DLA Piper Rudnick Gray Cary
2005 “State of the Market” Real Estate Survey

September 2005

DLA PIPER RUDNICK GRAY CARY

Executive Summary

"This should be another 'Goldilocks' year for real estate – not too hot, not too cold."

This comment, obtained from a respondent to DLA Piper's 2005 "State of the Market" Real Estate Survey, encapsulates the attitude expressed by a majority of participating executives. While the current "boom" occurring within the U.S. commercial real estate market is not necessarily expected to continue at its current pace, there is continued optimism throughout the industry for the coming year as most predict a "plateau" but not necessarily a downturn.

Highlights of DLA Piper's 2005 survey include:

- Cautious optimism among survey respondents exists for the coming year as 97 percent of respondents predict either a "continued boom" or flattening of the current real estate investment market despite rampant external discussion of a real estate "bubble."

- Multifamily continues to serve as the most attractive real estate investment opportunity in the coming year as 36 percent of survey respondents chose multifamily over other investment options.

- Respondents associated a positive view of the current U.S. economy with continued optimism regarding the U.S. commercial real estate market. A large majority of respondents (62 percent) cited the continued growth of the economy as the primary reason for their confidence in the commercial real estate market.

- The strength of the economy and the status of interest rates continue to serve as the two most important factors in the confidence or lack thereof for survey respondents.

- While a majority of respondents (76 percent) view inbound foreign investment as good for the U.S. commercial real estate market, most respondents (75 percent) have not been influenced by inbound foreign investment in their investment strategies.

- Despite a feeling that interest rates in both the short- and long-term will rise, a majority of respondents (60 percent) predicted that cap rates will hold steady over the next 6 to 12 months. We believe that this data indicates that cap rates are being driven by supply and demand rather than interest rates.

- Despite the fact that only 22 percent of respondents describe themselves as concerned or slightly concerned regarding their 12-month outlook on the U.S. commercial real estate market, there were more "bears" (53 percent) than "bulls" (44 percent) among our survey respondents.

Verbatims

Respondents were asked to share their thoughts on the U.S. commercial real estate market in an open forum for comment and feedback. The following represent select verbatims received from survey respondents.

- *This should be another "Goldilocks" year for real estate – not too hot, not too cold.*
- *Capital overflow has caused terrible underwriting by both equity and debt…period.*
- *Are developers building to meet the shelter needs of people and their businesses and possessions, or are they building to meet the needs of investors? The economy can be terrific, but we can still overbuild, leading to low occupancy rates, falling rents and weak values.*
- *When capital rotates out of real estate and cap rates move up, there is going to be a lot of stress in the market. I would guess that we are 2 to 3 years [away] from that happening.*
- *In several markets, we have witnessed a return to "spec" development, not in response to increasing demand, but to meet the investment needs of capital sources, resulting in a concern on the supply side.*
- *The risk premium for every asset class appears to be as narrow as it's ever been and thus all investors, in all asset classes, are probably facing lower returns than they underwrote going forward.*
- *There is now an important newer risk category "media hype risk". With ever more time and space to fill, many media channels are hyping one form or another of real estate collapse. It can, to a degree, become a self-fulfilling prophesy.*
- *Can cap rates decline further pushing values yet higher? It's certainly possible if interest rates trickle even lower reflecting a weak economy. More likely, RE values have reached an apogee, but the question is what lies ahead? a plateau? a very gradual downslope?, or a ski run? Raise your glass to a flat traverse followed by a green slope - no need for a helmet.*

2005 "State of the Market" Survey Results

Respondents were asked to complete a short questionnaire designed to measure attitudes and perspectives on the future of the U.S. commercial real estate market. The following charts represent the collective input of 258 respondents to the survey, a 10 percent response rate. A full overview of the survey methodology can be found at the end of this report.

1. Within the next 12 months, is the U.S. commercial real estate investment market most likely to experience a:

Responses	Total	Percentage of total respondents	%
Continued Boom	69		26.74%
Bust	7		2.71%
Flatten Out	182		70.54%
(Did not answer)	0		0%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Cautious optimism among survey respondents exists for the coming year as 97 percent of respondents predict either a "continued boom" or flattening of the current real estate investment market despite rampant discussion of a real estate "bubble."

- With this in mind, it is interesting and somewhat surprising to note that 27 percent of respondents predict a "continued boom."

2. Which of the following sectors do you think presents the most attractive opportunities for real estate investors in the coming year? Please pick one:

Responses	Total	Percentage of total respondents	%
Retail	39		15.12%
Downtown office	24		9.30%
Suburban office	31		12.02%
Multifamily	93		36.05%
Industrial	26		10.08%
Hotel	38		14.73%
(Did not answer)	7		2.71%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Multifamily continues to serve as the most attractive real estate investment opportunity in the coming year as 36 percent of survey respondents chose multifamily over other investment options.

