Real Estate Insights, Forecasts & Strategies
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2011…A Year Of The "Re" Word

In This Issue

Friends & Colleagues:

The past 36 months have been transitional, transforming and, at times, terrifying for the real estate industry. **Business practices, business activities and business operating philosophies were questioned and in doubt. The old ways of doing business were cast aside in favor of day-to-day survival practices**. Dramatic asset value declines, lack of financing/credit, rising unemployment, increased government regulations and taxes, a jobless recovery, accelerated corporate and consumer de-leveraging and a retrenching tenant base became the New Normal. We heard positive and negative commentary from all stakeholders. We learned that after massive deficit spending, "this is not sustainable." From bankruptcies to bank failures, from foreclosures to fire sales and from too-big-to-fail to too-small-to-survive, **the real estate industry came very close to the proverbial edge but avoided a catastrophic fall**.

From the ashes incredible opportunities have emerged and will continue to emerge for the real estate industry. **The decisions every real estate company will make over the next 12 months probably will define their success, failure or muddle-through business outcomes**. The real estate industry is entering the perfect storm of decision-making, where the wrong decision can mean struggle, and the correct decision means prosperity. For many there are only a handful of chances to grab the brass ring, so **every decision and every strategy has significance and impact**.

In addition, you should **expect 2011 and 2012 to be the transition years between where you have been and where you are going**. The next 12 – 24 months will define, test and measure leadership skills, knowledge sharing, value creation and collaboration. **Real estate firms will either "get it" or they won't…there will be no middle ground**. The strategic theme for this annual forecast edition of *Strategic Advantage* as well as for 2011 will be to embrace the "Re" words and phrases.

The year 2011 is the second calendar year following one of the worst recessions in the past 50 years. In every recovery there are winners and losers, heroes and villains. The drag on our economy over the next 12 months will come from Federal and State spending. **This is not a "V"-shaped or even a "U"-shaped recovery…it will be a very slow recovery**. Moving into 2011 carries with it a lot of baggage. In 1970, 70% of Americans were optimistic about the country's future…today it is 54%.

Strategic Themes For 2011		
♦ Restructure	♦ Rebrand	♦ Redevelop
♦ Re-engineer	♦ Refresh	♦ Refocus
♦ Re-establish	♦ Retool	♦ Reinforce
♦ Re-create	♦ Reacquaint	♦ Realistic
♦ Re-adjust	♦ Real time	♦ Reassure
♦ Re-allocate	♦ Reappraise	♦ Recalibrate
♦ Re-arrange	♦ Reassess	♦ Receivership
♦ Rebuild	♦ Rebound	♦ Recover
♦ Recharge	♦ Reciprocate	♦ Recruit
♦ Recourse	♦ Rededicate	♦ Reduce
♦ Rediscover	♦ Redeploy	♦ Refine
♦ Reconsider	♦ Rehabilitate	♦ Reset
♦ Reinvent	♦ Rekindle	♦ Redistribute

The overriding theme here is the prefix "re"…a Latin word that means again or again and again. In 2011 real estate firms must re-think and re-set their vision, core strategies, business model, organizational structure and operating practices. **Your future possibilities can become a reality if you take responsibility for that future**. While the future is a current place for dreams, it is a reality that may already be here.

The thrill ride of opportunity has arrived. The next 12 months set the stage, lay the groundwork and establish the foundation for all that is to come. **Fasten your seat belts for a bumpy ride on the endless highway of opportunity**.

Economic Outlook For 2011 – A Series Of Unknowns

The outlook for 2011 can be summarized in two words, "Recalcitrant Recovery." There are those "re" words again. The lack of a well-defined national economic policy (note the resignations of President Obama's chief economic architects Paul Volcker, Christina Romer and Larry Summers) and an absent commitment to creating net job growth are now reflected in a **tepid economic and jobless recovery, low consumer confidence and unprecedented levels of deficit spending. This will not change dramatically in 2011**. The Keynesian solution to stimulus spending failed, casting doubt on its utility in today's economic world. The Republican sweep in the 2010 mid-term election and a President fighting for his relevance and re-election in 2012 will be visibly illustrated in a year of playground-like challenges, name-calling, pushing and shoving, resulting in an ideological and needed solutions stalemate. **The next 12 months are less about recovery and more about repositioning for re-election** (more "re" words).

As we begin 2011, my biggest concerns are: (1) a seeming inability and/or unwillingness of State and Federal leaders and representatives to reduce or rein in unprecedented deficit spending and entitlements; and (2) an unacceptable level of net job creation, a likelihood of higher taxes and continued ever-growing government intervention in Corporate America's ability to conduct business. Let's examine the facts.

Job Growth…"Brother Can You Spare A Dime?"

In January 2008, total private-sector employment in the U.S. was approximately 115.6 million. By November, 2010 that number had declined dramatically to 108.3 million…a drop of 7.3 million jobs. However, when you add 9 million part-time workers who would like full-time jobs, an additional 2.4 million workers who have given up trying to find employment, plus the 1.25 million new job seekers each year, **the real unemployment level is not 9%, but closer to 17% – 19%**. Gallup's U.S. employment measure reports the total underemployed to be 19.2%. The U.S. Bureau of Labor Statistics stated the U.S. jobless level in January 2011 is 16.1% (i.e., more than 28 million Americans out of work or without full-time work). So, we have around 17 million – 19 million persons either unemployed or under-employed. Household incomes are not expected to rise significantly…meaning lower retail sales.

The U.S. economy has more questions than answers.

- What will be the impact of QE2, and are we setting ourselves up for a 1970s-style inflation and future recession(s)?
- Will political futures get in the way of meaningful debate and much needed changes to our deficit spending elixir?
- Will global conflicts cascade into negative domestic outcomes?
- Will there be a cohesive job creation policy that stimulates/encourages private sector job growth?
- What will be the impact on economic growth of $3 trillion in deficit spending over the past 24 months and another $1.5 trillion deficit for 2011?
- When will interest rates rise (a distinct possibility in 2011)?
- What will be the impact of the Fed increasing its balance sheet from $739 billion in 2008 to $2.3 trillion by October 2010?
- When will inflation return? (And it will, with expected vengeance.)
- Are the Federal and State governments about to raise taxes during a recession recovery environment?

