

Mouse over for Annotation

The Capital Market/Spatial Market Divide

Presentation to
NAIOP 2008 Forum

by
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October 21, 2008

Presentation Overview

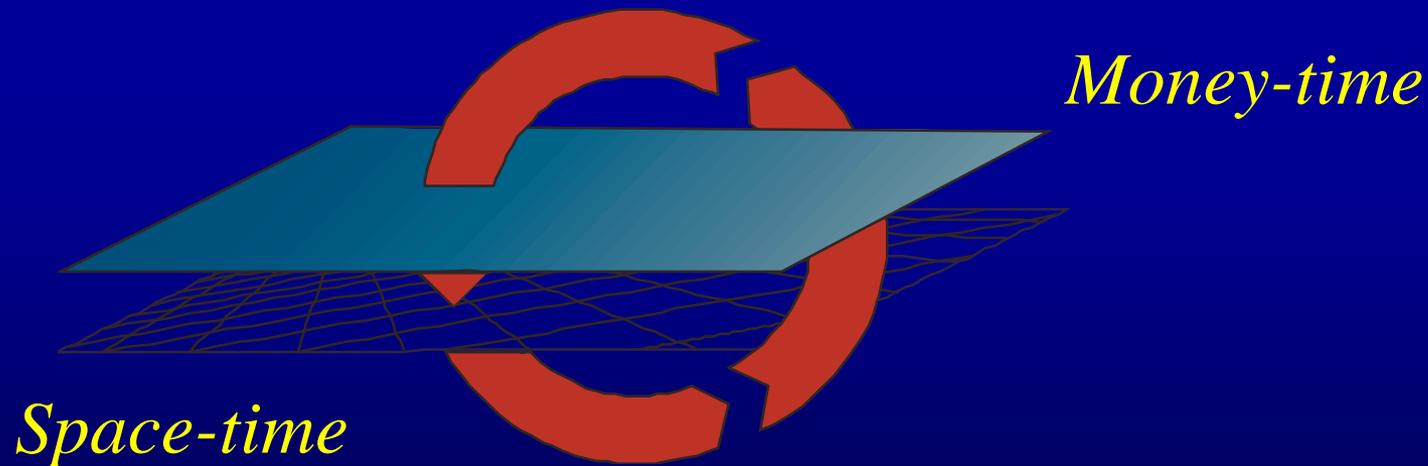
- Introduction
 - Part I: Macroeconomic Conditions
 - Part II: Capital Markets
 - Part III: Real Estate Fundamentals
- Challenges, Issues and Opportunities

The Definition of Real Estate

What is Real Estate?

Artificially delineated space over time with a fixed reference point to the earth.....

Dr. James A. Graaskamp





Mouse over for Annotation

Three Major Attributes of Real Estate

Three major attributes of real estate . . .

- *L*,
- *L*,
- *L*.

Political Preferences and Prognastication

- Which ticket do you personally prefer?

Barack Obama/Joe Biden		12	21%
John McCain/Sarah Palin		36	64%
Other, please specify View Responses		8	
Total		56	

#	Response
1	Undecided
2	Undecided
3	Independent
4	undecided
5	Undecided
6	Undecided...choosing death by drowning or by fire
7	None
8	Neither

- Which ticket will win?

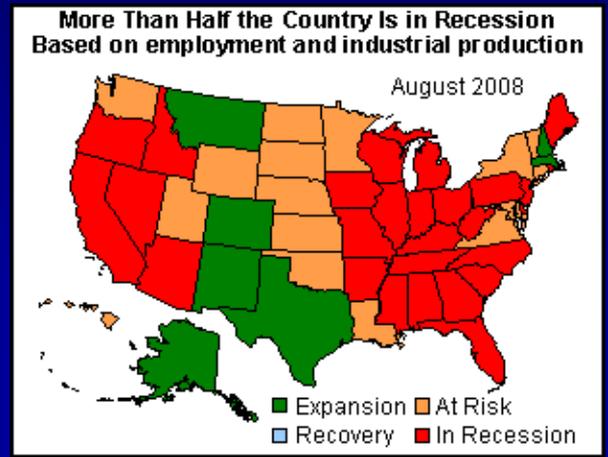
Barack Obama/Joe Biden		53	88%
John McCain/Sarah Palin		7	12%
Other, please specify		0	0%
Total		60	100%

Part I: Economic Growth & Recession?

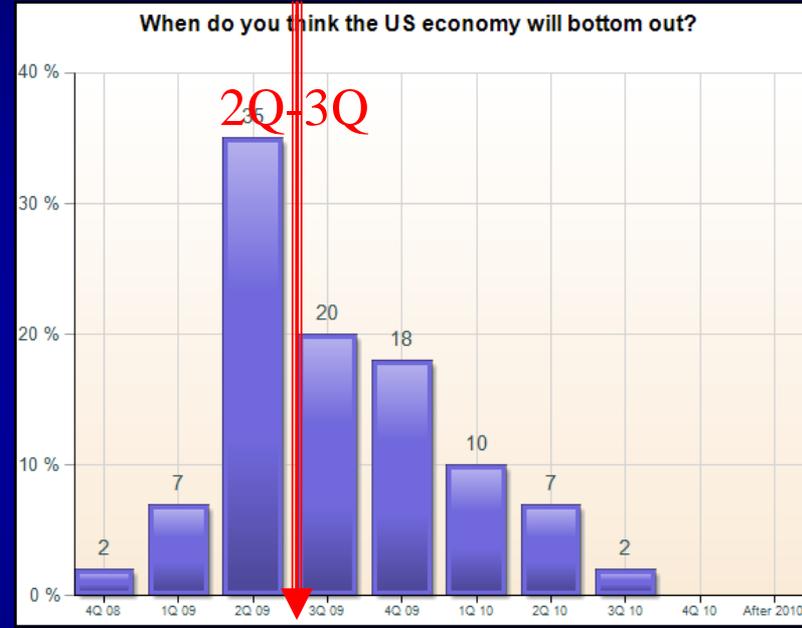
GDP was up 3.5% in 2nd Q, but...

How long?

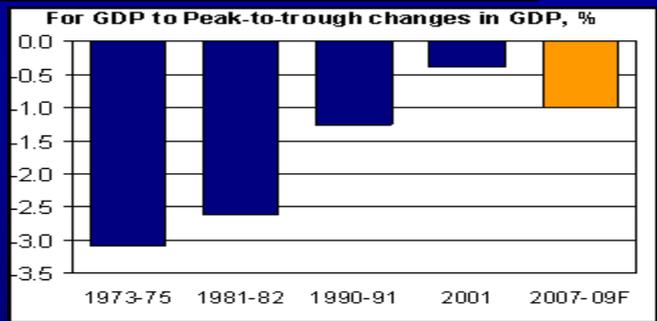
NAIOP Forum



Where?



How bad?



Source: Moody's Economy.com

Heading into major recession?

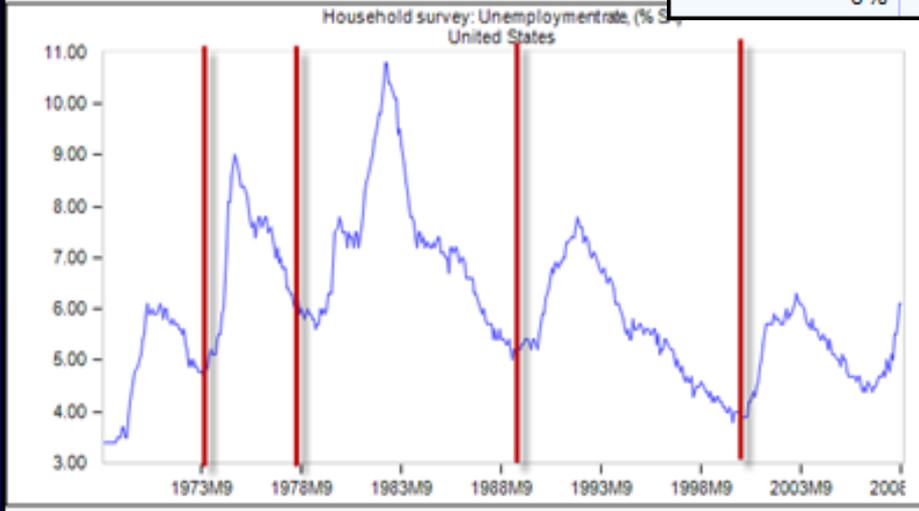
Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
14 23%	33 55%	11 18%	2 3%	0 0%

Unemployment Rates

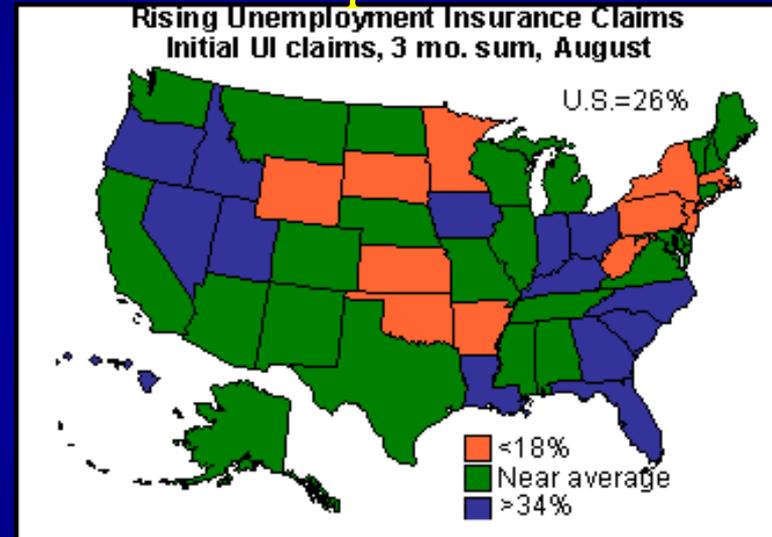
Employment to improve early '09?

Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
0 0%	2 3%	2 3%	42 70%	14 23%

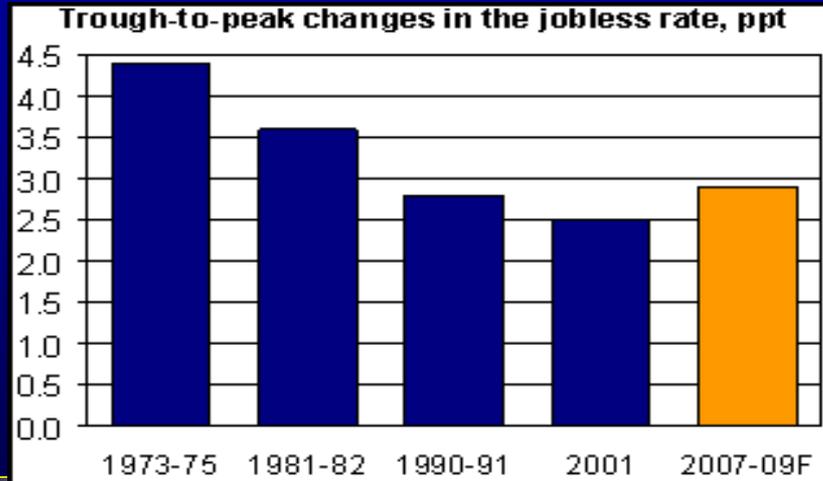
Unemployment



How Widespread?



How Bad?



Who's Next?

- State & Local Government
- Technology, retail
- University Professors???

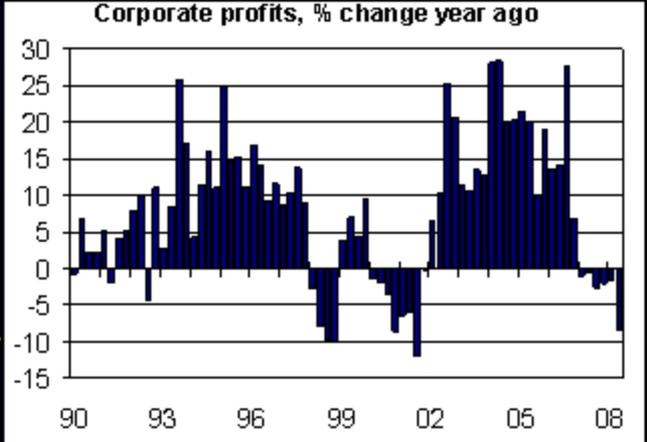
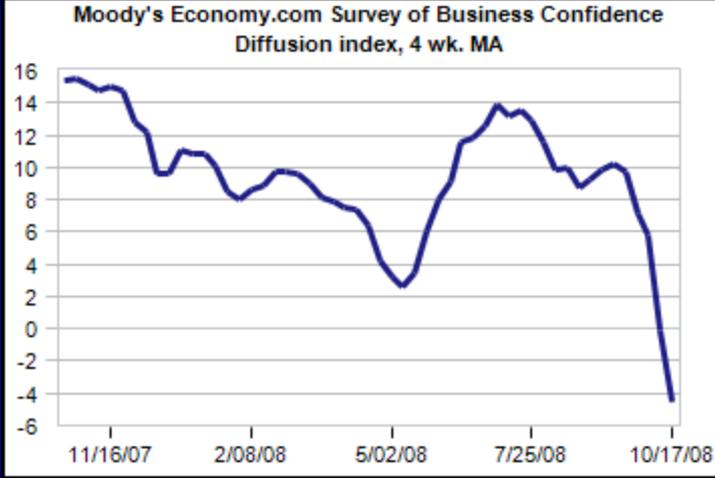
← Mouse over for Annotation

Business Indicators & Business Confidence

Corp Balance Sheets OK?
Exports will propel economy

Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
5%	72%	12%	12%	0%
0%	18%	33%	43%	5%

Inventories/Shipments



Business Confidence

Corp Profits

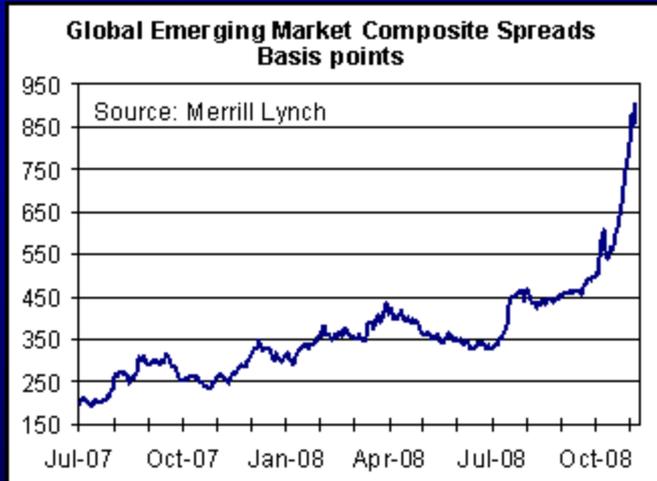
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Global Contagion: Diffusion of Credit Innovation

Most Affected Regions



BBC News 10/19



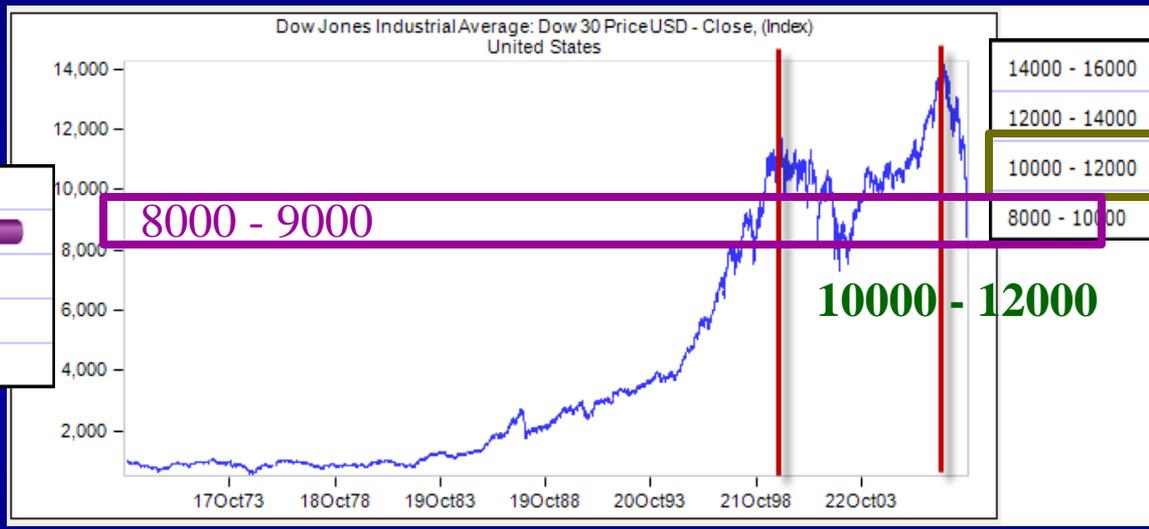
Emerging Markets

- **Netherlands** to inject €10 billion (\$13.4 billion) into ING Groep NV
- **Germany** worked out details of a €500 billion rescue package
- **Sweden's** financial stability plan, includes \$206 b bank guarantee
- **South Korea's** \$130 b guarantee and \$30 b infusion Korean banking
- **Iceland's** banking system essentially collapsed in the past month
- **China's** economic growth slowed more sharply than expected
- **Russia's** financial markets face rising interest rates and a liquidity shortage.
- **Japanese** economic stimulus package worth \$107 b.

