BURNHAM-MOORES
CENTER FOR REAL ESTATE
UNIVERSITY OF SAN DIEGO

Looking Over the Horizon
by
Norm Miller, PhD

Hilton San Diego Bayfront
March 3rd, 2011
10:40 – 11:20 a.m.

Slides will be available at:

The Burnham-Moores
Center for Real Estate

Summary Up Front: What do I believe?

- Housing and Commercial real estate prices will continue to see much dispersion based on quality. Averages and indices don't tell us much, but average prices will remain flat for 2011 based on a mix of trophy and trouble.

- Future commercial real estate values will be dependent on a race between higher interest rates and increasing rents.

- In about 2 to 3 years we will see rent spikes for office, industrial and retail property, even earlier for multifamily property. San Diego is a little behind average on these trends but will follow the pattern like a reluctant child.

- The best time to buy high quality commercial real estate was 2008 and 2009. But there is 2 to 3 years of distress opportunities left for those who can reposition, recapitalize or simply wait it out.

What should you do, if you believe me?

- Tenants: Despite the accounting disclosure problems tenants should now enter into leases that are as long term as possible, 15 years with an option would not be crazy.

- Landlords: I would suggest leases no longer than 2 to 3 years, expiring before the ramp up in new supply.

- Brokers: I would try and match up tenants that are growing with investors that have empty building opportunities where they partner in a residual equity upside sharing deal and eliminate the lease up risk which is plaguing real estate pricing.

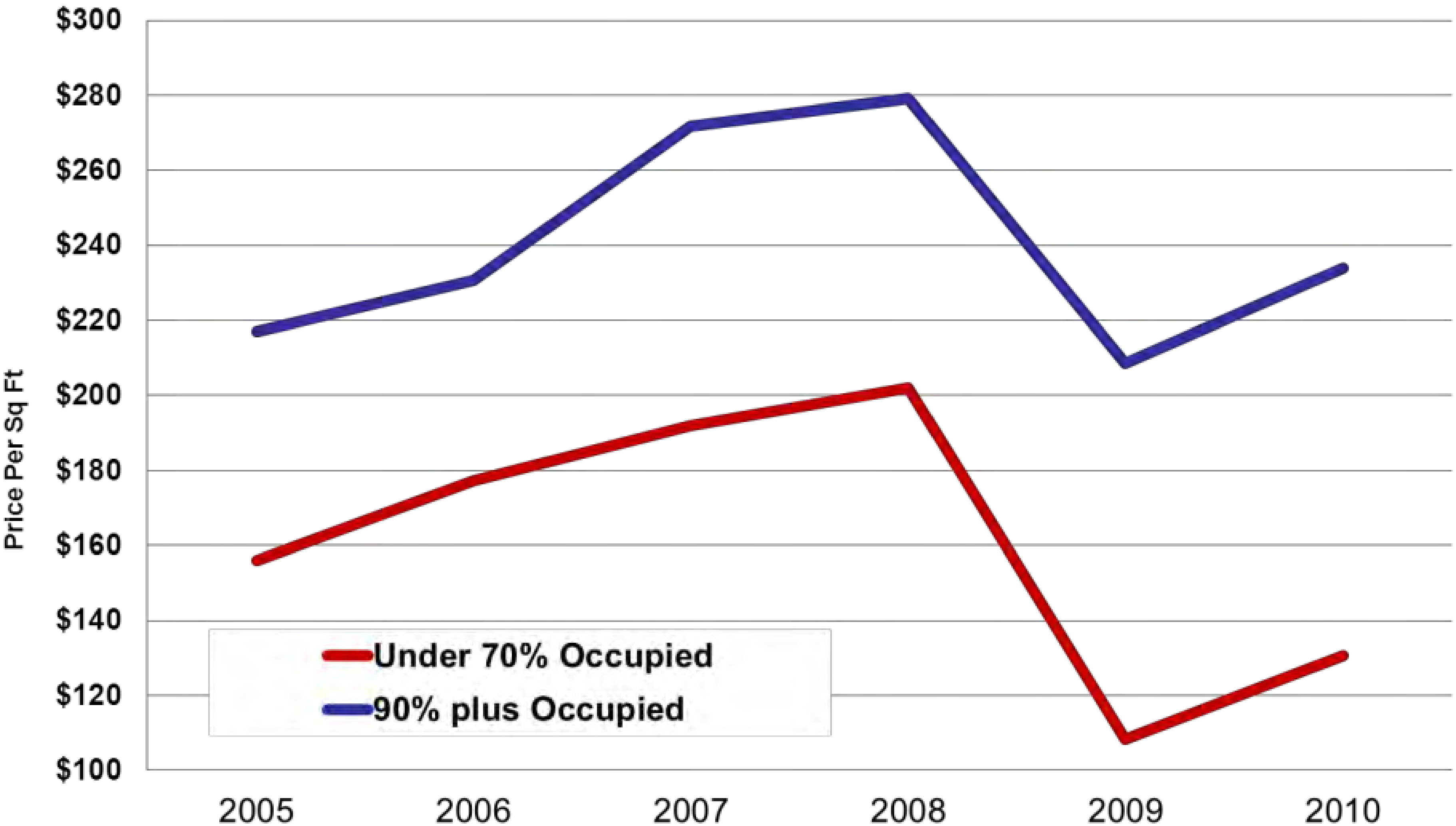
- Developers: With prices below construction costs only BTS's make sense, or upgrading existing buildings to the LEED EBOM standards or the GSA's standards.

Where are interest rates headed?

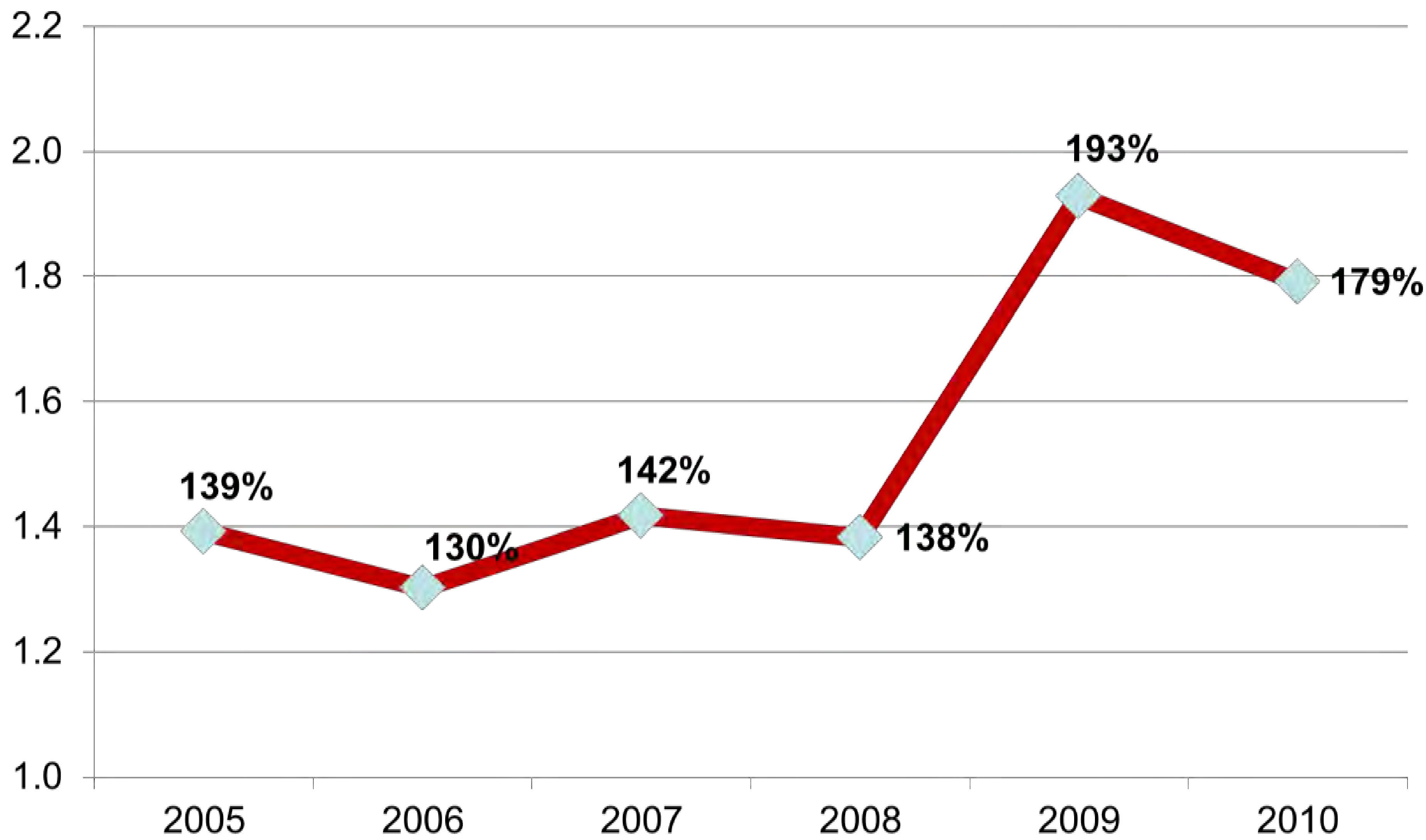
- Theory: LT Risk Free Gov't Rates should =
- Long term real growth rate, GR, plus the approximate
- Expected Inflation Rate, I, so :

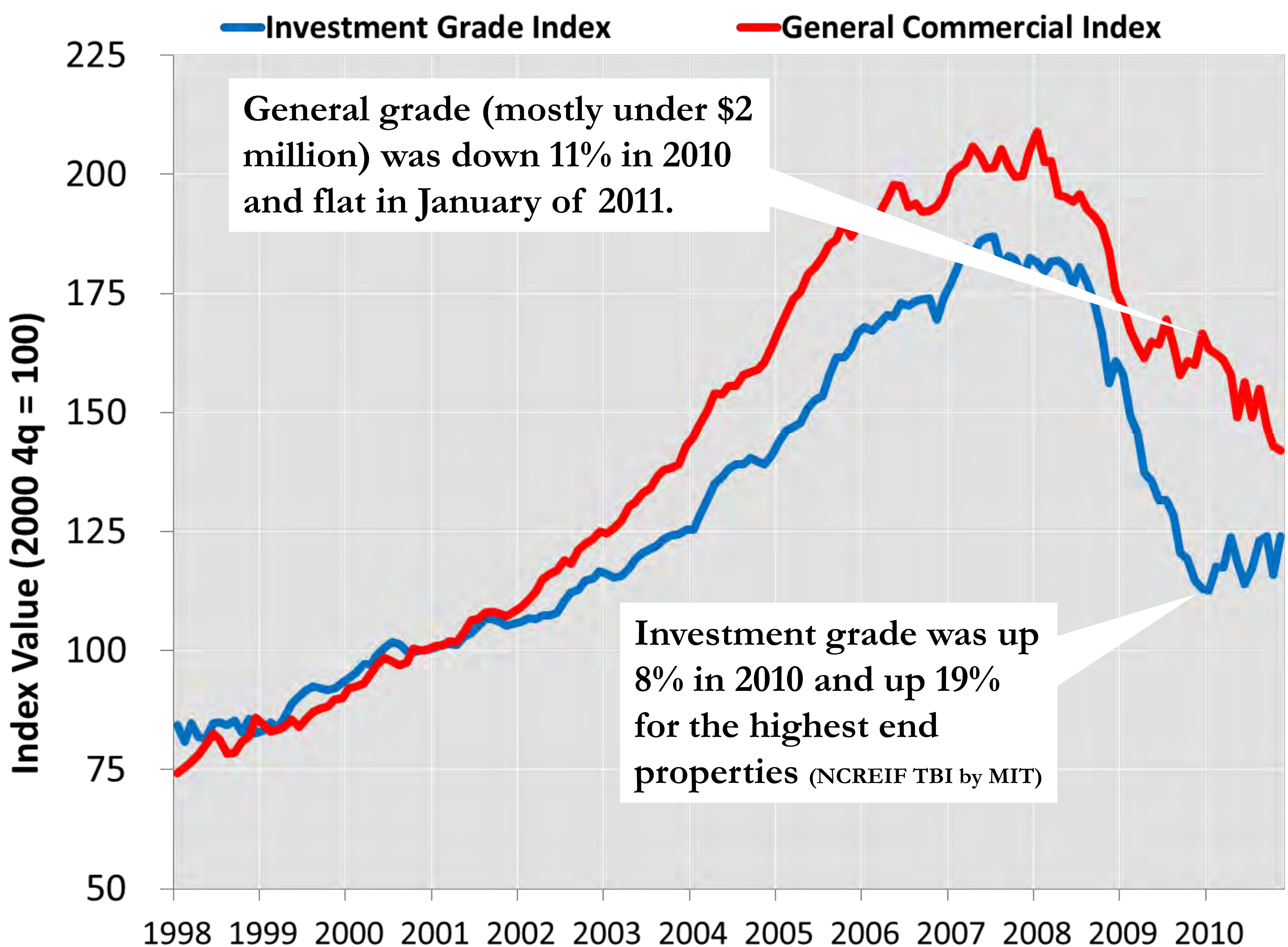
LT Growth Rate in GDP	Inflation	Nominal Rate for 10 Yr Treasury Bonds
2.5%	**2.0%**	**4.5%**
3.0%	**2.0%**	**5.0%**
3.5%	**3.0%**	**6.5%**
But QE2 could keep us well below these figures for 2011 until at least June when bond buying eases off.		

