
Capital Markets and Commercial Real Estate

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Greer Advisors, LLC

Goals of Presentation

- Disclaimers
- Market Drivers – Economy, Interest Rates
- Capital Market Trends - CMBS, REITs, CDS
- Financial Regulations (Dodd-Frank)
- Investment Banking
- Market Conditions (Sales Volume, Price PSF, Cap Rates)
- Outlook & Forecast

Disclaimers

This presentation is being conducted by Everett Allen Greer of Greer Advisors, LLC who is not affiliated with Bank of America Merrill Lynch and is solely responsible for the information presented in this program.

■ Market Drivers

Market Drivers

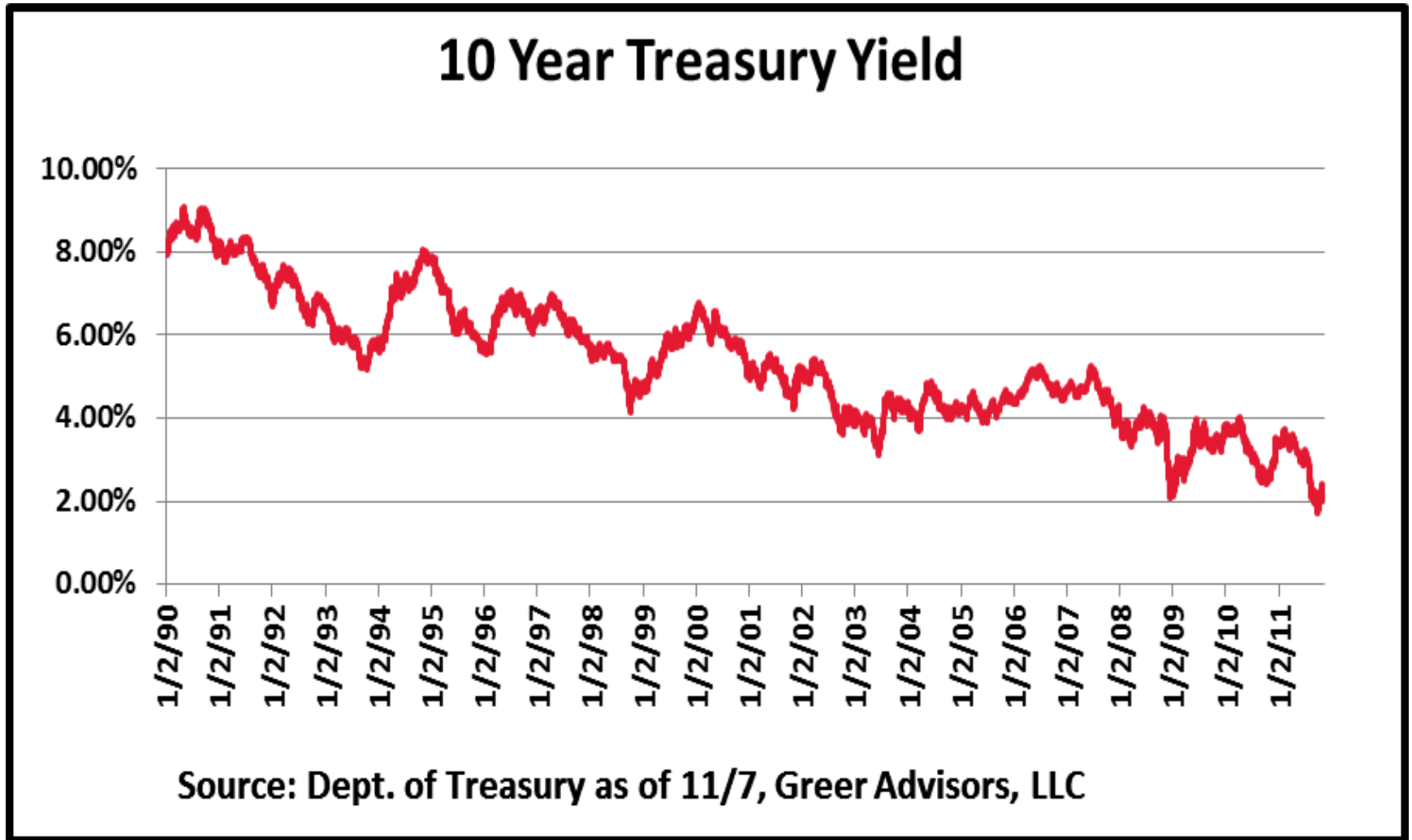
Supply / Demand – Not as bad as early 90's

- Non-Res. Supply Growth was Very Limited Growth
- Most Demand ties to Jobs, which is tied to GDP
 - 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!!!

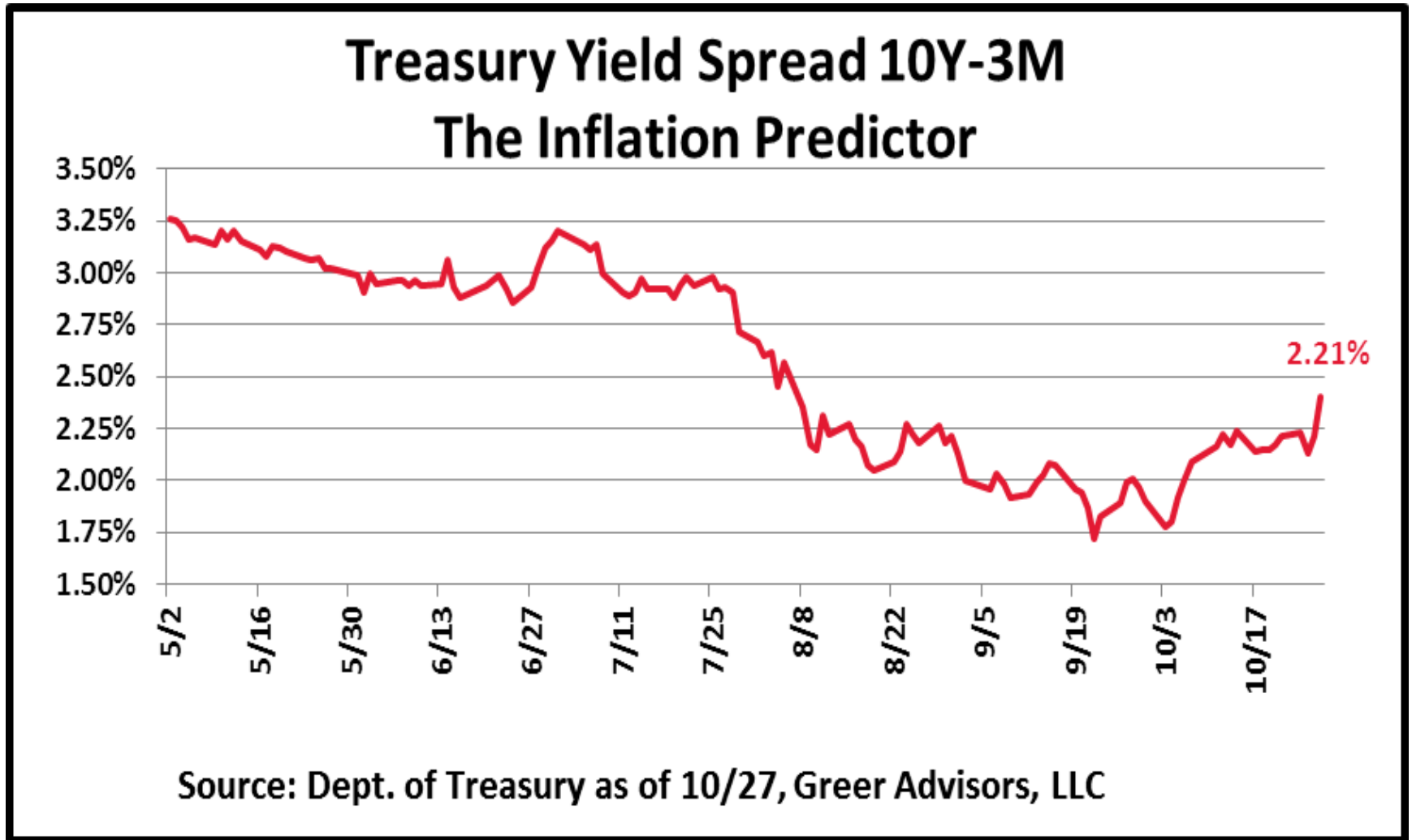
Financing – Is the Most Important Fundamental

