

# Leading the Enterprise™ 2008

*A perspective on the enterprise issues facing the industry's leadership.*



The Real Estate  
Roundtable



FPL ADVISORY GROUP  
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## **Leading the Enterprise™ 2008**

*FPL Advisory Group, in partnership with The Real Estate Roundtable, is pleased to present the second annual edition of Leading the Enterprise™. This report provides an inside look at the thoughts of nearly 200 CEOs and other senior executives in the real estate and related industries on key issues and trends that will impact their businesses in 2008.*

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## Preface

FPL Advisory Group, in partnership with The Real Estate Roundtable, is pleased to present *Leading the Enterprise™ 2008*. Based on surveys of and interviews with senior executives in the real estate and related industries, this unique report addresses the outlook for the coming year. The report looks at the challenges and opportunities that will affect companies in this space and offers an inside look at how executives and board members foresee the business environment in 2008.

Quotes used in this report are excerpted from many hours of interviews with senior executives. They provide a look at the multifaceted (and sometimes contradictory) views of the industry's leaders on the state of the overall economy and the real estate industry going into 2008, as well as the challenges, opportunities, and drivers of change they see as most important to their businesses.

Our sincere thanks goes to all participants. Their generous contribution of their time and insight made the creation of this report possible.

Respondents include CEOs, presidents, board members, and other senior executives from a broad list of industry sectors. Survey responses were gathered from the following sectors:

- 74% **Owners & asset managers** (REITs, investment managers, private equity funds, pension funds, homebuilders, public & private developers, corporate real estate firms)
- 19% **Financial services providers** (commercial & residential mortgage lenders, CMBS firms, hedge funds, investment banks, commercial banks, investment companies)
- 7% **Operators & service providers** (real estate operating companies, seniors housing companies, hospitality companies, commercial services & brokerage firms, associations, universities)

A partial list of participants is included at the back of this report.



# Executive Summary

How quickly things change! The unbridled optimism which characterized the industry at this time last year has indeed been tempered — and the major drivers of this change are (not surprisingly) uncertainty over the health of the economy and concerns about how the ongoing contraction in the financial markets will impact the availability of capital. Despite these worries, however, it seems that most executives across the industry don't believe that the sky is falling.

Perhaps even more revealing than the survey numbers are the insights gathered through hundreds of written comments from and interviews with industry leaders. Respondents are concerned about raising capital and achieving growth in a more difficult market.

However, many believe that the slowdown most likely won't lead to a full-blown recession. Many expect to benefit from difficulties faced by their competitors. Several believe that a downturn will be an opportunity to snap up "A-player talent." The continued growth in overseas markets is in many ways mitigating the pain some are feeling in the U.S. It seems that everyone we interviewed is trying to figure out where the market will go. As one executive said, "Right now it's hard to predict anything. Much depends upon where the economy is going. The only thing you can really do is throw a dart."

Since the survey was completed in late 2007, the world has continued to change. The significant fall in housing and the resulting credit pullback has led to many of the traditional effects of a slowdown: deteriorating consumer credit, decreasing consumer spending, and potentially higher unemployment (particularly in the financial services sector). What's now over \$100 billion in writedowns among financial institutions has created an even greater risk of continued financial pressure both here in the U.S. and abroad. On the brighter side, it seems likely that we'll see involvement from the U.S. government in the form of lowered interest rates, tax relief, and continued liquidity from foreign governments through sovereign wealth funds. Concerns that the commercial real estate space will feel a greater impact from the homebuilding crisis are on the rise.

As one *Leading the Enterprise™ 2008* participant said to us just before we went to press, "This could get messy." Time will tell just how accurate this prediction turns out to be.



## Economic Outlook

- While optimism has declined markedly since the same time last year, more than two-thirds of respondents are either confident or neutral about the strength of the U.S. economy, and 84% are confident or neutral about the strength of their respective sectors.
- Despite a high degree of uncertainty about the strength of the economy, the majority of respondents feel that industry fundamentals are solid and that overseas growth will mitigate the softening of the domestic market.

## Challenges

- When it comes to their top operational challenges, only 5% of respondents cite cost management and just 3% cite downsizing their organizations. Rather than hunkering down to wait out the storm, many executives remain focused on finding appropriate investments (33%).
- On a personal level, leaders cite the achievement of growth as their top challenge. Leadership development dropped to second place from its position as the number one personal challenge cited by executives in 2007, likely due to a slightly greater focus on achieving growth in a more volatile market.

## Opportunities

- The majority of respondents still expect their opportunities for growth to outweigh the effects of a shaky economy and numerous challenges. 69% of respondents believe their company's 2008 revenues will surpass 2007 levels, and 71% believe profitability will improve.
- Most frequently cited are the opportunities to build global platforms and to capture market share away from struggling competitors.



# Economic Outlook

It's no surprise that most executives' views of the world are less optimistic now than they were heading into 2007. It seems that it's anyone's guess as to how major economic indicators will change and what the impact will be on the capital markets. Certainly, there's been a departure from the jubilant atmosphere of the past few years.

At the same time, many feel that the correction will mean a return to reality for the market. In the words of one respondent, "Though debt will be constrained, it will end financial engineering and return investor focus to operating fundamentals." Many believe that this will give their companies an advantage over their competition. As one respondent wryly stated, "As the saying goes, in the midst of chaos or disruption comes opportunity."

The result is a mixed bag when it comes to the outlook for 2008. Those with a glass-half-full mentality might be encouraged to know that fully two-thirds of respondents are positive or neutral about the prospects for the economy in the year ahead, and a handful are still "strongly positive." On the other hand, their less optimistic colleagues might counter that the trend is quite negative compared with 2007 results.

Last year, 63% of respondents reported a positive outlook on the overall economy, with 9% expressing that they felt "strongly positive." This year, concerns about the health of the economy and the possibility of a recession have tempered optimism: just 38% indicate a positive forecast for 2008 (and less than 3% checked the "strongly positive" box). The number of respondents in the "neutral" camp is up from 25% to 29%. The biggest change is in the number of respondents who say they're "not very confident:" 32% versus only 12% last year.

