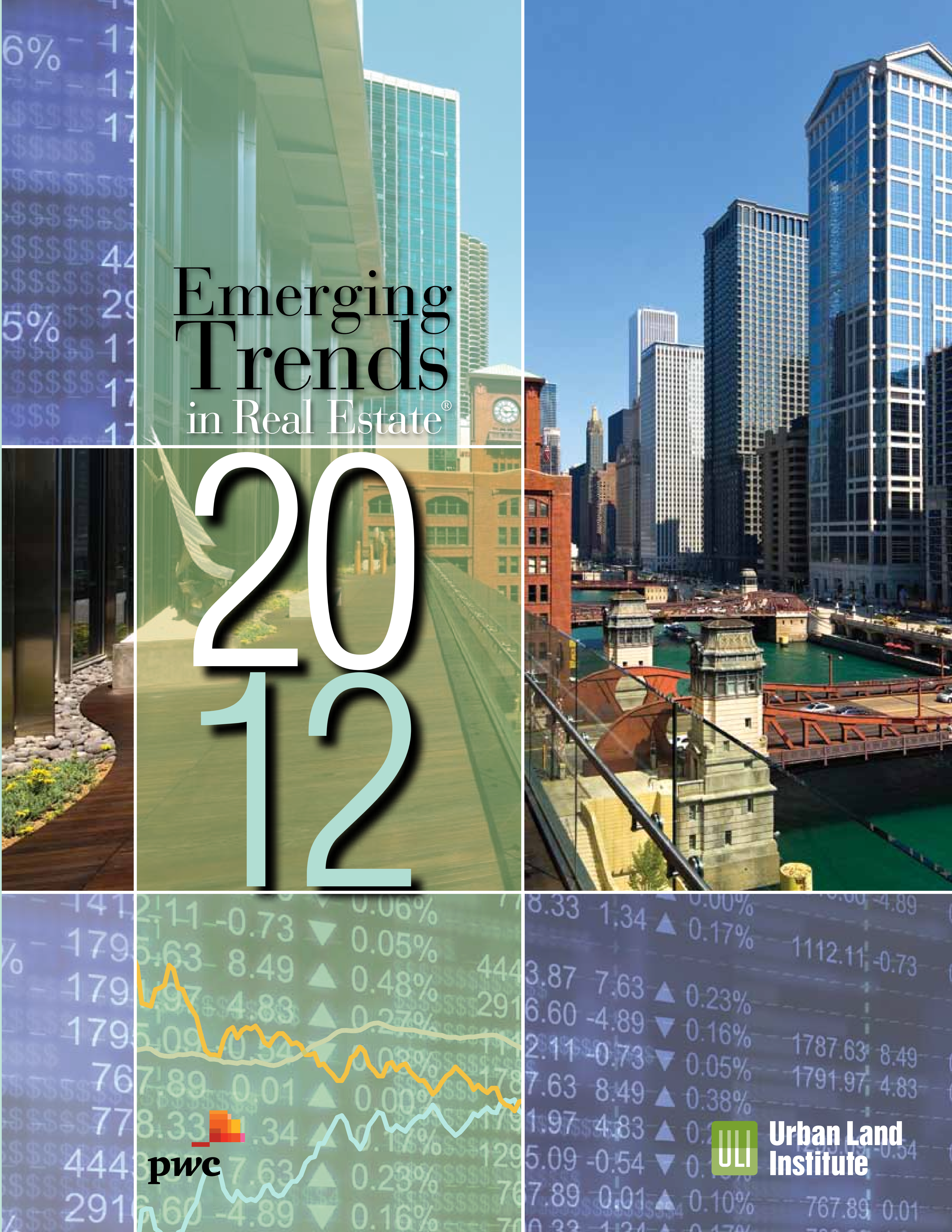

Emerging Trends in Real Estate® 2012

pwc

Urban Land Institute

Emerging Trends in Real Estate® 2012

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Executive Summary

For 2012, U.S. real estate players must resign themselves to a slowing, grind-it-out recovery following a period of mostly sporadic growth, confined largely to "wealth island" real estate markets—the primary 24-hour gateways located along global pathways. A handful of cities also should continue to benefit from expansion in locally based technology- and energy-related industries. Otherwise, most commercial markets have stabilized, but will find marked improvement in occupancies and rents relatively elusive. Despite some stepped-up bargain hunting, capital generally will continue to avoid commodity real estate in most secondary and tertiary cities. Among the property sectors, only apartments will score especially well: demographic trends and the aftermath of the housing bloodbath combine to increase and sustain demand for multifamily units.

Enduring economic doldrums and the absence of dynamic jobs generators hamstring overall demand, weighing on real estate markets. While the nation's lackluster employment outlook delays filling office space, the related drag in consumer spending compromises growth in retail and industrial occupancies and rents. Interviewees uniformly struggle to identify new employment engines: competition from overseas markets, technology gains, government and personal debt loads, an aging population, and global financial breakdowns all combine to stanch wage growth and hiring. As a result, businesses that are focused on squeezing profitability out of productivity gains and families forced into belt-tightening use less square footage. "The Era of Less" forecast in last year's *Emerging Trends* takes firm hold. Housing markets continue to founder in widespread borrower distress. Many cash-strapped, prospective buyers can meet neither stricter credit requirements nor higher equity hurdles. Casting a further pall on respondent outlooks, U.S. government disarray breeds uncertainty about policy affecting business and investment decision making.

Return expectations continue to ebb, although well-leased core real estate in leading markets will continue to produce solid single-digit income-oriented returns. Opportunistic investors ratchet down forecasts; even projections of returns in the midteens look like a stretch as risk increases from squirrely supply/demand fundamentals. Buying sentiment declines as selling interest increases. Investors who bought at or near market bottom in 2009 and 2010 consider cashing in some gains. Many players back off from bidding on trophy properties in better markets, fearing that pricing is outpacing the potential for recovery in net operating incomes. Cap rate compression has ended; a leveling off is expected, with possible upticks for some property sectors in certain markets.

Most developers and homebuilders will twiddle their thumbs in ongoing extended hiatus; without evident demand drivers, construction lenders hold back funding on most projects, except for multifamily development. Expect a ramp-up in apartment development across many markets justified by plunging vacancies and continuing rent increases. When the odd new office building goes forward, developers likely will employ green technologies and concepts; tenants begin to insist on cost-saving, energy-efficient systems.

Shaken by stock market declines and anemic bond yields, investors gravitate toward equity real estate, but grow somewhat unsettled in the face of limited property investment opportunities. "Face it: real estate doesn't offer enough growth potential to satisfy" the demand, says an interviewee. Although debt capital remains undersupplied, lenders and government regulators work hard to avoid a refinancing crisis with hundreds of billions in commercial mortgages maturing over the next three to four years. Well-capitalized borrowers and solid, revenue-generating properties have no trouble obtaining financing, while lenders and special servicers will continue to extend and pretend as long as borrowers on less-stable assets can pay something out of cash flows. Foreclosures will increase, but at a relatively restrained rate given the number of still-troubled properties.

The top investment markets remain the usual suspects, led by the 24-hour global gateways—Washington, D.C., San Francisco, New York City, Boston, and Seattle. Austin, the moderately sized Texas capital, sneaks into the number-two spot on the survey, benefiting from dynamics created by its large university, the local tech industry, government jobs, and regional energy-based economy. Houston and Dallas also solidify rankings off their oil and gas businesses and relatively strong jobs advances. Other tech- and/or energy-related markets scoring well include San Jose, Denver, and Raleigh-Durham.

Among property sectors, everybody wants apartments. Living smaller, closer to work, and preferably near mass transit holds increasingly appeal as more people look to manage expenses wisely. Interest cools on offices, especially suburban office parks: more companies concentrate in urban districts where sought-after generation-Y talent wants to locate in 24-hour environments. Investors continue to place bets on high-ceiling warehouses in the gateway ports and around international hub airports. And East Coast and Gulf Coast ports vie to attract the most new shipping traffic coming through a widened Panama Canal in 2014. Winning cities could transform into major distribution sites. Shopping center owners continue to face incursions from internet retailing: fortress malls and infill grocery-anchored centers consolidate business at the same time that older regional malls and fringe strip centers appear to lose ground. The hotel recovery begins to flag: good news concentrates in the prime business traveler/tourist gateways and in middle-market brands without food and beverage.

Canadian real estate markets remain the most stable in North America. Institutions hold on to the best properties and avoid boom/bust frenzies over pricing, while conservative fiscal policies discourage lax underwriting and licentious lending. A resource-rich economy does not hurt either. Interviewees expect these markets to weather world economic turmoil, particularly U.S. contagion, but anticipate a slowdown in 2012 as consumers and homebuyers back off a recent wave of uncharacteristic splurging. Eastern provinces tied to U.S.-related manufacturing could be affected more than western regions, living off energy stores and other commodities. Toronto and Vancouver stake claims as top markets; their gateway status attracts business and a surge in Asian investors parking capital in condo projects, which spring up in all directions. The two largest Latin American real estate markets head in different directions. Brazil matures into more of a core play, especially in Rio de Janeiro and São Paulo, where vacancies in top properties barely register and condo prices compete with New York City's best residential districts. Investors shy away from Mexico as drug violence takes an unfortunate toll.

Notice to Readers

Emerging Trends in Real Estate® is a trends and forecast publication now in its 33rd edition, and is one of the most highly regarded and widely read forecast reports in the real estate industry. *Emerging Trends in Real Estate® 2012*, undertaken jointly by PwC and the Urban Land Institute, provides an outlook on real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues throughout the United States, Canada, and Latin America.

Emerging Trends in Real Estate® 2012 reflects the views of over 950 individuals who completed surveys or were interviewed as a part of the research process for this report. The views expressed herein, including all comments appearing in quotes, are obtained exclusively from these surveys and interviews, and do not express the opinions of either PwC or ULI. Interviewees and survey participants represent a wide range of industry experts, including, investors, fund managers, developers, property companies, lenders, brokers, advisers, and consultants. ULI and PwC researchers personally interviewed more than 275 individuals and survey responses were received from 675 individuals, whose company affiliations are broken down below.

Private Property Company Investor or Developer	39.9%
Real Estate Service Firm	20.3%
Institutional/Equity Investor or Investment Manager	16.6%
Other	8.9%
Bank, Lender, or Securitized Lender	5.9%
Publicly Listed Property Company or Equity REIT	5.0%
Homebuilder or Residential Land Developer	3.4%

Throughout the publication, the views of interviewees and/or survey respondents have been presented as direct quotations from the participant without attribution to any particular participant. A list of the interview participants in this year's study appears at the end of this report. To all who helped, the Urban Land Institute and PwC extend sincere thanks for sharing valuable time and expertise. Without the involvement of these many individuals, this report would not have been possible.

Facing a Long Grind

"Don't let availability of capital cloud judgments. Demand drivers don't exist, and fundamentals need to catch up."

Some real estate players take comfort watching ample capital pour into U.S. property markets, escaping from a world of troubles plaguing other asset classes. "We are back to spread investing, with no place else to put money for a current return," one *Emerging Trends* interviewee says. But the seemingly intractable economic and political vicissitudes undercutting stocks and bonds eventually catch up to real estate investors. Absent increasing occupancies and rents, capital flows inevitably retreat, with sometimes dire consequences. For 2012, everyone must worry about leasing in soft markets where chronic economic malaise and technological productivity enhancements combine to dampen demand for space. The hard reality is businesses have learned they can increase profits using less, while people just cannot afford to live in more.

Most of the investment action concentrates in a handful of property-wealth islands—notably the diversified 24-hour gateways located along global trade routes, and the reliable multifamily sector, buoyed by the after-effects of the housing market collapse. Following the money, investors secure capital in the safe-bet cities where the nation does most of its business and the affluent settle, supporting local economies. With some overlap, markets generating jobs in resurgent tech and energy businesses also gain adherents. Apartments, meanwhile, score just about anywhere because not as many regular folks can afford to own homes and need to rent.

Otherwise capital generally avoids the surrounding sea of mostly commodity real estate. Local owners grapple in a tenants' market to lease space and secure cash flows without the benefit of cap rate compression to increase values. Because most commercial developers cannot obtain financing and little new supply will be added, "any improvement in demand can be amplified." But even in the wealth islands, expect "a slow-going grind" where stubbornly high unemployment delays the filling of office space, while the consumer drag hurts shopping centers and industrial space. "Face it: real estate doesn't offer enough growth potential to satisfy all the capital demand. People had been living and feeling large," mostly off borrowed money. "That's gone. We're living smaller," says an interviewee.

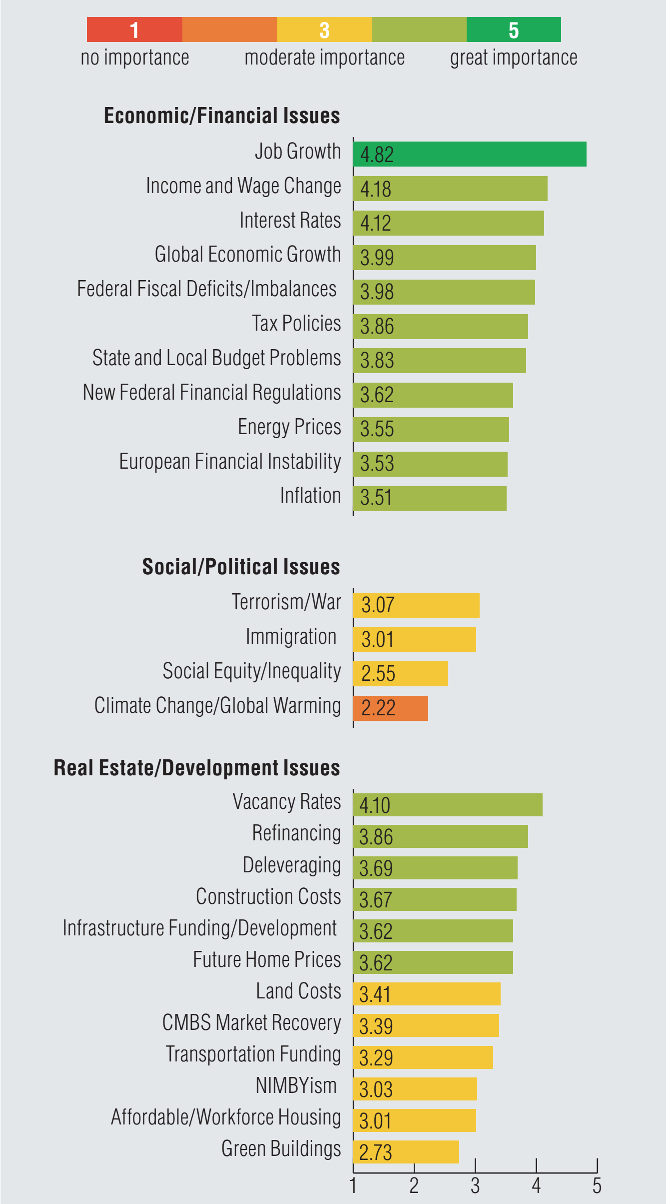
Indeed, the "Era of Less" heralded in last year's *Emerging Trends* report, appears to have taken hold of real estate fundamentals. During the past decade, the leverage-induced housing and private equity booms numbed impacts from stagnating wages and declining worker benefits across most income strata. Now, massive ongoing government and personal deleveraging erodes spending, as well as individual financial security. In general, people have less money or feel less inclined to spend what they have.

Even more unsettling, unprecedented government impairment gridlocks policy makers and roadblocks decisions that might encourage business expansion and hiring. Concern grows that any concrete political action awaits the outcome of next November's presidential election. In the meantime, the future of health care depends on a looming U.S. Supreme Court decision; what happens to Fannie Mae and Freddie Mac is anybody's guess; needed reforms to tax policy remain up in the air; and Dodd-Frank banking regulations are entangled in lobbying machinations. "With all this uncertainty, nobody wants to make a move," spawning additional risk.

For real estate investors, the big question—where are we in the cycle?—proves tough to answer. Almost three years after the economy hit bottom, recovery appears nearly stalled. Trophy

EXHIBIT 1-1

Importance of Various Issues for Real Estate in 2012



Source: *Emerging Trends in Real Estate 2012* survey.

real estate values escalate due to cap rate compression, but most other properties languish. "The bifurcation between 'have' properties versus the have-nots widens." "Vacancies aren't getting worse, but barely show improvement, and rents roll down as new leases mark to market." Tenants hold all the cards, and instead of expanding, some shrink their space requirements, "playing with existing inventory." Class A properties lease up at the expense of Bs and increasingly obsolescent Cs. The most optimistic interviewees hope for "a path more like a rolling hill than a steep mountain climb," featuring steadily increasing tenant demand "off very depressed levels," controlled development, and investors moving into secondary markets.

Despite widespread borrower distress, frustrated players uncover few bargains because lenders and special servicers hold back on disposing of problem assets in an enduring extend-and-pretend mode. As long as the economy goes sideways and government regulators turn a blind eye, the banks will continue to resolve bad loans at a snail's pace and help avoid a refinancing crisis.

All these forces combine to bend recovery and limit opportunity. Instead of a normal rebound, the cycle flattens in economic languor without prospects for much meaningful improvement. As markets creep back in 2012, investors can no longer "just ride the capital tide of rate compression, but instead must pick projects well and execute on management." The risk grows of overpaying for assets "based on rent spikes that aren't there," and developers—except for multifamily—remain frozen in suspended animation.

"We're in for a long slog."

Where Is Demand?

Interviewees' concern intensifies over a U.S. economy stuck in the doldrums. If the economy is not technically back in recession, exceedingly tepid gross domestic product (GDP) growth fails to ameliorate the drags of chronic high unemployment, suffocating debt loads, high energy prices, and rising health care costs. Roundly criticized government stimulus may have generated signs of recovery through 2010 into 2011, but when budget cutters and deficit hawks halted spending on various employment programs and began slashing public sector jobs, any momentum appeared to evaporate, and private companies have failed to pick up enough slack. Many economists call for increasing stimulus to boost employment, but others favor austerity and reducing deficits immediately. The resulting nasty and supercharged political wrestling match over jump-starting the economy may miss the point about the real problems facing the nation's future. Overcoming the following anchors weighing down demand will not be easy.

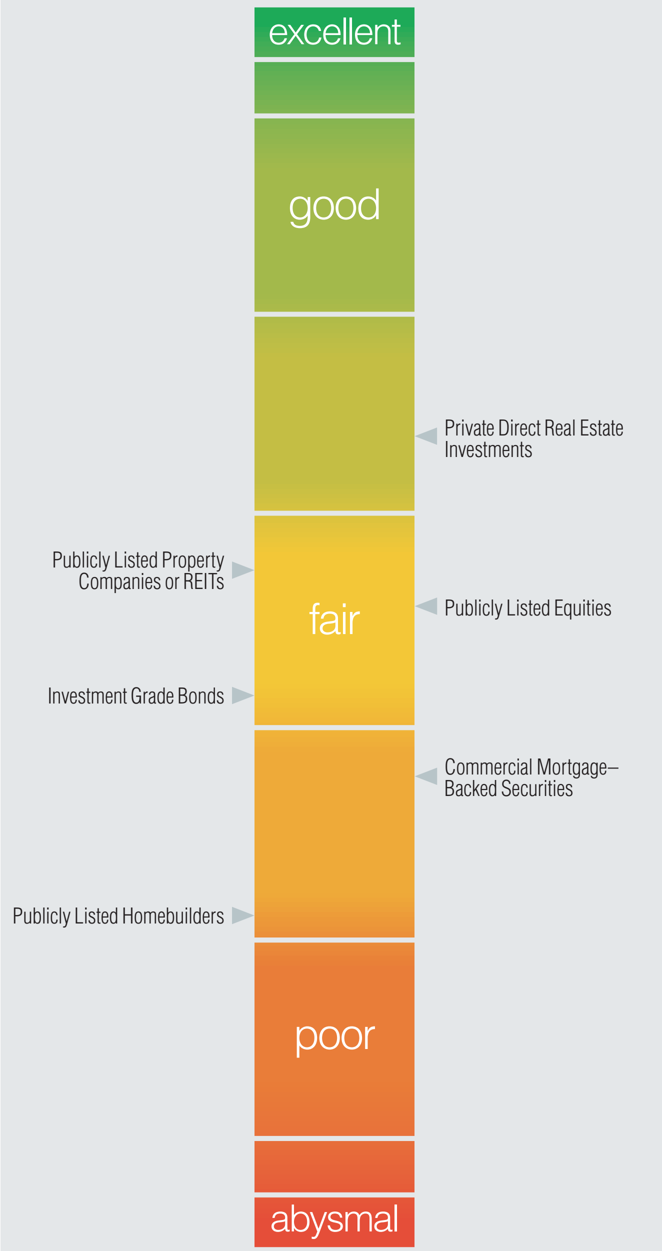
Global Jobs Arbitrage. U.S. wage rates increasingly become more uncompetitive now that many jobs—not just manufacturing—seamlessly can be transferred or outsourced via various communications technologies to lower-cost overseas markets. Among others, high-paying accounting functions and financial analysis head offshore. U.S. jobs do not disappear, but employers are not compelled to pay as much or hire as many domestic workers. No wonder many Americans take pay cuts in new jobs. The corporate pension turns into a dinosaur, and employers increase worker cost burdens to pay for medical care and other benefits. Insidiously, take-home pay either shrinks or does not grow enough to propel upward mobility for many people. "Manufacturing jobs exemplify what's happening: new hires earn at much lower wage rates than legacy workers. How can you support a family on $15 an hour?"

Productivity's Costs. The vaunted corporate gains from technology-enabled productivity enhancements may help fatten company bottom lines—many firms sit on cash, "waiting out uncertainty"—but the advances lead to reductions in hiring and demand for space. Mobile communications devices and wireless internet links eliminate old-line, bedrock office jobs—from secretaries and travel agents to file clerks and messengers. More employees can work from home or in the field, reducing the need for leased office space, and even computers take up less room. Hulking mainframes and workstations get replaced by microchips and tablets. Shopping centers and industrial properties take their own hits: logistics advances require less warehousing and reduced storage space in stores. Internet shopping, meanwhile, relentlessly chews into market shares of bricks-and-mortar stores.

Personal and Government Debt Loads. During the past decade, low interest rates and easy credit masked signs of fraying living standards. As long as housing bought without much equity appreciated and credit card offers piled up in the mail, consumer buying could accelerate into high gear apparently without consequences—that is, until values plummeted and bills piled up. "Now earnings will need to go to savings, consumption will stay down, and it won't come back to the way it was." Often spendthrift governments (federal, state, and local) had followed suit, borrowing excessively to pay for—among other things—wars, social programs, and public employee benefits. Unwieldy debt service loads now constrain future government spending. That may translate into more layoffs not only of public employees, but also workers at a host of private sector government contractors, including in the defense industry, at construction companies, and in not-for-profit organizations. "Deleveraging and austerity take a toll on jobs."

Demographic Realities. Unlike Germany, Italy, and Japan, the United States will not lose population during coming decades as long as immigration continues. But increasing percentages of seniors, as well as expected gains in the under-20-year-old population, could strain wage earners in prime adult years who overall will have more dependents per capita to support. Many older Americans may face tough times in tarnished golden years, weighed down by limited savings, abrogated pensions, and potentially diminished Social Security payouts.

EXHIBIT 1-2
Investment Prospects by Asset Class for 2012

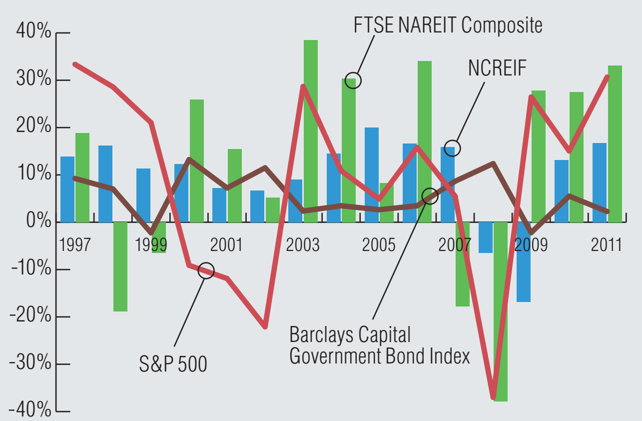


Source: *Emerging Trends in Real Estate 2012* survey.

The difficult jobs environment likely will keep more young adults living at home longer, too. As more "retro Waltons" families pool resources and share living arrangements out of necessity to make ends meet, they won't buy as much to furnish homes or require as much space per capita.

EXHIBIT 1-3

Index Returns: Real Estate vs. Stocks/Bonds



Sources: NCREIF, NAREIT, S&P, Barclays Group.
*2011 data annualized from second-quarter 2010.

Construction Slowdown. Slipping demand for space across all sectors means developers and building companies will have less to do, slowing any rebound in construction jobs, a once-reliable employment bulwark. Population growth—forecast at 3 million–plus annually—will fuel the need for more housing, but not necessarily create as many construction-related jobs as homeowners and renters economize. The construction industry could have plenty of work rebuilding the nation's increasingly deficient infrastructure, but government deficits and political wrangling could continue to short-circuit a ramp-up in public sector projects and resulting jobs.

Global Financial Morass. Massive deleveraging extends well beyond U.S. borders. "America is merely wounded; Europe risks death," and China depends on selling goods into Western economies, which lose at least some buying power. "The global economy really slows down" as the complexities of interconnected economies and banking systems complicate finding national or regional solutions. When Greece, let alone Italy or Spain, "spins toward economic Armageddon," the entire global banking system shudders into a crisis state, and fragile stock and bond markets crater, wiping out more wealth, says an interviewee.

Financial Industry Recalibration. America's once highly profitable and jobs-creating financial services industry struggles to regain its footing in these compromised markets. Most banks make money, just a lot less. Without escalating values and easy credit to boost returns, the transaction arcade quiets down, fee volumes diminish, and bottom lines erode. Deal-maker facilitators—lawyers, appraisers, brokers, and accountants—also feel the chill. Reality takes hold: the economy, including the real estate world, cannot sustain so many highly paid middlemen engaged in taking real profits out of deals without providing long-term economic benefits.

"Too Many Jobs Headwinds"

"All these structural economic changes can't be good for real estate"; they augur "a long period of adjustment and ratcheting down," featuring "a weak hiring environment" until declining labor and business costs reach a point where the United States can compete again. Interviewees lament this "slow crawl" of dismal jobs growth, which barely keeps pace with young people entering the workforce (4.5 million Americans turn 21 annually) and struggles to make up the nearly 9 million jobs lost during the recession (only a fraction have been recovered). "Real estate health simply depends on jobs, but there's no significant uptick."

Pockets of hiring occur in certain industries and parts of the country:

- The strong energy sector, driven by current high oil prices, helps Texas cities and some out-of-the-way places like North Dakota ("not exactly a happening real estate market," says an interviewee).
- Technology boosts northern California, the Seattle area, Boston, and smaller high-tech markets like Austin and Raleigh-Durham.
- Health care expands everywhere. The steadily graying population needs more medical attention, but work skews to lower-paid aides or highly skilled doctors, nurses, and technicians.

The country also experiences a shortage of engineers and specialized manufacturing artisans. "The economy produces service jobs at the low end and very high-skilled jobs at the other extreme." People either don't make as much money as they used to in manufacturing and services or need special skill sets and talent to make more, and many find themselves cast aside. Unfortunately, the nation's education system, particularly its public schools, lags in producing enough trained and accomplished workers despite still boasting the world's premier colleges and universities. Some attention-getting, new-age industries like social media and digital communications "either aren't mass employers or reduce more jobs than they produce through automation and tech efficiencies." Under these circumstances, how can office building absorption accelerate or consumers ramp up spending in malls? It likely won't happen in 2012.

Low Interest Rate Medicine, Cap Rate Caution, Inflation Bailout

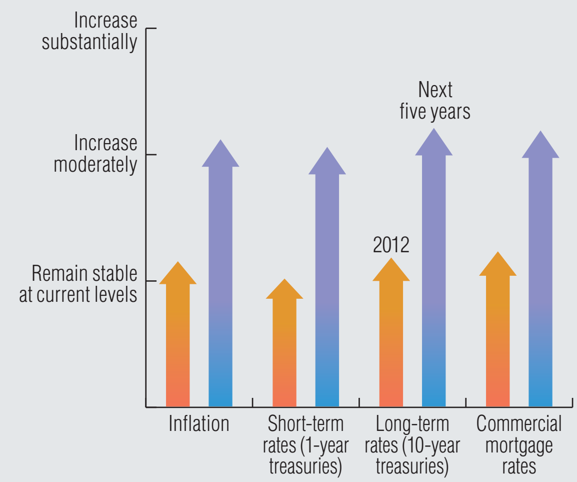
Essentially admitting the economy and housing market need further intensive care, the Federal Reserve reaches deep into its bag of tricks and holds down interest rates about as low as they can go. "The policy looks increasingly 'Japan-y,' where rates stay at extremely low levels and government budgets don't allow spending," says an interviewee. In the real estate world, the low rate environment and resulting extremely favorable spreads over other investments ignite buying of prime properties at rich prices, while weak fundamentals should be forcing down return expectations. If not yet a new bubble, investors may need to dial back to prevent creating one. Capitalization rates fall to pre-crash 2006–2007 levels; they "reach absurd numbers" on core assets "with crazy values." Low interest rates perversely "encourage investors into taking greater risk since they can't make money in bonds or money markets."

Despite Fed assurances about keeping rates at present levels past the election cycle, "people delude themselves if they think rates couldn't go up. Circumstances change, exogenous shocks happen, and the Fed may need to act." Investors should plan defensively for possible rate spikes. "Don't get caught with floating-rate debt, and instead try to lock in long-term fixed rates while the going is good." Keeping financing costs down over the investment holding period "can be as valuable an asset as the building itself, creating future gains when rates go up."

Survey respondents continue to forecast inevitable hikes: "Eventually interest rates must revert toward the mean" (exhibit 1-5), possibly signaling good news if dictated by a resurgence in economic growth. Respondents also predict heightened inflationary pressures: goods from Asia will cost more as Chinese wages increase, pricey gasoline could continue to raise transportation and food expenditures, and apartment rents continue to advance. But higher costs for goods would crimp already hard-pressed consumers in possible stagflation, and then what happens if the Fed decides to raise interest rates to tamp down raging prices?

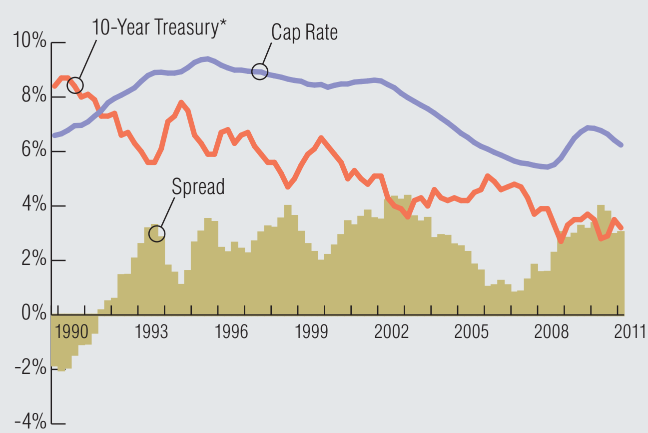
Some interviewees continue to tout inflation as "the only way out" of the current morass of deflated values and overborrowing. If inflation returns after nearly three decades in remission, the impacts may be lost on a new generation of office landlords who no longer insist on consumer price index bumps in leases. Without these clauses, real estate loses its attractive hedging characteristics in a high-inflation environment. "Fixed increases can be a disaster, and owners need to be careful."

EXHIBIT 1-5
Inflation and Interest Rate Changes



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 1-4
NCREIF Cap Rates vs. U.S. Ten-Year Treasury Yields



Sources: NCREIF, Moody's Economy.com, Federal Reserve Board, PricewaterhouseCoopers LLP.
*Ten-year treasury yields based on average of the quarter; 2011Q2 average is as of August 31, 2011.

Ebbing Return Expectations

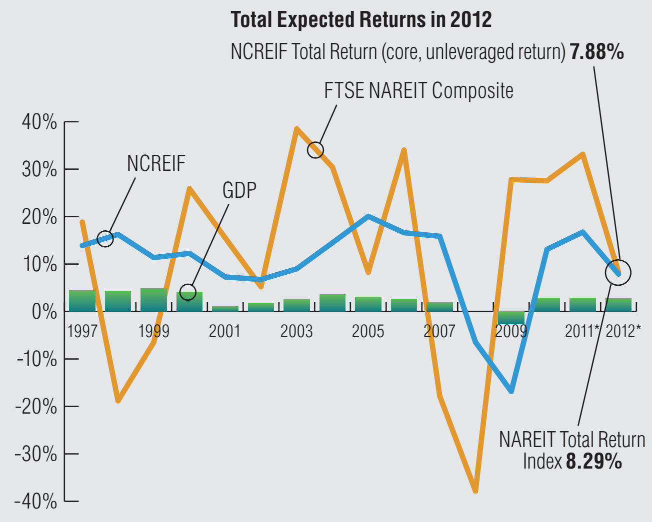
The return landscape for 2012 presents a mixed bag, and all depends on where and when investors bought, the amount of property leverage employed, and asset quality. Institutional investors in wealth-island core properties have enjoyed recent handsome annualized performance gains ranging from the low to high teens. "Appraisers overcorrected on the downside"; now they overcorrect on the upside, taking cues from "surplus capital" compressing cap rates. Anybody who bought in the gateway cities at or near market bottom should now "take some nice chips off the table." More recent core buyers should be satisfied with reliable, income-oriented returns without much, if any, appreciation. "Slow demand means no further lift. They need to hold long term."

For 2012, *Emerging Trends* survey respondents reasonably predict an 8 percent return for the institutional-quality NCREIF index—just slightly lower than their forecast for real estate investment trust (REIT) stocks (exhibit 1-6), which also focus on holding better-quality properties. "Real estate shouldn't be considered a screaming buy, but where else can you get a high-single-digit return? Cash flow should be the investment rationale."

Commodity property owners will fare considerably worse, especially in secondary and tertiary locations, which so far miss out on the capital wave. They hope investors, facing gateway sticker shock, shift attention to their markets, bidding up dormant prices still at rock bottom. But buyers in these places take higher risk, given subdued leasing velocity. Rents and occupancies may not move and could get worse. "Cap rates won't compress in these markets," says an interviewee.

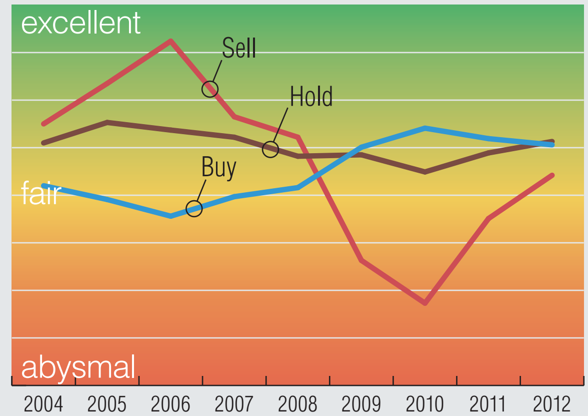
Opportunistic fund managers keep lowering their return expectations: "15 percent now may be a stretch." They can't make a quick buck at steep prices without more demand for space. Rents have done nothing, and leverage won't work its up-cycle magic today. Development strategies mean taking more risk, and securing construction loans remains extremely problematic, except for apartment builders. "If you think you're going into real estate today for a two-times return, you're in for a long wait."

EXHIBIT 1-6
U.S. Real Estate Returns and Economic Growth



Sources: NCREIF, NAREIT, *World Economic Outlook* database.
*GDP forecasts are from *World Economic Outlook*. NCREIF/NAREIT data for 2011 are annualized from second-quarter 2010, and the forecast for 2012 is based on the *Emerging Trends in Real Estate 2012* survey.

EXHIBIT 1-7
Emerging Trends Barometer 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

Transaction Markets Regear

Brokers and deal makers pull their hair out. Transaction activity pauses in a handful of major markets like New York City and Washington, D.C., where hard-won, bidding-war acquisitions now look "priced to disappoint." After "underwriting aggressive rent spikes in a recovery, we need to wait for recovery to actually happen before buying again." "No one priced risk adequately," one interviewee says. "Everybody became too optimistic too quickly." Some buyers will step up activity and poke around in secondary markets or off locations in primary cities, hunting for higher-cap-rate bargains. Not enough deals have occurred in smaller markets to get a bead on values. Some capital may seek to grab from a thin selection of A-quality properties in these cities, but "these investors move up the risk spectrum, possibly taking exaggerated gambles."

Interviewees expect pricing to level off in the top markets—"it'll be scary if it doesn't"—and the *Emerging Trends* barometer highlights how overall "buy" sentiment for 2012 will ebb, selling appetites will increase, and more owners will hold until the economy untracks (exhibit 1-7). The relative convergence in ratings for different strategic approaches only underscores the rising uncertainty in ambiguous markets.

Buyers continue their tedious vigil for banks and special servicers to dispose of more underwater assets just as the number of drowning borrowers expands on the refinancing bubble. "You need extreme patience until debt reprices." Most interviewees give up on predicting lender moves, especially since property fundamentals remain compromised, but expect gradually stepped-up dispositions. Many assets bottleneck in overleveraged, closed-end opportunity funds. "They can't be easily refinanced or sold because of complex partnership structures." Aggressive buyers of distressed debt pools "likely overpay to get some good assets at the expense of taking a lot of bad."

