Until November

Capital City Investors Await Election, Economic Recovery

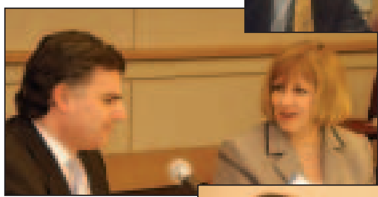
Transwestern and *CPN* joined in Washington, D.C., in February for the fifth annual commercial real estate investors' roundtable, which preceded the annual Washington, D.C.-Baltimore commercial real estate TrendLines event, hosted by Transwestern research arm Delta Associates. Moderated by Transwestern senior vice president David Popp and *CPN* editor-in-chief Suzann D. Silverman, the discussion among investors and developers active in the Washington, D.C., area covered topics from pricing and competition to green building.

***Suzann Silverman:* Was the slowdown that began in the middle of 2007 just the inflection point of a standard real estate cycle, or is the region in for more of a prolonged downturn?**

Andrew Czekaj: We've had a prolonged period of approximately 15 years of growth, with a slight hiccup there with the tech wreck and a slight real correction post-9/11, which led to a very quick recovery. So this was to be expected. ... Clearly, something happened that nobody expected, which was the subprime mess, and that sort of led to a ... crisis of confidence. ... We're still in that process. We're working through it. What's going to overlay that process is what looks like a normal supply/demand correction. The economy is slowing down at a time when most of the submarkets in this area are oversupplied. One could conjecture that (Downtown) D.C. ... will see double-digit vacancies within the next 24 months. The suburbs will go well into the teens. A lot of the suburban markets are already there. So we're nowhere near any bottom. If it were a nine-inning game, we're probably in the third inning.

Robin Burke: I don't think we're anywhere near the bottom. The oversupply in the market is going to push us along slowly, but if we really look back, the fundamentals are not as bad as they have been in past recessions. People have not been financing their properties at 115 percent loan-to-value. ... It's going to be until 2009 ... 'til we see something in the economy start pushing growth. ... We look for the defense contractors and they're not there, and we're looking for the professional firms and they're kind of tightening their belts, so it's going to be the election cycle. It's going to be some resolution of when we're going to be out of Iraq.






Jim Hedges: There are a lot of deals out there that have to get de-leveraged. And some people will feel the pain. Someone will recapitalize, and fresh equity will come into the deals, and, part and parcel, that will move everything forward.

Scott Brody: I am far more optimistic than the group. ... I should be, considering we've got a couple million square feet of speculative development in the ground right now. I certainly agree that we're in for an adjustment, but ... there are special opportunities. There

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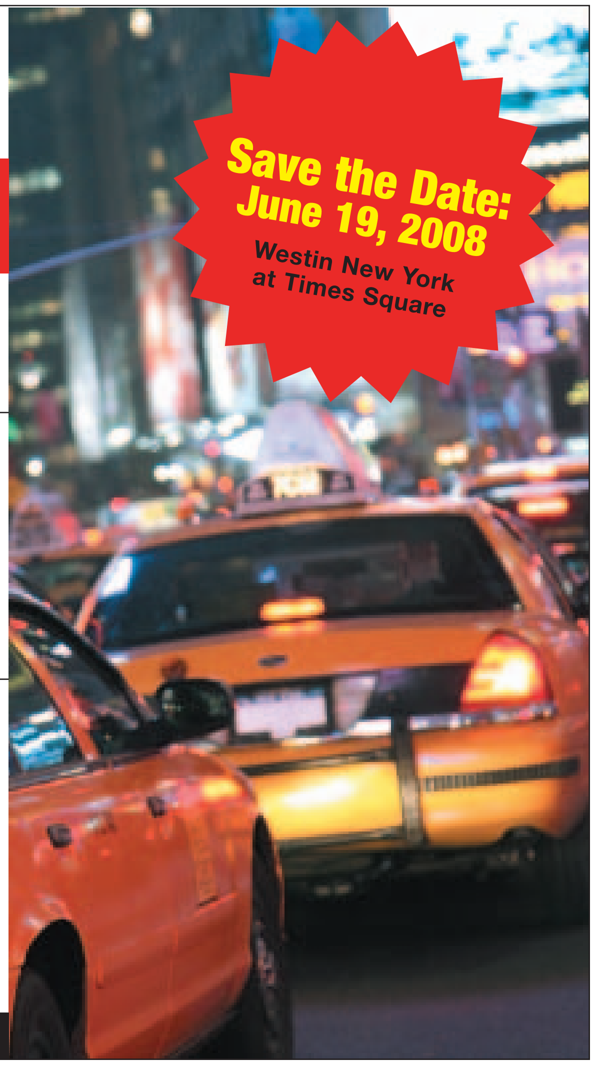

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have been significant markets that have been overbuilt. Some of the suburbs ... are going to be in for some challenge to get that stuff absorbed.

***David Popp:* Robin, you mentioned the election coming up. ... With this being an election year, and a new administration coming in 2009, does it make a difference if it's Republican or Democrat for the real estate market here?**

Greg Meyer: It absolutely makes no difference. (Of public policy expert) Stephen Fuller's statistics, the one that jumps out that you just can't dispute is the 36 years straight of government spending in the area never declining. And that's including '95, with Gore's reinventing government, putting a freeze on all new government leasing—and still, every year, it goes up.

