
Wall Street and Real Estate

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Greer Advisors, LLC

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Goals of Presentation

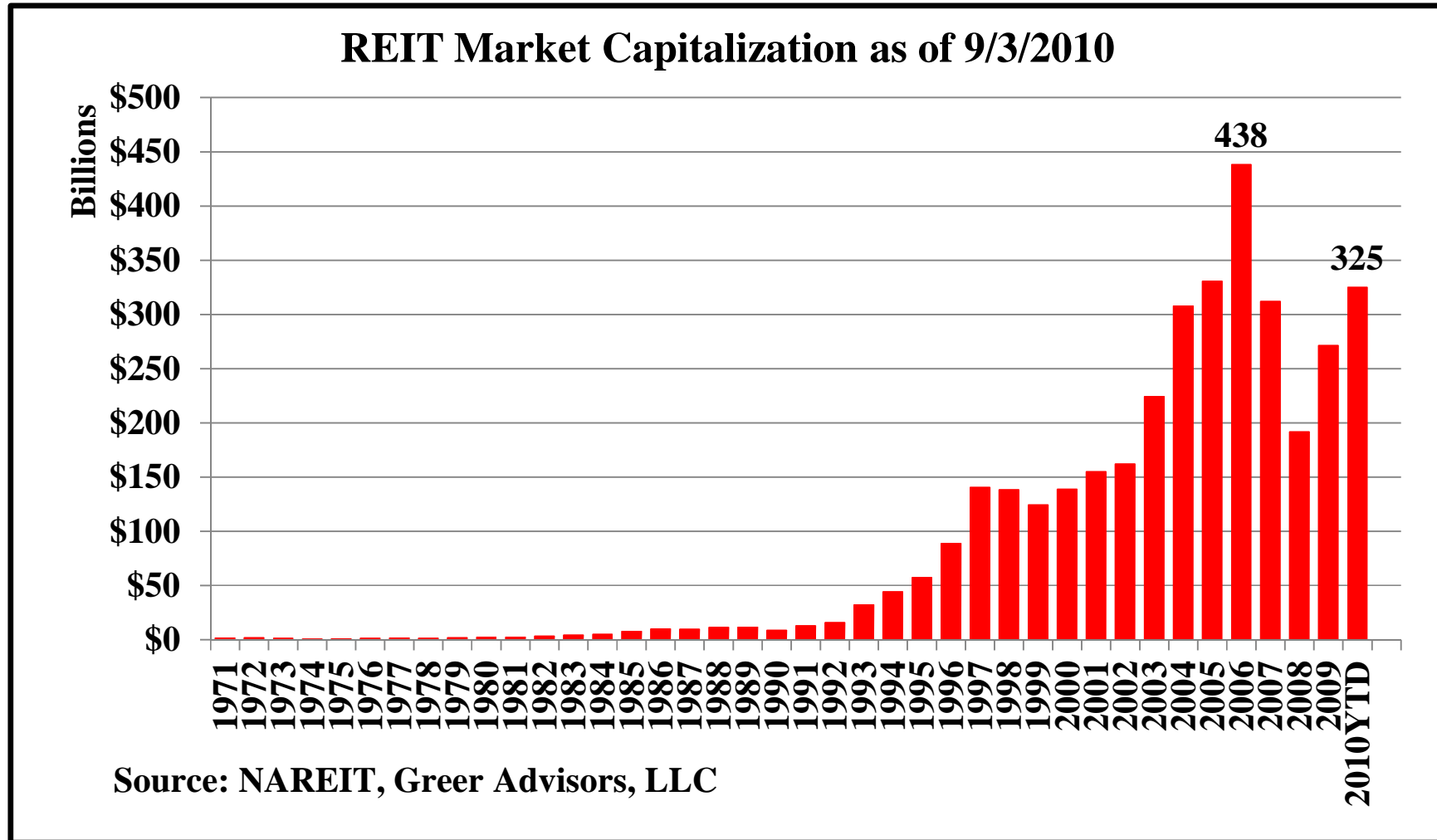
- Wall Street Creations and their Size
 - REIT / MBS / CDO / CDS
- Loan Stat's & Trends
 - Securitization
 - Credit Enhancements
 - “The Fall”
- Securitization – “Novus Ordo Seclorum”
- Greer's Requisites for Recovery

What is REIT?