I could go on…but it appears that the Fed and Administration are treating the symptoms, not the cause. **We hope not to set ourselves up for a dramatic fall in the 2017 – 2020 period.** Currently the government is not allowing the economy to heal itself, and that "tinkering" is an unknown risk. Making up the rules as they go along is clearly a prescription for failure. **Kicking the can down the road may generate good sound bytes, but not good policy.**

If economic policy and actions do not change over the next 24 months, I expect this decade to shift from one of "Muddle Through" to truly a "Decade of Lost Opportunity."

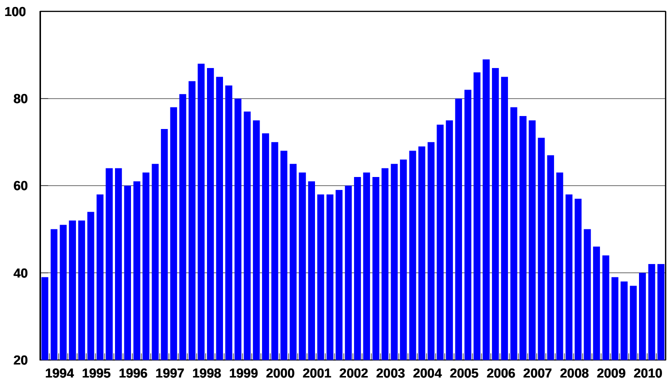
Under a best case scenario, the **U.S. will take at least 7 – 10 years to get unemployment down to a level of 5% or so.** Since many lost jobs are not likely to come back, I expect unemployment levels to stay in the 7.8% – 8.7% range over the next 24 months. Although the economy could add as many as 2 million jobs, job growth will be far below expectations until small businesses are incentivized to hire. However, if the level of deficit spending continues to prop up the U.S. economy artificially as we head into an election year, I am most concerned about "what happens next."

Job growth in 2011 will be reflected in the have and have not states. California could join Michigan, Nevada and Florida as one of the places not to be. I like Virginia, Utah, Texas, Colorado, Maryland and Massachusetts over the next 12 months. While 84% of the U.S. public believes jobs should be a top priority, only 26% think global warming should be a priority for the President and Congress. Leadership is lacking, so **real estate firms must seize this leadership moment and seek to control their destiny.**

GDP Likely To Reflect Sluggish Recovery

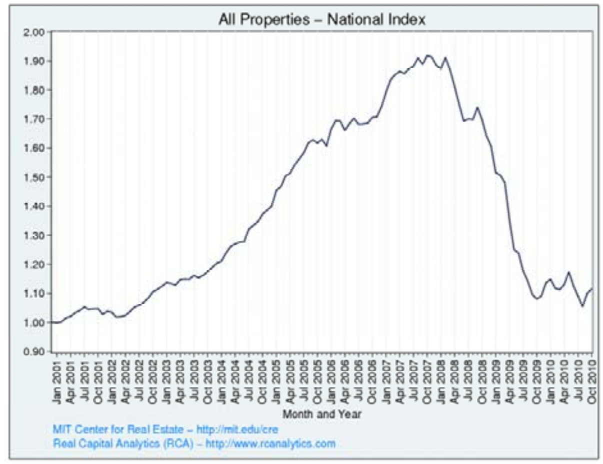
Over the past 18 months, **the rebuilding/restocking of inventories has driven U.S. GDP growth.** However, the moderation of consumer spending and the expiring impact of the $814 billion economic stimulus that did not stimulate will likely have an impact on future GDP growth in 2011. The extension of the Bush tax cuts could add 50 bsp-75 bsp to the GDP growth rate. While I think it's only a 25% probability, some economists are projecting a 4% or greater growth rate in 2011. With lower tax revenues, high unemployment, fewer or no consumer bailouts and gimmicks (home buyer tax credit, hybrid car tax credits, tax rebates, etc.), no U.S. Census takers (1.2 million hired for the 2010 Census which boosted employment), and several state government plans to raise taxes…**real economic growth is merely a political sound byte.**

CEL Real Estate Index



Source: CEL & Associates, Inc.

Moodys/Real Commercial Property Index



Source: MIT Center for Real Estate and Real Capital Analytics.

Ten Factors Contributing To Slow Growth

While many factors contribute to slow economic growth, real estate leaders must carefully monitor the following 10 factors.

1. Consumer and corporate de-leveraging trends.
2. Constriction of Federal and State government funding.
3. Trade policies and protectionism policies.
4. Fed policy.
5. Increased government intervention and regulation of private industry.
6. Deflation and later stagflation.
7. Cost of capital and lending policies/practices.
8. Reduced consumer spending.
9. Consumer and corporate America uncertainty.
10. Unprecedented Federal, State and local deficit spending.

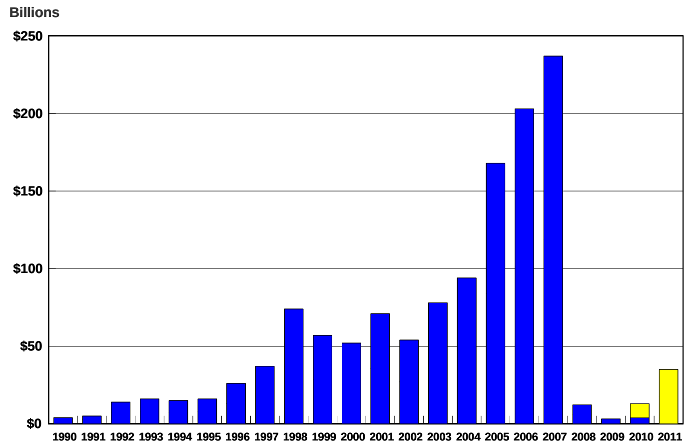
Having said this, **let me strongly reiterate that there are many, many opportunities for growth in the real estate industry.** But to find those nuggets and achieve a competitive edge requires tenacity, leadership, a plan, a talented team of Associates and financial resources. **Those who take advantage of this crisis and period of economic change will prosper into the next decade.**

I encourage all readers of *Strategic Advantage* to avoid looking to the past when making decisions about the future. If one anchors expectations for the future based on past precedents, then one is destined to adapt slowly to the new economic realities. **The real estate industry has gone through a transformation, not a transition.** The confluence of cyclical and structural changes to the industry have brought a new normalcy to the stage. In 2011 past biases and decisions rooted in history will become barriers to success.

