

Commercial Real Estate Economics, Values and Mortgage Trends 2009 - 2010

Prepared for

**Certified Commercial Investment Member (CCIM)
– Northern California**

Prepared by

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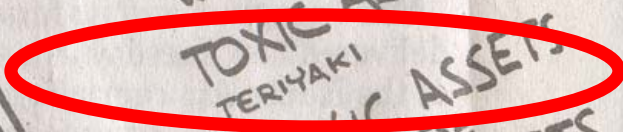
**Four Points Sheraton
51521 Hopyard Road
Pleasanton CA**

Tue 05/12/09



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TIM GEITHNER
AND I'LL BE
YOUR SERVER.

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- TOXIC ASSETS
WITH OLIVE OIL
- TOXIC ASSETS
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- TOXIC ASSETS
WITH CHEESE
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OVER RICE
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WITH GRILLED VEGETABLES
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COUNTRY STYLE
- TOXIC ASSETS



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Johnson Souza Group, Inc

- Over 20 years of real estate economic and financial research, and institutional due diligence underwriting. Specializes in apartment and commercial market research, valuation and brokerage services.
- Offering tax deferred vehicles: 1031 Exchanges, Tenants in Common (TIC), Deferred Sales Trusts (DST), etc.; and real estate related investments: partnerships, funds, REITs, etc.

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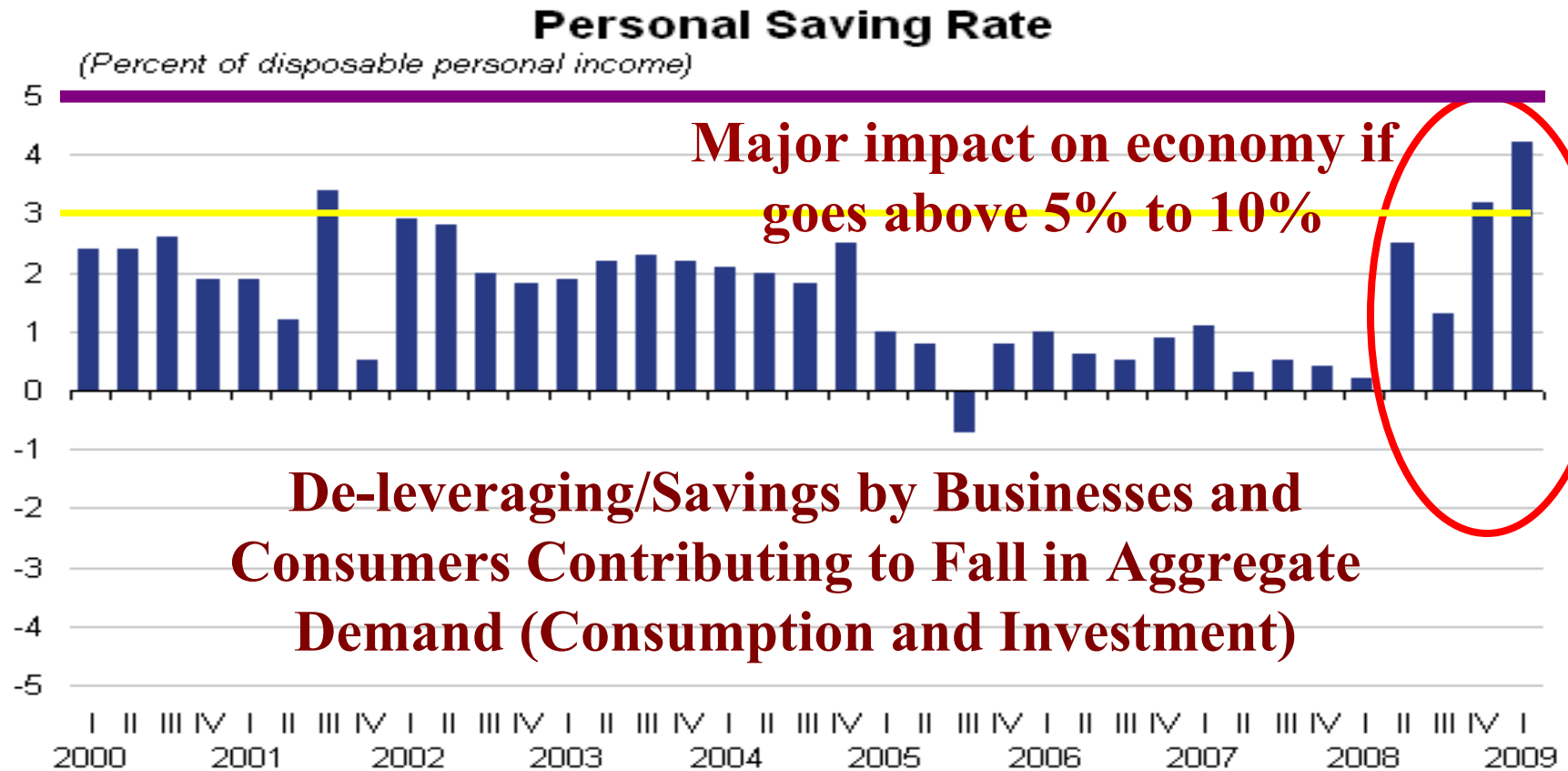
Business-Market Cycle Forecast

