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Boise Lures Lenders Again

By MAURA WEBBER SADOVI

In the latest sign that financing is starting to flow again in smaller markets, several commercial banks have originated a $150 million construction loan to finance Village at Meridian, a mixed-used development in suburban Boise, Idaho.

The development is a joint venture of CenterCal Properties, a California retail developer, and the California State Teachers' Retirement System. When completed, the retail- and entertainment-oriented project will total about one million square feet and include retail space, dancing-water fountains, an ice-skating rink, offices and about 300 residential units, a combination of apartments and townhouses.

Enlarge Image

CenterCal Properties

Lenders again are backing projects like Idaho's Meridian, in sketch.

The loan, which was provided by a group led by U.S. Bank, a unit of U.S. Bancorp, USB +0.27% comes as interest rates hover near record lows and as overall demand for commercial loans is declining, squeezing banks. To increase volume, some lenders are turning their attention back to construction companies, which are dependent on bank loans for development projects.

"Bankers are looking at various avenues to prudently expand lending," said Keith Leggett, a senior economist at the American Bankers Association.

To be sure, the floodgates have by no means opened, and banks are being far more careful when lending to real-estate developers than in the past. High default rates on construction loans were a major contributor to bank failures during the recession. But many of those problematic loans have been worked out or taken as losses, leaving some banks ready to pursue new development loans.

The total amount of outstanding construction loans at U.S. banks insured by the Federal Deposit Insurance Corp. stood at $203.9 billion in the fourth quarter. It was the 19th consecutive quarterly decline in outstanding construction loans and well below the prerecession peak of $632 billion in early 2008, according to the FDIC. However, Mr. Leggett expects to see construction lending begin to rise in the next few quarters as an improving housing market spurs more developers to build new projects.

U.S. Bank says construction loans accounted for nearly 50% of its total new loan commitments last year, up from 15% in 2008. The bank has also seen a rise in demand for construction loans in smaller metropolitan areas, where the real-estate recovery is following those seen first in bigger cities such as New York and Washington.

"This wouldn't have happened two or three years ago," said Valerie Heller, region manager for commercial real estate in U.S. Bank's Pacific Northwest region, of the Idaho construction loan.

Boise, Idaho's biggest city, anchors a metropolitan area that is home to an estimated 637,000 people. The region saw unemployment fall to 6.1% in March from 7.6% a year earlier, below the seasonally adjusted national rate of 7.6% in March, according to the Bureau of Labor Statistics.

CenterCal said the strengthening economy there started attracting retailers interested in leasing new space about two years ago. The terms of construction loans vary but can be lucrative. A construction loan for retail projects with institutional backing similar to CenterCal's might have an interest rate of about 3%, while similar projects being developed by backers with weaker credit might pay interest rates as high as 5%, people familiar with such deals say. That is juicy compared with the yield on the 10-year Treasury note, which was trading at about 1.78% on Tuesday. U.S. Bancorp declined to discuss the terms of its loan.

Still, construction-loan terms for borrowers are tougher than they were before the recession. Banks have learned some hard lessons and are seeking to hedge their bets on construction loans that are viewed as higher risk, in part because half-built properties can be hard to sell if the projects stall.

For example, banks want borrowers to pony up more equity and to prelease more of a property to make sure it won't sit empty, with no cash flow.

Developers had about 50% of the retail space in the Meridian's 830,000-square-foot initial phase leased to retailers such as a Gap store and to restaurants before it got the construction loan. By contrast, many projects before the downturn were financed with little or no preleasing and just 20% in equity investment from developers, said Fred Bruning, CenterCal Properties' chief executive. CenterCal Properties has had an easier time getting financing due in part to its institutional backing and because it has always sought to prelease properties even without banker prodding. CenterCal Properties, based in El Segundo, Calif., has four million square feet of retail projects under construction, part of a portfolio of about nine retail properties in the western U.S., valued at about $2 billion. But Mr. Bruning said he welcomes increased competition for his loans.

"At the end of the day, having more banks coming in is generally a good thing," said Mr. Bruning. "If banks know there's several lenders, they'll sharpen their pencil, give us a good rate and not delay a close."

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