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# Wall Street and Commercial Real Estate

Everett Allen Greer  
Director of Research, Bank of  
America

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# Goals of Presentation

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- CMBS / CDO / REIT Industries
- Size / Impact of Capital Markets
- Deal Structure – CMBS Example
- Capital Market Yields
- Rating Agencies / Risk Rating Trends
- Real Estate Trends
- Capitalization Rate — Interest Rate Lag
- What's New? What's Next?

# 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.

# 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.

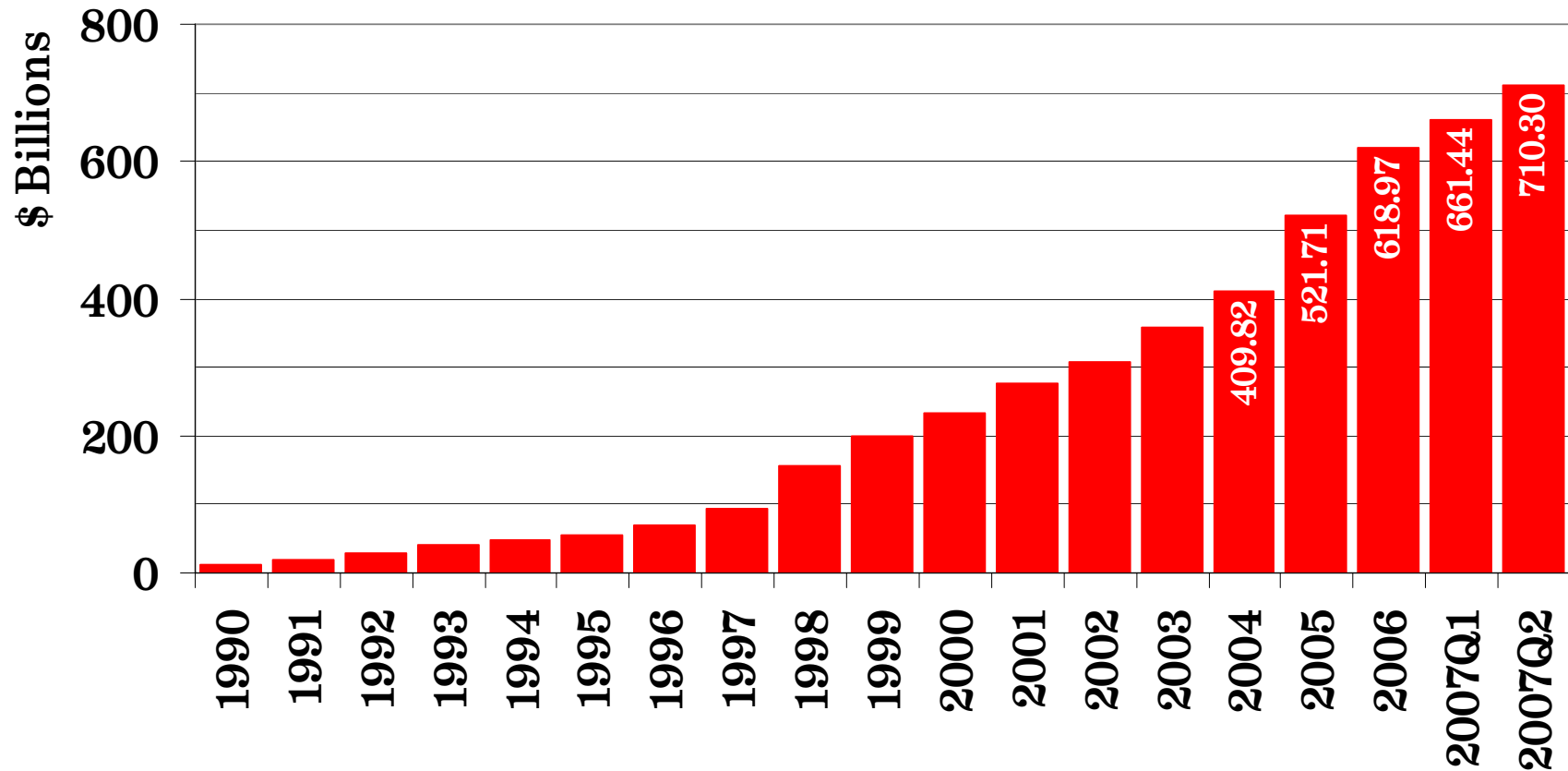
# What is REIT?

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## Real Estate Investment Trust

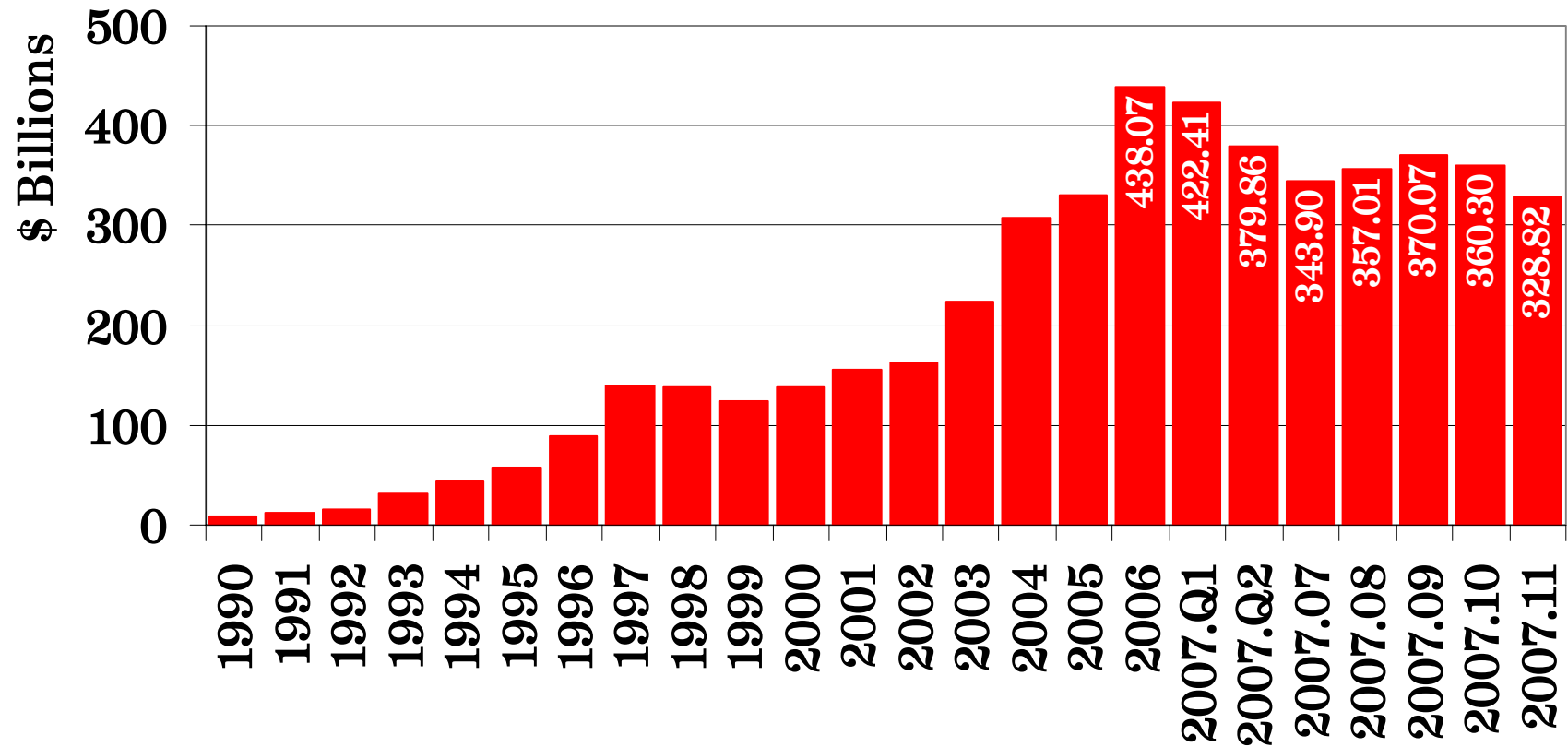
- Type of Pass-through Security
- Effectively a corporation
- 95% of income passed through to shareholders. No “corporate” tax. All earnings single-taxed at shareholder level.
- Current “Industry” Issues:  
Definition of Assets, Max Debt Load, Yield

