

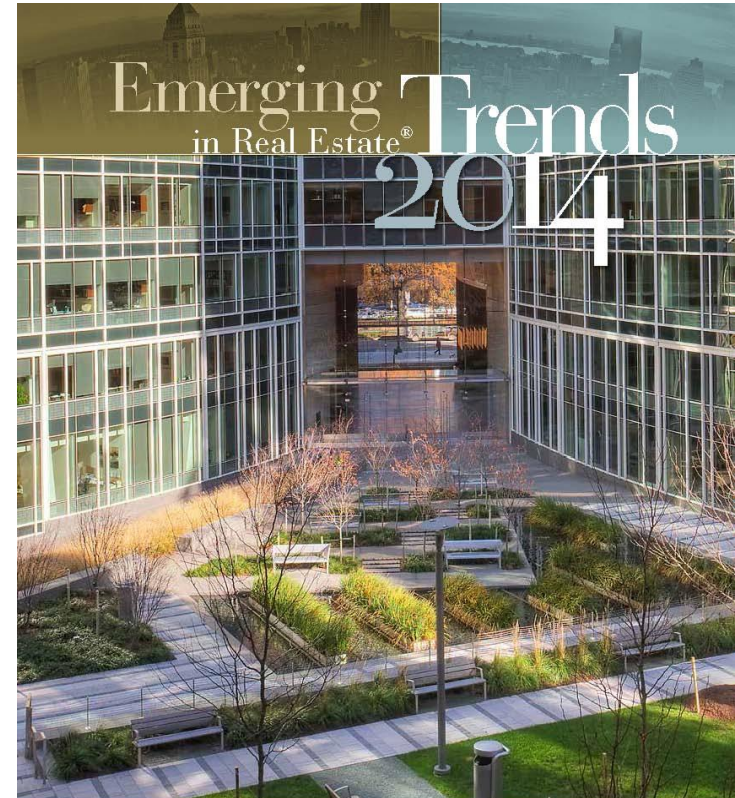
# Emerging Trends<sup>®</sup> in Real Estate

# 2014



# *Emerging Trends in Real Estate 2014*

- Emerging Trends is the industry's most predictive forecast
- 35th annual outlook
- Based on over 1,000 interviews and surveys of industry leaders
- Sponsored by PwC and the Urban Land Institute



## Emerging Trends Scorecard: How did we do?

2013 Trend	Yes	No	?
Highlighted slow recovery	✓		
Warned of continued political uncertainty	✓		
Warned of fiscal cliff			
Noted beginning of move to secondary markets	✓		
Warned on multifamily overbuilding in 2015			✓
Highlighted mezzanine and preferred equity investments	✓		
Change in tenant demand and use of office space	✓		
Highlighted reurbanization of suburbs	✓		

## Emerging Trends Scorecard: How did we do?

2013 Trend	Yes	No	?
Noted commercial developer headwinds	✓		
Highlighted chasing yield strategy	✓		
Noted increase in transaction volume	✓		
Consider single family housing funds	✓		
Focus on infill locations	✓		
Develop “new wave” office in 24-hour cities	✓		
Develop industrial in distribution hubs	✓		
Slow multifamily development in low barrier to entry markets			✓



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## *Gaining Momentum*

Fundamentals continue to improve...slowly... across all property groups and property markets

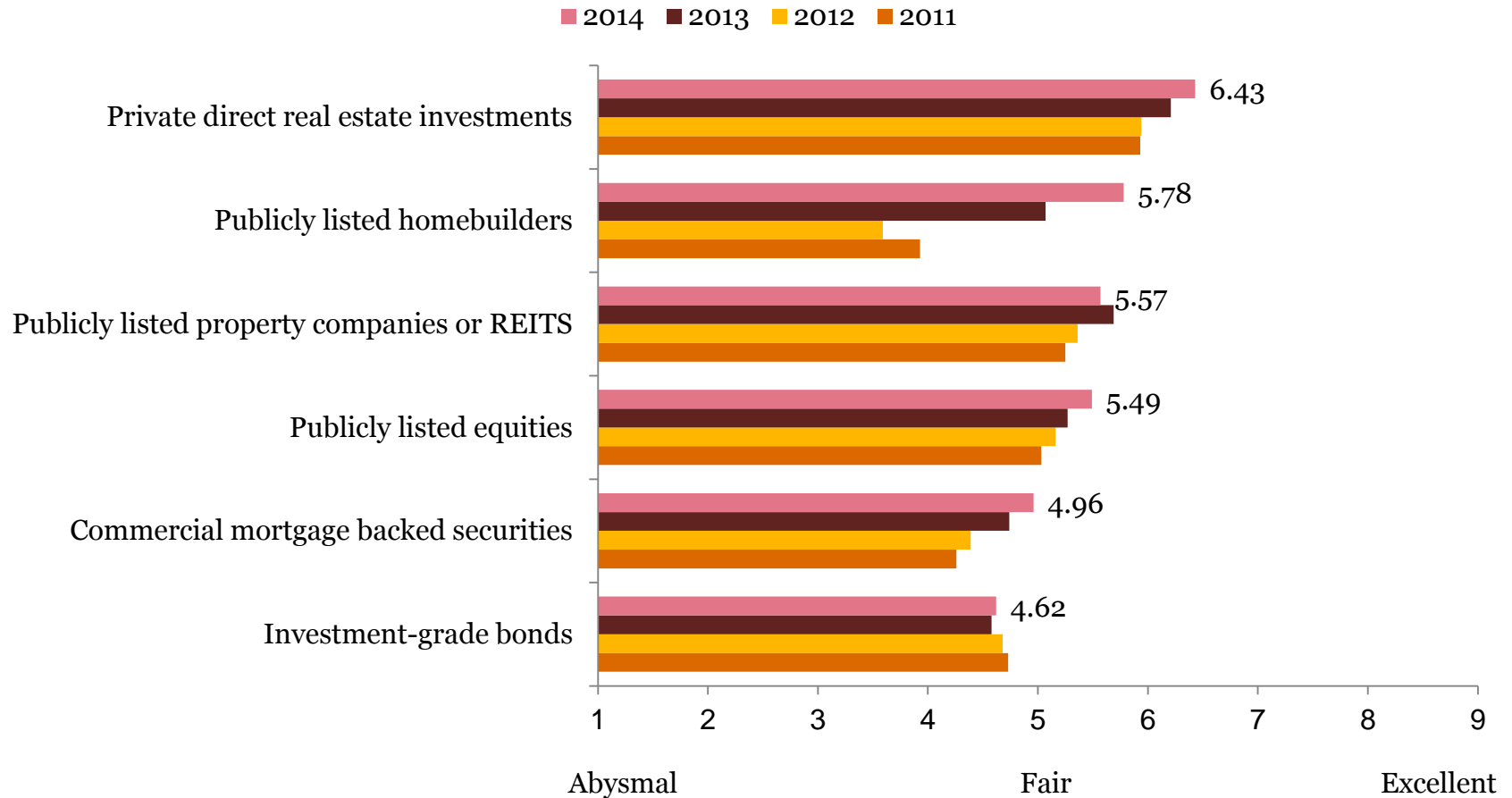
2014 expected to continue trends in employment (modest growth) and increasing demand for space

2014 likely to be last year industry benefits from 6 years of little increase in supply

Interviewees see industry reaching an inflection point where “valuations will no longer be driven by capital markets,” leverage, and financial engineering

Interest rates universally anticipated to increase; it's the magnitude of the increase that is uncertain

