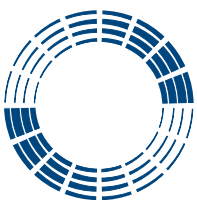




# The Real Estate Roundtable Perspectives on 2010

Featuring the 1<sup>st</sup> Quarter 2010  
Real Estate Roundtable Sentiment Index



The Real Estate Roundtable

# The Real Estate Roundtable Perspectives on 2010

## Introduction

One year ago, The Real Estate Roundtable launched The Real Estate Roundtable Sentiment Index and issued a report titled “Perspectives on 2009,” an examination of industry leaders’ expectations for the market in the coming year. In the report, the general consensus was that 2009 would be difficult, perhaps even worse than 2008. Most expected a continued decline in asset values, coupled with further erosion of fundamentals caused by the ongoing recession. Capital markets were expected to see some improvements, but only because the world was engulfed in a financial crisis and it didn’t seem possible for things to get any worse. Recovery wasn’t expected until 2010, at the earliest.

Fast forward twelve months, and it appears that many of these dire predictions came true. 2009 was indeed a tough one for the commercial real estate industry. Fundamentals deteriorated as unemployment reached 10%<sup>1</sup>, its highest level in years, and the economy suffered through one of the worst recessions in memory. The debt markets remained hostile for much of the year, putting downward pressure on both asset values and transaction activity (68% below 2008 levels, itself a down year)<sup>2</sup>. Commercial mortgage delinquency rates rose monthly, reaching 6.1% by December<sup>3</sup>. Fundraising for private equity firms fell dramatically and ended the year down 70%<sup>4</sup>. The list of troubling indicators goes on and on.

That said, 2009 did have a few bright spots which may offer some hope for the future. The recession finally appears to be nearing an end, as GDP growth returned in the third quarter (2.2% annual rate)<sup>5</sup> and is expected to continue to increase in the fourth quarter as well. Capital market conditions improved significantly, particularly for public companies. In conjunction with a broader rally in the public equity markets, U.S. REITs staged a rebound and generated returns of 27% for the year<sup>6</sup>. On top of that, they successfully raised approximately \$34.7 billion of debt and equity capital in 2009, up 93% from 2008 totals<sup>7</sup>. Even the CMBS market showed some signs of life.

### So what does this all mean for 2010 and beyond?

The latest edition of The Real Estate Roundtable Sentiment Survey, a quarterly study conducted on our behalf by FPL Advisory Group, provides a numerical perspective of over 110 industry leaders’ prognosis for the coming year. This is complemented by a series of interviews, conducted in early January, which provide a further illumination of the rationale behind the numbers.

In the following pages, we will go into detail on the information gathered from both of these sources. In general, Real Estate Roundtable membership does not expect 2010 to be a great year, though there is some hope that the worst is behind us.

- Most expect broad fundamentals to remain challenging even as the economy is emerging from recession.
- Capital markets have already begun to thaw, but there’s still more improvement needed.
- We have heard mixed messages on asset values, with some predicting that we are nearing the bottom of the market. Others think it may take longer to hit bottom, particularly for certain troubled asset classes.

Either way, most are predicting a slow recovery and a “long road” ahead.

