



RCK INSITES

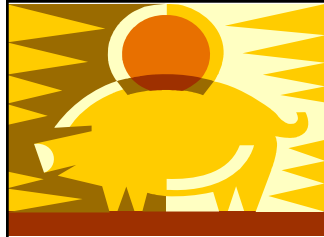
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APARTMENT LENDING IS BACK! *WHAT ARE THE DIFFERENCES BETWEEN FREDDIE MAC & FANNIE MAE?*

Multifamily property, as an asset class, continues to be a favorite of lenders primarily due to the Government Sponsored Entities (GSEs) with Freddie Mac (FHLMC), Fannie Mae (FNMA) and Federal Housing Administration (FHA) leading the way. They have set the bar for rates and terms as well as successfully securitized (sold) these mortgages.

So what are the current loan terms? For apartments, interest rates for a 10 year fixed-rate FHLMC/FNMA mortgage range from the upper 5s to the lower 6s. While shorter term debt is possible, the underwriting becomes dramatically more conservative which usually lowers the loan amount. For our market, the debt coverage ratio (DCR) is broad—starting near 1.25, it could be as high as 1.35. It is the DCR that is responsible for the reduced Loan To Value (LTV) - down from 75% to 60-65%. In some cases, we are seeing even lower LTVs.

In the past, there was little difference between the underwriting for the different FNMA and FHLMC loan types. Today, there are substantial differences. It is now more important than ever that an owner understand which GSE will best serve his/her interest.



In the recent issue of Apartment Finance Today, it states "Fannie [Mae] is seeing a lot of business from large institutions looking to refinance, while Freddie [Mac] seems to be winning more business on acquisition deals. Freddie offers a more flexible approach than Fannie, positioning the company to win more business as the transaction business picks up."

The article quotes Don King, head of agency lending at CW Capital, a Boston based Lender, "Borrowers looking to acquire solid assets in bad (or secondary) markets may have better luck with Freddie. Fannie paints weaker markets which a broader brush. Freddie is looking at individual transactions and making a business decision. Fannie is much more rigid."

The article continues "While Fannie will consider entire states 'pre-review' markets, Freddie will pick certain metros within those states to offer market rates.... Another key difference: Fannie is seeking a lot of business from large institutions wanting to refinance, while Freddie seems to be winning more business on acquisition deals."

RCK INSITES BOTTOM LINE:

- Looking to **acquire new properties**, **Freddie Mac** may be the wiser route
- Seeking to **refinance**, especially at a lower loan to value, **Fannie Mae** may make more sense

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CHECK OUT OUR WEBSITE!!

The address is:

WWW.RCKORG.COM

We have a great number of links to fantastic websites which will keep you on top of the latest developments in Real Estate, Finance, Politics and trends that have an impact on our industry. Many thanks to those who have sent in great suggestions.

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

2009-CAPITAL PRESERVATION, 2010 CAPITAL APPRECIATION

Oh, what a different mindset today!

One year ago, fear was rampant and the key words were **Preservation of Capital**. The primary concern was do not lose capital or the principal balance of assets. People invested in treasuries or money market accounts (MMAs) trying to not lose money. The focus on any proposed investment was to be certain that risk was minimal or maybe better said, concern for safety was primary. Few were willing to take any risk.

Today, the key words are **Capital Appreciation**. Investors

want to know how to GROW their money. In a word, greed has returned. Investors want to know, "How much will I make?"

In this environment, real estate investments are competitive. As the economy improves and confidence returns, more and more capital will flow from MMA's and treasuries into investments that can grow the invested principal. If CD's continue to offer abysmally low interest rates, this will only compel more and more investors to seek a higher return. The appetite for risk will grow over time as Investors look to get "back to even".

RTC 2.0: THROWING A PARTY BUT WILL ANYONE SHOW UP?

