Real Estate Insights, Forecasts & Strategies

Strategic Advantage

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A Contrarian Perspective

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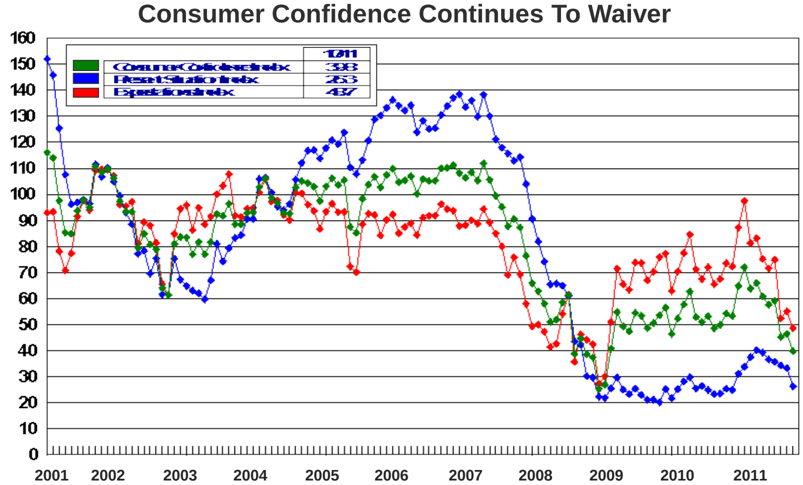
Friends & Colleagues:

Follow the path of independent thinkers and visionaries if you desire a better tomorrow. Follow emerging trends with the knowledge that the worse the situation, the greater the opportunity. Follow the actions of a contrarian if you fear a lack of being fearless. In today's phantasmagoric world of surprises, good followers can become great leaders.

Real estate leaders are generally optimists at heart, entrepreneurs by design and pessimists by default. However, in today's economic malaise and vacuum of political will, incredible opportunities will emerge for the contrarian. This is the time to grasp what is truly real and discard the mishigas which permeates today's prevailing opinion. Now is the time to view and capture opportunities resulting from today's difficulties. As Niccolo Machiavelli stated, "Entrepreneurs are simply those who understand that there is little difference between obstacle and opportunity and are able to turn both to their advantage."

I firmly believe that **far too many real estate practitioners suffer a confidence void**. There is declining confidence in the political governance abilities of our elected leaders to solve "obvious" problems on national, state and local levels. There is declining confidence in the direction the country is headed. There is declining confidence in the strategies and policies proposed to solve our nation's severe unemployment, reckless deficit spending, mounting national debt and future entitlement liabilities. There is declining confidence among a growing number of Americans that they will not be able financially to retire, to purchase a home, to provide a better tomorrow for their children and to realize the American dream. There is a lack of confidence that new business opportunities will return. Lack of confidence is contagious. Courage to confront this confidence barrier is needed to succeed. Ralph Waldo Emerson wrote, "The man of genius inspires us with a boundless confidence in our own powers." **What the real estate industry needs are confidence builders rather than confidence detractors**.

Consumer Confidence Continues To Waiver



Source: The Conference Board.

Contrarian Trends

In my April 2010 Strategic Advantage newsletter on Real Estate Cycles (*http://www.celassociates.com/onlinenewsletter/Cycles-2010-SA-K040110.pdf*), I shared my perspective and prediction that 2013 would be the beginning of the next boom in real estate. That is just a little over 12 months away, and we can already see many signs that this new growth period is indeed about to begin in select markets. The **Reluctant** are waiting for it to happen before jumping in; the **Hesitant** are cautiously moving forward and assuming new risks; the **Contrarians** are "all in" and are moving at lightning speed to capitalize on the unlimited opportunities not visible to those who continue to operate in an entrepreneurial cocoon.

Let's examine a few of the over 100 "positive" trends tracked by CEL & Associates, Inc.'s FutureScan that are now apparent to all, but action-able only to Contrarians.

