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# Wall Street and Commercial Real Estate

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Real Estate Risk Assessment

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# 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.
- Jobs & Retail Sales Drive Supply & Demand!!!

## Financing – Currently Most Important Fundamental

# Financing Fundamentals

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Capital Markets Drive Financing

CMBS / REITs are Benchmarks

Capital Markets Have Dried Up

Banks are in Middle of Credit Crunch

Few Banks are “In the Game” of Lending

Rates Across the Spectrum Have Risen

Equity, Mezzanine, Debt

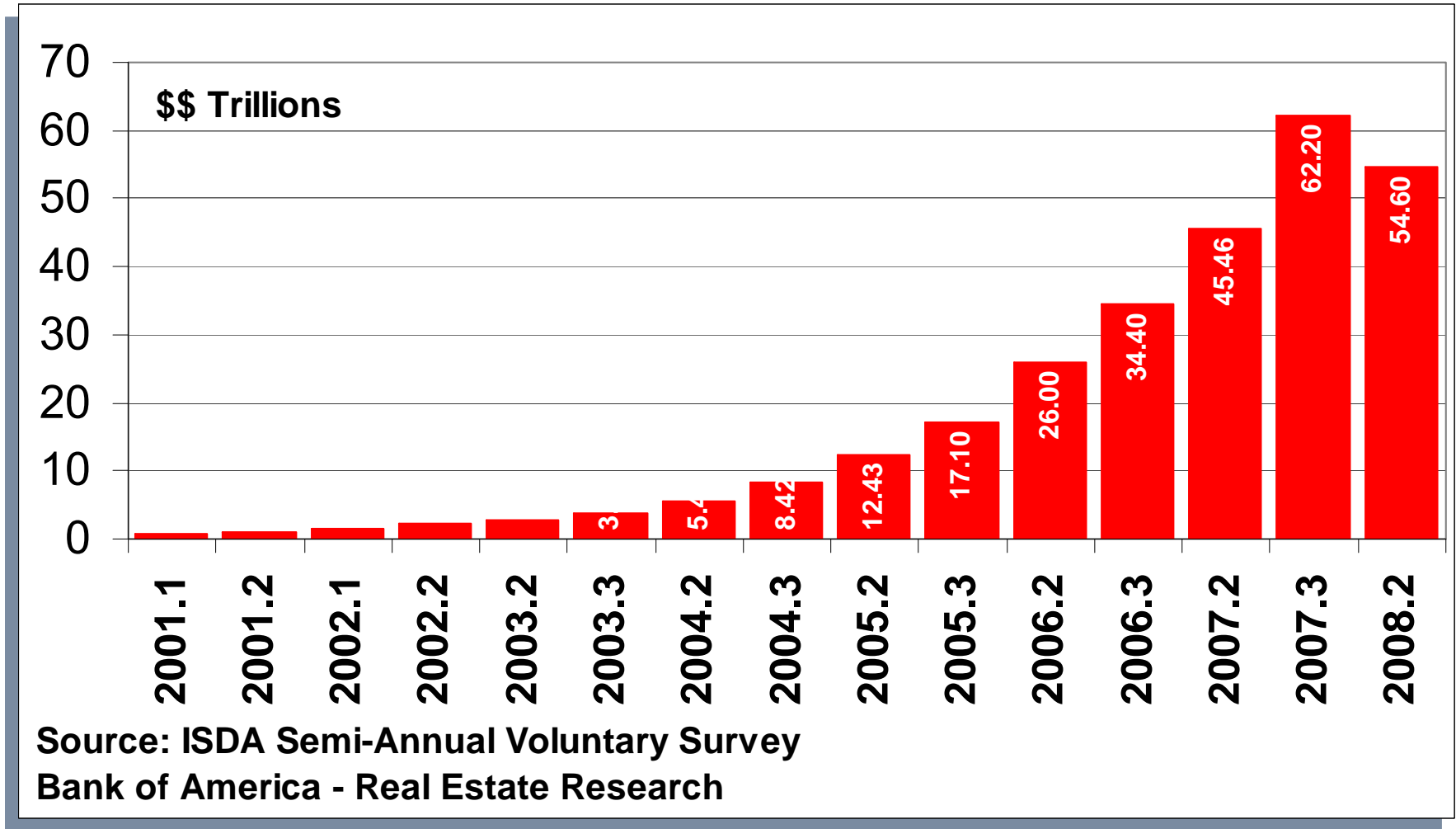
Deleveraging – Lower LTV / Higher DSC

# Evolution of CDS

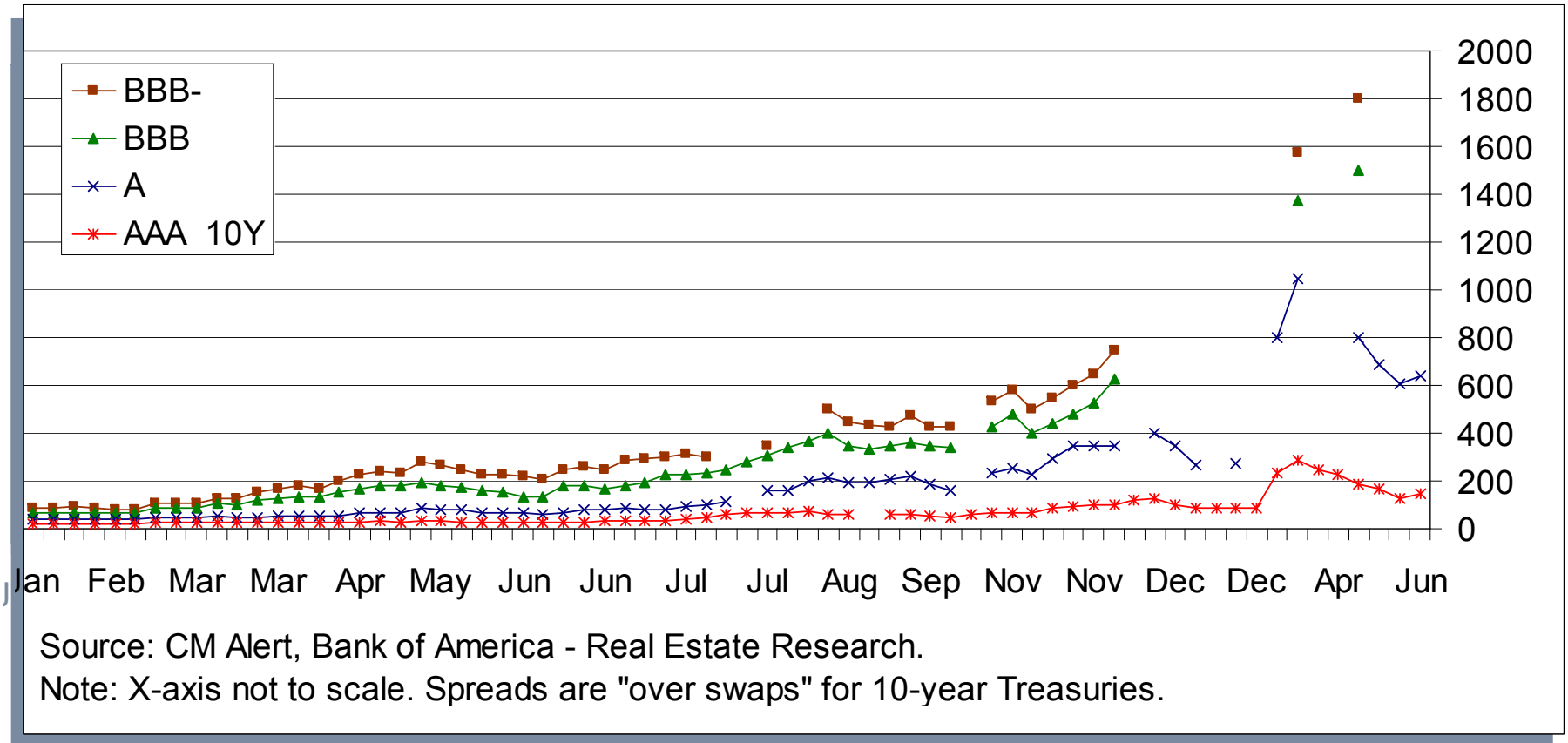
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- Simple CDS = “Full Coverage”
  - Buyer is Party to Credit Instrument
  - Seller Provides “Full” Coverage
  - Seller Pays (makes up) Shortfall or
  - Seller Buys Credit Instrument from Buyer
  - Buyer is “Made Whole”
- Buyer is Not a Part to Credit Facility, merely a speculator
- Sellers Provide Partial Coverage (ceiling) or Part of Credit
- Sellers Provide Incremental Coverage
  - Goal is to provide “Partial” Credit Enhancement
  - Ratings Are Moved (eg “BB” to “A” rating)
- CDS – Complex Credit
  - Multiple facilities
  - CMBS (vertical [multi-tranche buyer] or horizontal)
  - REITs added

