

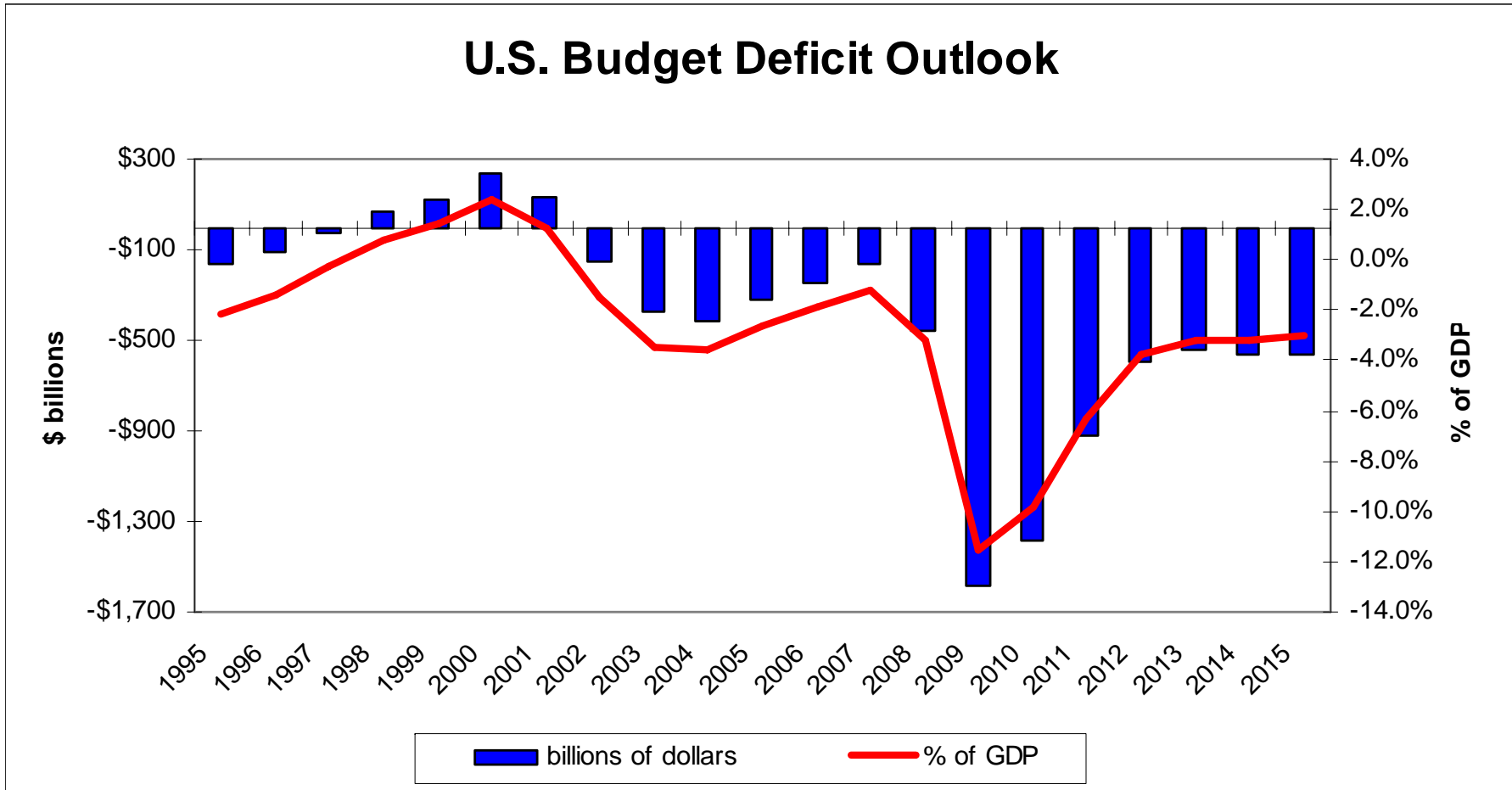
THE ROAD TO RECOVERY: CHALLENGES AND OPPORTUNITIES

