Opinions on the real estate market depend on the position of the commentator. Lenders, holding loans made to sell, are unhappy now as they can not securitize their loans or sell them to the sponsors of CDOs. Similarly, the holders of mortgage backed secur

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Brokerage companies have distinct groups of market opinions. The sales brokers, having deals impacted by credit tightening, think things are going downhill. Leasing brokers are having the time of their lives, as rental rates and leasing volumes have been surging. Similarly, buyers and owners have two distinct views of the market. Â Some owners may have negative feelings about the market if they are currently looking to close financing transactions and their lenders are increasing their rates and or not honoring commitments. On the other hand, owners with financing in place, are happy as they enjoy large increases in cash flow from recent rental rate increases in New York City properties. Â

My perspective of the market, as a real estate lender for M&T, is quite different than the perspective of lenders who were selling their originations. Splitting the responsibility of loan originations from the ownership of the mortgages, removed the discipline lenders used to have. Now, a sudden realization of the poor risk profile of many securitized loans has enabled the portfolio lender to regain market share. I am quite pleased with this development although it has made for an increased workload while my former competitors have decided to take a time out. Our customers looking to finance acquisitions, capital improvements or recapturing equity created by the increased cash flow of their properties, think the market is strong too and they value the flexibility and consistency of portfolio lenders. Â

Just because there has been an upheaval in some of the financing of real estate, doesn't mean that things have changed permanently. I came to New York in the 1970s and it looked like a scene from a Scorcese film, dirty and dangerous. Now, New York is full of opportunity and the safest major city in America. Real estate was at a nadir in 1992-1993 and today Â values and rents are still rising. Perspectives change not only the role of the participant but also over time. We have tried to broaden our role in real estate finance over time. M&T holds real estate loans in portfolio and seeks to maximize its product offerings to meet the needs of the market. In addition to portfolio lending on commercial and multifamily properties, M&T is a seller and servicer for government sponsored entities (GSEs) and provides FHA insured lending. We are also improving our lending platform through syndication and securitization platforms. Securitization has its place in real estate lending and we provide this financing vehicle when appropriate to the needs of our customers.

I believe the real estate market looks full of opportunities for lending to M&T's existing customers. We are active in the market and looking to expand our presence with hiring and finding new

customers.

Gardner Semet is administrative vice president, New York City commercial finance, at M&T Bank, New York, N.Y.At some point every property owner contemplates the right time to sell; when they have had enough of the headaches and the daily responsibilities. In the same moment, a quick calculation occurs, reminding them that although the appreciated value of the real estate will bring substantial profit, the capital gains tax will cause that figure to quickly drop. Investors seek to continue with real estate in their portfolio and certainly consider it a prerequisite to defer capital gains and depreciation recapture tax payments.

Mostly offered through the securities industry, tenant in common (TIC) properties have become an alternative for qualified investors who are planning to sell. In addition to the TIC properties being offered, programs involving Delaware Statutory Trusts (DSTs), Oil & Gas Royalties and UPREITs are available.

TIC ownership has been around for many years, but TICs as a replacement property solution within the IRC Â§1031 exchange are fairly recent, and the percentage of investors purchasing these has been consistently gaining momentum in the past five years. This is due in great measure to revenue procedure 2002-22, in which the IRS issued guidelines to assist taxpayers in determining if their anticipated TIC ownership will qualify under the exchange guidelines. These guidelines address items such as the allowable number of co-owners, their entitled voting rights, the ability to transfer the ownership interest, and how profits, losses and debt are shared.

Taxpayers sell their property as part of a tax deferred exchange, and acquire fractional shares as an undivided fee interest in real property, holding title as a tenant in common, either directly or as a disregarded entity. Typical properties may include retail centers and strip malls, office buildings, or large scale apartment complexes. The investor receives income in proportion to the percentage of ownership, as well as depreciation and interest deductions, and has a proportionate share of non-recourse debt secured by the property.

This alternative eliminates management burdens and day-to-day responsibilities for the owner and offers diversification by rolling funds into institutional grade real estate that the taxpayer may not otherwise be able to access.

