Real Estate Insights, Forecasts & Strategies

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Strategic Advantage

Issue K100812

What Is Your Core Strategy For 2013?

"Run For Your Life"…"Tread Water"…"Go All In"

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Friends & Colleagues:

Life in the real estate industry is all about risks - from hiring talent, selecting partners, identifying investments, incurring debt, terms and conditions, to pricing. Real estate is a game of calculations, maneuvers, assessments, strategy and decisions. As T.S. Eliot said, **"Only those who will risk going too far can possibly find out how far one can go."** Over the past 40 years, the real estate industry has been defined (and maligned) by those who do not want to be ordinary. The entrepreneurial risk-takers and the 10Xers, as Jim Collins would label them, have been rewarded.

However, as we get ready for 2013, this time it is different. **This time the road less travelled may not be worth taking,** or maintaining status quo may have far more risk than going all in. Opportunities seem hard to find because of an increasing reliance on heuristics. Indeed, these are uncertain times **when selecting the right strategy can be the difference between success and failure**. Knowing "what is next" or "what is around the corner" can be a daunting challenge for those possessed by *dubitare* (i.e. doubt/hesitation). **Today we are at a tipping point between more of the same and an era of endless possibilities**.

While the future of the real estate industry is assured, the journey and how-to-get-there are in doubt. The determination of **success over the next five to seven years will be based on strategy not tactics, actions not theories, leadership not fellowship, psychographics not demographics, and goals not hypotheticals**. Now is the time to shed cognitive bias and take control of your destiny. Failure to develop and execute the proper strategies ultimately will result in becoming Sisyphus forever.

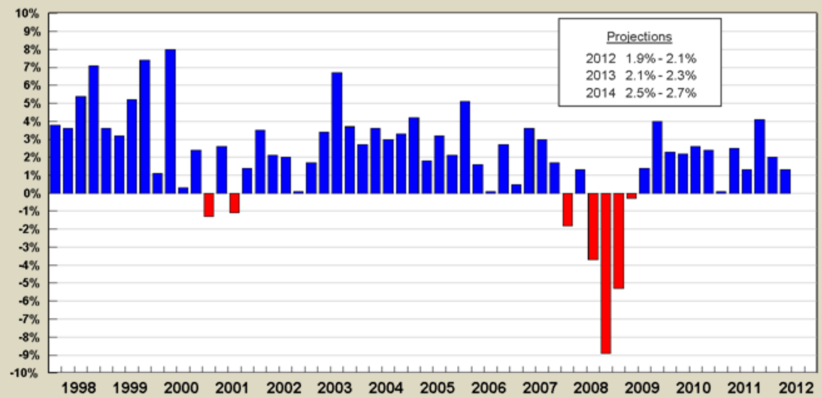
We have a fragile economy with an increasing probability of becoming recessionary by 1Q/2Q 2013. We have subdued expectations for economic growth. **QE3, the $480 billion fiscal rescue of choice, not necessity, by the Fed** ($40 billion a month until there is a substantial turn in job growth) is a report card on the failure of the current economic policies to revitalize the economy. **The Fed's balance sheet has risen to nearly $3 trillion from less than $1 trillion before the fiscal crisis**. Remember that the Fed holds $1.64 trillion of government debt (as of early September 2012), and as a result has reduced government interest expense and size of the government's operating deficit ($1.164 trillion for the first 11 months of fiscal 2012). **Today the Fed owns $1 out of $6 of the national debt…the largest percentage in history**.

Eventually interest rates will rise, and I expect by 2017 – 2018 net interest expense could rise to nearly 3% of GDP…the highest level since 1948. The Fed's QE3 bailout of excessive government spending distorts reality, and real estate entrepreneurs are uncertain whether to buy, sell or hunker down. **Inflation risks have increased with the QE3 decision**.

We continue to muddle through an anemic economic jobless recovery, and the 20 million or so unemployed or under-employed Americans are becoming frustrated and disillusioned. We have a Federal Reserve that, according to many analysts, is "out of tricks," and daily we experience the results of political gridlock, unprecedented deficit spending and the pending Taxmageddon in 2013. While I expect a more traditional economic recovery to begin in 2014, **the current malaise is, unfortunately, consistent with past real estate cycles** (see our newsletter on Cycles by **clicking this web link**).

So, what can one do? What are the options and macro trends to be considered for 2013 and beyond? Is this a good or bad time to invest in real estate? Is this the best or worst time to undertake growth initiatives? Is this the best time to hire or maintain the status quo? Is this the best time to accelerate new initiatives or curtail existing activities? Is this the perfect time to sit on the sidelines and wait for a more certain future or take advantage of turmoil and chaos? The answer to these and other questions asked by many readers is the basis for this month's issue of *Strategic Advantage*.

