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PwC Real Estate Market Outlook 2011

Burnham – Moores Center for Real Estate University of San Diego

Presented by:
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January 25, 2011

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PwC Real Estate Market Outlook 2011
Topics

PwC Real Estate Investor Survey™

Q&A

Emerging Trends In Real Estate®

Emerging Trends in Real Estate® 2011

32nd Annual Edition
600 survey participants
Over 275 interviewees
Released: Oct 2010

8th Annual Edition
339 survey participants
Over 290 interviewees
Scheduled: Feb 2011

5th Annual Edition
150 survey participants
Over 130 interviewees
Released: Dec 2010

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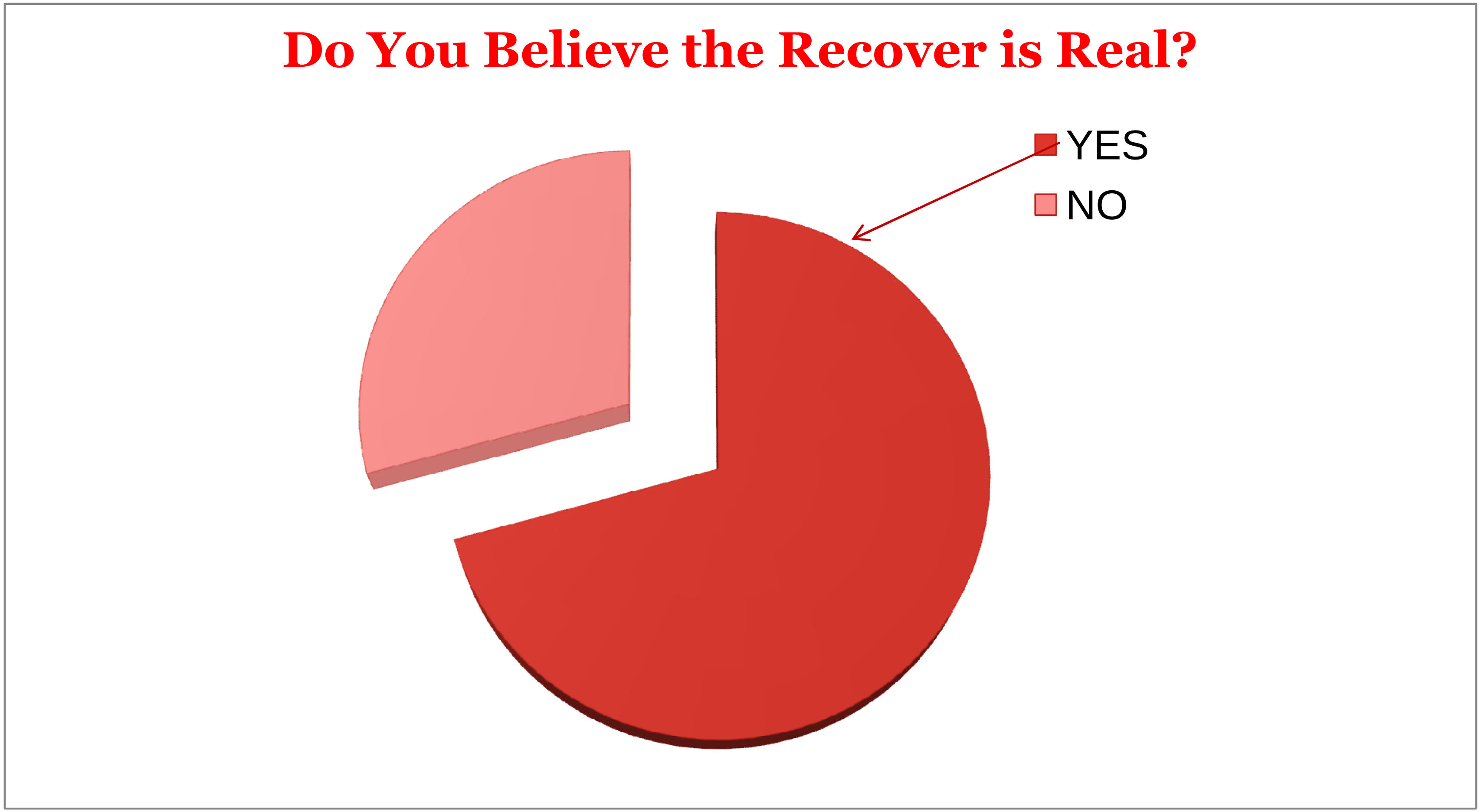
Emerging Trends in Real Estate 2011

- Longest published annual real estate outlook—32nd consecutive year
- “Most predictive industry forecast”
- Based on surveys/interviews with 875 industry leaders
- Written with “quotes”
- Jointly published by PwC and ULI

Recent Survey Conducted by PwC of over 200 Market Participants



Emerging Trends in Real Estate 2011 (cont.)

Entering the Era of Less

- Shrunken industry
- Lower returns
- Restrained development prospects
- Reduced credit availability
- Change in the profit model –the end of the endless refi
- Price discovery at lower levels

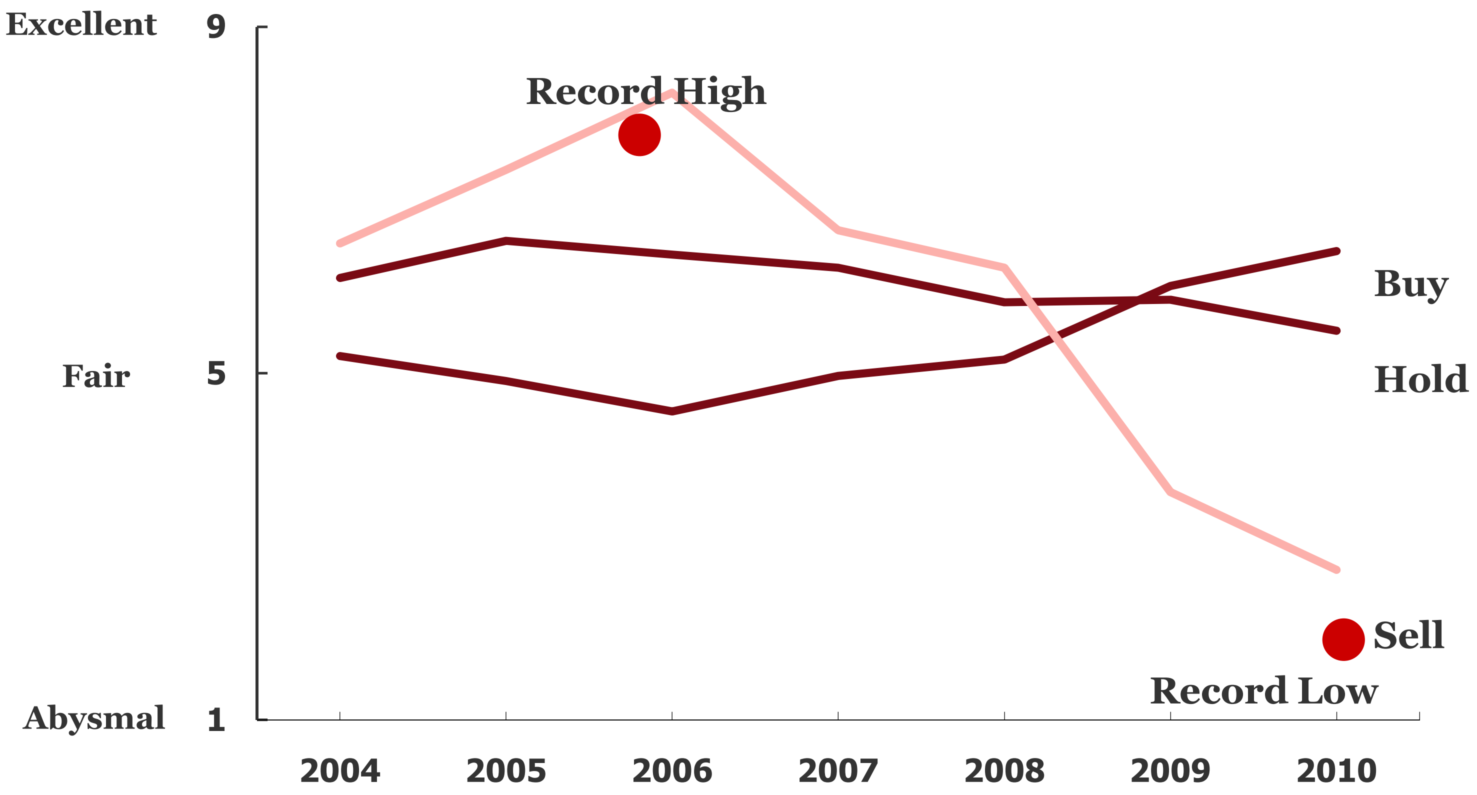
Recognition of substantial losses (30-50% haircuts on asset values)

The Good News: In 2011 We Are Off the Bottom

- Improved prospects for all markets and property sectors (albeit not great)
- Cash rich investors have plenty of options
- More buying opportunities
- Strengthening lender balance sheets
- Refinancing for owners with cash flows
- Recalibrated return expectations

ET 2010 Investment Barometer – Buy / Sell / Hold

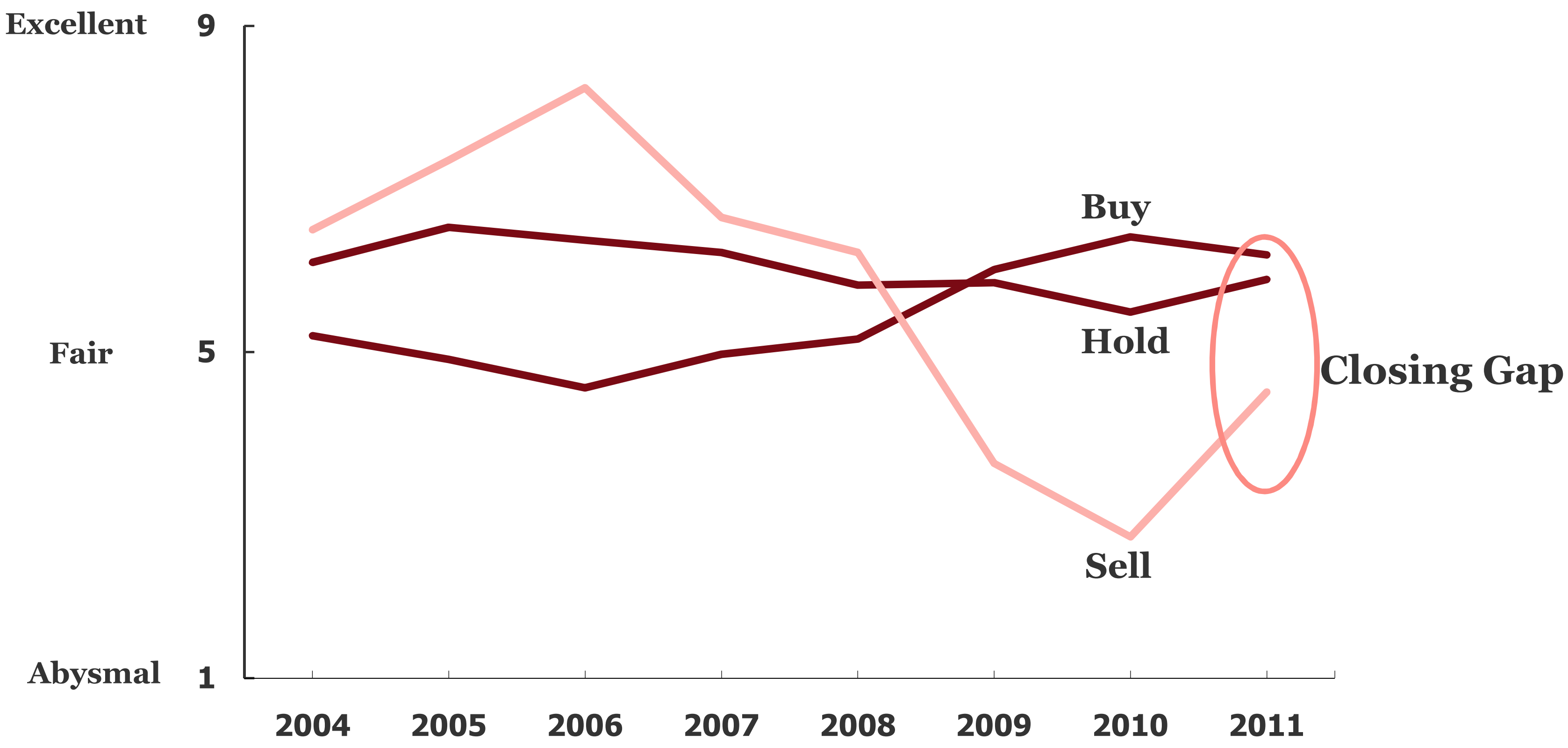
This is what it looked like last year – an all time low sell rating



Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on U.S. respondents only.

ET 2011 Investment Barometer – Buy / Sell / Hold

This year the gap closes



Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on U.S. respondents only.

Flight to Quality

"A deep canyon separates 'trophy' and 'trash' assets ..with a lot more trash... The best properties have cash flow and that's what buyers and lenders want."

"in a low interest rate environment – all I want is a good safe coupon "

Ample Availability of Equity

Real Estate Capital Market Balance Forecast 2011

“Investors with *dry powder* have plenty of options”

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on US respondents only.

More Quotes……

“There’s equity out there .. but it's far from abundant”

“What does the market need? Equity to fix the capital stack”

Still Limited Availability of Debt

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on US respondents only.

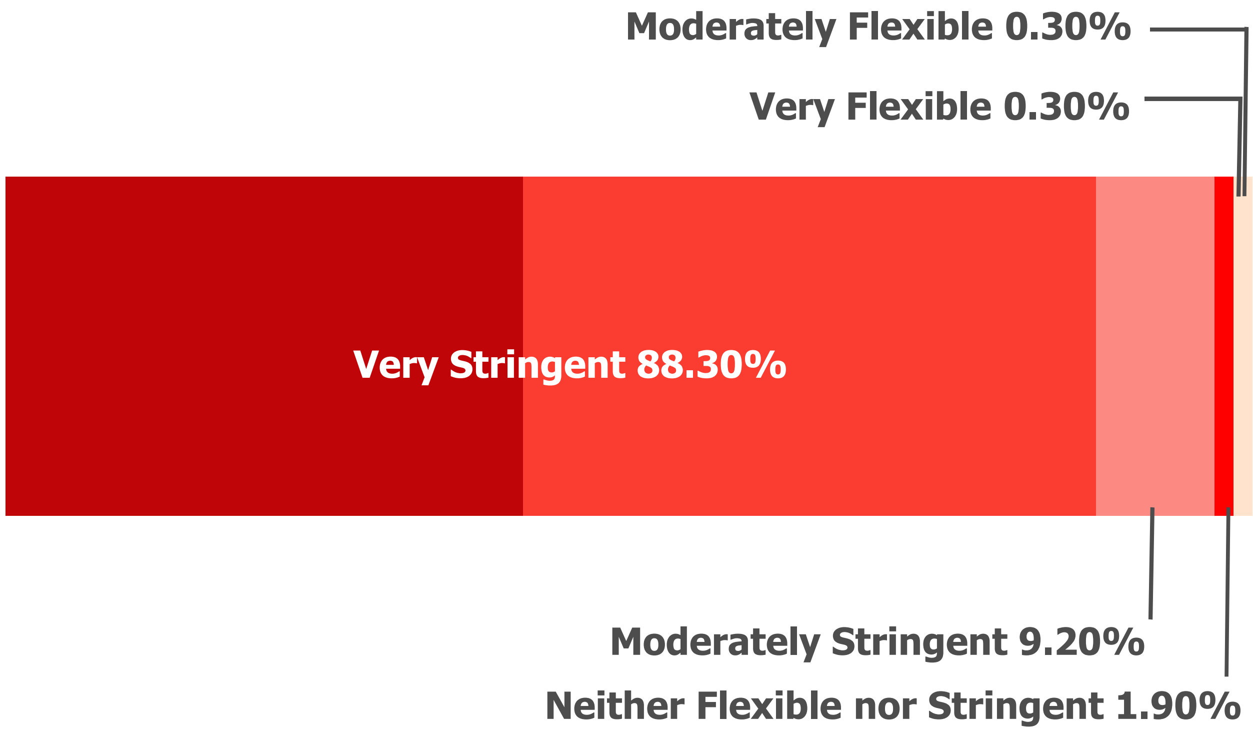
Outlook for Loan Underwriting in 2011

Less Rigorous	Remains the Same	More Rigorous
32.8%	40.6%	26.6%

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on US respondents only.