(Multifamily) Development Resumes

Starving developers champ at the bit for any action after a debilitating four-year hiatus, while property owners humbly realize that the dearth of new building has been their saving grace and reluctant lenders perfunctorily ignore most construction loan requests—except in apartment markets. In fact, multifamily developers and their equity partners can obtain "stone-cheap" financing from a host of sources, including Fannie Mae, Freddie Mac, and even insurance companies. Expect high-rise and mid-rise projects to mushroom in many markets across the country during 2012. "The activity picks up faster than expected," with projects meeting substantial demand in neighborhoods experiencing mid- to low-single-digit vacancies. "A lot of multifamily will get built." Developers "race to get out of the ground early before lenders start questioning the demand for all the new units."

Early apartment developments almost cannot miss. "If existing properties sell at a five cap rate and you can build new at a seven, then you build, as long as you can get the money." Eventually, oversupply becomes an issue after a comfortable two- to three-year window. "We all will drink the Kool-Aid," says an interviewee. "Housing will never come back and everyone wants apartments, but at some point a reversal happens." Apartment investors at low cap rates today need to weigh the impact of all these projects headed into the pipeline. Eventually raising rents will be more difficult for old product competing against just-completed units, especially in low-barrier-to-entry markets.

Otherwise, "it's just not a time to build" profitably. Interviewees generally agree about the overall commercial development landscape: "Retail will be terrible for years"; "no need for more office"; and "hotel is overbuilt, especially outside the major tourist and business cities." For now at least, many lenders adopt a "new realism"—"you cannot loan on spec," and "the farther away from gateway markets, the higher the leasing thresholds." Glacial-pace improvement in occupancies severely limits chances for project success, but some eager equity capital will bankroll new office space and even hotels, betting to catch a demand spurt at opening. "Investors want more upside than core deals provide, developers sense dollars are out there, a tension exists for capital to do something—all leading to some inane projects driven by capital availability, not need." Pent-up desires for developers to get back to work might be better focused outside the United States by exporting skills to Brazil and other Latin American countries, as well as some Asian and Middle East markets. "They don't call them developing countries for nothing."

Government Disarray

No matter their political stripes, interviewees rage over "unprecedented government dysfunction" and "inability to deal with issues," breeding more market uncertainty and failing to spur meaningful jobs growth. "The political system is now a risk factor: Can politicians continue to play with hand grenades and pins out?" Here are some of the biggest concerns:

- In a presidential election year, "you'd figure no one wants to screw up on jobs," but small-bore employment programs run into deficit-slashing buzz saws and tax-cut adherents.
- Dodd-Frank regulatory reforms' "attempts to put the genie back in the bottle" could unsettle lenders and compromise refinancing problem loans. For now, financial industry lobbyists seem to hamstring rulemaking. "No one knows what will come out in the fine print," says an interviewee.
- In particular, commercial mortgage–backed securities (CMBS) reserve requirements and rating-agency roles remain very much unresolved despite recent market calamity.
- Lawmakers go into rope-a-dope on whether to salvage Fannie Mae and Freddie Mac. Homebuilders fear scuttling the agencies will set back housing markets, raising borrowing costs for already whipsawed buyers, and apartment investors will lose their primary financing source, "causing great damage."
- Health care costs rise precipitously despite 2010's highly controversial legislation. The new law's main features take effect in 2014, if not overturned by the U.S. Supreme Court before then.
- Investors wonder about tax rates and deductions. Hackles rise over the vulnerability of favorable carried interest treatments.

"It's a mess for doing business," and the election may not resolve the gridlock.

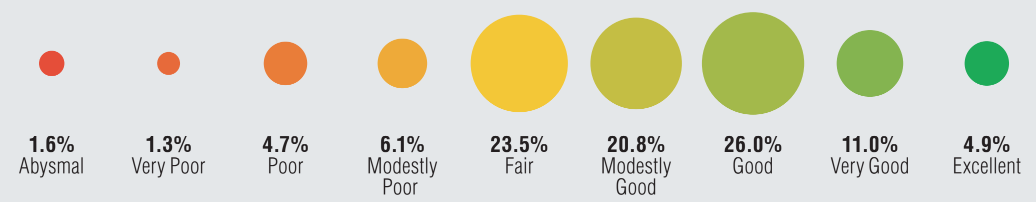
Improving Profitability

"Chronically optimistic" property players only reluctantly come to terms with the more limited opportunities in a shrunken industry ("which eliminated more jobs than most"). Investors talk the brave game that they will accept coupon-clipper returns over long-term holds, but they still really want the big, quick pops, which seem out of reach now. For starters, the lower-return environment reduces the chance for outsized manager

EXHIBIT 1-8

Firm Profitability Forecast 2012

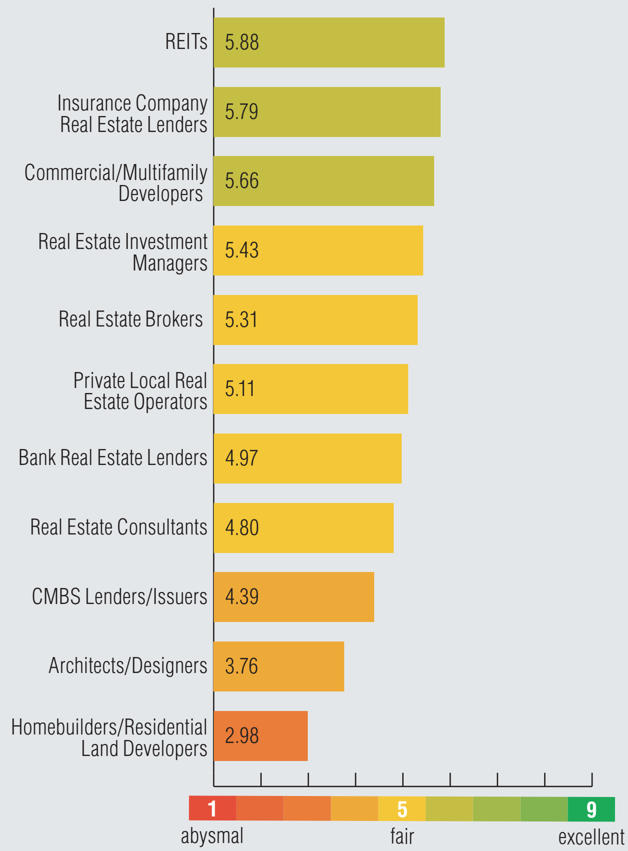
Prospects for Profitability in 2012 by Percentage of Respondents



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 1-9

Real Estate Business Prospects for 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

promotes. Developers cannot make as much, even if they stay in business. For brokers, the buy-and-flip game is over, reducing transactions and attendant fees, "although they have been doing better." Despite the angst, survey respondents hopefully expect their firms to record decent profits in 2012: 87 percent forecast fair or better results, and 42 percent expect to register good to excellent bottom lines by year end (exhibit 1-8). REITs, multifamily developers, and fund managers should have at least a "modestly good" year; while this is no surprise, homebuilders and architects gasp to hang on (exhibit 1-9).

To keep profits up, "companies go through a lot of leadership change and try to do more with less, "pushing people as hard as they can." CEOs and senior leaders require "different people skills." It isn't about deploying capital at all costs, but more about managing operations, assets, and expenses. "Top executives need to show prudent management abilities," take care of investors, and "motivate teams in a slow-growth environment where you can't make as much money or do as many deals." Hiring is confined to companies that "have capital or access to capital"—primarily REITs and investment managers. The fund managers pare back on deal makers and bulk up on asset managers. They also need client-facing executives to play defense, do mea culpas over legacy portfolios, and, most important, raise new money. In line with keeping lean operations, businesses show more interest in lower-paid young talent with potential and jettison more experienced senior workers who are higher on the pay scale.

Best Bets 2012

Except for multifamily, no markets or property sectors offer sure-shot opportunities for big gains in 2012. Owners can feel relatively secure in leading gateway cities, and buyers should focus on the few markets generating jobs—typically where technology and energy companies concentrate. Market-timing buyers at the 2009 rock bottom can pocket modest upside, selling into what's left of the capital wave. Commercial developers and construction lenders should best remain in hibernation outside of undertaking the odd project in a 24-hour bastion. The usual-suspect best-bet sector performers—fortress malls, infill neighborhood centers, gateway industrials, and business center hotels—should do relatively well. Investors can continue to capture attractive stakes by recapitalizing select assets in need of refinancing. But nobody should argue with anyone sitting on cash until the economy shows real signs of resuscitation.

Investment

Caution Still Rules. "It's not the time to be all in; investors should maintain liquidity" and focus on demand trends. Stop following the lemmings on capital moves. Instead, concentrate on the few markets showing hiring and leasing gains; steer clear of places with compromised longer-term growth prospects; and don't count on typical recovery tracks materializing the way they have after past recessions. "If you haven't figured it out by now, this time is different."

Blue-Chip Gateways. These relatively safe harbors all have issues: a Wall Street slowdown could hurt New York City, Washington confronts possible government cuts, and San Francisco is always volatile—but over time, assets in 24-hour markets dependably outperform because they lie on important global commercial routes and attract money from all over the world. The value of their barriers to entry also should never be underestimated. "Prices may be outrageous in the bigger cities, but do you have confidence investing elsewhere?" For 2012, holders and sellers may do better than buyers.

Job Centers. If real estate is "all about jobs," then head to the few cities where employment growth actually occurs. Besides the gateways, the current front-runners rely on energy, high tech, and health care–related industries, as well as universities and government offices. Austin becomes a current favorite because it claims all these attributes. Bigger Texas cities—Houston and Dallas—also sustain investor interest because of their energy backbones. High tech spurs Seattle and San Jose. Denver also offers a dose of energy and technology. But investors beware: the current high flyers tend to boom/bust, and some of these markets are susceptible to overbuilding. Don't take your eye off the ball.

Value-Add Plays. Instead of trying to justify "jaw-dropping" prices for core quality assets, look for class B properties in good infill markets "that haven't been shown any love" over the past five years. Apartments usually fit the bill, but certain well-located offices and hotels could profit from renovations and repositioning in anticipation of eventual market recovery. The availability of low-cost debt can help fund improvements and buttress eventual returns.

Fixed-Rate Debt. Owners should lock in long-term fixed-rate financing on assets while they can. Interest rates could easily track up again during expected holding periods without offsetting gains from fundamentals. Believe those crying "It's just a matter of time." If rates increase, floating-rate debt could dramatically cut into net operating revenues, while relatively low-interest, fixed-rate debt would help cash flows and boost future investment returns.

Recap Troubled Equity. The number of borrowers needing refinancing only grows as troubled loans from the market lending peak reach terms. Many decent assets remain structurally impaired and need cash infusions to remain competitive in bidding for tenants, who command pricey concession packages. More motivated borrowers, working with senior lenders, will strike favorable deals on mezzanine debt and preferred equity to stabilize assets and salvage something. At low interest rates, investors can achieve especially favorable risk/return spreads.

Distressed Debt. Banks and special servicers will continue to dribble out loan pools with various embedded gems. The hard part is figuring out if the good assets in offerings are worth acquiring given all the accompanying dreck. Some buyers of similar Resolution Trust Corporation (RTC) debt made out well in the 1990s, but rode a sharp market upturn to riches. This time it may not be so easy.

Land Holds. Cash buyers can fetch entitled single-family lots for cents on the dollar. "These are real steals." But purchasers may sit a long time before the homebuilding market comes back. The farther out on the metropolitan fringe, the longer the wait.

Development

Apartment Boom. Existing apartment stock in many markets cannot meet demand for units from surging numbers of gen-Yers, housing-bust refugees, and immigrants. If the economy picks up, renter interest could intensify further from people doubling up or young adults living at home but looking for their own space. Developers have little trouble convincing construction lenders, given the demographic evidence, and they can negotiate favorable deals with builders and contractors, who need the work. Commercial sectors offer very few opportunities, like occasional build-to-suits, the odd class A office building or hotel in a 24-hour market, and possibly shopping centers in burgeoning Hispanic areas adapted to attract retailers who specialize in serving Latin American populations.

Go Green. Tenants want energy-saving technologies simply to reduce costs. "It's not about tree hugging; it's about bottom lines," says a developer. The modest extra upfront project costs can produce long-term operating savings, which help improve building values and ensure competitiveness over time.

Property Sectors

Multifamily Any Way You Like It. It almost doesn't matter what part of the country is concerned, interviewees go totally gaga over apartments: buy class A, value-enhance class B, develop from scratch, purchase in infill areas, acquire in gateway cities, or hold in lower-growth markets. "Even buy class C and upgrade, spend a little more, hold a little longer—demand will be there." The only caveat: avoid severely affected housing markets where a surfeit of empty single-family homes will compete as rentals.

Fortress Malls, Infill Shopping Centers. Location and retailer quality gain importance in the shopping center world, fighting against e-commerce incursions. Aptly named fortress malls, near upscale suburban neighborhoods and strategic highway intersections, continue to concentrate the top brand chains and attract more shoppers away from their weakening competition—centers situated near older or more commodity-class housing districts. Grocery store–anchored centers with leading supermarket and drug store chains still command plenty of traffic from necessity shoppers, and investors love the steady cash flows.

Coastal Port Industrial Space. Global trade will power export activity around the nation's primary seaboard ports, where traditional big-box warehouse distribution assets rebound after experiencing uncomfortably high vacancies. All eyes focus on which East Coast cities can position themselves to capture Pacific container-ship traffic slated to come through a widened Panama Canal in 2014. Some winners will turn into new industrial hubs, but first need to dredge harbor channels to handle deep-hulled vessels. Miami, Charleston, Savannah, and Norfolk look like prime contenders, and New York/New Jersey will not be left out. Houston should pick up business along the Gulf Coast.

Business Center Hotels. "It's the point in the cycle where lodging makes sense." But only the major 24-hour cities attract consistently strong combinations of business and tourist travelers to sustain occupancies and advance room rates during the week, as well as into weekends. Middle-market hotels without food and beverage service lure budget-conscious travelers without outsized operation overheads, enhancing bottom-line results.

Trophy and Medical Offices. Gateway class A office space always commands attention, but interest flags elsewhere, especially in the suburbs. Expect slim pickings when dipping into second-tier cities, and forget about office parks. Niche-sector, medical office space gains favor: "The tenants are recession-proof," and "the health care act will help spur demand as more hospital procedures move into doctors' offices." Over the longer term, a bulging senior citizen population promises to expand needs for various outpatient facilities and clinics.

Housing Buys. The battered housing sector offers the best generational buying opportunities for oceanfront condos or dream suburban homes. Prices edge up off nadirs in better markets after unprecedented declines and mortgage rates remain highly attractive, if purchasers can muster enough equity and adequate credit scores. Oversupply of existing stock deflates homebuilder hopes, and 25 percent of borrowers remain underwater. Housing for seniors and student housing remain demographic plays, and manufactured-home sites could do well in the down economy: operators can earn income waiting for future land development opportunities.

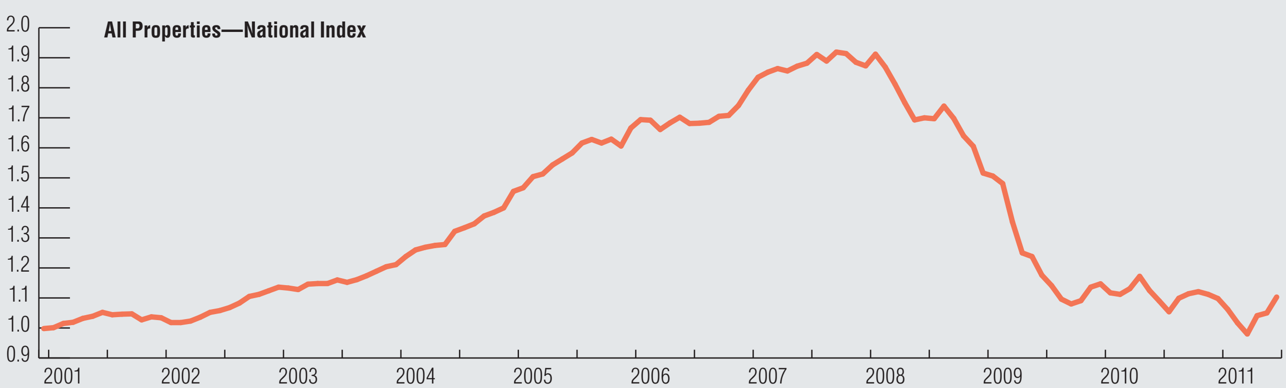
Real Estate Capital Flows

"It's a real estate market with too many dollars for too few opportunities."

The stock market bounces around producing a decade-long goose egg, and bonds throw off tiny yields. By default, capital turns to real estate: its cash-flowing returns, lease structures, and inflation-hedging characteristics command attention. "When treasuries return next to nothing, a 6 percent coupon on a piece of real estate is not so bad," says an interviewee. But in today's problematic market, always-fickle capital also proves "highly selective" and "concentrated." It's interested in real estate, but only in a relatively narrow segment of the property markets, bidding up prices on the best commercial assets in the more secure wealth islands and racing into the attractive multifamily sector. The rest of the underwater real estate landscape mostly misses out. When institutional investors talk up the property markets today, they really mean a handful of big cities, the best suburban fortress malls, and their latest apartment purchases. They have no interest in most assets in second-tier cities or outer suburban rings, many owned by borrowers whose mortgage balances outstrip values, which have fallen into the pits. And why should they when the economy stays in the dumps and prospects appear so limited for any occupancy or rent growth?

For 2012, the purveyors of capital will struggle with whether to cool it in the popular gateways, take a breather on apartments, or take a flyer on ferreting out true bargains among mostly commod-

EXHIBIT 2-1
Moody's/REAL Commercial Property Price Index



Source: Moody's, Real Estate Analytics LLC, MIT Center for Real Estate, Real Capital Analytics.

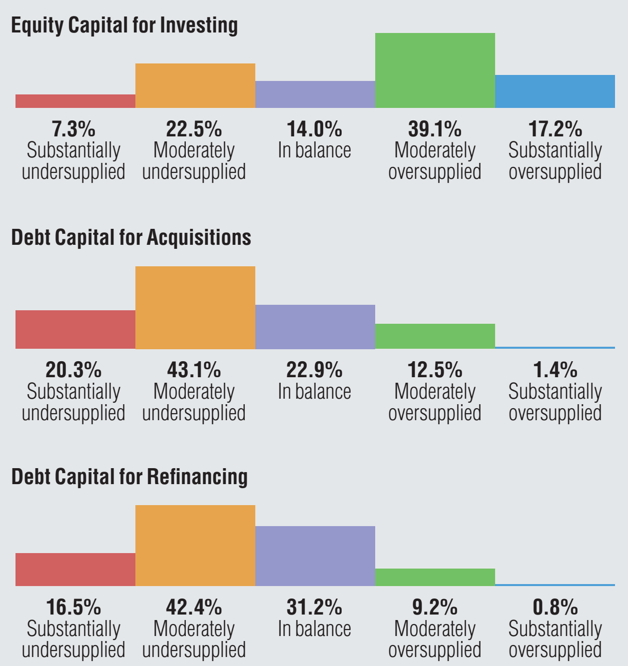
Note: This index is a periodic same-property round-trip investment price change index of the U.S. commercial investment property market. The index is based on the Real Capital Analytics database, which attempts to collect price information for every commercial property transaction in the United States over $2.5 million in value.

ity properties in off-the-beaten-path markets. Big pension plan sponsors still must extricate themselves from various failed limited partnerships and tally up more losses from fund investments gone belly-up. For all the PR about restored balance sheets, money center banks dribble out dispositions of distressed assets, and many regional bankers remain basket cases, weighed down by bad loans on properties no one wants almost at any price. Real estate may look better than other asset classes, but that does not mean the property sector has much to offer.

Too Much Equity. Respondents to the *Emerging Trends* surveys anticipate saturated equity capital demand: 56 percent of respondents say the market in 2012 will be moderately to substantially oversupplied, given the opportunities—similar to results posted in 2011's report (exhibit 2-2). "It's mind-blowing how everyone seems to have a real estate fund." Foreign investors, taking advantage of attractive currency exchange rates, head the list of active acquirers, followed by private equity firms, pension funds, private investors, and REITs. "A tremendous amount of capital sits waiting to be deployed."

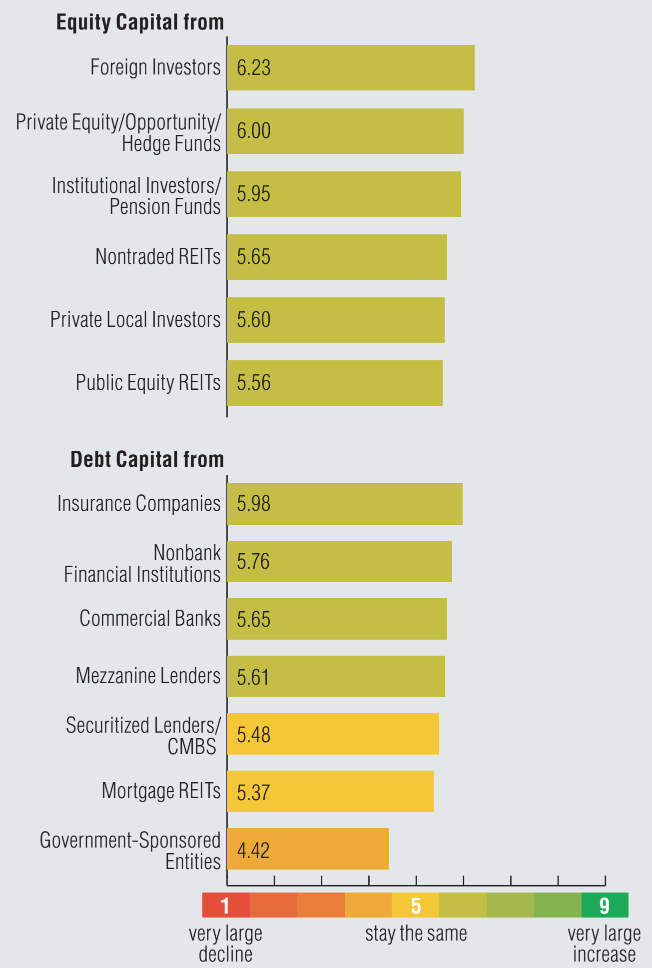
Debt Shortage. Respondents also continue to forecast a lack of critically needed debt capital as hundreds of billions of troubled mortgages reach their terms and require refinancing. Led by insurance companies, which focus on core properties, all the major debt suppliers should be active in the lending market in 2012 (exhibit 2-3), but they will be unable or unwilling to meet all the financing demand. Nearly 63 percent of respondents project that the debt markets will be moderately to substantially undersupplied during the year, blaming the spotty CMBS recovery and bankers' reluctance to lend when interest rates are so low. In fact, "low rates may have the unfortunate effect of delaying resolution of some of the refinancing problems." Lenders' also will continue their preferred strategy of extending many loans

EXHIBIT 2-2
Real Estate Capital Market Balance Forecast for 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

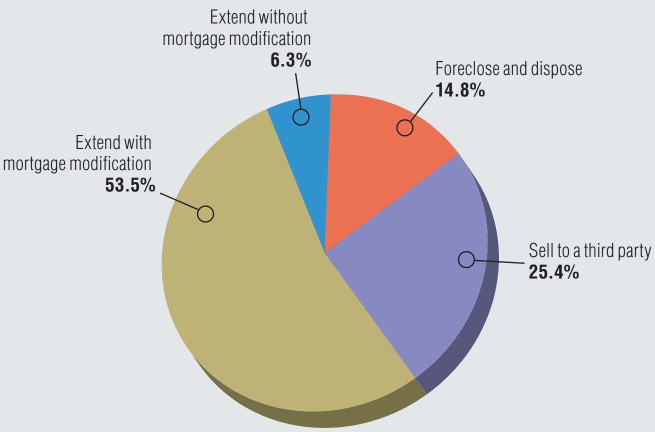
EXHIBIT 2-3
Change in Availability of Capital for Real Estate in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 2-4

Maturing Loans: Preferred Strategy for Lenders



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

with modifications rather than refinancing or disposing of them; they wait for more propitious opportunities and avoid balance-sheet issues until space markets improve. "The fundamentals aren't bailing them out yet" (exhibit 2-4). "We're only at the end of the beginning of market clearing as deleveraging continues." Special servicers "aren't geared to handle large volumes from all the CMBS deals coming due, and the presumption is the loans will get extended as long as borrowers make pay downs and pay fees."

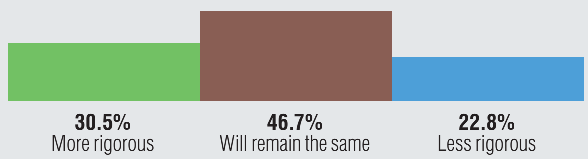
No Emergency. This gamesmanship, abetted by nervous regulators, probably will avert a feared "refinancing crisis." Good-credit tenants with well-leased real estate "can get money"; lenders just "put off as long as necessary dealing with assets in bad shape." Some borrowers could get forced into a box: buying time pushes their eventual refinancing into a potentially higher-cost, higher-interest-rate environment. Stronger financial institutions will be more proactive about taking necessary haircuts and undertaking dispositions in a stepped-up but measured sales process. And make no mistake, "borrowers who overpaid for properties and overleveraged see their equity basically wiped out." They may manage to recoup a fraction of their original investment—maybe a management contract or a chance at some future upside as a minority partner.

Needed Scrutiny. A majority of respondents forecast that underwriting standards will remain the same or become even more rigorous—both on debt and especially on equity transactions in 2012 (exhibits 2-5 and 2-6). They anticipate renewed attention paid to supply/demand issues in markets as players prudently take less for granted in recovery scenarios. "Real estate is a tough asset class. It's easy to get money out quickly to plenty of guys who will take it, but much harder to get consistent returns." The summer 2011 hiccup in CMBS issuance underscored the need for vigilance after "frothy underwriting" raised eyebrows among bond buyers. "Once again we had gotten ahead of ourselves, when you'd think recent experience would have kept that from happening."

Follow the Money. Indeed, important lessons from past investing snafus, including circa 2005–2007, highlight how buyers and lenders should retreat anytime capital rushes into real estate markets. A good barometer may be cap rates plunging below 5 percent. In the 1980s, too many dollars fueled overdevelopment and overpaying for prime assets just as a flood of cheap credit precipitated the recent hemorrhage. Easy capital availability can overwhelm property markets and blinds industry players to realities of supply/demand trends, as well as changing tenant behaviors. Even if one assumes the economy is in an early-stage recovery, these market indicators require greater scrutiny today when the economy takes such a bumpy and potentially uncertain path. Fund investors also should know by now "they cannot rely on manager discipline" to keep them

EXHIBIT 2-5

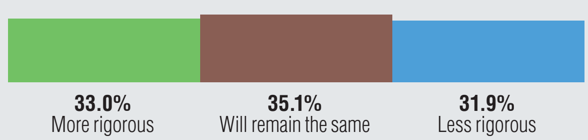
Equity Underwriting Standards Forecast for the United States



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

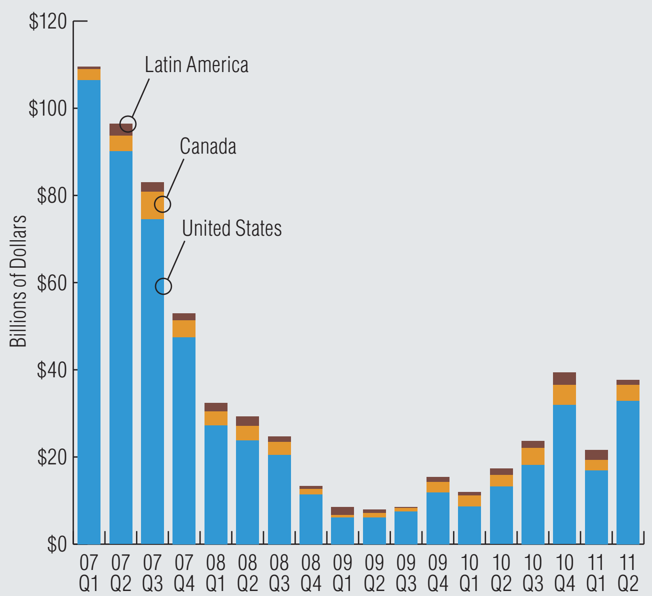
EXHIBIT 2-6

Debt Underwriting Standards Forecast for the United States



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 2-7
Sales of Large Commercial Properties



Source: Real Capital Analytics.

Note: For properties $10 million or greater; closed sales, commercial real estate only (office, retail, industrial).

out of trouble. "The advisers make money by constantly deploying dollars. If they don't invest or must return commitments, they're out of business."

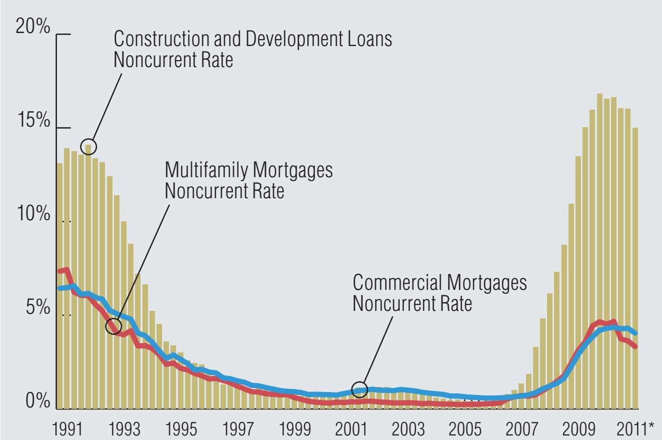
Simply put, when capital looks like it's out of control, it's definitely time to start worrying.

Banks

Still in "no rush to sell distressed assets and take losses," banks deliberately "square away problem loans one by one." It begs the question about the strength of "recovered balance sheets" and whether regulators "fear letting the market clear too quickly." This leisurely wind-down process could "take at least three more years." In 2012, anticipate more recapitalizations and sales, and distressed debt will remain difficult to refinance. "It's the same game plan," says a bank executive. "Our aim is to hit a lot of singles and not do something stupid." In dealing with defaults and handling foreclosures, banks are "not in the business of holding and owning." "They don't want to take back hotels, may be able to get good pricing on apartments, and kick the rest down the road. Foreclosures also take time, delaying deals coming to market."

Money center banks appear to be "awash in cash. "They have little reason to lend when they can make profitable spreads off borrowing from the Fed for next to nothing to purchase government bonds." But lending by banks picks up, especially to creditworthy institutional clients and REITs—"where they feel confident about getting a return"—on longer-term, recourse loans with higher reserves. Bankers also structure syndications for reducing risk, while construction lending concentrates on multifamily. "Spec projects need not apply," and borrowers must fork over "at least 20 percent cash equity" to qualify. Some borrowers point to "schizoid" bank approaches where well-capitalized opportunity funds can score "ample leverage" on up to 75 percent loan-to-value ratios from mortgage officers eager to pitch business, while the workout group across the hall refuses to talk to the same client about an existing problem deal on their books." Weaker regional and local banks may have less wiggle room on workouts and sales, "hurting prospects for quicker resolution of problems" in some second- and third-tier markets.

EXHIBIT 2-8
Bank Real Estate Loan Delinquency Rates



Notes: Delinquent loans are defined here as those that are noncurrent—either 90 days or more past due or in nonaccrual status. As of Q2 2011.

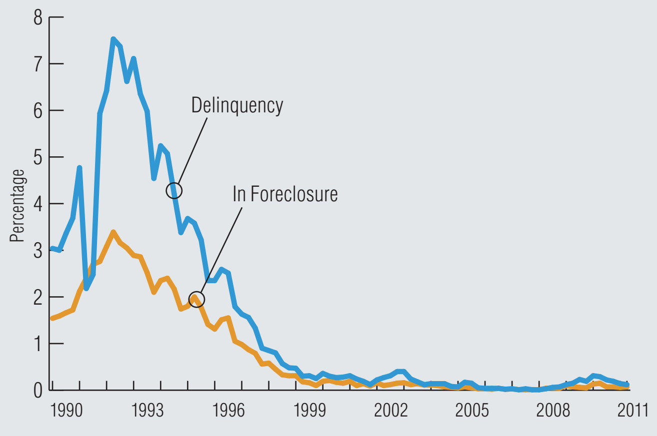
Source: FDIC.

Insurers

After years pushed to the commercial mortgage market periphery, life insurance companies stand out as "lending all-stars, "showing how discipline can pay off in preserving capital" and limiting downsides. "Back at full capacity without as many residual problems," they have "a ton of cash" to dole out to "best-breed borrowers who own class-A properties, and land excellent opportunities to "make decent loans" near market bottom. They can underwrite at "values well below past peaks with reasonable loan-to-values and good debt-service coverage, while solid NOIs [net operating incomes] from core properties give cushion." Uncharacteristically, the life companies also

EXHIBIT 2-9

U.S. Life Insurance Company Mortgage Delinquency and In-Foreclosure Rates



Sources: Moody's Economy.com, American Council of Life Insurers.

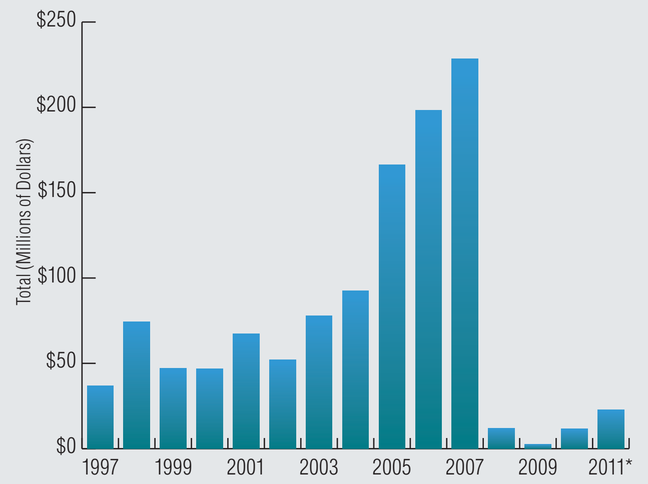
"jump with both feet into apartments," picking up slack from the pullback of Fannie and Freddie. "We'll consider construction to permanent loans" in moving up the risk scale, an insurance executive says. "The spread against treasuries gets a little more juice." But no one expects insurers to expand lending beyond their comfort range of about $40 billion to $50 billion annually. Given the hundreds of billions of dollars in loans coming to term, most borrowers must still count on banks and conduits.

CMBS

Teams handling CMBS deals watered down loan terms to get money out. Underwriting standards weakened, providing generous loan-to-value ratios and allowing even interest-only structures—"anything to build their volumes and fees." We're talking 2006 and 2007, right? No. This conduit lending behavior occurred in 2011, just 24 months after the CMBS market had been left for dead, drowning in bad debt. Fortunately, wary bond buyers rejected the loan packaging, and CMBS proponents now brush off the "disruption" as a "net market positive" and a "bump in the road," "keeping the industry honest." Though probably only a reset, the events give pause, especially since CMBS lenders "must get traction"—at about a $50 billion to $100 billion clip in annual origination—to help refinance starved-for-credit commodity real estate. "They are viewed as the salvation for the middle market," particularly secondary cities and suburban properties. "Clearly lessons have not been learned and bad practices can return quickly," says an interviewee. The demand side (particularly B-piece bond buyers) must police the system

EXHIBIT 2-10

U.S. CMBS Issuance



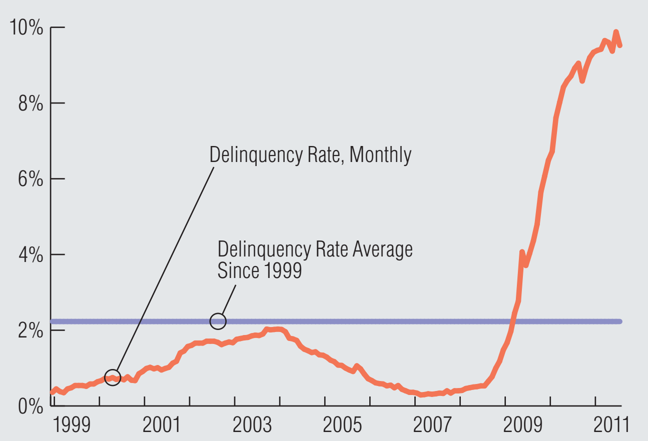
Source: Commercial Mortgage Alert.
*Issuance total through August 30, 2011.

because "nothing has happened in regulation or rating agency oversight to prevent a recurrence" of a meltdown sometime in the future, says an interviewee. "The breakdown last time happened when the B-piece buyers could resecuritize and pull out their money. That's not happening yet."