Trends Followed By Contrarians

- In the first six months of 2011, business spending on equipment/software increased at an annual rate of 7.9%.
- Interest rates are at all-time lows.
- U.S. corporations have around $2.0 trillion on their balance sheets.
- AIA's Architectural Billings Index (through September 2011) showed commercial/industrial billing gains for nine consecutive months.
- The manufacturing sector expanded in September for the 26th consecutive month (ISM).
- During 2Q 2011, 88% of home mortgages were current…up from 87.3% one year earlier.
- Vacancy levels of industrial properties have declined 20bsp and the amount of sublet space has declined.
- Sales of retail assets through the 3Q 2011 ($30.1 billion) are double those levels from one year ago.
- Consumer spending was up 0.8% in July…the biggest single-month gain in five months.
- The Leading Economic Indicator in the U.S. has increased 29 out of the last 30 months.
- Year-to-date sales of apartments ($36.2 billion) are up 65% – 70% over the prior year.
- U.S. retail sales continue to improve over the 2009 low and should hit $417 billion in 2012.
- Sales of office assets through the 3Q11 ($40.9 billion) are up 64% for the same period last year.
- West Texas Intermediate spot oil prices per barrel are expected to remain flat through 2012.
- The recovery rate on defaulted mortgages (non-single family) is now 68% despite a 70% surge in distressed property sales in 2011.
- Sales of industrial assets through 3Q11 ($17.8 billion) are up 57% from the same period last year.
- U.S. households have reduced their debt load by approximately $1.2 trillion over the past three years.
- Total U.S. property sales in the 3Q11 ($49.8 billion) were up 38% from a year ago.
- Multifamily vacancy rates for institutional assets are now below 6.0%.
- Cap rates for apartments and suburban office buildings declined 25 bsp in September.
- The NACREIF Property Index posted its sixth consecutive quarter (through 2Q11) of positive returns.
- Multifamily rent growth in 2012 is expected to be 60 bsp – 120 bsp higher than 2011.
- Sales of hotel assets were up 150% through the first six months of 2011.
- The vacancy level at major seaport-related industrial properties continues to drop.
- The volume of air cargo transport will triple over the next 20 years.
- Employment growth in the high tech, healthcare and energy-related industries account for 35% of the 1.8 million jobs added since February 2010.
- Unemployment claims four-week average now at six-month low.
- Home prices were up in 19 of the 20 markets covered in the June S & P/Case Shiller Index.
- The Cass Freight Index grew 4.4% in August, and the U.S. expects to add 800,000 manufacturing jobs in 2012.
- Europe's July exports to the U.S. rose 9.4%.

From a national perspective:

- ❑ U.S. banks are in far better financial shape (they just need to resume real estate lending).
- ❑ The lack of construction activity among all property types over the past 36 months is bringing the supply/demand balance in line in some markets and potentially out-of-balance in several markets.
- ❑ U.S. corporations have cash to spend on new equipment and facilities.
- ❑ The consumer is deleveraging and bringing his/her household “under control.”
- ❑ China, Japan, Mexico and Europe only account for 60% of U.S. exports.
- ❑ U.S. real estate (NAREIT Equity Index) continues to outperform the U.S. stock market and NASDAQ.
- ❑ The shift back to the urban area and Sunbelt states is creating many (re)development opportunities.

While there are many signs that deflation has and is occurring across categories (wages, income, tangible assets, foreign currency and commodities), the Contrarian views this time as the perfect storm of opportunity amidst the struggles of competitors. **A Contrarian studies the landscape, looks to the horizon and seizes those opportunities missed by myopic competitors**. There is not one region of the country, one asset type or one customer segment that does not have opportunity. There is not one public or private, large or small real estate firm that could not improve operating and financial performance. **The self-imposed barriers to performance can be removed…with courage, the desire to win and the willingness to embrace new ways of conducting business**. This is not rocket science…it is embracing values-based leadership and operating fundamentals. Vince Lombardi said, “…the will to win and the will to excel – these are the things that endure and these are the qualities that are so much more important than any of the events that occasion them.”

