




Real Estate Values: Have We Hit Bottom Yet?

John G. Ellis, MAI, CRE, FRICS

IRWA Chapter 1
2009 Annual Fall Seminar
October 20, 2009

- 
- 1. What is the current state of the market?**
 - 2. How did we get to where we are now?**
 - 3. What are the trends looking forward?**
 - 4. Have we hit bottom yet?**

Current State of the Market

- **Actually multiple submarkets**
 - Geography
 - Property type
- **But in most submarkets**
 - Sales volumes are down
 - Rents are lower
 - Cap rates are higher
 - Sale prices are lower

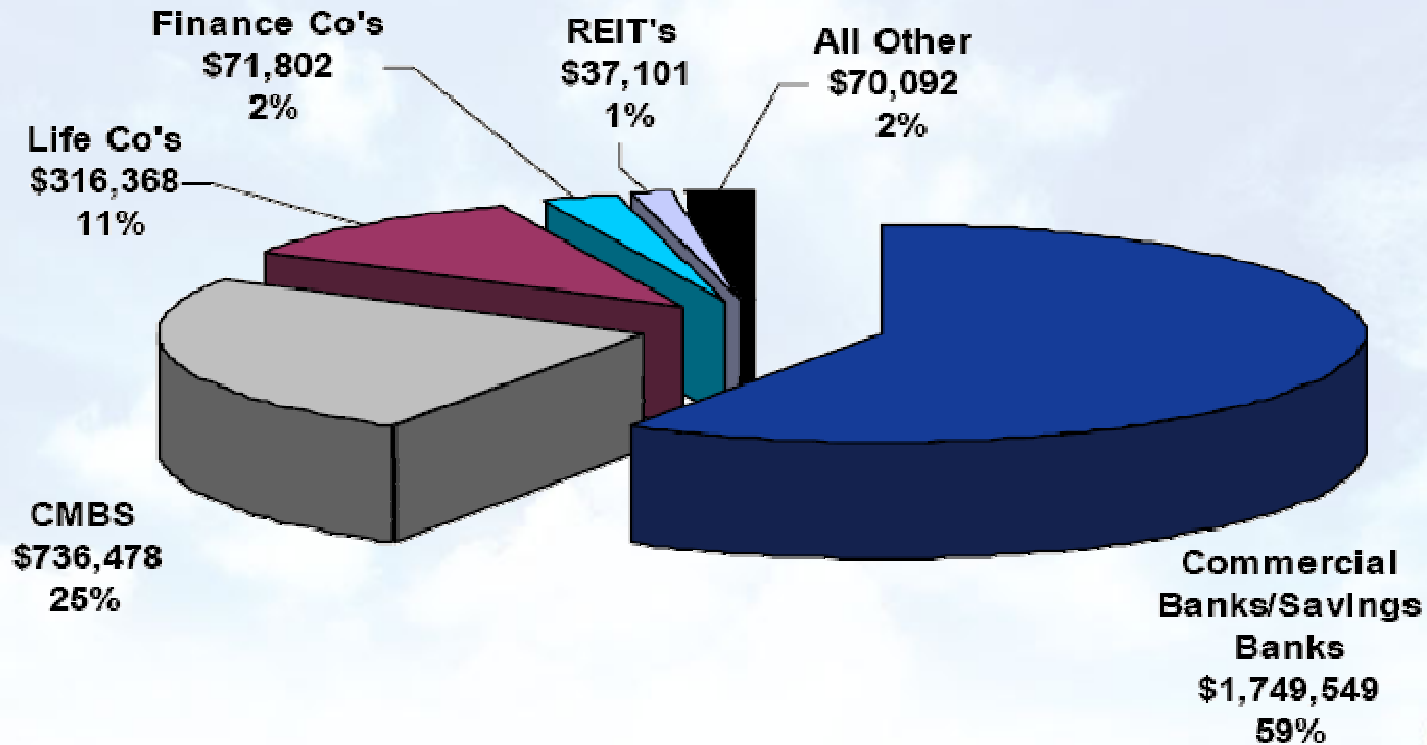
Is This Because of...

1. Real estate fundamentals?
2. Changes in the capital markets?
3. Overall economic recession?

Commercial Mortgages Outstanding

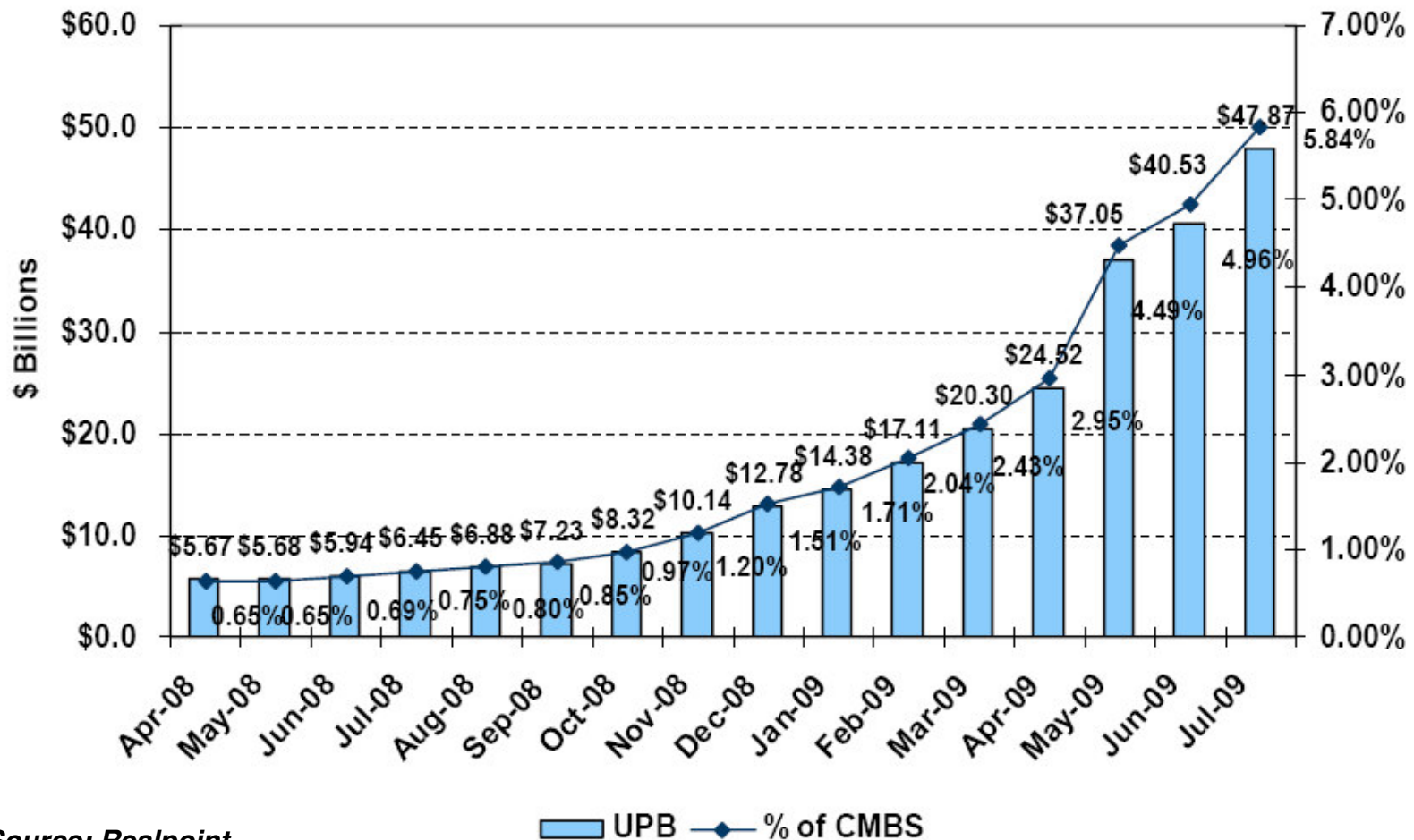
(\$Millions)

