

Note. This PDF is annotated. Click on the icon to the left on each page to view them. Right click and resize to read them or just scroll down. JRD

2010 Real Estate Outlook: To Walk, To Talk, To Walk the Talk?

presented to:

NAIOP Forums

October 14, 2009

by

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Runstad Professor of Real Estate & Director, Graduate Real Estate Studies



Presentation Overview

- Part I: Challenges
- Part II: Economic and Capital Markets
- Part III: Real Estate Capital Markets
- Part IV: Commercial Real Estate Market Update
- Part V. Implications for Real Estate



NAIOP Survey Respondent Profile

	Please indicate if you are a member of any of the following groups.					
Total 48 NAIOP	NAIOP Capital Markets IV Forum	NAIOP Business Park Development Forum	NAIOP Trends in Real Estate Development Forum	NAIOP Young Professionals I/II Forum	NAIOP Capital Markets III Forum	Response Totals
NAIOP Capital Markets IV Forum	100.0% (5)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	10.4% (5)
NAIOP Business Park Development Forum	0.0% (0)	100.0% (9)	0.0% (0)	0.0% (0)	0.0% (0)	18.8% (9)
NAIOP Trends in Real Estate Development Forum	0.0% (0)	0.0% (0)	100.0% (10)	0.0% (0)	0.0% (0)	20.8% (10)
NAIOP Young Professionals I/II Forum	0.0% (0)	0.0% (0)	0.0% (0)	100.0% (14)	0.0% (0)	29.2% (14)
NAIOP Capital Markets III Forum	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	100.0% (10)	20.8% (10)

Response Rate: 50%

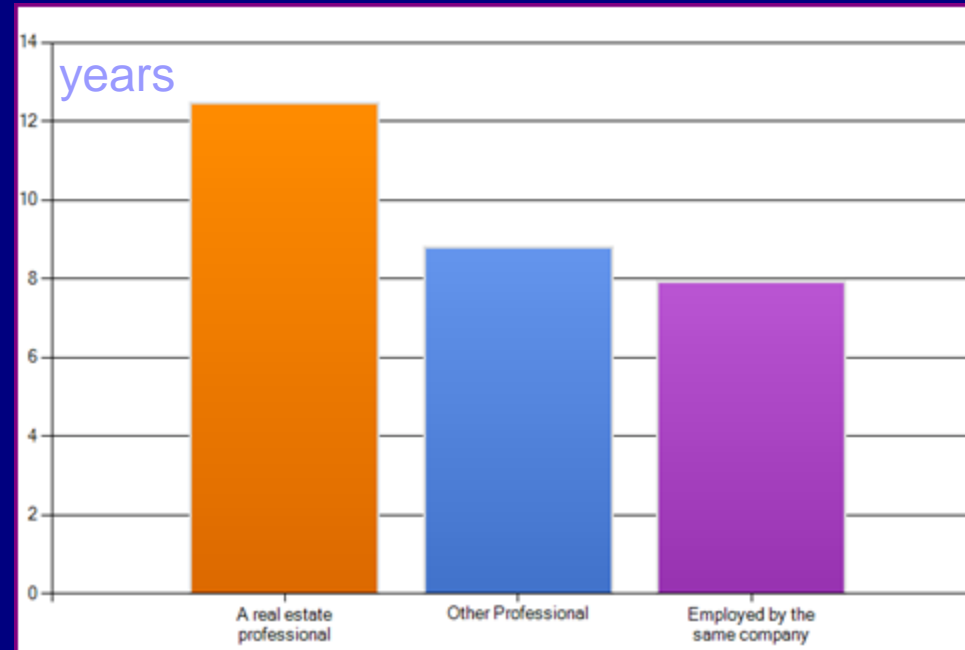


Professional Areas of Expertise

- Developer 36%
- Equity Investor 25%
- Lender 5%
- Investment Advisor 5%
- Consultant 7%
- Lawyer 3%
- Contractor 5%
- Other 20%

- Engineer, manufacturer
- 2 Property Managers, CPA
- Office REIT, Portfolio Manager
- New Distressed Asset Fund Manager....

Experience of Respondents



JRD Prediction

Number with Same Company will decline.....



Part 1: Challenges & Three Attributes of Real Estate

Three major attributes of real estate . . .



. vulnerable,

- L,



. vulnerable,

- L,

- L.



. vulnerable.

The 2009 regime of real estate . . .

- D distressed,

- D distressed,

- D distressed.

The 2010 + regime of real estate . . . **L, L, L**

Butt, what the “L”?

Liability, Litigation, Liquidity (NOT!)

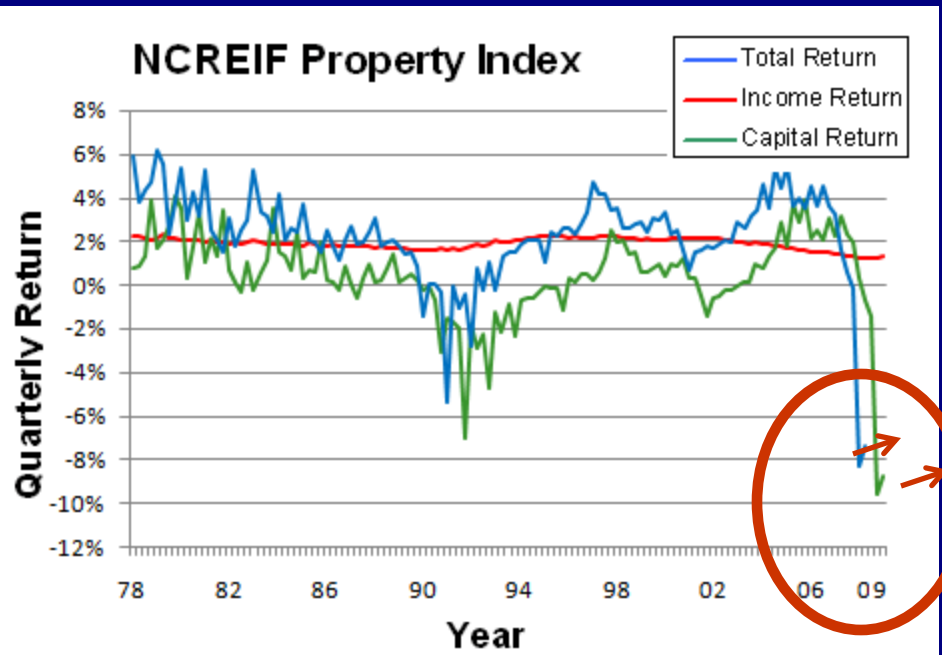


How We're Doing: Institutional Real Estate

NCREIF
National Council of Real Estate Investment Fiduciaries

NFI-ODCE Preliminary Snapshot Report ^(A)
Quarter-ended 9/30/2009
81% of Net Assets Reported

Released 10/12/09



The Good News....
It's not as bad as it was

NFI-ODCE

	Current Qtr Estimate	Previous Qtr Actual	Change
Income	1.50%	1.53%	0.06%
Appreciation	-8.96%	-10.53%	1.57%
Total, Gross of Fees ^(C)	-7.41%	-9.03%	1.62%



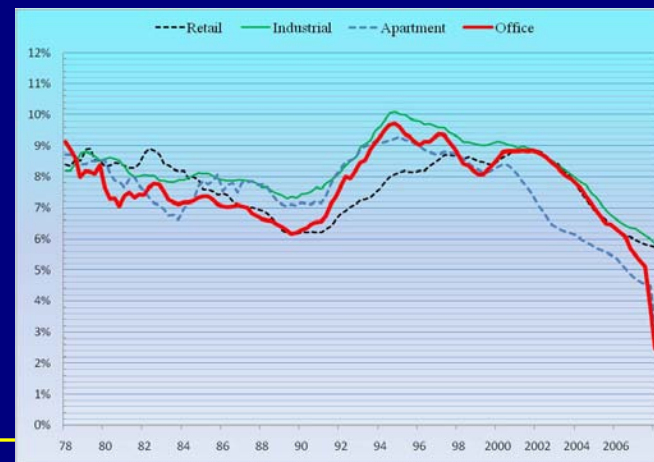
Institutional Real Estate: Remerging Trends....

The “Bad News” Implicit Cap Rate some 200bp below averages

NFI-ODCE				
	Current Qtr Estimate	Previous Qtr Actual	Change	
Income	1.50%	1.53%	0.06%	
Appreciation	-8.96%	-10.53%	1.57%	
Total Gross of Fees ^(C)	-7.41%	-9.03%	1.62%	

	1 Year	3 Years	5 Years	10 Years	SI ^(B) (31.75 Years)
	5.7%	5.3%	5.7%	6.9%	7.8%
	-38.1%	-12.4%	-3.5%	-1.1%	8.2%
	-35.3%	-7.6%	2.1%	5.7%	8.0%

Source: NCREIF





Cap Rate Forecasts

Current

8% 9% 10% 11% 12% 13% 14%

Current	Under 5%	5%	5.5%	6%	6.5%	7%	7.5%	8%	8.5%	9%	9.5%	10%	10.5%	11%	11.5%	12%	12.5%	13%	13.5%	14%
Institutional Institutional Grade Real Estate	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	2.6% (1)	2.6% (1)	2.6% (1)	28.2% (11)	25.6% (10)	28.2% (11)	8.1% (2)	0.0% (0)	0.0% (0)	0.0% (0)	2.6% (1)	0.0% (0)	2.6% (1)	0.0% (0)	0.0% (0)	0.0% (0)
Distressed Distressed/Troubled Real Estate	0.0% (0)	2.6% (1)	0.0% (0)	2.6% (1)	0.0% (0)	2.6% (1)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	2.6% (1)	7.9% (3)	2.6% (1)	15.8% (6)	0.0% (0)	21.1% (8)	2.6% (1)	15.8% (6)	0.0% (0)	7.9% (3)

12 Months Out

12 months out	Under 5%	5%	5.5%	6%	6.5%	7%	7.5%	8%	8.5%	9%	9.5%	10%	10.5%	11%	11.5%	12%	12.5%	13%	13.5%	14%
Institutional Institutional Grade Real Estate	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	5.1% (2)	7.7% (3)	23.1% (9)	20.5% (8)	17.9% (7)	17.9% (7)	2.6% (1)	2.6% (1)	0.0% (0)	2.6% (1)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)
Distressed Distressed/Troubled Real Estate	0.0% (0)	2.6% (1)	0.0% (0)	0.0% (0)	2.6% (1)	2.6% (1)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	13.2% (5)	2.6% (1)	13.2% (5)	0.0% (0)	21.1% (8)	2.6% (1)	15.8% (6)	2.6% (1)	7.9% (3)

3 Years

3 years from now	Under 5%	5%	5.5%	6%	6.5%	7%	7.5%	8%	8.5%	9%	9.5%	10%	10.5%	11%	11.5%	12%	12.5%	13%	13.5%	14%
Institutional Institutional Grade Real Estate	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	12.8% (5)	7.7% (3)	48.7% (19)	10.3% (4)	12.8% (5)	5.1% (2)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)	0.0% (0)
Distressed Distressed/Troubled Real Estate	0.0% (0)	0.0% (0)	0.0% (0)	2.6% (1)	2.6% (1)	2.6% (1)	0.0% (0)	0.0% (0)	0.0% (0)	13.2% (5)	5.3% (2)	21.1% (8)	7.9% (3)	7.9% (3)	5.3% (2)	13.2% (5)	7.9% (3)	0.0% (0)	2.6% (1)	2.6% (1)



Institutional Real Estate: Submerging Trends??

The Good News....

It's not as bad as it was

The “More Bad News”

Asset Class	Number of Years				
	1	3	5	10	32
NCREIF	-35.3%	-7.6%	2.1%	5.7%	8.0%
NAREIT	-28.4%	-12.4%	1.4%	9.5%	12.2%
Gov Bonds	6.7%	6.8%	5.2%	6.2%	
S&P 500	-6.9%	-5.4%	1.0%	-0.2%	11.2%
T-bills (3 mo)	0.4%	2.6%	3.0%	3.0%	5.9%

Institutional Investors

- Will not asset allocate to RE at 6% yields
- Diversification is means to an end, not an end



When will things turn the corner???

