Real Estate Finance 201: The Realities

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ULI – the Urban Land Institute

ULI 2012 Fall Meeting
Denver, Colorado
October 17, 2012
Two Speeches for You to Choose From:

Text your vote to:

4-5-6-6-6 [spells “gloom”] or
3-6-6-6-3-3 [spells “doomed’]
tenuous

[ten-yoo-uhs]

-adjective

1. thin or slender in form, as a thread.
2. lacking in sound basis, as reasoning; unsubstantiated; weak: a tenuous argument.
3. thin in consistency; rare or rarefied.
4. of slight importance or significance; unsubstantial: He holds a rather tenuous position in history.
5. lacking in clarity; vague: He gave a rather tenuous account of his past life.
Urban Land Institute Real Estate Capital Markets

Between Uncertainty and Extreme Uncertainty
Becoming Resigned to Uncertainty
Urban Land Institute Real Estate Capital Markets
October 7, 2007: Financial institutions were said to be “too big to fail”

October 14, 2011: Dodd-Frank reform legislation is said to be “too big to read”
Timeline of Increasingly Cyclical and Volatile Capital Markets/Real Estate Industry

- 1997: Asian Financial Crises, aka “Asian Contagion”, or “Asian Flu”
- 1998: Russia defaulted on its Sovereign debt; Long-term Capital Management “rescued” by Federal Reserve/Wall Street
- 1999: Worldwide preparation for Y2K
- 2000: Bursting of the dot.com, aka “dot.bomb”, bubble
- 2001: September 11th
- 2002: Start of corporate governance/accounting scandals
- 2003: Euro-corporate governance scandals
- 2004: Fannie Mae accounting scandal
• 2005: GM/Ford debt downgraded by rating agencies
• 2006: Trading breakdown in Japan
• 2007: The real estate industry and capital markets suffered
  “…end of an economic illusion, facilitated by a bubble, built on a delusion, perpetuated by greed, living on both borrowed time, and borrowed money”
• 2007: U.S. Sub-Prime Mortgage Crises gains momentum
• 2008: “34-Days from Hell” (Lehman bankruptcy; AIG rescue; Fannie Mae/Freddie Mac conservatorships; Goldman Sachs/Morgan Stanley “restructured” as commercial banks; Merrill Lynch, Washington Mutual, and Wachovia acquired)
• 2009: Global capital markets faced period of “Shock and Awe”
America’s Lost Decade (2000 – 2009) Finally Ends…Badly!
• 2010: “Sorting Through the Wreckage” began
• 2011: January 1\textsuperscript{st} through August 4\textsuperscript{th}

“I’ve got to admit it’s getting better, a little better all the time” (Getting Better, \textit{The Beatles})

• On August 5\textsuperscript{th} at 20:13:14 EST U.S. long-term debt rating lowered to AA+; negative outlook
  – Global capital markets received a “Shake-up Call”, i.e., a wake-up call to the 10\textsuperscript{th} power
• Implications of downgrade were immediate and far reaching
  – Volatility increased in the equity and debt capital markets
  – Industry participants hit the “pause” button
  – CMBS spreads widened as capital withdrew from market
  – Transaction velocity slowed; “MAC” clauses were invoked
• By mid-September, the European Flu was threatening both the U.S. as well as Asia
Quandary: Impact of the U.S. Credit Downgrade – A Short or Long-Term Problem?

- Will the capital markets, including real estate, repeat the “Head Fake” of 1998?
  - The flight to safety and liquidity caused by Russia’s default on it Sovereign Debt, combined with the Federal Reserve’s engineered rescue of Long-term Capital Management, lasted thorough December

- Or, will the capital markets repeat mid-August 2007’s “Real Deal” and remain closed for the next three years?
  - So far, a modest head fake.
“Everybody double your anti-depressants.”
• December 2010: The Arab Spring began in Tunisia
• September 2011: “Occupy Wall Street” began a Financial Markets Spring in New York; similar demonstrations had been held in over 70 cities worldwide
• January 13, 2012: France’s sovereign debt rating was lowered from AAA to AA+; S&P also notified other European governments of looming ratings downgrades
• March 2012: European financial firms faced 431 billion € of maturing bonds in 2012 (07% of 2011’s issuance
• March 2012: Global election cycle begins with Putin’s reelection as President, followed by Presidential elections in France and the U.S.
• December 2012: China’s leadership transitions to the next generation
THE END IS NEAR.