# CMBS Outstandings in U.S.



Source: Federal Reserve — Flow of Funds — Z1-L.126, BAC - Real Estate Research  
Note: Total of Multi-Family and Commercial Mortgage Asset Backed Securities.

# REIT Market Capitalization



Source: NAREIT, Bank of America Real Estate Research

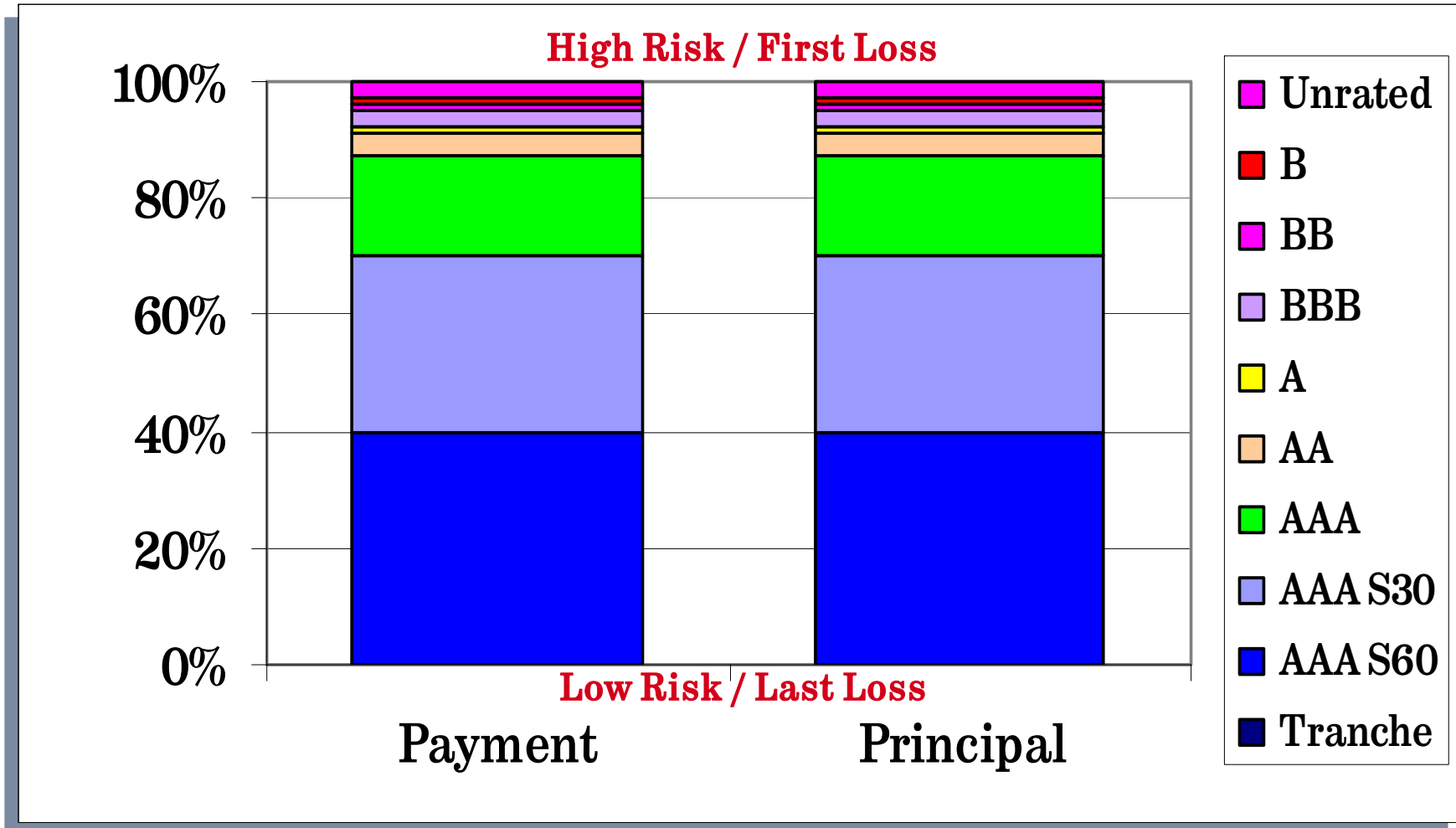
Note: Includes Equity, Debt and Hybrid REITS

