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Roundtable I

Comments of Attendees
as reported
by Mathew A. Wyman of
Cox, Castle & Nicholson LLP

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Peter Linneman opens by informing the group that this is the 15th time he and Sam have hosted the Conference. He notes that this is the 32nd gathering. A member of the audience disagrees and says it is the 33rd (continuing the ongoing debate). **Peter** continues that everyone is expected to participate, no one is an observer. **Peter** acknowledges the sponsors of the various events for the next two days. **Peter** then introduces **Marshall Bennett**.

Marshall Bennett starts by asking the group how many were here in the early 1990's. Only about 15 in the room raise their hands. **Marshall** remembers that after one session, he brought out what he calls the "crying towel". He had the towel framed and has kept it in his office ever since. He decided to bring it out again in anticipation of this year's session.

Peter then acknowledges his co-sponsor, **Sam Zell,** noting the energy he brings to this conference, including creating a great invitation book that goes out each year. Describing this as "uninteresting times", he introduces **Sam Zell** and asks for his opening remarks.

Sam begins by informing the group that he has brought a couple of notes with him. He reminds the group that last year after the first session he called out "bullshit," so he thought he would start this session by reading some quotes from that first session.

Perez "One to seven percent price reductions." "In six months, we will see the end."

Hashioka "Apartments are selling at a five cap."

Blau "This is not the top of the market."

Rowe "Not as bad as '91."

Sam states that that should be the limit of today's bullshit. He hopes that this time we will not waste half the session trying to con each other. There are too many smart people in the room for that.

Sam then moves on to his second set of notes. Consumption beyond disposable income is unsustainable. The credibility of the dollar is in jeopardy. The loss of the dollar as reserve currency is dangerous. A barter economy is arising worldwide, pointing to China and Brazil doing transactions to avoid pegging to the dollar. Next, he asks what are the rules if in bankruptcy the government can change the order of priority, if one group of creditors can be favored over another at the President's whim? What does that mean for the risk-takers in the room? He also sees massive change being proposed, but does not see the time or resources to do it. **Sam** believes that we cannot talk about real estate without understanding these macro issues. To do so is a "fools errand". Finally, notwithstanding the earlier quotes, **Sam** acknowledges that no one could have predicted a year ago what has happened in the last twelve months.

Peter then asks **Ken Rosen** to comment on the state of the housing market.

Ken starts by noting that we have been in a "great recession", the worst in the post-war era. We have suffered 6,000,000 job losses. When you include those people who have either been discouraged from looking or stopped looking for work as well as part-time workers, unemployment is approximately 16%. We built 1.25 million too many homes. We also built about 500,000 to 600,000 excess condominiums. There are, however, "green shoots" in the housing market, thanks in large measure to the Fed's efforts in keeping interest rates low. But that effort has stalled as interest rates have increased. Single-family starts are at 450,000. It will not be until about 2013 that we will hit equilibrium of closer to 1.1 million starts. In California, for example, 55% of all sales activities were either short sales or foreclosures. Nevertheless, the low end is doing relatively well as a result of the tax credits being offered, but prices are still dropping. On average, the drop is about 25%. In the worst markets, the prices have dropped from 40% to 50%. Some of this has been driven by the excessive foreclosure activity.

Sam Zell asks, "How do you factor in household formations?" **Ken** responds that there is normally about 1.4 million household formations per year. That means in 3-4 years we will be back at equilibrium. The demographics ultimately favor residential development. Immigration accounts for half of our population growth. But right now it is down, due to the poor economy. Normalcy should return around 2012-2013 and perhaps sooner in some areas. With regard to pricing, 2006 levels were unsustainable. This was largely driven by easy credit. However, the new administration and the regulators will not allow mortgages like this again. You will actually need to qualify and this will deter any big price increases. Pricing will ultimately get back to more sustainable and affordable levels.

Peter then turns to **Larry** Mizel and asks how homebuilders are dealing with the market.

Larry begins by observing that most builders are liquidating assets to pay creditors. Most private builders are, or are going to be, out of business. In many areas, finished lots are trading at 30% of cost without any value for the land. One problem with the land development business was that, unlike malls, there were low barriers to entry. It is a very difficult time in the industry. The commercial banks are liquidating the homebuilders off their books. So, the only construction that will be done will have to be self-financed. There is no one to build homes, no one to fund them, and no one to develop the land. Further, you cannot obtain subdivision or improvement bonds since the bonding companies have finally come to the realization that they were effectively giving billions of dollars in unsecured credit enhancements. Business is very slow.

Tony Downs interjects and asks, "Why don't the developers ever learn?" **Peter** responds with "It's not just the builders," and **Larry** adds sarcastically that "**Tony's** right. It's only the builders who got it wrong this time around."