Price Per Square Foot Top Ten Office Markets Show Bias for Occupied Property

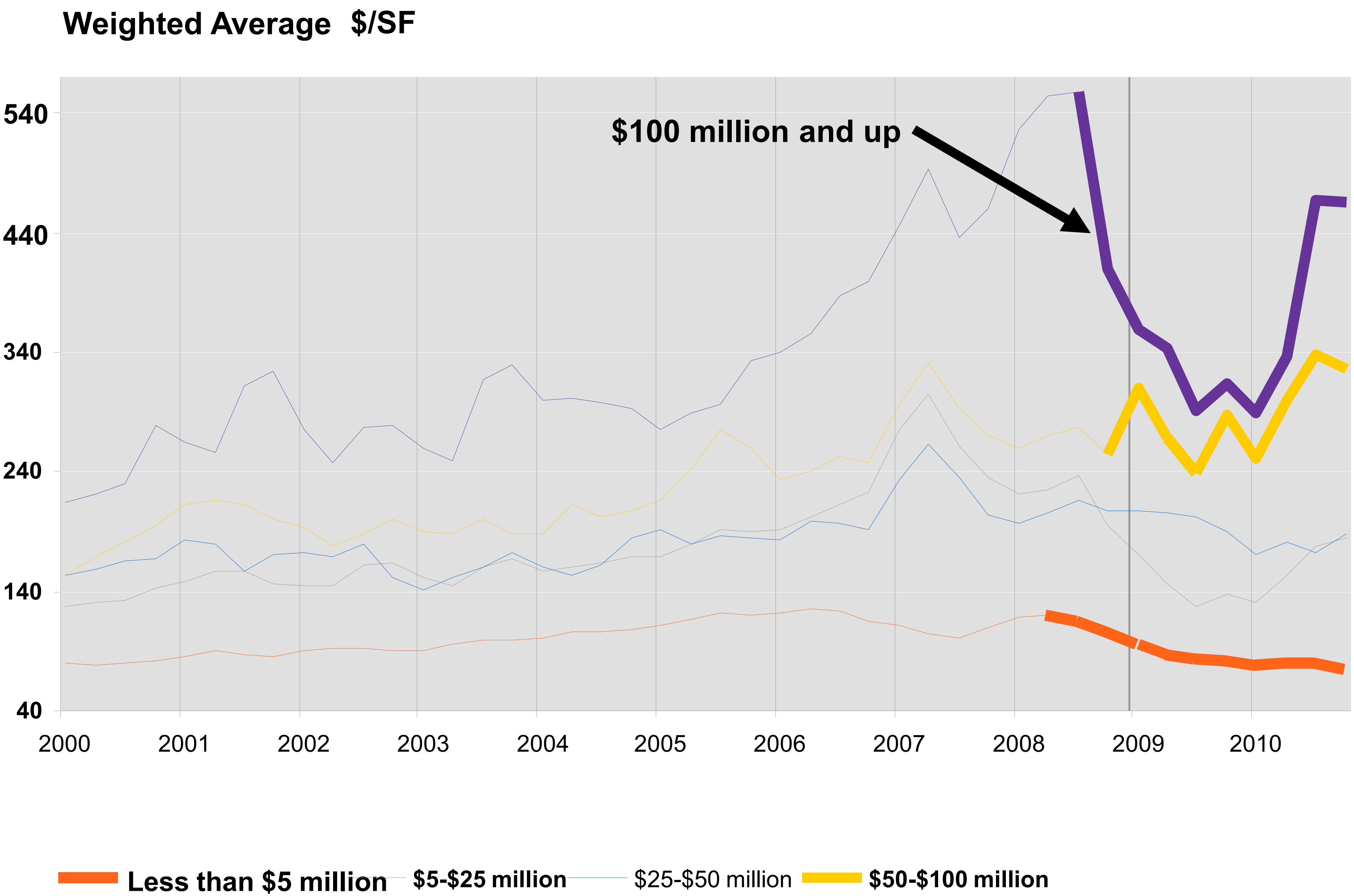


Price PSF for Office Buildings At 90% Plus Occupancy Over Those at 70% or Less



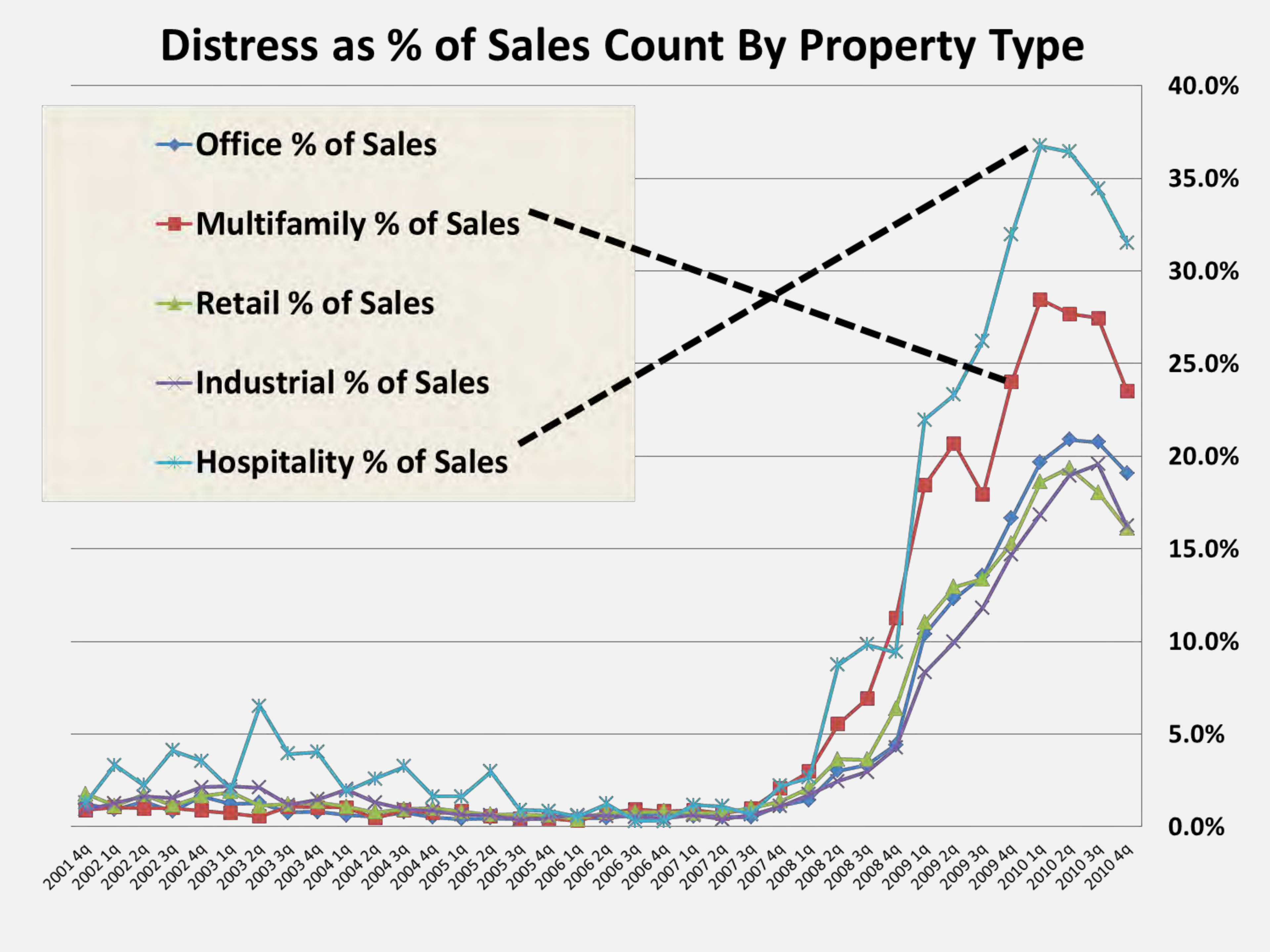

Investment Grade Index
General Commercial Index
General grade (mostly under $2 million) was down 11% in 2010 and flat in January of 2011.
Investment grade was up 8% in 2010 and up 19% for the highest end properties (NCREIF TBI by MIT)
Index Value (2000 4q = 100)
225
200
175
150
125
100
75
50
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010

We see huge price spreads by deal size



What about distress?

- Is it heading up or down?


Distress as % of Sales Count By Property Type
Office % of Sales
Multifamily % of Sales
Retail % of Sales
Industrial % of Sales
Hospitality % of Sales
40.0%
35.0%
30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
2001 4q
2002 1q
2002 2q
2002 3q
2002 4q
2003 1q
2003 2q
2003 3q
2003 4q
2004 1q
2004 2q
2004 3q
2004 4q
2005 1q
2005 2q
2005 3q
2005 4q
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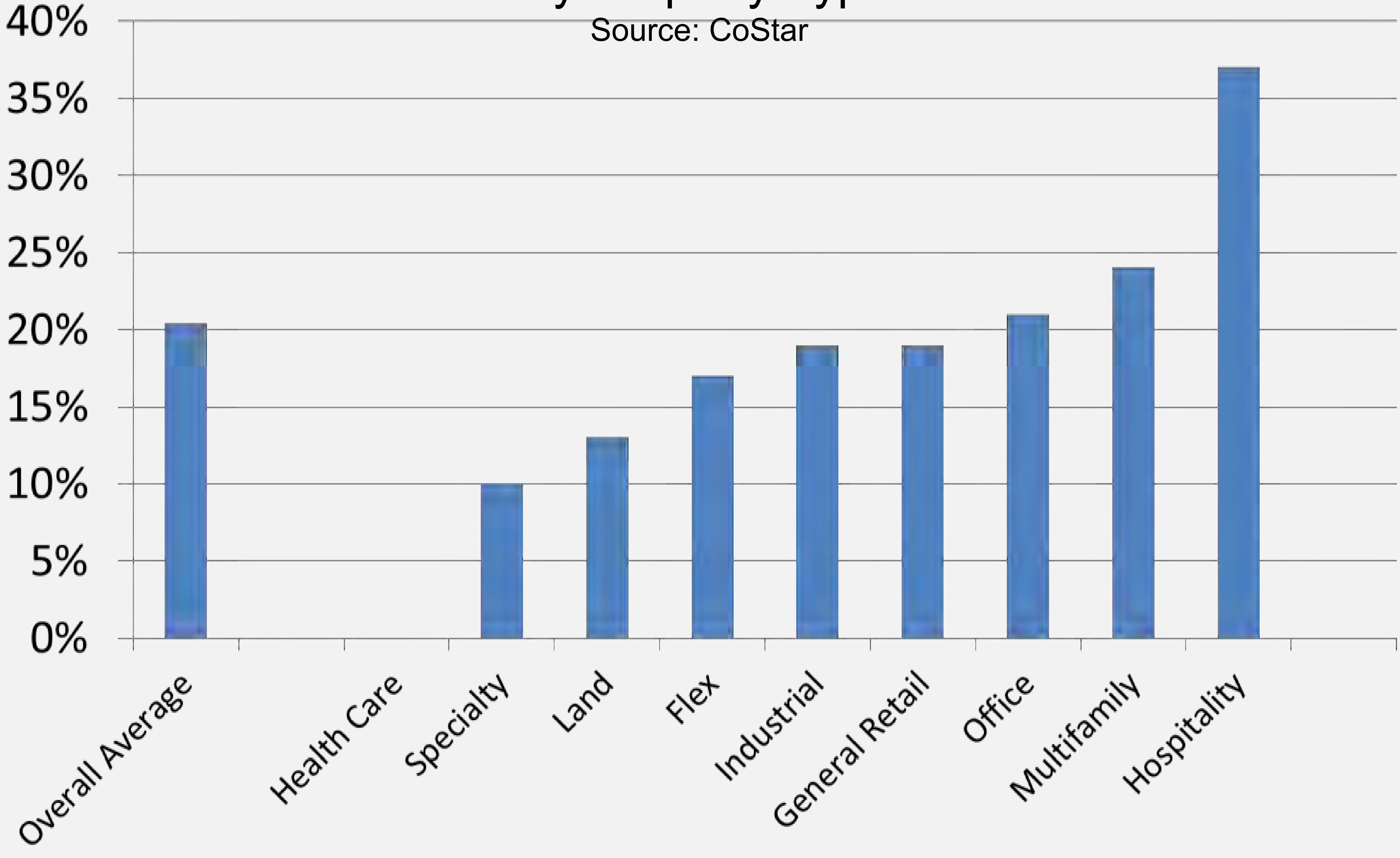
2006 2q
2006 3q
2006 4q
2007 1q
2007 2q
2007 3q
2007 4q
2008 1q
2008 2q
2008 3q
2008 4q
2009 1q
2009 2q
2009 3q
2009 4q
2010 1q
2010 2q
2010 3q
2010 4q