- Economy in decline/trough phase: employment contraction decelerating (36-to-60 month trough); worst case 7 year trough, 7 year stagnation.
- Next 12-to-24 months: Cap Rates up +200 bps, NOIs down 16%-to-20%, sales volumes down 75%-to-95%, values down 30%-to-50%, construction down 18%, rising defaults and delinquencies.
- Business-commercial real estate cycle: recovery 2010 – 2013, growth 2014 – 2015 (rent/value spikes) and peak 2016 – 2018.
- Target markets for commercial investment 2009-2010:

Urban-Infill/Supply Constrained/Transit Oriented/Diverse-Growth Economic Base Submarkets

Downtown San Francisco/San Jose; I-680/880 Corridors-
Walnut Creek/San Ramon (Pleasanton/Fremont); SF
Peninsula-Redwood City/Palo Alto (Marin/Santa Cruz)

Personal Savings Rate



U.S. Bureau of Economic Analysis

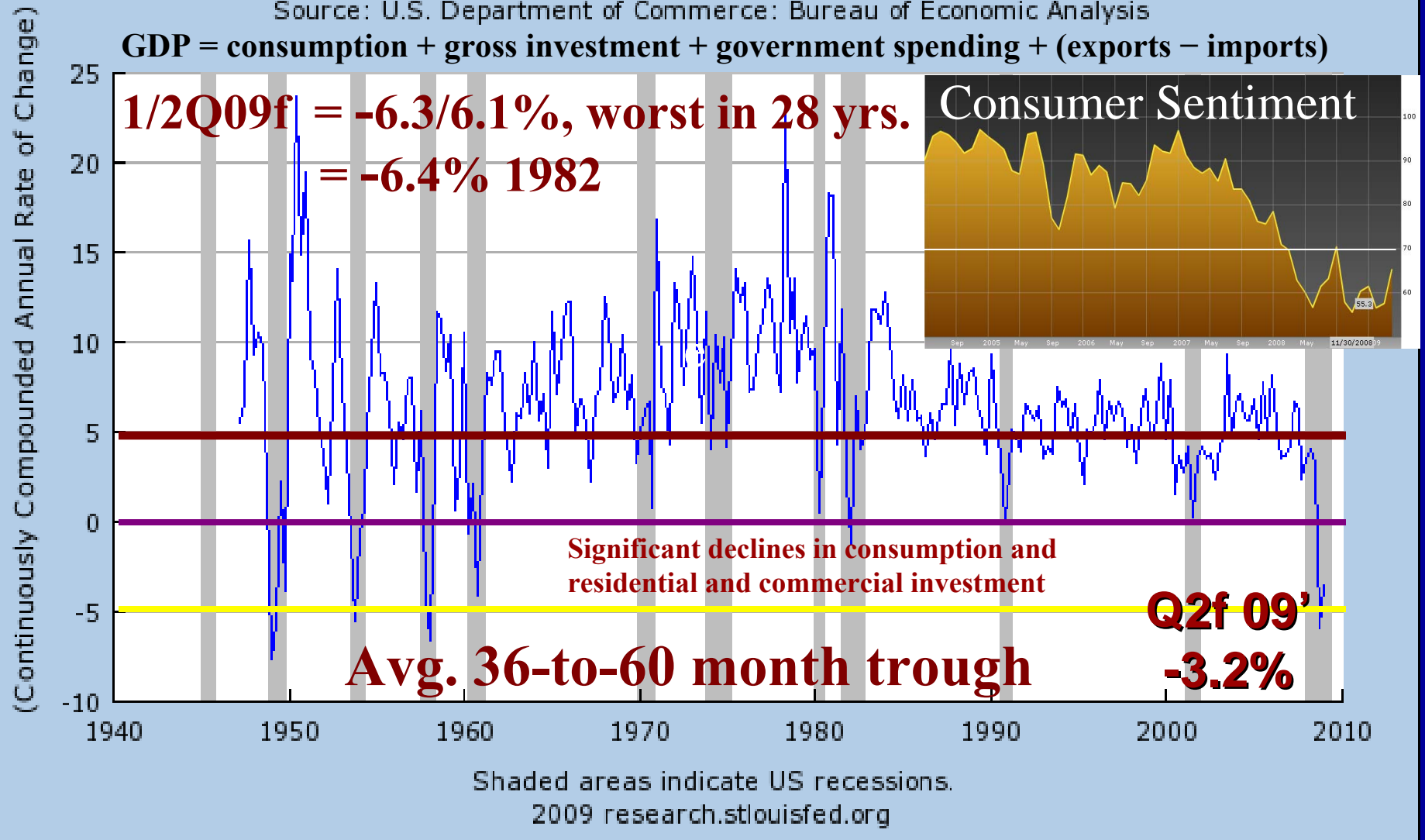
Source: Bureau of Economic Analysis. <http://www.bea.gov/briefrm/saving.htm>

Gross National Product (GDP)

Gross Domestic Product, 1 Decimal (GDP)

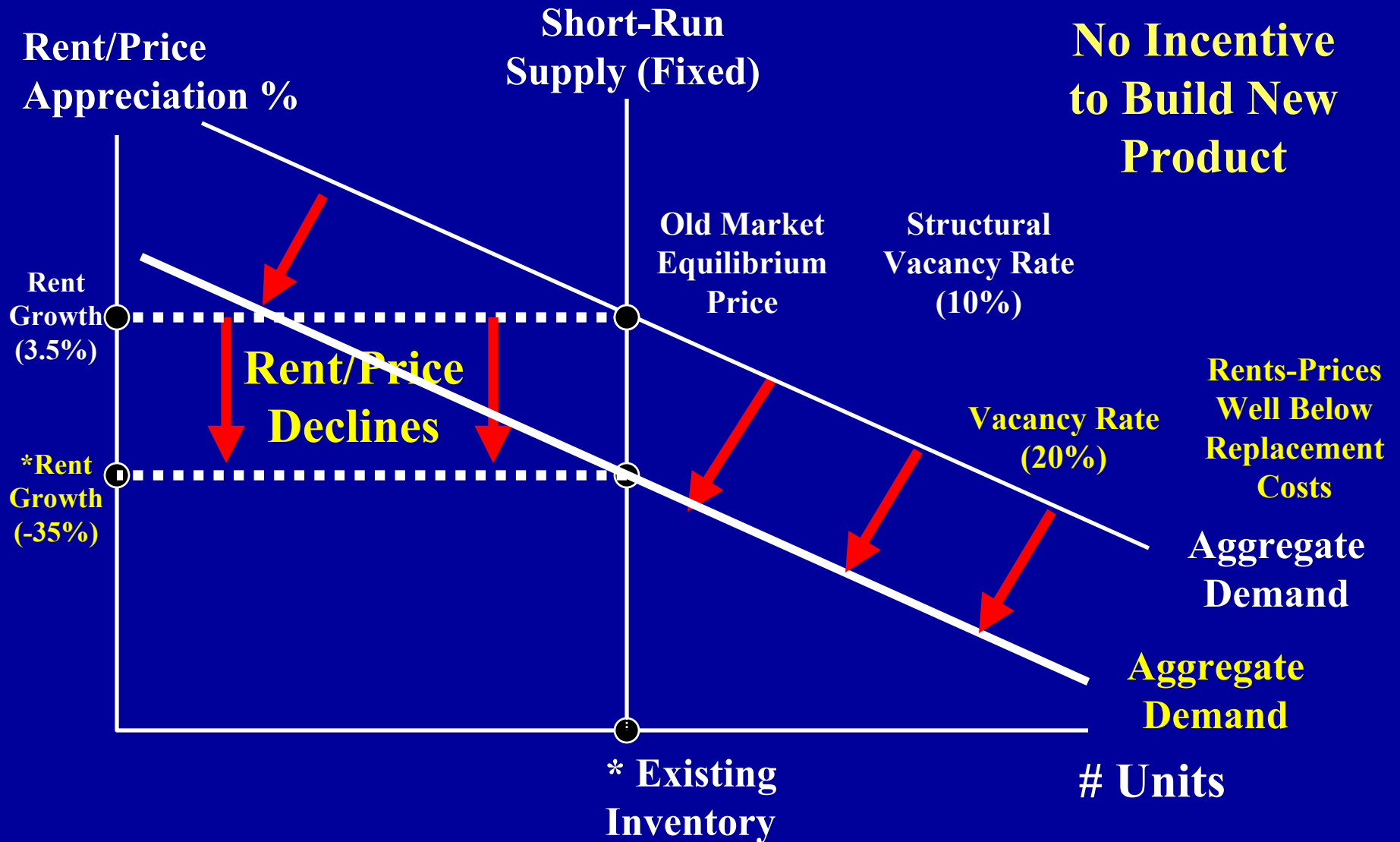
Source: U.S. Department of Commerce: Bureau of Economic Analysis

