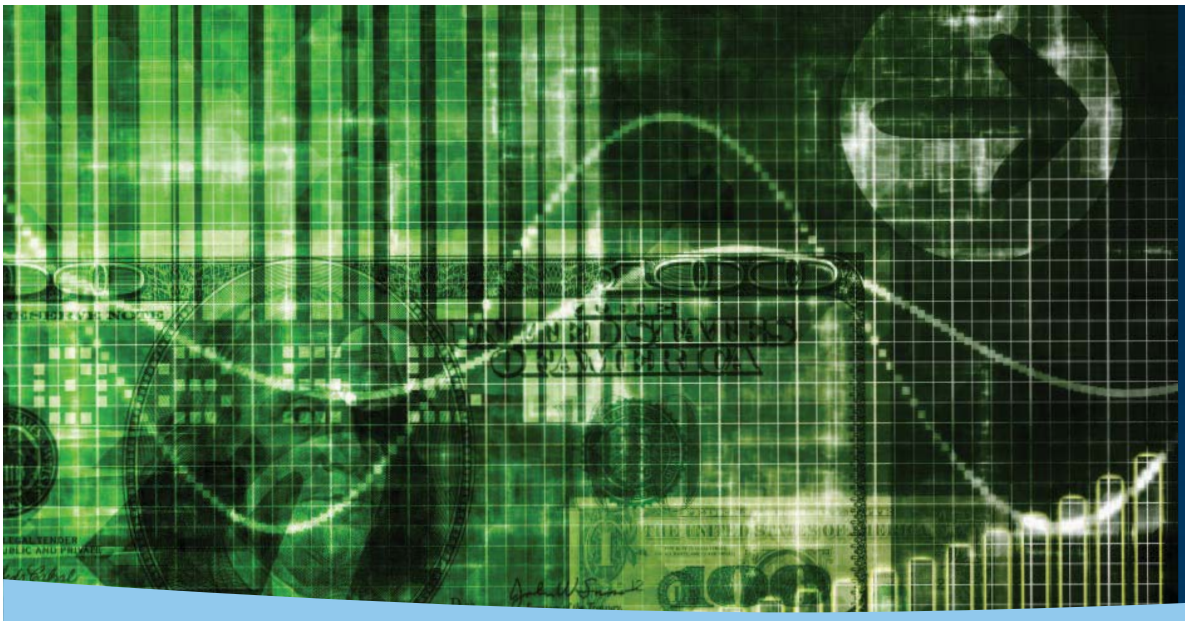

2012
HAMPTON ROADS MARKET REVIEW

CAPITAL MARKETS & REAL ESTATE FINANCE

Author

Victor L. Pickett
Senior Vice President, Regional Manager
Grandbridge Real Estate Capital LLC

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General Overview

Contrary to popular belief, there is pent up demand by commercial real estate lenders to make commercial real estate loans.

For the first time in the history of the Mortgage Bankers Association (MBA), the Association is forecasting commercial/multifamily origination volume. In 2012, the MBA is forecasting CRE loan origination to be $230 billion.

This production volume forecasted by the MBA, when compared to maturing mortgages on multifamily/commercial real estate in 2012 alone, falls very short of the $400 billion that will be maturing this year.

While interest rates remain at historically low levels, lenders are reluctant to take on additional risk or relax their current underwriting standards to meet this refinance volume.

The pent up demand for quality loans (capital) by the commercial real estate lenders will far exceed the availability of stabilized quality assets. The question then remains, will lenders be forced to take on more risk for more yield, thus filling the capital needs of borrowers to refinance the large number of maturing loans in 2012 and beyond?

Hampton Roads has been a stable market throughout recent history for institutional lenders and banks that make investments in commercial real estate. As the market continues to stabilize and basic fundamentals for all asset classes of commercial real estate trend positive, this capital will seek real estate investments in our region.

