real estate finance & investment

The newsweekly of the commercial property and capital markets

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A PUBLICATION OF INSTITUTIONAL INVESTOR, INC.

FEBRUARY 9, 2009
VOL. XV, NO. 5

Q&A: Bill Benjamin
AREA Property Partners' Bill Benjamin discusses the state of the European and U.K. commercial real estate markets.

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Career day continues for the buildings.
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FILLMORE IN TALKS ON 1540 BROADWAY, WORLDWIDE PLAZA

Fillmore Capital Partners, a mezzanine debt holder in 1540 Broadway and Worldwide Plaza in New York, is reportedly in talks to buy the two properties from **Deutsche Bank**. **George Comfort & Sons** may participate in the deal and the bank, which took back the keys from **Macklowe Properties** last spring, plans to offer seller financing. The sale may close this week.

Deutsche Bank had been close to arranging a sale of 1540 Broadway to **CB Richard Ellis Investors** (REFI, 1/12). Officials at CBRE Investors and Deutsche Bank declined to

(continued on page 11)

DUCA LEAVES MOODY'S

Jim Duca, head of commercial mortgage-backed securities ratings at **Moody's**, has left the agency. **Nick Levidy**, head of commercial real estate collateralized debt obligations ratings, and **Michael Gerdes**, senior v.p., will assume Duca's responsibilities. Separately, Moody is planning a review of its CMBS ratings methodology that could cause downgrades (see related story, page 2).

According to more than one report, Duca's departure was related to overall staff reductions in the CMBS group. His position was cut in a move to slim down the company's

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FDIC TO REQUEST BIDS FROM ONLINE LOAN AUCTIONEERS

The **Federal Deposit Insurance Corporation** is planning to request bids from online auction providers as part of its plans to sell off its largest inventory of assets from bad banks since the early 1990s. As of the end of January, FDIC had $14.7 billion of assets in liquidation, including $2.8 billion of commercial real estate assets, including loans, foreclosed properties and securities. That's up from $900 million at the end of 2007. "Now that the inventory has picked up and more assets are coming in, it just gives us more opportunities to sell assets and choose which of the companies we want to use," said **David Barr**, spokesman. The RFPs have not yet been issued.

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MURRAY HILL SEEKS EQUITY INVESTOR FOR 485 LEXINGTON

Murray Hill Properties, which has made an unsolicited offer to buy 485 Lexington Avenue from **SL Green Realty Trust**, is seeking a partner to put up $40 million. **The Carlton Group** is handling the assignment.

Murray Hill made an unsolicited offer of approximately $600 per square foot for the 926,000-square-foot property and now has a refundable soft contract. At this level, the building would be valued at around $550 million.

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Check www.iirealestate.com during the week for breaking news and updates.

Realpoint Launches CMBX Analysis

Realpoint has rolled out Realpoint for CMBX, a new service through which it offers analysis of each of the five iterations of CMBX, the synthetic commercial mortgage-backed securities index. **Joe Petro**, managing director, said that the monthly report analyzes all of the deals and underlying loans that make up each index. "We are basing most of the research on loss numbers at a loan-level, looking at high risk loans and and specially serviced loans and rolling it up to determine the impact on the performance of the index," he said.

The Horsham, Pa.-based rating agency is responding to requests from clients, who had been gleaning most of their research on the index from Wall Street. The agency expects that its clients will use this information to understand potential credit risks when evaluating a position on the index.

One of the primary drivers behind the loss analysis is a quantitative method of identifying high risk loans. Realpoint's model assigns a probability of default and a risk score to all the loans in the index. The probability of default is then used to determine the Realpoint projected loss. "Once we have data on losses, we look at the indices and how they are performing relative to each other." Petro said. "We are using both a qualitative and a quantitative methodology."

So far, Realpoint has found the highest level of projected losses in CMBX.3 and CMBX.2, but expects CMBX. 4 and CMBX.5 to surpass these with even higher projected losses in the future. "We are seeing a higher delinquency rate at earlier seasoning points," Petro said. CMBX.6 has been postponed indefinitely.

Moody's Reviewing CMBS Methodology

Moody's Investors Service is reviewing its rating methodology for commercial mortgage-backed securities issued after 2006 and is warning that it could downgrade some AAA-rated bonds. The review, launched in response to falling property values and rising delinquency rates, should be completed by the end of the quarter, according to a report penned by **Nick Levidy**, managing director, and **Michael Gerdes**, senior v.p. Neither returned calls by press time.

The agency is looking at conduit and fusion from the last three years and all large loan and single-borrower deals. In the report, Levidy stated that the conduit and fusion deals were rated assuming that losses wouldn't exceed 2% of the pool. Moody's now expects losses to hit 5%. As part of its review, the agency will increase stressed cap rates in its model by 50 basis points.

Downgrades could affect senior investment-grade bonds, including the AAA-rated AJ class, as well as on speculative and lower-rated grade bonds. Senior investment grade bonds will likely be downgraded four to five notches while lower rated bonds will likely see downgrades of five to six notches. This could result in an AAA-rated AJ bond downgraded to a A1/A+ rating and a B2/B –rated bond lowered to a Ca/CC rating. Super senior and mezzanine AAA-rated bonds are expected to maintain their ratings.

REFI TV

REFI sits down with **Anthony Westreich**, president and ceo of New York-based **Monday Properties**, to discuss the opportunities and challenges associated with being an owner and operator in today's market. To view, click on the REFI TV logo on our website at www.iirealestate.com.

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Real Estate Finance & Investment *is a general circulation newsweekly. No statement in this issue is to be construed as a recommendation to buy or sell securities or to provide investment advice.*

Real Estate Finance & Investment
©2009 Institutional Investor, Inc.

