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# Wall Street and Commercial Real Estate

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# Goals of Presentation

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- Two Fundamentals of Real Estate
- CMBS / CDO / REIT Industries
- Size / Impact of Capital Markets
- Deal Structure – CMBS Example
- Capital Market Yields
- Real Estate Trends
- Capitalization Rates — Lags
- What's New? What's Next?
- Conclusions

# Fundamentals

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## Supply / Demand

- Supply Growth – Development has Stopped
- “Big Picture” 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
  - During the last few years, has accounted for slightly less than 40% of all commercial real estate lending.

## Financing – Currently Most Important Fundamental

# What is a CMBS?

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## Commercial Mortgage Backed Security

- Type of pass-through security
- Commercial 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 the last few years, has accounted for slightly less than 40% of all commercial real estate lending.

# What is a CDO?

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## 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.

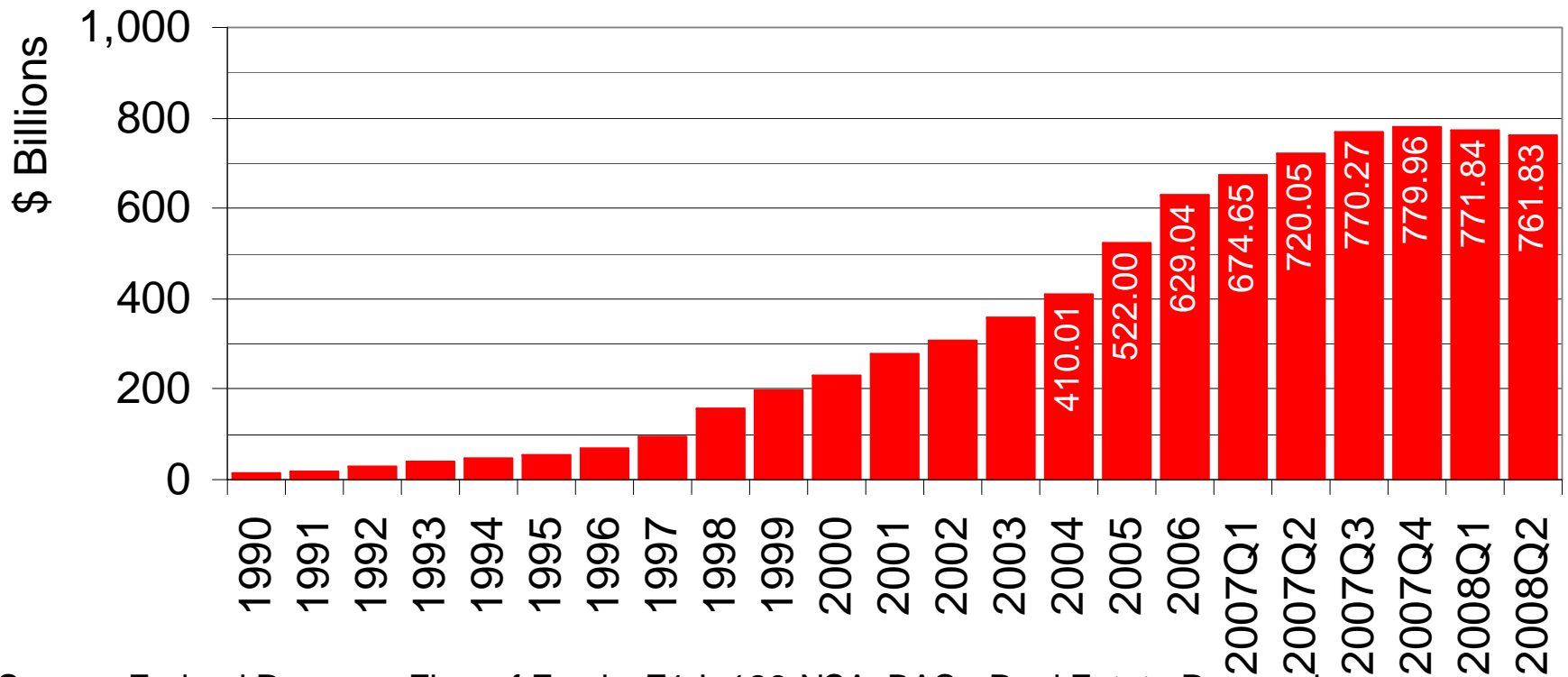
# What is REIT?

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## Real Estate Investment Trust

- Type of Pass-through Security
- Effectively a corporation
- 95% of income passed through to shareholders. No “corporate” tax. All earnings single-taxed at shareholder level.
- Current “Industry” Issues:  
Definition of Assets, Max Debt Load, Yield

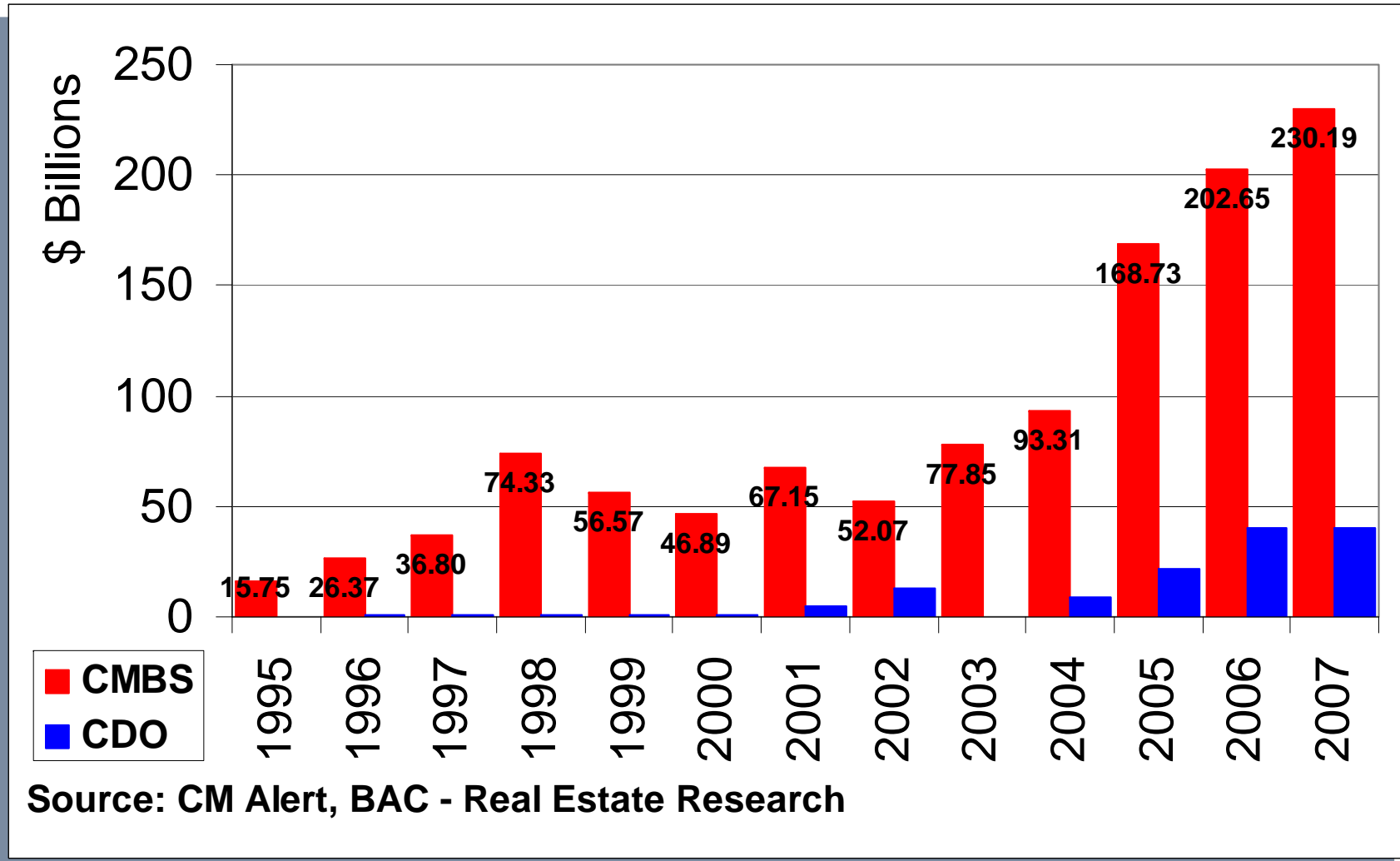
# CMBS Outstandings in U.S. - Grows



Source: Federal Reserve, Flow of Funds, Z1-L.126-NSA, BAC - Real Estate Research

Note: Total of Multi-Family and Commercial Mortgage Asset Backed Securities.

