Lowenstein Sandler's Real Estate Podcast: Terra Firma

Episode 4:
Real Estate Financing in Today's Economy: The Advantages of Starting Negotiations Early

By Stacey Tyler, Steven Tanico, Kim Lomot

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Stacey Tyler: Welcome to Terra Firma: Conversations on Commercial Real Estate. I'm Stacey Tyler.

Stephen Tanico: And I'm Stephen Tanico. Stacey and I are real estate attorneys at Lowenstein Sandler. On today's episode, we'll be joined by our colleague, Kim Lomot, to talk about lending. Kim is partner at Lowenstein Sandler, a financing extraordinaire, and formerly the biggest Bills fan in New Jersey and now the biggest Bills superfan in North Carolina. Thanks for joining us today, Kim.

Kim Lomot: Thank you. I love that the Bills got in there at the beginning. It just makes me happy.

Stacey Tyler: So, Kim, we all know that financial news is all doom and gloom right now, so what kind of lending do you see actually getting done?

Kim Lomot: Well, the good news is it is getting done, just probably slower and less frequently than before. Listen, it's no surprise that lenders and banks are tightening their underwriting standards and the cost of capital is pretty much through the roof comparatively to what it's been. So, the fact is it's just much harder to get a loan for everybody, period. But especially for parties who are looking to get financing on asset classes like office, retail, buildings. Those obviously, with what's gone on over the couple years, is the spot that is probably the tightest market. The good news is warehouse and industrial space is still a bit easier. Those valuations are holding stable. I'm seeing clients who are looking to get financing in that area not really having as much of a problem or at least not being so scared by the terms they're seeing.

And even certain lenders have put whole stops on providing loans to certain asset classes. That is not something that I like to say, but you didn't mention in the intro but I've actually been on both sides. I was formerly lender's counsel for years and years, and I worked at a firm where we did represent in 20, 30, 40, 50 banks. And now I've been on the borrower side for a lot of years and still have a lot of good relationships with a lot of the regional and national buyers, lenders. And there are some that just will not give loans to certain asset classes. And I'd like to try to communicate with a client early to let them know that too because this is just not something you're going to be able to get right now. Construction financing in certain, depending what you're building, where they're going to do it, location, all of these things kind of come into play in terms of trying to get financing and especially on terms that borrowers want, companies want.

Stacey Tyler: How are you seeing those terms change now in this kind of post-COVID environment?

Kim Lomot: Yeah, listen, interest rates obviously are killer. Costs have gone up. The banks are being very tight in terms of LTVs, they're being tight in terms of collateral packages. A lot of loans I see are so over-secured and sometimes you can bring that up early enough to say, "You shouldn't have to get this, especially with your appraised value." But there is some fear. There is some fear in the market and especially with certain players and regional players given what's gone on with some of the other banks.

So, I think it's all things that I think people will deal with, but you really need to walk into it eyes wide open so that you're ready and prepared for the terms that are going to be coming your way. And also that it's feasible because the cost for obtaining the loan obviously has skyrocketed and there's a lot of loans that are coming due. So, you just can't wait until the last minute. You can't be forced into terms that you're not going to be happy with and you're going to be stuck with, and you just don't want that. It's not ideal timing. So, just you really got to try to get in front of it because it's not as easy as it once was and there will be roadblocks and you may be having to go to multiple lenders just to get something that you feel can accommodate where the business is.

Stephen Tanico: You mentioned national banks, local banks, regional banks, are you seeing a difference in ... What is a difference, I suppose, in the way those banks are kind of lending? Obviously a national bank a lot more capital to deploy versus a more local bank.

Kim Lomot: Yeah. So, it does depend on the bank. Some of the nationals that I've worked with clients lately, they've been somewhat accommodating because they do want to move loans. They do want to put money out. But it does depend on the asset class and even with banks that I've had previous experiences with, things that never would have come into play are now in their terms sheets.

Stephen Tanico: Like what?

Kim Lomot: Stricter standards, more frequent financial reporting, really having eyes on things, not being so friendly with defaults in cure periods, over-collateralizing, covenant compliance, things that requiring guarantees, things that maybe you would have had more flexibility to get out of and now you can't. Now, there's good and bad. There's also regional banks sometimes people love the relationship. We have a lot of clients in middle market that they don't want a big lender. They've had terrible experiences with them. They want a little bit of a smaller bank. They want something that's a little more local, that pays a little bit more attention to them.

Kim Lomot: They want those things. They want that relationship. And the bank wants deposits too at the key of it. And they think that that has become really important, relationships. Some clients have been burned by some of the larger banks and they are seeking that.

But then you also run into some a little bit of smaller, regional player issues like instead of having a weekly approval to get a loan done during underwriting, their credit committee is meeting once a month. So, the loan takes longer. The underwriting process takes longer. It's taking just longer to get through the process to even get to a point where you have a terms sheet signed and then you're going to produce loan documents. You run into some of that.

And then a lot of it is a negotiation. I tell clients all the time sometimes I know who represents the banks and I can tell them very honestly this is going to be hard. They are not flexible. Sometimes they are not practical. And they are not really helping their client. So, sometimes that even factors into it. This is not who you want to go with because this might be an impediment to getting this deal done because we have really ... I've been through this before. And even going through with banks or even brokers who are bringing financings to clients that are coming in. That relationship part, I think, is important too in things to know.

Stacey Tyler: So, you're saying a lot of stuff that sounds kind of daunting. What would you say your best advice is to a client? What's the first step they should be really taking if they're considering financing in the near future or refinancing?

Kim Lomot: I know it's cliché, but to call me. To call me.

Stephen Tanico: Specifically you.