(Excluding HUD/Gov't) at 3/31/09, Total \$3.0 Trillion



Toxic Overhang?

Loans in Special Servicing as % of CMBS Outstanding

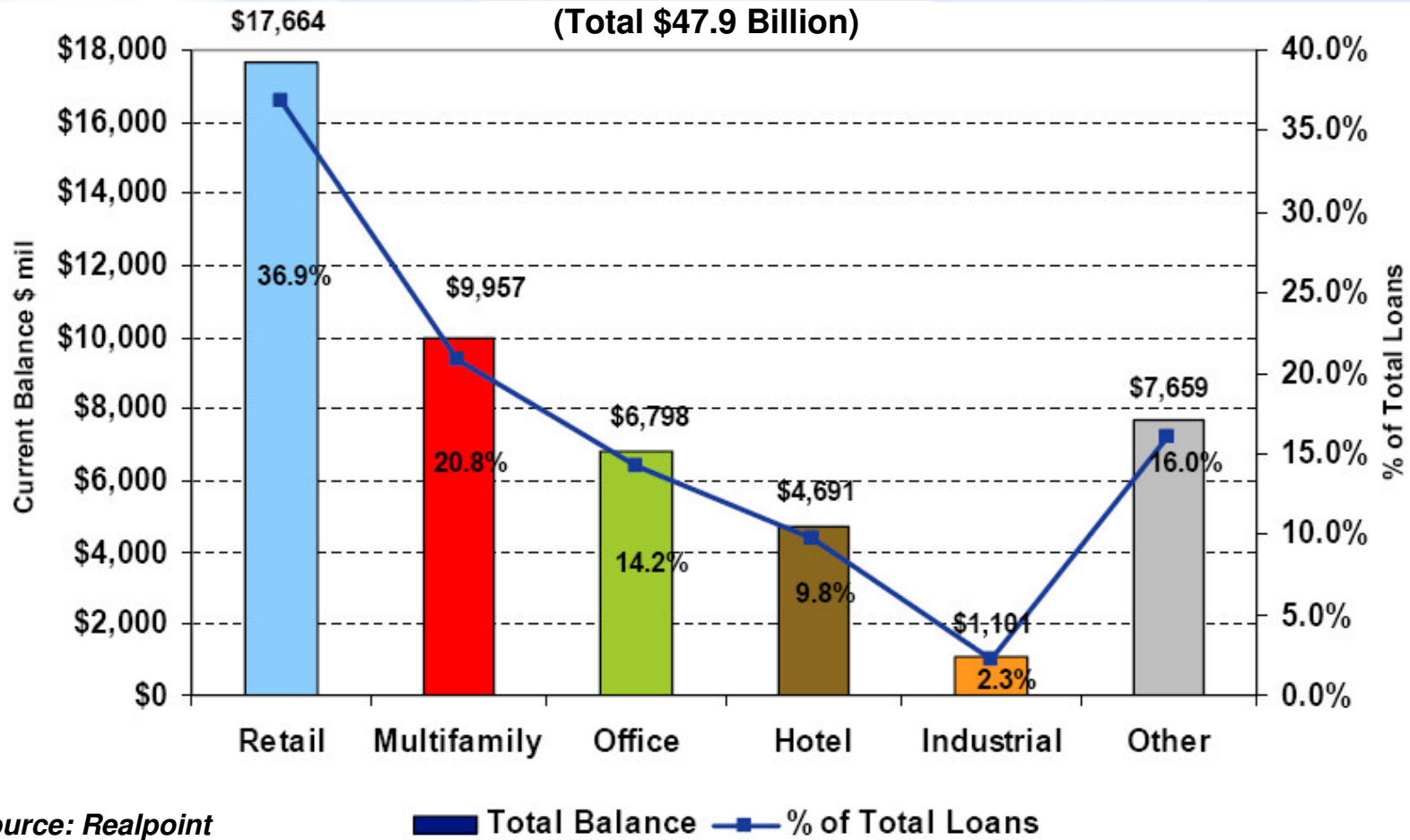


Source: Realpoint

Toxic Overhang?

Loans in Special Servicing by Property Type

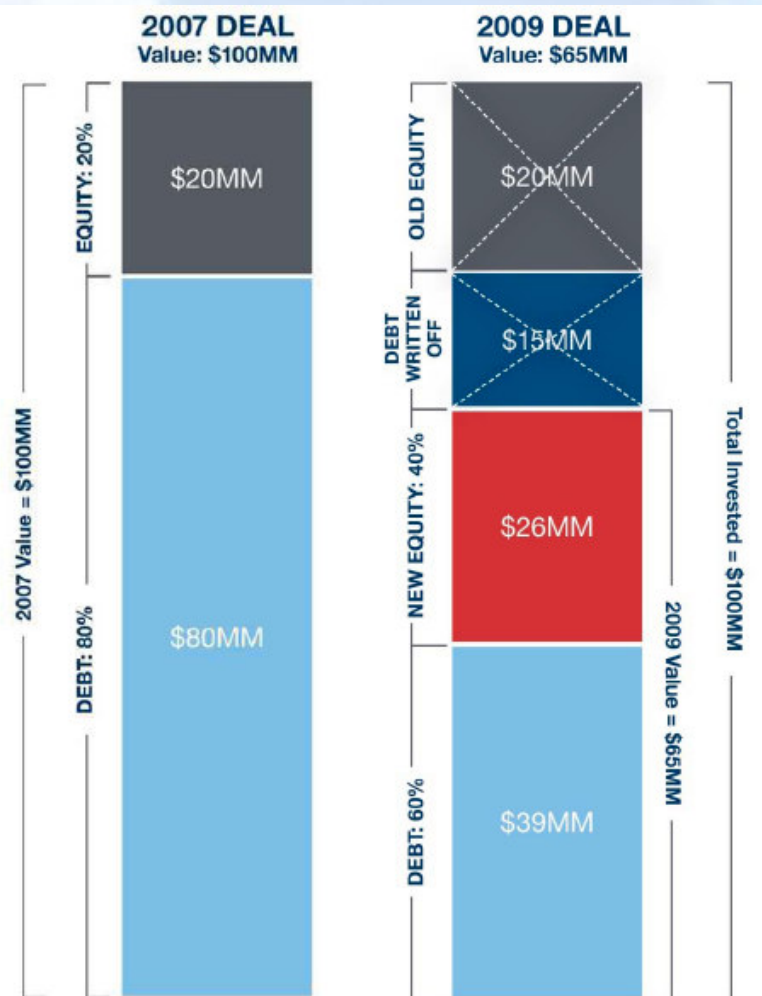
(Total \$47.9 Billion)