ISSN# 726-98670

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Capital Markets

FDIC Portfolio Goes Up For Sale

Oklahoma City-based **First Financial Network** is offering $420 million of commercial real estate loans on behalf of the **Federal Deposit Insurance Corporation**. The loans are being offered as part of two larger portfolios. Most of the loans were originated by failed Nevada-based **Silver State Bank**.

The loans, some non-performing, were made on properties in Arizona, Nevada, Texas, Florida and Arkansas. The loans will be divided into pools based on originator, performance and location. Bids are due March 3rd on a $485 million portfolio and March 10th for a $120 million portfolio.

The smaller portfolio is comprised of loans from the **Small Business Administration** and had collateral contributed from failed **First National Bank of Nevada, First Heritage Bank NA** and **Arkansas National Bank**.

B-Notes Gain Formal Real Estate Status

The **Securities and Exchange Commission** has issued a no-action letter to **Capital Trust** that affirms that b-notes qualify as interests in real estate, not securities. B-notes are the subordinate portions of senior mortgages.

The Investment Company Act of 1940 requires companies investing in securities to be subject to regulations over their operations. **Michael Zuppone**, a partner at **Paul Hastings**, said there was language in the law that addressed second mortgages, the form of subordinate debt that existed at its enactment. "We did not have structured finance in 1940 but we did have second mortgages. There was an exemption for interests in mortgages and real estate," he said. The firm worked on behalf of Capital Trust.

It took about a year and a half to obtain this no-action letter, with the broader market turmoil raising additional issues from a policy perspective with the SEC. "The SEC was struggling with whether the b-note was truly an interest in real estate or a security issued by the A-note holder," Zuppone said. "We argued that the returns on the B-note are derived from the borrower's payments on the underlying loans."

Prior to the no-action letter, firms treated b-notes as real estate interests without direct SEC guidance. About two years ago, the SEC ruled that mezzanine loans could be considered interests in real estate. Following that, Capital Trust asked for formal clarification on the status of b-notes. Zuppone described this no-action letter as the second leg in a three-legged stool. "We continue to talk with the SEC on the subject of b-pieces," he said.

More Loans Staying Delinquent: Fitch

A new report from **Fitch Ratings** has found that more than 80% of all loans that were 30 days delinquent in the fourth quarter were also delinquent at their next scheduled payment date. The agency found that this was more than double what was seen in the first three quarters of 2008 and attributes this in part to weakening fundamentals. "In the current economic recession, borrowers are less inclined to come out of pocket for a property not covering debt service if the perceived value of the equity in the property has declined substantially," said **Eric Rothfeld**, managing director.

Carlton Launches Loan Origination Platform

New York-based **Carlton Group** has launched **CSV Mortgage Capital**, a loan origination platform. The company will underwrite first mortgages with interest rates starting at 11%, targeting borrowers of transitional properties and owners that want to replace debt that has been repurchased at a discount from lenders, said **Howard Michaels**, chairman and ceo.

Loans will be made on an up to 65% loan-to-value ratio on a three-year term, with a one-year extension option. After origination, CSV will aim to sell the A-note to senior lenders while retaining the B-note.

Loan Venture Eyes Bank Balance Sheets

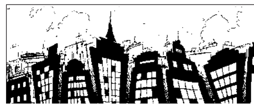
AZ-Garnet Loan Sale Advisors, a venture between **Garnet Capital** and **Ackman-Ziff Real Estate Group** has formed a venture that will work with banks to sell the loans that are stockpiled on their balance sheets. **Sean McVity**, managing director of Harrison, N.Y.-based Garnet, said he expects to see more commercial real estate developers and operators buying debt.

Operators and developers are responding to an increase in foreclosures and dropping valuations and see room to take control of properties. "We have owners and operators who want to continue to expand," said **Gerald Cohen**, chief operating officer at Ackman-Ziff. "People are looking for opportunities to get into the game."

The venture will sell loans on behalf of banks, financial institutions, governmental organizations, insurance companies,

funds and special servicers. Non-performing loans will make up roughly 30% to 40% of sales, McVity predicted.

Garnet was mostly inactive in the commercial real estate loan market last year due to wide bid/ask gaps between buyers and sellers. McVity believes the gap will narrow this year, pushed forward by sales from the **Federal Deposit Insurance Corporation**, increased regulatory pressure on banks and more realistic seller expectations.



Property Markets

JCR Capital Launches Debt, Distressed Property Funds

JCR Capital is starting up two funds that will invest in bridge loans and distressed properties, respectively. **Jay Rollins**, principal, said he launched the strategies in response to an observation that some investors wanted current low-risk returns while others are more bullish. "[Some investors are saying] 'This is the opportunity of a generation and I want to double my money,'" he said of the latter group. The firm does not have a set amount that it is raising for the fund.

JCR Capital Debt Fund 1 will originate short-term bridge loans. "The opportunity is to do short-term bridge loans on opportunistic deals for a 15% or 16% yield, pay the investors 12% and take the difference for us," Rollins said. The fund will buy loans of $1 million to $10 million. *JCR Capital Equity Fund 1* will seek higher returns buying distressed properties and making equity investments. It will also buy non-performing loans and performing assets that are overleveraged or jeopardized by the changing underwriting standards.

Geographically, the funds will seek acquisitions in all parts of the country apart from the Northeast. "Because we're in the West, we have a bias toward the Western U.S. But we wouldn't discount other markets we know—Florida, Texas and the mid-Atlantic," Rollins said. Rollins recently sold a 40% stake in his firm to **JAM Equity Partners**, a unit of Nashville-based private equity firm **Jacobs Asset Management**.

Opportunities today remind Rollins of the situation in 1992, when he formed **Eastern Realty Corporation** to acquire distressed assets and notes from thrifts and the **Resolution Trust Corporation**. "I've been to this movie before and it worked out pretty good the last time," he said. "This is a little trickier than 1992 because then it was just supply and demand. Here you've got to be thinking about how does the next guy buy it? Who has the cash? What's the NOI really worth?"