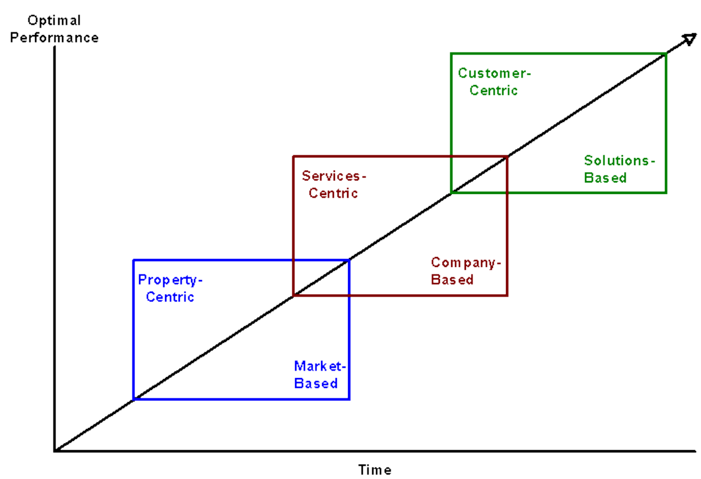
As the 4Q of 2011 moves steadily toward its end, real estate leaders, Boards of Directors and practitioners/professionals at all levels must take the time to create the contrarian strategies to win and prepare to implement those cornerstone actions in 2012. The following is a brief description of ways this can be achieved.

Contrarian Strategies

Create A Unifying Vision: Listed first, for a reason, this is the foundation from which all other strategic and tactical activities originate. **It is very difficult to know where you are going if all roads lead there**. Developing a motivating, memorable and measurable vision statement that is collaborative, embraced by all and that provides clarity for business priorities takes time. I have been involved in many vision-creating sessions over the past 30 years and witnessed the powerful results of what can happen when there’s unanimity around a vision of tomorrow. When all the musicians are following the same sheet of music, a wonderful sound is possible.

Shift To A Customer-Centric Business Model: Literally **everything that happens in the real estate industry involves a customer**. Whether that is a buyer, a seller, a tenant, a resident, a guest, a shopper, a lender, an investor or a community…creating a customer-centric organization and operating systems that build/enhance customer satisfaction and retention is critical. Remember, customer service is a behavior not a strategy or a policy.

Shift From Property To Customers



CEL & Associates, Inc.

Elevate Knowledge To The C-Suite: One of the biggest mistakes real estate firms, leaders and transaction professionals make is confusing information with knowledge. Too many decisions today are based on information alone, rather than the interpretation and conversion of data that provides knowledge. Creating a robust internal, or access to an external, research capability or resource is a must for 2012 and beyond. Today's constantly changing economic, financial and market environments mandate intimate, proprietary and perspective knowledge. **A competitive edge cannot be achieved by relying upon historiography.**

Take Care Of Your Talent: As the overall market continues to improve, rewarding and recognizing the achievements and contributions of others is very important. Every real estate firm which has not dramatically revised/updated their compensation plans and incentive system(s) must do so. Based on hundreds of calls and emails we receive at CEL & Associates, Inc. throughout the year, what and how to pay current and rising stars, leaders and performers, is a top concern of many real estate companies. An improving market creates financially rewarding opportunities to leave (i.e. the process of "buying talent"). The significant shifts in base salaries, annual and long-term incentive plans, production splits, and recruitment/retention strategies have been remarkable. **Without a contemporary talent management plan and an employee motivation program in place, performance excellence is in doubt.** As Steve Jobs said, "My job is to create a space for them, to clear out the rest of the organization and keep it at bay." Jobs *created an environment* for his employees in which they could do what they did best.