When it comes to predicting the strength of their own sectors, executives are generally more optimistic than they are for the overall economy, but are still less enthusiastic than they were at the same time last year.

## Exhibit 1-1. Confidence Level by Sector

### **Most Confident**

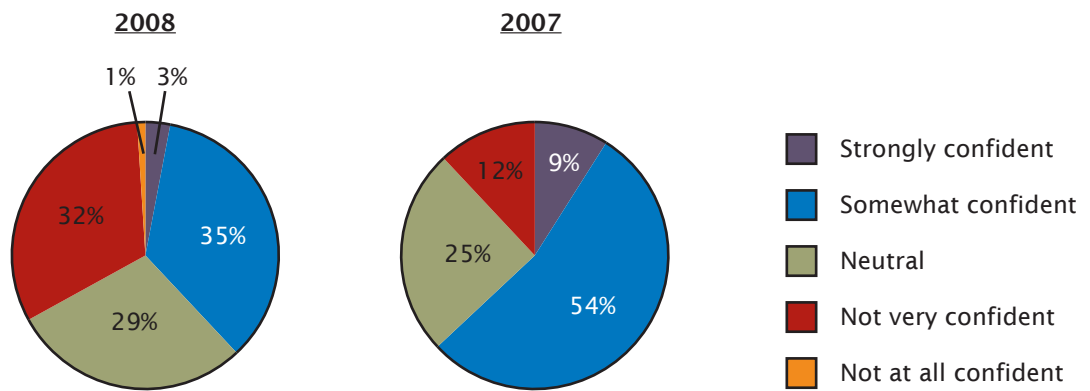
Equity REITs  
Investment Managers  
Private Equity Firms

### **Least Confident**

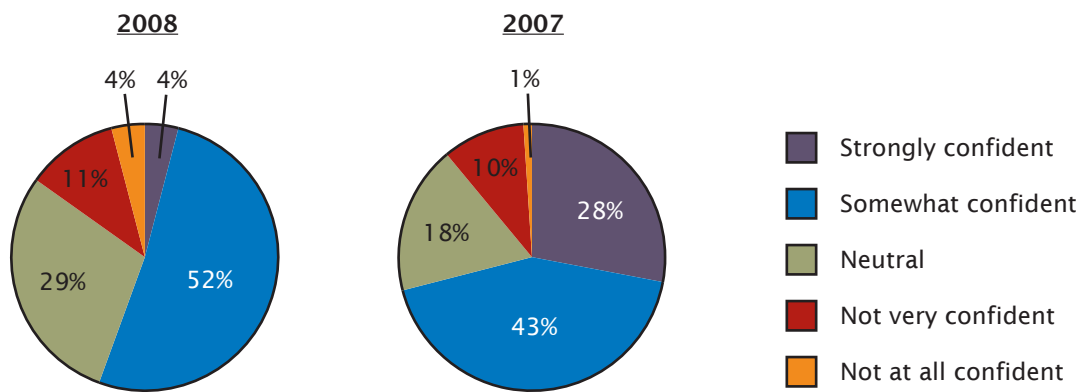
Homebuilders  
Investment Banks  
Developers



**Exhibit 1-2. Economic Outlook For Overall U.S. Economy, 2008 versus 2007**



**Exhibit 1-3. Economic Outlook For Respective Sectors, 2008 versus 2007**



While there's no clear consensus when it comes to predicting the direction and impact of various economic factors, here are a few highlights on what the majority think will happen and what the impact will be:

- 73% predict a continued drop in consumer confidence. 70% believe their businesses will be negatively affected by this drop.
- 63% predict a decline in job growth, with nearly as many expecting negative effects for their businesses.
- 83% expect construction spending to fall, and 40% believe this will be a net negative.
- The good news? Almost half expect interest rates to fall, and another quarter predicts they'll hold steady. Nearly 40% expect positive impacts from interest rate changes.

**Exhibit 1-4. Economic Factors Impacting the Industry**

| Interest Rates        |     | Inflation             |     | Strength of U.S. Dollar |     |
|-----------------------|-----|-----------------------|-----|-------------------------|-----|
| <i>In 2008, will:</i> |     | <i>In 2008, will:</i> |     | <i>In 2008, will:</i>   |     |
| Increase              | 28% | Increase              | 53% | Increase                | 17% |
| No Change             | 26% | No Change             | 36% | No Change               | 23% |
| Decrease              | 46% | Decrease              | 11% | Decrease                | 60% |
| <i>Impact:</i>        |     | <i>Impact:</i>        |     | <i>Impact:</i>          |     |
| Negative              | 20% | Negative              | 34% | Negative                | 29% |
| Neutral               | 43% | Neutral               | 51% | Neutral                 | 45% |
| Positive              | 37% | Positive              | 15% | Positive                | 26% |
| Consumer Confidence   |     | Job Growth            |     | Construction Spending   |     |
| <i>In 2008, will:</i> |     | <i>In 2008, will:</i> |     | <i>In 2008, will:</i>   |     |
| Increase              | 6%  | Increase              | 14% | Increase                | 3%  |
| No Change             | 21% | No Change             | 23% | No Change               | 14% |
| Decrease              | 73% | Decrease              | 63% | Decrease                | 83% |
| <i>Impact:</i>        |     | <i>Impact:</i>        |     | <i>Impact:</i>          |     |
| Negative              | 70% | Negative              | 62% | Negative                | 40% |
| Neutral               | 23% | Neutral               | 22% | Neutral                 | 32% |
| Positive              | 7%  | Positive              | 16% | Positive                | 28% |