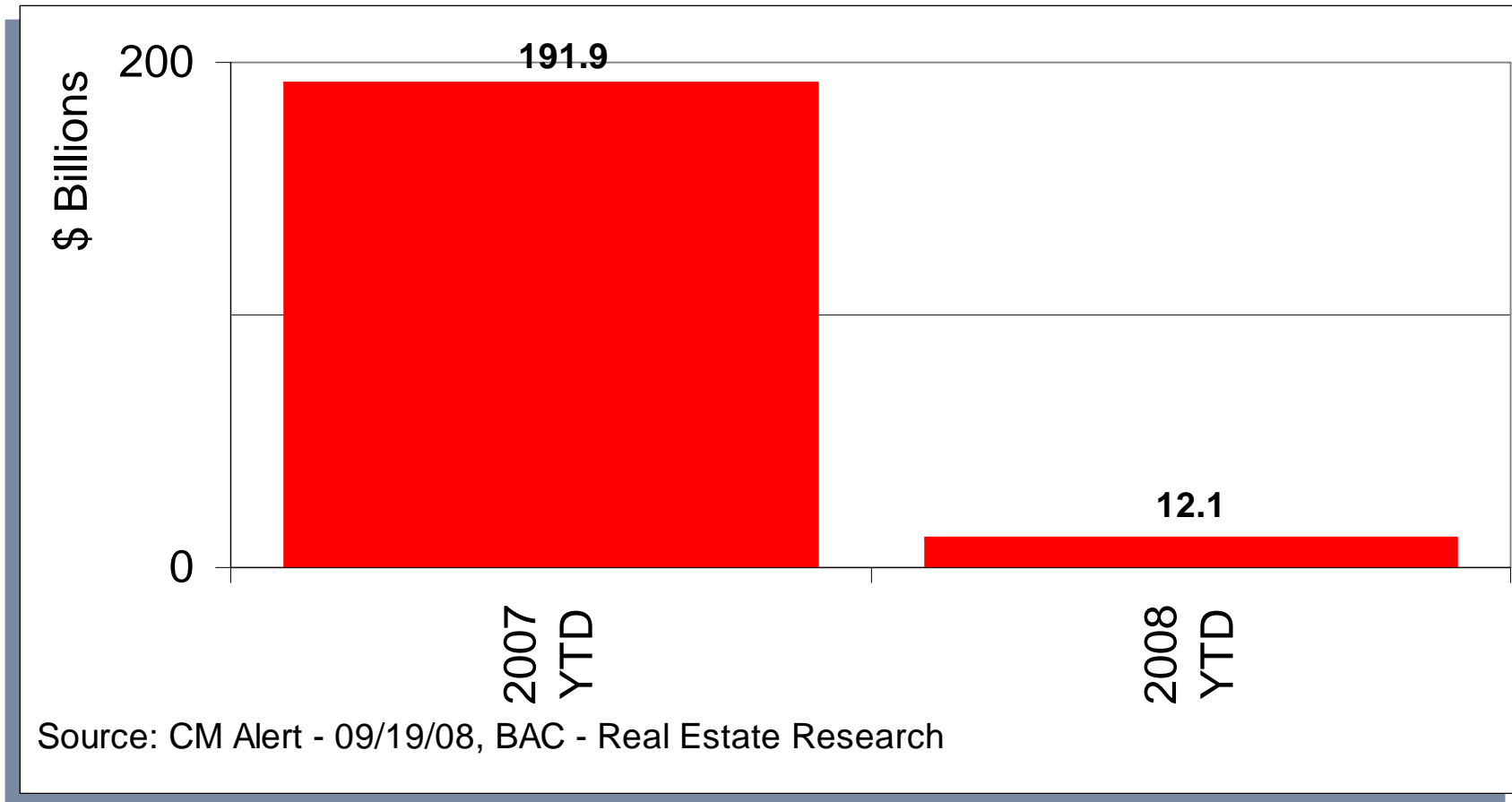
# CMBS Issuance in U.S. - Skyrockets



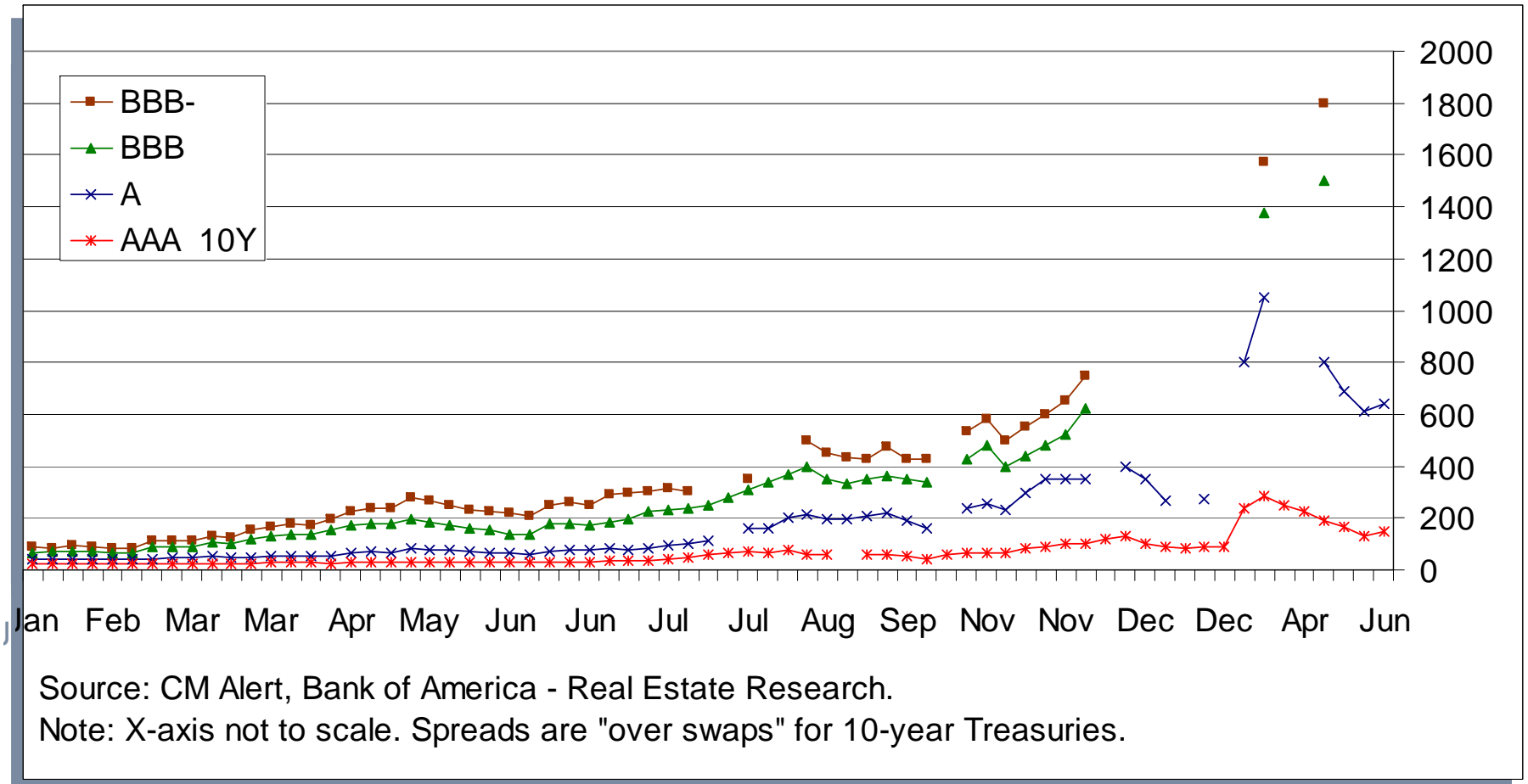
Source: CM Alert, BAC - Real Estate Research



# CMBS Issuance in U.S. - 2008 Off 94% YTD



# CMBS Yield Spreads (Spread to Swap)



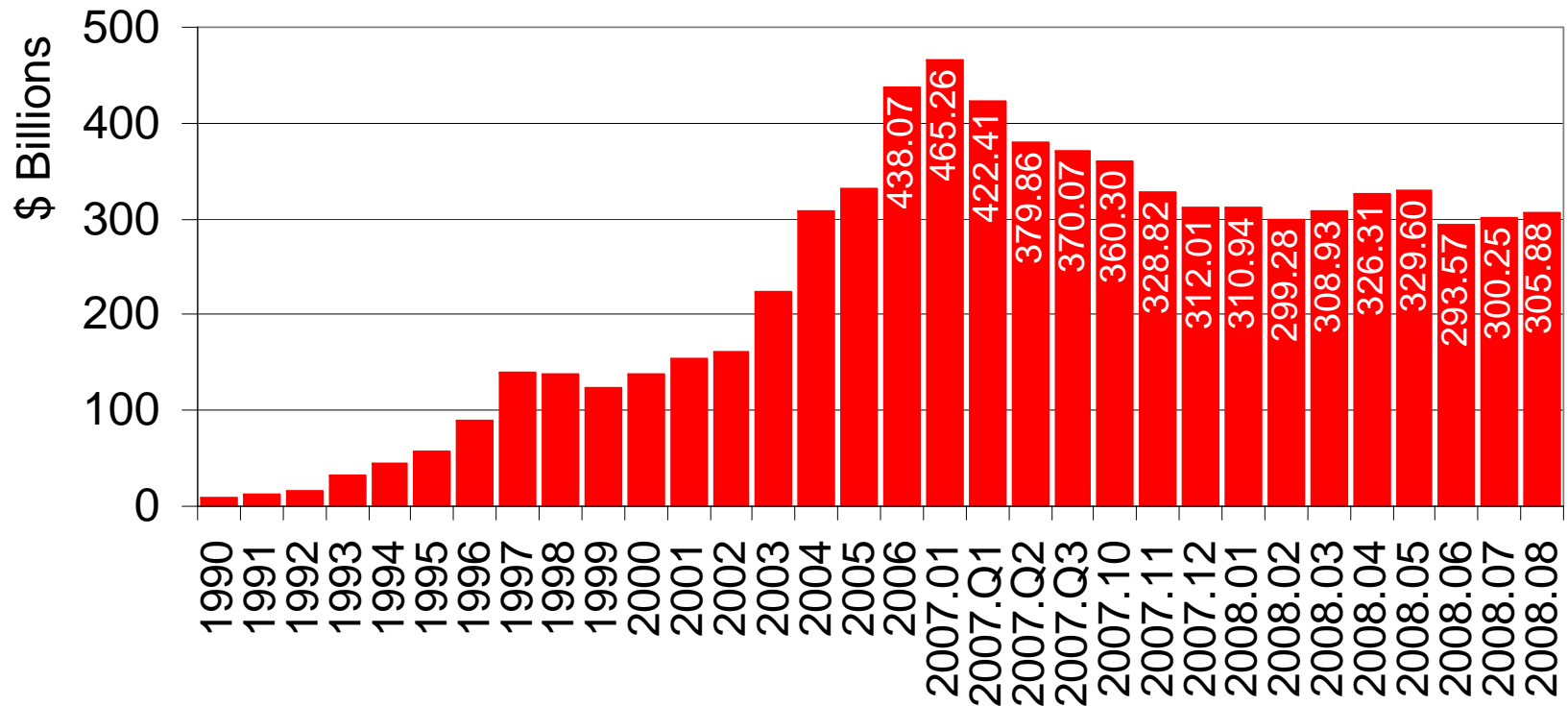
# CMBS Spreads — Yield Rate Implications

Tranche	Rise in Yield	Weight	Debt v Equity	Total Weight	Impact
AAA	130	85%	75%	63.75%	82.88
A	600	9%	75%	6.75%	40.50
BBB	1550	7%	75%	5.25%	81.38
BBB-	1700	5%	75%	3.75%	63.75
Unrated	1900	3%	75%	2.25%	42.75
Class A Prop.	1900	100%	25%	25.00%	475.00
Note: Class A assumed to have no "unrated" traunche				Total	807.25
Class B- Prop.	2200	100%	25%	25.00%	550.00
Note: Class B- assumed 250 bps above "unrated"				Total	861.25

Note: Market for < BBB paper is gone! Pricing is uncertain!

