PRICEWATERHOUSECOOPERS

Korpacz Real Estate Investor Survey®

Third Quarter 1999

PRICEWATERHOUSECOOPERS

Dear Reader:

I am delighted to welcome you to the third quarter 1999 issue of the Korpacz Real Estate Investor Survey®, the first issue published by PricewaterhouseCoopers LLP. And, to welcome Peter F. Korpacz, publisher of the Survey since its inception in 1988, and his staff who joined PricewaterhouseCoopers earlier this summer.

As you probably know, The Korpacz Organization was comprised of two entities – Peter F. Korpacz & Associates, Inc., and The Korpacz Company, Inc. The first group – which specialized in the analysis of large properties such as mixed-use projects, office buildings, shopping centers, industrial properties, apartment buildings and complexes, hotels, resorts and development land – merged into PricewaterhouseCoopers's existing Global Real Estate Valuation/Consulting Practice, which is headed by Robert K. Ruggles, III.

The other group, the company's real estate information, education, and publishing arm, will continue to publish the Korpacz Real Estate Investor Survey® and the Korpacz Real Estate Source Directory, as well as other current and proposed PricewaterhouseCoopers real estate research products. Peter F. Korpacz leads this new organizational group – the Global Strategic Real Estate Research Group.

The Korpacz Real Estate Investor Survey® is the industry's standard source of up-to-date capitalization and discount rates and other cash flow forecast assumptions of active investors. PricewaterhouseCoopers is committed to continuing this tradition and providing the necessary resources to enhance and expand the Survey in its coverage of global real estate markets. Work has already begun on enhancements to the publication and expansion of our coverage of the global real estate markets.

We at PricewaterhouseCoopers are committed to delivering timely, succinct, and accurate analyses of real estate investment market conditions and trends in the most respected publication of its kind – the Korpacz Real Estate Investor Survey®. With the addition of Emerging Trends, the real estate industry's premier annual forecast of market trends jointly published by PricewaterhouseCoopers and Lend Lease, to each subscription, you will now have the best real estate investment market information and forecasts available anywhere – on a timely and forward-looking basis.

I hope you enjoy this premier issue published by PricewaterhouseCoopers and continue to support our efforts. Your observations about this publication and suggestions for future markets, issues, and special reports you would like to see addressed are always welcome.

Sincerely,

Patrick A. Leardo
Global FAS Real Estate Leader

PRICEWATERHOUSECOOPERS

Korpacz Real Estate Investor Survey

Making News This Quarter

National Highlights

Outstanding Real Estate Performance Continues

And the beat goes on. The outstanding performance of the real estate market continues unabated. Investors, wondering just how long it can last, continue to enjoy the good times. The fundamentals of the market are very solid, and there is no significant activity pushing the market dramatically in either direction. Common words and phrases used by investors to describe current market conditions are stable, orderly, and an equilibrium market.

While some investors view the real estate market as approaching the top of the real estate cycle, others believe that the market has peaked, but is holding steady. "We have reached a plateau, an elongated peak," comments a participant. To many, the events of last fall are responsible, in part, for the real estate market's current prolonged peak. The restraints on capital continue to limit new construction and keep the majority of REITs out of the transaction arena. After a limited number of transactions were completed in the first half of 1999, transaction activity has picked up. With the right set of economics, transactions are being done. However, it is nowhere near the volume realized 12 to 18 months ago when nearly any deal could be done. New construction, for the most part, is occurring at reduced levels and is expected to remain under control.

The big factor currently affecting the real estate market is the increase in interest rates. In addition to impeding financing and thus limiting the number of transactions, the increase in interest rates is putting upward pressure on overall cap rates. The recent change, however, has not been dramatic. Still, buyers are using lower forecast growth assumptions, which are limiting seller's desires to market properties for sale. In turn, it is increasingly difficult to find good quality properties to acquire, and deals, particularly larger ones, are harder to get done.

As an alternative to buying existing properties, some investors are looking at buying properties that are in the construction pipeline, nearly completed (between 70.0% and 80.0% built), and preleased well. The risk is higher, but the reward is attractive.

With supply and demand relatively in balance, investors are optimistic that the good times will continue and that a recession is not likely to occur in the near future. If a recession does occurs, the real estate market is better prepared to withstand an economic downturn than it was during the last recession. There has been no significant overbuilding and properties are encumbered with lower debt service ratios. Hence, the somewhat reduced level of income would cause fewer foreclosures than in past recessions.

Investors continue to keep a close eye on the stock market, noting that it will likely be responsible for the next major change in the economy. However, the

Federal Reserve continues to closely scrutinize the economy and has successfully (so far) made quick adjustments to lessen the impact of recessionary forces to the benefit of the stock market.

REITs remain the less dominant buyers in the marketplace and are attempting to reenter through joint ventures with pension funds and private companies. Most have turned inward to concentrate on streamlining operations and fine tuning portfolios to improve performance. Some REITs are focusing on new property development. The primary buyers in the market include private individuals and groups, pension funds, and foreign investors. German investors have been very active throughout the country and in a variety of property types. U.S. investors are increasing their presence globally as well and typically mention Europe and Asia as favorite locations for foreign investments. Preferred property types for international investments include hotels and office buildings.

PUBLIC MARKET TRENDS

The inability of REITs to buy unabated continues to positively affect the real estate market. Sale prices have been moderated to more realistic levels and nonREIT investors are able to acquire properties. While it is not likely that REIT shares will recover to their peak levels anytime soon, investors do expect some REITs to make slow and steady gains. They are not entirely out of the real estate market. "Once REITs can prove to the market that they can swallow what they took in last year, they will start getting priced a little better," remarks a participant. Until this occurs, REITs are concentrating on asset management, operations, and strategic acquisitions and dispositions.

Despite strong underlying fundamentals in the real estate market, REIT stock prices declined an average of 3.67% during the month of July 1999, according to the National Association of Real Estate Investment Trusts' (NAREIT) Composite REIT Index. This follows a drop of 1.38% in June 1999.

Total REIT industry market capitalization increased in July according to NAREIT. As of July 31, 1999, the marker was $138.97 billion. Although this is up $7.64 billion (5.82%) from March 31, 1999's total of $131.33 billion, it is only $67 million (0.48%) above the year-end 1998 total of $138.30 billion.

The number of existing REITs totaled 211 as of July 31, 1999. Retail facilities represent the largest portion of existing REITs at 49 (allocated among 28 strip centers, 11 regional malls, 7 freestanding, and 3 outlet centers). This is followed by industrial/office REITs which total 40 (allocated among 19 office, 13 industrial, and 8 mixed use).

As of July 31, 1999, the amount of capital raised through initial public offerings (IPOs), secondary offerings, and unsecured debt was $12.07 billion. This is down significantly from the year-end 1998 total of $39.13 billion. This year, as of July 31, 1999, only two IPOs were issued. The total value was $292 million. By comparison, in the third quarter of 1998, no IPOs were issued.

CASH FLOW FORECAST ASSUMPTIONS

Commercial Markets

Cash flow forecast assumptions this quarter indicate that values are stable in most surveyed commercial markets. The composite average overall cap rate (OAR) is only 2 basis points higher than last quarter's. The average OAR decreased in only one market; a drop of 3 basis points occurred in the Manhattan office market. The average OAR increased in six markets. The range is from 2 basis points in the national power center market to 7 basis points in the San Francisco office market. There was no change in ten markets.

The average discount rate (IRR) decreased in five markets; the range is from 1 basis point in the national suburban office market to 13 basis points in the Dallas and Houston office markets. The average IRR increased in four markets. The range is from 1 basis point in the Manhattan office market to 4 basis points in the regional mall market. The average IRR remained unchanged in eight markets.

The average initial market rent change rate increased minimally in three markets and decreased in ten. Decreases range from 2 basis points in the Washington, DC office market to 85 basis points in the Dallas office market. There was no change in four markets.

National Hotel Market

For the national hotel market, the cur-

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Table 1
Yield Comparisons
JULY 1, 1999

YIELD INDICATORS	1993 AVERAGE	1994 AVERAGE	1995 AVERAGE	1996 AVERAGE	1997 AVERAGE	1998 AVERAGE	1999 JANUARY	1999 APRIL	1999 JULY
Korpacz Yield Indicator (KYI)[a]	12.25%	12.18%	11.96%	11.82%	11.59%	11.35%	11.27%	11.29%	11.28%
Long-Term Mortgages[b]	8.76%	9.00%	8.61%	7.86%	7.94%	6.93%	7.14%	7.54%	8.15%
10-Year Treasuries[c]	5.98%	6.92%	6.86%	6.33%	6.48%	5.34%	4.69%	5.27%	5.85%
Consumer Price Index Change[d]	2.99%	2.61%	2.78%	2.96%	2.07%	1.48%	0.73%	4.63%	1.20%
SPREAD TO KYI (Basis Points)									
Long-Term Mortgages	349	317	335	396	366	442	413	375	313
10-Year Treasuries	627	525	510	549	511	602	658	602	543
Consumer Price Index Change	926	957	918	886	952	987	1054	666	1008

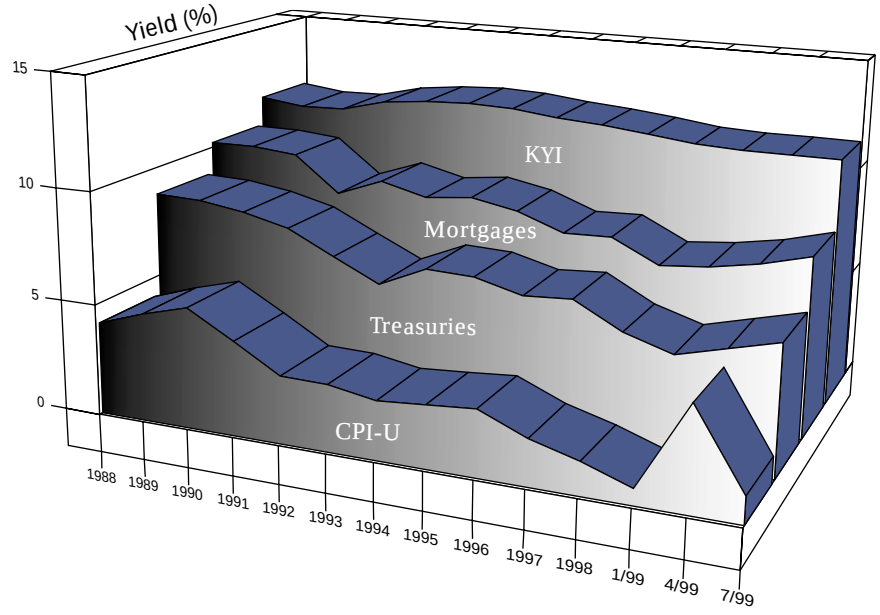
a. A composite IRR average of the markets surveyed.
b. 10-year or longer term for commercial and industrial property. Source: Research Department, Appraisal Institute and Federal Reserve; beginning October 1994, Crittenden Publishing, Inc.; compiled by The Korpacz Company, Inc.
c. Source: Federal Reserve.
d. Source: U.S. Department of Commerce; quarterly changes are annualized based on the index change from the prior quarter; the year-end change is based on the index change from the prior-year fourth quarter.

rent composite average overall cap rate (OAR) is 11 basis points higher than first quarter 1999. The average OAR increased in all markets. The range is from 2 basis points in the economy/limited-service market to 24 basis points in the extended-stay market.

The average discount rate (IRR) decreased in two hotel markets; the range is from 2 basis points in the luxury market to 6 basis points in the full-service market. The average IRR increased in two hotel markets. The range is from 7 basis points in the extended-stay market to 18 basis points in the economy/limited-service market.

The average initial average daily room rate (ADR) change rate decreased in the four hotel markets. Decreases range from 16 basis points in the economy/limited-service market to 48 basis points in the extended-stay market.

Figure 1
Comparative Yields
JULY 1, 1999



YIELD COMPARISONS:
Real Estate vs. Alternative Investments

The Korpacz Yield Indicator (KYI) decreased 1 basis point to 11.28% (see Table 1). The current rate is 7 basis points lower than the 1998 average. The KYI peaked at 12.29% in fourth quarter 1993. For the most part, it has trended downward since.

The average long-term mortgage rate is 8.15%, 61 basis points higher than the rate last quarter. The current rate is 122 basis points higher than the 1998 average. This reflects the continuing upward push on interest rates.

The 10-year treasury rate increased 58 basis points to 5.85%. The current rate is 51 basis points higher than the 1998 average.

The relationship between real estate yields and inflation is noted by comparing yields to the CPI. From April to July, the CPI change rate decreased 343 basis points from 4.63% to 1.20% (annualized). The spread between the KYI and CPI change rate is 1008 basis points.

The spread between the KYI and long-term mortgage rates decreased 62 basis points to 313 from last quarter's 375 basis points. The current spread is 129 basis points lower than the 1998 average.

The spread between the KYI and 10-year treasuries decreased 59 basis points to 543. The current spread is 59 basis points below the 1998 average. The tightening of the spread between the KYI and interest rates is typical in periods of rising interest rates. Although real estate yields are sensitive to interest rate changes, they do not move precisely in concert.

DIVIDEND COMPARISONS:

Public vs. Private Markets

REIT dividend yields can be compared with stock dividend yields, although they are not exactly comparable. As Merrill Lynch cautions: AP/E ratios for most companies incorporate measures of earnings after depreciation, whereas REIT earnings are measured as a function of funds from operation (FFO), which basically amount to earnings before depreciation. Adjustments to FFO for recurring capital expenditures still do not result in adjusted FFO (AFFO) measures which are readily comparable to GAAP [generally accepted accounting principles] earnings in other sectors.

The REIT dividend yield is somewhat comparable to the going-in cap rate (OAR) on an all-cash sale. The OAR is the dividend rate a direct real estate investor receives upon a cash purchase of a property. However, caution must be exercised here as well. The Korpacz Dividend Indicator (KDI) is a composite OAR (initial rate of return in an all-cash transaction) average of the 17 commercial markets surveyed (not including the hotel markets). The average annualized equity REIT dividend yield is for all companies, including for example, health care and manufactured homes, which we do not track.

As a result of such differences among dividends for equity REITs, the S&P 500, and OARs, the comparisons are not perfect. However, they do show trends among these three types of investments.

The KDI, average dividend yields for equity REITs, and the S&P 500, as well as spreads between the KDI and the other investments, are set out in Table 2. From 1991 through 1996, the annual average KDI consistently increased. At the same time, the spread between average annual IRRs and OARs consistently decreased. The narrowing spread is indicative of investors' diminished anticipation of both increased income and property appreciation.

In 1997 the annual average KDI decreased slightly. The spread between average IRRs and average OARs narrowed in three quarters of 1997. It widened slightly in all quarters of 1998. This quarter the spread is 214 basis points, a negligible 3-basis-point dip from last quarter. Since prices are expected to remain stable for the balance of the year, the relationship between average OARs and average IRRs is unlikely to change significantly.

Average annualized equity REIT dividends have fluctuated considerably during the 1990s, due primarily to fluctuations in their stock prices. By comparison, the average annual S&P 500 pattern has been steadier. It declined from 1991 through 1993, increased in 1994, and declined in each of the next four years. This is, in large measure, due to the dramatic increases in stock prices during 1995 and continuing through the present time.

As REIT dividends fluctuated between 1991 and 1996 and the KDI consistently increased, the spread between the KDI and REITs climbed from the 1991 annual average of 38 basis points to the historical high of 382 basis points, reached September 30, 1997. This quarter the spread increased 64 basis points to 180 as REIT dividend yields declined. The average annual spread from 1991 through 1998 is 215 basis points.

Table 2
Dividend Comparisons
JULY 1, 1999

DIVIDEND INDICATORS	1993 AVERAGE	1994 AVERAGE	1995 AVERAGE	1996 AVERAGE	1997 AVERAGE	1998 AVERAGE	1999 JANUARY	1999 APRIL	1999 JULY
Korpacz Dividend Indicator (KDI)[a]	9.28%	9.29%	9.31%	9.39%	9.35%	9.08%	9.11%	9.12%	9.14%
Equity REITs[b]	6.30%	7.25%	7.75%	7.09%	6.06%	6.01%	7.47%	7.96%	7.34%
S&P 500[c]	2.74%	2.85%	2.41%	2.11%	1.83%	1.57%	1.32%	1.28%	1.20%
SPREAD TO KDI (Basis Points)									
Equity REITs	298	204	156	230	329	307	164	116	180
S&P 500	654	644	690	728	752	751	779	784	794

a. A composite OAR (initial rate of return in an all-cash transaction) average of the markets surveyed.
b. Source: National Association of Real Estate Investment Trusts; average annualized dividend yield calculated by The Korpacz Company, Inc.; dividend yields are as of the last day of the prior quarter.
c. Source: S&P 500 Analysts' Handbook Office Series–Monthly Supplements; average annual dividend yield calculated by The Korpacz Company, Inc.; dividend yields are quarterly yields as of the last day of the prior quarter.

Changes in the spread between the KDI and the average S&P 500 from 1991 through present range from a low of 545 basis points in third quarter 1991 to this quarter's high of 794. This quarter's 794-basis-point spread topped the previous high of 779 reached January 1, 1999. The average annual spread from 1991 through 1998 is 654 basis points.

Average annual real estate dividends, as expressed by the KDI, are higher than REIT dividends and S&P 500 dividends in every year shown in Table 2. The likely reasons that the private market real estate dividends are higher than public market dividends are the burden of management and lack of liquidity in direct private ownership of real estate. In the public market, investors have no management burden and the opportunity for liquidity is present daily.

Historically the return on stocks, as represented by the S&P 500, has been considerably lower than the return from all forms of real estate ownership. Stocks have consistently provided the bulk of their return in appreciation of the stock over time.

INSTITUTIONAL vs. NONINSTITUTIONAL RATES

EDITOR'S NOTE: Table 3 shows noninstitutional-grade property discount rates (IRRs) and overall cap rates (OARs) for the surveyed markets for which sufficient data are available.

As with the rates published for institutional-grade property, we do not represent that the survey is statistically accurate for each surveyed market. Analysts are cautioned to test rates in local markets to verify spreads and relationships between institutional-grade and noninstitutional-grade property rates. Despite the survey findings that rates are higher for noninstitutional-grade property, in our appraisal work we have found that the reverse is true in some cases in some markets.

As would be expected, the IRRs in our Survey are higher for noninstitutional-grade property than for institutional-grade property, reflecting the greater risk in owning noninstitutional-grade real estate.

Average noninstitutional-grade IRRs range from 12.13% (Atlanta office market) to 15.00% (Washington, DC office market). The composite average noninstitutional-grade IRR for all markets is 13.28%. This is unchanged from the prior quarter. By comparison, the composite average institutional-grade IRR is 11.28%.

Like the IRRs, the OARs in our Survey are higher for noninstitutional-grade property than for institutional-grade property. Average noninstitutional-grade OARs range from 9.72% (San Francisco office market) to 11.97% (national strip shopping center market). The composite average noninstitutional-grade OAR for all markets is 10.62%. This is unchanged from the prior quarter. By comparison, the composite average institutional-grade OAR is 9.14%.

MARKETING TIME

Commercial Markets

Marketing time, the period from putting a property on the market to closing, has remained relatively stable since last quarter. Marketing time estimates for retail, office, industrial, and apartment properties are included in the Investor Survey Response tables in the back of our Survey. Averages for the 17 commercial markets are shown in Table 4. Last quarter and year-ago averages are also included.

This quarter the average marketing period for all surveyed commercial markets is 7.13 months. This is a 0.48% increase from last quarter, but a 3.30% drop from the average marketing period one year ago (7.37 months).

At 9.33 months, the Manhattan office market has the highest average marketing time. In addition, the average marketing time for the Manhattan office market has increased each quarter since year-end 1998 at the highest rate than any other market in our Survey. Although Manhattan is a top investment location, there has been a decline in the quality of buildings on the market. Since there is less investor interest for lower-tier properties, marketing time has increased.

The national apartment market again has the lowest average marketing time at 5.43 months. However, as sellers continue to market properties at prices above what buyers are willing to pay, marketing time is increasing. Although the current average is unchanged from last quarter, it is 2.26% above first quarter 1999's average and 16.77% higher than the average one year ago.

National Hotel Market

Marketing time estimates for each segment of the hotel industry are included in the Investor Survey Response tables in the back of our Survey.

Overall, the average marketing period is 6.76 months. This is an increase of 4.0% from first quarter 1999. Since our last report on the hotel industry in first quarter 1999, the average marketing time increased in each hotel segment.

With an increase of 7.99%, the greatest increase in marketing time occurred in the economy/limited-service hotel market. The average marketing period for this segment is 6.89 months. Continuous building is negatively affecting this segment and diminishing investor interest.

The luxury hotel market, the strongest segment of the hotel industry, reported the lowest increase in average marketing time of 1.34%. The average marketing period for this segment is 6.64 months.

The average marketing time for the full-service hotel market is 5.97 months, while the average for the extended-stay hotel market is 7.55 months.

Table 3
Rates: Institutional-Grade vs. Noninstitutional-Grade Property
THIRD QUARTER 1999

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	INSTITUTIONAL				NONINSTITUTIONAL				SPREAD TO INSTITUTIONAL	
	IRRs		OARs		IRRs		OARs		AVERAGE IRR	AVERAGE OAR
Market	Range	Average	Range	Average	Range	Average	Range	Average	Basis Points	Basis Points
National Regional Mall	9.75%-12.50%	11.19%	7.00%-10.50%	8.41%	11.00%-16.00%	13.50%	8.00%-12.50%	9.94%	231	153
National Power Center	10.25%-12.50%	11.20%	8.00%-10.50%	9.66%	NA	NA	NA	NA	NA	NA
National Strip Shopping Center	10.00%-14.00%	11.61%	8.25%-12.00%	9.78%	10.50%-18.75%	14.18%	9.00%-15.00%	11.97%	257	219
National CBD Office	9.75%-15.00%	11.24%	7.00%-11.00%	8.79%	11.00%-18.00%	13.28%	8.00%-14.00%	10.50%	204	171
National Suburban Office	9.75%-12.50%	11.09%	7.50%-10.50%	9.15%	10.75%-14.50%	12.35%	9.50%-12.50%	10.64%	126	149
Atlanta Office	9.75%-12.00%	11.08%	8.00%-10.50%	9.23%	11.00%-13.50%	12.13%	10.00%-11.00%	10.63%	105	140
Chicago Office	9.29%-13.00%	10.92%	8.00%-10.25%	9.14%	10.04%-14.75%	12.37%	8.50%-12.00%	10.23%	145	109
Dallas Office	9.00%-13.00%	11.23%	7.50%-12.00%	9.36%	11.50%-15.50%	13.17%	9.00%-14.50%	11.00%	194	164
Houston Office	9.00%-13.50%	11.51%	8.00%-12.00%	9.60%	12.50%-14.25%	13.00%	10.25%-11.50%	10.75%	149	115
Los Angeles Office	10.00%-14.00%	11.73%	7.00%-10.50%	8.86%	11.00%-20.00%	14.79%	8.50%-13.00%	10.16%	306	130
Manhattan Office	9.75%-13.00%	11.36%	7.50%-10.50%	9.03%	10.25%-15.00%	13.00%	8.50%-13.00%	10.71%	164	168
Pacific Northwest Office	10.00%-13.00%	11.30%	8.00%-11.00%	9.21%	11.50%-18.00%	13.85%	9.50%-13.00%	11.08%	255	187
San Francisco Office	10.00%-13.00%	11.02%	7.00%-11.00%	8.53%	10.25%-14.50%	12.90%	7.50%-11.50%	9.72%	188	119
Southeast Florida Office	10.00%-12.00%	11.08%	8.00%-12.00%	9.39%	11.25%-15.00%	13.20%	9.00%-14.00%	10.70%	212	131
Washington, DC Office	10.00%-13.00%	11.54%	7.00%-11.00%	9.17%	13.50%-18.00%	15.00%	10.50%-14.00%	11.50%	346	233
National Industrial	9.50%-12.50%	11.13%	8.00%-10.00%	9.15%	10.50%-16.00%	12.41%	8.75%-12.00%	10.35%	128	120
National Apartment	10.00%-15.00%	11.51%	7.50%-11.00%	8.86%	11.00%-17.00%	13.08%	8.25%-12.00%	9.88%	157	102

Table 4
Average Marketing Time (months)
THIRD QUARTER 1999

MARKET	CURRENT QUARTER	LAST QUARTER	YEAR AGO
National Regional Mall	8.11	8.11	9.55
CHANGE	—	0.00%	–15.08%
National Power Center	7.13	7.13	7.80
CHANGE	—	0.00%	–8.59%
National Strip Shopping Center	6.68	6.68	6.96
CHANGE	—	0.00%	–4.02%
National CBD Office	8.36	8.36	8.64
CHANGE	—	0.00%	–3.24%
National Suburban Office	7.75	7.75	8.25
CHANGE	—	0.00%	–6.06%
Atlanta Office	6.50	6.50	7.50
CHANGE	—	0.00%	–13.33%
Chicago Office	7.50	7.50	7.50
CHANGE	—	0.00%	0.00%
Dallas Office	7.14	7.14	6.69
CHANGE	—	0.00%	+6.73%
Houston Office	7.19	7.19	6.69
CHANGE	—	0.00%	+7.47%
Los Angeles Office	5.56	5.56	6.06
CHANGE	—	0.00%	–8.25%
Manhattan Office	9.33	8.35	7.86
CHANGE	—	+11.74%	+18.70%
Pacific Northwest Office	7.13	7.13	7.94
CHANGE	—	0.00%	–10.20%
San Francisco Office	5.63	6.00	6.50
CHANGE	—	–6.17%	–13.38%
Southeast Florida Office	8.07	8.07	8.42
CHANGE	—	0.00%	–4.16%
Washington, DC Office	7.17	7.17	7.33
CHANGE	—	0.00%	–2.18%
National Industrial	6.47	6.50	7.03
CHANGE	—	–0.46%	–7.97%
National Apartment	5.43	5.43	4.65
CHANGE	—	0.00%	+16.77%
All Markets Surveyed (Simple Average)	7.13	7.09	7.37
CHANGE	—	+0.48%	–3.30%

VALUATION ISSUES

Rent Spikes

Although some office markets warrant the use of rent spikes in cash flow forecasts, the majority of office markets do not. Only 36.5% of our survey participants are factoring spikes into their analysis of some potential acquisitions in markets where absorption is strong and rents are likely to continue to rise in the near future. This is down significantly from 75.5% a year ago.

