Discussion of:
“Can Securitization Work?
Lessons from the U.S. REIT Market”

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NAREIT Real Estate Research Conference
An Outline of My Thoughts

**OVERVIEW:**

- **HYPOTHESIS:** “Differential performance”
  - housing v. commercial real estate = f(REITs’ “civilizing influence”)

- **COMPETING PERSPECTIVES:** My focus will be on theory (not technique):
  - equity v. debt markets ← GSE distortions
  - aggressive debt in the CRE markets ← bridge-equity loans
  - relative size of the domestic REIT market
  - REITs specifically or securitization more generally? ← REOCs?
  - expansion of CRE market data/vendors
  - supply v. price/returns ← space- v. capital-markets risk

- **CONCLUSION:** Difficult to disentangle cause(s) & effect(s).

- **FOOTNOTE:** Did REIT investors heed the warning signals?
Residential v. Commercial Real Estate Appreciation

Another view of the “performance differential”

Comparison of Residential v. Commercial Real Estate Appreciation for the Period 1987-2012

Key Question: What drove this disparity?

Sources: Case-Shiller and NCREIF.
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Residential Appreciation = \( f(\text{Gov't Distortions}) \)?

Comparison of Residential v. Commercial Real Estate Appreciation for the Period 1987-2012

- Residential Appreciation = \( f(\text{GSE Distortions}) \)
  - Low-/no-equity loans
  - No-doc/"liar's" loans
  - Fannie/Freddie "Conservatorship" ($400 billion)
  - AIG bailout ($180 billion)
  - TARP ($700 billion)

Source: ProPublica, "History of U.S. Gov't Bailouts"
Residential Recovery = \( f(\text{Gov't Distortions}) \)?

Comparison of Residential v. Commercial Real Estate Appreciation using Rescaled CRE Values for the Period 1987-2012

Residential Recovery = \( f(\text{Gov't Distortions}) \):
* Tightening underwriting standards
  - Wider fluctuation in resi (than CRE)
* Did gov't intervention create a false bottom?
  - Home Affordable Modification Program
* What explains "dead cat" bounce? In light of:
  - "Quantitative Easing"
  - First-Time Home Buyer Tax Credit ($8,000)

Irony: Enter: Single-Family Rental business model

Rescaled CRE Values
Another View of Government Distortions

What explains Washington DC’s superlative performance?

"Bubble" Growth and Subsequent Decline for Certain US Housing Markets for the Period 2000 through 2012

Bubble Growth: Maximum Price Increase from January 2000

Source: S&P Case Schiller Index and instructor’s Calculations
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CRE Investors Are Not Immune to Aggressive Lending:

- A particular form of aggressive CRE debt: *bridge-equity loans*
- When such debt was available, CRE investors behaved like many of the residential homeowners/borrowers
- While these investments ended badly, they helped propel prices in the interim

### Examples of Certain Bridge-Equity Loans

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Size (millions)</th>
<th>Acquirer(s)</th>
<th>Seller</th>
<th>Senior Financing</th>
<th>Bride-Equity Loan Amount</th>
<th>Lender(s)</th>
<th>Investor Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>EOP (Manhattan)</td>
<td>$7,610</td>
<td>H. Macklowe</td>
<td>EOP/Blackstone</td>
<td>$6,360</td>
<td>$1,200</td>
<td>Fortress</td>
<td>$50 0.66%</td>
</tr>
<tr>
<td>Peter Cooper Village</td>
<td>$6,290</td>
<td>Tishman-Speyer &amp; BlackRock</td>
<td>MetLife</td>
<td>$4,400</td>
<td>$1,665</td>
<td>Wachovia &amp; Merrill Lynch</td>
<td>$225 3.58%</td>
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<tr>
<td>Stuy Town</td>
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<tr>
<td>Archstone-Smith</td>
<td>$23,689</td>
<td>Tishman-Speyer &amp; Lehman Bros.</td>
<td>Archstone-Smith</td>
<td>$21,202</td>
<td>$1,987</td>
<td>Lehman Brothers</td>
<td>$500 2.11%</td>
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<td><strong>$37,589</strong></td>
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<td></td>
<td><strong>$31,962</strong></td>
<td><strong>$4,852</strong></td>
<td></td>
<td><strong>$775 2.06%</strong></td>
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</tbody>
</table>


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  - expansion of CRE market data/vendors
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- **FOOTNOTE**: Did REIT investors heed the warning signals?