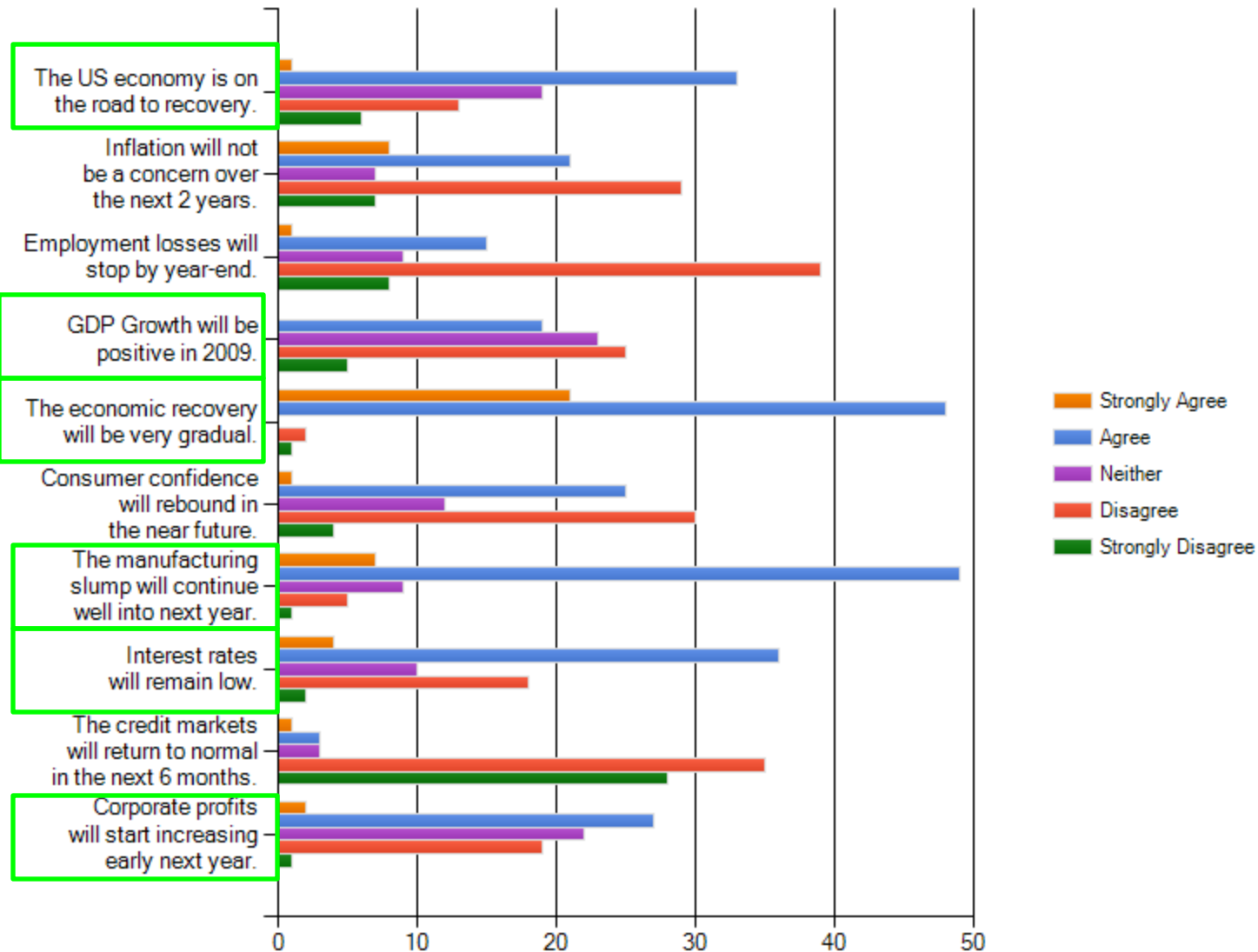
Economy										
	It has already	4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010	4th Quarter 2010	1st Quarter 2011	2nd Quarter 2011	3rd Quarter 2011	4th Quarter 2011
Market Timing	31.8% (14)	22.7% (10)	4.5% (2)	18.2% (8)	2.3% (1)	11.4% (5)	2.3% (1)	0.0% (0)	2.3% (1)	0.0% (0)

Housing Market										
	It has already	4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010	4th Quarter 2010	1st Quarter 2011	2nd Quarter 2011	3rd Quarter 2011	4th Quarter 2011
Market Timing	22.7% (10)	15.9% (7)	18.2% (8)	11.4% (5)	6.8% (3)	13.6% (6)	2.3% (1)	4.5% (2)	0.0% (0)	2.3% (1)

Commercial RE Market										
	It has already	4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010	4th Quarter 2010	1st Quarter 2011	2nd Quarter 2011	3rd Quarter 2011	4th Quarter 2011
Market Timing	2.3% (1)	2.3% (1)	6.8% (3)	6.8% (3)	20.5% (9)	13.6% (6)	11.4% (5)	13.6% (6)	2.3% (1)	2.3% (1)

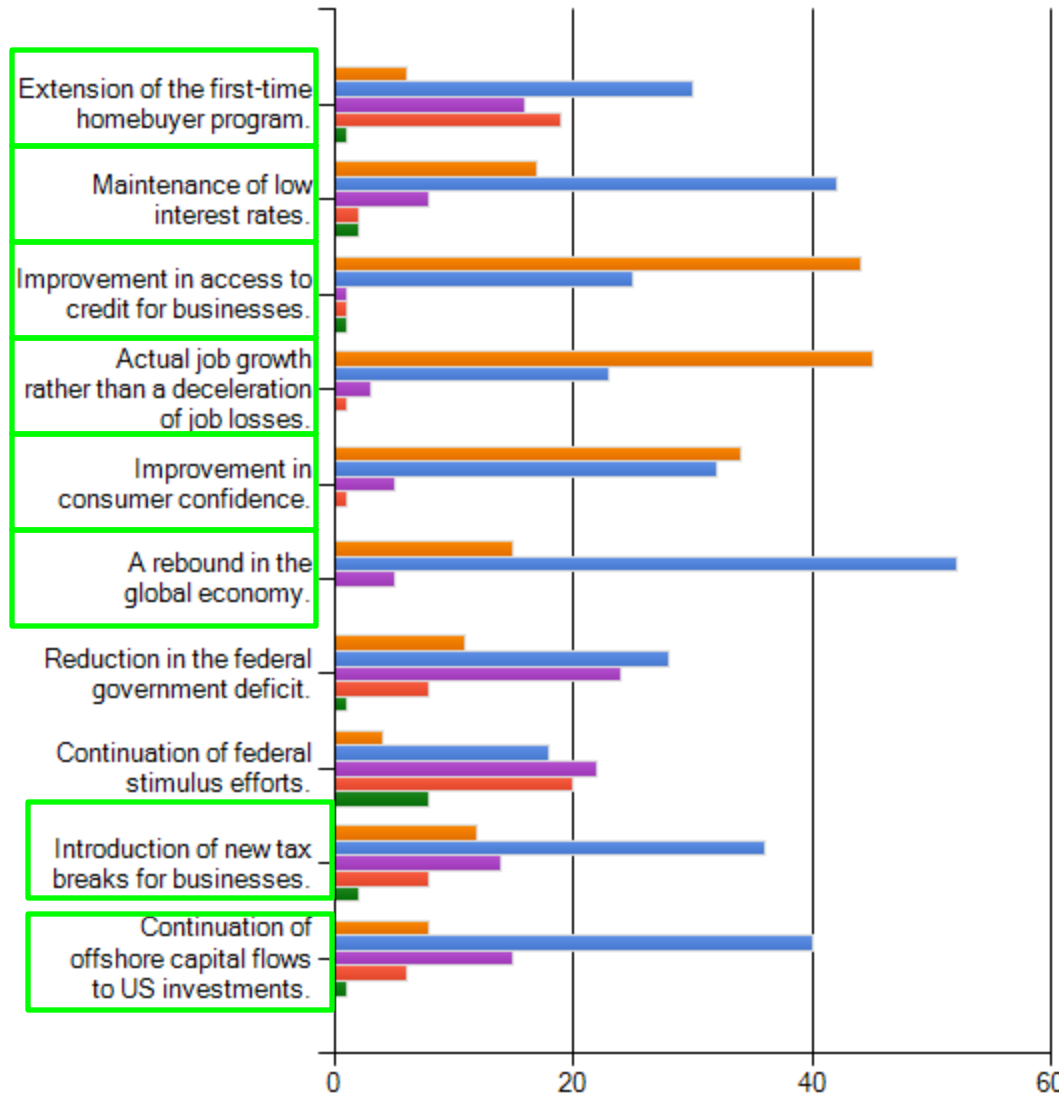


Part II: General Economic Outlook





Critical Elements to Sustainable Recovery



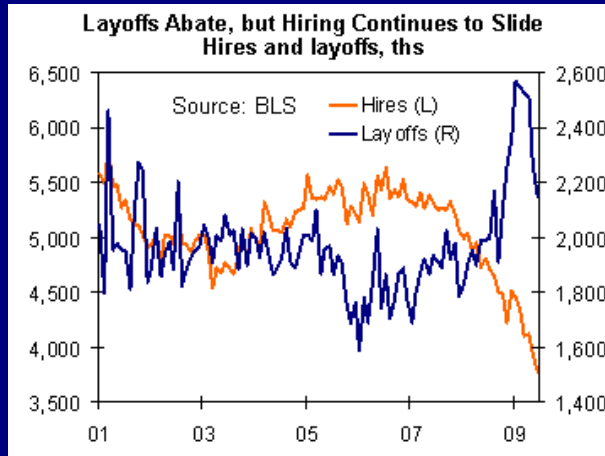
Not many degrees of freedom!!

- Extremely Important
- Important
- Neither
- Unimportant
- Extremely Unimportant



Employment Losses Slowing, Hours Increasing

Net Employment losses



Jobless Claims Slowing?

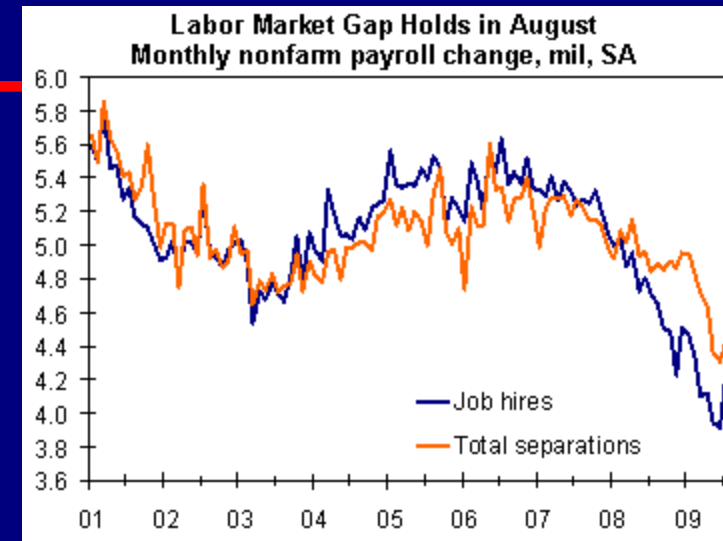
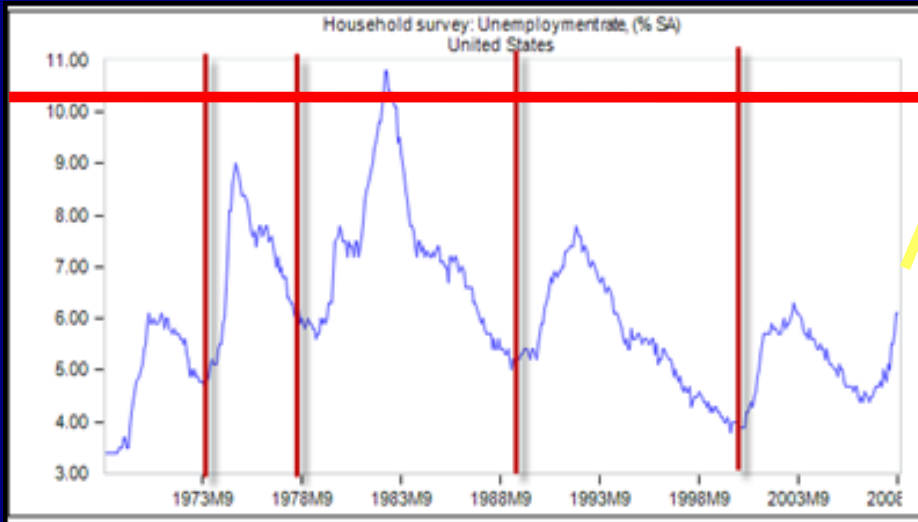
United States: Jobless Claims

Print | Definition | E-mail Alerts | Go To Source

Actual:	521,000
Previous: **	551,000
Moody's Economy.com:	540,000
Consensus: *	540,000
Coverage:	10/3/2009
Next Release:	10/15/2009
Archives:	10/8/2009
Updated:	10/8/2009 8:30 AM
Analysis By:	Michael Bratus in West Chester

Weekly Jobless Claims
Ths, SA

Unemployment





Federal Stimulus Funding: Pledged & Provided

Federal Reserve	Pledged	Provided
Term Securities Lending Facility	200	0
Commercial Paper Funding Facility**	1,800	42
TALF	1,000	43
Money Market Investor Funding Facility	540	0
TARP	700	575
Fed supplementary financing account	479	479
Back stop of Fannie Mae and Freddie Mac	400	97
Federal Deposit Insurance Corporation		
Guarantee of U.S. banks' debt*	1,400	330
Guarantee of Citigroup debt		10
Guarantee of Bank of America debt		3
Transaction deposit accounts	500	0
Federal Housing Administration		
Refinancing of mortgages	100	0
Congress		
Economic Stimulus Act of 2008	170	170
American Recovery and Reinvestment Act of 2009	787	787
Joint Fed, FDIC and Treasury		
Public-Private Investment Fund	1,000	0
Total	12,274	4,098

Sources: Fed, Treasury, FDIC, FHA, Moody's Economy.com

Wall Street on Track to Award Record Pay

Major U.S. banks and securities firms are on pace to pay employees about \$140 billion this year -- a record high that shows compensation is rebounding despite scrutiny of Wall Street's pay culture. Top workers can expect to earn even more than in the peak year of 2007.