Interviewees expect a major consolidation among the approximately 25 conduit lenders back in the market. "CMBS

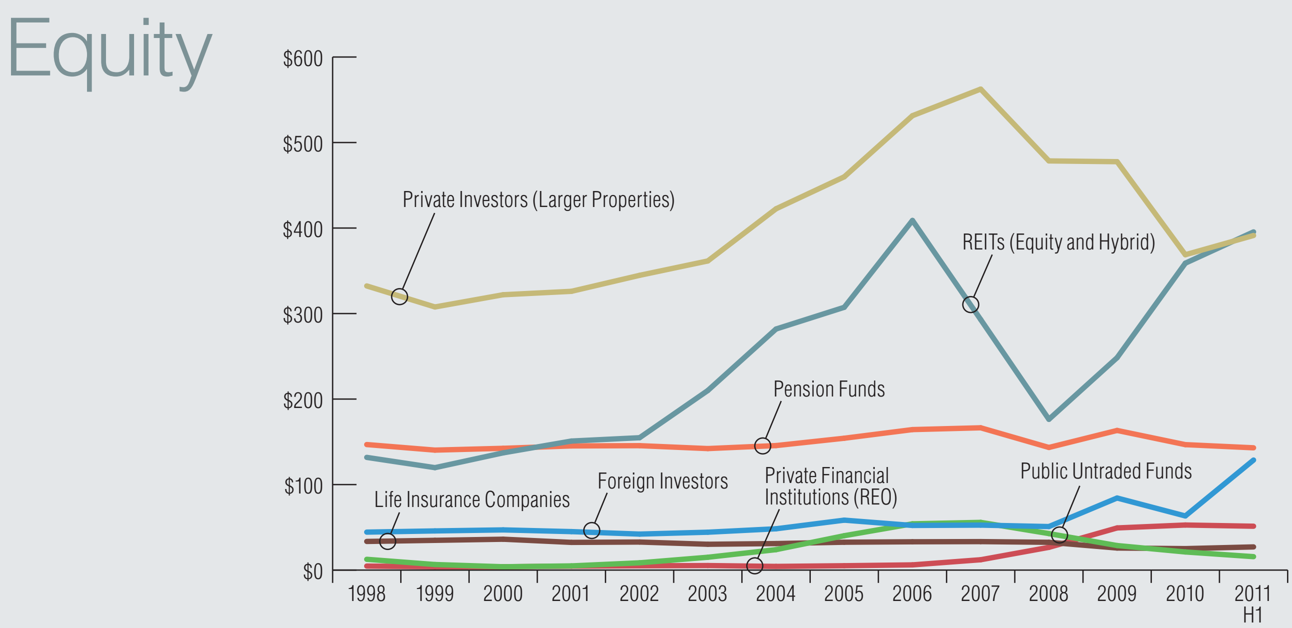
EXHIBIT 2-11

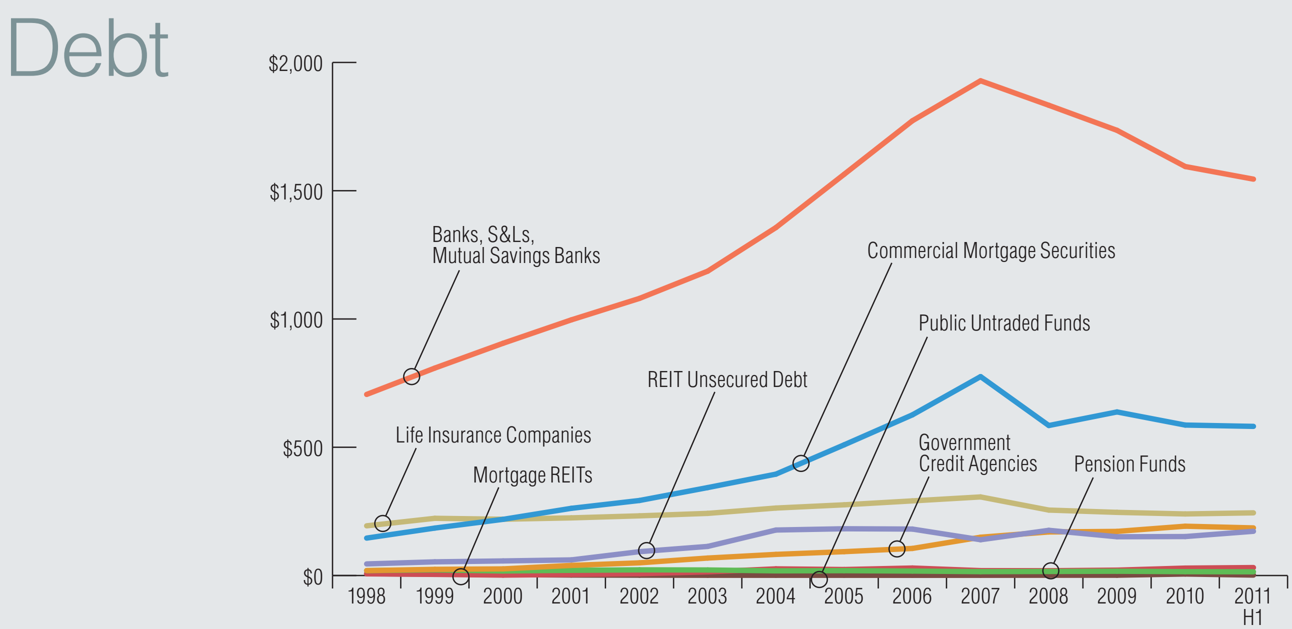
CMBS Loan Delinquency Rates



Source: Trepp LLC.
Note: Through August 2011.

EXHIBIT 2-12
U.S. Real Estate Capital Flows, 1998–2011

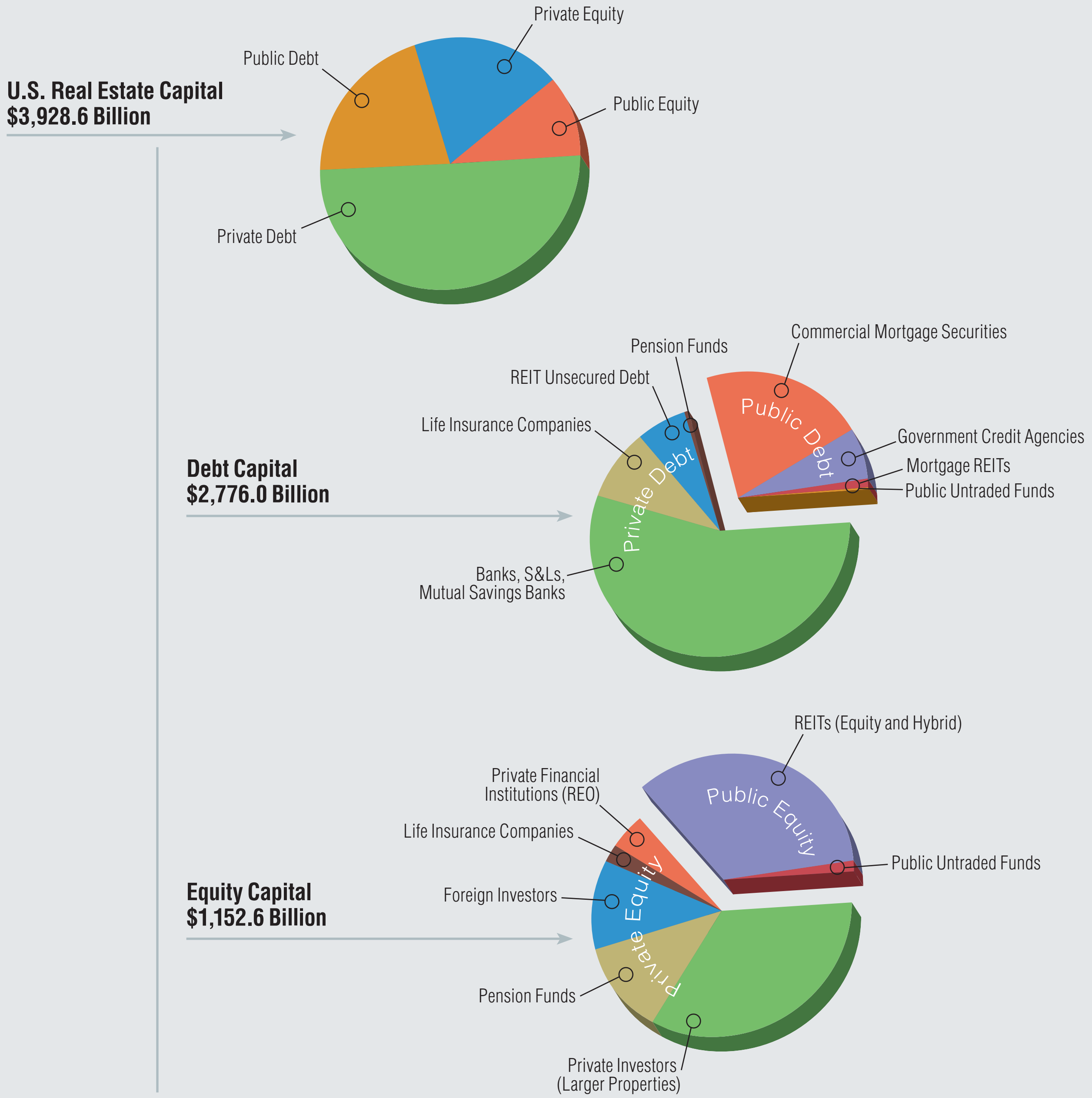




Sources: Roulac Global Places, from various sources, including American Council of Life Insurers, CMSA/Trepp Database, Commercial Mortgage Alert, Federal Reserve Board, FannieMae.com, IREI, NAREIT, PwC, Real Capital Analytics, and Robert A. Stanger & Co.
Note: Excludes corporate, nonprofit, and government equity real estate holdings, as well as single-family and owner-occupied residences.

EXHIBIT 2-13

U.S. Real Estate Capital Sources

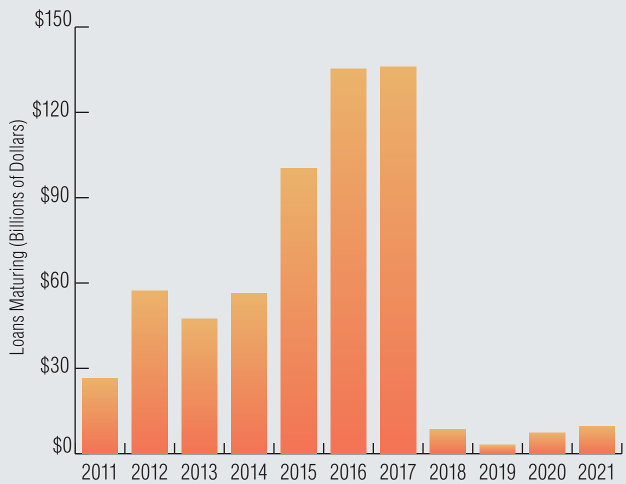


Sources: Roulac Global Places, from various sources, including American Council of Life Insurers, CMSA/Trepp Database, Commercial Mortgage Alert, Federal Reserve Board, FannieMae.com, IREI, NAREIT, PwC, Real Capital Analytics, and Robert A. Stanger & Co.

Note: Excludes corporate, nonprofit, and government equity real estate holdings, as well as single-family and owner-occupied residences.

*2011 figures are as of second quarter, or in some cases projected through second quarter.

EXHIBIT 2-14
CMBS Mortgage Maturities



Source: Trepp, LLC

Note: For the public conduit universe, including multifamily-directed, non-multifamily-directed, and fully defeased loans, as of September 2011.

is a low-margin business and the conduits with high cost of capital [investment banks, specialist finance companies] can't make their bogeys on a consistent basis." "Only teams that can drive volumes will be profitable." Smaller, undercapitalized firms, meanwhile, lack the warehousing capability and resources to survive. The consensus view expects CMBS lending to increase to over $50 billion annually in the next few years. "If we get over $100 billion, then it's time to watch out." For 2012, these lenders could "have trouble finding decent product and need to be careful. There is no penalty for not making a loan. No one is staffing up; investment banks hold back and feed fewer mouths after adjusting expectations. If the market gets out of control again, it won't be in 2012 or 2013."

Mezzanine Debt and Preferred Equity

The "mispricing of interest rates" provides significant spreads for mezzanine and preferred equity investors, who make deals with "motivated" borrowers in need of refinancing capital and their senior lenders. Under the circumstances, they succeed in pushing hard bargains for projected "equity-like returns" at 15 percent and up. Burned by recent experience, these lenders orient more to preferred equity positions "to participate in what happens to properties and have more control over exiting." Some insist on sales options. "We couldn't get out in 2006 and 2007, and got killed. The lesson learned is take more control over your destiny." Following the overall investment crowd, these players prefer multifamily over other sectors and have particular concerns about office: "It's harder to exit." For now, running scared seems sensible after watching positions evaporate in the market collapse.

Wall Street Opportunity Funds

Husbanding loads of dry powder, frustrated opportunity funds and private equity managers so far come up empty ferreting out compelling, high-octane transactions, and 2012 promises more of the same. "It's mostly a squirrel and rabbit game, not going after big scores." Core buyers have driven down yields to unappetizing levels in the best markets, while lenders and borrowers get another free pass from resolving their problems and disgorging assets. "The available deals involve really bad stuff." Performance expectations dive: sales teams strain credibility in promising 15 percent annualized returns to client prospects, who wonder about using uncomfortable amounts of leverage in low-growth markets. "Everybody says they can do off-market transactions, but not many are happening."

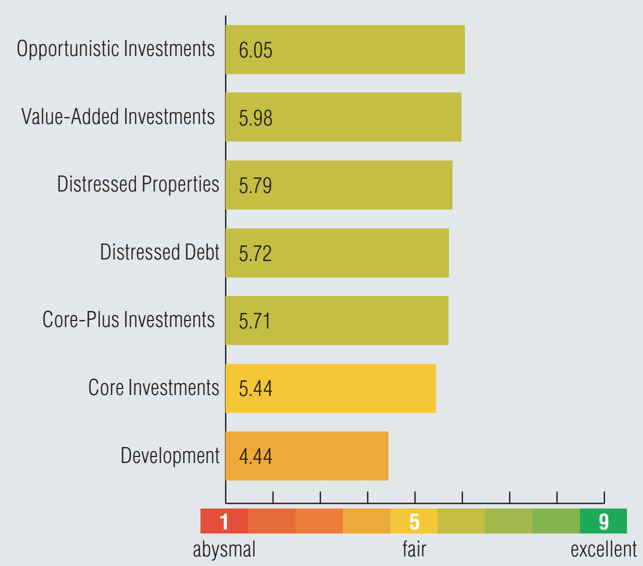
Ironically, a large array of potential target properties remains out of reach in last-generation closed-end opportunity funds, tangled in knots and suffering losses. Limited partners refuse to inject more capital to keep overleveraged assets afloat, but delay taking write-offs. General partners continue to manage the funds without a chance for promotes, and property conditions deteriorate without maintenance infusions. Complicated deals and conflicted parties delay workouts and resolutions, dragging down managers and bottlenecking transaction activity. Investment bankers may take some funds public to raise capital and resolve debt issues, "the way they did with developers in the 1990s."

In the meantime, the manager lineup morphs. Legacy problems sink many investment teams, and new or reconstituted firms try to pick up business but struggle without track records. Established asset managers with gold-plated brands attract the "really big bucks" from institutional and high-net-worth investors, who crave some semblance of security. "The big guys can more believably sell their access to capital and deals: the capital helps attract deals, which helps attract more capital." More investment banks may ankle the business. Executive suites don't see the point after recent losses, the poor outlook to score large performance fees, and potential new onerous reserve requirements.

REITs

Over the past 15 years, public REITs have strategically accumulated holdings of premier real estate assets across all property sectors, employing top-drawer management teams and deleveraging balance sheets. "They dominate the best real estate in the best markets," and look to weed out lesser performers in second-tier locations if capital demand materializes. Whipsawed from time to time in volatile stock market pricing, they maintain strong dividends and dominate acquisition markets, using low-cost-of-capital credit lines. "Private buyers have trouble competing against them." "In tall cotton with their cash flows," REITs in general have raised sufficient equity and debt to skirt choppy markets and have reserves to withstand any turbulence. Apartment sector companies will lead the charge into multifamily development. Stock market investors during 2011 noticed their solid positioning and once-again advanced share prices reaching toward perfection zeniths. "The best approach is to buy and hold the best companies through market ups and downs, collect the dividends, and buy more on dips. Over time, the model works."

EXHIBIT 2-15
Prospects by Investment Category/Strategy



Source: *Emerging Trends in Real Estate 2012* survey.

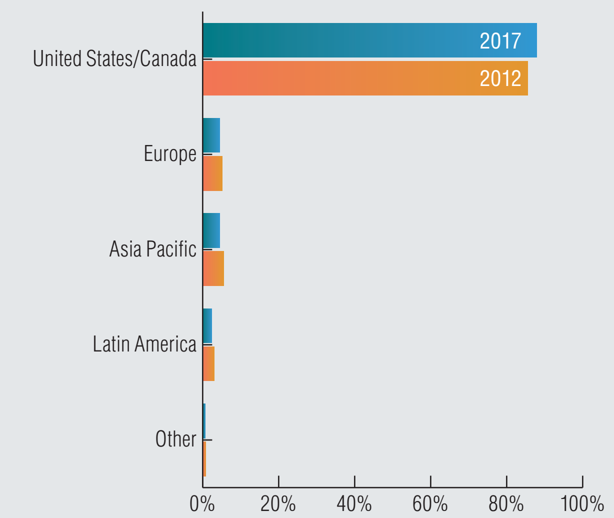
Pension Funds

The plan sponsor world goes topsy-turvy. Growing liabilities (arguably increasingly unsustainable) and recent losses (particularly in the stock market) force these temperamentally conservative players "to gun for higher and riskier returns." Richly priced, core property funds (already bulging with uninvested capital) cannot deliver outsized performance, so some pension teams pump more dollars into opportunity investments and consider B markets. "They need some big hits" to fix payout problems. "Under tremendous pressure," pension officers "say they like real estate for the income, but they shoot for more, and in the end the returns from real estate won't deliver," says an interviewee. Other plan sponsors just play it safe and keep investing in core anyway because it should deliver the mid- to high-single-digit returns they need to meet actuarial requirements. But core fund managers now have trouble finding reasonable deals in their favored markets: cap rate compression makes for unappealing transactions. Adding complication to carefully calibrated asset allocations, the falling stock market revives the denominator problem, possibly stalling out, at least temporarily, plan-sponsor commitments to the property sector. Existing holdings suddenly increase real estate shares above manager targets. "Pension funds operate on a six-month tape-delay basis, worrying about allocations versus worrying about today. Many go into delay mode," frustrating advisers trying to raise money.

Nontraded REITs, High-Net-Worth Investors, Local Operators

Nontraded REITs will be "active buyers," and despite high front-end loads, should continue to attract capital from individual investors looking for alternatives to a disappointing stock market and lackluster bonds. "With money markets earning next to nothing, they're ready to come into real estate for 5–6 percent

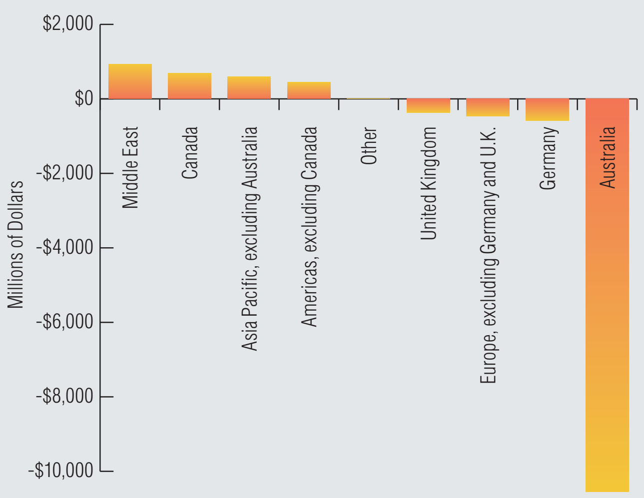
EXHIBIT 2-16
Percentage of Your Real Estate Global Portfolio in World Regions in 2012 and 2017



Source: *Emerging Trends in Real Estate 2012* survey.

EXHIBIT 2-17

Foreign Net Real Estate Investment in the United States



Source: Real Capital Analytics.

Note: Net capital flows from third-quarter 2010 through second-quarter 2011. All dollars in millions.

returns." But well-positioned local operators and investors turn more cautious: their on-the-ground soundings send signals about tenuous tenant demand and leasing prospects. "We're taking a hard look about trying not to put in as much of our own capital and laying off any exposure on partnerships with pension funds and other institutions." Savvy private offices of high-net-worth investors also turn more tentative; "they can be disciplined about pulling back since, unlike pension funds, they are not allocators, evaluating each purchase more absolutely."

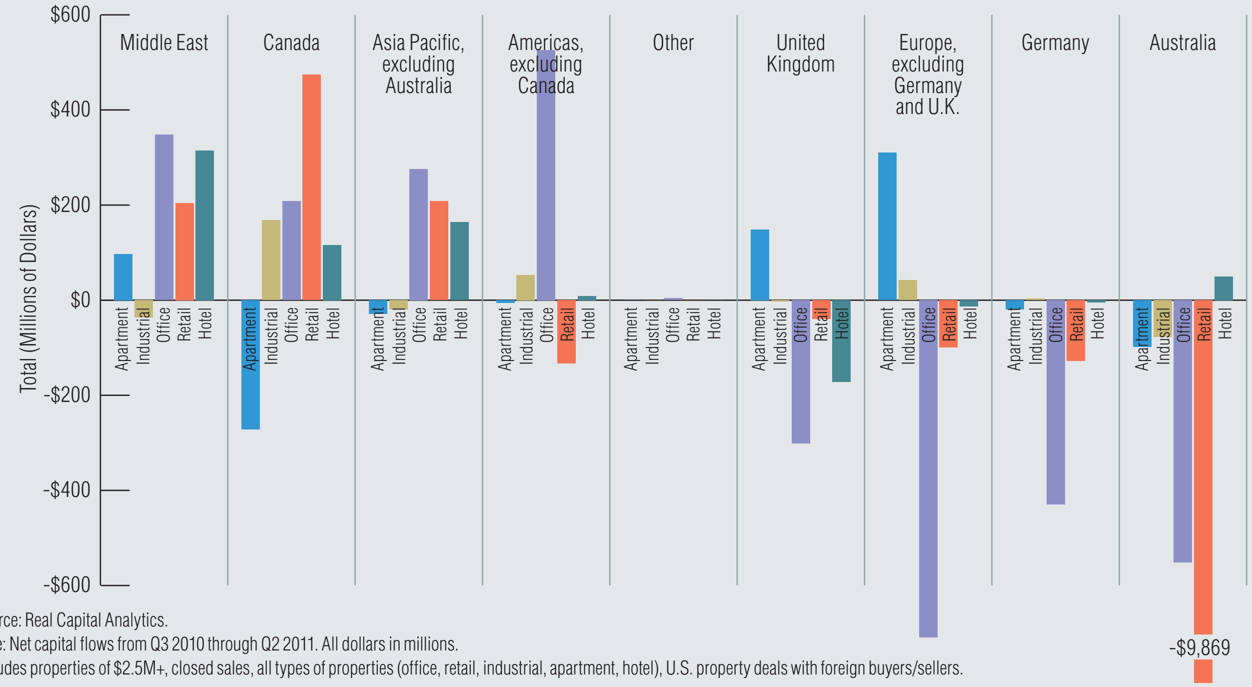
Foreign Investors

Because Europe is melting down in financial distress and inscrutable Asian markets have not met expectations, the United States still looks like a good parking spot for offshore capital, despite anemic prospects. Thanks to the favorable currency exchange rate, foreign players can maximize purchasing power and enjoy further upside if and when the dollar strengthens. "The big European pension funds see more risk in their local markets. The U.S. just seems safer." Investments, as usual, concentrate in the familiar gateway cities, especially along the coasts. "These are the most accessible markets—the ones along global pathways that they know and visit, and are most comfortable about." Central business districts in Washington, D.C., New York City, and San Francisco remain the favorites; offshore buyers have helped pressure down cap rates with their active bidding on deals. Southern California retains its significant allure, and Miami picks up considerable attention from Latin American investors. Foreign banks, long established in core markets, lend almost exclusively on trophy assets. "Based on purchases and lending activity, size of deals does not seem to matter."

The following is a rundown of interviewee views on foreign investor appetites:

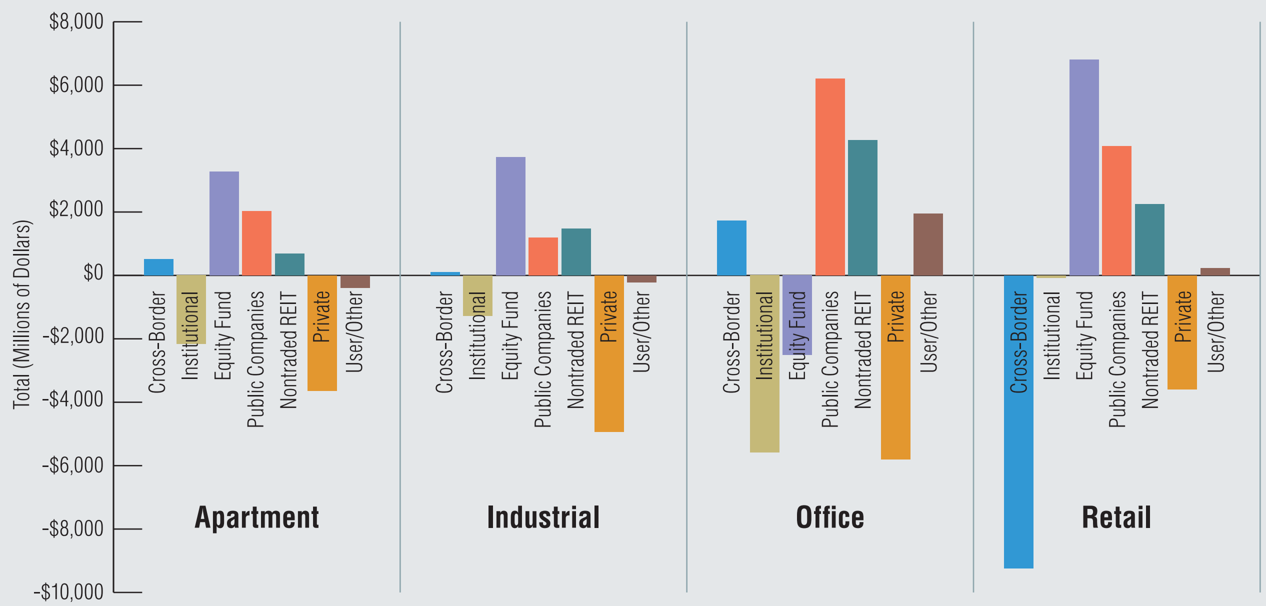
- Canadian institutions cannot find strong yields in their relatively closed markets and actively look for opportunities south of the border.
- German institutions stay neutral to slightly positive about the United States. "They read about all the housing problems and extrapolate to commercial markets. Their interest is not what it used to be." Expect "continued focus on office and some retail." Apartments and industrial space do not fit with their domestic investment models.
- "Pick any Asian sovereign wealth fund: they are all out there with huge allocations. Korea and Singapore have tons of money." In addition to Chinese capital, "they provide a lot of firepower, looking at the biggest deals."
- The Brazil boom and Venezuela's political instability propel more Latin American investment capital toward the United States. Bargain hunters make Miami condominiums favorite targets.
- Australian and Irish investors—"the buy-high-and-sell-low crowd before the crash"—continue to lick wounds and "stay in full retreat."
- The biggest surprise is Israel: "They're the new kid on the block." Middle East turmoil pushes more wealthy Israelis into U.S. transactions markets, following the longtime lead of Arab government funds and oil potentates, who remain active but very discreet players.
- Russian oligarchs "aren't evident, but you know they are out there."

EXHIBIT 2-18
Foreign Net Real Estate Investments in the U.S. by Property Type



Source: Real Capital Analytics.
Note: Net capital flows from Q3 2010 through Q2 2011. All dollars in millions.
Includes properties of $2.5M+, closed sales, all types of properties (office, retail, industrial, apartment, hotel), U.S. property deals with foreign buyers/sellers.

EXHIBIT 2-19
U.S. Buyers and Sellers: Net Capital Flows by Source and Property Sector



Source: Real Capital Analytics.
Note: For properties of $2.5M+, closed sales, for the period 2010 Q3 to 2011 Q2.

Markets to Watch

"Capital will search for yields beyond the overbought gateways and the few jobs-growth markets, taking on considerably more risk."

Despite "tenuous" economic outlooks, only one of the 51 U.S. cities surveyed for *Emerging Trends* failed to improve its investment score over last year's report. More than 60 percent now rate as fair or better prospects, compared with only 40 percent in 2011. "Most markets have stopped deteriorating, but most haven't really improved," one interviewee says. A surge of funding into the few favored cities showing better supply/demand fundamentals creates "capital markets pricing distortion." History "will repeat itself: investments will trickle down to higher-risk secondary and tertiary markets as capital reaches the crazy point of driving down cap rates in the best places." Employing a "pure timing play," the trick will be "to find the best assets in these [smaller] cities and get good current yields. You can't just keep putting money down on 48th and Park Avenue." But many interviewees warn about "dabbling too much" in secondary markets. "Buyer beware" about the "array of possible ten cap deals" when "high vacancies may not come down and rent growth will be very challenging." Especially in the current slow growth environment, opportunities in the second and third tier "will be thin at best."

Usual Suspects. Highlighting investor angst, Washington, D.C., the number-one city for the third consecutive year, suffered a slight downtick from 7.01 to 6.93 on the *Emerging Trends* 1 (abysmal) to 9 (excellent) ratings scale. Interviewees wonder if the market has become too dear in light of all the political talk about federal cutbacks. Not surprisingly, the rest of the rankings also look very familiar, dominated by the always highly rated 24-hour coastal gateways, which become steadily more strategic as international financial, commercial, and political centers. Just behind Washington, San Francisco leapfrogs New York City to number three, buoyed by high-tech hiring; Boston holds on to the fifth position; and Seattle, also a software and internet hotbed, stays at number six. Each of these cities is experiencing potentially unsustainable cap rate compression.

Jobs Centers. Significantly, energy region markets, enjoying better-than-average jobs growth, further solidify favored positions—Austin (number two) with an additional boost from local high-tech businesses and Houston (number eight) lead Texas oil patch cities. Not to be counted out because of their state's fiscal morass, San Jose (number seven) and the two largest southern California markets, Los Angeles (number nine) and San Diego (number ten), round out the survey's top ten.

Denver and Dallas follow: the relatively robust energy and technology sectors help these Sunbelt markets, too. Miami notably records the biggest ratings gain among major markets, improving from a mediocre 4.49 in 2011 to a modestly good 5.81 for 2012; this gateway to Latin America is breaking out of the housing funk that continues to plague other Florida markets. Respondents also signal a warmup for Phoenix, which is starting to overcome significant housing and overdevelopment woes. Chicago, a less-vibrant 24-hour market and Midwest gateway, continues to outrank the region's other struggling cities, while still regionally dominant but congenitally overbuilt Atlanta loses luster in the Southeast. Smaller markets Raleigh-Durham, Charlotte, and Nashville score better ratings.

"Cool Towns." Employers wanting to lure the best generation-Y brainpower are paying careful attention to where this bulging group of young adults wants to settle. "That's where companies want to be." "High-quality-of-life places do better": echo boomers want plenty of stimulation from entertainment and nightlife attractions convenient to work and residences. Many wouldn't

EXHIBIT 3-1

Investment Prospects for Commercial/Multifamily Properties by Market

generally good | fair | generally poor

1	Washington, D.C.	6.93
2	Austin	6.92
3	San Francisco	6.92
4	New York City	6.85
5	Boston	6.60
6	Seattle	6.60
7	San Jose	6.58
8	Houston	6.46
9	Los Angeles	6.30
10	San Diego	6.17
11	Denver	6.16
12	Dallas/Fort Worth	6.10
13	Northern New Jersey	6.10
14	Orange County, CA	6.01
15	Raleigh/Durham	5.96
16	San Antonio	5.83
17	Miami	5.81
18	Portland, OR	5.81
19	Westchester, NY/Fairfield, CT	5.74
20	Charlotte	5.58
21	Chicago	5.57
22	Honolulu/Hawaii	5.47
23	Phoenix	5.45
24	Philadelphia	5.44
25	Baltimore	5.44
26	Minneapolis/St. Paul	5.38
27	Nashville	5.32
28	Inland Empire, CA	5.30
29	Orlando	5.19
30	Salt Lake City	5.17
31	Pittsburgh	5.16
32	Virginia Beach/Norfolk	4.93
33	Tampa/St. Petersburg	4.79
34	Indianapolis	4.76
35	Kansas City	4.73
36	Atlanta	4.65
37	Oklahoma City	4.61
38	New Orleans	4.54
39	St. Louis	4.48
40	Jacksonville	4.48
41	Albuquerque	4.43
42	Milwaukee	4.33
43	Memphis	4.22
44	Tucson	4.21
45	Providence	4.20
46	Sacramento	4.20
47	Columbus	4.03
48	Cincinnati	3.97
49	Las Vegas	3.91
50	Cleveland	3.48
51	Detroit	2.88

Source: *Emerging Trends in Real Estate 2012* survey.

EXHIBIT 3-2

Development Prospects for Commercial/Multifamily Properties by Market

generally good | fair | generally poor

1	Washington, D.C.	6.41
2	New York City	6.16
3	San Francisco	6.16
4	Austin	6.04
5	San Jose	5.86
6	Houston	5.81
7	Seattle	5.81
8	Boston	5.68
9	Dallas/Fort Worth	5.42
10	Los Angeles	5.27
11	Denver	5.23
12	Westchester, NY/Fairfield, CT	5.19
13	San Diego	5.18
14	San Antonio	5.09
15	Raleigh/Durham	5.07
16	Northern New Jersey	5.01
17	Orange County, CA	4.92
18	Nashville	4.91
19	Portland, OR	4.87
20	Salt Lake City	4.71
21	Charlotte	4.66
22	Baltimore	4.54
23	Minneapolis/St. Paul	4.54
24	Honolulu/Hawaii	4.39
25	Chicago	4.31
26	Miami	4.22
27	Inland Empire, CA	4.22
28	Philadelphia	4.21
29	Pittsburgh	4.15
30	Orlando	4.08
31	Virginia Beach/Norfolk	4.04
32	Oklahoma City	3.92
33	Indianapolis	3.91
34	Albuquerque	3.90
35	Tampa/St. Petersburg	3.86
36	Kansas City	3.80
37	New Orleans	3.65
38	Milwaukee	3.62
39	Memphis	3.58
40	Providence	3.49
41	Jacksonville	3.48
42	Tucson	3.40
43	Phoenix	3.39
44	St. Louis	3.31
45	Atlanta	3.30
46	Columbus	3.26
47	Cincinnati	3.20
48	Sacramento	3.08
49	Cleveland	2.77
50	Las Vegas	2.48
51	Detroit	2.26

Source: *Emerging Trends in Real Estate 2012* survey.

EXHIBIT 3-3

For-Sale Homebuilding Prospects

generally good | fair | generally poor

1	Washington, D.C.	5.99
2	Austin	5.76
3	New York City	5.51
4	San Francisco	5.40
5	Houston	5.31
6	San Jose	5.27
7	Seattle	5.21
8	Dallas/Fort Worth	5.19
9	San Antonio	5.14
10	Boston	5.05
11	Westchester, NY/Fairfield, CT	4.91
12	Northern New Jersey	4.68
13	San Diego	4.64
14	Orange County, CA	4.58
15	Raleigh/Durham	4.54
16	Denver	4.51
17	Los Angeles	4.50
18	Portland, OR	4.41
19	Salt Lake City	4.37
20	Nashville	4.29
21	Honolulu/Hawaii	4.29
22	Baltimore	3.99
23	Philadelphia	3.96
24	Charlotte	3.92
25	Orlando	3.87
26	Minneapolis/St. Paul	3.87
27	Oklahoma City	3.86
28	Chicago	3.75
29	Miami	3.75
30	Pittsburgh	3.73
31	Virginia Beach/Norfolk	3.61
32	Indianapolis	3.53
33	Kansas City	3.49
34	Providence	3.37
35	Milwaukee	3.35
36	Inland Empire, CA	3.35
37	Jacksonville	3.34
38	Memphis	3.32
39	St. Louis	3.27
40	Tampa/St. Petersburg	3.26
41	Albuquerque	3.24
42	Tucson	3.19
43	New Orleans	3.17
44	Phoenix	3.03
45	Cincinnati	3.00
46	Columbus	2.94
47	Atlanta	2.93
48	Sacramento	2.69
49	Cleveland	2.46
50	Las Vegas	2.37
51	Detroit	2.02

Source: *Emerging Trends in Real Estate 2012* survey.

be caught dead living at the end of a suburban cul-de-sac, dependent on cars to get around. Besides the usual bright-lights, big-city 24-hour markets, "cool places like Austin, Seattle, and Portland attract more than their share" of overachieving young people. Denver's revived downtown, full of restaurants and sports attractions, fits the bill, too. More apartments, catering to this demographic, go up in and around infill neighborhoods in these cities, broadening their urban envelopes. In a continuing trend, aging baby boomers also gravitate to city lifestyles, appreciating greater convenience and proximity to stores, doctors, and cultural institutions, not to mention their now-adult children.

