CAPITAL MARKETS UPDATE
Tuesday, May 12, 2015
11:30 AM to 1:30 PM
The Wisconsin Club – City Club
THANK YOU TO OUR EVENT SPONSOR!

Associated Bank
GOLD CORPORATE SPONSORS
RETTHINKING THE EMPTY STOREFRONTS STRATEGY.

June 1st, 2015
8am - 5pm
Shops of Grand Ave

PROMO CODE: NAIOP
CONUNDRUMS & EXUBERANCE

Ms. Sara Walker, CFA
Senior Vice President &
Chief Investment Officer
Associated Bank
Yes, 100% of economists were dead wrong about yields

Not quite right
10-year Treasury yield falls in 2014 after economists predict rise

Survey shows 100% of economists think yield will rise over next six months

Source: Tradeweb
Enticing
GLOBAL MONETARY POLICY REMAINS HIGHLY SUPPORTIVE

Yellow = Negative Rates and/or Asset Purchases  Light Blue = Monetary Easing  Red = Monetary Tightening

**UK:** Barclays expects Q4 rate hike, but Bank of England forecast is for inflation to fall to 0% mid-year

**Europe:** Sweden last week joined the ECB, Denmark, and Switzerland in setting deposit rates at or below zero

**US:** Barclays and futures market both expect rate hike in June, but futures market thereafter projects far slower pace of tightening than Fed forecast

**China:** was seeking to slow credit growth, but now faces deflationary pressure. World’s largest exporter may undertake monetary easing and allow currency weakness, pushing disinflation to trading partners

**Japan:** targeting ¥80trn annual increase in base money

*Source: Barclays Research*
TIGHT PURSE STRINGS

![Graph showing durable goods orders % change from May 2014 to March 2015. The graph indicates a significant increase in July 2014, followed by fluctuations throughout the period.](image-url)
Making a significant dent
EXUBERANCE

**Employment Cost Growth Strengthens in Q1**

% change yr ago

- **Total compensation**
- **Wages and salaries**
- **Benefits**

Sources: BLS, Moody's Analytics
A fine conundrum

Personal savings rate
(% of disposable income)

Source: U.S. Bureau of Economic Analysis
INTEREST RATE AND BANK LENDING UPDATE

Mr. Thomas Toerpe
Managing Director
Associated Bank
“MONEY, CAPITAL, COIN!”

@NAIOP chairman Steve Martin-
What makes NAIOP tick?
"That's simple-it's the people."
What makes the industry tick?
"Money! Capital! Coin!"

4/6/15, 7:36 PM
RISING RATES? NOT YET…
FORECASTERS KEEP “CRYING WOLF”

10 Year US Treasury Yield vs Consensus Forecasts

- Interest rates have stayed low throughout the expansion.
- Forecasters keep revising their estimates downward as forecast date approaches.
- On average, consensus forecasts 12 months forward have been off by 70 basis points.
• Thirty-year bull market in bonds
• Longest period of low floating rates since 1940s
• Fed will keep short term rates near zero for a while longer…
• But not forever…

Source: Bloomberg LP
FOOD FOR THOUGHT: 225 YEARS!

Since 1790, the 10 year T's have been below 2.0% for only 25 months! Do you think this is a good time to borrow money for real estate??

4/16/15, 3:07 PM
WHY HAVE RATES STAYED LOW SO LONG?

- Low inflation
- Labor market slack
- Supply and demand for bonds
INFLATION IS A DISTANT MEMORY

Matt O'Brien @ObsoleteDogma... 1/8/15
Remember inflation?

Maxximilian Seij0 @MaxSeij0

@ObsoleteDogma I'm 22. I've never seen inflation.
1/8/15, 8:29 AM

Pat Regnier @patregnier 1/8/15
@MaxSeij0 @ObsoleteDogma
Knew the math, but this brings it home: Many adults haven't seen inflation. I'm 43, and it's a childhood memory
INFLATION BELOW FED TARGET FOR 3 YEARS

- Actual inflation has fallen short of Fed’s target for 34 months (green line)
- Professional forecasters maintain a benign price outlook
MARKET AGREES – MODEST INFLATION

“Inflation Compensation” – TIPS market

- TIPS breakevens moving back toward Fed’s 2% inflation target
- Reverses temporary effect of oil price decline

Source: Bloomberg LP
JOB GROWTH OUTPERFORMING PRIOR ECONOMIC CYCLE – WITHOUT THE BUBBLE

Comparing Job Recoveries
(months from end of recession)

