
Commercial Real Estate Issues

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October 28, 2011 – San Francisco Federal Reserve

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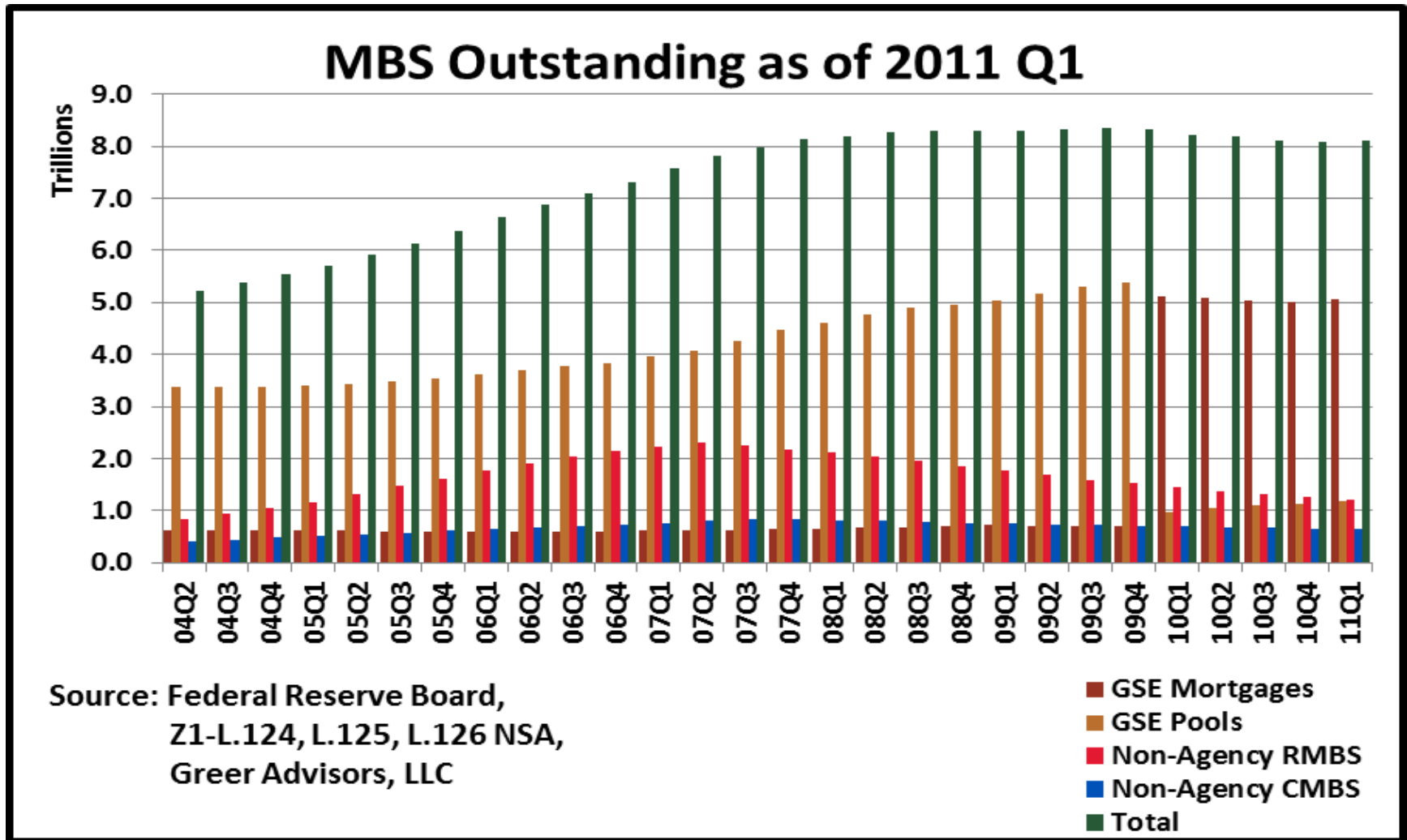
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Goals of Presentation

- Tea Leaves – Capital Markets / Wall Street
- Class A versus B/C – Risk Pricing
- Indexing Systems - “Spirit” of Evaluation
- Data Systems – Market Data, Appraisal, Review, Other
- Current Trends

- Tea Leaves – Capital Markets

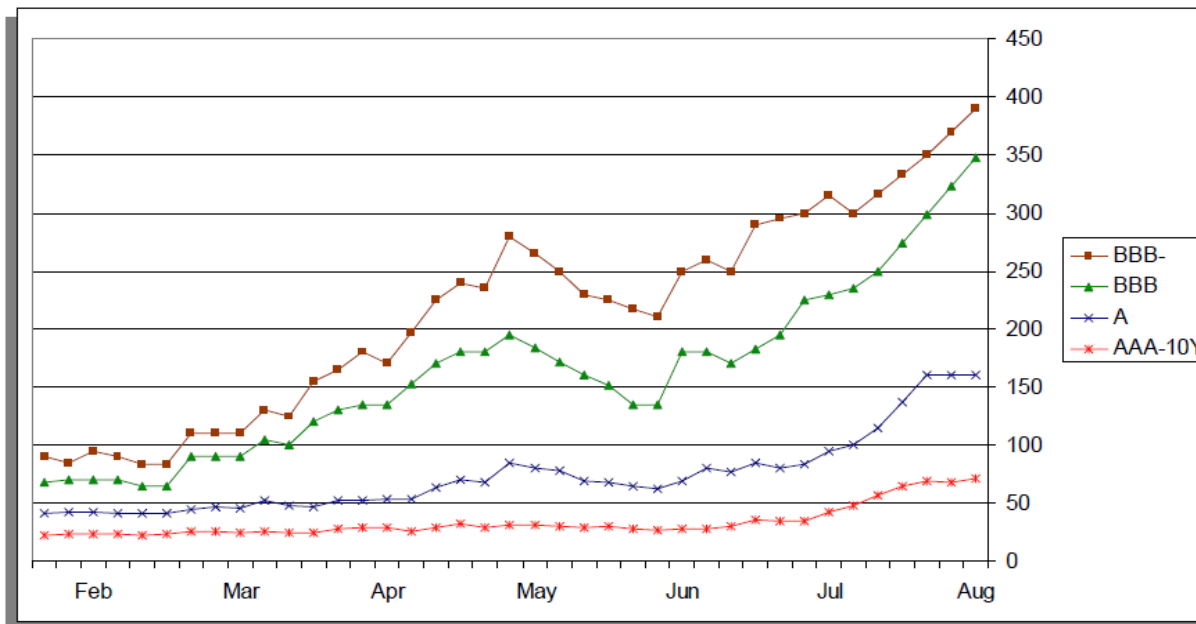
MBS Outstanding's in U.S. - Dropping



What Broke – CMBS Yield Rates Rose

- Slide from 8/3/2007 Presentation – it's on the web site

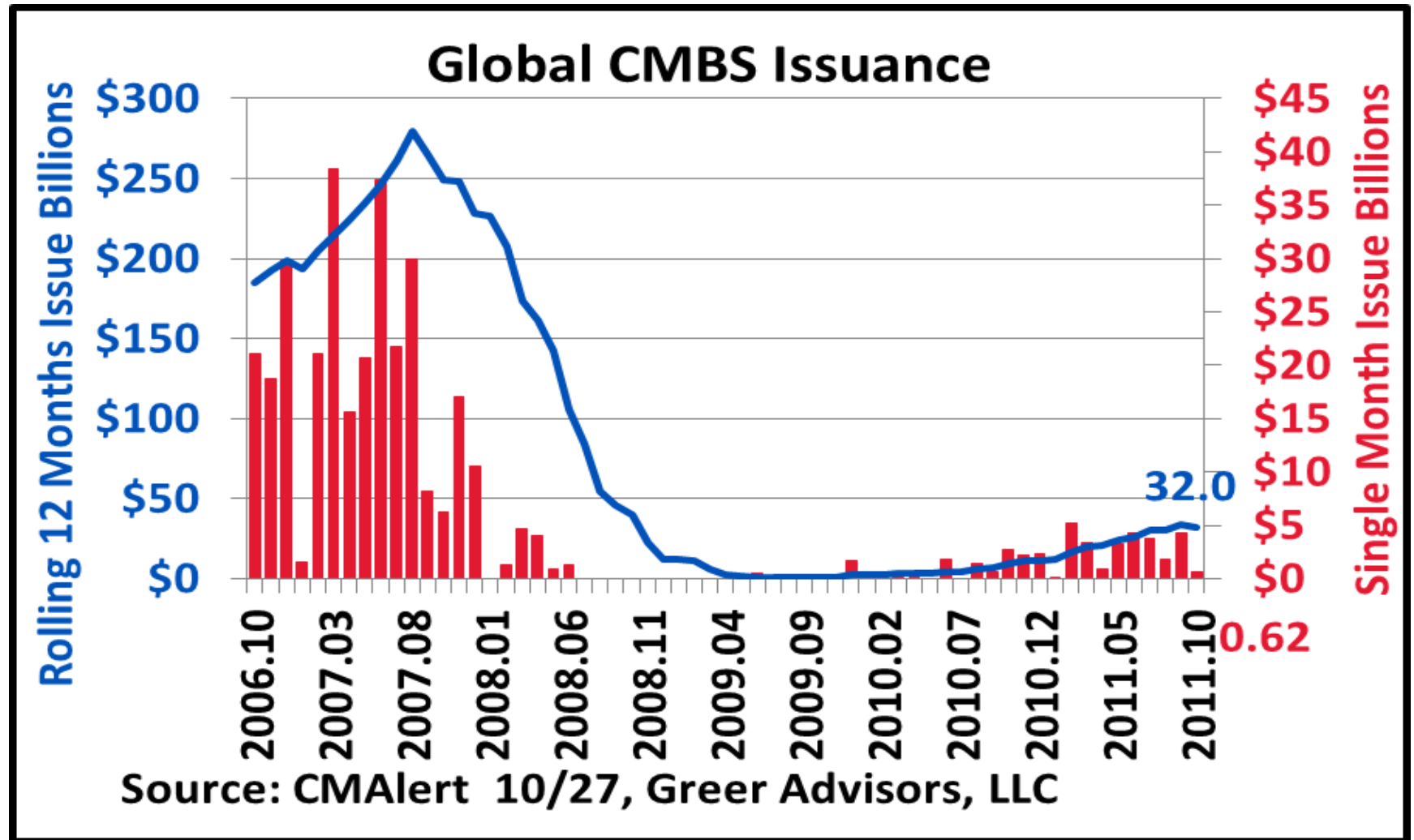
CMBS Spreads are Widening - Pricing Trends