A rent spike is defined as an increase in market rent that is markedly higher than the general inflation rate. For example, if inflation is 3.0%, one might expect a spike to be at least 50.0% to 100.0% higher than the inflation rate, say, 4.5% to 6.0%.

Participants who apply rent spikes maintain that spikes are property specific and heavily dependent on market and submarket conditions. For example, rents may already have spiked significantly and additional future spikes are not likely. Rent spikes are used "where and when appropriate" in markets where there is hard evidence that rents will increase substantially. Such evidence includes a diversified economic base, job growth, and good current absorption.

The percentage of survey participants who are using rent spikes in each of the surveyed office markets compared with one year ago is set out in Exhibit 1. The average rent spike in each market is also included.

The use of spikes decreased in all office markets since the year-ago quarter (except the Manhattan office market), perhaps indicating that rent levels are approaching their peak. The largest drop occurred in the Dallas office market (0.0% compared with 71.4%). Other office markets, which show great declines in the use of spikes, are Houston (33.3% compared with 85.7%), Southeast Florida (25.0% compared with 71.4%), and Suburban (42.9% compared with 78.6%). Manhattan increased from 40.0% to 44.4%.

Exhibit 1
Rent Spikes
THIRD QUARTER 1999

	PERCENT USING SPIKES		AVERAGE SPIKE	
OFFICE MARKET	CURRENT	YEAR AGO	CURRENT	YEAR AGO
National CBD	50.0%	81.8%	8.1%	8.5%
National Suburban	42.9%	78.6%	6.0%	6.4%
Atlanta	0.0%	0.0%	0.0%	0.0%
Chicago	44.4%	66.7%	6.9%	10.3%
Dallas	0.0%	71.4%	0.0%	8.2%
Houston	33.3%	85.7%	8.0%	8.2%
Los Angeles	80.0%	90.0%	5.4%	6.1%
Manhattan	44.4%	40.0%	6.5%	5.7%
Pacific Northwest	37.5%	50.0%	6.8%	5.7%
San Francisco	50.0%	85.7%	7.3%	8.6%
Southeast Florida	25.0%	71.4%	6.0%	6.9%
Washington, DC	30.0%	54.6%	6.3%	8.2%

Reported spike amounts for this quarter are as high as 8.1% (in the national CBD office market). Most spikes, however, fall into the 6.0% to 7.0% range. Spikes are most often applied in a series of years. However, an unusually high spike may be applied for one year only.

Many participants time application according to anticipated supply-demand conditions. Others use spikes in the early years of an analysis period, especially in markets that are on the verge of higher rents. Timing of spikes in our Survey ranges from the first to the fifth year of a 10-year forecast.

Leveraged IRRs

With the strong condition in the current transaction environment, positive leverage can be useful in tight bidding situations. The anticipated internal rate of return on equity can exceed the cost of debt capital in many cases. Buyers who are able to access economical debt capital to finance a portion of the sale price can anticipate a better yield than the indicated property yield, offer slightly more for a property than an all-cash buyer, and win the bid.

When the financed portion of a sale is in the 50.0% to 60.% range, most leverage buyers are willing to bid up the price by a small margin above the all-cash price. They can increase their equity IRR above the property IRR and thus do better than in an all-cash deal. They perceive only minimal additional risk as long as the financed portion is small enough to offset the possibility of the leverage becoming negative.

Current and year-ago leverage premiums are set out in Exhibit 2. Cur-rent average premiums range from 67 basis points in the national regional mall market to 363 basis points in the Atlanta office market. The average of all the markets surveyed (not including the hotel markets) is 187 basis points.

One year ago our Survey showed that 50.0% to 60.0% debt at market rates could result in an equity IRR premium of up to 286 basis points. The average was 153. This quarter's findings suggest that an increase in interest rates have resulted in a higher premium. As the loan-to-value ratio increases, the leverage premium would increase as well.

Exhibit 2
Leverage Premium on Equity Discount Rate
(50.0% to 60.0% Debt)
THIRD QUARTER 1999

	RANGE (Basis Points)		AVERAGE (Basis Points)	
MARKET	CURRENT	YEAR AGO	CURRENT	YEAR AGO
National Retail				
Regional Mall	0-200	0-100	67	56
Power Center	50-200	50-200	110	106
Strip Shopping Center	0-650	0-650	160	163
Office				
National CBD	0-375	0-150	121	88
National Suburban	0-375	0-150	91	70
Atlanta	300-400	200-250	363	225
Chicago	100-500	100-500	240	225
Dallas	200-400	0-250	250	175
Houston	200-300	0-250	230	175
Los Angeles	100-600	0-600	317	205
Manhattan	0-700	0-200	156	107
Pacific Northwest	50-250	50-250	165	155
San Francisco	0-300	0-250	145	115
Southeast Florida	100-700	50-250	288	160
Washington, DC	0-800	0-800	246	286
National Industrial	0-800	0-800	144	179
National Apartment	0-300	0-400	94	116
All Markets Surveyed (Simple Average)	0-800	0-800	187	153

Income Capitalized in Direct Capitalization

The method – that is, which level of income – investors use in direct capitalization is a significant item in our Survey because it is a component in defining the overall capitalization rate. The three methods are:

- Method 1: NOI after capital replacement reserve deduction but before TIs and leasing commissions
- Method 2: NOI before capital replacement reserve deduction, TIs, and leasing commissions

■ Method 3: Cash flow after capital replacement reserve deduction, TIs, and leasing commissions

Methods 1 and 2 are the same except for the treatment of the capital replacement reserve.

Results of the current quarter survey are shown in Exhibit 3. Comparisons with the year-ago report on this topic indicates that the composite percentage of participants who rely on Method 1 increased again. The composite percentage increased to 35.8% from 29.1% a year ago.

The composite average of participants who rely on Method 2 decreased to 53.7% from 55.1% one year ago. It greatly exceeds the percentage who rely on Methods 1 and 3 and continues to be the most widely used method.

Reliance on Method 3, which is generally an indication of investor focus on real cash returns after all expenses are satisfied, has decreased steadily since fourth quarter 1994. The current percentage of 10.5% is down from 14.6% one year ago.

Face/Effective Rents

As strong market conditions continue to diminish the overall use of concessions, the majority of real estate investors use face rents when analyzing properties. On average, 79.82% of the participants in our Survey use face rents. The remaining 20.18% use effective rents. This is off slightly from last quarter when the ratios were 78.97% and 21.47%, respectively.

When using face rents, concessions are forecast as they are scheduled to occur. If market rent is not forecast to increase at too high a rate throughout the forecast period, then the use of face rents prevents forecast cash flow distortion. The use of effective rents – that is, rents after all concessions are extracted – spreads concessions over the forecast period. This method is more generally used in markets that have a higher amount of available space.

This quarter there are two markets that reported significant shifts in the use of face or effective rents. The use of face rents in the national regional mall market declined from 100.0% to 87.5%, while the use of face rents in the Southeast Florida office market increased from 57.14% to 75.00%. Only three other markets reported minor shifts (San Francisco office, Washington, DC office, and the national industrial markets). All other markets remained unchanged from last quarter.

We continue to track the use of face or effective rents, but under current market conditions, few investors are using effective rents. Consequently, a comparative analysis is irrelevant. As significant changes occur, we will keep you posted. As the pendulum swings – and it will – we will reinstate a comparative analysis. ■

Exhibit 3
Income Capitalized in Direct Capitalization
THIRD QUARTER 1999

	METHOD 1		METHOD 2		METHOD 3		VARIES	
MARKET	CURRENT	YEAR AGO	CURRENT	YEAR AGO	CURRENT	YEAR AGO	CURRENT	YEAR AGO
National Retail								
Regional Mall	25.0%	25.0%	62.5%	62.5%	12.5%	12.5%	0.0%	0.0%
Power Center	37.5%	42.9%	50.0%	42.9%	12.5%	14.3%	0.0%	0.0%
Strip Shopping Center	31.6%	18.8%	52.6%	68.8%	15.8%	12.5%	0.0%	0.0%
Office								
National CBD	18.2%	0.0%	81.8%	81.8%	0.0%	18.2%	0.0%	9.1%
National Suburban	25.0%	10.7%	56.3%	64.3%	18.8%	25.0%	0.0%	0.0%
Atlanta	75.0%	40.0%	25.0%	40.0%	0.0%	20.0%	0.0%	0.0%
Chicago	55.6%	44.4%	44.4%	44.4%	0.0%	0.0%	0.0%	11.1%
Dallas	25.0%	25.0%	62.5%	75.0%	12.5%	0.0%	0.0%	0.0%
Houston	22.2%	25.0%	55.6%	75.0%	22.2%	0.0%	0.0%	0.0%
Los Angeles	30.0%	30.0%	50.0%	40.0%	20.0%	20.0%	0.0%	10.0%
Manhattan	22.2%	10.0%	66.7%	70.0%	11.1%	20.0%	0.0%	0.0%
Pacific Northwest	37.5%	25.0%	50.0%	50.0%	12.5%	25.0%	0.0%	0.0%
San Francisco	37.5%	28.6%	62.5%	42.9%	0.0%	28.6%	0.0%	0.0%
Southeast Florida	37.5%	42.9%	56.3%	42.9%	6.3%	14.3%	0.0%	0.0%
Washington, DC	40.0%	30.0%	50.0%	60.0%	10.0%	10.0%	0.0%	0.0%
National Industrial	28.6%	33.3%	71.4%	60.0%	0.0%	6.7%	0.0%	0.0%
National Apartment[a]	60.0%	63.2%	15.0%	15.8%	25.0%	21.1%	0.0%	0.0%
All Markets Surveyed (Simple Average)[b]	35.8%	29.1%	53.7%	55.1%	10.5%	14.6%	0.0%	1.8%

a. The three methods in direct capitalization in the apartment market are (1) NOI *after* capital replacement reserve deduction, (2) NOI *before* capital replacement reserve deduction, and (3) cash flow *after* capital replacement reserve deduction
b. Totals may exceed 100.0% due to rounding.

National Regional Mall Market

The number of buyers for top-tier regional malls has always been small, but lately it has become even smaller. "There are less than a handful of buyers for mall deals," says one participant. Yet, deals continue to be made. The main players are REITs and pension fund/REIT partnerships. Few pension funds, if any, are buying regional malls alone.

A recent rise in interest rates is affecting overall cap rates for Class-B malls. The majority of investors in second-tier regional malls are out of funds and out of the market. Most investors are not interested in Class-B malls and lenders are more cautious too. As a result, owners of Class-B product are finding it increasingly difficult to sell properties at cap rates similar to those received a year ago.

Class-A malls are feeling less of an affect by the increase in interest rates and buyers of top-tier regional malls still face a competitive market. Some trophy properties with average retail sales well over $400 per square foot are still trading at cap rates below 8.00% with some approaching the 7.0% level. "There is a bigger gap in cap rates between Class-A and Class-B properties than there was a year ago," says a participant.

Despite a harder sell, Class-B and Class-C regional malls are being purchased, mainly for redevelopment and repositioning. Developers are recycling older malls which have solid locations and strong customer bases, but lack good retail, into entertainment-retail facilities. It is the newest concept in retailing that is also occurring in conventional malls. Ice rinks, amusement rides, and IMAX theaters are becoming commonplace in a center's tenant mix.

The majority of regional malls are priced near replacement cost. Participants say that prices in the national regional mall market range from 80.0% to 120.0% of replacement cost. The average price is 98.75% of cost. Estimates of value change over the next 12 months range from 0.0% to 10.0%; on average, values are expected to increase 3.5%.

Most cash flow assumptions shifted this quarter. The largest shift occurred for the average market rent change rate which increased 12 basis points to 3.21%. This is a 21-basis-point increase from a year ago. The average discount rate (IRR) inched up 4 basis points this quarter to 11.19%, and the average overall cap rate (OAR) increased 3 basis points to 8.41%.

Cap rates for top-tier malls are considerably lower than the average OAR in the national regional mall market. For A+ malls, the range of cap rates is from 7.00% to 8.75%; the average is 7.65%. For A malls, the range is from 7.00% to 9.00%; the average is 8.00%. For B+ malls, the range is from 7.50% to 10.00%; the average is 8.75%. For B malls, the range is from 8.25% to 11.00%; the average is 9.66%.

There is debate from mall owners on how e-commerce will affect regional malls. Opinion is divided, and there is not yet sufficient evidence to support either side. The affect, if any, is likely to occur gradually and not all stores will be affected. The potential for a decline in retail sales and occupancy rates, however, is enough to make mall owners plan ahead. "We need to figure out how to benefit from the Internet and not get hurt by it," comments a participant. It is no surprise that some regional malls have started their own web sites offering coupons and insights on upcoming mall event. E-commerce is relatively new and gaining popularity. Thus, it is most likely that properties, which take advantage of the Internet, will prevail and remain more profitable. ■

Table 5
National Regional Mall Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.75%–12.50%	9.75%–12.50%	10.00%–13.00%
AVERAGE	11.19%	11.15%	11.28%
CHANGE (Basis Points)	—	+4	–9
Overall Cap Rate (OAR)[a]			
RANGE	7.00%–10.50%	7.00%–10.50%	7.00%–11.00%
AVERAGE	8.41%	8.38%	8.45%
CHANGE (Basis Points)	—	+3	–4
Market Rent Change Rate[b]			
RANGE	0.00%–4.00%	0.00%–4.00%	0.00%–4.00%
AVERAGE	3.21%	3.09%	3.00%
CHANGE (Basis Points)	—	+12	+21
Expense Change Rate[b]			
RANGE	3.00%–4.00%	3.00%–4.00%	3.00%–4.00%
AVERAGE	3.28%	3.28%	3.68%
CHANGE (Basis Points)	—	0	–40
Residual Cap Rate			
RANGE	7.50%–10.50%	7.50%–10.50%	7.50%–11.00%
AVERAGE	8.55%	8.55%	8.76%
CHANGE (Basis Points)	—	0	–21

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Power Center Market

Some investors are aggressively chasing deals for investment-grade power centers that are encumbered with long-term leases to national creditworthy tenants. Other investors are in a state of watch, deciding their next action. "It has been so good for so long, we are wondering if it can continue," says one participant.

There is no consensus among participants about the current state of supply and demand in the market. While some believe that there is equilibrium, others believe that the market is oversupplied. Many urban areas and in-fill locations are underserved by retail. Demographics for these areas, especially those with below-average household incomes, are considered less favorable and, therefore, do not attract many developers or tenants.

Whether the power center market is in balance or not, construction is typically spurred by a retailer's demand to enter a market than it is from consumer demand. "Unless there is something negative occurring internally, retailers are aggressive at opening stores," comments a participant. As a result, there is less difficulty in obtaining high-rated tenants for centers. "Not only do large tenants such as Home Depot and Wal-Mart want to be in every market possible, their strongest competitors want to be there too," adds a participant.

As more retailers set up web sites or acquire companies with online presence, it is evident that retailers are concerned about competition from online retailing. However, it is too soon to estimate how much e-commerce will impact retailers. "Everyone is behind right now in their thinking. The Internet numbers keep doubling every 18 months. If it continues, it has very serious implications for retail real estate," comments a participant. Power centers, which sell popular Internet commodities, are likely to see a shift in dollars.

To offset the affects from online sales, power center developers, like regional mall developers, are trying to create "destination" retail by incorporating entertainment, restaurant, and theme tenants into their centers. "People are looking for entertainment as part of their retail experience," comments one participant. Many large, vacant buildings in prime areas or along major highways are great prospects for entertainment-retail complexes.

The majority of power centers are priced near replacement cost. Prices range from 80.0% to 120.0% of replacement cost. The average price is 98.75% of cost. Values are expected to remain stable over the next 12 months.

All cash flow forecast assumptions remained unchanged this quarter. The spread between the average OAR and average residual cap rate is the lowest of all the markets surveyed. Thus, power centers are providing limited upside potential for investors.

Overall cap rate selection is viewed in different ways by participants and is based on income growth or tenant credit. In analyzing income growth, some participants believe that centers that are 100.0% occupied by big-box tenants have limited potential for rent growth and, therefore, command higher OARs. As in-line store space increases at a center, the potential for rent growth increases. Thus, this type of participant would apply a lower overall rate.

For investors that analyze power centers based solely on credit, the presence of noncredit in-line store space is seen as a credit risk. Therefore, a higher cap rate should be selected. Centers that are anchored by 100.0% creditworthy, big-box anchor stores have less credit loss and should command lower OARs. "In-line space is a headache, its credit loss, its management intensive – which would you pay more for?" says a participant. It's a question of different strokes for different folks. ■

Table 6
National Power Center Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.25%–12.50%	10.25%–12.50%	10.00%–12.50%
AVERAGE	11.20%	11.20%	11.29%
CHANGE (Basis Points)	—	0	–9
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–10.50%	8.00%–10.50%	8.00%–10.50%
AVERAGE	9.66%	9.66%	9.73%
CHANGE (Basis Points)	—	0	–7
Market Rent Change Rate[b]			
RANGE	0.00%–4.00%	0.00%–4.00%	0.00%–4.00%
AVERAGE	2.88%	2.88%	2.75%
CHANGE (Basis Points)	—	0	+13
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	3.00%–4.00%
AVERAGE	3.19%	3.19%	3.46%
CHANGE (Basis Points)	—	0	–27
Residual Cap Rate			
RANGE	9.00%–10.50%	9.00%–10.50%	9.00%–10.50%
AVERAGE	9.75%	9.75%	9.79%
CHANGE (Basis Points)	—	0	–4

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Strip Shopping Center Market

Offers for neighborhood and community shopping centers have declined and bidders for properties have become unpredictable. "You never really know who is going to show up," comments a participant. The majority of REITs are not active in the market since they do not have the capital necessary to close deals. Private groups, which were acquiring retail properties and assembling portfolios to sell to REITs, have stopped buying. Primary buyers in the market include pension funds and private companies.

As overall cap rates inched up in the beginning of the year, sellers pulled their properties from the market. "Strip and community centers should command a higher capitalization rate," states a participant. "The NOI is very static. There is relatively no upside potential due to the generally flat rentals of the credit anchors," adds another participant. Recently, more property owners have agreed. Being more acceptable to higher cap rates, properties have been put back up for sale. Yet, it is the opinion of some investors in the marketplace that strip shopping centers are still overvalued.

There is a fair amount of retail construction occurring, but investors believe that the rate of construction is down from prior years. Participants are not fearful of overbuilding since retail development typically follows in areas where there is new residential growth. "Construction based on consumer demand, as well as retailers' demand, is relatively balanced," says a participant.

Since the success of a strip center is usually dependent on its grocery store anchor, and grocery stores are driven by population, it is no surprise that investors are very interested in acquiring properties in California, especially southern California and the coastal areas. Other preferred areas include Texas, Florida, Georgia, Portland, Northern Virginia, and Washington.

Investor interest in Atlanta, where perpetual building is occurring, is very limited. "Development in Atlanta is getting to the point where new centers are mostly relying on taking tenants from existing centers," remarks one participant. This is unhealthy for the market.

The affect of retail web sites on the national strip shopping center market is a debatable issue. Some investors are concerned that even the slightest projected decline in sales will have an impact on the industry, others are more optimistic. "I would be more concerned if I was a catalog retailer," says one participant. "The more antiquated forms of retail distribution might be affected, but not the day-to-day grocery store anchor."

On average, prices in the national strip shopping center market are nearly at replacement cost. Participants estimate that they vary from 80.0% to 120.0% of replacement cost. The average is 97.79%. Prices are not expected to rise significantly over the next 12 months; the projected average increase is 2.08%.

Key value indicators in the national strip shopping center market are shown in Table 7. While the average discount rate (IRR) held steady at 11.61%, the average overall rate (OAR) increased 2 basis points to 9.78%. The largest mover was the average market rent change rate, which declined 22 basis points to 3.17%.

Strip shopping centers have traditionally been perceived to pose a higher investment risk than regional malls. Consequently, both the IRR and going-in cap rate reflect a premium for higher risk. The spread between the average strip center IRR and the regional mall rate declined this quarter to 42 basis points. The strip center OAR has consistently been much higher than the regional mall rate. This quarter's OAR premium is 137 basis points. ■

Table 7
National Strip Shopping Center Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–14.00%	10.00%–14.00%	10.00%–14.00%
AVERAGE	11.61%	11.61%	11.63%
CHANGE (Basis Points)	—	0	–2
Overall Cap Rate (OAR)[a]			
RANGE	8.25%–12.00%	8.25%–12.00%	8.00%–12.00%
AVERAGE	9.78%	9.76%	9.72%
CHANGE (Basis Points)	—	+2	+6
Market Rent Change Rate[b]			
RANGE	0.00%–6.00%	0.00%–7.00%	0.00%–7.00%
AVERAGE	3.17%	3.39%	3.22%
CHANGE (Basis Points)	—	–22	–5
Expense Change Rate[b]			
RANGE	2.00%–5.00%	2.00%–5.00%	2.50%–5.00%
AVERAGE	3.22%	3.21%	3.42%
CHANGE (Basis Points)	—	+1	–20
Residual Cap Rate			
RANGE	8.75%–12.00%	8.75%–12.00%	8.50%–12.00%
AVERAGE	10.03%	10.03%	9.95%
CHANGE (Basis Points)	—	0	+8

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National CBD Office Market

Overbuilding, whether perceived or actual, in some of the major suburban office markets is redirecting more investors to search for less risky investments in CBD office markets. Tenants, who are finding a renewed interest in downtown, are pushing vacancy rates into the single digits in most markets. Investors are following behind, leaving the uncertainty of suburban investments for opportunities in CBD markets.

Buyers of CBD office buildings are winning deals by bidding close to asking prices. On average, the sale price is within 5.0% of the asking price. Primary buyers are pension funds, private partnerships, and single individuals. Foreign investors', especially German investors', are also hot for downtown properties. Due to the slight up tick in interest rates, there is likely to be a slowdown in financing and sales.

Some buyers think that yields are too low, particularly on Class-A buildings, and are looking for investment alternatives such as buying properties that are nearing completion and preleased well. The risk is higher, but the reward is better than on operating properties. Others like the dynamics of the market.

Vacancy rates in most major CBD markets fell this quarter. Several downtown markets boast single-digit vacancy rates. According to Cushman & Wakefield, the national CBD vacancy rate was 10.1% as of the second quarter 1999. Although there is speculation that a slowing economy could put a halt to job growth or leave space available from downsizing, vacancy rates are so low that markets will likely continue to prosper.

Leasing activity is keeping pace with 1998. As of midyear 1999, approximately 40 million square feet were leased nationally. New construction in most markets is minimal. For the first half of 1999, only 328,600 square feet of new space were completed in the CBD market. The continued restriction on credit puts the future of many planned projects on hold.

Rental rate growth is still above inflation, but double-digit growth rates are not the norm. Even the tightest markets, such as San Francisco and Seattle, are seeing less growth in rental rates. In some instances, rent levels are holding steady. The current slowdown in rental growth rate should enable existing tenants to renew leases and not force relocation due to rising costs.

Most CBD office buildings can still be acquired at a large discount to replacement cost, but prices exceed cost in some instances. Participants estimate that prices in the national CBD office market range from 65.0% to 110.0% of replacement cost. The average price is 90.75% of cost.

Key value indicators in the national CBD office market are shown in Table 8. The average discount rate (IRR) remained unchanged at 11.24%; only 9 basis points below the average a year ago. The average residual cap rate held steady at 9.31%, unchanged from a year ago. The average overall cap rate (OAR) remained at 8.79%.

The average market rent change rent declined for the fourth consecutive quarter to 3.68%. Although investors are no longer including large rent increases in their analyses, rent spikes are still used by 50.00% of our participants. However, the average rent spike dropped 10-basis-points this quarter to 8.05%. Rent spikes are primarily used in years one, two, and/or three.

In terms of the real estate life cycle, investors sense that there is still upside potential in many CBD markets. Favorable markets include San Francisco, Manhattan, Boston, and Washington, DC. Participants caution that cities such as Houston, Denver, and Los Angeles are at the top of the real estate life cycle or may be heading down the other side. ■

Table 8
National CBD Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.75%–15.00%	9.75%–15.00%	10.00%–15.00%
AVERAGE	11.24%	11.24%	11.33%
CHANGE (Basis Points)	—	0	–9
Overall Cap Rate (OAR)[a]			
RANGE	7.00%–11.00%	7.00%–11.00%	7.00%–11.00%
AVERAGE	8.79%	8.79%	8.80%
CHANGE (Basis Points)	—	0	–1
Market Rent Change Rate[b]			
RANGE	0.00%–8.00%	0.00%–8.00%	0.00%–8.00%
AVERAGE	3.68%	3.83%	3.85%
CHANGE (Basis Points)	—	–15	–17
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	2.00%–4.00%
AVERAGE	3.33%	3.33%	3.50%
CHANGE (Basis Points)	—	0	–17
Residual Cap Rate			
RANGE	7.50%–11.00%	7.50%–11.00%	7.50%–11.00%
AVERAGE	9.31%	9.31%	9.31%
CHANGE (Basis Points)	—	0	0

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Suburban Office Market

The prospect for solid investments in the suburban office market is good, despite threats of overbuilding and a renewed interest in urban markets. The rate of new construction is worrisome for certain suburban markets, while others are boasting single-digit vacancy rates. Well-located suburban office buildings are hot commodities.

Even with the recent renaissance of many downtown markets, suburban markets will continue to flourish as companies maintain offices in both locations. Preferred suburban office markets include Seattle, Washington, DC (Northern Virginia), Boston, and New York.

According to Cushman & Wakefield, vacancy for the national suburban office market was 12.2% as of midyear 1999. This is 210 basis points above the national CBD vacancy rate of 10.1%. Although some suburban office markets have vacancy rates below 10.0%, there are many markets where the amount of new construction is outpacing demand. Investors are cautious about Chicago, Dallas, and Atlanta.

Financing may not be as easily available for new development, but the new supply of space has nearly doubled in comparison to a year ago. Based on statistics published by Cushman & Wakefield, a total of 31.5 million square feet were completed during the first six months of 1999. As of the second quarter 1999, 61.2 million square feet are under construction. The majority of the space is concentrated in the Southwest, including Dallas, Denver, Houston, Phoenix, and San Antonio. The Southeast, including Atlanta and Miami, and the Midwest have the least amounts of new construction.

Properties in the national suburban office market are close to fully priced. Participants say that prices range from 80.0% to 115.0% of replacement cost. The average price is 98.67% of cost. Price increases over the next 12 months in some markets may be as high as 10.0%. The average projected price increase is 4.88%.

Key indicators in the national suburban office market are shown in Table 9. Changes are minor this quarter. The average discount rate (IRR) decreased 1 basis point to 11.09%. The average overall cap rate (OAR) held steady at 9.15%. The average residual cap rate declined 1 basis point to 9.48%.