Underwriting Standards

FOGETABOUTIT!!!!



Source: *Emerging Trends in Real Estate 2010* survey.
Note: Based on U.S. respondents only.

Yet Loan Maturates Continue to Hang Over the Market

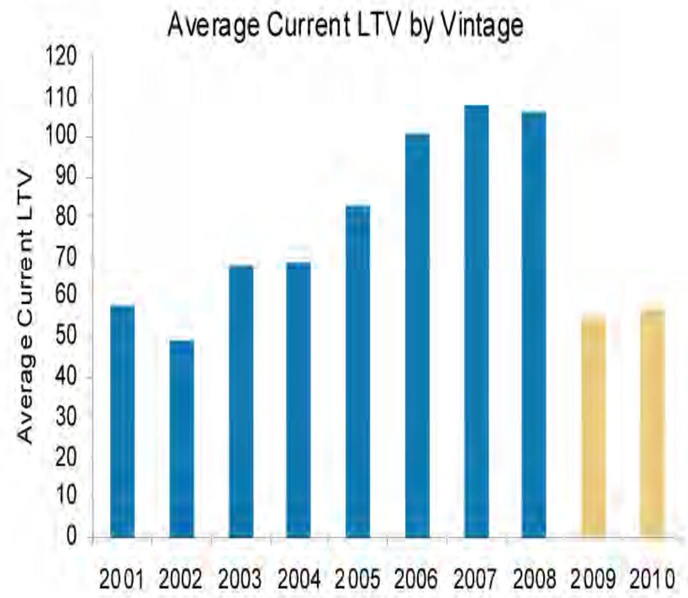
Approximately $1.4 Trillion in Commercial Real Estate Debt Set to Mature Through 2013, and $2.8 Trillion Through 2020

$ Bn	Banks*			CMBS				
Maturity Year	Core CRE	Multi-family	Const. / Lands	Conduit	Floater	Life Cos.	Other	Total
2011	$167.4	$35.4	$376.7	$38.9	$15.3	$18.0	$58.4	**$710.0**
2012	172.7	36.5		56.7	19.2	19.5	63.3	**367.9**
2013	165.9	35.1		42.5	1.1	20.3	63.1	**328.0**
2014	139.5	29.5		53.7	0.5	19.3	60.1	**302.6**
2015	113.4	24.0		101.3	1.3	18.2	51.6	**309.7**
2016	77.8	16.5		135.8	0.1	17.7	45.7	**293.6**
2017	60.1	12.7		136.3		16.9	39.0	**265.1**
2018	42.9	9.1		7.1		14.9	33.5	**107.5**
2019	30.7	6.5		4.0		12.4	24.2	**77.8**
2020	22.4	4.7		3.1		9.7	15.8	**55.8**
Total	**$992.8**	**$209.9**	**$376.7**	**$579.3**	**$37.5**	**$167.0**	**$454.7**	**$2,817.9**

*Banks maturity profile is an MS estimate

Source: Foresight Analytics, SNL, Intex, Trepp, Morgan Stanley

Average LTV's as of 2011 by Vintage Under Our Base Case Scenario

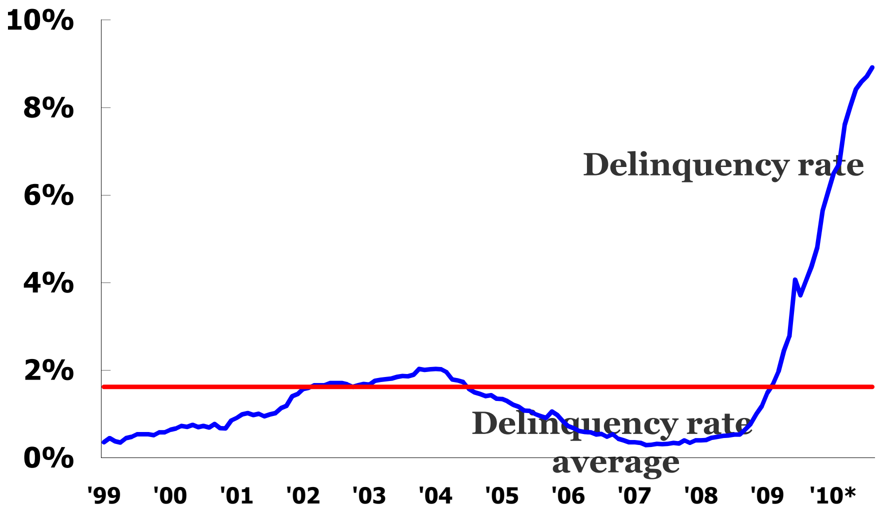


Source: CMA, Morgan Stanley Research
Note: 2009-2010 LTV's are initial, 2001-2008 come from our credit models

"The mountain of maturities keeps me up at night"

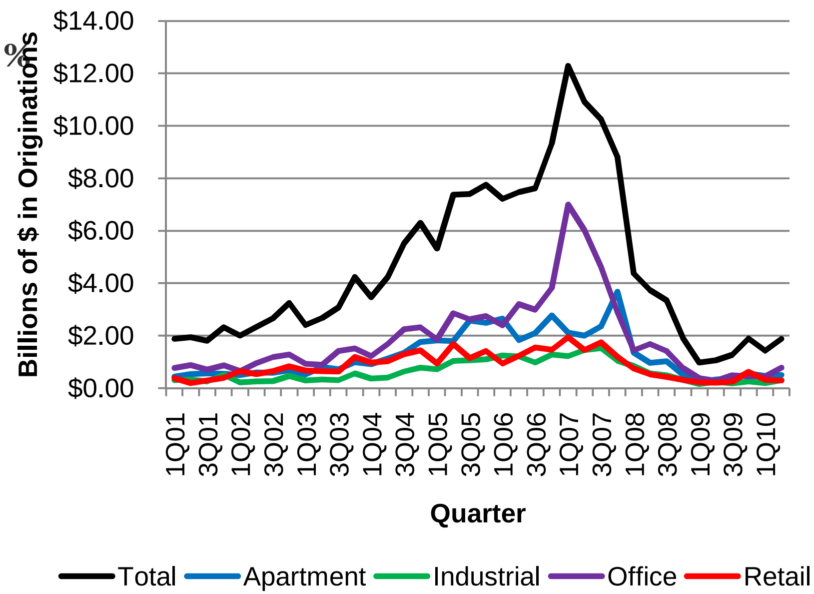
Delinquencies and Defaults

CMBS Delinquency Rates



Source: Trepp LLC

U. S. CRE Loan Origination



Source: RCA

The era of EXTEND and PRETEND is over – it's now AMMEND and EXTEND

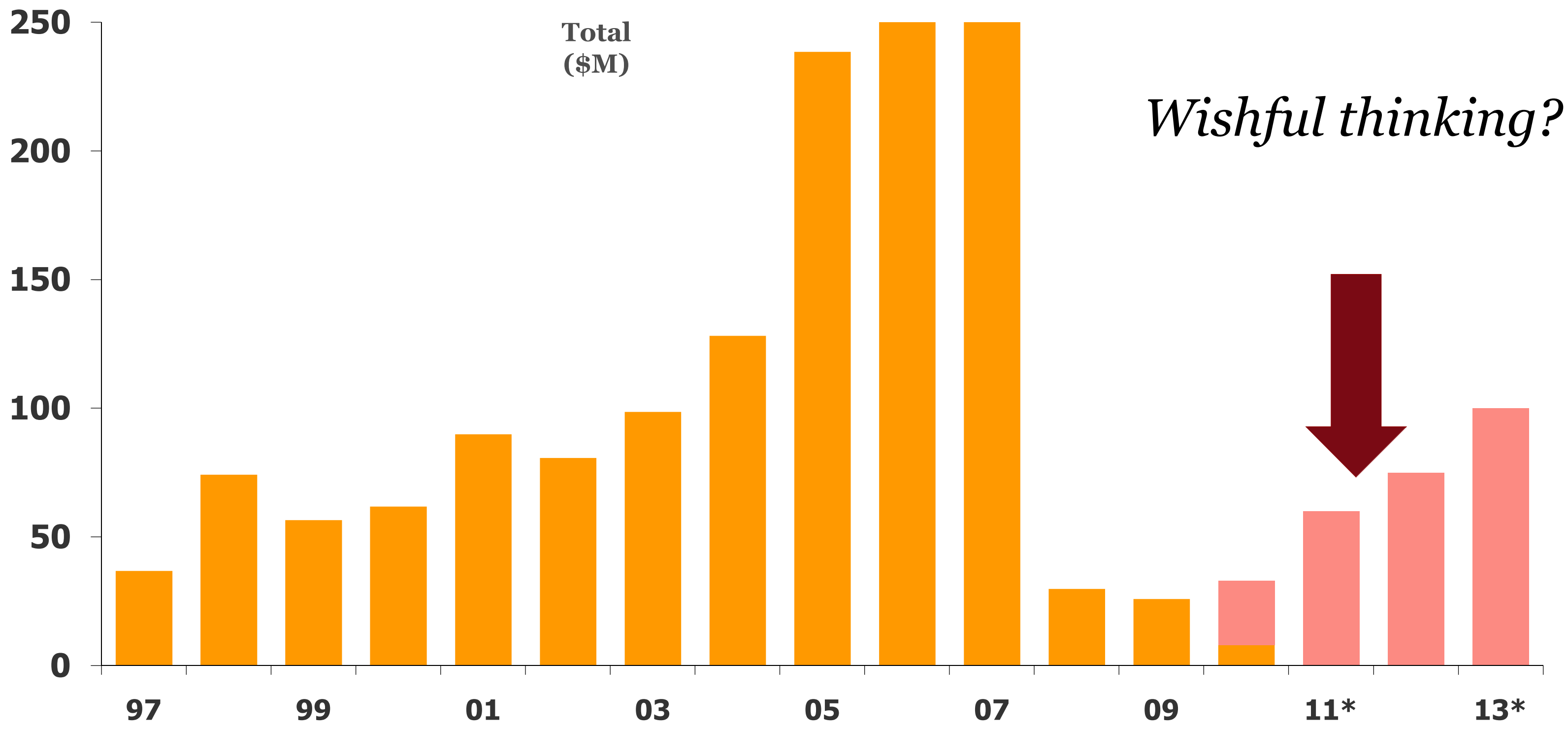
Prospects Obtaining (Re)Financing

Cash Rich Investors/Class A	**Very Good**	☺☺
Credit Stretched Owners/Class B+	**Good and improving**	☺
Underwater Borrowers/Class B/B-	**Problematic**	😐
Underwater Borrowers/Class C	**Ouch**	☹

"The better your collateral –
the more proceeds you can finance"

CMBS Redux ????

US CMBS Issuance



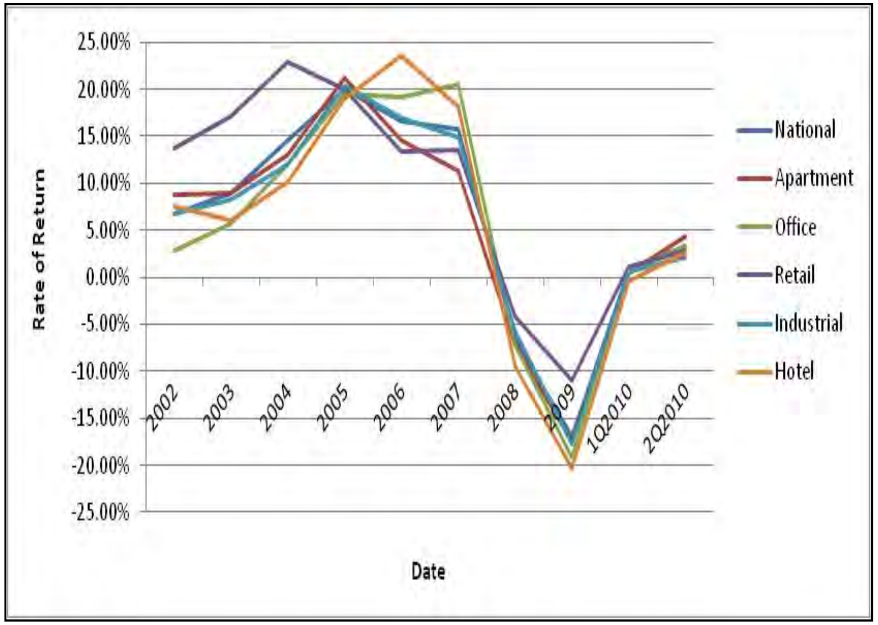
Source: Commercial Mortgage Alert. * Issuance total through August 31, 2010.
* Forecast based on Emerging Trends interviews

Return Outlook

"After a 30% to 40% loss it could take a long time to make up ground."

Core private unleveraged:	7.5%
REITs:	8.2%
Opportunity:	Mid-teens

The NCREIF Property Index (NPI)



“It’s very hard to get 15% to 20% rates of return without more risk and more leverage . The Real Estate Business today is more about cash flow and keeping assets leased.”