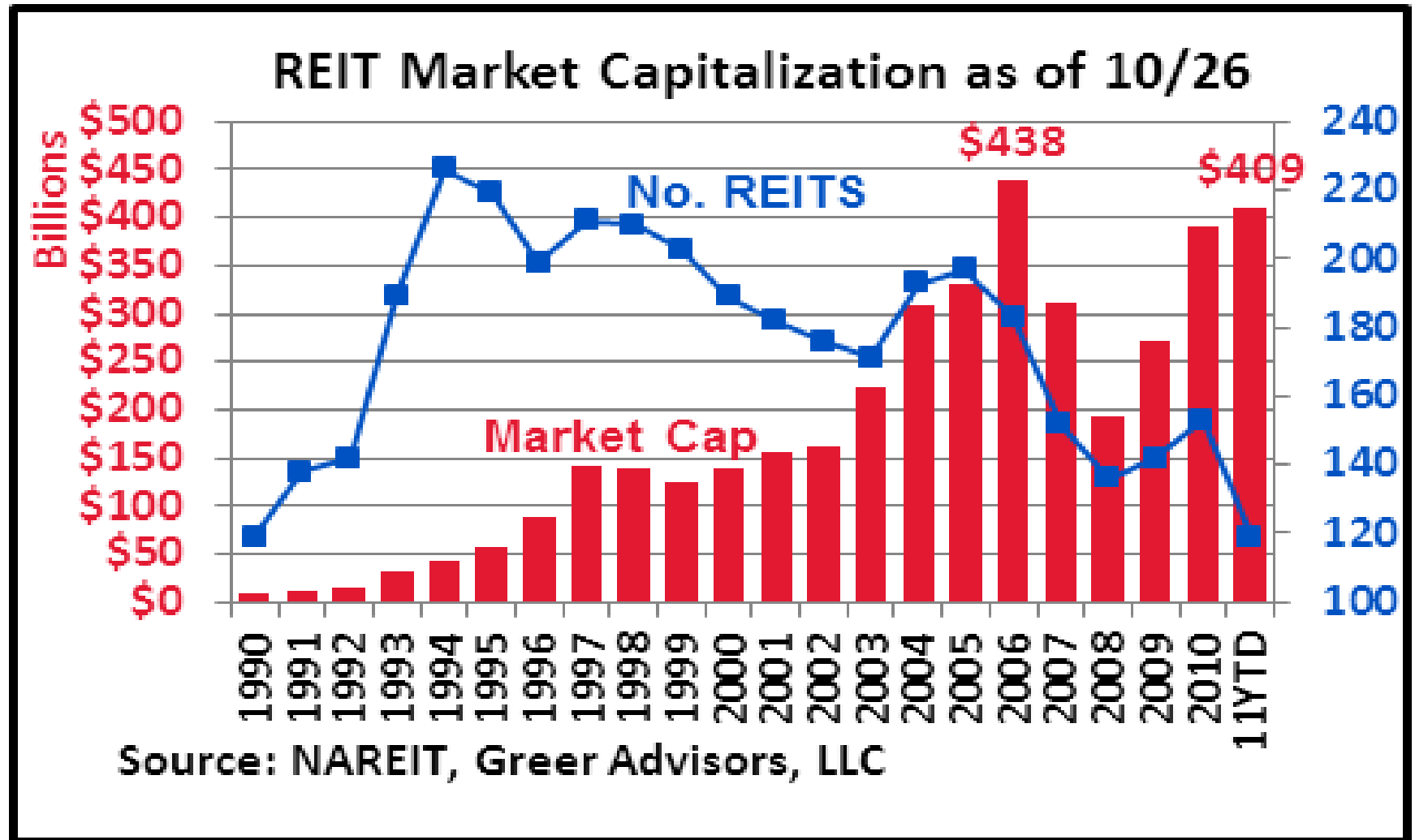
Source: CMAalert 8/10/07, CMAalert-Morgan Stanley 8/8/07, Bank of America - Real Estate Research