Peter then turns to **David LaRue** of Forest City and asks his views on the land business. **David** points out that there were about three million mortgages that are behind on payments in 2008. Another two million will be behind this year. Job losses also are continuing. There is still a lot of inventory on the market. As a result, the land business is at a dead stop. They are not willing to invest in land development. There are simply not enough home buyers right now to absorb the existing inventory.

Penny Pritzker asks if anybody has figures on the total existing inventory. **Ken Rosen** responds that the number is about 4,000,000, which is about 2,000,000 over what would be normal. **Ken** also agrees with **David** that the unemployment numbers are very worrisome.

Penny adds that there are about 55,000,000 mortgages outstanding in the U.S. Of those, 7,000,000 to 9,000,000 are either in default or about to be foreclosed on. The President's program is to try avoid between 2,000,000 to 4,000,000 of those foreclosures. She predicts that the best he will do is stop about 2,000,000. She feels that we are just in the second inning of this problem.

David believes that even avoiding 2,000,000 foreclosures will push the government's resources. The program does not involve any principle write downs, just extensions and lowering interest rates. The only way to really have an impact would be to write down principle and the government cannot afford to do that.

Ken Rosen says approximately 5,000,000 people bought houses who should not have. He suggests that restructuring these mortgages does not necessarily need to involve a write down of principle, but perhaps a shared appreciation component instead. He adds, however, that unemployment is the bigger problem. 2,000,000 restructures would simply not be enough.

Dan Neidich asks whether the banks have written down these bad loans. **Ken** responds that the banks have taken significant write downs on the subprime, not quite as much in the Alt. A loans and very little in the prime and jumbo mortgages.

Barry Sternlicht believes the easy way out of this is to just keep interest rates low. **Ken Rosen** responds that may be tough to do when borrowing two trillion dollars annually.

Barry adds that they are deploying capital, but they have not been able to buy lots in large quantities. The deals typically have only been in the $5 to $10 million range. The banks are sitting on assets. The market has not cleared. This includes both lots and houses. In one instance, he has heard that a special servicer is taking back homes, renting them, and freaking out the bond holders.

A member of the group then asks, "How can the government force these workouts?"

Ken Rosen responds that approximately 70% of all mortgages are held by Fannie Mae and Freddie Mac. So, they can do workouts on those mortgages. With respect to the balance, the TARP may require the private banks to do such workouts. Whatever solution is settled upon, it cannot be too complicated. We need to do something simple. We need to ignore values and allow for things like simple interest rate deductions.

Then **Peter** turns the discussion to condominiums.

He asks **Jerry Fogelson** to give an update on the status of the Chicago market.

Jerry replies that the operative word is "fear". The speculators, which at one time represented about 20-40% of the buyers, have largely exited the market. FHA and other tax credits are working well for units selling under $450,000. The market is different than it used to be. Buyers want to see their units before buying. This requires the builder to stage construction. Buyers also want to close on their units quickly. In Chicago, Mr. Trump is potentially the biggest problem. **Jerry** fears that he will dump all of his units into the marketplace. Those developers that are dropping prices in their buildings are committing suicide. The only bright note is that there is no new construction going on. He adds that the Fannie Mae/Freddie Mac requirement that 50% of a building be sold before they will provide a loan is a problem. Nevertheless, in the last 60 days, there has been some positive growth in sales.

Dean Adler interjects that he sees no recovery yet. He believes the calamity is still 12-18 months away. This will come as buyers of condominium construction loans from failed banks flood the market with units at a basis of $125 a square foot or less. This will destroy the market as these buyers foreclose and then clear the units at dramatic discounts. This is one reason why Fannie Mae and Freddie Mac will not finance these projects.

Peter then turns to **Jorge Perez** and asks him his views on the condo market.

Jorge begins by joking that **Sam** interrupted him last year when he said he saw light at the end of the tunnel. Had he been allowed to finish, he would have said that it was the red light of an oncoming train. He also apologizes to anybody in the group who had listened to him last year. **Sam** jokes that anyone that listened to him is not here this year.

Jorge then notes that, for better or worse, in Miami, they are a bit ahead of everyone else. They already have seen all the discounts that everybody is talking about. Units are selling fast right now, but at about 50% of peak pricing. Some of these buyers are speculators and investors who are interested in buying at $200 a square foot. Miami still has international money looking for a safe haven. Referring to last year, he admits that he had never been so off on his predictions. At the beginning of the year, they were selling condos at close to 70%-80% and in some cases from 90%-100%. However, by September, they were down to 60%. As the year went on, appraisals continued to go down and financing disappeared. They could not give away condos. Part of the problem was created by the lenders. They pleaded with them to allow the sale of units at 30% discounts. However, they were dealing in many cases with lender syndications and could not get the necessary approvals to move the units at lower prices. By the time they were able to obtain consent, the market had continued to move south. He believes that everyone is still waiting for the bottom of the market. He does not know when we will ultimately hit the bottom. However, wherever the bottom is, Jorge believes they will get more from individual sales than sales in bulk. The market is depressed and overbuilt. But what really surprised him was the exodus of foreign investors and that buyers were willing to leave 20% deposits on the table rather than buy the units. It was really a perfect storm between declining appraisals, the negative press and difficulties with lenders.

