

Distressed Real Estate

Crittenden Research, Inc.

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FUNDS BRIDGE LENDING GAP

With the painfully slow leaching of distressed commercial assets hitting the market, equity funds look for ways to get their money moving in the meantime. **Cobblestone Group** offers up bridge and construction loans including a deal for a parking lot in Denver. **JCR Capital** works with a potential client who is pursuing a note purchase from the FDIC. **Marcus and Millichap Capital Corp.** arranges a hard money bridge note to help a borrower with a maturing loan, and **Pathfinder Partners** considers jumping into the tempting lending market with its second opportunity fund.

The biggest wave of commercial real estate mortgage failures is expected to hit next year and some anticipate banks losing as much as \$300B, which will make lending even harder to come by. Commercial property values have fallen more than 40% since 2007 and more than half of the \$1.4T in CRE loans coming due are under water. Of the approximately \$3.5T of outstanding debt associated with CRE, about \$1.7T is on the books of banks and thrifts, according to the Federal Reserve Board. Along with losses caused by decreasing cash flows and eroding construction loans, additional losses will escalate due to depreciating collateral value underlying the maturing loans. This will put huge pressure on smaller regional and community banks with high concentrations of CRE loans. While many borrowers are upside down because of decreasing cash flows, oftentimes a troubled bank can put a borrower in a distressed situation despite the fact that the property is achieving enough cash flow to service the mortgage. If banks are willing to work with a discount and borrowers are willing to pay the higher yields of a bridge loan, a solution can be reached quickly and ultimately benefit the borrower.

Cobblestone Group targets lending to borrowers after finding it too difficult to navigate the tangled distressed asset and debt acquisition landscape. Cobblestone started lending about a month ago and is already bombarded with deals. The group works on a construction loan for a parking lot in Denver at 50% LTC and an interest rate in the high teens. Managing Director **James Carenza** boasts a very flexible structure with no defined interest rate. Loans will be competitively priced but will be on a deal-by-deal basis. Borrowers must put some skin in the game, however, to get any help from Cobblestone. Terms will run about 12 months depending on the deal.

Carenza thrives on messy situations that involve bankruptcies and litigation, as cash solves all those problems. Cobblestone will engage his attorney and work through the traffic jam with all parties. And while it takes a long time, in the end, it's worth the payoff. Carenza looks for mid-range deals between about \$5M and \$20M with the need to make between \$1M and \$1.5M on the investment. Carenza envisions transitioning from the debt side to the mezz side once banks come back. Cobblestone's fund is a true private money fund with \$100M available for immediate investment from a Canadian high-net-worth individual.

JCR works with one potential client who has a note under contract to purchase from the FDIC. JCR could come in and be the debt on the note for about \$0.35 on the dollar of the original principal balance. The company provides short to mid-term bridge loans with a defined exit strategy as one of many products it provides to the CRE industry, including participation in debt, preferred equity and equity. Principal **Jay Rollins** states the firm closed a \$20M in March but it remains open for new investments for 90 more days. The starter fund is likely the first step in series of funds, as JCR hopes to eventually have \$500M under management. In regards to bridge loans, interest rates will range from 10% to 15% with fees of 1% to 3% and run six months to two years on LTVs of 60% to 80%. There is no prepayment penalty and no yield maintenance. The company has also signed up three deals involving office, multifamily and land.

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Associate Director of Marcus and Millichap Capital **Ian Harrison** has a multifamily refi transaction that he is working on where the loan is maturing and the loan balance to market value is nearly 100%. Due to pressure from the regulators, the bank is not willing to extend or renew the loan despite the fact that the property has sufficient cash flow. This has put the borrower in a situation where he must sell or pursue a discount of the note balance via a bridge loan. Marcus and Millichap has arranged a hard money bridge note in an effort to discount the note, with the goal to refinance into a permanent FHA 223 program within the next year.

