RCLCO
ROBERT CHARLES LESSER & CO.

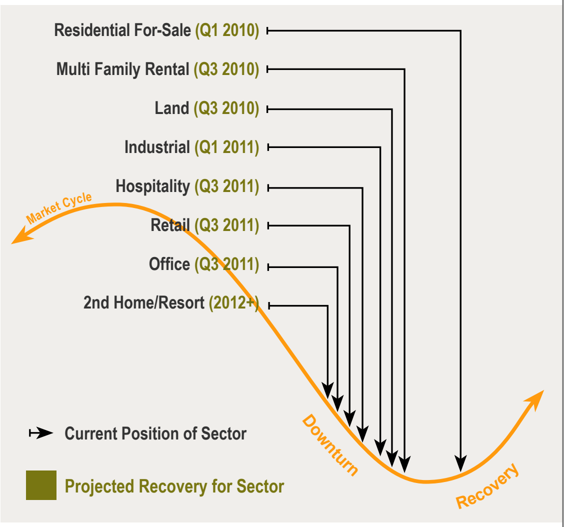
THE ADVISORY

SPRING 2010

RCLCO Market Outlook
A BRIGHTENING HORIZON?

OVERVIEW

Global real estate markets should further stabilize during the first half of 2010 and resume growth during the second half, as economic growth becomes more certain. This, in turn, will reawaken demand for property of all types. Prices and property values should stabilize during 2011 and may begin to grow from the end of next year and into 2012. Availability of debt capital will increase as lenders and investors regain confidence in the stabilizing economy and real estate markets.



Without dismissing the possibility of a W-shaped recovery—and, in particular, the potential negative impact of the looming CMBS maturities—there is reasonably sound evidence that the economic growth of the second half of 2009 will continue to broaden through 2011. Employment growth, which will begin this year, will be tepid at first, but will gain strength in the second half of 2010 and next year.

The growing segments of the economy and the real estate industry will overtake the declining segments, allowing net growth to continue enhancing consumer confidence, stimulating consumption and investment activity. We could, of course, fall back into a recession if the stimulus package of 2009 and planned additional measures prove insufficient, but we hold the likelihood of that occurrence at or below 25%.

The investment property sectors (office, retail, hotel, multifamily, etc.), which are still reeling from the impact of the economic downturn and the disruption of the credit markets, will begin to stabilize later this year. In many cases, operating fundamentals have now been reset (or will be by mid-year), and revaluations— as dictated by changes in the credit markets and rising cap rates—have already been priced into the market. (This has taken place faster than in previous market downturns.) Demand for new commercial development is expected to be limited, and most developers will hold off on new starts until the timing of the recovery is more certain.

IN THIS ISSUE

Relaunching of existing residential development projects that were stopped and have been repositioned will accelerate significantly this year, as existing inventory levels continue to approach historical norms and the housing market stabilizes. Sponsors of new projects will also be more likely to take advantage of the improved entitlements environment, with discernible evidence of opportunity on the horizon.

Meanwhile, buying opportunities for well-capitalized investors and developers are priming. The second half of this year is likely to see a dramatic increase in the volume of transaction activity, as buyers move to realize the value of assets for sale at less than replacement value, and owners continue to grow comfortable with new pricing realities—and become more eager to recapitalize and redeploy cash elsewhere.

As always, investment and new development opportunities vary by market and by project. All real estate markets are local, and there are substantial variations between markets and even within metro market areas. Job growth will be quickest to rebound in cities with strong technology, energy, and financial services sectors, and both the residential and commercial property sectors in these markets will experience 2010 as a year of recovery. Industrial economies and markets driven by household relocation during the last upcycle will continue to stabilize this year, with more meaningful recovery taking place next year or, in some cases, the year after.

Following is our market outlook for various sectors of the real estate industry.

FOR-SALE RESIDENTIAL

As projected in this space at the beginning of last year, the volume and price of existing and new home sales continued to decline through the first half of last year before reaching a bottom in late 2009 or the first half of 2010. Volume is already trending up in the best markets, and modest price increases will gain momentum through 2010. For-sale home prices need to return to replacement values to make new home construction broadly financially viable, but homebuilders are calling a bottom in many markets and acquiring lots in advance of growing end-user demand.

