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# Wall Street and Commercial Real Estate

Everett (Allen) Greer  
Greer Advisors, LLC

April 26, 2012 – Los Angeles, CA  
City National Bank

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**Greer Advisors, LLC**

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# Goals of Presentation

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

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# Disclaimers

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

**Investment Advice is not being provided.**

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# ■ Market Drivers

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# Market Drivers

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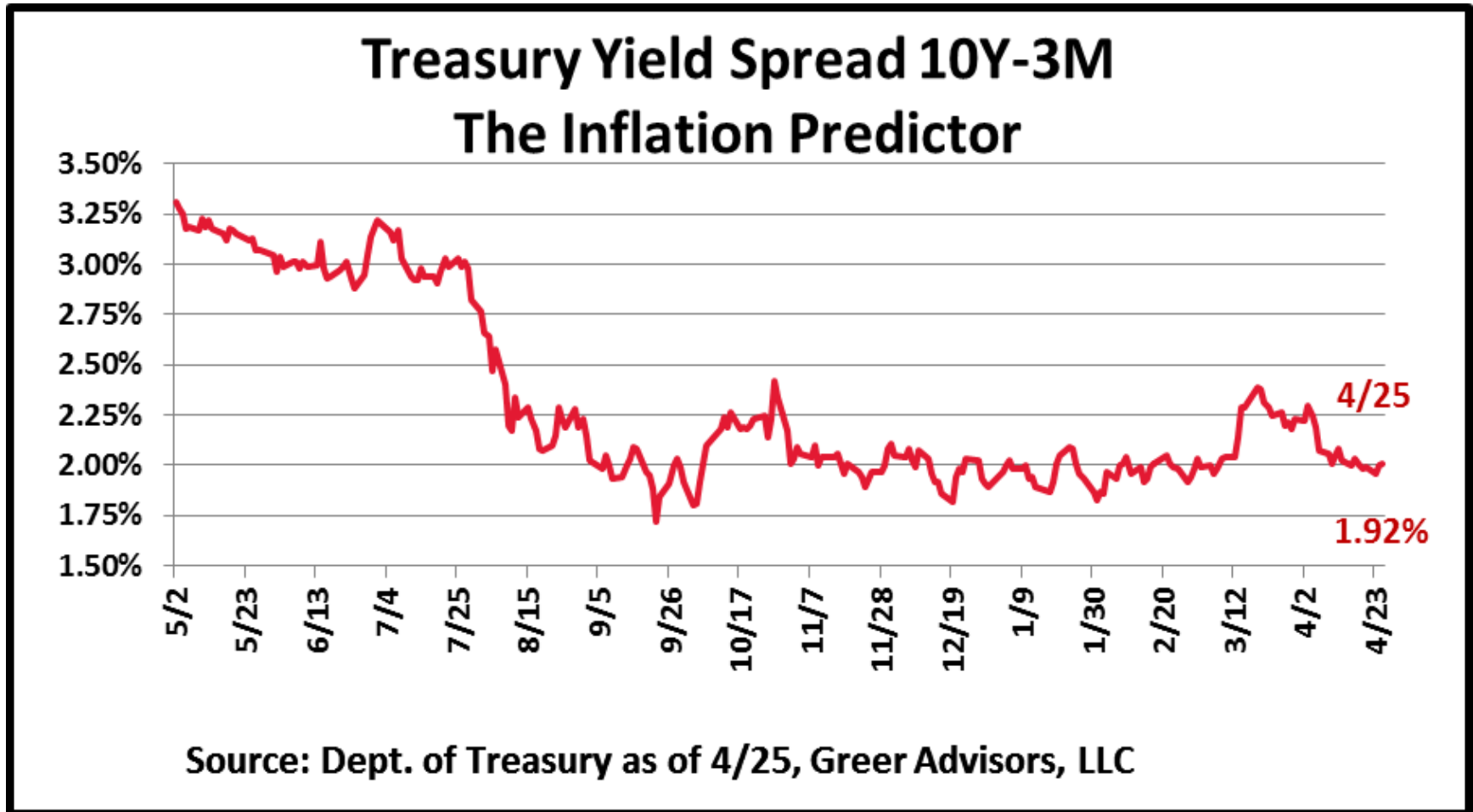
**Supply / Demand** – Not as bad as early 90's

- Non-Res. Supply Growth was Very Limited Growth
- Most Demand ties to 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**

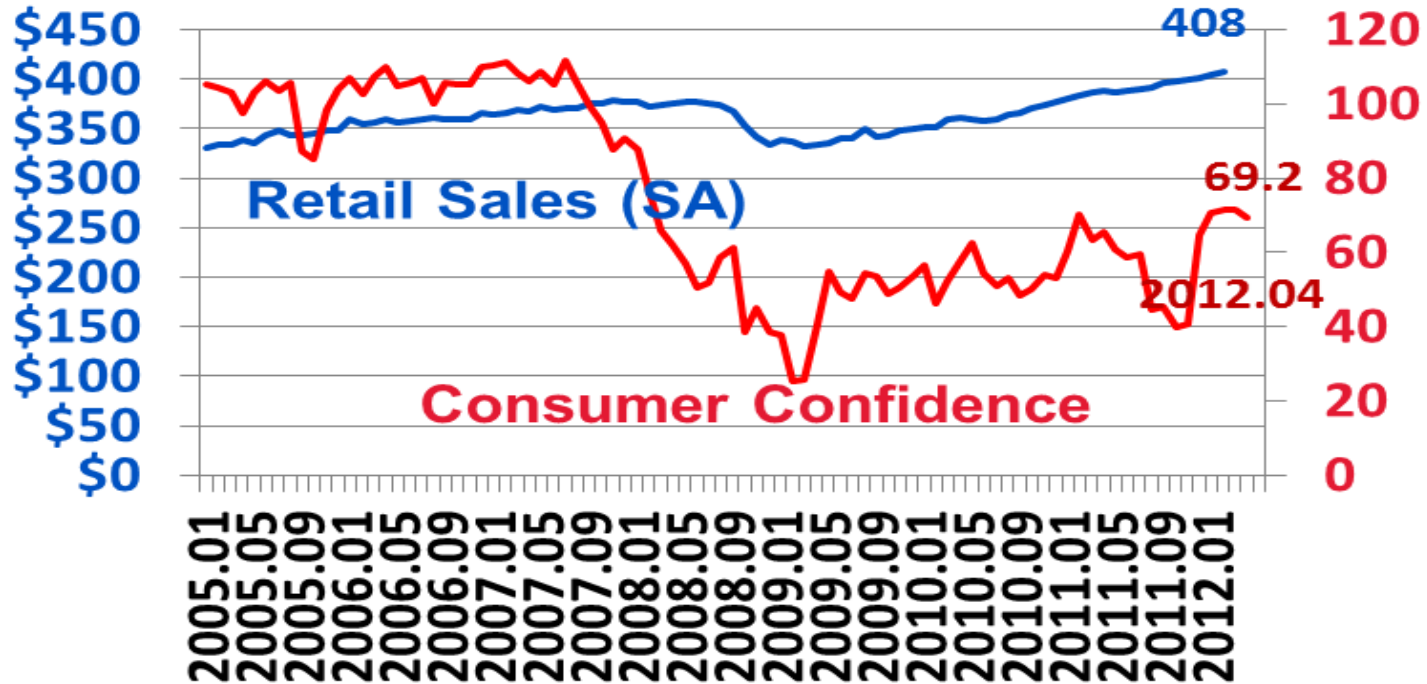
- Leverage, Rate, Term, Recourse

# Interest & Inflation



# Economy – Consumer Confidence & Sales

## Key Economic Indicators



Source: Conference Board, Census, Greer Advisors, LLC

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# Economy

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## Consumer Side

- Consumer Confidence is Poor at 69.2 (April Conf. Board)
- Unemployment Remains High
- Potential Sovereign Defaults Continue to Threaten (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