Source: Realpoint



Deleveraging Will Force Sales and Recapitalizations



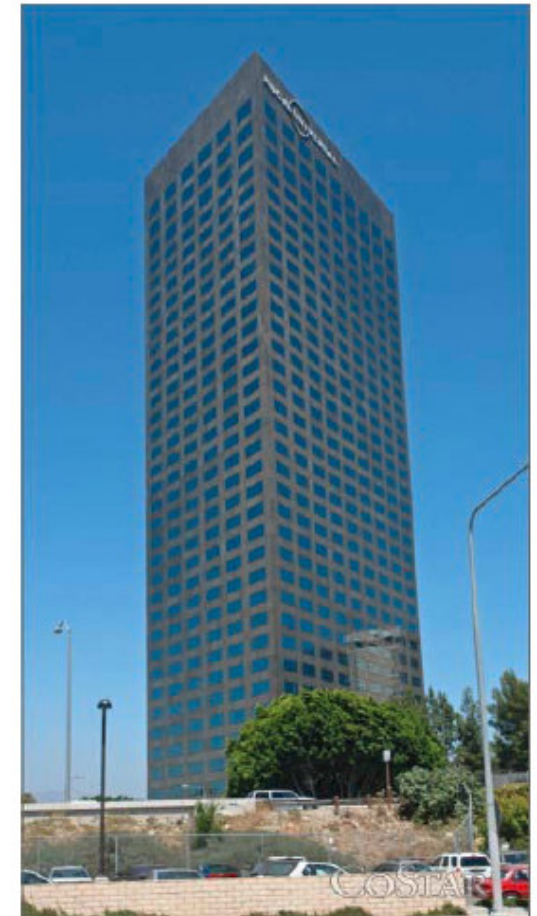
Original Equity: \$20MM (gone)

Debt Written Off: \$15MM

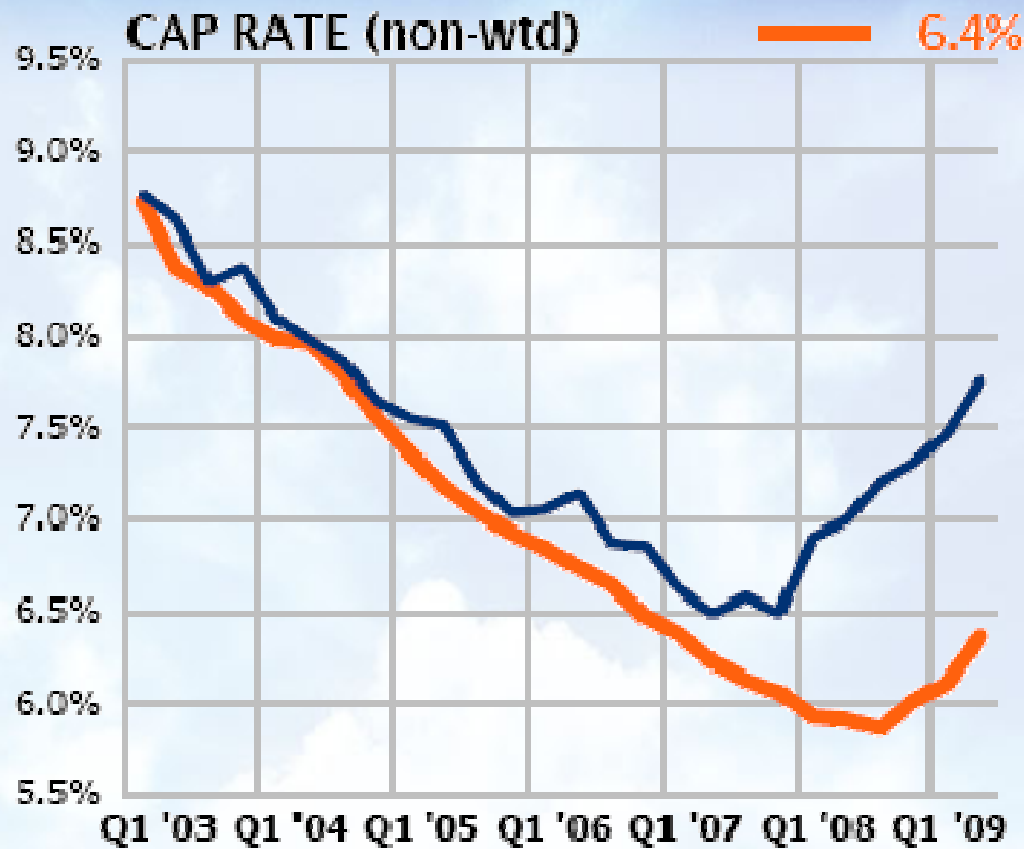
Additional Equity to Refinance at 60% of Today's Value: \$26MM

10 Universal City Plaza

| | December 2006 | April 2009 | % Change (from Peak) |
|-----------------------|---------------|---------------|----------------------------|
| Sales Price | \$370,000,000 | \$305,000,000 | (17.5%) |
| Price Per Square Foot | \$478 | \$395 | (17.5%) |
| In Place Cap Rate | 5.4% | 7.6% | |
| Year 1 Cap Rate | 5.7% | 7.7% | |
| 10 Yr. IRR | 10.0% | 9.0% | |
| 5-Year COC | 5.6% | 7.1% | |
| Year 1 Market Rent | \$38 PSF | \$36 PSF | (5.0%) |
| Year 5 Market Rent | \$54 PSF | \$41 PSF | (23.0%) |
| Occupancy | 95% | 99% | 4.2% |



