



RCK INSITES

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WHAT DO YOU DO IF YOU HAVE A LOAN THAT WILL BE DUE BEFORE 2012?

Back then, it seemed like a safe bet taking out a loan all due in ten years. Not that you really had a choice, but it was a leap of faith to believe there would always be a source to refinance when the time came. Who would have imagined that almost EVERY lender would vacate the CRE mortgage market.

Rather than pin your future on a "hope and a prayer", you need to think about what you will do when the time comes. You need to start sooner rather than later. Here are a number of tips to consider:

WHO IS YOUR LENDER?

Seems like a simple question, but many times it isn't who you think. Is it a conduit (or Wall Street traded) loan? Is it a loan with a balance sheet (Lenders who lend against deposits) lender? Is it a FNMA/FHLMC loan? Is it serviced by one entity but actually held by another?

START TALKING. Many times, there will be several parties that have a say in whatever you desire and/or choose to do, such as: the actual investors in the mortgage, servicing companies who process the payment and in the case of a conduit debt, a Special Servicer who oversees the entire mortgage pool. Occasionally, you could end up working with the originating lender who initially made the loan. Finally, if the loan was securitized, it is possible the rating agencies (S&P, Moodys, Fitch) could get involved as well.

Given the current crisis, some lenders are providing short term extensions (1-3 years) in what has

come to be known as "EXTEND & PRETEND." However, this is strictly on a "case by case" basis with very little or no precedent to follow.

WHAT ARE MY REFINANCE ALTERNATIVES?

If your loan is a conduit, we are not aware of any new securitized loans being made at this time. The most optimistic forecasters believe securitized CRE Loans won't return until 2011 at the earliest, but no one has a clue what those loans will look like.

Balance sheet Lenders such as JP Morgan/Chase, BankAmerica and Wells Fargo have expressed the willingness to discuss extensions for their loans. However, they are not providing new debt to outsiders. Best guess is they won't re-enter the market for a while (unless it is relationship driven). While there are a number of smaller community and regional banks beginning to re-enter the CRE loan market, their lending parameters may be more stringent, the loan very costly and shorter term (3-5 yrs).

This leaves us with the only logical choice: Freddie Mac and Fannie Mae. Currently, the Central Valley is one of those markets FNMA/FHMLC calls a "pre-review market". This means more stringent underwriting, higher debt coverage and most likely a higher interest rate. There will be all the usual third party reports with particular attention given to the current physical condition and commensurate reserve requirements. The GSE's will be looking very closely at your current operations trying to discover concessions, rent rebates and other

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CHECK OUT OUR WEBSITE!!

The address is:

WWW.RCKORG.COM

Recently we have added a number of great website links and stories we think you may find both informative and useful. There is also a link to REIS, a NY based market research firm that has just completed their first quarter report for the Fresno apartment market.

So register your email address, check it out and we will "see" you online!

LOSE YOUR JOB? NO PROBLEM, CANCEL YOUR LEASE!

When Hyundai Motors offered purchasers of their automobiles the right to return the cars if they lost their jobs, Hyundai's sales increased at a time every other auto maker lost sales. It was only a matter of time to see this manifest itself in other industries.

In the Apartment Sector, Western National Property Management (Irvine, CA) has launched such a program. Western National manages more than 144 properties totaling more than 24,000 units. If a resident in one of their properties is laid off, they can break their lease. The program is available to new tenants, as well as the time of lease renewal. If the tenant is laid off, they are

required to provide proof of being laid off and give a thirty day notice. If the tenant was fired or quit, they do not qualify. Western notified the existing residents via their newsletter and informs the prospective residents at the beginning of their tour.

In a time when consumers are nervous about making long term commitments, this program can alleviate much of their concerns. We have seen this crop up in Airlines, Vacation Resorts, Cruise lines and anywhere there is a need to overcome concerns regarding making long term commitments.

CONTINUED— WHAT TO DO WITH A LOAN THAT IS DUE

incentives. They will require, minimally, 90 consecutive days of 90% occupancy.

