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Terra Capital Eyes Opportunity, Starts Writing Mezzanine Construction Loans

Terra Capital Partners, which opportunistically got back into the mezzanine-lending business in 2009, has now moved into the construction lending business.

The New York investment manager recently has been able to take advantage of the pull-back from the construction sector by banks, which traditionally have provided such loans. It expects to write some $150 million of financing through the end of the year.

The company had moved back into the mezzanine lending business in 2009 when market conditions started to stabilize, but few lenders were willing to write such loans. Because it was one of the only games in town, Terra Capital was able to write very conservative mezzanine loans with attractive coupons. As more lenders gradually moved into the space, pushing down rates, Terra Capital moved into the value-add space, providing mezzanine financing against, say, an office property that would be converted to residential use. And two years ago, it started providing land acquisition loans and predevelopment financing.

More recently, sensing a new opportunity in the construction-lending sector, it's been moving in that direction. While banks continue to write construction loans, they've become far more cautious, thanks to new regulations. So instead of providing financing equal to say 75 percent of a project's total cost, they'll only provide 60 percent. The project's developer then either has to raise additional equity, which typically carries a hefty price tag, or mezzanine debt, or both.

"Regulations are cutting back the proceeds that traditional lenders will provide," explained Dan Cooperman, chief originations officer of Terra Capital. "They're still in the market, but they're not writing 75 percent LTV loans."

So Terra Capital is finding strong demand for its loans. While they're more expensive than what a bank would charge for a senior construction loan, they're typically lower cost than equity.

Meanwhile, because it's generally providing financing that comprises the 60 percent to 70-75 percent slice of a project's value, and it's lending against projects with strong sponsors, it's relatively well insulated against market downturns. After all, its borrowers typically will have 25 percent to 30 percent of equity in their projects.

And the pull-back by banks has allowed it to be more selective on the types of projects it will lend against.

A total of some 15 percent of the company's $500 million portfolio of loans is comprised of construction loans, a sector that wasn't represented a year ago.

The company funds its loans, which typically are between $5 million and $10 million, although it's gone substantially bigger, through two investment vehicles, Terra Income Fund 5 Inc. and Fund 6, the latter of which will be raising capital for another two years. Its capital is raised through the broker-dealer community, much like capital is raised for non-traded REITs.

In addition to sourcing loans through brokers, it has found that banks are increasingly becoming sources of referrals to fill out the capital stack for properties against which they're lending.