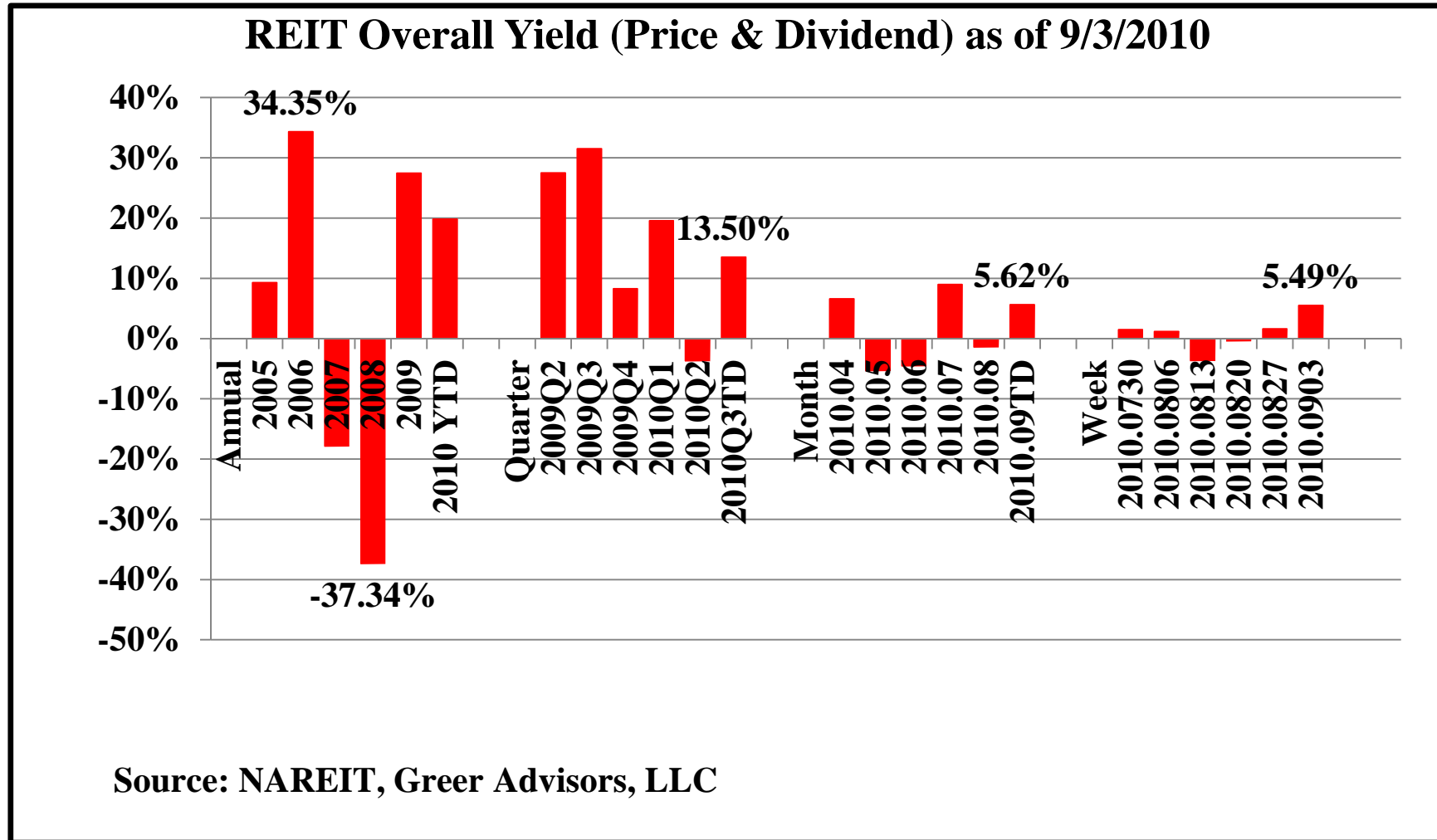
Real Estate Investment Trust

- Type of Pass-through Security
- Effectively a corporation
- As long as 90% of income passed is through to shareholders, there is no “corporate” tax. All earnings are single-taxed at shareholder level.
- Current “Industry” Issues:
Definition of Assets, Max Debt Load, Yield