Rollins believes that private equity firms will play a much greater role in the market. "When the dust settles, who's going to be lending, who's going to be the capital buyers? Numerous private capital providers like us who are going to have a big stake in the marketplace," he said. "Wall Street's gone, it's a total game changer. There will be numerous private capital providers like us who are going to have a big stake in the marketplace."

Retail Landlords Offering Tenant Concessions

Some retail landlords are starting to take the tack that it's better to reduce rents and keep tenants than to re-lease empty space. There are a few landlords who are offering rent reductions or are opting to collect a percentage of a tenant's sales revenue in lieu of rent. The concessions have become common, even when landlords aren't fighting an exodus of tenants, said **Deborah Jackson**, executive managing director at **Weiser Realty Advisors**.

In the past year at least 18 retailers have filed for bankruptcy, including **Value City**, **KB Toys**, **Mattress Discounters** and **Buffets, Inc**. Some have closed all their stores, according to **Realpoint**, a Horsham, Pa.-based rating agency. This is on top of more than 1,500 store closures announced by struggling retailers.

Faith Hope Consolo, chairman of the retail group at **Prudential Douglas Elliman**, is seeing landlords offer up to a year of free rent on 10-15 year leases. Landlords are also willing to freeze rental rates for the first two to three years. These concessions are coming against the backdrop of lower rental rates, she added. Asking rents on one retail property in New York's Midtown East recently dropped 10% to roughly $270 per square foot. The area has a number of older leases coming due, she added.

Another potential issue for landlords is the use of "kick-out clauses," which allow smaller tenants to break leases in the event of a big-box vacancy. This kind of movement could prove disastrous for smaller properties in secondary and tertiary markets. "It will be a nail in the coffin for those projects that have had problems," Jackson said.

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Europe

Benson Elliot Closes Pan-European Distressed Real Estate Fund

London-based private equity house **Benson Elliot Capital Management** has closed Benson Elliot Real Estate Partners III, a pan-European distressed real estate fund. The fund had a target size of €500 million at its 2008:Q3 launch, and has managed to raise around €510 million, officials at the firm said.

As heavily leveraged property investors come under increased pressure to liquidate their positions, property debt matures, and new debt remains scarce, a steady flow of distressed investment opportunities are likely to emerge, said **Marc Mogull**, managing partner at the firm.

"During the second half of 2008 virtually no private equity real estate funds were launched, due to the paralysis in the real estate sector and wider financial markets," he said. "The next few years will offer a once in a generation opportunity for savvy investors to buy great assets, in major markets like the U.K. and Germany, on sensible terms."

With the closing of BEREP III, Benson Elliot has access to over €600 million of discretionary equity, and buying power of up to €2 billion. The fund's investor base comprises mostly institutional investors from Europe, North America and Asia, such as pension funds, endowments and family offices.

Q & A

Bill Benjamin

Europe and Asia Chief Executive Officer, **AREA Property Partners**

Could you give me a quick background on AREA's investments in the U.K. and Europe?

We've been investing here since 1995. In that time, we have done more than 100 transactions in 15 countries and we have probably invested about $1.8 billion.

What is your take on the current market?

The current market is challenging, with a lack of visibility. Values have dropped and liquidity has decreased. That being said, there are opportunities.

How do you think this downturn compares to previous downturns?

In August, I thought that the downturn would be less severe because things were overvalued, not oversupplied. With the current scenario gripping the global banking sector and securitization market, I think that unfortunately, this could be worse than the last downturn.

Are there any particular sectors or countries that are seeing a greater impact than others?

The homebuilding sector is seeing a greater impact. Hospitality has been affected because it is dependent on discretionary spending.

The U.K. is a transparent and well-followed market and has reacted very quickly. That said, the U.K., Spain and Ireland have been affected. France, Germany, Poland and the Czech Republic have been hit less hard. There is a lack of liquidity in emerging European markets, such as Ukraine and Russia.

I believe that the Western European countries will come back more quickly than the Eastern European countries.

How is AREA financing its acquisitions? On an all-cash basis and then getting financing? How available is financing?

Financing is available on deals of less than $200 million at a 65% loan-to-value ratio. Banks are very selective. They want quality properties with good tenants and amortization.

AREA expanded its debt acquisition and origination activities last year. How is that playing out?

We are watching the market closely. We made two CMBS acquisitions but we are being very selective. There are lots of opportunities but we are not rushing in. So far, our activity has been focused on buying debt. We believe that it is too early to originate.

In the U.S. market, the complexity of debt structures is leading to rising fears of "tranche warfare"—essentially infighting between different classes of the capital stack. Is this as much of a concern in the U.K. and Europe?

Tranche warfare is going to be an issue in the U.K. and Europe. But securitization began earlier in the U.S. and was bigger in absolute terms, if you look at the total lending market.

What are the positives and negatives that you see in the current market?

These painful chapters of value destruction do pave the way for recoveries and periods of outperformance. I think everyone believes that in their heads but not yet in their hearts. Once the capital markets start to function again, then we will begin to see value.

Real Estate News Roundup

The Real Estate News Roundup is a summary of publicly reported real estate news briefs. The information has been obtained from sources believed to be reliable, but REFI *does not guarantee its completeness or accuracy.*

Mizuho Securitization Head Recalled To Tokyo

The head of securitization in the Americas at **Mizuho Corporate Bank** is leaving to head a commercial real estate finance group in Tokyo after eight years in New York. **Hiroyuki Kasama**, senior v.p., will be leading a team focused on financing the commercial real estate market, both in Japan and internationally. He is being replaced internally by **Shinichi Nochiide**, also a senior v.p. at the bank. Nochiide's prior role could not immediately be determined. **Patrick Phalon**, spokesman, characterized Kasama's departure as simply a move to take on a new role.

