



# PROPERTY IN PERSPECTIVE

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## Remain cautious but be prepared for opportunities

When we wrote our last update in September 2009 it seemed that economic indicators had calmed down. In Q4 2009 and the first weeks of 2010 equity markets rebounded and markets took a more positive stance. Too positive in our view as there is a lot of unsettled business. Country risks seem to be the biggest issue at the moment, diverting attention from company issues.

Companies that rely heavily on capital value growth instead of instant cash flow in their day to day business are readjusting their business models. This ranges from private equity to the financial industry, which includes real estate investment firms. The major issues we are currently seeing are country-related debt issues. McKinsey shed some light on this topic by stating that the highest debt ratio in 'recorded' history was the UK's debt of 286% of GDP right after WWII. Today, more than half of the rich western countries have a national debt of over 300% of GDP. The garlic belt (countries like Greece, Portugal, Spain and Italy) in particular has budget issues but parts of central Europe are also facing difficulties (Hungary, the Baltic countries and Rumania). This has substantially weakened the euro against the US dollar.

### WHAT DOES THIS IMPLY GOING FORWARD?

On page 7 of this edition of Property in Perspective we shed some light on demographic changes that will take place in Europe over the coming 10 to 15 years. These trends will have deep-seated effects on all aspects of European life, including pensions, housing, transport, etc. The conclusion is that southern Europe (Greece, Portugal, Spain and Italy) and Eastern Europe (Hungary, the Baltic countries, Lithuania and Rumania) especially will face demographic issues in the future due to low birth rates and migration to western Europe. Countries with a relatively bright demographic outlook are the

UK, the Netherlands, France and Finland. If these conclusions on demographics are combined with the budget deficits that southern and/or eastern European countries already have at the moment, it will become quite a challenge to reduce future budget deficits with declining future generations. There are parts of Europe that actually have relatively strong budgets as well as strong demographics: Germany, France, parts of Scandinavia and the Netherlands.

It is interesting to note that the current European budget issues seem to have diverted attention from the US, which does not mean that the problems in the US are solved.

McKinsey issued an interesting report in December 2009 (McKinsey Global Institute: 'Debt and deleveraging: The global credit bubble and its economic consequences') on historic patterns in deleveraging. The main conclusions are not surprising but still interesting:

- Countries in which deleveraging will be the biggest issue in the years to come are: households in the US, UK, Spain and to a lesser extent Canada and South Korea.
- On real estate level, deleveraging will be the biggest issue in the US, UK and Spain.

All in all, corporate and financial deleveraging will be the biggest issue in Spain in the years to come.

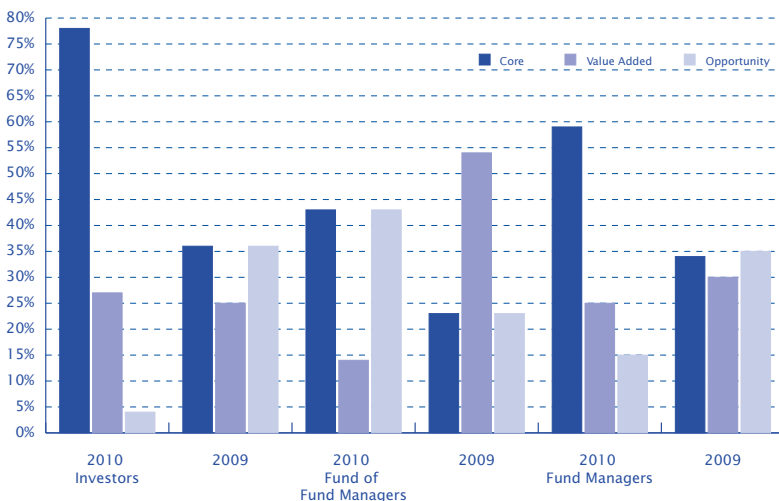
A historical analysis by McKinsey shows that:

- Historically, the process of deleveraging started two years after the start of a crisis, with the process lasting 6 to 7 years from the moment a crisis started.
- Economic output declined, almost without exception, in the 2 to 3 years after the start of the deleveraging process. One striking outcome was that countries that defaulted on their debt or managed their way out through inflation (or depreciation of their currency) ended up in a deeper recession but eventually generated

higher output growth. This might prove to be the way out that the US is going to choose.