It is estimated that from \$80 to 100 billion has been raised to acquire troubled real estate loans, properties or partnership positions. Investors were expecting 2009 to be the “turning point.” Then 2010 was pegged as the year when all “hell was breaking loose.” Now we are hearing it will be 2011 or 2012 at the earliest. What happened?

Well, to start with, most of the Owners and Lenders still remember what happened during the S&L crisis—namely that selling too quickly or under duress only attracted the most aggressive buyers. The net effect was a rapid decline in prices, further exacerbating already declining values.

Today, the IRS, FDIC, FHLMC, FNMA and almost every other government agency or department have issued rules which provide tremendous flexibility to lenders and CMBS special servicers to extend, modify and restructure existing loans. If the asset has any cash-flow to support operations and an operator willing and capable to stay on board, then there is hope for a loan modification.

This mindset appears, at first glance to lead to a nearly textbook definition of a “win-win” scenario: The Lender has someone who will operate the asset and the borrower avoids foreclosure. However, simply re-structuring the debt, does not increase the value of the asset. Rather, it only postpones being “marked to market.”

The net effect of this “extending and pretending” (or Delaying & Praying) is a high level of unmet expectations. Investors and hopeful buyers who are failing to meet their acquisition goals are having to re-think how to go forward. In an attempt to reach their goals, some actively seek to acquire the debt in hopes of foreclosing and owning assets, a strategy often known as “Loan to Own.”

The benefit to the Lender is obvious and immediate—by not foreclosing, they avoid the possibility of having to appoint a receiver, the sometimes messy process of foreclosure and best of all, are never in the chain of title. However, without the formal process of a foreclo-



sure, there is a whole new level of risk for the Investor such as bankruptcies, unrecorded liens and other types of title issues.

So why is this not playing out like the S&L crisis of the early 90's? First, it is important to remember that this particular cycle of troubled real estate loans was caused by a collapse in the Residential RE market—or more specifically, a collapse in the loan underwriting for 1-4 family properties. Most of the loss in value to Multi-family and Commercial RE is a result of the severe effects of what is now being called “The Great Recession.” In the previous downturn, commercial real estate and excessive construction caused 747 S&L's to collapse which led to the creation of the Resolution Trust Corporation or RTC.

Secondly, other than in a handful of markets, overbuilding was not evident. Over-leveraging was present, but with the willingness to modify the loan by all the interested parties, the number of assets tumbling into default and ending up on the books as a REO, will be a great disappointment to many “Vulture” funds.

So the question is, who will blink first? Owners and Sellers? Buyers and Investors? As disappointing as this may seem to some, we think the answer has too many “moving parts” to answer. Tax policy, the economy, investor expectations, sub-market recovery, individual property characteristics and performance will each play a critical role in trying to decide when an owner might best sell or an investor may be smart to buy.

One thing is certain. Last year was not a year to be a Seller, largely because distressed properties accounted for the majority of marketed properties. However, as we move forward into the future, it may be more prudent to RE-ALLOCATE capital as opposed to wait for another “up-cycle.”

In the end, the recovery will be NOT AS GOOD NOR AS QUICK as owners and sellers would like, but NOT AS BAD as buyers and investors were hoping.

STRATEGIC DEFAULTS: A RISING PHENOMENON (OR REVOLT)!

It is estimated that 7.9 million residential mortgages are delinquent. It has also been whispered that the reason behind the uptick in consumer spending for the last several quarters is due to people not paying their mortgage payments (or rent) but maintaining their lifestyle.

Several trends have changed homeowner attitudes. The most dramatic is the dislocation in home prices. In some markets, the loss in value is as much as 60%. Said another way, it could take some Owners as many as 50 years to recover the “losses,” when they could rent the same house across the street for less than half their mortgage payment. Under these conditions, the incentive to “toss the keys back” becomes pretty strong.

