
Wall Street and Commercial Real Estate

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Greer Advisors, LLC

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Greer Advisors, LLC

Goals of Presentation

- Disclaimers
- Market Drivers
- Financial Regulations (Dodd-Frank)
- Wall Street and Capital Markets (REIT / MBS)
- Market Conditions (Rent / Vacancy)
- 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**

Financial Regulations

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

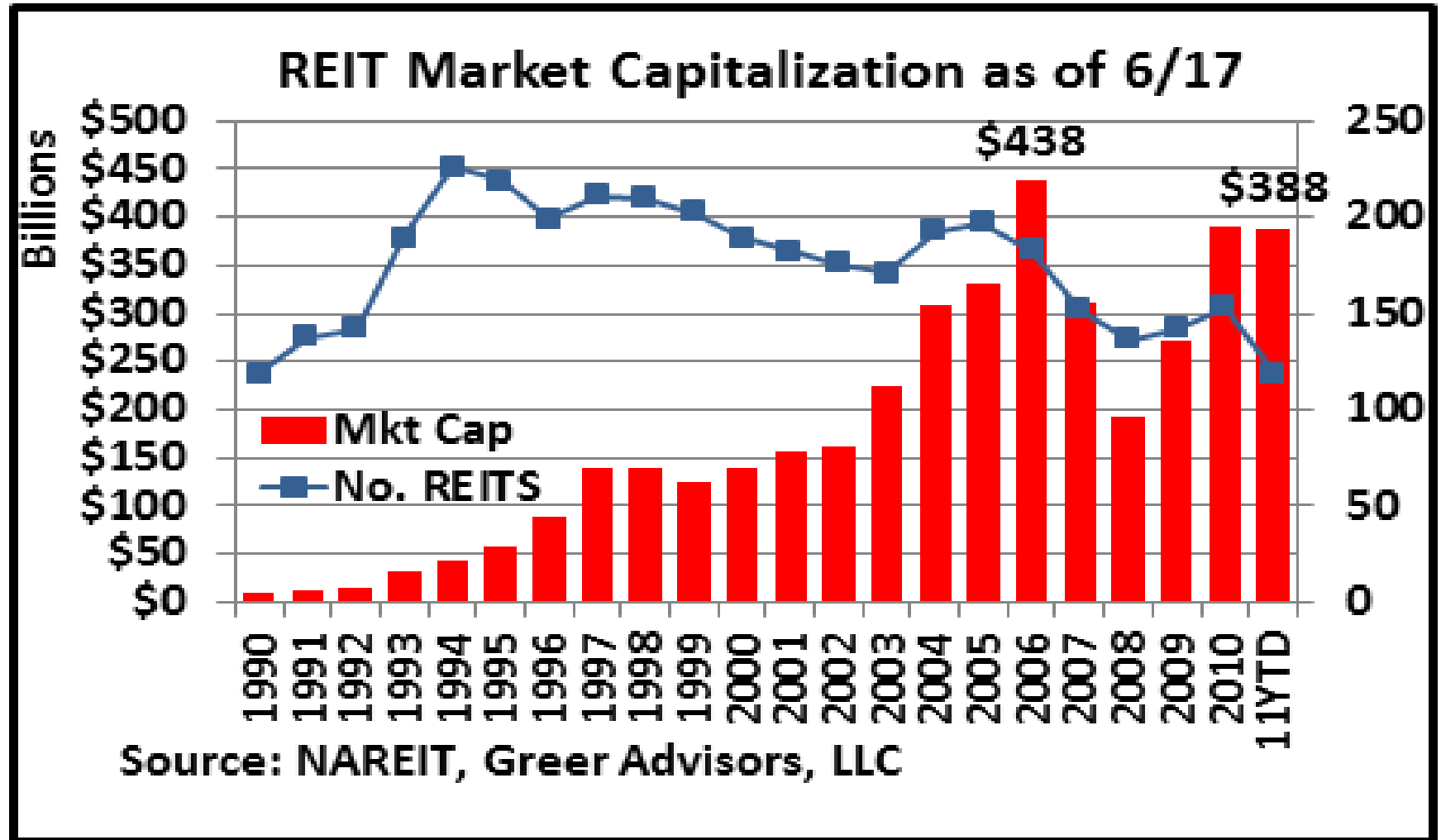
- Wall Street and Capital Markets

What is REIT?

