



CYCLE FORECAST — Real Estate Market Cycles

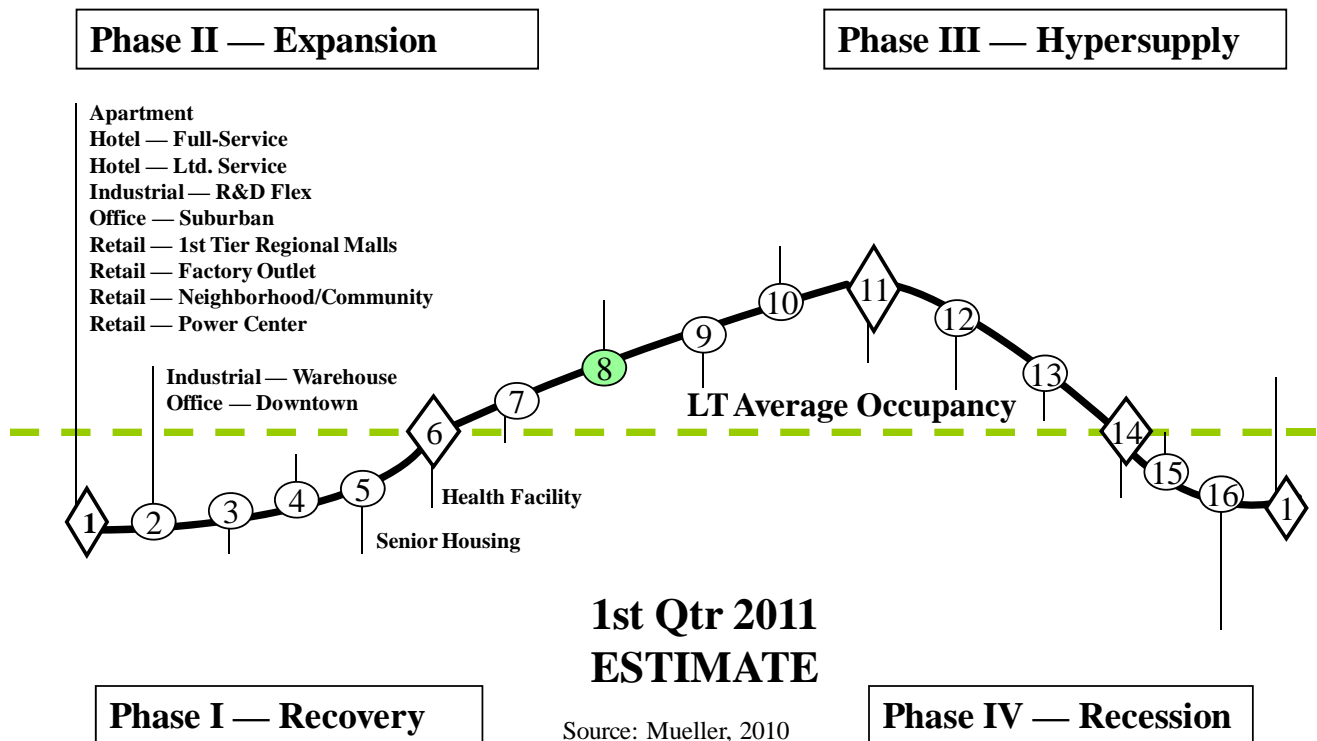
First Quarter 2011 Estimates
May 2010

The U.S. recovery is well underway with three quarters of positive GDP growth and two months of positive job growth as of April 2010. Our models show occupancies bottoming during different quarters in 2010 with all five property types showing occupancy recovery by the first quarter of 2011. However, rent growth is not forecast to begin until later in 2011.

- Office occupancies are forecast to improve 0.2% in 1Q11, with rent declining by 0.5% quarter-over-quarter.
- Industrial occupancies are forecast to improve 0.3% in 1Q11, with rents declining 0.2% quarter-over-quarter.
- Apartment occupancies are expected to improve 0.1% in 1Q11, with rents declining 0.4% quarter-over-quarter.
- Retail occupancies are expected to be flat in 1Q11, with rents declining 0.5% quarter-over-quarter.
- Hotels occupancies are expected to improve 0.1% in 1Q11 and a RevPAR decline of 0.7% quarter-over-quarter.

The National Property Type Cycle Graph shows relative positions of most sub-property types — major markets are reviewed inside.

