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The Impact of the *Credit Crunch* on Commercial Real Estate

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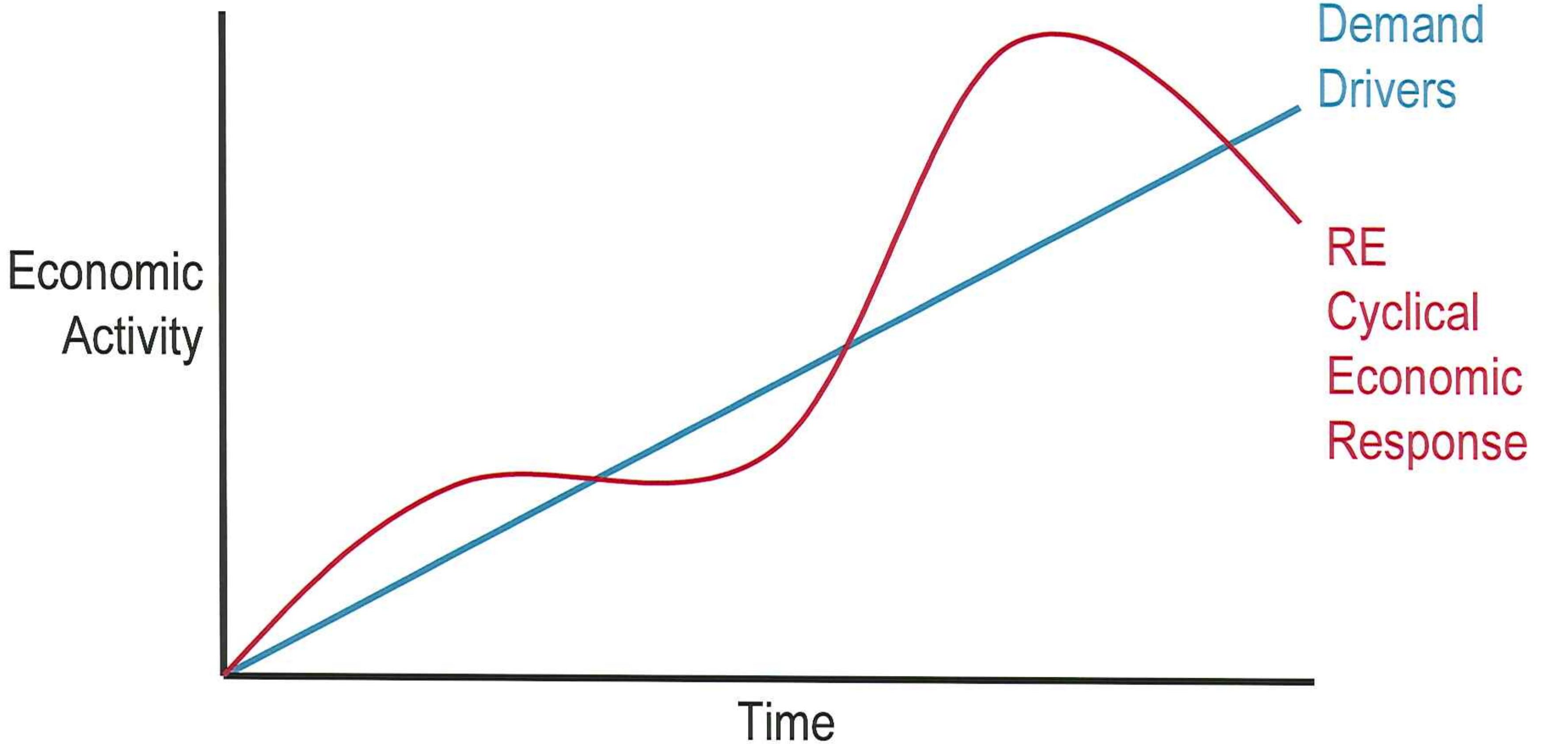
Why is there volatility?