- Leverage, Rate, Term, Recourse

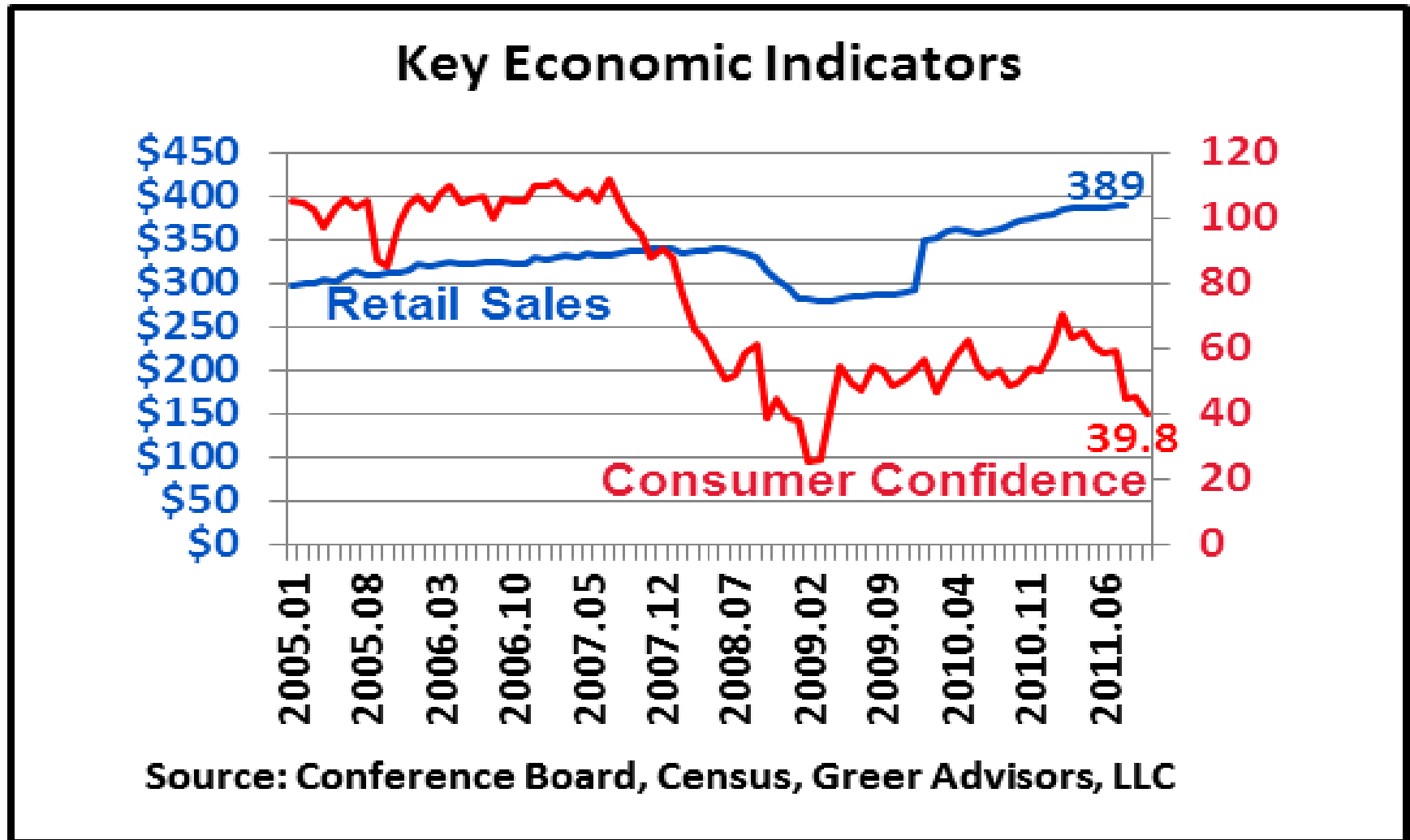
Interest & Inflation



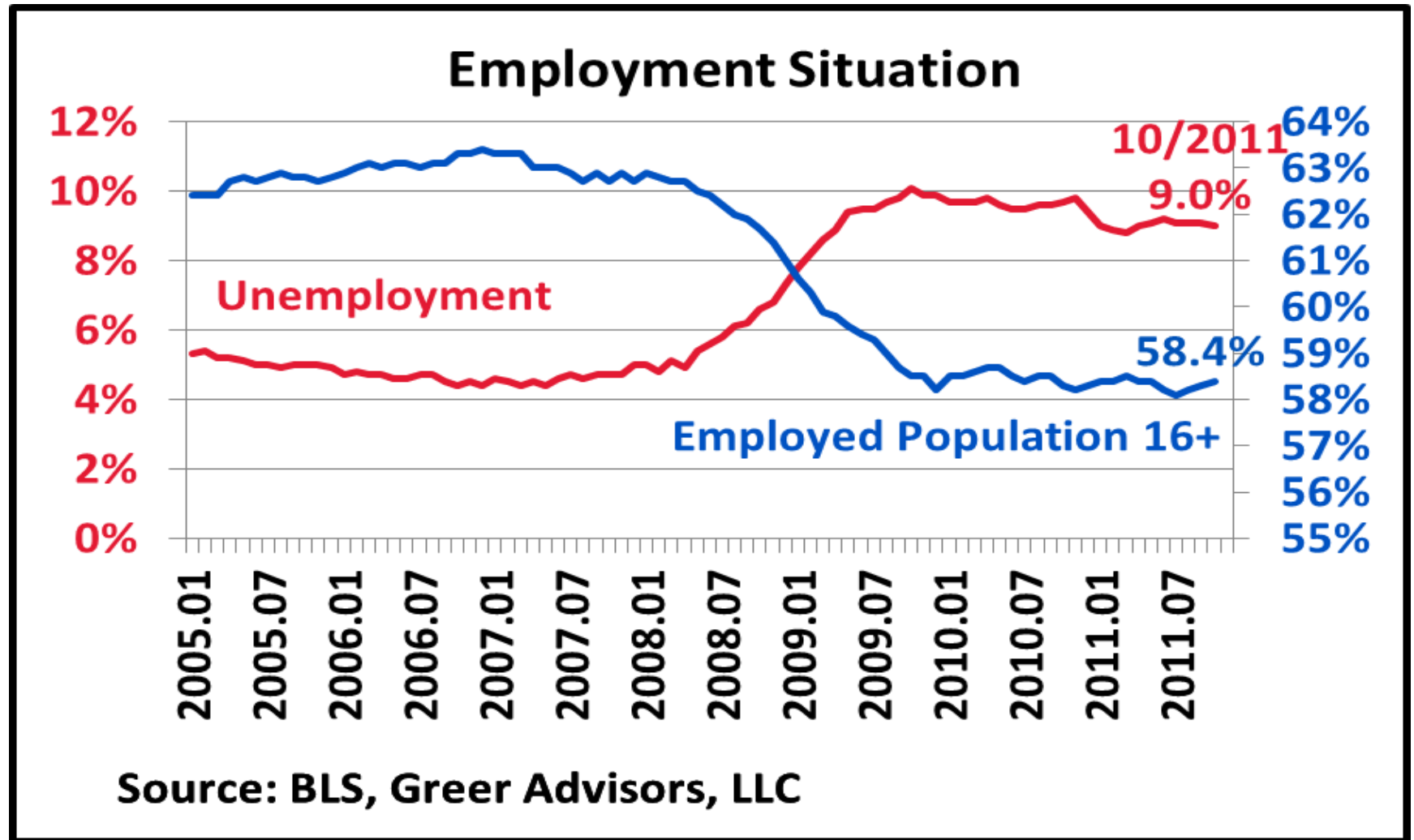
Interest & Inflation



Economy – Consumer Confidence & Sales



Economy – Employment



Economy

Consumer Side

- Consumer Confidence is Poor at 39.8 (10/25 Conf. Board)
- Unemployment Remains High 9.1% (Sept. 2011 – BLS)
- Potential Sovereign Defaults (PIGS)