GDP = consumption + gross investment + government spending + (exports - imports)

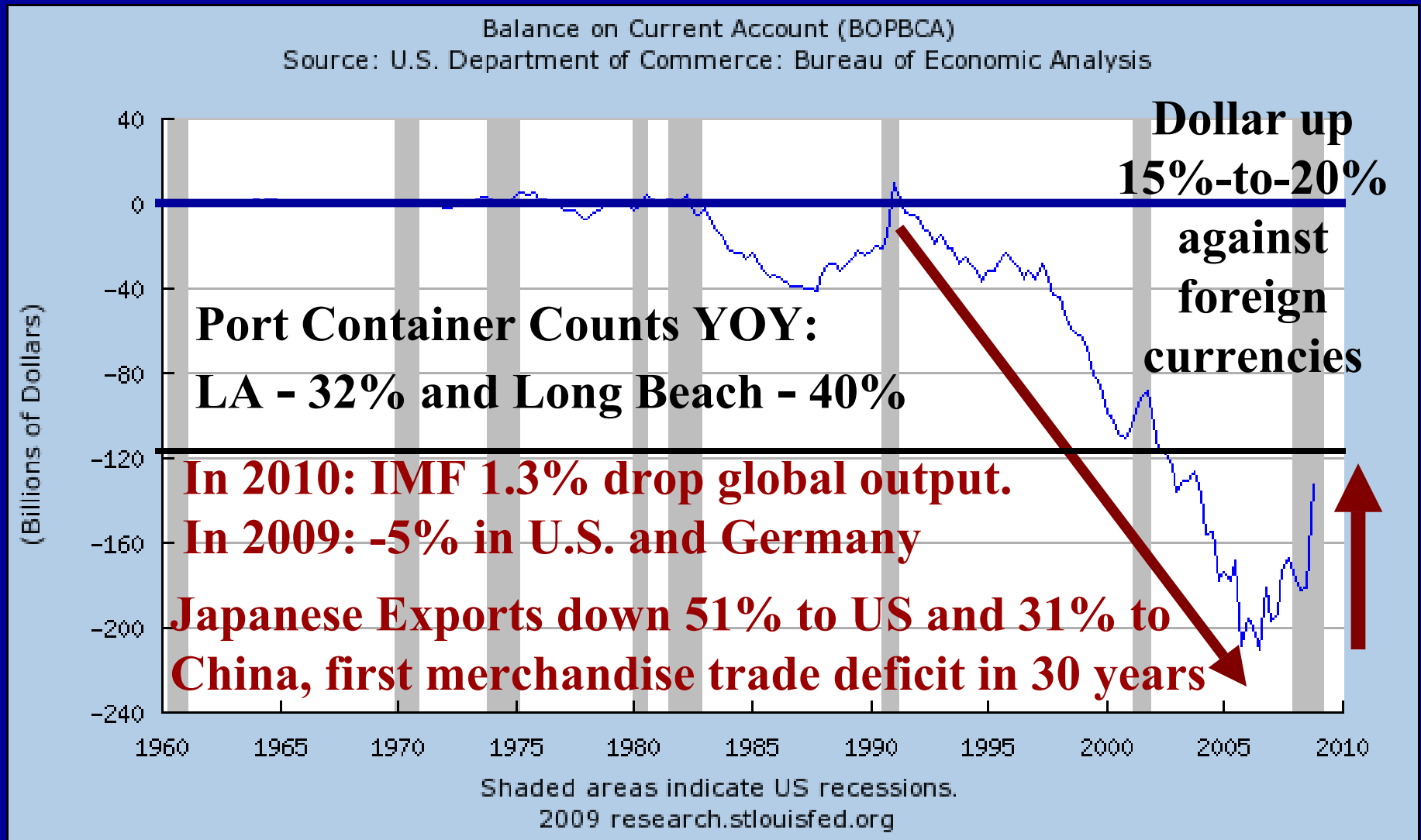


Real Estate Supply and Demand Analysis

Short-Run Supply Conditions with Negative Employment Demand Shock