- This view is consistent with DLA Piper's 2004 survey in which multifamily was also the most attractive investment opportunity according to respondents, followed closely by retail and hotel.

3. Which of the following sectors do you think is the weakest investment in the coming year. Please pick one:			
Responses	**Total**	**Percentage of total respondents**	**%**
Retail	36		13.95%
Downtown office	78		30.23%
Suburban office	59		22.87%
Multifamily	34		13.18%
Industrial	20		7.75%
Hotel	26		10.08%
(Did not answer)	5		1.94%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- In a trend that is consistent with question 2, respondents view the downtown and suburban office markets as the weakest investment opportunity over the next 12 months.

- We believe that the data supports a nationwide trend of weak office markets due to oversupply and limited demand with a few exceptions such as Washington, D.C. and New York City.

4. How would you describe your 12-month outlook for the U.S. commercial real estate market?			
Responses	**Total**	**Percentage of total respondents**	**%**
Confident	38		14.73%
Somewhat Confident	115		44.57%
Neutral	47		18.22%
Somewhat Concerned	49		18.99%
Concerned	9		3.49%
(Did not answer)	0		0%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Consistent with question 1, a majority of survey respondents (59 percent) are confident or somewhat confident in their 12-month outlook of the U.S. commercial real estate market. Only 22 percent described their outlook as concerned or somewhat concerned.

- Of those respondents who described their outlook as confident or somewhat confident, 97 predicted a “continued boom” in question 1 of the survey.

- Respondents who anticipate a flattening of the market in question 1 are almost equally divided in their view of the overall market -- 48 percent were either confident or somewhat confident and 59 percent were concerned or somewhat concerned – suggesting that respondents are split as to whether the flattening of the market is a positive or negative trend.

5. What is the primary reason for your confidence?			
Responses	**Total**	**Percentage of total respondents**	**%**
Continued growth of the U.S. economy	94		61.84%
Continued foreign investment in U.S. market	18		11.84%
Resurgence/strength in secondary U.S. real estate markets	14		9.21%
Industry has learned from mistakes made in the early 90's	9		5.92%
Other	17		11.18%
(Did not answer)	106		
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Respondents associated a positive view of the current U.S. economy with continued optimism regarding the U.S. commercial real estate market. A large majority of respondents (62 percent) cited the continued growth of the economy as the primary reason for their confidence in the commercial real estate market.

- Note that this question was made available only to those respondents who described their outlook as positive or somewhat positive. For this reason, the question was not applicable to 106 of our survey respondents.

6. Which of the following factors has the greatest impact on your confidence (or lack thereof) in the U.S. commercial real estate market? Please pick one:			
Responses	**Total**	**Percentage of total respondents**	**%**
Interest rates	70		27.13%
Economic/job growth	109		42.25%
Inbound foreign investment	7		2.71%
Stock market	6		2.33%
Performance of alternative investments (e.g. treasuries)	35		13.57%
Increasing costs (e.g. construction, energy)	30		11.63%
(Did not answer)	1		0.39%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- The strength of the economy and the status of interest rates continue to serve as the two most important factors in the confidence or lack thereof for survey respondents.

- Of those respondents who described their 12-month outlook on the U.S. commercial real estate market as confident or somewhat confident:
  - 24% indicated interest rates have the greatest impact on their confidence
  - 42% indicated economic/job growth
  - 21% cited the performance of alternative investments

- Of those respondents who described their 12-month outlook on the U.S. commercial real estate market as “somewhat concerned” or “concerned:”
  - 39% indicated interest rates have the greatest impact on their concern
  - 39% indicated economic/job growth
  - 12% cited increasing costs

- While survey respondents appear to agree on the key factors that influence their outlook (interest rates and economic/job growth), there is disagreement as to how those factors will evolve over the next 12 months.

7. What actions are your firm and/or your clients taking in order to hedge against a possible down-turn? Check all that apply.			
Responses	**Total**	**Percentage of total respondents**	**%**
Investing in Class A, institutional grade assets	39		15.12%
Diversification within real estate	74		28.68%
Diversification outside of real estate	27		10.47%
Pursuing outbound international investment	16		6.20%
Taking a patient investment approach	128		49.61%
No action	36		13.95%
(Did not answer)	7		2.71%
Total Responses	**327**	**20% 40% 60% 80% 100%**	
(Multiple answers per participant possible. Percentages added may exceed 100 since a participant may select more than one answer for this question.)			

- While a portion of survey respondents indicated that they are investing in class A institutional grade assets (15 percent) or are diversifying their real estate portfolios (29 percent), a majority of respondents are simply “staying the course” (50 percent) by taking a patient investment approach to hedge against a possible downturn.

