RCLCO U.S. Real Estate Chart Book

NOVEMBER 2013

RCLCO

ROBERT CHARLES LESSER & CO.

Austin | Los Angeles | Orlando | Washington, D.C.

Contents

RCLCO Outlook	03
Sector Fundamentals	04
The Real Estate Cycle	05
Apartment	06
Office	15
Retail	20
Industrial	25
Economic Backdrop	30
Capital Markets	34

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RCLCO

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RCLCO's Institutional Advisory Services group provides services to commercial real estate owners in the areas of:

- Strategic planning and investment policies
- Portfolio development and manager selection
- Portfolio analysis and monitoring
- Investment analysis, target markets, and hold/sell analyses
- Market analysis and independent research

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RCLCO Outlook

As is typical for this point in real estate recoveries, markets are now recovering at varying paces both by property type (apartment leading and retail lagging) and geography (think high-productivity, service-based sectors). With construction returning rapidly to many markets, pickings are slimmer and buyers should be more selective about new investments. However, a number of opportunities still exist as construction is just returning in many areas, rents and occupancies are generally rising (with some exceptions), and service-based jobs are growing by more than 2% a year in areas such as Austin, San Jose, and Salt Lake City. Simultaneously, a number of secular changes are also impacting many property types.

The apartment sector continues to be in the most advanced stage of the cycle of all property types with completions meeting or exceeding demand in nearly half of the top 20 markets this quarter. In addition to new completions, a nascent rental play is emerging in the newly institutionalized for-rent single-family sector, and the owned single-family sector is improving despite a bump in interest rates this summer.

The slow improvement in the U.S. office sector masks underlying regional variances. Despite lower space usage per employee, office employment is growing quickly in several markets, reigniting construction pipelines in Texas and coastal markets.

Retailers continue to explore e-commerce options in lieu of expanding physical space. Top performers are Class A malls, deep discounters, and luxury brands. While these properties are aggressively priced, B properties in non-strategic locations may not be discounted enough.

Industrial absorption is significantly outpacing retail, in part due to a number of e-commerce tenants who have been building million square foot facilities in key locations. Competition is fierce geographically as several east coast markets scramble to improve ports in anticipation of new traffic from the 2015 Panama Canal expansion. However, warehouse demand may skip over some of the smaller coastal markets in favor of inland markets with larger population and employment bases, and more diverse transportation infrastructure.

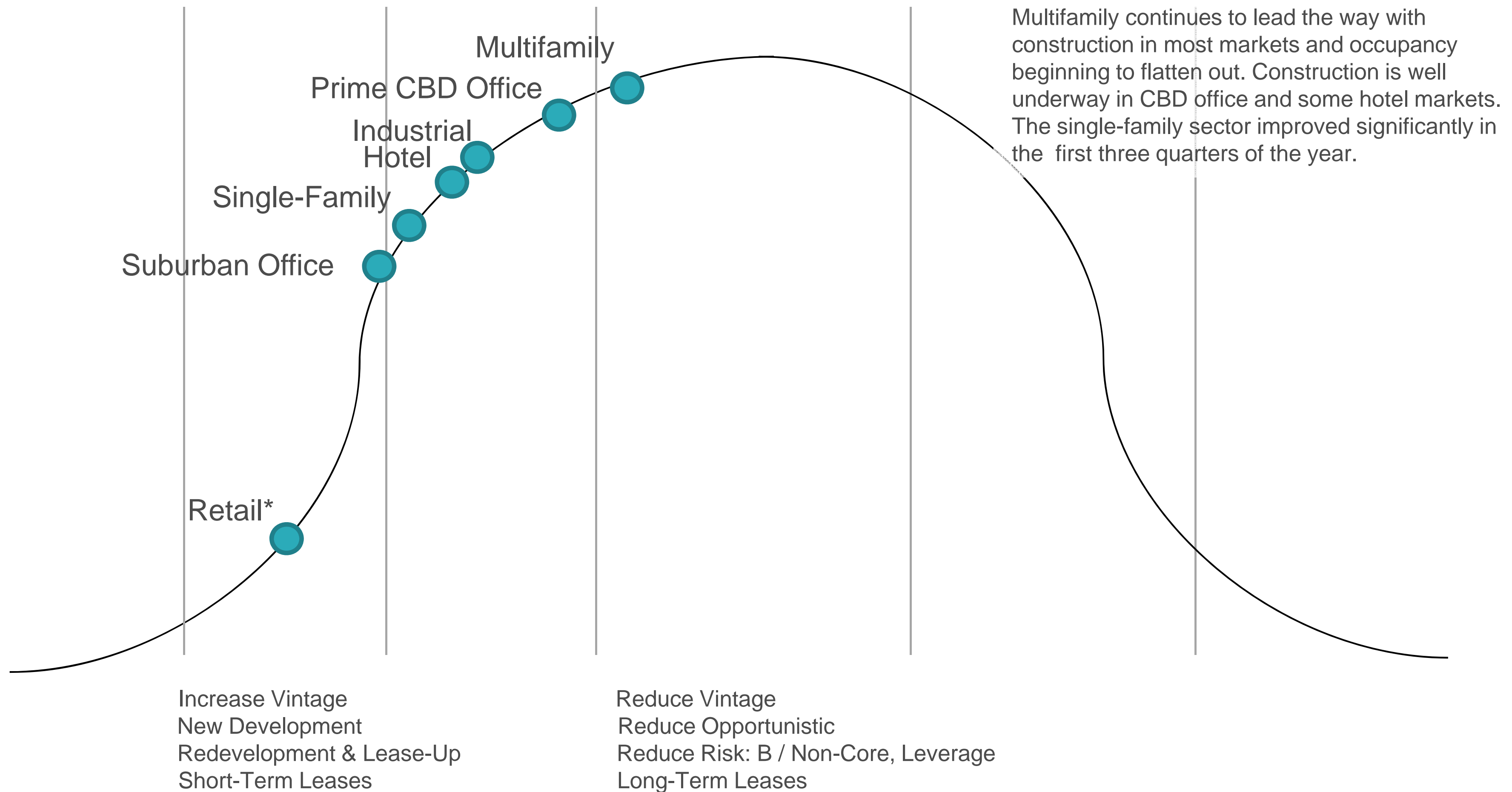
The big question remains whether—or rather when and by how much—interest rates rise and what the impact will be on property markets. Jobs, inflation, and the housing market are not showing enough strength yet to lead to Fed tightening, although volatility similar to the 100 bp rise in treasury yields this summer could occur again as the market continues to stabilize to more sustainable long-term monetary conditions. The good news is that after short-term weakness this summer, REITs, CMBS, and mortgages have all strengthened recently in line with higher treasury prices (lower yields). Additionally, spreads between interest rates and property yields remain wide, which, combined with growing incomes, should provide some cushion to the property markets—at least in the near-term.

— Paige Mueller, Director of Institutional Advisory Services

Sector Fundamentals

Apartments Lead U.S. Real Estate Cycle

Occupancy Low	Occupancy Rising	Occupancy Rising	Occupancy High	Occ. Above Average	Occupancy Low
Demand Improving	Demand Improving	Demand Improving	Occupancy Flattening	Occupancy Falling	Occ. Flat to Down
Rents Flat to Down	Rents Rising	Rents Rising	Rents Flattening	Rents Falling	Rents Flat to Down
No Construction	Limited Construction	Construction	Construction	Construction	No Construction



**neighborhood & community centers*
Source: RCLCO

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Housing Fundamentals

RCLCO

U.S. Apartment Absorption Continues to Outpace Completions

3rd Quarter 2013 apartment vacancy was down slightly quarter-over-quarter to 4.2% and down 50 bps year-over-year. Owners have pricing power as they leverage low vacancies into rent growth for the 15th straight quarter. Vacancies are expected to hit cycle lows this year, with completions outpacing absorption in 2014 and 2015 as developers respond to high rents and occupancy. The rent growth forecast below could face some downward pressure if new construction occurs faster than expected.

U.S. Apartment Absorption, Vacancy, Rent Growth

Square Feet (in millions)

