

# Appetites for Risk Increasing in Low-Yield Environment

The Money Chase 2013

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The Pacific Club in Newport Beach, CA, was a packed house on February 21, as Southern California's real estate professionals come together to hear an in-depth discussion about the current capital markets from both a panel on active lenders and a panel of equity providers. The debt dis-



The Money Chase is Southern California's premier capital markets event, organized by ULI members.

cussion was moderated by Jerry Fink, The Bascom Group, and consisted of executives from various portfolio and conduct lending institutions including David Nass, UBS; Kevin Jennings, Bank of America; Scott Douglass, Prime Finance and Tom Hirschauer, Principal Real Estate Investors. The equity panel included Stephen Corrigan, BlackRock; William Flaherty, Rosewood Property Company; Lynn King-Tolliver, Heitman LLC and

Thomas Whitesell, Lowe Enterprises Investors, and was moderated by Bryan McGowan, Shea Properties.

## Debt Markets: "Too Much Capital, Not Enough Deals"

The debt panel unanimously acknowledged increasing competition to place loans. "For the major balance sheet lenders, the capital issues are behind us," noted Jennings. "Now, it's all about revenue growth, which means we need to lend money, grow our balance sheets, and earn interest." The increased competition is tightening rate spreads, and some lenders are even beginning to increase loan-to-value and loan-to-cost thresholds to win business. The majority said they are still avoiding rollover and location risk, but they expressed concerns that as the competition continues, a lack of discipline could reemerge. "Our industry seems to operate in 10-year cycles, but with a 7-year memory," quipped Nass. The panelists said they are currently underwriting to debt yields

(the ratio of net operating income to loan amount) between 9-10% and commercial mortgage backed securities are requiring stressed loan-to-value of 100%.

When asked about the importance of borrower quality, most responded that it is an important factor but typically considered secondarily to deal quality. Fink pressed further on whether past blemishes, such as a bankruptcy or foreclosures, are deal-breaker and responses were mixed. Only one lender said it would be an absolute deal-breaker, and the others said they would be very cautious but it would depend on the circumstances of the past issues, as well as the quality of the current deal in question.

The panelists also noted that mezzanine and bridge loans are active and available in the today's marketplace. In many cases, mezzanine loans are enabling investors to lever up to around 90% loan-to-value.

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### About the Author:

Aaron Hirschi is the Student Representative for the ULI Orange County/Inland Empire Capital Markets Initiative Council. He graduates in Spring 2013, with a MBA and a MRED from USC.

The ULI Orange County/Inland Empire Capital Markets Initiative Council focuses on short-term and long-range issues that surround financial markets and how these issues are transforming the business of real estate finance, locally, nationally and globally. Bill Campbell, Knightsbridge Realty Capital is Vice Chair. Bill Shubin, Shubin Nadal Realty Investors, is Assistant Vice Chair. Eric Snyder, Talonvest Capital, is Vice Chair of Outreach. John Thomas, The Thomas Group, is Vice Chair of Education. Representing the Young Leaders Group are: Michelle Thrakulchavee, City Ventures; Scott Hay, Lyon Communities; and Aaron Hirschi.

## Equity: Looking for Yield by Moving Beyond Core

An abundance of capital chasing core deals has lowered yields on the safest assets and is forcing equity providers to venture further out on this risk scale. The specifics of the strategies varied, but all of the investors on the panel noted they are having to look further off the beaten path to achieve target yields. “Our policy is to stay out of the way of giants,” said Flaherty. “When the REITs and Core Funds start pushing caps to low levels in a market, we’re out.” Most of the panelists seek overall project returns in the mid-teens, and are asking for first-tier preferred returns around 10%. When McGowan asked if perhaps preferred return hurdles should be lowering to single digits given the extremely low cost of capital in the current environment, the panelists tactfully averted support of the notion.

When asked what advice the investors had for operators/developers looking to raise equity, the most prominent response emphasized the importance of relationship, reputation and track record. Whitesell suggested developing a good relationship with one or two mortgage brokers—noting that they are constantly active in the marketplace, which often gives them the timeliest knowledge about the activi-



Presenters at The Money Chase 2013 and Leadership of the ULI Orange County/Inland Empire Capital Markets Initiative Council.

*Save the date!*

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