National Property Type Cycle Forecast



Source: Mueller, 2010

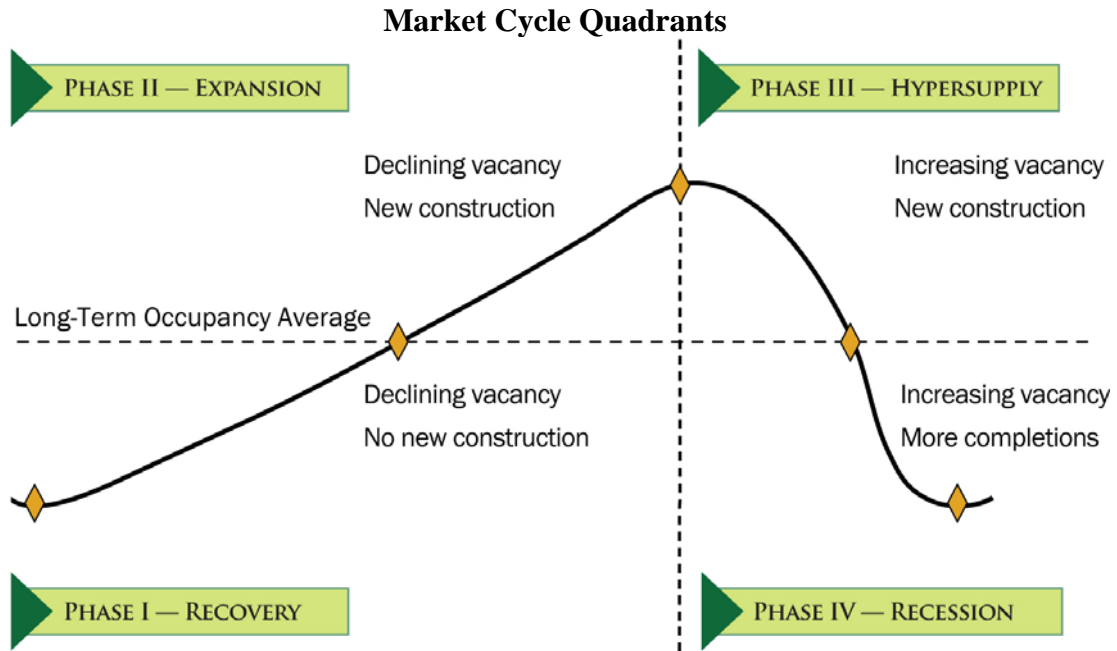
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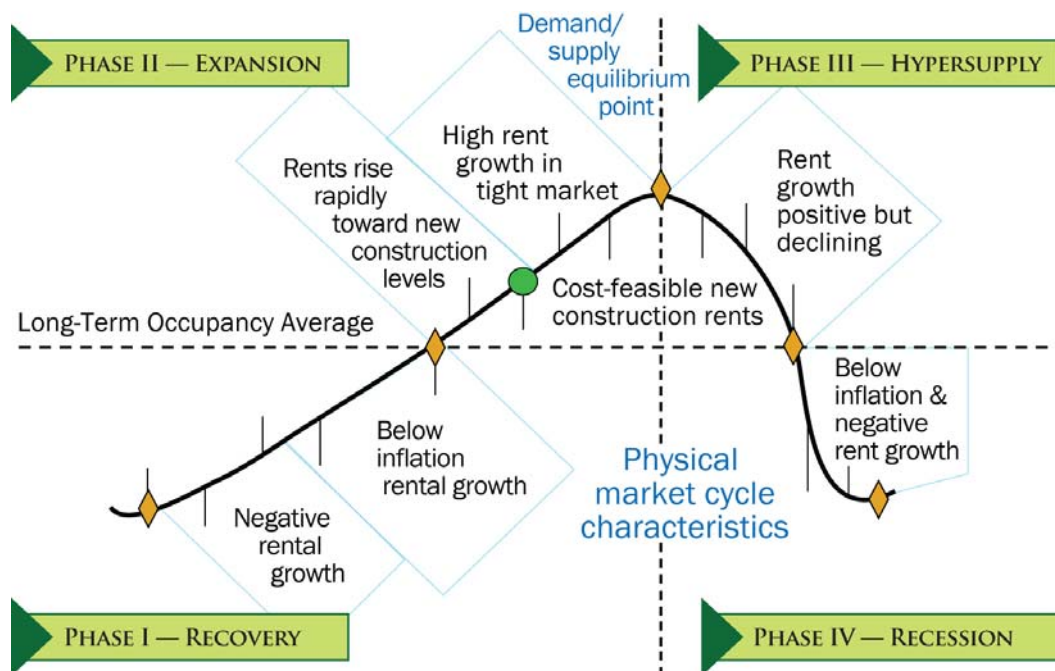
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All relevant disclosures and certifications appear on page 9 of this report.

The cycle forecast analyzes occupancy movements in five property types in more than 50 Metropolitan Statistical Areas (MSAs). The market cycle analysis should enhance investment-decision capabilities for investors and operators. The five property type cycle charts summarize almost 300 individual models that analyze occupancy levels and rental growth rates to provide the foundation for long-term investment success. Real estate markets are cyclical due to the lagged relationship between supply and demand for physical space. The long-term occupancy average is different for each market and each property type. **Long-term occupancy average** is a key factor in determining rental growth rates — a key factor that affects real estate returns.