Debt Markets Are A Tale Of Two Cities

Like the 1859 novel by Charles Dickens, *A Tale Of Two Cities*, the capital markets are a contrast between those who have capital and those who need capital. On one side are the lenders (banks, insurance companies, CMBS bond holders, GSEs, etc.), and on the other side are the current or prospective borrowers. **As values on commercial real estate declined 35% – 42% (peak-to-trough), a wave of new lending criteria was established and (at times) Draconian appraisals were the relied-upon statement of value, which left many borrowers struggling to renew or restructure existing mortgages.** In 2011, $296 billion in commercial loans at banks will mature, followed by $306 billion and $303 billion in 2012 and 2013, respectively. In 2011, $52 billion of CMBS loans will come due, with $65 billion and $46 billion following in years 2012 and 2013.

CMBS Origination

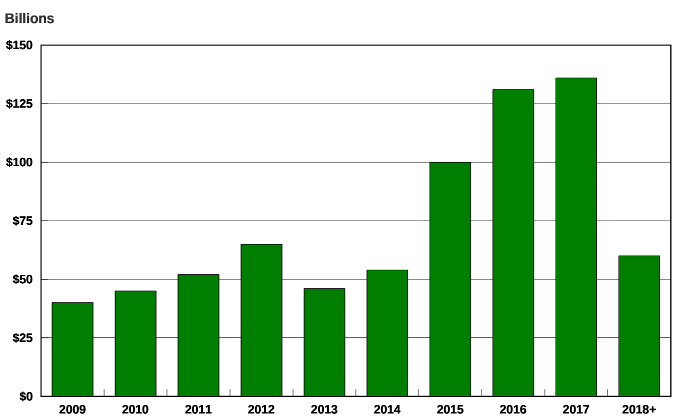


Source: Mortgage Bankers Association, Wells Fargo, Eastdil Secured, Commercial Mortgage Alert and CEL & Associates, Inc. 3Q 2010.

The CMBS delinquency rate is at 8.3%, and the recovery rate on a delinquent CMBS loan is around 51%. **I expect 2011 – 2017 to be years of ongoing restructuring, refinancing and asset sales. Borrowers do not have enough money, and lenders are reluctant to "make deals."** Pretend and extend loans and sales of underperforming or distressed debt will continue.

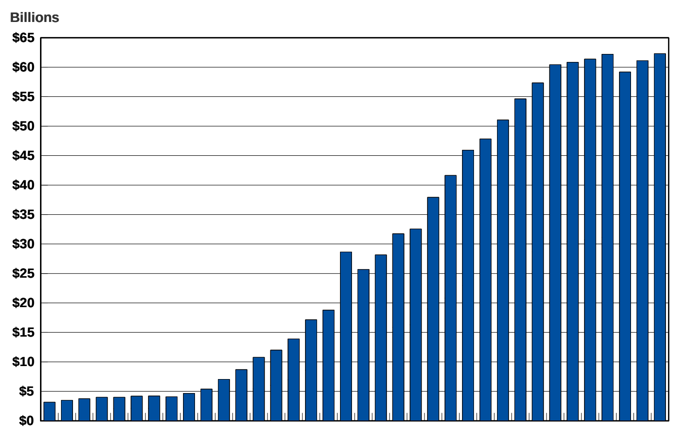
While interest rates are expected to remain low through the first three quarters of 2011, there is strong likelihood for a 20 bsp – 40 bsp increase as we head into 2012. **The real interest rate bumps are likely to occur after the 2012 election.** I expect the CMBS market will return in 2011 with the issuance of $30 billion to $40 billion of debt. Among those leading the CMBS charge over the next 12 months could include Goldman Sachs, J. P. Morgan and Deutsche Bank.

CMBS Maturities



Source: Goldman Sachs.

Monthly CMBS Delinquencies



Source: Realpoint. December 2010.

The tale of two cities will continue in 2011 as core assets in core markets attract multiple bidders with strong financing backing…but in the secondary and tertiary markets with a plethora of available assets…Good Luck! The haves and have-nots for capital will be the story line in 2011-2012.

Development Has Its Challenges

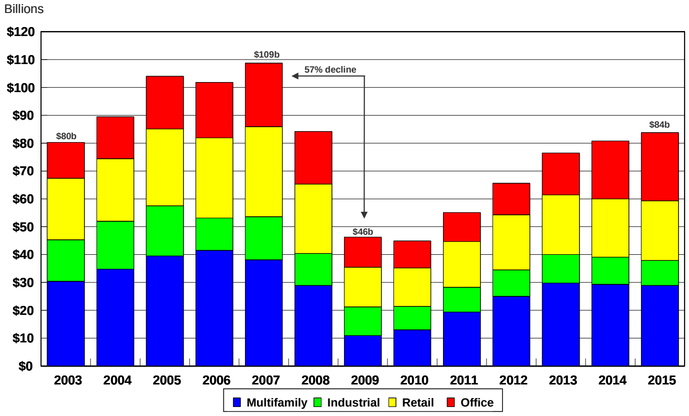
Citi Investment Research prepared a wonderful table on construction starts that highlights the current challenges for new development. It is clear from their research, illustrated in the table below, the volume of construction starts remains at historically low levels.

