Mid Atlantic Real Estate Journal

Friday, August 17, 2012 *Volume 24, Issue 15*

Multifamily Financing

By Bruce J. Coin, Bruce Coin Consulting, Inc.

The current commercial mortgage market

For more than a year, multifamily properties have continued to dominate the income property investment market. They are also dominating the commercial mortgage market.

Bruce J. Coin

Marcus & Millichap's second quarter "Apartment Outlook" report confirmed, among others, that;

- apartment demand was undeterred by the summer doldrums and slower hiring
- second quarter vacancy measured 4.7% down 20 basis points from the first quarter and down 120 basis points from one year ago
- effective rents grew 3.5% nationally measured on a year over year basis
- sales volume totaled $24.9 billion representing a 38.6% year-over-year increase
- cap rates have dropped 30 basis points to 6.2%

Accordingly, abundant mortgage financing is available for apartment acquisitions, refinancing and new construction. Primary sources are banks, insurance companies, Fannie Mae, Freddie Mac, FHA but not much from CMBS sources.

Fannie and Freddie remain a critical component of the exiting property market especially for longer term, fixed rate, non-recourse loans. Through the second quarter Fannie had closed $13.8 billion and Freddie had closed $11.2 billion. For an existing well leased property with 90% occupancy (exceptions at 85%) 80% loan to value (LTV) mortgages can be obtained for 5, 7 or 10 year balloon terms with 25 to 30 year amortization. Due to their current 5 year floor rate, borrowers are basically using them for 7 to 10 year money. Rates are typically fixed at between 225 and 250 basis points over treasuries. As of August 1st, a 10 year fixed rate would be between 3.75 and 4.00%. Some interest only loans are available. A 1% placement/commitment fee is typical. Underwriting is based on a minimum debt service coverage ratio of 1.25 times with an overall "cap rate" of approximately 6% applied to underwritten annual net operating income after reserves. In high barrier to entry markets a cap rate of less than 6% may be applied. Word on the street is that Fannie may move away from its yield maintenance prepayment formula to a stepped down percentage of loan amount.

Insurance companies offer different terms that vary by institution. For a non-recourse loan on an existing property they basically also offer 5, 7 or 10 year balloon term loans but with emphasis on providing only 25 year amortization schedules, a 1.25 debt service coverage factor and 70% LTV ratios. Fixed for term rates are typically based on a 2.50 to 3.25 basis point spread over treasuries. There are exceptions.

Commercial banks, especially for amounts under $20 million, are major sources for both permanent and construction loans. "Permanent" loans with 3, 5 and atypically longer balloon terms are being closed on existing properties with fixed rates in the range of 3.25 to 4.65%.

Most prefer staying at 70 to 75% LTV. For purchases, the upper limit is the lesser of 70-75% LTV or 80% of acquisition cost. Loans typically require a personal guarantee with non-recourse occasionally available at 60% LTV or below. 30 year amortization schedules appear readily available. Debt service coverage ratios can be as low as 1.15 to 1.20. Banks appear to be accepting appraisals with "cap rates" in the range of 5.25 to 6.25%.

For construction loans they are providing amounts as high as the lesser of 75% of as completed and leased value and 80% of total cost, excluding any builder's profit. Floating rates are typically quoted at spreads of between 2.50 and 3.50 basis points over LIBOR or as of August 1st, 2.75 to 3.75%. Fixed rates are available by purchasing a fixed rate swap contract. Most loans are for 24 months with either a series of one year extensions or a three year "mini-perm" being available. Fees are typically 3/4ths to 1%. Underwriting varies by institution but is typically based on applying a 6.25% "cap rate" to the projected underwritten net income upon completion and lease up and with a1.25 debt service coverage factor.

Obviously there are negotiable exceptions to all of the above. With so much apartment activity in the market I thought it appropriate, as we head into the fall, to provide the foregoing as guidance. Federal Reserve Chairman Bernanke has promised to keep these low rates through the end of 2014. Don't miss your opportunity.

Bruce J. Coin is director of Bruce Coin Consulting, Inc. ■