Higher subordination = even greater impact.

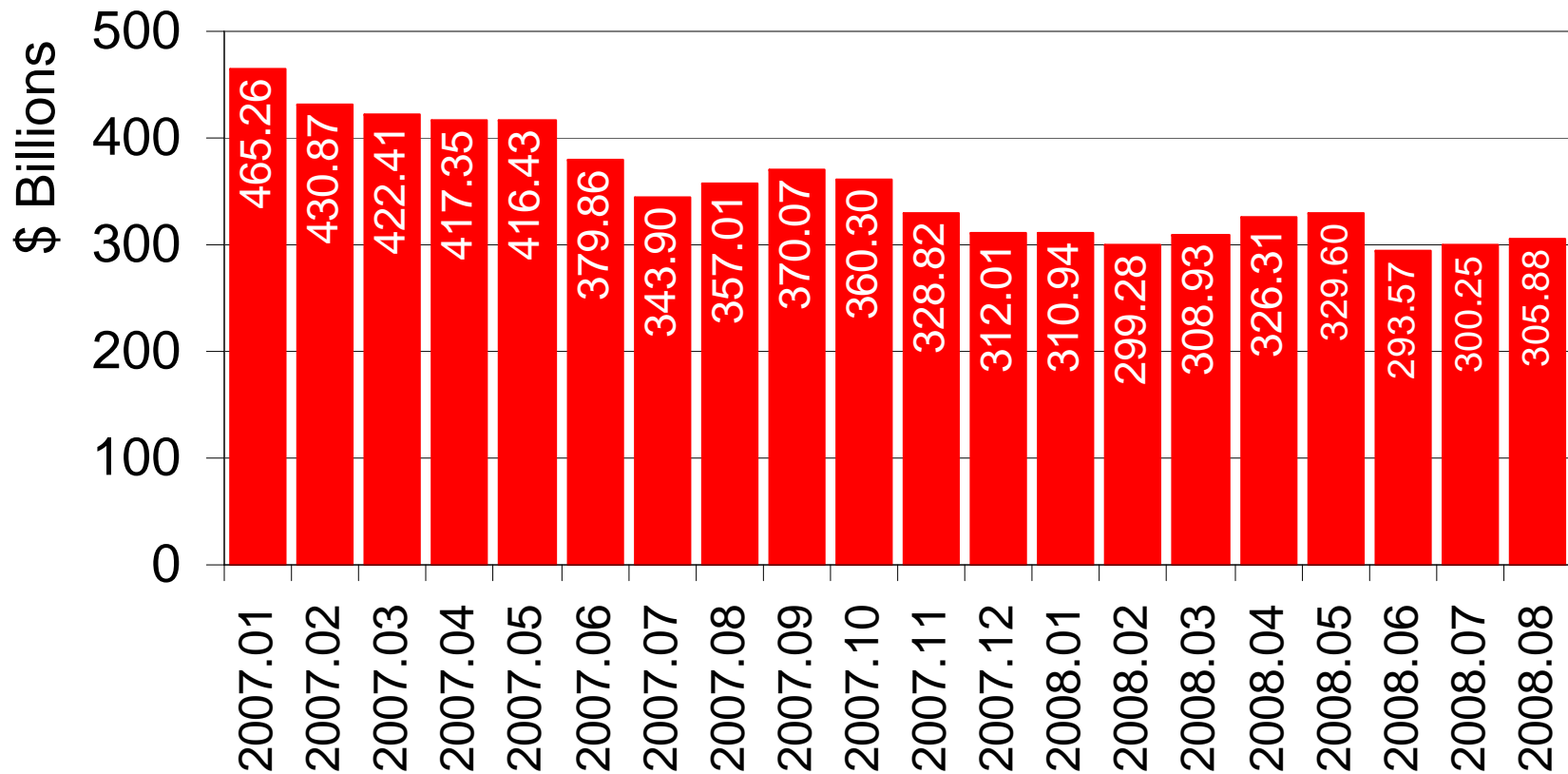
# REIT Market Capitalization



Source: NAREIT, Bank of America Real Estate Research

Note: Includes Equity, Debt and Hybrid REITS

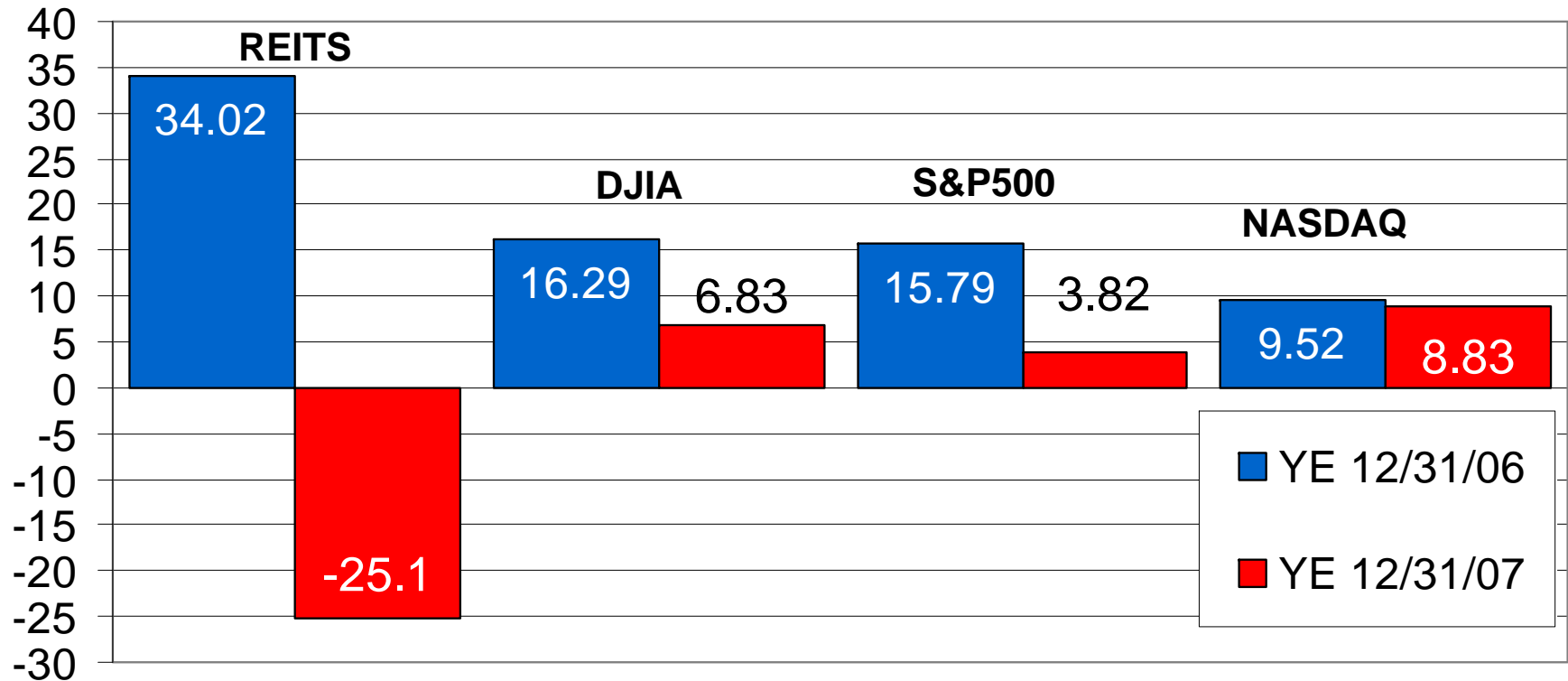
# REITs Lose \$159 Billion or 34% of value



