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JOBS: THE DRIVER OF REAL ESTATE DEMAND

FALL 2010 NEWSLETTER

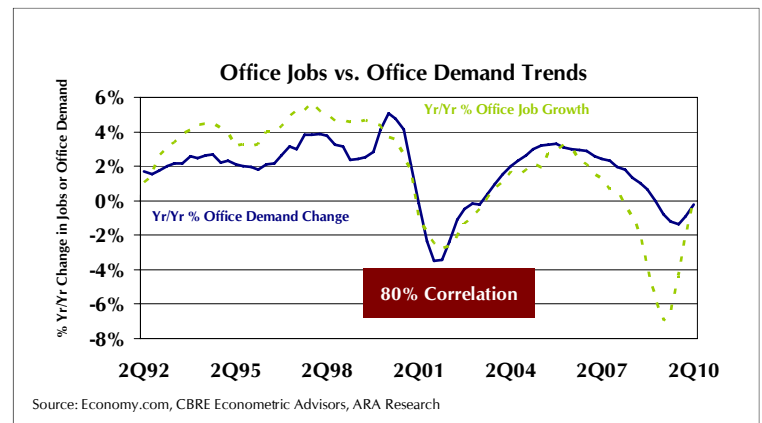
In this newsletter, we examine the relationship between employment trends and tenant demand for commercial real estate. In addition, we will set out realistic expectations regarding future trends for both of these factors, including a strategy for investing and leasing given the uncertainty in the job market. In addressing these issues, we will focus on the following key questions:

1. What is the historical relationship between jobs and real estate demand, and how are these trends anticipated to play out going forward?
2. On a relative basis, what segments of the job market are likely to be the primary drivers of future demand growth and what types of real estate are likely to benefit from these trends?
3. Compared to the past, which metros are expected to offer better employment driven improvements in real estate investment opportunities versus historical trends?
4. How should a real estate investor position a portfolio, given what lies ahead?

HISTORICAL RELATIONSHIP BETWEEN JOBS AND REAL ESTATE DEMAND

The relationship of jobs to commercial real estate demand has historically been strong, as employers need buildings to site employees and the goods with which they work. This means that as employment levels improve, the demand for all types of real estate is expected to improve as well. For example, with office assets, growth in office jobs creates an increase in office space demand.

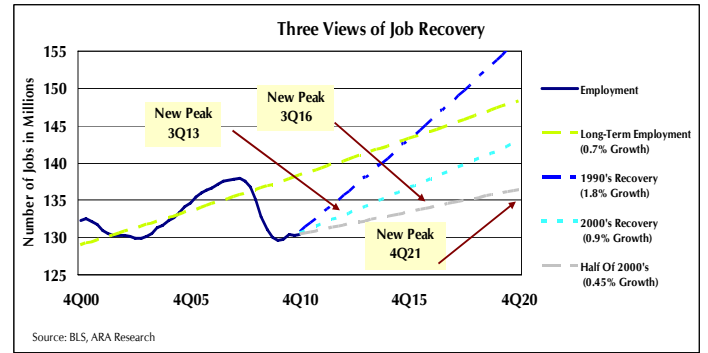
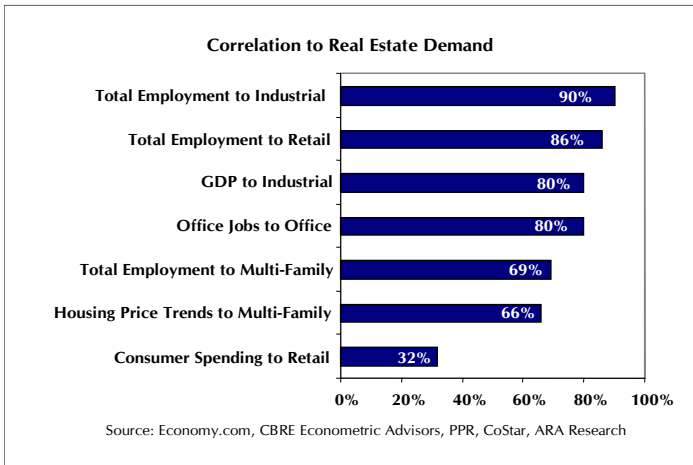
As employment levels expand, these new employees will help fuel the demand for other real estate sectors, via direct spending in the retail sector, the increased need for rental housing and the increased need to store goods used by the industrial sector. Statistically, this relationship of jobs to real estate demand is very strong at a 69% to 90% correlation. While other factors such as housing price trends in the multi-family sector or GDP in the industrial sector influence real estate demand, oftentimes these factors are related to what is happening in the local job market, which means that strength in the employment market is essential to a strong commercial real estate market.



