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Founder & CEO

Making Money in an Uncertain Environment

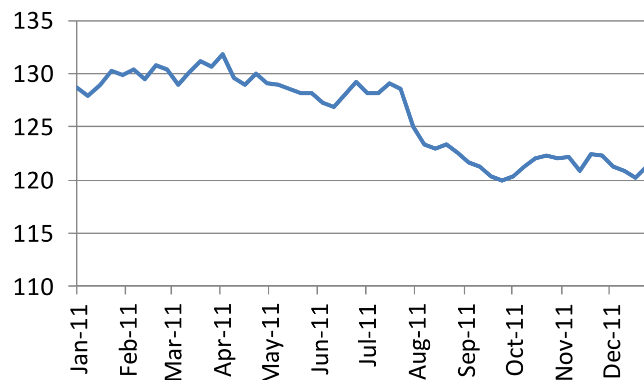
Highlights:

- The macro outlook for 2012 is clouded by a global economy suffering from financial crises, recession-like growth and austerity measures in developed markets.
- Attractive opportunities can be found in property companies that own high quality assets, cater to the higher income consumer, have secular growth fundamentals, as well as select value names.
- Several cyclical sectors are likely to experience deteriorating fundamentals resulting in earnings disappointments and declining valuations as the economic slowdown unfolds.
- Property yields are at historically wide spreads to 10 year U.S. treasury bonds, and when combined with solid growth and rising dividends should generate positive total returns.
- Acute shortage of lending activity is the greatest risk to property in 2012 as Europe's financial crisis unfolds.

In contrast to the start of 2011, 2012 is beginning with less uncertainty than several months ago, but uncertainty will be with us this year and will vacillate between uncertain and extremely uncertain. For property investors, attractive opportunities on the long side will likely be found in high quality companies, secular growth and select value. Cyclical names, by and large, are richly valued and do not reflect the likely downside to earnings.

At the most macro level, the economic outlook is clouded by the unfolding recession, austerity measures and the financial crisis in Europe, which will likely slow U.S. GDP by about 0.4% in 2012. European weakness, in isolation, may not be enough to derail U.S. economic growth. In the U.S., austerity measures of our own, political uncertainty, and low business and consumer confidence add to the risk that GDP expectations are too high and will experience recession-like growth in 2012 and weaker GDP in 2013 as government shrinks, fiscal policy drag will slow growth this year 0.6% and potentially 2.7% in 2013. As lenders in Europe repair balance sheets, their lending to the U.S. will be reduced, which could cause borrowing costs to rise for real estate, putting downward pressure on property valuations.

Figure 1: ECRI Weekly Leading Index Not Showing Much Improvement



Source: Bloomberg

Note: Data through 1/6/2012

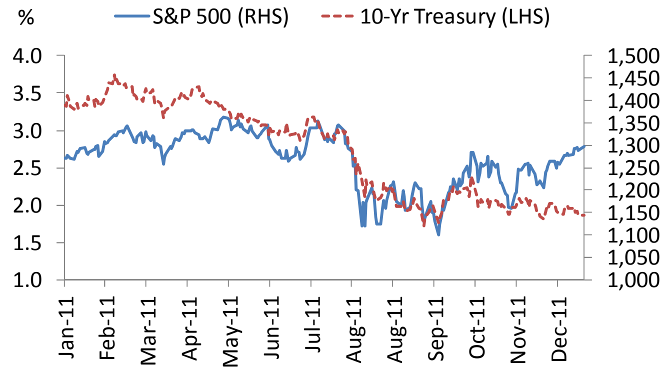
Recent U.S. economic data has rebounded from the dire predictions during the 3rd quarter, although much of the data confirms recession like growth. ECB actions to provide funds for Euro area banks have satiated investors for the time being as risk of insolvency has been removed for the moment. ECB will likely embrace quantitative easing later in the first half of 2012 as fiscal austerity measures fall into place. While this news has provided the market a shot in the arm, it is

likely short-term in nature. The Economic Cycle Research Institute's Weekly Leading Index continues to suggest a recession in the United States as negative self-reinforcing decisions on the part of business and consumers take hold. (Figure 1)