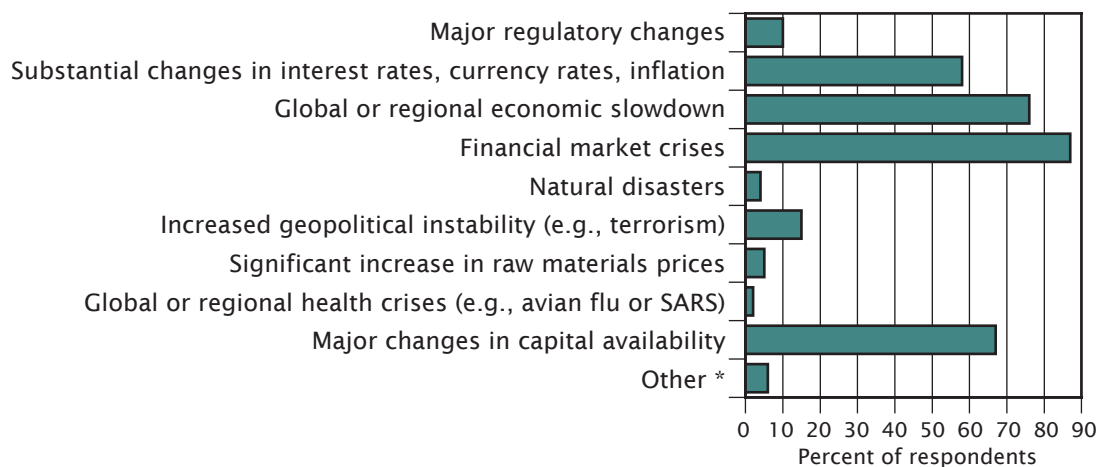


Interviews revealed a few key themes. While many believe that the fundamentals of the real estate business are still good, much depends upon what happens with the economy. There's a substantial amount of uncertainty on that topic. "Some big questions loom out there. Will the residential crisis affect consumer confidence and have a negative impact on the economy? Will the international capital markets close? Will the global perspective of many U.S. businesses neutralize the impact of negative consumer sentiment?" Many feel that at least the first half of 2008 will be characterized by an economic slowdown, but there doesn't seem to be widespread concern that the slowdown will be severe or long-lasting.

Most feel that fundamentals are still strong and that we won't see a precipitous decline in the commercial real estate space. In fact, many believe that the current softening in the real estate space is actually a healthy readjustment: "We're not sliding into an economic downturn. We're undergoing a necessary capital correction." Said another: "In short, the sloppiness is a good thing . . . the frenzy has largely subsided. Long term, this is great for our industry, because we were simply getting overheated."

When it comes to potential threats to the business, financial market crises rose from the third most important concern in 2007 to the number one concern in 2008. Worries over economic slowdowns and substantial changes in macroeconomic factors round out the top three areas of interest for the year, consistent with last year's report.

**Exhibit 1-5. Risk Management: Most Important Issues**



\* Responses include increased tax rates; new supply; energy and insurance costs; excessive price volatility; and prolonged reduction in consumer spending.

*Note: Respondents could select up to three answers.*

## IN THEIR WORDS:

# Economic Outlook

### On the economy:

- “There is clearly a lot of noise in the market and a variety of mixed messages. I don’t think we are heading into a recession, but we will probably move into some type of economic slowdown at least through the middle of 2008.”
- “One of the big questions is the economy. There’s still plenty of equity out there, but many people are sitting on the sidelines because pricing is virtually unknown.”
- “From an economic perspective, the Fed will continue to help by lowering interest rates. The global picture seems to be pretty good, and most U.S. businesses are active around the world. The jobs picture shows this. And pension funds will take a long-term look and stay committed to investors who have done well by them.”
- “There is probably a 10-20% probability of a recession in 2008. And this could jump to 30-40% depending upon what happens in the residential market and how this affects consumer confidence. GDP growth will be reasonably modest at 2% and nonetheless, employment growth seems reasonably robust.”
- “From my perspective, the macro economy is slowing down. It will inevitably hit real estate in the form of job losses as well as weaker consumer confidence. Performance will probably be down in 2008. Nonetheless, institutional investors will not abandon the asset class by any stretch.”
- “We view the market over the next three to six months to be in a pause, much like what happened in 1998 and 1999. We expect activity to pick up in the first quarter, or at the latest, the second quarter of 2008.”

### On the industry’s fundamentals:

- “The fundamentals of the real estate business are still strong, so our thought is that they’ll give back what leverage took away. Even though many buyers are on the sideline today given the unsettled pricing environment, better prices will ultimately evolve, and we’ll be able to compete much more effectively.”
- “Right now, the fundamentals are OK but we’re watching them closely. We see some softening, particularly in retail, but we don’t envision a disastrous downturn. Regarding the capital markets, only those deals which are perfectly underwritten and structured are getting done today.”
- “For the foreseeable future, I do think that demand will outstrip supply in the real estate industry, and hence things should remain reasonably stable.”

## “Right now it’s hard to predict anything. Much depends upon where the economy is going. The only thing you can really do is throw a dart.”

- “While it’s sloppy today, I don’t see this as a seminal time in our industry. I don’t believe that the economy is going to slam our business. Remember that the CMBS world is still a reasonably small part of the domestic real estate equity and debt universe. And furthermore, the operating side is still strong. Our performance numbers might slip a bit, but I don’t see occupancies weakening significantly.”
- “At this point in the cycle, the U.S. real estate market is in a mature stage in many geographies and property types. The phenomenal returns that the industry has achieved for the past five years for most investment vehicles (core, value-added, and opportunistic) will not be replicated . . . However, this is inevitable when you consider that core (minimal leverage) returns for the past three years have been 17%-plus — which is not sustainable in the long run. This is not to say that real estate is entering into dire territory . . . but returns will moderate.”

### On the capital markets:

- “Even with the credit crisis, it is extraordinary how robust the stock market is today. It’s hard to figure out. It seems like any good news drives anything up.”
- “Wall Street clearly needs to clear its CMBS inventory, and it probably won’t happen until early 2008 when investors have sufficient cash to buy again. It’s the old question of supply and demand. There is also a lot of capital coming in from other parts of the world which mitigates some of the concerns about a domestic capital crisis. However, our guess is that the debt markets won’t turn around until early 2008.”

