

When the Loan Matures but the Numbers No Longer Work

The Changing Landscape of Commercial Real Estate Financing

By: Khoren Bandazian, Shareholder

A commercial property can be fully occupied, generating positive cash flow, and performing exactly as its owner anticipated, yet still face a significant financial challenge when its mortgage matures. This is one of the more consequential issues facing commercial real estate owners as we move into 2027. According to the Mortgage Bankers Association, approximately $875 billion in commercial and multifamily mortgages were scheduled to mature in 2026, with another $652 billion scheduled for 2027. While the volume of scheduled maturities is beginning to decline, the underlying refinancing challenges have not necessarily disappeared.

The Problem is Not Always the Property. Sometimes it's the Capital Structure. Many commercial properties were acquired or refinanced when interest rates were historically low, capitalization rates were compressed, and lenders were comfortable with relatively aggressive valuations. Today, those same properties are being evaluated under very different financial conditions. Higher borrowing costs, more conservative underwriting, increased operating expenses, and changes in capitalization rates have altered the economics of refinancing. Consider a simple example. A multifamily property generating $1 million in annual net operating income might have supported a $20 million valuation at a 5% capitalization rate. At a 6% capitalization rate, that same property, generating the same income, would be valued at approximately $16.7 million. Assuming a $14 million outstanding mortgage and a new lender willing to advance 65% of the current property value, the maximum refinancing proceeds would be approximately $10.8 million. **The owner now faces a refinancing shortfall of more than $3 million, despite no deterioration in the property's net operating income.** And that assumes the lender's debt-service coverage and debt-yield requirements do not further reduce available proceeds. This is the fundamental challenge facing a segment of the commercial real estate market.

The Next Phase of the Market May be About Recapitalization, Not Acquisition. For years, much of the commercial real estate conversation centered on acquisitions, development, rising valuations, and the availability of inexpensive financing. The next phase may require a different approach. Property owners

approaching loan maturities will need to evaluate alternatives that extend beyond simply obtaining another conventional mortgage. Depending on the circumstances, those alternatives may include:

- Negotiating extensions or modifications with existing lenders.
- Restructuring existing debt obligations.
- Contributing additional sponsor equity.
- Bringing in new equity partners.
- Recapitalizing ownership structures.
- Negotiating discounted loan payoffs or pursuing asset dispositions where appropriate.

Each alternative presents different economic, legal, and practical considerations. Existing loan documents, lender consent requirements, ownership agreements, guarantees, and the rights of existing investors can significantly affect which solutions are available.

The Tax Implications Cannot Be Ignored. For some property owners, selling an asset to resolve a refinancing shortfall may not be a practical alternative. This is particularly true where a property was acquired through a tax-deferred exchange under Section 1031 of the Internal Revenue Code. In these transactions, owners may have deferred substantial capital gains from prior property sales. As a result, the current property may carry a relatively low adjusted tax basis, creating significant potential tax exposure upon disposition. A sale could trigger recognition of previously deferred gains, depreciation-related tax liabilities, and applicable state income taxes, even where the property's current value has declined from its peak. In certain circumstances, the tax liability associated with a sale could consume a substantial portion of the owner's remaining equity or exceed the cash proceeds available after repayment of existing debt. While another properly structured Section 1031 exchange may provide an alternative, it introduces its own timing, financing, and replacement-property challenges. Consequently, **a sale that appears economically sensible from a financing perspective may be unattractive or impractical when the tax consequences are considered.** This makes evaluating refinancing, restructuring, and recapitalization alternatives particularly important. Those alternatives also require careful tax analysis, since changes in ownership, debt forgiveness, and certain restructuring transactions can create their own tax consequences.

Preparation Will Be Critical. Owners with mortgage maturities approaching over the next 12 to 24 months should be evaluating their options now. Understanding current property valuations, realistic refinancing proceeds, lender requirements, potential capital needs, and tax consequences well in advance of maturity provides significantly greater flexibility. Waiting until a loan is approaching maturity can narrow the available options and weaken an owner's negotiating position. There are encouraging signs in the commercial real estate financing market, including improving lending activity and renewed investor interest in certain property sectors. However, a recovery in transaction volume does not automatically resolve the financing challenges confronting individual properties.

The Commercial Real Estate Market is Not Facing a Single Problem with a Single Solution. It is entering a period in which thoughtful financial restructuring, realistic valuations, tax planning, and creative transaction structuring may be just as important as identifying the next acquisition opportunity. For owners, lenders, and investors alike, understanding that distinction will be essential to navigating the market ahead.

Navigating the Challenges Ahead. Commercial real estate owners, developers, lenders, and investors facing upcoming loan maturities should begin evaluating their options well before refinancing becomes an immediate necessity. As a commercial real estate attorney with more than 30 years of experience representing parties in complex real estate transactions, financing arrangements, and restructurings, I work with clients to evaluate and implement practical solutions to challenging real estate situations. If you are confronting a refinancing shortfall, approaching loan maturity, or considering a restructuring or recapitalization, I welcome the opportunity to discuss your circumstances and potential alternatives.

Khoren Bandazian
Shareholder | Giordano, Halleran & Ciesla, P.C.
Email: kbandazian@ghclaw.com