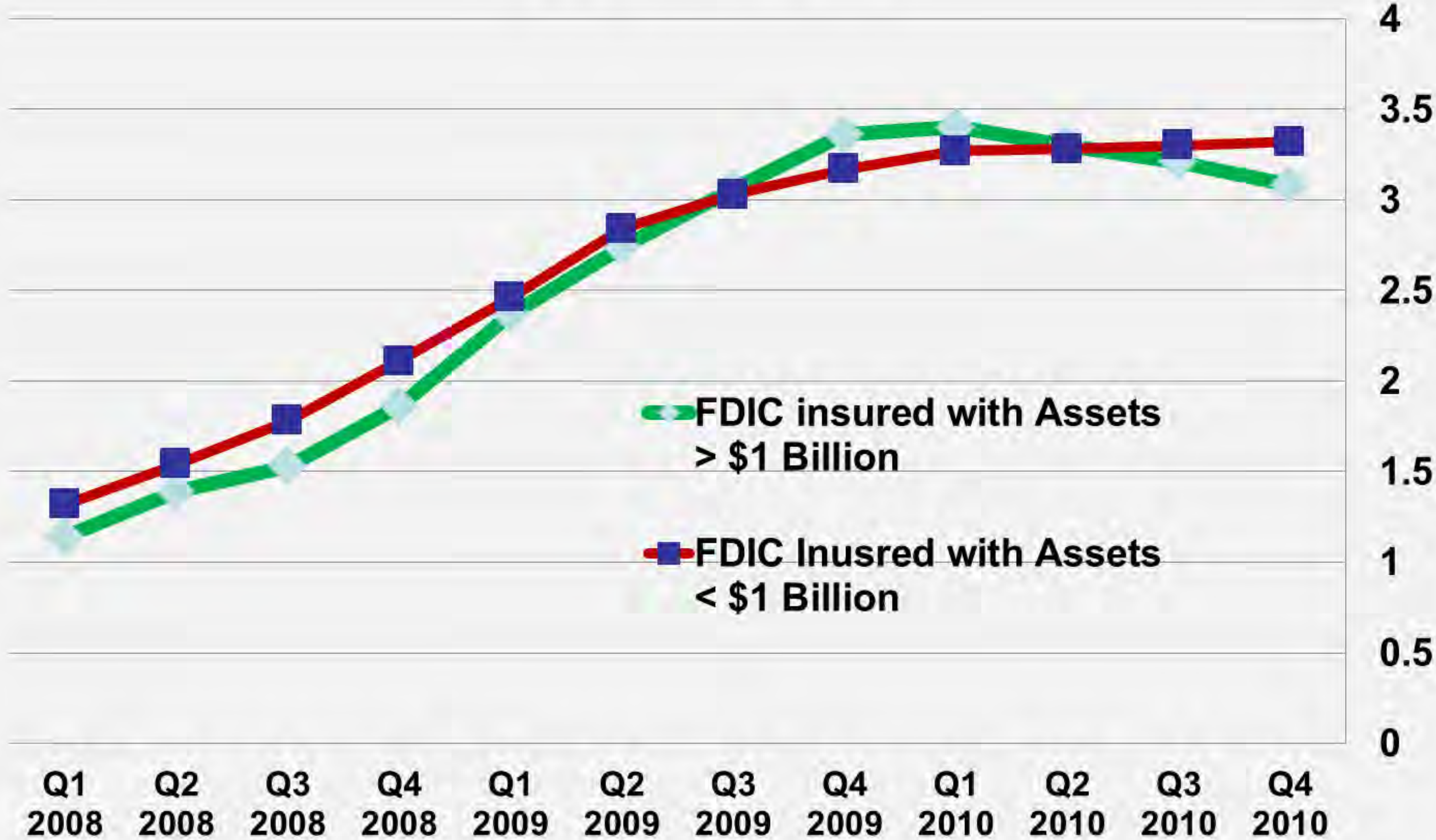
Distressed Sales as a Percent of Total Sales in the 4th Quarter of 2010

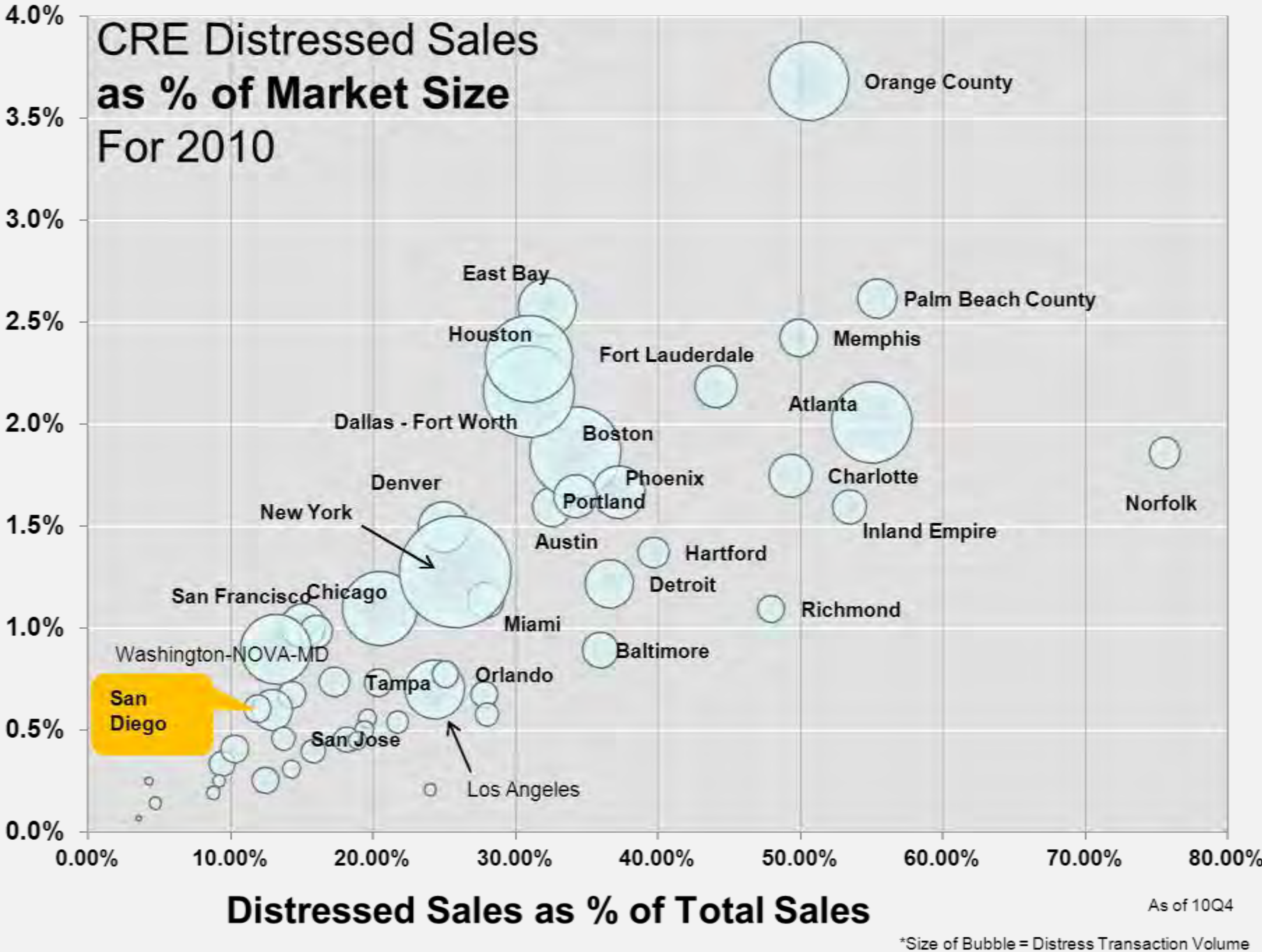
By Property Type

Source: CoStar



Percent of Bank CRE Loans 90 days or more past due Source: FDIC



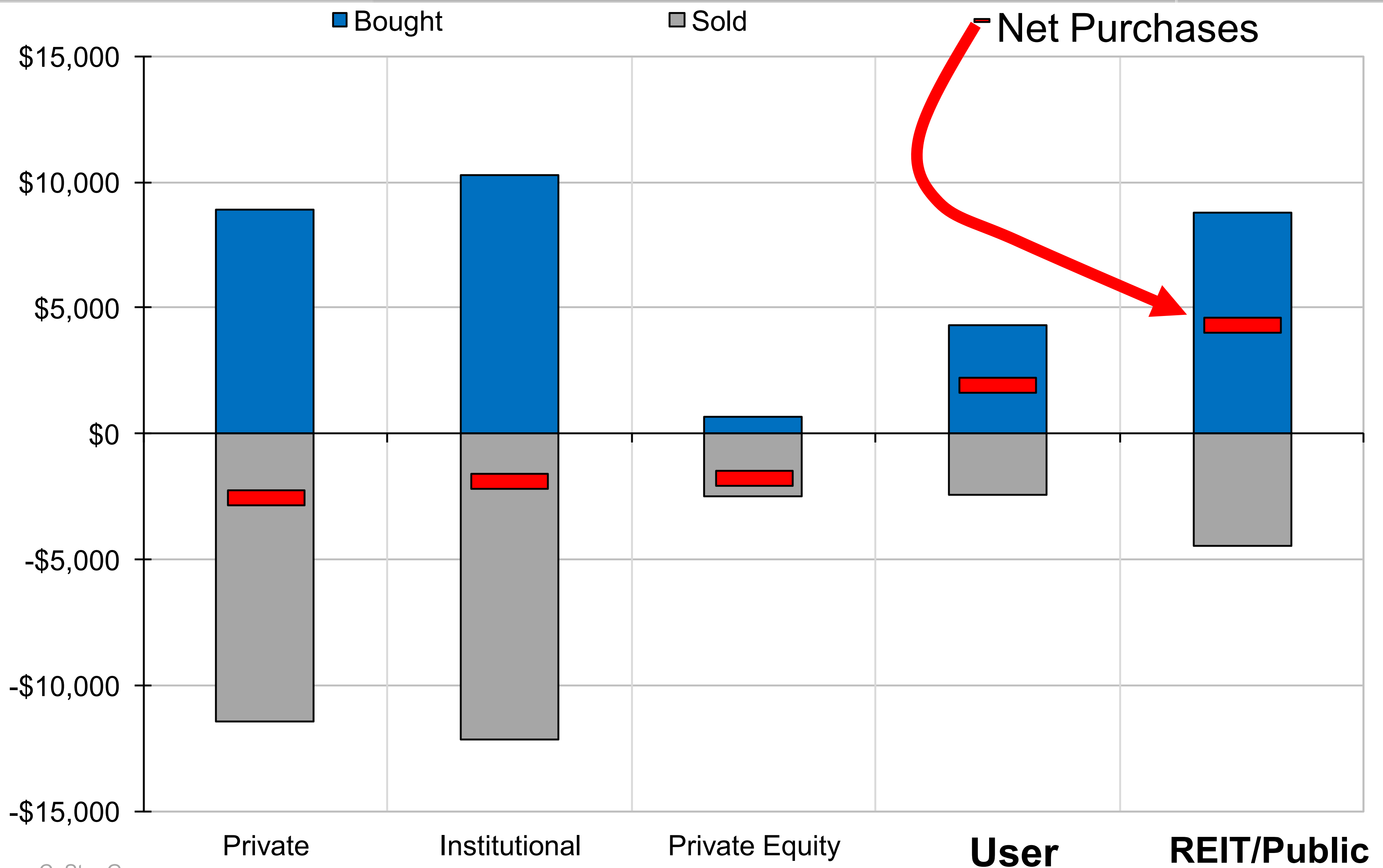


Source: CoStar Group, Inc.

