Q+A

Stuart J. Boesky

Chief Executive Officer of Pembrook Capital Management

***Mortgage Observer Weekly:* How did you get started in commercial real estate finance?**

Stuart J. Boesky: Early in my career I practiced real estate, securities and tax law. One of my first clients was Steve Ross, in the early years of the formation of The Related Companies. I became a partner after representing them for two years. At Related, I launched a company known then as CharterMac (now Centerline Capital) and grew it from essentially a start-up into a separate, publicly-traded company that amassed $19 billion of real estate assets. I left in 2005, and founded Pembrook Capital Management in 2007 after my non-compete expired.

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Who do you mainly lend to?

Pembrook finances middle market real estate developers and owners. When we say middle market, we're referring to a loan size of $5 million to $50 million. Our ideal borrower is an experienced local or regional operator with a strong track record in its market and product type. We believe that transitional properties—those undergoing renovation or repositioning—in the middle market are underserved given the consolidation of regional banks and the changed regulatory environment. There's a need for first mortgage bridge lending in addition to mezzanine and preferred equity to fill the gap between post-crisis bank advance rates of say 50 percent to 65 percent loan-to-value and 75 percent loan-to-value. We view this as a long-term opportunity.

Any concerns about the market at the moment?

We believe that market fundamentals are attractive. With a few exceptions, the commercial real estate market was at relative equilibrium running up to the most recent crisis. From a risk perspective, we are focused on cap rate expansion, given the potential for a rising interest rate environment. If rates increase by more than 150 basis points, we believe cap rates will expand. If this happens quickly, fundamentals will not off-set the expansion and values will be hurt. But as a lender, the owner's equity serves as our top-loss protection in that scenario, and we are less sensitive to rate increases because we are a shorter term floating rate lender.

Some of your deals are preferred equity, a piece of the capital stack akin to mezz.

Both mezz and preferred equity can be used to fill a gap in the capital structure with an overall better result for the owner. Suppose you're a developer and you have only enough cash to put down 25 percent equity toward a deal. You could bring in an equity partner who wants a high-teens return, and he wants to stay in the deal for five to seven years. Or you could bring in mezz or preferred equity with interest in the middle teens, which may be paid off in 12 to 24 months. For many developers and many deals, filling the gap with subordinate debt makes good economic sense.

What's the most exciting deal you've worked on recently?

Recently we provided an $18.6 million first mortgage bridge loan to a repeat customer to finance the acquisition and improvement of a stabilized class B multifamily rental property. Certainty of execution was important given the need for a 30-day, time-of-the-essence close. The loan was for 30-month term, with floating rate and at 75 percent loan-to-value. The borrower plans to add value by increasing rents following interior and exterior renovations. The borrower expects to repay us from the proceeds of a long-term fixed rate agency loan once they optimize NOI. This deal represents the kind of bread and butter balance sheet loan local and regional banks made before the financial crisis, but they were doing it armed with inexpensive FDIC-insured deposit money. MOW

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