Real estate, like all markets never move in a straight line…always under and over correcting to stimulus, confidence, supply and demand



That was then…this is now

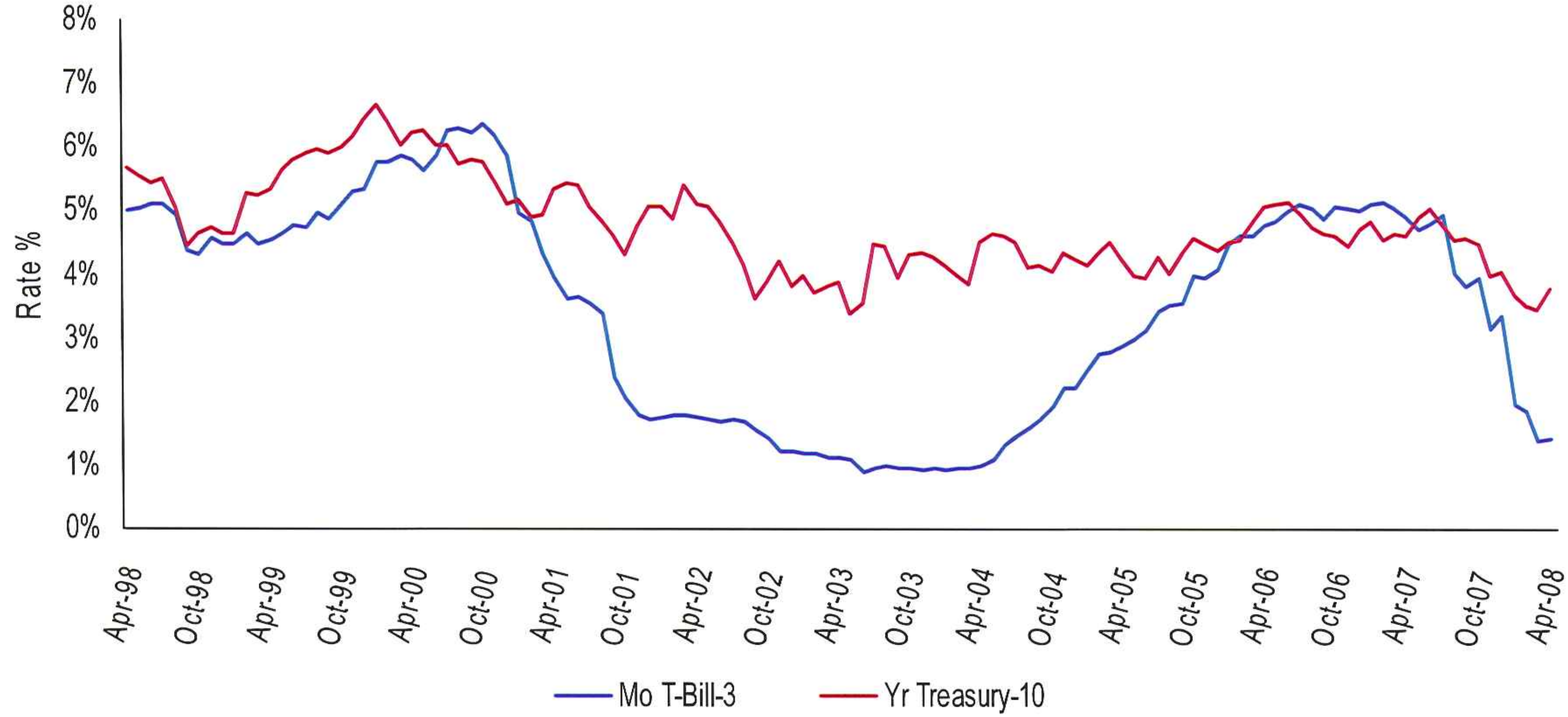
Comparison of the current environment to the most recent credit cycle