Stock Market: Now and Then

NAIOP on Where in 2 years?

NAIOP on Where bottom?



9000 - 10000	█
8000 - 9000	██████████
7000 - 8000	████████
6000 - 7000	██████
5000 - 6000	██

14000 - 16000	█
12000 - 14000	██████
10000 - 12000	██████████
8000 - 10000	██████

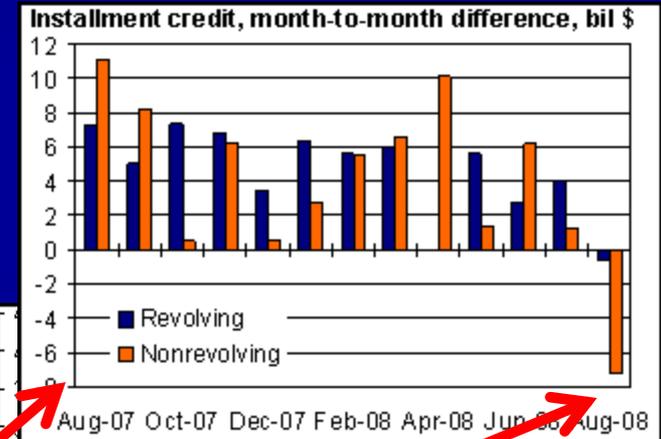
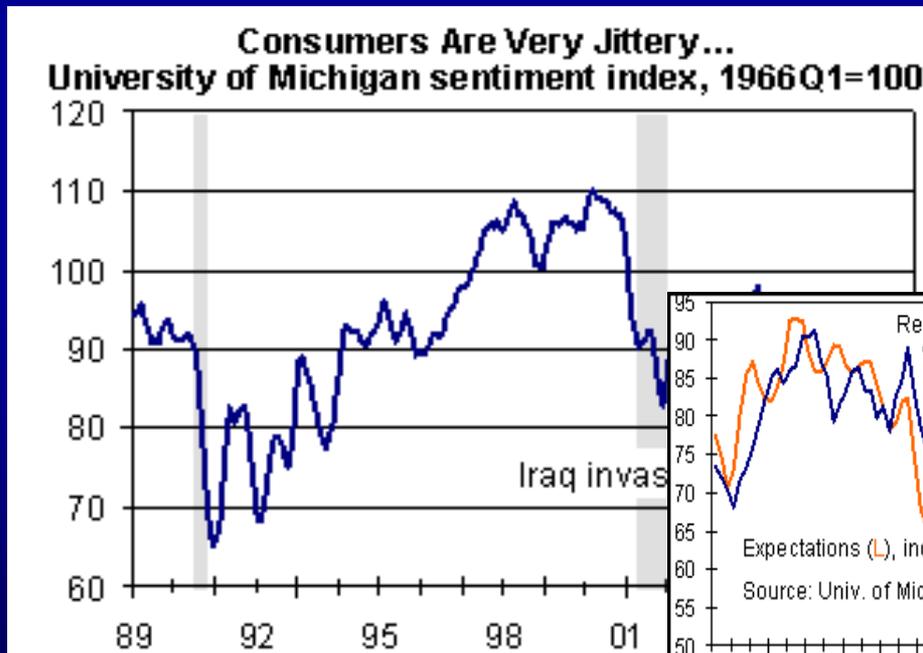
Post election pro-business incentives

Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
0 0%	16 27%	9 15%	19 32%	16 25%

Consumer Confidence, Spending & Credit

Consumers Contracting dramatically

Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
17 28%	32 53%	5 8%	4 7%	2 3%

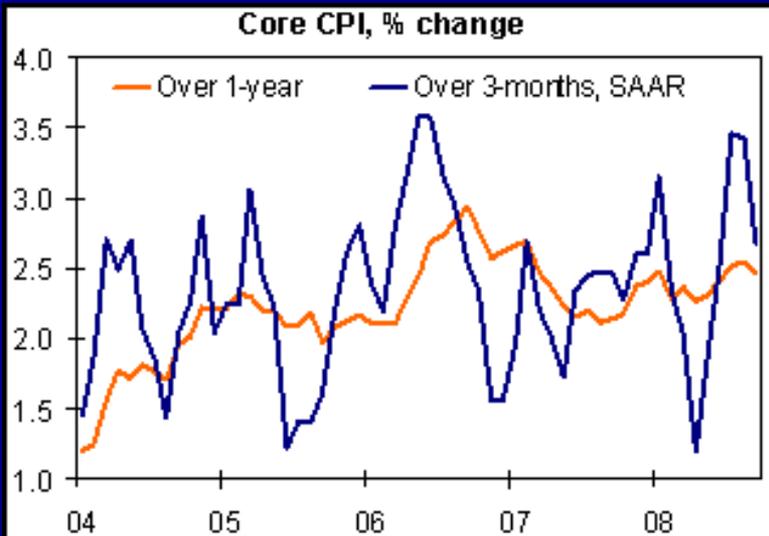


Inflation Trends

Inflation not major concern

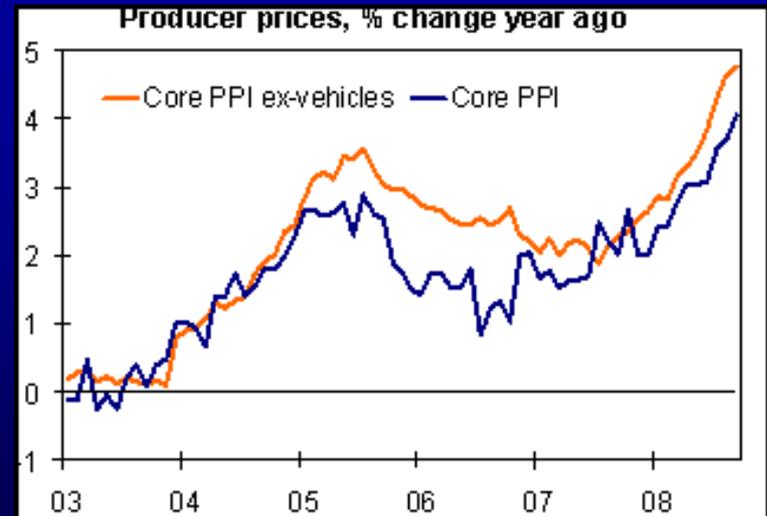
Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
7 12%	31 52%	6 10%	15 25%	1 2%

Core CPI



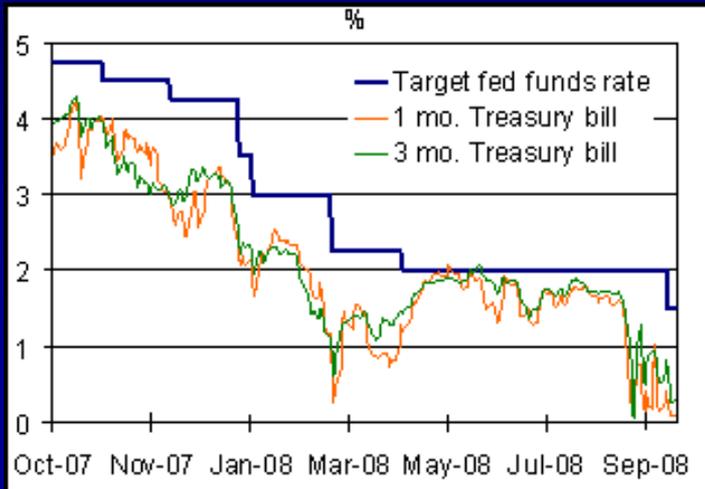
Decline due to Apparel & Auto Reductions

