

# **A Butterfly Flutters its Wings: Real Estate and the Global Economy**

**Counselors of Real Estate**

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**Presented By**

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## A Butterfly Flutters its Wings



HB 07

*“Am I to understand, then,  
that you are always bearish?”*

Reproduced courtesy of Grants Interest Rate Observer

# The Butterfly Flutters its Wings

**Presented July 7, 2007**

**CDO/CLO market has provided over US\$2 trillion of capital markets financing for LBO and MBS markets**

**Rising default risks have potential to alter bank behaviour dramatically**

**Risk of a credit crunch risen dramatically**

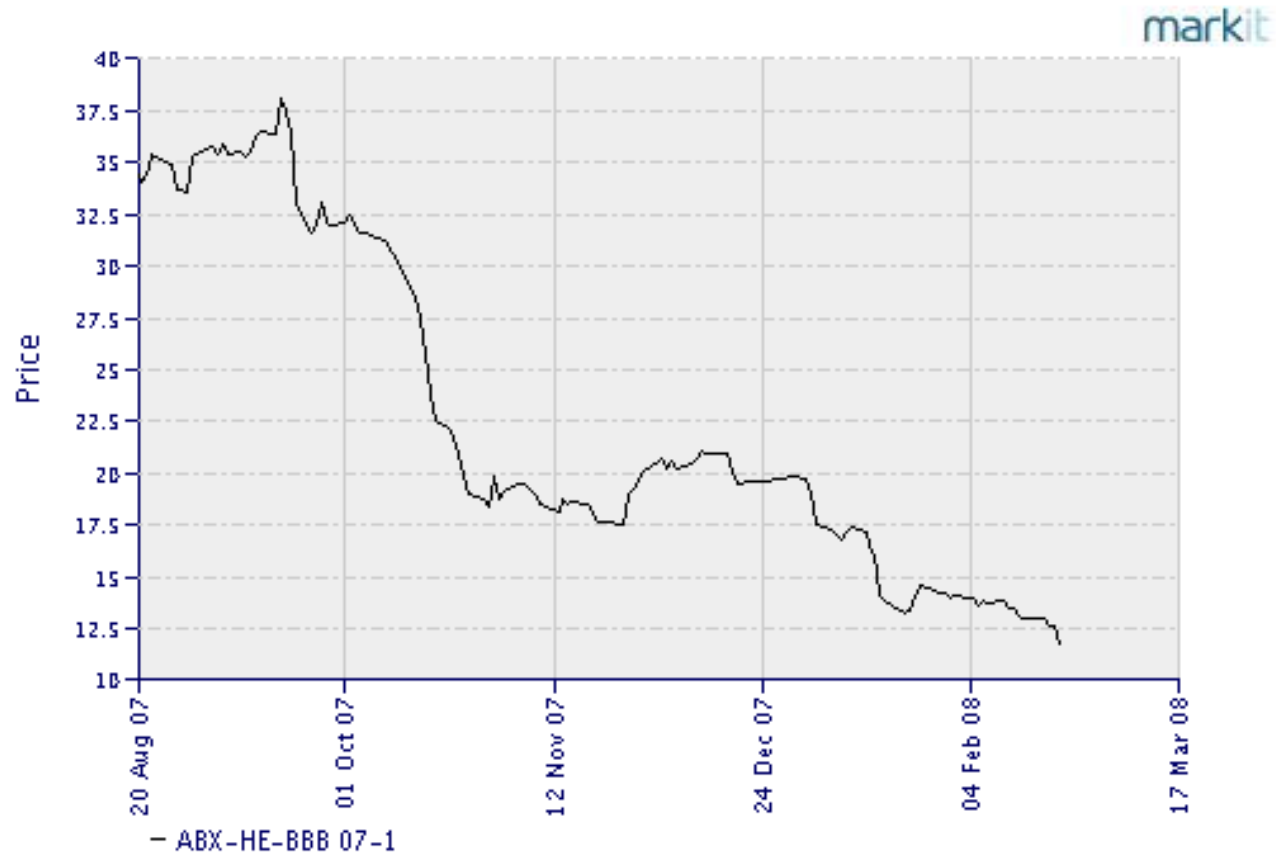
CDO markets plunge as market recognizes default risks



