Banking Credit Expansion Influences on Commercial Real Estate Finance

*Donald R. Cavan**

The banking industry has recently expanded credit lines and developed creative loan products. The author of this article describes this trend and the ramifications for commercial real estate companies.

National banks expanded credit lines and innovated with loan products for commercial real estate companies during the first half of 2011. Banks increasingly are offering secured asset financing with five to 10 year maturities, usually called term loans, the types of credits that are competitive with the domain of commercial mortgage loans offered by life insurance companies. Heightened banking attention toward longer term secured lending was coincident with some revitalization of the CMBS market since extended maturity term loans can be attractive for resale. Extended maturity term loans were offered at competitive interest rates and payment terms, many times with interest only debt service, that can provide large dividends to borrowers. By way of illustration, a property financed with a 53% loan to value $10.6 million mortgage at 4.45% interest for an asset purchased at a 7.8% capitalization rate generates an 11.5% equity return rate using interest only financing, whereas if a 25 year amortization loan product were utilized, the owners would receive only a 9.3% return on their equity. Interest only extended maturity term loan financing for commercial real estate may be highly advantageous for many borrowers and has the potential to be a loan product that could make a considerable impact upon commercial mortgage markets.

Additionally, the banking industry impacted real estate finance during the first half of 2011, by granting new or expanded lines of credit to a long list of commercial real estate companies including:

- Alexandria REIT, $325 million unsecured credit expansion to $2.225 billion from Citibank in January 2011;
- CB Richard Ellis and Duke joint venture, $275 million unsecured term loan from Wells Fargo Bank during March 2011;
- HCP, Inc., $500 million conditional unsecured revolving credit expansion from JP Morgan Chase, et al during March 2011; and
- DCT Industrial, $175 million unsecured term loan from Bank of America on June 6, 2011.

Alexandria REIT purchased $300 million of

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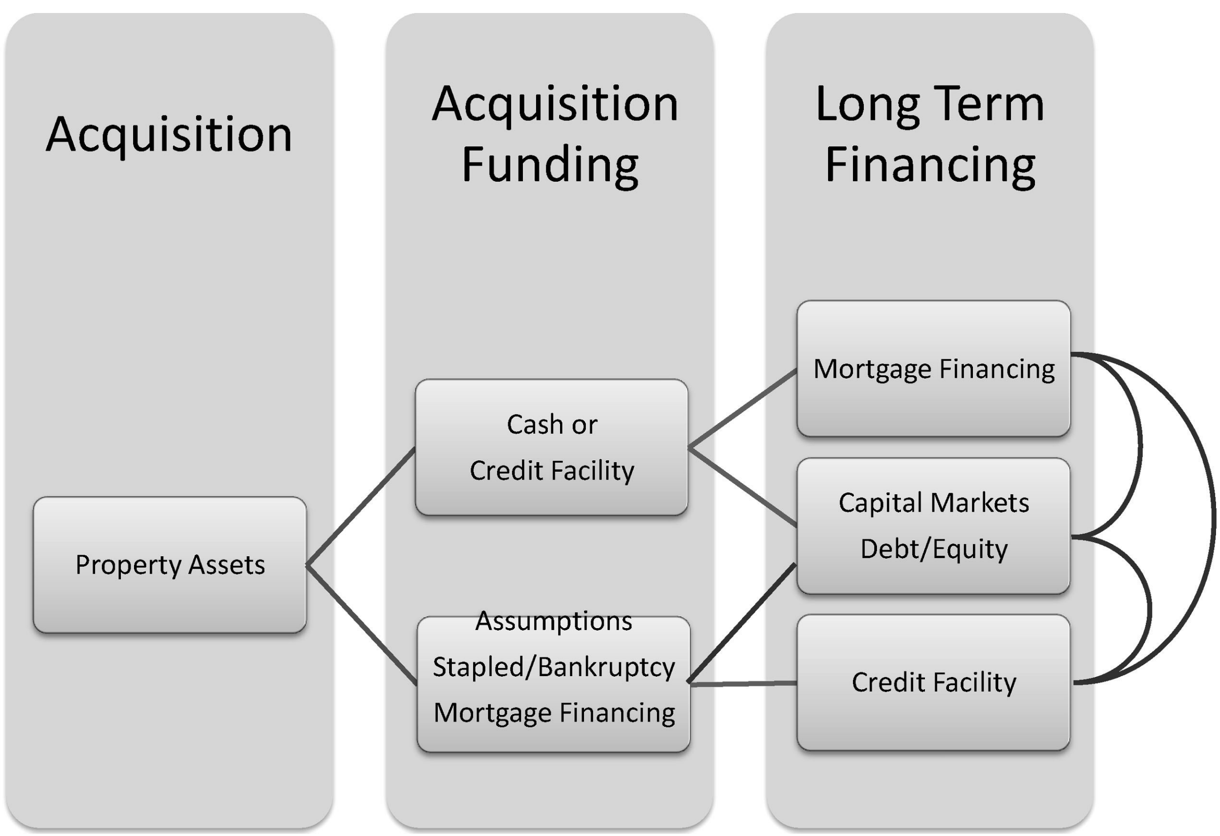
life science laboratory space during the second quarter of 2011. The CB Richard Ellis and Duke Realty joint venture completed a $516 million portfolio acquisition of suburban office buildings during the second quarter of 2011. HCP, Inc. acquired the senior housing and care real estate assets of HCR ManorCare, also during the second quarter of 2011 for $6.1 billion, a major deal amongst $20 billion in healthcare REIT acquisitions during the first half of 2011. DCT Industrial acquired $20 million of buildings during the latter portion of the same month their credit line was expanded. There are many recent examples of bank credit line increases being followed by rapid portfolio growth, sufficient to draw a correlation.