Peter asks **Jorge** if any of these buildings work as rentals? Jorge responded that people are buying individual units to rent, but not for current returns, more for appreciation over the long haul. The rent will cover the carrying costs and maybe a small amount over that.

Peter then turns to **Jeff Blau**.

Jeff starts by agreeing with **Dean Adler**. He does not feel that we have seen the worst yet. In Miami, there are 10,000 units of supply. This is not a normal market. There is very little investor demand. Prices that were $300 a foot a year ago, are now at $200 a foot. He points to **Jay Sugarman** as an example of someone who was smart enough to have dropped prices and sold out of the market quickly (**Jay** sarcastically thanks **Jeff** for the shout out).

Jeff believes that the current sales activity is reflecting the pent-up demand of what he refers to as "mini vultures." He feels, however, such demand is near satisfaction. $200 a square foot will not be a floor. It will more likely be a ceiling. We soon could be back to sales of one a month. These units work will not work well as rentals. It might work when buying one unit, but not buying in bulk. The HOA costs are just too high. You would need to buy for $100 a square foot or less. Finally, echoing Dean's comments, he fears what will happen when the Corus' loan portfolio hits the market.

Peter asks **Jeff** to summarize the New York condo market.

Jeff first distinguishes the Miami market from New York saying that most of his buyers are not investors. They are, in fact, residents who plan to live in the units. Also, there is no massive oversupply. However, the market price has dropped 20% to 30%. The buyers are very efficient about their decision-making. If they have a 20% deposit, they will close if the price has not gone down by more than 25%. If more, they will walk. Volume is way down. There is some volume in their "mid-market" 1,500 to 1,700 square-foot units. They have many buildings that over the last couple of years they have managed to close between 85% and 95% of the units, but there have effectively been no sales on the balance of the units in these buildings. That is because, in these buildings, it would not be a good idea to lower prices. They have, however, another class of buildings where there are only about 25% sold. In those buildings, they have cut prices dramatically, including cutting prices on units already under contract and units are selling and closing. He agrees with earlier comments that perhaps the only good news is that the production pipeline is effectively shut down. There is no construction financing nor any new construction financing on the horizon. And the biggest issue may, in fact, be the takeout loans. Buyers simply cannot obtain jumbo loans unless they have private banking relationships. Wells Fargo and some of the smaller banks, like First Republic, are by far the biggest players in this space now. Finally, Jeff adds that they spend a lot of time hand-holding buyers. They make the apartments perfect so there is no excuse for them to walk from their contracts. However, in some cases, there will be those that have lost their jobs and simply cannot close. He thinks that the New York market will continue to suffer further job losses.

Peter then turns to **Harry Frampton** and asks whether or not the mountain communities have been immune to this kind of drop.

Harry responds "no". He has seen drops in value of between 25% to 30%. The problem has not been over-building. They literally sold nothing from September through February. Since then, they have seen some activity, but at 25% to 30% declines in values. Obtaining financing for these buyers is brutal. There are no big banks providing this kind of financing, only small boutique banks. Harry adds that they also happen to own three hotels which have been "slaughtered." There simply is no group business and the consumer has become very smart and effective at shopping around. They built a new Westin in their Vail community and while the occupancy has been okay, it has been at 50% of the rack rates. Another problem with communities like Vail is that small businesses are suffering. They are under extraordinary pressure and he worries that this will continue to add to the unemployment problem. Harry was then asked in what range are sales occurring. **Harry** responds that the bigger homes are suffering the most. Recently, a buyer with a $1,000,000 deposit on a $21,000,000 home walked in and requested a big price drop in order to close. They took the lower price. The $1,000,000 to $3,000,000 range is selling. But the projects have to be good; either single family homes, townhomes or cluster homes.

John Bucksbaum asks if **Harry** has seen declines across the board in these mountain communities or do the better quality communities like Aspen and Vail tend to hold up better. **Harry** responds that the nicer resorts are holding up better. If they are near a major city that is also very helpful.

Peter Rummel agrees that the secondary market will be a flight to quality. **Peter Linneman** asks **Peter** how sales in Central Florida are doing. **Peter** responds that Central Florida is struggling dramatically. The first home business is okay and doing better than Miami, but still down between 25% to 30%. North Florida never had the peak, but is suffering from the same flight to quality.

