
Wall Street and Commercial Real Estate

Everett Allen Greer

March 16, 2011 – Los Angeles

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Goals of Presentation

- Disclaimers
- Market Drivers
- Wall Street and Capital Markets
 - REIT / MBS / CDO / CDS
- Property Trends
- Expected Changes / Outlook
- Greer's Forecast / Signs

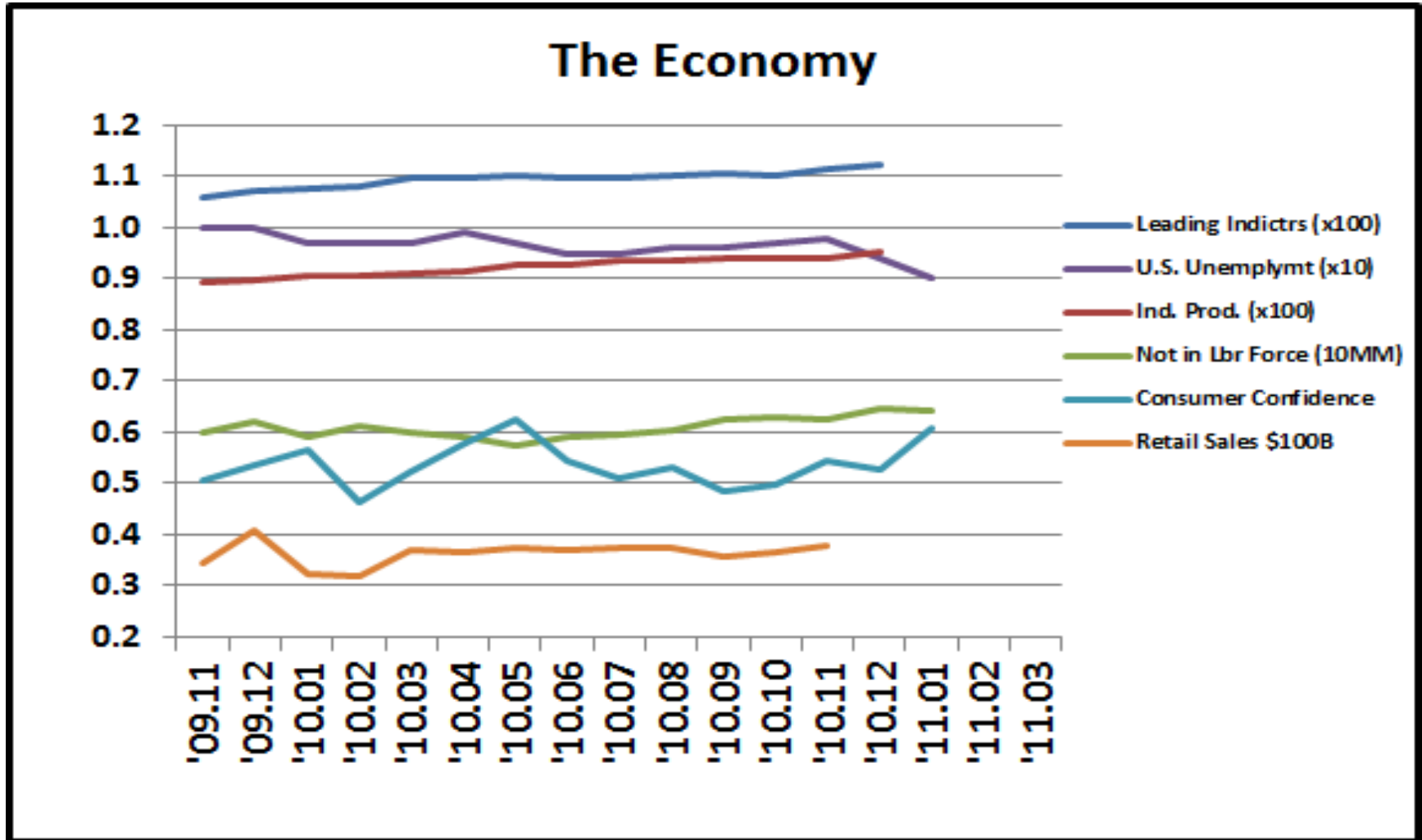
Market Drivers

Supply / Demand – Not as bad as early 90's

- Non-Res. Supply Growth was Very Limited Growth
- Most Demand ties to Gross Domestic Product
 - Office – FIRE Employment, Portion of Service Employment
 - Retail – Household Formations, Income Growth
 - Industrial – Manufacturing vs. Distribution
 - Multifamily – Households
 - Hotel – Corporate Travel – Office Employment
- Jobs & Retail Sales - Drive Supply & Demand!!!

