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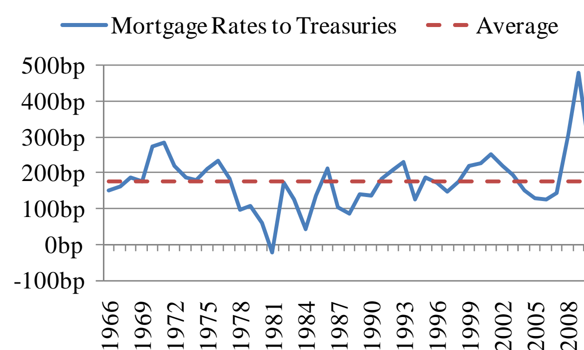
2011 Commercial Real Estate Outlook
Animal Spirits Alive and Well for Real Estate: Mid-Teen Total Returns Expected

Professor Shiller and Akerlof's new book "Animal Spirits" provides the missing link to traditional securities analysis by looking at how confidence, fairness, corruption, money illusion and stories often influence returns in ways that traditional securities analysis does not. Fortunately, Animal Spirits are alive and well in the capital markets. The continued improvement in the economy is driving a pop in real estate fundamentals and institutional investors are allocating more capital to real estate. Lenders are becoming unshackled from doomsday underwriting and are feeling a new bravado as they increase their loan growth plans.

"Capital Keeps Raining on My Head"

"Capital Keeps Raining on My Head" was the theme song of Sam Zell's 2005 holiday message "Theory of Relativity" and the tag line best captures what is likely to unfold in 2011. Core private real estate funds have growing queues from institutional investors and are obliged to buy properties to "get the money out." The improving economic outlook will be a further catalyst as these investors see real estate fundamentals having a multiyear recovery from the cyclical trough. Banks are over-capitalized and as the outlook improves will be under pressure to make loans. As such, spreads will likely narrow, while loan to values rise, (Figure 1). Non-bank lenders and mezz lenders will emerge as borrowers' confidence in the cycle recovers and they seek more debt. The seeds of the next bubble are being sowed, but as we mistakenly thought in early 2005 that the bubble would pop in 2005, it is unlikely it will pop in 2011.

Figure 1: Life Insurance Companies Spread to Treasuries Remain High



Source: ACLI, ISI, Land & Buildings Estimates

Figure 2: Economic Outlook is Improving

	2010 Forecast	2011 Forecast	2012 Forecast
GDP (%)	2.8	3.0	3.2
CPI (%)	1.6	1.5	2.0
S&P EPS	84.01	92.75	101.79
Yr. over Yr Growth		*10.4%*	*9.7%*
Job Creation (millions)	1.1	1.5	2.0
Unemployment Rate (%)	9.7	9.4	8.7
	4Q'10	**4Q'11**	
10-Year Treasury Yield (%)	3.2	3.6	
3 Month LIBOR (%)	0.3	0.6	
Fed Funds Target (%)	0.25	0.25	

Source: Bloomberg, ISI, Land & Buildings

Note: 2010, 2011, and 2012 figures are full year averages; 4Q figures are 4Q averages.

Benign Environment Supportive of Mid-Teen Total Returns for US Property Companies

GDP growth of 3.0%, modest inflation of 1.5% and job growth of 1.5 million are neither too hot nor too cool, suggesting a benign economic backdrop which is supportive of a continued recovery in commercial real estate (Figure 2). Earnings growth of 10% and 4% dividend yields with constant multiples should drive mid-teen property total returns in 2011. Actual total returns may be a bit stronger if multiples expand and growth exceeds expectations. Improvements in occupancy and rents as real estate recovers from trough levels as well as refinancing of debt at lower interest rates are the primary drivers of growth in 2011. Earnings growth may well exceed 10% by year-end as the economy appears a bit stronger than these growth forecasts incorporate. Growth over the next several years will likely moderate from 2011's strong pace to the 8% range.

New Supply of Commercial Real Estate at Generational Lows

Be it apartments, office buildings, shopping centers or single family homes, the financial crisis caused new construction to grind to a halt of generational proportions. New construction activity is down 80% from the peak, and is the lowest in over 20 years (Figure 3). Despite the depressed levels of new construction, the demand drivers for real estate are healthy: 1) population and household growth continues at around 1% annually, 2) S&P 500 earnings are expected to surpass its prior peak in 2011, and 3) GDP has exceeded the prior peak.

Lean and Mean Will Drive Demand

Many businesses hunkered down for Armageddon during the financial crisis and are operating lean and mean. As confidence picks up, retailers will increase store opening plans, young adults will move out of their parent's house, roommates will get their own place and office users will make new hires and expand. The trickle of new demand we discussed last year will turn into a stream in 2011. Combined with strong balance sheets property companies are well positioned for development or acquisition opportunities.