Richard Ziman interjects that from Beverly Hills to the ocean in Los Angeles they are seeing the first break in pricing. Beverly Hills is down 15% to 20% and west of that, in areas like Santa Monica, they are seeing declines of as much as 30%. In Malibu, values are off between 35% and 40%. There are 17 homes for sale on his street. He thinks that the second home market is cracking and "cracking big."

Jorge Perez interjects that Naples, Daytona and similar markets have no rental market. In these markets, they cannot give away the homes. This is much more of an issue with those markets where you simply cannot create the demand at any price then in areas like Miami and Fort Lauderdale. At least there is some demand in these markets.

Barry Sholem points to the Yellowstone Club as an example of the declines in value. He reports that there is no velocity at all and that the prices need to be about half off before anyone will even start looking.

Neil Bluhm stands up and wonders if someone could tell him when this will all change. He asks, "Are we just going to sit here for the next two days and say how horrible it is?"

Issy Sharp responds by noting that as bad as the hotel industry is, right now they continue to focus on delivering a good product that will give people a reason to pay. He also points out that certain regions are doing okay, such as the Middle East and parts of Asia. The demographics in areas like India, China, and Latin America are positive. These areas are no longer underdeveloped. Travel and tourism are still one of the biggest industries worldwide. Unfortunately, the government has undermined the notion of travel. He admits that we are in the worst recession that we have seen. But, he believes that being frugal will not last for long once the recovery begins. Once people begin to see a turnaround, they will aspire to a nicer lifestyle.

Dean Adler counters saying he does not quite know where to begin with **Issy's** comments. First, the hospitality industry is the most volatile of all the asset classes since there are no fixed leases. Second, there has been a significant backlash against higher-end hotels. People are not going to be taking trips if they are laying off people. No one wants to see the names of certain hotels on their expense reports. He wonders how many hotels will survive in light of their high leverage. Perhaps **Issy** is optimistic because he is getting management fees irrespective of whether or not the hotel can cover the debt service. Many hotels are experiencing negative EBITDA.

Peter Linneman then asks **Mike Shannon** to discuss the resort sector. **Mike** starts by admitting that the resort sector is the worst of all the hotel classes. Further, what has been hit hardest is the ancillary revenue. It used to be that ancillary revenue was a significant multiple of the room revenue. However, they are seeing that category decline faster than room revenues. After 9/11, it took five years to restore revenues. And it took seven years to restore profitability. Initially, this time around, the resort business was doing okay because of cancellation fees from the group business. However, group business continues to be down 20% to 40%. He believes that 2010 will be the bottom. After that, it will get better. The one good bit of news is that the supply is very constrained.

Steve Ross, responding to **Issy's** earlier comments, is not so sure that the next generation is interested in aspiring to stay at places like The Four Seasons. His children do not want to stay at these type of resorts. They do not aspire to the same level of affluence that our generation aspired to.

Peter Linneman then turns to **Bob Lowe** and asks him if he is seeing any buying opportunities in the hotel sector.

Bob responds that he does not see any opportunities yet. They are operating hotels in the four star category and revenues are off 17%. However, he is not seeing as big a drop-off in ancillary revenue as **Mike** seems to be experiencing. He thinks that things will start to level off in the fourth quarter at least on a year-over-year comparison. The drive-to resorts are experiencing some increase in business. The activity is much more robust both in rentals and lot sales. Nonetheless, at this point in time, there are no real opportunities to acquire troubled assets. He reports one encouraging bit of news. They recently opened a hotel which they had been working on for 11 years. It is located on 100 acres of ocean front property in Southern California. He is not sure it will last, but right now things are going quite well.

Peter Linneman then asks **Tom Pritzker** if he is seeing any opportunities.

Tom responds that there is simply no visibility in the marketplace right now. Publically-traded companies RevPar is off substantially in '09. It started down 8% to 10% in December, then 13% to 15% in January, and finally 18% to 20% in the second quarter. No one can predict where the bottom is. And the grass is not any greener internationally. In North America, they have dropped 19%; in South America, 23%; Europe, 32%; and in South Asia, 43%. Each market, however, is slightly different. Things in Washington D.C., for instance are looking slightly better.

Chris Nassetta agrees with Issy that the future will be bright, but it is hard times right now. He also agrees that resorts are the worst asset class in the real estate business with the possible exception of residential. In fact, most resorts are no longer referring to themselves as "Resorts and Spas". If you drive up to the front of these properties, you will see holes where they took the "and Spa" off the name.

The best performing class of hotels are interstate properties such as The Hamptons Inn. Luxury product is down 30%. Decline in revenue is both from rate and occupancy. While occupancy may be stabilizing a bit, rates are continuing to decline. In their hotels, they are seeing fairly consistent declines around the world of about 18% on average. The Asia Pacific is the worst and China is in a freefall of about 40%. The Middle East seems to be suffering the least, but he is not sure that will last. He believes that next year will be the bottoming out of the market. But right now, there are no "green shoots." The only positive sign is that occupancy worldwide is increasing. However, before there will be any significant change, group business will need to reestablish itself. Finally, he agrees with **Mike** that the recovery is five years for revenues to come back and then seven years for profitability.

