RCK ORGANIZATION

RCK INSITES

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"EXTEND AND PRETEND" "DELAY AND PRAY"

NEW TERMS FOR THE "*NEW NORMAL*"

With every major financial crisis comes new ways to express what is happening. We thought we would put together a few of the most popular ones being used today.

EXTEND & PRETEND: With $125,000,000,000 in CRE loans coming due annually for the next five years, lenders realize that they cannot enforce the call provisions without severely affecting the underlying value of the asset. The result: they enter into forbearance or loan modification agreements extending the due date anywhere from six months up to two years. Most are suspending the normal underwriting parameters because of their belief that the asset would not re-qualify for the loan. As long as the borrower is not in default and is a capable operator, then the property is in the "best hands." Recent changes by the IRS have made the process much easier for lenders and servicers to restructure debt without tax consequences (see IRS Revenue Procedure 2009-45). Another policy change by the FDIC on Oct 30 now *allows loan extensions and modifications to credit-worthy borrowers without the loan being re-classified adversely even though the underlying asset value has declined.* Another phrase describing the same event is DELAY AND PRAY.

LOAN TO OWN: This is the investment strategy of purchasing mortgages with the intention of enforcing the loan provisions, typically through foreclosure, thereby becoming the fee title holders. These loans could be performing or non-performing. Investors would like a discount but will settle for par if the underlying fundamentals are strong. These types of investors fall into two groups: Those willing to stay in position as a lender for the full term and those who would love for the borrower to default. Investors are interested in both whole loans as well as securitized debt.

NEW NORMAL: This phrase has arisen because of the belief that whatever recovery takes place, we will not return to the yields experienced during the 2002-2006 boom times. This leads us to the next term.

RE-SET: The "Great Recession" (now there's another term...) has caused tenants, businesses and consumers to drive the cost of leases, goods and services down. This is having a major impact on operations. In the boom times, leverage amplified the returns. Today, with rents being reset, fixed debt costs are limiting some owners ability to compete against owners who have much lower leverage. On the other side of the ledger, owners are going back to see if they can lower both fixed *and* variable costs. They are aggressively renegotiating anything and everything.

DE-LEVERAGE: One of the causes of the downturn was excessive debt held by consumers, investors and businesses. Today, consumers (PLEASE SEE PAGE 2)

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. Thank you to those who have sent in great suggestions.

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

SAY IT ISN'T SO...CAPITAL GAINS RATE MAY RISE 69%?!

Recently, a Wall Street Journal editorial pointed out that buried deep within the recently passed House healthcare bill is a 5.4% surtax on incomes above $500,000 for individual or $1,000,000 for joint filers. This surtax is on *modified adjusted gross income* which ***includes capital gains.***

IIf enacted, it will take effect on January 1, 2011, the same day the Capital Gains rate is supposed to rise from 15% to 20%. This means the new tax rate would be 25.4%, a 69% increase !!!

While the tax hike may not survive final passage, you need to stay on top of this. A similar tax hike occurred in 1987 which was precipitated by a "rush for the exit door" by investors seeking to lock in gains prior to the tax hike.

For properties purchased prior to 2002-03, owners need to seriously consider "the right" time to exit the market, locking in their hard fought gains at the current historically low capital gain rate of 15%.

We will keep an eye on this tax change. In the meantime, you should discuss the implications of this tax hike with your accountant.

CONTINUED– NEW TERMS FOR THE NEW NORMAL

saving at historical rates. Businesses are paying off debt where they can. Real Estate investors are seeking ways to convert debt into equity. This final strategy makes sense when investors are receiving extremely low rates of return on their cash investments (CD, MMA). REITS have had great success in their IPO's using the proceeds to retire debt.

