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Mid-Year 2011 Outlook

What We Know Versus What We Fear

Since May, the stock and bond markets have been in a “what we fear mode” specifically related to:

- Fear of Sovereign defaults.
- Fear of a European banking crisis.
- Fear of China having a hard landing.
- Fear of inflation.

“What we know” about the macro economies and real estate is:

- Global growth is slowing but not contracting.
- Property demand is outstripping limited new supply.
- Property is cheap when compared to bonds.
- Real estate has a muted business cycle.
- Real estate has inflation hedge characteristics.

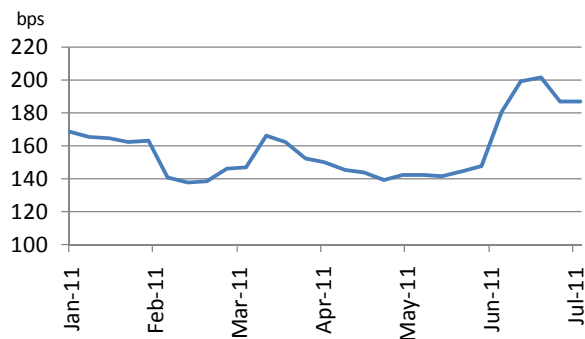
Recent events suggest a positive turning point for the global economy:

- EU has vowed to rescue Greece and has recently turned its attention to Italy.
- Premier Wen states China’s inflation is under control.
- A coordinated release of strategic oil reserves suggests central governments are determined to get the economy going.
- Vehicle production is set to surge in July and a budget debt deal is likely soon.
- Approximately 75% of second-quarters earnings have beaten expectations versus 55% in Q4 2008, a recession quarter.

Property Resilient to Macro Concerns

Property continues to benefit from positive tailwinds. When the structural macroeconomic challenges facing the developed and emerging markets reach an economic breaking point, these tailwinds will likely become headwinds, but the breaking point is unlikely now. Further, the order of magnitude relative to the GFC of 2008 will unlikely be repeated due to limited new supply and healthier balance sheets.

Figure 1: CMBS Spreads Trading in a Tight Range



Note: CMBS composite spreads to Treasuries.

Source: L&B, JP Morgan

A recovery in spreads is key to real estate continuing to see valuations expand. Since the European financial crisis resurfaced in May, CMBS spreads to Treasuries have widened out modestly to just over 180 basis points in part reflecting the decline in Treasury yields and modest elevated risk. (Figure 1) New CMBS issuance of \$15 billion in the second quarter and \$10 billion planned in the third quarter suggests demand for property related paper is attractive to investors, as such, providing increased liquidity to property owners facing debt maturities. While equities have rallied on the Greek bailout, investment grade spreads have not rallied leaving some lingering concern.

The European financial crisis is real. If poor policy decisions are made, there is the potential to pull the global economy into recession through a combination of a chain reaction from sovereign defaults to runs on banks with sovereign exposure and fiscal drag from austerity measures.

Real Estate Remains Attractive Relative to BBB Yields

Real estate is attractively valued when compared to investment grade bonds with spreads wider than historical levels. (Figure 2) Implicit in the spreads is an expectation of higher Treasury yields.

However, given the subdued growth outlook and moderating inflation, materially higher Treasury yields are unlikely, leaving room for spreads to narrow as fears of contagion from the European financial crisis subsides.

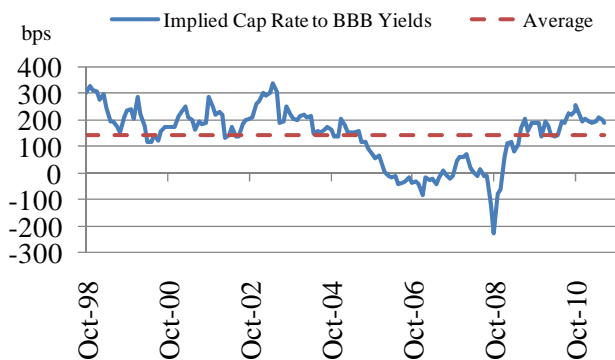
Despite The Fear, Real Estate Still Well Positioned

Barring a Global Financial Crisis II, real estate with high barrier to entry characteristics, real estate catering to the high end, and publicly traded real estate with secular growth drivers should generate returns of 15-25% over the next 12-18 months. Conversely, property in low barrier markets with below average demographics will continue to struggle.