# Credit Default Swaps

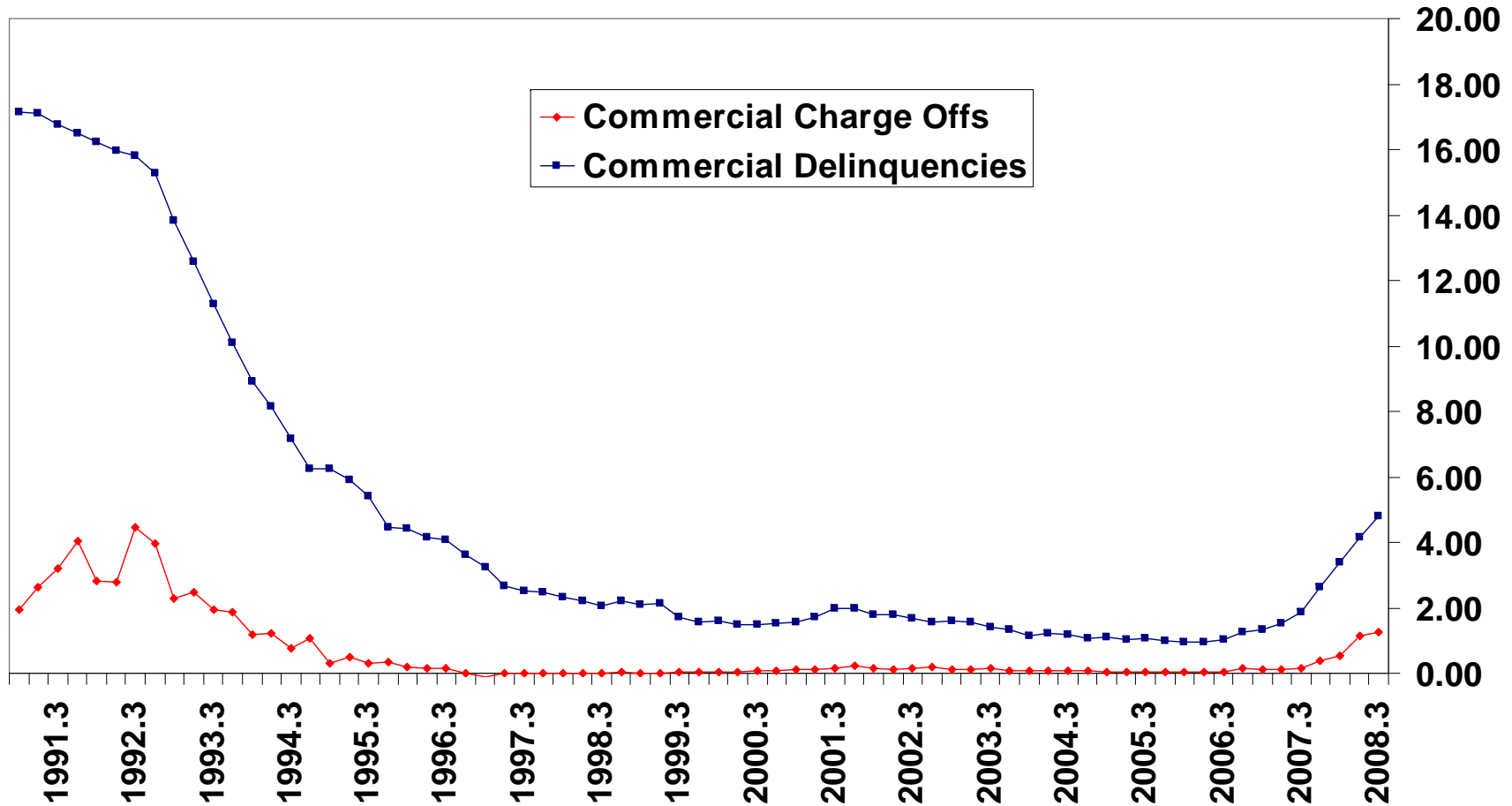


# CMBS Yield Spreads (Spread to Swap)



Note: Last CMBS closed was June 29, 2008

# Commercial Real Estate Loans



Source: Federal Reserve Board, Top 100 Banks, Seasonally Adjusted

## Synthetic CMBX Yields (Spreads to Swaps)

Tranche *	Yield over Swaps* 1/21/09	Approx CMBS 1/2007 **	Rise in Yields**
CMBX.5 AAA	680.83	20.0	660.83
CMBX.5 AAA AJ	1,621.83	35.0	1,586.83
CMBX.5 AA	2,120.50	45.0	2,075.50
CMBX.5 A	2,642.83	55.0	2,587.83
CMBX.5 BBB	3,535.33	75.0	3,460.33
CMBX.5 BBB-	3,728.67	85.0	3,643.67
CMBX.5 BB	4,484.50	105.0	4,379.50

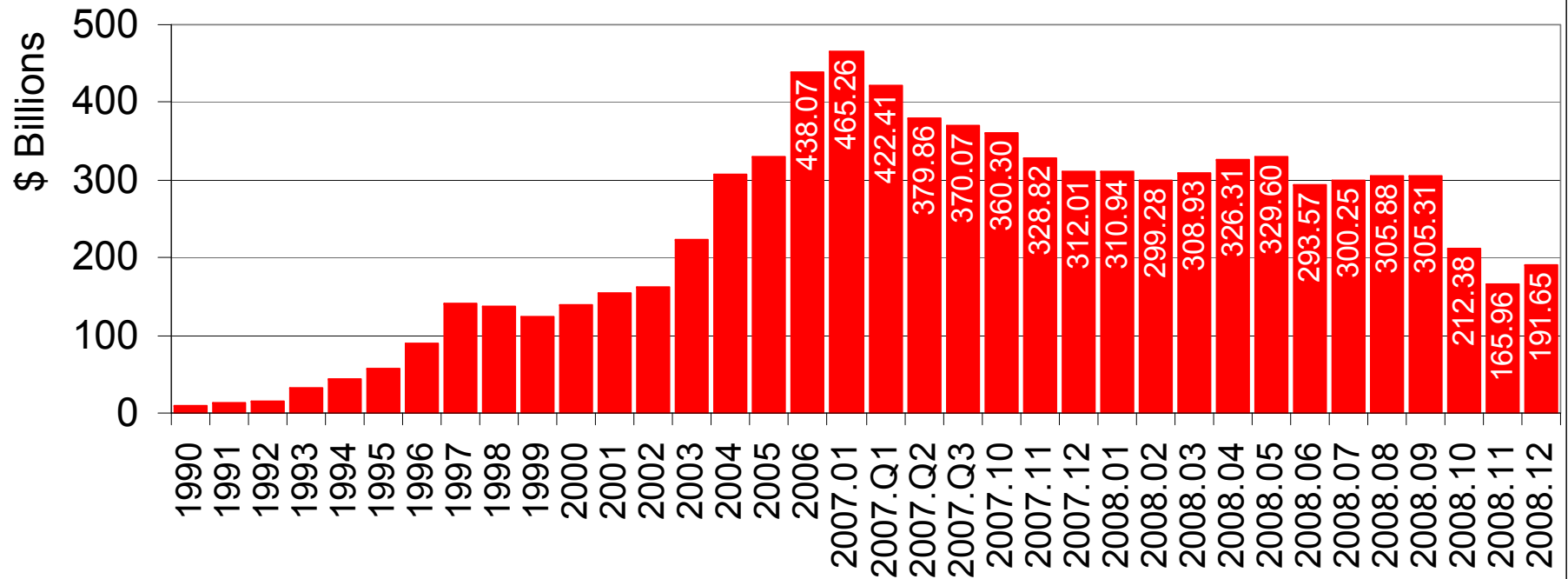
Source: \*Markit, \*\*BAC Real Estate Research



# CMBS/X - Implied R.E. Yields

Tranche	Yield Spd	Suboord	Weight D	Debt	Wght T	Total
AAA Sr	680.83	29.76%	70.24%	75%	52.68%	5.43%
AAA Jr	1621.83	12.70%	17.06%	75%	12.80%	2.52%
AA	2120.50	10.63%	2.07%	75%	1.55%	0.38%
A	2642.83	8.00%	2.63%	75%	1.97%	0.59%
BBB	3535.33	4.72%	3.28%	75%	2.46%	0.96%
BBB-	3728.67	3.68%	1.04%	75%	0.78%	0.32%
BB	4484.50	2.69%	0.99%	75%	0.74%	0.36%
Unrated	5200.00	0.00%	2.69%	75%	2.02%	1.12%
			100.00%			
Class A Prop.	3700.00	100%		25%	25.00%	10.13%
Swap Rate	350.00				Total	20.64%
Class B Prop.	5200.00	100%		25%	25.00%	13.88%
Note: Class A yield assumed $\approx$ BBB-, Class B assumed 1000 bps higher					Total	25.55%

