Reinhart

Boerner Van Deuren s.c. Attorneys at Law

WEEKLY REAL ESTATE REPORT

THE MADISON REAL ESTATE GURUS

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ASK THE REAL ESTATE GURUS

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As we continue to struggle with the crisis that is currently gripping the financial markets, we want to take this opportunity to share our thoughts on the impact that the turmoil is having on the commercial real estate markets.

State of the Commercial Real Estate Market. The commercial real estate market is still not, at least on the local level, suffering from bad fundamentals. We are not seeing the see-through office buildings that we saw in the late '80s and early '90s when there was substantial over-building. In some of the larger financial markets such as New York, we are beginning to see office vacancies increase as some of the large financial institutions either disappear or retrench. We expect this trend to continue. We also expect to see some trickle down so that even the local market is impacted (as reflected, for example, in Whole Foods deciding last week to cancel its Madison/Hilldale project). The question of whether we are in a recession has been replaced by the question of how deep the recession will be or whether it will turn into a depression. Inevitably this has resulted in a sharp drop in consumer confidence and will lead to a continuing decline in retail spending. This will undoubtedly result in certain businesses failing, increasing vacancies.

State of the Commercial Financing Market. The commercial financing market is extremely tight. Conduit financing is virtually non-existent. Even life insurance companies have been caught in the fray (*e.g.*, AIG) and those that are lending have become far more conservative. The use of low-floating bonds has become suspect as the rates that investors are demanding as a return when they buy these bonds have skyrocketed. For example, low-floating bonds that typically have been marketed at about the LIBOR rate are now marketed at 4 to 5 points in excess of LIBOR (meaning rates in excess of 8%). Traditional bank financing has returned as the principal mechanism to finance transactions. Needless to say, with the nervousness in the banking community, even these transactions are very difficult to put together with both lenders and their appraisers becoming far more difficult to satisfy.

Status of the Transaction Market. As a result of the foregoing, we are seeing far fewer purchase and sale transactions occurring. The issue has shifted from whether cap rates are too low to whether a transaction can even be accomplished considering the financing environment. Similarly, the tax-deferred exchange market has also weakened considerably. More taxpayers who are selling are now considering whether to take the tax hit now, rather than try to reinvest in real estate. Almost everyone believes that the historically low capital gains tax rates will rise when the next administration takes over.

So, What Can We Learn From the Current Crisis?
Leverage creates risk. While we have all understood that leverage creates both greater risks and greater rewards, the current crisis has once again reminded us how quickly equity can disappear when properties are under-capitalized. While investors have enjoyed sitting at the closing table pulling cash out of projects as they were refinanced at low cap rates and high valuations, we should not forget the increased risk that results from increased debt. Having a rainy day fund is certainly very helpful. Although the commercial real estate markets have remained relatively stable, as those short 3 to 5 year bank notes come due, borrowers should expect increased scrutiny from both lenders and appraisers.

Assumptions. We can no longer rely on certain assumptions that always helped guide investors' decisions. For example, when investors entered into swap transactions with counter-parties such as Lehman Brothers and Bear Stearns, they assumed that they did not need to worry about the strength of such counter-parties. As we have learned, when those entities took on greater leverage, the risk to the average real estate investor who entered into swaps with such entities increased dramatically. Similarly, as investors entered into interest rate hedge agreements while they waited for the conduit transaction to be committed and closed, they put up substantial sums to lock the interest rate. As the conduit financing dried up, they saw those funds become subject to forfeiture, notwithstanding that both the borrower and its project remained financially strong. Finally, we saw that lenders would rely on the "material adverse condition" provision in their loan commitments to avoid closing loan transactions.

Duration. While we hope that the financial rescue legislation that President Bush signed into law on Friday, October 3, 2008, will provide some stability to the markets, it is clear that the crisis is not over. If housing prices continue to drop we will continue to see the ripple effects throughout the entire economy. The commercial real estate market will inevitably be adversely impacted.

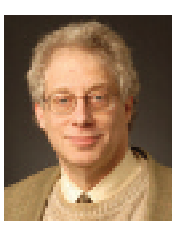
What to do? First, we must all keep in mind that adversity also creates opportunities. Remembering back to the last significant real estate crisis of the late '80s and early '90s, those investors who hung on and struggled through the difficult times were richly rewarded when the market returned. Similarly, there are opportunities as lenders try to dispose of their bad loans. We have seen a significant amount of buying of bad loans by investors who have purchased at a price that they believe takes most of the risk out of the transaction. Investors with available capital may want to consider buying distressed real estate that has sound fundamentals.

Second, try to keep ahead of the curve. Make sure you keep on top of when loans come due and plan far enough in advance so that you can find a lending solution. Calling a mortgage broker and expecting to receive 4 or 5 proposals in a short time from conduit lenders and life insurance companies no longer works. Plan ahead and be realistic. We are blessed with some very talented commercial lenders in our community and they can be of enormous help.

Third, do not take any actions that could cause you to default under your loans. In particular, non-recourse conduit and life insurance loans have some "bad-boy" provisions in their guarantees that could turn your non-recourse obligation into recourse debt. For example, trying to further encumber such properties with secondary financing often triggers such a result. Interestingly, courts have recently been very willing to enforce the "bad-boy" guarantees and hold guarantors personally liable.

Finally, as is always true with commercial real estate, investors need to fully understand the tax implications of anything they do with their property. Even giving back over-encumbered property to a lender may result in both the imposition of ordinary income and capital gains taxes. This unfortunate result may arise even when there is no cash available to pay the tax. Always consult with us or your tax professional before taking any action.

At Reinhart we have enjoyed the opportunity to work with you through some very strong real estate markets. We also look forward to working with you during these difficult times so that you can be among those who successfully navigate these difficult waters.



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Have a question for a Real Estate Guru? Click here!

CURRENT RATES

		[Associated Bank]()	[Grandbridge Real Estate Capital LLC]()	[US Bank]()	[Bank of America]()
Apartment/Multi Family Loans	Rate	L*+ 200-250	6.10% - 6.60%	L*+175-200	L*+175-225
	Term	Up to 10 Years	10 Years	Up to 5 Years	5 Years
	LTV	80%	80%	Up to 80%	80%
	Amortization	Up to 30 Years	Up to 30 Years	Up to 30 Years	Up to 30 Years
Retail/ Office Loans	Rate	L*+ 220-275	6.55% - 6.95%	L*+175-225	L*+175-225
	Term	Up to 10 Years	10 Years	Up to 5 Years	5 Years
	LTV	75%	75%	Up to 80%	80%
	Amortization	Up to 25 Years	Up to 30 Years	Up to 30 Years	Up to 30 Years
Commercial Loans	Rate	L*+ 220-275	6.55% - 6.95%	L*+175-205	L*+175-225
	Term	Up to 10 Years	10 Years	Up to 5 Years	5 Years
	LTV	75%	75%	Up to 80%	80%
	Amortization	Up to 25 Years	Up to 30 Years	Up to 30 Years	Up to 30 Years

**L equals the Libor swap rate for the applicable period*

Maturity	**Today**	**Last week**	**Last month**
5 year Treasury	2.63%	2.69%	2.91%
10 year Treasury	3.61%	3.58%	3.70%

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