The Fall of our Discontent:
Development Outlook 2012

NAIOP Development II Forum Presentation

by
James R. DeLisle, Ph.D.
October 18, 2011
Overview

- Respondent Profile
- Market Timing

- Part I: Economic Outlook
- Part II: Capital Market Overview
- Part III: Real Estate Market Outlook
- Part IV: Challenges, Issues and Opportunities
What Do You Want Me To Talk About?
## Careers: Past & Future

**How many more years do you think you will be active in the real estate industry?**

<table>
<thead>
<tr>
<th></th>
<th>Under 5 years</th>
<th>5-7 years</th>
<th>8-10 years</th>
<th>11-15 years</th>
<th>16-20 years</th>
<th>20-25 years</th>
<th>26-30 years</th>
<th>31-35 years</th>
<th>36-40 years</th>
<th>Over 40 years</th>
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</thead>
<tbody>
<tr>
<td><strong>Let's talk about your future career plans and how they may have changed.</strong></td>
<td>0.0% (0)</td>
<td>5.0% (1)</td>
<td>10.0% (2)</td>
<td>35.0% (7)</td>
<td>30.0% (6)</td>
<td>5.0% (1)</td>
<td>5.0% (1)</td>
<td>5.0% (1)</td>
<td>5.0% (1)</td>
<td>0.0% (0)</td>
</tr>
</tbody>
</table>

**How have your retirement plans changed recently (i.e., # years shorter or longer) due to recent events.**

<table>
<thead>
<tr>
<th></th>
<th>-10 years</th>
<th>-5 years</th>
<th>-2 years</th>
<th>No change</th>
<th>+2 years</th>
<th>+5 years</th>
<th>+10 years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Let's talk about your future career plans and how they may have changed.</strong></td>
<td>5.0% (1)</td>
<td>0.0% (0)</td>
<td>0.0% (0)</td>
<td>60.0% (12)</td>
<td>0.0% (0)</td>
<td>25.0% (5)</td>
<td>10.0% (2)</td>
</tr>
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</table>
Market Timing: When Will Recovery Start

- Economy
- Housing
- Commercial RE

<table>
<thead>
<tr>
<th>It already has</th>
<th>4Q2011</th>
<th>1Q2012</th>
<th>2Q</th>
<th>3Q</th>
<th>4Q</th>
<th>1Q-2013</th>
<th>2Q</th>
<th>3Q</th>
<th>4Q</th>
<th>After 2013</th>
</tr>
</thead>
</table>
Confident Owner/Uncertain Buyer

Case A: Deal Seller’s

Case B: Negotiated

Tone: Neutral

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Confident Owner/Buyer IVs

Case A: No Deal

Case B: Negotiation

Tone: Quick
Market Expectations and Real Estate Cycles
## Part I: Economic Environment for Real Estate

### 2010 Outlook
- Recession over; slow recovery; some downside risk
- Big businesses okay; Small struggling, stock market up
- Consumers guarded; CEOs hopeful

### 2011 Outlook
- Recession really over? slow recovery; some downside risk
- Big business bragging profits up; small business lagging.....
- Consumers wanna do it; CEOs hopeful

### 2012 Outlook
- Double-dip? Slow recovery at best; more downside risk
- Big business balance sheets okay; small business slipping.....
- Consumer discontent; CEOs defensive
Agree/Disagree on Economy

- The economy is recovering and we will... (Strongly Agree)
- Inflation will not be a concern over... (Agree)
- Employment gains will accelerate by year-end. (Neither)
- GDP growth will rebound in 2012. (Disagree)
- Consumer confidence will rebound in... (Strongly Disagree)
- The manufacturing slump will continue... (Strongly Agree)
- The economic recovery will be very gradual. (Agree)
- Interest rates will remain low. (Strongly Agree)
- The credit markets will return to normal... (Neither)
- Corporate profits will continue... (Disagree)

Country Is Headed in Wrong Direction, 74% Say
Consumer Confidence & the TINR Principle

There Is No Reality

Percentage Saying Economic Conditions Are "Getting Worse," by Month, 2008 to 2011

Source: Gallup.com
New Research: Informational Disintermediation

**Twittering**

- Twitter's Global Moods
- Positive Feelings
- Negative Feelings

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**Blogging**

WSJ BLOGS

Deal Journal
An up-to-the-minute take on deals and deal makers.

OCTOBER 17, 2011, 5:04 PM ET

The Big Picture for Global Banks

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Small Business Confidence: Where the Jobs Aren’t

Sales vs. Credit is driving confidence for small business

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How Important to a Recovery?

