

National Commercial Real Estate Market Trends

2010 Strategies for Success in Construction Lending

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What Moves A Market? – Fundamentals

Capital structures impact values. Lower mortgage-equity ratios means more equity is required to complete deals.

Office and industrial real estate is a house for employees.

- Increase in employees means an increased demand for space.
- If employment falls, demand falls. When demand falls, rental rates decrease and vacancy increases.

Leverage Impact on Cap Rates

Cap Rate Comparison – Pre and Post Credit Freeze

Cap Rate Prior to Credit Freeze:

Loan:	70%	times	7.00%	=	4.90%
Equity:	30%	times	7.50%	=	<u>2.25%</u>
Total:	100%				7.15%
Cap Rate (Rounded):					7.20%

Cap Rate After Credit Freeze:

Loan:	50%	times	7.50%	=	3.75%
Equity:	50%	times	10.00%	=	5.00%
Total:	100%				<u>8.75%</u>
Cap Rate (Rounded):					8.80%

Change in Cap Rate: 22.2%

This shows that credit freeze in late 2008 caused an increase in cap rates of about 20% to 25% resulted in a drop in property values of close to 20%. Assumes no change in vacancy and rent.

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What Happened Last Year in Office Market?

- The office vacancy rate ended 2009 at 17.6%, up from 14.8% at year-end 2008 (Grubb & Ellis), an increased of 19%. Impact on property income was about a 3% drop overall from vacancy change.
- Office rental rates dropped 4% according to Grubb & Ellis, but effective rent including free rent and other concessions dropped by 12%.
- Inflation in operating expenses continues to increase at near inflation of 2% to 3% (IREM).
- The impact on office net income was a drop total of about 18%.

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What Happened Last Year to Office Values?

		2008	Change		2009
Gross Income:		\$100,000	-12.0%		\$88,000
Vacancy:	14.8%	\$14,800		17.6%	\$15,488
Effective Gross Income:		\$85,200			\$72,512
Expenses (RealtyRates):	50.0%	\$42,600	2.0%	59.9%	\$43,452
Net Income:		\$42,600			\$29,060
Divide by Cap Rate:		7.20%			8.80%
Value Indicated:		\$591,667			\$330,227
Indicated Value Drop:			44.2%		

As shown, the combination of increasing cap rates, increasing vacancy, and decreasing income resulted in a drop of over 40% from pre-financial melt-down values to today.

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What About The Industrial Market?

- Similar to offices, Grubb & Ellis shows that average effective rent dropped by 12% in 2009.
- Vacancy according to Grubb & Ellis ended 2009 at 10.7%, up sharply from 2008.
- Expenses continued to increase.
- Similar overall impact on values as the office market nationally.

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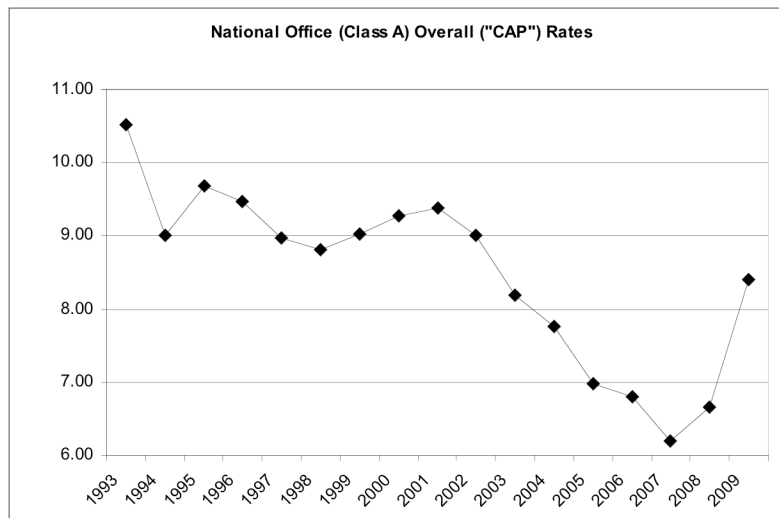
Where Are The Markets Heading?

- FMV searched nationally for sales of Class A office and industrial buildings over 100,000 square feet.
- We extracted cap rate and price per square foot information.
- We compared prices to employment since early 1990s to project future trends.

