

Corporate and Construction Update

January 2010

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SAVE THE DATE: SPRING SEMINAR

APRIL 13, 2010

Willis Tower, 233 S. Wacker Drive, Chicago, IL
8 a.m.- noon

Recession Year 2:
Business Problems and Legal
Solutions

Bankers Round Table:
Can I get a loan now?

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Our firm's corporate and construction clients continue dealing with the challenging events as we emerge from the Great Recession. In an effort to assist our clients analyze strategic issues and manage daily operations, we address various topics in our newsletters. If you have questions about these or other topics, then please let us know.

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Is it Time to Buy?

The BAD News: National unemployment continues to hover around 10%. It may be higher or lower in your area. **FOR LEASE** signs are everywhere....office buildings, strip malls, regional malls. Foreclosures continue, and banks continue to foreclose on property that they don't want to own.

The GOOD News: Banks are willing to lend to creditworthy borrowers. Interest rates remain low. Economists are forecasting that consumer spending is expected to increase in 2010. The stock market continues to rise.

AND: in comparison to a few years ago, many properties are on the market for a fraction of what owners paid for them.

Some of the big players are acquiring properties. In December, Simon Property Group announced that it was taking over 22 shopping centers that were located in Texas, Florida, Pennsylvania, Maryland, Virginia, Ohio, Tennessee, South Carolina, and California.

As we move into the spring, large grocery store operators anticipate acquiring smaller troubled grocery chains in New York, Virginia, North Carolina, South Carolina, Tennessee, and Georgia.

What Type of Commercial Real Estate Should I Look For?

Many power centers or strip malls are in good condition, but the neighborhood conditions have changed. A new housing development stalled, and the number of families in the trading area is less than anticipated. A plant or factory closed, and people are out of work. Several retail tenants have gone out of business, and the center has several vacancies. In these situations, a careful financial analysis of the 1 to 3 year outlook for the immediate neighborhood will be critical in determining the carrying costs until conditions improve. Each situation is different, but banks have been listing properties with presently performing loans for 80% of the outstanding mortgage. For commercial properties that have loans that are not performing, many banks have been willing to sell the property for 40% - 50% of the outstanding loan balance.

Some properties that are owned by lenders need some capital improvement. Lenders are very hesitant to "throw good money after bad". In these situations, the lender is probably willing to unload the property for an even deeper discount.

If neighborhood conditions are stable, but the building has run into problems because the tenants have gone dark and the current owner didn't have the cash to maintain the property; then a shrewd investor may acquire a diamond in the ruff.

What about financing?

Although a recent Fed survey of bank loan officers has shown a fourth consecutive decline in the number of bank respondents that are tightening their lending standards, banks continue to analyze each loan very carefully. In most real estate owned ("REO") situations, the bank would like to exit the property completely. However, if the buyer (i) has a strong balance sheet, (ii) is willing to infuse capital into the project, and (iii) has a good "story" (e.g., the buyer can bring in a new national or regional tenant; the buyer is willing to invest and give the property a facelift; or a new plant or factory is moving into the community), then the bank may be willing provide financing.

Grocery store and drug store chains continue to expand and acquire choice anchor locations in urban and heavily populated areas that have been vacated by other retailers. Banks give high value to these leases.

Run the Numbers!

Make certain that you carefully analyze neighborhood market conditions, carrying costs, vacancy rate, creditworthiness of tenants, capital improvement costs, and other cash flow items in determining a purchase price.

Sellers will request an earnest money deposit. Once the deposit is made, it may be difficult to have it returned unless the seller authorizes the release. Therefore, consider depositing the escrow funds after all of the due diligence have been completed.

The due diligence analysis will identify additional costs that need to be considered. Be certain to analyze the following:

Physical Inspection. The roof, ceilings, walls, floors, foundation, HVAC systems, alarm and sprinkler systems, and electrical systems should be inspected by professionals. If the premises includes a parking lot, then don't forget to determine its condition as well as any lighting or other improvements located on the lot. In addition to having professional inspections, talk with current or past tenants. If the landlord is in a difficult financial situation, the tenants may inform you about various repair and maintenance items that may have been postponed.

Regulatory issues. Make certain to investigate all zoning, code, and other governmental requirements. If you have expansion plans, then make certain that the new building meets parking and local floor area ratio requirements.

Environmental issues. The Phase 1 Environmental Site Assessment should be certified to the buyer. Consider whether core samplings of various areas of the property are needed. In today's economy, many sellers are incurring the costs associated with

both the Phase 1 and Phase 2 assessments, which were previously a buyer's expense.

Title and Survey. Analyze the easements that are described in the title commitment and the survey. The building may share a driveway with the neighboring building. If so, the easement for the driveway may impact expansion plans.

Contracts, Books, and Records. If the building has tenants, then examine the rent roll, leases, and financial stability of each tenant. Every tenant should provide an estoppel letter to confirm the status of the lease. Management, maintenance, and other contracts should be reviewed to determine whether there are future obligations that come along with the building. If the gas and electric bills seem excessive given the size of the building, then the building may need a new HVAC system, caulking, windows, etc.

