SunTrust
Live Solid. Bank Solid.℠

EXPLORING IMPEDIMENTS TO A REAL ESTATE RECOVERY:

A POLICY DISCUSSION

December 1, 2011

Walter E. Mercer
Commercial Real Estate
Line of Business Manager

Definition

- *Impediment*: A hindrance or obstruction in doing something: "an impediment to progress”

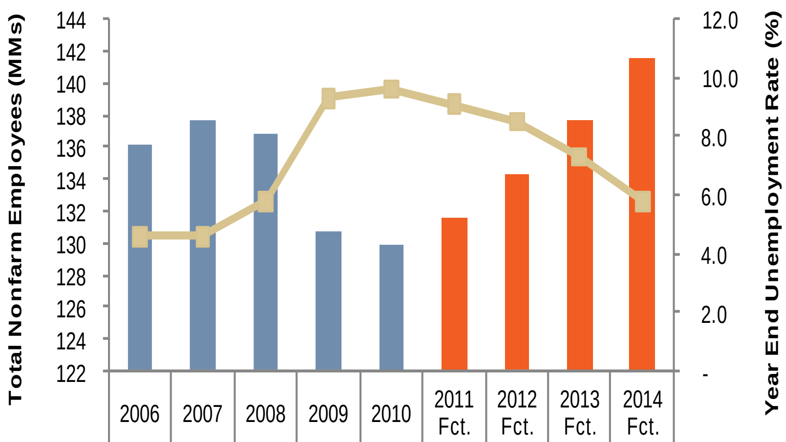
- *Hindrance*: A thing that provides resistance, delay, or obstruction to something or someone.

Hindrances to real estate growth

- Weakness in real estate markets, both commercial and residential, continue to affect the overall growth of the economy.
- The rate of deterioration in market and credit conditions has leveled off, and there are some early signs of price stabilization. Nonetheless, CRE delinquencies and losses are expected to remain elevated for some time.
- Construction in commercial properties continues to lag due to high vacancy rates of existing inventory along with lower property values
- The CRE total debt market is estimated at $3 trillion, of which banks have approximately $1.5 trillion. It is estimated as much as $1.7 trillion of CRE debt matures over the next three years, representing substantial refinancing risk and the opportunity for further declines in commercial property values.
- FIRPTA creates barriers to capital investment in U.S. real estate by non-U.S. investors, thus limiting possible infusions of fresh equity that is needed to deleverage the market.
- Historically high unemployment rates will continue to hamper progression in CRE.

Market Environment

Job Creation Has Been Slow



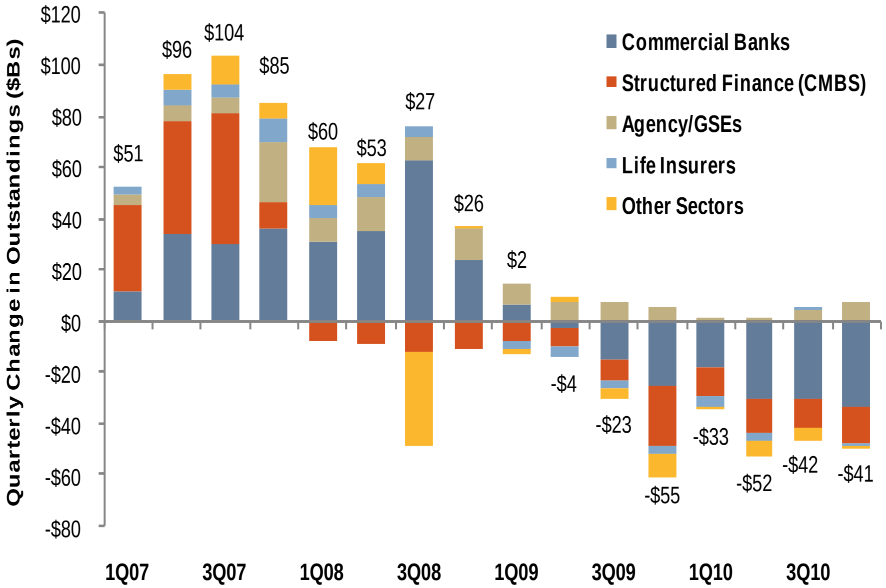
	2006	2007	2008	2009	2010	2011 Fct.	2012 Fct.	2013 Fct.	2014 Fct.
Nonfarm Empl.	136.1	137.6	136.8	130.8	129.8	131.5	134.3	137.7	141.5
Unemployment	4.6	4.6	5.8	9.3	9.6	9.1	8.5	7.3	5.8