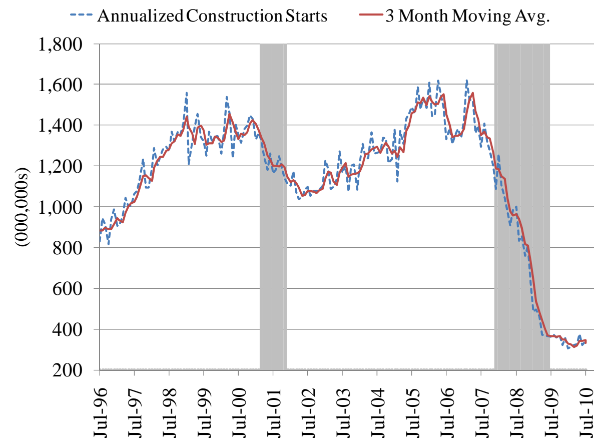
Strong Earnings, "Capital Raining on My Head", and Low Interest Rate Foster Valuation Upside

US property stocks are trading at 6.5% cap rates which is not demanding and in-line with historical spreads to 10-year US Treasury bonds (Figure 4), BBB corporate bonds and TIPS, despite depressed earnings which suggests wider than historical average spreads. Cap rate compression of 30-50 basis points may be in the cards.

Landmines Abound and Will Require Sharp Focus on New Developments

Government debt and deficits, sovereign defaults, muni bond troubles, currency wars, political missteps, high unemployment, and declining housing prices are all problems that will not simply go away. They need to be monitored closely and could easily derail our outlook for property. Fiscal discipline will likely become the

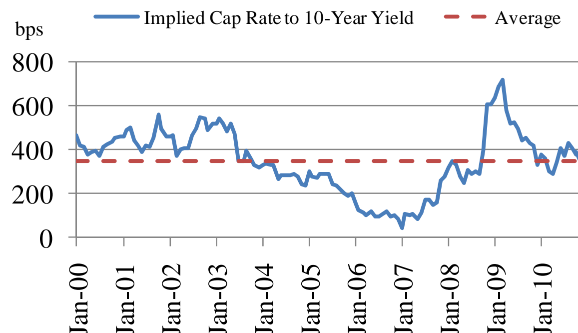
Figure 3: New Construction Activity Remains at Historically Low Levels



Source: Citi

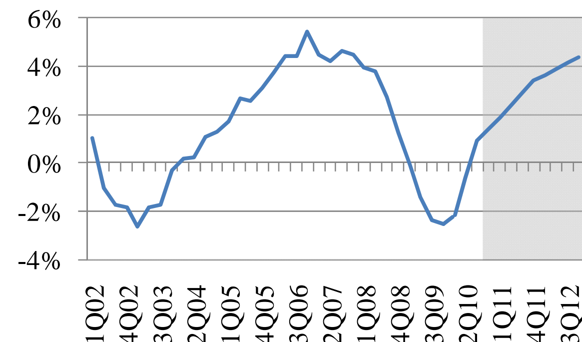
Note: Data through November 2010. Shaded areas represent recessions.

Figure 4: Implied Cap Rate Spread to 10-Year Yield In Line With Historical Average



Source: Citi

Figure 5: Same-Store NOI Multi-Year Cyclical Rebound



Source: Citi, Land & Buildings Estimates

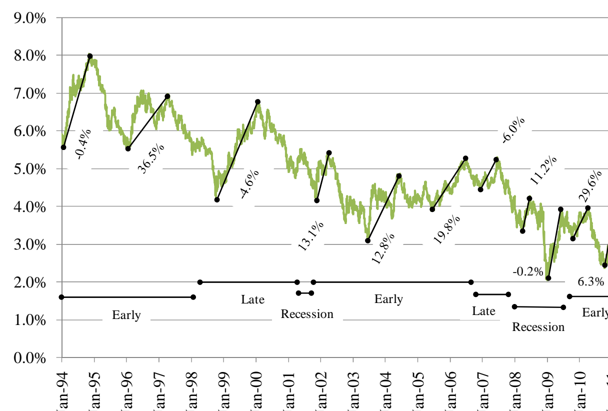
Note: Reported data through Q3 2010. Shaded area represents forecast.

playbook for 2011 and could be a double-edged sword; too much discipline too fast could quash the recovery, while too much spending could stoke inflation. Sovereign defaults are unlikely, as the EU likely recognizes the repercussions given the fallout from the bankruptcy of Lehman Brothers. A massive back up in the 10-year to 5-8% would be problematic for whatever reason.

Property Stocks Have Risen During Periods of Rising Interest Rates

Property shares have risen 10.7% on average since 1990 during 11 periods when the 10 year treasury yield rose 60 basis points or more for a sustained period. Breaking the 11 periods of rising interest rates into early and late periods of economic expansion highlights the strong performance of property shares during early economic expansions, and weak performance of property shares during periods of late economic expansions. The economy is in an early economic expansion, as such property shares will likely deliver attractive total returns and outperform the S&P500.