Other issues. Many towns are having financial difficulties; thus an easy way to avoid the wrath of local residents is to increase taxes on commercial property and businesses. Increases in property taxes could be a result of building a new school, new library, increase in fire and police, etc. Also, the timing of payments may be changing. In Cook County, the first installment property tax was 50% of the total tax bill for the prior year. Starting with the 1st installment that is due in early 2010, 55% of the prior year's bill will be due. Due to the current economic problems; many taxpayers did not pay their recent tax bills, which resulted in a cash flow shortage for many government agencies. Thus, increasing the amount received with the 1st installment will help local government agencies manage cash flow shortages.

These are only a few of the due diligence items that should be analyzed when purchasing a commercial property. Each property is unique, thus due diligence items will vary.

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Is There Stimulus Money for Me?

This article is a companion piece to the seminar and round table discussion we presented last summer,

“Construction Development: From Surviving to Thriving -- Where is the Work, Money, and Profit?”

Many companies and commercial developers looking to expand now have a new financing mechanism available to them as a result of last year's federal stimulus program. And, it is not too late to take advantage since final applications and submittals are not due until September 2010 and the underlying bonds need not be sold until January 1, 2011.

Many areas in Illinois and northeast Indiana meet the qualifications for designation as a “recovery zone” based upon various economic indicators. If your local government, typically at the county level, has passed the appropriate resolutions, your business may be able to apply for financing supported by the sale of bonds by the local government through this program. State, county or large municipal governments can adopt the recovery zone designation. Illinois alone was allocated over 1 billion dollars (\$1,000,457,000), so there should be plenty of funding available.

Recovery Zone Facility (“RZF”) Bonds are a new type of exempt facility bond specifically created by the American Recovery & Reinvestment Act of 2009. The financing opportunities are available to manufacturers, distributors, service providers and retail businesses – unlike traditional tax exempt financing available only to manufacturing concerns under the federal tax code. The Internal Revenue Code defines qualified businesses as “any trade or business except residential rental property, private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling or any store the principle business of which is the sale of alcoholic beverages for consumption off premises.” Examples of facilities that can be financed within a recovery zone, with proceeds of RZF Bonds, include large manufacturing facilities, office buildings, shopping centers, malls and grocery stores, other retail stores, recreational facilities (e.g., bowling alleys), banks, warehouses, and hotels.

Thus, the range of business that can take advantage of this program is quite extensive. Prior to the stimulus program, none of these businesses could be financed with tax-exempt bonds.

The RZF Bonds carry the same benefits to businesses as traditional industrial revenue bonds, and investors purchase these bonds from the local government as tax-exempt investments. The RZF Bonds, in turn, support loans to qualifying businesses with interest rates typically well below market. The funds must be used for the acquisition of “qualified property.” Qualified property is any depreciable property which a qualified business purchases, constructs, or renovates after a “Recovery Zone” is designated (the date President Obama signed the ARRA bill into law was February 17, 2009).

There are some restrictions, however. Substantially all of the use of the property must be within the designated recovery zone and, of course, it can only be used by the types of qualified businesses noted above. Ninety Five percent (95%) of the RZF Bond proceeds must be used for recovery zone property. The original use of the property must commence with the taxpayer, with an exception for any purchase/rehab projects. Acquisition of existing property is allowed, provided that certain other rules are met pertaining to the adjusted basis of the property and the time within which renovations must be completed.

Typically, the bond and loan levels are going to be in substantial amounts, and some applications carry a \$1,500 fee. Inquiries in Cook County, Illinois should be directed to the Cook County Department of Planning and Development at 312-603-1070, while entrepreneurs in Lake County, Illinois can contact Lake County Partners at 847-247-0137. Interested parties in DuPage County, Illinois should call Choose DuPage at 630-955-2090 for more information.

If you have any questions regarding RZF Bonds, please feel free to contact:

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Bryce Downey & Lenkov LLC is a firm of experienced business counselors and accomplished trial lawyers who deliver service, success, and satisfaction. We exceed clients' expectations while providing the highest caliber of service in a wide range of practice areas. With offices in Chicago, Oak Brook, Merrillville, IN, Memphis and Atlanta and attorneys licensed in multiple states, Bryce Downey & Lenkov LLC is able to serve its clients' needs with a regional concentration while maintaining a national practice. Our practice areas include:

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The attorneys at Bryce Downey & Lenkov LLC constantly strive to keep you updated regarding the latest developments in Workers' Compensation law in Illinois and Indiana. If you have any questions regarding Illinois and Indiana Workers' Compensation law, please contact Richard Lenkov at 312.377.1501 or rlenkov@brycedowney.com, or any member of our Workers' Compensation team.

The firm also strives to keep you updated regarding the latest developments in Insurance and Tort law in Illinois, Indiana and other states. If you have any questions regarding these issues, please contact Storrs W. Downey sdowney@brycedowney.com or Terrence J. Madden tmadden@brycedowney.com or at 312.377.1501 or any member of our General Liability Team.

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