# Investment Prospects by Asset Class

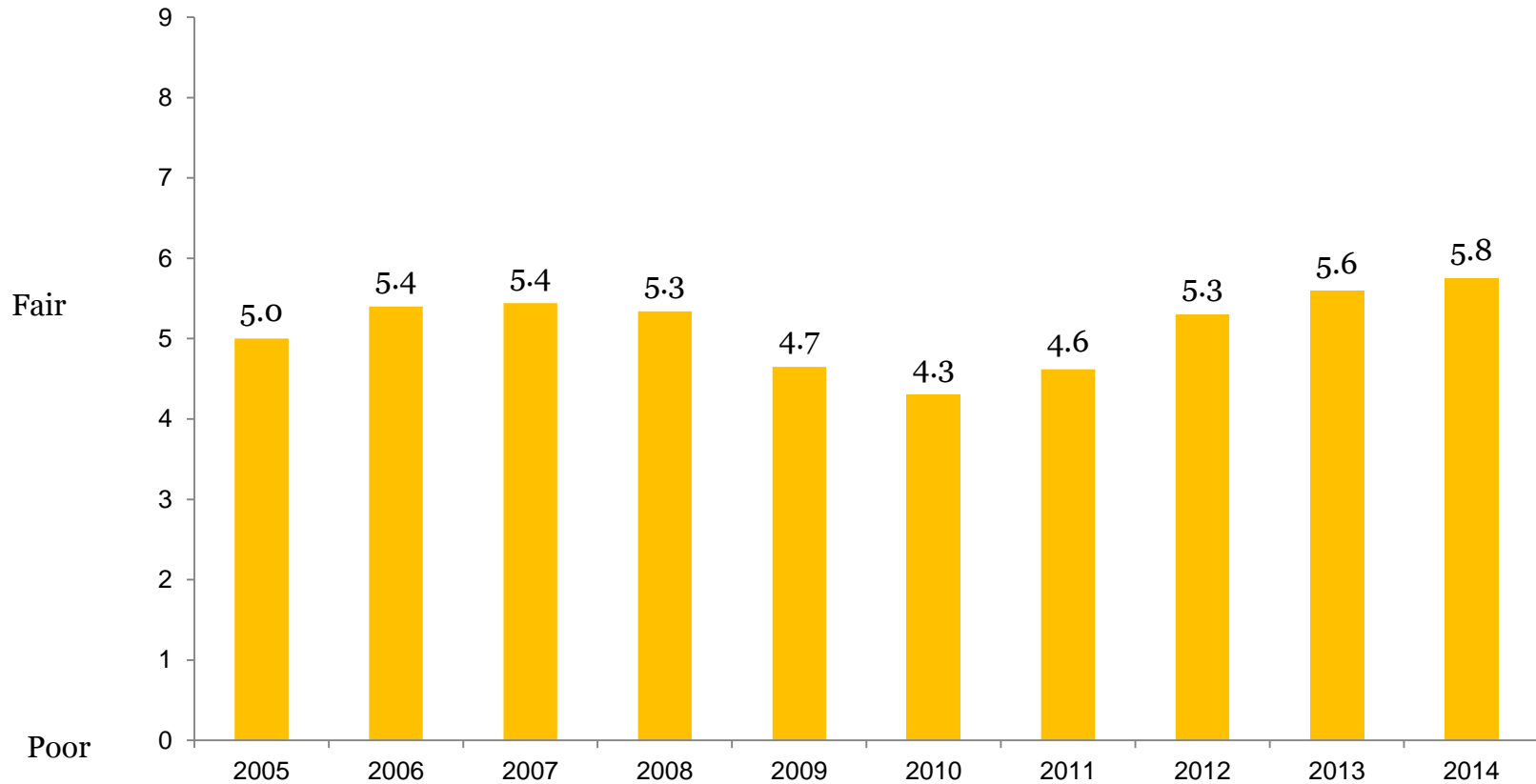


Source: Emerging Trends in Real Estate surveys

# Average Market Score

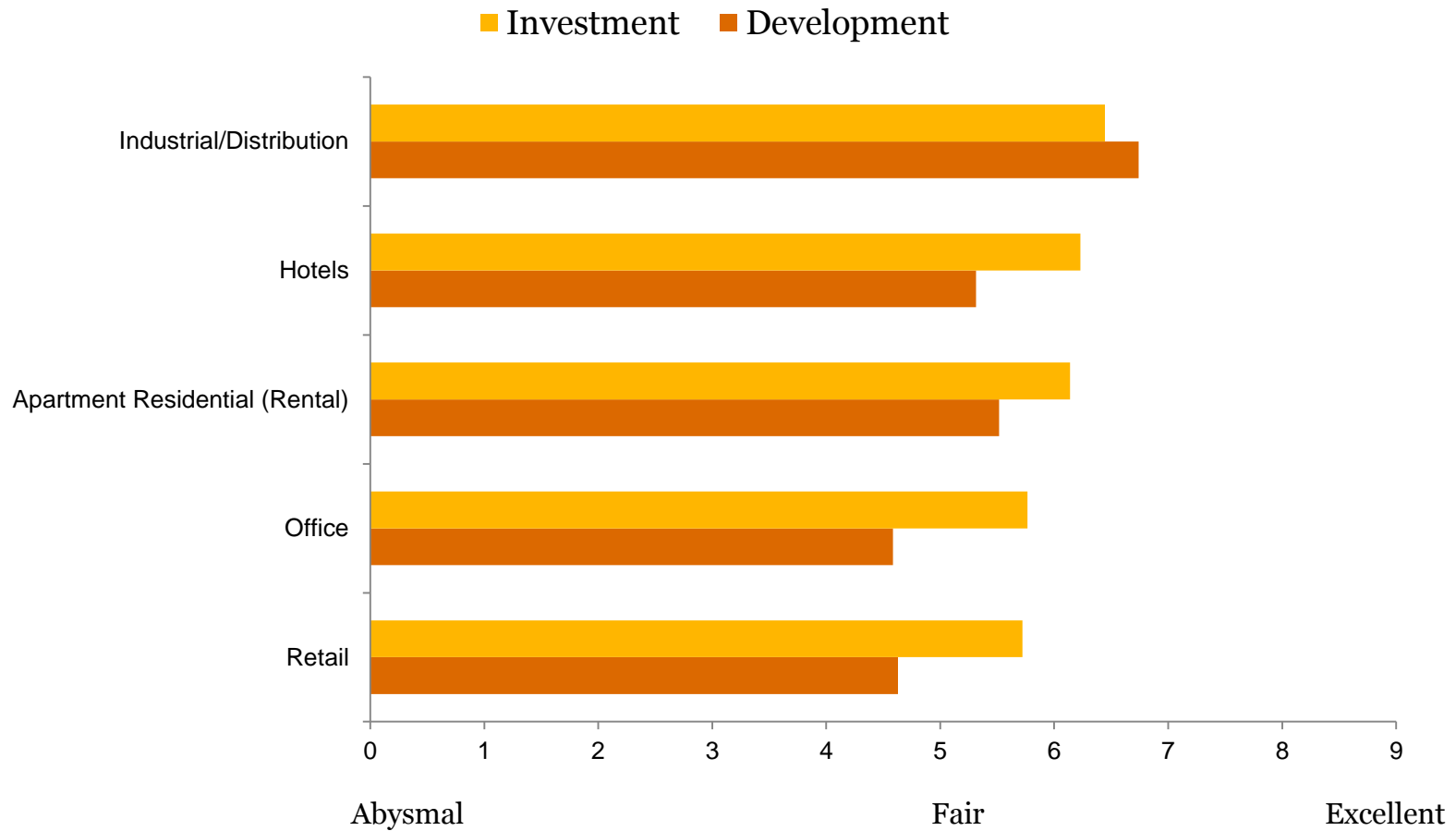
Investment Prospects

Excellent



Source: Emerging Trends in Real Estate surveys

# Average Property Score

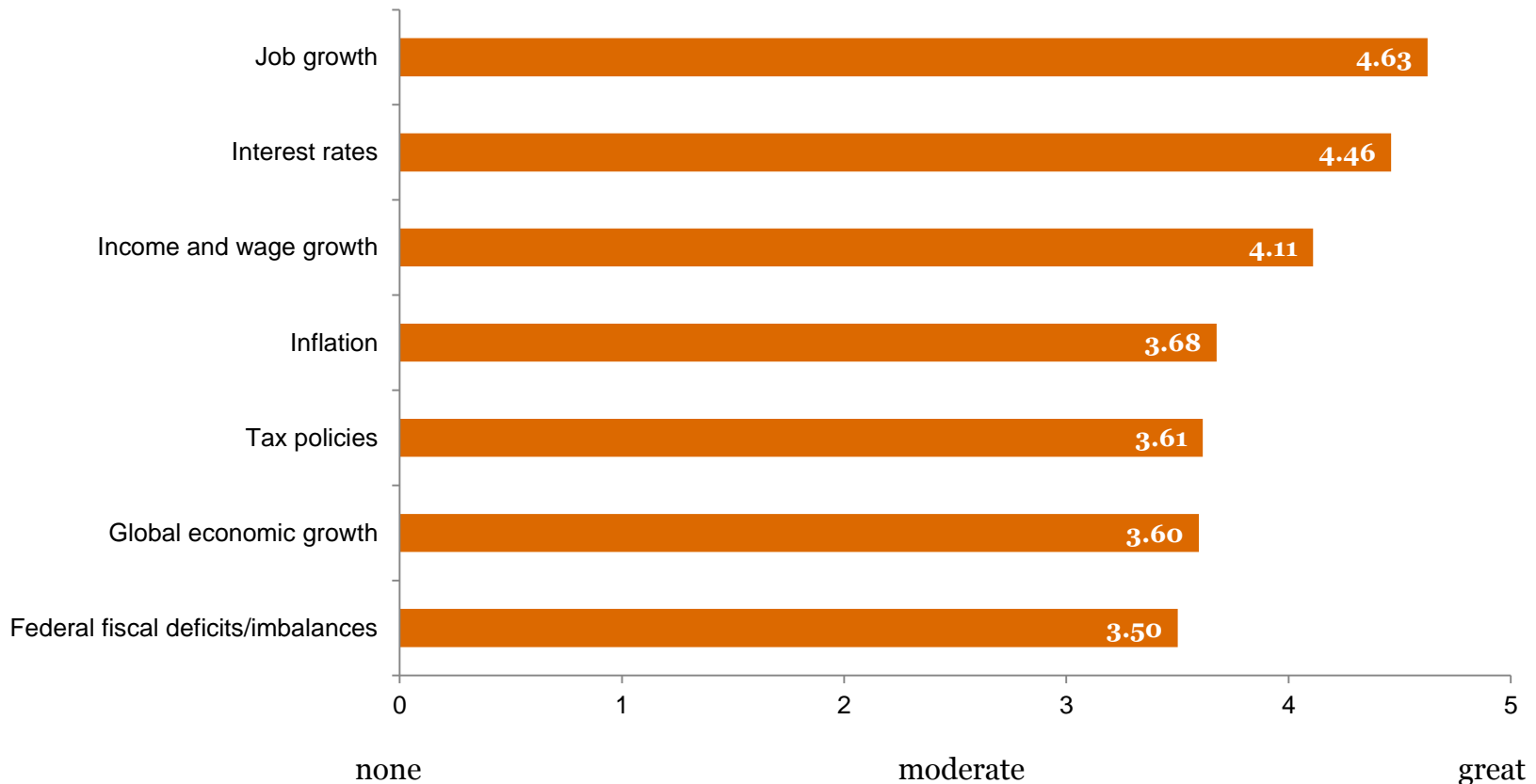


Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only



# *Issues of importance for real estate*

## *Economic/Financial Issues*

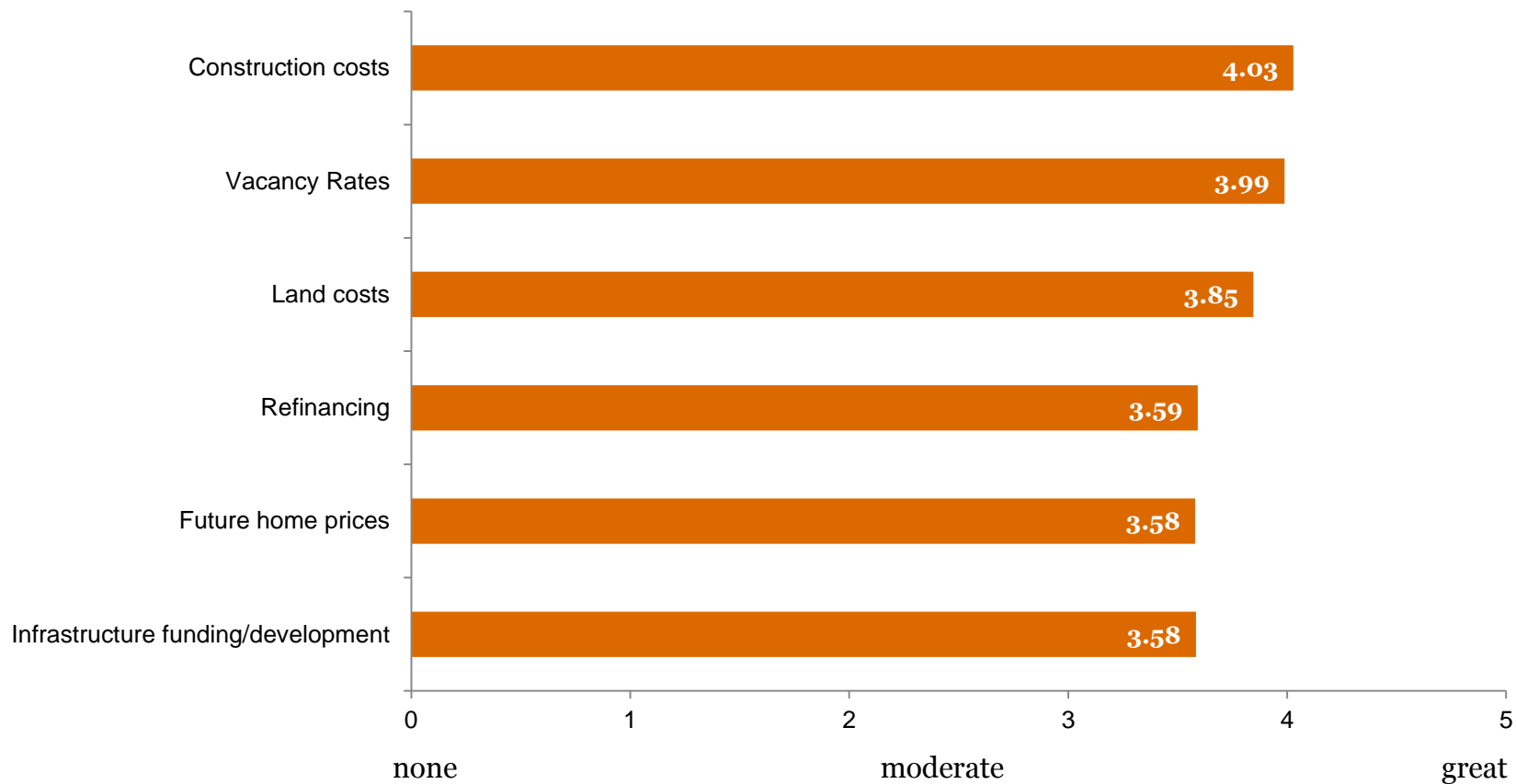


Source: Emerging Trends in Real Estate 2014 survey

Note: Based on US respondents only

# *Issues of importance for real estate*

## *Real Estate/Development Issues*



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

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***“With the economy in a position where the tailwinds are now stronger than the prevailing headwinds, 2014 should be a year when we see real estate fundamentals improve in sectors beyond the very healthy rental growth multifamily sector—and in a number of markets—to a point where we could see above-inflation-rate rental growth”***

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# *Headwinds Facing the Real Estate Industry*

A “stubbornly high’ unemployment rate

Uncertainty over government regulation and fiscal policy

Likely increase in the cost of both equity and debt capital

Economic uncertainty in the Euro-zone

China’s moderating economic growth

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## ***Tailwinds Benefiting the Real Estate Industry***

“Good if not great” job growth in industries with high real estate utilization including: energy, technology, health care, and medical research

Even education and financial services sectors are projected to support increased space needs in 2014

Increasing corporate profits

Continuing recovery in the single-family housing industry

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## ***Emerging Trends: Key Drivers for 2014***

Industry profitability expected to continue to improve

Interest rates anticipated to increase

Dependence on cap rate compression to drive increase in value to be replaced by emphasis on asset management

Markets are expected to be “well supplied” with both equity and debt capital

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## ***Emerging Trends: Key Drivers for 2014***

Opportunities to develop property finally appear in sectors other than multifamily

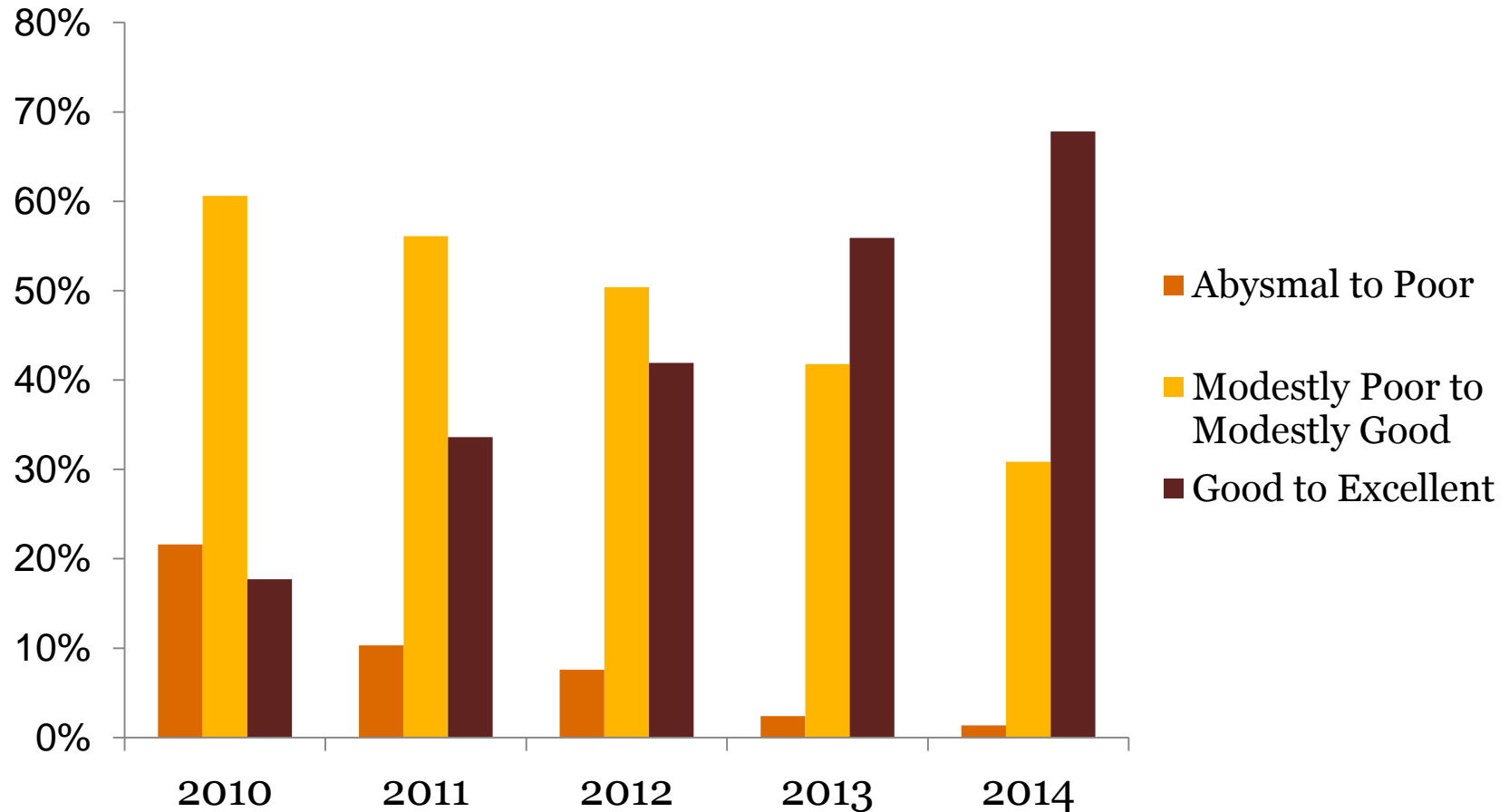
Industry begins to notice and understand needs of both Gen Y and the baby boomers

Needs of end users of commercial space continue to evolve

The single family housing market continues to make a positive contribution to the overall economy



## *Prospects for profitability by percentage of respondents*



Source: Emerging Trends in Real Estate surveys  
Note: Based on US respondents only

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## ***2014 Condensed***

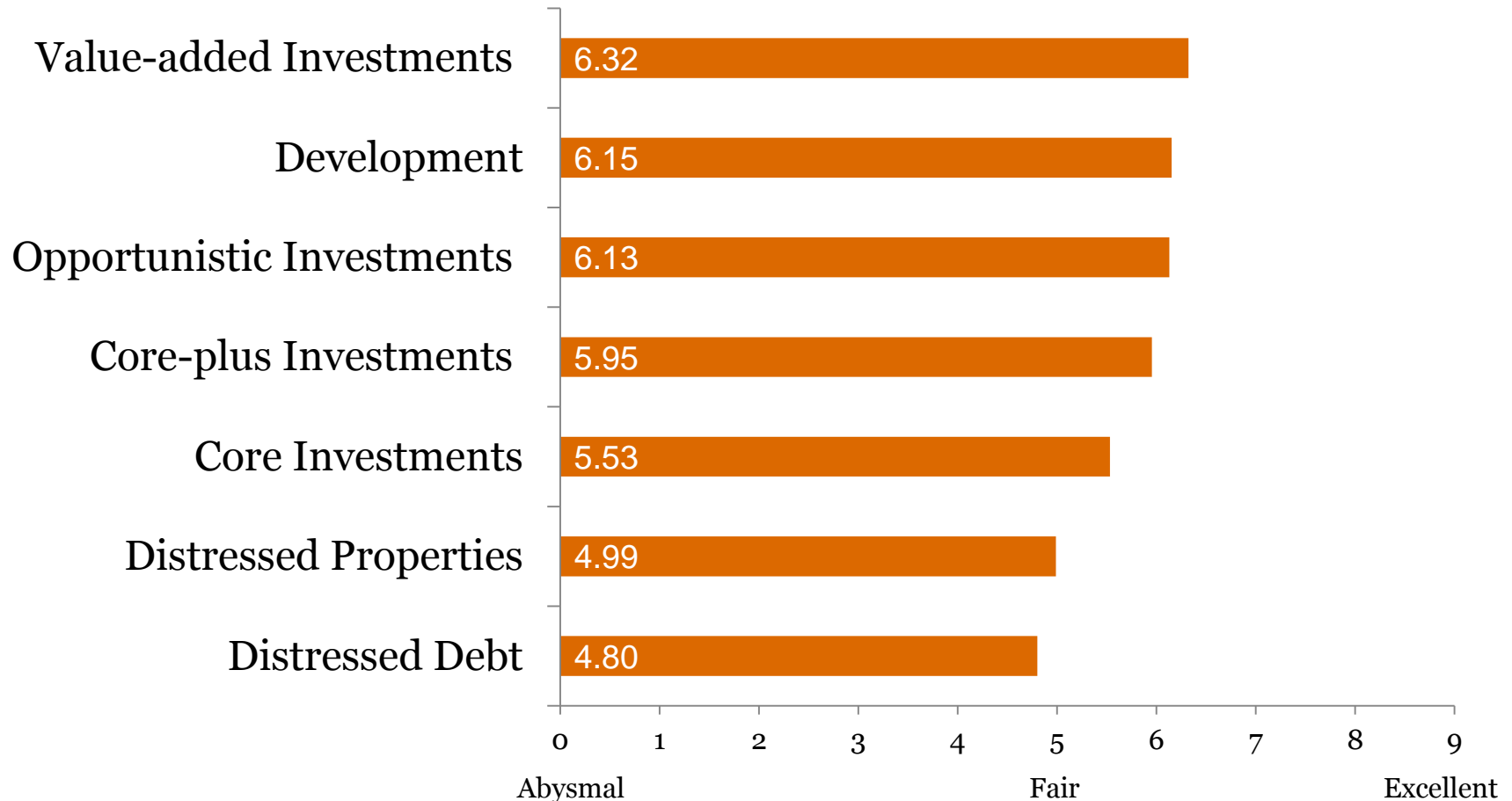
The beginning of the “middle innings” of the “recovery from the recovery”

Use of financial structuring and leverage as means to create value will be replaced by property operating skills

Focus will continue to shift from “solely core in gateway 24-hour” markets to overlooked markets and property sectors as well as value-added strategies including repositioning, re-leasing, re-tenanting, renovation, and the like

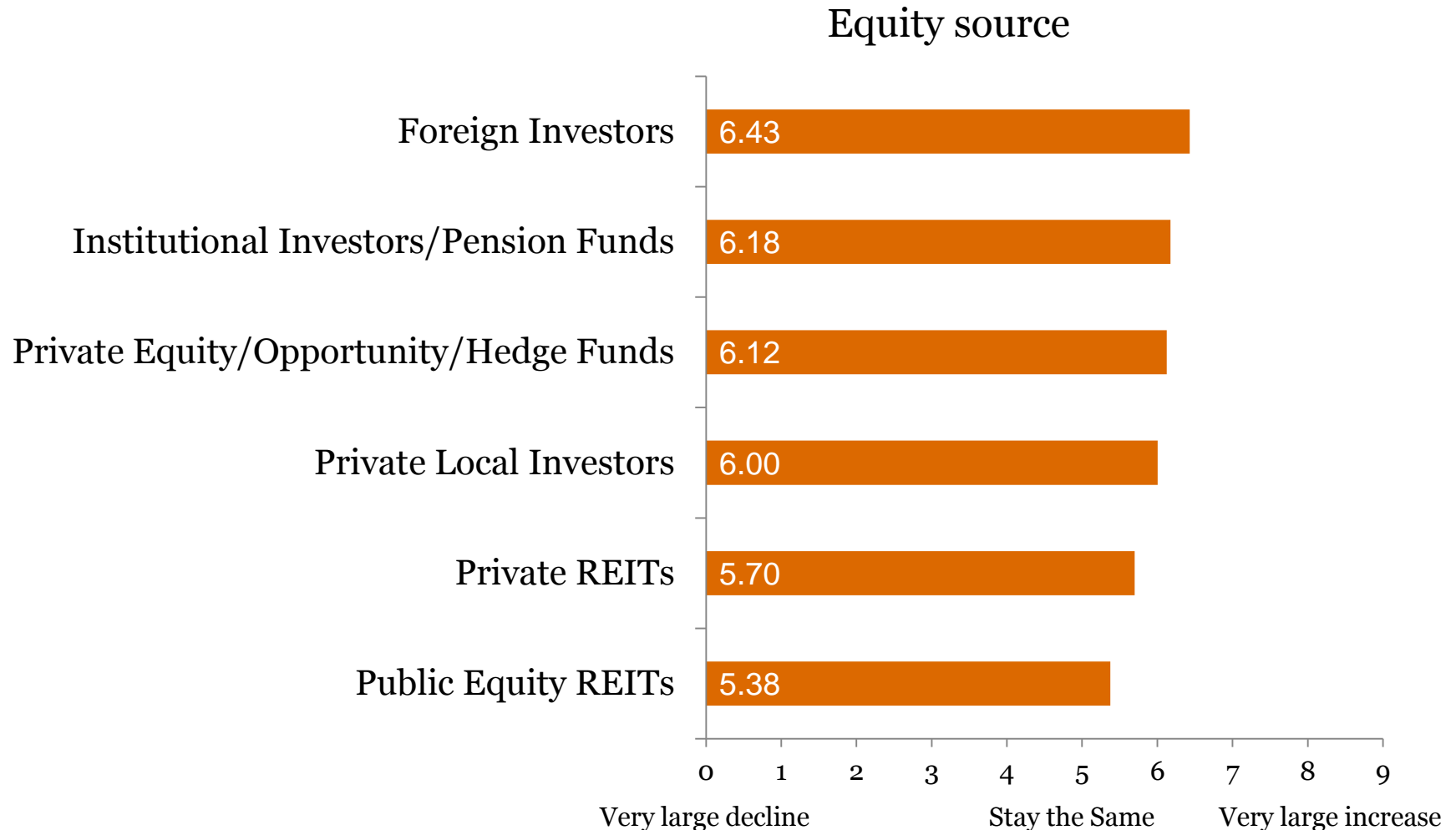
# *Capital markets*

# *Prospects by Investment Category/Strategy*



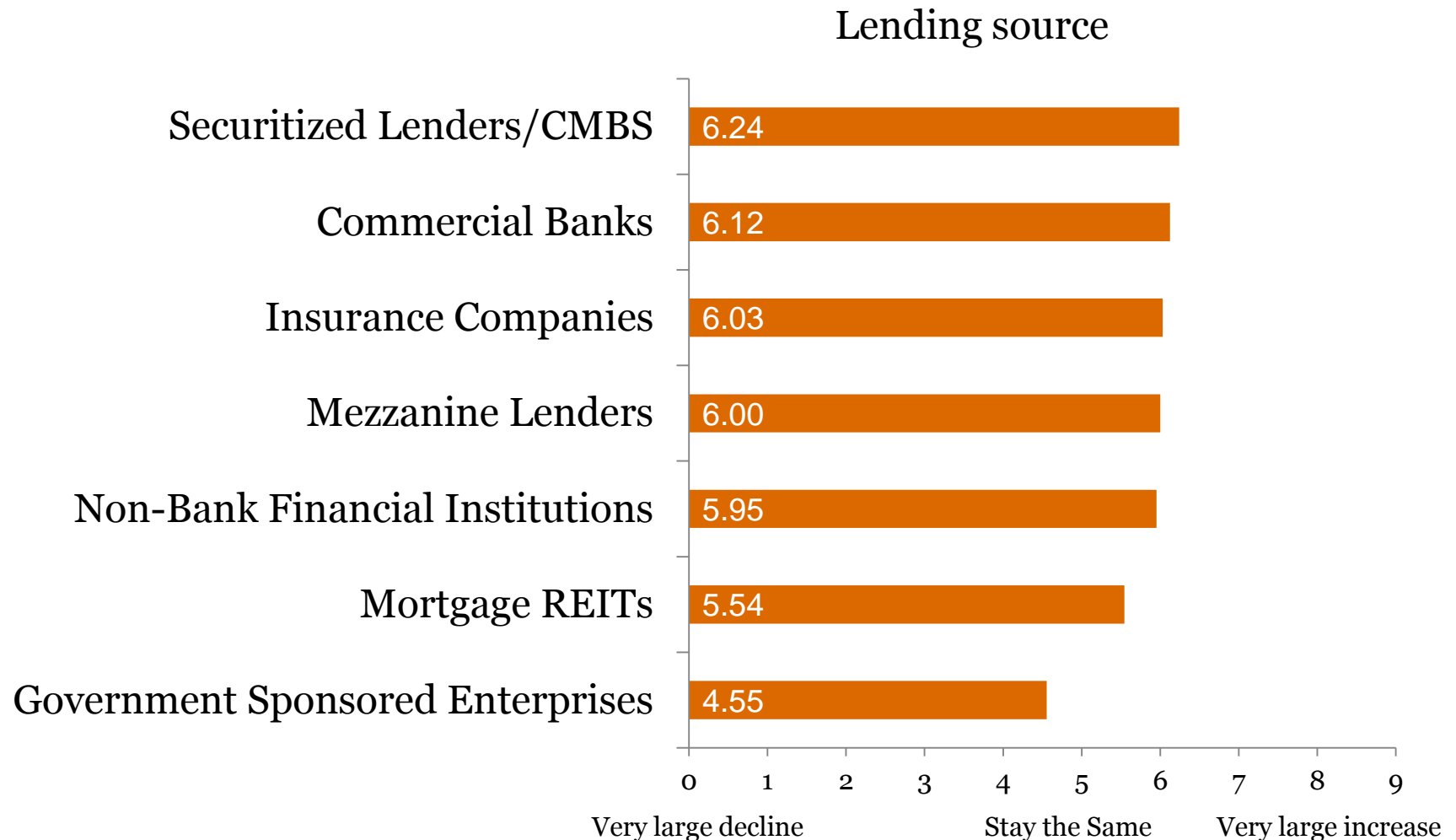
Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