Source: NAREIT, Bank of America - Real Estate Research

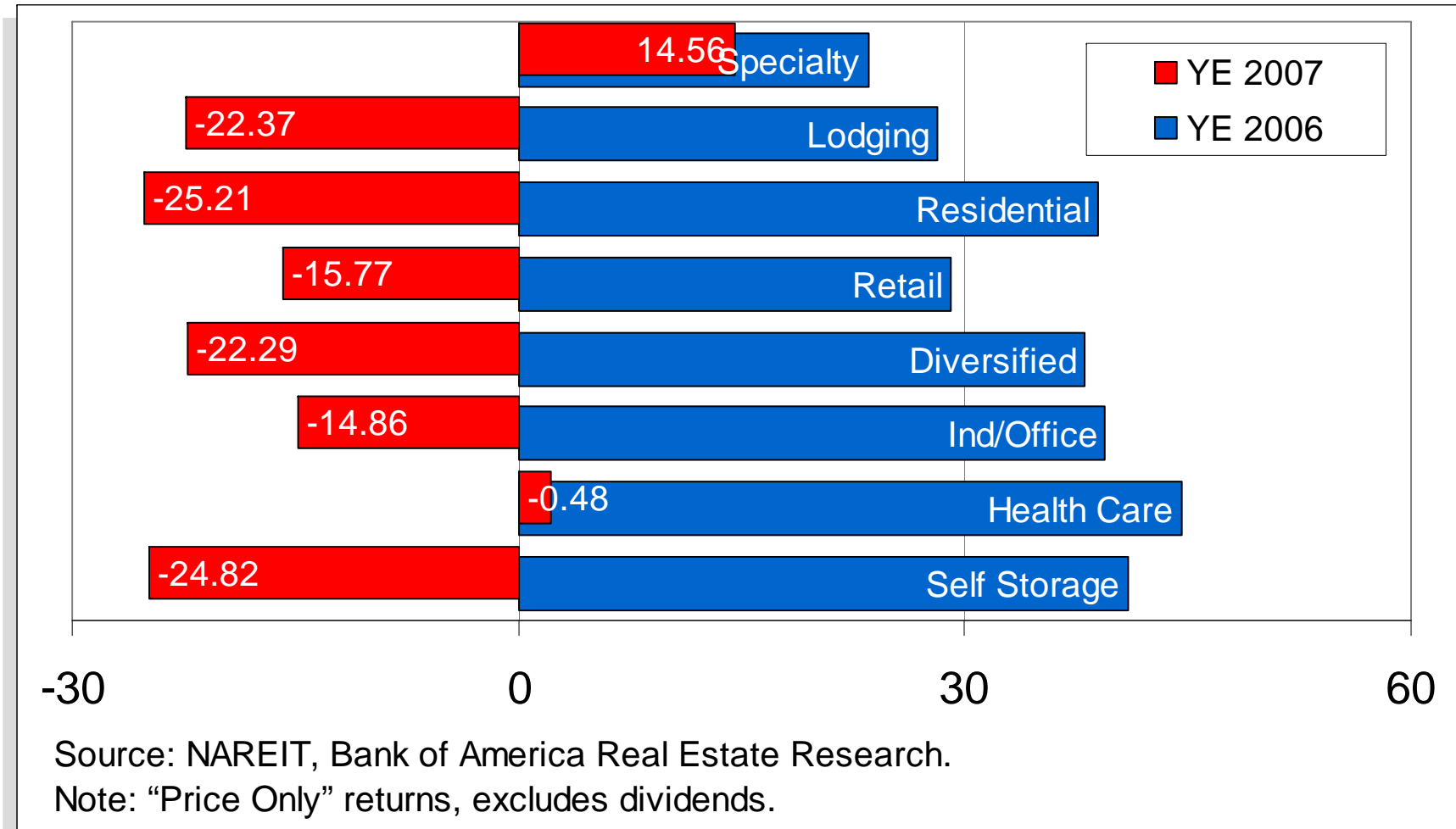
Note: Includes Equity, Debt and Hybrid REITS

# Benchmark Returns — Changes so Fast!

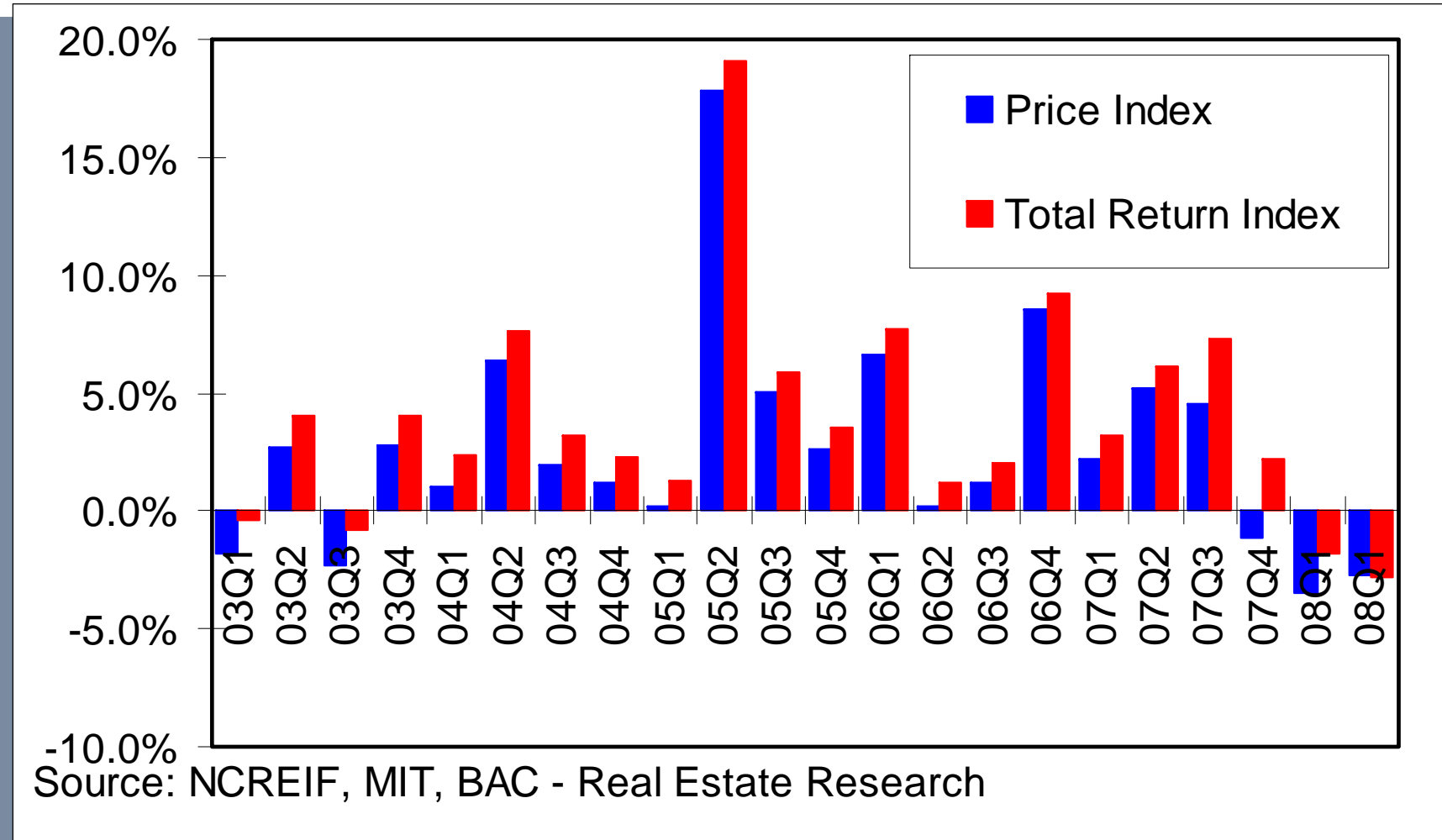


Source: NAREIT, Bank of America Real Estate Research.  
Note: "Price Only" returns, excludes dividends.

# REIT Property Type Returns — Old vs. New



# NCREIF 08.Q2 Price Down/ Total Down





# Value Fundamentals

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CMBS Market is Effectively Broken = Opportunities

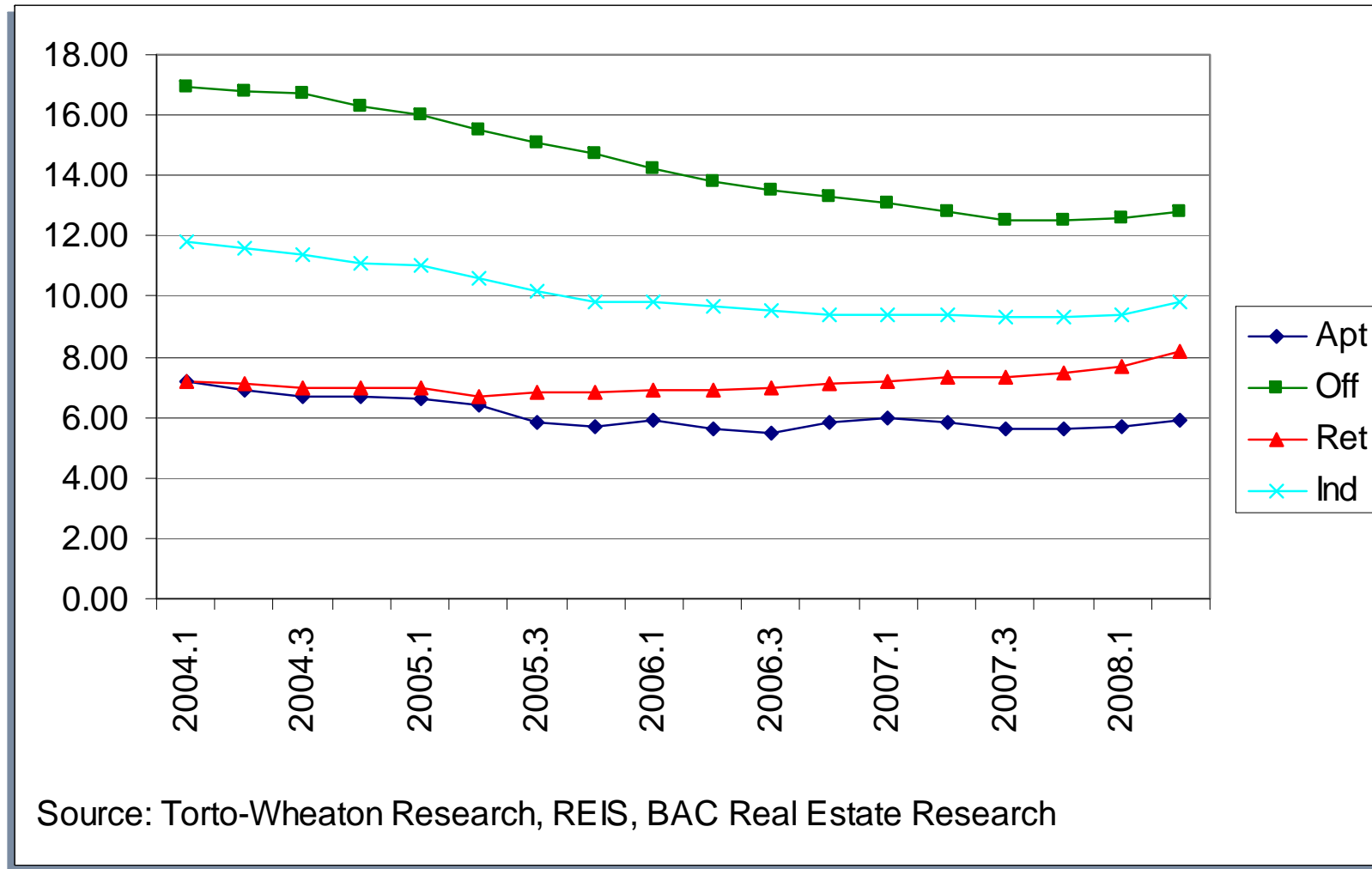
CMBS Indicates Nearly 60% Decline in Value  
(8.0% rise in capitalization rates = 62% decline)