Certainly the continued availability of the federal tax credit for first-time homebuyers has buoyed the market. Other buyers include those who sat on the sidelines through the past market peak and are now positioned to take advantage of favorable pricing. The rate at which the recovery accelerates will still depend largely on market psychology. As economic growth matures into employment growth—probably later this year and in 2011—move-up activity, in particular, will accelerate, creating more dramatic pricing power as the market becomes significantly more fluid.

LAND

The market for residential land at all stages will improve significantly this year. In many markets, the availability of finished lots has diminished already, prices have begun to rise, and early investors in this asset type should see strong short-term gains. Developers who have succeeded in holding onto their projects will begin to put new lots into production in expectation of slowly rebounding demand. Owners of raw land will move more decisively to capitalize on the more favorable current entitlement environment.

We anticipate good land buying opportunities and increasing transaction volume in 2010. Interest in finished lots, even in the most oversupplied markets, will become more widespread, and early-stage or “mothballed” community development projects will find an increasingly interested market. The market for raw land and for communities with large infrastructure requirements will require another 12 to 24 months to mature.

RETAIL

This year will be another challenging one for the retail sector. Demand for new retail space, which normally trails residential development, will remain flat in most markets across retail asset classes. While consumer activity will continue to normalize over the course of 2010, more meaningful economic recovery will be required for retailers to regain confidence and reenter the marketplace. Next year and 2012 should see stabilization and even a return to growth, but volatility will continue to characterize the market, and local market fundamentals will dictate project/asset performance.

OFFICE

Even as the economy begins to grow and job creation begins in earnest, operating fundamentals for the office sector will remain challenging. New tenancies in most markets are nonexistent and likely to grow very slowly. As leases roll, tenants wanting to achieve favorable rates will be more flexible in terms of location, and will be conservative in committing to space for future needs. At the same time, new supply is delivering and owners are likely to be more aggressive in terms of lease rates to win relocations or re-sign tenants.

Vacancies should peak mid-2010, with a slow recovery unlikely to create favorable conditions for new development before late 2011 and 2012. Investors in this asset class with a high risk tolerance may find excellent buys, but developers, even in prime locations, will be challenged to achieve preleasing at construction-feasible rates.

MULTIFAMILY RENTALS

The multifamily sector appears to be bottoming out in most markets, albeit with relatively high vacancy levels and significant concessions the norm. Last year, operating fundamentals were stressed, with new deliveries (including condo deliveries) compounded by a significant interruption in the rate of household formation. As job growth resumes—and as the number of echo boomers leaving college and seeking well-located lifestyle apartments grows—so will demand. We project occupancy levels will continue to rise through 2010 as concessions burn off, with stronger rent growth likely in 2011.

RESORT/HOTEL

Demand for second-home and vacation ownership product is very weak and will continue to be so throughout 2010. Over the longer term, and in response to favorable demographic trends, the outlook is favorable. Hotel performance will also continue to be challenging this year, with the added burden of new deliveries in many markets that were financed and initiated at the end of the previous market cycle. Assuming the economy continues to improve over the next 12 to 18 months, this sector should begin to improve in late 2011 and 2012.

In conclusion, 2010 will be a better year for owner/operators than 2009, with brightening on the horizon over the course of the year. Developers will slowly get back into business in anticipation of a more normal market and should be thoughtful in anticipating new market realities and creative in planning new product to capitalize on them. And buyers, who largely remained on the sidelines last year, should be prepared to move more decisively in the coming months to take advantage of the excellent buying opportunities that exist today.

There are many niche opportunities for the repositioning of existing assets and the development of new projects in select locations and circumstances. These opportunities are particular to the time and the place of the real estate; they address an underserved customer segment or a need that cannot be fulfilled by the abundance of inventory that will likely dominate the headlines for the foreseeable future. Those who can identify these opportunities will prosper.