Gross Domestic Product
(Percent Change, Seasonally Adjusted Annual Rate)



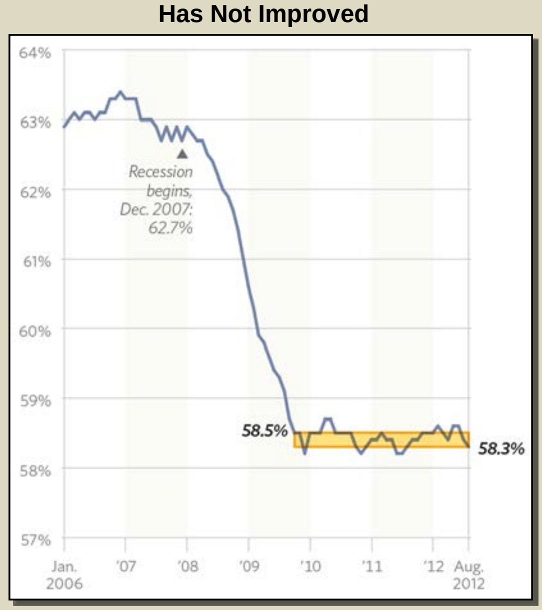
Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Overall	4.4%	4.8%	4.1%	1.1%	1.8%	2.5%	3.5%	3.1%	2.7%	1.9%	-0.3%	-3.1%	2.4%	1.8%	2.0%

Note: From 1997 until 2012 the average GDP was 3.3% (red line).
Source: Bureau Of Economic Analysis.

Economic Growth…Or Lack Thereof

We are in a "high-anxiety" economy with more concerns than positive opinions. U.S. economic growth was 2.0% in 1Q 2012, and only 1.3% in 2Q. The ISM PMI Index for September (51.5%) reveals the first sign in three months of a slowly recovering manufacturing sector. Consumers are cutting back on their purchasing of big-ticket items, opting instead for discounts and less pricey food and essentials. **American consumers have concluded that they need to spend less and owe less**. Consumer prices in August saw the biggest rise in more than three years. Energy prices increased 5% in August, and real hourly earnings in August fell 0.7%, the most since June 2009. The warm winter probably contributed to payroll growth over the first six months; however, GDP remains 12% - 13% below its historical trend, and **total employment remains over 10 million jobs below what is "normal."**

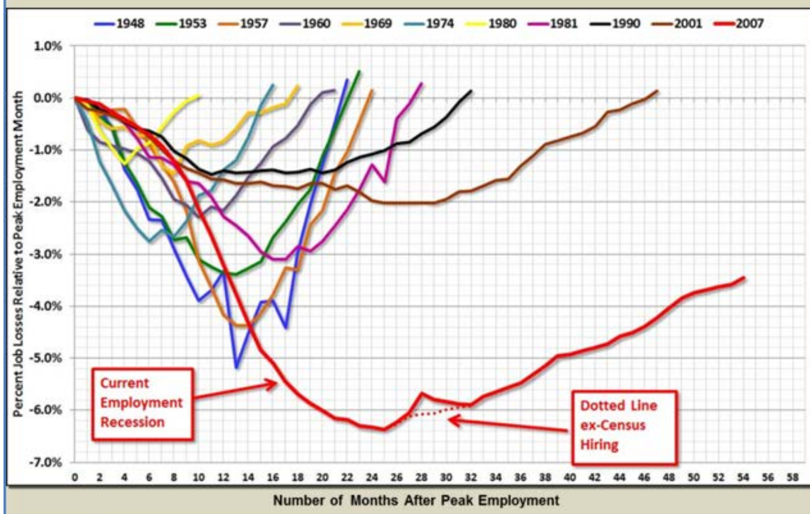
The Unemployment / Population Ratio Has Not Improved



Source: Heritage Foundation.

Since 2009, household incomes have declined by more than $2,000, according to the U.S. Census Bureau. Approximately 2.7 million more people are living in poverty now than in 2009. SNAP (formerly known as food stamp programs) enrollment is up 46% (46.7 million Americans), disability enrollment is up 18% and direct Federal payments to individuals are up 21% since 2009. The top 1% of wage earners now pay 37% of all income taxes.

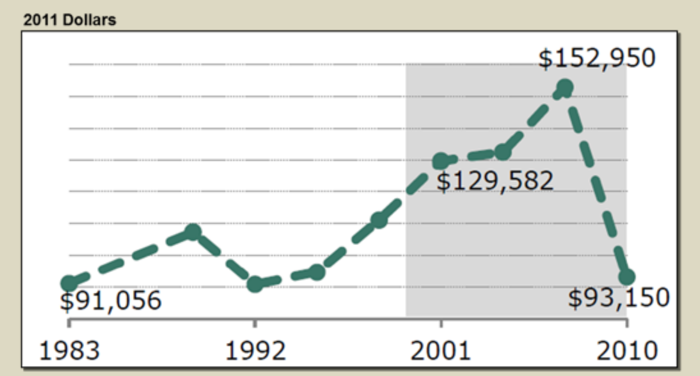
Percent Job Losses In Post WWII Recessions



Source: www.calculatedriskblog.com.

For 18 – 29 year-olds, the backbone of the apartment industry, the unemployment rate is 12.7%, and **only 49% of college graduates in 2009 – 2011 found full-time jobs within one year of graduating**. During the past five years, over 50% of college graduates say their current job does not require a four-year degree.

Middle Class Net Worth Plummets



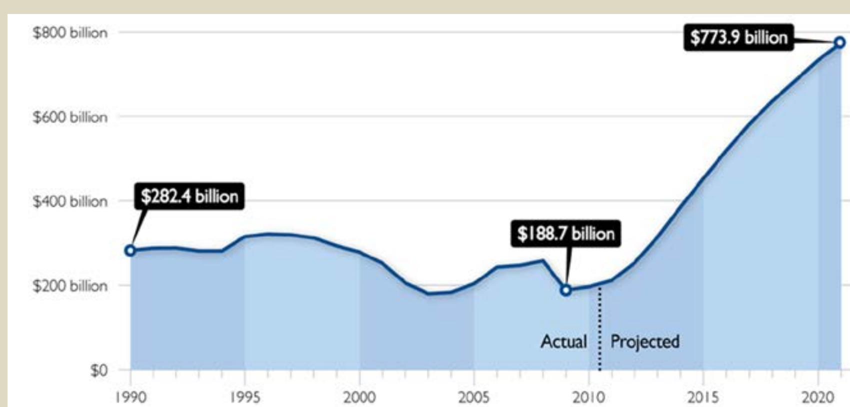
Source: Pew Research.