Kasama first moved to New York in 2001 to head the securitization group, which was then a sub-group within the strategic finance division. The group was later broken out into a separate division, which currently has 11 professionals.

Equitable Execs Form Advisory Firm

Three former **Equitable Real Estate Investment Management** executives have formed **TRECAP Partners**. The firm, a venture with **Transwestern**, aims to provide investment advisory services to high-net-worth and institutional investors. Founders **Doug Tibbetts**, **Gary Sligar** and **Paul Klick** each have more than 30 years of experience in the commercial real estate industry. "Today's financial and real estate crisis, while disturbing, is not uncharted territory," Tibbets said. He added that the firm will work with Transwestern to have a better national reach for its clients.

Starbucks To Close 300 Underperforming Stores

Starbucks is planning to close 300 under-performing stores in the U.S. and international markets. According to data from Horsham, Pa.-based rating agency **Realpoint**, about 200 of those stores are in the U.S. The coffee chain closed 600 stores last year. Although Starbucks did not disclose the stores to be closed, Realpoint found 303 locations where Starbucks is one of the largest tenants. This translates into 303 loans across 177 CMBS deals. "The effect to any single deal will be small in our view because Starbucks occupies a small portion of the gross leasable area in most cases," said **Frank Innaurato**, managing director.

DJM Realty Tapped For Circuit City Disposition

DJM Realty has been selected to oversee the disposition of all remaining **Circuit City Stores**. The firm will market leases on retail spaces as well as distribution centers and office spaces. It will also market fee-owned properties for sale. The retailer filed for bankruptcy last year. Andy Graiser, co-president, said that the buildings have a number of other uses, including other retailers, supermarkets and non-retail uses, such as schools.

E&Y Names Non-Performing Loan Chief

Ernst & Young has named **Christopher Seyfarth** to lead its non-performing loan services and transaction real estate services group in the Pacific Northwest. As part of the job, Seyfarth recently moved from Boston to San Francisco. Seyfarth, a partner at E&Y since 1991, has been focused on the distressed debt markets in countries such as China, Taiwan, Japan and Korea as well as European markets.

California Loan Delinquencies Rising

Commercial real estate loans in California saw delinquencies rise from 0.08% to 0.15% from the third to the fourth quarter. This is triple the rate seen a year ago, according to data from the **California Mortgage Bankers Association**. The firm is finding that the multifamily sector is seeing the greatest effect, with a delinquency rate of 0.23%. On the flip side, the industrial sector was seeing a much smaller impact.

Carlton Selected For Asian Equity Raise

Carlton Advisory Services has been hired by **East Pacific Capital Private Limited** to raise $25 million of equity capital that will be used for the development of limited service hotels in Southeast Asia. The capital will be used on a non-discretionary basis to build hotels under the TuneHotels.com brand. The venture's aim is to achieve returns of more than 25%. Carlton is arranging the financing on behalf of a Singapore-based investment company that includes the co-founder, former ceo and the third-largest shareholder of Tune Hotels.

Behringer Harvard Launches Advisory Platform

Behringer Harvard has launched **Behringer Harvard Investment Management**, an advisory business that aims to work with owners, lenders, government institutions and service companies. The company, which will be based in Dallas, will focus on strategies to enhance value for these clients and will emphasize customization, said **Robert Behringer**, chairman and ceo. "The goal is to work with a select group of clients on projects that are managed by skilled dedicated teams and supported by the entire Behringer Harvard organization," he added.

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Strategies

May Realty Plans Expansion

Los Angeles-based **May Realty Advisors** wants to double its activity over the next 18 months by increasing its client base. The advisory and brokerage firm has geared up several business ventures that include working with distressed retailers to scale down the size of their space and forming a value-added division to help clients cut costs and reduce taxes, said **Matthew May**, president.

In its work with distressed retailers, the company will look to international retailers moving into the U.S. "Landlords need to reach farther and broader to find tenants that are expanding. This allows us to provide a better service," May added.

The company has focused primarily on the urban retail sector in the five counties of Southern California and also works with 40 affiliates throughout the U.S. May believes that Class A properties will always be a magnet.

To help it compete, May Realty has changed the way in which it markets properties to potential buyers. This includes expanding its Web site to include videos. "Say you go to a small local restaurant. You go there because you know it's a part of the community," he said.

Apartment Specialist Chases Upended Deals

The Connor Group, a Dayton, Ohio-based garden apartment owner and operator, is finding bargains in scrapped acquisitions. The company recently bought Northlake, a 357-unit apartment complex in suburban Atlanta, for $42 million after a real estate investment trust walked away from a contract to buy the property for $54 million.

These opportunities are cropping up given the turmoil in the market, said **Larry Connor**, ceo. "We historically have never been able to buy new or almost brand new properties," Connor said. "They've been generally acquired by institutional owners that were willing to take a 5% return on capital. Our return on equity threshold is significantly higher than that."

The acquisition boosted the company's holdings to 14,000 units in Atlanta, Raleigh-Durham, Dallas, Fort Worth and three Ohio cities—Columbus, Cincinnati and Dayton. With Northlake, Connor plans to reduce the property's costs by more than 20% by improving operational efficiency. He expects it will represent an 8% cap rate within two to three years. The company also expects to close on the purchase of a 242-unit complex in midtown Atlanta for $29 million and is working on another deal in Raleigh.

The company is well-positioned to buy after tightening its underwriting standards in the summer of 2007. At the time, Connor assumed going-in cap rates would increase 100 to 200 basis points, depending on the market, and that every purchase would need to support at least an 8% loan, up from 6.75% earlier. But, as Connor said, "we did not predict the credit crisis. What we thought was going to happen was that interest rates would move significantly north. Our reasoning was wrong abut our actions were right."