Producer Prices

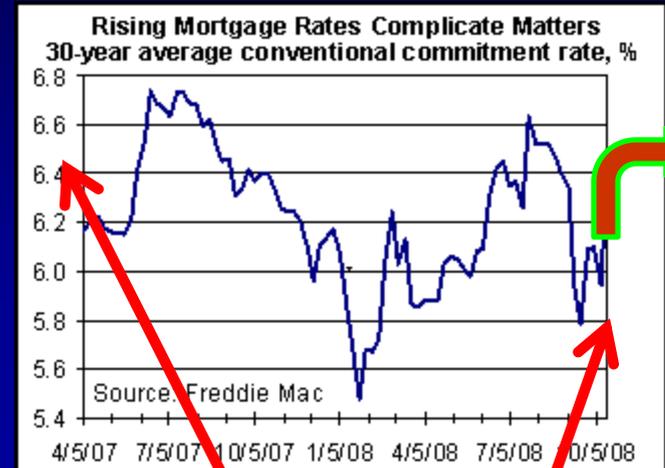


Interest Rates, Mortgage Rates & Spreads

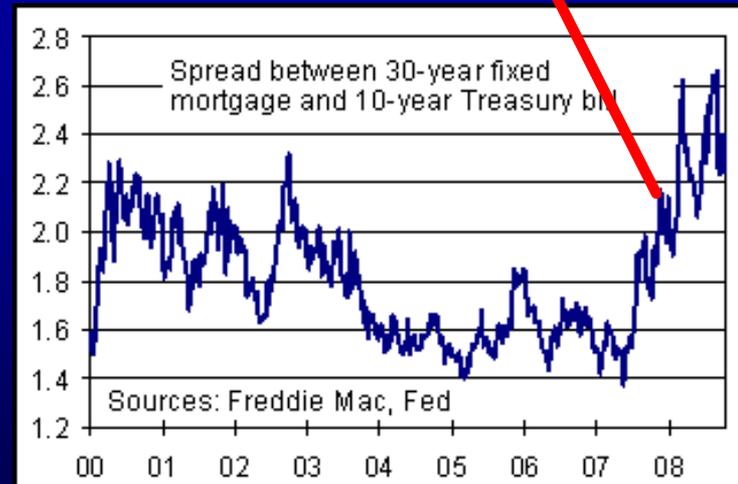
Fed Funds Rate



Mortgage Rates



Mortgage Spreads

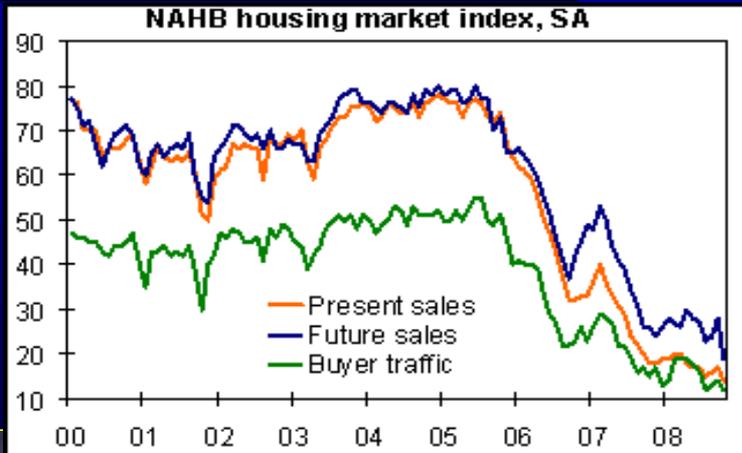
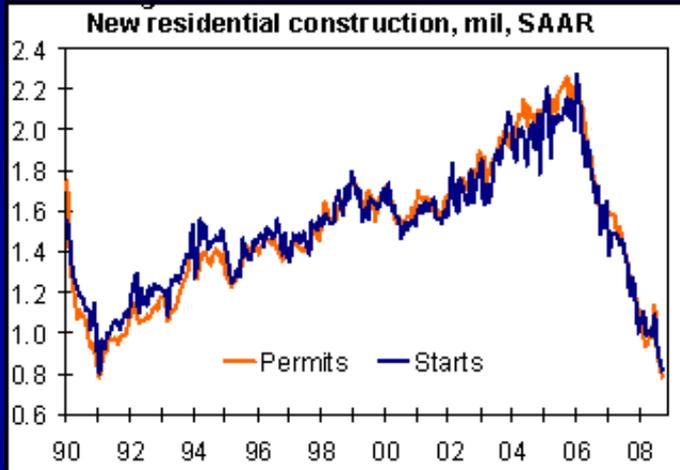


Housing Activity and Delinquency Rates

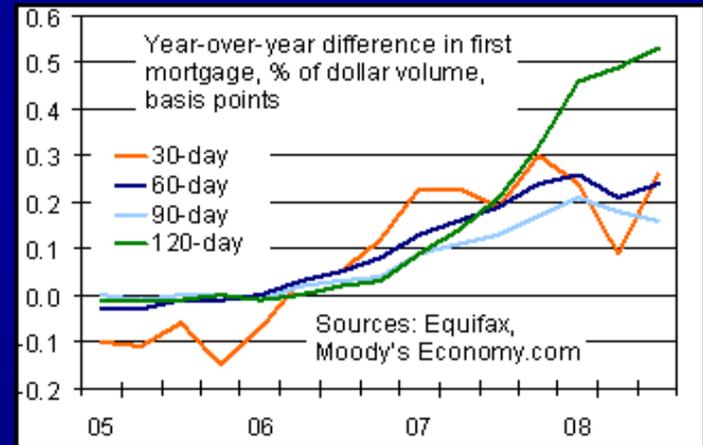
In 6 mo, housing crisis behind us

Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
1 2%	2 3%	4 7%	37 62%	16 27%

Construction



Delinquency & Default



Housing Index

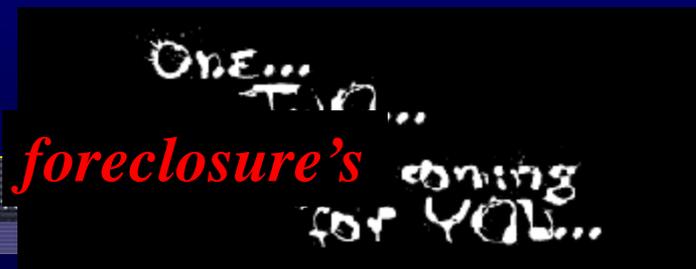
The American Dream or ...

A NIGHTMARE ON **ARM** STREET



My lender, my friend

My Freddie



Government Intervention: Credit & Housing

- Troubled Asset Relief Program (TARP)
 - Objectives
 - Stabilize financial institutions & provide liquidity
 - Restore business and consumer confidence
 - \$700 billion Bailout (?) Budget
 - \$250 b to take equity-like positions in financial institutions
 - Purchase commercial paper
- FDIC
 - Insurance \$250,000 for interest deposits
 - Unlimited for non-interest deposits (i.e., business working capital)
- Federal Housing Finance Agency (FHFA)
 - Placed Fannie Mae & Freddie Mac in conservatorship
 - Spending \$200 b buying troubled mortgages,
 - Encouraging workouts to reduce foreclosures

Economic Environment: Snapshot

Macroeconomic Environment

- Economy in recession; painful and long
- Businesses struggling, stocks volatile
- Consumers bearish