Then	Now
A Wall of Capital	The Capital Crunch
Perfect Calm	Perfect Storm
Irrational Exuberance	Irrational Fear
Subprime/Alt-A Credit	Junk Debt/Toxic Waste
Equity Priced as Debt	Debt Priced as Equity
Cap Rate Compression	Credit Spread Expansion
Highly Leveraged Returns	Return of Negative Leverage
Conduits/CMBS/Shadow Banking	Balance Sheet Lending
Covenant "Lite"/No-Doc Loans	Complete and Prudent Underwriting
Financial Engineers	Professional Investors/Operators

Real estate capital markets highlights

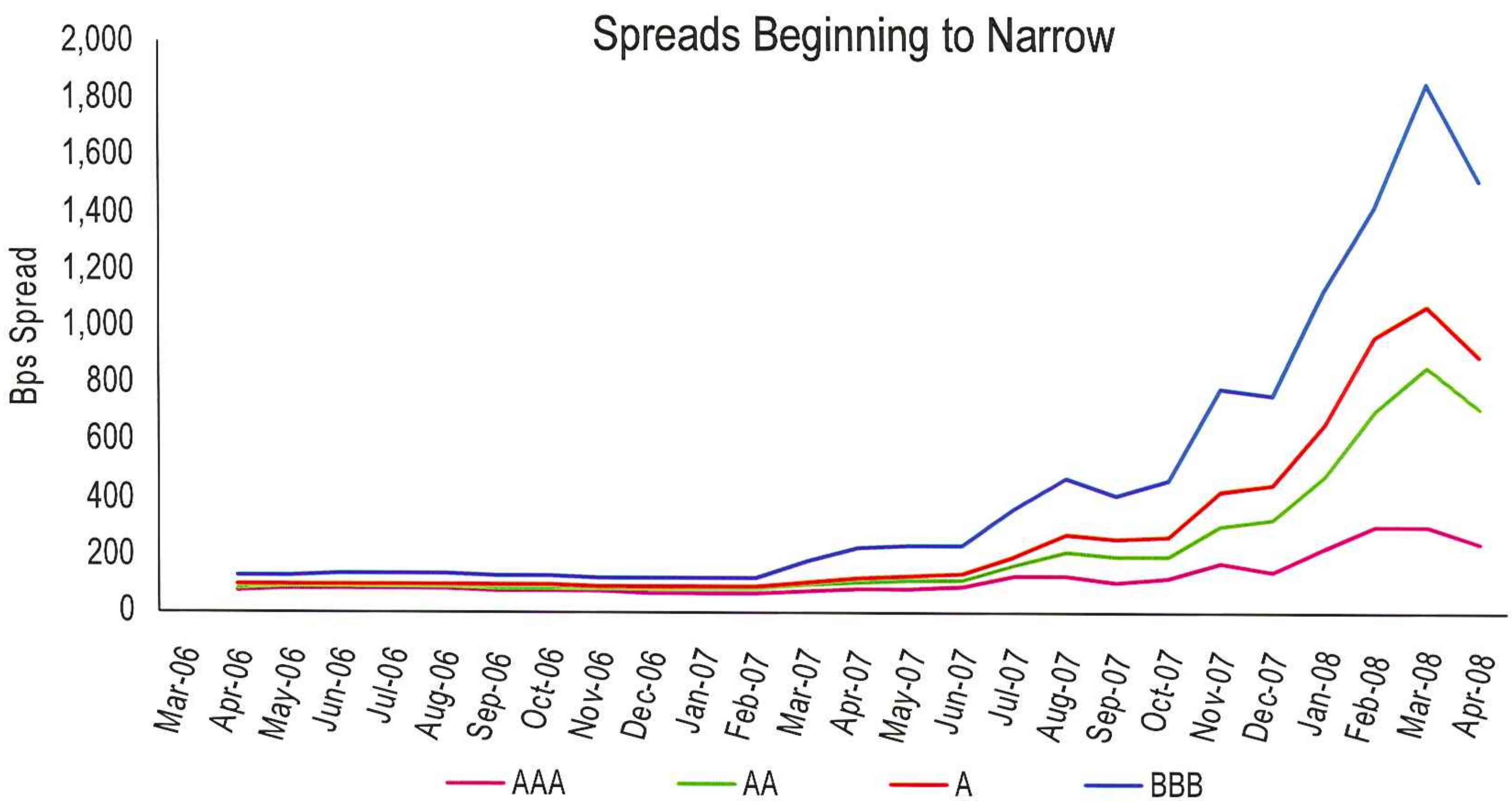
- Availability of debt has been greatly restricted
- Risk-free rates have dropped
- Credit spreads have surged and with much stricter terms required
- Cap rates have already risen 75-100 basis points since 2007
- Asset pricing remains in the midst of a correction with average values declining by 10-15% from their peak
- Transaction activity to be down 50% in 2008