YOU WISH.
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The Best of Times

The Worst of Times

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M. Stevens
2013: Observations and Conclusions

- “Smaller” industry with improving, but lower, profitability
- Lower, more rational, return expectations
- Less development
- Lower availability of credit
- Lenders begin to recognize losses; borrowers have no choice
- Markets begin to come off the bottom…slowly
- Some “Generational” buying opportunities if you have cash
- Refinancing available for owner’s with stabilized properties
- Plenty of “Rescue Capital” to assist in restructurings
- Buyers and lenders remain highly selective
• Banker’s focus on top tier properties in strongest markets
• CMBS continues its Lazarus-like rise
• Refinancing remains a problem for the rest of the decade
• “Duration” is added to real estate borrower’s vocabulary
• Opportunity funds have “finally” learned that big returns require high leverage and high risk
• Non-bank lenders and mezzanine investors re-emerge
• Institutional investors continue to increase allocations to real estate, subject to the denominator affect
• Transaction volume continues to increase…slowly
• The economy…it remains all about jobs
• Refinancing of existing mortgage debt a long-term, global problem that we will be talking about for “years”
  – Amend, extend, and pretend have become institutionalized methods of operation
• Single family housing finally starts to turn the corner
• While the CMBS “cleaning” process is beginning, it will take several years to perfect, depending on the servicer
  – Some will extend; other will decide it’s “Hammer Time” and foreclose
• Commercial banking will improve; 2012 will be better than 2011
• Long-term deleveraging will continue in the U.S. and will be a primary objective of European banks
• Global regulatory uncertainties will constrain lending
• CMBS got “a little far out on its skis” in mid-summer 2011
  – “We suffered major league ‘push-back’”
  – Industry got the message and tightened up
• “CMBS remains the lender of last resort”
• Insurance companies: same old blah, blah, blah
  – Stronger borrowers, properties, markets
  – “Pick of the litter”
• Euro-crises has led to deleveraging and repatriation of capital
• Overall, rates are record lows and lenders are instituting floor pricing
• Financing world “size constrained”; anything above $500 million requires a club deal
• Per company limits in the $250 to $500 million range, thereby limiting deal size; don’t expect an “Equity Office II”
• Mortgage REITs are not the answer; “something” non-bank, non-regulated, non-public needs to be invented
• 2012 problems: Euro-crises; U.S. election cycle; French election cycle; new Chinese leadership; global economy; global political gridlock; and volatility (the new normal)
• Private equity: are properties
  – “Priced to perfection”? or
  – “Priced to disappoint”?
• Interest rates “out of the equation until 2015”
• “Fate of the world’s economies is in the hands of politicians”
• REITs have money and access to more; they’ll be active investors
• Private equity fundraising: those with legacy problems need not apply
  – Investors almost “schizophrenic” about two extremes: core and opportunistic
    • Core pricing to a 6.5% to 7.5%, unleveraged IRR
      – Value-added strategies staging a comeback
• What happens when interest rates and capitalization rates eventually spike? Will economic growth be sufficient to move NOIs to where they support will values and refinancing?
Q & A

• What should I focus on? “Restructuring Debris”
• Are there really opportunities in the distressed space? Yes, but the playing field is very competitive
• What’s your best strategy? Financing distressed owners, not distressed properties, needing “Rescue Capital” due to overleveraging; anything starting with an “R”
• Are banks selling distressed assets? Yes Virginia, they finally are, but slowly
• What about land? In general, still too expensive
• Is financing becoming more readily available? Yes, especially for larger players (it figures)
• What about secondary and tertiary markets? “Capital chasing yield”; very property specific
• With the exception of the gateway markets, why are investors reticent to commit? “They are waiting for the train to run them over so they can be sure it’s on the tracks”
• What about retail property? “We’re not over-retailed; we’re under-demolished”
• How would you approach the secondary markets? Buy the “A” property; someone will come along to take you out
• Will smaller REITs become merger and acquisition, consolidation, targets? Yes they will
  – Note: this is said at every conference; therefore, it will eventually happen and someone will be proved right
“Good news—I hear the paradigm is shifting.”
Real Estate Yields vis-à-vis Capital Markets Returns as of 3Q 2012