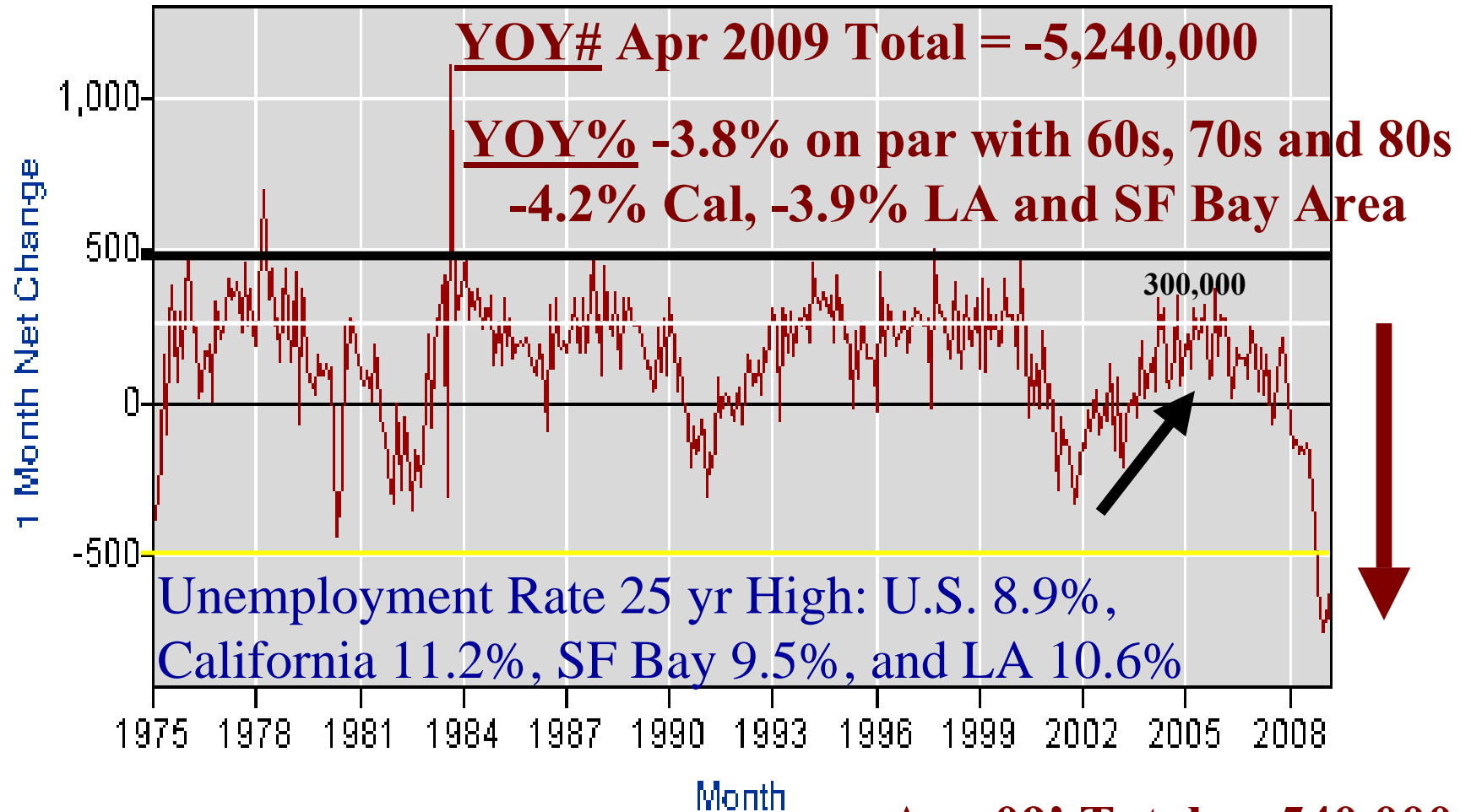


Balance of Trade



Sources: U.S. Department of Commerce: Bureau of Economic Analysis
<http://research.stlouisfed.org/fred2/series/BOPBCA/13>

Non-Farm Payroll Employment



