NO BUST NO BOOM

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FOREWORD

Forecasting real estate trends is an inherently risky activity. Unforeseen events can suddenly turn the tables on the most carefully researched prognoses—at the most inopportune moments. Each year our *Emerging Trends* interviews and surveys are conducted during the summer and the report is written and edited in September. As this year's interviews progressed, our respondents grew increasingly gloomy about economic prospects, and fears of recession intensified. Reading economic tea leaves requires leaps of faith and creates discomfort for prognosticators under any circumstances.

1971 — 2001

Then on September 11, the odious terrorist attacks in New York and Washington stunned the markets and dashed everyone's sense of security. Today, uncertainty reigns. Risk—both personal and investment—has increased. America feels more vulnerable than at any time in the past 50 years—even during the nuclear scares of the Cold War. The '90s decade of stock market wealth creation and peace dividends seems like a Disney dreamworld in retrospect. First the tech bubble burst; now Americans' rock-solid confidence in the future has been bruised.

Our soundings in the wake of this unprecedented tragedy indicate that the United States, its economy, and its real estate markets stand well positioned to weather the challenges that loom—inevitable business downturns, rising global tensions, even the prospect of warfare. The country has steeled itself, and its reservoirs of determination, creativity, and wealth run deep. The collective wisdom of our more than 150 industry experts—investors, developers, lenders, brokers, researchers, consultants, and planners—points realistically to a difficult, but manageable year ahead, with most investments staying solidly in the black. A potent combination of public market discipline, low interest rates, and controlled supply have kept real estate markets in relative equilibrium—ready to withstand reduced demand from the expected recessionary fallout.

Now in its 23rd year, *Emerging Trends in Real Estate* is published by Lend Lease Real Estate Investments and PricewaterhouseCoopers. PwC conducts the invaluable interviews and surveys of real estate leaders and Lend Lease writes and produces the report, which is recognized as the industry's most respected annual forecast. Both companies provide additional research and executive insights.

As always, we thank our interviewees for their considerable time and informed perspectives. Our hearts and prayers go out to the victims of the horrendous skyjackings and nightmarish destruction of the World Trade Center and Pentagon. New York's skyline may be temporarily scarred, but the nation's spirit and enduring values will sustain our resilience—certainly in the year ahead.

PRICEWATERHOUSECOOPERS LLP

LEND LEASE REAL ESTATE INVESTMENTS, INC.

CHAPTER 1

NO BUST NO BOOM

The beat goes on. Real estate weathers its cycles and economies suffer their inevitable recessions. Last time around, real estate led the downturn—in an orgy of blind lending and overbuilding. Now more of a "bystander" than driver, commercial property feels the whiplash of the tech bloodbath and the searing aftermath of terrorist strikes on U.S. soil—sharp reminders that double-digit performance isn't forever and opportunity funds cannot guarantee 20%-plus returns. The beat goes on and on.

2002 should mark the nadir of a sudden correction in U.S. real estate markets, ushering in a modest growth phase for the 2003-2005 period that closely tracks the economic turnaround. Equilibrium will be tested, but most markets will stay in relative supply-demand balance despite recently climbing vacancy rates and rent declines. New development, though ample, appears under control in most areas. "Overleasing occurred, not overbuilding." In 1999 and 2000, "we borrowed against the future, with all the leasing growth from dot-coms and telecoms—particularly in certain cities. Now we're coming back to earth."

Expect total unleveraged real estate returns for 2002 to reflect continued strong cash flows from established, well-leased properties combined with flat value growth or even marginal value decline. That translates into performance ranging from 7% to 9%. If the economy tanks into a feared L-shaped recession and remains in a trough, corporate growth and consumer spending will be squeezed more severely—putting a further damper on returns. "The economy is the bogeyman," says an interviewee. "You tell me what the economy does and I'll tell you how bad real estate can get."

"Appreciation, you are the weakest link," quipped a portfolio manager, voicing a common concern. REITs can expect a choppy year—with cash flow growth crimped but basic dividends remaining high. Long-in-the-tooth opportunity funds, especially those employing liberal leverage strategies, will take haircuts—possibly worse if they're forced to cash out in hiccuping markets. But opportunistic investors should find deals in the market dip—it could be their best year to buy since the 1997-98 period. And may be the best acquisition year of the slower-growth cyclical updraft forecasted to follow.