Long term rates have dropped with credit crunch and weak economic outlook; rates are low historically



Source: Jones Lang LaSalle, Economy.com

CMBS spreads over treasuries



Source: Jones Lang LaSalle, Commercial Mortgage Alert

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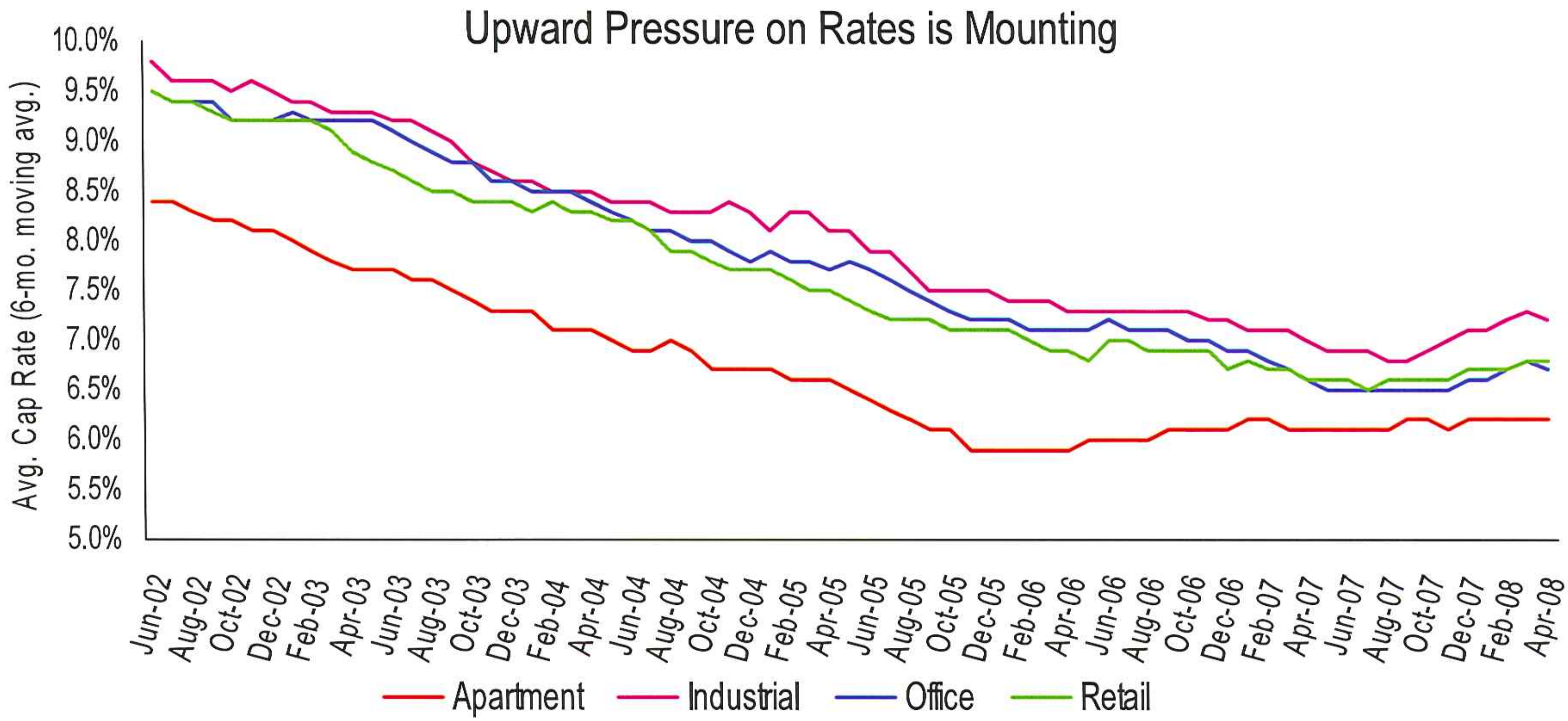
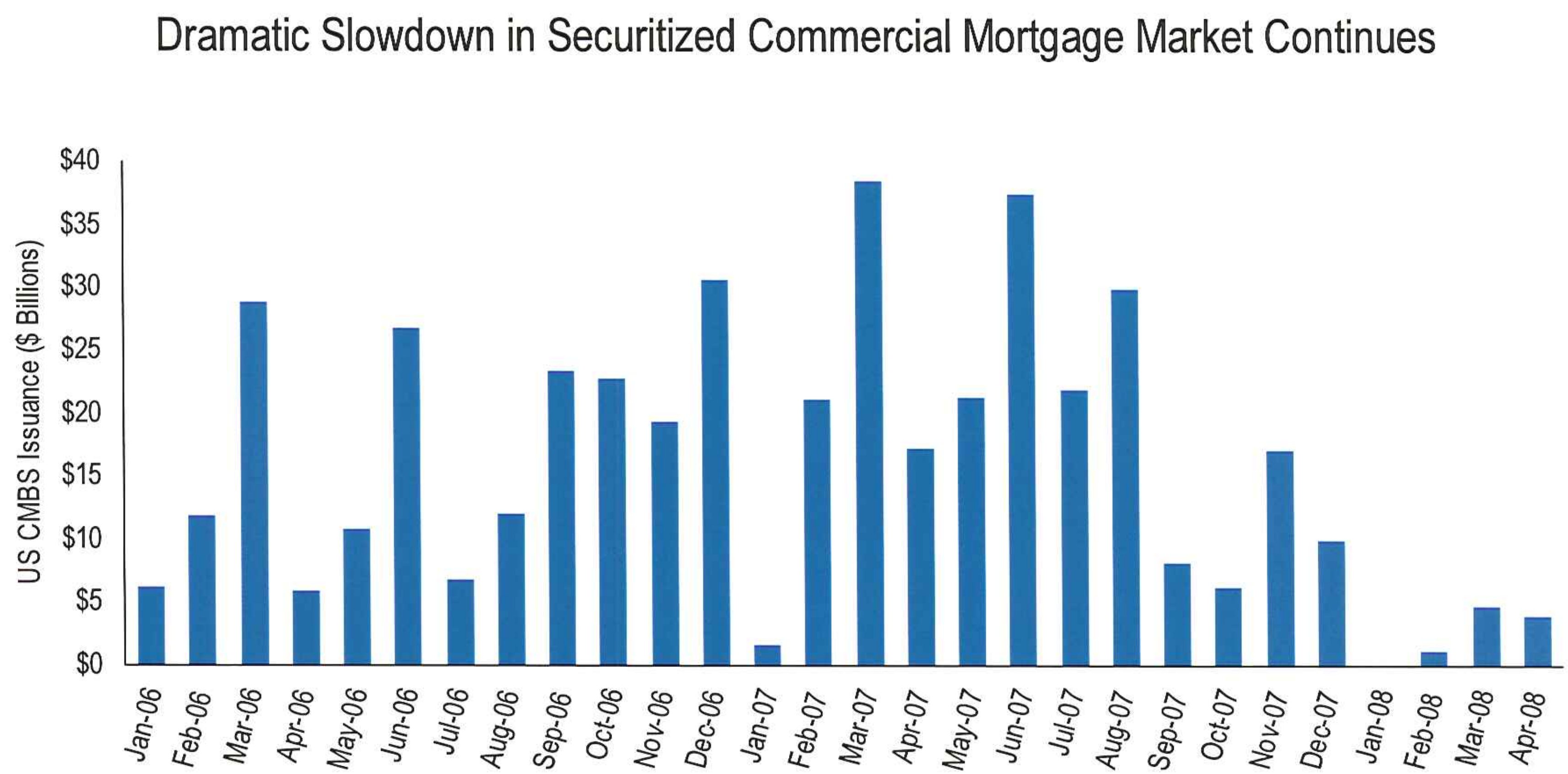
Cap rates on the move up



