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By: Michelle Napoli

*Since launching his own mortgage banking business in 2004, Frank Satterfield, principal of Houston-based **Harbor Capital Group**, has made a name for himself in putting a significant focus on arranging financing for TIC and DST deals. His company arranged more than $1 billion of such financings during 2004 and 2005, and the company's projections are for more than $1 billion in 2006. TIC Monthly recently spoke with Satterfield about trends in financing for co-ownership investments.*

Satterfield

Q: Is debt financing as freely available, and at the same cost basis, for TIC deals as for any other comparable properties?

A: When we first started out, there was a premium paid by the sponsors for a tenant-in-common transaction loan. But as it's become a more common form of ownership as the tenant-in-common/1031 ownership structure for exchanges has taken off, those premiums narrowed. Today, we work with a core group of lenders that has gotten very comfortable with the tenant-in-common structure and in particular with our clients, our borrowers, and so now it's as competitive as any other structure out there.

Q: What about DST structured deals? The thought was lenders would look at these more, though I don't think that has come to fruition.

A: It has and it has not. That topic is high up on my list, because we have the CMBS market right at the moment that has effectively shut out DST ownership or borrowing structures completely, with the exception of single-tenant, net-leased properties. Now, the DST structure works perfectly good for a multifamily rental property, wherein the sponsors enter into a master lease and lease the property back and create basically a single-tenant, net-lease situation. But the B-piece buyers in that marketplace have collectively gotten together and decided that they're not going to do DST structures on multifamily. So right at the moment there is very little opportunity to finance these in the securitized marketplace. On the other hand, portfolio lenders have taken a different tack altogether. They have reviewed the tenant-in-common structure, and we have done a significant amount of business with life insurance companies using the tenant-in-common structure, with people like **MetLife**, **John Hancock** and some others. Then last July when the IRS ruled that a DST structure was equally acceptable for 1031 exchange, so long as it met certain criteria, we talked to our portfolio lenders - the life companies - about this structure, and they all to the same degree felt like this was a much better structure for them than the tenant-in-common structure. So, we have two separate reactions to the same situation. On the one hand the portfolio lender has decided it would much rather prefer DST deals with a master lease on apartments than they would TIC deals. In fact, some of the lenders that we've done them with have basically said, 'bring us all your DST deals, but we don't want to do any more deals on a TIC structure.'

Q: The B-piece buyers aren't called 'the cartel' for nothing.

A: That is exactly right. There are certain objections that the B-piece buyers raise when they're looking at the multifamily DST deals, the so-called seven deadly sins. However, there are solutions to overcome these weaknesses, if you will, in the DST structure, and yet they have refused to acknowledge those as being acceptable. Whereas the lawyers from the portfolio lenders have…We are working constantly to try to overcome that, by trying to educate where we can both lenders and B-piece buyers.

Q: Whether it's a TIC or a DST, a conduit or portfolio lender, what really makes a lender comfortable with a co-ownership deal?

A: With the tenant-in-common structure, I think that lenders feel comfortable using that as an ownership structure. It has taken some degree of education and experience in the marketplace, but the overriding thing that makes them feel comfortable is the same thing that makes them comfortable with any loan. That is having a qualified borrower/sponsor, somebody that understands the particular discipline in which they're working, whether it's an office building owner/operator, whether it's an apartment professional or whether it's a retail sponsor that has a track record in operating successful properties. Once you get past the hurdle of understanding a tenant-in-common structure, and really understand how the control is exercised, then it really boils down to the same thing that you always look to—a quality piece of real estate, a great location and a good sponsor/borrower. With a DST, of course again the property and the sponsorship enter into it. At the end of the day, the portfolio lenders are comfortable with the DST because it eliminates the multi-borrower situation. You have one borrower, the DST, you have the master lease on the multifamily side, and you've got a qualified operator that plays in that multifamily market.

Q: Conversely, what makes them wince or hesitate?

A: There are a number of issues the B-piece buyer have with the DST but the one that causes them the most problem—the focal point if you will—is the fact that a DST is prohibited from refinancing and/or providing additional capital in the event that there is a problem. So they have focused on that issue and no matter how you have structured the deal to eliminate that potentiality, they have refused to recognize it. The solution for that is simply that once a property gets in trouble, then the trustee is empowered to collapse the DST into an LLC and then as the managing member of the LLC, you then have the ability to raise and provide additional capital to the members…There are some lenders out there that for whatever reason do not do tenant-in-common deals, period. And they have never made the effort to understand the structure. They cannot get beyond the fact that you can have up to 35 individual borrowers, and so rather than figure out how to make these loans and feel comfortable with it, they have opted not to do them…All the things a lender is normally concerned with…on other types of deals, they're concerned with on the tenant-in-common structures as well. And the fact that they have gotten beyond their concerns about having 35 individual borrowers, and understand that the real control is vested with the sponsor, then they become okay with it.

Q: There is concern that certain kinds of debt are being used in some deals to engineer marketable investment returns. What do you hear from the lender's perspective?

A: From a lender's perspective, yes, they do have concerns. The main concern that they have is that by the time the loan comes due, that not enough of it will have amortized off in order to comfortably do a refinancing. So, their concerns about that particular practice are just in theory. However every real estate loan, every real estate transaction has different attributes and if you've got a situation where you've got a superior property, in very good quality physical condition, a location that can easily be underwritten for its long-term place within its submarket, then all those things go to mitigate it, make it more palatable for interest only deals. Now, at the same time, when you're making these loans that have a significant amount of interest only. For our purposes here I would say more than three years interest only, probably not more than five, then the loans are made at a lower loan to value, so by the time the loans get to the point where they're fully paid off, they're back to where they would have been had they been amortizing.

Q: What is your outlook for 2006?

A: I see certainly for the first half of '06 everything to be the same. There's plenty of money available for TIC transactions. There seems to be significant, continued demand from investors to invest in these transactions. So I see '06 to continue with at least as much volume as transpired in '05. If anything were to limit the volume of tenant-in-common transactions, I think it would come from the investors' side as opposed to the debt side. Interest rates, despite the fact that they have ticked up recently, if you go back over the past 25 years, they are still at a historically low position on that scale. So even though they've gone up a little bit and even though long-term rates may continue to rise, so long as they don't rise in a sudden and dramatic way and it's a general, gradual uptick, the market will stay pretty much in sync with it and not be impacted one way or the other.