REITS are “Off” more than 30% = Opportunities

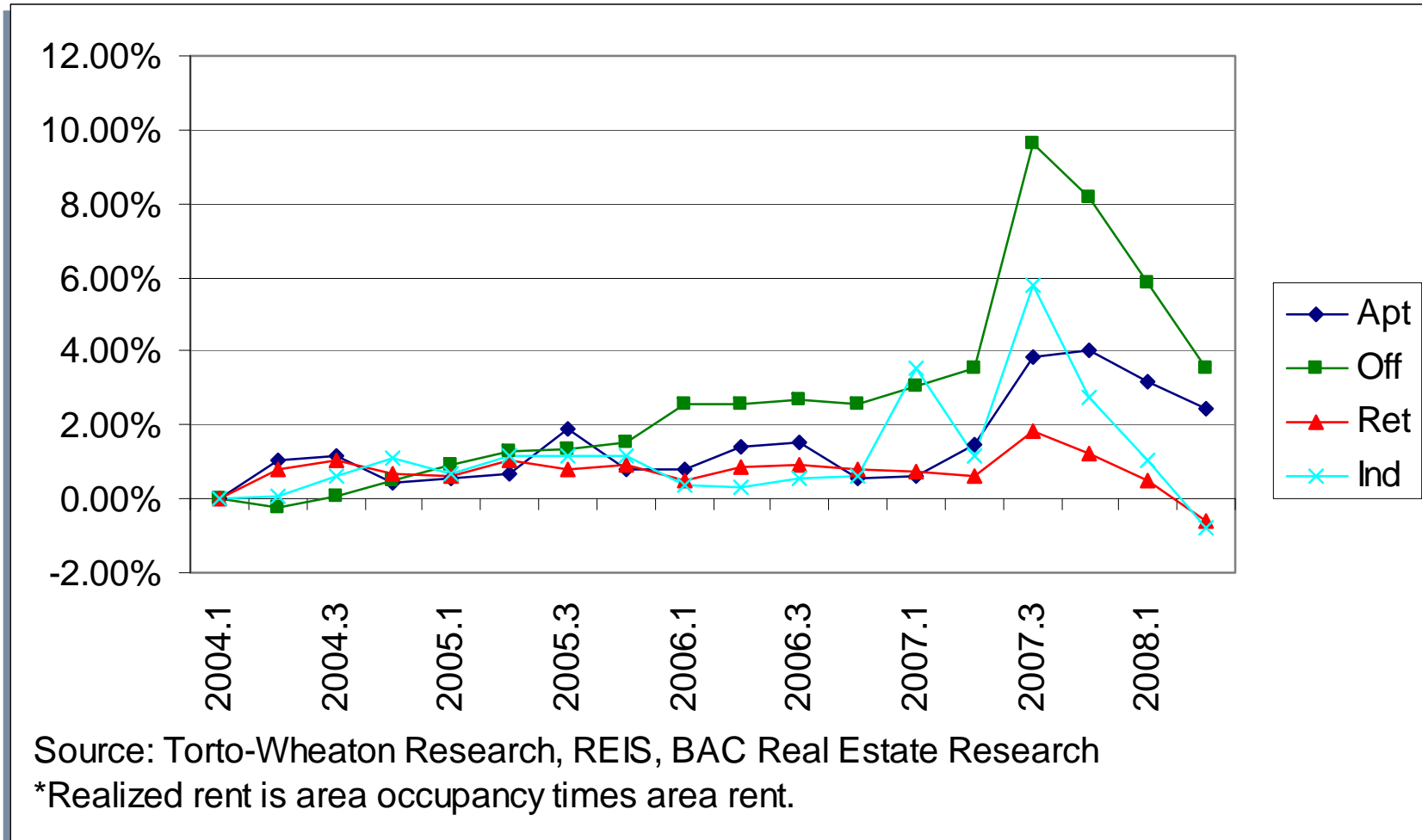
NCREIF is nearly Flat (down -2.7% and -2.8%)

Market Change brings Opportunities!

