When Your Commercial Real Estate Project Hands You Lemons…

**RECAPITALIZE**

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### Current Interest Rate Environment

**How low can rates go?**

[Pie chart showing the breakdown of current interest rate environment for Commercial & Multifamily Debt Outstanding]

- 34% Banks & Thrifts  
- 24% Agency & GSE-back Mortgage Pools  
- 13% Other  
- 10% Life Insurance Companies  
- 15% CMBS, CDO & Other ABS Issues  
- 4% State & Local Government
Life Insurance Companies

Terms:
3 to 10 years

Rates:
- 2.50% for short term loans
- 3.50-4.00%  5 to 7 years
- 4.00-4.50%  10 year terms
- 60-70% loan to value maximum
- Non-recourse
- Some structuring
Banks

- Relationship focused
- Full or Partial Recourse is usually required over 50% leverage
- Floating Interests Rates over Prime or LIBOR
- Fixed Interest Rates typically 1-5 years
- 25 year amortizations
- Leverage up to 75%
- No prepayment penalties
- Debt Service Coverage 1.25

Banks are typically more concerned about previous borrower issues. Strength of borrower and relationship is more heavily weighted than for CMBS lenders.

Agency Lenders: Freddie Mac/Fannie Mae/HUD

- Non-recourse
- Floating or Fixed Interest Rates
- Fixed rate loans more common and 10 year term is optimal for proceeds
- 30 year amortizations with interest only possible is some cases
- Leverage up to 80%
- Yield Maintenance/Defeasance and Step Down Prepayment is available
- Debt Service Coverage 1.25
- Liquidity of 10% of loan amount required

Freddie and Fannie dominated the lending activity in Q2 2012 accounting for 47% of total commercial lending. Nearly all Freddie and Fannie loans are now securitized, which has changed since 2009 when both lenders were primarily portfolio lenders.
### Freddie Mac - Fixed Rate Pricing

<table>
<thead>
<tr>
<th>Term</th>
<th>Spread</th>
<th>Treasury</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Year</td>
<td>2.55%</td>
<td>0.70%</td>
<td>3.25%</td>
</tr>
<tr>
<td>7 Year</td>
<td>2.40%</td>
<td>1.19%</td>
<td>3.59%</td>
</tr>
<tr>
<td>10 Year</td>
<td>2.07%</td>
<td>1.83%</td>
<td>3.90%</td>
</tr>
</tbody>
</table>

### Fannie Mae - Fixed Rate Pricing

<table>
<thead>
<tr>
<th>Term</th>
<th>Spread</th>
<th>Treasury</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Year</td>
<td>2.41%</td>
<td>0.70%</td>
<td>3.11%</td>
</tr>
<tr>
<td>7 Year</td>
<td>2.29%</td>
<td>1.19%</td>
<td>3.48%</td>
</tr>
<tr>
<td>10 Year</td>
<td>2.14%</td>
<td>1.83%</td>
<td>3.97%</td>
</tr>
</tbody>
</table>

### HUD FHA

<table>
<thead>
<tr>
<th>Term</th>
<th>Leverage*</th>
<th>Spread (10 Yr)</th>
<th>Rate**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apartment New</td>
<td>40</td>
<td>1.20/83.30%</td>
<td>1.14%</td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Apartment Refinance</td>
<td>35</td>
<td>1.20/83.30%</td>
<td>0.86%</td>
</tr>
</tbody>
</table>

### CMBS

- **Fixed Rates - 4.50-5.50%**
- **Term – 10 years**
- **More loan proceeds**
- **70-75% Loan to Value**
- **Non-recourse**
- **Rate locked at closing**
- **Issue with servicing post closing**

**CMBS AAA & AA Bond Spreads**
What role does CMBS play in capital markets today?

The Good
- Provides liquidity and alternative loan options
- Higher loan to value = proceeds
- More flexible structuring
- Will work around sponsorship challenge

The Bad
- Existing CMBS loans maturing
- No relationships to work through problems
CMBS: A FORECLOSURE NEAR YOU

Office Building 100,000 sq.ft.