The lending market is piquing some interest for Pathfinder Partners, which explores some equity recap deals. Pathfinder has four separate funds under management and has the parameters in its *Pathfinder Opportunity Fund II* to lend. The company has enough equity to buy \$400M to \$500M in assets and debt over the next 18 months. Lending could be a good fit for the fund as Sr. Managing Director and Co-Founder **Lorne Polger** looks to recirculate its capital as quick as possible.

FDIC MOVES LOANS OFF BOOKS

Loan sales are a hot target right now, as CRE sales barely simmer and many financial institutions are prolonging foreclosures. Investors craving a piece of the distressed pie can find some interesting options through the FDIC, which is anxious to get the loans off its books and markets options through approved advisors. **First Financial Network, DebtX, Garnet Capital Advisors, Mission Capital Advisors** and **Eastdil Secured** maximize returns and go through an extensive process that includes valuation, underwriting, marketing, selling and closing the transactions. Portfolios are analyzed by loan size and type, performance commonality, underlying collateral and geographic distribution before grouping them into smaller pools. The advisor group has grown from two to five firms in the last several years and it's likely more advisors will come online as many expect up to 500 more banks to hit the skids this year. But others think the volume won't be as great as expected because the FDIC is dealing with an overwhelming amount of structured debt.

This downturn shows significant growth in the number of qualified buyers waiting to jump on the next opportunity, bringing local investors to the table that might otherwise purchase real property, while sellers continue to strategize their approach. Boutique firms and smaller investors aggressively bid on specific loans or diversify possible risk through several loan pools. Discounts vary from 8% to the mid-30% range, but many of the failed bank's assets are actually performing. Banks increased capital by extending loans in 2007 and 2008 and head toward financial stability, so they can begin dealing with troubled loans. The required rate of return depends on the seller. Wall Street might be looking up, though recovery for the CRE market will be longer than first anticipated.

First Financial prepares portfolios that will come out later this year and is going through the analysis process with numerous banks that look to spread their losses through 2010 and 2011. CRE loans comprise 30% of First Financial's total sales. The Oklahoma City-based firm is in negotiations with potential buyers on a portfolio of three loans totaling \$20.6M for a community bank, not through the FDIC. It includes a \$4.8M non-performing loan for a retail property in Bloomington, Ill., and performing loans for two hotels in Champaign, Ill. President and CEO **Bliss Morris** points to the troubled CMBS market as a sign that CRE won't improve for several more years, with more than a trillion dollars either delinquent or heading that way.

Morris began her career with the FDIC/RTC during the S&L crisis and, in 1989, established First Financial, which handles the FDIC's more complex and politically sensitive portfolios. The company also performs subset services for the FDIC on structured loan sales, even if it doesn't complete the final sale. Loan sales were part of the S&L solution, but buyers were few and selling platforms were just being developed. Today's technology draws more savvy buyers, however, Morris warns of new, inexperienced firms popping up to capitalize on the market activity.

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DebtX sells \$94.6M of non-performing and performing CRE, agriculture and consumer loans for the FDIC. **Independent Bankers Bank** in Springfield, Ill., originated the loans that are primarily located in Illinois and Indiana. The portfolio includes about 100 notes, with 14% classified as non-performing. Boston-based DebtX will sell most loans individually and will open bidding on April 20. DebtX, a full-service loan sale advisor for commercial, consumer and speciality finance debt, sees more income producing properties coming online this year. CEO **Kingsley Greenland** believes pent-up demand for commercial assets, especially multifamily, will attract more buyers looking for loans and note pools.

New-York based Garnet Capital offers \$70M in mixed-loan types that include \$25.9M in C&I loans, which originated from the failed **Barnes Banking Co.** in Kaysville, Utah. Barnes' doors shut on January 15. The C&I pool includes 248 assets that have an average loan balance of \$104K. Non-performing loans represent about 27%, which are mostly owner-occupied businesses. The transaction closes on April 23. Garnet received the FDIC contract in 2009 and closed its first sale in January. Managing Partner **Lou DiPalma** sees new interest from foreign banks and sovereign funds. He notes that warehouse lines and commercial mortgage conduits are also selling loans and that pricing has improved five to 10 points, depending on the product.