# And Then Flutters Some More!

CDO markets plunge as market recognizes default risks

March 2008

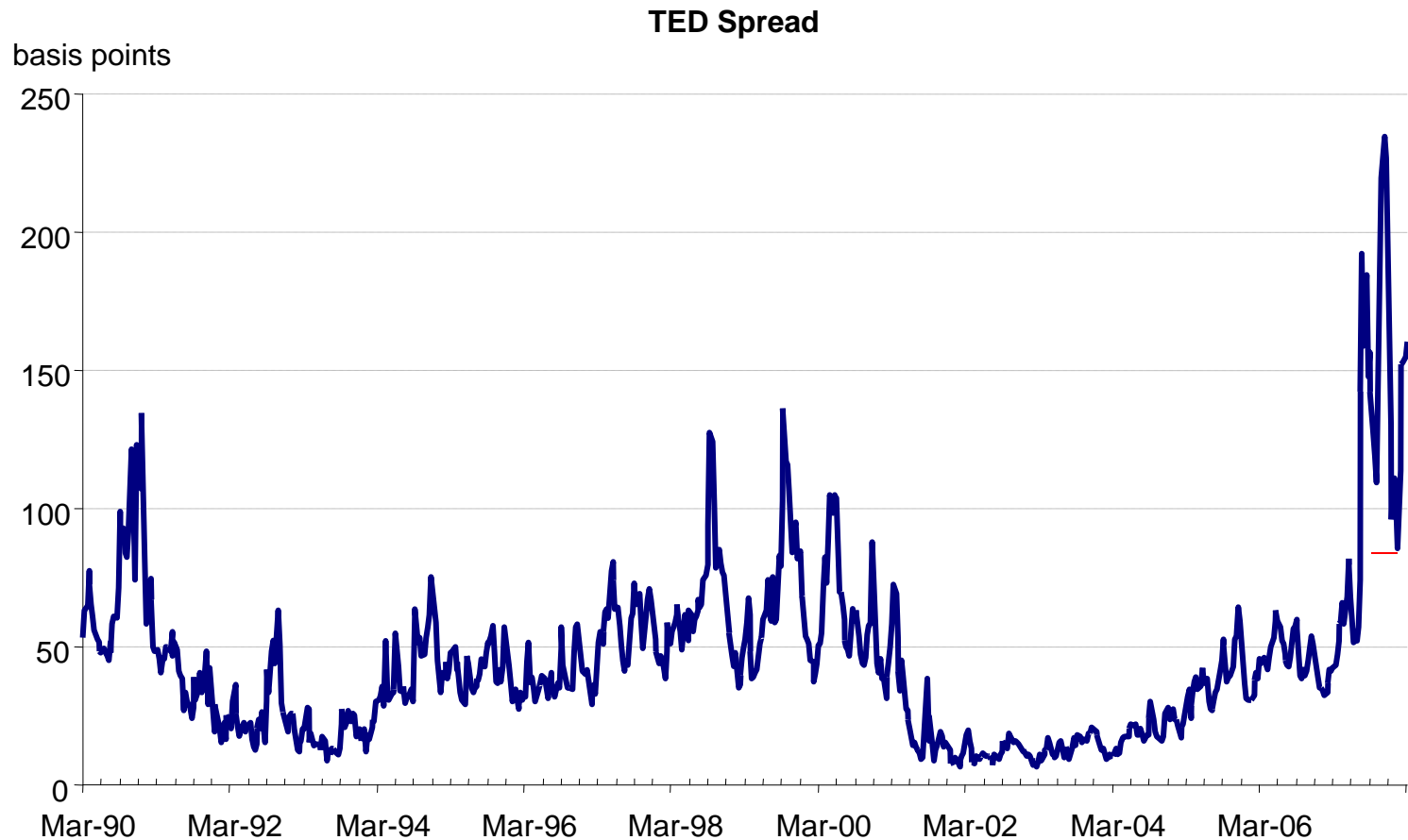


# Fear and Loathing in Banking: The TED Spread

**April 2008**

**The flight to quality continues. Is there an intervention that will fix this?**

**Spread is large but not without precedent**



Source: Federal Reserve

**2008: Risk is BAACKKK!**



# How to Heal a Credit Crisis in Three Easy Steps (+ One)

1. Slash interest rates.
2. Devalue the currency.
3. Recapitalize the banking system.
4. Inject Economic Stimulus

**All of this usually takes years  
not months.**

# Step 1: Cut Interest Rates

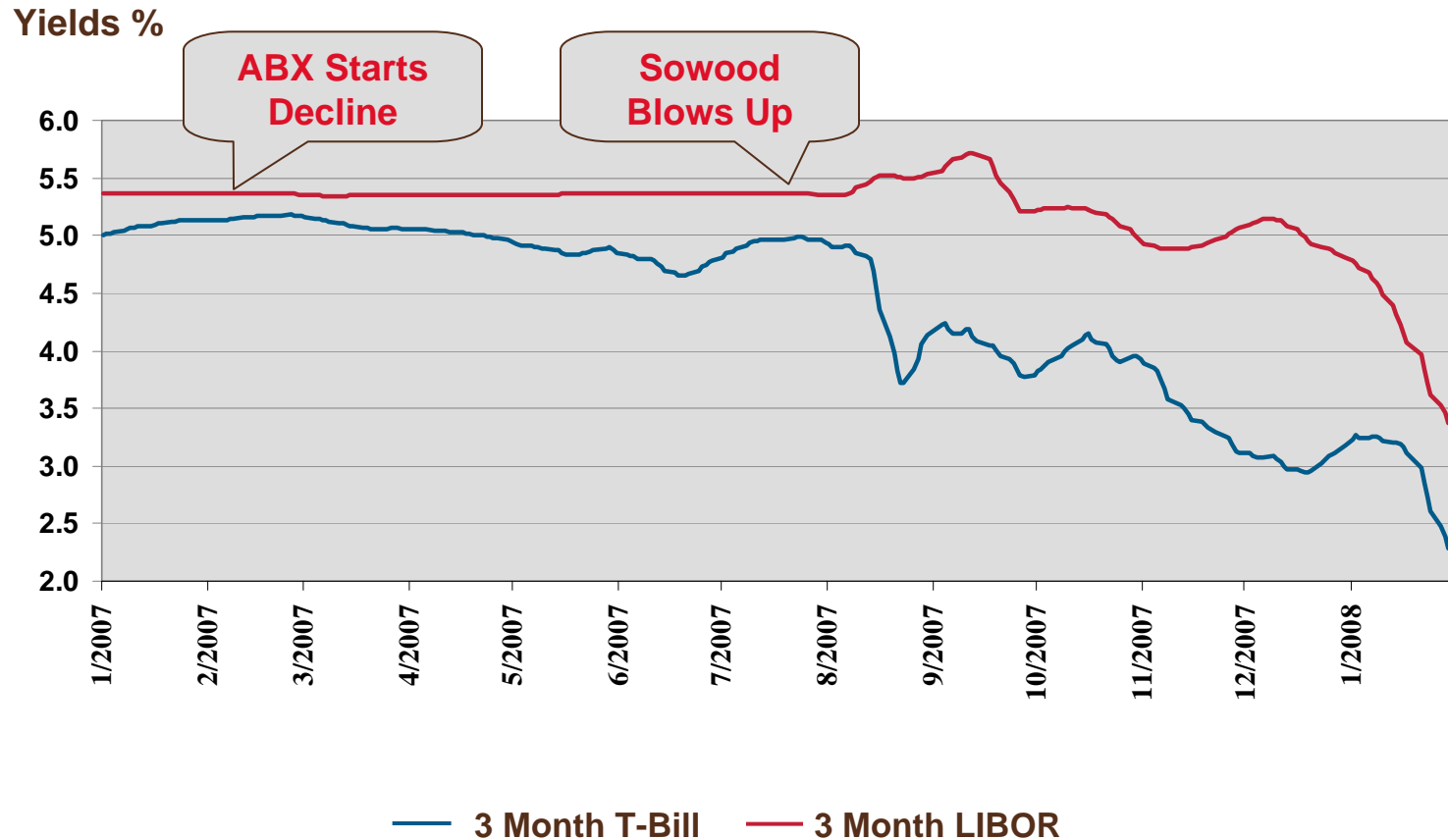
## The Fear Factor: Global Shakeout Develops

February  
2008

LIBOR is the  
benchmark  
rate today.

Is the Fed  
now targeting  
LIBOR?

Of course, it  
had to!



Source: Bloomberg

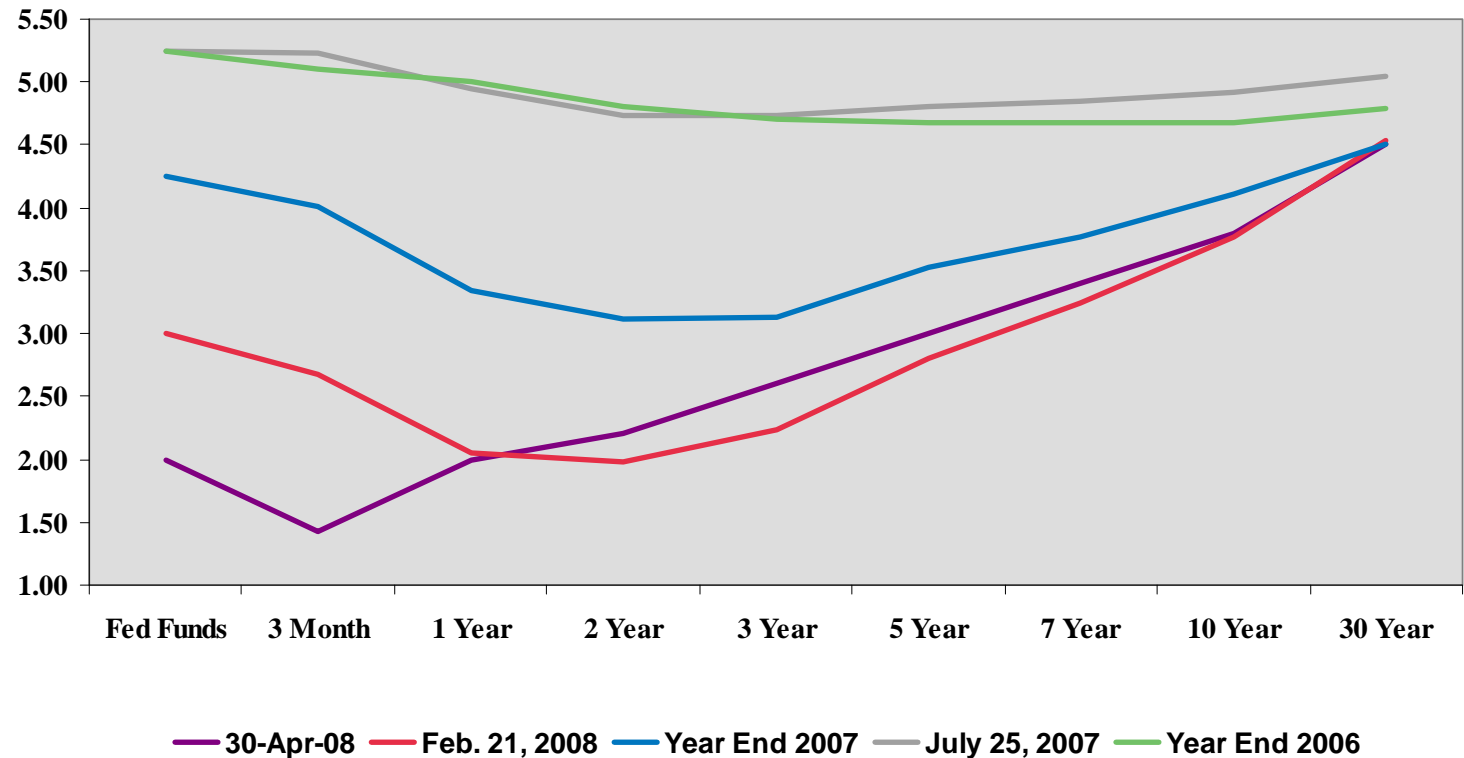
# Warning Signs were there: We ignored them!