REIT Market Capitalization as of 9/3/2010



REIT Yield as of 9/3/2010



Fundamentals

Supply / Demand – Not as bad as early 90's

- 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
 - Subdivisions – household formation
- Jobs & Retail Sales Drive Supply & Demand!!!

Financing – Currently Most Important Fundamental

- Losses are Worse, and Rising. Mark to Market Non-existent
- Cheap Rates = Drugs

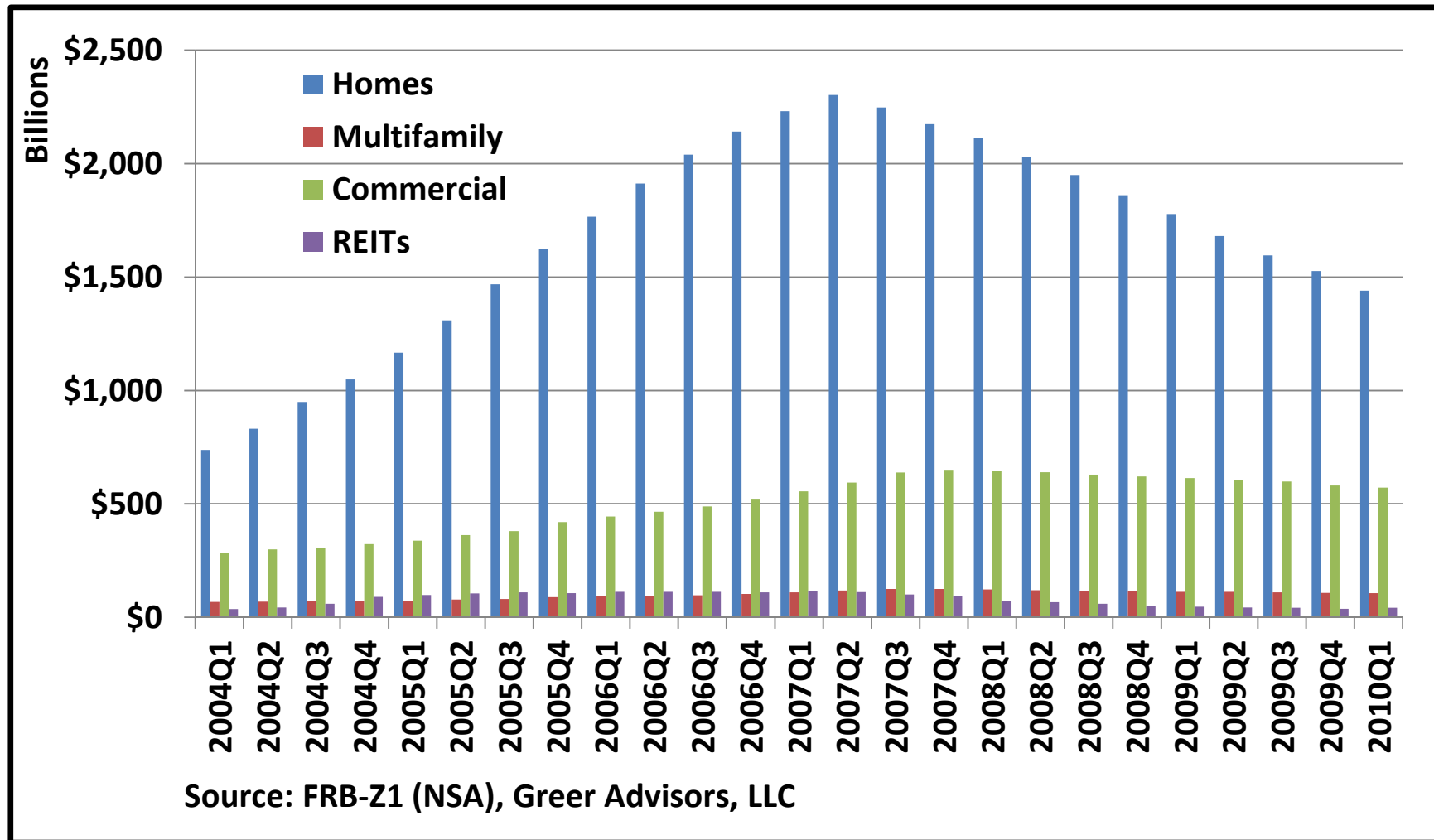
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What is a MBS?