Bond Market Stall Confirms Weak Outlook

The 10-year U.S. Treasury yield has declined 50 basis points since October suggesting that bond investors are concerned about weak growth as the Federal Reserve implements Operation Twist, the buying of longer dated Treasuries. Corporate and real estate debt spreads also remain above their lows of last year, confirming concerns on the part of fixed income investors on the outlook for the economy. In the first half of 2011, the bond market was an early warning sign of the pending decline in the equity markets as the 10-year treasury yield was falling as equities were range-bound. (Figure 2)

Figure 2: S&P 500 Disconnected With 10-Year Treasury



Source: Bloomberg

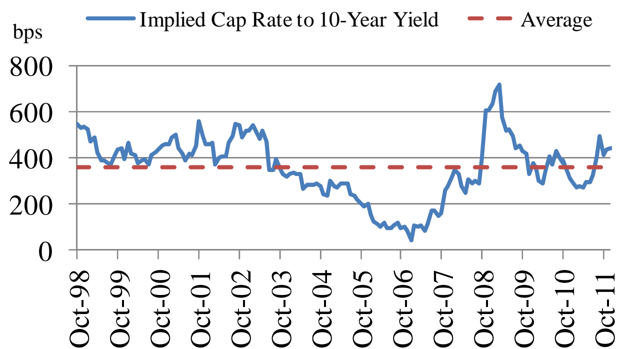
Property Companies Positioned to Generate Positive Returns in 2012

Property stocks are well positioned despite recession-like growth in 2012, a similar scenario to the 2000-2002 recession. Specifically, property stocks present attractive valuations, stable fundamentals with little new supply added over the past 4 years, strong balance sheets and favorable dividend yields.

Given an uncertain economic environment in 2012, the thirst for yielding investments is unlikely to abate and property companies should be beneficiaries due to attractive valuations relative to fixed income investments and stable to rising cash flows. Property stocks are trading at wide spreads to a host of bond market measures today. (Figure 3) Specifically, there is:

- a 440 basis point spread to 10-year Treasury yields vs. a historical spread of 360 basis points since 1998
- a 220 basis points spread to BBB Corporate yields vs. a historical spread of 140 since 1998
- a 640 basis point spread to 10-year TIPS (inflation protected) vs. a historical spread of 530 since 2003

Figure 3: Implied Cap Rate Spreads to 10-Year Yields Are 80 bps Wider Than Historical Average



Source: Citi

Portfolio Positioning – A Focus on Quality, Secular Growth and Select Value

In the current environment, secular growth, quality and select value are attractive, while cyclical companies and those with deteriorating fundamentals at rich valuations and elevated earnings expectations are likely to disappoint.

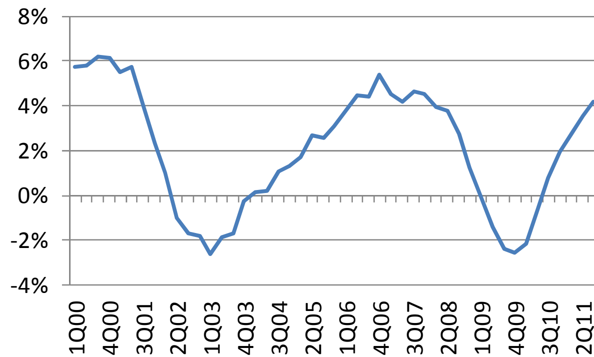
Quality companies with stable to improving fundamentals, and companies with strong secular growth appear particularly attractive in the current environment of tepid economic growth with significant uncertainty. Quality companies that own the best real estate in the best markets should see the strongest demand and pricing for assets, generating strong FFO growth in 2012. Companies with tailwinds from strong secular demand (cell towers, data centers) should generate above-average growth with less sensitivity to an overall economic slowdown.

Solid Growth on the Heels of Modest Demand & Limited Supply

Property companies experienced a strong rebound in same store net operating income following the financial crisis with third quarter growth of 4.2% aided by generational lows in new construction. (Figure 4) The recovery has been uneven, with owners of real estate in coastal markets, high income areas and central business districts enjoying stronger growth.