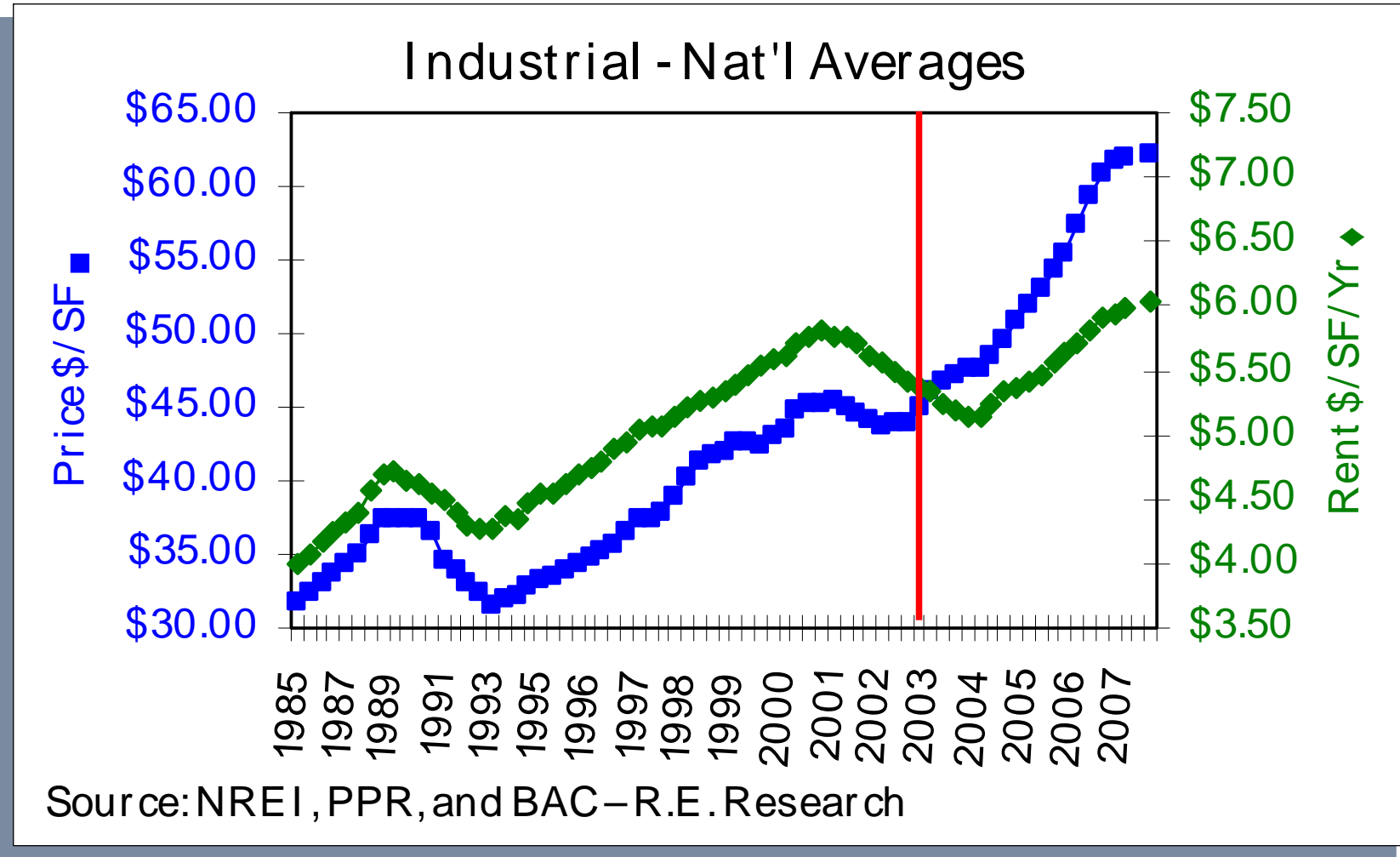
# National Trend — Vacancy



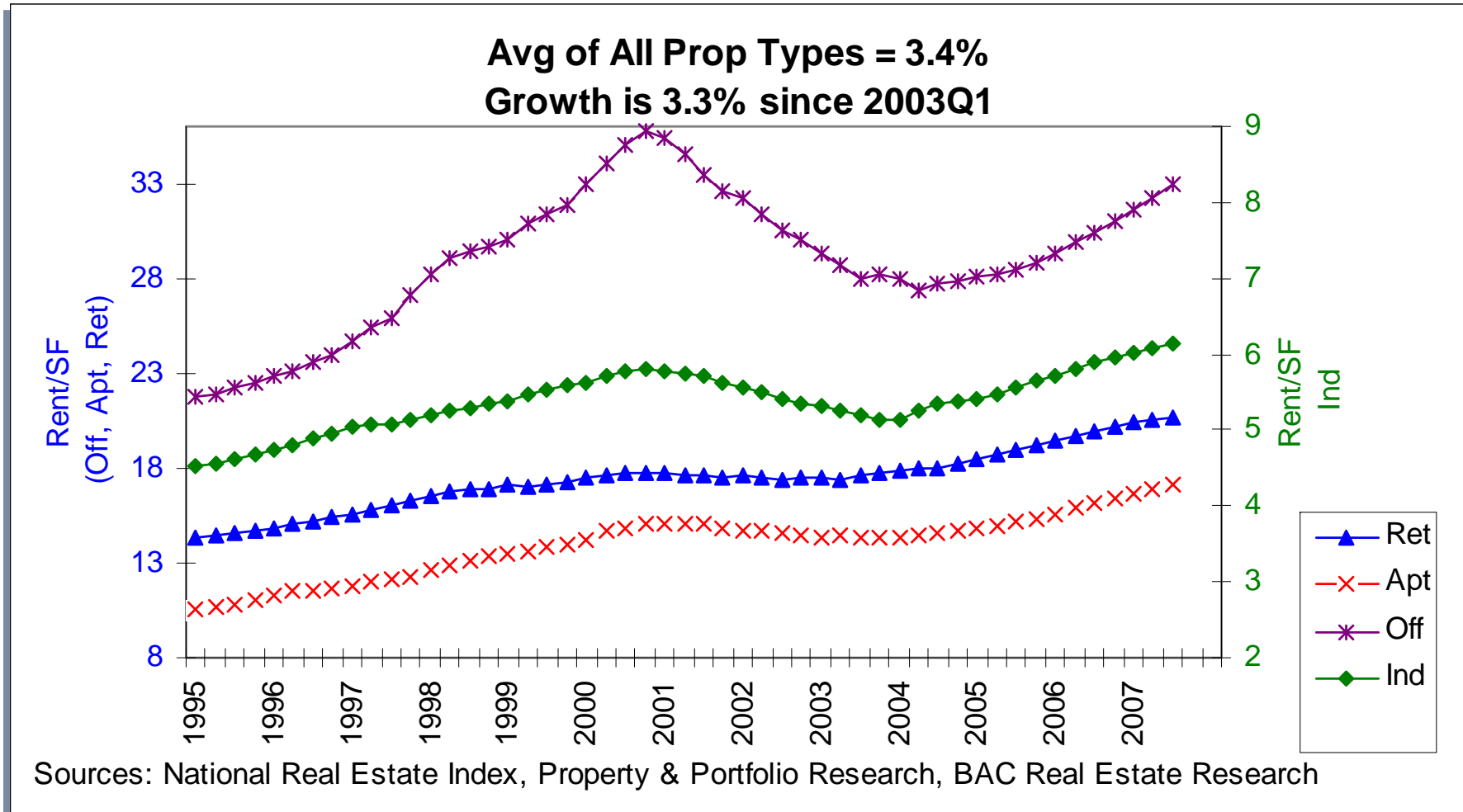
# Realized Rents



# The Relationship Breaks in 2003

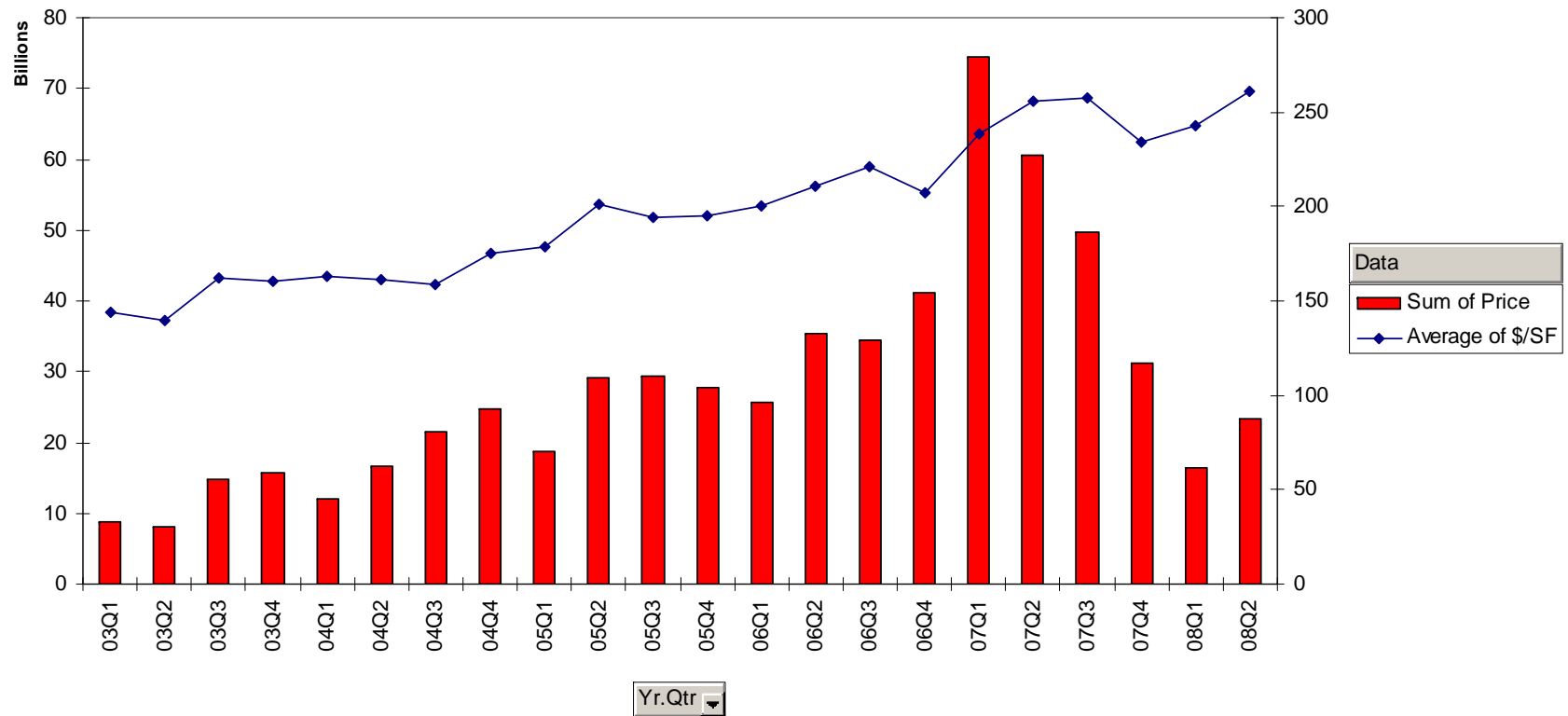


# Market Trends — National Rents



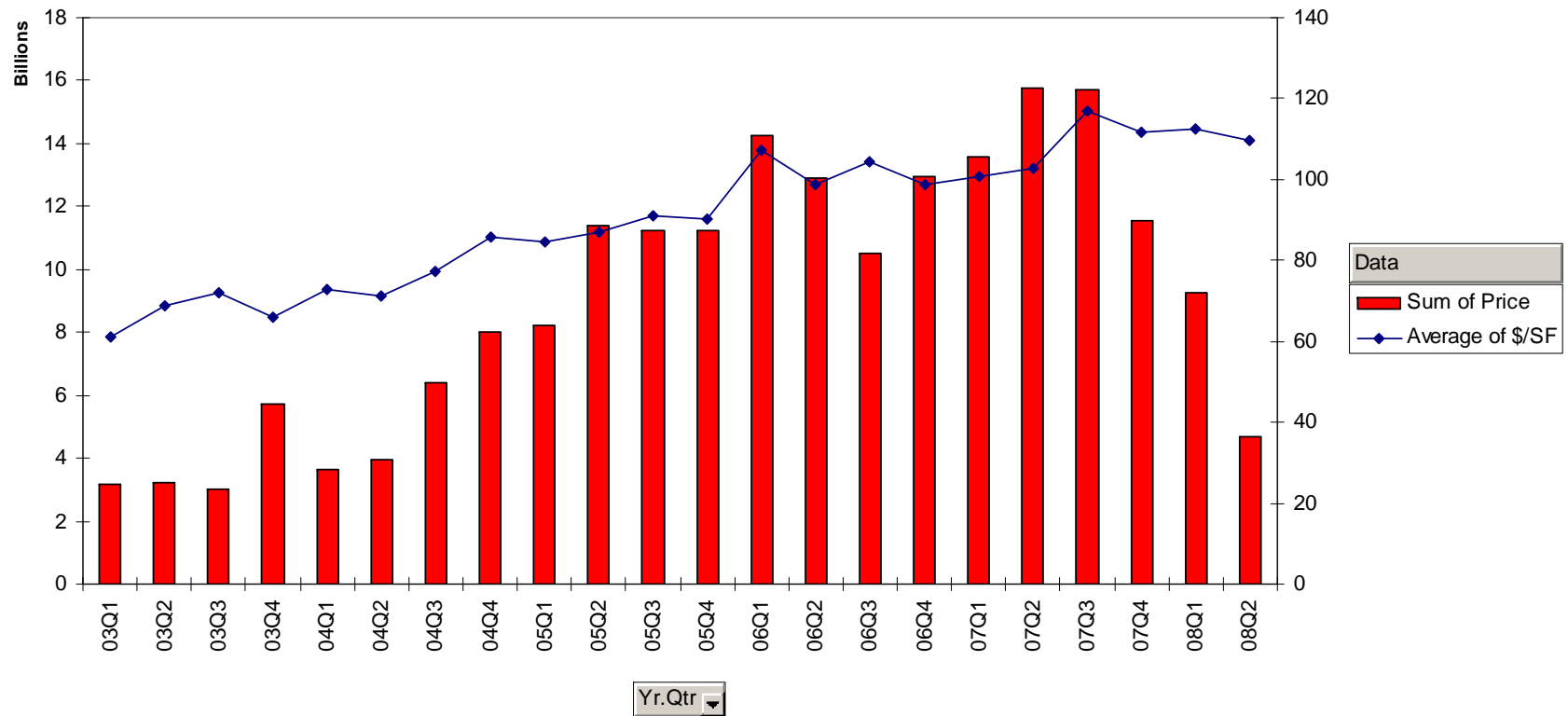
# Market Trends — National Sales - OFF

Main Type Office RCA\_Metros\_tx (All)