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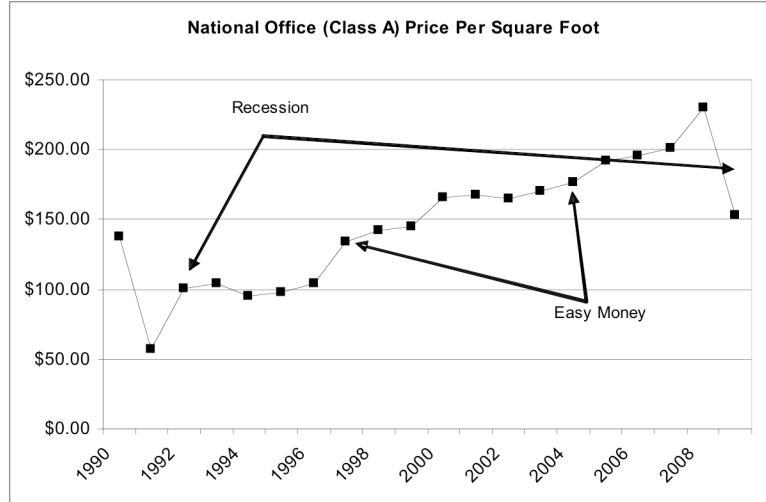
Office Cap Rates Moving Up



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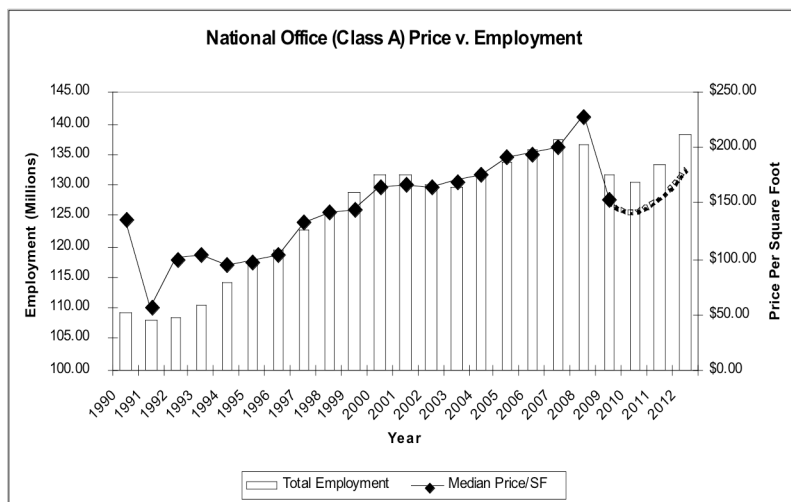
Office Values Dropping



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When and Where is Office Recovery?



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Industrial Cap Rates Moving Up

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Industrial Values Dropping

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When and Where is Office Recovery?

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What About the Residential Market?

The rate of sales is increasing and the inventory of unsold homes is decreasing.

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What About the Residential Market?

Prices bottomed out in spring last year and are showing modest recovery.

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Prices Showing Recovery

Important is inventory decline from 3.97 million (8.9 months) in 2007 to 3.29 million (8.8 months) now.

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Clouds on Horizon or Smooth Sailing?

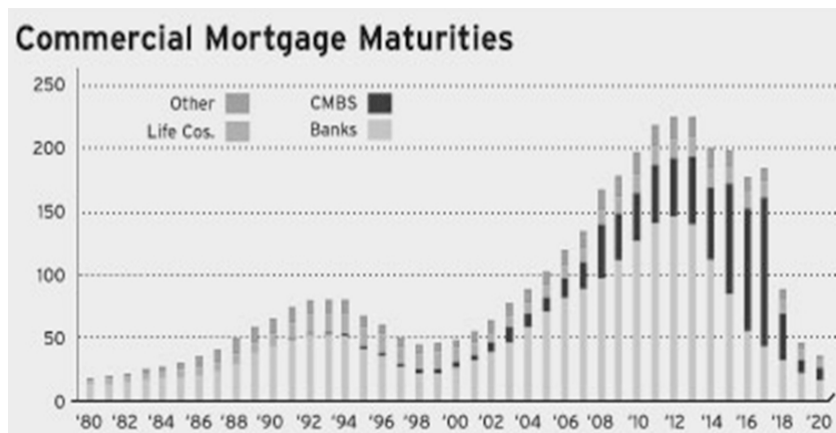
- CMBS & commercial mortgage maturities – Can loans maturing be refinanced with lower values and tighter underwriting?
- Job growth – When will jobs start to grow? This is a major component to commercial real estate recovery.
- Interest rates – With Fed printing money, what happens when velocity increases? Rates will have to go up, home price affordability drops, real estate values decline and the second dip occurs.

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Commercial Mortgage Maturity Trends

Source: Foresight Analytics



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 - Experience With Public & Private Entities
- Experienced Team of Professionals
 - Staff of Approximately 75 Professionals
 - Alum From "Big Four", I-Banks, Houlihan, Business Operations, Commercial Lending
 - Six Office Locations:
 - Irvine, San Francisco, Los Angeles, New York, Dallas, Chicago
 - Senior Management Involvement in Each Project
 - IRS & Court Experience
 - IRS Audit Rate Well Below Industry Average

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- Real Estate Valuation Services
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 - Financial Reporting
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 - Litigation Support
 - Extensive court room experience (Robert Dietrich with over 60 appearances in court as an expert witness)
 - Eminent domain
 - Bankruptcy

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