COMMERCIAL REAL ESTATE FINANCE

The fundamentals of commercial real estate (CRE) turned more positive in 2011. First mortgage debt placements were higher for life insurance companies than any other time. Agency lenders continue to have success in originating multifamily loans. Commercial real estate trends have rebounded significantly since reaching bottom in 2009. Most all property types showed economic stability and growth in 2011. Both 2012 and 2013 should be positive transitional years as occupancies increase and rent growth continues to improve. Supply and demand will stay in check, with no new major developments in process, and fundamentals will continue to improve, albeit slowly.

Commercial real estate finance, as it relates to permanent first mortgage debt, had its best year since the bubble of 2006 and 2007. Production or origination volume was up with lender participation having included life insurance companies, commercial mortgage-backed securities (CMBS) participants, banking institutions, HUD and the government sponsored entities (GSE) of Fannie Mae and Freddie Mac. With fundamentals improving across all sectors, CRE finance lenders will continue to be very active in 2012 with equal or increased allocations.

2011 Commercial/Multifamily Originations (In Billions)

	2007	2009	2011 *
Life	$42	$17	$50
CMBS	$230	$4	$30
HUD	$4	$7	$13
Fannie	$26	$21	$24
Freddie	$22	$16	$20
Total Volume	**$324**	**$65**	**$137**

Sources: MBA, ACLI, Fannie Mae & Freddie Mac, HUD
**Actual through 3rd quarter with 4th quarter estimated*

Debt originations for commercial and multifamily real estate lenders increased to $137 billion in 2011. As you can see from the origination chart, lenders are more confident and capital will continue to flow back into CRE, assuming fundamentals continue to improve.

The upturn of new capital moving back into the commercial real estate market in 2011 and 2012 is very positive for owners and investors. This momentum comes at a critical time as a large number of loans in the portfolio of banking institutions, life insurance companies, CMBS lenders and GSEs are maturing. A significant number of loans and $400 billion in dollar volume will mature in 2012. Loan maturities alone will increase every year through 2017, the single largest year for maturities estimated at $1.5 trillion. This debt maturity, coupled with global deleveraging, slow economic growth, increased regulation, and paranoid markets will create continued refinance and financing challenges to both lenders and borrowers in 2012 and beyond.

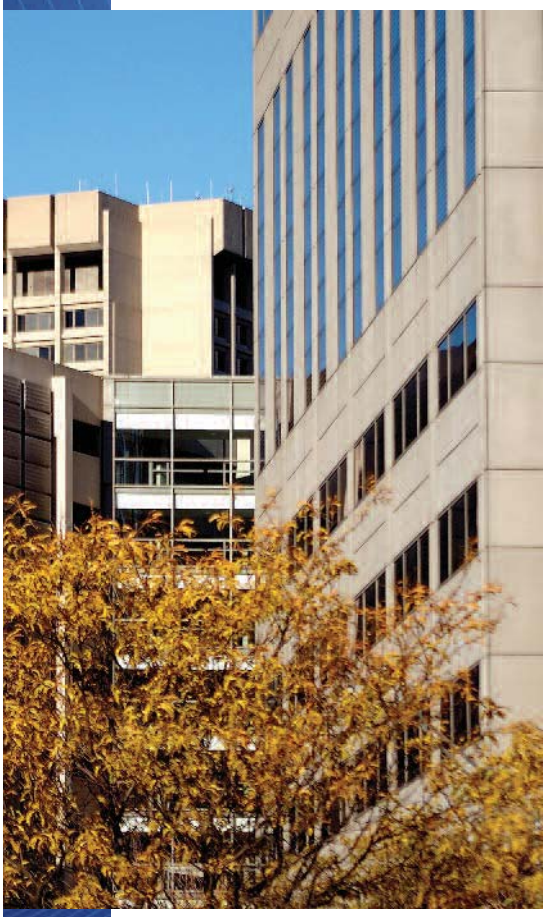
CRE Mortgage Debt Outstanding 2011 Q3

	($millions)	% of total
Bank and Thrift	793,004	33.4%
CMBS, CDO and other ABS issues	606,501	25.6%
Agency and GSE portfolios and MBS	337,500	14.2%
Life Insurance Companies	309,553	13.1%
Other	324,650	13.7%
Total	**2,371,208**	**100%**

Source: Mortgage Bankers Association

Between 2012 and 2017, there will be approximately $2 trillion of CMBS loans maturing according to TREPP. It becomes very apparent that the historical annual production volume of life insurance companies and CMBS lenders will not fill the void of capital necessary to refinance these maturities as noted above.

