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Founder & CEO

Select Growth Opportunities

Highlights:

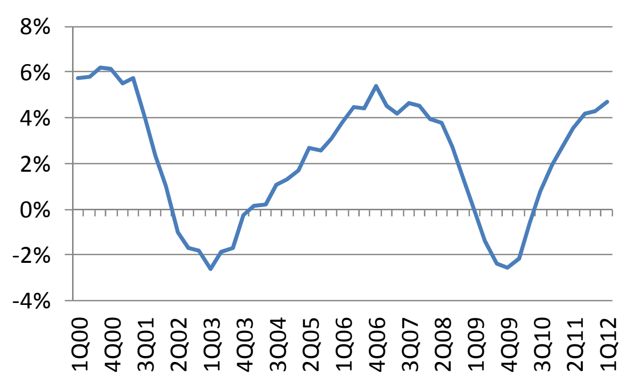
- First-quarter earnings confirm strong fundamentals and the best total return potential in cell towers, high-end retailers, data centers and apartments.
- Suburban office and lower-end shopping centers remain unattractive areas to allocate capital as demand remains tepid.
- Recent meetings with local sources suggest the New York City and Washington DC office markets will remain sluggish for balance of the year.

First Quarter Earnings—Visible Opportunities

First-quarter earnings in the cellular towers, high-end malls, data centers, and apartments continued to show strengthening fundamentals while shopping centers, suburban office and New York City and Washington DC office remain tepid.

Property company FFO growth was 10.2% in the first quarter, ahead of the 6.2% expected growth, with 60% of companies beating estimates. Same store net operating income growth continued to improve, accelerating to 4.7% year-over-year. (Figure 1).

Figure 1. Same-store NOI Continues to Improve



Source: Citi.

Sector Commentary

High-end Malls—Strong Tenant Sales Support Pricing Power

High-end malls continue to offer mid-teens total return upside with the strongest sales per square foot across the retail arena. In the first quarter, owners of high-end malls reported a significant increase from a year ago with 6.1% same-store NOI growth (versus 3.7% in 2011) and compared to 3.3% NOI growth this quarter for their shopping center brethren.

Strong pricing power drove rents up 14.2% on new leases in the quarter—some of the strongest rent growth of any property sector. With no new supply, redevelopment opportunities, both domestic and abroad, generating 9+% yields compared to acquisitions at sub-5% cap rates, high-end mall FFO growth should top 15% in 2012, exceeding company guidance and providing an additional catalyst for stock price appreciation.

Apartments—Company Guidance Too Conservative

Apartment companies' robust fundamentals continue to validate our bullish thesis on the sector. First quarter earnings were stronger than expected, setting the companies up for positive earnings surprises for the balance of the year. Same-store revenues accelerated 5.9% year-over-year and from 5.4% in 4Q11 while same-store NOI increased to 8.6%. With little new supply and move-outs to homeownership remaining low given the difficult mortgage financing environment, apartments should see near 20% FFO growth in 2012.

AIMCO (NYSE: AIV) had a standout first quarter earnings report as management began delivering on plans to reposition the company. Management is selling approximately $1.4 billion of non-core assets, focusing the portfolio into stronger markets, redeveloping assets and deleveraging the balance sheet by taking out high cost preferreds. The company currently trades at a 6.9% implied cap rate, a 25% discount to its peers (5.2% implied cap rate for the sector) and a significant discount to net asset value despite multi-year mid-teens expected AFFO growth.

Cellular Towers—Multi-Year Growth Continues

The cellular tower sector provides the strongest secular growth story in the property sector as global mobile data growth remains in the early innings. According to Cisco, global mobile data traffic grew 2.3 times in 2011 and similar growth is expected in 2012. First quarter trends confirmed the need for additional infrastructure to meet this data demand, as same-tower revenue growth came in at 8%-9%. Industry contacts stated leasing activity was 25% greater than last year's strong pace. This high level of growth is sustainable for at least the next several years. The wireless industry is enjoying cell tower lease amendment activity, which will be followed by increased cell-splitting and then a ramping up of new lease activity. The current 4G/LTE network build-out by the Big 4 (AT&T, Verizon, Sprint & T-Mobile) will not finish until 2014, with Sprint, T-Mobile and Clearwire taking until 2015 to complete their cellular network upgrades. DISH's wireless network and the proposed Public Safety Network are potential new demand drivers.

Cell towers' discounted valuation and strong AFFO growth should provide total return potential of over 20%. Blue-chip American Tower (NYSE: AMT) trades at an approximate 10% multiple discount to the overall REIT universe while SBA Communications (NASDAQ: SBAC) trades at a 20% discount despite industry-leading AFFO growth of over 40%.

Self-Storage—Strong Growth Continues

The self-storage sector continues to generate solid growth with 1Q12 same-store revenues of 4.4% and same-store NOI of 8.1%. The two largest storage companies, Public Storage (NYSE: PSA) and Extra Space Storage (NYSE: EXR), indicated street rates are up 4%–5% year-over-year, concessions are down, and that renewal rates on existing tenants are 7%–9%. With virtually no new supply coming on line, 4%–5% same-store revenue growth and 6% same-store net operating income is a strong run rate for high quality storage companies and positions the best operators for mid-teen total returns.

Shopping Centers—Demand for Low-End Centers Remains Tepid

Grocery-anchored shopping centers and big box power centers located in lower barriers to entry markets with lower household incomes continue to underperform. FFO growth for the sector is likely to remain a modest 3% in 2012, also weighed down by dilutive repositioning as several companies seek to sell weaker assets.

While large box space is largely occupied, the smaller shop space occupancy remains a soft spot. Also, potential downsizing by some of the larger tenants (e.g. Best Buy) could continue to weigh on the sector. Shopping centers with lackluster earnings growth for 2012 are trading at a 6.6% implied cap rate, in-line with core acquisition cap rates of 6%-7%, and appear richly valued.

Suburban Office—Continues to Lag

Suburban office fundamentals continue to be weak and the sector remains an unattractive area to allocate capital. During the first quarter, the public companies saw leasing activity down nearly 10% year-over-year, cash rent spreads on new and renewal leases were down approximately 8%, and 2012 same-store cash NOI is expected to be down 2% on average.

The sector trades at an average implied cap rate of 7.6%, but private market deals in the suburban office space are still stubbornly in the 8%-9% range. The high yields on these assets will eventually attract more buyers given the historically low cost of capital environment, but until there is greater certainty around job growth, there is unlikely to be significant cap rate compression.

New York City and Washington DC Office—Weakness To Persist

Leasing activity in New York City was down significantly in the first quarter, with Midtown Manhattan down nearly 40% year-over-year. Financial services firms and the businesses that support them, such as law firms, failed to produce strong demand. Instead, the weak demand is creating a musical chairs effect as space requirements continue to shrink.

While several large lease renewals took place in the first quarter, such as SL Green’s (NYSE: SLG) re-signing of Viacom for 1.4 million square feet at 1515 Broadway, the economics of these types of deals indicate continued Midtown weakness and a pronounced desire to keep tenants in place. Softness in the Downtown market also persists despite 50% lower rental ratsame-storees. While technology and media demand in Midtown South continues to be brisk, the public companies have little exposure to this market.

In Washington DC, recent meetings with local brokers indicated that first quarter office leasing volumes were down 75% year-over-year due to government gridlock and a weak private sector. This market will continue to face headwinds as the specter of federal budgets cuts loom, government uncertainty persists and new supply comes on line.

Data through 5/15/2012.

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.