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# Wall Street and Commercial Real Estate

Everett (Allen) Greer  
Greer Advisors, LLC

December 2, 2010 – Las Vegas

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**Greer Advisors, LLC**

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# Goals of Presentation

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- Disclaimers
- Market Drivers
- Financial Regulations
  - Consumer
  - Real Estate
  - Securitization
- Wall Street and Capital Markets
  - REIT / MBS / CDO / CDS
- Expected Changes / Outlook
  - Securitization
  - Lending
- Greer's Forecast / Signs

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# Market Drivers

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

- Non-Res. Supply Growth was Very Limited Growth
- Most Demand 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
- Jobs & Retail Sales - Drive Supply & Demand!!!

**Financing – Currently Most Important Fundamental for most of Country, add Global Economy for Las Vegas**

# Economy – Comparison

<b>Demographic - Comparison</b>	Las Vegas	North Las Vegas	Nevada	Arizona	California	United States
2010 - 2015 Population Growth	1.13%	2.76%	1.76%	1.87%	0.70%	0.76%
2010 - 2015 Household Growth	1.05%	2.89%	1.72%	1.83%	0.63%	0.78%
2010 Median Household Income	\$54,367	\$60,928	\$57,546	\$54,713	\$60,992	\$54,442
2010 Per Capita Income	\$25,773	\$21,183	\$26,969	\$25,823	\$27,845	\$26,739
<b>2010 Population by Age</b>						
Age 0 - 9 (young children)	15.1%	18.3%	14.1%	14.7%	14.7%	13.5%
Age 18+ (workforce)	74.3%	68.9%	75.6%	74.6%	74.3%	75.8%
Age 65+ (retirement)	12.5%	8.6%	12.7%	14.1%	11.1%	13.1%
Age 85+ (aging / health)	1.3%	0.9%	1.4%	1.9%	1.7%	2.0%
2010 Median Age	35.8	31.8	37.0	36.0	34.4	37.0
<b>Source: ESRI, U.S. Census Bureau, Greer Advisors, LLC</b>						