Compensation and Budgeting Trends

	Merit Increases				Other Budget / Planning Trends				
Year	Senior Management	Exempt Employees	Non-Exempt Employees	Company Average	General Inflation Rate	Incentive Compensation - Bonus Realization	U.S. GDP Growth (a)	Total Medical $ Growth (b)	Employee Share of Healthcare Costs (c)
2001	5.8%	4.9%	4.2%	5.2%	2.8%	92.0%	1.1%		
2002	4.0%	3.8%	3.5%	4.0%	1.6%	86.0%	1.8%		
2003	3.7%	3.6%	3.4%	3.8%	2.3%	80.0%	2.5%		
2004	3.9%	3.5%	3.2%	3.7%	2.7%	83.4%	3.6%		
2005	4.1%	3.5%	3.2%	3.7%	3.4%	87.0%	3.1%		5.6%
2006	4.2%	3.7%	3.3%	3.9%	3.2%	87.8%	2.7%	8.5%	5.4%
2007	4.7%	3.9%	3.7%	4.2%	2.9%	83.4%	2.1%	8.5%	12.8%
2008	3.3%	3.5%	3.5%	3.6%	3.9%	73.1%	0.4%	7.6%	10.1%
2009	1.4%	2.0%	2.1%	2.0%	-0.3%	64.4%	-2.4%	7.5%	14.7%
2010 Ave. (1) **2010 75th (1)**	**2.2%** **3.5%**	**1.9%** **3.3%**	**1.9%** **3.1%**	**2.0%** **3.5%**	**1.6%**	**67.3%**	**2.9%**	**7.8%**	**13.5%**
2011 Ave. (2) **2011 75th (2)**	**3.1%** **4.0%**	**2.5%** **3.5%**	**2.4%** **3.4%**	**2.5%** **3.8%**	**2.8%**	**77.8%**	**2.7%**	**7.7%**	**9.7%**
2012 Ave. (3)	**3.5%**	**3.1%**	**3.4%**	**3.4%**	**2.8%**	**80.3%**	**3.0%**	**8.5%**	**9.5%**

(1) Final results for 2010 as reported in CEL 2011 National Compensation Survey.

(2) 2011 figures based on CEL 2011 National Compensation Survey (2Q 2011). 2011 inflation is as of June, 2011.

(3) Forecast for 2012 incorporates early feedback on assumptions for budgeting.

Source: CEL & Associates, Inc./CEL Compensation Advisors, LLC.

Sell Non-Strategic Assets: Any property that is considered to be functionally, geographically, financially undesirable, not core to ongoing operations and/or not contributing to the brand of the enterprise, should be sold. Focusing on growing one's portfolio must be strategic and not governed by legacy or precedent decisions.

Refinance Now Before It Is Too Late: Federal Reserve Chairman Ben Bernanke's pronouncement that the Fed intends to hold interest rates at their current levels through mid-2013, was not without dissent. The bottom line of all the maneuvering by the Fed and Fed Chairman is a warning shot that interest rates will begin to rise. Thus, now and **over the next 12 months is the time to lock in loans at some of the lowest interest rates in years.** Talk to your lenders, refinance if you can, obtain as long a term as you can and move forward. Capitalize on this opportunity before it becomes a future challenge.

Secure A Deep-Pockets Capital Partner: Capital is king and will be for several years. If your organization has not secured a long-term capital partner (non-programmatic), now is the time to consider this strategy. You may need to sell a portion of your company to achieve this pertinent and aligned source of investment and operating capital…but based on recent transactions in which we have been involved, it is clearly worth it. **You must have cash on hand to play the 2012 – 2017 opportunity game.**

