

2011



Emerging Trends in Real Estate[®]



Emerging Trends in Real Estate® 2011

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Emerging Trends in Real Estate®

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72 Interviewees

Property Sectors

Buy or Hold Multifamily. Rental apartments will outperform everything else. In addition to positive demographic trends, even the dampened recovery and housing market shambles are pluses because more people cannot afford to buy or stay in homes. “Subsidized” financing from Freddie and Fannie just ices the cake. Institutional buyers push up prices close to peaks in prime infill areas, and interviewees expect rent spikes by 2012.

Buy or Hold Select Retail. Infill shopping centers with top supermarket chains and fortress malls sustain performance through the consumer pullback. Darwin rules everywhere else in the oversupplied retail universe.

Buy or Hold 24-hour, Gateway Office. Premier downtown buildings remain investor mainstays in New York City, Washington, D.C., and the select few 24-hour markets situated along global pathways. Suburban office space outside urbanizing nodes gets a big thumbs-down in *Emerging Trends* surveys.

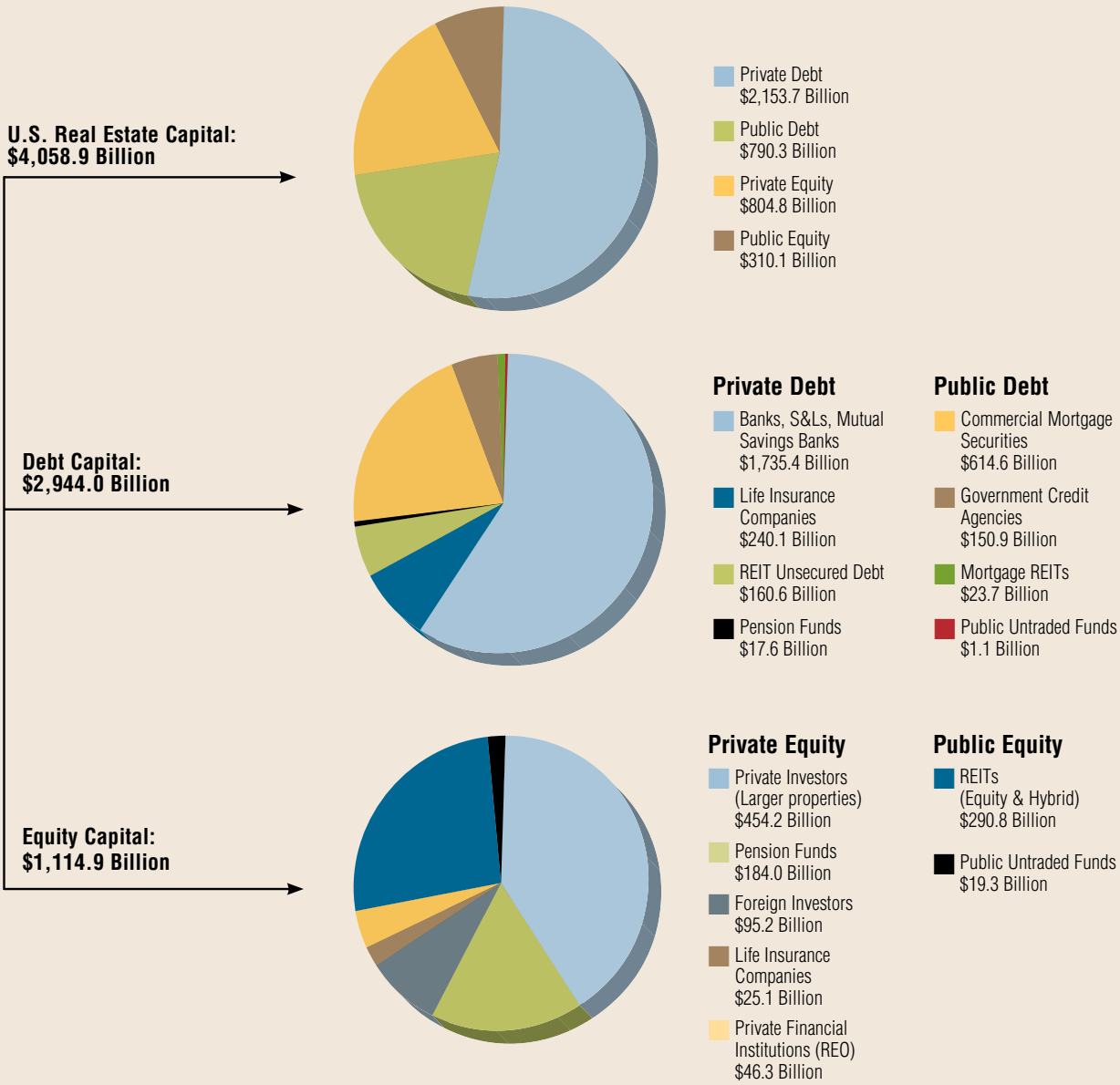
Buy Select Hotels. Always the most volatile property sector, hotels should be excellent buys at or near bottom. “They’re the cheapest and will come back the fastest.” Target downtown full-service hotels in major markets: many owners over-leveraged late in the market cycle and are vulnerable. No one gets excited about high-capex resorts or limited-service brands in commodity areas.

Buy Condos and Single-Family Housing. Markets have collapsed, the population will increase, and demand will return eventually. Now is the time to buy your dream house, if you have enough cash. But this is not a speculator’s market: do not expect a sudden future ramp-up in prices, except in the choicest urban neighborhoods and waterfront locations where values also tend to hold up better anyway. Avoid commodity, half-finished subdivisions in the suburban outer edge and McMansions; they are so yesterday. For good-credit borrowers, now is also the time to finance at locked-in, long-term rates.

BUSINESS IDEAS



EXHIBIT 2-12
U.S. Real Estate Capital Sources 2010



Sources: Roulac Global Places, from various sources, including American Council of Life Insurers, Commercial Mortgage Alert, Federal Reserve Board, FannieMae.com, IREI, NAREIT, PricewaterhouseCoopers, and Real Capital Analytics.

Note: Excludes corporate, nonprofit, and government equity real estate holdings, as well as single-family and owner-occupied residences.

*2010 figures are as of second quarter, or in some cases projected through second quarter.



Markets to Watch

“Gateway 24-hour cities will always **dominate** and outshine secondary markets.”

Economic doldrums bring the reality of the nation’s real estate markets into sharper relief, “dominant institutional buyers concentrate on only eight or nine markets,” and investors question the future of some secondary and tertiary metropolitan areas. If big corporate space users are any guide, “they’re focusing on the places where they need to be,” says a leading tenant rep. “They want the global gateway cities for headquarters and lower-cost Sunbelt cities with international airport access for back office.” Strategically, they eliminate most everything else. Those cities left out will depend increasingly on government facilities, health care complexes, and education centers to secure economic prospects. “Accessibility and workforce are key. It’s the yin and yang of links to global pathways—big airports, good labor pools, and company operations centers.” Other interviewees suggest investors should “follow where educated, energetic, creative young people want to be.” Inevitably, that path leads to the same group of highly favored metropolitan areas with 24-hour attributes.