In 2012, net operating income will likely rise 4-5%, and earnings grow 8-10%. If the U.S. economy weakens, demand for space and landlord pricing power will soften, but the low amount of new construction should limit the downside.

Figure 4: Same Store NOI Growth Continues to Accelerate



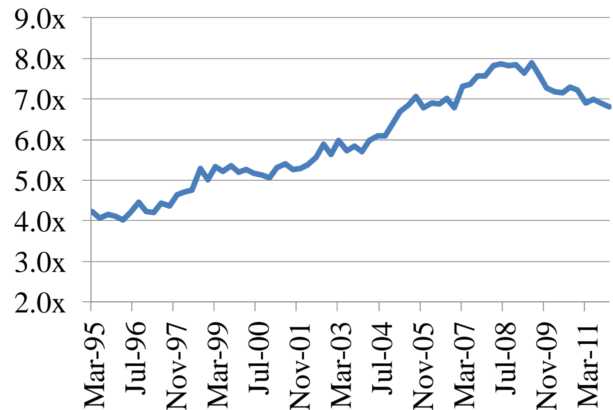
Source: Citi

Several cyclical sectors appear to be pricing in robust demand that will likely lead to earnings disappointments in 2012. Given the rich valuations, share prices will likely fall. Lodging and commercial real estate brokers are two sectors that appear susceptible to disappointment while suburban office, lower end malls and shopping centers will likely see weakness persist.

Property Company Balance Sheets Largely in Good Shape

Publicly traded property companies have strong balance sheets with debt/EBITDA of 6.8x and staggered debt maturities. (Figure 5) Credit markets for the public companies continue to provide attractive financing. Access to a broad array of financing options will continue to put the public companies at an advantage over the private operators.

Figure 5: Debt/EBITDA Ratios Continue to Improve



Source: KeyBanc Capital Markets

The Potential Risk—Real Estate Debt Market Recovery is Lagging

The real estate debt markets have not recovered from the weakness seen in the third-quarter of 2011 when the double whammy of the U.S. debt ceiling debate and the Europe Financial crisis increased risk aversion which also throws into question the sustainability of the current rally. Specifically, signs of continued strain in

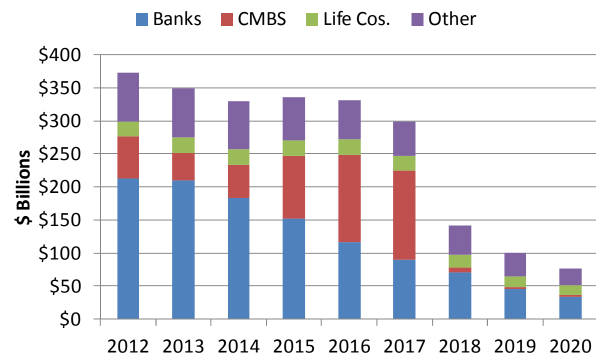
the real estate debt markets include: (See Appendix for charts)

- Real estate corporate unsecured bond spreads are now 330 basis points above treasuries, only a 10 basis point improvement since the October market bottom and 230 basis points wider than the tightest spreads last year.
- CMBX prices remain well off their highs, with BBB and AAA down 40% and 3% from the highs, respectively.
- CMBS issuance during the fourth quarter of 2011 was $4.8 billion, down 57% from the quarterly run rate for the first three quarters of 2011.