<table>
<thead>
<tr>
<th>Good Owner</th>
<th>Foreclosed Owner</th>
<th>New Owner Lower Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200/sf basis/value</td>
<td>$200/sf value</td>
<td>$140/sf basis/value</td>
</tr>
<tr>
<td>$20 rents</td>
<td>90 % leased</td>
<td>90 % leased</td>
</tr>
<tr>
<td>90 % leased</td>
<td>$150/sf loan (foreclosed)</td>
<td>$14 rents</td>
</tr>
<tr>
<td>$200/sf</td>
<td>$125/sf loan (purchased)</td>
<td>$125/sf loan</td>
</tr>
<tr>
<td>$125/sf loan</td>
<td>$100/sf (purchased)</td>
<td>New Money</td>
</tr>
</tbody>
</table>

Building 1
- Long term owner
- Put cash in property
- $20 rents = 10% return

Building 2
- CMBS forecloses
- Property condition declines

Building 2
- Property resold for $100/sf
- $40 TI & fixup
- $14 rents = 10% return

Competing for tenants with owners with lower basis

KNOW YOUR SERVICER & THEIR MOTIVATION

LNR Property LLC
- Owner: Vornado, Cerberus, Goldman, Star and Azista
- Brokerage Affiliate/Strategic Relationships: Archetype, Doren, and Auction.com

C-III Capital Partners
- Owner: Island Capital
- Brokerage Affiliate/Strategic Relationships: IFC, Realty, LLC and NAIGlobal

CW Capital
- Owner: Fortress Investments
- Brokerage Affiliate/Strategic Relationships: Rockwood Real Estate
Recapitalizing a deal today

- Forced refinance by existing lender
- Equity partner “wants” out
- Property needs releasing capital
- Market values have declined
- Rents have declined

What options does an owner have?

RECAPITALIZING A DEAL – THE PROBLEM TODAY

The Lemon
Office Building 100,000 sq.ft.

- Original value: $20,000,000
- Current value: $17,000,000
- Loan: $15,000,000
- Equity partner: $5,000,000

The Problems
1. Equity partner wants out “now”
2. Loan is coming due – As is loan to value = 88% LTV
3. Lender is “not happy”
4. Sponsor needs releasing capital
Recapitalization Alternatives

- Work with current lender
- Raise additional capital
  - New common equity
  - Preferred equity
  - Mezzanine money
  - “A” note / “B” note restructures with lender
- Note sale / note purchased
  - Short sale of existing loan
  - Discounted payoffs of existing loan

**Key Take-away: fresh capital required to recapitalize**

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**A Real Example**

A great owner: Did everything right

**The Problem:**
- Anchor tenant outgrew space at same time as 2 other tenants moved out
- Building went from 100% leased to 55% leased
- Owner needed $7,000,000 to refit building
- Interest rate on loan = 8% with yield maintenance
Turning Lemons to Lemonade

THE CAPITAL STACK

<table>
<thead>
<tr>
<th>Was</th>
<th>After Recapitalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>55% leased</td>
<td>95% leased</td>
</tr>
<tr>
<td>$20,000,000 8%</td>
<td>$20,000,000 5%</td>
</tr>
<tr>
<td>Value??</td>
<td>$7,000,000 Preferred equity</td>
</tr>
<tr>
<td>Debt</td>
<td></td>
</tr>
<tr>
<td>9 months to re-lease building</td>
<td></td>
</tr>
</tbody>
</table>

- Assistance from lender
- Owner brought in preferred equity partner to bridge capital need
- Preferred equity terms
  - 11% yield
  - Senior to owner’s capital & owner’s interest
  - 5 year term
  - Refinanced 8% debt-waived yield maintenance
- The outcome: Owner sold property, preferred equity was prepaid, debt was assumed, $10,000,000 profit to owner
Recapitalizing Strategy Today

- Interest rates on commercial real estate never been lower
- Rents have stabilized – NOI more predictable
- Stay in relationship with your lender – know its motivations & regulations
- Recapitalizing/restructuring almost always requires fresh equity