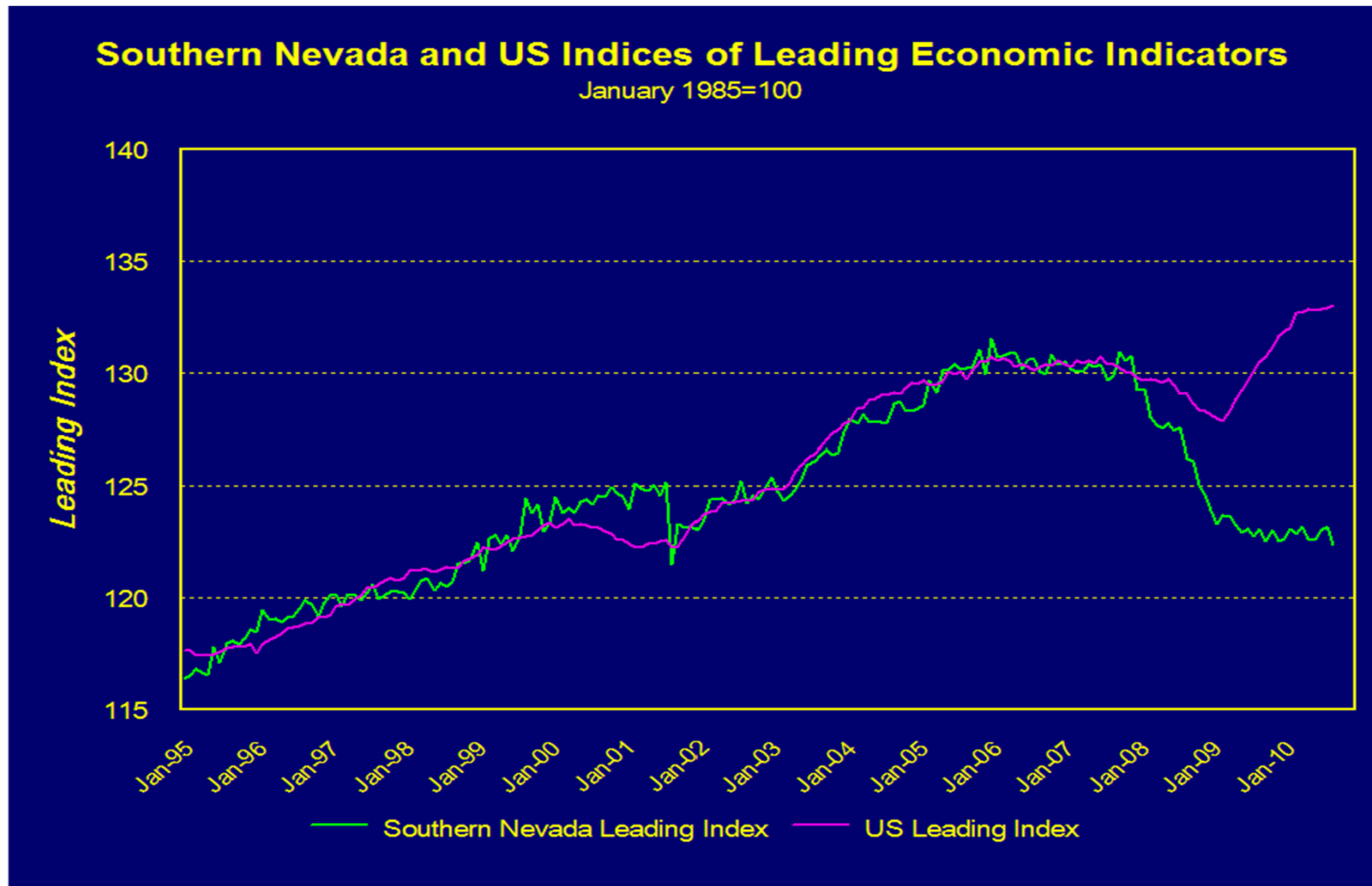
# Economy – Comparison

<b>2010 Employed Population 16+ by Industry</b>						
	Las Vegas	North Las Vegas	Nevada	Arizona	California	United States
<b>Total</b>						
Agriculture/Mining	0.2%	0.1%	1.1%	1.4%	1.9%	1.8%
Construction	9.1%	11.1%	8.6%	8.3%	5.9%	6.5%
Manufacturing	2.7%	2.9%	3.8%	6.8%	9.2%	9.6%
Wholesale Trade	2.2%	2.1%	2.5%	2.8%	3.6%	3.2%
Retail Trade	9.8%	9.0%	9.9%	12.0%	10.9%	11.4%
Transportation/Utilities	3.6%	3.6%	4.0%	4.6%	4.3%	4.9%
Information	1.9%	1.6%	1.8%	2.2%	2.9%	2.3%
Finance/Insurance/Real Estate	7.9%	6.4%	7.0%	8.5%	7.4%	7.1%
<b>Services</b>	<b>58.8%</b>	<b>58.8%</b>	<b>56.8%</b>	<b>47.5%</b>	<b>49.4%</b>	<b>48.0%</b>
Public Administration	3.8%	4.4%	4.5%	5.9%	4.5%	5.1%
<b>Employment Base Index (to Nation)</b>						
Agriculture/Mining	11.1	5.6	61.1	77.8	105.6	100
Construction	140.0	170.8	132.3	127.7	90.8	100
Manufacturing	28.1	30.2	39.6	70.8	95.8	100
Wholesale Trade	68.8	65.6	78.1	87.5	112.5	100
Retail Trade	86.0	78.9	86.8	105.3	95.6	100
Transportation/Utilities	73.5	73.5	81.6	93.9	87.8	100
Information	82.6	69.6	78.3	95.7	126.1	100
Finance/Insurance/Real Estate	111.3	90.1	98.6	119.7	104.2	100
<b>Services</b>	<b>122.5</b>	<b>122.5</b>	<b>118.3</b>	<b>99.0</b>	<b>102.9</b>	<b>100</b>
Public Administration	74.5	86.3	88.2	115.7	88.2	100
<b>Source: ESRI, U.S. Census Bureau, Greer Advisors, LLC</b>						

# Economy – Local Stats

	<b>Metropolitan Las Vegas Tourism Statistics</b>						
<b>Visitor Spending</b>	\$32,777,906,000	\$33,724,467,000	\$36,733,453,000	\$39,406,265,000	\$41,578,079,000	\$41,600,000,000 <sub>b</sub>	\$35,200,000,000 <sub>b</sub>
<b>Visitor Volume</b>	35,540,126	37,388,781	38,566,717	38,914,889	39,196,761	37,481,552	36,351,469
<b>Hotel Rooms</b>	130,482	131,503	133,186	132,605	132,947	140,529	148,941
<b>Occupancy Rate</b>	85.0%	88.6%	89.2%	89.7%	90.4%	86.0%	81.5%
<b>Room Nights Occupied</b>	39,760,735	41,953,010	43,166,172	43,496,236	43,978,733	42,967,252	41,986,134
<b>Average Room Rate<sup>a</sup></b>	\$82.48	\$89.78	\$103.12	\$119.66	\$132.09	\$119.19	\$92.93
<b>Gross Gaming Revenue</b>	\$7,831,273,707	\$8,711,998,881	\$9,717,372,388	\$10,630,452,393	\$10,868,455,573	\$9,796,750,908	\$8,838,053,367
<b>Airline Passengers</b>	36,265,932	41,441,531	44,267,376	46,304,376	47,729,527	44,074,707	40,469,012
<b>Convention Attendance</b>	5,657,796	5,724,864	6,166,194	6,307,961	6,209,253	5,899,725	4,492,275
<b>Convention Economic Impact</b>	\$6,546,775,778	\$6,860,512,075	\$7,608,151,056	\$8,182,818,340	\$8,449,208,768	N/A	N/A
Data sources: Las Vegas Convention and Visitors Authority, State of Nevada Gaming Control Board, McCarran International Airport.							
<sup>a</sup> LVCVA; 2003 and later Average Room Rate based on data provided from area hotels. Prior year room rates were taken from survey of visitors (Visitor Profile Study).							
<sup>p</sup> Estimated							

# Economy – Local Stats



# Economy – Local Stats

Southern Nevada Index of Leading Economic Indicators						
CLARK COUNTY SERIES	DATE	UNITS	LATEST PERIOD	CHANGE PREVIOUS PERIOD	CHANGE YEAR AGO	CONTRIBUTION TO INDEX*
Residential Building Units Permitted	September-10	# Units Permitted	243	-38.32%	-42.00%	-0.069%
Residential Building Permit Valuation	September-10	Dollars	\$29,072,660	-32.44%	-40.78%	-0.041%
Commercial Building Permits	September-10	# Units Permitted	22	-4.35%	15.79%	-0.020%
Commercial Building Permit Valuation	September-10	Dollars	\$4,484,103	66.43%	-55.53%	-0.005%
Taxable Sales	September-10	Dollars	\$2,324,288,849	-0.01%	-0.89%	-0.090%
McCarran Airport	September-10	Passengers Enplaned/Deplaned	3,268,931	-6.42%	-2.01%	0.050%
Gallons of Gasoline	September-10	Gallons	61,101,694	-7.23%	-2.48%	-0.044%
Gross Gaming Revenue	September-10	Dollars	\$785,717,694	-2.53%	1.50%	-0.438%
Visitor Volume	September-10	People	3,123,549	-2.44%	2.00%	-0.007%
Conventions Held Attendance	September-10	People	291,248.00	-15.60%	-27.43%	-0.01%
<b>Overall Change in Leading Indicator**</b>	<b>November-10</b>		<b>122.37</b>	<b>-0.68%</b>	<b>-0.59%</b>	<b>-0.68%</b>
*The contribution to the Index is a net-weighted average of each series after adjustment for seasonal variation.						
**The Index is a six-month forecast from the month of the data and four months from the month of the series.						
Sources: Local Building Permitting Agencies; Nevada Department of Taxation; McCarran International Airport; Nevada State Gaming Control Board; Las Vegas Convention and Visitors Authority						



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## Local Stats - Conclusion

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### **Las Vegas is Built on Discretionary Income (DI)**

- Increases in Discretionary Spends Lags Economic Growth
- Economic Crisis is Hurting Las Vegas more than most cities
- Economic Crisis is Global = No Countries are Spending
- Many Other Countries have Opened Gaming = Competition

**Las Vegas is dependent upon Services, and Visitors**

**Services and Visitors are due to Gaming**

**Wall Street and the Globe Drives our Real Estate!!!**

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# Financial Regulations

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## **Dodd-Frank Wall Street Reform & Consumer Protection Act**

- 16 Titles – See Summary on Wikipedia
  - 243 Rules to be created (about ½ done)
  - 67 Studies required
  - 22 New Periodic Reports
- Restructure of Regulators, elimination of OTS
  - Financial Stability Oversight Council (New)
  - Office of Financial Research (New)
- Keys for Commercial Real Estate:
  - Rating Agency Reform
  - Securitization Reform
  - Derivatives – minimal change