Source: Bureau of Labor Statistics.
<http://www.bls.gov>

Apr 09' Total = -540,000

Bay Area firms cut 5%-to-15% of payrolls

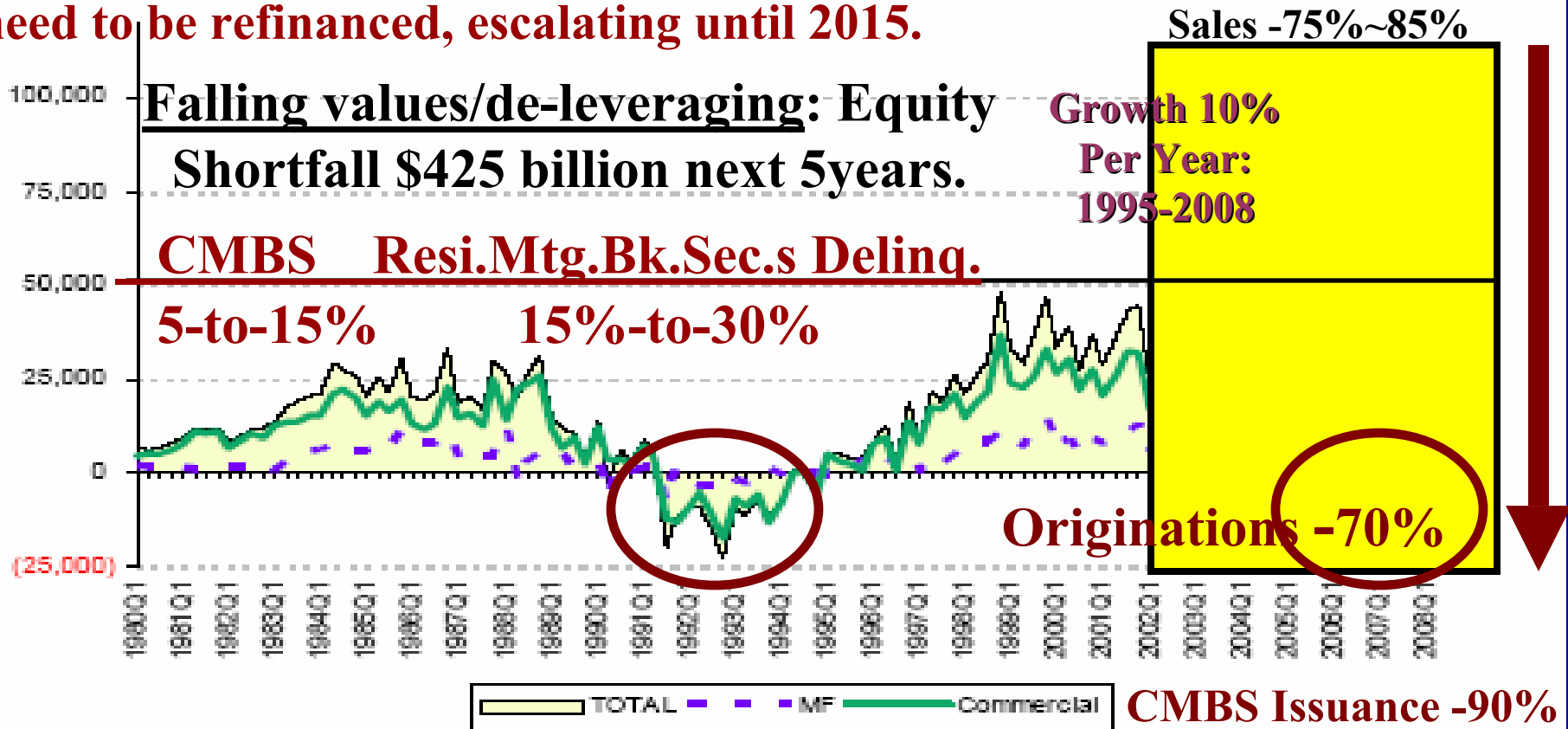
Net Change Commercial Mortgage Debt (1980-2008)

