

WASHINGTON, D.C., DECEMBER 7, 2009

Good Afternoon.

- It is a distinct pleasure to be afforded the opportunity to speak before such a distinguished audience.
- And I would like to recognize Shafik Gabr for bringing us all together.
- I have been asked to give you my analysis of where the US real estate market stands today.
- To put everything in proper perspective we should start with a number which represents the total value of commercial real estate in the US.

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- The Wall Street Journal places that number at \$6.7 Trillion Dollars and that number represents 13% of the United States Gross Domestic Product.
- Between 2000 and 2007 more than \$3 Trillion Dollars of commercial real estate loans were created in the United States.
- Of that \$3 Trillion Dollars nearly \$1 Trillion Dollars rests in Commercial Mortgage Backed Securities and the other \$2 Trillion Dollars represents mortgage loans that have been

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originated and are currently held in commercial banks.

- Deutsche Bank has projected that of the total sum of loans created:
 - \$204 Billion matured in.....2009
 - \$247 Billion will mature in 2010
 - \$296 Billion will mature in 2011
 - \$338 Billion will mature in 2012
 - \$331 Billion will mature in 2013
- That is \$1.4 Trillion Dollars of debt that must be refinanced or paid off in the next 4 years.

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- According to research firm Foresight Analytics \$770 Billion Dollars of the \$1.4 Trillion Dollars of commercial real estate mortgages that will mature between now and 2013 are under water.
- That means today the debt exceeds the market value of the real estate that serves as collateral for the loan.
- Here are some of the impediments to refinancing or paying off that \$1.4 Trillion Dollars of debt.
 - It is projected that the national office vacancy rate will hit 20% by year end 2010.

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- It is projected that nationally net effective rents will decline 25% on average.
- It is projected that nationally commercial real estate values will decline 35% to 45% on average.
- There is a lack of availability of credit and where credit is available the loan to value ratio is capped at 65%.
- I believe the drop in market value translates to a loss to the lenders of more than \$500 Billion Dollars.

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- There are more than 8,000 banks in the United States.
- Based on Bank Call Report Data distributed by the F.D.I.C. a disproportionate amount of commercial real estate exposure is concentrated in smaller banks (defined as banks with assets under \$10 Billion Dollars).
- These smaller banks account for only 20% of total commercial bank assets in the US but carry nearly 50% of total commercial real estate loans.
- In light of all these facts it would be reasonable to think that the market

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would be flooded with great investment opportunities.

- But in reality there is not a lot of quality product on the market. In fact the market has been almost frozen for the last 2 years.
- Research firm Real Capital Analytics has projected that the total value of all commercial real estate deals in excess of \$5 Million dollars in year 2009 will not exceed \$49 Billion Dollars.
- Compare that to 2007 when \$497 Billion Dollars changed hands.

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- Banks and troubled borrowers have not yet flooded the market with highly discounted properties.
- Lenders, hoping to avoid balance sheet markdowns have avoided foreclosing on overleveraged building owners.
- The term in the trade is now called “Extend & Pretend”.
- Extend the loan and pretend everything is all right until bank regulators force you to act.
- How long can we extend and pretend?

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- Between 2003 and 2007 just 10 banks failed in this country.
 - 2003/07..10 banks failed
 - 2008.....25 banks failed
 - 2009.....130 banks failed
 - 2009.....552 banks on watch list
- It should be noted that in the 2nd Qtr. Of this year the FDIC deposit insurance fund fell to \$10.4 Billion Dollars after just 24 banks had failed.
- By the end of the 3rd Qtr. the fund was negative \$8.2 Billion Dollars.

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- The expense to FDIC of bank failures clearly outpaces the influx of insurance premiums charged to insured banks.
- To offset the \$8.2 Billion deficiency FDIC has required healthy banks to prepay before the end of 2009 insurance premiums for the next 3 years to recapitalize the insurance fund.
- That will put FDIC \$37 Billion ahead.
- Clearly that is a very temporary fix with 552 banks on a watch list.
- This lack of liquidity in the FDIC insurance fund has resulted in policy

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decisions that will keep the commercial real estate market frozen.

- Let me explain.
- Prior to October 30, 2009 banks were required to record a loss on any troubled real estate loans where the appraised value falls below the amount owed.
- Clearly such a regulation if strictly enforced would cause massive bank failures as debt matures between now and 2013.
- What happened on October 30th?

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- The regulatory agencies of the federal government issued a 33 page guideline letter to every bank in the US explaining how banks could keep loans on their books as performing loans even if the value of the underlying properties have fallen below the loan amount.
- The new guidelines are targeted primarily at the hundreds of billions of dollars worth of loans that are coming due that cannot be refinanced nor sold at a price equal to the existing debt.
- The new guidelines state that loans to creditworthy borrowers that have been

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restructured and are current will not be reclassified as “high risk” by regulators solely because the collateral has dropped to an amount less than the loan balance.

- Obviously the guidelines are controversial.....critics say the government is prolonging the financial crisis by not forcing borrowers and lenders to confront inevitable problems.
- This is clearly a problem that is being pushed off into the future.

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- How aggressively regulators respond will determine how long the commercial real estate market remains frozen.
- I would suggest to you that as the US economy starts to recover and the FDIC insurance fund becomes more solvent the policy will change again to strict enforcement and commercial real estate will become available at steeply discounted prices.
- Thank You