



SummerStreetAdvisors

**Balancing Capital Supply
with Space Demand**

October 2, 2014

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Investment Capital Focusing on Real Estate

- Foreign capital flowing into U.S. with low current yield requirement
- Cap rates are already low by historical standards
- In many markets, rents and occupancy rates are just starting to rise

How great is the danger that supply rather than demand will drive the market?

Those Who Forget History....

1988-1990

- Unprecedented levels of institutional investment in real estate
- Influx of foreign investment with acceptance of low going-in yields
- Wave of spec development financed at +100% of cost—developers took zero risk
- To fill space, deals with anchor tenants approach zero net effective rent
- Tenants take more space than they need because it's so cheap

When the bubble burst, properties traded for half their replacement cost.

What's Different in Today's Market

- Very little spec development
- Tenants take only enough space to meet current needs
- Equity co-investment required from operating partners
- Public REITs provide discipline of daily market trading

These factors help maintain market balance, but capital supply is still a concern to watch.

Ideal Market Conditions

Availability of Capital

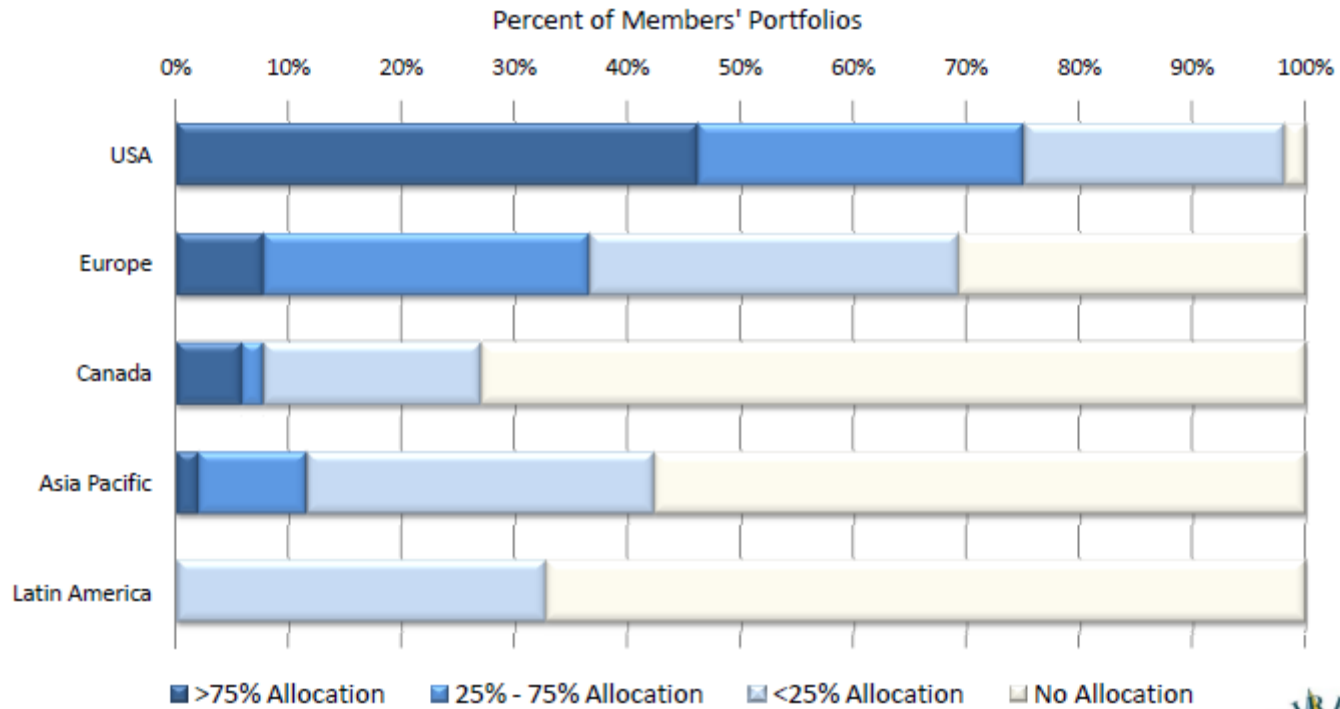
Growth in Demand for Space



“Wall of Money”

