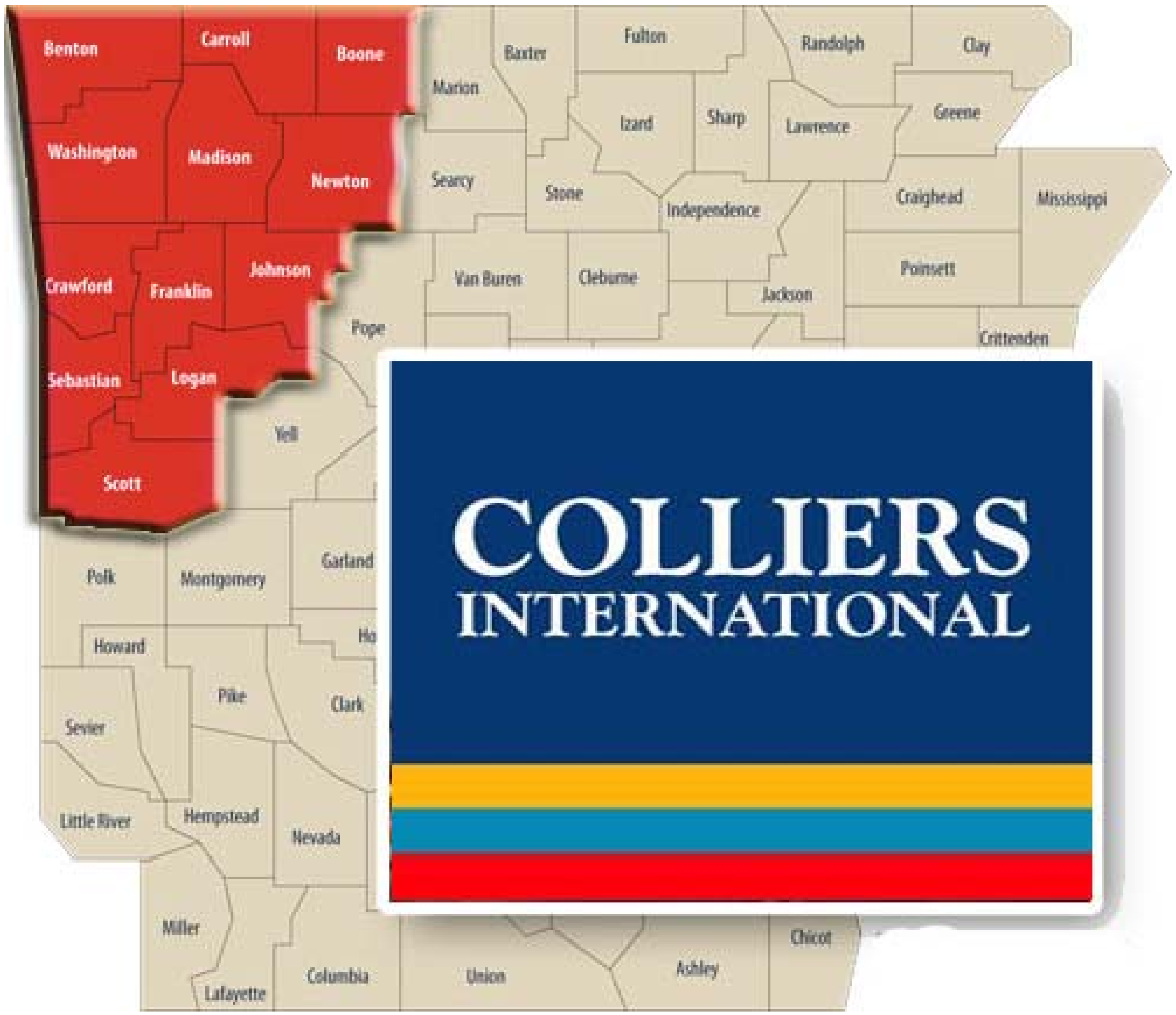
Northwest Arkansas Market Watch



Current Commercial
Real Estate Conditions

Market Watch

The New Deal: Workouts

With more than $1 trillion in loans set to mature in the near future, commercial owners and their legal counsels are trying to avoid disaster.

By Nellie Day

The housing market and many of its investors have already experienced what it's like to have a loan come due, only to come up short with the funds to pay it. Now, the commercial sector is gearing up for much of the same as low vacancies, high cap rates and restrictive cash flows continue to plague potential buyers and sellers.

Many individual and CMBS borrowers are counting the years or even months until their loans, debts and properties arrive on the chopping blocks. Most legal experts agree that the rough waters ahead will be overflowing with workouts.