Presented by:

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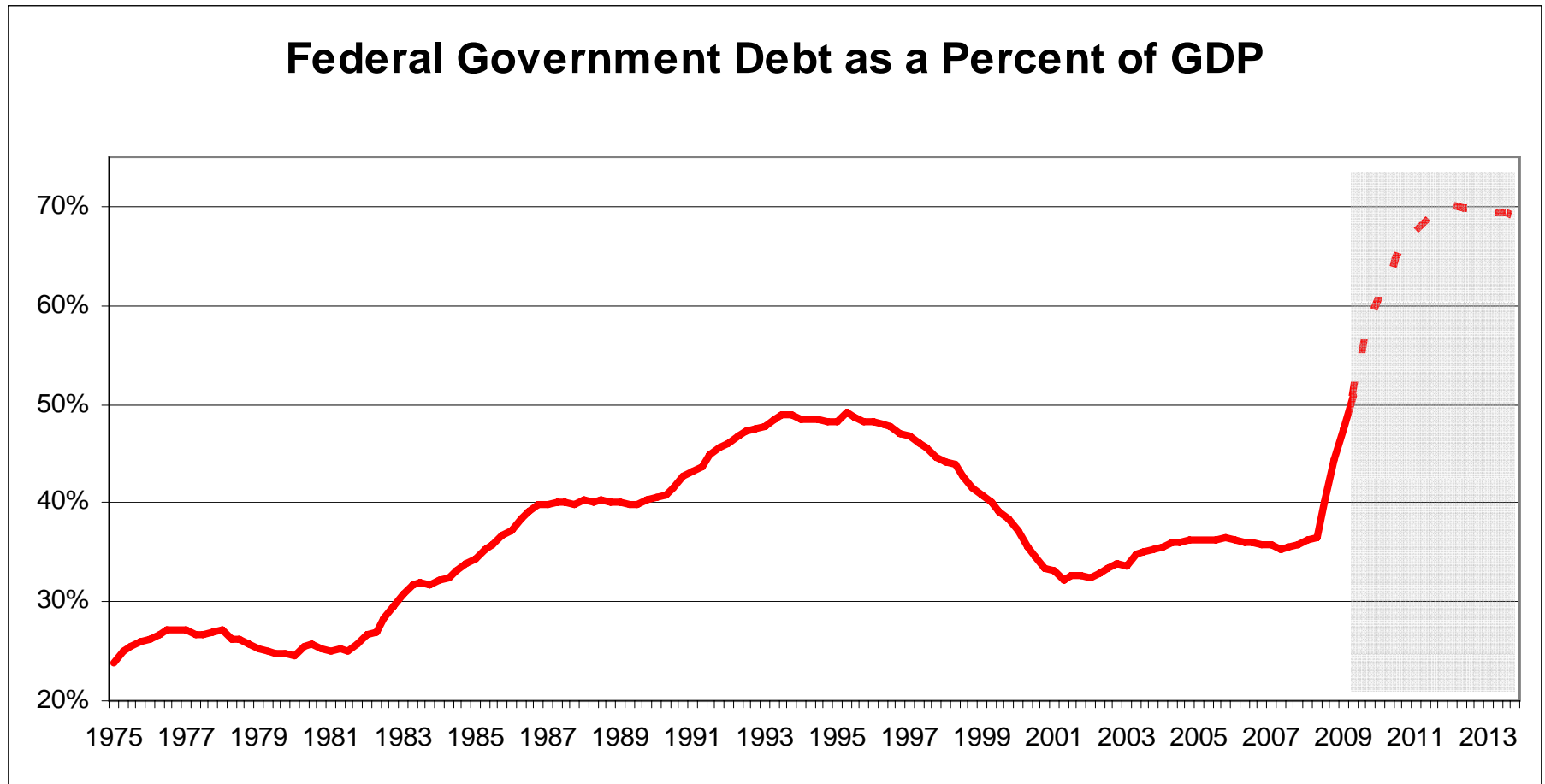
Commercial Real Estate Lags the Economy – Especially in the Recovery Phase

Dramatically increased government presence in economy...