- \$210 billion global investment volume in Q4 2013
 - Surpassed the previous peak in 2007
- Q1 2014 Americas investment reached \$62 billion, up 63% over 2013 (JLL report)
- Property funds raised more than \$50 billion globally in new money in 2013 (CBRE report)
 - Up from \$36 billion in 2012

Real Estate Portfolio Geographic Distribution



WISCONSIN
SCHOOL OF BUSINESS

JAMES A.
GRAASKAMP CENTER
for
REAL ESTATE

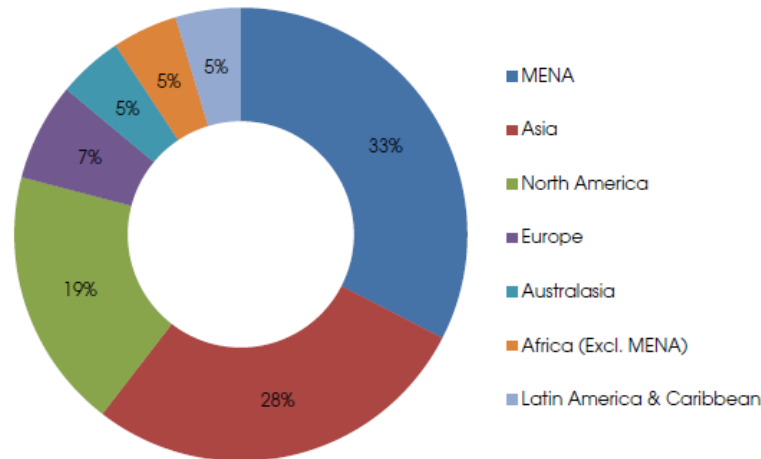


Investment Forecast

- 2014 global volume will increase to \$650 billion, a 20% jump over 2013 (JLL)
 - U.S. is getting the most attention by far
- Asian insurance companies will increase U.S. investment by 58% from 2013-2018 (CBRE)
 - \$75 billion net increase in investment over five years

Sovereign Wealth Funds

- Total assets exceed \$5.1 trillion
 - Real estate allocation currently at \$180 billion, about 4% of total
 - U.S. investment now at about \$60 billion could double in two years
 - U.S. is a “safe haven” at a time of worldwide turmoil



Source: 2014 Preqin Sovereign Wealth Fund Review

Breakdown of Sovereign Wealth Funds Investing in Real Estate

Yields

- Many SWFs and other foreign investors seek capital preservation over yield
 - Offering prices at current yields close to zero
- U.S. pension funds seeking going-in yields of 4-5%

The most aggressive bidder sets the price – what is the impact of low-yield investors on the market?

Property Values

- Prime office values rose 8.2 percent year-over-year
- Yield compression as high as 30 bps in Chicago and 20 bps in Boston (JLL)
- NAREIM member consensus: Rising interest rate environment is the top concern
 - Interest rate rise would either increase cap rates (reduce values) or tighten the spread

Office Space Supply and Demand

- U.S. net absorption totaled 13.9 MSF in Q2 2014, the best quarter since the recession (JLL)
- Leasing levels are up 6.2 percent and national vacancy rates fell 30 bps in Q2
- Year-over-year rent growth at 3.7 percent
- 47 MSF of new development completions over 12 months
- Construction volume up 38% over year-end 2013 levels to 65.4 MSF in Q2 2014
- Spec development under way in San Francisco, San Jose, Boston, Austin, New York, Houston

Is supply keeping up with demand? Is it in danger of exceeding demand?

Example: Chicago

- Average CBD office rent increased 6.9% over 12 months but still below 2007 peak (Colliers report)
- Vacancy rates of 13.4% have fallen by 60 bps in 12 months
- Net absorption of 365,000 in H1 2014
- 33 large contiguous blocks of space currently on market
- Largest new tenant, Google, occupies renovated space outside the CBD
- Several office developments including two all-spec projects are approved to break ground this year

How much is development driven by demand? How much is driven by supply of capital?

Discussion Points

- Based on what we can see today, how concerned should we be about the strong supply of capital?
- What factors are most important in deciding whether markets are in balance?
- What's the likelihood that a recession will occur, and what would be the impact on yields and values if a recession did occur?
- Will capital sources be able to pull back if markets get overheated?