DLA PIPER GLOBAL REAL ESTATE SUMMIT 2008

DLA PIPER STATE OF THE MARKET SURVEY

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EVERYTHING MATTERS

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Executive Summary

"Bigger than the savings and loan crisis."

The recent tidal wave of unprecedented events on Wall Street – including Lehman Brothers' bankruptcy, the federal government's bailout of AIG, Fannie Mae and Freddie Mac, and Bank of America's purchase of Merrill Lynch – is creating a sea change in the markets. Accordingly, respondents to DLA Piper's 2008 "State of the Market" Real Estate Survey report that the current credit crisis has now had a greater impact on the US commercial real estate market than the devastating savings and loan crisis of the late '80s and early '90s.

Simply put, financing – or the lack thereof – remains the chief concern of respondents as they flooded the survey with concerns over the availability of credit and debt.

Frustrated with the ongoing credit crisis that continues to reshape the financial markets, real estate executives are expressing a new record level of bearish sentiment as they continue to be reminded of the cyclical nature of the industry after nearly a decade of prosperity. However, even with the expected recovery further out than many would have predicted even six months ago, respondents still see opportunity in the current market environment.

Highlights of DLA Piper's 2008 survey include:

- Following the recent developments at Lehman Brothers, AIG and Merrill Lynch, the majority of respondents (60 percent) report that the current credit crisis has now eclipsed the savings and loan crisis of the late '80s and early '90s as the event with the single-greatest impact on the commercial real estate industry during the past 20 years.
- Interestingly, prior to the events of early September, the majority of respondents said that the savings and loan crisis was the event with the greatest impact on the real estate industry. Sentiment changed in a follow-up survey conducted after Lehman Brothers filed for bankruptcy. (Please see methodology for further details on this follow-up survey).
- Building upon this sentiment, 8 out of 10 respondents do not believe that the recent developments concerning Lehman Brothers, AIG and Merrill Lynch signal the "bottom" of the cycle, nor do respondents think they provide the "first sign of light" at the end of the credit crisis tunnel.
- In terms of the Lehman Brothers' bankruptcy, the overwhelming majority of respondents (96 percent) agree with the federal government's decision not to bail out the prominent investment bank.
- A record 9 out of 10 respondents (90 percent) describe themselves as "bearish," up from 68 percent in October 2007 when DLA Piper last surveyed the market in its 2007 "Credit Crunch" Real Estate Survey, and of these respondents, 71 percent attribute this to continued fallout from the credit crisis.

- Consistent with this outlook, the overwhelming majority of industry executives have concluded that the markets will not improve in 2009: The majority of respondents (62 percent) don't expect the real estate markets to stabilize until 2010 and 22 percent don't expect to see stabilization until 2011.
- Two out of three respondents think that John McCain, if elected, is likely to have a more favorable impact on the commercial real estate industry than Barack Obama.
- The majority of respondents don't expect securitized lending to recover and return to its previous market levels until at least 2011, while 16 percent reported that securitized lending will **never** again reach its prior levels.
- The majority of all respondents (51 percent) expect foreign investors to be the most active in the US during the next year and, consistent with that conclusion, nearly one in five respondents has engaged in a transaction involving investments from sovereign-wealth funds.
- In sharp contrast to DLA Piper's 2007 "State of the Market" Real Estate Survey, cap rates and interest rates are expected to move in parallel during the next six months, ending one of the industry's most significant eras of cap rate compression. 60 percent of respondents think interest rates are headed up while 63 percent of respondents think cap rates are also headed up.
- Hotel and retail investment opportunities have fallen out of favor and rank as the least attractive investments during the next 12 months, while multifamily (50 percent) ranks as the most attractive investment opportunity by a wide margin over the downtown office sector (19 percent).

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.

What is the primary challenge you face today with respect to the success of your real estate business?

