

## MBA Conference, Capital Markets Overview

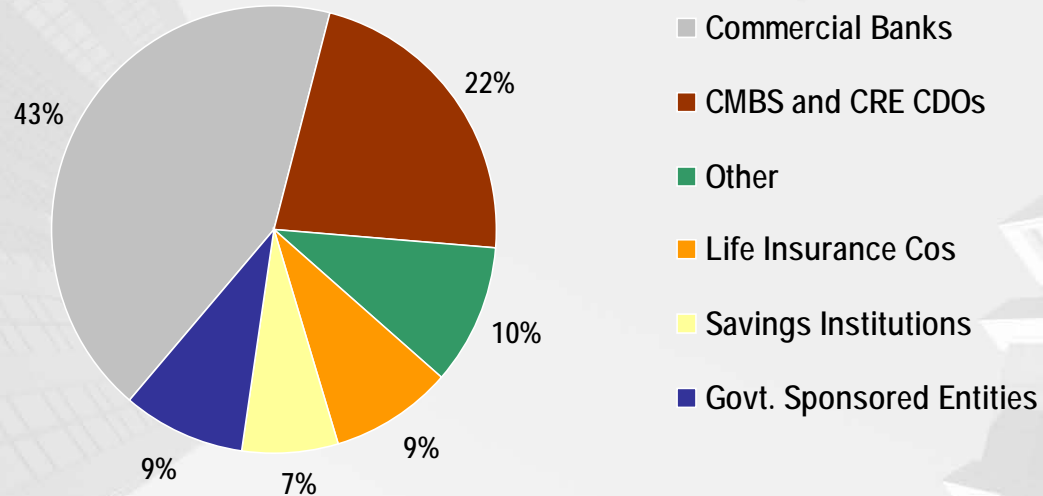
November 11, 2009



# TOTAL U.S. INSTITUTIONAL COMMERCIAL REAL ESTATE UNIVERSE - \$5.0 TRILLION

## Fixed Income Markets - \$3.39 Trillion

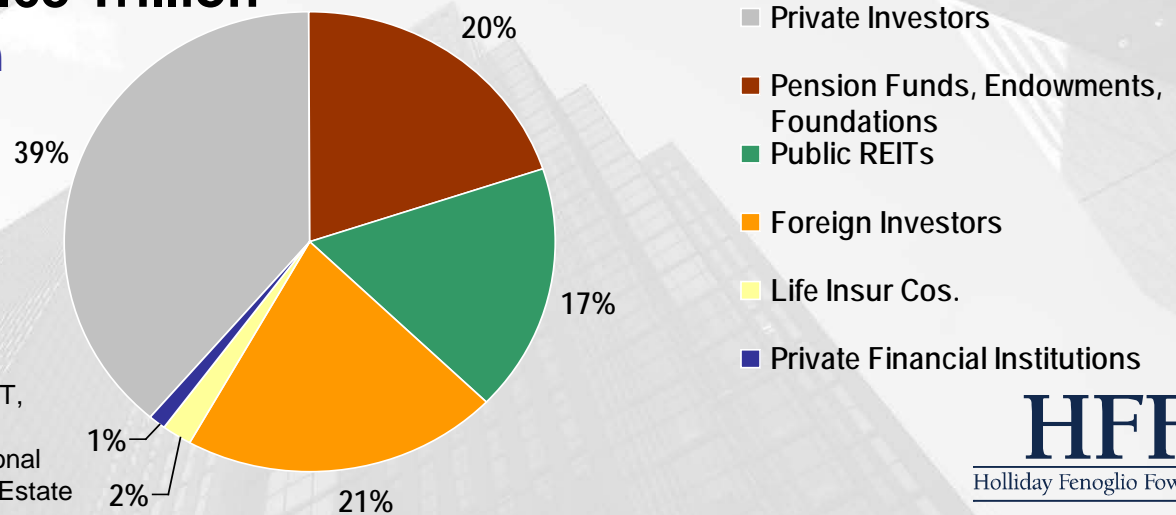
### Lender Composition



Sources: Federal Reserve Flow of Funds, 2Q 2008

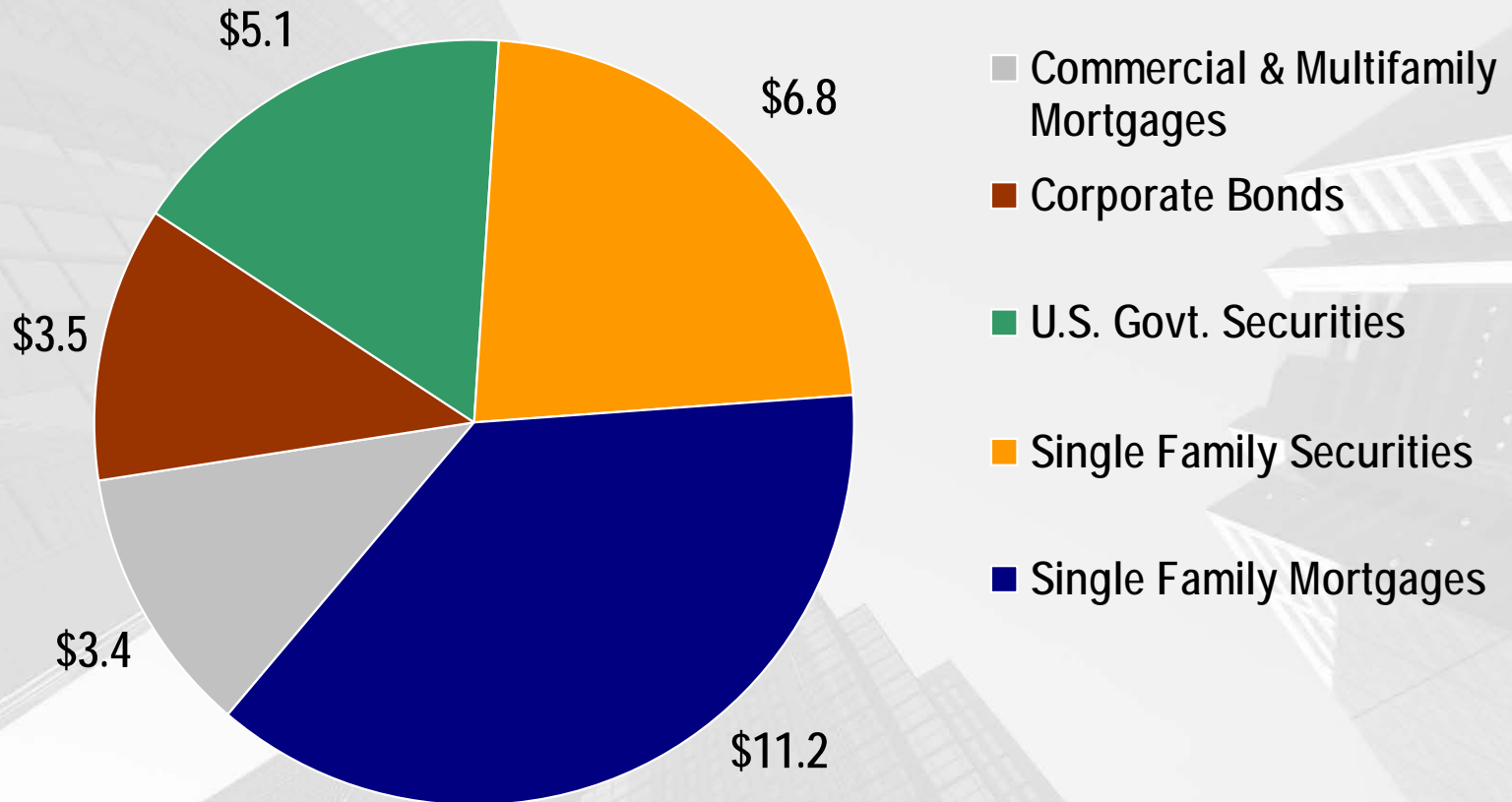
## Equity Markets - \$1.63 Trillion

### Investor Composition



Sources: Pension & Investments, NAREIT, ACLI, AFIRE, Information Management Network, Foundation Center, FDIC, National Credit Union Association, Principal Real Estate Investors, 2Q 2008

