Distressed Assets INVESTOR

Providing Field-Level Guidance on the Acquisition and Disposition of Distressed Assets

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DISTRESS OUTLOOK

DISTRESSED PROPERTY LISTINGS FROM RCA, TREPP

Private Equity's Sideways Entrance

As more private equity players align themselves with special servicers, the industry can expect to see more deals and a more regimented approach to pricing

BY ERIKA MORPHY

Whether distress commercial real estate investors realize it or not, the various companies that C-III Capital Partners LLC is acquiring represents a milestone for this part of the industry. It is easy to see why the message—that is, growth in distressed asset transactions is coming—might be lost. After all, New York City-based C-III is intent on building out a diversified, full service real estate company.

However, the bottom line for distressed asset investors is indeed that C-III and other private equity-backed funds are acquiring special servicers and their assets and bringing complementary business lines to the table while they're at it. They reason they're moving into this space is because they see the business, and the fees they can generate from it, as finally poised for growth.

Not that the industry is moving wholesale in this direction. Some companies are charging ahead full force toward this model, while others are approaching it from different angles. C-III, for the moment, appears to be the most aggressive of all these firms.

The company launched itself into the commercial real estate world with the March 2010 purchase of the institutional debt-fund management and loan servicing businesses of Centerline Capital Group, also based in New York. City Since then, C-III has moved into the mortgage origination, investment sales and title insurance arenas—and special loan servicing, when the company acquired the special servicing and CDO management businesses of JER Partners this past August. In a statement issued at the time of the acquisition, C-III noted that McLean, VA-based JER was the named special servicer for $35.5 billion of commercial property debt, of which about $4 billion was under active management.

Other investments of note: In June 2011, C-III announced it would acquire Princeton, NJ-based NAI Global, which runs what is reportedly the largest network of independent commercial

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EDITOR'S NOTE

The One-Stop Shop

The full-service model has been a hallmark of commercial real estate for years, as companies that began strictly as leasing or sales brokerages sought to expand their scope into a variety of consulting capabilities for their clients. Having taken hold from within the industry, it seems that the format is now coming into vogue from the outside, as Erika Morphy explains in her ***cover story***.

Specifically, private equity firms—most notably Andrew Farkas' C-III Capital Partners—are looking to put together platforms of complementary businesses that include special servicing. C-III has made acquisitions that expand its reach into mortgage origination and investment sales along with loan servicing—and, when the deal for NAI Global is finalized, into brokerage services, as well. David Tobin of Mission Capital Advisors tells Erika that such verticalization "results not only in an increase in transaction activity, but also in better recovery for bond holders."

This approach makes sense in view of the current distressed landscape. It's clear that there's still lots of distress on the books and that, given the fitful economic recovery, this situation will be with us for at least the next few years. At the same time, this will not be a replay of the early 1990s. There's no framework in place to ensure an orderly disposition of assets comparable to what the Resolution Trust Corp. accomplished two decades ago.

More than that, however, distress per se needs to be seen as part of a larger continuum. When you consider the role that distress can play in an opportunistic investment strategy, for example, or the importance of asset management in repositioning and re-tenanting troubled properties, clearly you have to tie all of these elements together.

In a look at the bigger picture, Rob Carr has asked a cross-section of industry experts on our advisory board for ***their take*** on the near-term outlook. Natalie Dolce investigates the ***often-overlooked investment opportunities*** available in secondary and tertiary markets. Both stories consider distress as part of a wider world, not unlike the private equity firms creating one-stop shops.

As this issue of ***Distressed Assets Investor*** brings 2011 to a close, I'd like to take this opportunity to wish you and yours happy and healthful holidays. And be on the lookout for exciting changes in 2012. ■

Paul Bubny, Editor
pbubny@alm.com

Distressed Assets
INVESTOR

GROUP PUBLISHER | Michael G. Desiato

EDITORIAL
Content Director | John Salustri
jsalustri@alm.com

Editor | Paul Bubny
pbubny@alm.com

Contributing Editors
Sule Aygoren Carranza, saygoren@alm.com
Robert Carr, rcarr@alm.com
Carl Gaines, cgaines@alm.com
Jacqueline Hlavenka, jhlavenka@alm.com
Erika Morphy, emorphy@alm.com
Morris Newman, morris.h.newman@gmail.com

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Executive Publisher | Gregg W. Christensen
gchristensen@alm.com

Vice President, Strategic Development | Daniel Ceniceros
dceniceros@alm.com

Vice President, Integrated Marketing | Scott Thompson
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PRODUCTION/ART
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Art Director | Nick Koutoufas
nkoutoufas@alm.com

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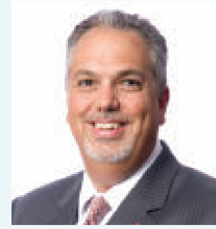

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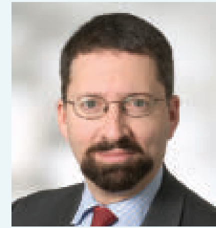

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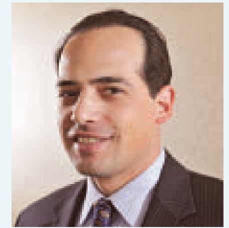

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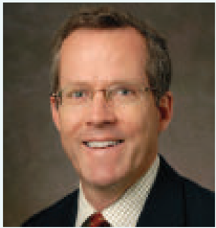

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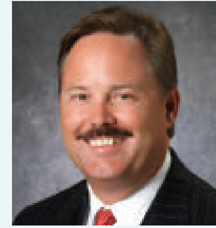

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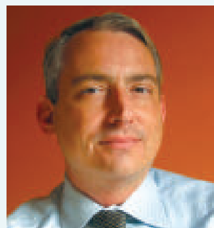

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real estate firms worldwide. The deal has not yet closed; it calls for NAI to operate as a separate company under its current management. It has also been reported, by GlobeSt.com, that Andrew L. Farkas, C-III's CEO and the former founder and CEO of Insignia Financial Group, has agreed to buy a stake in Grubb & Ellis. Most recently, in mid-November, C-III acquired two multifamily property management businesses: Carrollton, TX-based US Residential Group and Pacific West Management, based in Irvine, CA.