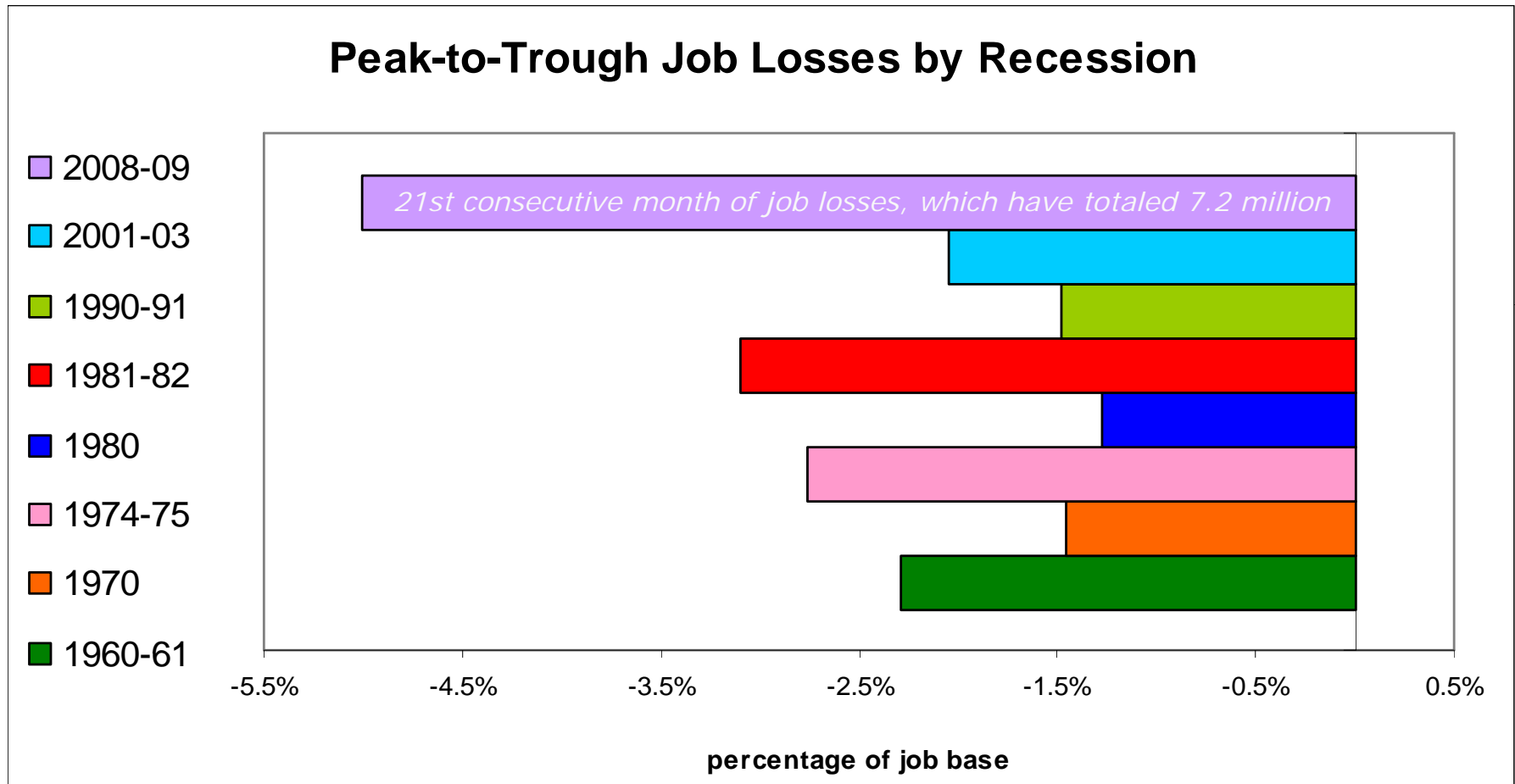
Sources: Congressional Budget Office, Moody's Economy.com, August 2009

...leading to record budget deficits



Sources: Congressional Budget Office, Moody's Economy.com, August 2009

A particularly severe job loss recession...