- Liquidity, Leverage, Interest (for non-AAA Debt) – Poor
- Retail Sales are OK, the Rest is near Flat Line

Investment Banks

- Capital IQ and Deal Logic show LBO's /M&A on the rise
- Record Profits – GS near 1,000 batting average every day since the Crisis Started
- IB's record profits – cost of taxpayer

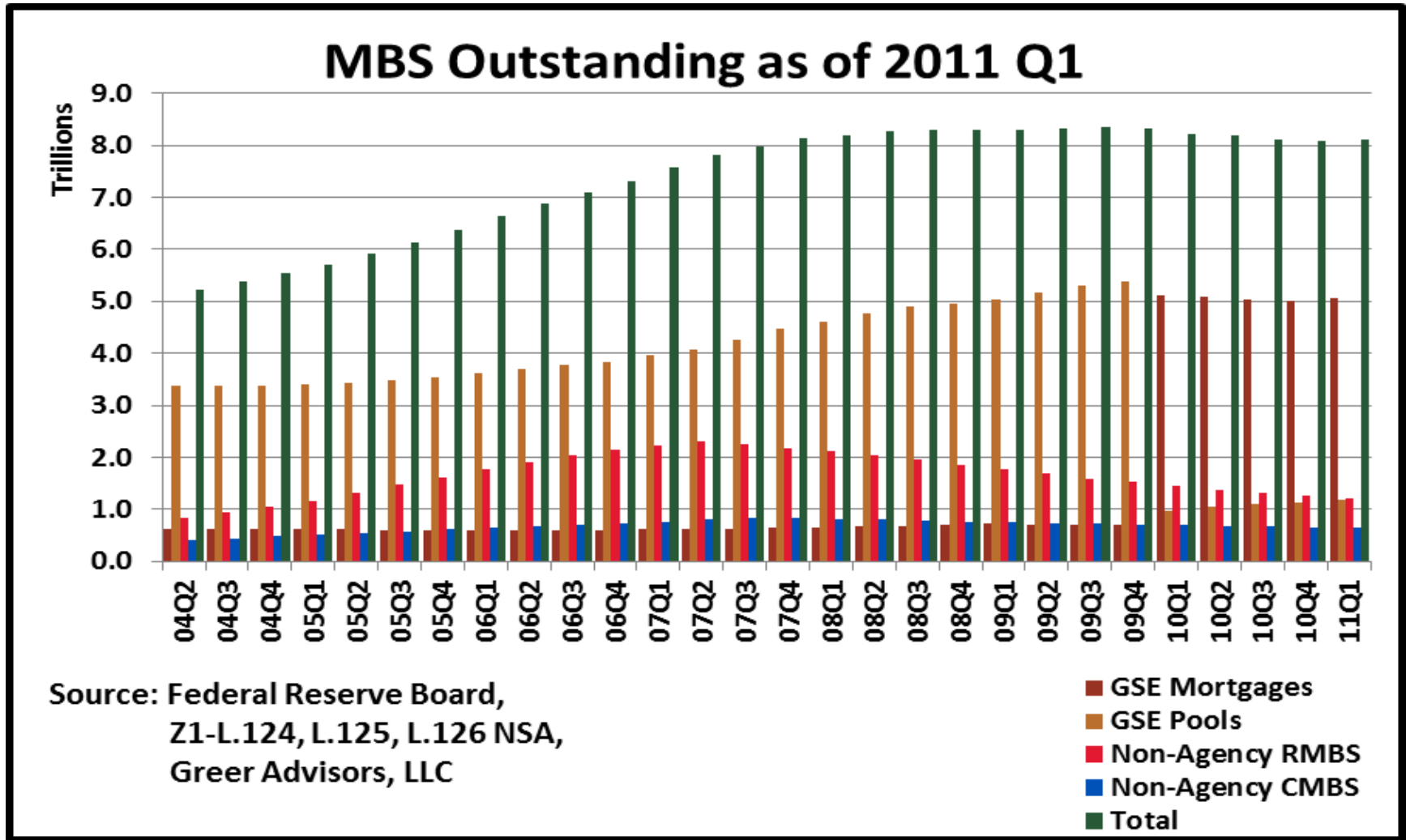
- Real Estate Capital Markets

What is a MBS?