In 1960, according to the U.S. Bureau of Economic Analysis, entitlement payments were $24 billion (in current dollars)…by 2010 that number had climbed to $2.2 trillion in money, goods and services.

The fastest growing jobs in America today (retail sales) pay only $10.97 per hour. **Three of the top 10 occupations between now and 2020, according to the U.S. Department of Labor, require no more than a high school education, and five others do not require a high school diploma**.

Nonfarm payrolls rose only 96,000 in August, the fourth time in five months that net hiring has been below 100,000. Remember, we need to add a minimum of 125,000 jobs per month just to keep pace with population growth. **Economic stagnation is keeping private sector employees on the sidelines**.

U.S. Net Interest Payments Expected To Triple

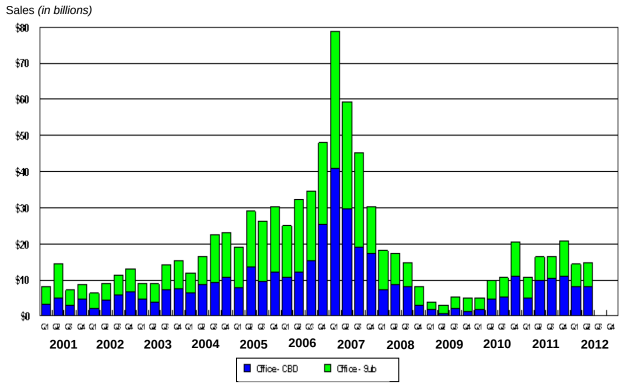


Source: White House Office of Management and Budget and Congressional Budget Office.

Median household income after inflation has fallen to $50,678… 8% lower than in 2007. Inflation-adjusted median household income declined 1.5% in 2011. Real median net worth has plunged 40% since 2007. This decline has and will continue to have a significant dampening effect on the real estate industry.

Commercial Real Estate Trends

Sales Volume – Office
2001 – 2012

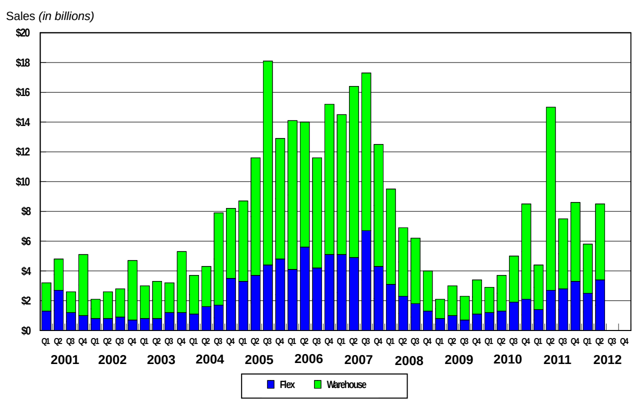


Select Office Vacancy Rates
2012 - 2015

Market	2012	2013	2014	2015
Austin	14.6%	11.9%	9.5%	7.6%
Boston	18.8%	18.2%	17.8%	17.6%
Chicago	17.9%	16.4%	14.8%	13.3%
Dallas	18.0%	14.1%	11.2%	9.1%
Denver	19.9%	18.7%	7.6%	5.6%
Houston	12.9%	10.0%	16.0%	14.9%
Minneapolis	19.0%	17.4%	12.1%	10.3%
San Diego	18.3%	15.1%	6.5%	5.1%
San Francisco	11.8%	8.7%	2.9%	0.3%
Washington, DC	10.6%	6.5%	17.4%	16.4%

Source: NCREIF.

Sales Volume – Industrial
2001 – 2012

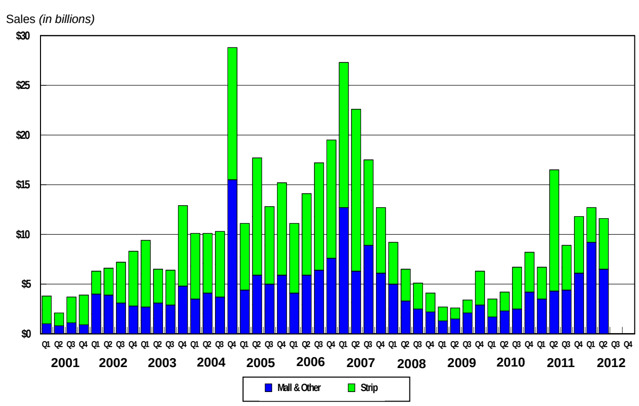


Select Industrial Vacancy Rates
2012 - 2015

Market	2012	2013	2014	2015
Atlanta	8.5%	6.3%	4.6%	3.3%
Chicago	9.0%	7.3%	5.3%	3.4%
Dallas	7.4%	5.0%	3.2%	1.7%
Denver	6.5%	5.0%	3.3%	2.1%
Houston	7.1%	4.8%	2.8%	1.3%
Los Angeles	5.8%	4.7%	4.4%	4.5%
Miami	7.8%	6.1%	4.6%	3.3%
Phoenix	13.4%	10.2%	7.4%	5.3%
San Diego	13.5%	10.7%	8.2%	6.3%
Seattle	8.7%	6.1%	4.0%	2.4%

Source: NCREIF.