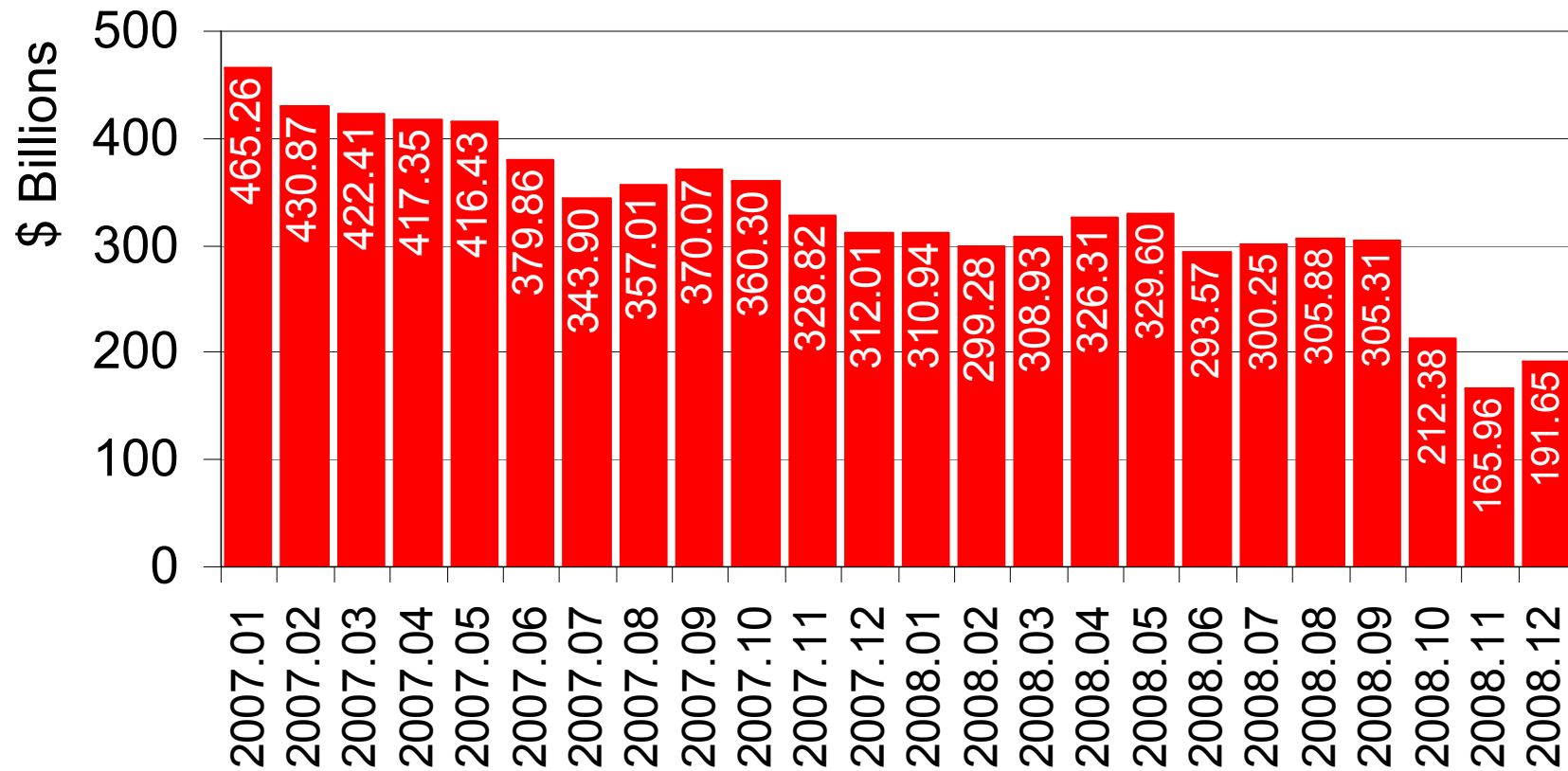
# REIT Market Capitalization



Source: NAREIT, Bank of America Real Estate Research

Note: Includes Equity, Debt and Hybrid REITS

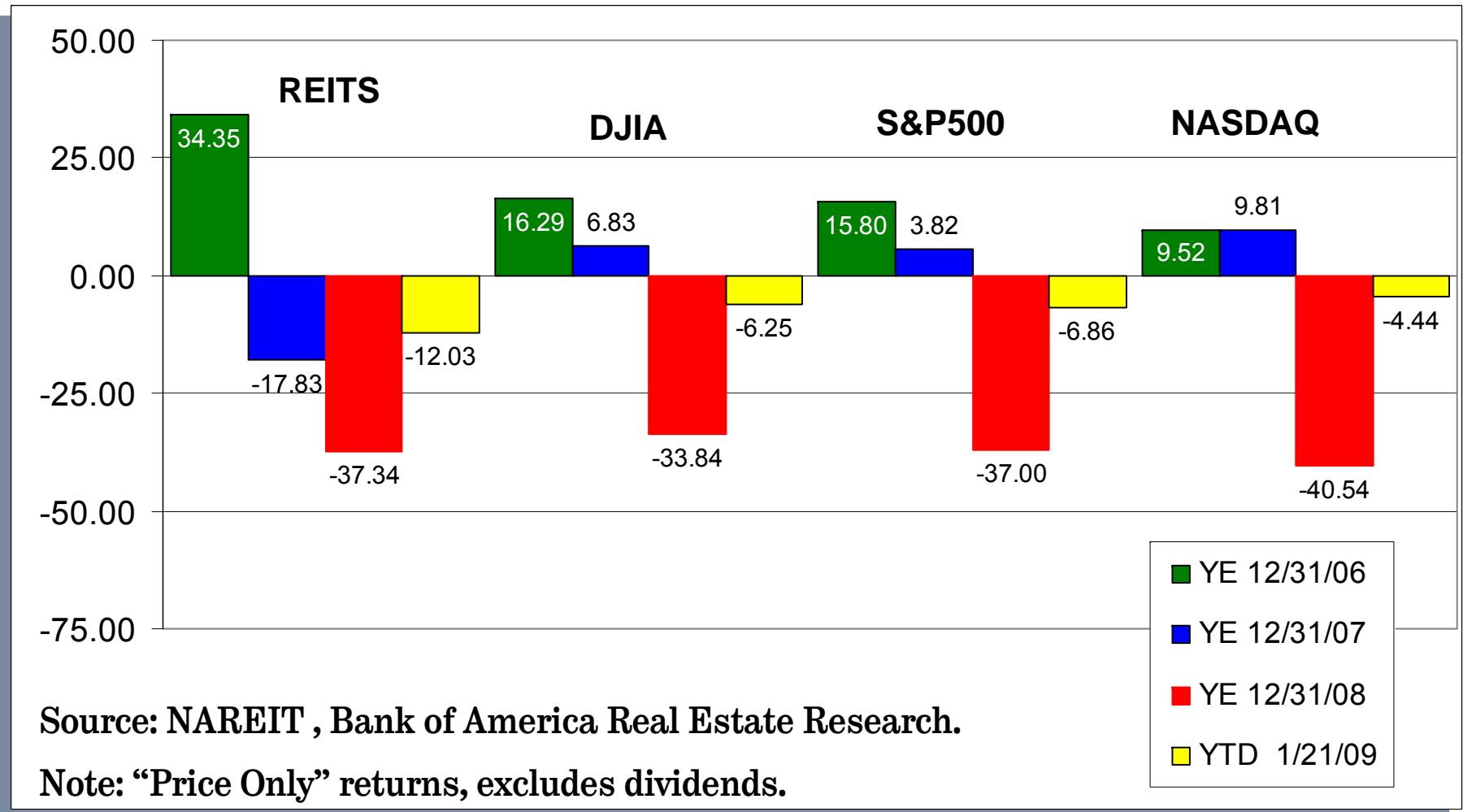
# REITs Lose \$274 Billion or 59% of value



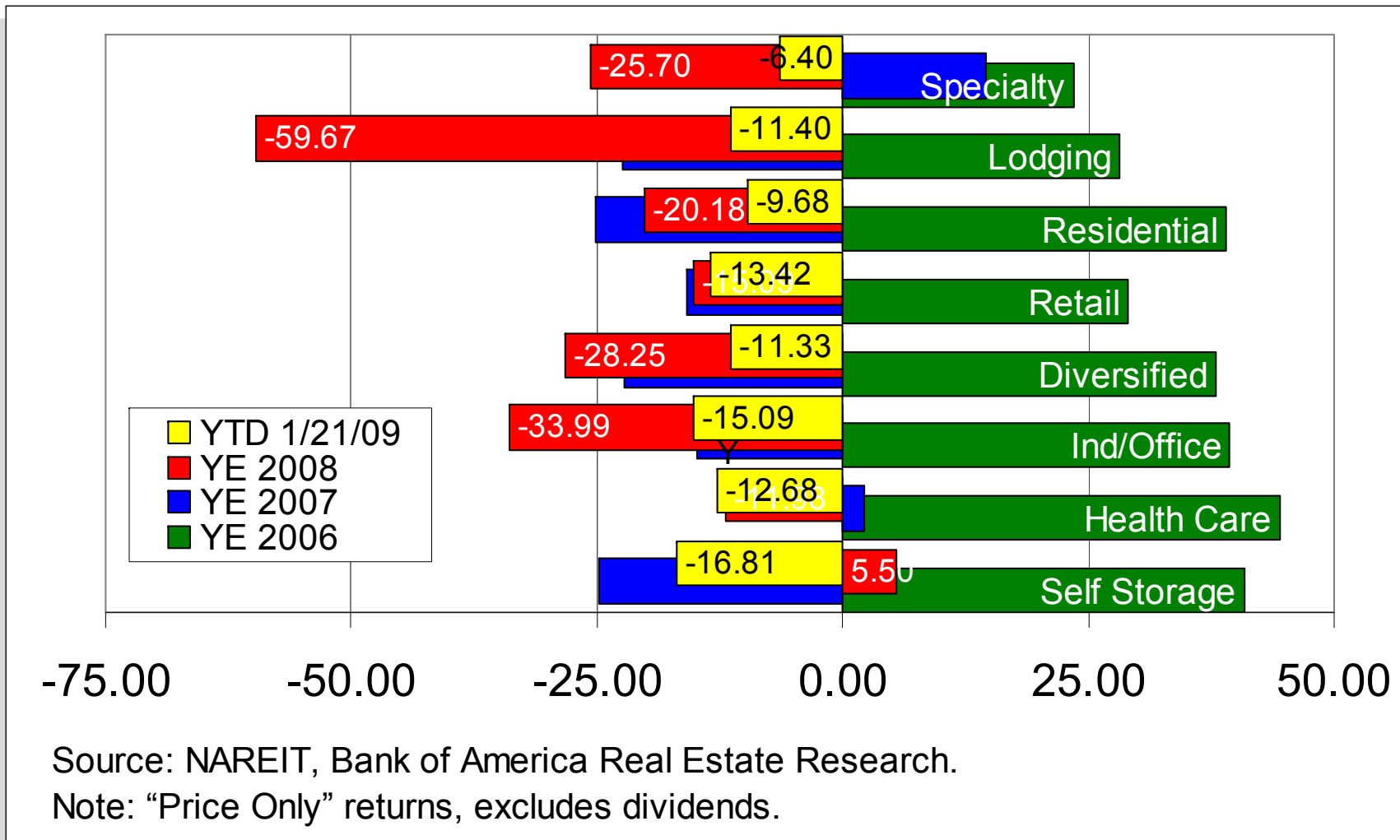
Source: NAREIT, Bank of America - Real Estate Research

Note: Includes Equity, Debt and Hybrid REITS

# Benchmark Returns — Changes so Fast!



# REIT Property Type Returns — Old vs. New



# Value Fundamentals

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CMBS Market is Effectively Broken = Opportunities

