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Capital Stack

A Variety of Capital is Available for Acquisition & Rehab Financing

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A variety of capital is available, to varying degrees, for multifamily acquisitions/rehabs

By Keat Foong, Executive Editor

Developers seeking financing for apartment acquisitions and/or rehabs are faced with a variety of situations depending on the type of financing—senior loan, transitional financing, or gap financing—that is being sought.

Permanent financing is generally in abundant supply today, agrees Paul Daneshrad, CEO of Starpoint Properties. "Development capital and debt is much easier to acquire. It is an open market. If the project, location and economics are right, you should have no problems."

Starpoint Properties focuses on investing in non-core, value-add, opportunities in the $20 million to $70 million range. Daneshrad is probably not alone in favoring Fannie Mae and Freddie Mac permanent financing. The GSEs, he agrees, are offering the most favorable interest rates and leverage.

By comparison, life insurance companies remain very competitive sources of permanent financing for top-quality, low-leverage, loans, but they may not provide more than 60 to 65 percent LTV. CMBS lenders may be slightly less competitive than the GSEs in the multifamily arena, and they are still restricting financing to larger loan sizes. Commercial banks are said to be not active in the permanent financing arena.

Although the general availability of permanent financing for the

multifamily sector is much touted, it may still be difficult to obtain such financing in many markets. Daneshrad says, for example, that parts of Texas and Detroit, and increasingly, Washington, D.C., may be encountering more supply issues.

When it comes to shorter-term transitional, or bridge, financing for apartments, more and more financing sources continue to emerge to serve the market. "Plenty of opportunity funds and equity shops are getting more active in lending into the space," says Larry Grantham, managing director of Karlin Real Estate.

Bridge loans are generally employed when the use of permanent financing is not yet possible, as when the apartment's occupancy is undergoing stabilization. Or, such financing may be employed when the transaction needs to be financed, and a permanent loan cannot be obtained in the short time available.

Situations that are pertinent today for the use of bridge financing include: the purchase of non-performing notes or REO properties; property repositionings involving significant renovation capital; and discounted payoffs by the existing borrower. Ultimately, the bridge loan is refinanced with a permanent loan with better terms.

Karlin Real Estate specializes in providing bridge financing for "middle-market" transactions of $5 million to $30 million located in secondary or tertiary markets. The company provides up to 85 percent LTV for its bridge loans for terms of one to five years, with typically one-year yield maintenance. Interest rate charged could be 8 to 10 percent, with the option to accrue the interest payments, says Grantham.

"Unfortunately, bank financing in many cases does not provide sufficient loan dollars."

In its loan decision, Karlin Real Estate emphasizes the debt basis—basis per square foot or per key—of the property in order to minimize the risks taken by the company, Grantham suggests. "Whether the loan is the right basis" is the company's primary concern in underwriting, he says. The company is also concerned about lending to dependable, "realistic" borrowers, who do not take excessive risks.

Besides the private funds, banks are a major source of bridge financing today. Unfortunately, bank financing may not provide the desired amount of loan dollars, the maximum LTVs provided being typically only 60 to 70 percent.

Addressing a perceived market need in transitional financing, Pembrook Capital Management LLC, which focuses on what it sees as the underserved, $10 million to $50 million, middle-market, supplies the needed loan dollars to bring the transitional financing to a higher leverage.

Coming out of the recession, commercial banks were limited in their ability to finance real estate. As Patrick Martin, president of Pembrook Multifamily Capital, points out, the banks also favored bigger, more established, players, and imposed more conservative limitations on their loans.

Staking a subordinate lien position, Pembrook can finance the needed gap in the bridge financing to carry the leverage of bank financing up to 80 or as high as 85 percent. It does this by supplying a mezzanine loan or preferred equity. In cases in which bank bridge loans are not already in place, Pembrook also offers to supply a high-proceeds bridge loan execution by combining a bridge loan with a mezzanine loan or preferred equity in a single execution.

Terms for Pembrook's gap financing are mostly two to five years, and the floating or fixed interest rates, depending on the market and the sponsor, can range from about 9 percent to 15 percent (for new construction). "Ultimately, we are not an equity provider, but a debt fund. We try not to play in the space that demands equity-like returns. We do not charge as much as equity," adds Martin.

It may still be a challenge to obtain mezzanine debt and preferred equity for transitional projects.