Credit facilities, secured and unsecured, usually have low interest rates and short term one year or two year maturities. Credit facilities are regarded as competitive advantages for credit worthy borrowers due to the speed and flexibility with which funds can be deployed, an especially useful attribute to facilitate acquisitions, and the larger the credit facility a company maintains, the better it can take advantage of opportune acquisitions. In this regard, companies use bank credit facilities as a type of warehouse financing for acquisitions pending longer term financing, such as the issuance of debt and equity in the capital markets. Others use credit facilities more as semi-permanent reservoirs of capital, confident in their renewal abilities. The relationships amongst the various sources of financing are many and varied and bank provided credit facilities figure prominently into generalized financial planning models for portfolio growth at several levels.



Credit Lines as Barometers of Capital Availability

One of the outcomes stemming from the international credit crisis of September 2008 was the extension of less credit to real estate companies through credit facilities. Major owners of commercial real estate, intensive users of credit lines, rapidly sought alternative sources of financing such as mortgages from life insurance companies and common share equity sales in the capital markets. There are many specific examples of credit line reductions that occurred during 2009, according to Termzsheets.com, which necessitated a broadening of sources of financing, including:

- Cedar Shopping Centers;
- Cogdell Spencer;
- Entertainment Properties Trust;
- Felcor;
- Lexington Properties;
- Ramco Gershenson; and
- Strategic Hotels.

Total assets carried on the financial statements of significant REITs actually declined from $379.7 billion at December 31, 2008, to $375.4 billion by March 31, 2009. The setback caused by the reduction in financing proved to be a temporary impediment for most companies, and portfolio expansion once again became possible with replacement sources of capital. Bank provided credit lines have contracted and then expanded since the international financial crisis of September 2008. Many of the large financial institutions that required investments from the Troubled Asset Relief Program have been leaders in the subsequent economic recovery with the result that credit facilities for real estate have again been expanding.

When Standard & Poors downgraded the credit rating of the federal government, market turmoil was the result, a political economic crisis of summer 2011. Following this unprecedented downgrading by Standard & Poors of the United States sovereign long term credit, anecdotal information concerning banking credit facilities extended to commercial real estate companies, including changes in commitment size and bank participation as well as interest rates and payment terms, should be monitored closely seeking implications for the trajectory of the industry. Banking credits are integral components of diversified sources of capital for well planned models of corporate finance. Banking influence has been growing as a result of an improved credit climate and expansions into longer term financial products. Some national banks are on the verge of becoming "one stop shops" for the credit needs of commercial real estate companies, the viability of which will ultimately be determined by the continued acceptance from equity markets and structured finance offerings.