No Surprises, Gaps Remain

Top *Emerging Trends* markets offer no surprises: Washington, D.C., and New York City pull away from the pack, followed by San Francisco, Boston, and Seattle. All qualify as preeminent gateway cities with attractive coastal (or near-coast) locations, barriers to entry, superior transportation hubs linked directly to global business centers, and concentrations of brainpower jobs. Houston and Denver also solidify rankings near the top, and respondents show faith in southern California’s resilience, despite recent setbacks. While

ratings improved over 2010’s results for markets from coast to coast, the gap between top and bottom continues to widen, and more than 50 percent of surveyed cities still fall below “fair” ratings for commercial/multifamily investment prospects. “If you look market by market, you see some winners and more losers.”

The Pittsburgh Scenario. “We’re going to see a lot more places end up like Pittsburgh, if they’re lucky,” says a senior investment executive. “Here’s a city that used to be a major manufacturing center with many corporate headquarters. Now it’s cleaned up, the high-paying factory jobs have diminished dramatically, and a high ratio of workers have government or quasi-government jobs in education and medical fields.” *Forbes* magazine ranked it as America’s most livable city in 2010. However, “Property values and rents have essentially been flat and development has been sporadic.” Pittsburgh ranks near the bottom on *Emerging Trends* surveys for investment and development prospects. Adds another interviewee, “Pittsburgh is a tight market, but stagnant. You can get decent, steady returns without much, if any, upside.” And in the Era of Less, modest, boring income returns should become more expected, accepted, and necessarily embraced in more markets.

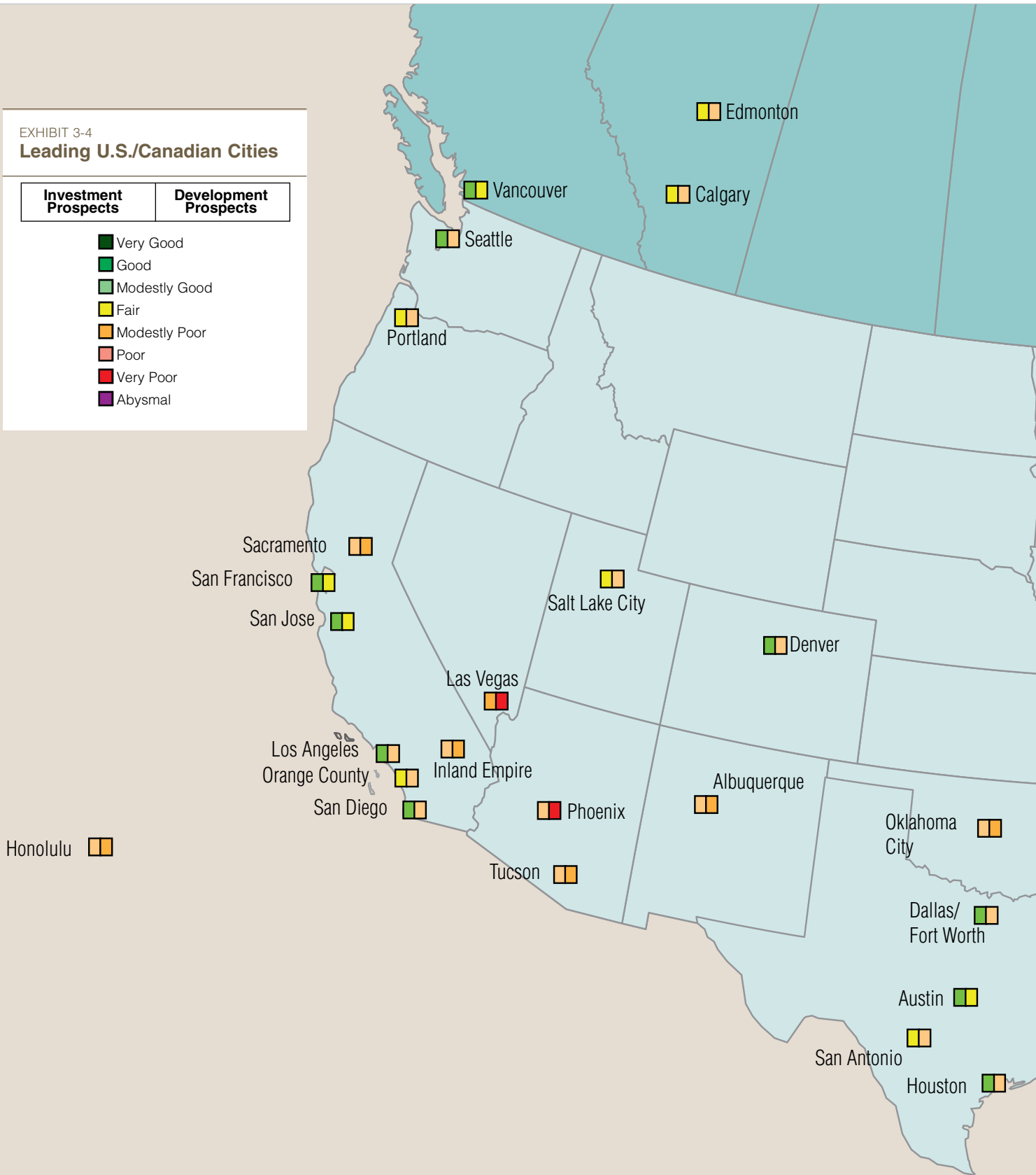
Better to No Prospects. Interviewees contend traditional interior, hot-growth cities can bounce back faster than many observers think, thanks to lower business costs and airports; Houston, Denver, and Dallas rate frequent mentions. Atlanta, another typically favored fast-growth center, draws less enthusiasm this year, despite its preeminent airport. Concerns grow

