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12 December 2014

U.S. REITs

Real Estate: The Year Ahead Conference – Key Takeaways

INDUSTRY UPDATE

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On Tuesday and Wednesday December 9-10, 2014 we held our annual Real Estate conference – Real Estate: The Year Ahead. The program consisted of 11 thematic panels comprised of senior management from more than 50 companies (public and private), a presentation of the Urban Land Institute/PWC Emerging Trends in Real Estate 2015 report, one-on-one management meetings, and a keynote address by William Strange (SmartCentres Professor of Real Estate, Rotman School of Management, University of Toronto). In this note, we provide a summary of each panel.

Key themes heading into 2015 include the following:

- The U.S. macroeconomic recovery is picking up steam; our panelists suggested that real estate market fundamentals will continue to be solid in 2015, with cap rates remaining at historically low levels. Most panelists (and audience members) do not believe that interest rates will rise materially in 2015, and that REITs will continue to have easy access to inexpensive capital. Many suggested the best opportunity is to monetize assets and redeploy the proceeds into higher yielding (re)development.
- Urbanization is accelerating, driven by both millenials and baby-boomers; the national population increasingly wants to live in 24-hour cities with convenient access to public transportation, the workplace, and be within close proximity to shopping hubs, restaurants, and nightlife. These trends are persistent and imperative to understand when making real estate investment decisions.
- The commercial transaction market appears to be broadening out in terms of property types and markets. Many panelists seemed to favor class B properties in secondary/tertiary markets, believing that we are in a later stage of the recovery with less attractive investment opportunities at high-quality assets in core cities.
- The two days of speakers, panels, and events supported our constructive outlook for commercial real estate fundamentals in the year ahead. We continue to believe industrial and class A mall REITs will be top performers. In our view, apartment fundamentals will also remain solid with urbanization and job growth creating greater opportunities in select markets. With cap rates low, and rising interest rates looming in the intermediate-term, REITs will likely continue to shift toward more disposition and (re)development. Strong public REIT performance in 2014 has created higher valuations; we remain neutral on the REIT group with a preference towards companies poised to benefit from secular shifts (e.g. urbanization and e-commerce growth) that support better than average earnings growth.

We expect to have an audio replay of the panel presentations as well as related slide decks available via our conference website shortly.

Emerging Trends in Real Estate 2015 – PricewaterhouseCoopers

Presenter: Andrew Warren, *Director*

Generally Positive Outlook for 2015. The Emerging Trends survey revealed an expectation for continued strong fundamentals for real estate in 2015, with over 70% of respondents expecting good-excellent firm profitability next year, the highest in the last five years. Supply growth is expected to remain relatively disciplined, at just half the peak of previous markets, with demand driven by continued strong economic growth and favorable demographic shifts. There continues to be significant tailwinds pushing the U.S. population toward the urban core, including fewer millennials driving and a related increase in demand for public transportation.

Emergence of the 18-Hour City. Outside of coastal gateway markets, a transformation of downtown areas in secondary markets such as Denver, Charlotte and Raleigh-Durham is taking place, with a mix of vibrant shops, restaurants, and entertainment drawing in the millennial population. These markets are significantly less expensive than coastal markets, but largely offer the same amenities as the more traditional 24 hour cities.

Millennials and Baby Boomer continue to accelerate urbanization. While the trend of millennials moving to cities is well documented, aging baby-boomers (age 65-73) are also moving to city centers and very often extending their careers with better heath care and longer life spans.

Labor Market Recovery is Gaining Traction. Job and wage growth should gain meaningful traction in 2015; peak entrants to the labor force from echo-boomers has already passed, and retirements will accelerate from baby boomers. These supply constraints could lead to a shortage in the labor force (already an issue for many skilled workers) in the intermediate term. Assuming the recovery can continue to chug along at even a modest pace, employment growth and higher wages should support stronger real estate fundamentals.

Technology disruption will accelerate. The impact of technology has impacted each property sector, with a focus on e-commerce and its impact on retail. Technology's impact will continue to intensify in 2015 and beyond, as the national population continues to increase its adoption of Smartphone's and other mobile devices, and a greater share of the population is trained to use these devices for retail and other purposes.

More Markets Look Attractive in 2015. The top performing markets are expected to include Houston, Austin, San Francisco, Denver, Dallas, and LA in 2015. Several of those markets, as well as Miami, are favored for development. In general, many markets present opportunity, but investors will need to look closely for value creation within those markets.

