Wall Street and Commercial Real Estate

Everett (Allen) Greer
Greer Advisors, LLC

February 13, 2014 – CCIM

Goals of Presentation

- Market Drivers
- Economic Trends
- Rents and Vacancy Trends
- Top/Bottom Markets – Vacancy & Growth
- Capital Market Trends – REIT / CMBS
- Financial Regulations (Dodd-Frank)
- Outlook & Forecast

- Market Drivers

Market Drivers

Supply / Demand – Not the Driver

- Most Demand ties to Jobs
  - Office – FIRE Employment, Portion of Service Employment
  - Retail – Household Formations, Income Growth
  - Industrial – Manufacturing & Distribution (Logistics)
  - Multifamily – Households, non-Top 25% HH Income
  - Hotel – Corporate Travel – Office & Industrial Employment

Financing – Is the Most Important Fundamental

- Availability
- Leverage
- Rate and Term
- Recourse

Interest

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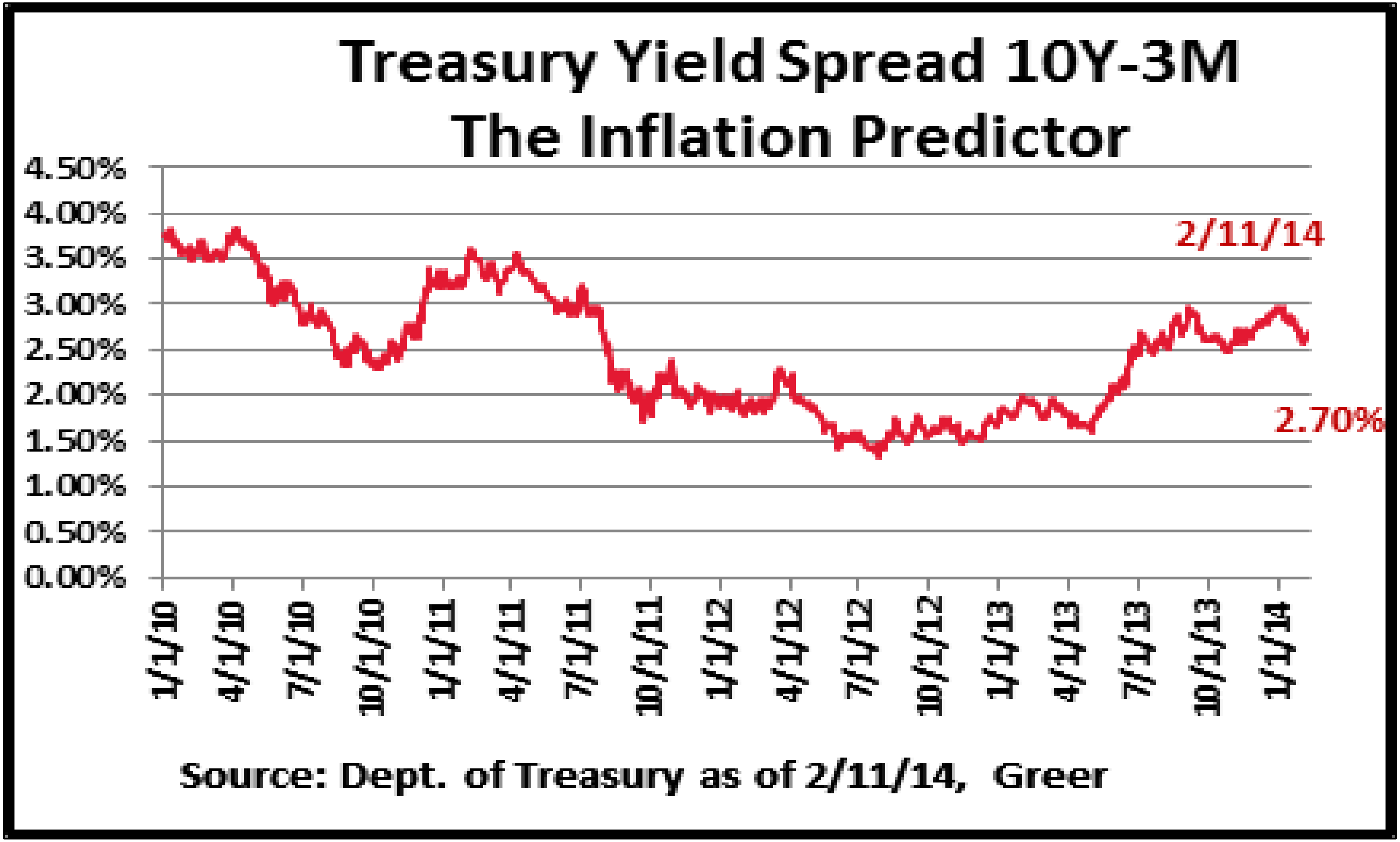
Inflation


