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## The RREEF Property Cycle Monitor: Year of Transition for Real Estate?

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### Introduction

In early 2007, the four major US property sectors are enjoying solid market fundamentals. Net absorption has slowed from the robust pace of the past three years, but remains steady, generally speaking. New construction deliveries are on the horizon but have yet to impact most markets and property types. The office and industrial sectors saw significant declines in vacancy during 2006. Apartment and retail witnessed modest increases in availability last year, which was nonetheless low by historical standards. Effective rents are pushing up from coast to coast, chasing the peak rental levels posted in 2000. These improving fundamentals are consistent with the growth part of the real estate cycle. Retail has been the exception to this trend, having entered the post-growth phase of the cycle, allowing for only modest rent growth. [An overview of the growth cycle, from recovery through growth to post-growth and contraction, appears in the Appendix.]

This year, however, appears to be a year of transition for real estate, as it progresses along the cycle. After several years of impressive declines, vacancy rates are stabilizing for apartment, industrial and office properties. Year-end 2007 vacancy rates are projected to remain at or close to the same level as when the year began. If this forecast plays out, 2007 will mark the first year since the 2004 recovery without broad-based improvements in occupancy. Declining demand for space this year and next, due to a slowdown in the US economy, is already affecting net absorption. In addition, increases in rental rates during the past few years are fueling a growing supply pipeline. The end result will be relatively flat vacancy rates, in contrast to the dramatic declines of recent years.

Stable US property fundamentals mask impending supply threats in several markets. After years of subdued construction activity, development activity is clearly accelerating. Not only are many markets witnessing the favorable supply/demand conditions that support new construction, but capital market factors also are encouraging investors to assume development risk in return for higher yields. Despite elevated construction costs, 2007 will see a significant delivery of new space at the same time that demand is slowing. While, overall, supply and demand are expected to remain in balance over the next few years, some markets may be at risk of over-supply. Supply is the biggest risk over the next couple of years.

Real estate fundamentals are expected to continue to improve in 2007 and over the next few years, though at a much more moderate pace than in recent years. Effective rent gains should continue but fail to match the strong pace of 2006. Downside risks appear to outweigh upside risks to this forecast. The outlook for the US economy is for a slowing economy in the near term, and new construction could exceed our expectations, despite elevated construction costs.

During 2007, the apartment, industrial and office sectors are expected to enjoy the benefits of the growth part of the cycle. Retail should continue to post inflationary gains in effective rents as it proceeds through the post-growth phase of the cycle. While demand

is expected to slow this year, 2007 deliveries of new supply should be modest by longer-term historical standards. Rental growth momentum is clearly still headed upward this year. Over the forecast horizon, however, oncoming supply should increasingly constrain effective rental growth.

### **Below-Trend Growth Restrains Real Estate Demand**

US economic performance has moderated in early 2007, with weakness permeating the nation's housing and manufacturing sectors. 2006 GDP growth was quite robust at 3.3%. In 2007, we forecast GDP growth of around 2.4%, which is considerably below trend. Our expectation is that the current weakness in housing and manufacturing will be balanced by strong growth in other sectors. With corporate balance sheets flush with cash, business spending should support economic expansion in the coming quarters. Strength in the global economy and a weak US dollar should encourage demand for exports. Even consumer spending appears likely to hold up, if at a slower rate of growth than in recent years.

Housing remains the biggest drag on growth. In the fourth quarter of 2006, GDP growth came in at an annualized rate of 2.5%. The pullback in residential construction took a full percentage point off the total GDP growth figure. Rising delinquency and default rates in the subprime mortgage market, with a concomitant drop in investor confidence in the value of mortgage assets, are encouraging lenders to pull back. More stringent underwriting standards should take some home buyers off the market. Home sales and home prices alike appear poised to drop further before they hit bottom. As a result, new residential construction is expected to remain low.

Consumer spending has yet to register a significant slowdown in response to housing market weakness. Consumers have been supported by rising wages, low unemployment, and a drop in energy prices. Spending growth appears likely to slow later this year as households absorb the impact of flat or falling home prices. In addition, financial stress for subprime mortgage home buyers will restrain consumer spending, particularly at the low end of the market.

For the first time in years, the trade sector should contribute positively to the GDP accounts in 2007. Economic growth in the rest of the world has surprised on the upside. The rate of expansion remains steady worldwide, with no major country in recession. Global GDP growth is forecast to slow from 3.9% in 2006 to a still healthy 3.5% in 2007. This, combined with a falling dollar, should encourage demand for US-produced goods. Support from business spending and exports, however, will not fully offset the slowdown in housing in 2007.

Although the housing downturn has been sharper than anticipated, the decline in oil prices from the high \$70s to near \$60 per barrel has made the soft landing scenario for the US economy a more viable base case. Lower oil prices, in addition to supporting growth, have reduced the upside risks to inflation in the near term.

US labor markets remain tight with the unemployment rate at 4.6% as of January 2007. Job growth averaged over 200,000 per month last year, a healthy pace despite setbacks in the nation's housing and auto sectors. New labor force entrants will be readily absorbed into this market. A projected modest increase in the unemployment rate will ease inflationary concerns, but unemployment will remain low by historical standards.

Within the US real estate sector, the slowdown in the economy may impact demand in the near term. The continued expansion of the economy, at a slower pace in 2007

followed by recovery in 2008, should nevertheless continue to provide a solid backdrop for real estate markets going forward. By early 2008, the housing market should recover sufficiently to no longer be a drag on growth. The shift in the drivers of growth from the housing and consumer sectors to business spending and international trade should impact the four property sectors in differing ways. The industrial and office sectors, in particular, should benefit. Retail is at risk of a slowdown in space demand.

## **Property Cycle Monitor: Apartment**

Of the four property sectors, apartments were the last to enter the recovery phase of the property cycle. Whereas retail recovered early, and office and industrial entered recovery in 2004, apartments did not get there until 2005, with vacancy rates dropping 110 basis points over the previous year. This produced strong rent growth and attracted considerable attention to the sector. However, apartments entered the growth phase of the cycle in 2006, with national vacancy rates rising by 20 basis points, but nonetheless producing strong rent growth.