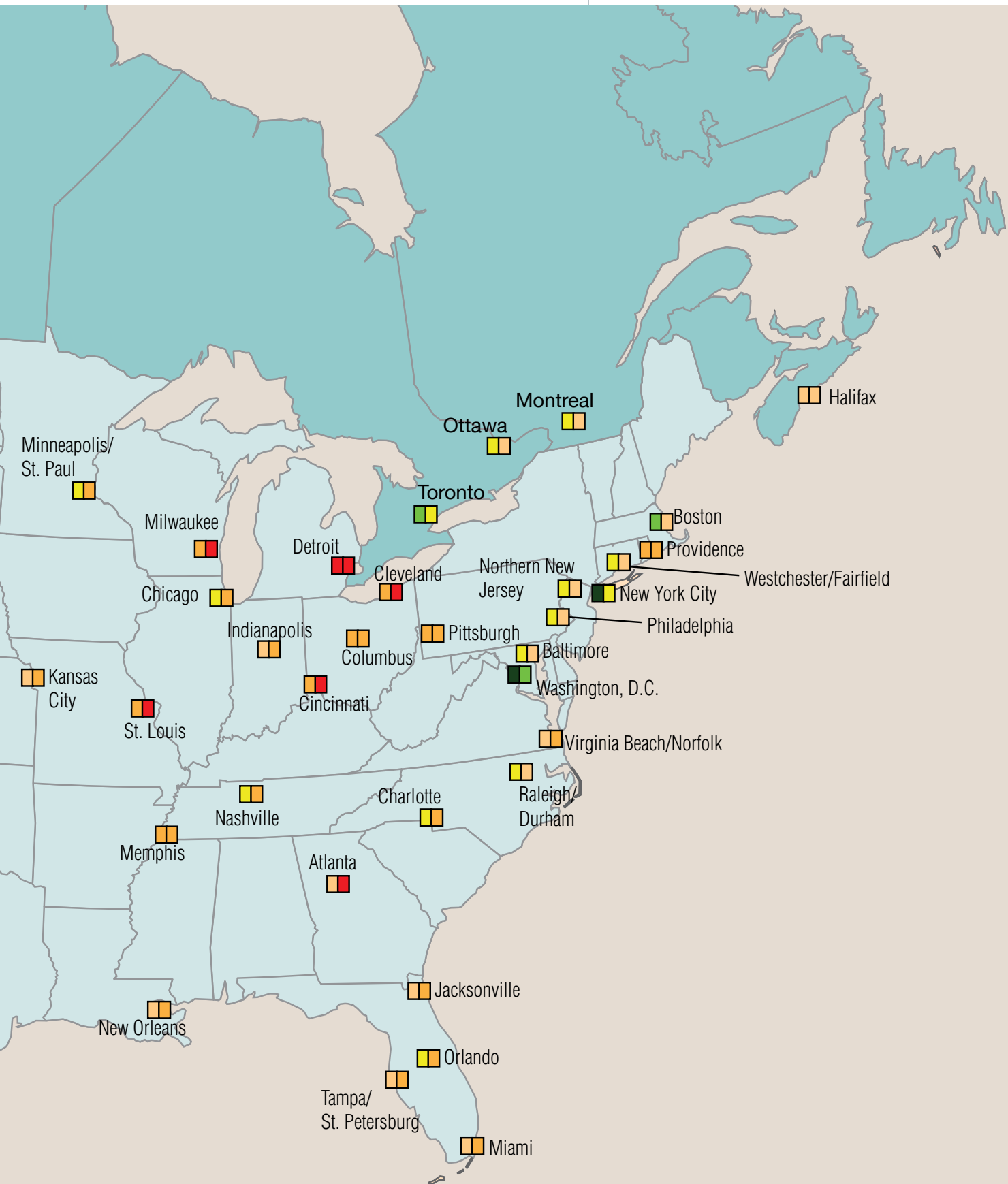
EXHIBIT 3-4

Leading U.S./Canadian Cities

| Investment Prospects | Development Prospects |
|----------------------|-----------------------|
|----------------------|-----------------------|

- Very Good
- Good
- Modestly Good
- Fair
- Modestly Poor
- Poor
- Very Poor
- Abysmal







Property Types in Perspective

“After apartments, it’s slim pickings.”

For 2011, investment and development prospects improve across all property sectors after a hard landing in 2010 (see exhibit 4-1). Hotels actually show the greatest improvement over last year’s dismal investment ratings, but only apartments register a good outlook. Highlighting the ongoing rush to income-producing core assets, survey respondents see modest recovery tracks for warehouses, downtown office properties, and neighborhood shopping centers, but more limited gains for malls, power centers, and especially suburban office property. Builders should take little solace from better—but generally poor—development ratings: only apartments warrant any possibility for new construction during the year, according to surveys.

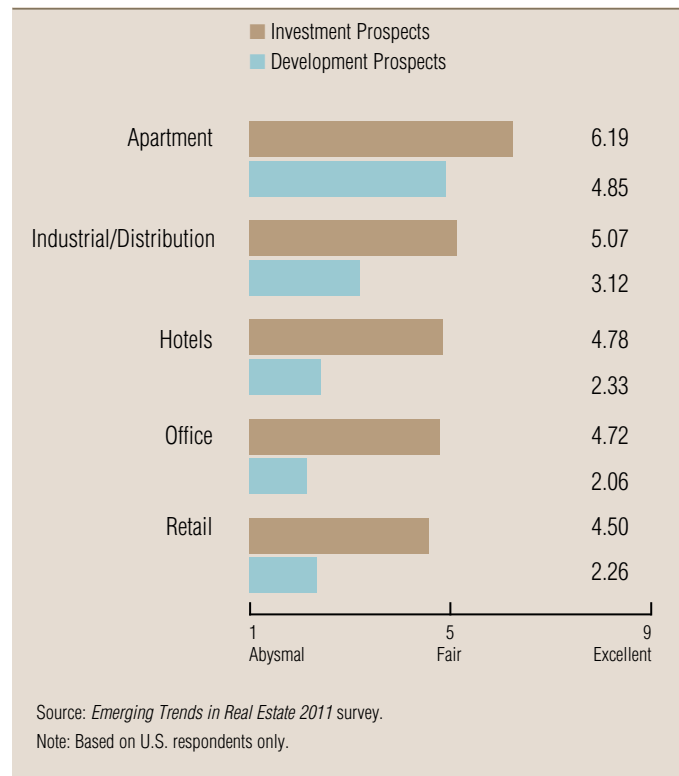
Prospects Improve

Holding Tenants

In general, new leasing activity will occur “at substantially lower rates” than precrash levels, and rents will decline on average, except for multifamily. In the immediate future, “job number one is keeping properties leased and retaining tenants at almost any cost.” Owners and managers must concentrate on cementing tenant relationships. Noted one interviewee: “The last thing you want to do is create a situation where the tenant isn’t satisfied with the building. If the tenant is happy, then you can get down to economics.” More tenants “renew and extend, which is good news, signaling confidence they can sustain their businesses and want to take advantage of lower rates.” Expect some firming of rents in certain warehouse and downtown office markets during the year, but until then, many leasing efforts could end in land-

EXHIBIT 4-1

Prospects for Major Commercial/Multifamily Property Types in 2011



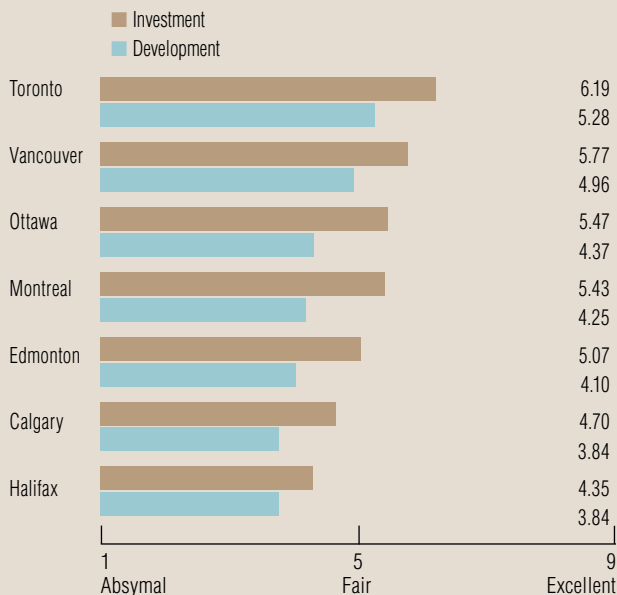


1 = strongly agree, 2 = agree, 3 = undecided, 4 = disagree, 5 = strongly disagree

EXHIBIT 5-11

Canadian Markets to Watch

Prospects for Commercial/Multifamily Investment and Development



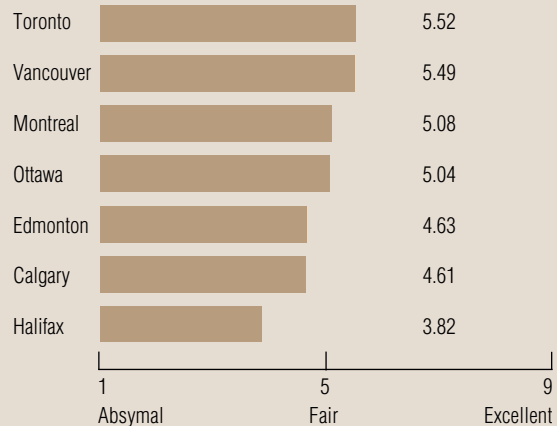
Source: *Emerging Trends in Real Estate 2011* survey.

