LANDandBUILDINGS

Must Own Property Stocks for 2013 January 2013

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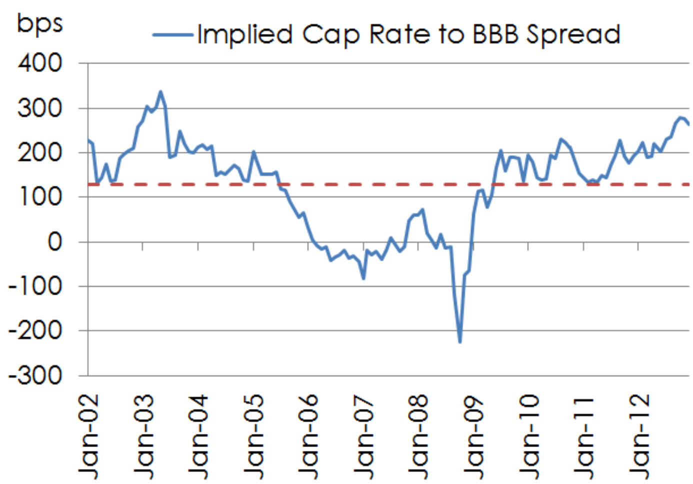
Must Own Property Stocks for 2013

- Property stocks are poised for a strong 2013 given positive underlying fundamentals.
- REITs are trading at discounts to net asset value given the availability of historically low rates on debt. Implied cap rate spreads are the widest to BBB yields in nearly 10 years.
- Same store NOI for REITs should be 4-5% in 2013 as real estate demand growth again outpaces modest new construction activity.
- The must own property stocks for 2013 include: BRE Properties, CoreSite, Extra Space Storage, General Growth Properties, Host Hotels, Kilroy Realty, and Las Vegas Sands.

Property stocks as a group are positioned for a strong 2013 as valuations are attractive, new construction is well below historic levels and demand continues to improve.

The property stocks that should generate the most outsized returns in 2013 have several common characteristics: 1) trading at discounted valuations, 2) strong growth is expected, and 3) growth will likely come in ahead of expectations.

Implied Cap Rate Spreads Widest to BBB Yields in Nearly 10 Years



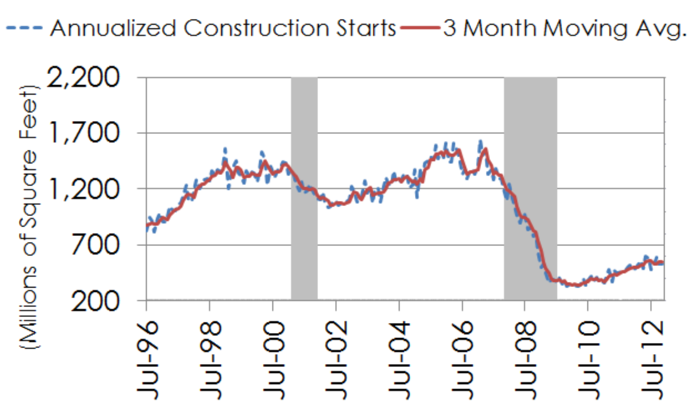
Source: LANDandBUILDINGS, Citi

Property valuations are attractive, with REITs as a proxy for property, the implied cap rate of 6.0% is 260 basis points above BBB corporate bond yields, allowing real estate investors to generate attractive cash on cash returns. These large cash on cash returns will likely be squeezed as investors push property valuations higher. The current discounted valuations provide a floor on property values and likely sets property up for rising valuations.

New supply of office, retail, apartments and warehouse is running less than 600 million square feet per year, well below the 1.3 billion it averaged for many years prior to the financial crisis. Demand, as measured by job growth, has been strong the past few years and consistent with the growth experienced prior to the financial crisis at about 150,000 jobs per month. Other measures of demand are also solid, with household formations of 1.1 million, or 1%, over the past year, retail sales growth of 5% and global trade volumes increasing 3-4%.

