



**Capital Metes and Bounds**

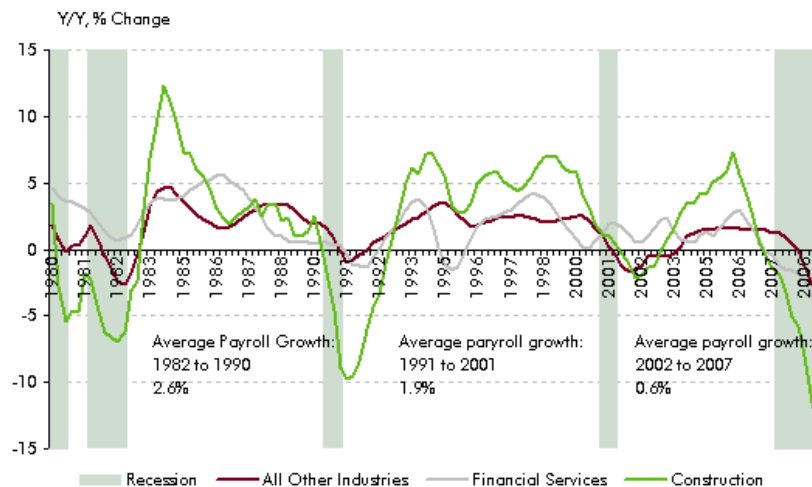
*By James M. Murphy, CMB, CRI*

**There will be light at the end of the tunnel!**

“Housing hit bottom in 2009. Now we expect commercial real estate to bottom out in 2010. Incredibly this industry collapse is going to be worse than the 1990s and the worst we’ve suffered since the Great Depression.” ULI Senior Fellow for Real Estate – Stephen Blank said in a web cast last week. The more we hear this doomsday philosophy from the pundits, the closer we get to a turnaround. Blank did say the investors with cash will do well in the next several years.

The fact is that this downturn began in November of 2007 when total employment peaked at just over 138 million jobs. Federal Reserve statistics show that since then, the economy has shed over 8 million jobs. The U-6 number put out by the Fed which includes unemployed, underemployed and discouraged job seekers now sits at over 26 million people or 17% of the work force. These numbers make Blank’s statement less of a prediction and more of a statement of fact. In any case the longest post WW II recession lasted 28 months and if you believe we are 24 months into this, we are closer to the end than the beginning. There are funds with tremendous liquidity sitting on the sidelines waiting to buy. What we need are transactions and they will begin with the New Year.

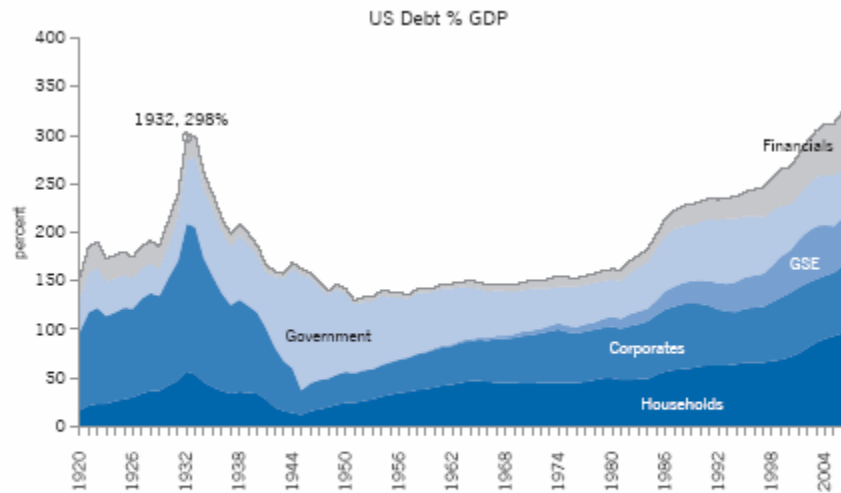
Employment growth continues to be the issue as this newsletter has stated ad-nauseam. A slightly different slant on the same issue is payroll growth which has declined precipitously in all sectors over the past four years. The positive spin put on this is to call it productivity growth, but in the end purchasing power has ebbed to new lows and should be nearing a bottom.



Source: Bureau of Labor Statistics

The real elephant in the room has been mushrooming debt across all economic sectors as shown in the chart below. De-leveraging has begun in every sector except government, which continues to balloon out of control. The country simply can not sustain an economy based on mountains of borrowing especially when the holders of the debt are foreign nations. China with \$1.3 trillion of government and agency debt could wreak economic havoc on us if they chose, by flooding the market with treasuries. It is obviously not in their best interest to do as long we allow them to run a huge trade surplus with us.