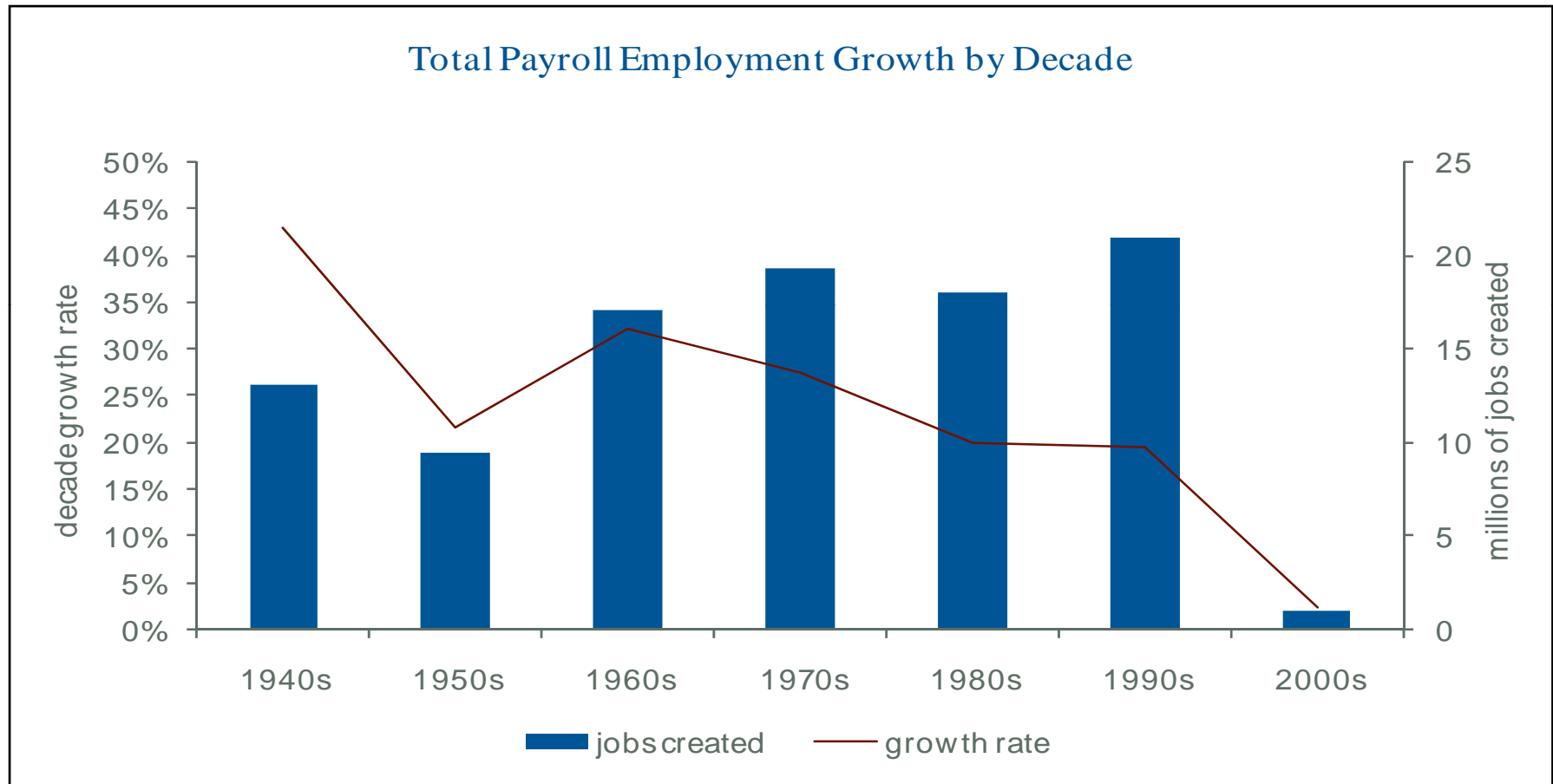


Source: Bureau of Labor Statistics, September 2009

Employment Picture Remains Grim

- 4,000 jobs gained in November – 85,000 lost in December
- Unemployment rose in 43 states last month
- Unemployment reported to be around 10% - could be as high as 17% counting those that “fallen through the cracks”

...leads to the lost decade of job growth.