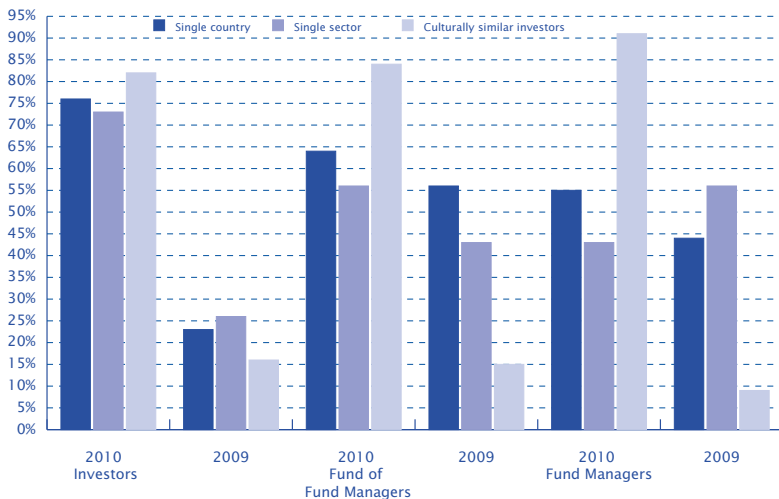
- This is the first time in history that half of the rich western countries have a national debt of over 300% of GDP and many countries are facing high debt burdens at the same time. This makes it less easy to 'export' debt issues away by increasing exports as 'everyone is facing the same problem'.
- Research has shown that in cases where governments applied an anti-cyclical or Keynesian budget policy, this only delayed the deleveraging problem for the entire economy. The impact of this is that once the private sector has completed its deleveraging process, the public sector will then need to start delaying economic growth again.

Graph 1: institutional investors go for core investments



Source: INREV Investment Intentions Survey 2010

Graph 2: Institutional investor preferences



Source: INREV Investment Intentions Survey 2010

#### HOW DOES THIS INFLUENCE REAL ESTATE INVESTORS?

The future scenario of an ageing population implies that, one by one, most pension plans will become net payers of pensions, whereas these pension plans had been net receivers of pension contributions in the past. This is reducing the maturity of pension funds' liabilities, which will lead to their requiring higher cash returns on their investments in order to match their liabilities. As a result, most institutional investors have made the shift away from value add (increased risk profile) and opportunistic (high risk profile) real estate funds towards core investments. The latest INREV investment intentions 2010 survey is interesting in this sense.

Some 68% of end investors like pension funds currently prefer core funds, compared to 36% at the start of 2009. The same goes for managers of institutional real estate funds as well as for managers of funds of funds. The tendency towards leverage has made a dramatic shift as well. Funds with Loan-To-Value ratios of 70% or higher had become normal in the vintage years 2005, 2006 and 2007. These days most institutional investors limit their gearing at fund level to 30 - 35% or even lower. The other striking element from this study is the renewed interest in single sector/single country funds (see graph 2). Investors showed a preference for this type of fund in 23% of cases in 2009, a percentage which jumped to 76% in 2010.

## Integrity in the real estate sector: interview with Tom Berkhout (Professor of Real Estate at Nyenrode Business University)

Tom Berkhout is Professor of Real Estate at Nyenrode Business University, Director of the Nyenrode Real Estate Center (NYREC) and Chairman of the Competence Center Real Estate of the Dutch Tax Authorities.

### ***What is your view on what happened in the Dutch real estate fraud?***

After the fraud in the Dutch construction industry in the years up to 2000, the reputation of the Dutch real estate sector was dealt another blow in 2008. The construction fraud in 2000 related to violations of anti-trust legislation between different suppliers and contractors in the construction industry. The real estate fraud is different in the sense that institutional investors like Philips' pension fund and Bouwfonds were involved, in the magnitude of the fraud and in the fact that pensioners' money is involved. There had been rumours in the market for years, but it took time before the fraud became apparent. The main suspects have not received their verdict yet, but two suspects have been sentenced already.

### ***What are your main conclusions with regard to the Dutch real estate sector on how to prevent this from happening again in the future?***

I have done some research together with Professor Jeurissen on the topic of integrity in the real estate sector by interviewing some 500 real estate professionals. The preliminary results show that real estate professionals clearly prefer to take their own sense of responsibility as their guideline, which implies that the values of these professionals and their environment become a major factor. This means that real estate professionals think that the responsibility for upholding integrity primarily rests with themselves as individuals, with their industry, and with their company. Less is expected from supervision and criminal investigation. Political pressure is regarded as the least pressure on integrity at all. Most interestingly, hardly anyone seems to be prepared to improve the policy of their organisations with respect to integrity, and legislation does not provide much of an answer either. I believe that the change in men-

tality needs to come from the industry itself as it offers the best intrinsic motivation for a real change: noblesse oblige.

### ***Which kinds of organisations or firms might be most sensitive to the fraud that has taken place?***

Generally speaking, companies in which company management and (therefore) personnel do not regard integrity as a major issue and in which internal compliance is not monitored or managed either. A couple of examples: (i) companies in which decision-makers have an unlimited mandate to execute transactions themselves, (ii) companies in which the four-eyes principle is not used, (iii) companies in which there are no guidelines with regard to the negotiation process for acquisitions; (iv) companies that do not monitor acquisitions and disposals and where no regular audit is being done on integrity, (v) companies that lack a structured approach to risks and vulnerability when it comes to integrity, (vi) companies that do not screen their business partners.