250
200
150
100
50
0
-50

10%
8%
6%
4%
2%
0%
-2%
-4%

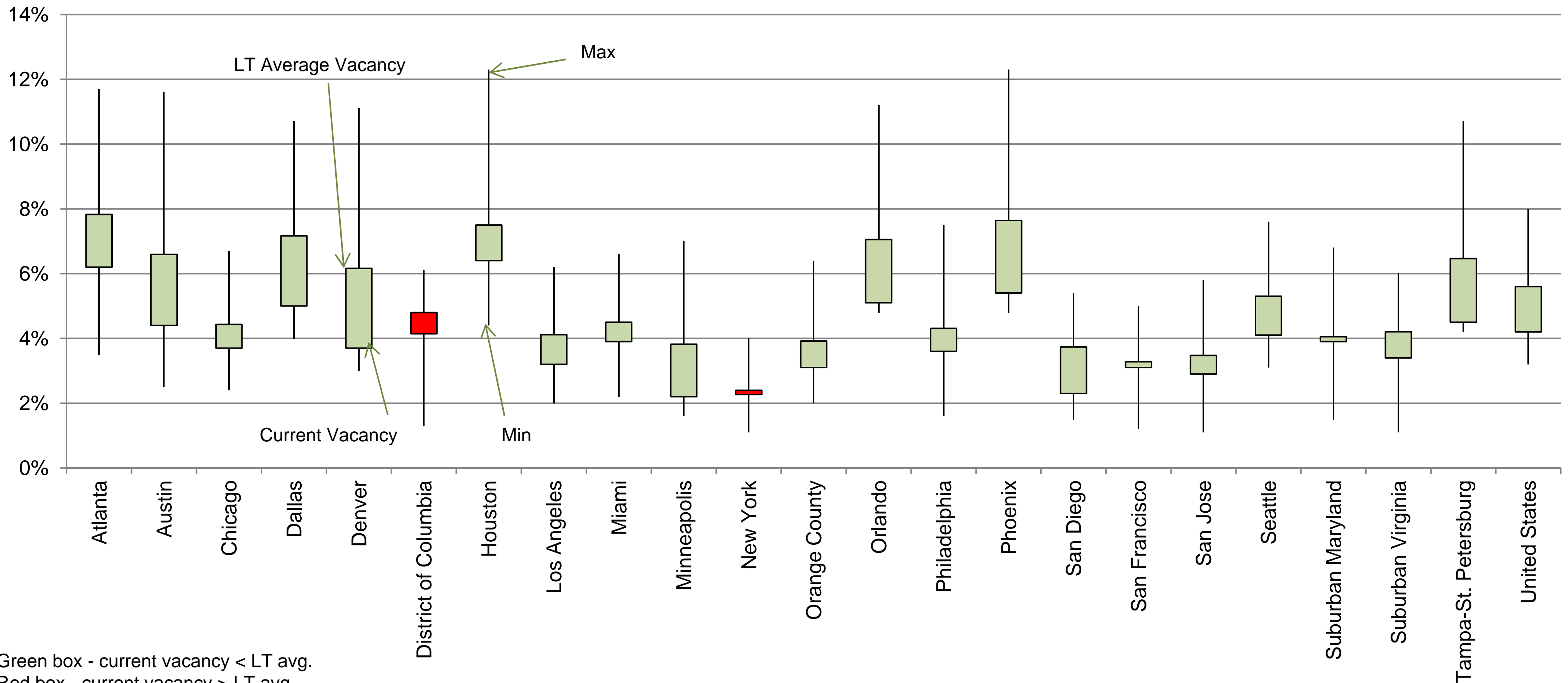
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 (f) 2014 (f) 2015 (f)

Completions | Net Absorption | Vacancy % | Rent Growth %

Source: REIS, Inc.; RCLCO

Apartment Vacancy Historically Low

Most major U.S. apartment markets are experiencing lower current vacancy than their long-term (1990-present) average. The only two markets with above-average vacancy are Washington, D.C. and New York, although vacancies remain low at 4.8% and 2.4%, respectively.



NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, REIS, Inc.

RCLCO

U.S. Apartment: Market Risk Indicator

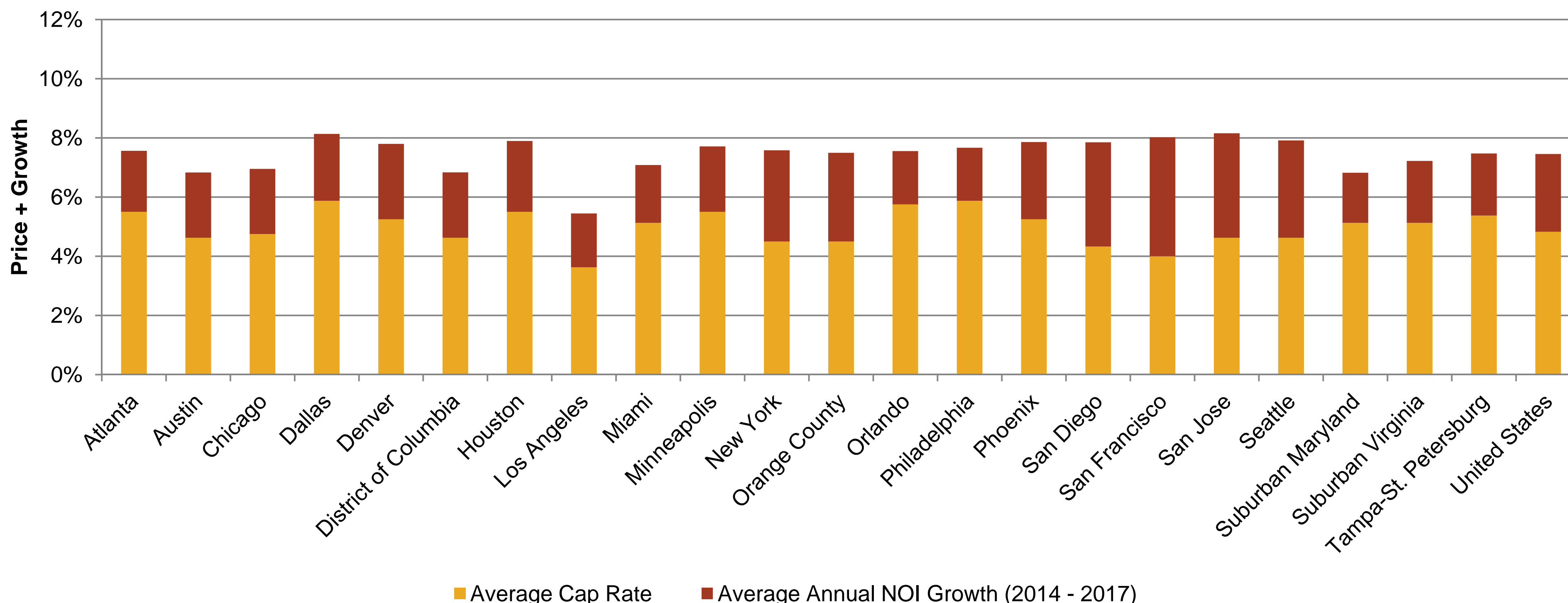
Rents continue to rise in most major apartment markets, although occupancy rates are beginning to flatten. Due to historically high occupancy and rent levels, construction continues to be in full swing in most markets.

	Net Absorption % of Stock Current* Quarter	Completions % of Stock Current* Quarter**	Under Constr % of Stock Current* Quarter***	Occupancy****	Q-o-Q Occupancy Change	Y-o-Y Occupancy Change	Q-o-Q Rent Growth	Y-o-Y Rent Growth
Atlanta	0.6%	0.5%	1.4%	93.8%	0.3%	1.1%	1.3%	2.9%
Austin	0.7%	0.8%	6.7%	95.6%	0.0%	0.0%	1.4%	4.1%
Chicago	0.3%	0.3%	1.1%	96.3%	-0.1%	0.3%	1.0%	2.6%
Dallas	0.6%	0.5%	4.6%	95.0%	0.2%	0.7%	1.0%	3.0%
District of Columbia	0.5%	0.9%	7.1%	95.2%	-0.4%	-0.5%	0.7%	2.2%
Denver	0.4%	0.3%	6.2%	96.3%	0.1%	0.3%	2.0%	4.5%
Houston	0.7%	0.6%	3.1%	93.6%	0.2%	1.2%	1.4%	4.5%
Los Angeles	0.1%	0.0%	1.3%	96.8%	0.0%	0.3%	0.7%	2.6%
Miami	0.7%	0.7%	1.8%	96.1%	-0.1%	0.2%	1.8%	3.3%
Minneapolis	0.5%	0.5%	3.6%	97.8%	-0.1%	0.3%	1.2%	3.3%
New York	0.9%	1.3%	5.4%	97.6%	-0.4%	-0.2%	0.9%	2.0%
Orange County	0.2%	0.1%	1.7%	96.9%	0.1%	0.4%	0.9%	3.3%
Orlando	0.2%	0.0%	3.8%	94.9%	0.2%	0.9%	0.8%	3.6%
Philadelphia	0.2%	0.1%	1.1%	96.4%	0.1%	0.3%	0.6%	2.5%
Phoenix	0.4%	0.3%	1.9%	94.6%	0.1%	1.1%	0.8%	2.7%
San Diego	0.2%	0.0%	2.1%	97.7%	0.2%	0.7%	0.8%	3.1%
Seattle	0.6%	0.7%	4.7%	95.9%	-0.1%	0.2%	1.9%	7.0%
San Francisco	0.5%	0.4%	2.1%	96.9%	0.0%	0.1%	2.2%	4.5%
San Jose	1.5%	1.5%	3.8%	97.1%	0.1%	-0.2%	2.2%	5.2%
Suburban Maryland	0.3%	0.0%	5.4%	96.1%	0.3%	0.2%	0.8%	2.8%
Suburban Virginia	0.8%	1.0%	5.3%	96.6%	-0.1%	0.4%	0.7%	2.1%
Tampa-St. Petersburg	0.2%	0.0%	2.3%	95.5%	0.2%	1.0%	0.7%	2.8%
United States	0.4%	0.4%	2.6%	95.8%	0.1%	0.5%	1.0%	3.1%

*Current quarter defined as Q3 2013
**Completions highlighted in Red if above 0.25% of Stock
***Under Construction highlighted in Red if above 1% of Stock
****Green if above city's historical average since 1990
NOTE: Above data includes only market rate rentable apartment space.
NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, Reis, Inc.

Apartment Pricing and Growth Expectations

Investors continue to favor the low vacancy rates of the apartment sector, with average Class A cap rates of around 5% or lower. The graph below shows average Class A cap rates and average expected NOI growth for the next four years, including expected changes in occupancies and rents. While NOI growth going forward is expected to be strong overall as a reflection of current low vacancy rates, forecasts could be moderated downward in the future if construction picks up faster than expected.



Initial yield and cash flow growth over the hold period are significant contributors to unlevered total return expectations. Low cap rates should thus be accompanied by higher growth expectations. While the above graph is an incomplete view, it does provide some indications of markets that should be particularly reviewed for further insights. For example, markets with low bars in the graph above may have less growth than needed to offset lower yields, or the growth may be more back-ended in a ten-year hold. Conversely, markets with high bars may be positioned to experience significant growth as compared to current pricing, or may be markets that are considered to be more risky and thus justify higher expected returns.

NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO; Reis, Inc.; CBRE

Housing Supply is Approaching Stabilized Levels

New and Existing Home Months Supply of Housing

Months Supply

14
12
10
8
6
4
2
0

01/99 01/00 01/01 01/02 01/03 01/04 01/05 01/06 01/07 01/08 01/09 01/10 01/11 01/12 01/13

Existing Home Months Supply — New Home Months Supply

NOTE: Home supply includes single-family, condo, and townhomes.
Source: FRED; NAR

Single-Family Housing Prices Still Below Peak Levels

Median Home Price and National Home Price Index

Median Home Price: $250,000 | $200,000 | $150,000 | $100,000 | $50,000 | $-

Home Price Index *: 250 | 200 | 150 | 100 | 50 | 0

01/99 | 01/01 | 01/03 | 01/05 | 01/07 | 01/09 | 01/11 | 01/13

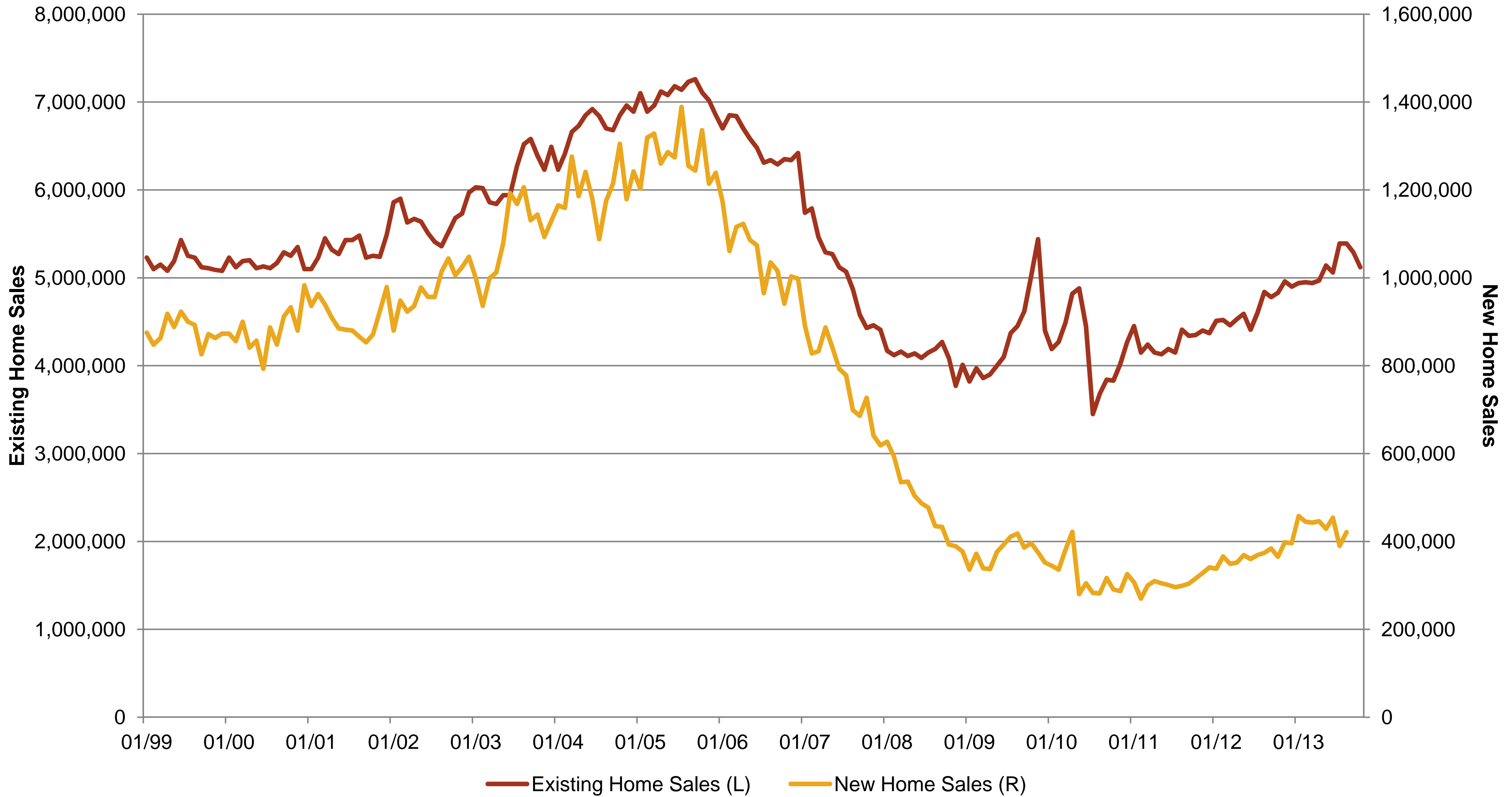
Median Home Price | National Composite Home Price Index

*Normalized to the year 2000

NOTE: Median Home Price is for existing homes only.

Source: FRED; S&P Case Shiller; RCLCO; NAR

Existing Home Sales Lead Housing Recovery



NOTE: Existing-home sales are based on closing transactions of single-family, townhomes, condominiums, and cooperative homes. New home sales are single –family.

Source: FRED; NAR; Census Bureau

Household Formation is Outpacing Single-Family Starts

Single-Family Housing Starts and Household Formation

Starts and Household Formations

1,600,000
1,400,000
1,200,000
1,000,000
800,000
600,000
400,000
200,000
0

Jan-1982 Jan-1983 Jan-1984 Jan-1985 Jan-1986 Jan-1987 Jan-1988 Jan-1989 Jan-1990 Jan-1991 Jan-1992 Jan-1993 Jan-1994 Jan-1995 Jan-1996 Jan-1997 Jan-1998 Jan-1999 Jan-2000 Jan-2001 Jan-2002 Jan-2003 Jan-2004 Jan-2005 Jan-2006 Jan-2007 Jan-2008 Jan-2009 Jan-2010 Jan-2011 Jan-2012 Jan-2013 Jan-2014 Jan-2015 Jan-2016 Jan-2017

SF Starts   New Households

NOTE: Housing starts include single-family, townhomes, condominiums, and cooperative homes.
Source: Moodys

Office Fundamentals

U.S. Office Vacancy Slowly Improving

3rd Quarter 2013 office vacancy was down slightly quarter-over-quarter at 16.9% and down by 30 bps year-over-year. Office absorption is expected to outpace completions over the next three years nationally.

Elevated vacancy rates near 15% by 2015 mask regional differences and indicate obsolescence risk ahead for poorly configured or located properties in slow-growth markets.

U.S. Office Absorption, Vacancy, Rent Growth

Square Feet (in millions): 200, 150, 100, 50, 0, -50, -100, -150

20%, 15%, 10%, 5%, 0%, -5%, -10%, -15%

1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 (f) 2014 (f) 2015 (f)

Completions | Net Absorption | Vacancy % | Rent Growth %

Source: REIS, Inc.

Office Vacancy Generally Still High

Most major U.S. office markets continue to experience higher current vacancy than their long-term (1990-present) average. Phoenix has the highest current vacancy rate of these major markets at 26%. The only two markets with below-average vacancy are Houston and NYC at 14.2% and 9.6%, respectively.

Office Current and Long-term Vacancy

30%
25%
20%
15%
10%
5%
0%

Max
Current Vacancy
LT Average Vacancy
Min

Atlanta, Austin, Boston, Charlotte, Chicago, Dallas, Denver, District of Columbia, Houston, Los Angeles, Miami, Minneapolis, New York, Orange County, Philadelphia, Phoenix, San Diego, San Francisco, San Jose, Seattle, Suburban Maryland, Suburban Virginia, United States

Green box - current vacancy < LT avg.
Red box - current vacancy > LT avg.

NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, REIS, Inc.

U.S. Office: Market Risk Indicator

Occupancy levels continue to rise in most major office markets, yet they remain lower than their historical city averages. Rents continue to increase, and are beginning to reach levels that are high enough to justify new construction as pipelines are picking up from current levels in several markets.

	Net Absorption % of Stock Current* Quarter	Completions % of Stock Current* Quarter**	Under Constr % of Stock Current* Quarter***	Occupancy****	Q-o-Q Occupancy Change	Y-o-Y Occupancy Change	Q-o-Q Rent Growth	Y-o-Y Rent Growth
Atlanta	0.0%	0.0%	0.4%	79.7%	0.1%	0.3%	0.1%	0.9%
Austin	0.7%	0.1%	3.1%	83.6%	0.7%	0.7%	0.5%	2.4%
Boston	0.3%	0.0%	2.7%	86.1%	0.3%	0.5%	0.3%	1.9%
Chicago	-0.2%	0.0%	0.5%	81.3%	-0.2%	0.0%	-0.1%	2.3%
Charlotte	-0.2%	0.0%	0.2%	82.2%	-0.2%	-1.5%	0.3%	2.2%
Dallas	0.0%	0.0%	2.9%	76.9%	0.0%	0.3%	0.3%	3.2%
District of Columbia	0.2%	0.1%	1.2%	90.4%	0.1%	-0.3%	-0.1%	0.8%
Denver	0.2%	0.0%	0.9%	82.5%	0.2%	1.3%	0.4%	2.0%
Houston	0.8%	1.0%	3.3%	85.8%	0.0%	0.1%	0.7%	4.2%
Los Angeles	0.1%	0.0%	0.2%	84.2%	0.2%	0.0%	0.3%	1.7%
Miami	-0.1%	0.0%	0.6%	83.1%	-0.1%	0.6%	0.0%	0.9%
Minneapolis	0.1%	0.0%	0.1%	82.7%	0.1%	0.9%	0.1%	1.8%
Northern New Jersey	0.6%	0.3%	0.0%	81.2%	0.3%	0.2%	0.3%	0.3%
New York	0.4%	0.4%	2.1%	90.3%	0.0%	0.4%	0.8%	4.6%
Orange County	0.1%	0.0%	1.0%	82.7%	0.1%	1.7%	0.4%	2.4%
Philadelphia	-0.1%	0.0%	0.1%	85.9%	-0.1%	1.1%	0.1%	0.8%
Phoenix	0.3%	0.0%	0.8%	74.4%	0.2%	0.2%	0.2%	1.0%
San Diego	0.0%	0.0%	1.1%	83.7%	-0.1%	0.5%	0.1%	1.2%
Seattle	0.7%	0.1%	3.4%	86.3%	0.6%	0.4%	0.5%	2.0%
San Francisco	0.3%	0.0%	2.4%	86.7%	0.3%	0.1%	1.3%	7.8%
San Jose	0.9%	0.8%	3.7%	81.4%	0.2%	1.0%	0.8%	5.6%
Suburban Maryland	0.0%	0.0%	1.2%	84.8%	0.0%	0.1%	-0.1%	0.9%
Suburban Virginia	-0.1%	0.0%	1.4%	83.0%	0.0%	-1.2%	0.1%	0.7%
United States	0.2%	0.1%	1.2%	83.1%	0.1%	0.3%	0.3%	2.3%

*Current quarter defined as Q3 2013
**Completions highlighted in Red if above 0.25% of Stock
***Under Construction highlighted in Red if above 1% of Stock
****Green if above market's historical average since 1990
NOTE; Above data does not include Medical Office
NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, Reis, Inc.