# Example of a “Typical 2006” CMBS

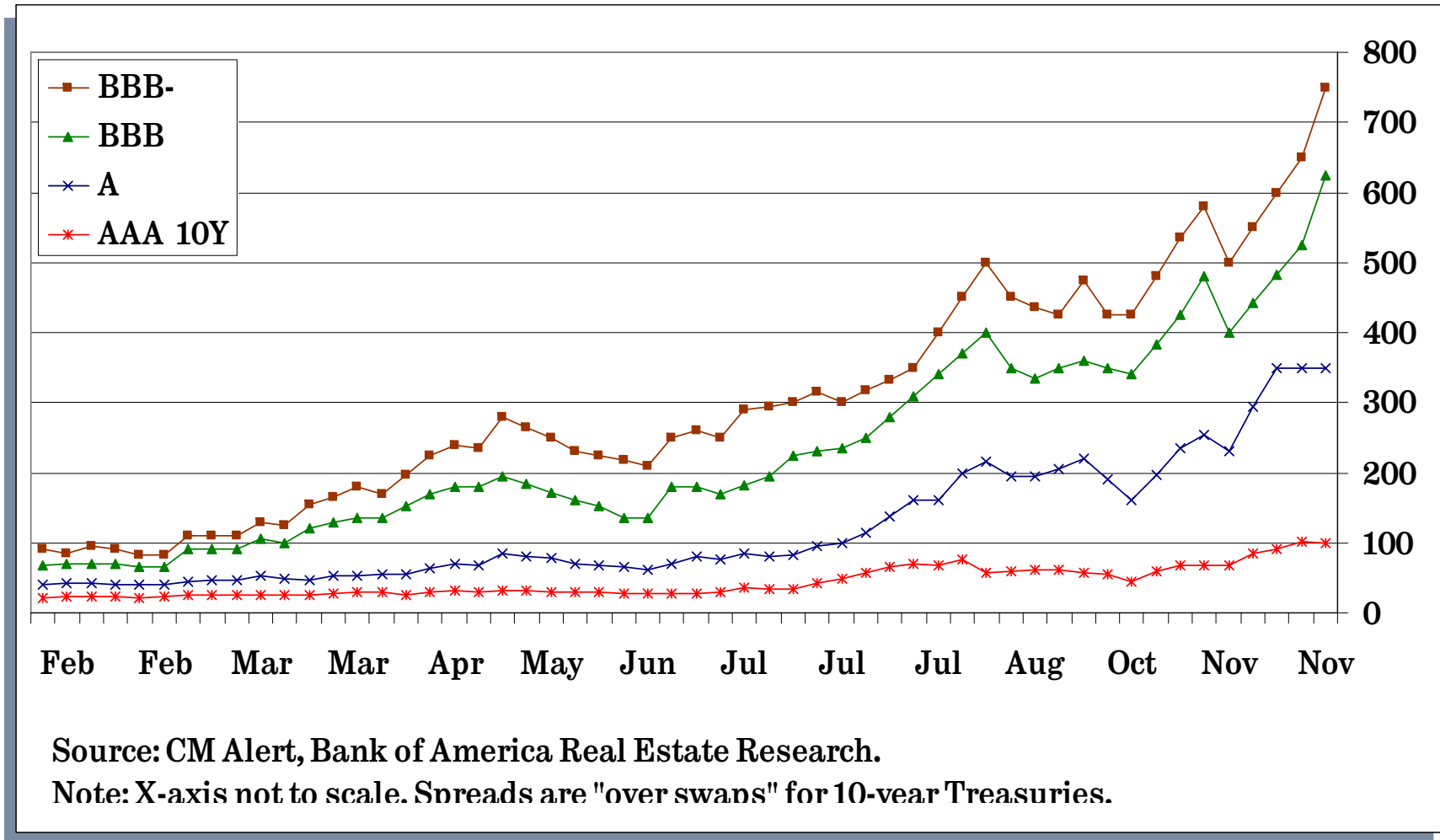
	<b>No. Loans</b>	<b>250</b>		
	<b>Avg. Loan Size</b>	<b>\$10,000,000</b>		
	<b>Total Loan Amt.</b>	<b>\$2,500,000,000</b>		
	<b>Index Name</b>	<b>10-Year Treasury</b>		
	<b>Index Rate</b>	<b>5.000%</b>		
	<b>Avg. Margin</b>	<b>1.750%</b>		
	<b>Avg Yield</b>	<b>6.750%</b>		
<b>Current Spread</b>	<b>Tranche Rating (10Y)</b>	<b>Approximate Subordination</b>	<b>Implied Yield</b>	<b>Yield x Weight%</b>
<b>0.22%</b>	<b>AAA S60</b>	<b>60.0%</b>	<b>5.22%</b>	<b>2.088%</b>
<b>0.25%</b>	<b>AAA S30</b>	<b>30.0%</b>	<b>5.25%</b>	<b>1.575%</b>
<b>0.30%</b>	<b>AAA</b>	<b>12.5%</b>	<b>5.30%</b>	<b>0.928%</b>
<b>0.40%</b>	<b>AA</b>	<b>9.0%</b>	<b>5.40%</b>	<b>0.189%</b>
<b>1.00%</b>	<b>A</b>	<b>8.0%</b>	<b>6.00%</b>	<b>0.060%</b>
<b>1.75%</b>	<b>BBB</b>	<b>5.0%</b>	<b>6.75%</b>	<b>0.202%</b>
<b>2.50%</b>	<b>BB</b>	<b>4.0%</b>	<b>7.50%</b>	<b>0.075%</b>
<b>4.00%</b>	<b>B</b>	<b>2.5%</b>	<b>9.00%</b>	<b>0.135%</b>
<b>5.00%</b>	<b>Unrated</b>	<b>0 to &lt;2.5%</b>	<b>10.00%</b>	<b>0.250%</b>
		<b>Weighted Average Yield</b>		<b>5.502%</b>
	<b>Implied Annual Excess Return</b>			<b>1.248%</b>
	<b>Note: Excludes swap, agency, trust, servicer and other fees.</b>			<b>\$31,200,000</b>



# Subordination Graph



# CMBS Yield Spreads (Spread to Swap)



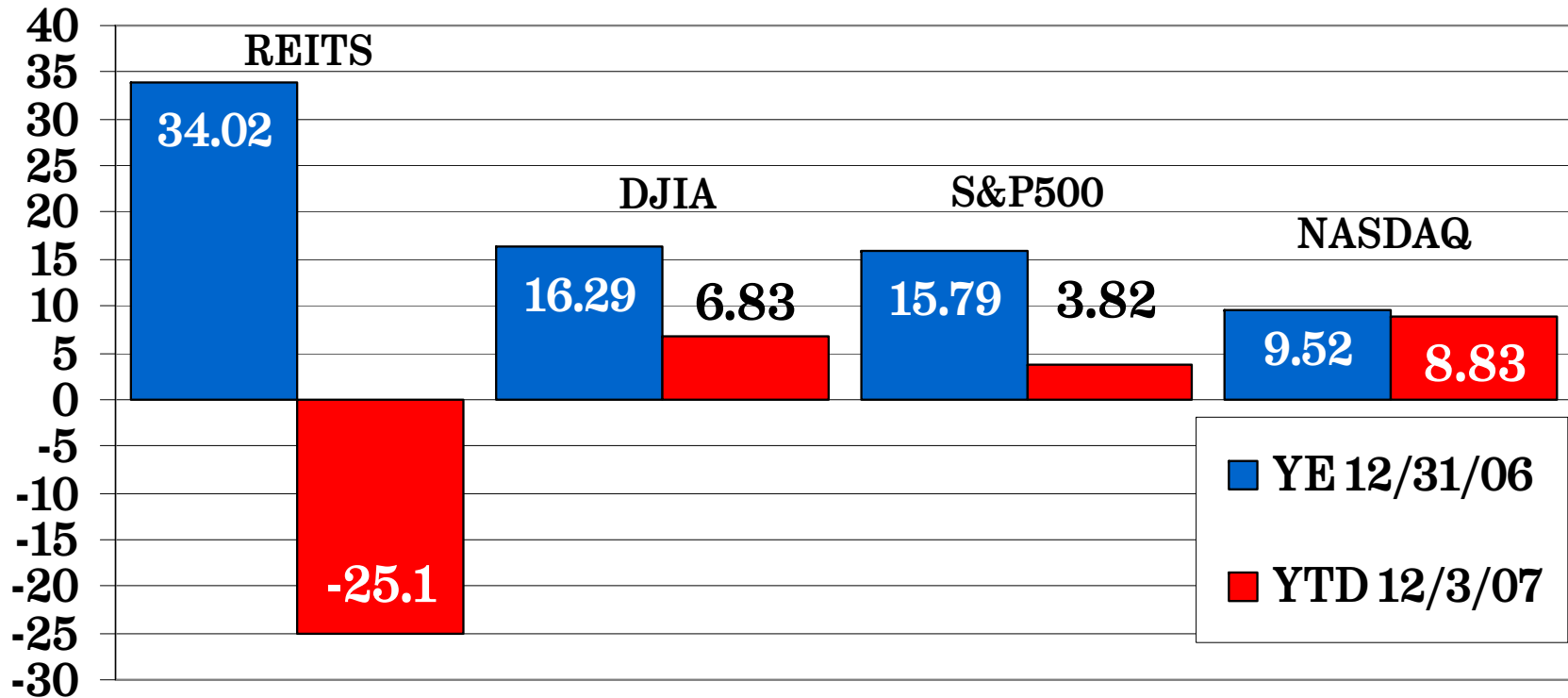
# CMBS Spreads — Yield Rate Implications