New York City-based Fortress Investment Group's recent acquisition of Rockwood Advisors, a deal that aligns the New York City-based Rockwood's investment sales platform with Fortress' special servicing unit, CWCapital Asset Management, is another industry example. Berkadia Commercial Mortgage has established an in-house brokerage team, for its part, and LNR Partners, headquartered in Miami Beach, has launched its own loan advisory group, Archetype Advisors.

Taken as a whole, these are important signs of where the industry is headed, says Sandy Monaghan, managing director of the Capital Markets Group at Cushman & Wakefield, based in New York City. "The timing of their pursuit of these brokerage firms and special servicers is in some ways an indicator that private equity players believe there will be more distressed sales transactions—hence more sales transaction fees," he says.

That is good news for distressed investors, who have been waiting for a more regular flow of transactions ever since the start of the crisis. For other players—the Jones Lang LaSalles, which have been edging into this space as well—it is not so good.

"These companies may not have the opportunity to represent C-III in as many asset sales as they may have had in past," Monaghan explains. "It would be one thing if the company were just building an internal platform, small in scale. C-III would still need to leverage itself into third party-brokerage platforms. But with these acquisitions, it can execute transactions now without them."

This shift in players, however, could mean more to distress asset investors than just a steadier flow of deals from which to pick, says David Tobin, principal and co-founder of Mission Capital Advisors in New York City, a loan-sale advisor that works with Boston-based CWCapital, among others. "The verticalization of special servicers results not only in an increase in transaction activity, but also in better recovery for bond holders," he says.

Tobin cites the track record of CWCapital, which reportedly has recovered 59% of par on average of the $1.4 billion of loans it has sold since the beginning of 2010. "When special servicers have access to investment sales platforms and in-house brokers they tend to be more successful in terms of par in loan sales," he says.

Tobin also points to recent data from Fitch Ratings showing that, between 2005 and 2010, the aggregate amount of resolutions increased by 500% while losses went down. "In 2009, loss severity was 57% on about $1.64 billion of resolutions," he says. "That compares with 53.4% in 2010 on $5.25 billion in resolutions."

Special servicers started their push to verticalization in earnest around 2009, and Tobin thinks Fitch's numbers are at least in part a reflection of that trend. "Historically, special servicers did not have a lot of tools available to do workouts," he says. Their options were either to foreclose on the asset or sell the loan.

After the servicer foreclosed, "it would retain an external appraisal, a broker and so on—but none of those parties had a vested interest in the deal," says Tobin. "They were just parties doing work for a fee."

Of course, not all special servicers are moving in this direction, Tobin says. "Different servicers have different approaches to resolutions and, frankly, all have their good points."

In general, servicers that are strictly fee-for-service are less likely to verticalize. Those companies that own the B piece, by contrast, are more likely to have a complementary platform. Some focus on just one client. Then there are those special servicers who don't have an exclusive relationship with one firm but are pure third-party plays.

"The verticalization of special servicers results not only in an increase in transaction activity, but also in better recovery for bond holders."

— David Tobin, Mission Capital

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Berkadia falls into this camp, and it has a solid record to support this particular model. Earlier this year, the Horsham, PA-based company was cited by Trepp as the special servicer with the lowest loss-severity level for the previous 14 months. Its average loss severity on special servicing loans was 32%, or nearly 10 percentage points better than the second-ranking special servicer in the report.

"One hundred percent of our business is third-party transactions," says Michael Carp, an executive vice president with Berkadia's servicing division. It is a distinction from the top special servicers, which tend to have single customers, such as LNR's relationship with Cerberus Cos., he says: "If you look at the top six special servicers, they generally have single customers. We have a multitude of customers for which we are responsible and we treat it as a business."

For that reason, Carp says, the company has elected not to buy any of these assets. "Our theory is if it is a great opportunity, we should notify our customers." There is also the perception of conflict of interest, he adds.

Whatever the approach a special servicer opts to take, however, clearly the industry is changing, Carp says. "For many years, special servicing was a loss mitigation department based on the premise that if you buy below investment grade, you should have the ability to control the workout."

The last recession turned that premise upside down, and servicing morphed into a cash cow. "Fees were negotiated long before the problems began to occur and these fees, especially when they came in the volumes that they did, were similar to other transactions," Carp says. Enter the private equity players.

In mid-November, CityBizList, citing Trepp, reported on the transfer of a $219-million loan on 315 Park Ave. South in Manhattan to special servicing. An all-cash buyer then emerged for the 334,000-square-foot Midtown South office building, with the borrower requesting a discounted payoff to sell the building.

It's the ideal transaction for a distressed-real estate investor, the sort of deal that has been more urban legend than fact. That appears to be changing, and this trend will be further facilitated by a private equity-fueled special servicing sector.

There is a theory that pricing for distressed assets will not be as frothy or overpriced as is has been. There is also plenty of evidence to suggest that banks and lenders no longer have the patience or reason—or perhaps most important, the regulatory cover—to continue their extend-and-pretend policies.

"There has been much talk about excess capital on the sidelines waiting to invest and the lack of product in this space," Monaghan says. "With this mix of events, though, that will change. Pricing in core markets for stable assets has gotten too high, though, so capital is moving into secondary markets seeking better yields."

In these markets, however, investors are not willing to pay premium prices, especially with distressed assets. At the beginning of this year, projections for economic growth were far rosier than the cautious view that many now hold. Jobs have not recovered and fundamentals in terms of rent and opportunity growth haven't improved materially that much, either.

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— Michael Carp, Berkadia Commercial Mortgage

"Investors are having trouble projecting future growth in their investments and that has impacted how much they're willing to pay, especially for assets that are troubled," Monaghan says. In turn, "the servicers are becoming more conservative because they're not sure about the pricing they'll achieve."

If everything falls into place, special servicers are going to bring more product to market in an orchestrated fashion along with a more regimented approach to pricing. Which, after all, has been what investors have been waiting for since the beginning of the crisis. It just took a nudge from private equity to deliver. ■

***Erika Morphy** is the Washington, DC correspondent for GlobeSt.com. She may be reached at emorphy@alm.com.*

Office Market Continues to Struggle

BY ALAN L. PONTIUS

A recent wave of distress hitting Atlanta has translated into new opportunities for investors and thus resulted in their movement off the sidelines and back into the market. Investors have been actively seeking office buildings, which are offering the most opportunities in the current cycle. In fact, sales of distressed office properties at steeply discounted prices increased 65% from mid-year 2010 through mid-year 2011. Retail properties are also facing high levels of distress. Meanwhile, the industrial and multifamily sectors face the least amount of distress moving into 2012.