Barry Sternlicht adds that one of the other parts of the hotel industry that we need to all keep an eye on is the card check issue with unions. For now, it is dead. But if it comes back, it will be a complete catastrophe. Another big issue is protectionism. This will stop the hotel business, particularly in the high end. Arabs have stopped traveling in France. Illustrating his point, he tells the story about the former wife of a wealthy middle-easterner who ran up an €8,000,000 bill that she has still not paid. The Russians have also left the market.

Peter next asks **Richard Saltzman** to comment on Las Vegas.

Richard observes that this recession is consumer-led and, as a result, retail, hospitality and gaming have suffered. RevPar deterioration has slowed down recently, but it is still in the mid-20s. Gaming is off less, the mid-teens. Properties on the Strip that were going for room rates of $300 to $400 a night are now down to $100 a room night, off 75%. Visits to Las Vegas are off by about 500,000 per month. The drop in group travel is substantial and the government continuing to bash travel and staying at resorts is not helping. Before anything changes, the consumer will need to stabilize. We will need to see housing prices stabilize and jobs increase.

Dean Adler adds that increased competition is another factor that will negatively impact Las Vegas, such as in Pennsylvania where they just approved 12 new gaming facilities. Other states will likely follow this pattern.

Neil Bluhm counters that while new casinos are being approved, opening a casino is very difficult. They have been trying to open a casino in Pittsburgh, but financing has been incredibly tough to obtain. The lender is underwriting the loan at four times EBITDA on today's revenue and requiring 50% equity.

Peter Linneman then turns the discussion to multi-family, asking **Richard Mack** his views

Richard informs the group that their strategy has been to be the low-cost housing provider in their region. That strategy has worked relatively well in the New York metropolitan area. They are running at about a 3% vacancy. They also have very little short-term debt. They are located in such areas as Brooklyn, Harlem and the Bronx. Fortunately, they are still so far below New York rates, they have been able to compete. Their suburban multi-family in other markets, however, is not holding up as well. One bright spot in the suburban areas is that there is a 200 basis point spread buying opportunity. They are working on deals that will generate cash flow sufficient to return all equity over 10 years. However, these deals are still hard to put together because of the lack of debt.

George Argyros says they have a 5,500 unit portfolio. Their markets are typically Orange County and northeast Los Angeles County. Much of their product was built in the late 1960's. They were smart in not trying to refinance their portfolio. However, he has never seen a market this bad in the last 40 years. They are experiencing 10 to 25% vacancy rates and no rental increases. They are lucky that their debt is so low. He thinks that the market is being impacted by the number of single family and condominium homes being rented. He is relatively optimistic in the long run because of the fact that no new supply is coming on the market. He jokes that his big business will probably be in the affordable housing market since he owns a company that makes dog houses. They are very large dog houses. He is still waiting for the first order to come in. Nevertheless, he is a big believer in income properties. Right now, the market is very difficult, but long term nothing is being built and the future for Southern California should be bright.

David Neithercut is then asked by **Peter Linneman** to comment on his portfolio in Boston, New York and Southern California.

David says he has 145,000 units in this marketplace. He is doing a little bit better than what **George** described. He is tending to run occupancy around 93.5%. The lowest is in Phoenix where he is down to around 91%. Net effective rentals are down 8%; renewals are on average down 1%, 4% in the worst markets. Revenue overall is down 3% to 4%. While renewals are coming down, they are experiencing reasonably decent traffic. Every market is different. New York is off between 15% and 18%, Boston is off just a little, and Florida is off in the single digits. At this point, he does not see any real buying opportunities that make sense.

Peter Linneman then asks **Ken Bacon** to provide his comments on the capital markets for multi-family.

Ken says that deal flow is way down. In the first quarter of '08, they did between $7,000,000,000 and $8,000,000,000. In the first quarter of '09, they were down to around $3,000,000,000. They have been given a mandate to shrink to one third of their size over the next 10 years. They will accomplish this mostly through securitization. They will try to avoid being a portfolio lender. He admits however that while they will not hold the paper, they will still provide the guarantees behind these loans. Last year, rates were hovering around 6.3%, but have dropped below 6% from the movement in treasuries. There is no Fed program to lower the cost of multi-family housing. They are tightening their underwriting requiring a 1.25 debt service coverage ratio. They are also delegating less to their lenders in terms of decision-making. They are looking at markets much closer than they have in the past. Some markets, like Phoenix, have been experiencing scary declines. These declines tend to be in value as opposed to NOI. Nevertheless, the increase in cap rates have wiped out borrower equity. This has created a significant refinancing risk. The delinquency rate this year in CMBS is ten times higher than last year.