### On the housing crisis:

- “The homebuilding crisis will be a problem. The homebuilders will be hit hard, since they did a number of transactions off balance sheet. However, I don’t think it will morph into a crisis for the commercial real estate business. Furthermore, I think the risk will be regionalized.”
- “I don’t believe that the homebuilding crisis will taint the commercial real estate sector but time will tell. Clearly if the economy weakens, and there are job layoffs, the office building market will be hit, including New York. And the condominium market will be troubled in many locations ranging from Florida to Chicago, Arizona, and Las Vegas.”
- “Consumer confidence will clearly be shaken by the residential problems. If there are job losses, and communities stop growing, that will not portend well for our sector. Given the consumer confidence issue, retail is the asset class with probably the most exposure.”
- “We have a falling savings rate in the U.S., and consumers will reduce consumption in order to increase savings. This is especially true as they have seen the equity value in their homes decline. It may take as long as a year or two to reset.”

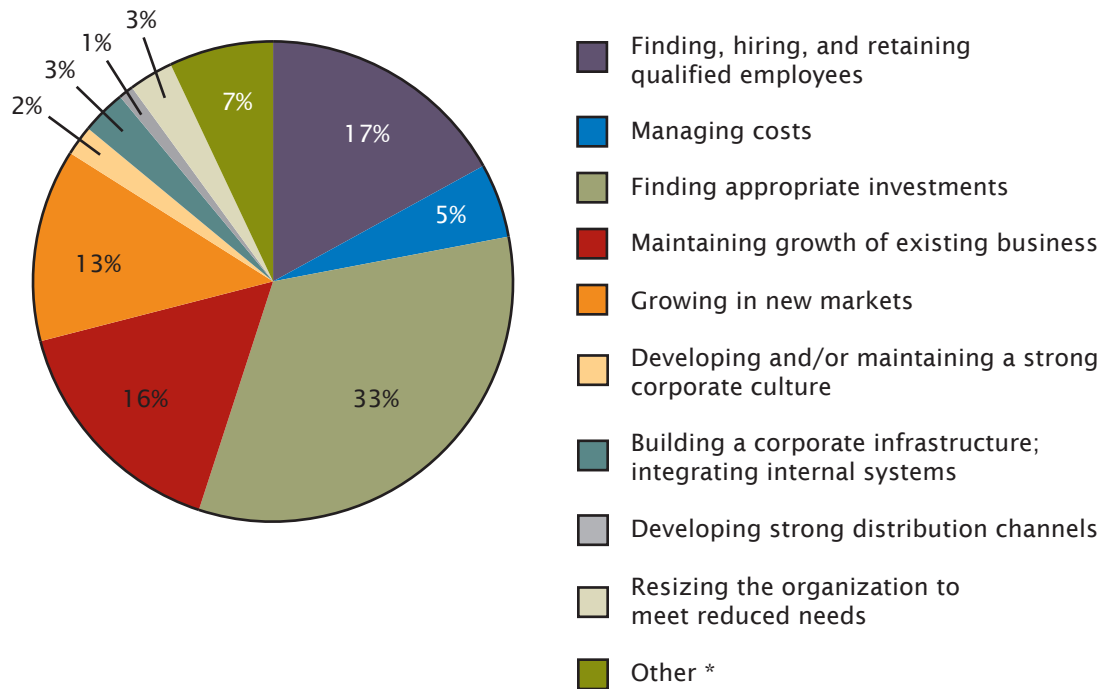


# Challenges

In the face of uncertain economic conditions and volatility in the capital markets, many are trying to weather the storm while keeping an eye out for growth opportunities: “[We’re trying] to not be blinded by all of the dust kicked up by the sub-prime/CDO/banking hysteria, and to identify the opportunities that are sure to present themselves during these tumultuous times.” We asked executives to name the single biggest operational challenge they expect to face in 2008. Among a list of ten options, the following stand out as most important. Notably, these were the same top choices as in 2007.


- **Finding appropriate investments (33%).** With the capital markets in turmoil and pricing still high, respondents are most focused on finding deals and obtaining financing. Respondents describe “finding good long-term investment opportunities that are reasonably priced” and “access to capital” — particularly “capital that’s long-term and focused on stable returns” — as a key focus in the coming year. “Diversification of capital sources” will be important. “There’s a whole new set of economics today,” notes one respondent, “and we need new partners for growth.”
- **Finding, hiring, and retaining qualified employees (17%).** Echoing the views of many, one CEO stated, “We need to recruit, inspire, and train the best and brightest.” Some worry that this might be particularly difficult in a down market: “A slowdown and lack of clear market direction may lead to significant personnel issues.” Demographics further complicate the picture: “Baby Boomers are beginning to retire and ‘Gen Y’ has a very different view about work than past generations. Keeping them motivated and engaged will be a challenge. They are not driven by the same goals that organizations have been set up to meet.” Overall, there’s a clear focus on leadership because “if we can retain our core group of talent, we can do anything.” Top of mind is “finding top talent overseas, particularly in Asia.” Several companies expanding overseas cite the importance “maintaining a successful culture as we grow.”
- **Maintaining growth of existing business (16%).** A big hurdle in 2008 will be “achieving growth in what will be a more challenging environment.” Factors such as “substantive competitive development” and “shrinking business volumes” make this particularly difficult. As a result, diversification into “new property types,” “new relationships and new markets,” and “new products” will be critical. Equally important will be “management discipline” and “successful execution.”

**Exhibit 2-1. Biggest Operational Challenge for 2008**



\* Responses include adapting to continued changes in market and competitive climate; addressing economic uncertainty; dealing with impact of continued downturn in housing, especially instability of mortgage markets; and accessing capital/growing capital sources.