The "Tiffanys" of Real Estate are Best Positioned

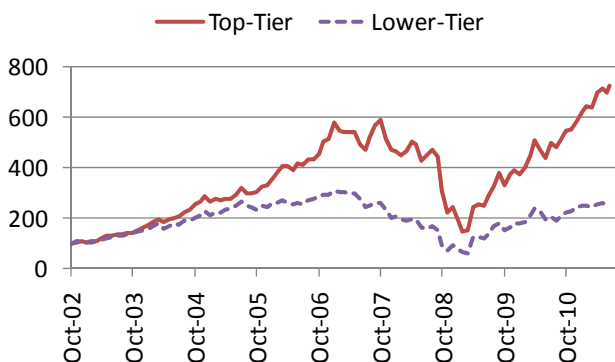
The "Tiffany" of property is the preferred place to invest. Tiffany's sales symbolize the dichotomy between the financial health of upper income households and the average American. Tiffany like real estate is seeing similar trends. Specifically, luxury lodging, Park Avenue office, prime apartment buildings, highly productive regional malls, and high roller gaming are enjoying strong demand from a demographic that is enjoying lower unemployment, higher household income, and improving prospects. The results posted by companies that own these assets clearly illustrate that these factors are at work.

Figure 2: Real Estate Yields Cheap to BBB Bond Yields



Source: L&B, Citi

Figure 3: Top Tier Property Has Historically Outperformed Lower Tier



Note: Categories comprised of a select group of real estate and real estate related companies. Indexed at 100 in October 2002.
Source: L&B, Bloomberg

What We Like & Dislike

Attractive Sectors

Sector

Rationale

US

Apartments	Strong household growth driving landlord pricing
Cell Towers	Built in rent growth and positive secular demand
CBD Office	Fundamentals improve as supply remains constrained
Data Centers	Pricing power for turnkey space maintained
High End Retail	Strong retailer and consumer demand

Non-US

Brazil Housing	Secular growth in middle class drives demand for new units
Brazil Retail Malls	Consumer led growth supports new supply of retail space
China Housing	Despite policy issues volumes in second and third tier markets strong
Hong Kong Central Office	Strong fundamentals creating accelerating rents and values
London West End Office	Scarcity of Class A space driving rents towards prior peaks

Global

Gaming	Accelerating demand in Macau, Singapore and Las Vegas
Lodging	Robust RevPAR growth in high end hotels
Real Estate Services	Cyclical recovery in transaction and leasing fee revenues

Less Attractive Sectors

Sector

Rationale

US

Healthcare	Rich valuation given modest growth prospects
Triple Net Leased Assets	Inferior growth prospects not reflected in valuations
Suburban Office	Poor fundamentals limit upside potential
Shopping Centers	Limited rent growth creates headwinds

Non-US

Europe/UK Retail	Slowing economies limit sales and rent growth
Secondary Offices	Lackluster fundamentals limit upside potential
Australia Housing	Slowing volumes impacting prospects

Domestic Investment Focus

Pullback in Lodging Stocks Creating Attractive Opportunity

The U.S. lodging sector should benefit from a cyclical rebound in room demand over the next few years, and with the group down 10% over the past few months, has created an attractive investment opportunity. Companies with exposure to key gateway markets such as Washington D.C., Boston, New York and San Francisco are likely to generate the strongest returns, as the fundamentals and capital markets should be the most robust.

Lodging Fundamentals Are Among the Best in Real Estate

The fundamental backdrop for the lodging sector is among the best in the industry. The recovery in hotel demand, driven by a recovery in business travel, should drive further improvements in occupancy and rates. Higher end hotels stand the most to benefit. Group business will likely accelerate as business confidence improves. RevPAR growth in 2012 will likely exceed the expected 6%-8% range in 2011. New construction remains at multi-decade lows at less than 1% of total stock. Lodging cycles typically have multi-year periods of strong RevPAR growth in economic expansions, which is likely again this cycle. (Figure 4)

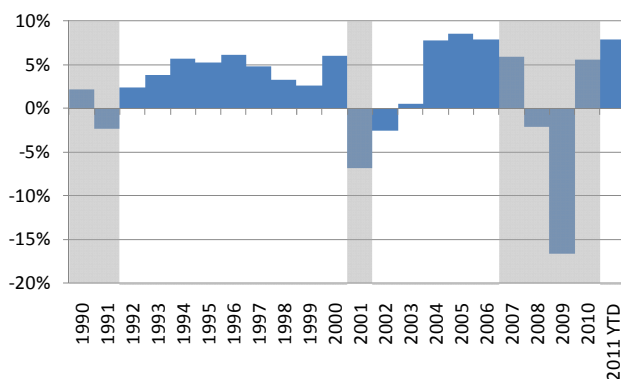
Significant operating leverage should result in net operating income and EBITDA growth approaching 20% for some companies over the next few years. Operating margins have plenty of room to expand and are 600 bps below the prior peak. Margins should expand 150-250 bps a year for the next few years going from 22% to 28% in 2013. (Figure 5)

RevPAR statistics continue to be strong despite weaker economic data points over the past few months, with second quarter 2011 RevPAR growth of 7.4%. This should give companies the comfort to maintain full year guidance ranges during second quarter earnings season.