### The elephant in the room



Through December 2008

Source: Morgan Stanley Research, BEA, Federal Reserve and "The Statistical History of the United States" by Ben Wattenberg

Apropos to what ULI's Blank has to say, housing is definitely improving and extension of the first time buyer tax credit along with introduction of a credit for any buyer will continue to help.



Through September 2009

Source: US Department of Commerce, Bureau of the Census and DRI

And Federal Reserve purchases of MBS are keeping rates low even as it balloons the Fed's balance sheet to over \$2 trillion in debt.

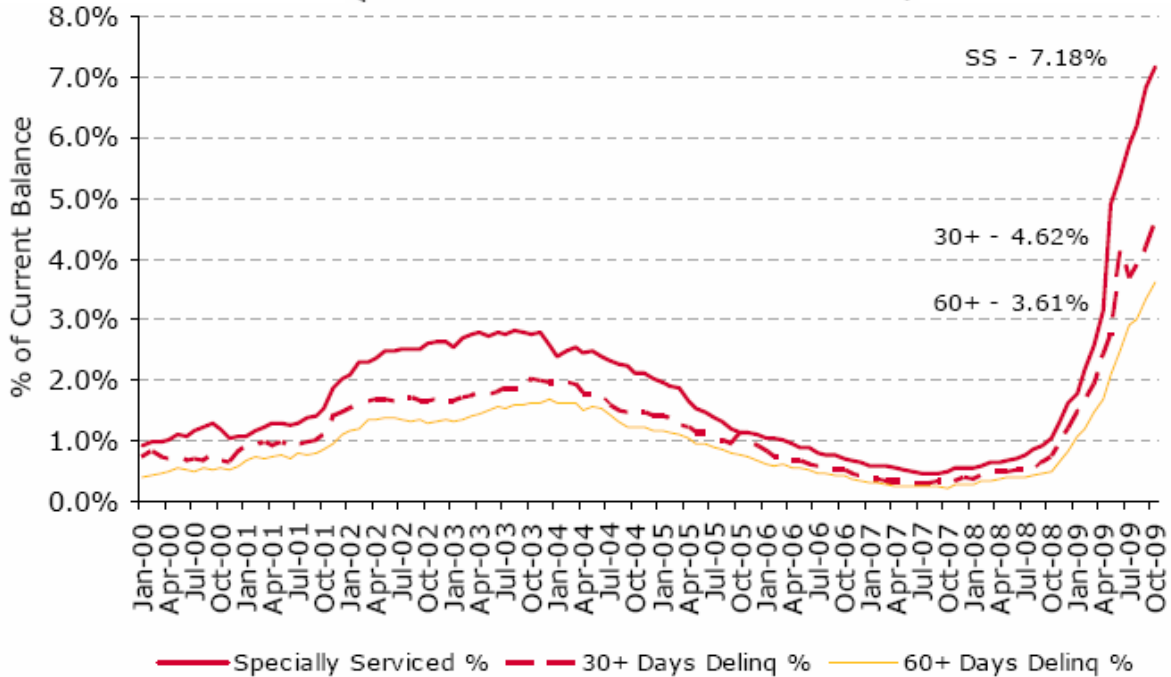


The trade off in addition to ballooning debt is a weak dollar!



Meanwhile the capital markets continue in disarray with CMBS delinquencies growing.

### CMBS Delinquencies and Special Servicing Percentage (Fixed-Rate Conduit Transactions)



Source: Wells Fargo Securities, LLC, and Intex Solutions, Inc.