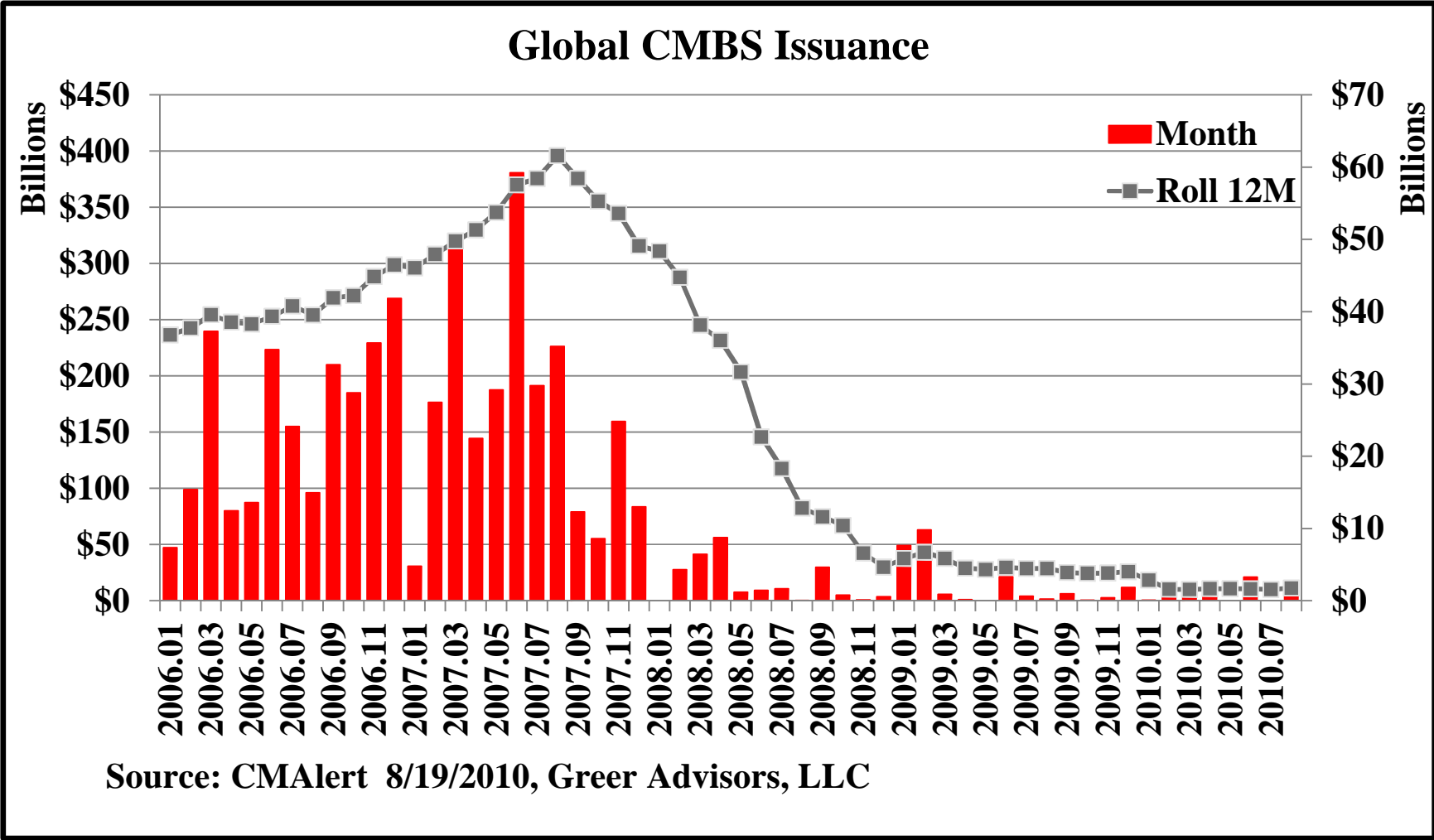
Mortgage Backed Security

- 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. Proceeds are distributed to investors based on the priority of their tranche.
