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MULTIFAMILY FINANCING

Lenders discuss the financing climate for multifamily properties in the Midwest.

Lindsey Walker

Heartland Real Estate Business recently spoke with several lenders to discuss the state of financing for multifamily properties. In the wake of the economic recession, the Midwest has struggled to recover at the same pace as the rest of the nation, leading to a somewhat cautious lending climate. However, with plenty of capital available in the marketplace and interest rates on the rise, lenders are optimistic about what the future holds for multifamily financing in the Midwest.

Economic Effects

The Midwest, though on the path to recovery, is currently experiencing a restrained climate for financing as compared to the other regions across the nation. With the downturn in the economy and job losses affecting a number of areas in the Midwest more so than in other markets, it has recently been a tougher environment to lend money in, according to Lamar Seats, senior vice president and head of production for Reilly Mortgage.

Mark Wiedelman, president of St. James Capital also notes the Midwest's slow recovery. "The Midwest, especially Michigan, is not seeing the same kind of economic recovery that other parts of the country are seeing," he says. "We are still seeing higher than normal vacancies. For a while it appeared as though Class B and Class C properties were starting to improve a little bit and now we are starting to see a bump in some of those. The recent trend has not been really positive."

Yet, it is not all bad news for multifamily borrowers. "There's a significant amount of capital available for multifamily through both agencies and life insurance companies, as well as the CMBS markets," says Jim Cope, executive managing director for Collateral Mortgage. "The funds are as plentiful as they've ever been."

Collateral recently funded a $4.1 million permanent fixed loan to refinance the Jupiter Crossings in Madison, Wisconsin. The property, which is located at 834 Jupiter Drive in the Grandview Commons neighborhood, features 57 units.

Seats is a little more reserved in his analysis. "There's plenty of money out there, but lenders are being very selective on the deals they look at and do, especially in the market-rate category because the markets are so soft right now," he says.

Jim Clifford, executive vice president and chief credit officer for The Marshall Group, agrees. "I think the [financing climate] is good, but I wouldn't call it hot," he says. "I think it's very available to developers who have well-thought out projects."

"Well-positioned multifamily, depending on the leverage level, is getting the most attractive pricing in the market of all the property types," says Pat Minea, senior vice president and managing director for NorthMarq Capital.

For borrowers, securing financing boils down to project economics. "It's tied back to project performance," Seats says. "If you've got a well-performing property, there are multiple sources of financing for that."

New Trends

Condominiums, instead of apartments, are currently dominating the multifamily market. "The general trend overall is that the multifamily market has been driven primarily by condominiums, both construction and conversion, given the low cost of capital for home buying," Cope says. "The traditional rental markets have not been as robust in terms of new construction and fundamentals."

Clifford notes the conversion movement in the Twin Cities. "In the warehouse district here, there is a lot of new condominium conversions of warehouses being done," he says.

The Marshall Group recently financed one such project at 700 North Washington Avenue in Minneapolis. The company provided an approximately $24 million acquisition/construction/renovation loan to the borrower, Tower Lofts LLLP, in connection with its purchase of two adjacent properties. Tower Lofts LLLP is redeveloping the office/warehouse into a mixed-use building called Tower Lofts. It will feature 142 residential condominiums and one commercial condominium. Kraus-Anderson Construction Co. is the general contractor; Ellness Swenson Graham Architects is providing architectural services.

Rehabilitation of older properties is another trend in the Midwest's multifamily market. "We are seeing a lot of substantial rehab," says Mark Unangst, senior vice president for Gershman Mortgage. "We are doing a lot in the St. Louis and Kansas City area with sub

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rehab of office buildings to apartments."

For example, Gershman Mortgage recently financing the rehabilitation of the Paul Brown Building in downtown St. Louis. The 16-story building, which is located at 818 Olive Street, is being converted into 222 loft-style apartments. The $53 million project, which is one of many initiatives to rejuvenate the Old Post Office district, will include 20,000 square feet of street-level retail space, a physical fitness center, a rooftop swimming pool, a clubroom and 130 underground covered parking spaces.

While conversions and rehabilitations are putting a lot of multifamily product in the marketplace, the construction of new properties has not been as active. "I wouldn't say that new market-rate construction is at a standstill, because there are a few projects being done," Wiedelman says. "But, it is nothing like you are seeing in Orlando and California." Wiedelman attributes this to population growth and demand. "The population trends are growing in those areas," he says. "From talking to people in other parts of the country, clearly the need here in the Midwest parallels the market-rate needs, and it's just not as strong here as it is in other parts of the country."

The decline in new construction is affecting the availability of funds. "It's having a major effect," Seats says. "There's lower occupancy in tandem with lower rent levels and, in many situations, it's very tough to get the loan amount the borrower wants."

Clifford, who is seeing some new multifamily properties come on line in the Twin Cities, has a more optimistic view of the recent decrease in new construction. "Housing starts were down slightly, and building permits were down a little bit, but not enough to be of any major concern," he says.

What's Next

Frank Sullivan, regional director for Cohen Capital, foresees abundant capital, both debt and equity, for the multifamily sector in the next 6 months.

"I see challenging valuations for assets, given the assets are fully priced for the expected recovery in the multifamily market," he says. "You need job growth and possibly an increase in interest rates to materially improve occupancy in the sector."

Minea expects the shortage of product to create more competition.

"With the rates being down, a lot of the apartments that could be refinanced already have been refinanced," he says. "Everyone will be fighting for the available properties."

For Unangst, the future of multifamily financing is bright for the Midwest.

"We're strong on it," he says. "We think there's a need, especially in independent living. A lot of the metropolitan areas in the Midwest have a need for that. We have a positive outlook." ❑