# FIXED INCOME MARKET SIZE COMPARISON (\$Tril.)

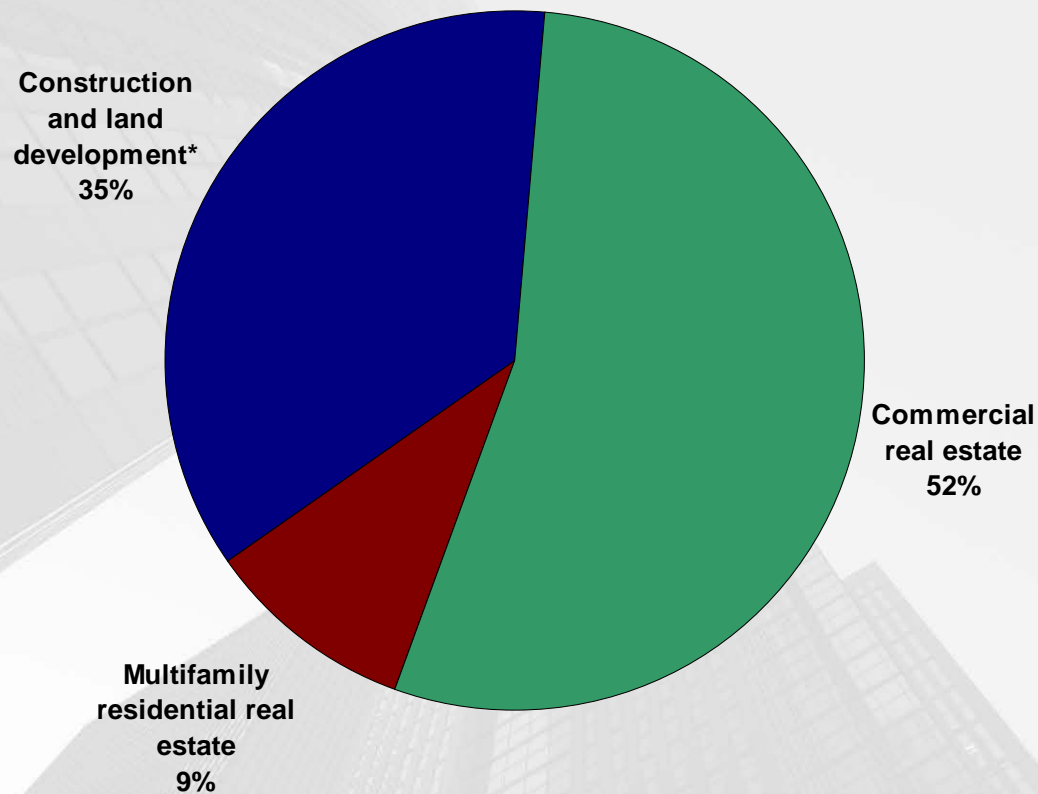


Source: Federal Reserve Flow of Funds, Raymond James

# BREAKOUT OF CRE ON BANK BALANCE SHEETS

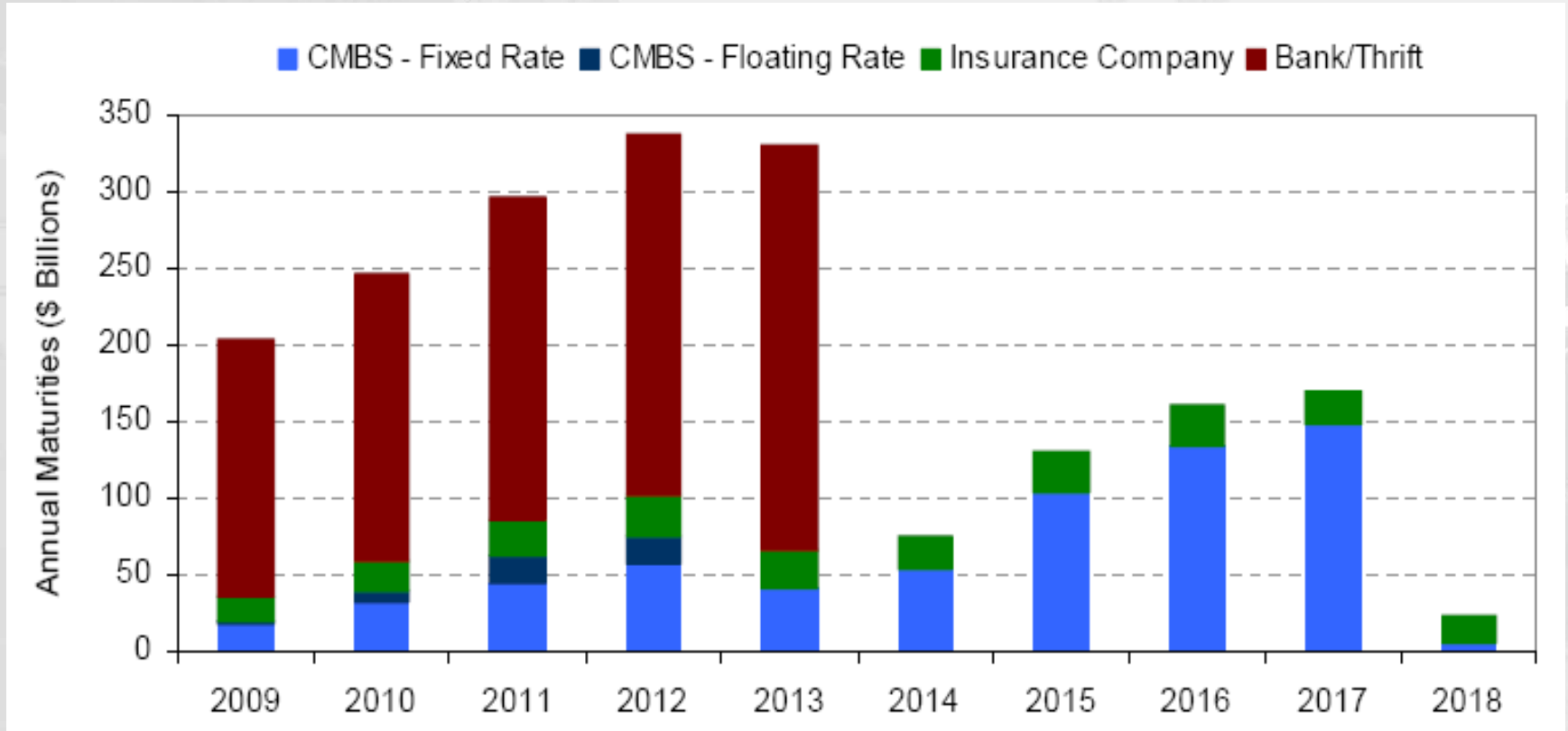
## Components of domestic CRE loans in commercial banks

**Total: \$1.6 Trillion**



Source: Buchanan Street Partners, *IREL* May 2009

# ESTIMATED MATURITY PROFILE OF COMMERCIAL MORTGAGES IN CMBS, BANK AND LIFE COMPANY PORTFOLIOS



Source: Deutsche Bank, Intex, Trepp, MBA, Federal Reserve  
April 22, 2009; Deutsche Bank CMBS Research report

## BANK CONCLUSION

- 1) Banks' 2009 lending production will be down 20% to 70% from 2008 depending upon the severity of losses.**
- 2) Pricing is 300-500 bp over the curve. Recourse is a given. Floor pricing of 6%-7% is routine.**
- 3) LTV's 50%-60% maximum; most domestic banks will limit balance sheet exposure and any given transaction to \$25MM and less. Syndication market is extremely difficult. Some foreign banks are now targeting loans in excess of \$100MM for best of quality sponsor.**
- 4) Construction loans will remain extremely difficult to obtain and will require recourse and best of class metrics (i.e. 50% LTC, sponsorship, project, location, pre-leasing).**