The Atlanta office market was the hardest hit of the four major property types and continues to struggle as weak permanent employment growth and reductions in square footage needed per employee will keep vacancy above 20% through year's end. Effective rents continue to fall, albeit at a slower pace, and concessions remain very high as tenants find bargains and remain firmly in control of the market. On a positive note, high vacancy has virtually shut down the development pipeline, as only 564,000 square feet of space came on line in the 12 months ending in mid-year 2011, representing a scant 0.1% increase in competitive for-lease stock.

Currently there are 90 office properties, representing $2.2 billion in loans, listed as distressed, the result of continued weakness in the sector. Atlanta CMBS office loans have a delinquency rate nearly twice the national average. Twenty percent of office loans are delinquent, with more than half of those already in foreclosure or REO. A significant number of office-building loans have matured, but are non-performing as servicers struggle with the best course of action in a very challenging environment. The heightened level of vacancy has crimped the overall office investment sales market, but the third quarter saw an increase in distress sales of both traditional and medical office properties that may encourage further marketing of distressed assets in the coming months. Those properties trading have done so at significant discounts, which should drive investor interest.

While the deterioration in Atlanta retail fundamentals has ended, the market has yet to see a significant rebound in occupancy as retailers remain hesitant to expand and smaller/mid-sized companies continue to face challenges as consumer sentiment remains muted. After a few nominal declines, vacancy climbed once again in Q2 and Q3, ending at 12.2%, with neighborhood and community centers experiencing rates closer to 15%.

The continued struggle in retail has led to many troubled properties, with more than 125 assets listed as distressed by the end of Q3, representing $783 million in loans. Loans originated through CMBS are contributing to the majority of distress in the retail sector, with 33 properties in foreclosure or REO and another 27 retail properties 90-plus days delinquent. Overall CMBS delinquency is at 10.6%, about

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half of the multifamily sector, but significantly above the national retail total, which is below 8%. Much of the retail product that has been foreclosed on is in the suburbs where, similar to the multifamily sector, the properties were built based on certain population and employment-growth assumptions that have not materialized due to the recession.

The Atlanta industrial market continues to struggle as the vacancy rate remains stubbornly high, above 13%, and average rents continue to fall in almost every submarket. A sizeable portion of the sector was intrinsically linked to the housing picture and the continued weakness in that sector has created a challenging leasing environment for property owners. Those owners have reported success in leasing space to telecommunications companies, but the pace has not been enough to generate marked improvement in the overall industrial sector. Surprisingly, industrial is the least distressed of the four major property types, both in number of transactions and dollar volume.

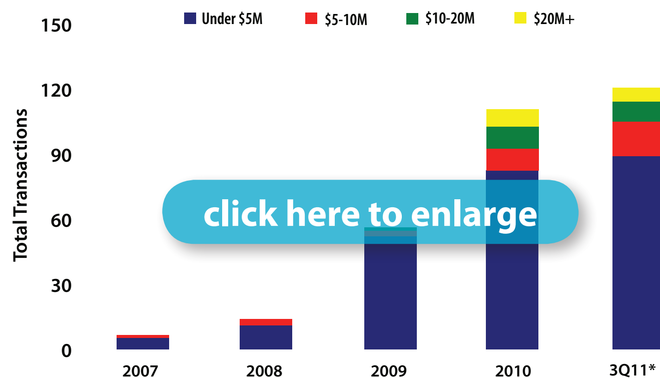
The industrial sector has historically experienced more conservative underwriting, and even loans made through the CMBS market are consistent with the overall averages. Just five CMBS industrial loans were delinquent at the end of Q3, equaling 11% of the total market and in line with the national figure. Overall, 60 industrial properties are distressed with an original loan balance of more than $400 million. The limited number of distressed properties has not produced many asset sales, but as more properties head further down the delinquency ladder, volume is projected to increase in early 2012. With occupancy not expected to see significant improvement by then, these distressed assets should come to market with opportunistic pricing for investors willing to take the risk.

The rebound in employment growth in Atlanta over the past 12 months has increased demand for rental housing, which pushed the apartment vacancy rate down to 8.7% at the end of Q3. While still above average and significantly higher than the national average, this does represent a substantial reduction from the high vacancy point of 11.5% reached in 2009.

With a vastly reduced construction pipeline, Atlanta is well positioned to see further gains in occupancy in the coming year, with the associated rent gains across all property classes. Unfortunately, for many properties the improvement in market fundamentals has come too late, as more than 160 apartment properties, representing $1.8 billion in original balances, are distressed.

The situation among loans originated through CMBS is more severe with nearly 19% of all apartment properties in distress, representing more than 21% of total originated dollar volume. While a significant portion of distressed deals are already in foreclosure or REO, slightly less than one-third of the total outstanding distress is listed as 90 days plus, which barring last-minute restructuring will produce another glut of foreclosures and REO. Many of the properties facing those possibilities are found in the outer ring of suburbs, where the path of growth was supposed to lead before the recent recession. The turnaround of these properties will be extremely challenging, but with prices on these assets at opportunistic levels, investors, who believe in the long-term growth of Atlanta, will find attractive assets with substantial long-term upside potential. ■

Volume Swells in Sales Under $5 Million



* Trailing 12 months ending 3Q11
Includes auction sales, bankruptcy sales, distressed sales, REO sales and short sales
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

Alan L. Pontius is managing director of the Special Assets Services division of Marcus & Millichap Real Estate Investment Services. He may be contacted at alan.pontius@marcusmillichap.com. The views expressed here are the author's own.

More Than a Platform For Real Success

BY BLISS A. MORRIS

With 2011 drawing to a close, it's the ideal time to take stock of where our economy is headed; look at how banks and other financial institutions are faring; and how we transitioned to a multi-faceted firm that is well positioned to meet the demands of today's market dynamics.

For much of 2011, the economy remained sluggish, with GDP growing only 0.4% in the first quarter and 1.3% in the second. Although Q3 saw GDP jump to 2.5%—well ahead of analysts' expectations—4% to 5% expansion is ideal following a recession. GDP aside, there are a number of additional challenges that have derailed growth, including volatile employment (the jobless rate is still stuck at around 9%) and the continued weak performance of the housing sector.

