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PROMUS MANAGEMENT

Commercial Property Financing in 2008 – More Trouble on the Horizon?

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It appears halfway through 2008 that the fallout of the sub-prime residential lending mess and its subsequent effect on the commercial financing market, in particular the securitized Conduit market, has now taken shape for the foreseeable future.



Even though Treasuries are near the historic low 2003 levels (which saw sub-five percent long-term Conduit and Insurance Company financing rates), today's mid- to long-term rates are nowhere near the previous levels.

Gone are the low spreads of 100-150bp from Conduit Lenders, as most have withdrawn from the marketplace. Of course, there are still some Conduits who are still promoting their lending with spreads approaching 400 bp. Contrasting May 2003 to May 2008, the only thing similar is the Treasury bond yields with a 10 year Treasury showing 3.57% (2003), compared to 3.90% (2008).

With the departure of the Conduits, the bulk of the fixed rate financing fell to the Insurance Companies, Pension Funds and Banks/Credit Unions. Although these are mainly portfolio lenders not subject to selling loans in the secondary market to investors who are requiring higher yields than in prior years, these lenders have typically maintained a minimum of 225-300 bp spread in order to keep their yields up.

While adjustable rates can still be found around 5%, the longer term 5-10 yr fixed rate market is trading in the high 5%-high 6% range today. Historically, this would have been considered a good rate. However, investors got spoiled by the sub-6% loans of the past few years (and in some cases sub 5%). This portion of the market is finding rates over 6% to be distasteful, and having a difficult time digesting a 10 yr fixed rate today at 6.5% or higher.

And while insurance companies are still running 10 yr fixed rates in the low-mid 6% range, that money has limits and loan dollars are typically more conservative and amortizations shorter (20-25 versus 30). Insurance Companies also usually have a limited amount of funds to loan each year. This compares against the unlimited pot of money typically available to the Conduits and many bigger banks.

With delinquencies increasing and further pressure being put on the economy from inflation, job losses, and spending pullbacks, it is likely we will continue to see a changing landscape in the commercial financing market.

Several industry analysts have recently estimated that commercial real estate values will drop 20% over the near future. In fact, cap rates have risen 50 bp on average since the meltdown began.

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But the truth is that deals are still being funded, albeit more slowly than before. Huge lenders like Citibank are sitting on the sidelines while other more active lenders have either reduced loan maximums or raised rates to slow down the deal flow. Loan to value ratios are becoming more conservative, as is underwriting.

Certainty of execution is becoming more important than ever – especially on purchase transactions. So many buyers are now turning to banks for their loans, although recourse is the order of the day for most banks.

Bottom line from this seat: there’s still plenty of money out there for purchase and refinance opportunities; it just may come at a higher rate and possibly lower loan to value and shorter amortization.

If you live in or near a major metropolitan area, you are more likely to obtain more flexible nationwide financing from major money center lenders located on the east or west coasts – including 30-year amortizations and longer-term fixed rates.

Just make sure to give yourself plenty of time to shop around for the best deal. You may also want to use a seasoned commercial mortgage professional to assist you, as many programs that may be available are not necessarily from locally-based financing sources.

Cutting Your Operating Costs



Wherever your property is located, odds are excellent you’re seeking ways to cut operating costs. Utility costs, insurance, advertising, personnel, fuel and maintenance expenses have all jumped, even as occupancy rates have been sinking.

Increasingly, the challenge is to mitigate costs without sacrificing appearances or the level of services your property offers.

One simple solution is to consolidate your property service contracts and develop a bulk-bidding program.

By properly structuring a bulk-bidding program, you can potentially save up to 30% from the costs of certain contract services in the first year!

Creating your bulk-bidding program is easier than you might imagine – just follow these simple steps:

1. Develop logically related categories, such as janitorial, elevator maintenance, landscaping, etc.
2. Create a pre-selected vendor pool from which to solicit bids
3. Provide tight specifications for each vendor in each trade category

The potential savings to be garnered from aggregating all your properties within a region into a single service contract for each trade category should typically more than justify the labor required on your part to establish and manage the bulk-bidding process. In the experience of the Promus Management team, the break-even can be reached at as few as five properties.

Investors with fewer than five properties can also benefit from the advantages of the Promus Bulk Bidding Program, which takes advantage of our portfolio size for the benefit of your commercial investment property.

Our current economy demands a tighter eye be kept on every dollar, whether coming in or going out. Given that reality, wise investors can take this opportunity to reduce service costs without sacrificing quality or service.

Aggregating service contracts is an excellent way to start that process.

Food for Thought

"Give a man an inch...
and he'll rent it."

-- Jacob Braude



What the Future Holds

The Southern California Area Government and SANDAG (combined report) expect there to be almost 29 million people in the bottom part of the state by 2030. So we dug a bit further and examined each county every five years to see just where those people will be.

Here's what to expect by county:

County	2010	2015	2020	2025	2030
Imperial	222,000	256,000	299,000	345,000	395,000
Los Angeles	10.6 million	11 million	11.6 million	12.1 million	12.7 million
Orange	3.2 million	3.3 million	3.4 million	3.6 million	3.8 million
Riverside	2.1 million	2.4 million	2.8 million	3.2 million	3.6 million
Santa Barbara	2.2 million	2.4 million	2.7 million	3.1 million	3.4 million
Ventura	855,000	910,000	982,000	1.05 million	1.13 million
San Diego	3.2 million	3.4 million	3.5 million	3.7 million	3.9 million
Total Projection	22,377,000	23,666,000	25,580,000	27,095,000	28,925,000

About Promus Management

We satisfy the nation's most demanding commercial property owners with our unique combination of skills, blending national credentials in commercial building management with an unprecedented local commitment to service.

We recognize building owners need to know that everything necessary to ensure a property's success has been anticipated and will be handled properly. From due diligence to leasing, management to upkeep, we recognize the importance of communications and prompt attention to both client and tenant needs.

Call Scott Cook today at 858-751-6300 for a free needs assessment of your property, and learn why Promus is the property steward of choice for discerning owners.