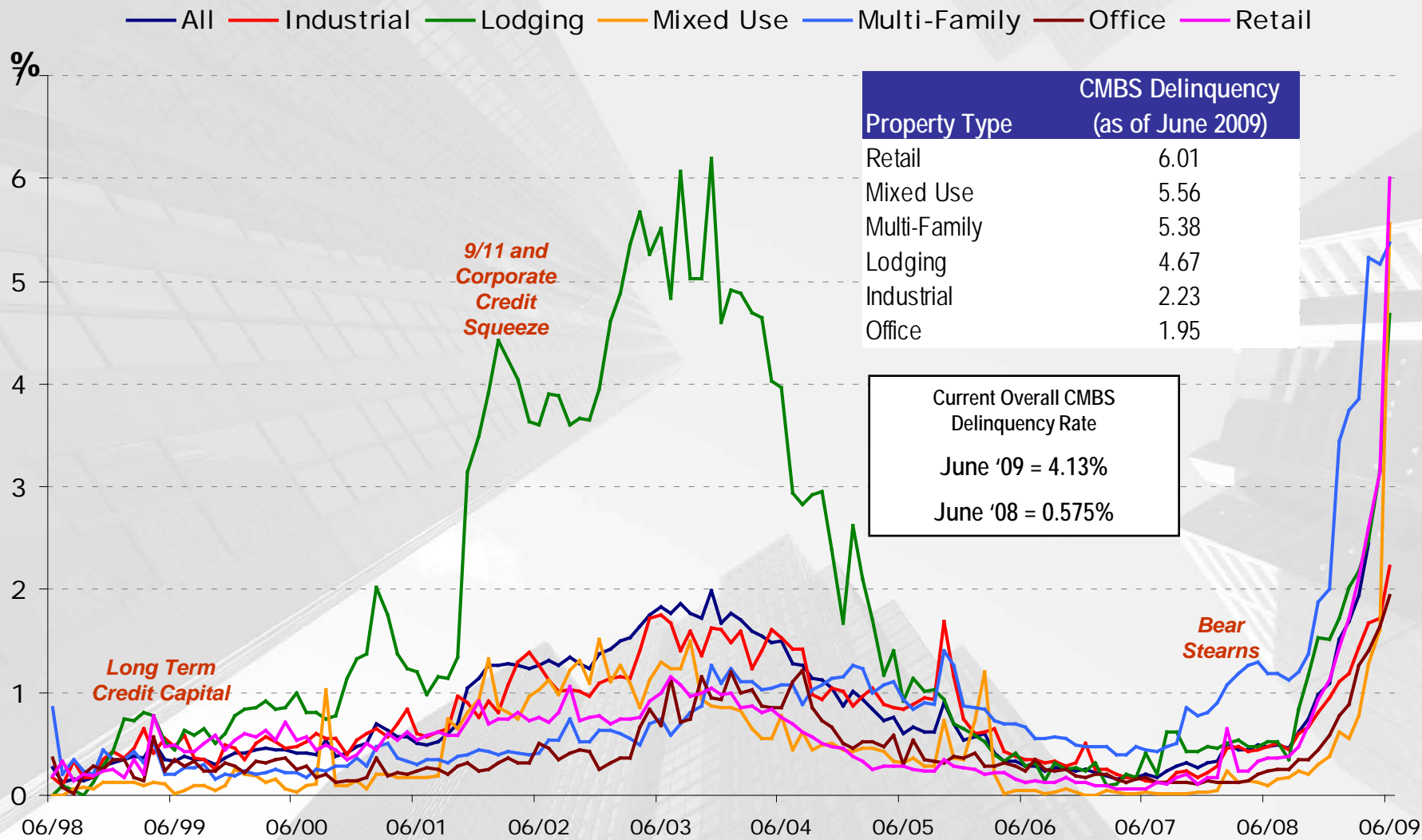
## BANK CONCLUSION (CONT.)

- 5) **FDIC \$250,000 deposit insurance measure has significantly helped regional/local banks which have continued to actively lend.**
- 6) **Use of TARP proceeds will go into three areas:**
  - a. **Maintain capital adequacy for anticipated losses (i.e. increase loan loss reserves)**
  - b. **Buy troubled assets/banks**
  - c. **Lend to primary market**
- 7) **Bank maturities are for the most part being extended 18-24 months with modest pay-downs, depending on the sponsor, project and location. Monetary defaults are another issue entirely and each bank has reacted differently based on many factors related to its own balance sheet. Losses are estimated at \$100 billion on the low end to \$300 billion on the high end.**

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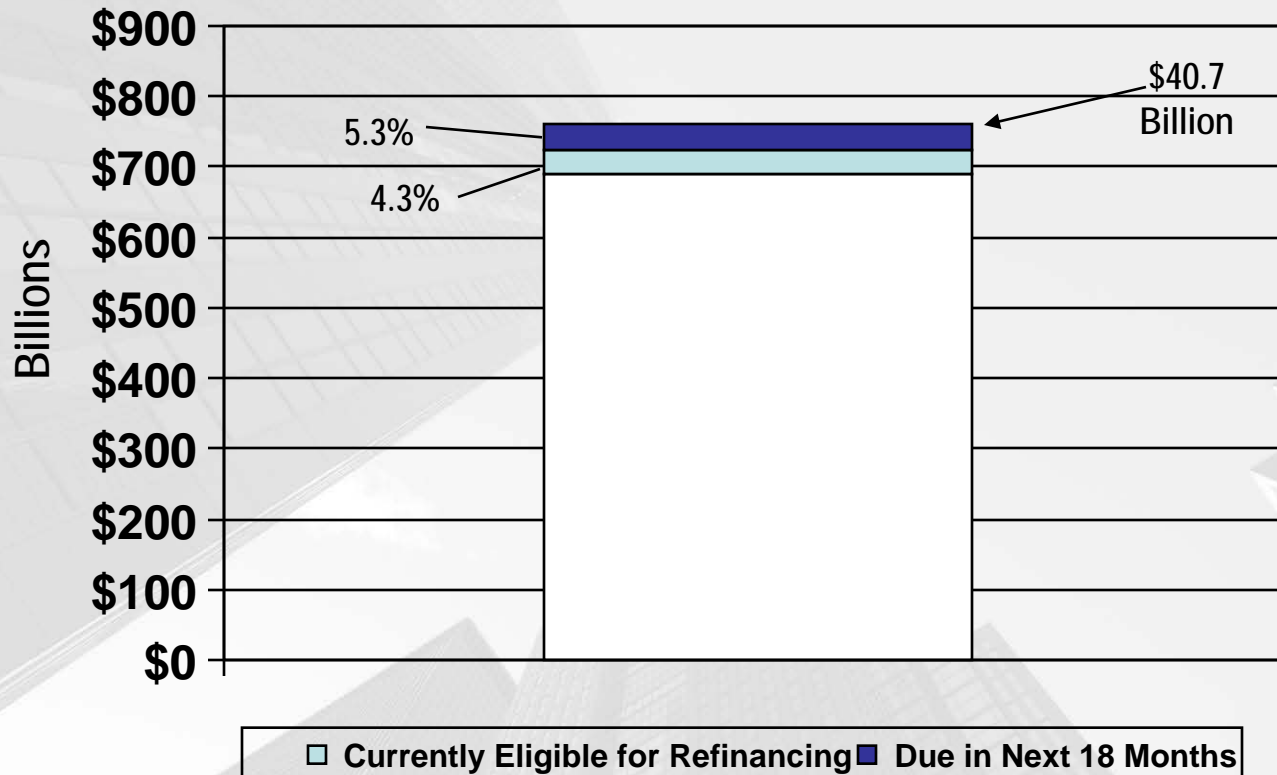
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# CMBS DELINQUENCY RATES ARE RISING & ARE EXPECTED TO RISE EVEN FURTHER – MATURITY & PROPERTY ISSUES STRESS AT THE PROPERTY LEVEL



Source: Trepp

# CMBS OUTSTANDING



Source: REIS, Raymond James; as of October 2008

## CMBS CONCLUSION

- 1) CMBS market will not be active in the primary lending area in 2009 with the exception of TALF sponsored executions in the fourth quarter, which will be the beginning of a re-emerging CMBS market.**
- 2) New business models are being formed to replace the old originate/distribute model.**
- 3) Rollovers will be an issue but servicers now have flexibility to extend for three years plus two one-year options.**
- 4) Expect delinquencies/defaults to rise substantially in 2009/2010, currently 6%-7% expected to peak at 10%-15%.**
- 5) Investors do not believe ratings are accurate/valid and are uncertain about resolution process.**

### **6) Special servicers will play key roll in 2009/2010.**

**The top five are:**

- **LNR**
- **CW Capital**
- **Midland**
- **AR Capital - Centerline**
- **JER**

**Most have seen portfolios increase 10x over the last year (e.g. from \$1 billion to \$10 billion).**

### **7) Real story in CMBS will be litigation between bond holders and servicers (i.e., the conflict resolution mechanism-just beginning) and liquidity needs within pools.**