After decreasing for the past two quarters, the average market rent change rate remained unchanged at 3.67% this quarter. The average expense change rate, which has also been declining since the end of 1998, held steady at 3.09% this quarter.

The average IRR for the suburban office market is now 15 basis points lower than for the CBD office market. Thus, investors view the suburban office market as less risky. However, the average OAR for the suburban office market is 36 basis points higher than the CBD rate. This suggests that investors see less potential for income growth in the suburban office market.

Leasing activity for the national suburban office market is in line with 1998 averages. As of midyear 1999, approximately 80 million square feet have been leased. The pace of absorption, while consistent in some markets, is slower in others. Markets plagued by slow absorption and continuous building are seeing rental rates dip and concessions appear. Investors are hopeful that any oversupply of space is short lived and that job growth will enable excess space to be leased. ■

Table 9
National Suburban Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.75%–12.50%	9.75%–12.50%	10.00%–12.50%
AVERAGE	11.09%	11.10%	11.14%
CHANGE (Basis Points)	—	–1	–5
Overall Cap Rate (OAR)[a]			
RANGE	7.50%–10.50%	7.50%–10.50%	7.50%–10.50%
AVERAGE	9.15%	9.15%	9.05%
CHANGE (Basis Points)	—	0	+10
Market Rent Change Rate[b]			
RANGE	0.00%–8.00%	0.00%–8.00%	0.00%–10.00%
AVERAGE	3.67%	3.67%	4.50%
CHANGE (Basis Points)	—	0	–83
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	2.00%–4.00%
AVERAGE	3.09%	3.09%	3.42%
CHANGE (Basis Points)	—	0	–33
Residual Cap Rate			
RANGE	8.00%–11.00%	8.00%–11.00%	8.00%–11.00%
AVERAGE	9.48%	9.49%	9.43%
CHANGE (Basis Points)	—	–1	+5

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Atlanta Office Market

Although Atlanta remains a cautious market for most investors, "I do not believe that the market is as bad as has been reported," comments one participant. Investments need to be made carefully. Atlanta is a market very sensitive to location. Many investors who discarded Atlanta as a potential acquisition market a year or two ago are starting to reexamine the area for possible investments – particularly in the hot upper Georgia-400 corridor (north Fulton County) and Buckhead.

The underlying fundamentals for the market suggest improving market conditions. According to CB Richard Ellis, the vacancy rate for downtown Atlanta declined 250 basis points from the first quarter to 12.5%. This is down 370 basis points from a year ago. For suburban Atlanta, vacancy as of second quarter 1999 was 9.5%, slightly below the prior quarter rate of 9.9%, but well above the rate from a year ago (7.7%).

Buckhead, which absorbed 471,000 square feet during the first half of 1999 according to Jamison Research, Inc., is the second strongest submarket in Atlanta. North Fulton County, with a mid-year absorption of 817,000 square feet, is the healthiest submarket.

Continuous absorption and declining vacancy rates are prompting new construction. The majority of recent new development in suburban markets is preleasing well and developers are contemplating new construction. However, developers are not willing to start without significant preleasing. "Any developer that starts a new project will need a large tenant to commit," says one participant.

The less favorable investment areas in Atlanta include the Perimeter 400 submarket and downtown. Construction data varies from source to source, but the consensus among participants is that construction is continuing at a rate that may outpace employment gains. "Developers feel they survived the first wave, so let's hit the market again, despite a projected slowdown in job growth," comments one investor.

Some buildings in the Atlanta office market are still priced below replacement cost, but most are fully priced. Participants report a range of prices from 90.0% to 110.0% of replacement cost. The average price is 100.0% of cost. Prices are expected to remain generally flat; the projected average increase over the next 12 months is only 1.92%. Hence, investors see limited upside potential in the market.

Key value indicators in the Atlanta office market are shown in Table 10. The average discount rate (IRR) remains at 11.08%. This is a 52-basis-point drop from one year ago. The average overall cap rate (OAR) held steady at 9.23%.

REITs may not be the primary buyers in the market, but they are active in suburban development. Cousins Properties Inc. and Equity Office Properties Trust are two REITs vying with two private developers to construct the next office building in Buckhead.

REITs are also branching out into other aspects of office development. CarrAmerica Realty, a Washington, DC-based REIT, is debuting a new office space concept that tenants can lease and move into the same day in suburban Atlanta called NowSpace. NowSpace offers workstations complete with furniture, operating phones, and access to copiers and fax machines. The temporary space is aimed at fast-growth companies and start-up companies that need office space immediately. The concept is similar to "hoteling" and is ideal for telecommuters and short-term corporate projects. Although local brokers embrace the concept, it remains to be seen if the concept can succeed in a market perceived to be plagued by traffic congestion, commuting woes, and labor availability. ■

Table 10
Atlanta Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.75%–12.00%	9.75%–12.00%	11.00%–13.50%
AVERAGE	11.08%	11.08%	11.60%
CHANGE (Basis Points)	—	0	–52
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–10.50%	8.00%–10.50%	8.00%–10.50%
AVERAGE	9.23%	9.23%	9.17%
CHANGE (Basis Points)	—	0	+6
Market Rent Change Rate[b]			
RANGE	0.00%–3.50%	0.00%–3.50%	0.00%–4.00%
AVERAGE	1.96%	2.21%	2.46%
CHANGE (Basis Points)	—	–25	–50
Expense Change Rate[b]			
RANGE	3.00%–3.50%	3.00%–3.50%	3.00%–4.00%
AVERAGE	3.08%	3.10%	3.65%
CHANGE (Basis Points)	—	–2	–57
Residual Cap Rate			
RANGE	9.00%–11.00%	9.00%–11.00%	9.00%–11.00%
AVERAGE	9.46%	9.46%	9.60%
CHANGE (Basis Points)	—	0	–14

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Chicago Office Market

Investors are impressed with Chicago's strength. The office market has held up fairly well since the crisis in the financial markets last fall. Transactions, although at a slower pace, continue to occur in both the downtown and suburbs. A German fund is reportedly under contract to purchase 150 North Michigan. The sale price is estimated at $150.00 per square foot, which is a fairly good price for a Class A- building in the East Loop submarket. However, recent consolidations and mergers and acquisitions are making investors nervous about large blocks of space waiting to hit the market.

Chicago's skyline will change with the addition of new buildings that are under construction or planned for downtown. Union Tower at 550 West Van Buren Street (332,608 square feet) and a 371,608-square-foot building at 550 West Washington are nearly complete. Financing for a third building at 550 West Jackson (330,000 square feet) was obtained, yet the timing of the project is not known. Site work for a mix-use project on North Dearborn (260,000 square feet of office space) is also completed. These buildings will likely fulfill preleasing requirements and be completed.

The construction in downtown Chicago appears to be in line with the rate of absorption. Vacancy downtown as of midyear 1999 was reported at 10.0% and participants do not expect this rate to change dramatically over the near term. Corporate downsizing and a decline in job growth are likely to hinder future development downtown. Due to preleasing difficulties, construction of a 1.45-million-square-foot office tower on North Wacker Drive stopped. The prospective tenant for the deal, AON Insurance, is reportedly close to signing a deal for former Amoco space. It is not clear whether the project will recommence anytime soon.

Vacancy in the suburban office market as of midyear 1999 is reported to be approximately 9.0%. Participants expect this rate to rise due to the construction boom (5.9 million square feet) and low preleasing (33.33%). Some space that has been delivered is still vacant. Investors are concerned that concessions may reappear and aggressive leasing packages will be needed to induce tenants to lease any available space.

Increases in construction are likely to ease rental rate growth downtown and in the suburbs. Participants anticipate initial-year market rent growth at between 0.0% and 6.0%. Rent spikes are projected by 44.44% of participants. This is down from 55.56% in the prior quarter. Rent spikes range from 5.0% to 9.0% and are applied in years one, two, and/or three.

Key value indicators are shown in Table 11. The initial market rent change rate declined again this quarter (22 basis points). This represents a decrease of 81 basis points over the past year. All other rates remain unchanged except for the average OAR, which inched up 3 basis points to 9.14%.

Strong market conditions closed the gap between replacement costs and sale prices this quarter. Prices in general range from 85.0% to 110.0% of replacement cost. The average price is 94.44% of cost. Prices are not expected to rise significantly over the next 12 months. Participants are projecting increases as high as 10.00%. The average is 2.57%.

In addition to new construction, Class-B and Class-C properties are being bought and renovated and retrofitted to target high-tech users. As with many cities throughout the country, the majority of employment growth is driven by new high-tech firms. The majority of these new, service-oriented companies want to be in close proximity to a major client base to generate high revenue. However, start-up companies find it difficult to pay Class-A rental rates. The renovated buildings provide a CBD location at discounted rental rates. ■

Table 11
Chicago Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.29%–13.00%	9.29%–13.00%	9.50%–13.00%
AVERAGE	10.92%	10.92%	10.79%
CHANGE (Basis Points)	—	0	+13
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–10.25%	8.00%–10.25%	8.00%–10.00%
AVERAGE	9.14%	9.11%	9.06%
CHANGE (Basis Points)	—	+3	+8
Market Rent Change Rate[b]			
RANGE	0.00%–6.00%	0.00%–6.00%	0.00%–9.00%
AVERAGE	3.44%	3.66%	4.25%
CHANGE (Basis Points)	—	–22	–81
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	3.00%–4.00%
AVERAGE	3.09%	3.09%	3.25%
CHANGE (Basis Points)	—	0	–16
Residual Cap Rate			
RANGE	8.00%–10.50%	8.00%–10.50%	8.00%–10.25%
AVERAGE	9.28%	9.28%	9.21%
CHANGE (Basis Points)	—	0	+7

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Dallas Office Market

The abrupt slowdown of new construction in suburban Dallas is good news for the market and for the developers who still need to find tenants to fill the millions of square feet completed in 1998 and year-to-date 1999. In the mean time, downtown Dallas is attracting more tenants due to its economic value and revitalization.

All of the new office construction is concentrated in the suburbs and, although construction has slowed, some investors feel it may be a little too late. Last year 11 million square feet were added to the inventory, while absorption was less than half of that, around 5 million square feet. At the end of June, 6.95 million square feet of office space were under construction in the Dallas area. Absorption over the same time period was 3 million square feet. This pattern of supply exceeding demand is pushing vacancy rates up. According to Cushman & Wakefield, vacancy in suburban Dallas increased 230 basis points over the past year to 13.3% as of midyear 1999.

The affect of rising vacancy rates in the suburbs is taking its toll. Concessions are increasing and rental rates are starting to level off and even dip in some areas. Even top investment markets such as Las Colinas and Far North Dallas are making investors nervous. However, there are some developers who remain upbeat. Three developers recently announced plans to build new office projects along the Dallas North Tollway. The buildings will add roughly 500,000 square feet to the market.

Downtown is expected to hold its own. The revitalization of downtown and declining vacancy rates are sparking investment interest. Along with a residential building boom, there are office redevelopment projects that are attracting tenants. Absorption is positive and numerous high-tech firms are relocating to downtown, where new housing is attracting employees. According to Cushman & Wakefield, vacancy downtown decreased 6 basis from the first quarter 1999 to 25.9% as of midyear 1999.

Transaction activity is occurring downtown. Negotiations are pending for the sale of Thanksgiving Tower. This 50-story tower was built in the 1980s and is owned by foreign investors. The sale price is expected to be about $160.00 per square foot. MetLife announced that it plans to sell its 45-story Lincoln Plaza. This 1.1 million-square-foot building was built in 1984. No asking sale price was disclosed.

Few markets in the nation have discounts to replacement cost as deep as in the Dallas market; the deepest discounts are in prices for older downtown buildings. Participants estimate that across the market properties can be bought for 50.0% to 110.0% of replacement cost. The average price is 90.8% of cost.

Key value indicators in the Dallas office market are shown in Table 12. All cash flow assumptions shifted this quarter. The greatest change is an 85-basis-point drop in the average initial market rent change rate. This reflects a 220-basis-point plunge from a year ago. Clearly, investors are concerned that excessive building is putting downward pressure on rental rates. The average discount rate (IRR) decreased 13 basis points to 11.23%. The average overall cap rate (OAR) increased 3 basis points to 9.36%.

Due to the time lapse between breaking ground on a new project and delivery to the market, the surge of construction in 1998 is being reported now, while the benefits of the current drop in construction will not likely be realized until 2001. Until then, much of the real estate investment will likely shift downtown except for developers that are able to obtain financing for, and are optimistic about, continued development in the suburbs. ■

Table 12
Dallas Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.00%–13.00%	10.00%–13.00%	10.00%–14.00%
AVERAGE	11.23%	11.36%	11.56%
CHANGE (Basis Points)	—	–13	–33
Overall Cap Rate (OAR)[a]			
RANGE	7.50%–12.00%	7.50%–12.00%	6.50%–11.00%
AVERAGE	9.36%	9.33%	8.83%
CHANGE (Basis Points)	—	+3	+53
Market Rent Change Rate[b]			
RANGE	0.00%–10.00%	0.00%–10.00%	2.00%–10.00%
AVERAGE	2.36%	3.21%	4.56%
CHANGE (Basis Points)	—	–85	–220
Expense Change Rate[b]			
RANGE	2.50%–4.00%	2.50%–4.00%	3.00%–4.00%
AVERAGE	3.13%	3.31%	3.56%
CHANGE (Basis Points)	—	–18	–43
Residual Cap Rate			
RANGE	8.00%–12.00%	8.00%–12.00%	8.00%–11.00%
AVERAGE	9.66%	9.53%	9.44%
CHANGE (Basis Points)	—	+13	+22

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Houston Office Market

Fueled by concerns of mergers and acquisitions and low oil prices in the market, the pace of the Houston office market has slowed. New construction starts are down and transaction activity is minimal. There is very little investment property being marketed for sale. Rental rates and vacancy rates are holding steady.

With the recent entrance of Chevron Corporation into the market, investors who were concerned about the market's reaction to the merger of British Petroleum and Amoco are feeling more optimistic. Chevron is expected to bring two divisions and additional jobs to Houston.

Due to the drop in construction, the percentage of preleasing in newly constructed suburban office projects is keeping absorption strong and allowing developers to continue building. There is talk of a new speculative high-rise property for downtown, as well as a built-to-suit project. However, fewer projects are breaking ground as the capital markets continue their restraint on speculative construction.

Demand for office space is concentrated in the suburbs except for most financial institutions and large-space users who prefer to be downtown. Absorption was 573,990 square feet during the first half of 1999 in the Houston suburban markets according to Cushman & Wakefield. Absorption may slip as some tenants migrate to downtown. Overall, vacancy was 13.5% in the suburbs as of midyear 1999.

With the threat of overbuilding in the suburban markets, investment opportunities downtown have gained momentum. New residential lofts, restaurants, a ballpark, and entertainment venues are attracting businesses and residents. Participants are hopeful that the revitalization of downtown will enhance its tenant appeal and curb vacancy rates. Downtown Houston has the third highest vacancy rate of the office markets surveyed. As of midyear 1999, Cushman & Wakefield reported an overall vacancy of 13.7%. Only two other cities in our Survey, Dallas and Los Angeles, have higher vacancy rates.

A few investors are investing in the new craze for loft office space downtown by purchasing older buildings for redevelopment. The 36,000-square-foot Commercial National Bank building was recently purchased for such a renovation. Other investors have their eyes set on opportunities in midtown, which is attracting tenants.

Key value indicators in the Houston office market are shown in Table 13. All cash flow assumptions changed this quarter. The largest increase occurred in the average expense change rate, which dropped 22 basis points to 3.22%. The average market rent change rate declined 6 basis points to 3.36%. The average discount rate (IRR) decreased 13 basis points to 11.51%. The average overall cap rate (OAR) increased 5 basis points to 9.60%.

Of all the markets surveyed, Houston is second in terms of the greatest discount at which buildings can be acquired in relationship to replacement cost. Manhattan is ranked first. For Houston, participants report that sale prices are between 50.0% and 105.0% of replacement cost. The average price is 83.3% of cost. The majority of participants expect values to rise over the next 12 months. The rate of appreciation ranges from 3.0% to 15.0%. The average is 6.79%.

Houston's economy is more diversified now. Future employment growth will be realized by energy companies, as well as high-tech, financial, and law firms. Although the underlying fundamentals of the market are less attractive then other major cities in the nation, investors are expecting a favorable outcome for Houston. ■

Table 13
Houston Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.00%–13.50%	10.00%–13.50%	10.00%–14.00%
AVERAGE	11.51%	11.64%	11.63%
CHANGE (Basis Points)	—	–13	–12
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–12.00%	8.00%–12.00%	6.50%–11.00%
AVERAGE	9.60%	9.55%	9.02%
CHANGE (Basis Points)	—	+5	+58
Market Rent Change Rate[b]			
RANGE	0.00%–8.00%	0.00%–8.00%	0.00%–8.00%
AVERAGE	3.36%	3.42%	3.94%
CHANGE (Basis Points)	—	–6	–58
Expense Change Rate[b]			
RANGE	3.00%–4.00%	3.00%–4.00%	3.00%–4.00%
AVERAGE	3.22%	3.44%	3.59%
CHANGE (Basis Points)	—	–22	–37
Residual Cap Rate			
RANGE	8.00%–12.00%	8.00%–12.00%	8.00%–11.00%
AVERAGE	9.81%	9.75%	9.59%
CHANGE (Basis Points)	—	+6	+22

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Los Angeles Office Market

Office properties for sale in Los Angeles are attracting multiple bidders. However, buyers are not willing to pay any large premiums. "No one is going crazy over prices," says one participant, "there have not been any surprise transactions." Market conditions in a majority of the Los Angeles submarkets are favorable for investors. However, the market remains relatively calm.

Vacancy rates in the Tri-Cities and West Los Angeles average approximately 11.00%. Speculative construction appears to be under control and rental rates continue to increase. It is not surprising that most institutional investors prefer these less risky submarkets. These areas are also favorable to tenants and developers.

Downtown Los Angeles continues to suffer from a surplus of space. As of midyear 1999, Cushman & Wakefield reported a vacancy rate of approximately 25.0% – one of the highest CBD rates in the country. The available space represents nearly 40.0% of the total space available in the county. Some brokers argue that the data is inflated since it includes office space located in Class-C buildings that are obsolete. Excluding these properties, however, the underlying fundamentals for downtown are still weak.

With no new office construction on the horizon for downtown, there is hope that the projected employment growth will deflate the available space. The telecommunications industry appears to be the dominant employment force in the downtown market. According to Cushman & Wakefield, approximately 120,000 square feet have been leased to high-tech tenants in 1999. In 1998, over 400,000 square feet were absorbed by this industry.

Upside potential exists for office properties in the Los Angeles market since sale prices are still generally below replacement cost. Across the market, prices range from 75.0% to 100.0% of replacement cost. The average price is 87.81% of cost. Prices are expected to increase as much as 10.0% over the next 12 months. The average projected increase is 5.07%.

Key value indicators are shown in Table 14. While the average overall cap rate (OAR) and average residual cap rate remained unchanged at 8.86% and 9.25%, respectively, the average discount rate (IRR) increased 2 basis points to 11.73%. The Los Angeles average IRR is now the highest IRR of all the office markets surveyed and 49 basis points higher than the national office market IRR (11.24%) and 64 basis points higher than the national suburban office market IRR (11.09%)

Going against a prior trend, the average initial market rent change rate increased 3 basis points to 4.39%. This is 105 basis points below the average a year ago. The expense change rate remains at 3.25%. Some participants use rent spikes, but they are property specific.

New office construction in the submarkets is occurring at a steady pace and properties have significant leasing in place prior to completion. Construction is occurring in West Los Angeles (Santa Monica and Marina Del Ray), South Bay (Cerritos), and the Tri-Cities (Glendale, Burbank, and Pasadena). Following the purchase of a 20.5-acre parcel of land in Burbank's South San Fernando redevelopment district, Crown Realty plans to build a master-planned facility to include studio, office, and retail space. The Burbank Media District, which boasts a vacancy rate of 1.5%, is the strongest Tri-Cities submarket.

Investment opportunities exist in Los Angeles, but the market is sensitive to location. As with other markets, REITs will remain the less prominent buyers, and enable other investors to benefit from the market's confident economic and demographic outlook. ■

Table 14
Los Angeles Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–14.00%	10.00%–14.00%	10.00%–15.00%
AVERAGE	11.73%	11.71%	11.71%
CHANGE (Basis Points)	—	+2	+2
Overall Cap Rate (OAR)[a]			
RANGE	7.00%–10.50%	7.00%–10.50%	7.00%–10.50%
AVERAGE	8.86%	8.86%	8.74%
CHANGE (Basis Points)	—	0	+12
Market Rent Change Rate[b]			
RANGE	3.00%–6.00%	2.50%–6.00%	3.00%–10.00%
AVERAGE	4.39%	4.36%	5.44%
CHANGE (Basis Points)	—	+3	–105
Expense Change Rate[b]			
RANGE	3.00%–4.00%	3.00%–4.00%	3.00%–4.00%
AVERAGE	3.25%	3.25%	3.47%
CHANGE (Basis Points)	—	0	–22
Residual Cap Rate			
RANGE	8.00%–11.00%	8.00%–11.00%	8.00%–11.00%
AVERAGE	9.25%	9.25%	9.35%
CHANGE (Basis Points)	—	0	–10

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Manhattan Office Market

Due to solid market fundamentals, Manhattan continues as a top investment location. The market has adjusted to restrained lending, and both buyers and sellers are being more conservative with potential deals. The recent slowdown in transactions earlier this year was more a reflection of a decline in the quality of buildings on the market than of a decrease in investor interest.

Currently, transaction activity has picked up. Two properties in Midtown and one property Downtown traded in the latter part of the first half of the year. 450 West 33rd Street, at the corner of Tenth Street, sold for $223 million ($139.00 per square foot). 521 Fifth Avenue, at the corner of 43rd Street, was bought for approximately $93 million ($210.00 per square foot). The purchase price excludes $4 million that the new owner will use to renovate the property. GE Investments sold 14 Wall Street for $100 million ($100.00 per square foot). Overall, Class-A properties Downtown are trading at an average of $185.00 per square foot according to Cushman & Wakefield. For Midtown, the average is $287.00 per square foot.

Insurance companies, private partnerships, and foreign investors are active buyers. REITs are also participating in the market. Although the total monetary investment in Manhattan by REITs is down from last year, they represent a larger portion of the buying pool.

The market continues to benefit from the continued restraint on speculative new construction. Vacancy rates are still low. In Midtown the rate was 7.4% at the end of the second quarter, according to Cushman & Wakefield, which reports a Downtown second-quarter vacancy rate of 8.4%. Some submarkets, such as Midtown South, have vacancy rates under 6.0%. Vacancy rates are even lower for Class-A space — 4.0% Downtown and 5.2% in Midtown. Tight market conditions are minimizing concessions.

Table 15
Manhattan Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.75%–13.00%	9.75%–13.00%	9.75%–13.00%
AVERAGE	11.36%	11.35%	11.06%
CHANGE (Basis Points)	—	+1	+30
Overall Cap Rate (OAR)[a]			
RANGE	7.50%–10.50%	7.50%–10.50%	7.50%–10.00%
AVERAGE	9.03%	9.06%	8.84%
CHANGE (Basis Points)	—	–3	+19
Market Rent Change Rate[b]			
RANGE	0.00%–6.00%	0.00%–6.00%	0.00%–6.00%
AVERAGE	3.50%	3.56%	3.56%
CHANGE (Basis Points)	—	–6	–6
Expense Change Rate[b]			
RANGE	3.00%–4.00%	3.00%–4.00%	3.00%–5.00%
AVERAGE	3.44%	3.44%	3.67%
CHANGE (Basis Points)	—	0	–23
Residual Cap Rate			
RANGE	8.00%–10.00%	8.00%–10.50%	7.00%–10.50%
AVERAGE	9.17%	9.19%	9.08%
CHANGE (Basis Points)	—	–2	+9

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Key value indicators in the Manhattan office market are shown in Table 15. This quarter there were minimal shifts in most cash flow forecast assumptions. The average discount rate (IRR) inched up 1 basis point to 11.36%. The average overall cap rate (OAR) slipped down 3 basis points to 9.03%. The market rent change rate dropped 6 basis points to 3.50%, while the expense change rate held steady at 3.44%.

Prices for Manhattan office properties are still generally below replacement cost. Discounts range from 10.0% to 40.0% with the greatest discount being received by Class-B properties. However, prices for Class-B buildings are increasing. Overall, participants estimate that the average price of Class-A and Class-B properties together is 82.0% of replacement cost. Prices are expected to increase from 3.0% to 10.0% over the next 12 months; the average projected increase is 6.63%. This is a decline of 77 basis points from the prior quarter.

The shortage of space and continued job growth are helping to keep rental rates high. In Midtown the overall average asking rent was $41.54 per square foot; for Class-A space, the average was $48.11. Downtown the overall asking rent hit $32.31 per square foot; for Class-A space it was $38.84.

There is some uncertainty as to how long rental rates can keep climbing. Although there is no fear that an oversupply of space may put downward pressure on rent growth, investors are wary that persistent growth in rental rates will slow leasing activity or cause tenants to relocate out of the market.

Investors, concerned that there is minimal upside in current rent levels, are scouting the market for investment-grade properties which were leased during the recession of the early 1990s hoping to benefit from near-term lease expirations. Investors estimate that some leases are currently up to 20.00% below-market rent. ■

Pacific Northwest Office Market

While new construction is occurring in the Pacific Northwest, transaction activity remains relatively quiet. After Chicago-based Equity Properties Trust bought numerous buildings in Seattle over the last two years, remaining investment opportunities in downtown Seattle are minimal. "Nothing substantial has been on the market. Sale offerings out of Seattle are flat," comments one investor.

Despite new construction and Boeing continuing to downsize and sell some of its owner-occupied buildings, market conditions are stable. There has been no real boom or bust activity to push the market in either direction, and there is an amble pool of investors who stand ready to invest if opportunities arise.

There is development occurring in downtown Seattle and on the fringes of both Portland and Seattle where land and development costs are cheaper. The last office tower built in downtown Seattle was completed in 1991. Low vacancy rates are prompting new construction.

During 1999, three new office buildings broke ground. Earlier this year, a 180,000-square-foot office building at Second Avenue and Columbia Street went into construction and a 300,000-square-foot office tower at Seventh Avenue and Pike Street was started. Reportedly, neither property has signed significant tenants. A third office tower is under construction at 700 Olive Way. This 24-story office tower is being built by a joint venture between Clise Properties and Nordstrom Inc. Nordstrom will occupy 80.00% of the 500,000-square-foot building. The remaining space (100,000 square feet) remains available for leasing.