- During 2006-2007, accounted for slightly less than 40% of all commercial real estate lending, and higher rate for residential.

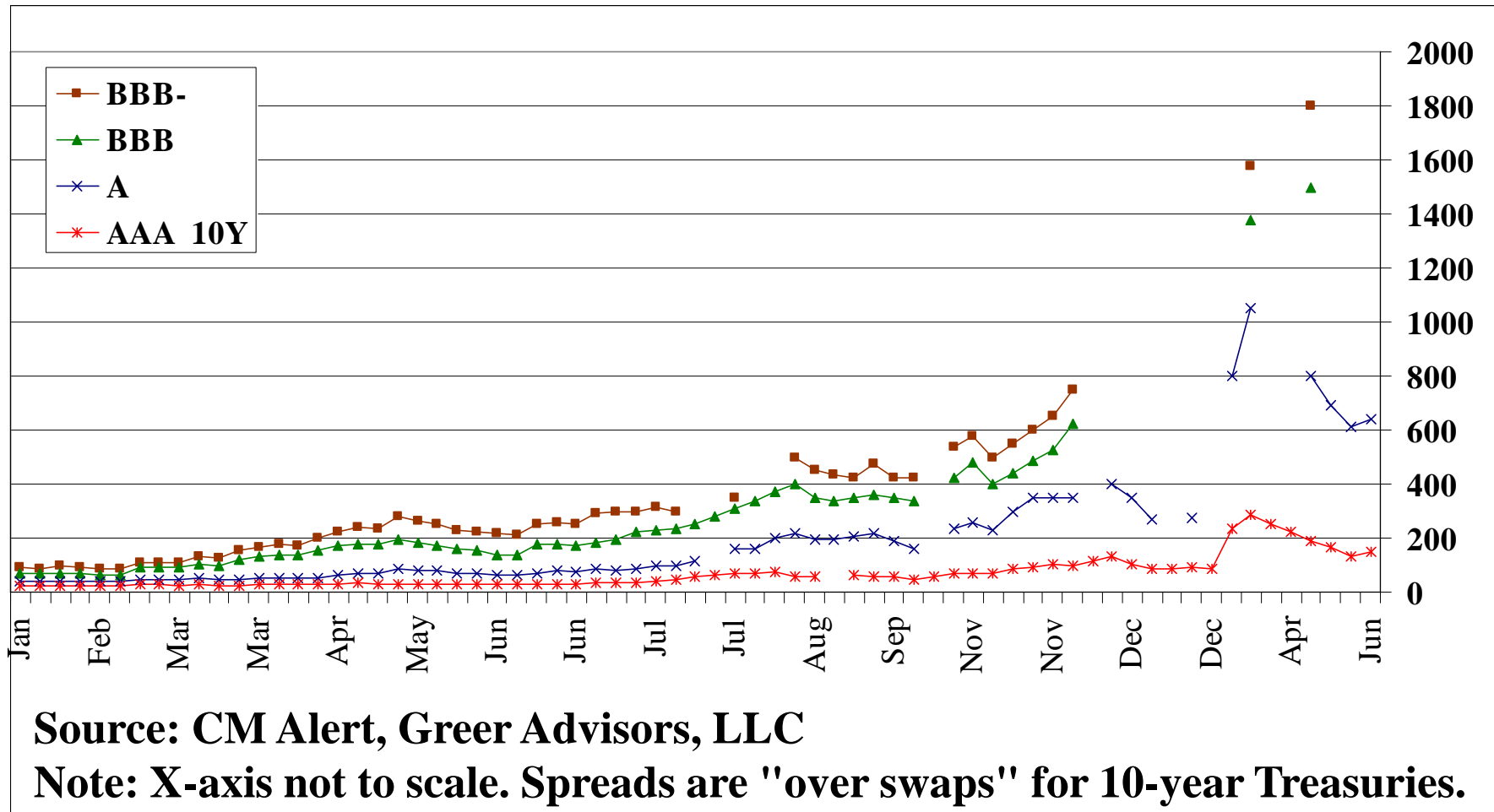
MBS Outstanding(s) in U.S. – Grows & Falls



