PREF, LLC

MARKET COMMENTARY
January 2012

Below is a brief commentary on the commercial real estate investment market. When all of this started in 2008 we predicted that it would be 2011 or 2012 before the capital and leasing markets turned the corner. While activity increased in 2011, the markets were hardly robust as lenders tried to deal with mounting inventory of problem or maturing loans. Property fundamentals remain weak as a result of persistently high vacancies, flat rents and tenant failures. With property values in many cases still below loan balances and operating income barely sufficient to cover debt service, banks and servicers of securitized loans are having a difficult time trying to figure out how to satisfy their regulators (Banks) or Bondholders.

The bright spots have been sale of institutional core assets, multi-family housing which has made a major comeback resulting from the problems in the housing market and the availability of financing, and medical office buildings. These asset classes have been attractive because of their stability.

<u>(2011) What we expected</u>

- A weak leasing year with improving fundamentals late in the year
- An increase in velocity of investment sales
- Continued loan defaults resulting from maturities, insufficient capital to meet obligations, or failure to meet loan requirements
- Limited loan availability for acquisitions
- Values for "distressed" assets at 40-60% of previous peaks

<u>(2011)What Actually Happened</u>

- With a few exceptions the leasing markets showed little or no improvements. Small businesses remain under financial stress, technology continues to dampen the need for new office hires, and internet sales continue to erode store sales. All these factors led to a lower demand for space
- The number of investment sales increased but still remains anemic. The institutional core asset market was very active and banks made available what many consider to be their less desirable REO assets. The market has been described as a "barbell" with properties on either end being sold but little activity on the value add properties in the middle.

- With limited availability of core assets (including single tenant net leased properties) and much cash sitting on the sideline prices for these assets were bid up and bargains were scarce. Although there were plenty of buyers for value add or distressed situations often the discounts were not steep enough and the properties remained unsold.
- Many lenders (particularly banks) extended loans or delayed foreclosures due to the sheer volume of problem loans
- Banks showed an increasing preference for selling discounted notes over foreclosure which requires them to operate REO assets before they sell them. They are finding the loan discounts are no worse than those on the REO.
- Servicing companies as expected were slow to sell. The bondholder agreements are very complex and extreme caution is required to make sure the bondholder interests are fully protected. In some cases opportunistic investors have attempted to buy the servicing companies to gain control of the assets being managed.
- There were very few "off market" deals as owners, lenders, and servicers sought maximum market exposure through brokers and "On line auctions

(2012) Our Forecast

- With an improving economy we expect leasing activity to accelerate. Occupancies will increase before rents begin to rise. Hopefully the worst of tenant failures is behind us. Overall we should see improving financials.
- The loan maturity bubble will continue. Banks will continue to focus on note sales in lieu of foreclosure with eventual sale of the property at a discount. There should be more value add opportunities in the middle of the barbell.
- We don't expect pricing to change much during the year. Institutional core assets will remain pricey as will single tenant net leased assets with long term leases.
- Buyers will be active seeking value added opportunities but only at the right price. Sellers and lenders will continue to balk since these prices will be well below previous values (40-60%); however properties will be sold out of pure necessity.
- Acquisition financing should be more readily available but underwriting will be conservative and terms will be strict. Loans for core asset purchases will be less of a problem.

The Opportunity

For 2012 our goal is to be a transaction facilitator. Limiting oneself to buying opportunities closes the door to many potential highly profitable situations. Areas on which we will be focusing: purchasing discounted notes, providing equity for a distressed owner, providing an investment fund with market knowledge and ownership expertise ,or helping an owner develop and execute a work out strategy. While there are many brokers, consultants and advisors, our experience as owner/operator, our network of professionals and ability to bring fresh capital into a deal gives us a different perspective and significant benefit to our clients.

We believe strongly that fundamentally sound real estate, bought at the right price, and properly leveraged should be a part of most diversified portfolios and over time will outperform most financial investment instruments. We are also of the opinion that much commercial real estate is still very undervalued but that professional advice is necessary to properly analyze the opportunity and structure the best deal. After all cheap junk is still junk.

We look forward to working with you in 2012.