Commercial Debt Maturities Manageable In the Near Term

Debt maturities in 2012 are manageable and consistent with the past few years. Lenders will likely continue to be inclined to extend mortgages in periods of stress and in periods of strength, will push borrowers to pay-off the loans. The CMBS maturities of 2015-2017 are likely to be the most problematic given high leverage and the fact that these loans were originated at the peak real estate values of 2005-2007. (Figure 6)

Figure 6: Approximately $375 Billion of Commercial Real Estate Debt Maturing in 2012



Source: Morgan Stanley, Foresight Analytics, Trepp, Intex

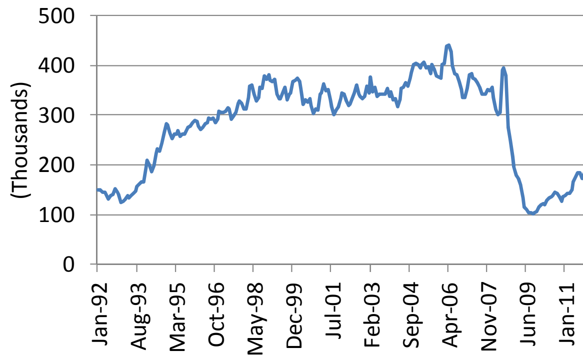
Apartments— Pricing Power Should Remain Strong in Coastal Markets

Fundamentals for apartment landlords in coastal markets should continue to be robust in 2012, given a captive, growing renter pool, the high cost of owning a home and limited new supply. Coastal apartment companies should generate 6+ percent same store NOI growth in 2012.

New apartments in the Sunbelt markets are likely to lose some steam with overall multifamily construction permits up to 209,000 units from the low of 87,000 units in July 2009. Increased affordability of single family homes compared to renting as well as Obama's proposed rental program of foreclosed homes, in markets such as Atlanta, Las Vegas and Phoenix, could weigh on rental growth. (Figure 7)

National rent as a percent of income data supports further apartment rent increases, as the ratio is currently 20.0% versus the historical average of 20.5%. (Figure 8) Pent up household formations should be a tailwind for the sector over time, with a 2.1 million increase in the number of households doubled-up (i.e. young adults living with their parents, roommates) in 2011 versus 4 years ago.

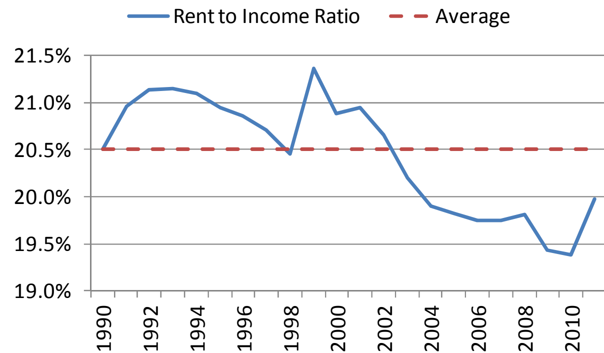
Figure 7: Multifamily Permits Well Below Demand



Source: Bloomberg

Note: Data through 11/30/2011 represents 3-month rolling average of number of units being permitted.

Figure 8: Apartment Rent to Income Remains Below Historical Averages



Source: Green Street Advisors, REIS, Axiometric

Cellular Towers—A Strong Secular Story

Cellular towers are an undervalued sector with compelling, robust and highly visible secular growth. The build-out of carrier networks to support greater smartphone penetration and greater device data usage, as well as technology upgrades to 4G technology, points to accelerating antenna demand. For example, iPhone 4S users consume almost twice as much data as iPhone 4 users. Compared to a typical smartphone, tablets such as the iPad use five times as much data and laptops/netbooks use over 20x as much data.

Based only on demand from the major carriers and a ramp up internationally, the towers are likely to beat estimates and raise guidance in 2012. Additional leasing upside can still manifest from numerous sources: Clearwire, DISH, Public Service Network, etc.

The risk of industry consolidation was significantly lowered when the AT&T/T-Mobile merger collapsed under the weight of regulatory scrutiny and future M&A between wireless players, such as Verizon's acquisition of spectrum from a consortium of cable companies, may even act as a catalyst as spectrum gets in the hands of those who can best utilize it.

Same-tower EBITDA growth should be in the high single digits in 2012 driven by contractual rent increases, continued lease amendments and occupancy gains. The tower stocks are fundamentally undervalued. Tower valuations are attractive at 16x 2012 cash flow multiples, versus 18x for the traditional real estate sectors. For 2012, towers should generate in excess of 15% cash flow growth versus the REIT sector's average of 10%. The sector also has low ongoing CapEx requirements. EBITDA multiples remain below historical norms.