Figure 6: Property Has Outperformed as 10-Yr Rates Rise During Early Economic Expansions



Source: Bloomberg

Note: Returns are REIT returns during the specified rate rising period

Figure 7: Public Property Should Outperform in An Early Recovery Period

Period			Rate Increase (bp)	Beginning 10-Year Rate	Ending 10-Year Rate	NAREIT	S&P	NAREIT vs. S&P
Jan-94	-	Nov-94	224	5.8%	8.0%	-0.4%	1.7%	-2.8%
Jan-96	-	Mar-97	134	5.6%	6.9%	36.5%	29.1%	7.4%
Nov-01	-	Mar-02	123	4.2%	5.4%	13.1%	3.9%	9.2%
Jun-03	-	May-04	174	3.1%	4.9%	12.8%	12.7%	0.2%
Jun-05	-	Jun-06	136	3.9%	5.2%	19.8%	5.7%	12.6%
Oct-09	-	Apr-10	81	3.2%	4.0%	29.6%	16.5%	10.9%
Aug-10	-	Dec-10	106	2.5%	3.5%	6.3%	18.4%	-8.3%
Early Recovery Avg.			**140**	**4.0%**	**5.4%**	**16.8%**	**12.6%**	**4.2%**
Oct-98	-	Jan-00	263	4.2%	6.8%	-4.6%	48.7%	-54.7%
Dec-06	-	Jun-07	87	4.4%	5.3%	-6.0%	7.0%	-12.7%
Late Stage Expansion Avg.			**175**	**4.3%**	**6.0%**	**-5.3%**	**27.8%**	**-33.7%**
Mar-08	-	Jun-08	96	3.3%	4.3%	11.2%	7.1%	2.2%
Dec-08	-	Jun-09	187	2.1%	3.9%	-0.2%	7.6%	-5.1%
Recession Avg.			**141**	**2.7%**	**4.1%**	**5.5%**	**7.3%**	**-1.4%**
Total Avg.			**146**	**3.8%**	**5.3%**	**10.7%**	**14.4%**	**-3.7%**

Source: Bloomberg

- **Early economic expansions** have occurred 7 times since 1990 during which time property stocks on average generated total returns of 16.8% from the onset of the back up in the 10 year treasury yield, outperforming the S&P 500 by 4.2%. In just one of these periods, 1994, did property stocks generate a negative total return of -0.4%, a period when the Fed was aggressively raising the Fed Funds interest rate.
- **Late economic expansions** have occurred 2 times since 1990 during which time property stocks generated negative total returns of -5.3% from the onset of the back up in treasury yields and underperformed the S&P 500.

The drivers of the outperformance during early economic recoveries is likely driven by a combination of attractive valuations at the trough of the cycle, inflation characteristics and improving growth prospects. The reverse is true during the late stage of an economic expansion, when valuations are full, growth is peaking and inflation expectations are moderating as the Federal Reserve is tightening. The current economic expansion is a bit of an experiment on the part of central bankers and governments. As such, relying on past performance may be fraught with error, and it is critical to monitor developments that suggest the experiment is not working.

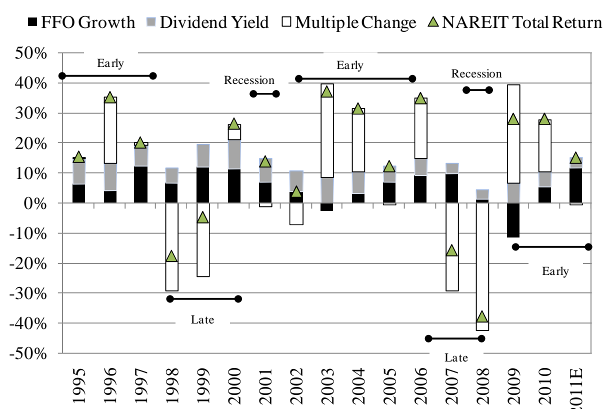
Property Stock Valuations Have Increased During Early Economic Expansion

Property shares have seen earnings multiples rise 15% on average during the early stages of an economic expansion, and contract 26% during the late stage of an expansion. With the economy in the early stages of an economic expansion, property shares are poised to see improvements in valuations (Figure 8).

To derive expected total returns a dividend plus growth model is the most objective given no assumptions about changes in valuation. With 2011 growth of 10% and 4% dividend yields, mid-teen total returns are likely. A strong case can be made that valuations have room to expand. (Figure 9).

Whether it is Animal Spirits, or a more formulaic explanation some derive to make a call on change in valuations, it is typically keeping your finger on the pulse of the capital markets and fundamentals that will keep one the best informed on the changes likely to come in valuations. The capital markets are becoming increasingly more open, and while they can change on a dime due to an event, unforeseen or foreseen such as the Russian Debt Crisis in 1998, or the Sowood and Bear Stearns hedge funds collapsing during the summer of 2007, the stage is set for continued valuation improvements.