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# ■ Wall Street and Capital Markets

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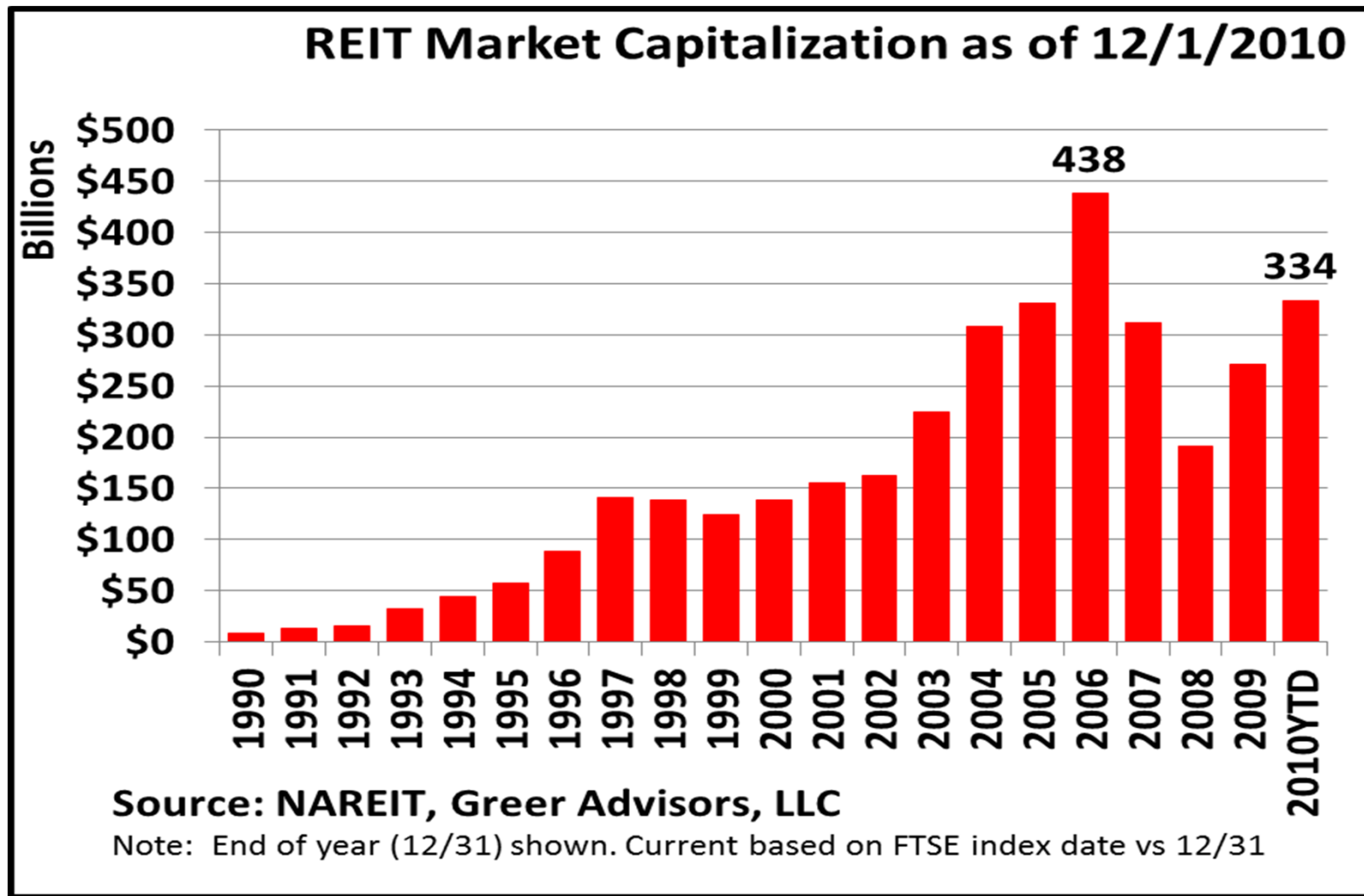
# What is REIT?

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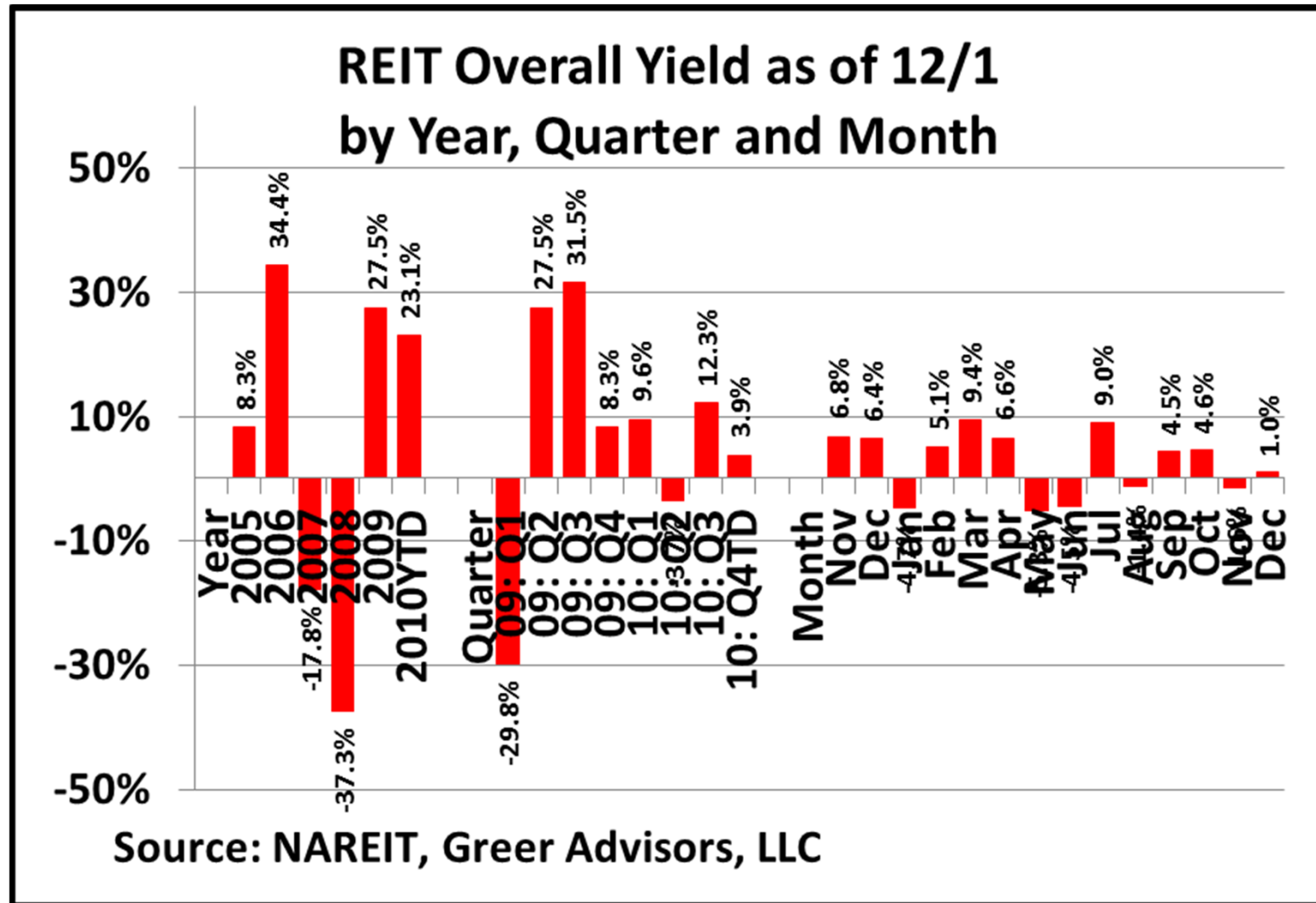
## Real Estate Investment Trust

