



**Private Real Estate Capital**  
www.jcrcapital.com

**JCR Capital Market Update**  
**June 10, 2008**

Dear Friends & Colleagues:

As a salute to summer, this version of the JCR Capital Market Update will be in an “easy to read,” brief highlight form.

Pick what you like.

**The Market**

The market continues to be filled with only “have to’s.” These are people who “have to be in the market.” No one wants to be in this market. “Have to’s” occur due to:

- Loan defaults
- Equity pressure to exit
- Partner problems
- Personal situations: Death, divorce, illiquidity

No one wakes up in June of 2008 and says, “good time to sell real estate.” Thus, real estate volume is drastically down.

**Lots of Capital, Few Deals Getting Done**

There is an over abundance of “opportunity equity capital,” and not enough distress to go around. Since there is very little debt available, equity must achieve 15-20% un-leveraged returns, which is hard to do without “market capitulation.”

This market has not yet seen capitulation. The Fed has done a good job of keeping the banks afloat and investment banks liquid. The current discounts offered by lenders on non-performing loans are not large enough to allow for the required un-leveraged returns.

**Where were you in 1992?**

1992 was the last time the real estate capital markets had a serious dislocation. Yes, 1998 was bad for some, but the capital markets did not go through a structural change like we are currently experiencing.

If you did not go through the 1992 or the “RTC days,” this is all new to you and you are most likely in a state of shock or panic. If you did go through 1992, you know how quickly values can change and why cash is king. Yet, you also know a thing or two about distressed assets, including:

- Forbearance agreements
- Foreclosure
- Judicial vs. non-judicial foreclosure
- Bankruptcy

- Redemption periods
- Reps & warranties
- Deed in lieu of foreclosure
- Lender liability
- Cram downs
- Cash for keys

**In our continuing effort to educate, we have attached a slide called “The Distressed Asset Life Cycle.” It helps put the “distress process” into context.**

### **Are We There Yet?**

No. The ride looks like it’s getting longer, not shorter. The CMBS model is going to be rebuilt before it gets back on the road. Here are a few things to look for at the CMBS asset level.

### **Asset Level Underwriting: New World Order**

- **Real LTV’s:** 70-75% maximum loan amount, based on higher “exit caps” and trailing-12 NOI.
- **Real NOI’s:** Based off of trailing-12 month performance (the average of the last 12 months).
- **Real cap rates:** 7.5-8.5% will be the norm.
- **Real valuation:** Market and location will matter again. All cash flow will no longer be treated equal.
- **Real sponsorship:** Sponsorship experience and financial strength will matter again.

### **Securitization Level: New World Order**

- New regulations/rules for CMBS bond rating are in the works.
- New rules for how rating agencies interact with investment banks are in the works.
- The originating/underwriting lender will most likely need to hold some risk – skin in the game for all.

### **So Now What? Where do I get a Loan?**

This is going to take a while. So, for the time being it’s:

- Banks (look for underwriting to get tougher as the year goes on)
- Life companies (very selective)
- Freddie/Fannie/FHA (multifamily or health care)
- Private lenders: JCR Capital, among others

The contraction of securitized debt will lead to the emergence of private lenders, who will have to charge more for debt as their cost of capital will be much higher than the bank/S&L’s and other government insured programs. This will in turn make leveraged ROE’s harder to achieve. This will in turn bring down the price/value of commercial real estate.

**This was demonstrated on the previous JCR Market Update – “The Best Power Point Slide Ever.” If you did not receive a copy, please let us know.**

### **Where is all of the Distress?**

A lot of distressed equity capital is seeking a home. Commercial distressed assets are few and far between. If you want distress now, don't expect income producing assets – it's land and condos.

#### **Land**

The land distress is most available in the following pecking order in terms of availability, which is the inverse order of desirability:

- Un-entitled land
- Approved/non platted
- Platted
- Finished lots

*There are land opportunities in the market and they are growing. JCR Capital does provided debt and equity for such situations.*

#### **Condos:**

More condo distress is coming: Look for more condo mark downs and write offs in the second half of 2008 and early 2009. Banks will have to let them go as interest reserves run out, and developers cannot carry them. Many cities such as San Diego, South Florida, and Denver will get a fresh supply of distressed condos in late 2008.

#### **The Death of the Golf & Cigar Guy:**

For the past five years, just knowing someone who needed a loan or wanted to buy real estate was enough to make a good living. Those days are gone. Intellectual capital is back.

**Real estate professionals now must know the business. They must be well-versed in NOI, ROE, IRR's, promote structures, cash flow waterfalls, leveraged ROE, the return multiple, cash on cash return, loan constants, etc. If you don't know these concepts well and want to learn, click here: <http://www.youtube.com/watch?v=liZ13e5r7Cc>**

#### **2008 - What to Look For in the Second Half of the Year:**

- Forget about CMBS in 2008.
- Look for the emergence of smaller, higher priced private lenders.
- Look for regional banks and community banks to start selling non-performing notes and REO in the second half, especially in the fourth quarter.
- Look for the bid/ask gap on performing assets to continue.
- More capital will form for distressed deals, but there will not be enough distressed deals to go around.
- Look for distressed equity to create new ways to put this new money to work.
- Get used to real underwriting and real valuation analysis. History will view 2005 & 2006 as aberrations. We are not going back there any time soon.