**May 2008**

**Yield curve inverted in December 2006 and stayed inverted through the summer of 2007.**

**Stock market did not peak until October 2007**

**Fed steepens the yield curve to restore bank profitability**



Source: Federal Reserve

## Step 2 – Devalue the Currency

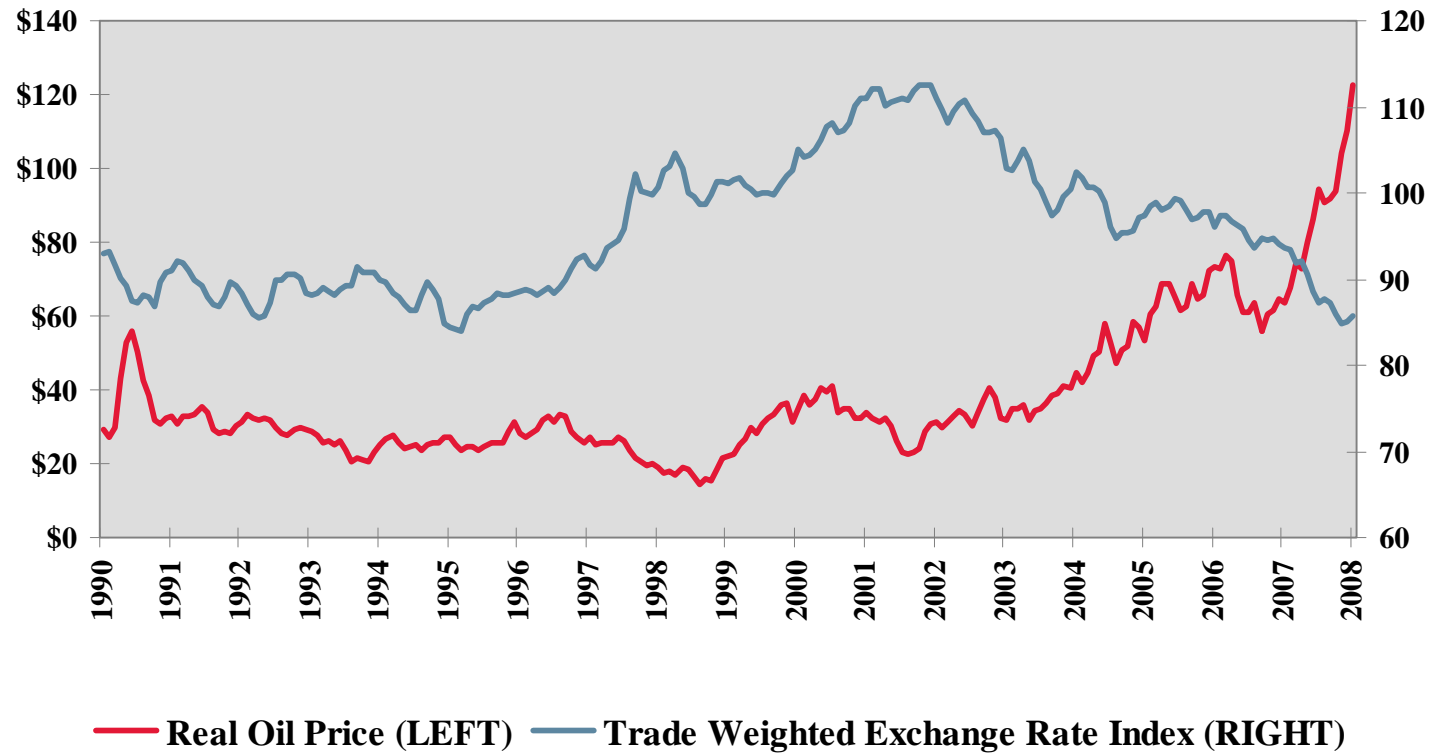
**June 2008**

**Weak dollar is  
inflationary**

**Oil trades in  
dollars;  
Weak dollar =  
high oil**

**US “on sale”  
to the rest of  
the world**

**Export growth  
is surging**



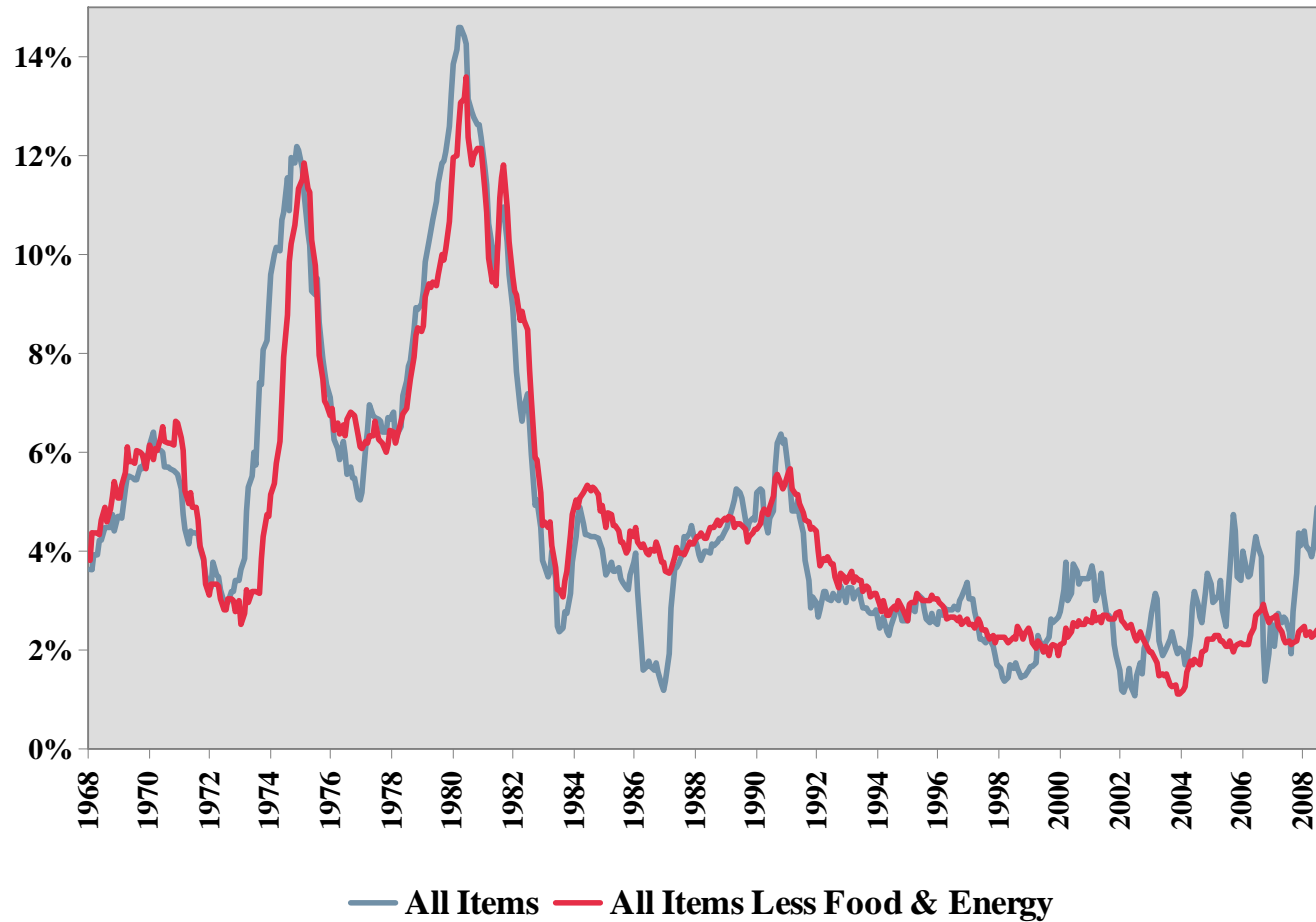
Source: AEW Research, economy.com

AEW Real Estate Market Outlook

“Cold and Hungry” consumers are getting cranky



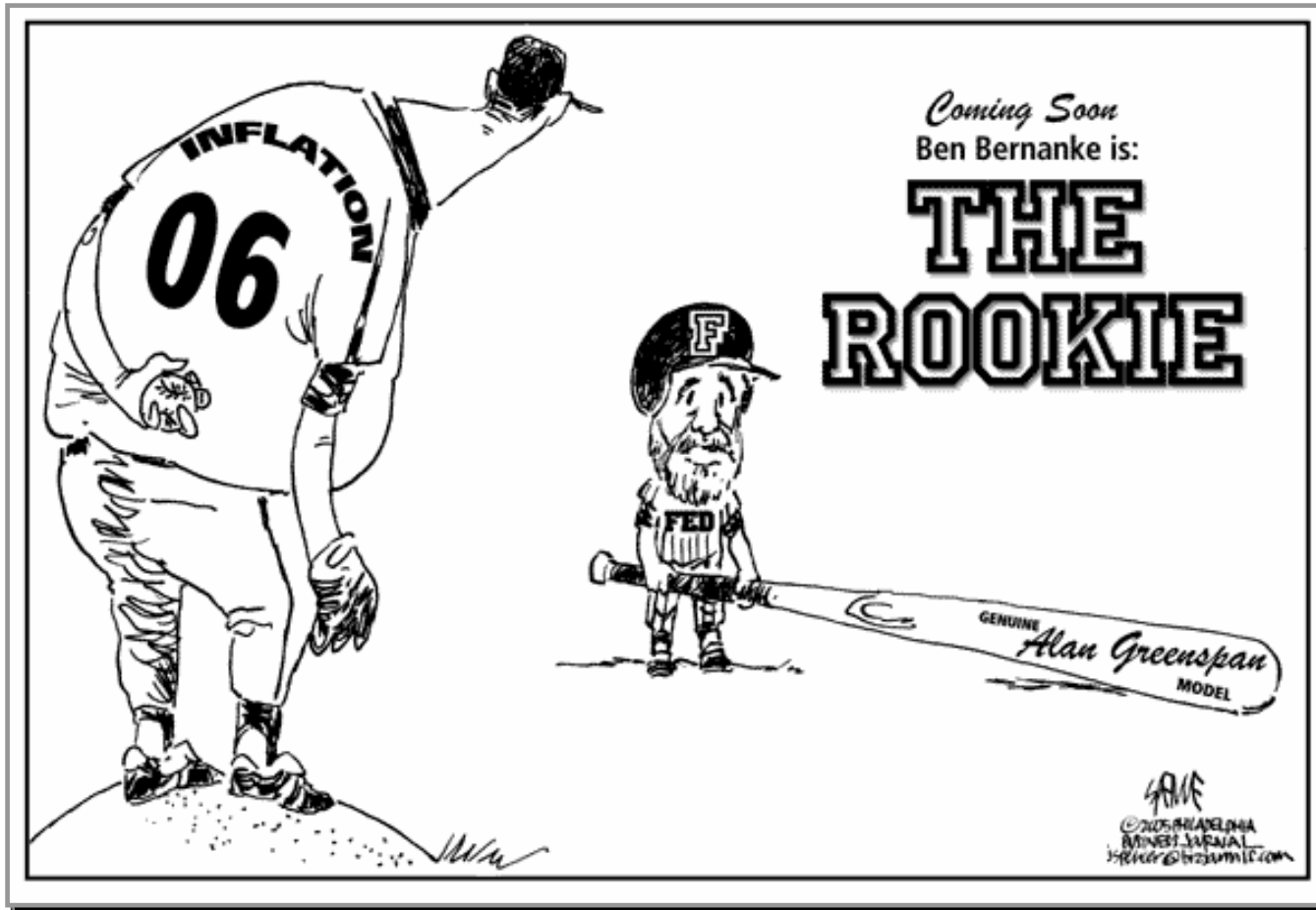
## But Keep an Eye on Inflation



Source: AEW Research, [economy.com](http://economy.com)

AEW Real Estate Market Outlook

# From Fall 2005: The End of an Era – What Comes Next?



# From Fall 2005: The End of an Era – What Comes Next?

INFLATION RATE UNDER THE LAST FIVE FED CHAIRMEN



Source: U.S. Bureau of Labor Statistics

## Step 3 - Recapitalize the Banking System

August 2008

Total losses now as big as the impact of RTC

There is a difference between a lender and an originator

Desperately Seeking SWF

WORLDWIDE FINANCIAL LOSSES AND CAPITAL RAISED THROUGH MAY 23, 2008 (\$ BILLIONS)