Part II: Capital Markets & Submerging Trends

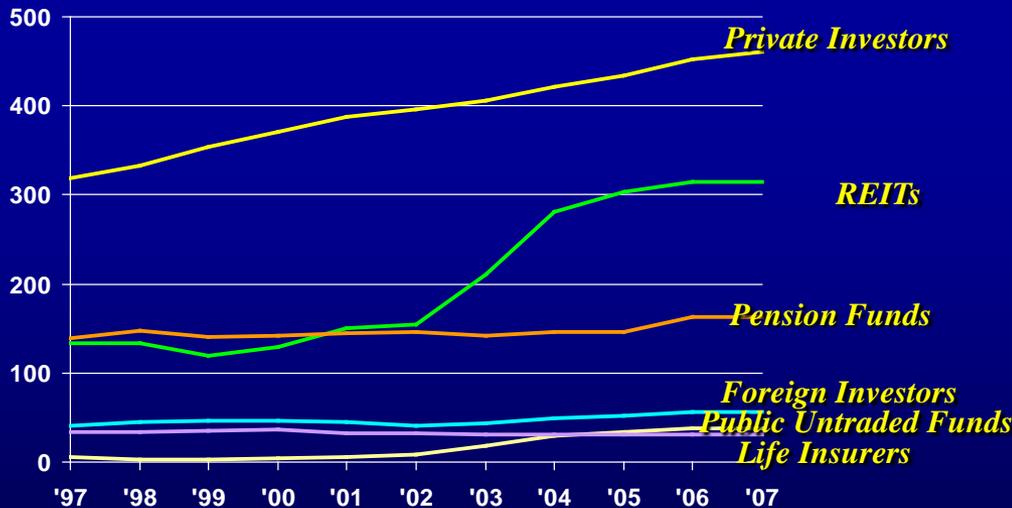


The Perfect Storm

- Credit
- Confidence
- Consumers

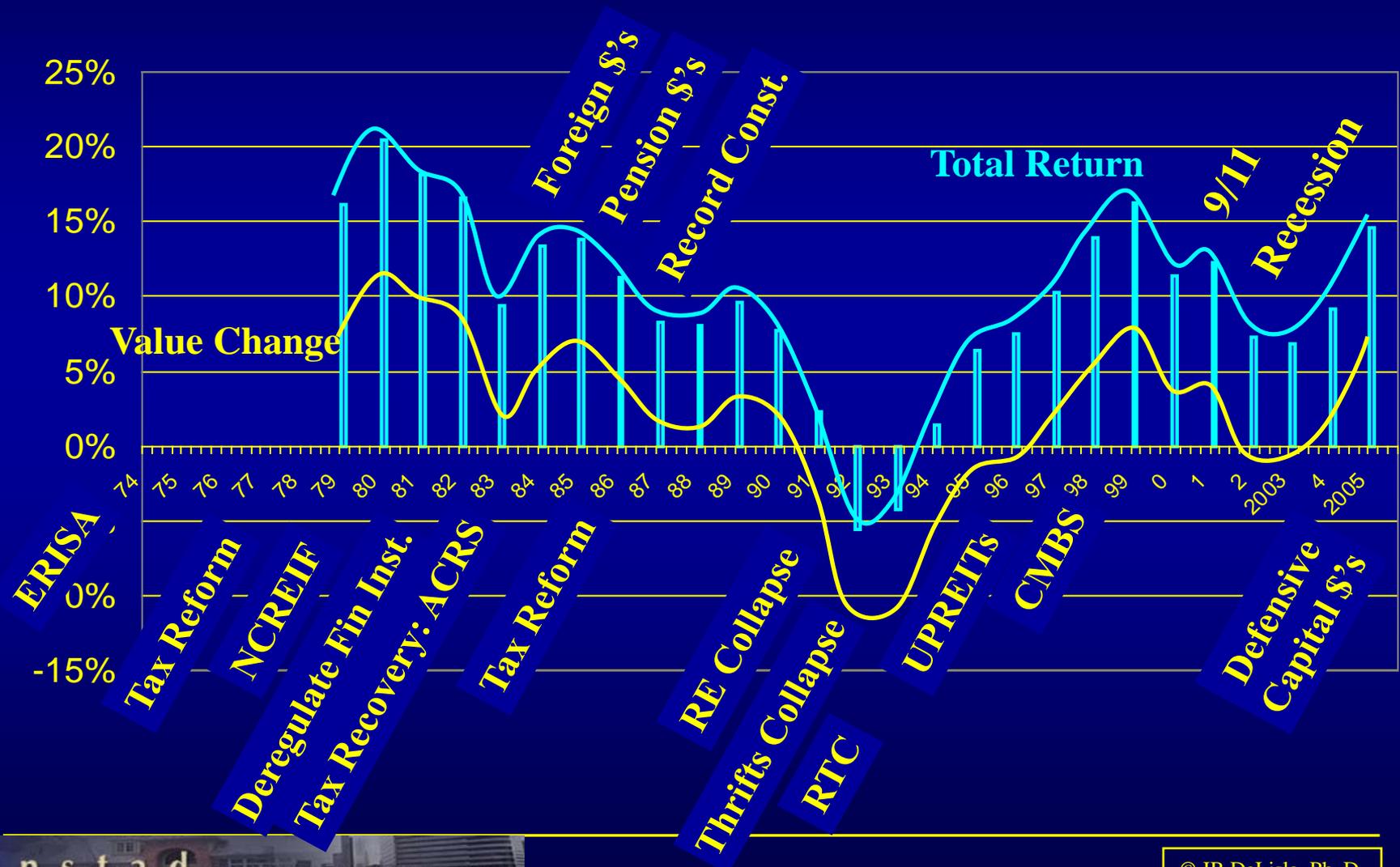


Institutional Capital Flows

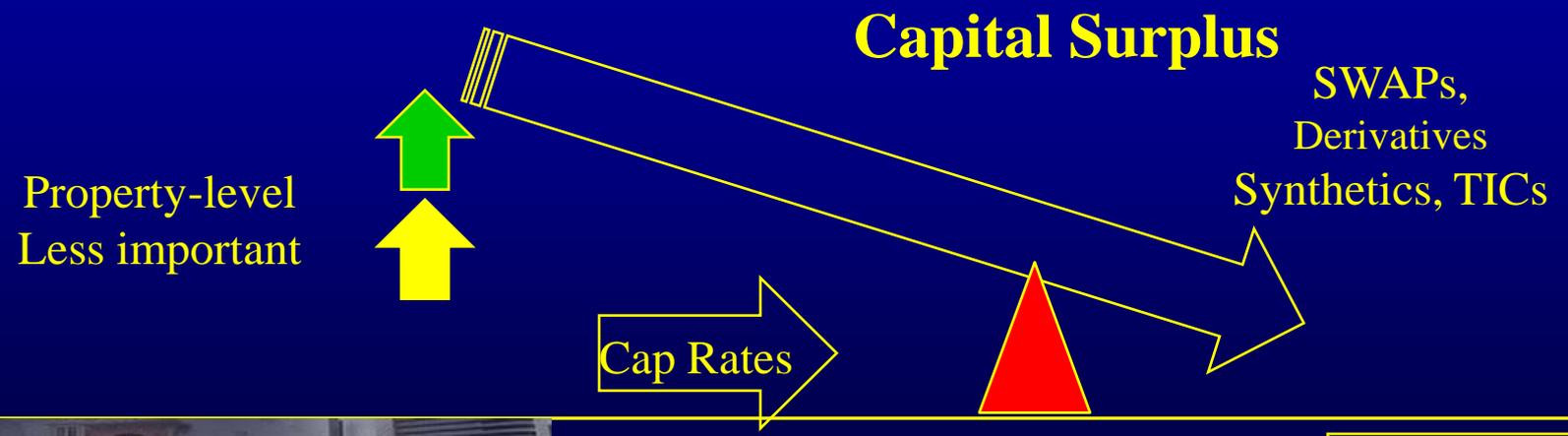
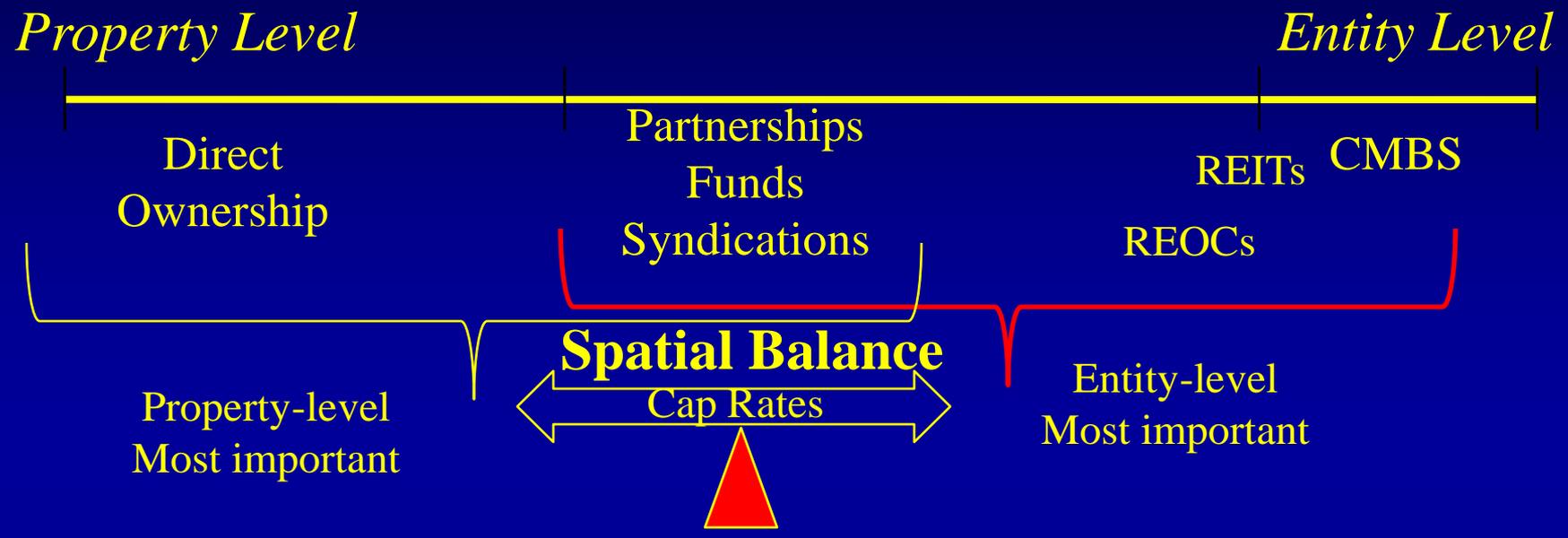