### ***What would be your recommendations to real estate investment companies in order to prevent fraud taking place in their organisation?***

Obviously, internal auditing should be in place. The most important recommendations are that leaders in the real estate industry should: (i) not only prepare theoretical codes of conduct for sections and professions that lay down what is expected, but should also (ii) educate their staff/people thoroughly, have them participate in training and dilemma exercises, show role model behaviour themselves while making sure that their employees conform to it, and coach and support their employees in practice. (iii) Leaders of organisations should follow this path throughout their entire career. Leaders of organisations as well as the trade associations

Tom Berkhout



should advocate installing comprehensive and continuous concern for integrity, which should be more than an innate trait or something that 'you just have or do not have in your DNA'. Integrity should be regarded as one of the most important characteristics of a real estate professional as it involves the ability to manage in a professional manner all the responsibilities that their position involves, including monitoring the rights and interests of other parties involved in the sector or a specific transaction. Moreover, it should be appreciated within organisations that besides the integrity of individuals in the organisations, the integrity of colleagues, associates, business relations, clients, and other relationships should be protected and nourished. 'Paper' codes of conduct that are not supported throughout the organisation, and that paint a better picture of things than they are in reality, will not help. The best results will be obtained by organisations that have a wide range of integrity enhancing measures and provisions in place: a code of conduct, a trusted contact person or compliance officer, training opportunities, an ethics committee, etc."

***Do you believe that market regulators like the AFM are able to prevent this from happening again in the future? What do you believe Dutch regulators might consider doing based on this particular case in order to prevent this from happening again?***

External supervisors will always have a role to play. The effectiveness of supervision will increase when this is done in close collaboration with the sector. These partners in supervision will have to focus more and more on prevention instead of time consuming and detailed repressive supervision.

***Do you believe that wealthy families looking to invest in real estate will change their attitude and start structuring how they invest in real estate forwarding the future and why?***

With the right control mechanisms and awareness, it is possible to make it more difficult for people with the wrong intentions to act. Commercial real estate markets are not transparent (detailed information is usually unavailable) or heterogeneous by nature. There is no transparent pricing mechanism as there is for bonds or equities. Personal contacts, formal and

informal networks are indispensable in order to obtain valuable information and to have the edge in knowledge. Real estate investing is and will remain a people business and integrity is and will remain an issue for real estate investors now and in the future. In that sense, there is nothing new.

## Demographic changes in Europe

### What can be expected and the impact on real estate

This column is the first of two articles that IBUS will publish on demographic changes. The reason for the article is that demographic changes will be one of the major indicators of future economic development and thus future demand for real estate. This first column is on Europe and elaborates on the challenges that Europe has ahead of it, whereas the next column will be on the US. Let's start by stating the facts and conclude that changing demographics do not necessarily pose a threat but are an opportunity as well:

**Population decline will affect pensions, housing and transport** There are currently 21 births per thousand every year in the world, in the US there are 14, in Europe there are 10. Increasing this number in Europe from 10 to 11 would stabilise the population in Europe, but it would not offset the decline in Europe's working population. The magic figure for demographers is 2.1 births per couple (2.05 in the US but immigration is high and fertility rates among US immigrants are raising the US average). The last time that fertility in Europe was above replacement level was in the mid-1960s. This implies that the population in most European countries will start or is already declining. Today, emigration and sub-replacement fertility rates are the principal issues related to any regional population decline. A number of nations are experiencing population decline, stretching from Northern Asia (Japan) to Eastern Europe through Russia including Kazakhstan, Ukraine, Belarus, Moldova, Estonia, Latvia, Lithuania, Bulgaria, Georgia, Armenia, Bosnia, Croatia, Slovenia, Hungary, and now Italy. Countries rapidly approaching population decline (but currently still growing, albeit slowly) include Greece, Spain, Denmark, Finland and Austria. Recent studies show that for each decade from now on, if fertility stays at its present level, there will be a further fall in the EU population of 30-40 million people from its current level of around 500 million people, according to the European Ideas Network. (The US is expected to show an increase in population from 308 million at present to 439 million in 2050). One might expect that in Europe fertility rates would be highest in the Catholic south. But intriguingly, the opposite is the case. The south has a more rapidly falling population than the Protestant north. The strong traditions, not just in Catholic Spain and Italy but in Orthodox Greece too, are not boosting the fertility rate as many might suppose. These trends will have

deep-seated effects on all aspects of European life, including pensions (pension funds will become net payers instead of receivers of money, which will change their investment profile), housing (more urban senior citizens), transport (more or less congestion, depending on where you look), etc. The conclusions on demographic changes in southern Europe are especially striking if one takes into account that the majority of the current government budget issues are at their most alarming in southern Europe as well.

**Populations are moving from East to West** Many projections have been made about how population might change in an EU with expanding borders. The practical outcome is that much of Eastern Europe is losing and has lost population due to migration to Western Europe. Many nations in Western Europe (and the EU as a whole) would have declining populations today if it were not for international immigration. The total population of the continent of Europe (including Russia and other non-EU countries) peaked around the year 2000 and is currently declining.

