NAIOP BREAKFAST SERIES

TODAY'S LOW CAP RATES:
NASDAQ 5000 OR A STRUCTURAL CHANGE?

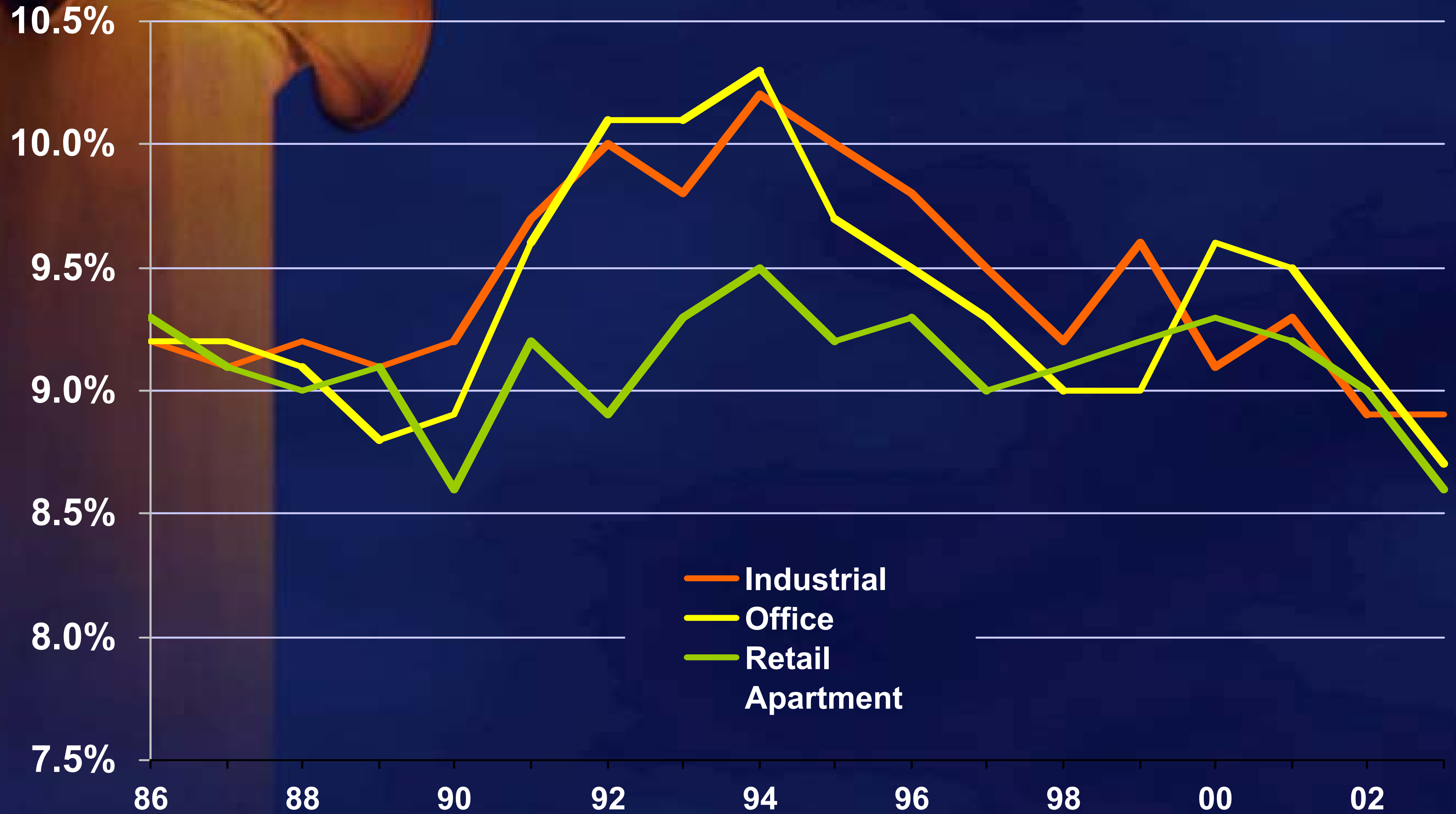
An examination of the impact of
of capital flows, demographics & related forces
on real estate pricing, performance
& investor expectations

