VCU Virginia Commonwealth University

INSTITUTIONAL INVESTOR AND CAPITAL MARKET UPDATE

Virginia Commonwealth University

•

18th Annual Real Estate Trends Conference

INSTITUTIONAL REAL ESTATE, INC. | Publishers and Consultants

Overview

- Who will save our souls?
- Pension Funds and other sorrows
- When will the log jam break?
- Other concerns
- What the government is doing
- Problems with the asset backed markets
- Sovereign Wealth Funds and China
- The bottom line

Who will save our souls?

- Pension funds?
- The Government?
- Sovereign Wealth Funds?
- The Chinese?

Key Questions to Address

- Why aren’t investors investing more now? Why the log jam?
- What will it take to get them moving?
- What are the root causes and what can (or should) we do about them?
- What’s likely to happen next?
- Will the actions being taken now be enough?
- Where do we go from there?

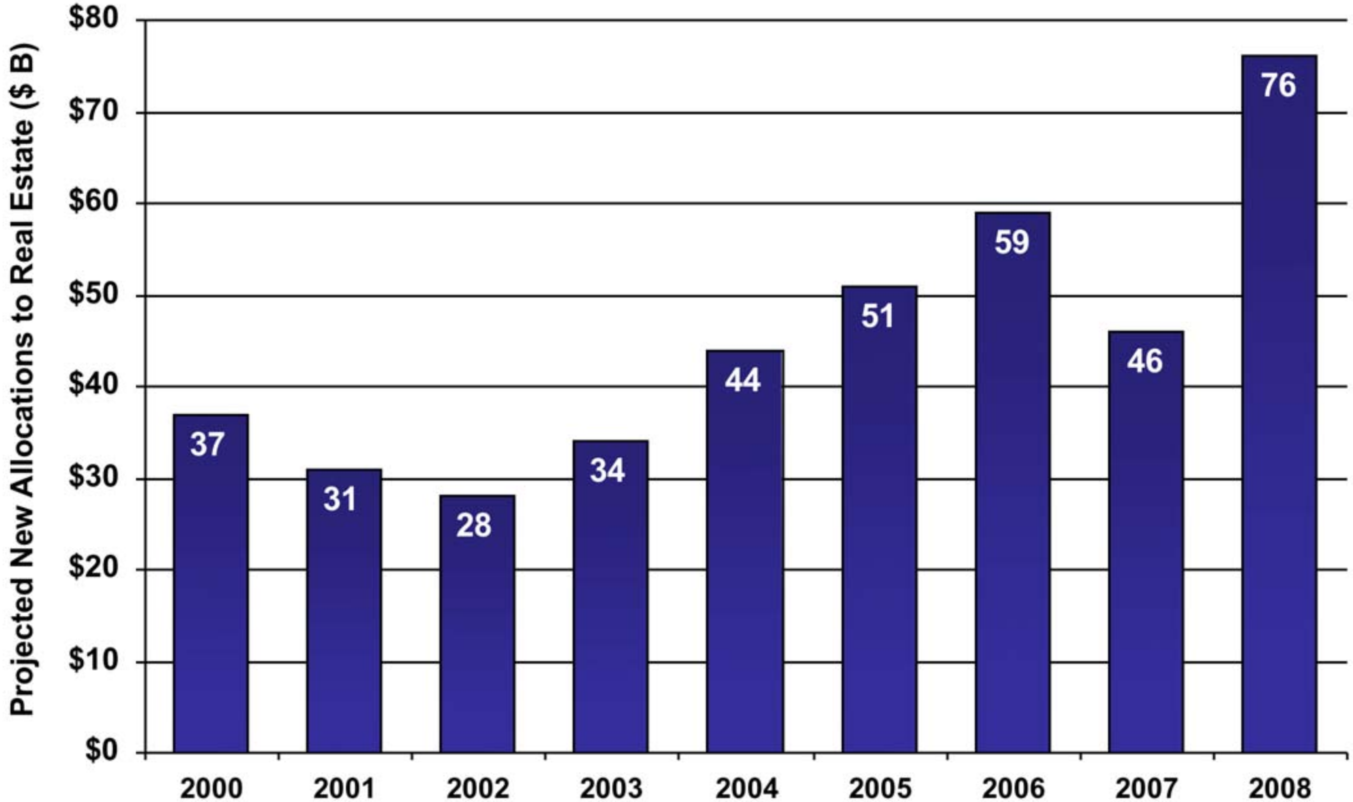
U.S. Pension Fund Target Allocations vs. Actual Investment Positions