**Household size is declining** The number of households is increasing, whereas the average number of people per household is declining. Currently, the European household contains 2.5 people, compared to 4.15 in 1915. This number is expected to decrease further as the number of one-person households increases from 30% in 2000 to 36% by 2015. While Europe's population increased by 5% between 1980 and 1995, the same period saw the number of households increase by 19%. Smaller households have a higher consumption per capita than large ones. Most European countries saw average household size drop, although it remained constant in Iceland, Luxembourg, Sweden, and the United Kingdom in the above-mentioned period. However, the



average size of dwellings did not decrease in tandem, growing from 83 to 87 square meters (+5%) between 1985 and 1997. This implies that the increase in the number of households (+19%) in combination with the increase in the average size of dwellings (+5%) have had a positive impact on total demand for residential space. The implication is that an increasing demand for housing is still possible, even when population starts declining, backed by a larger number of small households. However, the type of housing in demand will change dramatically because of the different needs of their inhabitants.

**The rise of the Ruppie (or Retired Urban Professional)** The population aged 60 and over is increasing. In 1955, there were 12 people aged over 65 for every 100 aged under 20. By 1995, the old/young ratio was 16/100; by 2025 it will be 31/100. Average life expectancy at birth in Europe in 1955 was just 48 years; in 1995 it was 65 years; in 2025 it will reach 73 years. The coming 10 years will show the rise of the Retired Urban Professional or Ruppie. Ruppies are retired baby boomers, who have spent their careers working in urban areas and want to stay in these urban areas once they retire. They want to enjoy all the city has to offer like theatre, the opera, restaurants, shopping and friends. Now that the age of 65 is no longer considered old due to longer life expectancy and improving healthcare, Ruppies will be major economic drivers for urban areas as they are wealthy and have time to spend their money. Their housing needs are different from what is being offered now, which presents an opportunity.

**Urbanisation** There is a global trend of people living in urban areas. In 1955, 68% of the global population lived in rural areas and 32% in urban areas. In 1995 the ratio was 55% rural and 45% urban (81% in urban areas in the US!); by 2025 it will be 41% rural and 59% urban. Urban areas/cities will face population growth, whereas rural areas will face population decline. Local examples like the ones everyone knows in former East Germany, where people are leaving the countryside in vast numbers, will become more apparent in other parts of Europe as well. On the other hand, high density and the need for better and additional infrastructure will increase in urban areas as people move there.

## WHAT ARE THE IMPLICATIONS FOR REAL ESTATE?

**Think global, act local** Despite the fact that globalisation will retain its pace from this point on, local demographic differences will become greater, implying that local knowledge of the local real estate market and economy is and will remain key.

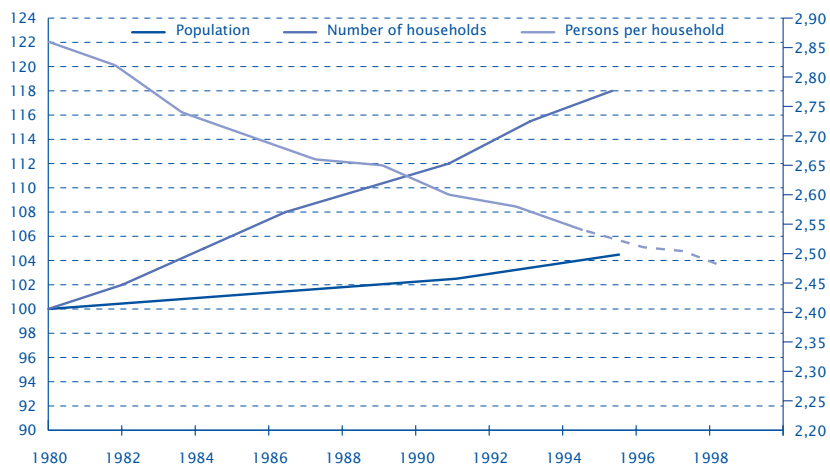
**Redevelopment of existing real estate versus new development** Green/brown field development areas in Europe will decline. Instead, inner city redevelopment of existing real estate will become a more important topic for real estate owners and developers. Adding value to existing real estate and rejuvenating existing real estate based on new requirements will become the challenge for many real estate owners.

**Tailor-made development** Due to the fact that certain areas will face a declining population, developers will need to readjust in the sense that it will no longer be possible to develop a 'one size fits all' type of real estate, especially in areas facing declining population. For example, in the residential market, property development needs to become more tailor-made based on the needs of end users. We expect that large green field residential development sites will become things of the past. The question then arises of whether that will lead to a different role for developers from this point on as they pursue more of a 'develop on demand' structure for existing real estate than a 'develop and demand will be there' structure, especially in areas facing population declines. Individual projects will probably be smaller in scale than in the past when population was not an issue.