Event Risk is a Key Concern. Real estate professionals remained concerned about the "black swan" event that could derail the economic recovery. Last year, many were worried about government gridlock impacting the growth trajectory; there is some belief that a lower price of oil could tip the scale in the wrong direction. While survey respondents didn't have a specific draconian scenario in mind as a whole, it remains at the forefront of concerns underpinning ongoing strength in fundamentals.

Net Lease: Long Term Growth Alternative

Moderator: Scott Schaevitz, *Co Head Americas Real Estate Investment Banking,* Barclays

Panelists: Trevor Bond, *CEO*, W.P. Carey Inc.

Ben Butcher, CEO., President & Chairman, STAG Industrial

Gordon DuGan., CEO, Gramercy Property Trust

Jay Leupp, Portfolio Manager, Lazard Asset Management

Christopher Volk, CEO, STORE Capital

Do Investors Distinguish Between How a Net Lease Company is Viewed (bond investment, stock investment, or investment in operating company?) The general view was that net lease real estate has characteristics of stocks, bonds and a real estate operating company. Mr. DuGan believes that net lease players are real estate operators focused on buying good real estate in major markets that would have ample demand if the current tenant vacated; this strategy will create steady income and hedge inflation. If interest rates/cap rates rise, Mr. Du Guan believes it would translate to higher ROE for the REITs. Mr. Volk believes that the internal/external growth prospects for REITs make them unique relative to bonds. Mr. Leupp stressed the importance of REIT dividend growth above inflation. Mr. Butcher believes that rising rates is a competitive advantage for public REITs versus private real estate players (and bonds) because of high access to capital markets.

The Net Lease REIT Industry is Growing Rapidly; What is Your Outlook for Consolidation in the Space? The general belief was that growth opportunities exist for net lease real estate without the need for consolidation. Mr. Volk thinks consolidation only makes sense when it benefits both parties; otherwise one player would be sacrificing their own growth for someone else's. Mr. DuGan believes that net lease growth is in the early innings noting that only 3-5% of net lease assets are owned by public REITs. His view is that the industry does not need consolidation to grow and that it often introduces cultural issues. Mr. Leupp believes that 2 – 4 players may enter the net lease space during the next five years; he also believes that current industry participants have 10 years of external growth in front of them before meaningful consolidation occurs. Mr. Volk's view is that net lease will be the fastest growing real estate sector; he did note that even with growth, some industry players will inevitably exit the space.

What does your Company's Current Pipeline Look Like? The panelists uniformly stated that external growth pipelines are growing and that competition for new assets has declined recently. Mr. Butcher stated that Stag Industrials pipeline is roughly double the size it was a year ago. He estimates that cap rates are down ~50 bps; going forward, he thinks rental rate growth will be above average for the next 3 - 4 years. Mr. DuGan stated that Gramercy's pipeline is the busiest it has ever been. He believes that recent events at a large competitor may have driven prices on large deals down, although he thinks it's still too early to assess the longer term pricing impact. Mr. Leupp thinks that opportunities are still attractive domestically; he also noted that more companies are also looking abroad for growth. Mr. Volk noted that his pipeline is up 10-15% driven by lower cost of debt.

What's your take on Short Duration Leases? There were differing takes on short term leases ranging from opportunistic to not the core competency for a net lease REIT. Mr. Bond believes that short term leases require a different skill set/thought process. He believes it is better to space out expirations and sell assets with shorter remaining duration. His focus is on longer duration leases with credit worthy tenants and built in rent increases. Mr. Butcher, on the other hand, views short lease duration as one of many factors when assessing real estate. He is not scared of vacancy and views it opportunistically. Mr. Volk noted that net lease occupancies are typically very high (98%) and short leases are not the core competency for a net lease REIT; he prefers to renew leases as they near expiration. Mr. Leupp stated that the industry was traditionally a dividend play, but is evolving into a total return opportunity. He thinks there are growth opportunities for short term leases while also stressing the important of credit quality/concentration.

Retail: The Post E-Commerce World

Moderator: Glenn Rufrano, *Chairman & CEO*, O'Connor Capital Partners

Panelists: Kenneth Bernstein, *President & CEO*, Acadia Realty Trust

Mike Carroll, CEO, Brixmor Property Group Inc.