15 Note: All Spreads are quoted as "Spreads over Swap Rates"

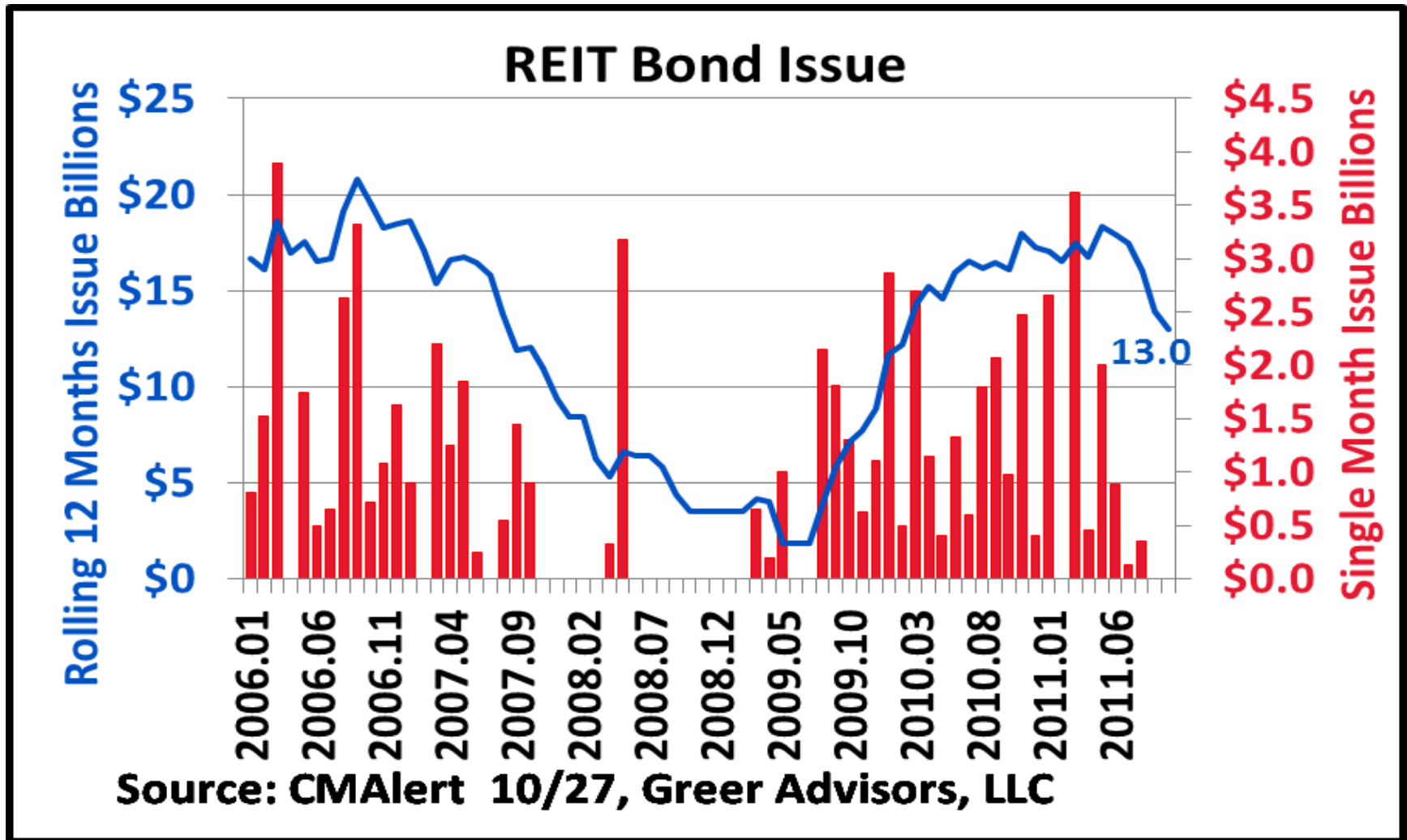
CMBS Issuance



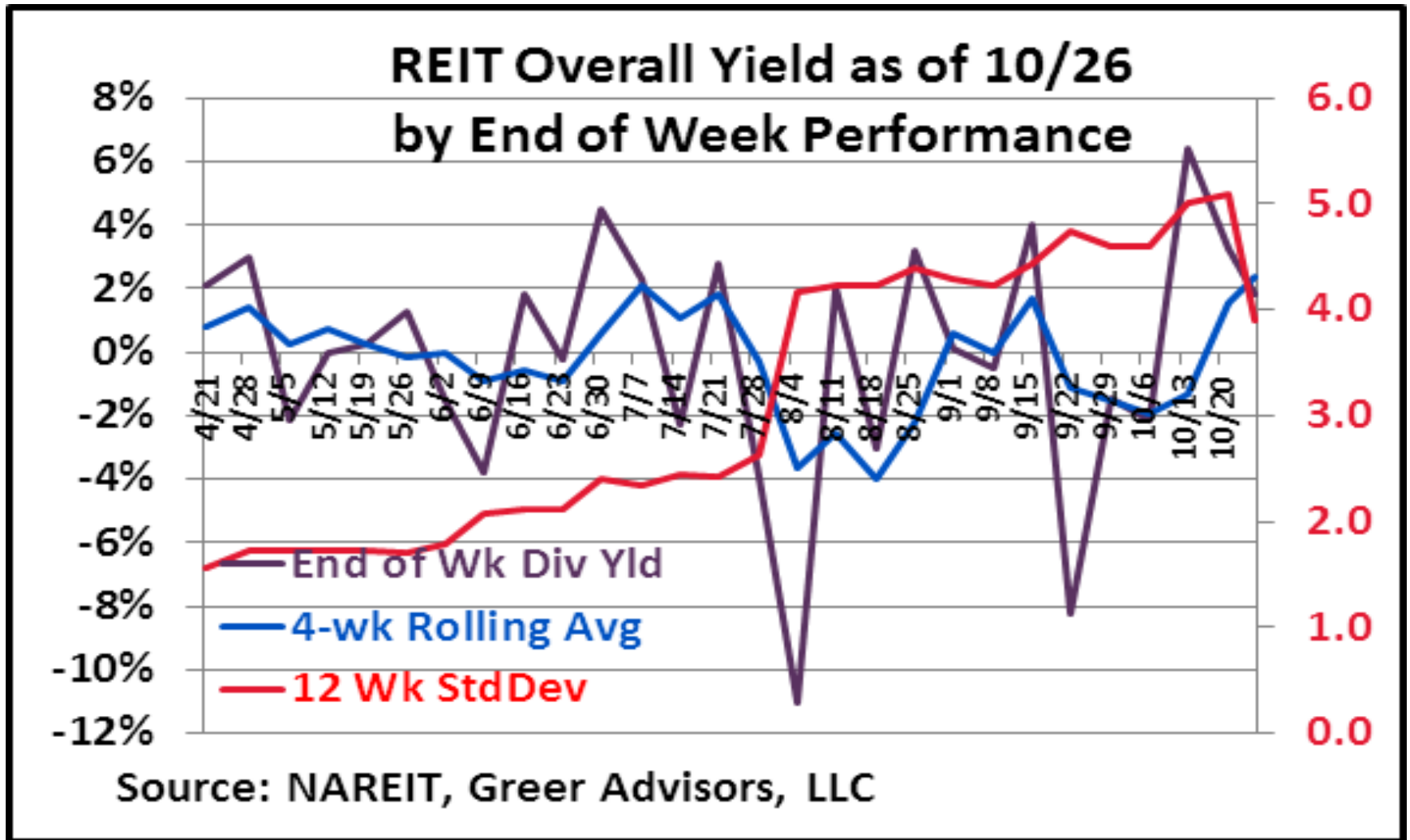
REIT Market Capitalization



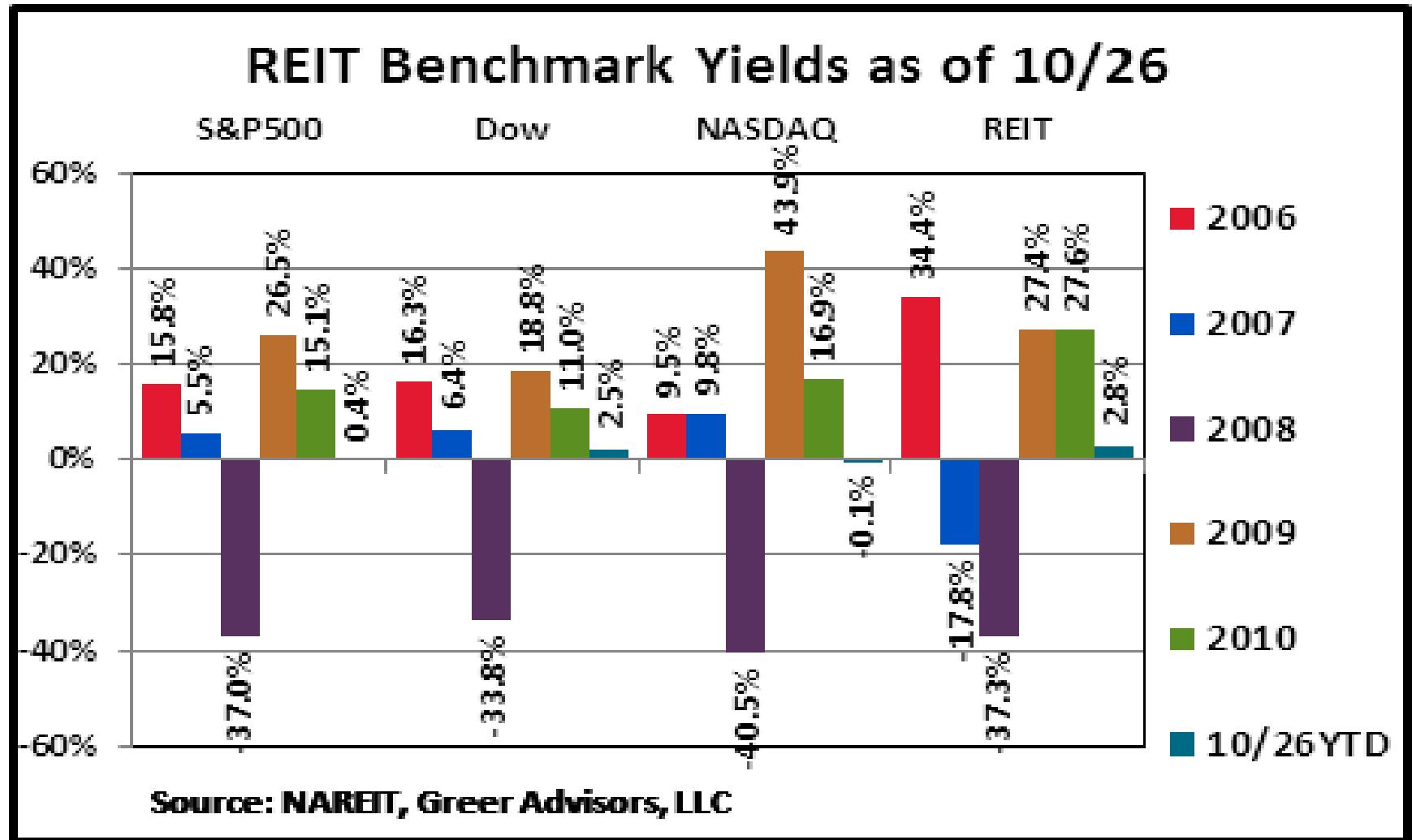
REIT Bond Issuance



REIT Dividend Yield - Volatility



REIT – Benchmark Yield Comparisons



- **Class A versus B/C**

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???