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means of comparison, prior recessions typically achieved a new employment peak within two to four years, while this recession is projected to take double this time period.

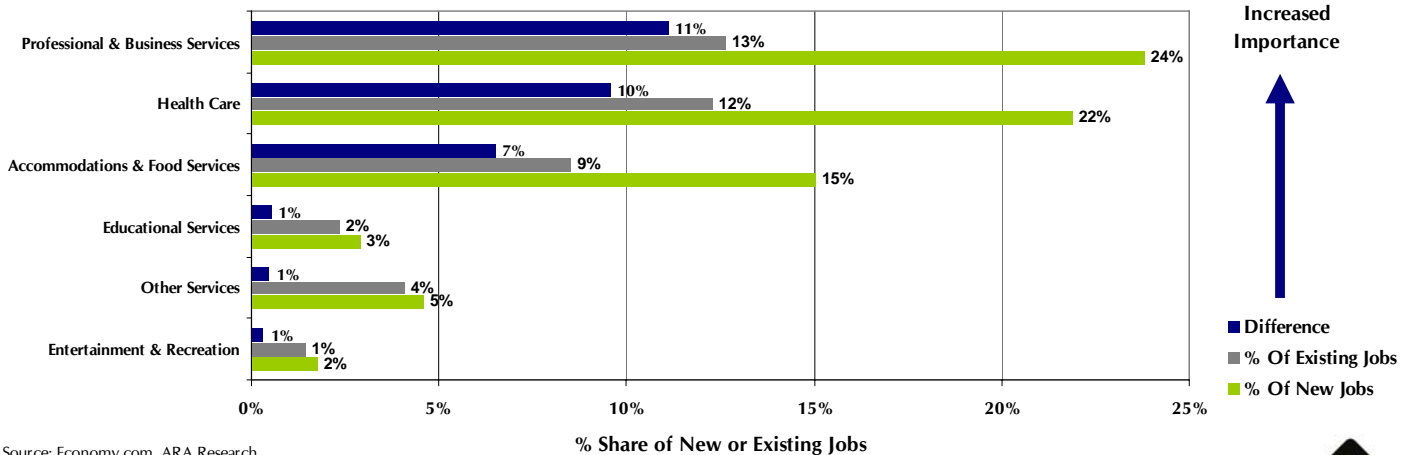
While employment recoveries are typically driven by a broad base of employment growth, we expect Professional and Business Services such as Legal, Consulting and Technology service providers to drive one quarter of all new job growth in the 2011-2013 period. Similarly, Health Care should provide an additional quarter of the new jobs, as the demographics of an aging population continue to drive demand for these services. For core real estate investors, this means the demand for office space should show reasonable strength, provided the economy exhibits steady growth. Supporting this view, a recent industry survey of returns suggested that while returns by property sectors are likely to be similar, the office sector was identified as likely to slightly exceed market averages during the next five years. Due to long-term leases, total returns for the office sector, however, should be below average for the next year or two.

For real estate investors, the strong relationship between jobs and real estate demand means that once the economy stages a rebound in employment, growth in real estate demand is likely to follow.

SO WHAT IS THE FORECAST?

Because the recession has been particularly hard on employment, with job losses more than double that of prior recessions, we expect that the recovery will be prolonged. In particular, the job market is not likely to hit a new peak in many markets until sometime between 2013 and 2016, first in the stronger growth and more diversified markets, with weaker growth and some single-industry dominant markets lagging. A case could be made for even slower projected growth, considering that since the recession ended in June 2009, the rate of job growth is only half of what was achieved during the recovery in the 2000's at a comparable point in time. If this worst case scenario for anticipated employment growth were to hold true, it would be 2021 before a new peak in employment would be reached. As a