## *Change in Availability of Capital for Real Estate in 2014*



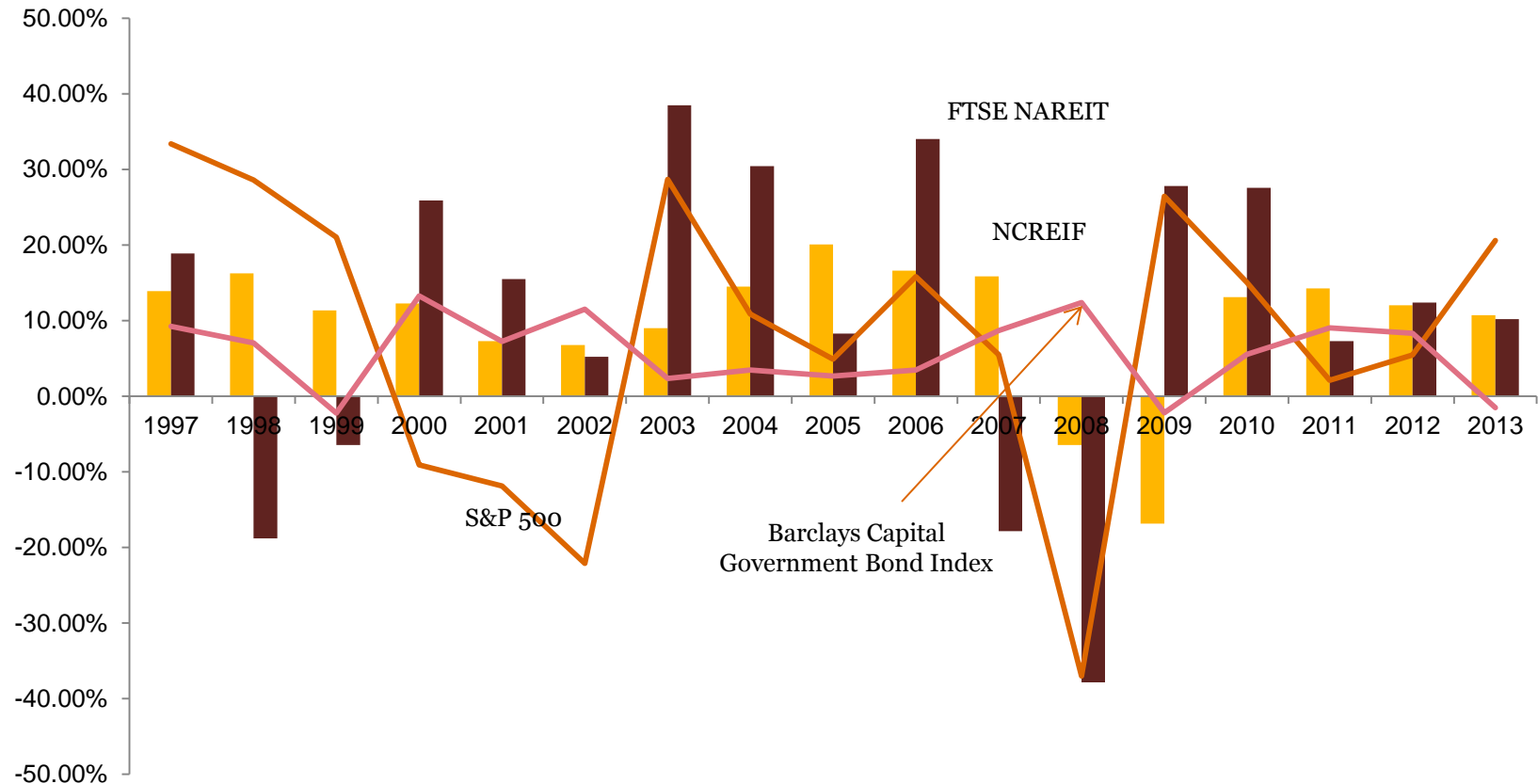
Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

## *Change in Availability of Capital for Real Estate in 2014*



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

## Index Returns: Real Estate vs. Stocks/Bonds

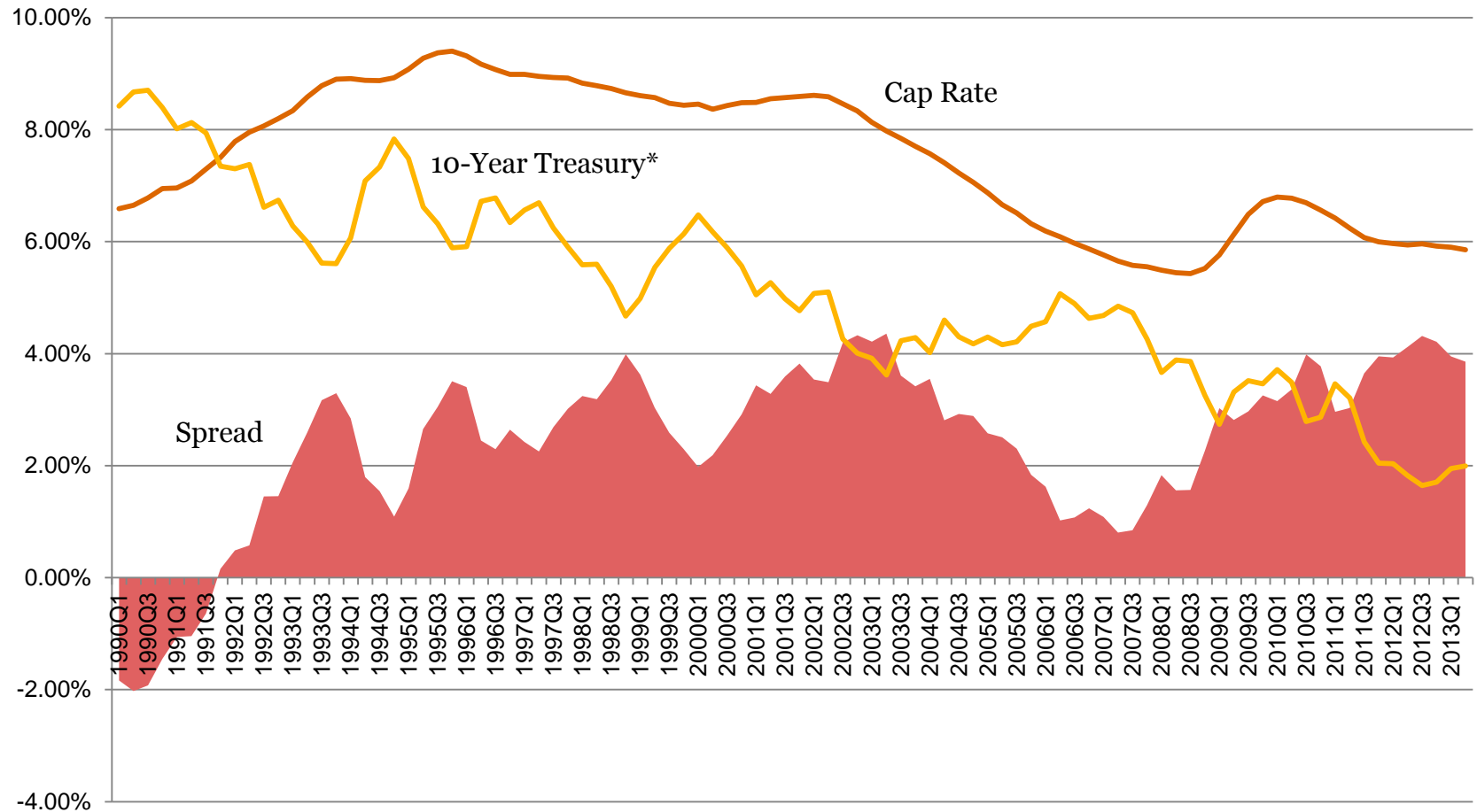


Source: NCREIF, NAREIT, S&P, Barclays Group

Note: 2013 data annualized from second-quarter 2013



# NCREIF Cap Rates vs. U.S. Ten-Year Treasury Yields



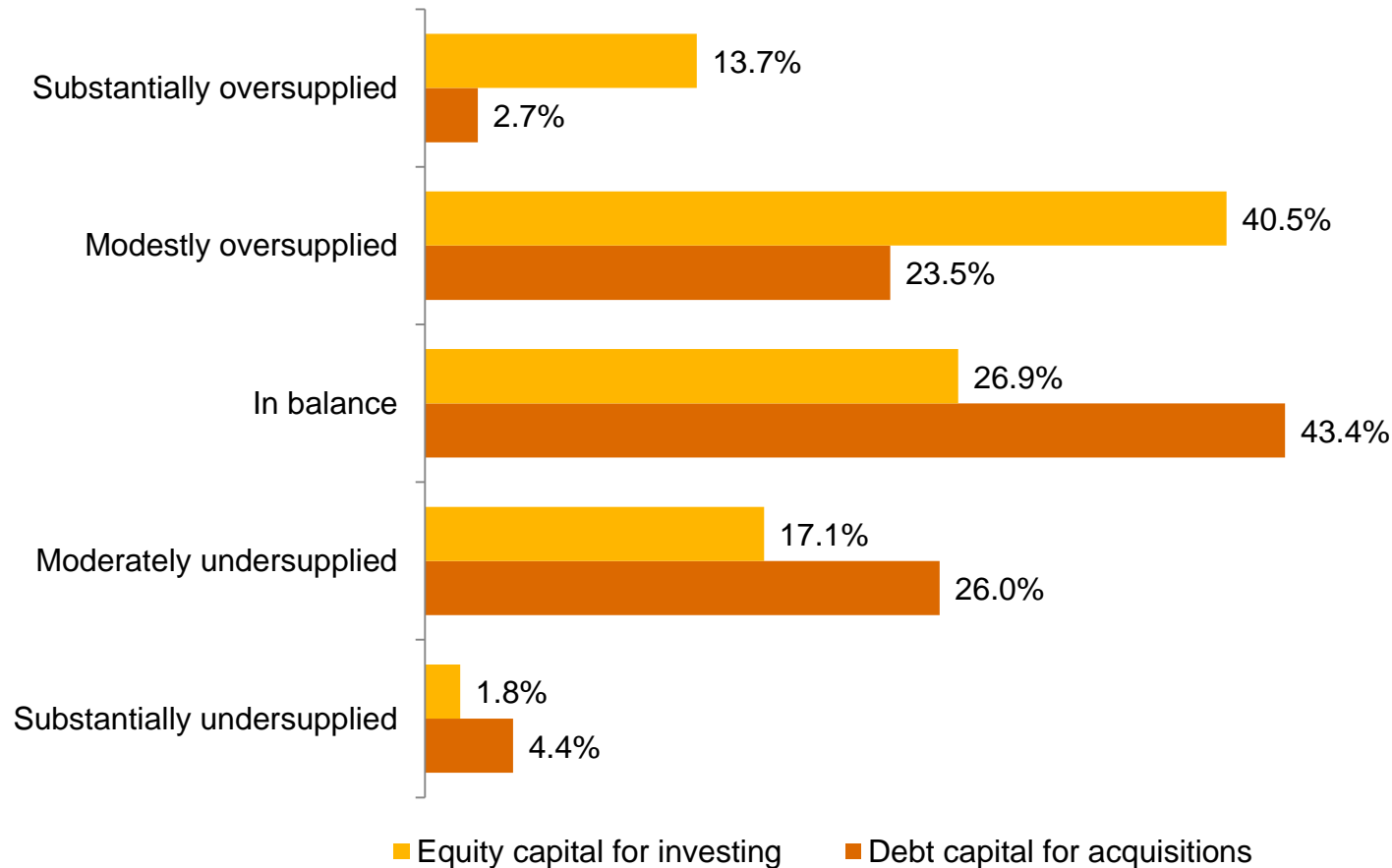
Source: NCREIF, Moody's Analytics, Federal Reserve Board

\*Ten-year Treasury yields based on average of the quarter, 2013Q2 average is as of July 2013