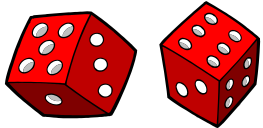
Players in “Simple” CDS

Business Issues Bonds

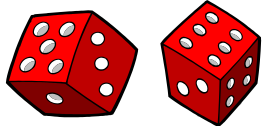


Bonds initially rated too poor for market, eg “BB”

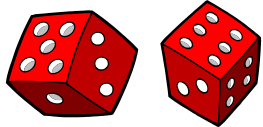
Side Bet 1



Side Bet 2



Side Bet 3

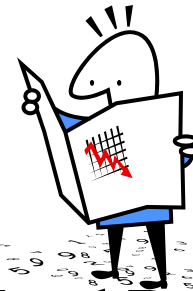


Investment Bank issues CDS (aka Credit Enhances Debt) Enough to make BB = AA, if debtor fails, IB buys bonds

Rating Agency Rates Bonds



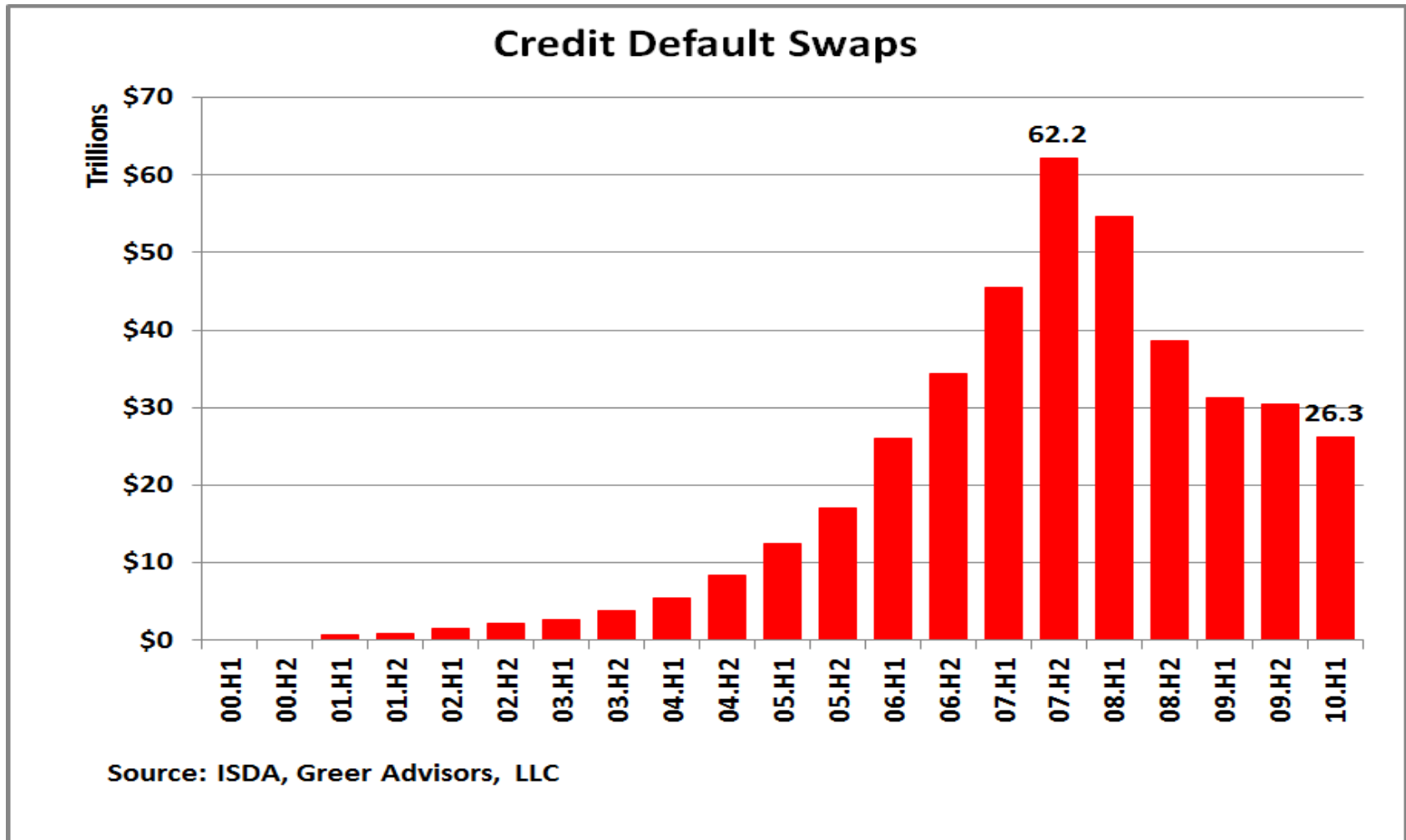
Gives loss forecast & amount required for “AA” rating



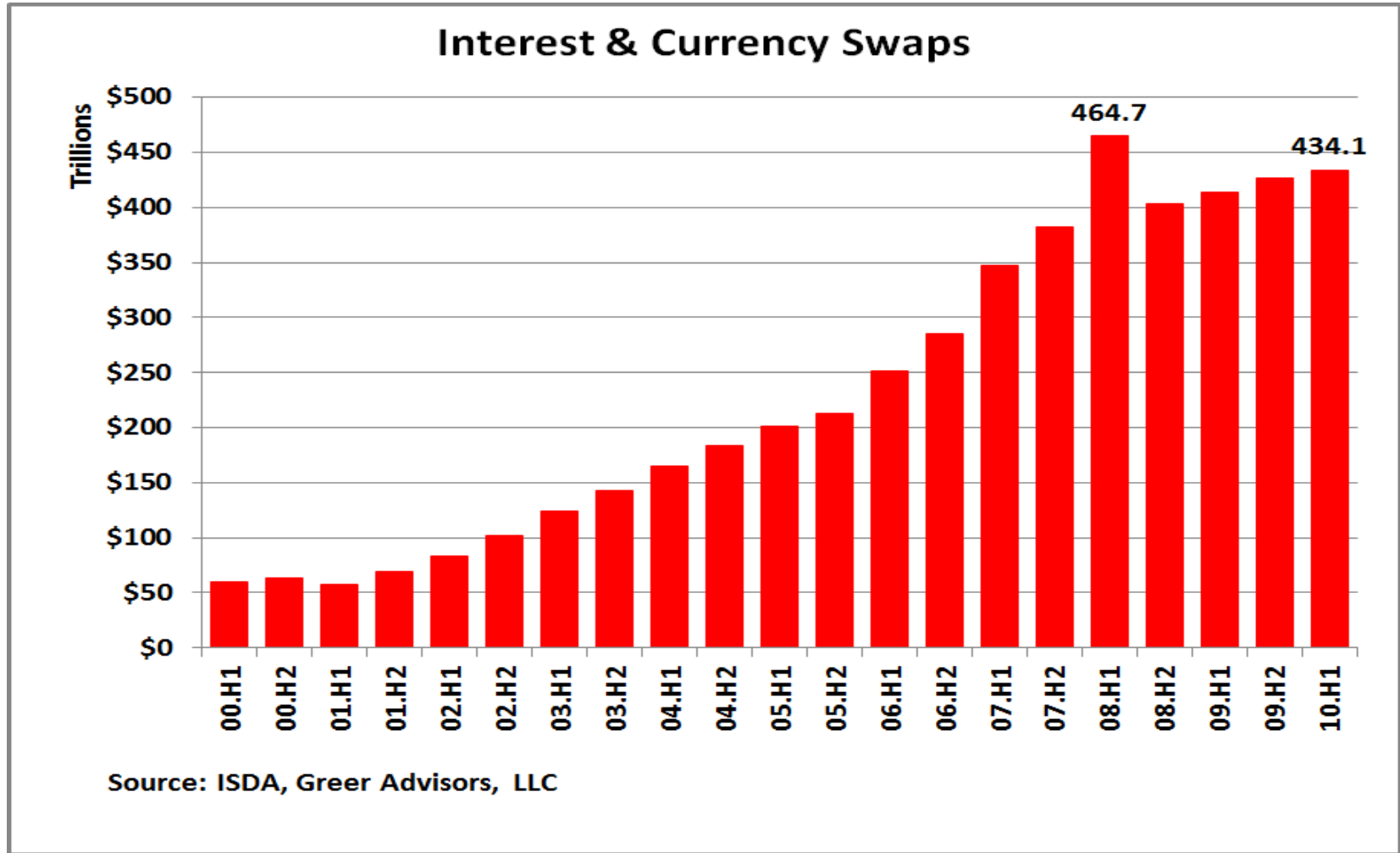
Pension Fund Buys Bonds with CDS enhancement
Thinks it's AA investment

