



October 14, 2010

Dear Friends & Colleagues,

Over the past couple of weeks, JCR Capital has attended the following real estate conferences, and we wanted to share our thoughts on the “pulse of the market”:

- ⇒ IMN’s 2nd Bank & Special Asset Executive Forum on Distressed Real Estate
- ⇒ IQPC’s 6th Global Forum on Investing in Distressed Debt
- ⇒ CMBA’s Western States Commercial Real Estate Finance Conference

I have condensed for you the major themes, key points, and of course added some of our own observations. As always, we welcome your feedback.

The Market Paradox

These are strange times we are living in. We are continuing to experience the pain of deleveraging in our industry, at the same time that new leveraging programs are starting back up. More simply, new “stabilized lenders” are entering the market, at the same time, default rates continue to rise, foreclosures and workouts are increasing, and distressed real estate continues to grow. We are used to seeing markets that go up or down, but not both at the same time.

The New Loan Underwriting

The new lenders are seeking the perfect loan:

- ⇒ 75% LTV
- ⇒ 1.25 DSC
- ⇒ Solid rent rolls
- ⇒ The 10-12% debt constant
- ⇒ Primary markets

For the “new lenders,” these loans are hard to find, and when they are found, the rates are very competitive.



Inside this issue:

- “Pulse of the Market
- New Loan Underwriting
- Rise in Commercial Loan Defaults
- Opportunities & Challenges Ahead

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The Rise in Default Commercial Loans

There are two types of defaults:

- ⇒ Payment default: Debt service cannot be paid current.
- ⇒ Maturity default: The loan matures and sponsor cannot or will not refinance the loan.

While we have been seeing payment defaults for some time, we will now be seeing more and more maturity defaults. The major difference now is how different lenders are managing their maturity defaults.

Bank loans: Not as aggressive on maturity defaults. Extensions continue to be available for the loans that can pay interest current.

As the old banking saying goes, “a rolling loan gathers no loss”.

The banking system is just too fragile for banks to demand payment on both payment defaults and maturity defaults. The result is good news for existing borrowers, as they stay in the game. However, this is bad for future borrowers, as the bank’s commercial real estate portfolio will be at full capacity for some time to come.

All lenders are not created equal. The better the balance sheet the bank has, the more likely they will sell notes and clear their books.

Money center banks: They will extend the larger loans and are starting to “clear” the smaller loans via foreclosure/REO and note sales.

Regional banks: They are getting tougher on extensions. They will still do them, but expect more foreclosures and note sales.

Community banks: They have the hardest time. They cannot afford to foreclose, because they can’t take the write downs. Don’t expect to see much product from these banks.

CMBS: They are very different from banks. They have no franchise value to protect, and loans need to be collected. Special servicers vary in their approach, but tactics include:

- ⇒ Note sales: Becoming more popular. Look for a lot more small balance note sales.
- ⇒ Recapitalizations: This requires real money from the borrower – no pretending with the CMBS lenders.
- ⇒ Restructures: These can happen, but will include paydowns and cash sweeps.

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Opportunities and Challenges Ahead

Expect a bifurcated market for some time to come. We will be in the “dual mode” for some time. There will be new loans and workouts in the same market at the same time for the foreseeable future.

Predictions

Determining real value will continue to be a challenge:

- ⇒ Rents will continue to soften
- ⇒ Occupancy will remain fragile

As foreclosed properties re-enter the market with a lower basis, they will create rent and occupancy pressure on their submarkets.

Lenders and buyers must look at each submarket and determine if distressed properties will reset their rent and occupancy assumptions.

Note sales: Look for a major increase in offers of small balance commercial note sales from \$500K-\$5MM.

Less capital: Banks will be stuck with legacy loans for some time, and will not be aggressively back in the market.

Emerging capital: JCR Capital is one of the new emerging capital providers. JCR specializes in:

- ⇒ Borrower note repurchases
- ⇒ Non-performing loan purchases
- ⇒ REO acquisitions

JCR Capital Commercial Real Estate Finance

Investment Overview:

- ⇒ Borrower note repurchases
- ⇒ Note financing
- ⇒ REO financing
- ⇒ New acquisitions
- ⇒ DIP loans
- ⇒ Special situations

Investment Products:

- ⇒ Debt
- ⇒ Equity

Deal Size: \$1-10 million

Terms: 6 months-3 years



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Submitting Deals to JCR

JCR Capital will review investment opportunities between \$500,000 and \$10MM. For the quickest response, please complete a JCR Capital Fast Track Deal Form (see attached), which can also be downloaded from our website:

<http://www.jcrcapital.com/pdfs/Fast-Track-Deal-Form.pdf>

*As always, we welcome your
feedback and questions.*