- *Finding attractive risk-adjusted returns.*
- *Lack of leverage available for transactions. Wait and see attitude of all participants killing activity.*
- *Consumer confidence seems to be really fading fast and that on top of the lack of supply in the credit markets will postpone many development project starts.*
- *Bid/ask disconnect and investor uncertainty.*
- *The demand to create new real estate has rapidly curtailed. Tenants are not looking to expand, so growth has waned and demand for real estate follows into the down cycle.*
- *The perception of real estate as a "damaged" asset class as portrayed by the media and generally accepted by the public as the truth.*
- *Global economic uncertainty and current credit crisis.*
- *Investing committed capital into a rising cap rate environment; we have had the benefit of falling interest rates, falling cap rates and improving real estate markets for almost the entire decade, and now we face a reversal of these conditions.*
- *Cap rates still too low. Lack of mortgage financing at adequate LTV's.*
- *Despite having equity capital to invest, the fear is if property values decline our investment return could be at risk.*
- *The primary challenge in today's market is lack of available debt and increasing spreads between buyer and seller pricing. In some cases, sellers have no choice but to hold assets, as sale pricing would be below in-place debt.*
- *Lack of liquidity, both debt and equity. Gap between buyer/seller expectations.*
- *In the following order these are the primary challenges: The lack of financing for large transactions, looming job losses, and fragile investor confidence.*

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2008 “State of the Market” Survey Results

In late August, respondents were asked to complete a short questionnaire designed to measure attitudes and perspectives on the future of the US commercial real estate market. The following charts represent the collective input of 424 respondents to the survey. A full overview of the survey methodology can be found at the end of this report.

1. How would you describe your 12-month outlook for the US commercial real estate market?

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Bullish	42	9.91%	
Bearish	382	90.09%	
(Did not answer)	0	0%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Nine out of 10 respondents (90 percent) describe themselves as “bearish,” up sharply from 68 percent in October 2007 when DLA Piper last surveyed the market as part of its “Credit Crunch” Real Estate Survey.
- Consequently, only 10 percent of respondents now describe their 12-month outlook as “bullish,” down sharply from 31 percent in October 2007.

2. What is the primary reason for your confidence?

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Expected rebound of the US economy	7	16.66%	
Foreign investment in US market	3	7.14%	
Industry has learned from mistakes made in the early ’90s	2	14.20%	
Investment opportunities created by market correction/credit crunch	21	50.0%	
Abundance of equity capital available for investment	6	14.28%	
Upcoming presidential election	3	7.14%	
Other (please specify)	0	0%	
Total Responses	**42**		**20% 40% 60% 80% 100%**

- The majority of respondents (50 percent) who hold a bullish outlook for the US commercial real estate market cite new investment opportunities created by the market correction/credit crunch (i.e. those likely to be in the distressed debt or opportunity fund markets).

- This is the first time in the history of DLA Piper's "State of the Market" Real Estate Survey, launched in 2004, that the US economy was not the No. 1 reason cited by "bulls" for their optimism.
- **Note:** This question was only made available to those respondents who described their outlook as "bullish." For this reason, the question was not applicable to 382 of our survey respondents.

3. What is the primary reason for your lack of confidence?

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Sluggish economic/job growth	81	21.20%	
Performance of alternate investments (e.g. Treasuries)	0	0%	
Continued fallout from credit crisis (e.g. unfavorable financing terms, lack of available debt, etc.)	272	71.20%	
Equity capital remaining on the sidelines	18	4.71%	
Uncertainty surrounding the future of Fannie Mae and Freddie Mac	10	2.61%	
Other (please specify)	4	1.04%	
Total Responses	**382**		**20% 40% 60% 80% 100%**

- The overwhelming majority of "bearish" respondents attribute their outlook to the continued fallout from the credit crisis (71 percent) – consistent yet up slightly from 2007 when bears also named the credit crunch as the primary reason for pessimism (66 percent).
- Though queried before the federal government's bailout of Fannie Mae and Freddie Mac, respondents indicate the status of Fannie and Freddie was not a primary concern held by those in the US commercial real estate market (3 percent) before the federal government intervened.

Note: This question was only made available to those respondents who described their outlook as "bearish." For this reason, the question was not applicable to 42 of our survey respondents.