Apartment performance is typically highly correlated to the strength of the labor market. For 2006, employment growth reached a cyclical peak, the highest rate of job growth since 2000, with 2.5 million jobs added. This strong job growth should have suggested particularly healthy apartment performance. While employment growth is still a crucial link to the health of the apartment sector, recent performance suggests that other factors were at work.

Given the dynamics of the overall housing market in 2006, it is difficult to peg the actual vacancy rate, and reported vacancy rates are misleading. The for-sale market, which experienced frothy growth during the past several years, slowed considerably in much of the country during the second half of 2006. This slowing of housing sales brought the dramatic housing price appreciation of the past few years to a sudden end, with declines in many markets. At the same time, single family home and condominium construction activity ramped up considerably. The national vacancy rate for single-family homes increased to 2.7% from 2.0% one year ago and 11% of condominiums (5 plus units), remain vacant, up from 6.7%. These numbers are well above historical averages, 1.5% and 5.0%, respectively, over the last decade. This for-sale housing overhang is having an impact on the rental market, and is playing havoc with apartment statistics.

This recent stress in the for-sale market resulted in an abrupt end to condominium conversions; a fall-out in the sub-prime category of mortgage loans; vacant homes as a result of speculative home-buying; and a steady climb in unsold home inventories. The resultant downturn in the for-sale market has affected the rental component of the housing sector in oblique ways. This inevitably results in mixed signals in performance.

Apartment data are being skewed by this weakness in both the single-family home and condominium markets. In certain markets, the weak for-sale market is having a negative impact on apartments. However, rental data in these markets is murky. For example, in those markets that experienced excessive condominium conversions, the data for rental vacancies are unreliable. Many apartments removed from the inventory and emptied for conversion are being reconverted to rental. However, data sources do not always accurately report rental availability, and often over-state vacancy due to time lags in reporting. Other markets, on the other hand, may understate vacancy, where condominiums being returned to rental have not been picked up. Nevertheless, it is clear that apartment demand weakened in late 2006.

Condominium reversions to apartments are having a negative impact on rents as well. Failed conversions can result in current ownership *temporarily* reducing rents far more than necessary to ensure a speedy re-leasing effort. Competitors may quickly respond in kind. A one or two month concession offered in a market that has a stabilized occupancy rate probably is not reflective of true market rents. This is a major challenge in the current cycle of assimilating broken condo schemes and competing with homeowner condo rentals while trying to establish a true market rent and apartment value.

While performance in the apartment sector waned nationally in the fourth quarter of 2006, as evidenced by the small but unexpected increase in the vacancy rate to 5.8%, performance differed substantial by metro. A handful of markets surprised us to the downside in 2006 and weigh fairly heavily on the roll-up to the US vacancy. On average, markets trended up by 25 to 50 basis points in vacancy, which is unusual at this point in the growth phase of the real estate cycle. In markets with lower barriers to entry, strong home-building trends, and affordable homes, including Atlanta, Raleigh, San Antonio and Houston, vacancy rates edged well ahead of our forecasts, despite impressive economic growth, leasing activity and rent gains. Regionally, the sharp curtailment of condo conversions adversely impacted the entire Washington, DC metropolitan area, extending into the previously steady Baltimore metro. In South Florida, Fort Lauderdale and, in particular, West Palm Beach, posted high vacancy rates as well, also due to condo reversions.

The outlook for the apartment sector over the next year should be viewed within the context of a "cycle within a cycle" playing out against a backdrop of often conflicting data. A slowing economy and a for-sale housing market that will continue to experience a painful adjustment foretell a moderate year for apartment performance. Vacant inventory in the single family home market will likely be absorbed during 2007, but overbuilt condominium markets are likely to remain weak into 2008.

This downturn in the apartment sector will be moderated by positive events. Unlike other housing downturns, the economy is nonetheless expected to add a substantial number of jobs, although at a slower pace than in 2006. In addition, strong demographic and immigration trends and recovery in personal income growth will contribute to a healthy demand-side story. Income growth is also positive, with an essentially full employment economy. At the same time, apartment construction has been very restrained. Approximately 100,000 new units are forecast for delivery in 2007, representing a nearly 32% increase over last year. Nevertheless, this production remains well below its historical average. In addition, for-sale home builders and condominium developers have sharply reined in new construction starts. As a result, rental absorption is expected to be strong. In spite of the impact of competition from units in the for-sale market, the vacancy rate is projected to remain unchanged by year-end 2007 at 5.8%.

Metro markets are expected to continue to diverge in 2007, with those most impacted by oversupply in the for-sale market faring the worst. In the stronger rental markets, the capital markets will continue to influence development strategies of REITS and merchant builders as they seek development opportunities in lieu of paying the low cap rates in the current acquisition environment. As a result, the supply pipeline will need to be closely monitored.

Longer term, the outlook is quite favorable. For-sale homebuilding is expected to be restrained over the next few years as the excesses of the past few years are worked off. Yet household formations are expected to increase by 15% over the next decade as compared to the previous decade due to growth in echo boom, non-traditional, and

elderly households as well as immigration. The silver lining to supply side concerns may be that the markets at highest risk are also some of the fastest-growing in the country, both in jobs and population growth. The overbuilt condition we expect in these markets may resolve in 12-18 months if developers, investors and lenders exercise restraint in markets where the fundamentals simply do not support further construction.

U.S. National Apartment Market Cycle		Forecast Years					
2006		2007	2008	2009	2010	2011	
	GRW	PGW					
	REC	CON					
Job Growth	1.9%		1.2%	1.3%	1.5%	1.4%	0.9%
Net Abs. (Units) *	-5 K		93 K	86 K	87 K	92 K	83 K
Supply (Units)	76 K		100 K	82 K	93 K	99 K	93 K
% Vacant	5.8%		5.8%	5.7%	5.7%	5.7%	5.7%
Rent Momentum	Increase		Increase	Increase	Increase	Increase	Increase

Key: REC = Recovery GRW = Growth PGW = Post-Growth CON = Contraction  
 \* Note: Net absorption figure includes condo conversions.  
 Source: Global Insight, REIS, and RREEF Research

## Factors Shaping the Apartment Cycle (Time Frame)

### ***Drivers of Recovery***

- Job growth (on-going but slowing)
- Strong personal income growth
- Continued recovery and growth in high tech (intermediate-term/long-term)
- Demographic trends (on-going and accelerating)
- Immigration (on-going)