CMBS Issuance



CMBS Yield Spreads (Spread to Swap)



Note: Prior to 2 weeks ago, last "TRUE" CMBS closed
 10 was June 29, 2008. Graph covers 1/2007 – Jun 2008

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Structure of a MBS – Then vs Now

		No. Loans		250		
		Avg. Loan Size		\$10,000,000		
		Total Loan Amt.		\$2,500,000,000		
		Index Name		10-Year Treasury		
		Index Rate		4.000%		
		Avg. Margin		1.750%		
		Avg Yield		5.750%		
THEN	NOW			THEN	NOW	
		Tranche	Approximate			
2007.01	2010.0907	Rating (10Y)	Subordination	2007.01	2010.0907	
0.0020	0.0038	AAA S60	60.0%	4.200%	4.383%	
0.0025	0.0061	AAA S30	30.0%	4.250%	4.613%	
0.0030	0.0160	AAA	12.5%	4.300%	5.596%	
0.0040	0.0442	AA	9.0%	4.400%	8.421%	
0.0100	0.1136	A	8.0%	5.000%	15.360%	
0.0175	0.2658	BBB	5.0%	5.750%	30.582%	
0.0250	0.2796	BBB-	4.0%	6.500%	31.964%	
0.0400	1.0000	BB	2.5%	8.000%	104.000%	
0.0500	1.5000	Unrated	0 to <2.5%	9.000%	154.000%	
Weighted Average Yield				4.494%	11.212%	
Implied Annual Excess Return				0.256%	-6.462%	
Note: Assumes 1% swap, agency, trust, servicer and other fees.				\$6,400,000	-\$161,543,540	

What is a CDO?

