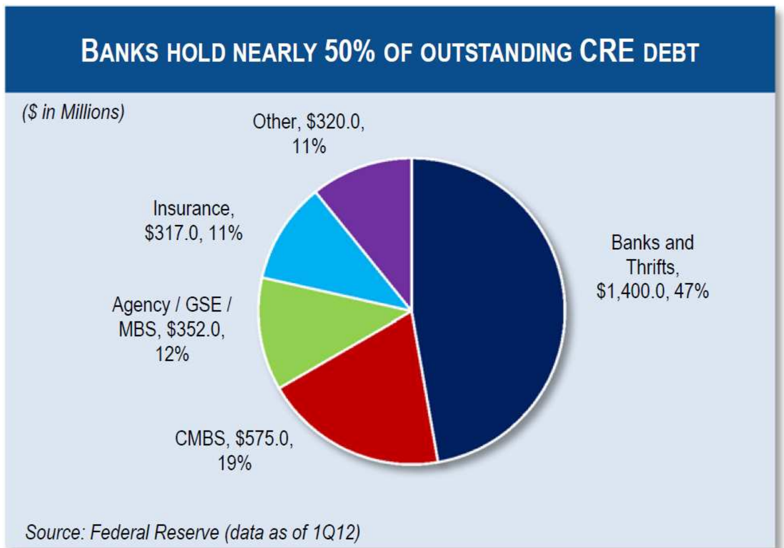
PCCP Market Commentary

Is There Enough Distress to Go Around?

Fourth Quarter 2012

The past four years have yielded nonstop headlines about hundreds of failed banks, billions of soured mortgages and a tsunami of upcoming maturities. However, the institutional commercial real estate investor wants to know how much of this distress is collateralized by institutional-quality real estate, and is there enough distress to go around?

Of the $3.0 trillion of U.S. commercial real estate debt, banks / thrifts and CMBS trusts hold approximately 65% of the total outstandings as of 1Q12. Agencies, Insurance Companies and "Other" (specialty finance companies and mortgage REITs) hold the remainder. Delinquency rates for agency and insurance company debt are less than 50 bps as of 1Q12[1] and specialty finance companies have either been absorbed by other groups or are generally in a holding pattern. For purposes of this analysis, PCCP has focused on outstanding commercial real estate debt held by banks / thrifts and CMBS trusts.



In order to determine the amount of distressed debt collateralized by institutional-quality assets within the banks and CMBS trusts that would result in potential investment opportunities, PCCP focused on the following two attributes:

- ***Loan balance > $10,000,000 at origination*** – PCCP believes that most institutional-quality real estate will require a loan of at least $10 million.
- ***Distressed*** – PCCP's definition of "distressed" includes: 90+ days past-due, non-performing matured balloons, foreclosures and REO.

[1] *Source: MBA Commercial Real Estate/Multifamily Finance Quarterly Databook, Q112.*

According to Trepp, as of September 17, 2012, total CMBS outstanding was $671 billion (which includes multifamily CMBS). Loans with initial balances greater than $10 million totaled $467.9 billion (or 69.7%). Of this amount, 8.3% was "distressed." This is consistent with the overall CMBS delinquency rate being just over 10% as of the second quarter of 2012:

CMBS Debt		
	$ in bns	Ratio
Total Outstanding	$671.42	100.0%
Original Balance > $10mm	$467.90	69.7%
Distressed & > $10mm Original Balance	$38.80	8.3%

PCCP then applied these ratios to the CRE holdings of the top 30 banks (by exposure to commercial real estate debt). The top 30 banks are national in scope, as opposed to local thrifts and therefore are more likely to originate loans collateralized by institutional-quality assets.

Bank Debt - Top 30 Banks		
	$ in bns	Ratio
Total Outstanding	$695.50	100.0%
Original Balance > $10mm (estimated)	$484.68	69.7%
Distressed & > $10mm Original Balance	$40.19	8.3%

We estimate that nearly $1.0 trillion of outstanding CMBS and debt held by the top 30 banks is collateralized by institutional-quality real estate. Honing in on reported distress, we estimate that there is approximately $79.0 billion of distressed, institutional-quality real estate. If we expand the universe to include the top 100 banks and apply the same institutional-quality and distressed ratios, total distressed, institutional-quality real estate increases to $90.0 billion.

Conclusively, we believe that the distressed opportunity is at ***least*** $79 billion today. This estimate is narrow in that it does not include, for example: i) loans that are meeting current interest payments but are likely to default at maturity; or ii) underperforming loans cross-collateralized within a portfolio. Furthermore, while there are currently 111 U.S.-focused opportunity funds in the market seeking $33.4 billion of capital commitments,[2] not all opportunistic funds are chasing distressed deals, and not all funds will raise capital. From our perspective, there is more than enough distress to go around.

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[2] *Source: Institutional Real Estate Investor, September 26, 2012.*