



mhg DETROIT

CAPITAL MARKETS | MULTI-HOUSING GROUP

Third Quarter 2010 Newsletter

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Multi-Housing Update

By: W. Keith Johnson, Director

CB Richard Ellis | Detroit Multi-Housing :: Private Client Group

DETROIT AREA FACTS

The population of the Detroit area stands at 4.55 million, 9th largest of the multi-housing markets we track. The average per capita income (according to recent data from Moody's Economy.com) is estimated to be \$37,206—approximately 6% below the national average. Total employment stands at 1.73 million workers.

MULTIHOUSING MARKET FORECAST

The short-term forecast calls for an overall increase in the number of workers through year-end 2011. Total net absorption is forecasted to be a negative 1,837 units, lagging supply during the same period. By year-end 2011, the annualized vacancy rate is expected to be 8.0% while rents are forecasted to decline to \$710.97 compared to current market rents of \$718.58.

THE DETROIT ECONOMY

Over the last five years, total employment in the Detroit area has declined at an average annual rate of 3.7% while across the U.S., employment has declined at an average annual rate of 0.5%. In the last 4 quarters, Detroit's employment has declined at an average annual rate of 2.5%. Our forecast predicts growth of 0.7% in the Detroit area in the next five years. Detroit's construction employment sector will post the best job performance over the next five years.

ECONOMIC DRIVERS OF DEMAND

Population, personal income, and most importantly, total employment are the primary economic drivers of multi-housing demand. The graph below shows the annual growth rates of these variables from 1998 through year-end 2011.



EMPLOYMENT

Total employment in the Detroit area is projected to grow by 40,500 jobs during the 2010-2015 period. During the same time period, new supply is expected to average 22 units, while net absorption is expected to average 831 units, out-pacing new supply. Vacancy rates are expected to improve to 6.5%, while rents are forecasted to rise to \$773.61.

Employment Levels and Growth Rates: Detroit vs. Nation

NAICS Category	Level (x 1000)	Location Quotient	Avg Annual Growth Rates (%)					
			Last 5 Years		Last 12 Mos.		Next 5 Years	
			Metro	U.S.	Metro	U.S.	Metro	U.S.
Agriculture & Mining	3	0.33	-3.4	2.9	0.0	2.3	0.0	0.1
Construction	47	0.62	-11.1	-5.1	-10.2	-8.2	2.1	4.2
Manufacturing	183	1.18	-9.2	-3.9	-0.8	-2.2	-0.1	0.1
Wholesale Trade	75	1.02	-4.5	-0.6	-6.8	-0.9	0.5	1.4
Retail Trade	194	1.01	-3.2	-1.1	-3.1	-0.9	0.3	1.2
Transportation & Warehousing	47	0.84	-4.9	-0.9	-4.3	-1.8	-0.1	0.9
Information	26	0.71	-4.1	-2.3	-7.5	-3.3	0.2	1.5
Financial Activities	92	0.91	-4.8	-1.3	-7.2	-2.3	0.1	1.1
Prof. & Business Svcs.	299	1.35	-4.6	-0.2	-0.7	0.7	1.8	3.4
Education & Health	289	1.12	1.5	2.4	0.4	1.9	0.9	2.4
Hospitality & Leisure	172	0.99	-1.8	0.4	-2.9	-0.1	1.2	2.8
Other Services	86	1.21	-1.4	-0.2	0.3	-0.6	0.6	1.6
Government	213	0.70	-2.4	0.9	-4.0	0.7	0.3	0.8
Total	1,733	n/a	-3.7	-0.5	-2.5	-0.5	0.7	1.8

Source: Moody's Economy.com, CBRE Econometric Advisors



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Non-Recourse Loans require Caution in Foreclosure Circumstances

By: Steven D. Sallen, Esq.

Most non-recourse loans were never really, fully, non-recourse. Even in non-recourse deals, one or more of the principals of the borrower typically executed personal guarantees of the so-called “bad boy” carveouts. These carveout guarantees would provide for springing recourse (i.e., the entire loan balance would become fully recourse to the guarantors) upon the happening of certain events, such as: missing the very first payment, filing of a petition in bankruptcy, or breaching the due-on-sale provisions of the mortgage. These are fairly bright-line events that most borrowers have control over and can avoid. For example, don’t file for bankruptcy!

