

Commercial Market Snapshot: 2009



A LOOK BACK

- As a spill-over affect of the sub-prime mortgage situation - in July of 2007, investors lost confidence in the mortgage backed securities market.
- This resulted in a liquidity crisis sparking unprecedented moves on behalf of government entities and major financial institutions.
- As the financial crisis deepened: Banks, Mortgage Lenders and Insurance Companies failed – all with ties to the MBS market (mortgage backed securities – securitized pools of residential mortgages), the CMBS market (commercial mortgage backed securities – securitized pools of commercial mortgages), the CDO market (collateralized debt obligations – an asset backed security tied to the cash flow from debt instruments) and the Credit Default Swap Markets (a hedge or insurance that an entity will repay its debt obligation).
- As the financial markets searched for stability; the housing market continued its decline and the economy moved into a recession. This caused a decline in consumer confidence and corporate earnings.
- The unemployment rate significantly increased (to 8.3% through Mar) with the loss of 4.64M jobs since December 2007 (as of March, 2009). This represents a loss of jobs every month since the end of 2007. In contrast, prior to November 2007, the economy had seen positive job growth for 54 consecutive months.
- Job loss, consumer confidence declines, corporate downsizing, tightened spending, retracted growth plans, reduced imports have all had a material effect on the commercial real estate markets.
- In August of 2007, the commercial real estate credit markets experienced a significant downturn. The lack of available debt capital immediately began to impact transaction volume and over the past twenty months, this has taken its toll on pricing and related CAP rates.

“THE GREAT DE-LEVERAGING”

This period is becoming known as “The Great De-leveraging.” Two effects are at work:

1. Capital values are falling as investors reappraise their appetite for risk:
2. As commercial real estate fundamentals decline, there will be a direct and further impact on real estate values:
 - As such, investors today are trying to identify the point when unleveraged privately invested real estate returns will provide a suitable risk premium over the risk-free interest rate.
 - Where the markets had relied on leverage to drive investment decisions in the past, the market today will look at more or less – pure income return.
 - In the boom of the past decade of growth, investors looked to the debt markets to bolster yields; but then securitization of debt portfolios helped mitigate risk, driving even further investment opportunity.
 - This was followed by even more complex financial products where the risk could be further “sliced and diced” – like the CDO market.
 - As the market heated, lending standards were relaxed and the boom market became somewhat of a bubble.
 - Then, as the subprime mortgage situation drove fear throughout the credit markets, the securitized debt market (which financed 95% of virtually all commercial real estate transactions in 2007) ground to a halt.
 - Overall investment sales volume in the United States declined 75% from 2007 through 2008.

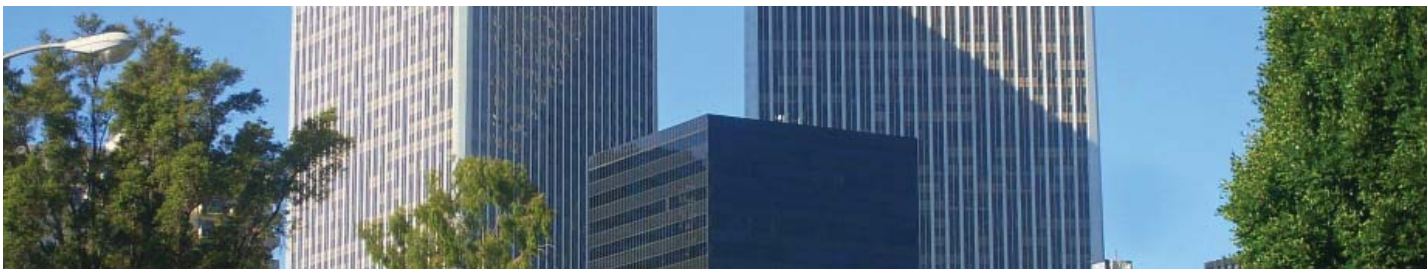


PROPERTY SECTORS - Nationally

- **Office:** There is a continued increase in vacancy, with a national rate today of 14% and expected to continue to grow throughout the year. Landlord concessions are increasing with free rent, larger TI packages and more flexible terms coming back into the market. Rents are expected to decline between 5-6% this year as demand declines and the overall market sees negative net absorption.
- **Retail:** The retail sector has seen the sharpest moves in the fundamental picture over the past four quarters. Vacancy has risen over 200 bps from a low in the residential market boom of 2005 and sits today at 8.9%. Effective rents have declined the past three quarters and are expected to decline further as retailers curtail expansions plans, and several retailers pull back and close stores. Expect to see a very challenged retail market (with the exception of deep discounters like Wal-Mart and Dollar Stores, which will experience a growth in consumer demand).
- **Industrial:** the investment market has also continued to see a further decline, with fewer than \$400M in industrial sales closed nationally. Newly listed properties continue to grow with close to \$2B of inventory on the market. CAP rates are averaging 8.4% reflecting an 80bps increase since September 2008. It should be noted that asking CAP rates are averaging 7.7% with only a 10bp increase over the same period. Net growth in new product and no significant pricing moves speaks to the disconnect between buyer and seller expectation.
- **Multi-Family:** The multi-family sector was also off to a slow start in January and has seen significant decline since December 2008. \$600M of assets traded with the largest transaction priced at \$67.4M. Comparatively from previous years, that's a very small figure. New listings outpaced closed transactions by a 5:1 margin. Cap rates have increased only 50 bps since September 2007 and stand today at 6.4% on average.

WHAT TO EXPECT THROUGHOUT 2009

- The overall economy will continue to weaken
- Rents will fall; concessions will grow; and overall returns will reflect these changes
- Many owners will be upside down and potentially looking for an exit
- Retail will suffer the most
- Lodging will suffer as well with business and leisure travel declining
- Office product will continue to be weak with further growth in unemployment throughout the office sector
- Industrial will be impacted less but still will experience a decline
- Multi-Family will perform better than the rest from an operational standpoint but debt will still be hard to come by
- Expect to see "traditional CRE business" to be off another 15-20%, with the hardest hit housing markets to potentially be off further.



WHERE ARE THE OPPORTUNITIES IN 2009

- **For tenants:** Do what is called “Blend and Extend” (or an advance Lease Renewal); take advantage of the market and lock in for longer terms.
- **For landlords:** keeping tenants is key – focus on property management functions, reduction of operating expense and tenant relations programs.
- Focus on smaller sales transactions with private investors. In fact, the buyer profile has changed significantly from institutional and equity fund buyers to private investors who made up more than 40% of the market in 2008.
- REO and distressed asset opportunities will be abundant. You need to understand the objectives of financial institutions and be able to provide a full-service platform with a single point of responsibility. This is where collaboration of the industry really comes in to play; with property management, leasing, sales, appraisal, engineering, title and the like all coming together to offer a single platform.
- Most financial institutions are not staffed to handle the myriad of issues with REO and will look to outsource in the most effective and advantageous manner possible.
- NPL portfolios and other distressed debt purchases - many of these borrowers are looking to recapitalize and there is a lot of money being raised to acquire opportunistically.
- Student housing will continue to perform, as colleges and universities look for ways to accommodate their student body and grow enrollment.
- Everyone is looking for ways to maximize facilities.
- Health care – including Medical Office/Ambulatory Care facilities will continue to have demand. In fact, while the economy gave up over 4.64M jobs since December 2007, the healthcare industry has added close to 500,000 jobs.
- Opportunities with the Federal Government; with various programs as a part of the government stimulus, there are a number of government related opportunities.