## General Conditions

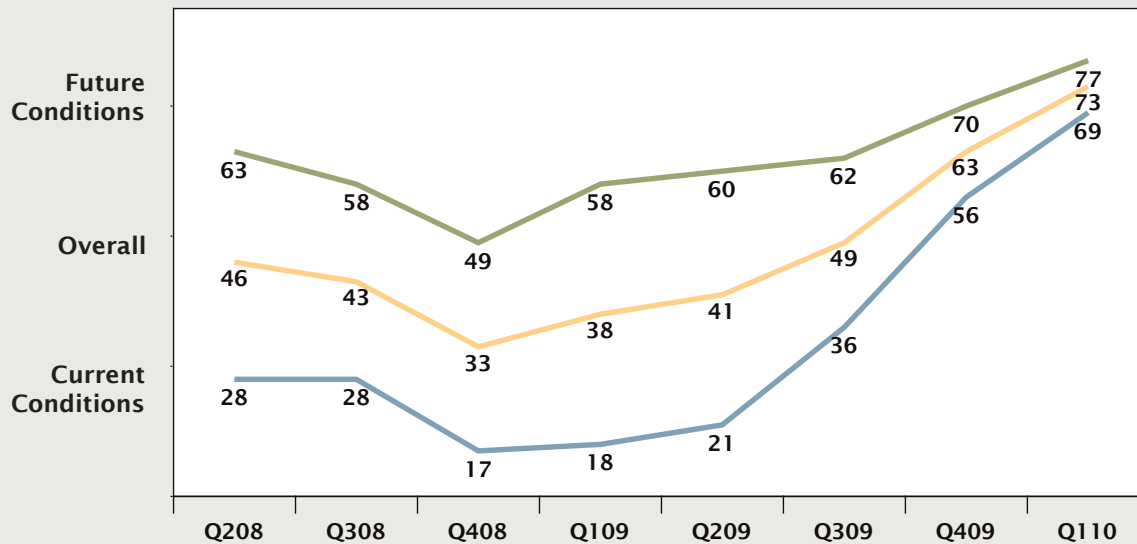
Overall, Real Estate Roundtable members believe the market is close to the bottom, though 2010 is still shaping up to be a tough year.

The latest edition of The Real Estate Roundtable Sentiment Index indicates that market conditions have been improving. The Current Index, which measures market conditions today versus one year ago, came in at 69, a 13 point increase from last quarter. The Future Index, at 77, also registered an increase. Our interviews reinforced this perspective, with general sentiment well represented by a real estate leader who commented, "We're at least a heck of a lot better off now than we were a year ago."

That being said, very few people we spoke with think we are even close to being out of the woods. The financial system meltdown may be behind us and capital market conditions may be improving, but the situation is "still a long way from normal," said one interviewee.

Exhibit 1

### The Real Estate Roundtable Sentiment Index



# General Conditions

(continued)

An even greater concern is the impact of declining fundamentals and deterioration in NOI in 2010. As one CEO commented, "There are 20 million or more people who are under/unemployed. Businesses are being very cautious. The federal government is considering raising taxes. All of this is causing uneasiness." Another leader added, "Things will be slow to recover because growth in the economy and jobs takes time. Jobs drive fundamentals."

As for a potential rebound, few expect one to come quickly. Even those who feel the market is at or near the bottom are not predicting big things until fundamentals improve and the deleveraging process "works its way through the system." Said another CEO, "2010 and 2011 will still be weak, but I could see the market becoming strong in 2012-2014."