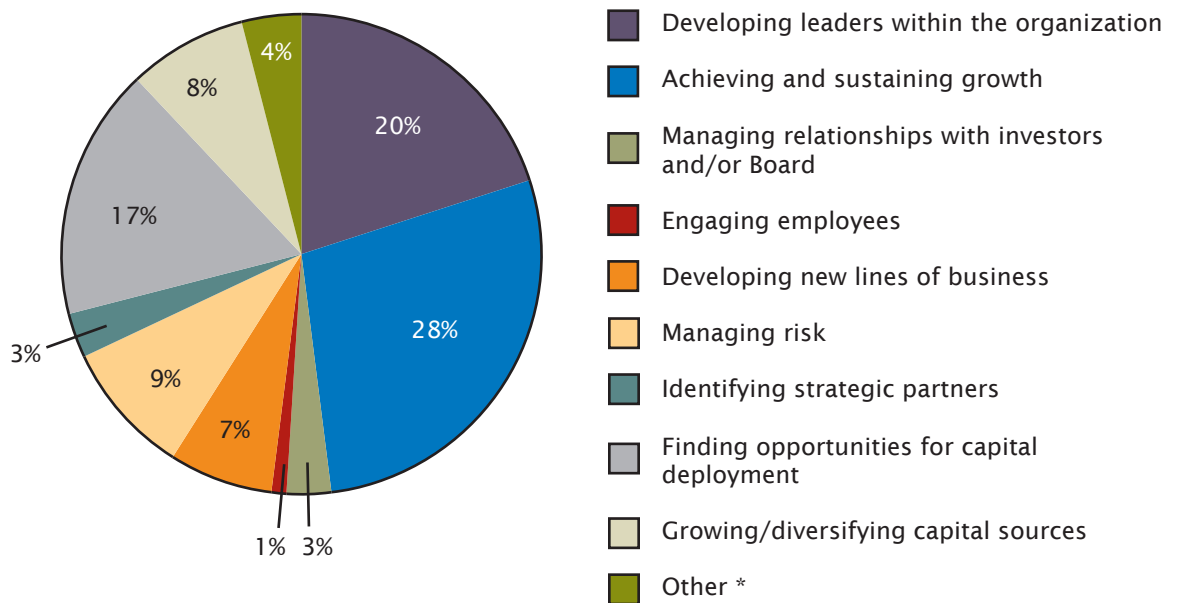
*Note: Respondents could select up to three answers.*



On a personal level, leaders cite the same challenges as their top three, but in reverse order. Interestingly, development of leadership dropped from its position as the number one personal challenge cited by executives in 2007, most likely due to a slightly greater focus on achieving growth in a more difficult market.

- **Achieving growth (28%).** “Our biggest challenge in '08 is to achieve growth in what will be a more challenging environment,” explained one senior executive. Specifically, others listed “substantive competitive development,” “shrinking business volumes,” and “the stalemate in the CMBS market” as obstacles to growth in 2008. Some are refocusing on growing their core businesses and believe strong execution will be key: “We need continued strict adherence to, and crisp execution of, our long-term strategic plan” and “we’re focusing on developing the internal discipline to execute on a timely basis.” Others believe the path to growth leads overseas, which will come with its own unique set of challenges: “we need to figure out how to manage the complexity that comes with global growth.” As more firms build their global platforms, there’s “increasing competition” and concerns about how to “expand globally on a basis that will provide our investors with a product comparable to that which we provide in the U.S. — while doing so profitably for our company.”
- **Developing leaders within the organization (20%).** “If we can retain our core group of talent, we can do anything,” proclaimed one CEO. Another said, “One of my biggest concerns is the retirement of senior executives who have made a tremendous amount of money and decide to do something different. The question is how do you prevent that, and if it occurs, how do you support the rest of the team?” “Skill sets and brains will make the difference as it relates to consummating deals.” Simply put, “Focus on leadership,” advised one CEO.
- **Finding opportunities for capital deployment (17%).** In an unpredictable market, “It’s tough to deploy capital.” The large amount of equity capital seeking investment opportunities makes this even more challenging. Lamented one executive, “Too much capital is looking to be invested in too few assets. Too much of this capital is fee-based with those controlling investing the dollars not having enough of their own skin and dollars at risk. This historically has been an invitation for disaster.”

**Exhibit 2-2. Biggest Personal Challenge for 2008**



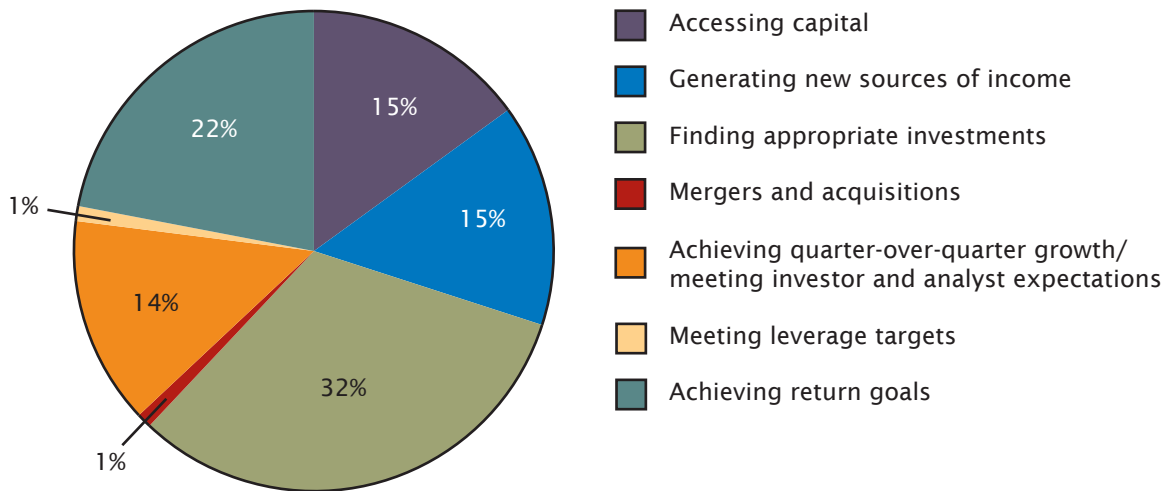
\* Responses include executing against dramatic expansion; getting enough sleep/balancing stress; staying motivated despite weak company leadership; accelerating enhancements to product quality to meet changing customer requirements; adjusting to deteriorating market conditions; and making money.