## LIFE COMPANIES CONCLUSION

- 1) Expect 2009 production to equal \$30-\$35 billion...approximately 2004 levels.**
- 2) Pricing is 300-400 bp over the curve with floors of 6.5%-8.0% on 7-10 year terms and 6%-7% on five-year terms.**
- 3) LTV's are 50%-65%, based on capitalization rates of 8%-10% or comparable underwriting constants (i.e., 12%-15%). These are applied to the "Underwritten NOI" not the existing NOI.**
- 4) Several are targeting loans in excess of \$100MM.**
- 5) Most have adequate liquidity; however, beware of REITs entering the secured market and absorbing excess liquidity.**

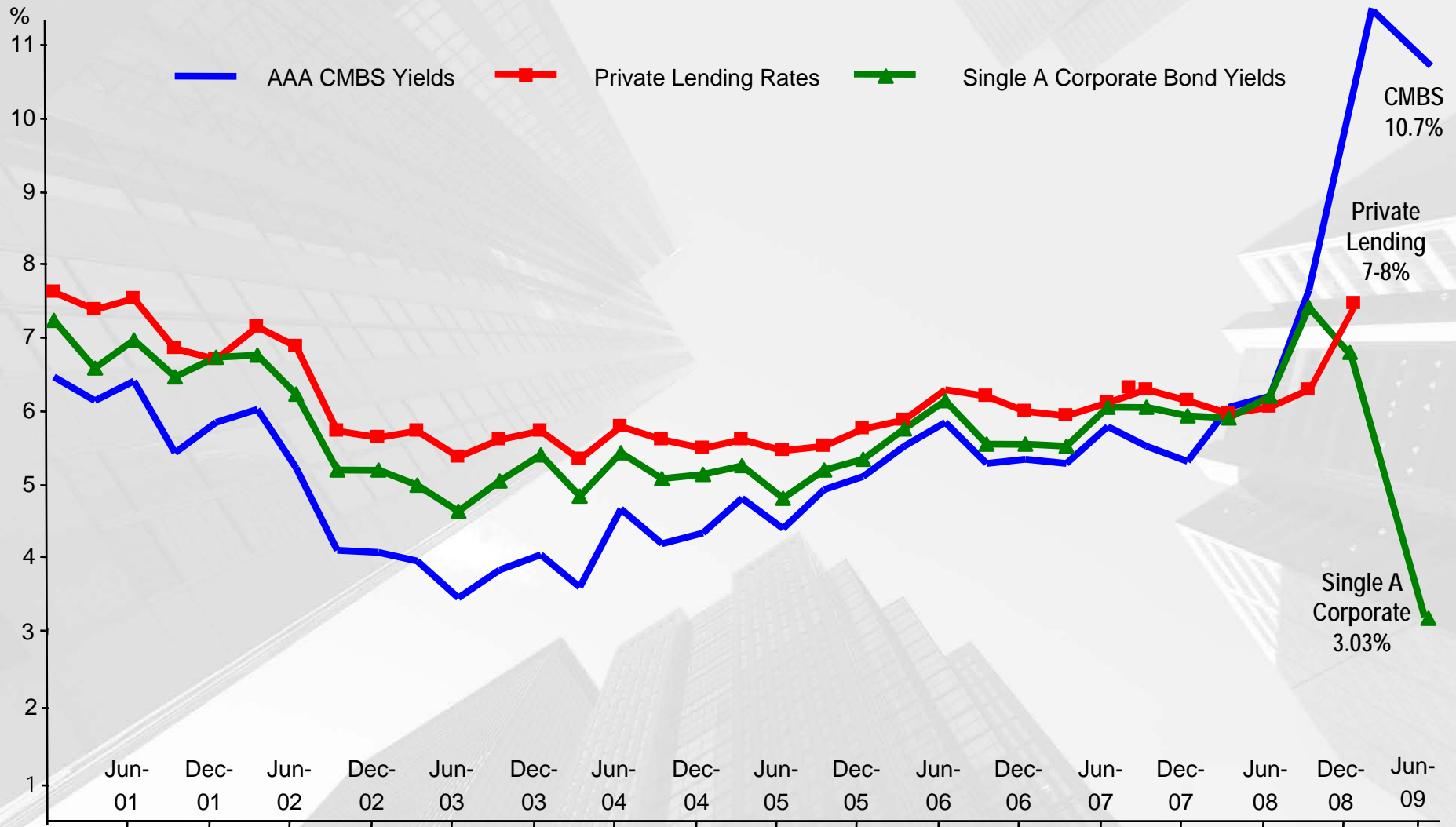
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## LIFE COMPANIES CONCLUSION (CONT.)

- 6) There is a definite “Have” and “Have Not” division between insurance companies, those who have rock solid balance sheets and those who do not. The “Have’s” cash flows are significantly increasing.**
- 7) In general, the benchmark for commercial mortgages in the insurance industry is the “A” corporate bond not the CMBS market.**
- 8) In the last 30 days insurance company’s have begun to feel pressure from Boards and stockholders to deploy/invest significant cash positions held on the books. The asset class of choice is the fixed income arena and CRE mortgages will be a significant recipient.**

# BOND YIELDS VS. PRIVATE LENDING RATES – ONE REASON PRIVATE LENDERS ARE NOT MAKING MORE ON-BOOK LOANS



Sources: Barclays Capital Inc. and HFF; updated 8-21-09

# LESS CREDIT AVAILABLE FOR BORROWERS MORE EQUITY REQUIRED

	<b>July 2009</b>			
	<b>August 2007</b>	<u>Based</u> <u>on Coverage</u>	<u>Based on Value</u>	<u>Underwritten</u> <u>NOI 3Q09</u>
Asset Value	\$25,100,000	\$18,825,000	\$18,825,000	\$15,060,000
Cap Rate	6%	8%	8%	8%
Net Operating Income	\$1,506,000	\$1,506,000	\$1,506,000	\$1,204,800
Capex and Reserves	\$120,000	\$120,000	\$120,000	\$120,000
Net Cash Flow	\$1,386,000	\$1,386,000	\$1,386,000	\$1,084,800
Treasury (10 year)	4.72%	3.72%		
Spread	1.28%	3.78%		
Rate	6.00%	7.50%		
Years of Amortization	0	30		
Constant	6.00%	8.39%		
Minimum Coverage	1.15x	1.25x		
Proceeds	\$20,000,000	\$13,215,000	\$11,300,000	DSCR: \$10,336,000
Loan-To-Value	80.00%		60.00%	LTV: \$9,036,000

The result is a building with the same income profile specified above, would support approximately \$8.70 million less in proceeds (~43% leverage reduction) now than before the credit crunch began. Based upon lenders' current underwriting parameters, the loan to value ratio (vs. debt service coverage ratio) would be the limiting factor with regard to loan proceeds.

Source: HFF

DEBT PLACEMENT

INVESTMENT SALES

PRIVATE EQUITY & CORPORATE FINANCE

STRUCTURED FINANCE

LOAN SALES

LOAN SERVICING

## Equity



# PENSIONS WITHER AMID WALL STREET MELTDOWN

	Recent Assets (\$Mil.)	As of Date	Assets (12/07)	Change (%)
Calpers	\$182,600	12/08	\$253,000	-27.8
California State Teachers	125,689	11/08	173,695	-27.6
New York Common Fund	123,100	10/08	153,900	-20.0
Florida State Board	95,700	11/08	132,400	-27.7
New Jersey State Investment	60,600	11/08	78,100	-22.4
Wisconsin Investment	60,174	11/08	87,803	-31.5
Ohio State Teachers	54,500	10/08	77,265	-29.5
Washington State Investment	51,511	10/08	65,814	-21.7
Ohio Public Employees	48,400	11/08	69,960	-30.8
Oregon Public Employees	46,052	11/08	63,363	-27.3
Virginia Retirement	43,027	10/08	58,700	-26.7
Alaska Permanent Fund	28,584	12/08	39,841	-28.3
Maryland State Retirement	26,653	11/08	39,535	-32.6
Iowa Public Employees	18,000	11/08	22,940	-21.5
Illinois Municipal	17,488	11/08	24,200	-27.7
Alaska Retirement Management	14,859	11/08	18,711	-20.6
Illinois State Board	9,210	10/08	12,500	-26.3
Ohio Police & Fire	8,700	11/08	12,795	-32.0
Ohio School Employees	8,500	10/08	11,723	-27.5
Arkansas Teachers	8,000	11/08	10,008	-20.1

Source: Real Estate Alert, 1-7-09

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## DENOMINATOR EFFECT

Pension funds have specific allocations to real estate, as well as other asset classes, to allow for a balanced investment portfolio.