Sales Volume – Retail
2001 – 2012



Select Retail Vacancy Rates
2012 - 2015

Market	2012	2013	2014	2015
Atlanta	10.4%	8.4%	6.8%	5.8%
Austin	6.9%	4.1%	1.6%	-0.4%
Chicago	9.9%	8.2%	6.3%	4.6%
Dallas	10.2%	7.9%	6.0%	4.6%
Denver	7.6%	5.9%	4.1%	2.8%
Houston	8.5%	6.3%	4.5%	3.1%
Minneapolis	8.2%	6.6%	5.1%	4.0%
San Diego	2.6%	-0.6%	-3.3%	-5.4%
San Francisco	1.0%	-2.1%	-4.3%	-5.8%
San Jose	3.3%	0.0%	-2.6%	-4.5%

Negative vacancy indicates more demand than space available.

Source: NCREIF.

Median Household Income 1970 – 2010	Looming Economic Threats Cause U.S. Consumer To Re-Trench

2011 Dollars

Source: Pew Research. Not adjusted for household size.

Looming Economic Threats Cause U.S. Consumer To Re-Trench

- Social Security…needs $3.7 trillion today to meet future liabilities.
- Medicare…needs $22.1 trillion to fund future liabilities.
- Global restructuring (Europe) and Middle East tensions/conflicts.
- Infrastructure…needs over $1.0 trillion to keep up with demand and decay.
- State Pension Funds…needs $2.5-$3.0 trillion to fund future liabilities.
- Health Care…needs $2.0 trillion to fund future liabilities.
- Roaring inflation when the money multiplier rises.
- Federal Debt…now $14.3 trillion projected to rise to over $20.0 trillion by 2020.
- Household Wealth…still $8.0 trillion below pre-recession level.
- Taxmageddon…$500 billion tax increase beginning January 1, 2013.
- Unprecedented Federal deficit spending and likely deflationary environment.

Source: CEL & Associates, Inc. and various news sources.

According to CoreLogic, **10.8 million or 22.3% of all residential properties had negative equity by the end of 2Q 2012. An additional 2.3 million borrowers had less than 5% equity in their homes**. Currently 84.9% of borrowers underwater continue to pay their mortgages. Nevada (59%), Florida (43%) and Arizona (40%) have the highest percentage of mortgages with negative equity.

While the U.S. has regained around 3.8 – 3.9 million jobs, the combination of the new workforce (1.25 million) added annually, under-employed and those no longer seeking work reveals a very large pool of “available workers” with no prospects. The national accounting firm **Ernst & Young released a study in July 2012** indicating the current Administration’s proposed tax hike on the wealthy (“small businesses”) **could result in 700,000 additional jobs lost. If the automatic Budget Control Act takes effect January 2, 2013, analysts project an additional 2.14 million Americans could lose their jobs**. According to research at George Mason University, unemployment will climb over 9%, and U6 unemployment could increase to 16% - 17%. It’s hardly an economy on the mend.

GDP growth was 2.4% in 2010, 1.8% in 2011 and in the 2Q 2012 economic growth was revised downward to 1.3%. A few years ago America’s debt to GDP ration was around 60%...today that is rising above 100%.

It took the first 205 years for America to run up $5 trillion in national debt. It has taken less than four years to add another $5 trillion, with more trillions of debt budgeted to be added over the next several years. Federal debt is on track to grow another $1 trillion in 2013. Foreigners now own over 48% of U.S. federal debt and the Fed owns 15.1%.

With rising unsustainable national debt, U.S. businesses are delaying/curtailing investments, borrowings, hiring decisions and/or growth initiatives due to the uncertain economic direction emanating from Washington, DC. Based on current trending data, I expect U.S. businesses will face higher costs as well as the U.S. consumer, who will likely have less income over the next several years. Real estate firms must adjust their business and operating strategies to meet and overcome this reality.

According to a recent study (March 2012), **the cost of Federal regulations is now over $1.75 trillion**. Small firms (with less than 20 employees) spend $10,585 per employee per year to comply with Federal regulations, vs. $7,755 per employee for firms with more than 500 employees. The cost of hiring is becoming prohibitive to some.

Premiums for employer-provided family healthcare coverage have risen to $3,065 (74%) from 2008 to 2012. If one looks at just the 2009 to 2012 period, premiums have increased $2,370, according to the Kaiser Family Foundation.

U6 unemployment, a truer picture of unemployment in the U.S., now stands around 15%. Some analysts believe the real unemployment/under employment figure is closer to 17% - 19%. **The U.S. workforce participation rate (63.6%) is now at its lowest level since 1981**. In order to drop the unemployment rate by 1%, we need 250,000 net new jobs per month. In September, only 114,000 jobs were created. On September 13, the Fed Chairman stated that the economic recovery is in jeopardy if the automatic spending cuts and the proposed tax hikes take effect. **Fed Chairman Bernanke warned of a "fiscal cliff" and of a "major fiscal shock" if current fiscal policies remain unchanged**.

On September 14, 2012, ratings firm Egan-Jones cut its credit rating on the U.S. government to "AA-" from "AA," **citing that the new quantitative easing (QE3 or "printing money") would "hurt the U.S. economy."** Moody's Investor Services has indicated it may downgrade government bonds if Congress and the White House don't reach a budget deal before $1.2 trillion in spending cuts and tax increases go into effect at the beginning of 2013. Remember, in August 2011, Standard & Poor's announced that it has downgraded the U.S. credit rating.