Note: Cap rate based on four-quarter moving average of current-value cap rate

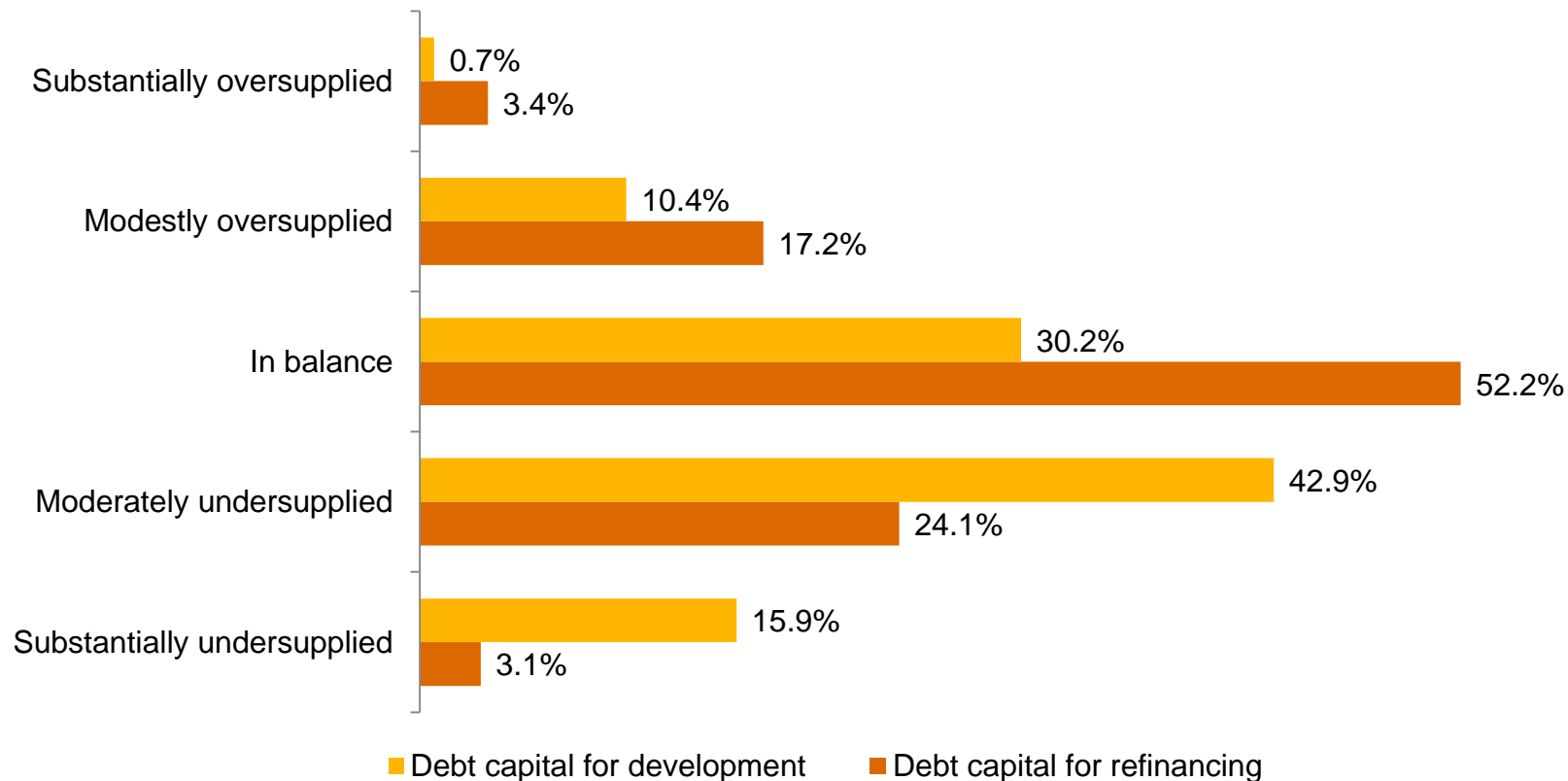
# *Capital flows outlook*

## Real estate capital market balance forecast for 2014



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

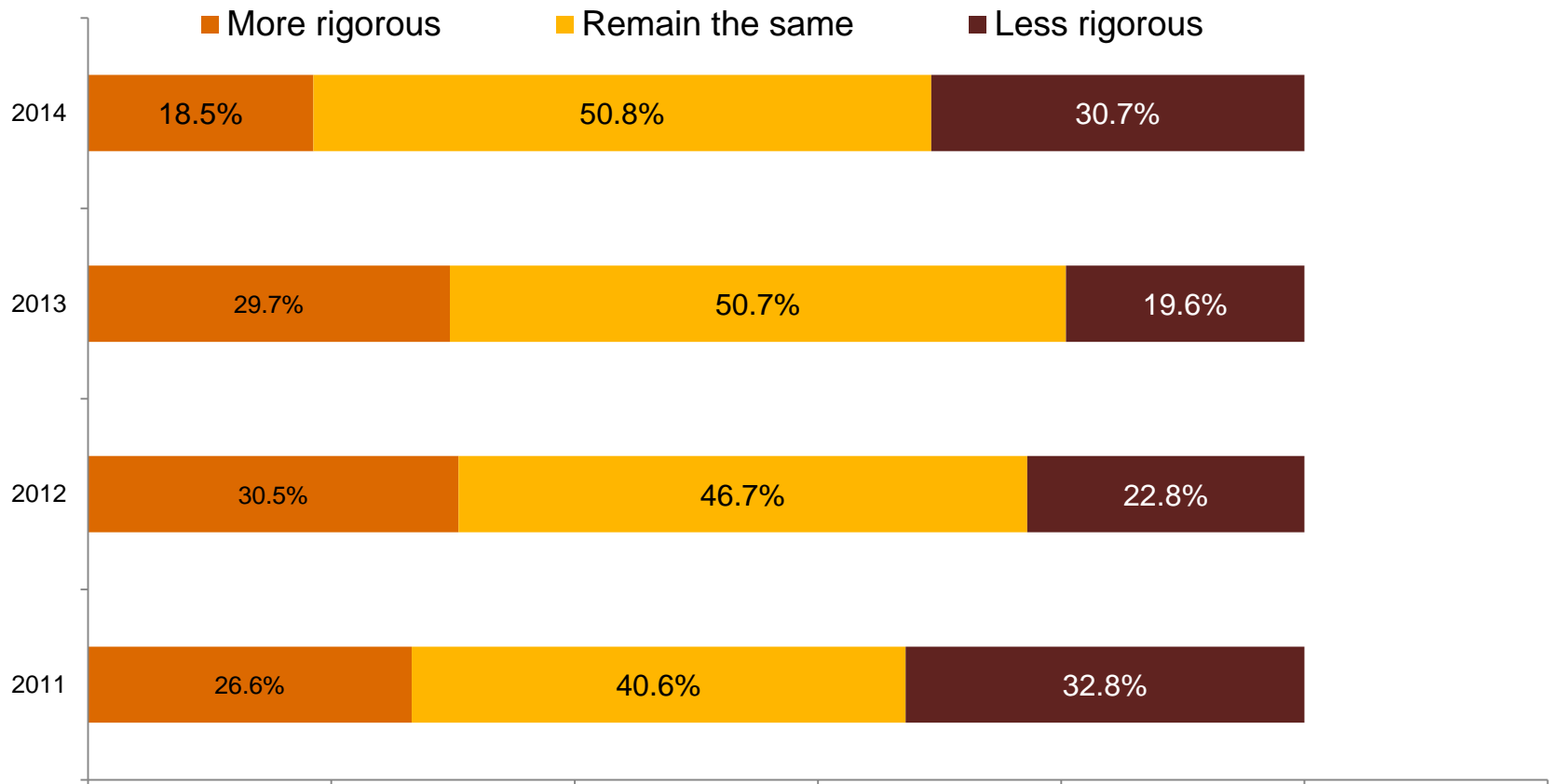
## *Debt capital for specific uses*



Source: Emerging Trends in Real Estate 2014 survey

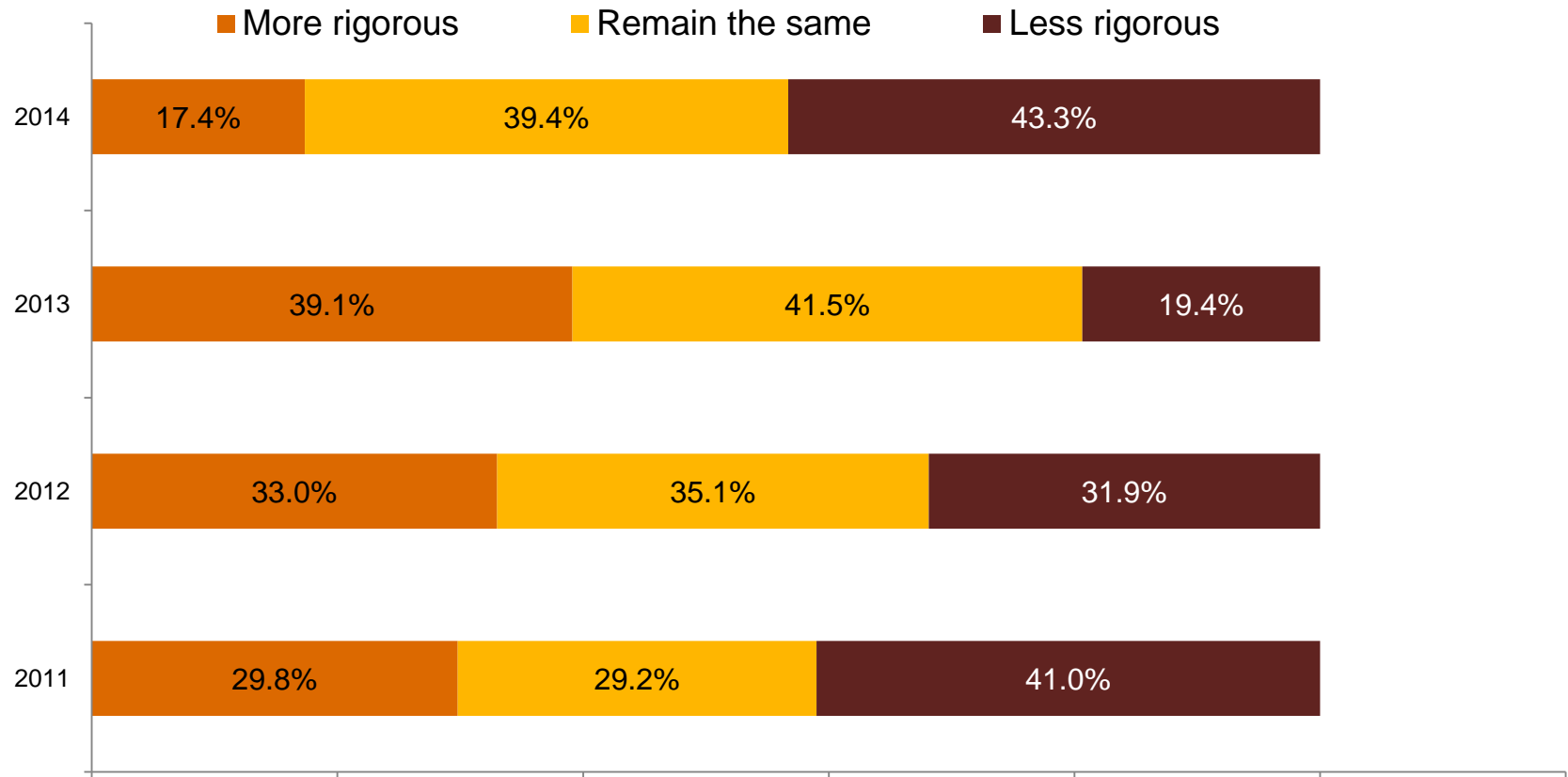
Note: Based on US respondents only

# Equity Underwriting Standards Forecast



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

# Debt Underwriting Standards Forecast

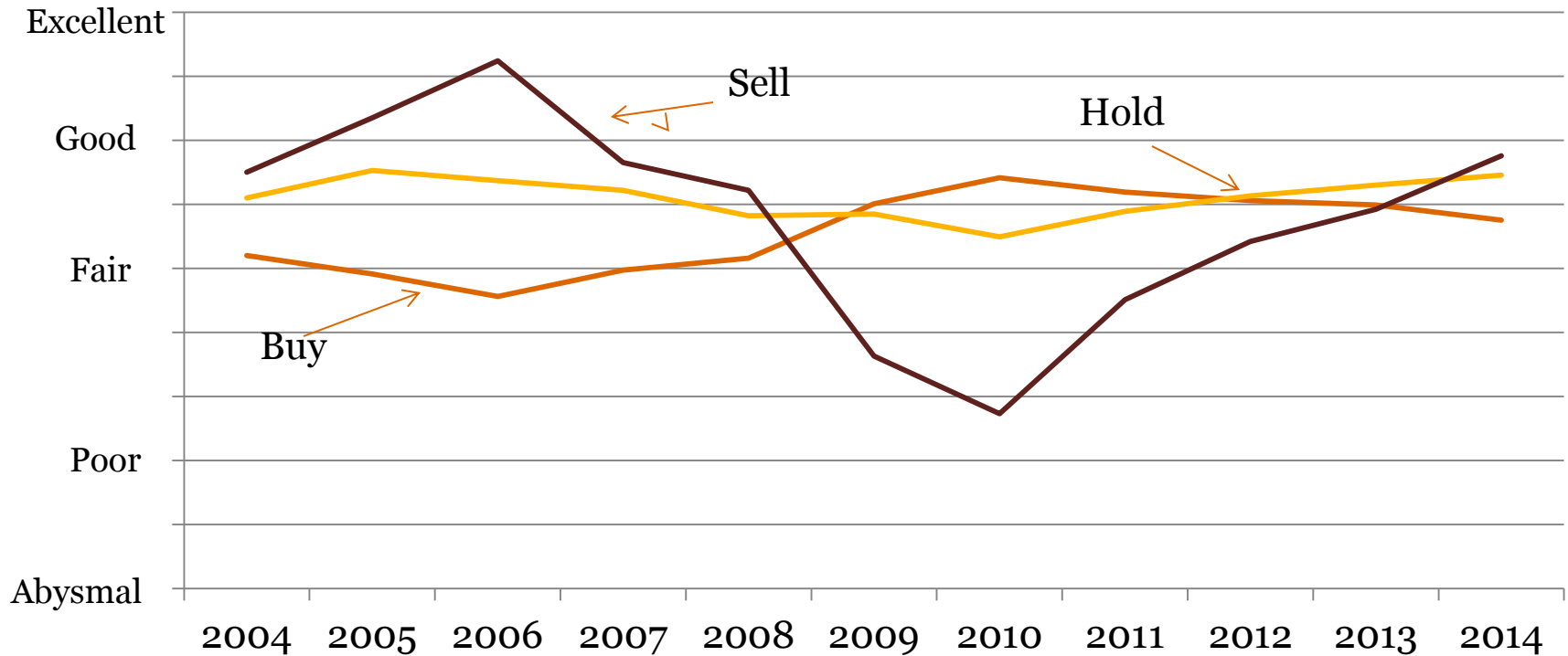


Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

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# ***Top Real Estate Capital Markets Trends***

# Emerging trends barometer 2014



Source: Emerging Trends in Real Estate surveys

Note: Based on US respondents only



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# ***Real Estate Capital Flows***

## **Survey participants anticipate an increase in both equity and debt capital**

- Equity investors will continue to expand search for yield, turning focus from solely core in 24-hour markets to a wider geography and range of asset classes
- Lender's return to corporate profitability “allows them to get back in the game”
- For both investors and lenders, real estate provides an increasingly attractive investment alternative

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# ***Increase in Availability of Debt Capital***

**Respondents expect an increase in availability of debt capital from five sources**

CMBS (securitized) market

Commercial banks

Life insurance companies

Mezzanine lenders

Non-bank financial institutions

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## ***CMBS Revival Continues***

**Survey participants ranked CMBS first in terms of change in availability of capital for real estate in 2014**

2013 transaction volume expected to exceed \$80 billion; 2014 originations anticipated to exceed \$100 billion

CMBS lenders continue to fill the gaps left by conventional lenders in terms of deal size (under \$25 million) and property location (secondary versus solely primary locations)

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## ***Commercial Banks***

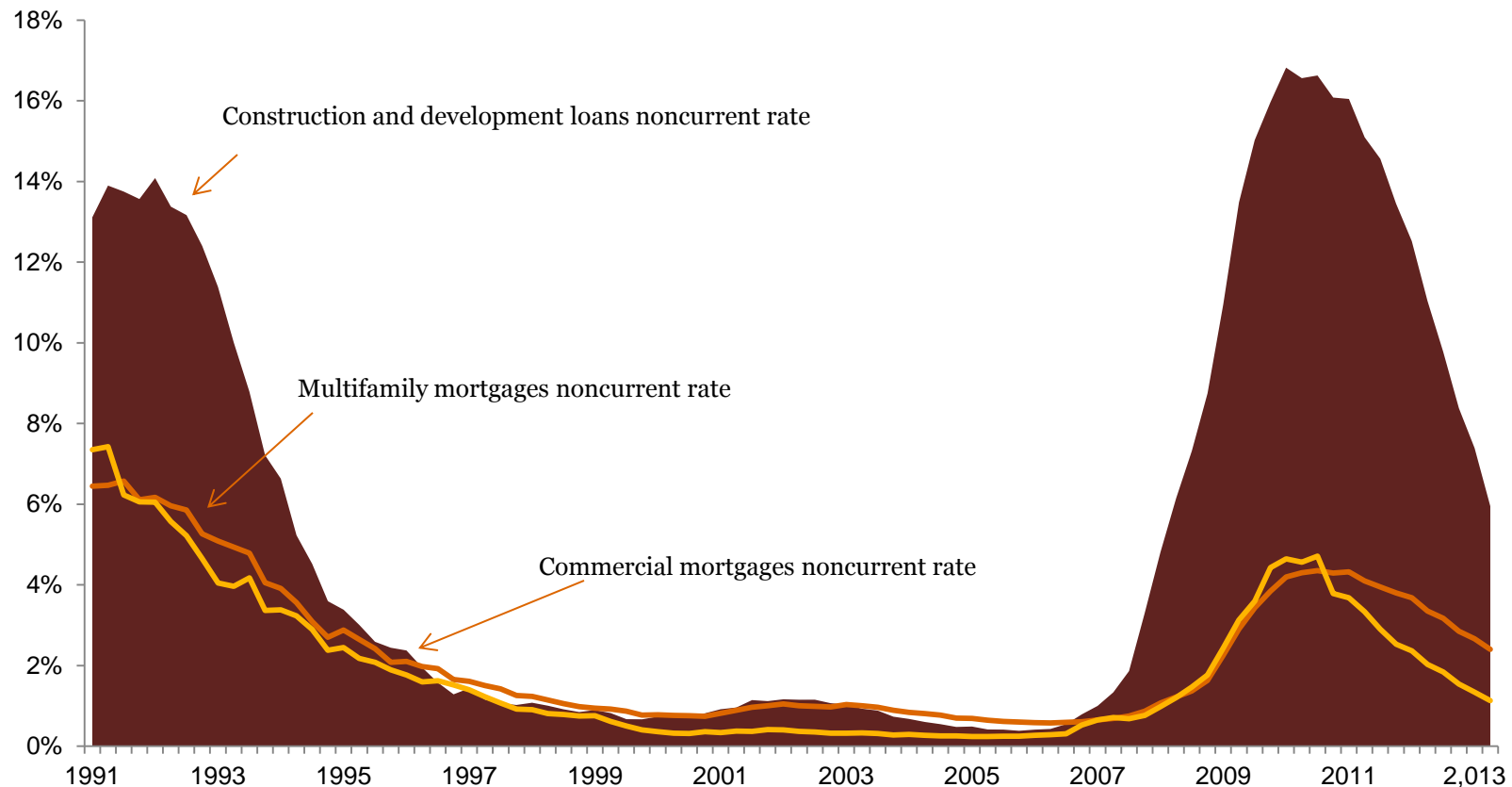
Expected increases in interest rates (and profitability) will make real estate lending increasingly attractive

Regional and local banks are expected to become increasingly active as real estate lending returns to become a major part of their business model

National banks, searching for opportunities, will increasingly compete on a regional and local basis

Development and construction loans will become increasingly available for borrowers with strong credentials and track records, and properties with substantial pre-leasing

# Bank Real Estate Loan Delinquency Rates



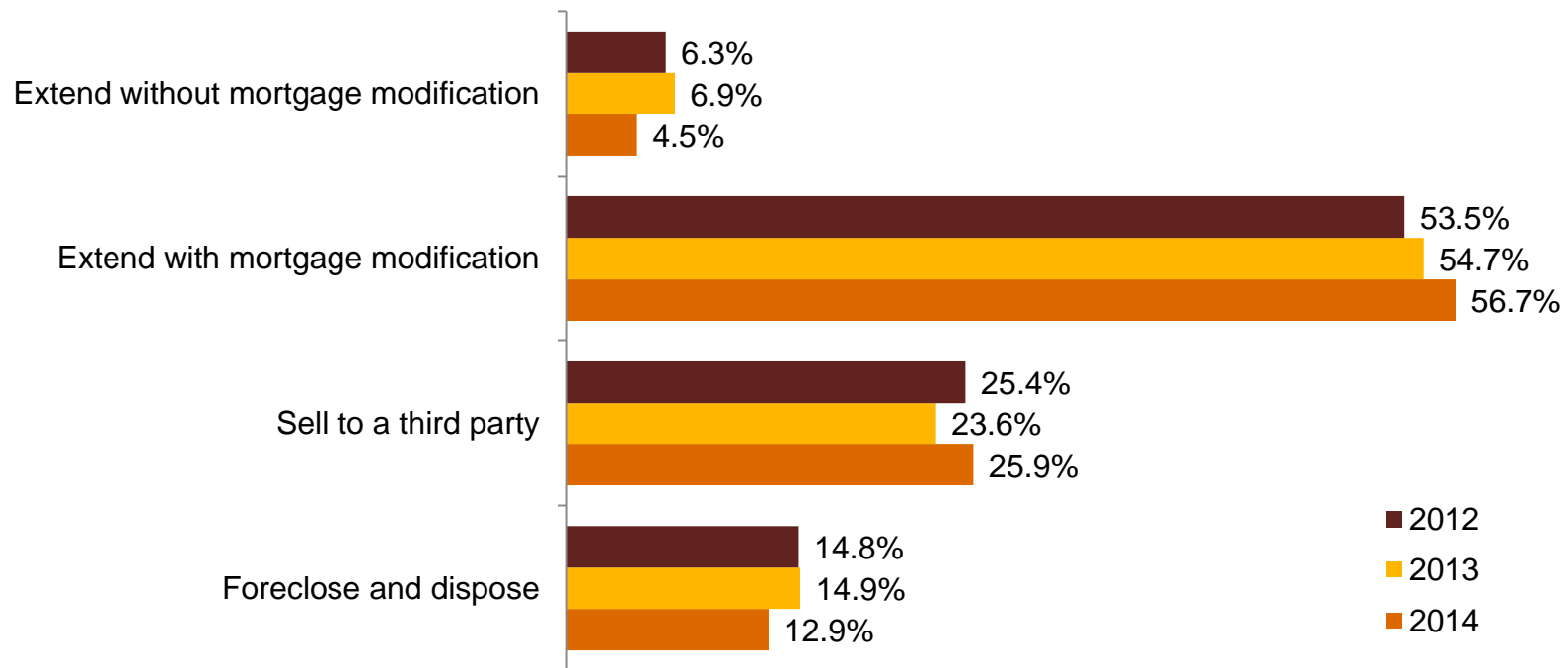
Source: Federal Deposit Insurance Corp.

Note: Delinquent loans defined here as those that are noncurrent, either 90 days or more past due or in noncurrent status

\*as of second quarter 2013

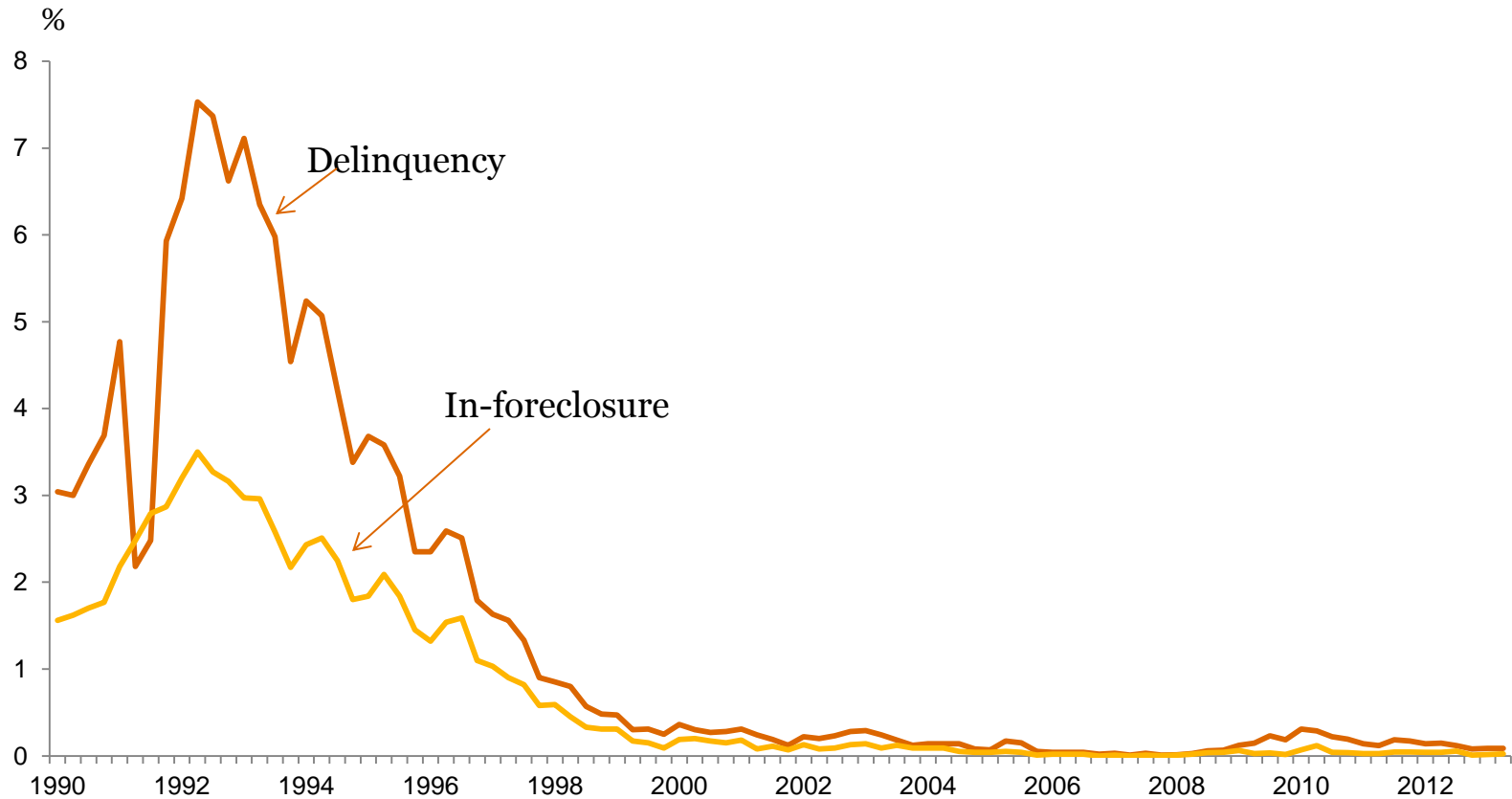
# Dealing with problem loans

## Preferred strategy for lenders



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

## *Life insurers mortgage delinquency and in-foreclosure rates*



Source: Moody's Analytics, American Council of Life Insurers

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## *Mezzanine Financing*

Interviewees and survey participants seem of two minds regarding the roll of mezzanine financing in 2014

“The biggest question on mezzanine is where the returns are going to be. If mezzanine rates don’t increase enough and we don’t feel we’re getting paid enough, we’ll stop. At a 200 [basis point] difference, we don’t think we’re getting paid for the risk.”

Other interviewees predict an “increase in B-piece, mezzanine, and debt funds to fill gaps in transaction structure” and “an increase in the use of mezzanine financing combined with higher-cost senior debt.”



