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## Savvy mezzanine lenders tap senior housing market with lines of credit

By Daniel Edrei

Aging Americans are generating new opportunities for commercial real estate lenders, especially savvy mezzanine lenders. In this fiercely competitive market, with so many financial institutions scrambling to invest in commercial real estate, senior healthcare facilities of all types are now all the rage. One of the ways perceptive mezzanine lenders can drive a stake in this market is by issuing lines of credit to borrowers with demonstrated turnaround capabilities. The demand for mezzanine lending in these transactions has become huge, though there are still a few mezzanine lenders willing to fill the niche.

Americans have enjoyed greater longevity thanks to recent medical and medicinal advances, thus providing a growing demand for residential assisted living. Currently, about 12 million people in the United States live in long-term care facilities, and every day another 10,000 Americans turn 65. The baby boomers will start moving into nursing homes by 2010. The potential growth of demand for rooms in residential assisted living facilities is so strong that many with below-average occupancy may represent a possible windfall.

The continuing consolidation of healthcare facility ownership also benefits mezzanine lenders by enabling them to work with companies with a proven track record. These companies often need to move quickly when they identify a property for acquisition. Having a line of credit available can make the difference between acquiring a target property and not getting it at all.

AREI, a Redding, Calif.-based senior housing company that draws on a mezzanine line of credit to acquire senior housing properties for its tenant-in-common investors, recently had that experience in the acquisition of two nursing facilities in California and Nevada. "They were middle-of-the-road properties. They had cash flow, but they also had occupancy upside potential, and our ability to use \$4 million from our mezzanine line of credit enabled us to close in a timely fashion. We could have fallen out of contract and lost the deal if we hadn't had the line of credit in place," said AREI President and CEO Peary Wood, whose company currently owns 22 senior housing properties. "When you have a property under contract, you have contractual obligations and deadlines to meet. It becomes difficult when you are raising your equity capital from tenant-in-common offerings. Having a mezzanine line of credit enables us to take our time and present the transaction to our tenant-in-common investors properly."

Often, nursing care facility acquisitions are underwritten conservatively by senior lenders, generating a distinct demand for mezzanine financing. Since the mezzanine financing represents a small portion of the total debt, it raises the borrower's cost of money nominally and can facilitate capital for other acquisitions. Traditional lenders tend to be an inefficient source of short-term financing, according to AREI Chief Financial Officer Adam Peterson. "We circulate interest in properties to high-net-wealth individuals. We needed a bridge from the time we close on the property until we raise the equity from investors," Peterson said. "It's usually a three- or four-month process. That's the main thing the line of credit really helps us out with. We have to pay for the added flexibility. It's a reasonable trade."

The healthcare industry in general is enjoying what we anticipate to be a lengthy upswing. The aging population will continue to generate increasing demand. If we have a borrower that has identified a facility with mid-range occupancy, we recognize that there is a very substantial opportunity to increase it to meet or exceed the market. Under proper management, subsequent stabilization will result in a higher overall capitalized value. Confident that it soon will be sitting in a position of lower overall combined loan-to-value ratio, the mezzanine lender can find solace where others fear to tread.

Many traditional lenders find mezzanine lending a little scary. As with funding any growing concern, financing senior care facilities will always be a little more challenging. There may be an element of speculation in these transactions; however, the astute mezzanine lender can protect its interest without too much brain damage. This sort of lending requires a thumb on the pulse of the operation. Typically, there will be previously stipulated ongoing requirements and reserves at the initial closing of the line of credit. These requirements may involve maintenance or escalation of revenues, occupancy, debt-service coverage ratios, etc. There may be a lock-box agreement structured as a pass-through account to ensure payment of the senior debt, taxes and insurance. There will typically be an imperative for monthly reporting. In addition, the mezzanine lender will want to ensure that it has the "right to cure" in the event of a default.

Private mezzanine lenders can act with more flexibility than larger lenders and institutions that are not able to easily think outside of the box. We like to think of ourselves as "patient money." We can wait a little longer to see the tables turn, so long as the trend is upward. If we believe in the property and the outlook on the industry is good, the loan may still be feasible. The potential upside of stabilizing such properties may make it worthwhile to give the borrower a little more time to bring occupancy to target levels. Of course, the lender should have confidence in the borrower's ability to turn the properties around.

Transactions that don't fall within underwriting parameters are the bread and butter of the mezzanine lender. We have the flexibility to stretch and mold terms for both lines of credit and single transactions. If things go awry, we can work out a way to make good on the senior and mezzanine debt and gracefully both retain our investment as well as our relationship with the borrower, so that hopefully, we may continue to do business together.

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