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Real Estate Yield</td>
<td>8.7%</td>
<td>10.0%</td>
<td>9.3%</td>
<td>8.8%</td>
<td>8.7%</td>
</tr>
<tr>
<td>10-Year Treasury Bond</td>
<td>3.8%</td>
<td>3.6%</td>
<td>2.9%</td>
<td>2.6%</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

| Yield Spread (Real Estate Yield minus 10-Year Treasury Bond) | 10-Year Treasury Bond | 4.9% | 6.4% | 6.4% | 6.2% | 7.1% |

Source: RERC Investment Survey; Federal Reserve.
It’s always the economy!

• “If you laid all the economists end-to-end, they would never reach a conclusion”
  – George Bernard Shaw

• “It has been said that the only purpose of economic forecasts is to make astrology look respectable”
  – Anonymous
"I want you to switch from alchemy and shape-shifting to job creation."
Job Growth Drives the Real Estate Economy

<table>
<thead>
<tr>
<th>Monthly Job Growth</th>
<th>Job Growth Benchmark</th>
<th>Gain on a Percentage Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>-0</td>
<td></td>
<td>0.00%</td>
</tr>
<tr>
<td>126,000</td>
<td>October 2003</td>
<td>1.15%</td>
</tr>
<tr>
<td>136,000</td>
<td>10-Year Average</td>
<td>1.26%</td>
</tr>
<tr>
<td>190,000</td>
<td>30-Year Average</td>
<td>1.75%</td>
</tr>
<tr>
<td>245,000</td>
<td>1990s Expansion</td>
<td>2.27%</td>
</tr>
</tbody>
</table>

Source: CBRE Research.
“And this is where we adjust the interest rate.”
Senior Loan Officer Opinion Survey (3Q 2012)
Regulatory “Corn Maze”
"By God, for a minute there it suddenly all made sense!"
Potential Impact of Dodd-Frank on Commercial Real Estate Lending

• Volker Rule: prohibits banks from proprietary trading, investing in hedge funds, private equity

• Risk Retention: CMBS issuers retain at least 5% of “something”

• Impact:
  – Lower credit rated borrowers may find it more difficult to obtain bank loans
  – Risk retention requirements may negatively impact amounts allocated to underwriting and warehouse lines
  – Transaction cost increases will be passed on to borrowers
What about Fannie and Freddie?

• Option 1: Minimum government role
• Option 2: Government plays a role during a housing crises
• Option 3: Government as re-insurer

• Not surprising, Option 4: “Kick the can down the road until after the 2012 Presidential election” was exercised
“You steered the proper course, Cap’n, when you had us bury this instead of investing it in the market!”
Real Estate and Capital Markets Investment Strategies

<table>
<thead>
<tr>
<th>Real Estate Investment Trusts</th>
<th>Commercial Mortgage-Backed Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core, Value-Added, and Opportunistic Property Investments</td>
<td>Whole Loans, Bridge Loans, and Mezzanine Debt</td>
</tr>
</tbody>
</table>
# The Sudoku Approach to Investing

<table>
<thead>
<tr>
<th>Strategies</th>
<th>Primary</th>
<th>Secondary</th>
<th>Tertiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core</td>
<td><strong>Today</strong></td>
<td>Today</td>
<td>Soon</td>
</tr>
<tr>
<td>Value-Added</td>
<td></td>
<td>Sooner</td>
<td>Not so soon</td>
</tr>
<tr>
<td>Opportunistic</td>
<td></td>
<td>Soon</td>
<td>Much later</td>
</tr>
</tbody>
</table>
“Basic economics—sometimes the parts are worth more than the whole.”
“It’s a REIT World After All

• Equity REITs total return in 2011 outpaced the DJIA, S & P 500, NASDAQ Composite, and Russell 2000
  – Third year in a row; can they four-peat?
"The little pig with the portfolio of straw and the little pig with the portfolio of sticks were swallowed up, but the little pig with the portfolio of bricks withstood the dip in the market."
REIT “Themes” for 2013