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## ***Shadow Banking***

**Shadow banking is commercial lending outside of the regulated universe of insured depository institutions and life insurance companies**

While not the “lender of last resort”, borrowers in the shadow banking market will find themselves dealing with a “hodge-podge” of well capitalized private funds, wealthy individuals, family offices, refugees from other lending markets and the like who are in this market solely because the spreads are attractive

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# *Equity Sources*

Foreign investors

Private equity funds

Pension funds

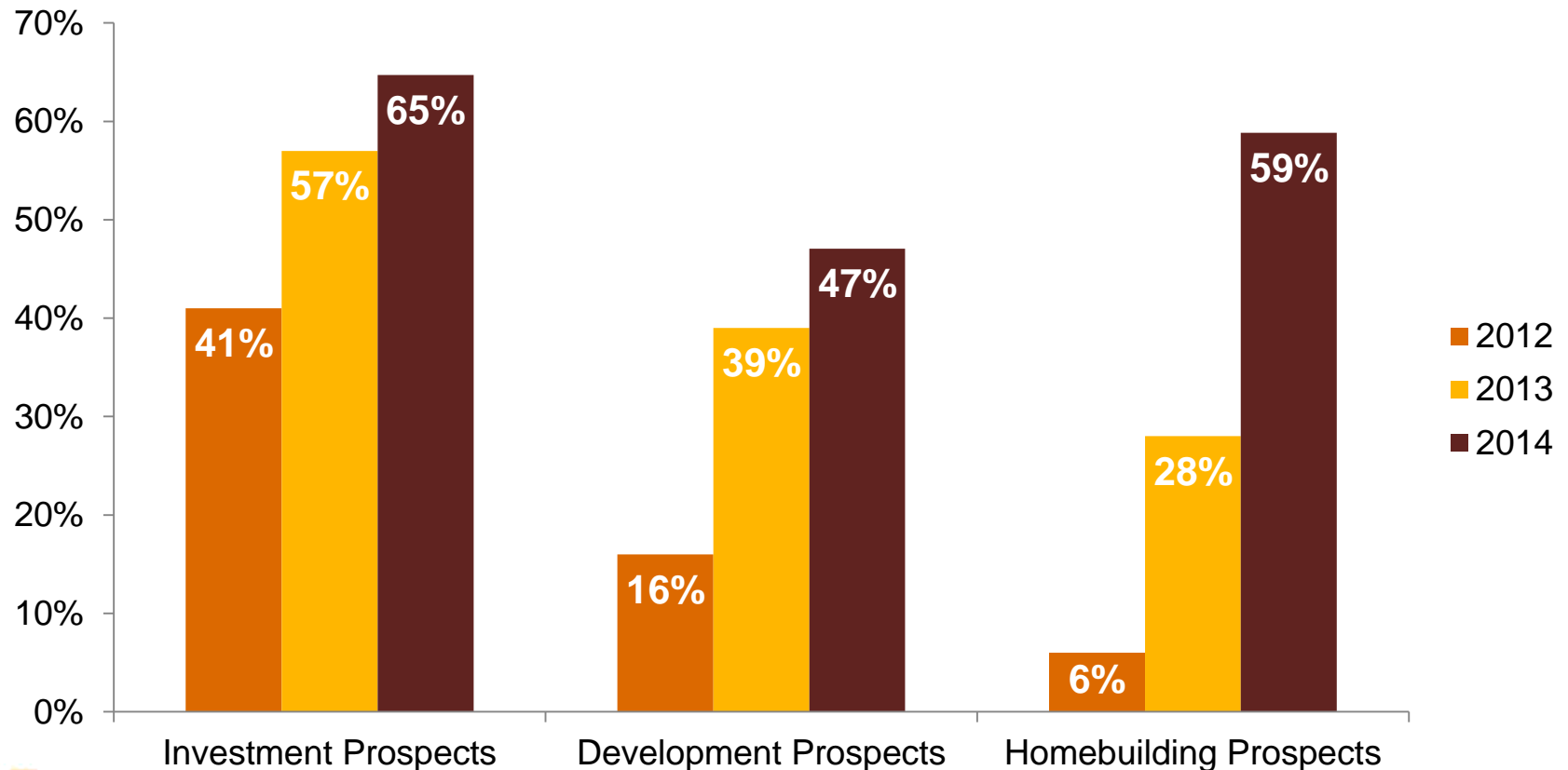
Equity REITs

# *Markets to watch*

More markets begin to look attractive

# *The lack of new supply has allowed the steady nature of the economic recovery to drive improvement in real estate*

Percent of markets ranked moderately good or better

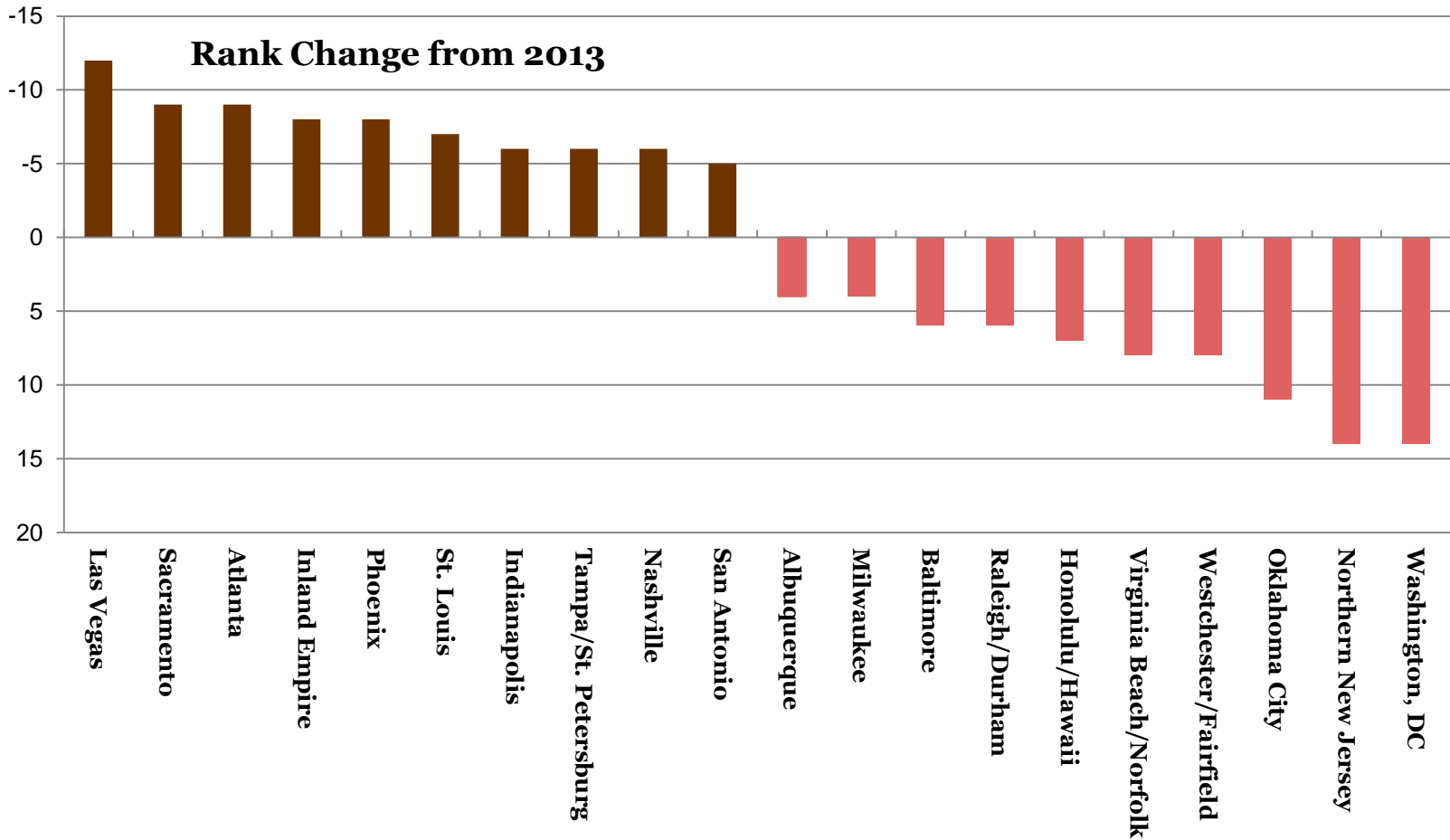


Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

# Changing positions

## Best and worst

Position change

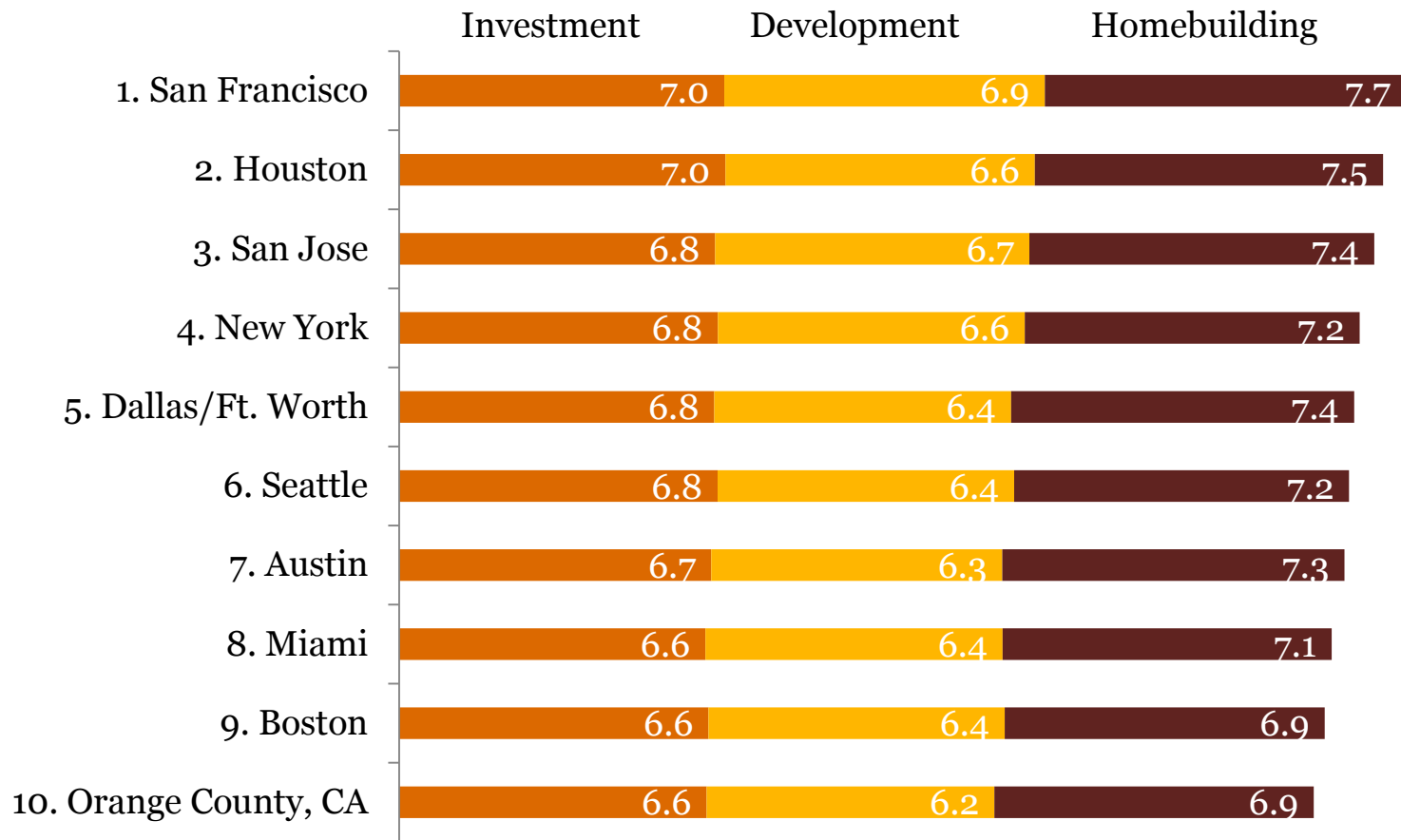


Source: Emerging Trends in Real Estate surveys  
Note: Based on US respondents only

## *Outlook improves for more markets*

Markets with Investment Prospects of Good or Better			
2011	2012	2013	2014
New York City	Austin	Austin	Austin
Washington D.C.	Boston	Boston	Boston
	New York City	Houston	Dallas/Ft. Worth
	San Francisco	New York City	Houston
	San Jose	San Francisco	Miami
	Seattle	San Jose	New York City
	Washington D.C.	Seattle	Orange County
			Portland
			San Francisco
			San Jose
			Seattle

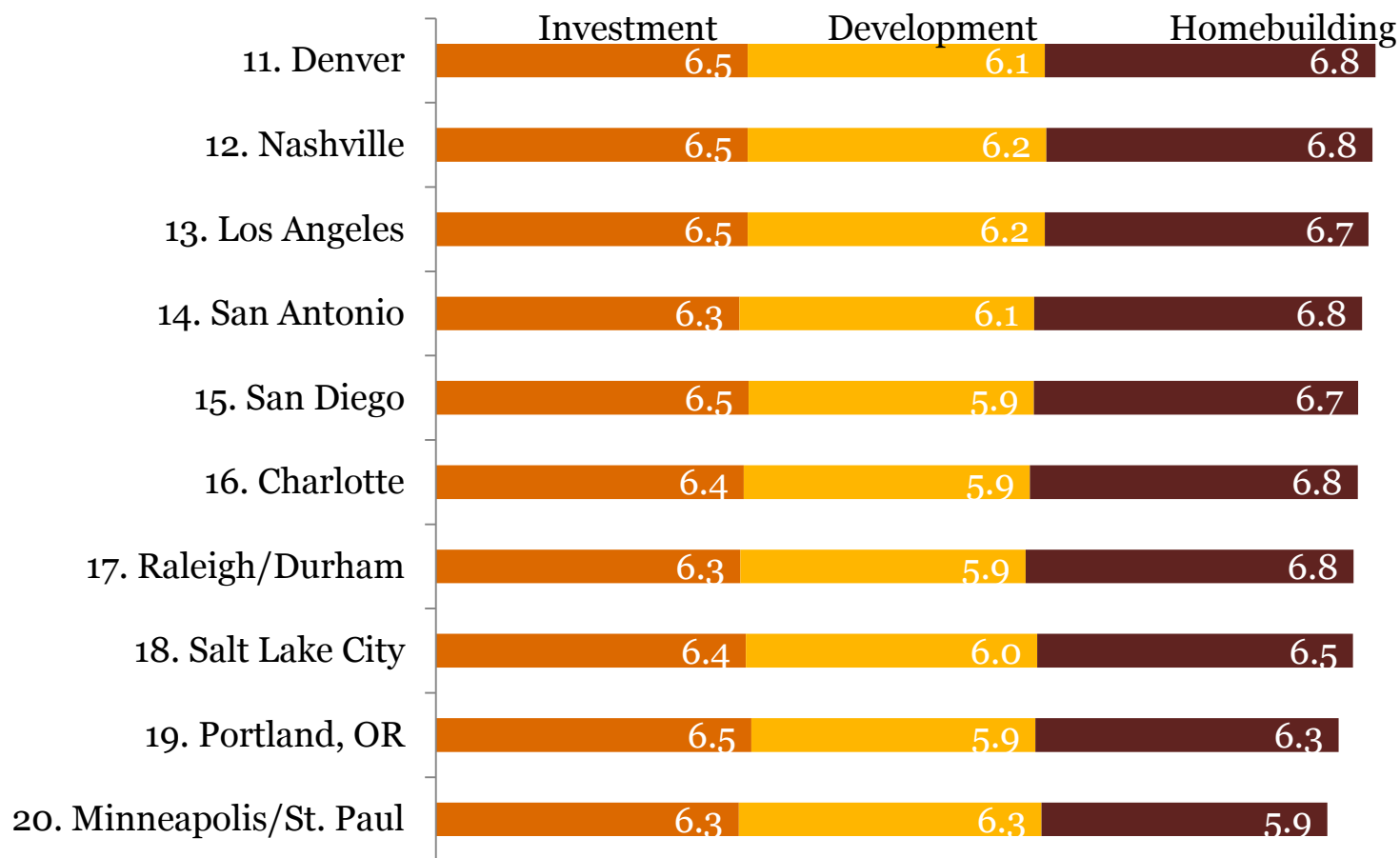
# Top 10 total rank 2014



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

## *Next 10 markets*

### 2014

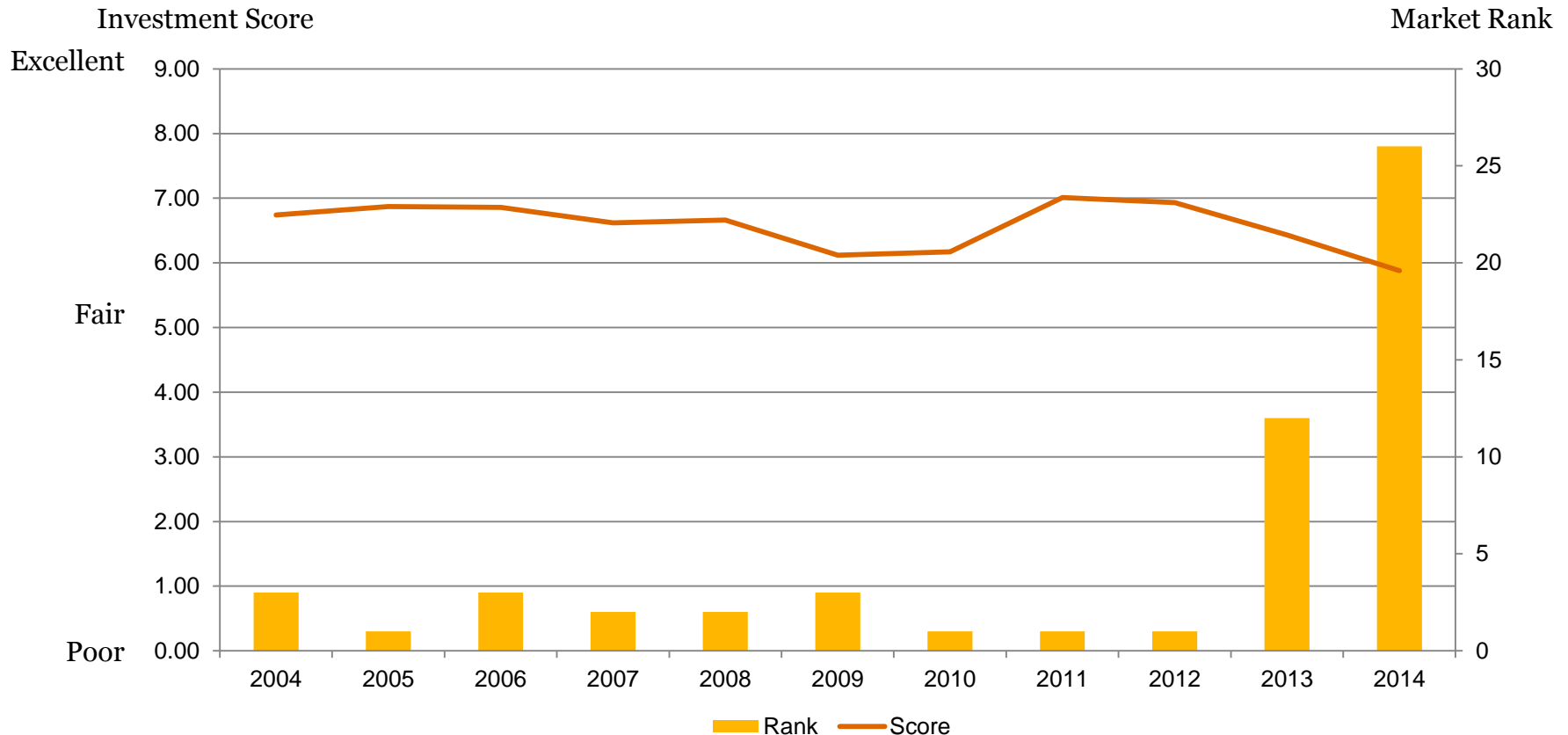


Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only



# *The impact of uncertainty*

## Impact on the outlook for Washington, DC



*The outlook for Washington, DC succumbs to fed fatigue*

Source: Emerging Trends in Real Estate surveys  
Note: Based on US respondents only