Los Angeles Office Cap Rates



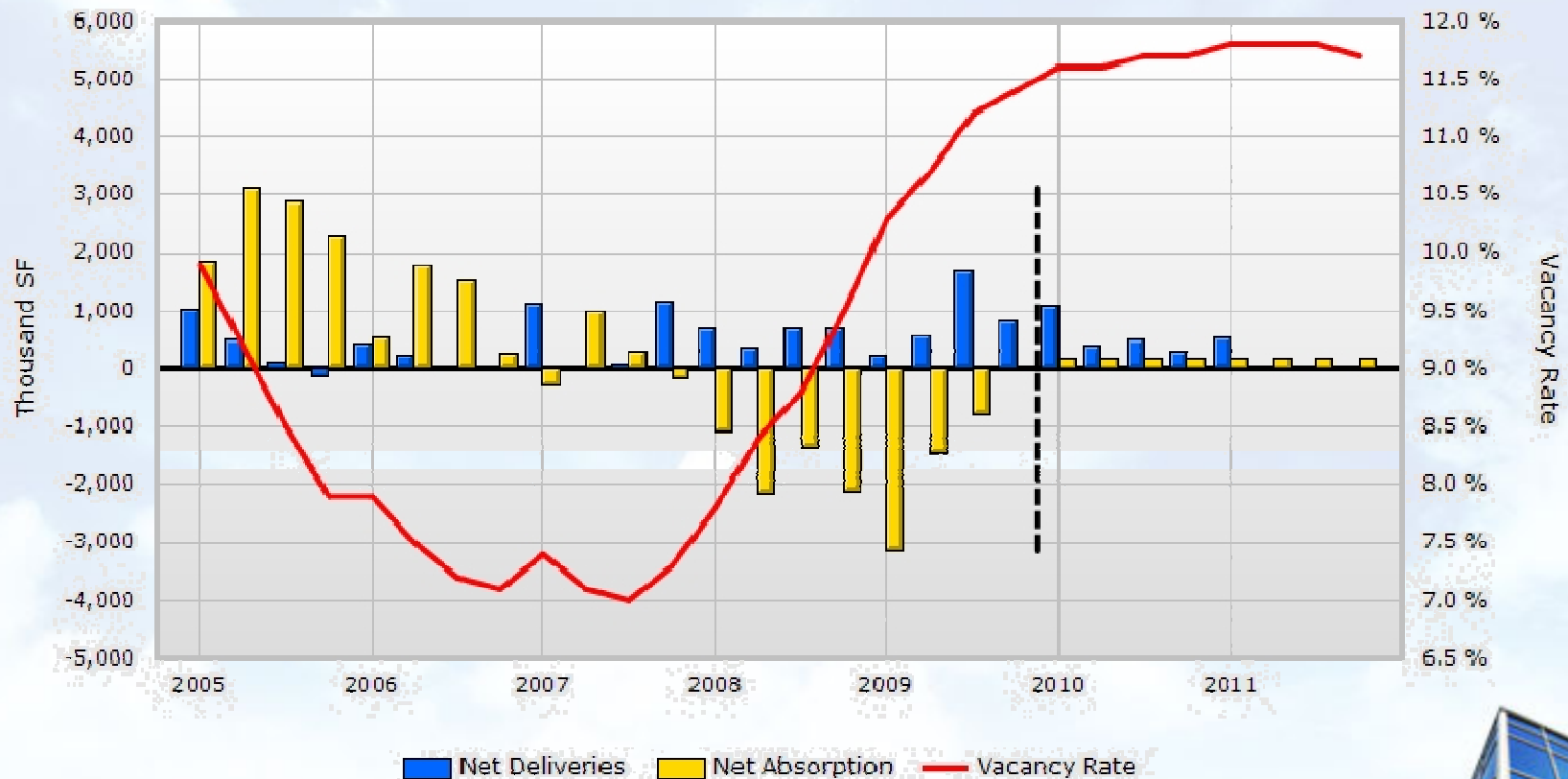
Los Angeles 12-mo. avg

US quarterly avg

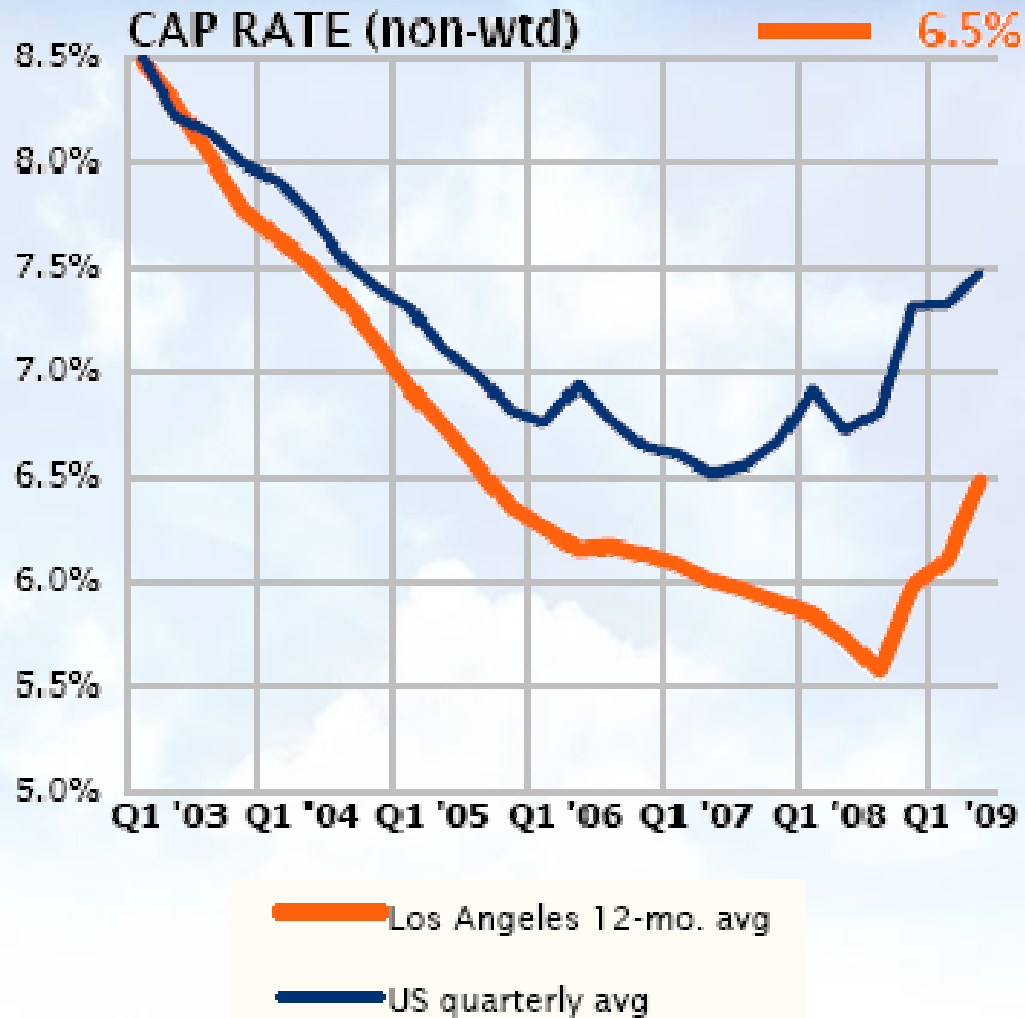
