Duvall & Associates, Inc.

<u>Taking Care of Business</u>

BANKS HATE REAL ESTATE LOANS

"Can we call it a loan...on a bet that I lost?" Jackson Browne

Nationwide, financial institutions are claiming "We're in business to make loans." But they really aren't sincere. Consider the recessionary calamity regarding real estate loans.

First illusion – Commercial real estate loans have 15 year payment terms. Reality - Generally loans contain a 3-5 year term renewal clause whereby banks can unilaterally determine whether to re-loan said debt (for another 3-5 year term).

Second illusion – Financial institutions will automatically renew the loan assuming a stable borrower and punctual payment history.

The problem – the value of commercial real estate is in decline and banks are requiring new appraisals as conditions precedent to approval of "clean" renewals. When the reduced property value is delivered, the lender discovers it is "under water" on the loan, and actively conspires to get the loan off its books.

   <u>Example</u> – Company X buys a <u>$1,000,000</u> commercial building with a <u>$200,000</u> down payment and a mortgage of <u>$800,000</u>.

   At the 5-year renewal date, borrower has timely made all payments and still owes <u>$600,000</u>. The bank orders a new appraisal which generates a current value of only <u>$600,000</u>, which when multiplied times the institution's $80% to loan criteria, yields an "acceptable" loan value of <u>$480,000</u>.

   The bank is immediately forced to accrue a $120,000 loss on its loan – and instructs the creditor to seek another lender. Meanwhile, the bank imposes massive penalties and   fees on the borrower for the administrative inconvenience   of carrying a non-compliant loan on its books.

The borrower is compliant with the debt terms and is stable financially – yet is being viciously punished for virtual market conditions which it cannot control.

And politicians wonder why businesses aren't investing in real estate. Stimulus anyone?

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