Tranche	Rise in Yield	Weight	Debt v Equity	Total Weight	Impact
AAA	100	90%	75%	67.50%	67.50
A	300	4%	75%	3.00%	9.00
BBB	600	3%	75%	2.25%	13.50
BBB-	700	2%	75%	1.50%	10.50
Unrated	1500	1%	75%	0.75%	11.25
Class A Prop.	700	100%	25%	25.00%	175.00
Note: Class A assumed to have no "unrated" traunche				Total	286.00
Class B- Prop.	1750	100%	25%	25.00%	437.50
Note: Class B- assumed 250 bps above "unrated"				Total	549.25

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

Higher subordination = even greater impact.

# Benchmark Returns — Changes so Fast!

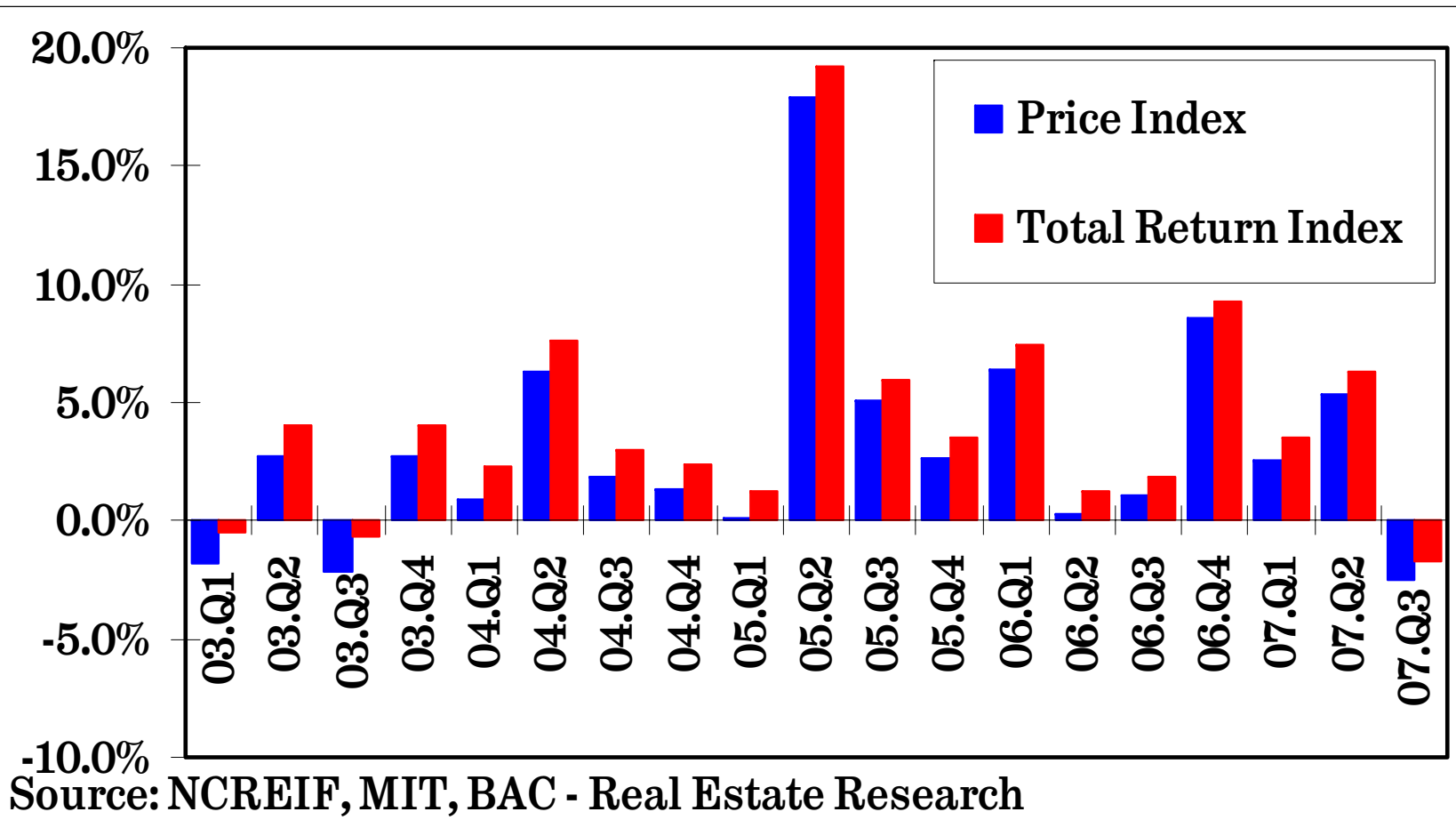


Source: NAREIT, Bank of America Real Estate Research.