Sources: Bureau of Labor Statistics (Actual) and Moody's Economy.com (Forecast)

- The Commercial Real Estate Sector will not recover until the jobs lost during the recession are fully recovered.
- Between January 2008 (peak) and February 2010 (trough), the U.S. lost 8.8 million jobs, or 6.3% of all nonfarm jobs. Since February 2010, only 1.5 million jobs, or 17% of jobs lost, have been recovered.
- A full recovery of nonfarm jobs is not expected until 2013.
- The job recovery depends on industries other than the construction industry. Between April 2006 and January 2011, the U.S. construction industry lost 2.2 million jobs (from 7.7 to 5.5 million), representing 29% of all nonfarm jobs lost. The excess supply of real estate coupled with tepid demand for such space implies no significant creation of construction jobs until the commercial real estate sector recovers.

Market Environment

Commercial & Multifamily Mortgage Deleveraging Continues



Source: Federal Reserve

Dollar amounts represent the total quarterly change in mortgage loans outstanding

- The $3.15 trillion in commercial and multifamily mortgage debt outstanding recorded by the Federal Reserve in 4Q10 represented a decrease of $168 billion, or 5.1%, from $3.32 trillion at 4Q09 and a decrease of $249 billion, or 7.3% from $3.40 trillion at 4Q08.

- The CMBS market has produced $28 billion of new issuance YTD. More recently new issuance has been hampered by wider spreads, high levels of subordination, and lower levels of confidence.

Market Fundamentals

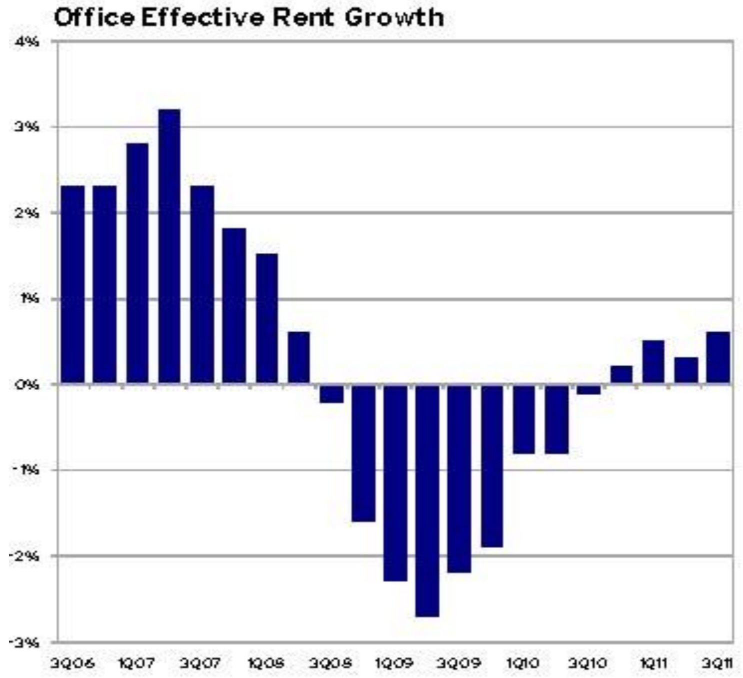
Office

• Monthly data suggests a slowdown in leasing activity that is largely reflective of the disruptions in the economy during the last two quarters

• Net absorption in September 2011 was roughly 1.0M square feet, down from 2.1M square feet in August 2011 and 3.0M square feet in July.

• Rents have also increased fairly consistently over the last four quarters, albeit at less than spectacular rates. During the third quarter of 2011 we observed the fourth consecutive quarter of asking and effective rent increases. Asking and effective rent increases of 0.4% and 0.6% respectively.