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Market Spotlight on Los Angeles

SIGNS FOR OPTIMISM IN THE APARTMENT MARKET

Bob Gardner
Managing Director

Los Angeles' economic story is similar to that of many metro regions in California. The good news is that many believe the Great Recession has hit bottom, while the bad news is that the economic recovery will be slow. While the unemployment rate is approaching 13% in Los Angeles County, the expectation is that total employment should rise and the number of unemployed should decline in 2010. Peak employment experienced in 2007 will not be matched for several years to come.

Residential real estate markets not surprisingly reflect the severity of the economic downturn. Existing home sales in 2009 were higher than in 2008, enabling existing home prices to stabilize and actually show some gains. New home sales in the seven-county Southern California region, however, are at 15-year lows. Notices of default have risen to record levels, which should dampen any expectation for a quick turnaround in housing prices. Most forecasts expect home prices to move higher in 2011 with an improving economy. The apartment market remains a bright spot in Los Angeles County, with vacancies in the 5% to 6% range—an excellent performance, considering the severity of the downturn. While the lack of financing will constrain apartment construction in the short term, new apartment developments will need to break ground within the next couple of years to meet emerging demand.

Commercial markets offer a mixed picture. Industrial market vacancies in Los Angeles County are well below 5%, and any convincing evidence of employment growth should spur increased construction. Office markets are in disarray, as vacancies have risen well into the mid teens; 2010 will remain a tenants' market, for sure. Job growth in 2011 should finally arrest the downturn in the office markets and improve occupancies and values, but new office development is not expected for at least several years.

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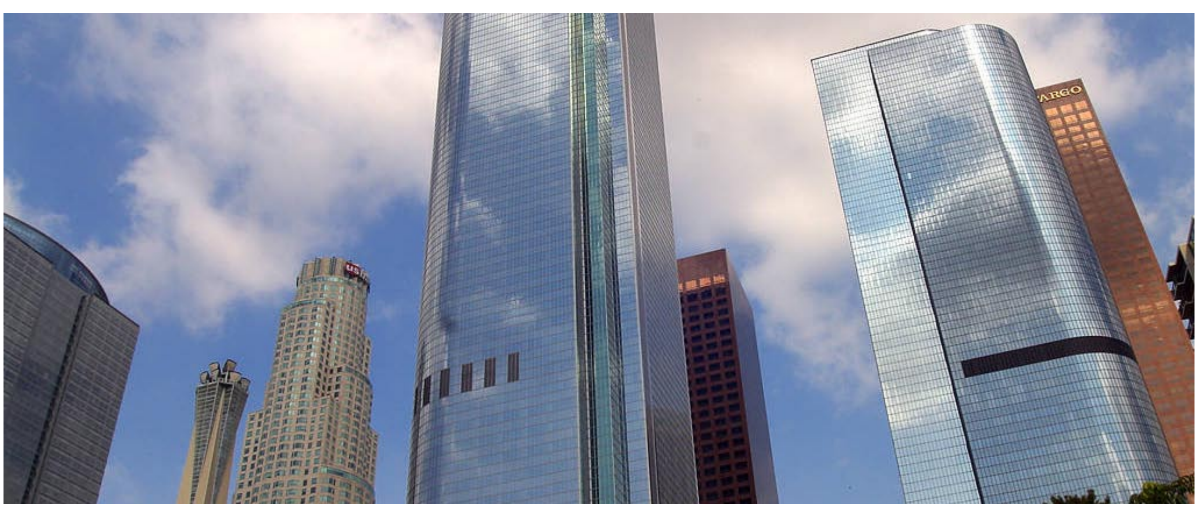

Green Renters

FIVE STRATEGIES FOR GREENING AMERICA'S APARTMENTS

Shyam Kannan, LEED® AP
Vice President – Director of Research and Development

Residential green building is gradually becoming main-stream, but until now we have known very little about the demand for green apartment homes and the people who are drawn to live in them. Who are the green renters of today and tomorrow? What motivates them when they are making decisions about where to live? What environmental issues are most important to them, what types of green features and amenities are they looking for, how big a role do those features play in their decision-making processes, and what are they willing to pay for them? RCLCO recently conducted a survey designed to help apartment community builders and owners understand the consumer demand for green apartment homes. Those surveyed were residents of professionally managed, market-rate or better apartment communities who plan to rent their next home. The survey results suggest the following five strategies.