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# ■ Financial Regulations

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# Financial Regulations

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

- 16 Titles – See Summary on Wikipedia – Post TARP 😊
  - 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”

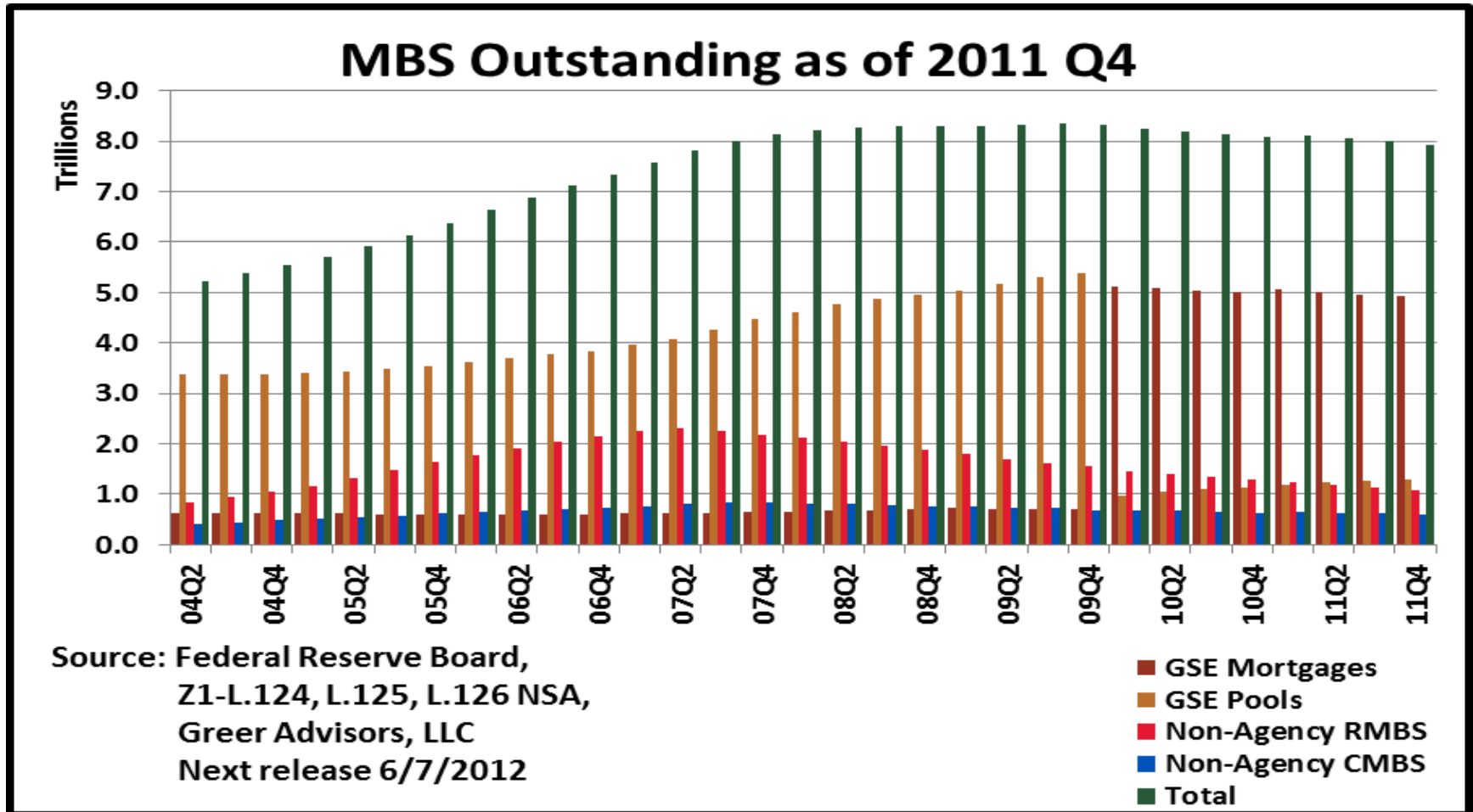
▪ Troubled Asset Relief Program

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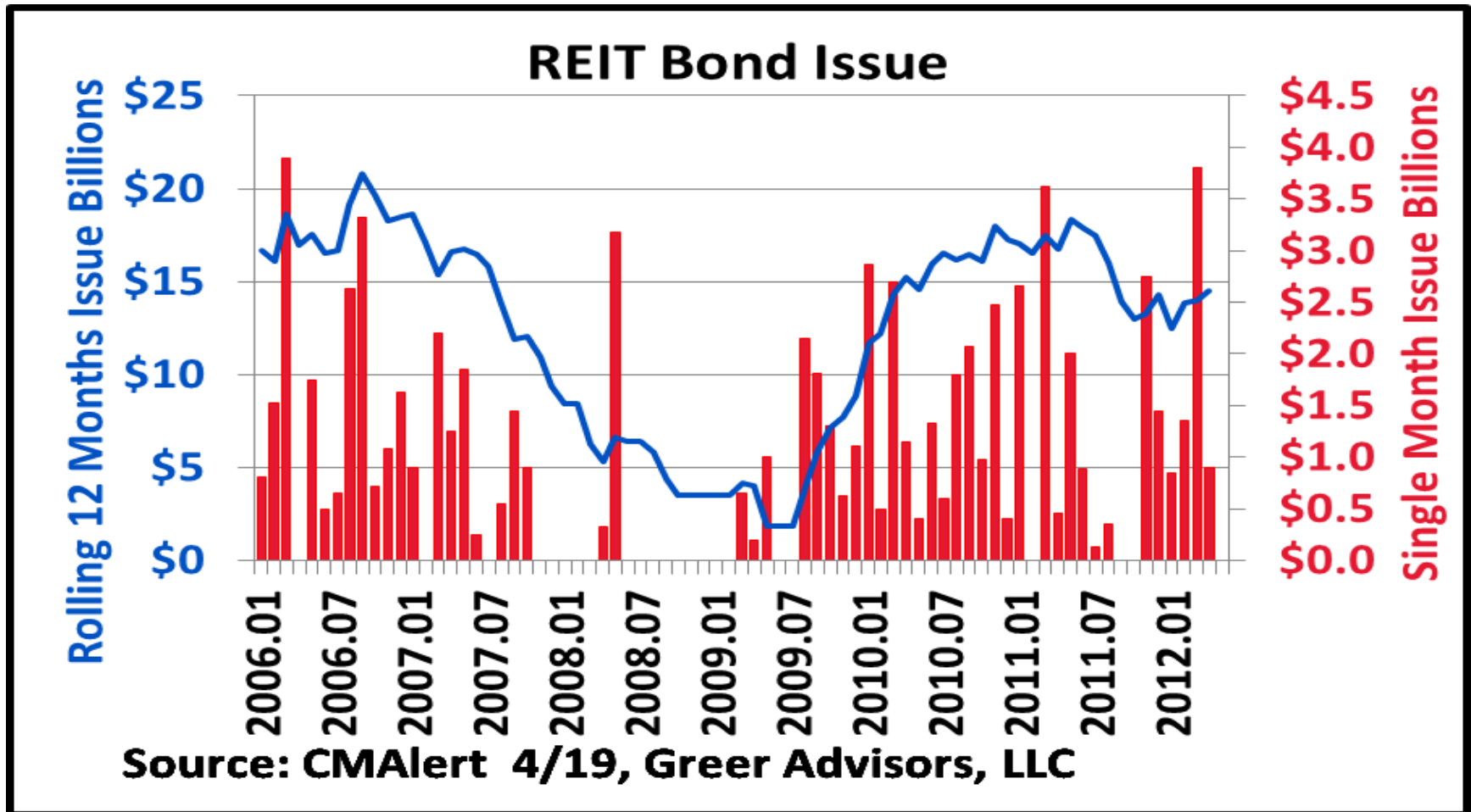
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- Real Estate Capital Markets

