

**October 27,
2008**

Volume 2 Number:26
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Rates

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Can you hear the other "shoe" dropping?

Optimist, pessimist, or realist? What are you in this environment? Clearly it's easy to be a pessimist when the stock market falls 200 points and you think it's been a good day. To be an optimist in this market is really a challenge.

There are many smart folks who see the commercial real estate market as the next major arena to feel the pain. Given the non-stop bad news, it's easy to join the doomsday crowd.

My friend Clain Brandt publishes a world class newsletter in which he reports on the securities markets, commercial real estate and the economy in general. Clain is a very astute observer of our world. He is frequently called upon to opine on the capital markets by the Mortgage Bankers Association and the banking media industry. [Click here for a complimentary copy of Clain's newsletter.](#)

Clain is definitely ia pessimist when it comes to the economy and commercial real estate. He fully expects the commercial real estate lenders to experience a lot of pain when the full impact of this recession hits. Values will fall and fall hard. Loans coming due will not underwrite sufficiently to pay off the debt. Defaults will follow. It's hard to argue with this logic.

Ok, call me a silly optimist; I think some of the fundamentals that crashed the housing market are not in play in the commercial space. Commercial lenders generally (and I mean generally) did not, for the most part, over-lend. The lessons learned in the last big crash in the early 1990's and the regulatory restrictions imposed on construction lenders prevented over building. That was not in play in the income producing property arena.

Now I do believe there will be real pockets of pain. Here are some specific arenas that I think will be in trouble:

- **Retail** is in trouble as we are seeing more contraction in the last year than perhaps ever before. There will be many an empty store front begging for tenants that could sit vacant for years. There will be significant defaults in this arena.
- **Tenants In Common deals.** The TIC business grew exponentially in the last ten years because conduits provided non-recourse financing. Even though the leverage was low, there are virtually no portfolio lenders that will fill this space when these loans start coming due. Portfolio lenders want straight forward, recourse loans. How do you make 35 folks recourse for each other?
- **Large Assets.** In past credit crunches, the big guys got money and the small guys were shut out. This time, borrowers with large commercial properties cannot find financing. Until (and if) the conduits return, this market segment is in for a squeeze.
- **Construction Loans.** Why take construction risk when so many other stabilized assets are begging for money? Yes there are a few lenders in the market but, as we have been reporting, it's tough to get a construction loan without a lot of equity, liquidity, and cash to deposit in the bank.
- **Highly Leveraged Assets** will have problems when loans come due and borrowers cannot replace their debt. This doesn't mean the asset hasn't performed, it simply means that borrowers are going to need to de-leverage or lose their properties.

The bottom line to all of this is the liquidity of the credit markets. Until the credit markets fully reopen the tap, everyone will have pain. Lenders need to liquidate all of the existing unsold loan inventory to have money to lend. But, once that happens, the commercial loan markets should reopen.

I am not quite as pessimistic as many other folks **because we have money for good deals at very attractive rates today on reasonable underwriting terms.** This was not true in the early 1990's. There was simply no money then for any deals.

Secondly, there is a tremendous amount of cash on the sidelines that has to go somewhere. What asset sector offers more security at greater yields than commercial real estate? Will investors flock back to the stock market after getting crushed? Will, lenders look at commercial real estate and gain comfort that through this entire financial disaster, commercial real estate out performed many other asset classes?

Perhaps I am in the minority on this view but I don't see a disaster scenario for commercial real estate. I see a 15-20% decline in value in the short run. This devaluation is primarily because investors are requiring higher yields than they did a

year ago. The problems with the credit markets impact available, cheap debt and hurt cash flows. Therefore, values have to drop so buyers can get competitive yields.

The opportunity cost and competitive asset issues are not, however, creating the same devaluation issues facing other asset classes. In the long run, the value of commercial real estate will be dictated, as always, by interest rates and rents.

Yes, rents will decline somewhat as demand declines but, when the economy recovers, commercial real estate will regain its value. Further, it is unlikely that new construction lending will flood the market with space and drive down rents and values.

Long term, commercial real estate will be fine.

-Joe Forman, CEO and President

MultiFamily and Mobile Home Park Small Balance Program

Sample Rates (80% LTV / 1.20 DSCR)

5 yr - 5.95%

7 yr - 6.09%

10 yr - 6.18%

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