Collateralized Debt Obligation

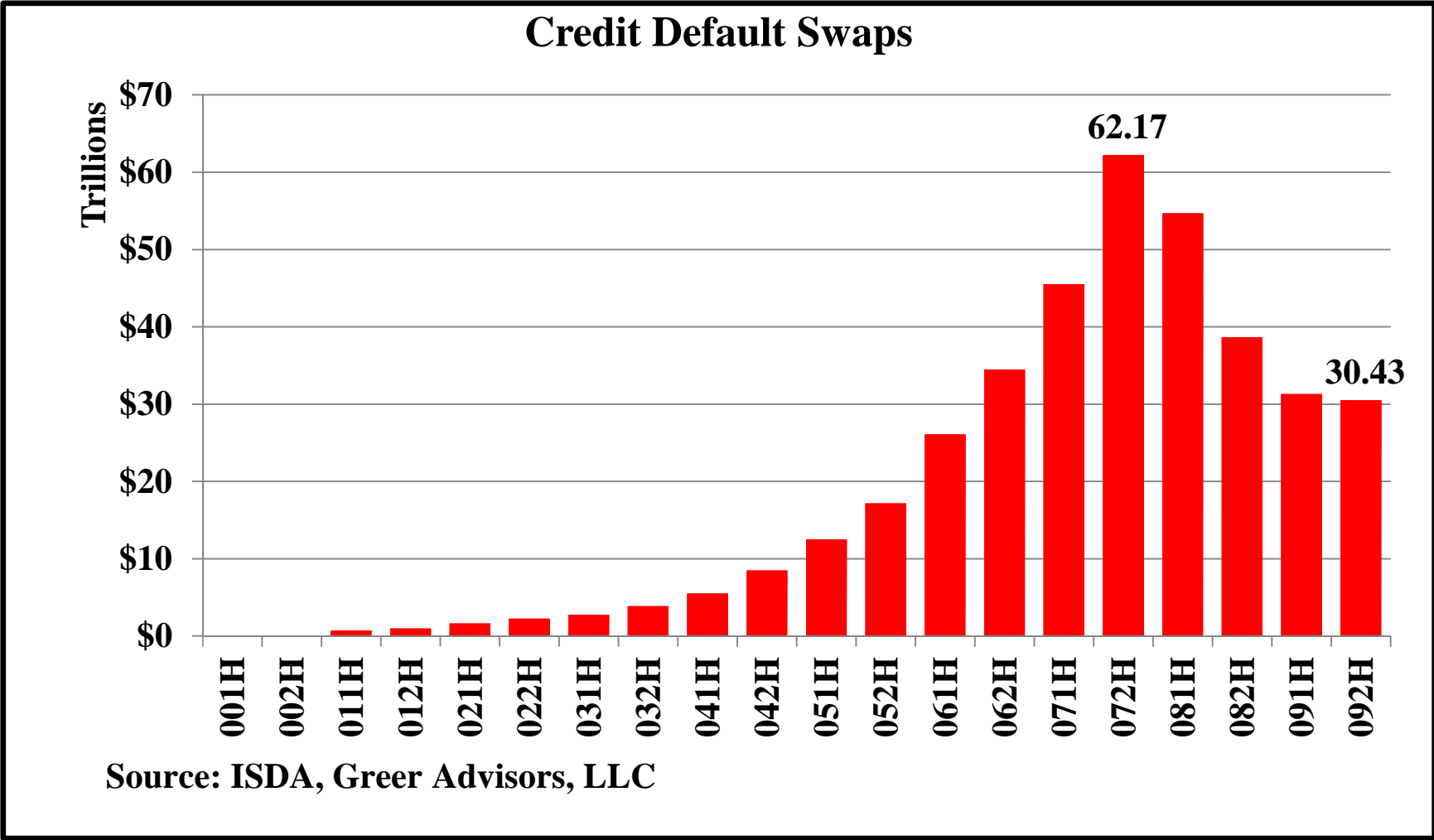
- Type of pass-through security
- CDOs are securitized debt pools, similar to CMBS, but debts can be CMBS/CDO paper, car/boat/plane loans, credit cards, or virtually any type of debt obligation. Rights to the revenue from the obligations are divided into many smaller pieces (tranches, strips, slices), each with differing priorities. Proceeds are distributed to investors based on the priority of their tranche.
- Tough to gauge accurately, but most experts believe these have accounted for 5-10% of all commercial real estate lending the past few years.

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 calls these “Weapons of Mass Destruction”

Credit Default Swaps

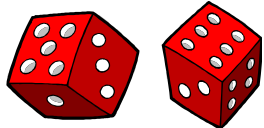


Players in “Simple” CDS

Business Issues Bonds

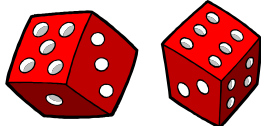


Side Bet 1

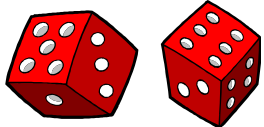


Bonds initially rated too poor for market, eg “BB”

Side Bet 2



Side Bet 3

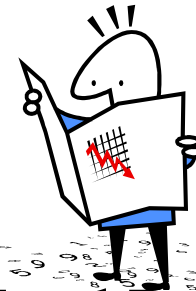


Investment Bank issues CDS (aka Credit Enhances Debt) Enough to make BB = AA, if debtor fails, IB buys bonds

Rating Agency Rates Bonds



Gives loss forecast & amount required for “AA” rating



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

Evolution of CDS

- 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 Party to Credit Facility, merely a speculator
- Sellers Provide Partial Coverage (ceiling on loss)
- Sellers Provide Incremental Coverage
 - Goal is to provide “Partial” Credit Enhancement
 - Ratings Are Enhanced (eg “BB” to “A” rating)
- CDS – Complex Credit
 - CMBS (vertical [multi-tranche buyer] or horizontal)
 - Multiple facilities
 - REITs added