However, high unemployment and a lackluster housing market are not the only components that have slowed overall economic growth. The commercial and industrial markets have also had their fair share of problems. Although most banks and financial institutions now know which of their loans flatlined and recognize that the underlying assets are potentially deteriorating, one of their most pressing issues is whether other types of still-solid loans could become nonperforming.

So how does one succeed in such an uncertain marketplace? In short: by adapting. The players who will come out on top are those that recognize the paradigm shift early and develop partnerships and creative solutions to deal with the unprecedented distressed market conditions.

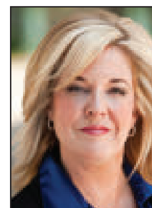
Simply having a platform is not enough, as we saw during the dot-com boom in the late 1990s and early 2000s. At that time, a number of companies that had the technology to sell loans and other assets went into business, but what they failed to understand is that you need a good deal more than a platform to trade debt successfully. A platform is but one tool necessary to unlock value in loan sales. In addition, you need to provide accurate loan valuations, sound legal framework, qualified bidders, intense buyer interaction and sound back-end processes to support the entire transaction.

The players who will come out on top are those that recognize the paradigm shift early.

Along that vein, First Financial Network has shifted from a pure loan sale advisory firm to being regularly tapped to provide due diligence and valuation services for clients seeking to acquire banks or determine critical balance-sheet issues necessary for raising capital.

Technology also aided in our move to a more agile firm ideal to meet the demands of current market dynamics. Speaking specifically to loan sales, it plays a major part in maximizing the value of assets, especially given the constantly changing regulatory demands. For sellers and buyers, designing and implementing new technologies that better serve their requirements is imperative in today's market.

One of our major initiatives is staying ahead of technological advances in the industry. In August, we launched our customized Loan Sale Network designed to assist financial institutions and individual investors around the world in marketing and acquiring large portfolios or individual loans. The platform allows any number of loans to be sold in any combination or as a one-off trade. It also includes a secure virtual data room for the online dissemination and review of indexed loan documentation and data. Authorized potential purchasers can search for specific loans based on defined criteria, perform due diligence, ask questions, search and annotate loan documentation, receive portfolio updates, review legal documents and place bids. ■



__Bliss A. Morris__ is president and CEO of First Financial Network and a member of the DAI editorial advisory board. She may be reached at bmorris@firstfinancialnet.com. The views expressed here are the author's own.

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Larger Pipeline in 2012: That's a Good Thing

Between now and 2015, $1.77 trillion of commercial and multifamily debt will come due; the implications are both positive and negative

BY ROBERT CARR

Experts in distress, including the *DAI* advisory board members providing insights here, agree that 2012 will see more problem properties emerging than this year, but most believe this larger pipeline will mean good things for the industry. The few naysayers, however, posit that the third quarter's depressed fundamentals, including the European debt crisis, signal too many problems for distress professionals in the next few years.

Alan Pontius, national director of special assets for Encino, CA-based Marcus & Millichap, says these past two years have shown improvement, conflicting with the prediction for 2012. "There's been a shrinking volume overall in delinquencies for the past seven quarters," Pontius says. "We're also seeing workouts outpace the new introduction of distress into the system." Outstanding distress as of early November was $172.4 billion, and workouts were expected to make a strong dent in this figure, according to Real Capital Analytics.

However, Pontius says the total $1.77 trillion in estimated commercial and multifamily debt maturities in 2011-2015 will force expansion in the overall volume of distress. This signifies a bad situation, as added properties will bring existing price points down. But there's a more positive possible outcome, Pontius says, as lenders will be forced to "prune their books of distress."

As an example of the growing pipeline, in November Miami-based Easton Lynd purchased $49 million worth of notes on Florida multifamily assets from seller LNR Property LLC, also based in Miami. David Lynd, president and COO of Easton Lynd's sister company, Lynd Co., says he expects to spend about $150 million on the expected opportunities.

With about $550 billion of expirations coming due over the next 18 to 24 months, and CMBS having dropped to virtually nothing compared to the market's peak, financing on these deals is almost impossible, Lynd says.

Sandy Monaghan, managing director of New York City-based Cushman & Wakefield's Capital Markets Group, agrees that distress was looking good as the US entered the third quarter this year. "The debt markets were cooperating and even CMBS was beginning to ramp up," he says. "Now all that seems to have taken a pause. We're at a crossroads; nothing I'm seeing indicates jobs are coming back. Corporations continue to be cautious in spending."

He says after the midyear pause, lenders and special servicers started to take a harder stance on loans, cutting back on the practice of extend-and-pretend. This sends the market into

"There will be no watershed event next year, though I expect transaction activity to be higher by about 25% from the low volume in 2011."

— Mark Grinis, Ernst & Young

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some turmoil, because without solid lending today, it's hard for people to know how to price the assets.

Now, the US distress market will see a slow grind in 2012, with lenders continuing to leak assets, he says. The "though I expect transaction activity to be higher by about 25% from the low volume in 2011."

There's just too much choppiness coming out of Europe, he says, and owners will have to face the facts about will happen with fewer worries than expected. There may be a bump-along market for a year or so, though, he says. "That said, there's plenty of people who are optimistic that they can make money in 2012," Fink says.

"We're at a crossroads; nothing I'm seeing indicates that jobs are coming back. Corporations continue to be cautious in spending."

— Sandy Monaghan, Cushman & Wakefield

one wild card, says Monaghan, is the future CMBS distress level, which as of early November stood at about $80 billion. The delinquent unpaid balance of CMBS could hit $66 billion by the end of December and will likely increase for the next few years. "It's likely this will all correct itself in the next five to seven years," he says.

Steve Pumper, executive managing director of Houston-based Transwestern, says the low interest rates have allowed owners of distress to survive so far. A November report by Delta Associates, a division of Transwestern, detailed that distress volume has slowly decreased from the March 2010 plateau of $191.5 billion. The number of failing banks has also dropped since Q3 2009.

Now, Pumper says, the time has come for lenders to clear their balance sheets. "REO will pick up as leases and extensions burn off in 2012 and 2013," he says.

