

Global Visions. Local Solutions.

2008 CRE Midyear Meeting

Distressed Debt Opportunities

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April 14, 2008

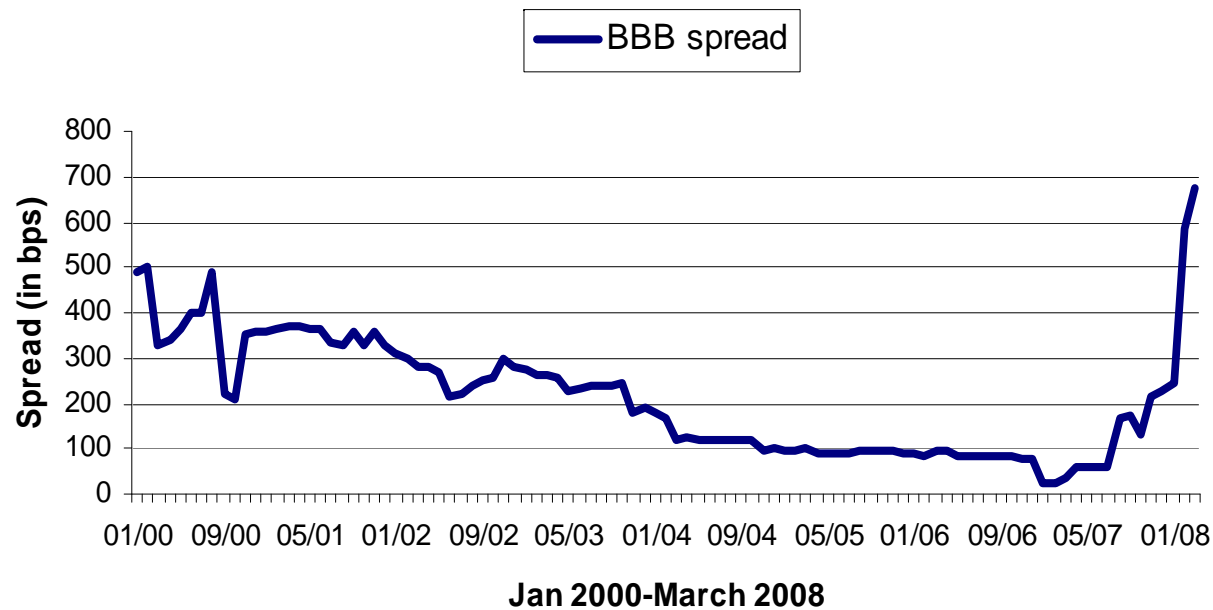


Here to Make Four Points

- 1. We see traditionally wider spreads on a range of real estate debt securities.
- 2. Wider spreads make risk-adjusted debt returns look attractive (i.e., positive alphas).
- 3. Positive alphas need not imply investor irrationality. Returns facing investors may be negatively skewed.
- 4. Of utmost concern is a further economic slowdown and greater negative skewness.