- 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

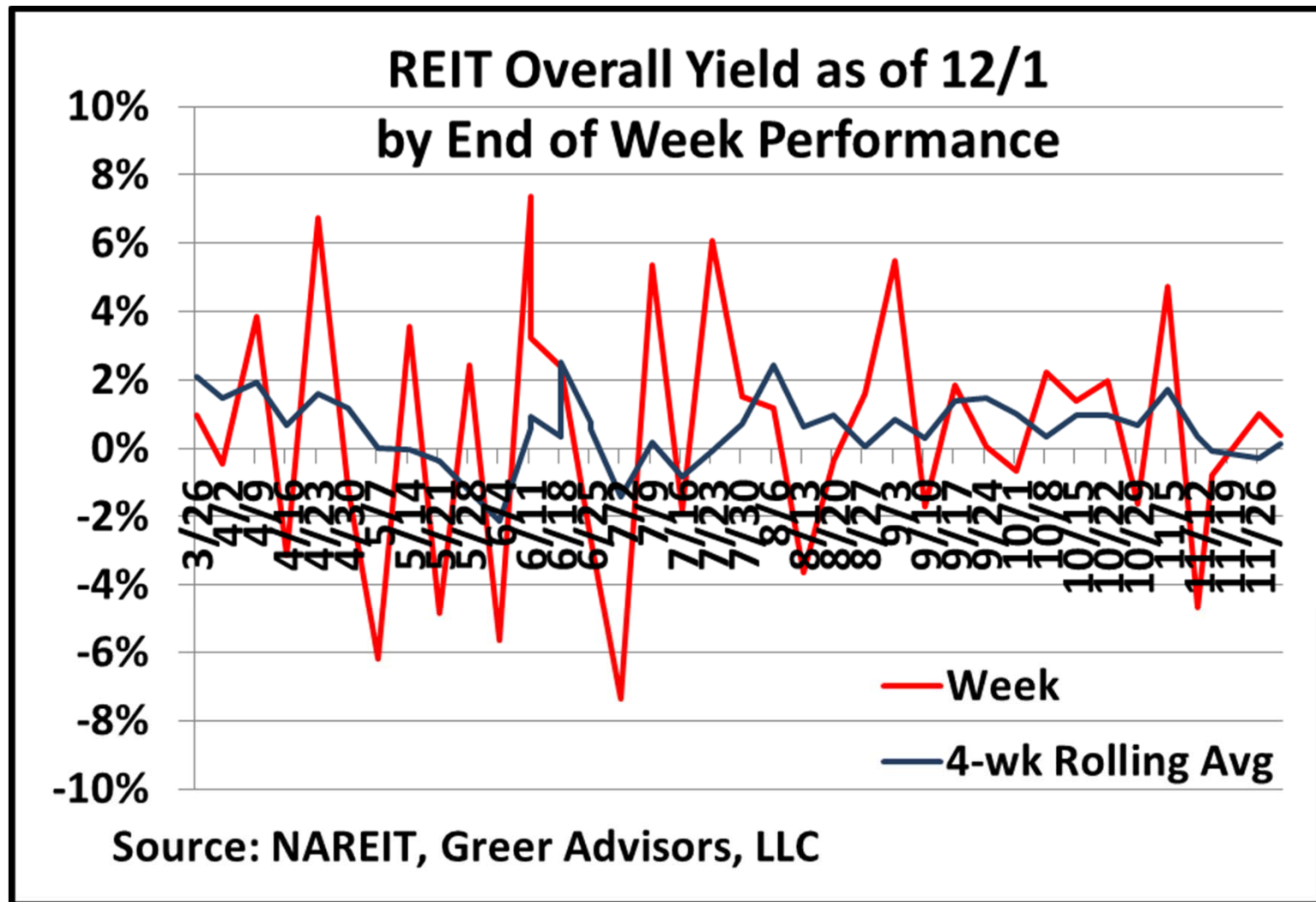
# REIT Market Capitalization



# Overall REIT Dividend Yields – Stable?



# Overall REIT Dividend Yields – Stable?



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# What is a MBS?