	Total		Q3 2008		Q2 2008		Q1 2008		Q4 2007		Q3 2007		Prior	
	Losses	Capital	Losses	Capital	Losses	Capital	Losses	Capital	Losses	Capital	Losses	Capital	Losses	Capital
America	189.3	159.5	0.0	0.0	15.2	68.8	69.4	60.1	75.5	29.8	28.0	0.8	1.2	0.0
Europe	205.5	148.0	0.0	0.8	0.6	93.3	99.0	26.5	87.2	17.1	15.9	5.4	2.8	4.9
Asia	21.4	18.4	0.0	1.9	0.5	13.0	9.7	3.5	10.9	0.0	0.3	0.0	0.0	0.0
Worldwide	416.2	325.9	0.0	2.7	16.3	175.1	178.1	90.1	173.6	46.9	44.2	6.2	4.0	4.9

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Source: Bloomberg

*"How much you puttin' in?"*

AEW Real Estate Market Outlook

# Negative Sentiment Dominates

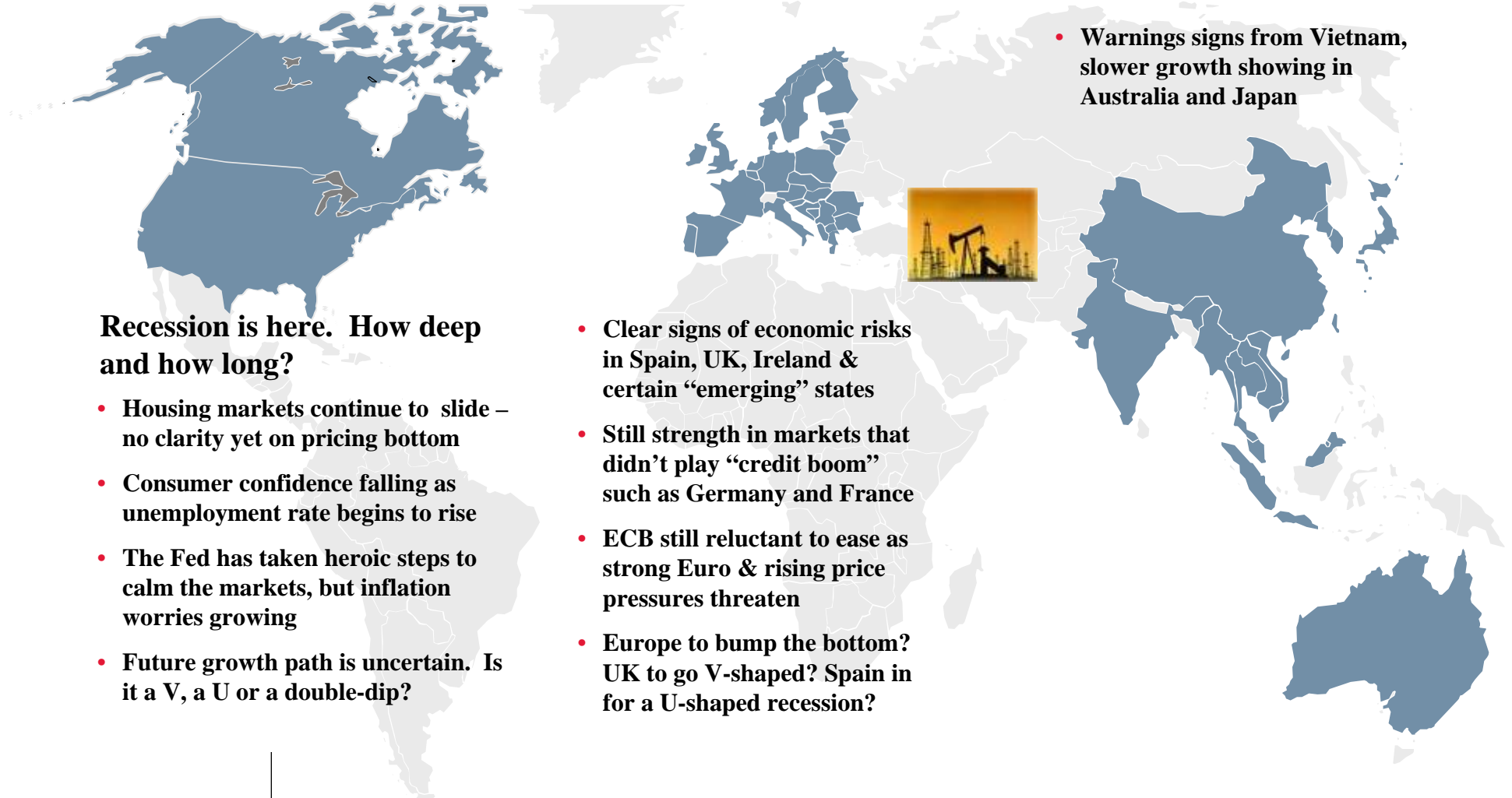
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*"Nation-wise, we're in a pickle."*

# The Economy: September 12<sup>th</sup> View

- Growth will slow but the region is likely to avoid an outright recession for now
- Is it different this time or is Asia in denial?
- Warnings signs from Vietnam, slower growth showing in Australia and Japan



## Recession is here. How deep and how long?

- Housing markets continue to slide – no clarity yet on pricing bottom
- Consumer confidence falling as unemployment rate begins to rise
- The Fed has taken heroic steps to calm the markets, but inflation worries growing
- Future growth path is uncertain. Is it a V, a U or a double-dip?

