MARK FREERKS

**Marc Osheroff and Alan Gross partnered to buy Hialeah retail and office buildings.**

# Meltdown puts squeeze on commercial lending

BY OSCAR PEDRO MUSIBAY

Commercial real estate investor Marc Osheroff paid about $40 million for the mall, office building and parking garage attached to Palmetto General Hospital in Hialeah.

The sale, which closed Jan. 16, would have cost him $1.2 million less if he had closed in November, as planned – or six months ago, when financing was easier to come by and more money was available for deals.

The big issue for investors like Osheroff is that lenders are applying greater scrutiny to deals, capping the loan-to-value ratio at no more than 65 percent, and requiring more equity in both residential and commercial transactions.

And the vise is only getting tighter, real estate experts say.

The subprime meltdown has squeezed commercial lending, making deals more expensive and more complicated.

"I have to put in 30 cents on the dollar, or pay cash," Osheroff said.

To close the hospital deal, he took out a $3.5 million home equity line. For future deals, he plans to draw on the equity in the three office buildings he owns in Miami Lakes.

His ability to draw on his equity will allow him to continue to operate through the market's current credit crunch, but he understands a lot of smaller players will be standing on the sidelines with no options.

Prior to the subprime collapse, individual buyers could get up to 95 percent financing because the secondary market was buying up everything, including exotic financing like interest-only loans.

The residential market was brimming with jumbo loans. Developers, brokers and lenders convinced buyers the real estate boom would never end, and that buying a bigger home would only result in a bigger return down the road.

Today, the secondary market has collapsed, while billions of dollars in losses continue to ripple through the market.

Despite the fact that commercial loan delinquencies are at historic lows, people are concerned about the continued spillover effect of the credit crunch on the commercial sector. This fear has some investors in a holding pattern to see how asset valuations shake out in a market that hasn't hit bottom. It's a stark contrast to a handful of years ago, when having a deal was enough to get a lender interested.

## RESIDENTIAL LOSSES SPILL OVER

Losses on the residential lending side began seeping into the commercial financing markets last year. Loss-riddled banks tightened their standards and Wall Street investors turned up their noses at real estate, similar to what they did to Internet companies during the dot-com crash.

The spillover effect has continued into the new year.

In the second week of January, Citigroup (NYSE: C), the parent company of CitiMortgage, announced it had lost $9.83 billion in its fourth quarter. The following week, Merrill Lynch & Co. (NYSE: MER) said it took $14.6 billion in write-downs and adjustments in the fourth quarter due to investments and trades impacted by the subprime mortgage crisis.

Alex Zylberglait, associate director for Marcus & Millichap, said that banks are so rattled by the losses that they are "offloading

SEE PAGE 22

MARK FREERKS

Alex Zylberglait says banks are 'offloading assets' to decrease their exposure.

# Credit on all types of properties is more expensive, tied up longer

FROM PAGE 20

assets," even performing loans, to decrease their exposure. Jumbo loans might as well be radioactive, further stalling the residential market.

This is particularly thorny for sellers and developers in downtown Miami's new condo canyons. Buyers of units priced above the $417,000 conforming loan cap are on their own if they don't have cash.

Credit on all types of properties is also more expensive and is tied-up longer, even for the financially well heeled.

Tighter rules means lenders will provide between 60 percent and 70 percent financing – and charge more for it, said Alan Gross, Osheroff's partner in three Miami medical-office buildings and a principal of Davie-based Gross Mortgage Finance.

"Today, you can still find money, but in the 6.5 percent [interest] range, with a 30-year amortization, where before, you could get 5.5 percent with interest only."

Zylberglait said what's now perceived as "cautious behavior" was standard operating procedure for commercial underwriting up until four years ago. For example, banks have returned to mainly using a property's past performance – instead of projected revenue – as an indicator of its value. The change is making sales of some shopping centers and office buildings with vacancies, regardless of the location, harder to finance.

"If you were getting a steal, they would finance it, they would recognize the equity," Osheroff said. "They are not doing that now."

Even at full occupancy with investment-quality tenants, shopping center deals are being underwritten with a 5 percent hedge in the quoted vacancy rate.

"So, whatever you say, we are taking 5 percent off the top," said Andy Elfmont, president of mortgage brokerage Elfmont Associates. "That's getting down and very dirty."

## TOO EARLY TO TELL

It's still too early to calculate the impact of the rule tightening on recent commercial activity. But transactions declined from 2006 to 2007 in South Florida's industrial, office and retail sectors, according to CB Richard Ellis data.

Today, institutional investors, all-cash and low-leverage buyers control the playing field because the barriers to entry are greater, said Manuel de Zarraga, executive managing director of Holliday Fenoglio Fowler in Miami.

"The difficulties in the debt markets have resulted in lower loan amounts and higher constants – interest and principal payments – than before the debt market difficulties commenced in April 2007," he said. "These factors have made it more difficult for buyers that tended to try to maximize the amount of leverage in acquisitions."

Other players are stepping in.

"Every deal is now sitting with the insurance companies," Elfmont said. "They have the entire country to pick from."

De Zarraga pointed to the fact that long term mortgage financing for commercial real estate is priced off U.S. Treasuries, which have dropped by nearly 150 basis points since April. During the same time period, spreads over Treasuries for commercial mortgage-backed securities (CMBS) have seen a 150-point uptick. As a result, interest rates today are about the same for commercial loans as they were in March.

"The big difference is that it is now very difficult to secure an interest-only loan, and lenders have reduced the loan-to-value they will accept," de Zarraga said.

Prior to the tightening, the market was seeded for institutional dominance. Rising insurance and tax rates made commercial transactions more of a challenge.

The historically low delinquencies further fuels investor interest in commercial assets.

The South Florida market's current credit challenges heighten the barriers to entry, making the market even more attractive to cash-heavy buyers such as life insurance companies.

"South Florida ranks as one of the top commercial real estate investment markets for institutional investors who are attracted by good balance between supply and demand of space, difficulty of developing new projects, strong employment growth – even with less construction of condos – and the international trade significance of South Florida," de Zarraga said. "Institutions have done well here."

omusibay@bizjournals.com | (954) 949-7567