But there is a separate group of carveouts providing for personal liability up to the extent of “damages” suffered by a lender for certain other borrower acts or failures. A typical (but by no means, exhaustive) list of such carveout liabilities includes:

- Fraud or intentional misrepresentation by a borrower in connection with the loan;
- Damage on account of the gross negligence or willful misconduct of borrower;
- The removal or disposal of any portion of the property;
- Misappropriation or conversion of rents received by borrower after the occurrence of an event of default;
- Misappropriation or conversion of tenant security deposits or rents collected in advance, except to the extent they may have been applied in accordance with the terms of any lease;
- Misappropriation or conversion of the proceeds of insurance or award given in condemnation;
- Personal property removed from the property by or on behalf of borrower and not replaced with personal property of similar utility and value;
- Any fees or commissions paid by borrower to a related party;
- Failure to pay charges for labor or materials resulting in filing of a construction lien against the mortgaged property;
- Borrower’s breach of environmental representations, warranties or covenants; and
- Attorneys’ fees and court costs of enforcing carveout liabilities.

Most borrowers paid these provisions little mind when entering into mortgage loans, believing themselves to be fully insulated from personal liability by the general non-recourse nature of the loan, their lack of malicious intent, and by significant equity in the collateral, which equity was expected to grow as the loan was paid down and the property appreciated over time. However, with the real estate market now on its head, failing to understand the impact of, and to plan in the face of these *carveout provisions* upon occurrence of a loan default, *could have serious financial repercussions to the carveout guarantors*, thereby adding further economic injury.

As lenders cope with mounting foreclosures, and mortgage balances exceed property values, they are looking for any way they can to minimize their losses, even in non-recourse loan situations. Notwithstanding the moniker “bad-boy” carveouts, malicious intent is not a requisite to liability under one or more of the carveouts. Consequently, *pre-foreclosure planning is essential for borrowers and their principals, to avoid personal liability* for things they may have long since forgotten about or overlooked.

A prime example is security deposits. Most borrowers would agree that upon foreclosure they must and will turnover any security deposits held on account of tenant leases. However, most landlords “hold” security deposits by means of a liability kept on the journal books of the property; they don’t actually maintain a separate security deposit account, except in the multi-family housing/apartments sector where state laws may mandate holding security deposits in a segregated account. Chances are that in most commercial leasing situations, security deposit monies were used to pay for brokerage commissions, tenant improvements and other expenses incurred concurrently with new lease signings. Now, flash forward several years to today, when property owners must set aside those security deposit dollars in order to pay them to their foreclosing mortgagee, or risk personal liability up to the amount of aggregate security deposits. However, the foreclosing mortgagee may take the position that setting aside of those dollars, especially after (or, perhaps, even in preparation for) a loan default is actually a misappropriation of rental income. This puts the borrower in a Catch-22 position, where the lender may claim personal recourse against the borrower either for failing to turnover security deposits, or for misapplying rentals.

Another situation. At the time of foreclosure, the lender undertakes to perform environmental due diligence in the form of a phase 1 environmental site assessment, or even soil or groundwater testing, or some limited remedial activities, especially for industrial properties. Many lenders are taking the position that their investigational expenses are personal recourse obligations to the carveout guarantors. However, the guarantors probably intended to guaranty against “problems” not mere investigational activities preceding foreclosure!

Many property owner/borrowers have, in recent years, made lease termination deals where national tenants have bought their way out of leases for underperforming locations. If these transactions were not approved by the lender, there may be non-recourse exposure for misapplication of pre-paid rentals long since accounted for and forgotten.

Or, consider the property owner who tried to make an out-parcel to his shopping mall more leaseable.

Non-Recourse Loans require Caution in Foreclosure Circumstances

By: Steven D. Sallen, Esq.