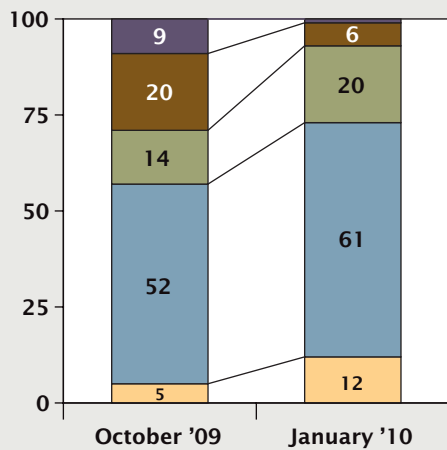
Exhibit 2

## Perspectives on Real Estate Market Conditions

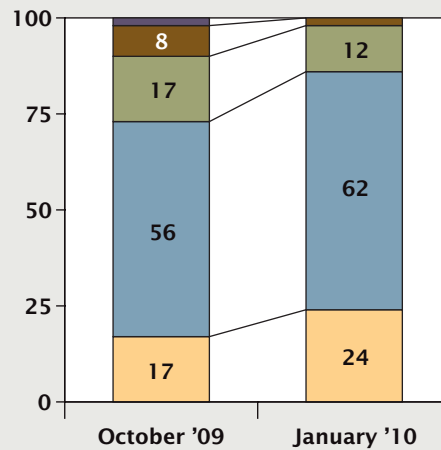
% of respondents

■ Much worse ■ Somewhat worse ■ About the same ■ Somewhat better ■ Much better

### Today vs. One Year Ago



### One Year From Now vs. Today



# Capital Markets

## Stabilization of the capital markets was the critical factor in 2009.

An improved outlook on the state of capital markets is perhaps the biggest reason for the positive change in sentiment this quarter. As indicated in Exhibit 3, approximately two-thirds of respondents said capital is more accessible now than one year ago. This is true for both debt and equity capital. This result should not be surprising, however, as the baseline for comparison (one year ago) occurred during the height of the financial crisis.

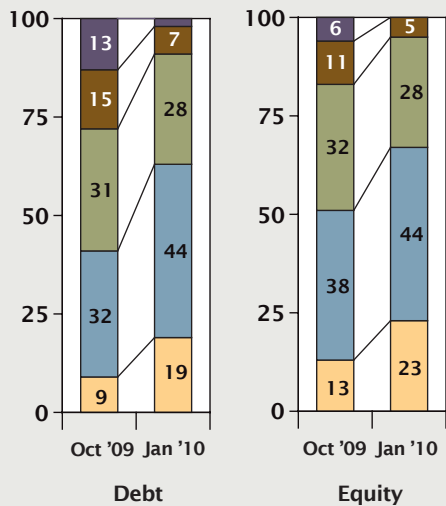
Exhibit 3

### Availability of Capital

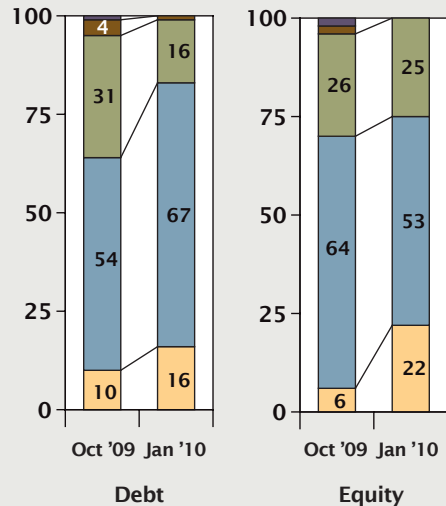
% of respondents

■ Much worse   
 ■ Somewhat worse   
 ■ About the same   
 ■ Somewhat better   
 ■ Much better

#### Today vs. One Year Ago



#### One Year From Now vs. Today



## Capital Markets

(continued)

Interview results were consistent with the survey, in that nearly all interviewees commented that capital market conditions have improved and that there is a significant amount of capital waiting to be deployed in the real estate sector. One lender commented, "There is more competition on debt. Not much, but enough to tighten spreads." Another added to this perspective saying, "One year ago there were no life companies; now there are 40-50 in the market. One year ago it was 50-55% LTVs, and now we're at 60-65%. One year ago there was absolutely zero CMBS activity; at least now there is some activity."

On the equity side, the comments were also mostly positive, particularly regarding the public space in light of REITs' success raising capital in 2009. In the private market, fundraising has continued to be difficult, though. As one private equity CEO said, "At least investors have climbed out of the short-term perspective and are now seeing things in a longer-term light."

### Looking forward to 2010, capital markets still have room to improve.

An overwhelming majority of survey participants expect capital markets to become more accommodating in 2010, with 83% predicting increased availability of debt capital and 75% predicting increased availability of equity. While this sentiment is a good sign for 2010, it also indicates that there is still a long way to go before conditions are back to "normal."

As one industry leader commented, "We won't see a rebound until debt and equity markets loosen up further, which we should see in 2010. Banks will re-enter the market and spreads will become more attractive." One investment banker further added, "There will be more volume in the bond market in 2010 than last year. There's plenty of equity capital too."