## *Top 10 investment markets*

	2014	2013	Rank Change
1. Houston	7.00	6.84	+4
2. San Francisco	6.98	7.21	-1
3. New York	6.84	7.14	-1
4. Seattle	6.83	6.72	+2
5. San Jose	6.78	6.89	-2
6. Dallas/ Fort Worth	6.76	6.47	+4
7. Austin	6.69	6.71	-
8. Boston	6.64	6.85	-4
9. Orange County, CA	6.60	6.48	-
10. Miami	6.57	6.47	+1

## *Top 10 development markets*

	2014	2013	Rank Change
<b>1. San Francisco</b>	6.88	6.87	-
<b>2. San Jose</b>	6.75	6.58	+1
<b>3. Houston</b>	6.64	6.36	+2
<b>4. New York</b>	6.58	6.76	-2
<b>5. Miami</b>	6.38	5.89	+6
<b>6. Dallas/Fort Worth</b>	6.37	6.20	+1
<b>7. Seattle</b>	6.36	6.13	-1
<b>8. Boston</b>	6.35	6.31	-2
<b>9. Minneapolis/St. Paul</b>	6.27	5.06	+16
<b>10. Austin</b>	6.25	6.40	-6

Source: Emerging Trends in Real Estate 2014 survey

Note: Based on US respondents only

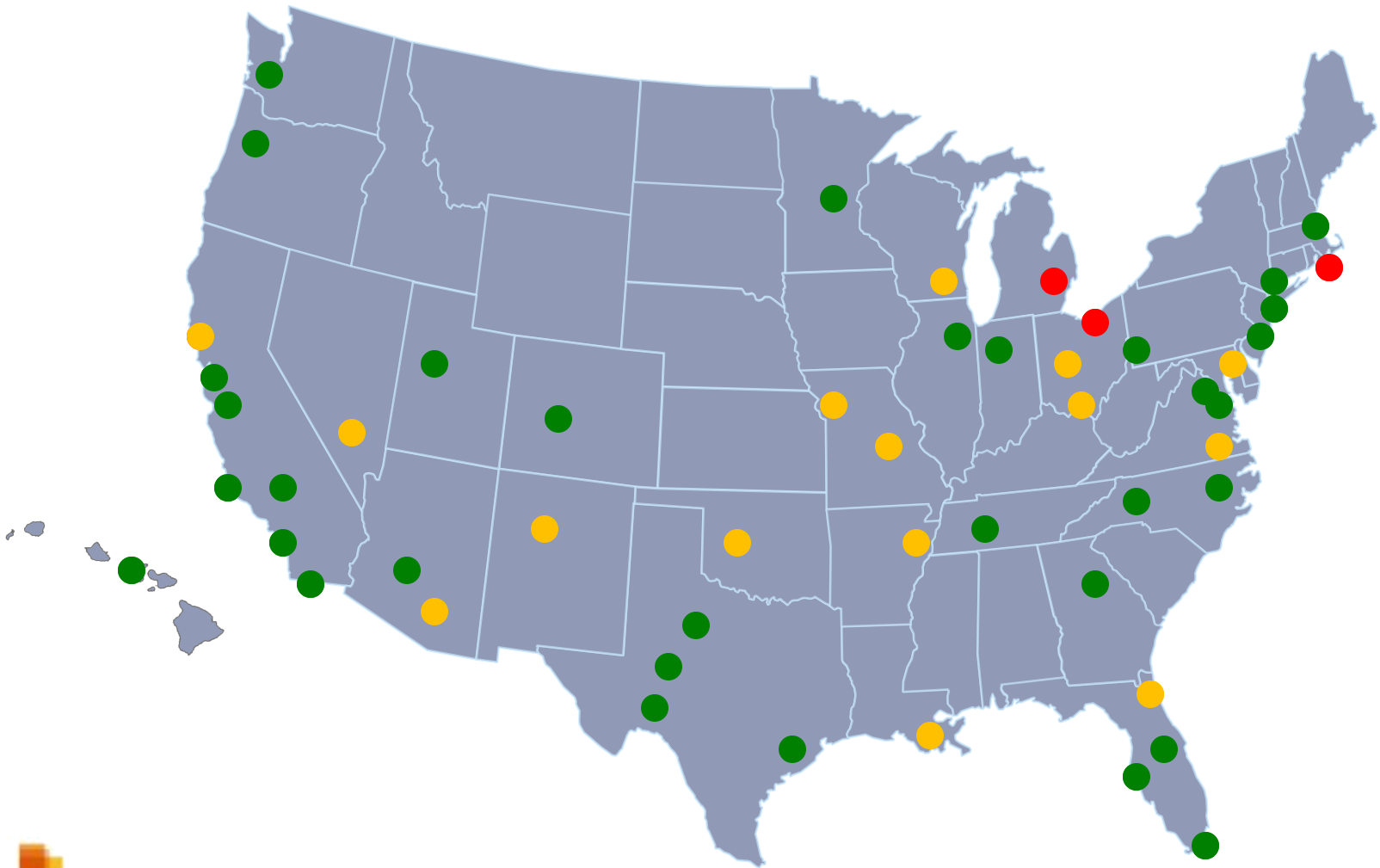
## Top 10 homebuilding markets

	2014	2013	Rank Change
1. San Francisco	7.74	6.80	-
2. Houston	7.48	6.15	+4
3. San Jose	7.40	6.58	-1
4. Dallas/Fort Worth	7.36	5.86	+6
5. Austin	7.34	6.26	-
6. New York	7.19	6.42	-3
7. Seattle	7.19	6.14	-
8. Miami	7.06	5.44	+8
9. Boston	6.87	6.05	-1
10. Orange County, CA	6.85	5.91	-1

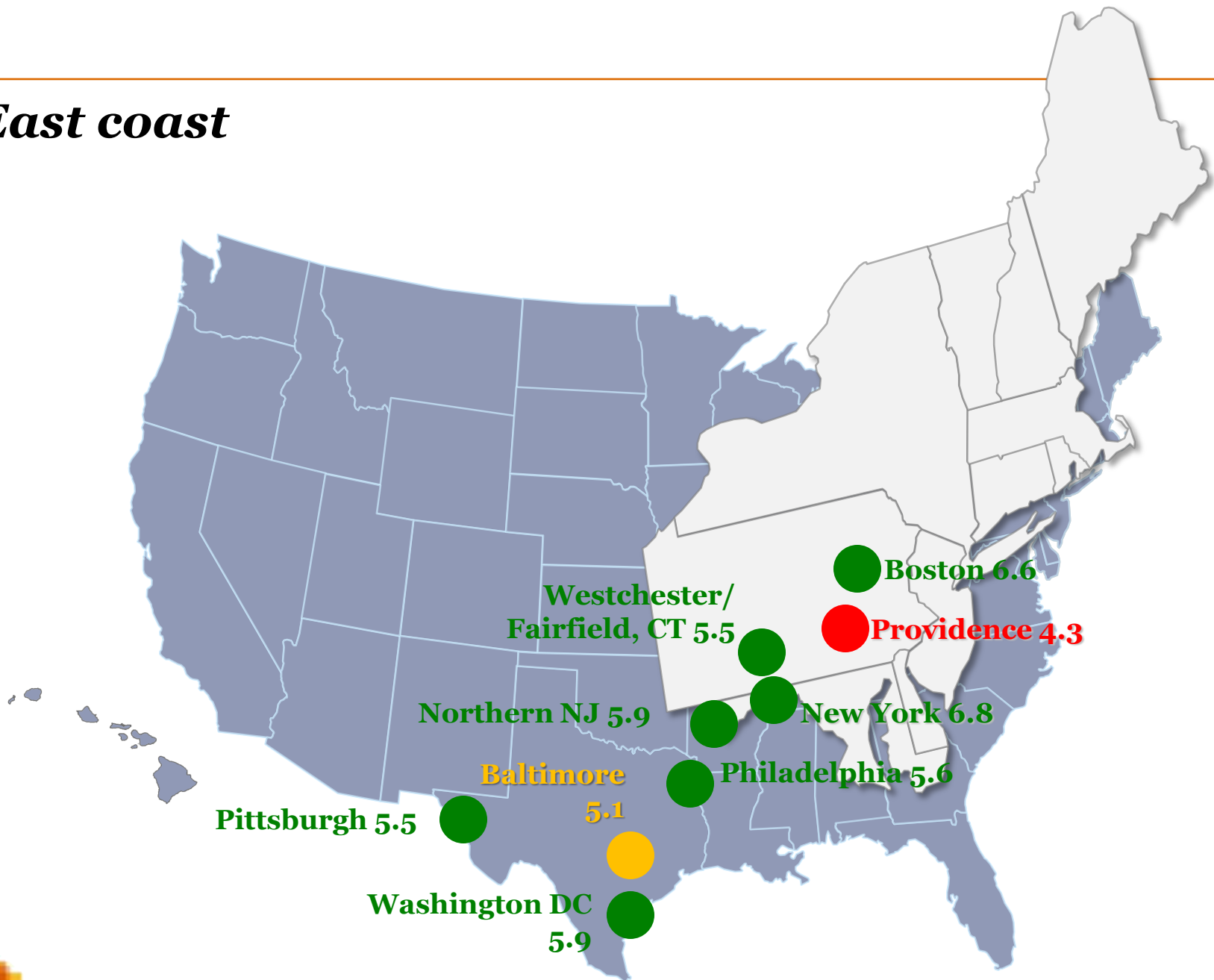
Source: Emerging Trends in Real Estate 2014 survey