The vacancy rate for downtown Seattle declined 80 basis points from the first quarter to 3.8%. This is down 100 basis points from a year ago. In suburban Seattle, the vacancy rate increased 110 basis points from the first quarter to 6.4%. For downtown Portland, the vacancy rate increased 20 basis points from the first quarter to 5.1%. In suburban Portland, the vacancy rate increased 100 basis points from the first quarter to 8.6%.

Some buildings in the Pacific Northwest office market are priced higher than replacement cost, but more are available at a discount to the cost benchmark. Prices are 85.0% to 110.0% of replacement cost. The average price is 97.9% of replacement cost. One participant believes that prices could drop over the next 12 months; most, however, look for increases between 2.0% and 5.0%. The average projected increase is 2.38%.

Key value indicators in the Pacific Northwest office market are shown in Table 16. The average discount rate (IRR) inched up slightly (3 basis points) from the second quarter to 11.30% as of the third quarter. The average overall cap rate (OAR) and residual cap rate remained unchanged. The market rent change rate and expense change rate each incurred moderate decreases from the prior quarter.

After seeing above-inflationary increases in rental rates in Seattle over the past 18 months, participants are projecting only moderate increases. Rental rates for the top buildings in Seattle are about $40.00 per square foot. Rental rates for lower-end Class-A buildings are at the $30.00-per-square-foot range. Rental rates in Portland are still in the mid $20.00-per-square-foot range.

Although vacancy rates in downtown Seattle may increase slightly due to the addition of speculative space, the economic and demographic outlook for Seattle and Portland is positive. Hence, the office markets in both major cities of the Pacific Northwest are likely to remain healthy. As a result, investors will continue to seek investment opportunities. ■

Table 16
Pacific Northwest Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–13.00%	10.00%–13.00%	10.00%–15.00%
AVERAGE	11.30%	11.27%	11.52%
CHANGE (Basis Points)	—	+3	–22
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–11.00%	8.00%–11.00%	8.00%–11.25%
AVERAGE	9.21%	9.21%	9.27%
CHANGE (Basis Points)	—	0	–6
Market Rent Change Rate[b]			
RANGE	2.50%–8.00%	2.50%–8.00%	0.00%–8.00%
AVERAGE	4.29%	4.43%	4.38%
CHANGE (Basis Points)	—	–14	–9
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	3.00%–4.00%
AVERAGE	3.19%	3.34%	3.42%
CHANGE (Basis Points)	—	–15	–23
Residual Cap Rate			
RANGE	8.50%–10.50%	8.50%–10.50%	8.50%–10.75%
AVERAGE	9.44%	9.44%	9.42%
CHANGE (Basis Points)	—	0	+2

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

San Francisco Office Market

Investor interest for office properties in San Francisco remains strong despite new construction, a slight rise in vacancy rates, and a slowdown in rental rate growth. "Market conditions are not as strong as they were a year ago," comments one participant. "Some property owners in the market are trying to cash out before there is no liquidity left," adds another investor.

REITs remain on the sidelines finding it difficult to finance acquisitions in the pricey San Francisco market. Sale prices for Class-A office space in San Francisco are still in a tight range – between $300.00 and $350.00 per square foot estimates one participant. Properties are trading with cap rates in the low 7.00% range, with buyers anticipating rental rates continuing to increase. Foreign investors, pension funds, and private investment companies remain the major buyers.

Investors are eager to see how the market will react when available space is added to the market following the completion of approximately 1.50 million square feet of new office space scheduled for completion over the next three years. Although the new buildings are approximately 60.00% preleased to major tenants, including Arthur Andersen, PricewaterhouseCoopers, and The Gap, rental rates in San Francisco are currently so high that prospective tenants may find it financially difficult to lease space.

According to The CAC Group, a brokerage firm in San Francisco, rental rates as of midyear 1999 ranged from $40.00 to $60.00 per square foot. Investors are concerned that occupancy costs for tenants may reach a point where, even though the tenant does not want to leave the market, they can't justify staying. Although recent increases in rental rates are well below the surges realized over the last three years, above-inflation increases are still occurring. As a result, some companies have relocated to suburban markets and nearby Oakland.

While leasing and transaction activity remains steady in the suburban submarkets, the downtown is by far the most active area. The hot spot within downtown is the South of Market Street (SOMA) submarket. The strength of SOMA is tied to an explosion of new Internet and technology-related companies – "dotcom" firms –, as well as traditional companies leasing space for their Internet-related divisions. As demand increases in SOMA, rental rates are nearly as high as the NOMA (North of Market) submarket, where law and financial tenants are typical occupants.

Some buildings in San Francisco are priced higher than replacement cost, but more are available at a discount to the cost benchmark. Prices are 70.0% to 110.0% of replacement cost. The average price is 96.25% of replacement cost. Most participants believe that prices will increase over the next 12 months. The projected increases range between 2.0% and 10.0%. The average increase is 3.94%.

Key value indicators in the San Francisco office market are shown in Table 17. The average discount rate (IRR) decreased 3 basis points to 11.02%. The average overall cap rate (OAR) inched up 7 basis points to 8.53%, the lowest of all surveyed office markets.

After declining 67 basis points last quarter, the average initial market rent change rate increased 28 basis points this quarter to 4.28%. Participants are not expecting significant rental rate growth like that realized over the past three years (15.0% to 30.0%). While some investors believe that rents will stabilize as new space coming into the market is absorbed, others anticipate better than average rent growth. This quarter, however, fewer participants (50.0%) are using rent spikes. This is down from 57.14% last quarter. Rent spikes range from 2.0% to 10.0%; the average is 7.3%, 70 basis points lower than last quarter. ■

Table 17
San Francisco Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–13.00%	10.00%–13.00%	9.25%–13.00%
AVERAGE	11.02%	11.05%	11.07%
CHANGE (Basis Points)	—	–3	–5
Overall Cap Rate (OAR)[a]			
RANGE	7.00%–11.00%	7.00%–11.00%	7.00%–11.00%
AVERAGE	8.53%	8.46%	8.43%
CHANGE (Basis Points)	—	+7	+10
Market Rent Change Rate[b]			
RANGE	0.00%–10.00%	0.00%–10.00%	0.00%–11.00%
AVERAGE	4.28%	4.00%	6.14%
CHANGE (Basis Points)	—	+28	–186
Expense Change Rate[b]			
RANGE	3.00%–4.00%	3.00%–4.00%	3.00%–4.00%
AVERAGE	3.31%	3.43%	3.61%
CHANGE (Basis Points)	—	–12	–30
Residual Cap Rate			
RANGE	8.00%–10.00%	8.00%–10.00%	8.00%–10.00%
AVERAGE	8.94%	8.89%	8.86%
CHANGE (Basis Points)	—	+5	+8

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Southeast Florida Office Market

Office properties in the central business districts (CBD) of Fort Lauderdale and Miami are the preferred property types for investors. Although some developers and investors are scouting the non-CBD submarkets for real estate opportunities, rising vacancy rates and continued construction are likely to dampen their enthusiasm. Commitment for new office space is down from last year and the first six months of 1999. As with many other markets throughout the country, investment timing is a key issue.

A relatively small market, the Southeast Florida office market is spread over three counties — from the middle of Palm Beach County, through Broward County, to the end of Dade County. The major office markets are West Palm Beach, Boca Raton, Fort Lauderdale, and Miami. Miami-Dade County contains more than 26 million square feet of institutional-grade office properties. There is not a significant supply of institutional-grade office space outside of Miami; Broward County contains approximately 13.5 million square feet, and Palm Beach has just under 12.5 million square feet.

While vacancy rates in the CBDs of Fort Lauderdale and Miami declined during the first six months of 1999, vacancy rates in the non-CBD submarkets increased. The increases in vacancy resulted from the completion of speculative space and the lack of absorption. As of the second quarter 1999, the vacancy rate in the CBD was 14.5%, according to Cushman & Wakefield. Outside of the CBD, the vacancy rate was 13.4%. The average Class-A asking rent is approximately $25.00 per square foot.

Speculative construction is also occurring in West Palm Beach, especially in Boca Raton. Of the approximate 600,000 square feet of space completed to date, 57.0% is preleased. Rents are higher than in Fort Lauderdale or Miami, however. The average rental rate for Class-A space is roughly $28.00 per square foot. Transaction activity in West Palm Beach indicates a broad range of prices depending on building quality, location, and size. A 20,000-square-foot office building at 5840 Corporate Way recently sold for $1.1 million or $55.00 per square foot. Crocker Realty Trust purchased approximately 610,000 square feet of office space in Palm Beach County for $75 million or $122.00 per square foot.

Prices are nearing or exceeding replacement costs. Survey participants feel that the range is from 80.0% to 110.0% of replacement cost; the average is 98.2% of cost. Participants expect prices to rise over the next 12 months, but the rate of increase is modest, from 2.0% to 3.0%. The projected average increase is 2.5%.

Key value indicators in the Southeast Florida office market are shown in Table 18. All cash flow assumptions remain unchanged from the prior quarter. The average discount rate (IRR) is 11.08%. For the third consecutive quarter, the average overall cap rate (OAR) is 9.39%. The average initial market rent change rate is 3.50% and the average expense change rate is 3.09%.

More new space is planned for the market. Approximately 1.3 million square feet are under construction, the majority in the Brickell Avenue and Airport/West Dade County submarkets. Preleasing is estimated at 11.0%.

Developers are optimistic that steady job growth will enable the space to be absorbed. Investors are concerned that a slowdown in job growth will impede absorption. Rental rates will suffer and concessions will increase.

Not all construction is speculative. Built-to-suit projects continue to benefit the market. The Internal Revenue Service is planning a 140,000-square-foot facility in Plantation. Other developers are aggressively chasing deals for built-to-suit projects. ■

Table 18
Southeast Florida Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–12.00%	10.00%–12.00%	10.00%–13.50%
AVERAGE	11.08%	11.08%	11.00%
CHANGE (Basis Points)	—	0	+8
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–12.00%	8.00%–12.00%	8.00%–12.00%
AVERAGE	9.39%	9.39%	9.46%
CHANGE (Basis Points)	—	0	–7
Market Rent Change Rate[b]			
RANGE	2.00%–7.00%	2.00%–7.00%	2.00%–7.00%
AVERAGE	3.50%	3.50%	4.21%
CHANGE (Basis Points)	—	0	–71
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	3.00%–4.00%
AVERAGE	3.09%	3.09%	3.43%
CHANGE (Basis Points)	—	0	–34
Residual Cap Rate			
RANGE	9.00%–11.00%	9.00%–11.00%	9.00%–11.00%
AVERAGE	9.72%	9.72%	9.82%
CHANGE (Basis Points)	—	0	–10

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

Washington, DC Office Market

Investors are trying to enter into the Washington, DC market before it is too late in the game. "How much longer can it go on?" asks one participant. There are still profitable deals to be made in the market, but they are becoming the minority. Preleasing on new construction is unbelievably high and rental rate growth has come so far so fast. Despite the jitters, investors view Washington, DC as a hot investment market.

The majority of public-funded REITs remain quiet in the market. REITs with capital are still active, but they are few and far between. Foreign investors, including German and Dutch buyers, are interested in Class-A projects downtown. Pension and opportunity funds are enjoying the prosperity of the suburbs.

Vacancy rates are extremely low and are expected to remain so, as preleasing in newly constructed buildings is strong. The overall vacancy rate is just over 5.0%. The average asking rent in the District is over $30 per square foot; Class-A space ranges from the mid-$30s to over $40 per square foot. There is talk that rental rates may be up to as high as $50.00 per square foot in some premier buildings downtown. Concessions are extremely rare in the market and there is no pressure for concessions to start.

Rental rate growth is expected to slow. Only 30.0% of participants anticipate continued rent spikes. This is down from 50.0% in the prior quarter. Rent spikes range from 4.0% to 10.0% and occur in years one and/or two. The average rent spike of 6.33% remains unchanged from the prior quarter.

Preleasing for buildings under construction is very strong. Properties developed in 1998 are significantly leased and projects scheduled for delivery in 1999 are estimated to be 60.0% preleased. Due to the area's extremely low unemployment rate, it is uncertain where the tenants will come from to fill the properties. "Companies are building for future employees which may be difficult to obtain," comments one participant. "I think that many of the companies have optimistic hiring plans that may not materialize."

Problems associated with traffic congestion also loom over the market. "It is a difficult market to get in and out of," says one participant. The suburban areas of Northern Virginia are particularly difficult for commuters; especially, the Dulles Toll Road corridor. However, "It doesn't keep people from coming," a participant states.

Key value indicators in the Washington, DC office market are shown in Table 19. Minor changes in cash flow forecast assumptions occurred this quarter. The average discount rate (IRR) decreased 3 basis points to 11.54%. The average residual cap rate decreased 4 basis points to 9.36%. The OAR remained unchanged at an average of 9.17%.

Downtown and suburban office projects continue to trade at prices generally below replacement cost. CIGNA recently purchased 1800 M Street for $114.8 million. This ten-story, 535,000-square-foot Class-A office building was 100.0% occupied at the time of sale. The sale price equates to $215.00 per square foot. 7600 Leesburg Pike in Tysons Corner recently sold for approximately $150.00 per square foot. Reportedly, a building in Reston is under contract for slightly over $200.00 per square foot. Better discounts can be found in suburban Maryland.

Overall, prices range from 75.0% to 110.0% of replacement cost. The average is 92.2% of replacement cost. Over the next 12 months, values are expected to increase up to 10.0%; the average projected increase is 3.2%. Properties in the market sell in a relatively short period of time. The average marketing time is 7.2 months. ■

Table 19
Washington, DC Office Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–13.00%	10.00%–13.00%	10.00%–13.00%
AVERAGE	11.54%	11.57%	11.33%
CHANGE (Basis Points)	—	–3	+21
Overall Cap Rate (OAR)[a]			
RANGE	7.00%–11.00%	7.00%–11.00%	7.00%–11.00%
AVERAGE	9.17%	9.17%	8.88%
CHANGE (Basis Points)	—	0	+29
Market Rent Change Rate[b]			
RANGE	0.00%–10.00%	0.00%–10.00%	0.00%–10.00%
AVERAGE	2.93%	2.94%	2.93%
CHANGE (Basis Points)	—	–1	0
Expense Change Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	3.00%–4.00%
AVERAGE	3.23%	3.23%	3.48%
CHANGE (Basis Points)	—	0	–25
Residual Cap Rate			
RANGE	8.00%–11.00%	8.00%–11.00%	8.00%–11.00%
AVERAGE	9.36%	9.40%	9.23%
CHANGE (Basis Points)	—	–4	+13

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Industrial Market

There is consistent demand for Class-A bulk warehouse product in the national industrial market, but the supply of available properties is declining. "We can't find enough of it," says one participant. The larger, bulk-warehouse properties are preferred by investors because they are less management intensive and more marketable than smaller industrial buildings. "Since everyone is looking for big-box industrial buildings, your exit strategy is a lot easier," remarks a participant. However, investors need to select properties with caution. Tenants who typically occupy larger warehouse properties are more likely to downsize at the sign of a slowing economy.

Some investors are scouting established high-tech markets to acquire R&D properties that have been renovated for flex-office use for tenants such as computer engineers and software developers. Sale prices for these properties are usually slightly higher then typical R&D buildings, but they are perceived as being less risky. They are likely to command higher rental rates and, therefore, provide investors with greater income potential.

Construction activity is brisk. During the first half of 1999, 67.3 million square feet were completed, according to Cushman & Wakefield. As of midyear 1999, 72.6 million square feet are under construction. In addition to new construction, older properties located in established markets, where land availability is limited but demand from users is strong, are being redeveloped.

Chicago is a favorite market for investors, especially the south and west sections of the market. The appeal of Atlanta is diminishing. Although investors favor the I-85 corridor of Northeast Atlanta, the overall market is starting to soften and concessions are becoming commonplace. "Everyone is trying to attract the new tenants in the market to their building," comments a participant. Nonetheless, developers are still building in Atlanta. Outlying areas such as Doraville and Suwanee are seeing increased development due to an abundance of land and cheaper prices.

As developers plan projects farther from established markets, there is concern that it will be increasingly difficult to secure a skilled labor force. Accessibility is also a concern. Existing road networks will likely need to be improved and expanded.

Prices in the national industrial market are stable. Institutional-grade warehouses remain above replacement cost, while lower-grade product is generally at replacement cost. R&D and flex properties are still generally below this marker. Across the market, prices range from 80.0% to 110.0% of replacement cost. The average is 98.0% of cost. Prices are expected to increase as much as 10.0% over the next 12 months; the average projected increase is 2.17%.

Key value indicators are shown in Table 20. The majority of cash flow forecast assumptions held steady from the prior quarter. The average discount rate (IRR) remained at 11.13% and the average overall rate (OAR) is again at 9.15%. The average residual cap rate dipped 3 basis points to 9.50%.

The risk of ownership of R&D/flex properties is higher than in the warehouse segment. This is evident in comparing rates for R&D/flex space with those for warehouse/distribution facilities. The range of IRRs for warehouses is from 9.50% to 12.50%; the average is 11.00%. The range of OARs is from 8.00% to 10.00%; the average is 9.03%. For R&D/flex properties, the range of IRRs is from 8.00% to 13.00%; the average is 11.54%. The range of OARs is from 8.00% to 12.00%; the average is 9.77%. ■

Table 20
National Industrial Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.50%–12.50%	9.50%–12.50%	10.00%–12.50%
AVERAGE	11.13%	11.13%	11.15%
CHANGE (Basis Points)	—	0	–2
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–10.00%	8.00%–10.00%	8.00%–10.00%
AVERAGE	9.15%	9.15%	9.02%
CHANGE (Basis Points)	—	0	+13
Market Rent Change Rate[b]			
RANGE	1.50%–6.00%	1.50%–6.00%	2.00%–6.00%
AVERAGE	3.29%	3.32%	3.57%
CHANGE (Basis Points)	—	–3	–28
Expense Change Rate[b]			
RANGE	1.50%–5.00%	1.50%–5.00%	1.50%–5.00%
AVERAGE	3.25%	3.25%	3.48%
CHANGE (Basis Points)	—	0	–23
Residual Cap Rate			
RANGE	8.50%–10.50%	8.50%–10.50%	8.50%–10.00%
AVERAGE	9.50%	9.53%	9.30%
CHANGE (Basis Points)	—	–3	+20

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Apartment Market

It is becoming increasingly difficult to find existing high-quality apartment investments at reasonable sale prices throughout the country. Some sellers are marketing projects with unrealistic expectations of what investors are willing to pay. In turn, sellers are receiving fewer offers and price adjustments are still occurring. Buyers are using tougher underwriting standards and lower revenue growth assumptions.

New products keep entering the market and there appears to be no shortage of funds available for apartment development. Heavy permitting activity is occurring in Orlando, Dallas, Charlotte, Austin, Las Vegas, and Phoenix. "Investors need to get the message out to the developers and construction lenders of the world that they have to stop building," comments one participant. The continuous building is negatively affecting occupancy rates, rental rates, and income growth. These markets are attracting fewer buyers. As a result, marketing time is longer and sale prices are softening.

There is speculation that market fundamentals in Dallas and Austin are turning around. "We are starting to see some light at the end of the tunnel," comments a participant. Rents have started to come up, although they are still depressed from where they were 12 months ago. Concessions are going away. "How fast and when it is going to come back is the question, but it looks like it is starting to turn in the right direction," continues the participant. Sellers are likely to hold onto properties in these markets until buyers' perceptions improve.

The amount of construction is less of a concern in tight markets such as the Pacific Northwest and Southwest regions of the country, as well as Washington, DC, Boston, Minneapolis, and Chicago. "We do not have any fears of overbuilding, we are more cautious of how much we have to pay to get the product we want," says a participant. The high cost of entry to most of these markets will likely keep market conditions favorable.

Pension funds are very active in the apartment market. REITs may not be the primary investors in the market, but apartments are their preferred property type. Based on a report prepared by the National Multi Housing Council, apartment REITs outperformed all other REIT sectors in the first quarter of 1999. Compared to a 5.5% overall decline in the NAREIT index, apartment REITs were down just 1.2%. For March 1999, apartment REITs posted the second-highest gain at 1.0%.

There is a wide spread in prices in relation to replacement cost in the national apartment market. Participants say that, overall, prices range from 75.0% to 120.0% of replacement cost. The average price is 95.86% of cost. Projected increases over the next 12 months are not large; the range is from 0.0% to 6.0%, with an average increase of 2.64%.

Key value indicators in the national apartment market are shown in Table 21. The average residual cap rate declined 1 basis point to 9.21%. Both the average discount rate (IRR) and the average overall cap rate (OAR) held steady this quarter. The average IRR is 11.51%, while the average OAR is 8.86%. However, many investors are selecting higher cap rates within the range when negotiating deals.

Some participants view the apartment market as being over the peak on the real estate cycle. It is hard to generalize. There are markets which are very tight, while others are so on the verge of crashing that any slight shift in employment or population growth will hurt them very fast. Investors not interested in paying high prices for Class-A product, or pessimistic about development, are buying older, Class-B and Class-C products in strong markets to renovate and reposition. ■

Table 21
National Apartment Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	LAST QUARTER	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–15.00%	10.00%–15.00%	10.00%–13.00%
AVERAGE	11.51%	11.51%	11.26%
CHANGE (Basis Points)	—	0	+25
Overall Cap Rate (OAR)[a]			
RANGE	7.50%–11.00%	7.50%–11.00%	7.00%–11.00%
AVERAGE	8.86%	8.86%	8.76%
CHANGE (Basis Points)	—	0	+10
Market Rent Change Rate[b]			
RANGE	0.00%–6.00%	0.00%–6.00%	0.00%–7.00%
AVERAGE	3.08%	3.08%	3.28%
CHANGE (Basis Points)	—	0	–20
Expense Change Rate[b]			
RANGE	2.00%–5.00%	2.00%–5.00%	2.00%–5.00%
AVERAGE	3.18%	3.18%	3.28%
CHANGE (Basis Points)	—	0	–10
Residual Cap Rate			
RANGE	8.00%–10.25%	8.00%–10.50%	8.00%–10.25%
AVERAGE	9.21%	9.22%	9.28%
CHANGE (Basis Points)	—	–1	–7

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Hotel Market Highlights

The dynamics of the hotel industry have changed. Aggressive buyers with endless capital have been replaced with a slower-paced, more focused group of players. Strategies to dominate the industry by accumulating the most properties have been replaced by internal strategies to be the top operator in the industry. "There has been a decreased emphasis on portfolio size and an increased emphasis on how to dominate through operation," comments a participant.

The current lull in the hotel transaction arena is allowing hotel investors to reevaluate their portfolios and devise plans to improve performance, both externally and internally. Some companies will not survive the current capital crunch. "Companies that succeeded only because of asset growth may not be smart enough or efficient enough to maintain the same profits with internal restructuring," says a participant. "The dominant hotel companies will now be confirmed," adds the participant.

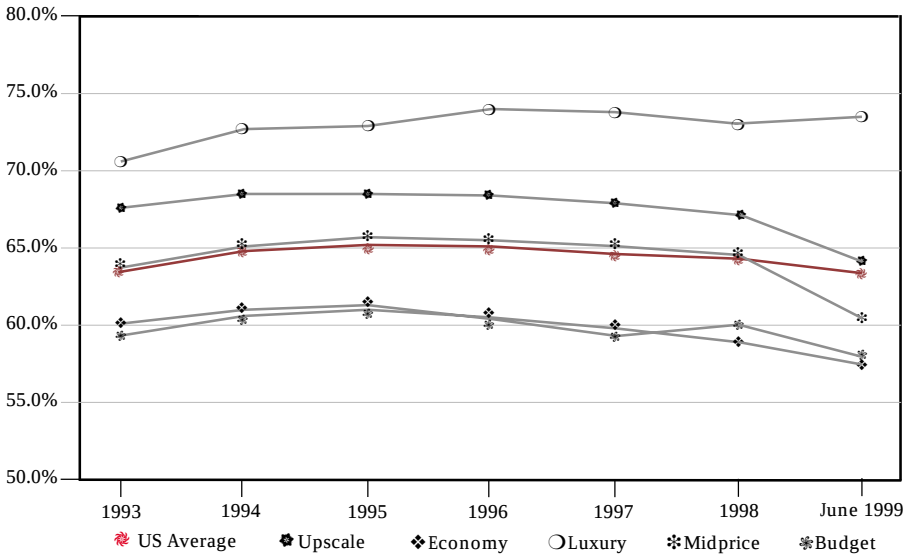
The hotel industry recorded record-breaking profit for 1998, despite dips in average daily room rate (ADR) growth and occupancy levels. According to Smith Travel Research (STR), 1998 profits for the hotel industry are estimated at $20.9 billion. This is 23.0% higher than the industry's $17.0 billion profit in 1997 and 67.0% higher than the profit from 1996 ($12.5 billion). For 1999 through 2001, STR is projecting profits to increase annually, reaching $29.0 billion by year-end 2001.

Industry Performance

Despite a slip in occupancy and ADR growth during the first six months of 1999, the underlying fundamentals for the hotel industry are solid.

The industry's occupancy rate declined to 63.0% as of midyear 1999 according to STR (see Exhibit H-1).

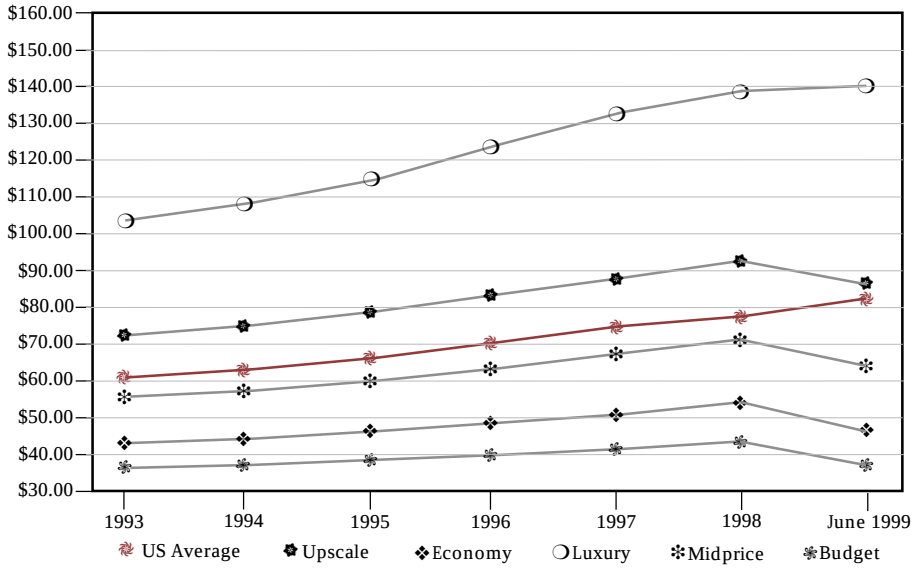
Exhibit H-1
Occupancy Trends 1993-June 1999



This is a decrease of 1.56% from year-end 1998. All hotel markets, except luxury hotels, realized declines in occupancy during the first six months of 1999. Midprice hotels recorded the highest drop, a 5.15% decrease, to reach an occupancy level of 60.8%. Luxury hotels posted a 0.96% gain to reach an occupancy level of 73.6%.