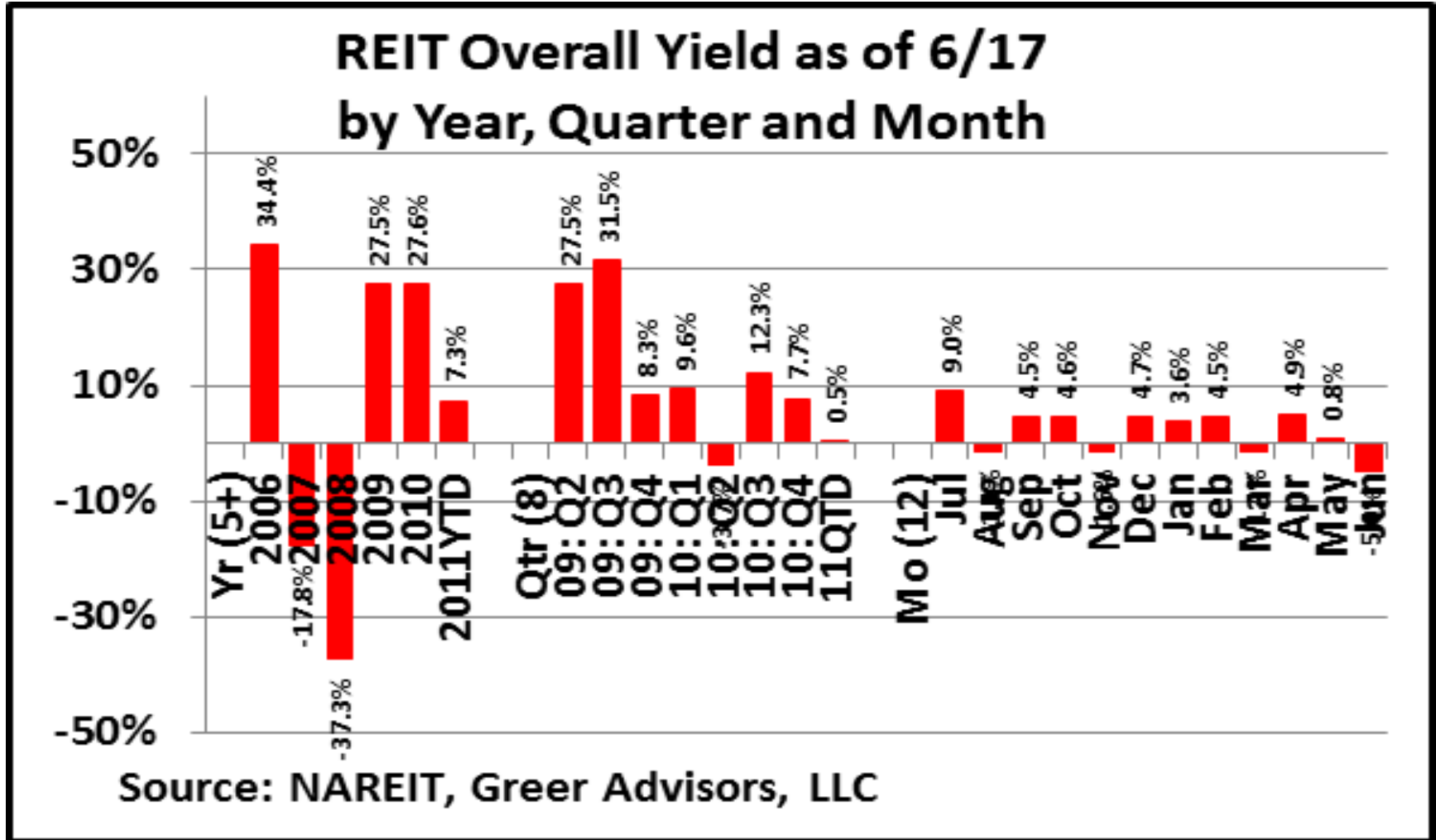
Real Estate Investment Trust

- Type of Pass-through Security
- Effectively a corporation
- As long as 90% of 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