- REITs have managed their balance sheets, reducing leverage, paying down credit lines, and extending maturities
  - Result is ample supply of “dry powder” to fund acquisitions and/or selective development
- Able to raise additional capital through secondary offerings of common and preferred shares and sale of unsecured debt
- Year-to-date, REITs have raised $20.5 billion in common equity, $7.2 billion in preferred equity, and $12.3 billion in unsecured debt
- 5 initial public offerings raised approximately $800 million in 2012
CMBS Issuance: 1995 – 2012 (Projected)

Source: Commercial Mortgage Alert.
CMBS Loan Delinquency Rates

% 30+ Days Delinquent

<table>
<thead>
<tr>
<th>Month</th>
<th>% Delinquent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-11</td>
<td>9.65</td>
</tr>
<tr>
<td>May-11</td>
<td>9.60</td>
</tr>
<tr>
<td>Jun-11</td>
<td>9.37</td>
</tr>
<tr>
<td>Jul-11</td>
<td>9.52</td>
</tr>
<tr>
<td>Aug-11</td>
<td>9.56</td>
</tr>
<tr>
<td>Sep-11</td>
<td>9.51</td>
</tr>
<tr>
<td>Oct-11</td>
<td>9.77</td>
</tr>
<tr>
<td>Nov-11</td>
<td>9.58</td>
</tr>
<tr>
<td>Dec-11</td>
<td>9.52</td>
</tr>
<tr>
<td>Jan-12</td>
<td>9.37</td>
</tr>
<tr>
<td>Feb-12</td>
<td>9.37</td>
</tr>
<tr>
<td>Mar-12</td>
<td>9.68</td>
</tr>
<tr>
<td>Apr-12</td>
<td>9.80</td>
</tr>
</tbody>
</table>
CMBS Maturities: 2011 - 2020

64% of maturities ($375 billion) in 2015-2017.

Source: Wells Fargo, Intex, Trepp, Jones Lang LaSalle
2007 Vintage Loans: The Peak of the Market

• Depending upon who you listen to…
  – “First major wave of maturities from the 2007 vintage which were issued during a frothy period at the peak of the market came due this year”
  – Two-thirds of the loans do not meet one or more the current refinancing thresholds for conduit lending
  • Debt yield (NOI / mortgage amount) of 11.0%
  • Debt service coverage ratio equal to 1.40 x 1
  • Mark-to-market loan-to-value ratio equal to 65% to 70%
CMBS Refinancing Prospects Look Dim

Key
Very Likely — Meets all 3 sizing thresholds
Likely — Meets 2 of 3 sizing thresholds
Potentially — Meets 1 sizing threshold
Not Likely — Meets none of the sizing thresholds

Sources: Trepp, RCA, and Citi Investment Research and Analysis
Many Peak-of-Market CMBS Loans Facing Bleak Prospects in 2013

Source: Citi Investment Research and Analysis

Scary!
CMBS 2.0: Finished and Unfinished Business

1. Refinancing will continue to affect the industry well into the coming decade
2. Cleaning up the system and eliminating legacy assets from balance sheets to allow lending volume to grow
3. Restore credibility of rating agencies
4. Improve product structure
5. Improve transparency
6. Resolve regulatory and accounting uncertainties
7. Restore investor demand
"War is the highest form of the real-estate business. May I quote you?"
P.S.: “Core and value-added are the most popular strategies among investors”

![Bar chart showing investment strategies and their popularity](chart.png)

Source: Preqin.
Private Real Estate Equity Capital Markets

• Fundraising, in general, was slow in 2009 to 2012, primarily due to investor caution, little sense of urgency to commit, and legacy performance
  – Expected to remain extremely challenging for many in 2013
• Many fund managers (correctly) are focused on asset management and debt restructuring
• Consolidation and contraction of private equity real estate platforms is expected to continue in 2013
• Institutional investors evidencing interest in co-investment and “club” structures as a means of exerting control
• Sources of equity capital include: foreign investors; high net worth/family office; pension funds; private equity funds; insurance companies, etc.