The slowdown in ADR growth continued through the first six months of 1999. As of midyear 1999, ADRs increased 3.21% to $81.14. Luxury hotels achieved the highest gain of 0.72% to reach an ADR of $140.00. ADRs for all other segments declined during the first half of 1999. With a decline of 13.55%, budget hotels reported the largest drop to $38.47.

Exhibit H-2
Average Daily Room Rates 1993-June 1999



REITs

The drop in REIT stocks is still affecting the hotel market. Lending is more conservative and construction is occurring at a slower pace. In the long run, the inability of REITs, and particularly paired-share REITs, to buy unabated will positively affect the market. Sale prices have been adjusted downward to more realistic levels and other non-REIT investors are able to acquire properties.

It is not likely that REIT shares will recover to their peak levels anytime soon. Investors, however, do expect some REITs to make slow and steady gains. "REITs are not entirely out of the picture," comments a participant. "Once REITs can prove to the market that they can swallow what they took in last year, they will start getting priced a little better, remarks a participant. MeriStar and Host Marriott are consistently mentioned by participants as top REITs that will continue to dominate the market.

For the time being, lodging REITs are likely to act like hotel companies and concentrate on asset management, operations, and strategic acquisitions and dispositions. The majority of future transactions will likely be through private equity and joint ventures with private companies.

Construction

Between 1975 and 1998, according to Bjorn Hansen, Ph.D., Global Industry Partner for Hospitality and Leisure practice in PricewaterhouseCoopers' Financial Advisory Services, room starts averaged 89,659 rooms. The highest level during that period was reported in 1985, when there were approximately 160,000 room starts. During the recession of the early 1990s, room starts were minimal. Following 1993, room starts increased annually before peaking near 150,000 in 1997. This is nearly double the average between 1975 to 1998.

Although the capital crunch in the latter part of 1998 did not hinder new room starts, a downward trend is projected through 2001 as shown below.

YEAR	ROOM STARTS
1998 actual	145,875
1999 forecast	130,000
2000 forecast	115,000
2001 forecast	115,000

The slowdown is a result of the restraints on capital as well as a slowdown in the underlying market fundamentals. The decrease in construction should enable occupancy levels to remain steady or increase slightly.

The distribution of the total existing supply of hotel rooms to the total rooms under construction is shown below.

	EXISTING SUPPLY	UNDER CONSTRUCTION
Economy	28.2%	28.8%
Midscale w/ with F&B	25.9%	6.6%
Midscale without F&B	16.0%	20.5%
Upscale	12.1%	20.6%
Upper upscale	17.7%	23.5%
Total	100.0%	100.0%

It is not surprising that fears of overbuilding still loom over the economy/limited-service hotel segment. This segment represents the highest percentage of existing rooms, as well as the highest percentage of new rooms under construction. Although a large amount of luxury hotel construction is occurring, historical construction in this market has been minimal. Hence, there are less fears of overbuilding for the luxury market.

Throughout the country, the largest percentage (28.0%) of new rooms under construction or in the permitting stages of development are in the South Atlantic region in areas such as Florida, Georgia, Virginia, the Carolinas, Maryland, and West Virginia. The least amount of building, 4.4% of total construction, is occurring in the New England region, in areas such as Massachusetts, Rhode Island, Connecticut, and Maine.

Leveraged IRRs

Positive leverage is useful in tight bidding situations. Buyers who are able to access economic debt capital to finance a portion of a sale price can anticipate a better yield than the indicated property yield, offer slightly more than an all-cash buyer, and win the bid. When the financed portion of a sale is between 50.0% to 60.0%, most leverage buyers are willing to bid up the price by a small margin above the all-cash price. As the loan-to-value ratio increases, the leverage premium would also increase.

Current and year-ago leverage premiums for the hotel industry are shown in Exhibit H-3. The current average premiums range from 293 to 583 basis points. The overall average premium is 387 basis points. This is 83 basis points higher than the overall average a year ago.

The lowest premium is reported for the full-service market, while the highest premium is reported for the extended-stay market. A year ago, the full-service market reported the lowest premium, while the economy/limited service market had the highest premium. ■

Exhibit H-3

Leverage Premium on Equity Discount Rate
(50.0% to 60.0% Debt)
THIRD QUARTER 1999

HOTEL MARKET	RANGE (Basis Points) CURRENT	RANGE (Basis Points) YEAR AGO	AVERAGE (Basis Points) CURRENT	AVERAGE (Basis Points) YEAR AGO
Full Service	0-1100	250-450	293	292
Economy/Limited Service	100-1000	100-600	415	344
Luxury	0-450	100-450	258	296
Extended Stay	300-1300	0-450	583	283
All Hotel Markets Surveyed (Simple Average)	0-1100	0-600	387	304

National Full-Service Hotel Market

Full-service hotels are hot commodities with some sellers believing that their properties are still worth the premium prices paid during last year's buying frenzy. However, with limited funds for acquisitions and buyers concentrating on strategic purchases, the number of transactions occurring this year is much less than 1998.

Investors weary of high prices are looking to build full-service hotels. Barriers to entry in strong markets are limiting their opportunities. Midscale hotels with food and beverage represent the least amount (6.6%) of the total rooms under construction as of year-end 1998. Upscale hotels, which also include some full-service product, represent 20.6% of the total rooms under construction.

Some participants believe that a recession is possible, but most are not overly concerned over the near term. The economy is strong, unemployment and inflation are low, and consumer demand is high. In addition, public markets are carefully scrutinized. However, as one participant warns, we need to be cautious. "The industry is tied to the stock market and a slight blip could lead to a recession." Most investors believe that the hotel industry will withstand a national slowdown better than it did during the last recession since construction has eased, fundamentals are stronger, and hotels operate more efficiently today.

As of midyear 1999, the occupancy rate for full-service hotels declined to 64.8% according to Smith Travel Research (STR). This is a 3.86% decline from year-end 1998 and a 0.9% decline from year-to-date 1998. Occupancy peaked in 1995 at 68.5%. Participants expect occupancy levels to continue to dip slightly as the industry adjusts to new construction.

Total available rooms increased 5.0% between January and June, while total room demand was 4.0%. As a result of room supply outpacing room demand, the average daily room rate (ADR) dropped to $86.42 as of midyear 1999 according to STR. This is a 5.52% decrease from the end of 1998, but a 2.3% increase from year-to-date 1998. Projections for ADR growth vary depending on the underlying fundamentals of the specific geographic market. Overall, ADR growth is expected to decline further. Tight markets, such as New York, Boston, and Denver, should see the highest ADR growth rates.

All cash flow assumptions changed this quarter. The largest shift was a 29-basis-point decrease in the average ADR change rate to 4.56%. The average operating expense rate fell 6 basis points to 3.21%.

The average discount rate (IRR) dropped 6 basis points and at 13.11% is 32 basis points higher than the luxury hotel market IRR (12.79%). However, the average IRR for full-service is well below the extended-stay and economy/limited-service markets. The average overall cap rate (OAR) jumped 13 basis points to 10.15%, and the average residual cap rate inched up 4 basis points to 10.58%.

U.S. investors are becoming international investors too. Whether it is the result of a strong global economy or the easy accessibility to markets through the Internet, interest in hotel investments is increasing. London is the foreign hot spot for hotel acquisitions.

For U.S. investments, the Northeast and West (especially California and Arizona) and major airport markets are frequently named as good full-service hotel locations. Convention markets, such as Boston, San Francisco, New York, and Washington, DC, are also favored for full-service hotels. ■

Table 22
National Full-Service Hotel Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	FIRST QUARTER 1999	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.00%–16.00%	9.00%–16.00%	9.00%–16.00%
AVERAGE	13.11%	13.17%	13.00%
CHANGE (Basis Points)	—	–6	+11
Overall Cap Rate (OAR)[a]			
RANGE	8.00%–13.00%	8.00%–13.00%	8.00%–12.00%
AVERAGE	10.15%	10.02%	9.56%
CHANGE (Basis Points)	—	+13	+59
Average Daily Rate Chg. Rate[b]			
RANGE	2.00%–10.00%	2.00%–10.00%	2.00%–10.00%
AVERAGE	4.56%	4.85%	4.88%
CHANGE (Basis Points)	—	–29	–32
Operating Expense Chg. Rate[b]			
RANGE	1.00%–10.00%	1.00%–10.00%	1.00%–10.00%
AVERAGE	3.21%	3.27%	3.31%
CHANGE (Basis Points)	—	–6	–10
Residual Cap Rate			
RANGE	8.00%–12.00%	8.00%–12.00%	8.00%–12.00%
AVERAGE	10.58%	10.54%	10.24%
CHANGE (Basis Points)	—	+4	+34

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Economy/Limited-Service Hotel Market

It is becoming increasing difficult for willing investors to find profitable investments in the economy/limited-service market. Most markets throughout the country are saturated with economy/limited-service hotels that are not performing as anticipated due primarily to excessive competition. Investors trying to sell hotels in overbuilt markets are finding limited interest from buyers. The markets hardest hit are those which experienced significant office development over the past couple years such as technology corridors in Atlanta and Denver.

Although there has been a recent slowdown in construction due to capital restraints and a recognition by developers that there is overbuilding, it may be a little too late. "The damage has already been done," comments a participant. There is still a tremendous amount of construction in the pipeline. Economy hotels represent the largest percentage of rooms under construction (28.8%). It is worrisome that the largest amount of construction is occurring where there is the largest supply of existing space.

In the economy/limited-service market, the gap between room supply and room demand is the largest of all the hotel markets in our Survey. During the first half of 1999, room demand increased an average of 2.3%, while room supply increased an average of 6.4%, according to Smith Travel Research (STR). With room supply nearly three times the room demand, it is not a surprise that transaction activity is minimal.

The recent construction boom is causing declines in occupancy rates and average daily room rates (ADRs). Occupancy dropped to 58.57% during the first half of 1999. This is a 4.0% decrease from year-end 1998 and a 0.8% slip from year-to-date 1998 according to STR. The ADR fell to $50.23 as of midyear 1999, a 10.80% decrease from year-end 1998, but a 3.95% increase from year-to-date 1998. Participants are projecting a continued decline in ADR growth, occupancy, and RevPar until the gap between supply and demand is tightened.

All cash flow forecast assumptions shifted this quarter. The largest change occurred in the average discount rate (IRR) which increased 18 basis points to 14.75%. The average IRR for the economy/limited-service market is still the highest of the four hotel markets in our Survey. By comparison, the average IRR in the other hotel markets are 14.50% (extended stay), 13.11% (full service), and 12.79% (luxury).

The average overall cap rate (OAR) incurred a minimal 2-basis-point increase to 11.36%, while the average residual cap rate increased 11 basis points to 11.83%. Again, both rates are the highest of the four hotel markets in our Survey. The average ADR change rate declined 16 basis points to 3.28%.

To offset the affects of declines in occupancy rates and ADR growth, owners of economy/limited-service hotels are attempting to generate revenue from other sources. Extended business centers that offer copiers, printers, fax machines, modems, computers, etc. are becoming popular in hotels. Room rates may be increased slightly to compensate for their cost, or additional fees are charged at the time of use. Some hotels are increasing their use of take-out delivery services for patrons. In return for promoting a restaurant service, the hotel receives a fee.

Alternate sources for producing revenue are likely to be implemented until a reasonable equilibrium is reached in the market and occupancy rates and ADRs stabilize. Investors are hoping that the wait will not be too long. ■

Table 23
National Economy/Limited-Service Hotel Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	FIRST QUARTER 1999	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	10.00%–20.00%	10.00%–18.00%	10.00%–16.00%
AVERAGE	14.75%	14.57%	14.14%
CHANGE (Basis Points)	—	+18	+61
Overall Cap Rate (OAR)[a]			
RANGE	10.00%–13.00%	10.00%–12.00%	10.00%–12.00%
AVERAGE	11.36%	11.34%	11.34%
CHANGE (Basis Points)	—	+2	+2
Average Daily Rate Chg. Rate[b]			
RANGE	1.00%–10.00%	2.00%–10.00%	2.00%–10.00%
AVERAGE	3.28%	3.44%	3.44%
CHANGE (Basis Points)	—	–16	–16
Operating Expense Chg. Rate[b]			
RANGE	2.00%–4.00%	2.00%–4.00%	2.00%–4.00%
AVERAGE	3.06%	3.11%	3.11%
CHANGE (Basis Points)	—	–5	–5
Residual Cap Rate			
RANGE	10.50%–13.50%	10.50%–12.50%	10.00%–12.50%
AVERAGE	11.83%	11.72%	11.59%
CHANGE (Basis Points)	—	+11	+24

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Luxury Hotel Market

While the luxury market is the dominant segment of the hotel industry, occupancy levels have dipped and average daily room rates (ADRs) and RevPar are trailing in comparison to prior years. Investors, however, are cautiously optimistic that the fundamentals of the market will continue to provide opportunities for profit. Thus, whether it is through acquisition of an existing property or development of new product, most investors want to be part of the luxury market.

Despite strong interest from investors, the number of transactions has declined. "The investment community is still cautious," says a participant. Many investors are still waiting to see what the REITs are going to do. Although REITs by themselves remain relatively quite, they are likely to try and acquire properties through joint ventures.

Primary buyers for luxury hotels include C-Corps and private individuals. Foreign investors are also purchasing top-tier hotels in the United States. Le Meridien, part of Forte Hotels in the United Kingdom, purchased the 300-room Hotel Nikko at Beverly Hills for reportedly $267,000 per room. Foreign investing is being reciprocated as American investors continue to acquire luxury hotels in other countries. Starwood recently purchased the Hotel Santa Marina in Mykonos, Greece.

Construction activity has increased such as the 14-story, 300-room Ritz Carlton in Miami. This resort is scheduled for completion in 2000. Developers are also moving forward on plans to build the 162-room Hotel D'Orsay in Long Beach, California. In addition, a new 33-story luxury hotel is planned for downtown San Diego as part of a redevelopment project. The hotel will be operated by Westin Hotels Resorts, which is owned by Starwood.

Overall, new construction in the luxury market represents 23.5% of the total space under construction as of year-end 1998. Investors are hopeful that increases in supply will have only a minor affect on occupancy levels, ADRs, and profits. New construction is occurring in select markets that are strong and underserved.

For the first half of 1999, the luxury market achieved a 73.6% occupancy rate with an average daily room rate of $140.00. Although ADRs and occupancy for luxury hotels are up from year-end 1998, occupancy is down 0.8% from year-to-date 1998. ADR is up 3.2% from year-to-date 1998. While investors expect occupancy to remain high, ADR growth is expected to continue to decline.

All cash flow assumptions changed this quarter. The greatest shift is a 21-basis-point decline in the ADR change rate to 5.02%. This is a 71-basis-point drop from a year ago. The average operating expense change rate also declined this quarter to 3.08%; a decrease of 9 basis points.

The average discount rate (IRR) declined 2 basis points to 12.79%. This is 4 basis points above the rate a year ago. The average overall cap rate (OAR) moved up 4 basis points to 9.29%. After climbing 30 basis points from the third quarter 1998 to the first quarter 1999, the average residual cap rate dropped 14 basis points to 9.72%. The majority of luxury hotel participants (54.55%) apply the OAR to the forecast next 12 months income. The remaining 45.45% apply the OAR to the prior 12 months income.

As long as the economy remains healthy, investors will take advantage of select opportunities to invest in luxury hotels. Even with a slowdown in ADR growth, occupancy rates are expected to remain steady resulting in continued RevPar growth. ■

Table 24
National Luxury Hotel Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	FIRST QUARTER 1999	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	9.00%–16.00%	9.00%–16.00%	9.00%–16.00%
AVERAGE	12.79%	12.81%	12.75%
CHANGE (Basis Points)	—	–2	+4
Overall Cap Rate (OAR)[a]			
RANGE	6.00%–12.25%	6.00%–12.25%	6.00%–12.25%
AVERAGE	9.29%	9.25%	9.19%
CHANGE (Basis Points)	—	+4	+10
Average Daily Rate Chg. Rate[b]			
RANGE	3.00%–10.00%	3.00%–10.00%	3.00%–12.00%
AVERAGE	5.02%	5.23%	5.73%
CHANGE (Basis Points)	—	–21	–71
Operating Expense Chg. Rate[b]			
RANGE	1.00%–5.00%	1.00%–5.00%	1.00%–5.00%
AVERAGE	3.08%	3.17%	3.29%
CHANGE (Basis Points)	—	–9	–21
Residual Cap Rate			
RANGE	7.00%–11.50%	7.00%–11.50%	7.00%–11.50%
AVERAGE	9.72%	9.86%	9.56%
CHANGE (Basis Points)	—	–14	+16

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Extended-Stay Hotel Market

The extended-stay market continues to be the fastest growing segment of the hotel industry and attracts business travelers, as well as people relocating, building homes, or attending family functions. Occupancy levels are typically above those of traditional transient hotels and operating costs are lower. The appeal of higher profit margins is attracting new investors, as well as keeping current investors searching for additional investment opportunities.

Although there has been rapid growth over the past several years, development has been occurring in all segments of the market, including economy, midprice, and high-end. Overall, most segments are reportedly performing very well and construction is projected to continue. The rate of construction, however, is occurring at a slower pace.

According to a recent report prepared by The Highland Group, extended-stay hotels represent only 4.0% of the total room supply in the country. There are, however, areas of the country where overbuilding is likely occurring. In some markets, extended-stay hotels represent over 30.0% of the total room supply. If building continues in these saturated areas, rate reductions may occur and operating profits will decline.

Overall, the total extended-stay room supply is projected to increase by 45,000 rooms in 1999 and total 300,000 rooms by year-end 2002 (approximately 8.0% of the total hotel room supply in the country). Most of the new construction is occurring in high-growth areas such as Dallas, Denver, and Atlanta. Participants also note Colorado, Utah, and Florida as preferred states for extended-stay investments. The Northwest region of the country is also a favorable area for investors.

All cash flow assumptions changed this quarter. The largest shift occurred in the average ADR change rate, which declined 48 basis points to 3.83%. The average operating expense change rate inched up 3 basis points to 3.19%.

The average discount rate (IRR) increased 7 basis points to reach 14.50%. The average overall cap rate (OAR) realized a 24-basis-point increase to 10.83%. The rate is now 1 basis point higher than a year ago. The average residual cap rate moved 29 basis points higher to 11.26%, 44 basis points above the rate a year ago. The extended-stay market continues to have the highest average discount rate of the four hotel segments in our Survey. Thus, participants view hotel investments in the extended-stay market as the most risky. "The amount of construction continues to push discount rates up," comments a participant.

Midprice extended-stay hotels, the newest product of the extended-stay market, are apparently being well received. As a result, many economy/limited-service owners are continuing their efforts to build customer loyalty through frequent-stay guest programs and other gimmicks. Some economy/limited-service owners, however, are taking the "if you can't beat 'em, join 'em" approach by expanding into the extended-stay market. Motel 6 recently announced their new extended-stay line – Studio 6. Motel 6, like other limited-service hotels with established brand loyalty, is hoping to retrieve customers lost to extended-stay hotels.

The underlying economics of the extended-stay market are appealing to travelers, as well as investors. The extended-stay market is projected to nearly triple over the next five years. Developers, however, need to exercise caution on new construction in certain markets or overbuilding will hinder the potential for future growth in the market. ■

Table 25
National Extended-Stay Hotel Market
THIRD QUARTER 1999

KEY INDICATORS	CURRENT QUARTER	FIRST QUARTER 1999	YEAR AGO
Discount Rate (IRR)[a]			
RANGE	12.00%–17.00%	12.00%–16.50%	12.00%–16.50%
AVERAGE	14.50%	14.43%	14.04%
CHANGE (Basis Points)	—	+7	+46
Overall Cap Rate (OAR)[a]			
RANGE	9.00%–12.00%	10.00%–12.00%	10.00%–12.00%
AVERAGE	10.83%	10.59%	10.82%
CHANGE (Basis Points)	—	+24	+1
Average Daily Rate Chg. Rate[b]			
RANGE	2.00%–10.00%	3.00%–10.00%	2.50%–10.00%
AVERAGE	3.83%	4.31%	4.00%
CHANGE (Basis Points)	—	–48	–17
Operating Expense Chg. Rate[b]			
RANGE	2.00%–5.00%	2.00%–5.00%	2.00%–5.00%
AVERAGE	3.19%	3.16%	3.18%
CHANGE (Basis Points)	—	+3	+1
Residual Cap Rate			
RANGE	10.00%–13.00%	9.50%–12.50%	9.50%–12.50%
AVERAGE	11.26%	10.97%	10.82%
CHANGE (Basis Points)	—	+29	+44

a. Rate on unleveraged, all-cash transactions
b. Initial rate of change

National Regional Mall Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT ADVISOR ■ Forecast Period: 10 to 15 years Interested in dominant Class-A malls with strong anchored lineups and above-average trade area demographics; major emphasis on DCF but also looks at direct capitalization and price per square foot; uses face rents and reflects concessions as they occur.	Years 1-4 varies per market; 3.0% thereafter	3.0%	3.0%	7.50% to 10.00%	1.0% to 2.0%	10.00% to 12.00%	7.00% to 10.00%	9 to 12	60.0% to 75.0%	5.0% to 7.0% (nonanchor)	$0.15 to $0.25	6 to 12
INVESTMENT BANKER ■ Forecast Period: 10 years Relies on DCF (IRR) and direct capitalization (initial cap rates); does extensive sensitivity analysis on residual cap rates, growth rates, and initial market rents; retail sales based on historical and market analysis; typical sales growth per market per year is at the inflation rate (CPI); analysis of TIs is an important cash flow forecast item; believes market for malls is improving.	2.0% to 4.0%; varies per market	3.0%	3.0%	7.75% to 8.75% (Best); 8.75% to 10.25% (Most)	1.5%	10.00% to 11.00% (Best); 11.00% to 12.50% (Most)	7.00% to 8.50% (Best); 8.50% to 10.50% (Most)	3 to 4	70.0% to 75.0%	2.0% to 5.0%	Varies by mall	6 to 9
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Buys free and clear; average IRR consists of a 6.5% to 7.0% real rate of return plus the inflation rate; the indicated growth scenarios help to determine sensitivity of investment to inflation; relies on DCF (IRR) and overall cap rates equally; uses face rents and reflects concessions when they are scheduled to occur.	Years 1-3 varies per market; thereafter at inflationary rate	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	7.50% to 8.00%	1.0%	10.50% to 11.00%	7.00% to 8.00%	3 to 4	70.0% to 75.0%	1.0% to 3.0%	$0.15	3 to 4
PENSION FUND ADVISOR ■ Forecast Period: 10 years Looks at DCF (IRR), direct capitalization (initial cap rates), and price per square foot; uses face rents and reflects concessions when they are scheduled to occur.	3.0% to 4.0%	3.0%	3.0%	9.00% to 10.50%	2.0%	11.50% to 12.50%	9.50%	6	50.0%	5.0%	$0.25	9 to 18
REIT ■ Forecast Period: 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve; applies rollover vacancy of 1.5%; replacement reserve is dollar amount.	4.0%	3.0%	3.0%	8.00%	2.0%	12.00%	8.25%	2	75.0%	0.0%	—	3
REAL ESTATE ADVISOR ■ Forecast Period: 10 to 15 years Retail sales are based on historical and market analysis; typical sales growth initially flat, then increasing 3.0% to 5.0% per year in typical markets; relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; strives for realistic cash flow forecast; relationship of price to retail sales (1.0 to 1.5 times sales) is carefully analyzed; uses face rents.	2.0% to 3.0% initially; varies thereafter	3.5%	3.0% to 4.0%	8.50% to 9.50%	1.0% to 2.0%	10.75% to 12.25%	8.25% to 9.25%	4 to 6	60.0% to 70.0%	2.0% to 5.0%	$0.25 to $0.75	9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Retail sales growth is based on historical performance and market analysis; very strong evidence is required to exceed 5.0% per year; spreads between A and B properties getting wider; prefers free and clear properties; uses all valuation techniques and correlates; does not rely on any one technique; looks for sale price to be 100% to 125% of sales volume; looks at components of NOI growth; uses face rents.	0.0% to 4.0%	3.5%	3.5%	7.50% to 9.00%	1.5%	10.00% to 11.00%	7.00% to 9.00%	2	60.0%	3.0% to 10.0%	$0.10	6 to 10