Source: 2008 Emerging Trends

Institutional RE Investment: An Historical Look



Valuation: Spatial Balance, Capital Surplus



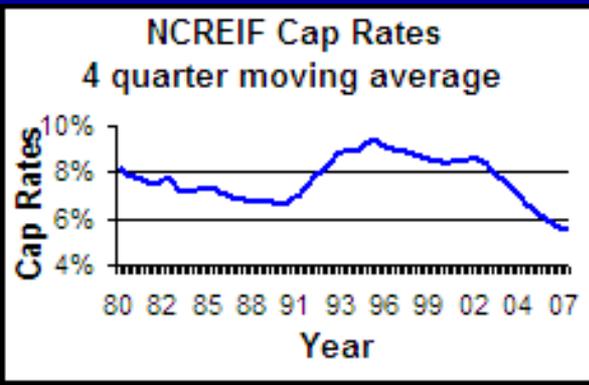
Commercial Leverage Issues

- **Leverage Issues; Project Risk**
 - DCRs: lowered; escrow subsidized; eased via bullets: 3, 5, 10 yrs
 - LVs
 - Record values/low Cap Rates;
 - Some 100% financing; financial engineering, mezzanine debt
- **Leverage Spread: Borrower Risk**
 - Easy credit & relaxed underwriting standards
 - Non-recourse debt
 - Unqualified or unregulated Investors: (TICs)
- **Outlook for Commercial Debt**
 - Limited supply; flight to quality
 - Tighter; increased equity requirements and recourse

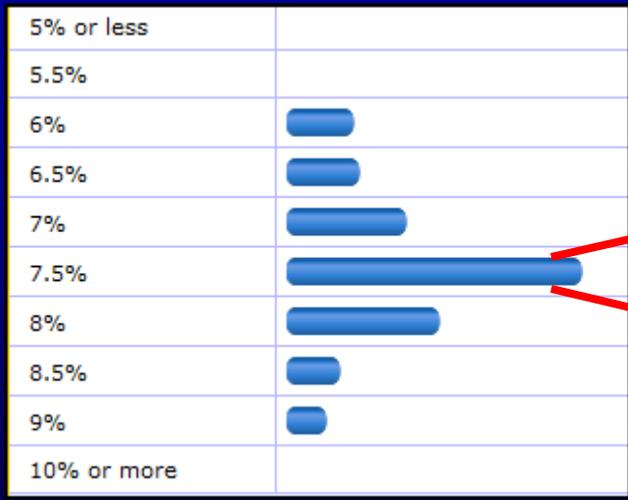
Institutional Cap Rates: Today & Tomorrow

Cap Rates too low
Cap Rates up for 2+ years
Lenders too risk-average
Investors can't price risk

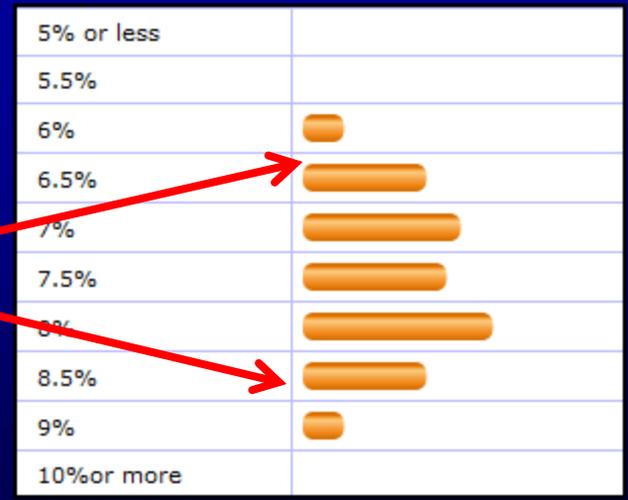
Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
7 12%	25 42%	15 25%	13 22%	0 0%
6 10%	27 46%	8 14%	15 25%	3 5%
14 23%	32 53%	6 10%	7 12%	1 2%
11 18%	30 50%	4 7%	13 22%	2 3%



Cap Rates Today



Cap Rates in 2 Yrs

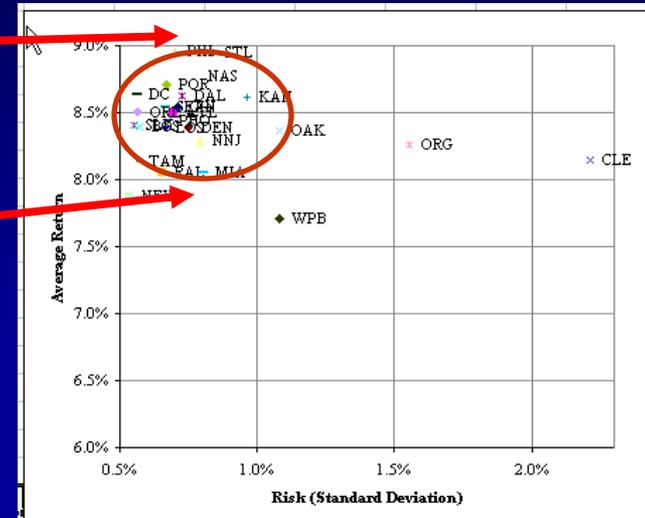
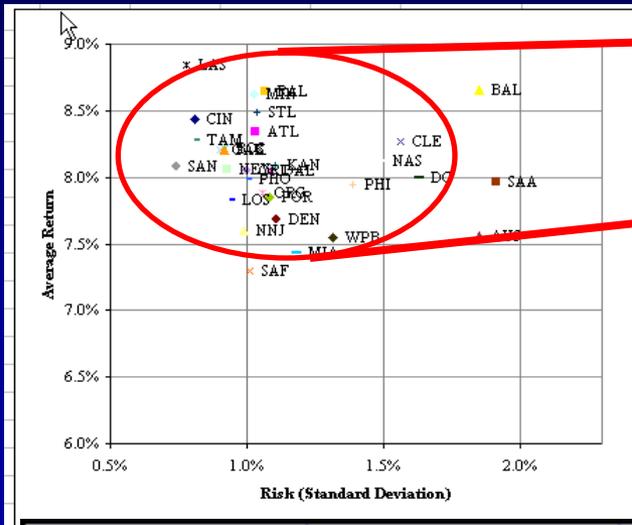


Institutional Capital Flows & Outlook

- **Decreased capital flows**
 - Rising Return/Yield hurdle
 - Allocation down via denominator effect
- **Investment Preferences**
 - Search for value/yield; eschew risk
 - Fewer products/structures
- **Timing**
 - Patient; waiting for bottom
 - Indecisive; slower to act
- **Opportunities**
 - Cash is king; Big and Quick
 - Channel sourcing; REO, TICs
 - Asset takeovers
 - Promoted interests
 - Portfolio Acquisitions

Capital/Spatial Divide: Commoditization

Market Risk/Return Long-Term



Recent: 5 yrs

Commoditized Pricing Behind Us

Strongly Agree	Agree	Neither	Disagree	Strongly Disagree
6 10%	19 32%	15 25%	16 27%	3 5%

Challenges

- 2nd and 3rd Tier Markets
- Weak Product: location, design, tenancy

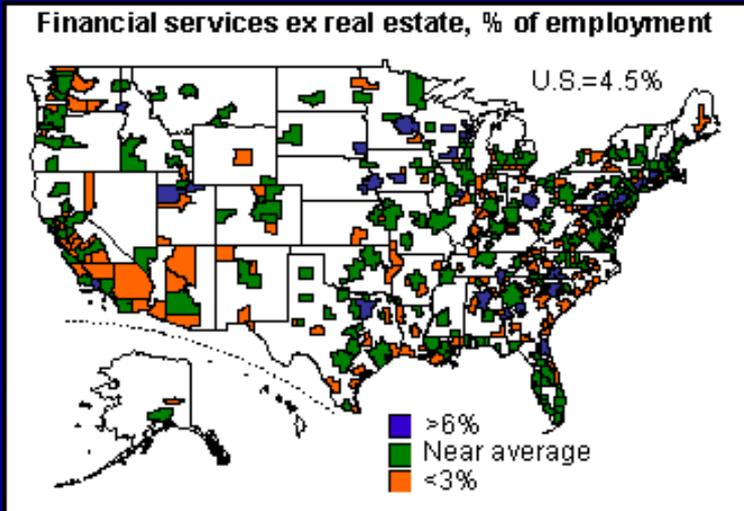
Opportunities

- Market Targeting/Timing
- Market Fundamentals; specialized skills & expertise

Local Market Challenges

Market Challenges

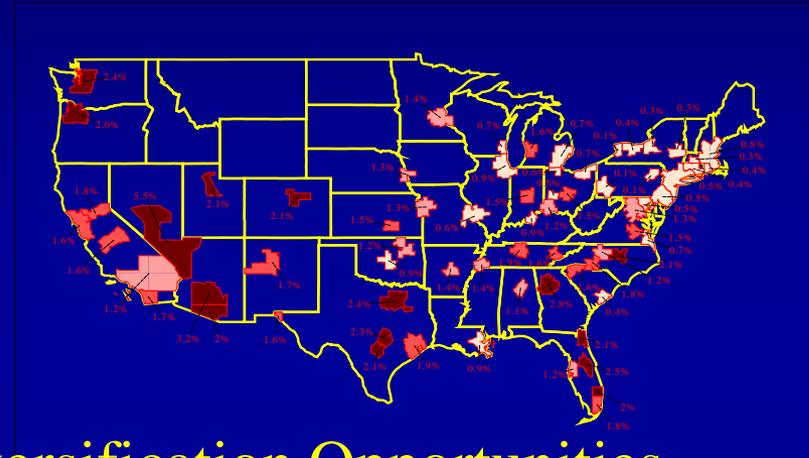
- Financial Service-Dominated
- Secondary and Tertiary Markets