4. Where do you think interest rates are headed in the next six months?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Up Significantly	8	1.89%	
Up Slightly	245	57.78%	
No Change	135	31.84%	
Down Slightly	35	8.25%	
Down Significantly	0	0%	
(Did not answer)	1	0.24%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- 60 percent of respondents think interest rates will move "up" in the next six months but the overwhelming majority of this group believes that interest rates will only move "up slightly."

5. Where do you think cap rates are headed in the next six to 12 months?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Up	267	62.97%	
No Significant Change	126	29.72%	
Down	26	6.13%	
(Did not answer)	5	1.18%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Illustrating the uncertainty surrounding property valuations during the past 12 months, the majority of respondents (63 percent) believe cap rates will rise while 30 percent do not expect any significant changes.

6. Given the near-frozen state of the CMBS markets, when do you expect securitized lending transactions to return to the market at prior levels?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
2009	16	3.77%	
2010	139	32.78%	
After 2010 (e.g. 2011, 2012, 2013...etc)	197	46.46%	
Never	69	16.27%	
(Did not answer)	3	0.71%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- The majority of respondents don't expect securitized lending to recover and return to its previous market levels until at least 2011 (47 percent), while 16 percent reported that securitized lending will **never** again reach its prior levels.

- In an apparent show of wishful thinking, however, 4 percent of respondents believe securitized lending will fully recover in 2009.

7. When will the real estate markets stabilize?

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
2009	51	12.03%	
2010	263	62.03%	
2011	94	22.17%	
After 2011	14	3.30%	
(Did not answer)	2	0.47%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Consistent with respondents' bearish outlook, the overwhelming majority of respondents (62 percent) don't expect the real estate markets to stabilize until 2010 and 22 percent don't expect to see stabilization until 2011.
- The credit crisis hangover has lasted much longer for the US commercial real estate market than originally expected. Last October, the overwhelming majority of respondents (61 percent) predicted we would see a recovery by September 2008 – at the latest.

8. Which industry sector do you think presents the most attractive opportunity for real estate investors during the next 12 months? Please pick one.

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Hotel	21	4.95%	
Industrial	53	12.50%	
Multifamily (includes senior housing, assisted living facilities, student housing, etc.)	211	49.76%	
Office-Downtown	79	18.63%	
Office-Suburban	20	4.72%	
Retail	26	6.13%	
(Did not answer)	14	3.30%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Hotel and retail investment opportunities have fallen out of favor and rank as the least attractive investments during the next 12 months, after both sectors ranked third (tie) in 2007.
- Benefiting from the flight of investors from the hotel and retail sectors, multifamily (50 percent) ranks as the most attractive investment opportunity by a wide margin over the downtown office sector (19 percent).

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9. Which of the following international markets/regions outside of the US 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	99	56	52	37	18	18	12	9	1 (1,840)
India	33	71	51	48	47	26	17	8	2 (1,615)
South America	47	50	39	30	37	31	30	37	3 (1,448)
Middle East	52	36	26	34	25	35	45	48	4 (1,337)
Eastern Europe	17	33	41	56	46	46	41	21	5 (1,318)
Latin America	20	26	51	36	60	44	41	23	6 (1,305)
Western Europe	25	18	30	36	39	54	49	50	7 (1,152)
Russia	8	11	11	24	29	47	66	105	8 (821)
(Did not answer)									123
Total Responses									**424**

- Consistent with 2007, respondents rank China and India as the two most attractive international markets for investment but the similarities to this year's results end there.
- Continuing to scour the globe for new opportunities amidst what has become a global credit crisis, respondents have turned their attention to two new regions in particular: South America and the Middle East.
  - Respondents rank South American as the third most attractive international market – up from sixth in 2007.
  - Respondents rank the Middle East the fourth most attractive international market – up from eighth (last place) in 2007.
- After Russia gained ground in 2007 (seventh overall), respondents took note of its recent dispute with the country of Georgia, dropping Russia back into eighth place (last place) by a significant margin.