Mark Grinis, transaction real estate leader at New York City-based Ernst & Young, says he's not seeing signs of improvement in 2012. "There will be no watershed event next year," he says, their properties. "At some point there has to be capitulation," Grinis says. "There continues to be a mood of distress, and there will continue to be opportunistic trades. There will have to be some acknowledgement by people to understand what they have, and either decide to live with it or move out."

Scott Farb, managing principal of Bethesda, MD-based Reznick Group PC, sees a bifurcation between the valuations and sales volume of class A assets and loans in primary markets versus the lesser-quality assets in most markets, sending mixed signals about the level of recovery. "Cumulative distressed debt totals are being resolved at a rate of $5.5 billion a month, but it's estimated that US banks are carrying more than $50 billion of REO on their books," he says.

Smaller banks, holding assets below $10 billion, represent an estimated 70% of the commercial mortgages maturing over the next five years, he says. "A sluggish property market could be fatal for them," says Farb.

Tom Fink, senior vice president and managing director at New York City-based Trepp LLC, says the disposal

So, the answer to the question "Are we there yet?" is still a definite "no," says Spencer Levy, Baltimore-based senior managing director at CBRE Capital Markets. "If you had asked me in June, I might have said yes. The market is very thin from an investor appetite standpoint, and there's a lack of confidence in the marketplace."

However, he says just the fact that the industry made it through the recession says something about the strength of the property markets. "There's so much cash sitting on the sidelines, trillions of dollars with a lot on the corporate balance sheets, that once we break this cycle of bad news, we can recover quickly," Levy says. "For example, let's say the Greek austerity package works and the country sees a recovery. A positive news item like that would see a rapid flow to positivity." ■

__Robert Carr__ is Midwest region editor for GlobeSt.com and Real Estate Forum. He may be reached at rcarr@alm.com.

Buying Distressed Real Estate Out of Bankruptcy

BY ANTHONY THEOPHILOS

The current state of real estate markets is providing investors with significant opportunities to acquire distressed property at rock-bottom prices. However, those assets are often owned by a company in bankruptcy. So the question is: How exactly do you go about buying real estate out of a bankrupt estate?

There are two important and practical rules to keep in mind when shopping for real estate that is subject to a bankruptcy court's jurisdiction. First, any owner of property with equity remaining will almost always file for bankruptcy protection in an attempt to preserve that equity and to buy time within which to sell the asset, repay the lender and emerge from bankruptcy with its equity in hand.

Second, an owner with no equity in the property will seldom spend the money to file for bankruptcy protection (although occasionally owners with no equity may file in an often-unsuccessful attempt to exert some leverage over the mortgage holder). Thus, it is more likely than not that the value of the property in bankruptcy exceeds the mortgage debt.

The problem, however, is that any offer to buy real estate in foreclosure is subject both to bankruptcy-court approval and over-bidding at the hearing to approve the sale. If the value of the property exceeds the mortgage debt, the court will generally approve the sale (assuming that there are no significant creditors other than the mortgage holder). The over-bidding element is required in order to ensure that the seller has always maximized the prospective sale proceeds. In that case, a potential buyer has to worry if it is worth the effort to draft and negotiate a purchase agreement and to begin due diligence, when the property may be snatched away by an over-bidder.

An owner with no equity in the property will seldom spend the money to file for bankruptcy protection.

In such a situation, the prospective buyer is considered a stalking horse. There are a number of steps a stalking horse buyer can take to protect itself. The most common of these is to negotiate a breakup fee with the seller. This is a fee paid to the stalking-horse buyer to compensate it for having played a role in generating an over-bid, which is to the seller's benefit. Further, a portion of the fee is intended to reimburse the stalking horse for its due-diligence expenses. However, if a breakup-fee arrangement has been agreed upon by the parties, it is equally important for the seller and the bankruptcy court to agree on the minimum over-bid amount. Generally, this is the same amount as the breakup fee and is designed to ensure that the seller will not be out of pocket after sale of the property and payment of the fee.

An offshore client recently contacted me to draft a purchase agreement to acquire a mixed-use project in Northern California for $87 million. However, we immediately discovered that the seller had just filed for protection under Chapter 11 of the US Bankruptcy Code, primarily to protect its equity and stall foreclosure while seeking a buyer. As a result, we revised the buyer's offer to provide for a breakup fee of $1 million, plus up to $250,000 in reimbursement of due-diligence costs, if the buyer's offer was over-bid. Further, in order for this to make sense for the seller, the minimum over-bid would have to come in at around $1.2 million over the buyer's offer. The seller accepted our proposal and we now await a hearing in bankruptcy court for its approval of the breakup fee, the due-diligence cost reimbursement and the minimum over-bid amount. ■

Anthony Theophilos is a real estate attorney at San Francisco-based Starr Finley LLP. He may be contacted at tony@starrfinley.com. The views expressed in this article are the author's own.

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With Risk Comes Reward

Even with the recent worldwide market volatility, distressed investors say the slow-to-recover secondary and tertiary markets provide ample opportunity to get more value for your dollar

BY NATALIE DOLCE

Investors spent much of 2011 crowding into top-tier cities in search of the perfect distressed opportunity. And although prime assets continue to draw significant interest, many investors are turning to the often-overlooked secondary and tertiary locations, despite turbulence in the global financial markets and worries surrounding the eurozone debt crisis. Those lower-tier markets, experts say, can offer surprising opportunities in both pricing and asset quality.

Moving toward the mid-part of 2011, investors began to shift their focus from the core, well-located primary assets—where cap rates had dropped to the low 5s and 4s in the best markets—to more secondary markets or assets with more fundamental risk, explains New York City-based Jay Koster, Jones Lang LaSalle's Americas capital markets president. "However, given the recent worldwide market volatility, investors' overall desire for risk has become muted and they remain very price-sensitive for any additional market or fundamental risk they are undertaking outside of those prime markets."

While Cohen & Associates, for example, invests in core markets throughout the West, president Gidi Cohen tells ***DAI*** that the firm is not shying away from secondary and tertiary opportunities. In fact, the Los Angeles-based company is looking at secondary and tertiary markets in California, Florida, Georgia, Colorado, Nevada and Arizona. "We look for deals that are near large corporate headquarters or business districts, because where people work is also where people live," says Cohen.

Cohen points out that the more appealing markets are those that are more distressed or "have seen more pain" and thus experienced greater price decreases from the peaks of the mid-2000 cycle. A great example, is the Orlando area, hit hard by the crash, not only because of new construction pullouts, but also because many existing homes and units were managed as vacation rentals.