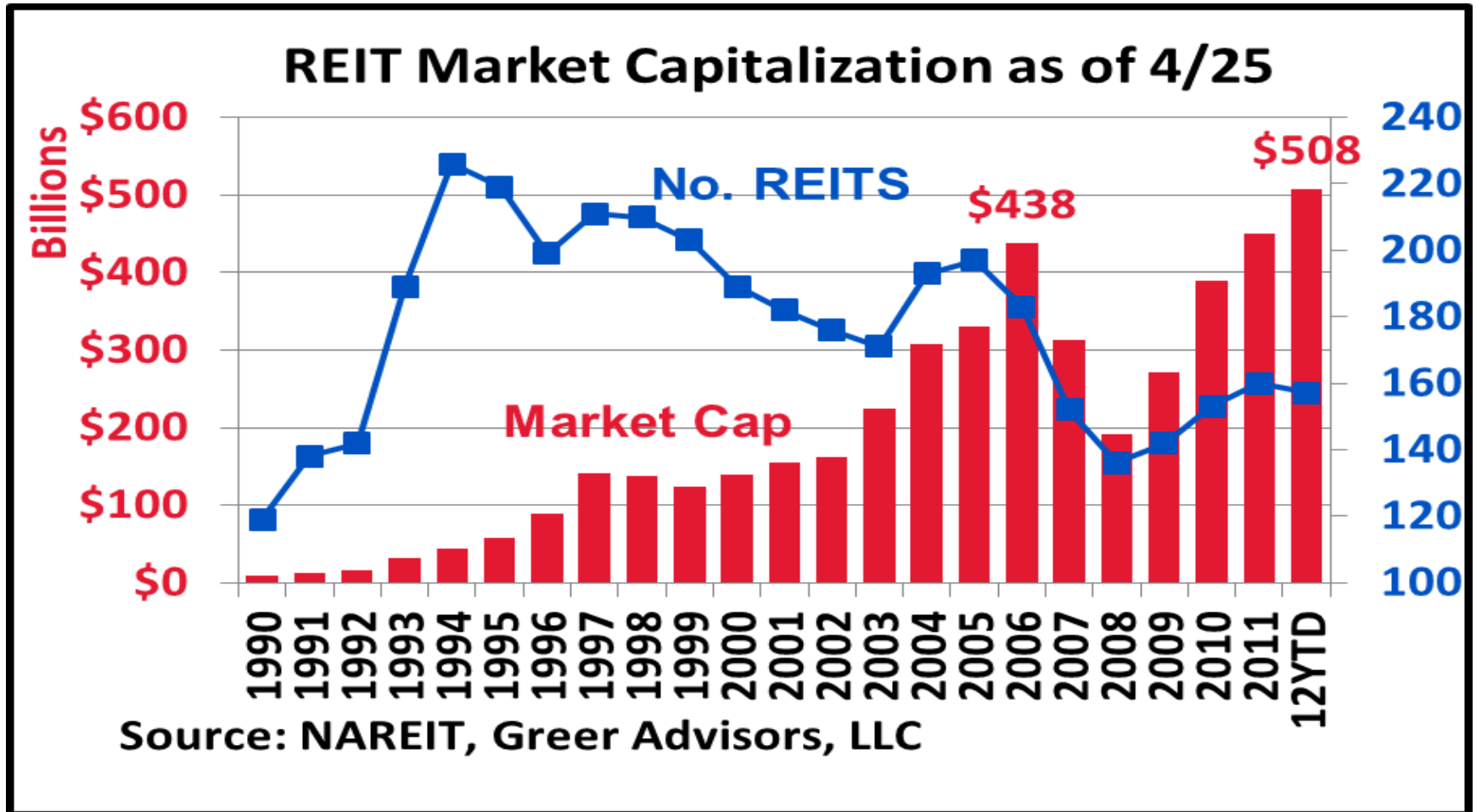
# MBS Outstanding's in U.S. - Dropping



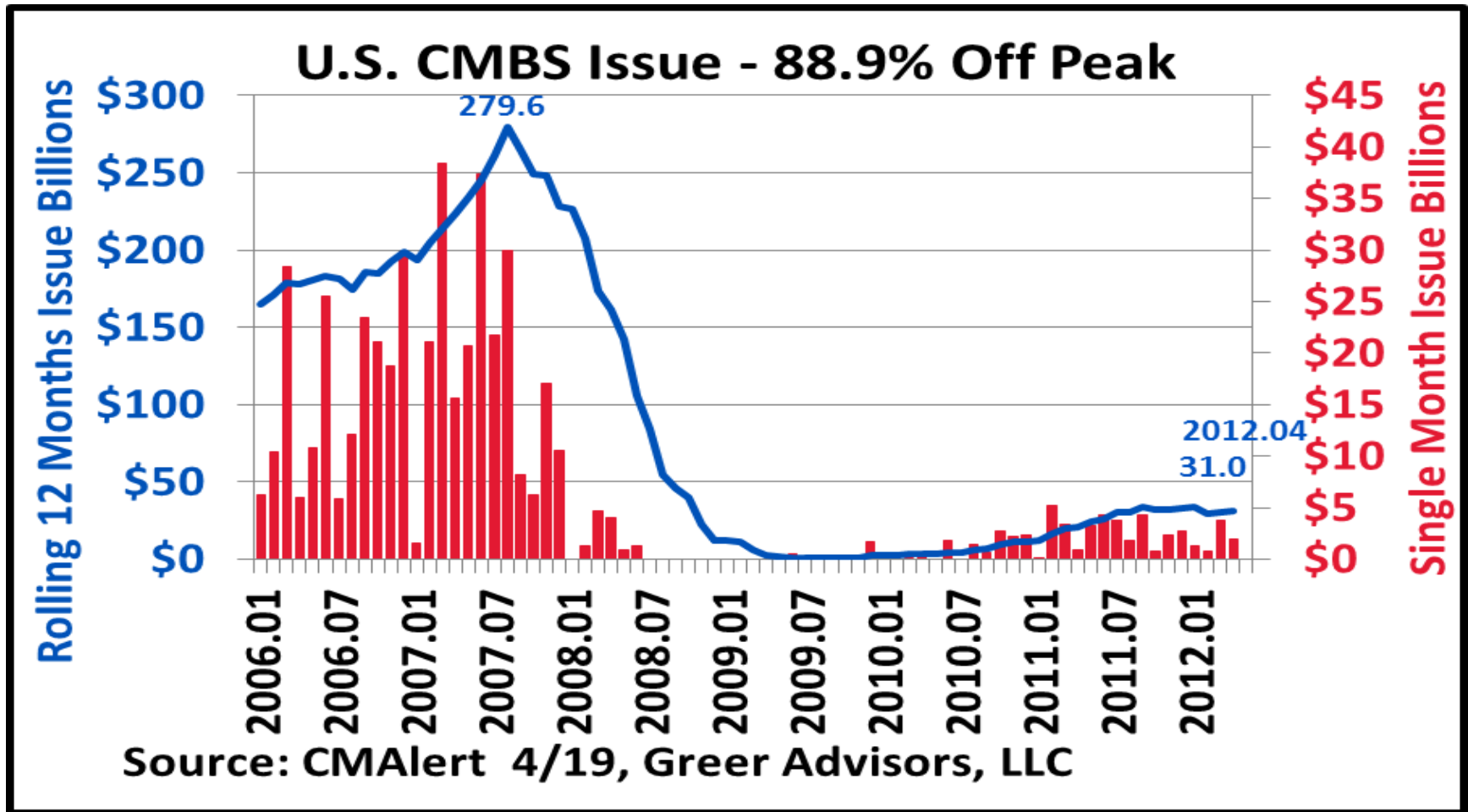
# REIT Market Capitalization – Long Term