Art Coppola, Chairman & CEO, Macerich Company

Nora Creedon, Co-Lead Portfolio Manager REITS Strategies, Goldman Sachs Asset Management

Greg Maloney, President & CEO of Retail, Jones Lang LaSalle

Retail Investment Activity in 2014 to Match Peak Year (2007). Glenn Rufrano noted that 2007 represented a peak year in retail transaction volume, ending in $75 billion of retail trades. Based on data from JLL, retail deal activity in 2014 is estimated to be $70 to $75 billion. Glenn posed the question of how to reconcile this high level of investment activity with generally negative sentiment towards consumer retail. Notably, negative headlines like the growth of ecommerce and omnichannel have skewed public perception. To wit, in 2013, ecommerce sales grew 20%, while total retail sales only increased 4.5%. E-commerce however, still only represents mid to high single digits of total retail sales.

The Impact of Omnichannel on Retailer Profitability. Nora Creedon raised the issue of retailers' significant and expensive investments in omnichannel initiatives and how that could impact profitability or the ability to pay rising rents. Art Coppola suggested this issue is offset by the need to build brand awareness. In his view, ecommerce sales are simply another piece of the total revenue puzzle, the channel from which sales are generated do not matter. Operating an ecommerce site is now a necessity and will likely always be a retailer's best "store" in terms of generating the highest sales volume; whether it's done profitably remains to be seen. Still, if the presence of a store has helped further brand awareness, then, in Art's view, it has been successful.

Success of a Shopping Center Less Tied to Demographics. On the topic of differences between A and B class assets, Mike Carroll noted that a zip code is not an apt predictor of how well property a property will perform. More relevant is how well a grocer is doing in that particular area. We think this is because grocery anchored centers offer retailers and services that are more necessity-based (relative to an enclosed mall) and best in class grocers can draw traffic from a wide area.

Amazon Bears Similarities to Wal-Mart. Ken Bernstein likened Amazon's business model to that of Walmart's loss-leading business model, which resulted in businesses or entire retail sectors (i.e. such as book stores) going out of business. Still, brick and mortar retail has a place in this world and its success goes back to fundamentals. To prevent A and B centers from becoming C's and D's, the following factors need to be present: 1) strong barriers to entry, 2) income growth, 3) existence of young, educated shoppers and 4) landlords that have the money to invest back into the properties.

Investment: Strategic Allocation and Performance

Moderator: Doug Sesler, *President,* True Square Capital LLC

Panelists: Michael Ashner, *Chairman & CEO*, Winthrop Realty Trust

Jeff Krasnoff, CEO, Rialto Capital

Richard J. Mack, Co-Founder & CEO, Mack Real Estate Group

Jay Rosenberg, Managing Director, Portfolio Manager, Nuveen Asset Manager

Darcy Stacom, Vice-Chairman – Investment Properties Group, CBRE Group, Inc.

What are you Seeing in Today's Market? There are differing views on opportunities in today's market; on one hand, investors still see areas of opportunity. On the other hand, given asset pricing levels, some investors view the market as not offering strong risk adjusted returns.

Mr. Mack is focusing on long term investments in class A multi-family assets in urban gateway markets. He also noted that the lending business has solid returns and will be a focus for his company going forward. Mr. Ashner believes real estate is expensive, selling assets and giving capital back to shareholders is the best option. Mr. Krasnoff thinks the U.S. is in an expansion phase driven by a need for cash flow. Mr. Rosenberg is looking for companies with outsized growth and other potential dislocations in the market. He stated that there are still refinancing opportunities and that increased regulation is pushing capital into the private side. Ms. Stacom believes the leasing market is strong today, noted that REITS, pension and insurance companies are taking in partners, and the transaction market remains vibrant.

Are Current Values Fair?

The general takeaway was that as real estate continues to perform well, investors must search more for areas of opportunity. Mr. Mack believes that space needs and opportunities must be assessed on a sub-sector basis. Mr. Ashner believes real estate investors have been penalized in the past for pushing valuations to high, yet it still happens. Mr. Rosenberg stated that REIT stock investors tend to be short term focused and sell off shares when a REIT decides to sell assets without an announced program to redeploy the proceeds. On the other hand, when a more cogent plan is clearly articulated to the market (using proceeds for development or de-levering), the stocks react more positively.

How do you Compare Today's Market to 2006/2007?

While asset pricing is approaching pre-crisis levels, the panel generally believes that lower leverage makes the real estate rally more sustainable now relative to 2006/2007. Mr. Mack noted that total capital raised today is far lower today compared to 2006. He thinks things are a little frothy but the capital markets haven't exacerbated rising valuations with excess lending. He believes that the environment today is more sustainable than it was 2006. Mr. Ashner believes that REITs were much more levered during the recession than they are today because they were borrowing against their equity at a period of rapidly rising prices. Ms. Stacom thinks that underwriting is more disciplined today than it was in 2006 but notes that returns are similar.