“After a decade of anemic stock market returns – high single digits in Real Estate aren't so bad”

Doubting US Economy

- Outsized personal and government debt
- High unemployment
- Stagnating wages
- Consumption down, savings up

According to Those Surveyed – The Shape of Recovery

No Way	Hopefully	Probably	Help
V	U	Reverse 	DD

"Regardless of the shape, the [recovery] will be jobless"

"It's All About Jobs"

- Global competition: America's high cost labor market loses to lower cost places
- Internet/Telcom: Manufacturing jobs losses now extend to service and tech sectors
- Firms learn to operate profitably - with fewer workers in less space
- Jobs shift to lower paying *right to work* states
- Technology eliminates many traditional middle class jobs
- States/local government cut workers to balance budgets

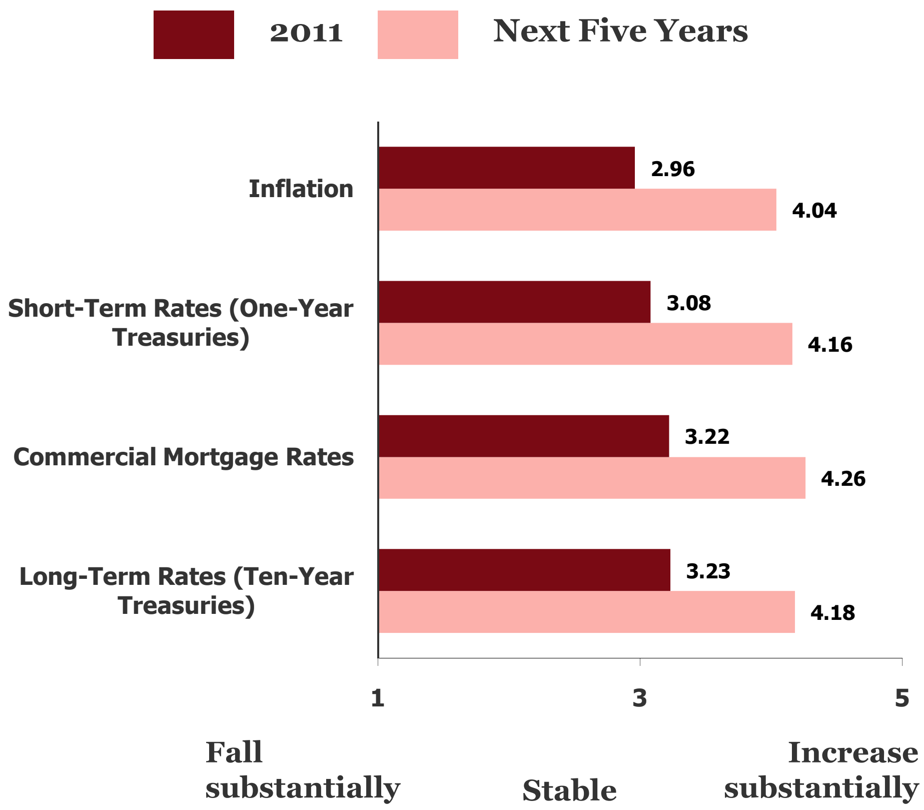
Real Estate Demand Formula

Less jobs = Less demand for space

- Absorption will be slow
- Thankfully the days of spec construction are over

Inflation v. Deflation

- Interest rates stay low, increase longer-term
- As Fed prints money, inflation is in our future
- Hard assets like real estate benefit, if demand picks up
- Beware another asset bubble, if rates stay down too long – the "bubblette"



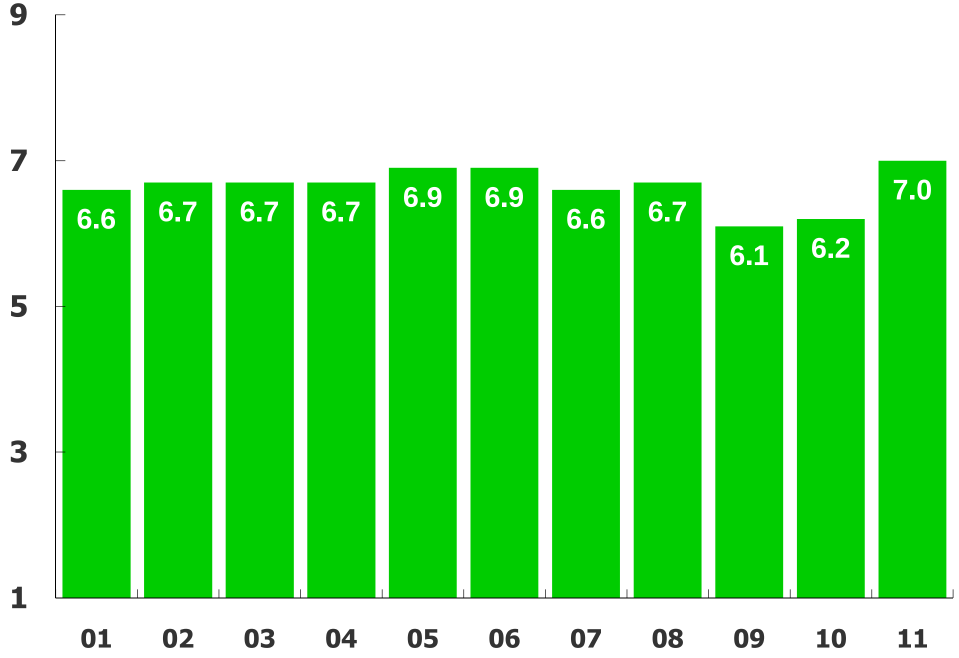
Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on US respondents only.

"If deflation occurs we're all in the wrong business."

Markets to Watch

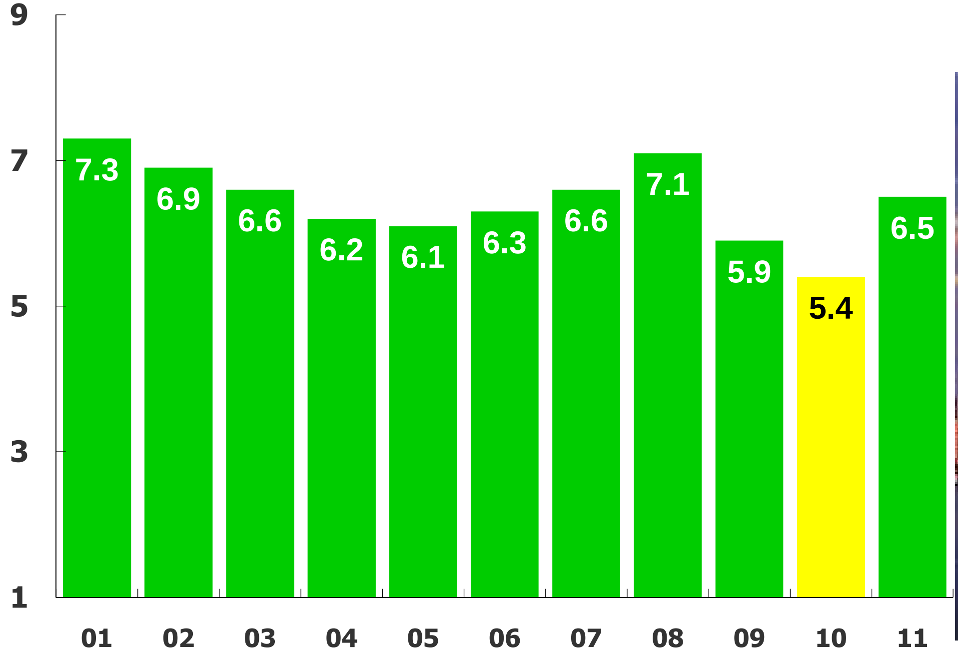
Survey #1: Washington DC

Historical Rating



Survey #2: New York

Historical Rating



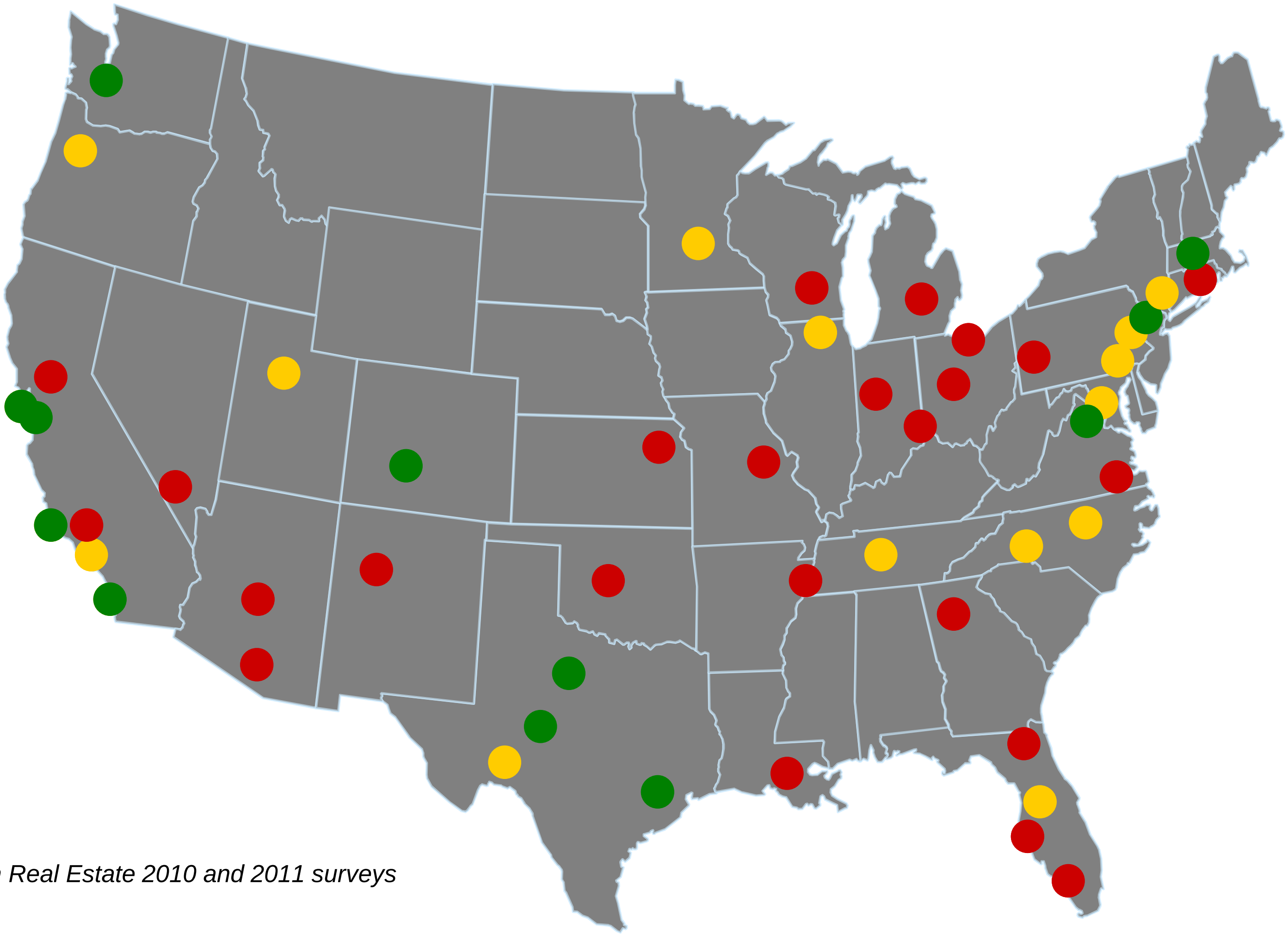
Survey Top 10

	2011	2010
1. **Washington D.C.**	7.01	6.17
2. **New York** (4th in 2010)	6.56	5.41
3. **San Francisco** (2nd in 2010)	6.34	5.57
4. **Boston** (3rd in 201o)	6.20	5.42
5. **Seattle** (6th in 2010)	6.09	5.31
6. **Houston** (5th in 2010)	6.02	5.39
7. **Los Angeles** (9th in 2010)	5.84	5.13
8. **San Diego** (10th in 2010)	5.63	5.04
9. **Denver** (7th in 2010)	5.58	5.21
10. **Dallas** (8th in 2010)	5.50	5.10

Our Color Coding

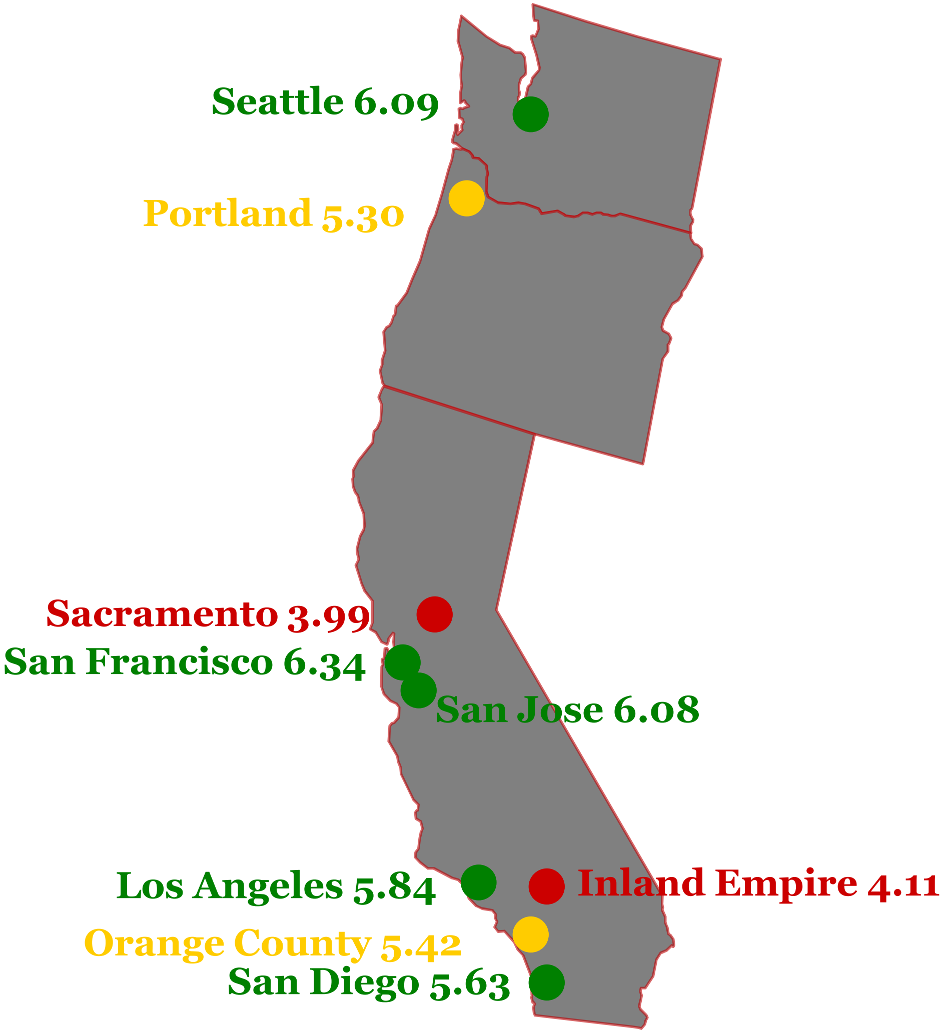
- Green = Not So Bad
- Yellow = Not so Good
- Red = Really Bad