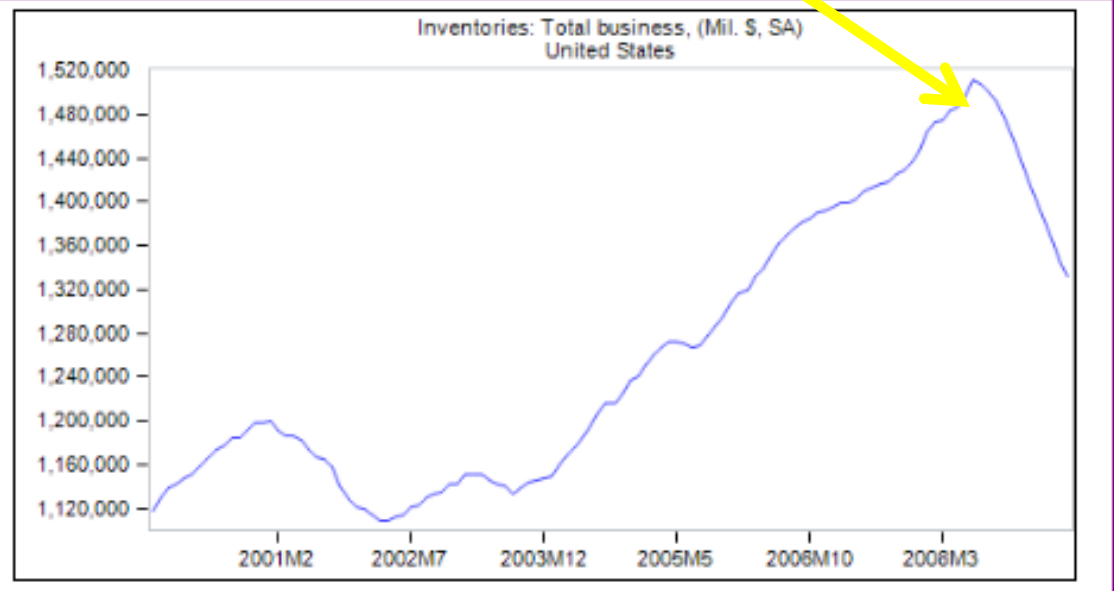
Overall Business Inventories Declining

United States: Business Inventories (MTIS)
 Print | Definition | E-mail Alerts | Go To Source

Actual: -1.0%
Previous: ** -1.1%
Moody's Economy.com: -1.1%
Consensus: * -0.9%
Coverage: July 2009
Next Release: 10/14/2009
Archives: 9/15/2009
Updated: 9/15/2009 10:00 AM
Analysis By: Andrew Gledhill in West Chester

Business Inventories % change

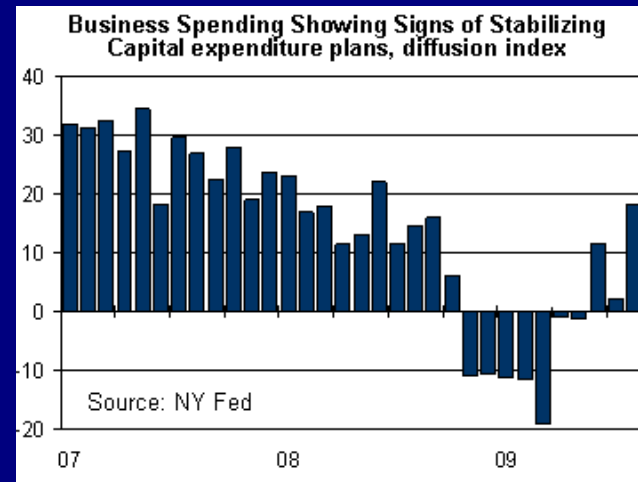
Month	% change
Sep-08	-0.2
Oct-08	-0.4
Nov-08	-0.8
Dec-08	-1.4
Jan-09	-1.2
Feb-09	-1.3
Mar-09	-1.2
Apr-09	-1.2
May-09	-1.2
Jun-09	-1.4
Jul-09	-1.0



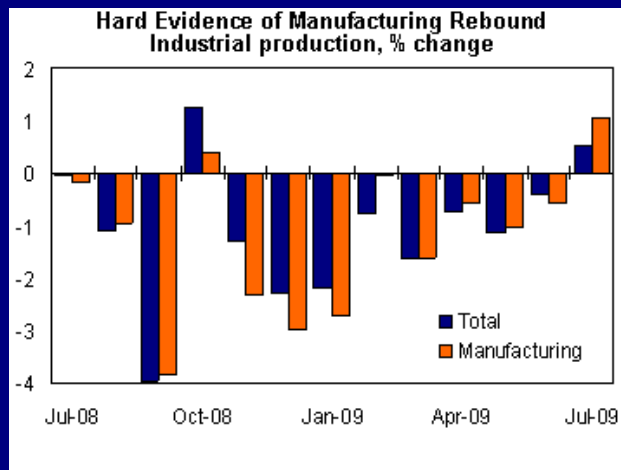


Some Good News: Manufacturing & Autos

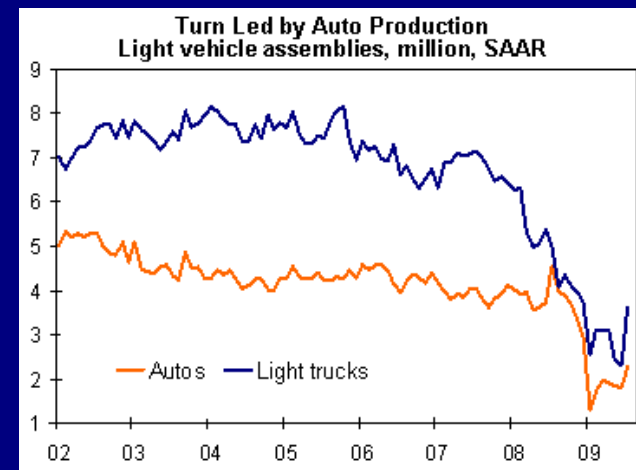
Business Spending



Some Good News: Manufacturing up



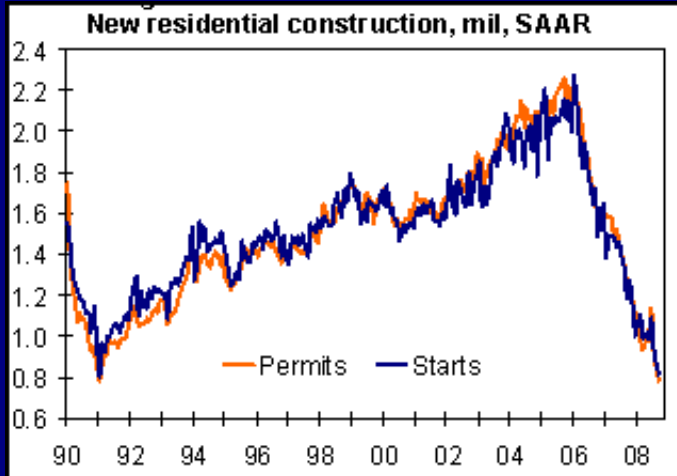
Cash for Clunkers....



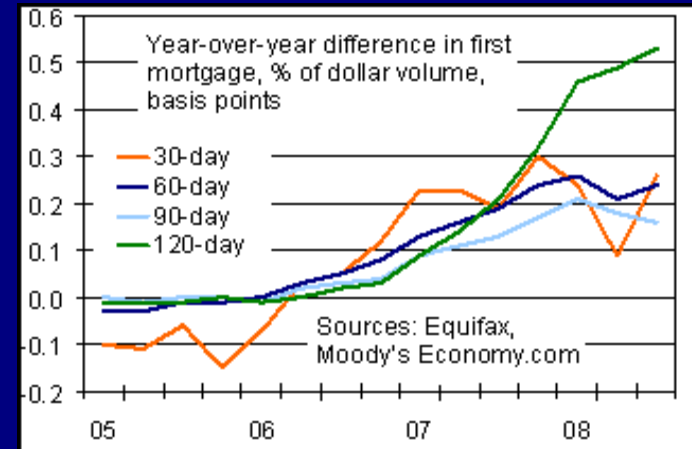


Housing Activity and Delinquency Rates

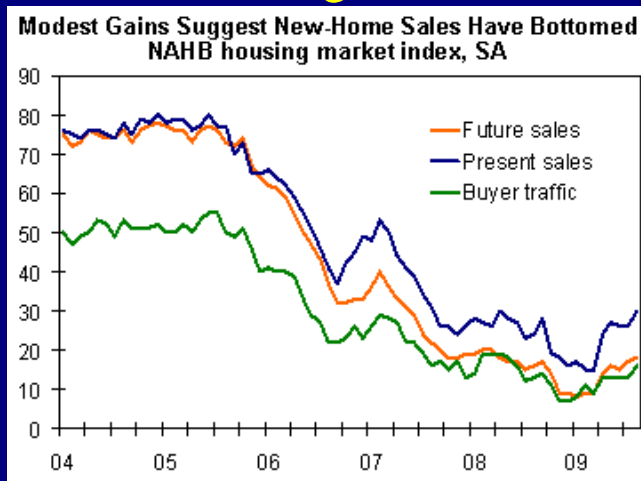
Construction



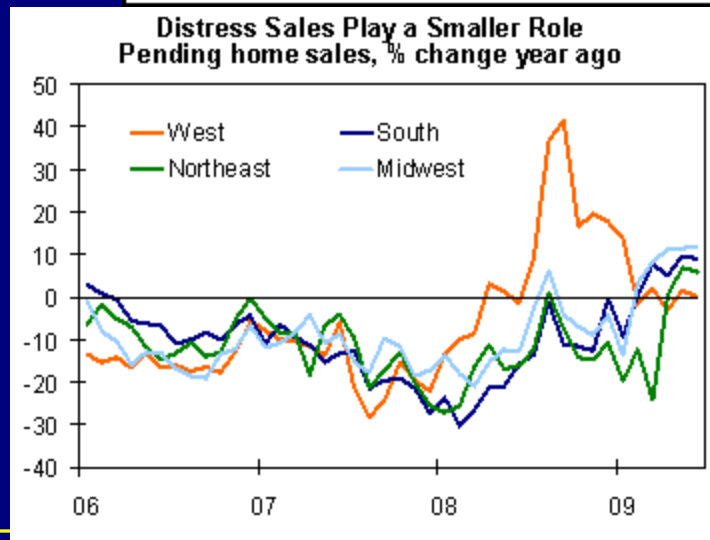
Delinquency & Default



Housing Index



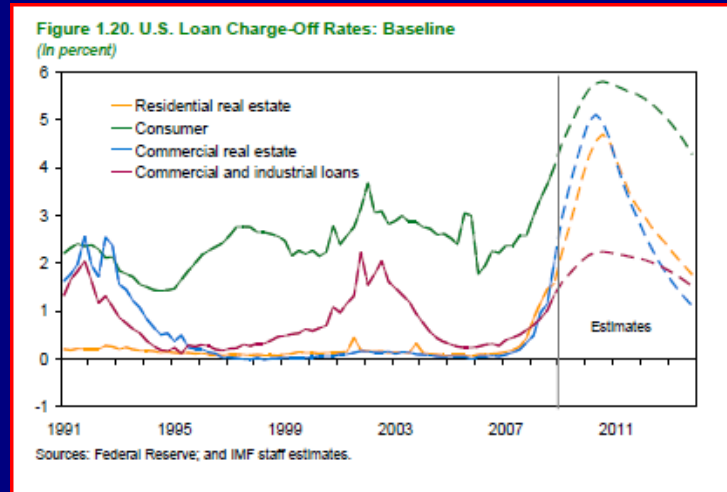
Distress Sales Play a Smaller Role Pending home sales, % change year ago