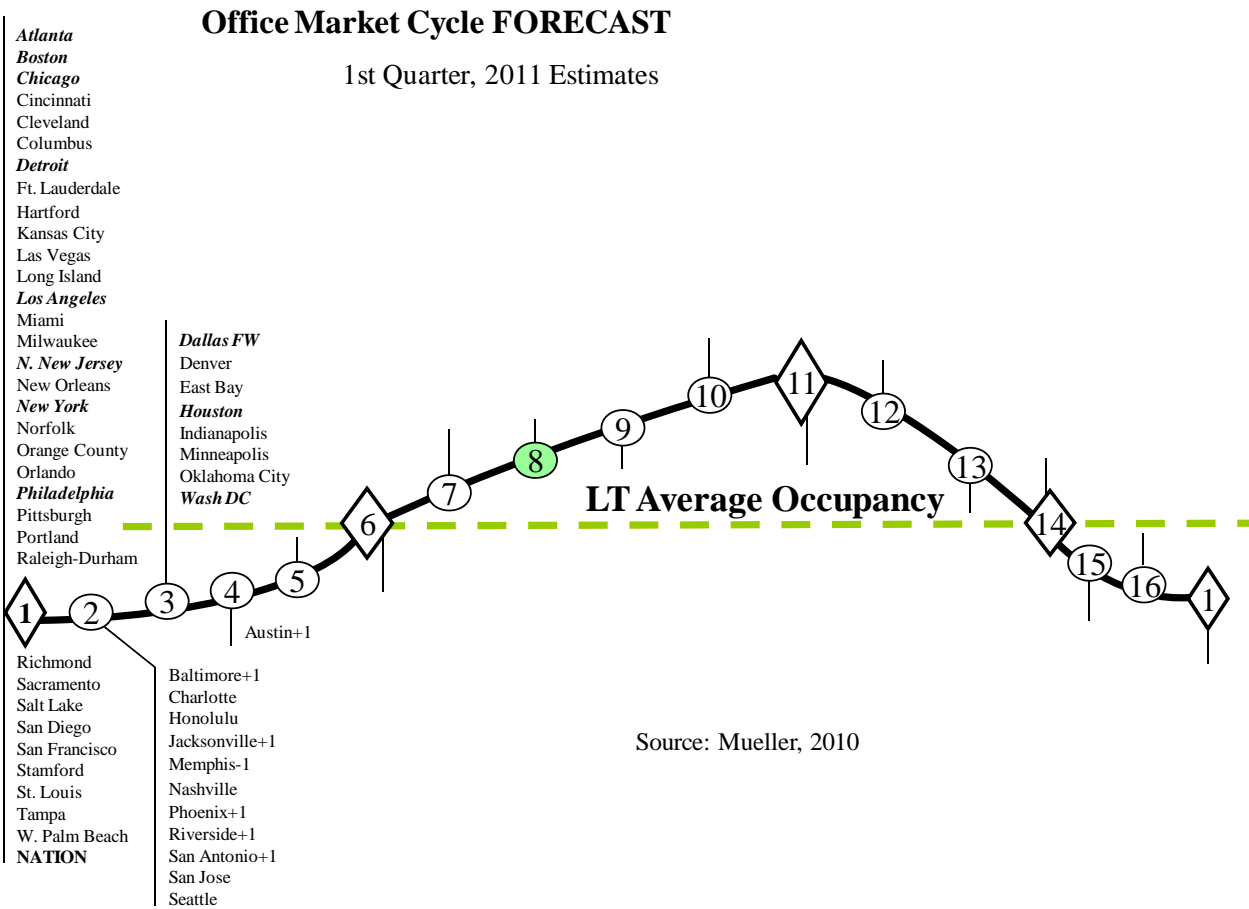


Rental growth rates can be characterized in different parts of the market cycle, as shown below.



OFFICE FORECAST

Office occupancies are forecast to improve 0.2% in 1Q11, as the employment growth that started in 2Q10 should positively affect demand. Year-over-year occupancies are expected to be down a mere 0.3% as we predict occupancies to bottom in 2Q10. Many firms have empty space they can re-fill before needing to rent more space, creating this lag in space demand behind employment growth (historically three quarters long). Renters also know that there is plenty of vacant space available, keeping downward pressure on rents for an additional few quarters. We forecast rents to drop 0.5% in 1Q11, creating a 4.3% year-over-year decline.

