Emerging Trends in Real Estate 2014

- Emerging Trends is the industry’s most predictive forecast
- 35th annual outlook
- Based on over 1,000 interviews and surveys of industry leaders
- Sponsored by PwC and the Urban Land Institute
Fundamentals continue to improve...slowly... across all property groups and property markets

2014 expected to continue trends in employment (modest growth) and increasing demand for space

2014 likely to be last year industry benefits from 6 years of little increase in supply

Interviewees see industry reaching an inflection point where “valuations will no longer be driven by capital markets,” leverage, and financial engineering

Interest rates universally anticipated to increase; it’s the magnitude of the increase that is uncertain
Average Market Score

Investment Prospects

Excellent

Fair

Poor

Source: Emerging Trends in Real Estate surveys
Average Property Score

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Issues of importance for real estate
Economic/Financial Issues

- Job growth: 4.63
- Interest rates: 4.46
- Income and wage growth: 4.11
- Inflation: 3.68
- Tax policies: 3.61
- Global economic growth: 3.60
- Federal fiscal deficits/imbalance: 3.50

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
“With the economy in a position where the tailwinds are now stronger than the prevailing headwinds, 2014 should be a year when we see real estate fundamentals improve in sectors beyond the very healthy rental growth multifamily sector—and in a number of markets—to a point where we could see above-inflation-rate rental growth”
Headwinds Facing the Real Estate Industry

A “stubbornly high’ unemployment rate

Uncertainty over government regulation and fiscal policy

Likely increase in the cost of both equity and debt capital

Economic uncertainty in the Euro-zone

China’s moderating economic growth
Tailwinds Benefiting the Real Estate Industry

“Good if not great” job growth in industries with high real estate utilization including: energy, technology, health care, and medical research

Even education and financial services sectors are projected to support increased space needs in 2014

Increasing corporate profits

Continuing recovery in the single-family housing industry
Emerging Trends: Key Drivers for 2014

Industry profitability expected to continue to improve

Interest rates anticipated to increase

Dependence on cap rate compression to drive increase in value to be replaced by emphasis on asset management

Markets are expected to be “well supplied” with both equity and debt capital
Emerging Trends: Key Drivers for 2014

Opportunities to develop property finally appear in sectors other than multifamily

Industry begins to notice and understand needs of both Gen Y and the baby boomers

Needs of end users of commercial space continue to evolve

The single family housing market continues to make a positive contribution to the overall economy
Prospects for profitability by percentage of respondents

Source: Emerging Trends in Real Estate surveys
Note: Based on US respondents only
The beginning of the “middle innings” of the “recovery from the recovery”

Use of financial structuring and leverage as means to create value will be replaced by property operating skills

Focus will continue to shift from “solely core in gateway 24-hour” markets to overlooked markets and property sectors as well as value-added strategies including repositioning, re-leasing, re-tenanting, renovation, and the like
Capital markets
Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
**Change in Availability of Capital for Real Estate in 2014**

<table>
<thead>
<tr>
<th>Equity source</th>
<th>Rating</th>
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<tbody>
<tr>
<td>Foreign Investors</td>
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<td>Institutional Investors/Pension Funds</td>
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<td>Private REITs</td>
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<td>Public Equity REITs</td>
<td>5.38</td>
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Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Change in Availability of Capital for Real Estate in 2014

Lending source

<table>
<thead>
<tr>
<th>Lending Source</th>
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<tr>
<td>Securitized Lenders/CMBS</td>
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<td>Mezzanine Lenders</td>
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<td>Non-Bank Financial Institutions</td>
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<td>Mortgage REITs</td>
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<tr>
<td>Government Sponsored Enterprises</td>
<td>4.55</td>
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</tbody>
</table>

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
**Capital flows outlook**

Real estate capital market balance forecast for 2014

- **Substantially oversupplied**
  - Equity capital for investing: 13.7%
  - Debt capital for acquisitions: 2.7%

- **Modestly oversupplied**
  - Equity capital for investing: 40.5%
  - Debt capital for acquisitions: 23.5%

- **In balance**
  - Equity capital for investing: 26.9%
  - Debt capital for acquisitions: 43.4%

- **Moderately undersupplied**
  - Equity capital for investing: 17.1%
  - Debt capital for acquisitions: 26.0%

- **Substantially undersupplied**
  - Equity capital for investing: 1.8%
  - Debt capital for acquisitions: 4.4%

Source: Emerging Trends in Real Estate 2014 survey

Note: Based on US respondents only
Debt capital for specific uses

- Substantially oversupplied: 0.7% (3.4%)
- Modestly oversupplied: 10.4% (17.2%)
- In balance: 30.2% (52.2%)
- Modestly undersupplied: 24.1% (42.9%)
- Substantially undersupplied: 15.9% (3.1%)

Debt capital for development  Debt capital for refinancing

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Equity Underwriting Standards Forecast

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Debt Underwriting Standards Forecast

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Top Real Estate Capital Markets Trends
Emerging trends barometer 2014

Source: Emerging Trends in Real Estate surveys
Note: Based on US respondents only
Real Estate Capital Flows

Survey participants anticipate an increase in both equity and debt capital

- Equity investors will continue to expand search for yield, turning focus from solely core in 24-hour markets to a wider geography and range of asset classes

- Lender’s return to corporate profitability “allows them to get back in the game”

- For both investors and lenders, real estate provides an increasingly attractive investment alternative
Increase in Availability of Debt Capital

Respondents expect an increase in availability of debt capital from five sources

CMBS (securitized) market
Commercial banks
Life insurance companies
Mezzanine lenders
Non-bank financial institutions
CMBS Revival Continues

Survey participants ranked CMBS first in terms of change in availability of capital for real estate in 2014

2013 transaction volume expected to exceed $80 billion; 2014 originations anticipated to exceed $100 billion

CMBS lenders continue to fill the gaps left by conventional lenders in terms of deal size (under $25 million) and property location (secondary versus solely primary locations)
Commercial Banks

Expected increases in interest rates (and profitability) will make real estate lending increasingly attractive.