Sector	Construction Starts		Pre-Recession Level 2007
	Current As A % Of Stock	Historical As A % Of Stock	
Office	0.3%	1.9%	2.0%
Industrial	0.4%	2.5%	3.2%
Retail	0.5%	2.4%	2.9%
Multifamily	0.5%	1.5%	2.0%
Aggregate	0.5%	1.8%	2.3%

Source: Citi Investment Research

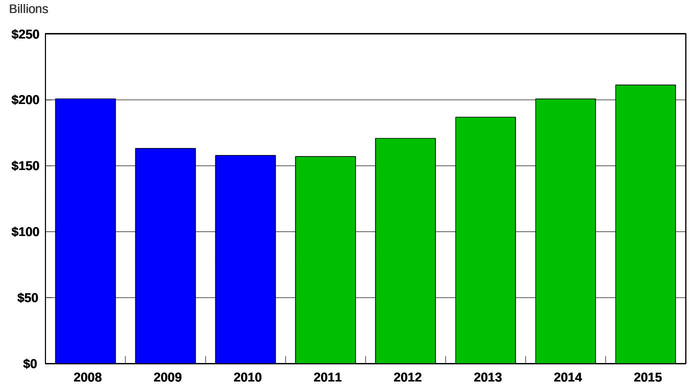
When I examine historical and current construction activity and projected economic, population and job growth, the conclusion is fairly clear…**lack of construction activity over the past 24 – 36 months will result in a dramatic rise during the four-year period 2011 – 2014.** Developing new or modifying old buildings to LEED or Energy Star standards will be one of the main drivers behind this activity.

Total Construction Activity



Numbers have been rounded.
Source: Reed Construction Data.

Total Value Construction Starts Non-Residential



Numbers have been rounded.
Source: Reed Construction Data.

Over the next decade, do not be surprised to hear that Congress has passed legislation mandating an escrow account be established for all commercial and multifamily buildings sold which are non-compliant with national energy efficiency standards. This would result in an "added cost or tax" that must be used to improve the energy efficiency of the particular property.

However, real estate leaders should beware…**inflation may be just around the corner.** Rising commodity prices are the first indicator. **Don't be surprised to see the Fed dramatically reduce or eliminate its policy of quantitative easing.** Prices for oil, gasoline, copper, food, medical costs, insurance, cotton, etc., will mean higher costs to the consumer in 2011. Development for retail and office will be fairly low by historical standards.

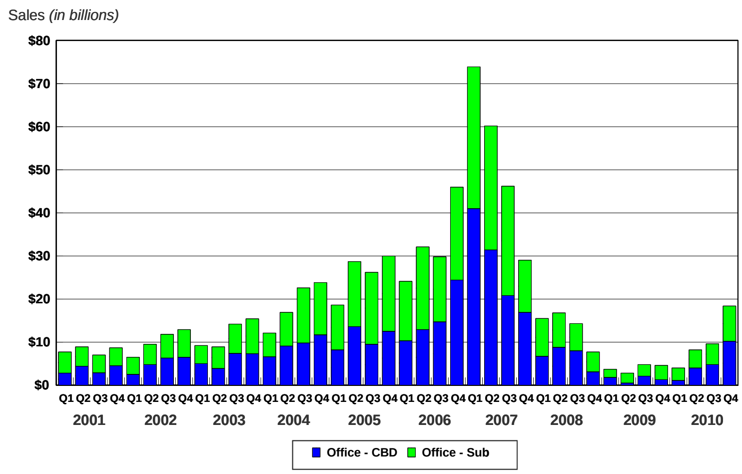
If I were looking for development deals in 2011, I would focus on a market- and customer-centric versus a site-specific business model. The real sleeper in 2011 could be an unprecedented growth in senior and assisted living facilities.

Office Continues To Fight Headwinds

The lack of job growth, a tepid economic recovery and an **unwillingness of Corporate America to spend $1.6 trillion of "on-the-sidelines" money will keep the office sector performance-challenged throughout 2011.** With the uncertainty over taxes, cap and trade, healthcare costs, government regulations and job creation, employers who occupy office space have adopted a wait-and-see attitude. A portion of those who are spending are investing in emerging overseas markets. Financial institutions aren't growing and are now required to retain more capital on reserve. Tech companies and others continue to outsource or offshore, and small business owners have received no benefit/break during or post recession.

In 2010, investor appeal for core office assets in the top five markets and selectively in the top 40 markets resulted in $41.6 billion in sales, according to Real Capital Analytics©. That sales volume was 140% above the 2009 totals. With lenders and special servicers holding on to their distressed assets (i.e., "we got burned in the late '80s and do not want to repeat our mistakes in 2010"), the availability of office buildings for sale was below historical levels. Cap rates for CBD buildings finished the year around 6.2%, while suburban office buildings recorded a 7.7% cap rate in the 4Q. **I expect cap rates to remain fairly status quo through 2011** (10 bsp – 30 bsp movement either way is a possibility).

Sales Volume – Office
2001 – 2010

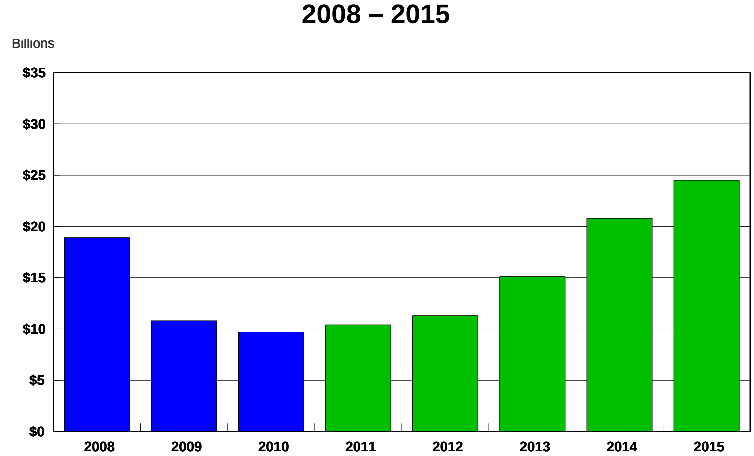


CBD office buildings will perform better than suburban properties. Because the market recovery is likely to be uneven, **I expect the growth rate for jobs requiring office space to be 1.3% – 1.8% in 2011.** The national vacancy level will decline 60 bsp – 80 bsp over the next 12 months, while effective rent growth will remain around 1%. I expect we will see:

- Class A Tenants continuing to downsize their space needs.
- Tenants moving from Class B to Class A buildings because they can now "afford" perceived inexpensive rent in a better building.
- Around 35 to 45 million square feet of net absorption in 2011. Grubb & Ellis Research is projecting as much as "one third of new demand will be accommodated by shadow space."