### ***Constraints on Recovery***

- Substitutability of housing options
- Slowing job growth (short -term)
- Potential for rising construction volumes (intermediate-term)

### ***Implications: Timing of the Cycle***

- National market is in established steady growth mode.
- Most tech markets exhibiting improvement in supply/demand conditions
- Supply-constrained markets with low housing affordability will weather the downturn most successfully

## Apartment Metro Performance

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### US Apartment Market Metro Performance 2007

Out-Perform	Average*	Under-Perform
Denver	Atlanta	Boston
Ft. Lauderdale	Austin	Raleigh
Los Angeles	Chicago	St. Louis
New York	Dallas	San Antonio
Portland	Houston	
San Francisco	Miami	
San Jose	Phoenix	
Seattle	Riverside/SB	

\* broadly in line with national trends

Source: RREEF Research

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**U.S. Property Cycle Monitor**  
**Apartment**

**March 2007**

----- Forecast -----

		2006	2007	2008	2009	2010	2011
<b>U.S.</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.8%	5.8%	5.7%	5.7%	5.7%	5.3%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Atlanta</b>	Stage	Growth	Growth	Growth	Growth	Post-Growth	Post-Growth
	Vacancy	8.5%	7.5%	6.5%	5.8%	5.9%	6.6%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Austin</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	7.2%	7.4%	6.3%	6.0%	5.5%	5.1%
	Rent Momentum*	Increase	Increase	Increase	Increase +	Increase +	Increase +
<b>Baltimore</b>	Stage	Growth	Post-Growth	Post-Growth	Contraction	Recovery	Recovery
	Vacancy	5.8%	6.4%	6.6%	6.7%	6.5%	6.0%
	Rent Momentum*	Increase	Increase	Increase	None	Increase	Increase
<b>Boston</b>	Stage	Growth	Post-Growth	Contraction	Contraction	Recovery	Recovery
	Vacancy	5.5%	6.7%	7.5%	7.9%	7.7%	7.6%
	Rent Momentum*	Increase	Increase	None	None	Increase	Increase
<b>Charlotte</b>	Stage	Growth	Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	6.9%	5.8%	6.9%	7.0%	7.0%	6.9%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Chicago</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	5.2%	4.9%	4.7%	4.7%	4.8%	5.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Dallas</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.3%	8.0%	7.3%	7.2%	7.0%	6.1%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Denver</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.3%	8.4%	8.4%	8.2%	7.7%	7.3%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Ft. Lauderdale</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	3.9%	3.4%	3.3%	3.5%	4.2%	5.3%
	Rent Momentum*	Increase	Increase +	Increase +	Increase	Increase	Increase
<b>Houston</b>	Stage	Growth	Growth	Growth	Growth	Post-Growth	Post-Growth
	Vacancy	7.1%	7.1%	6.1%	5.6%	5.6%	6.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Los Angeles</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	3.1%	3.2%	3.2%	3.4%	3.5%	3.9%
	Rent Momentum*	Increase +	Increase +	Increase +	Increase	Increase	Increase
<b>Miami</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	3.8%	4.2%	4.1%	4.5%	4.8%	5.5%
	Rent Momentum*	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Minn./St. Paul</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	4.9%	4.7%	4.7%	4.8%	4.9%	5.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>New York</b>	Stage	Growth	Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	2.3%	2.5%	3.3%	3.2%	3.5%	4.4%
	Rent Momentum*	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>No. New Jersey</b>	Stage	Growth	Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	3.8%	4.0%	4.0%	4.1%	4.1%	4.1%
	Rent Momentum*	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Oakland/East Bay</b>	Stage	Growth	Growth	Growth	Growth	Growth	Post-Growth
	Vacancy	4.9%	4.7%	4.6%	4.4%	4.5%	4.6%
	Rent Momentum*	Increase	Increase	Increase +	Increase +	Increase	Increase
<b>Orange County</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	3.3%	3.4%	3.4%	3.8%	4.0%	4.0%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>Orlando</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Contraction	Contraction
	Vacancy	4.9%	5.5%	6.3%	7.0%	8.4%	9.1%
	Rent Momentum*	Increase	Increase	Increase	Increase	None	None
<b>Philadelphia</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	4.5%	4.8%	4.9%	5.0%	5.1%	5.2%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Phoenix</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	6.6%	6.9%	7.1%	6.6%	6.9%	7.1%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%

Increase: 3% - 4%

Increase+: Over 4%

**U.S. Property Cycle Monitor**  
**Apartment**

**March 2007**

----- Forecast -----

		2006	2007	2008	2009	2010	2011
<b>Portland</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	5.2%	4.2%	3.6%	3.8%	3.8%	4.1%
	Rent Momentum*	Increase +	Increase +	Increase +	Increase	Increase	Increase
<b>Raleigh</b>	Stage	Growth	Growth	Contraction	Recovery	Recovery	Recovery
	Vacancy	8.8%	8.7%	8.7%	8.3%	8.1%	7.9%
	Rent Momentum*	Increase	Increase	None	Increase	Increase	Increase
<b>Riverside/SB</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.4%	5.5%	5.2%	5.1%	4.7%	4.4%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Sacramento</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.5%	5.3%	4.9%	4.4%	4.1%	3.9%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>St. Louis</b>	Stage	Contraction	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	8.0%	7.7%	7.5%	7.4%	7.4%	7.5%
	Rent Momentum*	None	None	Increase	Increase	Increase	Increase
<b>San Antonio</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	7.4%	7.5%	7.4%	7.3%	7.1%	6.5%
	Rent Momentum*	Increase	None	None	None	Increase	Increase
<b>San Diego</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	4.0%	4.5%	4.3%	4.6%	4.8%	5.4%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>San Francisco</b>	Stage	Growth	Growth	Growth	Growth	Post-Growth	Post-Growth
	Vacancy	4.4%	4.0%	3.9%	4.7%	5.1%	5.5%
	Rent Momentum*	Increase +	Increase +	Increase +	Increase	Increase	Increase
<b>San Jose</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Post-Growth
	Vacancy	4.6%	4.3%	4.1%	3.4%	2.9%	3.1%
	Rent Momentum*	Increase	Increase +	Increase +	Increase +	Increase +	Increase
<b>Seattle</b>	Stage	Growth	Growth	Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	5.0%	4.9%	5.2%	5.3%	5.0%	4.8%
	Rent Momentum*	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Tampa</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	5.4%	5.5%	5.6%	5.6%	5.9%	6.3%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Washington, D.C.</b>	Stage	Post-Growth	Contraction	Recovery	Recovery	Recovery	Growth
	Vacancy	4.3%	5.2%	5.1%	4.8%	4.7%	4.2%
	Rent Momentum*	Increase	None	Increase	Increase	Increase	Increase
<b>West Palm Beach</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Contraction
	Vacancy	6.5%	7.0%	6.2%	6.9%	6.9%	7.3%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	None