Portfolio values are taking a hit as are property values. Thus if funds are not actively balancing their portfolios they will exceed their targeted allocation which is causing a slowing of funds to the sector.

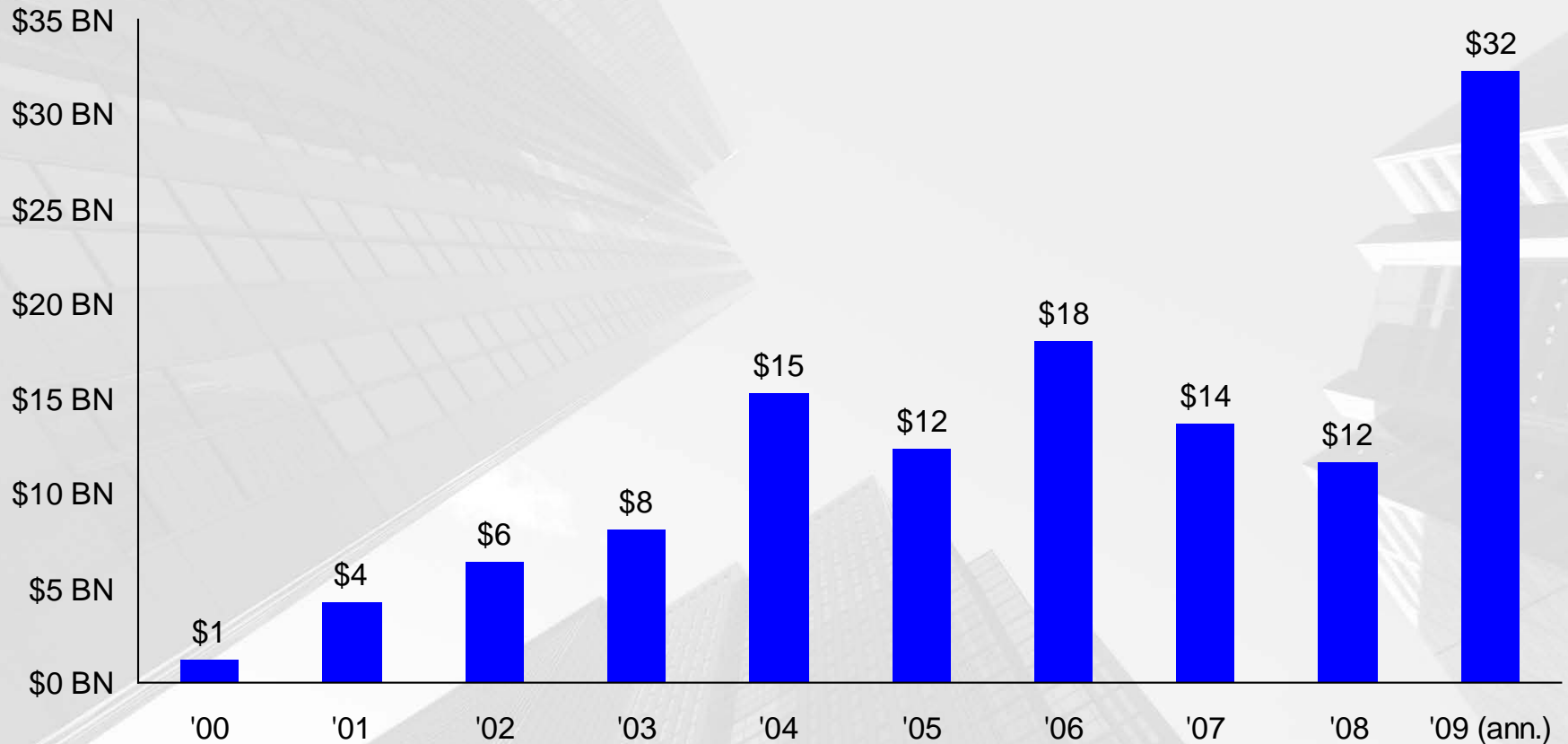
The industry is now experiencing the effects of these issues, however, there are mitigating factors as well.

The real issue is most funds are overcommitted based on now inaccurate assumptions of investment dollars being repatriated.

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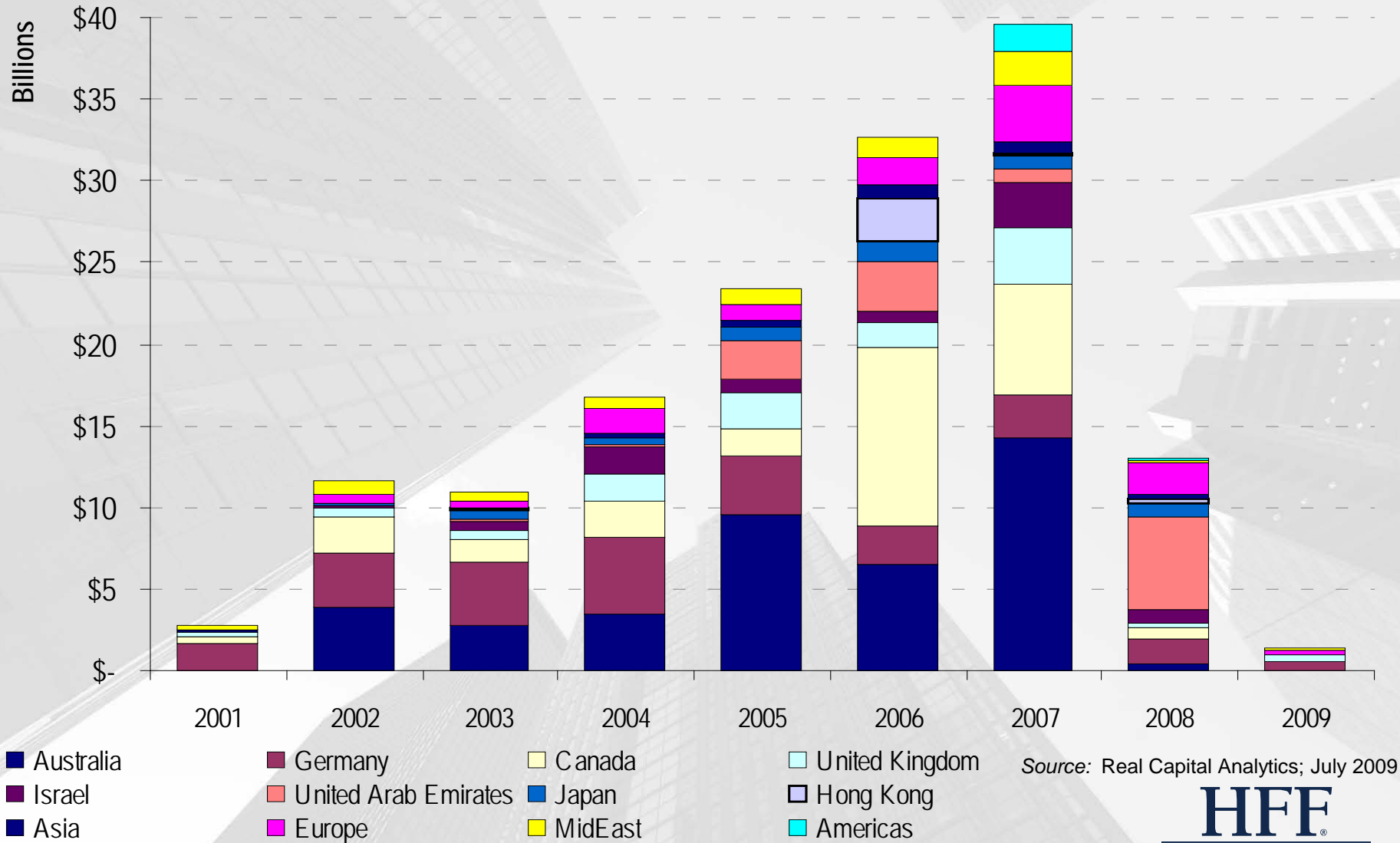
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# EQUITY ISSUANCE HAS PICKED UP



Sources: NAREIT and Green Street. '09 is amount raised thru June 5 and is annualized.