As of 12/15/07

ASSET CLASS	TARGET		ACTUAL		OVER / (UNDER)
Real Estate	9.60%	$374.40	8.50%	$331.50	$(42.90)
US Stocks	35.10%	$1,368.90	36.70%	$1,431.30	$62.40
Foreign Stocks	18.00%	$702.00	18.90%	$737.10	$35.10
Fixed Income	22.70%	$885.30	21.90%	$854.10	$(31.20)
VC / Private Equity	6.10%	$237.90	4.90%	$191.10	$(46.80)
Cash	0.50%	$19.50	1.30%	$50.70	$31.20
Hedge Funds	5.50%	$214.50	5.80%	$226.20	$11.70
Other	2.50%	$97.50	2.00%	$78.00	$(19.50)
Totals	100.00%	$3,900.00	100.00%	$3,900.00	

Historic and Projected Pension Fund Capital Available for New Commitments

As of 12/15/08



INSTITUTIONAL REAL ESTATE, INC. | Publishers and Consultants

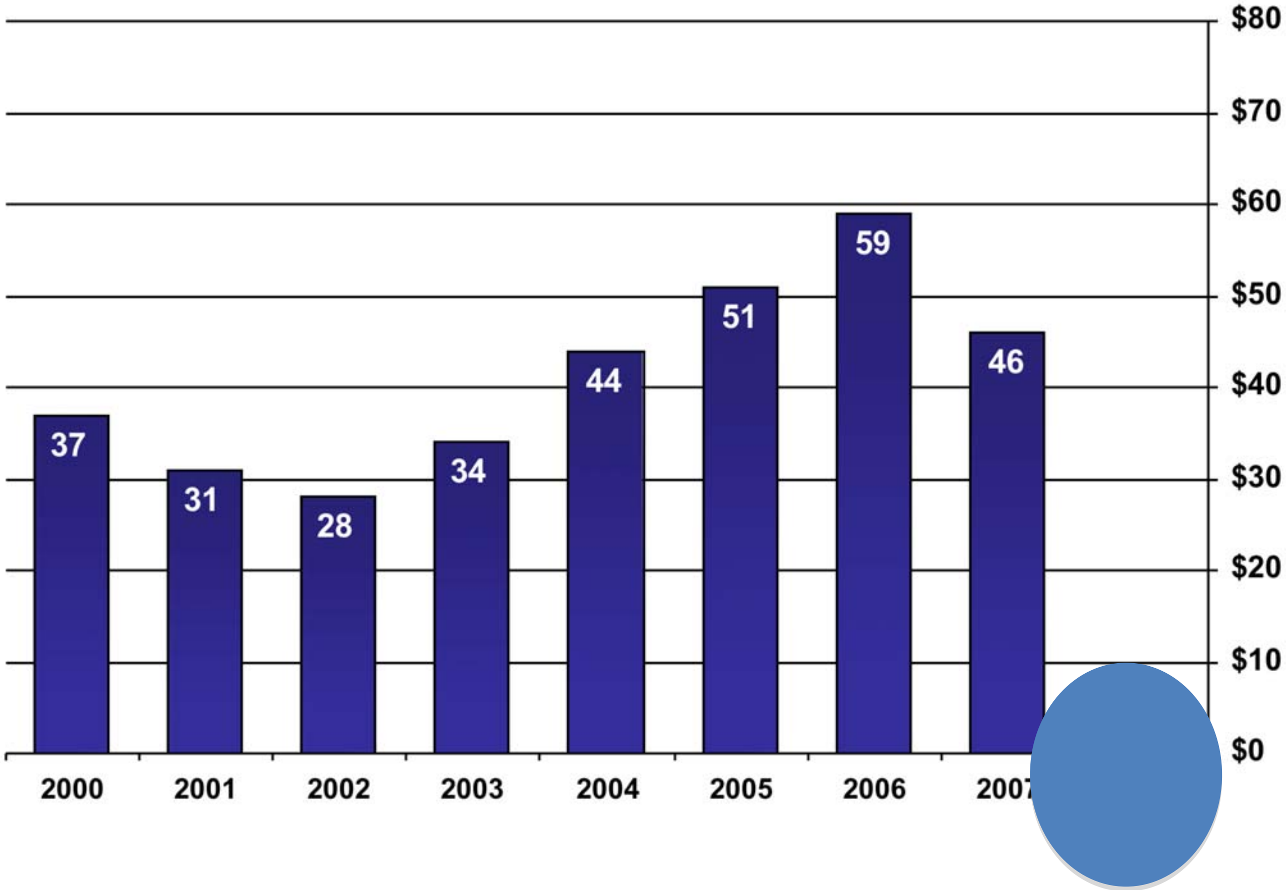
U.S. Pension Fund Target Allocations vs. Actual Investment Positions