Figure 8: Multiples Expand in an Early Expansion Period



Source: Bloomberg
Note: Forecasted 2011 Data.

Figure 9: Strong Returns Generated During Early Expansion

Period	Annual NAREIT Total Return	Annual FFO Growth	Dividend Yield	Multiple Change
1995 - 1997	24%	8%	8%	8%
2002 - 2006	24%	4%	7%	13%
2009 - 2010	28%	-3%	6%	25%
Early Expansion Avg.	**25%**	**3%**	**7%**	**15%**
1998 - 2000	1%	10%	7%	-16%
2007 - 2008*	-27%	6%	3%	-36%
Late Expansion Avg.	**-13%**	**8%**	**5%**	**-26%**
2001	14%	7%	8%	-1%
2008*	-38%	1%	3%	-42%
Recession Avg.	**-12%**	**4%**	**6%**	**-22%**
Total Periods Avg.	**13%**	**5%**	**7%**	**1%**

Source: Bloomberg
Note: Due to the annual nature of the data, the full year 2008 figures have been included in the calculation of Late Expansion Average and the Recession average

US Portfolio Strategy – Blue Chips, Reasonably Valued Growth and Select Value Opportunities Should Outperform

Three strategies that should outperform in 2011 are: 1) owning blue chip property companies, 2) companies with reasonable valuations with strong or improving growth and 3) select value opportunities where depressed valuations are unwarranted. Several sectors with weak supply/demand fundamentals appear mispriced and will likely underperform in 2011 as valuations do not reflect the growth prospects. Below we highlight a few of these opportunities.

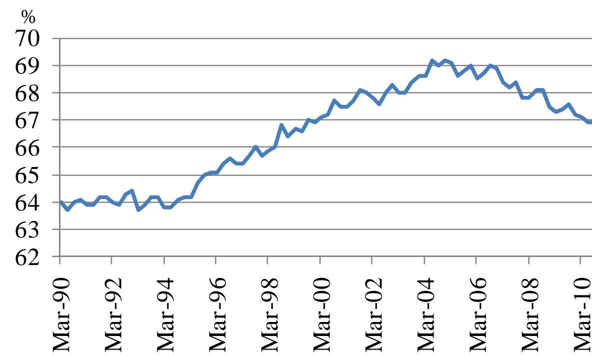
Blue Chips Should Generate Superior Returns

Blue Chip property companies should outperform in 2011 as these companies will benefit from their high-quality portfolios in supply-constrained markets with improving demand. These companies should also benefit from external growth opportunities through acquisition or development, leveraging their strong balance sheets and the expertise of the management teams. Many companies with inferior real estate portfolios, balance sheets and management teams will likely lag as they cannot capitalize on the improving economy.

Apartments – Strong Tailwind Over Next Few Years

The apartment sector should benefit from a strong tailwind over the next few years, with rising rates of household formation, job growth, limited new construction and rising propensity to rent over owning. Pricing power improved significantly throughout 2010 and will likely continue in 2011 with upside in earnings estimates as same store NOI growth may exceed initial targets and reach at least 6%. Apartments in the private market are trading at full valuations. However, public property apartment companies are trading at discounts to the private market at a 5.5% implied cap rate. Stabilizing to an improving single family home market could moderate the apartment growth and merits close monitoring. However, the dearth of new supply of for rent and for sale housing will likely continue to drive strong rent and occupancy growth. The homeownership rate has declined 230 basis points from the peak in 2004 as of the end of the third quarter and will likely stabilize at 65-67% (Figure 10). The recession suppressed household growth with roommates doubling up and young adults living at home with their parents. There are approximately 1.5 million more young adults living at home with their parents than normal, which should unwind over the next few years and drive apartment demand and household growth (Figure 11).

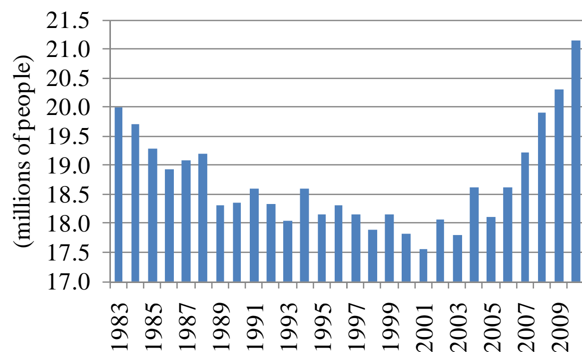
Figure 10: Declining Homeownership Rate Has Benefited Apartment Landlords



Source: US Census Bureau

Note: Data through 9/30/2010

Figure 11: Pent Up Housing Demand From Excess Young Adults Living With Parents



Source: Raymond James

Cell Towers – Near-term Concerns Will Abate

Fundamentals for cell towers remain robust, and near-term concerns about funding plans for Clearwire should abate allowing the stocks to resume their upward trajectory. Clearwire's funding plans will likely prove a sideshow given that demand for cell antenna capacity is growing faster than new supply, leaving Clearwire's network a valuable commodity should funding not materialize to expand their network. Clearwire's principal shareholder is Sprint and there is mutual dependency of the two companies and a likely solution to the funding plans. The tower companies are trading at 15-16x 2011 EBITDA multiples and a 10-15% growth profile, attractive given similar valuation to traditional real estate with superior growth.