Marriott City Center • Denver, CO
Tuesday, October 12, 2004
9:15 AM to 10:00 AM

Overview

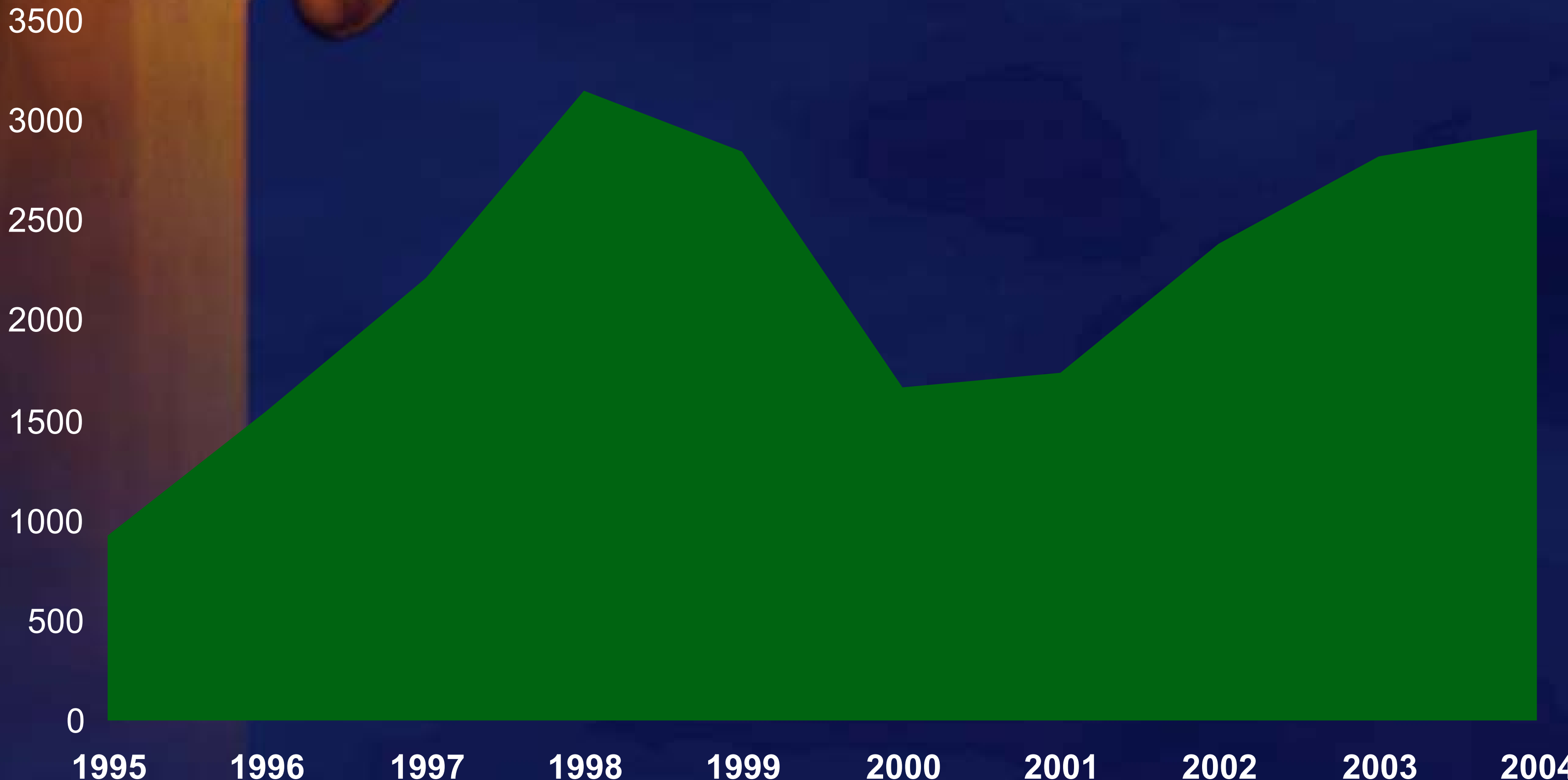
- Current pricing vs. historical pricing
- A virtual wave of capital and transaction volume
- Why all this sudden interest in real estate?
- What's the <u>real</u> driving force?
- Where has capital been flowing?
- Is it secular or cyclical?
- Implications

Cap rates by property type



Source: Rosen Consulting Group (ACLI)

Number of institutional quality real estate transactions



Source: Institutional Real Estate Universe

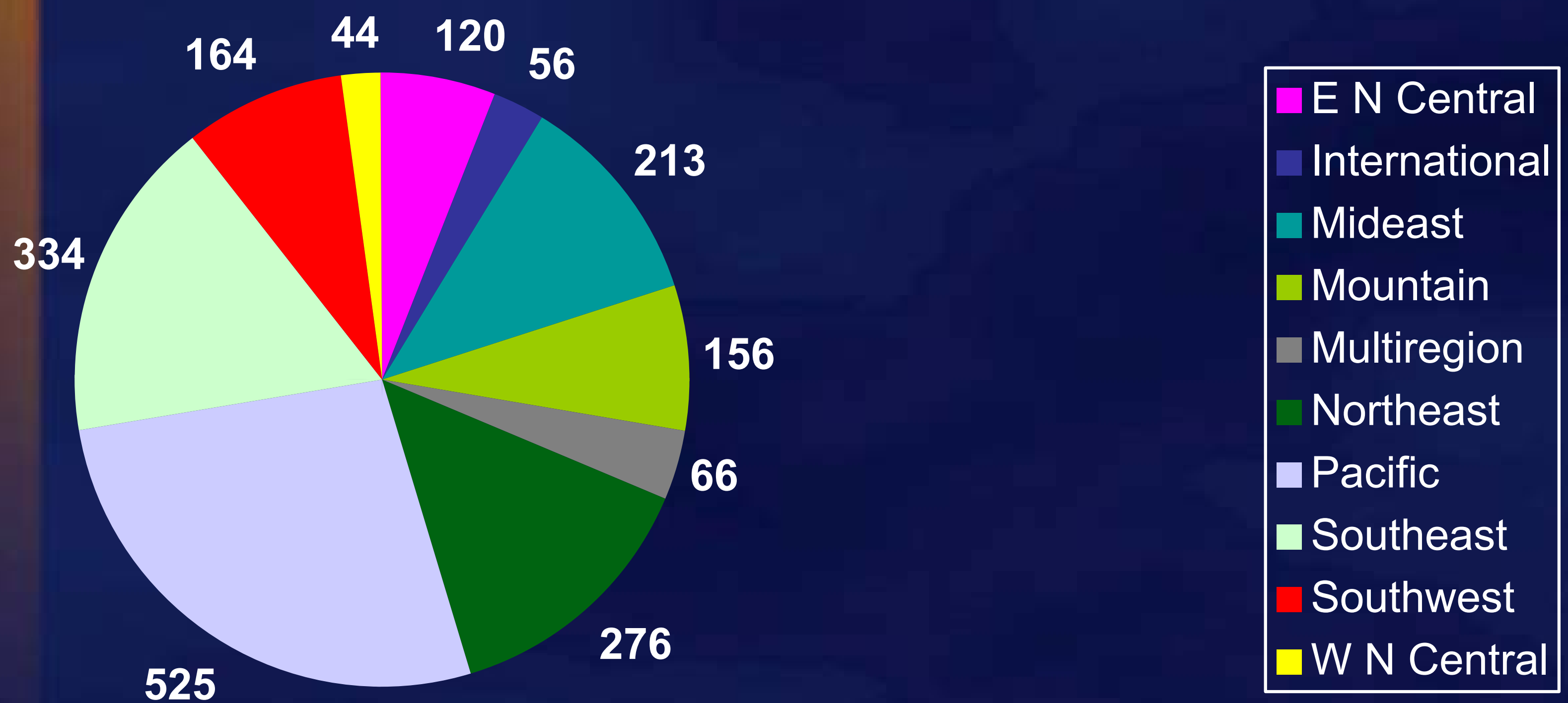
Changes in tax-exempt capital flows to real estate

Source: Institutional Real Estate, Inc. 2004 Plan Sponsor Survey, Kingsley Associates

So where is all this capital flowing?

