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CONSTRUCTION LOANS – DEBT, DEBT AND MORE DEBT!
Part II of II

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Continued from the May 30th New York Edition

Last week, we looked at the construction lending market and the growth of construction loan coverage over the last 10 years. Now that we know about this trend, let's delve into what has caused this change in the market.

The following are some of the factors driving lenders to make these large construction loans.

- The lending market has seen a rise in competition. Private lenders, REITs and mortgage bankers have emerged as viable construction lenders, and in order to compete most banks in New York City have staffed and geared up a construction lending group. In addition, the traditional securitized lenders, such as Lehman Bothers and Bear Stearns, have recently jumped into the construction lending market. For the first time, Fitch Ratings issued criteria for the securitization of commercial construction loans, and securitized construction loans have been closing with increasing frequency.
- Over the years, the spreads and the profits of conventional loan interest rates have decreased. With a hot real estate market and decreasing conventional loan profits, the logical place for banks to place their money is in the development market.
- Retaining the existing customer base has always been a primary focus of all banks. At first glance, it may seem like the retention is only in trying to keep their existing developer and construction clients. However, with a strong development market, many banking customers, traditional manufacturers, distributors and retailers have been able to either develop their property and need construction loans to do so or have sold their property and are looking to reinvest the proceeds in new properties. Dennis Graham, head of the construction lending group at Banco Popular says, "We try to look at every possible way to satisfy our existing customer base and keep a balance of making smart loans. We take a pragmatic approach to evaluating each deal, and customer satisfaction, obviously a very important factor."

As to the "developers" and why they are willing to take these types of loans, the answer is simple, because they can! Most developers look at the market and figure that if the banks and lending institutions are willing to make the type of loans described above, then why shouldn't they take the loan proceeds and develop the project. In addition, with so many new developers in the market, people are not worried by the experience of the 1980's or the repercussions of a bad deal on their reputations. Matthew Lonuzzi, President of Cheever Development Corp. and a long time developer of residential apartment buildings and condominiums, believes that “if you have done this long enough, you understand that great construction financing terms should not drive a deal. A deal either makes sense or it doesn’t. Over leveraging yourself is not the way to go.”

All of the above factors have created a slippery slope. When are there too many projects and who will be left holding the bag? With so much competition and product currently being brought onto the market, this is a situation that needs to be carefully watched.