SHADOW INVENTORY: Initially, it was thought that all of the newly built or newly converted condominiums being reverted back into rental housing would have a significant impact on rental inventory. Today, there is a much greater threat coming from the thousands of recently foreclosed single family homes bought by investors at unheard of prices. They are putting these homes into the rental pool, offering them at rental rates roughly equal to those of the mid-90's. Stories of rental rates as much as 50% off of previous levels is draining from apartments those tenants who are either seeking: 1)more room (and a yard) or 2) to "double up," (creating 1 household from what may have previously been 2 or more), by providing more space.

SHRINKING AFFORDABILITY GAP: As a consequence of the price drop in foreclosures, the cost of ownership in some markets is actually BELOW the cost of renting, causing a surge in home buying by first timers. These buyers are further spurred on by State and Federal tax credits. Until the supply of foreclosures diminish and current prices rise, this will continue to have an impact on rental demand.

CAP RATE DE-COMPRESSION: In the boom times, the difference between class "A" and "C" properties, as well as between primary and tertiary markets, reached generational lows. Today, spreads are returning to historical norms and investors are gravitating back to core markets and class "A" properties. An analysis of 2009 transactions nationwide shows a preponderance of institutional grade properties being bought and sold. Class "C" properties in secondary markets will have to wait until the "cap-rate bar" is re-set. Then and only then will investors, lenders and appraisers be able to price accordingly. For now, we expect current values will be held hostage by the proliferation of distressed sales which do not accurately reflect current values.

DIVIDEND RATE: Otherwise known as cash on cash return. In the recent past, values were determined by the Market Approach i.e., what price did the building "next door" bring. As the market heated up, less and less attention was given to the income approach. Today, the only sales that are occurring are distressed sales. This has caused the market approach of valuating to be very punitive.

We predict a return to the income approach of determining value. Put simply: ***What is the actual pre-tax cash return after expenses AND debt service on the dollars invested?*** We expect cash on cash returns to be in the 6 to 9% range starting THE FIRST DAY. While this may be a disappointment for many investors, it will be far better than using what few sales that are occurring as a measurement of value.

2010– GET READY FOR A RUSH OF COMMERCIAL REO SALES

For the last year, the CRE industry has been expecting a flood of foreclosures and subsequent sales of distressed properties on the market. But as we approach the end of 2009, the number of transactions has been few and far in between. We need to be careful not read too much into this.

A closer examination reveals lenders were ill prepared to take the losses on their books. A recent survey of 800 banks revealed just 38 cents set aside for every dollar of bad loans. That is a sharp drop from $1.58 for every $1 in bad loans back in January of 2007. The FDIC rehired many of the old veterans from the early 90's to pour over the nation's bank books to see where the "bodies are buried." This has created a large number of "zombie" banks who are only still open because the FDIC is tapped out. The FDIC in late August said their Watchlist of troubled banks reached a 15 year high of 416, up from 305 in March.

To remedy this, not only has the FDIC gone back to the Treasury and Congress to seek additional funds. But, as so many infomercials are quick to add, "But wait, there's more…." To further fund their takeover activities, the FDIC is collecting, in advance, three years worth of premiums from their member banks. While it has been widely reported that the rate of seizures has dramatically dropped, soon they will be able to step up their seizure activity. The FDIC Failed Bank List website which can be viewed at www.fdic.gov/bank/individual/failed/banklist.html .

As a precursor to seizures, the FDIC issues a "Cease and Desist" order to banks who are "under water." Once issued, a bank is not allowed to take in any more "hot" deposits (time deposits bearing over market rates, typically peddled by money brokers) and are given a period of time to raise capital. Once the order is issued, it is very difficult to comply, and many become "zombie banks" just waiting for the day (typically a Friday afternoon) when the regulators move in.

Other banks are urgently replenishing their reserves. This is one of the reasons the Fed is keeping the rate they charge the banks at 0%. At this rate, banks can re-build their reserves to address the losses anticipated from bad loans. Additionally, banks have also been scrambling to build up their asset disposition departments which had been dismantled after the S&L crisis of the early 90's.