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Office Pricing and Growth Expectations

Pricing varies significantly by market, with cap rates below 6% for Class A office buildings on average in prime markets such as Boston, Washington, D.C., New York, and San Francisco. The graph below shows average cap rates and average expected NOI growth for the next four years, including expected improvements in occupancies and rents. While NOI growth going forward is expected to be strong in several markets, growing construction pipelines in markets such as Washington, D.C., may limit returns.

Class A Office Price + Growth

Price + Growth

12%
10%
8%
6%
4%
2%
0%

Atlanta, Austin, Boston, Charlotte, Chicago, Dallas, Denver, District of Columbia, Houston, Los Angeles, Miami, Minneapolis, New York, Orange County, Philadelphia, Phoenix, San Diego, San Francisco, San Jose, Seattle, Suburban Maryland, Suburban Virginia, United States

Average Cap Rate
Average Annual NOI Growth (2014 - 2017)

Initial yield and cash flow growth over the hold period are significant contributors to unlevered total return expectations. Low cap rates should thus be accompanied by higher growth expectations. While the above graph is an incomplete view, it does provide some indications of markets that should be particularly reviewed for further insights. For example, markets with low bars in the graph above may have less growth than needed to offset lower yields, or the growth may be more back-ended in a ten-year hold. Conversely, markets with high bars may be positioned to experience significant growth as compared to current pricing, or may be markets that are considered to be more risky and thus justify higher expected returns.

NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO; Reis, Inc.; CBRE

Retail Fundamentals

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U.S. Retail Absorption Positive but Weak

Neighborhood and Community Center (N/C) net absorption at 0.1% of stock in 3Q 2013 continues to be weak, but follows the positive demand trend from 2012. N/C vacancy peaked at 11.0% in 2011, the highest rate since 1991. Vacancy remained unchanged Quarter-over-Quarter at 10.5% in 3Q 2013 with minimal new completions. Although we expect a gradually strengthening retail sector over the next few years, bricks and mortar retail is facing long-term headwinds from changing retail patterns, slow demographic growth, and e-commerce. With weak forecasted demand, vacancy is expected to remain above 10% through 2014.

U.S. Retail Absorption, Vacancy, Rent Growth

Square Feet (in millions)

60
45
30
15
0
-15
-30

12%
9%
6%
3%
0%
-3%
-6%

1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 (f) 2014 (f) 2015 (f)

Completions | Net Absorption | Vacancy % | Rent Growth %

Source: REIS, Inc.

Retail Vacancy Generally Still High

All of the major U.S. retail markets are experiencing higher current vacancy than their long-term (1990-present) average except for Houston, which has recently increased its occupancy levels to 88% (better than its long-term average of 87%). Atlanta and Orlando are off their long-term averages by the widest margins, while Miami and Southern California retail markets are only slightly less occupied than normal. Vacancies should continue to improve, albeit very slowly.

Retail Current and Long-term Vacancy

25%
20%
15%
10%
5%
0%

Max
Min
Current Vacancy
LT Average Vacancy

Atlanta
Chicago
Dallas
Denver
Houston
Los Angeles
Miami
Minneapolis
Orange County
Orlando
Phoenix
San Diego
Seattle
United States

Green box - current vacancy < LT avg.
Red box - current vacancy > LT avg.

NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, REIS, Inc.

U.S. Retail: Market Risk Indicator

Occupancy levels continue to rise in most major retail markets, yet they remain lower than their historical averages. Rents continue to grow. While new construction is minimal, it is beginning to pick up, particularly in Chicago, Los Angeles, and Orange County.

	Net Absorption % of Stock Current* Quarter	Completions % of Stock Current* Quarter**	Under Constr % of Stock Current* Quarter***	Occupancy****	Q-o-Q Occupancy Change	Y-o-Y Occupancy Change	Q-o-Q Rent Growth	Y-o-Y Rent Growth
Atlanta	0.1%	0.0%	0.7%	86.1%	0.2%	0.3%	0.4%	0.7%
Chicago	0.0%	0.0%	1.1%	88.8%	-0.1%	0.4%	0.4%	0.8%
Dallas	0.2%	0.1%	0.9%	86.6%	0.2%	0.8%	0.6%	1.9%
Denver	-0.1%	0.1%	0.0%	88.3%	-0.1%	0.1%	0.9%	1.3%
Houston	0.0%	0.1%	0.4%	87.9%	-0.1%	0.4%	0.8%	2.3%
Los Angeles	0.0%	0.0%	1.6%	94.0%	0.0%	0.1%	0.4%	1.3%
Miami	0.1%	0.0%	0.2%	92.9%	0.1%	0.1%	0.4%	0.7%
Minneapolis	0.2%	0.0%	0.5%	89.1%	0.2%	0.6%	0.5%	2.1%
Orange County	0.0%	0.0%	1.0%	94.4%	-0.1%	0.2%	0.0%	1.4%
Orlando	0.4%	0.1%	0.6%	87.3%	0.4%	1.3%	0.3%	2.1%
Phoenix	0.2%	0.0%	0.0%	89.0%	0.2%	0.6%	-0.2%	1.0%
San Diego	0.5%	0.5%	0.7%	93.8%	0.0%	0.2%	0.8%	1.6%
Seattle	0.1%	0.0%	0.3%	93.2%	0.1%	0.2%	0.7%	1.3%
United States	0.1%	0.1%	0.0%	89.5%	0.0%	0.3%	0.4%	1.1%

*Current quarter defined as Q3 2013
**Completions highlighted in Red if above 0.25% of Stock
***Under Construction highlighted in Red if above 1% of Stock
****Green if above city's historical average since 1990
NOTE: Above data includes only Neighborhood/Community centers; does NOT include power centers, regional malls, or lifestyle retail centers
NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, Reis, Inc.

RCLCO

Neighborhood/Community Retail Pricing and Growth Expectations

Pricing variation by geographic market in retail is not as differentiated as in other property types, as retail yields vary more by property type and strength of the location and retailers. The graph below shows average cap rates and average expected NOI growth for the next four years, including expected improvements in occupancies and rents. NOI growth for most markets is expected to be moderate, reflecting reluctance of retailers to increase space needs and strong e-commerce competition.

Neighborhood/Community Retail Price + Growth

Price + Growth

12%
10%
8%
6%
4%
2%
0%

Atlanta
Chicago
Dallas
Denver
Houston
Los Angeles
Miami
Minneapolis
Orange County
Orlando
Phoenix
San Diego
Seattle
United States

Average Cap Rate
Average Annual NOI Growth (2014 - 2017)

Initial yield and cash flow growth over the hold period are significant contributors to unlevered total return expectations. Low cap rates should thus be accompanied by higher growth expectations. While the above graph is an incomplete view, it does provide some indications of markets that should be particularly reviewed for further insights. For example, markets with low bars in the graph above may have less growth than needed to offset lower yields, or the growth may be more back-ended in a ten-year hold. Conversely, markets with high bars may be positioned to experience significant growth as compared to current pricing, or may be markets that are considered to be more risky and thus justify higher expected returns.

NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO; Reis, Inc.; CBRE

Industrial Fundamentals

U.S. Industrial Absorption Remains Strong

Industrial vacancy rates have improved from previous peak levels, dropping to under 10% in the previous quarter. Rent growth is expected to continue to be positive, with significant upside in several markets as rents remain more than 20% below peak levels.

U.S. Industrial Absorption, Vacancy, Rent Growth

Source: REIS, Inc.

Industrial Vacancy Falling

Most major U.S. industrial markets are experiencing slightly lower current vacancy than their long-term (1990-present) average, which represents a change from just a year ago, when vacancies were higher than their historical average. New construction is not keeping pace with demand in most markets, so vacancy continues to fall.

Industrial Current and Long-term Vacancy

30%
25%
20%
15%
10%
5%
0%

Max
Min
Current Vacancy
LT Average Vacancy

Atlanta
Baltimore
Boston
Central New Jersey
Chicago
Dallas
Denver
Fort Lauderdale
Houston
Indianapolis
Los Angeles
Memphis
Miami
Northern New Jersey
Oakland-East Bay
Orange County
Phoenix
San Bernardino/Riverside
San Diego
San Francisco
Seattle
United States

Green box - current vacancy < LT avg.
Red box - current vacancy > LT avg.

NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, REIS, Inc.