As of 10/14/07

ASET CLASS	TARGET		ACTUAL		OVER / (UNDER)
Real Estate	9.60%	$279.35	11.05%	$321.56	$42.20
US Stocks	35.10%	$1,021.38	31.33%	$911.74	$(109.65)
Foreign Stocks	18.00%	$523.79	13.93%	$405.41	$(118.38)
Fixed Income	22.70%	$660.55	29.06%	$845.56	$185.01
VC / Private Equity	6.10%	$177.51	5.25%	$152.88	$(24.63)
Cash	0.50%	$14.55	1.74%	$50.70	$36.15
Hedge Funds	5.50%	$160.05	4.95%	$144.09	$(15.96)
Other	2.50%	$72.75	2.68%	$78.00	$5.25
Totals	100.00%	$2,909.93	100.00%	$2,909.93	

Historic and Projected Pension Fund Capital Available for New Commitments

As of 10/14/08



INSTITUTIONAL REAL ESTATE, INC. | Publishers and Consultants

Constraints on Pension Fund Investment Activity

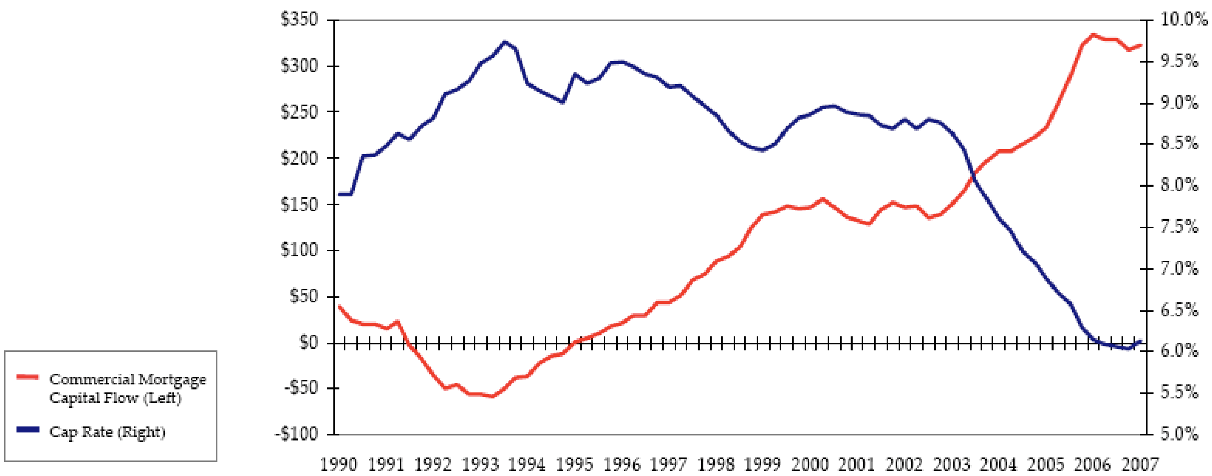
- The denominator effect
- Inconsistent investment manager responses
- Fear of acting too early
- Lack of motivation / urgency

… but pockets of money are still available

When will the log jam break?