Garnet launched a JV with **The Ackman-Ziff Real Estate Group LLC**, allowing them greater access to real estate owners and developers. Last year, Garnet mostly valued loan portfolios and advised clients to hold off on selling, but that's starting to change. The pipeline contains about \$200M of non-performing leases, as well as \$100M of non-flagged hotels, mixed-use and A&D from a large, healthy bank. Garnet is also closing deals on A&D loans in the Midwest and hotel loans in the Southeast. About 20% of the firm's business is from the FDIC, which is expected to increase.

Mission offers an FDIC \$5.4M loan/lease portfolio from the failed **Bank of Leeton** in Leeton, Mo., and **Marshall Bank, N.A.** in Hallock, Minn. Nearly half are non-performing or sub-performing and the portfolio includes C&I assets. Bidding begins at 2 p.m. EST on April 13. Mission Capital also offers a \$12.3M loan portfolio, including non-performing, sub-performing and performing notes, from the same banks. Slightly more than half the loans are performing with an average balance of \$650K. The 18 loans range from \$15.5K to \$2.8M and are secured by multiple product types, such as office buildings, hotels, residential, healthcare facilities, business assets and land. The close date is April 14.

Mission Principal **William David Tobin** targets new investors that could be the next **Starwood Capital Group** or **Fortress Investment Group** and that have an aggregate buying capability of \$50M to \$200M. Mission generally uses a seal-bid process with dual bids — indicative and final bid rounds — and sells about 74% of its offerings once closed. Commercial loans typically trade individually and the smaller pools attract more strategic funds and private equity groups.

Eastdil will close \$6.5M in C&I and consumer loans on April 15 for assets previously held by **Citizens State Bank** in New Baltimore, Mich. The portfolio consists of 146 non-performing and performing loans. Twelve loans carry a balance of more than \$100K, while the remaining loan balances average \$12K.

THE BIG FIVE TACKLE COMMERCIAL DEBT

With acquisitions and mergers occurring regularly since the financial collapse, some banks post more CRE losses after the transition. **Bank of America Corp.**, **JP Morgan Chase & Co.**, **CitiGroup Inc.**, **Wells Fargo & Co.** and **U.S. Bankcorp** analyze how the growing amount of distressed assets and non-performing loans will impact their bottom line. Many banks reduce debt through dispositions and run-off, while others have reorganized to handle increasing debt balances and to work with stressed borrowers.

Though some execs anticipate the worst is behind them because lending was mostly tied up in home mortgages, other insiders speculate the problem is just beginning and could take at least three years before signs of recovery begin to show. Lending remains at a standstill, but credit is starting to flatten and could improve late 2010.

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CRE fundamentals won't pick up in the short term as the sector experiences a long-term adjustment in value. Anticipate rents and values to drop further and cash flow for owners to remain next to nothing. Net charge-offs (NCOs) for C&I loans increased 37% or \$2.3B, according to the FDIC. Banks continue adding to their reserves in anticipation of more losses. The typical credit cycle lasts six to eight years and occurs in three phases — the market cycle, consumer cycle and C&I loans. These loans dropped an average of 17% industrywide last year due to waning demand rather than an influx of product. Overexposed to credit risk, the pendulum has swung the other way for these financial giants, as they employ stricter underwriting practices. For now, stressed borrowers could find some relief in lower interest rates.

Bank of America's President and CEO **Brian Moynihan** feels the bank is well positioned to mitigate future losses, especially since it doesn't carry a great deal of risk in small retail and hotel lending, although he remains wary of the CRE sector. Excluding homebuilder activity, BofA's non-performing commercial loans and foreclosed properties totaled \$4.8B, rising from \$1.2B in 2008. Distressed loans in the following segments account for the increase: \$729M in office, \$546M in multifamily, \$1.1B in shopping centers/retail, \$160M in hospitality, \$442M in industrial/warehouse, \$416M in multi-use, \$968M in land/land development and \$417M in other loans either unsecured or not secured by the property. Outstanding CRE loans, which include homebuilders, increased \$4.7B to \$69.5B. Those in California top the list at \$14.2M followed by the Northeast, Southwest, Southeast and Midwest.

