PLETTER

AUGUST, 2007

1031 EXCHANGE DANGERS: **Recently two different 1031 exchange companies went under with $71Mil and $115Mil in trust funds. The facilitators were using the constant float of about 50% of the funds to invest. In the case of the larger company, the money was invested in real estate deals. These deals were either bad; or, slow to mature. The facilitator didn't have the money when the exchange funds were demanded to close deals. You can see the nightmare for the clients. I.R.S. was uncooperative. The clients were under contract to close new transactions with all contingencies "waived". Lastly; the clients had to hunt and fight to try and get their money returned.**

Some little known facts about exchanges are: (1) This is a completely unregulated industry. (2) A Client has the right to negotiate where the exchange funds are invested during the exchange term. You can also negotiate what rate of interest is to be earned on the deposit; and, who gets the interest. (3) The Client has the right to be a co-signer on whatever account the money goes into - - so; the facilitator does not have complete discretion over the funds. As long as the Client cannot have access to the money, the exchange qualifies.

SUBPRIME RESIDENTIAL MARKET AFFECTS COMMERCIAL: **All those subprime residential loans (2/28 financing where the borrower pays 5.5% during the first two years; then, 7.875% or more for the next 28 years – with a hefty prepayment penalty) are affecting commercial real estate lending. The residential loans are all placed in Mortgage Backed Securities (MBS) and sold to investors in various "traunches". This is an effort to make the sum of the parts worth more than the whole. Some investors have traditionally "bought" the lowest rated traunches. Such investors would get the least credit worthy portion of the pool of mortgage notes(** ***known as the "b" piece)*****. Or; this could even be just the late payment fees from the delinquencies. When 26% of these loans become delinquent; and, or, go into foreclosure, these investors panic. With foreclosure, even the late fees become questionable.**

A vastly smaller version of this residential situation could arise in commercial lending. The underwriting criteria have been stretched over the last 4 to 5 years through the efforts of "Conduit" lenders. The conduits have offered interest only periods in the loan; 30 year amortization; and, 80%+ loans to value. The loans made by conduit lenders go into MBS as well. The risk is sold off to investors in the same fashion as it is sold in the residential market.

The investors who hesitate in the residential market are also going to pull in the reins on their commercial investments. We have had insurance company lenders raising the spreads over the treasury bill from 150 to 178. Wells Fargo announced on the 23rd of July that they were exiting the Subprime residential loan market.

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