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Our skyline, their cash: Out-of-town lenders continue to dominate Nashville's building boom

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As Nashville continues to lure lenders with deeper pockets, Nashville's construction blitz doesn't need local banks. We reviewed the construction loans paying for all of the cranes in Music City, and nearly three-fourths of that debt is tied to outside money.

Jutland Capital Management's headquarters may be more than 2,500 miles away, but the Canadian investment firm is the financial power behind Fifth + Broadway, the downtown development set to permanently alter the dynamic of Nashville's prime tourist district.

And Jutland is just one of many out-of-town financiers investing huge amounts to reshape Nashville's skyline. Two years ago, Nashville didn't have a construction loan of more than $100 million. Now, it has six. All of them were financed by out-of-town lenders, and the top three are foreign investors.

It's further proof that Nashville's breakneck construction boom doesn't need local banks anymore, as the city's growth continues to attract new lenders and developers with even bigger pools of cash.

We looked at projects on our Crane Watch map that are under construction and have publicly filed construction loans valued above $10 million. Sixty-one projects fit that bill, totaling more than $3 billion in loans. Of that debt, 70% is tied to out-of-town lenders — a sharp increase from when we last analyzed this data two years ago.

In our previous analysis, out-of-town lenders were backing less than 50% of projects under construction that required a construction loan over $10 million, accounting for $937 million worth of loans. That total has nearly tripled, with out-of-town banks now footing the bill for $2.4 billion in construction debt.

Local and regional banks split the rest. Only four local lenders — Pinnacle Bank, FirstBank, Franklin Synergy Bank and Wilson Bank & Trust — have loans above $10 million, accounting for 14% of the Davidson County construction loans included in our analysis.

Local lenders' absence on most of these project loans can be traced to two primary reasons. Today's deals are too big for community banks to serve as the primary lender; instead, they sometimes sign on as supporting lenders, a status that is not publicly disclosed. Additionally, several local bank chiefs have become wary of big-ticket construction lending amid increasing talk of an economic slowdown.

Nashville's banking insiders argue that having a large influx of out-of-town money — while exciting to those hoping to see the city expand — isn't without risk, particularly so long into the city's building blitz. The fear is that demand won't meet supply, and one project's collapse could trigger a breakdown in Nashville's lending environment.

"Many of the projects being financed are inherently speculative," Mike Hendren, a senior credit officer with Pinnacle, said of the city's lending landscape. "The proof will be in the returns over the coming years if capital keeps coming to Nashville. ... Commercial real estate is just a set of boxes that house the economy, and as long as the economy is growing, you're going to need more boxes."

Big deals beyond reach

The average loan in our analysis is $56 million. For many local lenders, a $56 million deal exceeds their lending limit — the maximum dollar amount that a single bank can lend to a given borrower based on federal law. A bank's lending limit is a percentage determined by its capital base and reserves. Often, banks will have internal loan limits that are even smaller, to further reduce risk.

“Whether in Nashville or Atlanta or Dallas or New York, it doesn’t matter. When you’re talking about loans over $100 million, there aren’t many banks that will do that loan without participating it out,” said Lance Patterson, of Atlanta-based Patterson Real Estate Advisory Group, which connects developers to capital. “You’re at a loan amount that’s beyond any of your local banks. And really, once you get above $50 million, there are very few banks that could do it.”

Participations are when a bank signs on with a developer to do a deal, then that bank — now considered the lead bank — sells pieces of the loan to others, spreading out the size and risk of the loan. In the end, the lead bank files the construction loan with the developer, but behind the scenes, several banks could have small stakes in the deal.

In Nashville, participation loans have allowed local lenders to get a piece of bigger deals. Those deals, however, can be slowed down if a bank needs help to cover the costs. For this reason, developers often prefer when banks can front the cost of a loan on their own.

That was one of the things that helped Arkansas-based Centennial Bank stand out to developer Joel Pizzuti when looking for a bank to finance The Joseph Nashville, a 21-story hotel in SoBro, in May 2018.

“At the time, it was the most expensive hotel [being built in the Nashville market],” said Pizzuti, who is based in Columbus, Ohio. “People weren’t really sure what valuations would be achieved. People all love Nashville and believe in where the city’s going, but banks deal in facts. There were not a lot of [comparables] similar to what we were doing.”

He added: “We talked with a lot of lenders on the front end. … Centennial was one of the ones we thought could carry the loan themselves.”

Centennial loaned Pizzuti more than $83 million for his project. For perspective, that’s $23 million more than the internal loan limit at Pinnacle Bank, Nashville’s largest lender.

"If you look at some of these really large-ticket items … [out-of-town lenders] hold the whole thing," Pinnacle CEO Terry Turner said. "I don't think that's a sound risk for our company, and it wouldn't be a sound risk for other local banks."

Local lenders hold back

Turner is one of several local bank chiefs to publicly balk at the city's breakneck construction. In January, he doubled down, again telling analysts he doesn't want his team funding new hotels in the city's urban core.

"We've talked about these asset classes before, like multifamily in downtown Nashville," Turner said. "We've had a hard stop on that in the past, but I would say we have a caution flag now, which means it's better than we used to believe it was. I think hospitality is an area we would still look pretty hard at before we would want to do another transaction there. … [Those are] the two modest exceptions there, but generally, we feel good about risk in the loan book."

Chris Holmes, CEO of FirstBank, listed the same types of projects earlier this year when analysts asked where FirstBank was cautious. Holmes said FirstBank wasn't giving up on construction lending, but instead was prioritizing new deals with existing clients.

"We're relationship-based," Holmes said. "So if we get somebody in the hospitality industry, [and] we are accustomed to dealing with them … we typically will continue to deal with them."

Hendren, the Pinnacle credit officer, said the $25.6 billion bank remains interested in construction deals involving industrial spaces, office buildings and multifamily projects outside of the urban core, as well as smaller retail projects that are anchored by specific tenants, such as grocery stores.

Like Pinnacle, Lebanon-based Wilson Bank & Trust is being more selective about which real estate projects it finances, said John McDearman, the bank's president.

It's about finding "the right amount of gas and right amount of brakes," he said.

"We'll stay smaller than what we've done in the past because of where we're in the business cycle," McDearman said, noting a small project for Wilson Bank is about $5.5 million. "We've, along with smaller banks, helped build this Nashville boom together. … But [when it comes to lending in today's market], we're looking at the timelines for projects now."

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