"When vacationers stopped visiting, the incoming revenue decreased and the foreclosure rate skyrocketed," says Cohen. "It went up so much that some parts of Florida actually began conducting auctions online, rather than in an actual courthouse. As the Florida markets stabilize, the property values naturally increase." In addition, he says, as other parts of the country recover and as wages and employment increase, "people will be eager to go on vacation and take their kids to places like Disney World in Orlando."

In areas where values remain depressed compared to core cities, such as Las Vegas and Kissimmee, FL, larger upside growth is anticipated when the markets rebound. "Many of these markets have been slow to recover and as a result we're still able to buy at a lower cost basis," Cohen says. "Also, when considering those assets that we buy at price per unit and price per square foot as a commodity, we get much more value for our dollar."

In the western US, for example—a focus for Newport Beach, CA-based Voit Real Estate Services—the more appealing secondary and tertiary markets for distress include Sacramento, San Diego, Phoenix and Las Vegas. Portland, to the northwest, is also attractive, as is Bellevue, WA, east of Seattle, according to Cary Calkin, the firm's director of asset services. "What makes these markets appealing is the strength of the cities nearby or the fact that the distressed properties have been priced so low as to have the risk taken out of the purchase," he says.

It isn't just about where you look, but also about what product type you look at. For example, Cohen points out that he would look for undeveloped land in California, while in Colorado, Florida, Las Vegas and Arizona, he would look more at multifamily. He adds that "multifamily near universities is good, because students will always rent versus buy." That comment was echoed by panelists during a recent ***GlobeSt.com webinar*** on the subject, where speaker James Halliwel, managing director of Principal Real Estate Investors in Des Moines, said he's seen some great success in multi-

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family in places like Pittsburgh.

At the recent Urban Land Institute Fall Meeting in Los Angeles, Taylor Grant, founding principal of Real Estate Receiverships, moderated a panel that discussed the issue of possible over-heated core markets and the need to look carefully at second-tier cities. The consensus, he says, was that depending on the capital source's criteria, class-A properties in lower-echelon cities may be a better bet. That's because the cash flow—due to higher cap rates going in—may more than offset the perceived safety of buying only in core markets.

Like Cohen, Grant, who's firm is also based in Newport Beach, says the sector getting the most play is apartments, but he also sees strong interest in supermarket-anchored retail centers.

Rich Walter, president of Faris Lee Investments in Irvine, CA, agrees, telling ***DAI*** that shadow-anchored drug and food properties offer good opportunities to buy distress in secondary and tertiary markets. "Many tertiary locations were planned areas where there was growth of housing," he says. "Then housing shut down and the retail properties were built ahead of the growth." As the residential market recovers, "these properties can be exceptional buys for a patient investor."

Walter points out that Las Vegas retail is doing well in anchored centers, "but they likely trade at higher cap rates than major markets." He adds that regardless of the market, the key factor is buying well-located real estate.

According to Grant, the groups starting to look in those markets are larger funds with "experienced real estate operational people who can filter through the available properties and find one with a unique set of facts" that may represent "a great defensive buy. Many well-funded private sources are already finding the $5-million to $15-million properties in second-tier cities."

Secondary markets are also reigniting interest among European and Asian investors, according to JLL. Steve Collins, Americas managing director of the firm's international capital group in Washington, DC, says that foreign investors are "moving slightly further out on the risk continuum into solid, well-located properties in secondary markets." Even if they stay in core cities, he adds, they're broadening their search to include value-add or even distressed assets within those markets.

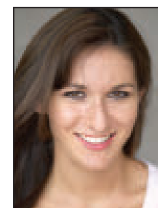
During the GlobeSt.com webinar, Warren Dahlstrom, Washington, DC-based president of Colliers International Investment Services Group, pointed to an annual global survey showing that US investors are more ready to move up the risk scale than those in other parts of the world. "They are more likely to take on riskier projects or properties, and that certainly means secondary markets because of volatility and size," he said. "Secondary markets do require more risk, but the good news is that you can get higher yields there."

Grant says that "if you buy at a 4.5% cap rate, it's difficult to project any cap-rate compression over your hold period. If you buy at a 7% or 8% cap, you can project even a 1% compression with minimum rent increases and obtain a reasonable return." Overall, he adds, "there is possibly just too much 'homeless capital' looking, and some buyers may have already overpaid."

The best deals, according to Voit's Calkin, will be for owner-users who are financially stable and have sought a building for a long time but have been priced out of the market. "Those buyers make up a significant segment of the market," he says. "Investors with good relationships with specific tenants or users comprise another big segment. If you have a tenant in tow, you can make a safe investment decision on a distressed asset." ■

"What makes these markets appealing is the strength of the cities nearby or the fact that the distressed properties have been priced so low as to have the risk taken out of the purchase."

— Cary Calkin, Voit Real Estate Services



__Natalie Dolce__ is the West Coast regional editor for GlobeSt.com and Real Estate Forum. She may be reached at ndolce@alm.com.

Troubled properties present opportunities for savvy investors not averse to some risk. On the following pages you will find details of assets in some degree of distress. Listings in this section represent direct-investment properties financed with both balance sheet and CMBS loans. The following page lists CMBS loans in distress. Loan status is indicated in all cases. These listings are updated on a monthly basis for *DAI* by Real Capital Analytics and Trepp, respectively.