Office

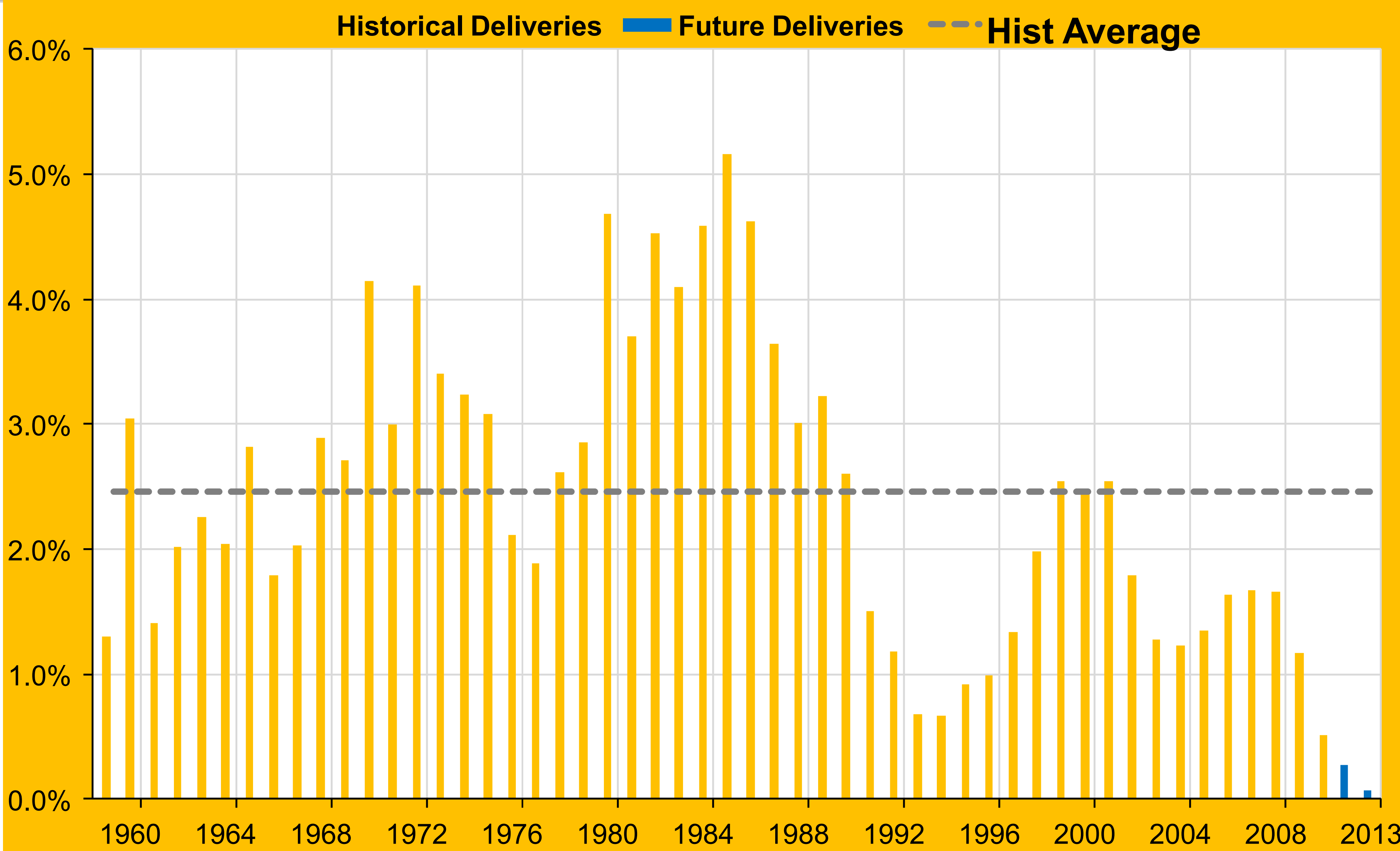
- Key indicators
  - Who is buying?
  - Starts
  - Absorption
  - Vacancy rates
  - Asking Rents