Markets: 2010 and 2011 Emerging Trends



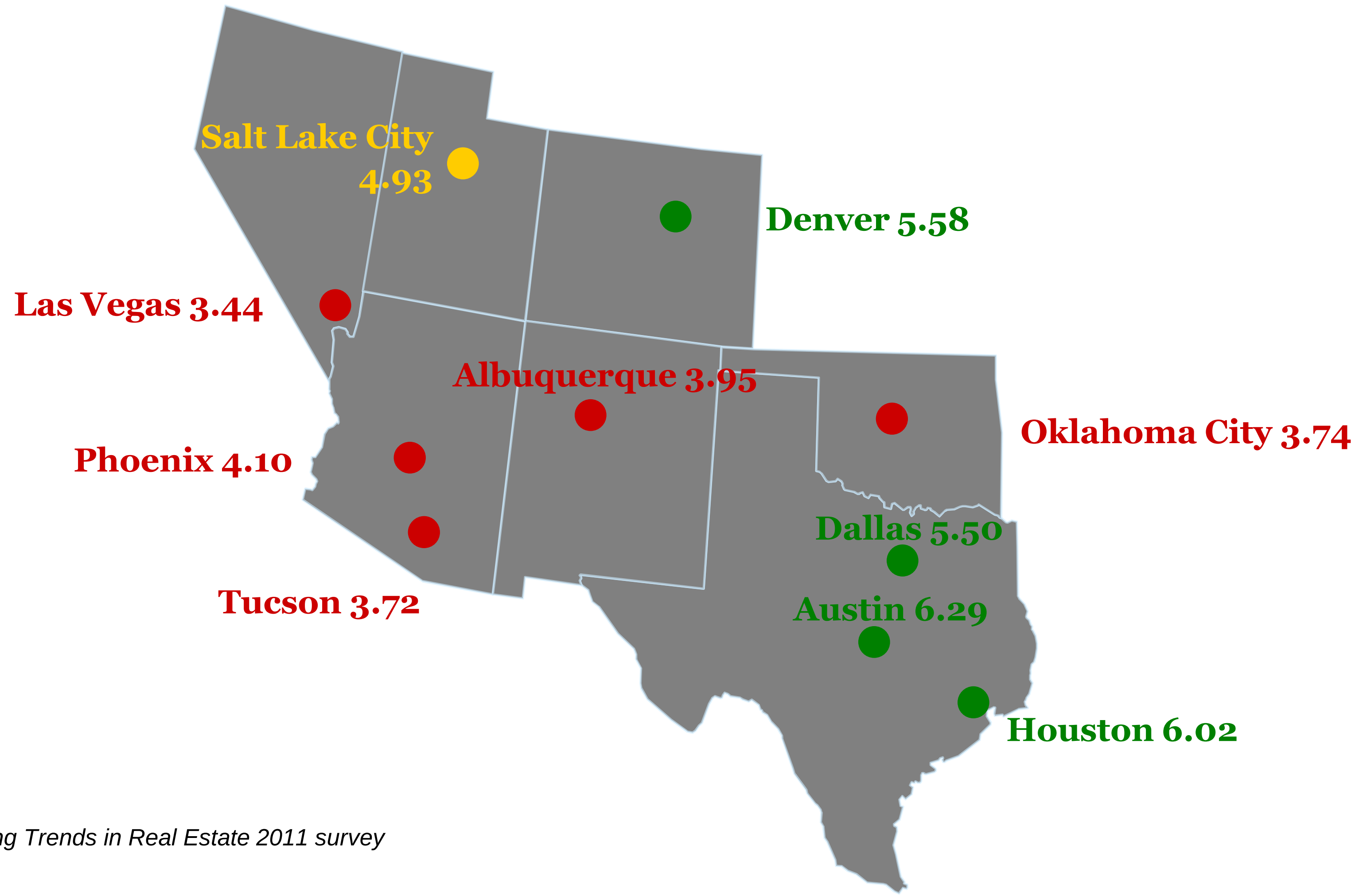
Source: *Emerging Trends in Real Estate 2010 and 2011 surveys*

West Coast



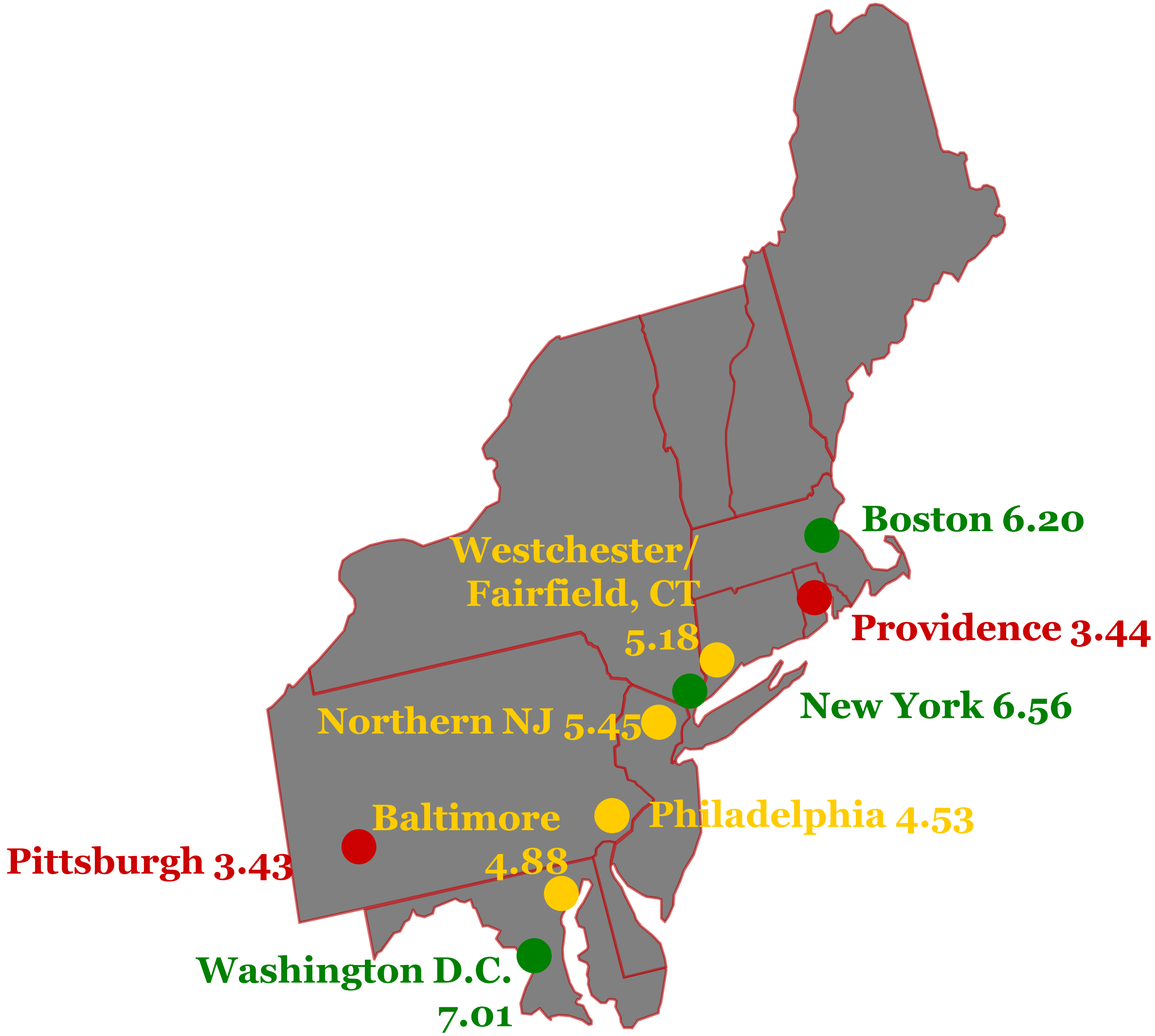
Seattle 6.09
Portland 5.30
Sacramento 3.99
San Francisco 6.34
San Jose 6.08
Los Angeles 5.84
Inland Empire 4.11
Orange County 5.42
San Diego 5.63

Southwest

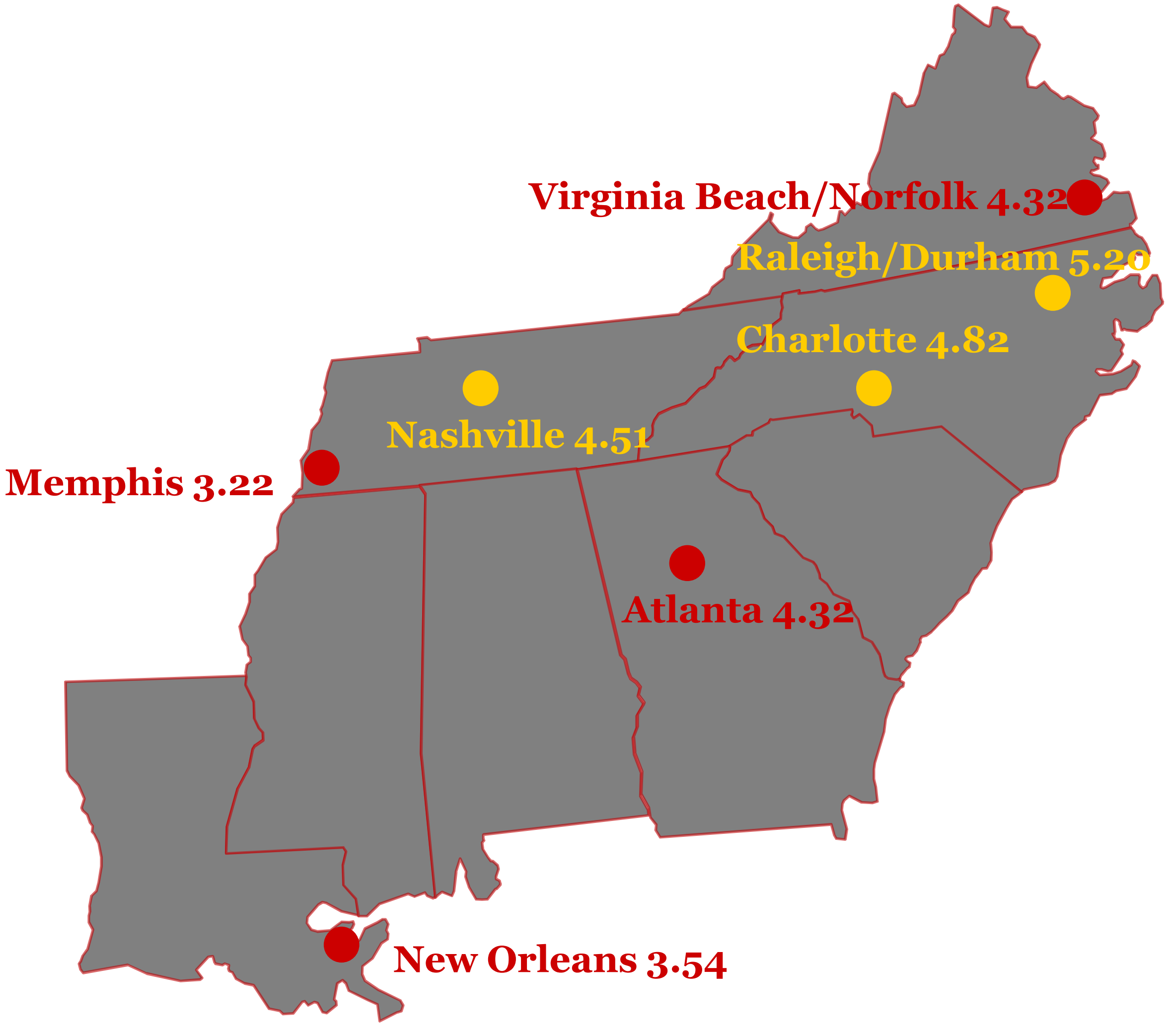


Source: *Emerging Trends in Real Estate 2011 survey*

East Coast

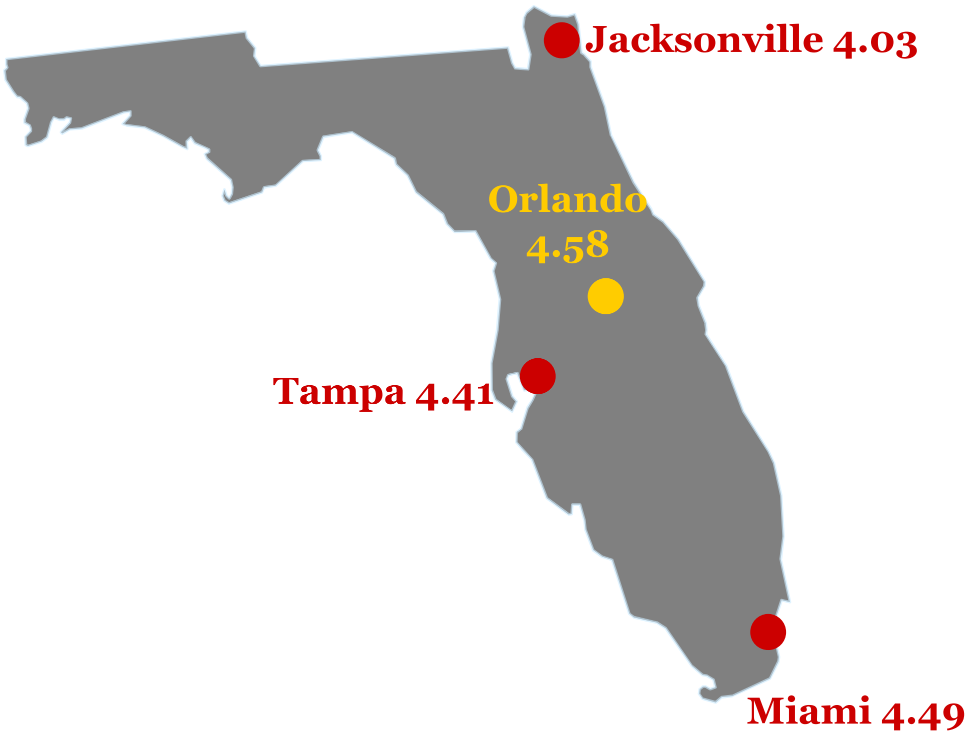

Boston 6.20
Westchester/
Fairfield, CT
5.18
Providence 3.44
New York 6.56
Northern NJ 5.45
Baltimore
4.88
Philadelphia 4.53
Pittsburgh 3.43
Washington D.C.
7.01

