

Private Lenders Could Gain Steam in Apartment Refinancing As Traditional Sources Dry Up

Firms Angle for Larger Share of Declining Business for Loans



The Lowe apartment property in Savannah, Georgia, was recently refinanced through a private lender instead of a bank. (CoStar)

By [Richard Lawson](#) and [Mark Heschmeyer](#)

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Alternative lenders could end up carving out a bigger niche among apartment owners as traditional bank routes have narrowed for refinancing loans.

This year, \$27.9 billion in apartment debt is set to mature, according to debt rating firm Morningstar, including loans through government agencies [Freddie Mac](#) and [Fannie Mae](#), private lenders and multifamily commercial mortgage-backed securities. It's a topic of discussion for the rental housing industry as owners and investors gather this week in Atlanta for the National Apartment Association's Apartmentalize conference.

Soaring interest rates last year sent the cost of borrowing money higher. Slowing rent growth combined with fears of a recession sent banks into belt-tightening mode.

With less to lend, borrowers are having to rely on, or put up much more of, their own capital to complete a refinancing. The combination means investors have less capital for acquisitions, renovations and possibly a smaller return to their investors.

“It’s extremely common” when lending markets tighten for lenders to require more equity in refinancing, Daniel Jacobs, managing partner with Atlanta-based private equity firm ACRE, told CoStar News. “It’s the reality of the market.”

His firm recently refinanced a construction loan Washington, D.C.-based MED Developers used in building [The Lowe](#), a 135-unit apartment property in Savannah, Georgia, that opened in

March. A \$26.5 million deal replaced a \$24 million loan given in 2021 that was set to mature in September, according to Chatham County property records.

Liquidity Shortage

Private lenders are taking advantage of the liquidity shortage in the broader debt markets. “The banking system is essentially closed,” Toby Cobb, managing partner and co-founder of Miami-based private lender 3650 REIT, told CoStar News.

Cobb said the lion's share of the challenges in the banking industry financing are tied to the fallout from the failures of Silicon Valley Bank and First Republic this year. In response, big banks have become “super conservative” to whom they lend, he said.

The Mortgage Bankers Association reported in its commercial real estate lending forecast May 16 that overall lending is expected to drop from \$816 billion last year to \$654 billion this year, representing a 20% decline. Multifamily lending is forecast to drop 14% this year to \$375 billion from last year's \$437 billion.

Cobb said that alternative private lenders with investors including pension funds and insurance companies have capital to lend and will “become a much bigger source of capital.” But he said they are a long way from cutting deeply into lending from big banks, which make about 65% of all commercial real

estate loans. Private lenders have about 5% to 6% of the lending market.

Cobb's company, 3650 REIT, has had a busy few months despite the challenges in the broader lending market. The private real estate investment trust provided a \$58 million loan to refinance [Brookview Commons](#) in Danbury, Connecticut, and closed a \$103 million loan joint venture between sponsors David Werner Investments and Onyx Partners that recapitalized 12 properties spread across Louisiana, South Carolina, Georgia and Tennessee.

Cost of Debt

Lending began trailing off in the back half of last year when the Federal Reserve pushed interest rates up quickly.

Freddie Mac's \$35.7 billion in 10-year loans originated in 2018 had an average interest rate of 4.646% and a loan-to-value ratio of 66.8% in 2018, according to Freddie Mac data. Similar loans on properties valued at \$8.5 billion and securitized this year carry an average interest rate of 6.012%.

Loans through private lenders tend to run 3.5 to 4.5 percentage points higher than the secured overnight financing rate, known as SOFR, which has been running at about 5.06%, said Jacobs with private equity firm ACRE.

Borrowers received loan amounts totaling \$3.5 billion, a less than 50% loan-to-value ratio, according to Freddie Mac data. If these loans were underwritten at 2018 figures, borrowers could have received up to \$5.7 billion. That totals out to borrowers having \$2.2 billion more of their own capital locked up in their properties than they would have had at 2018 underwriting levels.

Their loan proceeds this year are costing them \$47.8 million more per year at today's interest rate over that of 2018, according to Freddie Mac data.

The change in lending conditions has grown even as pandemic disruptions started fading last year and the Federal Reserve started marching borrowing rates higher and higher each month.

“During the first quarter of last year there was a lot of competition in the market from multiple capital sources,” TJ Edwards, chief production officer of multifamily finance at Walker & Dunlop, told CoStar News in an email. “This resulted in a very competitive market for both Freddie Mac and Fannie Mae. Also, interest rates were more stable and floating rate debt was more attractive.”

Effect of Higher Rates

ACRE's Jacobs said that “when interest rates were near zero, people pushed the leverage to the limits.”

The first quarter of this year was an entirely different economic environment with a lot of market uncertainty, and “refinance and acquisition volumes” slowing down compared to the first quarter last year, Edwards said.

Because of higher interest rates, slow multifamily rent growth and increased expenses, deals are not getting sized to previous loan-to-value levels, Edwards said.

Some refinancing is resulting in cash-ins from borrowers. As a result, some are more hesitant to refinance, especially in scenarios where the net operating incomes don’t support cash-out proceeds.

“On floating rate deals, the increase in SOFR and replacement cap escrows has significantly impacted the ability for some sponsors to make distributions to investors or execute renovation plans,” Edwards said. SOFR is a broad measure of the cost of borrowing cash collateralized by U.S. Treasury securities.

“In other situations, the ability to refinance” with cash-out proceeds or to use supplemental financing to pay back equity or renovate an asset “is becoming more challenging,” he said.