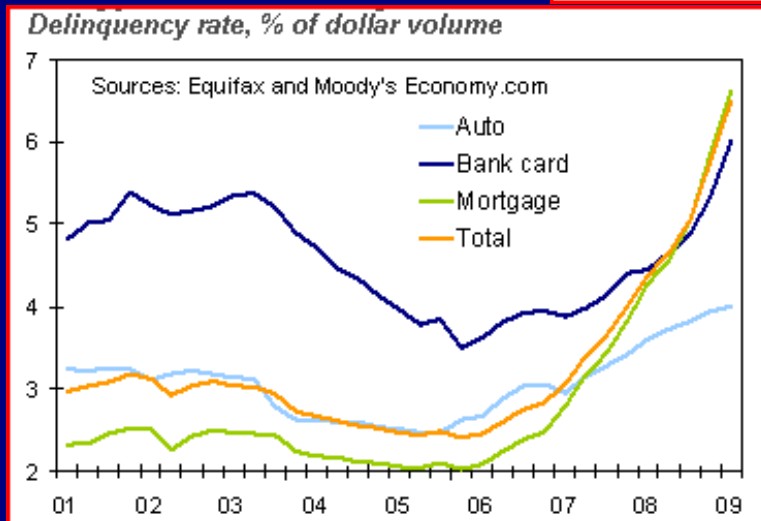


Delinquency and Loan Charge-Off Rates

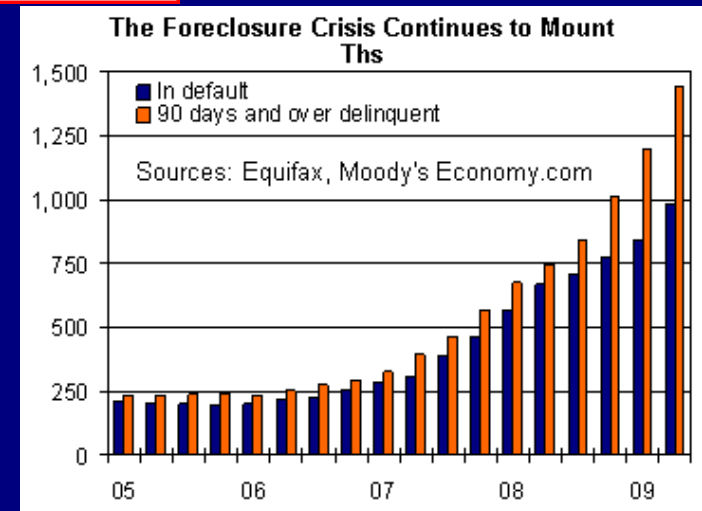
Loan Charge-Off Rates to Rise



Delinquency Rates



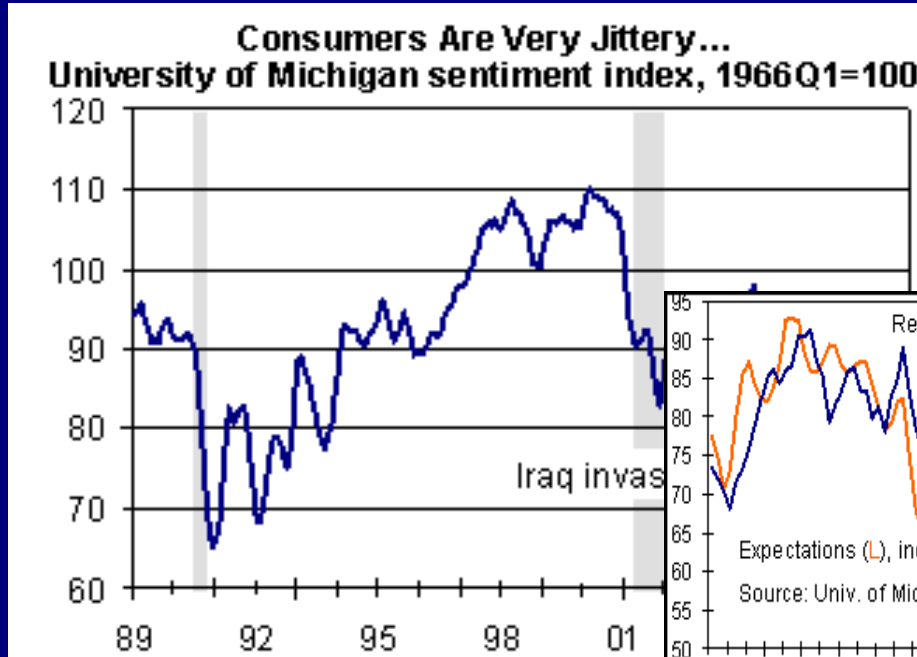
Residential Foreclosures



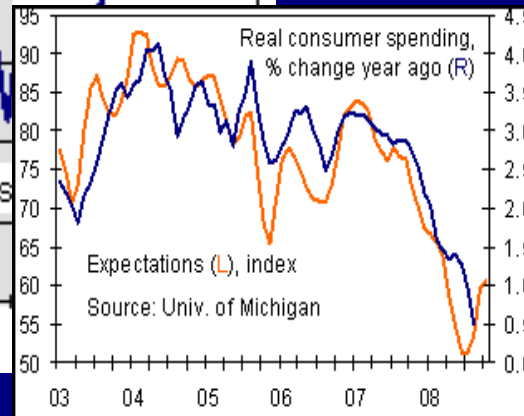


Consumer Confidence, Spending & Credit

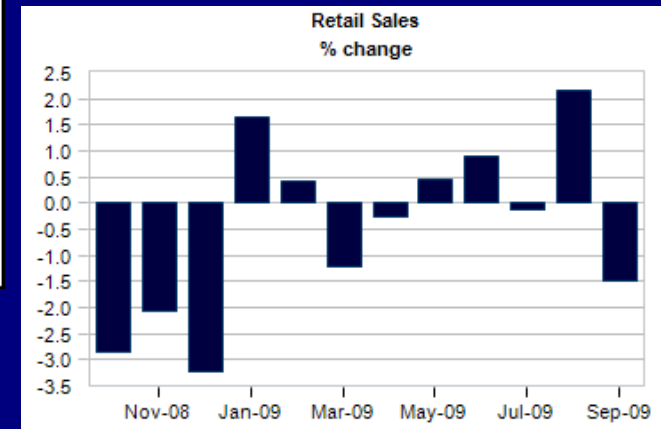
Consumers Contracting



As of October 2009, consumers are over 70% of GDP....



Source: economy.com



As of October 2009, recent uptick in retail sales on Year over Year; partly weak 2008...

Butt...

OCTOBER 14, 2009, 8:42 A.M. ET

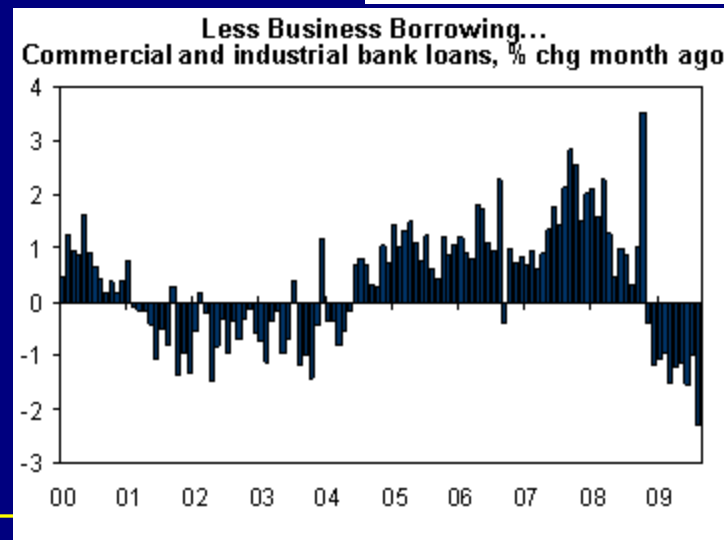
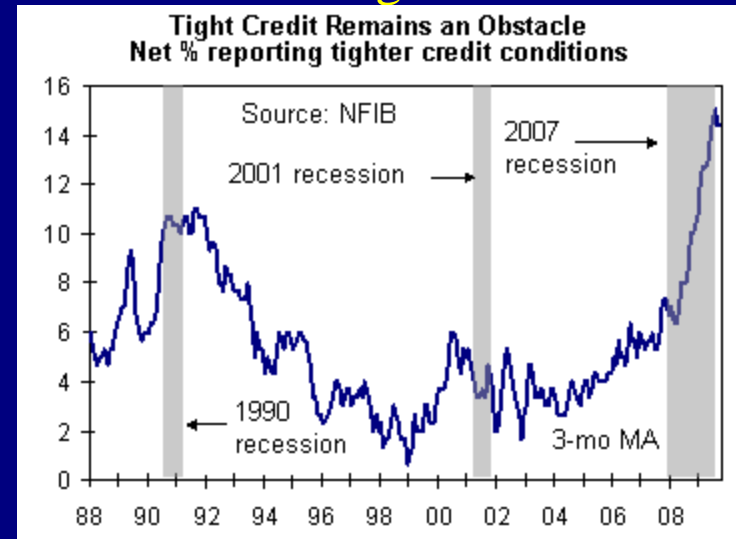
Retail Sales Drop on Fall in Autos



Focus on Small Business

- Small business report tighter credit
- Reactions
 - Cutting payrolls
 - Reducing inventory
 - Reducing capital spending
- Outlook
 - No near-term improvement

Credit Remains Tight for Business



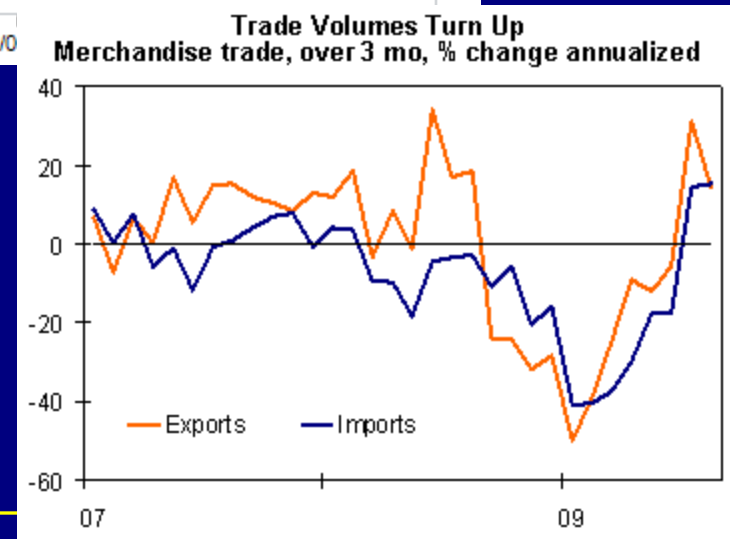
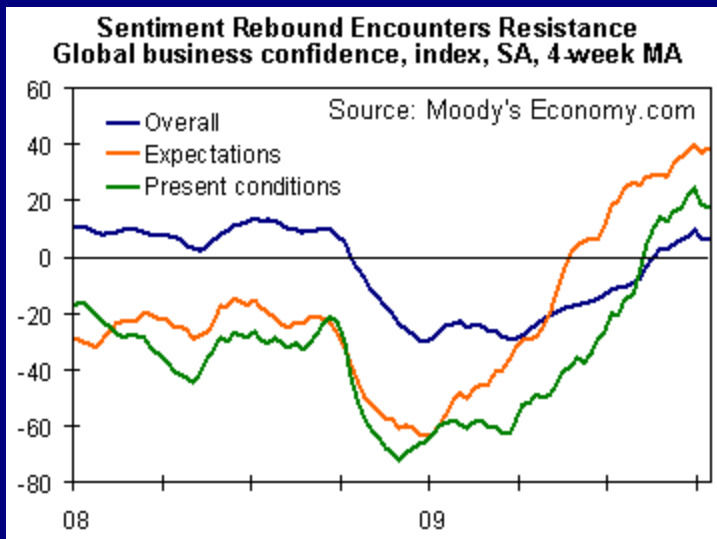
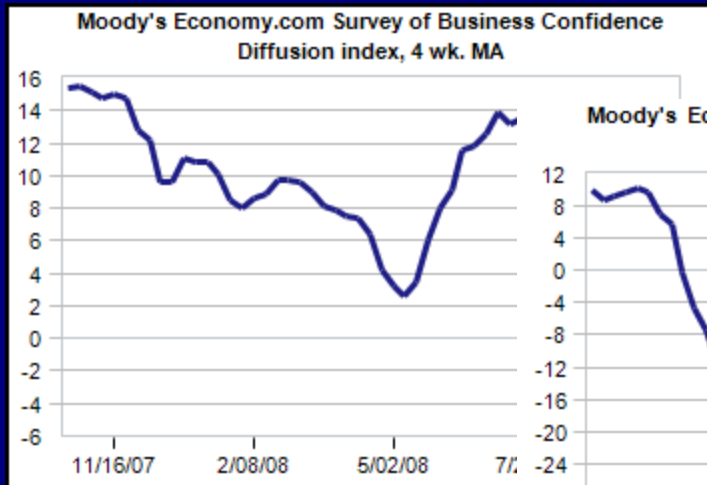
Source: economy.com