* Properties of at Least $5 Million
Source: Jones Lang LaSalle, Real Capital Analytics

US CMBS issuance



Source: Jones Lang LaSalle, Commercial Mortgage Alert

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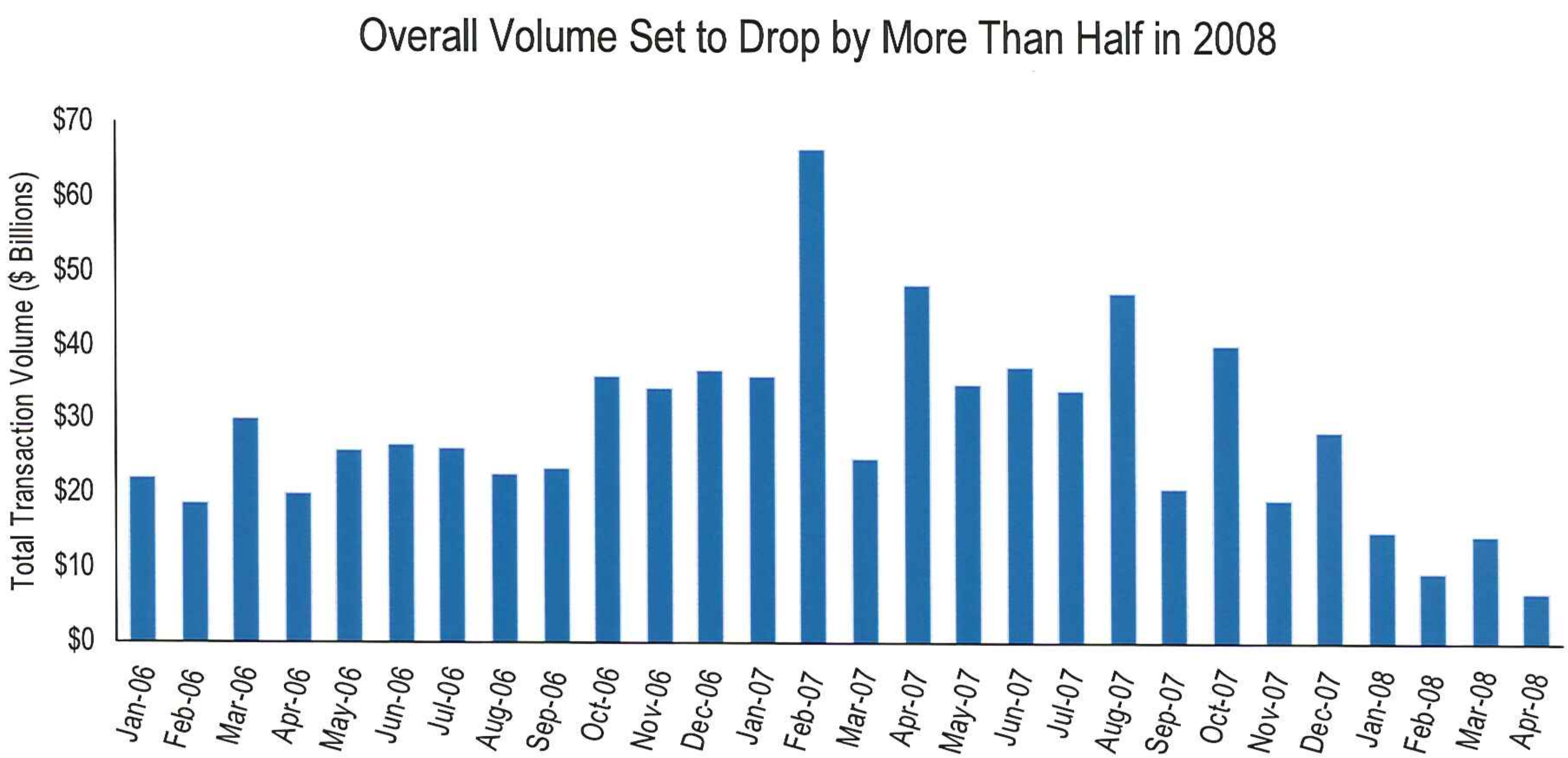
Total monthly transaction volume