CDS – Credit Enhancement – Market Change

■ **DEBT ISSUANCE**

- Debt Issued \$1B
- SRA Rates Debt
- Estimated Loss = \$10MM = “B” Rating
- SRA says \$1MM = AA
- \$9MM CDS bought
- Debt “credit enhanced” from “B” to “AA”

■ **DEBT RE-RATED**

- Existing Debt 6 mo’s later
- SRA Re-Rates Debt
- Estimated Loss now \$20MM = “unrated” security
- SRA says \$1MM = AA
- CDS provided \$9MM coverage, now addtl \$10MM expected loss
- Credit Enhancement not enough to yield desired rating on security

Note: Above is Hypothetical Example

Future - Mortgage Backed Security

- ‘Til MBS Returns, Real Estate markets WILL NOT recover
- Most banks ARE NOT in the business of holding debt
- New MBS WILL EMERGE with terms as follows
 - No “quick buck” investment banks/mortgage bankers
 - Issuer holds 1-5% of pool as “1st Loss / Good Faith” position
 - 60-80% of pool will be AAA, not 90+%
 - Buyers of paper will “re-underwrite” pools, regardless of SRA
 - Loans will get “kicked out” of pool by B-piece buyers
 - Could Fed’s replace NSROs?

New Underwriting & Stats

Latest Quarterly Banking Profile from FDIC shows largest lending declines in history past 4 qtrs.

9/7/2010 Trepp Reports CMBS Delinquency hits 8.92%

Delinquency Rate more than doubled 1 year ago 4.03%

Deleverage – Expect More

Lower LTV (old = 80-85% versus new = 50-60%)

Higher DSC (old = 1.05-120 versus new = 130-150)

Guarantees and Restrictive Covenants

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



Conclusions

- MBS Market – Yield Spreads are 10-100x higher than 1/07
- MBS – New Business Model will Arise
- REITs – have effectively recovered
- Lenders Remain Closed, Stopped or Reduced Lending
- Insurance Companies and Fannie/Freddie Lenders are Active
- Financing / Cap / Yield Rates Have RISEN
- CASH IS KING!
- Value Growth will Lag Rent Growth – by a Lot
- Rents / Vacancies Remain better than early 1990s
- Value Correction will Continue

Greer's 3-Year Forecast as of 9/9/2010

- Borrowing Rates will Continue to Rise. More banks will fail.
- Margins (to 10 Yr Treasuries or LIBOR) will rise and settle at 300 ± 50 bps over 10 year Treasuries, but might over-correct in the short run, say 10Yr 400+ bps for 70% LTV
- Rent Growth will Lag CPI growth by 2-8%
- Values will continue to fall 5-25%/yr thru 2012. Individual Market Performance will vary widely. (10-30% difference in Top vs Bottom)
- Capitalization Rates will Rise 2-4% during 2010-2012 (eg 5.0% to 7.25% = 30% decline in value)
- Declines: #1=Res Land, #2 Retail; #3=Industrial & Office; then Apartment
- Change Creates Opportunities

Greer's Recovery Signs – Prereq's to Recovery

- CDS Exposure under \$20 Trillion (i.e. say 30% of peak)
- Stable or Decline in MBx Yield Spreads for 6 straight weeks
- Re-emergence of MBS market
 - New MBS Market will include:
 - Issuer Keeps 1-5% 1st-loss piece
 - AAA Subordination near 30%....
 - AAA is 70%, not 90% of issue
- √ REIT Market Capitalization (Total Value) Stabilizes or Increases for 6 months
- Consumer Confidence Rises and Stays Above 70 for 6 months
 - As of 8/31/10 (last report) index at 53.5 (1985=100)
- Risk Curve (AAA Sr. vs BBB-) flattens to under 500 bps. As of 9/7/10, CMBx spread stands over 2,750 bps.

Questions / Answers

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