National Power Center Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; initial growth rates typically are between 0.0% and 3.5%; preference for infill locations with minimum land available and high barriers to entry; seeks very strong leases with "going dark" protection; 80.0%+ of overall return component should be generated by current income.	0.0% to 3.5%	3.5%	—	9.5%	2.0% to 2.5%	10.50% to 11.50%	10.00%	6 to 9 (nonanchors); 9 to 12 (anchors)	40.0% to 60.0%	0.0% to 3.0% (anchors); 6.0% (nonanchors)	$0.10 to $0.15	6 to 12
INVESTMENT BANKER ■ Forecast Period: 10 years Considers power center investments "coupon clipper" deals; uses both DCF and direct capitalization; focuses on West Coast; prefers urban areas with easy access and good anchor tenancy; credit is key; IRR is 10.25% to 11.50% on centers with good credit tenants.	4.0%	3.0% to 4.0%	4.0%	9.00% to 10.00%	2.0%	10.25% to 12.00%	8.00% to 10.00%	3 to 6	65.0% to 75.0%	5.0% to 10.0%	$0.10	6
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Primarily interested in high-credit deals; uses both DCF and direct capitalization but focuses on IRR; develops IRR using tenants' bond rate plus 200 to 400 basis points for real estate related risks; lower IRRs are for high-credit deals with "bond" leases; uses present value analysis of effective rents.	2.0% to 3.5%	2.0% to 3.5%	2.0% to 3.5%	9.50% to 10.00%	2.0% to 2.5%	10.50% to 11.25%	9.25% to 10.00%	3 to 6	50.0% to 60.0%	1.0% (anchors); 4.0% to 6.0% (nonanchors)	$0.15 to $0.25	6 to 9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; credit of tenants is major determinant of rate; consolidations among anchors will cause continuing fallout vacancies; sees a smaller pool of investors for power centers than for regional malls.	0.0% to 4.0%	3.5%	3.5%	10.00% to 10.50%	1.5%	11.00% to 12.00%	9.75% to 10.50%	2 to 6	60.0%	5.0% to 10.0%	$0.10	6 to 12
INVESTMENT ADVISOR ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; applies OAR to NOI after capital replacement reserve deduction but before TIs and leasing commissions; views as credit deal; some growth assumed in cap rate; focuses on acquisitions in Florida.	3.0% to 4.0%	3.0% to 3.5%	3.0% to 3.5%	9.50% to 10.50%	2.0%	11.00% to 12.50%	9.00% to 10.00%	4 to 8	70.0% to 80.0%	3.0% to 5.0%	$0.15 to $0.25	4 to 8
INVESTOR-DEVELOPER ■ Forecast Period: 11 years Uses both DCF and direct capitalization; in direct cap, capitalizes cash flow after TIs, leasing commissions, and capital replacement reserve; in analyzing power centers with greater percentage of in-line space compared with big-box space, would likely apply a lower overall cap rate due to potential for increased income.	3.0%	3.0%	3.0%	10.00%	2.0%	12.00%	10.50%	3	66.0%	Actual; 5.0% noncredit tenants	$0.10 to $0.25	6 to 9
REALTY ADVISOR ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; typically does not invest in power centers due to low yields and no upside.	3.0%	3.0%	3.0%	9.00% to 9.50%	1.5% to 3.0%	10.25% to 10.50%	8.25% to 8.75%	Does not use	65.0%	5.0% to 8.0%	$0.10 to $0.25	6

National Strip Shopping Center Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT ADVISOR ■ Forecast Period: 10 to 12 years Concerned about stability of anchor tenants; seeks centers with strong national anchors, low in-line tenant area components, and strong trade market area demographics; major emphasis on DCF, but also looks at direct capitalization and price per square foot; uses face rents.	Years 1-4 varies per market; 3.0% thereafter	3.0%	3.0%	9.50% to 12.00%	2.0% to 3.0%	11.00% to 13.00%	8.75% to 11.50%	6 to 12	50.0% to 70.0%	5.0% to 10.0% (nonanchor)	$0.15 to $0.25	6 to 12
INVESTMENT BANKER ■ Forecast Period: 10 years Does extensive sensitivity analysis on residual cap rates, growth rates, and initial market rents; retail sales based on historical and market analysis; initial cash return is more important than the IRR; TIs are an important cash flow forecast item.	Years 1-3 varies per market; 3.5% thereafter	3.0%	3.0%	8.75% to 11.00%	2.0%	10.50% to 14.00%	8.25% to 11.00%	4 to 8	60.0%	5.0% to 10.0% (noncredit tenants)	$0.15	4 to 12
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Buys free and clear; average IRR consists of a 6.75% to 7.50% real rate of return plus the inflation rate; the indicated growth scenarios help to determine sensitivity of investment to inflation; relies on DCF (IRR) and overall cap rates equally; uses face rents and reflects concessions when they are scheduled to occur.	Years 1-3 varies per market; thereafter at inflationary rate	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	9.00% to 9.75%	2.0%	10.75% to 11.50%	8.75% to 9.75%	4 to 6	60.0% to 70.0%	5.0% (noncredit tenants)	$0.10 to $0.20	4 to 6
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Relies on DCF, also uses direct capitalization and price per square foot; residual cap rate may be developed through a second 10-year DCF analysis (years 11 to 20).	2.5% to 3.0%	2.5% to 3.0%	2.75% to 3.0%	9.50% to 11.00%	3.0%	10.00% to 12.00%	9.25% to 10.50%	6	50.0% to 70.0%	7.5% (nonanchor)	$0.10 to $0.20	—
REAL ESTATE ADVISOR ■ Forecast Period: 10 to 15 years Retail sales are based on historical and market analysis; typical sales growth is initially flat, then increasing 3.0% to 5.0% per year in typical markets and 7.0% per year in strong markets; relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; strives for realistic cash flow forecast, especially in market rent growth rate, retail sales growth rate, and credit loss; greater distinction is being made between A and B centers; great concern over stability of anchors; uses face rents.	0.0% to 3.0% initially; varies thereafter	3.5%	3.0% to 4.0%	9.75% to 10.75%	2.0% to 4.0%	11.00% to 12.50%	9.50% to 10.50%	6 to 8	50.0% to 60.0%	3.0% to 5.0%	$0.50	9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Dominant grocer and other anchors are a must; infill locations with true supply constraints are important.	0.0% to 4.0%	3.5%	3.5%	9.25% to 10.50%	1.5%	11.00% to 13.00%	9.00% to 10.00%	2 to 4	50.0%	5.0% to 10.0%	$0.10 to $0.20	6 to 9
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Invests primarily in 200,000- to 400,000-square-foot well-anchored community centers and good credit quality anchored power centers; relies on DCF; market rent growth rates vary according to supply-demand balance in specific market; uses effective rents.	Varies per market until stabilized; thereafter at inflation rate	2.0% to 3.5%	2.0% to 3.5%	9.50% to 10.00%	2.0% to 3.0%	11.00% to 11.50%	9.50% to 10.50%	4 to 6	50.0% to 60.0%	1.0% to 3.0%	$0.10 to $0.20	6 to 9
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Buys free and clear; interested in higher quality community centers; relies on DCF (IRR); uses direct capitalization as a check only; may apply rent spike if appropriate based on analysis of leases in place; uses face rents in model that allocates actual concessions when they are scheduled to occur; some development interest.	3.25%	3.25%	2.5%	9.75%	3.0% + any local tariffs	11.25% to 11.50%	9.75%	6 to 8	70.0%	6.0% to 8.0%	$0.10 to $0.20	6
MORTGAGE BANKER ■ Forecast Period: 10 years Relies on direct capitalization, shifting away from DCF; in DCF focuses on first 5 years of 10-year forecast period; uses face rents.	3.0%	3.0%	4.0%	9.50%	3.0%	11.00% to 13.00%	10.00%	3 to 8	70.0%	5.0%	$0.20 to $0.25	6

National CBD Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT ADVISOR ■ Forecast Period: 10 to 15 years Prefers free and clear properties; uses rent spikes if appropriate based on demand and relationship of current rents to rents required to justify new construction; relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; uses face rents and reflects concessions when they are scheduled to occur.	Years 1-5 varies per market; 3.0% thereafter	3.0%	3.0%	8.50% to 10.00%	1.0% to 3.0%	10.25% to 12.00%	7.50% to 10.00%	6 to 12	50.0% to 75.0%	2.0% to 3.0%	$0.15 to $0.25	6 to 12
INVESTMENT BANKER ■ Forecast Period: 10 years Real cash on cash (after capital expenditures) more important than IRR; real interest in newer CBD buildings at 8.0% to 10.0% cash-on-cash rates; investor interest is increasing, more deals are coming to market, and prices are rising as capital seeks these deals.	3.0% to 5.0%	3.0%	3.0%	8.50% to 10.50%	2.0%	10.00% to 13.00%	7.50% to 10.00%	3 to 9	60.0% to 70.0%	3.0% to 5.0%	Varies	6 to 9
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Buys free and clear; average IRR consists of a 6.0% to 7.0% real rate of return plus the inflation rate; the indicated growth scenarios help to determine sensitivity of investment to inflation; relies on DCF (IRR) and overall cap rates equally; use of face or effective rents varies with market.	Years 1-3 varies per market; at inflationary rate thereafter	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	8.75% to 9.25%	2.0%	10.50% to 11.50%	8.50% to 9.25%	6 to 9	60.0% to 70.0%	2.0% to 5.0%	$0.10 to $0.15	9 to 12
INVESTMENT ADVISOR ■ Forecast Period: 5 to 10 years Seeks a discount to replacement cost in recovering markets; uses face rents; in certain markets may apply rent spike in first three years.	0.0% to 7.0%	3.5%	3.5%	9.00% to 10.00%	1.0% to 3.0%	10.75% to 12.50%	7.50% to 9.00%	6 to 12	50.0% to 75.0%	3.0% to 7.0%	$0.20 to $0.40	6
REAL ESTATE ADVISOR ■ Forecast Period: 10 to 15 years Relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; uses face rents and reflects free rent and other concessions when they are scheduled to occur; placing additional emphasis on average cash-on-cash rates for years 1 to 5, 6 to 10, and then the average rate for 1 to 10, coupled with partitioning present values and placing greater weight on cash flow vs. residual; continuing caution.	0.0% to 5.0%	3.0% to 4.0%	3.0% to 4.0%	9.00% to 10.00%	2.0% to 4.0%	10.50% to 12.00%	8.50% to 9.50%	6 to 9	60.0% to 70.0%	3.0% to 5.0%	$0.20 to $0.50	12 to 18
INVESTMENT ADVISOR ■ Forecast Period: 10 years Prefers free and clear proprieties with joint venture partner and preferred return; uses all valuation techniques and correlates; does not rely on any one technique; looks at components of NOI growth; uses face rents.	0.0% to 8.0%	3.5%	3.5%	9.00% to 10.00%	1.5%	11.00% to 15.00%	8.00% to 11.00%	4 to 8	60.0%	5.0% to 10.0%	$0.20	6 to 12
PENSION FUND ADVISOR ■ Forecast Period: 10 years Relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; uses face rents.	3.0% to 4.0%	3.0%	3.0%	9.00% to 10.00%	2.0%	11.00% to 12.00%	8.75% to 10.00%	6 to 8	60.0%	5.0%	$0.15	6 to 12
DOMESTIC PENSION FUND ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; uses face rents and reflects concessions when they are scheduled to occur.	3.0% to 3.5%	3.0% to 3.5%	3.5%	8.00% to 9.50%	—	10.00% to 12.00%	7.50% to 9.50%	6 to 12	60.0% to 70.0%	1.0% to 3.0%	$0.10 to $0.25	6 to 12
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; applies a 4.0% to 8.0% rent spike in years 1 to 3 in select markets.	3.0% to 6.0%	2.0% to 3.0%	3.0%	9.00% to 11.00%	1.0% to 4.0%	10.00% to 12.00%	8.00% to 10.00%	3 to 12	50.0% to 70.0%	3.0% to 6.0%	$0.20 to $0.40	3 to 12

National Suburban Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT ADVISOR ■ Forecast Period: 10 to 15 years Prefers free and clear properties; relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; total vacancy and credit loss including rollover vacancy is 5.0% to 10.0%; reflects actual rents and concessions.	Years 1-5 varies per market; 3.0% thereafter	3.0%	3.0%	8.50% to 10.00%	2.0% to 4.0%	10.25% to 12.00%	8.00% to 10.00%	6 to 12	50.0% to 75.0%	2.0% to 5.0%	$0.10 to $0.20	6 to 12
INVESTMENT BANKER ■ Forecast Period: 10 years Real cash on cash (after capital expenditures) more important than IRR.	Years 1-3 varies; 3.5% thereafter	3.0%	3.0%	8.50% to 10.50%	2.0%	10.50% to 12.50%	8.00% to 10.50%	6 to 9	65.0%	5.0% to 7.5%	$0.10 to $0.20	6 to 9
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Buys free and clear; average IRR consists of a 6.5% to 7.5% real rate of return plus the inflation rate; the indicated growth scenarios help to determine sensitivity of investment to inflation; relies on DCF (IRR) and overall cap rates equally; use of face or effective rents varies with market.	Years 1-3 varies per market; thereafter at inflationary rate	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	9.00% to 9.25%	2.0%	10.50% to 11.50%	8.75% to 9.50%	6 to 9	60.0% to 70.0%	2.0% to 5.0%	$0.10 to $0.20	9 to 12
INVESTMENT ADVISOR ■ Forecast Period: 5 to 10 years Seeks a discount to replacement cost in recovering markets; in certain markets may apply spike in first three years; uses face rents.	3.5% to 7.0%	3.5%	3.5%	9.00% to 10.00%	2.0% to 3.0%	10.75% to 12.50%	7.50% to 9.00%	6 to 12	50.0% to 75.0%	5.0% to 10.0%	$0.20 to $0.40	6
REAL ESTATE ADVISOR ■ Forecast Period: 10 to 15 years Relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; uses face rents and reflects free rent and other concessions when they are scheduled to occur; placing additional emphasis on average cash-on-cash rates for years 1 to 5, 6 to 10, and then the average rate for 1 to 10, coupled with partitioning present values and placing greater weight on cash flow vs. residual; continuing caution.	2.0% to 5.0%	3.0% to 4.0%	3.0% to 4.0%	9.25% to 10.25%	2.0% to 4.0%	10.50% to 12.00%	8.75% to 9.75%	6 to 9	60.0% to 70.0%	3.0% to 4.0%	$0.20 to $0.50	12 to 18
INVESTMENT ADVISOR ■ Forecast Period: 10 years Prefers free and clear properties with joint venture partner and preferred return; uses all valuation techniques and correlates; does not rely on any one technique; looks at components of NOI growth; uses face rents.	0.0% to 8.0%	3.5%	3.5%	9.00% to 10.00%	1.5%	11.00% to 12.00%	8.50% to 10.00%	4 to 6	70.0%	2.0% to 5.0%	$0.10 to $0.20	6 to 9
PENSION FUND ADVISOR ■ Forecast Period: 7 years Relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; uses effective rents.	3.0%	3.0%	3.0%	9.00% to 10.00%	2.0% to 3.0%	11.00% to 12.00%	9.00% to 10.00%	6 to 12	60.0%	5.0%	$0.15 to $0.20	6 to 12
INVESTOR ■ Forecast Period: 5 to 7 years Relies on DCF and direct capitalization; selling expense capped at $150,000; uses face rents.	3.0% to 5.0%	3.0%	3.0%	8.50%	1.5%	10.00%	8.00% to 8.50%	4 to 6	70.0%	0.0%	$0.75	3 to 6
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Relies on DCF, also uses direct capitalization and price per square foot; initial market rent change rate for years 1 to 3 is a spike and is a function of the Torto-Wheaton forecast rent in individual markets; residual cap rate is in part developed through a second 10-year DCF analysis.	Varies per market	2.5% to 3.0%	2.75% to 3.0%	9.00% to 11.00%	3.0%	10.50% to 11.50%	9.00% to 10.50%	6	60.0% to 80.0%	5.0% to 7.0%	$0.10 to $0.20	—
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Invests primarily in newer suburban office properties with credit quality tenants; relies on DCF; uses effective rents.	2.0% to 4.0%; varies thereafter	2.0% to 3.5%	2.0% to 3.5%	9.50% to 10.00%	2.0% to 3.0%	10.75% to 11.50%	9.00% to 9.75%	4 to 8	50.0% to 60.0%	1.0% to 3.0%	$0.15 to $0.20	6 to 7

Atlanta Office Market

INVESTOR SURVEY RESPONSES
THIRD QUARTER 1999

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
DEVELOPER ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve deduction but before TIs and leasing commissions; uses face rents and reflects concessions when they are scheduled to occur.	2.5%	3.0%	3.0%	9.00%	2.5%	9.75% to 10.50%	9.50%	6 to 9	67.0%	7.0%	$0.15 to $0.20	—
INVESTMENT ADVISOR ■ Forecast Period: 10 years Relies on DCF; does not do a true direct capitalization approach but analyzes the implied year 1 overall cap rate based on NOI divided by value conclusion.	3.5%	3.5%	3.5%	9.50%	1.5% to 2.0%	11.00%	9.20% to 9.60%	2 on weighted basis	60.0%	4.0%	$0.10	—
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; uses face rents and allocates concessions when they are scheduled to occur; no longer applies rent spikes.	0.0% to 3.5%	3.0%	3.0%	9.25% to 9.50%	3.0%	11.25% to 11.50%	9.00% to 9.50%	6	65.0%	5.0% to 10.0%	$0.20 to $0.25	3 to 6
INVESTMENT ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; uses face rents and reflects concessions when they are scheduled to occur; concerned that construction activity could soften market.	0.0% to 2.0%	$8.00 per square foot	3.0%	9.50%	1.0%	10.00% to 11.00%	8.75%	6	65.0%	7.0%	$0.25	—
LIFE INSURANCE COMPANY ■ Forecast Period: 5 to 8 years Uses DCF and direct capitalization; relies on DCF; in direct cap, capitalizes NOI after capital replacement reserve but before TIs and leasing commissions; uses face rents and reflects concessions when they are scheduled to occur.	0.0%	3.0%	3.0%	9.50% to 11.00%	2.0%	11.00% to 12.00%	8.00% to 10.50%	6	60.0%	4.0%	$0.25	6 to 9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Relies on DCF; typical management fees are 4.0%; typical leasing fees are 5.0% on new leases, 2.0% on renewals; typical TIs are $5.00 for new leases, $3.25 for renewals; uses face rents; structural vacancy	3.0%	3.0%	3.0%	9.25%	2.0%	12.00%	9.25%	0	75.0%	5.0%	$1.05	6 to 9

Chicago Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Relies on DCF; uses direct capitalization as a check only; real estate taxes are a major issue; prefers suburban markets; uses face rents and reflects concessions when they are scheduled to occur.	3.0%	3.0%	3.0%	8.00% to 10.00%	2.0% to 3.0%	9.29% to 11.80%	8.00% to 9.50%	3 to 6	60.0% to 75.0%	5.0%	$0.15 to $0.20	9 to 12
MORTGAGE BANKER ■ Forecast Period: 10 years Relies on DCF and uses direct capitalization as a test; cost, rent, and value per square foot are true "sanity tests"; real estate taxes are a big issue (usually more than 50.0% of property expenses); uses effective rents; geographic preferences are downtown and north suburban.	3.0% to 3.5%	3.0%	3.0%	9.25% to 9.50%	2.0%	11.00%	9.00%	6	70.0% to 75.0%	5.0%	$0.15	6 to 9
INSTITUTIONAL INVESTOR ■ Forecast Period: 5 years Relies on DCF; forecasts market rent at 6.0% year 1, 5.0% year 2, 4.0% year 3, and 3.0% thereafter; forecasts higher expenses in Cook County; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve.	3.0%	$7.00 to $8.00 per square foot	3.0%	9.00% to 10.00%	1.0% to 3.0%	11.00% to 13.00%	9.00% to 9.50%	6	70.0%	4.0%	$0.20	6
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Relies on DCF; uses present value analysis of effective rents.	2.0% to 3.5%	2.0% to 3.5%	2.0% to 3.5%	9.25% to 9.75% (Suburbs); 9.50% to 10.50% (CBD)	2.0% to 3.0%	11.00% to 12.00%	9.25% to 10.25%	4 to 6	50.0% to 60.0%	1.0% to 3.0%	$0.15 to $0.20	3 to 6 (Suburbs); 6 to 12 (CBD)
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Prefers suburban properties; uses both DCF and direct capitalization; relies on DCF; in direct cap, capitalizes NOI after capital reserve deduction but before TIs and leasing commissions; may apply rent spike on limited basis; uses effective rents.	3.0%	3.0%	2.5% to 3.5%	9.25%	2.5% to 3.0%	10.50% to 11.50%	9.00% to 9.50%	6	50.0%	7.0% to 10.0%	$0.15 to $0.20	9 to 12
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap; capitalizes NOI after capital replacement reserve deduction but before TIs and leasing commissions; does not use rent spikes; prefers suburbs (East and West Corridor, North Suburban, and Northwest suburban).	4.0% to 5.0%	3.0%	3.0%	9.00% to 9.25%	3.0% to 4.0%	10.00% to 11.25%	8.50% to 9.50%	3 to 6	60.0% to 65.0%	5.0% to 10.0%	$0.20 to $0.25	3 to 6
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; occasionally applies 7.0% to 9.0% rent spike for 1, 2, or 3 years on top-quality product in the strongest suburbs; buyers' market; uses face rents.	0.0% to 3.0% (CBD); 2.0% to 5.0% (Suburbs)	4.0%	—	9.25% to 9.50% (Suburbs); 10.00% (CBD)	2.0% to 2.5%	10.00% to 10.75%	10.00%	6 to 9 (Suburbs); 9 to 12 (CBD)	50.0% to 70.0%	3.0% to 7.0% (Suburbs); 5.0% to 10.0% (CBD)	$0.20 to $0.25	9 to 12

Dallas Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Relies on DCF; also uses direct capitalization and sales comparison in CBDs; properties with upside command lower going-in cap rates; uses rent spikes.	3.0% (Suburbs); 0.0% years 1 and 2 (CBD); 3.0% thereafter	3.0%	3.0%	9.00% to 12.00%	1.5% to 5.0%	10.50% to 12.00% (Suburbs); 11.00% to 13.00% (CBD)	8.00% to 12.00%	6	70.0% (Suburbs); 60.0% (CBD)	10.0% (Suburbs); 15.0% (CBD)	1.0% of EGI	12
INVESTMENT ADVISOR ■ Forecast Period: 3, 5, and 10 years Relies on DCF and direct capitalization; there are no concessions and no free rent in this market; no longer applies rent spikes.	0.0% to 2.0%	4.0%	4.0%	8.50% to 9.50%	2.0%	10.50% to 11.50%	7.50% to 9.50%	6 to 9	60.0% to 75.0%	5.0%	$0.25	9
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Buys all cash; focuses on DCF analysis, then looks at cash-on-cash returns in years 2 to 5; looks at 5-year averages and cash-on-cash returns after leasing commissions, TIs, and reserves; also "goes above the line" to see true capitalization rate.	0.0% to 5.0%	3.0% to 4.0%	3.0% to 4.0%	9.25% to 10.25%	2.0% to 4.0%	11.00% to 12.50%	8.75% to 9.75%	4 to 7	60.0% to 70.0%	2.0% to 3.0%	$0.20 to $0.50	3 to 6
INVESTMENT ADVISOR ■ Forecast Period: 10 and 20 years Criteria for downtown and suburban submarkets vary widely; uses both DCF and direct capitalization; ties most expenses to CPI but projects others (e.g., utilities and real estate taxes) at higher rate; uses effective rents.	4.0% to 10.0%	3.0%	3.0%	8.00% to 10.00%	2.0%	9.00% to 10.00%	8.00% to 11.00%	8	60.0%	5.0%	3.0% to 7.0% of EGI	6
REIT ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes cash flow after TIs, leasing commissions, and capital replacement reserve.	3.0%	3.0%	3.0%	10.00%	2.0%	11.50%	9.25% to 9.50%	6	65.0%	2.0% to 3.0%	$0.10	—
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve deduction but before TIs and leasing commissions; does not use rent spikes; uses face rents and reflects concessions when they are scheduled to occur.	0.0% to 3.0%	3.0%	3.0%	9.25% to 9.75%	2.0% to 4.0%	11.00% to 12.00%	9.00% to 9.50%	6	65.0%	5.0% to 10.0%	$0.20 to $0.25	4 to 9
LIFE INSURANCE COMPANY ■ Forecast Period; 5 to 8 years Uses DCF and direct capitalization; also looks at discount to replacement cost; relies on DCF; in direct cap, capitalizes NOI after capital replacement reserve but before TIs and leasing commissions; there are few concessions in this market, therefore face rent equals effective rent.	0.0%	2.5%	3.0%	9.00% to 11.00%	2.0%	11.00% to 12.00%	8.00% to 10.00%	6	60.0%	4.0%	$0.25	6

Houston Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Relies on DCF; also uses direct capitalization and sales comparison in CBDs; uses effective rents; properties with upside command lower going-in cap rates.	3.0% to 3.5% (Suburbs); 0.0% (CBD)	3.0%	3.0%	8.00% to 12.00%	1.5% to 5.0%	10.50% (Suburbs); 11.00% to 11.50% (CBD)	8.00% to 12.00%	4 to 6	70.0% (Suburbs); to 60.0% (All others)	8.0% (CBD) to 10.0% (Suburbs)	1.0% of EGI	12
INVESTMENT ADVISOR ■ Forecast Period; 3, 5, and 10 years Relies on DCF and direct capitalization; there are no concessions and no free rent in this market; applies 5.0% to 8.0% rent spikes in years 1 to 3 in suburban submarkets.	4.0% to 8.0%	4.0%	4.0%	9.00% to 10.50%	2.0%	10.50% to 12.00%	8.50% to 11.00%	6 to 9	60.0% to 75.0%	5.0%	$0.25	9
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Buys all cash; focuses on DCF analysis, then looks at cash-on-cash returns in years 2 to 5; looks at 5-year averages and cash-on-cash returns after leasing commissions, TIs, and reserves; also "goes above the line" to see true capitalization rate.	2.0% to 5.0%	3.0% to 4.0%	3.0% to 4.0%	9.25% to 10.25%	2.0% to 4.0%	11.25% to 12.75%	9.00% to 10.00%	4 to 7	60.0% to 70.0%	2.0% to 3.0%	$0.20 to $0.50	3 to 6
INVESTMENT ADVISOR ■ Forecast Period: 10 and 20 years Criteria for downtown and suburban submarkets vary widely; uses both DCF and direct capitalization; ties most expenses to CPI but projects others (e.g., utilities and real estate taxes) at higher rate; uses effective rents.	2.0% to 8.0%	3.0%	3.0%	8.00% to 9.50%	2.0%	9.00% to 12.00%	8.00% to 11.00%	10	60.0%	5.0%	3.0% to 7.0% of EGI	6
PRIVATE INVESTOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes cash flow after TIs, leasing commissions, and capital replacement reserve.	0.0% Year 1; 3.0% thereafter	3.0%	3.0%	10.00%	2.0%	12.00%	10.00%	6	70.0%	1.0%	$0.10	6
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Interest is in Houston suburbs only; uses DCF and direct capitalization; applies rent spikes of 5.0% to 7.0% in years 1 to 3; uses face rents and allocates concessions when they are scheduled to occur; marketing time estimate is for properties that are "priced right"; still some concern over cyclical nature of economy.	4.0% to 5.0%	3.0%	3.0%	9.25% to 9.75%	2.0% to 4.0%	11.25% to 11.75%	9.00% to 9.50%	3 to 6	65.0%	5.0% to 10.0%	$0.20 to $0.25	4 to 9
LIFE INSURANCE COMPANY ■ Forecast Period; 5 to 8 years Uses DCF and direct capitalization; also looks at discount to replacement cost; relies on DCF; in direct cap, capitalizes NOI after capital replacement reserve but before TIs and leasing commissions; uses face rents and reflects concessions when they are scheduled to occur.	2.0% to 4.0%	3.0% to 4.0%	3.0%	9.50% to 11.00%	2.0%	10.50% to 13.50%	8.00% to 10.00%	6	60.0%	4.0%	$0.25	6 to 9