Financing – **Currently Most Important Fundamental**

The Economy - Flatline



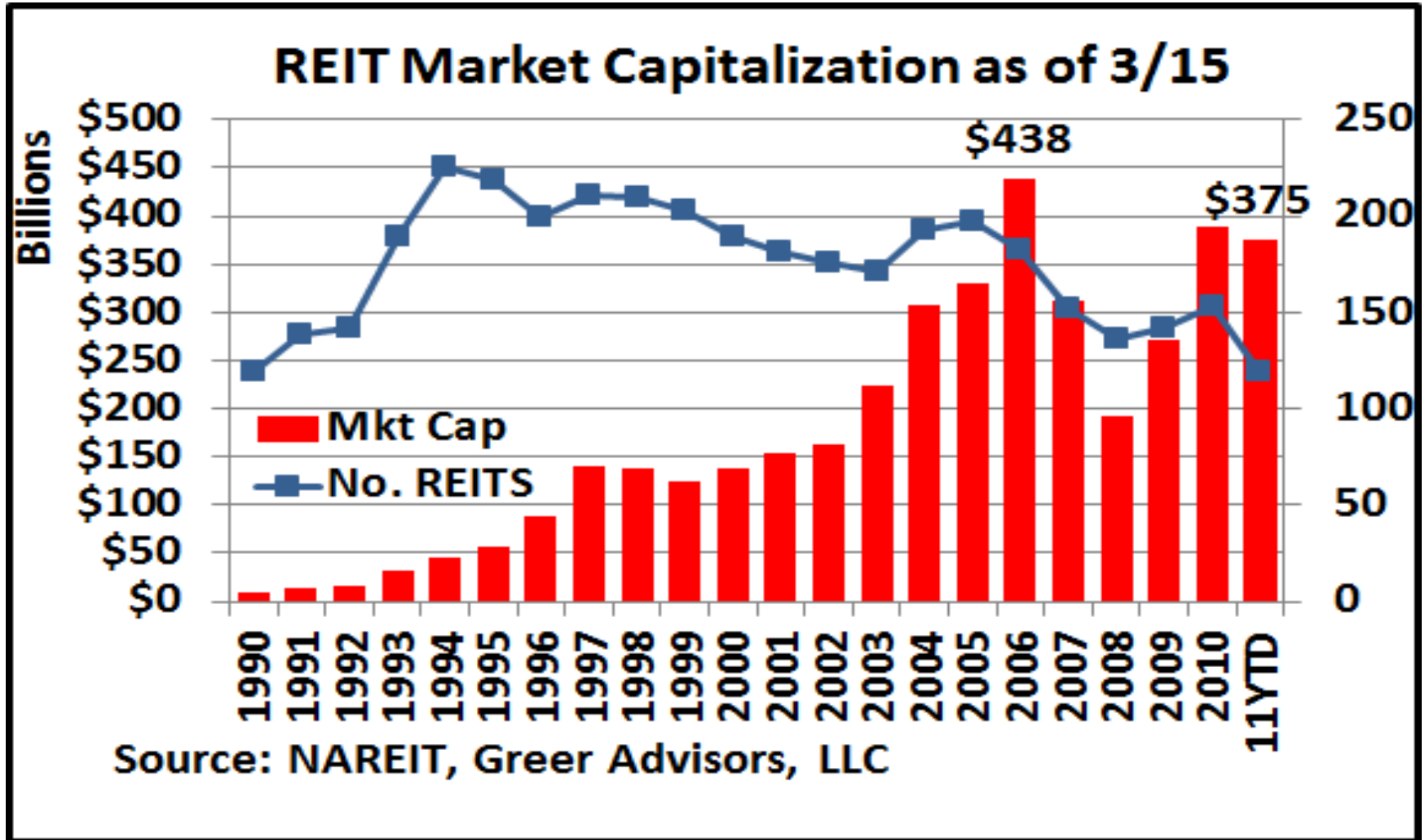
- Wall Street and Capital Markets

What is REIT?

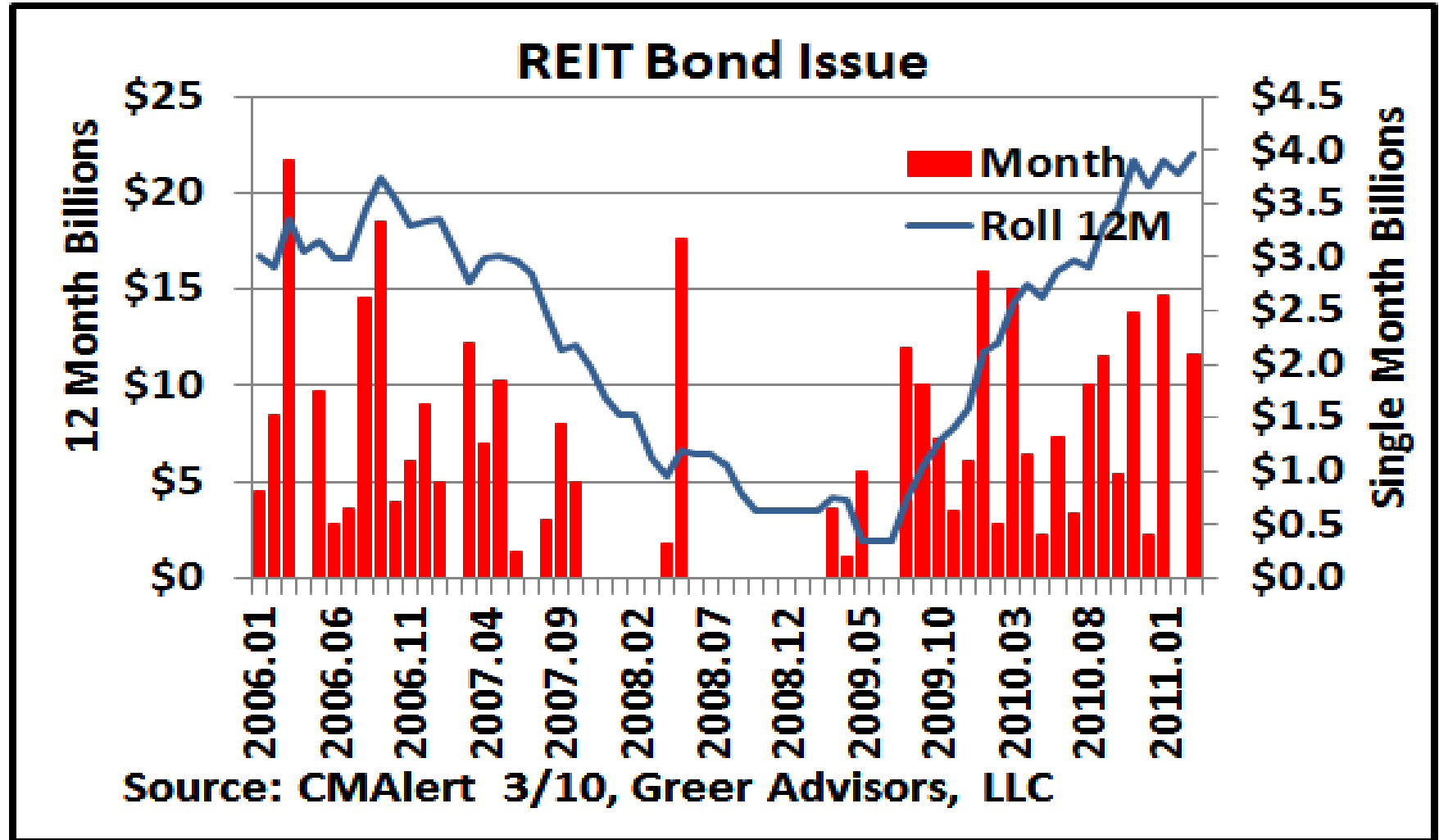
Real Estate Investment Trust

- Type of Pass-through Security
- Effectively a corporation
- As long as 90% of taxable income passed is through to shareholders, there is no “corporate” tax. All earnings are single-taxed at shareholder level.
- Current “Industry” Issues:
Definition of Assets, Max Debt Load, Yield
- Note: additional rules include:
 - 95% of income must be from interest, dividends & property income
 - Minimum 100 owners, 75% of assets in real estate, 75% of income from rents or interest
 - no more than 20% ownership in other REITs, 5 owner rule on 50% of assets each ½ tax year (5/50)