After reconfiguring a large single tenant building into a multi-tenant facility, the net result was six right-sized tenant spaces ready for lease, but in several thousand square feet fewer gross leaseable (albeit, more desirable, and significantly more leaseable) floor space. On foreclosure, however, the owner must be cognizant that the lender could take the position that the unauthorized building alteration amounted to a “removal” of collateral, thus triggering a non-recourse liability carveout, even though the value of the property was (at least in the eyes of the owner) enhanced.

As a matter of procedure, simply giving property back to a lender has become more difficult as well. Many lenders are refusing to settle these non-recourse carveout issues before they receive the property back. Some lenders are demanding immediate payment of security deposits and other amounts, before final settlement of all issues. So even where a borrower is willing to give a deed in lieu of foreclosure in exchange for a release from liability under the carveout guaranty, lenders are often demanding the property and money back first, and then “promising” to negotiate a settlement. This order of things is reversed, requiring borrowers to let go of the only leverage they have (control of the property and what little money is in their property management account) before lenders will negotiate a final settlement. What other business relationship requires one party to pay first, and negotiate a release later?

These are trying times for borrowers and lenders. But, even the most heavily negotiated loan documents are generally most favorable to the lenders. Now, lenders are using those favorable loan document rights and powers to exert maximum leverage over financially (and often emotionally) exhausted borrowers and guarantors. So, even “non-recourse” borrowers have to re-examine their loan documents when facing the prospect of foreclosure, or considering “walking away.”

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MULTI-FAMILY FINANCE

By: Jason Brown, Vice President
CB Richard Ellis | Debt & Equity Finance

AGENCY BRIEFS

Loan demand has picked up substantially for Fannie, Freddie and the FHA over the past few weeks. Yields on UST securities have continued near record lows, and GSE credit spreads for full 10 year loans have continued to remain below 200 bps. We see credit spreads remaining in the current range, but caution our clients about potential vitality with respect to UST securities as the benchmark index for fixed rate loans. The bias is towards rate spikes.

All three Agencies continue to focus on Borrower and Sponsor creditworthiness. Problems with past or existing deals do not prevent the ability to get a new Agency loan. However, full and timely disclosure, transparency and working with a sophisticated and experienced Seller/ Servicer can help produce positive outcomes. Relationships always matter in this business - they matter even more in a difficult market.

FREDDIE MAC FIXED TERMS

Leverage	1.25x/80%		1.35x/65%	
Term	Spread	Rate	Spread	Rate
5 year*	2.52%	3.78%	2.27%	3.53%
7 year	2.32%	4.17%	2.07%	3.92%
10 year	2.02%	4.49%	1.77%	4.24%

FANNIE MAE FIXED TERMS

Leverage	1.25x/80%		1.35x/65%	
Term	Spread	Rate	Spread	Rate
5 year*	2.45%	3.71%	2.25%	3.51%
7 year	2.31%	4.16%	2.11%	3.96%
10 year	2.15%	4.62%	1.95%	4.42%

FHA/HUD TERMS

	TERM	LEVERAGE*	SPREAD (10-YR T)	RATE
Apartment New Construction	40	1.20/83.3%	2.65%	5.65%
Apartment Refinance	35	1.20/83.3%	1.40%	4.40%
Healthcare New Construction	40	1.45/75%	2.65%	5.77%
Healthcare Refinance	35	1.45/80%	1.40%	4.45%

RECENT FINANCINGS:

CBRE Debt & Equity is the #1 Seller-Servicer for Freddie Mac with over \$1.3 billion in Freddie Mac loans closed during the first 6 months of 2010. Here is an example of two recent Freddie Mac financings in Michigan:

Harbor House Apartments, Ann Arbor, MI:

Acquisition financing for an experienced real estate investment firm in New York. The key challenge in this transaction was achieving full leverage of 75% LTV on a deal in Michigan (typically limited to 65-70% LTV).

Key terms of the financing:

- 75% TV
- 10-year term
- 30-year amortization
- Non-recourse
- Fixed rate below 4.50%

Royal Glen Apartments, Comstock Park, MI

Refinance on behalf of SMG Management in Sarasota, FL. The key challenge in refinancing this asset was the property construction was unique and not typically allowed in the Freddie Mac programs, however CBRE was able to convince Freddie Mac to buy the loan based on the track record of strong cash flow and the experience of the borrower.