Sources: REIS and RREEF Research

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%

Increase: 3% - 4%

Increase+: Over 4%

## Property Cycle Monitor: Industrial

The strong recovery that began in 2004 in the US industrial market is now settling into a steady growth cycle. After peaking at 11.8% at the end of the first quarter of 2004, the US industrial market vacancy rate has now produced 11 consecutive quarters of declining vacancy rates – closing 2006 with a vacancy rate of 9.4%. Industrial demand remained robust in 2006, posting 188 million square feet of positive net absorption, well above its 15-year historic average of 150 million square feet absorbed per year. Favorable market fundamentals have allowed landlords to push rental rates higher in most of the major US industrial markets. With market conditions strengthening across most markets, a new cycle of development has commenced. Over 155 million square feet of new industrial product was delivered to US industrial markets in 2006, its highest level since 2001. However, with many of the US coastal markets relatively supply-constrained, construction has not, nor is expected to reach the levels produced in the late 1990s/early 2000s when US industrial markets posted completion levels that averaged over 230 million square feet of space per year.

Capitalizing on strong import and export trends, the Global Gateway hubs continue to outperform the overall US industrial market by a wide margin. The coastal markets of Southern California, San Francisco Bay Area, Seattle, South/Central Florida, and New York/Northern New Jersey continue to experience tightening space conditions and rising rental rates. The big inland hubs of Atlanta, Chicago and Dallas-Ft Worth continue to post impressive demand numbers; however an active construction pipeline is preventing their vacancy rates from reaching single digits. A significant amount of large big box warehouse/distribution facilities that was delivered during the second half of 2006 remain vacant.

The recovery in the R&D/flex sector continues to gain momentum. The overall vacancy rate for this once battered sector is now down to 13.2% at the close of 2006 – a 400 basis point improvement in three years. Markets that have benefited from the rebound in business and technology spending have experienced the most strength; these markets include San Jose, Austin, Baltimore, Orange County, Raleigh, Portland, and Atlanta.

Since the US economy is forecast to expand at a more moderate pace, with particular weakening in 2007, we expect industrial demand to slow over the short-term. With decelerating industrial demand and a fairly constrained construction cycle, US industrial market availability is expected to stabilize close to current levels in the mid-9% range over the next 24 months.

Some metros are expected to under-perform in the short-term, however. Metros that are seeing acceleration in new construction, especially of large warehouse/distribution facilities, as well as metros with economies that were supported by the nation's housing boom are expected to see their market fundamentals deteriorate somewhat, with rising vacancies.

U.S. National Industrial Market Cycle		Forecast Years				
	2006	2007	2008	2009	2010	2011
	GRW PGW	GRW	GRW	GRW	GRW	GRW
	REC CON					
Job Growth	1.9%	1.2%	1.3%	1.5%	1.4%	0.9%
Net Abs.	188 MSF	157 MSF	123 MSF	169 MSF	179 MSF	155 MSF
Supply	155 MSF	165 MSF	148 MSF	132 MSF	155 MSF	164 MSF
% Vacant	9.4%	9.4%	9.5%	9.1%	8.8%	8.7%
Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase

Key: REC = Recovery GRW = Growth PGW = Post-Growth CON = Contraction

Source: Global Insight, Torto Wheaton, and RREEF Research

## Factors Shaping the Industrial Cycle (Time Frame)

### **Drivers of Growth**

- Job growth, consumer and business spending, trade flows (on-going)
- Global economic expansion (on-going)
- Increasing land and construction costs (on-going)
- Growth in high-tech (short-term/intermediate-term)

### **Constraints on Growth**

- Declining housing sector (short-term)
- Elevated energy prices (short-term)
- New speculative development (short/intermediate-term)
- Rising interest rates (short-term/intermediate-term)

### **Implications: Timing of the Cycle**

- National market, led by the coastal areas, have moved into steady growth mode
- Markets with an accelerated construction pipeline will lag the national rent growth (short-term)
- R&D/flex markets continue to strengthen in 2007

## Industrial Metro Performance

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### US Industrial Market Metro Performance 2007

<b>Out-Perform</b>	<b>Average*</b>	<b>Under-Perform</b>
Austin	Central New Jersey	Atlanta
Fort Lauderdale	Denver	Baltimore
Los Angeles	Houston	Boston
Miami	New York	Chicago
Oakland/East Bay	Minneapolis	Dallas-Ft Worth
Orange County	Portland	Philadelphia
Orlando	San Diego	Phoenix
San Jose		Riverside/San Berdo
Seattle		Washington, DC

\* broadly in line with national trends

Source: RREEF Research

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**U.S. Property Cycle Monitor  
Industrial**

