary capital sources today for non-recourse financing are Life Insurance Companies (AIG is an example of that), CMBS (Commercial Mortgage-Backed Securities), Banks and Bridge Lenders. Today, banks are focused on construction and shorter term loans or light bridge, predominantly five years and shorter, sometimes with full recourse or partial recourse, some of which are non-recourse in nature. Life Insurance Companies have short-term floating rate money and longer term fixed-rate loans with terms of three to 30 years typically within that permanent market. These are predominantly non-recourse in nature.

As pertains to Denver, if you have an early-80s vintage B-minus asset in the suburban market, a balance sheet lender might feel that it doesn't meet their criteria from an age or locational perspective so that would be a good fit for a CMBS loan. CMBS is a public market execution for permanent lending, and it typically plays on lower quality assets, sometimes inferior sponsorship, and tertiary markets. CMBS also differentiates from balance sheet lenders by providing higher leverage and, many times, more interest-only. They will even go up on the risk scale for better quality assets.

JANE KACHADURIAN, The PrivateBank: We are a bridge lender focusing on deals with a relatively short-term business execution of three to five years. We are seeing a lot of development and construction opportunities from our clients, so our portfolio is more heavily weighted in that currently. Ideally we would continue to balance the portfolio with reposition and value-add deals, but that is representative of the opportunities for our clients. Good buys are hard to find and development provides the opportunity to achieve their required or desired yields.

As far as asset types, we have exposure to the major food groups. There is a significant amount of retail, some multifamily and some industrial and office. For us, everything is relationship driven. Our goal is to develop relationships with clients through both credit and non-credit, deposit partnerships. In order to continue to grow, client deposits are important. The bank uses those funds to invest into that growth.

Question: What asset classes are you focused on and are occupying your time?

SUZANNE PITRUSU, Community Banks of Colorado: Some of the deals we've been looking at are retail, office buildings and hotel projects. Really for us, when looking at a hotel project, for example, it depends on the flag, structure and where the project is located. We are currently doing an 80+ unit multifamily project in the Highlands. A lot that plays into the hot asset classes are the questions such as: What's the equity they are going to bring to the project? Who are their investors? Where is it located? How long is it going to take to stabilize?

JULIE GIFFORD, Otten Johnson: I'm seeing a little bit of everything right now. Of course, multifamily has been the hot thing in the last few years, but that is certainly tapering off. I am working on financing a new multifamily construction project now. It's out in the suburbs and TOD. The younger generation is being pushed out price-wise of being able to afford an apartment downtown right out of the gate, but they still want transportation access to get to their jobs and fun downtown. So multifamily still might be a good place to put your money depending on location.

TODD: We like multifamily. We've always had a hard time building multifamily into the portfolio because of the agencies. They've always been the competitive lender of choice. What we do is try to take an early lead in financing out new construction during lease-up when it hasn't quite stabilized as an opportunity. We've been actively doing that in Denver, but there is a lot of new supply right now, which everybody is concerned about.

We like retail. The vacancy rate is very low and you've had a consistent three to four percent rental growth rate. Office is very selective, but there is a new type of environment that people are gravitating to and it's putting Class B in Class A locations, over and ahead of Class A office space. Creative tenants want to be in urban environments that have a lot of neighborhood amenities and have creative collaborative spaces. It's going to be tough for Class A office space, if it hasn't been tough already.

Industrial, it's just hard to get the deal size that we look for. You're seeing a lot of contemporary industrial buildings that are 500,000 to 1 million square feet that are being developed today and those have good strong credits involved.

We've always been a hospitality lender and it's slowing down. I think everyone believes that hospitality is in the eighth inning of the ball game.

Question: Creative office space is certainly in demand. Have your loan terms needed to adapt and become nontraditional, as well?

TODD: Look at some of the space in LoDo and RiNo that caters to the TAMI (Technology, Advertising, Media and Information) workforce. They're younger tenants and they want to be in urban locations. They use public transportation. You're seeing a lot of old converted space and then new spaces that are open-collaborative like the open warehouses. These are areas you wouldn't have been in five years ago, but now the new TAMI tenants like these edgy neighborhoods. You take an old, blighted industrial buildings and they are the office of choice. The older historic buildings that you thought were going to be torn down are now the gems.

Q: Multifamily housing, particularly in downtown Denver, has been a hot topic. Do you anticipate further reduced capital to multifamily projects and what are current vacancy rate assumptions?

ERIC: When the cycle first began, people were looking forward to where rent would be and benchmarking to those forward-looking economics. Today, everyone is looking at point-in-time. Most people are not willing to take the forward risk of a pro-forma. Everyone is being very careful to look at return on cost and being very disciplined as to their perception of what that return on cost is relative to where real cap rates are. They want to see 100 to 200 base point spread and they want to see that exit protection.

Keep in mind, lenders today are more protected by amount of the equity in front of them than the equity is protected. From a lender's perspective, you can make a small mistake and still be safe. From an equity perspective, a small mistake can lose your capital. So we haven't really seen lenders pulling back significantly, but we have seen them adjusting their underwriting parameters and how much exposure they'll take on in a given market.

Q: Are there any new banking regulations that are of particular concern to the industry?

JULIE: HVCRE (High Volatility Commercial Real Estate) loan classification is a big issue right now that banks are all looking at a little differently. What isn't different is that if a loan is categorized as HVCRE, then a bank has a higher capital requirement of one and a half times what it would otherwise be required to maintain. The goal then is for a bank to make sure it does not have to classify a loan that way. The result directly impacts borrowers in ways like requiring borrowers to maintain higher equity and keep that equity in the project until the loan is considered permanent financing or paid off.