Central Business District Office – Fundamentals Improving

The CBD office markets have begun to see fundamentals improve and these improvements will likely accelerate in 2011. Demand is returning in key markets such as Washington D.C., New York, Boston and San Francisco.

In Manhattan, SL Green recently increased asking rents by about 15% for much of its available space – a sign that pricing power is returning. Rents remain at least 25% below the peaks achieved a few years ago, which is creating an urgency for tenants to lock in rents today, before rents rise further. Rent growth of at least 20% over the next few years seems plausible, which would still leave rents below prior peaks. Market to market of rents in companies' portfolios should lead to expanded valuations as market rents rise despite NOI growth lagging in its recovery due to long term leases. Currently, the CBD office stocks are trading at implied cap rates of 5-6% based on in-place rents, which is higher than private market transactions and attractive given the trajectory of fundamentals over the next few years. We could see cap rates compress 50 bps in 2011 as rents recover.

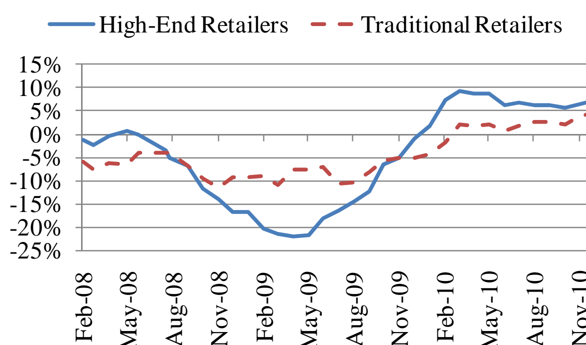
The financial services industry is a driver of demand in many CBD markets and increased demand from these companies is likely as the profitability improves. The financials are expected to generate 27% earnings growth in 2011 versus 10% for the S&P 500 overall.

High-End Retail – Benefitting From the Educated Consumer

Owners of high-end retail centers should benefit from stronger high-end retailers, which are generating strong same store sales compared to their lower-end brethren. During the fourth quarter of 2010, higher-end department stores generated 7.1% same store sales growth year-over-year, 330 basis points ahead of traditional department stores (Figure 12). The retail centers that are producing higher sales should be sought after by retailers as they plan store openings.

In addition, retail landlords will have more pricing power as retailers are enjoying improved profitability and retailers' ability to pay rent increases. Implied cap rates of 6 to 6.5% is above the levels of private market values with improving fundamentals, and solid same store NOI growth of near 3% in 2011 should drive cap rates lower.

Figure 12: High-End Retail Sales Outperforming Traditional Retail



Source: Merrill Lynch

Note: Data represents year-over-year change in same store sales

Lodging – Recovery Accelerating

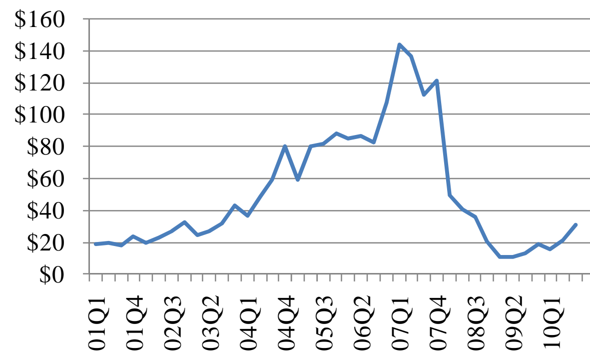
Business-oriented hotels are enjoying an accelerated recovery from the approximately 50% declines in EBITDA during the financial crisis. RevPAR (revenue per available room) for high-end hotels will likely be up at 6-8% or more in 2011, with much of these gains driven by higher rates charged to customers. In 2010, the REVPAR recovery was driven by occupancy gains; in 2011, the gains will be driven by rate and should lead to strong margin expansion and EBITDA growth of 15-20% or more.

Lodging companies have accelerated their acquisition activity in 2010 buying assets early in the cycle before what will likely be a multi-year period of strong RevPAR growth and asset appreciation. The high-end lodging companies are trading at approximately 16x 2011 EBITDA and $250,000 per room. Valuations are at premium EBITDA multiples to historical levels on cyclically depressed earnings, but are in line to slightly below private market transaction activity and a significant discount to replacement cost which is in excess of $300,000 per room.