Note: Based on US respondents only

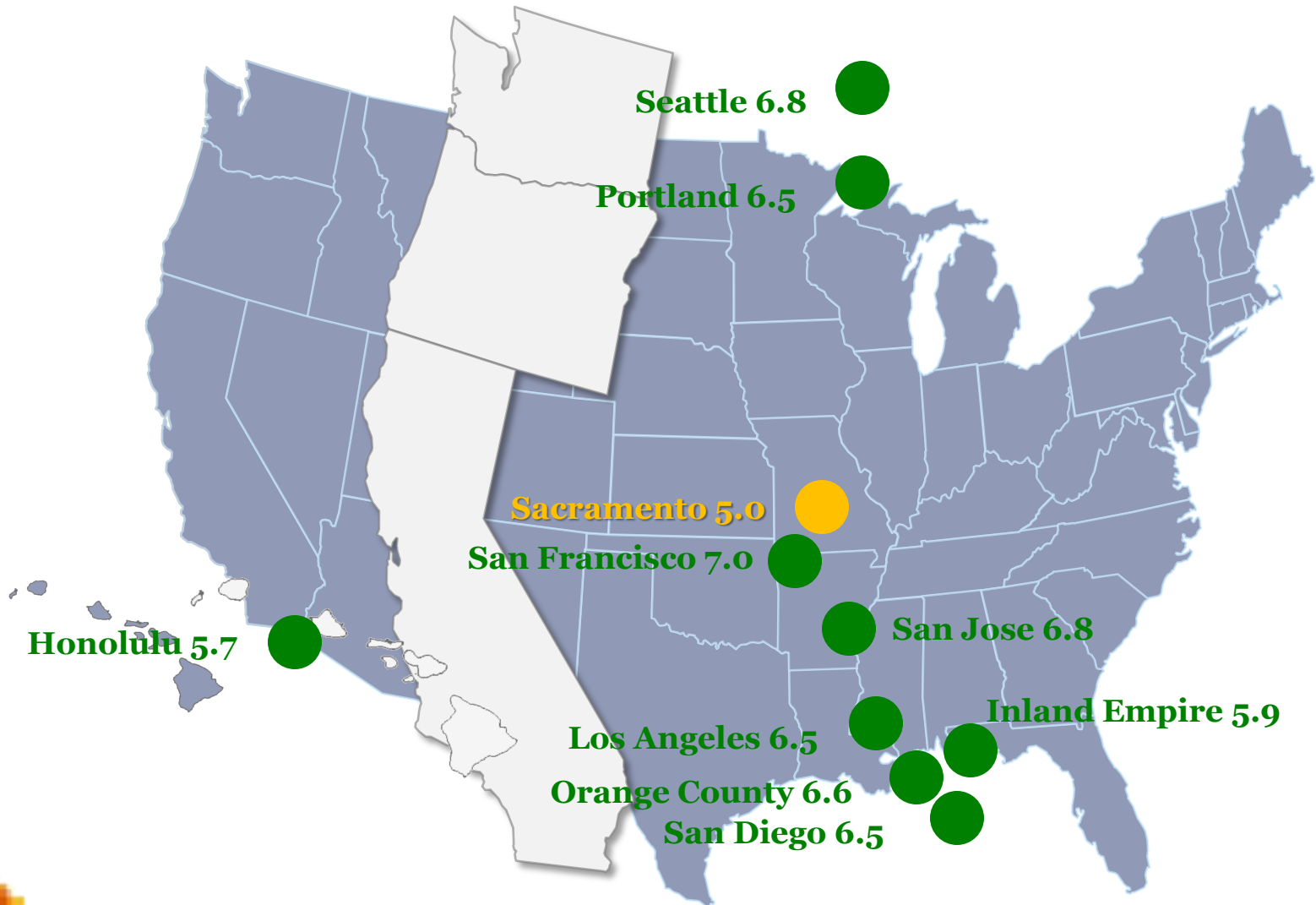
## *Markets: 2014 emerging trends*



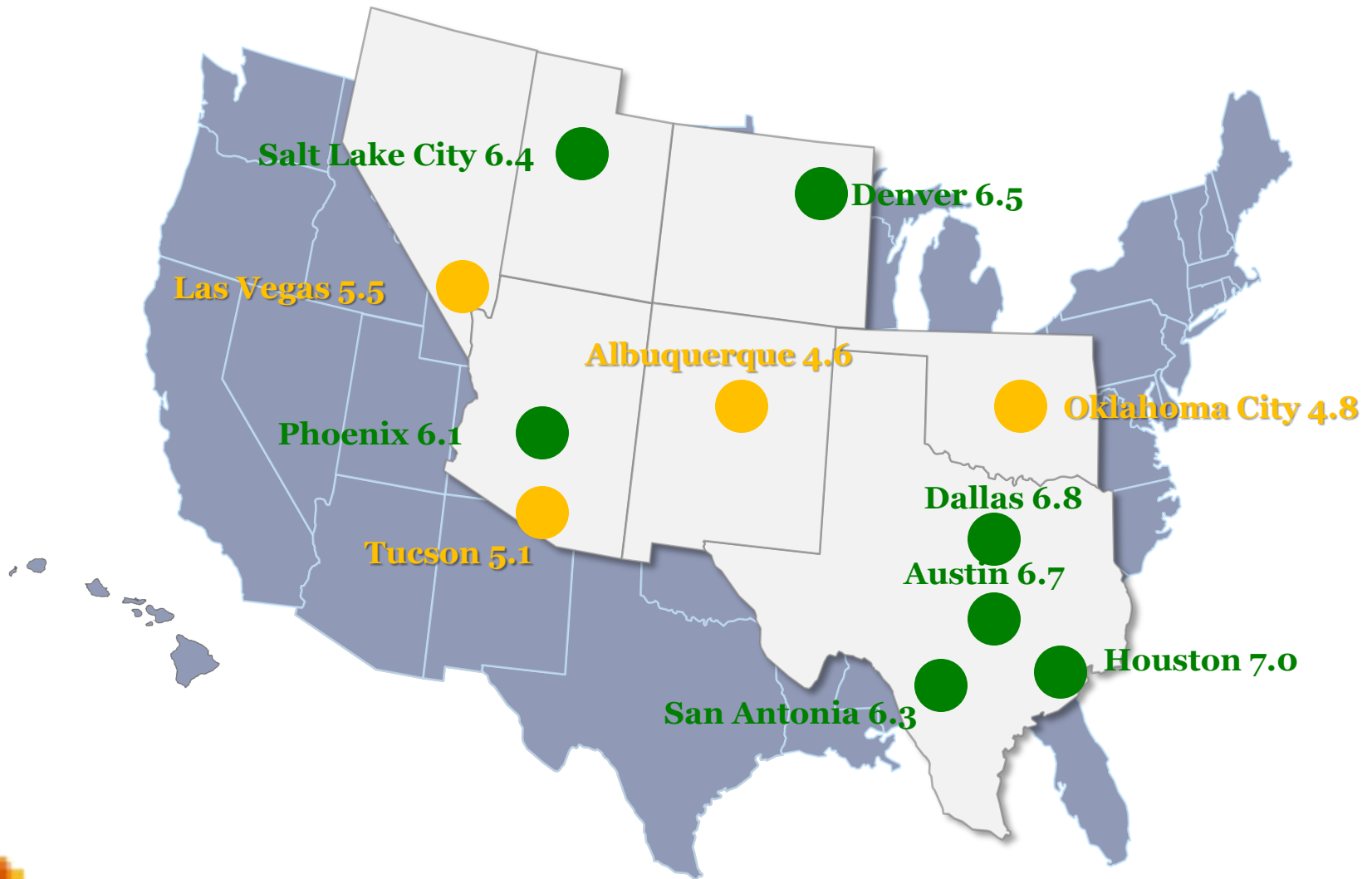
## East coast



## West coast

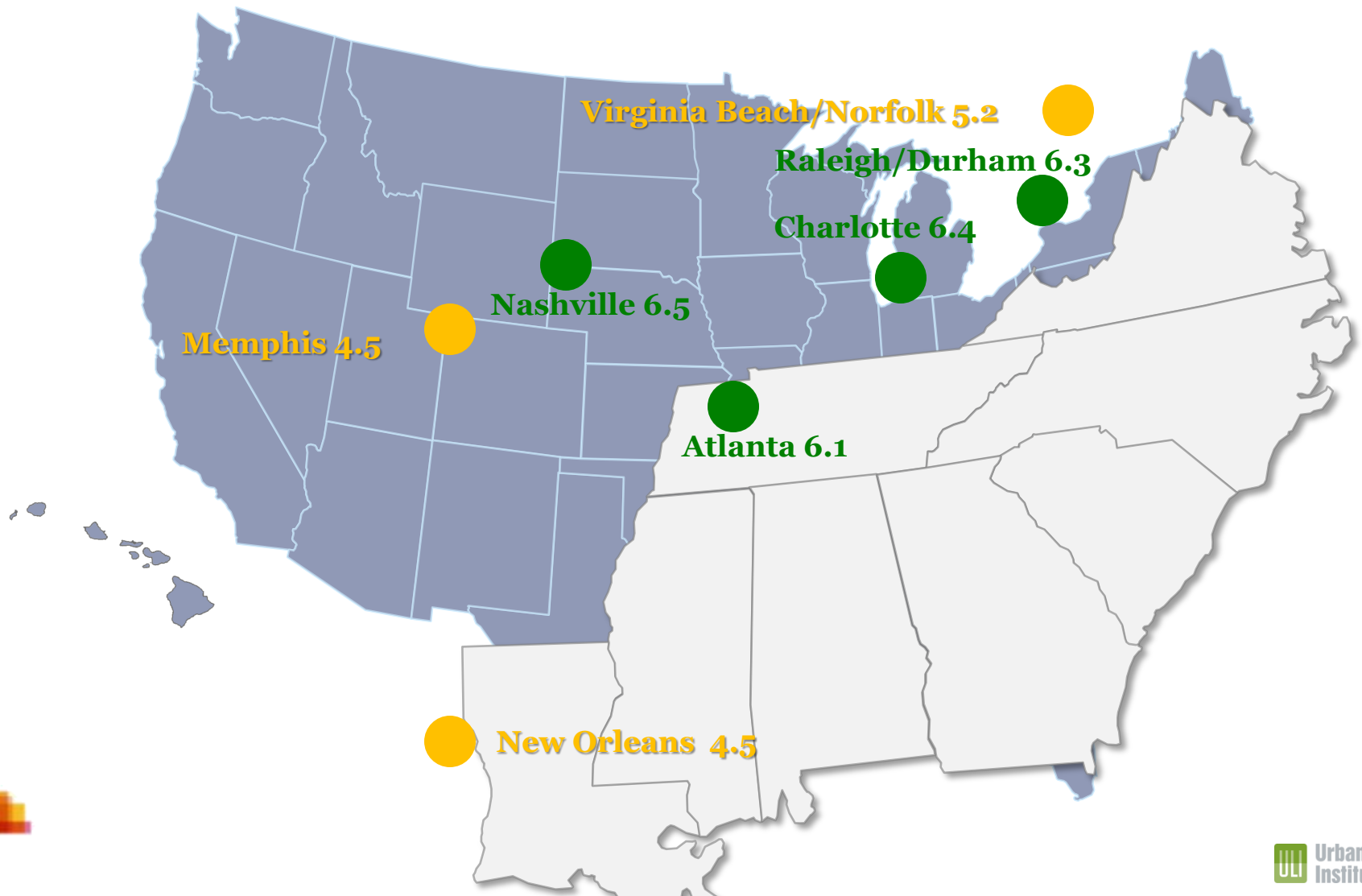


# Southwest

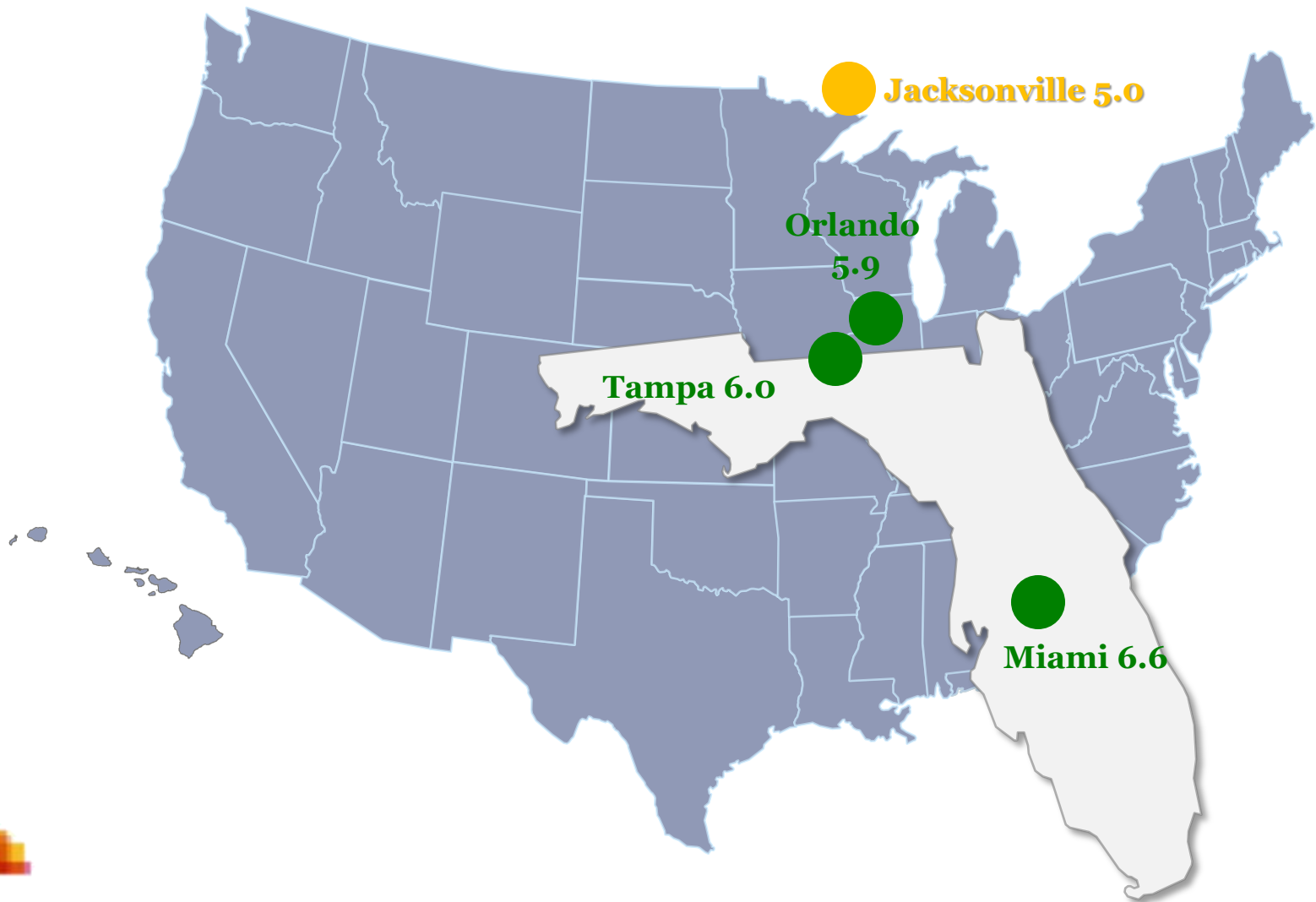




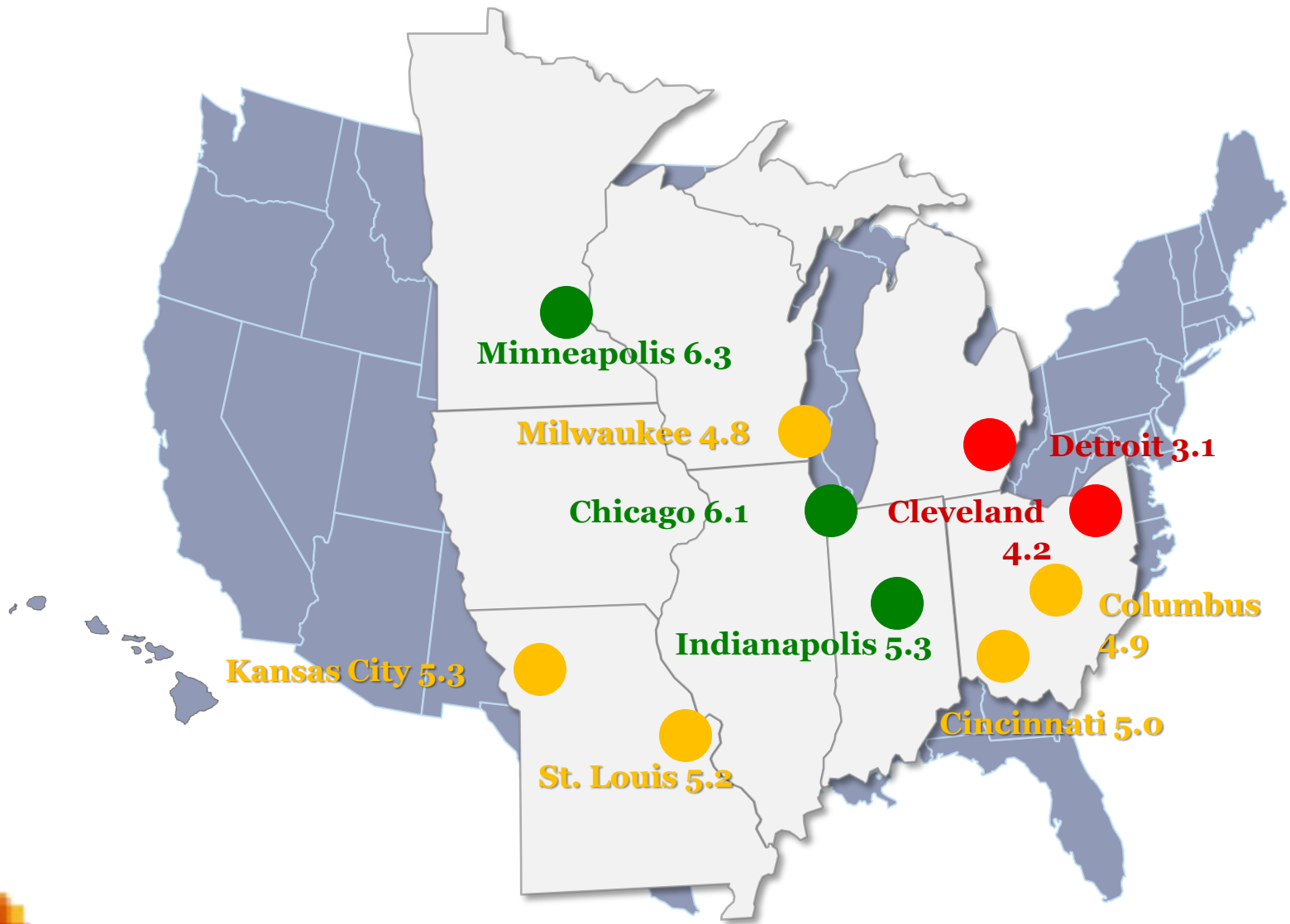
# Southeast



# Florida



# Midwest

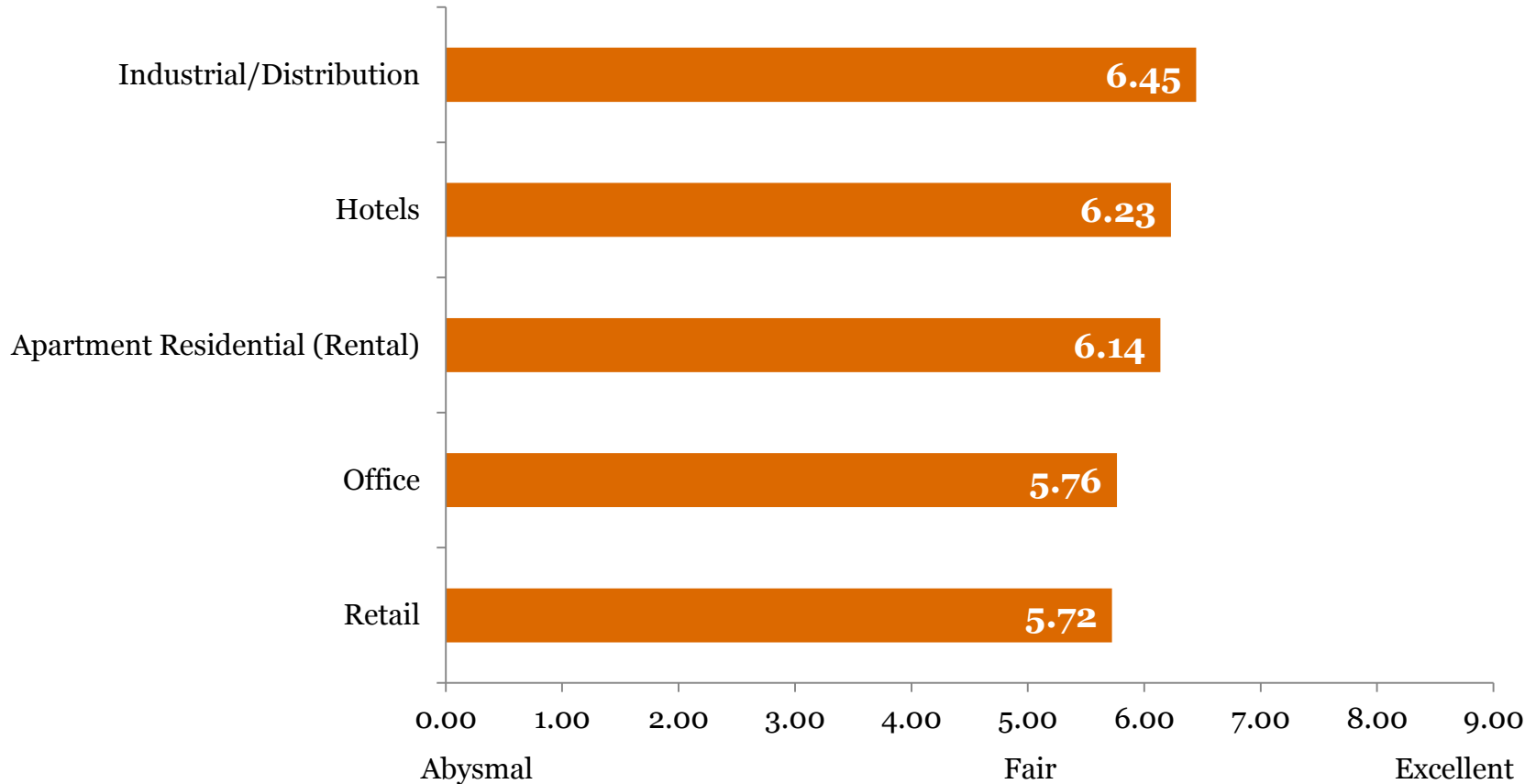


# *Property type outlook*

Industrial leads the pack

# *Industrial takes the top spot*

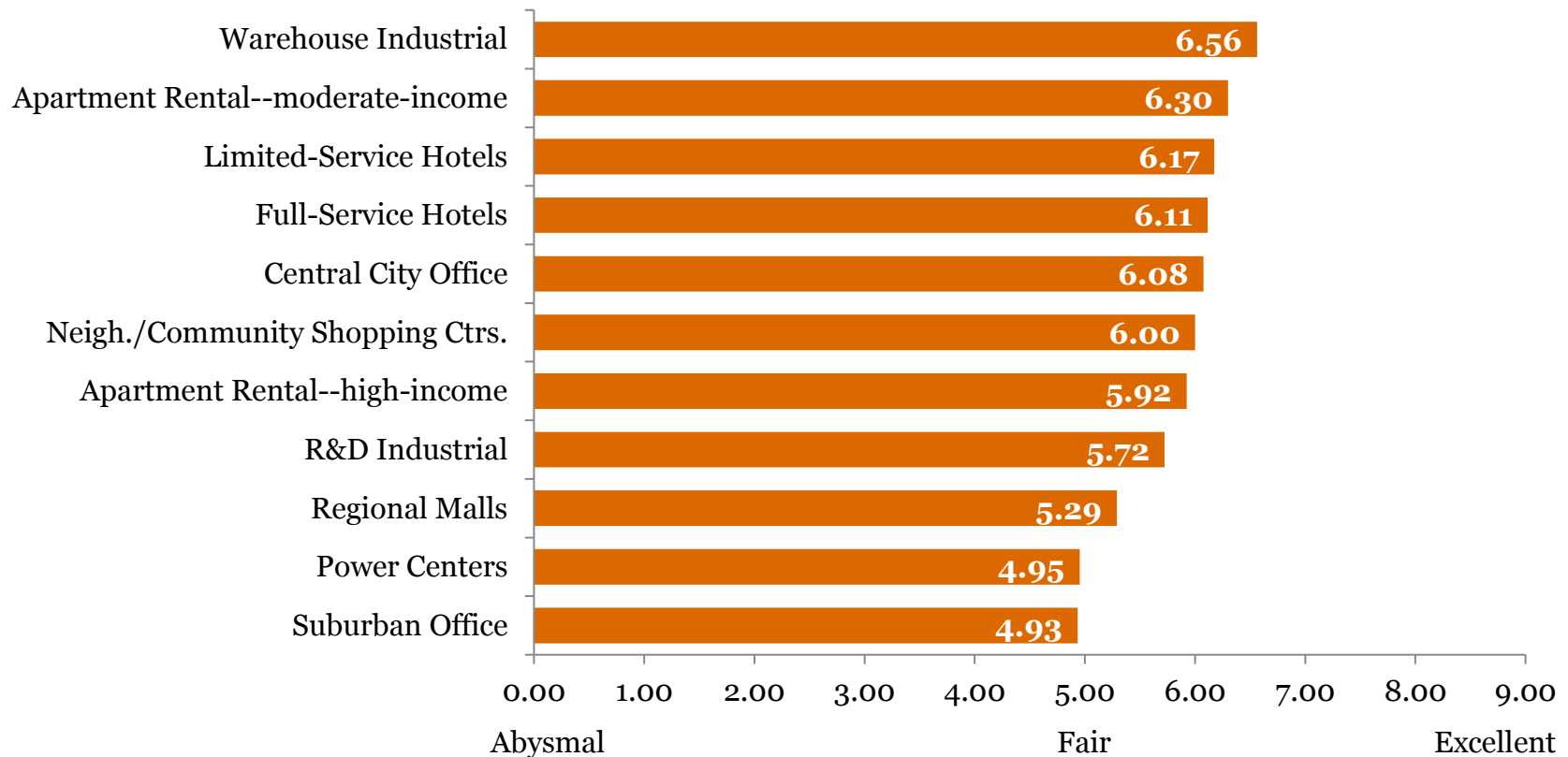
## Prospects for major commercial property types in 2014



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

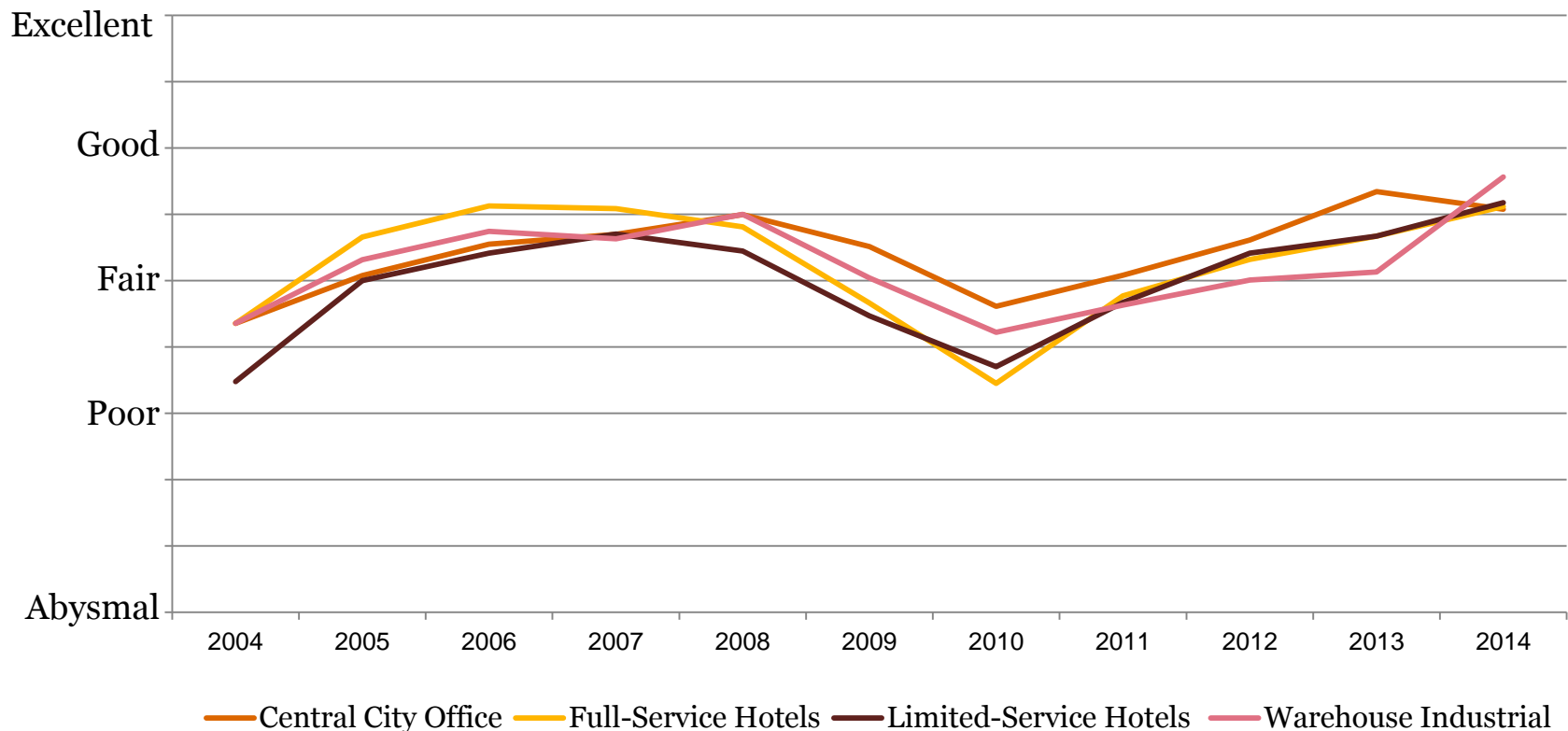
# *Subsector outlook shows diversity of recovery*