But what about the morality of voluntarily defaulting? This is a radical departure from years past. Homeowners would do anything to keep their home. But today, the link between Lender and Borrower is broken. Years ago, you would go into your local lender and apply for a loan. When the time came to refinance or payoff your loan, you would call the same Bank or Savings & Loan. Today, your loan has been “sliced, diced and re-packaged six ways to Sunday.”

There no longer exists the human contact. Further, homeowners are witnessing major banks, real estate developers, investment firms, companies and even nations default on their financial obligations. All of this is electronically transmitted 24/7 in today's news cycle. Whether it is on the other side of the world or in their own community, voluntary defaults are everywhere.

So a new phrase has emerged in our Language of the Great Recession; **Strategic Default** is *the act of walking away*. As stated before, 7.9 million mortgages are in delinquency. As time passes, more and more homeowners will realize that it is a lost cause to expect to get “above water” on their mortgages. For banks and holders of the nation's mortgages, this is a nightmare scenario.

But there is an upside. If Lenders realize that continuing to delay loan modification may lead to a cascade of defaults, then and only then will we see serious loan modifications take place.

In the end, this will have powerful impact on the relationship between lenders, homebuyers and home prices. Lenders just may realize loaning people more than the homes are worth just might be a really bad idea!

2009 APT SALES REACH A NEW LOW, 1Q10 OFF TO BETTER START

2009 will be remembered as having the lowest level of Major Apartment transactions since the survey was begun in 1995. Total sales amounted to \$19,875,000. The next closest year was ten years earlier in 1999 at \$44,537,000. When compared to 2008, the decline was greater than 80%.

Last year, there were nine transactions. In 2008, there were 20 sales. The average price per unit dropped from an all time high of \$86,788 per unit to \$46,549. In 2003, the average sales price per unit was \$43,369.

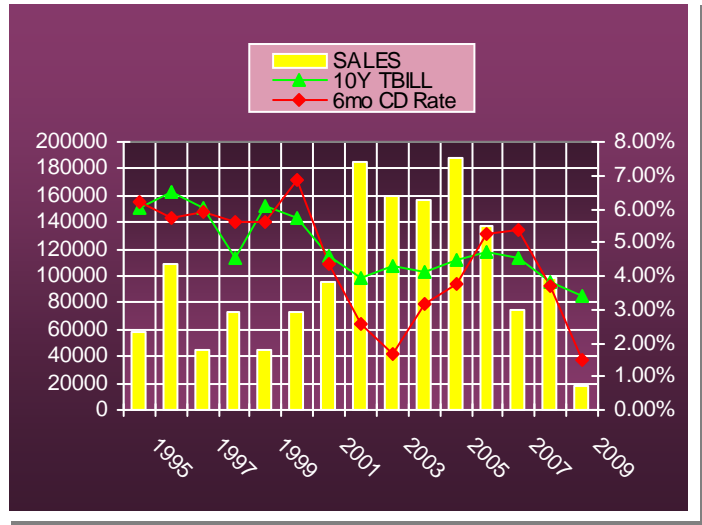
Is this atypical when compared to other markets or to the nation as a whole? In a nutshell, the answer is no. While the amount of decline year over year may vary, the best markets declined at least 50%. The reasons are the same. The historically wide bid vs. ask spread has brought the volume and number of transactions to a virtual standstill.

However, there was a change in the 4th quarter where activity began to pick up. This continued into the first quarter of this year, where we are tracking over \$35,000,000 in pending and/or closed transactions.

Is this a temporary uptick or a sign that the market has turned? We believe the market has turned. However, we must honestly admit that this is not a difficult (or risky) position to take, given the historical low of 2009. However, there are positive signs in a number of areas. An abundance of new and re-

turning investors are out looking to purchase property once again.

Two other factors point to a good recovery: The lack of new construction (which has historically preceded real estate downturns) and that 80+% of the existing rental inventory in Fresno/Clovis is over twenty years old.



THE NEXT BUBBLE—WHERE & WHAT?

