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Private Financing Supports CRE Funding Opportunities

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A10 Capital, Boise, Idaho, provided **$4.6 million** financing to an opportunity fund that purchased a **$10 million** distressed **commercial mortgage-backed securities** loan.

The opportunity fund purchased the defaulted loan that had a **$22 million** balance. It acquired the note in default because the **85 percent-occupied** multifamily property was over leveraged by the current owner.

“Even in an 85 percent occupancy, it didn't cash flow,” said **Jerry Dunn**, CEO of A10 Capital. “You can't fix an over leveraged situation. No matter how they decided to exit this loan, whether it be a loan sale, like they did, or a foreclosure, they were faced with a pretty material loss no matter which way they went.”

Dunn said this was an attractive deal for the opportunity fund, a multifamily operator, with a difference of nearly **$12 million**. Dunn would not disclose the interest rate on its financing, but he is confident it will get a fair return.

The **Mortgage Bankers Association** said multifamily loans dominated originations last year, representing **$64.6 billion**, or **36 percent** of total lending. While most commercial real estate investor originations declined, **Fannie Mae** and **Freddie Mac** increased **14 percent** and **15 percent** for the year, respectively.

Dunn said he does not view GSEs as purchasing distressed asset loans, but a strong financing source for multifamily.

“They have fairly rigid underwriting criteria,” Dunn said. “I don't think they are stretching to essentially help with a distressed asset, but they are a very attractive and robust financing source for conventional, multifamily financing needs right now.”

A10 Capital falls between a “hard money" lender and a conventional lender in its risk and pricing, Dunn said. Its recent transaction, structured on a non-recourse basis, allowed the opportunity fund to leverage its returns and magnify projected internal rate of return on its purchase.

“Rather than foreclosing, the lender decided to sell the note. It was an exit for them,” Dunn said. “[The opportunity fund] came to us because they did not want to put $10 million of equity out of their fund into the transaction.”

A10 Capital focuses on industrial, office, multifamily and retail properties, but it stays away from hotel and land loans. It will not consider construction loans, despite some groups that do finance them.

“That adds a whole new element of risk for the buyer. They have to step in and essentially complete the project,” Dunn said. “There is the uncertainty of development and construction, not to mention additional capital. That is not an area we would have interest in financing.”

A10 Capital looks at the note buyer's track record from a workout and operational perspective and wants to be comfortable with the property's fundamentals as it underwrites and reviews accompanying loan documents prior to financing.

The firm can also provide secured mezzanine financing and some equity placement through its own investment fund, but Dunn said he needs to see bid-ask gaps narrow more.

"There will definitely be opportunity going forward" for property investment, but bid-ask spreads will still need to further narrow before A10 Capital steps into equity placement, Dunn said. "With the banking system and the economy, we think at some point some of the sellers will be forced to sell, and then that's where some of the opportunities will come about in the future."

In the short term, however, he said tight credit continues to weigh on property values, including significant pressure on retail properties.

"Fundamentals of these income-producing properties will be hit in the form of lower market rents, higher vacancies, which drive down the income opportunity for that piece of real estate and, on top of that, because of the lack of capital in the marketplace, cap rates will go up," Dunn said. "If you add those three things together, that just creates a pressure on commercial real estate values, which we think will happen in the short run."

The opportunity fund's recent $10 million transaction closed in less than three weeks and, by purchasing the loan at its lower-than-face value cost, the opportunity fund will likely attempt to restructure the current owner's debt or foreclose on the property and try to resell it.

"Distressed debt has been going on for a long time in this economy, but just in the last three to four months—as the credit crisis has gotten worse—this has become a larger market," Dunn said. "We have a lot of these kinds of transactions in our pipeline, and we have a very robust pipeline and look forward to doing more of them."