Is development a good opportunity today?

The panellists had mixed views on development but generally thought that investors with development know-how were compensated for extra risk. Mr. Mack believes that development is an often overlooked skill set; it's risky, but investors are compensated for it. Mr. Krasnoff stated that retail/office development does not pencil; his preference is for well located assets that have not been kept up well. Mr. Ashner thinks that selling assets and redeploying into development makes sense in core markets but not elsewhere. Mr. Rosenberg thinks that selling assets and redeploying into development can add value long-term but the strategy is not always articulated well.

Strategy Going Forward

Mr. Mack focused heavily on buying multi-family from 2009-2012 based on demographic trends (urbanization, household formation, millennial preferences) which he believes are on-going. He is focused on development with a long term holding period. Mr. Ashner is indifferent between different levels on the capital stack but noted an ongoing detachment between yield and risk. To that point, he noted that cap rates are well below the historical average creating high risk relative to current yields if cap rates begin to rise. Mr. Krasnoff thinks that debt is often mispriced; he noted that the market for replacing debt originated during the recession is thin which recreates attractive refinancing opportunities. He also likes mezzanine debt on stabilized assets noting 11% yields with 65-80% loan-to-value. Ms. Stacom suggested that foreign capital will continue to flow into the U.S. and believes that in 2015, debt will play a much larger role as an investment.

Lunch – Capital: Liquid Implications

Moderator: Larry Kravetz, *Managing Director, Head of Primary CMBS Finance,* Barclays

Panelists: Dean Adler, *CEO*, Lubert Adler Partners LP

Michael Nash, Senior Managing Director, Blackstone Group Inc.

Tad Philipp, Director – Commercial Real Estate Research, Moody's

Mitchell Sabshon, President & CEO, Inland Real Estate Investment Corporation

Douglas Weill, Managing Partner, Hodes Weill & Associates

Underwriting standards have loosened, but will remain disciplined. Despite lending standards becoming more accommodating in 2014, there is still significantly less leverage being used to finance real estate transactions when compared to the pre-crisis period. The panel universally expects investors to continue contributing significant equity capital to deals, with many taking a longer term holding approach of 10+ years. Mr. Nash noted that he is focused on buying high quality assets with a conservative leverage profile, with the ability to maintain the asset in a downturn.

Institutional appetite for real estate assets is increasing. In an effort to increase yield, Mr. Weill noted that many pension funds are increasing their target allocations to real estate. With bond yields low, and pension portfolios often requiring greater than 7% annual returns, real estate assets provide both income and total return potential that matches the risk/return profile of many defined benefit plan needs.

Risk profile is intensified at lower cap rates. Mr. Adler strongly believes that downside risk is elevated in today's low cap rate environment, particular amongst class A assets with rich valuations in gateway cities; he is focused on markets with high occupancy, limited new supply, and an affordable price point that caters to millenials.

Debt investors will fare better than equity. While pricing has continued to rise for corporate debt and CMBS, the panel generally believed that there was significantly less discipline on the equity side. The panel voiced concern that there is considerable risk that equity investors will overpay for deals in 2015, buying long-term assets that are underwritten at short-term rates.

Regional banks and insurance companies offer competition. Local/regional banks and insurance lenders strengthened their balance sheets in the aftermath of the financial crisis, and are offering leverage at cheaper pricing than many larger banks in a relationship capacity.

Key concerns heading into 2015. The panel was generally concerned with struggling international economies contaminating strong underlying fundamentals in the US. With Europe and Japan continuing to generate tepid economic growth, the concern is if and when economic weakness abroad will impact both the health of capital markets, and fundamental economic growth in the US.

Office: Value Drivers

Moderator: Mary Ann Tighe, *CEO, New York Tri-State Region*, CBRE Group, Inc.

Panelists: Tim Callahan, *President & CEO*, Callahan Capital Partners
MaryAnne Gilmartin, *President & CEO*, Forest City Ratner Companies
Mark Howard-Johnson, *Portfolio Manager*, Blackrock Investment Management
Douglas Linde, *President*, Boston Properties
Scott Rechler, *Chairman & CEO*, RXR Realty LLC

Densification is unequivocally changing the approach to conducting business. Space continues to be delivered in a more efficient manner with increased permanent lounges, larger open areas and fewer individual offices. It is being done as both a means to reduce costs and to create a more collaborative environment. This has resulted in replacing flex space as a concept but has caused expansion opportunities to be more difficult to implement. It is also causing functional issues that need to be altered, such as building codes and elevator capacity. This is also really giving an advantage to new product; buildings from the '90s feel old by comparison and aren't as able to accommodate changes.