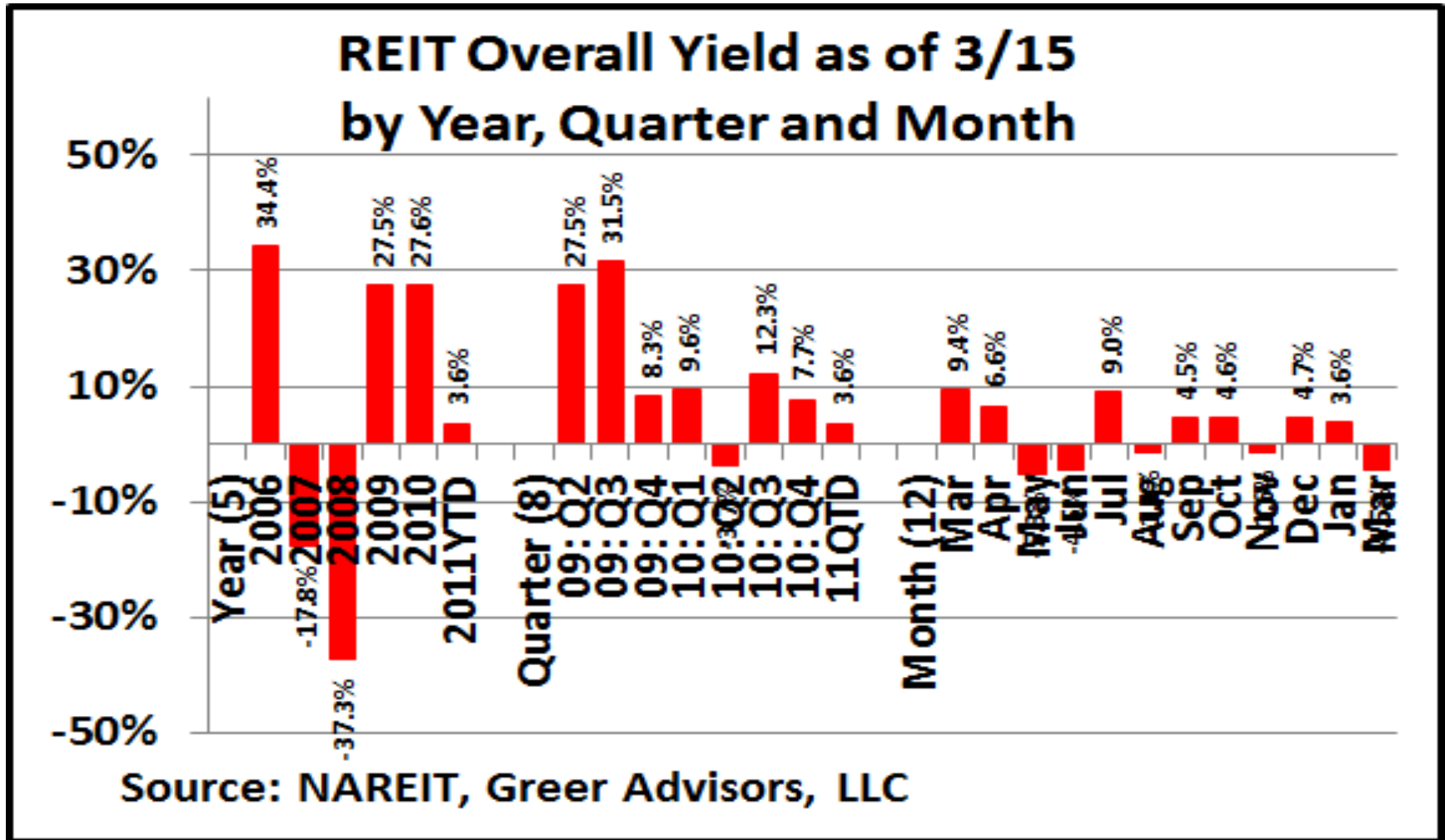
REIT Market Capitalization



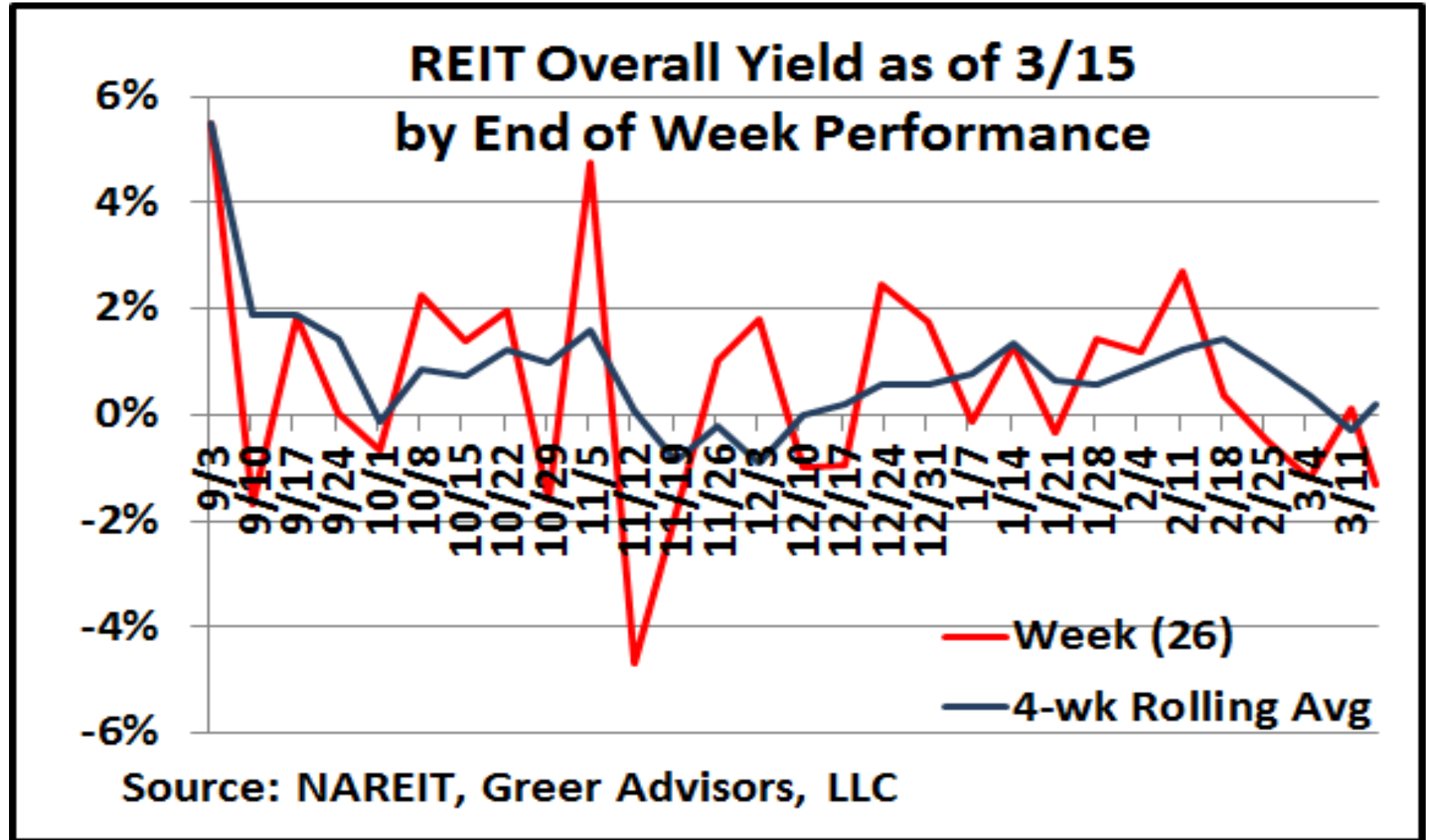
REIT Bond Issue



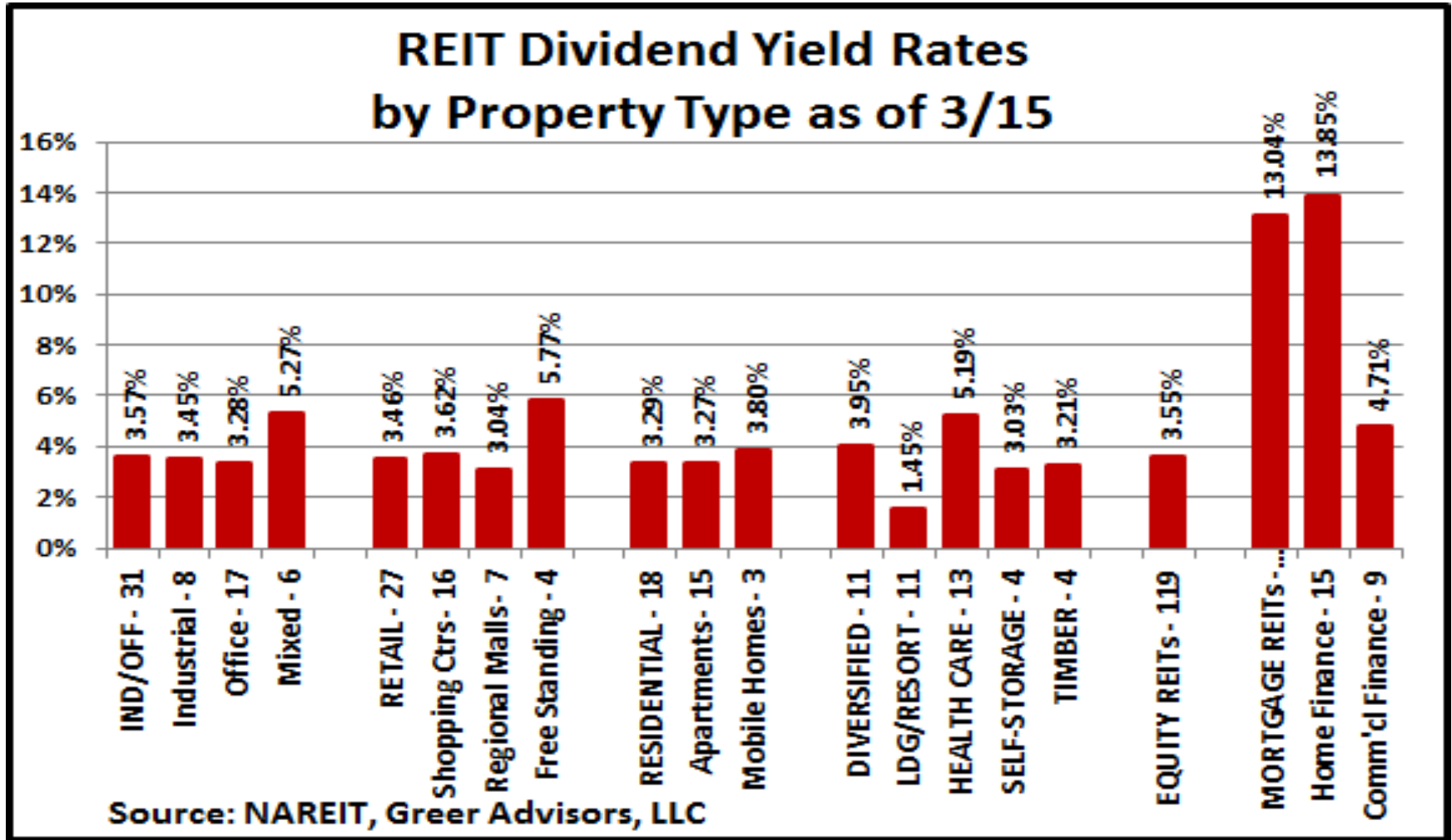