In trying to understand the causes of the housing bubble, it was apparent many of the purchasers were speculators and small investors. It has been said that one of the major reasons for buying was not only the rapid rise in housing values (Merced in 2002 was number one in the nation in housing price appreciation) but the horrible returns available in alternate investments. If you look at the chart above, note the rate of the 6 month CD rate from 1995 through 2009. Pay particular attention to the dip that followed 9-11. While the rate drop was great for borrowers (Thank you Greenspan!!), it was catastrophic for holders of CD's, MMA's, Treasuries and other savings instruments. This fueled the demand for alternate, more risky investing such as REIT's, partnership interests and yes, even houses.

So were are we today? Well, because of the Great Recession, the Feds have once again driven down interest rates. In 2009, the 6 month CD rate dropped to 1.49%. *What is even more interesting (I am not sure that is the right word) is today 6 month CD Rates stand at 0.3%.* This is even lower than the rates during the 2001-2004 period. Couple this fact with the fact that, on a global scale, there is UNPRECEDENTED LEVELS of wealth. Consider this fact: in 2000, if you totaled up the entire wealth OF EVERY PERSON & EVERY NATION, it came to 35 Trillion dollars. Today's total: **over 70 Trillion dollars.** While it took thousands of years to get to 35, it took ONLY TEN YEARS to double.

Yesterday, it was a housing bubble (loans bought by Investors/Nations worldwide). Today, there is talk of the existence

of a Commodity/Gold bubble.

So the question is where will all these pools of capital go? It's anyone's guess, but surely not into US Treasuries paying little or nothing!

INTERESTING TIDBITS

- ◆ **WATCH OUT! PROP 13 MAY NO LONGER PROTECT APTS:** You need to be aware of a proposed initiative that supporters are currently trying to get qualified for the November ballot. It would remove both the 1% cap on the portion of property taxes that are based on the property's assessed value, as well as the current 2% limitation to property tax increases for any year where the property is not sold. Additionally it would subject commercial properties to reassessment at their "fair market value" at least once every 3 years.
- ◆ **CAP GAINS RATE WILL RISE OVER 50% AT YEAR END:** Ouch! The Bush Tax cuts end 12/31. In addition, Health Care added a new tax on Cap Gains. Check (AGAIN!) with your Accountant.
- ◆ **SHORT SELLING? CALIF. WILL TAX YOU!!** If you are selling a property on a short sale, you have to pay a tax on the loan discount. You need to talk to your accountant!
- ◆ **FNMA BARS MERS:** Last issue we discussed the role of MERS. Now FNMA will not allow Lenders to foreclose their loans in the name of MERS.



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Why RCK Organization?

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

BRAVE NEW WORLD– SIX TRENDS TO WATCH FOR

- **One– Speed of Change:**
With the Internet, unlimited sources of information, a 24/7 news cycle, economic cycles are rapidly speeding up. Look how fast the downturn occurred in September of 2008. Look to see how fast a recovery will occur.
- **Two– Strong get Stronger:**
When “A” Properties re-price at “B” level rents, “B” properties are forced to charge lower rents at “C” class levels. Through pricing, the strong will gain market share.
- **Three– REO Inventory:**
Watch the impact of fore-closed properties (residential, commercial) re-entering the market as rentals at much lower rental rates.
- **Four– Tax Cuts Ending:**
At the end of this year, the tax rates will rise to pre 2002 levels. This will effect investor behavior both as an Owner as well as a Buyer or Seller.
- **Five– Feds withdraw from Economy:**
In March, the Feds stopped purchasing Residential Mortgage Backed Securities. Within this quarter, they will cease CMBS purchases. Time will tell if the markets can operate without Fed participation.
- **Six– Interest Rate Direction:**
The Federal Reserve is sending signals that their support will soon end. The immediate impact will be minimal because loan demand is so anemic. But once demand rises, borrowers will be competing with the enormous appetite of the US needing to finance debt. The Feds can charge whatever rate it takes to attract Investors. The private sector will need to pay more to get financing.