Distressed Status: Resolved

Data Partner: REAL CAPITAL ANALYTICS

Property Name	Location	Units/ SF	Former Distressed Owner	Initial Lender	New Owner	Main Type; SubType	Resolved Date
Fairmont Orchid	Kamuela, HI	539	Westbrook Partners JV Farallon JV Lodging Capital Partners	Barclays Group	Oaktree JV Woodridge Capital LLC	Hotel Full-Service	10/31/11
Pacific Center I & II	San Diego	438,552	GE Pension Trust JV Sentre Partners	LNR Partners OBO GCCF 2006-GG7	CommonWealth Partners	Office Sub	10/24/11
49 E. 34th St.	New York City	110	Esplanade Capital	iStar Financial	CIM Group	Apartment Mid/Highrise	10/25/11
Summit Office Campus	Aliso Viejo, CA	300,000	RREEF America	Allianz SE	Menlo Equities	Office Sub	10/28/11
District at Green Valley Ranch	Henderson, NV	212,622	American Nevada Co.	LNR Partners OBO GS 2005-GG4	Rockwood Capital JV Vestar Development	Retail Mall & Other	10/21/11
W Buckhead	Atlanta	291	Buckhead Realco LLC	Prudential RE Investors	Noble Investment Group	Hotel Full-Service	11/7/11
Palm Beach Mall	West Palm Beach, FL	702,427	Simon Property Group JV DeBartolo Dev	ORIX Capital Markets OBO JPM 2003 PM1	New England Dev. JV Eastern Dev. JV Lubert-Adler	Retail Mall & Other	10/21/11
Trailhead Lodge (Bulk Condo)	Steamboat Springs, CO	57	Resort Ventures West	Bank of America	SilverLeaf Financial	Apartment Mid/Highrise	10/25/11
District @ Green Valley Ranch II	Henderson, NV	171,485	American Nevada Co.	LNR Partners OBO GCCF 2007-GG9	Rockwood Capital JV Vestar Development	Retail Strip	10/21/11
Smith Tower	Seattle	263,807	Walton Street Capital	Munchener Hypothekenbank	CB Richard Ellis Investors	Office CBD	10/25/11
Aventerra	Mesa, AZ	576	GMAC Institutional Advisors JV REPFund	LNR Partners OBO BofA 2008-LS1	Summit Equity Investments Inc.	Apartment Garden	11/3/11
Deep Run III	Richmond, VA	382,570	Inland Western Real Estate Trust	C-III Capital Partners OBO BEAR 2005-TOP20	Markel-Eagle Partners LLC JV DRV LLC	Office Sub	10/19/11
Crowne Plaza Tampa East	Tampa	269	Columbia Sussex Corp.	Midland Loan Svcs. OBO GE 2005-C4	Interstate Hotels & Resorts Waramaug Hospitality LLC	Hotel Full-Service	10/28/11
Challenger Business Park	Palmdale, CA	34,300	Challenger Business Park LLC	Merrill Lynch	Meridian Property Co.	Office Sub	10/20/11
Gwinnett Center	Duluth, GA	263,742	Kaufman Realty Group	GE Capital	Global Growth Trust	Office Sub	10/19/11
Southwind	Memphis	306	Empire American Holdings	CW Capital Asset Mgmt. OBO GMAC 2006-C1	DRA Advisors Fogelman Management Group	Apartment Garden	10/18/11
Jacaranda Plaza	Ft. Lauderdale, FL	173,024	FIRC Group Inc. Cohen Commercial Properties LLC	LNR Partners OBO JPM 2005-CIBC13	Ram Real Estate	Retail Strip	11/9/11
Sheraton Orlando North Hotel	Maitland, FL	353	Paramount Hotel Grp LLC JV AMC Delancey Grp	Anglo Irish Bank Corp.	Lone Star Partners Full-Service	Hotel Full-Service	11/2/11
Mission Valley Resort	San Diego	202	Douglas Wilson JV Lehman Bros Holdings	LaJolla Bank	Morris Cerullo	Hotel Full-Service	10/24/11
Marin Commons	San Rafael, CA	315,000	Hines	CIGNA	County of Marin	Office Sub	10/19/11

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Troubled Assets

Assets	#Props	Vol (mil)
Troubled	7,183	$166,975.1
Restruct'd/Modified	807	$20,648.0
Lender REO	1,435	$24,492.0
Current Distress	**9,425**	**$212,115.1**
Resolved	1,334	$23,415.0
Total	**10,759**	**$235,530.2**

All Global markets

Source: Real Capital Analytics, www.rcanalytics.com

To learn more about RCA's data and Troubled Assets Radar reports visit: http://www.rcanalytics.com/tas

Distressed Status: Lender REO

Property Name	Location	Units/ SF	Former Distressed Owner	Lender/Owner	Main Type; SubType	Troubled Date
Pier at Caesars	Atlantic City	303,788	Taubman Centers JV Gordon Group Holdings	C-III Capital Partners OBO MS 2007-HQ13	Retail Mall & Other	10/29/11
Grand Traverse Mall	Traverse City, MI	310,150	General Growth Properties	Midland Loan Services OBO GE 2005-C4	Retail Mall & Other	10/19/11
Securities Centre	Atlanta	526,617	Argus Realty	LNR Partners OBO CITI 2006-C5	Office Sub	11/1/11
100-102 Duffy Ave.	Hicksville, NY	400,000	AREA Property Partners JV NY State Common Retirement Fund	Berkadia Commercial Mortgage	Office Sub	10/19/11
245 Perimeter Center	Atlanta	237,047	Novare Group	Merrill Lynch	Office Sub	1/1/11
Towne Center at Brookhill	Broomfield, CO	305,858	Gary Dragul	CW Capital Asset Mgmt. OBO COMM 2006-C7	Retail Strip	10/19/11
Hookston Square	Walnut Creek, CA	201,000	Griffin Capital	LNR Partners OBO GCCF 2005-GG5	Office Sub	10/19/11
Conifer Town Center	Conifer, CO	104,267	CTC Shopping Center LLC	LNR Partners OBO GCCF 2007-GG11	Retail Strip	10/26/11
Landings at Peachtree Corners	Norcross, GA	490	Lyon Capital Ventures	LNR Partners OBO LB-UBS 2006-C6	Apartment Garden	11/1/11
Empire Towers	Glen Burnie, MD	141,667	Empire Towers Corp.	C-III Capital Partners OBO MS 2007-TOP27	Office Sub	11/1/11
Parkside Village	Denver	288	Village by the Park LLC AKA Thistle Community Housing	Housing Authority County Adams Colorado	Apartment Garden	10/26/11
Foothill Views Apartments	Azusa, CA	96	Azusa	Midland Loan Services OBO BofA 2007-4	Apartment Garden	10/18/11
Royal Airport Center	Los Angeles	214,152	LAX Royal Airport Center LP	LNR Partners OBO MS 2006-IQ11	Office Sub	10/20/11
Ventana Lakes Village Center	Peoria, AZ	83,436	Ventana Center Associates LLC	C-III Capital Partners OBO LB TIAA 2007-C4	Retail Strip	10/27/11
16912 Von Karman Ave.	Irvine, CA	62,031	Prime Tech Cabinets	Wells Fargo & Co.	Industrial Warehouse	10/18/11
Plaza de Oro Commerce Center	Rancho Cordova, CA	80,749	Fourway Inc.	Washington Mutual	Retail Strip	10/19/11
Madison Center	Madison Heights, MI	220,088	Ramco-Gershenson Properties	LNR Partners OBO FU 2001-C3	Retail Strip	10/30/11
31225 La Baya Dr.	Thousand Oaks, CA	45,074	Baya Con Dios Venture LP & La Baya Anderson LLC	Midland Loan Services OBO ML-CFC 2007-7	Industrial Flex	11/2/11
4455 W. 117th St.	Hawthorne, CA	41,000	Gaffney Street Properties Inc.	California CU	Office Sub	10/19/11
Montgomery Sq. Phase 2	Portsmouth, VA	40	Rockville Development	Virginia Housing Development Authority	Apartment Garden	10/28/11