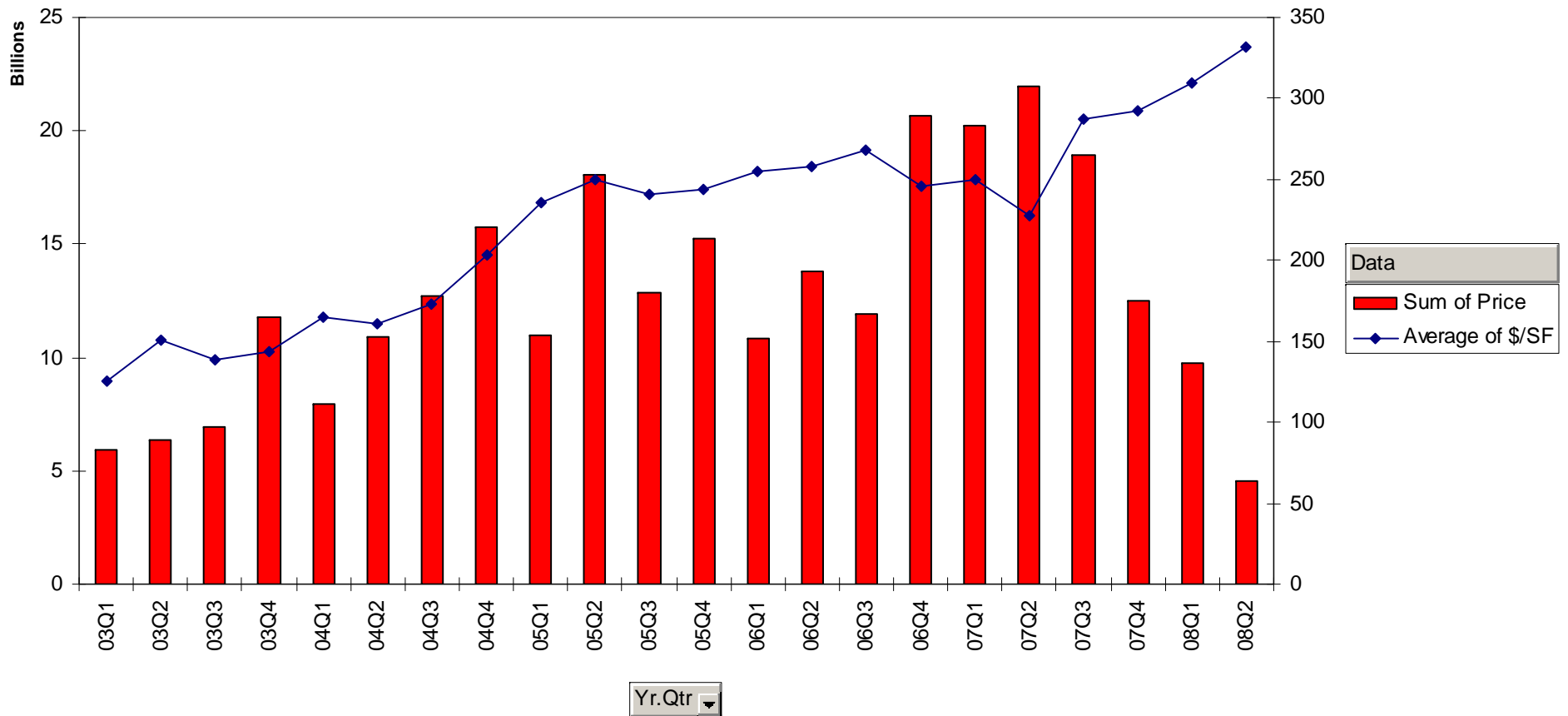
# Market Trends — National Sales - IND

Main Type Industrial RCA\_Metros\_tx (All)



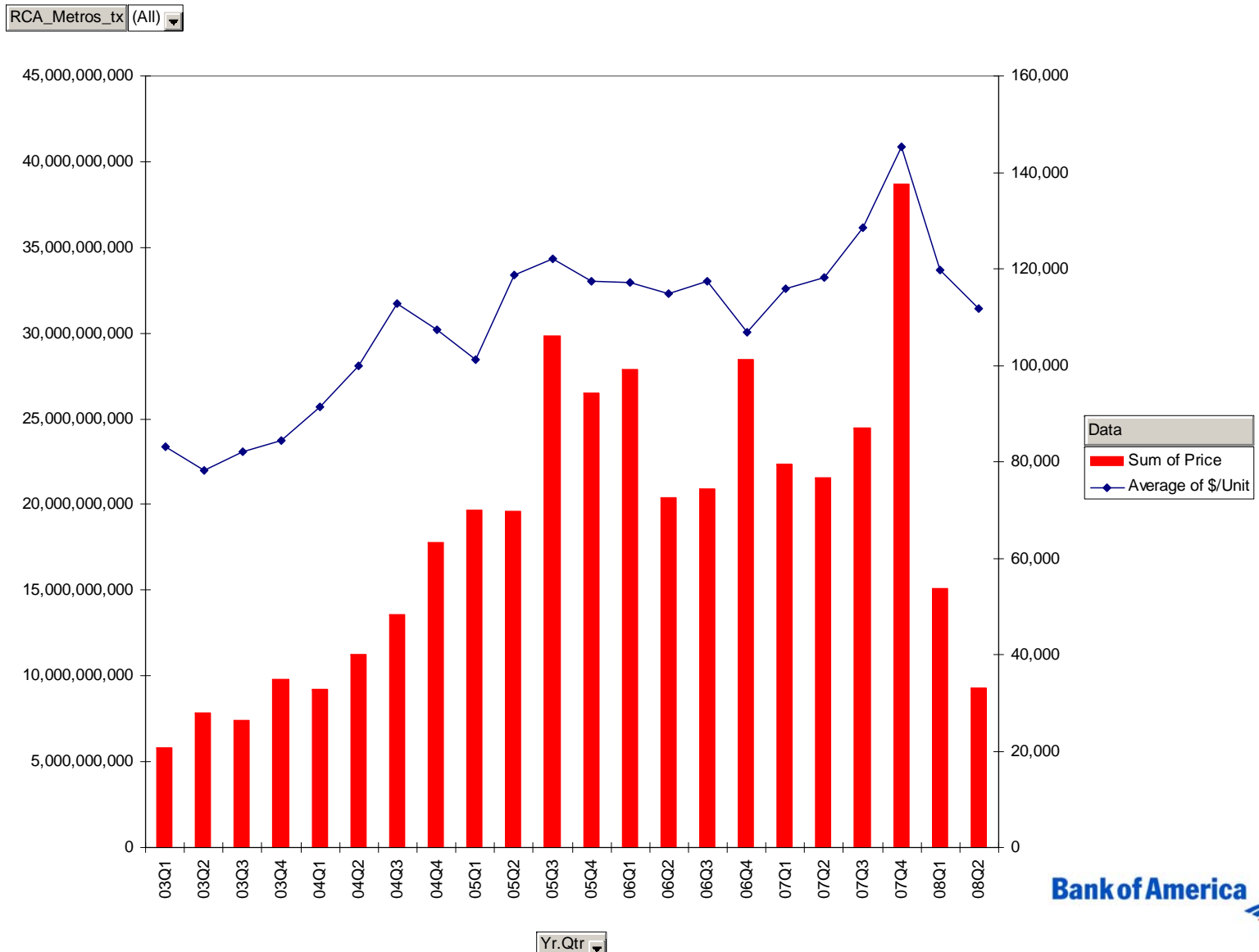
# Market Trends — National Sales - RET

Main Type Retail RCA\_Metros\_tx (All)