- Ending the political rancor in Washington.
- Maintaining low interest rates.
- Improving access to credit for businesses.
- Creating strong job growth through various programs.
- Resolving the budget problem.
- Improving consumer confidence levels.
- Helping settle the "Occupy Wall Street" movement.
- Resolving the debt crisis in Europe.
- Introducing incentives for businesses to hire employees.
- Continuing to attract offshore capital flows to the US.
Employment & Economic Trends

Labor Force Participation Rates

Good news....

Labor Supply vs. Demand: Unemployment and Openings

Bloomberg

U.S. Senate Shelves Obama’s $447B Job Plan

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Housing Trends

Next Generation of Homeowners Are Freaked Out

Home Builder Confidence Rises Four Points in October

NAHB Forecast
Inflation & Interest Rates

Wholesale Prices Indicate Continued Inflation Pressures

Producer Prices Rise More Than Expected

Total Compensation

% change

0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
0.9Q3 09Q4 10Q1 10Q2 10Q3 10Q4 11Q1 11Q2

Retail Sales

% change

Nov-10 Jan-11 Mar-11 May-11 Jul-11 Sep-11

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Global Interest Rate Targets: Changing Times
What’s the Fed to Do (Twist & Shout?)

Fed Launches New Stimulus
Dramatic Recasting of Securities Holdings Aims to Reduce Long-Term Rates

... the Fed will sell $400 billion in Treasury securities that mature within three years and reinvest the proceeds into securities that mature in six to 30 years, significantly tilting the balance of its holdings toward long-term securities.

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The Global Scene

China Gets Growth Help From Domestic Demand

GDP Slips from 9.5 to 9.1%....

Merkel Tempers EU Summit Hopes

Global Outlook: 5 Years (Gallup)

Cosmic Convergence? China Growth and U.S. Unemployment Rates Coincide

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## Part II: Real Estate Capital Markets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tentative, waiting to pounce, new players &amp; rules</td>
<td>Patient pouncers, old rules, core rules</td>
<td>Top-end frenzy, core investor apprehension</td>
</tr>
<tr>
<td>Rising Cap rates, declining values de-capitalizing</td>
<td>Cap rate halos; values unknown...</td>
<td>Cap rate compression, spread investment</td>
</tr>
<tr>
<td>Challenges re-levering; credit crunch for asset class</td>
<td>Re-levering at top only; credit crunch for rest</td>
<td>Window opening, headwinds closing, distress unrest</td>
</tr>
</tbody>
</table>
How Market Different?

More Behavioral

Optimistic  Pessimistic  Normal  Confident
Ratings on Capital Markets

- Investors will move down the food chain in...
- Distressed assets will start flooding the market...
- New capital flows to real estate will increase...
- Commercial mortgages for "good" properties will...
- Transaction levels are picking up and will accelerate...
- Commercial values will fall another 15-20% before...
- The negative talk about the commercial real estate...
- The CMBS market will recover from the latest...
- Banks will get much more aggressive with troubled...
- Commercial mortgage rates will stay low...

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How We’re Doing: Commercial Real Estate

3Quarter 2011

<table>
<thead>
<tr>
<th>Current Qtr Estimate</th>
<th>1 Year</th>
<th>3 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>1.29%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Appreciation</td>
<td>2.28%</td>
<td>12.1%</td>
</tr>
<tr>
<td>Total, Gross</td>
<td>18.3%</td>
<td>-11.8%</td>
</tr>
</tbody>
</table>

1.29% * 4 = 5.16%

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REITs, Don't Fail Me Now
Transactions: Americas

QUARTERLY TRANSACTION VOLUME
BY PROPERTY TYPE

$70 Billion

$60

$50

$40

$30

$20

$10

$0

1 2 3 4 1 2 3 4 1 2 3 4 1 2

'08 '09 '10 '11

PERCENT CHANGE IN TRANSACTION VOLUME
(H1'10 VS H1'11)

EVENT COVERAGE
Real Estate Remains Refuge for Capital

By Bob Howard

BEVERLY HILLS- Inflation fears and other factors will continue to push capital into real estate, according to a presentation at the annual Allen Matkins View From The Top conference.

