

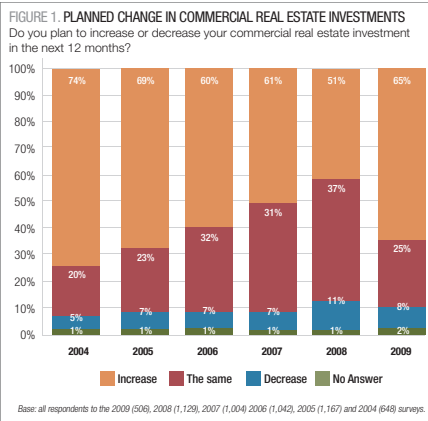
2010 Real Estate Investment Outlook

Marcus & Millichap

Excerpts from A Special Report, 2010 Real Estate Investment Outlook by National Real Estate Investor and Marcus & Millichap



Two-thirds of investors (65%) who responded to the 6th Annual Investment Survey plan to boost their investment in commercial real estate over the next 12 months. This survey was produced by National Real Estate Investor and Marcus & Millichap and polled 506 respondents between Oct. 9 and Nov. 5. Respondents to the annual survey who do plan to expand existing portfolios anticipate an average increase of 26% [Figure 1].



CRE investors are well aware of the **obstacles to expansion** that lie ahead. Impediments to expanded portfolios cited: the continued lack of financing, a

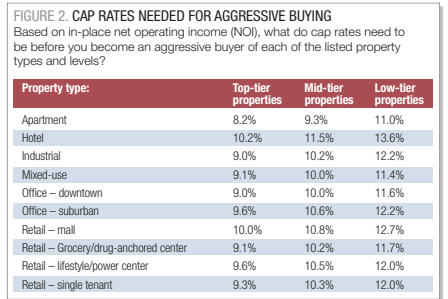
narrower but still sizable gap between buyer and seller price expectations, and uncertainty related to the volume of distressed properties coming to market. Notably, buyer traffic has picked up substantially over the last two to three months. However, according to Harvey Green, president and CEO of Encino, Calif.-based Marcus & Millichap, a logjam has been created by extremely conservative financing and underwriting that has swung too far to the other extreme from the market peak.

Even **access to capital** is no guarantee that acquisition strategies will find success in the current market. Camden Property Trust, the Houston-based apartment REIT, did not acquire any properties in 2009. However, Camden is continuing to scout for deals and is hoping that more opportunities will materialize in the latter half of 2010. "We have an acquisition appetite of \$1 billion-plus. The question will be whether we can find the right transactions," says Richard J. Campo, Camden's chairman and chief executive officer.

Finding good buying opportunities is more difficult as investors adopt conservative strategies to fit the current volatile climate. More than half of respondents (53%) rate their acquisition strategy as very cautious to cautious. However, 72% of respondents indicated that they are currently amassing capital in preparation for buying opportunities. The majority of investors expect to execute more transactions. More than one in four respondents (28%) say they have already started adding to their portfolios, while an additional 41% say they plan to begin acquiring property over the next six months.

Miami-based LNR Property Corp. is looking at opportunities in office, industrial, retail and apartment markets in 2010, as well as indirect investment in underperforming real estate debt and potential operating platforms. "This past year the fundamentals have been too uncertain, and it has been too early in the cycle, while next year should have more volume of higher-quality assets coming to market" predicts Eric Paulsen, a vice president at LNR Property.

One hurdle for buyers remains **pricing**. Many buyers are waiting for bigger price discounts before they jump into the market. The minimum cap rates respondents say would be necessary to spark aggressive buying in a particular property type range from an average low of 8.2% for top-tier apartment properties to an average high of 13.6% for low-tier hotels [Figure 2]. "The degree of cap rate movement needed for buyers to become aggressive in this market really points to a lingering pricing expectation gap," says Hessem Nadji, senior vice president and managing director at Marcus & Millichap.



Uncertainty regarding the volume and pricing of distressed properties that will eventually find their way to the selling block is creating hesitancy among investors. Three out of four investors (78%) expect that a moderate to large volume of distressed properties will hit the market during the next 12 months. Stiff competition and a limited supply of distressed properties on