Global and Domestic Business Confidence

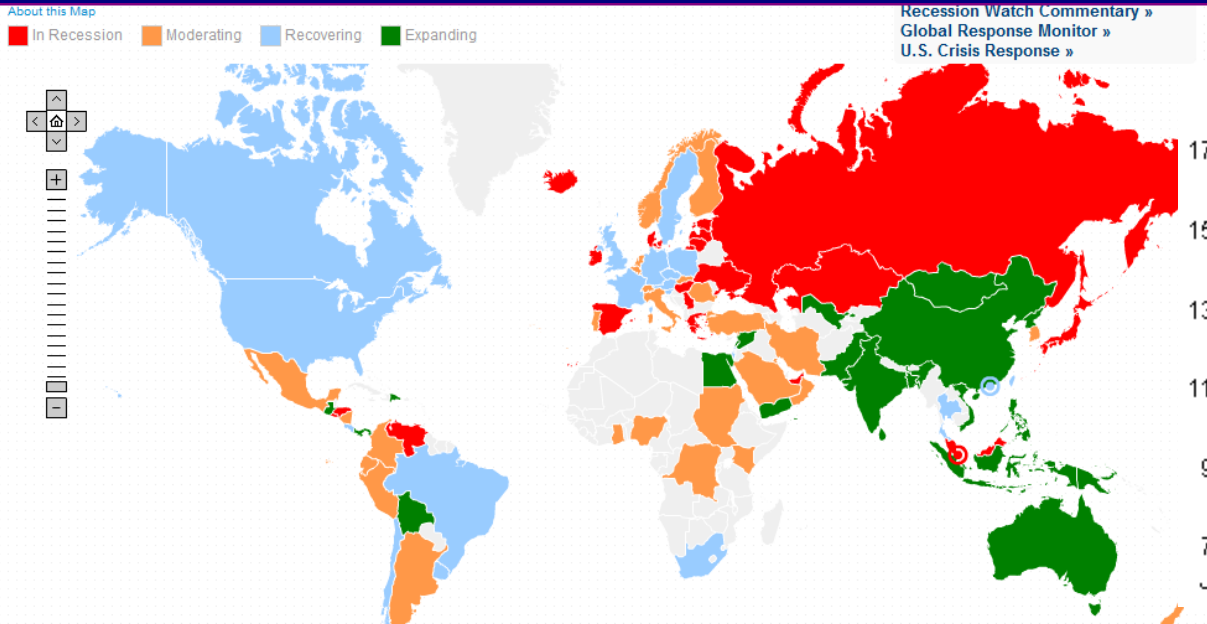
U.S. Business Confidence

Some improvement....





Global Recession Map



Global Emerging Market Composite Borrowing Rate %



World Summary

	2007	2008	2009F	2010F	2011F	2012F
Real GDP (%)	3.6	1.5	-2.6	2.2	3.7	4.5
Industrial production (%)	2.5	-2.3	-12.9	2.9	3.9	4.1
Employment growth (%)	1.5	1.4	0.1	1.2	1.6	1.8
Oil prices (WTI, US \$)	72.4	100.8	61.0	75.9	87.5	89.4
U.S. Federal Reserve monetary rate (year avg)	5.02	1.93	0.19	0.35	2.15	4.01
European Central Bank monetary rate (year avg)	3.94	3.69	1.13	1.06	2.28	3.63
Exchange rate: USD/EUR (year avg)	1.37	1.47	1.39	1.53	1.55	1.48
Exchange rate: JPY/USD (year avg)	118	103	98	102	103	100

Source: economy.com



Part II Summary: The Economy

Macro-economic Environment

- Economy showing some signs of turning
- Businesses struggling, credit tight
- Consumers bearish

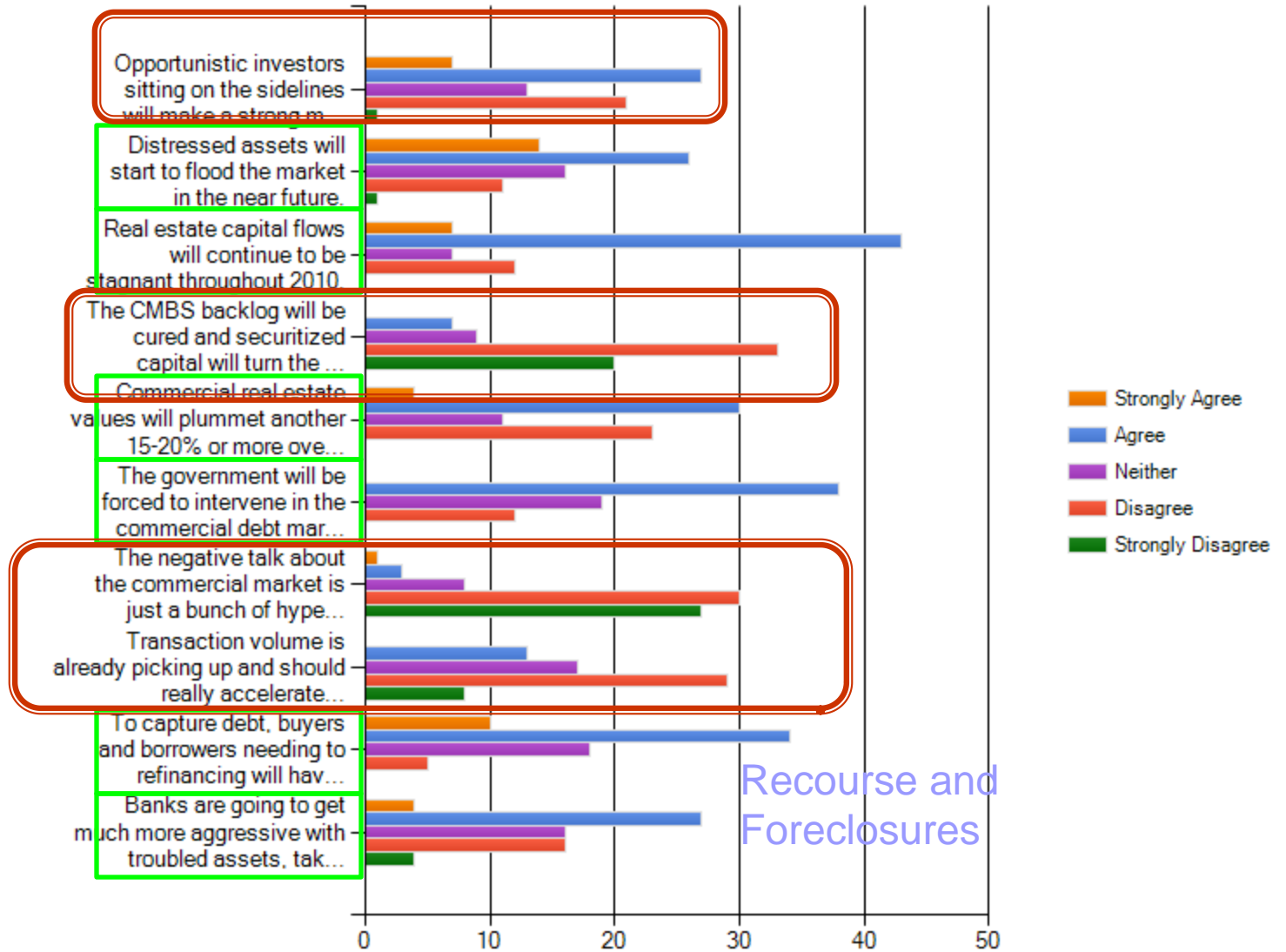


Part III: Capital Markets & Capital Flows

- Decreased capital flows
 - Investors still frozen
 - Denominator effect more muted
- Investment Preferences
 - Core assets at distressed prices
 - Major markets, strong assets
- Timing
 - Still waiting for bottom
 - Indecisive; slower to act
- Opportunities
 - Cash
 - Distress
 - Takeovers



Real Estate Capital Markets: Agree/Disagree



Recourse and Foreclosures



Biggest Capital Market Issues & Risks

Issues

Capital Access & Yields	10
Tough Banks/Bad Banks	5
Credit Access, Cost & Recourse	22
CMBS Replace	4
Valuation	5
Fundamentals	5
Distressed Assets	5
Refin Volume	11
Gov Rules	1

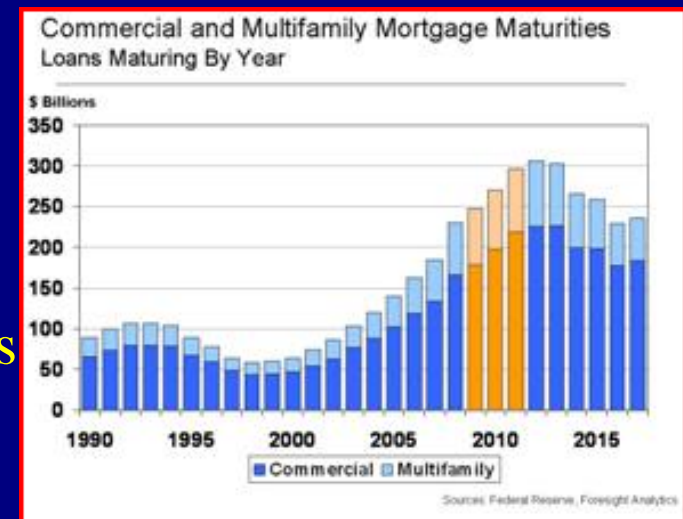
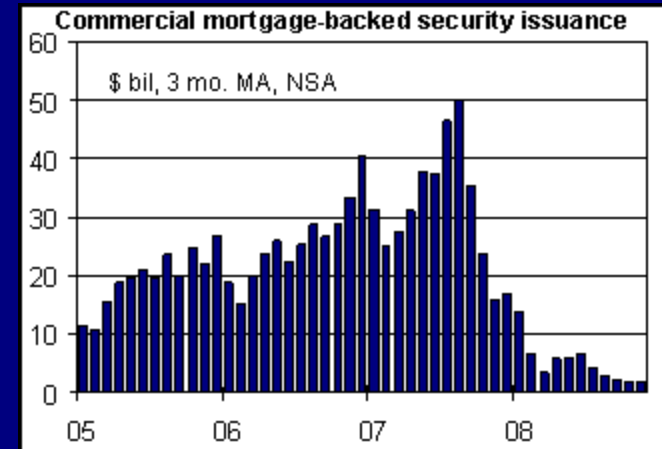
Risks

Leasing
Debt Roll
Inflation
Foreclosure
Inexperience/Distress
Distressed Debt



Commercial Leverage: Problems & Implications

- Tightened Credit
 - Higher DCRs and LVs
 - Hard valuations, less financial engineering
 - Recourse debt
 - Real equity positions
- Outlook for Commercial Debt
 - Limited supply; flight to quality
 - Tighter; increased equity and recourse
- Refinancing Crisis
 - No obvious sources of debt
 - Banks struggling with carry-over problems
 - No CMBS resurgence





Bid/Ask Spread: Trends and Value Pressures

- Bid/Ask De-Compression
 - Distressed Sellers will have to act
 - Distressed Assets will face melt-down risks
- Mark-to-Market Accounts
 - NCREIF - 35% w/o Distressed Sales
 - Going Forward: Three Strikes
 - Comps Down as Assets Dumped
 - NOI Erosion, Vacancy & Rents
 - Debt & Equity Yields Up
- Appraisals under increasing scrutiny



Here a Vulture, There a Vulture....