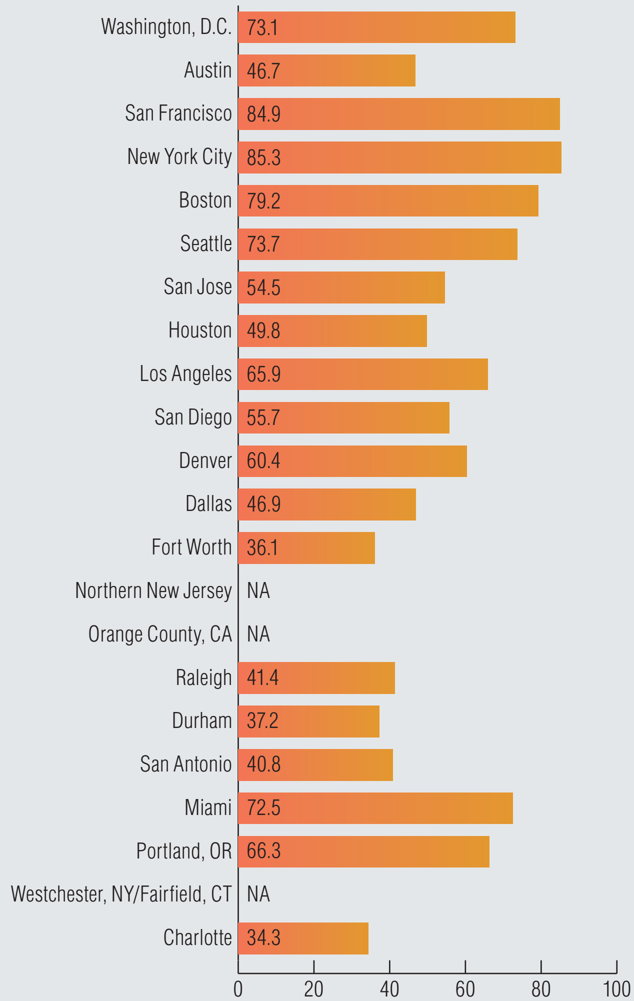
Perennial Choices. Since emerging from the depths of the early-1990s market cataclysm, five of the top six markets on the 2012 leader board—Washington, San Francisco, New York City, Boston, and Seattle—not coincidentally also entrench themselves as investor favorites over the past nearly 20-year market cycle (exhibit 3-1). Their established 24-hour characteristics, diversified economies, and prominent locations with geographic barriers along global pathways combine to offer relative stability: values tend to appreciate more in up markets and rebound more quickly after downturns. It is no coincidence that these top markets also tend to score the highest in walkability among the nation's cities: increasingly convenience counts as more people shy away from car-dependent places (exhibit 3-4). By attracting businesses, talent, and upper-income residents in outsized proportions, they exist as veritable wealth-island magnets for investors, including offshore capital.

Enduring Strength. Southern California's suburban agglomeration—prominently L.A. and San Diego—also stands the test of time, benefiting from the state's enduring and still substantial economic clout, as well as an appealing climate for which many people are willing to pay a premium. Chicago's heyday may be over—its ratings have slipped more than any other 24-hour market over the past decade—but the city retains formidable global trade connections. Until recent energy industry gains, hot growth cities Dallas and Houston consistently registered lagging investment ratings. As long as oil and gas prices remain high, these markets will continue to make survey inroads, but investors should remain wary of historic volatility resulting from a lack of geographic and zoning barriers to restrain development.

Development and Homebuilding. For 2012, expected ramp-ups in apartment projects spur improvement in development prospects. Sixteen markets score a rating of 5.0 (fair) or higher, compared with only one last year (exhibit 3-2). Again, 24-hour cities or markets with energy/tech-related hiring will fare considerably better than the rest of the pack. Ironically, "expect more commercial development in supply-constrained markets than in non-supply-constrained markets." Sentiment remains lackluster for homebuilders, although hints of recovery appear around the prominent gateways and jobs-rich Texas cities, which sustained only modest value losses in the housing bust (exhibit 3-3).

EXHIBIT 3-4

City Walkability Scores for Top 20 Cities



Source: Walkability data provided by Walk Score®, www.walkscore.com.

Notes: Scores are on a scale of 0 (car dependent) to 100 (walker's paradise). NA = not available.

Potential Distress. Fiscal shortfalls batter most local governments, forcing service cutbacks and retrenchment in needed infrastructure projects. Local authorities no longer can depend on the federal government to help fill funding gaps. Governors and mayors battle unions over increasingly untenable public pension liabilities and shed government workers while straining mightily and often unsuccessfully to hold the line on taxes

EXHIBIT 3-5

Metro Area Investment Prospects by Population

Metro Areas with 3 Million or More Population

1	Washington, D.C. (1)	6.93
2	San Francisco (3)	6.92
3	New York City (4)	6.85
4	Boston (5)	6.60
5	Seattle (6)	6.60
6	Houston (8)	6.46
7	Los Angeles (9)	6.30
8	San Diego (10)	6.17
9	Denver (11)	6.16
10	Dallas/Fort Worth (12)	6.10
11	Northern New Jersey (13)	6.10
12	Orange County, CA (14)	6.01
13	Miami (17)	5.81
14	Westchester, NY/ Fairfield, CT (19)	5.74
15	Chicago (21)	5.57
16	Phoenix (23)	5.45
17	Philadelphia (24)	5.44
18	Baltimore (25)	5.44
19	Minneapolis/St. Paul (26)	5.38
20	Inland Empire, CA (28)	5.30
21	Atlanta (36)	4.65
22	Detroit (51)	2.88

Metro Areas with 2 to 2.99 Million Population

1	San Jose (7)	6.58
2	San Antonio (16)	5.83
3	Portland, OR (18)	5.81
4	Orlando (29)	5.19
5	Pittsburgh (31)	5.16
6	Tampa/St. Petersburg (33)	4.79
7	Kansas City (35)	4.73
8	St. Louis (39)	4.48
9	Sacramento (46)	4.20
10	Cincinnati (48)	3.97
11	Cleveland (50)	3.48

Metro Areas with Less than 2 Million Population

1	Austin (2)	6.92
2	Raleigh/Durham (15)	5.96
3	Charlotte (20)	5.58
4	Honolulu/Hawaii (22)	5.47
5	Nashville (27)	5.32
6	Salt Lake City (30)	5.17
7	Virginia Beach/Norfolk (32)	4.93
8	Indianapolis (34)	4.76
9	Oklahoma City (37)	4.61
10	New Orleans (38)	4.54
11	Jacksonville (40)	4.48
12	Albuquerque (41)	4.43
13	Milwaukee (42)	4.33
14	Memphis (43)	4.22
15	Tucson (44)	4.21
16	Providence (45)	4.20
17	Columbus (47)	4.03
18	Las Vegas (49)	3.91

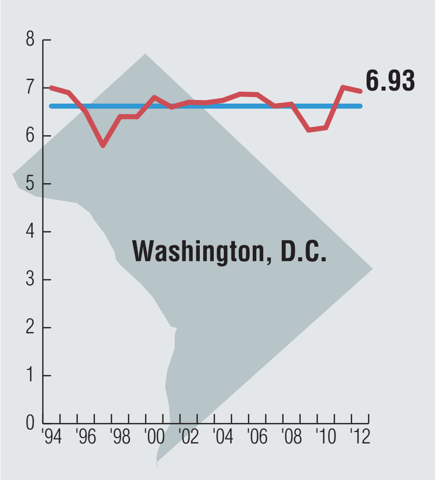
generally good | fair | generally poor

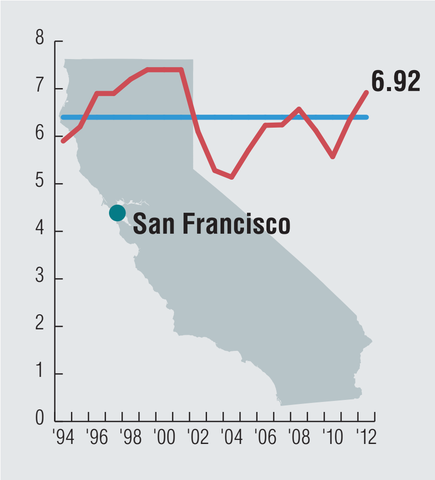
Source: *Emerging Trends in Real Estate 2012* survey.
Note: Overall rank is in parentheses.

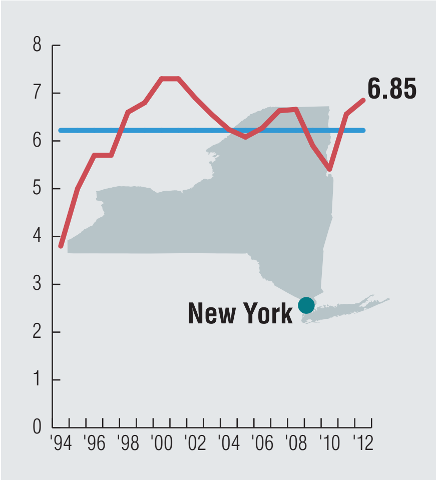
and various fee hikes. Investors should steel themselves and closely monitor any negative impacts on tenants and location preferences. Potholed streets and closed bridges could affect mobility; increasing crime rates and less street cleaning would compromise quality of life; and fewer teachers dealing with larger class sizes could deal another blow to struggling public schools. The 24-hour gateways will be hard pressed to escape detrimental market impacts, and most suburbs, once a refuge, will not be immune either.

The Top 20

Washington, D.C. (1). Should this survey's number-one choice for investment, development, and homebuilding carry an asterisk? The rock-solid D.C. market "may cool down if (and it's a big if) the government ever shrinks." Development activity revs up, including the ambitious 2.5 million-square-foot, mixed-use CityCenterDC project at the old convention center site, raising yellow flags: torrid cap rate compression, "pricing in a lot of growth which may not keep pace," forces buyers to swallow awfully hard. But no other market performs better during a recession or near recession, and the area's jobs base has diversified well beyond just government and lobbying into technology, communications, and biomedical industries. "No matter what happens" in the congressional hammer-and-tong budget give-and-take, "companies want to be there." Office vacancies level off in the high single digits, and a shortage of large blocks forces rents up in class A space. "More national retail tenants want presence" in the market, which features an affluent population and attracts a steady flow of top-tier gen-Y talent, coming to help change the world. "Apartments and infill housing do better in Washington, too"; home prices recover ahead of other cities. Close-in suburbs perform very well, especially in multifamily and retail space. Northern Virginia apartment development near Metro stops







warrants best bet status." Farther out in the burbs, markets weaken over typical sprawl and congestion issues.

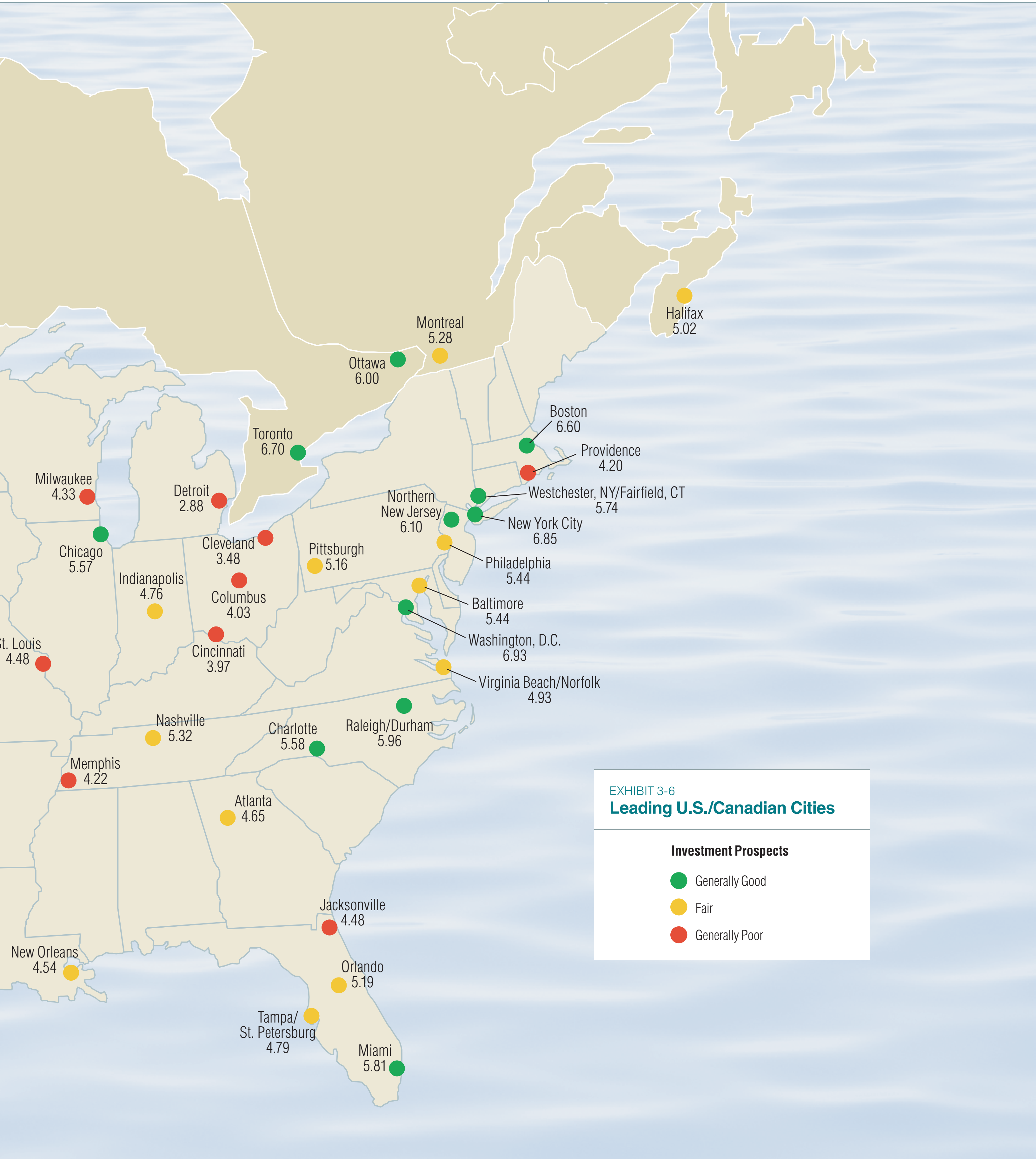
Austin (2). Although one step removed from global pathways, Austin notably registers significant interest on investor radar screens. This moderately sized city features all the other ingredients needed for a local economy to deal successfully with the nation's early-21st-century realities. State government provides an economic buffer, while the giant University of Texas campus attracts both energetic young brainpower and top professorial talent. The rich academic environment helps incubate and support burgeoning tech companies, as well as other higher-paying businesses offering cutting-edge career paths. In addition, the big university medical center provides health care underpinnings, and Texas's energy industry helps buttress the entire region. Unlike Dallas and Houston, the city also develops a 24-hour core, featuring pedestrian-friendly, in-town apartment neighborhoods with plenty of restaurants and nightlife attractions. Now, if only the city could plop Dallas/Fort Worth International Airport on its outskirts, the market would turn into a major player. The size issue limits investor opportunities, but the diversity of educational, medical, and government jobs, backed by high tech, insulates the market from boom/bust scenarios.

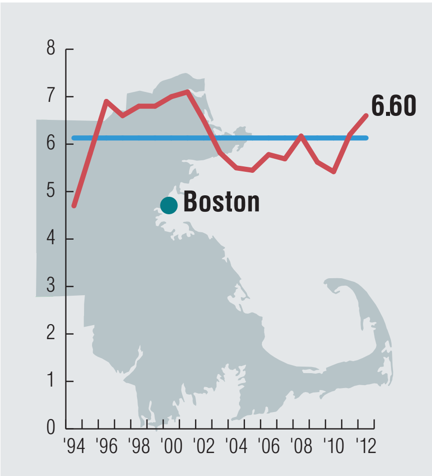
San Francisco (3). "It's back"—near the top—and rates as the survey's best buy for office and apartments. "Bullish market timers bet on room for big future office rent increases, pushing purchase pricing way ahead of fundamentals." Empty buildings counterintuitively look most attractive to some buyers: "They see so much upside in rents." In fact, the South of Market district "catches fire"—reminiscent of pre-tech-bubble-burst days in 2000. Computing and internet firms expand to satisfy young tech-savvy hires who want to work and live in the midst of 24-hour city amenities and action. Unlike tentative tenants in most other markets, Bay Area tech companies readily lease large blocks of space for future expansion. But overall market vacancies still register in the mid- to low teens, and demand in this Pacific gateway can fall suddenly. Cap rates on "bulletproof" apartments cannot drop much lower, and house prices show the biggest nationwide gains after some precipitous declines. Hotel occupancies recover smartly; several high-profile lodging properties list for sale to take advantage of the upswing. Institutional investor ardor never wanes for the expensive warehouse market serving one of the country's largest ports.

New York City (4). "Vastly different from the rest of the universe," Manhattan sees its "over-the skies" resurgence face headwinds from economizing at less-profitable investment banks and other financial institutions—the backbone of the city's economy. Under any circumstances, a transaction pause seems in order. "The only way to justify office prices assumes rents skyrocketing to unlikely heights," and "broker happy talk doesn't hide most employers' reluctance to add bodies." Vacancies actually drop to among the lowest levels in the country and rents increase ahead of other markets, helped by a lack of new supply. The city shows "remarkable resilience" buttressed by one of the world's best-educated, not to mention highest-paid, workforces. Given enduring stability, office investors "can be content with 4 to 5 percent cap rates." The nation's best hotel market flourishes in a sea of offshore tourist traffic: museums and Broadway shows flood with accents from the four corners of the earth. Visitors take advantage of favorable currency exchange rates, which temper lofty lodging, restaurant, and entertainment outlays. Highest-in-the-country apartment occupancies could vault rental rates to record levels as co-op/condominium values edge up again after generally holding their own in the downturn. Investors lose perspective if they spend too much time here: it's hardly a proxy for other parts of the country." New York City's suburbs—including **northern New Jersey (13)**, **Westchester, New York/Fairfield, Connecticut, counties (19)**—lag Manhattan, but gain from their proximity to the city.

Boston (5). Despite relatively high office vacancy rates, Boston retains plenty of adherents who value "an exceptionally well-educated workforce" drawn from numerous local colleges and universities, including Harvard and MIT. Some anxious investors look for and cannot find "the next knowledge-based industry market driver to push demand, but they need to keep the faith. One always comes along whether defense, technology or bio-med." Subdued outlooks


Edmonton
6.24
Saskatoon
5.47
Calgary
6.33
Vancouver
6.61
Winnipeg
5.00
Seattle
6.60
Portland
5.81
Minneapolis/
St. Paul
5.38
Sacramento
4.20
San Francisco
6.92
Salt Lake City
5.17
San Jose
6.58
Kansas City
4.73
Denver
6.16
Las Vegas
3.91
Albuquerque
4.43
Inland Empire
5.30
Oklahoma City
4.61
Los Angeles
6.30
Phoenix
5.45
Orange County
6.01
San Diego
6.17
Tucson
4.21
Dallas/Fort Worth
6.10
Honolulu/Hawaii
5.47
Austin
6.92
Houston
6.46
San Antonio
5.83

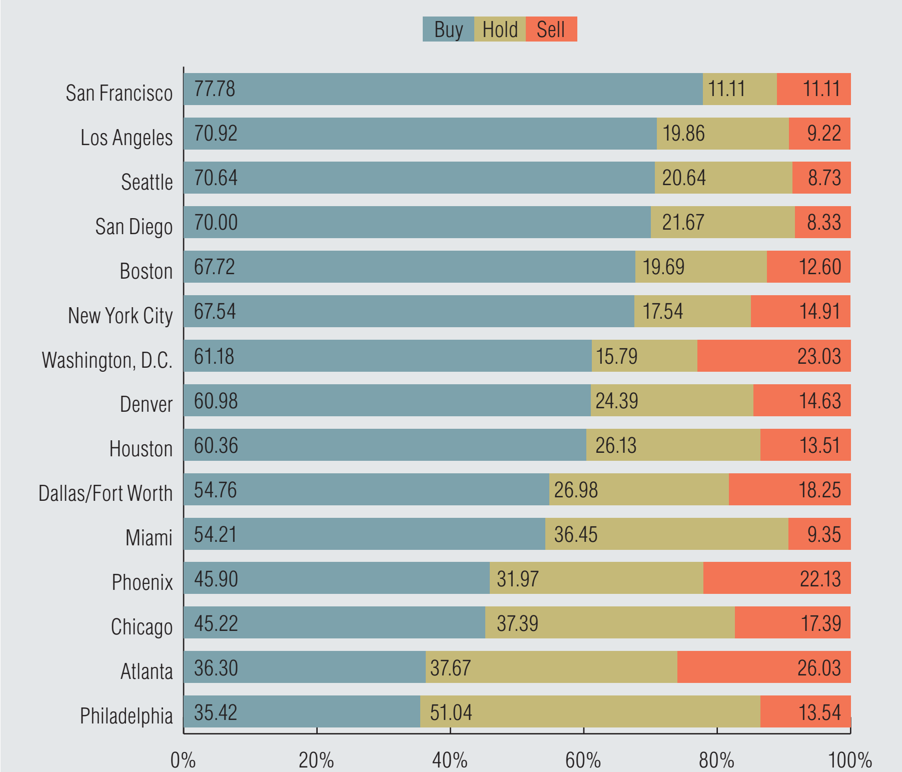

Montreal 5.28
Ottawa 6.00
Halifax 5.02
Toronto 6.70
Boston 6.60
Providence 4.20
Westchester, NY/Fairfield, CT 5.74
Northern New Jersey 6.10
New York City 6.85
Milwaukee 4.33
Detroit 2.88
Chicago 5.57
Cleveland 3.48
Pittsburgh 5.16
Philadelphia 5.44
Indianapolis 4.76
Columbus 4.03
Baltimore 5.44
Washington, D.C. 6.93
St. Louis 4.48
Cincinnati 3.97
Virginia Beach/Norfolk 4.93
Nashville 5.32
Charlotte 5.58
Raleigh/Durham 5.96
Memphis 4.22
Atlanta 4.65
Jacksonville 4.48
New Orleans 4.54
Orlando 5.19
Tampa/ St. Petersburg 4.79
Miami 5.81
EXHIBIT 3-6
Leading U.S./Canadian Cities
Investment Prospects
Generally Good
Fair
Generally Poor



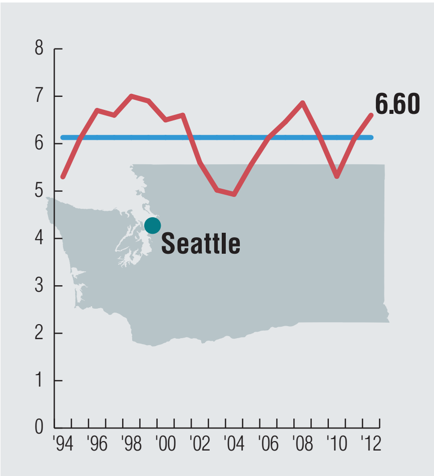
for mutual fund firms and other asset managers spark concern in the Financial District, whereas the Back Bay outperforms: Liberty Mutual erects a new tax break–subsidized building to expand operations. Most other office projects stay on drawing boards without greater leasing velocity, and development "proves difficult anyway because of barriers to entry." Any new building activity will concentrate around the seaport and Fan Pier along the harbor. The apartment market performs exceptionally well, and condo prices have remained surprisingly buoyant. New multifamily residences being built near Fenway Park between the Back Bay and Longwood Medical Center along Boylston Street cater to doctors and medical personnel. The corridor steadily evolves from semi-suburban to urban density. Housing prices increase again after suffering only modest declines in the downturn. Following the lead of other cities looking to ramp up their economies, local leaders push a $2 billion expansion of the convention center, already the largest in the Northeast upon opening just seven years ago, but still too small to attract big-league meetings.

EXHIBIT 3-7

U.S. Apartment Buy/Hold/Sell Recommendations by Metro Area



Source: *Emerging Trends in Real Estate 2012* survey.



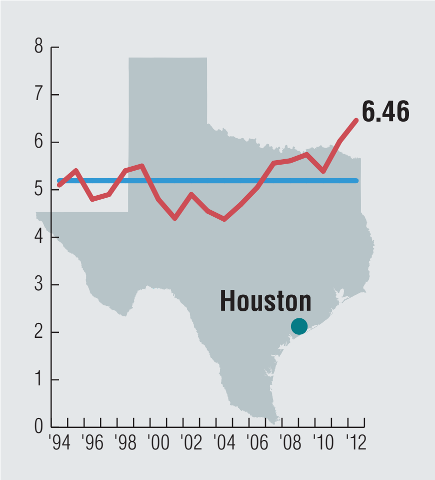
Seattle (6). "Starting to fire on all cylinders," Seattle bounces back thanks to its diversified new age corporate base, including Amazon, Microsoft, and Google, as well as other formidable employers like Boeing, Costco, and Nordstrom. Even Facebook and Sales Force move into town, tapping a wellspring of local brainpower drawn to the attractive Northwest gateway for high-paying tech jobs. Landlords gain confidence: some job growth resumes, office absorption ramps up, and institutional investor appetites for multifamily and office space appear "insatiable." New office buildings, delivered during the dismal 2008 and 2009 period, lease up; in 2012, the downtown vacancy rate could drop into the low teens, and rents probably will increase. "It's a complete turnaround. Institutions may pull the trigger on new office development soon. The window is open." Apartment vacancies sink below 5 percent in and around downtown, and work begins on new high-rise and mid-rise projects. Developers can achieve higher rents in these 24-hour, close-in districts. The always-tight industrial market—the survey's number-one buy for warehouses—remains "steady-eddy" in low-yield, low-volatility suspension. Some big-box retail centers took some hits, and empty store sites have been hard to fill. Suburbs fare less well, too, especially farther away from the Seattle core: "They're off investor and tenant radar screens." Bellevue holds up, but its velocity of recovery lags downtown. By 2016, a $2 billion tunnel under the city—"the Big Dig West," one of the nation's most ambitious infrastructure projects—will replace a rusting harborside viaduct. The project promises to transform the downtown waterfront with parks and housing, as well as new vistas of Puget Sound and surrounding mountains from existing office and apartment buildings. This city gets better and better.

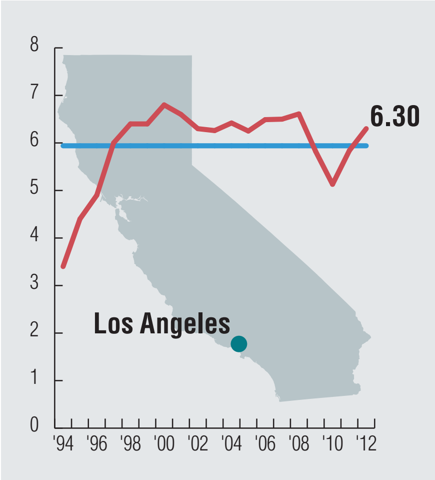
San Jose (7). Just south of the San Francisco gateway, San Jose does not skip a beat despite competition from the City by the Bay's downtown tech surge. The elite of microchips and digital worlds continues to congregate in and around Silicon Valley's research and development bastion. "That's one place in the country where office parks still work."

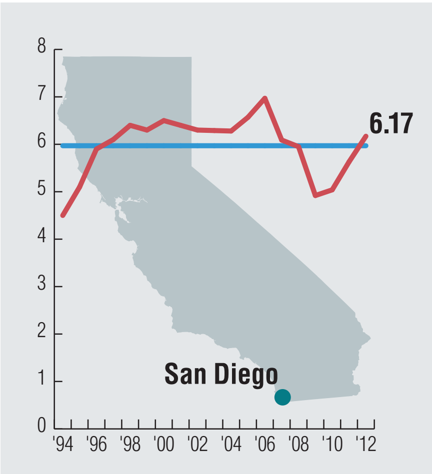
Houston (8). The U.S. energy capital profits from lasting high oil prices and expands off a Texas-sized service-sector employment engine. It is one place where work-starved Americans have a better-than-decent chance to find a job, and a modest cost of living, including inexpensive housing, stretches what wages can buy. Developers prepare to restart after an unaccustomed hiatus in an ever-expanding metropolis. After the crash, local construction lenders doused development. As a result, constrained building activity and the influx of population combine to tighten residential markets. For 2012, single-family housing "actually shows signs of life" thanks to low interest rates, and apartment developers will "vie to get projects out of the ground." Exxon Mobil shakes up the office market, announcing plans to consolidate operations in a new suburban campus. "They will leave a void downtown, but in Texas we can grow out of any problems." Panama Canal expansion should help increase port traffic and buoy warehouse demand. Houston's Gulf Coast location provides access to population centers to the east, north, and west, but the harbor will require dredging and new dock facilities to accommodate deep-hulled ships.

Los Angeles (9). Despite fashionable, "in-high-gear" California bashing—dysfunctional state government, broken tax structure, overblown business regulation, and outrageous cost of living—can you bet against a huge self-sustaining economy that has high-paying industries like entertainment, aerospace, and financial services, as well as the nation's largest port? Do you ignore the attractive quality of life and embedded affluence that supports service industries and the retail sector? Should investors shy away from southern California and Los Angeles? Most *Emerging Trends* respondents firmly reject the critics. "It will come back," one says, and, notably, the metropolitan area ranks as the nation's number-two apartment and industrial investment market in this year's survey. Relatively sky-high housing costs (even after major declines) keep apartments full and rents up: regional multifamily investments rate perennial best-bet status. L.A.–Long Beach industrial spaces, which handle one-third of U.S. container traffic, "have recovered nicely"; cap rates return to 2006–2007 levels. Inland Empire warehouses should continue to rebound, too—as long as new construction remains tamped down. Even if Asian shippers divert more goods through the Panama Canal—eating into West Coast market shares—port volumes should continue to increase because of overall anticipated growth in import/export activity. Business center hotels also do well, and housing prices start to climb back after precipitous declines: the closer to the coast, the better for value upticks. The bad news is concentrated in the office sector, where markets remain exceedingly soft. Vacancies range from the mid- to high teens in a tenant's market featuring rich concession packages. Companies show no signs of stepping up hiring enough to improve occupancies significantly during 2012, although lack of new construction will help absorption trends. Devastated by the mortgage industry breakdown, **Orange County (14)** regroups, buttressed by its position just south of the L.A.–Long Beach gateway.

San Diego (10). The increasingly suburbia-oriented office market goes off many investors' radar screens. Mid-teens vacancy rates across most submarkets and soft rents favor tenants, who actively engage in trading up to better space at cheaper lease terms. The city's hard-to-get-to, off-global-pathway status deters

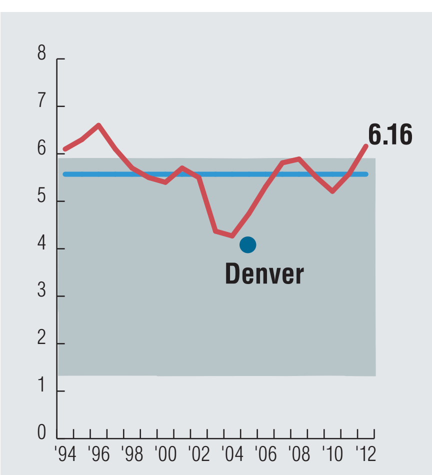






a major corporate presence, and limited mass transit options mean businesses cluster to avoid traffic congestion near prime bedroom communities, mostly north of downtown. Apartment investors always do well, hotel outlooks continue to improve, and housing prices revive before those in most national markets. San Diego's formidable ace in the hole remains near-perfect year-round weather, which helps attract talent pools to local biotech companies, as well as a steady stream of upscale retirees. The large U.S. Navy base doesn't hurt either, undergirding the local economy.

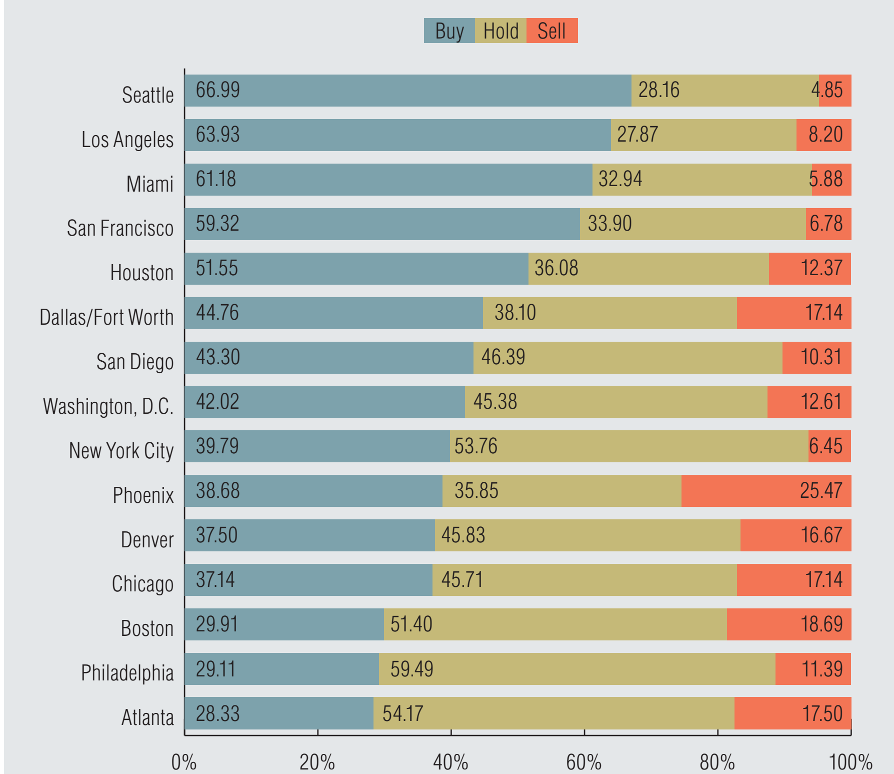
Denver (11). Downtown steadily remakes itself as an enticing, highly desirable 21st-century city center. The acclaimed LoDo (Lower Downtown) entertainment district is being built out, surrounded by sustainable office development and boutique apartment projects: 4,000 units begin to come off the drawing boards, promising "significant changes ahead." First, new restaurants and a sports stadium attracted nightlife; now developers cater to echo boomer residents with social amenities like landscaped roof decks, gyms, and community rooms. "We're gradually becoming a 24-hour city," an interviewee says. Union Station redevelops into a full-blown light-rail, bus, and train transportation complex, serving rising numbers of suburban commuters who now have alternatives to driving on congested highways. Transit-oriented development pops up along new suburban station stops. "Denver feels good. We have the draw of good-paying clean-tech, energy industry jobs with a reasonable cost of living and improving transportation." Although the office market moves sideways, housing sidestepped the boom/bust debacle. Better days definitely seem to be ahead.



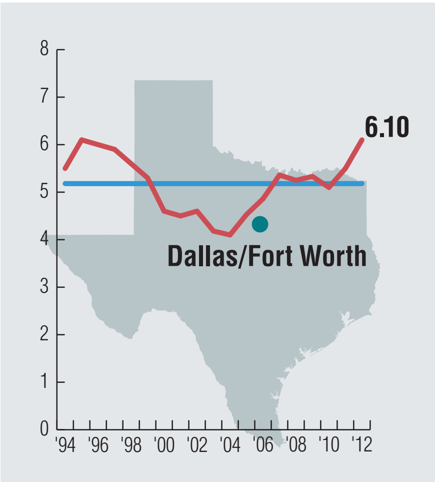
Dallas (12). Having "mostly dodged a bullet," Dallas benefits from the "Texas is good for business/low taxes" storyline. Companies continue to move data processing, sales, and administrative back-office operations to the Metroplex to take advantage of "low-cost labor, the great airport [D/FW], and central U.S. location." Recent discoveries of huge natural gas fields also buttress prospects. But investors always hesitate because of

EXHIBIT 3-8

U.S. Industrial/Distribution Buy/Hold/Sell Recommendations by Metro Area



Source: *Emerging Trends in Real Estate 2012* survey.

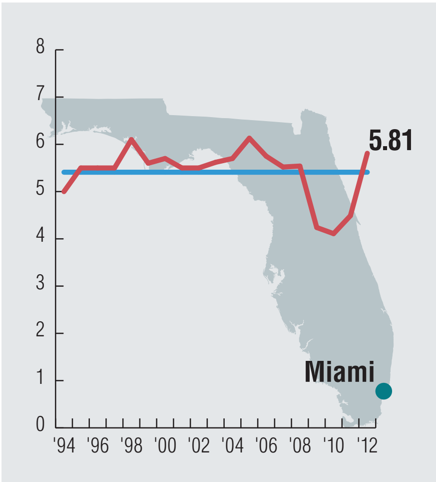


the wide-open development landscape: new projects constantly trump existing buildings, and rents barely move. Housing prices never crashed because they never boomed. Institutions have shied away from the suburbia-dominant office markets for decades, and downtown vacancies seemingly have not dropped under 20 percent in years. "Can you really make any money?" an interviewee asks. Wizened developers certainly do—if they build early in the cycle and sell out quickly. The better jobs scene draws relocating workers from the Midwest and West Coast, filling new apartments and supporting retail strips. Warehouses remain in a state of constant oversupply, but the city remains one of the country's most important distribution crossroads. As long as energy prices hold up, Dallas maintains its edge.

Raleigh/Durham (15). The Research Triangle uses an education/medical institution formula and "good quality of life" to solidify its solid ranking. Top universities and related hospitals draw talent and cultivate start-up companies in tech and biotech. Like Austin, Raleigh's state capital and government presence provide an additional edge.

San Antonio (16). A rising tide lifts all boats, so San Antonio receives a boost from Texas's good notices. Not much of an institutional market, the city enjoys steady growth supported by service industries and energy.