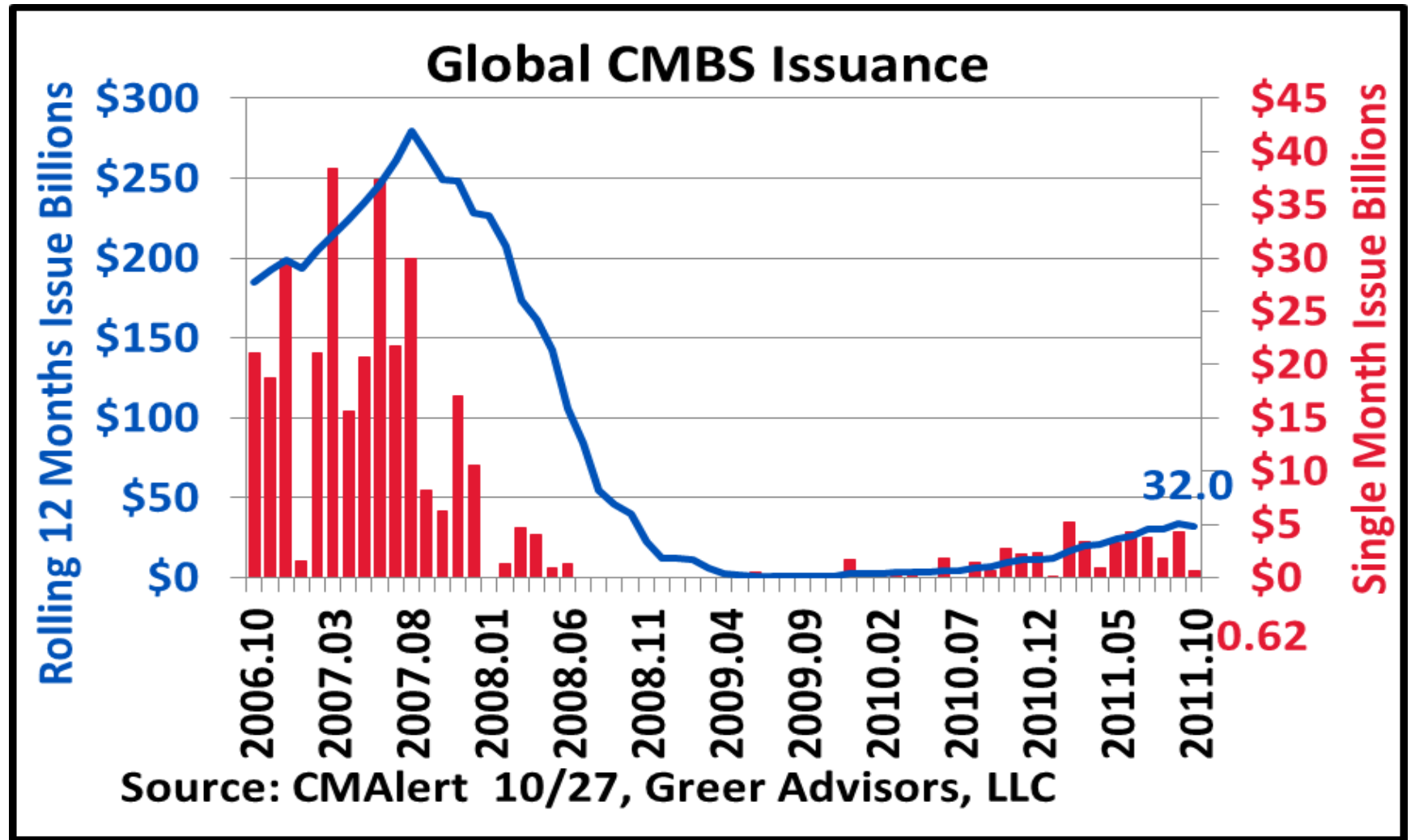
Mortgage Backed Security

- 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. 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



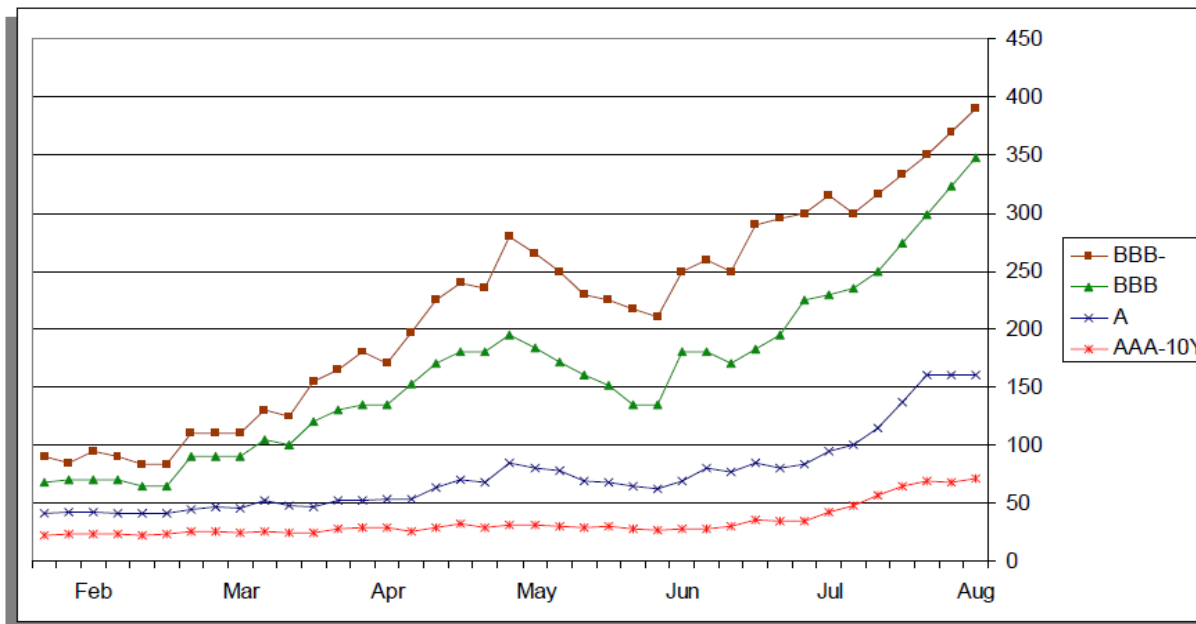
CMBS Issuance



What Broke – CMBS Yield Rates Rose

- Slide from 8/3/2007 Presentation

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"

Interest – What Broke - AAA vs BB Spreads

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.

Bubble Creation & Bursting - Causes

Drivers Leading Up to Bubble

- Vicious Upward Cycle of Growth Created Buyer Greed
- Cheap Supply of Capital to Fund Loan Demand
- Unrealistic Growth & Profit Incentives Across Industry
- NSROs, Issuers, Originators – Misaligned Incentives

Drivers Causing Bubble to Burst

- “Never Before” Rise in Delinquency & Loss Rates
- Faith in Ratings Lost
- Risk went from “Under-priced” to “Over-priced”

What is a CDO?

Collateralized Debt Obligation

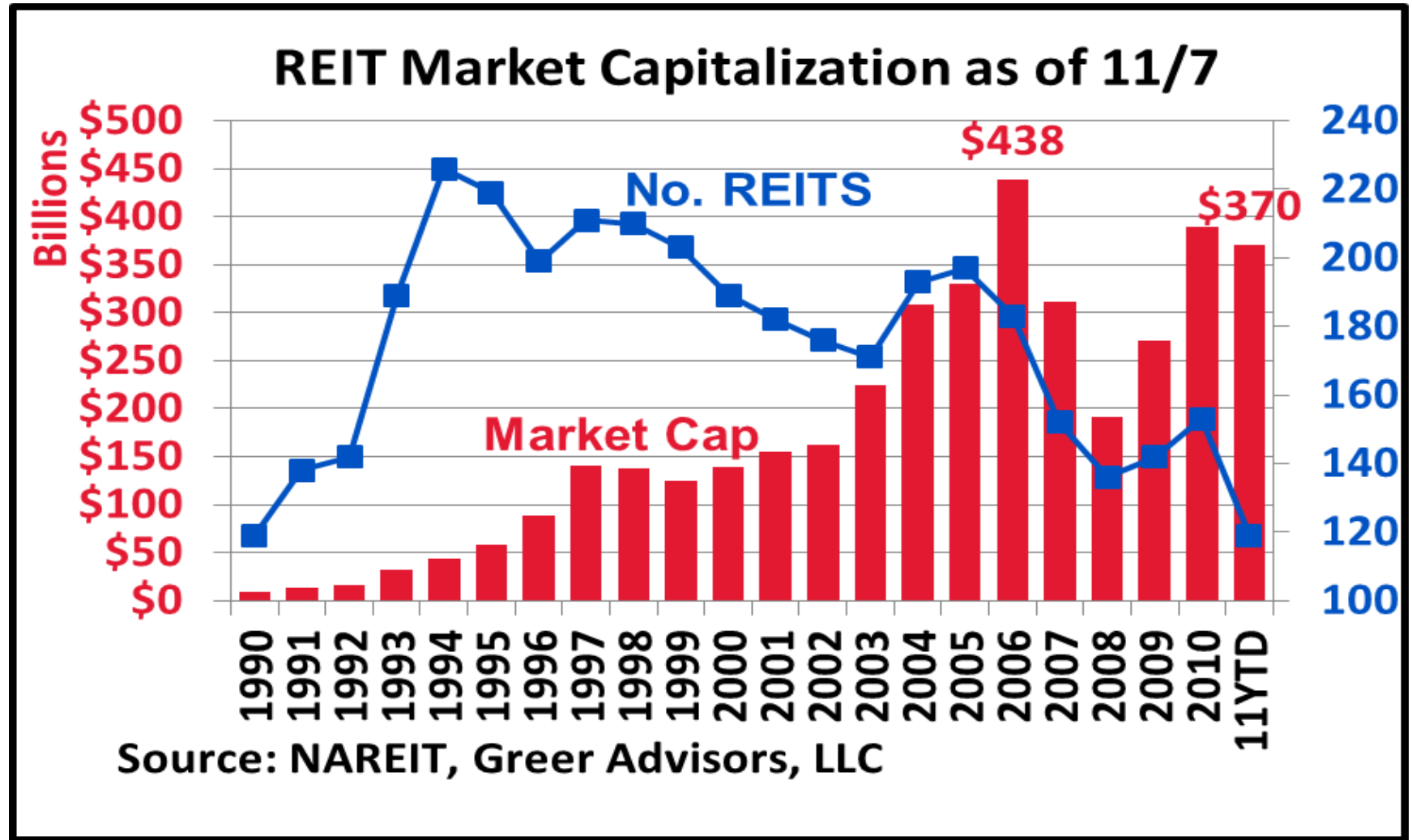
- Type of pass-through security
- CDOs are securitized debt pools, similar to CMBS, but debts can be CMBS/CDO paper, car/boat/plane loans, credit cards, or virtually any type of debt obligation. Rights to the revenue from the obligations are divided into many smaller pieces (tranches, strips, slices), 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 REIT?