Overall REIT Dividend Yields – History



Overall REIT Dividend Yields – Weekly



REIT Dividend Yields by Property Type

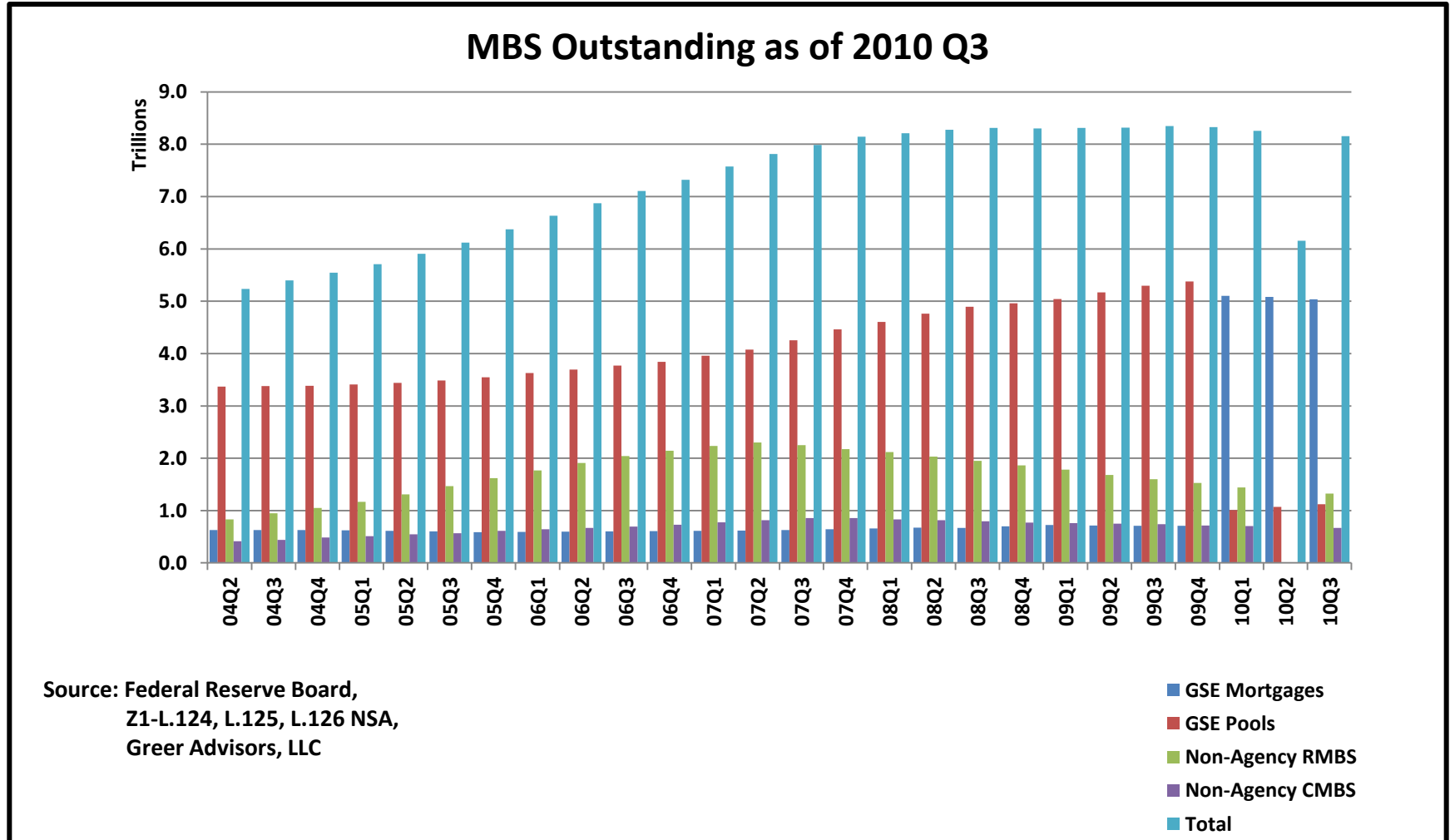


What is a MBS?