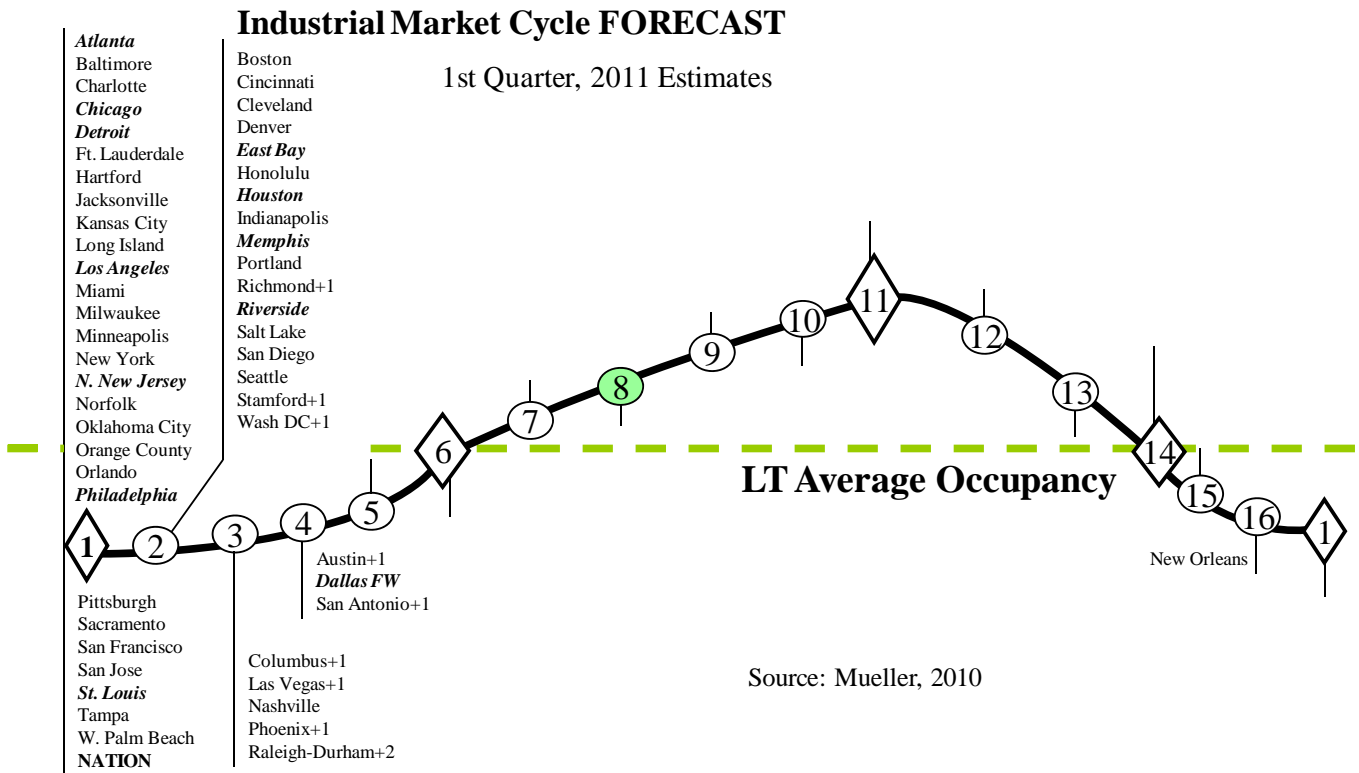


Note: The 11-largest office markets make up 50% of the total square footage of office space that we monitor. Thus, the 11-largest office markets are in **bold italics** to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

INDUSTRIAL FORECAST

We forecast a 0.3% improvement in industrial occupancies in 1Q11, producing a 1.3% improvement year-over-year. This also means that the national average occupancy level is poised to move forward to point #2 on the occupancy cycle in 2Q11 if the trend continues. Both the United States and many major economies around the world are forecast to have strong economic growth in 2011 (except for Europe), creating strong demand for goods and thus the need to ship them to businesses and consumers. However, with industrial occupancies still at the bottom, we expect rents to decline 0.2% in 1Q11 and be down 2.6% year-over-year, as tenants have the power to negotiate lower rents.



Note: The 12-largest industrial markets make up 50% of the total square footage of industrial space that we monitor. Thus, the 12-largest industrial markets are in **bold italics** to help distinguish how the weighted national average is affected.