Spreads on subprime ABSs have widened considerably

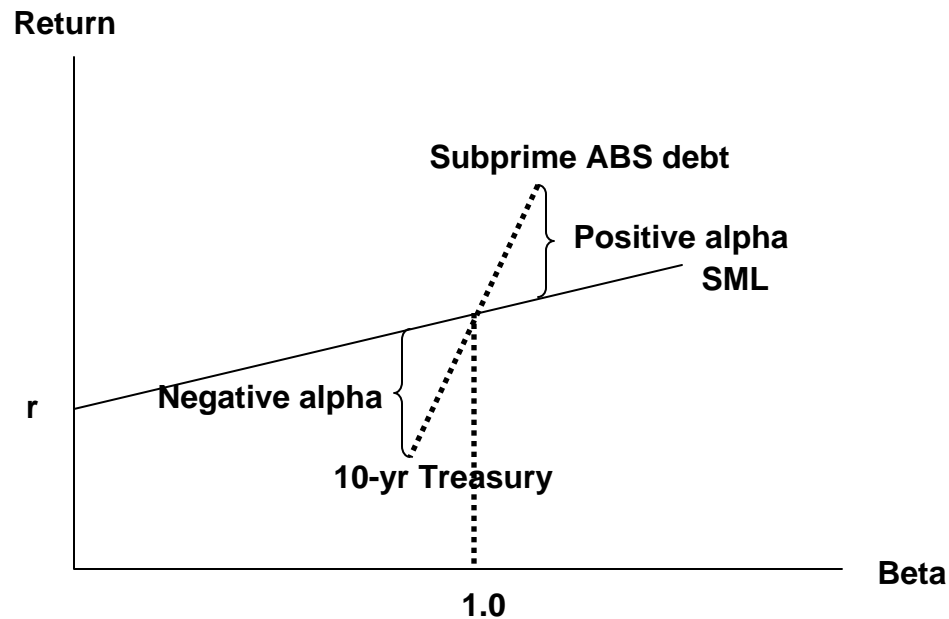
Home Equity ABSs



Source: Bear Sterns (BBZXSPA)

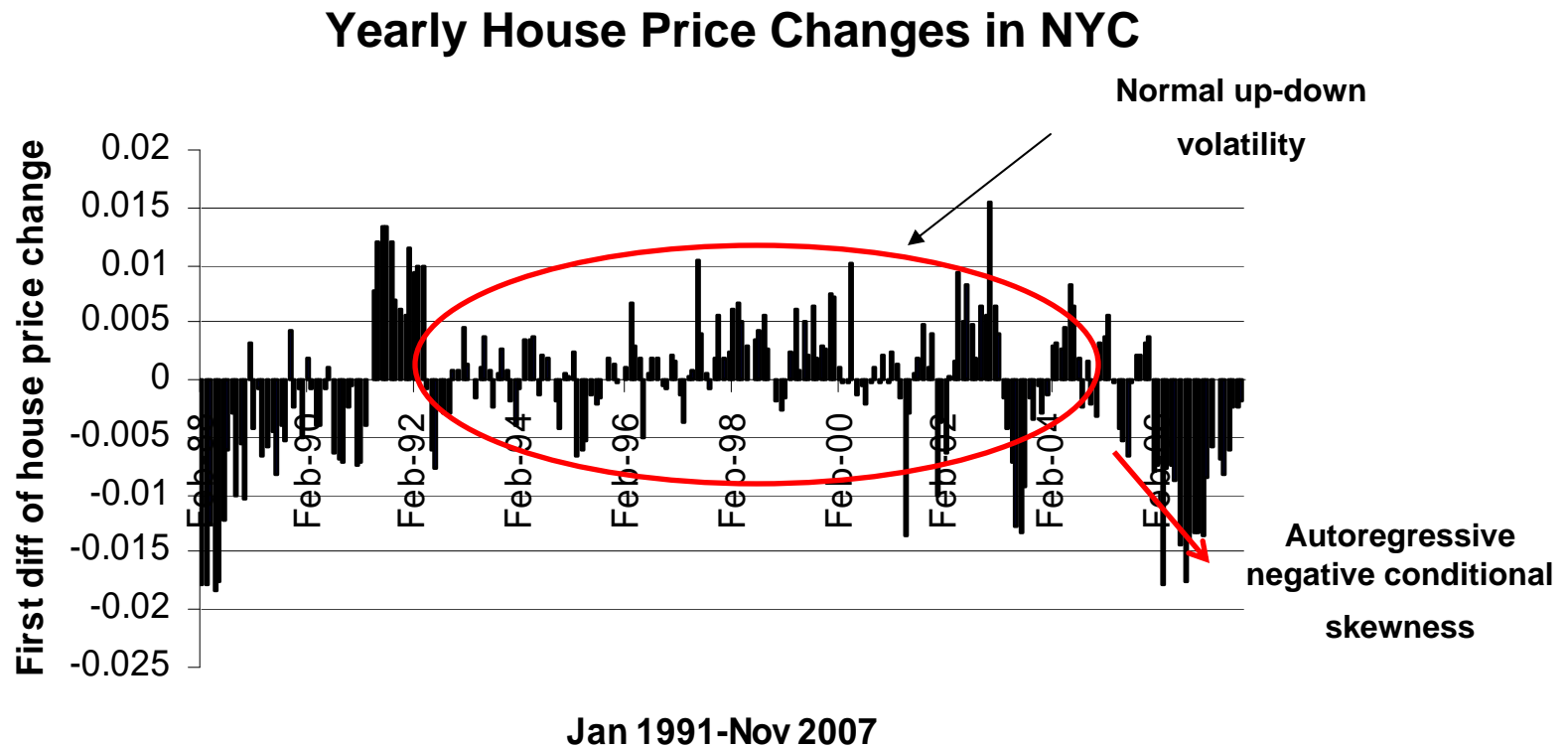
Wider spreads make subprime ABSs look attractively priced