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Source: Jones Lang LaSalle, Real Capital Analytics

Office fundamentals

- Demand has quickly downshifted in the face of the economic downturn, job losses and credit crunch
- Businesses are cautious and delaying space decisions
- Vacancies are poised to creep upward and concessions and incentive packages will begin to reappear
- Effective rents will face downward pressure in many markets
- However, with a starting point of generally below-equilibrium vacancy rates and restrained construction levels, many markets, especially top-tier CBD markets will have some economic insulation from a sharp pullback in leasing

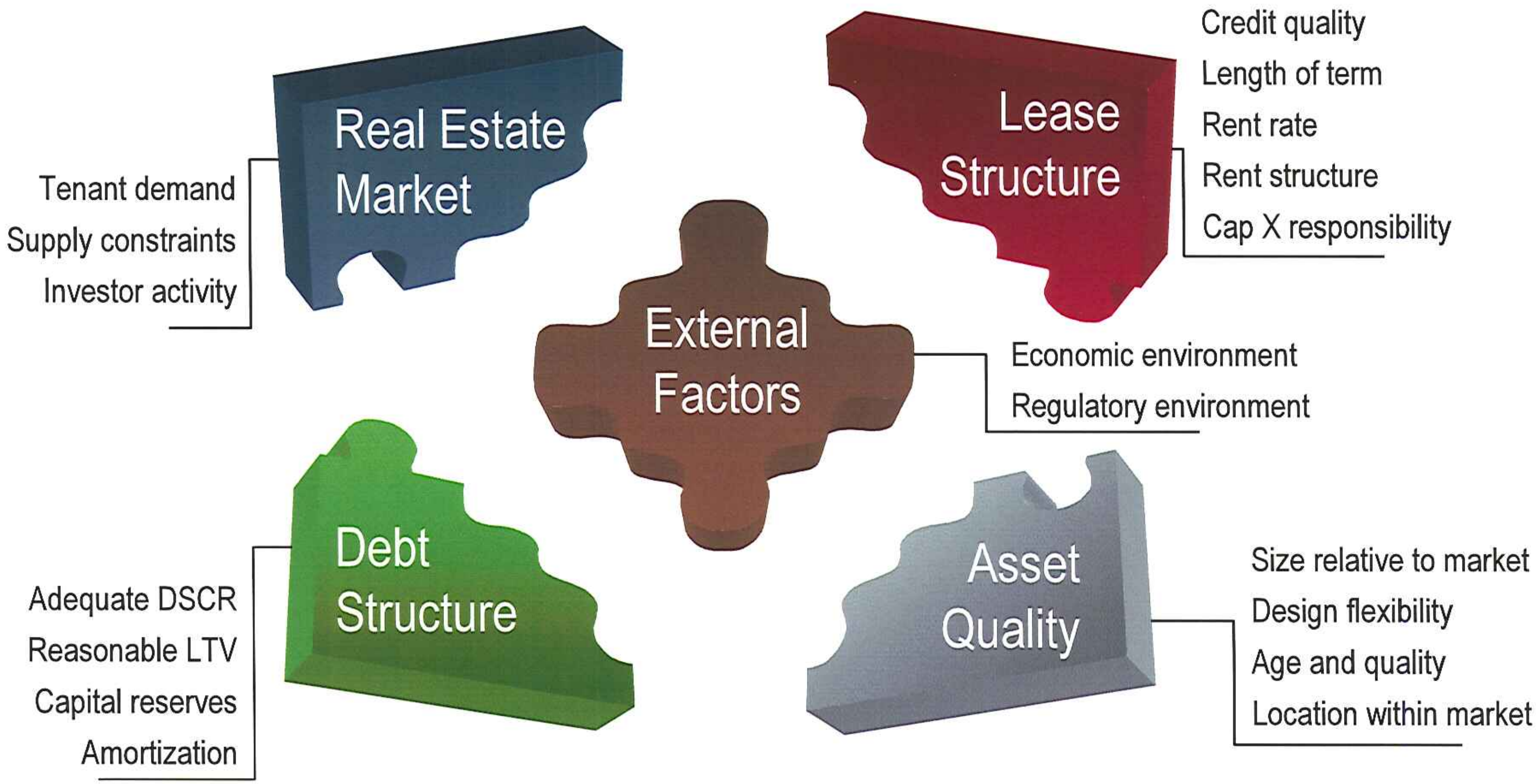
Capital markets recovery?