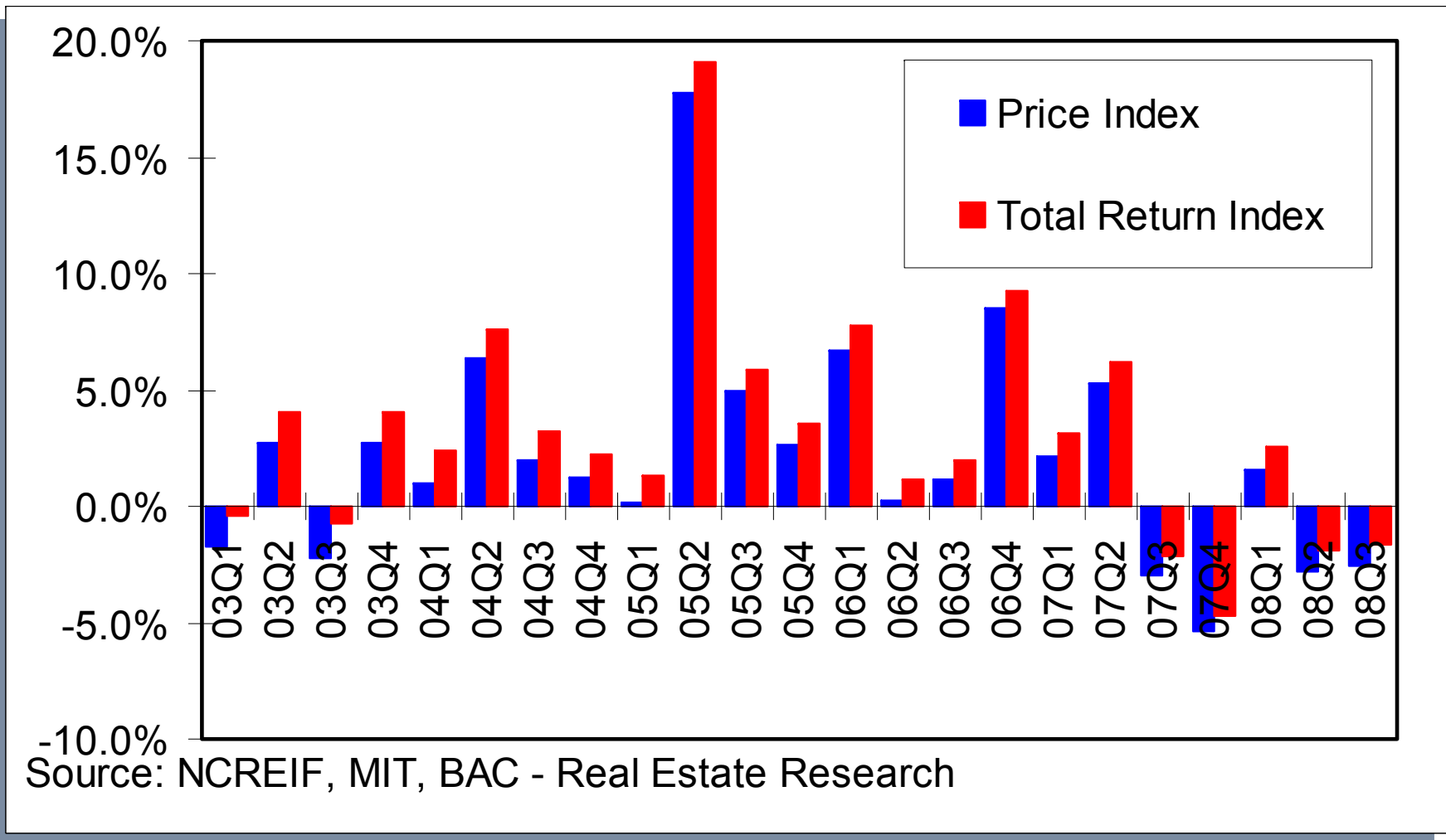
CMBS/CMBX Industry – Imply R.E. Yields Doubled

REITS are “Off” more than 50% = Opportunities

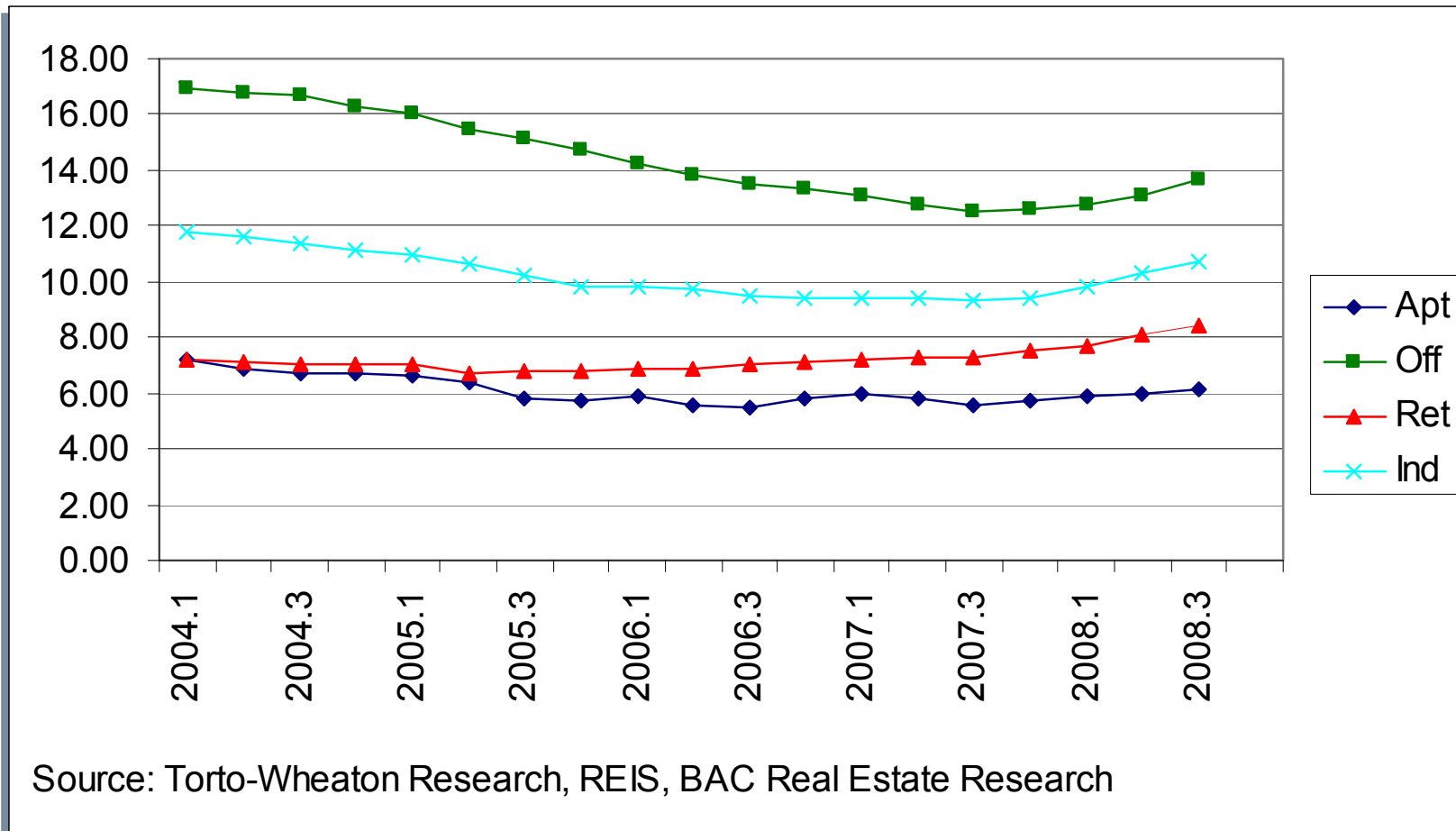
NCREIF is nearly Flat (down 2-3%)

Market Change brings Opportunities!