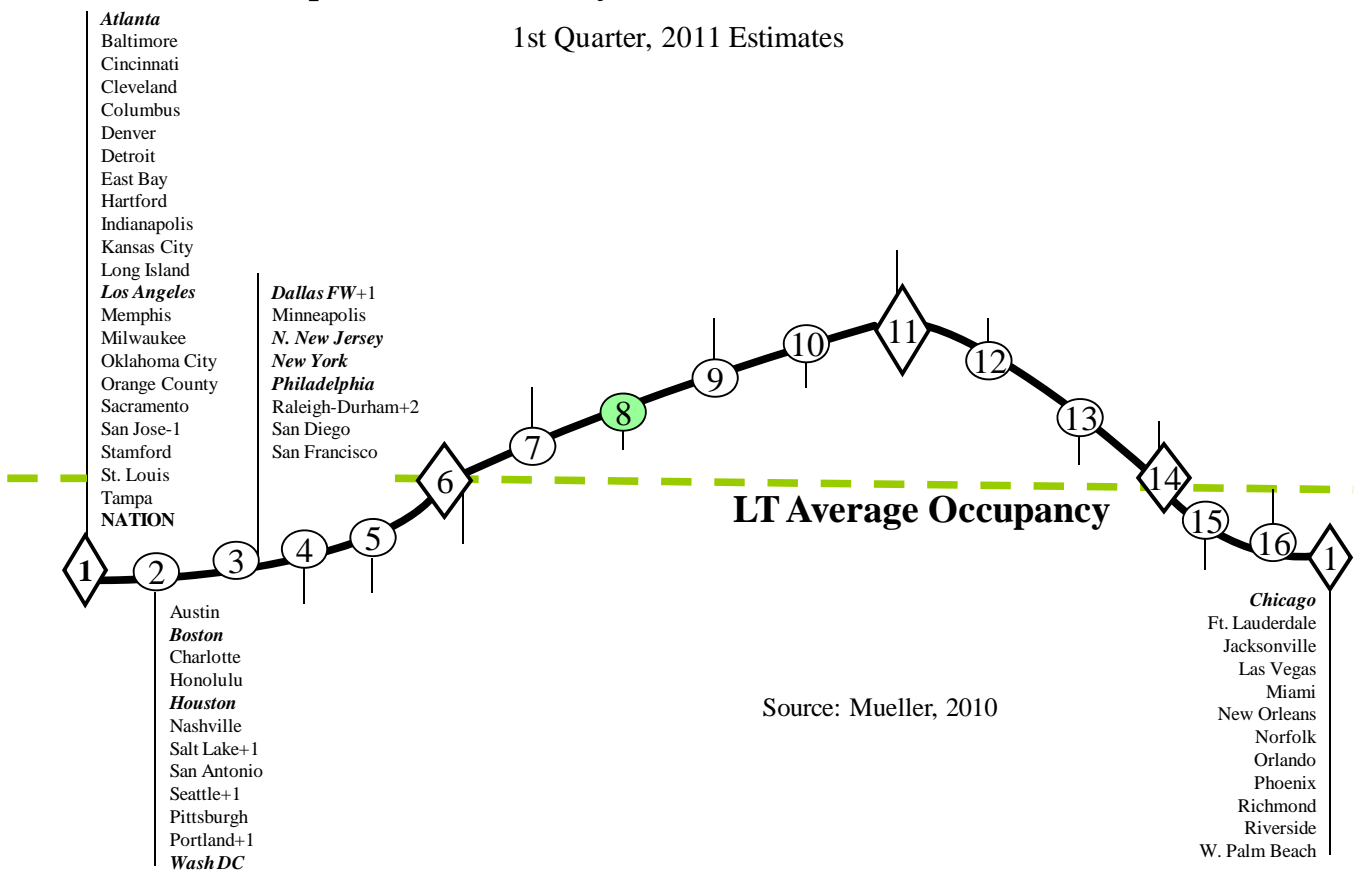
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APARTMENT FORECAST

We forecast an occupancy increase of 0.1% for 1Q11 but a year-over-year decline of 0.1%. With the economic recovery in full swing and almost a year of job growth in place, demand for apartments should be relatively strong. In addition, higher interest rates should slow the leakage of renters becoming first time home buyers — unless the government revitalizes their first time home buyer tax credit for a third time. We estimate the national apartment rental rate decline should slow to 0.4% for 1Q11, resulting in a year-over-year decline of 2.8%.