**March 2007**

----- Forecast -----

		2006	2007	2008	2009	2010	2011
<b>U.S.</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	9.4%	9.4%	9.5%	9.1%	8.8%	8.7%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
<b>Atlanta</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Post Growth
	Vacancy	13.0%	12.4%	12.7%	12.5%	12.3%	12.5%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
<b>Austin</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Post Growth
	Vacancy	10.8%	9.0%	7.8%	6.8%	7.8%	8.8%
	Rent Momentum	Increase +	Increase +	Increase +	Increase +	Increase	Increase
<b>Baltimore</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	12.5%	12.8%	13.5%	12.9%	12.0%	11.8%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase +	Increase
<b>Boston</b>	Stage	Recovery	Recovery	Growth	Growth	Growth	Growth
	Vacancy	15.3%	14.5%	13.4%	12.6%	12.3%	12.2%
	Rent Momentum	Increase	Increase	Increase	Increase +	Increase +	Increase
<b>Central New Jersey</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.7%	9.0%	9.5%	9.2%	8.5%	8.4%
	Rent Momentum	None	Increase	Increase	Increase	Increase +	Increase +
<b>Charlotte</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Post Growth
	Vacancy	10.5%	10.3%	10.0%	10.1%	9.9%	10.1%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
<b>Chicago</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	11.4%	11.0%	11.5%	10.6%	10.7%	10.2%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
<b>Cincinnati</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.2%	8.9%	9.7%	9.4%	9.0%	8.9%
	Rent Momentum	None	None	Increase	Increase	Increase	Increase
<b>Dallas/Ft. Worth</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	10.8%	10.2%	10.3%	9.9%	9.2%	9.0%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
<b>Denver</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	10.0%	9.4%	8.8%	8.7%	8.6%	8.4%
	Rent Momentum	Increase +	Increase	Increase	Increase	Increase	Increase
<b>Fort Lauderdale</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.5%	5.7%	6.6%	6.0%	5.1%	4.9%
	Rent Momentum	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Houston</b>	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Post Growth
	Vacancy	7.0%	6.2%	6.8%	7.5%	7.4%	7.7%
	Rent Momentum	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Los Angeles</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.5%	4.5%	4.2%	3.9%	4.0%	4.3%
	Rent Momentum	Increase +	Increase +	Increase +	Increase +	Increase +	Increase
<b>Miami</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.7%	5.7%	6.2%	5.9%	5.3%	5.5%
	Rent Momentum	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Minneapolis</b>	Stage	Growth	Growth	Growth	Growth	Growth	Post Growth
	Vacancy	7.8%	7.3%	7.4%	6.6%	6.7%	6.6%
	Rent Momentum	Increase +	Increase +	Increase +	Increase	Increase	Increase
<b>New York/NNJ</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.8%	8.6%	8.6%	8.1%	7.8%	7.8%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase +	Increase +
<b>Oakland/East Bay</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	9.6%	9.1%	8.6%	8.0%	7.3%	7.1%
	Rent Momentum	Increase +	Increase +	Increase +	Increase +	Increase +	Increase
<b>Orange County</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.9%	5.1%	5.3%	5.3%	5.0%	4.8%
	Rent Momentum	Increase +	Increase +	Increase +	Increase	Increase	Increase
<b>Orlando</b>	Stage	Growth	Growth	Growth	Growth	Growth	Post Growth
	Vacancy	7.5%	7.3%	8.1%	7.9%	7.6%	7.3%
	Rent Momentum	Increase +	Increase	Increase	Increase	Increase +	Increase +
<b>Philadelphia</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	11.0%	10.7%	11.2%	11.2%	11.2%	11.1%
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%

Increase: 3% - 4%

Increase+: Over 4%

**U.S. Property Cycle Monitor  
Industrial**

**March 2007**

----- Forecast -----

		2006	2007	2008	2009	2010	2011
<b>Phoenix</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.6%	10.1%	10.3%	8.8%	8.3%	8.1%
	Rent Momentum	Increase +	Increase	Increase	Increase	Increase	Increase
<b>Portland</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	6.4%	5.8%	6.1%	7.0%	6.7%	7.1%
	Rent Momentum	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Riverside/San Berdo</b>	Stage	Growth	Growth	Growth	Growth	Post Growth	Post Growth
	Vacancy	7.9%	10.9%	10.4%	8.9%	7.8%	8.1%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>St. Louis</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	9.5%	9.8%	9.4%	8.8%	8.5%	8.8%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>San Diego</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	8.7%	8.7%	9.3%	8.1%	8.0%	7.3%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>San Jose</b>	Stage	Recovery	Recovery	Growth	Growth	Growth	Growth
	Vacancy	12.0%	10.2%	8.2%	7.8%	7.3%	6.9%
	Rent Momentum*	Increase +	Increase +	Increase +	Increase +	Increase	Increase
<b>Seattle/Tacoma</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	6.0%	6.4%	6.5%	5.8%	6.1%	5.8%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>Washington, D.C.</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	10.6%	11.3%	11.1%	10.5%	10.1%	9.9%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase

Source: Torto Wheaton and RREEF Research

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%

Increase: 3% - 4%

Increase+: Over 4%

## Property Cycle Monitor: Office

The US office market has experienced tremendous improvement since it entered the recovery phase of the cycle in 2004, and continued into the growth phase last year. As a result, it has produced three years of solid occupancy gains on a national basis through solid absorption and restrained new supply, with vacancy falling to 12.6% by year-end 2006 from a peak of over 17% in 2002. Rental rate growth has responded, with double-digit increases for Class A space in the leading metros. Lagging markets have seen their availability rates stabilize and net absorption turn positive, producing more modest rent growth. Suburban markets have tended to follow growth in prime CBD markets.

On a geographic basis, the office sector's performance remains far from even. On a broad basis, the leading markets – those with low availability levels and strong upward movement in Class A rents – are clustered in the East (Manhattan, Washington, DC, Miami, Fort Lauderdale) and the West (Los Angeles, Orange County, San Diego, San Francisco and Seattle). Mid-western markets have now stabilized but the supply-rich markets of Dallas and Atlanta continue to lag as do the slow-moving economies of Philadelphia and Central New Jersey.

With the economy expected to pause from its strong growth of the past few years in the coming year, the office market is also expected to stabilize. New supply completions are forecast to approximate net absorption. As a result, the national availability rate is forecast to fall by only 10 basis points to 12.5% by the close of the year.

New development will remain concentrated in a handful of metros – most notably Washington DC, New York, Seattle, Las Vegas, San Diego and Orange County. In the latter two Southern California markets, while they remain strong long-term strategic locations, we anticipate a rise in availability in 2007 as new speculative construction outpaces short-term demand. Construction activity will also gear up in the high growth, land-rich markets of Phoenix, Dallas and Atlanta, which have been volatile historically.

Among the major markets, four metros will close out 2007 with an availability rate of 10% or below: Austin, Los Angeles, New York and San Francisco. Boston, Miami, Orange County and Washington, DC will be just above the 10% level.

While there will be significant submarket-level variations, in broad terms, the strongest percentage appreciation in Class A rents is expected in Boston, Denver, New York, San Francisco, San Jose and Seattle.