## Prospects for commercial subsectors in 2014



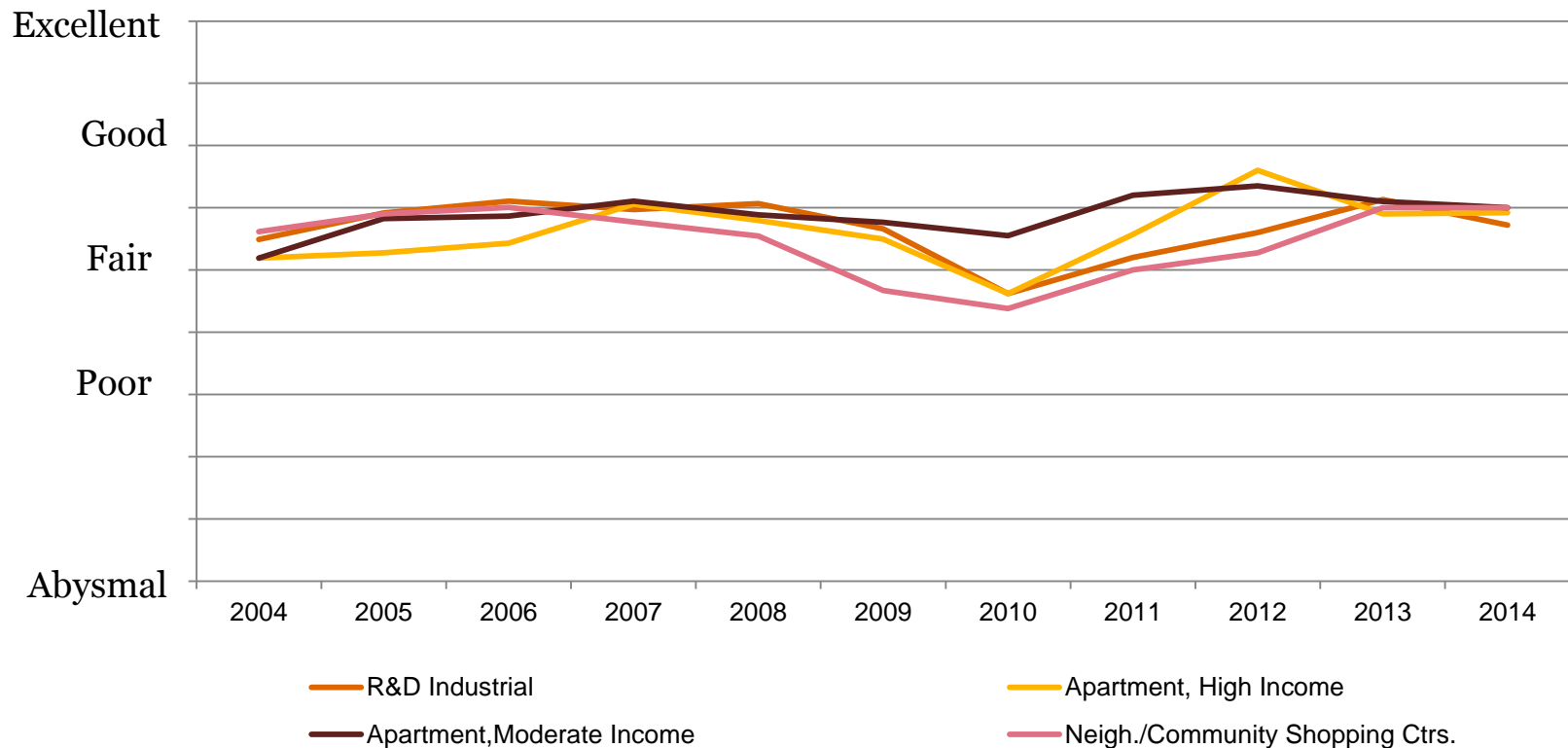
Source: Emerging Trends in Real Estate 2014 survey  
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## *Subsectors with the most promise*



Source: Emerging Trends in Real Estate surveys  
Note: Based on US respondents only

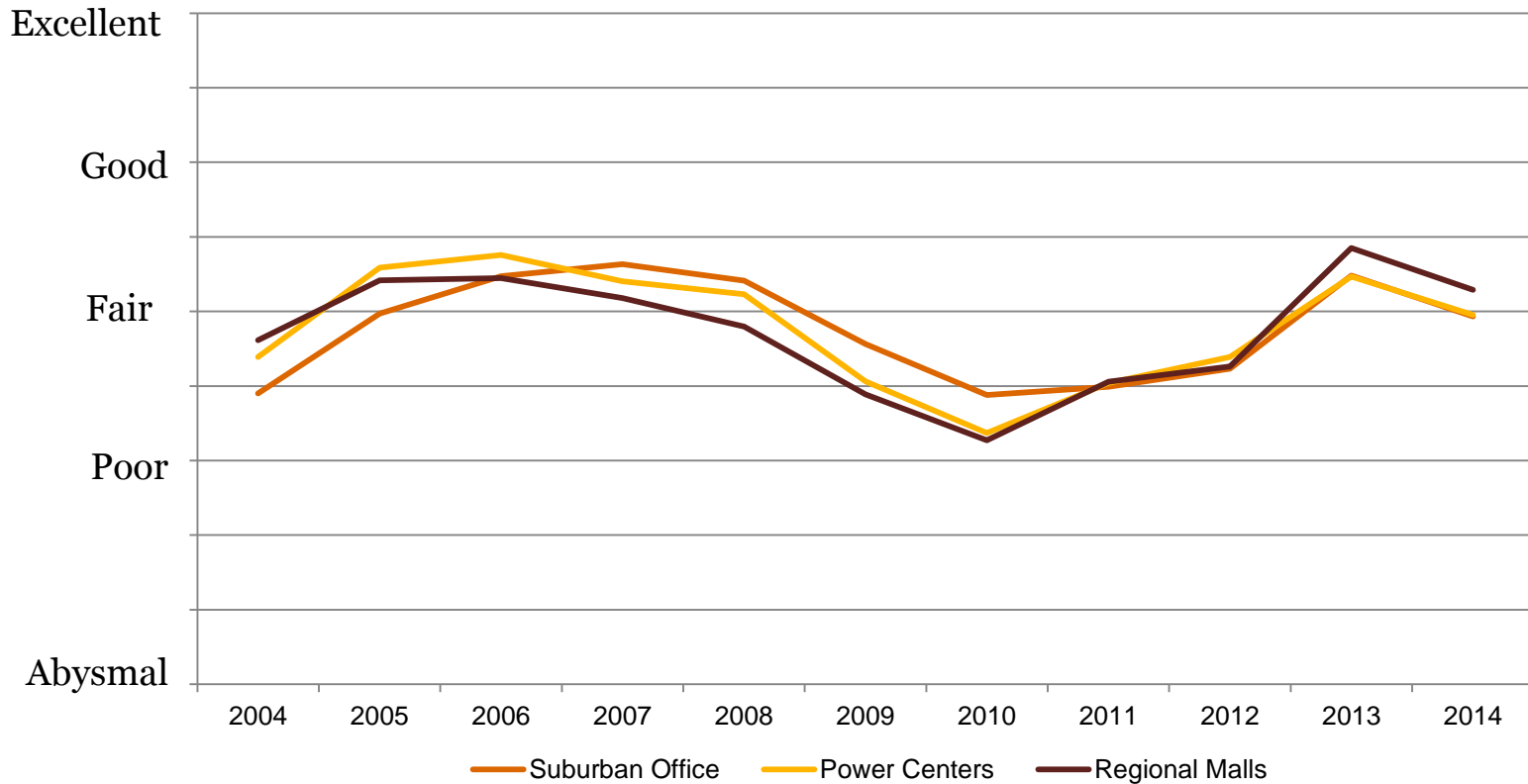
## *Middle of the pack subsectors*



Source: Emerging Trends in Real Estate surveys  
Note: Based on US respondents only



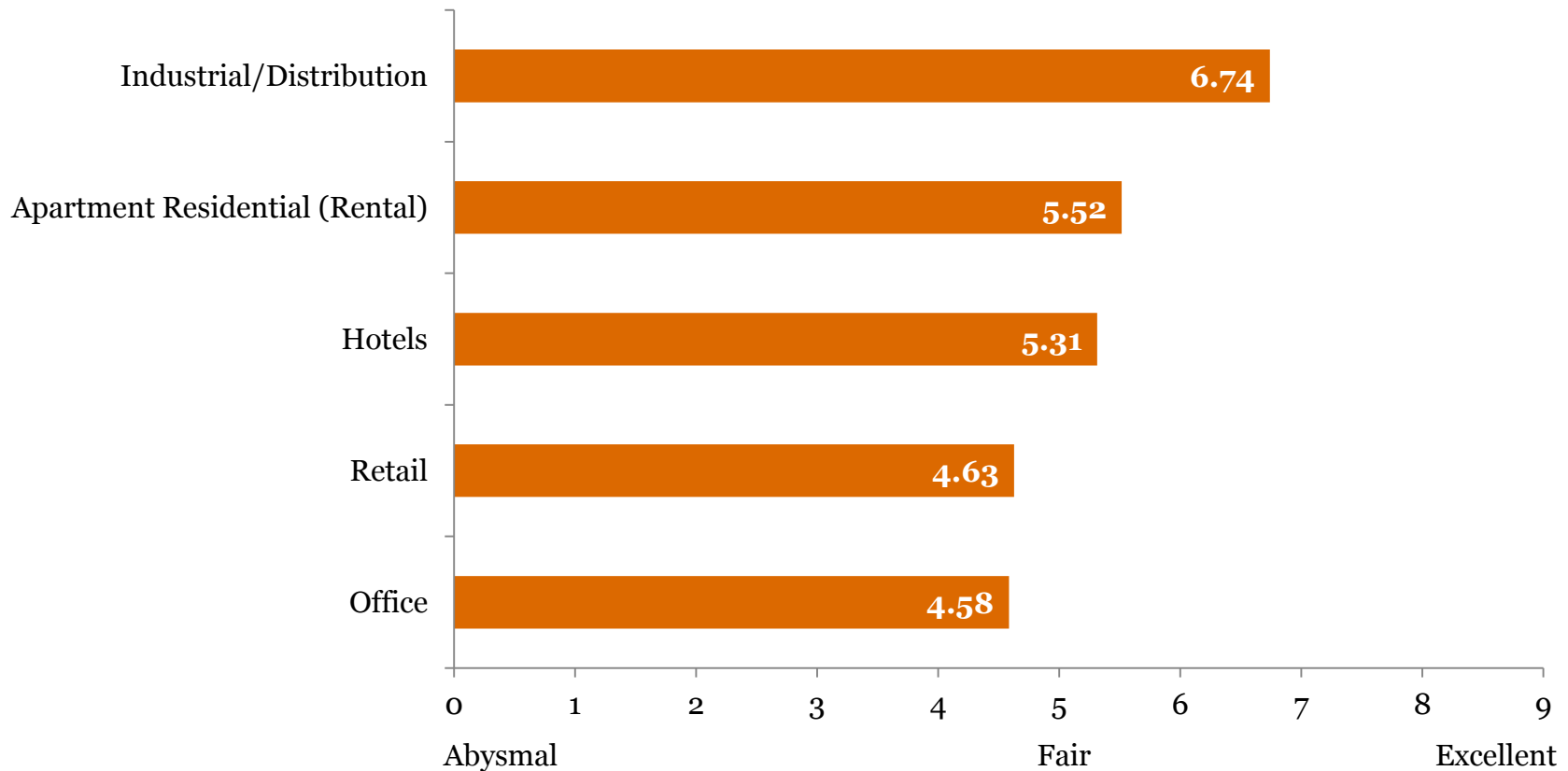
# Trailing subsectors



Source: Emerging Trends in Real Estate surveys  
Note: Based on US respondents only

# *Commercial development begins to look up*

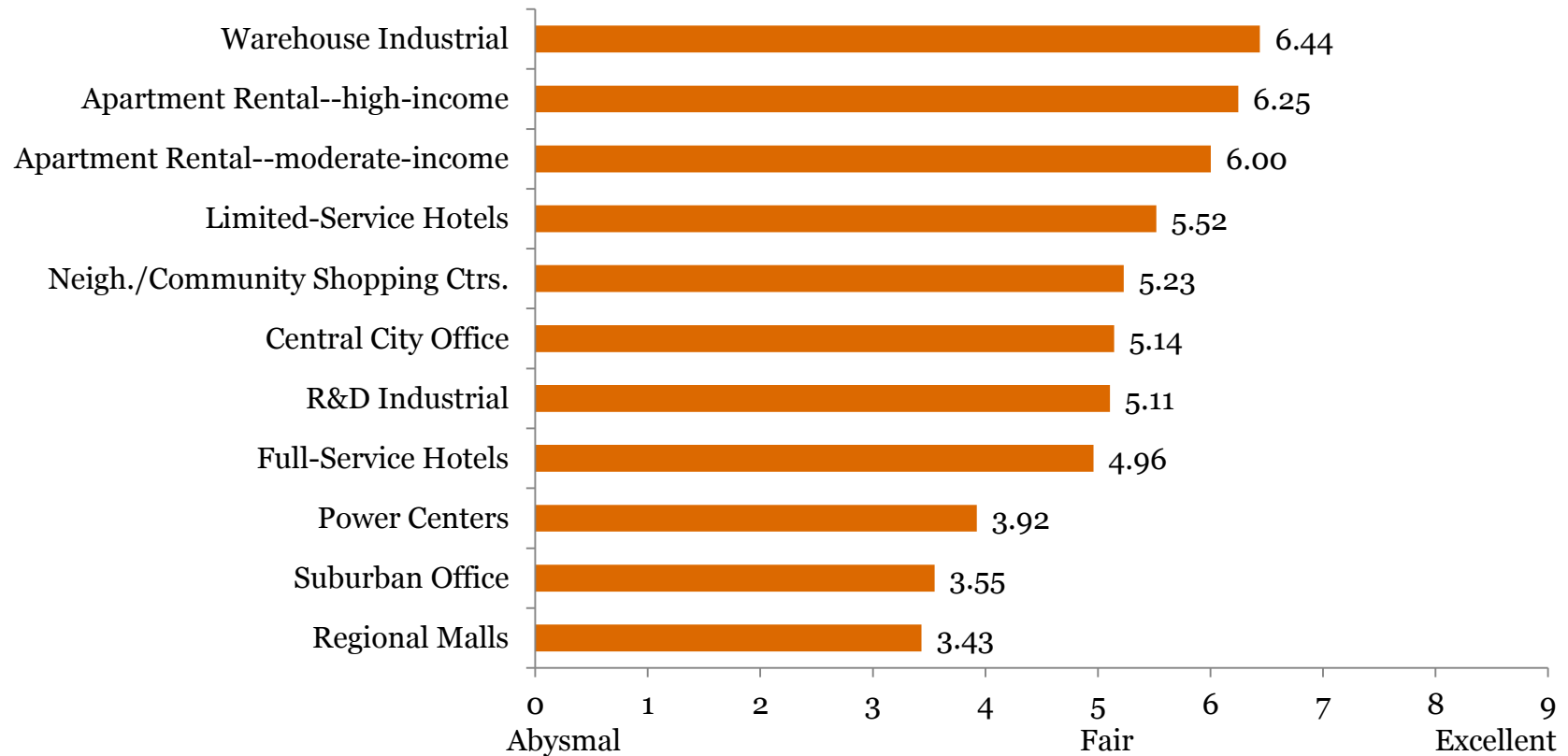
## **Prospects for major commercial property types in 2014**



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

# *Development prospects reflect where market is strongest*

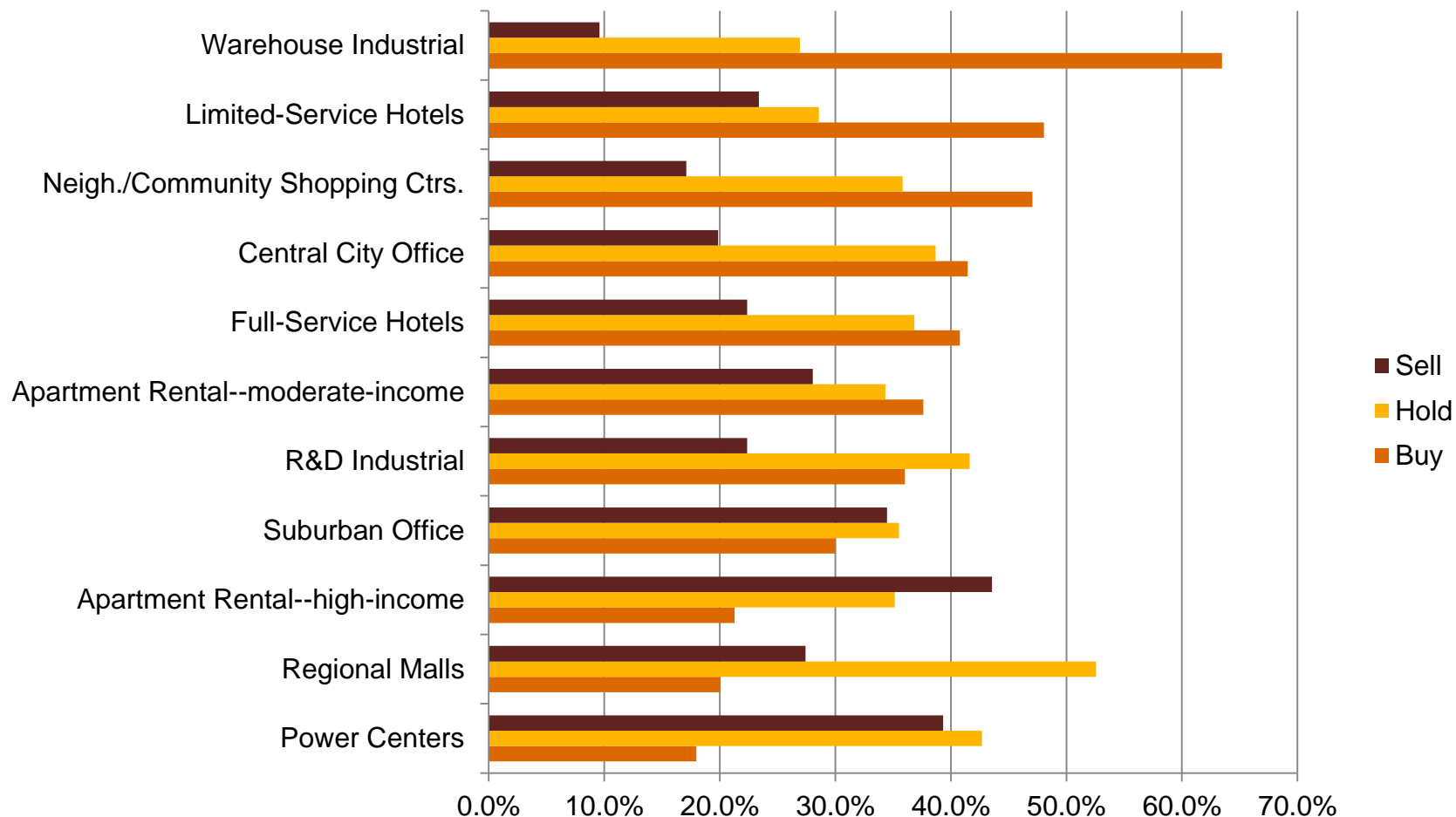
## Prospects for commercial subsectors in 2014



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only

# *Some changes in what investors want to buy*

## Investment recommendation of survey respondents



Source: Emerging Trends in Real Estate 2014 survey  
Note: Based on US respondents only



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# *Wrap up*

## Emerging Trends Scorecard: How will we do?

2014 Trend	Yes	No	?
Industry profitability continues to improve			
Interest rates rise			
More emphasis on property management and less on financial engineering			
More capital expected to be available			
Development opportunities outside of multifamily increase			
Industry changes to meet generational needs			
Needs of end users of space continue to change			
Single family home market continues to improve			