Office 2010 Net Buying by Investor Type in Millions



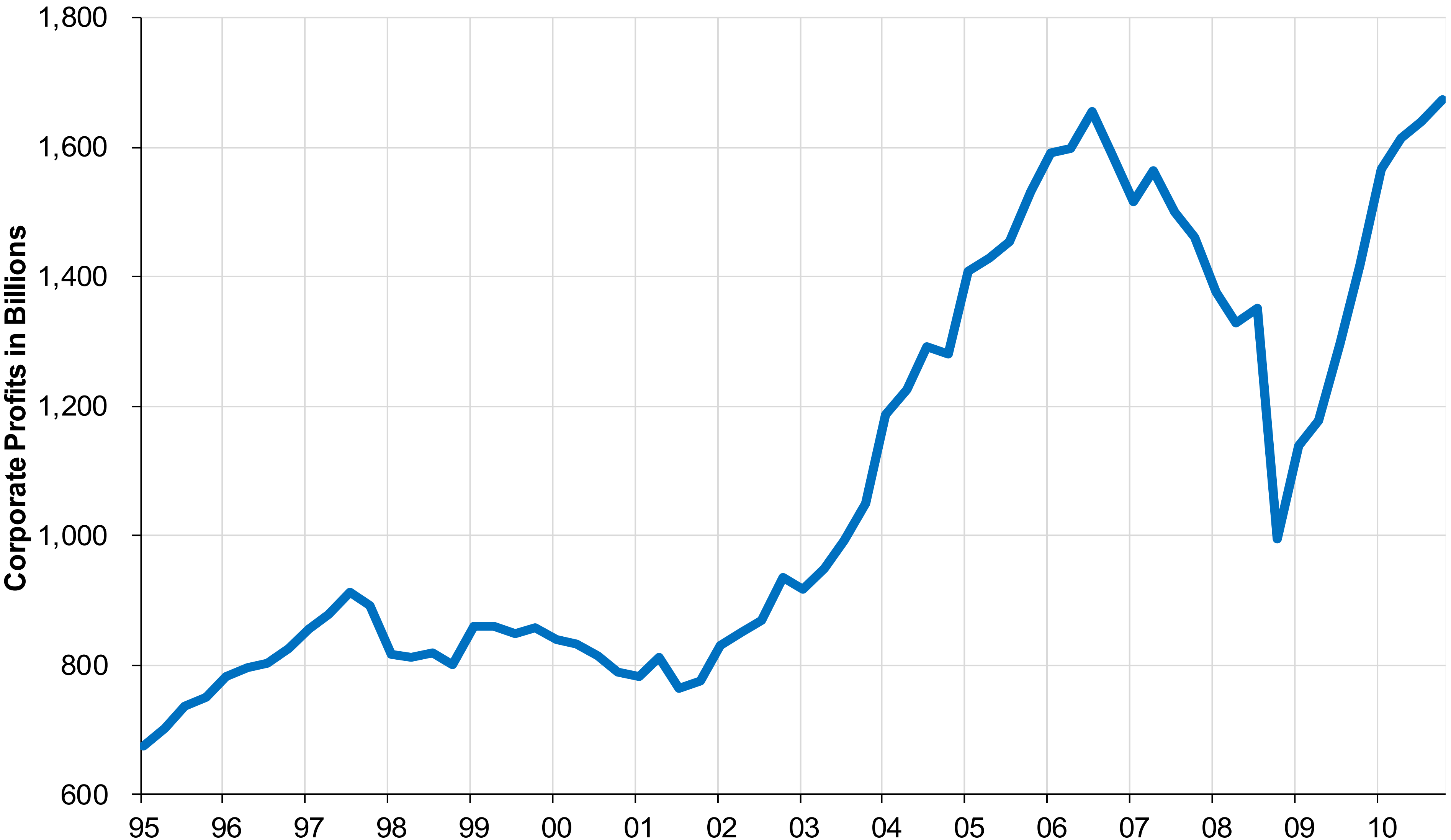
Source: CoStar Group

Long Term Office Deliveries as % of Inventory



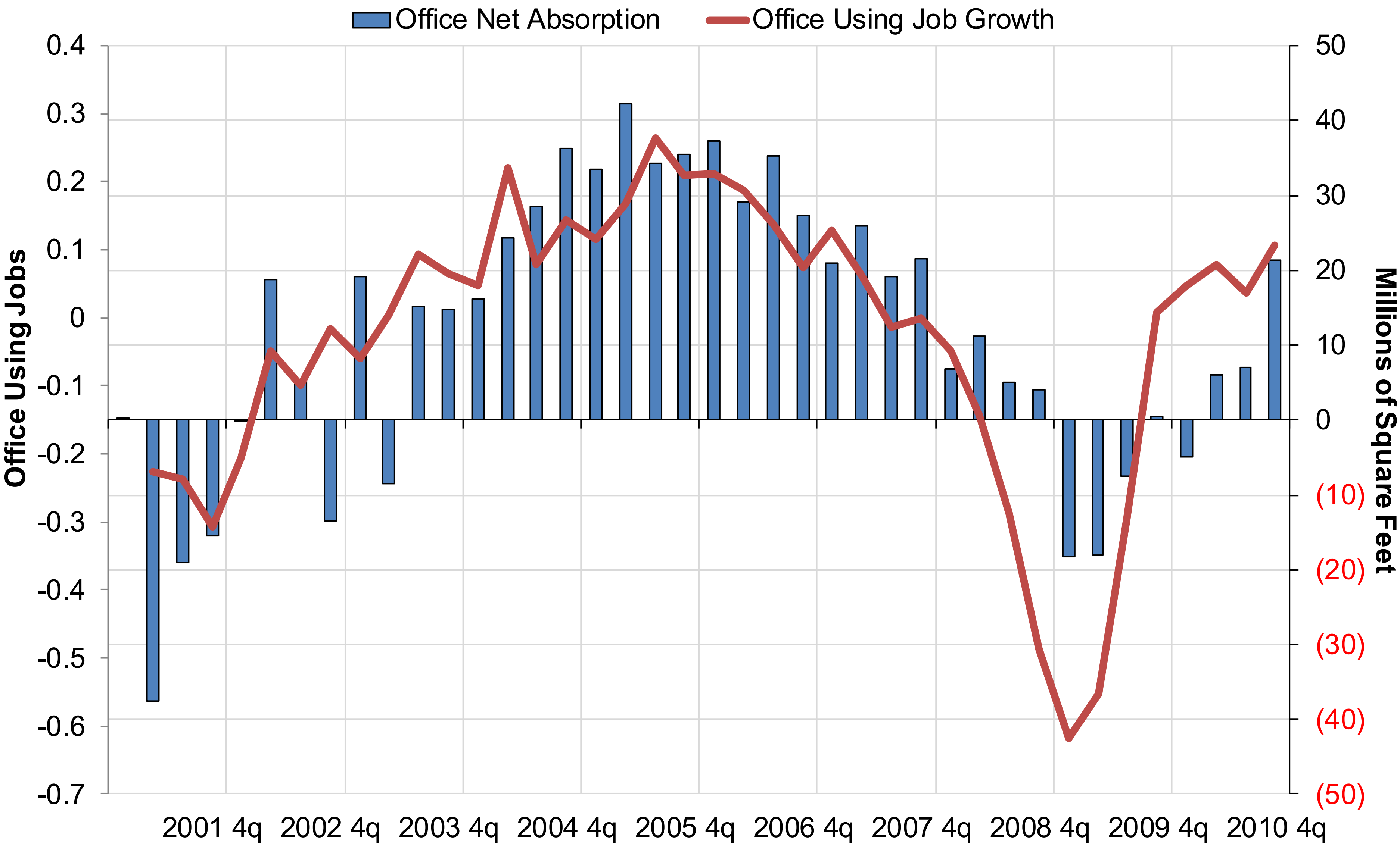
Source: CoStar Group

Corporate Profits lead employment which leads absorption



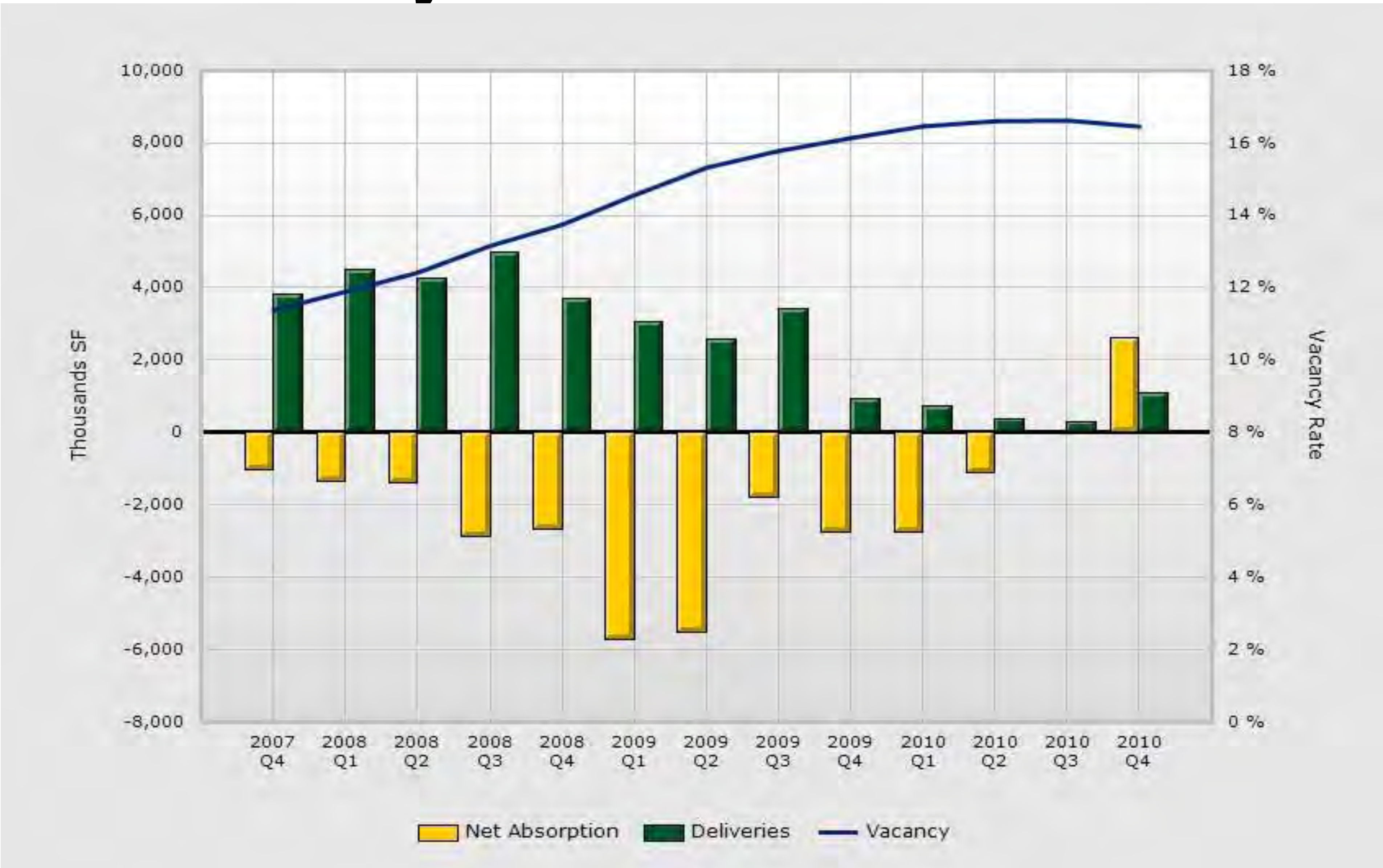
Source: Moody's Analytics

US Net Absorption and Office Using Job Growth

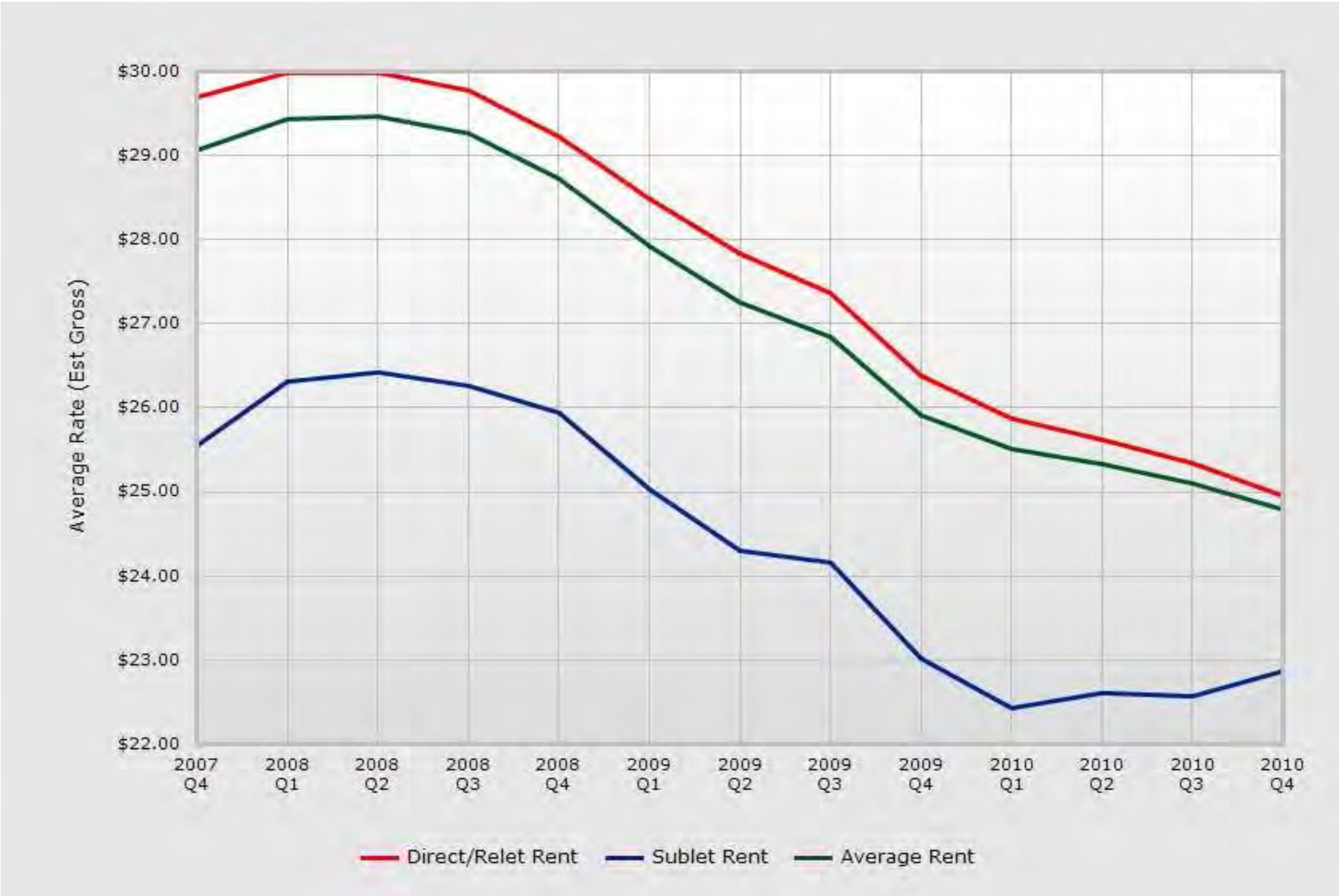


Source: CoStar Group

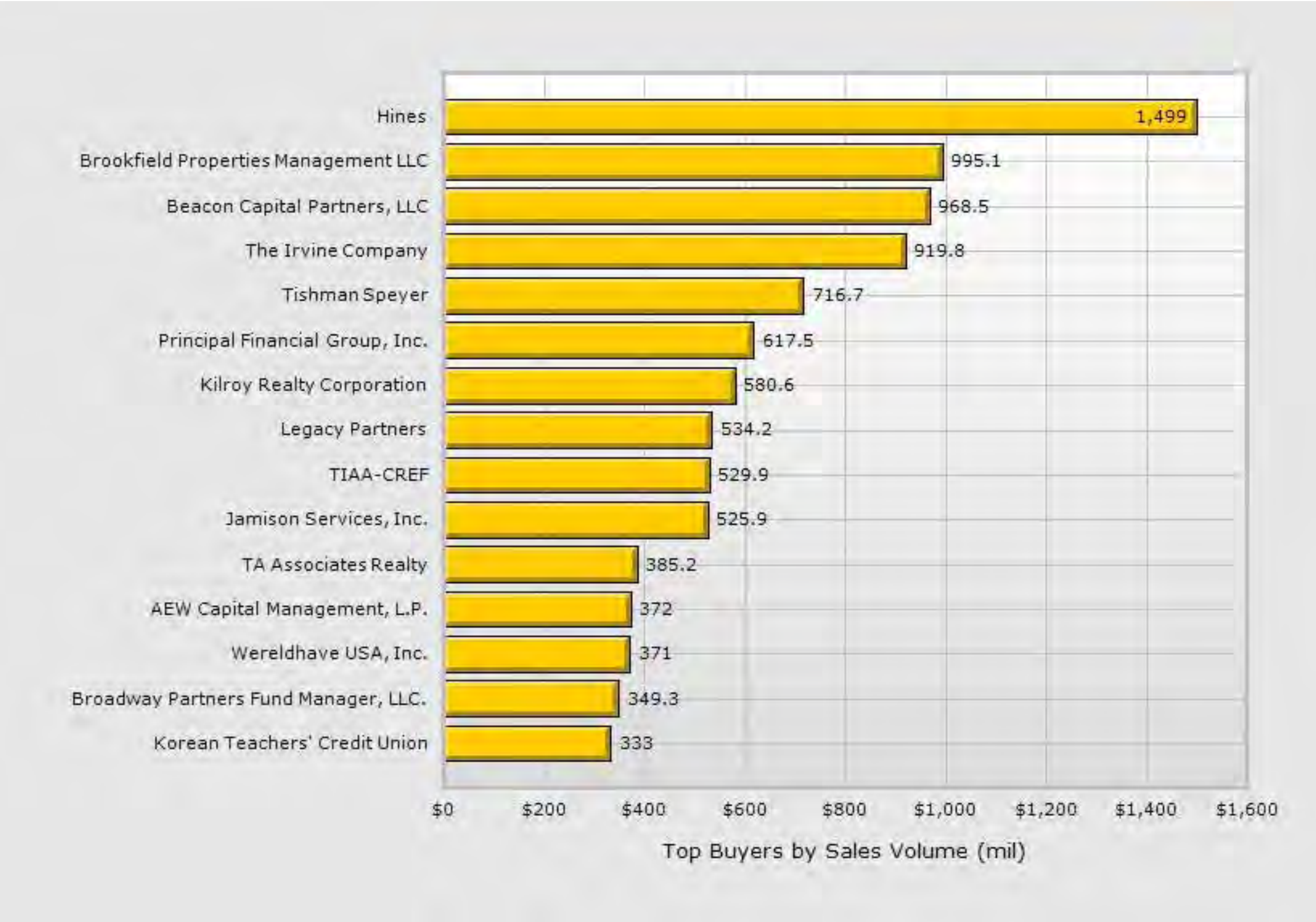
California Office: Absorption, Deliveries and Vacancy