*Note: Respondents could select up to three answers.*

Many of our conversations with executives focused on how they'll weather the ongoing storms in the capital markets. "The financial crisis and resulting lack of liquidity reduces our business dramatically," remarked one respondent. "We could see a massive disruption of the capital markets," worried another. Not surprisingly, responses regarding the most significant financial challenges reflect these concerns. The responses differ from last year in that there's a less singular focus on finding investments and an increased level of interest in achieving returns and accessing capital.

- Finding appropriate investments (32%).** "Our biggest challenge will be finding do-able deals. There's too much capital chasing overpriced deals," lamented one CEO. "We're struggling to find the proper risk/return ratio in a volatile environment." Says another, "The uncertainty around expected future returns makes it very difficult to establish current value." Yet another explained, "It's difficult to find opportunities that meet our underwriting standards in a weakening market."

**Exhibit 2-3. Biggest Financial Challenge for 2008**



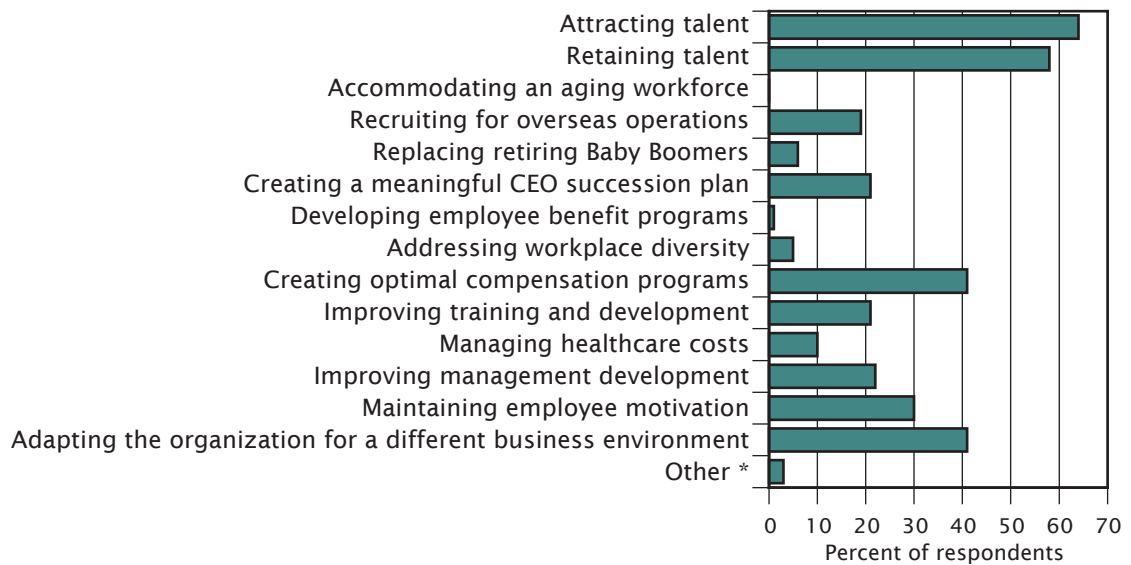
*Note: Respondents could select up to three answers.*



- **Achieving return goals (22%).** “Rising construction costs and interest rates,” “potential tax increases (is anyone currently running for office saying they’ll cut taxes?),” “too many legal/regulatory hurdles in the business,” “rising development costs,” “ever-steeper competition” — all these will combine to make the achievement of returns a challenge.
- **Accessing capital (15%).** “Capital availability to finance growth,” “shortage of capital,” “finding the last 35% of the capital stack from 65% to 100%,” “obtaining capital that is priced right” — across all sectors, capital availability is clearly a concern.
- **Generating new sources of revenue (15%).** Many are seeking new revenue streams: “we need to come up with new products,” and “we’re developing new lines of business.”

As in 2007, attracting and retaining talent are the top human capital challenges for industry leaders, followed by the creation of optimal compensation programs. There appears to be a slightly stronger focus this year on recruiting talent overseas as well as on CEO succession planning.

**Exhibit 2-4. Biggest Human Capital Challenge for 2008**



\* Responses include building/implementing technology tools; managing cost of human capital to enhance deal flow; and dealing with immigration reform.

*Note: Respondents could select up to three answers.*

## IN THEIR WORDS:

# Challenges

### On the capital markets:

- “The upheaval in the financial markets should take some of the frothiness out of the system as mortgage lenders apply more realistic underwriting standards. This will remove the highly leveraged buyers from the market who were more oriented to the financial engineering of the product than to the underlying aspects of the real estate.”
- “I worry about a number of things catching up with us. About 5% of sub-prime loans are now in default. If that number reaches 30%, we will have a social problem. There will be lawsuits facing many entities such as homebuilders and lenders. It will be a return of the ‘Enron Era.’ If this happens, the capital markets will unquestionably pull back.”
- “I’m concerned about the rating agencies melting down. After all, they’re the ones who rated these mortgage pools. Other resources are quite limited. Right now, we are keeping everything on our balance sheet except for what we can sell at par. If we have to sell mortgage pools at huge discounts, we will move from a liquidity crisis to a true credit crunch, which is problematic for everyone involved.”
- “Any sustained dislocation or downturn in the real estate capital markets would clearly have a negative impact on transaction volume, adversely impacting various elements of the CRE finance industry and the commercial real estate brokerage business.”
- “Financial market turmoil has decreased credit capacity for even the strongest borrowers.”

### On finding appropriate investments:

- “The obstacles to success relate to identifying attractive investments that can be acquired at pricing that does not strictly benefit the seller.”
- “Our biggest obstacle is a limited universe of quality product.”

### On accessing capital:

- “The big question is what ratings will be applied to commercial paper. Until some of this gets washed through the system, a number of big financial institutions will not be able to do much business, and if in fact they ‘hit the wall,’ real estate fundamentals will be impacted.”
- “My biggest concern is that our owners are not reinvesting in their assets, but are pocketing the rewards generated by their business success. This is disconcerting to us, because in order to be successful in our business, one needs scale and properties attractive to our customers, because there is plenty of competition.”