8. Is inbound foreign investment good or bad for the U.S. commercial real estate market?			
Responses	**Total**	**Percentage of total respondents**	**%**
Good	196		75.97%
Bad	11		4.26%
Neutral	47		18.22%
(Did not answer)	4		1.55%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

9. Has inbound foreign investment significantly influenced your investment strategy?			
Responses	**Total**	**Percentage of total respondents**	**%**
Yes	54		20.93%
No	194		75.19%
(Did not answer)	10		3.88%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- While a majority of respondents (76 percent) view inbound foreign investment as good for the U.S. commercial real estate market, most respondents (75 percent) have not been influenced by inbound foreign investment in their investment strategies.

- This trend is consistent with the data captured in question 6 which notes that inbound foreign investment has had minimal impact on respondents confidence, or lack thereof, in the U.S. commercial real estate market as only 3 percent of respondents chose that option.

10. Where do you think short-term interest rates are headed in the next six months?

Responses	Total	Percentage of total respondents	%
Up Significantly	26		10.08%
Up Slightly	211		81.78%
No Change	17		6.59%
Down Slightly	3		1.16%
Down Significantly	0		0%
(Did not answer)	1		0.39%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

11. Where do you think long-term interest rates are headed in the next 12 months?

Responses	Total	Percentage of total respondents	%
Up Significantly	32		12.40%
Up Slightly	189		73.26%
No Change	32		12.40%
Down Slightly	4		1.55%
Down Significantly	0		0%
(Did not answer)	1		0.39%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- A majority of respondents predict that both short- and long-term interest rates will increase slightly within the next 12 months.

12. Where do you think cap rates are headed in the next 6 to 12 months?			
Responses	**Total**	**Percentage of total respondents**	**%**
Up	89		34.50%
No significant change	154		59.69%
Down	10		3.88%
(Did not answer)	5		1.94%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Despite a feeling that interest rates in both the short- and long-term will rise, a majority of respondents (60 percent) predicted that cap rates would hold steady over the next 6 to 12 months.

- We believe this data indicates that cap rates are being driven by supply and demand rather than interest rates, which play a smaller factor in pricing.

13. How would you describe your perspective on investment opportunities in the coming year?			
Responses	**Total**	**Percentage of total respondents**	**%**
Bullish	113		43.80%
Bearish	137		53.10%
(Did not answer)	8		3.10%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Despite the fact that only 22 percent of respondents describe themselves as concerned or slightly concerned regarding their 12-month outlook on the U.S. commercial real estate market, there were more “bears” (53 percent) than “bulls” (44 percent) in our survey respondents.

- While more survey respondents described themselves as “bearish” regarding investment opportunities in the coming year, there were a significant number of respondents who described themselves as “bullish.” This, despite the fact that a majority of respondents predicted the market would flatten out over the next 12 months.

14. What types of investors do you expect to be most active in the U.S. in the coming year?			
Responses	**Total**	**Percentage of total respondents**	**%**
Pension funds	69		26.74%
Private equity	103		39.92%
REITs	31		12.02%
Insurance companies	6		2.33%
Foreign investors	43		16.67%
(Did not answer)	6		2.33%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Consistent with the data obtained in our 2004 survey, respondents continue to predict that private equity and pension funds will be the most active investors in the coming year.

15. Which of the following factors do you think has the greatest effect on the long term outlook for real estate investment and development?			
Responses	**Total**	**Percentage of total respondents**	**%**
Security issues	6		2.33%
Continued outsourcing of jobs to overseas markets	9		3.49%
Movement in interest rates	67		25.97%
Economic/job growth	174		67.44%
(Did not answer)	2		0.78%
Total Responses	**258**	**20% 40% 60% 80% 100%**	

- Consistent with data obtained in the 2004 survey, economic/job growth and movement in interest rates continue to serve as the leading factors in respondents' long-term view of the real estate investment and development market.

- Also consistent with data obtained in 2004, respondents continue to show little concern for the potential impact of security issues on the investment and development market.

Methodology

In September of 2005, DLA Piper Rudnick Gray Cary distributed a survey via e-mail to 2,500 top executives within the real estate industry, including CEO's, COO's, CFO's and other senior executives. The survey was completed by 258 respondents, representing a 10 percent response rate. The survey coincides with DLA Piper's 2005 Global Real Estate Summit held in Chicago on September 20, 2005 and is attended by many of the executives included in the survey.

It is important to note that the survey was completed by most participants prior to the devastation caused by Hurricane Katrina. Therefore, any influence the hurricane has had on respondents' outlook on the commercial real estate industry is not reflected in these results.

Question 5 was only made available to those respondents who described themselves as "confident' or "somewhat confident" in question 4.

Due to rounding, all percentages used in all questions may not add up to 100 percent.