Regional and local banks are expected to become increasingly active as real estate lending returns to become a major part of their business model.

National banks, searching for opportunities, will increasingly compete on a regional and local basis.

Development and construction loans will become increasingly available for borrowers with strong credentials and track records, and properties with substantial pre-leasing.
Mezzanine Financing

Interviewees and survey participants seem of two minds regarding the roll of mezzanine financing in 2014

“The biggest question on mezzanine is where the returns are going to be. If mezzanine rates don’t increase enough and we don’t feel we’re getting paid enough, we’ll stop. At a 200 [basis point] difference, we don’t think we’re getting paid for the risk.”

Other interviewees predict an “increase in B-piece, mezzanine, and debt funds to fill gaps in transaction structure” and “an increase in the use of mezzanine financing combined with higher-cost senior debt.”
Shadow Banking

Shadow banking is commercial lending outside of the regulated universe of insured depository institutions and life insurance companies.

While not the “lender of last resort”, borrowers in the shadow banking market will find themselves dealing with a “hodgepodge” of well capitalized private funds, wealthy individuals, family offices, refugees from other lending markets and the like who are in this market solely because the spreads are attractive.
Equity Sources

Foreign investors

Private equity funds

Pension funds

Equity REITs
Markets to watch

More markets begin to look attractive
The lack of new supply has allowed the steady nature of the economic recovery to drive improvement in real estate

Percent of markets ranked moderately good or better

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
**Outlook improves for more markets**

<table>
<thead>
<tr>
<th>Markets with Investment Prospects of Good or Better</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
<tr>
<td>New York City</td>
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<td>Austin</td>
<td>Austin</td>
<td>Austin</td>
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<tr>
<td>Washington D.C.</td>
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<td>Boston</td>
<td>Boston</td>
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<tr>
<td>New York City</td>
<td></td>
<td>Houston</td>
<td>Dallas/Ft. Worth</td>
<td></td>
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<tr>
<td>San Francisco</td>
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<td>New York City</td>
<td>Houston</td>
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### Top 10 total rank
#### 2014

<table>
<thead>
<tr>
<th>Rank</th>
<th>City</th>
<th>Investment</th>
<th>Development</th>
<th>Homebuilding</th>
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<tbody>
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<td>7.2</td>
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<td>Dallas/Ft. Worth</td>
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<td>6.9</td>
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</table>

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Next 10 markets
2014

<table>
<thead>
<tr>
<th>Rank</th>
<th>City</th>
<th>Investment</th>
<th>Development</th>
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<td>17.</td>
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<td>19.</td>
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<td>20.</td>
<td>Minneapolis/St. Paul</td>
<td>6.3</td>
<td>6.3</td>
<td>5.9</td>
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</tbody>
</table>

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
The impact of uncertainty
Impact on the outlook for Washington, DC

The outlook for Washington, DC succumbs to fed fatigue

Source: Emerging Trends in Real Estate surveys
Note: Based on US respondents only
### Top 10 investment markets

<table>
<thead>
<tr>
<th>Rank</th>
<th>City</th>
<th>2014</th>
<th>2013</th>
<th>Rank Change</th>
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<tbody>
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# Top 10 development markets

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<th>Rank</th>
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<th>2013</th>
<th>Rank Change</th>
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Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
## Top 10 homebuilding markets

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<th>2014</th>
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<td>4.</td>
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<td>5.91</td>
<td>-1</td>
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</tbody>
</table>

Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only
Markets: 2014 emerging trends
Property type outlook

Industrial leads the pack
Prospects for major commercial property types in 2014

Industrial/Distribution: 6.45
Hotels: 6.23
Apartment Residential (Rental): 6.14
Office: 5.76
Retail: 5.72

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Subsector outlook shows diversity of recovery

Prospects for commercial subsectors in 2014

- Warehouse Industrial: 6.56
- Apartment Rental--moderate-income: 6.30
- Limited-Service Hotels: 6.17
- Full-Service Hotels: 6.11
- Central City Office: 6.08
- Neigh./Community Shopping Ctrs.: 6.00
- Apartment Rental--high-income: 5.92
- R&D Industrial: 5.72
- Regional Malls: 5.29
- Power Centers: 4.95
- Suburban Office: 4.93

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Commercial development begins to look up

Prospects for major commercial property types in 2014

- Industrial/Distribution: 6.74
- Apartment Residential (Rental): 5.52
- Hotels: 5.31
- Retail: 4.63
- Office: 4.58

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Development prospects reflect where market is strongest

Prospects for commercial subsectors in 2014

- Warehouse Industrial: 6.44
- Apartment Rental--high-income: 6.25
- Apartment Rental--moderate-income: 6.00
- Limited-Service Hotels: 5.52
- Neigh./Community Shopping Ctrs.: 5.23
- Central City Office: 5.14
- R&D Industrial: 5.11
- Full-Service Hotels: 4.96
- Power Centers: 3.92
- Suburban Office: 3.55
- Regional Malls: 3.43

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only
Some changes in what investors want to buy
Investment recommendation of survey respondents

Source: Emerging Trends in Real Estate 2014 survey
Note: Based on US respondents only