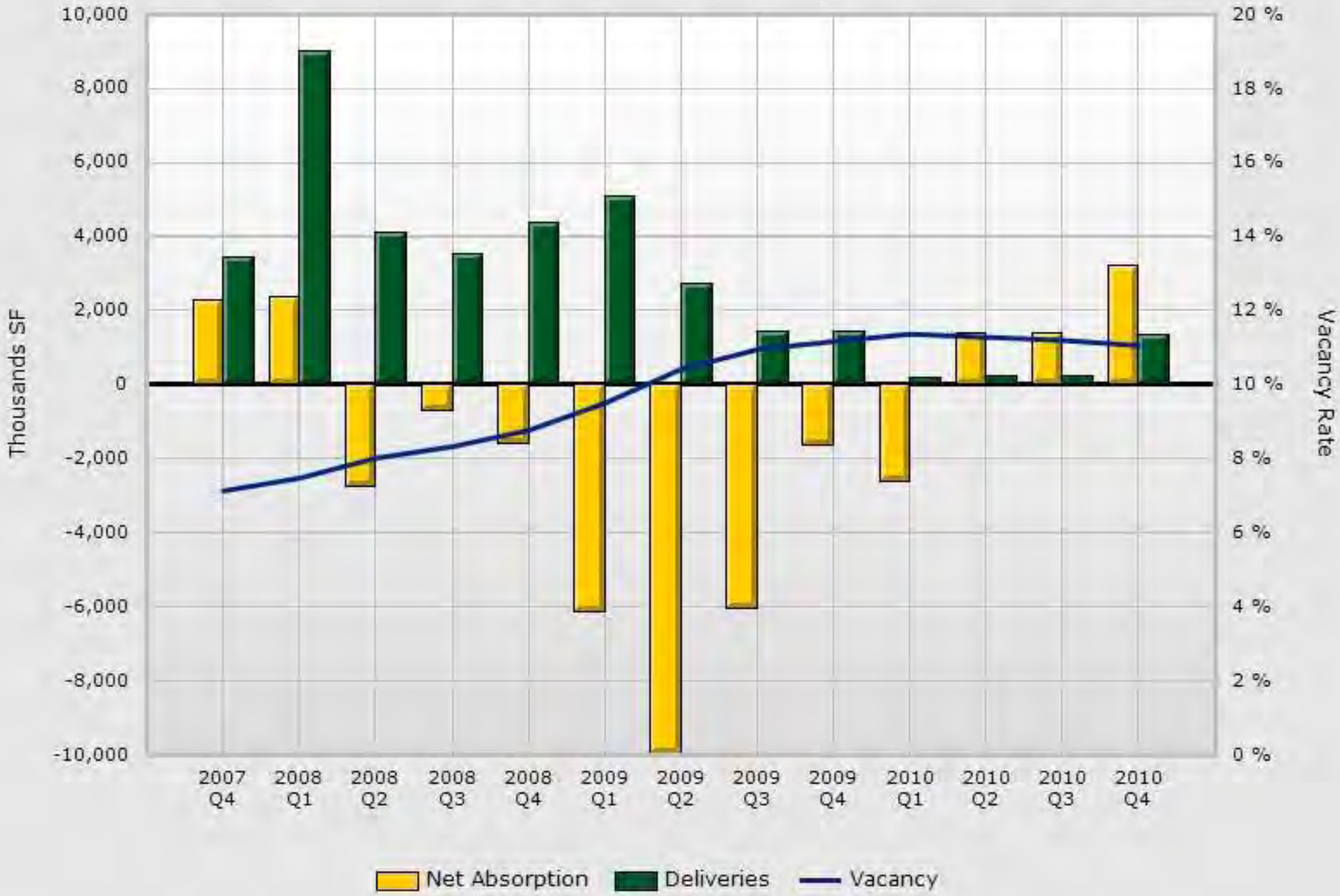
CA Rental Rates: Office All Classes



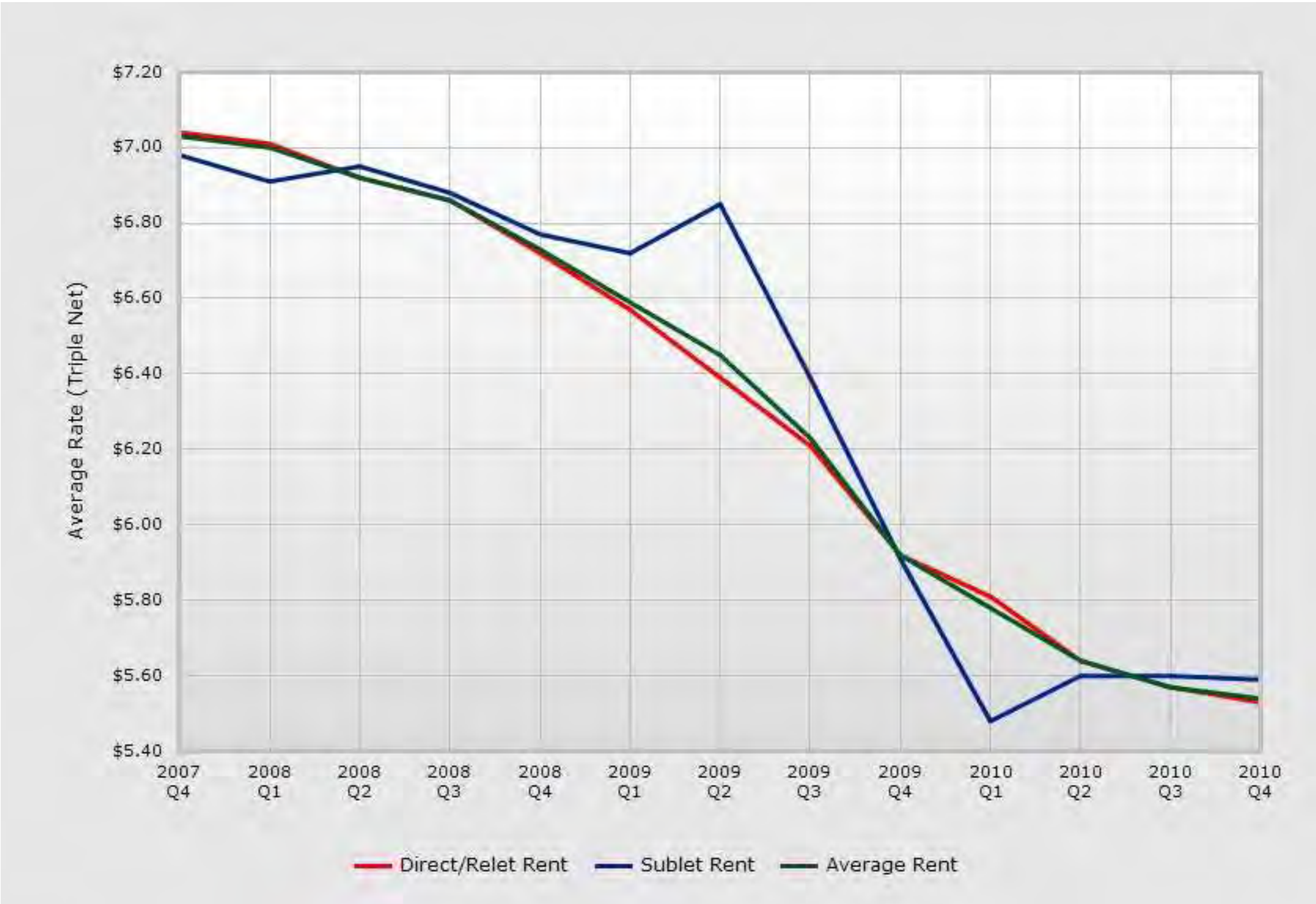
Top Buyers of Class A by Sales Volume



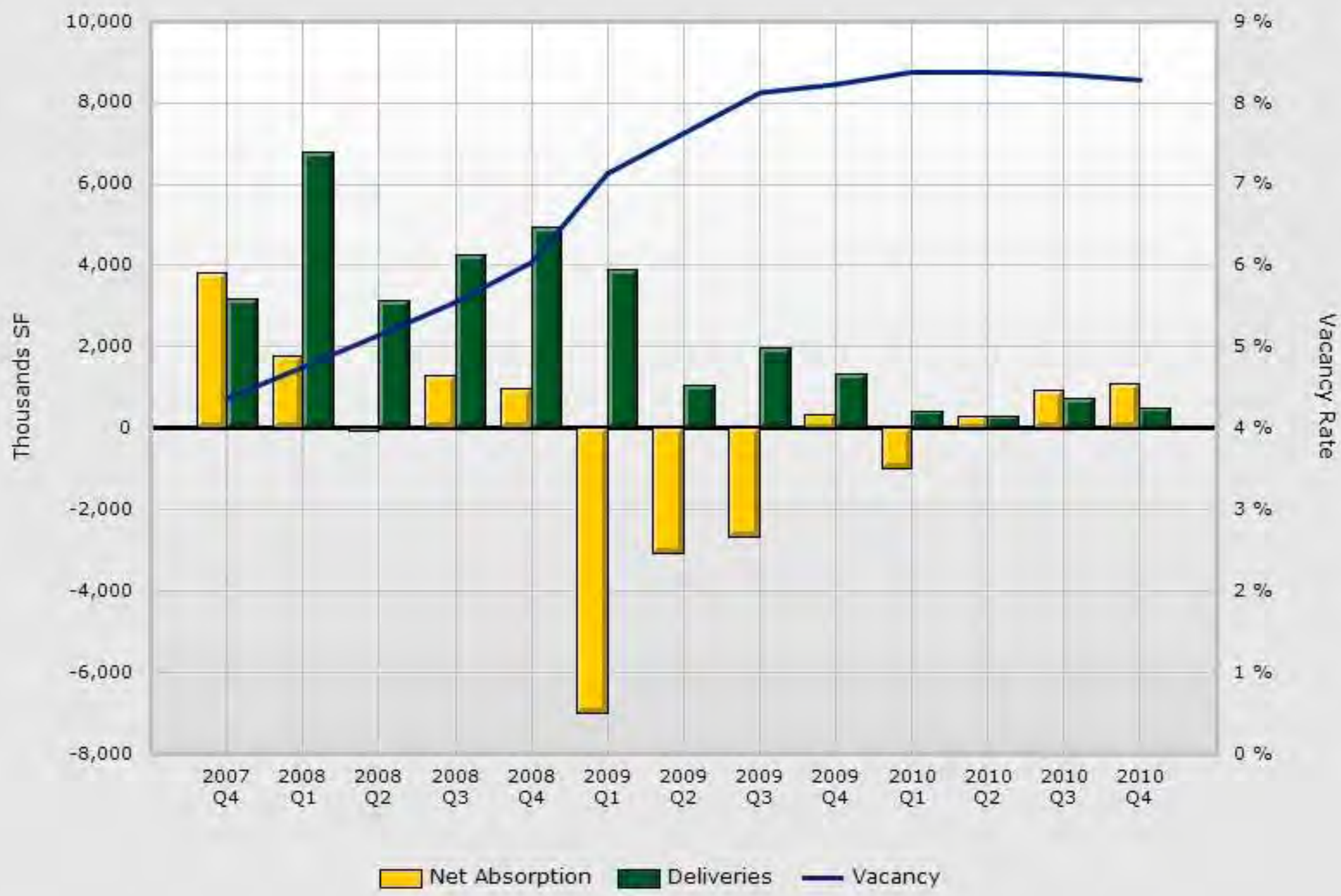
CA Industrial: Absorption, Deliveries and Vacancy