I am concerned about the long-term employment prospects for younger Americans. While the national unemployment rate is 7.8%, the unemployment rate for 16 – 24 year-olds is over 16%. For Latino youth, that unemployment figure jumps to 20.5%, and for African Americans, unemployment now tops 30.2%. Also, these unemployment numbers do not count those who have given up looking for jobs. **Today fewer than 50% of 16 – 24 year-olds hold any job at all. Many analysts believe the youth job recovery may not occur until 2021**. We indeed live in uncertain times and we are going to have to deal sooner rather than later with the unintended consequences of monetary and economic policies. What happens when the Fed stops printing money to control inflation? This is a very dangerous game and the impact on the real estate industry could last for years or perhaps decades. Thus, **the need for real estate firms to adjust their business strategy has moved to the #1 priority for 2013 and beyond**.

According to U.S. Census data there are 2.7 million fewer jobs for people 16 – 24 than if the economy were healthy. **The Bureau of Labor Statistics estimates that there will be 2 million fewer jobs for young people by the end of the decade**. One study found that for every percentage point increase in the unemployment rate, new labor entrants have wages at 6% – 7% lower than similar people who graduated during healthy times. When you add $900 billion in student debt (66% of which is held by Americans under age 40, with an average debt of $26,682) and the pending obligations of 37 million student loan borrowers in a jobless recovery, **is it any surprise that the U.S. is moving to a renter-based society?**

Strategic Advantage is predicting a 60% - 70% chance of a mild recession over the next nine months due to the influences highlighted above and below:

- ✓ Continued financial crisis in Europe.
- ✓ China's dramatic downturn from double-digit economic growth.
- ✓ Rising Middle East tensions.
- ✓ Continued consumer deleveraging.
- ✓ More regulations and higher taxes.
- ✓ Election-year uncertainty.
- ✓ Continued "kicking the can down the road" economic solutions.

Some believe we are in or entering a recession. This time the consumer will not rescue an ailing economy. With stagnant overall household income (since 1996), record levels of student debt, and the fact that up to 50% of homeowners are saddled by their homes (i.e., little, none or negative equity), U.S. consumers are taking a wait-and-see-attitude. However, **delaying the inevitable is no longer an option**. Excessive inventories will reduce housing prices further, reflecting Fed Chairman Bernanke's recent statement that the U.S. economy is "stuck in the mud."

According to Rent.com, **some of the reasons people are postponing purchasing a home include**: 47% are saving for a down payment; 11% are waiting for real estate markets to stabilize; 22% are waiting for their credit scores to improve; and 20% are waiting to feel that their employment situation is more secure.

With a Federal Funds rate at nearly zero, another round of quantitative easing is unlikely to have an impact. **Thus, we are at a crossroads between "trained" consumers who want to borrow and spend, and the reality of nearing the edge of the proverbial "fiscal cliff."**

I expect U.S. consumers to retrench over the next six to nine months. We are at the halfway point of what appears to be a lost decade of opportunity. The U.S. housing market is likely to stay in the doldrums until 2016 – 2017…with pockets of recovering markets. The lack of U.S. jobs and falling wages will result in a shift from a consumption-based to a renter-based society. **Once excessive inventories have burned off, the economic recovery will be more robust…unfortunately, that will require 36 – 48 months to complete**. Therefore, in many ways this economic stagnation and likely mini-recession will be consumer-driven. Shadow inventories, a renewed wave of foreclosures and dramatically lower housing starts will remind consumers that "we're not out of the woods yet." As one analyst stated, "There is no reason for exuberance."

The recession in Europe, the repeated failed attempts to find a collective solution to specific sovereign problems and overall Eurozone woes continue to contribute to lower economic growth. Fear of contagion is facilitating temporary solutions. **I expect Europe to remain in a recession for some time**. This will impact the sales volume of many U.S.-based firms which have relied upon Europe and/or Asia for growth. Although approximately only 2% of the U.S. GDP is exposed to the European risks, it will be a contributing factor to slower economic growth.

And There Is This $16 Trillion Debt Problem

- ✓ In 2012, the gross Federal debt will exceed $16.1 trillion, up from $5.3 trillion in 2008. A sobering website to visit is www.usdebtclock.org.
- ✓ Between 1997 and 2001, the U.S. debt was unchanged, hovering around $6 billion. Since 2001 the U.S. debt limit has been raised 13 times for a total of $10.4 trillion.
- ✓ Federal government deficit spending ($1.4 trillion in 2009, $1.3 trillion in 2010, $1.3 trillion in 2011 and $1.2 trillion in 2012) is not only unsustainable, it is foolish.
- ✓ In 2012, the U.S. debt ceiling was raised to $16.4 trillion. While our current Federal debt is 102% of GDP, by 2035 (if the current spending policies continue) that percentage could rise to 187%. At the end of 2008, the Federal debt to GDP percentage was 74%. Annual interest expenses are now $454 billion. The total per capita debt in the U.S rose from $35,153 in 2008 to $48,348 by 2011 and is expected to be higher by year-end 2012. Today, Greece's debt as a percent of GDP is 153%.
- ✓ Net interest payments for government debt will increase from 1.4% of GDP today to 9.5% by 2037.

The "debt problem" comes from mandatory or entitlement spending. By 2050 the current entitlement programs will consume 18.5% of GDP, nearly 100% of the average Federal spending over the past 50 years and more than the historical average of total tax revenues.

