TESTIMONY OF
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BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ENTITLED
"ALTERNATIVES FOR PROMOTING LIQUIDITY IN THE COMMERCIAL REAL ESTATE MARKETS, SUPPORTING SMALL BUSINESSES AND INCREASING JOB GROWTH"

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Chairman Frank, Ranking Member Bachus and committee members:

Thank you for the invitation to today's committee hearing to discuss Alternatives for Promoting Liquidity in the Commercial Real Estate Markets, Supporting Small Businesses and Increasing Job Growth. Before I begin, I would like to provide a brief overview of my background and qualifications. I am the principal and founder of Silo Financial Corp. which is a real estate finance company that provides capital to small and medium sized real estate owners, developers and investors. I have seen first hand how the times of easy credit over-fueled the business, and created irrational behavior. I now see how the lack of credit is destroying their companies, costing jobs, and continuing to create a downward spiral in real estate valuations, especially for the projects of $10MM or less. Since 1994 I have actively been involved in Commercial Real Estate Finance. In 2001, I founded Silo Financial Corp. My expertise lies in commercial real estate lending to small and medium sized developers, with project sizes of $10MM or less. I would be remiss if I didn't mention that Jay Rollins of JCR Capital who has a 25+ year track record in structured Real Estate Finance, but who could unfortunately not be here today, has worked tirelessly with me in our efforts to pursue this SBIC lending initiative.

I am certain that this committee is aware of the $1.4 trillion of maturing commercial real estate debt, which represents 40% of all commercial real estate debt. In an effort to save time, I have opted to not dwell on the overload of disturbing statistics about the commercial real estate marketplace. This pending debt disaster, combined with a weak financial system, no viable CMBS market, and no capital available to private lenders, will exacerbate the current problems and cause the real estate recession to deepen. These factors continue to drive down the value of commercial real estate and are the root cause of failure of our nation's community banking network.

In reference to H.R. 5816, I trust that this program could provide smaller community banks with a means to underwrite and originate new qualified commercial mortgages, which they are currently unable to originate due to balance sheet issues, over exposure to real estate and stringent regulatory oversight. It is essential for community banks to be able to provide businesspeople in their communities with small balance commercial real estate loans. Furthermore, the ability to finance more transactions could likely help create a floor for commercial real estate values and create work for many professionals including, appraisers, engineers, attorneys, real estate brokers, mortgage brokers, construction workers and more.

I would like to speak about the actual commercial real estate credit markets from where I am sitting on a daily basis. Credit is the backbone of commercial real estate and it remains extremely challenging for nearly all small balance commercial property owners to access mortgage capital. Please note that we define small balance commercial properties as properties with less than $10mm of existing or required debt. The exception to my previous statement includes few situations, which in scale are not meaningful to the overall market. This includes small businesses which own and occupy at least 51% of a property in conjunction with having adequate financials can presumably qualify for SBA financing. In addition, some might say that well capitalized borrowers, with nearly 100% occupied buildings and strong rent rolls, can still get financing (just like many wealthy home owners). But, the vast majority of small balance commercial borrowers find themselves without sufficient cash as:

1. These projects no longer provide steady cash flows due to declining rents and declining occupancy.
2. Their banking relationships are no longer strong, as most of these borrowers were clients of community banks who have suffered the most in this financial crisis. These community banks were the credit backbone of these borrowers.

The convergence of declining fundamentals, lack of capital (especially at community banks), and maturing loans have created a ticking time bomb of loan defaults, job losses and property foreclosures that will sweep through this country like the residential mortgage crisis. It has only been delayed by low interest rates and bank extensions, but this cannot go on forever.

Commercial Real Estate Linked to Small Business

As far as the commercial real estate industry and its relations to jobs, I would like to specifically point out that the commercial real estate marketplace is directly linked to jobs, GDP output, tax revenue and in of itself is a very large industry sector in our country's struggling economy.

The following facts which I will share have been taken from a 2007 Study by NAIOP titled "The Contribution of Office, Industrial and Retail Development and Construction to the US Economy;"

1) The value of commercial buildings extends well beyond their initial construction value. In order to substantiate the full measure of this value, the pre-construction, construction and **post-construction outlays** associated with commercial buildings must be calculated.

2) While the construction impacts of building 851.5 million square feet of new building space during 2007 represents a significant contribution to GDP, job and income growth nationwide, these new buildings continue to provide economic benefits to their host economies after their construction is complete. These economic impacts include **outlays required to maintain and operate these buildings and the value of their productive output**. **The operating outlays associated with the office, warehouse and retail space built in 2007 are estimated to total $2.4 billion annually. This direct spending of building operations would add $5.1 billion to GDP, support 56,887 new jobs and generate $1.6 billion in new personal earnings**.