Key terms of the refinance:

- 70% LTV
- 7-year Capped ARM
- 30-year amortization
- Non-recourse
- Floating rate below 4.25% with 7% ceiling
- Flexible prepayment structure

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SURVEY | Mid Year 2010 Results

By: W. Keith Johnson, Director

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Quick Stats

	Current	Change from last	
		Yr.	6 mos.
Occupancy	92%	↑	↑
Avg Rent Psf	\$0.91	↑	↑
Sales Activity	\$46M	↔	↔
Construction	0%	↔	↔

* The arrows are trend indicators over the specified time period and do not represent a positive or negative value. (e.g., absorption could be negative, but still represent a positive trend over a specified period.)

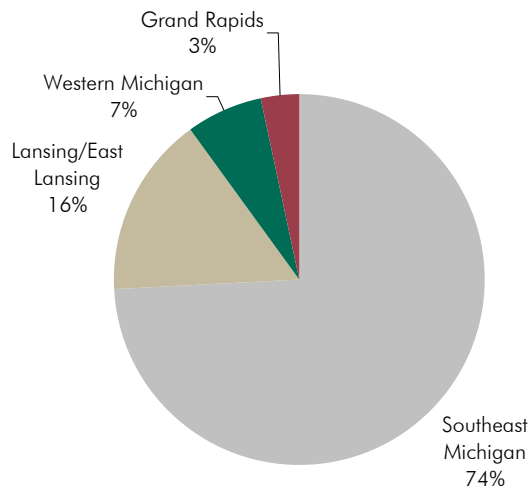
Hot Topics

- Overall occupancy increased slightly to 92%, a 0.8% increase since 4Q2009.
- Average rents increased slightly due to less monthly concessions being offered
- The number of residential construction permits issued continues to be minimal for the southeast Michigan region.
- Average cap rates stayed in the 8.50% - 10.25% range for stabilized assets.

The CB Richard Ellis Detroit Multi-Housing Group is pleased to present the results of our Mid Year 2010 Apartment Survey. **This survey represents the top 50 owners in the Michigan market, with a sample size of 137 properties or 29,797 units.**

The majority, or 74% of the apartments surveyed, are located in southeastern, Michigan, 16% are located in Lansing/East Lansing submarket, 7% are located in Western Michigan, and 3% are located in the Grand Rapids submarket.

Survey Respondent Locations



Survey Sample Statistics

Number of Properties	137
Total Units of Inventory	29,797
Avg No. of Units/Property	258
Average Occupancy Rate	92%
Smallest Property	44
Largest Property	981
Earliest Year Built	1915
Latest Year Built	2009
Average Year Built	1981



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AVAILABLE OFFERINGS

WOODWARD HEIGHTS, HAZEL PARK, MI



PROPERTY TYPE	MULTI-FAMILY HOUSING
UNITS	57
PRICE	\$1,100,000
NRA	42,000
YEAR BUILT	1967
STORIES	3

BENTLEY SQUARE, GARDEN CITY, MI



PROPERTY TYPE	MULTI-FAMILY HOUSING
UNITS	65
PRICE	\$1,900,000
NRA	51,500
YEAR BUILT	1974
STORIES	3

VALLEY DRIVE, MT. CLEMENS, MI



PROPERTY TYPE	MULTI-FAMILY HOUSING
UNITS	100
PRICE	\$2,990,000
NRA	77,800
YEAR BUILT	1975
STORIES	3

12925 KELLY ROAD, DETROIT, MI



PROPERTY TYPE	MULTI-FAMILY HOUSING
UNITS	24
PRICE	\$209,000
NRA	14,400
YEAR BUILT	1955
STORIES	2

TWIN PINES, MONROE, MI



PROPERTY TYPE	MULTI-FAMILY HOUSING
UNITS	18
PRICE	\$399,000
NRA	9,900
YEAR BUILT	1929
STORIES	3

CHAPOTON MANOR, ST. CLAIR SHORES, MI



PROPERTY TYPE	MULTI-FAMILY HOUSING
UNITS	100
PRICE	\$3,100,000
NRA	65,000
YEAR BUILT	1954
STORIES	2

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