Steve Klein: What you'll find is (that) allocations will be different if the Democrats get elected to the executive office. You'll have more in life sciences and that kind of stuff versus defense spending.

***Popp:* How about in terms of GSA? Joe, I know you've got a lot of GSA tenants in many of your buildings. They've been kind of flat.**

Joseph Flanagan: We're split right along the lines you're describing. The Maryland life sciences seem to be doing nothing at all to speak of, and we've been backfilling some of those spaces with private-sector tenants. ... But we have a strong presence down in Tysons, and it definitely will have an impact if there is a change of party in the White House. And with the double whammy of the hold on the Metro, things could be lackluster out there for the long term. So yeah, there's some concern on our part. We're starting to look at the closer-in Metro locations and inside the Beltway.

Czekaj: A reallocation, somewhat, from the war effort—should there be a change in administration ... to a Democratic side—would probably have a short-term more positive impact on the area.

Thomas Regnell: There are a lot of federal programs that could be going forward. ... When the train gets going, people are going to latch stuff onto them, and things are going to get approved. And the government's going to keep growing, and they're going to keep taking more space. ... But in '08, nothing's going to get done. In '09, things will get done, and we won't feel the impact until 2010, probably in real absorption of space—government or otherwise.

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***Silverman:* Are there any emerging markets that may present the next opportunities, after NoMa and the Southeast submarket?**

George Wells: This may come out of left field. It was known as the "hole in the doughnut," (but) Clarendon has gone through a massive renaissance here in the past few years, with a tremendous amount of residential being added to that stock and with people on the street. There has been a fair amount of retailers that are following up, and the amenities are really coming in, so we really believe that that area's a little underserved from an office perspective.

Regnell: Friendship Heights. You still have some available land there. ... You've

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got transportation there and a great existing base. It won't be huge, but for the first time in my career it really seems that there's some momentum going there that will be sustainable and will attract people who really come out of Downtown.

Meyer: I would add Rosslyn as an obvious one, with a couple of large, truly trophy-quality buildings that are going to be springing up in the next three to four years. That environment is going to become more and more just an extension of D.C. but with greater density.

Klein: Our trade is mostly value-added, so obviously NoMa and Southeast—that's really coming out of the ground. And what we continue to focus on and be comfortable with is urban infill stuff, (but) sort of the next ring out, the Rosslyn or Chevy Chase or Silver Spring infill stuff.

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***Popp:* Are you seeing the pricing for the trophy-quality (buildings) about where it was, or is it falling off?**

Hedges: A lot of talking and deals coming into the market supported by a lot of talking. There are a lot (of deals) the typical investor right now in Washington would look at, and there's still a disconnect between the ask and the bid. What's going to help some of these trophy assets is the weakness of the dollar ... so you'll see the trophy assets hold up well. ...

What you were seeing in '07 a little bit ... (was) the smart investors rode the B product up. ... (Some) people got out at the right time ... (but) some of that lower-quality product is going to be a problem.

But ... pricing so far is holding up ... and we all know there are a bunch of deals out there right now that have signed some pretty attractive leases that could be teed up in '08. ... We're all sort of in a dark closet, trying to pick a data point. And once you hit that data point, then you're going to see some of the better trophy assets come to market and hit an even higher threshold.

Czekaj: I (agree that) it's too early to tell, too few data points, a lot of talking, a lot of high-fiving and a lot of asking. The market is less liquid than it was, simply because the pricing function is, right now, too difficult to determine. And if you look at fundamental economics, you have a growing vacancy. You're going to continue to soften up on that side. There's no basis, at this juncture, for prices to go higher.

John Gattuso: We need to watch what happens with those rents. ... Until rental rates are actually achieved, consistently, in those trophy properties and go forward, there's very little room for yields to be justified at the rate that they are. There is an exception ... which is offshore money. It, many times, is looking simply to preserve principal. ■

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Roundtable Participants:

Scott Brody
Vice President & General Manager, Opus East L.L.C.
Robin Burke
Senior Vice President, KBS Realty Advisors
Andrew Czekaj
Chairman & CEO, Cambridge Holdings
Joseph Flanagan
Director of Asset Management, TIAA-CREF
John Gattuso
Senior Vice President for Washington, D.C., and Northern Virginia, Liberty Property Trust
Jim Hedges
Senior Vice President, Brookfield Properties Corp.
Steve Klein
Principal, JOSS Realty Partners
Greg Meyer
COO, Penzance Cos.
Thomas Regnell
Managing Director, WRIT Acquisitions
George Wells
Senior Vice President of Asset Management, Piedmont Office Realty Trust Inc.

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$47,640,000 Bridge Mixed Use	470 VANDERBILT AVENUE Brooklyn, NY
$14,309,000 Permanent Industrial; Office	GLADSTONE PORTFOLIO San Antonio, TX
$50,000,000 Mezzanine Mixed Use	RENAISSANCE SQUARE White Plains, NY
$31,000,000 Permanent Multifamily	THE OVERLOOK APARTMENTS Denver, CO
$21,500,000 Bridge Hotel	HOTEL INDIGO Nashville, TN
$39,000,000 Permanent Office	PILLSBURY WINTHROP Palo Alto, CA
$134,000,000 Construction Hotel	SEAGATE HOTEL RESIDENCES & BEACH CLUB Delray Beach, FL

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