U.S. National Office Market Cycle		Forecast Years									
		2006	2007	2008	2009	2010	2011				
		GRW	PGW								
		REC	CON								
Office Job Growth	2.9%	1.0%	1.4%	1.8%	1.9%	1.9%					
Net Abs.	76 MSF	61 MSF	55 MSF	62 MSF	65 MSF	65 MSF					
Supply	47 MSF	65 MSF	50 MSF	55 MSF	60 MSF	71 MSF					
% Vacant	12.6%	12.5%	12.2%	11.8%	11.5%	11.4%					
Rent Momentum	None	Increase +	Increase +	Increase	Increase	Increase					

Key: REC = Recovery GRW = Growth PGW = Post-Growth CON = Contraction

Source: Torto Wheaton, Economy.com and RREEF Research

Office job growth is projected to average 1.9% per year through year-end 2011, ahead of the overall national job growth rate of 1.5%. Apart from a slight dip to a still respectable 55.0 million square feet in 2008, annual net absorption is forecast to track at around 60.0 to 65.0 million square feet per year during this period. During the three years from 2008 to 2010, new supply is forecast to track slightly below net demand resulting in a steady decline in the national office availability to 11.5% by year-end 2010.

## Factors Shaping the Office Cycle (Time Frame)

### Drivers of Recovery

- Job growth (on-going but slowing)
- Strong corporate balance sheets driving business spending (short-term/intermediate-term)
- Recovery and growth in high tech (intermediate-term/long-term)

### Constraints on Recovery

- Rising interest rates (short-term/intermediate-term)
- Slowing job growth (short-term)
- Potential for rising construction volumes (intermediate-term)

### Implications: Timing of the Cycle

- National market is in established steady growth mode.
- Most tech markets exhibiting improvement in supply/demand conditions
- Leading suburban markets starting to rebound.

## Office Metro Performance

US Office Market Metro Performance 2007		
Out-Perform	Average*	Under-Perform
Austin	Chicago	Atlanta
Boston	Houston	Dallas
Denver	Los Angeles	New Jersey
Miami	Minneapolis	Oakland
New York	Phoenix	Orange County
San Francisco	Portland	Philadelphia
San Jose	Seattle	San Diego
	Washington DC	

\* broadly in line with national trends

Source: RREEF Research

----- Forecast -----

		2006	2007	2008	2009	2010	2011
<b>U.S.</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	12.6%	12.5%	12.2%	11.8%	11.5%	11.4%
	Rent Momentum*	None	Increase +	Increase +	Increase	Increase	Increase
<b>Atlanta</b>	Stage	Recovery	Recovery	Recovery	Recovery	Recovery	Growth
	Vacancy	17.1%	17.0%	16.7%	16.4%	16.4%	14.9%
	Rent Momentum*	None	None	Increase	Increase	Increase	Increase
<b>Austin</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	12.7%	8.7%	8.3%	9.4%	8.6%	10.1%
	Rent Momentum*	Increase	Increase +	Increase +	Increase +	Increase	Increase
<b>Boston</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	11.9%	10.2%	9.5%	9.6%	9.8%	10.0%
	Rent Momentum*	Increase	Increase +	Increase +	Increase +	Increase +	Increase
<b>Chicago</b>	Stage	Recovery	Recovery	Recovery	Recovery	Growth	Growth
	Vacancy	15.4%	14.6%	14.1%	15.0%	14.4%	14.0%
	Rent Momentum*	None	Increase	Increase	Increase	Increase	Increase
<b>Dallas</b>	Stage	Recovery	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	22.3%	21.8%	21.2%	20.2%	19.5%	19.5%
	Rent Momentum*	None	None	Increase	Increase	Increase	Increase
<b>Denver</b>	Stage	Recovery	Recovery	Growth	Growth	Growth	Growth
	Vacancy	14.6%	14.1%	13.4%	12.1%	11.8%	12.3%
	Rent Momentum*	None	Increase	Increase +	Increase +	Increase +	Increase
<b>Houston</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	13.1%	11.7%	11.1%	10.4%	10.9%	11.4%
	Rent Momentum*	None	Increase	Increase +	Increase +	Increase	Increase
<b>Los Angeles</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	10.0%	10.0%	9.6%	9.7%	9.8%	9.8%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Miami</b>	Stage	Growth	Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	9.2%	10.1%	11.8%	13.8%	13.1%	12.6%
	Rent Momentum*	Increase +	Increase +	Increase	Increase	Increase	Increase
<b>Minneapolis</b>	Stage	Recovery	Recovery	Recovery	Growth	Growth	Growth
	Vacancy	15.6%	15.0%	14.7%	13.8%	13.1%	13.4%
	Rent Momentum*	None	Increase	Increase	Increase	Increase	Increase
<b>New York</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	6.5%	5.3%	5.2%	5.1%	5.5%	6.1%
	Rent Momentum*	Increase	Increase +	Increase +	Increase	Increase	Increase
<b>Central NJ</b>	Stage	Recovery	Recovery	Recovery	Recovery	Growth	Growth
	Vacancy	15.5%	15.7%	15.6%	14.8%	13.8%	13.5%
	Rent Momentum*	None	None	Increase	Increase	Increase +	Increase +
<b>Oakland/East Bay</b>	Stage	Recovery	Recovery	Recovery	Growth	Growth	Growth
	Vacancy	16.1%	15.3%	14.0%	12.6%	12.0%	11.8%
	Rent Momentum*	None	Increase	Increase	Increase +	Increase +	Increase +
<b>Orange County</b>	Stage	Growth	Post-Growth	Post-Growth	Recovery	Growth	Growth
	Vacancy	8.3%	10.4%	9.9%	9.0%	7.7%	7.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase +	Increase +
<b>Philadelphia</b>	Stage	Recovery	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	70.0%	12.1%	12.6%	12.6%	13.0%	12.8%
	Rent Momentum*	None	Increase	Increase	Increase	Increase	Increase
<b>Phoenix</b>	Stage	Growth	Post-Growth	Post-Growth	Growth	Post-Growth	Post-Growth
	Vacancy	11.8%	14.1%	15.5%	15.3%	14.6%	14.2%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>Portland</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Vacancy	12.7%	11.9%	10.7%	10.0%	9.7%	10.1%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>San Diego</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Recovery	Growth
	Vacancy	13.3%	15.5%	15.9%	15.0%	13.7%	12.8%
	Rent Momentum*	Increase	None	None	Increase	Increase	Increase
<b>San Francisco</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	10.8%	9.8%	9.0%	8.2%	8.4%	8.8%
	Rent Momentum*	Increase +	Increase +	Increase +	Increase	Increase	Increase
<b>San Jose</b>	Stage	Recovery	Growth	Growth	Growth	Growth	Post-Growth
	Vacancy	13.3%	12.5%	11.1%	8.1%	9.7%	10.7%
	Rent Momentum*	None	Increase +	Increase +	Increase +	Increase +	Increase
<b>Seattle</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	9.4%	10.9%	11.1%	10.3%	9.4%	9.1%
	Rent Momentum*	Increase +	Increase	Increase	Increase	Increase	Increase
<b>Washington DC</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	9.1%	10.5%	10.2%	9.0%	8.4%	8.6%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase

Sources: CBRE/Torto Wheaton and RREEF Research

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%  
Increase: 3% - 4%  
Increase+: Over 4%

## Property Cycle Monitor: Retail

The retail sector entered the post-growth phase of the property cycle in 2006, as demand slowed substantially from recent years and a particularly strong 2005. The US retail market ended 2006 with a modest absorption of 15.7 million square feet, the lowest total in more than two decades (excluding 2001), and 36% below the four-year average through 2005 of 24.6 million. With retail sales excluding automobiles up 7.5% for the year, this lower absorption should not be blamed on underlying weakness in the retail sector. Rather, the drop likely represented a delayed reaction to the tremendous activity in 2005, when 27.8 million square feet of space was added to the markets nationally, the most in 14 years. The market absorbed all of that space and more, closing 2005 with about 29 million square feet of net absorption, itself the most since 1997. The drop in absorption last year also reflected the decline in new product delivered to market – down almost 20% from 2005 – as many projects were deferred until 2007. Only 22.6 million square feet of new space was completed last year, the lowest delivery since 2000.

Still, the impact of this slowdown in 2006 activity was relatively benign. Overall the retail vacancy rate finished 2006 at 6.9%, slightly higher than 2005's 6.5% rate, but still in line with the 6.8% average of the preceding ten years.

Going forward we anticipate that much of the new construction that had been scheduled for 2006 will finally deliver this year, which should help return absorption to more normal levels. Accordingly, we project net absorption of 28 million square feet this year, approximating the previous cyclical peak in 2005. The construction surge, from 23 million square feet in 2006 to 35 million in 2007, is expected to lead to another small rise in vacancy to 7.2%.

Beyond 2007, we expect a slower retail market, both from supply and absorption perspectives. A significant decline in growth of consumer spending has been forecast for some time, but has been headline news more recently. During the past four years, retail spending has increased by an average of nearly 7% annually, an unsustainable level of activity. Tied closely to a booming housing market with substantial value appreciation, retail spending is likely to be adversely impacted by the decline in the housing market, along with declining home values. As a result, retail sales growth is likely to remain in the 3% to 4% range over the next five years. This muted outlook has already impacted retailers' outlook, and store expansions are being reduced beyond 2007. As a result, retail net absorption is forecast to slow from over 28 million square feet in 2008 to an average of less than 23 million square feet annually between 2008 and 2011. With a slowdown in new store openings, construction is also projected to remain restrained over the next few years, averaging less than 23 million square feet annually. Vacancy rates are forecast to decline modestly, reaching 6.8% by year-end 2011.

		2006		Forecast Years					
		GRW	PGW		PGW		PGW		PGW
Retail Sales	7.5%			3.9%	3.8%	3.9%	4.1%	4.1%	
Net Abs.	16 MSF			28 MSF	24 MSF	22 MSF	23 MSF	21 MSF	
Supply	23 MSF			35 MSF	25 MSF	23 MSF	22 MSF	21 MSF	
% Vacant	6.9%			7.2%	7.1%	7.0%	6.9%	6.8%	
Rent Momentum	Increase			Increase	Increase	Increase	Increase	Increase	

Key: REC = Recovery GRW = Growth PGW = Post-Growth CON = Contraction

Source: REIS, Economy.com, and RREEF Research

The primary risk to this forecast is a sharper-than-expected decline in the housing market. Our current expectation is that home price will generally remain flat over the next few years as the market adjusts. If households face a significant decline in their net worth due to falling home prices, they may choose to rein in retail spending and thus set the stage for lower retail net absorption.

Aside from the completions that were deferred from 2006 to 2007, most markets have seen little change in forecast over the past six months. We remain generally more positive about supply-constrained, high-growth markets on the West Coast and in South Florida, and reserve most of our concern for continually over-supplied markets in Texas.

## Factors Shaping the Retail Cycle (Time Frame)

### *Drivers of Recovery*

- Job growth (on-going)
- Household and income growth (on-going)
- Rebuilding in the aftermath of Hurricane Katrina (short-term/intermediate-term)

### *Constraints on Recovery*

- Slowing consumer spending growth (short-term/intermediate-term)
- Restrained home mortgage refinancing and home appreciation wealth gains (short-term/intermediate-term)
- Higher prices for oil and natural gas (on-going)

### *Implications: Timing of the Cycle*

- Retail sector remains stable, holding to the post-growth stage of the cycle
- Most markets witness balanced market conditions and rising rents

## Retail Metro Performance

### US Retail Market Metro Performance 2007

Out-Perform	Average*	Under-Perform
Ft. Lauderdale	Atlanta	Charlotte
Long Island	Austin	Dallas
Los Angeles	Chicago	Fort Worth
Miami	Denver	Houston
Portland	Philadelphia	St. Louis
San Jose	Phoenix	San Antonio
Seattle	Tampa	