BAD NEWS BRINGS NEW BUSINESS

"It's coming," says Andrew Raines, senior partner with Beverly Hills-based Raines Law Group. "The CMBS loans that were made between 2003 and 2007 were mostly five-year loans. If you track the activity you can see that loans peaked between 2006 and 2007, which means that we're looking at a peak in loan defaults in 2011 and 2012."

As borrowers prepare for more than $1 trillion of commercial loans to mature in the next three years, some law firms are preparing for a plethora of activity—but only certain types of activity. In an attempt to expand its workout and foreclosure capabilities, the Downtown LA office of Seyfarth Shaw added five attorneys to its real estate group in late 2008. Meanwhile, Manatt, Phelps & Phillips joined investment banking firm George Smith Partners to create a combined-assistance strategy for workouts and CMBS loans, which must be handled through master or special servicers.

Ellen Marshall, co-chair of Manatt's banking and specialty finance practice group, believes that special servicers will be vital over the next few years as loans mature. She also notes their role can be confusing to borrowers, making it easy for them to misstep without even knowing it.

"There are a lot of myths about the restrictions that apply for servicers, which need to be corrected," she says. "There are myths that special servicers can't modify loans before going to all investors, myths that servicers can't approve changes to a loan until it's in default, myths that the loan itself can't be sold out of a trust. There's even a myth that tension often exists between a master and a special servicer."

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Market Watch

	2006	2009
Rent	$16.00	$14.00
Expenses	$4.00	$4.00
	$12.00	$10.00

Value:

20,000 SF x $12.00 = $240,000 NOI

$240,000 / .08 cap = $3,000,000

Loan:

$ 3,000,000 X 100% = $3,000,000

Value:

20,000 SF x $10.00 = $200,000 NOI

$200,000 / .11 cap = $1,818,818

Refinance:

$1,818,818 X 20% = $363,763

Loan Balance – Value

$2,646,379 - $1,818,818 = $827,561

Cash Required = $1,191,324

The Fed predicts values will fall by 40-50%

"Extend and pretend" days are over.

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Walmart Supplier Office Market

Current Market Conditions Affecting The Downturn

- **Project Impact** – Reducing SKU count (products) in the store translates into fewer suppliers.
- **Apparel Division** move to New York
- **National Economy**
- **Local Economy** – Developers simply overbuilt.

Walmart Supplier Office Market

Observations from 2009

- **Term** - Tenants wanted shorter terms due to the uncertainty of their product with the implementation of Project Impact.
- **Rates** -Rental rates have dropped approximately 10% - 20% depending on the property.
- **Market Rate Spread** - The spread of rental rates widened. For example, rates in Bentonville used to be $13.50 -$17.75. Now rates are $10.00 - $21.00.
- **Shell Space** - Shell space is extremely difficult to lease due to shorter terms required by the tenants.

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Walmart Supplier Office Market

- **Outsourcing** - A significant number of Walmart IT contractors moved to the market.
- **Availability** - Most of the availability is in smaller spaces.
- **Location Changes** - Generally, tenants either upgraded space at a lower cost or moved to lower cost space to save money.
- **Migration** - Many tenants have migrated to south Bentonville and southwest Rogers, which has been in process for a several years.

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Walmart Supplier Office Market

Current Trends

- **Project Impact** and **Apparel** impacts have slowed.
- **Improved leasing activity** since tenants have put plans on hold for over a year.
- **Vacancy** has probably hit bottom.
- **Lower Rates** - Landlords without money for tenant improvements may incentivize tenants with lower rates in lieu of improvements.
- **Lease Terms** have seen a slight increase.
- **Landlord Concessions** will remain prevalent (Tenant improvements and free rent)

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Walmart Supplier Office Market

- **Oversupply** of small spaces.
- **Sam's Club** new Home Office may cause some tenants to relocate between Walmart and Sam's Home Offices.
- **New construction** will be minimal. Good for existing building's, bad for land.
- **Build-To-Suits** will have to charge $4.00 - $5.00 more than market to make projects economically feasible.
- **Foreclosed properties** - Possible pressure on rents.

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Investment Market

2003-2006 Peak of the Market

Income Properties

- Capitalization Rates of 6-8%
- Capitalization Rates = Net Operating Income / Purchase Price. Example: A property with a $70,000 NOI that sold for $1,000,000 had a 7% CAP Rate.