Demographic Shifts are Causing Changes to Product Offerings. With baby boomers and millennials comprising over half the population, businesses have adapted to their desires. This has included not only a transition to more urban locations but one where the ideas of live, work and play have been blurred to the point where one CEO stated that the third word in the old real estate adage of location, location, location should now be place. People are not working in a traditional manner or with set hours anymore; examples of this include buildings having amenities such as doggie day care, bike facilities, more natural light, more common areas, which result in creating an atmosphere where people want to be. BXP President Doug Linde cited this phenomenon as the 3 Cs (culture, collaboration, community) where companies are striving to demonstrate and define a strong brand awareness and don't want pre-fabricated product but seek to establish a unique culture with more of an energy level.

Government is more of a partner of real estate sector than ever before. In an era where there is increasing demand to be in an urban environment, more public infrastructure has to be created for cities to work. This is manifested in several ways, including subsidies at the WTC site and Hudson Yards, public/private partnerships that accommodate rail and other transportation such as the Dulles Toll Road around Washington DC and transit system in San Francisco and other master planned communities that look to create platforms combining attributes like parks, transportation, other lifestyle amenities all into one. Discussions on examples of this included the Forest City partnership with Cornell on Roosevelt Island and SL Green's proposed development of One Vanderbilt adjacent to the Grand Central Terminal in NYC, where the company will effectively work with the city in revamping infrastructure needs and pay over $200M towards this end in developing its site.

Low interest rates keep healthy investment environment intact. Potential acquisitions remain expensive because the risk free rate is inexpensive. However, with the German 10-year bund at 0.8% and similar duration bonds in Italy and Spain hovering around 2.5%, the U.S. 10-year treasury at 2.3% is not necessarily priced to perfection. Spreads and fundamentals still look relatively solid; so it feels that risk is being properly priced in. In addition, there is a lot more equity invested into projects currently than in previous cycles, which will allow investments to have a larger cushion to withstand any downside pressure.

Low interest rate is creating lower return expectations. There is no shortage of capital coming into the U.S.; if anything the pace is accelerating as many institutions that have increased their target allocation have yet to put the funds to work. The effect of large sovereign funds in Norway and China putting so much money into real estate is that it becomes a self-sustaining mechanism of low cap rates, particularly in U.S. core markets that see much of this activity. The lack of alternative investment opportunities in other asset classes is also keeping a lid on cap rates.

International: Global Convergence

Moderator: Gary Garrabrant, *Managing Partner*, Jaguar Growth Partners

Panelists: Steve Buller, *Portfolio Manager*, Fidelity Management and Research Company

Adam Gallistel, *SVP & Head of Brazil*, GIC Real Estate, Inc.

Adam Metz, *Managing Director, Head of International Real Estate*, The Carlyle Group

Tim Morris, *Founder & Partner*, Proprium Capital Partners, LLC

Dean Shapiro, *Senior Vice President,* Oxford Properties Group

Overall, in the developed world, real estate is expensive and institutions are underinvested. This is partly due to investment mandates that have been maintained or increased that have not been fulfilled and also because it is becoming increasingly difficult to find attractive returns. There is an abundance of capital and real estate has become intertwined with other asset classes, which has created further volatility. Similar to the U.S, return expectations in developed markets have contracted; Dean Shapiro of Oxford talked of 7-10% targeted yields as a blended average for their projects, which includes U.S and western Europe but would be historically low for their portfolio.

Emerging Markets are in different stages of real estate cycle. While the BRIC countries are generally grouped together, each has very disparate strategies. Panelists stated that their companies are moving cautiously in emerging markets and investment in Russia has disappeared. In Brazil, residential has really been under pressure, with defaults from the publicly listed developers, to the extent that investors are seeing potential deep value distress. However, the majority of panelists with emerging markets exposure were overweight in China and India. Likewise, Mexico is also seeing substantial growth with FIBRAs (their version of REITs) buying lots of property types simultaneously.

