Mezz Lenders Capitalize On Murky Outlook

High-yield lending activity has picked up sharply in the wake of the pandemic, as investors seek to take advantage of a widespread pullback by originators of senior loans on commercial properties in the U.S.

Commercial Mortgage Alert's 11th annual survey of mezzanine lenders has identified 152 shops that provide subordinate debt on commercial real estate via mezzanine loans, B-notes and preferred-equity investments (see listing on Pages 20 to 42). The field reflects a slight increase from 144 lenders tracked a year ago.

While numerous operators of special-situations funds and other high-yield investment shops recently have demonstrated an eagerness to start originating or buying subordinate commercial real estate debt, many have found it difficult to follow through because they lack in-house expertise.

Recruiting seasoned staffers can be challenging in the current job market, and "anyone who's trying to get in the space today is going to have a hard time hiring a team," said **Warren de Haan,** co-chief executive at **Acore Capital.**

Meanwhile, industry pros said high-yield lenders already focused on commercial real estate have become more active across the board this year. They predicted that trend will continue to accelerate for the foreseeable future. Of the 109 survey respondents willing to divulge their 2021 volumes of subordinate debt and their comparable projections for this year, almost all predicted they would boost their annual lending volume.

Topping the mezzanine lenders list are Acore and **Citigroup,** which expect to originate $2.5 billion each this year, and **Blackstone,** which is targeting $2 billion to $3 billion of corresponding investments. Next up are **Deutsche Bank** and **Silverstein Capital Partners** ($2 billion apiece) and **Brookfield** ($1.75 billion).

Barclays, CIM Group, Goldman Sachs, Principal Real Estate Investors and **Square Mile Capital Management** each weighed in with $1.5 billion predictions, while another 10 lenders aim to hit the $1 billion mark this year.

The ongoing rise in mezzanine lending stems largely from economic uncertainty, which has prompted many CMBS shops, banks, insurers and other commercial real estate lenders to tighten underwriting standards and rein in leverage on senior mortgages this year. The murky outlook can be chalked up to widespread concerns about inflation and the impact of Russia's war in Ukraine, rising interest rates, soaring yields on U.S. Treasurys, and skyrocketing spreads on CMBS and commercial real estate CLOs.

"We've seen an increase in debt requests in general, but even more so for mezzanine debt due to the current volatility and uncertainty in the securitized marketplace," said **Kuvare Insurance Services** managing director **Bob Restrick,** who oversees commercial real estate investments for the firm.

"As senior lenders tighten credit and lower proceeds, borrowers who need to get more dollars will have to come to people like us. … We have already started to see it in the last few weeks," said **William Goldsmith,** who runs mezzanine lending at **Medalist Partners.** "We are getting [requests for] quotes we wouldn't likely have been seeing six to nine months ago."

Senior lenders will bounce back eventually, but in the meantime "groups like us will be there to fill gaps for strong [borrowers] and properties in good locations," said Blackstone managing director **Michael Eglit,** head of U.S. originations in the fund giant's real estate debt strategies group.

Commercial property fundamentals remain strong for the most part, and subordinate lenders see more opportunities to provide borrowers with "capital for refinancing debt that is coming due, for business plans that need more time and for projects that are ready to break ground," Eglit added.

Apart from senior lenders getting more conservative, the recent jump in yields on long-term Treasurys also has contributed to reduced proceeds from new senior mortgages, said **Jonathan Roth,** a managing partner and co-founder at **3650 REIT.**

"This is a good place to be if you are capable of underwriting the underlying real estate while taking into account the rapid changes in the use of properties," Roth said. For example, a mall poised for repositioning as a mixed-use property requires a mezzanine lender "with a deep understanding of the alternate uses and how they fit together," he said.

Meanwhile, Acore's de Haan cautioned that high-yield lenders should "double down on their core principles" as they ramp up subordinate loan originations.

"There is going to be more mezzanine capital deployed … [but] we as investors have to be hypervigilant and hyperaware of how we invest anywhere in the capital structure," he said. "We are taking on more risk than a senior lender and need to be more diligent." ❖