\* broadly in line with national trends

Source: RREEF Research

----- Forecast -----

		2006	2007	2008	2009	2010	2011
<b>U.S.</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	6.9%	7.2%	7.1%	7.0%	6.9%	6.8%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Atlanta</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	8.0%	8.4%	8.5%	8.4%	8.2%	8.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Austin</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	8.1%	8.5%	8.5%	8.5%	8.3%	8.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Baltimore</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.3%	3.6%	3.8%	3.9%	3.9%	3.7%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Boston</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.3%	4.4%	4.1%	4.2%	4.0%	4.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Charlotte</b>	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Recovery
	Vacancy	7.6%	8.3%	8.7%	8.5%	8.5%	8.3%
	Rent Momentum*	None	None	None	None	None	None
<b>Chicago</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	7.5%	7.7%	7.6%	7.4%	7.3%	7.3%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Dallas</b>	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Recovery
	Vacancy	11.0%	11.0%	10.6%	10.5%	10.4%	10.3%
	Rent Momentum*	None	None	None	None	None	None
<b>Denver</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	8.3%	8.3%	8.0%	7.6%	7.5%	7.6%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Ft. Lauderdale</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.3%	5.5%	5.6%	5.7%	5.6%	5.4%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Fort Worth</b>	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Recovery
	Vacancy	11.3%	11.5%	11.1%	10.8%	10.6%	10.5%
	Rent Momentum*	None	None	None	None	None	None
<b>Houston</b>	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Recovery
	Vacancy	11.1%	11.1%	10.6%	10.4%	10.4%	10.5%
	Rent Momentum*	None	None	None	None	None	None
<b>Long Island</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.7%	4.8%	4.6%	4.7%	4.5%	4.7%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Los Angeles</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	2.4%	3.0%	3.3%	3.7%	3.8%	3.9%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Miami</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.6%	4.8%	5.0%	4.9%	4.8%	4.9%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Minneapolis</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	7.4%	7.5%	7.4%	7.0%	6.1%	5.9%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>N. New Jersey</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.4%	4.7%	4.8%	4.6%	4.4%	4.5%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Oakland/East Bay</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.2%	4.4%	4.7%	4.6%	4.4%	4.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Orange County</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.0%	3.7%	3.5%	3.6%	3.6%	3.5%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Orlando</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	5.0%	5.7%	6.1%	5.9%	5.8%	5.9%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Philadelphia</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	6.7%	7.0%	6.9%	6.9%	6.8%	6.5%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%

Increase: 3% - 4%

Increase+: Over 4%

**U.S. Property Cycle Monitor**  
**Retail**

**March 2007**

----- **Forecast** -----

2006			2007	2008	2009	2010	2011
<b>Phoenix</b>	Stage	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	6.1%	6.4%	6.4%	6.5%	6.6%	6.8%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Portland</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.8%	4.9%	4.9%	5.1%	4.9%	4.8%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>St. Louis</b>	Stage	Contraction	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	10.3%	10.3%	9.9%	9.6%	9.2%	9.1%
	Rent Momentum*	None	None	None	None	None	None
<b>San Antonio</b>	Stage	Contraction	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	9.7%	9.6%	9.4%	9.1%	8.9%	9.0%
	Rent Momentum*	None	None	None	None	None	None
<b>San Diego</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.2%	3.4%	3.3%	3.7%	3.9%	4.0%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>San Francisco</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.3%	3.5%	3.5%	3.6%	3.6%	3.7%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>San Jose</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	2.7%	2.9%	2.9%	3.1%	3.0%	3.2%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Seattle</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.3%	3.7%	4.4%	3.9%	3.3%	3.1%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Tampa</b>	Stage	Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth	Post-Growth
	Vacancy	6.5%	6.8%	6.7%	6.8%	6.5%	6.4%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>Washington, D.C.</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	3.8%	4.1%	4.1%	4.3%	4.1%	4.1%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase
<b>West Palm Beach</b>	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	4.6%	4.9%	4.8%	5.1%	4.9%	4.5%
	Rent Momentum*	Increase	Increase	Increase	Increase	Increase	Increase

Sources: REIS and RREEF Research

\* Rent Momentum: Annual Rental Growth

None: 0% to 2%

Increase: 3% - 4%

Increase+: Over 4%

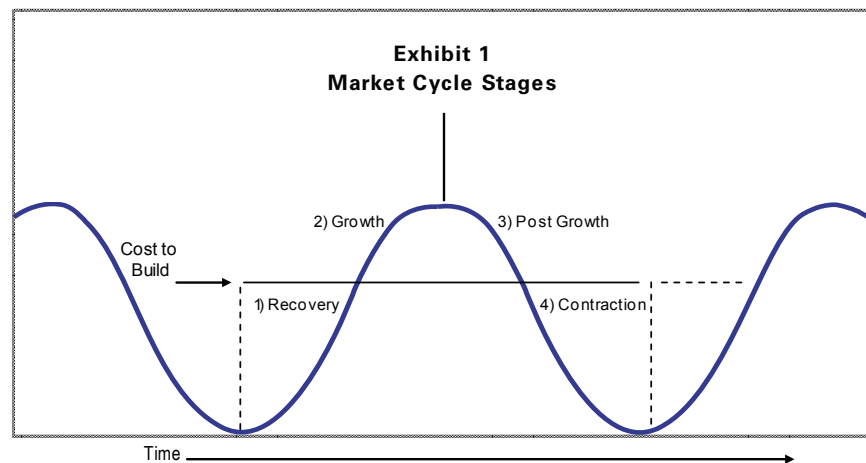
## APPENDIX

### ***Classifying Markets in the Cycle***

Among the 50 markets for which baseline forecasts are prepared, 25 to 30 from each property sector are included in the Property Cycle Monitor. Along with the national market, the markets included in the Monitor are classified in their respective cycle stage in the current market and over a five-year time horizon.

Property market cycle designations are based on four distinct stages shown in Exhibit 1.

<u>Stages</u>	<u>General Conditions</u>
1) Recovery	High but declining vacancy – demand exceeding supply – stable to rising rents/values
2) Growth	Low and declining vacancy – demand exceeding supply – rising rents supportive of construction – rising values
3) Post Growth	Low but increasing vacancy – supply exceeding demand – rising/flattening rents/values
4) Contraction	High or increasing vacancy – supply exceeding demand – falling rents/values



Source: RREEF Research

### ***Rent Momentum***

Following the designation of cycle stages, a rent category is assigned to the national and primary metro markets for each year of the forecast period. Rent categories are assigned based on the general typology displayed in Exhibit 2. They are intended to show the general *momentum* behind potential changes in rent, not an actual numerical increase or decrease in rates.

**Exhibit 2**  
**Rent Categories and**  
**The Property Cycle**

<b>Momentum Category</b>	<b>Cycle Stages</b>			
	<b>Contraction</b>	<b>Recovery</b>	<b>Growth</b>	<b>Post-Growth</b>
Increase +		✓	✓	
Increase		✓	✓	✓
None	✓	✓		✓
Decrease	✓			
Decrease +	✓			

Source: RREEF Research

**ANALYST CERTIFICATION**

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report.

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