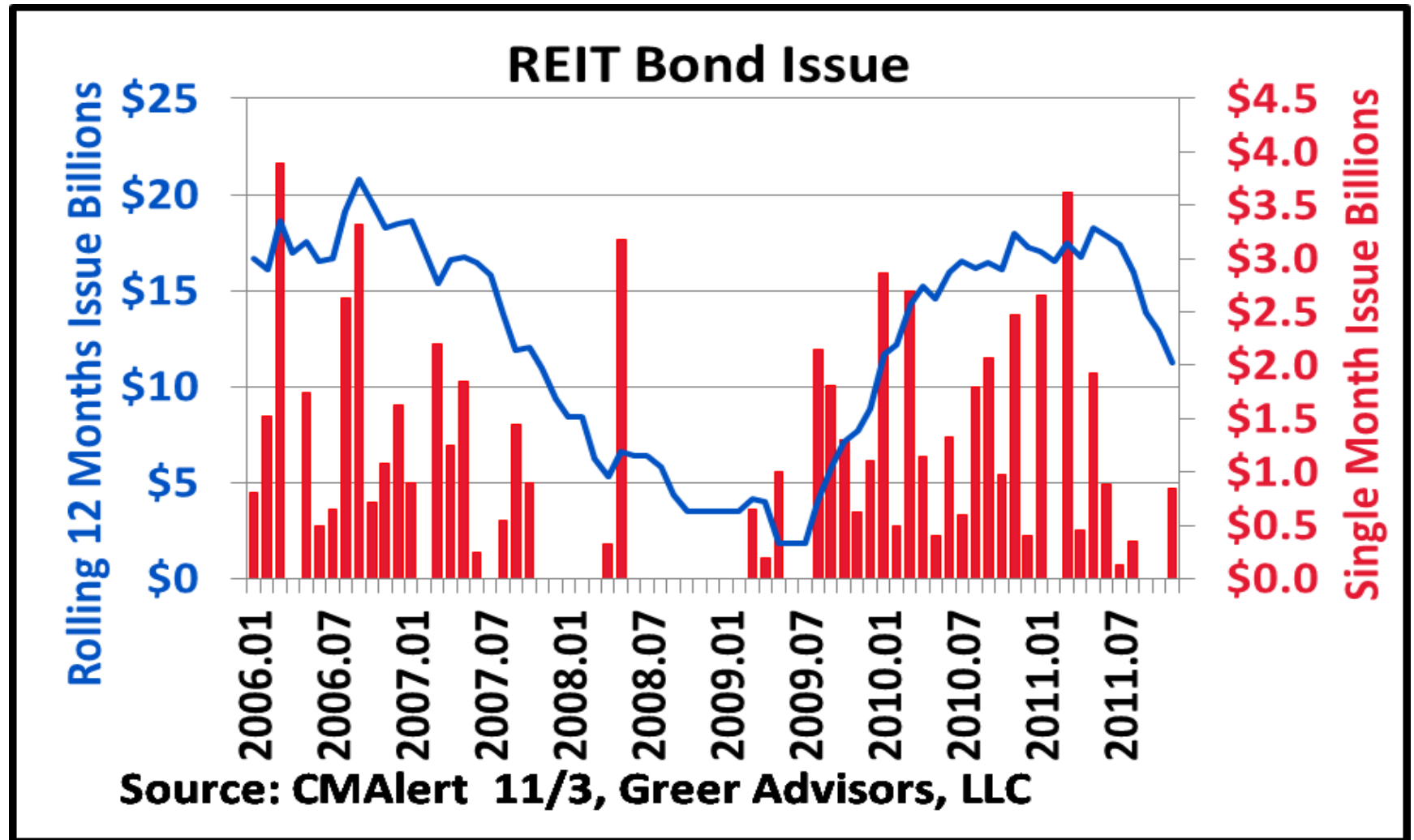
Real Estate Investment Trust

- Type of Pass-through Security
- Effectively a corporation
- As long as 90% of taxable 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
- Note: additional rules include:
 - 95% of income must be from interest, dividends & property income
 - Minimum 100 owners, 75% of assets in real estate, 75% of income from rents or interest
 - no more than 20% ownership in other REITs, 5 owner rule on 50% of assets each ½ tax year (5/50)

REIT Market Capitalization



REIT Bond Issuance



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???

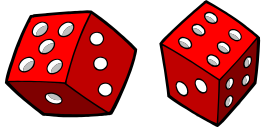
Players in “Simple” CDS

Business Issues Bonds

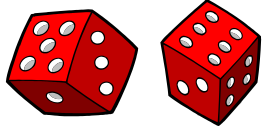


Bonds initially rated too poor for market, eg “BB”

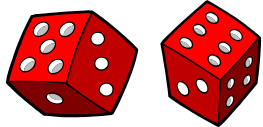
Side Bet 1



Side Bet 2



Side Bet 3

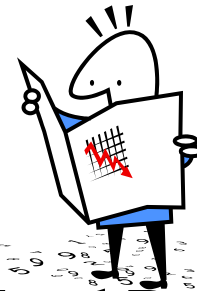


Investment Bank issues CDS (aka Credit Enhances Debt) Enough to make BB = AA, if debtor fails, IB buys bonds