He also sees some long term policy risks. A recent bill passed in the house, HR1728; restricts the ability of a lender to declare events of default and foreclose on borrowers. This bill has been held up in the Senate, but if it ultimately is passed, it would be detrimental to lenders, borrowers and investors. The demonization of their agency has also not helped. Many people are leaving as a result.

Peter Linneman then asks **Walter Rakowich** to discuss the industrial market.

Walter starts by observing that occupancy rates have dropped across the board throughout all markets. A lot of companies own industrial properties on their balance sheet. They have worked hard to encourage these companies to get these properties off their balance sheet, particularly in areas like Japan. Much of this product is obsolete outside of the United States. That has driven a lot of their business. They recently signed leases on five projects outside of the United States. However, the financing was not obtained by them. Instead it was obtained by third parties. In the United States, they do not have the same rate of obsolescence. Rents are down 4% in general. However, in the tougher markets, rents are down as much as 15%.

Phil Belling adds that in California port demand is off 28%. In terms of industrial, the biggest fall-off is in the Inland Empire. The west side is experiencing 8% vacancies and the east side is experiencing 17%+ vacancies. Some markets are doing better, such as in the City of Los Angeles, where vacancy rates are closer to 5%. The demand simply shut off in the first quarter. It has picked up somewhat since then. But rents continue to drop. At the low end, rents have declined 5%, but in some markets the drop has been between 20% and 25%. Again, the only bright spot, similar to other property types, is that no new inventory is coming on line. What is needed is an increase in consumer demand which will increase port activity.

Peter Linneman then turns to office starting with New York, asking **Billy Rudin** to provide his comments.

Billy begins by admitting that the New York office market is not great. Vacancies in mid-town, including shadow space, are between 8% to 16%. There is about 34,000,000 feet of vacant space; 11,000,000 of it is subleased. The downtown market is not as bad. The vacancies tend to run between 8% and 10% and shadow space does not seem to be as big a component. In terms of new leases, last year, amounted to about 6,000,000 square feet. However, in the fourth quarter of last year and the first quarter of this year, there essentially was no activity. It was not until mid-March that their phones started to ring and deals started to get done. But all of these deals are being done on tougher and tougher terms with substantial increases in work letters and free rent. The only bright spot has been the significant decline in the cost of build-outs, which has dropped about 50% from what was originally $65 a square foot to closer to $35 or $40 a square foot. Finally, another issue in New York is the State budget and the increase in taxes.

Dan Neidich asks whether the financial services cut back and property taxes have been an issue. Billy responds that Chase and UBS have all put a big block of space on the market. He is hopeful that the worst is over. Other sectors are off as well, however, like media. Property taxes have been an issue, but not as much. Finally, on the investor side, there is little to no activity. People are looking around. However, there is simply no debt capital available.

Dean Adler asks if there is a difference in how certain landlords will deal with the tenant improvement question. He wonders why landlords would invest in tenant improvements in situations where they have lost all their equity and they cannot obtain financing. **Billy** says that tenants are aware of this and they are willing to pay a premium for those building owners who have the capital to fund tenant improvements.

Scott Rechler notes the growing phenomenon of the zombie building. Many owners are looking at their buildings like an option. They are asking themselves, "How long will I continue to operate this building under these circumstances, on a deal-by-deal basis is it worth keeping the option and continuing to invest in TI's."

Sam Zell wonders how they can ever make the math work. **Scott** admits that in many cases, the math does not work. It may not be worth keeping these buildings occupied. He also worries that there will be a second wave of tenants exiting the market such as banks moving as they move to cheaper markets like Charlotte. In some respects, the significant decline in rental rates have helped stem this exodus as New York becomes more affordable.

Tony Malkin points out that many tenant brokers will not bring tenants to buildings where there is a significant risk that the landlord does not have the wherewithal to finance the tenant improvements. He does worry that there is going to be a knock on effect as these zombie buildings get cleansed through the system and a tremendous re-pricing occurs.

John Cushman interjects that in all the U.S. central business districts, which constitutes approximately 48 markets, vacancies are running at about 12.5%. In the suburban markets, vacancies are up to 17% on average and rents are down. He predicts that major law firms will stay flat, do further cut backs or go broke. However, law firms will not generally move because the required capital expenditure is just too great. What he is seeing is that tenants want flexibility. They are looking for shorter leases. One major bank that they are doing a deal with only wants a two year lease. CBDs in the Los Angeles areas are experiencing a 15.8% vacancy rate. However, in downtown Los Angeles, rents have not dropped as much as other areas have. He also notes that in

New York for the first six months of '09, there were no new leases over 300,000 square feet as compared to the first six months of '08 where there were six leases. Of the 48 CBD markets, only one has had positive absorption, Dallas, where **John** jokes they have been running at a 28% vacancy rate for the last "thousand years." They are now down to 27%. One of the big problems is that there is simply no trust between all the players, the landlords, the tenants or the banks. No one trusts that the banks will fund T.I.s and brokers' commissions. Internationally, everywhere is off as well. Russia and China are both down. Mexico is doing reasonably well and India is not quite as bad. However, the tenant improvement issue is the real one. There was one lease in New York where a tenant was given $125 a square foot tenant improvement allowance. The market is a mess.

