

Interview with John Fenoglio



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R John, thanks for spending time with REDNews. Our readership is of all ages, and most are in Commercial Real Estate (CRE) in one way or another. Will you tell us how you got started in the lending business, and what your educational background was that prepared you for it?

I received a BA in economics from the University of Texas at Austin in 1970, worked at Texas Commerce Bank for a year and then went to TCU and received an MBA. After graduating in 1972, I joined American General Investment Corp. (now AIG) and have been in the commercial real estate finance business ever since.

R Did you specialize in your career in any of the segments of CRE lending, or did you provide financing for all of them?

I have financed all property types (including a turtle farm!).

R How did the sources of CRE debt differ when you were starting out from what they are now? Have the new providers led to a healthier market around the country with less over-building, since information is more readily available in this day and age?

The sources of capital have varied over the years but the con-

stant recurring sources have been the banks and insurance companies. When I entered the business, insurance companies dominated the landscape with regard to permanent mortgages and the banks were predominantly construction lenders. New sources have come and gone throughout the various cycles including the mortgage REITs in the 1970s, the S&L's in the 1980s, the commercial mortgage back security (CMBS) lenders in the 1990s, and the rise of the Agency lenders (Fannie Mae and Freddie Mac) in the late 1990s through today.

The landscape today includes a mix of 1) banks doing construction, floating and fixed-rate term loans, 2) insurance companies mainly funding fixed-rate mortgages but also doing floating rate loans and construction to perm loans, 3) debt funds providing bridge and construction loans, 4) mortgage REITs doing bridge and renovation loans, 5) Fannie and Freddie doing both fixed and floating rate debt on multifamily properties, 6) CMBS lenders (who primarily ceased to exist in 2009 but have made a strong come back) doing fixed and floating rate debt, 7) pension funds doing fixed and floating rate debt and 8) various private lenders doing higher yield and often "hard money" loans on

land and transitional properties. There are plenty of commercial real estate debt capital sources at work today.

I would say that there is far more discipline today in all commercial real estate debt, especially in construction financing where significant equity, credit worthy guarantors and sponsorship expertise is usually required. Every cycle has seen a somewhat too aggressive construction source of capital that has tended to oversupply the market and for the most part that is not happening today. I think the lessons of the 2008 meltdown remain embedded in the collective lending memory and whereas lending volumes are increasing, the discipline is still at work.

R What about the sources of equity—are they different from what they were way back when?

When I entered the business in the early 1970s, one of the first transactions I worked on was a joint venture between an insurance company and a Houston developer for a CBD office building. Insurance companies dominated the institutional equity landscape and private equity from individuals/family offices was the other

primary source. Syndicated equity/limited partnerships were gaining momentum especially for land acquisitions in Houston.

The inflation of the late 1970s and early 1980s along with the steep rise in interest rates (Prime went to 21%) opened the door for pension funds and their advisors and equity REITs who were seeking investments that were inflation adjusted and commercial real estate became a number one alternative asset class. 1981 also saw the tax act that created accelerated depreciation for commercial real estate and unleashed the tax oriented syndications focusing on tax shelters. At the same time the S&Ls that had been caught with high rate deposits (liabilities) and assets primarily consisting of long term fixed rate loans at lower rates (disintermediation) were deregulated and some go-go entrepreneurs took the reins and started offering participating mortgages that had equity like features for new construction. International equity began to surface about this time as capital flight from Mexico (peso devaluation) and Italy (fear of communist control) along with the mid east accumulation of capital with the run up of oil prices in the 1970's, combined for new foreign sources of equity. In



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the late 1970s and early 1980s Houston, with its booming energy economy, was a unique beacon for development as the rest of the US was in a recession and all of these forces were unleashed. The banks were also looking for construction opportunities and development exploded with the harmonic convergence of deregulation of the S&Ls, the 1981 tax act, new foreign capital, active pension funds and equity REITs and hungry banks focusing on Houston as the rest of the US was suffering economically. We doubled the amount of office space in the city in the span of four years and overbuilt apartments, condos, hotels, retail and industrial. Oil prices crashed in November 1982 (remember that date) and Houston became a four letter word to the national real estate equity market as values crashed, banks and S&Ls went broke and the local economy shed several hundred thousand jobs from 1982 – 1987. The 1986 tax act ended the tax shelter business and the party was over.

Private equity from all over the world started acquiring assets in Houston in the late 1980s and early 1990s at bargain basement prices from the RTC and FDIC. A few contrarian institutional equity sources showed up in the early 1990s to acquire/ joint venture existing assets but private equity was the dominate source. With the stabilization of economy in the mid 1990s, insurance companies, equity REITs and pension funds began to “stick their toes in the water” in Houston. Many institutional sources had long memories and would not show up again until the late to mid 2000s as the economy started to heat up with increasing energy prices.

From 2005 – 2014 Houston became a poster child of increasing values (with exception of the 2008-2010 Great Recession) and equity has poured in from pension funds, insurance companies, private and public equity REITs, private equity funds, private syndications/partnerships, foreign capital and private investors/family offices. Many

of these sources have moved to the sidelines with the rapid decline in oil prices. Opportunity equity from institutional and private sources is circling the city thinking the 1980's will repeat itself but the capitalization of commercial real estate since 2004 with significant equity investments and the lack of overbuilding will not present a similar scenario.

R John, tell us a little about how you started HFF, and then how you went about going national. Did you roll up a bunch of mortgage banker shops across the country into one organization?

Remember that November, 1982 date? That is the month HF (the other F was added later) was started by Hal Holliday and myself. We had headed the commercial finance group at an old line Houston mortgage bank that was sold to a new S&L. Many of our insurance company lenders were not excited about being represented by a S&L and reached out to us with support if we were to do something else. We decided to move forward with a new firm and named it Holliday Fenoglio & Co. (not an Italian travel agency!). We began with four of us and by 1984 had expanded to 20 employees and bought a small office building to house our expanding firm. In 1984 we opened an Austin office, closed it in 1986 as the Texas economy plummeted and opened a South Florida office in 1987. In 1990 we opened a New York office and in 1992 opened a Dallas office. All of this growth was done by hiring key individuals looking for growth opportunities. In 1994 it was apparent that the new CMBS industry was a major source of capital and we did not have the balance sheet to fully participate in the securitization of the loans. We also saw numerous opportunities to expand our platform but were limited by our debt adverse capital structure. We had been approached by several firms that wanted to acquire us and in early 1994 we decided to seek a partner/ buyer who had the capital for our expansion. We sold to AM-

RESCO in August in 1994 and grew the platform from 4 offices to 29 offices by 1998 by way of acquiring two firms and hiring key people/ teams in other cities. By midyear 1998 we were the largest commercial banking company in the US.

R How did your exit strategy from that company work out, and what are you doing now?

I left in July 1998, took a year off and started a Houston based mortgage banking firm in 2000 with several of my former associates. We sold to a bank owned mortgage banking firm at the end of 2008. In 2012 CBRE offered us a great opportunity and 5 of us joined the capital markets team at CBRE. We have a great team of professionals and are active in all aspects of debt and structured finance.

R John, can you give some bits of advice to young people just out of school who want to get started in CRE lending? What pathway would you suggest them to take, or are there several?

For young people just out of school I would advise them to search long and hard as the commercial real estate lending industry is relatively small. Houston has always been a net importer of capital and has never been a major lending center so they may have to reach out to firms in New York or other cities with a concentration of lenders. Typical entry level positions are usually filled by graduates with real estate degrees or experience in complimentary industries such as due diligence firms, appraisal firms, commercial real estate brokerage firms and other lenders such as insurance companies or banks. ●

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