Treasury Yield Spread 10Y-3M
The Inflation Predictor
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
2/11/14
2.70%
1/1/10
4/1/10
7/1/10
10/1/10
1/1/11
4/1/11
7/1/11
10/1/11
1/1/12
4/1/12
7/1/12
10/1/12
1/1/13
4/1/13
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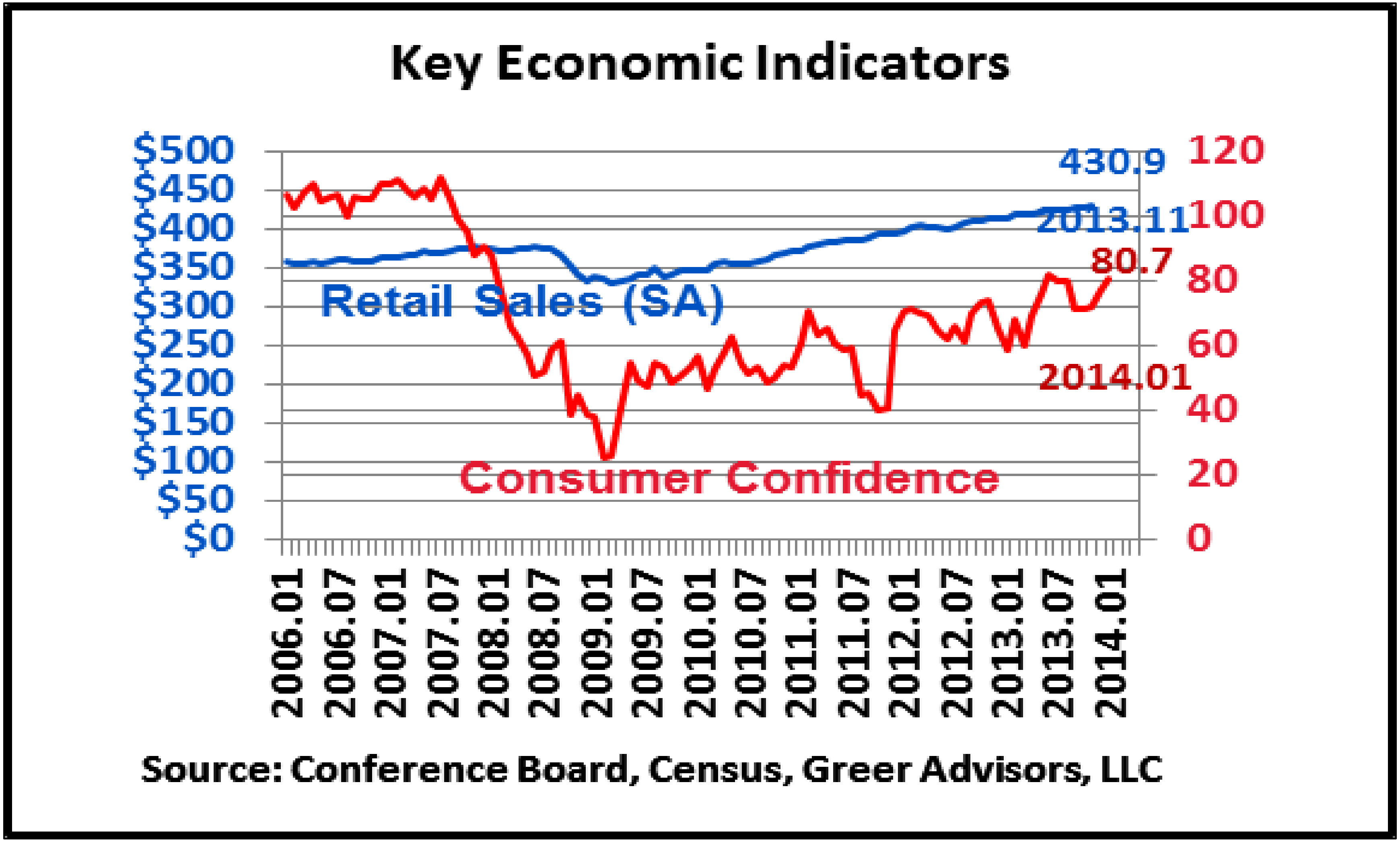
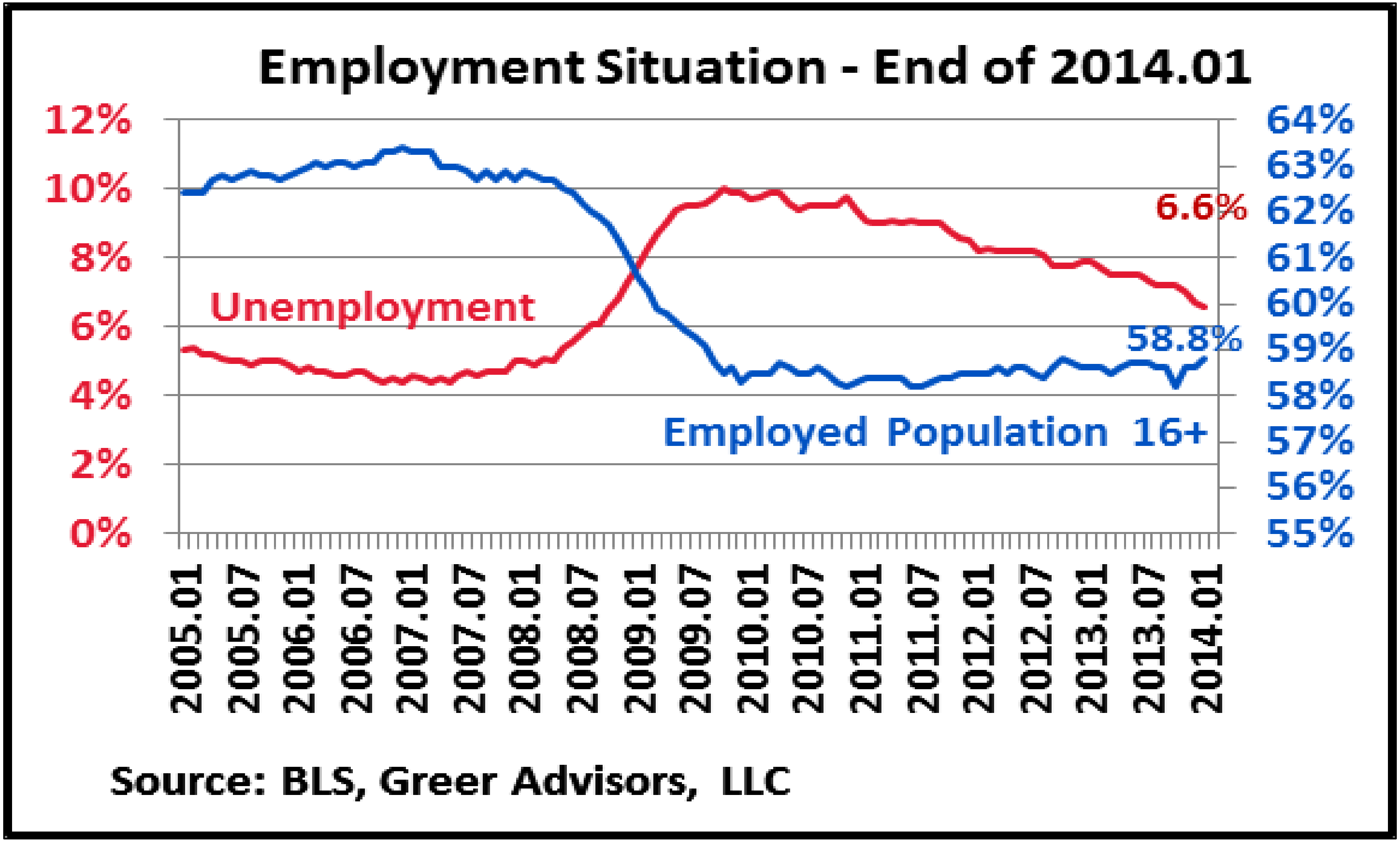
10/1/13
1/1/14
Source: Dept. of Treasury as of 2/11/14, Greer

Economy – Consumer Confidence & Sales



Economy – Employment



Economy – Strengths / Weaknesses

Consumer Side

- Consumer Confidence improving 80.7 (Jan. Conf. Board)
- Unemp/% Wkforce improving 6.6%/58.8% (Jan. BLS)
- ObamaCare, Debt, Deficit, Runaway Spending
- Liquidity, Leverage, Interest (for non-AAA Debt) – Poor
- Retail Sales Show Small, but Consistent Growth
- Event Risk, EMP, Potential Sovereign Defaults

Investment Banks

- Capital IQ and Deal Logic show LBO's☺
- M&A Continues to Grow
- Derivative Risk – Net vs. Gross VAR