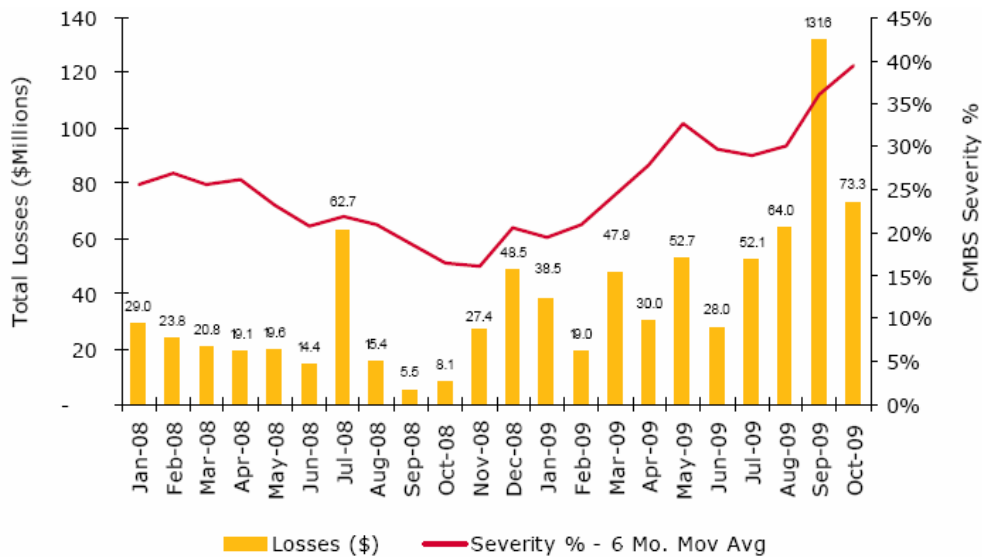
Of all the property types, industrial continues to perform best, while retail is experiencing the greatest losses.

### 30+ Day Delinquencies by Property Type

PropType	Amt (\$)	LnCnt	% of Amt	% of LnCnt
Healthcare	166,309,166	13	0.54%	0.46%
Hotel	4,147,741,282	244	13.42%	8.64%
Industrial	1,168,097,010	167	3.78%	5.91%
Multifamily	8,548,383,647	803	27.66%	28.43%
Office	6,156,318,545	508	19.92%	17.99%
Other	1,352,864,309	130	4.38%	4.60%
Retail	9,109,633,667	914	29.48%	32.37%
Self-Storage	255,797,917	45	0.83%	1.59%
<b>Totals</b>	<b>30,905,145,542</b>	<b>2,824</b>	<b>100.00%</b>	<b>100.00%</b>

Source: Wells Fargo Securities, LLC and Intex, Solutions, Inc.

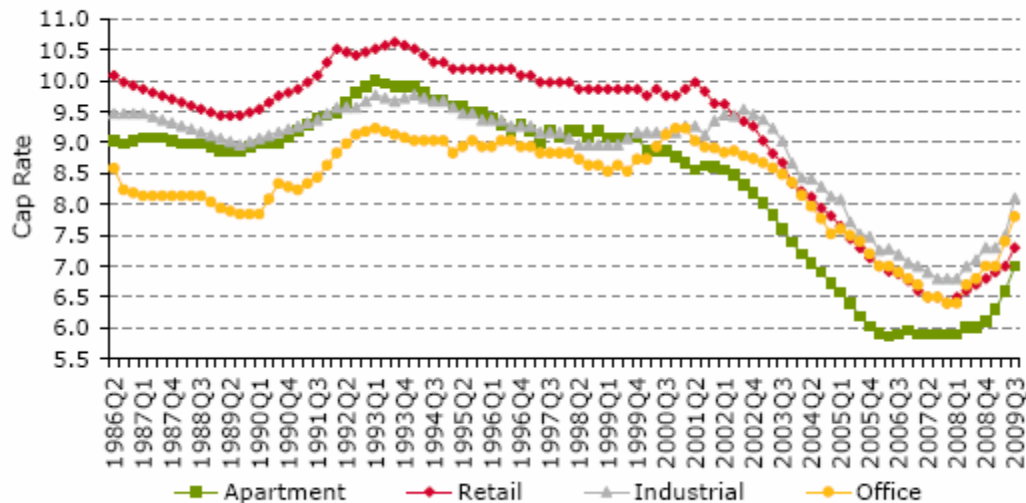
The severity and depth of the losses are reaching higher and higher into the rated credit tranches. This does not bode well for a complete resurgence of CMBS. However, the market was tested this week by an offering from Goldman Sachs on a Developers Diversified \$400 million loan using TALF money. The offering went well with the AAA tranche selling at 140 basis points over 5 year swaps or around 3.8%. Overall pricing was not disclosed and the offering itself was clearly the best that could be put forth consisting entirely of 95% occupied shopping centers.



Source: Wells Fargo Securities, LLC, and Intex Solutions, Inc.

Meanwhile values continue to move toward what we choose to call historic means.