Apartment Market Cycle FORECAST

1st Quarter, 2011 Estimates



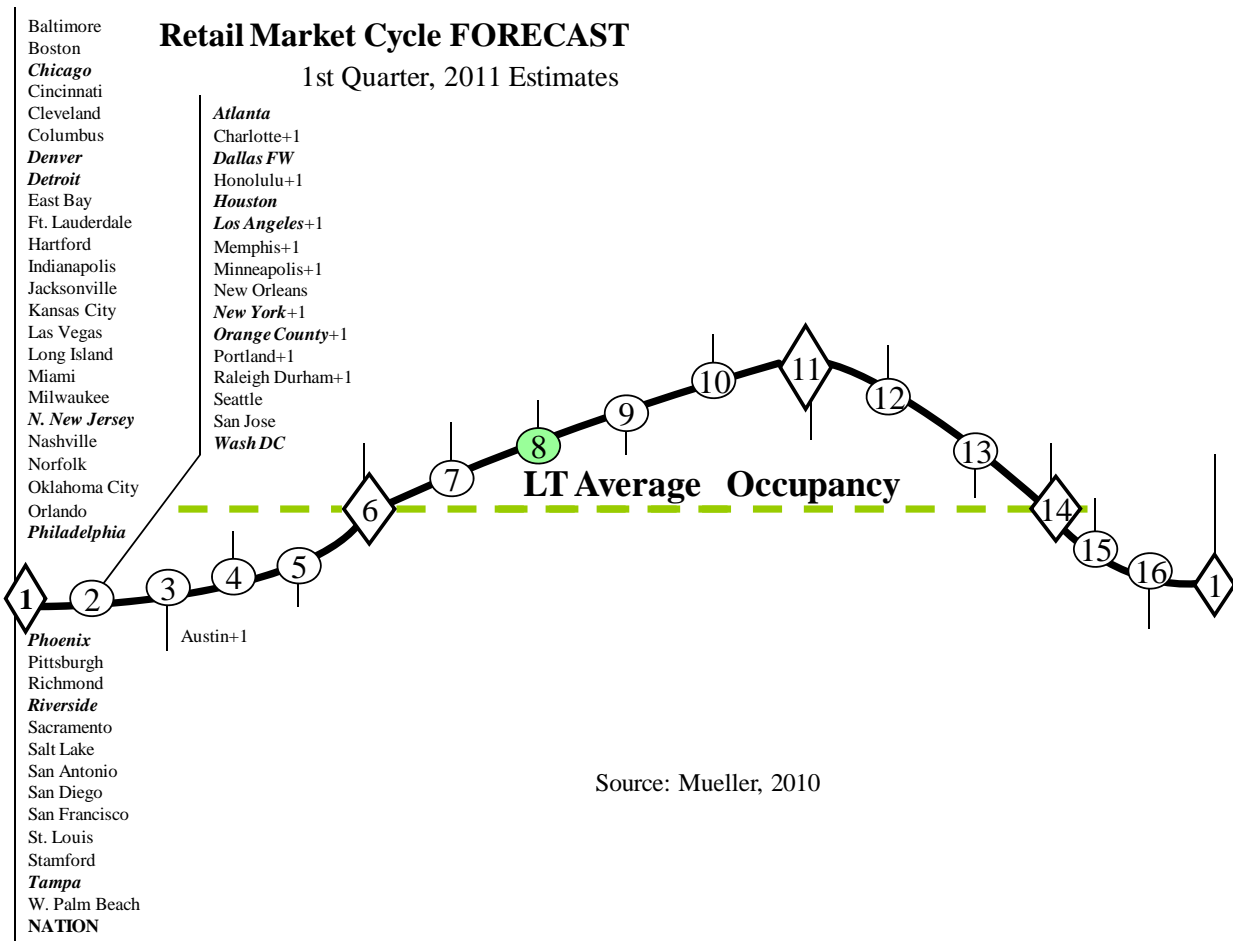
Source: Mueller, 2010

Note: The 10-largest apartment markets make up 50% of the total square footage of apartment space that we monitor. Thus, the 10-largest apartment markets are in **bold italics** to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

RETAIL FORECAST

Retail occupancy is forecast to remain flat in 1Q11 and be up 0.6% year-over-year. We expect solid improvement in retail sales for the late 2010 Christmas holiday season, which should prompt retailers to plan for growth in 2011. Consumer spending is forecast to have solid improvement as reflected by strong GDP and employment growth in 2011. We expect rental declines of 0.5% in 1Q11 that could produce a 3.5% year-over-year decline in rents. We do not expect to see any rent increases until mid-to-late 2011 for retail.



Source: Mueller, 2010

Note: The 15-largest retail markets make up 50% of the total square footage of retail space that we monitor. Thus, the 15-largest retail markets are in **bold italics** to help distinguish how the weighted national average is affected.