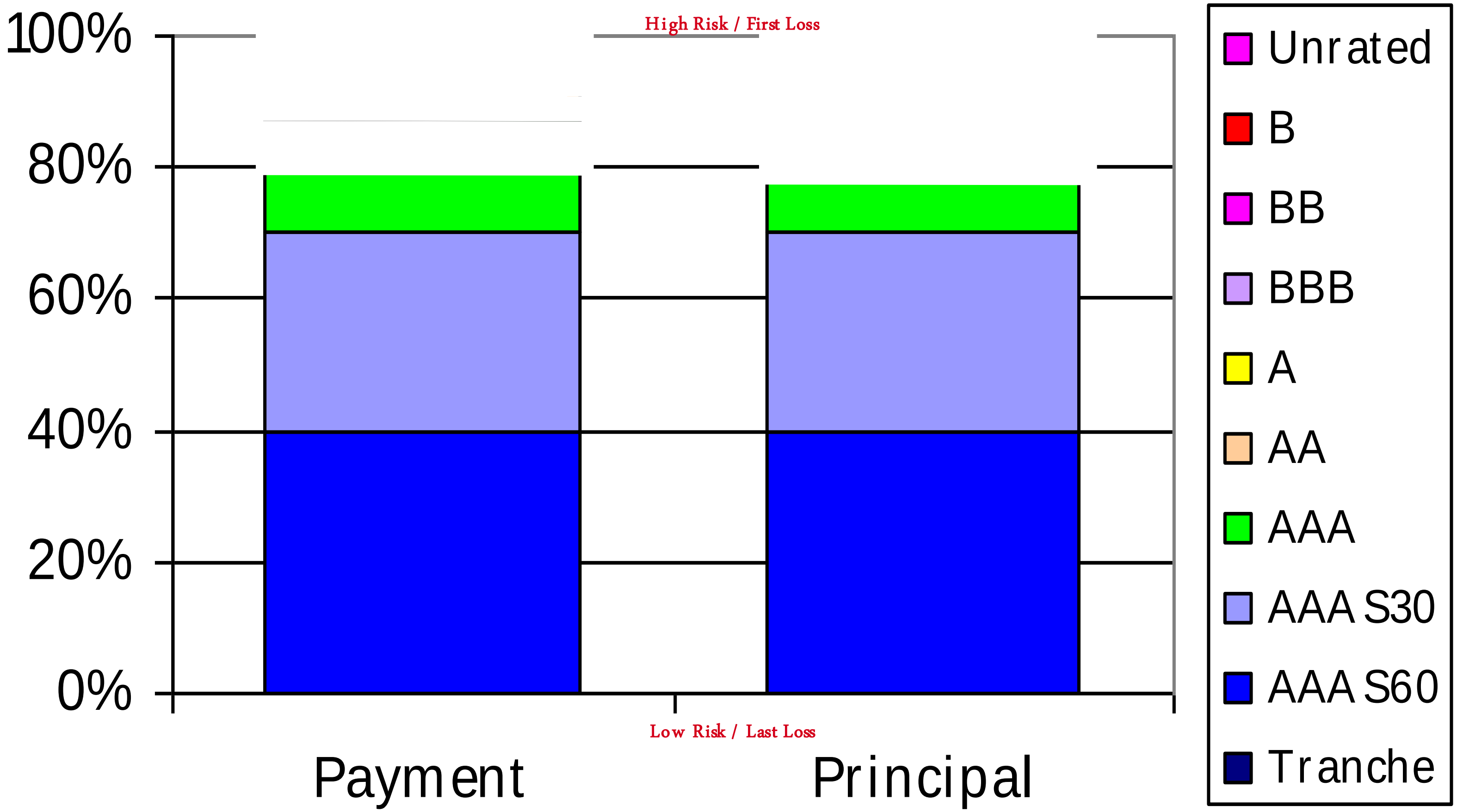
- Real Estate Capital Markets

What is a MBS?

Mortgage Backed Security (Type of pass-through security)

- 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 to payments. Proceeds are distributed to investors based on the priority of their tranche.
- Senior tranches are "credit enhanced" by having priority to payment over lower tranches. For example, a AAA tranche might have 30% of the "pool" behind it in payment priority, which means 31% of the pool must default before the AAA bondholder misses any part of their payment stream.
- During the "Peak" of 2006-2007, CMBS accounted for slightly nearly 40% of all commercial real estate lending. Residential was higher. Excluding the peak, CMBS has accounted for <30% of lending.

Subordination Graph



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 call**ED** these “Weapons of Mass Destruction”
- ………………...counterparty???