Based on the most recent TREPP Rollover Summary, borrowers are experiencing difficulties in finding lenders to take out the CMBS loans that are maturing today. In 2011, only 49% of maturing loans in all CMBS maturities were refinanced. This means 51% of the maturing loans in 2011 were amended, extended or restructured by pay down, rate adjustment, fees etc., or foreclosure.



Percentage of Loan Payoff in 2011 by Month

	% by Balance at Maturity Date	% by Count at Maturity Date
Jan 2011	38.7%	49.4%
Feb 2011	38.4%	47.2%
Mar 2011	55.5%	52.2%
Apr 2011	47.5%	53.8%
May 2011	34.9%	48.1%
Jun 2011	42.4%	56.1%
Jul 2011	39.6%	49.4%
Aug 2011	39.5%	43.1%
Sept 2011	64.4%	55.6%
Oct 2011	41.8%	44.2%
Nov 2011	47.1%	50.0%

Source: TREPP

As loans mature, the need for loan extensions between the existing lender and the borrower becomes necessary for various reasons. In most cases, these assets are over leveraged but are cash flowing, thus the existing loan is current, but the available loan terms in today's financing market cannot meet the loan request required. The financing gap can range from loan amounts in excess of the value to loans that may be only 5% to 10% higher in leverage than what is financeable. (Not all cases are leverage, but for the purposes of this discussion, leverage will be the focus.)

Borrowers or service providers are to be proactive on loan maturities. It is very important to start early in discussions with both the existing lender as well as alternative sources for new debt. Seeking professional advice 12 to 24 months in advance is highly recommended. The financing market is always changing and it is critical to stay abreast of current financing terms and conditions as well as trends relative to financing needs. Competition will be fierce for new loans and lenders will be very selective in 2012.

Outlined below are the basic terms and conditions available in the multifamily and commercial real estate debt market today. It should be noted and understood that every real estate asset is different and each loan situation will vary as to the final terms.

PROPERTY TYPES IN ORDER OF PREFERENCE TO THE LENDER:

Apartments
Grocery Anchored Shopping Centers
Credit, Single-Tenant Properties on long-term leases
Shadow Anchored Retail
Medical Office
Industrial
CBD Office
Suburban Office
Self-Storage
Well flagged limited- or full-service hotels