To be sure, the credit crisis hasn't been a windfall. Reluctance on the part of lenders has quashed potential deals for the company. "We have a very long track record of being able to turn these properties around, thus we have some very good banking relationships," Connor said. "We're having lenders that we've done business with for many, many years suddenly change direction with no warning."

Hines Expanding Green Initiatives

Hines has put out an internal policy through which every Hines-managed property performs feasibility and cost-benefit analyses measures put forth by the **U.S. Green Building Council**'s Leadership in Energy and Environmental Design for the Operation and Maintenance of Buildings program. In cases where it fits in with the business objectives for the property, Hines will pursue certification.

The company recently created a Sustainability Task Force, said **Andy Kitchen**s, v.p. The task force was created as a way for Hines to advance its position as an early adopter of sustainability at a time when the overall commercial real estate industry is increasing turning to sustainability. "It is particularly important in these times when we are seeking ways to be even more cost conscious and competitive for our tenants and investors," Kitchens said.

The company has been focused on green buildings for decades, spurred by founder **Gerald Hines**. In addition to developing green buildings, much of what the company does with existing properties it acquires involves seeing how a building can operate more efficiently with little or no initial capital investment. This includes educating building operating and maintenance personnel, reviewing past energy bills to develop an energy profile and plan and modifying equipment scheduling, sequencing and maintenance practices. Hines also looks to calibrating and, if necessary, repair control systems. "We look first for these types of no-cost and low-cost measures out of the box. Upgrading or adding technology is generally one of the last things we do," Kitchens said.

As part of its Sustainability Task Force, Hines has created an internal group—the Hines Center for Excellence in Sustainable Real Estate—that will allow staff to access and share energy savings ideas. It is also developing a library of sustainable measures to be implemented and used by the company, creating a roundtable to source energy and sustainability initiatives from inside and outside of the company and working with sustainability consultants.

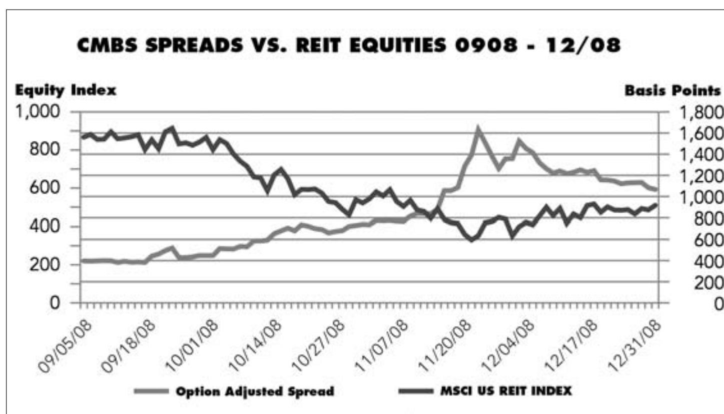
GUEST COLUMN

Public Debt Markets Could Predict REITs' Direction—Part Two of Two

By **Lowell Bolken**, **Advantus Capital Management**

Last week's guest column, the first in a two-part series, addressed the re-pricing seen in the commercial real estate sector on a historical and a current basis. In part two, the author discusses how the debt markets may provide some guidance for when a recovery could happen.

CMBS spreads moved inversely to REIT equity valuations in late 2007 and 2008. This is not surprising, as the public debt and equity markets reacted to the same information. In previous markets, what was often good for shareholders was bad for debt holders. A secondary equity offering is one example of an event that previously would be viewed negatively for share prices (dilution impact) but positively for debt holders, yet now it could be viewed as a positive event for both. As the credit market disruption intensified, there was an increase in concern over liquidity. Balance sheet liquidity became a key forward indicator for many REIT stocks as 2008 progressed, particularly those who in the past relied on CMBS or the unsecured debt markets to fund their businesses.



Although the CMBS market has recently improved (see chart above), there is still a long road ahead. Life insurance companies are suffering from the "denominator" effect in their portfolios: as other asset classes have also fallen in value, commercial real estate exposure mathematically increases. This poses a problem because of the estimated $50 billion of CMBS maturities and $250 billion of commercial mortgage maturities in 2009 alone.

Of the REIT debt maturities that are held by life companies and banks, the bulk will probably be refinanced on fairly punitive terms, or simply paid off. Foreclosure is not a welcome alternative, as it would force the lender to take over management and administration of the operations. In all likelihood, it would be less costly for the lender to continue with the current REIT as management if it is operating the property in a high quality manner. Averting foreclosure would also allow the life companies to collect refinancing fees.

It's not clear how the void will be filled for maturing CMBS and unsecured public debt. There are indications that hedge funds and other distressed funds may turn their attention from equity opportunities to commercial real estate debt. Indeed, some unsecured REIT paper is trading at markedly wider yields than preferred and common stock, despite being senior in the capital structure. That presents an obvious arbitrage opportunity that some players may find hard to resist.

The equity market, however, appears to expect life companies and banks to be substantial lenders in 2009. But we believe the likelihood is that both of these sources may reduce their exposure to commercial real estate in 2009.

We see a continued period of dislocation in both the equity and the debt markets. Up until the third quarter of 2008, commercial real estate fundamentals had not yet reflected the downturn in either the economy or the financial markets. Commercial real estate performance tends to lag the macro economy, so we would anticipate that 2009 will show weakness in occupancy and rental rate trends across all sectors. However, having already touched an intraday low (November 21, 2008) 75% below the February 7, 2007 peak, REIT equities may have priced in cap rate increases and weakening fundamentals. At the same time, the REIT market could remain in a phase of heightened volatility as it continues to test for further bottoms before recovering.