Real Estate Service Companies – A Beneficiary of Improving Real Estate Markets

Companies providing services to the commercial real estate industry including leasing, transaction brokerage and property management are leveraged to the improving trends in the commercial real estate space. The declines in leasing and real estate sales transaction activity during the financial crisis depressed revenues and profitability and will likely recover rapidly in 2011 and beyond as capital markets open up and properties need to be refinanced. Commercial real estate transaction volumes plummeted nearly 90% from their 2007 peak and are beginning to rebound (Figure 13). The public companies gained market share during the downturn and we expect their prominent positions in the industry will continue to grow. These companies should be able to generate at least 15-20% EBITDA growth the new few years
and are trading at attractive valuations of 10x-11x 2011 EBITDA given their growth profile.

Figure 13: Transaction Volumes Starting to Pick Up



Source: Real Capital Analytics

Note: Represents quarterly transaction volumes in billions of dollars.

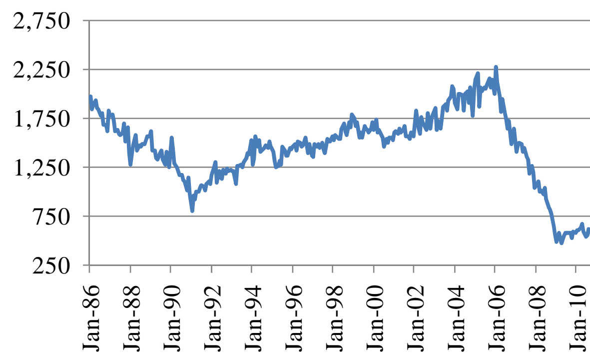
Datacenters – Strong Secular Growth

Datacenter owners have become a high-growth value opportunity due to concerns surrounding the potential for moderating growth and new supply. FFO growth of 20%-25% is likely for the group in 2011, but even if the growth slowed to 15%, it would still be attractive both on an absolute and relative basis. Their FFO multiple of 13x on 2011 is below the REIT industry at 16x. Growth is driven by a combination of internal growth through rent increases and external growth through redevelopment at double-digit yields and accretive acquisitions. Investment returns on development and acquisitions will inevitably compress over time due to new entrants. However, the barriers to entry remain high and owners of existing assets stand to benefit from cap rate compression.

Homebuilders – Increasingly Looking Attractive

The homebuilders stand to benefit from 1) a modest improvement in new home sales from current record low levels, 2) improved housing demand as consumer confidence improves and bank lending increases, 3) home affordability levels near record highs, and 4) improved profitability from selling homes on land purchased at depressed prices the past two years. Housing in the U.S. will likely face a supply shortage given current construction starts are near 500k-600k annualized, well below the pace of 1 to 1.5 million needed to meet demand (Figure 14). Assuming 1% household growth, a level in excess of 1 million homes is necessary before accounting for obsolescence.

Figure 14: New Housing Starts Running Significantly Below Normalized Levels



Source: U.S. Census Bureau

The housing market is still suffering a hangover from the excesses of the last decade with high delinquency rates that could add to current foreclosure inventory of approximately 2.5 million, which should also keep a lid on home prices overall as distressed inventory is sold by either homeowners or

banks. Markets with significant oversupply of vacant homes and homes in foreclosure will remain particularly challenging, but as we have seen so far in the recovery, people want new homes in locations that may not be where foreclosed homes are available, creating an opportunity for homebuilder volumes to increase.

The U.S. homebuilders are trading at depressed valuations near book value which is at the lower end of their historical range as concerns over the housing market remains. However, as these fears abate with improving new home sales volumes, the returns will likely be attractive.

Healthcare and Triple Nets – Rich Valuations

The healthcare and triple net property companies are trading at rich valuations given their inferior growth rates and lack of leverage to an improving economy. Earnings growth for these sectors will be largely dependent on external growth given the modest internal growth for most companies in the space; some companies are having trouble finding accretive acquisition opportunities, while others have grown to an extent that it will be harder to replicate growth off of a now larger base.

Low-End Retail – Target a Struggling Consumer

Retail landlords of centers that generate lower sales per square foot, have a greater proportion of local tenants and cater to the lower-end consumer will likely continue to struggle relative to centers that are more productive. These weaker centers will likely have a disproportionate share of store closings and less store openings as retailers rationalize their portfolios, looking to focus where they can get the most bang for their buck. The combination of additional potential pressure on occupancy levels and limited pricing power will likely keep same store NOI weak in the 0% to 1% range in 2011.