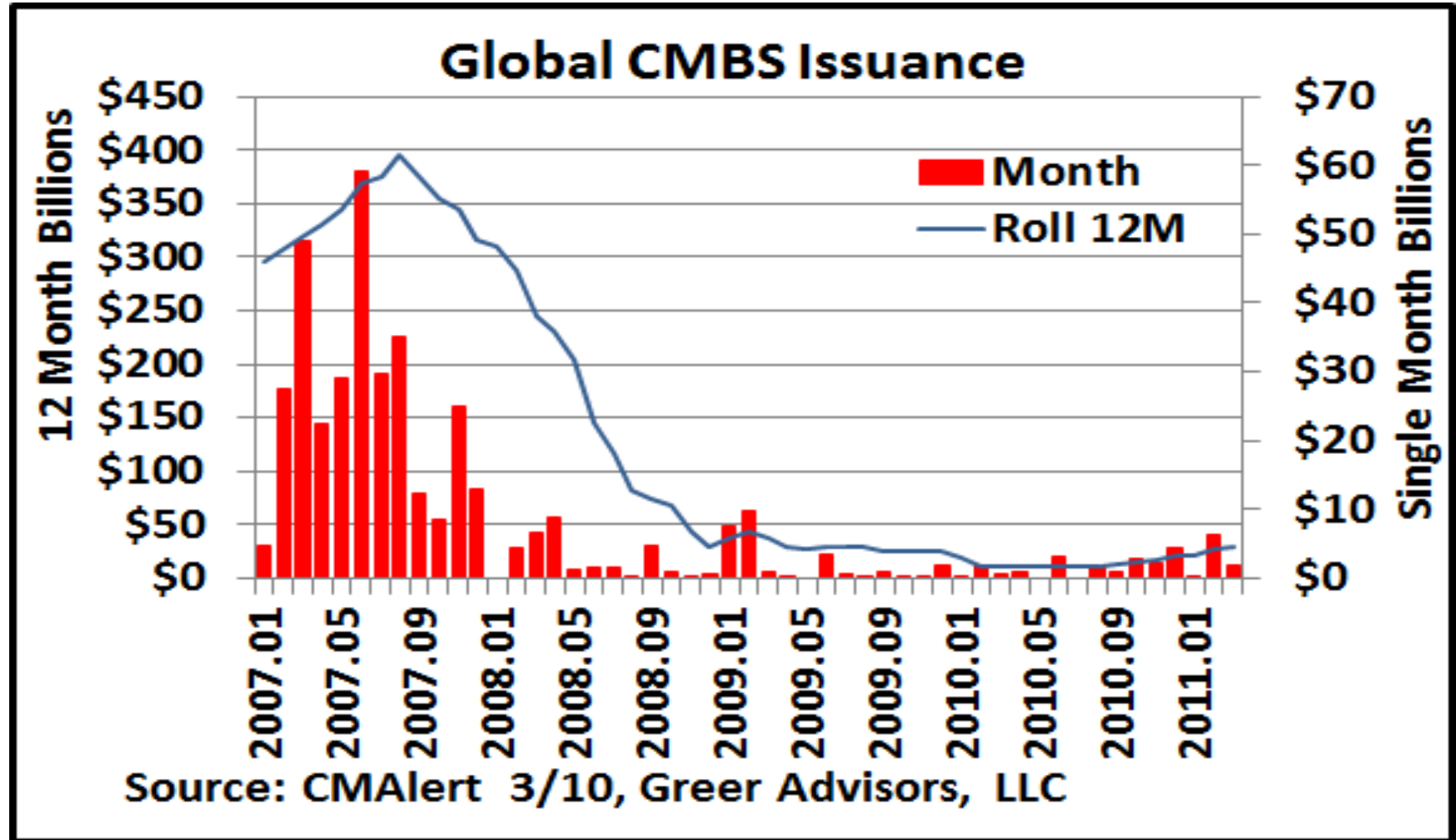
Mortgage Backed Security

- Type of pass-through security
- Mortgages are securitized into a pool. Rights to the revenue from the mortgages are divided into many smaller pieces (tranches, strips, slices), each with differing priorities. Proceeds are distributed to investors based on the priority of their tranche.
- During 2006-2007, accounted for slightly less than 40% of all commercial real estate lending, and higher rate for residential.

MBS Outstanding's in U.S. - Dropping



Global CMBS Issuance



CMBx Data

Greer CMBS / CMBx Yield RateTM				
Tranche	Yield	Suboord	Weight of Debt	Contribution to Total
AAA	3.77%	29.76%	70.24%	2.64%
AJ	4.64%	12.70%	17.06%	0.79%
AA	6.26%	10.63%	2.07%	0.13%
A	10.69%	8.00%	2.63%	0.28%
BBB	28.36%	4.72%	3.28%	0.93%
BBB-	29.70%	3.68%	1.04%	0.31%
BB	103.40%	2.69%	0.99%	1.02%
Unrated	177.00%	0.00%	2.69%	4.76%
Implied Overall Debt Yield			100.00%	10.87%
Loan to Value Ratio				75.00%
Class-A Equity Yield Total Yield			30.00%	15.65%
Class-B Equity Yield Total Yield			103.00%	33.90%

Notes: ① The table is somewhat complicated, as evidenced by the numerous footnotes. Several conclusions can be drawn. 1) If the 'Implied Overall Debt Yield' is much greater than loan rates in the marketplace, the CMBS market CAN NOT recover because the required yields are too high to make debt affordable to borrowers. 2) When the spread between AAA and BB tranches is above 500 bps (now at 9,963 bps), the market can't recover because of risk aversion for lower-rated tranches. As a point of reference, January '07 AAA-BB CMBS spreads were around 65 bps. Lastly, the yields for each tranche provide tremendous insight into the required yields for each layer in the capital stack.

② MarkitTM Data and Calculations based on close of 3/16. Swap (10Yr) as of 3/15.

③ Coupon and Price data were from MarkitTM for AAA Senior through BB bonds. MarkitTM data was used as part of the calculations by Greer Advisors, LLC to determine Spreads. Subordination levels were from MarkitTM.

④ Profit / arbitrage opportunity for the issuer was ignored.

⑤ The yield spread for "unrated" classes were based on (BBB-yield minus BB yield) times 1.0, round to the nearest bp. Class-A property equity yield was assumed equal to the BBB- (last investment-grade piece) yield rounded to the nearest 100 bp. Class B property equity yield was assumed equal to the BB yield, rounded to 100 bps.

What is a CDO?