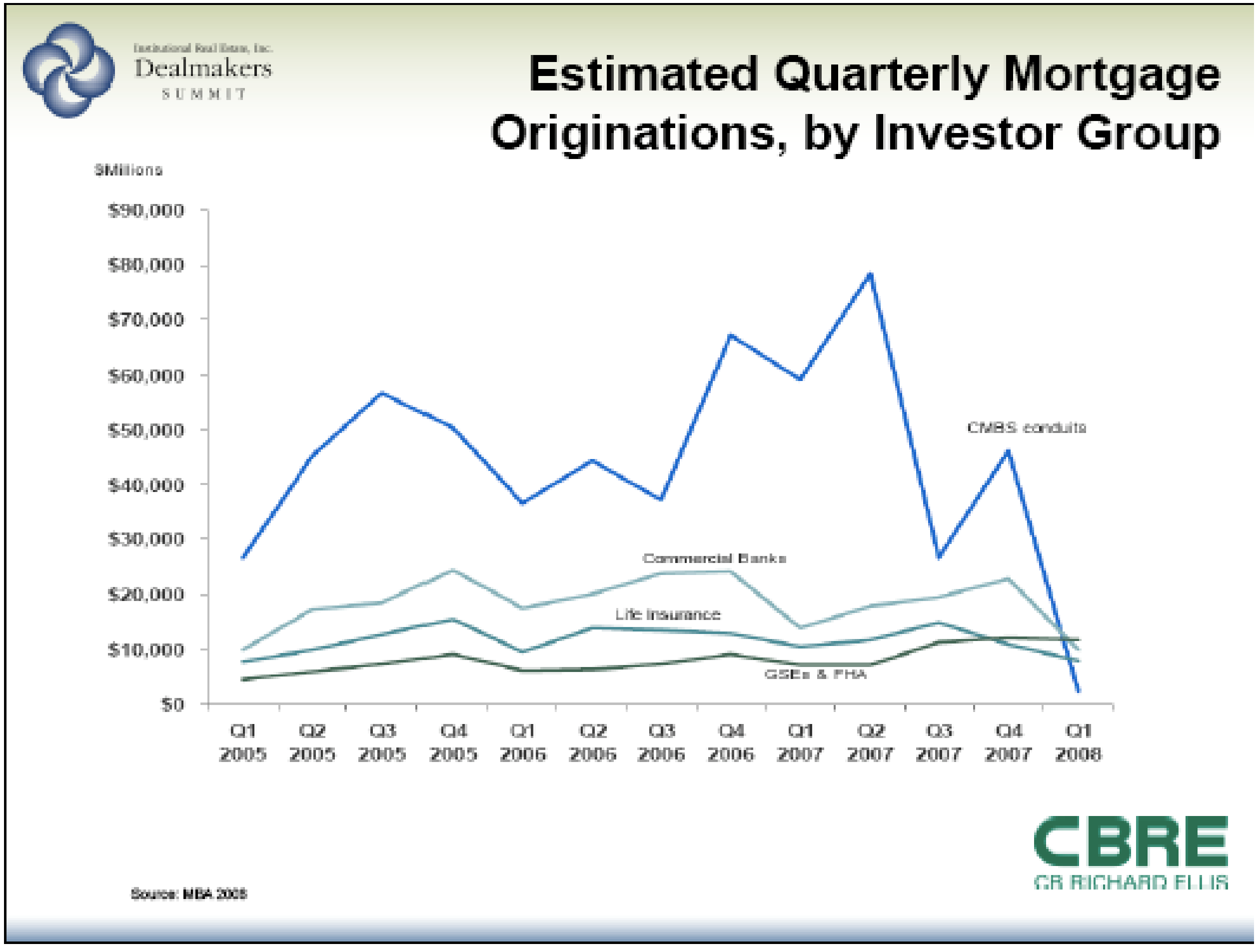
The relationship between debt capital availability and cap rates

Market Outlook



As of September 30, 2006
Source: Federal Reserve

What goes up, must come down (and vice versa)



Source: Brian Stouffers, CBRE Capital Markets, presented September 16, 2008

Debt availability's impact on value

Institutional Real Estate, Inc.
Dealmakers SUMMIT

Why are Values Going Down?