Los Angeles Office Price PSF



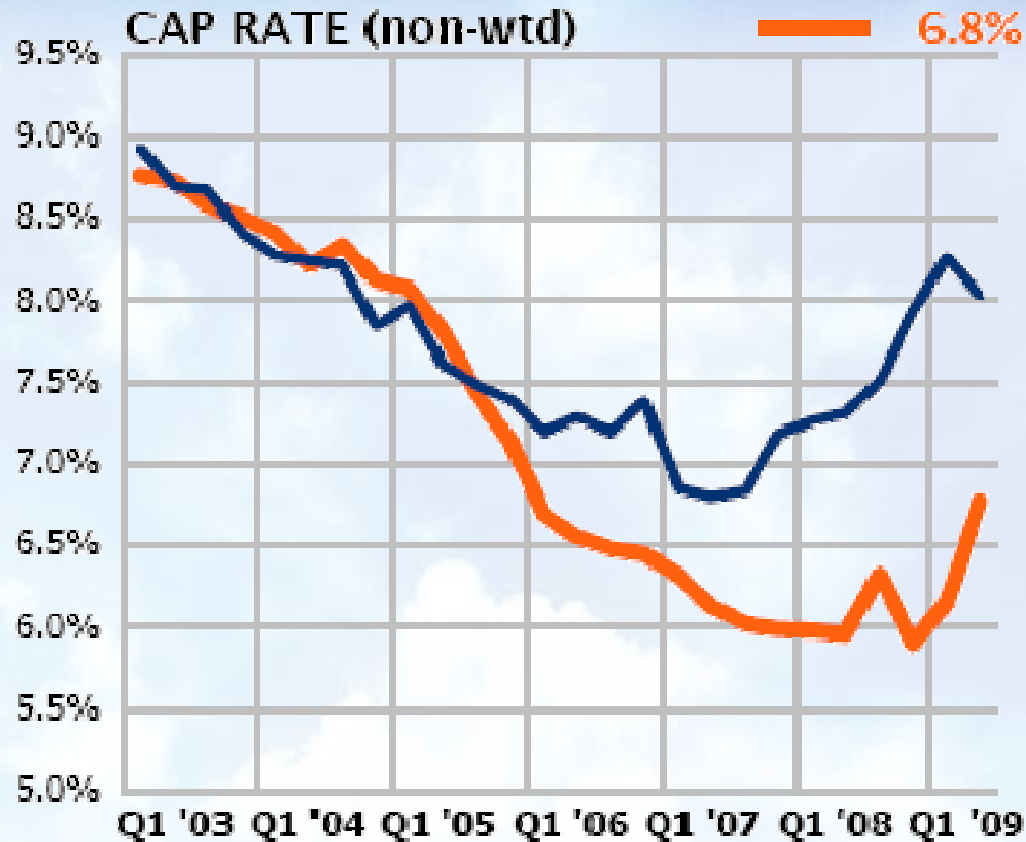
Absorption, Delivery, Vacancy Los Angeles County – Office