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Credit Default Swaps



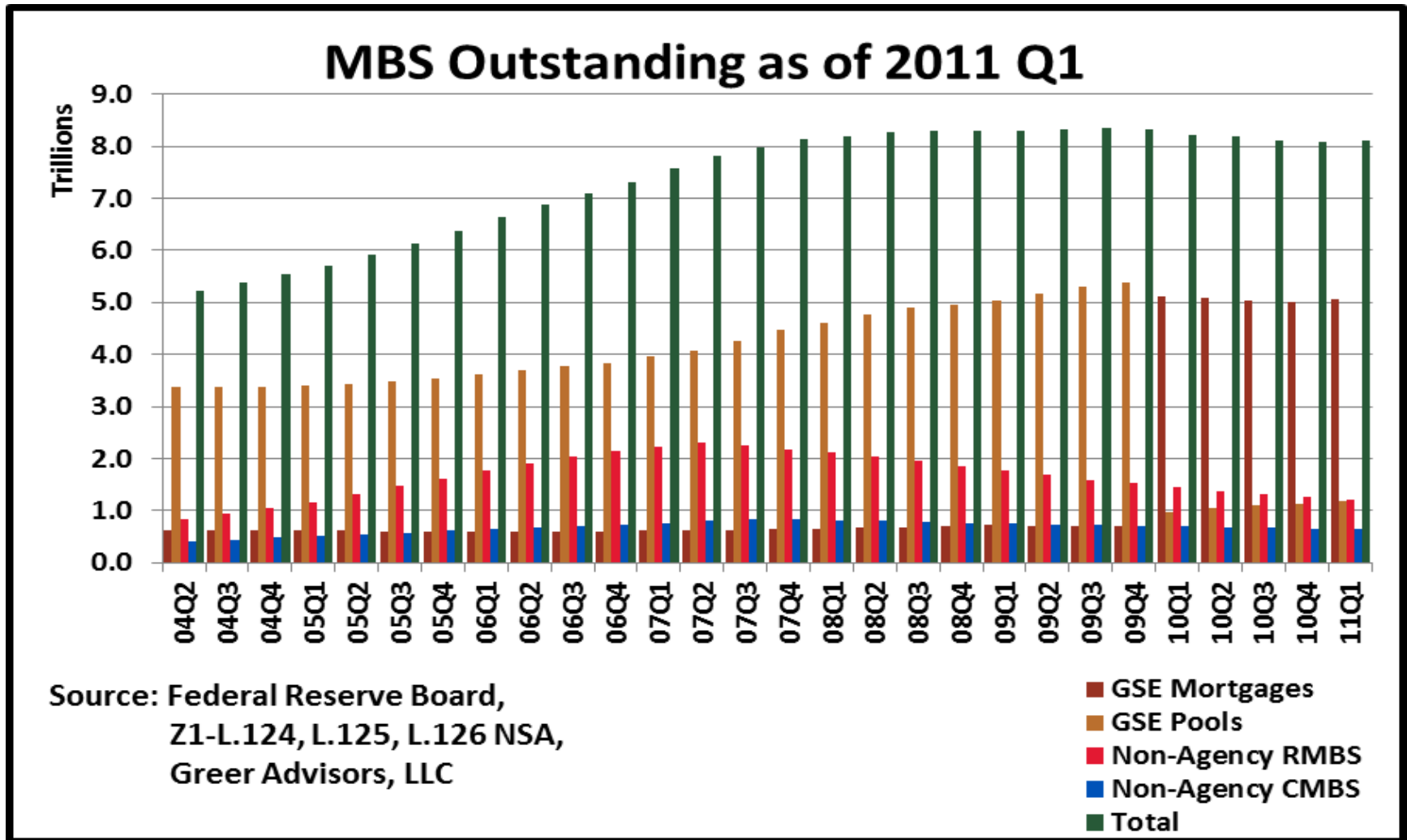
Interest & Currency Swaps



CDx – Yield Spreads

| | |
|---------------------|---------------|
| CDX.NA.HY | 5.255% |
| CDX.NA.IG | 0.885% |
| | |
| | |
| CDX.NA.HY.BB | 4.799% |
| CDX.NA.HY.B | 5.226% |

MBS Outstanding's in U.S. - Dropping



Indicators – Risk Spreads - CMBx

| Greer CMBS / CMBx Yield RateTM | | | | |
|--|--------------|----------------|-----------------------|------------------------------|
| Tranche | Yield | Suboord | Weight of Debt | Contribution to Total |
| AAA | 2.69% | 29.76% | 70.24% | 1.89% |
| AJ | 3.56% | 12.70% | 17.06% | 0.61% |
| AA | 5.18% | 10.63% | 2.07% | 0.11% |
| A | 9.61% | 8.00% | 2.63% | 0.25% |
| BBB | 27.28% | 4.72% | 3.28% | 0.89% |
| BBB- | 28.62% | 3.68% | 1.04% | 0.30% |
| BB | 102.32% | 2.69% | 0.99% | 1.01% |
| Unrated | 176.00% | 0.00% | 2.69% | 4.73% |
| Implied Overall Debt Yield | | | 100.00% | 9.79% |
| Loan to Value Ratio | | | | 75.00% |
| Class-A Equity Yield Total Yield | | | 29.00% | 14.59% |
| Class-B Equity Yield Total Yield | | | 102.00% | 32.84% |

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 10/27. Swap (10Yr) as of 10/26.

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.

■ Indexing Systems

Systems – Understand the Goal

- Caution – Selection Bias
 - Low Level Due Diligence Product, if fails, Higher Level
 - Models, Data, Results – Don't Live in a Vacuum
 - Gaming Systems - Fox and the Hen House
- Origination
 - BE AWARE OF SELECTION BIAS
- Monitoring – Maintain Consistent Application

Tax-Based Index Systems

- Raw Data versus Ratio Studies
- Periodic Index versus “On the Fly” Index
- Indexing Layers
 - Value
 - Location
 - Property Type
 - Anything that is Significant

Portfolio Index Systems

- Old “Dyna / Wells” Concept
- Discounted Cash Flows
 - Update Actual Contracts
 - Index Market Rent
 - Index Vacancy
 - Update Actual Expenses, if Possible
 - Index Expenses if Above Not Possible
 - Index Yield
- Commercial Real Estate (CRE) Market Monitor
- CRE Portfolio Optimizer

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| | | | | | | | |
|--------|----------------------|---------------|----------------------|--------------|----------------------|--------|----------------------|
| Market | <input type="text"/> | Property Tyoe | <input type="text"/> | Year:Quarter | <input type="text"/> | Change | <input type="text"/> |
|--------|----------------------|---------------|----------------------|--------------|----------------------|--------|----------------------|

- CRE Portfolio Optimizer

■ Data Systems

Data

- Loan, Risk & Portfolio Management – All Need Out Data
- Create a Seat at the Table
- Information is Power
- Learn the Language of Risk
- Knowledge is Power
- Own it, Control it, Create the Conclusions
- Multiple Use for Same Data
- Be Creative

Data Requirements for Institutions

- Capture Your Own Data, eg RIMS, Portfolio
- Rents & Vacancies
- Sales
- Expenses
- Capitalization & Yield Rates
- Loan Loss (EDF and LGD)
- Economic, e.g. Employment, Income, Sales
- Demographic, Age, Education, Household Size
- Data Servers, e.g. SQL, MySQL, Access, Excel
- Six Sigma / MS-CSE / MS-DBA

Use Data Reduce Work - Improve Performance

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Appraisal and Review Systems

