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Alternative Lenders Move Into the Mainstream

Commercial Real Estate Direct Staff Report

Alternative, or non-bank lenders, a staple in the commercial real estate industry for decades, have come into their own.

They're filling in gaps in the mortgage world where they find them, whether it be the result of increasing capital requirements for banks, consolidation in the banking sector, or a pullback by CMBS lenders. And they're not going away any time soon, given the vast sums of capital they've raised.

Last year alone, the six largest players in the sector: Blackstone Group, Mesa West Capital, Starwood Capital Group, TPG Capital and Mack Real Estate Credit Strategies, collectively funded some $20 billion of interim loans. Each focuses on providing relatively big-ticket mortgages that generally have initial terms of two to three years to allow sponsors to complete upgrades or stabilization efforts.

Dozens of others play in the field just below them, providing loans against properties that could be classified as middle-market, in that they have total capitalizations of say $10 million to $100 million.

While alternative lenders are getting more attention, they're still relatively small players in the massive arena that's the commercial real estate lending world. Last year, for instance, they held 3.1 percent of the nearly $3 trillion of mortgages outstanding, according to a tally by the Mortgage Bankers Association. That compares with banks, which held a 40.4 percent share, up from 38.6 percent in 2015; the housing-finance agencies—Freddie Mac and Fannie Mae—with a 17.6 percent stake; CMBS, with a 15.5 percent share; and life insurance companies, with a 14.2 percent share.

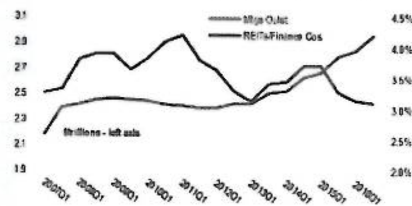
Banks' relatively heavy exposure to commercial real estate has piqued regulators' concerns. As such, they're pulling back, creating an opening for alternative lenders.

According to the recent Federal Reserve's Senior Loan Officer Opinion Survey, banks reported that they had tightened their lending standards over the past year. They increased loan spreads for all commercial mortgages and a significant percentage of banks had reduced their required loan-to-value ratios on construction, land development and multifamily loans. In most cases, banks had cited the uncertain outlook for commercial real estate and increased concerns about the effects of regulatory changes.

Banks Are 'Rationing' Loans

"It's not that banks aren't lending," explained Stephen Theobald, chief financial officer of Walker & Dunlop. They're effectively rationing their credit by not providing too much financing to any one developer, sector or geographic area. That's prompted some developers to quickly pay off their construction loans, well before their projects reach stabilization, in order to be able to line up new financing for their subsequent projects. Often, as a result, developers will turn to alternative lenders for interim loans that would take a project from construction completion to stabilization.

"Once upon a time, banks were the real estate lenders," explained Joshua Stein, a New York attorney who has specialized in the sector for more than three decades. But growing regulatory oversight "has made it difficult for them to do business. They've become very conservative."



Source: Mortgage Bankers Association

Thorofare Capital, a Los Angeles lender that focuses squarely on the middle market, pointed to that pullback, particularly by community banks, which were the meat-and-potatoes lenders to relatively small and mid-sized development projects throughout the country. They also were the traditional lenders to properties undergoing redevelopment or renovations.

"Before the downturn, they were doing deals for the real estate, not for the banking relationships," explained Felix Gutnikov, executive vice president of originations for Thorofare. Now, he said, they're typically reluctant to lend, unless they're able to generate additional business from their clients. That's created pockets of opportunity for Thorofare, which last year originated $345 million...

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