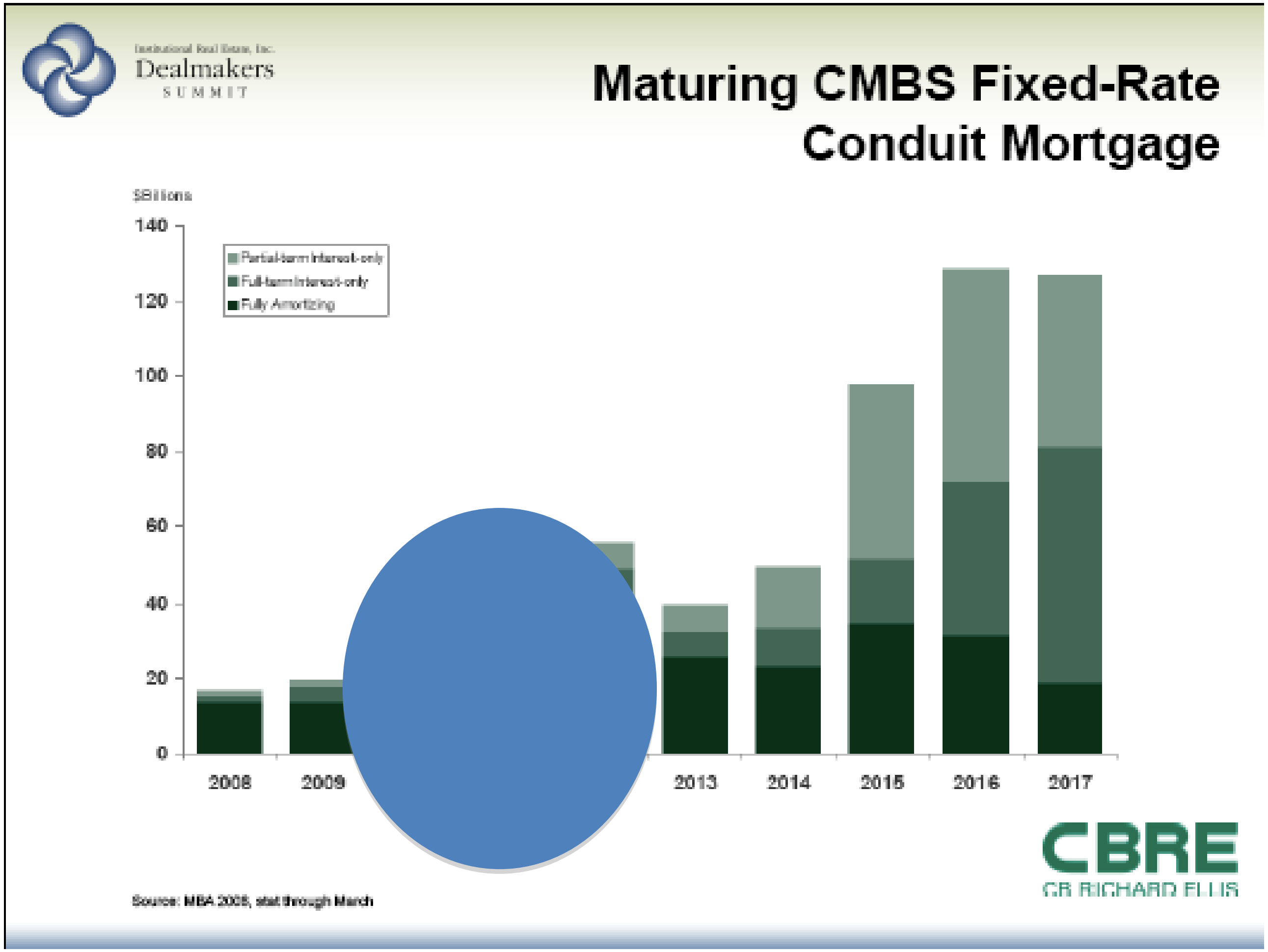
	July 2007	August 2008
Asset Value (6% Cap Rate)	$40,000,000	$40,000,000
Net Operating Income	$2,400,000	$2,400,000
Treasury	4.63%	3.90%
Spread	1.20%	3.00%
Rate	5.83%	6.90%
Years of Amortization	0	30
Constant	5.83%	7.90%
Minimum Coverage	1.15x	1.25x
Proceeds	$32,000,000	$24,294,000
Loan-To-Value	80.00%	60.00%
Equity	$8,000,000	$15,706,000
Cash on Cash Return	6.7%	2%