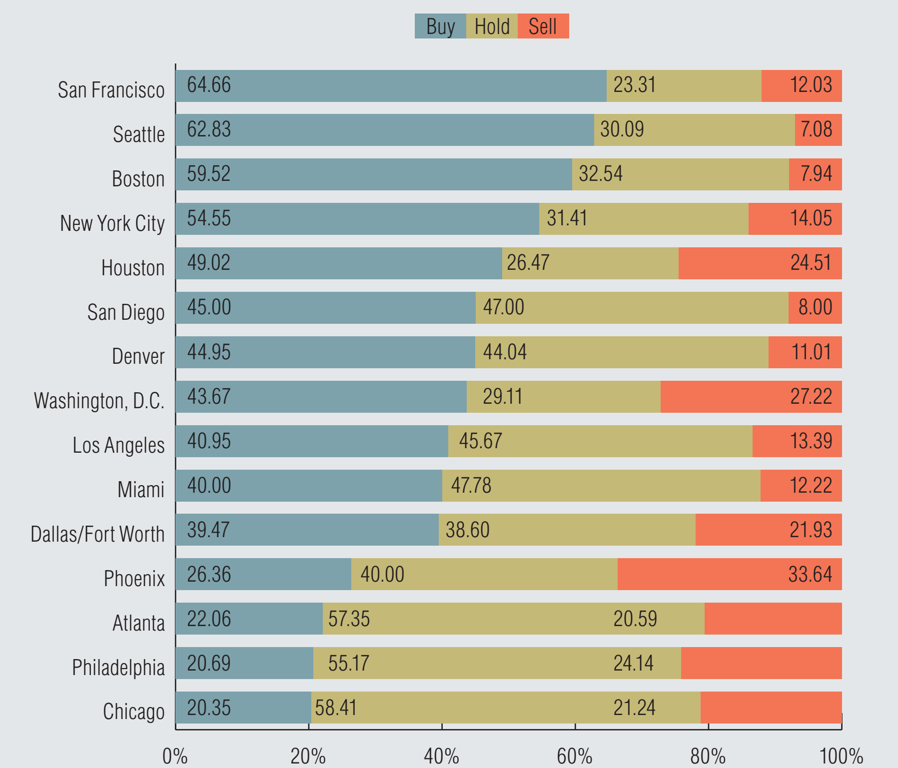
Miami (17). Emerging from the housing debacle well ahead of the rest of Florida, Miami begins to recapture its edgy, high-energy international vibe helped by a cheap dollar, an attractive location, and pro sports scene. Wealthy South Americans return in droves, filling South Beach hotels, buying in malls, and parking money in bargain-priced, high-end, waterfront condominiums. "President Chavez is south Florida's number-one real estate agent," one interviewee observes. Venezuelan capital pours into safe-harbor investments, and "Brazil's strong currency encourages buying." Euro traffic ratchets up, too: Brits, the French, and



Germans love the winter getaway from dark, cold homeland environs, and the euro exchange rate is almost too good to pass up. The multifamily market has

EXHIBIT 3-9

U.S. Office Buy/Hold/Sell Recommendations by Metro Area



Source: *Emerging Trends in Real Estate 2012* survey.

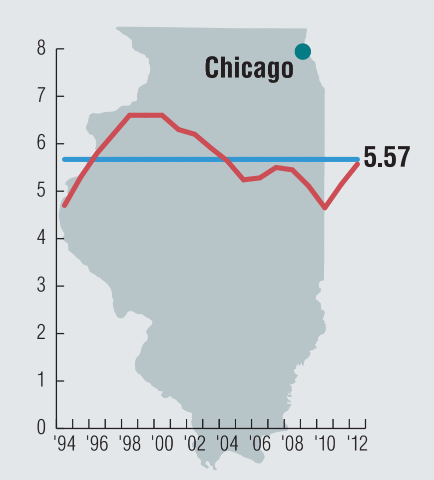
caught fire, too: condos turned to rentals lease briskly, and a "mini-development boom" in apartment towers is well underway. "We will be overbuilt in apartments by 2013, but developers enjoy a great spread since existing buildings are priced at sub-5 cap rates. People who get in early will do okay, but the window is closing." The industrial sector is "the hottest part of the marketplace." Miami joins the list of East and Gulf Coast ports angling to attract Panamax ship traffic. New tunnel and rail projects create links to the airport and routes out of town, but the city's extreme southerly location increases shipping distances to northern population centers. The office market lags badly: new projects underwritten by offshore capital worsen a 20 percent–plus vacancy rate. Public sector job shedding offsets any recent leasing gains from private companies.

Portland (18). Portland rates as the nation's top smaller 24-hour city. Developers have gnashed their teeth for years over its growth boundary restrictions, but residents treasure cozy neighborhoods and the ease of riding a bike to work. Without a major international airport hub, the city stands in Seattle's long shadow and will continue in a slow growth mode.

Charlotte (20). The city "depends too much on its banking sector." Will companies move out to a gateway financial center or just retrench? But temperate climes and affordability make the region attractive for relocating businesses and retirees.

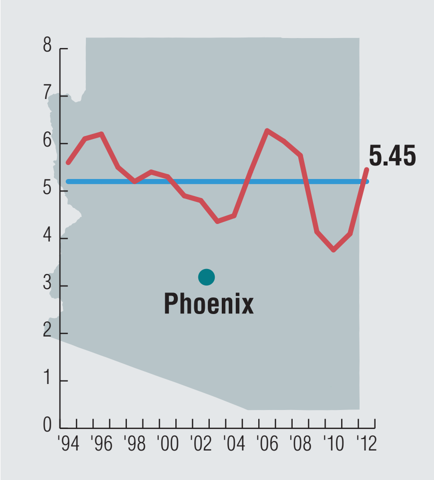
Other Major Markets

Chicago (21). Still a prominent 24-hour gateway, Chicago has fallen into a persistent funk—an outgrowth of the Midwest's general economic decline. "No longer a must place to have assets; investors lose interest; the whole market feels slow," one interviewee says. "Don't



expect much upside." Suburban office space suffers from "huge oversupply"; high vacancies and low rents "won't move much," so investors can forget about appreciation potential. Buyers overpay for trophy downtown office space: when new class A space inevitably gets built, existing buildings lose out in tenant musical chairs. An overhang of downtown condominium construction hurts sales prices and slows growth in apartment rents. Developers managed to overanticipate evident move-back-in trends, fed by vibrant urban attractions—Michigan Avenue stores, sports events, expansive parks, and world-class entertainment venues. "We also have top universities and O'Hare." The big airport buttresses a leading distribution center—warehouses, which "look like a bargain compared to L.A.–Long Beach."

Phoenix (23). Some interviewees tout the city's rising-from-the-ashes potential. "Continuing population growth could make for a comeback story," and the tortured housing market finally stabilizes after values dropped more than any other large market (56 percent) except Las Vegas (59 percent). Office vacancies start to dip into the low (but still uncomfortably high) 20 percent range, helped by a development shutdown, and job growth helps promising absorption resume. Doom-and-gloomers point to the



region's dependence on construction-related employment, back-office work, and retiree-based growth. "Don't rush back": the city "lacks big companies and brainpower jobs," while the wide-open desert environs provide no barriers to entry, and inevitable overbuilding subdues investment returns. Bottom-basement pricing arguably provides acquisition opportunities, although cautious buyers wonder whether the nation's economic drag will temper any typical hot-growth cyclical boom. For the future, the prospect of dwindling water supplies could restrict development and curtail the golf-based resort industry.

Philadephia (24). "Neither high risk nor high return," Philadelphia flatlines in "steady as she goes" cruise control. "Rents haven't increased in 20 years." Developers find little opportunity amid sleepy-state growth, and investors never muster much enthusiasm, although apartments and select suburban retail—both grocery-anchored centers and malls—can perform very well, especially around prime Main Line neighborhoods and other upscale communities. The Center City struggles to break out despite 24-hour attractions—world-class museums and arts institutions, fine restaurants, and a mass transit hub with direct connections to New York City and Washington. Unfortunately, these two

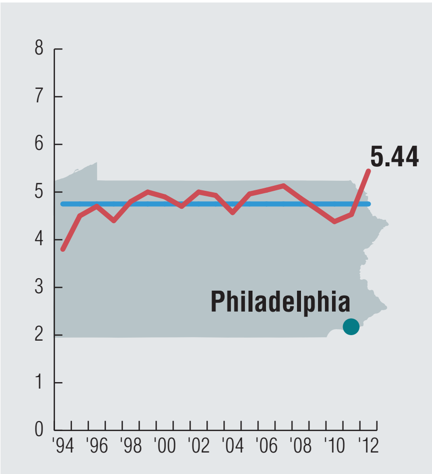
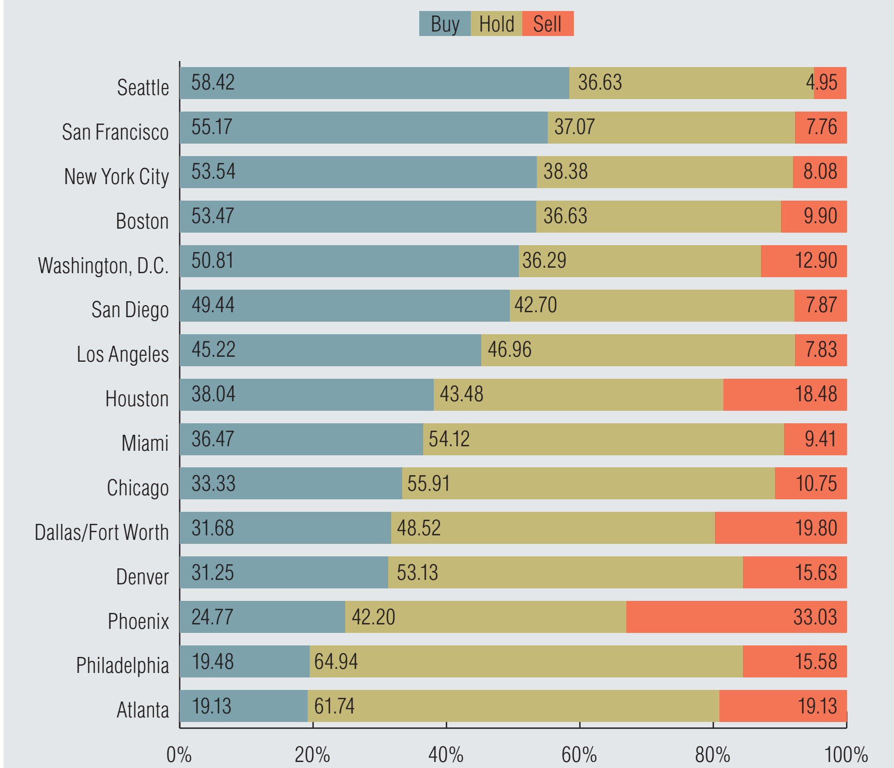


EXHIBIT 3-10

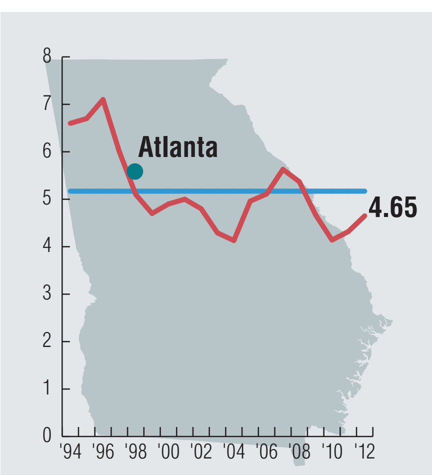
U.S. Retail Buy/Hold/Sell Recommendations by Metro Area



Source: *Emerging Trends in Real Estate 2012* survey.

gateways continue to sap attention and energy: most Amtrak Acela riders just pass through after the train stop at the 30th Street station. For the longer term, Philadelphia offers a lower-cost location to house satellite operations of New York City–based businesses.

Atlanta (36). A classic buy-low, sell-high market, Atlanta once again may be ripe for investment. "There may be no better time than right now" because real estate markets have been in the dumps. "We're a development town with no development." Absent housing construction to feed a high growth–based consumer economy, the market stalls. "It could take five years to get back to a decent place." Tenants readily take advantage of an exceedingly soft office scene, deflated by a spurt of pre-2008 projects centered in uptown Buckhead. The new developments attract occupancy with sweetened tenant-concession deals, robbing from existing buildings whose cash-flow outlooks tank. "There's not much net absorption." Condos in Midtown and Buckhead high rises begin to sell again, but at 40 percent off original asking prices. Widespread "mom-and-pop distress" hurts retail space along the never-ending roadway strips; hotels "improve to not-particularly-strong levels"; and multifamily rent projections "head off the charts, but aren't realistic." The large warehouse market keeps its fingers crossed that Savannah or Charleston can snag a large share of Panamax shipping traffic. Atlanta's strategic airport, which just added an impressive international terminal, and the city's status as an interstate highway hub provide an exceptional distribution platform to support either port. For the future, the city will continue building up its urbanizing spine between downtown and Buckhead, attracting more gen-Yers and empty nesters looking for hipper, more convenient in-town lifestyles. Once vacant apartments fill up, developers will build more mixed-use residential and retail space on Peachtree Road near upscale residential areas. "A critical mass has been established that won't be reversed." Smart money also accumulates sites west of Georgia Tech, anticipating a future development zone for extending the evolving urban core. An upcoming sales tax referendum for expanding mass transit could determine



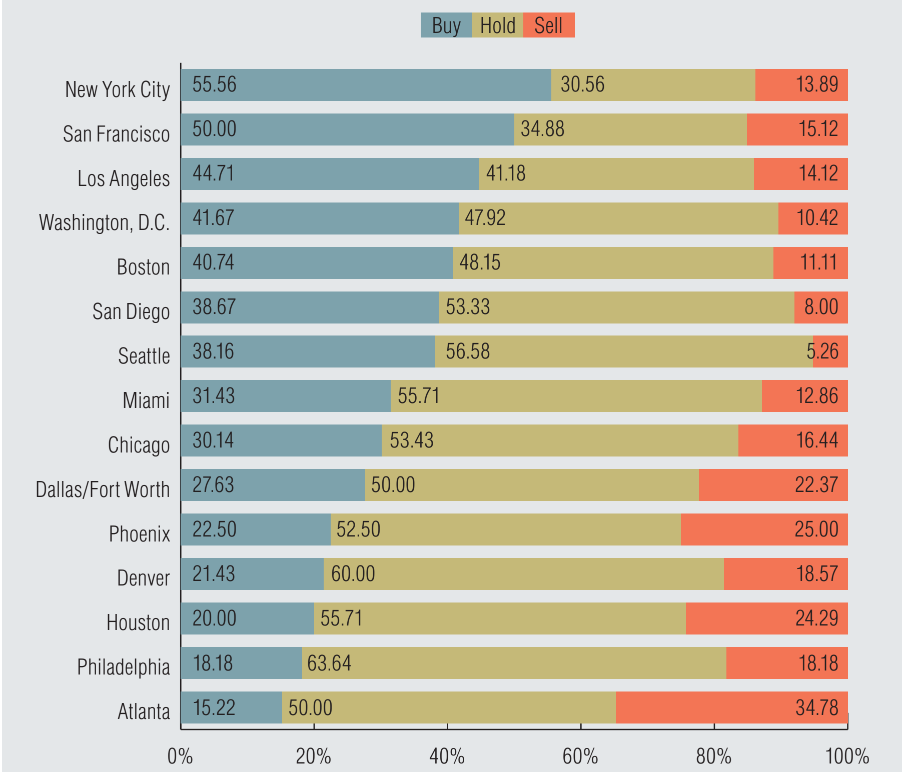
the urban growth track for the next generation. "It's a potential game changer for promoting transit-oriented development and overcoming congestion." Will antitax sentiment derail the city's bid to fund necessary infrastructure? Stay tuned.

Other Market Prospects

Frustrated hotel developers line up to start projects in **Honolulu (22)** and other parts of Hawaii, "but only a few make sense." Stiff vacation travel tabs from the U.S. mainland damp hotel business, and Japanese tourists haven't been in a spending mood either. . . . **Baltimore (25)** can work as a cheaper back office option for Washington, and its industrial market remains an important distribution point for the Mid-Atlantic states. . . . **Minneapolis (26)** and **Nashville (27)** play second banana to Chicago and Atlanta; respectively: they lack gateway international airports, and only so many can serve any region. The Twin Cities suffer from high office vacancies but will outperform other Midwest markets. . . . The **Inland Empire (28)** fell hard when housing collapsed; warehouses recover, but

EXHIBIT 3-11

U.S. Hotel Buy/Hold/Sell Recommendations by Metro Area



Source: *Emerging Trends in Real Estate 2012* survey.

single-family home prices will take much longer to rebound and probably need a heavy dose of inflation. . . . **Orlando (29)**, **Tampa (33**), and **Jacksonville (40)** struggle to decouple from Florida's housing woes. Jacksonville's port looks like a long shot in the competition for Panama Canal traffic. . . . **Salt Lake City (30)** offers limited opportunities but an attractive quality of life. . . . Investors tout **Pittsburgh (31)**, the biggest mover in the survey, for its Industrial Belt renaissance, relying on universities, hospitals, and government. Well-leased buildings at low rents sell for huge discounts to replacement cost. . . . **Virginia Beach/Norfolk (32)** has a good chance to expand market share in the hunt for potential business from future Panama Canal traffic. . . . From a mortgage lender's perspective, properly underwritten properties in generally less-favored Midwest markets—including **Indianapolis (34)**, **Kansas City (35)**, **St. Louis (39)**, and **Cincinnati (48)**—"will do okay." Institutional investors leave these cities mostly to local owners. Housing "is so cheap, people don't need apartments." . . . **Oklahoma City (37)** quietly benefits from energy sector performance. . . . **New Orleans (38)** shows a notable boost in the survey, emerging from the dark Katrina days. . . . California's government gridlock and fiscal austerity hurt **Sacramento (46)**. . . . **Las Vegas (49)** sits on foreclosure crisis ground zero: the city's fortunes ebb further as gambling and tourist traffic hits the skids at recently expanded hotel complexes. In the Era of Less, people just have less to blow at the roulette wheel. . . . **Cleveland (50)** and **Detroit (51)** cannot escape the vagaries of industrial decline.

Property Types in Perspective

"Get used to the new norm: rents stay about where they are—not getting worse, but not getting much better."

For 2012, investment and development prospects continue to advance across all major property sectors, led by apartments, which this year register the highest ratings for any category in *Emerging Trends* history (exhibit 4-1). Unfortunately, this general improvement in sentiment does not portend easy times. Investors should anticipate that "slow, choppy demand will gradually absorb space, while landlords struggle in every category except multifamily." Developers may lick their chops over apartment opportunities—finally they can break ground on something—but anemic demand drivers in other sectors turn off construction lenders. Retail, office, and hotels score "sickly" poor to modestly poor development ratings in the survey.

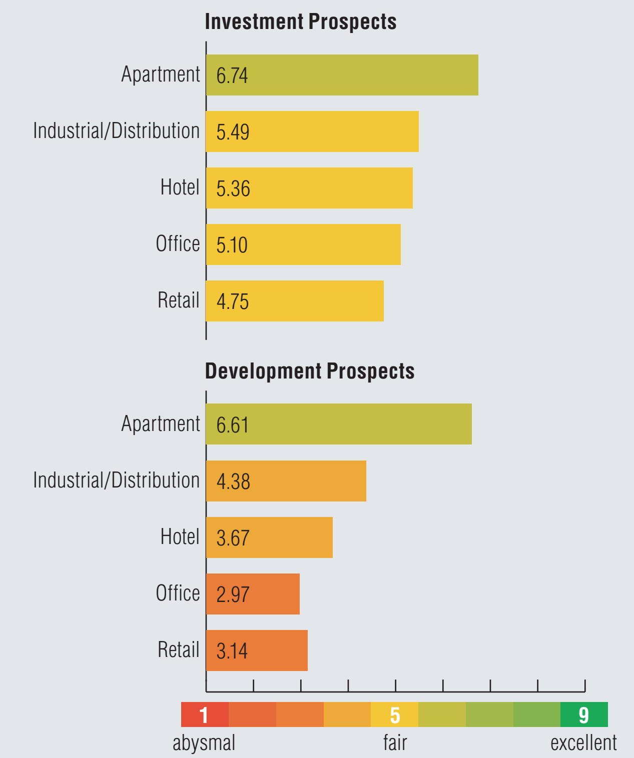
Slow Progress

Beyond Multifamily

Besides apartments, interviewees prefer downtown office buildings in 24-hour cities, warehouse properties producing cash flow in prominent port and airport gateways; full-service hotels in the major markets; limited-service hotels without food and beverage (Courtyard by Marriott, Hilton Garden Inn concepts); and neighborhood shopping centers serving stable infill suburban communities. Sentiment diminishes for power centers (because of concerns about big-box tenants) and malls: owners will not sell the best fortress malls (if you don't have one, you're out of luck), and most other regional centers face a shaky future. Suburban offices score the lowest investment marks; commodity buildings in campus settings isolated from urban amenities receive a big thumbs down.

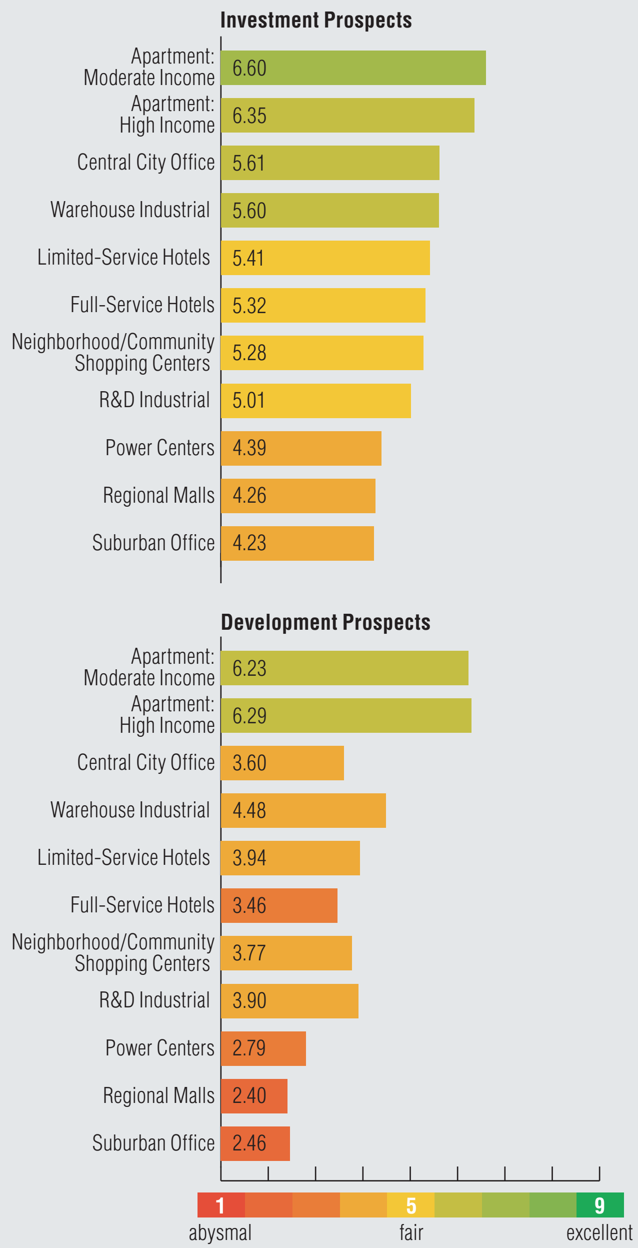
EXHIBIT 4-1

Prospects for Major Commercial Property Types in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 4-2
Prospects for Commercial/Multifamily Subsectors in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

Tenants' Market

"Tenants in all property types operate lean and mean," one interviewee says. "Corporate profits derive from using fewer people more productively in office and reducing space needs in the supply chain, affecting industrial and retail." Well-capitalized assets, meanwhile, secure distinct advantages against properties in refinancing limbo. "Rocky underpinnings work against owners": tenants "with plenty of choices" can trade up in quality, favoring "recapitalized landlords who appear better positioned to deliver on rich concession packages" without snafus and uncertainty. "Tenants will avoid anything with a whiff of trouble." This tenants' market dynamic could finally force more lenders and special servicers to resolve problem loans and revalue assets to stem deteriorating leasing prospects and stabilize building revenues. Under the circumstances, "predicting large rent increases would be foolhardy, even in top markets."

Stabilizing Cap Rates

In marked contrast with last year's survey, which correctly predicted a trend toward compressing cap rates, respondents forecast flattening cap rates across all property sectors during 2012 (exhibit 4-3). They even signal slight upticks for regional malls, full-service hotels, central business district office space, and high-income apartments. These outlooks underscore interviewee concerns about overeager capital bidding up pricing on highly sought-after trophy assets without enough actual pop coming in occupancies and rent growth. While low apartment cap rates appear more sustainable given strong leasing demand and revenue gains, other sectors could reverse course without noticeable increases in net operating incomes. "At this point, purchasers will need a burst of new cash flow to keep up."

"Green: No Longer a Development Frill"

Sustainable office design is gaining traction, pushed by new municipal laws and tenant preferences for more energy-efficient buildings. "It's almost a fait accompli for developers of class A space." Major cities take the lead, enacting laws to help control increases in power demand and related carbon emissions. At the same time "most major commercial tenants" and many government offices make sustainability a "checklist item" for choosing space: they want to bring down operating costs. "Energy will continue getting more expensive; new buildings will be around for 50 or 60 years. It just makes good business sense to develop green."

Some companies find a recruiting advantage in attracting brainiac echo boomers when they can showcase their offices in healthier buildings with new-age systems that can fetch high LEED ratings. "At the very least, a building better have

EXHIBIT 4-3

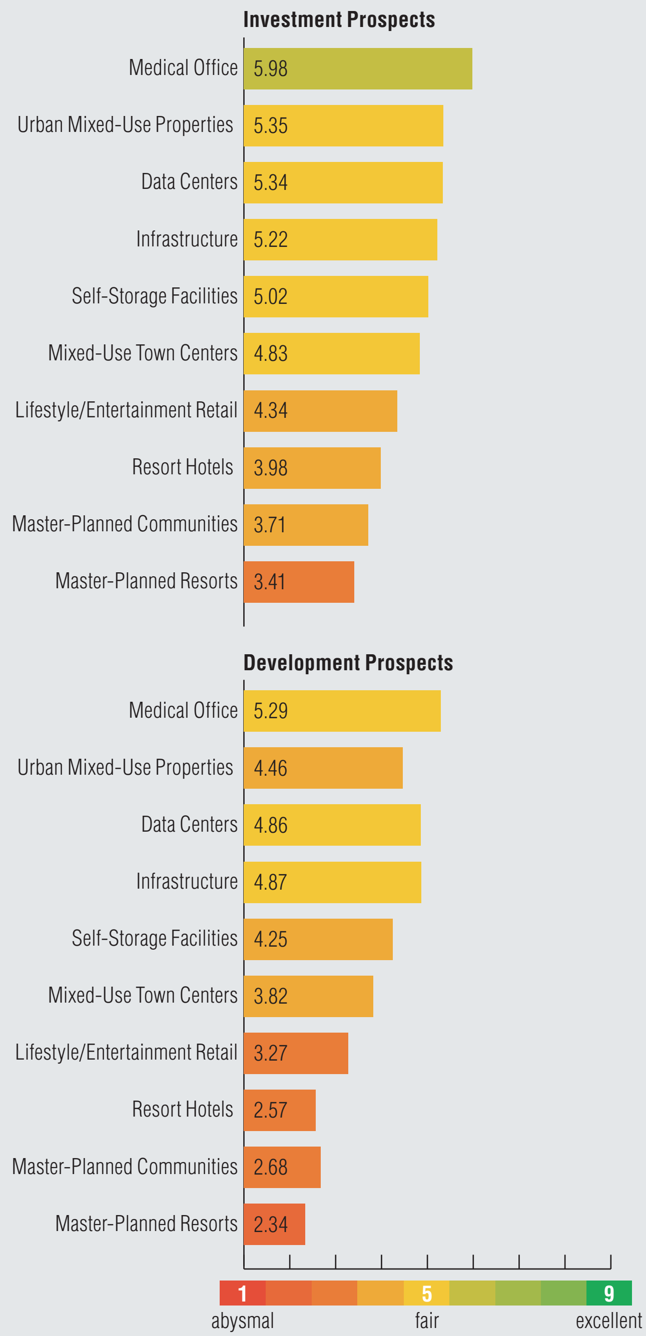
Prospects for Capitalization Rates

Property Type	Cap. Rate August 2011 (Percent)	Expected Cap. Rate December 2012 (Percent)	Expected Cap. Rate Shift (Basis Points)
Apartment: High Income	5.51	**5.62**	11
Apartment: Moderate Income	6.14	**6.17**	3
Central City Office	6.32	**6.43**	11
Regional Malls	6.66	**6.79**	13
Warehouse Industrial	7.02	**7.05**	3
Neighborhood/Community Shopping Centers	7.12	**7.13**	1
Power Centers	7.43	**7.46**	3
R&D Industrial	7.59	**7.61**	2
Full-Service Hotels	7.58	**7.68**	10
Suburban Office	7.77	**7.82**	5
Limited-Service Hotels	7.86	**7.88**	2

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 4-4

Prospects for Niche and Multiuse Property Types in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

a sustainability story and strategy. It may be enough that the property recycles, monitors and controls energy settings, and uses energy-saving light bulbs." Owners and buyers of older buildings should consider retrofitting to stay competitive. Timing works best when tenants roll over leases. Owners can incorporate costs into concession packages and factor renovations into financing agreements when buildings change hands. Other owners will continue to game the LEED rating system—sticking bike racks in basements in markets where everybody drives to work. "Prospective tenants should pay less attention to the ratings and examine closely the bottom-line impacts to their operations." Many owners like the expense savings, too, but claim "the jury is still out over whether sustainability strategies lead to higher rents." In the current market, green initiatives may be worthwhile to help hold vacillating tenants.

Green technologies also will be a coming attraction for industrial owners and some shopping centers. Solar panels fit perfectly on large, flat roofs, providing potential for energy savings that can be passed on to tenants. "Right now it's not economically viable." Other new roof systems can absorb heat in summer to lower cooling costs and help insulate buildings in winter to reduce heating bills. Some of these roof technologies also can capture rainwater for use in building systems. Water recycling becomes more essential (if not mandated) in drought-challenged areas, especially out west. Cisterns make a comeback, too.

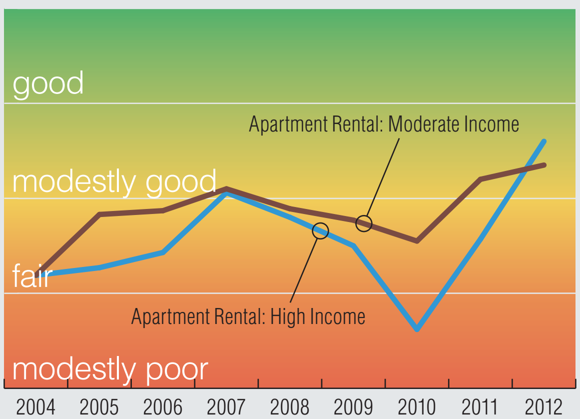
Apartments

Strengths

"The stars all align" to propel the apartment sector—strong demographics-based tenant demand, years of underdevelopment, declining vacancies, rising rents, and plenty of available financing, not only from the troubled government-sponsored enterprises, but also banks and even insurers. "Everybody's on the bandwagon." The housing bust and economic pessimism usher more would-be homebuyers and foreclosed owners into renting. Smaller, efficient apartment units closer to work look like better values than big houses in remote subdivisions. Convenience trends and rising auto-related costs orient lifestyles to 24-hour infill locations, especially toward apartments near mass transit stops, while tech-related advances in productivity affect "multifamily less than any other property type." After "an astonishing recovery," prices "already reflect" the heady rebound. "It's no secret multifamily is the best place to be for investors." In addition, a significant rent-growth cushion from short-term lease structures "can capture further expected demand from increasing numbers of post–college age echo boomers, as well as their downsizing baby boomer parents. Fervor from core investors only builds, sparked by historical performance: steady apartment cash flows have provided higher income-oriented returns with less volatility than any other property type, and buyer demand always provides a ready exit strategy.

EXHIBIT 4-5

U.S. Apartment Investment Prospect Trends



Source: *Emerging Trends in Real Estate* surveys.

U.S. High-Income Apartments

2012	Prospects	Rating	Ranking
Investment Prospects	6.60	Good	1st
Development Prospects	6.23	Modestly Good	2nd

Buy	Hold	Sell
40.5%	26.0%	33.5%

Expected Capitalization Rate, December 2012 5.6%

U.S. Moderate-Income Apartments

2012	Prospects	Rating	Ranking
Investment Prospects	6.35	Modestly Good	2nd
Development Prospects	6.29	Modestly Good	1st

Buy	Hold	Sell
54.0%	24.9%	21.0%

Expected Capitalization Rate, December 2012 6.2%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

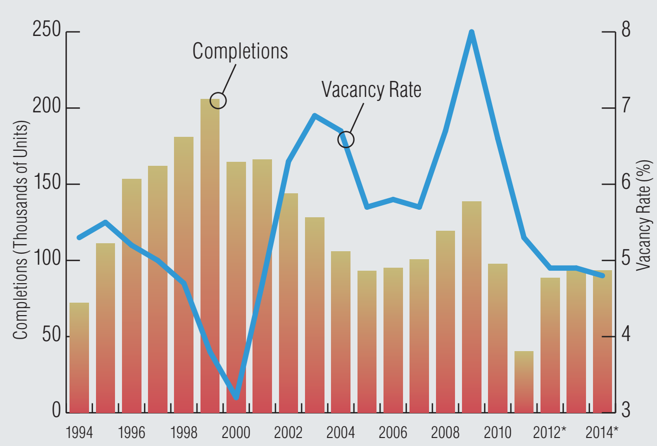
Weaknesses

A "little too overheated," apartment markets turn "brutally competitive," even in secondary locations where buyers head up the risk curve to secure assets. Stepped-up development could impinge on anticipated rent growth, "raising concerns when you're purchasing at sub–5 percent cap rates. Supply will come back quicker than we think." Fundamentals may have improved "to the point where room is limited to push rents to meet pricing expectations." Though high unemployment may temper homebuying in favor of renting, it also forces doubling up and move-back-in trends among people who would otherwise lease units on their own. Not all renters want apartments: multifamily owners can expect "plenty of competition from unoccupied single-family homes," especially in hard-hit housing markets. Multigenerational families and nontraditional households cluster in larger single-family rentals, pooling resources. "Typically, about 25 percent of single-family homes are rented. That could increase above 30 percent."

Best Bets

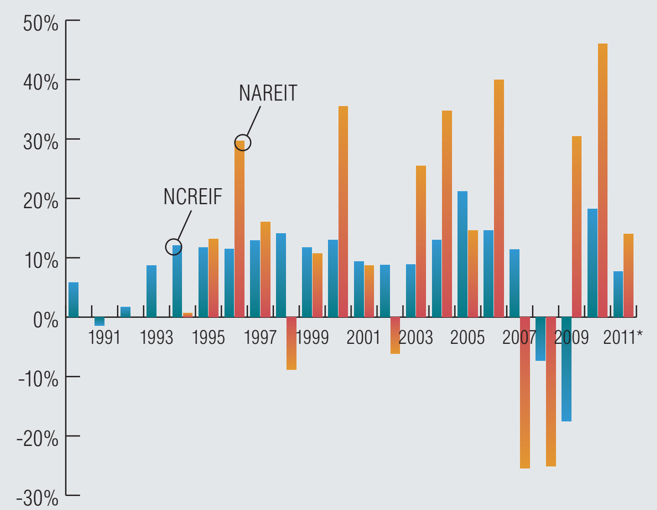
Apartment players enjoy an array of options. Existing owners seem best positioned: they can continue to reap solid income flows and hold assets long term with relatively little downside risk, or they can cull portfolios of weaker properties by selling into the buying wave. Patient money may swallow hard on pricing in high-barrier-to-entry gateway markets, "but that's where you want to be. The trick is getting in, and once there, you stay." Investors looking for better deals should do well with select, value-added purchases for mismanaged or lower-grade properties where new operators can boost revenues and rents with fix-up strategies—and maybe take advantage of a better jobs picture in the future. "There can be plenty of upside if

EXHIBIT 4-6
U.S. Multifamily Completions and Vacancy Rates



Source: REIS.
*Forecast.

EXHIBIT 4-7
U.S. Apartment Property Total Returns



Sources: NCREIF, NAREIT.
*Data as of June 30, 2011.

the employment outlook improves." In the worst case, owners secure decent occupancies and cash flows without immediate rent spikes.

Avoid

Steer clear of extreme housing-bust markets where too many empty homes and condo-apartments compete head-on with multifamily rentals. Also, be careful with new garden apartments in suburbs where a surfeit of single-family rentals could dampen overall demand.

Development

Building activity will heat up in many markets after an extended recession-induced hiatus; torrid demand should absorb any new supply over the next two to three years. "Sites are ready, zoning can happen quickly, and construction financing won't be a problem." REITs have lines of credit at their disposal, and even conservative lenders pull the trigger on can't-miss buildings. "Banks won't go crazy. They still want full recourse." Historically, multifamily projects generate relatively narrow profit margins, but low interest rates and plunging cap rates help provide attractive development spreads in infill locations. "Anything near mass transit will work." Federal housing programs for low-income projects have been "decimated" in government cutbacks. "Everybody will build class A, when it's more affordable housing we really need."

Outlook

Dollars will continue to flow into multifamily housing, eclipsing other property types, and aggressive developers will overbuild eventually—just not in 2012 or 2013, when new supply just begins to temper renter demand. Investors must be satisfied with "squeezed-down" coupon-clipper returns, especially in 24-hour markets. Cap rates could decline further in gateway cities to levels eventually comparable to other international citadels like London and Paris. Why shouldn't they? Apartments are the safest real estate investment bet, promising to sustain decent returns even if the economy fails to reignite. That's worth more than ever in uncertain times.