Tim Callahan points out that the real challenge for owners is how to preserve the remaining equity. You have money to put in, but no one is there to talk to at the banks.

Dennis Oklak after hearing the comments on hospitality and housing, says he feels a bit better about the office market. But, he admits that the office market will probably be there soon. They have buildings in the Midwest, Southeast and Washington DC. The occupancies are dropping below 90%. This also occurred in 2002, 1991 and the mid-80's. He hopes that the bottom will occur later this year. Concessions are being given everywhere, brokers and tenants are asking for funds in escrow so they are sure that commissions and tenant improvements will be paid. There is no new building going on. He thinks the strategy right now is "blend, extend and don't spend". He talks about a recent deal with a tenant whose lease was maturing in 2011. For rent concessions and minimum TIs, they were able to extend that lease to 2020. Overall, the high barrier markets continue to do better, such as Washington D.C., while low barrier markets will continue to suffer.

Peter then turns to **Alan Leventhal** and asks him to give his views on the office market.

Alan echoing **Dennis'** point, says that they have been focusing on markets that have the highest barriers to entry. What is happening in London and New York has been no surprise given the extent of their exposure to the financial industry. Also it has been no surprise that Washington, D.C. has done very well given the demands of the Federal Government. It is estimated that they will need around 10,000,000 square feet of space. As a result, in Washington, D.C., they are doing great, all things considered. Paris is stable, surprisingly so. Recently, in Paris, **Alan** had two tenants competing for a 245,000 square foot space. They were able to achieve rent that space at less than 10% off pro forma. San Francisco has been a big surprise. It is completely dead. Boston has done poorly, but not as bad as others. His perception was that last year there was no new supply coming on the market and, therefore, if you bought at a sufficient discount to replacement value, you would be safe. However, none of that seems to matter now. The fact that no new supply has come into market will eventually matter but, he is not sure when.

Jeff Johnson interjects that the lenders are acting counter-intuitively. If you have equity, they will do nothing. Lenders will extend, but will not invest new capital. They are just trying to avoid booking a loss. There is new money looking for rescue opportunities. However, very little is happening right now.

Peter then asks **Nelson Rising** to give his views on the California market.

Nelson informs the group that he recently took over as CEO of Maquire Partners and, among other things, inherited 24 assets they had purchased from EOP concentrated in Orange County. **Sam** thanks him for buying these buildings. **Nelson** believes Orange County is a great market, but right now they are struggling with these assets. This is largely because Orange County was the "subprime tenant capital of the world". And the apparent strength of this market encouraged a lot of overbuilding. In the airport area alone, there is 25,000,000 square feet of space. Their other significant markets are Central Orange County and Costa Mesa. The vacancy rates in the airport and Central Orange County areas vary from 7% to 19%. Rents are stable, but only statistically. Rents are around $3 a square foot (per month), but on much better quality space than in the past. However, one bright spot in Orange County is that they recently sold a building. The other markets that they are active in are Glendale, Burbank and Pasadena. Burbank and Universal City are doing quite well with a 5% to 7% vacancy rate. This is largely reflective of the relatively strong entertainment industry. Pasadena and Glendale, however, are a different story. They are tied to the financial services industry. Glendale has suffered between 4% and 20% vacancy rates. Pasadena is suffering with 7% to 12% vacancy rates. Universal City is the only area experiencing positive absorption rates.

Peter Linneman then turns to **Doug Shorenstein** and asks him to summarize the San Francisco market.

Doug starts by observing that in 2000 they were at 3% vacancy rate. 18 to 24 months later, their vacancy rate went to 23%. The same is happening now. He liked it better last year when we were all trying to BS each other. There is no positive absorption. So, for now, they are going back to the basics of managing their buildings.

Michael Fascitelli notes that net effective rents have declined 50% in one year. This is unprecedented. Tenant improvements are a huge issue. The bigger owners will do better because of their stronger capital position. Expect to see an increase in the so-called zombie buildings. Tenants will use the existence of these buildings as leverage to try and drive down rent. However, in Washington, D.C., they are experiencing the exact opposite. They are seeing development and other positive signs all because of U.S. Government spending. He adds that their retail properties in New York are also suffering. He sees a drop of 20% to 30% in high-end retail. He believes that there will be a big shake out in this area.