Omitted Variables
How Big a Segment Are Listed REITs?

- Clearly an important market segment
- Listed REITs represent ~40% of the equity market
- Other sectors are “uncivilizing forces”?

Source: *Emerging Trends in Real Estate: 2012*
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Securitized REITs v. Securitization Generally?

How do US REITs compare globally?

Country's Share of Publicly Traded Equity REITs

- USA, 61.2%
- Australia, 8.6%
- France, 5.9%
- Canada, 4.5%
- United Kingdom, 4.7%
- Singapore, 4.4%
- Japan, 5.5%
- Germany, 0.2%
- Italy, 0.2%
- Switzerland, 0.0%
- Russia, 0.0%
- Brazil, 0.0%
- Turkey, 0.2%
- Ukraine, 0.0%
- Belgium, 0.6%
- Cyprus, 0.0%
- Denmark, 0.0%
- Finland, 0.0%
- Greece, 0.0%
- Luxembourg, 0.0%
- Austria, 0.0%
- New Zealand, 0.3%
- Malaysia, 0.1%
- Vietnam, 0.0%
- China, 0.0%
- Hong Kong, 2.2%
- BVI, 0.0%
- Mexico, 0.5%
- Other, 0.0%

Source: SNL Financial | May 29, 2013
What about REOCs? How does US compare globally?
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A Remarkable Increase in Data Quality & Availability

For us graybeards, it’s been a quantum leap!
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Myopic Market: Focused Only on Space-Market Risks?

What about capital-market risks? Stagnant NOI v. fluctuating prices

Sources: NCREIF and instructor's calculations.
Is Muted Office Development Surprising?

Office has been among the worst-performing property types.

Sources: NCREIF and instructor’s calculations.
An Outline of My Thoughts

**Overview:**

- **Hypothesis:** “Differential performance”
  - Housing v. commercial real estate = \( f(\text{REITs’ “civilizing influence”}) \)

- **Competing Perspectives:** My focus will be on theory (not technique):
  - Equity v. debt markets ← GSE distortions
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- **Conclusion:** Difficult to disentangle cause(s) & effect(s).

- **Footnote:** Did REIT investors heed the warning signals?
Concluding Thoughts

- **INTERESTING HYPOTHESIS**: “Differential performance”
  - housing vs. commercial real estate = \( f(\text{REITs’ “civilizing influence”}) \)

- **CAVEATS**: Difficult to disentangle competing hypotheses:
  - equity vs. debt markets ← GSE distortions
  - aggressive debt in the CRE markets ← bridge-equity loans
  - relative size of the domestic REIT market
  - REITs specifically or securitization more generally? ← REOCs?
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  - supply vs. price/returns ← space- vs. capital-markets risk

- **CONCLUSION**: Agreed → REITs = “civilizing influence”
  Concerns → CRE = broad/evolving/competitive market

- **FOOTNOTE**: Did REIT investors heed the warning signals?
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Omitted Variables

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Footnote: Did REIT Investors Heed the Warnings?

- “Sell” signals from seasoned pros?
- 2005-07: 31 REIT privatizations/mergers ($155 billion of GAV)
- Some notable transactions:

  - AMLI Announces Morgan Stanley’s Bid (8-05)
  - Carr America Announces Blackstone’s Bid (2-06)
  - EOP Announces Blackstone’s Bid (11-06)
  - Archstone Announces T-S/ Lehman’s Bid (5-07)

Source: Yahoo Finance, June 3, 2013