Los Angeles Retail Cap Rates



Los Angeles Industrial Cap Rates



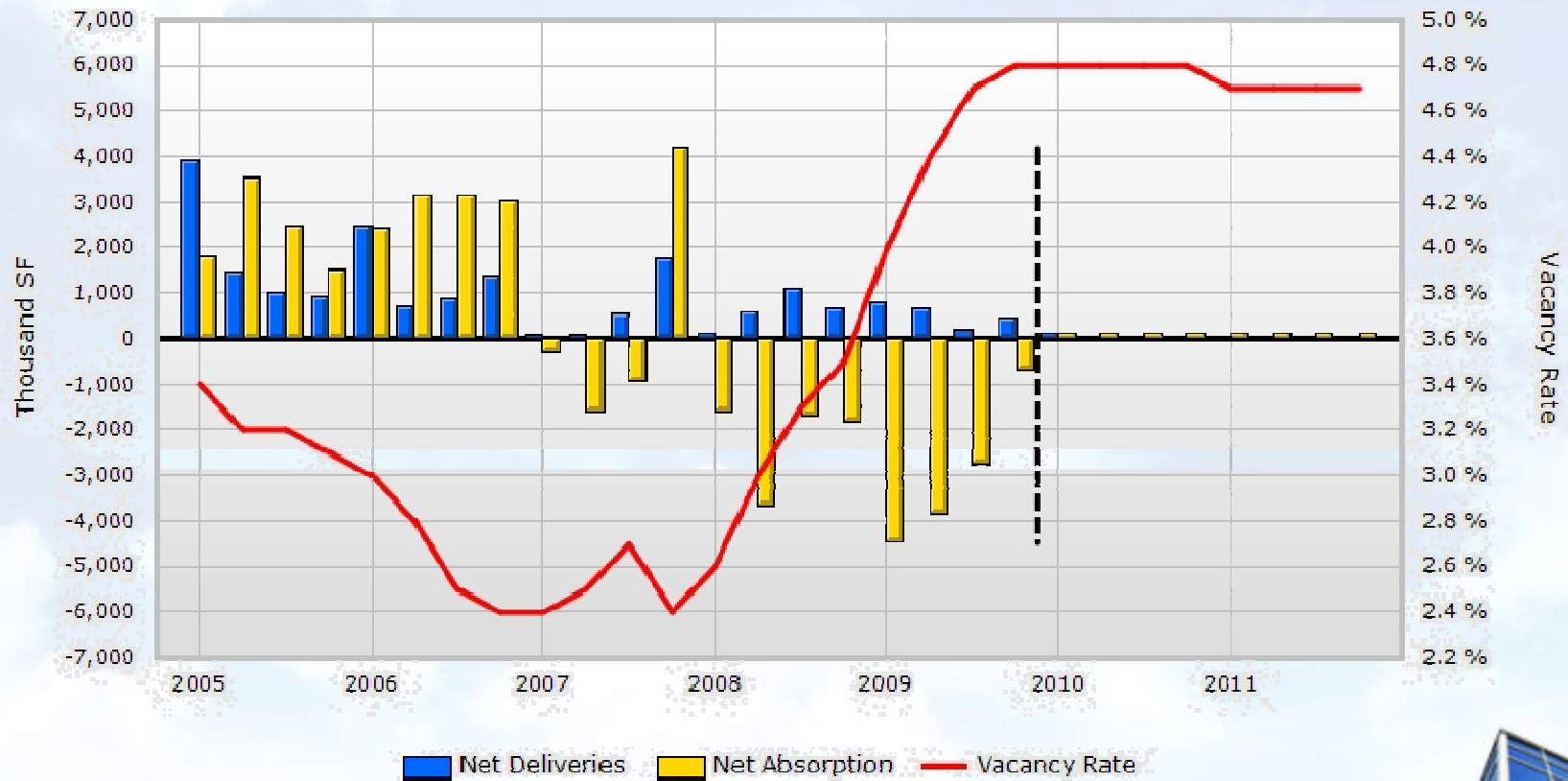
— Los Angeles 12-mo. avg

— US quarterly avg

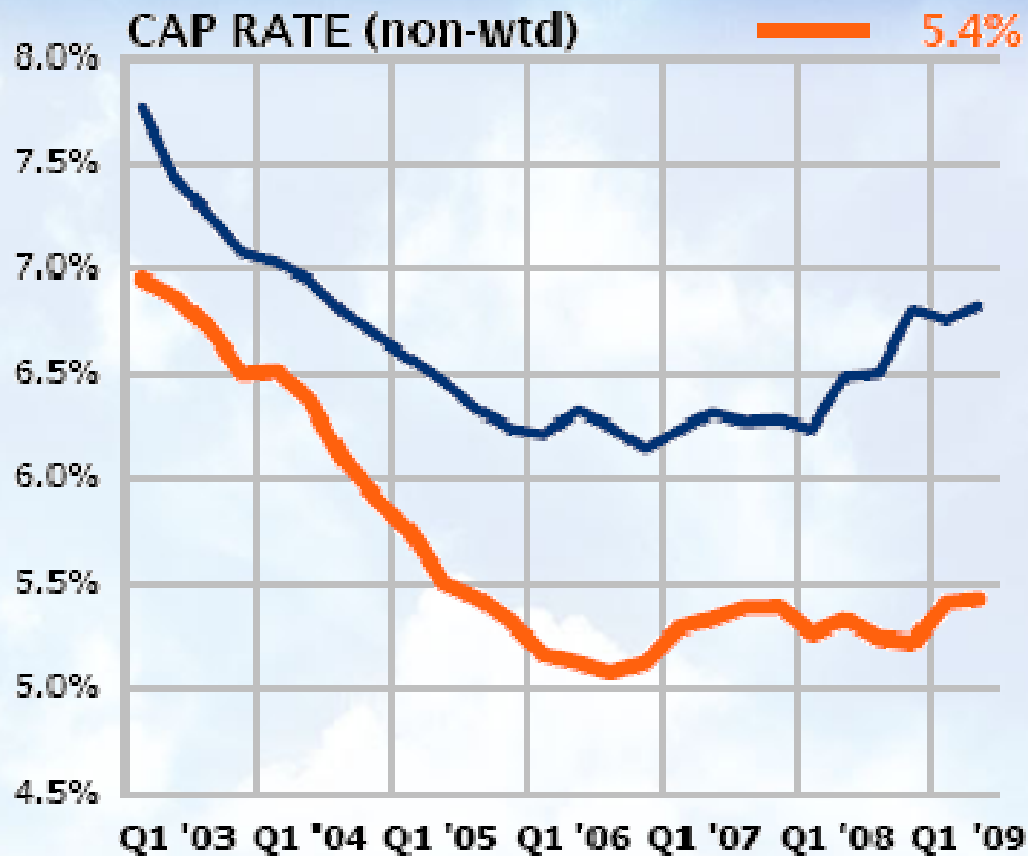
Los Angeles Industrial Price PSF