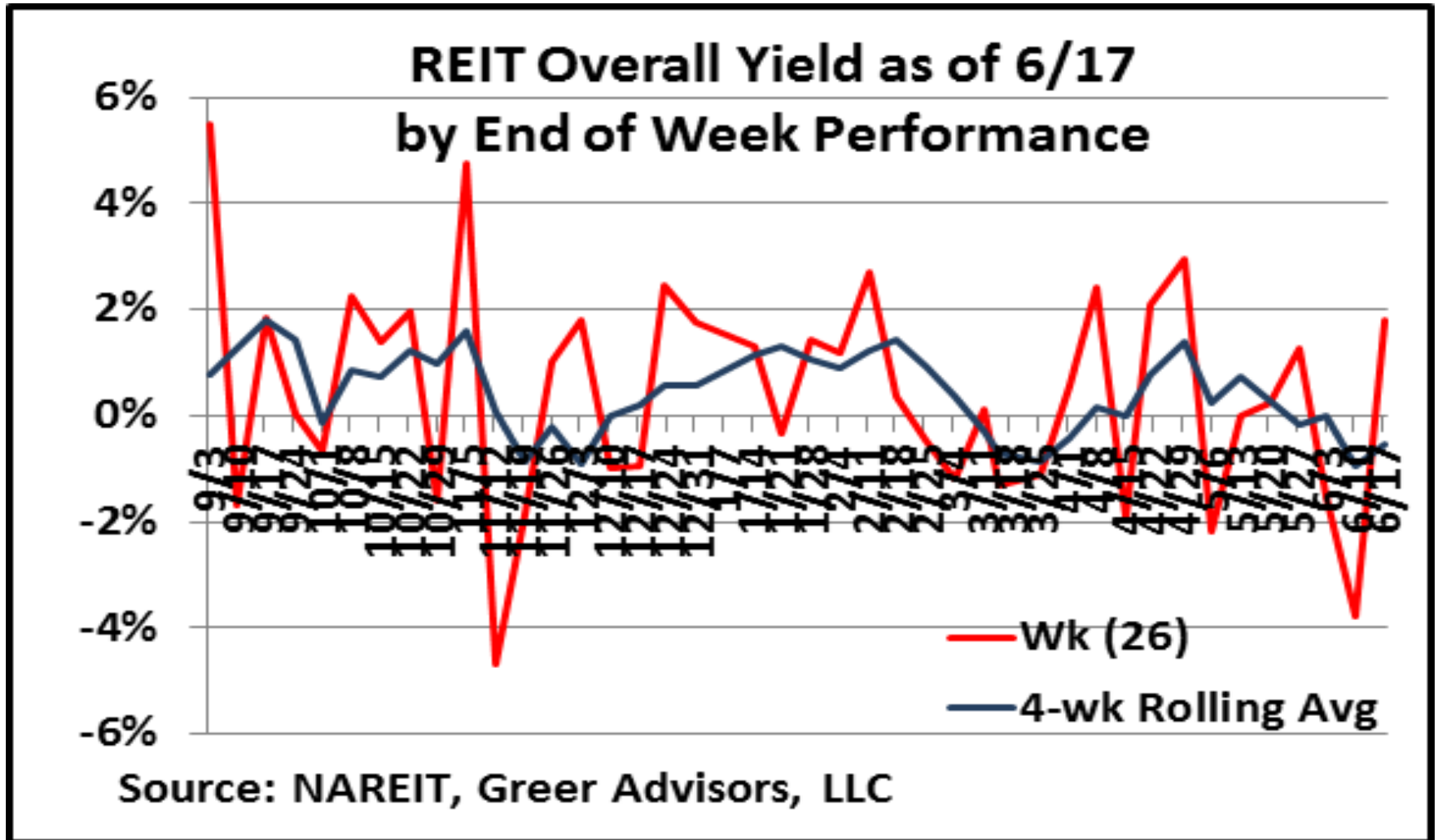
REIT Market Capitalization



Overall REIT Dividend Yields – Stable?



Overall REIT Dividend Yields – Stable?

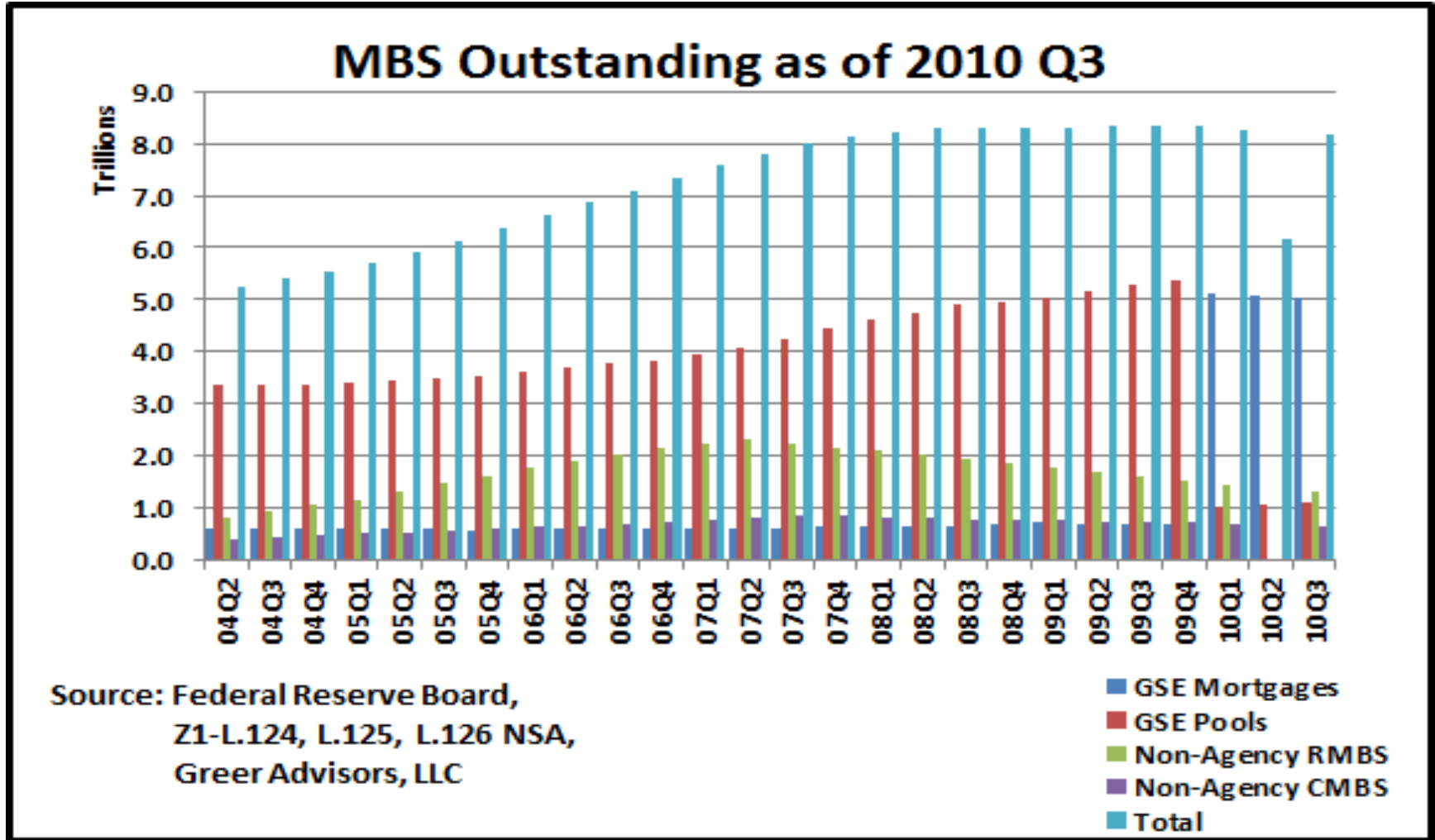


What is a MBS?