COMMERCIAL AND MULTIFAMILY MORTGAGE FLOWS

Net Change in Commercial and Multifamily Mortgage Debt Outstanding, by Quarter
(\$billions) -- \$3.4 trillion Outstanding: Banks (49%), CMBS (22%)

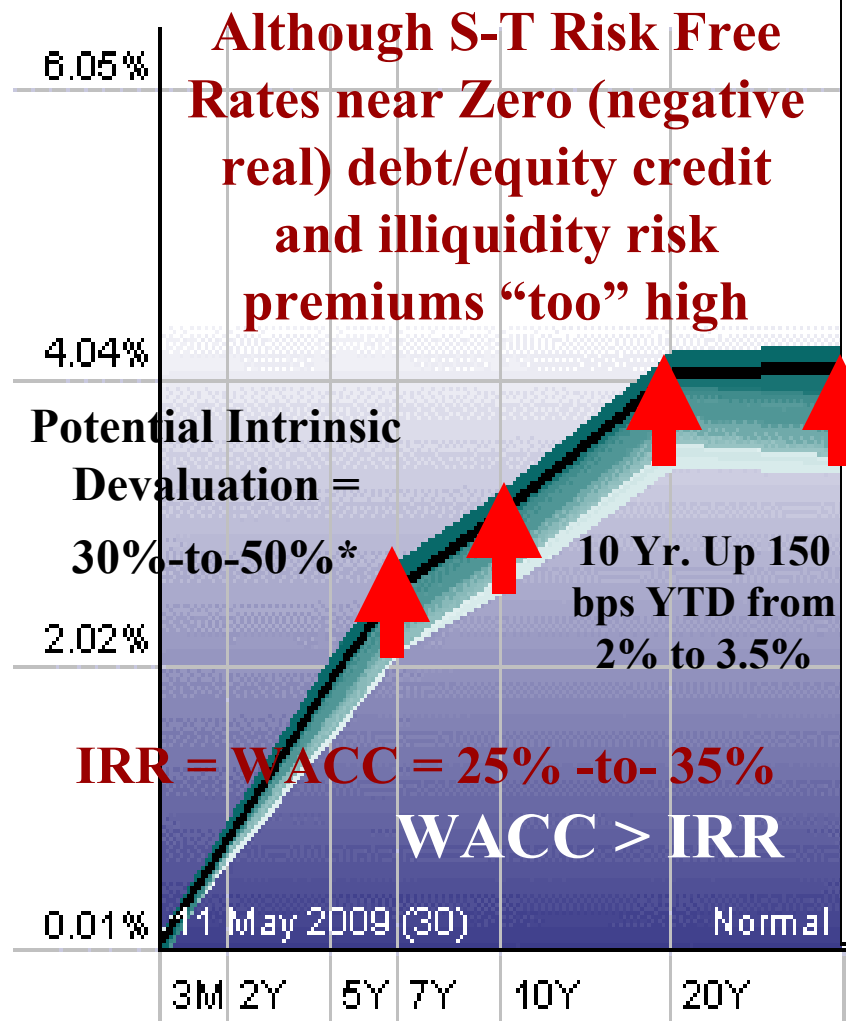


Next 4 Years: \$250-to-\$300 billion mtg. debt per year maturing, will need to be refinanced, escalating until 2015.



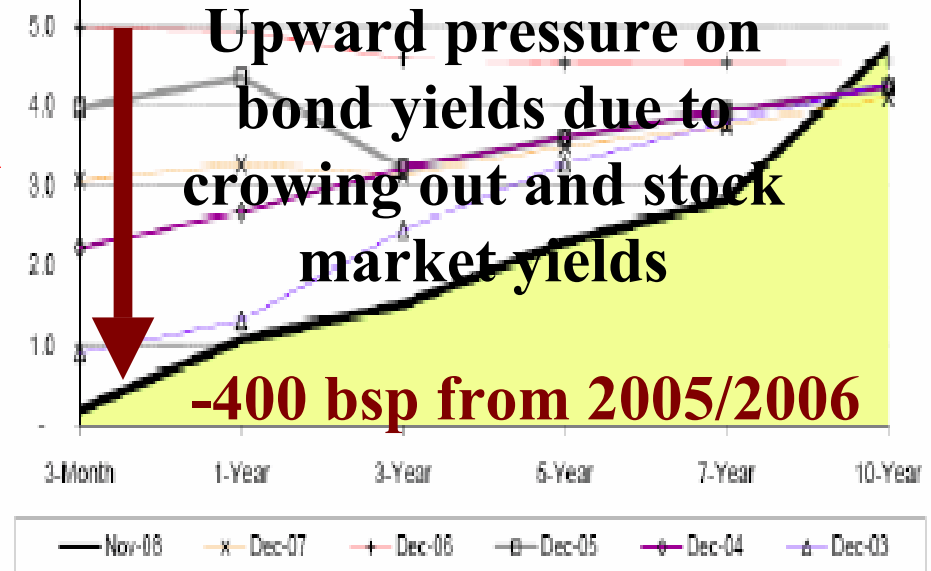
Sources: Kennedy Associates, Foresight Analytics, Federal Reserve Board of Governors, Mortgage Bankers Association, and Commercial Mortgage Backed Securities Association.

Yield Curve



Treasury Yield Curve Percent - Falling Prices

All debt + equity securities price off of the yield curve (term structure interest rates)



Source: Federal Reserve Board

Objective: Steep Rebuild Interest Margin, Loan Loss Reserves, Reserve Capital, etc.

<http://stockcharts.com/charts/YieldCurve.html>

Note *: 8%-to-16% NOI Declines, Cap Rates to Rise 150-to-200 bps

CHANGES IN COMMERCIAL MORTGAGE UNDERWRITING

	PreCredit Crisis	Today
Maximum loan-to-value	70%–75%	50%–60%
Minimum debt service coverage ratio	1.05x	1.20x–1.40x
NOI Underwriting	Borrower's pro forma NOI	Current in-place NOI
Spreads	85–125 bps	350–500+ bps (no transparency)
Loan proceeds	Sized using I/O DSCR	Sized using amortizing DSCR
Amortization	10 years I/O	3 years I/O on 10-year loan
Loan requirements	Minimal	Requires structuring (holdbacks, earn outs, TI escrows, recourse)

Source: AEW Capital Markets