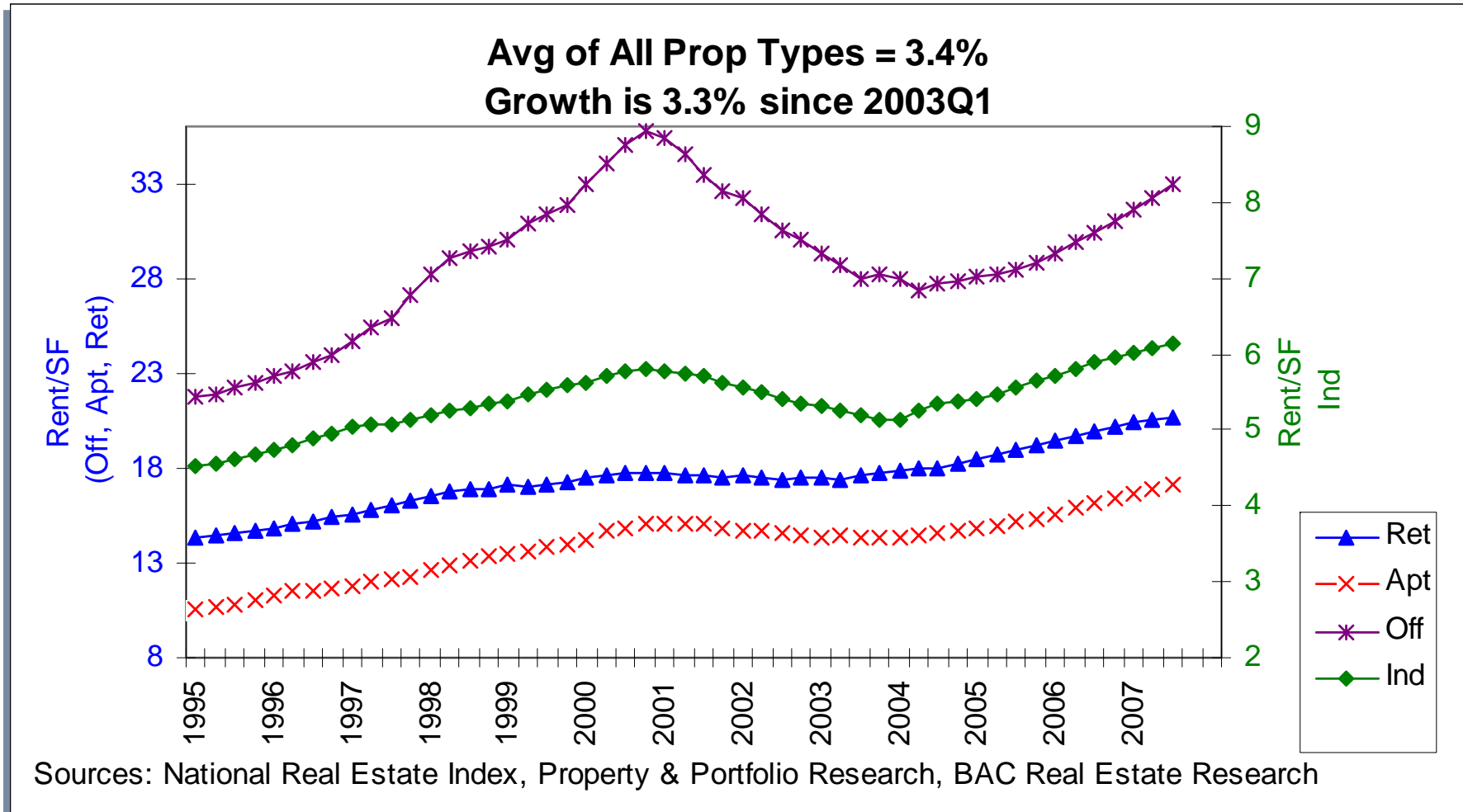




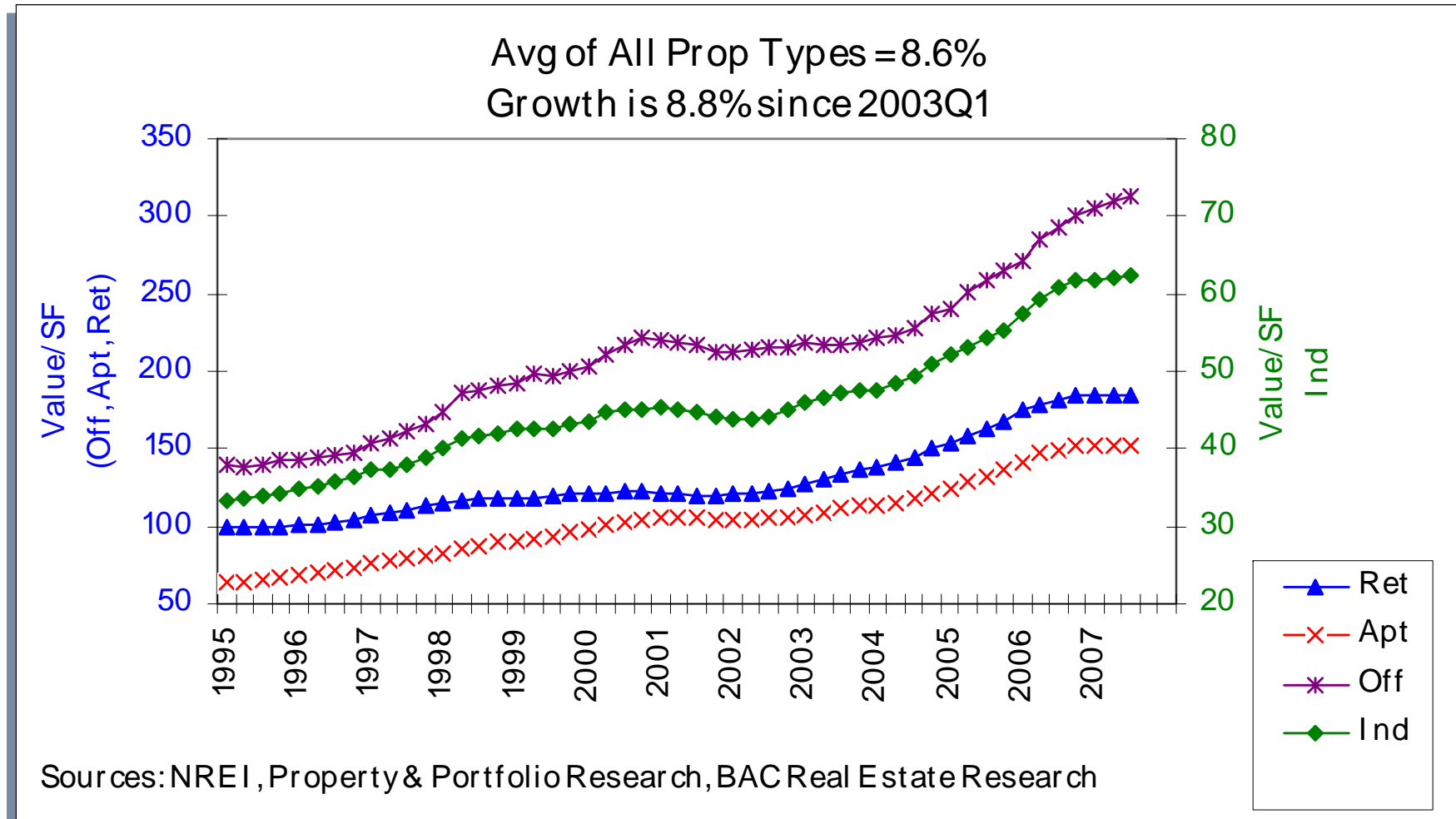
# Market Trends — National Sales - APT



# Market Trends — National Rents



# Market Trends — National Values



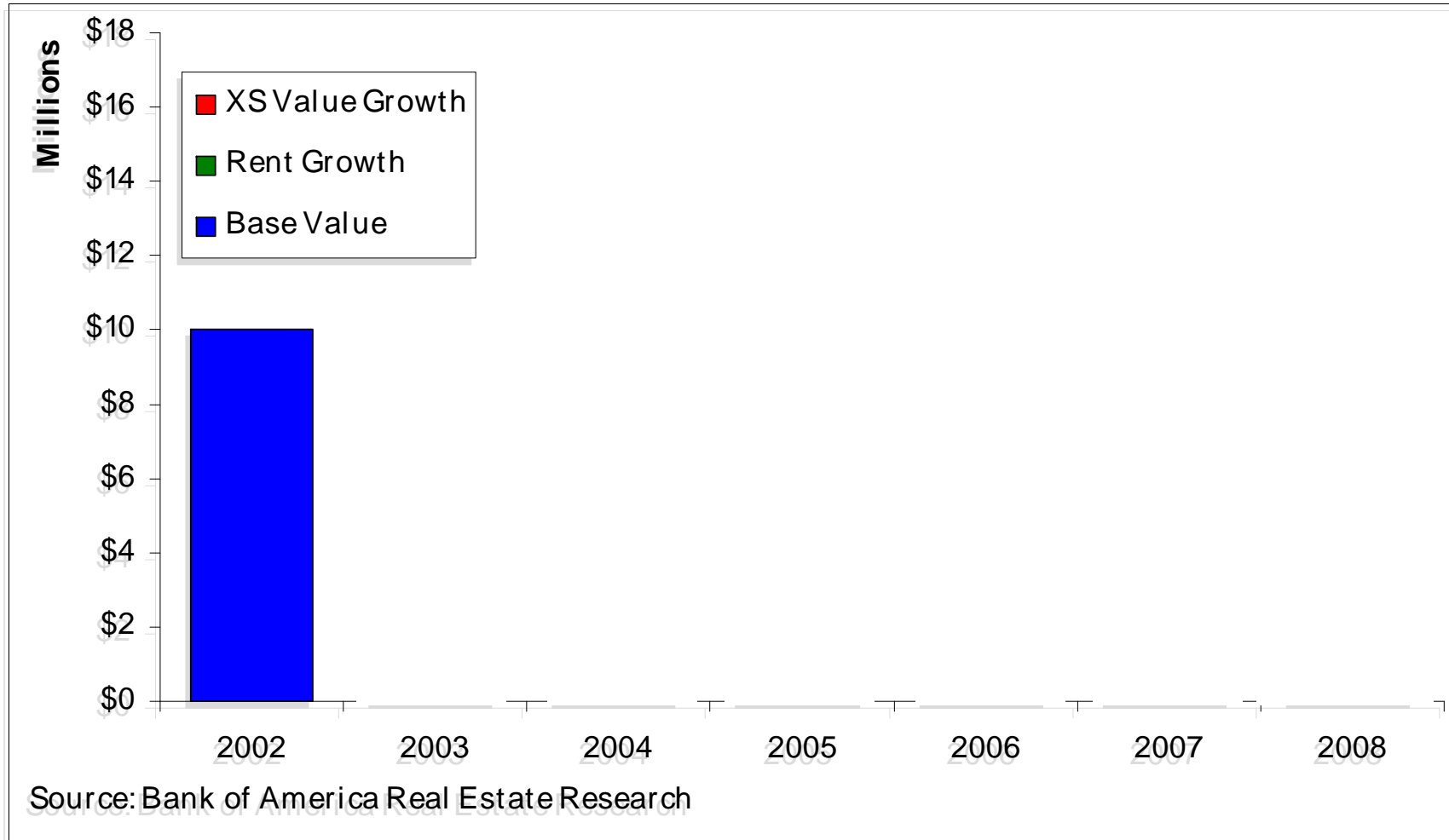
# Growth Example — Value vs. Income

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Year	Rent	RentG	Ind Cap	Value
2002	750,000	3.30%	7.50%	\$10,000,000

- Increase in value was only “interest rates” first 2 years. Momentum effect carried it further. What happens when it stops?

# Rent versus Value Growth



# National Vacancy Performance - 08Q2

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Prop Type	08Q2 National
Office	13.0%
Industrial	10.3%
Retail	8.2%
Apartment	6.0%
Hotel	64.0%

Source: Torto Wheaton Research, REIS, BAC-Real Estate Research



# Conclusions

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- CMBS Market – New Business Model will Come
- REIT Industry – Down 30+ Percent
- NACREIF – Mixed Signals
- Many Lenders are Closing or Reducing Volume
- Financing Costs Have Risen; Capitalization / Yield Rates
- CASH IS KING
- Spread Between Rent vs Value Growth
- Rents/Vacancies Should continue to Perform OK.
- Value(s) Will Undergo Correction  
.....see next slide!



# Greer - 3 Year Forecast as of 9/2008

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- Borrowing Rates for Commercial Real Estate will Rise
- Margins (to Treasury) will rise up to 200 bps 2008-09, and settle around 300-400 bps over 10 year
- Rent Growth will equal CPI, around 3% per year
- Value Growth will lag Rent Growth 30% over 2-3 years
- Values (National Average) will Fall 5-15% per year for next 2-3 years. Individual market performance will vary widely, with “extreme” markets performing several times better (or worse) compared to the National Average.
- Capitalization Rates will Rise 2.0-2.5% over next 3 years (eg 5.0% become 7.25% = 30%+/- decline in value)
- Retail will get hurt most. Office and Apartment Least.

▪ **OPPORTUNITIES!!!!**

**Bank of America**

