



BOND STREET CAPITAL NEWS

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Why I Write This Kind of Newsletter

Why do I write this newsletter? Is it because I am a glutton for criticism? I certainly do have my critics. I get criticism for my writing style, my grammatical mistakes (using "then" and "than" inappropriately, drives Mark Savan crazy), too much "bad news", not enough "good news", and not enough info on our great loan programs and on and on. If I were thin skinned I would take up knitting and stay out of the fray.

So why do I write about issues facing our industry when it would be so much easier to send out a puff piece every week with our closings or our programs? I'll tell you why. It's because it forces me to think about the "big issues" of our business. Where we are going as an industry? Are we going in or coming out of a credit crunch? Should I expand or contract our company? Should I go on that sabbatical to study tribal cultures for the rest of this year?

I receive an amazing number of responses from my readers. With so many newsletters and media pieces to read it's quite gratifying that many of you take the time to respond to my newsletters. It doesn't matter whether you confirm or dispute my positions. Either works for me. So, I will continue down this path until it becomes clear that as an industry we have moved into a stabilized environment and I can move on to more mundane tasks such as closing loans and playing golf.

THE NEWS!!

A 1.24 Billion dollar conduit pool went to market last week, priced very wide, and finally sold through all of the tranches. **YEAH-** we finally have a market. **BOO-** this deal priced very wide and had a very low subordination level (27%). The deal lost a ton of money. (My guess is over twenty million). Now some folks will finally breathe because something sold giving them pricing guidance. However, if you extrapolate that pricing to the folks in the small balance business for example, they will have to price in the high 7% range to be in the money. Ouch, not much demand from borrowers for loans priced in the high 7% range just now. In the larger balance loans, pricing will probably be a little better, but still not a lot of takers when our portfolio money is cheaper with much better terms. Still, most folks in conduit land will view this as a very positive development. **One question remains:** Did t his pool contain generic loans or was it specially crafted to

have minimal risk? If so, we didn't accomplish much with an estimated 100 Billion dollars of 2007 poorly underwritten loans still on the books of the investment banks.

This "positive" news comes too late for many folks. Last week **another good company shut down its commercial lending operation**. It's not public yet so I can't say who it is, but I am sure most of you will know soon enough. The shutdown was not due to losses or a lack of profitability. The parent bank has been taking on water because of reckless residential lending and now its capital is so impaired that it can't put capital intensive commercial loans on the books. Without a confirmed ability to sell the paper through to the capital markets, the doors were shut on the commercial real estate lending operation.

Why is all of this important? Because as the Capital Markets go, so goes the fate of many businesses. Never has it been so clear how reliant our industry is on the liquidity generated through selling loans into the Capital Markets. Whether its church loans, CTL product, plain vanilla or sub-prime commercial, many lenders relied on the Capital Markets to generate the liquidity they require to be in business. Without securitization, their business model was doomed and the doors slammed shut.

This is not good for anyone. Portfolio lenders will eventually fill up and money will dry up unless these markets come back and come back quickly.

Will we see a credit crunch at the level of the early 1990's? For those of us that lived through the early 1990's real estate depression in California, we know that you can have a market devoid of capital. The business of commercial lending all but vanished for a major portion of the players in the business when the S&L's were crushed. The collateral damage to our industry was vast.

Now, I DON'T THINK THAT IS WHERE WE ARE TODAY. But it is foolish for any of us to ignore the reality that the status quo has changed for not just a short time but perhaps forever. THE CAPITAL MARKETS WILL NOT BE THE SAME AS THEY WERE IN THE LAST FEW YEARS AND ANYONE WAITING FOR THEM TO COME BACK to 2006 levels is frankly smoking the wrong kind of lettuce.

To get a good feel for where we are today, think 1996. We had money available from banks and the surviving thrifts, there was some capital market activity, but **commercial lending was done by the book**. Marginal borrowers and marginal deals did not get institutional funding. There were different versions of the **lending bible** but everyone was a follower. That, in my opinion is where we are heading. Expect tougher underwriting, higher pricing and lower leverage. **Pray for the return of the Capital Markets!**

Winners and Losers in Commercial Lending

There will be winners and losers in this market as there are in every market. Who wins and who loses? Here is my list of the moment:

The Winners:

Portfolio and Hard Money Lenders: lenders originating loans targeted for their balance sheet will find plenty of product with good borrowers at wide yields. Hard Money lenders will fill the space where commercial sub-prime lenders dwelled. Most of those guys are gone, gone, gone.

Strong Borrowers with Cash: leverage in general is heading down. That means that borrowers with cash, experience and good credit will get the best priced financing and will be more competitive to acquire the best assets. Marginal players will not get the financing or will find that their cost of financing is extremely high.

Competent Commercial Mortgage Brokers: are back in vogue. Clients now need brokers because their traditional sources of capital are gone. It will be a big year for these folks if there is still money out there looking for a home. **Show them the money!**

The Losers:

Capital Markets Lenders: Any lender relying on the Capital Market to purchase loans is either now out of business or will be severely limited. Unless you have a balance sheet behind you or a flow origination deal, you may be out of business.

Marginal Borrowers or Marginal Properties: When there is market disruption, there is a flight to quality. Lenders will not take the risk on marginal borrowers (think less than 640 FICO) or will take it **but will really price for it.**

Incompetent, Uninformed (LAZY) Mortgage Brokers: Quality borrowers with quality deals are always hard to come by. These borrowers will demand excellence in who they work with. Brokers without experience, access to information or proper support will be unable to deal with the much tougher scrutiny that each deal will now require.

Did I get it right? Whom did I miss? Do you disagree? **Send your comments to jforman@bondstreetcapital.com**



Coming Soon!