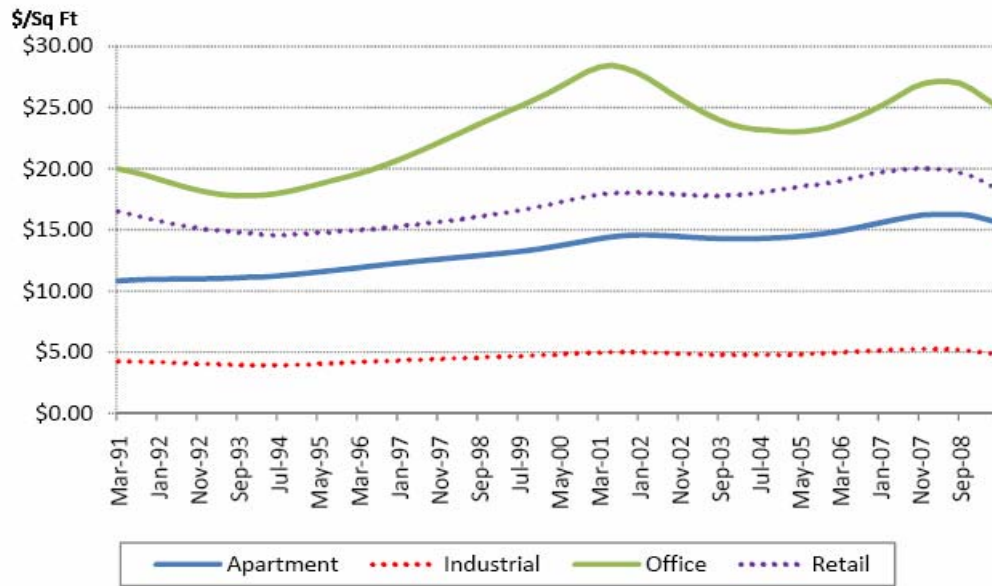
U.S. Cap Rate Trends (12-month rolling averages)



Source: Wells Fargo Securities, LLC, NREI and Real Capital Analytics.

Office is showing pricing weakness while industrial seems to be holding the line perhaps the weak dollar is helping manufacturers sell goods overseas.

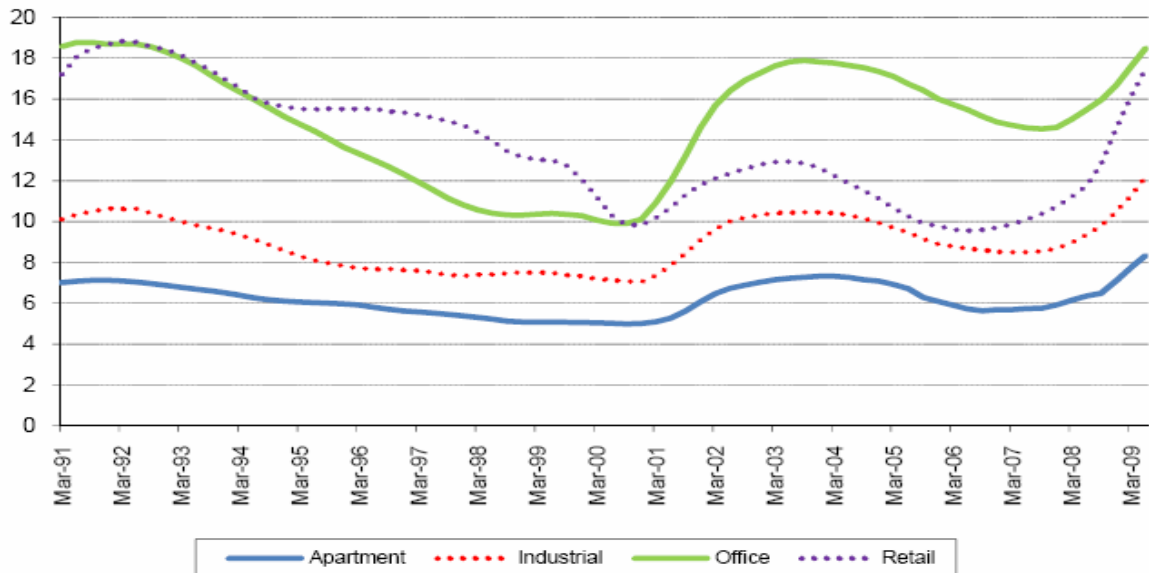
Average Rents



As one might expect, the vacancies impact rent across all property types.