Land

- From 2003-2006 land values increased from 50-500%. Example: Residential tracts went from $12,000 per acre to $45,000 per acre.
- Driven by speculators and easy money

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Investment Market

Current Market

Income Properties

•Capitalization Rates of 8-12% when you can find a buyer

•Financial markets are much more conservative

•Properties require substantial equity and a good debt coverage ratio

• Banks have set a floor on their interest rate

•Continued disconnect between sellers and buyers

Land

•Limited market except for end-users

•A few sales indicating bottom of market

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Investment Market

Current Market

Distressed Assets

•Active market in loans secured by distressed properties

•Loan prices are 10-60% of the face value of the loan.

•Most assets are coming from FDIC, institutional investors, REIT's and large financial institutions.

•Lots of money chasing distressed assets, but few sources at this time.

•FDIC is transitioning to "stop loss" agreements with stong banks to take over weak banks.

•ANB failure was a learning experience for FDIC and we are paying the price.

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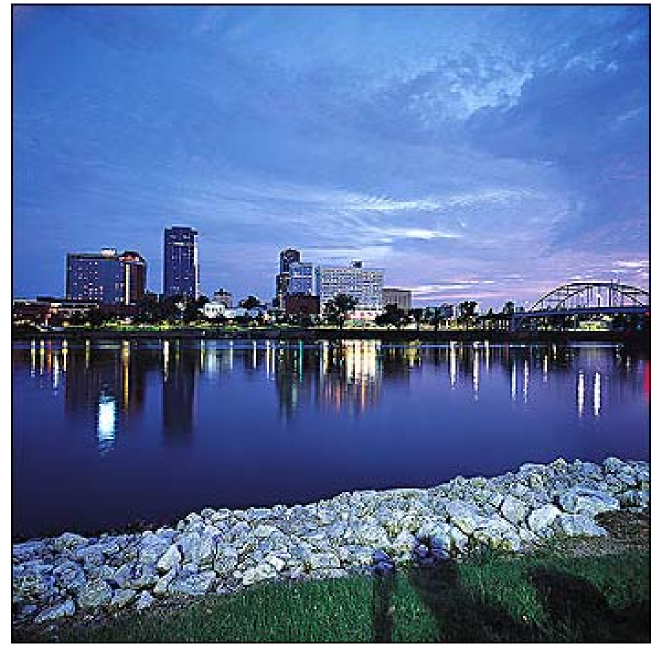
Distressed Properties

Forecast for Property Types in NWA



- Not So Good – Apartments
- Not So Good – Office
- OK – Retail
- Not So Good – Industrail
- Bad – Most Land

Retail Leasing

Where we are:

• Increased leasing activity in 2010.

• Strong activity with restaurants and some shop tenants.

• Mom and Pops having a tough time due to the credit situation.

• Rents stabilizing at $16 - $18 NNN for most Class A retail.

• 1999 – 2008 added $25 - $30 million square feet in neighborhood and community retail.

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Retail Leasing

Where we're headed:

- Vacancy rates will tighten with no new construction hitting the market.
- Lease rates will increase slightly for good properties.
- Values still adjusting due to "distressed asset" situations.
- 2010: 2.5 million square feet of new neighborhood and community retail → development is dead.
- Fundamentals should stabilize in 2010, but it will probably be 2012 before we see rents begin to grow again.

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Shopping Centers & Big Box Retail

Where we are:

- Retail sales were up in March, but coming off horrible 2009 sales.
- “New Frugality” has set in with shoppers.
- Rent concessions are common causing rents to go down.
- The “power center” format is <u>basically played out</u> in mid-markets.

Shopping Centers & Big Box Retail

Where we're headed:

- Bargain shoppers will continue to favor discounters.
- Growth for higher end retailers such as Nordstrom will be minimal.
- Retailers will be cautious moving forward.
- Focus on profit growth than growing sales by additional store square footage.
- Big Boxes to evaluate <u>smaller formats </u>for growth.
- More mixed use centers as developers look to re-enter market.

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NWA Retail Market

Where we are:

- Vacancy rates in mid-teens in most markets.

- Numbers are skewed by big boxes.

- Northwest Arkansas better fundamentals than nation overall.

NWA Retail Market

Where we're headed:

• Smaller developments- stand alone retailers, smaller strip centers and mixed use centers.

• Expect to see very few construction starts and virtually no "big projects".

• Fee squeeze- landlords and owners have rent pressure from users, fees go down across the board.

• Look for "normal market" to reemerge as distressed situations continue to work out.

• Renovation of existing space is the major opportunity for the next year into 2012.

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Questions?