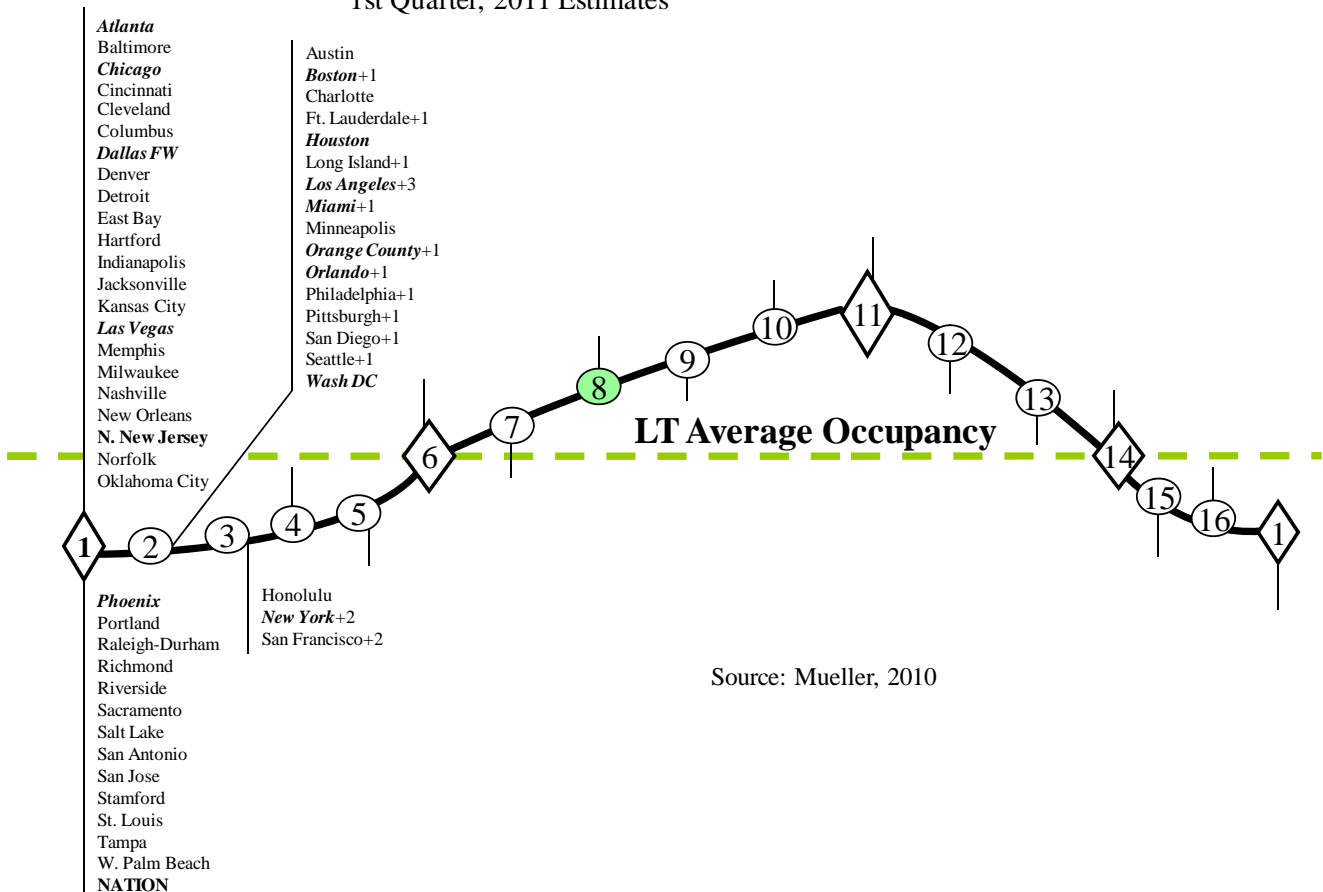
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HOTEL FORECAST

Hotel occupancy is forecast to increase 0.1% in 1Q11 and improve 0.4% year-over-year. GDP has historically been the best indicator for hotel demand, but a slow recovery may mute demand increases for hotels as both consumers and businesses are not expected to spend as freely as they have in previous recoveries. In addition, the airlines are not expected to expand the number of flights or routes as quickly as they have in the past, as they are finding profitability in restricting expansion and pushing plane fares higher instead of adding more flights. We estimate RevPAR may decrease 0.8% in 1Q11 as chains drop their rates to entice visitors, but be up by 2.1% year-over-year.

Hotel Market Cycle FORECAST

1st Quarter, 2011 Estimates



Source: Mueller, 2010

Note: The 14-largest hotel markets make up 50% of the total square footage of hotel space that we monitor. Thus, the 14-largest hotel markets are in ***bold italics*** to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