Employment Sectors Likely to Lead Growth

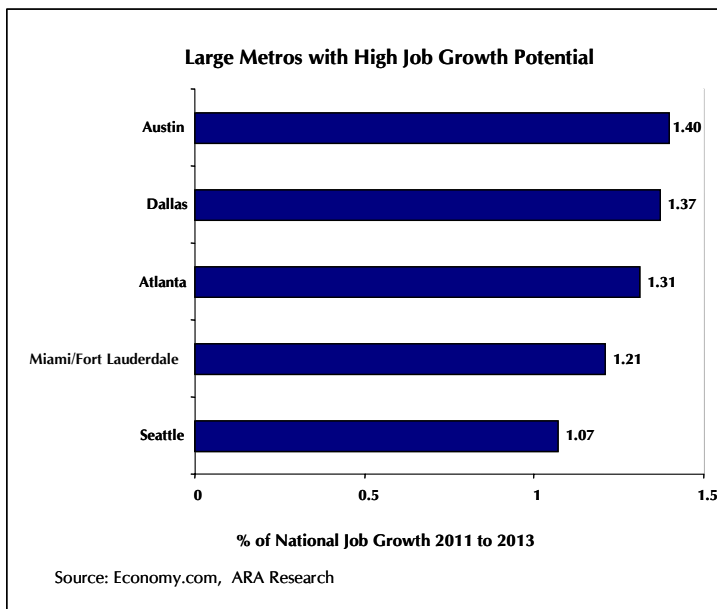


Mature Metros Likely To Show Gains vs. High Growth Metros			
	Forecast Job Growth as % of National 2011 to 2013	Historical Average Job Growth as % of National	Change
Los Angeles/Orange County	100%	42%	58%
Chicago	95%	51%	44%
San Francisco Bay Area	98%	55%	43%
New York/Northern New Jersey	76%	48%	28%
Philadelphia	91%	63%	28%
Boston	81%	58%	24%
Houston	143%	129%	14%

Source: Economy.com, ARA Research

WHICH METROS LOOK STRONGER?

The mature supply constrained major markets as a group are expected to see some improvement relative to historical averages. For example, markets such as Los Angeles, Chicago, San Francisco, New York and Boston, which typically achieve only 50% of the national job growth rate, should achieve job growth rates at 90% of the national rate over the 2011 to 2013 period. For our investors, investment strategies focused to these markets are likely to experience improving real estate demand fundamentals relative to what has been historically reported. Additionally, we have identified Austin, Dallas, Atlanta, Miami/Fort Lauderdale and Seattle as metros (see graph) that can likely attain above-average growth rates for the 2011 to 2013 period.



SUGGESTED INVESTMENT STRATEGY

While the strong relationship of job changes to real estate tenant demand is well demonstrated, accurate forecasts of employment trends are difficult to make, especially at market inflection points. Due to this risk, our suggested strategy is to do the following:

- **Focus on locations that have an above-average long-run occupancy rate in all market cycles, as having strong demand growth with uncontrolled supply will not support above-average returns due to high vacancy rates.** Supporting this strategy, our studies have shown that investments in these high occupancy markets typically average 1% to 2% higher returns than the market average, as a 1% to 3% higher occupancy rate normally results in higher than average rent growth, as well as higher than average Net Operating Income growth.
- **Purchase investments that are reasonably priced versus long-run trends.** It is important to pay careful attention to the price paid, as the correlation between the price paid and the achieved return has traditionally been high, especially for assets held for a short period of time.

SUGGESTED LEASING STRATEGY

Our suggested leasing strategy is focused on reducing occupancy risk over the next two to three years as the economy is recovering and is not likely to be very strong. As such, American favors three to five-year leases, as well as blend and extend leases, as opposed to properties that have long-term leases that are locked into low pricing due to the recession or worse, risking vacancy before the economy has had a chance to correct itself.



Conclusion

As has occurred with every prior recession, the pressures of population growth will eventually improve employment, although the timing of this is far from clear. The overall growth in employment will be favorable for core real estate demand. While we do not know the exact path that employment growth will take, it is likely to be a rather bumpy one with a quarter or two looking good only to be followed by a period of sub-par trends, or even a decline.

At this point, we expect job growth, when it does occur, to be concentrated to the Professional and Business Services and Health Care Service industries. Additionally, the mature metros of Los Angeles, Chicago, San Francisco, New York and Boston should achieve job growth rates at 90% of the national average, compared to only 50% of the national average historically, with Austin, Dallas, Atlanta, Miami/Fort Lauderdale and Seattle expected to achieve above-average job growth rates.

By adopting a diversified investment strategy focused to metros likely to experience solid job gains, above-average occupancy rates and reasonably priced assets, core real estate investors should be able to control risk and take advantage of the potential upside that typically ensues as the economy recovers.

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