While the current cycle is similar to the 1989-1993 commercial real estate depression, unlike that period, the credit markets globally are now in historic disarray. Without question, a turnaround in the REIT equity market will depend on a return to some form of funding liquidity to rescue the debt side of the balance sheet. At that point, the math that is driving cap rates to higher levels will finally reverse.

Follow the debt

Just as the debt market disruption led the real estate markets into the downturn, it might also provide clues about a recovery. Debt maturities loom ominously in the short term, the CMBS platform as an avenue for refinancing is dormant, and life insurers and banks as secured lending alternatives have been severely weakened.

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There's been less of a focus on the public unsecured market, which is also generally comatose. Spreads for unsecured REIT bonds have widened to the point where secondary trades have essentially frozen. REIT credit default swap (synthetic securities created to mimic cash bond characteristics) spreads widened to the point where cash bonds issued at an equivalent spread would have translated into a double digit coupon rate. This is troublesome in that REITs have been accustomed to refinancing existing public unsecured debt by simply rolling over into a new issue, usually with five- to ten-year terms.

Non-REIT unsecured bonds appear to be turning the corner. Corporate bond spreads had also spiked during the debt market crisis, but have since narrowed rather significantly. It's not surprising that the most dramatic tightening has been among those issuers that have either received funding through the federal government's Troubled Asset Relief Program or FDIC guarantees.

For REITs, the unsecured market has recently loosened, and spreads for the most liquid names have begun to tighten. For example, the chart on page one shows that credit default swap spreads on **Simon Property Group** (SPG), the highest-rated of the group and the presumptive bellwether, tightened recently to below 650 basis points from a high exceeding 900 basis points (five-year term). Similar cash bonds have also started to show signs of improvement. The spread tightening is especially significant because during this timeframe, Treasury yields have also declined. Theoretically, if SPG could price a secondary issue at a 650 basis point spread over a comparable 1.50 % five-year Treasury, the resulting 8 % coupon debt may suddenly be within the range of the new pricing paradigm of the commercial real estate market. If the cap rate environment does settle into a 9 to 11 % range, we believe unsecured debt issuance becomes economically feasible again.

It is difficult to predict if and when the public debt markets will return to some sense of normalcy. It is likely that REIT equity valuations, all else being equal, would find a new level of support, if this occurs. A renewed source of funding would take pressure off the REITs to forcibly sell or otherwise encumber their assets. When debt markets begin to normalize, the initial stage of healing in the markets will have begun.

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This is not to diminish the challenges faced by REITs during the economic downturn. Valuation multiples have already reached levels not seen since 2003, and flat to negative growth could potentially cause further deterioration. Yet with every trough in past markets, the prospects for future growth provide the spark for multiples to expand. When some degree of normalcy returns to the public debt markets, it will go a long way towards providing that spark.

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Loan Auction Calendar

Date	Collateral Composition	Seller	Amount (in millions)	Advisor
February				
10th	CRE loans on properties located in the Eastern U.S. Performing and non-performing.	FDIC	$92*	DebtX
		FDIC	$70*	DebtX
19th	CRE loans on condos, land, retail, office, marina and industrial properties located . in Arizona, Florida, Nevada and Texas. Sub- and non-performing	Unnamed seller	$296	Mission Capital Advisors
24th	CRE loans on properties located in the Eastern U.S. Performing and non-performing.	FDIC	$110*	DebtX
End of month	CRE loans on properties located in the Southern U.S.	Unnamed seller	$200	Mission Capital Advisors
March				
3rd	CRE loans. Performing and non-performing.	FDIC/Silver State Bank	$485*	First Financial Network
10th	CRE loans from the Small Business Administration. Performing and non-performing.	FDIC/Silver State Bank, First National Bank Nevada, ANB Bank, First Heritage Bank	$120*	First Financial Network
21st	CRE loans on properties located in Michigan and Florida. Florida property is non-performing.	Unnamed regional bank	$50	DebtX

Sources: **www.debtx.com, www.firstfinancialnet.com, www.missioncap.com**

* Portfolio also includes non-commercial estate loans

Development Strife To Hit Securitization Mart In Middle East

The real estate securitization market in the Middle East is expected to suffer deeply over the next year as the region's once booming development sector grinds to a halt. Deteriorating credit of underlying assets could negatively impact existing deals and the infrastructure slowdown will result in fewer being issued, according to industry analysts.

"Property prices are expected to continue to decline [and] transactions relying on future sales will struggle to overcome negative global economic sentiment," said analysts with **Fitch Ratings**. High-end luxury building projects are likely to suffer more than primary residence properties, they added.

Middle Eastern securitizations made a splash just before the inception of the credit crisis with the first Shariah-compliant securitization, Tamweel Residential ABS, comprised of leases on residential properties. Even throughout the turmoil, unique transactions like Sorouh Real Estate PJSC — the first deal to be backed by future contract receivables based on an island's development — were closed. But fleeing foreign investors and a redistribution of government funding for property development now means the projects which helped to attract funding may be postponed or cancelled altogether.

Cushman & Wakefield Sonnenblick-Goldman's Commercial Mortgage Rate Spreads

Senior Mortgage Matrix February 4, 2009

3-5 YEAR FLOATING-RATE MORTGAGES [1] INDEX: ONE-MONTH LIBOR				5-10 YEAR FIXED-RATE MORTGAGES [2 3] INDEX: EQUIVALENT MATURITY TREASURIES	
<60% LTV	>60% LTV	LENDER FEE	PROPERTY TYPE	<60% LTV	>60% LTV
			Residential		
450-500	500-600	75-100 bps	Apartments	400	400-450
			Retail		
450-550	500-700	150 bps	Malls	475-550	450-650
450-600	550-750	100-150 bps	Strip and Power Centers	500-550	450-550
			Industrial		
400-500	450-600	100 bps	Multi-tenant	475-550	550-700
			Office		
400-500	600+	100 bps	CBD	450-550	500-600
450-500	600+	100 bps	Suburban	450-550	500-600
			Hotel		
500-700	800+	100-150 bps	Full-Service	550-600	600+
500-800	800+	100-150 bps	Limited-Service	500-600	650+
1-Month LIBOR	0.45%* (0.35%)		5-Year Treasury	1.74%* (1.62%)	
3-Month LIBOR	1.23%* (1.12%)		10-Year Treasury	2.94%* (2.47%)	

[1]Assumes interest only

[2]Assumes no lender fee

*Number as of February 4, 2009 — Number in parentheses is as of January 21, 2009.

