

RERC/CCIM

Investment Trends
Quarterly

flash report

January 2007

**A preliminary view of the upcoming complete
RERC/CCIM Investment Trends Quarterly report.**

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Dear Subscribers to the *RERC/CCIM Investment Trends Quarterly*,

As part of your subscription to this new member report, you receive this complimentary **FLASH REPORT** of preliminary data each quarter. This **FLASH REPORT** is intended to provide an early look at the national investment and transaction trends for fourth quarter 2006.

Because the information in the **FLASH REPORT** is preliminary and intended only to depict trends, please note some data may differ slightly from the final quarterly research, which is analyzed and reported in the full *RERC/CCIM Investment Trends Quarterly*. The full *RERC/CCIM Investment Trends Quarterly* will include national economic and property-associated commentary, investment criteria and transaction totals, and it will also include specific data for 48 metro markets. The full *RERC/CCIM Investment Trends Quarterly* will be available to you in February.

Thank you for your support of this publication, and please contact us at **319-352-1500** or at ccim@rerc.com with any questions or comments.

Best Regards,

Real Estate Research Corporation

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Economic Summary

- U.S. economic activity grew during fourth quarter 2006, but at a more moderate pace, according to information released in the Oct. 12, 2006 and Nov. 29, 2006 Federal Reserve Beige Books. The commercial markets improved in nearly all districts, although single-family home sales continued to decline, and home prices were lower.
- The Federal Open Market Committee left the target federal funds rate unchanged at 5.25 percent at both the Oct. 25, 2006 and Dec. 12, 2006 meetings. The rate has remained at 5.25 percent since June 29, 2006.
- Real gross domestic product (GDP) increased at a revised annual rate of 2.0 percent during third quarter 2006, according to the Bureau of Economic Analysis. Real GDP increased 2.6 percent in second quarter 2006.
- According to the Bureau of Labor Statistics, the unemployment rate for December 2006 remained at 4.5 percent.
- Consumer spending increased 0.3 percent in October 2006 and 0.5 percent in November 2006. The increase in November marked the highest rating since July 2006.
- The consumer price index decreased 0.1 percent in November 2006, which is 2.0 percent higher than that reported in November 2005.
- Corporate profits increased \$61.5 billion in third quarter 2006, compared with an increase of \$22.7 billion during second quarter, according to the Bureau of Economic Analysis.

National Transactions by Property Type (preliminary data as of 12/31/2006)						
	Office	Industrial	Retail	Apartment	Hotel	Total
Volume \$ (Mil)	\$172,132	\$44,414	\$65,618	\$107,351	\$35,866	\$425,381
Unit Price						
Average	\$172	\$84	\$177	\$109,193	\$111,863	-
Median	\$139	\$67	\$126	\$87,500	\$82,776	-
RERC Estimated Capitalization Rate						
Range	4.7 - 10.3	5 - 10.6	4.7 - 10.1	3.9 - 9.5	6.2 - 12	3.9 - 12
Average	7.2	7.4	7.0	6.3	8.8	7.4
Unit prices based on data derived from samples of commercial transactions on local, regional and national levels. Capitalization rates based upon available transaction information, survey respondents and NCREIF Index Returns. Source: RERC. Content cannot be duplicated or reproduced without expressed written consent of RERC.						

RERC Required Return Expectations¹ by Property Type

	Office		Industrial			Retail			Apartment	Hotel
	CBD	Suburban	Warehouse	R&D	Flex	Regional Mall	Power Center	Neigh/Comm		
Pre-tax Yield (IRR) (%)										
Range	7.3 - 11	7.5 - 11	7.3 - 11	7.5 - 11	7.3 - 11	6.8 - 10	7.3 - 10	7.3 - 10	7 - 10	8 - 11.5
Average ²	8.7	9.3	8.6	9.1	9.0	8.4	8.6	8.5	8.4	10.3
Going-In Cap Rate (%)										
Range	6 - 9	6.5 - 9	6 - 9	6.5 - 9	6.3 - 9	5.5 - 7.5	6 - 7.5	6 - 7.5	5.5 - 7.3	6.5 - 9.5
Average ²	7	7.6	7.1	7.6	7.4	6.7	6.8	6.8	6.2	8.2
Terminal Cap Rate (%)										
Range	6.5 - 10	7 - 10	6.8 - 10	7 - 10	6.8 - 10	6.3 - 8	6.5 - 8	6.5 - 8	6.5 - 8	7 - 10.5
Average ²	7.6	8.3	7.7	8.3	8.1	7.4	7.5	7.5	7	9
Rental Growth (%)										
Range	0 - 4	0 - 4.5	0 - 4	0 - 4.5	0 - 3.3	2 - 3.5	2 - 3	2 - 3	2 - 5	2.5 - 4
Average ²	3	3.1	2.5	2.5	2.3	2.8	2.6	2.6	3.3	3.1
Expense Growth (%)										
Range	0 - 3.5	0 - 3.5	0 - 3.5	0 - 3.5	0 - 3	0 - 3.5	0 - 3.5	0 - 3.5	0 - 3.5	0 - 3.3
Average ²	2.7	2.7	2.6	2.5	2.3	2.6	2.7	2.7	2.6	2.4