U.S. Industrial: Market Risk Indicator

Occupancy and rent levels continue to improve in all major industrial markets. New inventory has hit the market during the last year, but demand is expected to outpace supply over the next several years. Demand is expected to be especially high just outside of major markets as companies try to cut transportation costs and e-commerce companies seek places to store goods before deliveries.

	Net Absorption % of Stock Current* Year	Completions % of Stock Current* Year**	Under Constr % of Stock Current***	Occupancy****	Y-o-Y Occupancy Change	Y-o-Y Rent Growth
Atlanta	1.3%	0.61%	0.64%	85.7%	0.8%	2.6%
Baltimore	1.9%	0.45%	0.94%	87.8%	1.5%	2.3%
Boston	1.6%	0.99%	0.85%	81.2%	0.8%	1.7%
Central New Jersey	1.2%	1.15%	0.98%	89.6%	0.2%	2.0%
Chicago	0.9%	0.31%	0.49%	90.6%	0.6%	2.2%
Dallas	2.1%	1.63%	2.32%	87.4%	0.7%	2.6%
Denver	1.4%	0.83%	0.88%	91.8%	0.6%	2.4%
Fort Lauderdale	1.8%	1.12%	0.00%	90.9%	0.8%	2.1%
Houston	1.7%	1.33%	1.07%	92.0%	0.5%	3.8%
Indianapolis	1.0%	0.77%	0.73%	90.2%	0.3%	2.6%
Los Angeles	0.7%	0.31%	0.08%	96.0%	0.4%	2.9%
Memphis	1.1%	0.26%	0.00%	84.9%	0.9%	3.0%
Miami	1.1%	0.62%	0.20%	94.0%	0.5%	2.3%
Northeast Region	0.9%	0.48%	0.00%	88.4%	1.0%	1.8%
Oakland-East Bay	1.1%	0.39%	0.10%	90.7%	0.8%	2.3%
Orange County	0.8%	0.28%	0.05%	96.1%	0.5%	2.0%
Phoenix	1.9%	1.43%	0.65%	88.6%	0.6%	1.6%
San Bernardino/Riverside	3.4%	2.41%	3.95%	93.2%	1.2%	4.2%
San Diego	1.1%	0.20%	0.25%	92.9%	0.9%	1.6%
San Francisco	1.1%	0.20%	0.03%	88.9%	0.9%	1.7%
Seattle	1.0%	0.27%	0.92%	93.7%	0.8%	1.9%
United States	1.1%	0.58%	0.76%	90.6%	0.6%	2.4%

*Current year defined as 2013
**Completions highlighted in Red if above 1% of Stock
***Under Construction highlighted in Red if above 1% of Stock
****Green if above city's historical average since 1990
NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO, Reis, Inc.

Industrial Pricing and Growth Expectations

Pricing varies significantly by market, with cap rates below 6% on average in port-oriented markets such as Los Angeles and Miami. The graph below shows average cap rates and average expected NOI growth for the next four years, including expected improvements in occupancies and rents. West Coast cap rates are generally lower, but are not always accompanied by higher expected cash flow growth. Pricing in the big five distribution markets (ATL, DAL, NNJ, CHI, and RIV) is split, with Riverside and Northern New Jersey priced competitively and the other three moderately priced.

Industrial Price + Growth

Price + Growth

12%
10%
8%
6%
4%
2%
0%

Atlanta, Baltimore, Boston, Central New Jersey, Chicago, Dallas, Denver, Houston, Indianapolis, Los Angeles, Memphis, Miami, Minneapolis, Nashville, Northern New Jersey, Orange County, Phoenix, Portland, San Bernardino/Riverside, San Diego, San Francisco, Seattle, United States

Average Cap Rate
Average Annual NOI Growth (2014 - 2017)

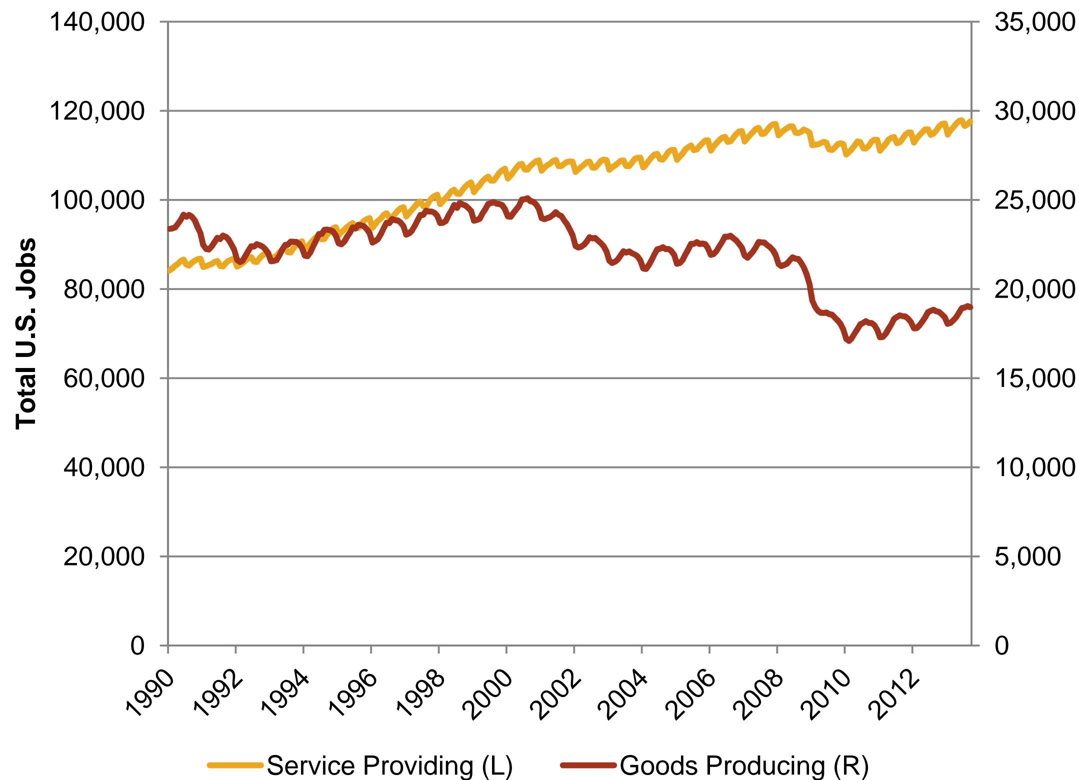
Initial yield and cash flow growth over the hold period are significant contributors to unlevered total return expectations. Low cap rates should thus be accompanied by higher growth expectations. While the above graph is an incomplete view, it does provide some indications of markets that should be particularly reviewed for further insights. For example, markets with low bars in the graph above may have less growth than needed to offset lower yields, or the growth may be more back-ended in a ten-year hold. Conversely, markets with high bars may be positioned to experience significant growth as compared to current pricing, or may be markets that are considered to be more risky and thus justify higher expected returns.

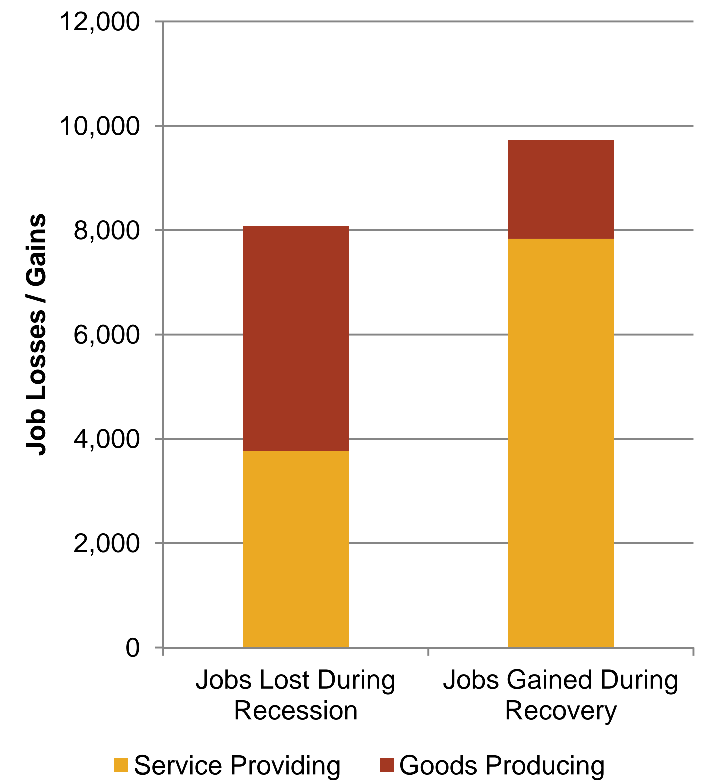
NOTE: The markets in the above chart are not necessarily MSAs or central cities, but are loosely defined real estate markets.
Source: RCLCO; Reis, Inc.; CBRE

Economic Backdrop

U.S. Employment Growth Favors Service Sector

The goods producing sector continues to gain steam, although a long way from a peak that is now more than a decade old. Robust growth continues to favor high productivity sectors such as tech and energy.