**Sustainability: marketing gimmick or crucial?** We believe that green certification for buildings will become a commodity in a number of years from now and will not have a fundamental impact on market or contract rent levels. However, green certification might influence the occupancy of individual buildings, especially as government-related tenants will require green certification from then on as part of their corporate policy. The costs of transforming existing real estate into sustainable property is paid for by the landlord, which does not necessarily lead to a higher sales price at exit. The same goes for a developer that develops sustainable real estate

at higher costs than in the past. Most likely selling prices do not make up for the higher costs of the developer, so it will likely reduce the development margin of the developer. The outcome of a recent survey done by INREV was striking in this context in that it showed that 90% of institutional investors in non-listed real estate like pension funds and funds of funds think that sustainability is an important aspect for new funds. However, the same study shows that in the past 12 months less than 10% of the same group has actually invested in funds that were clearly marketed as sustainable. This could indicate that product is still lacking or that investors think that other fund characteristics are more important than sustainability.

Graph 3: Total number of households, people per household and population



Source: The European environment agency



## French logistics property: High sustainable cash flows with limited risks

Most commercial property markets in Europe are currently struggling with oversupply as a result of a fall in demand for commercial space. Vacancy and availability in commercial buildings are rising and landlords have been forced to lower effective rents. In such an environment it is unlikely for initial yields to return to their most recent lows anytime soon. Some compression of yields is however likely – and is already taking place – as there is still substantial capital available for investment in European commercial properties. In such a sideways moving market, capital value increases will be limited. Attention is thus directed to the more traditional, institutional, investment-grade properties with credit tenants on long-term leases in established markets. Nonetheless, the amount of capital still available ensures that yields on such properties are still very low in most markets. In France, however, prime yields of logistics properties have risen substantially from 6.25% at the most recent peak of the cycle to 8.3% as little as a few months ago. Current prime yields have come down from their recent highs, but are still in the range of 7.7% to 8.0%. In our opinion, the characteristics of French logistics properties make this a highly attractive yield.

French logistics properties offer investors relatively secure income. Four main characteristics of the sector and location support this notion.

Tenants are typically greatly attached to their location. Warehousing is a low-margin business so most of these businesses try to be as close to their end users as possible in order to ensure fast and efficient delivery. Location choices thus largely depend on the location of the end users and various ways of accessing them.

Île-de-France (‘IDF’) is one of the most proven and established logistics markets in Europe. IDF has a population of over 11 million and a total stock of logistics warehousing space of over 10 million square metres. The market is one of Europe’s largest and most dominant due to its central location and excellent infrastructure as well as its own large pool of end users. Specialist logistic warehousing parks have been around in France for over thirty years and are located close to major highways, airports, seaports, railways and major population centres.

The larger users are typically highly professional businesses with strong credit ratings. The tenants can be divided into two major categories. The first consists of the better-known large logistics companies such as Kühne & Nagel, DHL, TNT, Norbert Dentressangle, La Poste, GEODIS, etc. who manage the entire logistics chain for their customers. These companies are often referred to as 3PL (Third Party Logistics). They use

their rented space to supply a diversified pool of customers. Their client contracts typically have a term of one to three years. Given their dependence on their customers’ needs, these tenants prefer a high level of flexibility in their leases and thus typically opt for a traditional 3/6/9 lease contract or even shorter leases for periods up to 18 months. The second category of tenants consists of retailers who manage their own distribution needs in-house. Some better known names in this category are Carrefour, ITM, Leclerc, Casino, PPR, Leroy Merlin, Decathlon, Lidl, Auchan, Manutan, Saint Gobain, etc. These companies choose strategic locations and are prone to stay in their location for many years. These are the tenants that will typically go for a minimum lease term of 6 to 9 years and often go for build-to-suit properties in which they will invest substantial amounts of money.

ÎDF is a relatively supply-constrained market. Even though the market has seen substantial new construction, obtaining licenses and permits to build a new warehouse is very time-consuming and complex due to zoning processes. In addition, the high dependence of tenants on infrastructure and facilities makes development in empty fields not only very difficult from a legal point of view but also from a business point of view.

At today’s yields, French logistics properties offer strong pro forma returns. Compared to Dutch logistics properties, for instance, but also in Europe as a whole, French yields have

risen substantially during the crisis. Yields in the Netherlands have moved up from around 6.25% to around 7.25% whereas in France yields have moved up from approximately 6.25% to approximately 8.25% (see graph 4).

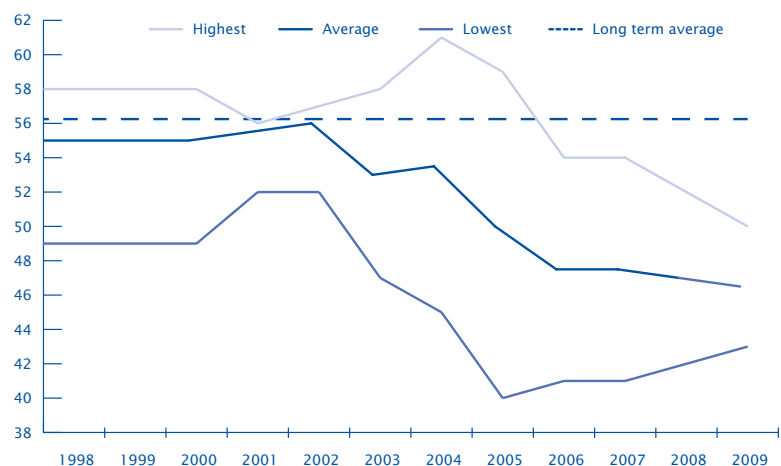
By their nature, logistics properties have less volatile rental levels compared to offices, for instance. In France this is no different. For years, rents have hovered around EUR 50 gross per square metre per year (see graph 5).