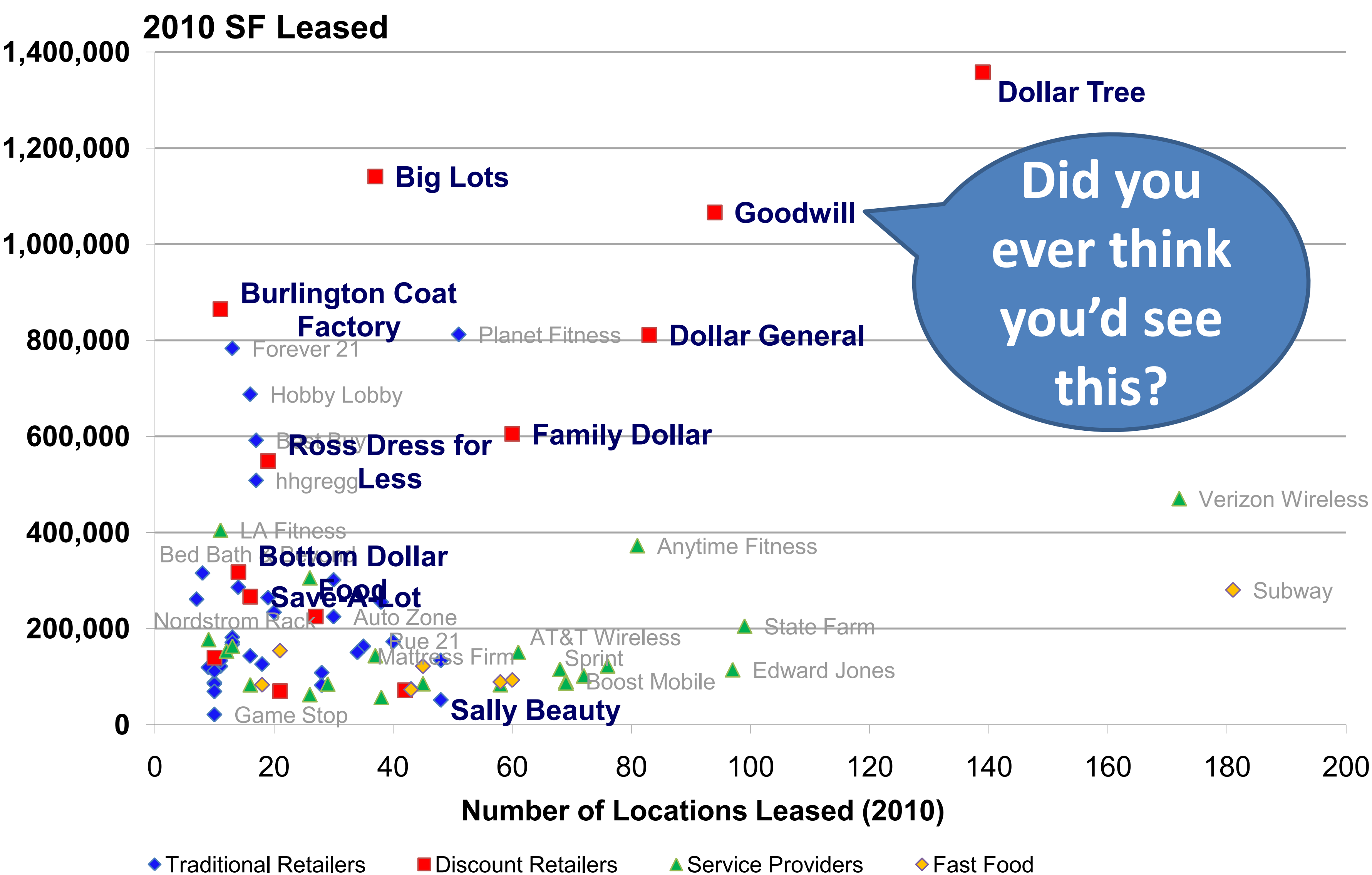
CA Industrial Rental Rates: All Classes



CA Retail: Absorption, Deliveries and Vacancy

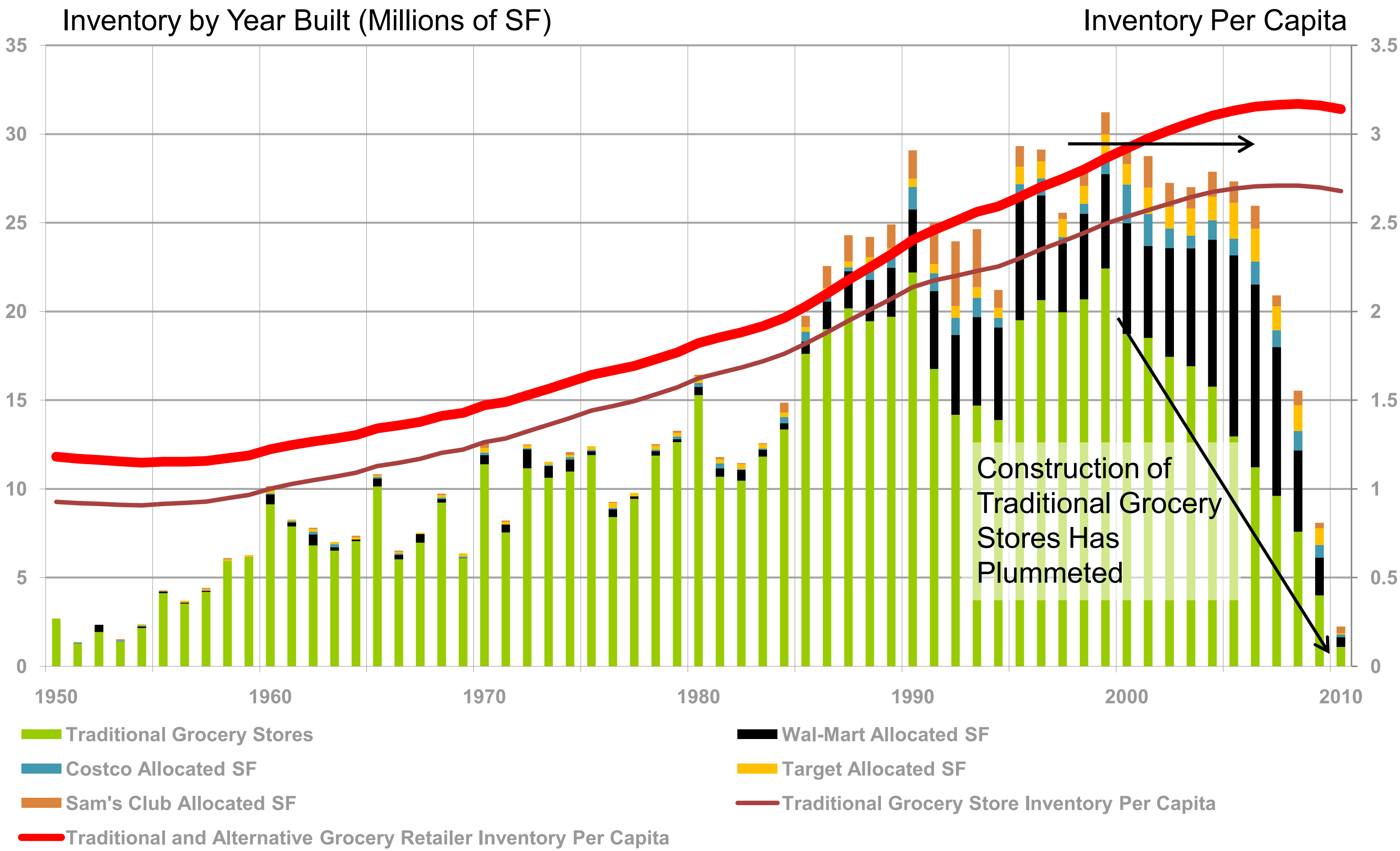


Leasing in 2010 Has Been Dominated by Discounters



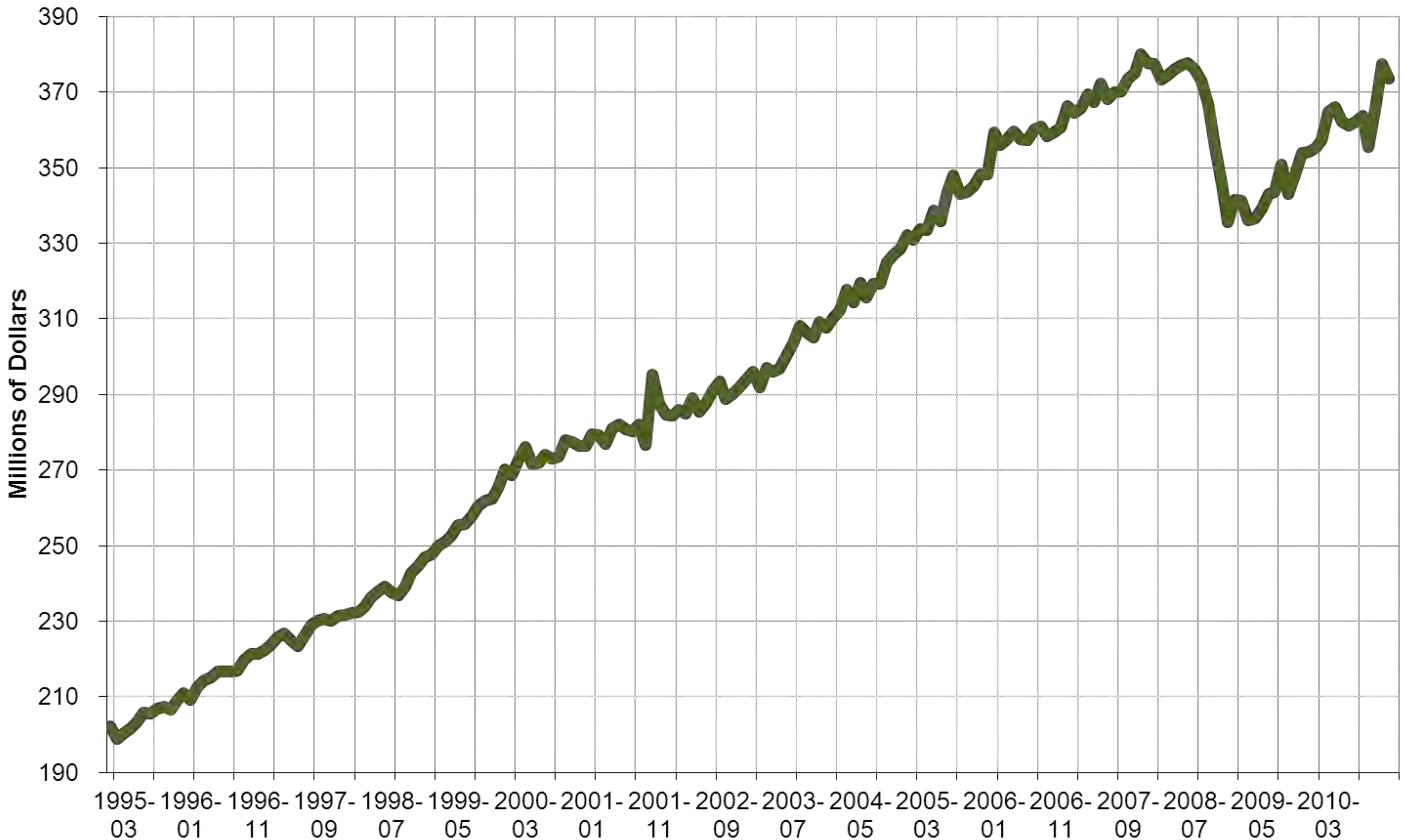
Source: CoStar; PPR

Grocery Stores Are Now Competing with Big Boxes – in most markets



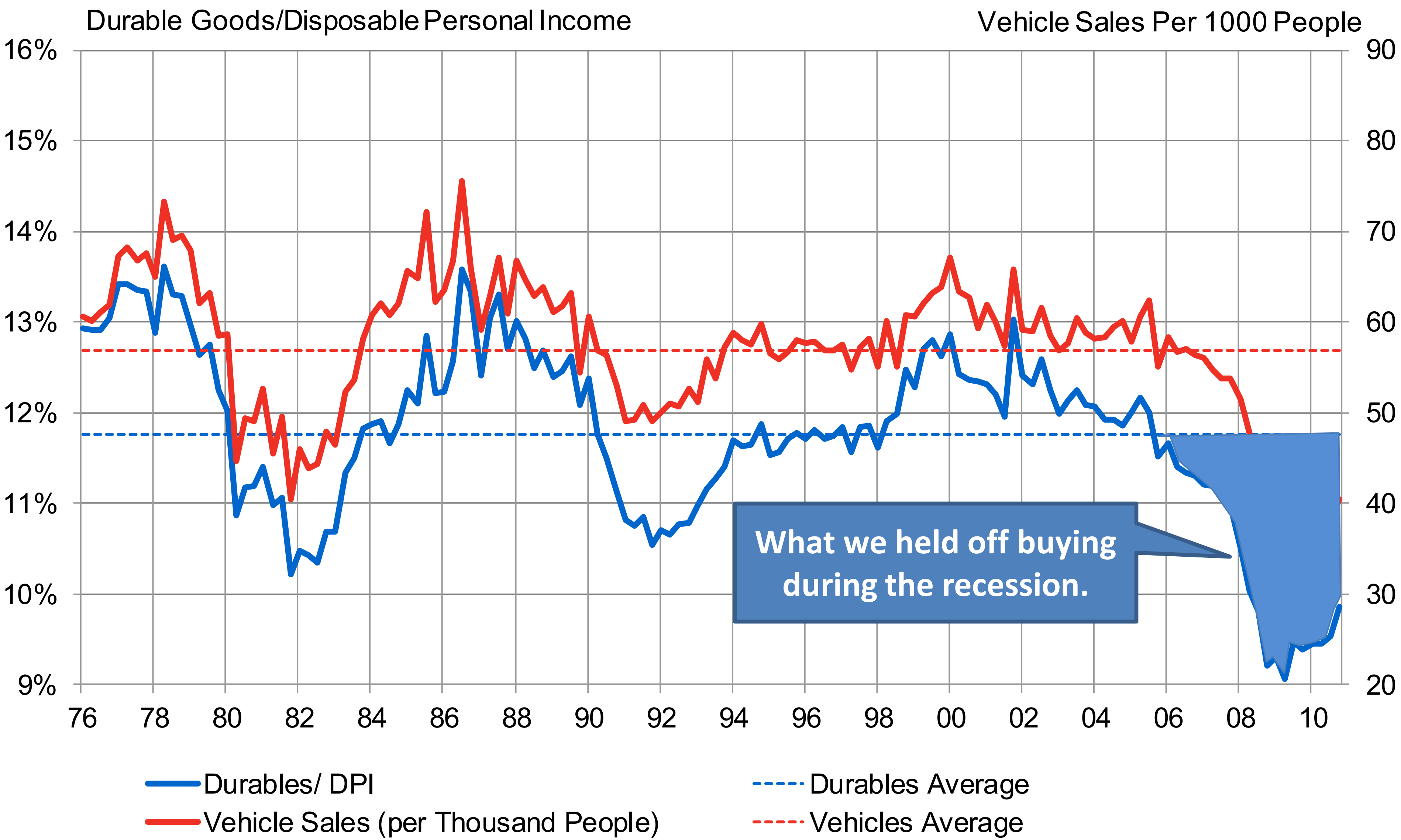
Sources: CoStar; PPR

US Retail Sales (Through Dec 2010)