2004 YTD TRANSACTIONS BY NCREIF REGION

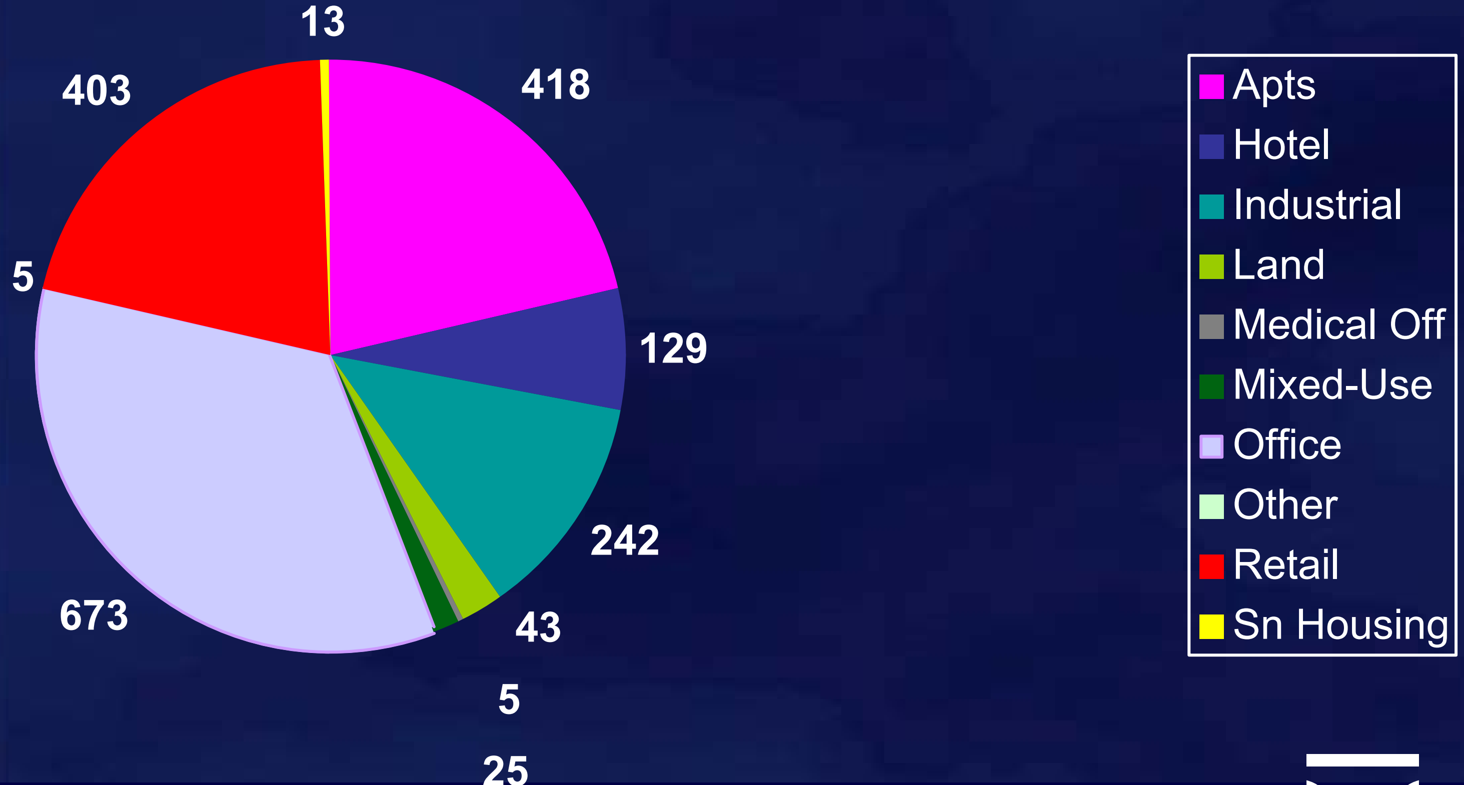
1,954 Transactions



Source: Institutional Real Estate Universe; Institutional Real Estate, Inc.