- Forces Aiding a Recovery
  - Interest rate cuts and consumer stimulus
  - Institutional and foreign buyers go on buying spree
  - Banking system has aggressively taken write-offs
  - Return of rational lending (to benefit over long term)
- Forces Thwarting a Recovery
  - Transaction paralysis
  - Looming recession
  - Additional write-offs
  - Return of rational lending (causing short term pain)

Pockets of opportunity

- Mezzanine debt is an attractive investment now
- Investors are beginning to buy properties with distressed debt and purchasing whole loans
- Apartments relatively strong as for-sale housing market continues to weaken
- Niche property types such as senior and student housing, and medical offices in which demographic trends provide much support
- Corporate-owned real estate opportunities including sale-leasebacks
- High-credit, high-quality real estate still in demand investors

What are the key pieces of a successful landlord and tenant transaction?



Lease Structure: GSA lease clauses and credit quality

- The Federal government's AAA credit quality can be a major attraction to the real estate debt and equity markets in today's environment
- However, the investment community requires market conformity on major lease issues in order to lower its risk assessment and pass along lower lease costs to the government:
  - Rights of assignment and substitution
  - Casualty and termination rights
  - Rental offset rights for maintenance and services
  - Maintenance self-help rights
  - Strict landlord default provisions for delivery, maintenance and services
  - Tenant alternation rights without notice or restoration obligations
  - Limitations on pass-throughs of actual maintenance and operating costs
  - Overly flexible tenant holdover provisions past lease expiration

Asset Quality: Market conforming buildings

- The investment/landlord community cares about the long-term residual value of leased buildings
- The ability to re-tenant a property long after the expiration and departure of current tenants enhances the intrinsic value of a property, lowers the investors risk and should enable the occupier to enjoy a lower lease cost
- The Federal government's efforts to design, seek, lease and occupy buildings which are more market conforming has allowed the private sector to respond with lower occupancy cost leases in recent years

What does the future hold?

- Banks and life insurance companies are still lending
- Underwriting standards and lender requirements will be more stringent
- Eventually, seller motivation levels will increase…leading to
- Greater transaction activity and new equilibrium pricing…and
- A rebound in demand for investments in 2009
- A firm foundation for the next upward cycle?

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Thank you