# FOREIGN CAPITAL – RECENT FLOWS INTO U.S. REAL ESTATE

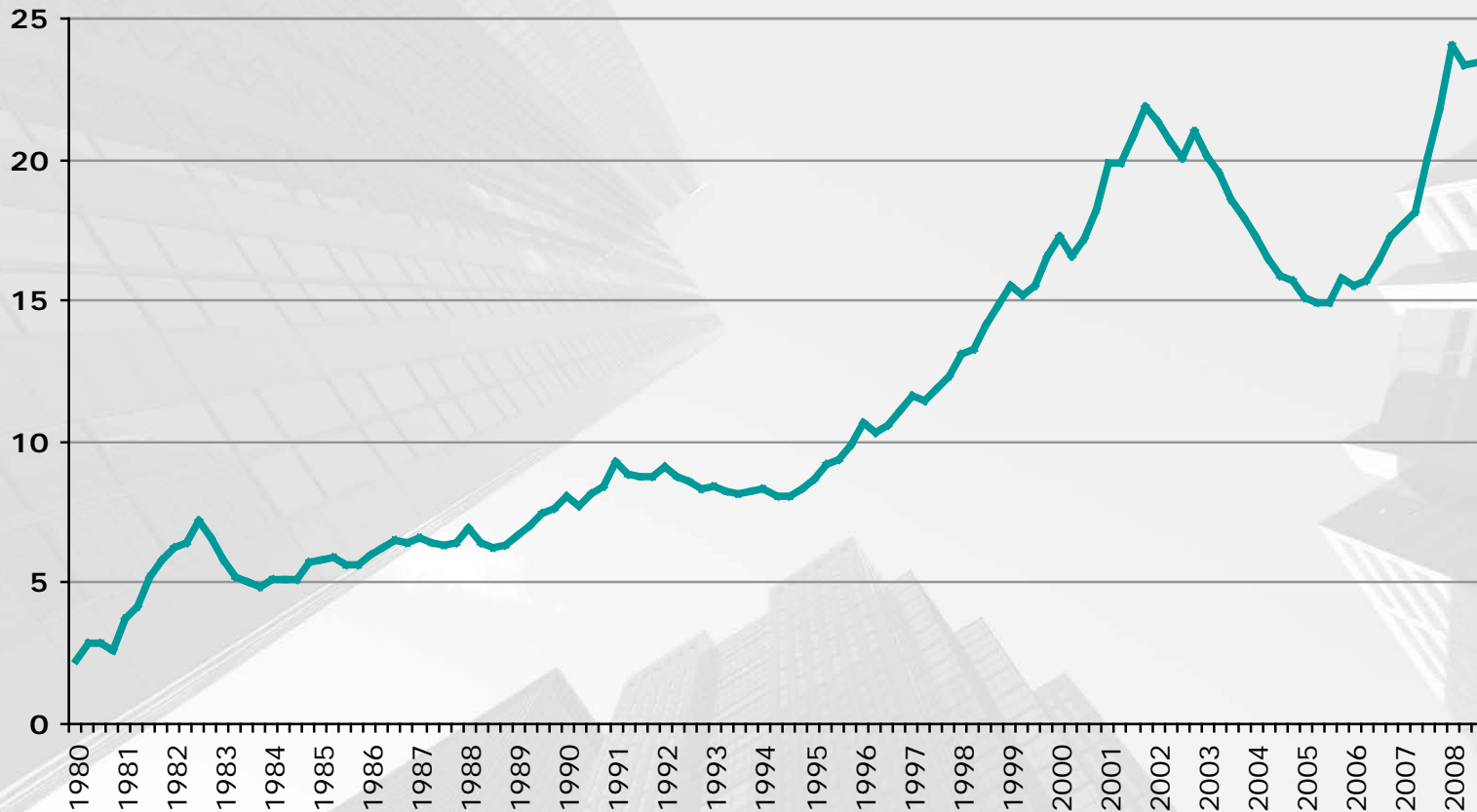


Source: Real Capital Analytics; July 2009

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# THERE IS A LOT OF CASH ON THE SIDELINES

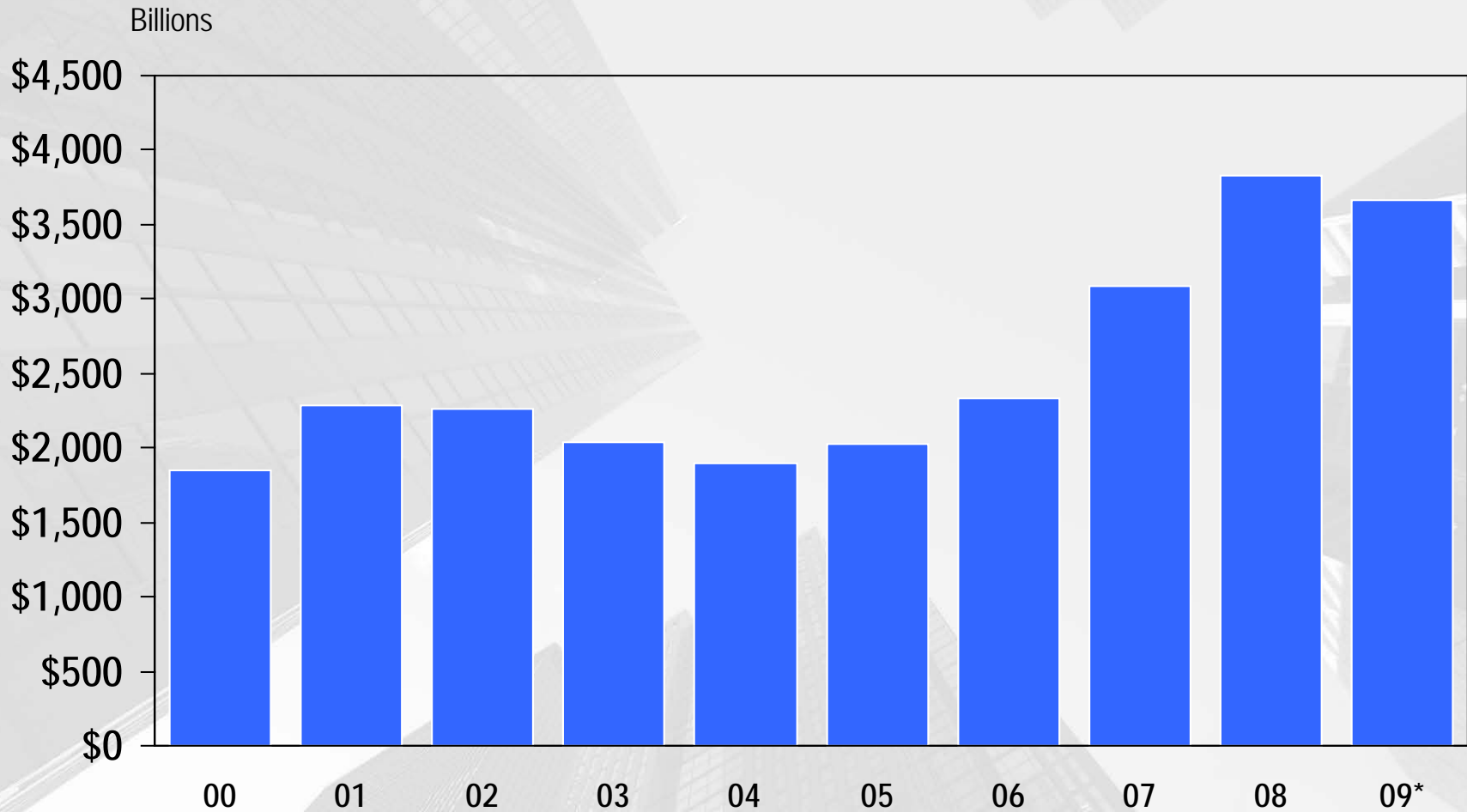
## Money Market Mutual Funds as % of GDP



Source: CBRE/TWR, Federal Reserve Bank

# MONEY MARKET FUNDS

## Year End Assets



Source: Morgan Stanley and Investment Company Institute

\*Through July 8, 2009

# PRIVATE REITS AND HIGH NET WORTH INDIVIDUAL AGGREGATORS CONTINUE TO RAISE CAPITAL

- 1) Inland**
- 2) KBS**
- 3) Hines**
- 4) Cole**
- 5) Dividend Capital**
- 6) Wells**
- 7) CBRE Investors**
- 8) Behringer Harvard**
- 9) Thompson National**
- 10) Foreign Managers**

# WHAT IS THE CAUSE OF SUCH LIMITED TRANSACTION VOLUME?

## PRICE vs. LIQUIDITY – WE THINK PRICE

### Factors to Consider:

- The REIT market raising \$20 Billion in three months at substantial discounts to NAV and trading ranges...meaning price drove liquidity.
- Large bank trades. The latest being Bank United requiring \$900MM of equity.
- Some intermediaries volume increasing with Sellers/Borrowers who MUST trade (i.e., meet the market).
- Significant tightening in the unsecured REIT bond market.
- Insurance companies now have pressure to deploy.
- Regional/local banks are extremely active.
- Foreign investors will be significant investors in the US in 2009-2010.