Southeast

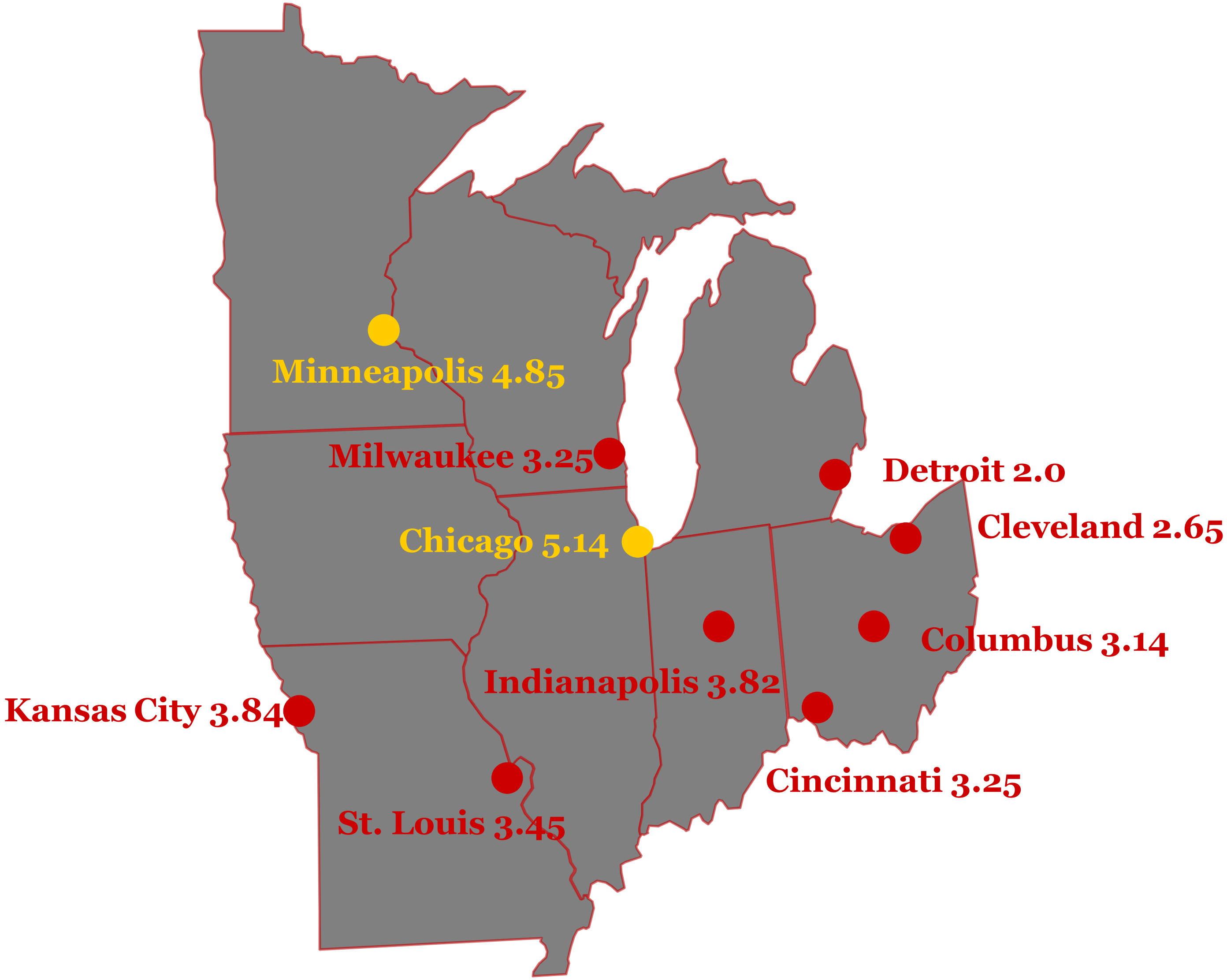


Virginia Beach/Norfolk 4.32
Raleigh/Durham 5.20
Charlotte 4.82
Nashville 4.51
Memphis 3.22
Atlanta 4.32
New Orleans 3.54

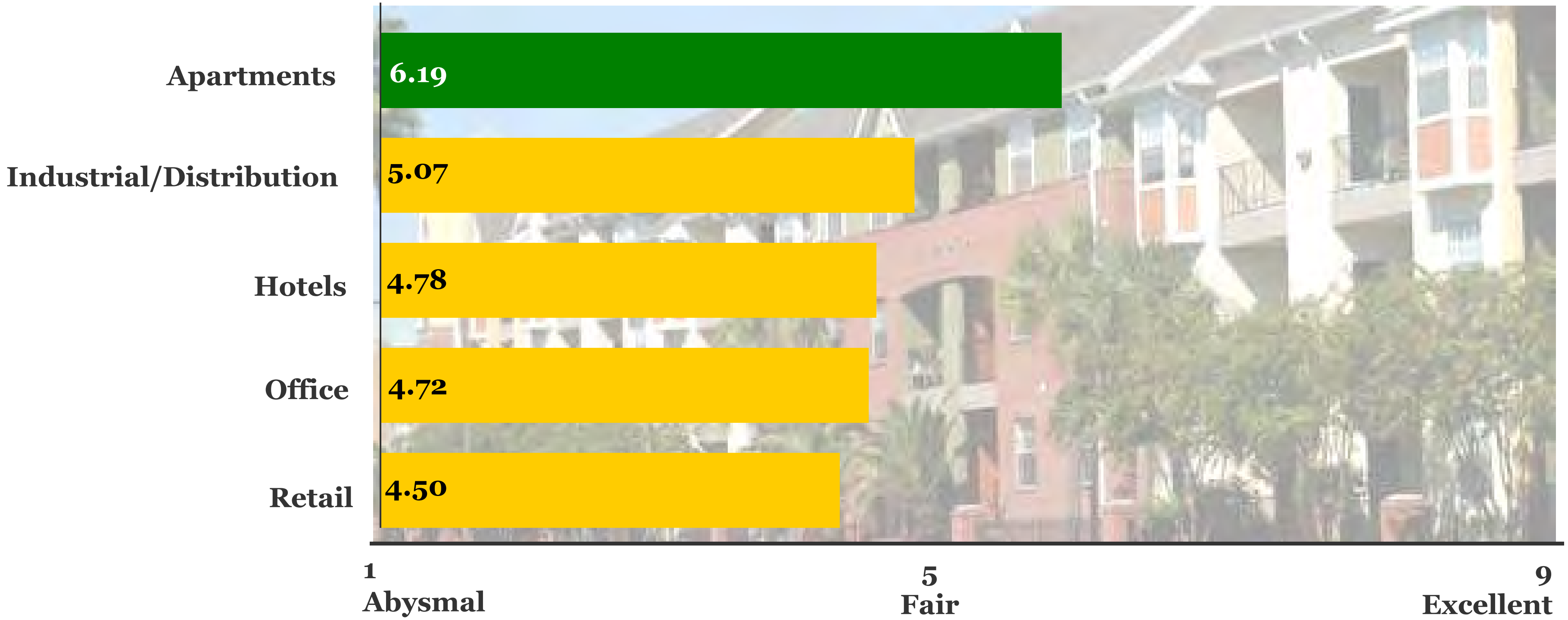
Florida



Midwest


Minneapolis 4.85
Milwaukee 3.25
Detroit 2.0
Cleveland 2.65
Chicago 5.14
Columbus 3.14
Indianapolis 3.82
Kansas City 3.84
Cincinnati 3.25
St. Louis 3.45

Property Sector Investment Rankings



Source: *Emerging Trends in Real Estate 2010* survey.
Note: Based on US respondents only.

Best Bets: Investments

- Temper expectations
- Lock-in leverage (if you can)
- Provide debt and recap equity
- Focus on global gateways, 24-hour markets
- Favor infill over fringe
- Buy or hold REITs
- Buy land
- Exercise caution on distressed loan pools

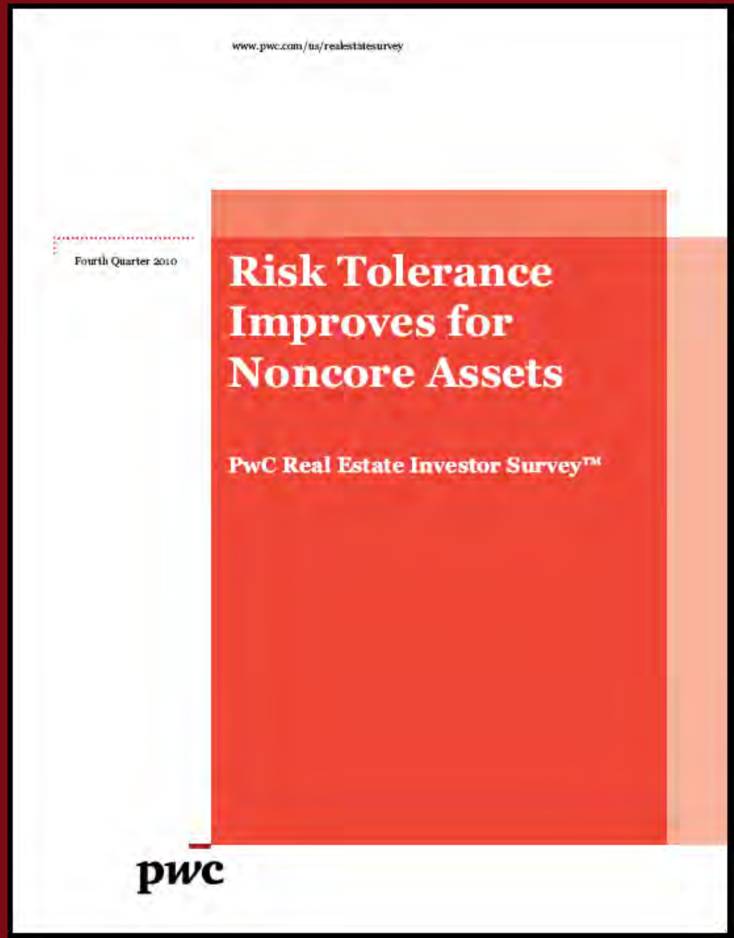
Best Bets: Development

- Apartments—increasing activity in tightening infill markets
- The odd warehouse
- Select build-to-suit office projects
- Demand for premium product three to five years out
- Housing—need to absorb excess supply from overbuilding, foreclosures
- Export talent
- Build green

Less Space

- Housing
  - Inter-generational living together
  - Less reliance on cars
- Office
  - Downsizing space per capita
  - Outsourcing to domestic freelancers and overseas, more hoteling
- Retail
  - Smaller stores, best locations, more e-commerce
- Industrial
  - Fewer links in distribution chains

PwC Real Estate Investor Survey™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Fourth Quarter 2010

Risk Tolerance Improves for Noncore Assets

PwC Real Estate Investor Survey™

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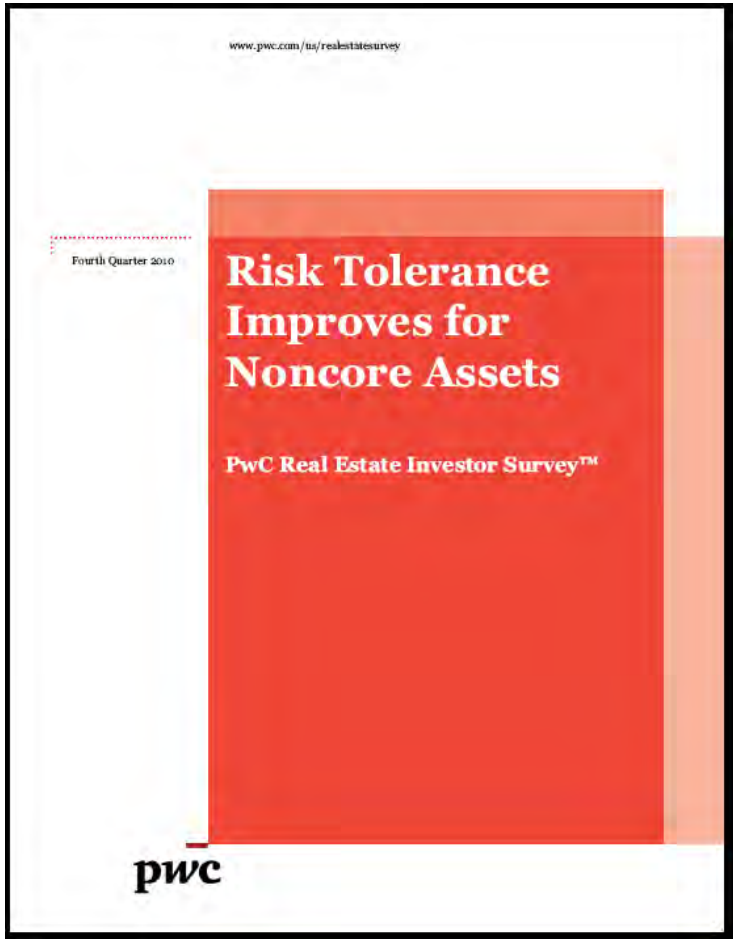
PwC Real Estate Investor Survey ™

- ✓ Formerly known as “Korpacz Survey”
- ✓ In its 24th year – longest running quarterly Real Estate Market Forecast
- ✓ Covers 31 national, regional, and city – specific markets
- ✓ Encompasses , office, retail, industrial and apartment properties
- ✓ Survey participants are asked to look forward NOT backwards
- ✓ Strong base of recurring survey participants of more than 125 (each quarter)



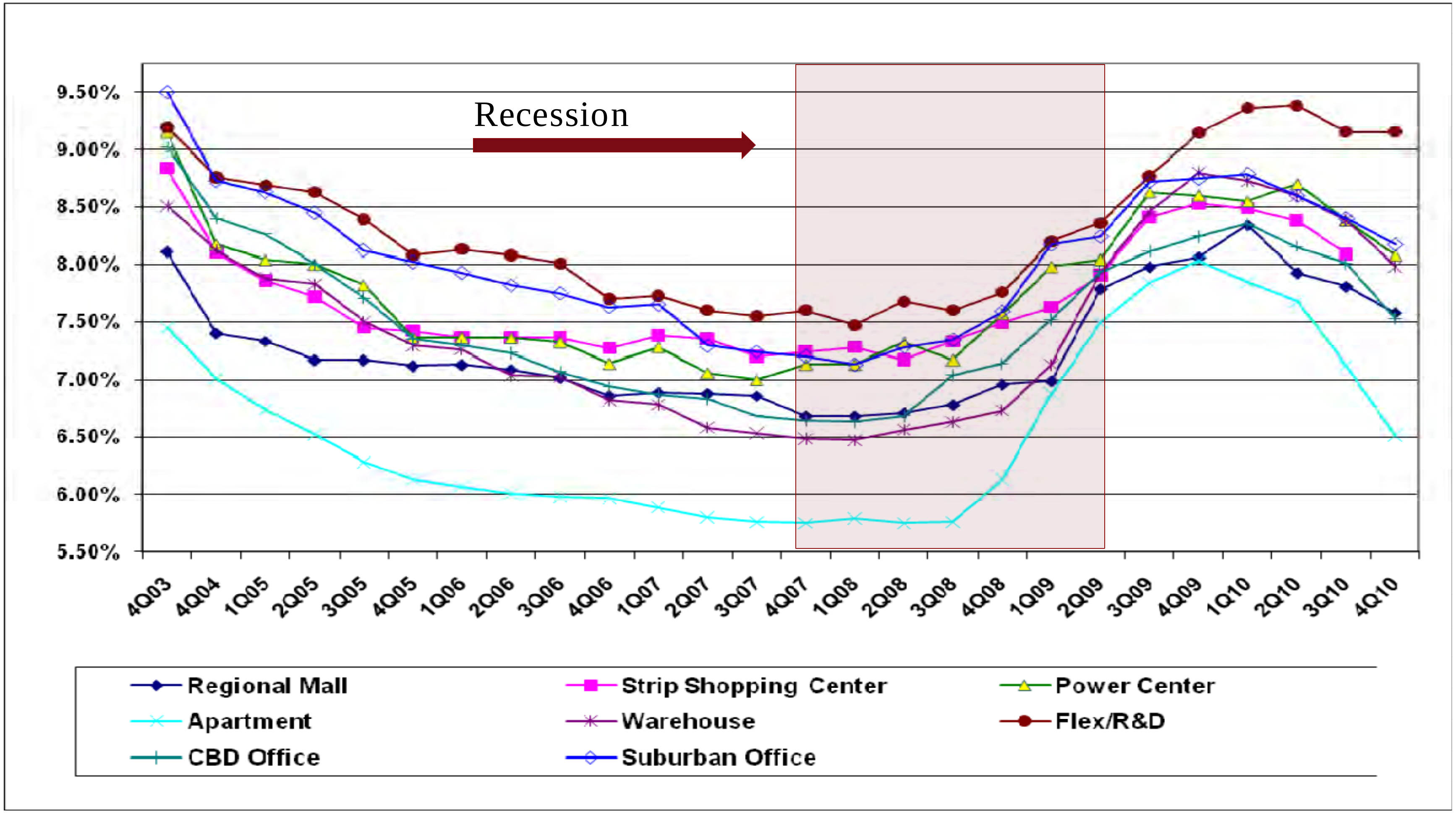
PwC Real Estate Investor Survey

National Highlights – Fourth Quarter 2010

- Investors signal signs that the US economy is likely to evade a double-dip recession.
- Supply-demand dynamics of the frail commercial real estate industry have mostly bottomed.
- Increased willingness to look for buying opportunities beyond core markets, trophy assets or vastly distressed properties.
- Both investors and lenders are gaining more confidence in the performance of the economy and the industry as a whole.
- Investors are looking to widen investment parameters and take on additional risk.
- Flight to quality .focus remains