Players in “Simple” CDS

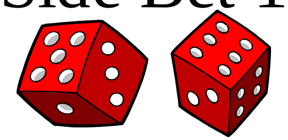
Business Issues Bonds

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

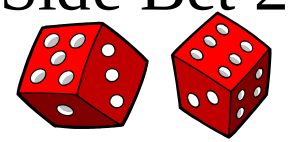
Rating Agency Rates Bonds

Gives loss forecast & amount required for “AA” rating

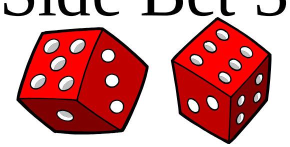
Side Bet 1



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

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

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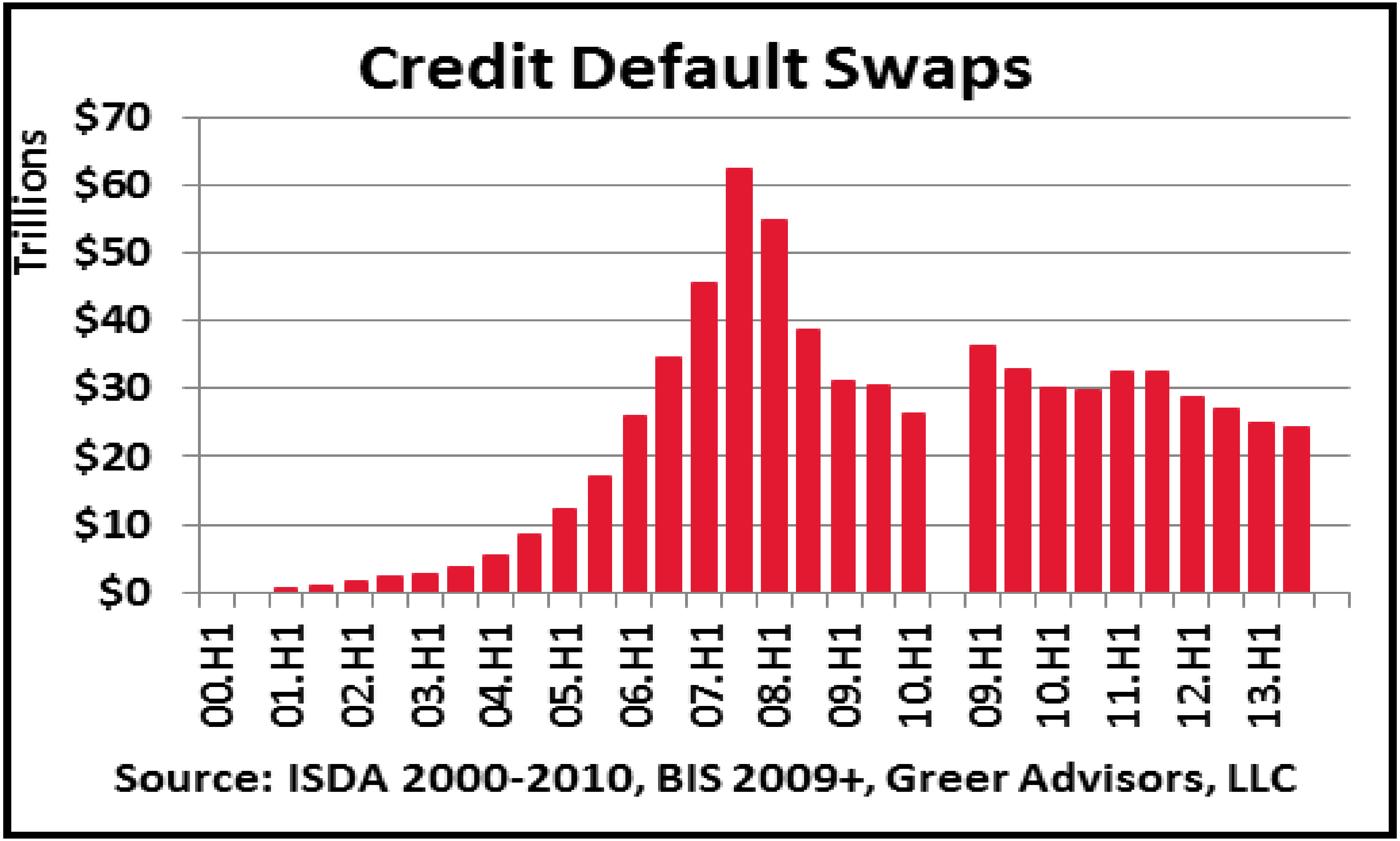
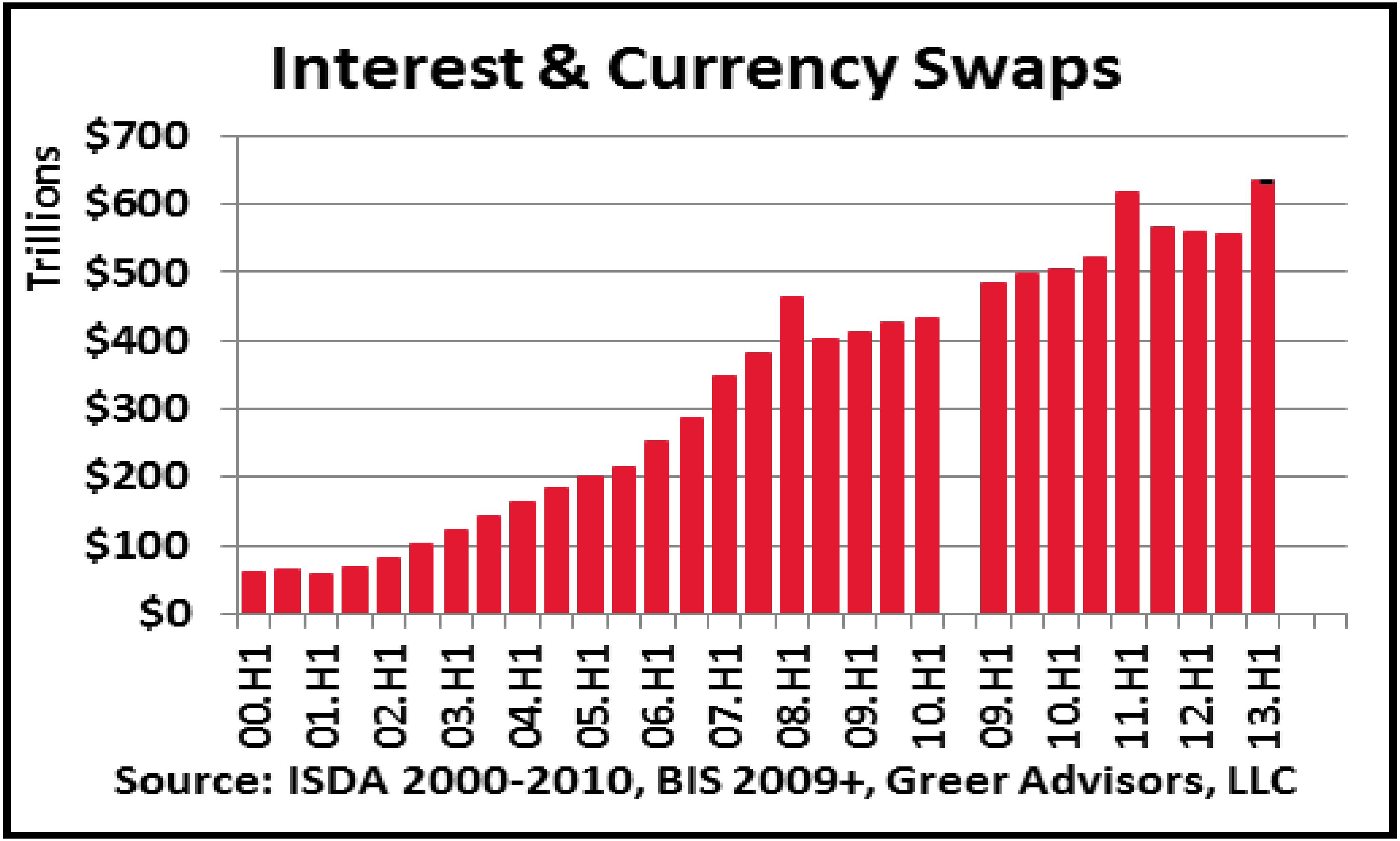
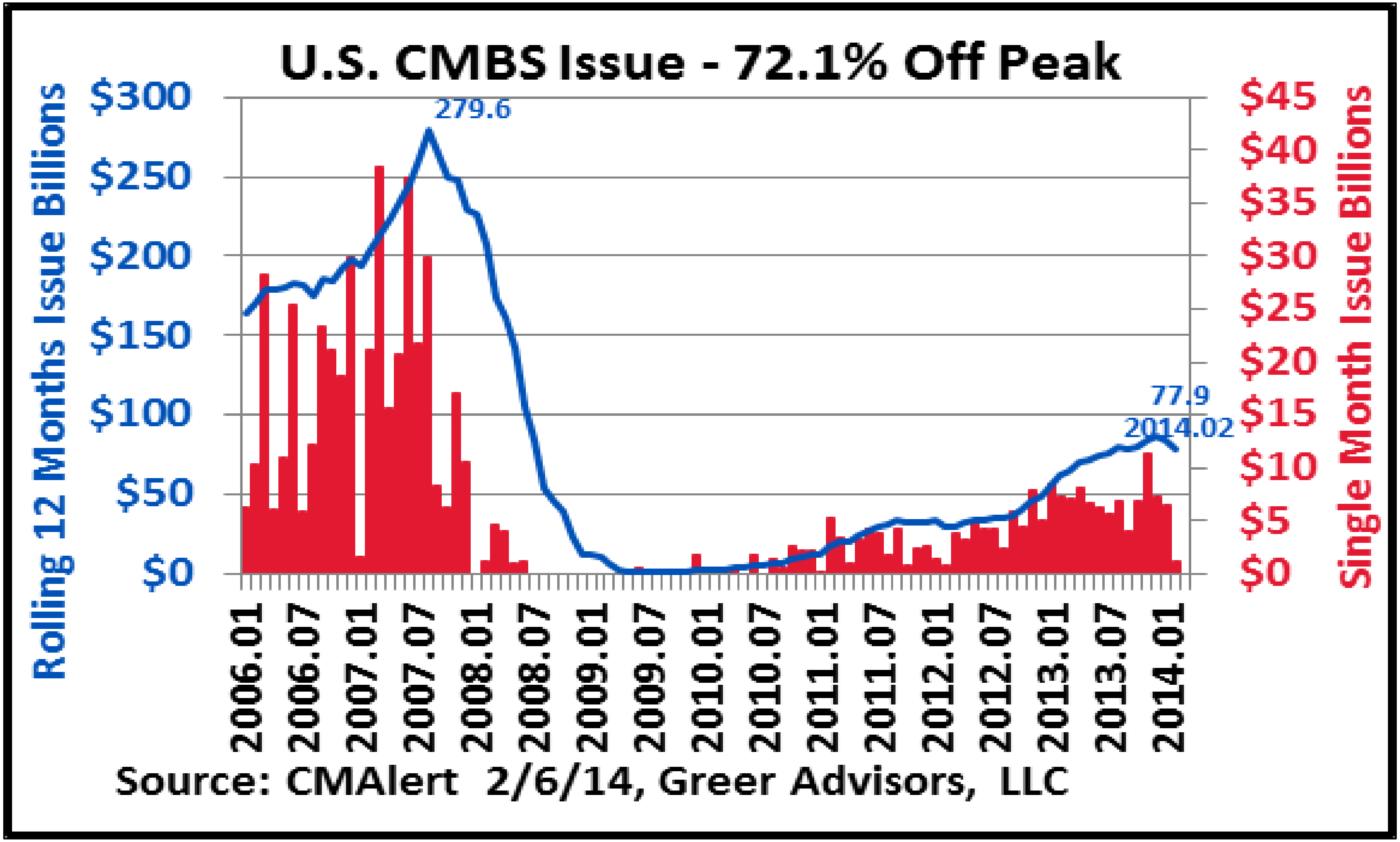
Credit Default Swaps



Interest & Currency Swaps



CMBS Issuance



CMBx Yields – Risk Pricing Getting Better

Greer CMBS / CMBx Yield Rate™				
Tranche	Yield	Suboord	% of Capital Stack	Contributi on to
CMBX.NA.AAA.6	3.35%	30.9%	69.1%	2.32%
CMBX.NA.AS.6	3.86%	21.1%	9.8%	0.38%
CMBX.NA.AA.6	4.36%	15.7%	5.4%	0.24%
CMBX.NA.A.6	4.85%	12.1%	3.6%	0.17%
CMBX.NA.BBB-.6	5.90%	6.9%	5.2%	0.31%
CMBX.NA.BB.6	7.92%	5.3%	1.6%	0.13%
All others	26.00%	0.0%	5.3%	1.38%
Implied Overall Debt Yield (Interest)			100.0%	4.92%

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 greater than loan rates in the marketplace, the CMBS market CAN NOT recover because the required bond yields are too high to make debt affordable to borrowers. 2) When the spread between AAA and BB tranches is high, say above 500 bps (now at 457 bps), the market can't recover because of risk aversion for lower-rated tranches. In January 2007, spreads were around 65 bps. For most of late 2008 through 2012, spreads were near 10,000bps. Lastly, the yields for each tranche provide tremendous insight into the pricing of risk premiums for each layer in the capital stack.