Rating Agency Rates Bonds



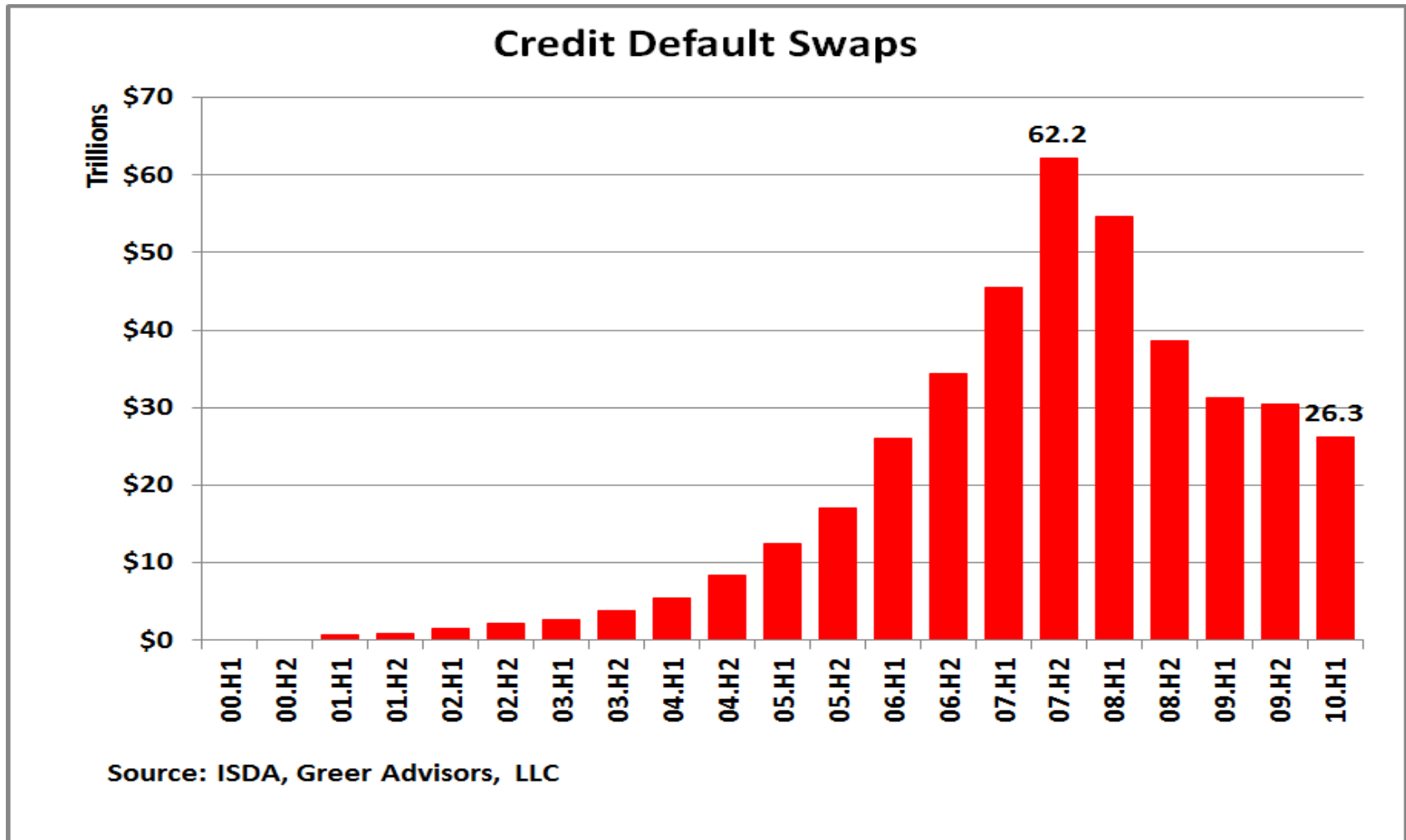
Gives loss forecast & amount required for “AA” rating



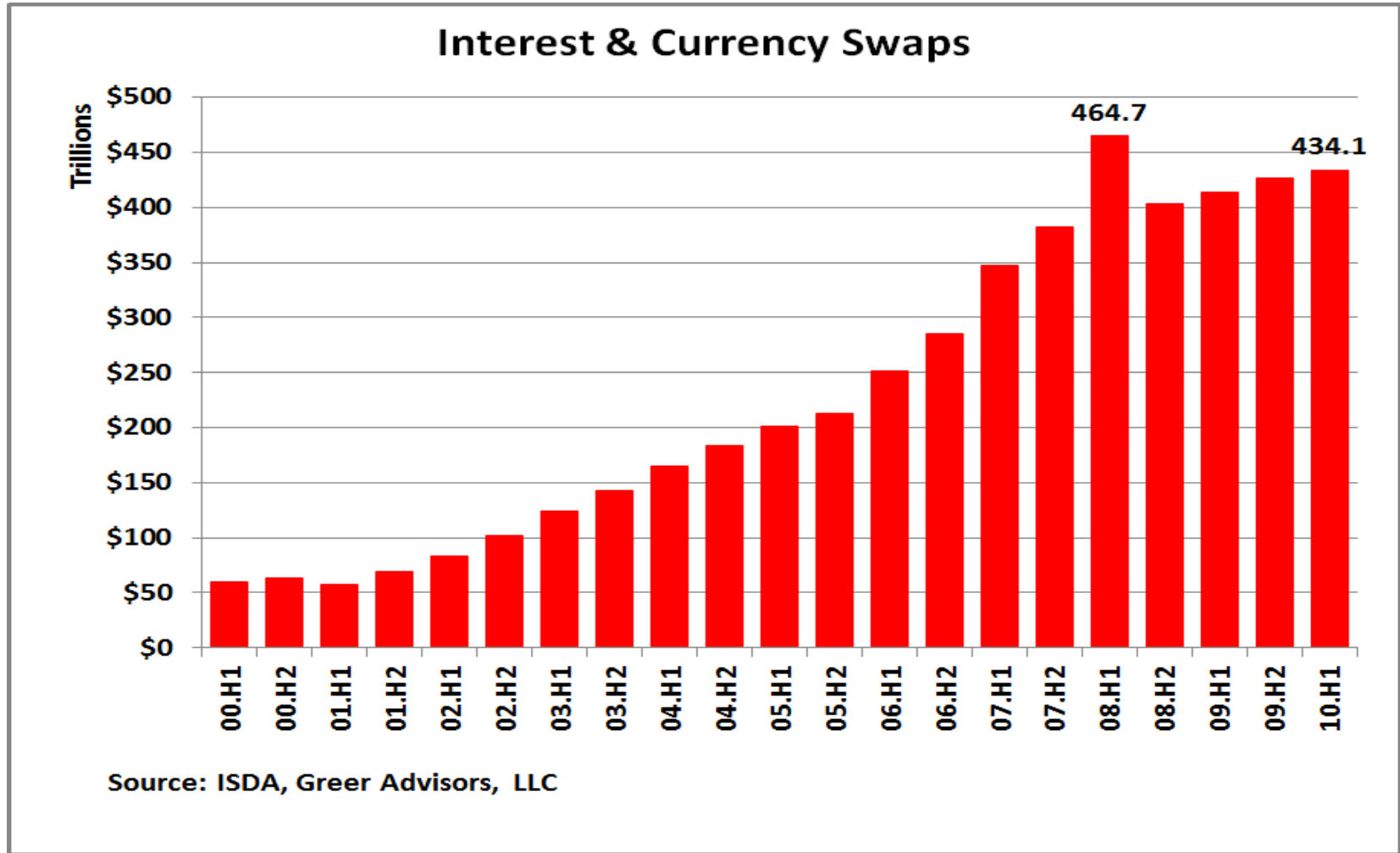
Pension Fund Buys Bonds with CDS enhancement
Thinks it's AA investment

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Credit Default Swaps



Interest & Currency Swaps



■ Financial Regulations

Financial Regulations

Dodd-Frank Wall Street Reform & Consumer Protection Act

- 16 Titles – See Summary on Wikipedia
 - 243 Rules to be created (reportedly 62% not done)
 - 67 Studies required (most are not done)
 - 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 (nominal change due to QIB clawbacks)
 - Derivatives – minimal change thus far due to “netting”

- Investment Banking

Investment Banking – Change over Time

Advise Companies, High Net Worth Organizations/Individuals

- Collect Fees on Products, and Services, 1-2% & 20% Profit

Structure Deals (Structured Finance) – Bonds, Stock, etc

- IPOs, Raise Equity, M&A
- Municipal Debt, CFDs, REITs, MBS, CMBS

Creation and Sale of New “Cash-Less Deals” (aka Derivatives)

- Options, Calls, Puts, Covered, Naked
- Futures Indexes, Commodities (Oil, Metals, Grains, Animals, etc)
- Swaps – Interest, Currency, Credit Default, Life/Longevity