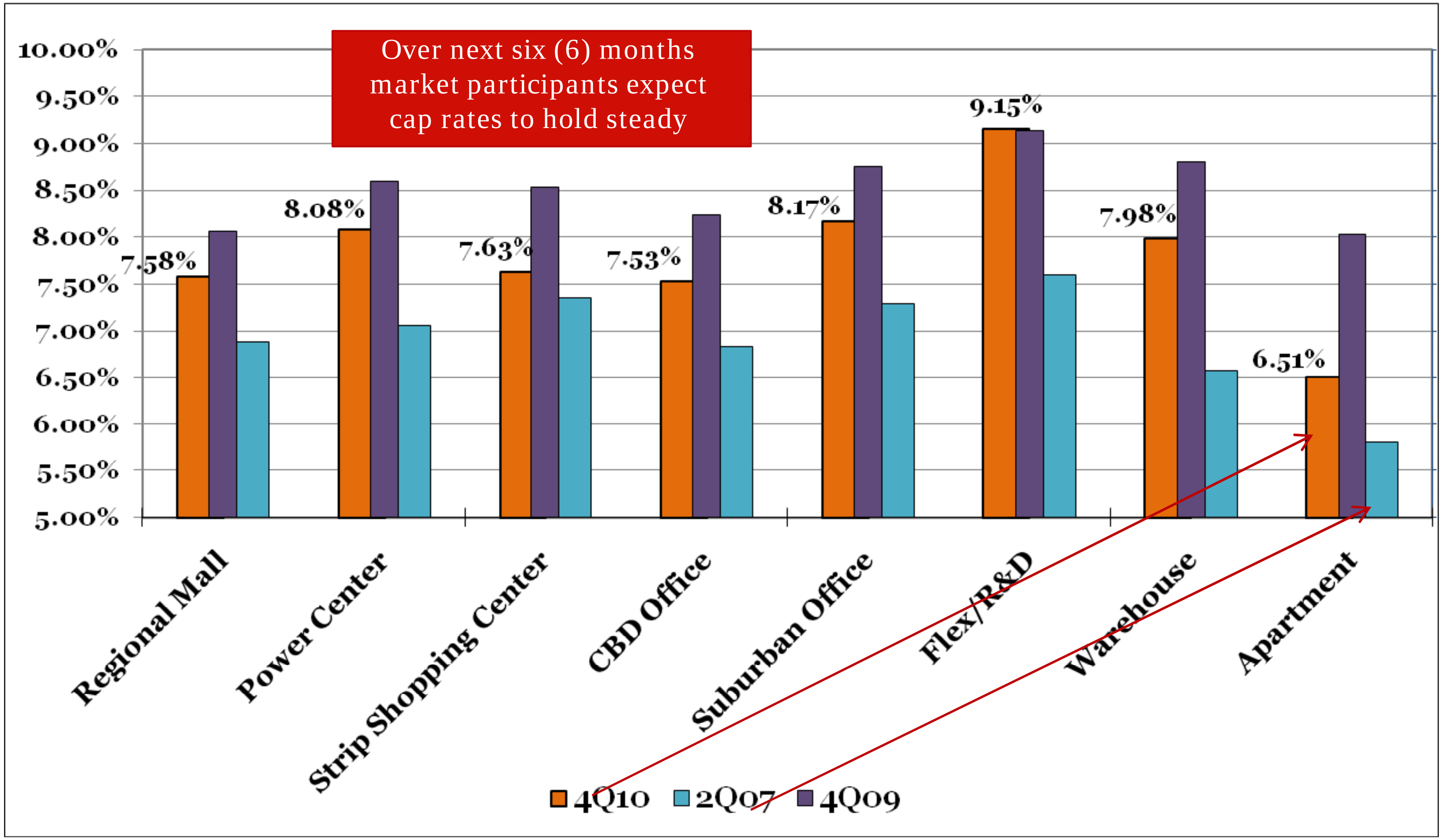
Overall cap rate trends

Strong buyer interest, debt availability, and low interest rates continue to compress overall cap rates for core assets.



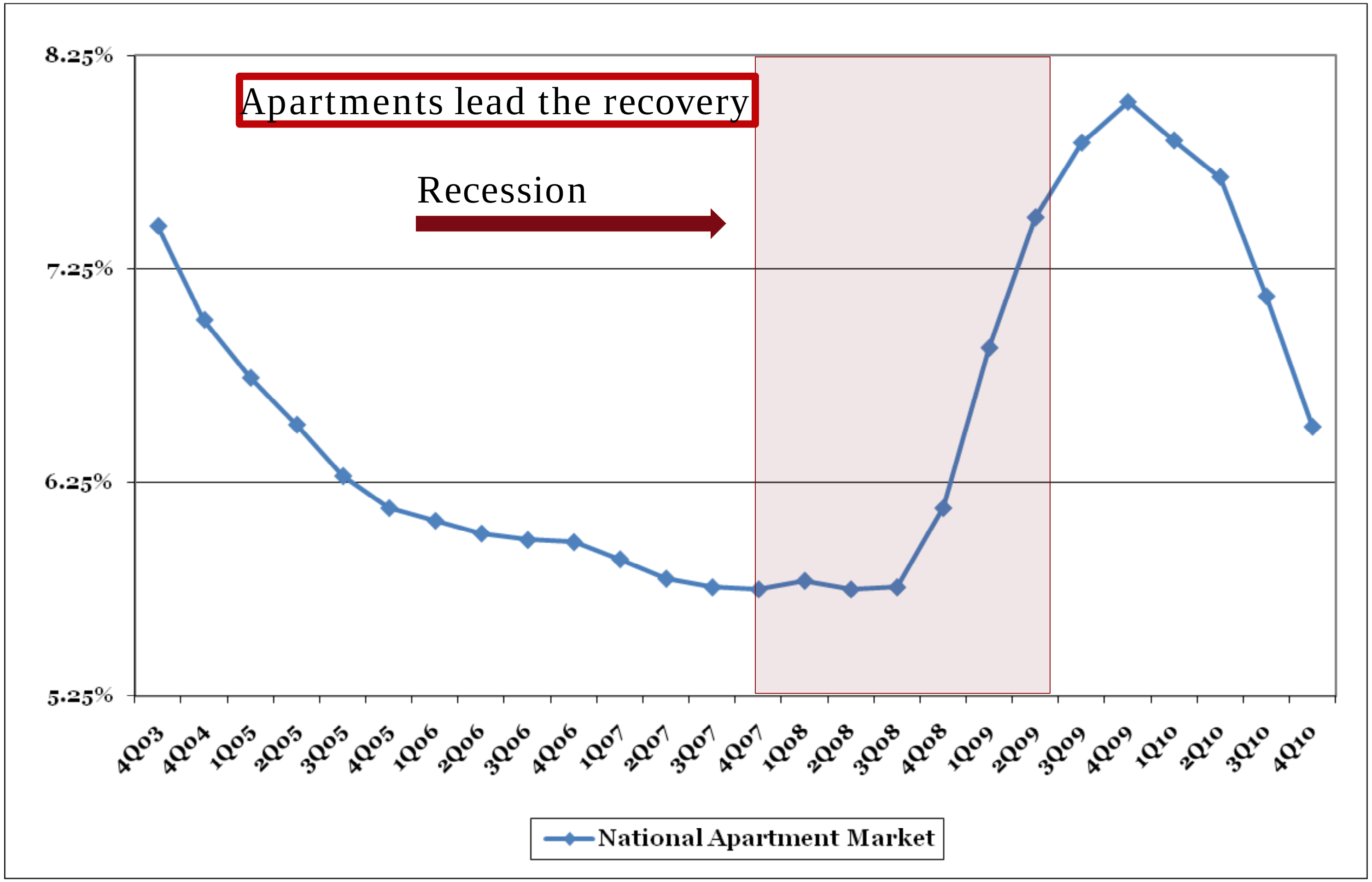
Overall cap rate trends

While averages have dipped for national markets (except flex/R&D) over the past year, they remain above 2007 levels.



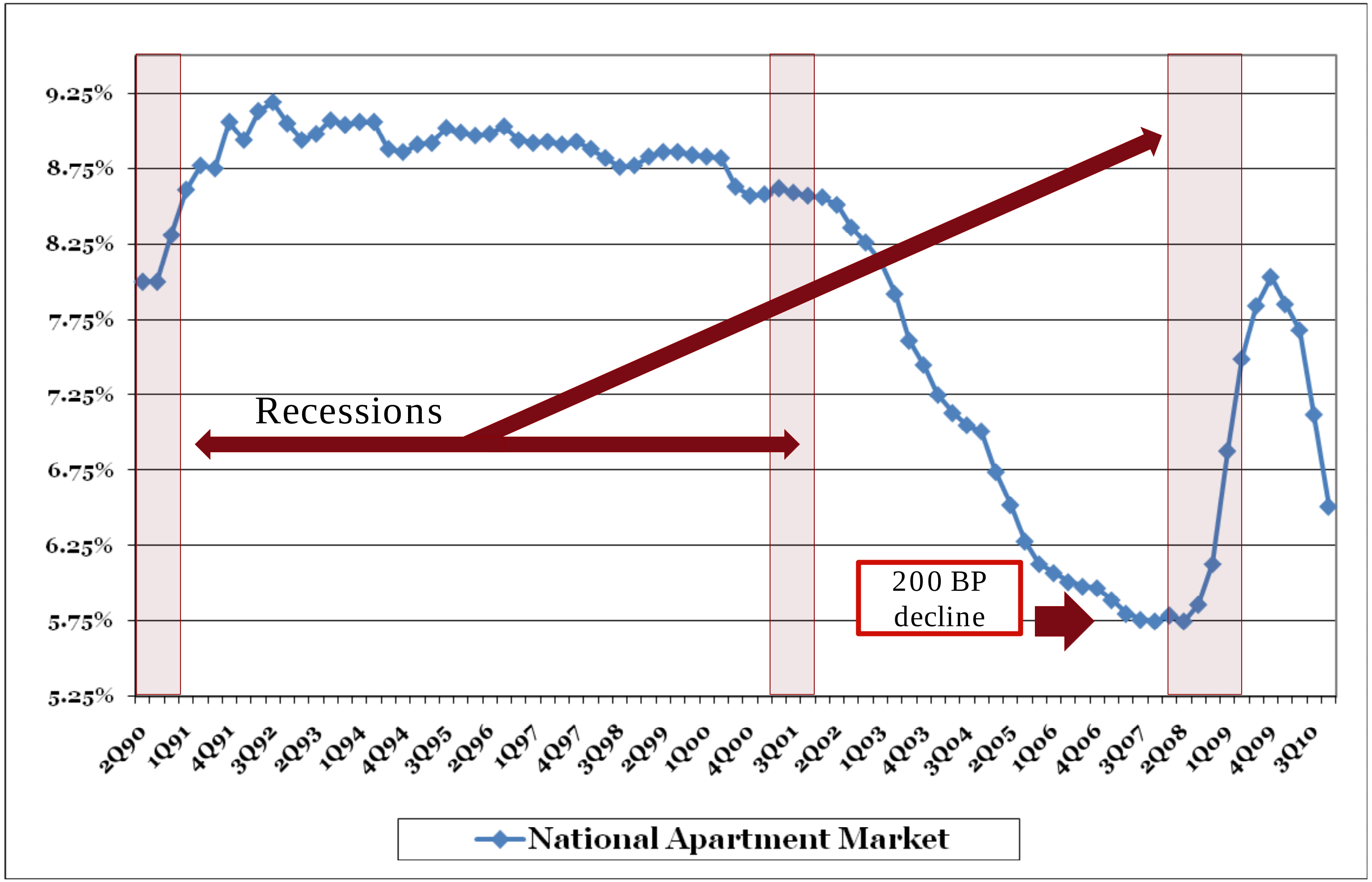
Overall cap rate trends - Apartments

Rates have expanded and compressed the most in the Survey's national apartment market.



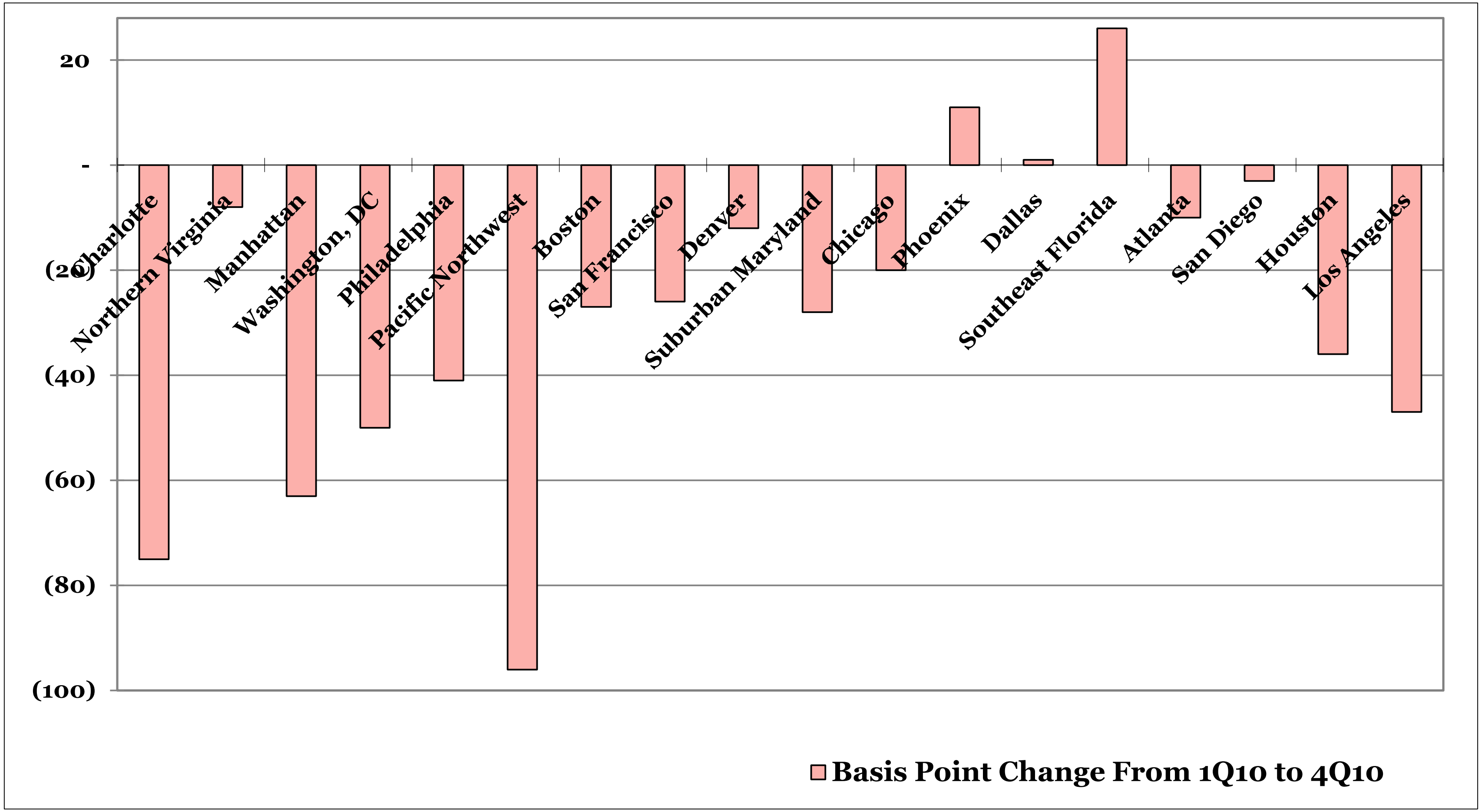
Overall cap rate trends - Apartments

Cap rate trends have changed significantly in the Survey's **national** apartment market over the past 20 years.

