Financing

Pembrook Sees Rise In Demand For Preferred Equity

Q&A: Stuart Boesky, Pembrook Capital Management

Stuart Boesky formed **Pembrook Capital Management** in 2006 in a joint venture with **MIG Holdings**. He has more than 34 years of experience, including 17 years as a principal of **Related Capital Company** and a principal of **The Related Companies**, and eight years at **Centerline Holding Company**.

Stuart Boesky

More middle-market borrowers are seeking preferred equity to bridge the gap between their own equity and what a senior lender will fund, according to **Stuart Boesky**, president and ceo of **Pembrook Capital Management**. About 20% of the firm's business is preferred equity and within that, there are a number of different possible permutations. "Some preferred equity structures are more debt like and others are more equity-like. One you get into this world, this is the continuum we have to work through," Boesky said.

The New York-based investment management company focuses on transitional deals of $10-50 million and originates balance sheet loans that include first mortgages, mezzanine loans, bridge loans, note financing and preferred equity. The company recently closed *PCI Investors Fund II* with $154 million of capital.

REFI: What is driving this demand for preferred equity?

SB: A lot of borrowers are coming to us and saying 'Gee, I have a loan from a bank and it's well-priced but it's not enough proceeds to get us where we want to be. Our bank will allow preferred equity behind them but they don't want a mezzanine lender there.' That is where we are starting to see more demand for preferred equity: the reason is largely legal and structural in nature.

REFI: What are the different flavors of preferred equity?

SB: The biggest distinction is that debt-like structures give the preferred equity holder the right to take control of the partnership that owns the property in the event that covenants are breached. The more equity-like structure doesn't give the preferred equity partner control rights if the covenants are breached. It's really more like "If the money is there, you get it first" as opposed to "If the money is not there, you get control and can exercise remedies."

REFI: When are you seeing it used most often?

SB: I would say that if you look at the calls coming in today, 50% are requests for preferred equity on construction deals.

REFI: What about from legacy CMBS borrowers?

SB: We see an awful lot of legacy CMBS borrowers who did a deal three to five years ago and have the right to bring in equity of up to 49% who are coming to us and asking if we are willing to take a 49% equity interest in property. The borrower needs the capital to put into the property to attract new tenants or wants to pull some equity and put it someplace else.

Preferred equity is obviously more flexible and can be used in many more situations than mezzanine debt. In many respects, it's a more flexible way to finance the equity portion of deal than going to a traditional equity shop, which will want to stay in the deal for a long time.

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REFI: What is the outlook for this segment of the market?

SB: I think you're probably seeing a lot of lending funds migrating into the preferred equity space. We are seeing funds being raised moving closer to equity and seeing a lot of equity guys who are moving closer to debt.

By and large, at least with respect to the business we are doing, we are not seeing the high loan-to-value transactions or transactions done based on future appreciation. Origination is way more sound than it was pre-crisis.

REFI: What's your take on origination standards?

SB: We think the banks are being very disciplined in what they are doing and that is good for the market. If the banks continue to play the role they are playing, I think it's an excellent thing for everyone.

The cost of capital is somewhat artificially low right now and when someone comes to the party with inexpensive capital, there is a propensity to misprice risk. What we are seeing now is that banks are being very good at staying senior on the capital stack and are getting the right risk-adjusted returns. The banks are being rightfully conservative in the way they are looking at LTV, which leaves room for people like us who price capital higher and are willing to take a little bit more risk.