Los Angeles Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
PENSION FUND ADVISOR ■ Forecast Period: 7 to 10 years Relies on DCF; looks at value indicated by direct capitalization; uses face rents and applies concessions when projected to occur; does not tie income or expenses directly to CPI.	3.0% to 6.0%	3.0% to 4.0%; taxes 2.25%	2.5% to 3.0%	9.00% to 10.00%	1.5% to 3.0%	11.00% to 13.00%	9.00% to 10.00%	4 to 8	60.0% to 70.0%	5.0% to 8.0%	$0.10 to $0.30	6 to 8
REAL ESTATE ADVISOR ■ Forecast Period: 5, 7, and 10 years Buys turnaround situations as well as rotational plays in suburban markets; uses both DCF and direct capitalization; relies on DCF; applies 4.0% to 10.0% rent spike in years 1 to 2 in submarkets where there is evidence that they will occur; uses face rents in DCF model, net effective rents in direct capitalization.	4.0% to 6.0%	4.0%	3.0%	8.00% to 10.00%	1.5% to 2.0%	11.00% to 13.00%	8.00% to 10.00%	2 to 12	65.0%	8.0% to 10.0%	$0.30 to $1.00	6
INVESTMENT BANKER ■ Forecast Period: 10 years Uses DCF (IRR), direct capitalization (initial cap rates), and price per square foot; does extensive sensitivity analysis and correlates all value indications; uses face rents; IRRs for Class-A properties are 10.00% to 13.00%; investors looking at IRRs again; cash on cash is important, but perceived improvement in market is more important.	4.0% to 5.0%	3.0% to 4.0%	3.0% to 4.0%	9.00% to 10.00%	2.0%	10.50% to 14.00%	7.00% to 10.00%	4 to 6	65.0% to 75.0%	5.0% to 10.0%	Does not use	6 to 9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; applies rent spike in years 1 and 2 in certain submarkets; uses face rents and reflects concessions when they are scheduled to occur.	5.0%	3.0%	3.0%	9.00%	2.0%	10.50% to 11.00%	9.00%	8	70.0%	5.0%	$0.20	—
INVESTMENT ADVISOR ■ Forecast Period: 3 to 7 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; uses face rents and reflects concessions when they are scheduled to occur.	3.5%	3.0%	3.0%	9.00% to 10.00%	1.0% to 5.0%	12.50%	9.00% to 10.50%	6 to 9	65.0% to 75.0%	3.0% to 5.0%	$0.10 to $0.15	4 to 6
INSTITUTIONAL INVESTOR ■ Forecast Period: 3 to 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve deduction but before TIs and leasing commissions.	3.0% to 5.0%	3.0%	4.0%	8.50% to 9.50%	2.0% to 5.0%	12.00% to 14.00%	8.00% to 9.00%	6	75.0%	5.0%	$0.15 to $0.20	3
INVESTOR ■ Forecast Period: 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; typically looks for Class-A, 150,000-square-foot and larger properties in Tier 1 locations; likes opportunities for turnaround, repositioning, and select renovation projects.	4.0% to 5.0%	3.0% to 3.5%	2.5%	9.50%	1.5%	12.00%	8.00%	4	70.0% to 75.0%	3.0% to 4.0%	$0.10 to $0.15	4 to 6
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Relies primarily on DCF; also uses direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; applies 4.0% to 5.0% rent spike in year 1 and/or 2 in certain West Los Angeles submarkets.	3.0% to 4.0%	3.0%	3.0%	8.50% to 11.00%	1.5% to 4.0%	10.50% to 12.00%	8.25% to 10.25%	6 to 12	50.0% to 60.0%	3.0% to 4.0%	$0.20 to $0.25	4 to 9

Manhattan Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT BANKER ■ Forecast Period: 10 years Strongest interest is in Midtown; 7.0% to 10.0% rent spike in Class-A buildings in Midtown.	5.0% years 1-3; 3.5% thereafter	3.0%	3.0%	8.00% to 10.00%	2.5%	10.00% to 12.00%	7.50% to 10.00%	6 to 12	65.0%	3.5% to 7.0%	Varies	6 to 9
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Buys free and clear; average IRR consists of a 6.5% to 7.5% real rate of return, plus the inflation rate used on market rent. The three indicated growth scenarios help to test the sensitivity of investment to inflation; relies on DCF (IRR); NYC reassessment at 45.0% of sale price with five-year phase-in and 2.0% tax rate increase beginning after phase-in; use of face or effective rents varies by submarket.	2.0% years 1-2; inflation thereafter	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	8.00% to 9.00%	1.0% to 6.0%	10.50% to 11.50%	8.25% to 9.25%	6 to 9	60.0% to 70.0%	2.0% to 5.0%	$0.10 to $0.20	9 to 12
PENSION FUND ADVISOR ■ Forecast Period: 10 years Reflects NYC reassessment at 40.0% to 45.0% of sale price with tax rate increases of 5.0% per year; looks at DCF, direct capitalization (initial cap rates), and price per square foot.	3.0%	3.0%	3.0%	9.00% to 10.00%	1.0% to 2.0%	11.00% to 12.50%	8.50% to 9.50%	6 to 9	60.0%	5.0%	$0.10 to $0.15	12 to 18
REAL ESTATE ADVISOR ■ Forecast Period: 10 to 12 years NYC reassessment at 38.0% to 45.0% of sale price with five-year phase-in; very concerned about NYC's assessment practices; relies on DCF (IRR), direct capitalization, and price per square foot; emphasis on cash-on-cash rates; more realistic credit loss, downtime, free rent, TIs, and annual capital reserve; uses face rents and reflects concessions when they are scheduled to occur; applies 5.0% to 7.0% rent spike in years 3 to 4 in selected Downtown submarkets; more concerned with the resale estimate.	3.0% to 4.0% (Midtown); 0.0% initially, then 2.0% to 4.0% (Downtown older product)	3.0% to 4.0%	3.0% to 4.0%	8.75% to 9.75%	2.0% to 4.0%	10.50% to 12.00%	8.50% to 9.50%	6 to 12	60.0% to 70.0%	1.0% to 3.0%	$0.20 to $0.50	6 to 12
INVESTMENT ADVISOR ■ Forecast Period: 10 years Prefers free and clear, reflects NYC reassessment at 40.0% to 45.0% of sale price with five-year phase-in and increase of tax rates at 5.0% per year; does not place primary reliance on any technique; uses all and correlates; also looks at components of NOI growth; uses face rents.	4.0%	3.5%	3.5%	8.50% to 9.50%	1.5%	11.00% to 12.00%	8.50% to 10.00%	4 to 6	65.0%	5.0% to 10.0%	$0.10 to $0.20	9 to 12
INVESTMENT ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital reserve; uses face rents and reflects concessions when they are scheduled to occur; foreign investors continue to have an interest in Manhattan office buildings.	3.5%	3.5%	3.5%	9.00% to 10.00%	1.0% to 3.0%	10.75% to 12.50%	8.00% to 10.00%	9 to 12	50.0% to 70.0%	3.0% to 7.0%	$0.40	9 to 12
REAL ESTATE ADVISOR ■ Forecast Period: 5, 7, and 10 years Uses both DCF and direct capitalization; relies on DCF; uses face rents in DCF model, net effective rents in direct capitalization; prefers Downtown and Times Square.	4.0% to 6.0%	4.0%	3.0%	8.00% to 10.00%	1.5% to 2.0%	11.00% to 13.00%	8.50% to 10.50%	2 to 18	60.0%	8.0% to 14.0%	$0.30 to $1.00	10
LIFE INSURANCE COMPANY ■ Forecast Period: 10 to 12 years Uses both DCF and direct capitalization; in direct cap, capitilizes NOI before TIs, leasing commissions, and capital replacement reserve.	3.0% to 4.0%	3.0%	3.0%	9.00% to 9.50%	1.0% to 2.0%	9.75% to 10.50%	8.00% to 9.00%	4 to 5	60.0% to 70.0%	5.0%	$0.15 to $0.25	4 to 6

Pacific Northwest Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; preference for DCF; interested in both CBD and suburban properties in both Seattle and Portland; uses	5.0%	3.0%	—	9.00% to 9.50%	2.0% to 2.5%	11.50%	9.50% to 10.00%	6	60.0% to 70.0%	5.0%	$0.20 to $0.25	9 to 12
INVESTOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; there are no concessions in this market; rental rates continue to rise in Puget Sound market area; vacancy rate continues to drop; prefers Puget Sound area and Spokane, Washington.	8.0%	3.0%	3.0%	8.50% to 10.00%	3.0%	10.75% to 12.00%	8.50% to 11.00%	3 to 9	75.0% to 80.0%	0.0% to 4.0%	Does not use	6 to 12
INVESTMENT BANKER ■ Forecast Period: 10 years Uses DCF (IRR), direct capitalization, and price per square foot; does extensive sensitivity analysis; reliance is on projections and IRRs; uses face rents.	4.0%	4.0%	4.0%	9.00% to 10.00%	2.0%	10.00% to 13.00%	8.00% to 10.00%	3 to 6	65.0% to 70.0%	5.0% to 10.0%	Does not use	6 to 9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Uses primarily DCF; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; applies rent spike in year 1 in certain submarkets; uses face rents and reflects concessions when they are scheduled to occur.	3.0%	3.0%	3.0%	9.00% to 9.50%	4.0%	10.50% to 11.00%	8.25%	6	65.0%	2.0% to 5.0%	$0.15 to $0.20	6
INVESTOR ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve deduction but before TIs and leasing commissions; does not use rent spikes; uses face rents and reflects concessions when they are scheduled to occur; prefers Puget Sound and Portland.	Varies	2.0% to 4.0%	2.0% to 2.75%	9.50% to 10.50%	3.0% to 5.0%	10.50% to 13.00%	8.75% to 10.00%	6	75.0%	5.0%	Varies	3 to 6
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; relies on DCF; in direct cap, capitalizes NOI after capital reserve deduction but before TIs and leasing commissions; uses effective rents.	2.5%	3.0%	2.5% to 3.5%	9.25%	2.5% to 3.0%	10.50% to 11.50%	9.25%	6 to 9	50.0%	7.0% to 10.0%	$0.15 to $0.20	6 to 9
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Buys free and clear; interested in attractive, well-located Class-A properties; relies on DCF (IRR); uses direct capitalization as a check only; may apply a 5.0% to 8.0% rent spike if justified by submarket conditions and specific property; uses face rents in model that allocates actual concessions when they are scheduled to occur; underlying vacancy and credit loss may be lower based on current occupancy, leases in place, and rollover risk.	4.0% to 5.0%	3.5%	2.5%	9.25% to 9.75%	3.0% + any local tariffs	11.00% to 11.50%	8.75% to 9.50%	6	70.0%	5.0% to 6.0%	$0.25 to $0.50	6

San Francisco Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT ADVISOR ■ Forecast Period: 5 to 10 years Relies on DCF; applies rent spike in years 1 to 3; typical management fees are 3.0%; typical leasing fees are $9.00 on new leases, $4.50 on renewals; typical TIs are $15.00 for new leases, $9.75 for renewals; structural vacancy has been reached in this market.	8.0%	3.0%	3.0%	8.25% to 8.75%	1.0%	10.00% to 10.50%	8.50%	2	75.0%	5.0%	$0.10 to $0.25	3 to 6
PENSION FUND ADVISOR ■ Forecast Period: 7 and 10 years Uses DCF and direct capitalization but relies on DCF; uses face rents and reflects actual concessions when scheduled to occur.	4.0% to 6.0%	3.0% to 4.0%; taxes 2.0%	3.0% to 3.5%	8.50% to 9.50%	1.0% to 2.0%	10.50% to 12.00%	8.00% to 9.00%	4 to 6	60.0% to 70.0%	5.0%	$0.10 to $0.20	4 to 8
REAL ESTATE ADVISOR ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; no longer applies rent spike; uses face rents and reflects concessions when they are scheduled to occur; is placing greater focus on rents in place.	1.5%	3.0%	3.0%	8.50% to 9.50%	1.0% to 1.5%	10.50% to 11.00%	7.50% to 9.00%	6	70.0%	5.0%	$0.15 to $0.25	6 to 9
REAL ESTATE ADVISOR ■ Forecast Period: 5 and 10 years Buys turnaround situations as well as rotational plays in suburban markets; uses both DCF and direct capitalization; relies on DCF; applies 4.0% to 10.0% rent spike in years 1 through 3 in submarkets where there is evidence that they will occur; uses face rents in DCF model, net effective rents in direct capitalization.	0.0% to 10.0%	4.0%	3.0%	8.00% to 10.00%	1.5% to 2.0%	10.50% to 13.00%	8.00% to 11.00%	2 to 18	60.0% to 65.0%	0.0% to 6.0%	$0.30 to $1.00	3 to 6
DOMESTIC PENSION FUND ■ Forecast Period: 10 years Prefers CBD; uses both DCF and direct capitalization; uses face rents and reflects concessions when they are scheduled to occur.	3.0% to 3.5%	3.5%	3.5%	8.50% to 9.50%	1.0% to 2.0%	10.00% to 11.50%	7.50% to 9.00%	8 to 10	60.0% to 70.0%	1.0% to 3.0%	$0.10 to $0.25	6 to 12
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; forecasts expenses at 100% of projected CPI; no longer applies a rent spike.	0.0% to 5.0%	3.0%	3.0%	9.00% to 9.50%	1.5% to 4.0%	10.00% to 11.25%	7.00% to 9.00%	3 to 10	60.0% to 70.0%	1.5% to 5.0%	$0.20 to $0.30	3 to 6

Southeast Florida Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
REIT ■ Forecast Period: 5 and 10 years Entrepreneurial buyer looking to buy going-in yield or value-added opportunities; uses price per square foot, stabilized cap, and 10-year DCF as checks; no longer uses rent spikes in this market; uses face rents and reflects concessions when they are scheduled to occur.	2.0% to 3.0%	2.0% to 3.0%	2.0% to 3.0%	10.00% to 11.00%	2.0%	11.00% to 12.00%	10.00% to 12.00%	6	65.0%	5.0%	$0.20	6
INVESTMENT ADVISOR ■ Forecast Period: 5 to 10 years Relies on DCF and direct capitalization; contract rents above market are reduced to market for pricing; market is improving; Miami's Airport West, downtown, and Brickell Class-A markets are very strong; uses effective rents.	5.0% to 7.0% years 1-3; 4.0% thereafter	3.0% to 3.5%	3.0% to 3.5%	9.50% to 10.00%	2.0%	10.50% to 12.00%	8.50% to 10.00%	4 to 8	75.0% to 80.0%	5.0% of noncredit space	$0.15	4
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve.	3.0%	3.0%	3.0%	9.25% to 9.50%	2.0% to 4.0%	10.50% to 11.75%	9.00% to 10.00%	4 to 6	65.0% to 70.0%	7.0% to 10.0%	$0.20 to $0.30	6 to 9
DOMESTIC PENSION FUND ■ Forecast Period: 3, 5, 7, and 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve but before TIs and leasing commissions; uses effective rents after all concessions are extracted; applies 5.0% to 10.0% rent spike in early years; target IRR is 12.00%+ on development deals.	3.0% to 5.0%	3.0%	3.0%	9.00% to 10.00%	2.0%	10.50% to 12.00%+	9.00%+	6 to 9	70.0% to 75.0%	5.0%	$0.10 to $0.20	Varies
LIFE INSURANCE COMPANY ■ Forecast Period: 5 to 8 years Uses DCF and direct capitalization; also looks at discount to replacement cost; relies on DCF; uses effective rents; typical concessions still include three to six months free rent and generous TIs.	3.0%	3.0% to 4.0%	3.0%	9.50% to 11.00%	2.0%	11.00% to 12.00%	8.00% to 10.00%	6	60.0%	4.0%	$0.25	6 to 9
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Interested in properties that are "value added" opportunities; uses both DCF and direct capitalization; occasionally applies 5.0% to 7.0% rent spike in year 3 or 4 in some markets; uses face rents and reflects concessions when they are scheduled to occur.	2.0% to 5.0%	3.5%	—	9.50%	2.0% to 2.5%	10.00% to 10.50%	9.50% to 10.00%	6 to 9	50.0% to 70.0%	5.0% to 7.0%	$0.20 to $0.25	9 to 12
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Relies on DCF; also uses direct capitalization and sales comparison approaches as secondary analytical tools; uses face rents; use of rent spikes is minimal but may apply in year 1; amount of spike is determined on a case-by-case basis.	3.0%	3.0%	3.0%	9.25% (Class A) to 10.50% (Class B)	2.0% to 4.0%	10.75% to 11.75%	9.00% to 9.50%	3 to 6	70.0%	8.0% to 12.0%	$0.20 to $0.30	6 to 24

Washington, DC Office Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT BANKER ■ Forecast Period: 10 years Active market; little new construction except for build-to-suit; vacancy rate declining; uses face rents; underlying vacancy and credit loss includes rollover vacancy; prefers Golden Triangle and East End submarkets.	3.5%	3.0%	3.0%	8.00% to 9.00%	2.0%	10.00% to 11.50%	7.00% to 9.00%	8	75.0%	2.0% to 5.0%	$0.10 to $0.20	6
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Buys free and clear; average IRR consists of a 7.0% to 7.5% real rate of return plus the inflation rate; the indicated growth scenarios help to determine the sensitivity of investment to inflation; relies on DCF (IRR) and cap rates equally; use of face or effective rents varies by submarket.	0.0% for period of years; then 3%, 5% spike + inflation	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	8.00% to 9.00%	1.0% to 2.0%	11.00% to 11.50%	8.00% to 9.00%	6 to 9	60.0% to 70.0%	2.0%	$0.10 to $0.20	6 to 9
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; prefers CBD and East End.	3.0% to 3.5%	3.0%	3.0%	10.00%	2.5%	12.00% to 13.00%	10.00%	6	70.0%	5.0% to 6.0%	$0.20	6
REAL ESTATE ADVISOR ■ Forecast Period: 5 and 10 years Buys turnaround situations as well as rotational plays in the suburbs; uses both DCF and direct capitalization; relies on DCF; applies 4.0% to 10.0% rent spikes in years 1 and 2 where there is evidence that they will occur; uses face rents in DCF model, net effective rents in direct capitalization.	0.0% to 10.0%	4.0%	4.0%	8.00% to 11.00%	1.5% to 2.0%	11.00% to 13.00%	8.00% to 11.00%	2 to 18	65.0%	8.0% to 14.0%	—	3 to 6
INVESTMENT ADVISOR ■ Forecast Period: 10 years Prefers free and clear properties with joint venture partner and preferred return; uses all valuation techniques and correlates; does not rely on any one technique; looks at components of NOI growth; uses face rents.	0.0% to 3.0%	3.5%	3.5%	8.50% to 10.00%	1.5%	11.00% to 12.50%	8.50% to 10.00%	4 to 6	60.0%	5.0% to 10.0%	$0.10 to $0.20	6 to 9
PENSION FUND ADVISOR ■ Forecast Period: 7 years Relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot.	3.0%	3.0%	3.0%	9.00% to 10.00%	2.0% to 3.0%	11.00% to 12.00%	8.75% to 9.50%	6 to 12	60.0%	2.0% to 3.0%	$0.15 to $0.20	12 to 18
INVESTOR ■ Forecast Period: 3 to 5 years and 10 years Uses DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; uses face rents and reflects concessions when they are scheduled to occur.	3.0% to 3.5%	3.0%	3.0%	9.50% to 10.50%	3.0%	11.00% to 13.00%	9.00% to 11.00%	6	60.0% to 70.0%	5.0% to 10.0%	$0.15 to $0.25	6 to 9
INSTITUTIONAL INVESTOR ■ Forecast Period: 10 years Relies on DCF; uses present value analysis of effective rents.	2.0% to 3.5%	2.0% to 3.5%	2.0% to 3.5%	9.00% to 10.00%	2.0% to 3.0%	11.00% to 11.75%	9.00% to 9.75%	3 to 6	50.0% to 60.0%	1.0% to 3.0%	$0.10 to $0.20	3 to 9

National Industrial Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES			RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	VACANCY ASSUMPTIONS			RESERVE	MARKETING TIME
	Market Rent	Expenses	CPI	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Months Vacant	Tenant Retention	Underlying Vacancy & Credit Loss	Per Square Foot	Months
INVESTMENT ADVISOR ■ Forecast Period: 10 to 15 years Prefers free and clear properties; relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; total vacancy and credit loss including rollover vacancy is 5.0% to 7.0%; uses actual rents and reflects concessions as they occur.	Years 1-3 varies per market; 3.0% thereafter	3.0%	3.0%	8.50% to 10.00%	2.0% to 4.0%	10.50% to 12.00%	8.00% to 10.00%	6 to 12	60.0% to 70.0%	2.0% to 3.0%	$0.10 to $0.15	6 to 9
PENSION FUND ADVISOR ■ Forecast Period: 10 years Prefers to buy free and clear; uses all valuation techniques.	3.0%	3.0%	3.0%	9.25% to 10.25%	2.0% to 3.0%	11.00% to 11.50%	8.75% to 9.50%	6 to 9	60.0%	5.0%	$0.15	6 to 9
INVESTMENT ADVISOR ■ Forecast Period: 10 years Prefers free and clear; relies on direct capitalization (initial cap rates), price per square foot, and DCF (IRR) and equity cap rates equally; hard to find in bulk (250,000 square feet or more); uses face rents.	2.0% to 4.0%	3.5%	3.5%	9.00% to 10.00%	1.5%	11.00% to 12.00%	8.50% to 9.50%	4 to 6	65.0%	4.0% to 8.0%	$0.10 to $0.15	6 to 9
DOMESTIC PENSION FUND ■ Forecast Period: 10 to 12 years Strongest market; buys free and clear only; average IRR consists of a 7.0% to 7.5% real rate of return, plus the inflation rate; the three indicated growth scenarios help to determine sensitivity of investment to inflation; relies on DCF (IRR) and initial cap rates equally; use of face or effective rents varies by market.	Years 1-3 varies per market; thereafter at inflationary rate	2.0%/ 4.0%/ 6.0%	2.0%/ 4.0%/ 6.0%	9.00% to 9.50%	2.0%	11.00% to 11.50%	9.00% to 10.00%	6 to 9	60.0%	2.0% to 5.0%	$0.10 to $0.20	6 to 9
REAL ESTATE ADVISOR ■ Forecast Period: 10 to 12 years Good market; continuing interest — more stress on supply/demand, etc.; relies on DCF (IRR), direct capitalization (initial cap rates), and price per square foot; emphasis on average cash-on-cash rates, more realistic; credit loss, downtime, free rent, TIs, and annual capital reserve; a lot of interest in this market but also very cautious; more concerned with the resale estimate — stabilized income, full selling commissions, full legal expenses, and real estate tax adjustment.	3.0% to 5.0%	3.0% to 4.0%	3.0% to 4.0%	9.25% to 10.25%	2.0% to 5.0%	10.50% to 12.00%	8.75% to 9.75%	6 to 12	50.0% to 60.0%	3.0% to 5.0%	—	6
REIT ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; uses effective rents after all concessions are extracted.	3.0%	3.0%	2.0%	—	2.0%	10.75%	8.25% to 10.00%	6	70.0%	7.0%	$0.05	6
REIT ■ Forecast Period: 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve.	3.0%	3.0%	3.0%	10.25%	2.0% to 4.0%	12.00%	10.00%	6 to 9	70.0%	5.0%	$0.10 to $0.15	6
PENSION FUND ADVISOR ■ Forecast Period: 10 to 14 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI before TIs, leasing commissions, and capital replacement reserve; vacancy assumption is 5.0% total including lag on noncredit tenants plus 1.0% to 2.0% credit loss.	1.5% to 3.5%	3.0%	3.0%	9.00% to 10.00%	1.0% to 2.0%	10.00% to 11.00%	8.50% to 9.50%	2	70.0%	1.0% to 2.0%	$0.10 to $0.15	2

National Apartment Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES		VACANCY	RESIDUAL		DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	RESERVE	MARKETING TIME
	Market Rent	Expenses	Total Vacancy	Cap Rate	Selling Expense	Free & Clear	Free & Clear	Per Unit	Months
DOMESTIC PENSION FUND ■ Forecast Period: 10 years Strong balanced market; groups leases by expiration dates for DCF analysis; typical NOI ratio is 60.0%; uses face rents since concessions are typically minor; leasing fees are in addition to a 4.0% management fee; relies on direct capitalization; uses DCF as a test.	4.0%	2.0%/ 4.0%/ 6.0%	5.0%	8.75% to 9.50%	2.0%	11.00% to 11.50%	8.50% to 9.00%	$150 to $250	3 to 4
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Continuing positive interest—people represent real demand; strong market; supply and demand in balance; groups leases by expiration dates for DCF analysis; management fee ranges from 3.0% to 5.0%; relies on DCF, direct capitalization, and sales comparison; emphasis on average cash-on-cash rates, more realistic credit loss, downtime, free rent, TIs, and annual capital reserve.	0.0% to 3.0%	3.0% to 4.0%	3.0% to 5.0%	9.00% to 10.00%	3.0%+	10.75% to 12.25%	8.50% to 9.50%	Specific by component, cost & life expectancy	6
DOMESTIC PENSION FUND ■ Forecast Period: 1 and 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve; reflects concessions as they occur; may burn off on new property during lease-up period in strong market.	3.0% to 3.5%	3.0% to 3.5%	5.0% to 10.0%	8.00% to 10.00%	—	10.00% to 12.00%	7.50% to 9.50%	$200 to $400	6 to 9
PENSION FUND ADVISOR ■ Forecast Period: 7 years Strong interest in this product nationwide; applies management fee of 3.0% to 4.0%; uses DCF and direct capitalization; emphasis is on initial returns.	2.0% to 3.0%	3.0%	5.0% to 7.0%	9.00% to 10.00%	2.0% to 3.0%	11.50%	8.50% to 9.50%	$300	6
INVESTMENT ADVISOR ■ Forecast Period: 5 to 10 years Good product for diversified portfolio, groups leases by expiration dates for DCF analysis; uses management fee of 4.0%; average NOI ratio is 40.0% to 50.0%; relies on direct capitalization and uses DCF to calculate yield.	Years 1-3 varies per market; 3.0% thereafter	3.0%	5.0% to 10.0%	8.00% to 10.00%	2.0% to 3.0%	10.50% to 12.00%	7.50% to 9.50%	$200 to $300	6 to 9
REAL ESTATE ADVISOR ■ Forecast Period: 5 and 10 years Relies on DCF, also uses direct capitalization; residual cap rate is 25 basis points over the going-in cap rate on a 5-year holding period, 50 basis points over the going-in cap rate on a 10-year holding period.	3.0% to 3.5%	3.5%	6.0% to 8.0%	9.25% to 9.75%	2.5%	10.75% to 11.50%	8.75% to 9.25%	$200 to $250+ $100 to $150 for capital improvements	6
PENSION FUND ADVISOR ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes NOI after capital replacement reserve deduction; buys 150- to 400-unit apartment complexes in first-and second-tier markets nationwide.	3.0%	3.0%	5.0% to 7.0%	9.00% to 10.00%	1.5%	11.00% to 12.50%	7.75% to 9.00%	$200 to $250	3
PENSION FUND ADVISOR ■ Forecast Period: 7 to 10 years Specializes in this market; increases annual rent in lieu of lease-by-lease analysis; uses management fee of 4.0% plus leasing costs and reserve (actually funded); relies on direct capitalization primarily; also uses sales comparison and cost; more equity and debt are flowing to this market; sees signs of overbuilding of new deluxe product.	0.0% to 2.0%	3.5%	6.0% to 8.0%	8.25% to 9.00%	2.0%	10.00% to 11.00%	7.75% to 8.50%	$200 to $250	4
INVESTMENT ADVISOR ■ Forecast Period: 10 years Specializes in this market; relies equally on DCF and direct capitalization; reserve amount depends on age and/or conditions.	3.0% to 3.5%	3.0% to 3.5%	5.0% to 10.5%	8.50% to 9.50%	2.0% to 3.0%	11.00% to 11.50%	7.75% to 9.00%	$150 to $300	3
REIT ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap applies OAR to NOI after capital replacement reserve deduction; acquisitions are in the Western region of the United States.	3.0%	3.0%	5.0%	9.25%	2.0% to 3.0%	11.00% to 12.00%	8.75%	$200	4 to 8
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Prefers newer suburban garden complexes in mature, stable markets; uses both DCF and direct capitalization; relies on DCF; in direct cap, capitalizes NOI after capital replacement reserve deduction.	2.5%	3.0%	6.0% to 8.0%	9.25%	3.0%	10.50% to 11.00%	8.75% to 9.50%	$250 to $400	9 to 12