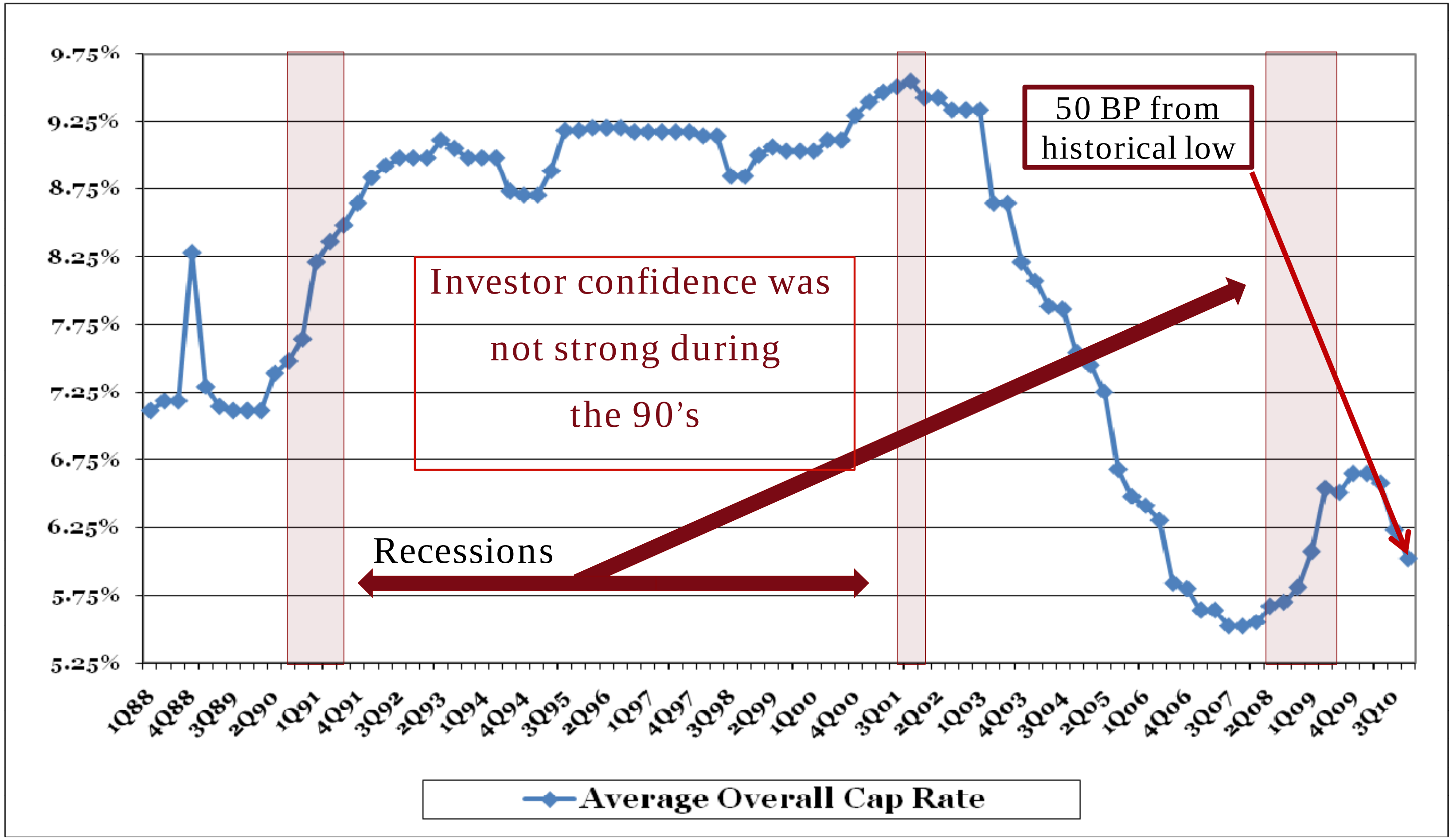


Overall cap rate trends - Office

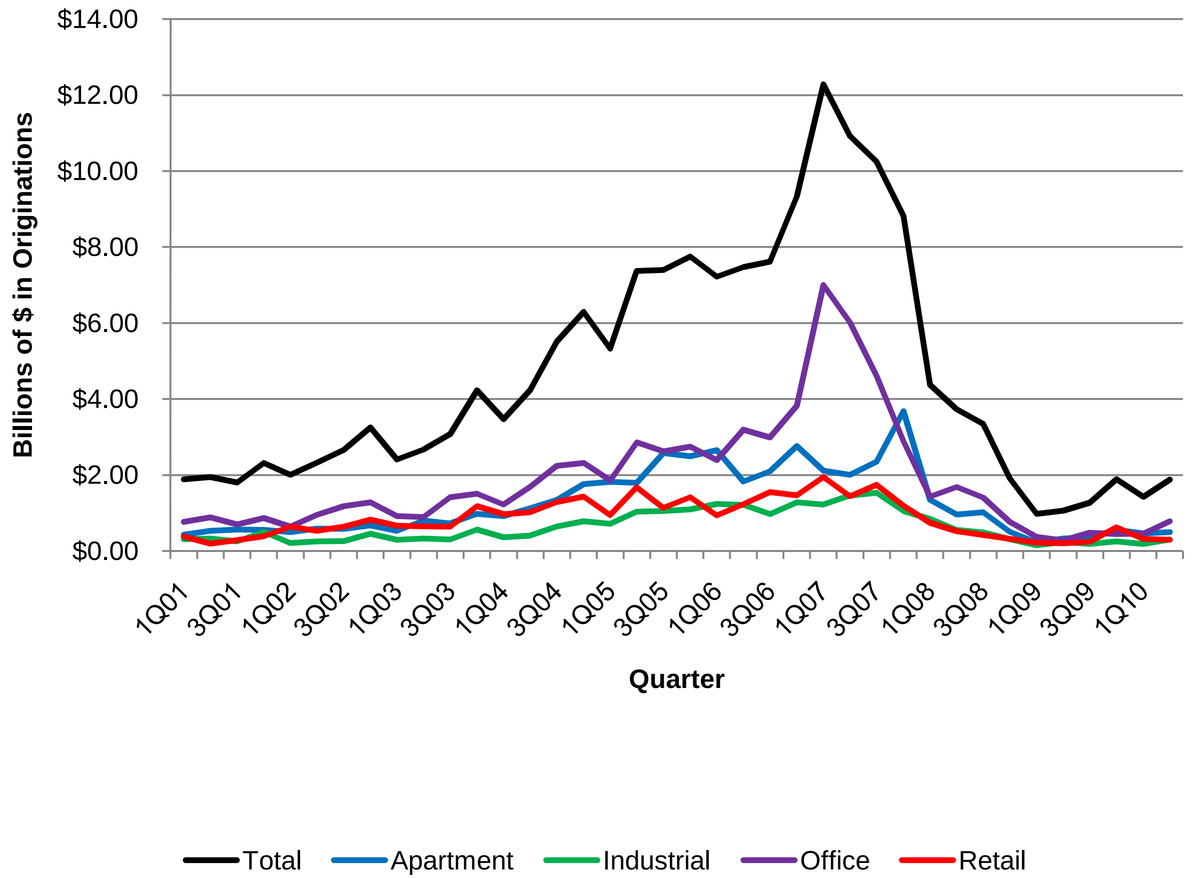
Office markets -- quarterly declines have not been uniform during 2010.



Overall cap rate trends – Office
A 23-year look at the Manhattan Office Market



Commercial Real Estate Loan Originations Source: RCA



PwC Real Estate Investor Survey

National Highlights – Fourth Quarter 2010

- Investors continue to use conservative underwriting assumptions.
- The "Year 1" market rent growth is negative for 10 of the Survey's 31 markets this quarter.
- A year ago, 20 markets reported negative Year 1 rent growth.

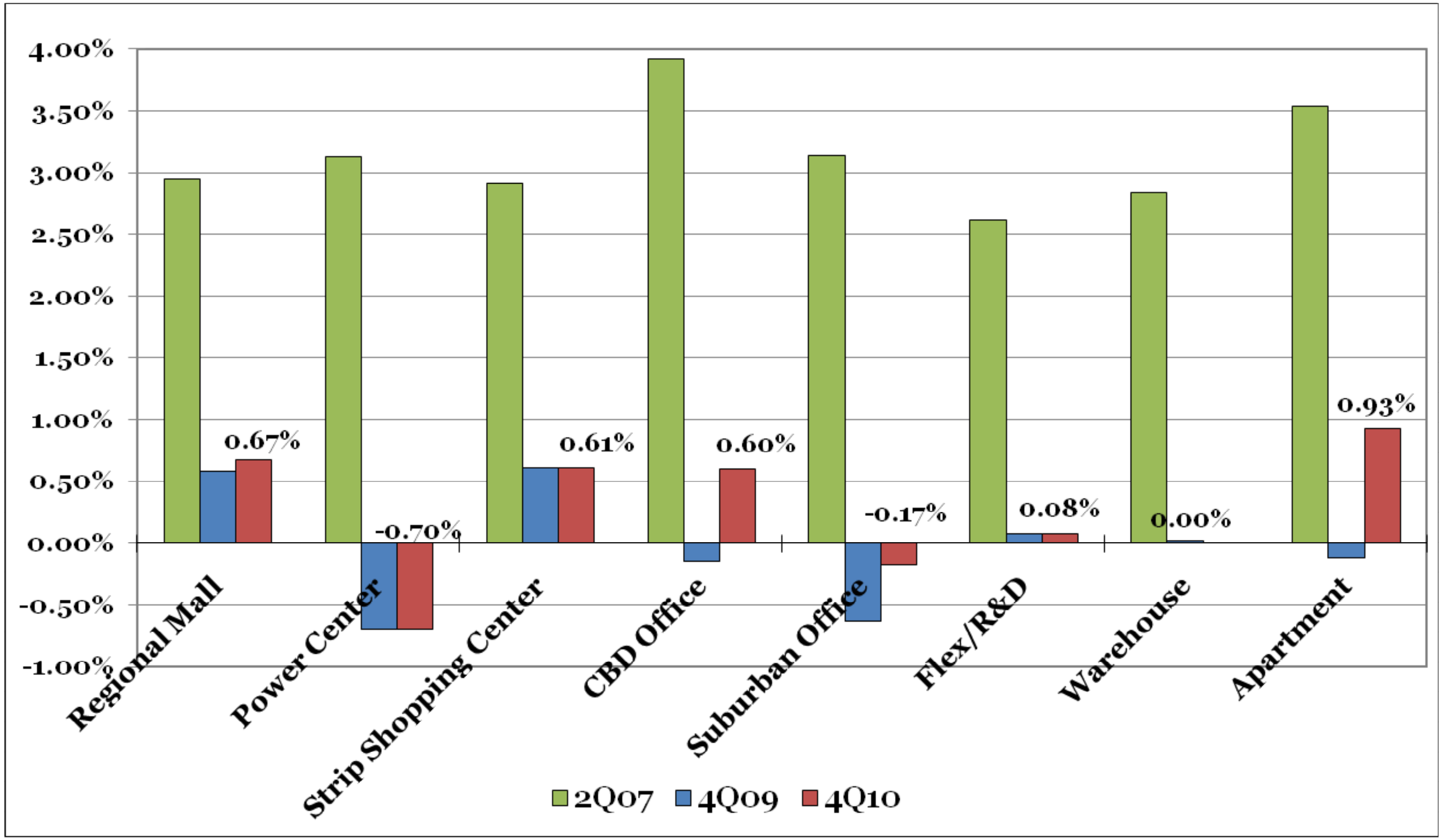
Markets with Negative Year 1 Rent Growth

1. National power center
2. National suburban office
3. Atlanta office
4. Boston office
5. Chicago
6. Denver office
7. Phoenix office,
8. San Diego office
9. SE Florida office
10. SE Region apartment

Market rent growth rate trends – nationally

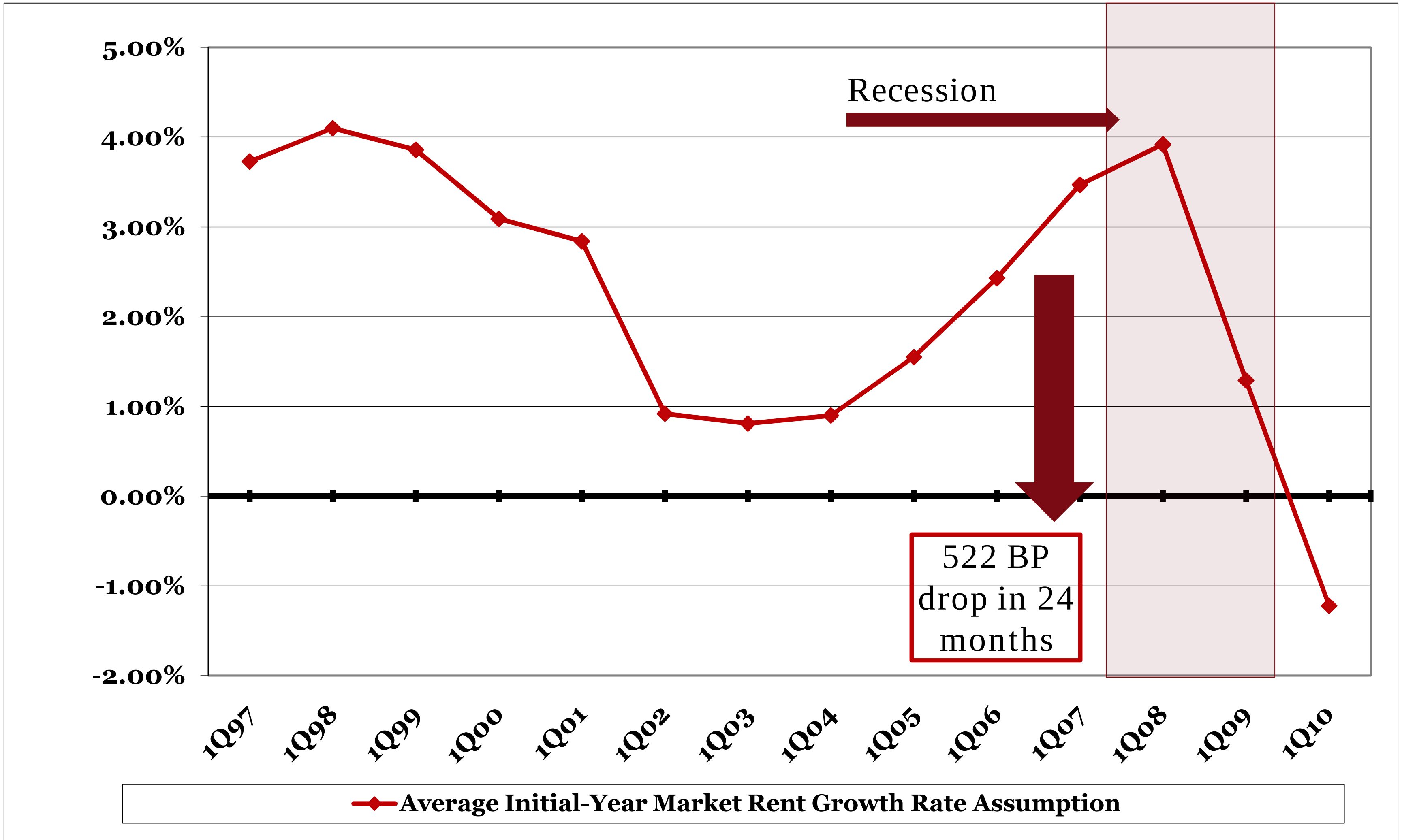
Year 1 rent growth has declined dramatically in each sector since the peak of the cycle.

