Terra Capital completes Miami apartment financing

Terra Capital, a New York-based lender that specializes in mezzanine and bridge loans nationally, has provided Greystone Development with a $6.25m mezzanine loan to finance the construction of an apartment building in Miami's Coral Gables submarket. The three-year financing includes two one-year extension options. Fifth Third Bank provided a $22m senior credit facility at an approximately 60% LTC, *REFI* has learned.

Terra has been seeing an uptick in demand as a result of an increase in regulations for banks. "Banking regulations, in particular [Basel III rules on] HVCRE, are causing banks like Fifth Third to curtail their commercial real estate lending and cap risk exposure at around 60%. For Greystone to make up that 15% reduction [in leverage] to get a 75% LTC [ratio], they can either raise more equity or come to a group like Terra," said Dan Cooperman, chief origination officer of Terra.

Basel III regulations introduced the concept of high volatility commercial real estate loans, requiring all loans that meet this definition to be reported separately from other commercial real estate loans and assigned a risk weighting of 150%, up from the prior 100%. Consequently, banks are required to hold more capital for HVCRE loans. While the regulations do not cap leverage on the construction component directly, most banks are erring on the side of caution and writing even lower leverage loans ranging from 60% to 65% LTC.

The planned ground-up, 14-story property at 1501 SW 37th Avenue includes approximately 6,400 square feet of ground-floor retail space and 100 one- and two-bedroom rental units. All units are expected to have private balconies, with two townhouse-style units boasting rooftop terraces. Amenities will include an outdoor pool and spa, club room, business center and a 24-hour fitness center. "The press has made plenty about the Miami [condo] market bubble, price reduction, new supply, and other challenges, but Coral Gables really is a strong submarket [benefiting] from access to retail, transportation and employment, separated from the macro noises in Miami," said Cooperman.

The property is across the street from a Publix-anchored Douglas Grand shop and is within walking distance of Downtown Coral Gables and Miracle Mile – the main East-West road through Coral Gables' downtown central business district.

Although the quality of the build means that the units could be sold, the property is planned as a rental. Smaller units that translate better for renters, Cooperman added. "We don't underwrite deals assuming rent will grow and be 10% higher than today. We take a look at the rent today and assume rent either won't grow at all or will go down," he explained.

The project, Greystone's third construction project in the Miami metropolitan area, is slated for completion in the first quarter of 2018. The company acquired the empty lot, a 34,690-square-foot development site, for $8.8m or $254 per square foot. Calls to the sponsor were not returned by press time. The New York-based real estate development, lending and advisory company is also developing 2500 Biscayne Boulevard, a 20-story luxury apartment complex with street level retail located near Biscayne Bay and has sold another development, The Mile, a 120-unit luxury rental building for $48m.

EXPECTED RISE IN REIT M&A COULD BOOST CMBS MARKET

An expected rise in mergers and acquisition activity among real estate investment trusts could be a boon to the beleaguered commercial mortgage-backed securities market. "Although the CMBS market has had a challenging year, it continues to provide great liquidity and banks advising on M&A see an opportunity to use a combination of CMBS financing and syndicated loans on these transactions," said Evan Levy, head of the real estate capital markets practice at Skadden.

A confluence of factors that included macro volatility, concerns over the implementation of risk retention, and wider spreads reduced CMBS volume substantially in the first half of the year. "The debt markets are still open for the highest-quality loans, which are mostly going to life insurance companies. For some banks, it may be hard to compete on one-off assets but they may be seeing more opportunity in M&A transactions. They're more complicated and require more liquidity than the one-off building," Levy said.

M&A activity in the sector has included traditional equity deals between two companies with the aim of making a more dominant player as well as foreign investors who want to achieve scale by acquiring a stake in a company. "We're also mindful of the generational shift that we're seeing in many public real estate investment trusts, where many of the original founders received operating partnership shares," Levy said. "The next generation now wants to monetize these assets in a tax-efficient way."

The U.K.'s recent decision to leave the EU will also have an impact on real estate, Levy added. "Foreign investors have increasingly been looking to real estate in the U.S., as the assets provide stability and more favorable yield than many other asset classes, and the uncertainty surrounding the potential impacts of Brexit may bolster this trend," he said.

MORE CMBS DEALS ADDRESSING IMPACT OF POTENTIAL HOPE NOTE LOSSES

An increasing number of the pooling and servicing agreements of new commercial mortgage-backed securities deals have language that more accurately reflects the impact that potential losses on hope notes could have on which party controls a transaction, according to a new report from Moody's Investors Service. The agency estimates that about 10-20% of current PSAs include this language, the lack of which the agency views as a credit negative position, according to Dan Rubock, senior v.p.

The hope note structure is typically used in the event of a default, with a special servicer carving out an A note that is equal to the market value of the property and a hope note that is equal to the "hoped-for" increased future value of the asset, Rubock noted. "[The new language] maintains credit neutrality and corrects a potential misalignment of interests that may otherwise arise," added Chaim Gottesman, v.p. and senior analyst.

Before the creation of a hope note, a defaulted loan would have been subject to an appraisal reduction. "[The appraisal reduction] could have shifted control of the governing securitization," Gottesman said. "When a loan is corrected and a hope note created, the previous appraisal-reduction amount disappears. Unless a realized loss has been written, the loan is back to its former full par value." While the creation of the hope note avoids the realized loss, the hope note may actually be worthless. "But because there is neither a realized loss nor an appraisal reduction, a party that has no real economic stake in the loan and in the securitization may be in control," he added.

The new language that is part of CMBS PSAs aims to fix the potential problem. "It essentially defines the amount of the hope note as a 'collateral deficiency amount' and applies that amount as if it were an appraisal reduction amount," Rubock said. "So PSAs that include collateral deficiencyamount language offer a more precise tool for barring parties that are out of the money from being in a control position."

The change in the language came about as a result of the efforts of a large, senior CMBS investor and Moody's first started to see the language in PSAs a numbers of months ago, Rubock said. "It's definitely a credit negative not to have this language," he said.