Mezzanine Financing Matrix February 4, 2009

DEBT PROVIDER	RATE	TERM	LTV RANGE (%)	LENDER FEE
Hedge/Opportunity Funds	17-22%	1-5 years	>60%	1-3%
Investment Banks	18-22%	1-5 years	>60%	1-2%
Insurance Companies	12-18%	3-10 years	60-75%	1-2%
Private Sources	10-16%	Six months to 6 years	>65%	1-3%

Source: **Cushman & Wakefield Sonnenblick-Goldman, LLC**

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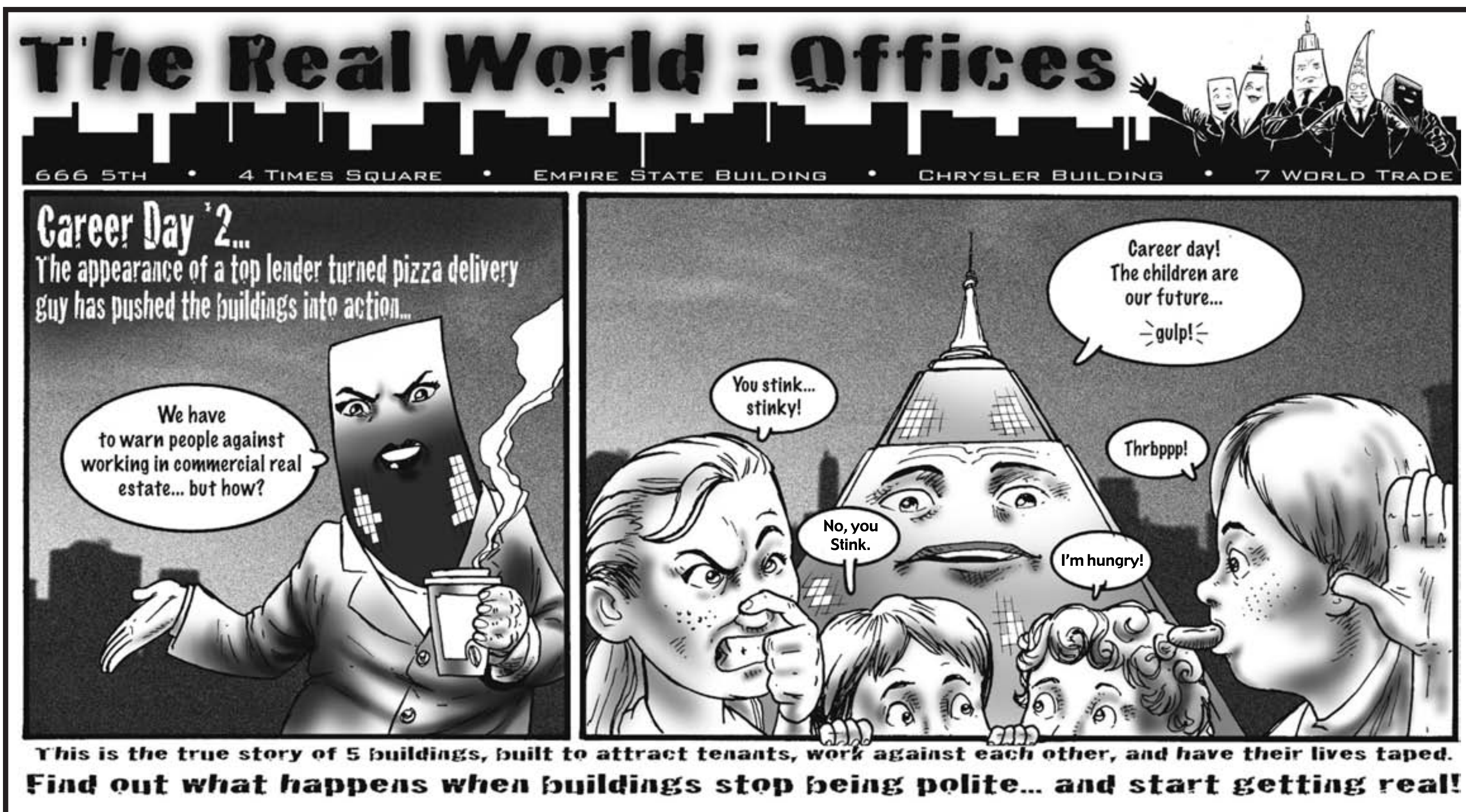

FDIC TO

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For commercial real estate, FDIC already works with **DebtX** and **First Financial Network**. Online auctions have allowed the FDIC to get loans off its balance sheet as soon as 90 to 120 days after a bank failure. "Before, if you had a bank failure in Houston, everyone would have to go to Dallas on a particular date to review the documents, remember that information the best they could and then fly back home and decide if they want to bid on it," Barr said. He added that the current levels are similar to what was seen during the S&L crisis.

Even with technology advances, some assets still prove to be a hard sell. Following a two-year stretch that ended in 2006 in which there were no U.S. bank failures, the agency had $350 million of assets in inventory. "When you get down to the real bottom of the barrel you can get to some that are very difficult to sell," Barr said. "You have environmental issues associated with them, you have title issues and some could be tied up in bankruptcy."