These statistics mentioned are only related to the 851 million sf constructed in 2007. Should we take these figures and multiply them by 30 times over, due to the fact that this country has over 32 billion sf of commercial real estate, then the numbers would be astronomical. These operating outlays are annual and recur yearly over the life span of a building. Similarly, the potential productive value of these new building spaces represent a significant annual contribution to the local, state and national economies, as does all commercial real estate.

I will now paraphrase two paragraphs from the Congressional Oversight Committee's Executive Summary in connection with Commercial Real Estate and its link to small business credit. I quote, "It is difficult to predict either the number of foreclosures to come or who will be most immediately affected. In the worst case scenario, hundreds more community and mid-sized banks could face insolvency. Because these banks play a critical role in financing the small businesses that could help the American economy create new jobs, their widespread failure could disrupt local communities, undermine the economic recovery, and extend an already painful recession.

There are no easy solutions to these problems and no one program can solve these complex issues. Although it endorses no specific proposals, the Panel identifies a number of possible interventions to contain the problem until the commercial real estate market can return to health. The Panel is clear that the government cannot and should not keep every bank afloat. But neither should it turn a blind eye to the dangers of unnecessary bank failures and their impact on communities."

To this point, we have developed a practical intervention initiative that could help contain and begin to remedy the commercial real estate crisis at no cost to taxpayers, and in fact, we are proposing a program where we the lenders will provide the equity or first lost capital. In this program, the government would be a secured lender at less than 54% exposure to today's value % LTV, at market rates, with private capital taking the loan share of the risk. Let me explain.

We would like to propose the expansion of the SBIC Program to include the financing of Small Balance Commercial Real Estate.

The existing Small Business Investment Company Act was formed in 1958 in efforts to provide capital to startup and capital deprived companies and businesses. In 1972 the ability to fund or invest in real estate was prohibited. In light of the commercial real estate crisis we are faced with, we are proposing a temporary lift of the Real Estate prohibition in the Small Business Investment Company Act.

The Small Business Investment Company (SBIC) Program is a unique public/private partnership that has provided $57.2 billion in financing to more than 107,000 small U.S. companies since the program's creation in 1958.

The mission of the Small Business Investment Company (SBIC) is to improve and stimulate the national economy and small businesses by stimulating and supplementing the flow of private equity capital and long term loan funds for the sound financing, growth, expansion and modernization of small business operations while insuring the maximum participation of private financing sources. We believe in the midst of this Commercial Real Estate Crisis the SBIC mission is an ideal fit to address this problem.

There are hundreds of small Real Estate Finance companies across the country, like Silo located in Stamford Ct and JCR Capital located in Denver CO, which provide commercial real estate loans, some public and mostly private. Typically these finance companies utilize private sector equity combined with bank lines or credit facilities to make loans. Unfortunately, the state of the commercial real estate market, coupled with the state of banks' balance sheets and their over exposure to real estate is prohibiting these smaller finance companies from accessing capital themselves. This in turn means even less capital can flow into the commercial real estate markets. This in turn causes banks to have less take out options, values continue to decline, and community banks are forced to close. **The SBIC program would be a perfect temporary fit until the traditional capital markets get back to normal.**

It is our understanding that the government has never lost money through the SBIC debenture program and it is in fact this debenture program, which would work perfectly to accommodate small real estate finance companies need for capital in effort to compliment bank lending in this environment. Presumably the success of the SBIC program and taxpayer protection is simple. SBIC's must have ¼ but in most cases 1/3rd of their own capital at risk in a 1st loss position. So for example, if ABC Real Estate Finance Company had $50mm of equity and where granted an SBIC Commercial Mortgage license, it could essentially borrow $100mm at market rates and be able to deploy have $150mm to deploy in the form of commercial real estate loans to small balance borrowers. To the extent, these loans in a portfolio where made at an average of 75% LTV or less, than the taxpayer's last dollar exposure would be no greater than 50% of today's appraised value.

Conclusion

While financial market conditions have improved in the United States, the overall lending environment remains strained, and significant concerns have been raised about the availability of credit to small businesses. Therefore, we are asking, suggesting and recommending that you consider either (a) a new program, much like the successful SBIC program to provide leverage to small commercial real estate finance companies or (b) to temporarily strike the prohibition of real estate under the current SBIC guidelines to allow access to leverage for small commercial real estate finance companies. This could be a practical and successful vehicle to assist the small bank commercial real estate borrowers in this time of crisis. We believe we have modeled a program that can provide capital, jobs, and assist community banks, all at no cost to taxpayers. We ask for your support, as Silo and JCR continues its work with the SBA to establish the Commercial Mortgage SBIC program.

Thank you again for your invitation to discuss these important issues at today's hearing. I would be happy to answer any questions that you may have.