REAL ESTATE INVESTMENT MARKET UPDATE

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HARBOR GROUP INTERNATIONAL

HOUSING VS COMMERCIAL REAL ESTATE

3 Key Reasons this is a Housing Recession and not a Commercial Real Estate Recession

1. Residential construction doubled over 5 year period from 2001 to 2006
2. Over-reliance of residential boom on speculative investors
3. Residential lending practices allowed "no money down"

NOT

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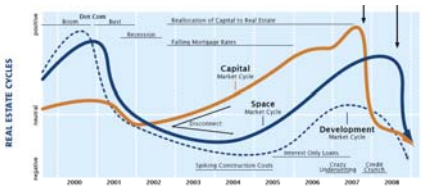
Current Real Estate Cycle



- Market is headed to the bottom of the current real estate cycle with exuberance ending and fundamentals dominating.
- Capital market moved out of line with property level fundamentals and was further exaggerated by the leverage markets.

Source: Real Capital Analytics, October 2008

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PERCEPTION IS REALITY

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LEHMAN BROTHERS

BEAR STEARNS

AIG

Merrill Lynch

citigroup

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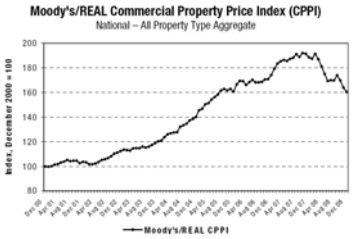
Appreciation/Depreciation in Property Values



- As of December 2008, Commercial Property Values have declined 14.9% over the last year.
- Apartments have dropped by –13.6%, followed by Office at –13.5%, Industrial at -13.9% and Retail at –8.5%
- Assets purchased in 2007 will require an increase in NOI to overcome the increase in capitalization rate in order to retain value.
- Assets purchased in the early 2000's have still appreciated.

Source: Moody's Investor Services, data through December 2008

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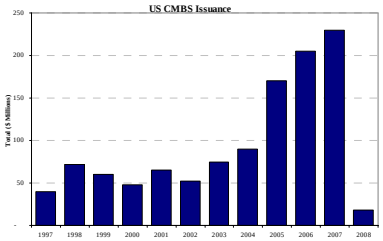
Where have all the Lenders gone?



• After posting huge increases over the last three years, 2008 US CMBS issuance dropped to volumes not seen in over a decade.

Source: Commercial Mortgage Alert

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The first step in a correction: Sales volume slows as bid/offer widens

Sales volume changes between 4Q 2008/2007

		Number Properties Sold	Total $ Volume	Avg. PSF/PPU
Office	CBD	-74%	-88%	-2%
	Suburban	-81%	-70%	-3%
	Total	**-80%**	**-80%**	**-12%**
Retail	Mall and Other	-73%	-80%	-45%
	Strip	-71%	-81%	-22%
	Total	**-72%**	**-81%**	**-22%**
Apt	Mid/High Rise	-55%	-77%	-11%
	Garden	-40%	-59%	-20%
	Total	**-42%**	**-62%**	**-22%**
Hotel	Full-Service	-60%	-86%	-25%
	Limited Svc.	-76%	-79%	-16%
	Total	**-68%**	**-85%**	**-25%**

Source: Real Capital Analytics

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Key Themes for 2009: The Bad News

- Deteriorating economy is exacerbating the decline of CRE fundamentals:
  - Cap rate compression assumptions unwinding
  - Pro-forma underwriting assumptions no longer hold
  - Rating agency assumptions that resulted in lower subordination levels are being revisited, which has led to wide-sweeping ratings changes
- Commercial real estate values expected to decrease roughly 30-35% peak-to-trough given tighter underwriting standards, less available liquidity and higher cost of capital
- Rating agency downgrades have and will continue to affect bonds issued in 2005-2007

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Key Themes for 2009: The Good News

- Significant governmental intervention:
  - Agency MBS
    - $500bn "buy" program from the Fed
    - $20bn/month from Treasury
  - TARP, TALF, TAF, etc.
  - $787bn stimulus package
- TALF 1.0 to be directed at the consumer (e.g. autos, student loans, cards, small business). Subsequent rounds (TALF 2.0) to address CMBS and private-label (prime) RMBS
- Limited CMBS refinance risk in 2009
  - $17 billion of fixed-rate and $1.5 billion of floating-rate securitized loans need to refinance in 2009
  - Insurance company and commercial bank whole loans due to be refinanced in 2009 were originated years ago, which allowed them to build equity
- Loan extensions

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Harbor Group's Outlook and Expectations

General

- TARP bail out funds have not had any immediate effect on banks lending abilities. Banks need to use the funds to cover losses and operations, little will trickle into real liquidity for new lending
- Loan extensions
- 2009 – Big money to be made buying debt
- Gap between buyer and seller expectations is expected to narrow and transaction volume expected to increase
- Second six months of 2009 and 2010 – Great opportunities to buy real estate

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Harbor Group's Outlook and Expectations

Office

- Transaction volume down for large assets due to lack of financing sources. Hard to sell unless assumable debt is included.
- Owners who do not need to sell, hold assets so as to not take a hit on pricing due to bottom feeding in the market.
- Smaller assets continue to trade as banks have some money to lend; however, banks want to be able to diversify that pool of funds across assets.
- Asset management key to retaining value.

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Harbor Group's Outlook and Expectations

Multi-Family

- Owners who do not need to sell, hold assets so as to not take a hit on pricing due to bottom feeding in the market.
- Freddie Mac and Fannie Mae continue to be more conservative with their debt and are unable to finance acquisitions of distressed assets. Agency financing available to refinance stabilized assets.
- Vultures with cash feasting on bank REOs.

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