# Asset Values

## Valuations may be close to bottoming

Throughout 2009, few people argued that asset values hadn't fallen significantly from peak levels. The key question remained — when would the bleeding stop and how far would valuations fall? While these topics are still up for debate, some industry leaders feel that the bottom may be near. As shown in Exhibit 4, 45% of survey respondents expect real estate asset values to increase in the coming 12 months. Another 35% expect them to remain flat, with 19% predicting further declines. For the first time since this study began in 2008, more people have predicted an increase over the next 12 months than a decrease.

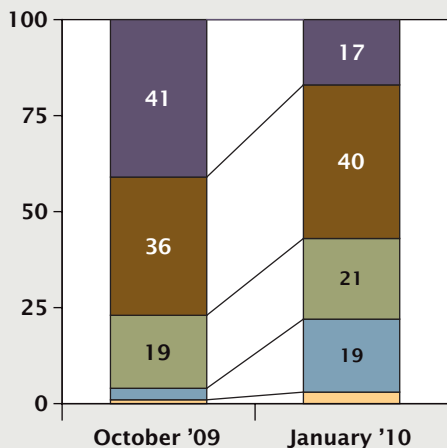
This being said, very few are expecting a quick rebound. “The free-fall in pricing has stopped,” said one interviewee, but not before adding, “Values are going to stay along the bottom through 2010.” Another participant reiterated this view saying, “In terms of valuations, we’re at the ‘muddle through’ point, with fundamentals continuing to provide downward pressure.” Even the optimists are cautious about the coming year: “Capital market improvements should suggest stability in pricing at least, maybe even some appreciation, but I certainly wouldn't bet on huge appreciation in 2010.”

Exhibit 4  
Real Estate Asset Values

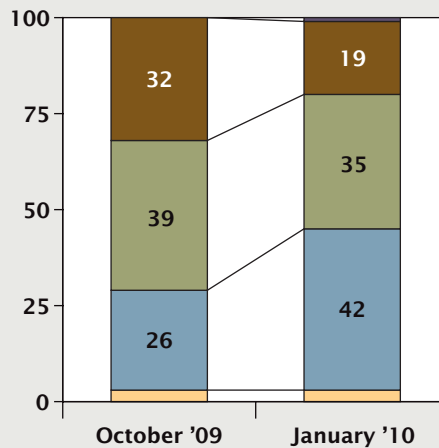
% of respondents

■ Much lower ■ Somewhat lower ■ About the same ■ Somewhat higher ■ Much higher

Today vs. One Year Ago



One Year From Now vs. Today



## Asset Values

(continued)

While the general direction of the market remains cloudy, one area of consensus was that certain markets will fare better than others. In particular, many interviewees were bullish on multi-family, with some saying we have already reached the bottom in that sector, provided the GSE lenders continue in their current roles. Class A properties are also expected to perform better than Class B or C, suggesting a continuation of the “flight to quality” trend from the past 12-18 months.

### Extensions continue to be offered

With hundreds of billions of dollars of CRE debt maturing annually over the next several years and limited ability to refinance, many have been expecting an abundance of distressed-buying opportunities to materialize. However, in 2009, lenders, hoping that time would preserve value, often agreed to extensions in order to avoid forced sales in a distressed market. Looking forward, interviewees expect this trend to continue, particularly for high quality assets. As one put it, “Any asset that can service a reasonable portion of the debt will get time. Banks remember the mid 90’s when private equity firms got rich off of them.” Class B assets are more likely to come to market as “sellers capitulate because they don’t want to carry negative cash flow.”

# Conclusion

## What's in store for 2010?

**Through interviews, survey responses, and other discussions with real estate leaders, it's clear that the mood has shifted.**

In light of a slight rebound in the capital markets, talk of "Armageddon" has moderated. Many feel that we will hit bottom soon, if we haven't already, and that there will be buying opportunities. Since there was not as much overbuilding leading up to this downturn in comparison to the 80's, many expect fundamentals and asset values to recover once the economy gets going again. Many respondents feel that for those fortunate enough to have access to capital, the coming year or two could represent a "once-in-a-career buying opportunity."