The Buying Opportunity

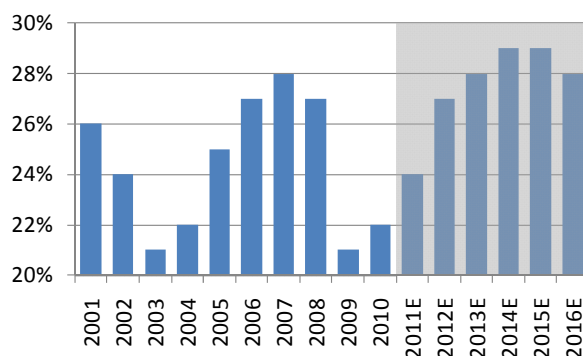
Lodging valuations are attractive, with the stocks now trading at a 10-15% discount to the net asset value based on recent private market transactions, with forward EBITDA multiples of 13x for the public companies. (Figure 6) Public company multiples are similar to the valuations early in the last recovery (2003/2004), which was an attractive entry point as the stocks had a strong run subsequently. EBITDA is even more depressed this cycle suggesting the trajectory of EBITDA should be even stronger over the next few years.

Figure 4: Lodging RevPAR Typically Experiences Multiple Years of Strong Growth in Expansions



Note: 2011 is year-to-date through 7/2/2011
Source: L&B, Citi

Figure 5: Lodging Operating Margins Should Expand Over Next Few Years

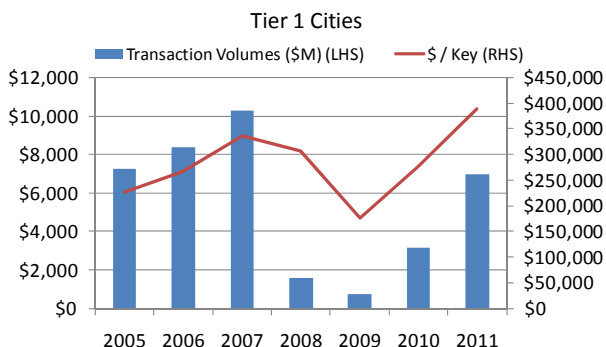


Note: Shaded area represents estimates.
Source: L&B, Green Street

Gateway Markets Should Lead

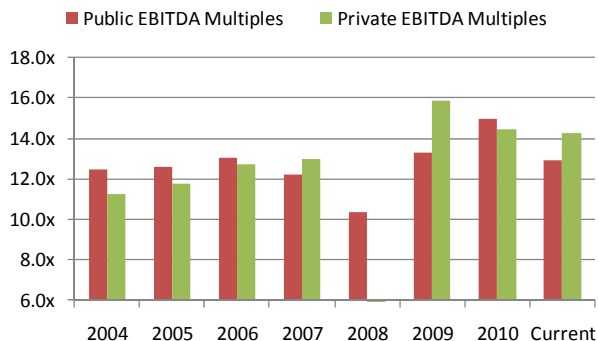
Lodging companies with exposure to key gateway markets where the supply/demand outlook is most favorable should see the strongest internal growth. The key gateway markets have shown a surge in transaction activity over the past year and valuations are near prior peak levels for some assets. Meanwhile, tier 2 and 3 lodging markets have seen a more subdued recovery due to weaker a weaker demand recovery. This dichotomy will likely persist. (Figure 7)

Figure 7: Top Lodging Markets Should Continue to See Best Price Appreciation...