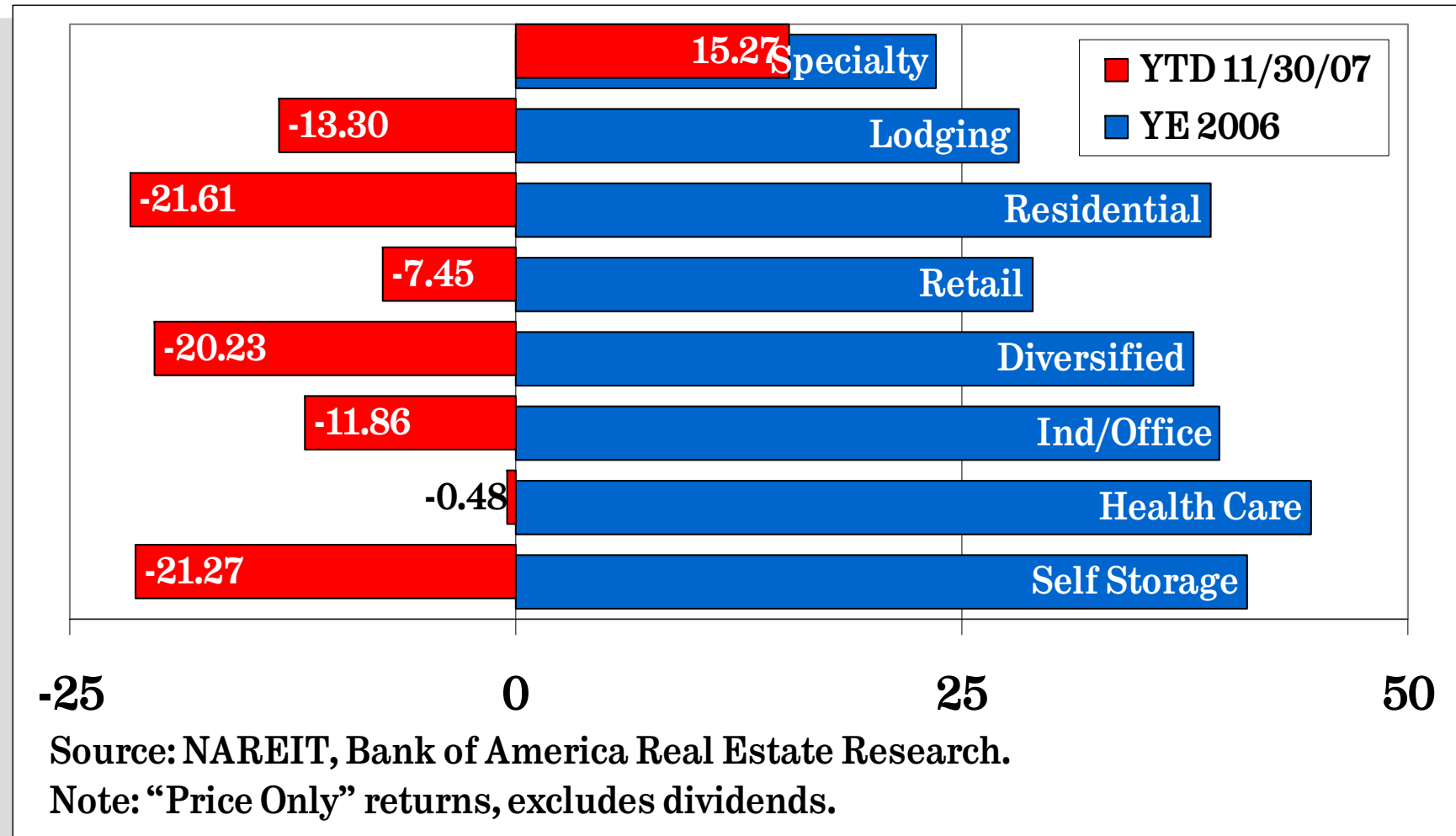
Note: “Price Only” returns, excludes dividends.

YTD = REIT = 11/30/07; Dow, NASDAQ, S&P = 12/3/2007

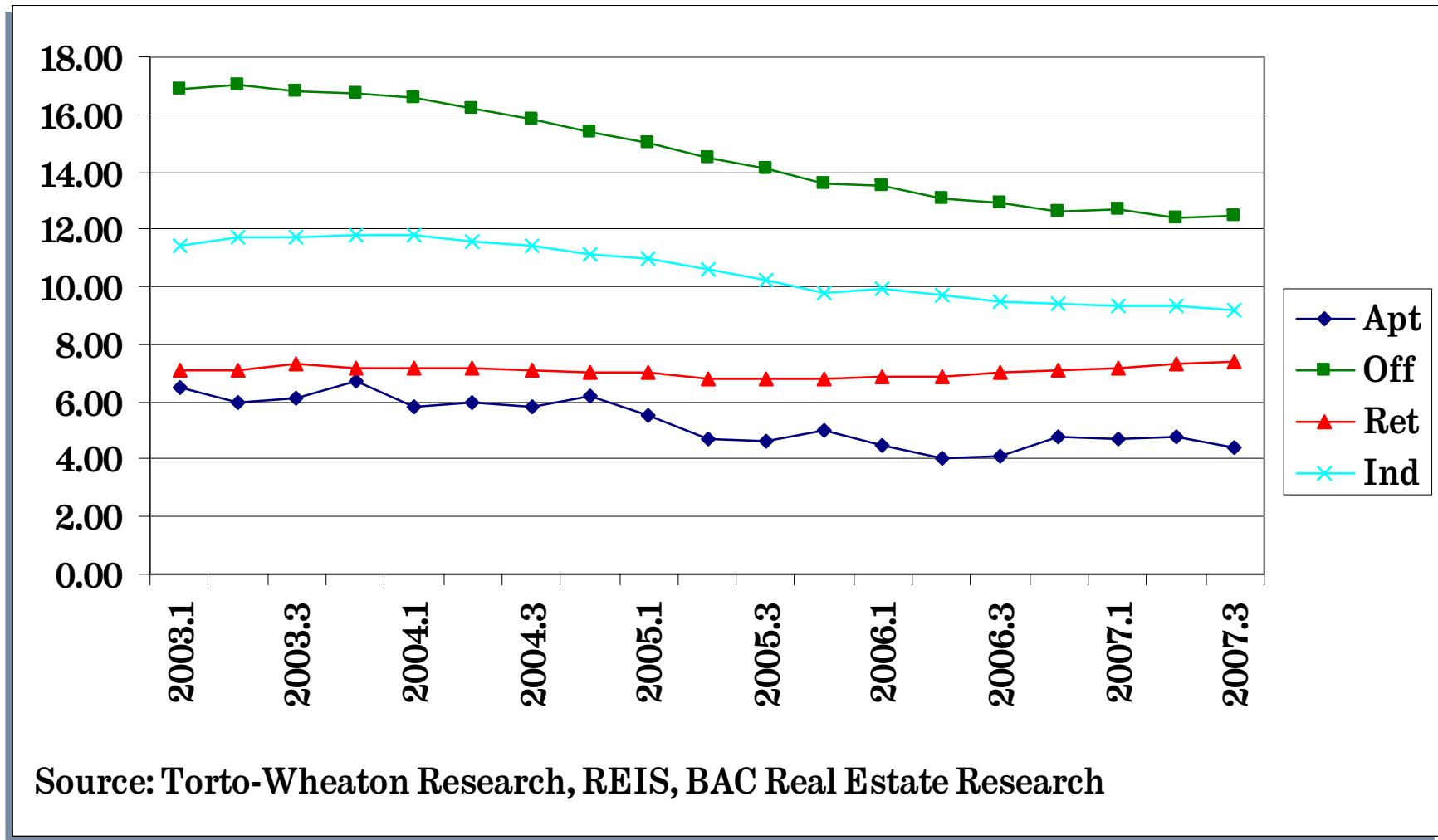
# NCREIF 07.Q3 Price -2.5% / Total -1.7%