## “The current ‘Gen Y’ has a very different view about work than past generations . . . They are not driven by the same goals that organizations have been set up to meet.”

- “We need access to capital that is focused on long-term, stable returns.”
- “We have developed a strategy of multiple funds/programs and ventures. Each one requires a distinct capital raise. This is going to be a big challenge!”
- “The challenge in the hospitality business today is for our development partners to find financing so that they can build properties.”
- “Consummating any transaction today depends upon one’s ability to obtain financing. A lot of assets are being re-priced. I don’t think we will see increased liquidity in the credit markets until early 2008. We don’t see a lot of the commercial banks or other portfolio lenders coming into the void.”
- “For the first time, the willingness of European Central Bank to accommodate the flow of capital will be critically important. Expect LIBOR to decrease in the second half of 2008.”
- “A key challenge will be attracting investors, getting them to accept lower returns, and keeping them interested in real estate over the long term.”

### On human capital:

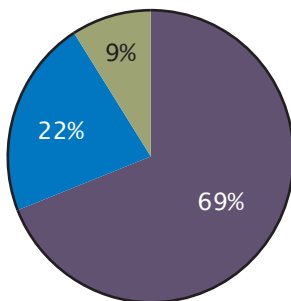
- “There are rumors that [a major investment bank] may be downsizing. There may be finally opportunities for us, among others, to let B players go and attract A players. Before, we had to pay a premium just to hold on to our B players.”
- “An important strategic challenge is paying people and retaining them. We have opted to pay up for quality people and not run the risk of compromising our organization.”
- “A huge issue is the industry’s inability to develop its talent relative to succession. From 1992 through 2002, the industry wasn’t doing much to attract young, highly talented people. [Some firms have] done a better job of that, recruiting both from within and outside the real estate industry. They’ve established mentorship programs and moved people across functions. While many of these people are young, they’re being pushed to take on more responsible roles simply because there’s no other choice.”
- “Unfortunately, our industry is horrible at planning for stress. And the easiest way to prepare is to make sure that your people are well trained to deal with asset restructurings and workouts. Unfortunately, the last time that this happened was in the late ‘80s and early ‘90s, so most of the people in the business who are 45 years old and younger have no idea how to respond.”
- “Given the increasing diversity in this country, we’re going out of our way to recruit and develop women and minorities.”

# Opportunities

So how does all this translate into the outlook for revenues and profitability? Despite their concerns about the economy, most executives expect 2008 to be an improvement over 2007. 69% forecast increases in revenues, and 71% expect their profitability to increase. Declines in revenue and profitability are predicted by only 9% and 11%, respectively. While positive, these projections are significantly more conservative than last year, when 85% of respondents predicted increased revenue and 80% predicted improved profitability.

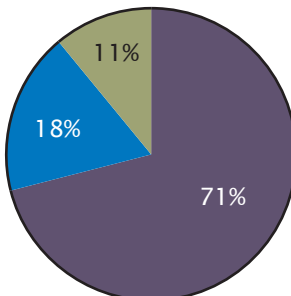
**Exhibit 3-1. 2008 versus 2007**

## Revenue



- 2008 revenue will increase over 2007 levels
- 2008 revenue will be approximately the same as in 2007
- 2008 revenue will decrease from 2008 levels

## Profitability



- 2008 profitability will increase over 2007 levels
- 2008 profitability will be approximately the same as in 2007
- 2008 profitability will decrease from 2008 levels



Here's what respondents told us about the most exciting opportunities they see for their businesses in 2008:


- **Globalization.** A majority of participating executives cite “continued overseas growth, particularly in Asia” as a major opportunity. Many are devoting untold resources to “building a global platform” and “expanding product lines and distribution to clients in new geographies.” “Remember that the United States represents only a third of the global market, and 75% of the institutional capital to date has been invested in the United States. Investors simply want to go global.” And the capital is flowing in from abroad as well. “There’s a lot of European and Middle Eastern capital that will come into the U.S. due to the weakness of the dollar.”
- **The silver lining.** An overwhelming number noted that the current uncertainty in the market will prove to be advantageous for their companies, providing opportunities as “the cream rises to the top.” As those companies which are hardest hit by the retraction of the debt markets are forced to downsize, others in strong positions to steal market share are “ready to pounce.” Industry consolidation is expected to continue.
- **Work environments and technological advances.** With globalization and contracting margins comes an increased focus on technology as a way to reach new markets and improve operating efficiency. Companies are using technology and product innovation to improve efficiencies and increase market share by better meeting customer needs. One executive noted that technological improvements necessitate more thoughtful use of workspace: “Technology is a tremendous tool toward productivity, but has hindered the personal relationships fostered through face-to-face meetings. A volley of terse emails and endless conference calls wastes time through miscommunication. I foresee increased demand for office space and wiser use of technology to foster better communication and productivity.”
- **Diversification.** Companies are rapidly expanding into new markets and new property types, and they’re highly focused on building new relationships to accomplish this. “A while ago, we focused on strictly apartments, but now we’re doing other property types such as industrial, office, and retail.” Another sees “real opportunity in bringing real estate investment products to multiple channels: institutional investors, high net worth investors, foreign investors.”
- **Growth in existing markets.** Not all growth will come from the foray into new markets. Many are refocusing on their core businesses as the most important area for growth. “We are focused on our current portfolio, and protecting our downside.” Said one lender, “In the small loan space, we have an excellent process and can churn out big time volume, and hence we can make 20 basis points. Ours is a Toyota business, among lenders who prefer the big deals (Ferraris), and that’s just fine with us.” Said another, “We’re driving growth in our core business on a focused basis.”
- **Green building.** The trend towards sustainable practices is providing opportunities for forward-thinking developers. “Sustainability of real estate development: the new mainstream movement in real estate!” declared one. “The continued shift towards high performance sustainable (aka ‘green’) real estate development and operations will create tremendous opportunities for early adopters/leaders not only because this is where the industry is moving towards but also because such a fundamental change will reduce cost, increase efficiency and profitability, and mitigate risk.”