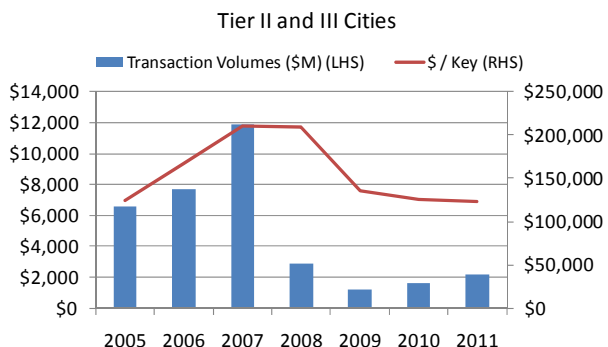
Source: L&B, ISI, Real Capital Analytics

Figure 6: Public Lodging Companies at Discount to Private Market Transactions



Note: Represents forward EV/EBITDA multiples. 2008 private market data unavailable. Private market multiples represent multiples for luxury and upper-upscale transactions. Source: L&B, Citi, Bloomberg

...While Tier II and III Cities Should Continue to Languish



International Investment Focus

London’s West End Office Market—Limited Supply Drives Rents and Values in the Upcoming Cycle

Since the 1980s, London has been the main driver of the U.K. as the shift to a knowledge-based economy from a manufacturing economy unfolded. Today, London’s population represents 20% of the U.K. with 8 million people. London’s success has transformed the city into one of the most international and cosmopolitan in the world and is considered the center of property investment in Europe for global institutional and high net worth investors.

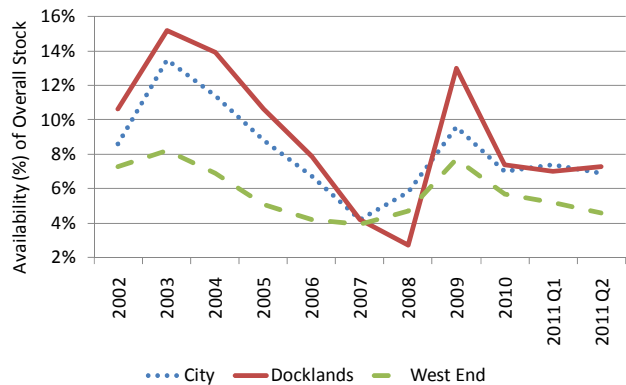
Strict Zoning in the West End Limits New Supply

The London office market is comprised of three major sub-markets: West End, the City and Docklands. The West End is the most desirable market; strict zoning restrictions have limited new supply to 1% per annum over the past 20 years vs. 5% in the City. Tenant demand has accelerated from the growth in small and medium sized financial, services and media tenants. Close proximity to prime residential and leisure venues make the area the first choice among firms looking for space. (Figures 8 and 9)

Scarcity Keeps Vacancy Rates Low and Drives Rents Higher

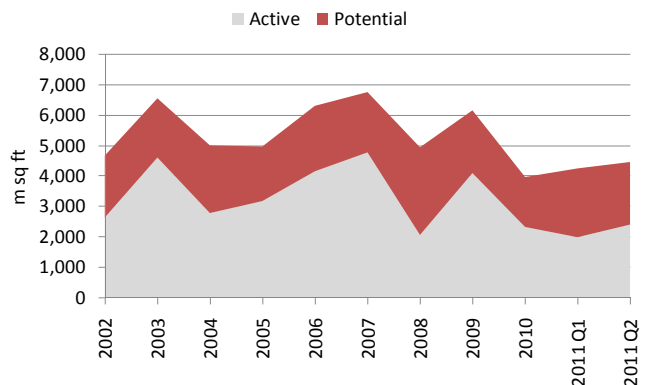
The West End market has outpaced the rest of London with low vacancy rates over the cycles, which in turn has led to both higher rents and less volatility. As of Q2, the West End Class A vacancy rate is 2.3%, approaching the lowest levels tracked over the past decade and well below the vacancy rates in the City and Docklands. The scarcity of high quality Class A West End office space coupled with improving demand will drive sector leading rent growth. Rents in the West End have recently bounced 20% off the bottom and our expectation is for a further 25-30% increase over the next two years as demand continues to outstrip supply. (Figures 10 and 11)

Figure 8: West End Outperforming Balance Of London Market



Source: L&B, Jones Lang LaSalle

Figure 9: West End Demand Improving



Note: Active refers to a declared/signed requirement for space in the short term whereas potential refers to the need for space in the future.

Source: L&B, Jones Lang LaSalle

Continued Cap Rate Compression Likely

West End values can increase 25% over the next 2 years as a result of rent growth and further cap rate compression. Cap rates on recent West End office transactions averaged 5%. This is a 3% spread to the 5-year UK bond rate of 2%, well above the 80 bps historical average spread. The market is implicitly building in a 2% interest rate increase in the 5-year which is less likely to materialize given a more modest recovery coupled with austerity measures. Cap rates can compress 50-100 bps for high quality properties suggesting price appreciation of 15% without taking into consideration increasing rents.