Section 1031 - 721 exchange (UPREIT) exchanging into TIC ownership is essentially purchasing a fractional interest in one specific property. The taxpayer remains on title for a period of years until such time as the ownership decides the property value has gained sufficiently to make a profit upon its sale. Because it is a single property, the risk may be the property does not significantly appreciate to make a sale worthwhile. A section 721 exchange starts off similarly to a section 1031, with the investor purchasing a TIC replacement property interest, and at a later date exchanging that fractional property interest for operating partnership units in a REIT. This exchange would not trigger capital gains tax allowing the investor to defer as well as receive dividends. After a period of time, the investor would have the option to convert these units into REIT shares. The benefit is that by exchanging into units, the investor now has diversified and is sharing in a pool of properties, rather than just one property. The downside is that the investor has lost the ability to continue exchanging under Section 1031, and converting REIT operating partnership units into REIT shares will be a taxable event.

These 1031 exchange replacement opportunities are generally not quick, last minute options.

Working in conjunction with their tax/financial advisor, the investor should determine his or her specific real estate needs and risk tolerances early on and thoroughly investigate potential sponsor companies and their real estate offerings, taking time to uncover the most suitable property match.

Patricia Flowers is assistant vice president for Investment Property Exchange Services, Inc. (IPX1031), Boston, Mass.I am not a stranger to derivatives. As an ex-floor trader on the New York Futures Exchange for E.F. Hutton & Co., as well as, a current member of the National Futures Association, I believe that pro-active measures can be taken to manage the risk associated with the financing of real estate development projects. This "real estate risk management" should be thought of as "credit protection" on the financing of the project, and the associated risk can be managed by using the derivatives on residential real estate that have been trading on the Chicago Mercantile Exchange (CME) since May 2006.
Recently (August 25), The Wall Street Journal said, "For the nation's real estate lenders, the other shoe may be about to drop: condominiums. Already plagued by rising home-loan defaults and foreclosures among overstretched consumers, major markets across the country - including parts of Fla., Calif. and Washington, D.C. - are seeing rising foreclosures and bankruptcies of entire condo projects."
On the very same day, The New York Times said, "In a sign that the real estate slowdown has hit even the most desirable locations, the developer converting the Savoy Hotel in the South Beach section of Miami into multi-million dollar Fendi-designed condominiums and condo hotels may be facing foreclosure."
Here's the big question, Can measures be taken to mange the risk associated with high profile condo projects that are commonplace in Manhattan?
The answer is yes, they can. Here this is how it could be done.
The Chicago Mercantile Exchange (CME) offers futures and options on residential real estate in 10 major markets in the United States, including New York. According to Frank Gerage, the answer to the problem associated with foreclosures and bankruptcies lie in a "transferable hedge."
Example: A developer wants to build 100 townhouses in Miami. Each unit sells for $1.5 million, the total project going for $150 million. The lender (bank) would require the developer to "hedge" the $150 million value of the project at an estimated 5%, or $7.5 million in this example. Because of this, the lender would offer a favorable lending term.
The hedge is "transferable," meaning that if the developer were to become insolvent, the hedge and property would revert to the lender. The hedge in this case would be what is known as a "selling hedge" consisting of put options. Lenders would find themselves in a much better position with a hedge in place if they had to reclaim a property that defaulted and in turn put that property back on the market (especially a declining market).
If the developer completed the example project shown above, and was ready to sell the units for $1.5 million each, the hedge would be prorated to the buyers of the townhouses.
Example: Each option can be exercised for one "futures contract." Each futures contract has an aggregate value of $50,000. Therefore, each buyer of a $1.5 million townhouse receives 30 put options with their purchase (30 x $50,000 = $1.5 million).
Keeping in mind the "transferability" of this hedge, when the buyer of the townhouse goes to his residential lender for his mortgage, not only is the property pledged to the lender, the hedge is pledged as well.

When the lender packages mortgages to be converted into mortgage-backed fixed income securities, these bonds would be based on mortgages that were hedged with these put options attached to them. In my opinion, this form of credit protection on mortgage-backed securities would be extremely timely in today's market.

The use of real estate futures and options is very popular in Europe, especially London where they have been using derivatives for about four years.

So why isn't Manhattan using derivatives?

In the brick and mortar market of real estate, there are not many individuals that have a clear understanding of derivatives. Conversely, on the derivative side, they do not have a clear understanding of the real estate market. These derivatives that trade on the CME offer tremendous opportunities in these troubling times.

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