General Shift from development to purchases of existing assets occurring. This transition has taken place in both private and public markets and also relates to a general convergence in cap rates and lowered return outlook. This is evidenced by a flight to quality, where London has experienced $50B of inflows in 2013. Broadly, fundamentals are still pretty weak in Europe, outside of UK, which is creating distressed opportunities there. Capital flows have increased in trying to anticipate improved fundamentals. For example, there was $7B of flows into Spain in 2013 but really the only thing that has changed is foreign sentiment; not underlying economic strength. Similarly, Italy and France are still struggling as well, although have not seen the same level of capital inflows as other European countries.

Public/Private Market Disconnect is still apparent within Emerging Markets. Investors on the private side have to wait longer to realize gains as there is no public market exit potential apparent in the near term for many holdings. Some of this is related to the failures relating to existing public companies. In China, Steve Buller noted that there is a prestige factor associated with being publicly listed, but not in making money; so investors have been frustrated with much of the investment universe there. Likewise, in Brazil, the struggles of the publicly traded homebuilders have also made investors wary. This is further reflected through the nascent state of the sector where listed real estate represents 10-11% of commercial space, aggregating $1.4T in the developed world, but a much lower percentage and only $300B in developing countries.

Keynote: The Changing Economics of Cities

Presenter: William Strange, *SmartCentres Professor of Real Estate,* Rotman School of Management, University of Toronto

Professor Will Strange delivered the key note speech, "The Changing Economies of Cities" which focused on: urban economics, cities and real estate markets. His opening remarks centered around the idea that cities and real estate are inextricably linked; the dynamics surrounding them constantly change and last decade's winners do not always remain so. He made five key points in his presentation:

1. The world is uneven. Only 2% of the US is actually developed, supporting the view that the world is bifurcated, divided into undeveloped and urbanized areas. China is a good example of this; reportedly they plan to develop 20 cities, each the size of New York City. Therefore, the Chinese real estate market will remain important to investors. Expanding upon Professor Strange's point, China does not have a lot of large cities right now relative to its land mass; most of it is undeveloped and lacks infrastructure, especially in the country's interior.

2. Some cities rise (San Jose), some fall (Detroit) and some reinvent themselves (Boston). Eight of the 10 largest cities since 1950 have lost at least 1/5 of their population. Boston has reinvented itself, but this city could have gone the way of the rust belt cities. Notably, large, expensive and growing cities are no longer centers of manufacturing. Rather, the businesses located in large cities are service-based and employ workers with more specialized skill sets. This is seen in the growth of cities where a high percentage of its workers possess a college degree.

3. The Agglomeration Economies. This is defined as knowledge spillovers and labor market pooling. It's not so much the scale of a business that aids growth, it's the scale of everything surrounding the business. In our view, Uber is a good example of benefitting from agglomeration economies. Agglomeration economies are seen in higher productivity of large cities; To wit, workers earn higher nominal wages in larger cities.

4. Who Lives in Cities. Professor Strange noted that the 'smart and the wealthy' live in cities. Skilled workers are now defined as those with high cognitive and social skills, but not those with high levels of physical skill. Workers in cities also score high for confidence on psychometric tests. To illustrate this point, he referenced Frank Sinatra's *New York, New York,* - "If I can make it here, I can make it anywhere".

5. The Link between Cities and Real Estate. There are indisputable forces governing uneven distribution, which in turn will govern the cities that thrive versus those that stagnate. The unevenness means that markets will prosper and decline or switch between prosperity and decline as a city's role changes. To wit, over the past three decades, San Francisco has grown 3.5% annually; Buffalo has grown 0.5%.

The Implication of Secular Change

Moderator: Chris Mayer, *Co-Director & Paul Milstein Professor of Real Estate*, Columbia Business School

Panelists: George Marcus, *Chairman,* Essex Property Trust I Marcus and Millichap Company

Sandeep Mathrani, *CEO*, General Growth Properties

Hamid R. Moghadam, *Chairman & CEO*, Prologis, Inc.

David Neithercut, *President & CEO*, Equity Residential

William Strange, *SmartCentres Professor of Real Estate*, Rotman School of Management, University of Toronto

Growth of Gateway Cities Will Continue. David Neithercut sees growth in gateway cities as continuing. A lot of the demand comes from the millennial generation, who value proximity to their workplace, sources of entertainment and quality healthcare. He noted that 50% of American adults are single, so he feels that gateway cities remain in the early innings of solid and sustainable growth.