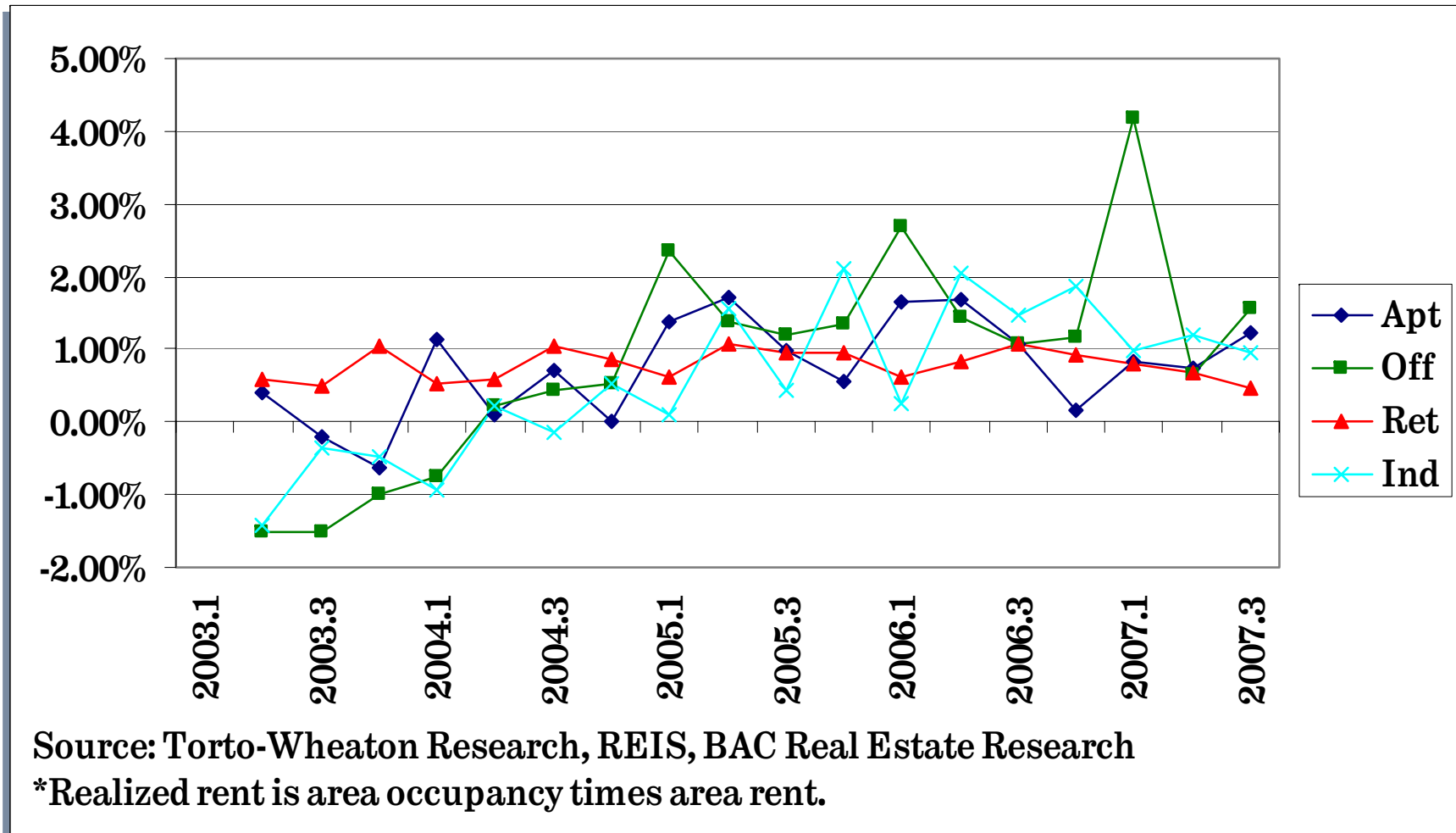
# REIT Property Type Returns — Old vs. New