Source: Bureau of Labor Statistics, September 2009

The Gauntlet Continues

Where are we in the Investment Cycle?

Price vs. Value Cycle

Key Issues

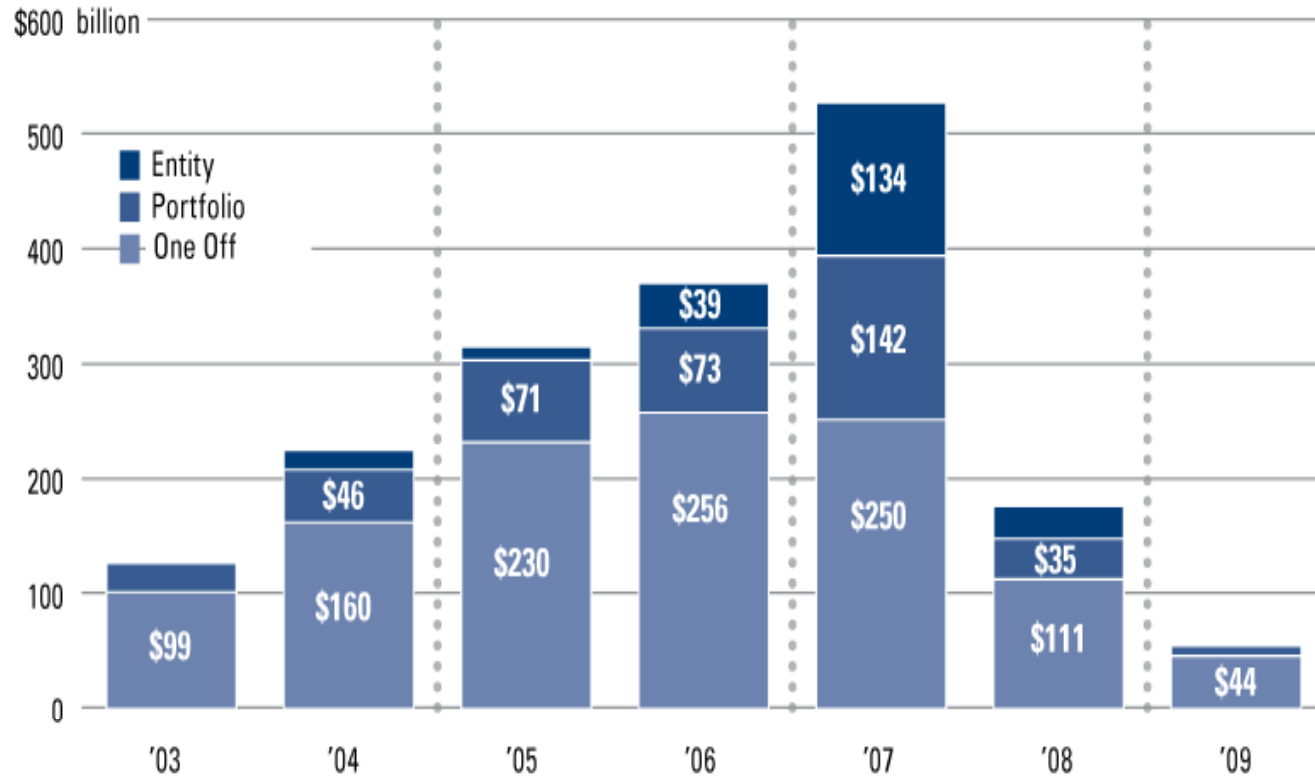
- More than 100 banks failed in 2009
- Lackluster economic rebound will prolong CRE Recovery
- Many believe not much traction until 2011 or 2012
- Until consist job growth – rental rates and NOI will continue to drop