Plot of Security Market Line (SML)



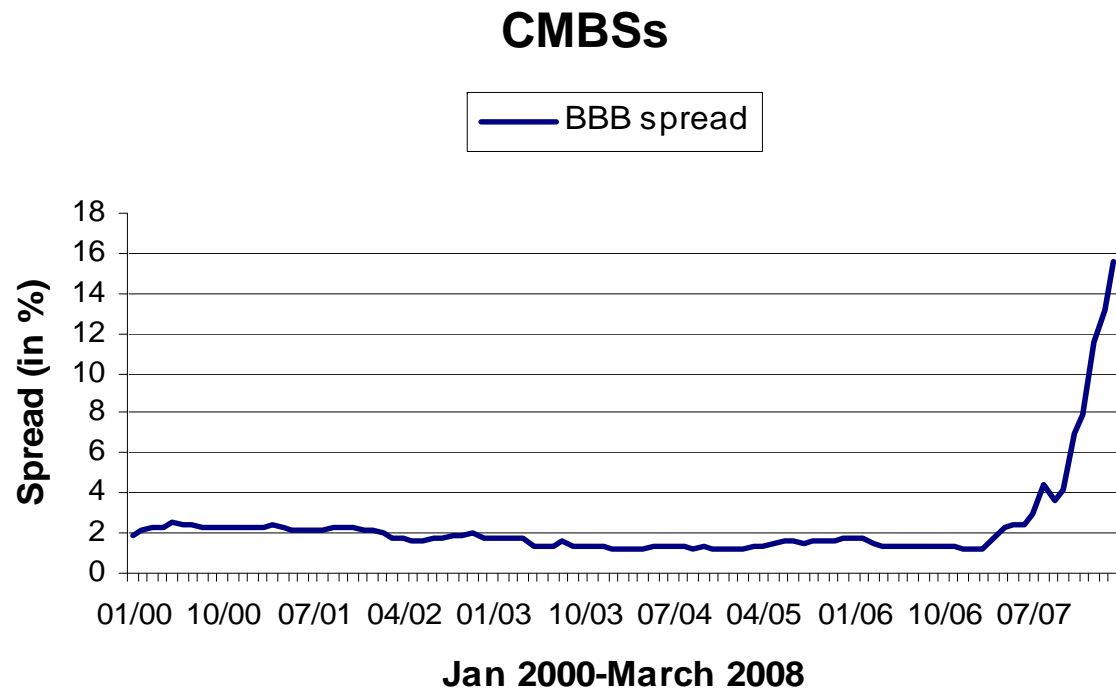
X-axis represents the risk (beta). Y-axis represents the expected return. r is the risk-free rate of return. SML results from the capital asset pricing model (CAPM) formula.