It will be 2012 – 2013 before the office sector reaches a semblance of normalcy. Further involvement by the government in regulating or taxing employers using office space (other than government), will likely cause office landlords to move into industrial, mixed-use and build-to-suit projects to diversify and reduce risk. Additional government regulations or oversight will give employers pause before moving forward with their space needs. **Office space landlords should focus on improving fundamentals and holding on to current customers.**

Office Construction – U.S.
2008 – 2015



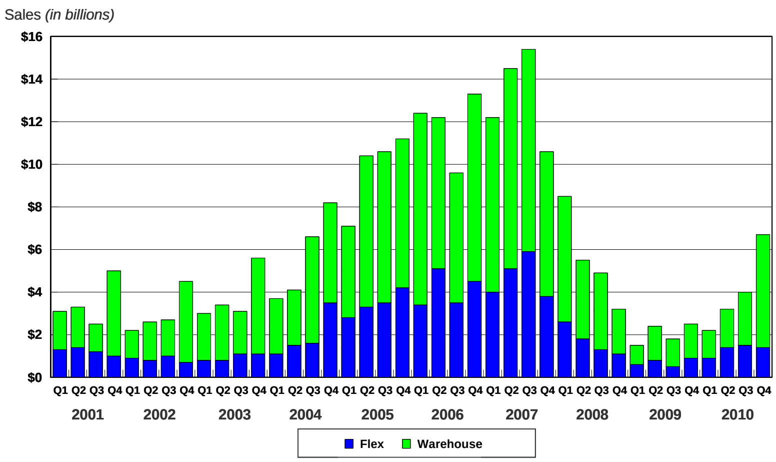
Numbers have been rounded.
Source: Reed Construction.

Over the next 12 months, the office sector will resemble a Dilbert cartoon where Dilbert says**, "What I need is a list of specific unknown problems we will encounter."** While the long-term outlook is positive in many markets, the unknown time waiting to get there will be frustrating.

The Fate Of Industrial Is Tied To The Consumer

It all comes back to "Jobs, Jobs and More Jobs." Industrial and warehouse properties are directly tied to consumer activity. Inventory levels for both finished goods and raw materials are around their lowest levels since 2004. Growth in GDP, improving consumer confidence, increasing spending levels by consumers and the need to rebuild inventories will improve demand for space.

Sales Volume – Industrial
2001 – 2010



Source: ©2010 Real Capital Analytics, Inc. All rights reserved.

In 2010 the sale of industrial properties, according to Real Capital Analytics©, was $18.9 billion…a 77% increase over 2009 levels. Cap rates fell to 8.2% in 2010. **I expect cap rates to decline 30 bsp–55 bsp over the next year as occupancy levels improve.** Net absorption in 2010 was around 20 million square feet; in 2011 that metric is expected to be around 30 million square feet. While far below the 175 – 190 million square feet of annual absorption in the go-go era of 2005 – 2007, it is movement in the proper direction. **Vacancy levels should decline 45 bsp–60 bsp in 2011.**

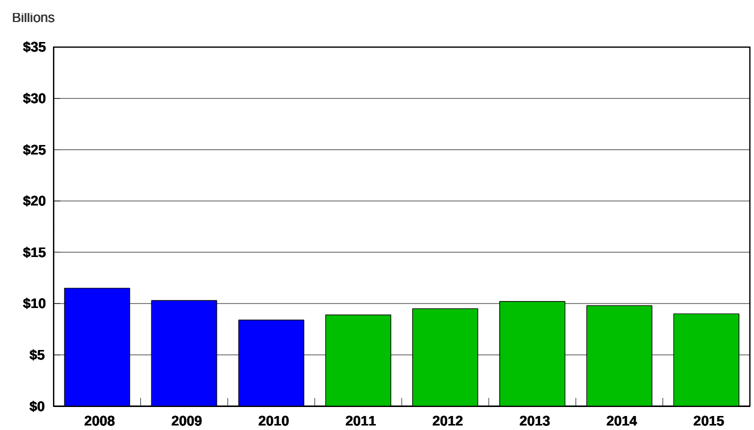
Effective rent growth should be .6% – .7% as landlords reduce concessions. The best opportunities for growth in 2011 will be around ports (in particular: Charleston, Norfolk and New Jersey), major airport hubs and in core markets. Global connectivity will be key to attracting and retaining talent. **The deployment of new stacking systems, shifts in logistics modeling and the impact of the 2014 Panama Canal expansion will drive industrial/ warehouse development and leasing activity.**

Five wild cards will concern industrial/warehouse landlords:

- The price of gasoline
- The U.S. trade policy
- Consumer confidence
- Economic and net job growth
- Capacity utilization

The first four of these concerns are moving targets, with no degree of certainty, and not likely to change in 2011. Another major unknown is the rate cut to existing lease renewals. **I expect lease rates for existing leases to decline 10% – 15%,** placing this asset class in the wait-and-see category.