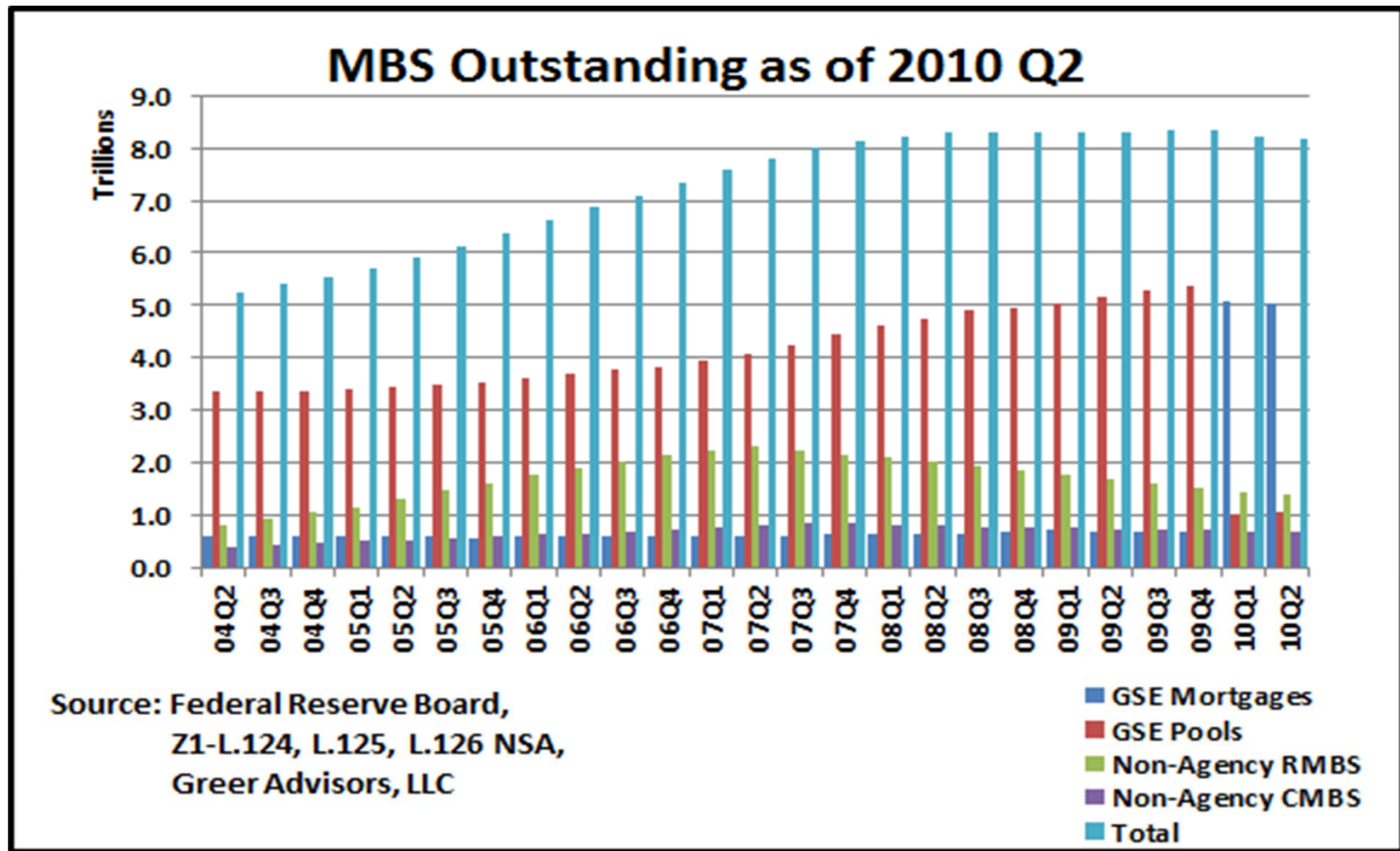
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## Mortgage Backed Security

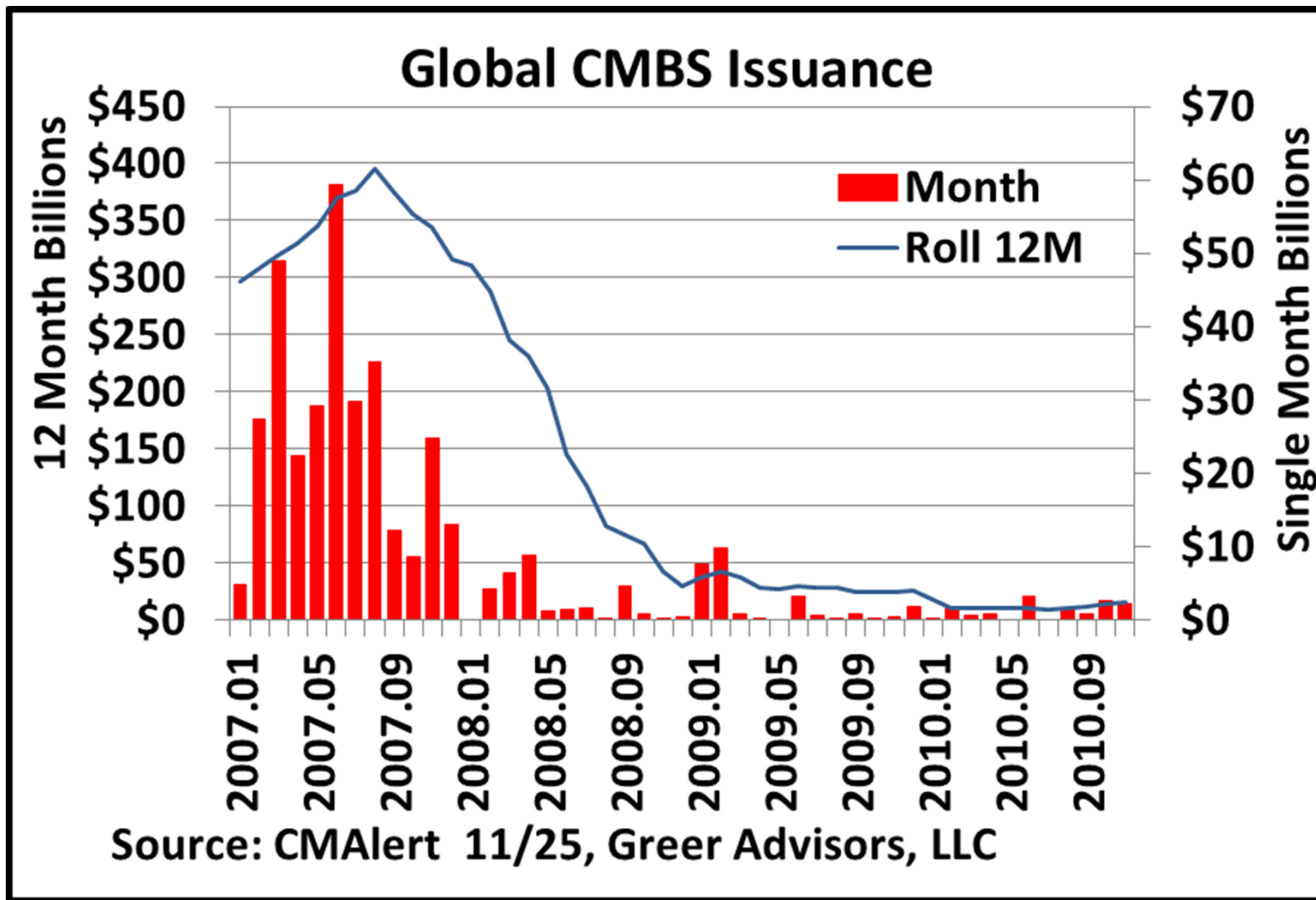
- Type of pass-through security
- Mortgages are securitized into a pool. Rights to the revenue from the mortgages are divided into many smaller pieces (tranches, strips, slices), each with differing priorities. Proceeds are distributed to investors based on the priority of their tranche.
- During 2006-2007, accounted for slightly less than 40% of all commercial real estate lending, and higher rate for residential.