- Clear signs of economic risks in Spain, UK, Ireland & certain “emerging” states
- Still strength in markets that didn’t play “credit boom” such as Germany and France
- ECB still reluctant to ease as strong Euro & rising price pressures threaten
- Europe to bump the bottom? UK to go V-shaped? Spain in for a U-shaped recession?

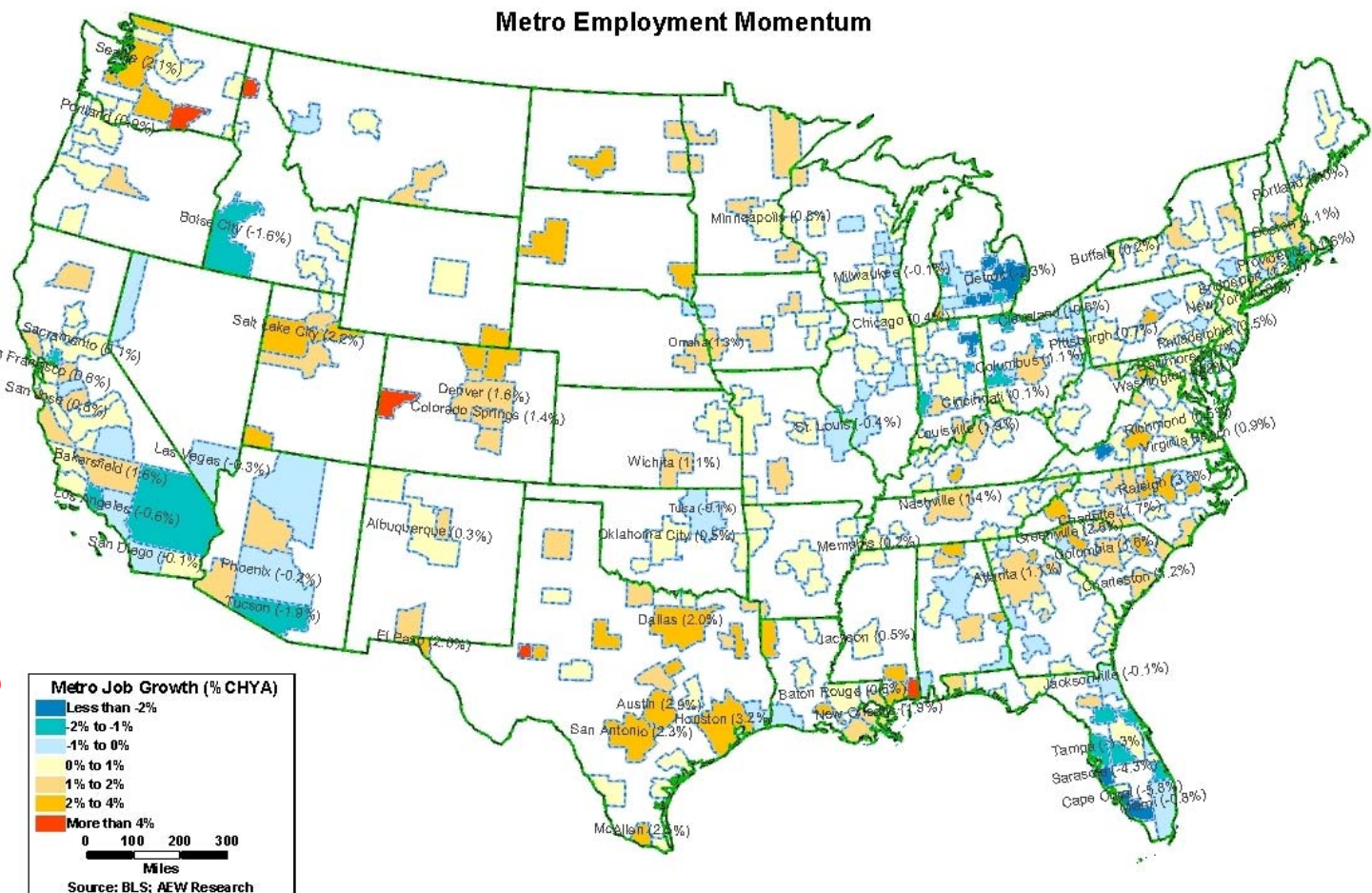
# A View of Job Growth: Red Hot, Blue Cold

September 12<sup>th</sup>  
View (Continued)

Pockets of strength in  
Pacific Northwest,  
Texas and  
South Central

Weakness in  
Industrial Midwest,  
Southern California  
and Florida

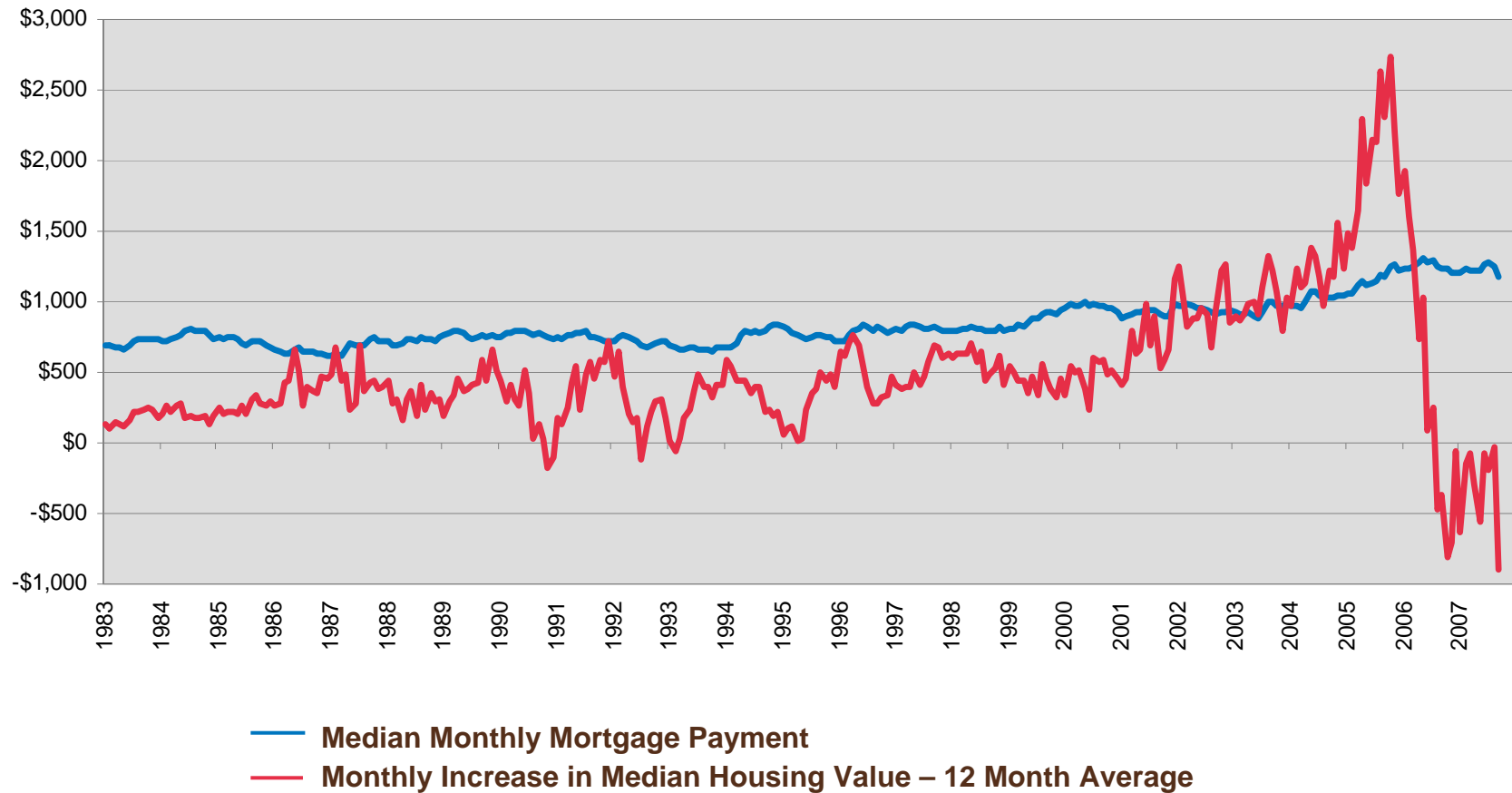
Illegals leaving  
Arizona in response to  
collapsing housing  
markets and anti-  
illegal legislation



