



Debt Financing

Prediction: The lending landscape goes back to a normal market. Imagine that, it took almost 18 years but we are back to having income, credit and assets that are real.

I have been through two down cycles now. The first being 1990-91 when I came out of graduate school from The University of Denver with my MBA in Real Estate Finance and Construction Management. I could not find a job as an MBA and started out carrying lumber for a local home builder. My dad told me it would be good for me and he was right.

Many of you know that banks will still make loans going forward but the heaviest interest for lenders, when looking to fund a loan, today is NOT credit or assets, it is cash flow.

Banks went from too liberal to now too conservative but this will mellow as we go back to more normal conditions. Most real estate cycles are 7 to 9 years up with 1 to 2 years down. We were up for 18 Years in our last real estate cycle, this would translate into 2 to 4 years down if conditions were normal but they weren't.

We are seeing the biggest wipe out of debt in history because everyone was allowed to leverage up. The new world order was "the US will continue to spend at any price" and this caught us hard.

Did it cost us our Country? Perhaps, we have yet to see. What it did cost was our reputation because of greed. Greed beyond imaginable.

How could we let this country, that has been held in the highest regard by worldwide investors, go to rot? Greed.

The Fathers of Wall St. decided to buy off on a concept that was concocted at Wharton Business School, called a "CMBS" loan (Collateralized Mortgage Backed Security). They sold billions of these securities to foreign investors and they all lost, BIG. They say this market is coming back but still nobody understands

it. Here are the facts, you have a commercial property that has a debt loan put in place for \$10.M by GE Capital. The coupon (interest rate paid by the borrower) is say 7%. CMBS loans are then cut up in parts and sold to various international institutions, 'the parties'. Going back to the \$10M example and assuming there were 10 buyers, they each would take \$1.M of the loan. If the debt comes due it is a mess and literally has to be 'unwound' costing the borrower big penalties.

A lot of these CMBS loans are in default or have defaulted since we have been in free fall since 2007. Tenants moved out and landlords could not pay the mortgage, giving the properties back. Banks and our President asked for a freeze on foreclosure and property owners trying to work through CH 11 reorganization assistance but without tenants paying rent there is little hope and a lot of properties will go back to the banks or government in 2010. The 10 investor (example listed above) will get wiped out or a significant loss will occur.

GE and Wall Street made BIG fees on the front end plus packaging and selling these loans to foreign investors on the back end but in the end are the securities secure? To date, no.

CMBS is a new security, coming out in the last cycle, and these loans have not performed well. In fact they have been a disaster. These loans help take out construction loans on huge projects like City Center in Las Vegas but is the debt market really getting better? So what will be the new take out loans that will work?

Residentially, FNMA & FHLMC are still not back or being run efficiently costing the American People Billions in losses and hurting our system. The Washington Post article dated Jan 1, 2010 stated:

"The Obama administration's approval of \$6 million benefit packages to Fannie Mae's and Freddie Mac's chief executives is close to criminal [U.S. promises unlimited aid to mortgage giants," front page, Dec. 25]. There is no sane justification for subjecting the American people to such greed and folly."

Barney Frank needs to be put in jail for what he has done, or not done. We have got to get control (through better management) of these most important clearing agencies and do a much better job regulating (reviewing the likelihood of a loan paying thru maturity) the bundled securities that get sold to foreign investors. If investors do not get the returns they are guaranteed then they will not continue to buy these mortgage backed securities which supports our system. We have to do a much better job of managing and analyzing what we sell them.

- ❖ It starts with better loan origination and review of underwriting at the grass roots level.
- ❖ State (not just Federal alone) agencies need to do a better job in reviewing funded loans.
- ❖ We need to hold the 'bad' loans that we discover and penalize mortgage companies, managers, Loan Originators (L/O's), processors and underwriters accountable for their mistakes.
- ❖ We need to sell a much stronger bundled security package to investors to rebuild confidence in what we sell and show that we are doing a better job to manage good and bad loan origination.

So what does this do to trust when Wall St. tries to sell again to foreign investors? It destroys it. Wall Street has destroyed its reputation over the past several years. They are now followers not leaders. Time will tell if trust can be regained. I can tell you that there is no other machine built in the world like the Stock Market with reconciliation of literally billions of dollars in trades a day. This is incredible and until China, Dubai or any other country figures out how to build a better machine then the United States still is a powerhouse.

So, the CMBS market is still not proven and the derivatives Wall Street agencies are still trying to sell in these asset back securities markets are floundering, hurting us all, and the real estate economy as a whole.

In closing, 2009 has been an over-reaction and an abyss. Private equity was non-existent but improving as we go into the New Year. \$163B in commercial real estate loans are coming due in 2010. Banks will have to work with borrowers and figure out how to extend, as cash flow is tight and the 1.25% DCR is out the window. It will be interesting to see if banks (and Congress) reduce the current lending laws. We will see how banks react to over-leveraged projects of past. There will be a lot of deal flow in 2010 which will stimulate all markets, which is good. Assets will be lost and new opportunities, at 50% off, will help bring equity back into the market.

It may take as long as 10 years to get back to a normal market from the start of the crash which started the end of 2007, but the serious wounds are starting to heal. Deals will still be done and we will be there to help those that need assistance whether it be; mezzanine financing, construction financing, permanent loan financing, bridge financing or hard money loans for residential or commercial properties.

If you are looking for debt financing we have many sources and can assist you. Debt relations are the key to a successful project. Sky West has the background and resources to place you with the right relationship.

Please give us a call to schedule an appointment. We look forward to working with you.

Cordially,



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