BE PREPARED TO PAY DOWN YOUR PRINCIPAL: If your loan was originated prior to 2001, chances are good that your remaining balance will not require a paydown. HOWEVER, if your loan is less than seven years old, you may have a problem. While this is an unpleasant thought, you will need to be realistic. This is made all the more distasteful when your property may have lost as much as 20-30% in value. You might consider seeking mezzanine financing but expect rates to be no less than 11-12% with the possibility of “equity kickers”.

If you have partners, this may present an opportunity to re-capitalise the partnership, basically buying out those who wish to “get out,” with cash from people who are more risk tolerant (existing and/or new partners). You could also fund a “B” partnership to cover the shortfall, providing them with a secured interest which could provide a number of tax advantages.

BUY YOUR MORTGAGE AT A DISCOUNT. Sounds crazy, but it happened with great frequency in the S&L Crisis of the early 90’s and it is beginning to occur once again. Some lenders are even willing to work with you to complete the deal. Although, in the past, discounts of 50% were achievable, today it is more realistic expect discounts in the 15-25% range.

WHAT IF YOU OWE MORE THAN THE FMV? A very uncomfortable thought. But one that has crossed everyone’s mind—even your Lender’s.

If you are “under water” today, the problem will become more complicated in the future when you are trying to refinance or raise equity. As discussed in previous issues, cap rates will continue to rise given the expected direction of mortgage interest rates. Yes, you can hope for things to be better, but proper planning requires that you have a strategy that does not depend only on hope. If you are the GP or the one who is responsible to make the “tough” decisions, and are aware that this scenario is highly likely in the future, then beginning to discuss the alternatives NOW is only prudent.

SHOULD YOU SELL NOW? As a Broker, of course we would love to say, “YES!” But the real answer is a lot more complicated than that. The true test involves considering: 1) what is my property worth today; and 2) what do I believe it will be worth when the time comes to refinance. If you have an older loan or a very low LTV, then really today

is most likely not a good time to be a seller (see accompanying article). Better to sit this year out.

But as difficult the decision is to sell in a “Buyer’s” market, just imagine how weak a negotiating position you may find yourself facing if your loan is due in a mortgage market that has very limited choices.

RCK INSITES. We have been through three of these down cycles. Our experience is that those owners who do not sit and fret about these issues, but are *purposefully proactive*, will come out the other side on top. You cannot change the facts, but you change how you deal with them. By meeting with your lender and/or your partners early, you can discuss your options—both those that seem possible and even those that may appear impossible. Who knows? You may even be surprised at the solutions that surface.

FED STRESS TEST:

CRE LOANS LESS STRESSFUL

An interesting and unreported fact surfaced as a result of the recent stress tests the Fed ran on the 19 largest banks. The test revealed the following “breakdown” of the potential for losses over a 2 year scenario as follows: **Residential Loans**—\$185.5 billion, **Trading & Counterparty Investments**— \$99.0 billion, **Consumer Loans**— \$83.7 billion, **Credit Card Loans**— \$82.4 billion, **Business/Corporate Loans**— \$60.1 billion and **Commercial RE Loans**—\$53.0 billion.

An interesting fact is that acquisition & development loans, land loans and condo developments are lumped together with CRE Loans. While the amount of CRE loans secured by Office, Industrial, Retail and Multifamily is still a large number, the “hysteria” about Commercial RE in the media is more noise than substance.

“GREED IS GOOD, GREED WORKS.....” G. GEKKO

Greed works, but not exactly. What is true is that greed is the flipside of fear. The period from 2003 to 2006 can best be described as greed run rampant. Sellers were able to dictate price and terms that put all of the risk on the Buyer. Little time or attention was given for due diligence or financing. Greed drove both Sellers and Buyers. Beginning in 2007, Greed’s time ended and Fear began to creep in, reaching a crescendo at the end of last year. However, as the second quarter 2009 began, Fear began to diminish and investors began to gain an appetite for risk. We have seen a rapid increase in calls from investors seeking new opportunities. The typical investor today is seeking to make a purchase at a substantial discount—some seek as much as 60%. Some were net sellers through the boom years. Others are recent converts hearing of single family homes selling at 20 cents on the dollar. What is interesting is that many are new investors unencumbered with poorly performing investments. They may have either missed the previous cycle or were scared off by it. Many, if not most, have an unrealistic expectation of making acquisitions at very deep discounts whether buying fee title, troubled mortgages or partnership



interests. The expectations are understandable given the initial need to compensate and overcome fear. We often hear something like “Make me a deal I can’t refuse.”