Yet yearly house price changes exhibit negative skewness



Source: S&P/Case-Shiller House Price Index

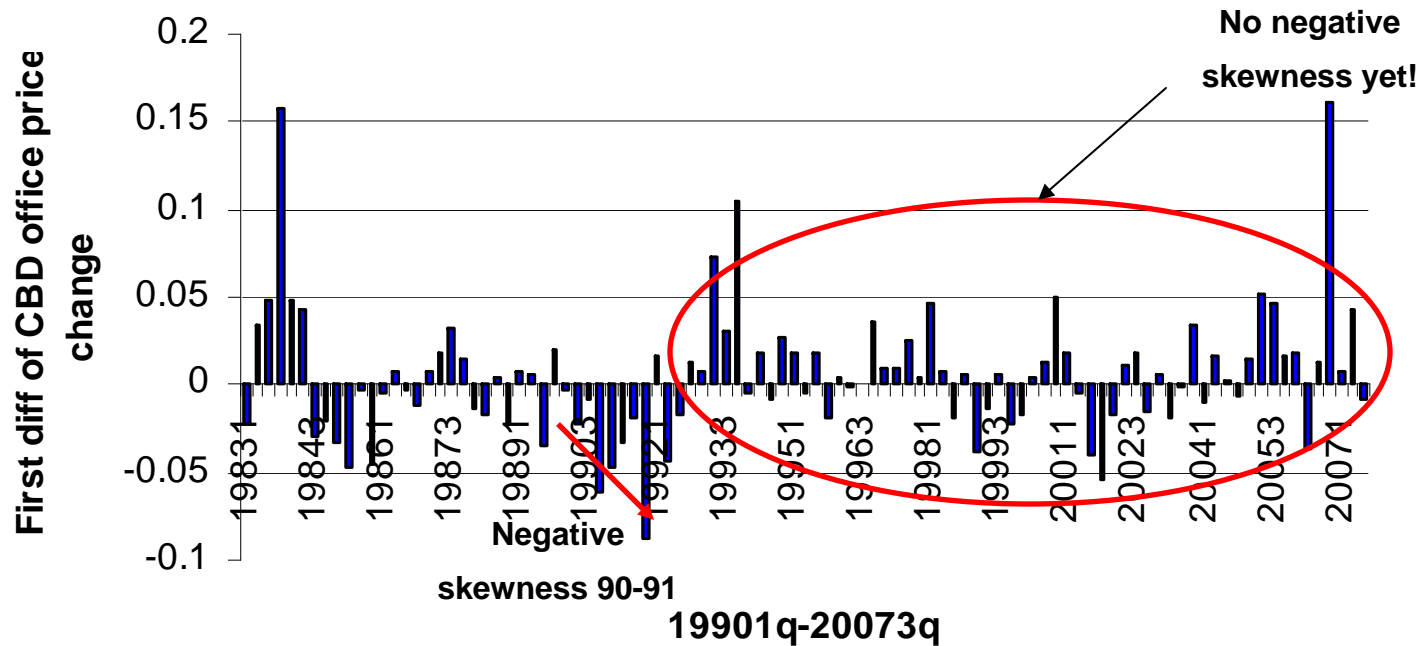
Story is similar for yield spreads on CMBSs



Source: Morgan Stanley (CMST)