Real Estate Returns vs. The Stock Market

Year	NAREIT Equity REIT Index Of Total Returns: Office	Industrial	Retail	Apt.	All Equity REITs	Stocks: S&P 500	Russell 2000	NASDAQ
1996	51.8%	37.2%	34.6%	28.9%	35.3%	22.7%	16.5%	23.0%
1997	29.0%	19.0%	17.0%	16.0%	20.3%	33.1%	22.4%	22.1%
1998	17.4%	-11.7%	-4.9%	-8.8%	-17.5%	28.6%	-2.5%	39.6%
1999	4.3%	3.9%	-11.8%	10.7%	-4.6%	21.0%	21.3%	85.6%
2000	35.5%	28.6%	18.0%	35.5%	26.4%	-9.0%	-3.0%	-39.3%
2001	6.7%	7.4%	30.4%	8.7%	13.9%	-11.8%	2.5%	-21.1%
2002	-6.8%	17.3%	21.1%	-6.2%	3.8%	-22.0%	-20.4%	-31.2%
2003	34.0%	33.1%	46.8%	25.5%	37.1%	28.7%	47.3%	50.0%
2004	23.3%	34.1%	40.2%	34.7%	31.6%	10.8%	18.3%	8.6%
2005	13.1%	15.4%	11.8%	-14.7%	12.2%	4.9%	4.5%	1.4%
2006	45.2%	28.9%	29.0%	40.0%	35.1%	15.8%	18.4%	9.5%
2007	-19.0%	0.4%	-15.8%	-25.4%	-15.7%	5.5%	-1.6%	9.8%
2008	-41.1%	-67.5%	-48.4%	-25.1%	-37.7%	-37.0%	-33.8%	-40.5%
2009	35.6%	12.2%	27.2%	30.1%	28.0%	26.5%	27.2%	43.9%
2010	18.4%	18.9%	33.4%	47.0%	28.0%	15.1%	26.9%	16.9%
2011	-2.8%	-9.3%	7.6%	10.3%	3.4%	-1.5%	-8.0%	-1.7%
Avg. Annual Return	15.3%	10.5%	14.8%	13.0%	12.5%	8.2%	8.5%	11.0%

Total Return: A stock's dividend income plus capital appreciation, before taxes and commissions. 11/1/11.
Source: NAREIT and CEL & Associates, Inc.

Expand Your Revenue Stream: A common mistake made by many real estate firms is the inability of unwillingness to vertically grow revenues from existing clients, or horizontally grow revenue from new clients. For real estate service providers, a more diverse platform of fee-for-service options is critical. CBRE and JLL have around 20 different lines of business. Adding a MBE, Green, Project Management, Appraisal, Government Services, Consulting, Research, Finance, Facility Management and Value Recovery capability is popular today. Conduct an internal audit to make sure all "potential" fees are being billed. Diversify your client base and seek ways to expand vertically and horizontally. Leverage your brand and harvest your relationships.

Utilize A Dashboard: It is very important to communicate progress-to-date in a transparent manner. Implementing a performance dashboard that contains historical, current, prior period, YTD and budget comparisons; the status of current strategic initiatives; highlights current Key Performance Indicators; and displays competitive benchmarks is key to "keeping everyone on track and focused on the proper priorities."

Growing Industry Sectors

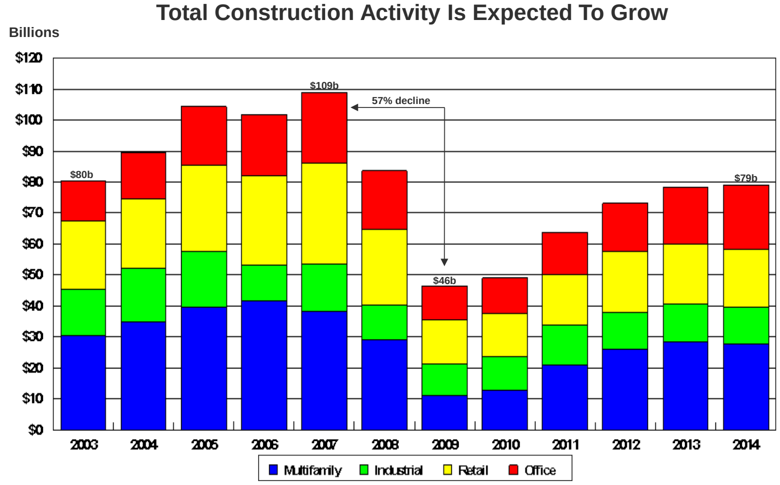
- Industries Serving Seniors
- Software Development
- Healthcare
- Life Sciences/Biotech
- Technology
- Government/Government Related
- Defense/Security
- Communications
- Trade/Logistics
- Data Centers
- Research & Development
- Full Service Grocery
- Personnel Management
- Consulting
- Electronic Media
- Wireless Technology
- Nanotechnology
- Food Distribution Logistics
- Waste Management
- Emerging Technologies
- Colleges/Universities
- Legal/Accounting
- Science
- Green Industries/Clean Tech
- Pharmaceutical
- F.I.R.E.
- Entertainment
- Energy & Alternative Energy
- Internet-Based Entities
- Financial Management
- Computer Programming
- Nonprofits
- Medical Devices
- Network Security