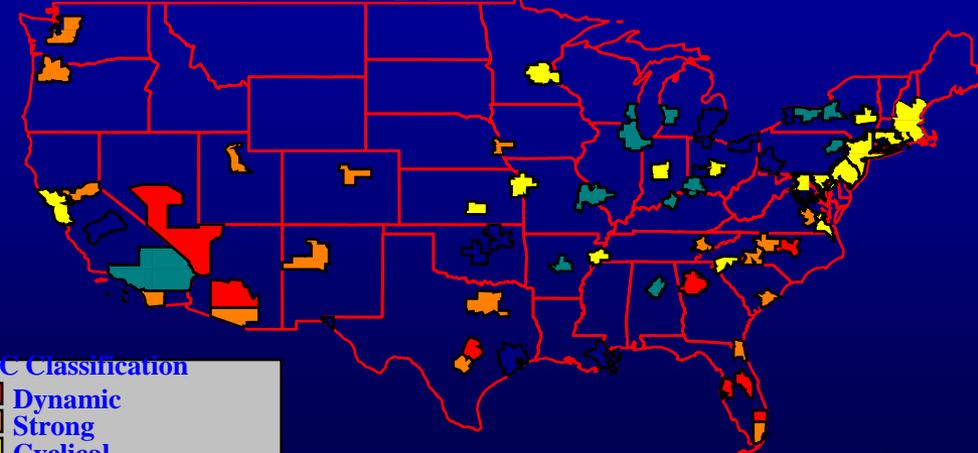
- Strategic Diversification
- Portfolio Acquisitions & SWAT Team Mobilized

Fundamental Opportunities

- High Growth
- High Barriers to Entry



Diversification Opportunities

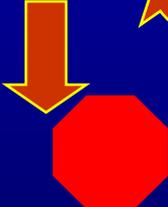


EBC Classification

- Dynamic
- Strong
- Cyclical
- Moderate
- Static

Real Estate Capital Markets Overview

- Construction Activity
- Private Equity Market
- Public Equity Market
- Commercial Mortgage Market
- Foreign Investment

- Significant Contraction 
- Demand off, wait & see 
- Tightening, discipline 
- Red light; down, down 
- Still attracted by cheap \$, but more deliberate 

Economic Environment vs. Real Estate Capital Market



Part III: Real Estate Market Fundamentals

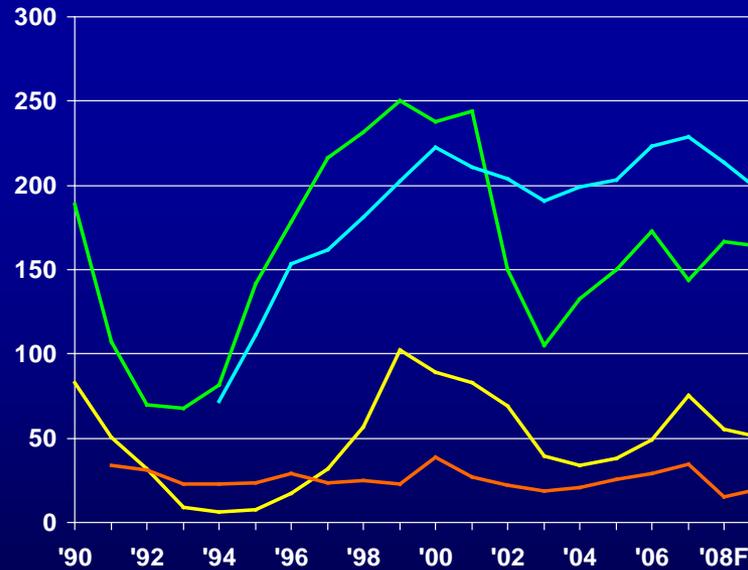


Vacancy Rates

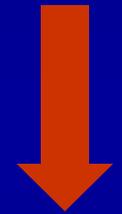


Suburban Office
 Downtown Office
 Industrial
 Retail
 Apartments

Construction Activity



Apartment
 Industrial
 Office
 Retail



Source: 2008 Emerging Trends

Office Real Estate

- Overview

- Corporations will be giving back space
- Sublease activity will increase
- Vacancy rates will rise
- Rents will soften
- Credit will be tight
- Construction will decline

- Areas of Concern

- Speculative projects
- Commodity product
- Capital Needs: Cap X, TI's
- Second and third tier markets
- Emerging sub-markets

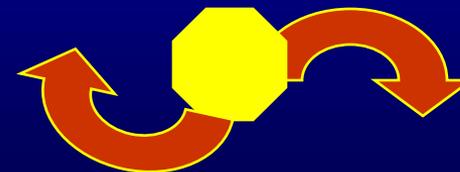
- Opportunities

- Projects

- Abandoned Projects
- Entitled Projects
- Capital Needs Projects
- Asset Takeovers

- Sourcing

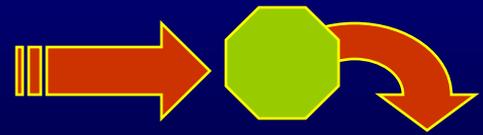
- Institutional REO
- Corporate REO
- Marginal Owner Refin



Retail Real Estate

- Overview
 - Retail Sales will be tepid
 - Inventories will be lean
 - Credit tight, local and regional players
 - Retailer contraction; unit profitability
 - Defensive capital to protect markets
- Areas of Concern
 - New unproven & unopened stores
 - Underperforming existing units
 - Unanchored Life-style centers
 - Tenant Bankruptcy
 - Mixed-use in marginal markets
 - TOD Oversaturation
 - Underparked MU

- Opportunities
 - Projects
 - Lost Anchors
 - Entitled/Spec Projects
 - Capital Needs Projects
 - Asset Takeovers
 - Sourcing
 - Undercapitalized owners
 - Institutional REO
 - Corporate REO
 - Tenant-owned Pads



Industrial Real Estate

- Overview

- Absorption slowing
- Rents softening
- Construction moderating
- Logistics Models
- Supply Chain/Technology
- Globalization

- Areas of Concern

- Overbuilt markets
- Functionally obsolescence
- Office Showroom/Flex
- R&D facilities

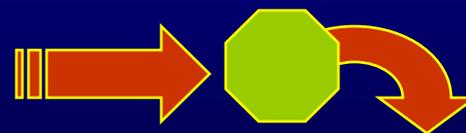
- Opportunities

- Projects

- Lost Tenants
- Functional Obsolescence
- Capital Needs Projects
- Changing H&B Use

- Sourcing

- Undercapitalized local owners
- Institutional REO
- Corporate REO
- Asset Takeovers



Multifamily Real Estate

- Overview

- Modal Shift: Rent vs. Own
- Demographic/Diversity
- Absorption rising
- Vacancy rates firming up
- Rents rising

- Areas of Concern

- Homogenized Product
- Product Positioning
- Re-apartmenting
- Density as an End vs. Means
- Parking: Shared