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

10. What types of investors do you expect to be most active in the US in the coming year?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Foreign Investors	215	50.71%	
Insurance Companies	24	5.66%	
Pension Funds	45	10.61%	
Private Equity	110	25.94%	
REITs	19	4.48%	
(Did not answer)	11	2.59%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Due to the credit crisis and relative weakness of the dollar, it is not surprising that the majority of respondents (51 percent) expect foreign investors to be the most active in the next year – jumping up from 13 percent in 2007 – and trailed by private equity (26 percent) and pension funds (11 percent).
- It is interesting to note that given the current credit conditions, insurance companies remain one of the only sources for loans in the US, and 6 percent of respondents expect to see a resurgence of investment activity from insurance companies – up from 1 percent of respondents in 2007.

11. Have you engaged in any transaction involving investments from sovereign-wealth funds?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Yes	76	17.92%	
No	343	80.90%	
(Did not answer)	5	1.18%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Consistent with the responses to question No. 10 and the expectation that foreign investors will be among the most active in the US in the coming year, nearly one in five respondents report having engaged in a transaction involving investments from sovereign-wealth funds.

12. Which presidential candidate, if elected, is likely to have the most favorable impact on the commercial real estate industry?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
John McCain	284	66.98%	
Barack Obama	129	30.42%	
(Did not answer)	11	2.59%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- Two out of three respondents believe that John McCain, if elected, is likely to have a more favorable impact on the commercial real estate industry than Barack Obama.

13. Are tenants showing a preference for leases in so-called "green" certified buildings?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Yes	248	58.49%	
No	148	34.91%	
(Did not answer)	28	6.60%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

- After receiving much fanfare over the years, the "green" movement has begun to take hold of tenants in the US commercial real estate market as the majority of respondents (59 percent) report that tenants are now showing a preference for leases in green certified buildings.

14. Are tenants willing to pay higher rents to be in "green" certified buildings?			
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Yes	109	45.60%	
No	130	54.39%	
Total Responses	**239**		**20% 40% 60% 80% 100%**

- Despite a strong level of interest in green certified buildings, slightly more than half of respondents (54 percent) indicate that tenants are still not willing to pay a premium in the form of higher rents for leases in these types of buildings.

Note: This question was only made available to those respondents who answered "yes" to question No. 13. For this reason, the question was not applicable to 185 of our survey respondents.

15. Which of the following events has had the largest impact on the state of the real estate industry over the past 20 years? Please rank in order with 1 being the largest impact:					
RESPONSES	RANK 1	RANK 2	RANK 3	RANK 4	WEIGHTED RANK (SCORE)
Savings and loan crisis (1989-1991)	244	129	23	8	1 (1,417)
Current credit crisis (2007-2008)	148	211	38	7	2 (1,308)
September 11th (2001)	9	49	192	154	3 (721)
Russian oil crisis and failure of Long Term Capital Management (1998)	3	15	151	235	4 (594)
(Did not answer)					20
Total Responses					**424**

- Despite their strong bearish sentiment, respondents originally ranked the savings and loan crisis as the event that has had the largest impact on the state of the real estate industry over the past 20 years – followed by the current credit crisis, September 11th terrorist attacks and the Russian oil crisis/failure of Long Term Capital Management in 1999.
- Responses received to this question were submitted prior to the Lehman Brothers' bankruptcy, the federal government's bailout of AIG and Bank of American's purchase of Merrill Lynch, prompting DLA Piper to issue a follow-up survey to examine the impact of those events on this question – the results of which can be found in the "State of the Market" Follow-up Survey section.

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

“State of the Market” Follow-up Survey: The Impact of Lehman, AIG and Merrill

Following the dramatic developments at Lehman Brothers, AIG and Merrill Lynch that began on September 14, DLA Piper issued a brief follow-up survey from September 16 – 17 in order to determine the impact of these events on the US commercial real estate market. 307 respondents completed this addendum to DLA Piper’s 2008 “State of the Market” Real Estate Survey.

1. Given the bankruptcy of Lehman Brothers and the sale of Merrill Lynch to Bank of America during the past weekend, do you believe the current credit crisis has now eclipsed the S&L crisis of 1989-1991 as the event with the greatest impact on the state of the real estate industry over the past 20 years?

