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Speculative lending is returning

Credit crisis dried up loans based on projected real estate deals.

By Jason W. Armstrong
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When the real estate and financial markets nosedived four years ago, banks' willingness to engage in lending for new speculative developments — funding based on projected details of a project on paper — all but dried up.

Now such loans are slowly beginning to trickle back into the market as lawyers negotiate to resurrect shelved projects and broker deals for which banks are agreeing to "spec" lend.

But spec financings are still few and far between, and the transactions that are happening are structured much more conservatively than at the height of the real estate boom in the middle of the last decade.

Steven N. Bloom, a partner with Frandzel Robins Bloom & Csato LC who focuses on real estate and commercial financing, debt restructuring and risk management, said that while he's not seeing a "marked increase" in spec lending, banks are beginning to tiptoe back into such deals for future developments. He said he's negotiating with a lender to fund a mixed-use development in Orange County and a 50-unit single family residential development in San Diego County that's in the beginning planning stages.

The bank in the Orange County project "is in the process of doing due diligence but seems excited about wanting to put that project together," Bloom said. In the San Diego development, he said, "we're in the process of documenting the loan," which would finance portions of the lot preparation and home construction.

"Where spec lending comes into play is in construction lending deals," Bloom said. "And from that standpoint, we're seeing a little bit more of it. But it's a trickle, not a flood."

Real estate lawyers, though, seem hopeful about even a trickle.

Roger H. Howard, a transactional real estate partner with Glaser, Weil, Fink Jacobs, Howard, Avchen & Shapiro LLP, said banks generally are "looking more aggressively to make real estate loans."

He said hedge funds have sprung up specifically to make construction loans and to refinance projects. "There seems be a move afoot of additional capital in the market, but I wouldn't say it's a landslide."

But Howard said most lenders continue to be "very skittish" about making spec loans because of tighter federal regulations imposed on financial institutions in the wake of the credit crisis, though certain sectors with high tenant demand, including apartment complexes and senior citizen housing, are more likely to get such funding commitments.

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Attorney Roger H. Howard, of Glaser, Weil, Fink Jacobs, Howard, Avchen & Shapiro LLP

"Most families today don't necessarily have the cash to qualify for a new home loan, so they're still renting, and rents have been going up in the last few years," Howard said. As a result, banks look upon apartment projects "as an attractive investment."

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— Adam B. Weissburg

Banks' slowly rising appetite to deploy capital for developments with less-than-certain futures comes amid a smattering of bright spots appearing across various real estate zones. Last month, Southern California home sales posted a five-year high, with 15,573 new and resale homes and condos trading hands. That was up 7.2 percent from January and 8.4 percent from February 2011, according to real estate data aggregator DataQuick. Statewide, 29,630 new and resale homes sold last month, a 5.4 percent gain from January.

On the commercial lending side, total loans outstanding for owner-occupied commercial and multifamily developments saw a slight increase this year. Owner-occupied projects saw a year-over-year advance from $452.6 billion to $457.2 billion, while multifamily loan balances ticked up from $212.7 billion to $218.5 billion, according to the Federal Deposit Insurance Corp.

Spec lending was common in the real estate boom, particularly for high-rise condominium projects and sprawling master-planned residential developments.

"Normally, lenders would want to see a certain number of units leased up or [purchased]" before committing financing, but "the standards were a lot looser before the downturn," said David A. Barksdale, a partner with Alston & Bird LLP's Global Finance Group.

Today, "the fundamentals are different ...for sales, leasing and refinancing," said Gregg J. Loubier, a partner with Allen Matkins Leck Gamble Mallory & Natsis LLP who chairs the firm's Banking and Financial Institutions practice.

It's harder to refinance entire developments, he said, making it more challenging for banks to "exit" the loan in the future. Also, it's tough to predict the long-term success of a development.

"We haven't seen a great amount of enthusiasm for spec lending, except on the right project for the right customer."

But Adam B. Weissburg, a partner with Cox, Castle & Nicholson LLP who focuses on secured real estate transactions, said lenders and developers are preparing for a new surge in spec financing as the market improves.

While "there's overall cautiousness permeating everything banks do right now," he said, "I certainly think the lending climate is such that lenders are being generally a little bit more expansive in the way they're approaching deals.

"The difference in what was once negativity to a more positive outlook is not insignificant," Weissburg said. "It's a sea change in the way people are thinking."