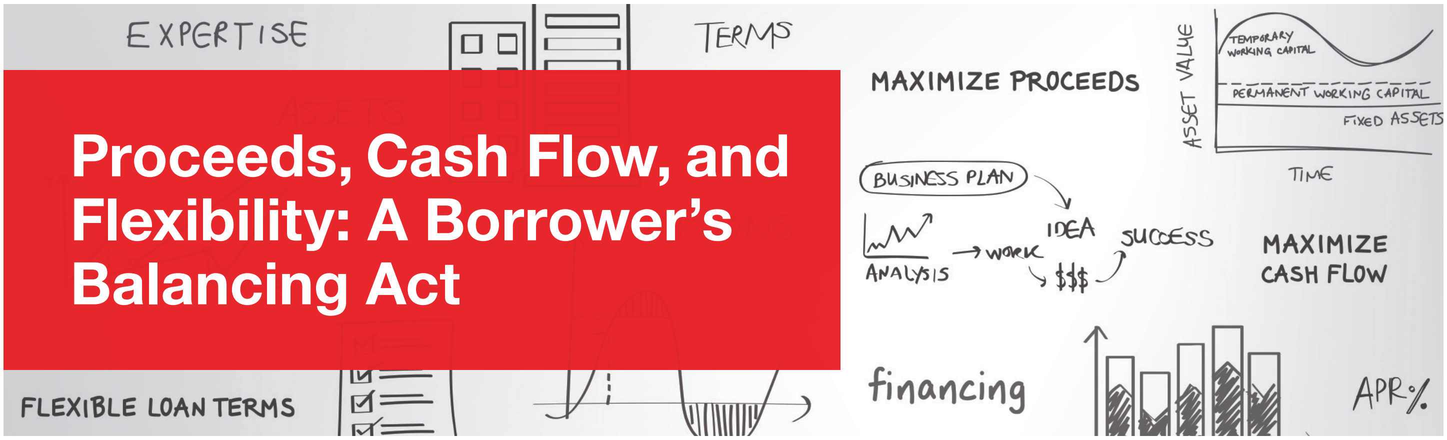
KeyBank
Real Estate Capital



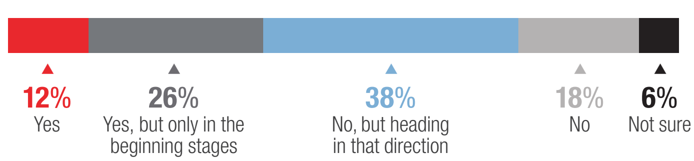
Proceeds, Cash Flow, and Flexibility: A Borrower's Balancing Act

With capital flowing freely in the commercial real estate debt market, borrowers looking for favorable terms can get just about anything they want—but they can't have everything. As a commercial property owner, you can aim for the lowest possible interest rate to get maximum cash flow, or opt for maximum leverage to preserve capital for more deals. What you can't do is maximize both in the same deal.

The key to success in today's debt market is to structure deals in ways that best meet the specific objectives of each situation. Some borrowers' value proceeds, some focus on cash flow, and others want terms that give them flexibility. One size does not fit all, but that's OK: In a capital-rich environment there are ways to meet every need. Your challenge as a borrower is to identify the financial solution that does the best job of advancing your overall strategy.

Deals that sound good at the closing table don't always end up that way, as many borrowers can attest—particularly those that got caught up in the lending frenzy that led to a credit crunch at the end of the last decade. While most borrowers don't expect to see another downturn this decade—there are those who do.

Do you believe the multifamily housing market is in a bubble?



Based on a recent survey of large multifamily housing owners, the graph above shows KeyBank Real Estate Capital client sentiment of what the current market looks like.

The good news is that those who see danger ahead can structure financing to minimize the effects of a downturn on their property, while those who see blue skies can use the capital-rich environment to make hay while the sun shines.

Key Takeaways

Proceeds, capital, and flexibility are all critical to obtaining the best real estate financing solution for your needs.

Debt deals should help borrowers advance their business priorities such as preserving capital, keeping payments low to maximize cash flow, or maintaining flexibility.

Expiring 10-year CMBS loans can be refinanced early to ensure favorable rates and terms.

A financial partner with balance-sheet capabilities can help keep deals on track during times of market volatility.

Balancing goals

If you're like most borrowers though, your primary concerns fall into three areas: proceeds, cash flow and flexibility. You want high leverage to preserve capital, but you also want low interest rates to keep your carry costs low, and you may be worried about getting "locked in" with terms that limit your options. Some people focus on one of these goals, while others aim for an optimal balance of all three.

Whatever your priorities, they should serve your investment strategy and reflect your view of the market. With the help of an advisor who offers a range of solutions, you might want to consider questions like the following:

Should I prepay my conduit loan or hold off and risk higher interest rates? Trepp reports that $87.1 billion in conduit loans mature this year and $105.8 billion will expire in 2017. This represents a 17% decline from last year's estimate of total maturities due to early refinancing and defeasance activity. As loans get closer to their maturation date, prepayment and defeasance amounts get smaller, favoring early action. However, the long-anticipated trend of rising interest rates has not materialized as a significant issue, so many borrowers are opting for the risk of higher rates instead of the certain cost of prepayment.

How important is leverage relative to cash flow? Do you need to preserve capital for additional deals? If so, you are probably looking for the highest loan-to-value ratio you can get. On the other hand, if positive cash flow is of primary importance, then you might opt for less leverage and a lower interest rate. And if your goal is to maximize total return, the best way to do that may involve a blend of moderate leverage and interest rate.

Will the loan covenants help or hinder my business goals? Are you considering a rehab or expansion of the property? Do you want the option to restructure debt in the next several years? Building flexibility into your loan documents will increase your cost of capital, but if it helps you realize your objectives for the property, it can be worth the additional cost many times over.

Will the underwriter service the loan, and how might that affect my strategy down the road? Many borrowers feel it's important for them to have a direct relationship with the loan servicer, in case terms need to be changed at a later date. As with other flexible terms, it may cost more to get a loan that will stay with the underwriter, and the peace of mind may be worth the incremental cost.

Does my lender offer a range of financing options? Chances are, if you work with conduit lenders, their advice will always be to go with a conduit loan. That's often good advice, but you're always better off getting an unbiased view from a lender that offers a wide spectrum of options. Even better, a lender that offers balance-sheet financing may be willing to provide bridge options in case the closing on your permanent financing deal is delayed.

Relationships are part of the balancing act.

Consistency is also important in choosing a capital partner. When the market faces volatility, opportunistic lenders close up shop and move on to the next hot asset class. Instead, consider a relationship-driven lender that will work with you throughout the market cycle, not just during the good times.

While some lenders offer only one or two products, finding a lending platform that provides a wide variety of balance sheet and capital markets executions, values relationships, and provides a highly rated loan servicing business that ensures you are not alone when conditions at the property change is critical.

In a highly liquid real estate market, you're likely to be offered tempting terms from lenders who may or may not be around if you should need them later. Deals that offer the highest proceeds or lowest rates may conceal the best course for you to achieve your strategic goals. An experienced, consistent issuer that's committed to cultivating borrower relationships is your best bet to optimize debt cost and flexibility, and can help you get to closing faster and more reliably.

To learn more, contact: John Hofmann, Senior Mortgage Banker, at 312-730-2745 or john_p_hofmann@keybank.com

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