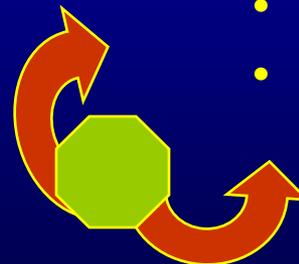
- Opportunities

- Projects

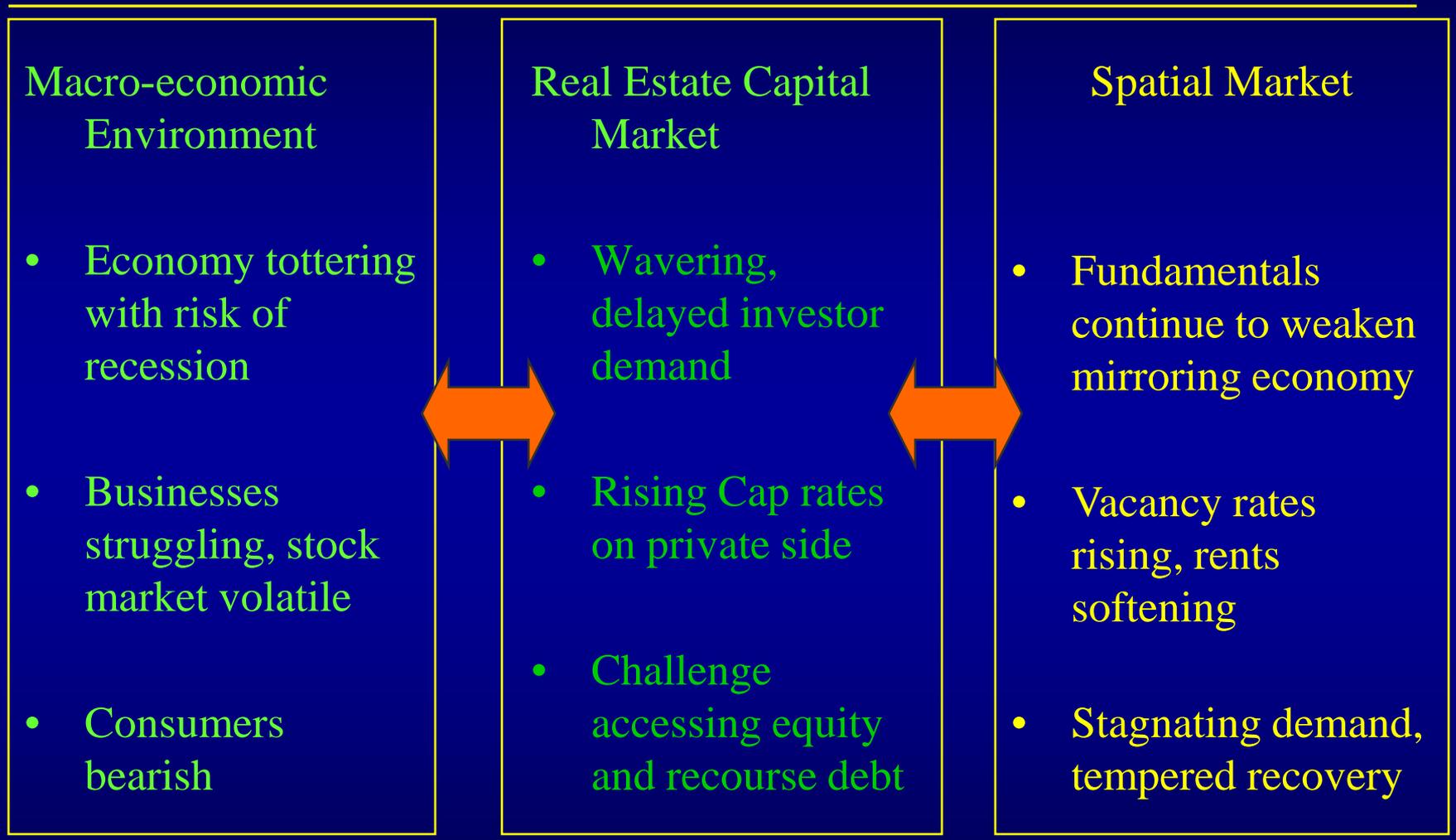
- In development
- Entitled
- Repositioning
- Conversion (future)

- Sourcing

- Undercapitalized local owners
- Institutional REO
- Corporate REO
- Asset Takeovers

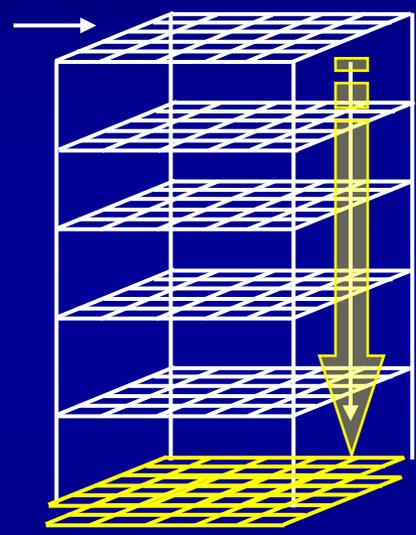


Economy vs. Capital Market vs. Spatial Market



Contemporary Portfolios: Capital/Spatial Convergence

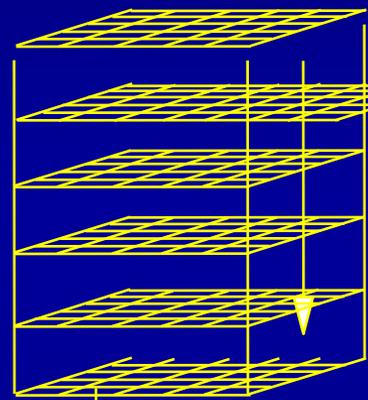
Client Goals & Objectives:
Portfolio Strategy



Aggregate First Generation Portfolio

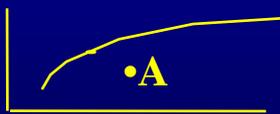
- Open-end Fund 1
- Open-end Fund 2
- Closed End Fund 1
- Closed End Fund 2
- Specialty Fund

Core



Aggregate Second Generation Portfolio

- Non-Core
- International
- Commercial Mortgages
- REITs
- Securitized Products/



Main Street

Wall Street

Will Government Intervention Work?

- No
 - Not enough \$; too little, too late
 - Not address mortgage issue
 - Ill-conceived; gov only stupid buyer
 - Cycle inevitable, let it play out
 - Not deal with fundamental issues
 - Not deal with commercial bomb
- Not right away
 - Not until credit crisis resolved
 - Curtail negative, but take time
 - Not a quick fix; eventually
- Limited
 - Marginal help
 - Too long, slow, costly
- Mixed/Maybe
 - Ok for banks, not taxpayers/econ
 - Essential to avoid further erosion
 - Create illusion of stability
 - They don't know what they'll do
- Yes, but only if...
 - Buy truly toxic loans
 - Have Stopgaps to avoid foreclosure
 - Banks forced to loan vs. hoard
- Yes
 - Restore Confidence; banks/market
 - Fear removed, mitigated
 - Put a floor on bottom
 - Add essential liquidity
 - Get wheels in motion

What More Should Government Do?

- No more actions
 - Don't know
 - Nothing
 - Enough already; Out of tricks
- Taxes
 - Cut capital gains taxes
 - Cut income & capital gains
 - Create incentives
- Mortgages
 - Lower rates
 - National loan program
- Market-based solutions
 - Stimulus package
 - Eliminate mark to market accounts
- Equity infusion
 - Inject equity; take positions
 - Pari pasu with private investors
 - Force liquidity; flow-through
- Psychic Interventions
 - Leadership stability (Paulson)
 - Restore accountability
 - Remove “entitlement”
- Regulation
 - Increase Oversight
 - Proactive regulations
- Other:
 - Global action/world leader
 - Create RTC-like entity
 - Education

Greatest Risks to Commercial RE?

- Equity
 - Decline in qualified buyers
 - Capital shortage near-term
 - Players on sidelines
- Debt Access
 - Tightened credit
 - Credit hangover
 - General shortages
 - Deleveraging effects
 - Illiquidity
- Debt Rollover
 - Maturing bullets
 - Mezzanine
 - Default increases
 - Non-recourse walk-always
- Demand
 - Employment losses
 - Tenant Bankruptcies
 - Consumers and confidence
- Fundamentals
 - Overall deterioration
 - Erosion in market balance
 - Rising vacancies, rents declines
 - Rising costs
- Re-pricing/Valuation
 - Some already occurred
 - Further valuations slippage
 - Foreclosures
 - Non-recourse walk-always

Greatest Opportunities?

- Get in the game
 - Be a player
 - Be Opportunistic
- Cash
 - At bottom
 - Cash is king
 - Deleverage
- Debt
 - Distressed
 - Discounted
- Distressed
 - Properties
 - Sellers; overleveraged
 - REO
 - Any form
- Markets
 - Secondary and Tertiary
 - Lower Cost
- Property Types
 - Land
 - Apartments, student, assisted
 - Industrial/flex
 - Medical
- Value creation
 - Repositioning assets
 - Adding management expertise
 - Takeovers
 - Re-tenanting
 - Provide liquidity, capital

Key Topics of Interest?

- What's happening?
- Where are we headed?
- Where's the money?
- Who steps in?
- What role securitization?
- What about sustainability?
- Demand/demographics?
- What to do?
 - Opportunities
 - Survival
- When to do it?
- Where to do it?
- How to do it?
- Lessons Learned?

Summary

- Introduction
 - Part I: Macroeconomic Conditions
 - Part II: Capital Markets
 - Part III: Real Estate Fundamentals
- Challenges, Issues and Opportunities

Contact info:

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