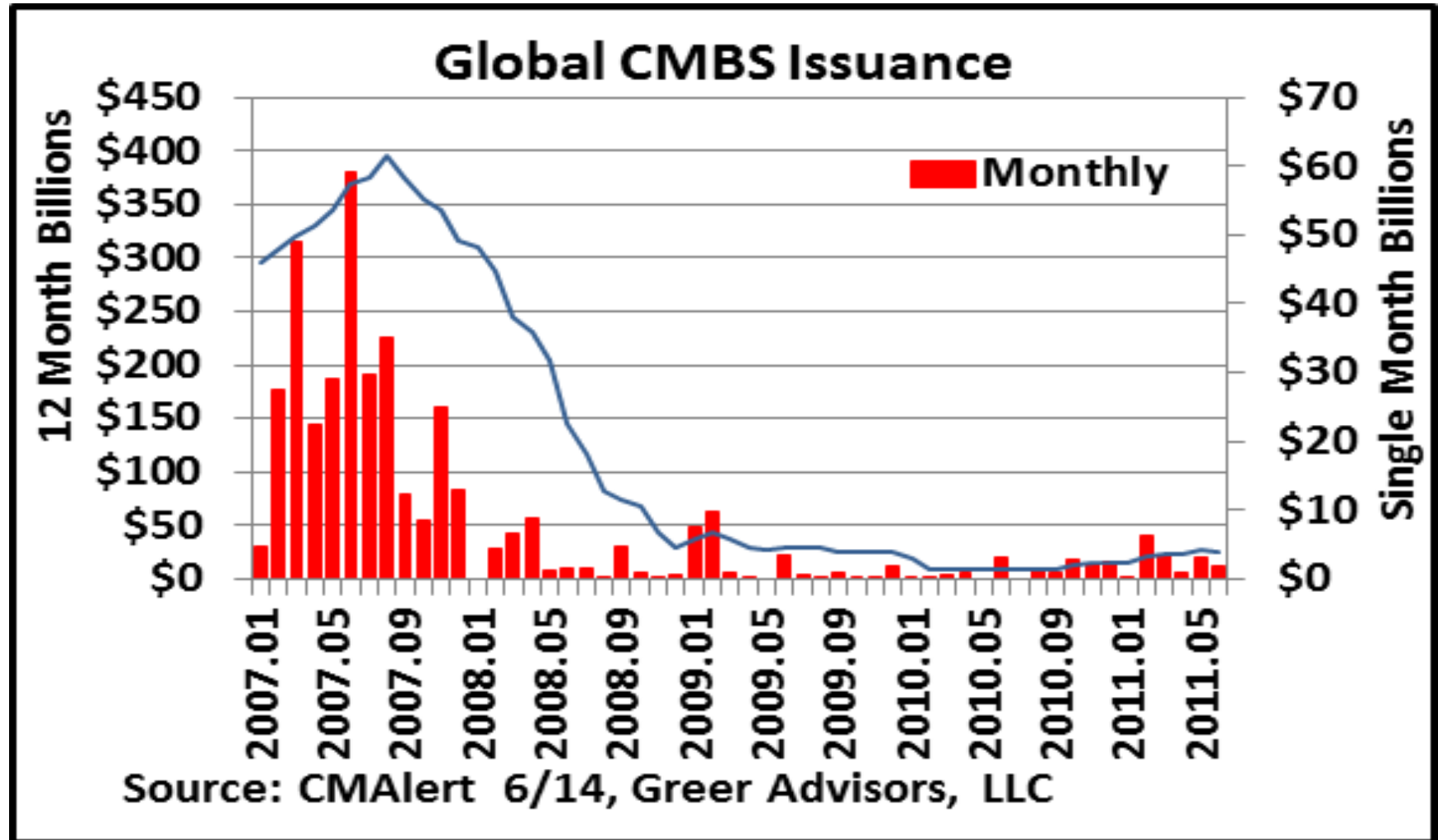
Mortgage Backed Security

- 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 – Not Recovered



CMBx Data

Greer CMBS / CMBx Yield RateTM				
Tranche	Yield	Suboord	Weight of Debt	Contribution to Total
AAA	3.47%	29.76%	70.24%	2.43%
AJ	4.34%	12.70%	17.06%	0.74%
AA	5.96%	10.63%	2.07%	0.12%
A	10.39%	8.00%	2.63%	0.27%
BBB	28.06%	4.72%	3.28%	0.92%
BBB-	29.40%	3.68%	1.04%	0.31%
BB	103.10%	2.69%	0.99%	1.02%
Unrated	177.00%	0.00%	2.69%	4.76%
Implied Overall Debt Yield			100.00%	10.58%
Loan to Value Ratio				75.00%
Class-A Equity Yield Total Yield			29.00%	15.18%
Class-B Equity Yield Total Yield			103.00%	33.68%

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 6/20. Swap (10Yr) as of 6/17. 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???