• It looks like the fledgling recovery of the office sector is proceeding at a slow pace. Vacancies remain mired in the mid-17s, a level unseen since the early 1990s. Absorption and rent growth are positive, but not very robust. These figures are all in line with slow economic growth and the anemic rate of job creation.



Source: REIS, Inc.

Market Fundamentals

SunTrust
Live Solid. Bank Solid.℠

Retail

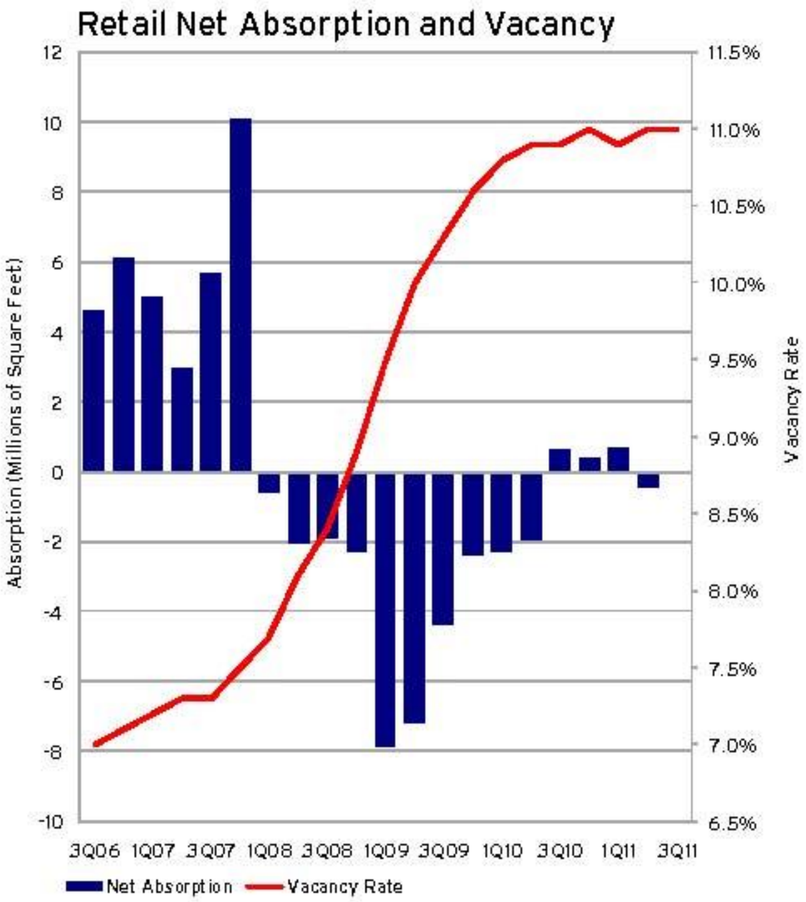
- Although the vacancy rate was unchanged versus 2Q11, net absorption remained negative for the second consecutive quarter.

- Effective rents have been deteriorating since the second quarter of 2008 while asking rents have been deteriorating since the third quarter of 2008.

- Vacancies for regional malls during the 3Q11 increased by 10 basis points. This marks the third consecutive quarter of vacancy increases.

- At this juncture, the key risk for the retail sector is depressed consumer sentiment and heightened fear of another recession.

- With demand anticipated to remain weak and more new space slated to come online in the fourth quarter, it is expected to see record or near-record vacancy rates for the remainder of 2011.



Market Fundamentals

SunTrust
Live Solid. Bank Solid.℠

Construction

• Completions in the apartment and retail sectors fell yet again after rising during the 2Q11.

• Office completions increased slightly, but all three property types are still near record-low levels for quarterly completions.

•Completion levels during the boom years of 2004 though 2008 were relatively constrained due to the high cost of construction, with the exception of retail. Since the beginning of the recession, construction costs have moderated. Due to the severity of the recession and the weakness in market fundamentals, this has not been sufficient enough to spur a meaningful increase in construction activity, which remains at a rather low level.

Third Quarter 2011 Completions

	Apartment (units)	Office (square feet)	Retail (square feet)
Q3 2011	8,183	2,982,000	812,000
Q2 2011	10,483	2,234,000	1,037,000
Q1 2011	7,492	4,623,000	213,000
Q4 2010	14,079	2,166,000	814,000

Apartment and office figures are based on 82 metros; retail, on 80 metros

Source: REIS, Inc.