Note: Based on Canadian respondents only.

EXHIBIT 5-12

Canadian Markets to Watch Prospects for For-Sale Homebuilding

Prospects for For-Sale Homebuilding



Source: *Emerging Trends in Real Estate 2011* survey.

Markets to Watch

For 2011, major Canadian real estate markets settle in a fair to good investment range, with only modest investment prospects and constrained development potential. Toronto bumps Vancouver from the top ranking in the *Emerging Trends* survey, while Calgary must hope to recuperate from cooled demand and a touch of development binging. Population continues to concentrate in and around a handful of major 24-hour cores scattered from coast to coast, leaving extremely limited investment opportunities in small cities and rural areas in between. Shut out of primary cores, some investors scrounge for product in select secondary and sub-urban markets.

Toronto. Canada's "where-to-be market," Toronto stands out as a primary North American gateway and the country's most important economic engine. This vibrant metropolitan area radiates "lots of positives"—the rock-solid Bay Street financial sector and diverse manufacturing industries and service

businesses, as well as immigration flows to support growth. "We're hard to slow down." Some softness creeps into the office market as major tenants "play musical chairs" and move into new Class AAA development projects. No one gets too worried about vacated buildings because institutional owners will spend the necessary money to upgrade, reposition, and release space into future demand. Market vacancy will not increase materially above the current mid-single digits, and any near-term additional office development will be "small and niche." Observers wonder how the condo market just keeps expanding: new apartment projects pop up in all directions, fashioning one of the world's most expansive vertical skylines. Provincial policies encourage density in high-rise development south of a legislated greenbelt, which pressures demand. "We need approximately 40,000 new housing units to keep pace with population growth, but new projects provide less than 20,000." Smart money figured out "you can make a ton on infill land parcels," and anything near transit stations looks like gold. However, opportunities are few: "If you're already in the game and own, you can make a lot of money; if you're not, it may be impossible to get in." Some interviewees worry about flattening apartment rents as a surfeit of condo investors lease out units. High housing prices and immigration flows help make apartments a good bet. Investors retain interest in

EXHIBIT 5-13

Canadian Apartment Buy/Hold/Sell Recommendations by Metropolitan Area

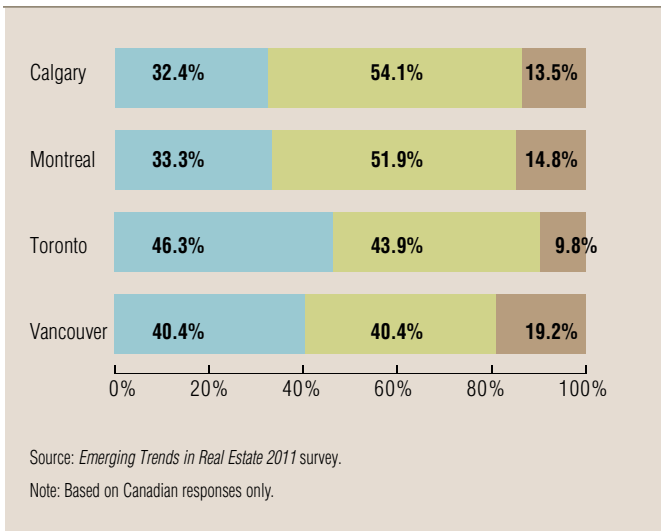


EXHIBIT 5-15

Canadian Retail Property Buy/Hold/Sell Recommendations by Metropolitan Area

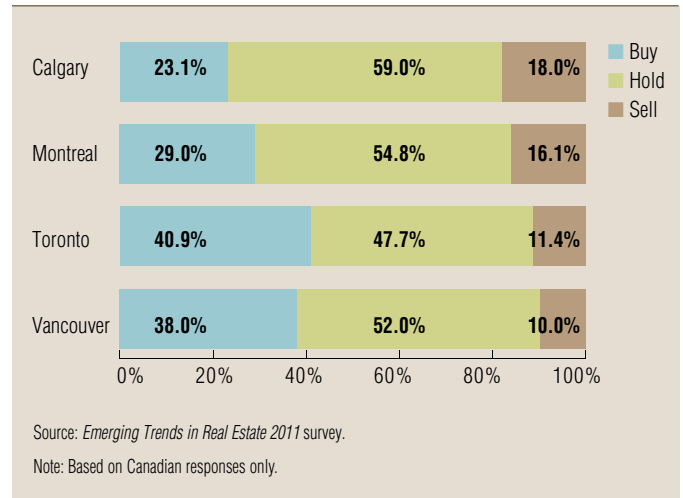
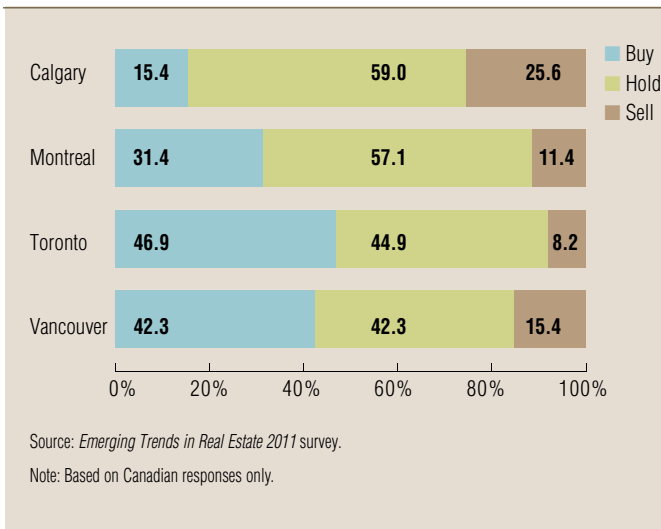


EXHIBIT 5-14

Canadian Office Property Buy/Hold/Sell Recommendations by Metropolitan Area



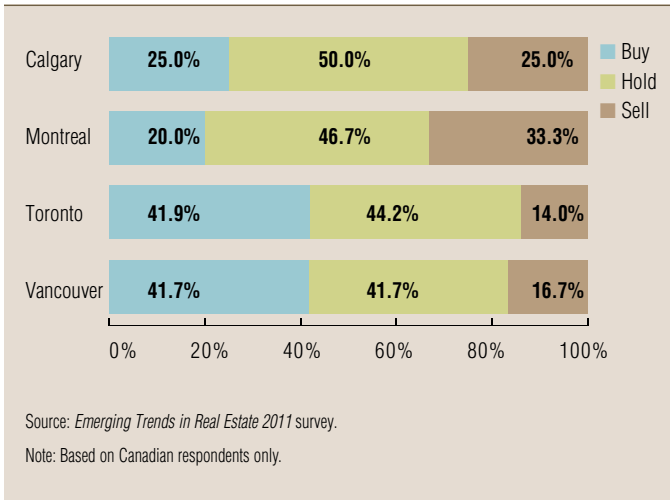
buying and holding industrial properties, which should recover from higher-than-average vacancies and rent declines once the United States gets untracked.