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Yes	181	59.73%	
No	122	40.26%	
(Did not answer)	4	0	
Total Responses	**307**		**20% 40% 60% 80% 100%**

- According to the majority of respondents (60 percent), the current credit crisis has eclipsed the savings and loan crisis of 1989-1991 as the event with the greatest impact on the state of the real estate industry during the past 20 years.
- In the earlier survey two weeks prior, respondents concluded that the savings and loan crisis was the event with the largest impact on the state of the real estate industry during the past 20 years – followed by the current credit crisis, September 11th, and the Russian oil crisis/failure of Long Term Capital Management in 1999.

2. Do the troubles surrounding Lehman Brothers, Merrill Lynch and AIG signal the ”bottom” of the cycle and the first sign of light at the end of the credit crisis tunnel?

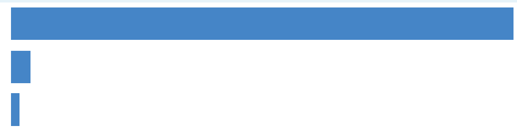
RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Yes	62	20.46%	
No	241	79.54%	
(Did not answer)	4	0	
Total Responses	**307**		**20% 40% 60% 80% 100%**

- Perhaps sharpening their “bearish” outlook even further, 8 out of 10 respondents do not believe that the recent developments at Lehman Brothers, AIG and Merrill Lynch signal the “bottom” of the cycle, nor do respondents think they provide the “first sign of light” at the end of the credit crisis tunnel.

- Consistent with the expectation that the real estate markets will not stabilize until 2010 or 2011, the majority of respondents are clearly not holding out hope for a recovery anytime soon and are instead preparing for more distress in the commercial real estate market linked to the credit crisis.

3. Following the Federal government's decision to bailout Fannie Mae and Freddie Mac, and play a lead role in the Bear Stearns sale to JP Morgan Chase earlier this year, do you agree with the government's decision not to bailout Lehman Brothers?

RESPONSES	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Yes	293	96.07%	
No	12	3.93%	
(Did not answer)	2	0	
Total Responses	307		**20% 40% 60% 80% 100%**



- The overwhelming majority of respondents (96 percent) agree with the federal government's decision not to bail out Lehman Brothers.
- Though heavily debated by the media when announced, the commercial real estate industry strongly agrees with the federal government's decision to let Lehman Brothers fail and not provide the storied investment bank with the type of financial "backstop" that AIG, Fannie Mae and Freddie Mac recently received.

Methodology

In August of 2008, DLA Piper distributed a survey via e-mail to top executives within the real estate industry, including CEO's, COO's, CFO's and other senior executives, which was completed by **424 respondents** (see below for regional breakdown).

Following the dramatic developments at Lehman Brothers, AIG and Merrill Lynch that began on September 14, DLA Piper issued a brief follow-up survey on September 16 in order to determine the impact of these events on the US commercial real estate market. **307 respondents** completed this addendum to DLA Piper's 2008 "State of the Market" Real Estate Survey.

The survey coincides with DLA Piper's 2008 Global Real Estate Summit held in Chicago on September 23, 2008 and is attended by many of the executives included in the survey.

Question No. 2 was only made available to those respondents who described themselves as "bullish" in question 1.

Question No. 3 was only made available to those respondents who described themselves as "bearish" in question 1.

Question No. 14 was only made available to those respondents who responded "yes" to question No. 13.

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

RESPONSES BY REGION	COUNT	%	PERCENTAGE OF TOTAL RESPONDENTS
Atlanta	15	3.54%	
Boston	48	11.32%	
Chicago	171	40.33%	
Dallas/Fort Worth	4	0.94%	
Houston	2	0.47%	
Los Angeles	26	6.13%	
New York	33	7.78%	
San Francisco Bay Area	14	3.30%	
Washington, D.C.	48	11.32%	
Other (please specify)	56	13.21%	
(Did not answer)	7	1.65%	
Total Responses	**424**		**20% 40% 60% 80% 100%**

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