Yet commercial markets have not yet exhibited negative skewness

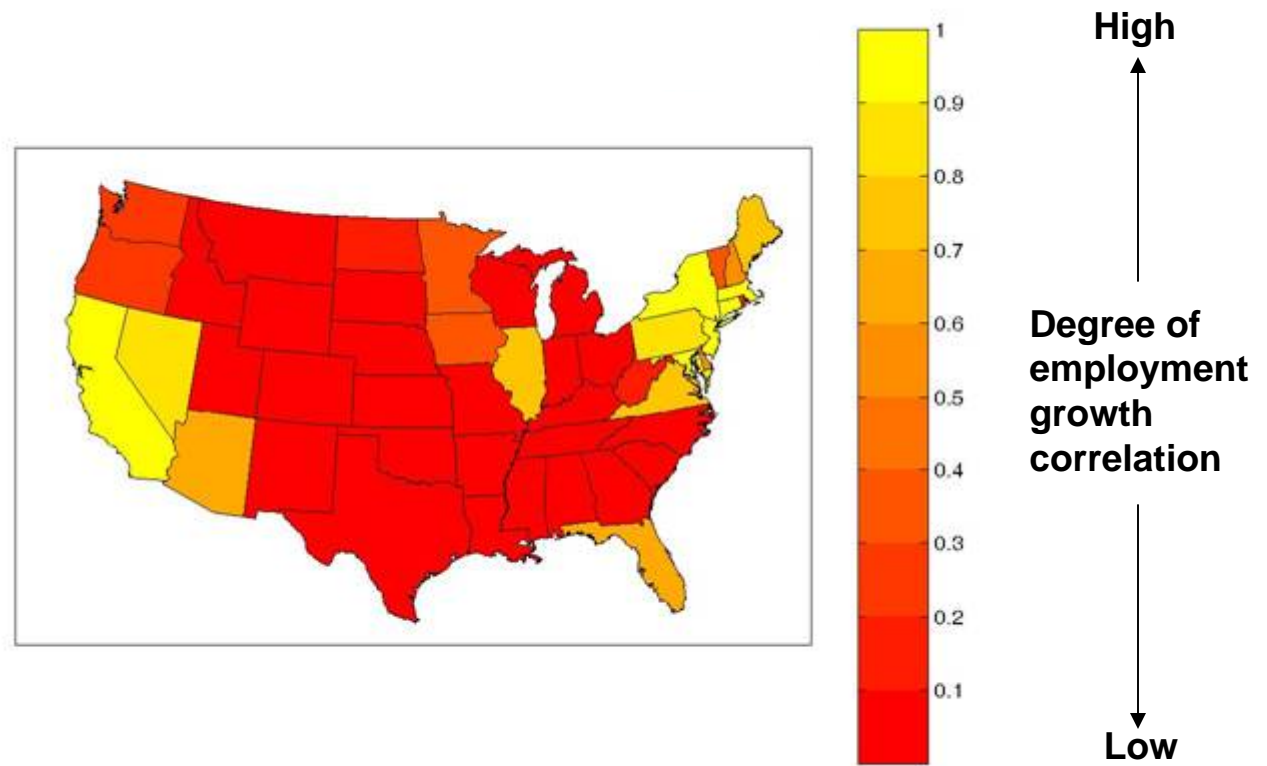
Yearly CBD Office Price Changes in NYC



Source: NCREIF

Not all markets are equally affected by negative skewness

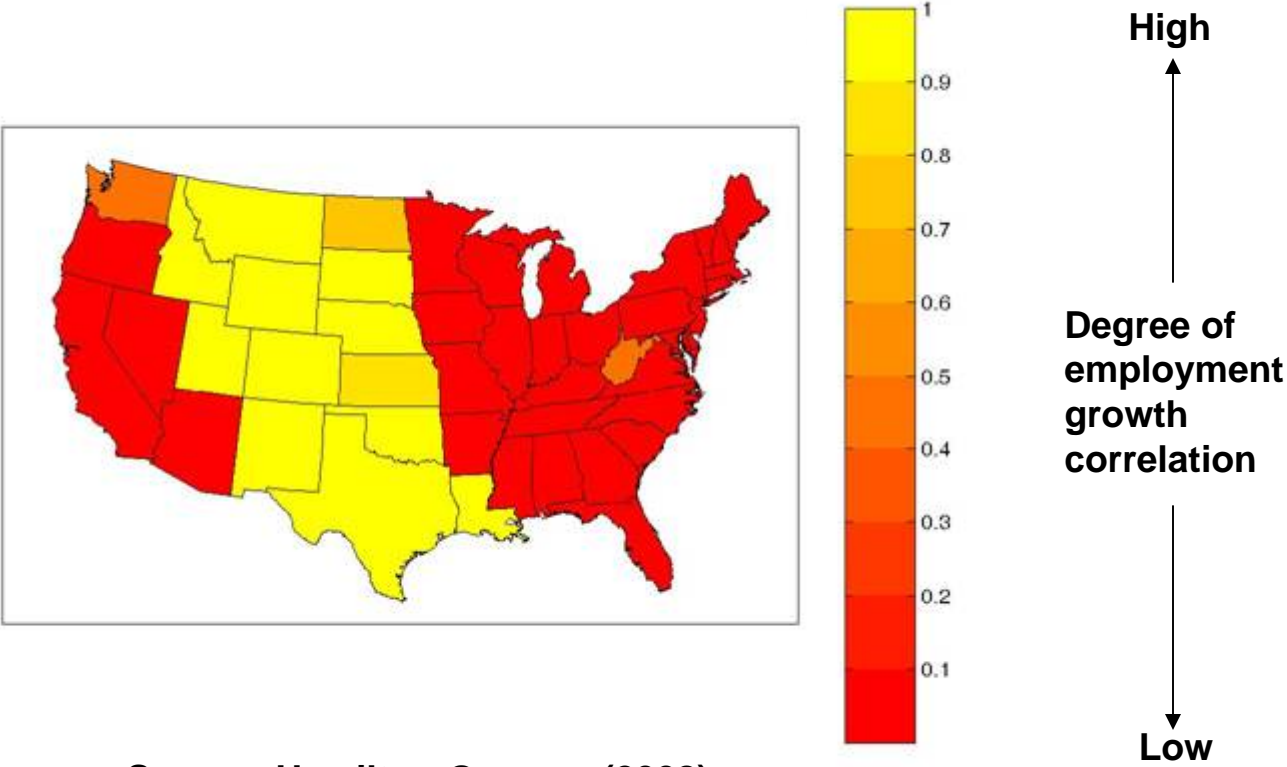
States in yellow can remain in recession for several quarters/years after most other states have begun their recovery