Average Vacancy Rates

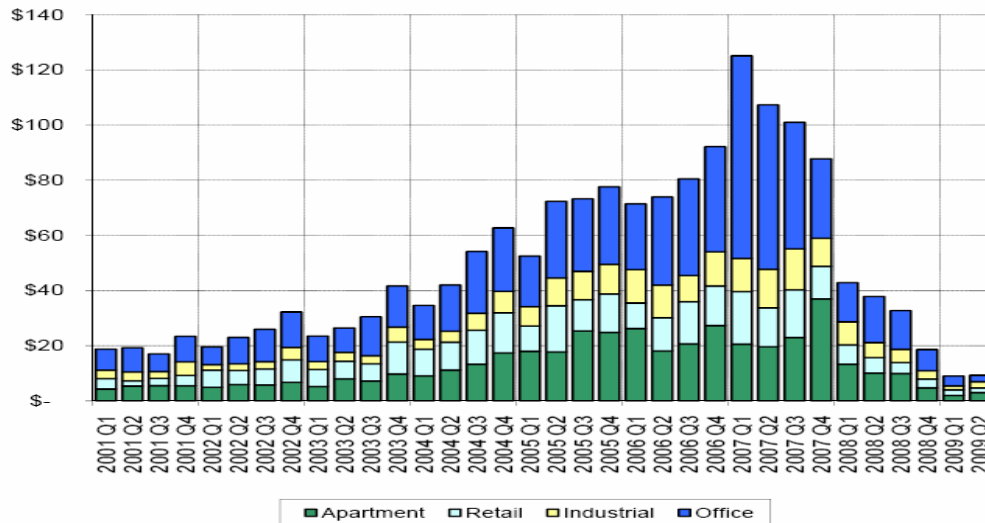
percent



Source: Property and Portfolio Research

**Transaction volume remains anemic as buyers and sellers remain disconnected but 2010 should bring an increase as market pressures force the hand of owners.**

Billions of dollars, Properties and portfolios \$5 million and greater

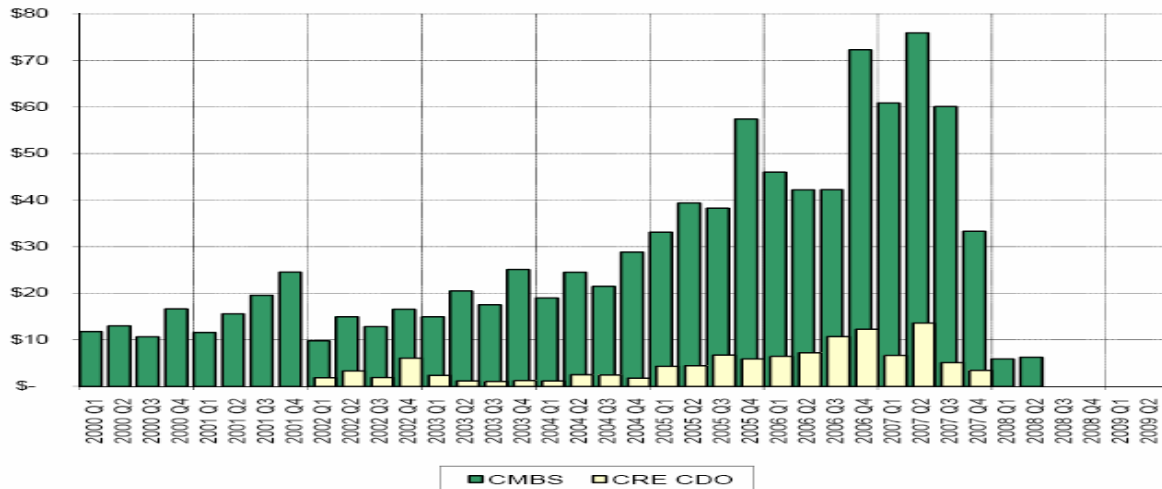


Source: Real Capital Analytics.

Meanwhile securitization has been non-existent, but hope springs eternal with Goldman’s offering coming to market. Of course, this offering would be impossible without government TALF funds. In order to return to a vibrant CMBS market, the system must be re-vamped to include risk where the profits are being made, sufficient compensation and time for rating agencies too bring discipline to the process and improvement in delineation of responsibilities and compensation in servicing.