ERIC: No two banks are looking at HVCRE the same. Unfortunately, we are in the infancy on what the regulators will say, how they view it, and where they will ding the capital cost and capital retention. We will probably be in a cloudy space for the next 12 months until there is more broad-based acknowledgement, acceptance, and understanding of it. In theory, it shouldn't be an impediment to borrowings other than the potential cost of that borrowing.

Q: Given the looming wave of maturing debt over the next two to three years, what is the current availability of debt refinancing? Is it sufficient to meet the demand going forward?

TODD: There is a lot of debt coming due and a lot of it is CMBS debt. There are some looming regulations that are going to hit the industry towards the end of the year. What you're seeing across the board is lenders being a little more conservative in terms of their leverage levels. Between lower leverage and lack of a large capital source, it is going to create bridge gap between existing debt and what it's going to achieve on a first mortgage. A lot of people are creating debt funds that are going to be out there as opportunity funds to create the difference between existing debt and the first mortgage. You're going to see the markets evolve again and all that comes with a lot of strings and a lot risks. It's going to become a hard place for borrowers with debt coming due to find an easy place to refinance. They're going to have to get into their checkbook or recapitalize.

ERIC: Given the reality that the market may become more conservative as we go further into the cycle, we are seeing owners of real estate being prudent about getting in front of it early. Clearly, the subordinate debt side of our marketplace as well as new investors entering is where the opportunity is truly starting to create itself.

Q: Are CMBS loans basically dead?

TODD: They're not dead. They might be in rehab. CMBS is a public market execution and it is dictated by the public markets. The bigger headwind that's creeping in is a new regulation coming in December and the general underwriting parameters of the CMBS pools will be scrutinized by investors. In a normalized market condition–with these new retention requirements, the scrutiny, and the risk of having the whole paper on the balance sheet longer than expected–we expect to see a natural decline in the number of originators.

Q: How are different types of lenders currently utilizing recourse debt to effect lending terms?

JANE: Our portfolio is split between recourse and non-recourse debt. What we learned from the last downturn is that sizing that recourse matters and it matters on both sides of the table. When analyzing recourse debt, it is important to determine a level of recourse that bridges the gap, that is meaningful to the bank and to the client. At some leverage levels, non-recourse debt is available. There were not many times during the downturn that lenders had a guarantor write the check for 100 percent recourse to cure a default or other issue. So 50 percent may be just as valuable as 100 percent on certain deals, and we do get creative about burning that off. We recognize that every lender that is looking at the contingent liabilities on the guarantor's balance sheet so managing that exposure is important to our clients. As the risk burns off, there is the opportunity to burn the recourse down or off so that the client can turn around and have more capacity on a next deal.

SUZANNE: The majority of the time we would want recourse for completion and, as Jane said, oftentimes build in some kind of burn off. Sometimes we see burn offs of that recourse all the way down to zero on that recourse. For us, it's really project specific.

TODD: We're a little different. People are typically attracted to a life company type loan because it's perceived as non-recourse, which it really is. We look to the equity as a cushion to our recovery. We do have recourse for what you call bad boy carve-outs or acts of malicious intent. Those are things we look to a guarantor for and it's really meant to hold the integrity of the borrower intact.

THE PANELISTS

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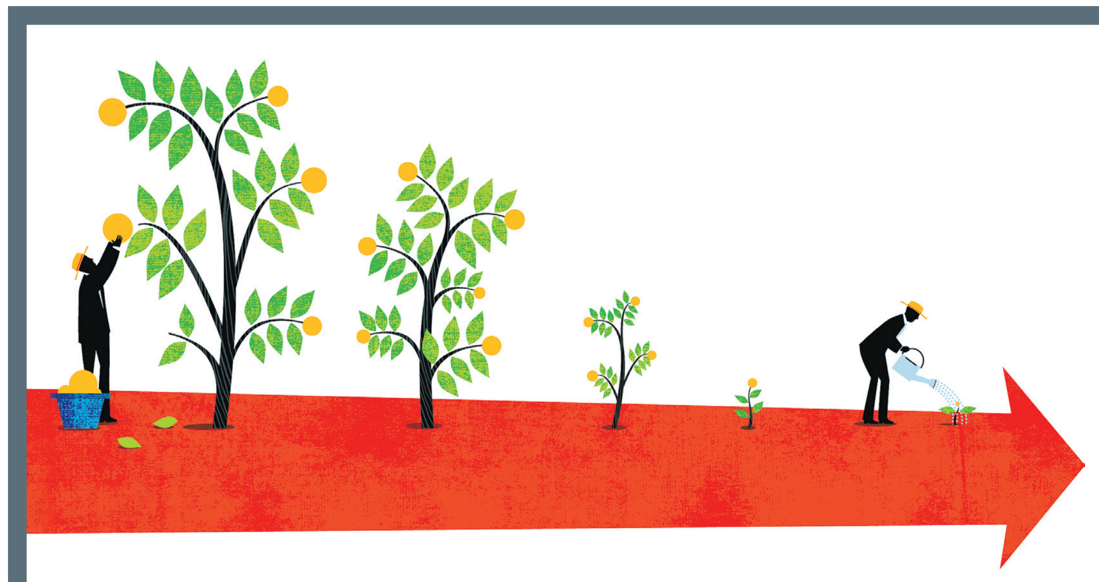

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