Source: Commerce Department

Pent-Up Demand For Consumer Durables

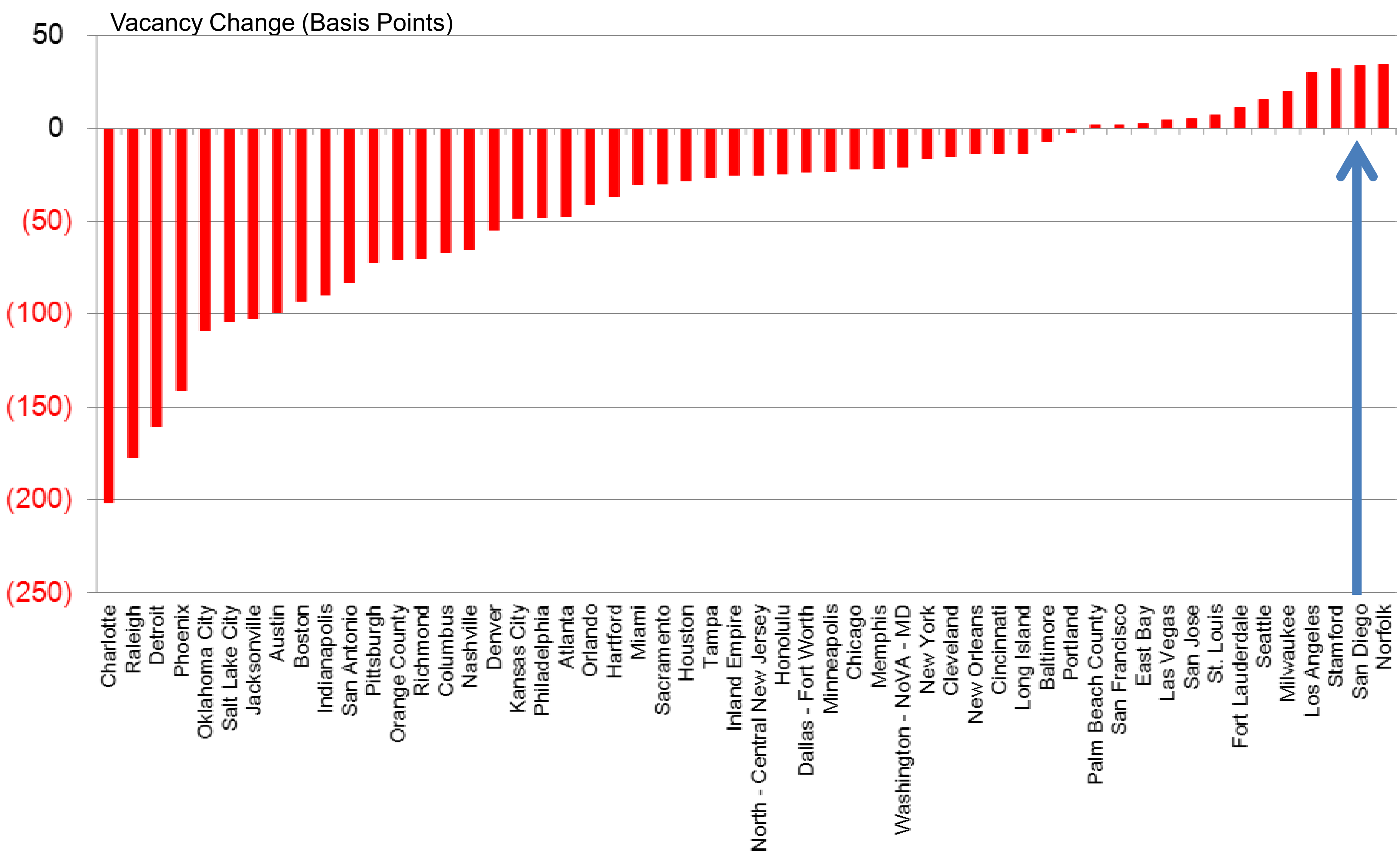


Sources: BEA; PPR

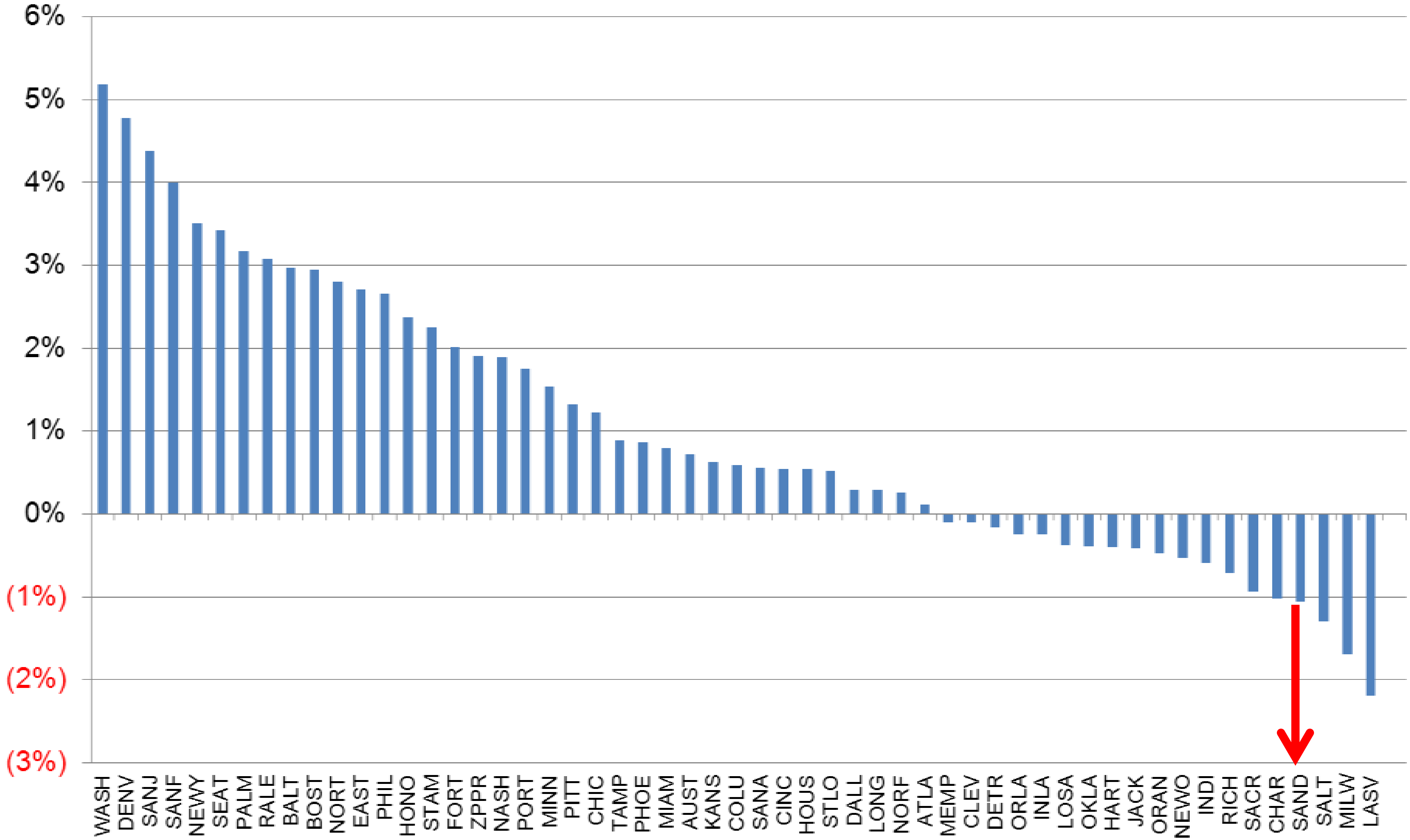
What else is driving retail spending? Could it be “strategic default”?

Homeownership Heading Down and Mortgage rates are heading up which is great for MF owners

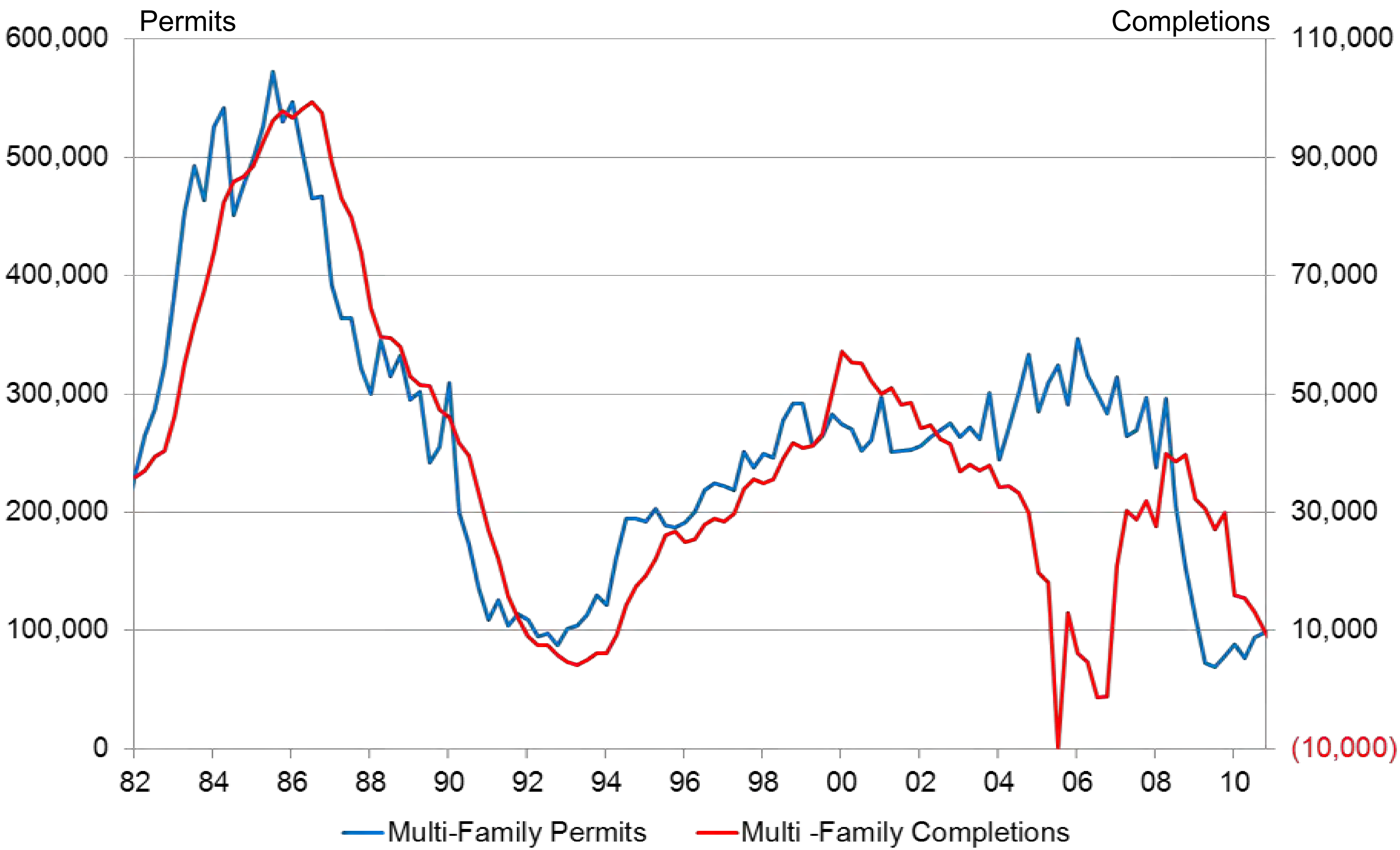
The Demand Remains Uneven: Vacancy Change Second Half 2010



2010 Change In Asking Rents on Apartments



Multifamily Permits Are Increasing But Still Very Low



Summary and Rational Strategies

Low Risk

1) Buy highly occupied properties and get low returns with low risk.
2) Develop or buy senior and health care housing facilities, medical office or student housing.

Moderate to High Risk

1) Time to buy hotels!
2) Buy distressed office real estate jointly with a major tenant and share in upside.
3) Buy distressed multifamily property from owners and lenders using short sales, especially if condo conversion down the road is possible. Note: Avoid HOAs like a plague.
4) Invest in Mez Equity to compliment the lower LTVs.
5) Upgrade properties for the GSA or others seeking Energy Star labeled property or LEED certified where demand is increasing.
6) Invest in data storage facilities or biotech after learning the nuances of tenant needs.
7) Start a business, some wild ideas include:

For a fee electric plugs in parking areas.

Customized manufacturing with 3 D printer design technology.

Thanks