By the first quarter, we expect to see an acceleration in foreclosures, short sales and other resolutions of distressed properties. While this story seems to conflict with the trend of "extend and pretend" pointed out on page one, the difference lies with those properties that, operationally, are under water. This may be due to the property being over-leveraged or the investors poorly capitalized. Properties that are experiencing huge vacancies, poor management, or some combination of both, are not candidates for loan modification. The recession has exposed the inefficiencies present in many properties.

There will be great opportunities to acquire assets at generationally low prices. There may also be an opportunity to BUY your existing loan back for a discount. The greatest deals will be made with a Lender who sees that the potential losses caused from disposing of REO's, as well as carrying bad loans on their books will be more than offset by the increase in the value of their stock if they "make the deal." Wall Street looks very favorably on those who have a clean balance sheet…while it's always been true, it's never been more true than it is now.

2009 MAJOR APT SALES ON TRACK TO FINISH AT A NEW LOW

2009 YTD (thru October) apartment sales for major (over$500K) transactions have come in at $13,450,000. At the current pace, 2009 would be projected to close at around $16,140,000, a historic low.

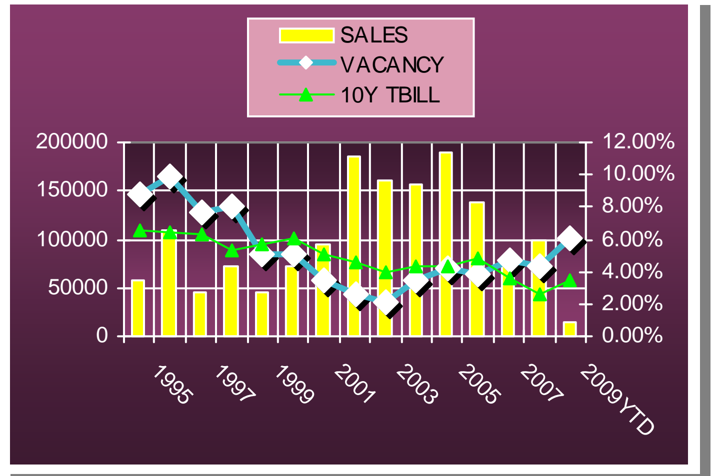
The flow of transactions is hampered in four areas: The recession, a lack of distressed sales , a dysfunctional credit market and (although we hesitate to mention it yet again) a mismatch of Buyer/Seller expectations

The impact of the recession has reduced investor's appetite for risk. Currently, the most active buyers are the opportunity or "value add" investors. These investors demand cap rates for properties not seen since the early part of this decade. Needless to say, there are few takers. With the lack of REO inventory available (see articles on page one and two), the number of transactions has ground to a virtual standstill.

The impact of a lack of available lending sources was never really tested because what few transactions that did occur were either all cash or cash to existing debt.

The total number of '09 UTD transactions are six (6), compared to twenty (20) for all of 2008. Inventory for sale has slightly increased at $110,700,000. At the current sales rate, this represents a 8.25 year supply.

Over time, the gap between Buyers and Sellers will narrow along with a large increase in the number of distressed properties for sale. With the proposed tax changes on the horizon and increasing interest rates, there will a greater sense of urgency to get a deal done in 2010. So while the number of transactions are slated to increase, the pricing will continue to fall in the near term.



REITS HARVEST GOLD IN RAISING CAPITAL

In 2009, just when you thought no one would be crazy enough to invest in Commercial Real Estate, publicly held property REIT's and large private operating companies had a fantastic Spring.

More than 30 of these companies went to the public markets raising more than eight billion dollars in fresh capital. Most of the dollars raised were used to retire secured and unsecured credit lines well as meet any loan obligations that had matured.

Their success came as a great relief to not only the investors, but the managers of these groups. Many had feared that they would be forced to liquidate properties in what is an illiquid market in order to clean up their balance sheets.