Source: Hamilton-Owyang (2008)

Some states can exhibit countercyclical growth patterns

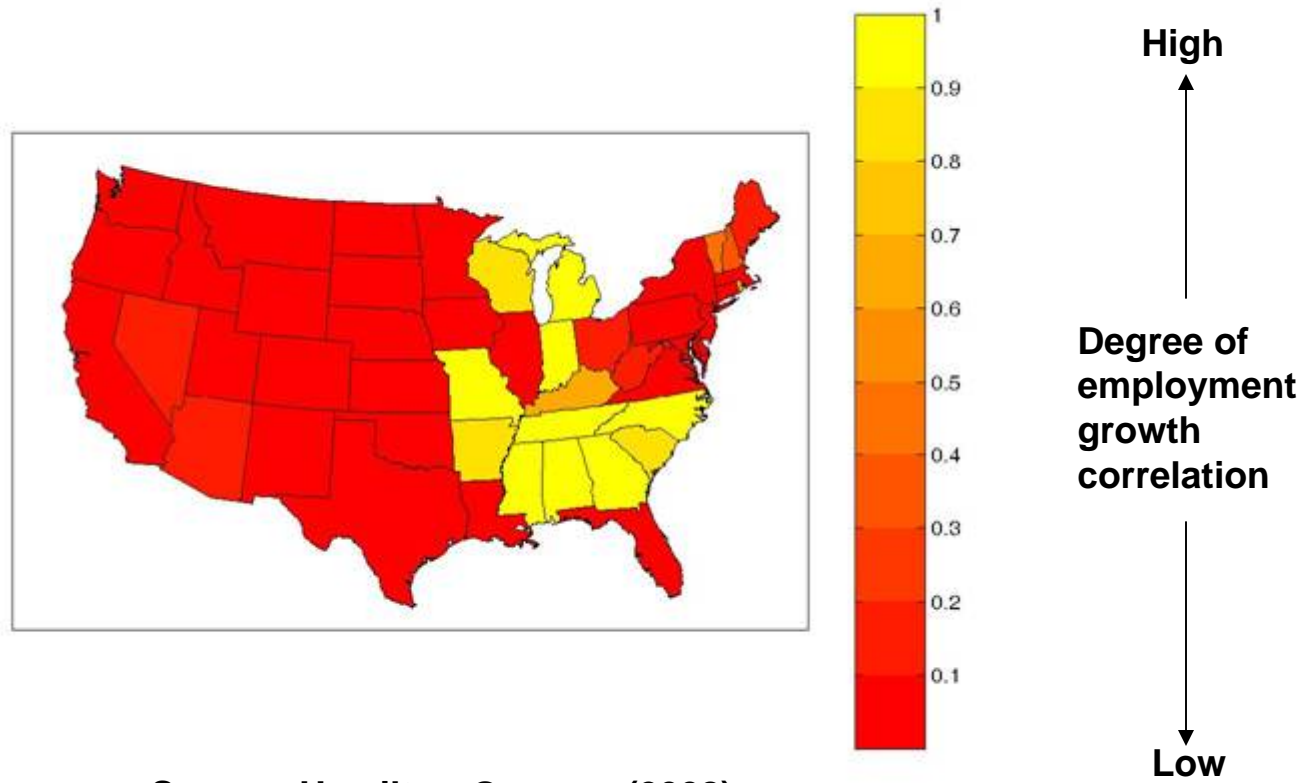
States in yellow can go into even when the rest of the economy avoids a downturn altogether.



Source: Hamilton-Owyang (2008)

Some states may lead the way to recession

States in yellow tend to go into recession one quarter before the rest of the country.



Source: Hamilton-Owyang (2008)