Kim Lomot: But no really, I think the attorneys can add so much value. I mentioned before about being on both sides. A lot of times I can help facilitate the introduction to a bank that I know is lending in that space, is lending in that market, has a program that they need. I can get in front of that for them.

Some of my clients know this by now because I've been able to help them with this in the past. Which is great because they will come to me and say, "Here's what we're looking to do. We're looking to secure this building we just finished building, and now it's tenanted and this is the area that it's in in Pennsylvania, New York, New Jersey."

And I can basically based on what the asset class is, and where the valuation is, what they're looking for, have a sense of, okay, here's who may be a good fit. And I can give them that advice. And they're free to go if they have an existing bank or relationship, but in a market where we're at, I think it is important to get in front of those things, to get us involved early, so that I can then help them hopefully save them time and money later. Sometimes they're just going back to their prior lender and realizing here's the terms that we got. When I see them they're not market or they're not what I've been seeing from other lenders, and just to talk through that with the client. I think that is really important.

I think unfortunately not everybody does that. I think what more likely happens is that we're getting involved after terms sheets stage. So, we'll have a client reach out, getting a loan for XYZ property, here's the terms sheet that was signed last week, take a look at it, loan docs are coming. We'll get engaged. Which I'm looking at the terms sheet and I'm seeing things that either aren't in there or are in there that shouldn't be in there or terms that are off-market. And at that point it's really hard to negotiate out of that in loan docs, right, because while a lot of those are not the law, most of them say, "This isn't binding, it's just the basis to which to create the loan documents." Still, if you have to try to go against something that's already in the terms sheet, you're at a disadvantage.

The ability to do that and having the lawyers look at that at the beginning, at the outset, and help you negotiate those terms and that commitment letter is really critical. And again, it's true, it will save you time and money later because now we're fighting about something that could potentially blow up a deal, kill a deal, that you can't get around it. They're not going to give you this cure period. They're going to make you do some sort of covenant compliance that you know is going to be a problem and now you can't get out of it.

Stacey Tyler: And you're five, six weeks in.

Kim Lomot: Yes.

Stacey Tyler: To the negotiation.

Kim Lomot: You've lost time.

Stacey Tyler: Yup.

Kim Lomot: And especially, I mentioned earlier about how many loans are coming due, commercial real estate loans. You have to get in front of those things because then timing becomes critical. And you run the risk of getting into trouble on the existing loan if we don’t have something we set up. It's just deals are not getting done at the speed in which they did. And now there's just such a more critical eye on the underwriting process.

Stacey Tyler: What's the minimum time you'd want? What's the runway ideally? What would you say is give yourself at least how many months?

Kim Lomot: Ideally three. I would want-

Stacey Tyler: I thought you were going to say 12.

Kim Lomot: No, no. You have to be in the process, know who you are hopefully by then. And then going through that process.

Stacey Tyler: Oh, three months from choosing the lender, signing the terms sheet to funding.

Kim Lomot: Yeah, yeah, to make sure you're not running up against any sort of time frame when your loan's coming due.

Stacey Tyler: But if you're bank shopping that's a couple more months.

Kim Lomot: Yeah, it is. It is because you don't know who is not lending in certain markets and for certain asset classes. It's just not something we had to deal with. Money was just easier to come by. And the cost of it can shock some of the parties who are used to paying different amounts. And just it's so much more expensive now. So, I think just again, eyes wide open while you're getting in to that setup so you know and you can be prepared for some of these things. And to talk it through with your advisors, your accountants, your internal operations people, and your lawyers. So that you're all kind of on the same page as to what's important to you.

Stephen Tanico: Kim, you did just hype yourself pretty hard as a lender's attorney. So, I think I'd be remiss if, and I'm not going to ask you as a magician to reveal all your secrets, but maybe one or two nuggets you could give us about what you would want to see in a terms sheet that you wouldn't typically think about or see.

Kim Lomot: So, I kind of put it back to finding out what the client wants. What's important to them? It changes for everybody. Some people are very focused on rate. Some are focused on some-

Stacey Tyler: Amortization.

Kim Lomot: Amortization. Some are focused on covenants. Some are focused on collateral. Some are focused on making sure that there's no guarantees that have to be given. I try to find out what is important to the client because those are things that then I can think through in my head as to what we need to make sure we focus on negotiating not only in the loan documents but in the terms sheet as we're going through that process with potential lenders. And making sure that those things get in there.

If they had a bad experience with their prior lender and something came up where it was a huge headache for them, like documents, providing financials. If they were over-burdensome, if they just became an administrative headache, they couldn't do it because of the setup within the company. Stuff like that. Stuff they want to make sure they don't have to do this. They only have to report semi-annually or annually. To things that they want to try to push back a little bit. Little things that have become important to them through the years maybe because they've been burned by it, maybe because situations with what their setup is in house in terms of the parties who are handling and helping to administer the loan on the business side.

So, I think a lot of it is client specific as to what they really want and what's important to them. And then to focus on making sure that those things are covered within the terms sheet, that you're not waiting to a later stage where you're behind the eight ball or you don't have the leverage to try to negotiate it at that point. Or you're up against a time crunch and you just have to cave because you have to get the deal signed.

Stacey Tyler: It's always about KYC, know your customer.

Kim Lomot: Yeah, that's right.

Stacey Tyler: Thank you so much, Kim. This about wraps up our time. This has been a very enlightening conversation. Thanks for helping us get a little smarter about lending.

Stephen Tanico: And thank you, listeners, for tuning in today. Be sure to like, subscribe, and follow Terra Firma wherever you're listening to this episode. Stacey and I would love to hear from you, so please feel free to reach out to us at terrafirma@lowenstein.com. Until next time.

Stacey Tyler: Peace.

Kim Lomot: Go Bills.

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