**Unfortunately, weakness in key areas counters these reasons for optimism.**

Economic indicators suggest that 2010 is still going to be tough. If interest rates are raised to counter inflation pressure, it could have a negative impact on the chances of a speedy economic recovery. Transaction activity is still light, as many owners have been reluctant to sell into this market. Lenders have been accommodating, delaying the deleveraging process that many feel is necessary for a rebound to occur. On top of that, there is still a large amount of debt coming due over the next several years, which is likely to lead to even more distressed situations.

**Taken together, this picture offers grounds for a guarded sort of optimism.**

Let's hope that current positive trends outmatch the downside concerns and that all of us experience a more profitable and rewarding year than in 2009.

# Participants

*(Please note that this is only a partial list. Not all survey participants elected to be listed.)*

**Alcatel-Lucent**  
Victor A. Del Pizzo

**AMB Property Corporation**  
Eugene F. Reilly

**American Hotel & Lodging Association**  
Joseph A. McInerney

**Armada LLC**  
Bruce T. Lehman

**Avison Young**  
Mark E. Rose

**BayNorth Capital, LLC**  
Charles F. Wu

**Beacon Capital Partners**  
Fred Seigel

**Bovis Lend Lease**  
Mike Bellaman

**Boykin Management Co.**  
Robert W. Boykin

**BRE Properties, Inc.**  
Constance B. Moore

**Callahan Capital Partners**  
Timothy H. Callahan

**Camden Property Trust**  
Richard J. Campo

**CapStar Hotel Company**  
Paul W. Whetsell

**Centro Properties Group**  
Glenn J. Rufrano

**Champion Partners, Ltd.**  
Stephen M. Modory

**Choice Hotels International, Inc.**  
Stephen P. Joyce

**CIBC World Markets**  
Michael P. Higgins

**Citigroup, Inc.**  
Thomas M. Flexner

**Classic Residence by Hyatt**  
Randal J. Richardson

**Clifford Chance**  
Alan Gosule

**CNL Financial Group, Inc.**  
R. Byron Carlock, Jr.

**Columbia Business School**  
Lynne B. Sagalyn

**Credit Suisse**  
Edmund Taylor

**CSCA Capital Advisors LLC**  
Bradley Razook

**DCT Industrial Trust**  
Thomas G. Wattles

**DePaul University –  
Real Estate Center**  
Charles H. Wurtzebach

**DRA Advisors LLC**  
David Luski

**Dune Capital Management**  
Daniel M. Neidich

**Eastdil Secured L.L.C.**  
Benjamin Lambert

**EastGroup Properties, Inc.**  
David H. Hoster, II

**Emigrant Realty Finance**  
Patricia Goldstein

**Ernst & Young**  
Stan Ross

**First Centrum, LLC**  
Mark L. Weshinsky

**Fisher Brothers**  
Ken Fisher

**Forum Partners Investment  
Management LLC**  
Caroline S. McBride

**Forsgate Industrial Partners**  
Alex Klatskin

**Gazit Globe Ltd.**  
Chaim Katzman

**Global Logistic Properties (GLP)**  
Jeffrey H. Schwartz

**Green Courte Partners, LLC**  
Randall K. Rowe

**Greenberg Traurig, LLP**  
Robert J. Ivanhoe

**Gunn Capital Ventures**  
Thomas P. MacManus

**Health Care REIT, Inc.**  
George L. Chapman

**HEI Hotels and Resorts**  
Gary Mendell

**Hilton Hotels Corporation**  
Christopher J. Nassetta

**Hines REIT**  
Charles Hazen

**Home Properties Inc.**  
Edward J. Pettinella

**Horizon Bay Senior Communities**  
Thilo Best

**Host Hotels & Resorts Inc.**  
W. Edward Walter

**HSA Commercial Real Estate**  
Robert E. Smietana