• Remain highly selective and directionally focused
  – Core, value added, restructuring/recapitalizations, and opportunistic

• Flight to quality an “enduring” theme: location; asset; sponsorship

• Secondary and tertiary markets continue to compete for investor attention

• Anticipated rates of return (leveraged):
  – Value-added: 15% - 17% IRR
  – Opportunistic: 18%+

• Sponsor co-investment must be considered “meaningful”
What Investors Think a Fund Manager Can Do to Standout

- “Have an interesting and unique approach, underlined by a strong track record.”
- “It’s very important for fund managers to have staff in their fund’s target countries.”
- “Offer a niche opportunity, which means demonstrating core competency in one aspect of real estate.”
- “Demonstrate a track record and an ability to find unique deals.”
- “Fund managers need to worry less about benchmarks and more about making money in absolute terms.”
- “Fund managers need to hold that first interim close, invest committed capital and make deals so investors can assess the fund’s portfolio.”
- “Exhibit stability, integrity, experience, track records; present compelling opportunities and follow through with investment strategy. Present themselves well and demonstrate why we should invest in their funds.”
- “We see a lot of funds that are duplicates, fund managers with the same stories.”
- “They need to be able to align the strategies they implement with the strategy of an investor, while being competitive on fees and demonstrating a good track record.”
- “Have a proven track record in both good and bad markets. Strategies should be relevant in today’s market.”
- “Focus on being competitive in relation to terms and conditions, while also establishing positive relationships with investors.”
- “Perform.”

$- 
$100.00 
$200.00 
$300.00 
$400.00 
$500.00 
$600.00 
$700.00 

U.S. Average Capitalization Rates by Property Sector

Source: Real Capital Analytics.
2013: Improving Prospects

- NCREIF National Property Index showed very “credible” results: 12.0% on trailing 12-month basis
- Capitalization rates continued to “firm” with the Real Estate Research Corporation quarterly survey showing 10 consecutive quarters of declines, from 8.40% to 6.96%
- Transaction volume, while “light” by historical standards, continued to increase sequentially; according to Real Capital Analytics, volume exceeded $210 billion for 2011
- Not out of the woods yet…
"Beg."
Lending Environment

• Lenders are becoming more active versus a year ago due to stronger balance sheets and income statements
  – Underwriting standards stringent and precise; focus on “quality, quantity, and durability” of income
  – Loan-to-value and debt service coverage ratios, and debt yield requirements are “reverting to the mean”, i.e., the long-term historical averages
  – Focus is on “bankable borrowers” with stabilized properties
• Few foreign banks remaining are focused on institutional quality properties, located in 24-hour gateway markets, and owned and managed by best-in-breed sponsors
Maturing Commercial Mortgages: Real Estate’s Current and Future “Black” Hole

![Bar Chart showing maturing commercial mortgages by year and type (banks, CMBS, life companies, other).]
Total Outstanding Distressed Loans
Preferred Strategies for “Resolving” Maturing Commercial Real Estate Loans

Source: Emerging Trends in Real Estate 2012 survey.
Note: Based on U.S. respondents only.
U.S. Commercial Bank Lending Activity 2011-2012

All Property Types by Year

2011
- CMBS: 16%
- Gov't Agency: 7%
- Int'l Bank: 25%
- Nat'l Bank: 19%
- Reg'l/Local Bank: 9%
- Pvt/Other: 13%
- Financial: 9%

2010
- CMBS: 15%
- Gov't Agency: 6%
- Int'l Bank: 25%
- Nat'l Bank: 17%
- Reg'l/Local Bank: 9%
- Pvt/Other: 14%
- Financial: 13%

2009
- CMBS: 39%
- Gov't Agency: 12%
- Int'l Bank: 9%
- Nat'l Bank: 14%
- Reg'l/Local Bank: 17%
- Financial: 9%

2008
- CMBS: 13%
- Gov't Agency: 13%
- Int'l Bank: 10%
- Nat'l Bank: 15%
- Reg'l/Local Bank: 20%
- Financial: 26%

