

## What's Ahead for Real Estate?

# RERC's Editorial Board Speaks Out...

Since its beginning in 1931, RERC has been recognized as one of the nation's leading independent observers of the real estate markets. As such, RERC has access to the expertise of some of the industry's foremost individuals, firms, and institutions associated with real estate investment. RERC shares some of the information offered by these experts each quarter with our readers through the *RERC Real Estate Report*.

Other research, like this information provided by members of the RERC Editorial Board, was gathered recently in one-to-one interviews by RERC's Ken Riggs. Given the uncertainty in today's market, we thought you would appreciate our Editorial Board's insight, and are pleased to offer comments from some of our members with respect to their outlook for real estate investment in 2005 and beyond.

**Ken Riggs:**

### **How do you view the economy and the investment climate for commercial real estate?**

**Charlie Grossman, ING Clarion:**

I feel less confident about the economy than I did a few months ago. The U.S. has had a very accommodative environment of growth—fiscal incentives, low interest rates, consumer spending, and recent business spending—but we are still facing headwinds.

**Dave Blankenship, AEGON:**

Despite solid employment numbers, both the known and unknown question is the employment picture. There seems to be a cyclical shift from corporate job creation to an apparently fairly robust job market in the entrepreneurial sector, which is not being reflected in the Government's employment numbers. Couple this with what appears to be a paradigm shift in the way jobs are advertised, and the employment picture is even muddier. Until the employment picture gains clarity, the commercial property sectors will move sideways.

**Glen Mueller, Legg Mason/John Hopkins University:**

We are adding approximately 2.5 million people each year in the U.S., which is equal to adding a major city each year. This is a lot of fuel for growing our economy and the commercial real estate markets.

**Sam Zell, Equity Investments:**

The economy looks solid—not outstanding, but good. The one metric we need to keep in sight is replacement costs. With the increasing cost of steel, lumber, and other commodities, replacement costs become more relevant than ever.

**Ken Riggs:**

### **How do real estate returns compare with returns for other investments?**

**Steve Graves, Principal:**

Commercial real estate is delivering historically low absolute returns, but the financial world has seen secular downward pressure on returns on most investments. We now live in a multi-asset world, and commercial real estate truly is connected to the financial markets. When you look at investments overall, today's real estate market is delivering solid risk-adjusted returns.

**Charlie Grossman, ING Clarion:**

Commercial real estate investing is all about being "relative" to the alternatives. Today, the accretive investor is winning the bids with very low return expectations—the lowest I have seen in a generation. Portfolio considerations are, to an increasing degree, explaining why some are selling while others are buying.

**Bill Ramseyer, Cornerstone:**

Real estate fits the bill as never before. Our demographics are so persuasive that they dictate in income-oriented environment, and given this relative investment climate, there is nothing on the horizon that should change this solid outlook for capital flows in the real estate markets.

**Rich Sokolov, Simon Properties:**

The REIT market is at a place that I would not have envisioned 10 years ago. Real estate offers a solid income return, coupled with a reasonably solid appreciation component—this is not too bad in today's world.

Ken Riggs, RERC:

## What can we expect from future real estate returns?

**Charles Lowrey, Prudential:**

Capital flows are as solid as I've ever seen them. In this environment, real estate is offering, on a relative basis, both attractive current yields as well as solid risk-adjusted returns. As a result, investors are finding real estate to be an attractive asset class in which to invest.

**Joe Pagliari, Citadel Realty/Northwestern University:**

If you believe that core, unleveraged real estate can deliver a real return of at least 4 percent, then real estate merits meaningful allocation in the mixed-asset portfolio. Of course, issues such as risk and transaction-cost differentials have to be included in such an analysis.

**Rich Sokolov, Simon Properties:**

If the market players are buying on the belief that prices will rise, then prices will rise—as long as there are buyers. But we will all be a lot smarter in 6 months and time will tell. Today, you want to err on the side of patience, which was not the case a year ago.

**Charlie Wurtzebach, Henderson:**

Return expectations are lower across the board. Investors will start to see fewer institutional trades as investors hold onto assets. Commercial real estate investments will continue to be scarce, especially as capital continues to chase yields and investors hunker down into a holding position for the medium to long term.

Ken Riggs, RERC:

## What advice can you offer investors?

**Sam Zell, Equity Investments:**

A post mortem of the industry in 2010 will reveal that we acted rationally, given the information and environment that we had in 2005. We are not expected to be fortune tellers, but rational investors doing the right thing for our investors. This is what we are doing today and need to continue doing—this was not necessarily the case 10 years ago.

**Glen Mueller, Legg Mason/John Hopkins University:**

The real estate market is definitely in a recovery mode and at a lower risk level than ever before seen in our generation. But even with powerful demographic forces, the demand side of the recovery will be slow, due to continued supply side risk.

**Charles Lowry, Prudential:**

Investing is all about focusing on the fundamentals—it is about blocking and tackling and gaining a yard or two here and there to reach the goal. In today's environment, there are still opportunities to invest through relationships, off-market transactions, and taking out joint venture partners—but there are no easy deals.

**Allan Sweet, AMLI:**

The costs of doing nothing where passive yields are 1 or 2 percent is very expensive. The cost of delay and the cost of waiting need to be approached very carefully. The investment world is competitive, and you have to always consider the cost of not putting your capital to work.

Thank you to all **RERC's Editorial Board** members for your various contributions and support. We appreciate your views and your commitment to the industry.

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