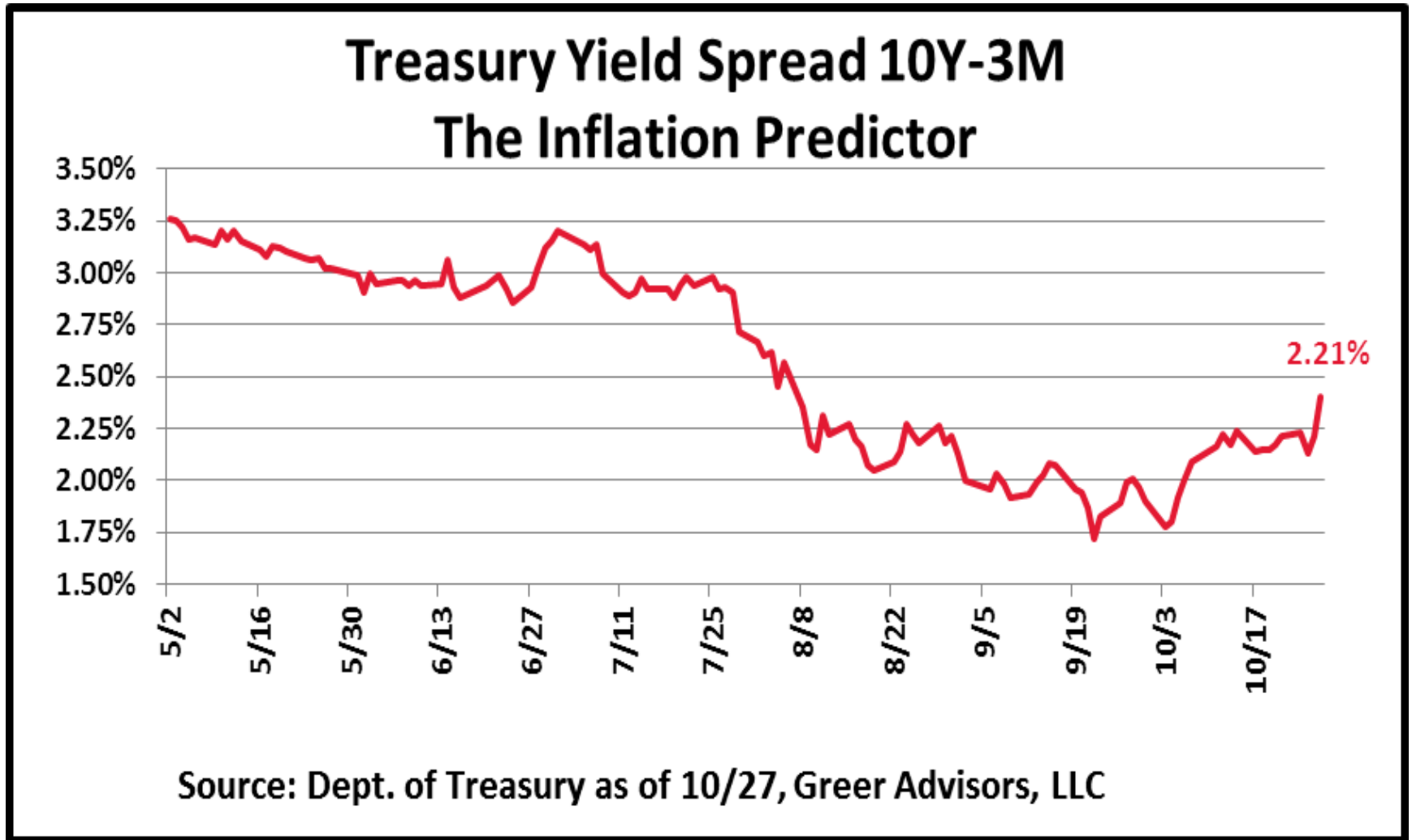
- Work Smarter not Harder
- Capture Data – Use Systems to Analyze and Write
- XML
- Data Stream
- Concatenate
- Realm
- Edge
- Narrative1
- RIMS

■ Current Trends

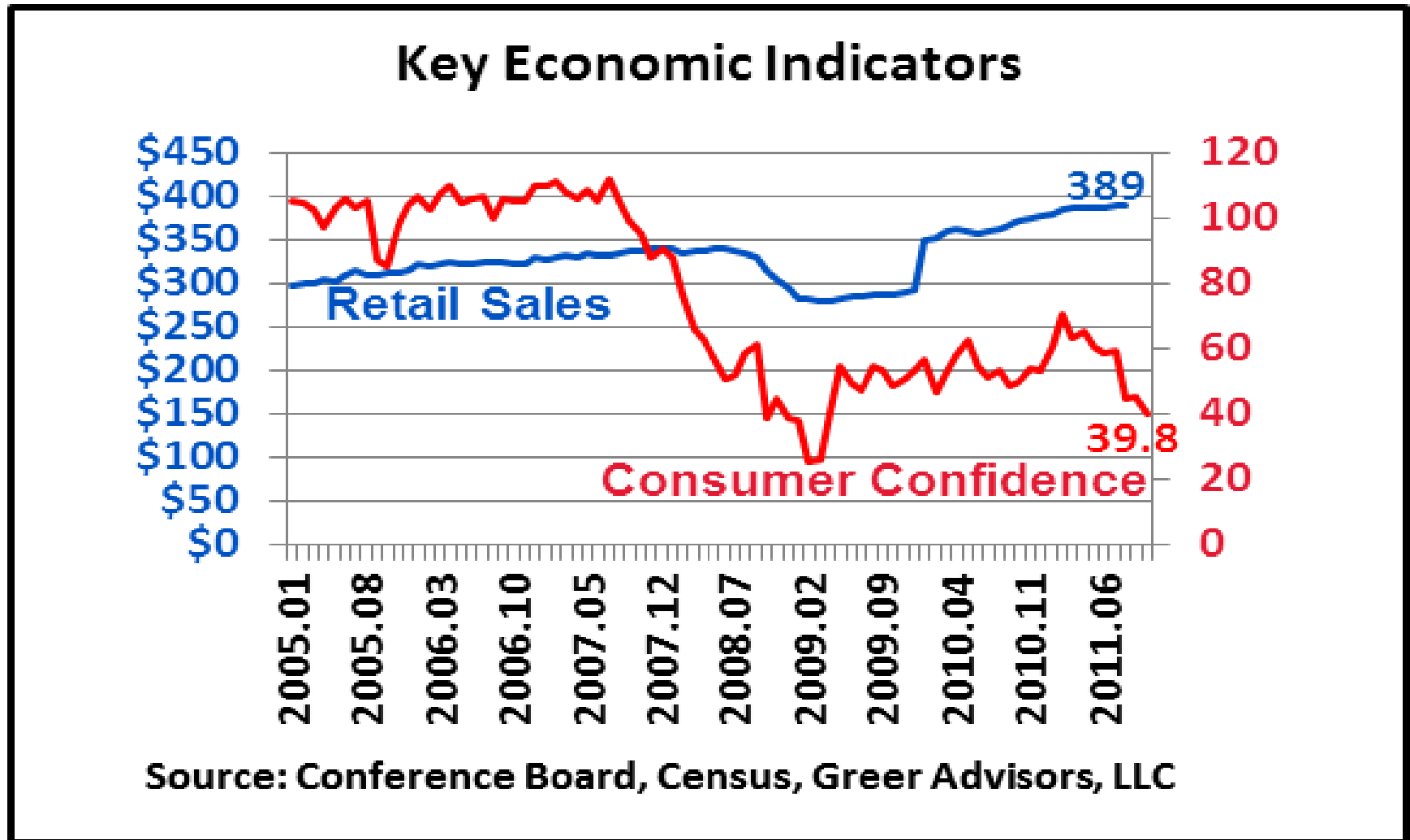
Market Drivers

- Employment
 - Interest Rates
 - Capital Markets, they drive Yields
 - Retail Sales
 - Employment
 - Rents & Vacancies
 - Capitalization & Yield Rates
-
- Many Times it's First Derivative, i.e. the Change, that Matters