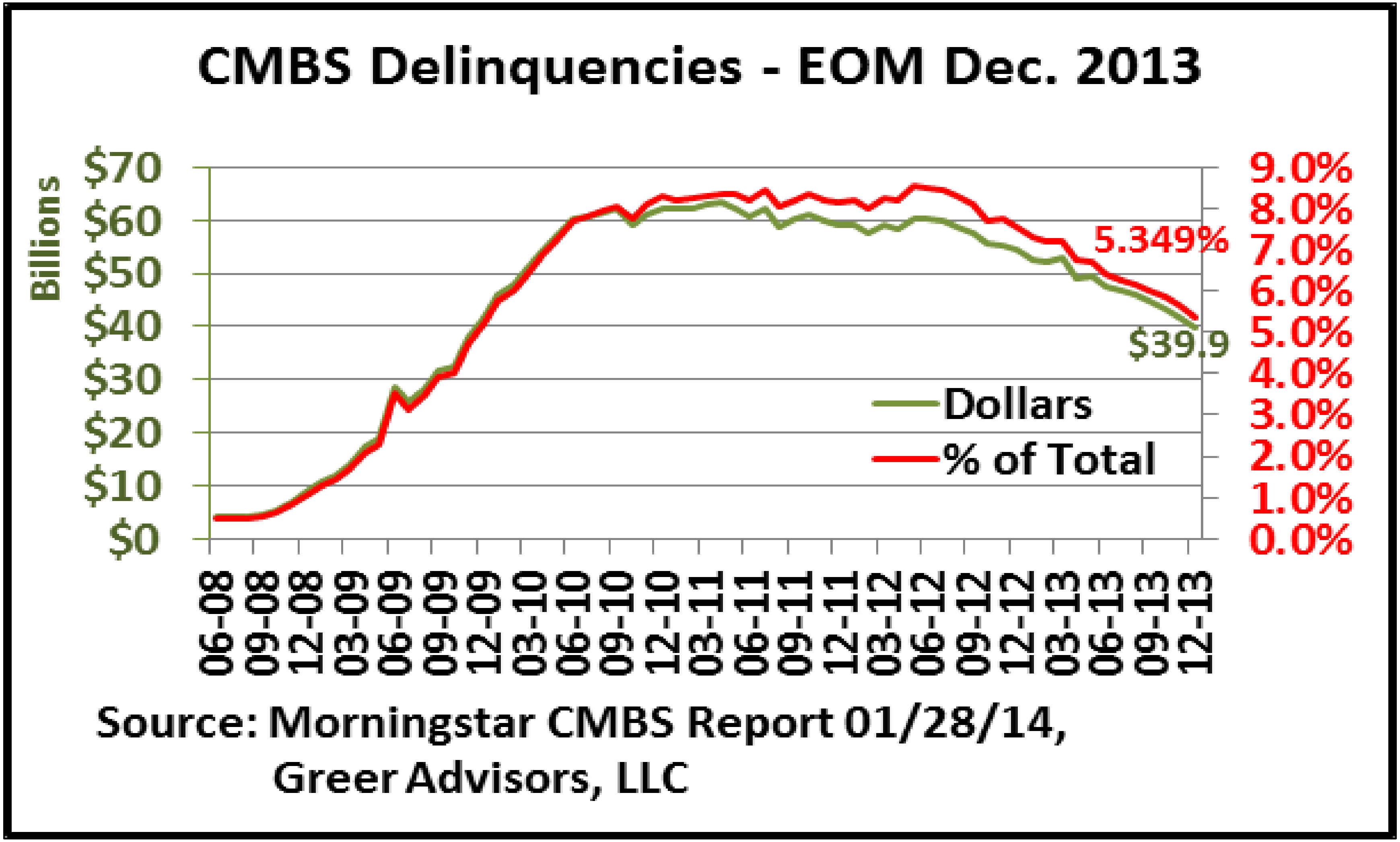
② MarkitTM Data and Calculations based on close of 2/12. Swap (10Yr) as of 2/11. CMBx prices are based on Series 6 data. Subordination levels are based on average credit enhancement.

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 yields.

④ Profit / arbitrage opportunity for the issuer was ignored.

⑤ The yield for "other" classes was based on (BBB- minus BB yield) times 4.0, round to the nearest bp.

CMBS Delinquencies – Strong Improvement

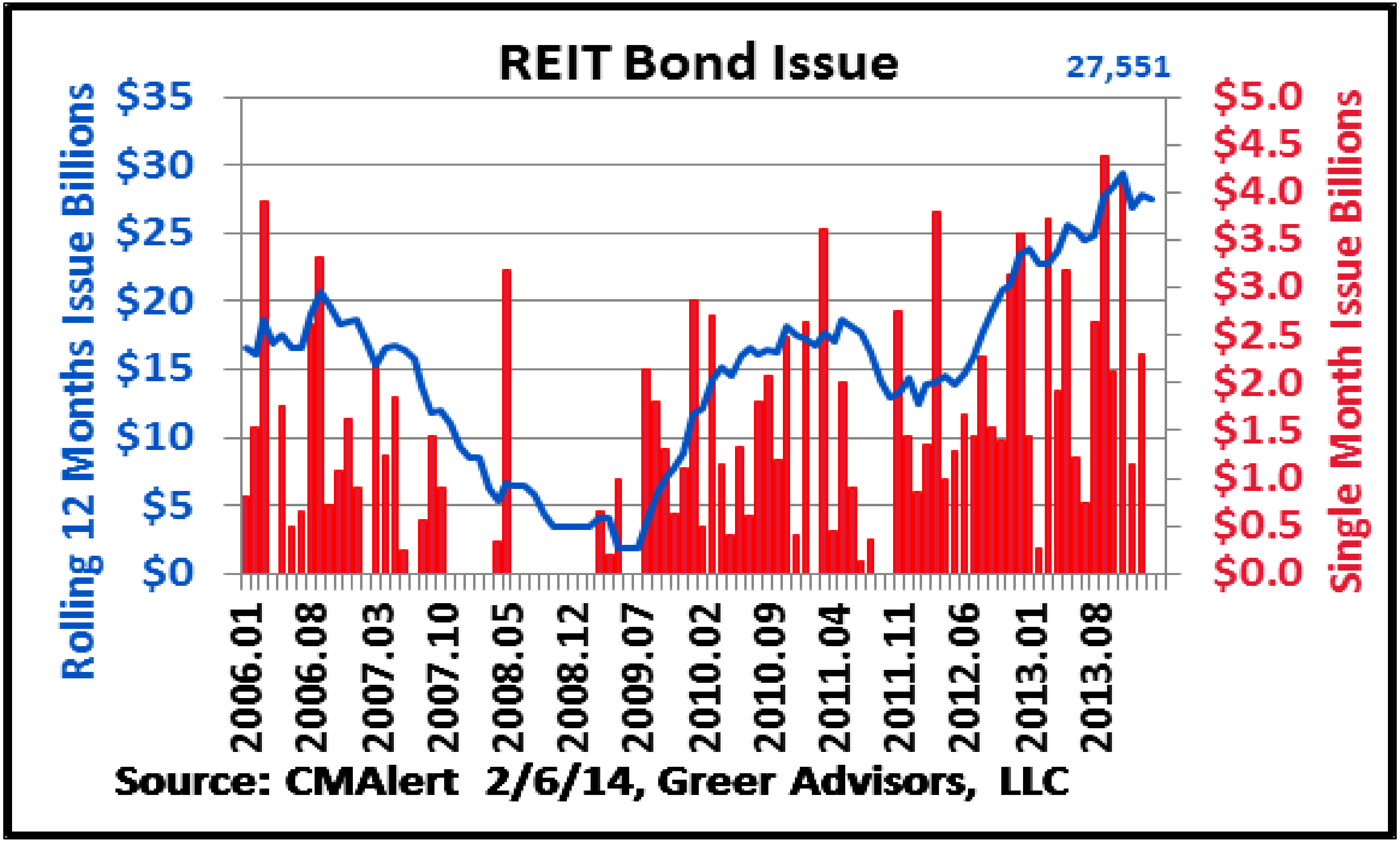


What is REIT?