Source: Bloomberg LP
OUR REGION HAS SHARED IN EXPANSION

Comparing Job Recoveries

- For most midwest states, job growth is keeping pace with each state’s experience in the 2001-2006 recovery.
- However, all except Minnesota have lagged the national trend.
NOW, JOB MARKET SLACK ALMOST GONE

- Unemployment rate is now back to normal: 5.4%
- Full time job growth back to normal: 85% of net new jobs in past year were full time
- Participation rate still lags: stable in past year at ~63%
- Gap in participation rate is partly demographic
DEMAND FOR BONDS: GLOBAL SAVINGS GLUT

- Trade imbalances with the US created a global savings glut that boosts demand for US Treasuries.
- From 2000-2006, this was driven by oil producers and China. As China’s surplus has shrunk, the crisis in Europe has led to imbalances between the US and the eurozone.
- Over time, the drop in oil prices and resumption of growth in Europe should lead to a decline in the glut – and higher long term rates.

Selected Current Account Balances

Data source: IMF via @benbernanke
• Deficits have normalized, and now are below their 50 year average
• Bond market has capacity to absorb this level of new supply
US TREASURIES: “HIGH YIELD ASSET”

- 10 year US Treasury yields are quite attractive vs. other developed economies
IMPACT ON CRE: SOLID INVESTOR DEMAND

10 year BBB REIT vs 10y US Treasury Yields

Source: Bloomberg LP

Debt ceiling crisis
CAP RATES DOWN, BUT STILL REASONABLE

Midwest Cap Rates

<table>
<thead>
<tr>
<th></th>
<th>Q1-02</th>
<th>Q1-06</th>
<th>Q1-15</th>
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</thead>
<tbody>
<tr>
<td>Apartment</td>
<td>8.8%</td>
<td>7.0%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Office</td>
<td>10.1%</td>
<td>7.7%</td>
<td>6.6%</td>
</tr>
<tr>
<td>Retail</td>
<td>8.4%</td>
<td>7.0%</td>
<td>6.8%</td>
</tr>
<tr>
<td>Industrial</td>
<td>9.8%</td>
<td>7.2%</td>
<td>8.3%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>9.3%</strong></td>
<td><strong>7.2%</strong></td>
<td><strong>7.1%</strong></td>
</tr>
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Ten Year Treasury

<p>| | | | |</p>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Apartment Cap Rate vs. Treasury</td>
<td>3.4%</td>
<td>2.2%</td>
<td>5.0%</td>
</tr>
</tbody>
</table>
VALUATIONS AT SUSTAINABLE LEVEL

Cap Rates vs 10 Year Treasury Yield

Midwest multifamily cap rate vs UST

National multifamily cap rate vs UST

Source: Bloomberg LP
FURTHER RENT GROWTH TIED TO WAGES

Change in Rents vs. Wage Growth: National

Shaded areas indicate US recessions - 2015 research.stlouisfed.org
FURTHER RENT GROWTH TIED TO WAGES

Change in Rents vs. Wage Growth: Midwest
FOMC WANTS TO TIGHTEN THIS YEAR

FOMC’s “Dot Plot”

- Federal Reserve policymakers still anticipate raising rates this year.
- The “dots” above show the range of forecasts is wide, but all FOMC members look for rates in the 3.00%-4.25% range by 2018.
PACE OF TIGHTENING TO BE SLOWER

FOMC's “Dot Plot"

- Federal Reserve policymakers still anticipate raising rates this year.
- The “dots” above show the range of forecasts is wide, but all FOMC members look for rates in the 3.00%-4.25% range by 2018.
MARKET IS MORE DOVISH THAN THE FED

Forward rates imply an even “shallower” pace of increases
This is incorporated into long term market rates
IN FACT, POLICY IS ALREADY NORMALIZING

"Shadow" Short Rate

- Economists like Leo Krippner at RBNZ have constructed “shadow” rate indexes to track policy stance in a zero rate environment.
- Incorporates impact of QE, forward guidance and other FOMC tools.
- The Fed has already removed much of its accommodation.
MY INTEREST RATE OUTLOOK

• Fed will make a move by September.
• Most likely by pushing the “floor” Fed funds rate up to 0.25%.
• Dr. Yellen will take a “wait and see” approach after that.
• Long term rates will react, then settle into a new range that is slightly higher.
• Sustained higher rates won’t occur until global imbalances recede – or the Fed sells its $4 trillion bond portfolio.
BANK LENDING: CRE UP 8% IN PAST YEAR