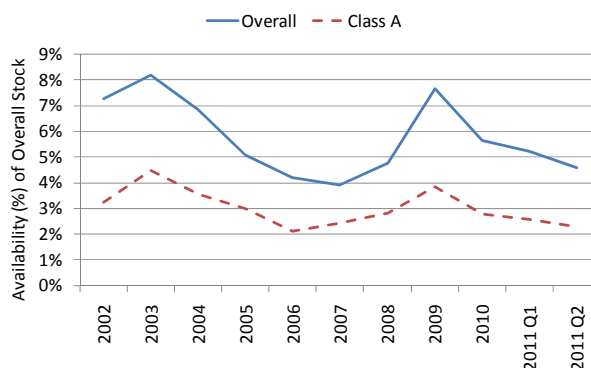
Company Highlights—Great Portland & Derwent London

West End Office REITs are poised for strong double digit returns. Great Portland and Derwent London focus on refurbishment and redevelopment of well-located, less-competitive Class B space into Class A space. Their business models work very well in a scarce asset market as demand for new quality space from tenants and investors accelerate. The long time horizons and expertise needed to execute redevelopment in the West End provides a competitive advantage vs. passive investors. (Figure 12)

Great Portland Estates (GPOR LN) – Near-Term Redevelopment Portfolio Positions Company For Growth

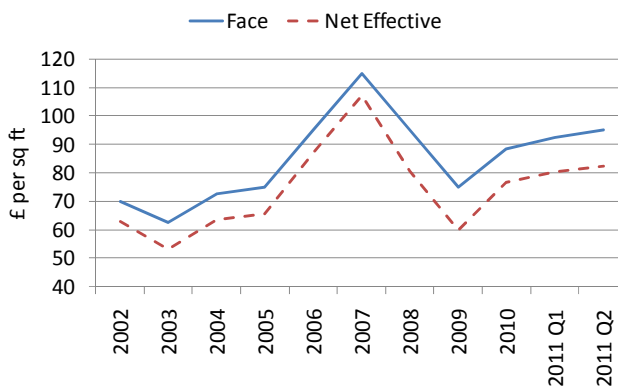
- Redevelopment pipeline is 30% of investment portfolio.
- 80% of the assets are in the West End.
- Incremental ROE of 15% on development capex and 25% development margins.
- 30% growth in EBITDA through 2014.
- 28% leverage allows ample room for execution of pipeline.
- Trades at implied 5% cap rate excluding properties under redevelopment .
- Portfolio rents are 20% below market.
- Development assets are forecast to stabilize at 6%-7% yield on cost.

Figure 10: Scarcity of Class A Space In West End



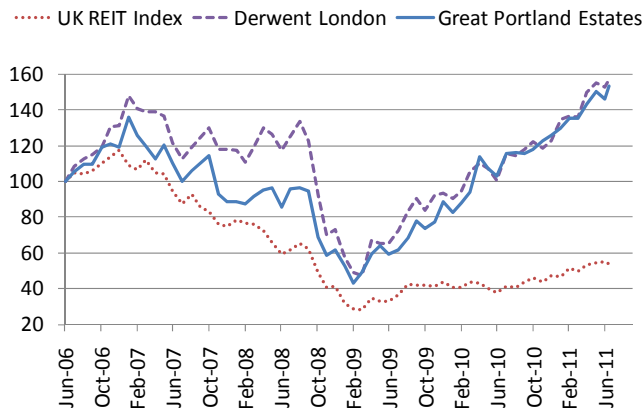
Source: L&B, Jones Lang LaSalle

Figure 11: West End Rents Recovering and Continue To Rise



Source: L&B, Jones Lang LaSalle

Figure 12: Companies with West End Exposure Outperform All U.K. REITs



Note: Data indexed at June 2006

Source: L&B, Bloomberg

Derwent London (DLN LN)– Development On The West End Periphery Creates Long-Term Value

- Pipeline is 40% of investment portfolio.
- Capital recycling business model - acquisition, redevelop, sell.
- Focus on world-class design transforming periphery locations to core West End.
- 18% returns on incremental capital, 25% development margins.
- 25% growth in EBITDA through 2014.
- 35% leverage modest given asset recycling model.
- Trades at 5.25% cap rate excluding assets under development.
- Developments forecast to yield 7.0% on cost.

Note: All figures are as of July 12, 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.

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