While deficit spending and rapid increases to U.S. debt levels may seem daunting to many or of no concern to some, the big question is **what does this mean for the real estate industry?** Other than the obvious: fewer jobs, slower economic growth, reduced consumer spending and decline in demand for some asset classes, my real concern is the impact of possible policy solutions.

Any shift by state, county and/or local governments from defined benefit to defined contribution retirement programs could de-emphasize individual asset plays and represent a boom for securitized real estate. I have no doubt this will happen; it just may take 10-15 years for the real impact to be felt by the real estate industry.

I am also concerned that any rise in interest rates to attract/retain international owners of U.S. debt (China $1.1 trillion, Japan $1.0 trillion, among others), will reduce government spending or further increase debt obligations. It is very likely that interest rates will remain low, **yet capital available for real estate may be less than it is today**.

Capital availability for REITs remains favorable, but many now are asking, "Is this as good as it gets?" The CMBS market has seen some improvement. Remember CMBS represents around 23% of all CRE loans in the U.S. During the week of September 10, 2012, $1.25 billion in CMBS were sold and another $2.34 billion in CMBS were being marketed. In 2012, CMBS debt issuance through September 11 was $22 billion. **I expect CMBS issuance could reach $45 billion in 2013**. Expect capital to be used to improve balance sheets, refinance debt and fund growth initiatives. I expect an increase in M & A activity over the next 24 months, because size does matter to Wall Street.

Real Estate Has Become A Psychological Issue

Human behavior and real estate are an interwoven fabric of preferences. The relationship between price or cost of goods and/or services and a capacity to consume is clear. This understanding of consumer needs and preferences provides a foundation for predicting behavior resulting in the ability to calculate demand. Behavior psychologists such as B.F. Skinner and John Watson, and the noted humanist psychologist Abraham Maslow, have highlighted why individuals behave in certain ways. In today's economic turmoil, U.S. consumers have, are and probably will continue to actualize their condition in life. For example, in Maslow's Hierarchy of Needs, individuals need food, shelter and well-being before they can engage in non-essential activities. Thus, **what we see today is rising demand for apartments, healthcare and grocery-anchored real estate**. **U.S. consumers are traumatized by the economic collapse/crisis of 2008**, concerned about their future and feeling less in control of their destiny. As analysts have stated, "The animal spirits are hibernating," and it is very unlikely that U.S. consumers suddenly will emerge from their shell. **One of the lessons learned from this economic downturn is that a growing number of consumers now know risk is real**.

Too often real estate firms dissect and over-analyze property-based metrics, asset pricing and historical trending, and they fail to understand the "real demand" factors. **Demand for real estate is not linear, but psychological**. From CEOs who need to "decide" to (re)lease space, individuals who "decide" to rent, consumers who "decide" to buy, etc., **real estate decisions are based on psychological factors…supported or justified by the economics**.

Consequently, **there is a hierarchy of real estate solutions or asset types**. First, there is the **"basic/necessity" real estate**. This would include apartments, healthcare facilities and grocery stores. The next level is **"productive" real estate**. When consumers feel safe and secure with their basic needs, the ability to grow and consume increases. In the **"productive" real estate phase**, buildings that house public sector workers, infrastructure-based employers, back-office industries and logistic firms flourish. When the individual is safe, secure and employed, third **"phase/niche" real estate** assets prosper. Big-box retailers, single-family developers and corporate build-to-suits become predominant and preferred asset classes. The fourth and highest stage of real estate-based human behavior is **"discretionary real estate."** Property types such as malls, restaurants, lifestyle retail, second homes, etc., tend to be in demand. (See the hierarchy representation on the following page.)

Thus, in an anemic recovery, a recessionary-like economic environment and with consumer doubt, the safe strategy is apartments, the status quo strategy is office and the risk-based strategy is high-end retail. Obviously, there is a great deal more to this. However, preparing for 2013 and beyond mandates a very different way of creating strategies to win. **Build-to-core with long-term hold strategies can be very successful**. For contrarians, go where "everyone" is most pessimistic. Today, Real Capital Analytics data highlights a shift to quality and safe investing; but investing in real estate is emotional.

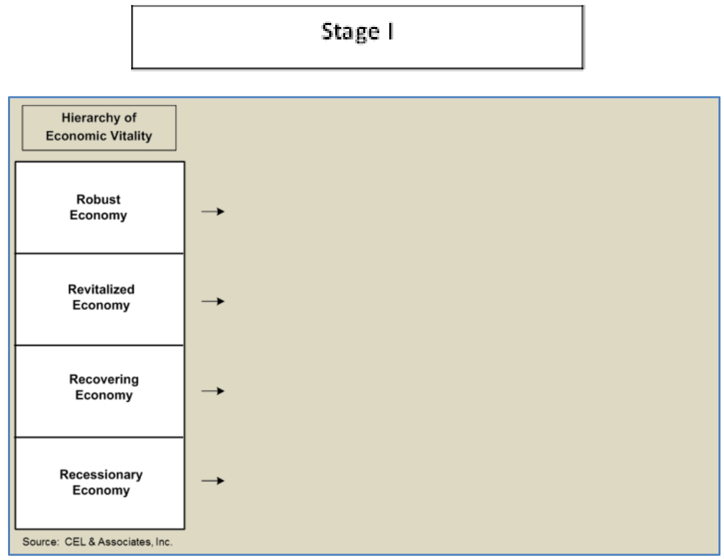
Is Now The Time To Invest In Real Estate?