- Where have all the vultures gone?
- What is a Vulture?
- What role do they play?
- When will they do there thing?
- Who will they be?
 - REITs?
 - Opportunity Funds?
 - Offshore Investors?



REITs

• Changing Game?

- Through June, raised \$12 billion in stock
- Who?
 - Office: Boston Properties, Vornado Realty Trust
 - Retail: Regency Centers, Simon Property Group

• Challenges

- Existing Leverage
- Eroding Fundamentals
- Falling Property Values

Accretive?

Buy at 8-10,
payout 4-6

Property Sector/Subsector	Total Return (%)			Dividend Yield ²
	2008	September	Year to Date	
FTSE NAREIT Equity REIT Index	-37.73	6.40	17.00	4.39
Industrial/Office	-50.28	5.32	20.27	5.53
Industrial	-67.47	3.56	0.08	3.65
Office	-41.07	7.00	26.42	5.62
Mixed	-33.99	1.57	33.67	2.74
Retail	-48.36	6.20	16.59	3.72
Shopping Centers	-38.84	3.83	-5.28	1.08
Regional Malls	-60.60	8.92	42.03	6.96
Free Standing	-15.09	3.01	23.82	4.73
Residential	-24.89	12.51	18.96	4.72
Apartments	-25.13	12.66	18.77	4.91
Manufactured Homes	-20.18	9.90	24.62	2.99
Diversified	-28.25	10.75	8.63	0.91
Lodging/Resorts	-59.67	16.36	57.04	6.41
Health Care	-11.98	-1.33	11.14	3.55
				5.09

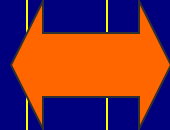




Part III Summary: Real Estate Capital Markets

Macro-economic Environment

- Economy showing some signs of turning
- Businesses struggling, credit tight
- Consumers bearish



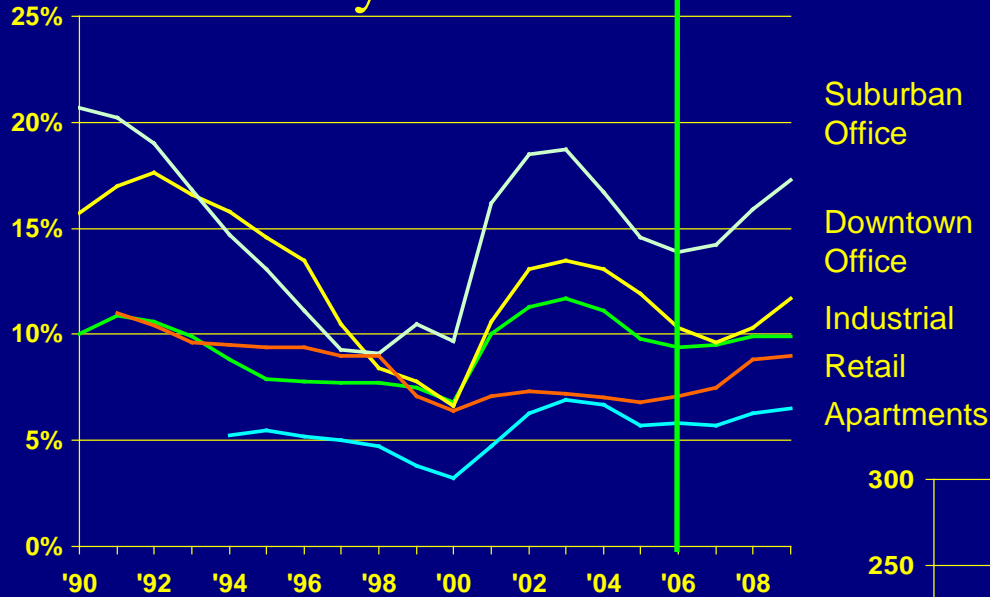
Real Estate Capital Market

- Still shut down; some activity increasing
- Rising Cap rates, tighter credit, picky sources
- Major challenge in de-levering

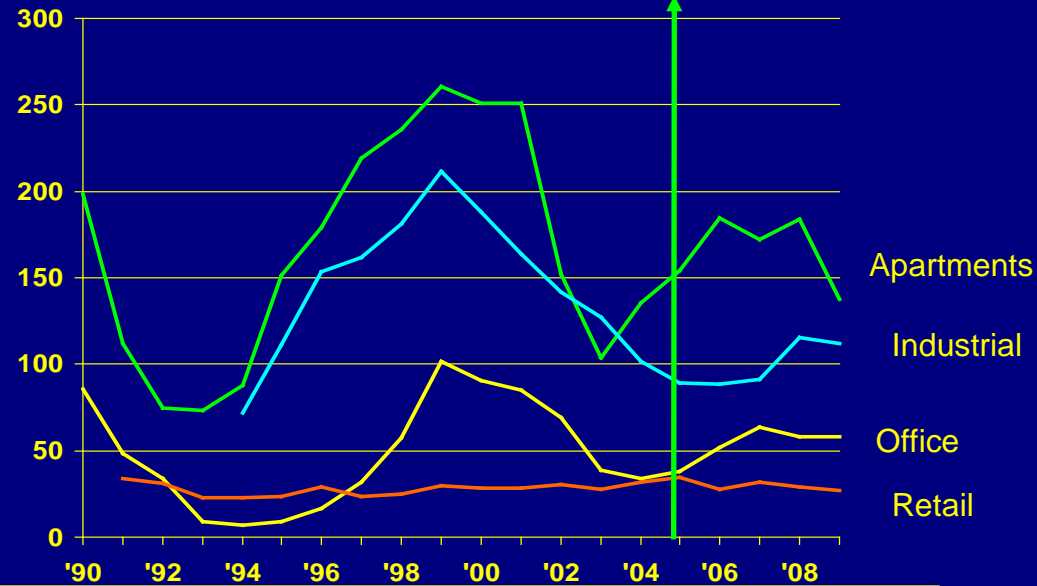


Part IV: Commercial Market Fundamentals

Vacancy Rates

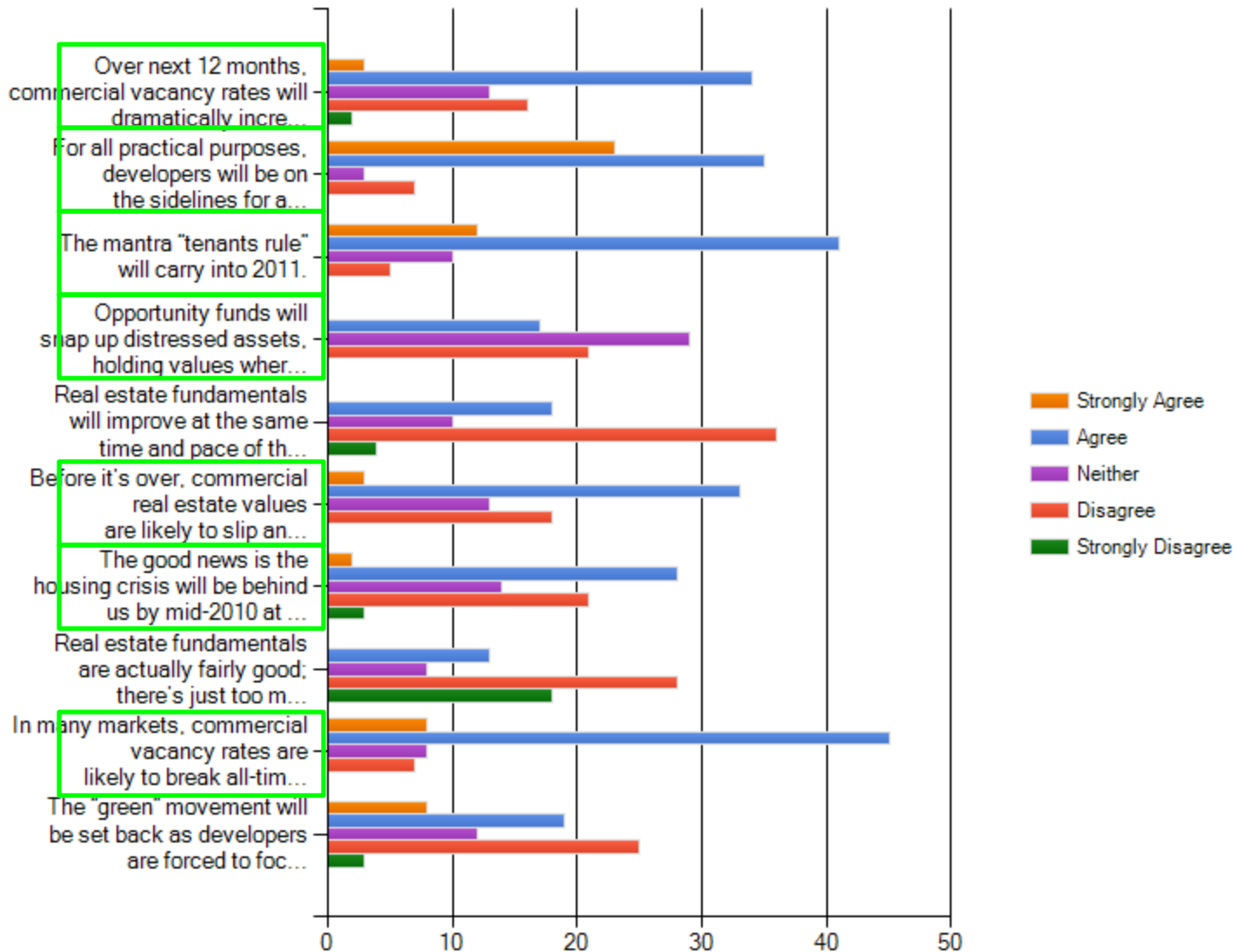


Development (msf)