Best Long-Term Risk-Adjusted Returns from Investing in Cities. Hamid Moghadam pointed out that just because a city is doing well doesn't always mean one can make money in these concentrated areas. Rather, sometimes the less expensive, lower quality real estate markets are more attractive because of their low prices; investing in these secondary markets can be an effective strategy. Longer-term, for horizons 10-years plus, it makes more sense to invest in prime urban markets, which go through up and down cycles, but still manage to grow at a higher rate in the long run. David Neithercut supported this view, adding that the key is to be in a supply-constrained, strong barrier-to-entry market with highly skilled workers.

The Rise of the Educated Class and Technology Has Provided More Choices. George Marcus noted that, today, the quality of life matters to educated professionals. Thirty-four years ago, the prevalent attitude of "build and they will come" rang true. Today, it does not, because people with intellectual capabilities can choose where they want to live. The success of Silicon Valley wasn't a random occurrence because the proximity to culture and recreation support a pleasant lifestyle. Relating this to an earlier point made by Professor Strange, cities with more bowling alleys have deteriorated, whereas cities with more theatres have flourished.

The Impact of Growing Economic Disparity on Retail. Sandeep Mathrani views his business model of owning and operating Class A malls as insulated from potential negative impact. Sandeep views the key as being in markets with strong barriers to entry. There are no material new mall developments occurring due to the high cost and length of time it takes to build one (10-15 years). On the other hand, in defense of secondary and tertiary markets, it only takes 100,000 people in a certain trade areas to accommodate a Nordstrom (which caters to higher-income shoppers) meaning one can still be quite successful in a secondary market.

Multi-Family: Sustainable Gains

Moderator: Ron Witten, *President*, Witten Advisors LLC

Panelists: Ric Campo, *Chairman & CEO,* Camden Property Trust

Todd M. Farrell, *President*, Lennar Multifamily Communities, LLC

Matthew Lawton, *Executive Managing Director*, HFF

David Schwartz, Co-Chairman & CEO, Waterton Associates LLC

Neil Abraham, Portfolio Manager, Alliance Bernstein

Multi-family outlook in 2015: a lot like 2014. Our panelists agreed that 2015 will continue to benefit from the same strong fundamentals that we observed in 2014 for multi-family real estate: resilient demand for apartments driven by favorable demographic trends (millennial urbanization and a low home ownership rate) and solid job growth, balanced by new supply that will remain disciplined due to heightened construction and land costs. Mr. Schwartz noted that he expects his company’s same-store portfolio growth to be in the low-4% area in 2015, similar to 2014 results; Mr. Campo noted that he believes CPT's portfolio will continue to be above-trend in 2015.

Supply growth steady and likely near the peak. While the primary concern for shareholders of multi-family has been overbuilding, Mr. Witten noted that we have seen steady starts of 320-360k per month in 11 of the last 12 months, while occupancy has continued to rise as demand has absorbed deliveries. Mr. Witten was hesitant to call it the peak of new construction, but noted that it looks to be close to that point. The panel also noted that many new projects are not pencilling at higher construction costs, particularly as labor costs are volatile and vary significantly by market.

Lower price of oil will have an impact on Texas, but it will be subdued. Mr. Campo does not believe that layoffs are imminent in the energy industry given the lower price oil; instead, he believes energy firms will reduce capital spending, which will likely lead to a reduction in job growth in Houston over the next couple of years. At the same time, Mr. Campo believes the Houston economy is more diversified than most investors realize, with a large petrochemical industry to help drive job growth in the gulf region. He also noted that the lower price of oil will have a positive impact on consumer spending and economic growth in most markets outside of Texas, which is a positive development for multifamily real estate as a whole.

Single family recovery is a concern. The recently announced easing of underwriting standards for private loans that are eligible for purchase by Fannie Mae and Freddie Mac (some buyers now required to put just 3% down) is a potential catalyst to increase the home ownership rate, though it is unclear if renters have saved a down payment, even with lower requirements. The panel also noted that a strong single family market is good for the apartment sector overall, as it implies that more people have jobs and consumer confidence is rising.

Demand for class B, urban assets continue to rise. Mr. Schwartz commented that class B properties typically price at a $500-$600 discount to new product in his company's urban markets. Mr. Lawton said that 15 million millenials are living at home in the parents' house, and are likely to move into a B-level apartment when they move out, which will continue to bode well for this segment of the market.

Favorite apartment markets in 2015: divided across the panel. Mr Schwartz noted his preference for the Atlanta market in 2015 as it has been late in the development cycle, and doesn't have quite the level of deliveries when compared to other diversified job markets. Mr. Campo believes that Southern California and Las Vegas will be above trend in 2015, and will help to offset weakness from CPT's DC portfolio. Mr. Lawton likes Charlotte, Austin, Denver, and believes DC will improve after being flat for the last couple of years.