Strategy #1:
Stop Asking the Wrong Question

The data suggest that the next wave of apartment consumers—Generation Y (those born between 1979 and 1996, who also are known as Millennials)—is demonstrating tendencies to demand green apartments, but is not likely to be willing to pay more for green features. Builders and owners who want to know what kinds of premiums they can demand for green features are asking the wrong question. Building green apartments costs more, but owners typically will not be able to charge premiums for them. The challenge will be to figure out how to build this product at a price the audience can afford; to incorporate green features in new apartment communities in a cost-effective way, enabling owners to market green apartments without charging higher rents.

Strategy #2:
You Don't Have to LEED by Example

Brands do matter, but the development community currently is chasing the wrong brand. For the past 20 years, architects and engineers have "owned" the conversation about green building, and have kept this discussion unnecessarily technical and building-science oriented. Most apartment consumers are not engineers or scientists; they do not have time to research complicated technical issues. LEED, EarthCraft, and other green building certifications mean little or nothing to apartment consumers. These people do, however, know and respect the ENERGY STAR brand—and it appears to be the only brand for which they are willing to pay more.

Strategy #3:
It's About Walkability, Stupid

News flash: people hate traffic; they are looking for ways to spend more time living and less time driving. The survey results confirm large, pent-up demand for walkable urban apartment communities that do not require residents to do lots of driving. Although only 20 percent of respondents said that they currently live in an urban or urbanizing environment, 65 to 70 percent indicated that they want their next apartment home to be located in such an environment. This contradicts the persistent industry belief that most people still want be able to drive up

to a garden apartment and drive to work and shop. Many do, but the data reveal that there are more people who want a walkable environment than there are places that satisfy that demand. Supply also is a concern for environmentally compatible apartments; while some 23 percent of respondents might be interested in renting a green apartment for their next apartment home, only 11 percent are aware of green rental options in their area.

Strategy #4: Know the Green Renter Profiles

There are three primary motivating factors for choosing a green apartment: energy savings, health factors, and environmental responsibility. Different segments of the rental market display differing preferences for energy-saving homes, healthy homes, and environmentally friendly homes. Understanding these motivating factors will help builders and owners decide which green features and amenities to incorporate in their apartment projects.

Forgetting about baby boomers and those who live in garden-style apartments is a big mistake. Boomers are the group that is most likely to pay for a green apartment, while suburban renters bring their own strong brand of “commonsense” green to the table. The data suggest that the market for green apartment communities is about one-quarter of the entire market. In an attempt to better identify who these prospective renters are, we have broken them into the following three market segments:

► **Bamboo Shoots.** These are idealistic, well-educated, typically young (mostly in their 20s) renters who prefer to live in urban or urbanizing locations.

► **Old Oaks.** These idealistic renters by choice are older (most are over the age of 45) and have higher annual incomes (typically above $100,000) than the bamboo shoots, but share their preference for urban and urbanizing locations.

► **Shrubs.** These pragmatic, price-sensitive, less-educated, moderate-income renters (typically in their 30s and early 40s) prefer suburban and garden-style locations and products.

Bamboo Shoots, Old Oaks, and Shrubs comprise a moderate but significant segment of the market for apartment homes. Builders and owners must recognize that renters come in many different shades of green; that personal health and pocketbook issues are more important to more renters than broader environmental issues; and that the key to success will be fine-tuning marketing messages to target appropriate motivating factors for specific segments of the market. The biggest opportunities lie in focusing on and marketing "energy-saving apartments" and "healthy homes."

Strategy #5:
Focus on "Me Green", Not "We Green"

Today's renters are smart enough to recognize the difference between green features that add value to apartment homes and "greenwash." "Me green" features and benefits—those that impact residents' personal health and finances—are actually going to drive rental decisions, while "we green" features and benefits—those that may slow global warming or reduce carbon footprints—will have little or no impact on renter behavior. In other words, green features and amenities do have perceived value for a portion of the rental market—but only certain features/amenities, and only for certain subsets of the market. Renters will make meaningful decisions about where they chose to live based on the presence or absence of specific green features and amenities.