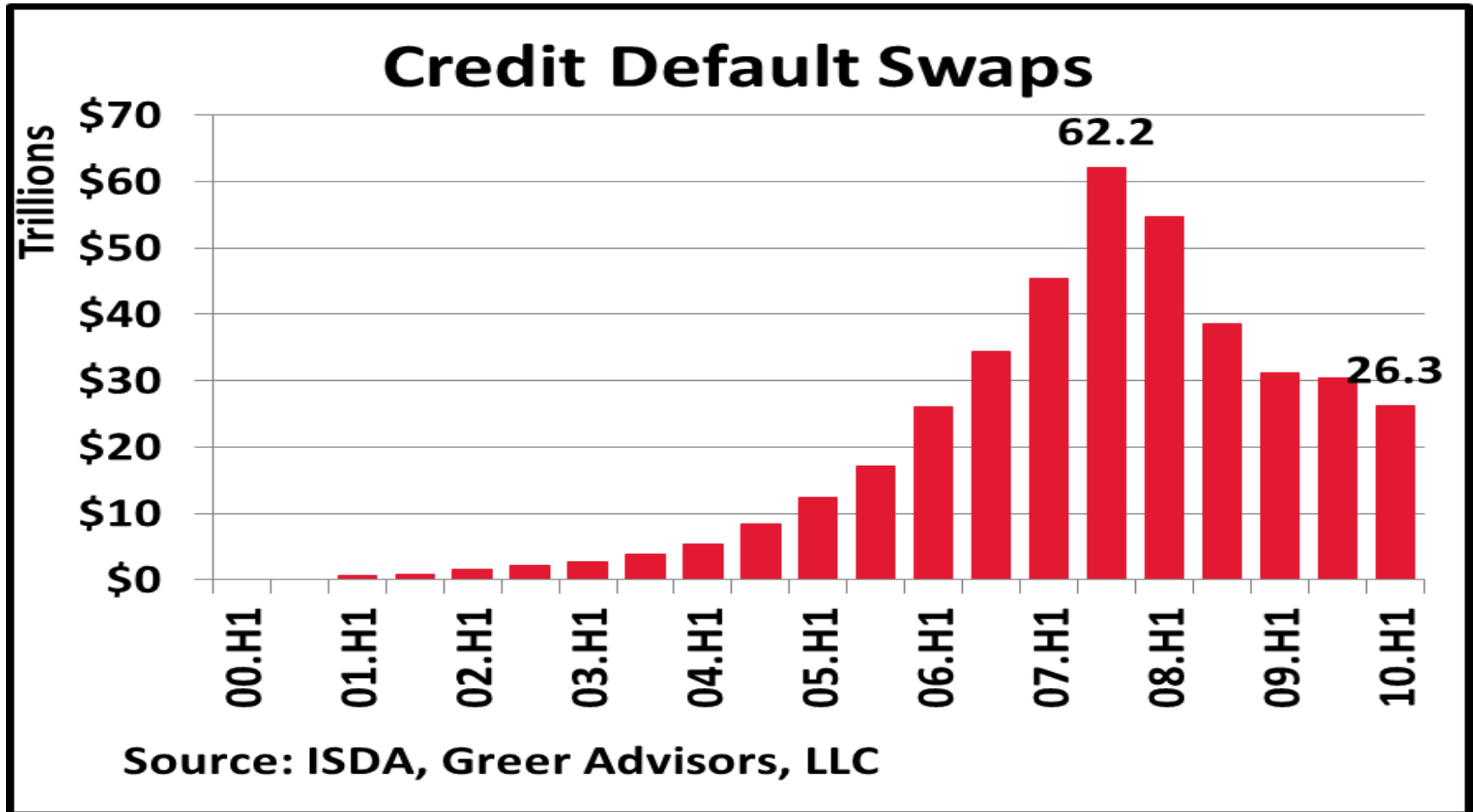
# REIT Market Capitalization



# CMBS Issuance

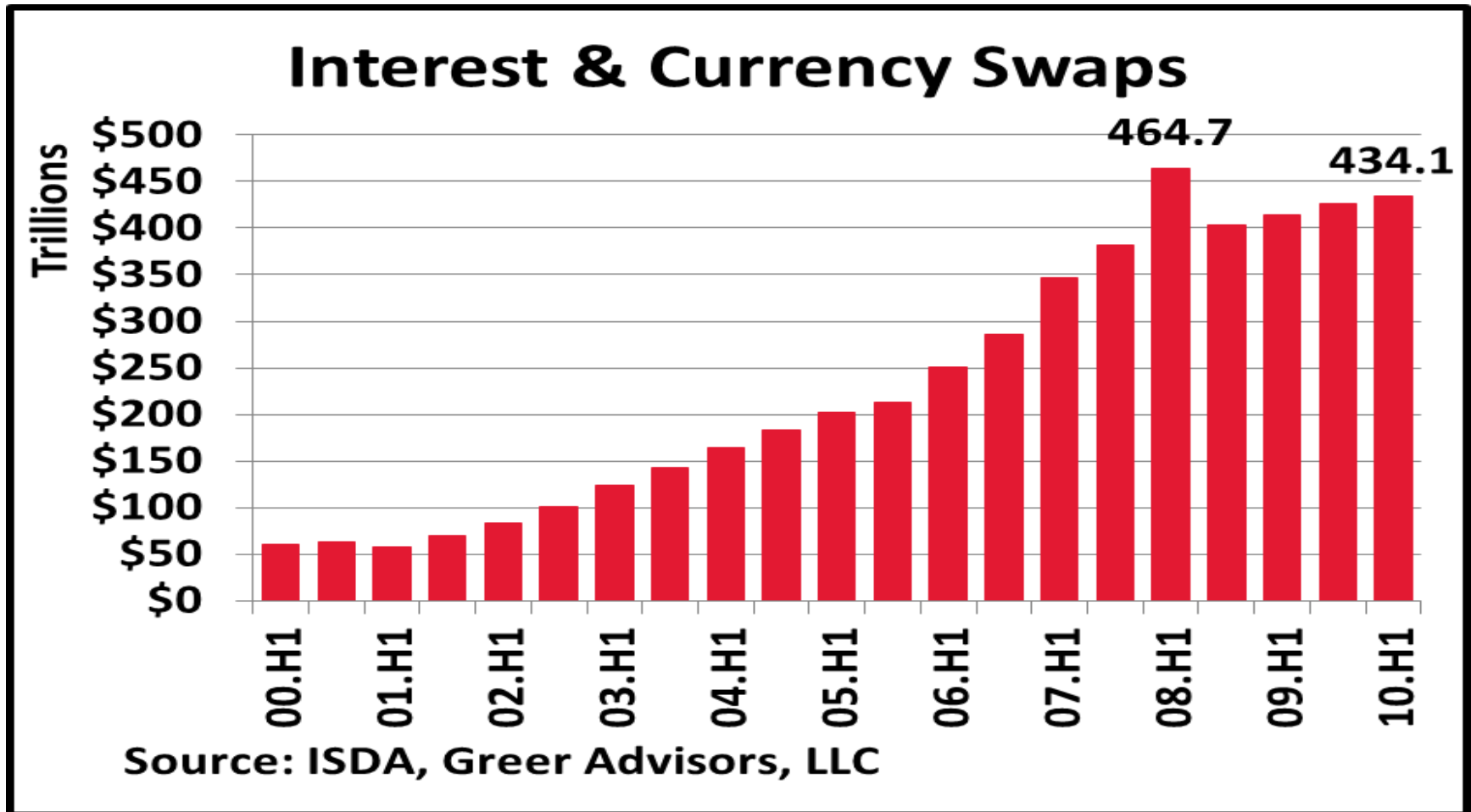


# CDS – Notional Balance





# Interest & Currency Swaps

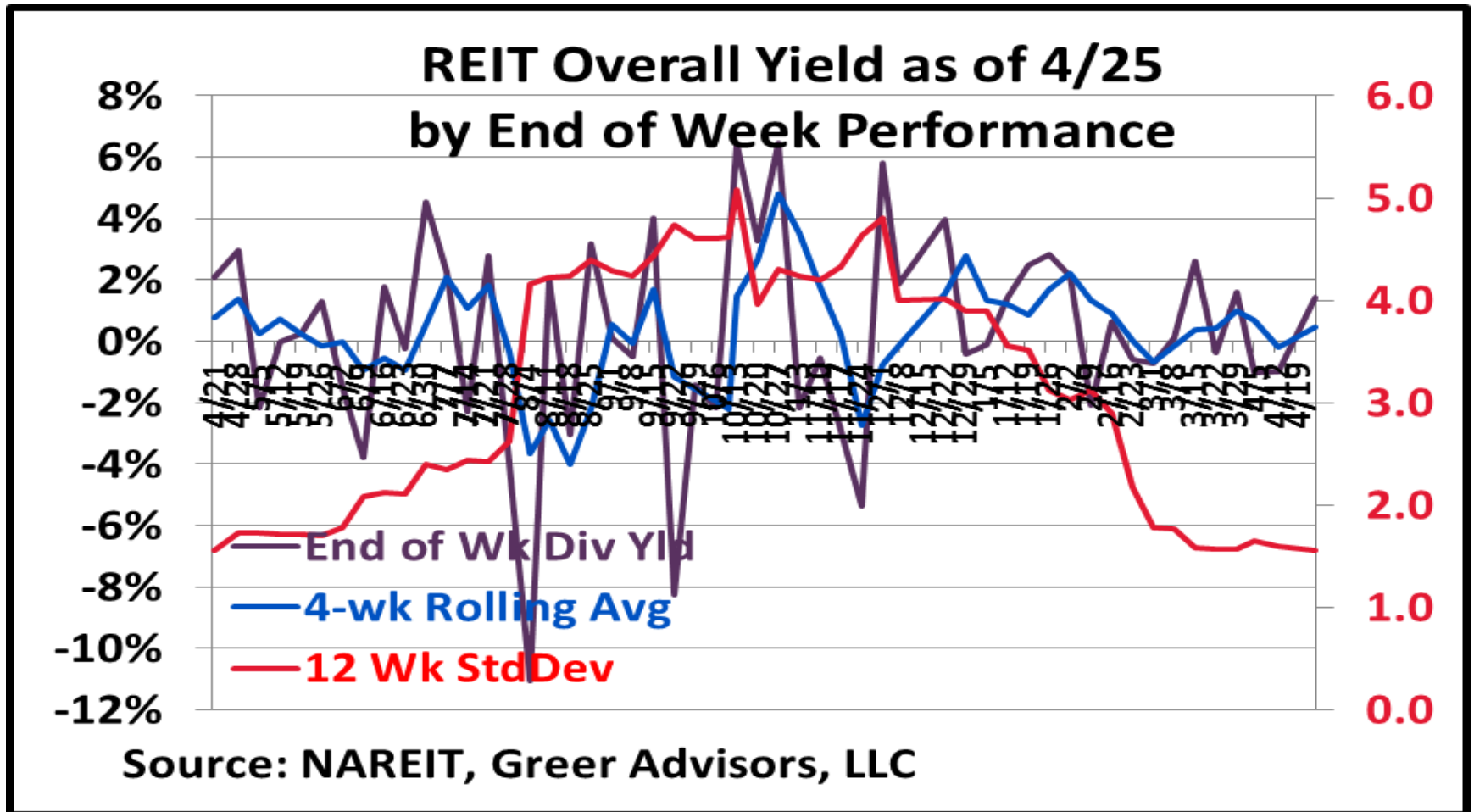


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# ■ Risk Pricing

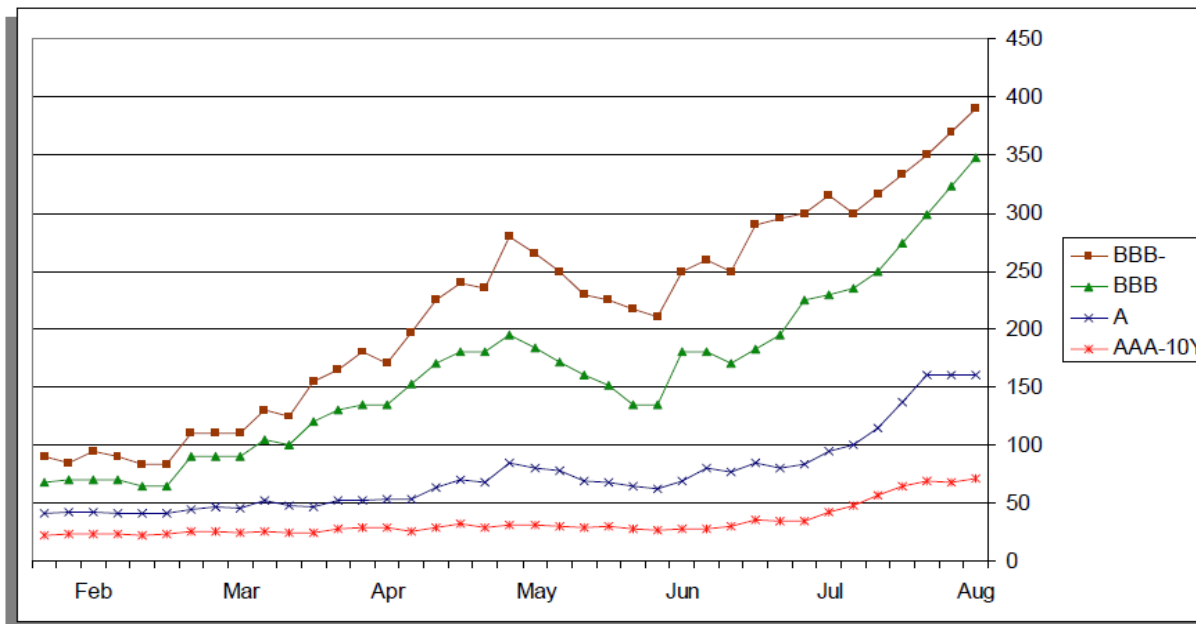
# REIT Dividend Yield - Volatility



# 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

<b>Greer CMBS / CMBx Yield Rate<sup>TM</sup></b>				
<b>Tranche</b>	<b>Yield</b>	<b>Suboord</b>	<b>Weight of Debt</b>	<b>Contribution to Total</b>