2004 YTD TRANSACTIONS BY PROPERTY TYPE

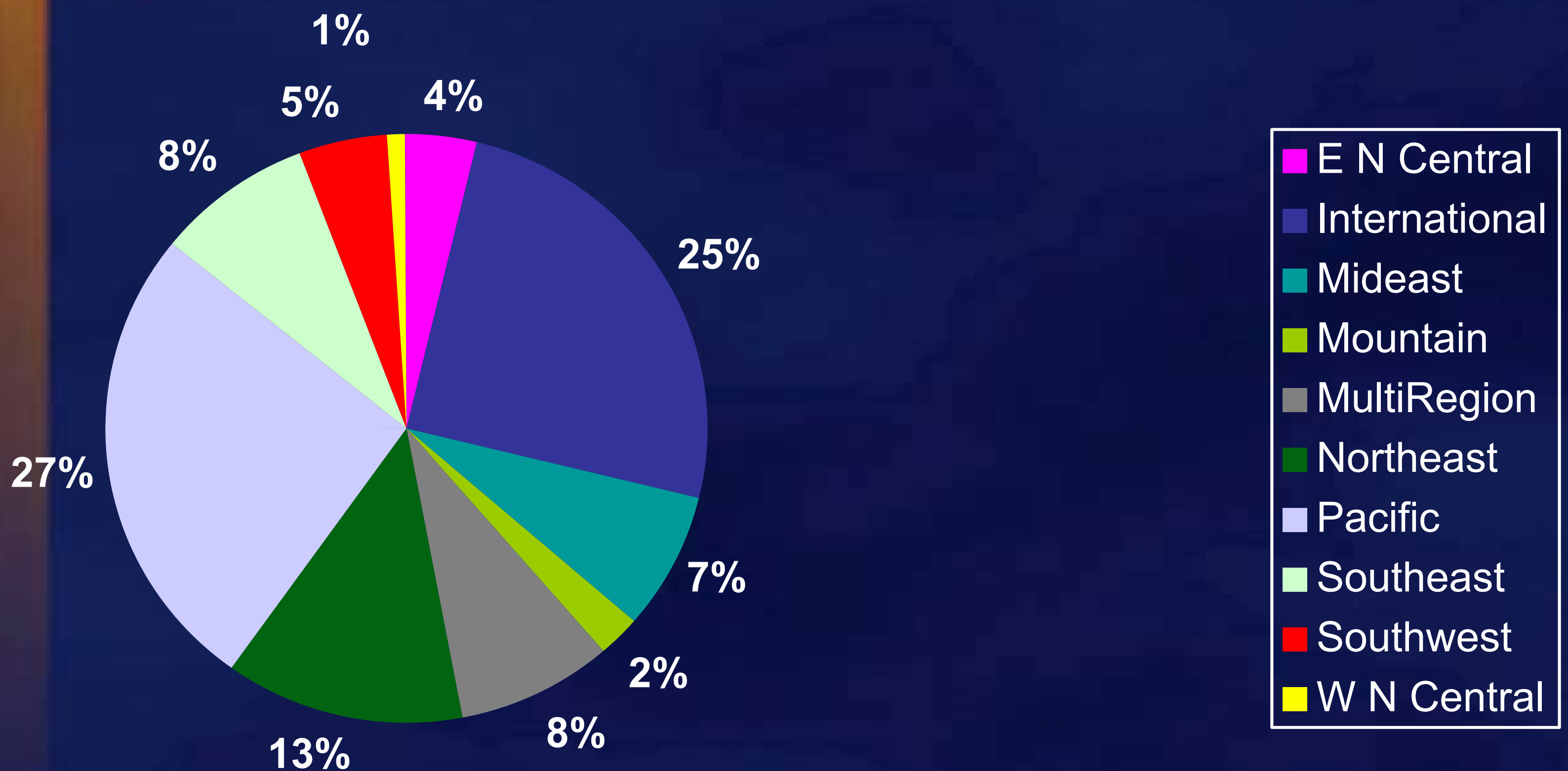
1,954 Transactions



Source: Institutional Real Estate Universe; Institutional Real Estate, Inc.

