DLA Piper 2007 "State of the Market" Real Estate Survey

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Executive Summary

"No deal is too big."

In the words of one respondent to DLA Piper's 2007 "State of the Market" Real Estate Survey, this comment illustrates how cautious optimism – which defined the U.S. commercial real estate market for much of the last decade – has given way to a new type of exuberance as current pricing and abundant capital flows have fostered an insatiable demand for real estate assets.

As in years past, DLA Piper surveyed leading real estate industry executives to gauge their perspectives and attitudes related to the current state of the U.S. Commercial Real Estate Market in preparation for its seventh Global Real Estate Summit.

Highlights of DLA Piper's 2007 survey include:

- 78 percent of respondents describe their 12-month outlook for the U.S. commercial real estate industry as "bullish," up from 43 percent in 2005*.
- Consistent with DLA Piper's 2004 and 2005 surveys, a large majority of respondents cited the continued growth of the U.S. economy as the primary reason for their confidence in the commercial real estate market.
- Nine out of 10 respondents expect that the public-to-private M&A trend will continue in the coming year, a conclusion strongly held by both public (88 percent) and private (92 percent) companies alike.
- Survey respondents recognize that a confluence of key factors is driving the record number of public-to-private deals, including private equity funds willing to pay a premium for real estate assets, cheap rates in the debt market and the public markets undervaluing REITs.
- Nearly half of respondents (44 percent) expect the public-to-private M&A trend will create more opportunities for companies other than the "large" players.
- China and India ranked as the most attractive markets outside the U.S. for international investment trailed slightly by both Eastern and Western Europe.
- Respondents expect private equity, pension funds and foreign investors to be the most active real estate investors in the U.S. during the coming year.
- Despite the greatest cap rate compression in the history of the U.S. commercial real estate industry, 10 percent of respondents believe cap rates will dip further into historic lows while 72 percent do not expect any significant changes.

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*Data furnished from DLA Piper's 2005 "State of the Market" Real Estate Survey, released in September of 2005.

Verbatims

Respondents were asked to share their thoughts on the following question in an open forum for comment and feedback. The following represent select verbatims received from survey respondents.

On the heels of the Blackstone/Equity Office transaction, what impact do you believe the public-to-private M&A trend will have on the real estate market in the coming year?

- *Increased consolidation generally brings with it compressed margins and, in the short run, limited market supply. The field will belong to the large players in this phase. However this phase will end and the market will again broaden, though perhaps not until '08 or '09.*

- *Continued demand for big transaction of quality assets in key markets, which may continue to drive down cap rates irrespective of property economics.*

- *Spur sales of additional assets to capitalize on potentially premium pricing. Push to hold/drive up rents to make those big bets work.*

- *It will be paradoxical. On one hand, consolidation will lead to less opportunities in certain markets and in other markets, portfolios will be broken up resulting in more opportunities.*

- *Many will follow but as we approach a presidential cycle, the possibility of change will be tempered by "an inconvenient reality."*

- *Rents being set by "inflated" property values are not sustainable. Reminds of the tech bubble.*

- *Remaining REIT shares should increase in value due to scarcity. Private property values will continue to be high due to ongoing demand from private capital and availability of debt. More single-asset and small portfolio sales as private entities will prune portfolios.*

- *It will serve to increase activity in the near term as any public company is now fair game to be taken private.*

- *Someone will get caught overpaying on these assets.*

- *Look for more firms to consider going "public" in the coming years to capitalize on the shortage of good public REITs.*

- *Upward pressure on prices will make new construction more competitive, leading to excessive development, higher vacancies, and the next down cycle.*

- *It will embolden the lending market to bear more risk and increase development/construction financing.*

2007 "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 274 respondents to the survey, an 11.5 percent response rate. A full overview of the survey methodology can be found at the end of this report.

1. Which of the following factors is driving the record number of public-to-private deals? Please rank in order of importance with 1 being most important:							
Responses	**Rank 1**	**Rank 2**	**Rank 3**	**Rank 4**	**Rank 5**	**Rank 6**	**Weighted Rank (Score)**
Private equity funds willing to pay a premium	107	59	36	15	28	14	1 (1196)
Cheap rates in the debt market	51	63	57	36	30	23	2 (1040)
Public markets undervaluing REITs	43	47	42	35	51	39	3 (907)
Regulatory hurdles and administrative costs associated with being a public REIT	26	41	35	49	50	57	4 (805)
Ease and speed of completing transactions as a private company	15	25	51	73	55	40	5 (788)
Increased demand for real estate exposure to diverse portfolios	19	29	38	51	41	81	6 (727)
(Did not answer)							11
Total Responses							**274**

- Survey respondents recognize that a confluence of key factors are driving the record number of public-to-private deals, led by a combination of private equity funds willing to pay a premium for real estate assets, cheap rates in the debt market and public markets undervaluing REITs.