# And Now the Multipliers are Multiplying!

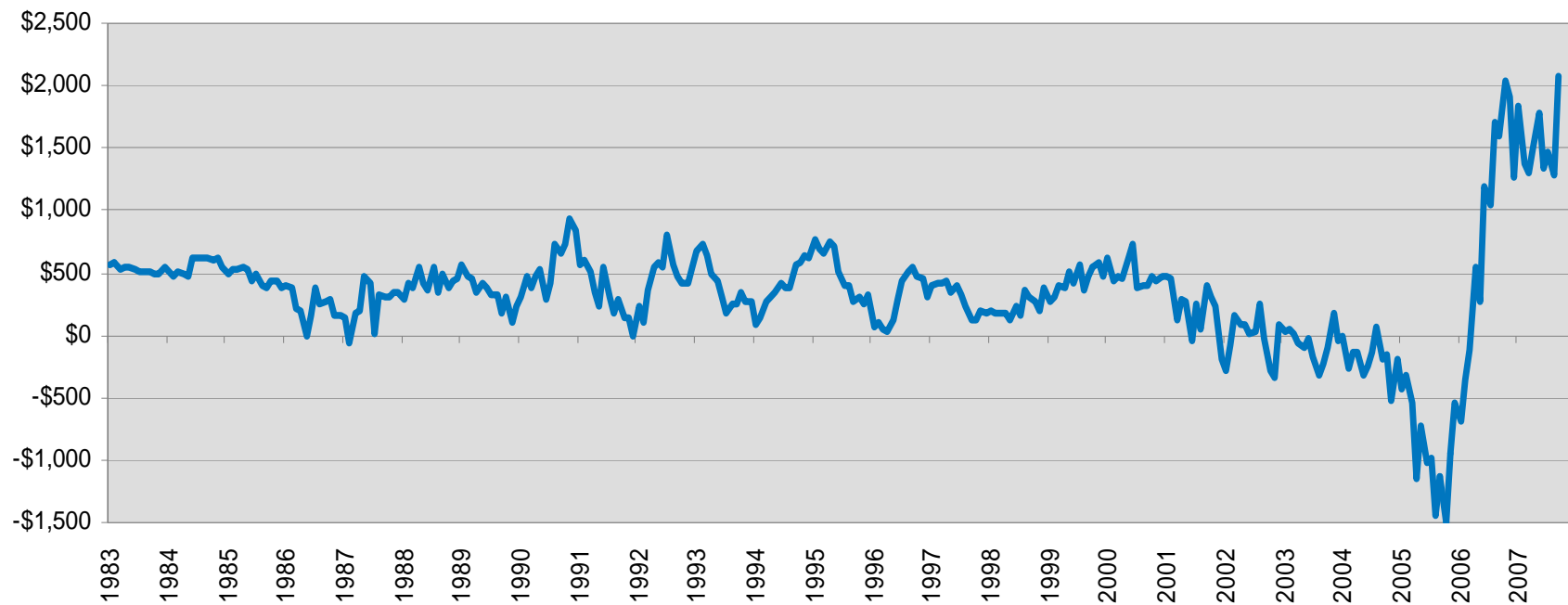


# The End of the Great Housing Free Lunch



Source: AEW Research

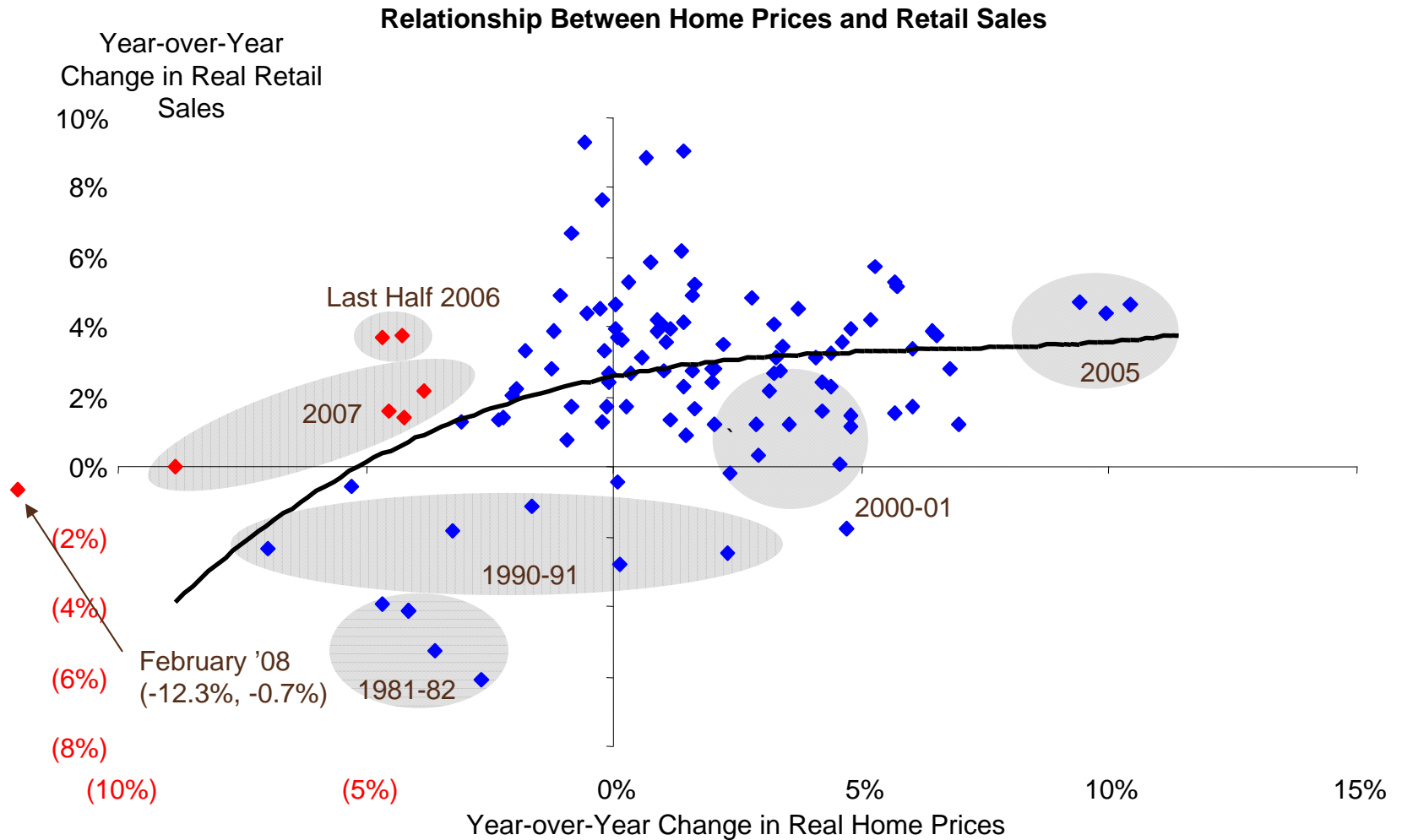
# The Price of Housing is Rising not Falling



— Median Monthly Mortgage Payment After Appreciation

Source: AEW Research

# The End of Lunch? Retail Sales and Housing Prices



Sources: Census Bureau; National Association of Realtors; Moody's Economy.com; PPR