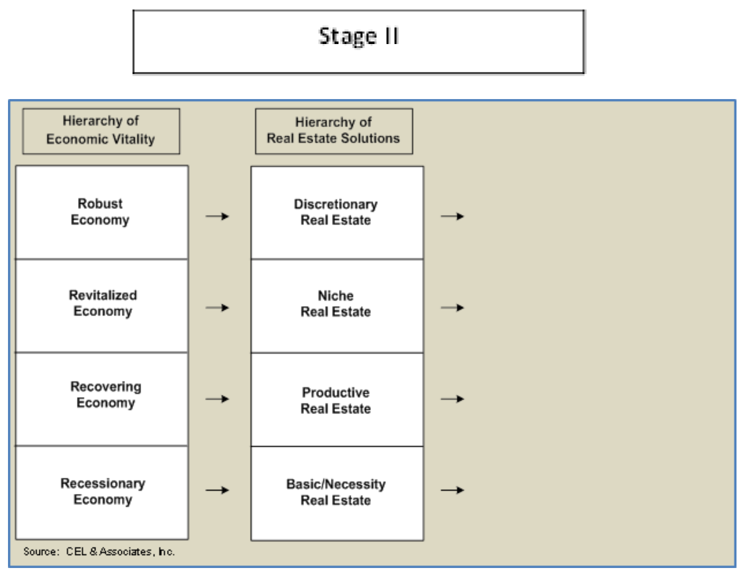
As the U.S. begins to emerge from its severe debt crisis, traditional debt sources have changed. CMBS issuance is far below historical averages. Banks (which hold 44% of real estate debt) are imposing more stringent underwriting criteria. Life insurance companies are slowly emerging as a debt option but are very cautious and deliberate in their lending. The wave of debt maturities through 2018 will also impact the amount of capital available for lending. **RREEF estimates, "The shortfall between mortgage originations and demand…could be "approximately $789.5 billion through 2017."**

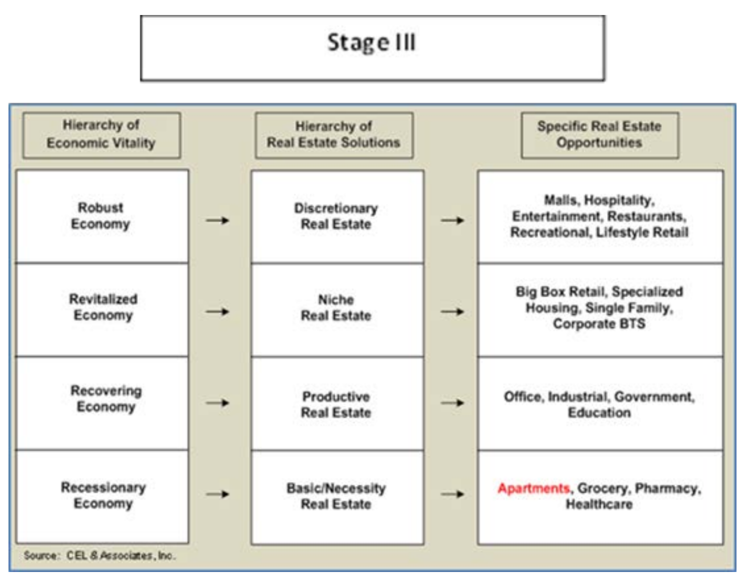
Historically the best time to invest in real estate has occurred in a debt crisis. **This is why today I like mezzanine lending, value-add acquisitions, niche build-to-suits, specialized service providers and, for long-term investors, land banking**.

The apartment sector is very strong and has been the best performing sector in real estate over the past 24 months. Sales of garden apartments are up 76% (YOY through August), according to Real Capital Analytics. In August, sales of distressed multifamily assets totaled $1.1 billion. Cap rates have averaged around 6.1% over the May through August period. **Rising rents, declining vacancies, strong fundamentals and pent-up demand will keep this sector on every investor's radar screen through 2017**. Apartment owners and operators need to pay close attention to: a growing risk of supply/demand imbalance; declining home prices that make owning more affordable than renting; continued pressure on wages that would prevent renters from keeping pace with rent increases; and "nutty" buyers who will over-pay for core assets. One of my concerns is a national rent control initiative emanating from Washington, D.C. that would impact GSE borrowers.

The office sector is slowly recovering, but success will be geographically based and industry sector driven. Sales of office buildings totaled $5.3 billion in August,







according to Real Capital Analytics. Cap rates are hovering around 7.3% (San Francisco, at 5.7%, and NYC Boroughs, at 5.0%, were some of the exceptions). **I like those markets with growing industries** (e.g., tech, energy, healthcare, waste management, alternative energy and green technologies). With little or no development activity, vacancy levels should drop below 14% by 2014 and 12% by 2015. According to RREEF, "During the past 20 years, office jobs have expanded at 1.7 times the rate of those in the overall economy, with a similar ratio expected through 2016."

I like the steady upside potential in the industrial sector. Sales of significant industrial properties totaled $2.3 billion in August. One-off property sales were up 20%, according to Real Capital Analytics. Cap rates for institutional properties were around 7.6%. Demand for larger bulk warehouse and distribution space will accelerate within core markets. Values should move upward, and I expect rent and occupancy growth through 2016. Overall vacancy levels could drop below 10% by 2015. Many key economic business drivers for industrial space are improving, and multi-tenant industrial properties should perform well in the recovery.

