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More on the Distressed Asset Acquisition Program (DAAP)

The announcement about DAAP generated a flurry of questions. The following is additional information regarding the program:

Is the program nationwide? Yes, but keep in mind that certain markets are difficult to lend in because of problems with the local or regional economy. However, if the borrower can show the ability to generate value in an asset properly valued in today's tough economy, then we might be able to do the deal. For example, raw land for residential development in Florida needs to reflect current value, not a value from last year and there has to be a plan that shows that even in today's market, the deal still makes sense. Some of our investors in the program are contrarians and will consider assets in distressed markets.

Does the asset have to be purchased from a financial institution or will refi's be considered? The primary reason for the program to focus on REO or the acquisition of notes is that it is much easier to understand value in the purchase of a distressed asset from an institution than a typical refinancing. Institutions are highly motivated to liquidate distressed assets so there is a general perception that assets purchased from institutions are a bargain. It's much harder to determine value in a refinancing situation. Many borrowers trying to refinance a property are simply unwilling to deal with the fact that they own assets that are worth substantially less today than just a year ago. Acquiring an REO or even getting a short pay provides a very useful indicia of value.

Will you consider residential lot deals? Again the issue is valuing the lots and then assessing how long it will take to liquidate them. No one can accurately predict how long it will take for certain markets to recover. A liquidation strategy that relies on near term lot sales to third party builders

will probably not work. Yes, there are spot markets where the standing inventory is not extensive and builders are still buying lots, but we don't lend in Kazakhstan. If the proposed buyer is a solvent builder/developer and does not rely on third party builders to provide an exit strategy, then perhaps there is a deal to be made.

Deal Examples:

- **\$16,000,000: Construction Loan on partially completed, 70% leased retail center in a great location.** This is the kind of project that would normally be done institutionally but the current market will not accommodate the borrower on the timing of the transaction. The borrower had a pre-sale of the center arranged with a purchaser who, unrelated to this project, could not complete the purchase. The borrower now needs immediate cash to complete the project. This is a quality asset, in a great location, with very strong developers and is substantially pre-leased.
 - **\$4,500,000: Acquisition of three distressed multi-family properties in the mid-west.** The borrower is an experienced contractor and asset manager. He is acquiring three properties from a bank. Once fully renovated and leased, the all in cost of the project should be about 75% of the current value of similar properties in this market. This borrower is bringing 25% of the purchase price and renovation costs to the deal, expertise in construction and asset management and the value on completion should be sufficient for BSCCI to refinance the property with a conventional mortgage. This is the kind of deal we can assess quickly and provide the borrower the financing to buy the asset at the right price!
 - **\$14,000,000: Closed Hospitals Purchased out of Bankruptcy:** This transaction is difficult because of the special purpose nature of the properties. On the positive side if the Borrower has sufficient capital and experience, we may be able to overcome the special purpose issue provided the Borrower has a viable exit strategy.
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REALITY Part 2 “every day is a new investment decision.”

I received a request the other day from a broker requesting a 35% LTV loan on a residential development deal. I asked the broker how he arrived at a \$7,000,000 value on the property. He told me with some arrogance that he had an MAI appraisal in his hot little hand. I wrote him back and asked him the date of the appraisal. You guessed it: August, 2006. Mr. Broker, do you think that this is the only residential development property in the U.S. to avoid a steep decline in value in the last 12 months?

For this broker to properly represent his client, he needs to bring **reality** to the situation. Given all of the market information out there on the drastic decline in the value of residential land and homes, this broker should have been willing to tell the client that the value of his property is probably worth less than 50% of what it was in 2006. Ouch, I hate to be there when this Borrower finally “gets it.”

My friend Richard is the smartest business man I know. He is a professional investor as comfortable in the securities markets as he is in real estate. His mantra is the following: **“every day is a new investment decision.”** Typically that phrase is used to address the value of securities he is holding but it applies to everything in his business life. The decision on whether to continue investing time or money on a project is not based on his investment; it is based on the value of that asset today and its prospects for the future.

The fact that the borrower above put \$2,000,000 into a deal in 2006 that was worth \$7,000,000 has nothing to do with what he should do today. Today he must decide if he will put more money or more time into this asset based on its value today. Would he buy that property today? What price would he pay? Would he invest his valuable time on this particular transaction? Every day we have to make a new decision on whether to proceed with our current course of action or change direction. That decision should be based on **today’s market, not on the past.**

Mezz Lenders are Singing the Blues

With the shortage of conventional capital in the market, you would

think that Mezz lenders would be a happy bunch. Apparently that is not the case as was openly discussed at a recent Mezz conference here in LA. The Mezz lenders on a whole were singing the blues. Why? First, their investors are demanding higher yields because of valuation concerns and alternative investment opportunities. Whereas typical Mezz debt pre 2007 was yielding say in the low-teens, current expectations are for yields approaching 20%. The problem is that there are fewer deals that will deliver that kind of yield without taking on an unacceptable level of risk. It all comes down to valuation. Everyone is concerned that we have not identified the “bottom” nor have we clearly seen the extent of the problems in the commercial sector. So, these guys all want high yields with little risk. Hmmm, what else is new?

- Joe Forman, President & CEO