Datacenters—Internal & External Growth Potential

Datacenters remain a compelling sector in 2012 as the companies create substantial value through both internal and external growth. The secular growth story marches on as the sector continues to be at the intersection of many of the strongest trends of the decade, including cloud and mobile data. The sector's large exposure to financial services is manageable and serves as a catalyst for datacenters as firms searching for

operating cost savings increasingly outsource their IT. Demand for datacenter space remains robust and supply worries have yet to materialize in most markets.

Healthcare—REITs Largely Insulated From Government Reimbursement Cuts

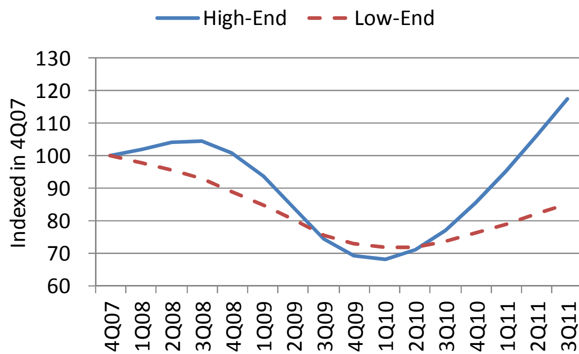
The healthcare REITs that own diversified portfolios with limited government reimbursement risk should generate 2-3% same store NOI growth in 2012 with limited economic sensitivity. Companies with a high concentration of government reimbursement exposure are less attractive as additional reimbursement cuts are likely as the government and states look to cut costs and balance their budgets. Companies whose tenants experience revenue declines from declines in reimbursements from the government will see the value of their assets decline.

Retail—High End Should Outperform

Owners of higher-end shopping centers and regional malls should be able to push rents aggressively and experience further occupancy gains as retailers continue to consolidate their space in higher-productivity centers. The high-end malls generated 11% same store sales growth in the first three quarters of 2011 compared to 4% at their lower productivity peers. This outperformance likely continued into the holiday season as higher-end department stores reported 7% sales growth year-over-year, 440 basis points ahead of their traditional department store peers. (Figure 9)

The high quality malls have generated 2.5% higher same store NOI growth over the last three years on average as the low end consumer weakened and retailers shut stores. (Figure 10) Owners of higher-end centers are trading at implied cap rates of 5.5% to 6.0%, cheap relative to recent private market transactions at 4.5% to 5.0%; institutional capital should continue to support valuations. A renewed slate of announced store closures and a continuation of higher input costs witnessed in the latter half will likely result in the additional closings.

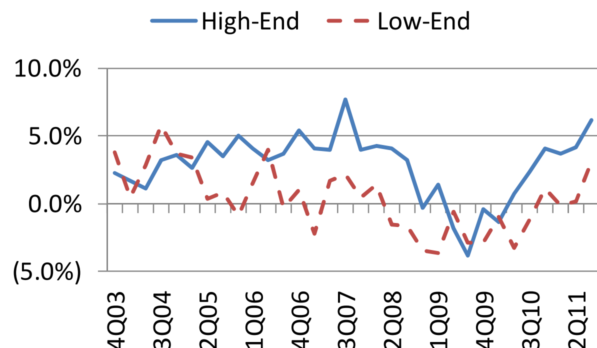
Figure 9: High-End Malls Continue to Generate Stronger Same Store Sales



Source: Company reports

Note: Represents index of high and low end mall same store sales based on year-over-year quarterly data.

Figure 10: High-End Malls Show More Resilient Same Store NOI



Source: Citi

Note: Represents year-over-year quarterly data.

Storage—Consistent Growth

The storage sector will likely provide consistent growth in 2012 as life events for the consumer continue to drive demand, allowing operators to generate 4-6% same store NOI growth in 2012, driven by rent increases, reduced concessions and modest occupancy gains. Low supply growth, increasingly efficient operations and public companies taking market share should continue to provide tailwinds, and allow the public operators to outperform their private market peers in 2012.