1 This survey was conducted in October, November and December 2006 and reflects expected returns for Fourth Quarter 2006 investments.

2 Ranges and other data reflect the central tendencies of respondents: unusually high and low responses have been eliminated.

Source: RERC Investment Survey

Expected Leasing Assumptions, Marketing & Holding, and Investment Recommendations

	Renewal Prob. (%)	Time to Release (months)	Vacancy Loss (%)	Marketing Time (months)	Holding Period (years)	Buy (%)	Sell (%)	Hold (%)
Office - CBD	71.3	6.2	6.2	8.0	9.9	15	15	70
Office - Suburban	69.0	7.0	7.1	7.4	9.5	67	0	33
Industrial - Warehouse	71.8	6.9	6.7	6.9	9.5	30	20	50
Industrial - R&D	67.8	7.8	7.9	7.7	9.3	13	50	37
Industrial - Flex	69.5	7.4	7.6	8.2	9.3	0	29	71
Retail - Regional Mall	72.8	6.6	5.7	8.1	10.0	0	33	67
Retail - Power Center	73.0	6.8	5.2	7.9	10.0	0	38	62
Retail - Neighborhood	72.8	6.3	5.4	7.2	9.9	0	15	85
Apartment	65.9	4.1	5.7	6.6	10.0	27	18	55
Hotel	N/A	N/A	N/A	8.8	9.4	14	43	43
All Types	70.4	6.6	6.4	7.7	9.7	17	26	57

Risk of overbuilding rated: 1 = no risk to 10 = high risk

Source: RERC Investment Survey, 4Q 2006

Real Estate Highlights

- The commercial real estate market continues to fare much better than the residential real estate market, according to the Nov. 29, 2006 Federal Reserve Beige Book. Demand for office space is increasing generally in all districts.
- Along with record levels of investment, the commercial real estate market is seeing continued improvement in fundamentals, especially in the office and industrial sectors, reports the National Association of REALTORS®.
- RERC's fourth quarter 2006 preliminary required going-in and terminal capitalization rate estimates are trending upward for office and industrial properties over third quarter ratings. Preliminary capitalization rates are trending down slightly for retail properties, while apartment rates are generally steady. Preliminary capitalization rates are down 30 to 40 basis points for hotels. (RERC's final fourth quarter 2006 required going-in and terminal capitalization rates will be available in the full first quarter *RERC/CCIM Investment Trends Quarterly* in mid-February 2007.)
- As the number of pending home sales continues to level off, the National Association of REALTORS® suggests that the housing sector as a whole is reaching a level of stability. The Pending Home Sales Index fell 1.7 percent in October to 107.2, which is 13.2 percent lower than a year ago. This decline marks the third consecutive month of falling rates, indicating a narrowing in the number of homes being sold and purchased. Existing home sales are expected to increase during 2007, but at a much slower rate than in recent years.
- According to several reports, fewer people took out home equity loans or applied for first-home mortgages during fourth quarter 2006 as compared to third quarter.

National Market Preliminary Analysis - 4Q 2006				
RERC Price vs. Risk Assessment				
Office	Strong Upside	Newark	Nashville	Miami
	Fully Priced	Minneapolis	Austin	Chicago
Industrial	Strong Upside	Newark	Miami	Tampa
	Fully Priced	Pittsburgh	Atlanta	Detroit
Retail	Strong Upside	Newark	Nashville	Las Vegas
	Fully Priced	Columbus	Cincinnati	New York
Apartment	Strong Upside	Pittsburgh	Memphis	Cincinnati
	Fully Priced	San Francisco	New York	Honolulu
Hotel	Strong Upside	Omaha	Richmond	Portland
	Fully Priced	New York	Washington, D.C.	Baltimore
*Relative earnings are based on RERC's economic cashflow forecast. Market risk assessment is based on a measure of the average sale price vs. relative earnings among the 40 markets RERC tracks each quarter.				