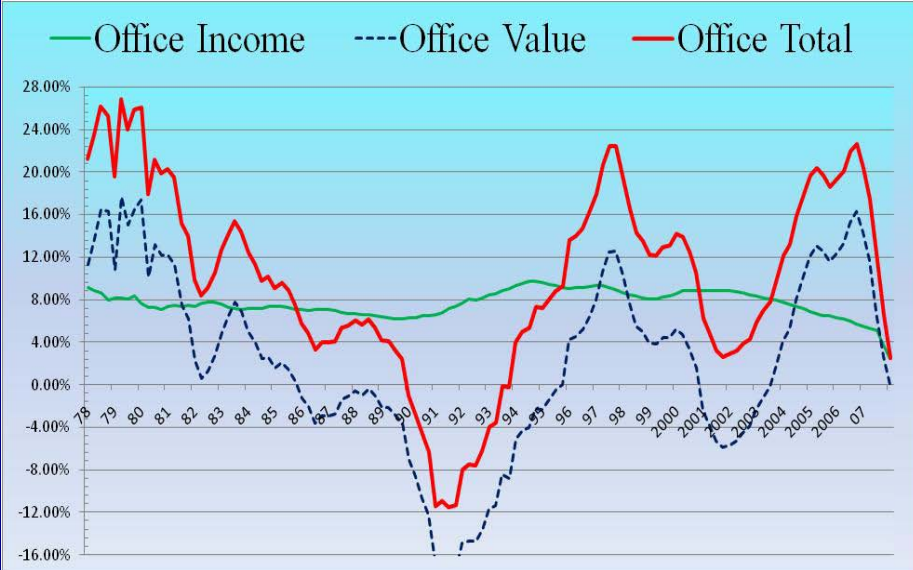
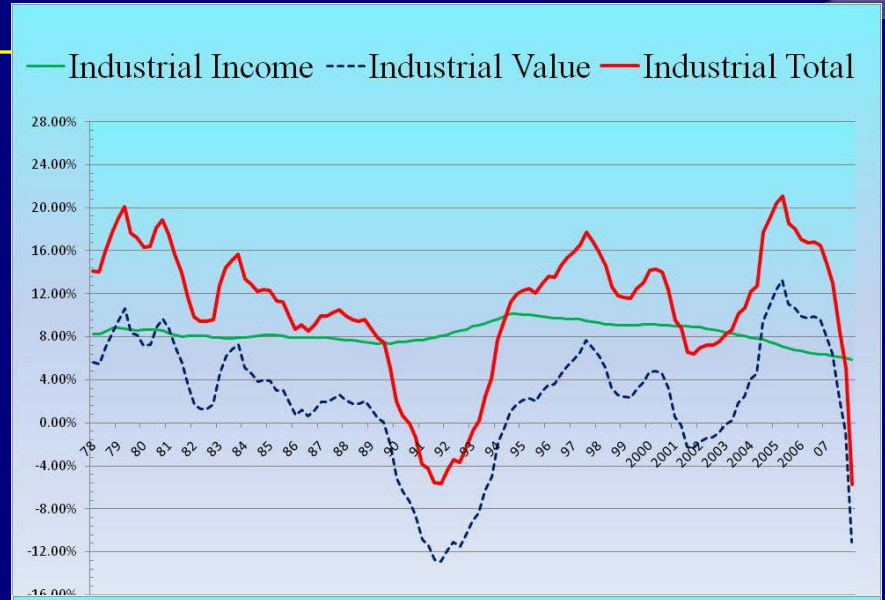
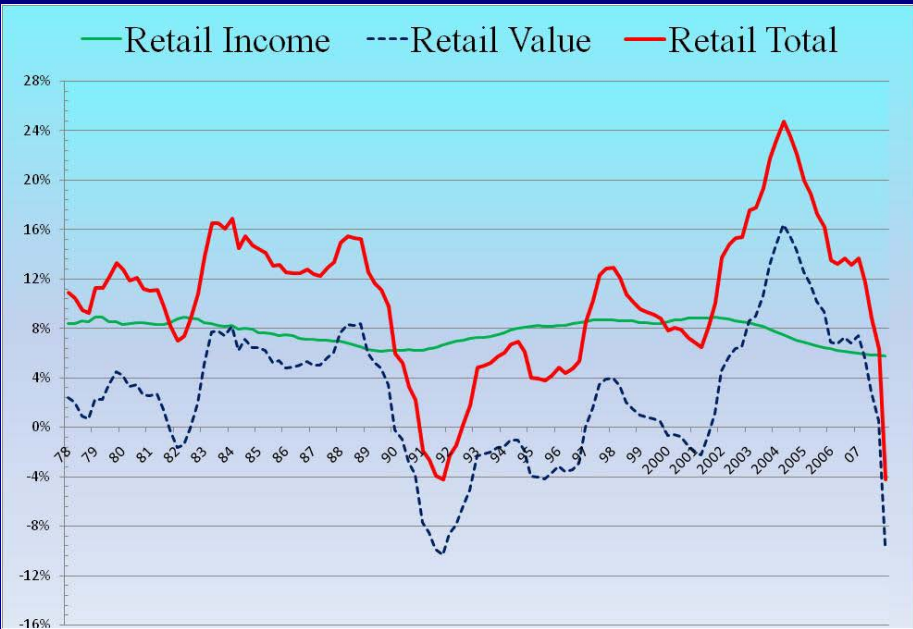




Real Estate Fundamentals: Agree/Disagree



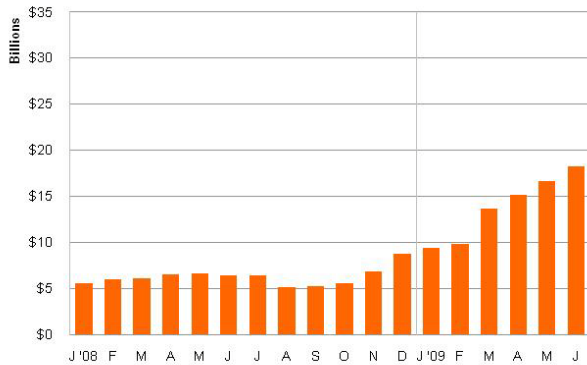
NREIF Returns by Source by Property Type