2007
- CMBS: 54%
- Gov't Agency: 7%
- Int'l Bank: 4%
- Nat'l Bank: 5%
- Reg'l/Local Bank: 9%
- Financial: 12%
Insurance Companies

• Industry met or exceeded 2011 goals
• In similar position in 2012
  – Financing only the “Best and the Brightest”
  – Very selective as to borrower, market, and property
• While commercial real estate mortgages offer relatively attractive yields versus alternatives, market remains “fragile”
  – Subject to being upset by almost “anything”
    • U.S. economy; Euro-zone economy; Sovereign debt crises, volatility, etc.
• Starting to compete with Fannie/Freddie Mac for multifamily mortgage loans
• Many have size limits per deal; “clubs” formed for large deals
• Most are charging floor pricing:
  • 5 year term: 3.50%+/-; 10 year term: 4:00%+/-
Mirror, Mirror on the Wall, Who’s Commercial Mortgages Held up Best of All? Insurance Companies

[Graph showing delinquency and in foreclosure percentages over time, with sources: Moody's Economy.com, American Council of Life Insurers.]
## Current Lending Environment: Sources and Terms

<table>
<thead>
<tr>
<th>Capital Source</th>
<th>Agency Financing(^1)</th>
<th>Life Company / Pension Fund</th>
<th>Investment Fund, Finance Company</th>
<th>Money Center / Offshore Banks</th>
<th>Conduits</th>
<th>Local / Regional Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred Loan Size</td>
<td>$3+ million</td>
<td>&gt;$10 million</td>
<td>$20 - 100 million</td>
<td>$10 - 100 million</td>
<td>&gt;$10 million</td>
<td>$3 - 25 million</td>
</tr>
<tr>
<td>Cost of Capital</td>
<td>2.60% - 3.75%</td>
<td>3.00% - 5.00%</td>
<td>5.25% - 7.50%</td>
<td>3.00% - 5.00%(^2)</td>
<td>4.25% - 5.50%</td>
<td>3.50% - 5.00%</td>
</tr>
<tr>
<td>LTV / Debt Yield</td>
<td>55% - 83% LTV</td>
<td>50% - 65%</td>
<td>55% - 85%</td>
<td>50% - 65%</td>
<td>Up to 70%</td>
<td>50% - 65%</td>
</tr>
<tr>
<td>DSCR</td>
<td>1.20x - 1.55x</td>
<td>1.25x - 1.50x</td>
<td>0.75x - 1.40x</td>
<td>1.35x - 1.50x</td>
<td>&gt;1.20x</td>
<td>1.35x</td>
</tr>
<tr>
<td>Salient Covenants</td>
<td>Non-recourse</td>
<td>Non-recourse</td>
<td>Non-recourse</td>
<td>Potential recourse</td>
<td>Non-recourse</td>
<td>Potential recourse</td>
</tr>
<tr>
<td></td>
<td>5-35 year term</td>
<td>Prefer fixed rate</td>
<td>Floating rate or fixed via swaps</td>
<td>Fixed or floating</td>
<td>Fixed</td>
<td>Fixed or floating</td>
</tr>
<tr>
<td></td>
<td>Development financing available through HUD only</td>
<td>3-20 year term</td>
<td>2-5 year term</td>
<td>2-5 year term; 10 year possible</td>
<td>Defeasance</td>
<td>3-5 year term; 10 year possible</td>
</tr>
<tr>
<td></td>
<td>Ability for supplemental financing</td>
<td>Limited credit for vacancy</td>
<td>Flexible prepay</td>
<td>Flexible prepayment</td>
<td>Limited credit for vacancy</td>
<td>Depository relationship</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>May want additional banking business</td>
<td>Time consuming execution</td>
</tr>
</tbody>
</table>

\(^1\) Multi-family only
\(^2\) Assumes swapped rates
Salvation? Private Real Estate Debt Funds

• Formed to take advantage of current void in the real estate debt capital market
• Wide array of investment strategies
  – Publicly traded securities to performing first mortgages
  – Distressed, mezzanine, preferred, etc.
  – Acquisitions, recapitalizations, bridge loans, etc.
  – Stabilized to transitional
• Many geared to generate equity-like returns
• Fixed and floating-rate
• High quality property with distressed owner and upside down financial structure
Best Ideas for 2013