Collateralized Debt Obligation

- Type of pass-through security
- CDOs are securitized debt pools, similar to CMBS, but debts can be CMBS/CDO paper, car/boat/plane loans, credit cards, or virtually any type of debt obligation. Rights to the revenue from the obligations are divided into many smaller pieces (tranches, strips, slices), each with differing priorities. Proceeds are distributed to investors based on the priority of their tranche.
- Tough to gauge accurately, but most experts believe these have accounted for 5-10% of all commercial real estate lending the past few years.

What is CDS?

Credit Default Swap

- A bilateral contract where two parties agree to trade the credit risk of a third-party. A protection buyer pays a periodic fee to a protection seller in exchange for a contingent payment by the seller upon a default or failure to pay. Once triggered, the seller either takes delivery of the collateral (eg bond, note) or pays the buyer the difference between the par value and recovery value of the bond (cash settlement).
- They resemble an insurance policy, as they can be used by debt owners to hedge against credit events.
- Warren Buffet called **ED** these “Weapons of Mass Destruction”
-counterparty???

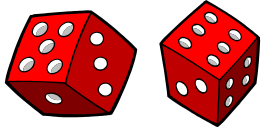
Players in “Simple” CDS

Business Issues Bonds

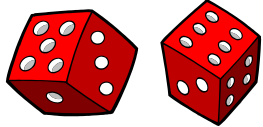


Bonds initially rated too poor for market, e.g. “BB”

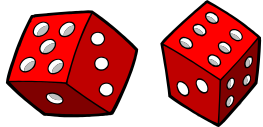
Side Bet 1



Side Bet 2



Side Bet 3

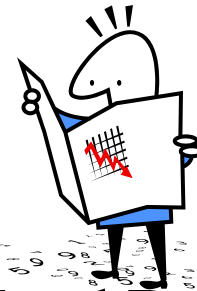


Investment Bank issues CDS (aka Credit Enhances Debt) Enough to make BB = AA, if debtor fails, IB buys bonds

Rating Agency Rates Bonds



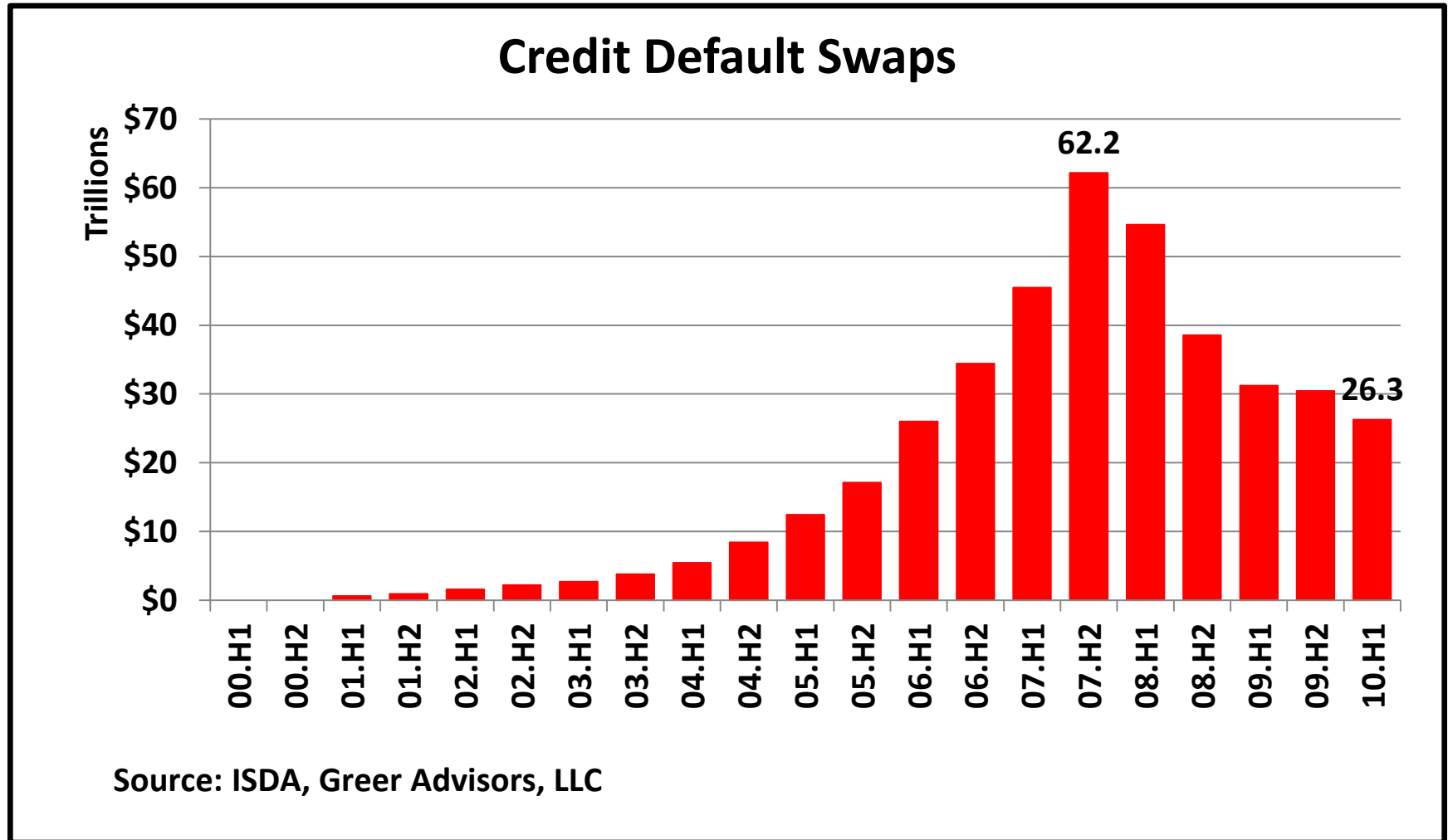
Gives loss forecast & amount required for “AA” rating