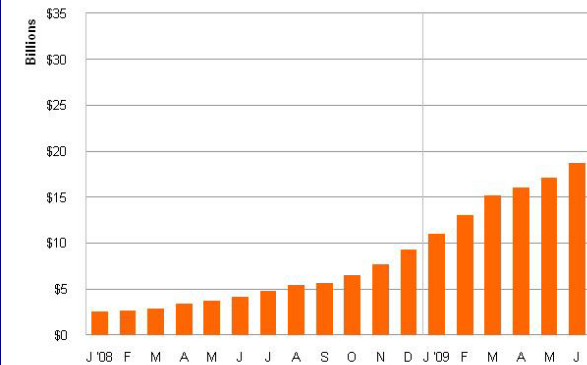


Growth in Distressed Assets by Property Type

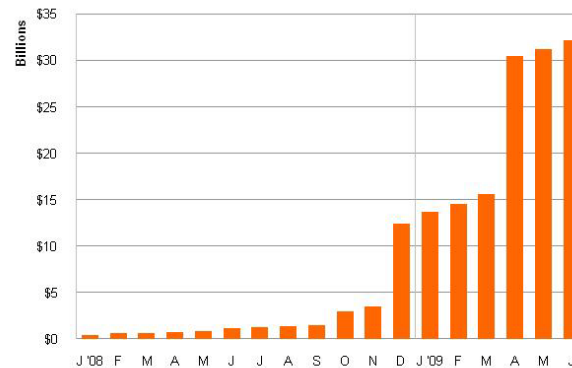
Monthly Cumulative Distress
Office



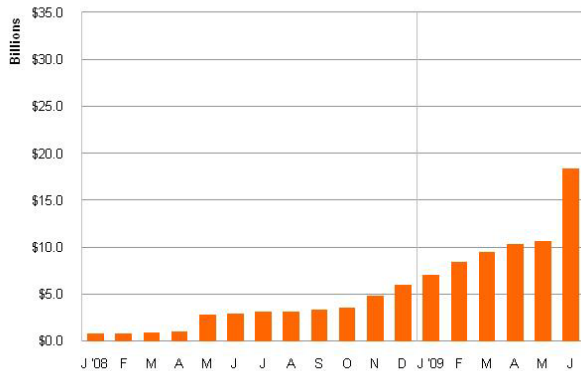
Monthly Cumulative Distress
Apartment



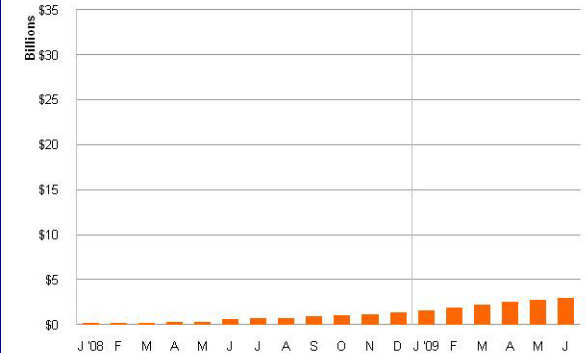
Monthly Cumulative Distress
Retail



Monthly Cumulative Distress
Hotel

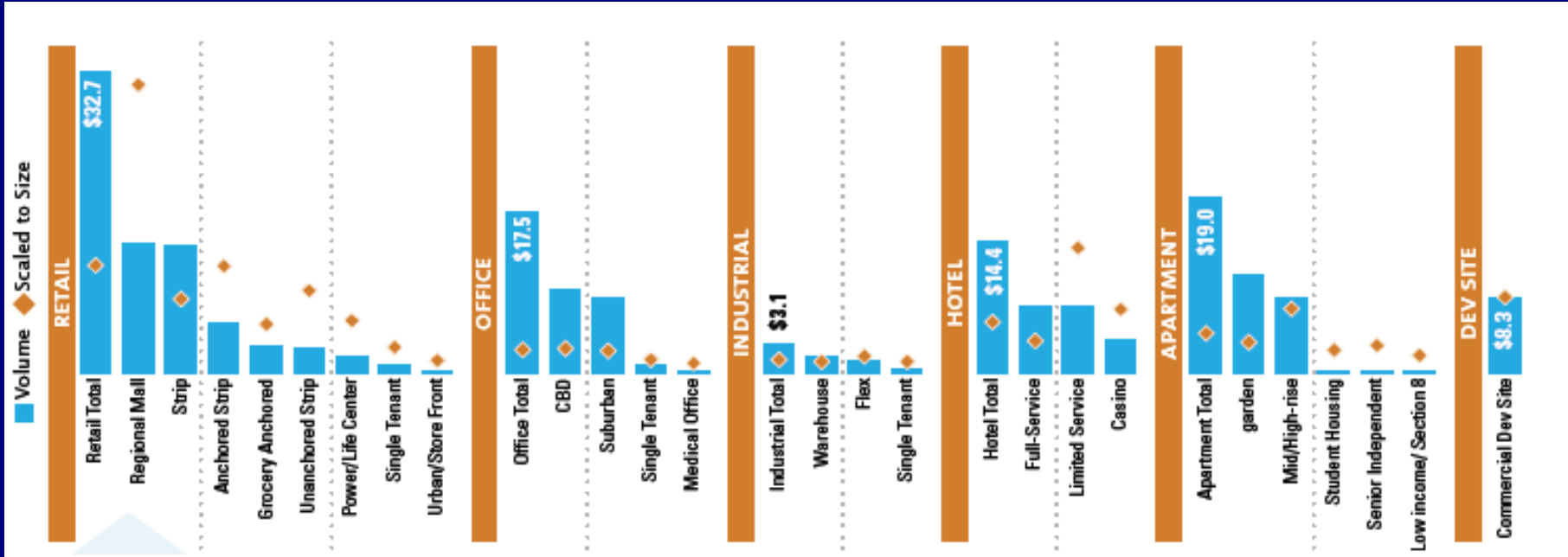


Monthly Cumulative Distress
Industrial



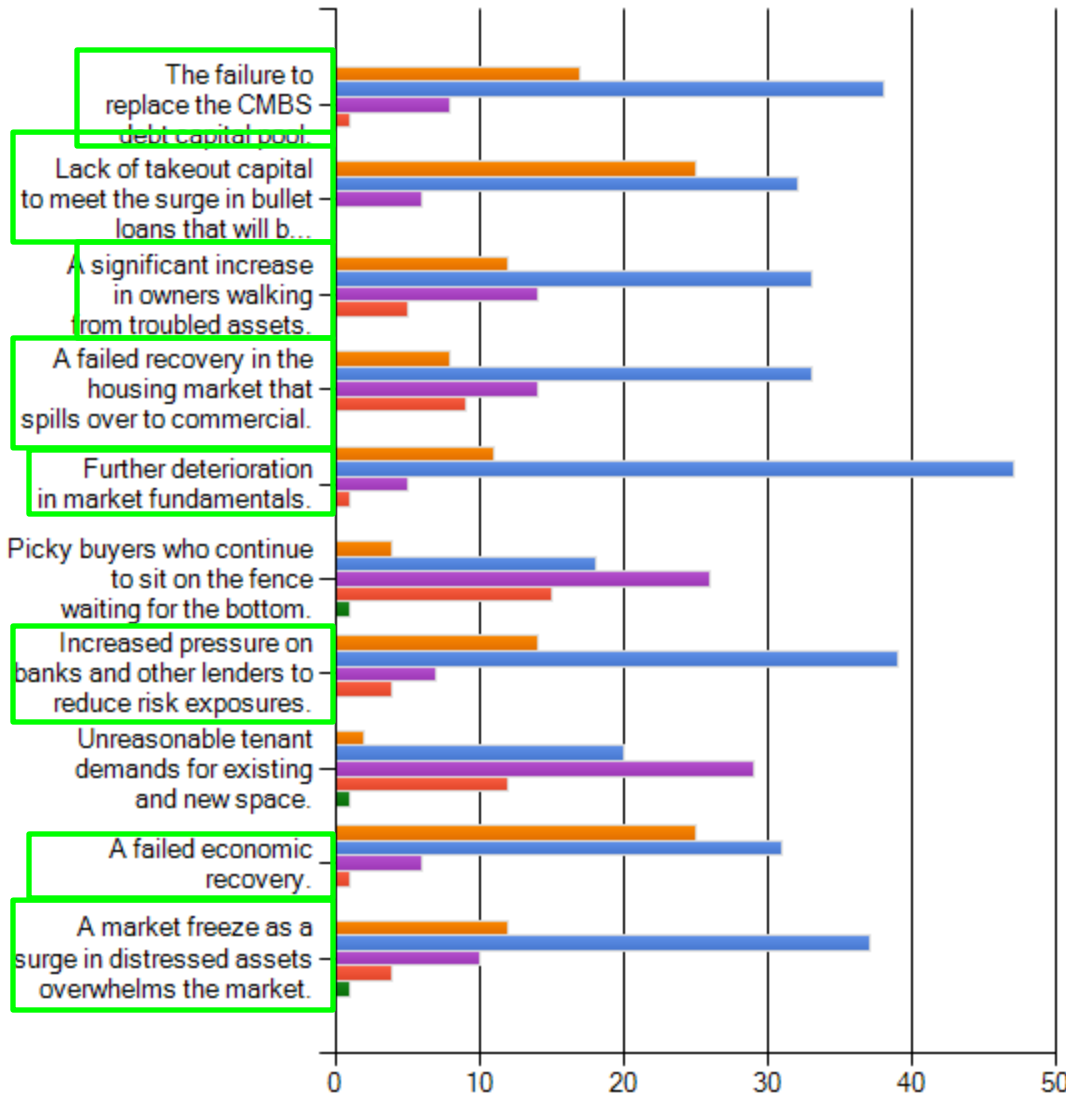


Distressed Assets by Property Type and Subtype





Risks to Commercial Real Estate Industry

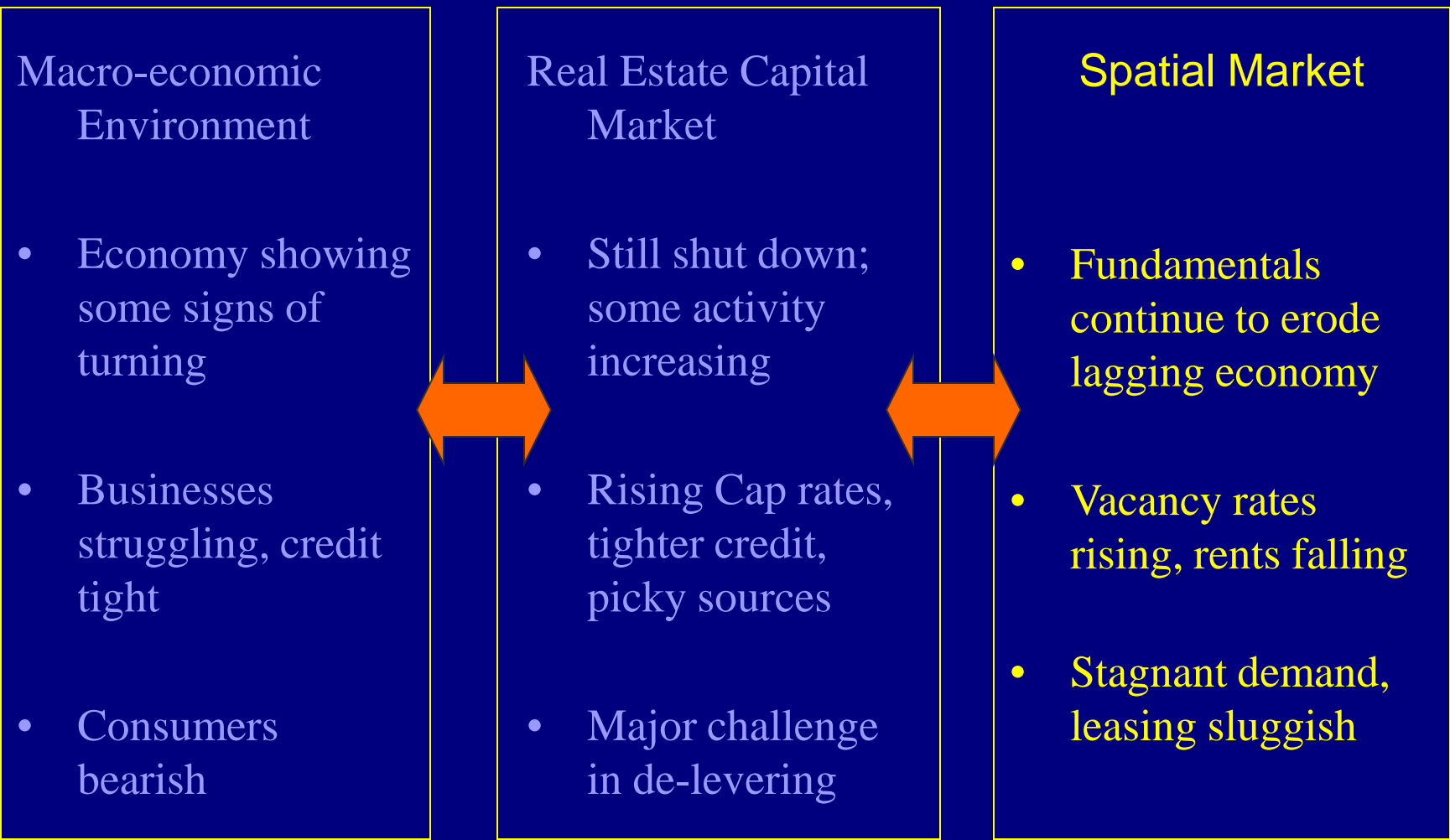


THE RISKS ARE ALL REAL

- Extremely Significant
- Significant
- Neither
- Insignificant
- Extremely Insignificant

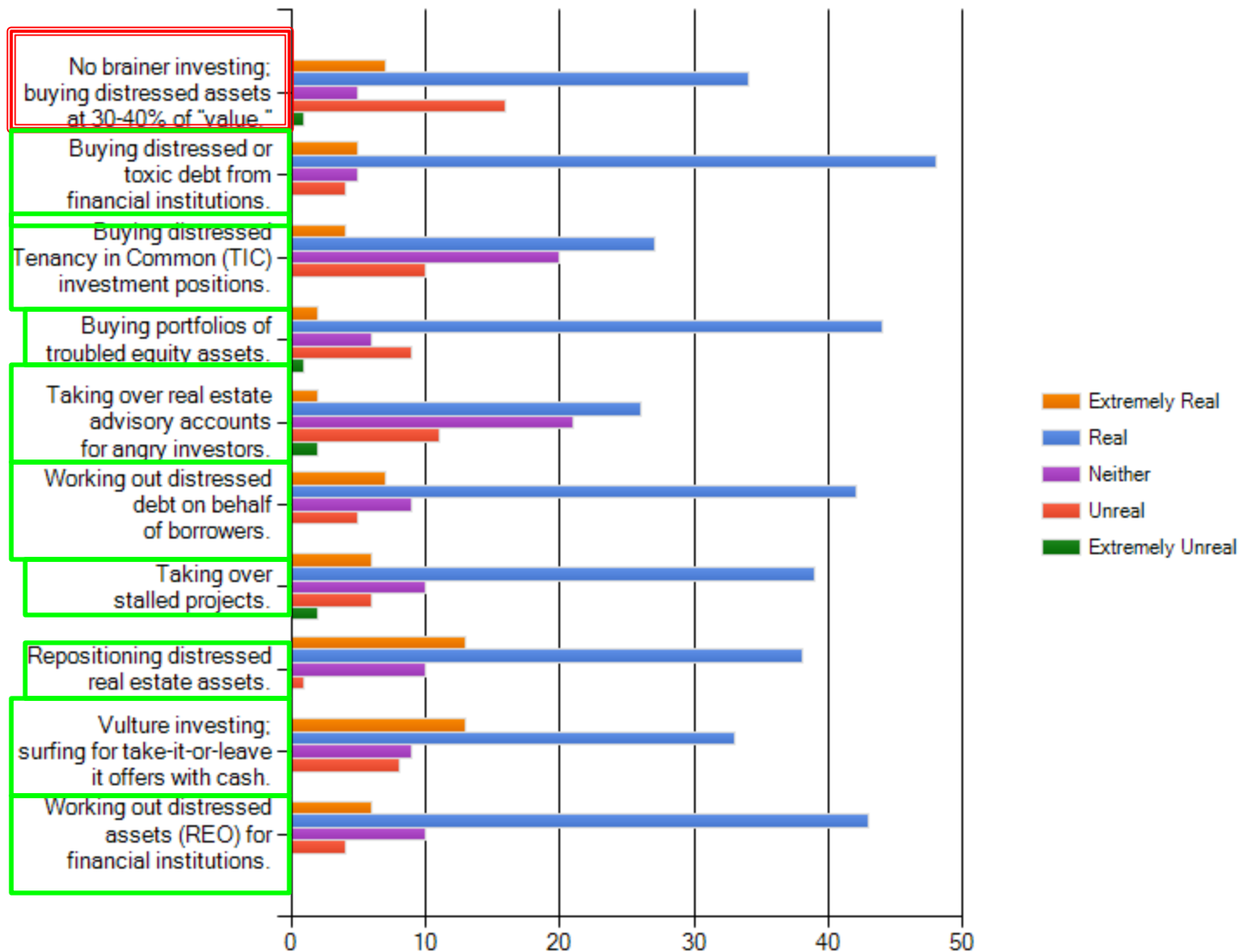


Part IV Summary: The Spatial Markets





“Real?” Opportunities in Real Estate





Fundamentals Rule: A New Game is Coming

- Risk
 - Despite write-downs on assets to date, risks will be higher
 - Market will be frothy enticing quick action
 - More money will be lost on both the buy and sell sides
 - Buyers will tend to walk as better deals come on the market
- A return to fundamentals
 - Will be painful but warranted
 - In the long-term, it will be healthy
- Research
 - Renewed emphasis on research
 - Must be integrated into decision-making process
 - Must be proactive vs. reactive



Leasing, Liquidity & Transaction Challenges

- Commercial Leases
 - More complex negotiations
 - Early negotiations and renewals
 - Cannibalization threat by distressed owners will spill-over
 - Tenants will become more aggressive on rents & incentives
- Liquidity
 - Selling good assets at “fair value” will be difficult at best
 - Weaker assets will languish
 - Closing will be much more difficult
 - Shortage of capital for maintenance, TI’s and capital needs
- Volume & Size
 - Over next 12-18 months, dramatic increase in transactions
 - More bundled transactions and bulk sales coming



Distress and Debt

- Distress
 - Not the “opportunity” many expect; not a “no-brainer” stage
 - Concept not well understood in a risk management context
 - Determination of what is curable and incurable will be key
 - Real danger that distress will turn to panic

- Debt
 - A major wild-card although market is discounting shortage
 - Money will be tight at best with recourse and equity increased
 - Seller financing will be critical to many transactions
 - Creative financing will re-emerge as a driver




Players, Distress and Debt

- **Players**
 - Emergence of new players will create further problems
 - Many naïve buyers will clog up the system
 - Intermediaries will raise capital but struggle to deploy
 - Infrastructure not in place to deal with sheer volume of deals
- **New Funds**
 - Expect a spate of new funds, some with experience others not
 - Closed-end fund structures will be popular
 - Off-shore investors will be a major target for money managers
- **Products**
 - A spate of new products will be introduced to lay off risk
 - New Partnership arrangements will match expertise with capital



So, To Walk, To Talk, To Walk the Talk???

- That is the question....
- There is no one answer....
- Strategic thinking and survival instincts will rule...
 - If not, there's always school....

JrD_{dr} Professor James R. DeLisle, Ph.D.		
October 13, 2009 Home About Courses Market Watch Retail Watch Research Cases/Tutorials Presentations Video Tutorials OnDemand Glossary Ask DrD	<p>Overview</p> <p>I am the Runstad Professor of Real Estate and Director of Graduate Real Estate Studies in the College of Built Environments at the University of Washington and the former Director of the Rundstad Center for Real Estate Studies.</p> <p>This is a non-commercial website I have established to serve as a portal I can use to help advance the real estate discipline and improve market efficiency by disseminating some of some of my research, teaching and service materials. It is also serves as a forum I can use to help me continue to bridge the gap between the academic communiity in which I currently reside and the professional community in which I have served in the past.</p>	 <p>DrD</p>
<p>New Items: Just Released</p> <p>Live Survey: Click on Economic, Capital Market and Real Estate Survey to take a brief internet survey regarding the economy, capital markets and real estate markets. Once you complete the survey, you will be directed to the results so you can see how your position compares to your peers and other market players and observers. I will periodically compile the results and incorporate them in my NAIOP Forum presentations in Chicago on October 18 2009. I will update the results and publish them in my Market Watch section shortly thereafter and add my own interpretation and outlook.</p>		