# NCREIF 08.Q3 Price Down/ Total Down

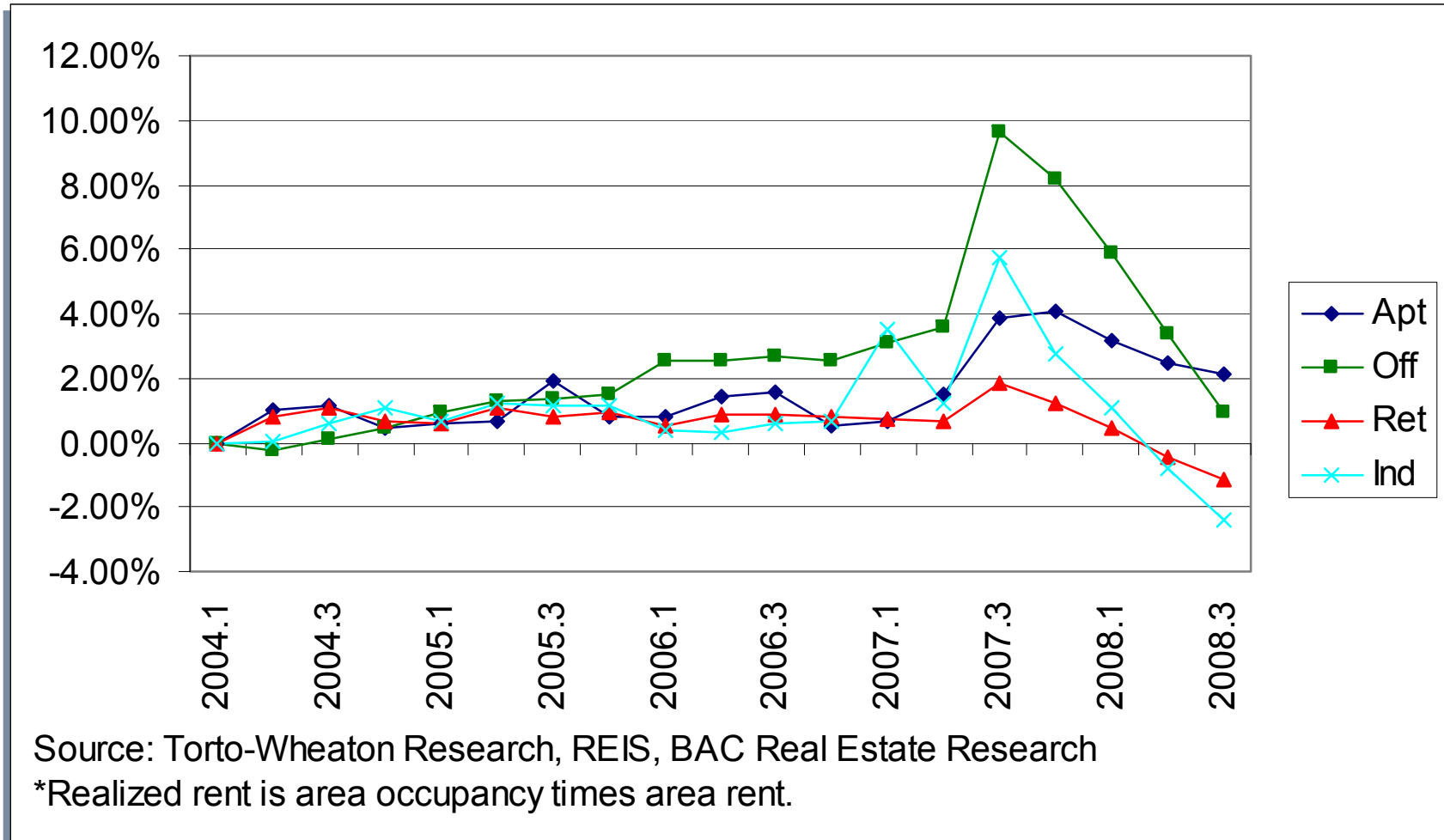


# National Trend — Vacancy

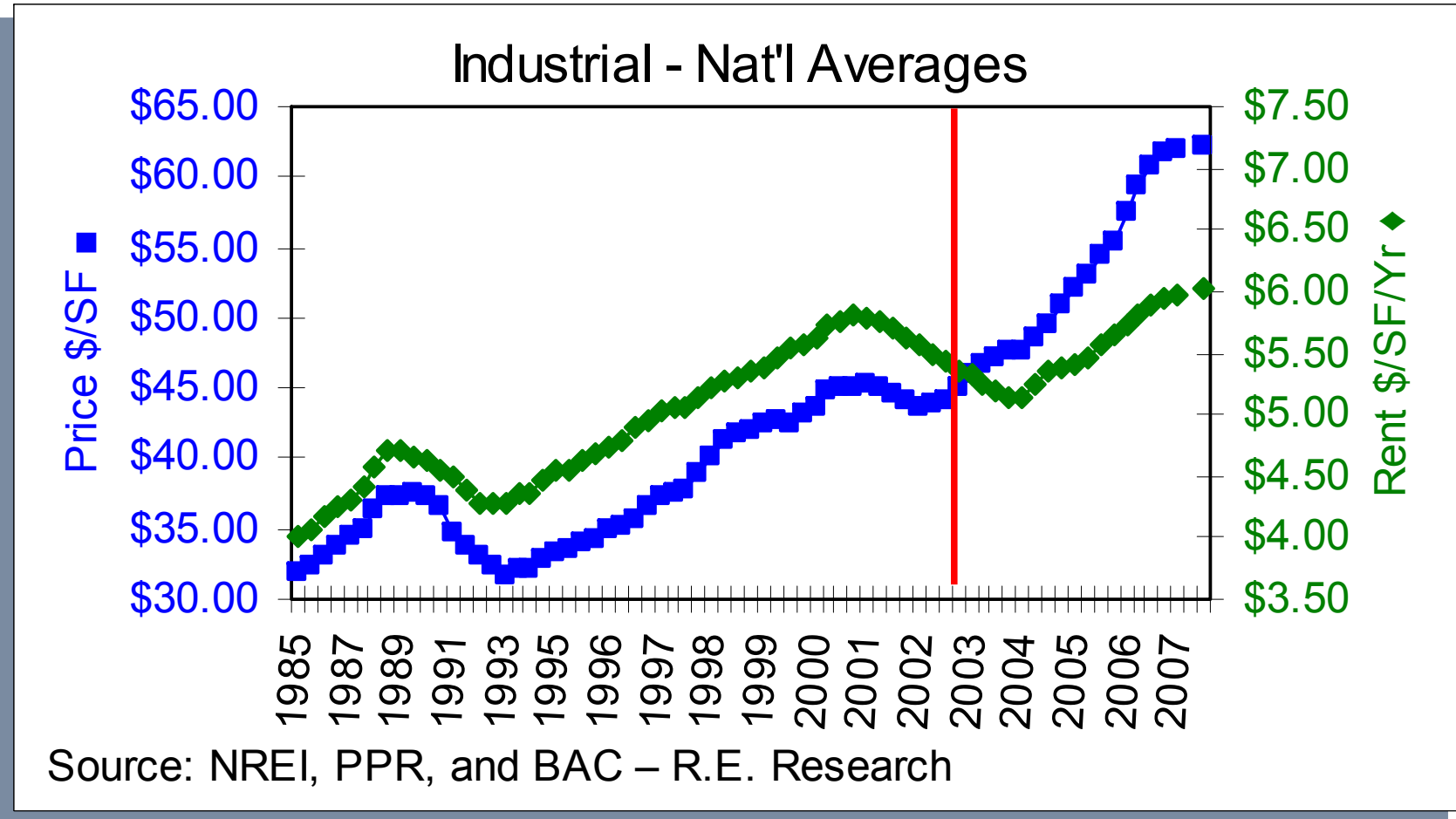




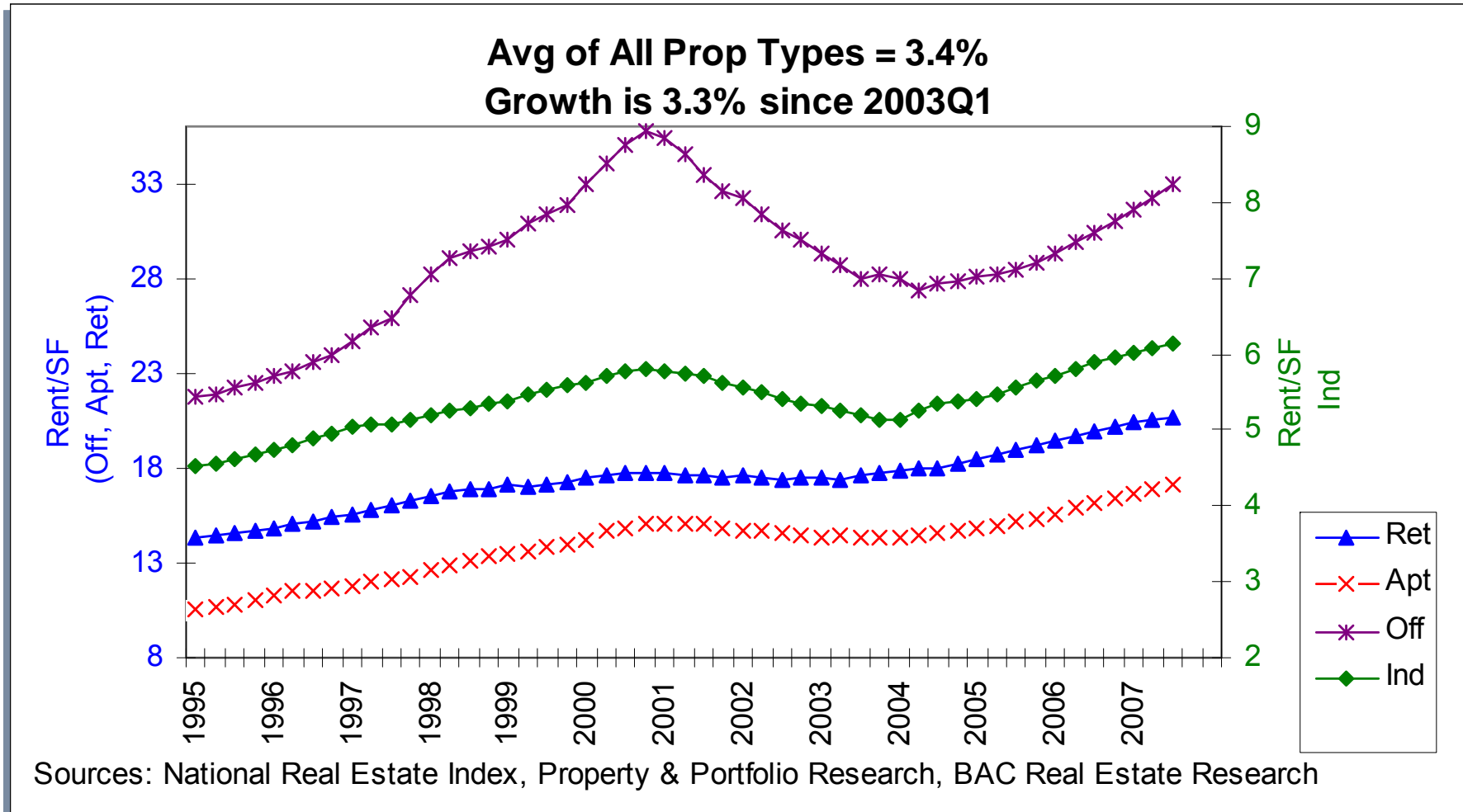
# Realized Rents



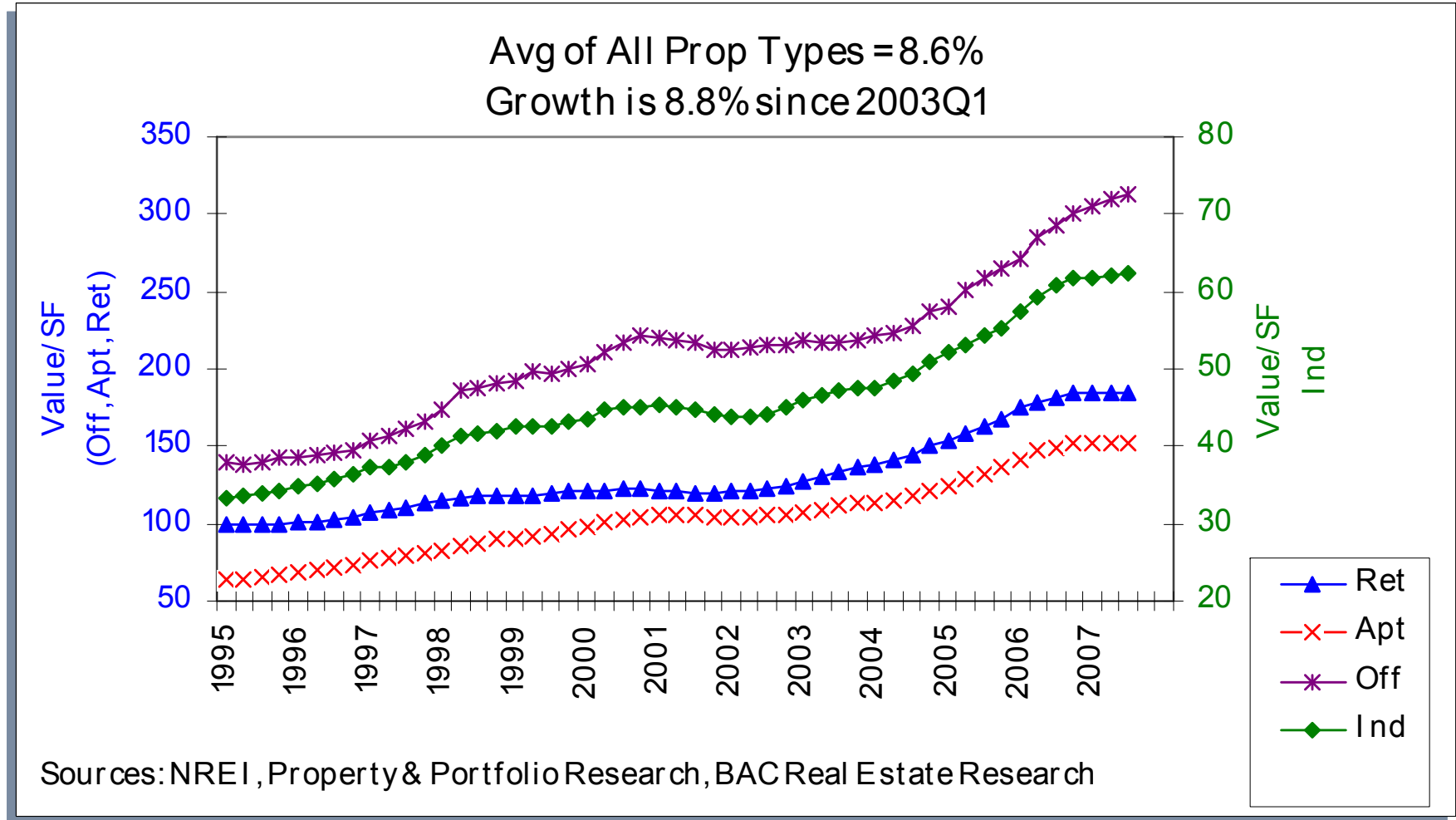
# The Relationship Breaks in 2003



# Market Trends — National Rents



# Market Trends — National Values

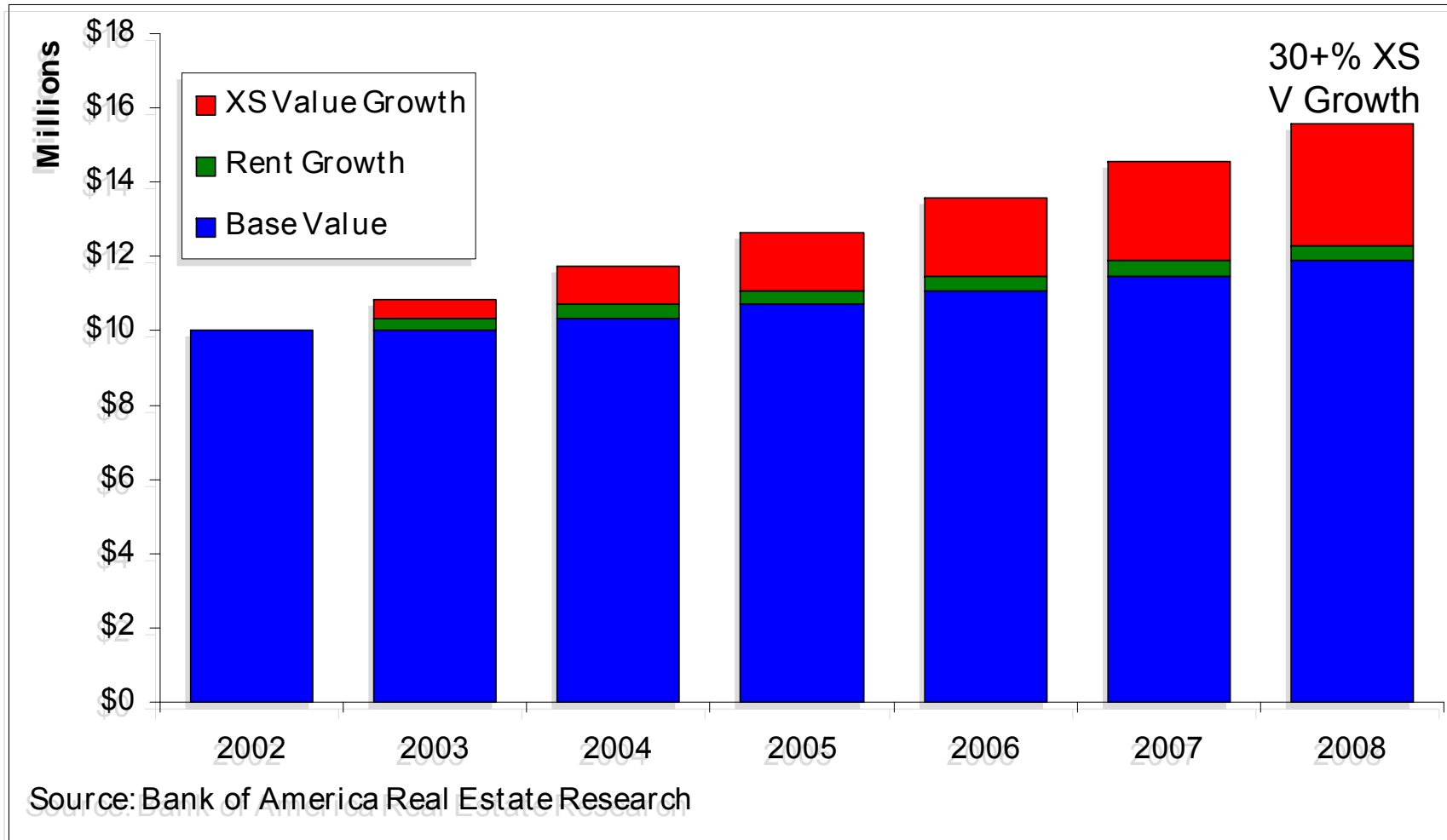