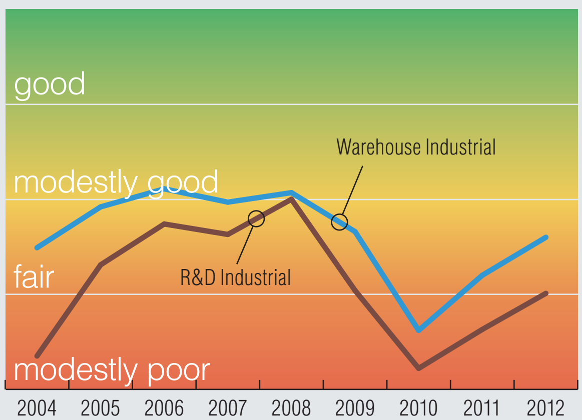
Industrial

Strengths

Despite a recovery that is more protracted than normal, institutional investors lock in on warehouse cash flows, bidding up always-popular high-ceilinged distribution facilities in the primary international airport/port hubs (those gateway cities again) through which most import activity funnels. Resulting price spikes and solid increases in occupancy in these prime markets give comfort to owners, who recoup paper value losses from the downturn. At the same time, international trade resumes after "a disastrous pause," and retail sales show some comforting, if tentative, gains. Finally, national vacancy rates drop below 10 percent—still historically high, but offering another promising sign. Nobody should expect much rent growth: even in good times, industrial rents do not move much, but sellers always command a bevy of buyers.

EXHIBIT 4-8

Industrial/Distribution Investment Prospect Trends



Source: *Emerging Trends in Real Estate* surveys.

U.S. Warehouse Industrial

2012	Prospects	Rating	Ranking
Investment Prospects	5.60	Modestly Good	4th
Development Prospects	4.48	Modestly Poor	3rd

Buy	Hold	Sell
45.7%	42.1%	12.3%

Expected Capitalization Rate, December 2012 7.0%

U.S. R&D Industrial

2012	Prospects	Rating	Ranking
Investment Prospects	5.01	Fair	8th
Development Prospects	3.90	Modestly Poor	5th

Buy	Hold	Sell
24.9%	56.1%	19.0%

Expected Capitalization Rate, December 2012 7.6%

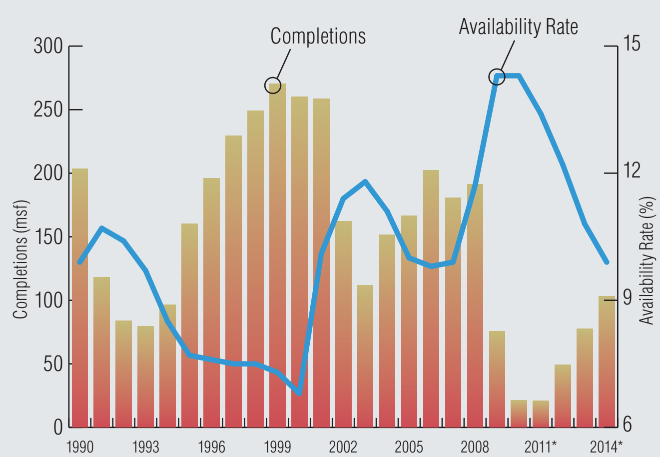
Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

Weaknesses

Cyclical economic malaise and shocks from ongoing advances in secular productivity combine to hamstring growth in demand for warehouse space. National vacancies have receded at painfully slow rates from record highs. Improved global trade flows cannot make up for just-in-time economizing trends. New shipping-container systems "turn trucks and trains into warehouses" for direct shipment to point-of-sale locations, and some big-box retailers effectively transform into warehouse stores. E-commerce makes further inroads, eliminating links in increasingly archaic distribution chains. "The Amazon model is the new way." Landlords, especially owners of smaller, traditional warehouse facilities, "find little to no pricing power." Warehouse adherents contend that cutbacks in the retailer inventory pipeline will be temporary—that eventually they will expand again, instead of reducing their arrays of styles and sizes in stores. "As consumption comes back, retailers will bring back choice." Maybe so, but declines in inventory/sales ratios underway for decades are appearing to accelerate. Cap rates cannot go any lower: "Pricing is way above replacement cost."

EXHIBIT 4-9

U.S. Industrial Completions and Availability Rates



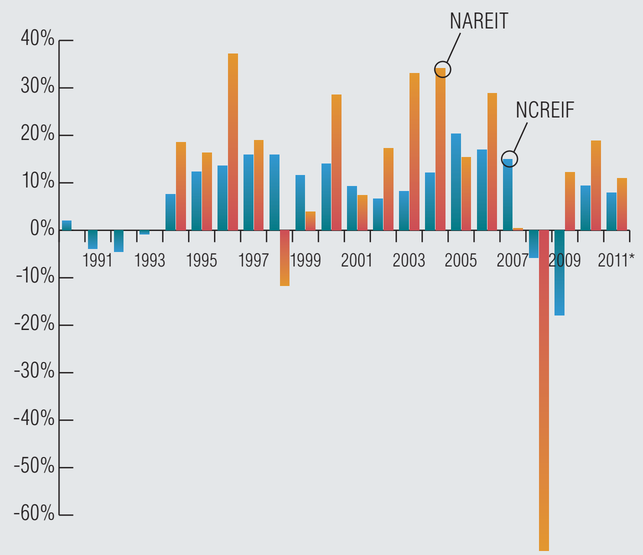
Source: CBRE Econometric Advisors.
*Forecasts.

Best Bets

Follow global trade routes and understand the logistics needs of shippers as more retail goods sell over the internet. "Users rethink supply chains and operate from multiple regional distribution centers to lower fuel costs," but the locations remain the usual handful of hub markets with the best access to ports, international airports, interstate systems, and rail lines (regaining some market share from trucks). The global trade markets along the coasts firm their positions as "the best places to invest." Enhancement plays concentrate on converting 18- and 24-foot space into 36-foot clear buildings in the best markets. "Ceilings go higher and higher. Owners can expand capacity and revenue potential on the same land footprints." Some interviewees tout "good regional markets with lower growth prospects and higher cap rates. Centrally located cities like Columbus, Indianapolis, Louisville, and Memphis prove attractive for e-commerce fulfillment strategies. Kansas City and Harrisburg provide excellent rail access, and Phoenix is well-positioned near the West Coast as a lower-cost alternative to California "and even Texas."

EXHIBIT 4-10

U.S. Industrial Property Total Returns



Sources: NCREIF, NAREIT.
*Data as of June 30, 2011.

Avoid

Old, increasingly obsolescent space "needs a new purpose." Low-ceiling warehouses in off locations become increasingly superfluous during the slow recovery and will be weeded out as tenants gravitate to new facilities with better distribution capabilities. The just-in-time game makes long-term storage less important.

Development

Aside from special-purpose distribution facilities for e-commerce purveyors and the odd new warehouse in major hubs, building activity should remain subdued. All attention turns to East Coast ports, which jockey for new Panama Canal traffic and the potential for game-changing expansion. Winners should see a major ramp-up in distribution center development activity and infrastructure construction over the next five to ten years. Among the hot contenders: either Savannah or Charleston can link to Atlanta's airport and interstate highway hub serving a growing car manufacturing region, Miami benefits from proximity to Latin American markets, while northern New Jersey, Baltimore, and Norfolk have direct access to major Mid-Atlantic and New England population centers. Houston along the Gulf Coast also makes a strong case to serve all regions. Deepening shallow ports and building new rails and highways to move goods through populated districts will be major challenges just as government budget constraints crimp funding infrastructure. "It all comes down to where shippers can access the most customers," as well as raw political clout: politicians must deliver federal bacon to pay for harbor projects.

Outlook

Prices probably have topped out after a fierce run-up, and chronic slow growth impedes chances for a strong, near-term rebound. Occupancies and operating revenues will take longer than usual to rise. The sector desperately needs economic improvement to spur more manufacturing, construction projects, and consumer spending—all of which drive goods movement. The Panama Canal widening "shouldn't create a sea change along the West Coast." Over time, L.A.–Long Beach, San Francisco, and Seattle ports "may lose some market share, not volumes." Any increase in U.S.-based manufacturing would help some markets, "but exports don't use as much warehouse space as imports." Concern will grow about the dilapidated state of aging interstates, tunnels, and bridges, as well as worsening congestion around major gateway cities—potentially disrupting logistics schedules and increasing costs. "The sector has become all about distribution rather than storage."

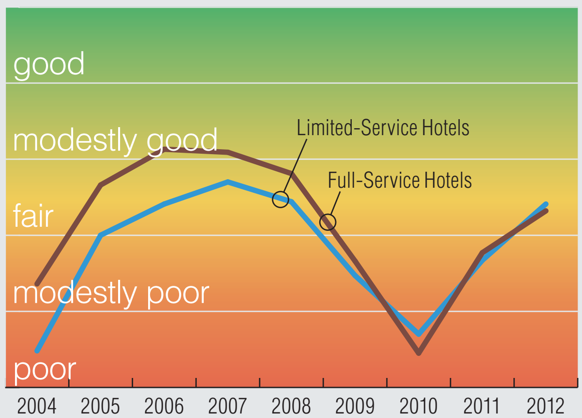
Hotels

Strengths

Occupancies recover to more normalized levels near ten-year averages for most lodging segments. "Demand is definitely back." Increased corporate travel—"the return of the weekday business warrior has had the most impact"—combined with a weak dollar drawing offshore tourists, helps boost revenues in major gateway markets. New York City, Boston, San Francisco, Chicago, and Miami all do well. Overall, leisure travel holds fairly steady, but tourists stay price-conscious. Midscale segments without food and beverage show the best bottom-line results, meeting the needs of travelers' no-frills mindset. Reasonably leveraged properties rebound off good cash flows: owners can invest in overdue upgrades to gain greater advantage over highly leveraged competition. Some local governments in tourist areas offer tax breaks and incentives to owners and developers to upgrade and build new properties, hoping to jump-start more convention business, create jobs, and expand the tax base—anything to reinforce otherwise flagging economies.

EXHIBIT 4-11

Hotel Investment Prospect Trends



Source: *Emerging Trends in Real Estate* surveys.

U.S. Hotels: Limited Service

2012	Prospects	Rating	Ranking
Investment Prospects	5.41	Fair	5th
Development Prospects	3.94	Modestly Poor	4th

Buy	Hold	Sell
32.3%	46.2%	21.6%

Expected Capitalization Rate, December 2012 7.9%

U.S. Hotels: Full Service

2012	Prospects	Rating	Ranking
Investment Prospects	5.32	Fair	6th
Development Prospects	3.46	Poor	8th

Buy	Hold	Sell
29.7%	46.9%	23.4%

Expected Capitalization Rate, December 2012 7.7%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

Weaknesses

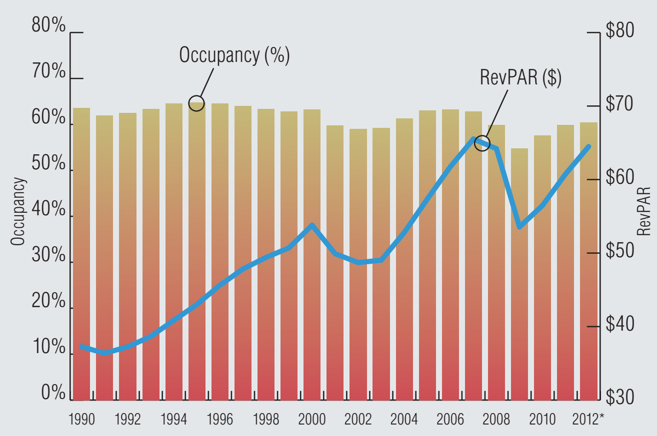
Returning demand fails to translate into pricing power: "Room rates are a big industry issue." Industry yields suffer from greater reliance on discounting programs and third-party, internet distribution channels—Expedia, Priceline, etc. These new related commission structures gnaw at bottom lines. "The old call center booking model has become a dinosaur since people become comfortable booking online." More penny-pinching corporations also push to negotiate favorable bulk purchase agreements on room nights with business center hotels. Food and beverage profits, meanwhile, have been slashed. "Companies meet again, but don't spend as much on ancillaries," and they have no compulsion to coddle employees or provide entertainment budgets: "That's not coming back anytime soon." Wedding and party business also remains constrained—most folks lose their appetite for fancy bashes—while spa and hotel stores also take a hit. Given extremely high fixed costs to maintain these operations, "any declines can crush bottom lines." Weekend business remains extremely feeble—"you can roll a bowling ball down the halls"—especially in secondary and suburban markets where developers engaged in pre-crash overbuilding. A disconnect in pricing expectations keeps transactions at a trickle despite significant distress among owners who overborrowed at or near market highs. Banks and special servicers keep the extend-and-pretend game going: they do not have the expertise to operate lodging properties and hold out as long as possible to avoid writedowns. Struggling borrowers on floating-rate mortgages get a reprieve from the Federal Reserve; they remain extremely vulnerable if interest rates ever advance.

Best Bets

Concentrate on major flags in the familiar 24-hour cities. Investors should follow guest traffic and enhanced performance "to the better seaboard markets, across all price points." Refinancing opportunities abound—especially mezzanine debt and bank equity. Banks will let go of these management-intensive assets as more workouts occur: "They certainly don't want them in REO [real estate owned] portfolios." In the current market, profits are generated by rooms, so focus on midscale

EXHIBIT 4-12

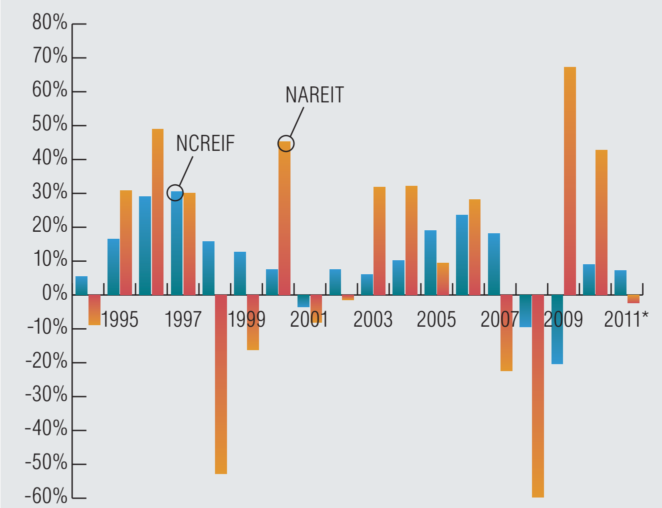
U.S. Hotel Occupancy Rates and RevPar



Sources: Smith Travel Research (1987 to 2010), PricewaterhouseCoopers LLP (2011 and 2012).
*Forecast.

EXHIBIT 4-13

U.S. Hotel/Lodging Property Total Returns



Sources: NCREIF, NAREIT.
*Data as of June 30, 2011.

brands without food and beverage overheads. Operators always are key to driving results. "They must be hotel specialists, not real estate guys."

Avoid

Overleveraged resorts—saddled with whopping upkeep and staffing budgets—look like black holes, especially properties depending on residential sales or vacation time-share features. "A boatload of unsold inventory exists without a market." The price per key might look good on some older hotels, but heavy capex requirements should be "deal killers" on any product threatened with obsolescence. About half the nation's 5 million lodging properties are owned by independents, many of which struggle to replace even carpets or bedspreads. The overbuilt economy sector, particularly highway interchange motels, copes with a chronically high-fuel-cost environment, reducing vehicle trips and occupancy rates.

Development

Except for uber–tourist destination markets like New York City, lenders will effectively "place a lid on new supply" until the economy shows sustained improvement, which will not happen in 2012. "If you want to find an underserved market, try North Dakota. The opportunities are that few and far between." Most projects will be outside the United States.

Outlook

Without enough oomph from the economy, the typical sharp hotel recovery track slows prematurely. "The play seems gone" before it started. Normally investors buy near lows, try to limit plowing too many dollars into properties, and then sell into a rising market before economic growth sours and derails business. This time the economy never started really firing. Top markets will continue to outperform, but improvements in occupancies and revenues per room will probably flatten out. Outside of favored cities, expect limited transaction activity.

Office

Strengths

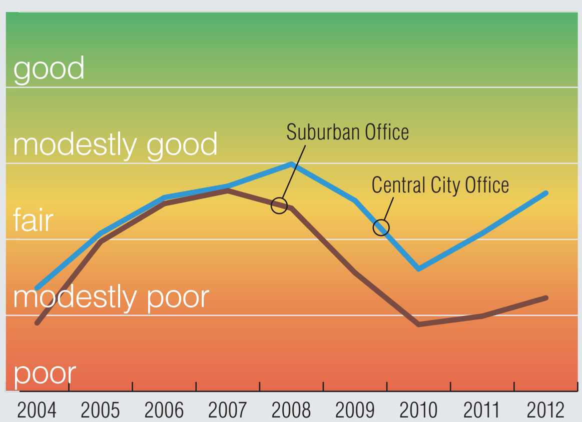
Despite "some crazy low cap rates and "a lot of capital chasing deals," trophy properties in 24-hour gateway markets make sense. They can attract tenants and hold values as well as any property niche. Corporate headquarters and satellite or support businesses—such as lawyers, accountants, and media—increasingly congregate in a few key cities to interface with major companies and clients, operating along global pathways. Tenants overwhelmingly favor buildings with solid, institutional ownership and avoid properties encumbered by financial turmoil. Low rents in many markets offer opportunities for acquisition or recapitalization timing plays to stabilize well-located properties and ride a cyclical recovery, if the economy ever kicks into gear. Moribund development activity improves chances for absorbing existing high vacancies. "You need to play your cards right—know when to double down or walk away—but understand it's hard to make money holding on to most office buildings."

Weaknesses

Talk about the need to time transactions right! "Inflation-adjusted rental rates show no growth in any major U.S. office market over the past three decades, and many markets register zero nominal rent growth over the past 15 years." Some assets see revenues and values yo-yo, while others just wallow in static-state torpor. "It's scary not seeing job growth to fill the space," and some industries with the best prospects for job creation—health care, transportation infrastructure, and energy—do not necessarily populate traditional office space with a splurge of hires. Tenants now readily take advantage of "historically low rents and historically high concessions," playing musical chairs, upgrading from B to A space without absorbing much vacancy. Absent enough demand, this capex-intensive process fails to move the needle much on net effective rents. Many owners stay on an unprofitable merry-go-round, "throwing out perfectly good drywall every few years to keep or attract tenants. It boggles the mind. You can't get appreciation to justify the costs." Thawing lease-signing activity "doesn't mean tenants take more space." The average company "realizes they probably need only 80 percent of what they currently lease. They move people around, change configurations, and force more productivity out of every square foot. The more unusual the floor plate or less flexible the layout, the less likely

EXHIBIT 4-14

Office Investment Prospect Trends



Source: *Emerging Trends in Real Estate* surveys.

U.S. Central City Office

2012	Prospects	Rating	Ranking
Investment Prospects	5.61	Modestly Good	3rd
Development Prospects	3.60	Modestly Poor	7th

Buy	Hold	Sell
34.5%	43.9%	21.7%

Expected Capitalization Rate, December 2012 6.4%

U.S. Suburban Office

2012	Prospects	Rating	Ranking
Investment Prospects	4.23	Modestly Poor	11th
Development Prospects	2.46	Very Poor	10th

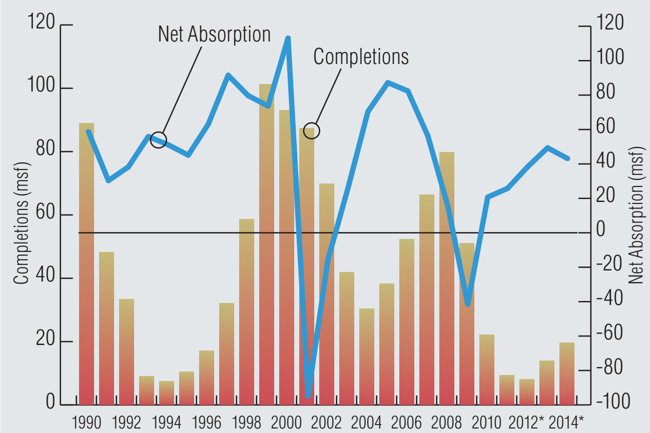
Buy	Hold	Sell
16.4%	50.6%	33.0%

Expected Capitalization Rate, December 2012 7.8%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

EXHIBIT 4-15

U.S. Office New Supply and Net Absorption



Source: CBRE Econometric Advisors.
*Forecast.

buildings make their cut." Even administration-intensive law firms eliminate secretarial bays and slice support staff. "Downsizing space realizes immediate savings for businesses with bottom-line impact," and landlords must grin and bear it.

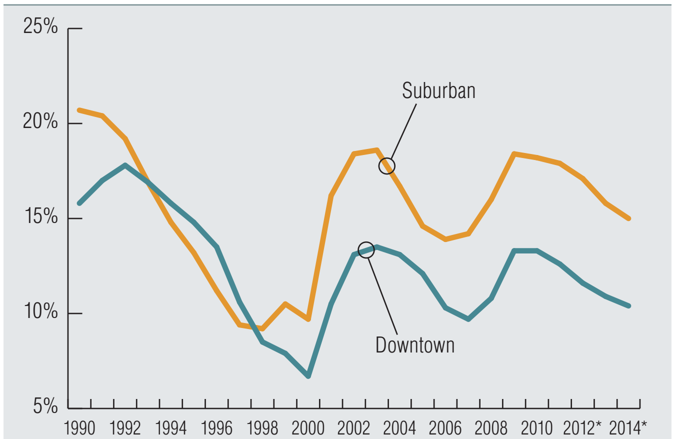
Best Bets

Institutional-quality, core office buildings in 24-hour cities remain blue-chip-portfolio keepers for investors satisfied with solid income-oriented returns; otherwise, owners should sell out into the capital rush. Recapitalizations of overleveraged trophies may offer chances to gain attractive equity positions at somewhat better pricing. In general, owners need to diversify tenant bases as much as possible and avoid dependence on large space users, which have plenty of options and can always coerce major concession deals. "Signing big tenants means writing big checks just to keep NOIs stable." Health care trends—rising older demographics and skyrocketing costs—make medical office space a logical play, but this niche sector with limited opportunities investing in smaller buildings could easily be overwhelmed by capital.

Avoid

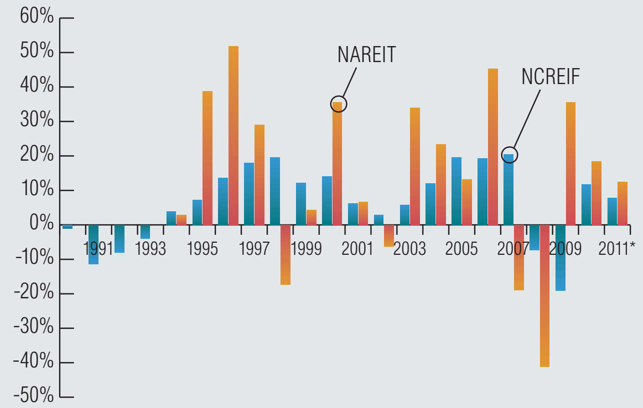
During early recovery phases when often-sluggish markets cope with high vacancies, interviewees traditionally raise red flags "about whether older buildings burdened by obsolescent features will ever lease." Typically, cyclical demand improves enough and lower-quality office space can be filled—albeit at comparatively low rates. But what about now, when tenants orient to "less is more" strategies, want greater flexibility, and crave convenient locations to attract employees? In the new world order, it appears many commodity office parks will struggle for survival away from burgeoning suburban nodes. "It's tough to make the suburban case with vacancies so high—20 percent or more. Demand doesn't work to bring up puny rents, and these properties need costly makeovers to compete." Not only does younger employee talent gravitate to urban action, but "they also want to work in newer buildings with sustainable features, and more companies want green space to attract them." Some languishing "B and C office will be torn down," following the unfortunate "path to oblivion of many lower-quality suburban shopping malls."

EXHIBIT 4-16
U.S. Office Vacancy Rates



Sources: CBRE Econometric Advisors.
*CBRE Econometric Advisors.

EXHIBIT 4-17
U.S. Office Property Total Returns



Sources: NCREIF, NAREIT.
*Data as of June 30, 2011.

Development

No surprise: office builders struggle to find work, and new construction limps along at the lowest level in five decades. Other than a one-off tower in a major gateway city or a build-to-suit campus for a large corporation, "you won't see new building." Developers orient projects to provide efficient floor plates and more contiguous space with sustainable, energy-saving features employing natural light and under-floor air systems for better air quality. LEED ratings—the higher the better—become the necessary standard. Despite higher asking rents, these new buildings will offer enough advantages to lure top-tier tenants out of last-generation office product and hasten the decline of low-end dinosaurs.

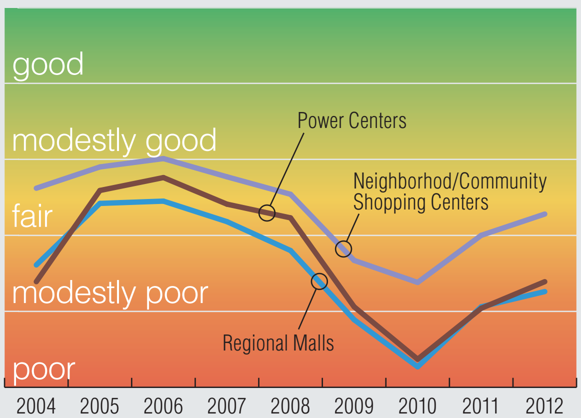
Outlook

Vacancy rates will continue to edge down in 2012, but not enough to restore much landlord pricing power, except for prime space in the most sought-after gateway city locations. "The further you drive out of town, the more risks investors take." In addition to the lackluster economy, secular changes in corporate workforce deployments, staffing needs, and use of office space will mitigate chances for a robust sector recovery. Executives in cubicles and work-at-home options appear to be here to stay. "I'm sharing an office," says a top honcho. "The message is get used to it." That tough love advice also applies to investors and developers: "Office ain't what it used to be."

Retail

EXHIBIT 4-18

Retail Investment Prospect Trends



Source: *Emerging Trends in Real Estate* surveys.

U.S. Neighborhood/Community Centers

2012	Prospects	Rating	Ranking
Investment Prospects	5.28	Fair	7th
Development Prospects	3.77	Modestly Poor	6th

Buy	Hold	Sell
38.0%	41.9%	20.2%

Expected Capitalization Rate, December 2012 7.1%

U.S. Power Centers

2012	Prospects	Rating	Ranking
Investment Prospects	4.39	Modestly Poor	9th
Development Prospects	2.79	Poor	9th

Buy	Hold	Sell
10.0%	53.2%	36.8%

Expected Capitalization Rate, December 2012 7.5%

U.S. Regional Malls

2012	Prospects	Rating	Ranking
Investment Prospects	4.26	Modestly Poor	10th
Development Prospects	2.40	Very Poor	11th

Buy	Hold	Sell
12.2%	60.9%	26.9%

Expected Capitalization Rate, December 2012 6.8%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

Strengths

It's all relative: in view of the depths of the housing crisis and consumer distress, the shopping center sector "hasn't done badly." Fortress mall occupancies and rents tick up. Owners will not sell these "irreplaceable," "almost priceless" assets where retailers cluster and shoppers concentrate. Store chains look for space in the strongest gateway markets where a shortage exists in prime locations, and some European brands take advantage of the weak dollar and expand U.S. footprints. "Nothing new has been built in several years, creating undersupply in these few select areas." The recession alters buying habits: shopping centers need to focus on "consumers' value-driven orientation, delivering product more cheaply and conveniently without frills." Infill "necessity retail" will do fine near neighborhoods that sidestepped housing woes, and investors bid up prices to borderline nosebleed levels, trying to capture steady, highly reliable revenue flows.

Weaknesses

Away from wealth islands, the retail world undergoes stressful transformation. "Essentially, people don't have as many dollars to spend," and e-commerce continues to "compound its market share," now heading for 10 percent. "The web starts to be a big deal" beyond just the loss of book and record stores and creates uncertainty over which merchandise sector will be next to fall. "What I don't know or anticipate scares me," says an investor. More retailers shift to smaller store-as-showroom models with less merchandise, encouraging customers to buy off the internet for wider selections. They also aim to use less backroom space for storage, reducing real estate bills further. Prospects for overall space needs shrink: "One-third of regional malls should be bulldozed. We don't need new retail." At midlevel centers, store chains aggressively "negotiate down lease terms." "They play 'take my terms or I'll close down my store.'" The big problem remains the wobbly consumer in the midst of deleveraging who cannot sustain buying off paychecks that don't grow much. "Many big-box brands look vulnerable," and the venerable department store format remains under siege. "A lot of marginal retail product will limp along indefinitely."

Best Bets

Retail real estate developers and investors must think outside the box. "The major players begin to look at retail very differently" and consider greater integration of e-commerce and bricks-and-mortar merchandising. The recession aftermath, consumer gloom, and internet incursions push existing malls more toward different formats—either upscale social gathering spots or merchandise distribution hubs. Fortress malls could evolve into centers of "well-ambienced, high-touch, smaller stores with visual appeal, which retailers use for brand recognition." Food and entertainment become even more important for driving traffic and sales. The mass distribution centers would provide greater convenience for shoppers who order online. "They can pick items up for more instant gratification or return them easily without the hassle of waiting in lines." Many tired malls selling commodity merchandise should be adapted to serve as multifaceted town centers with education, community, or medical facilities, taking advantage of their often pivotal community locations.

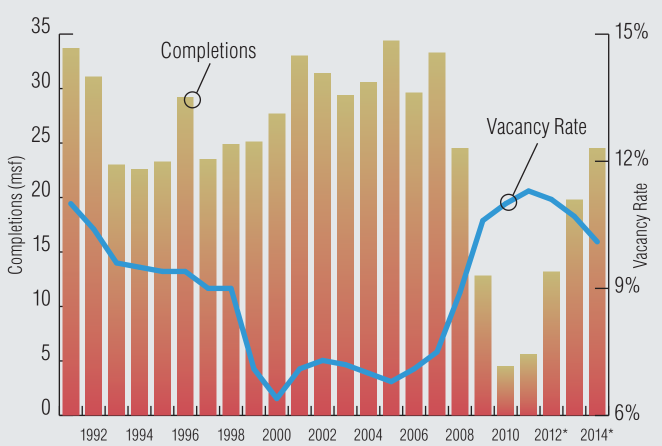
For 2012, the fortress centers and well-situated grocery-anchored retail—"like buying a bond"—will do well. "Neighborhood center buyers must be extremely selective about locations, targeting assets with the top local supermarket chains and highest sales-per-square-foot numbers." Major opportunities exist in burgeoning underserved or unserved Hispanic markets, especially in the Southwest and on the West Coast. "Population and income in these communities grow ahead of national trends. The opportunity exists to stake out centers in neighborhoods, which can evolve with their demographics."

Avoid

REITs strategically winnow portfolios, "selling cats and dogs." Buyers should think twice before making deals. "If the big mall companies couldn't make them work, why should anybody else have a chance?" Be very careful about upgrading strategies for older malls—"they probably require a different use"—and worry even more about power centers with lineups of too many commodity retailers, which may be vulnerable.

EXHIBIT 4-19

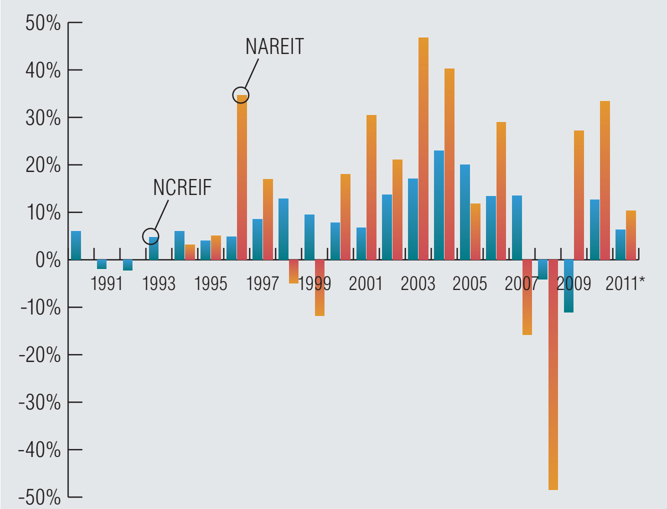
U.S. Retail Completions and Vacancy Rates



Source: REIS.
*Forecast.

EXHIBIT 4-20

U.S. Retail Property Total Returns



Sources: NCREIF, NAREIT.
*Data as of June 30, 2011.

Development

The United States simply does not need additional shopping center square footage, especially in old formats. Space per capita will undergo a major squeeze-down for the foreseeable future, but plenty of opportunity exists for redevelopment and redesign. Construction lending will be bifurcated: smaller players will have trouble scrounging financing from local and regional banks, whereas REITs and institutional owners can access credit lines from money-center institutions. Malls can reinvent themselves quickly, so expect local operators with reuse ideas to work with local governments on converting class C and D malls and attempt to turn around tax-base drains. "Some properties won't make it." "Luddites can build more traditional centers outside North America" in underserved, developing regions. Brazil is calling.

Outlook

"Very profound structural challenges" (online retailing competition) will continue to push "transformative, not cataclysmic" change in the shopping center world. "Outside of A/B+ malls [controlled by a REIT oligopoly] and select cash-cow neighborhood strip centers," the "environment looks very rugged." Although the recession claimed surprisingly few casualties, players "require clear-eyed realism" to recognize and capitalize on changes, or they could lose ground quickly.

Housing

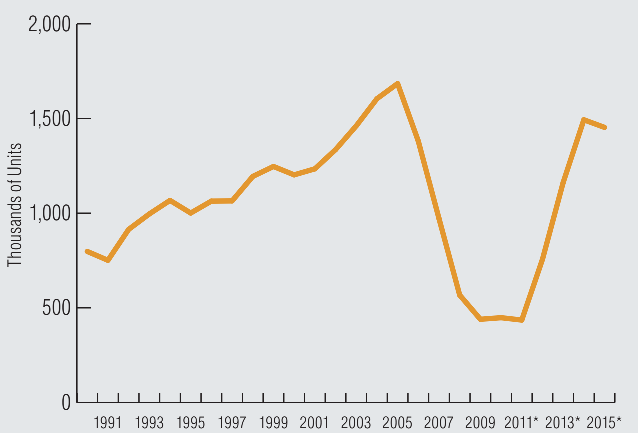
Strengths

New inventories "aren't out of whack." Surviving homebuilders manage to endure in near-shutdowns, "affordability is the best in decades," and the interest rate environment cannot get better. Markets continue to bump along the bottom, and stronger neighborhoods register some modest pricing gains. "If you take out the distressed, foreclosed product, values increase modestly" in most places, but to levels substantially below pre-crash peaks. Problems are concentrated in bubble-burst cities where the premise for building new homes was not job growth but selling to speculators and retirees. Formerly hot growth places with more diversified economies like Phoenix and south Florida can rebound faster than Las Vegas or central Florida. Banks necessarily go into slow motion on foreclosures, heeding nervous regulators. "They won't dump product and make things worse."

Weaknesses

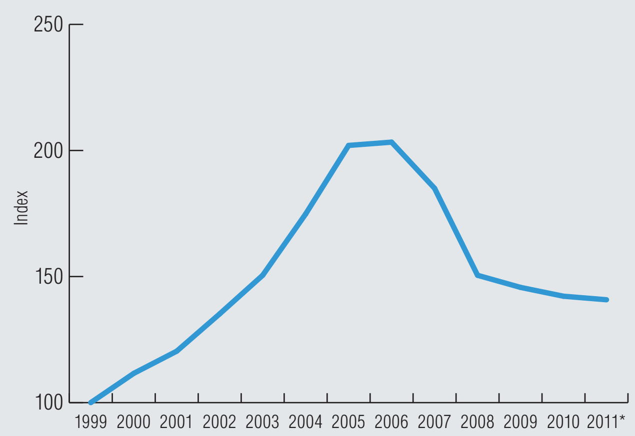
The surfeit of existing homes for sale and the discouraging dimensions of underwater homeowners harpoon the prospects for already-reeling homebuilders "stuck with land they can't develop." Any sudden move to clear the market without some cushion—either from lenders or the government—could upend millions of Americans, further deflate already-imploded values, and rattle the fragile economy. But enormous public sector deficits and antitax sentiment short-circuit proposals for government support ("bailouts") to overleveraged homeowners. Relatively few potential homebuyers have the confidence, equity, or credit ratings necessary to acquire homes, and the lugubrious jobs scene will continue to depress the number of house hunters. The government, meanwhile, delays action on Fannie Mae and Freddie Mac. Any reasonable regulatory solution likely will restrict licentious lending practices, necessarily moderating any future ramp-up in mortgage activity. "We won't have the same old formula of homeownership subsidized by the federal government," and the long-held belief in buying housing as a secure investment dies. Deflated second-home markets rely on luring a shrunken group of affluent buyers who have cash and shop for bargains. Does America really need another championship golf course community?

EXHIBIT 4-21
U.S. Single-Family Building Permits



Source: Moody's Economy.com.
*Forecasts as of August 2011.

EXHIBIT 4-22
The S&P/Case-Shiller Home Price Composite-20 Index



Source: Standard & Poor's.
Notes: Seasonally adjusted. *Data as of June 30, 2011.

Best Bets

Now is a great time to purchase that dream home or retirement condo in a prime location, but that's out of the question for most cash-strapped folks. In good neighborhoods, well-heeled private investors buy houses to rent and eventually will convert them back to for-sale homes when the market finally allows. In the meantime, they can secure rents to more than cover taxes and other expenses. Land bankers could eventually score by purchasing tracts for cents on the dollar, but they need to be prepared to hold nonproductive assets for (quite) a while. The seniors' housing wave has only just begun. Developers should cater to rising demand from downsizing empty nesters who want urban lifestyles and greater convenience without car dependency. In-town seniors' apartment housing could gain over suburban models. One caveat: the demise of pensions and recent stock market losses leave many aging Americans, and particularly baby boomers, in problematic financial straits. Larger percentages may not be able to afford seniors' housing product, living instead with children and grandchildren to pool resources, or staying in existing homes as long as possible. Student housing still has legs. The bulging generation-Y tail has about six or seven years to run, "but after that, the pig will have moved." Investors need to monitor impacts of reduced student aid on admission trends.