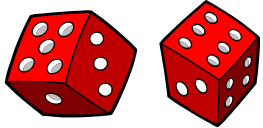
Players in “Simple” CDS

Business Issues Bonds

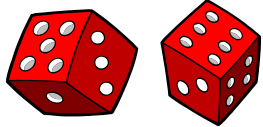


Bonds initially rated too poor for market, eg “BB”

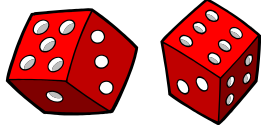
Side Bet 1



Side Bet 2



Side Bet 3

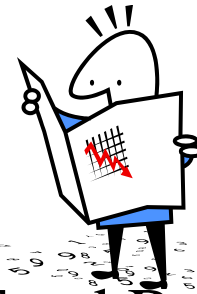


Investment Bank issues CDS (aka Credit Enhances Debt) Enough to make BB = AA, if debtor fails, IB buys bonds

Rating Agency Rates Bonds



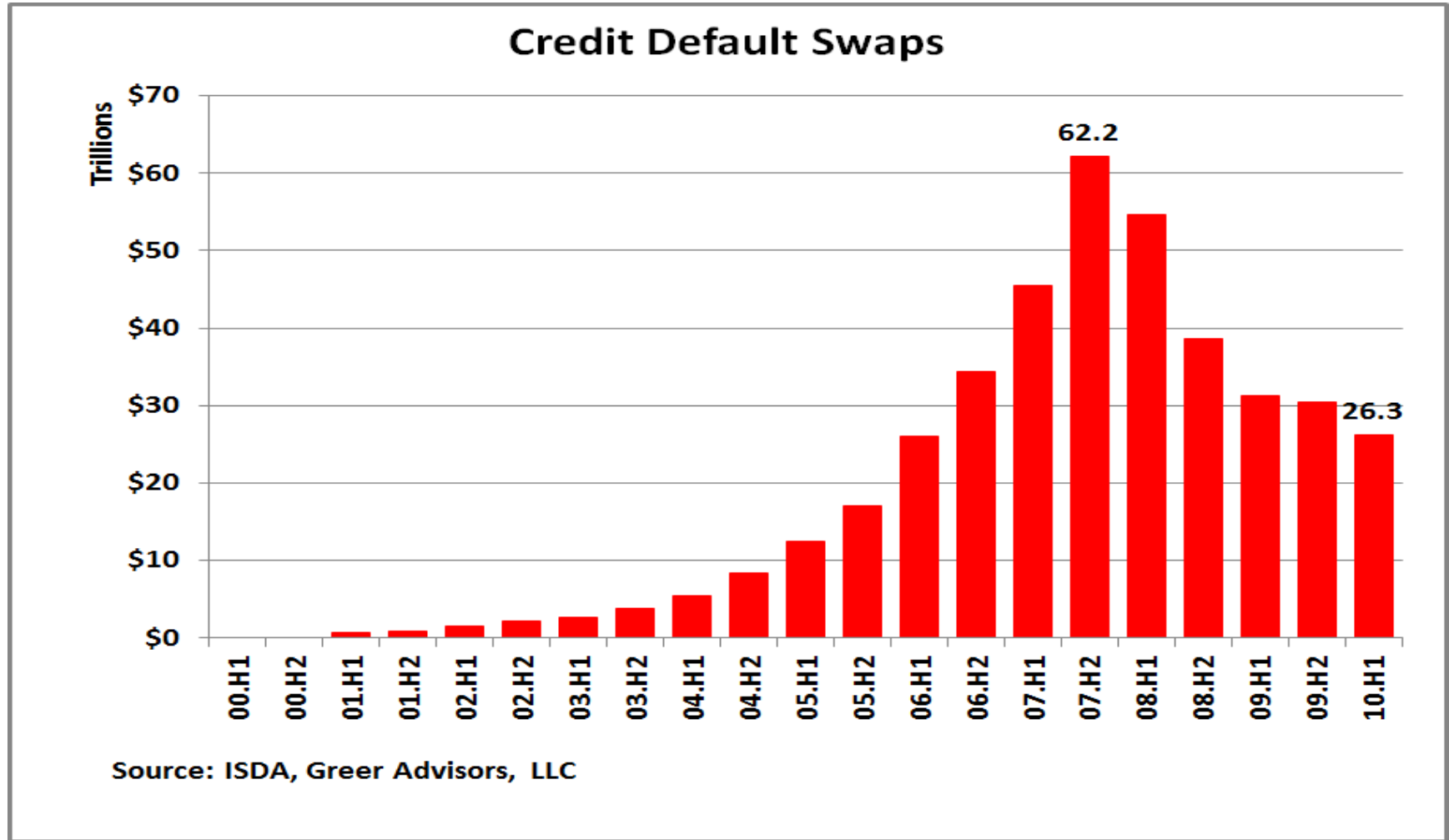
Gives loss forecast & amount required for “AA” rating



