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Liquidity Crunch Hits Real Estate—CLF Continues Funding and Originating

CMBS markets remain in turmoil as the "world wide margin call" and associated liquidity crunch hits conduit lenders and REITs hard. Driven by unsettled world markets and the melt down of several major hedge funds, investors continue to be drawn to the quality and liquidity of U.S. Treasuries—drying up funds which would otherwise be available for investment in corporate bonds, CMBS and other asset backed securities. The result has been a sharp drop in treasury rates which saw the 10 yr. bond plummet to a low of 4.15% in early October, while corporate and CMBS spreads widened dramatically. For example, when Mac Saver Financial Services, a unit of Heilig Meyer (BB) issued a 10 yr. corporate bond a year ago it traded at 160 over the 10 yr. treasury—one year later it is trading at 900 over! CMBS spreads have followed corporate spreads, more than doubling in the last 90 days. By mid October, 10 yr. AAA rated paper reached 210 over in the secondary markets and demand for BBB and below rated paper became non existent, especially in light of the bankruptcy of Crimi Mae and the sale by Amresco of its below investment grade portfolio. The result:

- Major conduit lenders such as Nomura, Lehman, C.S. First Boston, Conti Financial, WMF, CitiMae and Amresco have stopped or drastically curtailed lending either because they don't know where to price transactions or lack the liquidity to make loans.
- Literally every capital markets lender **except CLF** has exited the CTL market and life companies are increasingly selective as to which CTL transactions they will finance.
- CTL deals are being quoted with fixed floor coupons—generally starting at 7.0 to 7.25 for the best credits.

Despite the "liquidity crunch" CLF is continuing to originate and fund CTL loans. Since the beginning of August we have funded/ committed over $200MM of loans. CLF's ability to continue to lend in today's market reflects its in-depth expertise and focus on CTL lending, strong support from its financial partner Hyperion Fund and warehouse lender BankAmerica, the quality of its CTL loans—over 95% of which are with investment grade tenants and the continued strong quality loan origination by its correspondents.

"Hot Button" Lease Terms

Thirteenth in a series to help your borrower obtain the best credit lease financing.

Ground Leases with Ongoing Construction

Given today's market conditions and increased rating agency sensitivity to loans based on ground leases where the construction is not complete, borrowers need to be sensitive to what can and cannot be financed as credit before construction is complete.

The rating agencies view a ground lease for a building under construction as problematic because if the building is not completed the collateral underlying the loan will be less valuable, especially if the tenant is able to abate rent or terminate the ground lease if construction is not completed.

Generally the most financeable situation is where the borrower has a date certain ground lease at full rent, the credit tenant is responsible for building and construction is underway. While a lender may hold back some funds in escrow to assure the building is eventually completed, the ground lease can be financed. On the other hand, if a third party is responsible for construction, even with a date certain lease, it will be difficult to finance the project prior to completion since the tenant is likely to be able to terminate the ground lease if the project is not completed because he did not get the "benefit of the bargain" of having a completed building.

Bottom line—if construction is involved, we strongly recommend that your borrower consult with a CLF originator to make sure the ground lease can be structured and financed prior to the completion of construction. This is especially important if a borrower is buying a property and expects to finance the purchase by financing the ground lease.

CREDIT UPDATE

Sainsbury (J.) PLC parent of U.S. grocery retailer Shaw's has been downgraded to A stable from A+ reflecting the company's loss of market share in its U.K. market. **Shaw's U.S.A.** without its parent company guarantee is considered non investment grade.

Boston Edison Co. was upgraded to A- from BBB as the company's financial condition has benefited from the divestiture of significant excess generating capacity.

Columbia HCA's outlook has been revised downward to BBB negative reflecting management's debt to capital ratio target of 55% and strong competition.

The Sports Authority has been removed from negative credit watch and is now rated BB- stable as a result of the termination of the merger agreement with Ventor Group Inc.

Toys "R" Us, Inc. rated A+ was placed on negative watch after the company announced it will take a $678MM pre tax restructuring change. It is likely the company will be downgraded in the near future if earnings are weak.

McDonald Corp and Mobil Corp's ratings have been reaffirmed as AA.

Health South Corp's outlook has been revised to BBB negative from stable because of ongoing pricing pressures and the possibility that the company will repurchase its stock.

PhyCor Inc. has been downgraded from BB+ to BB negative watch due to weakened earnings prospects and increasing debt levels.

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