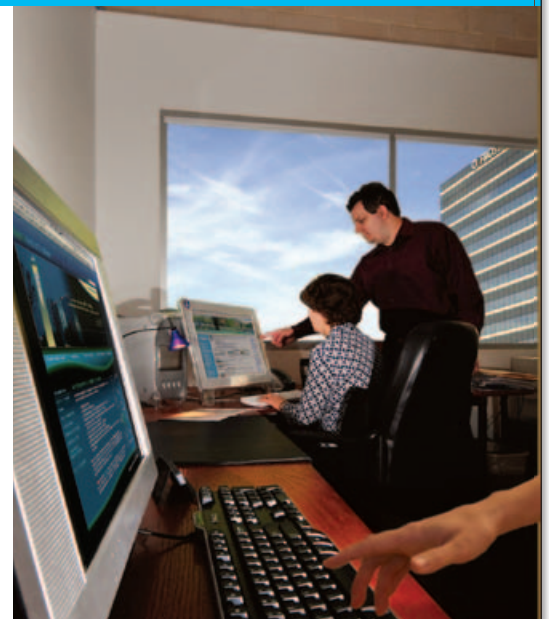
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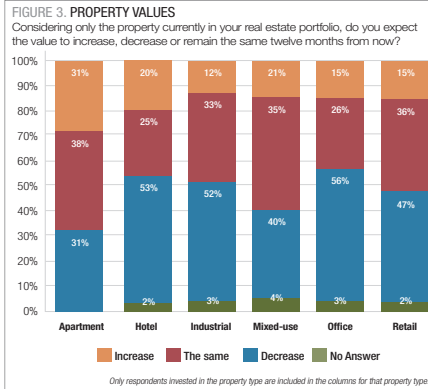
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the market have combined to keep opportunistic buyers such as LNR Property from making any new investments during 2009. The firm is targeting potential acquisitions that deliver returns in the high teens. "We believe there will be greater potential for investment opportunities next year, but we may need some kind of government mandate that forces the issue, otherwise it will continue to be a slow trickle of properties to the market," says Paulsen of LNR.

The build-up of distressed properties among lenders is clearly on the rise. The total delinquency rate among bank commercial mortgages that are 90-plus days past due reached an estimated 4.7% in the third quarter, according to Foresight Analytics. The delinquency rate on CMBS loans climbed to 3.9% in September on loans that are either already real estate owned or 30+ days delinquent, according to Realpoint Research. The complexity of unraveling securitized and off-balance sheet loans, coupled with banks' need to postpone further losses, is largely to blame for the delay in the discounting and sale of distressed assets. Impatient investors believe that government solutions aimed at addressing toxic assets are only contributing to that hold-up.

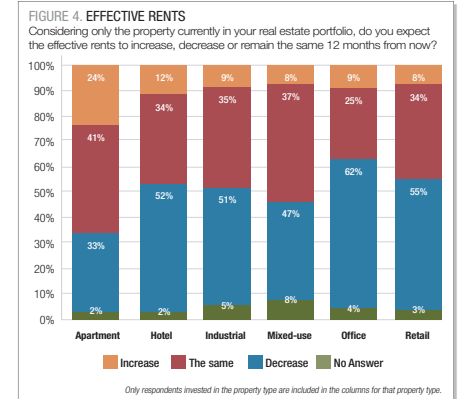
Investor demand appears to be rebounding even as buyers brace for a slow economic recovery. More than half of respondents (57%) believe that net job growth is a year or more away, while nearly two-thirds of respondents (62%) do not expect real estate values to return to their peak values for six years or longer. Apartment investors are the most optimistic, with opinions evenly split at 31% among those who expect valuations to increase or decrease during the next year. Another 38% who believe values will remain the same. In comparison, more than half (56%) of office owners are bracing for a decline in values, while 26% believe values will remain the same and 15% anticipate an increase [Figure 3]. **The apartment sector** is the only property type where owners expect values to hold up with an expected increase over the next year of a slight 0.2%. Only a fraction of investors expect effective rents will rise in the coming year, while the majority of investors expect additional deterioration. [Figure 4].



Expectations regarding effective rents are a key concern for investors who are relying more on cash flow and less on property appreciation when it comes to underwriting deals today. "When we're underwriting today, we're building in declines in cash flow between now and the end of 2010 and early 2011, but then we think there is going to be a substantial uptick in cash flow because of the lack of new supply," says Campo of Camden Property Trust. Camden's target returns are for an unleveraged IRR of 10% to 11%.

Investor expectations regarding the availability of financing have remained consistent throughout 2009. The majority of respondents (77%)

expect that the availability of capital will remain the same or increase in the coming year. In comparison, 64% expect that the cost of financing will increase next year, while 32% believe it will stay the same and 4% believe financing costs will decrease. "The full impact of the stimuli will also materialize in 2010, but it will take time for government solutions to normalize credit markets," Nadji emphasizes. On a positive note, evidence is emerging that both buyers and sellers are returning to the table, and there has been some narrowing of the pricing gap. "Quality assets are coming to market at reasonable prices that are generating as many as 20 offers because those buyers aren't trying to time the bottom," explains Green. "They see the long-term value of the real estate."



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