Vancouver. "Office and condo markets almost defy logic"; they stay "red hot." Instead of experiencing a post-Olympics dip, the city caught the attention of well-heeled international visitors, who stuck around and bought apartments after the games. "Everybody wants a view and waterfront location, but not everybody can afford it." Many wealthy Asians park money and look for a path to eventual citizenship. Institutional investors control the relatively small office market, which enjoys minuscule vacancies. Surrounded by water and mountain vistas, Vancouver's natural barriers control development and attract investors—a powerful combination. But some interviewees grow uneasy: "The market is artificially inflated; it's been too hot for too long." A new provincial sales tax raises costs and temporarily cools demand for midtier housing in some areas outside the core.

Ottawa. Canada's federal center offers low risk and little upside. "Nothing much changes." The government does not downsize, but the Canadian capital will never attract the same lobbying intensity or contractor-related business drawn to Washington, D.C.'s much more vast bureaucracy and

EXHIBIT 5-16

Canadian Industrial/Distribution Property Buy/Hold/Sell Recommendations by Metropolitan Area



military/life sciences–related enterprises. A new convention center opens next year and could provide a potential market lift, especially for hotels and retail.

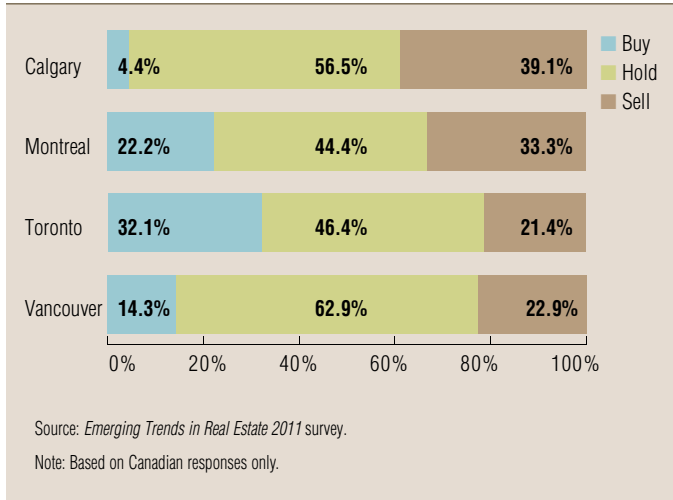
Montreal. Investors tend to short-shrift “slow and steady” Montreal in comparison with Toronto and Vancouver, but the market holds its own. “It’s a good value” with “better yields.” Besides mainstay Quebec provincial government offices, the city features a fairly diversified economy, including aerospace and financial services.

Edmonton. Edmonton “comes off a boil,” avoiding the level of oversupply that deflates Calgary. Oil services businesses thrive because Canada strengthens its position as a leading supplier of oil and gas to U.S. markets. Locals expect positive impacts to filter through the economy, including employment growth.

Calgary. This market behaves more like a U.S. Sunbelt metro area than the typical Canadian 24-hour city. Sprawl and overbuilding “temporarily” subdue outlooks, but “absorption will come.” Developers retreat in the face of high vacancies and show no appetite for new office projects. Locals put faith in robust commodities markets and U.S. consumption of oil from tar sands. “We may have a dirty process, but not comparable

EXHIBIT 5-17

Canadian Hotel Property Buy/Hold/Sell Recommendations by Metropolitan Area



to what happened with BP in the gulf.” Expect spreading hot growth to resume in coming years; voters rejected a high-density-development greenbelt modeled after the one in Toronto.

Halifax. Off the radar screens of the big institutions, Halifax muddles along in slow growth mode. The Maritime Provinces fail to draw much new population and industry.

Property Types in Perspective

Reflecting modest expectations, property sector ratings improve over last year’s tepid forecasts, especially for apartments and offices. Retail and industrial hold up, but hotels suffer from reduced U.S. tourist travel. Commercial markets promise to deliver cash flow but not much appreciation, while housing prices could ebb after an unsustainable surge. Most investors take heart in consistent metrics from markets, which linger in reasonable equilibrium; it beats writedowns, defaults, and foreclosures.

Apartments. Owners do not sell, and buyers bid up any multi-residence deal that comes to market—even older product. “You can’t wrestle anything away from all the mom-and-pop landlords.” Immigration fuels “high” tenant demand, while operators “fatten bottom lines” with cost controls, and overbuilding is a nonissue. Buying REIT stocks may be the

best way to get a piece of this action. Some investors grow concerned about deferred maintenance on aging stock: “You need to factor capex into pricing.”

Office. Occupancies trend well over 90 percent in all major markets except Calgary, where vacancies settle in the relatively manageable low teens. Even the best U.S. markets cannot come close to approaching these healthy supply/demand fundamentals. Rents generally stay in a narrow range without significant growth drivers. Pension fund owners “don’t like vacancies,” so they willingly make allowances in lease deals. In Canada, office investments behave the way core real estate is advertised, delivering reliable, income-oriented returns.

Retail. Shopping centers lease to capacity: “At 2 to 3 percent vacancies, they’re essentially full.” Low interest rates encouraged higher-than-normal levels of consumer debt, but most Canadians never caught credit fever and avoid going into hock. After only a mild recession, “we have decent consumer confidence and people feel good.” Several U.S. department stores consider expanding across the border—“reinforcing already-strong demand for space”—but find few pad options at potential mall sites. Development activity focuses on small projects in infill areas; urban retail is under-supplied with stores, but land is difficult to find.

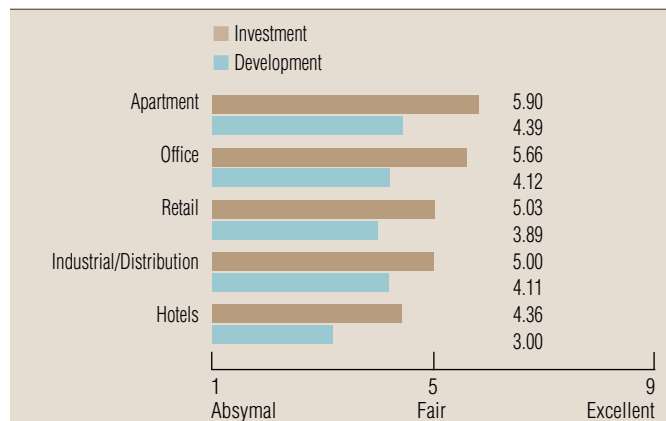
Industrial. Until U.S. exports increase, expect only “marginal improvement” in warehouse rents and occupancies, which begin to stabilize after a slump. “Owners work hard to fill empty space,” but most are not overleveraged and can persevere through the turbulence. Seemingly insatiable investor demand appears unaffected by market softness. If owners get in trouble, they have ready exits. In Ontario, some warehouse markets outside of Greater Toronto face greater challenges, particularly Windsor.

