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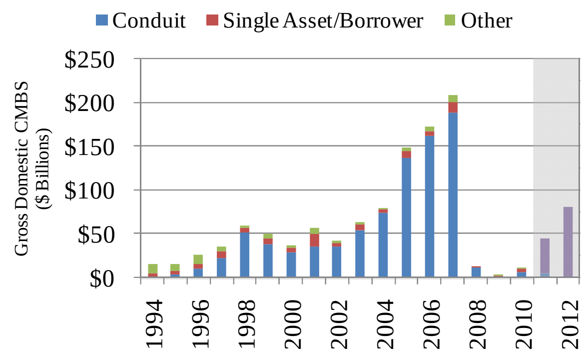
February 2011 Commercial Real Estate Outlook: Full Steam Ahead

Full steam ahead is the message coming out of US property companies' earnings as they report fourth quarter results. Growth expectations for 2011 have risen to 13.1% from 11.8% at the beginning of the year. Rents and occupancies continued to improve and even struggling suburban office markets showed signs of stabilization. Development activity, which has been largely non-existent the past three years, is becoming a larger piece of external growth for several companies. Acquisition activity is picking up, but is unlikely to drive growth given full valuations. AMB Property's merger with ProLogis is likely a precursor to further consolidation as management teams who looked into the abyss during the financial crisis decide to hit the bid.

Financing Market Opening Up

Lenders are becoming increasingly less conservative. $8 billion in new CMBS issuance has been completed year to date, on pace to meet or exceed full year expectations of $45 billion. Mortgage interest rates remain near generational low levels despite the back up in 10-year Treasury Yields. Property values continue to rise as investors see the improving fundamentals and inflation hedge characteristics of commercial real estate.

Figure 1: New Issuance Could Reach $45B This Year



Note: Shaded area represents forecast

Source: J.P Morgan, Commercial Mortgage Alert

High Quality IPO Activity Likely to Heat Up

IPOs of quality real estate companies are likely on deck for later in 2011 and will be a welcome change from the mediocre cadre of IPOs since the financial crisis. Given the size of these IPOs, they will likely come at attractive valuations. Values are finally approaching levels that will allow several previously public companies that went private with high leverage to re-IPO and in the process, restructure their balance sheets. IPOs of companies such as apartment landlord Archstone-Smith, parts of Equity Office and Hilton Hotels are likely on deck.

Macro Factors May Drive Near-Term Weakness

The popular uprisings in the Middle East may prove more destabilizing for markets than pundits are predicting. Recall the first eruption of the sub-prime crisis was largely dismissed, as was the first challenges of Greece's financial troubles. As such, events in the Middle East require close monitoring. Recent policy initiatives may have adverse implications on for-sale housing. Employment is critical to the recovery; employment in January and December came up well short, and if progress is not made toward creating jobs, the markets will be challenged. Finally, inflation talk is ubiquitous and is already an issue in the emerging markets. Monetary and fiscal policy in the developed markets risk sparking inflation, which at the moment remains tame, but is becoming an increasing concern.

Fannie Mae and Freddie Mac Wind Down to Fuel Apartment Demand

Apartments may get a further boost from the plans to phase out Fannie Mae and Freddie Mac as homebuyers opt to rent given less favorable terms. Rent growth expectations of 25% over the next three years may well be exceeded. Compounding housing's headwinds is President Obama's plan announced as part of his budget to reduce the deductibility of home mortgage interest and real estate taxes. Homebuilders, which we had been warming up to, could meet headwinds as these twin policy initiatives weigh on the housing market.

Earnings Season Off to a Strong Start

Knocking the cover off the ball were the real estate service companies Jones Lang Lasalle and CB Richard Ellis, whose real estate transactions business meaningfully exceeded expectations during the fourth quarter. Taubman Centers, a high end regional mall owner, enjoyed record same store sales, with year-over-year growth of 13% during the fourth quarter, boosted by strong results out of its Apple stores.

Cell tower owner Crown Castle delivered strong results with 22% cash flow growth during the fourth quarter. The outlook for 2011 has brightened for cell towers now that emerging carrier Clearwire will improve its cash flow situation by focusing on wholesale distribution of its service rather than retail. One of the weaker reports thus far this quarter was Corporate Office, a suburban office landlord focused in the Mid-Atlantic, which made limited progress on leasing its development pipeline and reported operating results that did not live up to the company's premium valuation.

Camden Property Trust – Accelerating Fundamentals at an Attractive Valuation

Camden (NYSE: CPT) is an apartment landlord focused in markets principally in the southern half of the US with accelerating growth that represents an attractive value opportunity with potential to generate a 20% total return over the next 12 months.