- Like Printing Money

Investment Banking – Derivatives - Volker

Derivatives can be used as a Hedge

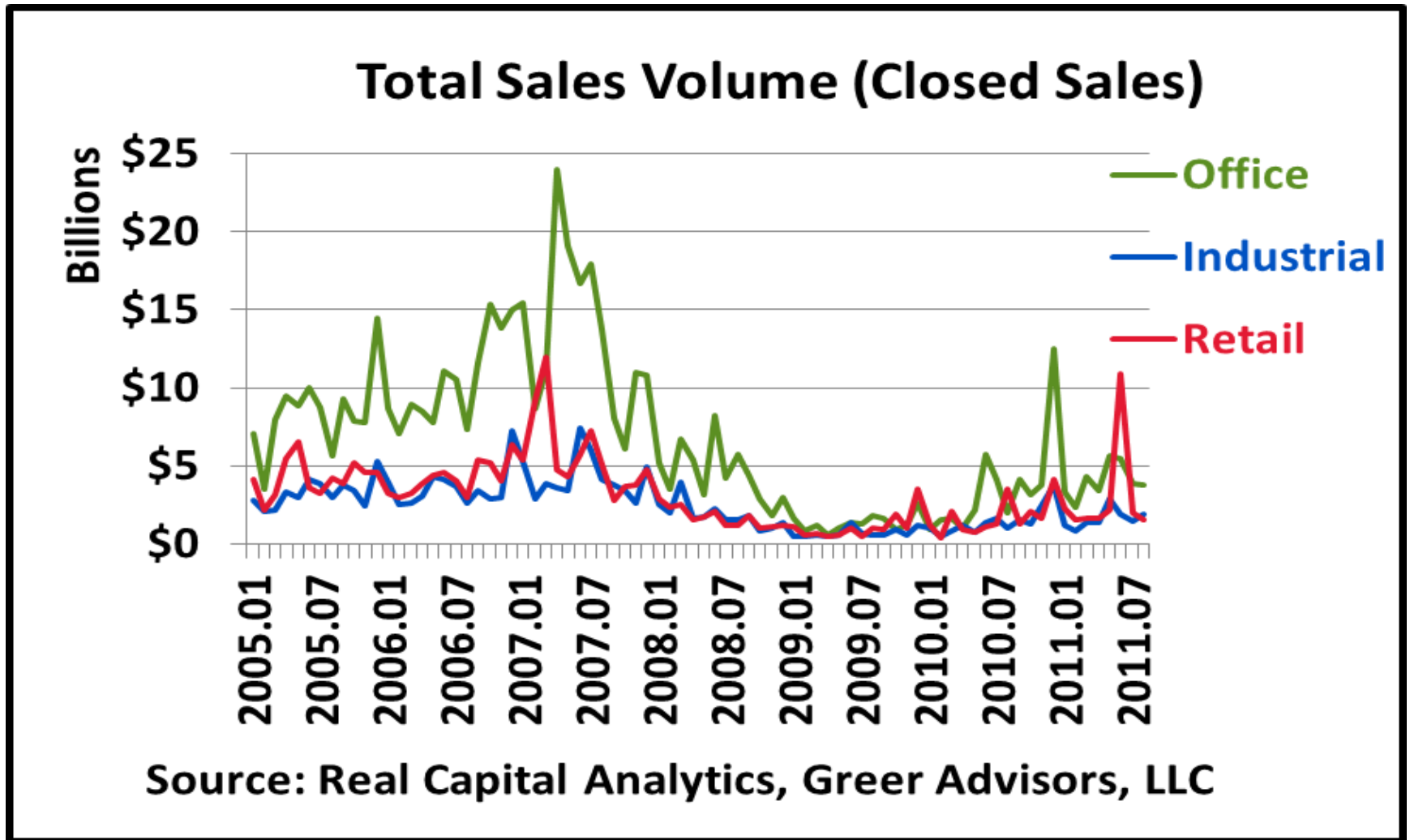
- Oil Consumer buys Futures Contract to Lock in Price
- Holder of Stock Buys Put Contract as Insurance against Loss
- Borrower with Variable Rate Loan buys Interest Swap
- Buyer of Bonds buys CDS “like” Credit Insurance
- Corporation Buys Death Swap on Board of Directors

What is the IB’s Role?

- Are they Hedging an Existing Position or merely Placing a Bet
- Are they a Market Maker on the underlying instrument or derivative?
- If they sell two sides of a Swap, do they have risk?