Hotels. Lodging-sector fundamentals show signs of life, but need a bigger lift from American visitors, who stay closer to home. Some borrowers cry uncle and bail, giving cash investors a rare opportunity for bottom feeding.

Housing. Interviewees expect house prices to level off and soften, possibly slipping 5 to 10 percent, after a solid run. Rising interest rates and higher sales taxes in Ontario and British Columbia douse buyer fervor. The market had taken advantage of “free money”; now it’s time to back off. Overseas purchasers buoy Toronto and Vancouver condo markets.

EXHIBIT 5-18

Prospects for Major Commercial/Multifamily

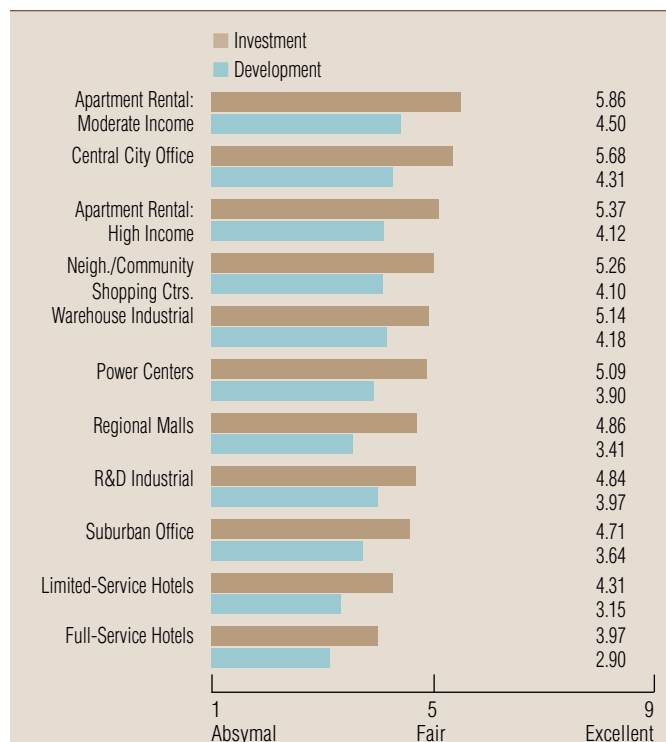


Source: *Emerging Trends in Real Estate 2011 survey.*

Note: Based on Canadian respondents only.

EXHIBIT 5-19

Prospects for Commercial/Multifamily Subsectors in 2011



Source: *Emerging Trends in Real Estate 2011 survey.*

Note: Based on Canadian respondents only.

EXHIBIT 5-20

Prospects for Residential Property Types in 2011

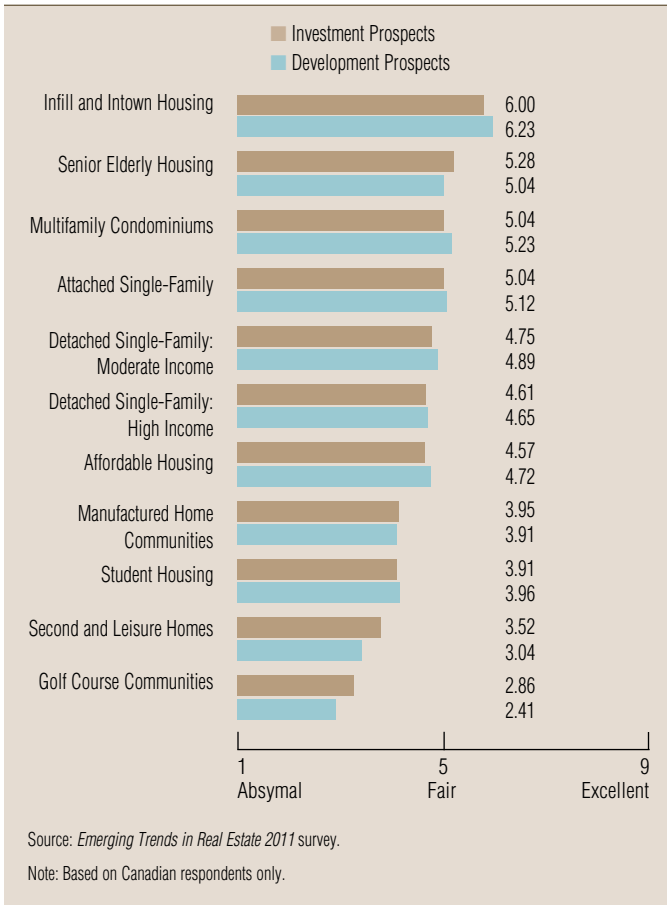
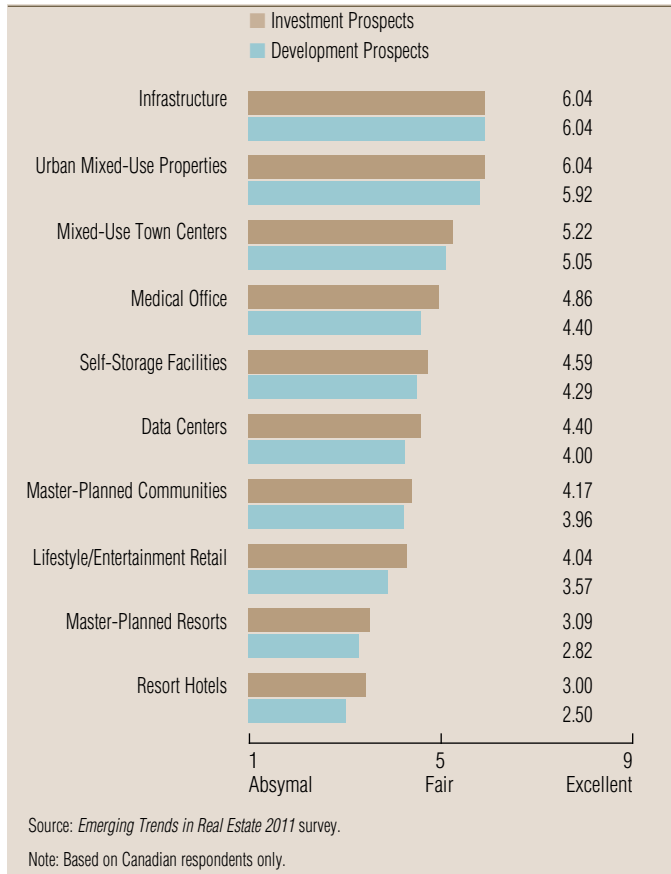


EXHIBIT 5-21

Prospects for Niche and Multiuse Property Types in 2011



Best Bets

- Winnow portfolios of select low-yielding assets and reinvest opportunistically in a U.S. market recovery.
- Time investments to the market and buy down-but-not-out center city hotels.
- Ditto on struggling industrial properties in the Greater Toronto area.
- Buy apartments if you can find anything available. "They offer the best security."
- Look for underperforming infill retail or commercial space, and position for redevelopment as condos. Canadian cities will continue to grow vertically as planners seek to encourage 24-hour environments.
- Husband land sites inside the Toronto greenbelt for future residential development; demand and pricing should continue to increase.