# National Trend — Vacancy

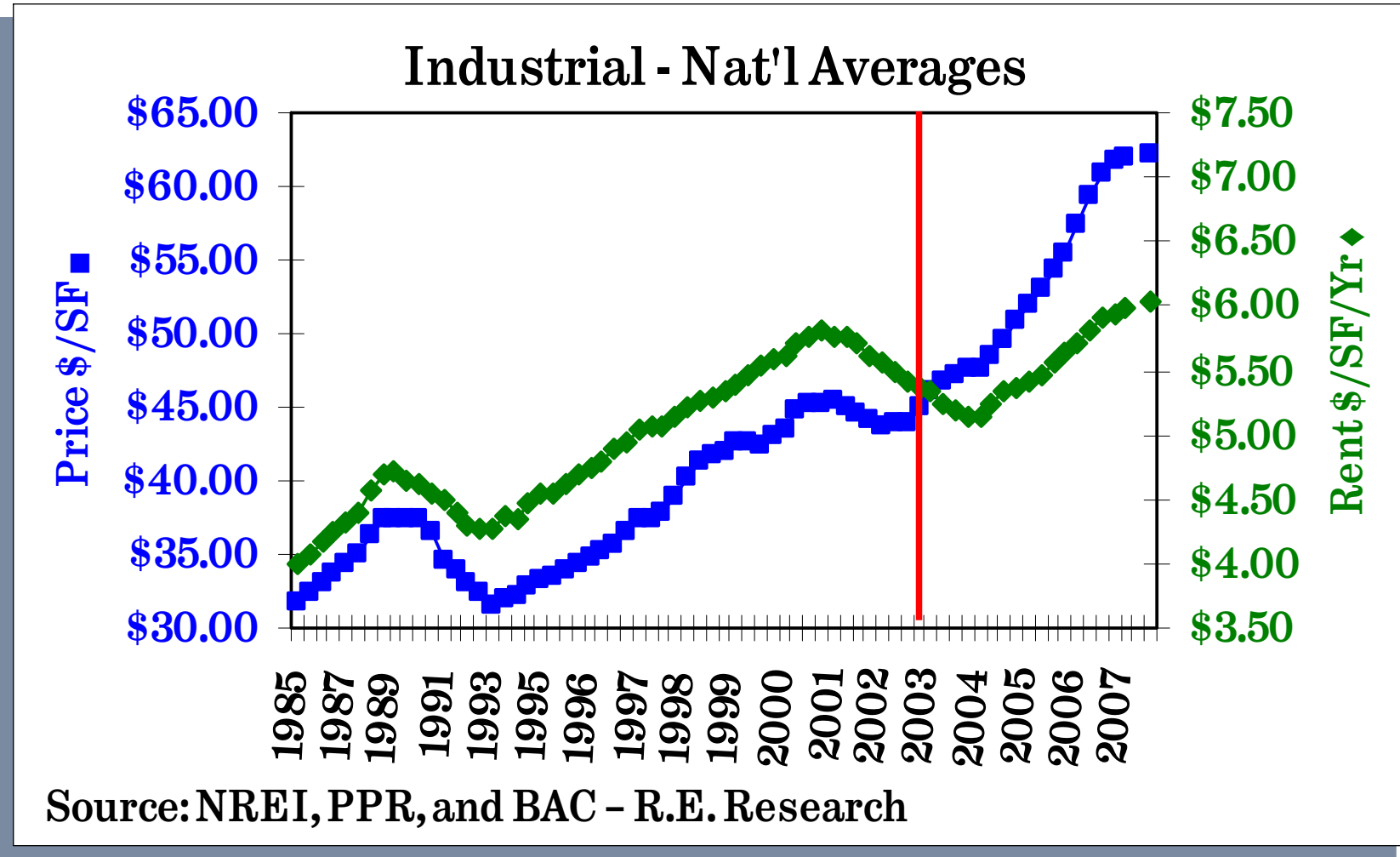


# Realized Rent Growth

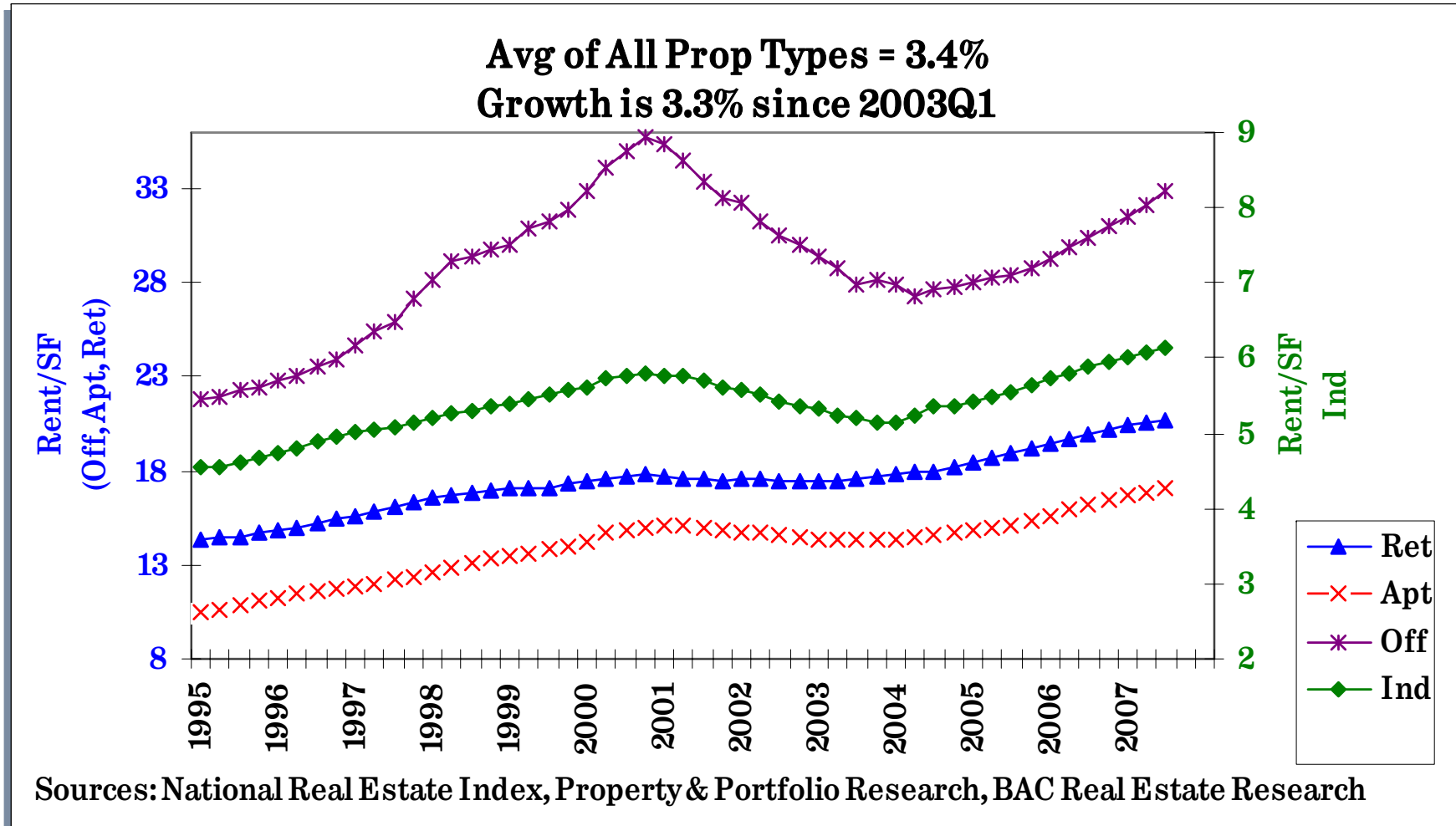




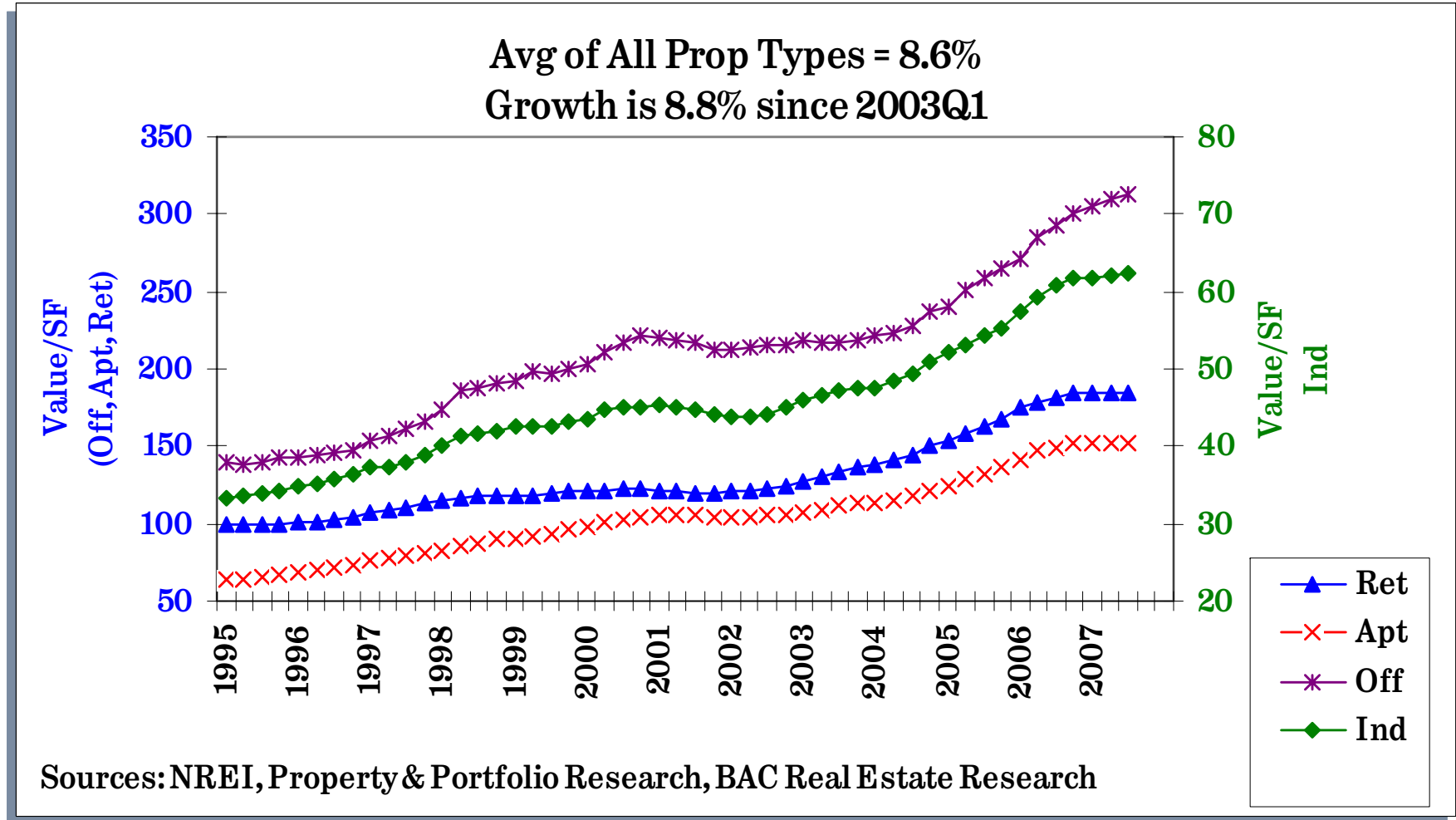
# The Relationship Breaks in 2003



# Market Trends — National Rents



# Market Trends — National Values



# Los Angeles Performance

<b>Prop Type</b>	<b>National Vacancy</b>	<b>Los Angeles</b>	<b>Rank</b>
<b>Office</b>	<b>12.5%</b>	<b>9.7%</b>	<b>6 : 58</b>
<b>Industrial</b>	<b>9.2%</b>	<b>4.6%</b>	<b>1 : 59</b>
<b>Retail</b>	<b>7.4%</b>	<b>2.6%</b>	<b>1 : 82</b>
<b>Apartment</b>	<b>4.4%</b>	<b>3.0%</b>	<b>10 : 60</b>
<b>Hotel</b>	<b>70.5%</b>	<b>79.3%</b>	<b>7 : 53</b>

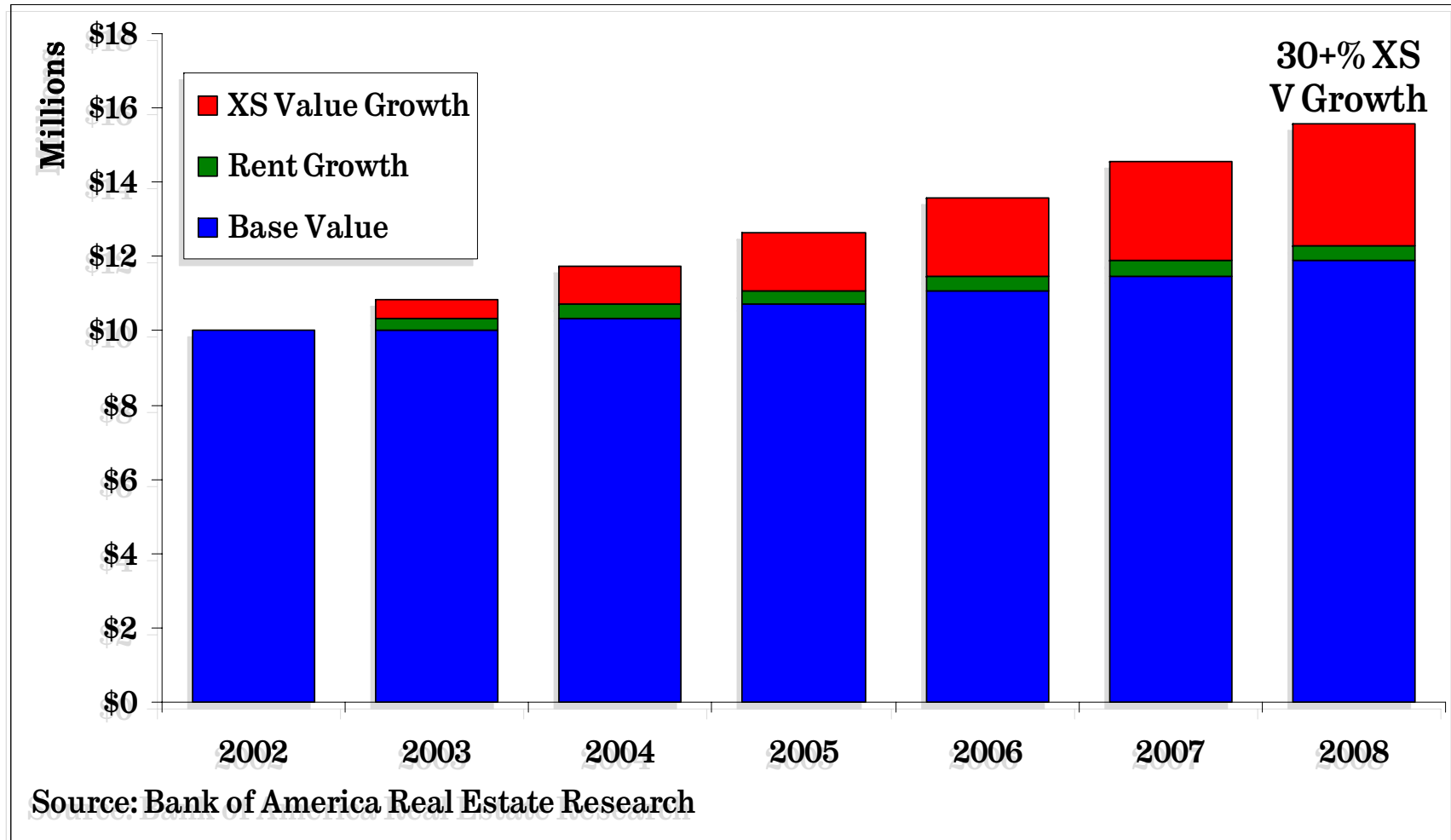
Source: Torto Wheaton Research, REIS, BAC-Real Estate Research

## Growth Example — Value vs. Income

Year	Rent	RentG	Ind Cap	Value
2002	750,000	3.30%	7.50%	\$10,000,000
2003	774,750	3.30%	7.12%	\$10,880,000
2004	800,317	3.30%	6.76%	\$11,837,440
2005	826,727	3.30%	6.42%	\$12,879,135
2006	854,009	3.30%	6.09%	\$14,012,499
2007	854,009		5.60%	\$15,245,598
	average	3.30%		8.80%

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

