



CAPITAL Insight

- The U.S. economy is beginning to stabilize and investors are slowly coming out of their tortoise shells. As the U.S. begins recovery, things will slowly begin to look brighter for the rest of the world. The current recession is the worst downturn in economic activity since the Great Depression, but barring more government "salvation" we have hit bottom.
- Global real GDP growth has been negative since October 2008. U.S. GDP bottomed in the third quarter, and employment will lag by about a year. At a 3% annual real GDP growth rate, it will take until April 2010 to get back to where we were a year ago.
- Employment is still falling, but at a declining rate. Early in 2009, monthly job declines were wiping out 500,000-700,000 jobs. In July, that number had diminished to about 250,000, but increased to 265,000 the next month. The unemployment rate stood at 9.7% in August.
- There are signs that capital markets are beginning to work. Quarter-over-quarter through the second quarter of 2009, yields on 10-year Treasuries have risen to 3.5%. We believe 10-year Treasury yields are still some 125 basis points too low. They have risen by 145 basis points as of mid-August 2009, from their low of 2.1% in December 2008. If all were normal, 10-year Treasury yields would be around 4.75-5%, where they hovered before October 2007. Nonetheless, we are reaching pre-TARP levels. The S&P 500 rose by 15% in the second quarter and by an estimated 12% in the third quarter. NAREIT's Equity REIT Total Index rose by 60% between March and August.
- Recently, LIBOR and 30-day Treasuries have raced to zero. The LIBOR spreads over 30-day Treasuries in June were an average of 22 basis points, versus a peak of 351 basis points in October 2008. The average spread over the past month compares to the 286-basis-point average from 2003-2006. A low LIBOR has become the life blood for many borrowers with floating rate debt.
- Spreads have narrowed on corporate debt, providing more evidence that investor jitters are subsiding. In February 2007, 10-year AAA corporate spreads over Treasury were 67 basis points, before exploding to 268 basis points in March 2009. They have since declined to 178 basis points over 10-year Treasuries as of September, though still slightly above the 10-year average of 142 basis points.
- Commercial mortgage delinquency rates have risen across the board, most visibly at banks and thrifts, and CMBS.
- Equity markets have rebounded, with five straight months of S&P 500 gains. Since bottoming at 676 in March, it has risen by 54%, and stood at 1,400 in early September, 33% below its peak in October 2007. This rebound in equity pricing is good news for the property sector as it will slowly work its

continued on page two

CAPITAL

continued from page one

way through to commercial real estate.

- The under-pricing of real estate has gone from almost 70% to about 10% over the past quarter, reflecting the strong rebound in REIT prices. This model still shows substantial underpricing of both BBB bonds and commercial real estate based on their long-term risk characteristics, reflective of a lost faith in "risk" in the face of investor fear.

- Although most of the facts reveal bad news, the economy has bottomed and is on the road to recovery. Historically, the U.S. economy has rebounded in ways that were unimaginable at the time and usually within two years of a recession. In the 24 months following the other two super-recessions, 1973-1975 and 1980-1982, uniform (not annualized) growth was registered: Real GDP grew by 10% and 14%, respectively; employment grew by 6% and 8%; automobile sales rebounded by 49% and 15%; industrial output grew by 19% in both cases; construction increased by 33% and 66%; housing starts had rebounded by 100% and 25%; the unemployment rate fell by 250 basis points in both instances; and real wealth rose by roughly 9.1% and 8.2%, respectively.

- The point is that when we do hit bottom (and we believe we were there in July 2009), there will be a far more robust pick-up than any of us can credibly forecast. And we will rebound even in the absence of rules.

Excerpted from "Is This A Recovery?," a new white paper from NAI Global's Chief Economist Dr. Peter Linneman. Visit www.naiglobal.com/publications to download the full white paper.



Recent Financings

WSI Sale Leaseback Fond duLac, WI Industrial - \$2,295,000	Birchwood North Branch, MN Apartments - \$1,500,000	Franklin II Franklin, WI Industrial - \$4,950,272
BridgePoint S. St. Paul, MN Industrial/Mixed Use - \$1,585,189	Block Apartments Minneapolis, MN Apartments - \$900,000	Corner Shops Maplewood, MN Retail - \$2,750,000
316 Larpenteur Maplewood, MN Apartments - \$864,000	PaR Systems Shoreview, MN Industrial - \$4,350,000	Dalquist-Nordic Ware St. Louis Park, MN Construction - \$4,000,000
Creekridge I & II Bloomington, MN Office - \$8,058,500	Shoppes at Riverdale Commons Coon Rapids, MN Retail - \$2,200,000	Southwind Apartments Bloomington, MN Apartments - \$1,400,500
Multifamily Portfolio St. Paul, MN Apartments - \$985,000	Eden Square Eden Prairie, MN Industrial - \$1,222,650	Valley Square Eden Prairie, MN Industrial - \$1,825,200
International Square Golden Valley, MN Industrial - \$2,802,150	8849 Wentworth Ave S Bloomington, MN Apartments - \$1,185,000	Cedar Bridges Bloomington, MN Apartments - \$1,655,000
Pairings Food & Wine Market Minnetonka, MN Retail - \$1,500,000	Dalquist-Nordic Ware St. Louis Park, MN Industrial - \$4,940,000	Upper Landing Commercial St. Paul, MN Retail - \$935,000
Oakwood St. Cloud, MN Apartments - \$2,740,600	Hadley Business Center Oakdale, MN Industrial - \$3,000,000	Oakdale Interstate Business Center Oakdale, MN Industrial - \$5,250,000