Triple net (NNN) leases mean that tenants pay for most of the operating expenses, which ensures that net rents are almost equal to gross rents during full occupancy. As a result of limited economic ageing, maintenance costs are typically very low. Major investments are not usually needed either, as tenants primarily look at the location and functionality of a building as well as the costs associated with renting a building. Although class A properties currently account for the bulk of vacant space – due to large additions to the inventory of speculative space – in the medium term it is the only viable class for a core investment strategy and prospects are promising, since take-up is almost exclusively taking place in this class. The underlying driver of this dynamic is the all-important licensing system for logistics properties which is causing a gradual move from older properties that are not properly licensed to the next generation of properties which fully comply with the new rules. The most recent changes to the licensing system in France became effective in 2002. The changes were primarily about safety and surroundings. There are still a large number of properties that do not fully comply with the new rules. Occupation by current tenants is still tolerated, but as tenants move out over time these buildings effectively become obsolete as administrative bodies will not issue new permits to operate these buildings unless work is carried out to bring the property up to date.

*IBUS will launch a new fund that will invest in French logistics properties. One of the main reasons for choosing to invest in French logistics properties is that they allow for substantial diversification in terms of tenants, type of buildings and remaining lease terms. Another reason is the high yield and low maintenance and investment requirements which allow for sufficient cash re-*

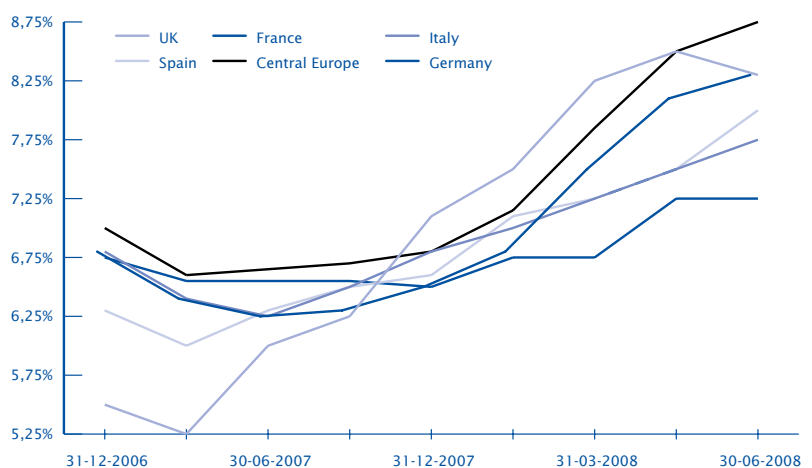
*serves to be set aside for leasing costs without substantially diluting the attractiveness of the high current yield to investors. For the majority of its investments, the fund will target class A logistics warehouses in IDF with mostly 6/9 leases that will not expire during the first five years, that have all the necessary permits in place and that range in size from 15,000 to 20,000 square metres. A minority of the investments will be aimed at value-add type industrial and logistics warehouses. We anticipate strong releasing upon expiry of leases as the movement to newer buildings continues.*

Graph 4: Pan-European Yields Logistics Warehouses



Source: Prologis

Graph 5: Rents Large Logistics Warehouses Île-de-France



Source: CBRE

## US Banks and distressed sales

For the last 6 to 9 months, a lot of discussion and speculation has been going on about if and when fire sales of distressed properties will start. The answer to this lies with the banks that effectively control most of these deals. For a better insight into what the lending status of US Banks is and how this translates to the sale of distressed assets, we interviewed Scott H. Park, Managing Director of Columbia National Real Estate Finance, one of the foremost loan brokers in Washington, DC.

### ***What does a loan broker do?***

We underwrite, structure, and place mortgage loans with investors on behalf of multifamily and commercial real estate property owners. Investors include Insurance Companies, Banks, Government Sponsored Entities (GSEs) such as Freddie Mac, Fannie Mae and FHA, Wall Street firms, Mortgage REITs, and Private Funds.