Average Market Rent Growth Expectations



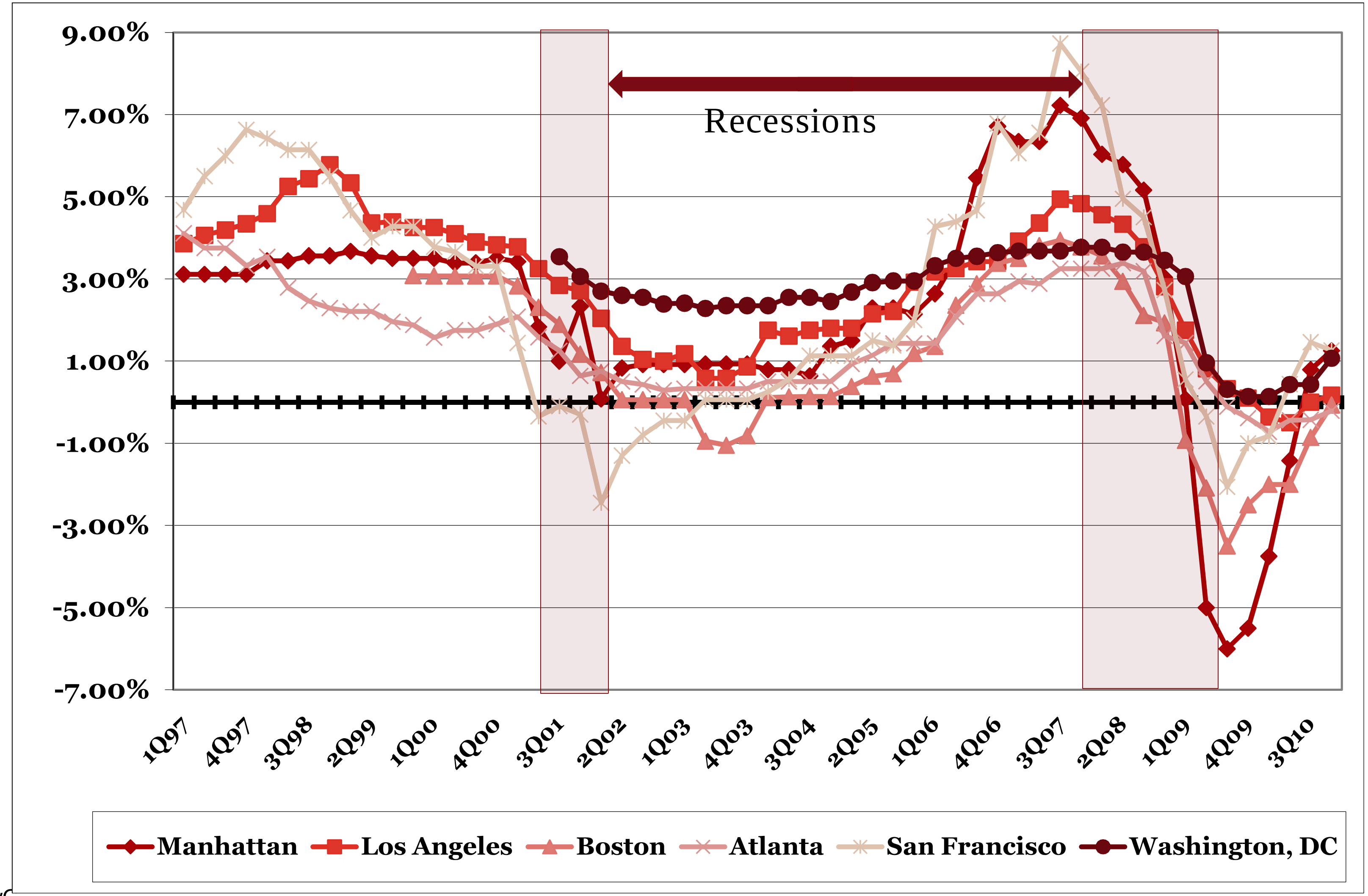
Market rent growth rates – office markets

For the 18 city-specific office markets -rent growth expectations have plummeted and are rising very slowly.



Market rent growth rates – select office markets

Growth rate assumptions have expanded and contracted the most in Manhattan and have been steady in the DC.



Upcoming Research from PwC's Real Estate Practice

Upcoming Research

•**Much of our Research at PwC is survey –based**

•**We recently took the opportunity to poll the audience of more than 200 real estate market participants**

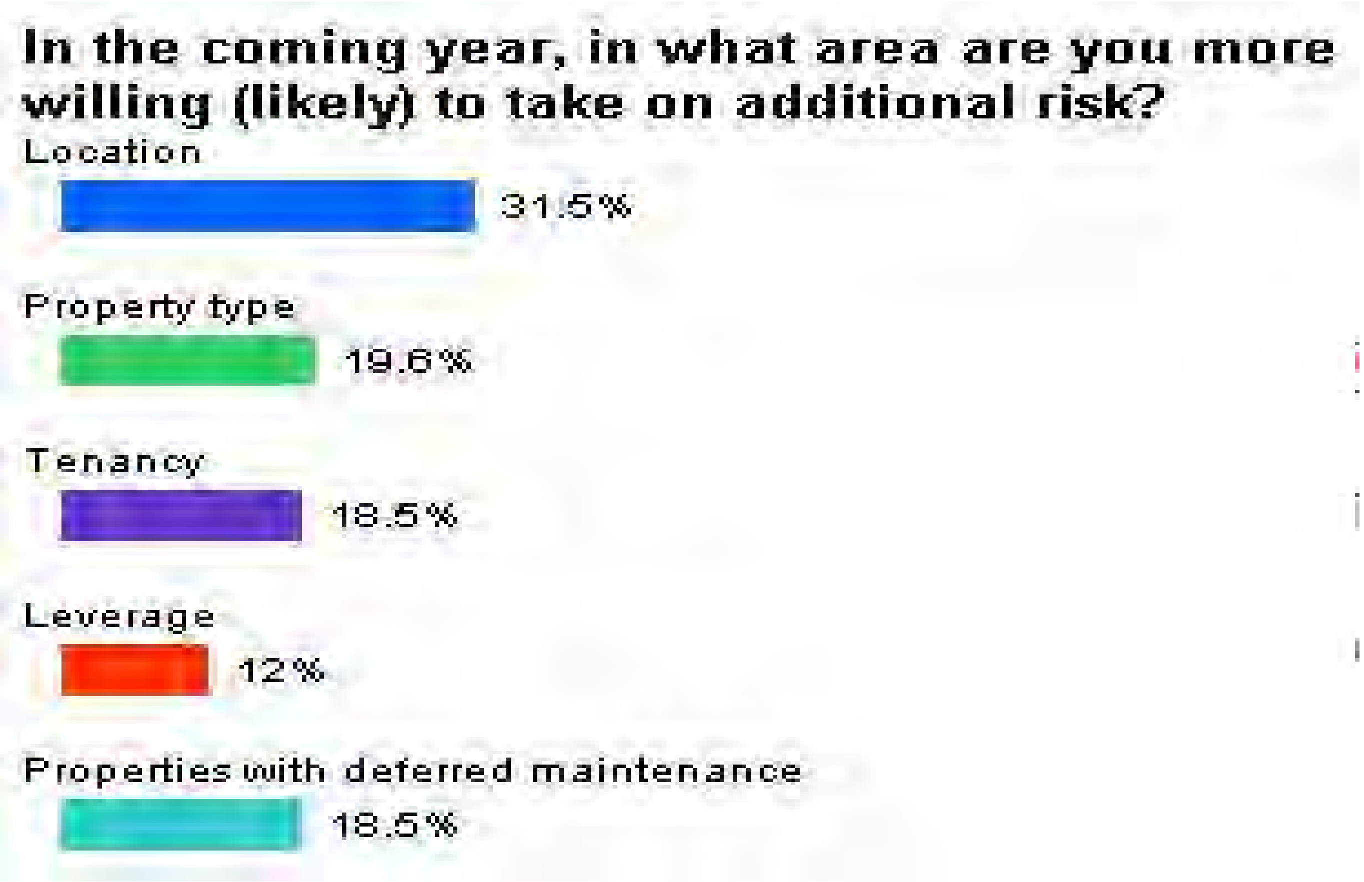
•**The questions and results follow**

Polling question

In the coming year, in what area are you more willing (likely) to take on additional risk?

1. Location
2. Property type
3. Tenancy
4. Leverage
5. Properties with deferred maturities

In 2011 – In what area are you willing to take on more risk?

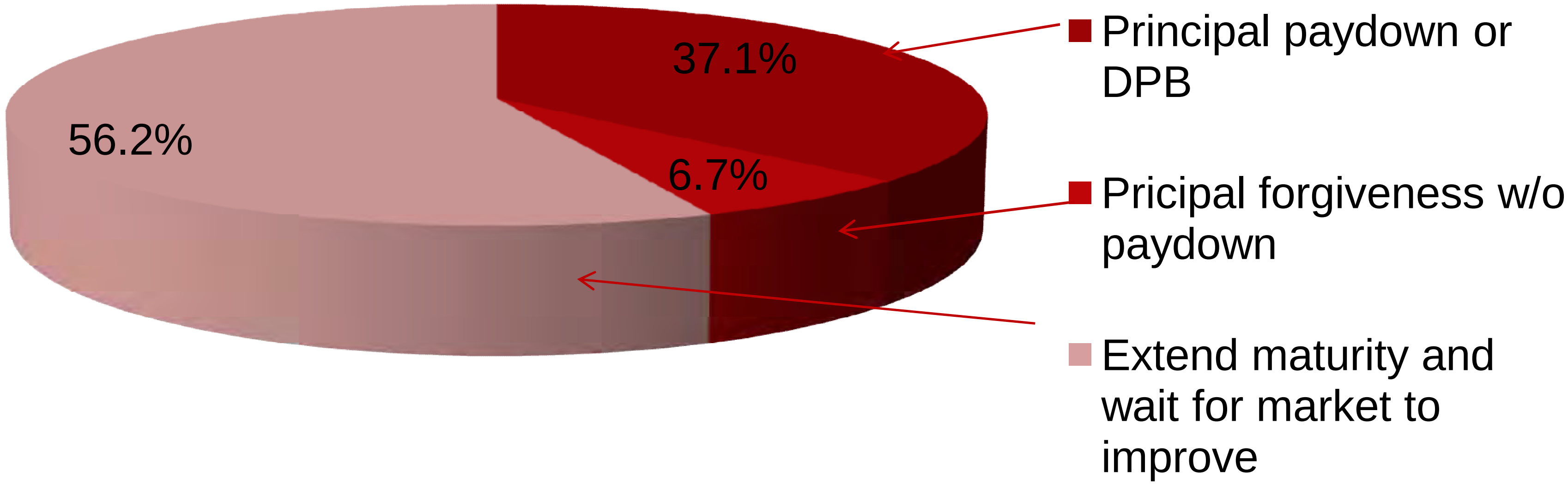


Polling question

How do you intend to fix “out-of-balance” loans?

1. Principal pay-down or discounted payoff
2. Principal forgiveness from lender without borrower pay-down
3. Extend maturity and wait for market to improve

How do you intend to fix an out of balance loan?

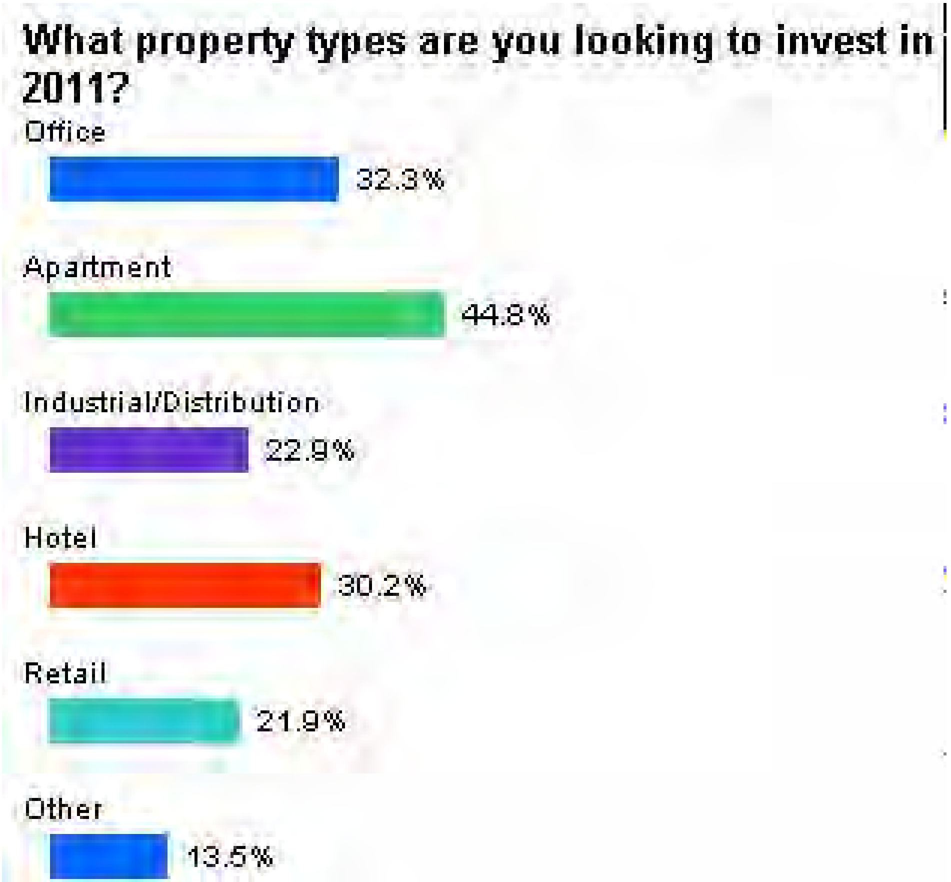


Polling question

What property types are you looking to invest in 2011?

1. Office
2. Apartment
3. Industrial/Distribution
4. Hotel
5. Retail
6. Other

What property types are you looking to invest in 2011?



Q & A

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