Industrial Construction – U.S.
2008 – 2015



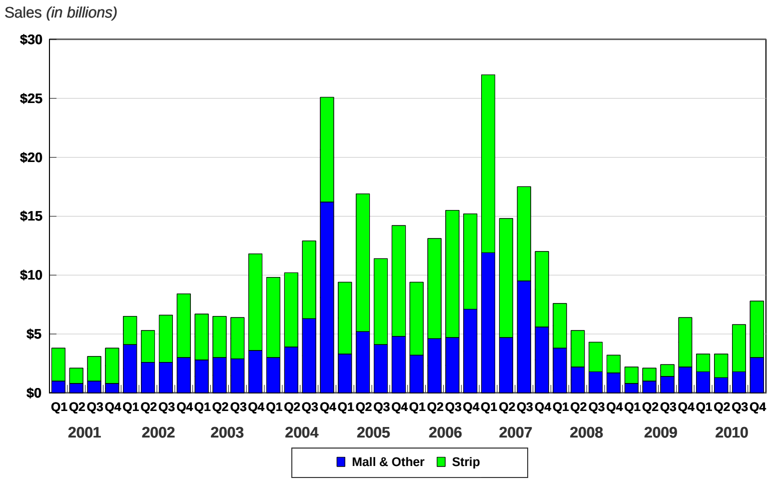
Numbers have been rounded.
Source: Reed Construction.

The future of the industrial sector is bright, but **industrial real estate companies should retool and reshape their business plans and models to take advantage of new dynamics**. The increasing role of shipping by rail and a focus on energy conservation will alter the movement of goods and services. As President Eisenhower said, **"Neither a wise nor a brave man lies down on the tracks of history to wait for the train of the future to run over him."**

Retail Will Continue To Be A Sector Of Contrasts

The combination of a snail's pace recovery, lack of meaningful net job growth, rising costs of producing goods, flat to nominal increases in household income and the increasing likelihood of higher federal and municipal taxes does not bode well for retailers and retail real estate in 2011.

Sales Volume – Retail
2001 – 2010



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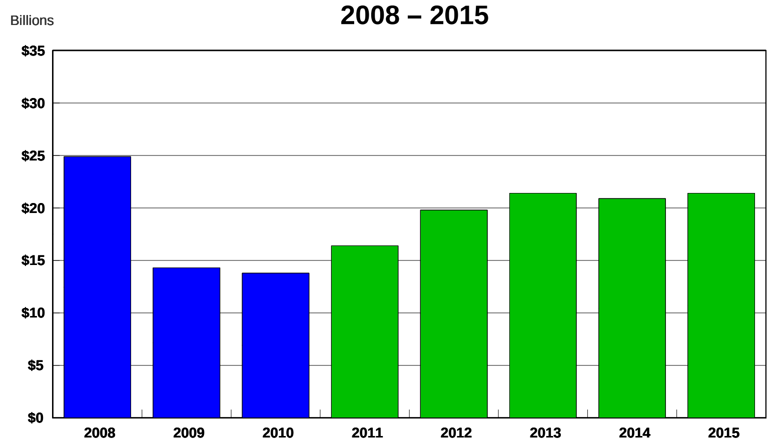
With the $2.3 billion sale of Prime Outlets to Simon Property Group, total retail asset transaction volume in 2010 was $22.6 billion…up 51% from 2009 totals. **The real performers in 2010 were sales of strip centers (up 57%).** According to Real Capital Analytics©, strip center cap rates fell to 8.2%, while mall cap rates dropped to 7.4%. In 2011 **I expect cap rates to decline 30 bsp – 50 bsp for strip centers and 20 bsp – 40 bsp for malls.** This decline is driven more by demand for core assets in core markets than investor delight with this asset class. **Risk spreads are likely to remain high in 2011 (400 bsp – 450 bsp).**

Consumers are just beginning to spend more. While this is encouraging, **most shoppers are seeking discounts, sales, coupon-driven incentives and core essentials instead of luxury or discretionary items.** Motivated by the mindset "can't get any cheaper," U.S. consumers will spend more in 2011 out of fear they won't be able to afford it later on and/or fear of inflation. **The "promotional/bargain" environment will, in my opinion, prevail through most of 2011.**

The delivery of retail square footage was only 46.5 million in 2010, a far cry from the 149.7 million square feet delivered in 2006 and 158.0 million square feet in 2007. Current retail is at 38 square feet per person in the U.S., versus 29 square feet in 1983. Vacancy levels are now slightly below 11%. **I expect vacancy levels to rise to 11.7% in 2011 before they begin a slow decline.**

Effective rents in 2010 were down around 1.5%, and a gap of 12% – 14% remains between "asking" and effective rents. I expect that gap to narrow to 9% – 11% in 2011 as the reality of declining demand, tenants wanting more concessions to "stay alive" and looming re-financings cause landlords to blink. **Effective rent growth in 2011 will be .7% – .9%.**

Retail Construction – U.S
2008 – 2015



Numbers have been rounded.
Source: Reed Construction.

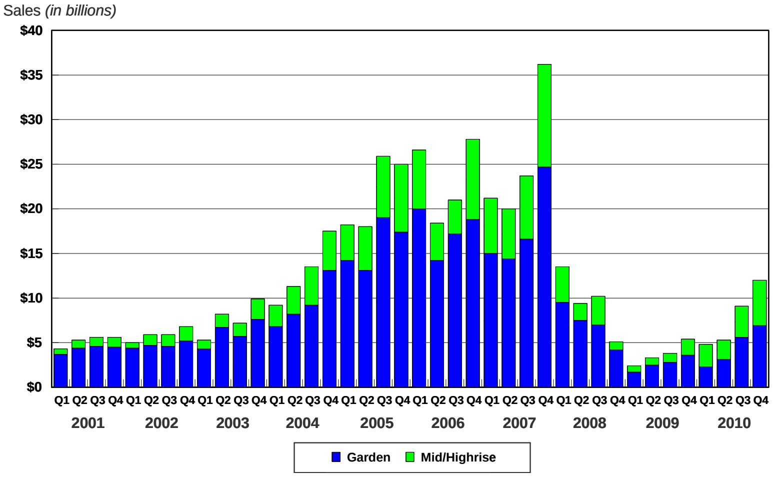
There will not be regional mall development until 2013 – 2014, and most mall activity will be portfolio buys, entity purchases, troubled asset sales or repositioning, global expansion and partnering, and refining the tenant mix in existing centers. Internal growth will be the mantra of mall owners in 2011. But watch for nominal rent increases over the next 24 months as retailers struggle to improve anemic profit margins.