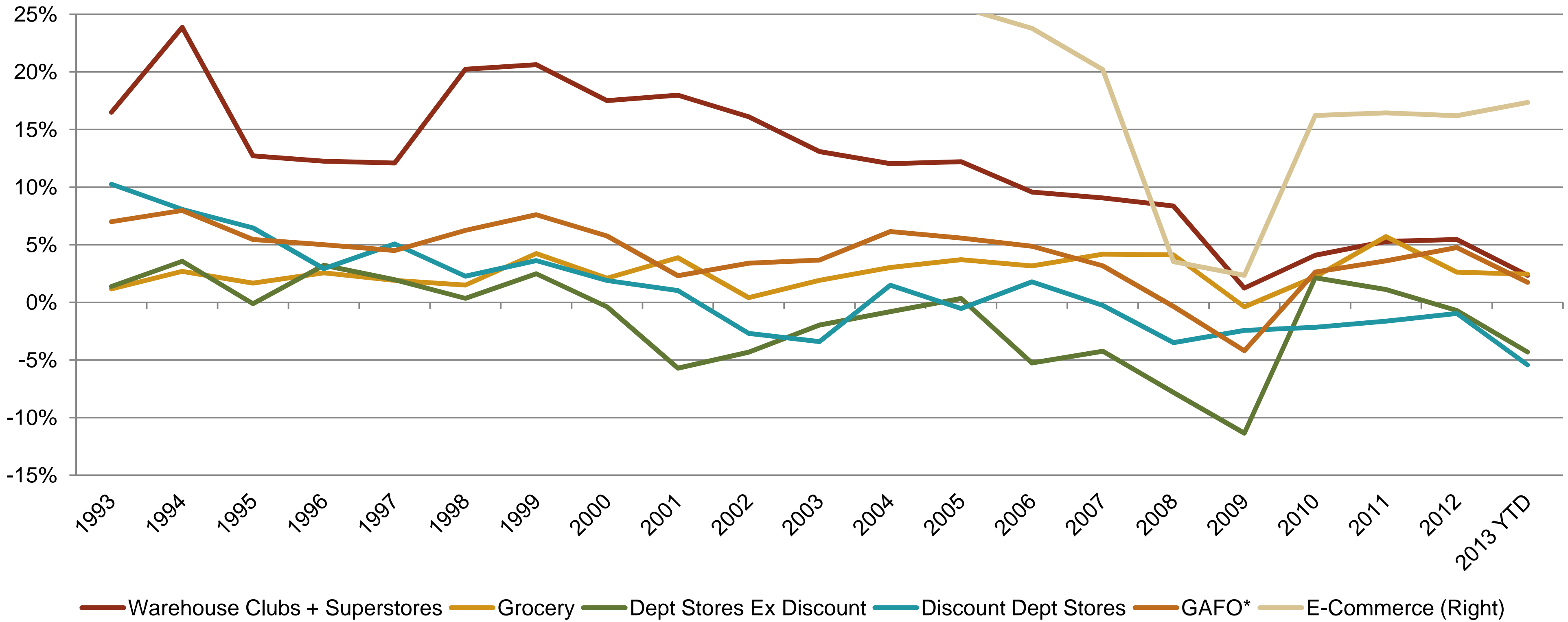




NOTE: Seasonally adjusted at annual rates.
Source: Bureau of Economic Analysis

E-commerce, Food, and Super Discounters Lead Retail Sales Growth

The retail sector continues to be a world of haves and have-nots. Warehouse clubs, which had previously been taking market share, are now showing signs of maturity, while e-commerce sales continue to gain. High-end retailers are also outperforming, with weakness in department stores. The stability of the food sector continues to attract new entrants, including many big box retailers.



*GAFO = general apparel, furniture, and other mall-type stores

NOTE: 2013 YTD data is through October.
Source: U.S. Census; ICSC

Interest Rates and Inflation Remain Subdued

After a bump this summer, treasury yields fell recently, providing relief to public real estate markets and mortgage markets. Both actual and expected inflation remain low, which combined with still-inflated unemployment rates and a slowly recovering housing market are giving the Fed some room to delay monetary tightening. Our estimates indicate another 100 bps+ increase in 10-year treasuries is likely just to return to normalized real rates. The question is when and how quickly this will happen. Cap rates are expected to be less volatile, and are unlikely to face significant pressure until treasury yields surpass 3.5%.

Nominal Interest Rates and Inflation, 2000 – 2013

8%
7%
6%
5%
4%
3%
2%
1%
0%
-1%
-2%
-3%

Jun-00 Jun-01 Jun-02 Jun-03 Jun-04 Jun-05 Jun-06 Jun-07 Jun-08 Jun-09 Jun-10 Jun-11 Jun-12 Jun-13

3 Mo. LIBOR | CPI | 10 Yr. Treasury | Expected Inflation

Source: BLS; Federal Reserve, www.fedprimerate.com

Capital Markets

RCLCO

Lending Standards Easing

Banks continue to loosen commercial real estate lending standards following improving occupancy and rental rates.

Net % of Banks Tightening Lending Standards

100%
80%
60%
40%
20%
0%
-20%
-40%

Q2 1991
Q2 1992
Q2 1993
Q2 1994
Q2 1995
Q2 1996
Q2 1997
Q2 1998
Q2 1999
Q2 2000
Q2 2001
Q2 2002
Q2 2003
Q2 2004
Q2 2005
Q2 2006
Q2 2007
Q2 2008
Q2 2009
Q2 2010
Q2 2011
Q2 2012
Q2 2013

Source: Federal Reserve

Lending Improving, but Lagging the Improvement in Property Values

Net lending volumes continue to lag the improvement in property values. Despite the recent rise in interest rates, we expect lending to continue to increase as a result of improving occupancy and rental rates.

Commercial Net Debt Investment and Values

Net Debt Investment (in billions)

$400
$300
$200
$100
$0
-$100
-$200
-$300
-$400

% Change in Commercial RE Values

30%
24%
18%
12%
6%
0%
(6%)
(12%)
(18%)
(24%)
(30%)

1986 1989 1992 1995 1998 2001 2004 2007 2010 2013*

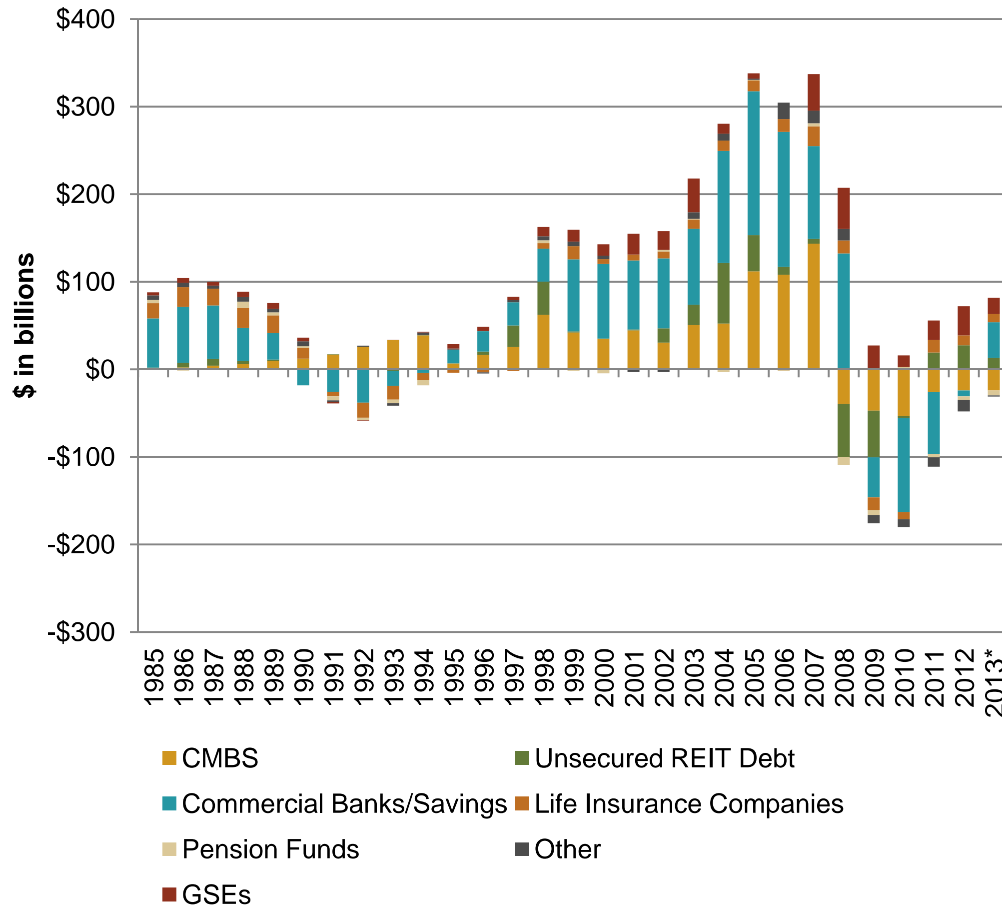
Net Debt Investment - Commercial / MF RE (L)
Commercial RE Values (R)