Avoid

Commodity subdivisions look sketchy, especially in areas with high default and foreclosure rates. Flagging living standards spell ongoing trouble for workforce housing neighborhoods; pricing could be chronically impaired. Oversized homes in fringe areas look like white elephants: on top of plunging values, who wants to pay the heating and maintenance bills? Many foreclosed or near-foreclosed assets exist in a wasting mode: nobody wants them and nobody maintains them. "It's ugly."

Development

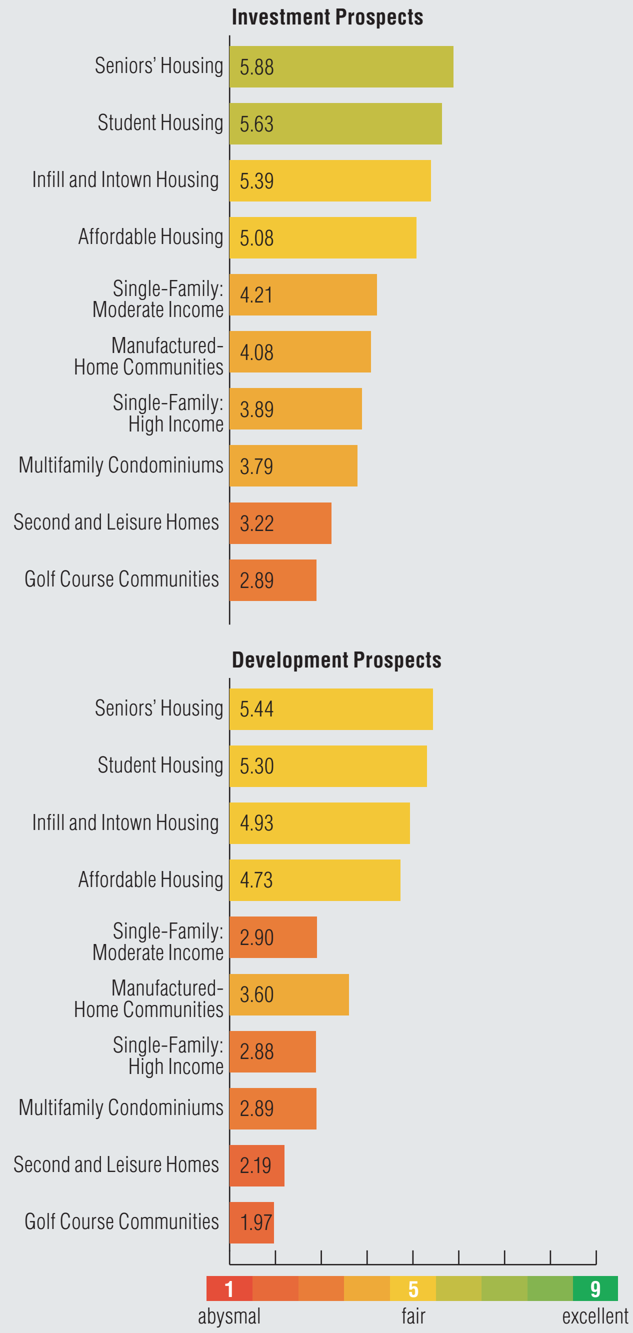
Here's a news bulletin: don't expect any large-scale homebuilding activity "for quite a while." About "3 percent of existing stock sits empty," while residential developers concentrate on the multifamily sector. Infill and in-town projects have much better prospects than greenfield subdivisions.

Outlook

Broken homeowners' psyches will take a long time to fix, and more Americans come up empty: they just cannot afford to buy in the Era of Less. Expect three to four more years of bottom slogging until the employment outlook improves enough to buttress buyer self-assurance and pocketbooks. Wealth-island neighborhoods will begin to strengthen and many infill markets have overcorrected, but any pricing rebounds will be measured, damped by anemic demand. The boom/bust's legacy may be generational tepid growth.

EXHIBIT 4-23

Prospects for Residential Property Types in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on U.S. respondents only.

Emerging Trends in Canada

"We're hedged against most bad outcomes.
It's hard to blow it here."

Appreciating their "island in the storm," temperamentally conservative Canadian real estate players grapple with tamping down unaccustomed overconfidence and wondering whether mostly stable property markets won't be buffeted by world economic turmoil, particularly U.S. contagion. Offsetting the increasing "global market risk," Canada's considerable aces in the hole remain "a robust banking system," the fiscally sound government, and rich stores of natural resources and commodities, as well as steady immigration. "If not for what's happening elsewhere in the world, Canada would be on fire. It makes a big difference when the government is not broke."

Investment Trends

Slowdown. For 2012, solid market recoveries could turn more muted, sustained by modest, "not stellar" income growth. Western provinces and Newfoundland will prosper as long as energy prices allow, while most of the east deals with an export/manufacturing slowdown and potential financial industry belt-tightening. According to an interviewee, "The downgrade of the American system and the volatile status of the oil patch make the economy fragile and unpredictable," and create more marketplace risk. Typically restrained Canadian consumers had been on uncharacteristic spending and homebuying binges encouraged by low interest rates, but their self-assurance has ebbed, and job growth has decelerated in response to all the noise about European and U.S. debt woes. Sensing a "general slowdown," interviewees signal taking a better-to-be-cautious investment approach. "Greed is off the table. We need to remember we're a small player in a big pond."

Strengths and Weaknesses. Canadian companies have strong balance sheets, and the overall economy is buffered

EXHIBIT 5-1
Firm Profitability Forecast 2012

Prospects for Profitability in 2012 by Percentage of Respondents

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

by exports of oil from Alberta oil sands, hydropower, potash fertilizers, and many minerals, including precious metals and industrial materials. The resource industry seeps into other sectors and helps support finance, accounting firms, and lawyers. Manufacturing concentrated in Ontario and Quebec "has become more problematic," hobbled by reduced U.S. imports and the strong Canadian dollar. "If Asia gets hurt by a consumer pullback in Europe and the U.S., then Canada won't escape pain" from further slippage in export demand. Banks "turn the screws" on lending to typically frugal Canadian consumers—average household debt suddenly eclipses U.S. levels—and, consequently, spending will subside. Economists cannot figure out why Canada's productivity badly lags that of the United States. "Maybe because the economy has more mom-and-pop, smaller companies, which haven't caught up to employing Fortune 500 efficiencies," one person interviewed speculates. While interviewees expect flat to slight growth in 2012, "we're more immune from shocks and less tied to the U.S. hip than ever before."

More Tentative Jobs Outlook. Canada's unemployment rate manages to stay nearly 2 percentage points below that of the more troubled United States, helped by the country's various resource industries. In Alberta, oil sands workers can easily make $100,000 a year, and both Newfoundland and the Maritime Provinces show signs of life thanks to recent offshore energy activity. Still, interviewees overall see "little jobs growth" and point to trends similar to those that constrict employment gains in the States. Formerly high-paying blue-collar manufacturing work declines, the victim of global competition, and office jobs requiring a financial skill set could be stymied by retrenchment in banking and investment-related businesses. "We need to develop more high-skilled manufacturing industries like Germany." If energy and commodity prices ever drop in a global economic recession, those high-paying energy sector jobs would be in peril, too, and the expected consumer pullback could hurt service sector businesses, including retailers. The employment scene looks "extremely flat without any apparent kick start," and "the fizz could easily go out of the market."

Lots of Money, No Product. Canada's resilient property sectors appear ready to weather any potential problems without severe distress. Occupancies of 90 percent and higher persist in a near steady-state equilibrium across most commercial markets from coast to coast. Stringent lending practices and mortgage regulation keep the housing sector healthy, and condominium developers prosper in further densifying 24-hour cores. Canadian pension fund owners and REITs seem well satisfied clipping coupons on most of the country's iconic office buildings and fortress malls. "It doesn't make sense to sell when you already have the best income-producing properties." As a result, substantial sidelined capital attracted to a safe haven finds slim pickings; partnering with local developers may be the only way for frustrated investors to break into closed office markets. But disciplined banks temper construction lending on speculative projects, limiting those opportunities and stanching potential overbuilding. By keeping capital at bay, Canada's real estate performs as advertised—providing steady cash flows and modest appreciation without much volatility.

EXHIBIT 5-2

Real Estate Business Prospects for 2012

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

Credit Culture. The country's "conservative credit culture" remains the foundation for relative stability, helping short-circuit the chance for boom/bust cycles that now routinely devastate U.S. real estate investors. Influenced by an immigrant ethos for building wealth off savings, Canada applies a heavy hand of regulation to its banking and investment sector. Borrowers need substantial equity or must take out loan insurance to get home mortgages; exotic CMBS and other security structures never found footing; and most business is financed by well-capitalized national institutions. "Any potential contagion would be contained within our borders." Now, a big problem for the country's sturdy banks and large public pension funds is where to invest capital in the face of limited domestic opportunities. Some of their biggest investment snafus come outside the borders in less-regulated markets, including notably the United States. Canada's solidity attracts a continuing influx of immigrants who undergird growth in burgeoning 24-hour cities and help sustain "an edge for the economy." They view Canada as a "safe place to come," where "ethnic groups not only feel comfortable at universities, but also stay after graduation."

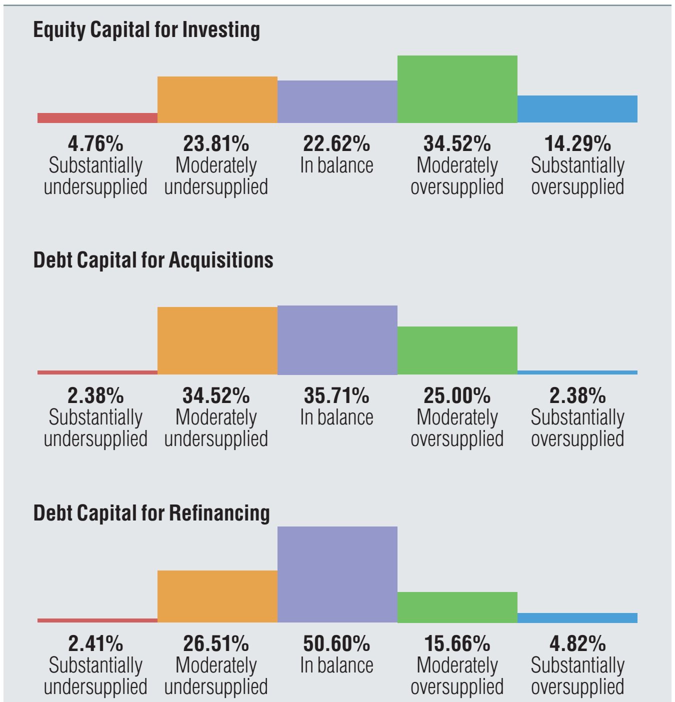
Unbound Urbanization. Noninstitutional offshore money can find a home in 24-hour-city condominium towers and upscale residential properties. Chinese capitalists with newfound wealth actively park cash in Vancouver and Toronto apartment units, leading to a wave of new construction. The transformation of skylines in other Canadian cities, including Montreal, Calgary, Ottawa, and St. John's, also begins with new high-rise, glass-and-steel box residential profiles as some local governments put growth boundaries into effect to discourage further suburban sprawl. Investors readily turn units into rentals to cover expenses, tapping intense demand from young professionals and empty nesters looking for urban action and greater lifestyle convenience. Retailers want to expand downtown footprints, too, and work with developers on "Eurostyle" mixed-use projects incorporating apartments on upper stories and stores along streetscapes and lower levels. Companies also rethink suburban office strategies, following gen Y talent back into the cores. Local governments, meanwhile, take advantage of in-town building activity. In Vancouver, Toronto (inside the 905 belt), and increasingly in Calgary, they saddle developers and homebuilders with "onerous" development fees to raise revenues in lieu of higher property taxes. Not surprisingly, infill land costs skyrocket: low-rise and even mid-rise projects become more uneconomical on small sites, so 50- and 60-story condo towers rise up in Greater Toronto. At some point, back-to-the-city trends may stall out due to escalating living costs: "It's becoming very expensive." Antisprawl laws also increase values on existing single-family homes within growth boundaries: they become more precious commodities, especially for families outgrowing all those cramped apartments.

Development. Commercial construction remains pretty tepid. Don't expect much office development in many markets; manufacturing weakness holds back most warehouse construction; and retail projects focus on infill developments tied to condominiums. Concerns increase about all the high-rise residential projects springing up in major cities, particularly Toronto and Montreal. "It's pretty scary when planners push density at developers, who start building 60-story condo towers and get 20 to 25 percent margins. They'll just keep building until it's just a matter of time [before] too many get built." Banks will become more nervous about lending standards for these projects. "You see a lot of apartments not sold on top floors of upscale buildings, which suggests a lack of depth in the market." Buyers in Vancouver and Toronto skew toward Asian investors and speculators, who rent most of the units. "This activity is unsustainable." Pure rental apartment developers cannot price out product against the condo competition, so they join in on the action. But many interviewees contend the condo wave can continue, supported by urbanization move-back-in trends and large numbers of immigrant renters. Minuscule residential vacancy rates support their views.

Some developer sector specialists work together in tight infill

EXHIBIT 5-3

Real Estate Capital Market Balance Forecast for 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

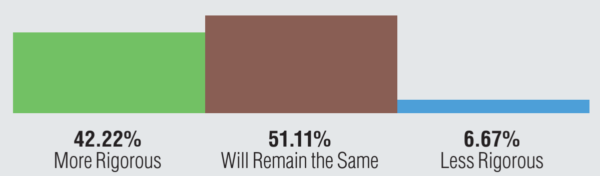
markets to build synergistic residential, retail, and office projects that combine uses at constrained sites. "Local government intensification policies force them to look at new forms and concepts to lower costs," and create more attractive projects that feature convenient amenities. Toronto adopts more streetscape retail, á la Manhattan.

Developers in Toronto, Vancouver, and Calgary grumble about staff cutbacks at planning agencies and lengthier government approval processes, not to mention skyrocketing fees and surcharges. Other significant developer gripes mentioned by interviewees include higher infill land costs, parkland setasides in the Toronto 905, parking requirements in the Toronto 416, and infrastructure funding shortfalls. Municipal regions clash over agendas and lack coordination in planning infrastructure and future housing needs, interviewees claim. Tenant demand for more sustainable projects focuses developers on LEED certifications: "It's become a significant leasing prerequisite," but hasn't translated into higher rents yet.

Capital Markets

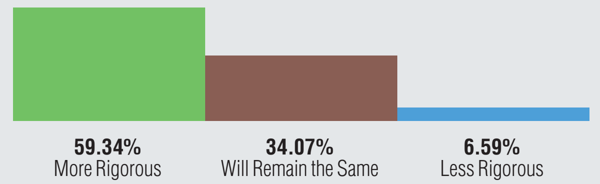
For 2012, *Emerging Trends* respondents forecast a continuing ready supply of both equity and debt capital for the real estate industry (exhibits 5-3, 5-4, 5-5, and 5-6), accompanied by increasing levels of lender scrutiny and vigilance. "Banks aggressively price mortgages, but lend cautiously," exercising greater due diligence. As usual, their high-credit, blue-chip clients with good track records have ready access to funds, while marginal players face much higher financing hurdles. "Debt may not even be available to suspect credit or new builders." Bankers also go through "more internal processes before extending loans"

EXHIBIT 5-4
Equity Underwriting Standards Forecast for Canada



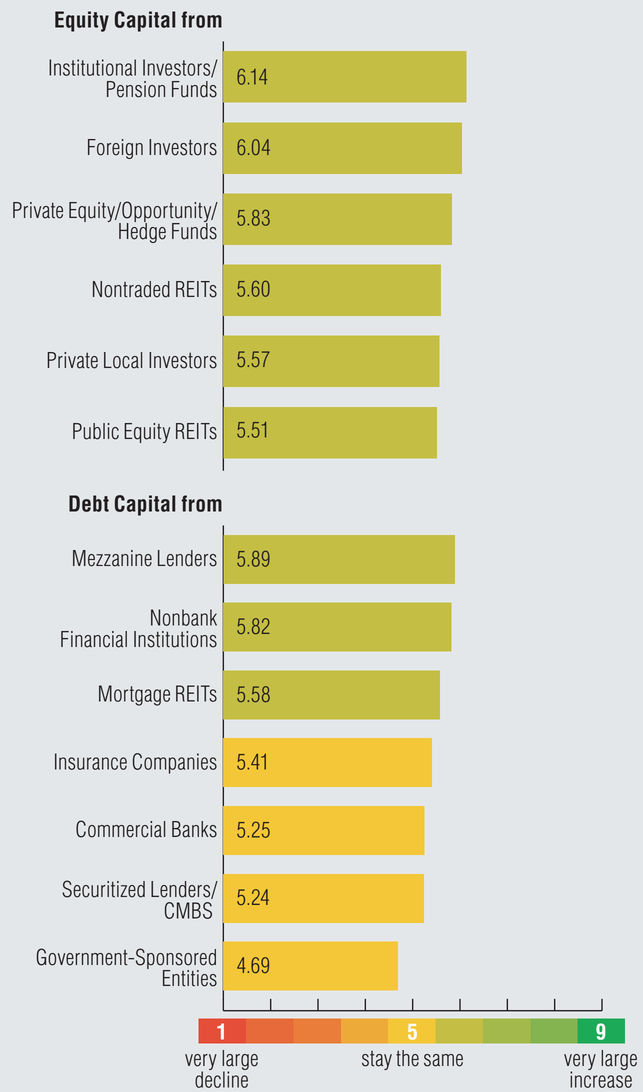
Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-5
Debt Underwriting Standards Forecast for Canada



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-6
Change in Availability of Capital for Real Estate in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

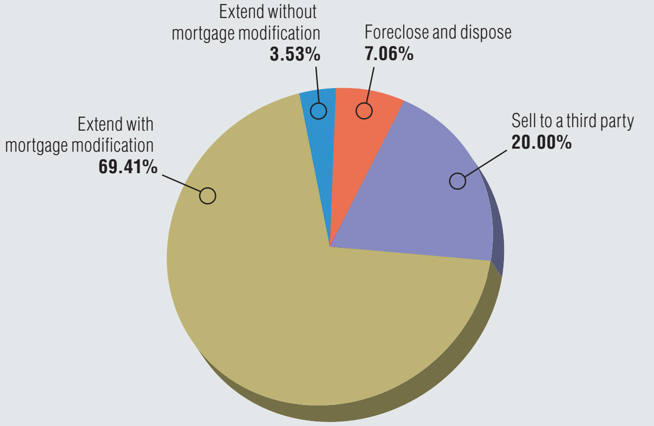
and require greater equity contributions from borrowers (exhibit 5-7). "The U.S. effect [debt crisis] influences policy and makes them even more disciplined. In Canada, bankers will always find something to pick on, no matter what point in the cycle." But who can argue with the approach. "Not a single mortgage over $10 million has defaulted."

Fed up with disappointing stocks and low-yielding bonds, investors sit on "lots of funds," "looking for long-term cash-flowing assets like real estate," but "have trouble placing the monies they have." Pension funds and other institutions "feel pressures to put dollars out" and condition themselves to accept lower domestic returns or go overseas to "chase higher yields." REITs using "cheap" bank lines of credit have been more aggressive than institutional investors, pushing up pricing to potentially discomfiting levels. Some interviewees have raised a concern that some of the REITs may not have been as rigorous in their underwriting, and projected cash flows may not pan out. Their lower cost of capital and easy access to credit allows them to take the lead on new development as well. To foreign investors, Canada looks like a reliable bet compared with most other regions, as well as a highly ethical and transparent country "where it is easy to do business." But entrenched REITs and pension funds that hold on to assets "easily squeeze" offshore institutions out of markets. The majority of foreign activity concentrates in Asian flight capital targeting condominiums in the gateway cities.

Transactions. Ample capital scouring markets dominated by long-term holders signals diminishing prospects for buyers in

EXHIBIT 5-7

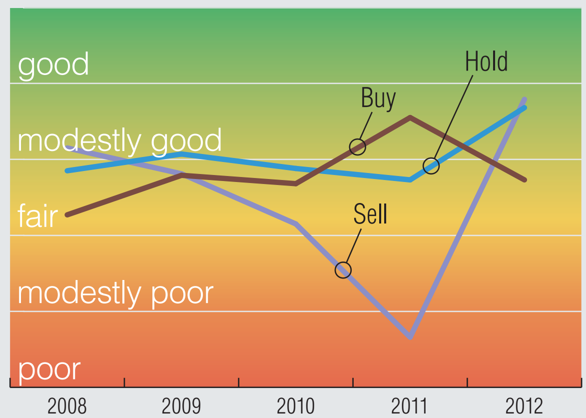
Maturing Loans: Preferred Strategy for Lenders by Mid-2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-8

Emerging Trends Barometer 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

2012, an outlook reinforced by the *Emerging Trends* buy/hold/sell barometer (exhibit 5-8). Buying sentiment declines from 2011's apparent cyclical pinnacle while selling interest spikes sharply: owners realize they should strike before capital turns tail. "The smart money takes chips off the table, selling into the peak, but holds off reinvesting and counts gains." This portends a continuing sluggish transactions market where relatively few deals trade at high (if not outrageous) prices, with most players backing off and contentedly holding on to what they have. "Institutions will continue to complain they have nothing to buy, but won't sell because it's too hard to replace."

Cap Rates and Values. The low-trading, core-oriented real estate market compresses capitalization rates back toward 2007 lows. Some interviewees predict "a permanent shift downward closer to European levels" based on enduring supply/demand equilibrium and ownership dominated by institutions. "The days of 8 percent to 10 percent yields are gone." But a majority of interviewees counter that the prospect for higher interest rates eventually will push cap rates up absent growth in rents, which historically stay relatively flat. They suggest a leveling to slight increase in rates for 2012, led by suburban office and power centers (exhibit 5-9). Under any circumstances, investors should prepare for lower returns over time, including a modest correction in commercial values for properties in secondary markets. Institutional-quality property probably registers modest value gains in 2012.

EXHIBIT 5-9

Prospects for Capitalization Rates

Property Type	Cap. Rate August 2011 (Percent)	Expected Cap. Rate December 2012 (Percent)	Expected Cap. Rate Shift (Basis Points)
Apartment: High Income	5.40	**5.43**	3
Apartment: Moderate Income	5.75	**5.69**	(6)
Regional Malls	5.92	**5.94**	3
Central City Office	6.14	**6.15**	2
Warehouse Industrial	6.65	**6.60**	(6)
Power Centers	6.55	**6.67**	12
R&D Industrial	7.00	**6.95**	(5)
Neighborhood/Community Shopping Centers	6.98	**6.95**	(3)
Suburban Office	7.02	**7.16**	13
Full-Service Hotels	7.60	**7.66**	6
Limited-Service Hotels	7.81	**7.88**	8

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

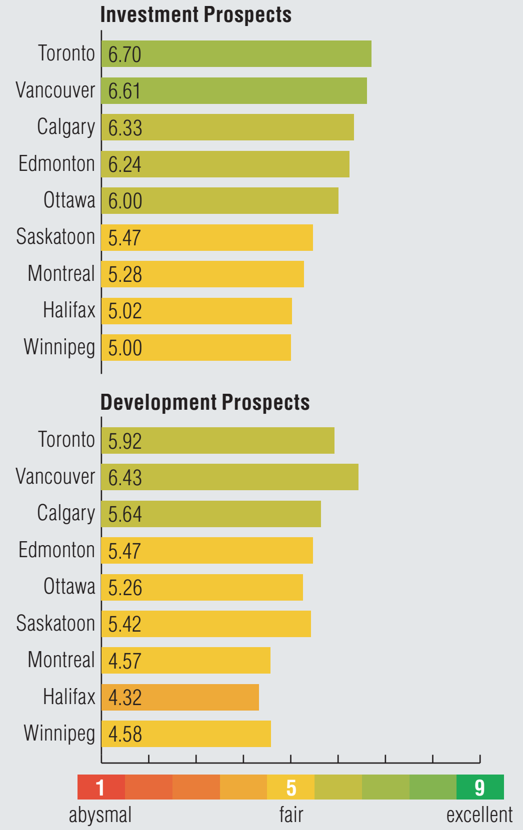
Markets to Watch

Toronto and Vancouver retain their top survey rankings, boosted by international gateway status and diversified economies. Calgary and Edmonton rebound with recent energy market gains, while Ottawa benefits from its large and sustaining government jobs base. Montreal holds steady, and Halifax shows new strength from ramped-up energy exploration activity off the East Coast. In general, major metropolitan areas actively encourage development of downtown residential space and try to discourage suburban sprawl, creating growth boundaries. They look to control costs on building and maintaining expensive transportation, sewage, and water infrastructure to outlying districts, and to relieve increasing traffic congestion. These moves should enhance already-attractive 24-hour environments in these cities and position them to deal with expanding populations over coming decades. Local planners may need to pay greater attention to providing parks and other recreational space in and around new condominium corridors located near center cities. Especially in Toronto, the proliferation of new apartment towers leaves residents without immediate access to playing fields or nearby green environs. The accommodations may work for young professionals more interested in the local bar and restaurant scene, but do not accommodate the needs of families with children. Limitations on single-family housing projects, meanwhile, increase values on highly coveted suburban homes located in inner rings. Some interviewees wonder whether prices will become unaffordable for many families, killing the dream of marrying and raising children in a house and yard.

Toronto (1). Canada's preeminent global gateway, Toronto dominates the country's business landscape, concentrating financial services and industrial activity. "It's where people want to be: the bulk of immigration heads there." In a "close to bulletproof" office market, rents have firmed just as the important banking sector starts to cut back, "putting a cap on office development." Institutions own 75 percent of downtown buildings: "They effectively work in concert to keep vacancies low and avoid shooting themselves in the foot." "Spotty" suburban office space suffers from move-back-in trends favoring downtown locations. Commercial nodes situated near mass transit stations perform better. About half the nation's industrial space is located in the Greater Toronto area (GTA); the manufacturing dip hits older warehouses harder, but new higher-ceiling space

EXHIBIT 5-10

Canadian Markets to Watch: Prospects for Commercial/Multifamily Investment and Development



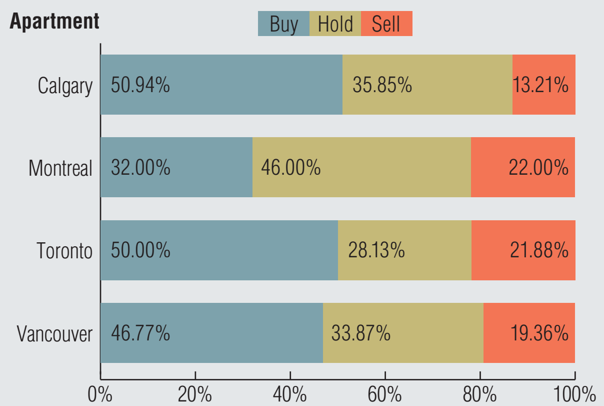
Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

leases up. High land costs will restrain new industrial building and help tighten vacancies. Most attention focuses on residential space. "We're the hottest housing market in North America, and probably the hottest condo market in the world." Despite more than a decade of seemingly nonstop high-rise construction concentrated in the city's core, relentless renter demand from immigration and in-migration from other provinces and the countryside absorbs about 40,000 units annually and keeps inventories low. "Lender presale requirements, including hefty buyer downpayments, protect against unbridled speculative development," and Asian investors keep purchasing units to rent out. Developers figure "let's ride the wave as long as we can"—more than 70 projects head skyward—"but it can't continue like it's been going." Government intensification mandates escalate land prices in suburban nodes like Mississauga, where developers cannot make money without going the high-rise route. Nosebleed land prices and development restrictions inside the greenbelt also hobble homebuilders' entitlement efforts, so existing single-family home prices spike on average above $500,000. Outside the greenbelt, home prices are lower, but the trade-off is much longer commutes. Homebuilders fare poorly in these 905 suburbs, too, because sizable government development charges—up to $60,000 per house—cut into profits. Toronto rapidly transforms into a vertical world.

Vancouver (2). Canada's beautiful Pacific-facing gateway, Vancouver experiences ongoing real estate spikes precipitated by a surge of Asian flight capital flooding into residential markets. Chinese and other Pacific Rim–nation buyers willingly pay multimillions of dollars for penthouses in new high-rise projects, which have taken over the city's core, as well as suburban manses. Local players talk confidently about maintained demand but realize any change in China's political environment would mean "slippage" or at least leveling off in what some interviewees term the "overpriced" condo market. Separately, a repeal of housing sales taxes and delayed imposition of new provincial tax policy could freeze transaction activity until pricing implications become more certain. Under any circumstances, geographic barriers-to-entry—mountains, ocean, and bays—restrict new development opportunities and help sustain real estate values. Commercial trade, regional commodity markets, energy companies, and financial services all expand, firming up occupancies and rents. Downtown is mostly built out. Enough pent-up demand exists to absorb space in two recently completed boutique office projects, keeping vacancies comfortably in the mid- to high single digits. Several other modest projects totaling about 600,000 square feet will not be completed until 2014 or 2015. Developers concentrate residential and commercial projects around stations near the city's popular and expanding Skytrain mass transit network. The availability of reliable train service coupled with Vancouver's carbon tax has changed commuting patterns and reduced driving into downtown. Interviewees complain about "extortionist" development fees and call for a long-term, regional strategy for planning residential areas, commercial districts, and green space to serve an expanding population and protect highly desirable, but increasingly crowded environs.

EXHIBIT 5-12

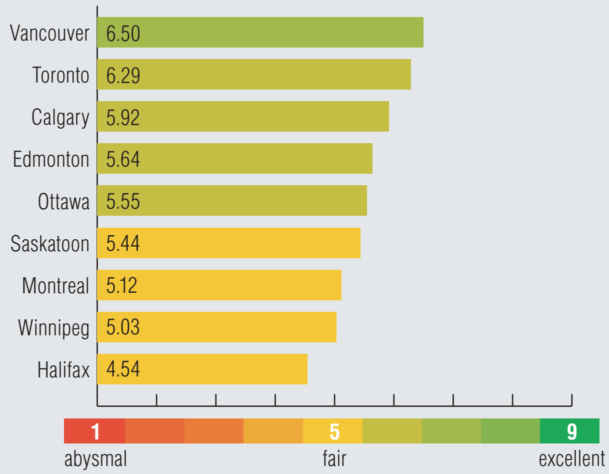
Canadian Apartment Buy/Hold/Sell Recommendations by Metropolitan Area



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

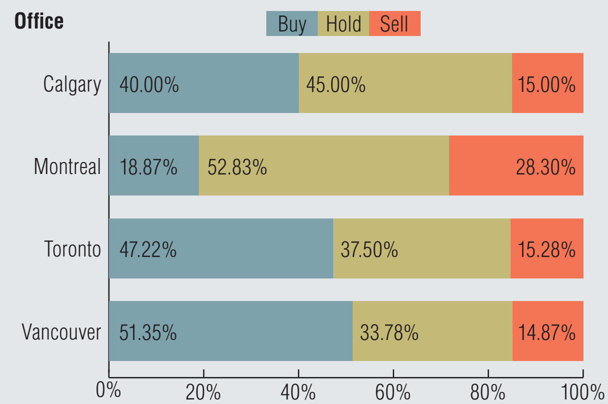
EXHIBIT 5-11

Canadian Markets to Watch: Prospects for For-Sale Homebuilding



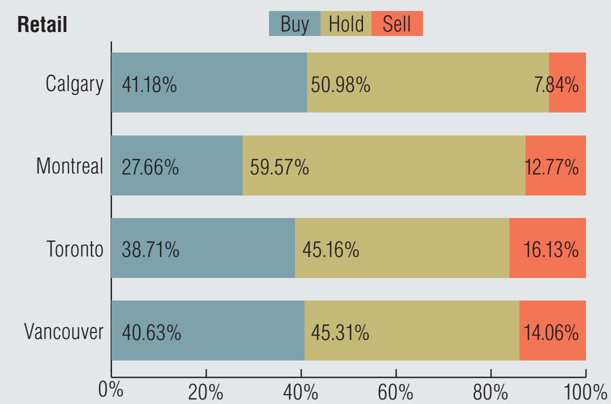
Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-13
Canadian Office Buy/Hold/Sell Recommendations by Metropolitan Area



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-14
Canadian Retail Buy/Hold/Sell Recommendations by Metropolitan Area



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

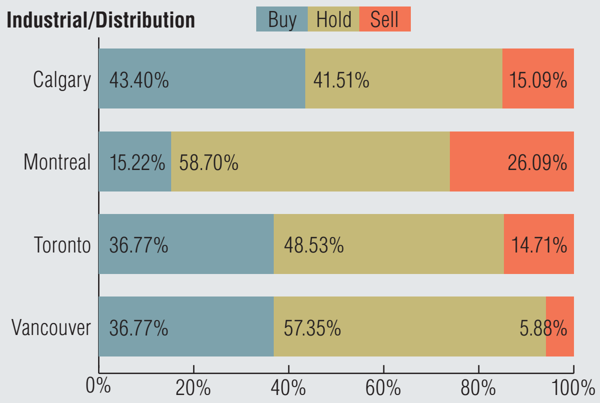
Calgary (3). Canada's hot growth mecca, Calgary can boom and bust suddenly. Down last year in the midst of a too-much-new-development "train wreck," the city rebounds overnight in concert with resurging regional energy companies. "Calgary is quite independent from the rest of the country. The market depends entirely on demand for oil and gas." Office vacancies recently in the midteens quickly decline into single-digit territory again. "The new construction digested quickly, so more will be on the way with oil companies back in expansion mode." The market's big question for the future is whether the United States approves a new oil sands pipeline through Alberta into the States in the face of environmental challenges. "All eyes turn to D.C." A go signal could rev up the market to another level. More sprawling than other Canadian cities, Calgary sees local leaders take steps to densify the downtown and discourage unfettered suburban expansion. Mass transit development gets into gear, and condo projects begin to form more of a residential footprint in and around downtown. Green and sustainability initiatives gain less traction in Big Oil country. If you want to gauge Calgary's prospects, just keep tabs on energy prices.

Edmonton (4). Another oil sands market and the gateway to the north (both for oil sands and for mining industries in the Northwest Territories), Edmonton quietly prospers in less of a seesaw mode, historically cushioned by the presence of the provincial government. Construction costs (labor) are escalating in Alberta for 2012, and there is some carryforward of 2011 backlog projects into next year. "The commercial tenancy differs from Calgary, featuring more stable engineering companies and not so many wildcatters." Absorption is slower and steady—not so volatile—but the city still is driven by the health of the energy industry. Locals wonder if heightened government budget discipline might temper demand and soften the market. Commercial development activity remains relatively restrained, and local leaders aim to push residential construction closer to the city core where new contemporarily designed arts center and museum buildings provide the sleepy, 1980s-style downtown with a shot of pizzazz. The industrial market tightens to almost microscopic vacancies; warehouse and distribution centers service the extraction activity due north of the city. Retail also does well: workers earn big bucks in oil sands country and spend in local malls and power centers, including one of the world's largest in west Edmonton. Homebuilders do extremely well throughout Alberta: ample salaries support large homebuying appetites. Local governments take advantage by hiking development assessments. "It's good political optics versus raising property taxes."

Ottawa (5). The nation's capital throws off returns like a reliable bond: high occupancies and steady rents generate decent yields with the opportunity for "mild growth." New product rarely trades, and landlords cannot find a more creditworthy tenant than the federal government, which leases most of the market's space. But will government budget paring lead to rising vacancies? Although lease terms shorten for government deals, the public sector "has never stopped growing." Any reversal would send shockwaves through both commercial and traditionally stable residential markets. New laws mandate green measures and access for the handicapped in government-tenanted properties, requiring renovations for older buildings to stay competitive. As in other cities, residential devel-

EXHIBIT 5-15

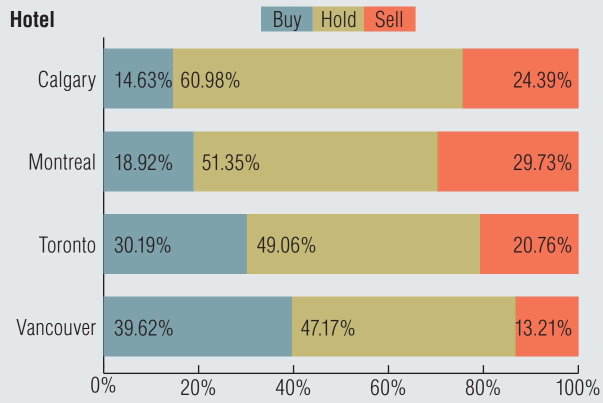
Canadian Industrial/Distribution Buy/Hold/Sell Recommendations by Metropolitan Area



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-16

Canadian Hotel Buy/Hold/Sell Recommendations by Metropolitan Area



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

opment features high-rise construction, and population growth concentrates within urban boundaries. Old hotels charge "shockingly low" room rates despite higher-than-average occupancies; developers come up empty for financing new lodging product.

Montreal (7). One of North America's most attractive cities, Montreal transforms itself, converting from old manufacturing to new-economy industries, including high tech, health care, electronics, and web design. Two new hospital complexes are under construction, and major universities like McGill and the University of Montreal lure 200,000 students into the city, helping energize the new direction. "Quebec is ahead of other provinces in using education as a business catalyst." Younger workers want to live downtown, which features an array of cultural, entertainment, and sports attractions, and eager developers jump-start condo construction, now second only to Houston in North America. Plenty of available sites along the St. Lawrence River offer outstanding views of the cityscape. Land is cheaper than in either Toronto or Vancouver, and most units sell to owner-occupiers, not speculators. Bell Canada's move to a new suburban office complex has softened downtown Class A space and mothballed construction for years. However, two or three multiuse projects, including residential and retail elements, finally may come off the drawing board to meet renewed urbanizing demand. The industrial sector presents a weak spot: the strong Canadian dollar and U.S. problems dim the important manufacturing sector. The same issues hurt hotel businesses: travel from the States remains extremely lackluster. But the city regains its footing, leaving behind past political turmoil over language and secession, which scared away business and limited growth.