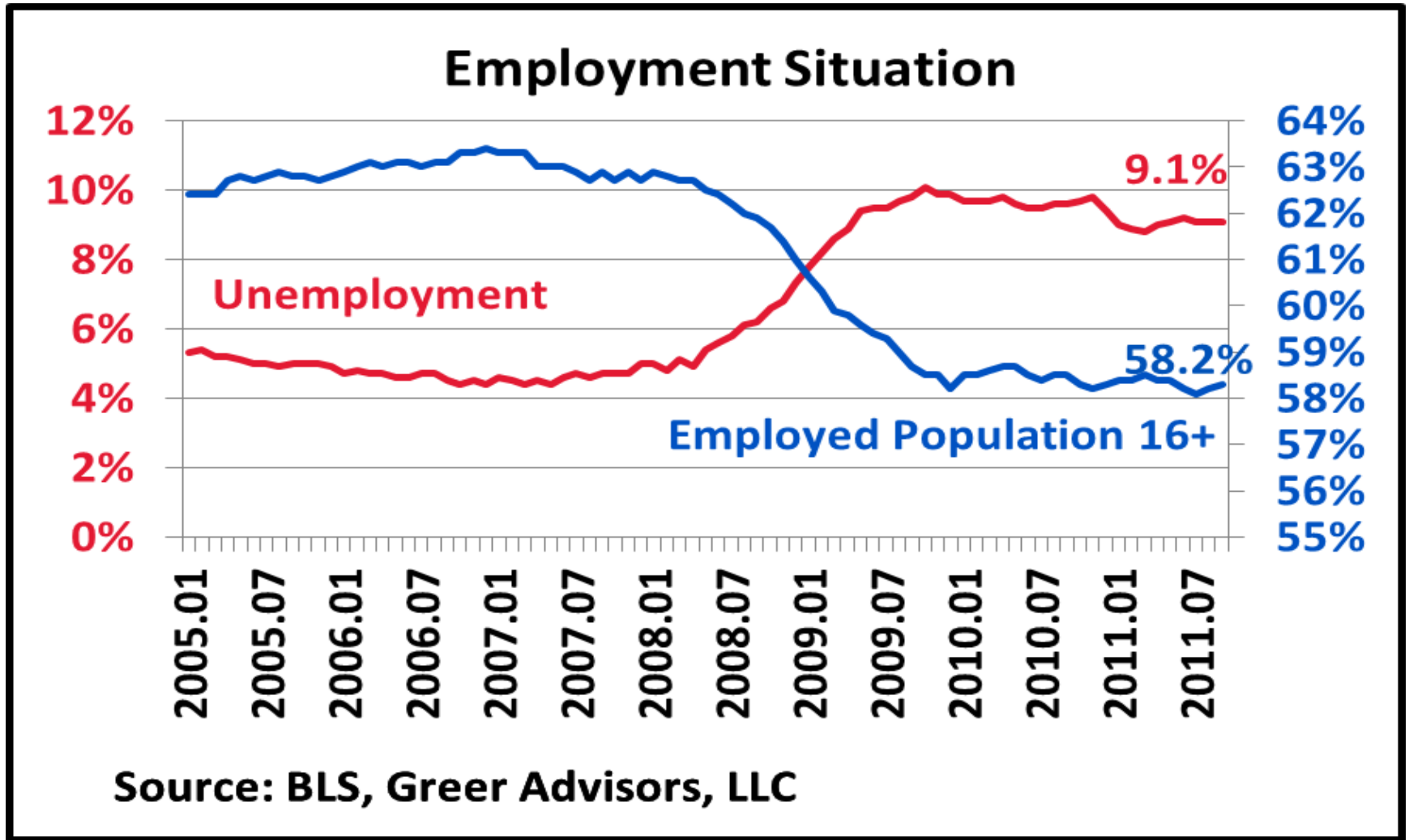
Inflation & Interest



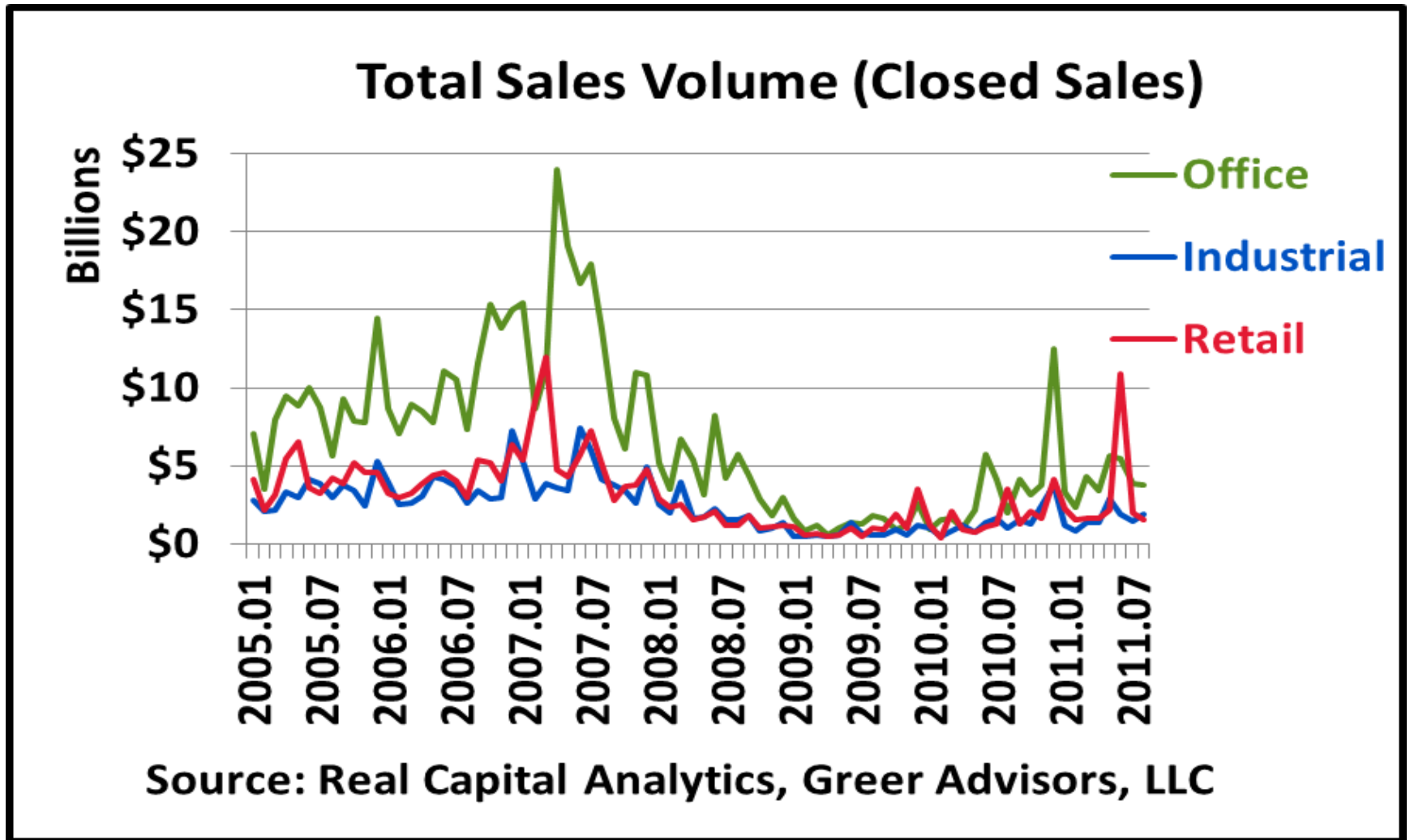
Economy – Consumer Confidence & Sales



Economy – Employment

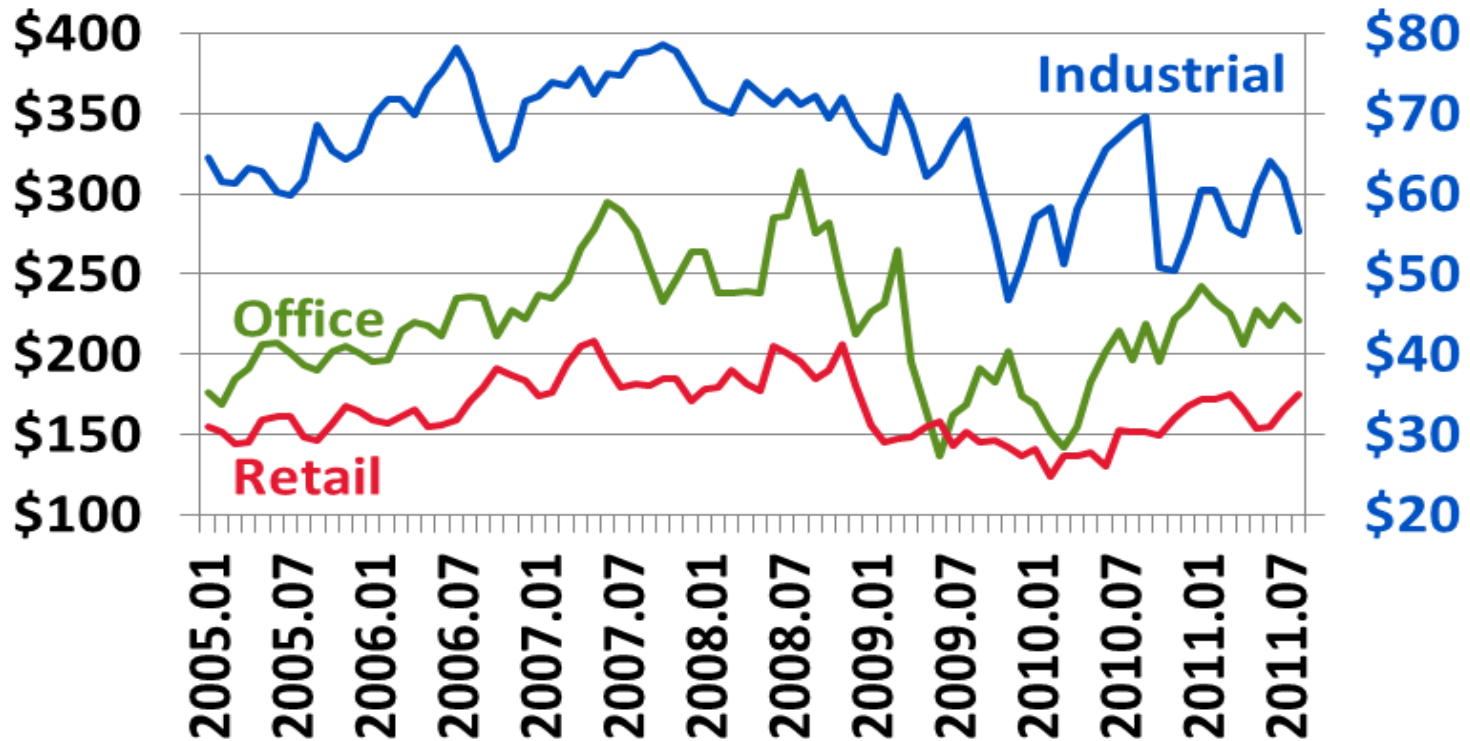


Commercial Real Estate Sales Volume



Commercial Real Estate Prices \$\$ PSF

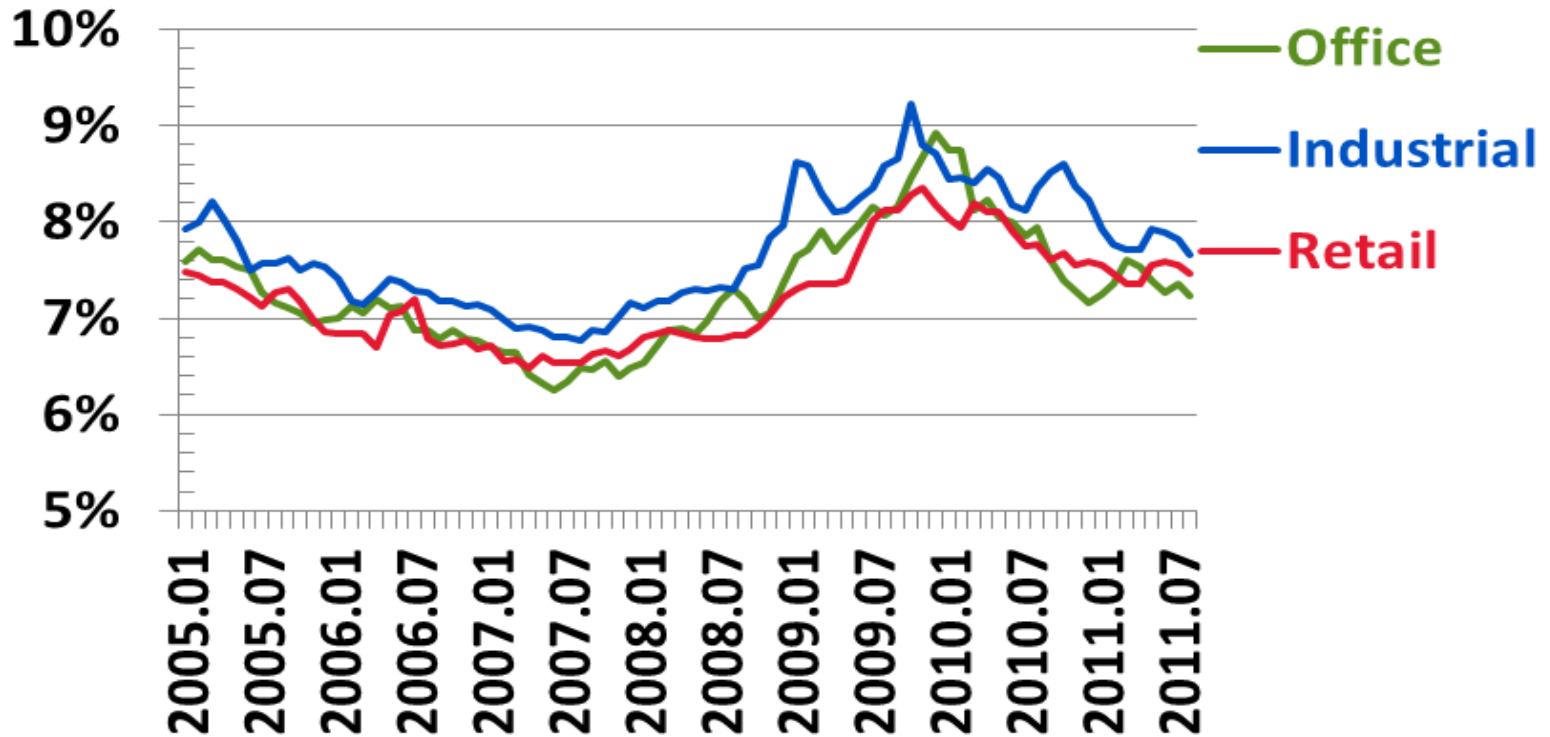
Prices per SF (Closed Sales)



Source: Real Capital Analytics, Greer Advisors, LLC

Commercial Real Estate Cap Rates

Commercial R.E. Cap Rates (Closed Sales)



Source: Real Capital Analytics, Greer Advisors, LLC

Top - Bottom Market Stats – as of 2011 Q2

| INDUSTRIAL - 2011.Q2 | | | | OFFICE - 2011.Q2 | | | | RETAIL - 2011.Q2 | | | |
|---|----------------|-------|-------------|-------------------------|-----------------|-------|-------------|-------------------------|-------------------|-------|-------------|
| Vac | Metro | Vac % | Eff Rent \$ | Vac | Metro | Vac % | Eff Rent \$ | Vac | Metro | Vac % | Eff Rent \$ |
| 1 | Los Angeles | 7.3% | \$6.68 | 1 | Honolulu | 7.9% | \$21.99 | 1 | San Francisco | 3.8% | \$29.71 |
| 2 | Salt Lake City | 8.4% | \$4.86 | 2 | Albany | 8.4% | \$14.94 | 2 | Fairfield County | 4.5% | \$24.99 |
| 3 | San Francisco | 10.1% | \$7.87 | 3 | New York | 8.9% | \$55.26 | 3 | Northern New Jer | 5.8% | \$24.42 |
| 4 | Houston | 10.4% | \$5.59 | 4 | Pittsburgh | 10.6% | \$17.80 | 4 | Long Island | 5.9% | \$22.68 |
| 5 | Orange County | 10.4% | \$8.13 | 5 | Long Island | 11.9% | \$19.88 | 5 | San Jose | 6.1% | \$26.61 |
| 6 | Portland | 10.6% | \$6.19 | 6 | San Francisco | 12.0% | \$22.25 | 6 | Los Angeles | 6.2% | \$25.17 |
| 7 | Kansas City | 10.7% | \$6.49 | 7 | Trenton | 12.5% | \$24.50 | 7 | Oakland-East Bay | 6.4% | \$24.90 |
| 8 | Long Island | 11.2% | \$5.45 | 8 | Oklahoma City | 12.7% | \$14.66 | 8 | Orange County | 6.4% | \$26.58 |
| 9 | Minneapolis | 11.5% | \$4.96 | 9 | Boston | 13.1% | \$27.10 | 9 | Suburban Virginia | 6.4% | \$24.30 |