## Growth Example — Value vs. Income

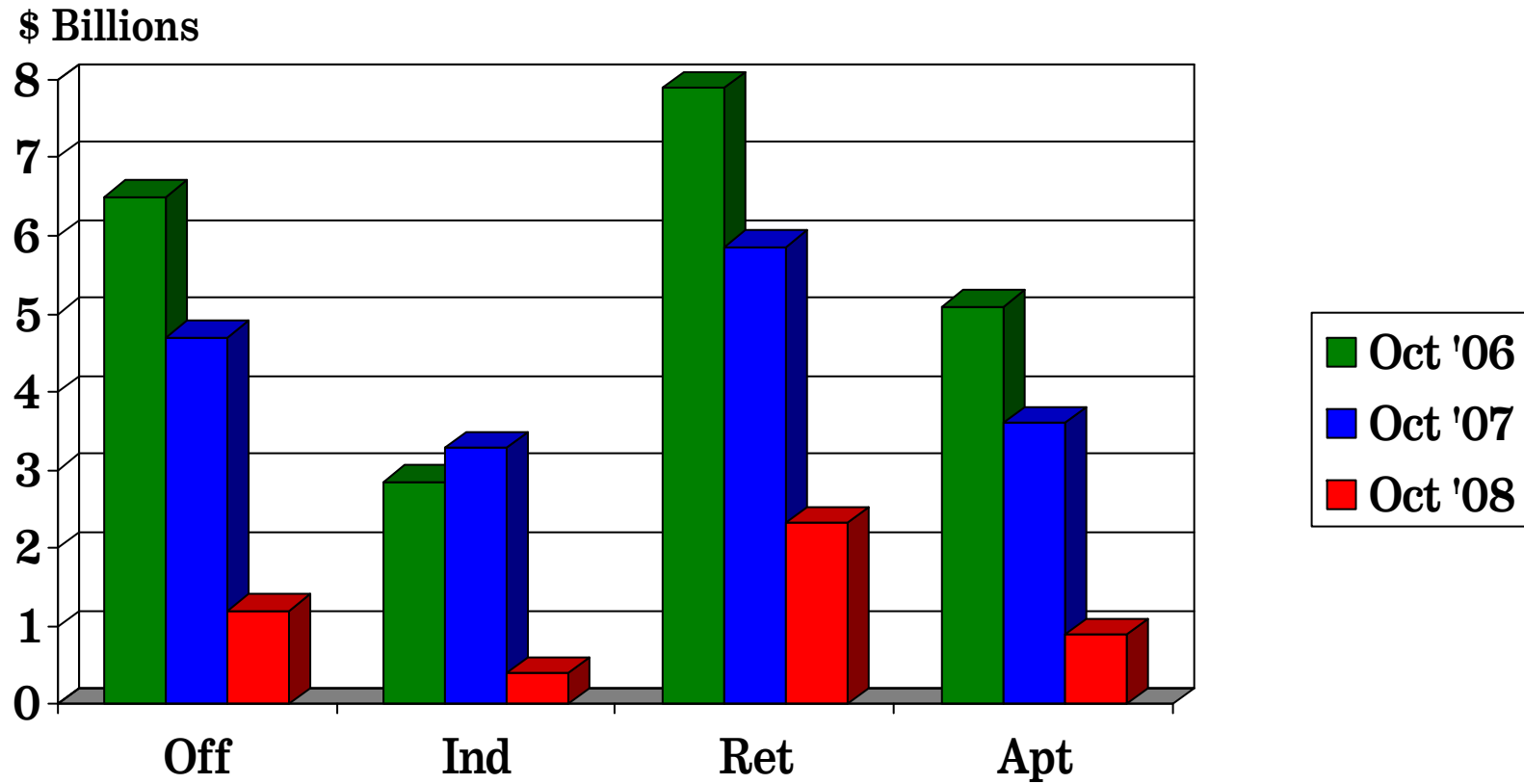
Year	Rent	RentG	Ind Cap	Value
2002	750,000	3.30%	7.50%	\$10,000,000
2003	774,750	3.30%	7.12%	\$10,880,000
2004	800,317	3.30%	6.76%	\$11,837,440
2005	826,727	3.30%	6.42%	\$12,879,135
2006	854,009	3.30%	6.09%	\$14,012,499
2007	882,192	3.30%	5.79%	\$15,245,598
2008	911,304	3.30%	5.49%	\$16,587,211
	average	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