- As summarized by one respondent: *"The M&A trend is driven by cheap debt and private equity liquidity. These will continue to have a positive impact on commercial real estate."*

Note: To calculate the weighted rank (score), selections were ranked 1-6 using an inverse weighted scale that valued each response as follows:

- 1 – 6 points
- 2 – 5 points
- 3 – 4 points
- 4 – 3 points
- 5 – 2 points
- 6 – 1 point

2. Do you expect the public-to-private M&A trend to continue during the next 12 months?			
Responses	**Total**	**%**	**Percentage of total respondents**
Yes	247	90.15%	
No	16	5.84%	
(Did not answer)	11	4.01%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- Nine out of 10 respondents expect that the public-to-private M&A trend will continue in the coming year, a conclusion strongly held by respondents from both public (88 percent) and private (92 percent) companies alike*.

- According to one respondent: "*Public-to-private deals will continue for 1-2 more years, then be flat for 1-2 years, and then reverse to private-to-public.*"

- Another respondent suggested: *"It will continue the voracious appetite to do more deals. REITs will probably become the subject of more takeovers as investors seek to unlock their values."*

<u>*Note:</u> Public and private company data were calculated via cross tabulation to responses from question No. 14.

3. In the coming year, how will continued consolidation impact the number of opportunities for companies other than the large players?			
Responses	**Total**	**%**	**Percentage of total respondents**
Create more opportunities	121	44.16%	
Create less opportunities	66	24.09%	
No change	76	27.74%	
(Did not answer)	11	4.01%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- Despite a forecast for continued consolidation, nearly half of respondents (44 percent) believe it will create more opportunities for smaller companies, while 28 percent believe it will have no impact.

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5. Which of the following international markets/regions outside of the U.S. are most attractive for investment during the next 12 months? Please rank in order of importance with 1 being most attractive:									
Responses	**Rank 1**	**Rank 2**	**Rank 3**	**Rank 4**	**Rank 5**	**Rank 6**	**Rank 7**	**Rank 8**	**Weighted Rank (Score)**
China	63	56	29	18	14	10	9	2	1 (1266)
India	45	43	33	23	19	21	10	5	2 (1138)
Eastern Europe	18	28	44	32	33	23	13	7	3 (998)
Western Europe	38	18	23	30	34	17	22	18	4 (967)
Mexico	22	17	22	32	23	44	24	13	5 (872)
Central/South America	11	20	22	19	33	27	28	33	6 (757)
Russia	4	8	18	28	22	31	49	36	7 (651)
Middle East	6	13	12	16	16	20	40	73	8 (568)
Total Responses									**274**

- Respondents ranked China and India as the most attractive international markets for investment, trailed slightly by both Eastern and Western Europe.

- Exploring new opportunities for growth, respondents also indicated that they are turning their attention to emerging markets such as Central/South America, Russia and the Middle East, which are beginning to build favor with investors.

Note: To calculate the weighted rank (score), selections were ranked 1-6 using an inverse weighted scale that valued each response as follows:

- 1 – 6 points
- 2 – 5 points
- 3 – 4 points
- 4 – 3 points
- 5 – 2 points
- 6 – 1 point

6. 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**
Hotel	38	13.87%	
Industrial	30	10.95%	
Multifamily	70	25.55%	
Office - Downtown	62	22.63%	
Office - Suburban	26	9.49%	
Retail	38	13.87%	
(Did not answer)	10	3.65%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- Despite economic concerns throughout the residential real estate market, multifamily continues to be the most attractive real estate investment opportunity in the coming year as 26 percent of survey respondents chose multifamily over other investment options.

- Fueled by aggressive pricing and record levels of private equity investment, the appeal of the downtown office sector in the coming year climbed to 23 percent, up from 9 percent in 2005.

  - With this in mind, the downtown office market continues to experience its strongest resurgence since the Sept. 11th terrorist attacks and is approaching a full recovery.

  - Bullish respondents think that the downtown office market (24 percent) is the most attractive, while bearish respondents more heavily favor multifamily (35 percent).

7. 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**
Hotel	25	9.12%	
Industrial	31	11.31%	
Multifamily	48	17.52%	
Office - Downtown	46	16.79%	
Office - Suburban	61	22.26%	
Retail	49	17.88%	
(Did not answer)	14	5.11%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- In a trend consistent with responses from question No. 6, respondents view the suburban office market as the weakest investment opportunity over the next 12 months.

8. How would you describe your 12-month outlook for the U.S. commercial real estate market?			
Responses	**Total**	**%**	**Percentage of total respondents**
Bullish	214	78.10%	
Bearish	59	21.53%	
(Did not answer)	1	0.36%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- 78 percent of respondents are “bullish” on the 12-month outlook for the U.S. commercial real estate market, up from 43 percent in 2005.

- This data supports a broader comfort level with commercial real estate investments built upon the perception that there is an overabundance of capital, cheap debt and a near insatiable desire to deploy this capital quickly.