### ***How has the general stance of US banks with regard to rollover of existing loans evolved and what do you expect for the coming months?***

In 2008 & 2009 US Banks generally extended cash-flowing loans for short periods of time (+/- one year) and captured any excess cash flow to pay down the principal balance. In the wake of the credit crisis and the current recession, many banks have already failed and many more will be shut down in the coming year(s). There were 25 bank failures in 2008, 140 in 2009, and 16 so far in 2010 (early February), this trend of three banks a weekend is expected to continue for the foreseeable future. Restructuring or extending loans will be nearly impossible with banks that have failed, or are facing imminent takeover. The same difficulties are occurring with loans that have been widely syndicated to a large number of banks. Very recently, beginning in the 4<sup>th</sup> quarter of 2009, we have started seeing slightly longer extensions of two to three years from the banks. Borrowers with cash flowing loans held by stable banks continue to be able to rollover loans for a two to three-year term. Any rollover or restructuring that is not a solid 70% or better LTV may require the borrower to bring something substantial to an extension or restructuring process. This might be personal guarantees, mandatory borrower-funded reserves for future operating expenses, excess cash flow sweeps to go towards principal reduction, cash pay down of the loan at the time of extension, or all of the above.

### ***Is there a difference between small local banks, large US-wide banks and Fannie/Freddie when it comes to rollovers and their requirements?***

The regional, community and large US banks have been dealing with increasing portfolios of non-performing loans and loan maturity defaults for several years now. Marginal loans have been shuffled along for six months or one year at a time and many believe the banks will begin selling non-performing loan notes or directly foreclosing on projects and selling the repossessed assets (REOs) more earnestly in 2010. So far, the primary seller of distressed debt has been the FDIC, who sold 3,500 commercial estate loans in 2009 with a book value of over USD 6 billion. Loans structured as Commercial Mortgage Backed Securities (CMBS) are also seeing increasing liquidation: USD 1.3 billion in 2008 and USD 2.2 billion in 2009; November and December alone had USD 840 million of CMBS loan liquidations, indicating a quickly increasing pace. CMBS liquidations include discounted note payoffs, loan sales, and disposition of REOs. Freddie Mac and Fannie Mae multifamily loans are generally non-recourse (the lender has no recourse to the borrower if the liquidation value of the asset is not enough to repay the loan balance) and currently their 60 day + delinquency/default rates are extremely low: 25 basis points and 50 basis points respectively.

### ***What can you tell us about development in the number of foreclosures and the geographical spread?***

Land loans, broken condominium projects, poorly timed development deals and operationally distressed assets are seeing high foreclosure rates and/or their notes are being auctioned or sold. The number of foreclosures is rising and will continue to rise. Construction loans and other loans that originated in 2005 - 2007 will continue to experience operational defaults (inability to service the debt) and maturity defaults



Scott Park, Columbia  
National Real Estate Finance

(inability to repay the loan when it is due). It is estimated that 50% of the loans that originated during this period are presently above 100% LTV. Geographically speaking, the regions mostly affected were the Southwest (California, Nevada, and Arizona), the Southeast (Florida and Georgia), and the Midwest/rust belt (Michigan, Indiana, Illinois, & Ohio). The Southeast and Southwest had rapid economic growth and price increases and were classic pricing bubbles. The problem in the Midwest is really a declining employment base. This real estate crisis did not emerge as an oversupply problem (overbuilding); the origins were financial in nature. However, in areas where unemployment rises above 10% it quickly becomes a supply/demand problem for office, retail and industrial properties. No area or region is immune.

***How are the banks handling the foreclosure process and what do they do with repossessed assets?***

Banks and CMBS lenders generally do not want to own properties, those who pursue foreclosure are generally doing so to sell the property either at foreclosure, or immediately thereafter. This has been true so far and I expect it to continue. Alternatively, if they choose to sell the note into the secondary market, many of the participants and active purchasers of these notes are buying them at a discount and intend to take control of the asset through foreclosure.

***Do you see a rising appetite among investors to buy problematic loans in order to be able to gain control over the assets?***

There is absolutely a rising appetite among investors to buy distressed debt in order to gain control over the underlying assets. Many of the FDIC loan sales from failed banks have happened in large pools. The buyers have been very large institutional investors who in some cases are actually entering into joint ventures with the FDIC in the note purchases. The FDIC will provide the debt and 50%-60% of the equity. They are staying in the deals for the upside rather than parting with the assets at today's fire sale prices. There should be opportunities to buy smaller pools, or individual loans, from these "bulk purchasers" in 2010 and 2011. Special servicers of CMBS loans are disposing of assets (loans or REO) on more of an individual asset basis. I expect banks, large and small, to increase their

disposition of non-performing loans, performing loans and REO as we go forward. There is over USD 1 trillion of US commercial real estate loan maturities in the 2010 - 2012 time period across all lender types.

***What do you see in the market as regards pricing of regular and distressed real estate?***

Prices of investment properties are still suffering but CAP rates in top markets have stopped plummeting for core stable assets; indeed, for multifamily properties CAP rates actually seem to be increasing again for class A products. The problems and stress are mostly related to loan maturities: the loans that cannot be paid off under current market conditions. A lot of owners are tackling their portfolios using a two-step process. First, solve the capital structure problems (if you can) and survive to deal with the operating problems. Secondly, solve the operating problems and exit at reasonably low CAP rates. New investors on the other hand are looking to take advantage of those who fail in the first step (ideal), or in their second step. Of the loans sold by FDIC last year (USD 6+ billion) the non-performing loans sold for 37 cents on the dollar and performing loans sold for about 57 cents on the dollar. The CMBS loans/REO sold in 2009 were liquidated at losses near 66%. The publicly traded REITs, and private REITs, have been very successful in raising cash (debt and equity) in the capital markets over the past 9-10 months. They are poised to take advantage of 'best-in-class' assets as they become available.