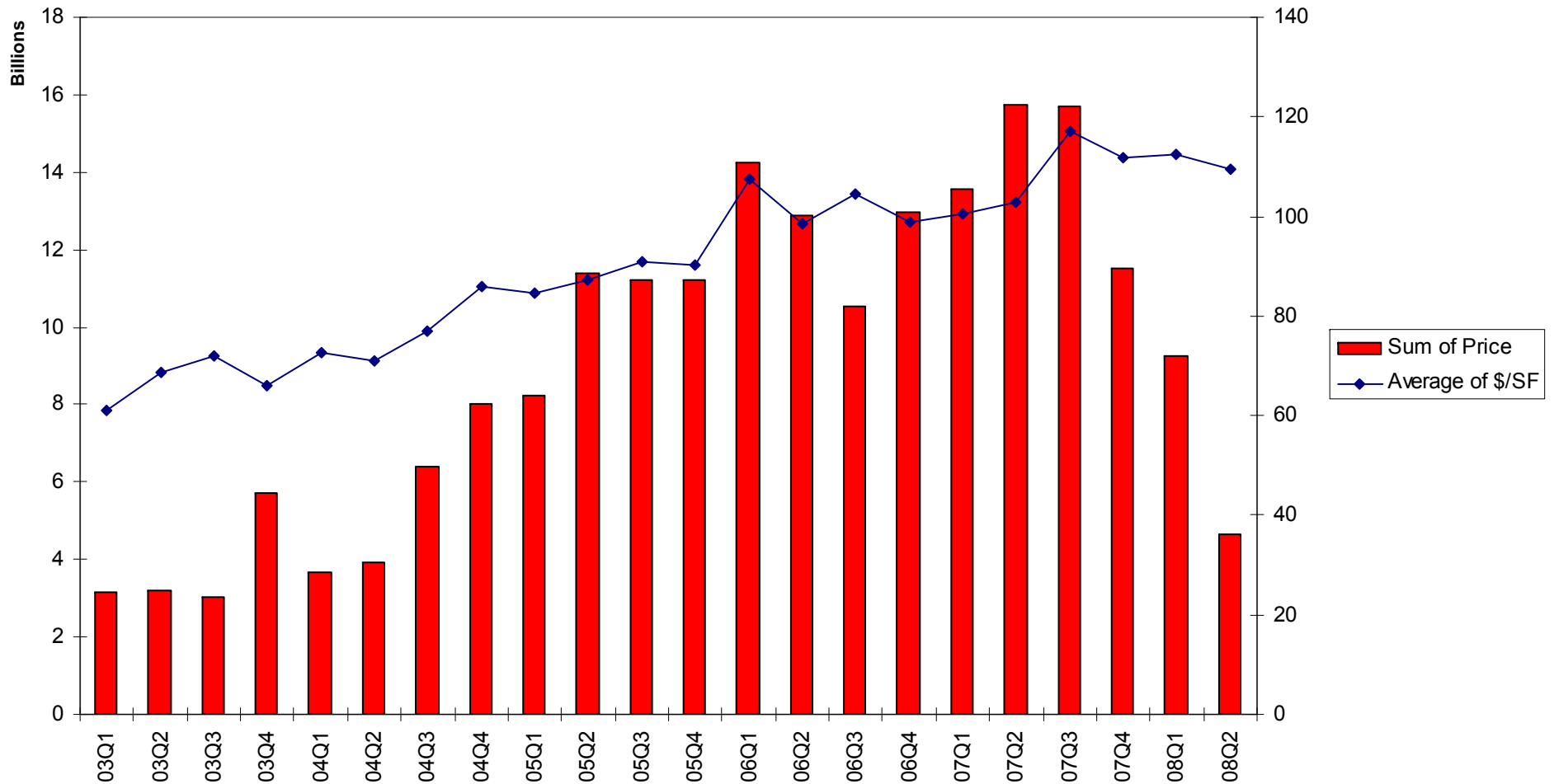


# Sales Volume Trends (National)



Source: Real Capital Analytics CTM 11/08, Bank of America Real Estate Research

# Sales Trends - Ind - 54% Q3 '08 vs. '07

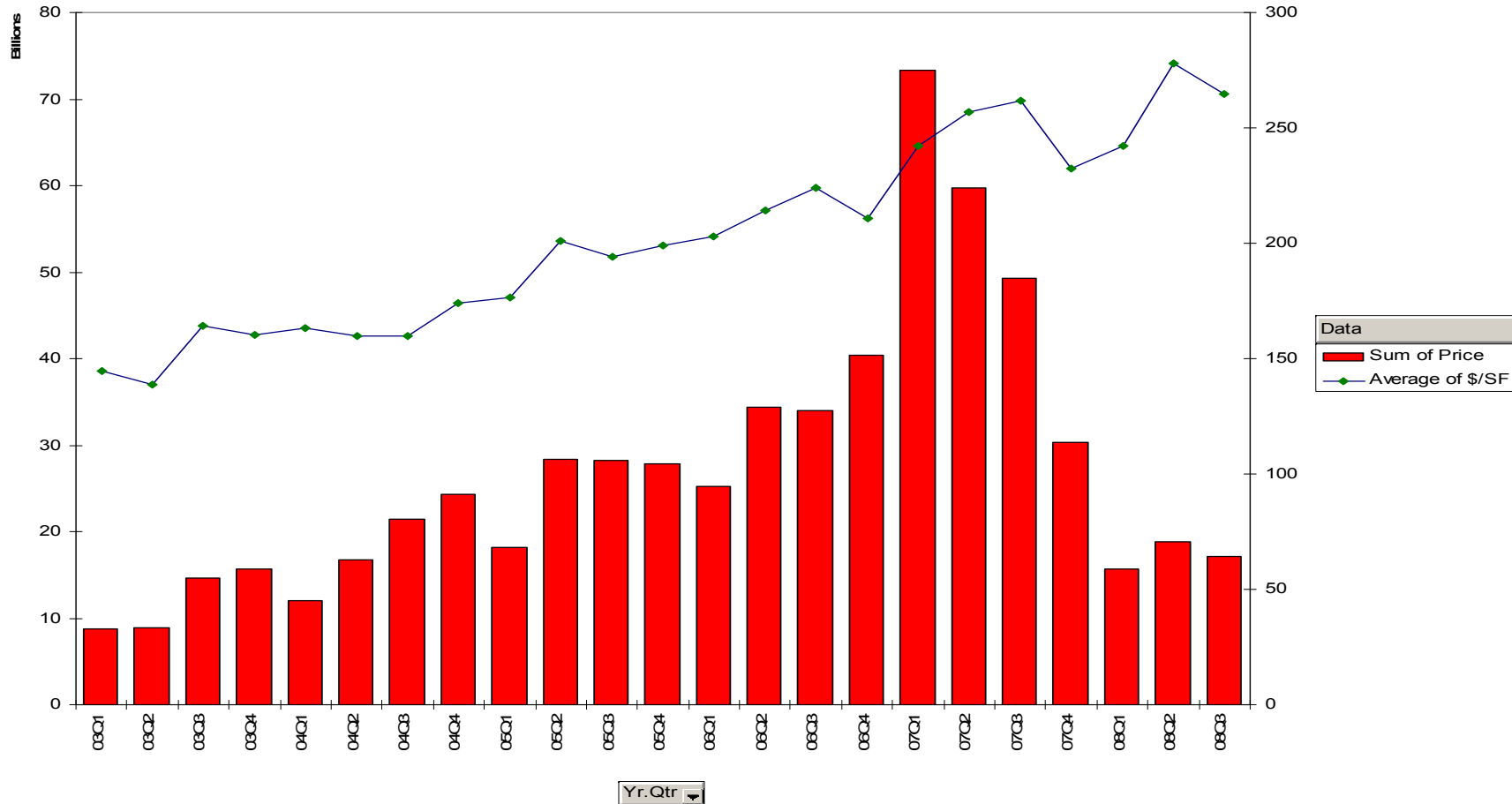


Source: Real Capital Analytics, Bank of America Real Estate Research



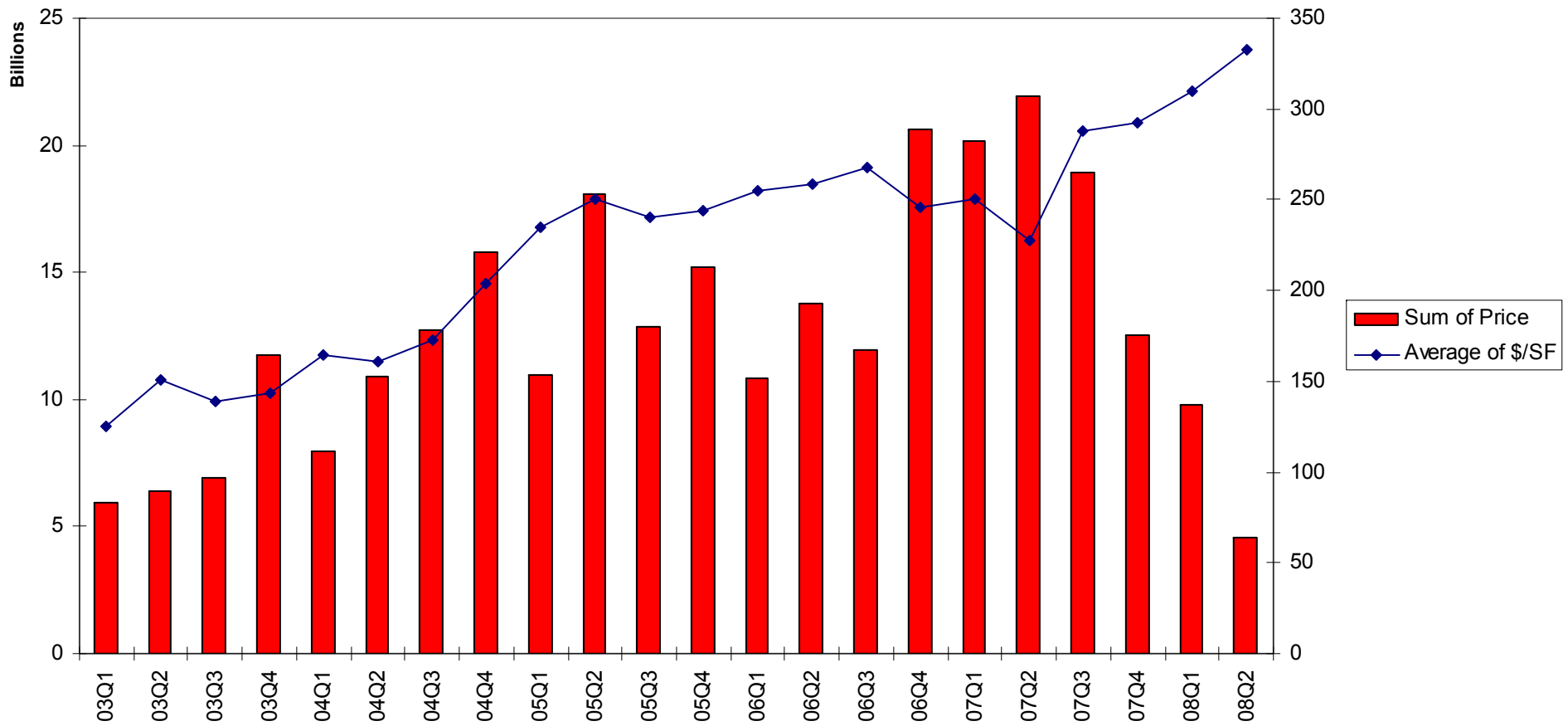
# Sales Trends - Office - 75% Q3 '08 vs. '07