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US Transaction Momentum

QUARTERLY US PROPERTY SALES

YOY CHANGE

Search by Style

2011 YEAR-TO-DATE SEARCH SUMMARY

Completed Searches
Publicly Announced $615.0M
Pending Allocations $1,555.0M

Allocations by Strategy ($)
High-Yield 23%
Core 77%

Equity Real Estate Allocations ($)
Private 100%

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# Cap Rates: Current Cap Rates

<table>
<thead>
<tr>
<th></th>
<th>Under 5%</th>
<th>5%</th>
<th>5.5%</th>
<th>6%</th>
<th>6.5%</th>
<th>7%</th>
<th>7.5%</th>
<th>8%</th>
<th>8.5%</th>
<th>9%</th>
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</thead>
<tbody>
<tr>
<td>Office</td>
<td>0.0% (0)</td>
<td>3.1% (1)</td>
<td>0.0% (0)</td>
<td>15.6% (5)</td>
<td>9.4% (3)</td>
<td>21.9% (7)</td>
<td>15.6% (5)</td>
<td>18.8% (6)</td>
<td>6.3% (2)</td>
<td>3.1% (1)</td>
</tr>
<tr>
<td>Retail</td>
<td>0.0% (0)</td>
<td>0.0% (0)</td>
<td>3.6% (1)</td>
<td>10.7% (3)</td>
<td>3.6% (1)</td>
<td>21.4% (6)</td>
<td>17.9% (5)</td>
<td>17.9% (5)</td>
<td>17.9% (5)</td>
<td>7.1% (2)</td>
</tr>
<tr>
<td>Industrial</td>
<td>0.0% (0)</td>
<td>3.4% (1)</td>
<td>6.9% (2)</td>
<td>17.2% (5)</td>
<td>3.4% (1)</td>
<td>13.8% (4)</td>
<td>20.7% (6)</td>
<td>10.3% (3)</td>
<td>6.9% (2)</td>
<td>13.8% (4)</td>
</tr>
<tr>
<td>Apartments</td>
<td>3.3% (1)</td>
<td>23.3% (7)</td>
<td>16.7% (5)</td>
<td>23.3% (7)</td>
<td>16.7% (5)</td>
<td>3.3% (1)</td>
<td>3.3% (1)</td>
<td>0.0% (0)</td>
<td>3.3% (1)</td>
<td>3.3% (1)</td>
</tr>
<tr>
<td>Mixed-use</td>
<td>3.4% (1)</td>
<td>3.4% (1)</td>
<td>0.0% (0)</td>
<td>13.8% (4)</td>
<td>10.3% (3)</td>
<td>20.7% (6)</td>
<td>13.8% (4)</td>
<td>13.8% (4)</td>
<td>6.9% (2)</td>
<td>6.9% (2)</td>
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Cap Rates: Current Cap Rates in 12 Months

<table>
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<th>6%</th>
<th>6.5%</th>
<th>7%</th>
<th>7.5%</th>
<th>8%</th>
<th>8.5%</th>
<th>9%</th>
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<tbody>
<tr>
<td>Office</td>
<td>3.2%</td>
<td>0.0%</td>
<td>3.2%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>19.4%</td>
<td>32.3%</td>
<td>12.9%</td>
<td>12.9%</td>
<td>9.7%</td>
</tr>
<tr>
<td></td>
<td>(1)</td>
<td>(0)</td>
<td>(1)</td>
<td>(0)</td>
<td>(0)</td>
<td>(6)</td>
<td>(10)</td>
<td>(4)</td>
<td>(4)</td>
<td>(3)</td>
</tr>
<tr>
<td>Retail</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>14.8%</td>
<td>7.4%</td>
<td>11.1%</td>
<td>29.6%</td>
<td>22.2%</td>
<td>14.8%</td>
<td>0.0%</td>
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<tr>
<td></td>
<td>(0)</td>
<td>(0)</td>
<td>(0)</td>
<td>(4)</td>
<td>(2)</td>
<td>(3)</td>
<td>(8)</td>
<td>(6)</td>
<td>(4)</td>
<td>(0)</td>
</tr>
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<td>Industrial</td>
<td>0.0%</td>
<td>0.0%</td>
<td>10.7%</td>
<td>17.9%</td>
<td>3.6%</td>
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<td>7.1%</td>
<td>10.7%</td>
<td>14.3%</td>
<td>7.1%</td>
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<td>(6)</td>
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<td>(4)</td>
<td>(2)</td>
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<td>27.6%</td>
<td>24.1%</td>
<td>13.8%</td>
<td>3.4%</td>
<td>6.9%</td>
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<td>3.4%</td>
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<tr>
<td></td>
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<td>(1)</td>
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<tr>
<td>Mixed-use</td>
<td>3.6%</td>
<td>0.0%</td>
<td>3.6%</td>
<td>3.6%</td>
<td>25.0%</td>
<td>14.3%</td>
<td>17.9%</td>
<td>14.3%</td>
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<td>3.6%</td>
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<td></td>
<td>(1)</td>
<td>(0)</td>
<td>(1)</td>
<td>(1)</td>
<td>(7)</td>
<td>(4)</td>
<td>(5)</td>
<td>(4)</td>
<td>(2)</td>
<td>(1)</td>
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## What's Trading?