Office—Suburban Office Demand Weakness Persists and CBD Softens

Job growth has shown some signs of life in recent months, but overall office demand is likely to remain tepid with only a few bright spots. The West Coast should experience the strongest rent and occupancy gains, with less financial service exposure and greater reliance on other industries (tech, media).

Washington DC should continue to be challenging after a tough 2011 when leasing activity was down 17% due to a slowdown in government and government-related leasing. Manhattan leasing activity slowed in the second half of 2011 after record first half activity, with the typically strong fourth quarter being the slowest leasing quarter of the year in 2011. Financial services will likely be a headwind for Manhattan in 2012 with recent bank and Wall Street layoffs. Investment banks have reduced their footprints in Manhattan by 16% since 2008, and further reductions are likely. (Figure 11) Related business such as law firms and private equity will likely experience weakness as well.

Figure 11: Investment Banks Have Reduced Occupancy by Nearly 16%

Firm	Occupied Sq. Ft. in 2008	% Change 2012 / 2008
Barclays/Lehman Brothers	2,771,000	-33%
Goldman Sachs	3,134,000	-28%
Bank of America / Merill Lynch	6,107,000	-27%
UBS	1,751,000	-20%
Citigroup	5,730,000	-16%
Wells Fargo / Wachovia	1,520,000	-12%
Morgan Stanley	3,821,000	-8%
JP Morgan / Bear Stearns	7,403,000	-7%
Credit Suisse	3,158,000	-4%
Deutsche Bank	2,268,000	-2%
Total	**37,663,000**	**-16%**

Source: ISI

Suburban office fundamentals are likely to remain weak with same store NOI growth flat to down 5% in 2012. Several companies with current valuations at close to 9% appear fair after taking into account the NOI declines that will be experienced over the next few years. If credit markets weaken, these assets will be disproportionately impacted, however.

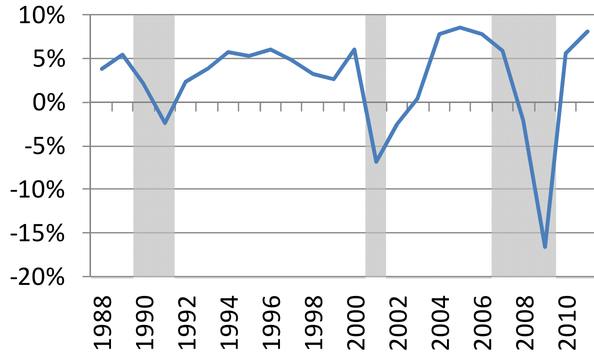
Lodging— Rich Valuations and Decelerating Same Store Growth

Lodging companies are trading at premium valuations and earnings will likely fall short of expectations. The group is trading at 13.7x 2012 TEV/EBITDA multiples, a 12% premium to historical averages of 12.2x. U.S. RevPAR will likely decelerate in 2012 due to corporate belt tightening, recession in Europe and slower growth in emerging markets. Forward visibility is limited and RevPAR can quickly turn south with economic weakness. (Figure 12)

Companies with significant non-U.S. exposure appear to have the greatest earnings risk given deteriorating RevPAR growth in Europe and a stronger U.S. dollar. Europe has experienced a significant RevPAR deceleration to 3.7% in local currency over the past three months through November. (Figure 13)

In 2012, Starwood's management expects RevPar to rise by 4% to 8%, which appears high given the backdrop of European recession and slower economic growth globally.

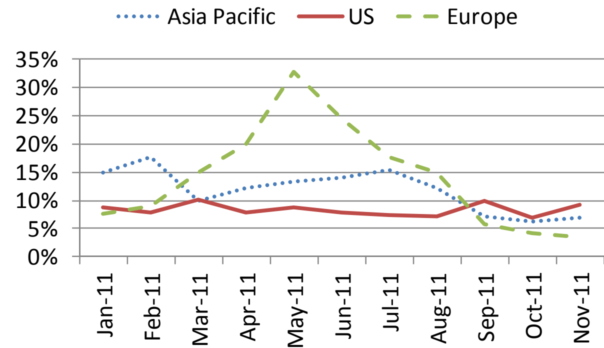
Figure 12: Lodging RevPAR Peaking and Likely to Slow



Source: Citi, Smith Travel Research

Note: Shaded areas represent recessions.