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## PRICING SUMMARY

- 1) Based on current credit markets, positive leverage math and public market indicators, cap rates have increased to 7.5%-10% which denotes a minimum 30%+ loss of value in general.
- 2) The effects of deleveraging from 75%-80% to 50%-60% has further exacerbated a decline in value at least another 10%. Therefore, values are off 40%-50% from peak on core assets, much more on opportunistic assets.
- 3) The public market for CRE in general has swiftly made the adjustment where as the private CRE market is just beginning to do so.
- 4) The private CRE market is not competitive with the public market at present which constrains flow of capital to the industry as capital flows to the best risk adjusted return. It would appear the public market has corrected and the private market is lagging badly.
- 5) Bid-Ask Gap will persist until the following catalysts mandate trades:
  - a. Maturity defaults
  - b. Monetary defaults
  - c. Redeployment strategies

The driver will most certainly be the banks.

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## PRICING SUMMARY (CONT.)

- 6) Most institutional CRE managers are holding and are not deploying. Aggressive market-to-market strategies have diminished the queue and brightened the outlook for fund in-flows to Legacy funds. Expect more “trades” from institutional owners in the fourth quarter and in 2010.
- 7) Asset prices essentially doubled from 2004-2007 for all product types and, therefore, a reasonably good benchmark for current pricing is 2003-2004 values for a hold-sell-buy analysis.
- 8) **BIG IS BAD**. Premiums on large asset/portfolio trades are 100-150 bps in both capitalization rate and all-in borrowing costs.

# BUYERS/LENDERS UNDERSTAND POSITIVE LEVERAGE MATH

<b>Interest Rate Costs:</b>	<b>7%-8%</b>
<b>30-Year Constant:</b>	<b>8.06%-8.88%</b>
<b>Cap Rates:</b>	<b>7.5%-10%</b>
<b>Apartments:</b>	<b>6.75%-7.50%</b>

# SOMETHING HAS ALREADY GIVEN DEAL VOLUMES ARE DOWN DRAMATICALLY IN 2008 AND 2009

2008 vs 2007 Overall Volume of Sale Transactions Down 71%

Office -75%

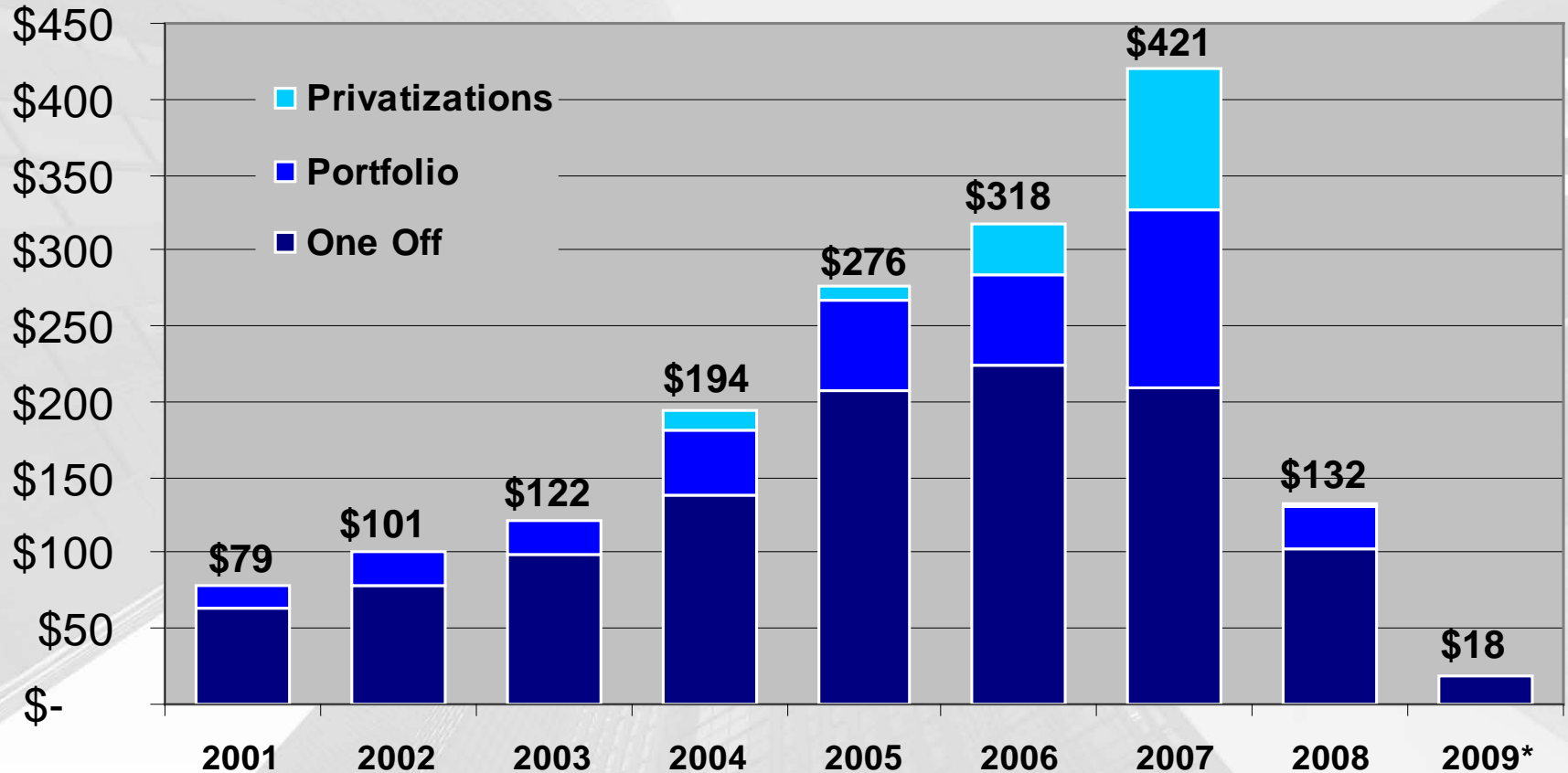
Hotel -86%

Retail -68%

Industrial -58%

Multifamily -62%

(\$Bn)