**iStar Financial, Inc.**  
Jay Sugarman

**Jack Resnick & Sons, Inc.**  
Burton P. Resnick

**J.P. Morgan Asset Management**  
S. Michael Giliberto

**J.P. Morgan Chase**  
Peter E. Baccile

**Johnson Capital Group, Inc.**  
Guy K. Johnson

**Kennedy Associate Real Estate Counsel**  
John M. Parker

**King & Spalding LLP**  
Scott J. Arnold

**Lane Construction**  
Robert Alger

**Lazard Freres & Co.**  
Matthew J. Lustig

**LCOR, Incorporated**  
Eric Eichler

**Lowe Enterprises Investors, LLC**  
Robert J. Lowe

**M3 Capital Partners**  
Donald E. Suter

**Maguire Properties, Inc.**  
Nelson C. Rising

**Malkin Holdings**  
Anthony E. Malkin

**Marcus & Millichap**  
Harvey E. Green

**Marriott International, Inc.**  
William J. Shaw

**Mayer Brown LLP**  
Michael Blair

**Merrill Gardens, LLC**  
Bill Pettit

**MetLife**  
Robert Merck

**Mid-America Apartment Communities**  
H. Eric Bolton, Jr.

**MidCap Financial LLC**  
Kevin J. McMeen

**Molinaro Koger, Inc.**  
Robert Koger

**Nationwide Health Properties, Inc.**  
Douglas M. Pasquale

**New Boston Fund, Inc.**  
Jerome L. Rappaport, Jr.

**Northwood Investors**  
Erwin K. Aulis

**Occom Capital Partners, LLC**  
Michael D. Coster

**Osprey SA**  
M. Biber

**Paramount Group, Inc.**  
Albert P. Behler

**Partners Group**  
Nori Gerardo Lietz

**Post Properties, Inc.**  
David P. Stockert

**Prima Capital Advisors, LLC**  
Gregory A. White

**Prudential Mortgage Capital Company**  
David A. Twardock

**Q10 Capital**  
James M. Murphy

**RBC Capital Markets**  
John P. Case

**Realty Investment Company / Sunburst Hospitality**  
Charles A. Ledsinger, Jr.

**Rockpoint Group, LLC**  
William H. Walton, III

**Rockwood Capital Corporation**  
Edmond A. Kavounas

**RSR Realtors**  
James L. Helsel, Jr.

**Security Capital Research & Management Inc.**  
Anthony R. Manno

**Simon Property Group**  
Stephen E. Sterrett

**SL Green Realty Corporation**  
Stephen L. Green

**Starwood Hotels & Resorts Worldwide**  
Simon M. Turner

**Sunstone Hotel Investors, Inc.**  
Robert A. Alter  
Arthur L. Buser

**Terreno Capital Partners**  
W. Blake Baird

**Tetrad Corporation**  
David Scott

**Thackeray Partners**  
Anthony Dona

**The Bozzuto Group**  
Thomas S. Bozzuto

**The Brookdale Group**  
Charles L. Davidson, III

**The Swig Company**  
Tomas Schoenberg

**Thomas Properties Group Inc.**  
James A. Thomas

**Transwestern Commercial Services**  
Robert D. Duncan  
Lawrence P. Heard

**Tufts University – Department of Economics**  
Jeffrey E. Zabel

**UBS Investment Bank**  
Douglas B. Lee

**UDR, INC.**  
Thomas W. Toomey

**ULI – the Urban Land Institute**  
Stephen R. Blank

**University of California, Irvine**  
Kerry D. Vandell

**University of Connecticut**  
John P. Harding

**Watson Land Company**  
Bruce A. Choate

**WCI Communities, Inc.**  
David L. Fry

**World Trade Center Properties, LLC**  
Jannd Lieber

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# Contact

Please direct all inquiries regarding this study to:

**Jonas D. Bordo**

Senior Director

FPL Associates L.P.

191 North Wacker Drive

Suite 2850

Chicago, Illinois 60606

Phone: (312) 368-5088

Fax: (312) 368-0359

E-mail: [jbordo@fplassociates.com](mailto:jbordo@fplassociates.com)

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