Halifax (9) and the Maritimes. Halifax and other Maritime cities draw more investor and developer attention now that energy companies are moving into the region to exploit newly discovered offshore oil and gas reserves. A venerable government/military/university town, Halifax has lagged other Canadian cities in urbanizing trends. Residential and office development concentrates in easy-to-build peripheral areas away from the "hollowed-out" downtown, where preservation-related restrictions and lack of forward-thinking planning for swaths of government-owned land have sidelined builders for years, interviewees say. Low downtown office rents also stymie any case for new projects. With Halifax not being much of a condominium market, apartment developers find a more open playing field there than in other Canadian cities. "You see lots of cranes in the burbs."

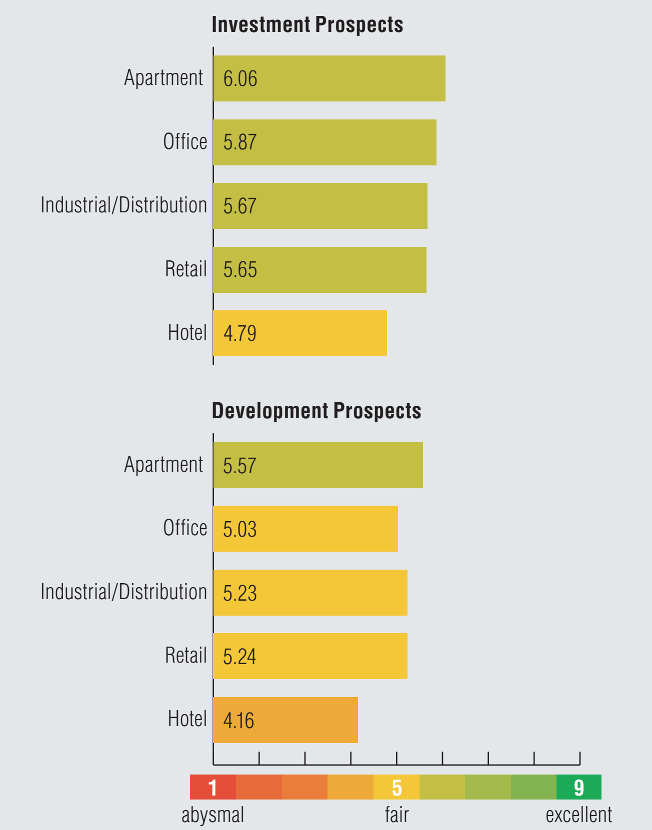
Other Markets. In **Quebec City**, the provincial government undergirds a mature market always in the shadow of Montreal. Apartments, as well as office, retail, and industrial space, all show high occupancies, providing steady returns. Office and industrial properties offer best development opportunities. Condo construction will slow as demand softens. . . . Small but booming, **St. John's**, Newfoundland's biggest city, catches fire from the sudden energy boom. "No commercial space is available; there's zero vacancy." The scramble by energy companies and related businesses to glom onto the offshore action "pushes hotel and office rates up to Toronto levels." Left off radar screens for years, the town needs new building and upgrades to outmoded facilities. "We need new everything"—condos, hotels, offices—but limited numbers of sites, high union costs, and environmental regulations will complicate development initiatives and increase costs. For now, "institutions have nothing to buy." . . . In New Brunswick, **Fredericton** and **Moncton** could also be development plays. Local families make very strong returns. . . . The prairie outpost of **Saskatoon (6)** benefits from oil patch spillover and a favorable commodity cycle, including flush potash prices. Investors cannot find much to buy because there is not much to trade. "Local owners are holders." The market "could be a development play. It's a place to watch for the future." . . . **Winnipeg (9)** boasts some of the nation's lowest office, retail, and industrial vacancy rates, but offers limited investment opportunities.

Property Types in Perspective

In 2012, Canada's property sectors, except hotels, should bathe in a comfortable equilibrium of high occupancies, steady

EXHIBIT 5-17

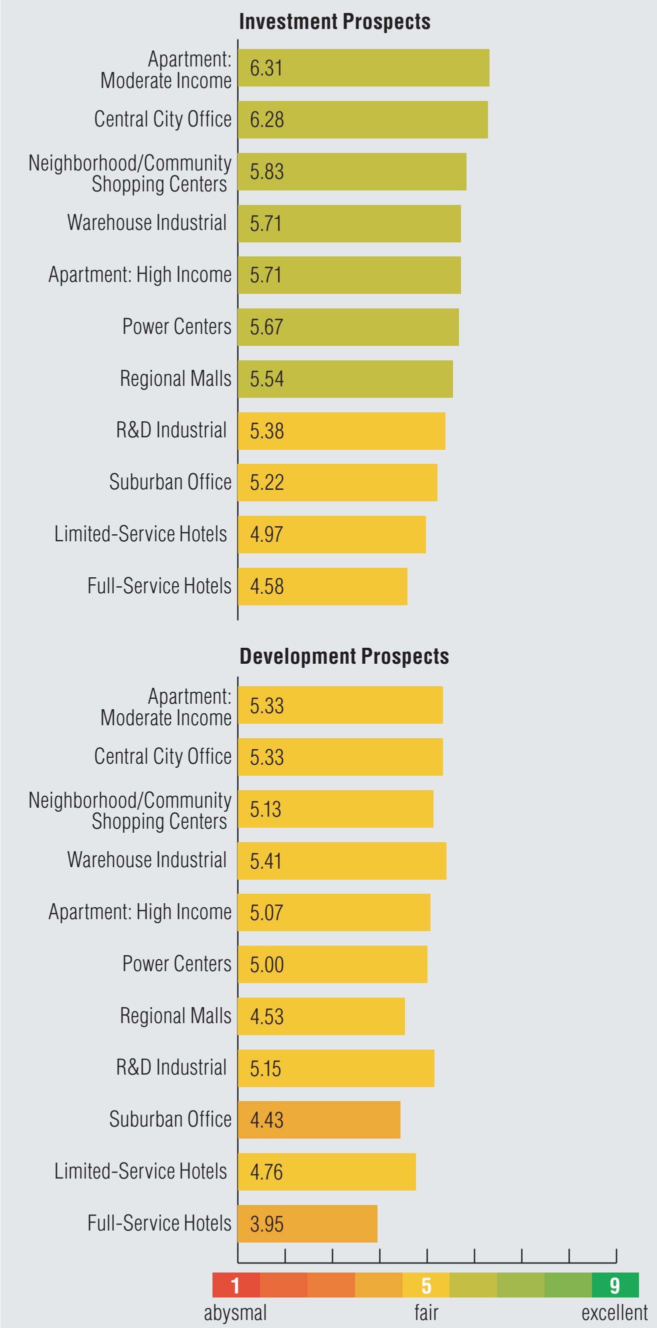
Prospects for Major Commercial/Multifamily Property Types in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-18

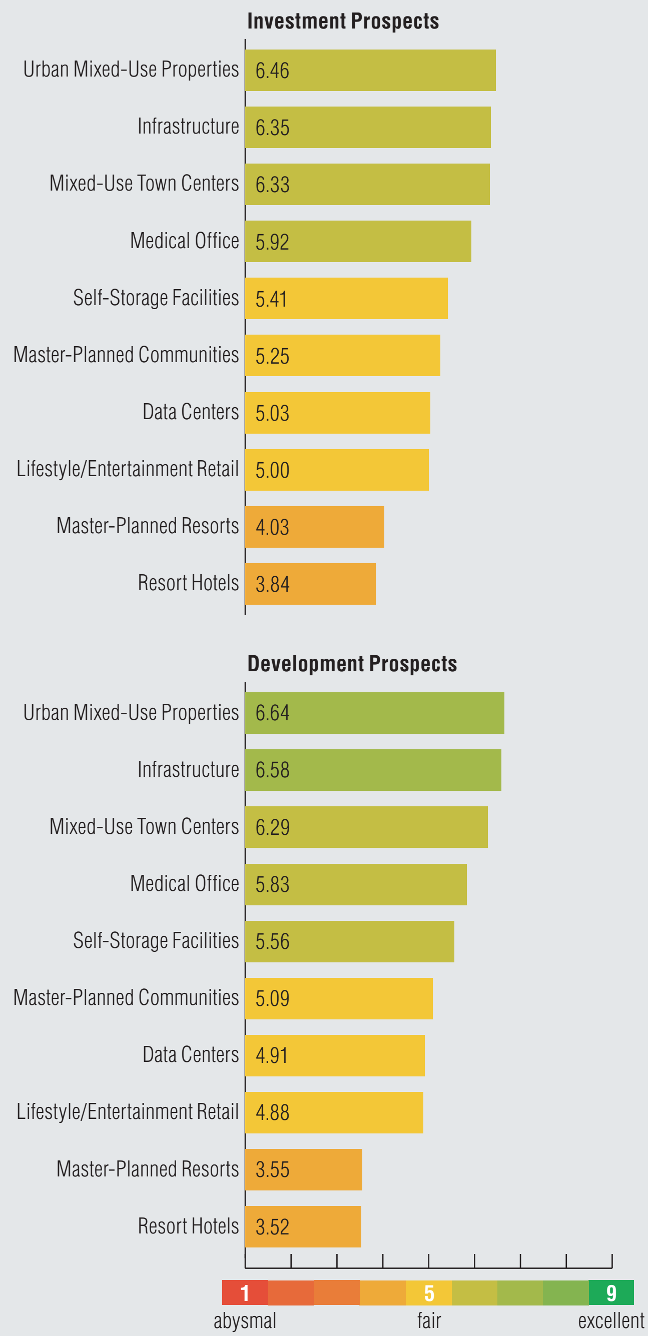
Prospects for Commercial/Multifamily Subsectors in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-19

Prospects for Niche and Multiuse Property Types in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

rents, and level demand. Vacancy rates settle in the mid- to high single digits across office and industrial markets, and even lower in retail and apartments. Development remains controlled without the threat of overbuilding unless buyer demand for condominiums declines dramatically in Toronto, Vancouver, and Montreal. For investment, survey respondents favor apartments, downtown offices, and neighborhood shopping centers over suburban office space and hotels (exhibit 5-18). On the development front, "everything looks stable; rents are about the same as ten years ago, and all the caution about the world debt crisis will keep construction under control. It's more of the same."

Apartments. The multifamily residential sector will stay tight as continuing immigrant flows sustain demand in the major cities. Even if job growth declines and homebuying cools, apartments should be "a safe haven." When people have less, they rent. Increasing numbers of younger adults delay buying houses; they simply cannot afford them after recent price spikes. Aging demographics also favor more apartment demand: empty nesters and seniors move out of suburban homes into smaller, easier-to-maintain units with urban conveniences. Apartment developers can readily obtain construction financing, but thin margins dampen interest: renters look for higher-finish condo-quality buildings,

EXHIBIT 5-20

Canadian Apartments—Moderate Income

2012	Prospects	Rating	Ranking
Investment Prospects	6.31	Modestly Good	1st
Development Prospects	5.33	Fair	3rd

Buy	Hold	Sell
51.7%	39.7%	8.6%

Expected Capitalization Rate, December 2012 5.7%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-21

Canadian Apartments—High Income

2012	Prospects	Rating	Ranking
Investment Prospects	5.71	Modestly Good	5th
Development Prospects	5.07	Fair	6th

Buy	Hold	Sell
29.8%	52.6%	17.5%

Expected Capitalization Rate, December 2012 5.4%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

conditioned by all the condo units for rent. Until the market turns, developers do better building condos instead. Investors "can never get their hands on enough apartments. And everybody has the same idea. When you get some, hold onto them."

Retail. Unlike the United States, Canada has not overbuilt stores, and many burgeoning residential districts in downtowns are underserved. Expected declines in consumer spending should not precipitate major problems: landlords anticipate leveling cash flows and minor vacancy increases from low- to mid-single-digit levels. Some U.S. retailer bankruptcies actually open up space for new U.S. chains previously shut out of markets. REITs and pension fund owners work "cozily" with tenants in "an oligopoly" to avoid overbuilding and maximize sales in existing malls. Neighborhood shopping centers in prime suburban areas do well, too: planning controls on sprawl limit competition from too much commodity development. Most of the new construction activity will concentrate in cities as part of high-rise residential projects. Retail and condo developers join forces to meet growing urban demand for stores and provide better amenities for projects in a win-win collaboration. "Urban retail is where it's at—not only mixed use, but also low-rise sites and street-level forms." Internet impacts "feel more like a continuum and evolution" because bricks-and-mortar sites are not oversupplied. Some retailers carry less inventory and use less storage space.

Industrial. The lingering U.S. export malaise continues to dampen outlooks for Ontario industrial markets, especially for owners of older, low-ceiling space, which is threatened by obsolescence. Investors follow tenants, who gravitate to newer big-box distribution product. Excellent absorption of these high-

EXHIBIT 5-22
Canadian Neighborhood/Community Centers

2012	Prospects	Rating	Ranking
Investment Prospects	5.83	Modestly Good	3rd
Development Prospects	5.13	Fair	5th

Buy	Hold	Sell
30.6%	41.9%	27.4%

Expected Capitalization Rate, December 2012 7.0%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-23
Canadian Power Centers

2012	Prospects	Rating	Ranking
Investment Prospects	5.67	Modestly Good	6th
Development Prospects	5.00	Fair	7th

Buy	Hold	Sell
15.3%	61.0%	23.7%

Expected Capitalization Rate, December 2012 6.7%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-24
Canadian Regional Malls

2012	Prospects	Rating	Ranking
Investment Prospects	5.54	Modestly Good	7th
Development Prospects	4.53	Fair	9th

Buy	Hold	Sell
33.9%	54.2%	11.9%

Expected Capitalization Rate, December 2012 5.9%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-25
Canadian Warehouse Industrial

2012	Prospects	Rating	Ranking
Investment Prospects	5.71	Modestly Good	4th
Development Prospects	5.41	Fair	1st

Buy	Hold	Sell
46.6%	37.9%	15.5%

Expected Capitalization Rate, December 2012 6.6%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-26
Canadian R&D Industrial

2012	Prospects	Rating	Ranking
Investment Prospects	5.38	Fair	8th
Development Prospects	5.15	Fair	4th

Buy	Hold	Sell
32.7%	50.9%	16.4%

Expected Capitalization Rate, December 2012 6.9%

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

ceiling facilities offers opportunities for developers to replace old warehouses on well-located sites. Interviewees wonder if car manufacturing will ever recover because automakers shift facilities to cheaper plants in right-to-work states south of the border. “They won’t be building new plants in Canada.” The near-par exchange rate also hurts the industrial sector: Canadian goods no longer look as cheap to U.S. buyers. But demand intensifies for new data centers: companies outgrow old space and need to accommodate new technology for backing up systems and disaster recovery. “The cloud needs to go somewhere.”

Office. Institutional investors and REITs cuddle their class A downtown towers in the primary 24-hour cities. They have no intention of letting go of these cash-flowing babies in markets stuck in near-perpetual supply/demand balance. “Any supply bulge from the 2009 recessionary blip has been absorbed,” but owners need to keep close tabs on decisions from Bay Street executive suites in Toronto and government budget hawks in Ottawa and Edmonton. Will workforces in these cities be slimmed down? At the very least, interviewees have trouble identifying sources of new job growth to create pressure on rental rates, except in energy markets as long as oil prices and demand stay up. On average, “don’t expect any increases”; trophy buildings may register slight upticks, while class B buildings may get nicked. “It looks like a flat market for 2012.” Investors grow more leery about suburban locations: traffic congestion and move-back-in trends work against them. “Without barriers to entry, suburban nodes don’t hold value as well.” Investors must be “more agile” and market-time quick exits. “The challenge for larger suburban commercial districts is how to turn into full-fledged cities” by building the proper transit infrastructure. Companies and their workers “want greater convenience and avoid car dependency.” Tenants show signs of following the lead of U.S. companies, “jamming more people into less space. It may never go back to the old ways.” They also want to manage energy costs and pay attention to LEED ratings. “Their issue is expenses, not environmental consciousness. They still ask for more parking spaces.”

EXHIBIT 5-27

Canadian Central City Office

2012	Prospects	Rating	Ranking
Investment Prospects	6.28	Modestly Good	2nd
Development Prospects	5.33	Fair	2nd
Buy 43.9%		Hold 47%	Sell 9.1%
Expected Capitalization Rate, December 2012		6.2%	

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-28

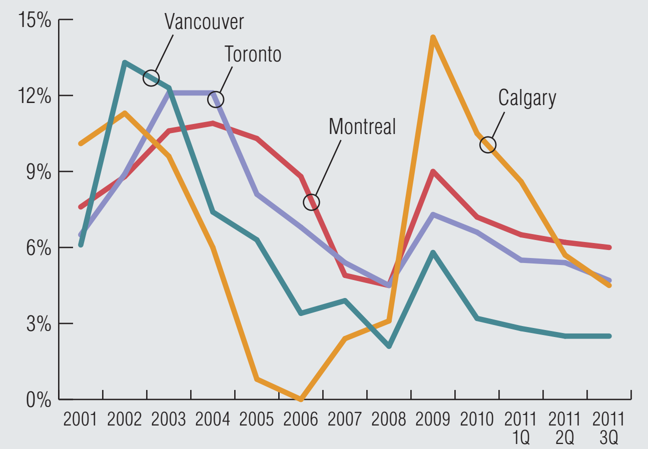
Canadian Suburban Office

2012	Prospects	Rating	Ranking
Investment Prospects	5.22	Fair	9th
Development Prospects	4.43	Modestly Poor	10th
Buy 14.3%	Hold 50.8%		Sell 34.9%
Expected Capitalization Rate, December 2012		7.2%	

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-29

Canada: Downtown Office Vacancy—Class A Space



Source: CBRE

Hotels. The lodging sector hobbles along. A weak U.S. dollar continues to discourage cross-border visits. At least, “liquidity is back and the better stuff trades,” though significant yield spreads separate “trophy and trash.” This gap is “not nearly as wide in other sectors.” Financing for acquisitions or new projects remains “very difficult” compared with “unavailable” several years ago. Established business center hotels in Toronto and Vancouver hold their own without new competition and can score high occupancies during the workweek. Resort and vacation destination properties suffer from restrained tourist demand, while suburban and limited-service hotels struggle to raise room rates. Many properties bought at or near market peaks look a little ragged around the edges as struggling owners delay capital upgrades. On a bright note, in St John’s the revved-up resources business leads to new development. Room rates have rocketed at the limited number of existing hotels.

EXHIBIT 5-30
Canadian Hotels—Limited Service

2012	Prospects	Rating	Ranking
Investment Prospects	4.97	Fair	10th
Development Prospects	4.76	Fair	8th
Buy 18.8%	Hold 50.0%		Sell 31.3%
Expected Capitalization Rate, December 2012		7.9%	

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

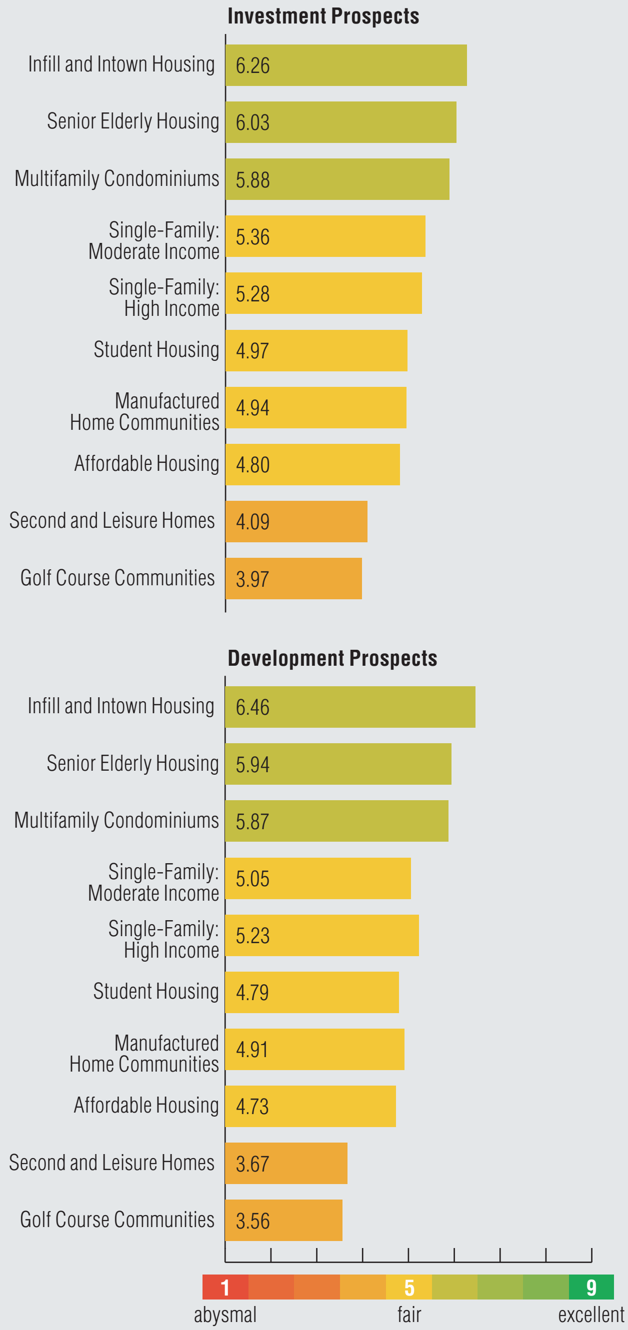
EXHIBIT 5-31
Canadian Hotels—Full Service

2012	Prospects	Rating	Ranking
Investment Prospects	4.58	Fair	11th
Development Prospects	3.95	Modestly Poor	11th
Buy 14.6%	Hold 54.2%		Sell 31.3%
Expected Capitalization Rate, December 2012		7.7%	

Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

Housing. Tightening credit standards in the wake of consumer splurging puts a wet blanket on Canadians' recent homebuying bender. "Low interest rates caused distortion in housing and consumption. People didn't know where to put capital; housing seemed like the best place to go." Interviewees expect an ongoing "pullback from the golden mean" as the economy levels off and when "interest rates inevitably tick up." Any correction should be mild compared with that in the United States. Mortgage borrowers must put down significant equity stakes to obtain loans and take out insurance in case of default. The Asian investment boom in "frothy" gateway-city condominiums—"the first thing you do in China when you make money is invest in Canadian real estate"—likely will run out of gas, but maybe not in 2012. Developers need to read the Asian market tea leaves carefully. "The party can continue as long as these investors don't see opportunities elsewhere" or don't face a reversal of fortunes back home. In the meantime, condo inventories sit at historic lows, helping drive up prices, and projects cannot obtain

EXHIBIT 5-32
Prospects for Residential Property Types in 2012



Source: *Emerging Trends in Real Estate 2012* survey.
Note: Based on Canadian respondents only.

financing without significant presales and substantial (15 to 25 percent equity) deposits. "Developers also have the right to sue for specific performance on the entire sales price if buyers try to back out." Affected by government intensification policies and European-inspired greenbelts, infill land costs escalate to eye-popping numbers in site-restricted 24-hour-city neighborhoods, especially around Toronto and Vancouver. Land bankers can score grand slams on projects thanks to their lower basis or jam through hard bargains partnering with developers looking for sites. "In core areas around the GTA, developers' margins get squeezed on land costs. That's why they start building more big towers." Homebuilders get clobbered by the inflated land costs, too, especially within intensification zones, and are forced out to the fringes. Everyone complains about municipal development charges—upwards of $60,000 a unit in some places. Looking to limit unpopular property tax hikes, governments hit developers, who pass on costs to homebuyers or eat some of the expenses. Increasing bureaucratic hassles and approval delays also raise blood pressure levels.

Best Bets

Investment

Hold Those Trophies. That's the Canadian way. Husband cash flows, astutely manage properties to control costs and retain tenants, and consider retrofitting with energy-saving technologies to ensure future competitiveness. "In the low-interest-rate environment, clipping coupons makes sense."

Buy or Hold Infill Land. Intensification policies will continue to propel land values in the gateway cities: available sites look like gold. Prices may appear "crazy" today, but could seem like bargains tomorrow. "You won't be able to replicate these opportunities in the GTA or Vancouver." Move-back-in trends work against outer suburbs and disconnected suburban nodes.

Don't Take Chances. Equilibrium markets provide limited opportunity to score big investment gains, and the economy enters a slower growth mode. For more opportunistic returns, investors could partner with hands-on operators to take underused class B–/C apartment buildings and improve NOIs. Old, well-located warehouse space in prime GTA locations could be ripe for conversion or redevelopment into condominium or mixed-use space.

Development

Turn More Wary. The big-city condo surge looks unstoppable, but maybe it's time to turn a bit more cautious. Whenever something looks too good to be true, it usually is. The investor wave could give out, and pricing may need to take a breather.

Be Selective. Other sectors offer few opportunities beyond a choice office building in certain 24-hour downtowns like Vancouver or even Montreal. Mixed use gets a boost across all major markets: retail developers work on infill projects aligned with condo construction. New apartments make sense in markets where condo construction is muted; demand will always be there. Hotels go nowhere.

Property Sectors

Buy or Hold Apartments. Continuing immigration will fire steady demand.

Buy or Hold Class A Offices. These are irreplaceable assets in the downtown cores.

Buy or Hold Fortress Malls and Grocery-Anchored Retail. In prime suburban districts with barriers to entry, these properties will continue to excel.

Buy or Hold Big-Box Industrial Properties in the Toronto Area. The tenant market gravitates to new distribution properties over old-school storage space. Development opportunities exist for converting well-located low-ceiling warehouses into big-box formats.

Hold Hotels. It's no time to sell.

Emerging Trends in Latin America

"Brazil looks less like an **emerging market;** Mexico **struggles** with drug violence."

Led by Brazil, more Latin American countries rapidly shed vestiges of Third World backwardness and banana republic dictators, and transform into reliable economic engines; middle classes expand and property markets score gains. The investor world takes notice because the region managed to circumvent most downsides from the global credit crisis; GDP forecasts predict above-average growth for Latin America, well ahead of that for the United States and Europe, and many governments boast relatively healthy fiscal balance sheets from disciplined monetary policies. Brimming with natural resources and rich stores of commodities, some countries have become major Chinese trading partners, feeding the Asian juggernaut's manufacturing sector with lucrative export deals. Major cities like São Paulo, Rio De Janeiro, Mexico City, Buenos Aires, and Santiago evolve into more dynamic, diversified, and cosmopolitan global gateways, and many secondary cities remain ripe for development—especially housing and retail catering to burgeoning consumer classes. Offshore players must navigate a host of familiar emerging-market obstacles—heavy-handed bureaucracies, graft, favoritism for connected local entrepreneurs, and arcane laws. Brazil remains South America's lodestar, understandably concentrating investor attention. Drug wars temporarily consume Mexico, but Colombia shows signs of blossoming and Peru may be next.

EXHIBIT 6-1
Latin America General Indicators

	Unemployment (%)	Inflation (%)
Argentina	9.0	10.2
Brazil	6.7	6.3
Chile	7.2	3.6
Colombia	11.5	3.6
Ecuador	7.3	3.5
Mexico	4.5	3.6
Peru	7.5	2.7
Uruguay	6.9	7.2
Venezuela	8.1	29.8

Sources: International Monetary Fund, *World Economic Outlook* database, April 2011; Moody's Economy.com.

Brazil Arrives

Just as most developed countries sputter in the global marketplace, Brazil's economy "fully emerges," and its primary real estate markets rapidly transform from opportunistic to more core-oriented risk/return profiles. "You need to accept more pedestrian performance." A "self-sufficient" nation, Brazil benefits from a wealth of natural resources and agricultural commodities and a burgeoning manufacturing base, as well as internal demand driven by an emerging middle class. "The potential has been met." The country is even a net creditor to the International Monetary Fund. In light of significant benefits, offshore players downplay acknowledged investment downsides—corruption favoring locals, "a ton of bureaucratic red tape," social stratification issues, and education shortfalls. Deficient infrastructure also could hamper growth: half the nation's roads remain unpaved, including sections of highways between large cities, and mass transit is limited.

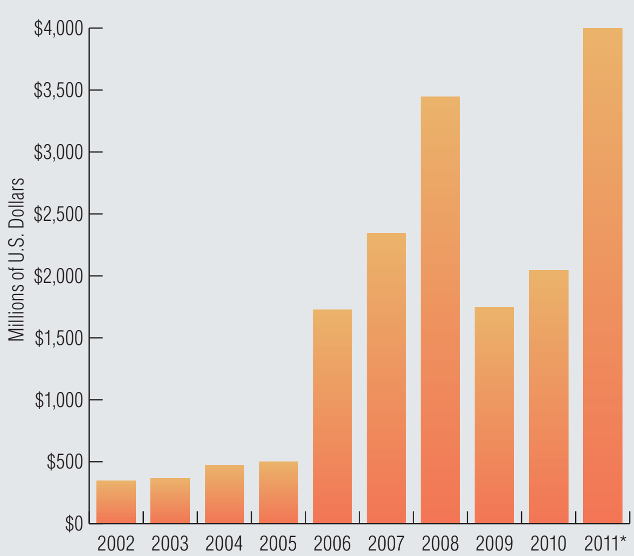
São Paulo and Rio de Janeiro register "insane" property pricing. "Growth has already been factored" into real estate values. Over the past five years, cap rates have dropped from low double digits down to the mid-singles. "Price per pound for office and apartment condos actually exceeds New York and Washington, D.C.; the cat is out of the bag." With the Rio Summer Olympic Games approaching in 2016, investors don't expect a correction, but markets need to take a breather: "Returns will flatten out." Supply constraints in both cities will help support residential and office prices, but the chance clearly passes for outsized year-over-year gains, and acquisition opportunities remain scarce.

Significant development opportunity exists in the underserved, "blowing-and-going" retail sector, with only 400 shopping centers in a country of 200 million people generating nearly 10 percent annualized sales growth. "Rio and São Paulo are spoken for—local developers and their partners control the most attractive retail sites—but 18 secondary and tertiary cities with million-plus populations offer major investment plays. "Malls and strips don't exist there yet," and workforce housing is also undersupplied in these markets.

Do you know foreign real estate investors who have come out ahead in China, India or Russia? "Brazil is the only one of the BRIC [Brazil, Russia, India, and China] countries so far to really deliver on its promise."

EXHIBIT 6-2

Brazil: Foreign Direct Real Estate Investment



Source: Central Bank of Brazil (compiled by Altus Group Latin America, Inc.)
*Projection by Altus Group Latin America, Inc.

Mexico No Go

Foreign money simply turns tail on Mexico after talking up significant potential for years. "The country looks out of control," says an active investor in Latin America. "I wouldn't go anywhere near there until they figure out their drug problems." The U.S. economic funk doesn't help either, stanching demand for Mexican border factory locations and tourist hotels. The pullback comes as the Mexican economy kicks back into "low gear" and domestic consumer buying advances from a growing middle class.

While the government euphemistically characterizes drug-related violence in northern border cities as "security issues," once-sanguine real estate players now steer entirely clear. "It's downright grotesque and extremely dangerous." Juárez and Reynosa have been epicenters of violence; "no one goes there." Monterrey is "less impacted," and Tijuana remains unsettled.

Property pricing along the borders declines, "but not as much as you'd think since many U.S. companies continue to operate factories and facilities on long-term leases." Although most development and new investment goes into limbo, rising manufacturing costs in China could eventually bring back more factories to Mexico. "U.S. companies will stay active, especially in medical products, auto parts, and electronics. Tijuana is the TV set production capital of the world." Mexican factory sites also retain a significant edge over Asian countries for manufacturing heavy industrial machinery headed for U.S. markets, which cost more to ship from overseas.

Border turmoil issues recede in "the relatively stable environment around Mexico City," one of the world's biggest urban centers, which prospers from "significant internal demand drivers." The border may be "messed up," but the national capital and gateway "remains viable" and "values have held up; it gets a bum rap." Institutional investors in general back off even here. "They feel they have too much in Mexico under the circumstances." New capital development certificates (CKDs), which encourage pension funds to invest in real estate projects and new infrastructure, "may pick up the investment slack." Several major investment managers from the States move in to manage some of these funds. "The idea is to allow plan sponsors to diversify and get better rates of return than from low-yielding government bonds." CKDs essentially invest in the country, improving real estate stock, roads, transit, and water/sewer systems while putting more people to work." Developers certainly applaud the initiative as they struggle to emerge from a postcrash limbo.

Even in the best of times, outsider investors hit obstacles breaking into Mexican markets. "Locals own to hold, keeping properties in families for generations." This behavior shows no prospect for changing.

EXHIBIT 6-3
Latin America Economic Growth

	2007	2008	2009	2010*	2011*	2012*	2013*	2014*
Argentina	8.7	6.8	0.8	9.2	6.0	**4.6**	4.2	4.0
Brazil	5.7	5.1	-0.6	7.5	4.5	**4.1**	4.1	4.2
Chile	4.7	3.7	-1.7	5.3	5.9	**4.9**	4.5	4.4
Colombia	7.5	2.4	1.5	4.3	4.6	**4.5**	4.5	4.5
Ecuador	2.5	7.2	0.4	3.2	3.2	**2.8**	2.5	2.4
Mexico	3.3	1.5	-6.1	5.5	4.6	**4.0**	3.4	3.2
Peru	8.9	9.8	0.9	8.8	7.5	**5.8**	5.7	5.7
Uruguay	7.6	8.5	2.6	8.5	5.0	**4.2**	4.0	4.0
Venezuela	8.4	4.8	-3.3	-1.9	1.8	**1.6**	1.3	1.6

Sources: International Monetary Fund, World Economic Outlook Database, April 2010.
* Projections.

Other Markets: Colombia Draws Interest

Mexico's drug problems flared once Colombia's full-scale assault on traffickers and rebel supporters gained some traction, largely pushing smuggling operations north into Central America. Now Colombia suddenly catches investors' attention. This country of 45 million looks like a potential junior version of Brazil, helped by the discovery of offshore oil fields. "A ton of dollars pours in." Bogotá, Calle, and other primary cities transform into secure places. "Colombia now is one of the safest Latin American countries." The "business-friendly" government offers tax advantages and gains an investment-grade rating. Hopes run high that the U.S. Congress will ratify a free trade agreement, which could open up new markets for natural resources, including oil and precious metals, and spur manufacturing businesses. "People start to pull out of poverty. The feeling grows that the country could bust out like Brazil did five years ago." For starters, Colombia needs shopping centers and housing projects. Early investors have a chance to score big returns, but with an ample dose of emerging country risk.

Mature South American economies—**Chile** and **Argentina**—have lower growth prospects, so offshore players looking for opportunistic returns can't get too excited. Santiago office vacancies barely register, pushing up rents and prices, but local owners dominate and transaction activity is limited, so "why bother." Concerns linger about inflationary pressures in Argentina. Vacancy rates trend higher in Buenos Aires, and unsettled politics compromise attempts at needed fiscal reforms. . . . **Peru** starts to catch on and bears watching, benefiting from renewed political stability and new trade deals with Asian markets. "It could be another Colombia." . . . **Panama City** should gain from the canal widening. . . . **Venezuela** remains hands-off as long as the ailing Hugo Chávez stays in power.

Interviewees

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Allied Properties REIT
Michael Emory

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APG Asset Management US Inc.
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Apollo Global Management, LLC
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ARA Finance
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AREA Property Partners
Steve Wolf

ARES Capital Management
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Artemis Advisors, LLC
Dale Anne Reiss

Aspac Developments Ltd
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Aspen Properties Ltd.
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R. Scott Hutcheson

Aviva Investors
Steve Felix

AXA Equitable
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Raymond Wong
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James Carpenter
Bruce Ficke
Glenn Rufrano

Cushman & Wakefield Sonnenblick-Goldman
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William H. Roberts

Ginkgo Residential
Philip Payne

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Alan Shapiro

Glimcher Realty Trust
Marshall Loeb

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Hugh McWhinnie

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Edward Siskind

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GreenOak Real Estate
Sonny Kalsi

Greenpark Group of Companies
Carlo Baldassarra

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Ashish Parikh
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HomeFed Corporation
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Chris Hunt

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Metrus Properties Ltd.
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Westbank Group
Ian Gillespie
Judy Leung

Westbrook Partners
Sush Torgalkar

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Rich McClintock

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Jason Underwood

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Emerging Trends in Real Estate® 2012

What are the best bets for investment and development in 2012? Based on personal interviews with and surveys from more than 950 of the most influential leaders in the real estate industry, this forecast will give you a heads-up on where to invest, what sectors and markets offer the best prospects, and trends in the capital markets that will affect real estate. A joint undertaking of PwC and the Urban Land Institute, this 33rd edition of *Emerging Trends* is the forecast you can count on for no-nonsense, expert insight.

Highlights

- Tells you what to expect and where the best opportunities are.
- Elaborates on trends in the capital markets, including sources and flows of equity and debt capital.
- Indicates which property sectors offer opportunities and which ones to avoid.
- Provides rankings and assessments of a variety of specialty property types.
- Reports how the economy and concerns about credit issues are affecting real estate.
- Discusses which metropolitan areas offer the most and least potential.
- Describes the impact of social and political trends on real estate.
- Explains how locational preferences are changing.

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