Absorption, Delivery, Vacancy Los Angeles County – Industrial



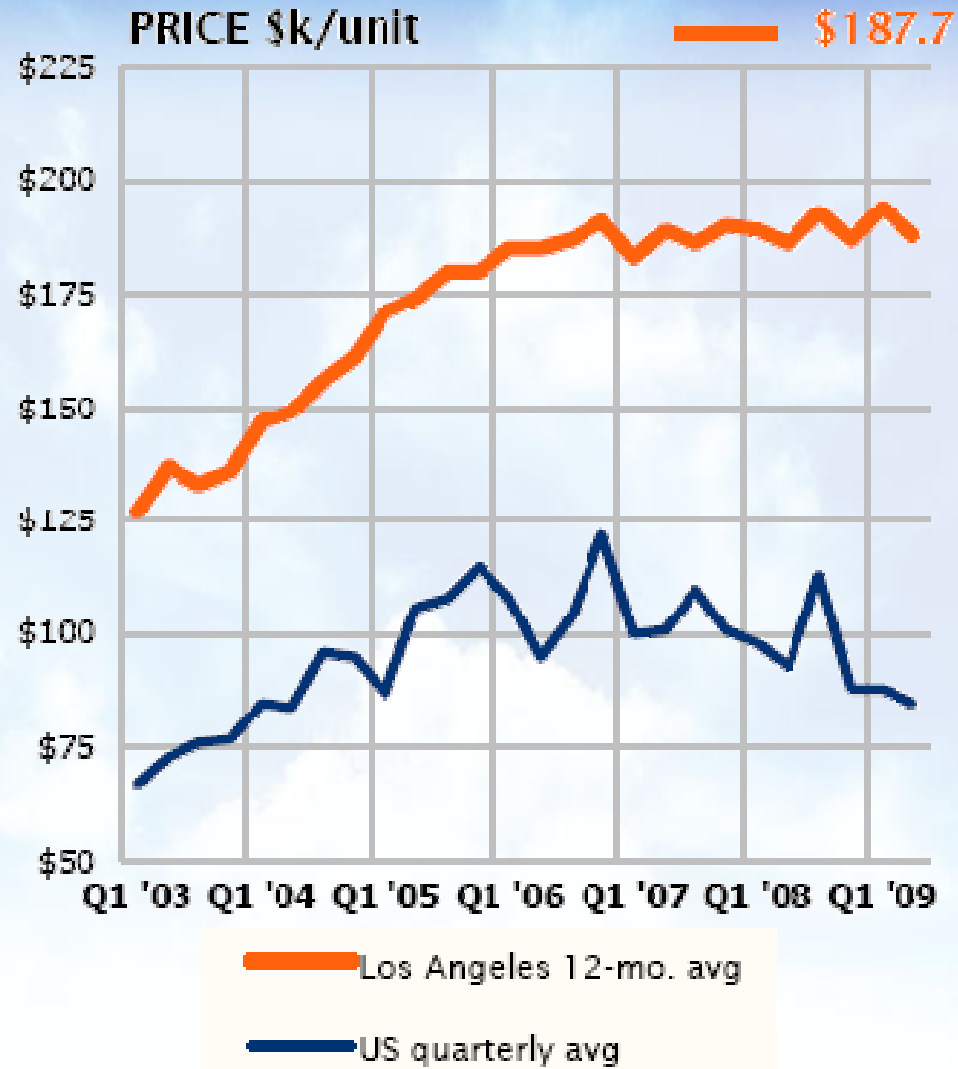
Los Angeles Apartment Cap Rates



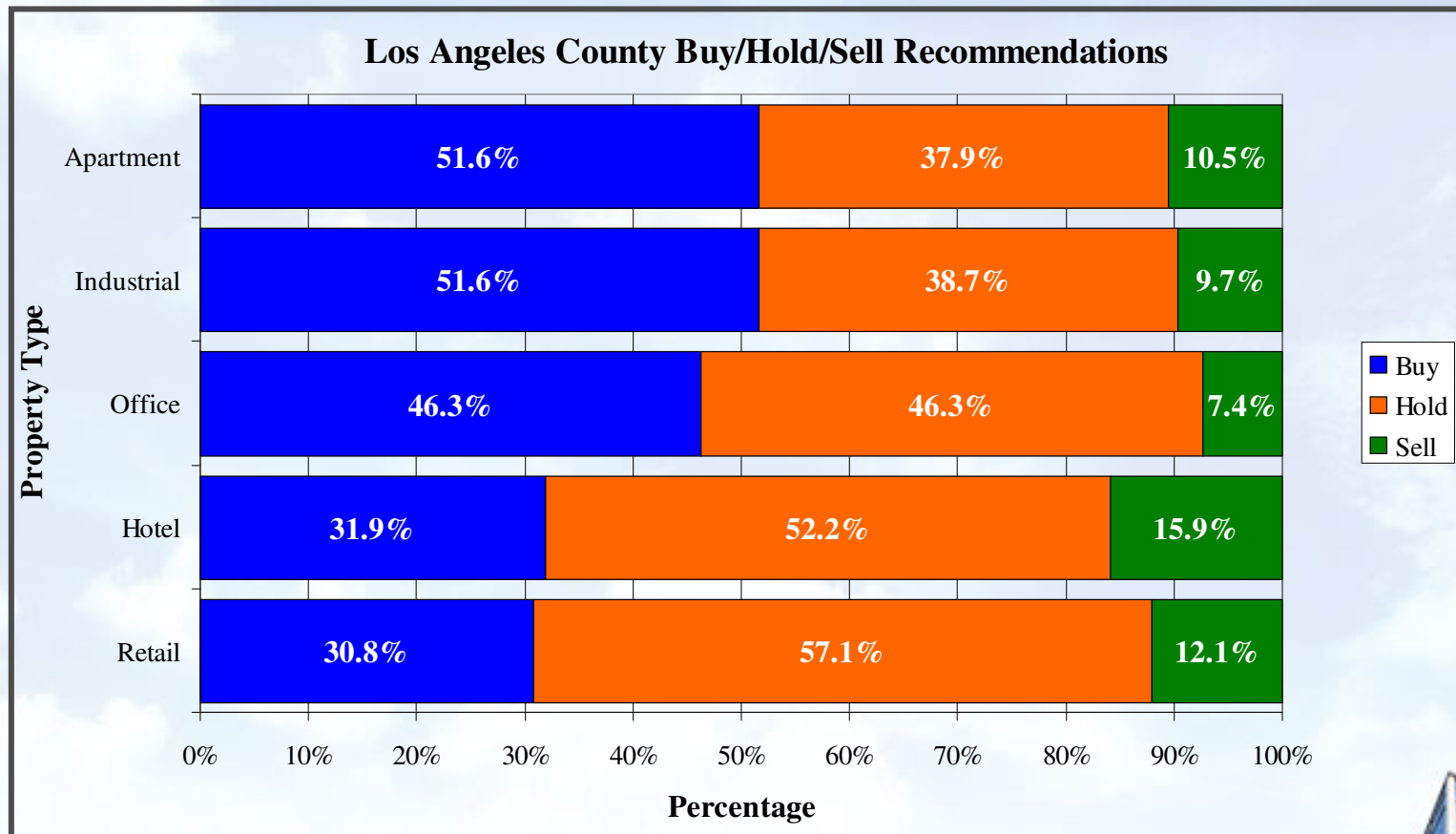
— Los Angeles 12-mo. avg
— US quarterly avg