Moynihan feels the outlook on credit is improving, although BofA likely won't return to historically low normal credit costs for at least several more quarters. The bank carried about \$8B in non-performing CRE loans and foreclosed commercial properties at year's end, however, Moynihan contends distressed CRE isn't a big issue for BofA because it has about \$10B in the portfolio's reserves. Half of the bank's charge-offs in 2009 came from its homebuilder portfolio, while CRE posted only about \$1.5B in the last two quarters. The bank had approximately \$2.2T in assets at year's end.

Citigroup CEO **Vikram Pandit** plans to further debt reduction measures through business dispositions, asset sales and run-off. The bank internally reorganized into Citicorp and Citi Holdings, which handles assets no longer central to its strategy and represents 30% of the bank's total assets. Citi Holdings' CRE loans, leases and letters of credit totaled \$13.5B or about 94% of the face value. In North America, CRE loans were \$10.6B, with about 3.4% past due 90 days or more. Citi Holdings reported losses of \$8.2B last year versus \$36B in 2008. The division includes local consumer lending (LCL), a special asset pool and brokerage/asset management, which comprise about 65%, 28% and 6% of Holdings' total assets, respectively. CRE represents 4% of LCL. The special asset pool (SAP), a portfolio of securities, loans and other assets, will be reduced through sales and run-off. CRE write-downs in the SAP pool were \$1.3B. Pandit notes that approximately \$61B in assets will be transferred from Citi Holdings to Citicorp this quarter, mostly consisting of high-quality U.S. mortgages and corporate and commercial assets. Citigroup's assets were about \$1.9T at year's end.

Wells Fargo deals with the problem assets and loans it assumed from the Wachovia merger, burdening it with a CRE portfolio larger than many of its peers. The bank wrote down \$5.6B in Wachovia's purchased credit impaired CRE loans at year's end. CRE losses were expected to peak in the second half of 2010, however, Chairman and CEO **John Stumpf** expects the numbers will beat original projections. The bank's portfolio includes real estate mortgages and construction loans that posted combined outstanding balances of \$134.5B or 17% of the total loans. Construction loans tallied nearly \$30B and CRE loans comprised the remainder, with most originating in California and Florida. They represented 22% and 11% of the loan portfolio, respectively. By product type, office buildings and industrial/warehouse properties totaled almost 35%. Wells' legacy CRE portfolio had smaller balances and more owner-occupied assets before the merger. Stumpf notes Wells Fargo closed deals in the debt portfolio by recognizing the losses and grouping problem assets. The bank had about \$1.3T in assets at year's end.

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Crittenden National Real Estate Conference: April 25-27, 2010
Hard Rock Hotel & Casino, Las Vegas

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U.S. Bank serves 24 states, with California, Washington and Oregon carrying the greatest percentage of CRE at 21.8%, 9.7% and 5.2%, respectively. Percentages by property type were 32% for owner occupied, 16.5% for multifamily, 13.2% for retail, 10.5% for office, 5.3% for hospitality and 4.4% for industrial. NCOs in U.S. Bank's CRE portfolio totaled \$614M in 2009, or more than half of the total. In Q4, charge-offs rose 7% and non-performing assets increased 5%, and U.S. Bank Chairman, President and CEO **Richard Davis** notes that future quarters should fall in this range. The bank might be close to the inflection point, there is still erosion in its credit book. The bank continues to add to its loan-loss provisions — money the bank likely won't get back, so Davis is careful not to over-fund or under-fund the reserves. U.S. Bank is trimming down its reserve build from 100% to 25% and first quarter 2010 will fall under 25%. The bank is the smallest among its peers with \$281B in assets as of December 2009.