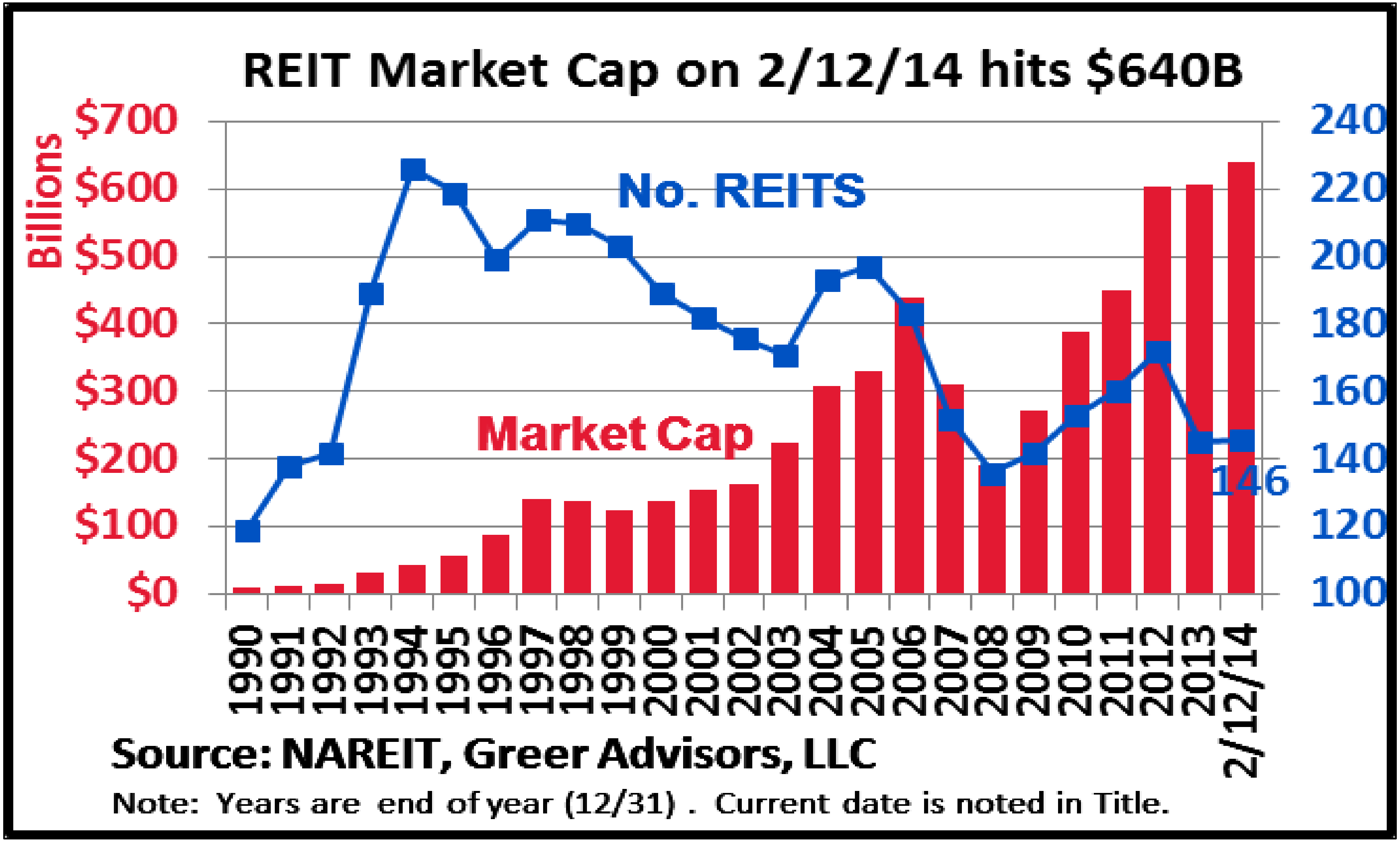
Real Estate Investment Trust

- Type of Pass-through Security
- Very similar to a corporation with shareholders. Investors are called Bondholders.
- As long as 90% of income passed is through to bondholders, there is no “corporate” tax. All earnings are single-taxed at shareholder level.
- Most REITs are “Equity” REITs. The REIT obtains loans on all the properties, and the value of the REIT is the remaining “Equity.” Bond covenants limit the total debt on the REIT, typically 50% maximum debt; hence, they’re generally considered “low risk” with only 50% debt load.
- Current “Industry” Issues:
  Definition of Assets, Debt, Yield

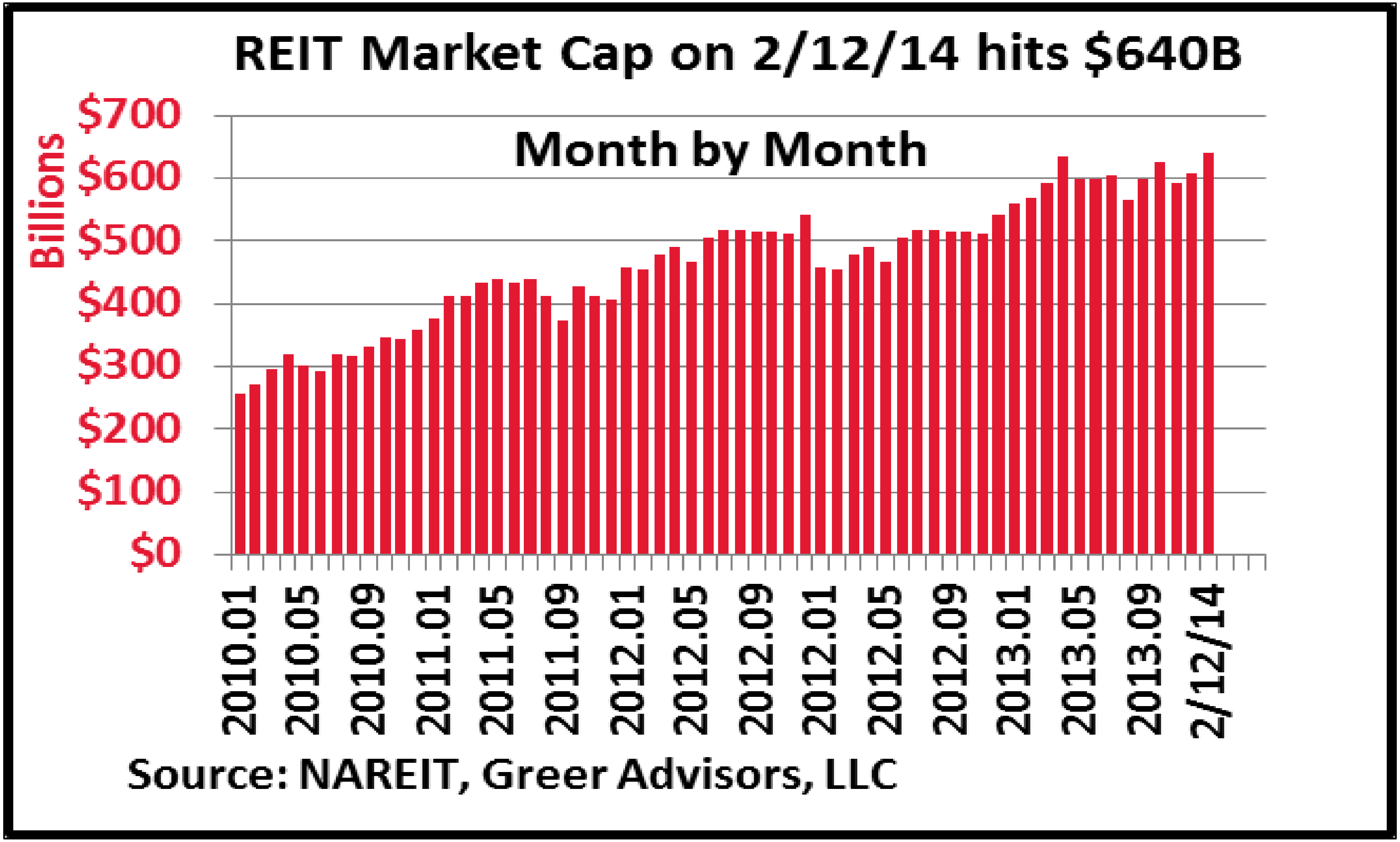
REIT Bond Issuance ($27.6B as of 2/6/14)