Main Type Office RCA\_Metros\_tx (All)



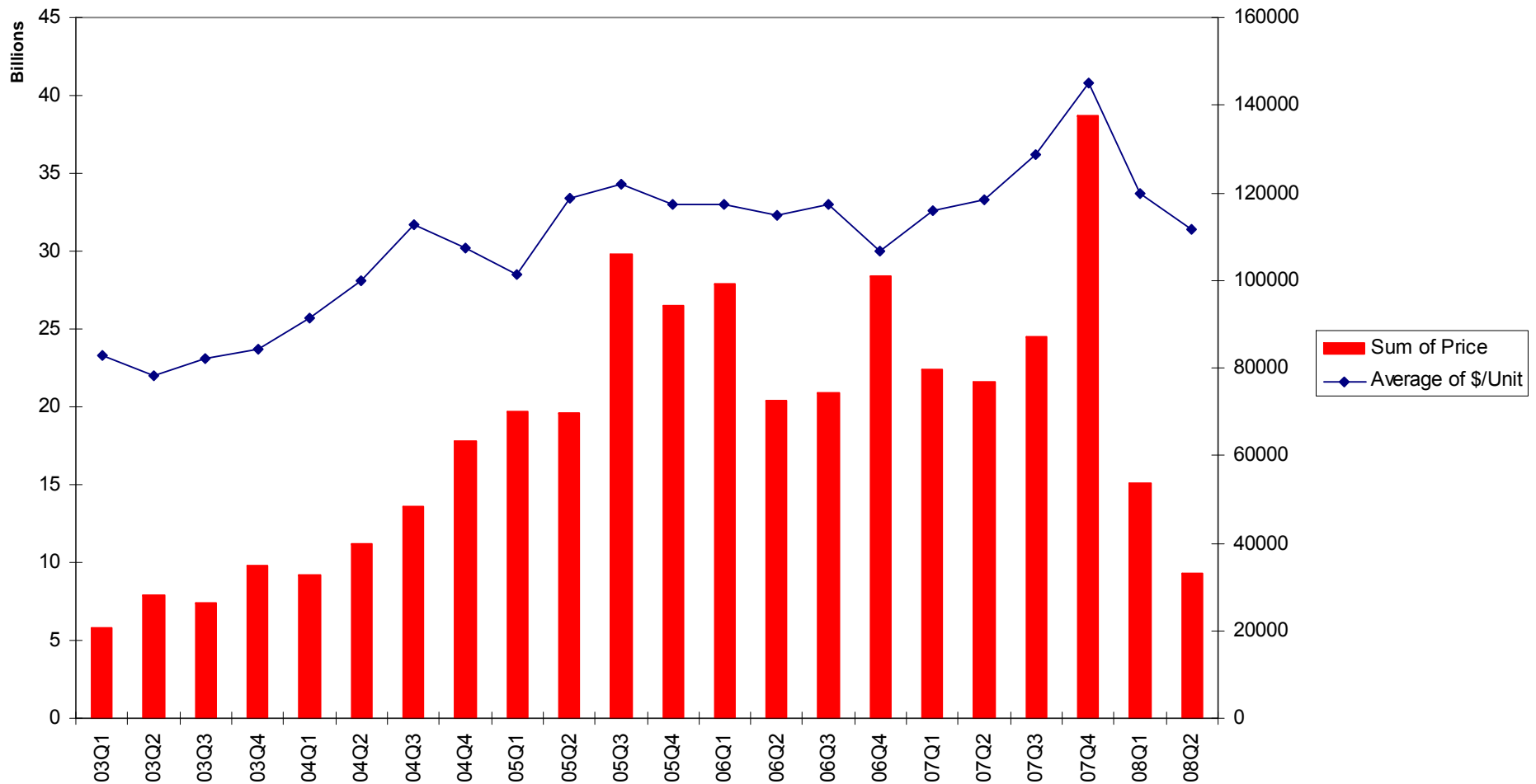
Source: Real Capital Analytics, Bank of America Real Estate Research

# Sales Trends - Retail - 71% Q3 '08 vs. '07



Source: Real Capital Analytics, Bank of America Real Estate Research

# Sales Trends - Apt - 49% Q3 '08 vs. '07



Source: Real Capital Analytics, Bank of America Real Estate Research

# Vacancy - Top / Bottom Markets - '08Q3....

U.S.		Off - 13.4%		Ind - 10.7%		Apt - 5.8%		Ret - 8.4%		Hot* - 68.2%	
Top	1	New York	6.2	Los Angeles	5.4	Pittsburgh	2.7	Fairfield	3.6	San Francisco	85.4
	2	Honolulu	9.2	Salt Lake City	6.3	Newark	3.4	San Jose	3.8	New York	85.0
	3	San Francisco	9.7	Tucson	6.4	San Diego	3.4	Los Angeles	3.9	Seattle	81.3
	4	Long Island	9.9	Houston	7.0	Oakland	3.5	Orange Cty	3.9	Long Island	79.7
	5	Seattle	9.9	San Francisco	7.1	Edison	3.6	N New Jersey	4.0	Portland	77.9
Bottom	5	W Palm Bch	19.2	Stamford	15.9	Dayton	8.2	Cincinnati	14.4	New Orleans	57.9
	4	Dallas	20.3	Detroit	17.5	Atlanta	8.5	Columbus	14.4	Tucson	55.1
	3	Phoenix	20.3	Memphis	18.5	Greensboro	8.6	Syracuse	14.8	West Palm Be	52.3
	2	Edison	21.1	Trenton	19.0	Phoenix	9.8	Dayton	15.4	Phoenix	51.0
	1	Detroit	22.0	Ann Arbor	21.0	Jacksonville	10.0	Birmingham	15.5	Tampa	50.1
Spread			15.8		15.6		7.3		11.9		35.3

Source: Torto Wheaton Research (Off, Ind, Apt, Hot), REIS (Ret)  
BAC-Real Estate Research; \* Hotel = Occupancy

# Vacancy Performance - 08Q3

Prop Type	08Q3 National	08Q3 San Diego	SD Rank
Office *	13.4%	17.7%	51 : 58
Industrial *	10.7%	10.6%	29 : 59
Retail **	8.4%	4.3%	7 : 80
Apartment *	5.8%	3.4%	3 : 60
Hotel *	68.2%	77.0%	7 : 53

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

Note: Hotel = Occupancy

## Vacancy - Top / Bottom Submarkets - '08Q3....

SD	Off - 17.7%		Ind - 10.6%		Apt - 3.4%		Ret - 4.3%		Hot* - 77.0%		
Top	1	Point Loma	0.3	Central	4.7	West San Diego	1.8	West San Diego Beach	3.4	Sea World / Oldtown / Airport	76.2
	2	La Jolla	4.8	Central Suburban	5.3	La Jolla / University City	2.5	South County	3.9	San Diego Downtown	75.4
	3	North Beach Cities	5.7	East County	5.4	Outer San Diego County	2.6			Mission Valley	74.2
	4	Old Town	5.7	Hwy-78 Corridor	10.2	Lemon Grove / National City	2.7			San Diego NE / Escondido	70.0
	5	Rose Canyon / Morena	7.3			El Cajon	2.8				
Bottom	5	Miramar	25.7			Intown / Coronado	3.4				
	4	Governor Park	25.7	I-15 Corridor	11.6	Santee / Lakeside / Poway	3.5				
	3	San Marcos / Vista	26.3	North City	10.6	Mission Valley	3.5			San Diego / La Jolla	69.8
	2	Temecula	29.1	North County West	18.0	North San Diego	4.2	Northwest County	4.7	Carlsbad / Oceanside	67.4
	1	Carlsbad	29.5	South Bay	15.0	North County	4.3	Northeast County	5.3	San Diego South & East	66.1
Spread			29.2		10.3		2.5		1.9		10.1

Source: Torto Wheaton Research (Off, Ind, Apt, Hot), REIS (Ret)

BAC-Real Estate Research; \* Hotel = Occupancy



Note: Downtown Office = 15.4%, Ind, Ret & Hot have <10 mkts

# Quote of the Day

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

~~NY Yankee #8, Yogi Berra~~

Niels Bohr

Nobel Laureate, 1922



# Conclusions

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- CMBS Market – Spreads 10-50x Higher – R.E. Yields Double
- CMBS - New Business Model will Come
- REIT Industry – Down 60+ Percent
- NACREIF – Mixed Signals
- Many Lenders have Closed or Reduced Lending Volume
- Financing Costs Have Risen; Capitalization / Yield Rates
- CASH IS KING
- Value Growth (appreciation) will Lag Rent Growth
- Rents/Vacancies will remain better than early 1990s
- Value(s) Will Undergo Correction

.....see next slide!



# Greer - 3 Year Forecast as of 1/2009

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- Borrowing Rates for Commercial Real Estate will Rise
- Margins (to Treasury) for Commercial RE Loans will rise 200 bps 2008-09, will settle to 300± 50bps over 10 year Treas.
- Rent Growth will lag CPI by 0 to 5%
- Value Growth will lag Rent Growth 30-35% 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 2.0-3.0% over next 3 years (eg 5.0% become 7.25% = 30%+/- decline in value)
- Declines: #1 Retail, #2 Industrial & Office, then Apartment
- Change Creates OPPORTUNITIES!!!!

**Bank of America**