With time, we will see the familiar (and predictable) cycle of Fear subside as the markets continue to stabilize and the sounds of Chicken Little’s “The sky is falling” diminish. Individual investors, as well as hedge fund managers and syndicators, lower their return expectations and raise their tolerance for risk as they are forced to acknowledge that “stealing a property” (or a 20% return) is more a dream than a reality.

But before you get Greedy (as a seller), understand that we are merely returning to a state of equilibrium where risk and reward are balanced. The last time we witnessed this balance in RE Investing occurred from the mid 90’s (following the S&L crisis) to the Dot-Com crash of 2000.

Boring? Maybe...but a whole lot better than the terrifying roller coaster we all rode in 2008.

2009 MAJOR APARTMENT SALES OFF TO A VERY SLOW START

2009 YTD (thru May) Fresno apartment sales for major transactions (over \$500K) total \$10,990,000. At this pace, 2009 would end with sales totaling \$26,400,000, an historic low. While we believe the second half will be substantially better than the first half, it will be very difficult to end the year equal to the previous low set in 1997 and 1999 of just over \$44,000,000.

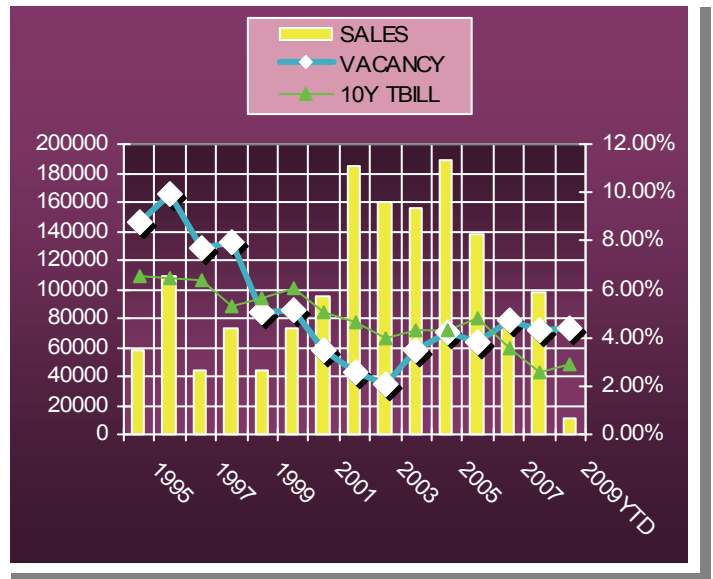
It is our belief that the root cause is the wide gap that exists between Bid vs. Ask. As discussed many times before, things are just not as bad as Buyers think they are nor are they as good as Sellers believe. In time, both will temper their positions and the number of transactions will increase.

Inventory for sale is the same as six months ago—\$108,600,000. The total number of major sales YTD through May 2009 is four (4), compared to twenty (20) for all of 2008. At the current rate of sales, the existing inventory represents a four year supply, OUCH! Under closer examination, one owner has 48.4% of the entire available inventory.

The majority of today's offerings can best be characterized as "C" class properties in below average submarket locations. In fact, only 5.5% of the available offerings are located in "A" locations. An examination of last year's sales reveals that more than 67% of the properties were in "A" locations. We draw two conclusions from these facts: **First**, well-located properties will receive above average interest and can expect to garner the majority of offers. **Second**, the "shelf" for commodity or "C" class offerings is exceptionally crowded. To attract investor interest and stand out among the many current offerings, a "C" property must be very competitively

priced. Otherwise, it will be a VERY LONG time before a sale will occur.

In looking ahead to 2010 and beyond, it is difficult to predict when we might see sales activity recover. However, before this occurs, the two factors that increase the demand for rental units—population growth and lack of new construction—must exist. This will help the revenue side of the ledger. For the foreseeable future, the more difficult question may be whether revenue will sufficiently exceed the costs associated with debt, plus operating expenses.