# MBS Outstanding's in U.S. - Dropping



# Global CMBS Issuance - Falls



# CMBx Data

Greer CMBS / CMBx Yield Rate <sup>TM</sup>					<p>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. 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. Jan. '07 AAA-BB CMBS spreads were under 100 bps. Lastly, the yields for each tranche provide tremendous insight into the required yields for each layer in the capital stack.</p> <p>Note: Markit<sup>TM</sup> Data and Calculations based on close of 11/26. Swap (10Yr) as of 11/29.</p> <p>Source: Coupon and Price data were from Markit<sup>TM</sup> for AAA Senior through BB bonds. Markit<sup>TM</sup> data was used as part of the calculations by Greer Advisors, LLC to determine Spreads. Subordination levels were from Markit<sup>TM</sup>.</p> <p>Note: Profit / arbitrage opportunity for the issuer was ignored.</p> <p>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.</p>
Tranche	Yield	Suboord	Weight of Debt	Contribution to Total	
AAA	3.38%	29.76%	70.24%	2.37%	
AJ	4.30%	12.70%	17.06%	0.73%	
AA	5.99%	10.63%	2.07%	0.12%	
A	10.54%	8.00%	2.63%	0.28%	
BBB	27.84%	4.72%	3.28%	0.91%	
BBB-	28.86%	3.68%	1.04%	0.30%	
BB	103.01%	2.69%	0.99%	1.02%	
Unrated	177.00%	0.00%	2.69%	4.76%	
Implied Overall Debt Yield			100.00%	10.50%	
Loan to Value Ratio				75.0%	
Class-A Equity Yield   Total Yield			29.00%	15.13%	
Class-B Equity Yield   Total Yield			103.00%	33.63%	

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# What is a CDO?

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## 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.

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# What is CDS?

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## 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???

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# Players in “Simple” CDS

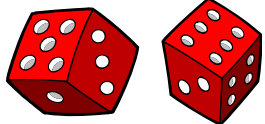
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## Business Issues Bonds

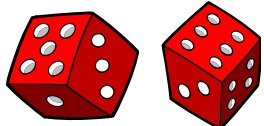


Bonds initially rated too poor  
for market, eg “BB”

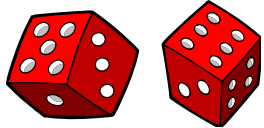
Side Bet 1



Side Bet 2



Side Bet 3

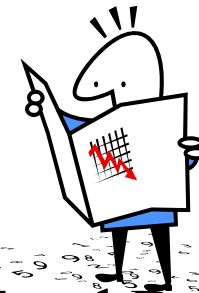


Investment Bank issues CDS  
(aka Credit Enhances Debt)  
Enough to make BB = AA, if  
debtor fails, IB buys bonds

## Rating Agency Rates Bonds



Gives loss forecast & amount  
required for “AA” rating



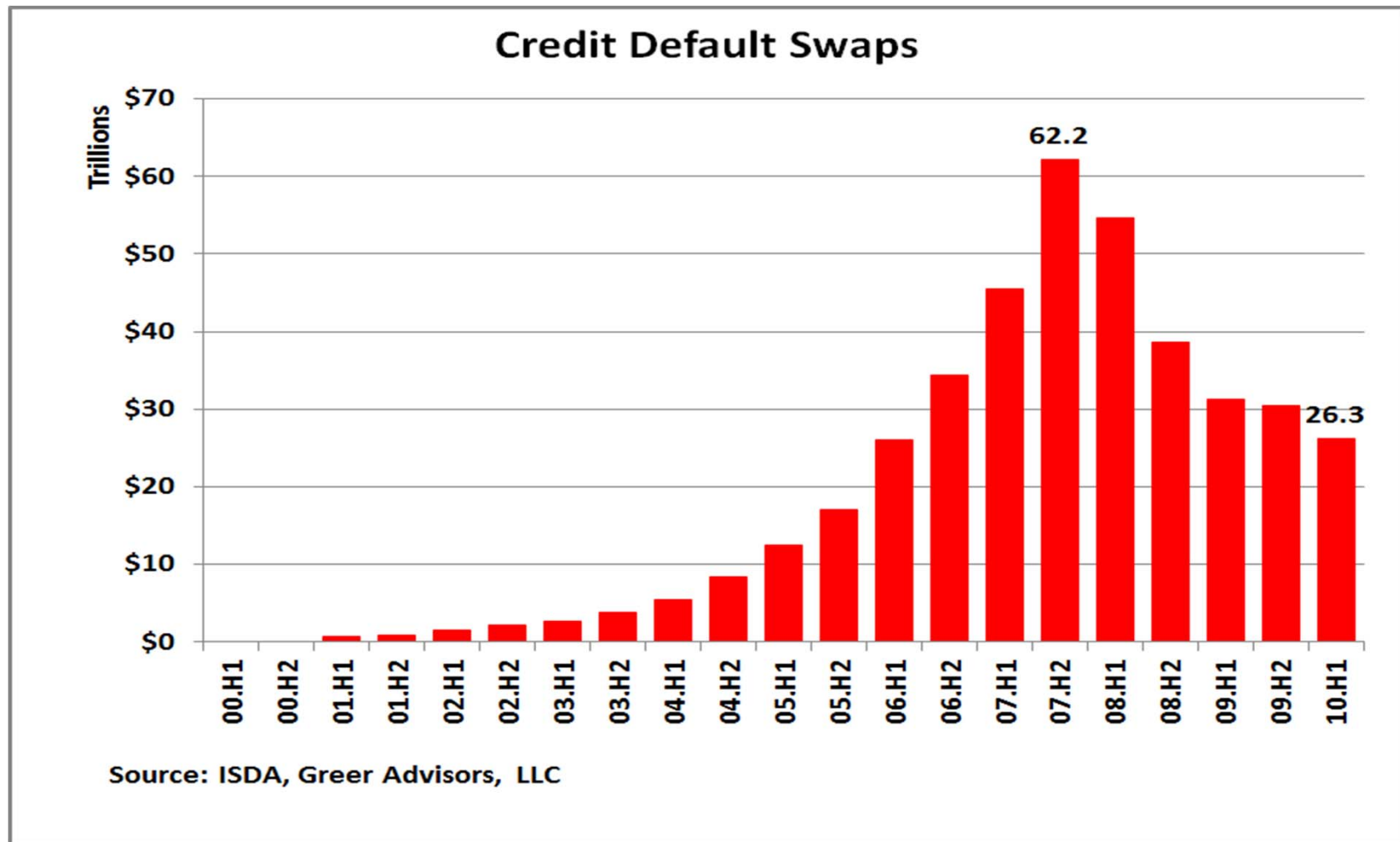
Pension Fund Buys Bonds  
with CDS enhancement  
Thinks it's AA investment