- Delinquency rate CRE loans more than doubled in last year – 9.5% in Q309 – Federal Reserve
- \$1.4 trillion with a “T” of CRE debt maturing by end of 2011 – CMBS & Whole Loans – Total CRE market ±\$6.5 trillion
- Property cash flows will not recover in time to help.
- Could sidetrack the U.S. economic recovery

CRE Suffers on Two Fronts

- Space Demand = Fewer workers & fewer customers = less space required
- Upside down credit – large numbers of loans coming due when property values are less than amount owed.

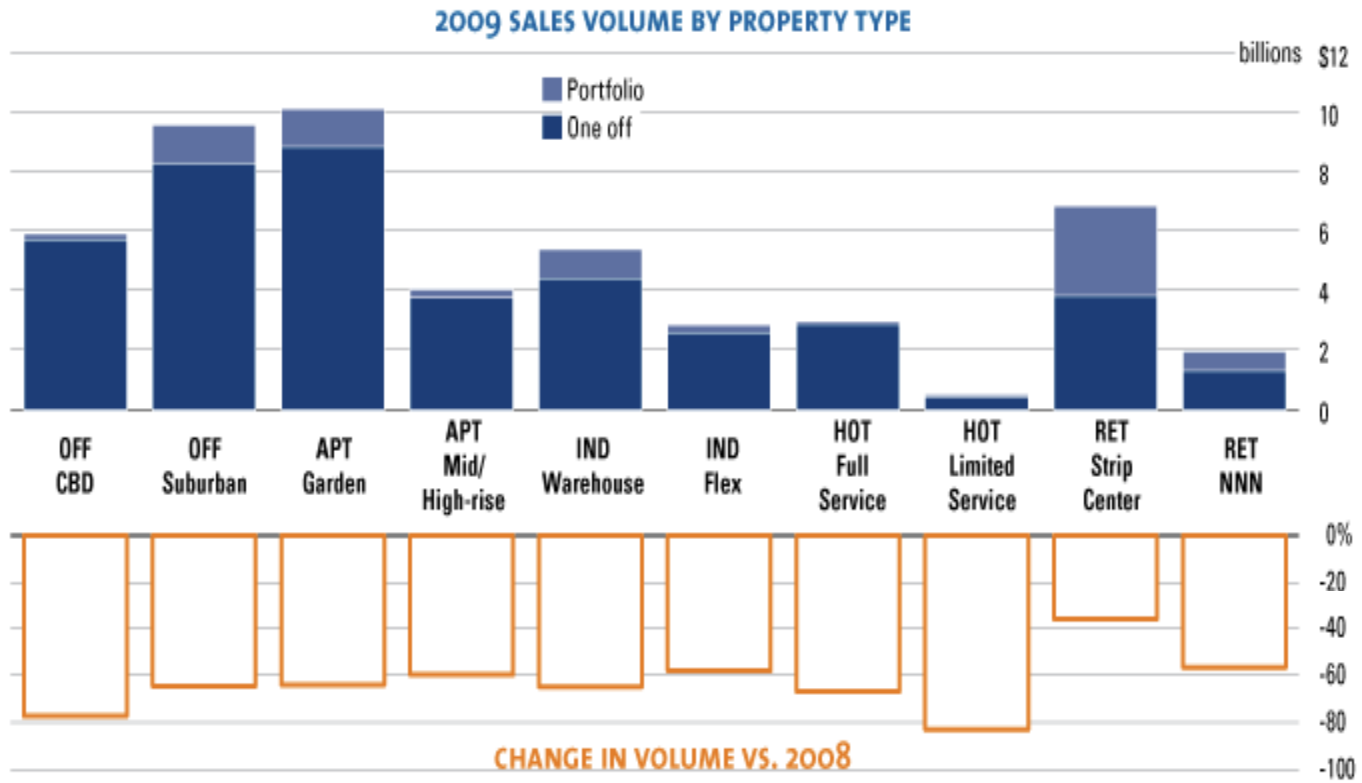
PROPERTY SALES ALL CORE



Source: Real Capital Analytics

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CRE Price Adjusters

- Cap Rate Expansion
- Revenue Deterioration
- Debt Squeeze

Property Sectors

- Apartments – 5.8 rating - 7.6% (5.9%) cap rate
- Suburban Office 3.9 rating – 8.6% (6.6%) cap rate
- CBD Office – 4.9 rating – 8.0% (6.0%) cap rate
- Industrial – 4.7 rating – 8.5% (6.5%) cap rate

Property Sectors

- Regional Mall – 3.8 rating – 8.4% (6.4%) cap rate
- Power Centers - 3.1 rating – 8.6% (6.4%) cap rate
- Neighborhood/Community Centers – 4.3 rating – 8.8% (6.5%) cap rate
- Hotels – 2.5 rating – 10.7% (7.5%) cap rate

Property Sectors

- Apartments – Best of a bad lot – 90% decline in sales activity since peak in volume - first to recover
- Office – fundamentals will continue to deteriorate
- Industrial – with low consumer confidence and spending there is reduced demand for goods and thus warehouse space

Property Sectors

- Retail – Unemployment and economy have a brutal impact. Stores struggle and close or seek rent relief – universe of potential tenants has been dramatically reduced. Co-tenancy clauses kick in
- Hospitality – impacted by reduced business and leisure travel.

Cap Rate Comments

- RERC's fourth quarter 2009 required cap rate of 8.5% has remained relatively flat from first quarter's rate of 8.4%
