Brokers are essential link in US property debt chain

Lenders and borrowers say 70% of deals now involve intermediaries, writes Al Barbarino

"I just did a Midwest deal with a client who has a quarter-of-a-billion-dollar real estate portfolio and very deep banking relationships, but they still came to us," says Tal Bar-Or, a managing director with Meridian Capital, one of the largest commercial mortgage brokers in the US.

Bar-Or's client was looking for more aggressive leverage on the deal than they typically would, he says. Sure, they could have gone out to their banking relationships on the deal – had they wanted 65% leverage with full recourse.

But Bar-Or secured a 90% loan-to-value finance package with limited recourse, split between a senior and mezzanine loan from two non-bank lenders. "You can't do that with the local bank," he says. "The biggest borrower out there is still not doing as much business as us. We do more than pretty much any REIT out there, except maybe a Blackstone."

The numbers speak for themselves. Meridian Capital was the third largest intermediary of loans last year, arranging more than $30bn in originations.

Data from the Mortgage Bankers Association shows that the top five brokers alone (serving as intermediaries, excluding loans on their own books) originated nearly $130bn in loans in 2014. They were: Eastdil Secured ($36.70bn), HFF ($33.70bn), Meridian Capital Group ($30.04bn), CBRE Capital Markets ($18.85bn) and JLL ($9.78bn) (see table).

A select few borrowers involved in a large number of financings may not use brokers, preferring to negotiate their own terms. For instance, a spokesperson for

"AN INTELLIGENT BROKER'S JOB IS TO APPROACH THE RIGHT LENDERS WITH THE RIGHT DEAL THAT WORKS BOTH FOR THE CLIENT AND THE LENDER"
Tal Bar-Or, Meridian Capital

Related Companies, a major New York-based developer with a $20bn real estate portfolio, says all of the company's financing is sourced directly with banks: "We have $20bn in assets and yes, we have all of those relationships directly."

AN ESSENTIAL PART OF THE SYSTEM

But by and large, lenders and borrowers – from small firms that originate $5m loans to the Starwoods and the Blackstones, which both borrow and lend huge sums – argue that brokers (as intermediaries) are an essential part of the commercial real estate system, involved in the majority of deals.

"They're a big part of the industry, we have great relationships with them and we hire them quite often," says Mike Nash, head of Blackstone Real Estate Debt Strategies (BREDS).

Brian Stoffers, CBRE's global president of debt and structured finance, adds: "Even the most experienced borrower will hire us because we can often find deals they can't. The market is inefficient, so we take a deal to market and get a wide range of quotes."

It is a good line for lenders to claim they don't rely on brokers for business. But while direct relationships are a staple of businesses with large, in-house staff, which is a draw for certain types of investors, even the largest of lenders use brokers for a significant percentage of their business.

"Some like to broadcast that they have direct relationships with the borrowing community," one lender says, but it's a rare circumstance that any company putting out commercial real estate debt is sourcing less than 50% of their business from brokers. Most lenders and borrowers interviewed

for this article said the figure is likely to be around 70%, as broker influence increases.

As brokers increase their market share, some lenders have argued that the tight pricing and aggressive structural features sought create market risk. However, others argue that there is sufficient discipline in the market now, and that brokers actually taper such risk by creating more transparency.

"We source most of our business from brokers," says Terence Baydala, managing director, originations, at Pembrook Capital Management, who was head of structured finance with Meridian before joining Pembrook in January.

"That's not to say I don't have personal relationships, but a lot of times those are represented by brokers, especially on the high-yield transactions that carry a set of very unique circumstances."

On the other hand, Baydala says: "If a borrower wants to call me directly that's fine, but at the end of the day he's going to want coverage and a variety of quotes, and the best way to get that is to employ a broker."

THE GOOD, THE BAD AND THE UGLY

There are, of course, good and bad brokers. Certain brokers may not be totally up front about a borrower or the project's history. Others might not have the expertise to work a particular type of deal, while still others may blast out transactions to too many lenders. Some are incompetent, others insecure.

"Some guys try to hide the bacon, but that almost never works," Baydala says. "If Jim calls with a deal he knows I'll be interested in, but tells me: 'I want you to know, this borrower has a history,' he does that not only because he's honest, but because he's smart.

"There are brokers whose calls I won't take," he admits. "If I ask a technical question and they don't know the answer, that's really counterproductive. If I determine two days before closing that a broker misled me, then I'm not working with that broker again."

The headline-grabbers don't always help with the industry's image, either; it's not

"WHEN [BROKERS] FIND THAT RELIABILITY, THEY COME BACK. BUT IF YOU STUMBLE OR YOU DON'T DELIVER, YOU'LL WONDER VERY QUICKLY WHY YOUR PHONE ISN'T RINGING"
Terence Baydala, Pembrook CM

uncommon to read that another broker, whether commercial or residential, has defrauded someone.

"If you take a very stereotypical and ignorant approach, a banker might say: 'We don't need brokers, because they lie, cheat and steal, and even if they are good they will beat me up on rate and not focus on me," Bar-Or says. "I'm sure there are brokers out there like that… but that's a [bad] broker. An intelligent broker's job is to approach the right lenders with the right deal that works both for the client and the lender."

Honest, established brokers spend copious amounts of time on the analysis and underwriting of deals. They have wider access to lenders and close relationships with them, and these relationships will allow them to ultimately arrive at the best deal, driving down labour costs (despite fees), experts say.

In addition, large, sophisticated borrowers become more cautious in times of great change or rapid growth, preferring that an experienced third party canvass the market for them, essentially serving as an extension of their businesses. Lenders, no matter what their size, will find themselves with far fewer lending options if they fail to deliver when a broker calls.