9. What is the primary reason for your confidence?			
Responses	**Total**	**%**	**Percentage of total respondents**
Continued growth of the U.S. economy	100	47.85%	
Continued foreign investment in U.S. market	43	20.57%	
Resurgence/strength in secondary U.S. real estate markets	29	13.86%	
Industry has learned from mistakes made in the early 90's	19	9.09%	
Other	23	11.00%	
Total Responses	**214**		**20% 40% 60% 80% 100%**

- Consistent with DLA Piper's 2004 and 2005 surveys, a large majority of respondents (48 percent) cited the continued growth of the U.S. economy as the primary reason for their confidence in the commercial real estate market.

- Optimism was also buoyed by continued foreign investment, which 21 percent of respondents cited as their primary reason for confidence in the commercial real estate market, compared to 12 percent in 2005.

Note: This question was made available only to those respondents who described their outlook as "bullish." For this reason, the question was not applicable to 60 of our survey respondents.

10. What is the primary reason for your lack of confidence?			
Responses	**Total**	**%**	**Percentage of total respondents**
Economic/job growth	24	40.68%	
Inbound foreign investment	1	1.70%	
Increasing costs (e.g. construction, energy)	19	32.20%	
Interest rates	6	10.17%	
Performance of alternative investments (e.g. treasuries)	6	10.17%	
Stock market	1	1.70%	
Total Responses	**57**		**20% 40% 60% 80% 100%**

- The majority of both "bullish" and "bearish" respondents cite U.S. economic growth (or lack thereof) as the primary reason for their divergent viewpoints on the U.S. commercial real estate market.

- Among the "bears," increasing costs relative to construction and energy rose sharply to 32 percent, up from 12 percent in 2005.

- Only 10 percent of respondents who hold a "bearish" outlook for the U.S. commercial real estate market attribute their outlook to interest rate concerns, down from 39 percent in 2005.

Note: This question was made available only to those respondents who described their outlook as "bearish." For this reason, the question was not applicable to 214 of our survey respondents.

11. 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**
Foreign investors	35	12.77%	
Insurance companies	3	1.09%	
Pension funds	47	17.15%	
Private equity	167	60.95%	
REITs	10	3.65%	
(Did not answer)	12	4.38%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- Given their expectation for continued consolidation, it is not surprising that respondents expect private equity (61 percent), pension funds (17 percent) and foreign investors (13 percent) to be the most active real estate investors in the U.S. during the coming year.

- Tempering their expectations for REITs during the current public-to-private trend, just 4 percent of respondents believe REITs will be the most active real estate investors in the coming year, compared with 12 percent in 2005.

12. Where do you think cap rates are headed in the next 6 to 12 months?			
Responses	**Total**	**%**	**Percentage of total respondents**
Up	45	16.42%	
No significant change	197	71.90%	
Down	26	9.49%	
(Did not answer)	6	2.19%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- Despite the greatest cap rate compression in the history of the U.S. real estate industry, 10 percent of respondents believe cap rates will dip further into historic lows while 72 percent do not expect any significant changes.

- Cap rates have proven difficult to predict. In 2005, only 4 percent of respondents predicted the recent downward trend while 90 percent believed cap rates were headed up or wouldn't experience a significant change.

13. Where do you think interest rates are headed in the next six months?			
Responses	**Total**	**%**	**Percentage of total respondents**
Up Significantly	3	1.09%	
Up Slightly	144	52.55%	
No Change	88	32.12%	
Down Slightly	34	12.41%	
Down Significantly	0	0%	
(Did not answer)	5	1.82%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

- Consistent with speculation that the Federal Reserve is now more likely to raise interest rates than cut them, 53 percent of respondents think interest rates will move "up slightly."

14. Which of the following best describes your organization?			
Responses	**Total**	**%**	**Percentage of total respondents**
Publicly traded	49	17.88%	
Private (including pension funds, private equity funds, etc.)	218	79.56%	
(Did not answer)	7	2.55%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

15. In which market are you located?			
Responses	**Total**	**%**	**Percentage of total respondents**
Boston	21	7.66%	
Chicago	125	45.62%	
Dallas/Fort Worth	1	0.36%	
Houston	2	0.73%	
Los Angeles	18	6.57%	
New York	19	6.93%	
San Francisco Bay Area	11	4.01%	
Washington, D.C.	37	13.50%	
Other (please specify)	30	10.95%	
(Did not answer)	10	3.65%	
Total Responses	**274**		**20% 40% 60% 80% 100%**

Methodology

In April of 2007, DLA Piper distributed a survey via e-mail to 2,400 top executives within the real estate industry, including CEO’s, COO’s, CFO’s and other senior executives. The survey was completed by **274 respondents**, representing an **11.5 percent** response rate. The survey coincides with DLA Piper’s 2007 Global Real Estate Summit held in Chicago on May 1, 2007 and is attended by many of the executives included in the survey.

Question No. 9 was only made available to those respondents who described themselves as “bullish” in question 8.

Question No. 10 was only made available to those respondents who described themselves as “bearish” in question 8.

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