CBRE
CB RICHARD ELLIS

Source: Brian Stouffers, CBRE Capital Markets, presented September 16, 2008

INSTITUTIONAL REAL ESTATE, INC. | Publishers and Consultants

CMBS maturities



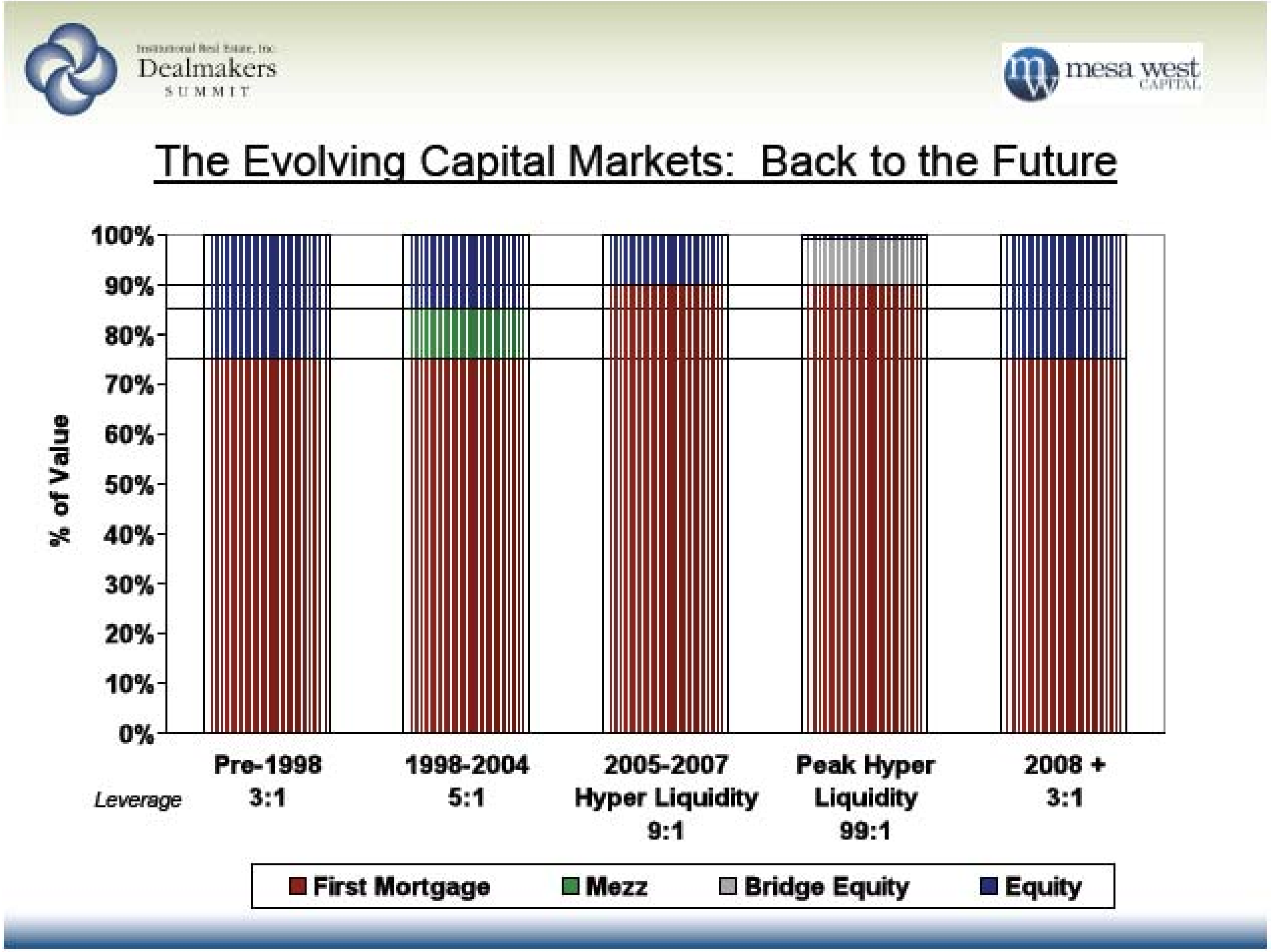
Source: Brian Stouffers, CBRE Capital Markets, presented September 16, 2008

INSTITUTIONAL REAL ESTATE, INC. | Publishers and Consultants

How the numbers will force the log jam to break?

