

SEPTEMBER 2007

Interest Rates: Because of the turmoil in the money market, investors have departed from the stock market and invested in U.S. Treasury Bonds. This has driven the 10 year U.S. Treasury yield down to the 4.35% area from 5.10% just weeks ago. The Insurance Company investors have been unwilling to believe that this drop is a lasting trend. As a result, they have continually raised their “spread” over the T-bill to keep lending in the 6.25% to 6.50% range for 10 year money. Some are cherry picking “quality” deals and doing them at 165 to 175 over the T-Bill. Conduit lenders (Morgan Stanley/Wells Fargo) have been priced at 205 to 215 over the T-Bill. The terms offered by the Conduit lenders have been constrained by risk considerations. They are not offering quite so dramatically different terms from the Insurance Companies. Pricing for a good quality deal today would be 6.00% fixed for 10 years.

Smaller Deals: are getting tougher to do with Insurance Companies. With costs going up, there are getting to be fewer loan requests under \$1,000,000.00. When a borrower looks at the combined closing costs for an Insurance Company loan (\$18K to \$22K) it starts to be significant when compared to a \$750,000.00 loan.

The Next Big Abuse: The selling of condominiumized Office, Medical and Industrial properties is going to be another misused business. The local joke is that if you cannot sell a building for \$200/ft, condominiumize it and sell the units for \$340/ft. This is just what is happening. I would have to guess that most of the financing for these sales is either SBA or small bank financing – and highly leveraged. The appraisers and lenders are not thinking these transactions through very well. Why is something worth 70% more just because the insurance agent is buying it instead of leasing it? Wouldn't you just love to attend the “Association” meeting of these owners in a few years when they need a new roof – or have to repave the parking lot?

I can finance condo units – but – only larger deals where the loan is millions; and, the ownership is very well thought out.

Recession or No?? The Federal Reserve is really on the hot seat for this one. The U.S. dollar is already at historic lows against the Pound and the Euro. Pouring more money into the system, as has been done during the last four weeks, is going to magnify this problem. Americans are already starting to pay more for everything. Oil hit \$80/barrel today. That's inflationary. The falling value of the dollar makes foreign investors much less prone to invest in American securities. They want higher yields. A second issue is keeping interest rates at 6.00 to 6.125% for residential lending. The Fed wants to do this to keep the construction industry from imploding. Further; the sub-prime loan situation is going to be much worse if interest rates rise. So; the trick will be to try and cool growth without killing it. The Fed has a poor record on this problem. Maybe things will go better this time. I find that public opinion is what drives these things. When we have too many newscasts telling us bad news; then, we get more bad news and the public pulls back on the reins until we have a recession. Real growth resumes when people can see “deals” or “good buys” on things.

Factoid: Countrywide has 2,600 employees in its “Home Retention Center”. Those people do nothing but modify loans to try and keep borrowers out of default. Last year they helped 35,000 people.