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Capital markets awash in cash for real estate deals

Lenders, investors seek flight to safety as stock market falters

Don Jacobson Editor

Lingering doubts about the staying power of the economic recovery and a lackluster performance by the stock market so far this year has led to billions of dollars of capital being funneled into the relative safety of commercial real estate - which in turn has resulted in plenty of equity and debt financing dollars becoming available for developers, according to local observers.

Even with short term interest rates nudging higher, local investors and lenders seem undeterred in their belief that there's no "bubble" in Twin Cities real estate values as money continues to pour into the sector. For lenders, this has meant more competition for promising deals.

But for borrowers the situation could hardly be better as bankers line up to propose creative ways to obtain financing for their customers.

"There's an abundance of capital available for real estate products for many different reasons," says John Davis, executive managing director of Collateral Mortgage Capital of Minneapolis. "One is a disfavor with the stock market. Another is that real estate is really being viewed as a favored asset class. Our markets have improved.

"So when you combine an abundance of capital, the status as a favored asset class, and historically low interest rates, it is indeed a borrower's market." Davis says just about any kind of financing can be satisfied in today's climate, frequently through creative mechanisms that "really go all the way up the capital stack.

"A developer or an investor can achieve just about any type of need that he or she wants, whether it be a permanent first mortgage, a first mortgage with preferred equity, or mezzanine financing."

"Lenders are hungry for deals," agrees Tom Bobak, senior vice president and regional manager of LaSalle Bank's Minneapolis office.

"There are fewer deals going on, and it's great for the borrower. From the lender's perspective, in order to win these deals the newer players in the market are being aggressive on structure, though maybe not so much on pricing."

Bobak's theory is that because real estate was not the culprit in the economic downtown triggered by the meltdown of technology stocks in 2001, its reputation and status as an investment vehicle has been greatly enhanced.

"During this last recession, some people in the industry were waiting for the real estate 'bubble' to burst. But that hasn't happened because the fundamentals are still very good, actually better than in the last seven years." The good performance of real estate investments in the last few years hasn't gone unnoticed and many observers are continuing to note a "flight to hard tangible assets."

Long term interest rates haven't shown the same upward trajectory as short term rates, and that has also led many financial gurus to keep the "buy" sign on for real estate investments, especially institutional investors such as insurance companies and pension funds.

Rich LaFleur, a Washington-based assurance partner for Grant Thornton, says his research on the real estate investment trust (REIT) market has shown that big investors are steering more and more capital into the sector.

"I recently attended the National Association of Real Estate Investment Trusts conference, and while there was general agreement there that real estate values are certainly inflated, there was also a consensus among the investment bankers that, 'no we're not in a bubble,'" he says.

"Yes, real estate values are up, and beyond the reach of many right now. But there is so much capital being diverted into real estate these days, they think we don't have a bubble but what we may have is a cooling-off period or a ceiling where even if interest rates were to rise, you wouldn't see a drastic decrease in real estate values, and in turn, share prices of REITs."

LaFleur says the thinking was that there might be a pullback in values in the 10 percent range, but underlying the overall strength of the market is the fact that interest by big investors is still very high.

"One of the things that was thrown out at the meeting was that many of the pension funds are targeting allocations of something like 8-to-10 percent of their portfolios to real estate, where now on average they're in the 6-to-7 percent range," he says.

"We're talking about billions of dollars being reallocated into real estate because of the underlying belief that real estate is less volatile, that diversification is appropriate, and that it's a good tax-flow mechanism as well."
He also agrees that even if short-term rates continue upward, it may not cool the real estate fervor.

"I think the general feeling of the REIT industry is that even if rates nudge up a little bit, there's still so much cash available that's been earmarked for real estate that that'll be a mitigating factor," he says.

For lenders, says Ken Dayton, vice president of St. Paul-based Glaser Financial Group, the yield curve on real estate loans has "gotten flatter" as more and more capital chases relatively fewer deals.

"We're doing more collateral support and getting creative, and the biggest hurdle everybody faces is the condition of the economy," he says.
"We're not seeing a lot of momentum in terms of job growth and of new people getting into the market."