AAA	2.46%	29.76%	70.24%	1.72%
AJ	3.33%	12.70%	17.06%	0.57%
AA	4.95%	10.63%	2.07%	0.10%
A	9.38%	8.00%	2.63%	0.25%
BBB	27.05%	4.72%	3.28%	0.89%
BBB-	28.39%	3.68%	1.04%	0.30%
BB	102.09%	2.69%	0.99%	1.01%
Unrated	176.00%	0.00%	2.69%	4.73%
<b>Implied Overall Debt Yield</b>			<b>100.00%</b>	<b>9.57%</b>
<b>Loan to Value Ratio</b>				<b>75.00%</b>
<b>Class-A Equity Yield   Total Yield</b>			<b>28.00%</b>	<b>14.18%</b>
<b>Class-B Equity Yield   Total Yield</b>			<b>102.00%</b>	<b>32.68%</b>

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 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 pricing of risk premiums for each layer in the capital stack.

② MarkitTM Data and Calculations based on close of 4/25. Swap (10Yr) as of 4/24.

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.

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# Bubble Creation & Bursting - Causes

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## 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”

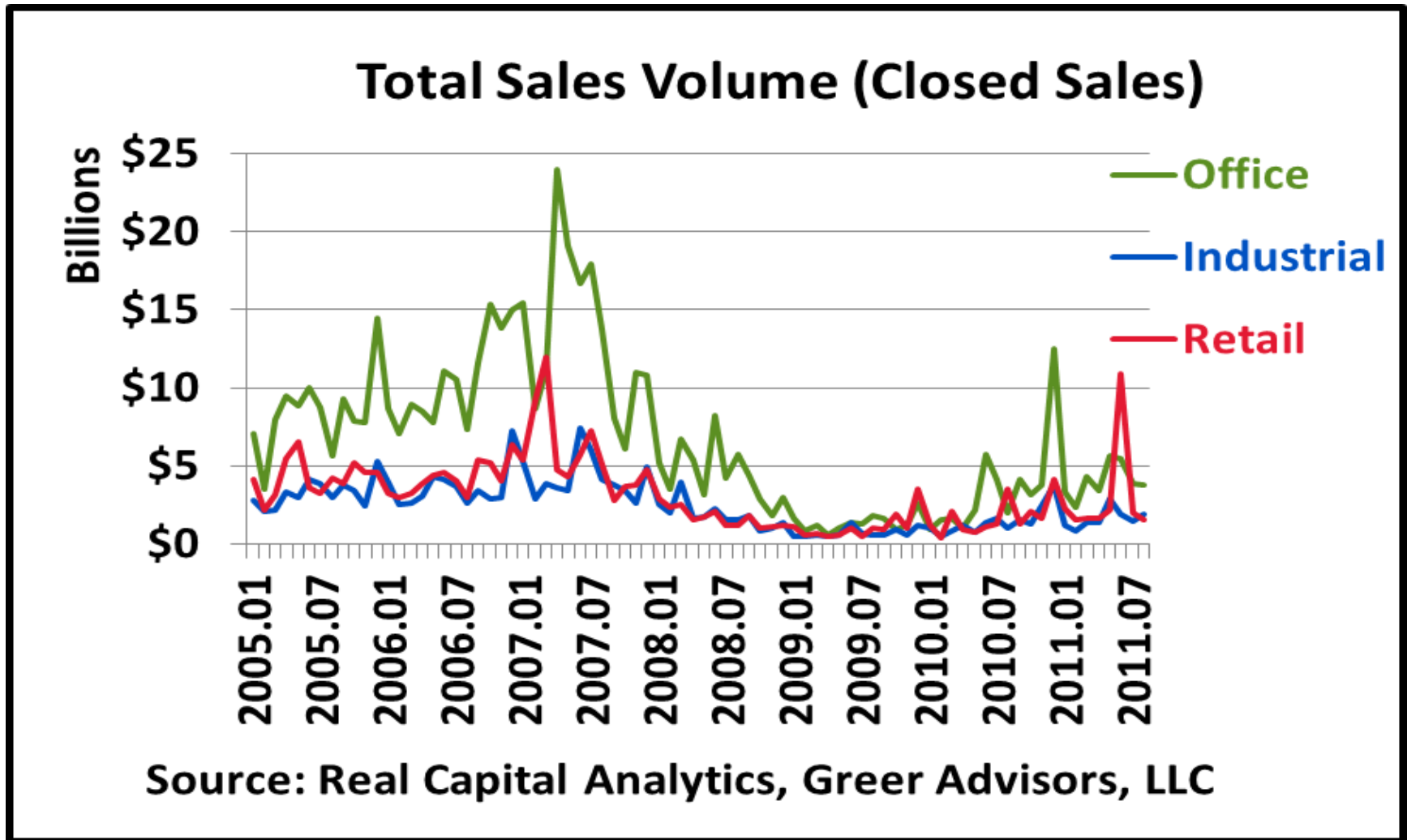
■ National Statistical Rating Organization