Source: CEL & Associates, Inc.

Know How To Price Risk: It is easy to acquire an asset or make an investment. It is very difficult to make the right risk-based decisions on when, where and how much to invest. **Pessimism and reduced confidence can influence the market price of risk**. Often pessimism is perceived to be perpetual and real estate investors tend to adopt an "anticipated utility" model that assumes a stream of future outcomes. The results are investment decisions that do not include the transition probabilities (i.e. the assumption that future outcomes will be based on historical outcomes). The ability to price risk is the foundation upon which future outcomes are dependent.

Listen To The Voice Of The Customer: When was the last time you received an independent assessment of your performance from your customer's perspective? **Do you wonder what your customers really think about your services/performance?** Over the past several years, CEL & Associates, Inc. has conducted over 10 million surveys and have learned unequivocally that: no two firms are alike; what you thought was occurring wasn't; and the differences between the tenant or resident and onsite management teams are often dramatic. An annual survey conducted by an independent expert is the only solution.

Total Construction Activity Is Expected To Grow



Numbers have been rounded.

Source: Reed Construction Data.

Place A Premium On Innovation: One of the positive results from the recent recession is the new and increased value real estate firms place on innovation. During prior periods of financial challenge, real estate firms were among the first to "return to the basics," "discontinue new initiatives," or forgo investments in new technologies or business practices. However, **innovation is not just a process; it is a system of reinventing the way business is conducted**. Innovation creates a competitive advantage and therefore those innovation activities must be collaborative with all Stakeholders.

Go Green: This is one business practice that will not go away…it has become an imperative strategy that is now viewed as an obligation. While the requirements and existing solutions to Go Green are abundant, every real estate firm must embrace and adopt sustainable and environmentally-friendly business practices…**even though tenants are not willing, at this time, to pay for it**. Perhaps the first step is to empower a Green Committee to identify the opportunities and potential actions that could occur. From adopting Green leases, recycling, use of energy-efficient equipment and products, application of green materials for TI finishes, to embracing Energy Star practices…the opportunities are endless.

Embrace Process Improvement Initiatives: There is not a real estate firm in the U.S. today that could not improve operating performance, worker productivity and supply chain efficiency by 10% or greater. Some firms have adopted or are considering zero-based budgeting, while others are considering internal continuous improvement initiatives. Reduction of overhead expenses; monitoring use of law firms, accountants, marketing specialists, and pre-development consultants; and setting clear policies on expenditure authorizations are important areas to focus attention. **Every real estate firm in 2012 should have at least two to three process improvement initiatives** with measureable outcomes.