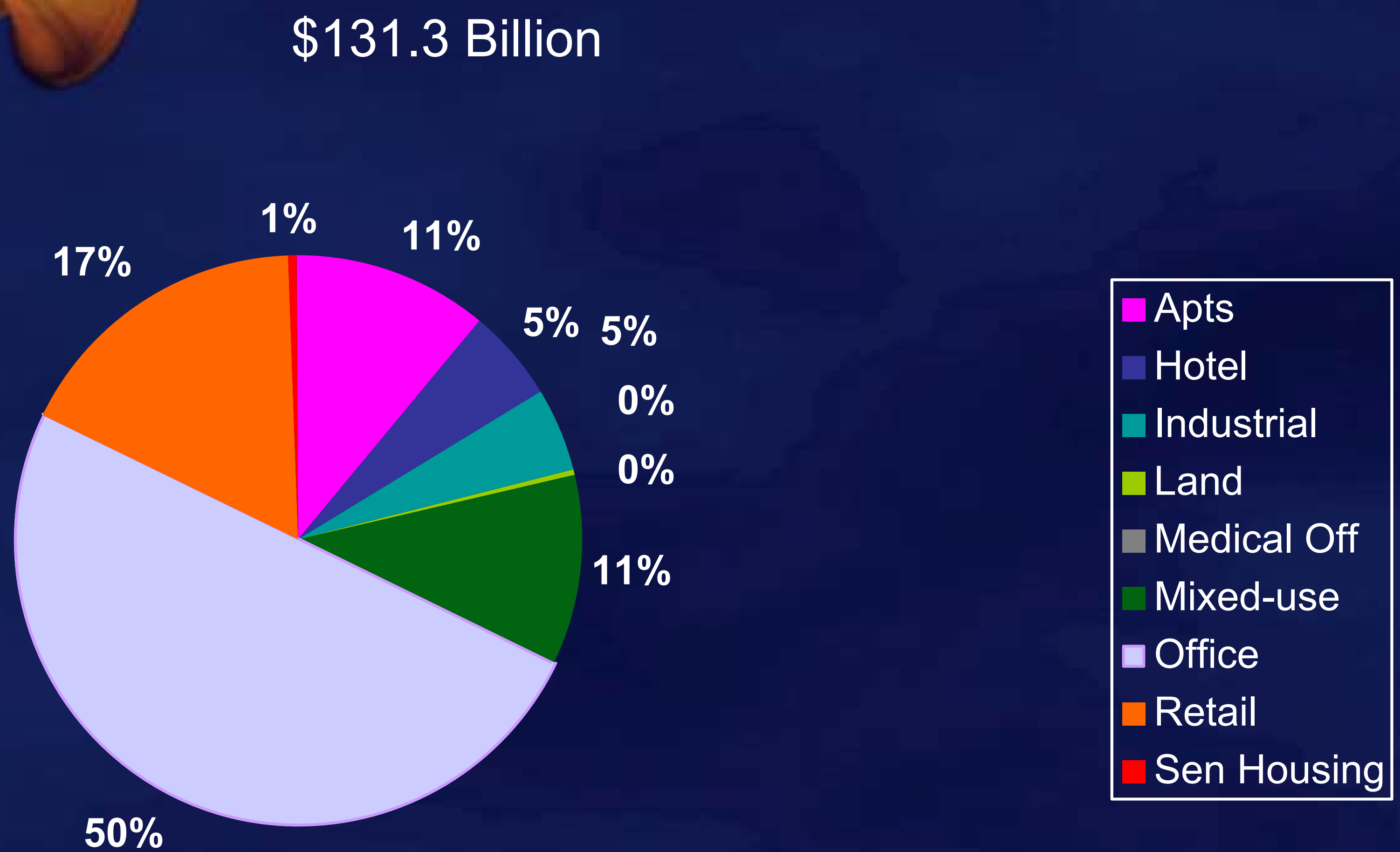
2004 YTD CAPITAL FLOWS BY NCREIF REGION

$131.3 Billion



Source: Institutional Real Estate Universe; Institutional Real Estate, Inc.

2004 YTD CAPITAL FLOWS BY PROPERTY TYPE



Source: Institutional Real Estate Universe; Institutional Real Estate, Inc.

YTD dollar volume: July 2004 vs July 2003

	YOY Percent Increase
Office	66%
Multi-Housing	40%
Retail	33%
Industrial	12%

Source: Real Capital Analytics; Torto Wheaton Research

Top five office ACQUISITION markets

Investor Type	2001	2002	2003
Foreign	New York Washington DC Boston Philadelphia San Francisco	New York Chicago N New Jersey Washington DC So Florida - Miami	New York Washington DC Chicago Atlanta Philadelphia
Private U.S.	Washington DC Chicago Los Angeles Atlanta Boston	New York Chicago Washington DC Dallas/Ft Worth N New Jersey	Washington DC Los Angeles New York Boston Chicago
U.S. Institutional	New York Washington DC Los Angeles Boston N New Jersey	Chicago Washington DC Boston Orange County Los Angeles	Chicago Washington DC Los Angeles N New Jersey San Francisco
REITs	New York Washington DC Chicago San Francisco N New Jersey	New York Washington DC Philadelphia Chicago Boston	Washington DC New York Los Angeles Atlanta San Jose