Suburban Office – Anemic Demand Continues

Suburban office companies will likely continue to struggle from anemic demand as tenants reduce their space needs, creating additional vacancy in portfolios. Much of the demand in these markets is musical chairs with companies shopping for a better price rather than organic demand growth. In 2011, additional occupancy loss combined with weak pricing power will likely result in the weak same store NOI growth in 2011, with companies likely to see same store NOI decline by 5%, following similar declines in 2010. The companies are trading at implied cap rates in the 7.5% to 8.5% range based on most recent quarter NOI, but stocks would look more expensive on 2011 NOI given the anticipated declines. Cap rate compression is unlikely to materialize until fundamentals show improvement, which is unlikely near term. Private market transactions are limited in this segment but suggest values of the public companies' portfolios have limited upside potential.

<u>International Portfolio Strategy – Several Attractive Investment Opportunities Globally</u>

Non-US property markets are enjoying a recovery as the global economy heals from the financial crisis, as fundamentals improve with rising rents and occupancies and the capital markets continue to open up.

What We Like:

- *HK Office and Retail Property Companies* – Our recent trip to Hong Kong visiting with real estate companies and market brokers reaffirmed our view that underlying real estate fundamentals should continue to improve with Central district office rents up 25% over the next six months, reaching previous peak levels. Key drivers for this strong increase in rental growth will be continued job growth in the financial and services sector following growth from China and limited new supply. In 2010, net absorption was 3.5 million square feet, above the historical average of 2 million square feet, pushing rents up 33%. Upcoming supply is limited in Central with only 700K square feet of new supply over the next few years. The retail environment is also

strong with retail sales up 18.3% year-over-year, putting upward pressure on rents. With the Hong Kong dollar pegged to the US dollar, interest rates should remain low for an extended period of time and continue to put upward pressure on real estate values. Shares continue to trade at 15-20% discounts to underlying real estate values and are not capturing the continued growth in rents. The key risks remain Fed tightening and a slowdown in China filtering into Hong Kong.

- *Brazil Homebuilders* – The Brazilian economy continues to grow at a healthy clip. The economy is benefiting from its young and growing population, increasing domestic demand and developing credit markets. The Brazilian homebuilders have an attractive long term growth profile as the government's housing program provides mortgages to low-income families to address the 7.2 million housing deficit. The Brazilian homebuilders focused on the affordable housing segment are well positioned to benefit from the government's favorable policies and should be able to generate 15-20% annual growth in launches given the strong demand for low-income housing. House price caps in the affordable housing plan will likely be increased as the government has made the affordable housing program one of the key pieces of their platform. Valuations are attractive with the sector trading at an 8x P/E multiple, a 30% discount to historical averages. Key risks remain rising inflation expectations and rising interest rates.
- *Brazil Malls* – As Brazilian consumerism develops on the back of 6.5% real wage growth, retail sales have grown at double-digit rates and shopping center owners have increased rents comparable amounts. Earnings should grow as public companies consolidate the highly fragmented mall business and consumers increase their use of organized shopping malls. Developments will also drive growth for the public companies given the dearth of organized retail with just a half a foot per capita in Brazil vs. 20 feet per capita in the US. BR Malls (Ticker: BRML3 BZ), the largest Brazilian mall operator should generate 40% EBITDA growth next year, one-third internally with the remaining coming from acquisitions and developments. The key hurdle for the Brazilian malls remains valuation. BR Malls trades at a 7.5% implied cap rate on current NOI, but on forward year earnings the stock looks more attractive with the implied cap rate increasing by almost 200 basis points.
- *Japan Real Estate Developers* – The Japanese large cap real estate developers should generate 20% plus returns over the next 12 months as share prices narrow their wide discount to underlying asset values and fundamentals improve. Share prices do not reflect the recent improvement in fundamentals. Specifically, office vacancy rates are now 5.2% in November 2010, down sharply from 6.5% at the end of 2009. New supply is limited where the major Japanese developers have a majority of their existing office stock, despite supply increasing outside of the three primary wards is greater. The condo market has posted a strong recovery in 2010 with new contracts signed up 32% year-over-year in the Tokyo market and supply up just 20%. The recovery should continue into 2011 benefiting the property majors shares. The large cap developers traded in the high 5% cap rate range, with cap rates on private properties and some blue chip JREITs that own comparable buildings trading in the low 4% cap rate range. In addition, most of these large cap developers finance their properties at ~1.5%, leaving a wide margin between cap rates and bond rates. The key risk in Japan remains the sluggish recovery in the overall economy.

Places Where the Recovery Has Been Choppy:

- *Homebuilders in China, Hong Kong, Singapore* – Fundamentals in China, Hong Kong and Singapore are very attractive with strong economic growth driving wage growth and demand for residential real estate. The governments have announced various controls on mortgages, purchase restrictions and taxes in order to control inflation and residential price appreciation. Underlying demand should prove to be strong for residential real estate, but the implementation of these

various policies will continue to weigh on the shares. On a historical basis, the shares are trading at discounted valuations. However, the shares could be range bound until sales volumes prove to be sustainable. The Chinese homebuilders trade at a 9.5x P/E multiple a 25% discount to historical levels.