The agency doesn't sell acquisition, development and construction loans online because there's not enough of a market for them. "We've been taking a lot of these and placing them in a limited liability corporation," Barr said. "Then we hire a financial advisor to market those LLCs and we actually sell the LLC and retain a revenue-sharing arrangement with the buyers, almost like a securities private placement."

In addition to individual assts, the agency uses an online bidding process to sell entire banks. A program called interlinks blasts an e-mail to potential buyers, alerting them to the sale without revealing the name or exact location of the bank until the suitor expresses interest and signs confidentiality agreements. "We've had a pretty active Web presence since the early 1990s," Barr said. "Just the process of examining banks is highly automated and IT-centric." —*M.J.*

FILLMORE IN TALKS

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comment. **Wayne Maggin**, **Adam Spies** and **Doug Harmon** at Eastdil Secured, which is marketing the sale for Deutsche Bank, didn't return phone calls or e-mails.

Last year, George Comfort was named as a potential buyer of the two properties. It was reportedly one of the bidders early on for Worldwide Plaza and has a longstanding relationship with Deutsche Bank."

Completion of the deal would mark the first sale of Manhattan office towers this year. "The completion of two such high-profile transactions will finally give the market some pricing metrics, for which it has been so desperately starved in the post-**Lehman Brothers** era," said **Will Silverman**, a managing director in **Studley**'s capital transactions group.

Deutsche Bank has been trying to sell the properties since last spring after foreclosing the seven-building portfolio. Macklowe bought the buildings from **The Blackstone**

CMBS Trading Matrix FEBRUARY 4, 2009

Conduit
Newly Originated Mortgage Collateral, Balloon, Call-Protected, Multiple Borrowers, Zero Delinquencies, Par, 5 yr AAA is narrow window, 10 yr AAA is senior AAA

Rating	5-yr Fixed	10-yr Fixed	5-yr Float (uncapped)
AAA	S+1136	S+980	L+600
AA	NA	S+3945	L+675
A	NA	S+4605	L+775
BBB	NA	S+5803	L+900
BBB-	NA	S+6303	L+1000

Outstanding CMBS
One week and four week returns and excess returns for four classes of CMBS included in Banc of America Securities' CMBS index.

Rating	One Week Return	Excess Return	Four Week Return	Excess Return
AAA (10 yr)	-3.79%	-245.6	-12.55%	-1091.9
AA	-0.13%	+42.9	-1.99%	-211.8
A	+0.12%	+53.7	-0.61%	-108.8
BBB	+0.47%	+71.3	+0.37%	-52.0

U.S. Swap Spreads
Premium to swap fixed-rate CMBS to floating-rate bonds, based on three-month LIBOR

	5 year	10 year
Current Spread	+63	+22
1-Week Change	+0	+1
4-Week Change	+13	+1
12-Month Change	-12	-41

Source: **Banc of America Securities**

Group in 2007 after the private equity firm acquired **Equity Office Properties**.

Worldwide Plaza, a 1.5 million-square foot building, has about a million square feet of vacancies. The roughly one million-square-foot 1540 Broadway about 200,000 square feet of office vacancy. *—Matt Jarzemsky*

DUCA LEAVES

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senior management roster at a time when CMBS issuance has disappeared. Calls to Moody's were referred to a spokesman, who declined to comment. Duca could not be reached.

Duca was promoted to co-head the CMBS group alongside **Tad Phillip** in 2002 and later took over as group head. Amid rising concerns over underwriting standards, Duca, along with Philipp, oversaw Moody's decision to raise CMBS subordination levels in April 2007. *—Sarika Gangar*

MURRAY HIL

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Calls to **Norman Sturner**, president of Murray Hill, did not return calls. **Howard Michaels**, chairman of Carlton, also did not return calls and a spokesman for SL Green was unable to comment by press time.

The 31-floor property, between 46th and 47th Streets, was built in 1956. According to SL Green's website, the glass and steel building is undergoing renovations on its lobby, entry, windows and façade. Major tenants include **Citibank** and **Fairchild Publications**. *—M.J.*

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Calendar

NYCREW is hosting an event, Strength in Numbers: Women in New York Real Estate on Monday, March 2 from 5:00 to 8:00 PM at the 40 W. 23 Street on the third floor. Speakers include **Faith Hope Consolo**, chairman of **Prudential Douglas Elliman**'s Retail Leasing & Sales Group. For more information, visit www.nycrew.com/programs.

Quote Of The Week

"We did not predict the credit crisis. What we thought was going to happen was that interest rates would move significantly north. Our reasoning was wrong abut our actions were right."—**Larry Connor**, *ceo of **The Connor Group**, a Dayton, Ohio-based garden apartment owner and operator, on how its decision to tighten its underwriting standards in 2007 paid off (see story, page 7).*

One Year Ago In Real Estate Finance & Investment

Wells Fargo Bank decided not to take part in a commercial mortgage-backed securities deal from **Morgan Stanley**'s TOP program, citing volatility…**Canyon Capital Realty Advisors** and **Magic Johnson Enterprises** were raising a $1 billion fund to invest in workforce housing in major urban centers…**Holliday Fenoglio Fowler** was working with lenders to pre-syndicate loans for its clients as a result of the credit crunch.

Five Years Ago

RREEF acquired Centergate King Farm, a luxury apartment complex in Rockville, Md., from the **Pritzker** family for $206 million…A partnership between **Murray Hill Properties** and **ING Realty Partners** was set to sell more than $500 million of Class B office properties in Manhattan…A partnership between **Blackacre Capital Management** and **Marriott International** was preparing to unload a portfolio of choice hotels across the United States that could be worth as much as $600 million.

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