Much of the need for gap financing derives from the acquisition of properties that require repositioning or refinancing or that may be overleveraged, says Martin. In some cases, the borrower is purchasing the property back from the bank. In all cases, the transitional loan is not providing leverage at a sufficient level to meet the borrower's need.

The property's basis is one of the top considerations for Pembrook when it evaluates applications, suggests Martin. The lender is also very focused on the quality of the sponsor, the viability of the exit and the soundness of the execution. Many of Pembrook's transactions have been focused on New York City and Los Angeles, but they also extend to Dallas, Miami and Seattle. In following market recoveries, Pembrook also provides financing for secondary markets throughout the nation, such as Denver, Raleigh, and Oklahoma City.

Whereas the position of permanent financing in the multifamily arena appears to be secure, and first-lien bridge financing is increasingly available, gap capital may still be more limited. According to Martin, there are more providers in the preferred equity and mezzanine debt sector than there used to be, but the middle market is still underserved. More than $2 billion in transactions cross its desk per year, but Pembrook approves less than 10 percent of these inquiries. MHN

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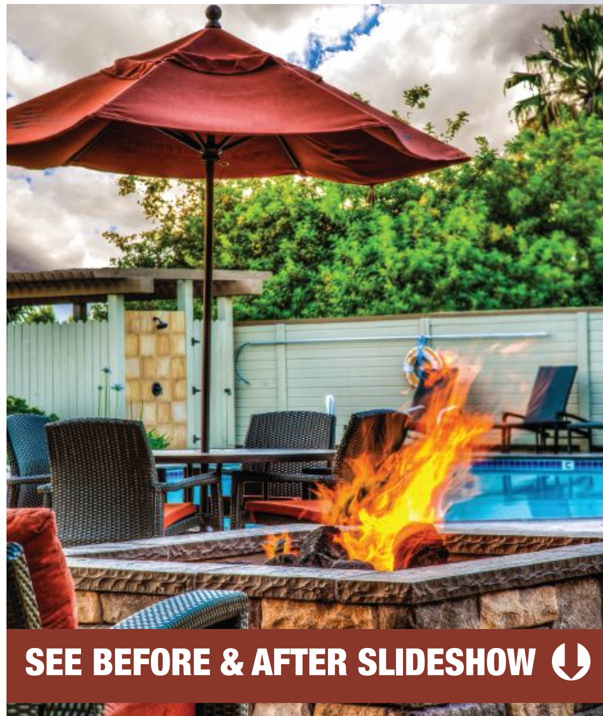
Freddie Mac Loan Facilitates Acquisition, Rehab for Starpoint

When Starpoint Properties LLC purchased the 558-unit Parkview Terrace Apartments, Redlands, Calif. in 2011 for $79 million, it announced that it had completed one of the largest transactions in the Inland Empire at the time.

The Class B property was located in a relatively healthy submarket, characterized by average annual household income of about $85,000, a 95 percent occupancy rate and no concessions. "We liked the location of the property, especially its vicinity to employers including Loma Linda [University Medical Center]," said Paul Daneshrad, CEO of Starpoint Properties. Parkview Terrace, he added, was also desirable for its amenities, unit mix and overall layout, relative to other competing apartment properties in the submarket.



Starpoint Properties' purchase was financed with a $40 million Freddie Mac acquisition loan via Walker and Dunlop, said Daneshrad. The seven-year fixed-rate loan carried an interest rate of about 4 percent. The company opted for the Freddie Mac financing supplied through Walker & Dunlop because of the fixed-rate feature, relatively low interest rate and favorable LTV being offered, said Daneshrad. "Freddie Mac is one of the most competitive programs in the country."

Starpoint invested about $2.5 million in equity in renovating the 32.5-acre property, said Daneshrad. Renovations were centered on the common areas, as in-unit upgrades had already been performed by the previous owner, Equity Residential. New amenities included a Vegas-style pool and fire pit; beach volleyball, basketball and tennis courts; golf driving range and putting green; and built-in barbecues and seating near the pool areas. A movie theater and business center were added to the clubhouse; the office space was reconfigured to accommodate the new uses; and the gym and all common-area bathrooms were upgraded. A fountain was also added to the center of the courtyard.

Parkview Terrace Apartments was about 94 percent occupied when it was purchased by Starpoint Properties at a cap rate of about 6 percent, Daneshrad indicated. The rents were originally about $1,200 to $1,900.