- *Australia* – Australian central bank tightening combines with weak underlying fundamentals weighed on the property shares in 2010. Despite the strength in the resource sector, little impact has been made in the office sector with rent concessions remaining high. In addition the large equity offering by Westfield (Ticker: WDC AU), also put pressure on the space. As a result, Australian REITs are trading at about a 12.5x P/E multiple below the 13-14x historical average and a 15% discount to underlying real estate values. Cap rates are above comparable developed markets and high relative to historical levels however, given weak fundamentals there is little catalyst currently for the valuation gap to be narrowed.

What We Like: Hyatt Hotels – A Discounted Lodging Recovery Story with Catalysts

Hyatt Hotels (NYSE: H) could generate a 25% total return over the next year principally through earnings growth and secondarily multiple expansion given the discount to its peers.

Strong Earnings Growth Likely - The lodging industry is undergoing a strong demand recovery for business-oriented hotels and Hyatt is poised to benefit. Over the next two years, Hyatt will likely generate at least 6-8% annual RevPAR growth, principally through rate increases, which should drive margin expansion and approximately 20% EBITDA and cash flow growth annually over the next two years. Hyatt is undergoing renovations of several hotels in 2011, which could drag down 2011 growth slightly, but this should enhance growth in 2012 as these renovations come on line.

Discounted Valuation to Peers Could Lift - Hyatt is trading at 15x 2011 EBITDA, or approximately a 10% discount to its high-end public peers. The discount is likely attributable to 1) the company's limited track record as a public company (went public in 2009), 2) limited share liquidity and 3) a significant ownership interest of 46% of the company and 60% of voting power by the founding Pritzker family. An equity offering to allow the Prizker family to monetize a portion of their stake in the company could accomplish two things: 1) increase the liquidity of the shares in the public market and 2) lift an overhang that has been on the shares since the lock-up expired in the Fall of 2010. The discount could also narrow over the next year as the company delivers on its business plan and grows earnings and its operating platform.

Flexible Balance Sheet to Expand Portfolio and Brand - Hyatt is in a net cash position with about $1.6 billion of cash positioning the company to grow its portfolio and brand through marquee assets like the Park Hyatt development in Manhattan that will be completed in 2012.

What We Don't Like: Corporate Office Properties – Rich Valuation Given Soft Fundamental Outlook

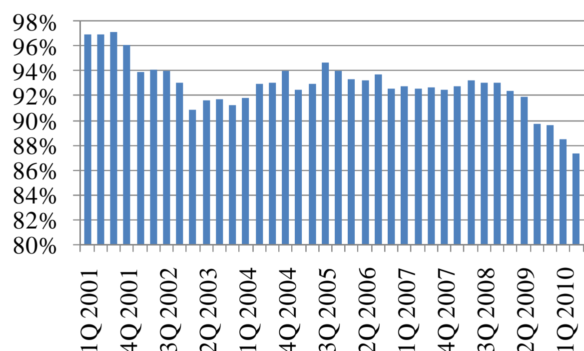
Corporate Office Properties (NYSE: OFC) is an owner of office assets primarily in the Mid-Atlantic that is trading at a valuation that does not reflect the operating fundamentals of the company's real estate. The stock could deliver a negative total return of approximately 10% in 2011 driven by 1) 40bp cap rate expansion to a 7.25% cap rate, 2) same store NOI decline of 2% in 2011 and 3) a 4.6% dividend yield.

Cap Rate Expansion of 40 bps to 7.25% Appropriate – Corporate Office's operating results and outlook do not merit a significant premium valuation that company has historically garnered relative to other suburban office landlords. Multiple expansion of 40 bps to a 7.25% reflects a blend for likely lower cap rate (6-6.5%) for the company's defense industry focused assets (50-60% of the portfolio) and a cap rate similar to other suburban office landlords of 8%-9% for remaining traditional suburban office assets. OFC's occupancy has declined by over 600 bps to 86% since 2008 and rent declines on leasing activity

during the first three quarters of 2010 were down 7% from prior in-place cash rents (Figure 15). These results do not justify the premium valuation and a turnaround in 2011 is unlikely.

Defense Spending Cuts Could Remove Tailwind **-** Approximately 60% of OFC's portfolio caters to government agencies and private contractors that work with the government, which has been a source of growing demand for the company. However, budget cuts that are being proposed by Defense Secretary Gates will likely be a drag on this traditional source of excess demand. If demand is negatively impacted, leasing up the development pipeline could be more challenging than it has proved to be historically.

Figure 15: OFC Occupancy Has Slipped Significantly



Source: Company reports, Bank of America-Merrill Lynch
Data through Q3 2010

Note: All figures are as of January 10, 2010.

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 and Ambika Goel, Co-Founders and Principals at LANDandBUILDINGS, were key members 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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