REIT Market Capitalization – Long Term

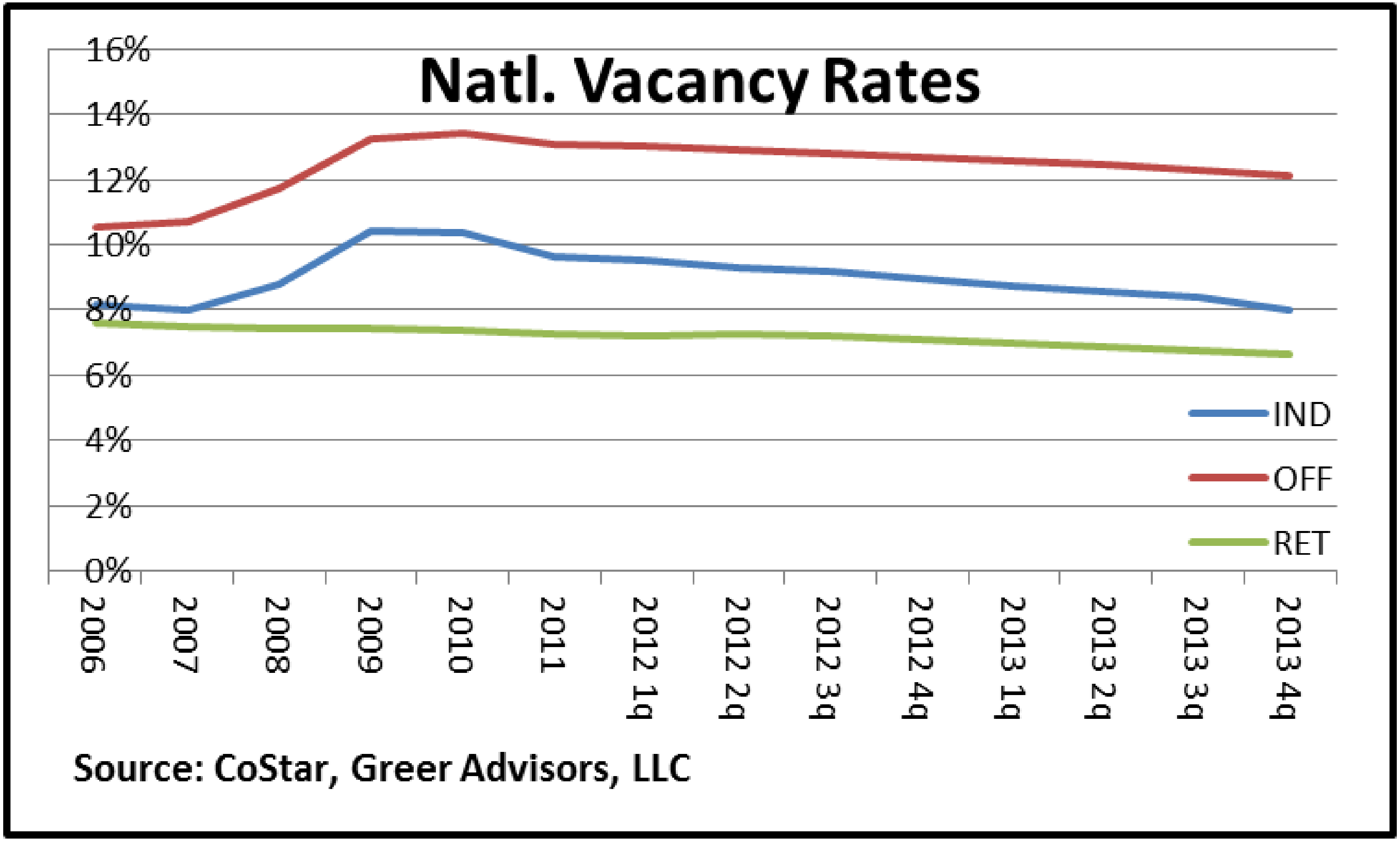


REIT Market Capitalization – Short Term

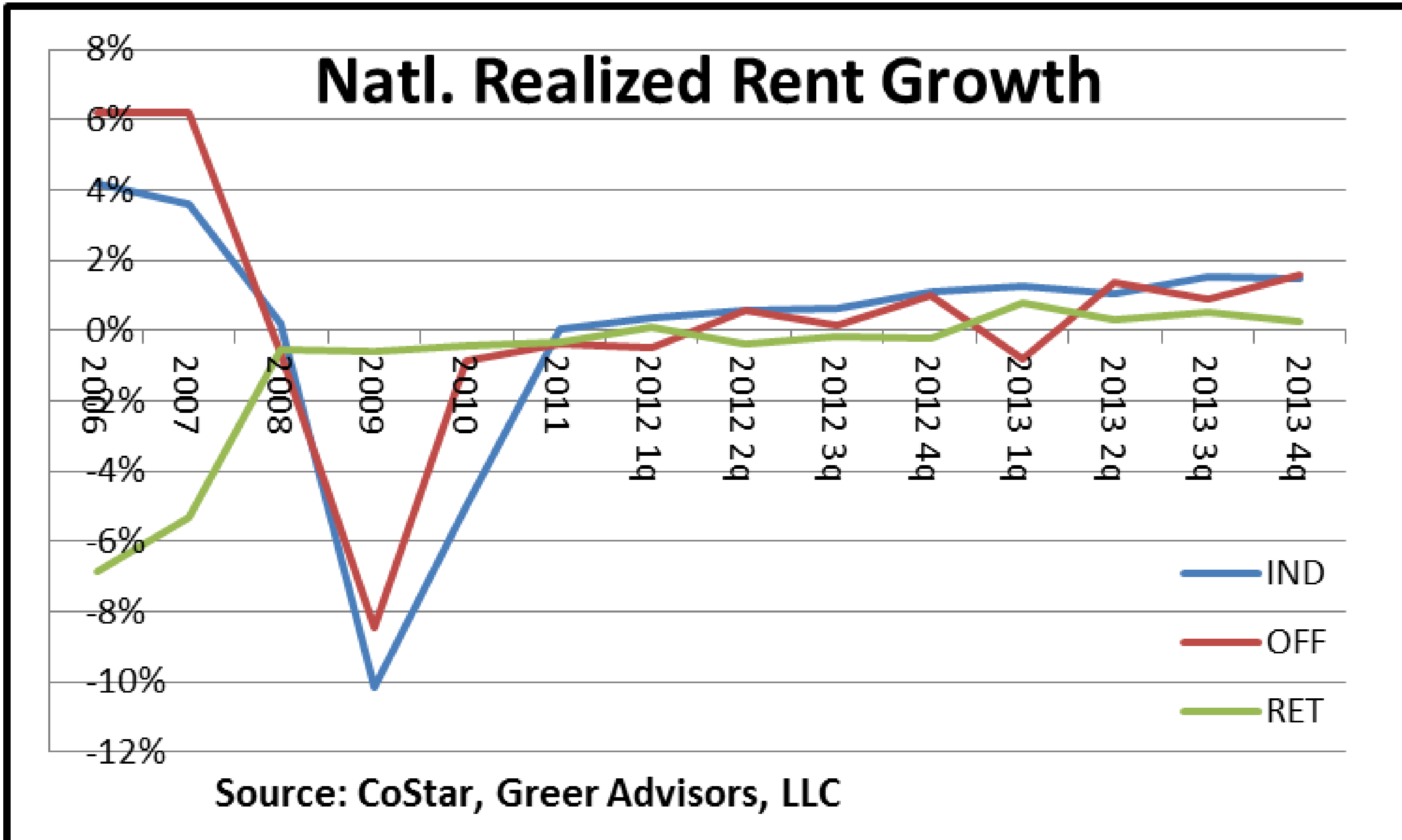


- Market Performance

National Vacancy Trends



National Realized Rent Growth



Vacancy Rankings – Top 55 U.S. Markets

Rank	Industrial 2013Q4 Metro	Vac %	Rent $	Rank	Office 2013Q4 Metro	Vac %	Rent $	Rank	Retail 2013Q4 Metro	Vac %	Rent $
1	Salt Lake City	4.1%	$4.70	1	Salt Lake City	7.1%	$17.57	1	San Francisco	2.3%	$31.89
2	Los Angeles	4.8%	$7.67	2	Albany/Schen	7.5%	$14.12	2	Miami-Dade C	4.0%	$27.85
3	Orange Count	4.8%	$8.71	3	Long Island (N	7.8%	$26.59	3	Pittsburgh	4.0%	$12.15
4	Long Island (N	5.2%	$11.76	4	Nashville	7.9%	$19.03	4	Albany/Schen	4.2%	$11.68
5	Houston	5.2%	$5.74	5	Pittsburgh	8.1%	$18.83	5	Boston	4.3%	$16.63
51	Atlanta	11.2%	$3.92	51	Atlanta	15.0%	$18.85	51	Sacramento	9.4%	$15.51
52	Sacramento	11.9%	$5.02	52	Palm Beach C	15.7%	$25.71	52	Detroit	9.5%	$11.89
53	Memphis	12.2%	$2.92	53	Detroit	17.4%	$17.49	53	Memphis	9.6%	$9.65
54	Phoenix	12.4%	$6.53	54	Las Vegas	18.2%	$19.36	54	Las Vegas	10.0%	$15.42
55	Dayton	13.3%	$3.30	55	Phoenix	18.3%	$20.30	55	Phoenix	10.4%	$13.94
	National Avg	8.0%	$5.36		National Avg	11.5%	$22.06		National Avg	6.6%	$14.59
2	Los Angeles	4.8%	$7.67	31	Orange County (	11.6%	$22.96	9	San Diego	4.5%	$21.54
3	Orange County (	4.8%	$8.71	34	San Diego	11.8%	$26.14	14	Orange County (	5.1%	$22.34
7	Inland Empire (C	5.4%	$5.23	35	Inland Empire (C	12.0%	$18.90	15	Los Angeles	5.2%	$24.19
28	San Diego	8.3%	$10.18	40	Los Angeles	12.3%	$29.19	48	Inland Empire (C	8.7%	$15.83
	Min	4.1%	$2.92		Min	7.1%	$12.24		Min	2.3%	$8.92
	Max	13.3%	$14.28		Max	18.3%	$52.35		Max	10.4%	$31.89
	Spread	9.2%	$11.36		Spread	11.2%	$40.11		Spread	8.0%	$22.97

Note: 1) Rents are Quoted Rents, 2) National Totals Cover all 140+ Markets, 3) Rankings limited to Top 55 Markets based on RBA

Source: CoStar Group, Inc. Greer Advisors, LLC

Rent Growth – Top 55 U.S. Markets

Rank	Industrial Metro	Size MM SF	% Grwth	Rank	Office Metro	Size MM SF	% Grwth	Rank	Retail Metro	Size MM SF	% Grwth
	13Q4 YoY Δ				13Q4 YoY Δ				13Q4 YoY Δ		
1	South Bay/San Jo	203.4	8.0%	1	San Francisco	160.6	9.9%	1	San Francisco	80.4	11.1%
2	Denver	284.8	7.7%	2	Austin	86.7	9.7%	2	Long Island (N	277.8	10.7%
3	Dallas/Ft Worth	786.9	5.2%	3	South Bay/Sa	107.6	8.0%	3	Boston	312.2	6.8%
4	Houston	521.7	5.0%	4	Denver	187.0	7.7%	4	Raleigh/Durha	92.0	6.6%
5	Orange County (C	302.8	4.9%	5	Dallas/Ft Wort	340.2	5.2%	5	Pittsburgh	133.2	6.3%
51	Milwaukee	312.9	-1.7%	51	San Antonio	69.2	-1.4%	51	Memphis	82.1	-4.2%
52	Stockton/Modesto	148.6	-2.0%	52	Milwaukee	78.1	-1.7%	52	Inland Empire	184.4	-4.2%
53	Dayton	116.5	-2.8%	53	Albany/Schen	56.2	-1.7%	53	Austin	100.3	-4.5%
54	Birmingham	131.1	-3.8%	54	Birmingham	55.4	-3.8%	54	Greensboro/W	99.3	-5.0%
55	Salt Lake City	213.6	-4.0%	55	Salt Lake City	88.4	-4.0%	55	Charlotte	149.5	-8.2%
5	Orange County (C	302.8	4.9%	7	Orange Count	152.3	4.9%	11	San Diego	134.2	3.8%
10	Inland Empire (Ca	512.9	4.2%	12	Inland Empire	70.2	4.2%	19	Orange Count	138.7	2.4%
12	San Diego	189.5	3.6%	14	San Diego	113.1	3.6%	24	Los Angeles	451.3	0.7%