- RERC's required cap rates have returned to the level of first quarter 2004 (prior to cap rate compression)

Cap Rate Comments

- First quarter 2004 through fourth quarter 2007
 - RERC cap rates declined by 200 basis points

Value Comments

- NCREIF value expansion from 2004 – 2008
 - Roughly **45 percent** during this 4-year period
- NCREIF capital component last 4 quarters
 - **negative 26.9%** from 4th quarter '08 to 3rd quarter '09

Concluding Comments

Courage, Conviction, Decisiveness.

The Road to Global Economic Recovery

Some commercial real estate investors are farther down the road to recovery than others.

- Most of the large institutional investors already have worked through a lion's share of repricing issues. This is due to the regulatory requirement of mark-to-market accounting and pressure from institutional boards to get their portfolios valued at market.
- Unfortunately, the same cannot be said for the broader commercial real estate market. As a whole, property investors have not embraced the market's harsh realities, so 2010 will be a year of reckoning for many investors who up to now have been able to defer their issues to a later date.

Simple Valuation Model

- Gross Rent – Vacancy – Operating Expenses = Net Operating Income (NOI)
- $\text{NOI} / \text{Cap Rate (OAR)} = \text{Value}$
- Assume NOI = \$1,000,000 – 7.5% OAR = \$13.3 M whereas 9.5% OAR = \$10.5 M – A +20% loss in value

Concluding Comments 2010

- CRE Market needs to Stabilize before it can Recover

Concluding Comments 2010

- Most large core CRE players focused on debt issues or deleveraging
- Good year to buy distressed CRE
 - Wealthy entrepreneurs & opportunistic funds seize market opportunities

Concluding Comments 2010

“Price is what you pay. Value is what you get.”

“Be greedy when others are fearful.”

“You don’t make money by betting against the U.S.”

- Warren Buffett

The Gauntlet Ends Here: For Now!

Thank You...

Questions?