• Development: multifamily apartments…that’s it!
• Investment:
  – the gateway markets; the technology centers
  – value-added; properties with opportunities for renovation, rehabilitation, re-leasing, repositioning…
• Finance:
  – Lock-in long-term, fixed rate debt…now!
• Rescue Capital
  – Strategic investments in troubled borrowers, not troubled properties
• Buy your own debt back from the lender at a discount; while you’re at it, buy someone else’s debt back at a discount
• Learn how to “Green” your space; there’s a lot of low hanging financial fruit to be picked
• Buy land...if you have the patience
• Property sectors
  – Multifamily…obviously
  – Fortress malls and in-fill shopping centers…obviously
  – Industrial/distribution space in port cities…obviously
  – Business center hotels, any trophy office building as yet unbought, and medical office properties
Themes and Trends

• “Resigned to Uncertainty” on both a short-term (U.S. election and “fiscal cliff”) as well as long term (Euro-crises, slowing down of Asia [China’s] economy
• Housing seems to have reached bottom; may not go up except in very few markets but at least it has stopped falling
• Transitional assets on my mind
• Reluctance to commit due to uncertainty
• Fewer acquisition opportunities means “hand-to-hand” combat between buyers to get money invested
• Higher risk assets and locations
• Search for yield means accepting increased credit risk of some type
• $300+ billion of commercial real estate mortgages mature each year; resolve a few, sell a few, rollover the rest
• No “new”, non-bank commercial mortgage sources have appeared to date; yields need to increase to attract capital
• Increasing interest in secondary and tertiary markets; you have to be interested in something don’t you. You know the arguments.
• With few exceptions, little to no new construction except multifamily
• “Re-urbanization”; if your down on suburban office you should be up on something; I’m just not sure I believe how much re-urbanization will actually occur in this cycle Low interest rates through 2014 and maybe into 2015
• Need to be “large” or a “local sharpshooter” to remain “relevant”
• Globalization of investment, investors, and capital flows
• De-leveraging of financial institutions and investors (except private funds) worldwide continues
• Real estate’s “relative value” advantage over other asset classes continues (as it remains the “cleanest dirty shirt in the closet”)
• Regulatory “corn maze” remains annoying and may even prove to be troublesome
• Technology and e-commerce
• Smaller industry
• Best bet: anything that starts with an “R” – renovation, rehabilitation, re-position, re-lease, refinance
• “Tech” markets remain “hot”
• After a strong start to 2012, the U.S. economy is losing momentum.
• While corporate balance sheets and earnings continue to improve, unemployment is expected to remain high as anemic GDP growth argues for modest job creation.
• Consumer spending remains sluggish due to loss of "housing wealth" and continued de-leveraging.
• Consumer confidence seems to be improving but remains uncertain and volatile due to deteriorating job market and political uncertainty.
• Presidential election, combined with fiscal cliff uncertainties, leads to consumers and businesses postponing spending and hiring decisions.
• Lame duck Congress will face 5%+- of GDP fiscal belt tightening (absent legislation which will just kink the can down the road some more).
• European markets have been severely impacted by Greece and Spain and this may only be the beginning.
• China's potential economic hard landing combined with its leadership change adds to uncertainty; despite this, emerging markets continue to be attractive to many investors.
• In 2012, property was "priced to perfection"; in 2013, property purchased will be priced to disappoint.
• 2013: fewer acquisition opportunities means hand-to-hand combat to get money invested.
• Businesses will continue to cut costs to improve productivity.
• Economy will not recover until 2014 or later.
• Worries: European crises; job growth; healthcare costs; regulation.
• Demand for yield driving investor and manager investment decisions.
• Underlying fear about availability of liquidity.
• De-leveraging continues with no end in sight.
• Real estate investment driven by relative value comparisons; how low can yields go - how much can spreads narrow?
• Need to be either “large or local sharpshooter” to remain relevant
Source: CREPoint.
“I’ll pause for a moment so you can let this information sink in.”
Real Estate Finance 201: The Realities

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ULI 2012 Fall Meeting  
Denver, Colorado  
October 17, 2012