EXHIBIT 5-22

Canada: Downtown Office Vacancy—Class A Space

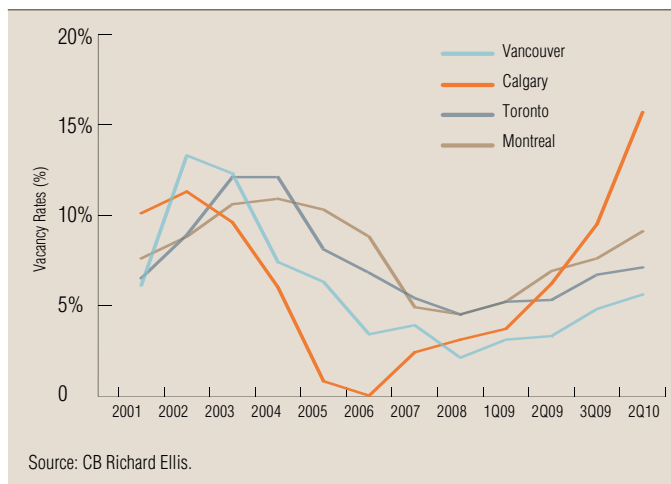


EXHIBIT 5-23

Canadian Central City Office

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Good | 7.26 | 1st |
| Development Prospects | Modestly Poor | 4.31 | 2nd |
| Expected Capitalization Rate, December 2011 | | 6.4% | |
| Buy | Hold | Sell | |
| 41.9% | 46.5% | 11.6% | |

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-26

Canadian Neighborhood/Community Centers

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Fair | 5.26 | 4th |
| Development Prospects | Modestly Poor | 4.10 | 5th |
| Expected Capitalization Rate, December 2011 | | 6.9% | |
| Buy | Hold | Sell | |
| 34.2% | 47.4% | 18.4% | |

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-24

Canadian Apartments—Moderate Income

| 2011 | Prospects | Rating | Ranking |
|---|---------------|-------------|---------|
| Investment Prospects | Modestly Good | 5.86 | 2nd |
| Development Prospects | Fair | 4.50 | 1st |
| Expected Capitalization Rate, December 2011 | | 6.1% | |
| Buy | Hold | Sell | |
| 59.0% | 35.9% | 5.1% | |

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-27

Canadian Warehouse Industrial

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Fair | 5.14 | 5th |
| Development Prospects | Modestly Poor | 4.18 | 3rd |
| Expected Capitalization Rate, December 2011 | | 7.6% | |
| Buy | Hold | Sell | |
| 31.7% | 53.7% | 14.6% | |

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-25

Canadian Apartments—High Income

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Fair | 5.37 | 3rd |
| Development Prospects | Modestly Poor | 4.12 | 4th |
| Expected Capitalization Rate, December 2011 | | 5.7% | |
| Buy | Hold | Sell | |
| 38.5% | 48.7% | 12.8% | |

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-28

Canadian Power Centers

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Fair | 5.09 | 6th |
| Development Prospects | Modestly Poor | 3.90 | 7th |
| Expected Capitalization Rate, December 2011 | | 6.7% | |
| Buy | Hold | Sell | |
| 23.7% | 63.2% | 13.2% | |

Source: *Emerging Trends in Real Estate 2011* survey.
Note: Based on Canadian respondents only.

EXHIBIT 5-29

Canadian Regional Malls

| 2011 | Prospects | Rating | Ranking |
|---|--------------|-------------|---------|
| Investment Prospects | Fair | 4.86 | 7th |
| Development Prospects | Poor | 3.41 | 9th |
| Expected Capitalization Rate, December 2011 | | 6.9% | |
| Buy | Hold | Sell | |
| 23.7% | 73.7% | 2.6% | |

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canada respondents only.

EXHIBIT 5-32

Canadian Hotels—Limited Service

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Modestly Poor | 4.31 | 10th |
| Development Prospects | Poor | 3.15 | 10th |
| Expected Capitalization Rate, December 2011 | | 9.0% | |
| Buy | Hold | Sell | |
| 12.1% | 63.6% | 24.2% | |

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-30

Canadian R&D Industrial

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Fair | 4.84 | 8th |
| Development Prospects | Modestly Poor | 3.97 | 6th |
| Expected Capitalization Rate, December 2011 | | 7.8% | |
| Buy | Hold | Sell | |
| 21.1% | 60.5% | 18.4% | |

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-33

Canadian Hotels—Full Service

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Modestly Poor | 3.97 | 11th |
| Development Prospects | Poor | 2.90 | 11th |
| Expected Capitalization Rate, December 2011 | | 8.7% | |
| Buy | Hold | Sell | |
| 8.8% | 64.7% | 26.5% | |

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.

EXHIBIT 5-31

Canadian Suburban Office

| 2011 | Prospects | Rating | Ranking |
|---|---------------|--------------|---------|
| Investment Prospects | Fair | 4.71 | 9th |
| Development Prospects | Modestly Poor | 3.64 | 8th |
| Expected Capitalization Rate, December 2011 | | 7.3% | |
| Buy | Hold | Sell | |
| 18.4% | 65.8% | 15.8% | |

Source: *Emerging Trends in Real Estate 2011* survey.
 Note: Based on Canadian respondents only.



Emerging Trends in Latin America

Offshore investors see plenty of **potential** in two primary emerging markets, but various hurdles **limit** opportunities.

Where the United States has gone boom-bust and Canada offers only modest growth, Latin America's story centers on the enormous potential of two emerging markets—Brazil and Mexico. Together they account for two-thirds of the region's population “and most of its growth dynamics.” But amid the swirl of young populations, an energized middle class, and the immense promise of expanding industries, investors deal with inevitable corruption and lack of transparency, the need to sort out the reliability of local partners, and—in the case of Mexico—the scourge of drug violence. Enticements and obstacles leave most North Americans intrigued by the possibilities, but not straying off home turf. In the United States, particularly, con-

tending with difficult domestic issues distracts from considering emerging market investments. But for those who do, the action is all about two countries: “They take the oxygen away from all other Latin American markets.”

Brazil: Opportunities and Limits

Emerging Trends interviewees express few doubts: “The boom period has legs, the cat is out of the bag, people want to be where the action is, and that’s Brazil.” The country is self-sufficient in agriculture and energy, and expands its high-tech manufacturing. More offshore institutions “get their feet wet,” but find limited opportunities in existing real estate because only a handful of buildings meet investment grade. Then they confront hurdles from Brazil's transaction culture of “group ownership,” which makes deal making difficult. “It’s hard to get all parties to sell.”

Development may be where the real action lies. “There’s a ton of demand for a ton of new space. You can build housing forever, and people will want it.” Plus, shopping centers are few and far between, and distribution warehouse facilities are in short supply to serve growing consumer appetites. “The middle class is huge and dramatically increasing; populations concentrate in urban areas, creating intense demand for high-rise residential and retail.” Again, local companies with big development platforms and insider connections have “a tremendous advantage and try to maintain a stranglehold; outsiders can’t compete” and must make alliances. “Brave investors” enter secondary markets to develop malls, and strip centers will follow next.

