



2009 Market Update & Forecast

2008, an End of an Era: A Year to Remember and Forget A Quick Trip down Memory (Nightmare) Lane before We Look Ahead

March 2008: Bear Stearns fails (many thought this was the end, but as we know it was the beginning)

September 2008:

- Fannie Mae & Freddie Mac are taken over by U.S. government
- Lehman Brothers fails
- Merrill Lynch agrees to be sold to Bank of America
- U.S. government seizes control of AIG
- Morgan Stanley agreed to be converted into bank holding company
- Goldman Sachs agreed to be converted into bank holding company

October 2008: U.S. government approves \$700 billion TARP plan

November 2008: U.S. government rescues CitiGroup:

- Guarantees \$300 billion for troubled assets
- Injects \$20 billion of capital into the company

December 2008:

- Bernie Madoff arrested in a \$50 billion Ponzi scheme

It was not pretty, but it was historic and it has changed our business for the foreseeable future.

The painful reality of the greatest evaporation of wealth and liquidity of a generation is now sinking in.

Home Prices: Values have fallen 15%-50%, wiping out home owner's equity.

Stock Market: Equity investments are down 30-40%. (market portfolios, 401k's, 529 plans).

Unemployment: All sectors are laying off workers, causing a sudden surge in unemployment.

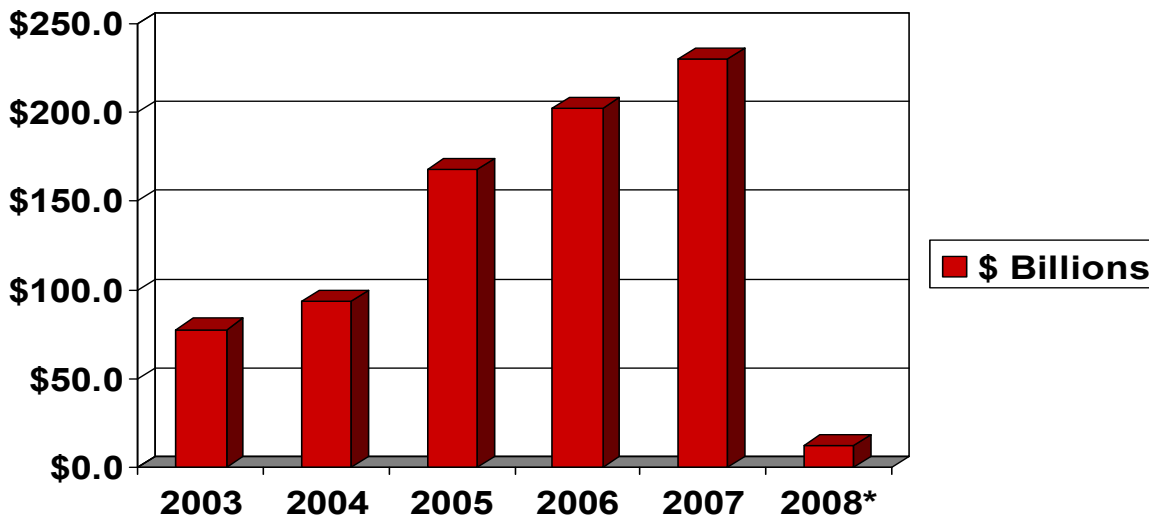
Zombie Banks: Banks are laden with underperforming assets, and TARP has only given them hope of survival. Banks have no incentive to write down loans to clear the market, as they would be announcing that they are insolvent (stay tuned for the federal government's next big idea to fix the banks).

Securitization: The largest, most reliable and accessible real estate liquidity provider, CMBS, has evaporated right before our eyes.

The Elephant in the Room

The sudden evaporation of the securitization market is the biggest story not being reported in the mainstream press. The CMBS market is GONE! The repercussions of this are still hard to comprehend. Our entire industry relied on the assumption that there was a reliable and predictable permanent loan market at 80% of value and at 1.25x debt service coverage. Billions of dollars of loans were made on that assumption. Now it's gone.

CMBS Origination by Volume



(YTD as of Sept-08)

Source: Commercial Mortgage Alert

Maturity Defaults

The effects of the securitization market evaporation will be the number one cause of the pending maturity defaults. Virtually every loan coming due cannot be refinanced at its current loan balance. Banks are using the “amend, extend and hope” strategy. The continuing story for 2009 will be how the master servicers and special servicers will handle the massive amount of maturity defaults.

