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Banks Pick Up Greater Share of Multifamily Lending Business

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Bank lenders are making a lot more permanent loans on apartment properties. “Banks are looking to place money in cash-flowing, stabilized properties,” says Elliott Throne, managing director with capital services provider HFF.
These banks are lending to owners of stabilized apartment buildings even as they step away from funding new construction projects. New regulations and worries about overbuilding are driving many banks to make smaller construction loans, and to lend on fewer properties.

Banks lenders originated more than a third—38 percent—of all permanent apartment loans in the first half of 2016. That’s not far behind the share of apartment loans made by agency lenders, including Fannie Mae and Freddie Mac, which have been the dominant source of lending on stabilized apartment properties since 2012.

Agency lenders still originated more apartment loans than any other type of lender, but their lead is shrinking, with less than half—just 44 percent—of all permanent apartment loans in the first half of 2016, according to New York City-based research firm Real Capital Analytics (RCA). That’s the lowest share for the agencies since 2012.

Local and regional banks, on the other hand, have been growing their permanent lending business at a brisk pace. About 1,300 regional or local banks were recorded as originating a significant commercial mortgage in the first half of 2016, a 37 percent increase from a year earlier. Local and regional banks captured 19 percent of the apartment lending business over the same period, up from 11 percent in 2014.

At the same time, banks are making far fewer construction loans as apartment experts begin to worry about overbuilding in certain markets and the percentage of vacant apartments begins to rise on average nationwide, according to research firms including Reis Inc. “The banks have gotten out of the construction lending business,” says William Mathews, vice president and principal with real estate services firm Colliers International. “They want to turn these construction loans into permanent loans.”

The new lending regulations going into effect this year are “forcing banks to focus on the stabilized assets, because they have to set aside less capital,” says Throne.

Banks typically offer permanent financing with shorter terms than agency and CMBS lenders. They strongly prefer to focus on five-year loans, Throne notes, but some are willing to go up to seven- and 10-year terms. That’s a good fit for private equity funds, which have become major buyers of apartment properties. Private equity funds tend to buy and hold properties for about five years at a time.

The interest rates for these bank loans often float from 250 to 350 basis points over LIBOR. “Most are floating rate executions,” says Mathews.

Local and regional banks have increased their share of market activity in all regions, but they have done so at a greater pace in the Southeast and the Midwest—regions that previously had a greater reliance on CMBS financing, according to RCA.

"Instead of banks taking market share from agency lenders, the banks are taking market share from CMBS," says Mathews.

Risk-retention rules shadow CMBS

CMBS lenders survived volatile bond markets earlier this year, but now they have to contend with new risk retention rules that will come into effect at the end of the year. That will cut into their profits and will probably motivate some lenders to raise the interest rates they charge for CMBS loans, perhaps by 25 to 30 basis points.

"That will make CMBS less competitive, and force some borrowers to banks," says Mathews.

CMBS lenders currently offer all-in interest rates fixed at around 4.0 percent for 10-year loans. That's a big difference from earlier this year, when CMBS lenders offered rates closer to 5.0 percent. "The all-in rate for CMBS is just a little higher than agency loans," says Throne.

Fannie Mae and Freddie Mac lenders offer all-in interest rates that are fixed at just under 4.0 percent for 10-year loans or a little more than 200 basis points higher than the yield on 10-year Treasury bonds.

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