Davis expects the bank's non-performing assets to continue rising in 2010, but at a slower rate. CRE comprises \$34B or 17.5% of the bank's \$195B in loans. Its non-performing and delinquent CRE loans increased from 3.3% in 2008 to 5.2% in 2009. Non-performing CRE assets rose from about \$1B in 2008 to \$1.8B in 2009, including \$581M in commercial mortgages and \$1.2B in C&D loans.

Todd Maclin, CEO of the JP Morgan commercial banking business, believes the bank carries less risk in its CRE portfolio compared to its peers. Even so, CRE losses comprise 64% of the total losses, with the largest being \$584M in loans originated by Washington Mutual before the merger. Maclin doesn't expect more problems within the portfolio, although he thinks prices will drop further in some markets. Outstanding real estate loans totaled \$29.2B in Q4 2009, while commercial lending decreased 16% for the year. To make up for the revenue loss, JP Morgan increased loan pricing by 40% or about 60-basis points when loans reach maturity — approximately one-third of the loans turn over annually. The loan-loss reserve ratio rose from 2.45% to 3.12% year over year. Regionally, commercial term lending is \$15.4B in SoCal, \$10.4B in NoCal/Pacific Northwest, \$7B in the eastern U.S., \$2.6B in central U.S. and \$584M in Florida. The NCO rate by respective region is 0.11%, 0.56%, 1.2%, 1.5% and 22.4% — the losses in Florida alone tally 39% of the bank's CRE losses. JP Morgan's average commercial loan is \$1.4M and the average property is 20 units.

BOUTIQUE FIRMS PROVIDE BIG SERVICE

Anticipating the growing needs of distressed commercial real estate owners, **Ocean West Capital Partners** and **Voit Real Estate Services** target troubled properties in the western U.S. Ocean West envisions closing several deals in the next few weeks, as the company focuses on working with banks and servicers in California that don't have the resources to handle the volume of issues coming their way and by capital constraints. Voit, which provides a full-service platform for individual properties or portfolios, picks up several assignments with banks and should close several more in the next few weeks.

Commercial real estate continues to battle weak fundamentals and sluggish investment. And even though many feel the bottom is near, the coming months are expected to bring increased default rates due to the record credit issuance in 2006 and 2007. Loans are still defaulting at a record pace and velocity. One source states that CCC credit ratings experience a 40% default within five years, so it's likely that the worst glut of defaults are ahead, leaving lenders and servicers trying to figure out how to handle the mess. Add to that the approximately \$1.4T in CRE loans maturing in the next four years. Banks and servicers are starting to move slowly but restructuring and recapitalizations are still at the beginning. Transactions that are taking place, for the most part, are back-door deals.

Ocean West is very close on a few deals with special servicers, so bet on an announcement soon. The fledgling firm's main focus is trying to do off-market structured deals with banks and servicers, and the company has the background to get it done. Principals include **Russ Allegrette**, **Ted Bischak** and **Phil Choi**, formerly of Maguire Properties/Investments, **Troy Miller** from Centerline and attorney **Peter Swain**. The group has executed more than \$50B of CRE transactions; restructured more than \$3B of troubled real estate debt and sold more than \$10B of loans secured by CRE. The principals have also managed more than 55 million s.f. of CRE and over 6,000 apartment units.