TRAILING 12-MONTH TRANSACTIONS AS OF 12/31/06					
	Office \$/SF	Industrial \$/SF	Retail \$/SF	Apartment \$/Unit	Hotel \$/Unit
East Region					
Baltimore	\$136	\$72	\$126	\$97,702	\$205,542
Boston	\$173	\$87	\$148	\$181,185	\$132,671
Charlotte	\$145	\$54	\$110	\$53,158	\$40,362
Hartford	\$105	\$50	\$114	\$68,913	\$66,640
New York	\$342	\$121	\$367	\$178,395	\$268,690
Newark	\$163	\$90	\$176	\$93,950	\$89,961
Philadelphia	\$135	\$56	\$132	\$77,283	\$102,577
Pittsburgh	\$104	\$66	\$182	\$48,970	\$84,841
Richmond	\$105	\$59	\$149	\$68,919	\$37,205
Washington, D.C.	\$283	\$117	\$260	\$125,079	\$212,217
East Total	\$202	\$74	\$186	\$138,721	\$139,742
Midwest Region					
Chicago	\$140	\$65	\$168	\$100,092	\$131,938
Cincinnati	\$87	\$42	\$102	\$39,207	\$29,311
Cleveland	\$101	\$40	\$104	\$38,177	\$64,104
Columbus	\$94	\$41	\$137	\$46,508	\$52,719
Detroit	\$153	\$51	\$177	\$52,864	\$54,084
Indianapolis	\$102	\$51	\$153	\$59,899	\$101,071
Kansas City	\$100	\$60	\$143	\$53,493	\$37,453
Minneapolis	\$133	\$58	\$168	\$94,622	\$87,801
Omaha	\$128	\$32	\$96	\$73,451	\$18,369
St. Louis	\$141	\$52	\$177	\$69,901	\$46,498
Midwest Total	\$113	\$48	\$132	\$80,911	\$81,768
South Region					
Atlanta	\$134	\$54	\$156	\$54,397	\$66,483
Austin	\$126	\$106	\$166	\$61,972	\$150,645
Dallas/Ft. Worth	\$118	\$49	\$117	\$51,762	\$106,987
Houston	\$96	\$50	\$145	\$61,702	\$57,228
Memphis	\$78	\$44	\$121	\$40,066	\$50,281
Miami	\$177	\$82	\$188	\$109,971	\$112,068
Nashville	\$105	\$58	\$112	\$59,148	\$107,903
Orlando	\$156	\$69	\$170	\$126,457	\$80,031
San Antonio	\$86	\$48	\$110	\$67,764	\$57,079
Tampa	\$137	\$74	\$140	\$85,218	\$95,360
South Total	\$130	\$64	\$140	\$79,292	\$91,248
West Region					
Denver	\$122	\$78	\$146	\$69,023	\$65,102
Honolulu	\$221	\$139	\$400	\$174,126	\$216,253
Las Vegas	\$238	\$142	\$214	\$78,732	\$64,791
Los Angeles	\$225	\$127	\$233	\$147,195	\$125,239
Phoenix	\$158	\$95	\$196	\$76,223	\$103,410
Portland	\$142	\$102	\$196	\$71,265	\$62,789
Salt Lake City	\$105	\$59	\$130	\$71,939	\$88,686
San Diego	\$227	\$153	\$263	\$156,157	\$136,045
San Francisco	\$252	\$131	\$237	\$190,941	\$149,765
Seattle	\$199	\$112	\$179	\$127,247	\$95,684
West Total	\$181	\$110	\$200	\$132,269	\$103,182

Scope and Methodology

Report Methodology

The RERC Real Estate Investment Survey summarizes the required rates of return (ex ante), property selection criteria, and investment outlook of a representative sample of large institutional investors and regional respondents throughout the United States. We survey both regional and institutional investors across the nation quarterly, questioning them on specific investment criteria in their local marketplace and trends across the country. The results are collected, averaged, and then displaced in our quarterly report.

Published quarterly, the data provides timely insight into yields, return criteria, and risk adjustments that institutional investors rely on when making acquisitions. The survey data is used by investors, developers, appraisers, and financial institutions to monitor changing market conditions and to forecast financial performance.