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- **Market Performance**

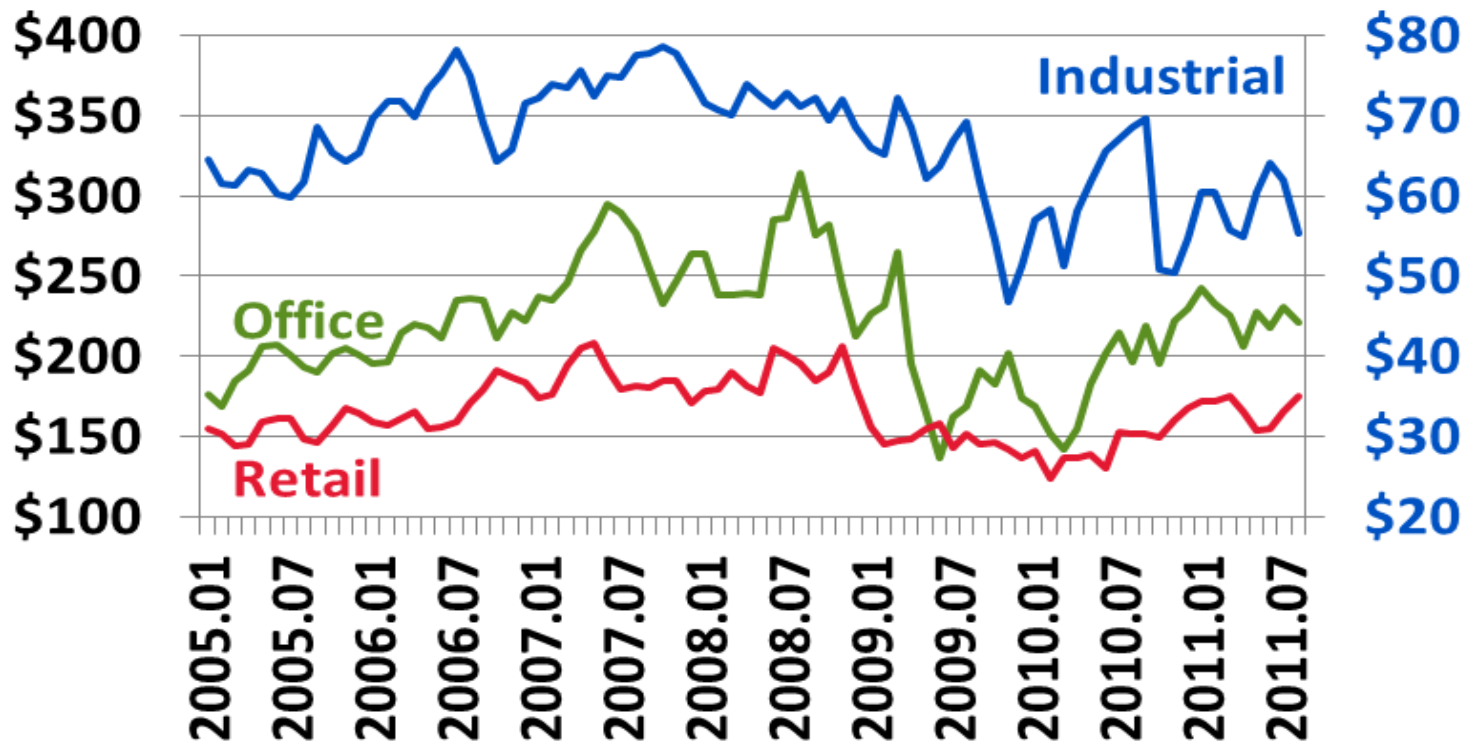
# Commercial Real Estate Sales Volume





# Commercial Real Estate Prices \$\$ PSF

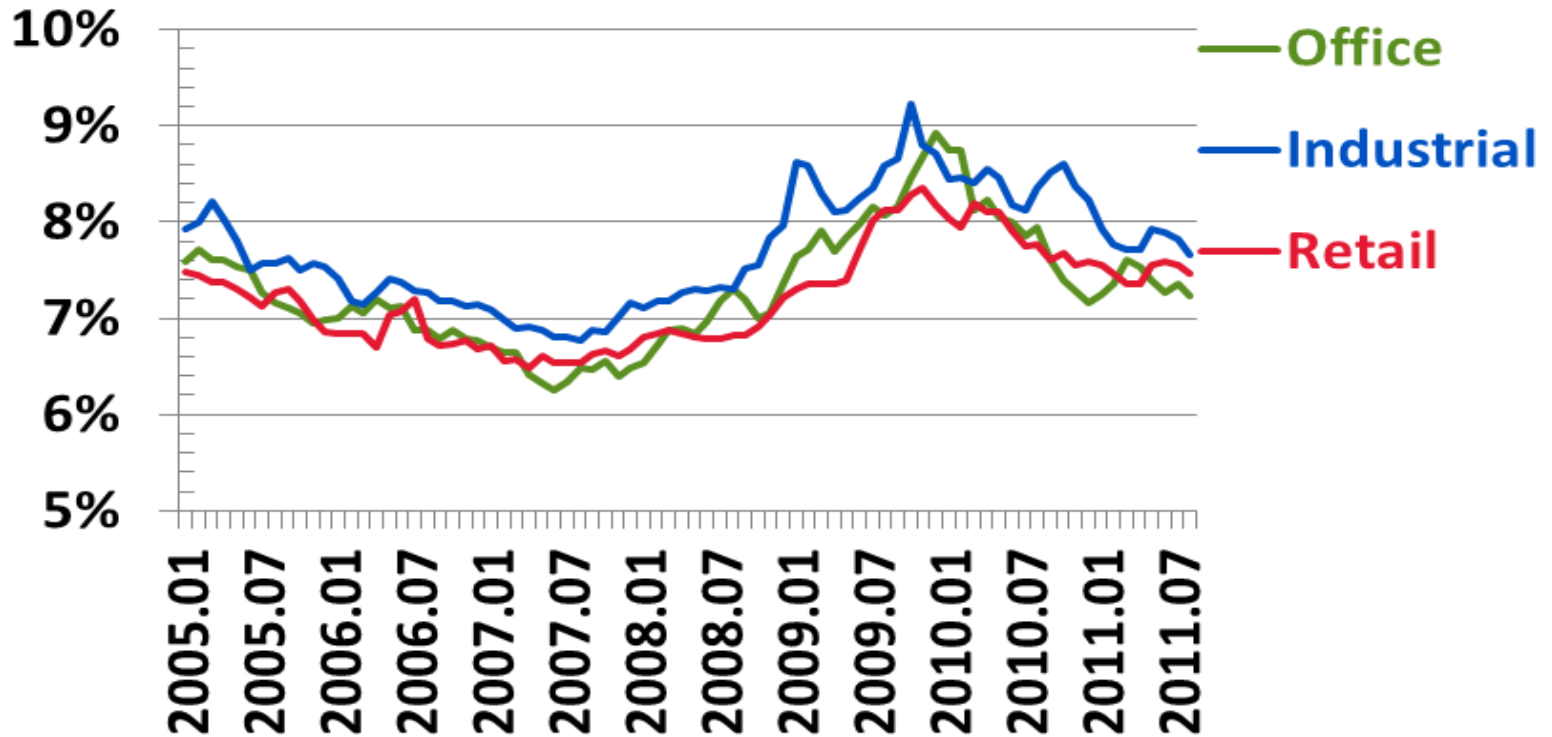
## Prices per SF (Closed Sales)