Excerpt from NAIOP'S Development Magazine

featuring Welsh Capital's Peter Austin



In short, although it may seem as if more firms are lining up to dive into the workout business, a spectrum of distress is emerging and it is widely expected to worsen before it improves. Distress runs the gamut from maturing loans, loans in technical default, loans in actual default, loans foreclosed and CMBS debt under the control of special servicers.

A few sobering statistics:

- Foresight Analytics LLC, based in Oakland, Calif., estimates that there is some \$814 billion in commercial mortgages maturing in the next three years.
- According to Credit Suisse, CMBS loans coming due will grow to \$42 billion in 2010 and \$69 billion in 2011, up from \$15 billion this year. Moody's expects the aggregate rate of delinquencies among U.S. CMBS loans to reach five to six percent by the end of this year.
- Real Capital Analytics' Troubled Assets Radar reported in July that the volume of commercial properties in distress more than doubled in 2009 versus 2008, with the value of assets in default, foreclosure or bankruptcy at over \$107 bil-

lion. While hotels and retail properties are the most problematic, office distress is up 118 percent year-to-date.

Searching for Solutions

Peter Austin, senior vice president of Welsh Capital, said that the in-house mortgage banking division of Minneapolis-based Welsh Companies LLC is doing about 50 percent of the business it did in 2008 and much of that volume is in the multi-family category. He believes that we will be well into 2010 before a meaningful turnaround; the crucial period will be the next 12 to 24 months.

"We tell clients to be more pro-active, be in constant contact with lenders, dialogue early," he said. "If you want an extension you need at least six months to figure out a Plan B." He also advised owners to "go out and visit properties: make sure they're in good shape, that there are no angry tenants and be adept at dealing with issues. Lenders are looking more at the developer than anything else. You have to tell the story."

Austin said that some solutions with commercial banks have involved chang-

ing non-recourse to recourse loans, with more leverage; or arranging for a banker to provide a line of credit that's personally guaranteed. "There is some mezzanine financing but the yields are in the mid- to high teens, so it may be better to get a personal line of credit. People have brought in partners, with fresh equity. But that's rare."

For non-performing loans, solutions are achieved on a case-by-case basis, depending on the lender. He remarked that some lenders are hesitant to foreclose and prefer to keep the borrower in place if there is hands-on ownership rather than an absentee landlord.

Austin noted that it is easiest to work with a borrower's existing lenders. "But expect a lot more scrutiny of rent roll, TIs, rollovers," he said. Moreover, even if tenants are paying what may be above-market rents, lenders will likely underwrite based on current or lower-than market rents.

Excerpt from "Inside Finance," *Development* magazine, Fall 2009.
www.naiop.org/developmentmag

Transaction of the Quarter



Recently a client that had just signed a 10-year lease with a government entity on an 11,214 SF industrial condominium needing substantial improvements came to Erik Johnson for a solution. The appraisal didn't support the client's 100% financing request, which included acquisition costs, improvements, and soft costs since it was based on market rents, not the lease rate. The client was not interested in

amortizing the loan over the 5-year term since they had an 'out' clause after year five of the lease.

The borrower pledged an unencumbered mixed-use property in Minneapolis as additional security, which essentially "plugged the hole" caused by the shortfall in value. The lender then provided a permanent loan with a 25-year amortization and a five year fixed interest rate.

W E L S H

C A P I T A L

4350 Baker Road
Suite 400
Minnetonka, MN 55343

EXPERT ADVICE, UNPRECEDENTED ACCESS, POWERFUL ADVANTAGES.

Our Commercial Loan Group can make a big difference in the successful closing of your investment financing. At Welsh Capital, we're financing specialists. Unlike a local bank, we have extensive real estate experience and a variety of local and national funding options which provide our clients with a powerful advantage.

For more information on financing contact:

Peter Austin

Senior Vice President
952.897.7813
paustin@welshco.com

Jason Hardy

Senior Associate
952.897.7893
jhardy@welshco.com

Lucas Goring

Associate
952.897.7703
lgoring@welshco.com

George Zeller

Senior Vice President
952.897.7798
gzeller@welshco.com

Erik Johnson

Senior Associate
952.897.7718
ejohnson@welshco.com

Kip Dunkelberger

Vice President
952.897.7755
kdunk@welshco.com