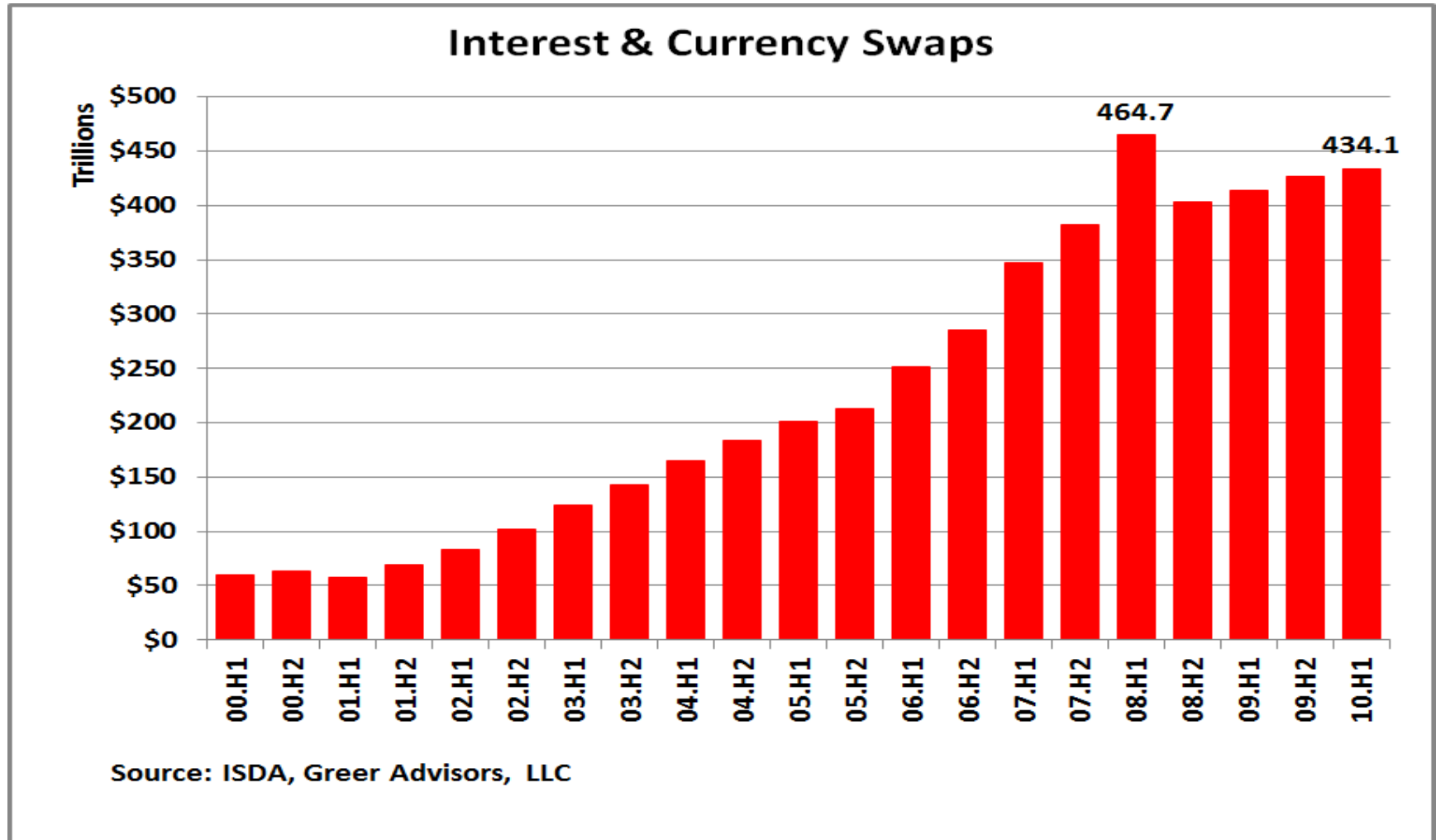
Pension Fund Buys Bonds with CDS enhancement
Thinks it's AA investment