Leases will get shorter, performance of retail assets will be challenging and throughout 2011 the retail sector will wander as it seeks stable ground. With the exception of grocery, drug and discount/warehouse retailers, 2011 will feel like a redo of 1973 – 1975. As Will Rogers once said, "Too many people spend money they haven't earned, to buy things they don't want, to impress people they don't like."

Multifamily Emerges First In The Recovery

Over the past two years the number of construction starts fell more than 60% below levels in 2005, 2006 and 2007. **In 2010 the number of starts (5+ units) rose to approximately 105,000 units.** According to NMHC, the third quarter activity in 2010 **was the largest year over year change in more than 25 years**. Completions declined to around 147,000 units. The shift has occurred from absorbing the delivery of units that began in 2007 and 2008. The dramatic two-year decline in construction activity bodes well for multifamily property owners in 2011 and beyond.

Sales Volume – Apartments
2001 – 2010



Source: ©2010 Real Capital Analytics, Inc. All rights reserved.

The perfect storm of favorable demographic trends, declining number of homeowners, tighter lending standards, limited additions to supply, slightly improving job market and economy plus favorable financing from the GSEs makes the apartment industry the darling of investors. According to Real Capital Analytics©, sales of significant apartment buildings rose 96% from a year ago to $33.7 billion. Cap rates for garden apartments were 6.9% by year-end 2010, while cap rates for mid/high-rise apartment buildings stood at 6.1%.

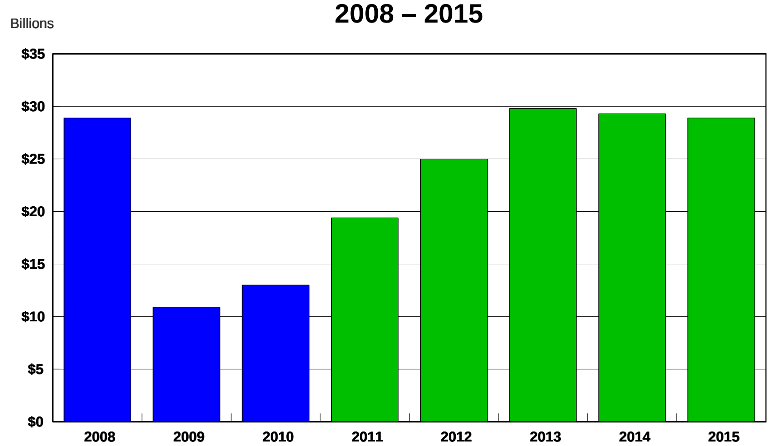
In 2011 I expect cap rates to decline 30 bsp – 50 bsp in core markets, and 10 bsp – 30 bsp in non-core markets. Despite cap rate compression, I expect the spread between the average cap rates to range from 150 bsp – 180 bsp above borrowing costs in 2011. This spread for leveraged deals will attract investors throughout the year.

Because only 55,000 – 62,000 units are expected to come online in 2011, **vacancy levels for all apartments should decline 50 bsp – 65 bsp.** Investment grade apartment vacancy levels should decline 45 bsp – 60 bsp to or slightly below 5.6%. **Effective rent growth should be around 2% (higher in some markets).**

The apartment industry further benefits from:

- Nearly a two-year delay in the average age of first-time marriage partners and subsequent birth of their first child.

Multifamily Construction – U.S.
2008 – 2015



Numbers have been rounded.
Source: Reed Construction.

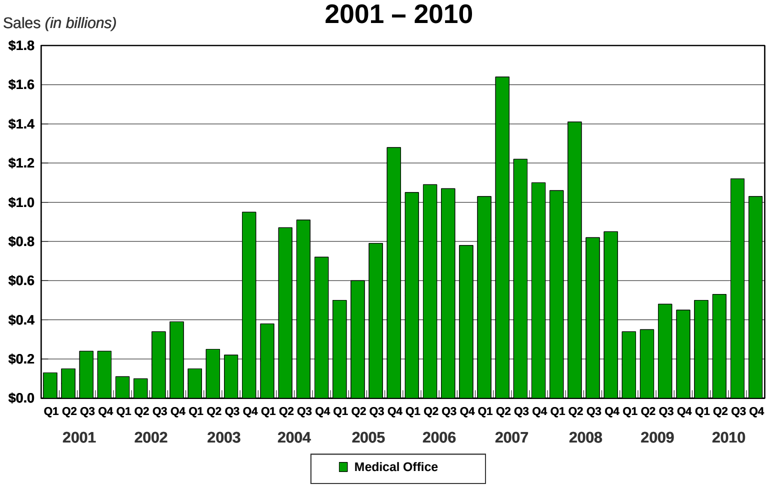
- **Only 12% of renters now have plans to buy a new home.**
- There are 20.3 million adults ages 18 – 34 living at home with their parents, while 3.8 million family members returned home to live between 2005 – 2009.
- Nearly one-third of Americans (according to Zillow) could not qualify for a home mortgage due to having low credit scores.
- The rising cost of transportation.

Improving fundamentals (core NOI likely up 5% – 6% in 2011), a shift to a more urban environment (e.g., mixed-use, redevelopment projects), and continued housing affordability issues will benefit the multifamily sector.

Healthcare Properties About To Take Off

Regardless of the outcome of current healthcare reform, meeting the needs of an aging and growing population will require additional healthcare facilities. According to Reed Construction, in 2011 63.0 million square feet of hospitals and clinics will be under construction. The overall value of hospitals and clinic construction in 2011 is expected to be $18.8 billion. Some analysts are projecting the need for as much as 50 million square feet of new medical facilities as a result of the healthcare legislation.