- Total commercial lending in the US has been on an upward trend for four years, rising 10.4% to $3.5T in the past 12 months.
- CRE turned later and rose slower: up 8% in past year vs 12% for C&I loans.
DEMAND FOR CRE BANK LOANS RISING – BUT A BIT MORE SLOWLY

Net Percentage of Domestic Respondents Reporting Stronger Demand for Commercial Real Estate Loans

- All commercial real estate loans
- Construction and land development
- Nonfarm nonresidential
- Multifamily

- Q4 Q1 Q2 Q3 Q4 Q1 Q2
- 2013 2014 2015
New CRE issuance in the syndicated loan market rose to $167 billion in 2014 (+3.0%)

- Average transaction size $175 million
- One quarter of syndicated transactions (and 5% of volume) are under $75 million.
- Q1 2015 new loan production down 23%, with drop in multifamily construction.

- Average spreads on agented project loans down slightly.
- Stabilized office and investment grade build-to-suit product coming to market.
- Higher volume of condo, hospitality, and data center projects focused on preserving yield.
SUMMARY

• Low interest rates, good spreads and a healthy market for both bank debt and syndicated loans make this a good time to fund projects.
• Cap rates are reasonable in light of the interest rate environment.
• Economy has steadily morphed from “Recovery” into “Expansion,” providing support for continued growth across product types.
• Monetary policy has already begun to ease; the Fed seems determined to raise short term rates this year.
DISCUSSION

Q & A

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Competing for New Capital in MKE

A Window of Opportunity

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steven.buss@cbre.com
10-Year Treasury vs. 30-Day LIBOR

Source: Federal Reserve, April 2015
CMBS Issuance

Vintage Loans: High % Interest Only
High LTV
Lower DCR

'05 – '07 ($615B total Volume)
Seven years of business in three years!

Source: Commercial Mortgage Alert, April 17, 2015
Who’s Buying?
Commercial Real Estate Transactions by Buyer Type

*Through Q4 2014
Source: Real Capital Analytics
Preferred Asset Type
What type of property assets are most attractive for you to purchase in 2015?

- Value-add: 53%
- Good secondary: 20%
- Prime or core assets: 14%
- Opportunistic: 13%

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Risk Appetite for Secondary Assets

What is your risk appetite for secondary assets compared to 2014?

Preferred Property Sector

In North America, which property sector do you believe to be the most attractive for investment purchase in 2015?

Origin of New Capital into Milwaukee Since 2010
Office, Industrial, Retail and Multifamily Investment (In Millions)
Top Cross Border Investors
Last 5 Years -- All Property Types  (# of Properties/Volume in Millions)

Source: Real Capital Analytics
Top Cross Border Investors
Last 5 Years -- All Property Types  (# of Properties/Volume in Millions)

MINNEAPOLIS

Source: Real Capital Analytics
Top Cross Border Investors
Last 5 Years -- All Property Types  (# of Properties/Volume in Millions)

CHICAGO

Source: Real Capital Analytics
## Milwaukee’s Scorecard

**Key Metrics for Outside Capital**

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014 GDP Growth</td>
<td>2.38%</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>5.2%</td>
</tr>
<tr>
<td>2014 MSA Population</td>
<td>1.57 million</td>
</tr>
<tr>
<td>Population Growth 2010 to 2014</td>
<td>1.05%</td>
</tr>
<tr>
<td>Fortune 500 HQs</td>
<td>7</td>
</tr>
</tbody>
</table>
A Closer Look at Population

Net In-Migration to Milwaukee

<table>
<thead>
<tr>
<th>Milwaukee Wins</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Chicago, IL</td>
<td>+ 602</td>
</tr>
<tr>
<td>Lake County, IL</td>
<td>+ 263</td>
</tr>
<tr>
<td>Green Bay, WI</td>
<td>+ 69</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Milwaukee Loses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Phoenix, AZ</td>
<td>- 265</td>
</tr>
<tr>
<td>Minneapolis, MN</td>
<td>- 265</td>
</tr>
<tr>
<td>Madison, WI</td>
<td>- 98</td>
</tr>
<tr>
<td>Overall</td>
<td>-3,604</td>
</tr>
</tbody>
</table>

Source: Moody’s Analytics, IRS 2011
Illinois Challenges = Milwaukee’s Opportunity

Illinois Pension Blowup
“State pensions are underfunded by $111 billion”

May 9, 2015

2014 State of Illinois out-migration
SAVE THE DATES!

- June 1: The Empty Storefronts Conference
- June 4: Epic Campus Tour (Madison)
- June 16: Developing Leader CRE Icon Roundtable
- July 23: NAIOP Boat Cruise