Los Angeles Apartment Unit Prices



Investment Recommendations

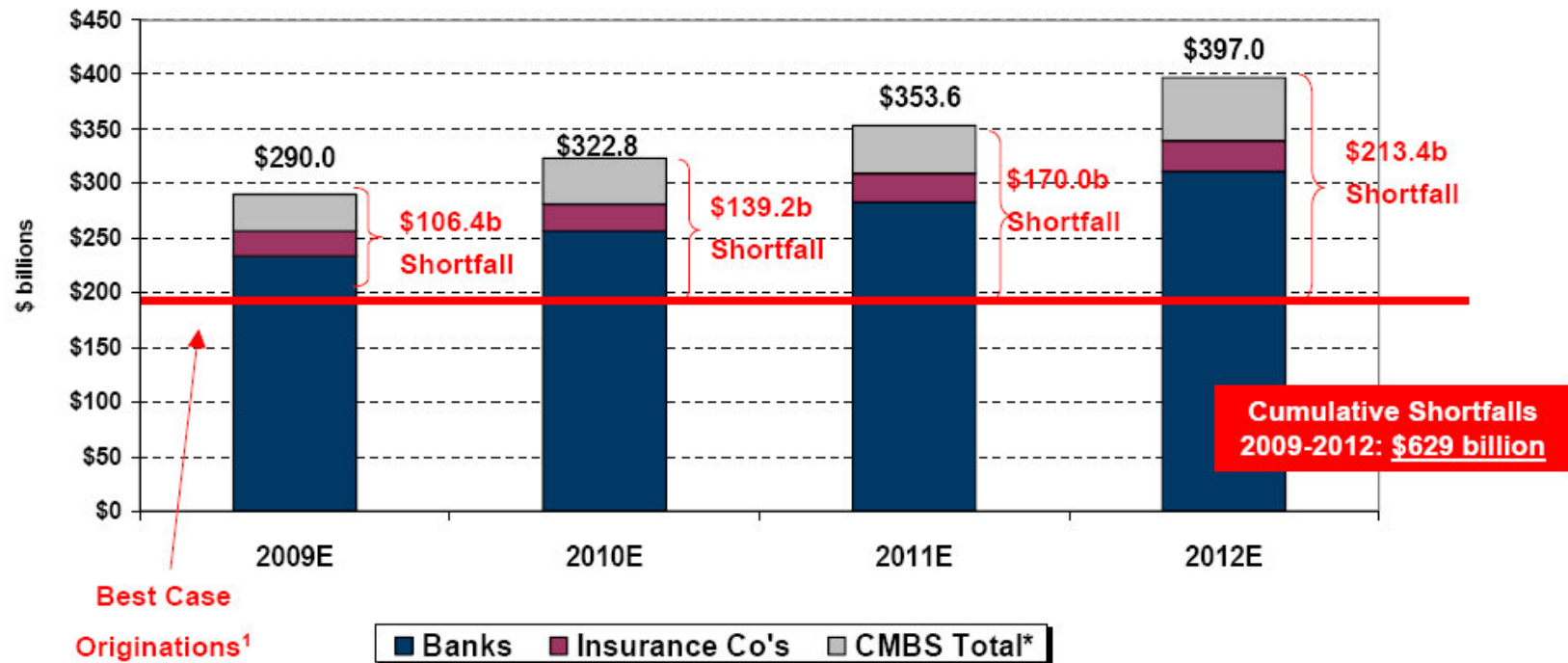


Source: *Urban Land Institute, 2009*

Land Value: Residual Example

| | August 2007 | September 2009 | |
|---|---------------|--------------------|----------|
| Hypothetical Example: Retail Project | 15,000± SF | 15,000± SF | |
| Projected Rent PSF/Mo. | \$2.50 | \$2.25 | |
| Monthly Gross Potential Income | \$37,500 | \$33,750 | |
| Annual Gross Potential Income | \$450,000 | \$405,000 | |
| Vacancy and Non-reimbursed Expenses (10%) | (\$45,000) | (\$40,500) | |
| Net Operating Income (NOI) | \$405,000 | \$364,500 | |
| Overall Capitalization Rate (OAR) | 6.0% | 7.25% | |
| Value as if Completed and Stabilized | \$6,750,000 | \$5,027,586 | |
| Rent loss during initial absorption: 6 months | (\$225,000) | (\$303,750) | 9 months |
| Value upon Completion of Construction | \$6,525,000 | \$4,723,836 | |
| Construction Costs | | | |
| 15,000± SF @ \$175 psf (All inclusive) | (\$2,625,000) | (\$2,625,000) | |
| Residual Land Value | \$3,900,000 | \$2,098,836 | |
| Land Area | 40,000± SF | 40,000± SF | |
| Indicated Land Value per Square Foot | \$98 | \$52 | |
| Indicated Decline in Land Value | | -46.2% | |

Loan Maturities Will Pose a Challenge!



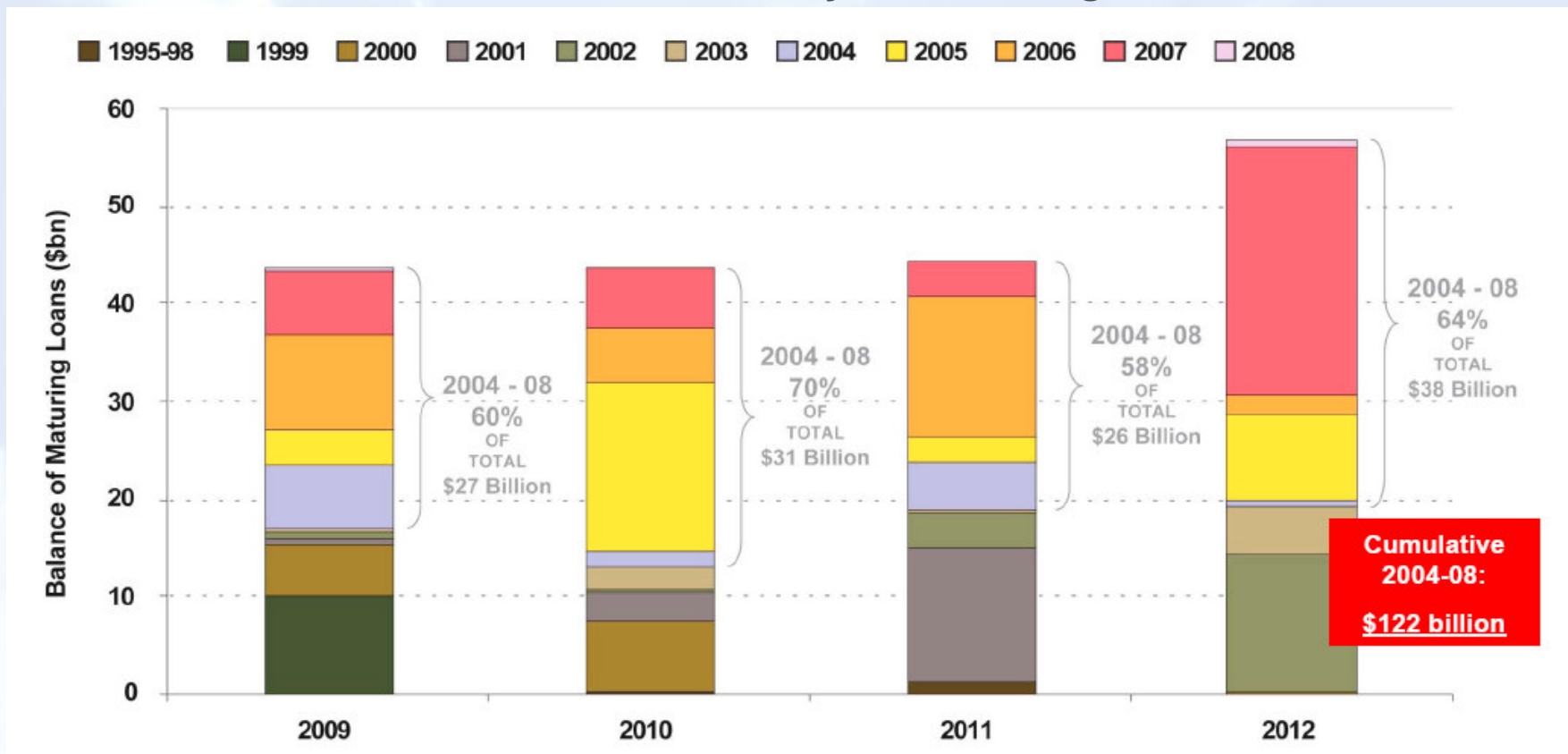
¹ Origination projections based on the average 4-year historical **gross** originations from all non-CMBS lenders (excludes HUD/Gov't).

* CMBS total includes both fixed and floating rate loans to first maturity.

Source: Wachovia

Aggressive Underwriting Will Compound the Challenge

CMBS Maturities by Loan Vintage



Potential Government Assistance: TALF

- Provides reasonable cost senior debt to our market
- Restarts CMBS market
- Facilitates fixed income capital back to our market
- Initially most helpful to low leverage borrowers with unencumbered assets
- Facilitates liquidity, but does not solve over leverage issues
- Expires 6/30/2010

Public-Private Investment Program: Legacy Loan Program



- FDIC to facilitate financing through a debt guarantee of up to 6:1 leverage.
- PPIP's purchase price based upon the highest bid for the 50% equity contribution by the private investor
- Similar to RTC N-Series Structure

Other Government Stimuli

- **Federal infrastructure spending**
- **Small Business Administration**



Have we hit bottom yet?

**When will we see recovery in the
commercial real estate markets?**