Jonathan Litt
Managing Principal

June 2011 Commercial Real Estate Outlook:

No Signs of Weakness From Management

Last week, we met with the management teams of 30 property companies, and it was evident that the *Haves* keep getting better, despite the macro headwinds, and the current sell-off is likely a buying opportunity; meanwhile, the *Have Nots* continue to struggle.

Going into our company meetings, we had two primary macro questions:

- First, has there been any change in underlying demand in the past few months as the global economy has showed signs of slowing?
- Second, has there been any change in the debt capital markets?

Consistently, management teams indicated there has been no slowdown in real estate demand or the availability and pricing of debt despite recent weakness in the synthetic CMBX market. Compared to our meetings in June 2007 when the lack of financing was clear and the bubble had popped, our recent meetings revealed no debt concerns.

However, macro news continues to dominate and weigh on the markets, specifically concerns including:

- Renewed concerns about a default by the PIGS in the Euro Zone.
- The standoff between Democrats and Republicans on increasing the debt ceiling.
- Fear that the markets will roll over as QE2 expires at the end of June.
- Global GDP growth slowdown.

Weakness created by the first three will likely create a buying opportunity. The slowdown in global growth may prove to be more concerning and requires careful monitoring. A combination of factors has lead to the slowing global economy. The easy one to dismiss is Japan as demand will likely come back in the second half. However, tightening policies in the emerging markets and austerity measures in the developed markets in combination with the first three issues have the potential to disrupt the best laid plans.

Oversold, Now Undervalued

Several property types are the favorites of short sellers at the first whiff of economic weakness and look interesting:

- Lodging shares have fallen 14% since they peaked and are now trading at 12x 2012 EBITDA, a 10% discount to recent private market transactions, and attractively valued considering the expected annual EBITDA growth 2010-2012 of 20%. Based on discussions with management, there has been no slow

Figure 1: Lodging and Gaming Stocks are Attractive

	Peak to Current Total Return	2012 EV / EBITDA	2010 - 2012 EBITDA / AFFO Growth	Implied Cap Rate
	(%)	(x)	(%)	
Regional Mall REITs	-6.7	16.7	6.0	6.3
Shopping Center REITs	-9.6	17.2	2.5	6.6
Triple Net REITs	-8.9	13.5	3.3	6.9
Residential REITs	-3.7	19.5	14.7	4.9
Storage REITs	-6.8	19.0	6.7	5.5
Office REITs	-7.7	17.6	7.1	5.7
Industrial REITs	-13.1	20.3	17.3	6.5
Mixed Office/Industrial RE	-6.6	14.6	1.3	7.0
Healthcare REITs	-9.7	14.7	9.4	6.2
Senior Housing C-Corps	-20.5	11.1	14.5	-
Lodging	**-14.0**	**12.1**	**20.3**	-
Homebuilders	-16.4	NM	NM	-
Property Management	-17.1	9.0	31.1	-
Gaming	**-14.6**	**10.8**	**32.5**	-
Prisons	-16.9	7.4	2.7	-
Towers	-12.6	14.2	15.2	-
Timber	-12.8	12.4	12.6	-
Total Wtd. Avg.	**-8.9**	**15.8**	**-**	**6.0**

Note: Average annual 2010 - 2012 AFFO growth rates for REITs and average 2010 - 2012 annual EBITDA growth rates for other sectors. Peak to current total return is based off each sector's respective peak through 6/10/2011.

Source: Citi, Bloomberg

down that can be attributed to the macro economy. Group bookings improved from the first quarter, and transient business continues to be robust with rising room rates.

- Gaming stocks are down 15% from their recent highs despite no apparent slowdown in fundamentals with Las Vegas improving and Macau continuing to post strong results. The shares are attractively valued at 11x 2012 EBITDA with 33% average growth in 2010 - 2012. The recent opening of Galaxy Macau has been well received and should drive more visitations to the Cotai Strip and benefit nearby properties.

The *Haves* Have It

Based on discussions with management, the companies are enjoying strong pricing power due to accelerating demand and limited new supply causing operating results to track ahead of expectations for the second quarter. At the same time, the *Haves* are enjoying a continued improvement in the capital markets with no signs, at this point, of the global slowdown impacting their activity. Apartments lead the way, followed by NY office, high-end regional malls, lodging, gaming and commercial brokerage.

Archstone-Smith, an apartment company that was taken private for $22 billion at the peak, was widely discussed as a potential IPO. Recently, it has been reported that those plans are on hold as they are finding better pricing in the private market for their assets. The implications for the public apartment REITs suggests they are trading cheap to the private market, otherwise Archstone would go public. How cheap? We have been hearing of cap rates in the sub-4% range for prime assets. If that is the case, look for a pop in apartment stocks as transactions get announced.

Similarly, NYC office is increasingly being bid at sub 5% cap rates, with the NYC office REITs trading at low 5% implied cap rates. Further upside in these shares is possible as the gap between the public and private market closes.

The *Have Nots* Continue to Struggle

The *Have Nots* continue to suffer from little new demand, excess vacancy and weak pricing on asset sales, although financing is improving according to management. The most difficult space is suburban office where demand is non-existent and most of the leasing activity is coming from musical chairs as tenants move. Shopping centers, secondary malls, warehouse, skilled nursing facilities and homebuilders all face tough sledding based on our most recent meetings.

Several of the *Have Nots* are seeking to deleverage their balance sheets and/or sell lower quality assets. The opening of the debt markets partially offsets this dilution, but further distances their performance from the *Haves*.

The Hiccups

American Tower (NYSE: AMT) sold off sharply on the announcement of a subpoena from the SEC regarding its historical tax disclosure. The good news is that the IRS has been involved with the company to understand its conversion to a REIT and to date has signaled that the planned REIT conversion is a go. It appears a restatement of historical tax disclosure may be in the cards, and while possible, we believe it is less likely, and will instead come in the form of a fine for improper reporting.

AMT, at a 7% implied cap rate, is undervalued on a real estate basis and compared to REITs, which will increasingly be its peer universe after the conversion takes effect January 1, 2012. AMT will have amongst the best EBITDA growth, at 15% in the REIT industry. Trading at a discounted valuation, this hiccup is likely buyable.

Brookdale Senior Living (NYSE: BKD) lowered guidance for a modestly softer April and May with 250 fewer leases out of 5,500 in a typical quarter. Although they are confident in their full year guidance and cannot attribute the weakness to a particular issue, the market reacted with a decisive opinion that global weakness is impacting demand. Historically, senior housing has been one of the more resilient property types through economic downturns. Ventas also commented that April is a seasonally slow period and conclusions about the full year should not be drawn from Brookdale's comments. BKD trades at a 7.7% implied cap rate, a 20% discount to the 6.5% cap rate Ventas paid for senior living operator Atria. Further, with an expected annual EBITDA growth rate of 15% between 2010 and 2012, Brookdale and the senior living sector in general represents one of the fastest growing sectors.

Note: All figures are as of June 10, 2011.

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. LANDandBUILDINGS was seeded by funds advised by Citi Alternative Investments in the summer of 2008, now SkyBridge Capital. Land & Buildings Investment Management is a Registered Investment Adviser with the SEC.