"Brokers will call us when they have special circumstances: maybe it's fast executions or high certainty," Baydala says. "We can give them a fast quote and terms that are reliable. When they find that reliability, they come back. But if you stumble or you don't deliver, you'll wonder very quickly why your phone isn't ringing."

The number of lenders a broker will approach with a deal depends on the type of deal: for example, going out to a handful of lenders on a complex construction loan, as opposed to a more commodity-type loan, where a wide range of lenders are likely to be targeted on a straightforward deal.

THE MOST AGGRESSIVE CAPITAL

"In some cases we want a very targeted approach, so we might only approach six life companies; in others, we might do a complete scrub of the market," Stoffers says. "But our job is to stay one step ahead to make sure we are giving borrowers the most aggressive capital at any given point.

"Banks and life insurance companies used to do all of their business directly, but that changed because they wanted to hire eyes and ears in other cities. It was our role to show them good business or we would lose that account.

"MetLife and Prudential have a lot of direct relationships and they don't have to compete as much for that business, but we are so involved in the market that they

TOP 10 CRE/MULTI-FAMILY FINANCE INTERMEDIARIES, BY 2014 ANNUAL ORIGINATION VOLUMES

Rank	Intermediary	Amount $bn	Number	Average size $m
1	Eastdil Secured	36.70	245	149.8
2	HFF	33.70	1,126	29.9
3	Meridian Capital Markets	30.04	3,479	8.6
4	CBRE Capital Markets	18.85	892	21.1
5	JLL	9.78	313	31.3
6	NorthMarq Capital LLC	9.72	817	11.9
7	PNC Real Estate	8.96	64	140.1
8	Grandbridge Real Estate Capital LLC	3.79	486	7.8
9	Q10 Capital LLC	3.71	535	7.0
10	Berkadia	3.59	316	11.4

Source: Mortgage Bankers Association

almost have to work with us and ultimately we drive their labour costs down."

The broker's goal typically is not to find someone lending more dollars, but rather to find a lender offering a narrower spread or more favourable terms, whether that be more flexibility for interest-only loans or being open to financing secondary assets.

"In some instances borrowers don't want to offend lenders, so they hire us to take the deal to market, optimise the capital stack, come up with the best structure possible and they don't have to tell lenders 'no' – we do," Stoffers says.

A borrower usually pays the broker a flat fee per transaction or a percentage on each deal. The agreement will typically stipulate a time period – be it one year, two years, or so on – during which the borrower will continue to pay fees if the relationship with a lender was first sourced through the broker. However, brokers and their clients say this fee is worth paying, assuming the broker is a good one.

"A good broker earns his or her fee," says Niso Bahar, chief financial officer with real estate developer Alexico Group. "They are closer to the market and have good

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Brian Stoffers, CBRE

information on which lender is looking for what. There are so many ways to finance a deal now: CMBS or commercial banks, the international debt markets or EB-5 [a US government programme allowing foreign investors to obtain a green card by investing over a certain sum]. A sophisticated outfit will have good advice on which direction is best for a particular transaction."

The relationship is more person-to-person than being based on which broker an adviser is working for, others say. Larger brokers may have more resources and contacts to go out to the market and find the best deals, compared with smaller shops.

As one large borrower puts it: "The guy from XYZ in Charlotte probably has a half dozen contacts... we have contacts with more than 5,000 lenders around the world".

But smaller, more localised borrowers argue that they get better service from a smaller shop. "Jonathan [Hakakha] is involved in most of our financing needs, even if we are getting the financing from outside our relationship with Jonathan, because he helps streamline the process," says Robert Hanasab, president of Robhana Group, a Los Angeles-based commercial real estate investor that exclusively uses the services of Quantum Capital Partners, headed by Hakakha and Mike Yim.

"We know our core competencies and we focus on them," he adds. "Preparing data isn't what we do best. We give him raw data and he prepares it in a manner that is presentable for banks and other lenders."

Does commission chasing build flaws in brokers' fee structures?

One executive with a large lending and borrowing business, who wishes to remain anonymous to preserve relationships with other companies in the market, argues that there are intrinsic problems in the way almost all brokers operate, with a compensation structure based strictly on commissions.

This removes any incentive for teamwork and collaboration and can pit individuals at the same firm against one another, he says. "Why the [expletive] wouldn't you guys work together?" he asked a broker buddy on a recent golf outing.

A typical compensation structure at a major broker gives an individual broker half of the profits, minus a few percentage points for expenses. However, it means that there is no incentive to share your rolodex of contacts with the guy sitting next to you, he claims.

The executive previously worked for Eastdil Secured, arguing that Eastdil's "totally discretionary" compensation structure, subject to a review process that incorporates a variety of additional factors beyond sales numbers, is the most effective approach because it fosters collaboration.

"The compensation is no different than it would be at an investment bank," he says. "I had no idea what my bonus was going to be. You might have a great deal guy, but if he's a gigantic [expletive] that everyone hates and doesn't help out the junior guys, he'll get paid less than if he'd done the right thing."

Naturally, others disagree. Brian Stoffers, global president of debt and structured finance with CBRE, notes that despite having a commission-based compensation structure, CBRE regularly works in teams. He adds that while a "discretionary income" might encourage teamwork, it can also discourage top producers from working for you.

"A vast majority of CBRE's business involves multiple teams, either within one office or among various offices," Stoffers says. "We need to deliver the best team to each deal we work on, because the client always comes first. We frequently involve other business units that might offer assistance. If we're trying to analyse expenses, for example, CBRE's asset management professionals can opine on the expense factors for a project we're financing."

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