Figure 13: European RevPAR Decelerating



Source: Citi

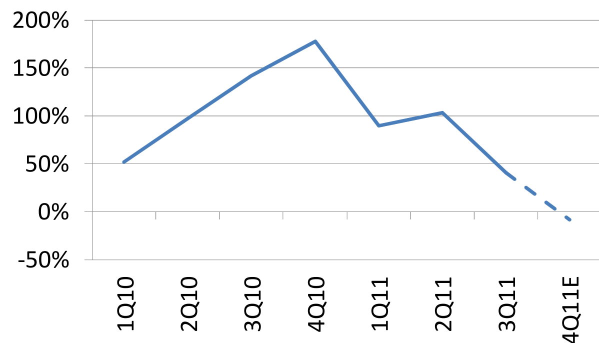
Note: Represents monthly RevPAR in USD through November 2011.

Real Estate Brokers—Expectations Are Elevated

Real estate brokers are vulnerable to an economic slowdown, with expectations high despite a rapid decline in transaction volumes in the second half of 2011, making the stocks rich on 2012 earnings estimates. Recent industry data and market commentary from the real estate service companies themselves indicate a low growth, challenging operating environment in 2012. According to Real Capital Analytics, U.S. transaction volumes declined 19% year over year in November on the heels of a rather tepid October. December U.S transaction volumes will likely be down year over year as well. The slowdown in investment sales can primarily be blamed on a poor financing environment emanating from the European financial crisis. (Figure 14)

On the U.S. office leasing front, Cushman and Wakefield suggested 4Q11 activity did not improve over 3Q11 with weakness in New York City, Washington DC and Boston, and that 2012 is likely to be similar to 2011. As a result, earnings expectations for the sector likely need to come down for 4Q11 and 2012.

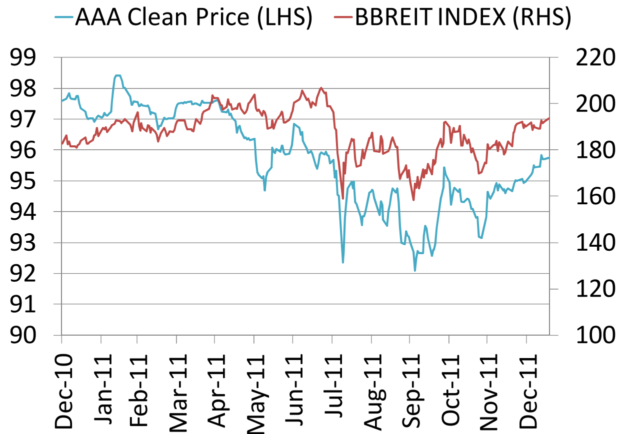
Figure 14: Transaction Volumes Are Down an Estimated 8% in Q4 2011.