For example, when asked which resource-conserving features/benefits were important to them, 60 percent of respondents replied that saving money on utility bills was an issue that they care about and that may influence their rental decision; 51 percent said the same thing about minimizing their consumption of electricity. Of those respondents, one-quarter said they may be inclined to choose a rental community that would minimize their electricity consumption, more than one-fifth said they may be inclined to remain in a rental community that did so, and one-tenth said they would be willing to pay more for this feature.

But there are significant regional variations in consumer sentiment. Apartment builders and owners who want to attract green renters will need to align the cost of building green features and amenities with the perceived value of those features/amenities within a given submarket. What is important to renters in Denver may not matter to those in Atlanta, and vice versa. Likewise, renters in one market or submarket may be willing to pay more for a specific green feature than those in another.

Apartment builders and developers have a lot to learn about marketing green housing to consumers. Their expectations about pricing and their thoughts on branding are often wrong. Our survey results reveal that the market for green apartment homes is about one-quarter of the entire rental market, and that even more renters are looking for specific green features and amenities but that, in most cases, they are unwilling to pay higher rents for those features. Renters already recognize which green features are important within their own specific regions. In order to meet the demands of Bamboo Shoot, Old Oak, and Shrub renters, apartment builders and owners must ensure that they are better informed about the cost and value of incorporating various green features and that they are responsive to the demands of today's—and tomorrow's—renters.

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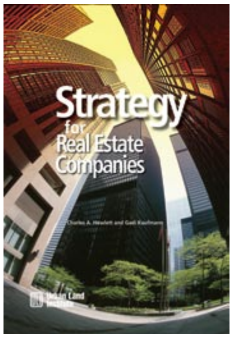
announcements



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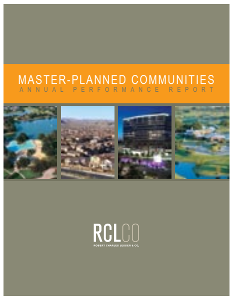

Upcoming: RCLCO to Release MPC Performance Results for 2009

Contact Laura Cole 240-396-2340 to obtain 2009 Rankings and Insights from our annual survey.

upcoming events

March 2010

March 18, 2010
Bob Gardner
ULI Urban Marketplace
Roundtable Discussion on Distressed Assets
Los Angeles, CA

March 23, 2010
Bob Gardner
Benjamin S. Crocker Symposium
“Multifamily Conditions and Trends”
Los Angeles, CA

April 2010

April 15, 2010
Gadi Kaufmann
Urban Land Institute Spring Council Meeting
“Capital Markets and Project Recapitalization”
Boston, MA

April 15, 2010
Gadi Kaufmann
Urban Land Institute Spring Meeting (CDC)
Priming the Pump: MPC Performance Update
Boston, MA

May 2010

May 19-22, 2010
Jonathan Bartlett
Congress for New Urban Urbanism: CNU 18
Quantifying Sustainable Development
Atlanta, GA

about RCLCO

Since our founding in 1967, RCLCO has been at the leading edge of real estate trends and issues. Our impressive record of accomplishments has made us the “first call” for clients seeking strategic advice. We can help you with everything from market research to product programming; financial sourcing to deal structuring; conceptual design to development strategies. We set the highest industry standards by partnering with our clients to answer key questions and solve complex issues--offering strategic guidance that is always market driven, analytically based, and financially sound. Our real estate advisors help clients make the best decisions about property development, planning, and investment, so they can seize the right opportunities for tomorrow ... today. We are real estate consultants, analysts, financiers, developers, and designers--and we are dedicated to offering end-to-end solutions.

In 1985, RCLCO published its first Advisory Newsletter. Since then, subsequent issues have come to represent significant milestones in our intellectual history. Today, our e-newsletter provides over 5,000 real estate professionals with free research, tips, and original articles on various industry trends and issues.