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Don't Let Money Squeeze You: Deal With Rising Interest Rates

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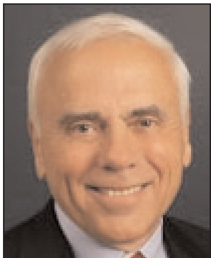

To be sure, no one expects commercial real estate loans to dry up and blow away. Commercial banks, insurance companies and pension funds have been, and will continue to be, the mainstay of real estate funding. But as interest rates have gradually risen, traditional lenders have become more skittish about "monster" loans – those from $1 million to $1 billion. That trend is affecting funding for a range of developments, particularly malls and office building complexes.

Rising interest rates can lower property values, especially in overdeveloped or economically depressed areas. Decreased property values – often coupled with decreased revenue – can make it difficult to service debt on the multiple mortgages that usually combine to keep major projects afloat. When this occurs, lenders tend to get nervous and pull in the reins. But, in addition to refinancing short-term loans and floating rate debt with long-term fixed rate debt, there are some basic things developers can do to deal with "lender nerves" and ensure you have the money you need to fund your next big development.

Rely on long-term relationships. Whenever possible, work with lenders with whom you have a history. They're most likely to consider your past record when making loan decisions during a tight-money period. Developing and maintaining long-term relationships with funding sources can often inure lenders to particular developers when economic seas get rough. Bankers respect savvy clients who show loyalty and manage their projects by the provisions of loan agreements. They also respect clients who could be wooed away by a competitive funding source with a 25 or 50 basis point advantage on the rate, but stick with their present banker.

Choose projects carefully. In a tight-money environment, you need to be particularly discerning about the projects that make it to your drawing board. Be sure they offer solid revenue potential and are in areas with increasing property values, as exhibited by low unemployment and high rental occupancy rates and ample new construction. A killer location, perhaps a strong franchise, and a verifiable potential market are critical elements of making the right choice.

Crunch the numbers. Do your homework before meeting with lenders. Be prepared to show exactly what the property will earn and how much it will appreciate. Lenders are more likely to open their wallets if you give them clear, persuasive evidence that you'll be able to make scheduled payments. Such evidence could include documentation of executed leases or rental receipts, current sales prices of other comparable properties in the area and realistic operating performance projections. In this regard, working with a highly skilled certified public accountant who specializes in real estate development and construction always pays off handsomely. Taking the time to identify an accounting firm that specializes in real estate and has gained solid credibility in that area is a must today.

Consider a partnership. By partnering with another investor, you double available resources and borrowing muscle. But partners should be chosen with care. To prevent unpleasant surprises from surfacing after a partnership agreement is signed, be sure to look closely at prospective partners' finances, history and current business operations. Ask your accountant to interview your potential investment partner. Often, the accountant will gather information that the developer may not have been aware of and, with a two-pronged evaluation approach, the trouble that can arise from picking an inappropriate investor can be avoided.

Look to your state or municipality. Many states and municipalities provide funding and tax incentives to spur development in specific areas. They can be attractive alternatives in tight-money times. Keep in mind, however, that government-funded projects often are in depressed areas with low property values and limited revenue potential. Before taking on one of these projects, confirm that the local government is committed to doing its part to improve services and infrastructure – thus increasing property values and attracting business to the area.

Consider an offshore investment. While money may be getting a little tight in the United States, it's flowing freely in other parts of the world. In China and Southeast Asia, for example, public and private funding for commercial projects abounds. Laws regulating foreign investment in Asia – and especially in China – can add a layer of difficulty to any project, so enlist expert advice before jumping into the often-turbulent waters of Asian investing.

In short, tight money doesn't have to stall opportunities for new project development. The preceding ideas can keep the lending dollars flowing and your investment engine running smoothly. Remember, lenders are in the business of making a profit as are commercial developers. The banker counts on the developer to bring deals that make sense and manage the project in accordance with a well-considered plan. Bankers thrive on stability, and a developer and his accountant – working as a team – can provide that important sense of stability to the lender. ■

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