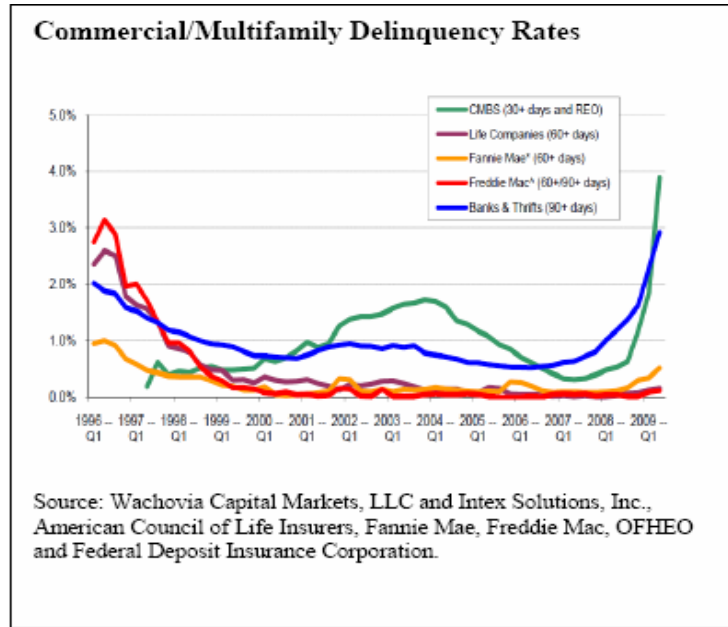
**QUARTERLY ISSUANCE OF COMMERCIAL MORTGAGE BACKED SECURITIES (CMBS) and COMMERCIAL REAL ESTATE COLLATERALIZED DEBT OBLIGATIONS (CDOs)**

Billions of Dollars



Source: Commercial Real Estate Direct

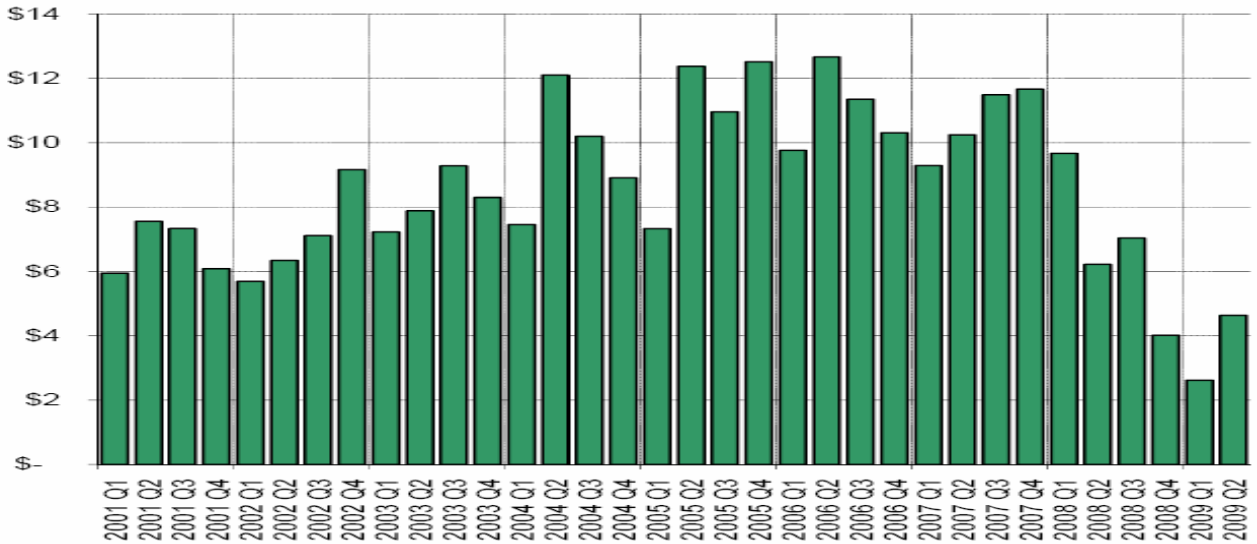
The life insurance industry continues to outperform all other lender classes when it comes to defaults.



Perhaps this explains why life insurance company lending has begun to increase although well below historic norms and with strict underwriting. Another factor improving the life insurance lending environment is significant narrowing of spreads in the bond market which has enhanced the attraction to mortgages.