*IBUS has been active in the US since its inception in 1993. IBUS is constantly reviewing market opportunities in the US market. US apartment opportunities are particularly being monitored, as this market segment offers an interesting combination of cash return, lack of new supply and stabilising or slowly recovering market fundamentals.*

# CHANGES IN PORTFOLIO

## Washington 2801 15th Street sale

IBUS sold the apartment building 2801 15th Street in Washington, DC in January 2010. The building has a net lettable area of approx. 45,000 sq ft and contains 63 apartments. The buyer was a local professional buyer, who paid USD 4.6 million (USD 102 per sq ft). The acquisition price of the building in July 2002 was USD 1.6 million. The complex sold was part of a larger portfolio of apartment buildings in Washington, DC. Following this sale, around 450 apartments spread over five buildings remain of the original 750 rental apartments in the portfolio.



## Vinings Main foreclosure

In 2007, IBUS and a partner invested in a mixed use project in the historical city centre of Vinings, a wealthy suburb of Atlanta, Georgia. The project consisted of 148 condominiums, approx. 17,000 sq ft of retail space and over 35,000 sq ft of office condominiums. While the leasing and sale of the retail and office components was successful, the sale of the condominiums lagged behind expectations and so IBUS and its partner applied for a zoning modification to temporarily change the condominiums into rental apartments. Participants in the fund, the bank consortium as well as the buyers of the condominiums that had already been sold all agreed to the plan to commit additional money in order to transform the condominiums into rental apartments. The local County Commission rejected the re-zoning application in September 2009, based on the argument that the zoning modification could become a precedent for other condominium projects in the area. In December 2009, the bank foreclosed on the property and "bought" its loan back.

## Major letting in Iliade office building in Paris

IBUS has recently signed a lease contract for 9,000 sqm in the Iliade office building, which is located in Massy. The tenant is Sagem, which is part of the Safran Group, a company that specialises in biometric technologies for fingerprint, iris and face recognition, aircraft equipment and systems and equipment for inertial navigation, avionics, optronics, tactical drones and other defence applications. The rent per sqm has been agreed at EUR 235. The office building has a rental surface of more than 18,000 sqm, was completed mid-2009 and sold to a French institutional buyer with a one-year rental guarantee in 2009. Including the Sagem letting, around 13,000 sqm (72%) of the building is now let. Both in sqm as well as in investment volume, Iliade is one of the larger office developments that IBUS has been involved in over the years.



## BRF IV placement

IBUS has finalised the placement of a fund which invests in four British high street retail properties. The shares in the fund were fully placed, with investors comprising a limited number of high net worth individuals and family firms. The invested capital amounts to around GBP 13.0 million. The properties are located on the prime pitch of four medium-sized British cities in the greater London area. The properties are let to leading retail chains that operate on a national level in the UK.

## Contract renewal with Sentinel

Sentinel Real Estate Corporation and IBUS have extended their contract. IBUS assists Sentinel in structuring, placement and marketing of new and existing Sentinel funds. Sentinel is a New York-based institutional real estate investment manager with approximately 1,300 employees. Sentinel has approximately USD 4.5 billion of Assets under Management and performs both asset management and property management on behalf of its 65 international institutional clients.

## Nyenrode workshop for ultra high net worth investors

IBUS hosted a workshop for around 40 Ultra High Net Worth investors and family offices on 18 March 2010. The workshop was organised in close cooperation with the Center for Wealth Management and the Center for Real Estate at Nyenrode University and PwC Private Wealth Solutions. The theme of the workshop was: 'Real estate as a necessary instrument for capital preservation'.



Bad Doberan, Germany



Krijgsman 6  
P.O. Box 8010  
1180 LA Amstelveen  
T. +31 (0)20-755 90 00  
F. +31 (0)20-755 90 90  
E-mail: [info@ibus.nl](mailto:info@ibus.nl)  
[www.ibus.nl](http://www.ibus.nl)

The IBUS Company is an independent group established in 1992 by Onno Husken, former Chief Executive Officer of Wereldhave N.V. and Kempen & Co. IBUS develops and invests in office, retail, residential and hotel properties in the United States, Europe and Asia. Since inception, 48 real estate funds, with a total investment consideration in excess of € 1.2 billion, have been introduced with private and institutional investors. Over the years, more than half of these investments were successfully sold. IBUS also uses its real estate knowledge and experience to advise financial institutions, listed companies and institutional investors. These assignments are directed towards portfolio analysis, asset allocation policy, investment strategy and second opinions on direct and indirect real estate investments. IBUS is based in offices in Amstelveen (The Netherlands), Washington DC (United States) and Ho Chi Minh City (Vietnam).