National Full-Service Hotel Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES		RESIDUAL			DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	GROSS ROOM REVENUE MULTIPLIER	MANAGEMENT FEES	RESERVE FOR REPLACEMENT OF FIXED ASSETS	MARKETING TIME
	Average Daily Rate	Operating Expenses	Cap Rate	Year Capped	Selling Expense	Free & Clear	Free & Clear	GRRM	Base Fee	Percent of Total Revenues	Months
REIT ■ Forecast Period: 10 years Focuses on large MSA markets such as New York, Los Angeles, San Francisco, Chicago, Seattle, as well as resort destinations; uses both DCF and direct capitalization; in DCF, forecasts 3.0% to 5.0% initial average daily rate but 5.0% to 10.0% if repositioning; in direct cap, capitalizes both prior 12 months and forecast next 12 months income.	3.0% to 10.0%	3.0%	10.00% to 12.00%	10	3.0%	12.00% to 15.00%	—	—	3.0%	4.0%	—
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income.	2.0% to 6.0%	3.0%	10.00% to 12.00%	11	2.0% to 4.0%	10.00% to 11.50%	8.50% to 10.00%	Does not use	3.0% to 6.0%	4.0% to 6.0%	4 to 12
REAL ESTATE ADVISOR ■ Forecast Period: 5 to 7 years Buys nationwide; uses both DCF and direct capitalization; relies on DCF but is sensitive to market rates; growth rates are specific to the market; forecasts demand growth from the fundamental demand side based on forecast growth in room rate demand and models the mix of four different sources of business, each of which typically has a different rate.	2.0%	4.0%	9.50% to 11.00%	6 or 8	1.0%	12.00% to 15.00%	10.00% to 13.00%	—	Varies	5.0% to 8.0%	2 to 3
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Interested in full-service and luxury due to better opportunity for growth than economy/limited-service product; uses both DCF and direct capitalization; may use base or incentive management fee, with incentive fee very property specific; in direct cap, usually caps forecast next 12 months; prefers hotels in major markets with good job growth, regional and local room demand, major business travel centers, submarkets convenient to major airports.	Varies per market	3.0% to 4.0%	10.00% to 11.00%	11	2.0% to 3.0%	12.00% to 16.00%	9.00% to 11.75%	Does not use	2.5% to 4.0%	3.0% to 5.0%	6 to 12
REIT ■ Forecast Period: 5 years Relies on direct capitalization; capitalizes prior 12 months income.	4.0% to 8.0%	3.0%	9.50% to 10.50%	10 or 11	3.0%	—	12.00%	Does not use	2.0%	3.0%	—
HOTEL OWNER-OPERATOR-FRANCHISOR ■ Forecast Period: 10 years Seeks opportunities nationwide; uses both DCF and direct capitalization; initial average daily rate growth rate in stabilized markets where supply and demand are near equilibrium is close to the CPI; selling expense depends on size and value of the property.	3.0%	2.5%	9.00% to 11.00%	11	1.5%	12.00% to 14.00%	9.00% to 10.00%	Does not use	3.0%; uses base + incentive in some cases	4.0% to 6.0%	6 to 9
LIFE INSURANCE COMPANY ■ Forecast Period: 7 to 10 years Prefers well-located properties in growing suburbs, airport markets, and conference centers with potential to turn around and add value.	3.0% to 4.0%	3.0%	10.50% to 11.00%	11	1.0% to 2.0%	13.50% to 14.50%	9.75% to 10.50%	—	2.0% to 3.0%; 0.05% to 1.00% incentive fee	4.0% to 5.0%	1 to 6
PRIVATE HOTEL COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income; prefers West, Northeast, and Southeast.	4.0%	3.0%	10.00%	10	2.0%	9.00% to 10.00%	—	—	3.0%; 10.0% AGOP incentive fee	4.0%	—
PENSION FUND ADVISOR ■ Forecast Period: 7 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers California (both Northern and Southern), Arizona, Seattle, Chicago, New York, and Mid-Atlantic region.	5.0% to 6.0%	3.0% to 10.0%	8.00% to 12.00%	8	2.0% or $ specific	13.00% to 14.50%	8.00% to 9.00%	3 to 4	2.0%; 1.5% incentive fee	5.0%	4

National Economy/Limited Service Hotel Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES		RESIDUAL			DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	GROSS ROOM REVENUE MULTIPLIER	MANAGEMENT FEES	RESERVE FOR REPLACEMENT OF FIXED ASSETS	MARKETING TIME
	Average Daily Rate	Operating Expenses	Cap Rate	Year Capped	Selling Expense	Free & Clear	Free & Clear	GRRM	Base Fee	Percent of Total Revenues	Months
HOTEL OWNER-OPERATOR-FRANCHISOR ■ Forecast Period: 5 to 10 years Criteria are for new mid-scale hotels with restaurants being developed nationwide; uses both DCF and direct capitalization; initial average daily rate growth rate in stabilized markets where supply and demand are near equilibrium is close to the CPI; selling expense depends on size and value of the property.	3.0%	3.0%	11.00% to 12.00%	6 to 11	3.0%	14.00% to 16.00%	11.00%	Does not use	3.0%; uses base + incentive in some cases	4.0%	3 to 6
HOTEL OWNER-MANAGER ■ Forecast Period: 3 years Focuses on direct capitalization; in direct cap, capitalizes prior 12 months income; prefers Midwest, South, and Northwest.	2.0% to 3.0%	60.0% of revenues	11.00%	—	—	—	11.00%	—	4.0%; 10.0% of distribution incentive fee	5.0%	4
PRIVATE HOTEL COMPANY ■ Forecast Period: 10 years Prefers Northeast, Southeast, and Southwest; uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income.	4.0%	3.0%	11.00%	10	2.0%	10.00%	—	—	3.0%; 10.00% AGOP incentive fee	4.0%	—
PENSION FUND ADVISOR ■ Forecast Period: 7 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers California, Denver, Seattle, Midwest (Chicago), East Coast to New York.	3.0%	2.0% to 4.0%	12.00%	8	3.0% to 5.0%	13.00% to 15.00%	10.50%	2.0 to 2.5	3.0%; 1.0% to 2.0% incentive fee	4.0%	6
HOTEL MANAGEMENT COMPANY ■ Forecast Period: 3 to 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers Texas, Florida, and Denver.	3.0% to 4.0%	2.5% to 3.0%	11.00% to 12.00%	5	2.0% to 3.0%	15.00%	11.00% to 11.50%	Does not use	5.0%; 15.0% of cash flow in excess of owner's priority incentive fee	5.0%	6 to 12
REIT ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income; prefers West and Northeast.	2.0% to 4.0%	3.0% to 4.0%	12.25%	11	3.0% to 4.0%	15.00%	11.50% to 12.00%	2.5 to 3.5	3.0% to 4.0%; deal-specific incentive fee	4.0% to 5.0%	6 to 12
HOTEL COMPANY ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income; prefers major CBDs with barriers to entry in the Northeast and West.	3.0% to 10.0%	2.0% to 3.5%	10.00% to 13.00%	6 to 11	1.0% to 4.0%	14.00% to 16.00%	9.50% to 12.50%	Does not use	3.0% to 5.0%	3.0% to 5.0%	3 to 6

National Luxury Hotel Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES		RESIDUAL			DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	GROSS ROOM REVENUE MULTIPLIER	MANAGEMENT FEES	RESERVE FOR REPLACEMENT OF FIXED ASSETS	MARKETING TIME
	Average Daily Rate	Operating Expenses	Cap Rate	Year Capped	Selling Expense	Free & Clear	Free & Clear	GRRM	Base Fee	Percent of Total Revenues	Months
REAL ESTATE ADVISOR ■ Forecast Period: 10 years Interested in full-service and luxury due to better opportunity for growth than economy/limited-service product; uses both DCF and direct capitalization; may use base or incentive management fee, with incentive fee very property specific; in direct cap, usually caps prior 12 months; prefers hotels in major markets with good job growth, regional and local room demand, major business travel centers, submarkets convenient to major airports.	3.0% to 5.0%	3.0% to 5.0%	10.00% to 11.50%	11	2.0% to 3.0%	13.00% to 16.00%	9.25% to 12.25%	Does not use	2.5% to 4.5%	3.0% to 5.0%	6 to 12
HOTEL OWNER-OPERATOR-FRANCHISOR ■ Forecast Period: 10 years Criteria are for upscale and resort hotels; seeks opportunities nationwide; uses both DCF and direct capitalization; initial average daily rate growth rate in stabilized markets where supply and demand are near equilibrium is close to the CPI; selling expense depends on size and value of the property.	3.5% to 4.5%	3.0%	9.00% to 10.00%	11	2.0%	12.00% to 14.00%	8.00% to 9.50%	Does not use	3.0%; uses base + incentive in some cases	4.0% to 6.0%	6
LIFE INSURANCE COMPANY ■ Forecast Period: 7 to 10 years Uses both DCF and direct capitaliation; in direct capitalization, may capitalize trailing 12 months income or forecast 12 months on a case-by-case basis.	3.0% to 3.5%	3.0%	9.50% to 10.00%	11	2.0%	12.00% to 13.50%	9.50% to 10.00%	—	2.5% to 3.0%	4.0% to 5.0%	—
LIFE INSURANCE COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income; prefers major urban and major beach resort markets.	3.5%	3.0%	10.00% to 10.25%	11	1.0% to 2.0%	11.00% to 12.50%	10.00%	Does not use	3.0%	4.0%	—
PRIVATE HOTEL COMPANY ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income.	4.0%	3.0%	9.50%	10	2.0%	9.00% to 10.00%	—	—	3.0%; 10.0% AGOP incentive fee	4.0%	4
PENSION FUND ADVISOR ■ Forecast Period: 5 to 7 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers West Coast, East Coast, and Midwest.	6.0% to 10.0%	3.0% to 4.0%	7.00% to 9.00%	6 to 8	2.0%	12.00% to 14.00%	7.50% to 8.00%	3 to 6	1.5% to 2.0%; 1.0% to 3.0% incentive fee	8.0%	4
REIT ■ Forecast Period: 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes both prior 12 months income and forecast next 12 months; OAR is 8.00% to 9.00% on prior 12 months and 10.00% to 11.00% on forecast income; prefers urban resort and convention markets.	3.0% to 5.0%	1.0% to 3.0%	9.50% to 10.00%	5	1.5% to 2.0%	13.00% to 15.00%	8.00% to 9.00%	Does not use	1.0% to 2.5%	4.0% to 5.0%	4
HOTEL OWNER-INVESTOR ■ Forecast Period: 5 to 7 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers top 50 urban MSA markets.	4.0% to 6.0%	3.0%	9.50% to 10.50%	5 to 7	1.5% to 2.0%	13.50% to 14.00%	9.50% to 10.50%	Does not use	2.5% to 3.0%	4.0%	6
REIT ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers North and Northeast.	5.0% to 6.0%	3.0% to 4.0%	9.50%	11	2.0% to 3.0%	12.00% to 13.00%	9.00%	Does not use	2.0% to 3.0%	4.0% to 5.0%	6
INVESTMENT BANKER ■ Forecast Period: 1 year Uses direct capitalization; depending on upside, applies OAR to either or both prior 12 months and forecast 12 months income; growth rates depend on market and position of hotel within the market.	Varies	Varies	—	—	—	—	6.00% to 10.00%	Does not use	3.0%	3.0% to 4.0%	6 to 9

National Extended-Stay Hotel Market

PRICEWATERHOUSECOOPERS

INVESTOR SURVEY RESPONSES*
THIRD QUARTER 1999

*Representative sample; due to space constraints, not all responses are included.

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	CHANGE RATES		RESIDUAL			DISCOUNT RATE (IRR)	OVERALL CAP RATE (OAR)	GROSS ROOM REVENUE MULTIPLIER	MANAGEMENT FEES	RESERVE FOR REPLACEMENT OF FIXED ASSETS	MARKETING TIME
	Average Daily Rate	Operating Expenses	Cap Rate	Year Capped	Selling Expense	Free & Clear	Free & Clear	GRRM	Base Fee	Percent of Total Revenues	Months
HOTEL DEVELOPER-MANAGER-OWNER ■ Forecast Period: 3 years All hotels are new construction; uses both DCF and direct capitalization; in DCF expects 15.00% yield upon stabilization; in direct cap, applies a 30.00% OAR to income and capital proceeds from debt and sale over a 3- to 5-year period; prefers Northern California and Pacific Northwest markets with barriers to entry.	5.0%	3.5%	10.50%	3	2.0%	15.00%	—	—	3.5%; 10.00% of incremental cash flow over hurdle	2.0% to 4.0%	12
HOTEL OWNER-OPERATOR-FRANCHISER ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income.	3.0%	3.0%	10.00% to 11.00%	6 to 11	2.0% to 3.0%	13.00% to 15.00%	10.00%	Does not use	3.0%; uses base + incentive in some cases	4.0%	6
HOTEL MANAGEMENT COMPANY ■ Forecast Period: 5 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income; prefers Texas, Colorado, Utah, Florida; focuses on upscale extended stay not economy products.	4.0% to 5.0%	3.0% to 3.5%	10.75% to 11.50%	5	2.0%	14.00% to 14.50%	11.00%	Does not use	3.0%; 15.0% of cash flow in excess of owner's priority incentive fee	4.0% to 5.0%	6 to 9
REIT ■ Forecast Period: 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income; prefers West and Northwest.	3.0% to 4.0%	3.0% to 4.0%	12.00% to 12.50%	11	3.0% to 4.0%	14.50% to 15.50%	11.50% to 12.00%	Does not use	3.0% to 4.0%	4.0% to 5.0%	6 to 9
HOTEL COMPANY ■ Forecast Period: 5 to 10 years Uses both DCF and direct capitalization; in direct cap, capitalizes forecast next 12 months income; prefers Northeast and West.	3.0% to 10.0%	2.0% to 5.0%	10.50% to 12.50%	6 to 11	2.0% to 4.0%	14.00% to 16.50%	10.00% to 12.00%	Does not use	3.0% to 5.0%	3.0% to 5.0%	3 to 12
INVESTMENT BANKER ■ Forecast Period: 1 year Uses direct capitalization; applies OAR to either or both prior 12 months income or forecast next 12 months income depending on history and product position; growth rates depend on market and position of hotel within the market; prefers major metro areas.	Varies	Varies	—	—	—	—	10.00% to 12.00%	Does not use	3.0%	3.0% to 5.0%	6 to 9
INVESTMENT BANKER ■ Forecast Period: 7 years Uses both DCF and direct capitalization; in direct cap, capitalizes prior 12 months income.	3.0%	3.0%	13.00%	8	2.5%	17.00%	12.00%	1.8	4.0%	4.0%	6

Investment and Property Market Characteristics: Office Markets

PRICEWATERHOUSECOOPERS

THIRD QUARTER 1999

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	FORECAST VALUE CHANGE NEXT 12 MONTHS		PRICE AS % OF REPLACEMENT COST		STRUCTURAL VACANCY		YEARS TO STRUCTURAL VACANCY		TIs - NEW (PSF)		TIs - RENEWAL (PSF)	
Market	Range	Average	Range	Average	Range	Average	Range	Average	Range	Average	Range	Average
National CBD	2.00%-10.00%	4.93%	65.00%-110.00%	90.75%	4.00%-10.00%	7.38%	0-5	2.5	$10.00-$50.00	$27.67	$0.00-$25.00	$11.83
National Suburban	0.00%-10.00%	4.88%	80.00%-115.00%	98.67%	4.00%-8.00%	6.50%	0-3	1.1	$8.00-$35.00	$16.45	$4.00-$20.00	$7.18
Atlanta	0.00%-6.00%	1.92%	90.00%-110.00%	100.00%	5.00%-8.00%	6.75%	0-0	0	$5.00-$15.00	$10.90	$3.25-$10.00	$5.55
Chicago	0.00%-10.00%	2.57%	85.00%-110.00%	94.44%	2.00%-10.00%	6.39%	0-4	0.9	$10.00-$40.00	$21.94	$5.00-$20.00	$9.45
Dallas	0.00%-10.00%	3.50%	50.00%-110.00%	90.83%	5.00%-30.00%	9.00%	0-6	2.1	$8.00-$30.00	$15.14	$2.00-$15.00	$7.00
Houston	0.00%-15.00%	6.79%	50.00%-105.00%	83.33%	3.00%-10.00%	6.19%	0-4	1.4	$5.00-$30.00	$15.19	$2.00-$15.00	$6.56
Los Angeles	0.00%-10.00%	5.07%	75.00%-100.00%	87.81%	5.00%-10.00%	6.79%	1-3	2.2	$5.00-$30.00	$17.56	$0.00-$15.00	$6.17
Manhattan	3.00%-10.00%	6.63%	60.00%-90.00%	82.00%	0.00%-12.00%	6.75%	0-2	0.8	$30.00-$45.00	$35.83	$5.00-$20.00	$11.50
Pacific Northwest	(10.00%)-5.00%	2.38%	85.00%-110.00%	97.93%	3.00%-7.00%	5.17%	0-3	0.9	$5.00-$35.00	$16.69	$0.00-$15.00	$6.79
San Francisco	(5.00%)-10.00%	3.94%	70.00%-110.00%	96.25%	3.00%-8.00%	5.20%	0-0	0.0	$5.00-$50.00	$23.29	$0.00-$20.00	$8.21
Southeast Florida	2.00%-5.00%	2.50%	80.00%-110.00%	98.21%	5.00%-10.00%	7.00%	0-3	1.0	$12.00-$27.00	$17.40	$3.00-$15.00	$6.40
Washington, DC	0.00%-10.00%	3.50%	75.00%-110.00%	92.22%	4.00%-8.00%	6.52%	0-3	1.7	$0.00-$35.00	$18.33	$0.00-$15.00	$9.83

Investment and Property Market Characteristics: National Markets

THIRD QUARTER 1999

Source: Personal survey conducted by PricewaterhouseCoopers, LLP during July 1999.

	FORECAST VALUE CHANGE NEXT 12 MONTHS		PRICE AS % OF REPLACEMENT COST		CLASS-A+ and A MALLS				CLASS-B+ and B MALLS				STABILIZED OCCUPANCY	
					IRRs		OARs		IRRs		OARs			
Market	Range	Average	Range	Average	Range	Average	Range	Average	Range	Average	Range	Average	Range	Average
Regional Mall	0.00%-10.00%	3.50%	80.00%-120.00%	98.75%	9.75%-12.50%	10.91%	7.00%-9.00%	7.84%	10.50%-13.50%	11.98%	7.50%-11.00%	9.15%	92.00%-99.00%	94.60% (Class-B to A+)
Power Center	0.00%-0.00%	0.00%	80.00%-120.00%	98.75%									90.00%-97.00%	94.14%
Strip Center	0.00%-10.00%	2.08%	80.00%-120.00%	97.79%									90.00%-98.00%	94.42%

					WAREHOUSE/DISTRIBUTION				R&D/FLEX							
					IRRs		OARs		IRRs		OARs		TIs - NEW (PSF/UNIT)		TIs - RENEWAL (PSF/UNIT)	
					Range	Average	Range	Average	Range	Average	Range	Average	Range	Average	Range	Average
Industrial	0.00%-10.00%	2.17%	80.00%-110.00%	97.83%	9.50%-12.50%	11.00%	8.00%-10.00%	9.01%	8.00%-13.00%	11.54%	8.00%-12.00%	9.77%	$0.00-$15.00	$3.94	$0.00-$8.00	$1.69
Apartment	0.00%-6.00%	2.64%	75.00%-120.00%	95.86%									$35.00-$350.00	$165.00	$0.00-$150.00	$50.00

Survey Process

Survey participants represent a cross section of major institutional equity real estate market participants who invest primarily in institutional-grade property. Initially, each participant is interviewed by telephone or in person regarding the cash flow assumptions used in analyzing real estate investment opportunities throughout the United States. Subsequent quarterly surveys are completed by mail with telephone follow-ups. Information is criteria applied in the quarter in which it is reported.

As a group, the survey participants collectively own, control, or acted as agent in 1998 transactions of institutional-grade real property assets with a total estimated value in excess of $200 billion. The minimum equity investment of the participants is from $5 million to $50 million (excluding hotel participants). Rates and other assumptions presented in this survey indicate participants' expectations from institutional-grade real property investment. They do not reflect performance of such property. The information is not generally applicable to investments that are not institutional grade. Although we do not represent that the survey is statistically accurate, the survey results provide important insight into the thinking of a significant part of the equity real estate marketplace.

Definitions

- INSTITUTIONAL-GRADE REAL ESTATE
  Real property investments that are sought out by institutional buyers and have the capacity to meet generally prevalent institutional investment criteria.
- KORPACZ YIELD INDICATOR (KYI)
  A composite IRR average of the surveyed markets
- KORPACZ DIVIDEND INDICATOR (KDI)
  A composite OAR average of the surveyed markets
- MARKETING TIME
  The period of time between the initial offering of a property for sale and the closing date of the sale
- STRIP SHOPPING CENTER
  Neighborhood or community center
- RESPONDENT TYPE
  Classification of survey participants into descriptive categories (e.g., domestic pension fund, REIT, investment advisor)
- FORECAST PERIOD
  Time for projection of anticipated cash flow benefits for discounted cash flow analysis
- CHANGE RATE
  Annual compound rate of change

  Market Rent
  Achievable current rent if vacant

  Expenses
  Total property expenses
- RESIDUAL
  Estimated total price at conclusion of forecast period

  Cap Rate
  Overall capitalization rate used in calculation of residual price

  Selling Expense
  Transaction expenses (legal, brokerage, marketing, etc.) paid by the seller
- DISCOUNT RATE (IRR)
  Internal rate of return in an all-cash transaction, based on annual year-end compounding; formerly termed the *free and clear equity IRR* in the Korpacz Survey
- OVERALL CAPITALIZATION RATE (OAR)
  Initial rate of return in an all-cash transaction; formerly termed the *free and clear equity cap rate* in the Korpacz Survey
- VACANCY ASSUMPTIONS
  Months Vacant
  The number of months a space remains unleased at the expiration of a vacating tenant lease

  Tenant Retention
  Percentage of leased rentable area that is expected to be released by the existing tenants at lease expiration

  Underlying Vacancy/Credit Loss
  Percentage of total revenue uncollected due to unexpected vacancy or credit loss (in addition to any rent loss from vacancies at lease expirations)
- NET OPERATING INCOME (NOI)
  Income remaining after deduction of all property expenses. In direct capitalization, investors capitalize one of the following:
  1. NOI *after* capital replacement reserve deduction but *before* TIs and leasing commissions
  2. NOI *before* capital replacement reserve deduction, TIs, and leasing commissions
  3. Cash flow *after* capital replacement reserve deduction, TIs, and leasing commissions
- REGIONAL MALL CLASSIFICATIONS

Class	Retail Sales PSF
A+	$400 and up
A	$300 to $399
B+	$250 to $299
B	$200 to $249
C+	$150 to $199
C	$100 to $149
D	Less than $100

- RESERVE
  Amount allocated for periodic replacement of building components during a property's economic life
- FULL-SERVICE HOTEL
  Hotel with restaurant and lounge facilities, meeting space, and a minimum service and amenities level; moderate to lower upper-tier pricing; includes all-suite hotels
- ECONOMY/LIMITED-SERVICE HOTEL
  Hotel with "rooms only" operation and no food and beverage except possibly continental breakfast; lower-tier pricing
- EXTENDED-STAY HOTEL
  Hotel with rooms that generally include work stations with two-line phones, access to fax machines; mid- and upper-price hotels include kitchenettes, separate lounging area; weekly rates.
- LUXURY HOTEL
  High-quality hotel offering personalized guest services, typically with extensive amenities; upper-tier pricing; includes four- and five-star resorts
- OPERATING EXPENSES (HOTEL)
  The on-going expenditures incurred during the ordinary course of business necessary to maintain and continue the production of gross revenues, not including reserves, debt service, and capital costs
- GROSS ROOMS REVENUE MULTIPLIER (GRRM)
  The relationship, or ratio, between sale price and gross rooms revenue
- MANAGEMENT FEE (HOTEL)
  An expense item representing the sum paid for or the value of management service, excluding incentives, expressed as a percentage of total revenues
- RESERVE FOR REPLACEMENT OF FIXED ASSETS (HOTEL)
  An allowance that provides for the periodic replacement of building components, and furniture, fixtures, and equipment, which deteriorate and must be replaced during the building's economic life
- RevPar
  Revenue per available room

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