IN THEIR WORDS:

# Opportunities

## On taking advantage of the current environment:

- “We’re keeping our powder dry, hoping there will be opportunities.”
- “From my perspective, it’s back to reasonableness and lending as we did it before. Financing 85% of a transaction, irrespective of price, is simply ridiculous. Lenders were doing anything to get a transaction done.”
- “The good thing that’s happened in the market today is that leverage is no longer king, but cash is king. You’ve got to put 30% equity into deals, whereas before, 15% was acceptable. We were losing a lot of transactions to these highly leveraged investors. And these were the value-added transactions, in which our firm was particularly interested given the return opportunities.”
- “If the business gets tough, those firms that have been in business for awhile will fare much better. The more recent startups will have no track record of success, and their recent investments will probably not fare all that well given the prices that were paid. In fact, some investment managers may ask other firms, like ours, to take over a startup investor which has a troubled portfolio. These startups jumped into the momentum game, and may not survive.”
- “We’re buying distressed development deals at a discount.”
- “After a five year bull market in real estate, the next several years will finally be more balanced, which should lead to real value opportunities for contrarian investors.”
- “We’ll grow our market share while our competitors are downsizing.”
- “This downturn is better for us. We understand the real estate and come at it from an asset management perspective. Many of the other firms in the finance business are much less competent, and will flush out on some basis.”
- “We feel that the credit crisis was a welcome relief. We felt the last eighteen months were unsustainable, and now it’s back to the fundamentals for the business. We were on the edge of too much financing driving deals that weren’t making that much sense. And now we feel that there are good opportunities for growth.”
- “We still have access to debt and equity capital while our competition seems to have trouble with this.”
- “We’re finding public-to-private arbitrage opportunities.”



“We have chosen not to ‘chase the rabbit down the hole.’ In short, the frenzy in the industry should slow down, and this is a good thing.”

**On globalization:**

- “The opportunity today is global diversification, because that is what investors demand.”
- “Today, as we look to fund-raising efforts, it’s easier to raise a global fund, and then utilize our own discretion in investing around the world versus betting on one market which could become troubled pretty quickly.”
- “Interestingly, South America is reasonably robust.”
- “Globalization is here to stay, and that’s influencing their business significantly. The GDP growth in some of the secondary markets around the world is quite extraordinary at 6% to 12%. The weak dollar is also helping the export picture. So industrial real estate firms that have the capacity to go global should be aligned to perform well in the future.”
- “I do think that the [seniors housing] industry will continue to globalize in order to grow.”



# Conclusion

With the industry in a constant state of flux, it's impossible to predict what the business environment will look like even a few months from now, let alone what *Leading the Enterprise™ 2009* will reveal. What we do know is that the industry's leadership expects the majority of change to be driven by a few major forces:

- **Economic Factors.** “What’s keeping me awake at night? Interest rates, debt margins, cap rates, employment, income growth, construction costs, inflation, housing values — the list of economic drivers that are keeping executives awake at night is a long one,” said one executive. “As with any industry, supply and demand drive change. Real estate is no exception,” said another.
- **Globalization.** “The biggest driver of change in the real estate business is the impact of global markets, both in the sense of exploring foreign markets for investing and attracting capital to the U.S. (which is currently on sale for foreign buyers due to the weak dollar),” explained one. Another said simply, “Globalization, globalization, and globalization.”
- **Capital Flows/Availability.** “The cost of capital always drives real estate,” and capital flows are a major concern. Many worry that “changes in the credit markets and the economy will dampen capital flows,” and some believe “the abundance of new, inexperienced, capital entering the space will have dilutive impacts.”
- **Changing Investor Climate.** “Private equity investment appetite” is growing as real estate “emerges as a mainstay of the broader capital markets.” Real estate is now “a valid asset class even in this economic climate of uncertainty and chaos on Wall Street, and [we expect that] pension funds and other institutional investors continue to increase their allocation to real assets.”
- **Demographics.** Trends such as the “aging of the world population,” and the impact of “Boomers, echo-Boomers, and Gen-Xers who are spending more time and money on lifestyle and leisure pursuits” are driving demand and changing the profile of the labor pool.

Amidst so much uncertainty, one thing is clear: it's going to be a very interesting year.



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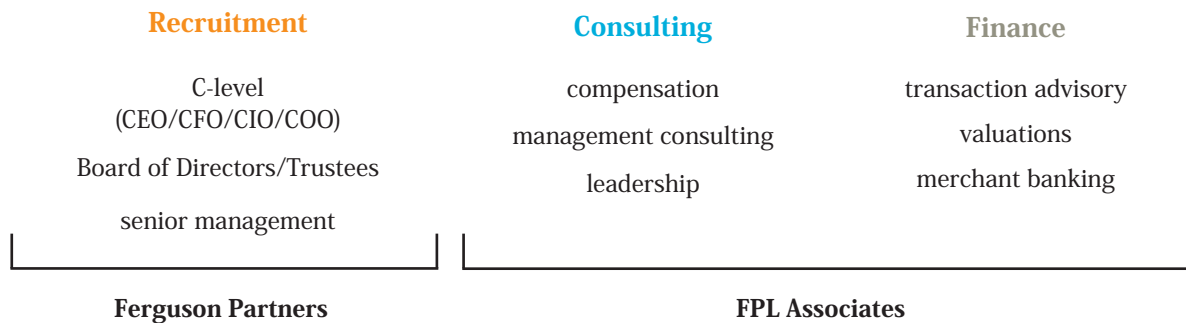
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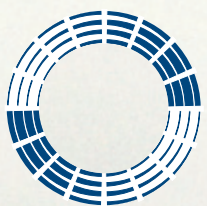


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# Leading the Enterprise™ 2008

Based on surveys of and interviews with nearly 200 senior executives in real estate-related industries, *Leading the Enterprise™ 2008* is a unique report that addresses the outlook for the coming year based on the experiences and observations of industry leaders. The report looks at the challenges and opportunities that will affect companies in this space, and offers an inside look at how executives and board members foresee the 2008 business environment.

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