Peter then asks **Michael** to comment on how the capital markets are viewing large deals.

Michael responds that "big is bad." He describes a recent refinancing of a loan with $900,000,000 outstanding that was resized to $350,000,000 and it still does not matter because even at that size, obtaining a loan in this market is theoretical. **Michael** describes another recent deal on Third

Street for 100,000 square feet which went for $55 a foot with much higher T.I.s than in the past years, as compared to $85 a foot which was the market in 2006 and 2007.

John Cushman adds that if you are in Washington, D.C., Virginia or Maryland, then you are doing well. For every one billion dollars spent by the US Government, they are creating 1,000 jobs in those areas.

Peter then turns the discussion to retail, asking **David Simon** to give his thoughts on this product type.

David starts by saying that he does not understand **Michael's** comment that big is bad. He wants to be bigger and he wants to buy. He informs everyone that if they want to sell, just call him. However, he apologizes to **Richard Saltzman** saying, "I don't want your stuff". David, continues that in general, "retail sucks". And our tenants, "they really suck." They have been suffering since September and October of '08. If they stay down for much longer, it will be a big problem.

Sam Zell, referring back to **Phil Belling's** earlier comment regarding the decline in port activity, believes that a about the drop of 28% at the Long Beach Port creates big problems for retailers. **David** agrees that yes it is a problem, but retailers have become very good at running at low inventories. However, they can only do this for so long. They will be okay this year, but 2010 is unknown. David predicts that NOI will be flat in 2009. Occupancy rates are at 92%, which is about a 100 to 150 basis point drop. 2010 could be a real problem. There are an increasing number of tenant bankruptcies and he sees more coming.

Dean Adler adds that as tough it is in the capital market for real estate, it is very tough for the retailers. This is particularly the case with retailers who were involved in large levered buy-outs with covenant debt that is coming due. The factors in the businesses are saying that it is the worst that they have seen. **Dean** wonders how these retailers will obtain financing.

David Simon adds that small businesses are getting killed. They are experiencing death by a thousand cuts.

A member in the audience asks, what will happen if Sears runs into trouble.

David Simon responds that losing an anchor is not terrible for them, they will just sit on the space for awhile.

Bob Taubman responds that we were in an over-consumption mode over the last seven to eight years. The last quarter of 2008 was down 13.7% and the last quarter of 2008 was down 13.5%. If there is no increase in retail sales, at least on a year over year basis, in the first quarter of 2010, it will be very difficult. 2010 and 2011 will be the real test. So for now, they are managing cash and not opening new stores. **Bob** admits that he does not really know what will happen. They can handle one major chain going down, but the experience of lifestyle centers has shown the deficiencies in non-anchored centers.

Art Coppola informs the group that the low-end retail is doing okay. Luxury is horrible. They hope by the fourth quarter, things will flatten out. Even with sales not doing well, rents are holding up. But, that will not last forever. When Sears goes broke, it is "forever 21".

Peter asks **Hap Stein** to comment on the Strip Center Market end of the market.

Hap reports that it is tougher than he has ever seen. Although bad, it is not as bad as others seem to be experiencing. Vacancies are up 48%, but they are still 93% occupied. They are signing 40% fewer new leases, but retailers are still looking for good spots.

Chaim Katzman notes that in their shopping centers, they have lost 260 basis points in occupancy. In same store NOI, they have lost 100 basis points. They used to have 20% positive leasing spreads on new leases. Now, they are lucky if they get 5%. The silver lining in their centers is that the consumer is trading down. So, the tenants like Family Dollar are the best performers. More and more consumers are coming to the TJ Max's of the world. Retailers are also trading down. Some mall names are now looking to locate in their centers, including a new deal that they just did with Nordstrom's. Internationally, the Nordic region is doing okay, but Central Europe is very soft with extreme downward pressure on rents.

Scott Wolstein, reacting to **Neil Bluhm's** earlier comment, tells the group that he has some good news, he jokes that he saved money on his car insurance by switching to Geico.

Scott continues that it is the same story for them. They have experienced a 45% increase in vacancies. This is largely driven by the bankruptcies of Linen & Things and Circuit City. However, if you factor out the bankruptcies, they are at 95% occupancy. Rents are declining. However, one good piece of news is that retailers are being much more reasonable on TIs. They are seeing drops from $65 to $16 a foot on re-leasing. Another bit of good news is that there is no new supply for these retailers and some of them are still growing. **Scott** reports that there are new store openings, just with lower rents.

Chaim comments with all the bad news, only one anchored center is being sold in Florida, but there are no other sales. **Dean Adler** interrupts that all he wants is a six cap for his centers. **Chaim** responds saying, "I'm a buyer at 7½."

With that, **Peter Linneman** ends the first session and thanks everybody for their participation.

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