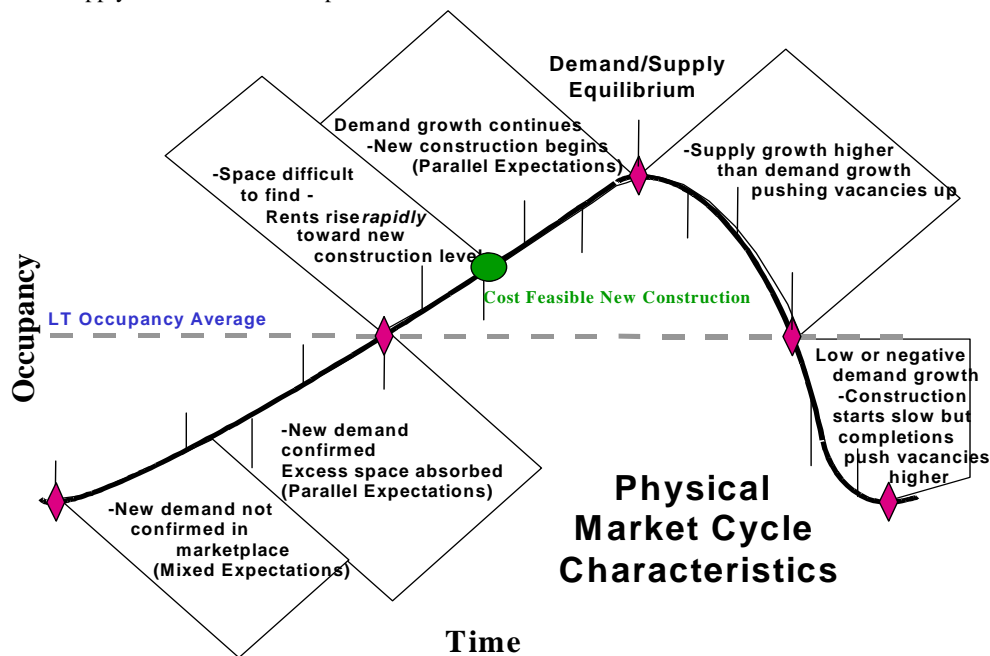
MARKET CYCLE ANALYSIS — Explanation

Supply and demand interaction is important to understand. Starting in Recovery Phase I at the bottom of a cycle (see chart below), the marketplace is in a state of oversupply from previous new construction or negative demand growth. At this bottom point, occupancy is at its trough. Typically, the market bottom occurs when the excess construction from the previous cycle stops. As the cycle bottom is passed, demand growth begins to slowly absorb the existing oversupply and supply growth is nonexistent or very low. As excess space is absorbed, vacancy rates fall, allowing rental rates in the market to stabilize and even begin to increase. As this recovery phase continues, positive expectations about the market allow landlords to increase rents at a slow pace (typically at or below inflation). Eventually, each local market reaches its *long-term occupancy average* whereby *rental growth is equal to inflation*.

In Expansion Phase II, demand growth continues at increasing levels, creating a need for additional space. As vacancy rates fall below the *long-term occupancy average*, signaling that supply is tightening in the marketplace, rents begin to rise rapidly until they reach a "cost-feasible" level that allows new construction to commence. In this period of tight supply, rapid rental growth can be experienced, which some observers call "rent spikes." (Some developers may also begin speculative construction in anticipation of cost-feasible rents if they are able to obtain financing.) Once cost-feasible rents are achieved in the marketplace, demand growth is still ahead of supply growth — a lag in providing new space due to the time to construct. Long expansionary periods are possible and many historical real estate cycles show that the overall up-cycle is a slow, long-term uphill climb. As long as demand growth rates are higher than supply growth rates, vacancy rates will continue to fall. The cycle peak point is where demand and supply are growing at the same rate *or equilibrium*. Before equilibrium, demand grows faster than supply; after equilibrium, supply grows faster than demand.

Hypersupply Phase III of the real estate cycle commences after the peak/equilibrium point #11 — where demand growth equals supply growth. Most real estate participants do not recognize this peak/equilibrium's passing, as occupancy rates are at their highest and well above long-term averages, a strong and tight market. During Phase III, supply growth is higher than demand growth (hypersupply), causing vacancy rates to rise back toward the long-term occupancy average. While there is no painful oversupply during this period, new supply completions compete for tenants in the marketplace. As more space is delivered to the market, rental growth slows. Eventually, market participants realize that the market has turned down and commitments to new construction should slow or stop. If new supply grows faster than demand once the long-term occupancy average is passed, the market falls into Phase IV.

Recession Phase IV begins as the market moves past the long-term occupancy average with high supply growth and low or negative demand growth. The extent of the market down-cycle will be determined by the difference (excess) between the market supply growth and demand growth. Massive oversupply, coupled with negative demand growth (that started when the market passed through long-term occupancy average in 1984), sent most U.S. office markets into the largest down-cycle ever experienced. During Phase IV, landlords realize that they will quickly lose market share if their rental rates are not competitive; they then lower rents to capture tenants, even if only to cover their buildings' fixed expenses. Market liquidity is also low or nonexistent in this phase, as the bid-ask spread in property prices is too wide. The cycle eventually reaches bottom as new construction and completions cease, or as demand growth turns up and begins to grow at rates higher than that of new supply added to the marketplace.



Source: Mueller, Real Estate Finance, 1995

This Research currently monitors five property types in more than 50 major markets. We gather data from numerous sources to evaluate and forecast market movements. The market cycle model we developed looks at the interaction of supply and demand to estimate future vacancy and rental rates. Our individual market models are combined to create a national average model for all U.S. markets. This model examines the current cycle locations for each property type and can be used for asset allocation and acquisition decisions.

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