Create A Plan For Growth: Revenues do not grow just because your firm is "open for business." Identifying, targeting, pursuing, securing and harvesting new customers and opportunities cannot be done in a vacuum. Best-in-class real estate firms and contrarian leaders are laser-like in their pursuit of new business. Heading into 2012, does your firm know who it will pursue for new business? Who are your firm's top 10 or 20 target clients? Who is accountable for securing that opportunity? **How is your firm mining existing customer relationships?**

Stay True To Your Core Values: Nothing could be more important than adhering to a set of core beliefs. Aristotle stated, "We do not act rightly because we have virtue or excellence, but we rather have those because we have acted rightly." Confucius said, "To see what is right and not to do it is want of courage." Values are not nice statements that appear in brochures or wall plaques, they are core beliefs that govern behavior, business practices and decisions. Values are the ethical ideals of an organization. **Do you know and can you recite your firm's core values and code of conduct?**

Cultivate An Appetite For Change: If you are looking for today's rapidly moving, constantly changing environment to slow down…you are going to be sorely disappointed. Continuing to live and operate in a cocoon of denial is a prescription for failure. So rather than avoid or assume change is not necessary, contrarian leaders embrace change. **Status quo is not an option**. There are new ways of conducting business. There are new business practices that can improve the overall level of quality, service and performance. The New Normal begins and ends with a continuous question of "why" things are as they are and "how" they could be changed to reflect current and emerging market conditions.

The Comments Of Change Killers

- ❑ "We can't afford this" or "It isn't in the budget.
- ❑ "We're too busy to make these changes."
- ❑ "Why change when we have been so successful?"
- ❑ "None of our competitors are doing this."
- ❑ "Let's form a committee to evaluate this."
- ❑ "Why change what we have been doing for years?"
- ❑ "Can you guarantee that your idea will work?
- ❑ "Let's discuss this later."

Source: CEL & Associates, Inc.

Closing Comments

Contrarians are those who avoid the pessimism of today, go against the prevailing market trends and embrace a future many are unable to envision. **Contrarians bring wisdom to the business-as-usual opinions of others.** Lasting success in the real estate industry does not happen by chance…it occurs because someone had the insight and ability to see above the clouds of uncertainty and doubt. The future indeed has many challenges. **The clouds have arrived…now is the time to soar above them**.

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

Regards,

Christopher Lee

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Prior Newsletters: If you would like to download prior newsletters, please go to the following links.

The Role Of Real Estate In Society
http://www.celassociates.com/onlinenewsletter/TheRoleOfRealEstateInSociety-SA-K091411.pdf

Prospects For A Real Estate Recovery Could Wait Until 2013
http://www.celassociates.com/onlinenewsletter/ProspectsForRealEstateRecovery-SA-K082211.pdf

Tomorrow Has Already Arrived
http://www.celassociates.com/onlinenewsletter/TomorrowHasAlreadyArrived-SA-K062711.pdf

Age Of Consequence & Opportunity
http://www.celassociates.com/onlinenewsletter/AgeOfConsequence-SA-K050611.pdf

Take Control Of Your Destiny
http://www.celassociates.com/onlinenewsletter/TakeControlOfYourDestiny-SA-K032911.pdf

2011…A Year Of The "Re" Word
http://www.celassociates.com/onlinenewsletter/2011AYearOfTheReWord-SA-K021111.pdf

Closing Out 2010 And Preparing for 2011
http://www.celassociates.com/onlinenewsletter/ClosingOut2010AndPreparingFor2011-SA-K120310.pdf

Talent…Opportunity Or Crisis?
http://www.celassociates.com/onlinenewsletter/Talent-OpportunityOrCrisis.SA-K102010.pdf

Twelve Cornerstone Strategies 2010-2011:
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Real Estate Outlook 2010-2020 Part II:
http://www.celassociates.com/onlinenewsletter/RealEstateOutlook.2010-2020-PartII.SA-K060110.pdf

Real Estate Outlook 2010-2020 Part I:
http://www.celassociates.com/onlinenewsletter/RealEstateOutlook.2010-2020-PartI.SA-K050110.pdf

Real Estate Cycles – They Exist…And Are Predictable:
http://www.celassociates.com/onlinenewsletter/Cycles-2010-SA-K040110.pdf