Source: Real Capital Analytics; PriceWaterhouseCoopers

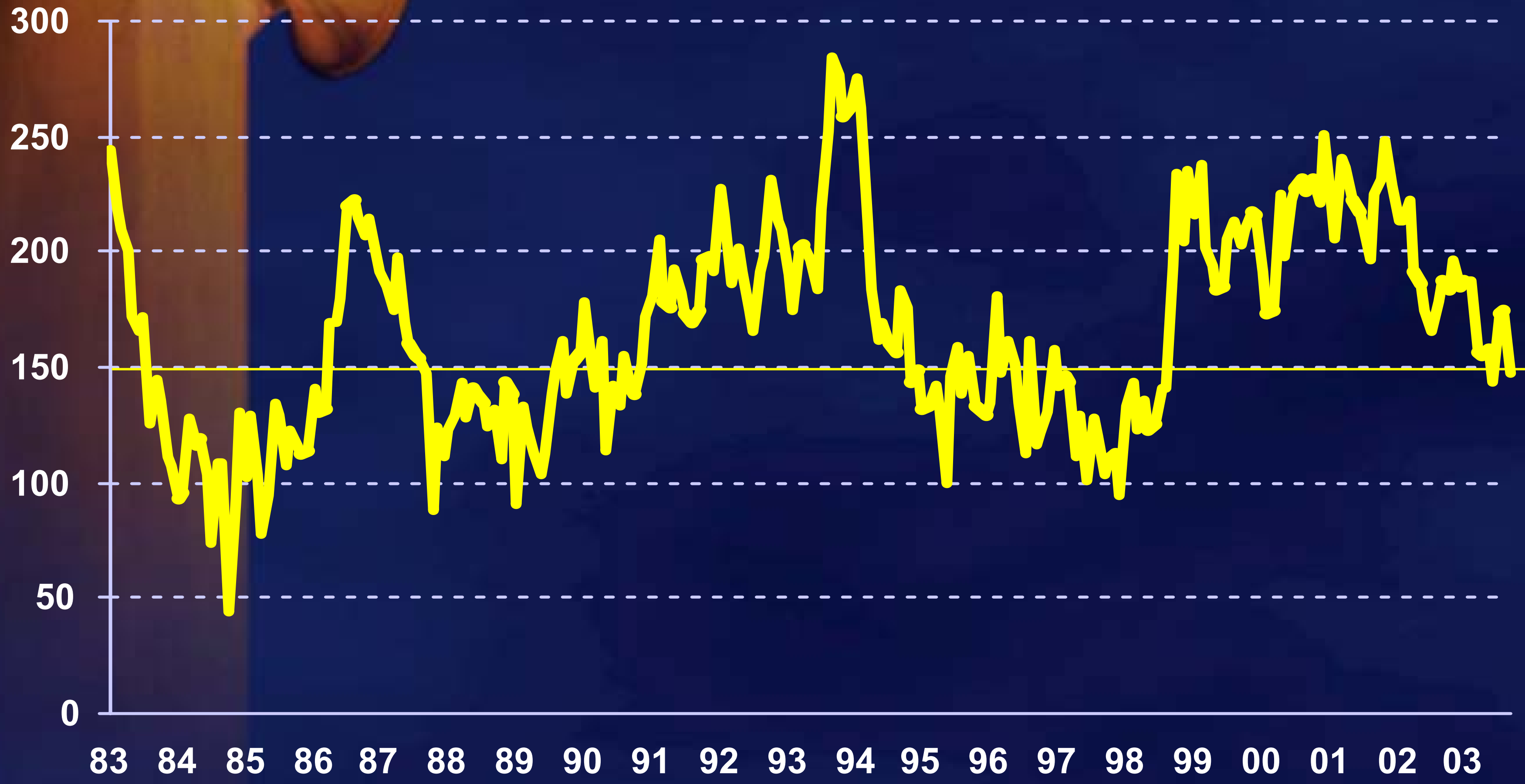
Top five office DISPOSITION markets

Investor Type	2001	2002	2003
Foreign	New York Chicago Washington DC Atlanta Los Angeles	New York Los Angeles Boston N New Jersey Chicago	Los Angeles New York Washington DC San Francisco Atlanta
Private U.S.	New York Washington DC Boston San Francisco Chicago	New York Chicago N New Jersey Washington DC Orange County	Washington DC New York Chicago Los Angeles San Diego
U.S. Institutional	New York Washington Boston San Francisco Los Angeles	Chicago Los Angeles New York Washington DC Philadelphia	New York Los Angeles Chicago Washington DC\ N. New Jersey
REITs	Washington DC New York Los Angeles Houston San Francisco	Washington DC Chicago Dallas/Ft Worth Los Angeles San Francisco	Chicago New York Washington DC Los Angeles San Francisco

Source: Real Capital Analytics; PriceWaterhouseCoopers

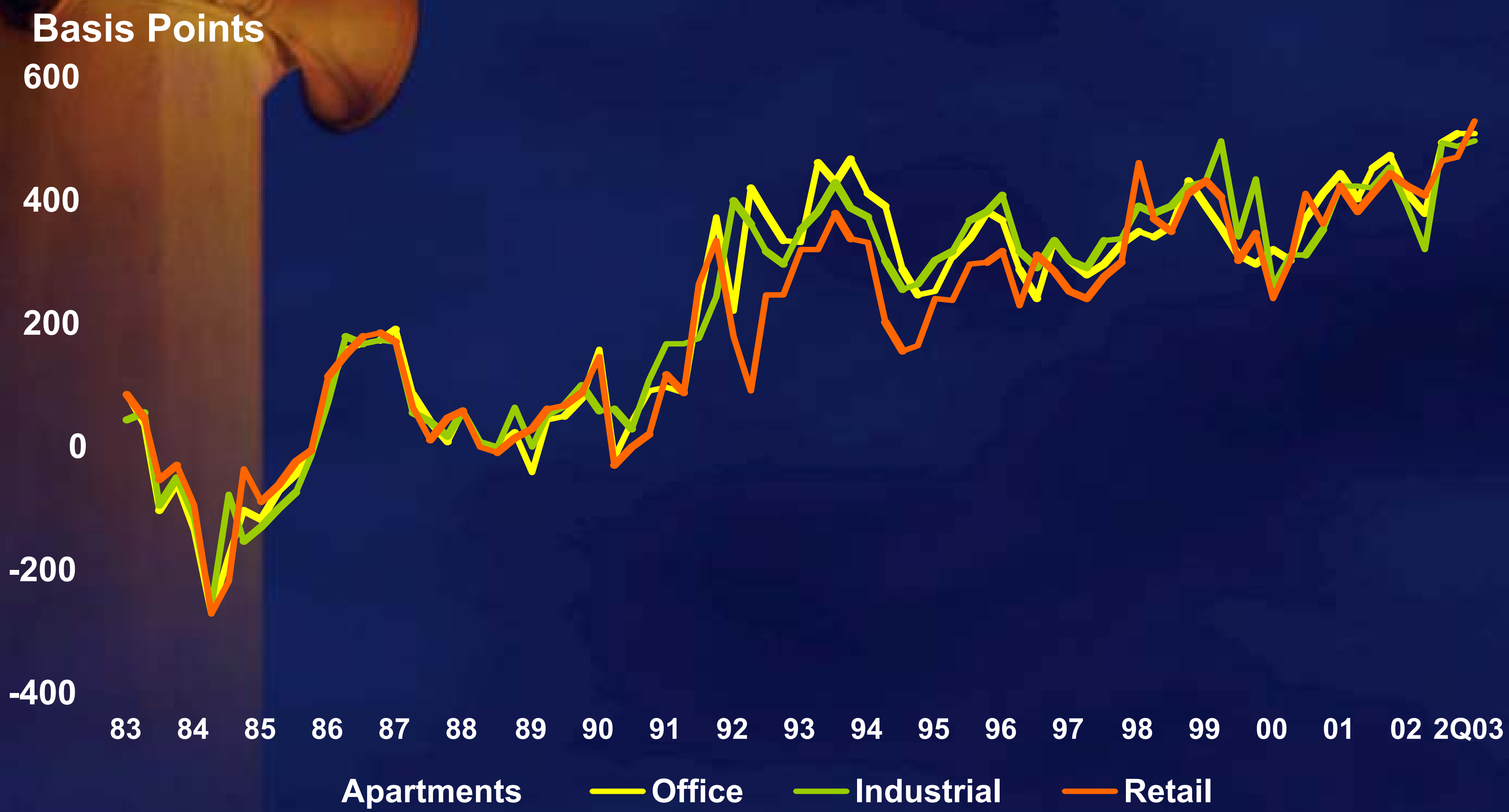
Why is real estate so attractive to so many right now?