How to Make Money in 2015

Moderator: Schecky Schechner, *Managing Director*, Barclays

Panelists: Michael Fascitelli, *Founder*, MDF Capital

William Rudin, Vice Chairman & CEO, Rudin Management Company, Inc.

Jay Sugarman, Chairman & CEO, iStar Financial Inc.

We are in the midst of a $1.0 trillion change with the drop in oil prices in the last six months. Foreign crude has been replaced by domestic crude, with the latter having been 20% of supply and is now at 90%. The prevailing thought was Saudi Arabia's decision to not take supply out of the system means alternative energy is still 10 years away. That said, the U.S is still headed toward energy self-sufficiency in the next five years. The reduction in oil prices is essentially a tax cut but at the same time is causing rig projects to be put on hold. Long-term rates are currently pegged to Europe and lower oil prices will keep them lower. However, short-term rates can't move either because they're held down by long term rates; so the net effect is a continued maintenance of a low rate environment.

People have been wrong about interest rates for five years. Rates have stayed low for much longer than anticipated as initial expectations would have assumed short term rates to be 3-4.5% at this point. Nevertheless, we are still seeing flight to quality. This is partly due to the U.S. offering sanctuary given a stronger growth profile where its interest rates at a 10-Treasury of 2.3% is relatively high in comparison to other countries like Germany with an equivalent duration note of 0.8% and much riskier, weaker growth countries like Italy and Spain at similar levels to the U.S. A majority of people in the room thought that the 10-year Treasury would be in the 2.5-3.0% range next year, although a 20-70bps increase is probably right in line with what would have been expected a year ago and instead it fell by 70bps.

Connection to Urbanization trend will continue to deliver outsized results. This is due to both changing demographics in the U.S. where residents desire to work and live in cities as well as the increased internationalization of the buyers, who want to focus on trophy assets in gateway markets and also are more accustomed to urban settings in where they come from. This is becoming a self-fulfilling, virtual process where more companies are coming to cities because the smartest people they want as employees are the ones who want to be here. This can also be seen in trends that the suburbs of NYC are not really seeing growth as the safety and schools of NYC have improved and are resulting in staying in the city for longer. Mike Fascitelli felt that a long-term, buy and hold mentality that is focused more on absolute dollar return than IRR is the best approach. In an era where there is increasing demand to be in an urban environment and pricing has become frothy, there will be more search for the next up and coming neighborhood.

Cycle of Compression is Changing the Landscape. The panel discussed how return expectations have come in and it's very difficult to make more traditional 10-15% returns and in such a low rate environment 6-8% returns aren't that bad; especially considering assets are not levered like they were in the previous 2006-2007 cycle when prices had gotten toppy. Moreover, the approach that many of the companies are taking of selling at a 4% cap rate and building at a 6% yield produces higher spreads than a more customary sell at an 8% yield, build at a 10% yield. Furthermore, we're seeing the market driven by highest and best use of property, where on the margin, things are moving to better alternative uses. One example is condo conversion because pricing has risen to the $2,500-3,500 psf level, which is at least double what typical office building value would be. Jay Sugarman pointed to the mortgage REIT business where the companies can't scale with short term duration and businesses that demand growth can't be built with short term financing.

Concept of scarcity will deliver whether it's Real Estate or Sports. The conversation progressed to a discussion about ownership of sports franchises with Mike Fascitelli a part owner of the Milwaukee Bucks in the NBA and Jay Sugarman as owner of a Philadelphia soccer franchise. In both cases, they likened the investments to ones in real estate. Mike Fascitelli discussed the concept of scarcity as a rationale and used an analogy that there are only 30 NBA teams in comparison to the barrier to entry strength and desirability of gateway markets in real estate. He pointed out that that a new television contract that tripled revenue was a key part of the transaction, but generally owning a team is not done for the operating business but for capital appreciation upside on the exit of a long term trade – similar to real estate, although the operating side of real estate has more profitability as well. Similarly, Jay Sugarman pointed out both the scarcity and global demand of soccer and thought possessing a team in the relative incipient stages of the U.S. league really had growth potential in the face of international capital flows, whose mentality is more inclined towards soccer than what has historically existed in the U.S. On the real estate side, Mike Fascitelli thought street retail had the best risk adjusted returns presently. He thought the development market was currently difficult but the inherent risk was adequately compensated for with excess returns of 150-200bps, which represents higher spreads in the current environment.

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