Source: Real Capital Analytics, LANDandBUILDINGS

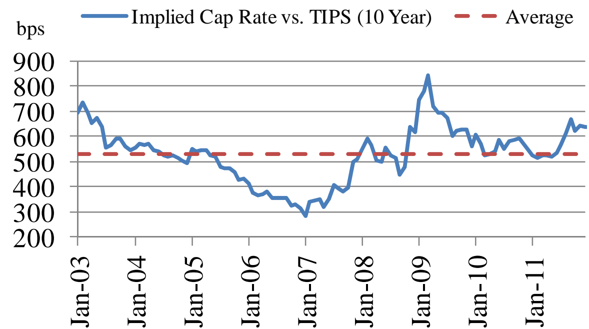
APPENDIX

Figure 15: CMBX AAA vs. REITS



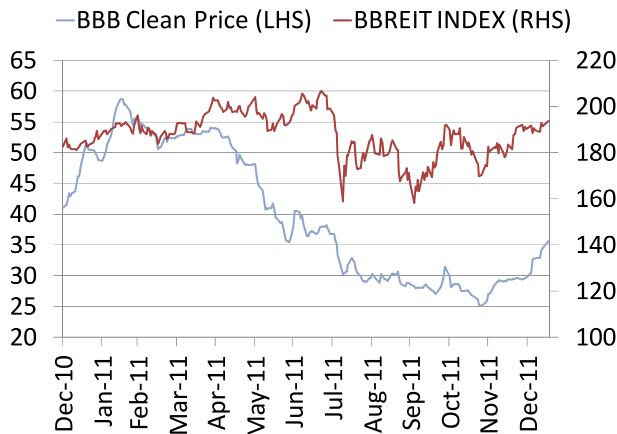
Source: Bloomberg

Figure 16: Implied Cap Rate to TIPS (10-Year) Spread



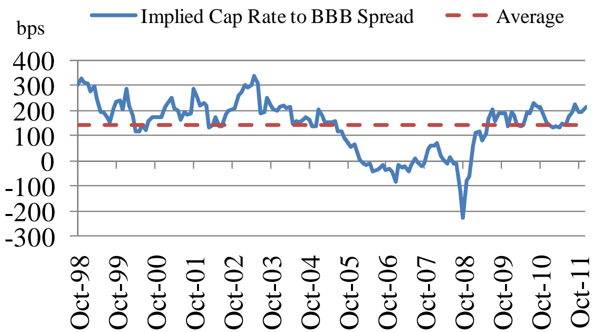
Source: Citi

Figure 17: CMBX BBB vs. REITS



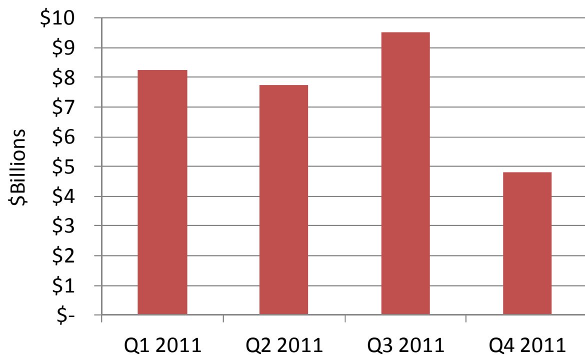
Source: Bloomberg

Figure 18: Implied Cap Rate to BBB Yields Spread



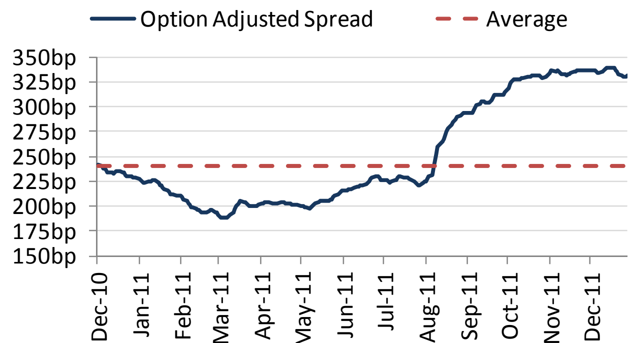
Source: Citi

Figure 19: CMBS Issuance



Source: JP Morgan

Figure 20: REIT Unsecured Debt Spread to Treasuries



Source: ISI

Data through 1/18/2012.

LANDandBUILDINGS Background:

Jonathan Litt is the Founder and CEO of LANDandBUILDINGS, a long/short investment firm that actively invests in securities of global real estate and real estate related companies. Prior to LANDandBUILDINGS, Jonathan Litt was Managing Director and Senior Global Real Estate Strategist at Citigroup where he was responsible for Global Property Investment Strategy from 2000 to March 2008. Jonathan Litt led the #1 Institutional Investor All American Real Estate Research Team for 8 years and was top ranked for 13 years while at Citigroup, PaineWebber and Salomon Brothers. Craig Melcher, Co-Founder and Principal at LANDandBUILDINGS, was a key member of the Citigroup team. Land & Buildings Investment Management is a Registered Investment Adviser with the SEC.

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