**QUARTERLY COMMERCIAL MORTGAGE COMMITMENTS BY LIFE INSURANCE COMPANIES**

Billions of Dollars



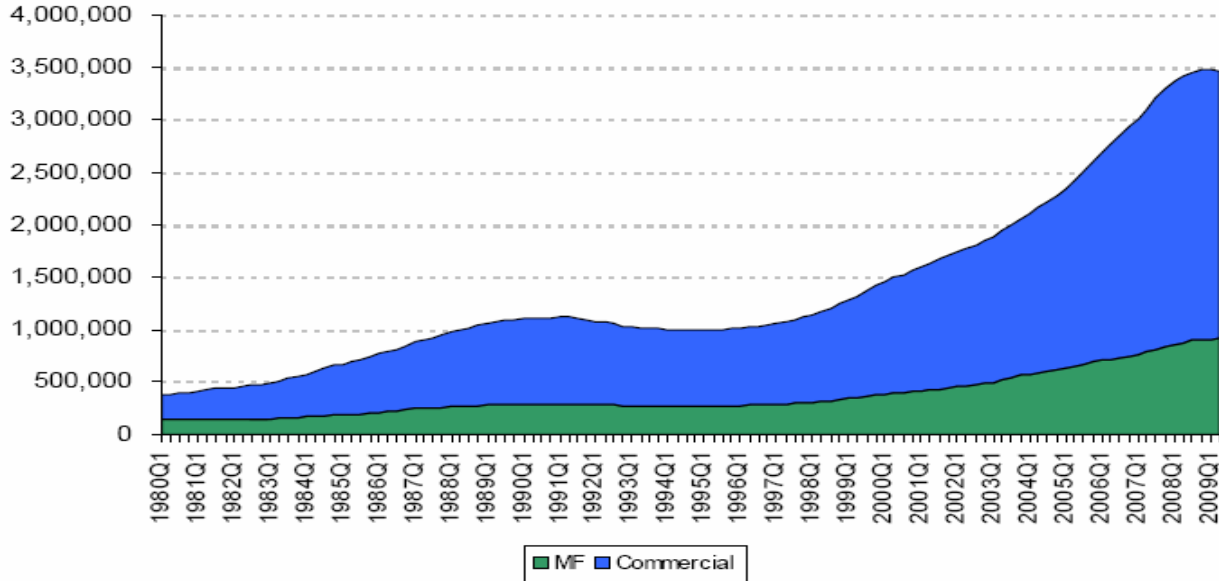
Source: American Council of Life Insurance Companies (ACLI).  
 a. Annual figures may not equal the sum of quarterly figures due to change in reporting.

**Total Debt Outstanding is still at record levels!**

**COMMERCIAL AND MULTIFAMILY MORTGAGE DEBT OUTSTANDING**

Total Commercial and Multifamily Mortgage Debt Outstanding, by Quarter

(\$millions)



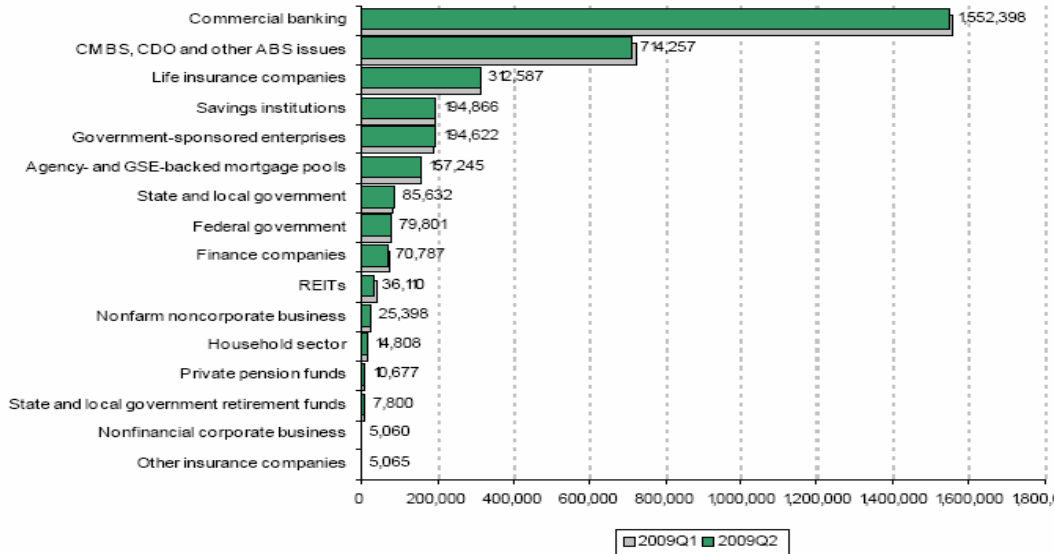
Source: Flow of Funds Accounts, Federal Reserve Board of Governors