In addition, with this new capital, REIT's have been buying back their existing debt, some at various rates of discount, some even at par. It becomes a "win-win" situation. Investors like the de-leveraging that is occurring, while being rewarded with the benefits of debt reduction—usually at a discount. Lenders are all too happy to reduce their exposure to commercial real estate.

We are now hearing stories of private partnerships of well placed institutional grade properties going back to their investor base to discuss an add-on offering or "A/B" partnerships to either reduce the principal or retire the loan entirely. When you think about it, what better place to put your investment dollars then what you already know and understand. Is there an opportunity for you and your investors?

INTERESTING TIDBITS

Here are three stories about Securitized Mortgages you may find interesting:

WHO REALLY OWNS YOUR MORTGAGE?

Ownership of mortgages may change hands many times between lenders, servicers, mortgage pools, etc. MERS or MORTGAGE ELECTRONIC REGISTRATION SERVICE was set up by FNMA, FHLMC and others to act as the note holder or nominee of a mortgage. It simplified the process of assigning loans. HOWEVER, a recent court case in the Kansas Supreme Court questioned who really was the Owner of the Mortgage that was in foreclosure. What rights does a nominee really have? Can they enforce the remedies available such as evictions, receiverships and trustee sales. Well, they ruled that a proper assignment of the mortgage never took place and therefore, the foreclosure was basically estopped from proceeding. Now the actual owners of the mortgage are running around trying to re-record the mortgages. We shudder to think of the chaos if this case holds up.

KICK OUT THE "BAD APPLES"

Managers of CMBS have been closely examining the mortgages in their pools and are discovering that a couple of "bad apples" are spoiling the credit rating of the entire pool. Their solution? Pull out those loans in default and replace them with better, and obviously performing loans. This can have a very dramatic impact on the rating of the pool which in turn effects the overall asset value. Fitch reported seven different servicers traded out 11 impaired assets. They were sold at 2—50% of par. One asset was just wrote off completely. Is there an opportunity here?

EVERYONE IS WATCHING 1st CMBS

This month, the first CMBS offering will hit the credit markets. It is $400MM in bonds secured by 28 shopping centers owned by Developers Diversified Realty Corp. The demand is expected to be very strong and most likely will be over-subscribed. This is a very important milestone to help re-establish the CMBS market.

R C K ORGANIZATION

545 East Alluvial Avenue Suite 111
Fresno, California 93720

559.449.0700
559.449.1104 fax
Email: rckane@rckorg.com
glarkin@rckorg.com

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**

STAIRWAY TO HEAVEN IN 2011

OK, while heaven may be a bit overdramatic, it is becoming quite apparent that 2010 will be the year that separates the "winners from the losers". The best way to describe 2009 was a year of shock, re-adjustment and just surviving. As we approach the first quarter of the new year, you need to plan on where you see yourself and your business in the coming decade. More importantly, who are the people who can achieve your goals? Are you and your employees, partners and associates prepared to work hard to capture and increase your share of the market.

The time for excuses is over. 2009 was a horrible year. But now's the time to *get over it.* You can either continue more of the same or make the decision to change and improve.

*"...And a new day will dawn, for those who stand long..." **

For the last several years we have been the harbingers of gloom and doom forecasting the downturn we are now experiencing.

Here's the deal: WHAT ARE <u>YOU</u> GOING TO DO ABOUT IT?

No—it will not be easy.
Yes— there are troubling signs ahead of all us.
But now is the time to develop your plan for the future.

*"...In my thoughts I have seen rings of smoke through the trees and the voices of those who stand looking...Ooh, it makes me wonder..."**

There are three kinds of people in this world:

- those who wonder *WHAT HAPPENED,*
- Those who sit on the sidelines *WATCHING IT HAPPEN*
- Those who *MAKE IT HAPPEN.*

Which group will you be in d 2010?

*From "Stairway to Heaven" - Jimmy Page & Robert Plant, 1971