Pricing spreads
Commercial Mortgages to 10 YR Treasury



Sources: Rosen Consulting Group (Barron's/Levy, Federal Reserve)

Cap rate spreads vs. 10 year treasury



Source: Rosen Consulting Group (ACLI, Federal Reserve)

Cumulative total returns

MARKET INDEX	1 year	2 Years	3 Years
NCREIF	10.84	9.23	7.97
NAREIT	27.02	14.93	15.36
S&P 500	19.11	9.28	-.069
Lehman Government Bond	-1.35	4.80	6.12
U.S. 90 Day T-Bills	0.96	1.18	1.61

Source: NCREIF, returns calculated through 2nd Quarter 2004, PriceWaterhouseCoopers

Bottom line

- Property cap rates continue to drop
- Real estate debt and equity appear reasonably priced
- Stock and bond markets continue to disappoint
- Capital continues to flow to real estate markets
- The tallest midget in the circus

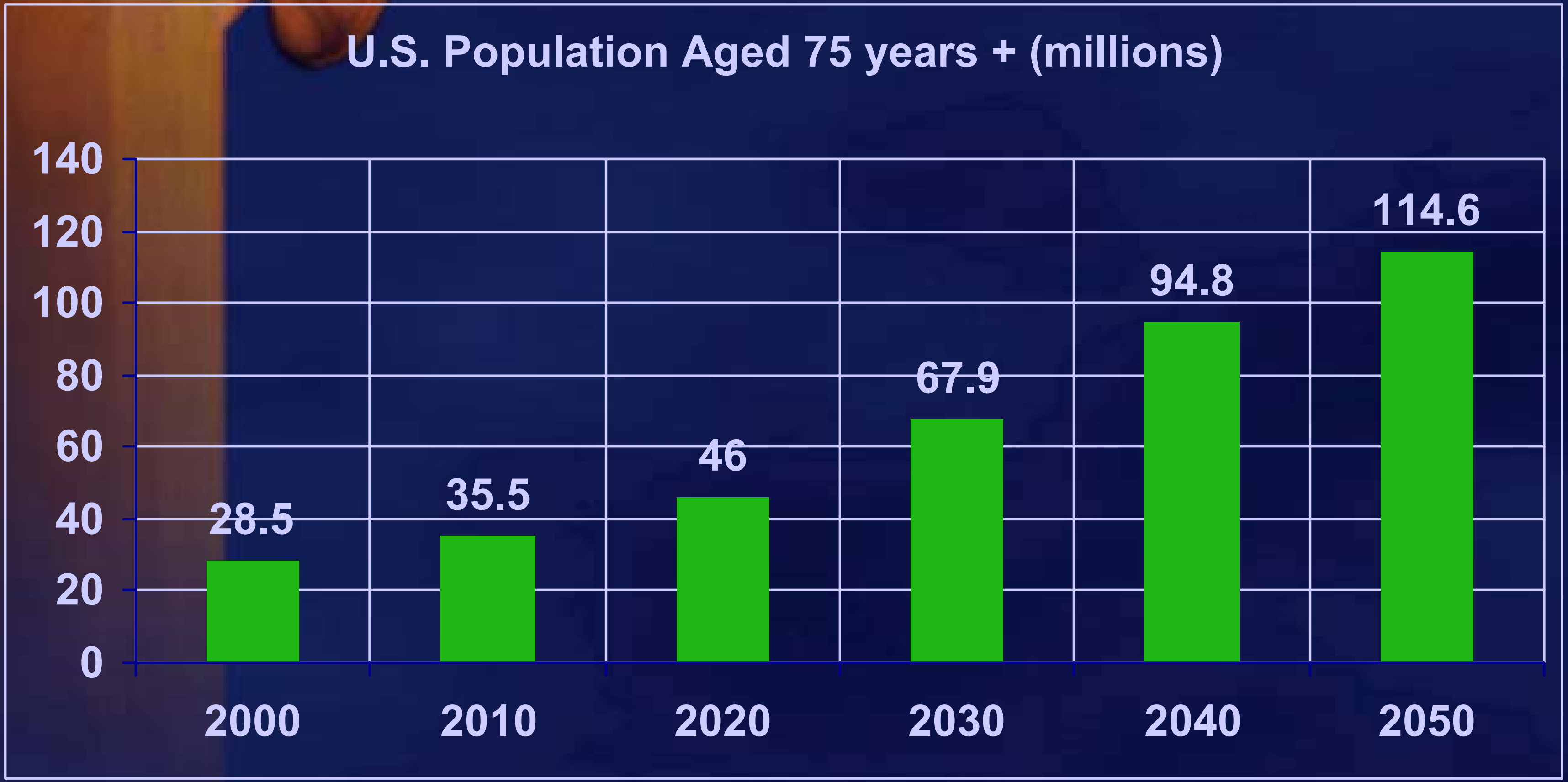
But what's driving all these changes?

And how long will they last?