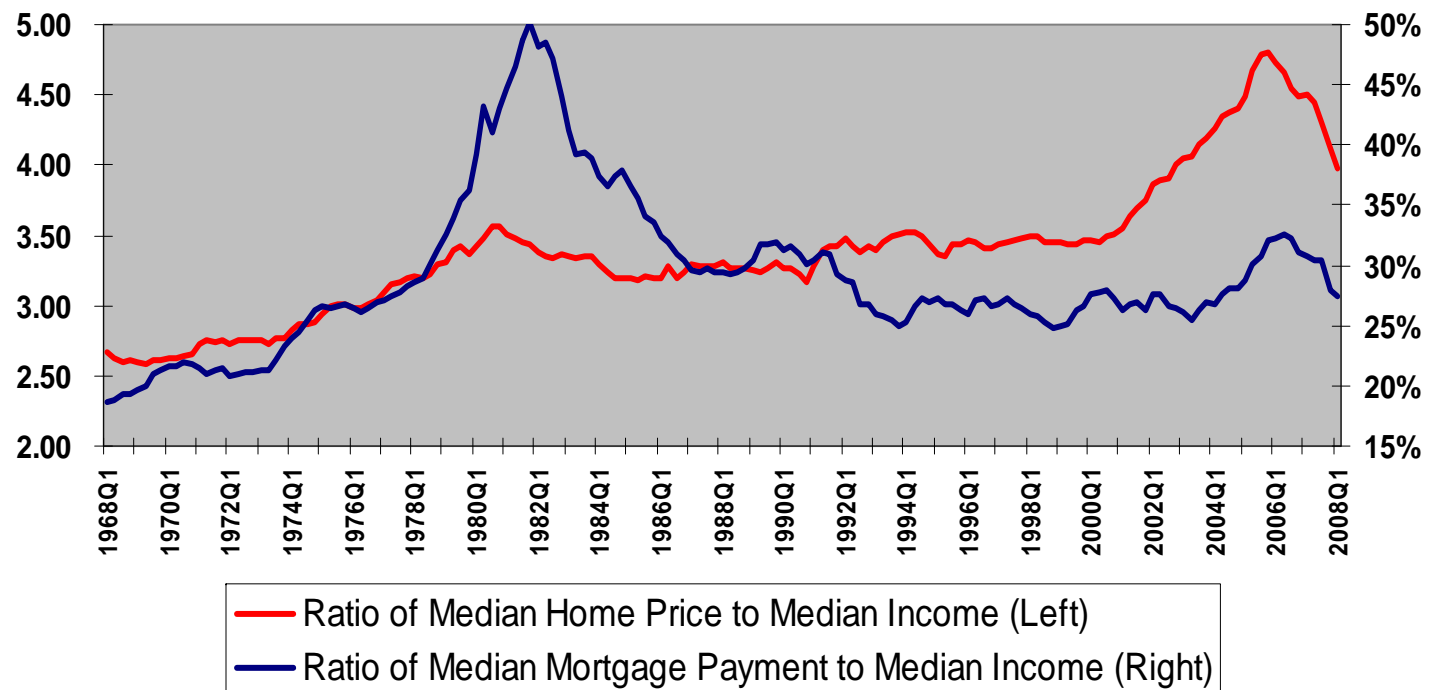
# The Case-Shiller Debate: How Much Must Prices Fall?

**August 2008**

**Bob Shiller: Price to Income measure indicates additional 10%+ drop.**

**Chip Case: Payment to Income measure says prices are almost back to average.**

**Of course this assumes no declines in incomes!**



Source: AEW Research, [economy.com](http://economy.com)

# Neither a Lender nor a Borrower Be?



Source: Cartoonbank.com

# With Conduits Shut Down, Who Fills the Void?

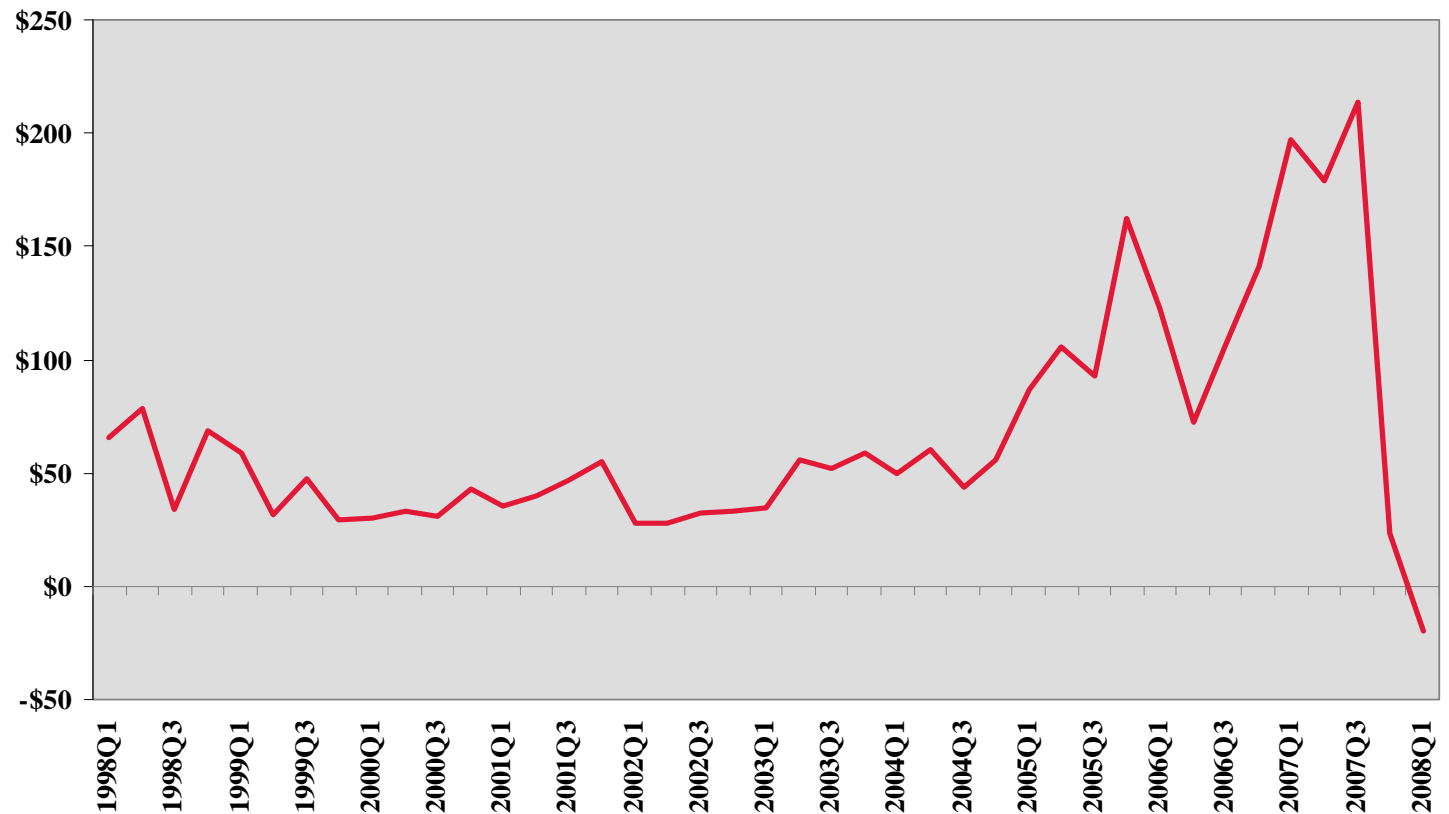
**Conduits represented more than 50% of all borrowing in recent years**