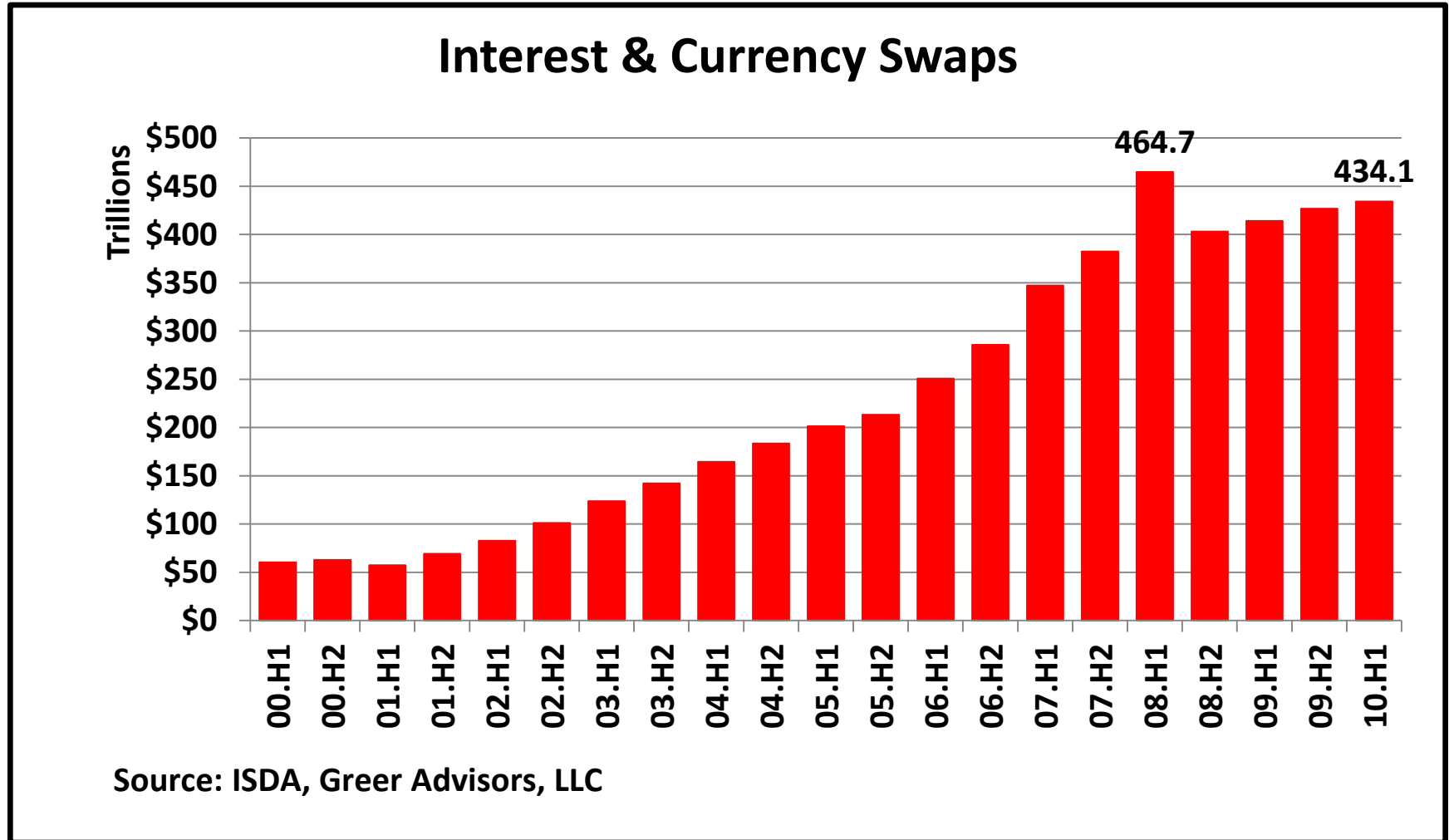
Pension Fund Buys Bonds with CDS enhancement
Thinks it's AA investment

Greer Advisors, LLC

Credit Default Swaps



Interest & Currency Swaps



Financial Regulations – Largely Unresolved

Dodd-Frank Wall Street Reform & Consumer Protection Act

- 16 Titles – See Summary on Wikipedia
 - 243 Rules to be created (about 1/2 done)
 - 67 Studies required
 - 22 New Periodic Reports
- Restructure of Regulators, elimination of OTS
 - Financial Stability Oversight Council (New)
 - Office of Financial Research (New)
- Keys for Commercial Real Estate:
 - Rating Agency Reform
 - Securitization Reform
 - Derivatives – minimal change