EXHIBIT 6-1

Latin America General Indicators

| | Unemployment (%) | Inflation (%) |
|-----------|------------------|---------------|
| Argentina | 8.8 | 10.1 |
| Brazil | 6.8 | 5.1 |
| Chile | 9.1 | 2.0 |
| Colombia | 13.5 | 3.5 |
| Ecuador | 8.3 | 4.0 |
| Mexico | 5.2 | 4.6 |
| Peru | 8.8 | 1.5 |
| Uruguay | 7.4 | 6.2 |
| Venezuela | 6.6 | 29.7 |

Source: International Monetary Fund, *World Economic Outlook* database, April 2010; Moody's Economy.com.

EXHIBIT 6-2

Latin America Economic Growth

| | Percentage Real GDP Growth | | | | | | |
|-----------|----------------------------|------|-------|-------|------------|-------|-------|
| | 2007 | 2008 | 2009* | 2010* | 2011* | 2012* | 2013* |
| Chile | 4.7 | 3.7 | -1.5 | 4.7 | 6.0 | 4.8 | 4.6 |
| Peru | 8.9 | 9.8 | 0.9 | 6.3 | 6.0 | 5.7 | 5.7 |
| Mexico | 3.3 | 1.5 | -6.5 | 4.2 | 4.5 | 5.2 | 4.9 |
| Brazil | 5.7 | 5.1 | -0.2 | 5.5 | 4.1 | 4.1 | 4.1 |
| Colombia | 7.5 | 2.4 | 0.1 | 2.3 | 4.0 | 5.0 | 5.0 |
| Uruguay | 7.6 | 8.5 | 2.9 | 5.7 | 3.9 | 3.9 | 3.9 |
| Argentina | 8.7 | 6.8 | 0.9 | 3.5 | 3.0 | 3.0 | 3.0 |
| Ecuador | 2.5 | 7.2 | 0.4 | 2.5 | 2.3 | 2.0 | 2.0 |
| Venezuela | 8.4 | 4.8 | -3.3 | -2.6 | 0.4 | 0.5 | 1.6 |

Source: International Monetary Fund, *World Economic Outlook* database, April 2010.
* Projections.

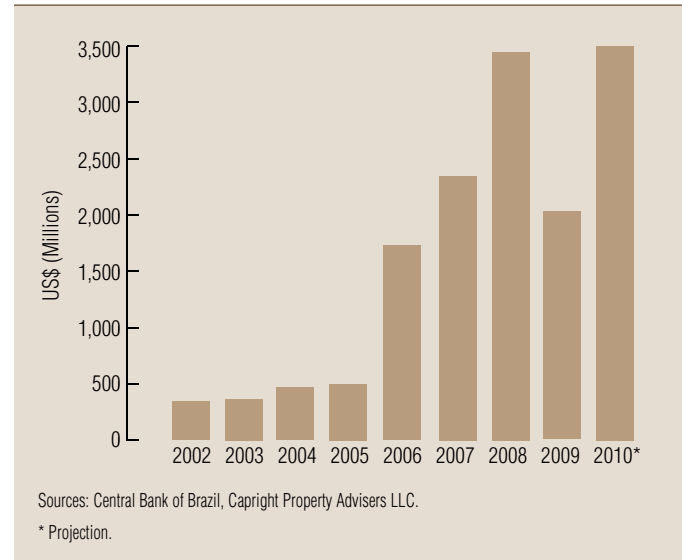
For office markets, investors find an extremely limited menu in only two cities—Rio de Janeiro and Sao Paulo. “Everyone wants to be in Rio. The relatively small business district has virtually “zero percent vacancy,” and rents skyrocketed “30 percent in the last year.” The mountains-rising-from-ocean landscape leaves “no place to build,” while the coming Olympics and World Cup fuel interest. Similarly, Sao Paulo’s office sector remains tight, escalating rents and values. “It’s a bubble driven by user demand, not speculators.” Poor infrastructure limits new development opportunities. The city’s roads and mass transit cannot handle population growth; 800 new cars each day add to already congested streets.

Interviewees expect yields to squeeze down, and markets to cool off but remain enticing. “Five years ago, investors expected IRRs [internal rates of return] of 40 percent. Now that’s dropped into the high teens, and core funds are next.”

Mexico: Potential and Concerns

Mexico offers obvious positives—a hard-working population, an expanding middle class, and the resulting increased demand for homes and consumer goods. But everybody reads about mind-blowing drug wars, police corruption, and political assassinations. In addition, real estate markets hit the skids when the U.S. economy tanked. Prices declined 30 to 35 percent and now recover—more than “halfway back”—but it’s been “tough sledding.”

EXHIBIT 6-3

Brazil: Foreign Direct Real Estate Investment

Finally, banks relax lending curbs after “a huge liquidity crunch” brought on by the worldwide credit crisis. Mexican investors did not overborrow: patient equity players “take a patrimonial view” and count on long-term returns, relying on healthy demographics and controlled development. In fact, most cities and property sectors have avoided overbuilding. Boosters suggest that “markets now align” for significant growth from pent-up demand, and highlight opportunities to fill the remaining capital gap. “There’s a large hole to fill,” especially for construction loans. New laws allow domestic pension funds to invest in real estate and infrastructure, which could increase property market liquidity and demand for product. “We’re seeing the checkbook at the end of the tunnel.” But many jobs depend on the U.S. economy—manufacturing of time-sensitive products or heavy machinery that cannot be shipped by boat from Asia, hotel- and tourism-related businesses, and call centers. Locals necessarily raise concerns about when and whether the United States will emerge from its doldrums.

Industrial real estate “should improve during 2011” after a no-demand, no-development period. The U.S. downturn cuts two ways: overall declines in manufacturing and distribution activity, especially from “hardest-hit” northern border states, have been offset somewhat by more U.S. manufacturer relocations due to the weakened peso. Interior warehouse markets, serving Mexico City, suffered less. Retail “makes a good long-term play,” betting on the growing middle class. Office markets show decent recovery and low vacancies in Mexico

City, but offer “negligible investment opportunities” because mostly domestic owners do not sell. Lenders require tenants in place for financing new construction, so “speculative development won’t happen.”

Most multifamily housing is owner occupied and heavily government subsidized. Developers receive a guaranteed return over ten-year periods without much upside. For-sale housing remains supply constrained by lack of construction financing, while the second-home market “went off the cliff” when U.S. retiree demand evaporated. Canadians fill some of the void, gaining buying power from their stronger dollar and the weaker peso. In favored coastal Baja and resort markets, cheap land could be a bargain. “The second-home market will come back.”

Locals lament “too much distraction from drug issues,” which torpedo revenues for some resort hotels already feeling the effects of U.S recession. “We need to deal with perceptions; it’s our biggest hurdle to overcome.” Other interviewees admit to “grim” security concerns, particularly in northern cities like Tijuana, Juárez, and Monterrey. “Business goes on, but not many relocations.”

Government planners encourage future development to focus on more urban concepts and city centers, getting away from expanding suburban envelopes. The road-dependent sprawl model, copied from the United States, reaches the point of diminishing returns, creating hardships for many Mexicans who cannot afford cars or cannot support multicar households. Serious congestion and pollution, especially around Mexico City, must be addressed, too.

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