INVESTMENT

NATIONAL HIGHLIGHTS

Buyers Waiting Patiently for Opportunities

So far, the deleveraging of the commercial real estate industry has disappointed many equity investors who have been waiting patiently to acquire decent, stable assets at distressed pricing. "We are surprised at the lack of buying opportunities given all the turmoil right now," comments a participant. Despite a still-struggling U.S. economy, ill credit markets, deteriorating property fundamentals, and precipitous declines in commercial real estate values, only a handful of quality "distressed" assets and "forced sales" have occurred thus far in 2009.

This current situation, however, could soon change. Due to the huge amount of leverage used to fuel the buying frenzy during the peak of the cycle between 2006 and 2007, many investors sense that it is only a matter of time before the for-sale market is flooded with properties by owners who are unable to cover their debt service obligations and incapable of refinancing. "Over the next year, more and more property owners will be in a position where they can't make their payments and can't supply additional equity to the lender in order to refinance," explains a participant.

While some investors are looking to the looming $153.0 billion of CMBS (commercial mortgage-backed securities) loans coming due in 2012 as the catalyst to jump-start buying opportunities, other investors are expecting near-term defaults with commercial banks to provide some distressed buying prospects. According to the Mortgage Bankers Association, CMBS and other securitized loans account for 21.0% of the outstanding commercial real estate debt while commercial banks account for about 45.0% of the debt total. "Many traditional lenders are not recognizing the huge problem in front of them and seem to have no urgency in finding a solution," remarks an investor.

Certain investors believe that many banks are playing a "timing game" – attempting to replenish their capital reserves while the economy and industry both strive to recover and bolster property values. If successful, the distressed sales activity that many eager buyers were anticipating would be limited. "It's a terrible time for anyone, including banks, to have to sell an asset," attests an investor. If property values continue to erode in the commercial real estate industry, many investors are hopeful that banks will be unable to continue to "pretend and extend" the troubled loans on their balance sheets and will need to declare their losses and place assets up for sale.

If such buying opportunities do materialize in the industry, the next challenge for investors will be asset pricing. "A bid-ask pricing gap still exists across all property sectors and in nearly every geographic area," notes a participant. Although some participants indicate that this gap is closing a bit, conservative cash flow models and a tremendous amount of uncertainty tied to the economy, the industry, and the unraveling of the debt markets are keeping offers quite low.

Such challenges are also keeping numerous investors on the sidelines, concentrating on asset management and value preservation rather than new acquisitions. "The chance to buy at steep discounts during this downturn will be here for a while so we are focused on maintaining and improving our existing cash flows," states an investor. Even though investors agree that survival mode is paramount now, they also maintain that opportunities to acquire quality assets at distressed pricing levels should not be overlooked.

OVERALL CAP RATE ANALYSIS

The average overall capitalization rate (OAR) increased for all surveyed markets except one over the past three months, ranging from seven to 67 basis points and averaging 33 basis points. One of the largest quarterly shifts was posted for the national power center market, where diminished consumer spending, increased vacancy rates, and declining revenue streams have plagued numerous properties. In the office sector, individual markets that posted large quarterly increases in their average OAR were Houston, Phoenix, and the Pacific Northwest.

...INVESTMENT CONTINUED

LOOKING AHEAD

A large majority of Survey participants expect overall cap rates to increase over the next six months. The amount of the expected increase declined slightly in ten markets this quarter, increased in 11 of them, and remained unchanged in five. Even though the overall simple average for all markets increased only a little bit over the past quarter and the high end of the ranges increased in only five markets, investors are still concerned about the near-term performance of the real estate industry.

With an average increase of nearly 15 basis points, the national suburban office market reported the largest increase in expected OAR growth for the next six months. Furthermore, the high end of the range for this market's OAR forecast moved up 50 basis points to reach 200 basis points. Due to job losses, waning tenant demand, and oversupply issues, many investors believe that suburban office markets will continue to weaken through 2009 and into 2010.

CBD vs. SUBURBAN OARs

It appears that overall cap rates remain lower for most CBD submarkets than for their suburban counterparts. A main reason for this difference is that higher barriers to entry and a lack of available land for new development tend to keep supply and demand a bit more balanced in a market's CBD. As a result, they typically achieve higher rental rates. In addition, downtown cores tend to provide better forms of mass transportation and embody a 24-hour, live-work lifestyle that appeals to many individuals. As a result, CBD assets are generally perceived as providing less investment risk to the owner – less risk, lower overall cap rate.

Source: KORPACZ

LOCAL MARKET

Only five investment properties over $2,000,000 were sold in Metro Detroit during the second half of 2009. A lack of financing and nervousness over the GM and Chrysler bankruptcies has moved investors to the sidelines. Notable sales include: Riverside Office Center, Southfield, $5,800,000, $29 per sq. ft., 10% cap; 160 E. Congress Parking Deck, Detroit, $7,200,000, 12% cap; Applebee's, Canton, $2,040,000, 9.8% cap; Lexington Manor Apartments, Brighton, $2,300,000, 8.7% cap, 120 units.

OVERALL CAPITALIZATION RATES
3RD Quarter 2009

NATIONAL MARKETS	AVERAGE	QUARTERLY CHANGE*
Apartments	7.84%	+35
Regional Mall	7.98%	+19
CBD Office	8.11%	+17
Strip Shopping Center	8.41%	+50
Warehouse	8.46%	+53
Power Center	8.63%	+59
Surburban Office	8.72%	+48
Flex/R&D	8.77%	+41
Net Lease	8.90%	+ 7
MOB**	8.91%	+33

OFFICE MARKETS	AVERAGE	QUARTERLY CHANGE*
Manhattan	6.51%	- 3
Washington, DC	6.98%	+55
Los Angeles	7.62%	+ 9
San Francisco	7.84%	+49
Northern Virginia	7.98%	+49
Suburban Maryland	8.08%	+51
San Diego	8.11%	+29
Denver	8.14%	+35
Boston	8.40%	+11
Chicago	8.49%	+27
Dallas	8.64%	+26
Southeast Florida	8.80%	+31
Houston	8.90%	+67
Phoenix	8.91%	+51
Atlanta	9.01%	+13
Philadephia	9.19%	+ 7
Charlotte	9.21%	+25
Pacific Northwest	9.50%	+50

**Basic points*
*** Medical office buildings*
Source: Korpacz Real Estate Inventory Survey

MAJOR INVESTMENT TRANSACTIONS

INVESTMENT	CITY	SALE PRICE
160 E. Congress Parking Deck	Detroit	$7,200,000
Riverside Office Center	Southfield	$5,800,000
Lexington Manor Apartments	Brighton	$2,300,000
Applebee's	Canton	$2,040,000