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Ample capital sources available for retail properties

As we kickoff 2015, commercial real estate continues to display a healthy performance. While market strength alone may seem like a good enough reason for institutions to invest in commercial real estate, the capital market has created additional incentive. Much like last year, as interest rates remain low, institutional portfolio managers are finding commercial real estate yields attractive compared to other asset classes. With the supply of capital exceeding demand, commercial real estate lending is expected to be vigorous this year, and retail property owners are fortunate to have a wide variety of financing options available.

Even in this highly competitive lending environment, lenders remain selective. Appetites differ greatly from lender to lender, especially within the retail sector. Retail owners who seek financing in 2015 need to know what lenders are looking for. After all, the most competitive loan terms usually come from the lender that most wants to win the business.

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Life Companies

Life companies are well known for being conservative lenders, and in exchange for lending on low-risk, stabilized properties, life companies offer the best available interest rates in the marketplace. Generally speaking, life companies prefer low-leverage loans, usually not exceeding 65 percent to 70 percent loan to value. Furthermore, many life companies will underwrite using internal, above-market cap rates to account for future market softness. Beyond seeking conservative deals, life companies don't all evaluate retail properties the same way. These are a few life company hot buttons:

Anchored centers. Many (but not all) life companies specifically seek grocery- or drug-anchored shopping centers. They will swing hard to win this business. Accordingly, retail owners should be armed with tenant sales figures so they can convey the strength of their anchor. For a grocer, lenders want to see sales figures that exceed at least $300 per square foot, and $400 per sf is considered good. Some lenders also evaluate a tenant's overall occupancy cost by calculating the ratio of total rent to gross sales. Ideally, this percentage should be in the low single digits.

Quality of tenant lineup. Life companies are always sensitive to lease rollover, however, they also pay more attention than ever to the types of retail users in occupancy (especially for noncredit tenants). As e-commerce continues to gain popularity, lenders strongly prefer tenants whose products and services can't easily be purchased online. For example, lenders favor restaurants, coffee shops, health clubs, and hair and nail salons, compared with clothing, shoe and bookstores. They generally like shop space ratios to be less than 35 percent of the total net rentable area, including the anchors.

Loan per square foot. Since life companies are conservative balance sheet lenders (meaning they tend to hold loans on their books for the entire term of the loan), aside from considering loan-to-value ratios to measure leverage, lenders also are focused on a metric called loan per square foot. Generally, life company lenders compete best if a requested loan per sf is $200 or less.

CMBS Lenders

Commercial mortgage-backed security lenders are the best option for borrowers who seek maximum leverage and the lowest loan constants. CMBS lenders underwrite using market cap rates, and they aren't afraid of 75 percent leverage. Additionally, although CMBS rates tend to be 20 to 50 basis points higher than life companies, CMBS lenders usually can offer longer amortization schedules, making their overall loan constants competitive. CMBS lenders also tend to be the best option for financing unanchored strip retail (because so many life companies are focusing on grocery- and drug-anchored centers), especially when a loan request exceeds $150 per foot. Here are a few important trends to know about the CMBS market:

Improvements to loan servicing. We've all heard horror stories about the frustrating inefficiencies of CMBS servicing in past years, however, retail owners who have avoided CMBS loans should consider taking a fresh look. The CMBS market heard these complaints and listened. Some CMBS lenders are looking for mortgage banking firms who can service the loans they originate. This allows mortgage bankers to provide better servicing and stand by their borrowers for the duration of a loan.

Focus on timeline. CMBS lenders are very focused on shortening the time it takes to close a loan, making them very competitive when it comes to financing acquisitions. Once CMBS lenders begin their process, they want to close and race to securitization. This translates to fast acquisitions for borrowers; CMBS lenders can close within 45 days. Also, as a side note, CMBS lenders won't shy away from low going-in cap rates (as long as the market justifies).

Banks and Credit Unions

Banks and credit unions deserve a mention, as they actively lend on retail properties. Because banks have a lower appetite for long-term, fixed-rate deals than life companies and CMBS lenders, banks tend to compete best for financing construction, short-term loans and transitional assets. Credit unions, on the other hand, still will entertain long-term, fixed-rate deals, however, they require full recourse to the borrower. Further, credit unions are not permitted to charge prepayment penalties, so they provide a very flexible exit for borrowers who don't mind signing recourse.

Nonrecourse Bridge Lenders

Nonrecourse bridge lenders are eager to finance transitional assets, and due to the low supply of value-add retail properties in the Colorado market, they're forced to be aggressive in order to compete. Bridge lenders typically will fund 70 to 75 percent of an acquisition price, and also will fund 100 percent of future "good news capital" (capital for tenant improvements and leasing commissions) as leases are signed. Bridge lenders typically must be comfortable that the value-add business plan can get executed within 36 months. By the time a bridge loan is fully funded, often bridge lenders will have financed 80 to 85 percent of the overall capital stack.

Even though the real estate market is flooded with capital, capital sources each have their own specific lending appetites, and it's beneficial to understand where each capital source will be most competitive. For stabilized assets, life companies will continue to compete best on deals with low leverage, grocery or drug anchors, low tenant rollover risk and quality tenant lineups. They're also the best option for borrowers who seek forward-rate locks six to 12 months in advance. CMBS lenders consistently step up on higher leverage-deals, and their renewed focus on servicing and speed of execution has made them more competitive. Overall, it's a great time to leverage retail properties. Best wishes for a prosperous 2015!▲