Developers land low rates for construction loans

by Mark Anderson
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Plymouth-based developer Dominium was a beneficiary of low loan rates for its redevelopment of the Buzza Building in Minneapolis. Its $15.4 million variable rate loan is currently priced at just over 3 percent. (File photo: Bill Klotz)

Competition among eager banks is 'downright fierce'.

The demand for new commercial construction may still be weak — except in the multifamily sector — but seasoned developers are finding plenty of bank suitors ready to make loans right now.

"The competition is as high as we've seen in five years — it's gotten downright fierce out there," says Terry Kriesel, senior vice president for commercial real estate lending at St. Paul-based Bremer Bank. The interest rates charged by those lenders started dropping in mid-2011 and continued to fall in the first quarter of 2012.

Kriesel said the most aggressive banks have lowered spreads over indexes to just 2 percent, which would mean a total interest rate of 2.24 percent on a construction loan. (In general, banks price construction loans based on a spread above the one-month Libor rate, which was 0.24 percent on Wednesday.) More conventional, current rates range from upper 2 percent to just more than 3 percent, but developers and lenders say rates on many loans have dropped below 3 percent.

Alex Young, a senior vice president for development at St. Paul-based MSP Commercial, said his company will start construction on a new $5 million Veterans Administration medical building in Maplewood next month with a construction loan priced at below 3 percent.

"We saw the prices coming in every month this year, and this project definitely is benefiting by that trend. This is much below the rates we were looking at last summer," Young said.

Bremer Bank handled MSP's loan.

Dominium, the Plymouth-based multifamily developer and investor, is also saving borrowing costs on several projects under way now, including the redevelopment of the historic Buzza Building in Minneapolis' Uptown neighborhood. That 96-year-old manufacturing building is being converted to affordable apartments using tax credit financing.

The developer obtained a bridge loan from U.S. Bank to pay construction costs, which priced at just over 3 percent, while waiting for the tax credit to take effect, said Shane LeFave, a senior development associate with Dominium. Dominium obtained a $15.4 million bridge loan for the $34.5 million project.

“We’ll do projects at that price all day long,” LeFave said. “Historically, those are extraordinary rates.” The lender competition driving rates down has grown largely because banks say they cannot find enough borrowers to put their deposits to work. Alternative investments in securities or Federal Reserve investment banks offer returns below 1 percent, so construction loans — even at very narrow spreads — are lucrative, Kriesel said. “There aren’t enough good assets out there to feed all the banks,” he said. But the competition is also being spurred by the growing number of banks that are lending to developers again, as the economy slowly improves and their balance sheets get stronger.

“There are more players engaged in that market now,” said Jeanne Crain, market president for M&I, a part of BMO Financial Group in the Twin Cities. Her bank is one of those newly engaged lenders. “We weren’t actively trying to build our portfolio last year,” Crain said. “We didn’t have the capital to do that, and we were focused on managing what we had. But we’re back and want to grow again.” Crain said M&I is seeing banks move competition beyond pricing to the location and deal structure. “Banks are willing to look at locations that they would have turned their back on a year ago,” she said, adding that they are also offering fixed-rate loans for up to 10 years beyond the construction loan. “But banks aren’t going to get crazy again” on the terms, she said.

One sign of that post-recession prudence is the increased importance lenders are placing on debt service coverage now, Young said.

“Three or four years ago, banks didn’t emphasize those, which meant you could build projects with 20 to 30 percent pre-leasing,” Young said. “Now we’ve got to have 70 percent, and that’s actually good for everybody.”

Cheap and cheaper

Libor 30-day rate: 0.24%

Spread range in Twin Cites: 2.00-3.50%

All-in loan construction loan rates: 2.24-3.74%