**Conduits are on now a net outflow for commercial mortgages**

**Life companies and finance companies are in control for now**

**Agency lenders (Fannie and Freddie) were the most active in multifamily. What's the future?**

**ANNUALIZED NET FLOW OF COMMERCIAL & MULTIFAMILY MORTGAGE (\$ Bil.)**

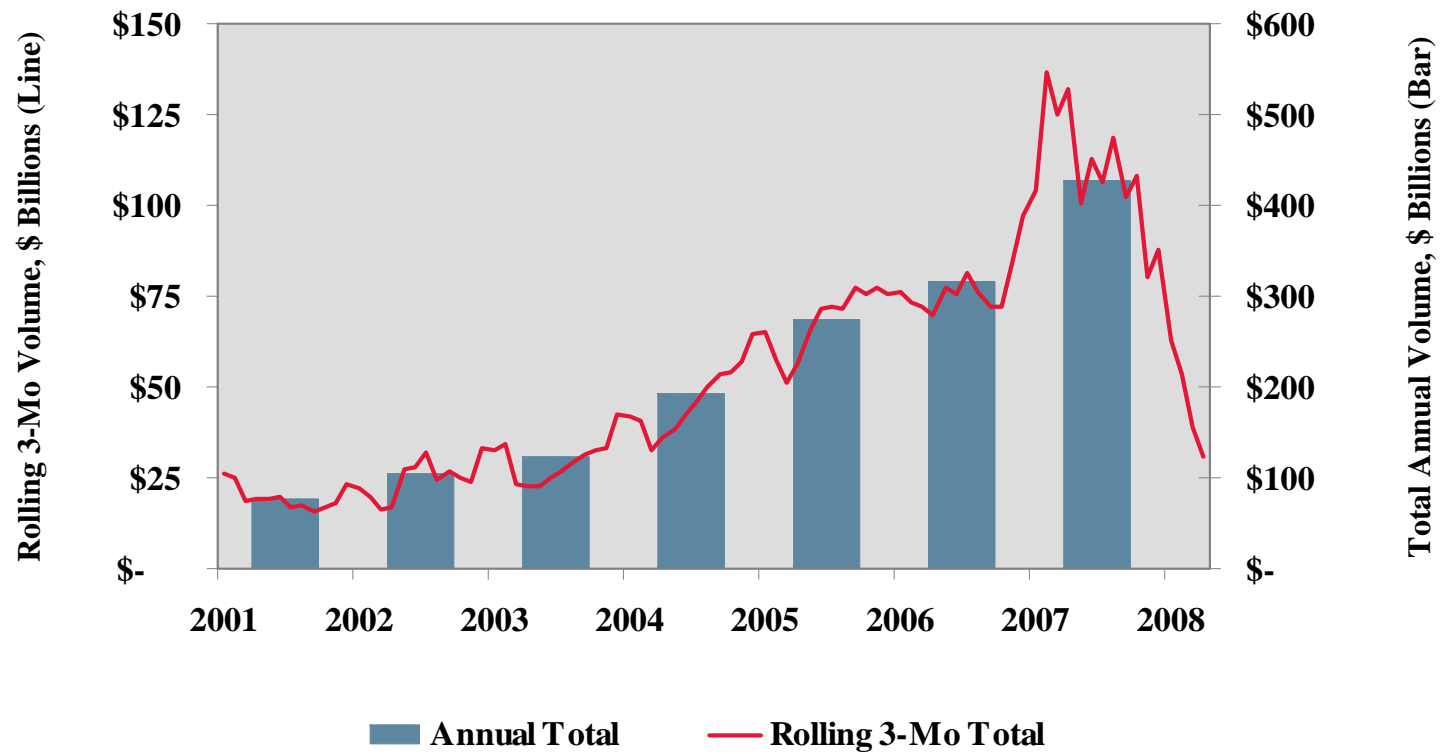


*Source: Federal Reserve Bank, As of 4Q 2007*

# Transaction Volumes Slowing Rapidly

With limited debt available, transactions volumes are down 80%

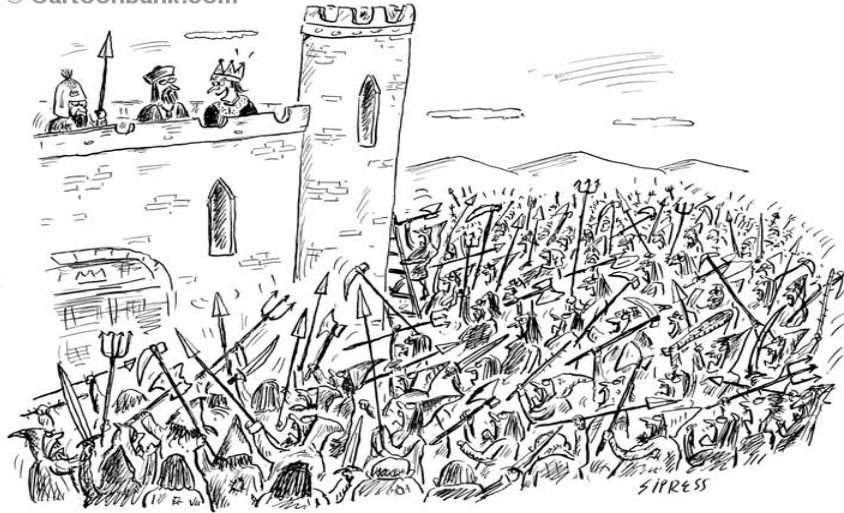
QUARTERLY VOLUME \$ BILLIONS



Source: Real Capital Analytics, Inc.

# Election 2008

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*"I know—what if I promise them change?"*

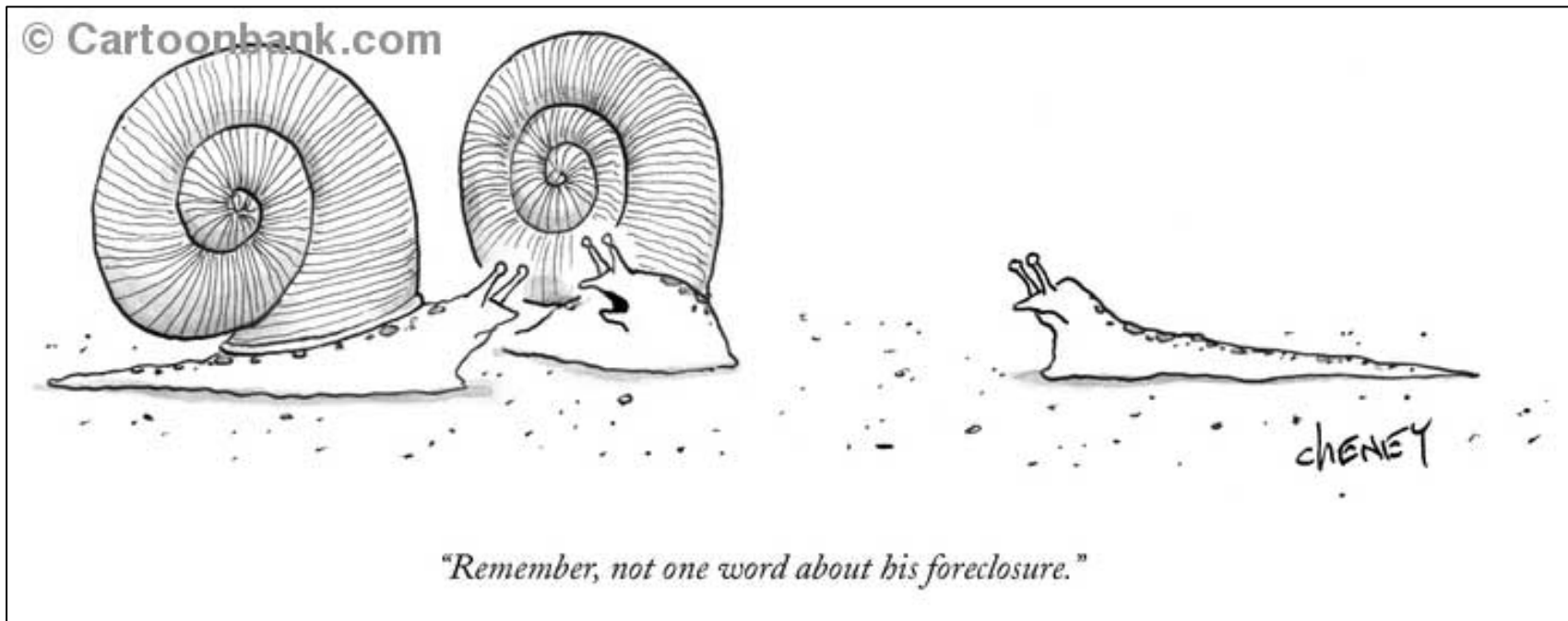
**Protectionism is one of the greatest risks in the current election.**

**We buy their goods and they buy our bonds.**

- First election since 1928 without sitting President or Vice President candidate.
- In 1928, Hoover won and the depression followed.
- Who wins in 2008 and what do they do?
- Dueling Economists: Mark Zandi vs Austan Goolsbee

“ the sort of person -- amiable, empirical and reasonable -- you would want at the elbow of a Democratic president, if such there must be” George Will

# 2008 is Painful for Many



Source: Cartoonbank.com

# What Everyone Will Be Saying

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*"I want my bubble back."*