### Selected Investment Sales Transactions Reported in the Past 3 Months

<table>
<thead>
<tr>
<th>Property Name</th>
<th>SF/Units</th>
<th>Year Built</th>
<th>Price PPSF/PPU</th>
<th>Buyer Seller Broker</th>
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<tbody>
<tr>
<td>Helmsley Building</td>
<td>1212,576</td>
<td>1929</td>
<td>$763,266,667</td>
<td>Invesco Real Estate by Houlihan Lokey from Monday Properties</td>
</tr>
<tr>
<td>Atrium on Bay</td>
<td>1070,287</td>
<td>1981</td>
<td>$356,221,543</td>
<td>H&amp;R Real Estate Investment Trust from Hines Real Estate Investment Trust Inc by Brookfield Financial BMO Capital Markets</td>
</tr>
<tr>
<td>The Corner</td>
<td>196</td>
<td>2007</td>
<td>$209,000,000</td>
<td>TIAA-CREF from Gotham Organization Inc JV Phillips International JV Rhodes New York by CB Richard Ellis</td>
</tr>
<tr>
<td>Millennium Warner Center</td>
<td>438</td>
<td>2010</td>
<td>$132,883,333</td>
<td>Essex Property Trust from Dinerstein Companies by Institutional Property Advisors - Marcus &amp; Millichap Company</td>
</tr>
<tr>
<td>Rockhill Apartments</td>
<td>1000</td>
<td>1999</td>
<td>$120,417,957</td>
<td>Ivanhoe Cambridge from Canapen</td>
</tr>
<tr>
<td>Prime Outlets Jeffersonville</td>
<td>409,959</td>
<td>1993</td>
<td>$134,000,000</td>
<td>Tanger Factory Outlet from Simon Property Group by Jones Lang LaSalle</td>
</tr>
<tr>
<td>Scottsdale Promenade</td>
<td>433,533</td>
<td>1999</td>
<td>$10,000,000</td>
<td>Excel Trust Inc from Levine Investments LP by Lucescu Realty</td>
</tr>
<tr>
<td>New York Palace Hotel</td>
<td>899</td>
<td>1981</td>
<td>$377,000,000</td>
<td>Northwood Investors LLC from Brunel Investment Agency (BIA)</td>
</tr>
<tr>
<td>YOTEL</td>
<td>669</td>
<td>2011</td>
<td>$315,000,000</td>
<td>IFA Hotels &amp; Resorts JV Kuwait Real Estate Co by Hodges Ward Elliott Inc from Related Companies JV Goldman Sachs</td>
</tr>
</tbody>
</table>
Long-term Commercial Transaction Trends

Institutional Allocation by Vehicle

Global: Cross-Border

Private: Market Timers
Commercial Loan Maturities: CMBS Land & Payoffs

CMBS Delinquencies

CMBS Issuances

Projected Commercial Mortgage Loan Maturities

CMBS Issuances

Bloomberg

CMBS Sales to Reach $30 Billion in 2012 on Refi Needs, JPMorgan

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## Part III: Spatial Market Fundamentals

<table>
<thead>
<tr>
<th>Year</th>
<th>Market Condition</th>
</tr>
</thead>
</table>
| **2010 Spatial Market** | - Still weakening, negative absorption; more downside risk  
- Vacancy rates pushing records, rents declining  
- Negative absorption, lagged recovery |
| **2011 Spatial Market** | - Still weak, limited absorption; more downside risk  
- Vacancy rates peaking, rents stabilizing but low  
- Absorption flat, recovery lagging tenants nagging |
| **2012 Spatial Market** | - Spotty correction, plateau in connection, deferred resurrection  
- Vacancy peaking, rents creaking  
- Modest absorption, tenant reflection, landlord perplexion |
Office Market: National Snapshot

U.S. Office Vacancy Rates

- Downtown
- Suburban

OFICE INVESTMENT TRENDS
CAP RATE

PRICE PER SQUARE FOOT

VOLUME

U.S. Office Absorption
(MILLIONS OF SF)

Downtown
- Manhattan, D/T: 7.6
- Manhattan, Midtown: 7.9
- Portland: 9.7
- Washington, D.C. D/T: 10.2
- Houston: 11.4

Suburban
- Cambridge: 9.0
- Pittsburgh: 10.6
- San Francisco: 10.9
- Nashville: 11.1
- Virginia Northern: 13.3

DISTRESSED PROPERTY SALES

QUARTERLY CUMULATIVE DISTRESS VOLUME

ADDITIONS AND REDUCTIONS TO DISTRESS

Lowest Vacancy

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What Should Professionals Do?
Presentation Summary

• Part I: Economic Outlook
• Part II: Real Estate Capital Markets
• Part III: Real Estate Market Fundamentals
• Part IV: Challenges, Issues & Opportunities