Market Fundamentals

Apartments

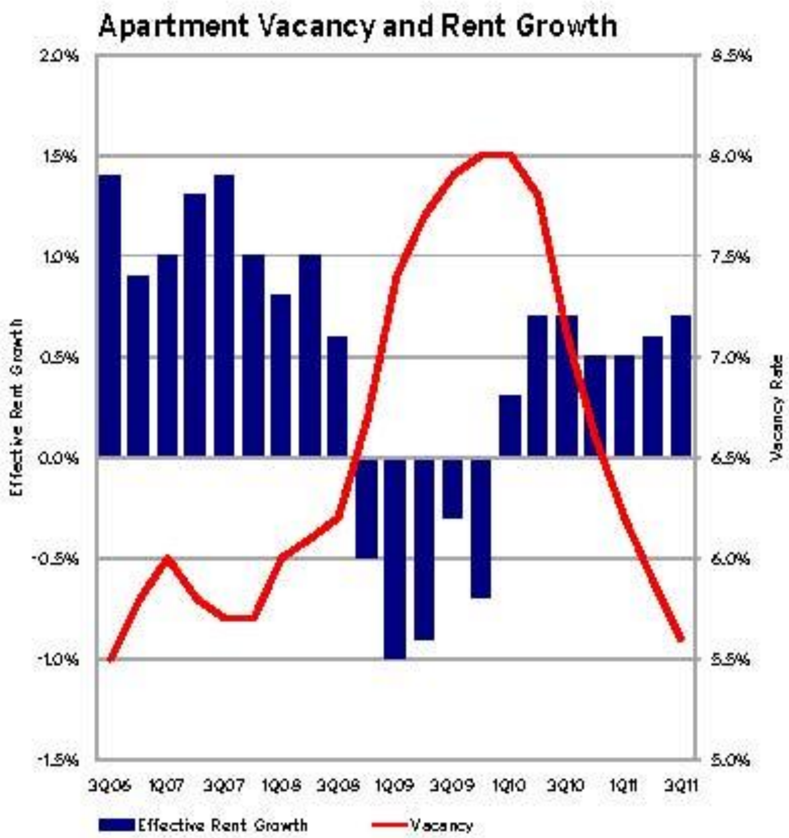
• Slow economic growth during 2011 appears to have affected the rate of improvement in the market. Real GDP growth slowed during 2011, but more importantly, sentiment turned severely negative during August and there was a heightened fear of the economy backsliding into another recession.

•National vacancies fell by 30 basis points, from 5.9% to 5.6%, as the sector posted positive net absorption of roughly 36,000 units.

•Furthermore, effective rent increases continue to slightly outpace asking rent increases, indicating that concession packages continue to erode. Unless sentiment and fear tip the economy back into a recession, it is expected that the recovery will continue for the remainder of 2011.

• As the absolute number of jobs continues to rise, particularly in the 20- to 34-year-old segment of the labor market, demand for housing is increasing.

•There are growing concerns about over saturation as this is the only "hot product" right now.



Source: REIS, Inc.

Next Steps

- The real estate market is showing signs of an ongoing recovery along with slight but promising signs for the economy as a whole.

- Decreasing apartment vacancies and increasing rents are two signs that this sector will continue its recovery throughout 2012, but it may be in danger of becoming overheated.

- Financing will not prove to be a hindrance in real estate recovery. Financial institutions are carefully moving back in to lending.

- Demand will be the hurdle to overcome as stubbornly high unemployment and lack of job creation slows consumer confidence. Jobs will need to be created in order to encourage consumers to stimulate the economy. The projected acceleration in job growth will have a positive impact on all sectors of the commercial real estate market.

- The real estate market in many places is meaningfully over leveraged and requires new sources of funding to meet the demand of CRE loans that are set to mature in the coming years. Repealing or modifying FIRPTA could create new funding streams for real estate industry.

- The Fed's stance on maintaining a low interest rate environment continues to favor investment in commercial real estate.