Payment Defaults

Prior to the 4th quarter of 2008, commercial real estate problems were thought to be a paper problem, not an asset problem. The recession has changed that. Layoffs, lack of consumer spending, and limited business activity are now affecting real estate cash flows. The economy is now taking its toll on all property types and we all expect to see increasing vacancy, decreasing rents, and a drop in NOI. This will cause a spike in payment defaults, especially on highly leveraged properties and new construction projects.

Future Real Estate Values: A One-Two Punch that is Driving Down Values

1. **Capital structure changes:** Equity requirements have gone from 10% of total costs to 40% of total costs. This structural change alone will account for a significant decline in value.
2. **Cash flow (NOI) decreases:** Commercial real estate values depend on cash flows. Declining NOI's will be the “second blow” to commercial real estate values.

Combined, these two factors will cause commercial real estate to decline 20-40%, depending on asset class, market and location.

2009 Market Forecast

2009 will be a gut-wrenching, shake out year for the commercial real estate industry. There will be less capital, lower prices, and less transaction volume. As the year goes on, the federal government will provide clarity on how they will address the “financial crisis.” The options appear to be:

- Government “aggregator bank” that buys the bad assets from existing banks ?
 - Government holding bad assets on the federal balance sheet ?
 - Government selling bad assets to the private sector ?
- Government joint venturing bad assets with the private sector ?
- Government providing preferred equity into banks ?
- Government providing common equity into banks ?
- RTC II ?

Our industry will remain in stagnation until the federal government picks a direction, and we all know the new capital market rules.

What’s In and What’s Out

What ever choice the government makes, we can clearly say what’s in and what’s out for 2009.

In: Distressed asset acquisitions

Out: Value added development plays

In: Non-performing note acquisitions

Out: New development loans

In: Equity to recap existing projects to meet new equity requirements

Out: Cash out deals

In: High yield (hard money) bridge lending

Out: Libor plus 250

In: Workouts

Out: 90% acquisition loans.

In: Underwriting declining property performance

Out: Underwriting increasing property performance

Underwriting in a Down Market Environment

2009 Land Underwriting

- The only land that has value today is finished lots. Finished lots are being bought for 50%-75% of the cost
- Therefore, today platted lots have no value. Only long term, very patient investors can invest in platted land.

2009 Condominium Underwriting

- Condos should be valued at their apartment value

- **A quick valuation method:**

Apartment rent per foot x square foot of space =

Vacancy: Subtract greater of 10% or market vacancy

Expenses: Use a 40% expense ratio

Cap rate: Use 8-9%

Total revenues

(Less vacancy)

(40% of revenues)

NOI

8.5%

Value of condo

Income Properties

Commercial asset investing over the next two years will be driven by two basic metrics:

1. **Investor basis in the asset**: This is typically measured in per square feet, per unit, per door. Investors will seek to have their cost basis below replacement cost. A low basis will allow the investor the ability to lower rents and still be able to achieve an acceptable return on equity.
2. **Cap rate to investment basis**: This is the same as the cap rate if the investor is buying an asset fee simple with pari pasu equity. This metric is higher (better/safer/more yield) if the investor is entering the deal as preferred equity or as participating debt.

Investors will calculate this metric on an unleveraged basis, and on forward looking, downward trending, “market” assumptions such as lower occupancy and lower rents. Investors will be looking for unleveraged yields of 10-12%, depending on the asset class and the market. This will be achieved via:

- Distressed/opportunistic purchase price
- Subordinate seller financing
- Investors entering a deal either as preferred equity or participating debt

As the commercial market continues to evolve, the above two metrics will be the key to the “go / no go” question.

JCR Capital & You in 2009

JCR Capital is open for business and is currently providing capital for the following transaction types:

Debt Transactions

- **Security**: First Trust
- **Investment Profile**: Commercial properties
- **Rate**: Starting at 13%
- **Fees**: 1-3%
- **Term**: 1-2 years
- **Investment Strategy**: Short term bridge loans with defined exit strategies on income producing assets

Equity/Distressed Transactions

- **Security**: Joint Venture Equity, Preferred Equity or Participating Debt
- **Investment Profile**: Commercial properties, land, condominiums, special situations
- **Return Requirements**: 18-25% IRR, 1.75x minimum profit multiple
- **Term**: 1-3 years
- **Investment Strategy**: Non-performing note purchases, project recapitalizations, opportunistic acquisitions, special situations

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