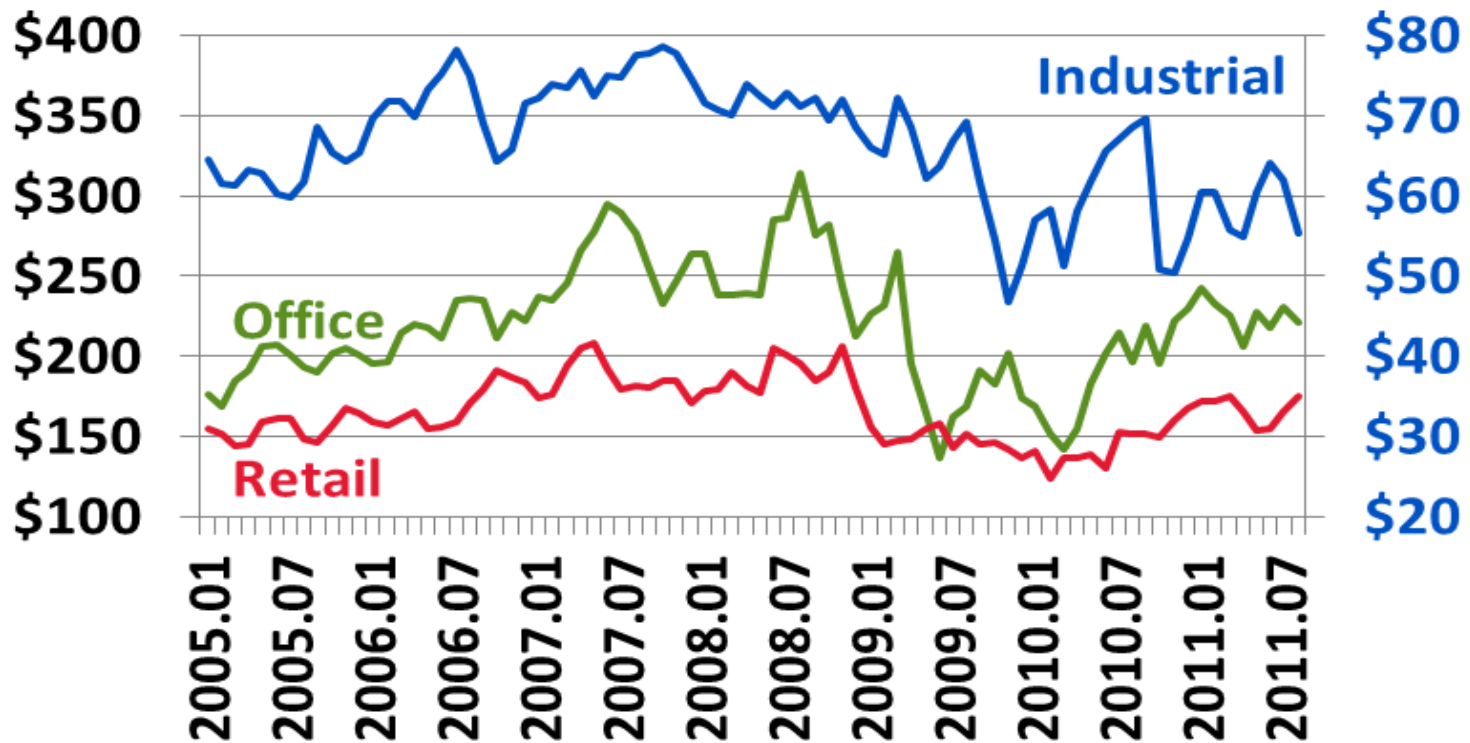
- Real Estate Markets

Commercial Real Estate Sales Volume



Commercial Real Estate Prices \$\$ PSF

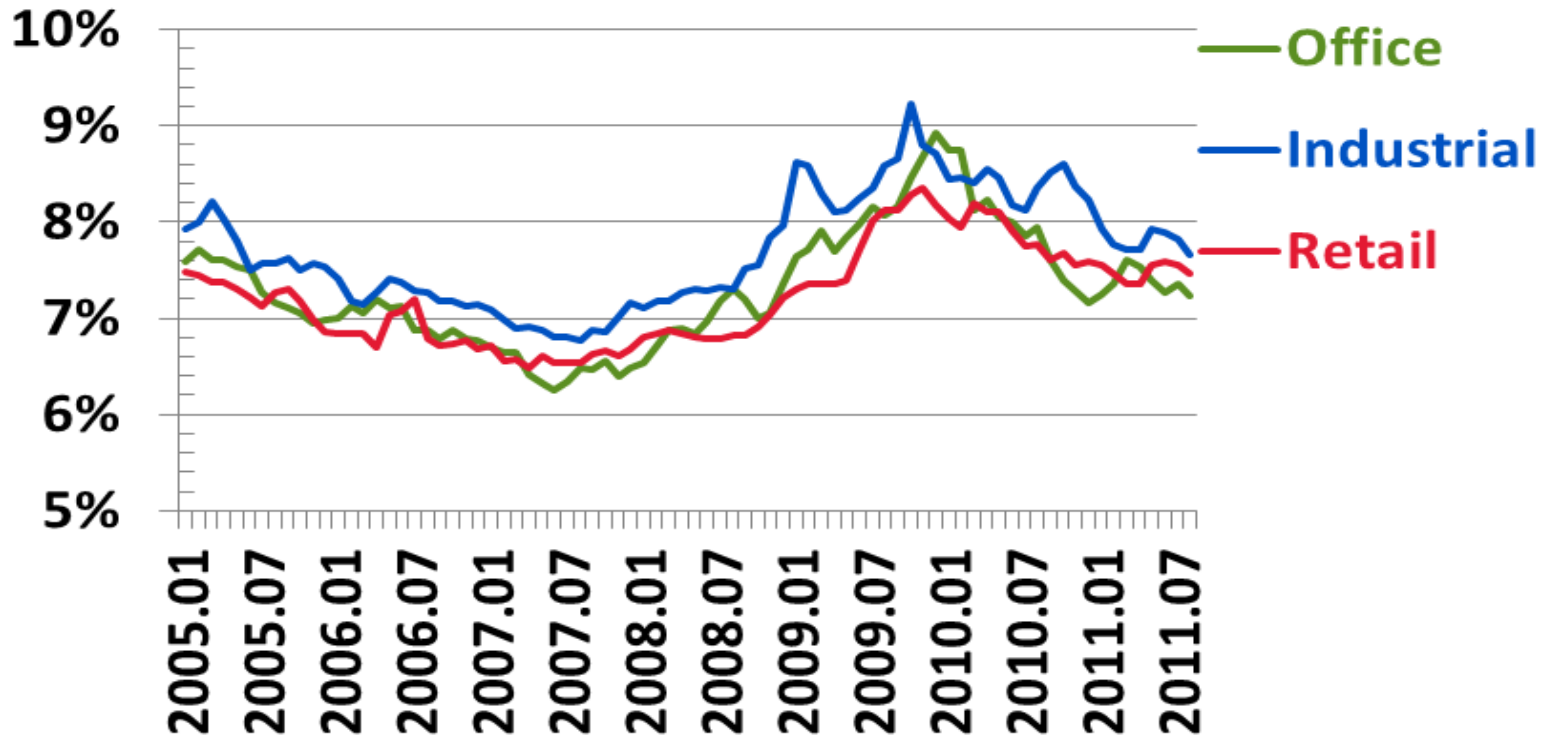
Prices per SF (Closed Sales)



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.Q3			
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
41	Charlotte	15.5%	\$4.23	34	Charlotte	16.8%	\$15.49	33	Charlotte	10.8%	\$15.57
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	15.1%	\$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%	\$8.81
	National Average	14.4%	\$5.08		National Average	16.8%	\$20.20		National Average	11.1%	\$15.82
	Min	7.3%	\$2.32		Min	7.9%	\$14.34		Min	3.8%	\$8.81
	Max	23.4%	\$8.13		Max	25.6%	\$55.26		Max	17.1%	\$31.80
	Spread	16.1%	\$5.81		Spread	17.7%	\$40.92		Spread	13.3%	\$22.99
Source: CBRE Economic Advisors, Greer Advisors, LLC								Source: REIS, Greer Advisors, LLC			

Source: CBRE Econometric Advisors (Q2),
REIS, Inc. (Q3), Greer Advisors, LLC

Greer Advisors, LLC

Charlotte Commercial R.E. – as of 2011 Q2*

INDUSTRIAL - 2011.Q2			OFFICE - 2011.Q2			RETAIL - 2011.Q3			
Submarket	Vac %	Ask Rent \$	Vac	Vac %	Eff Rent \$	Submarket	Type	Vac %	Ask Rent \$
Airport/West	12.2%	\$4.80	CBD	13.4%	\$23.42	North	A	12.3%	\$12.04
Cabarrus County	29.3%	\$4.45				North	N	11.8%	\$15.97
CBD	20.8%	\$4.15	East Charlotte	6.6%	\$10.49	East	A	2.7%	\$9.30
East	10.3%	\$6.76	Midtown	15.9%	\$28.42	East	N	12.8%	\$14.30
North	18.5%	\$4.57	North Charlotte	19.1%	\$18.94	South	A	8.9%	\$15.03
Northeast	10.4%	\$4.21	South Charlotte	18.1%	\$18.91	South	N	11.8%	\$22.72
Northwest	14.8%	\$3.17	Southeast Charlotte	19.6%	\$20.92	Gaston County	A	16.3%	\$6.68
Southwest	16.3%	\$4.17	Southwest Charlotte	22.6%	\$10.52	Gaston County	N	10.9%	\$12.41
Union County	12.2%	\$4.04	Subtotal: Suburban	18.9%	\$14.20				
York County	12.2%	\$3.80							
Source: CBRE Economic Advisors, Greer Advisors, LLC						Source: REIS, Greer Advisors, LLC			

Source: CBRE Econometric Advisors (Q2),
REIS, Inc. (Q3), Greer Advisors, LLC

Greer Advisors, LLC

■ Outlook & Forecast

Greer's Recovery Signs – Prereq's to Recovery

- \sqrt CDS Exposure under \$25 Trillion (i.e. under 50% of peak)
- \sqrt 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
 - AAA Subordination near 30%....
 - AAA is 70%, not 90% of issue
- \sqrt REIT Market Capitalization (Total Value) Stabilizes or Increases for 6 months
- Consumer Confidence Rises and Stays Above 70 for 6 months
 - As of 10/25/11 (last report) index at 39.8 (1985=100)
- Risk Curve (AAA Sr. vs BB) flattens to under 500 bps. As of 11/8/11, CMBx spread stands nearly 100 pts (2.72 v 102.35) or 9,963 bps

Greer's 3-Year Forecast as of 11/8/2011

- Barbell Modest Growth or Global Recession
 - Global Economy Heals or Not – 60/20/20
- Cap Rates will Rise 0.5-2.0% during 2011-13
 - Mostly in class B/C
 - Trophy Class A will remain low until Flight to Quality Stops
- CMBS must return for Class B/C recovery
 - New MBS – Skin in the Game
 - Deleverage for Loans AND MBS paper
- Individual Market Performance will continue to vary widely.
 - Difference in Top vs Bottom Markets is Growing (3x+ vacancy)
- Change Creates Opportunities – Build Businesses
- SBA will remain very Active – Fed's Best tool

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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