Top - Bottom Market Stats – as of 2010 Q4

INDUSTRIAL - 2010.Q4					OFFICE - 2010.Q4					RETAIL - 2010.Q4					APARTMENT - 2010.Q4				
Vac	Metro	Vac %	Eff Rent \$	RR Rent Q-Q Chg	Vac	Metro	Vac %	Eff Rent \$	RR Rent Q-Q Chg	Vac	Metro	Vac %	Eff Rent \$	RR Rent Q-Q Chg	Vac	Metro	Vac %	Eff Rent \$	RR Rent Q-Q Chg
1	Los Angeles	7.5%	\$6.33	-1.2%	1	New York	8.4%	\$52.97	-0.8%	1	San Francisco	3.6%	\$29.96	0.1%	1	Pittsburgh	2.3%	\$893	1.4%
2	Salt Lake City	7.9%	\$4.80	5.1%	2	Honolulu	8.7%	\$21.45	-5.3%	2	Fairfield County	4.2%	\$25.22	-0.2%	2	San Jose	3.3%	\$1,587	1.3%
3	Houston	10.6%	\$5.25	1.4%	3	Trenton	11.1%	\$24.03	1.9%	3	Long Island	5.6%	\$22.76	0.7%	3	Newark	3.4%	\$1,367	2.8%
4	Orange County	10.8%	\$7.90	-1.5%	4	Pittsburgh	11.2%	\$17.39	1.4%	4	Northern New Jer	5.6%	\$24.62	0.0%	4	Washington, DC	3.9%	\$1,413	1.0%
5	Kansas City	11.1%	\$6.43	0.4%	5	Long Island	11.6%	\$20.11	-0.6%	5	San Jose	6.0%	\$26.65	-0.1%	5	Oakland	4.0%	\$1,321	0.7%
6	Long Island	11.3%	\$5.55	-0.6%	6	Boston	13.0%	\$26.86	-0.5%	6	Suburban Virginia	6.1%	\$24.33	-0.2%	6	Ventura	4.0%	\$1,403	1.5%
7	Portland	11.3%	\$6.20	-1.1%	7	Washington, DC	13.0%	\$34.18	-0.6%	7	Los Angeles	6.2%	\$25.13	-0.3%	7	El Paso	4.1%	\$699	0.9%
8	San Francisco	11.3%	\$7.84	4.5%	8	Stamford	13.1%	\$26.09	-0.6%	8	Orange County	6.6%	\$26.52	-0.2%	8	Miami	4.1%	\$1,096	0.7%
9	Minneapolis	11.8%	\$4.80	-0.9%	9	San Francisco	13.7%	\$21.51	-0.2%	9	Boston	6.7%	\$19.47	0.4%	9	Minneapolis	4.1%	\$944	0.9%
10	Seattle	11.8%	\$7.86	-2.4%	10	Nashville	14.2%	\$19.74	-0.6%	10	Oakland-East Bay	6.7%	\$24.84	0.3%	10	Portland	4.1%	\$844	1.1%
51	Jacksonville	16.6%	\$4.54	-0.7%	50	West Palm Beach	21.1%	\$20.39	-1.0%	71	Wichita	14.4%	\$10.41	0.3%	55	Tucson	8.4%	\$622	0.1%
52	Hartford	18.1%	\$5.88	-8.4%	51	Edison	21.2%	\$17.56	0.5%	72	Cleveland	14.8%	\$12.87	-0.9%	56	Fort Worth	8.6%	\$665	0.0%
53	Sacramento	18.6%	\$4.83	-0.3%	52	San Jose	21.3%	\$24.52	-1.3%	73	Syracuse	14.8%	\$10.54	-0.1%	57	Birmingham	8.7%	\$760	0.3%
54	Atlanta	19.0%	\$3.36	4.2%	53	Sacramento	21.6%	\$19.71	-2.5%	74	Dallas	14.9%	\$14.03	-0.1%	58	Phoenix	9.1%	\$717	0.9%
55	Boston	19.2%	\$5.90	0.1%	54	Tampa	21.6%	\$18.72	-0.2%	75	Cincinnati	15.0%	\$12.32	0.5%	59	Las Vegas	9.4%	\$733	-2.2%
56	Phoenix	19.2%	\$5.00	-1.0%	55	Riverside	22.4%	\$18.66	-0.3%	76	Indianapolis	15.4%	\$12.37	0.7%	60	Atlanta	9.5%	\$770	-0.1%
57	Stamford	19.2%	\$5.78	-1.8%	56	Dallas	22.5%	\$17.68	-0.6%	77	Tulsa	15.5%	\$9.74	0.2%	61	Dayton	9.9%	\$640	-2.0%
58	Detroit	20.3%	\$3.19	-3.1%	57	Las Vegas	24.7%	\$21.59	-1.6%	78	Birmingham	16.0%	\$12.18	-0.4%	62	Houston	9.9%	\$794	0.0%
59	Memphis	20.4%	\$2.35	0.3%	58	Detroit	25.0%	\$14.78	-2.6%	79	Columbus	16.4%	\$10.66	-0.4%	63	Jacksonville	10.1%	\$741	-0.4%
60	Trenton	23.4%	\$3.80	-2.4%	59	Phoenix	25.9%	\$18.39	-2.2%	80	Dayton	16.8%	\$8.84	0.8%	64	Memphis	11.5%	\$680	-1.6%
	Average	14.7%	\$5.10	-0.7%		Average	17.3%	\$20.54	-0.9%		Average	11.0%	\$15.84	-0.1%		Average	6.2%	\$955	0.3%
1	Los Angeles	7.5%	\$6.33	-1.2%	32	Los Angeles	17.3%	\$23.39	-2.1%	7	Los Angeles	6.2%	\$25.13	-0.3%	26	Los Angeles	5.4%	\$1,493	-0.4%
4	Orange County	10.8%	\$7.90	-1.5%	45	Orange County	19.6%	\$21.38	-2.4%	8	Orange County	6.6%	\$26.52	-0.2%	15	Orange County	4.6%	\$1,488	-0.1%
31	Riverside	14.8%	\$4.26	-1.3%	55	Riverside	22.4%	\$18.66	-0.3%	30	San Bernardino/R	10.2%	\$17.94	-0.6%	32	Riverside	5.8%	\$1,032	0.5%
38	San Diego	15.3%	\$7.11	-1.2%	40	San Diego	18.4%	\$24.48	-0.2%	13	San Diego	7.5%	\$25.19	-0.2%	14	San Diego	4.3%	\$1,325	0.1%
13	Ventura	12.5%	\$8.08	-0.9%	41	Ventura	18.4%	\$17.62	-2.6%		NA				6	Ventura	4.0%	\$1,403	1.5%
	Min	7.5%	\$2.35	-8.4%		Min	8.4%	\$14.59	-6.4%		Min	3.6%	\$8.84	-1.6%		Min	2.3%	\$571	-2.2%
	Max	23.4%	\$8.08	6.2%		Max	25.9%	\$52.97	1.9%		Max	16.8%	\$32.04	1.0%		Max	11.5%	\$2,199	3.0%
	Spread	15.9%	\$5.73	14.7%		Spread	17.5%	\$38.38	8.3%		Spread	13.2%	\$23.20	2.6%		Spread	9.2%	\$1,628	5.3%

Source: CBRE Economic Advisors, Greer Advisors, LLC

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Source: REIS, Greer Advisors, LLC

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Future - Mortgage Backed Security

- If NSROs don't "**Get It**" Feds could replace them
- 'til MBS Returns, Real Estate markets **WILL NOT** recover
- Most banks ARE NOT in the business of holding debt
- New MBS WILL EMERGE with terms as follows
 - No "quick buck" investment banks/mortgage bankers
 - Issuer holds 1-5% of pool as "1st Loss / Good Faith" position
 - 60-80% of pool will be AAA, not 90+%
 - Buyers of paper will "re-underwrite" pools, regardless of

Future of Banking

Past Three Years have Shown largest lending decline in history - see FDIC QBP

CMBS and Banks Loss Rates - All Time Highs

Separation of “Best of Best” Class A vs. Class B/C

Deleverage – Expect More for Class B/C

More Restrictive Covenants for REITs, CMBS

“R” word for Loans (recourse)

Capital Ratios – Leverage – QE2

Conclusions

- MBS Market – Spreads are 10-100x higher than 1/07
- MBS – New Business Model will Arise
- REITs – Virtually Recovered
- Many Lenders Closed, Stopped or Reduced Lending
- Insurance Companies and Fannie/Freddie Lenders are Active
- **CASH IS KING!** Cap/Yield Rates Have **RISEN** for Class B/C
- Value Growth will Lag Rent Growth – by a Lot
- Rents / Vacancies Remain better than early 1990s
- Real Estate Cost is **NOT** the Largest Cost of Business!!!

Quote of the Day

“...prediction is very difficult, especially when it’s about the future...”

~~NY Yankees #8, Yogi Berra~~

Niels Bohr

Nobel Laureate, 1922

Atomic Structure /

Quantum Mechanics



Greer's 3-Year Forecast as of 3/16/2010

- Forecast is a Barbell
- Margins (to 10 Yr Treasuries or LIBOR) will rise and settle at 300 ± 50 bps over 10 year Treasuries, but might over-correct in the short run, say 10Yr 400+ bps.
- Rent Growth will Lag CPI growth by 2-6%.
- Values will continue to fall 0-10%/yr thru mid-2011. Individual Market Performance will vary widely. (10-30% difference in Top vs. Bottom)
- Capitalization Rates will Rise 1-3% during 2010-2012 (e.g. 5.0% to 7.25% = 30% decline in value)
- Declines: #1=Retail; #2=Office & Industrial; then Apartment
- Change Creates Opportunities – Build Businesses
- Complete Barbell Forecast

Greer's Recovery Signs – Prereq's to Recovery

- CDS Exposure under \$25 Trillion (i.e. under 50% of peak)
- Stable or Decline in CMBx Yield Spreads for 6 straight weeks
- Re-emergence of CMBS market
 - New CMBS Market will include:
 - Issuer Keeps 1-5% 1st-loss piece
 - AAA Subordination near 30%....
 - AAA is 70%, not 90% of issue
- \sqrt REIT Market Capitalization (Total Value) Stabilizes or Increases for 6 months
- Consumer Confidence Rises and Stays Above 70 for 6 months
As of 2/24/11 (last report) index at 70.4 (1985=100)
- Risk Curve (AAA Sr. vs. BB) flattens to under 500 bps. As of 3/16/11, CMBx spread at nearly 100%.

Questions / Answers

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