| 10 | Seattle | 11.6% | \$7.46 | 10 | Louisville | 13.3% | \$14.81 | 10 | Boston | 6.7% | \$19.51 |
| 10 | Seattle | 11.6% | \$7.46 | 23 | Seattle | 15.8% | \$23.54 | 14 | Seattle | 7.5% | \$20.23 |
| 51 | Hartford | 17.2% | \$5.85 | 55 | West Palm Beach | 20.4% | \$20.39 | 71 | Syracuse | 14.5% | \$10.52 |
| 52 | Sacramento | 17.7% | \$4.51 | 56 | Atlanta | 21.1% | \$17.31 | 72 | Colorado Springs | 14.7% | \$11.92 |
| 53 | Phoenix | 18.1% | \$4.67 | 57 | Tampa | 21.1% | \$18.08 | 73 | Cincinnati | 14.9% | \$12.33 |
| 54 | Atlanta | 18.2% | \$3.35 | 58 | Edison | 21.3% | \$17.54 | 74 | Dallas | 15.0% | \$14.07 |
| 55 | Boston | 18.6% | \$5.71 | 59 | Dallas | 22.1% | \$17.43 | 75 | Cleveland | 15.1% | \$12.75 |
| 56 | Stamford | 18.6% | \$5.91 | 60 | Riverside | 22.5% | \$18.39 | 76 | Indianapolis | 15.3% | \$12.39 |
| 57 | Detroit | 19.1% | \$3.14 | 61 | Sacramento | 23.0% | \$18.13 | 77 | Tulsa | 15.5% | \$9.74 |
| 58 | Memphis | 19.5% | \$2.32 | 62 | Phoenix | 25.4% | \$18.07 | 78 | Birmingham | 15.9% | \$12.19 |
| 59 | Trenton | 21.6% | \$3.92 | 63 | Detroit | 25.5% | \$14.34 | 79 | Columbus | 16.1% | \$10.69 |
| 60 | Ann Arbor | 23.4% | \$6.63 | 64 | Las Vegas | 25.6% | \$20.85 | 80 | Dayton | 17.1% | \$8.82 |
| National Average | | 14.4% | \$5.08 | National Average | | 16.8% | \$20.20 | National Average | | 11.1% | \$15.82 |
| Min | | 7.3% | \$2.77 | Min | | 7.9% | \$14.34 | Min | | 3.8% | \$8.82 |
| Max | | 23.4% | \$8.13 | Max | | 25.6% | \$55.26 | Max | | 17.1% | \$31.80 |
| Spread | | 16.1% | \$5.36 | Spread | | 17.7% | \$40.92 | Spread | | 13.3% | \$22.98 |
| Source: CBRE Economic Advisors, Greer Advisors, LLC | | | | | | | | | | | |
| Source: REIS, Greer Advisors, LLC | | | | | | | | | | | |

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

Greer Advisors, LLC

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



Questions / Answers

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