THE DRIVING FORCE

- Aging
- Aging
- Aging

Growth in cohort aged 75 +

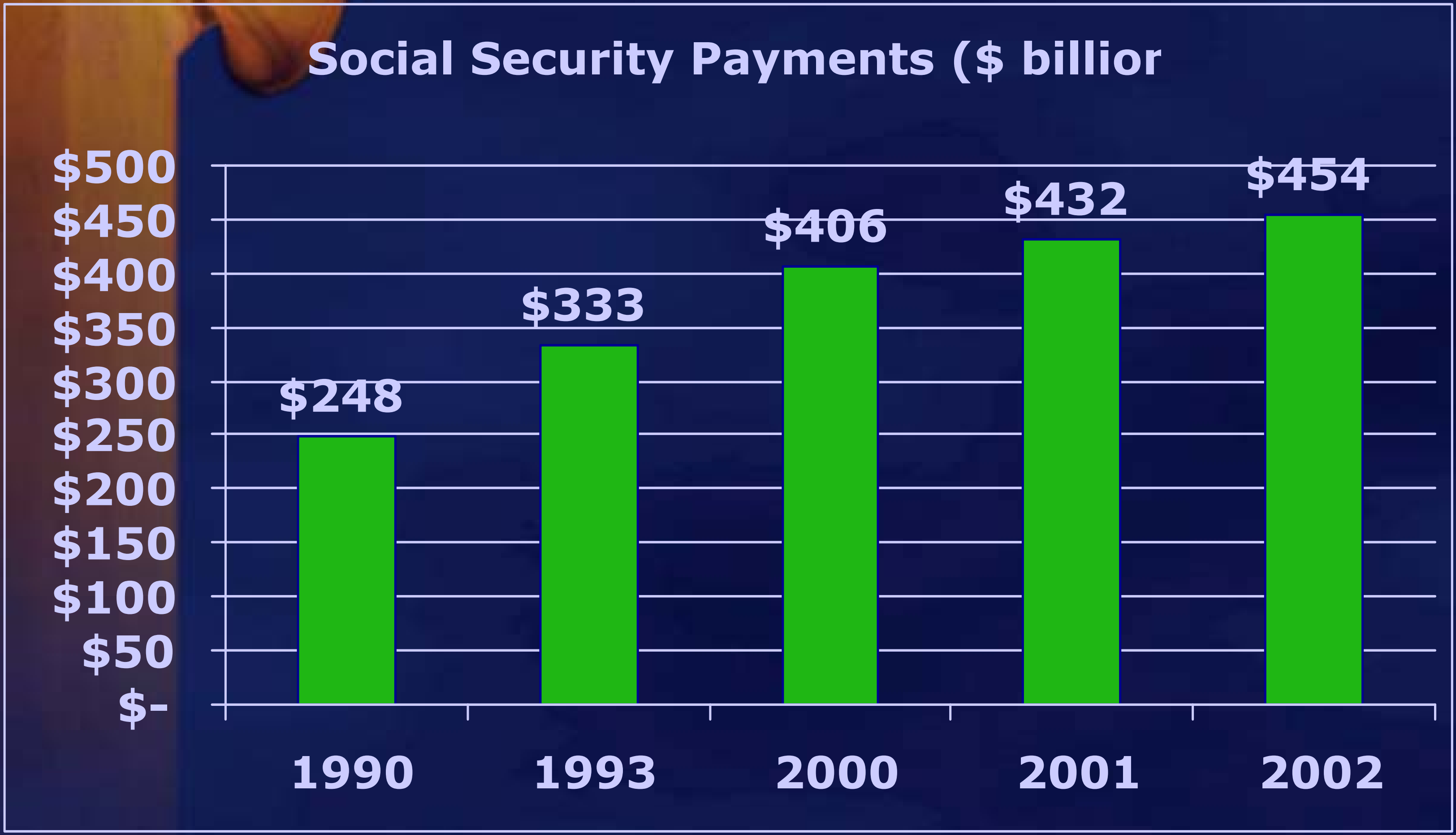


Source: National Institute on Aging, U.S. Bureau of the Census

Consider the impact of aging on

- Individual investor investment objectives
- Pension fund liabilities
- Medicare liabilities
- Social security liabilities
- Life insurance company liabilities
- Institutional investor investment objectives
- Demand for income-oriented (less risky) investments
- Demand for growth-oriented (riskier) investments
- Economic and productivity growth
- Corporate earnings growth
- Capital market dynamics

Social security system annual benefits payouts



Source: USA Today

A tale of two outcomes

- Capital remains income-oriented
- Downward pressure on rates continues
- Earnings growth gradually declines
- Job growth & productivity growth remain sluggish
- Property returns drop below historical averages
- But continue to be attractive vis a vis alternatives

… or we're just smoking something again

How do you know when you've hit the market bottom?

Answer:

"When people stop asking where the bottom is."

How do you know when we've reached the market top?

Answer:

When people start arguing:

"This time, it's different."

It's equally foolish …

- To suppose things <u>are</u> different when they're <u>not</u>
- To suppose things <u>aren't</u> different when they <u>are</u>

In 1989-1992

- Boomers were just entering their asset accumulation years
- We eventually emerged from recession with a jobless recovery
- Markets were significantly overbuilt
- Vacancies were at all time highs
- The stock market was poised for a 10 year bull run
- Interest rates were relatively high
- There was no capital left in the property markets

In 2000-2004

- Boomers are just entering their asset-dependency years
- Job growth remains sluggish
- Markets have been significantly under-occupied
- The stock markets have been sluggish
- Interest rates remain near all time lows
- Pension liabilities remain significantly under-funded
- Social Security & Medicare liabilities are growing
- States & municipalities are teetering on bankruptcy
- Property markets remain flush with capital

The problem

- 78 million baby boomers exiting the work force
- 64 million echo boomers entering the work force
- Medical costs & current benefit pay out requirements are rising
- Unfunded long term liabilities are growing
- Funding base is shrinking
- Everyone is living longer
- A scenario being repeated world wide

Questions to Ponder

- Will aging boomers become less or more conservative as they continue to age?
- When will the majority of boomers & their pension fund managers start to reposition their portfolios for income production?
- Who is going to buy the boomer's and their pension funds stock holdings, when they do start to reposition portfolios?
- Will productivity growth go up or down as echo boomers continue to enter and baby boomers continue to exit the work force?
- Will the economy & earnings grow faster or slower if a larger percentage of the population is no longer working, or working full time?
- If stock and bond markets remain sluggish, how will pension funds meet their 8-10% return assumptions?
- If pension funds don't meet their return assumptions, how are they different from other pay-as-you-go systems?
- What impact will all this have on government spending and corporate earnings growth (I.e., the markets)?

Implications

- Slower economic and productivity growth
- Continued downward pressure on interest rates & earnings growth
- Lower investor return expectations & requirements
- Prolonged bull market for income
- Persistent attractiveness of real estate and other alternatives
- Continued ready supply of real estate investment capital
- More challenging environment for property owners, leasing agents & managers

A mirror image of the 1980s and 1990s

Questions:

IN THIS TYPE OF ENVIRONMENT:

- Where will the biggest threats & opportunities lie?
- How should you be positioning your assets?
- How can you and your company add value?
- Where & how can competitive advantages be created?

Questions?
Comments?