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Credit Default Swaps



Interest & Currency Swaps



Top - Bottom Market Stats – as of 2011 Q1

INDUSTRIAL - 2011.Q1					OFFICE - 2011.Q1					RETAIL - 2011.Q1					APARTMENT - 2011.Q1				
Rnk	Metro	Vac %	Rent \$	Rent Chg	Rnk	Metro	Vac %	Rent \$	Rent Chg	Rnk	Metro	Vac %	Rent \$	Rent Chg	Rnk	Metro	Vac %	Rent \$	Rent Chg
1	Los Angeles	7.3%	\$6.64	4.9%	1	Honolulu	8.5%	\$21.74	1.4%	1	San Francisco	3.6%	\$29.89	-0.2%	1	Pittsburgh	2.0%	\$922	1.0%
2	Salt Lake City	8.0%	\$4.76	-0.8%	2	New York	9.3%	\$52.81	-0.3%	2	Fairfield County	4.3%	\$25.26	0.2%	2	San Jose	2.8%	\$1,635	1.9%
3	Orange County	10.5%	\$8.06	2.0%	3	Pittsburgh	10.6%	\$17.82	2.5%	3	Long Island	5.4%	\$22.75	0.0%	3	El Paso	3.2%	\$707	1.5%
4	Houston	10.8%	\$5.41	3.0%	4	Long Island	11.7%	\$19.86	-1.2%	4	Northern New Jer	5.4%	\$24.52	-0.4%	4	Portland	3.2%	\$870	1.5%
5	San Francisco	10.9%	\$7.75	-1.1%	5	San Francisco	12.8%	\$22.40	4.1%	5	San Jose	6.0%	\$26.68	0.1%	5	Minneapolis	3.4%	\$989	1.2%
6	Kansas City	11.0%	\$6.52	1.4%	6	Boston	13.1%	\$26.33	-2.0%	6	Los Angeles	6.2%	\$25.15	0.1%	6	Newark	3.6%	\$1,304	1.4%
7	Las Vegas	11.1%	\$5.81	3.2%	7	Stamford	13.1%	\$26.18	0.3%	7	Orange County	6.2%	\$26.56	0.2%	7	Oakland	3.8%	\$1,326	1.3%
8	Portland	11.3%	\$6.20	0.0%	8	Washington, DC	13.2%	\$34.71	1.6%	8	Oakland-East Bay	6.3%	\$24.88	0.2%	8	San Francisco	3.9%	\$1,969	1.5%
9	Albuquerque	11.4%	\$5.28	0.4%	9	Trenton	13.4%	\$24.40	1.5%	9	Suburban Virginia	6.5%	\$24.25	-0.3%	9	Boston	4.1%	\$1,512	1.2%
10	Long Island	11.5%	\$5.51	-0.7%	10	Nashville	13.9%	\$19.77	0.2%	10	Boston	6.7%	\$19.49	0.1%	10	Miami	4.1%	\$1,079	1.7%
8	Portland	11.3%	\$6.20	0.0%	16	Philadelphia	14.5%	\$21.02	1.3%	20	Portland	9.2%	\$17.32	0.0%	4	Portland	3.2%	\$870	1.5%
14	Seattle	12.1%	\$7.85	-0.1%	20	Seattle	16.4%	\$23.37	4.5%	16	Seattle	7.6%	\$20.16	-0.3%	19	Seattle	4.8%	\$1,040	1.3%
50	Raleigh	16.3%	\$5.76	-0.2%	49	Minneapolis	20.3%	\$19.75	1.6%	72	Syracuse	14.5%	\$10.53	-0.1%	52	Greenville	7.8%	\$675	1.7%
51	Hartford	17.5%	\$5.84	-0.7%	50	West Palm Beach	20.7%	\$20.34	-0.2%	73	Cincinnati	14.6%	\$12.32	0.0%	53	San Antonio	7.9%	\$734	0.5%
52	Sacramento	18.3%	\$4.68	-3.1%	51	Atlanta	21.1%	\$16.72	-2.8%	74	Dallas	15.0%	\$14.04	0.1%	54	Tampa	8.2%	\$831	0.9%
53	Stamford	18.3%	\$5.84	1.0%	52	Tampa	21.5%	\$18.57	-0.8%	75	Cleveland	15.1%	\$12.83	-0.3%	55	Tucson	8.2%	\$630	0.2%
54	Atlanta	18.5%	\$3.29	-2.1%	53	Edison	21.7%	\$17.62	0.3%	76	Indianapolis	15.4%	\$12.38	0.1%	56	Tulsa	8.7%	\$576	0.7%
55	Phoenix	18.5%	\$4.69	-6.2%	54	Sacramento	22.2%	\$19.01	-3.6%	77	Tulsa	15.5%	\$9.77	0.3%	57	Fort Worth	9.0%	\$683	0.6%
56	Boston	18.7%	\$5.73	-2.9%	55	Dallas	22.4%	\$18.07	2.2%	78	Birmingham	15.9%	\$12.19	0.1%	58	Las Vegas	9.4%	\$727	-0.7%
57	Detroit	19.6%	\$3.15	-1.3%	56	Riverside	22.7%	\$18.45	-1.1%	79	Columbus	16.2%	\$10.69	0.3%	59	Phoenix	9.5%	\$718	0.9%
58	Memphis	19.9%	\$2.32	-1.3%	57	Las Vegas	25.2%	\$21.05	-2.5%	80	Indianapolis	16.3%	\$12.33	0.0%	60	Houston	9.8%	\$807	0.6%
59	Trenton	23.1%	\$3.78	-0.5%	58	Detroit	25.4%	\$14.33	-3.0%	81	Dayton	17.0%	\$8.82	-0.2%	61	Birmingham	9.9%	\$744	0.6%
60	Ann Arbor	24.2%	\$6.49	-1.7%	59	Phoenix	25.9%	\$18.08	-1.7%	82	Dayton	17.0%	\$8.79	-0.1%	62	Atlanta	10.2%	\$786	0.4%
	Average	14.5%	\$5.16	-0.2%		Average	17.3%	\$20.56	-0.1%		Average	11.1%	\$15.77	-0.1%		Average	5.9%	\$974	0.8%
	Hi	7.3%	\$2.32	-6.2%		Hi	8.5%	\$14.33	-4.4%		Hi	3.6%	\$8.79	-1.6%		Hi	2.0%	\$575.59	-0.7%
	Low	24.2%	\$8.06	4.9%		Low	25.9%	\$52.81	4.5%		Low	17.0%	\$31.94	0.7%		Low	10.2%	\$2,240.89	1.9%
	Spread	16.9%	\$5.74	11.1%		Spread	17.4%	\$38.48	8.9%		Spread	13.4%	\$23.15	2.3%		Spread	8.2%	\$1,665.30	2.6%

Source: CBRE Economic Advisors, Greer Advisors, LLC

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Source: REIS, Inc, Greer Advisors, LLC

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Source: CBRE Econometric Advisors,
REIS, Inc., Greer Advisors, LLC