15	Los Angeles	988.2	3.4%	17	Los Angeles	424.7	3.4%	52	Inland Empire	184.4	-4.2%
	Totals	20,869	4.4%		Totals	10,369	2.4%		Totals	12,410	1.3%
	Min		-4.0%		Min		-4.0%		Min		-8.2%
	Max		8.0%		Max		9.9%		Max		11.1%
	Spread		12.0%		Spread		13.9%		Spread		19.4%

Note: Growth is based on change in realized rents, which is area occupancy times rent. Rankings limited to Top 55 Markets based on RBA.

Source: Greer Advisors, LLC

- Financial Regulations

Financial Regulations

Dodd-Frank Wall Street Reform & Consumer Protection Act

- 16 Titles – See Summary on Wikipedia – Post TARP☺
  - 243 Rules to be created (reportedly >50% not done)
  - 67 Studies required (most are not done)
  - 22 New Periodic Reports
- Restructure of Regulators, elimination of OTS
  - Consumer Financial Protection Bureau (CFPB)
  - Financial Stability Oversight Council (New)
  - Office of Financial Research (New)
- Keys for Commercial Real Estate:
  - Rating Agency Reform
  - Securitization Reform (nominal change due to QIB clawbacks)
  - Derivatives – minimal change thus far due to “netting”

- Troubled Asset Relief Program

- Outlook & Forecast

Conclusions

- Interest Rates are Still Near All-Time Lows
- Rents / Vacancies Remain better than early 1990s
- Office and Industrial Rents Show Modest Rise in Rents
- Retail Rent Growth is Nearly Flat
- Vacancies Generally Declining Across the Board
- SBA will remain Top Source for Small Properties, especially with High Leverage
- MBS – Finally Showing Real Signs of Recovery
- CASH WILL REMAIN KING!

Greer's Recovery Signs – Prereq's to Recovery

- √CDS Exposure under $25 Trillion (i.e. under 50% of peak)
- √Stable or Decline in CMBx Yield Spreads for 6 weeks
- Re-emergence of CMBS market
  - New CMBS Market will include:
    - Issuer Keeps 1-5% 1st-loss piece..(No)
    - AAA Subordination near 30%.....(Yes)
    - AAA is 70%, not 90% of issue…(Yes)
- √+ REIT Market Capitalization (Total Value) Stabilizes or Increases for 6 months
- √- Consumer Confidence Rises and Stays Above 70 for 6 months. Jan. 2014 at 80.7, 9 mo's above 70, three barely.
- √ Risk Curve (AAA Sr. vs BB) flattens to under 500 bps. Just hit 459 recently. Was near 10,000 bps most time since crises.

Greer's 3-Year Forecast as of Feb 13, 2014

- Barbell Modest Growth or Global Recession
  - Global Economy Heals or Not, Event Risk
- Cap Rates will Rise Slightly 0.25-0.50% during 2014-15
  - Mostly in class B/C due to perceived Risk
  - Trophy cap rates will remain low until Flight to Quality Stops
  - Federal Reserves will keep maintain rates low to avoid defaults
  - QE will be extended 6-12 mo's beyond initial planned expiration
- Values have recovered across most markets, mostly due to cap rate compression. "Real" rent growth has been minimal.
- Individual Market Performance will continue to vary widely.
  - 10-30% difference in Top vs Bottom
- Change Creates Opportunities – Build Businesses
- SBA remains very Active

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

Newsletter

Most of today's information is published in a newsletter.

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Questions / Answers

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