**The bulk of which is still held by commercial banks.**

**COMMERCIAL AND MULTIFAMILY MORTGAGE DEBT OUTSTANDING**

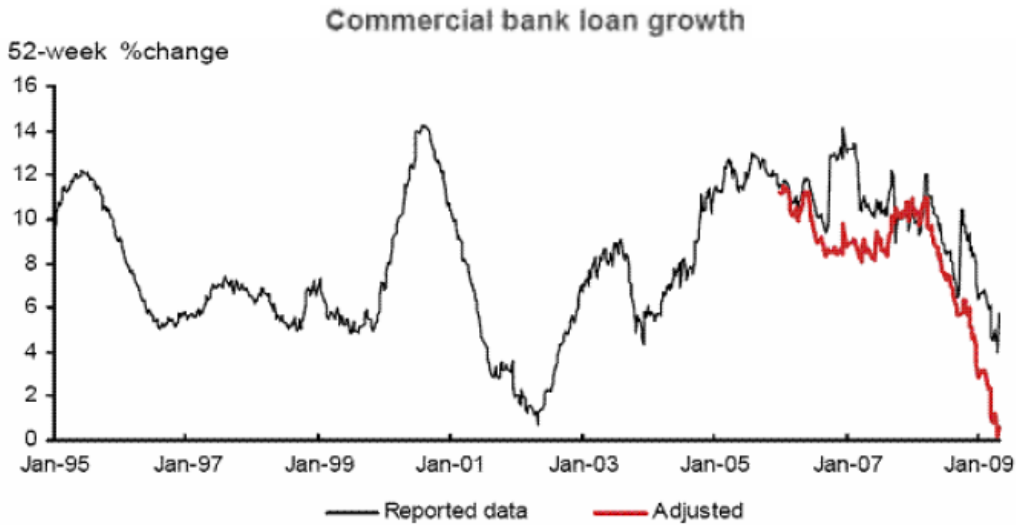
Total Commercial and Multifamily Mortgage Debt Outstanding, by Sector

(\$millions)



Source: Flow of Funds Accounts, Federal Reserve Board of Governors

In spite of government bail out funds flowing into banks, they are not lending on anything instead they are using the funds to shore up their equity and investing in treasuries. What if you could borrow money at 0% interest invest it at 2% in U. S. treasuries? What would you do?

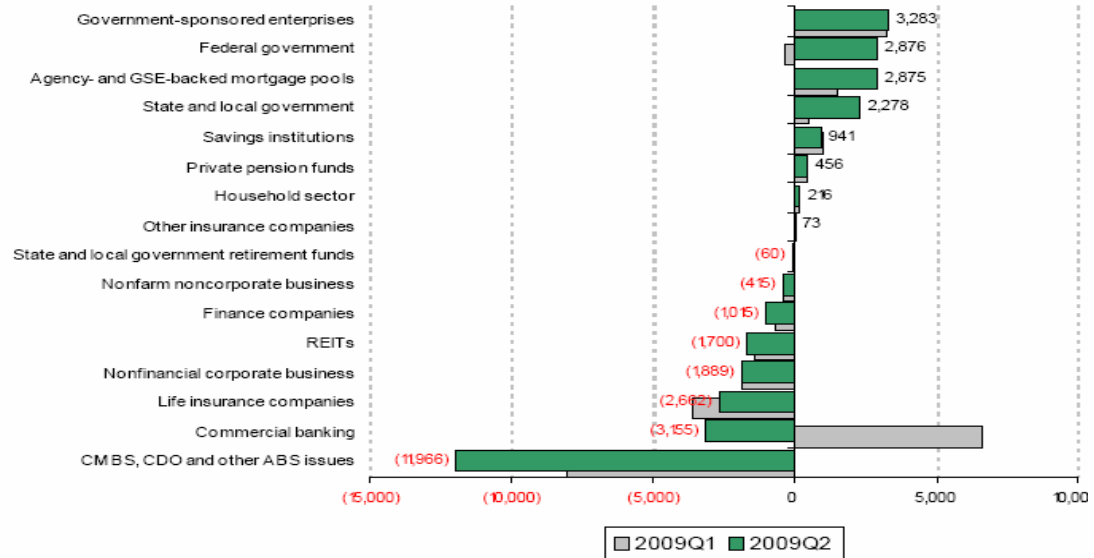


Source: [Global Weekly Economic Monitor](#), courtesy of [Nomura Research](#).

The GSEs continue to lose taxpayer money and loan money at interest rates well below the private sector market.

### COMMERCIAL AND MULTIFAMILY MORTGAGE FLOWS

Net Change in Commercial and Multifamily Mortgage Debt Outstanding, by Sector (\$Millions)



Source: Flow of Funds Accounts, Federal Reserve Board of Governors

Here at Q10 New England Realty Resources we don't need to look for your lender, we have you lender. Year to date Q10 has closed \$1,247,000,000 in 222 deals nationwide. If you are in need of financing for your commercial real estate, call your Q10 New England Realty Resources loan office for a quote.