Sales Volume – Medical Office
2001 – 2010



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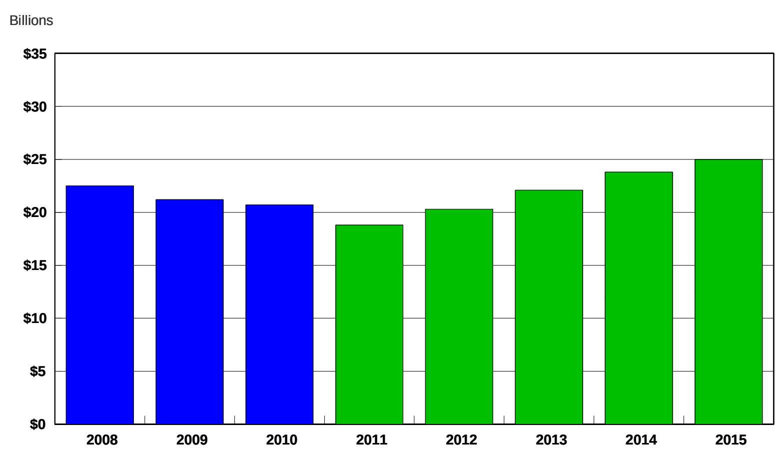
Healthcare is now around 16% of the U.S. economy (in 1980 it was 9% of the GDP). By 2030 70 million Americans will be over age 65. From 2011 through 2014, the construction expenditures for healthcare facilities are projected to be over $110 billion. **Over the next decade, more than 4.3 million new healthcare workers will be needed.** Among the fastest growing areas in healthcare today are nursing homes, centers for the care of dementia and Alzheimer patients, outpatient facilities and treatment/rehab centers. The rapid growth of medial devices, pharmaceuticals, orthobiologics, biotechnology, and nanotechnology are creating demand for space.

Over the past 12 months, $2 billion in significant medical office buildings were sold. **I expect cap rates to decline 50 bsp – 65 bsp in 2011 and vacancy levels of MOBs to hover around 6.0% – 7.1%.** Rents will continue to climb. The primary area to watch in the healthcare sector will be positioning and repositioning of companies seeking a national footprint, segment domination and brand recognition. Entity mergers and acquisitions will be the focus of many throughout the year. I expect development activity to pick up in 2011 and accelerate once financing becomes more accessible.

Healthcare Construction – U.S.
2008 – 2015



Numbers have been rounded. (Hospitals/Clinics)
Source: Reed Construction.

Service Companies Poised For Growth

The prevailing mantra among brokerage and property management firms in 2010 was (re)positioning for an expected recovery in 2011. By summer 2010, real estate service companies began to believe that the worst was behind them. Publicly traded service providers (CBRE, Grubb & Ellis, JLL, First Service) posted vastly improved 3Q results. According to my conversations with leaders in privately held service providers, around **80% were having "a better second half than expected," and most were very optimistic heading into 2011.**

In 2011 I expect investment sales volume to accelerate dramatically as the "workouts" and "sales" of troubled, non-performing or refinancing-challenged assets move through the system. **Valuation services could be up as much as 14% – 17% over the prior year,** and leasing activity will continue to improve as Corporate America renegotiates existing or expiring leases.

The challenge for real estate service companies in 2011 will not be a lack of opportunity, but it will be holding onto their talent base in a recovering market. Watch for continued talent movement between firms, talent spin-offs and increasing pressure to improve Broker split agreements. Leaders of real estate service companies must focus on expanding business lines, recruitment, rebuilding one's brand and facilitating the creation of dynamic, new business plans. Vigilance must be maintained for controlling costs and keeping G & A down.

Watch for continued consolidation, mergers and acquisitions in 2011 as companies seek to reposition and reinvent themselves in response to the New Normal. I expect entity multiples to rise 65% – 72% in 2011 as the global real estate service providers battle for what I believe will only be three, or possibly four, major players by 2015. Keep your eye on the activities of CBRE, JLL, Colliers International and Cushman & Wakefield. Hovering around the coveted fourth slot are NAI Global, Newmark Knight Frank, Avison Young and Cassidy Turley.

I also expect more, not fewer, leadership changes among the top five positions within the top 10 real estate service providers. The next 12 months will seem like musical chairs, with fewer available chairs to land.

Areas for growth in 2011: financing; appraisal, consulting; apartment brokerage; asset management; sustainability; recovery/restructuring; healthcare; and government services.

Real Estate
Service Company Performance

Category	Percent Change Over Prior Year	
	2010	2011
Leasing	+23% to +26%	+11% to +14%
Investment Sales	+40% to +50%	+12% to +15%
Property Management	+8% to +11%	+10% to +13%
Net Income	+9% to +11%	+15% to +20%

Source: CEL & Associates, Inc.

EBITDA profit margins in 2010 were around 11.8% -12.6%. Service companies are now performing at 2005-2006 levels. Gross revenues in 2010 were up 10%-13%.

Closing Comments

The real estate industry has avoided the abyss and finally can see the proverbial "light at the end of the tunnel." These next 12 months will be the year of the "Re-" word.

There are many tremendous opportunities for real estate owners and operators (public and private), but they will not be delivered on a silver platter. CEL & Associates, Inc. is tracking over 30 growing industry sectors and many growing markets. For real estate leaders in 2011, please consider the advice of Lou Holtz, **"Life is 10% of what happens to you and 90% on how you respond to it."** (Also a "re" word.) **Onward into 2011.**

If you'd like to share your comments, insights or ideas with me, please email them to newsletter@celassociates.com.

Regards,

Christopher Lee

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http://www.celassociates.com/onlinenewsletter/RealEstateOutlook.2010-2020-PartI.SA-K050110.pdf

Real Estate Outlook 2010-2020 Part II:
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