Camden is benefitting from a confluence of factors that should lead to some of the best fundamentals in the real estate space over the next few years. Specifically: 1) improving job growth and consumer confidence that should result in an accelerated pace of household formation, a key driver of apartment demand, 2) a greater propensity to rent rather than own due to tighter lending standards and concerns about further home price declines and 3) limited new construction.

Figure 2: Total Return Potential of 20% for CPT

Net Asset Value Analysis	
2011E Net Operating Income	$403
Cap Rate	5.50%
Value of Operating Assets	$7,332
Cash	$176
Other Assets	$160
Development Pipeline & Land	$316
Less Liabilities	-$3,135
Net Asset Value	$4,848
Shares	75
NAV Per Share	**$65**
Current Stock Price	$56
Stock Increase to Trade at NAV	16%
Dividend Yield	3%
Total Return	**20%**

Note: Figures in millions other than per share data.
Source: L&B, Citi

Camden is trading at an attractive valuation at a 5.7% implied cap rate; comparable private market assets are trading at a 5.0%-5.5% cap rate, while public peers are trading 40 bps tighter. Camden should generate same store net operating income (NOI) growth of 6%, a comparable level to its peers focused in higher barrier to entry coastal markets, making Camden a cheaper way to invest in the strong apartment sector. The company is enhancing its growth targeting $400 million of development starts in this year, as well as $600 million of acquisitions through joint ventures.

Shares of Camden should generate a total return of 20% over the next 12 months driven by 1) 6% same store NOI growth in 2011, 2) a 5.5% cap rate, representing a 20 bp decline from current levels reflecting the company's discounted valuation to the private market and public peers and 3) a 3.2% dividend yield.

Liberty Property Trust – Sluggish Recovery Not Priced Into Stock

Liberty (NYSE: LRY) is a suburban office and industrial owner with significant exposure in the Mid-Atlantic that is trading at a valuation that is not reflective of the slow improvement in operating fundamentals that will likely transpire over the next few years. We expect Liberty's same store NOI will remain weaker than other major property types in the real estate space due to continued occupancy struggles in the office segment of the portfolio (60% of the company) and rent declines when in place leases expire.

Liberty recently acknowledged the struggles of two tenants:

- **Tenant Space Downsizing** – Liberty announced plans to develop a 205,000 square foot office building and for GlaxoSmithKline, which highlighted two issues: 1) the creation of a vacancy at an existing Liberty office building where GlaxoSmithKline will be ending its lease two years early as part of the consolidation into a to be developed building and 2) declining space requirements will be an issue that will linger for suburban office landlords, as GlaxoSmithKline will be downsizing from approximately 700,000 square feet in multiple offices into 205,000 square feet despite housing the same number of employees.

Figure 3: Total Return Potential of Negative 10% for LRY

Net Asset Value Analysis	
2011E Net Operating Income	$502
Cap Rate	8.00%
Value of Operating Assets	$6,271
Cash	$108
Other Assets	$128
Development Pipeline & Land	$183
Less Liabilities	-$3,216
Net Asset Value	$3,474
Shares	119
NAV Per Share	**$29**
Current Stock Price	$34
Stock Decline to Trade at NAV	-16%
Dividend Yield	6%
Total Return	**-10%**

Note: Figures in millions other than per share data.

Source: L&B, Citi

- **Tenant Financial Health Still Unstable in Some Cases** – Tasty Baking Company, which leases space from Liberty that represents 1.0%-1.5% of NOI, is suffering from liquidity problems, which could ultimately result in an early termination of the lease or a rent concession to improve liquidity for the company if conditions do not improve. Since a significant portion of the leased space is an industrial facility used for baking that was developed by Liberty in late 2009, the space would likely need to be modified for a new tenant and result in reduced NOI for Liberty.

Cap rates in the private market remain high for the majority of the company's portfolio and we do not anticipate a meaningful improvement until operating fundamentals begin to show steady improvement. Using the company's own estimates, they are seeking to acquire assets at an 8%-10% cap rate and sell assets at a 9%-11% cap rate in 2011, which both suggest the company's current implied cap rate of 7.5% is rich relative to the private market.

Liberty could generate a negative total return of about 10% over the next year, which is driven by: 1) a 3% same store NOI decline in 2011 driven by ~10% rent declines on expiring leases, 2) cap rate of 8.0%, 50 bps above the company's current implied cap rate and 3) a 5.5% dividend yield.

Note: All figures are as of February 15, 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, 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.