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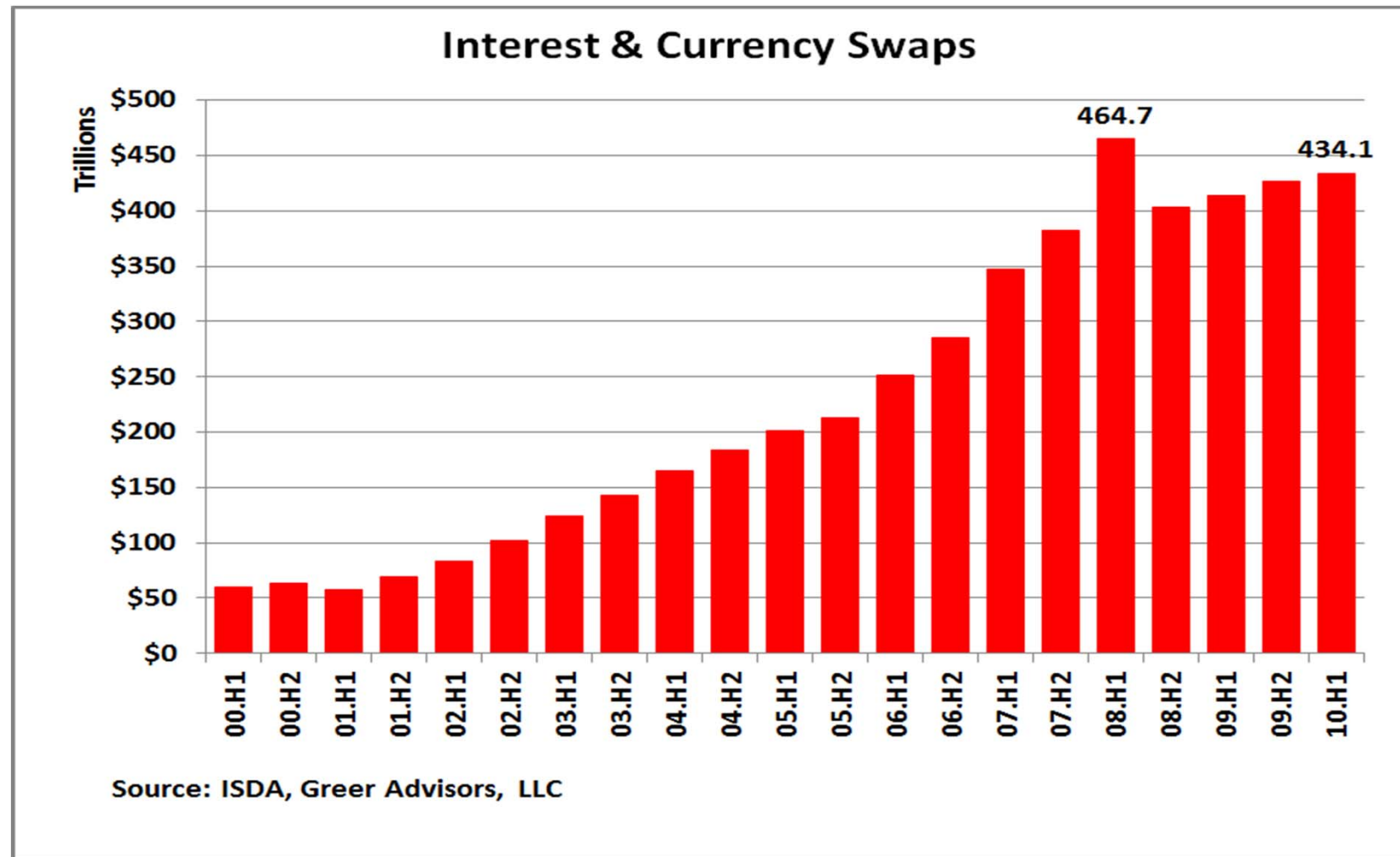
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# Credit Default Swaps