ORIGINAL LOAN VALUE (assuming 80% LTV)	$175,000,000,000
ORIGINAL PROPERTY VALUE	$218,750,000,000
ORIGINAL EQUITY	$43,750,000,000
CURRENT PROPERTY VALUE (assuming 12% value decline)	$192,500,000,000
MAX LOAN PROCEEDS AVAIL TODAY (assuming max of 60% LTV)	$115,500,000,000
ADDITIONAL EQUITY NEEDED TO PAY BACK ORIGINAL LOAN	$59,500,000,000
ADDITIONAL EQUITY NEEDED TO MEET NEW LOAN REQUIREMENTS	$77,000,000,000
TOTAL NEW EQUITY REQUIRED TO REFINANCE	$136,500,000,000

But … An 80% LTV original underwriting assumption could be conservative!



Source: Jeff Friedman, Mesa West Capital, presented September 16, 2008

INSTITUTIONAL REAL ESTATE, INC. | Publishers and Consultants

Other Concerns

- Home foreclosures continue
- 1,000 regional and community banks poised to fail
- Hedge fund redemptions, margin calls, potential failures
- Property derivatives and REIT market signals
- Collapse of highly leveraged property transactions, funds and managers
- Will the actions of the Fed, Central Banks and Congress be “enough”?

What the government is attempting to address:

- The seizing up of bank and other financial institution lending activity
- Tumbling single family residential home prices and foreclosures
- Plunging stock market values
- The collapse of iconic financial institutions
- The threat of additional bank and financial institution failures

What the government is failing to address

- Failure of institutional memory during extended bull markets
- The tendency towards excessive risk tolerance during extended bull markets
- Over leveraged bank, financial institution and money manager balance sheets
- Fundamental flaws in the structure of the asset backed securities markets
- Lack of transparency and regulatory oversight in derivatives markets
- Mark-to-market accounting and its impact on financial institution solvency
- The implications of rescinding the Glass-Steagle Act
- The implications of rescinding up tick rules for short selling

Fundamental flaws in the asset-backed securities markets

- Faulty underwriting processes, procedures and disciplines
- Insufficient transparency
- Conflicts of Interest / Agency problems
  - Whose interests do the rating agencies, originators and issuers represent?
  - The way in which the rating agencies get paid
  - The way in which originators and issuers get paid
  - Originators and issuers retain no risk

Possible solutions

- Eliminate competition for business between the rating agencies
- Establish flat fee schedules for the rating process
- Create clear, uniform, inviolable underwriting standards
- Pay originators and issuers for performance as well as origination
- Require originators and issuers to retain some risk
- Create and maintain central databases available to underwriters
  - Require all borrowers and originators to register & update loans & loan terms
  - Require all parties to derivatives contracts to register & update contract terms
  - Issue at registration a CUSIP-like number to all such contracts for tracking purposes
  - Require secondary market loan purchasers and sellers to register& update all transactions
  - Require secondary market derivatives contract participants to register all transactions
  - Impose severe civil and even criminal penalties for non-compliance
- Rescind mark-to-market accounting for illiquid assets (maybe)
- Reinstate Glass-Steagle and up tick rules for short sellers

Sovereign Wealth Funds

- More than $4 trillion, growing to $14 trillion
- Moved in early and got burned
- Limited interest in real estate investing so far
- Will sit on the sidelines and wait
- Will move in to pick up cheap assets at the end
- Not a viable source of “rescue capital”

The Chinese

- Huge trade surpluses
- Giant pools of capital
- Moved in early, got burned
- Limited interest in real estate investing
- Have their own internal problems to address
- Not our friends
- Not a viable source of “rescue capital”

The bottom line

- No one is going to “save” our souls
- Deleveraging must continue … and it will!
- Economy will continue to weaken
- Bankruptcies will punch holes in rent rolls
- As fundamentals continue to erode, values will weaken further
- Placing more and more pressure on borrowers as loans come due
- It won’t be over any time soon
- Brace yourself for a long, bumpy, uncomfortable ride

Eventually

- The transaction log jam will break
- Excessively leveraged transactions, funds and fund managers will fail
- Property values will continue to decline
- Pressure on borrowers will continue to grow
- Buying opportunities will emerge
- But debt capital will remain scarce

… at least, for a while

Meanwhile

- The emphasis will be on asset management
- Acquisition focus will be on quality of cash flow
- Secondary and tertiary markets will be out of favor
- Distressed selling activity will pick up
- Cash will be king
- Measures taken by Governments will help soften the negative impacts
- BUT … root causes still will need to be addressed