LOAN-TO-VALUE

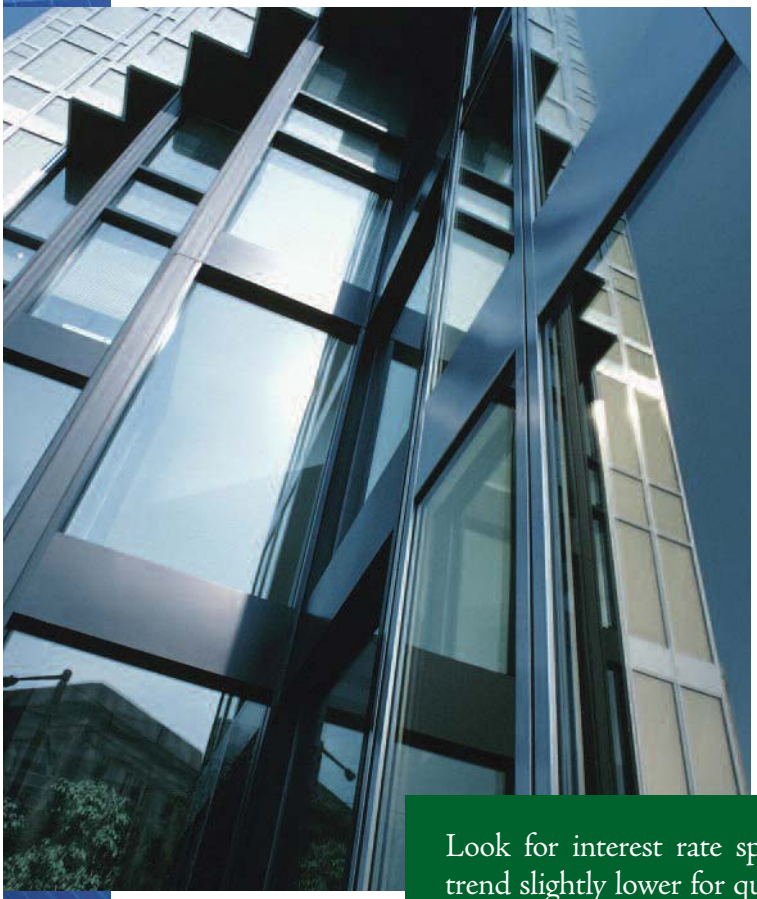
A major improvement over the past 24 months between all lenders is their willingness to extend higher loan proceeds relative to value. In 2009, the maximum loan-to-value (LTV) for CRE by the life insurance company lenders was on average around 50% to 60%. CMBS lenders were not in the market during this time. In 2011, CMBS lenders came back in and pushed loan-to-value back to 75% on most property types. Life insurance companies followed in 2011 and the average leverage was 65% loan-to-value and insurance lenders stretched to 70% to 75% LTV for "best in class assets". In 2012 and going forward, increased competition will exist in the market amongst all capital sources for top quality multifamily, retail and industrial properties. Borrowers will see loan-to-value increase to 75% for these assets. For less than top tier assets, most insurance companies will continue to limit loans to 65% loan-to-value. In 2012, look for insurance companies to stay the course at 65% to 70% loan-to-value and CMBS lenders to drop down to 70% LTV. The GSE multifamily lenders can lend up to 80% loan-to-value with caveats.

INTEREST RATES

The initiative by the Federal Reserve to keep base interest rates low has helped drive mortgage rates for commercial real estate to historical lows. Mortgage rates are derived by taking an index, in most cases the 10-year U.S. Treasury rate, and adding a spread or credit adjustment to the base rate for an overall interest rate. During 2009 and most of 2010, lenders charged a high spread due to the perceived risk, and consequently, spreads were at an all time high. During the second half of 2010 and all of 2011, spreads generally contracted and the yield on the 10-year Treasury rate dropped from the mid 3% level to around 2% today.

In 2011, we saw overall interest rates for 10-year term money fall below 4% on "best in class" assets for the first time. First mortgage interest rates are at historically low rates and demand by lenders is very high. At the time of this narrative, the 10-year Treasury rate was 2%. The generally quoted interest rate today for a 65% leveraged asset meeting the underwriting standards for the reported asset classes would be as follows:

Apartments	3.50% – 4.50%
Commercial Real Estate	4.00% – 5.00%
Hotels	4.75% – 6.00%
Self-Storage	4.50% – 5.00%



As you can see from the chart, published spreads for the mid-point of a fixed rate 10-year commercial mortgage varies depending on the property type. Apartments tend to always have the lowest spread vs. hotels being the highest among all assets.

Mid-Point of Fixed Rate Commercial Mortgage Spreads for 10-Year Commercial Real Estate Mortgages

Property Type	1/8/12
Multifamily – Non-Agency	+240
Multifamily – Agency	+235
Regional Mall	+250
Grocery Anchor	+245
Strip and Power Centers	+260
Multi-Tenant Industrial	+245
CBD Office	+250
Suburban Office	+265
Full-Service Hotel	+300
Limited-Service Hotel	+305
10-Year Treasury	2.00%

Source: Cushman & Wakefield Sonnenblick Goldman

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In conclusion, 2011 was a transitional year for the real estate finance industry. Property fundamentals showed stabilization with growth, albeit slow, in rental rates and occupancy trends moving positive.

Demand by all lenders will be strong in 2012 and competition will be fierce for low leverage quality assets. Look for greater allocations to CRE by most all life insurance company lenders and continued large volume of multifamily loans by the GSEs. The CMBS lenders will be trying to find their market with core lenders staying the course and making this market. Estimates for production volume by CMBS lenders in 2012 will be at 2011 levels or slightly higher.