TROUBLED ASSETS MARKETPLACE—CMBS

Data Partner:

Listings in this section represent individual properties within distressed CMBS pools and are broken down by property type. These listings are updated monthly by Trepp for DAI.

Top 10 Loans Performing w/ Special Servicer

Property Name	Balance	Delinquency Status	City	State	Loan Type
Beacon Seattle & Washington D.C. Portfolio	1,916,149,279	Current	Various		Fixed
Farallon Portfolio	1,286,629,447	Current	Various		Fixed/Fltg
Kyo-ya Hotel Pool	962,633,724	Perf Mat Balloon	Various		Floating
Boca Resorts Hotel Pool	779,914,865	Perf Mat Balloon	Various	FL	Floating
Four Seasons Resort Maui	425,000,000	Current	Wailea	HI	Fixed
Bank of America Plaza	363,000,000	Current	Atlanta		Fixed
Solana	360,000,000	Current	Westlake	TX	Fixed
TW Hotels Portfolio	309,643,751	Current	Various		Floating
Riverchase Galleria	305,000,000	Current	Hoover	AL	Fixed
Bethany Maryland Portfolio	296,680,000	Current	Various	MD	Fixed

Top 10 Delinquent Hotel Loans

Property Name	Balance	Delinquency Status	City	State	Loan Type
CNL Hotel & Resorts, Inc. Resort Portfolio	1,000,000,000	NonPerf Mat Balloon	Various		Fixed
Innkeepers Portfolio	825,402,542	90+ Days	Various		Fixed
Resorts International - Casino Portfolio	207,929,759	Foreclosure	Various		Floating
Westin Portfolio	207,498,502	90+ Days	Various		Fixed
Windsor Capital Embassy Suites Portfolio	175,092,414	NonPerf Mat Balloon	Various		Fixed
Four Seasons Resort and Club - Dallas	175,000,000	REO	Irving	TX	Fixed
Hyatt Regency - Jacksonville	150,000,000	Foreclosure	Jacksonville	FL	Fixed
Westin Casuarina Hotel & Spa	145,987,950	Foreclosure	Las Vegas		Fixed
Hyatt Regency- Bethesda	140,000,000	Foreclosure	Bethesda	MD	Fixed
Westin Casuarina Resort & Spa - Cayman Islands	135,559,576	Foreclosure	George Town	FO	Fixed

Top 10 Delinquent Multifamily Loans

Property Name	Balance	Delinquency Status	City	State	Loan Type
Peter Cooper Village & Stuyvesant Town Pool	3,000,000,000	Foreclosure	New York		Fixed
Alliance SAFD - PJ	475,000,000	90+ Days	Various		Fixed
Empirian Multifamily Portfolio Pool 1	384,750,000	90+ Days	Various		Fixed
The Belnord	375,000,000	90+ Days	New York		Fixed
Empirian Multifamily Portfolio Pool 2	335,000,000	90+ Days	Various		Fixed
Empirian Multifamily Portfolio Pool 3	330,250,000	90+ Days	Various		Fixed
Riverton Apartments	225,000,000	REO	New York		Fixed
Savoy Park	210,000,000	30 Days	New York		Fixed
Babcock & Brown FX 3	195,095,563	Foreclosure	Various		Fixed
New York City Apartment Portfolio Roll-Up	195,000,000	Foreclosure	New York		Fixed

Top 10 Delinquent Office Loans

Property Name	Balance	Delinquency Status	City	State	Loan Type
666 Fifth Ave.	929,500,000	90+ Days	New York		Fixed
Two California Plaza	470,000,000	Foreclosure*	Los Angeles		Fixed
237 Park Ave.	419,600,000	30 Days	New York		Fixed
DRA-CRT Portfolio I	180,900,000	REO	Various		Fixed
119 W. 40th St.	160,000,000	Foreclosure	New York		Fixed
Duke Cleveland East Suburban Portfolio	135,000,000	90+ Days	Various	OH	Fixed
Renaissance Tower Office Building	129,000,000	90+ Days	Dallas		Fixed
Pacific Center	121,200,000	Foreclosure	San Diego		Fixed
123 North Wacker	120,346,998	30 Days	Chicago		Fixed
Colony Square	116,000,000	NonPerf Mat Balloon	Atlanta		Fixed

Top 10 Delinquent Retail Loans

Property Name	Balance	Delinquency Status	City	State	Loan Type
Montclair Plaza	190,000,000	REO	Montclair	CA	Fixed
DDR/Macquarie Mervyn's Portfolio	153,354,932	NonPerf Mat Balloon	Various		Fixed/Fltg
Tri-County Mall	148,175,810	90+ Days	Cincinnati		Fixed
The Promenade Shops at Dos Lagos	125,200,000	REO	Corona	CA	Fixed
Valley View Center	125,000,000	Foreclosure	Dallas		Fixed
The Source	124,000,000	NonPerf Mat Balloon	Westbury	NY	Fixed
Southridge Mall	124,000,000	30 Days	Greendale	WI	Fixed
Silver City Galleria	123,343,721	Foreclosure	Taunton	MA	Fixed
Louisiana Boardwalk 29	122,287,259	REO	Bossier City	LA	Fixed
Lakeforest Mall	118,721,201	NonPerf Mat Balloon	Gaithersburg	MD	Fixed

*Loan is listed as current on payments, but with a special servicer workout strategy of "foreclosure"

Source: TREPP

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