Findings reflect ex-ante required returns, or goals, of investors contemplating acquisitions. Thus, the RERC survey acts as a barometer of current market perceptions and confidence among the nation's top professionals.

Sales transactions were analyzed by and are reported on by RERC. Information about individual transactions was provided by CCIM members, RERC contacts in the market place, and various public resources.

RERC Definitions

Basis Point Spread (bps): The difference between the yield (as defined) and an alternative investment with a comparable life (10-Year Treasuries, Moody's Baa, Moody's Aaa).

Going-In (Overall) Capitalization Rate: Going-in capitalization rate is usually defined as the first year NOI (before capital items of tenant improvements and leasing commissions and debt service but after real estate taxes) divided by present value (or purchase price).

Pre-tax Yield (IRR, Discount Rate): The pre-tax yield is the rate of interest that discounts the pre-income tax cash flows received on an unleveraged investment back to a present value that is exactly equal to the amount of the original equity investment. (It is in effect a time-weighted average return on equity and, as used here, is synonymous with the term "yield.")

RERC Estimate vs. Survey Rates: In addition to the survey responses (survey rates) that RERC receives and analyzes each quarter, RERC also developed a model that incorporates unemployment, vacancy rates, and other financial and space market data. This modeled information, combined with the data received from the survey responses, is the RERC Estimate.

RERC Portfolio Index (RPI): The RPI is RERC's required return utilizing a weighted average based on the NCREIF Property Index.

Reserves: Amount allocated for periodic replacement of long-lived building components during a property's economic life.

Terminal (Residual) Capitalization Rate: Terminal cap rate is the rate used to estimate resale or reversion value at the end of the holding period. Typically, it is the NOI in the year following the last year of the holding period that is capitalized. Similar to the going-in capitalization rate, but applied at the end of the holding investment period.

NCREIF

The National Council of Real Estate Investment Fiduciaries (NCREIF) is a non-profit organization dedicated to the compilation and distribution of performance data for the institutional real estate market.

Total Return: includes appreciation (or depreciation), realized capital gain (or loss) and income. It is computed by adding the Income and Capital Appreciation return on a quarterly basis.

Implied Cap Rate (Income Return): measures the portion of total return attributable to each property's net operating income (NOI). It is computed by dividing the NOI by the average quarterly investment.

Capital Appreciation Return: measures the change in market value adjusted for any capital improvements/expenditures and partial sales divided by the average quarterly investment.

Annual and Annualized Returns: are computed by chain linking quarterly rates of return to produce time-weighted rates of return for the annual and annualized periods under study. For time periods beyond one year, the annualized returns are expressed as an average (geometric) return per year.

For a detailed description of the proceeding returns as well as the calculations used by NCREIF to derive these figures, please visit <http://www.ncreif.org/indices/>

The combined returns are the weighted average of the returns for each property type according to the proportionate market value of properties surveyed relative to the total market values surveyed during a time period.

RERC Defined Regions

West: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming

Midwest: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin

South: Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, Oklahoma, Tennessee, Texas

East: Connecticut, Delaware, Kentucky, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, Washington D.C., West Virginia

Note of Caution: It is imperative to exercise caution when interpreting required rates of return. RERC national return data shows a normal range of expected returns from all categories of investment-grade properties. Obviously, properties with greater investment risk will be at the high end of the scale. Rates obtained from this survey are not directly applicable to non-investment grade properties.

We also note that investors generally strive to achieve a diversified portfolio; this motivation partially explains the variation in IRR requirements. Ranges and other data reflect the central tendencies of respondents, and unusually high and low responses have been eliminated.

Your Involvement Is Needed To Make the *RERC/CCIM Investment Trends Quarterly* A Success...

A few of you have already expressed interest in providing assistance in the report development process. We welcome your support in a variety of ways:

- ❑ Faithfully enter your transaction information into the online CCIM Transactions database. The more raw data we have, the more viable our research and analysis will be (and the more useful to you). Click <http://transactions.ccim.com/> to share your information with the CCIM Institute.
- ❑ Serve as a contact for your area. There may be times we will need to follow up on a transaction that took place in your area. If we could call on you to help provide leads or contacts for tracking down information, this would help a great deal.
- ❑ Share data or published reports on transactions or trends in your region.
- ❑ Offer to provide insight on your market, either by telephone interview or by writing a short description of market conditions.
- ❑ Encourage CCIM candidates to subscribe to this research report! At only \$189/year for CCIM candidates, the *RERC/CCIM Investment Trends Quarterly* is an excellent research value.

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