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 Q3

INDUSTRIAL - 2011.Q3				OFFICE - 2011.Q3				RETAIL - 2011.Q3			
Vac	Metro	Vac %	Eff Rent \$	Vac	Metro	Vac %	Eff Rent \$	Vac	Metro	Vac %	Eff Rent \$
1	Los Angeles	6.8%	\$6.43	1	Albany	7.9%	\$15.62	1	San Francisco	3.7%	\$29.84
2	Salt Lake City	7.9%	\$4.92	2	Honolulu	8.8%	\$23.48	2	Fairfield County	4.9%	\$24.99
3	San Francisco	9.8%	\$7.78	3	New York	9.8%	\$55.46	3	Long Island	5.6%	\$22.68
4	Orange County	10.0%	\$8.40	4	Long Island	11.3%	\$20.88	4	Northern New Jer	5.7%	\$24.39
5	Houston	10.2%	\$5.66	5	Oklahoma City	11.5%	\$15.11	5	San Jose	6.0%	\$26.59
6	Portland	10.6%	\$6.12	6	Pittsburgh	11.5%	\$17.81	6	Oakland-East Bay	6.4%	\$24.97
7	Kansas City	10.7%	\$6.48	7	Trenton	12.0%	\$24.66	7	Orange County	6.4%	\$26.72
8	Long Island	11.0%	\$5.44	8	Stamford	12.5%	\$27.00	8	Suburban Virginia	6.4%	\$24.33
9	Minneapolis	11.4%	\$5.09	9	Washington, DC	13.1%	\$35.63	9	Los Angeles	6.5%	\$25.21
10	Gary	11.5%	\$2.93	10	Boston	13.2%	\$28.05	10	Boston	6.8%	\$19.55
50	Phoenix	16.9%	\$4.65	56	West Palm Beach	21.5%	\$21.44	71	Wichita	14.7%	\$10.41
51	Hartford	17.0%	\$5.83	57	Edison	21.6%	\$18.18	72	Colorado Springs	14.8%	\$11.85
52	Sacramento	18.0%	\$4.44	58	San Jose	21.6%	\$25.84	73	Syracuse	14.8%	\$10.54
53	Atlanta	18.1%	\$3.34	59	Jacksonville	21.9%	\$16.35	74	Dallas	14.9%	\$14.09
54	Boston	18.4%	\$5.71	60	Tampa	21.9%	\$19.50	75	Indianapolis	15.1%	\$12.38
55	Stamford	18.5%	\$5.91	61	Dallas	22.4%	\$18.40	76	Cleveland	15.3%	\$12.77
56	Memphis	18.7%	\$2.32	62	Riverside	22.4%	\$19.38	77	Tulsa	15.8%	\$9.75
57	Detroit	19.7%	\$3.15	63	Las Vegas	24.6%	\$22.70	78	Birmingham	15.9%	\$12.18
58	Trenton	20.1%	\$3.71	64	Detroit	24.9%	\$15.69	79	Columbus	16.0%	\$10.71
59	Ann Arbor	24.2%	\$6.37	65	Phoenix	26.1%	\$19.53	80	Dayton	17.0%	\$8.81
	<b>National Average</b>	<b>12.5%</b>	<b>\$5.28</b>		<b>National Average</b>	<b>17.1%</b>	<b>\$21.05</b>		<b>National Average</b>	<b>11.1%</b>	<b>\$15.82</b>
<b>1</b>	<b>Los Angeles</b>	<b>6.8%</b>	<b>\$6.43</b>	<b>35</b>	<b>Los Angeles</b>	<b>17.2%</b>	<b>\$24.71</b>	<b>7</b>	<b>Orange County</b>	<b>6.4%</b>	<b>\$26.72</b>
<b>4</b>	<b>Orange County</b>	<b>9.8%</b>	<b>\$7.78</b>	<b>41</b>	<b>Ventura</b>	<b>17.8%</b>	<b>\$18.60</b>	<b>9</b>	<b>Los Angeles</b>	<b>6.5%</b>	<b>\$25.21</b>
<b>16</b>	<b>Riverside</b>	<b>12.1%</b>	<b>\$4.28</b>	<b>48</b>	<b>San Diego</b>	<b>18.9%</b>	<b>\$25.54</b>	<b>11</b>	<b>San Diego</b>	<b>7.1%</b>	<b>\$25.17</b>
<b>17</b>	<b>Ventura</b>	<b>12.1%</b>	<b>\$8.03</b>	<b>51</b>	<b>Orange County</b>	<b>19.8%</b>	<b>\$22.74</b>	<b>26</b>	<b>Ventura County</b>	<b>9.9%</b>	<b>\$24.72</b>
<b>42</b>	<b>San Diego</b>	<b>15.3%</b>	<b>\$7.51</b>	<b>62</b>	<b>Riverside</b>	<b>22.4%</b>	<b>\$19.38</b>	<b>28</b>	<b>San Bernardino/R</b>	<b>10.3%</b>	<b>\$17.94</b>
	<b>Min</b>	<b>6.8%</b>	<b>\$2.74</b>		<b>Min</b>	<b>7.9%</b>	<b>\$15.09</b>		<b>Min</b>	<b>3.7%</b>	<b>\$8.81</b>
	<b>Max</b>	<b>15.1%</b>	<b>\$8.40</b>		<b>Max</b>	<b>26.1%</b>	<b>\$55.46</b>		<b>Max</b>	<b>17.0%</b>	<b>\$31.85</b>
	<b>Spread</b>	<b>8.3%</b>	<b>\$5.66</b>		<b>Spread</b>	<b>18.2%</b>	<b>\$40.37</b>		<b>Spread</b>	<b>13.3%</b>	<b>\$23.04</b>
Source: CBRE Economic Advisors, Greer Advisors, LLC								Source: REIS, Greer Advisors, LLC			

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# ■ Outlook & Forecast

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

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- $\sqrt$ 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% 1<sup>st</sup>-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 April 2012 (last report) index at 69.2 (1985=100)
- Risk Curve (AAA Sr. vs BB) flattens to under 500 bps. As of 4/25/2012 CMBx spread stands at 9,593 bps, nearly 100 pts

# Greer's 3-Year Forecast as of 4/26/2012

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- Barbell Modest Growth or Global Recession
  - Global Economy Heals or Not
- Cap Rates will Rise 0.5-2% during 2012-13
  - Mostly in class B/C
  - Trophy Class A will remain low until Flight to Quality Stops
- 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.
- Values have recovered slightly.
- Individual Market Performance will continue to vary widely.
  - 10-30% difference in Top vs Bottom
- Change Creates Opportunities – Build Businesses
- SBA remains very Active

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# Conclusions

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- MBS Loss Rates Remain at All Time Highs
- Class A vs. B/C Big Cap Rate Spreads
- Reduced Leverage for ALL Investor Deals, More RECOURSE
- SBA will remain Only Source for High Leverage
- MBS – Very Very Slow Return. Need New Business Model
- Insurance Co's, Fannie/Freddie and Some Lenders are Active
- CASH WILL REMAIN KING!
- Rents / Vacancies Remain better than early 1990s

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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 Bera~~

Niels Bohr

Nobel Laureate, 1922

Atomic Structure /

Quantum Mechanics





# Questions / Answers

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