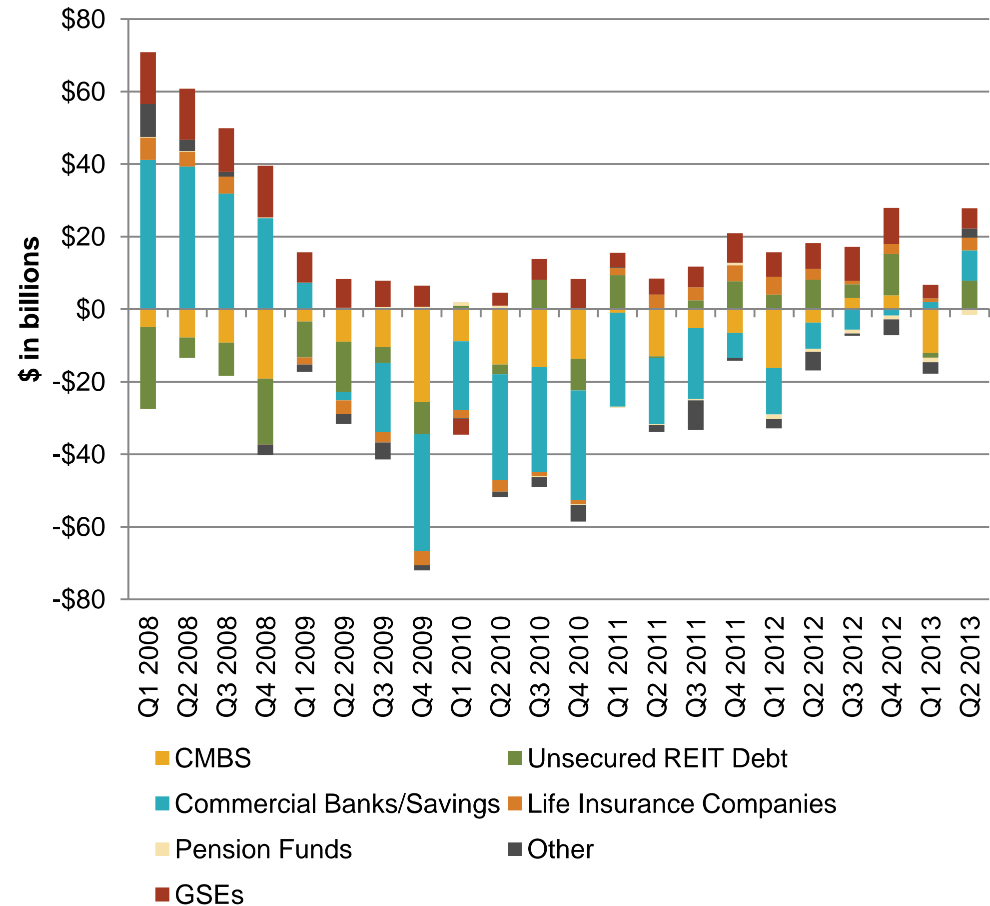
*2013 is a rolling four quarter percentage from 4Q 2012 through 3Q 2013

Source: Federal Reserve; NCREIF

Deleveraging has Ended

In 2009 to 2012, more loans were issued than matured. The trend is finally reversing in 2013. GSEs, including Fannie Mae and Freddie Mac, public debt markets, and life insurance companies, are net positive lenders.



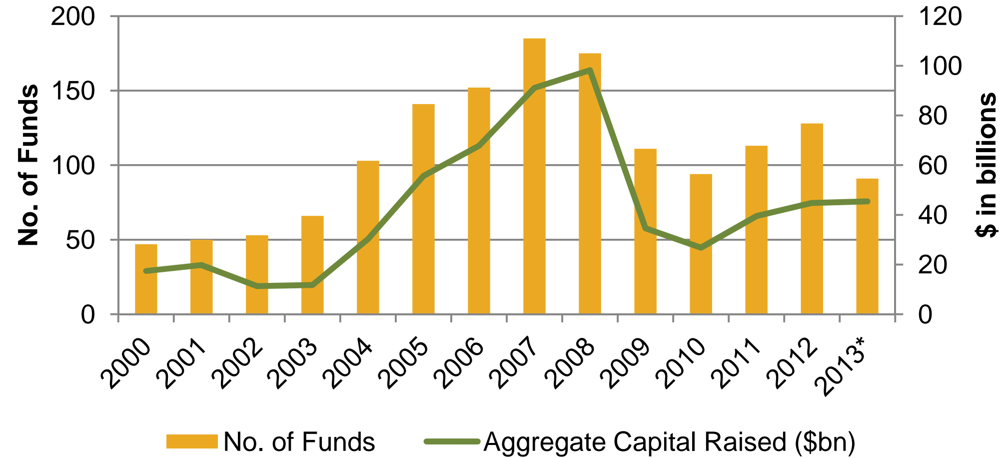


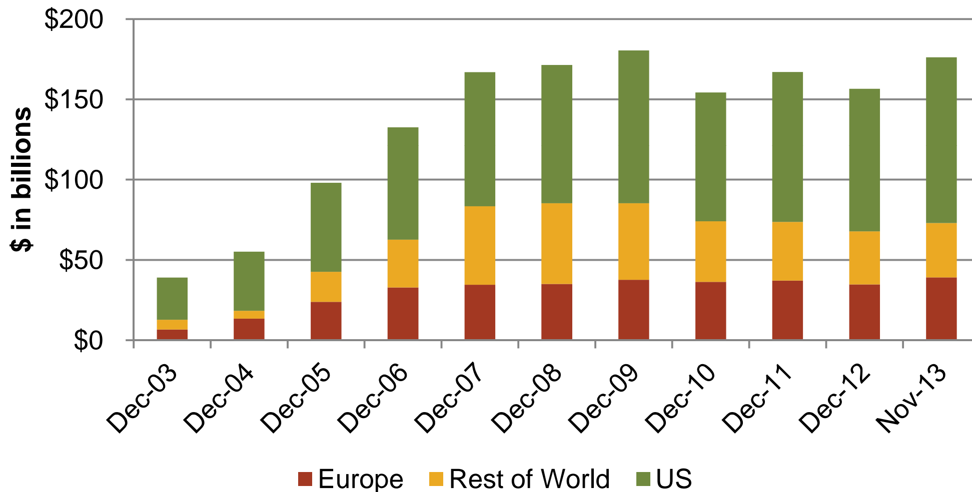
Source: Federal Reserve; NAREIT

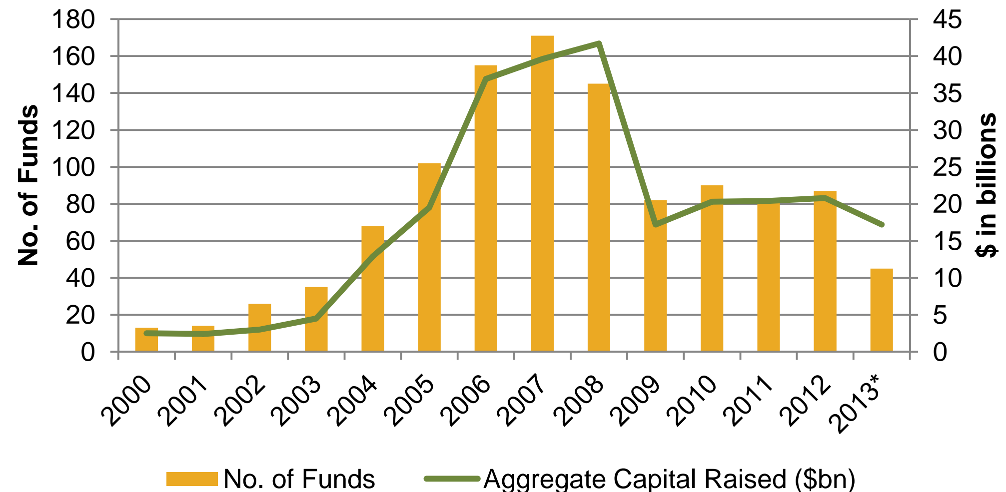
Fundraising Remains at Moderate Levels, Favoring Domestic Funds

Thus far in 2013 investors have stayed home, with more fundraising in the U.S. than for non-U.S. funds. PE fundraising in 2013 in the U.S. and abroad is not on track yet to eclipse 2012 fundraising totals.

Dry powder worldwide increased substantially from 2003 – 2007, as fundraising outgrew the ability to deploy capital at investors' required returns. Dry powder has remained at slightly over $150 billion every year since then, although some of this could have been used to restructure deals.