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Portland SubMarket Snapshots – as of 2011 Q1

INDUSTRIAL - 2011.Q1				OFFICE - 2011.Q1				RETAIL - 2011.Q1				APARTMENT - 2011.Q1			
SubMarket	Inv (1,000)	Vac	AskRntGr	SubMarket	Inv (1,000)	Vac	AskRntGr	SubMarket	Inv (1,000)	Vac	Eff Rent	SubMarket	Inv (Units)	Vac	Rent/U
Northeast	39,034	10.1%	\$5.40	<u>Downtown</u>	<u>16,513</u>	<u>9.4%</u>	<u>\$21.58</u>	Downtown/Hillsboro	2,244	4.2%	\$12.35	Central Portland	93,161	3.4%	\$975
Northwest	42,757	10.0%	\$4.75	Subtotal: Downtown	16,513	9.4%	\$21.58	Downtown/Hillsboro	2,094	13.2%	\$19.99	South Portland/Oregon City	20,592	3.3%	\$865
Southeast	30,116	8.8%	\$5.75	Airport Way	561	22.8%	\$21.47	I-5/217 Corridor	3,137	5.8%	\$15.31	Vancouver	24,736	4.6%	\$784
Southwest	60,341	14.8%	\$11.69	Barbur Blvd	558	14.7%	\$16.43	Eastside/Gresham	3,510	11.3%	\$22.14	West Portland/Beaverton	47,464	2.6%	\$845
Vancouver	20,520	9.4%	\$15.02	Beaverton	3,157	22.1%	\$18.09	Eastside/Gresham	2,828	5.5%	\$9.98	Total: Portland	194,895	3.2%	\$870
Total: Portland	192,768	11.3%	\$8.83	Clackamas	1,095	18.0%	\$21.45	East Clackamas	1,963	14.9%	\$19.61				
Total Warehouse	124,913	12.1%	\$6.92	Eastside	1,425	20.6%	\$15.11	Vancouver/Clark Co	2,018	3.3%	\$11.87				
Total Manuf	25,522	8.5%	\$4.17	Hillsboro	1,262	35.4%	\$19.61	Vancouver/Clark Co	1,964	13.1%	\$17.13				
Total R&D	31,376	14.1%	\$13.01	Johns Landing	1,104	15.7%	\$20.87	Total	19,758	8.9%	\$16.05				
				Kruse Way	1,880	21.5%	\$26.08	Note: Non Weighted							
				Lake Oswego	365	18.6%	\$23.99								
				Lloyd Center	2,599	7.3%	\$19.11								
				Northwest	2,909	11.4%	\$21.80								
				Tigard	2,334	17.3%	\$21.38								
				Tualatin	823	25.3%	\$20.95								
				Vancouver	4,123	21.2%	\$19.67								
				Washington Square	1,172	25.5%	\$21.29								
				West Hills	767	12.0%	\$17.58								
				<u>Wilsonville</u>	<u>700</u>	<u>37.0%</u>	<u>\$19.29</u>								
				Subtotal: Suburban	26,834	19.2%	\$20.36								
				Total: Portland	43,347	15.5%	\$20.69								
Average		11.0%	\$8.39	Average		19.0%	\$20.40	Average		8.9%	\$16.05	Average		3.4%	\$868
Hi		8.5%	\$4.17	Hi		7.3%	\$15.11	Hi		3.3%	\$9.98	Hi		2.6%	\$784
Low		14.8%	\$15.02	Low		37.0%	\$26.08	Low		14.9%	\$22.14	Low		4.6%	\$975
Spread		6.3%	\$10.85	Spread		29.7%	\$10.97	Spread		11.6%	\$12.16	Spread		2.0%	\$192

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REIS, Inc., Greer Advisors, LLC

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 Loss Rates – Still All Time Highs, Banks better

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 Bera~~

Niels Bohr

Nobel Laureate, 1922

Atomic Structure /

Quantum Mechanics



Greer's 3-Year Forecast as of 6/21/2011

- If Global Economy Heals = Modest Recovery, 60-70%
If not = Global Deep Recession, 30-40%. No middle.
- Margins (to 10 Yr Treasuries or LIBOR) for debt on Class B property will rise and settle at 300±50 bps over 10 year Treasuries, but might over-correct in the short run.
- Rent Growth Lag CPI growth by 1-3%, expect more Yrs 2-5.
- Values appear to have stabilized. They fell from through mid-2011. Individual Market Performance varied widely.
(10-30% difference in Top vs Bottom)
- Capitalization Rates will Rise 0.5-2% during 2011-2012, almost all in Class B/C. Trophy Class A cap rates stay low.
- Value Growth: #1 Apartment; #2=Office & Ind.; #Last Retail
- Change Creates Opportunities = Build Businesses

Greer's Recovery Signs – Prereq's to Recovery

- \sqrt CDS Exposure under \$25 Trillion (i.e. under 50% of peak)
- \sqrt Stable or Decline in CMBx Yield Spreads for 6 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
 - At 5/31 (last report) index at 60.8 (85=100) prior = 65.4
- Risk Pricing, aka Curve (AAA Sr. vs BB) flattens to under 500 bps. As of 6/17/11, CMBx spread nearly 10,000 bps or 100 pts (3.47 v 103.10% yield)

Questions / Answers

Greer Advisors, LLC

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