# Interest & Currency Swaps





# Top - Bottom Market Stats – as of 2010 Q3

Office			Industrial			Apartment			Hotel			
MSA	Vac%	Rent \$	MSA	Vac%	Rent \$	MSA	Vac%	Rent \$	MSA	Occ	ADR	RevPAR
1 New York	8.7	\$55.62	1 Los Angeles	8.1	\$6.67	1 San Jose	2.9	\$1,555	1 Honolulu	85.3	\$156.86	\$133.81
2 Honolulu	8.8	\$26.44	2 Salt Lake City	9.3	\$4.57	2 Pittsburgh	3.4	\$863	2 San Francisco	84.6	\$135.35	\$114.48
3 Long Island	11.3	\$19.82	3 Kansas City	10.3	\$6.10	3 Philadelphia	3.5	\$1,097	3 New York	84.1	\$215.02	\$180.89
4 Pittsburgh	11.5	\$17.10	4 Houston	10.5	\$5.32	4 Oakland	3.7	\$1,270	4 Boston	80.7	\$150.21	\$121.15
5 Trenton	12.0	\$23.82	5 San Francisco	10.5	\$7.76	5 San Diego	3.7	\$1,320	5 Seattle	79.0	\$114.84	\$90.77
6 Stamford	12.5	\$26.08	6 Long Island	10.9	\$5.58	6 Newark	3.8	\$1,230	6 Long Island	77.8	\$133.49	\$103.92
7 Washington D.C.	13.1	\$35.23	7 Portland	11.0	\$6.25	7 Boston	3.9	\$1,436	7 San Diego	76.0	\$129.12	\$98.14
8 Boston	13.2	\$27.18	8 Orange County	11.1	\$8.54	8 Minneapolis	4.0	\$914	8 Orange County	73.8	\$111.08	\$82.03
9 San Francisco	14.1	\$21.65	9 Seattle	11.2	\$9.21	9 Portland	4.0	\$819	9 Los Angeles	73.3	\$118.03	\$86.56
10 Nashville	14.2	\$19.85	10 New York	11.8	\$5.61	10 Albuquerque	4.1	\$688	10 Portland	71.5	\$91.52	\$65.39
50 West Palm Beach	21.5	\$20.87	51 Vallejo	16.2	\$5.62	55 Birmingham	8.2	\$756	45 Hartford	57.4	\$91.90	\$52.73
51 Edison	21.6	\$17.15	52 Hartford	17.7	\$6.39	56 St. Louis	8.2	\$727	46 New Orleans	57.1	\$103.15	\$58.91
52 San Jose	21.7	\$25.93	53 Boston	17.9	\$5.87	57 Tucson	8.3	\$619	47 Houston	57.0	\$89.92	\$51.25
53 Jacksonville	21.9	\$15.76	54 Sacramento	18.3	\$4.73	58 Atlanta	8.4	\$759	48 Dallas	56.8	\$82.20	\$46.72
54 Tampa	21.9	\$18.83	55 Phoenix	18.7	\$5.03	59 Fort Worth	8.4	\$652	49 Detroit	56.8	\$77.47	\$44.01
55 Dallas	22.3	\$18.22	56 Atlanta	18.8	\$3.25	60 Phoenix	8.8	\$677	50 Richmond	56.2	\$75.94	\$42.68
56 Riverside	22.4	\$18.57	57 Stamford	19.4	\$5.95	61 Jacksonville	9.2	\$741	51 West Palm Beach	54.6	\$95.69	\$52.26
57 Las Vegas	24.6	\$21.07	58 Detroit	20.5	\$3.67	62 Indianapolis	9.3	\$670	52 Tampa	50.4	\$82.48	\$41.59
58 Detroit	24.9	\$15.92	59 Memphis	20.7	\$2.36	63 Houston	9.5	\$754	53 Tucson	48.3	\$74.29	\$35.87
59 Phoenix	26.1	\$18.73	60 Trenton	21.2	\$3.92	64 Memphis	10.4	\$657	54 Phoenix	46.0	\$73.43	\$33.80
Best - Worst	17.4		Best - Worst	13.1		Best - Worst	7.5		Best - Worst	39.3		
57 Las Vegas	24.6	\$21.07	24 Las Vegas	13.6	\$5.62	54 Las Vegas	7.9	\$716	Not Tracked			
59 Phoenix	26.1	\$18.73	55 Phoenix	18.7	\$5.03	60 Phoenix	8.8	\$677	54 Phoenix	46.0	\$73.43	\$33.80
30 Los Angeles	17.2	\$25.29	1 Los Angeles	8.1	\$6.67	11 Los Angeles	4.1	\$1,474	9 Los Angeles	73.3	\$118.03	\$86.56
Sum Of Markets	16.6	\$26.44	Sum of Markets	14.0	\$5.20	Sum Of Markets	5.7	\$1,158	Sum Of Markets	66.2	\$109.66	\$72.62

Source: REIS, Greer Advisors, LLC

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# Vital Stats on Las Vegas

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- Move to Internet:
- <http://www.lvcva.com/getfile/624/ES-YTD2010.pdf>

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# Future - Mortgage Backed Security

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- If NSROs don't "**Get It**" Feds could replace them
- '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 "1<sup>st</sup> Loss / Good Faith" position
  - 60-80% of pool will be AAA, not 90+%
  - Buyers of paper will "re-underwrite" pools, regardless of

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# Future of Banking

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**Past Two Years have Shown largest lending decline in history - see FDIC QBP**

**CMBS and Banks Loss Rates - All Time Highs**

**Separation of “Best of Best” Class A vs. Class B/C**

**Deleverage – Expect More for Class B/C**

**More Restrictive Covenants for REITs, CMBS**

**“R” word for Loans (recourse)**

**Capital Ratios – Leverage – QE2**

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# Conclusions

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- MBS Market –Spreads are 10-100x higher than 1/07
- MBS – New Business Model will Arise
- REITs – Virtually Recovered
- Many Lenders Closed, Stopped or Reduced Lending
- Insurance Companies and Fannie/Freddie Lenders are Active
- CASH IS KING! Cap/Yield Rates Have RISEN for Class B/C
- Value Growth will Lag Rent Growth – by a Lot
- Rents / Vacancies Remain better than early 1990s
- Real Estate Cost is **NOT** the Largest Cost of Business!!!

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## Quote of the Day

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“...prediction is very difficult, especially when it’s about the future...”

~~NY Yankees #8, Yogi Berra~~

Niels Bohr

Nobel Laureate, 1922

Atomic Structure /

Quantum Mechanics



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**Greer Advisors, LLC**

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## Greer's 3-Year Forecast as of 12/01/2010

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- Global Economy Heals = Recovery for Las Vegas (Barbell)
- Margins (to 10 Yr Treasuries or LIBOR) will rise and settle at  $300 \pm 50$  bps over 10 year Treasuries, but might over-correct in the short run, say 10Yr 400+ bps.
- Rent Growth will Lag CPI growth by 2-6%.
- Values will continue to fall 0-10%/yr thru mid-2011. Individual Market Performance will vary widely. (10-30% difference in Top vs Bottom)
- Capitalization Rates will Rise 1-3% during 2010-2012 (eg 5.0% to 7.25% = 30% decline in value)
- Declines: #1=Retail; #2=Office & Industrial; then Apartment
- Change Creates Opportunities – Build Businesses
- Complete Barbell Forecast

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## Greer's Recovery Signs – Prereq's to Recovery

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- CDS Exposure under \$25 Trillion (i.e. under 50% of peak)
- Stable or Decline in CMBx Yield Spreads for 6 straight weeks
- Re-emergence of CMBS market
  - New CMBS Market will include:
    - Issuer Keeps 1-5% 1<sup>st</sup>-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 11/30/10 (last report) index at 54.1 (1985=100)
- Risk Curve (AAA Sr. vs BB) flattens to under 500 bps. As of 11/26/10, CMBx spread stands nearly 100 pts (3.38 v 103.01)



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# Questions / Answers

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**Greer Advisors, LLC**

[www.GreerAdvisors.com](http://www.GreerAdvisors.com)