Retail real estate is a challenge. There will be an even quilt of winners and losers as location becomes the insurance policy for success. Sales of significant retail properties totaled $2.7 billion in August. According to Real Capital Analytics, sales of malls and single tenant properties are up 88% YTD. Cap rates for strip centers were around 7.6%, while malls were averaging around a 7.0% cap rate. Retailers across the U.S. are retooling their business models, their stores, their product offering and customer strategies. While consumer credit rose $18.1 billion in August, overall credit card debt is 17% lower compared to an all-time high of $1.03 trillion four years ago. For the short-term, I like core and recovery markets. Second- and third-tier markets could struggle through 2015. Markets with the greatest supply constraints will do well. Grocery-anchored properties will outperform centers which lack a major anchor. I do not expect appreciable rent growth or vacancy declines until at least 2015 or later. **Until there is a jobs-based recovery, retail will be a gambler's game of "hold 'em, all in, or fold 'em."**

Watch for a dramatic increase in investor/real estate entrepreneur ventures as capital seeks a consistent pipeline of opportunities and real estate entrepreneurs seek a stable source of capital. **The next 24 – 36 months could be termed "The Period of M & A" within the real estate industry**.

What Must You Do?

The real estate industry is a profession of risks, and we are in a very risky time. However, there has never been a time in the past 50 years when one could not make money in real estate. During times of turmoil, great fortunes have been made. In periods of economic malaise and challenge, market and customer share can be secured for future years. In a global environment of financial uncertainty, real estate is the safe harbor for many investors.

Success, however, requires a new way of thinking, new strategies and new ideas. Status quo, cocooning or hunkering down are not options, and following the herd is obviously not a viable strategy. Now more than ever, one needs to step out of the comfort zone, examine new venues of opportunity, discard anchors of the past and engage in a discussion of possibilities, not limitations.

Does your organization have a winning 2013 – 2016 strategic and long-range business plan? What is your organizational strategy? How do you intend to differentiate yourself from others? What is your brand? Do you have a vision? What is your value proposition? How do you measure success? **Is your firm still relevant?** Do you have aligned leadership? What is your talent management plan? What is your capital strategy? What are your priorities? How are you becoming more customer-centric and knowledge-based? What is your backup plan? The answers to these and other similar questions will separate the winners from the also-rans.

Closing Comments

In the real estate industry, you are either looking forward or visible in the rear-view mirror. **Leadership defines the transformational opportunity, talent provides the resources to implement and well-conceived strategies determine winners versus everyone else**. Today and the next seven years are not normal, so it will be incredibly challenging and awash with opportunities for those who are prepared. What decision will you make? What direction do you intend to take? What strategies will provide the greatest propensity for prosperity?

To share your comments, insights or ideas, please email them to newsletter@celassociates.com.

Regards,

Christopher Lee

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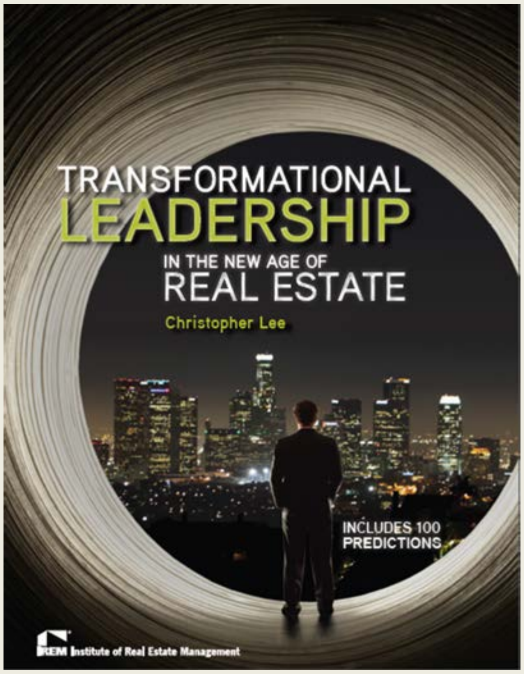

★★★★★

Surviving, prospering and achieving a competitive edge in today's marketplace can be challenging. *Transformational Leadership* is a book that traces the history of real estate, provides insights into what's ahead, highlights the timing of the next real estate cycle and provides strategies on how to succeed and thrive. The book also includes 100 predictions you will find fascinating and thought-provoking.

Simply click on this following link *IREM* and you will be directed on how to purchase your copy.

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Due to an increasing number of requests from Owners and Boards of Directors to assist:

- Finding secure/stable long-term financial partners.
- Owners wishing to sell all or a portion of their company.
- Finding a long-term source of capital to facilitate growth.

CEL & Associates, Inc. has formed:

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For small to mid-size real estate companies including: developers, service providers, owners/operators and investors who want to secure one's future, monetize enterprise value, develop succession planning, and/or accelerate growth strategies, contact **CEL Capital Advisors**. A conversation regarding your current business strategy and need for capital may provide the optimal solution. **CEL Capital Advisors** can be reached by calling 310.571.3113.

Jeff Hawkins, who leads CEL Capital Advisors, has over 18 years of experience in private equity, investment banking, capital markets and consulting. Mr. Hawkins has been directly responsible for raising over $500 million of equity capital for commercial real estate investments and has been involved in over $1 billion of real estate transactions. Prior to joining CEL & Associates, Inc., Mr. Hawkins worked in investment banking at Merrill Lynch & Co. and in mergers and acquisitions at Deutsche Bank Securities where he provided capital advisory and transaction services to private equity firms and public corporations.

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