** Private equity cash reserves held to fund future obligations*

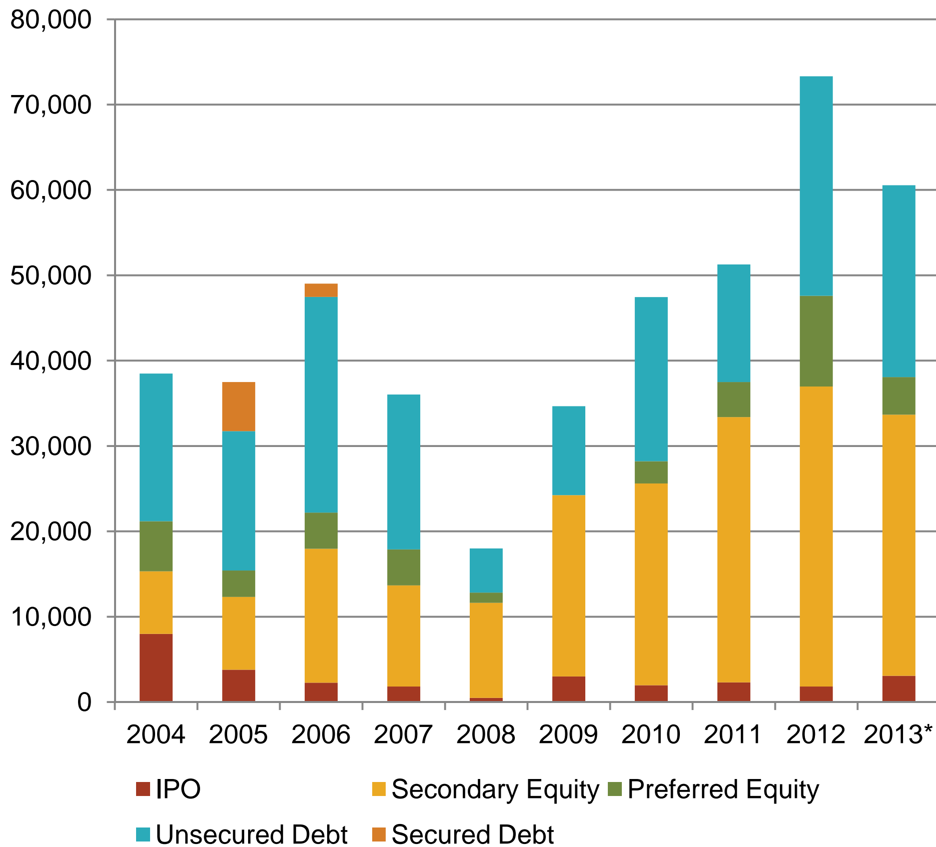
Source: Preqin

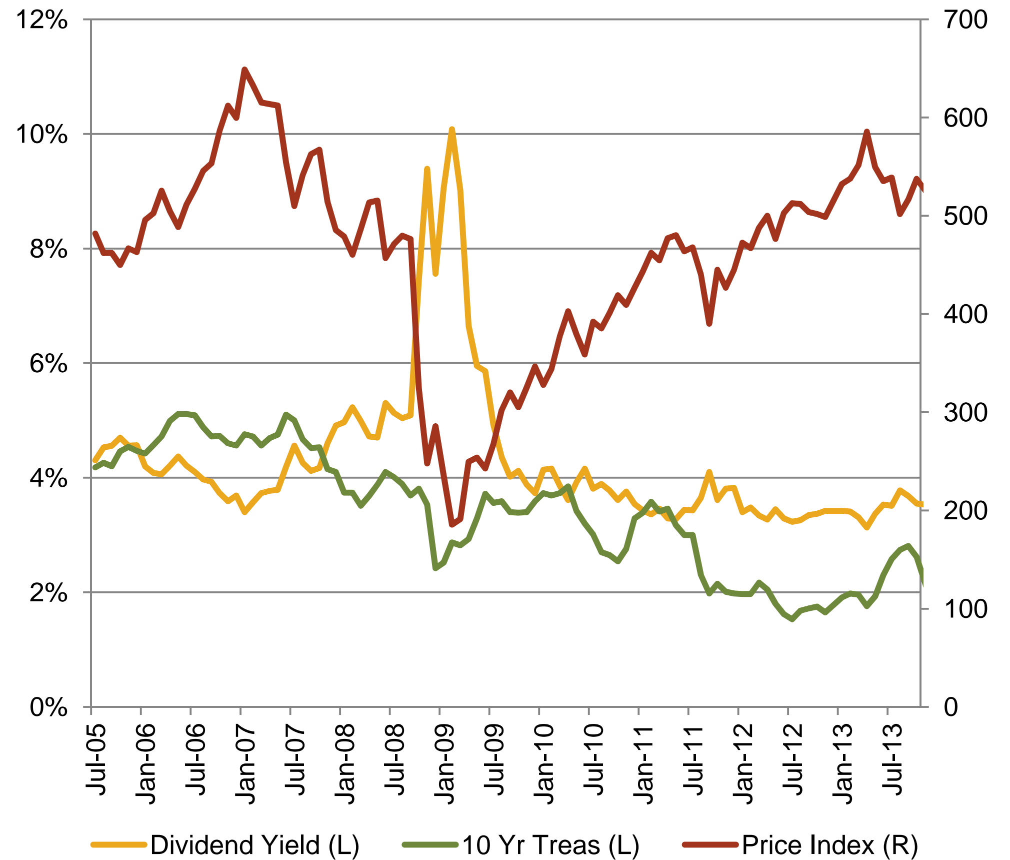
RCLCO

REIT Offerings Near All-Time High

The 10-year Treasury yield recently reversed the summer spike upwards, and treasury yields remain historically low. Public markets responded with some recent improvement in REIT prices.

REIT offerings in 2012 were at an all-time peak level, and 2013 appeared poised to eclipse 2012 totals, but have since come off slightly.





*2013 is as of November 1
Source: SNL; NAREIT

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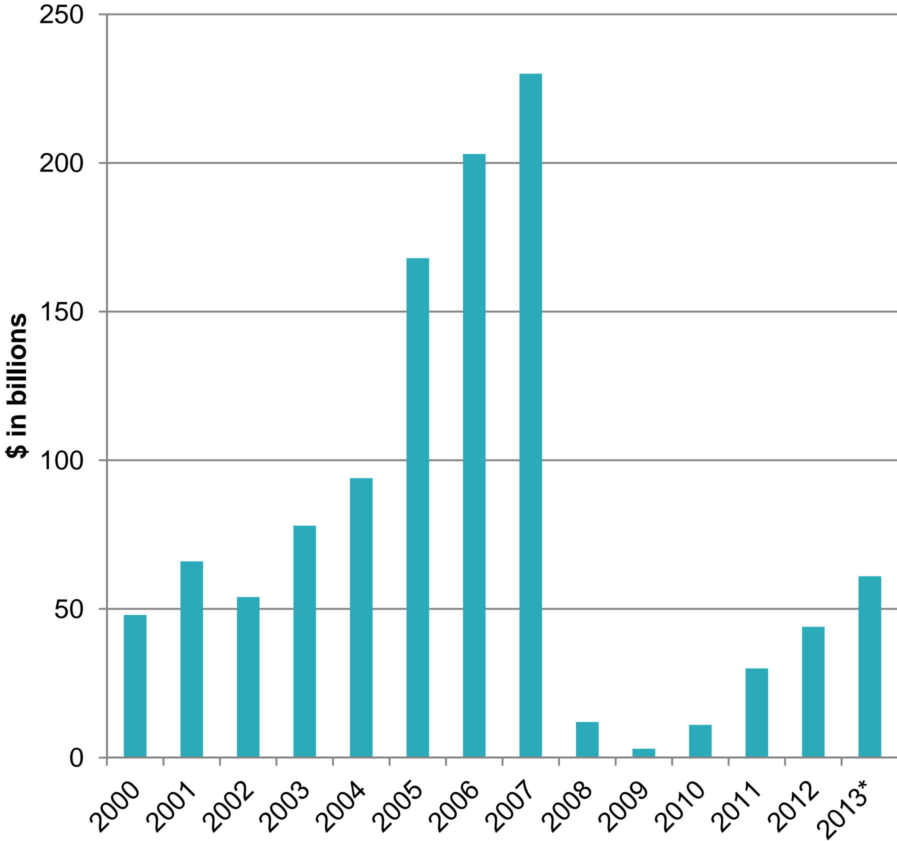
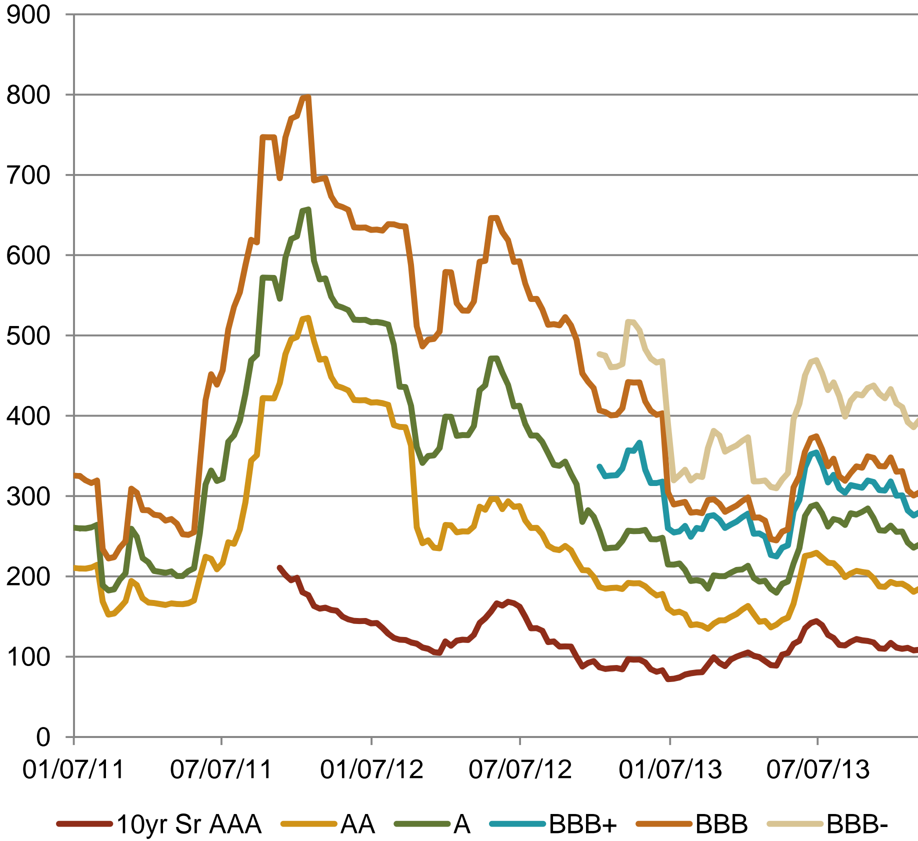
CMBS Market Slowly Recovers

The CMBS market continues to recover, albeit slowly, forecasted at $61 billion for 2013—nearly a 40% increase from 2012 totals. After spiking in the summer, CMBS spreads have moved downward again, reflecting generally positive property fundamentals.





*2013 Is forecasted from October onwards

Source: CRE Finance Council, JP Morgan

Retail Leads Returns

Hotels, not surprisingly, were the hardest-hit sector during the downturn of 2008 – 2009, but perhaps the most surprising asset class is retail, having not dropped as precipitously during the downturn and maintaining solid growth during the rebound. This is primarily a reflection of Class A malls in the database.

NCREIF Total Returns

40%
30%
20%
10%
0%
-10%
-20%
-30%

1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013*

Hotel
Apartment
Retail
Industrial
Office

Source: NCREIF

Price Recovery Focused in Major Markets

Major markets have consistently sold at a premium to non-major markets since the turn of the cycle, and the delta between the two is increasing as investors make their flight to quality in this post-recession landscape. The unusually large gap may present investment opportunities in non-major markets if investors can get comfortable with lease-up risk.

Moody's/RCA CPPI Index

225
200
175
150
125
100
75

Dec-00 Dec-01 Dec-02 Dec-03 Dec-04 Dec-05 Dec-06 Dec-07 Dec-08 Dec-09 Dec-10 Dec-11 Dec-12

National All-Property | Major Markets | Non-Major Markets

Source: RCA; Moody's Analytics

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