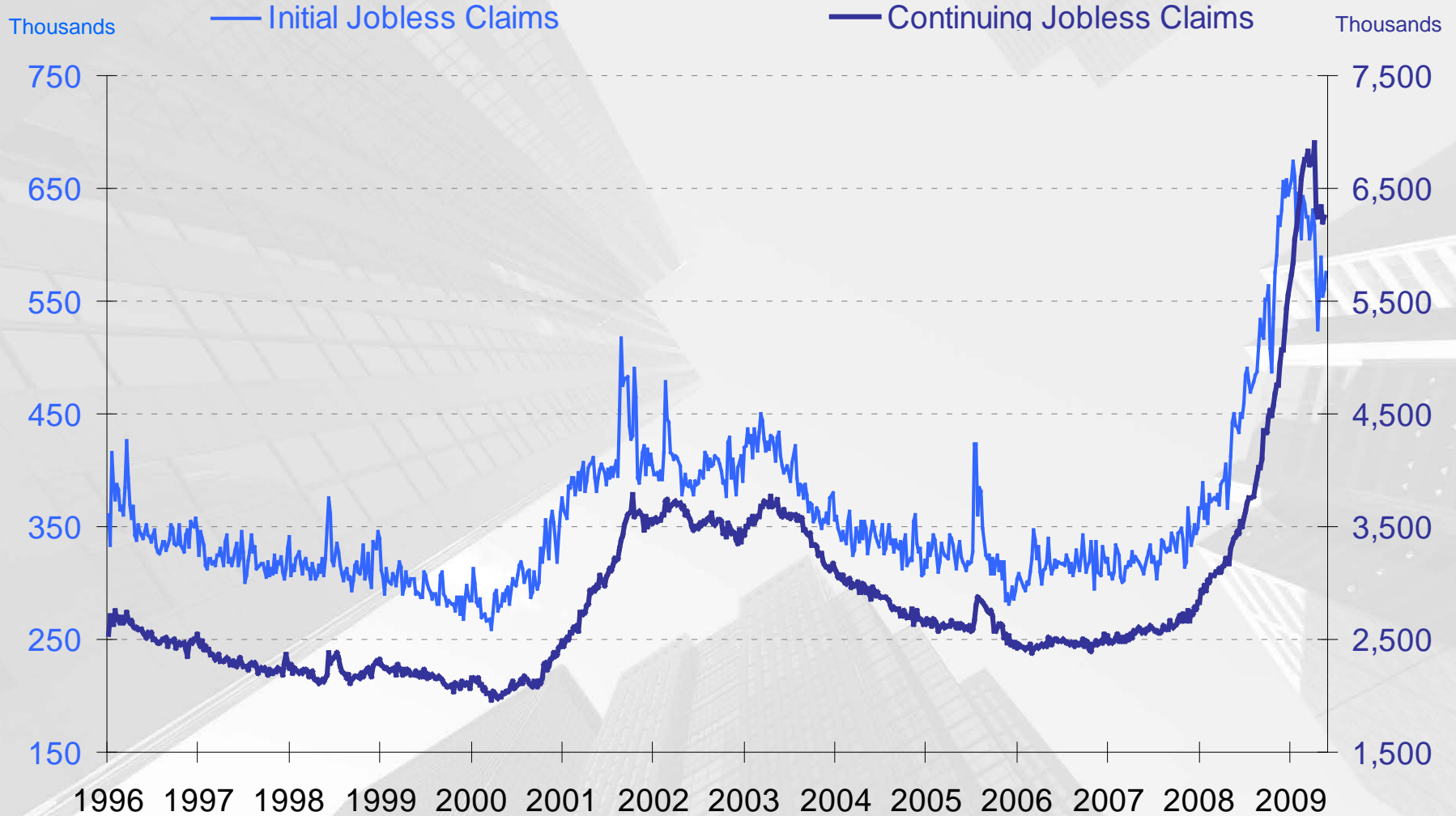
Source: Real Capital Analytics, office, industrial multifamily & retail properties \$5 mil+

\*Sales through June 2009

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# JOBLESS CLAIMS - THE TREND IS NOT OUR FRIEND! STRESS AT THE PROPERTY LEVEL GLASS HALF EMPTY



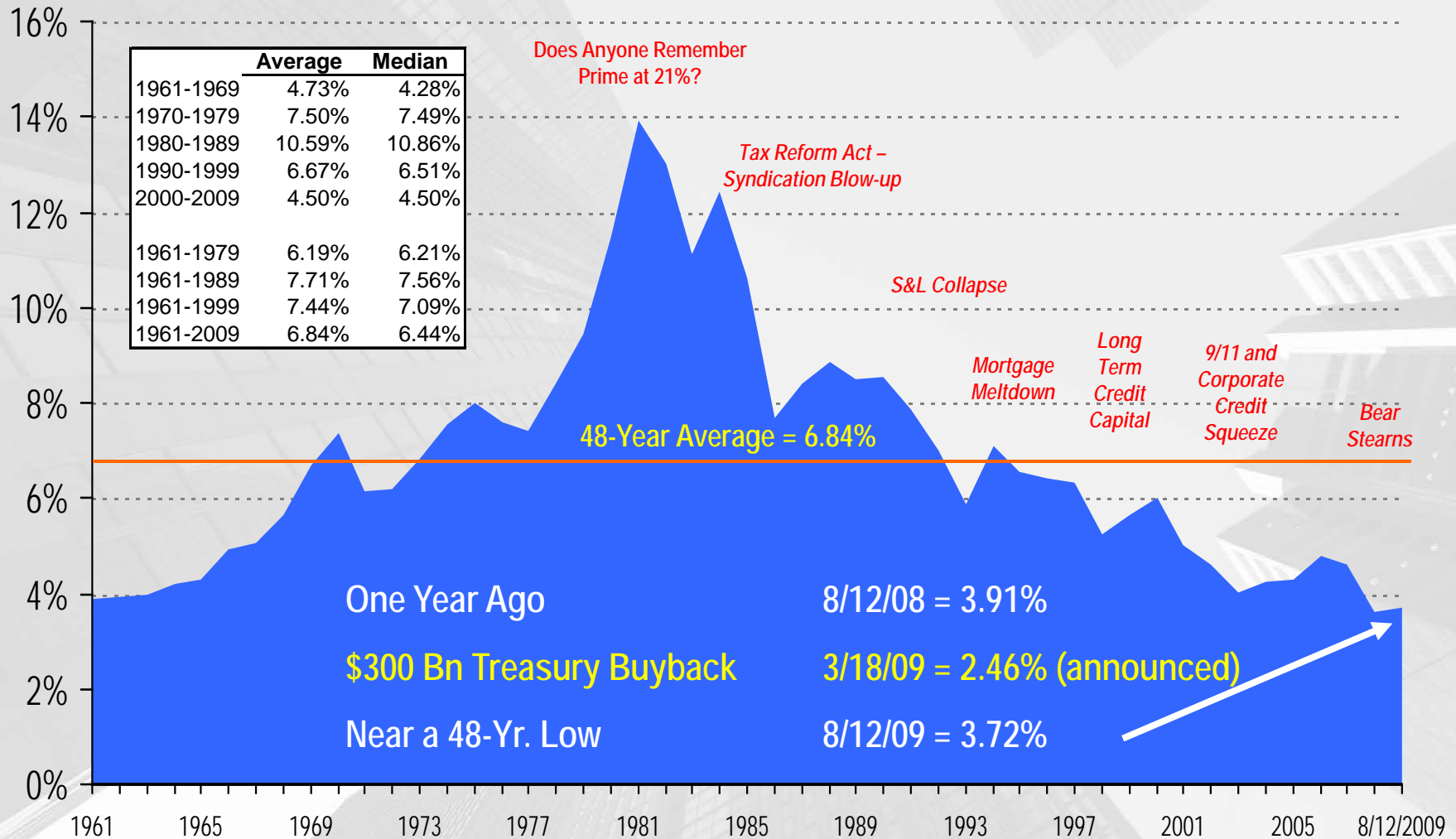
Source: Bloomberg; seasonally adjusted claims, weekly data with last updated August 21, 2009

# THE UNDERWRITTEN NOI

The concept of the “Underwritten NOI” is at the center of the bid-ask gap.

- a. Assumption: 2009 Operating Statement of a stabilized 93% occupied Class “A” asset in major market
- b. Underwriting:
  1. Vacancy – 12%-15% to account for weakening fundamentals, credit quality of tenants
  2. Rents – Decreases of 20%-40% depending upon the market
  3. T.I.’s – Increases of 50%+ from current market
  4. Lease-up – Essentially doubling lease-up time
  5. Reserves – Will be fully loaded but vary based on product type
- c. Result:
  1. NOI’s at least 20% less than actual operating statements
  2. Lender LTV: 50%-60%, Borrower LTV: 40%-50%
  3. Buyer Cap Rate: 8%-10%, Seller Cap Rate: 10%-13%
- d. The Conundrum: Except for hotels, actual cash flows are not close to the “underwritten NOI”. So the questions of most owners, relative to a hold/sell decision are:
  1. How long will job losses prevail?
  2. Can we withstand 2-3 years of deteriorating fundamentals?
  3. Do I have the necessary reserves to survive?
  4. What are our investors objectives/needs?
  5. Are we better off to sell and re-deploy?

# 48-YEAR HISTORY OF THE 10-YEAR TREASURY CAN THE FED KEEP THE 10 YEAR YIELD DOWN? LIKELY HEADED HIGHER GIVEN THE GROWING DEFICIT



Source: The Department of the Treasury

# WHERE IS THE PRODUCT

## Catalyst

**Banks:**

**Monetary defaults**

**Specials:**

**Monetary defaults; no reserves**

**Institutions:**

**Liquidity needs within funds or the investor itself.**

## THE SPECIALS

- 1) \$750 Billion market**
- 2) Defaults will reach 10%-15% (\$75-\$100 Billion)**
- 3) Lack of liquidity is an issue in funding T.I.'s, capital expenses, etc.**
- 4) Conflicts of interest among classes of bond holders**
- 5) Finite terms on each pool**
- 6) HFF BOV activity has picked up dramatically over the last few months**

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