# Rent versus Value Growth



# Commercial Lending News

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- **Moody's Announces 5-10% layoffs – 11/30**
- **Credit Suisse Pulls Plug on Canadian Operation – 11/30**
- **Moody's Reports decline in US Property Values – 11/20**
- **Artesia Mortgage shuts down Atlanta & New Orleans 11/16**
- **Goldman Sachs consolidates (5 regions to 3) – 11/16**
- **Wachovia Lays off CMBS/CDO staffers – 11/2**
- **Principal R.E. Investors Hire 5 Regional Mgrs – 11/2**
- **Credit Suisse Lays off 50 staffers – 10/26**
- **Macquarie hires small contingent from LaSalle 10/12**

Source: CM Alert, Various Papers.

# Quote of the Day

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

Niels Bohr, Nobel Laureate



# Conclusions

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- **CMBS Market – New Market Pricing – HIGHER**
- **REIT Industry – Down 25+ Percent**
- **NACREIF – Down Slightly**
- **Many Lenders are Closing or Reducing Volume**
- **Financing Costs Have Risen; Capitalization / Yield Rates**
- **Cash is KING**
- **Spread Between Rent vs Value Growth Requires Correction**
- **Rents/Vacancies Should continue to Perform**
- **Value(s) Undergoing Correction**