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MULTI-FAMILY LISTINGS

Stone Ridge Apartments

3025 N. 32nd St.

Phoenix, AZ 85018

Units: 61

Price: TBD

Occupancy: 70%

Year Built: 1968

Auction scheduled for May 5, 2010

Walter Driggers, Tranzon

One N.E. First Ave., Suite 301,

Ocala, FL 34470

(352) 369-1047 or wdriggers@tranzon.com

Coral Gables Apartments

10522 Beechnut St.

Houston, TX 77072

Units: 318

Price: \$5.2M

Year Built: 1979

Occupancy: 69%

Todd Marix, HFF LP

9 Greenway Plaza, Suite 700,

Houston, TX 77046

(713) 852-3457 or tmarix@hfflp.com

Fairfield Trails Apartments

10750 Westbrae Parkway

Houston, TX 77031

Units: 276

Price: N/A

Year Built: 1984

Occupancy: 75%

Todd Marix, HFF LP

9 Greenway Plaza, Suite 700

Houston, TX 77046

(713) 852-3457 or tmarix@hfflp.com

Overlake Apartments

7920 NW 21st St.

Bethany, OK 73008

Units: 338

Price: Under Contract

Year Built: 1975

Occupancy: 25

Eva Wills, CBRE

1200 N.W. 63rd St.

Oklahoma City, OK 73116

(405) 272-5300 or eva.wills@cbreok.com

Stockbridge Apartments

3328 Euclid Ave.

Cleveland, OH 44115

Units: 77

Year Built: 1911

Occupancy: 57%

Linda LaFleur, Keller Williams

30400 Detroit Road, Suite 100,

Westlake, OH 44145

(440) 892-2211 or linda@justcalllinda.com

Highland Knolls Apartments

3691 Buford Highway

Atlanta, GA 30329

Units: 70

Price: \$1.75M

Year Built: 1965

Occupancy: 80%

Marc Robinson, Southeast Apartment Partners

Piedmont Center 15,

3575 Piedmont Road N.E., Suite 100,

Atlanta, GA 30305

(404) 442-5600 or mrobinson@seapts.com

Live Oak Manor Apartments

1610 E. Martin Luther King Dr.

Abbeville, LA 70510

Units: 119

Price: Unstated Minimum; Earnest Money: \$75K

Year Built: 1972

Occupancy: 75% (as of Dec. 2008)

Becky Alrubaiie, HUD

801 Cherry St., Unit 45, Suite 2500

Fort Worth, TX 76102

(817) 978-5815 or becky.s.alrubaiie@hud.gov

BOUTIQUE FIRMS PROVIDE BIG SERVICE...*Continued from Page 6*

Ocean West will deploy capital to purchase assets and debt or invest in distressed situations. Hold periods will vary by deal. Banks and servicers want to get out as quick as possible, so Ocean West will get the property stabilized and then likely sell in two to five years. Pure investment plays will run five to seven years. The company doesn't want to be tied down to a fund with expectations right now, since the market is so slow and deals are taking months to close.

Ocean West will put in some of its capital and is also managing investments for a half-dozen separate accounts, which include some international money, pension funds, opportunistic funds and high-net-worth individuals, looking for returns in the mid- to high teens. Ocean West's sweet spot is offices and apartments in California, where it has a strong background with those asset classes. Ocean West targets Class A and B, 40,000-s.f. properties and higher. But smaller middle market properties provide better opportunities from an investment standpoint with less capital chasing those deals. If a bank has a defaulted loan for an office or apartment and the borrower is tapped out and isn't going to commit any more equity, Ocean West can work with the bank to come in and take over management, infuse capital to stabilize the property and then sell it 24 months or so down the road.

Voit has several specific assignments with banks and Managing Director **John Strockis**, who joined the team from CBRE, credits that to the firm's confidentiality and strong underwriting. Chances are Voit will announce new deals in next few weeks in the western U.S. Voit changed its focus from development to management of distressed assets late 2008, when CEO **Bob Voit** saw the tide turning. The company recently added **Matthew Stephenson** as an asset manager. Stephenson was formerly a VP with **Buchanan Street Partners**. The FDIC is coming under increasing pressure to get its money back and bring assets to market, and Voit is working with some of the banks on the troubled watch list to help map out a game plan for their troubled loans. The debt-free company implemented all new software systems so it can be a resource and advocate to managers of distressed real estate, including special servicers and the FDIC. Voit Real Estates Services can scale asset management, property management, market research, property leasing and sales, financial underwriting, construction and development services. The firm provides clients with strategic alternatives to allow owners of distressed real estate assets to maximize proceeds while minimizing risk. Voit will JV with banks on Class A assets and will also recapitalize existing partnerships. The firm works with numerous sponsors that are looking to allocate funds in the commercial arena.

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