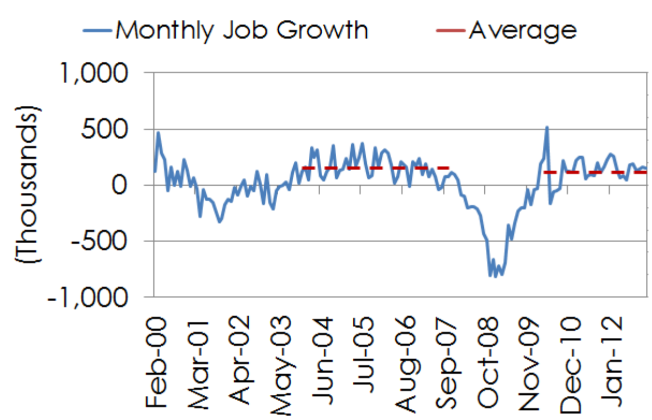
The potential headwinds for property stocks in 2013 could be equity issuance overwhelming demand for shares or a backup in interest rates without a commensurate increase in growth. Core property net operating income growth of 4-5% in 2013 is well ahead of GDP growth of 2% and should drive earnings growth of 10% for property shares; the must own property names for 2013 should generate 20% plus earnings growth.

Supply is Limited with Only 0.8% Construction Starts as a Percent of Stock



Source: LANDandBUILDINGS, Citi

Job Growth is Close to Pre-Crisis Levels of 150,000 Per Month



Source: LANDandBUILDINGS, Bloomberg

Must Own Property Stocks for 2013

There are clear winners in the property markets today and these companies will generate outsized returns. The following seven property stocks are "must owns":

- **BRE Properties (NYSE: BRE**) – One way or another this west coast apartment company should make investors money given its incredibly discounted valuation and accelerating growth. We prefer it getting there on its own, but in the meantime it is time for the board to evaluate strategic alternatives. The net asset value of the company is $68 per share based on private market values of the company's real estate. Public peers could acquire the company for $68 and have the transaction be accretive to their earnings, even without considering cost or revenue synergies.

- **CoreSite (NYSE: COR)** – The company's significant exposure to high barrier to entry network-dense datacenter assets with strong tenant demand gives COR multiple levers to grow both internally and externally in 2013. We believe COR can generate double-digit same-store NOI this year through occupancy gains, rental rate growth and more robust interconnection. Longer-term, COR can double the size of the company in a few years' time simply by using the land and buildings already on its balance sheet.

- **Extra Space Storage (NYSE: EXR)** – Virtually no new self-storage supply and accelerating demand will allow occupancy gains to continue, street rates to rise and discounts to further decrease. Accretive external growth should remain robust as the company's potential acquisition pipeline numbers in the billions of dollars. At the same valuation, where we still see room for improvement, this stock can return 20%-plus.

- **General Growth (NYSE: GGP)** – GGP appears best positioned amongst the high end mall companies to generate 25%-plus total returns. With the Bill Ackman noise out of the way and new capital already invested into its assets after emerging from bankruptcy, investors will be rewarded with accelerating growth in 2013. Same store NOI growth has lagged its higher end peers by 15% cumulatively over the past 5 years. We expect the company will now begin to close this gap with 4% or greater same store NOI the next few years. The implied cap rate should compress further as growth improves.

- **Host Hotels (NYSE: HST**) – Host's high-end lodging portfolio will have significant tailwinds from recent renovations and improving group business trends as corporate spending rebounds due to increased economic and political certainty. The company is on track to beat RevPAR forecasts when it reports fourth quarter earnings after strong industry results at the end of 2012 and upside to 2013 RevPAR expectations of ~5% from many industry participants is likely. Greater pricing power and margin expansion will make current valuations look too cheap following a flat return in 2012. The stock is trading at 13x 2013 EBITDA, a 15% discount to its average multiple over the last 3 years, with core growth in excess of 10%.

- **Kilroy Realty (NYSE: KRC)** – Kilroy's internal and external growth prospects stand out in the office sector. Its allocation of capital to the Bay Area over the past few years from acquisitions and most recently developments are creating significant shareholder value. Same store NOI has averaged in excess of 5% over the past 2 years and the growth should continue to be robust as market rents rise and the company continues to gain occupancy.

- **Las Vegas Sands (NYSE: LVS)** – Macao's gross gaming revenue is rebounding from the growth scare of last summer/spring as is evidenced by the 20% growth in December, well ahead of expectations. With nearly 70% upside to underlying asset value, shares should deliver strong returns in 2013. For LANDandBUILDINGS full analysis, please see our September 2012 presentation, Las Vegas Sands: Unleashing The Best Mall and Lodging REITs in the World (And Why the Stock Can DOUBLE).