The CRITTENDEN REPORT Real Estate Financing™

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Lenders Compete for Office DSCs

Debt service coverage ratios are dropping as conduits compete for quality office space in top-notch locales. For a quality deal with credit tenants on the lease, DSCs are dipping all the way down to about 1.05 DSC. For something a little less than blue chip, a 1.15 DSC has become the norm as lenders look to appease borrowers in an environment of rising interest rates. Among the lenders in the hunt for office perms are **Citigroup**, **KeyBank** and **Wachovia Securities**.

Not too long ago, DSC was in the neighborhood of 1.2 to 1.25, but that was before Treasuries began their ascent. Of course, interest-only is another tool being offered to enhance cash flow and help deals pencil out. If a borrower has substantial skin in the game, is a strong sponsor or the asset is prime, look for lenders to underwrite a healthy chunk of interest only.

Securitized lenders are still the most aggressive on proceeds and pricing. Spreads continue to narrow for quality loans. Of course, this breeds a competitive environment, forcing lenders to accept lower underwriting standards when higher interest rates threaten proceeds. If you want to close deals nowadays, you need to keep those dollars flowing, even if you're exposing your backside a bit on debt coverage.

An illustration of a lender swallowing a lower DSC to close a deal involved KeyBank. The bank's conduit funded a $6.24M loan for a Class A building in Woodlands, Texas, a suburb of Houston. At the inception of the deal, Treasuries were about 4.6%. When it closed, they had spiked to about 5%. Despite the increase, the amount of loan proceeds remained the same. Of course, the lender swallowed a DSC below 1.2, but good sponsorship in a tight office market made the deal more palatable.

The loan is for 10 years and has an interest-only component that eventually will convert to a 30-year amortization. Pricing is just over 6% and LTV is 75%. The deal was arranged by **Josh Chambers** of the **Harbor Capital Group**. Look for KeyBank's conduit to entertain deals starting at $2.5M, with its sweet spot from $10M to $20M. KeyBank looks to close around $20B in commercial loans in 2006.

Citigroup recently funded a $133M forward commitment made in the latter part of 2005. The deal, which is collateralized by an office park in Brea, Calif., closed at pricing sub-6%. The LTV was 75%, but the lender will go up to 80% for a first. Look for the conduit's deal size to start at $1M, although it clearly looks to land the bigger fish.

Wachovia will consider deals starting at $500T. It is historically one of the most prolific conduits around, so look for the lender to originate more than $10B in commercial deals in 2006.