

**WREB
 BANKS &
 COMMERCIAL
 LENDING
 SURVEY**



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Rance Gregory is CEO of NBS Real Estate Capital in Portland, Oregon.

1) How do you see the commercial lending/financial market in '08?

I do not see things settling down in 2008 or 2009. The banking and housing crisis likely will continue to drag on until the end of 2009 with a slow recovery beginning in 2010. The banks have not capitulated, therefore, liquidation of their risk positions cannot begin in earnest until they have recognized their losses. Once liquidation occurs, then we will have reached a bottom. Any economic recovery will have to lead through housing. Both banking and housing will take at least 2 years to heal.

There will be minimal capital for conventional debt in 2008 and possibly extending into 2009. Debt will be limited to portfolio lenders, primarily banks and life insurance companies with banks reducing their lending through the rest of 2008. I do not expect conditions to improve in 2008. Financial institutions need to clean up their balance sheets, and investor confidence needs to return before the market can significantly improve.

Given a generalized contraction of available credit, reduced job formation, over-leveraged consumers and weakening bank balance sheets, I can only assume conditions will get much worse before they get better. It is very hard to imagine a bottoming in 2008. We should see a bottom in 2009 or 2010 but we anticipate a slow recovery from that point. We've enjoyed a 15-year expansionary run in commercial real estate. It is only reasonable to assume that a correction will take some time.

2) Is there a sweet spot where you feel comfortable lending in today's environment? What criteria must deals hold today to garner your attention?

We are comfortable originating mezzanine loans up to 85 percent on high-quality real estate with strong sponsorship. We are actively pursuing mezzanine opportunities on most income-producing properties using a current pay/accrual structure.

Yes. Stabilized properties, preferably multi-tenant, at less than 65 percent loan-to-value ratios with financially strong sponsorship.

Since mid-2007, we have mainly focused on underwriting new loans (mezzanine, preferred equity and bridge) and acquiring loans. As a lender, we seek to provide capital to quality sponsors with defined business plans and properties that are capable of servicing debt on in-place income. As a loan buyer, we target performing loans that are being sold by banks and investment banks due to capital markets conditions and not underlying deficiencies in the real estate.

3) Do you find in this market that you are focusing more locally, regionally or nationally?

We are focusing locally where we understand the property markets best, which happens to be the West Coast.

We are focusing on local and regional markets.

As a lender, we have a bit of a broader platform but tend to focus on these same western markets (Colorado and all parts west). Certainly our lending footprint has expanded a bit geographically as we've acquired larger diversified loan portfolios.

4) What is the biggest concern or demand you're hearing now from commercial developer and investor clients?

The biggest concern from commercial developers is that they cannot find non-recourse, floating-rate first mortgage debt up to 75 percent. All of our clients can access the equity and mezzanine market, but are challenged to find conventional financing. This is the most problematic part of the capital stack today.

Some developers are finding it difficult to generate enough loan dollars in a bridge or permanent loan to pay off their construction loans. Lack of capital is also a concern as some properties are not finance-able in today's market.

Investor and developer concerns relate almost entirely to availability of debt financing... That said, the much bigger concern seems to be take-out financing. Western markets are characterized by an enormous tally of construction loans coming due in the next 6 to 12 months. With conduit lenders out of the market, we simply do not have a sufficient supply of permanent first mortgage debt to refinance all these maturing construction loans.

5) What property type should stand out the most during the rest of 2008?

Industrial in strong distribution markets with global reach. Retail and hotels are stressed due to consumer spending and business travel, respectively. Office will deteriorate due to the higher unemployment numbers.

Apartments, multi-tenant industrial and high-quality warehouse/distribution.

Like many investors, we currently rank the product types as follows: 1) multifamily; 2) industrial; 3) office; 4) retail. Multifamily product will benefit from demographic forces including Echo Boomers graduating from high school and college and a relative lack of new construction in recent years.

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1) How do you see the commercial lending/financial market in '08?

The comparison to months of fields mired in dung may be too visual an image for the gentle summer reader. We will simply return to the traditional old days of lending at the end of the year to early next. There may not be a true return until 2010. This is a natural corrective cycle but more extreme given the high leverage from the CDOs. We will see more write downs, bank failures, devaluations and media frenzies before the true bottom has been seen. New, private and foreign money will come to the market. We also need to move past this constant election psychology.

The commercial lending and financing market will continue to show signs of stress in 2008 as the economy weakens and commercial real estate, particularly the retail, office and hospitality sectors, reflects the economic slowdown. The stabilization and strengthening of the consumer, an increased willingness to lend at reasonable rates and an overall reduction of energy costs will help reduce volatile conditions.

We see the year being very weak. Liquidity will continue to be tight until financial institutions clear their bad debt exposure and buyers of real estate securities regain confidence in those markets. Once these events occur, availability of takeout financing should improve.

We project that the current situation will ease when there is a convergence of the buy versus sell price differential on loans being marketed. We feel that the re-emergence of a permanent debt takeout market can only occur after rating agencies regain investor confidence perhaps through government oversight or mandated peer review.

2) Is there a sweet spot where you feel comfortable lending in today's environment? What criteria must deals hold today to garner your attention?

Multifamily and self-storage deals we love! Neither are very sexy but stable, boring ol consistent cash flow cows are suddenly very enticing.

Good location, strong actual debt coverage levels and strong secondary support from the loan's guarantor(s).

The sweet spot is the multifamily sector, including student housing and senior, age-restricted housing. Due to new lender underwriting standards for home purchase financing, fewer potential purchasers will qualify, forcing them to rent. This coupled with the fact the Fannie and Freddie Mac are the major source of takeout financing will allow this sector to remain healthier than others. However, that being said, the classic underwriting metrics must be strictly adhered to in order to prevent over-building.

3) Do you find in this market that you are focusing more locally, regionally or nationally?

Most of the business comes through e-mail. It commonly spreads virally beyond the West Coast to the national market. We focus on California and Nevada, regionally, but I have a request for an international loan probably once a week.

Locally

We tend to be more nationally focused because certain local markets are more favorable than others. This flexibility allows us to capitalize on markets that are better than others.

4) What is the biggest concern or demand you're hearing now from commercial developer and investor clients?

"When will this [stuff] end!?" they say. Competitive sources for loans are not what they used to be. The trite phrase managing expectations is fully utilized. Gone are the days of higher dollars. Everyone wants more money, leverage they're seeking equity and long-gone interest-only terms. There is a demand for refinances as they must be done. Everyone is waiting for the bottom to seemingly continue to drop before purchasing. Construction is particularly difficult at the moment.

Lack of capital in the commercial real estate market.

The liquidity issue is impacting everyone, both in amount of leverage available and even obtaining a loan at any level. Construction financing has been the biggest issue with our clients. For example, we have clients that have a to-be-developed multifamily project with permits and plans in place and ready to start, but they cannot find construction financing. Again, this is a result of financial institutions not having a source to get their existing loans repaid.

5) What property type should stand out the most during the rest of 2008?

Positive standouts are multifamily, particularly senior and student housed apartments, and self-storage. Both are obviously results of people moving themselves and their stuff out of their homes, which are no longer in their own possession.

Affordable multifamily, mobile home parks and industrial.

I would say that multifamily is the easiest to finance at this juncture in the economic cycle, as long as the fundamentals make sense.