WHAT IF NO APARTMENTS ARE BEING BUILT?

In the previous two boom/bust cycles, apartment construction ran wild. In the 78-82 market, thousands of apartments were built due to advantageous "Tax Shelters." (For those too young or too old to remember, you used to be able to utilize paper losses to "shelter" your personal income). This came to crash with the advent of the Tax Reform Act of 1986.

Then, in the late 80's, another boom in construction occurred as the S&L's tried to "gin up" investor returns by getting into the RE Development business along with the explosion of Tax Exempt Bond Developments. This came to a horrible crash in 1989 with FIRREA (Financial Institutions Reform Recovery and Enforcement Act), leading to the S&L crisis, the RTC and FADA.

During our current boom, there was little or no new apartment construction. In fact, in the last ten years, only 6,534 multifamily permits were issued in Fresno. Many—we estimate as much as 65% - of these were for Low Income Tax Credit or Senior Citizen communities. That leaves approximately 2,287 market rate units over the last ten years or an average of 228 per year. To give per-

spective, in the 70's, over 27,000 units were constructed in the same time frame.

Many of the previous builders of market-rate communities have abandoned multi-family and began building single family homes. The reason was simple: That's where the money was. Additionally, increased litigation—reaching a feverish pitch early in this decade—created class action lawsuits in many common area developments.

Then there's no excess of new inventory to absorb, *greatly enhancing* the potential to rebound more quickly once the economy recovers.

So, what if no apartments are being built? Then there's no excess of new inventory to absorb, *greatly enhancing* the potential to rebound more quickly once the economy recovers. What is even more encouraging is that new construction is unattractive unless and until rents and sales prices return to

more attractive levels, thereby providing the rewards needed to motivate builders. We would guess that several years will pass in the recovery before these prerequisites for constructing new units will be in place.

We find this a pleasant thought in today's climate—one you may want to remember...



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Why RCK Organization?

- ◆ Sold over 5,000 Units in Central Valley since 2001
- ◆ Handled the LARGEST MULTI-FAMILY Transaction ever recorded in Fresno County
- ◆ Achieved the HIGHEST sales price per unit

THE NEW BUZZWORD FOR TODAY: **RE-SET**

Like the "EASY" button in the Staples Office Supplies commercial, September 2008 hit what can best be described as the "RE-SET" button. Prices for everything have dropped—across all sectors of the economy. From hotels, airlines and cars to restaurants, plumbers, automobile repairs, groceries and even Real Estate. From home prices to rent on apartments, offices, retail and industrial space. Businesses are going back to their suppliers, contractors and workers and renegotiating everything.

Painful? Yes, but necessary to "RE-START" the economy. We all need to re-examine our cost structures to find ways to lower them in order to compete in the years to come. Expecting to do business like the period 2002-2006 is a prescription for failure. To begin your "RE-START" in the apartment sector, there are three primary areas to examine: Rents, Expenses and Debt/Equity.

Are your rents truly competitive? What are your immediate and secondary competitors charging? What are the available concessions? What about the "Shadow Inventory" of foreclosed homes/condos undercutting the entire market? Are you focused on trying to retain an old rent rate that is no longer applicable in

today's competitive market? You need to compete!

With respect to expenses, have you thought of ways to work with your suppliers and service contracts to lower your costs and yet keep their loyalty? Finding a "cheaper" source may be counter-productive, but there are many ways costs can be reduced for both you and the contractor. For example, buying supplies in bulk can be a great cost reducer or applying for a Property Tax reduction can save quite a lot of \$\$\$.

RCK Organization provides this service—call us for more info.



Regarding debt and equity, if you have an old loan that is amortizing too much principal, think about refinancing (No Cash out) to re-amortize the remaining balance over a new 30 year schedule. We have seen newly raised equity retire or reduce existing debt. Think about it. You can pay investors a return far better than what they are presently receiving at their bank.

Bottomline: Understand what the new normal looks like. You need to run *lean and mean*...or *leaner and meaner*. In times like this, we understand that the "Boom Times covered a multitude of Sins." Now is the time for absolution!