"On balance the real estate downturn will be modest," says a research guru, "feeling worse than reality." For disheartened investors, the realization is sinking in—a prodigious seven-year expansion is over, with no prospects for another tech-propelled demand surge soon. But unlike the stock market retreat, withdrawal from the best of times for real estate will be tempered, because markets did not get radically out of whack. Returns should stay safely in the black, absent a capital-market shock or economic debacle—although after September 11 nothing can be taken for granted.

Tenants facing imminent lease rollovers are now sighing in relief—the daunting landlord's market is over. In some recently overheated office markets, even humble rent concessions and (can you believe it!) broker cold-calling returned when the "artificially" high rates vaporized along with e-business dreams. Rental rates and pricing should settle back into the range of replacement cost, allowing properties to chalk up solid income gains as old leases roll over. If those rent spikes seemed too good to be true, they were! At least, most dealmakers were rational enough not to underwrite transactions at unrealistic market tops. What a dramatic contrast from a decade ago, when the industry blew through the limits of reasoned investing without hesitation—and then collapsed.

A CRUCIAL YEAR

With growth prospects retreating, 2002 promises to be a critical time for defining real estate's future position in investors' portfolios. How performance behaves will determine "whether we've finally grown up. Are we legit or not?" according to a prominent pension fund real estate advisor. The stigma of the early-1990s debacle won't be easily expunged, but if portfolio cash flows hold firm—and fundamentals suggest they will—strong income yields should draw increased interest from capital sources for equity and debt investments. "Real estate will be better regarded if it can get through this cycle without being the whipping boy again." The stakes are large. In the event of a real nosedive, a lot of players could be turned off permanently.

On the equity side, all eyes focus on pension funds. To date, they've been reluctant to raise real estate allocations in their mixed-asset portfolios from a "why bother" 3% average. The stock market slide combined with recent solid property performance has overweighted real estate allocations for many plan sponsors. Skittish about performance, nervous about world events, and wedded to their asset targets, many funds have pulled back from the public and private property markets altogether or are taking a wait-and-see approach. "Capital demand has fallen off the cliff." But en masse Baby Boomer retirements loom, and plan sponsors arguably will need income-oriented investments like core real estate to meet their growing liabilities by the beginning of the next decade.

Conservative plan sponsors are typically slow to move off their laboriously considered investment programs, and they insist on extensive studies with consultants before making meaningful adjustments. However, if property returns hold their own in 2002, and income maintains its premium to bonds, real estate's checkered reputation will be boosted.

Meanwhile, the youthful but highly influential CMBS markets—commercial mortgage-backed securities—will be tested for the first time by rising delinquency rates and foreclosures. Hotels and retail

What a dramatic contrast from a decade ago, when the industry blew through the limits of reasoned investing without hesitation—and then collapsed.

could be trouble spots. Everyone will be gauging market psychology if bad loans proliferate and special servicers drop the hammer on struggling borrowers. "Worst case delinquencies will run around 3%"—less than half the 1993 commercial lending industry peak—predicts a conduit pro, echoing the consensus view. "It should be manageable." If CMBS weathers the squall without disappointing its growing legions of fixed-income investors and hangs onto its fragile cartel of B-piece buyers, the public markets will establish themselves definitively as the primary future source for commercial mortgage capital.

The beat goes on, but there's no doubt about it: 2002 will be an important year.

CUSHIONED DOWNSIDE

"The real estate industry never projects downward shifts very well," a wizened pro admits resignedly. Ditto Wall Street analysts for the stock and bond markets. Self-preservation dictates that the Chamber of Commerce doesn't short itself: when a downdraft hits, hopes and wishful thinking cloud the forecasting. Without exception, *Emerging Trends* interviewees focus on the economy and emphasize that real estate appears relatively well positioned to weather a recession without too much self-inflicted damage. Here's why:

1

Markets have been in equilibrium.

Office vacancies are climbing, but from extremely robust occupancy levels. Apartment and warehouse markets have been solid; while demand slippage could cut into income growth, their considerable staying power should help ride out any economic decline. Hotel profitability had been at record levels, and most operators felt well insulated to contend with an economic slowdown. But the "crushing" fallout from the terrorist attacks in New York and Washington will test the lodging industry well into 2002. The recession will also hit retail harder than other sectors.

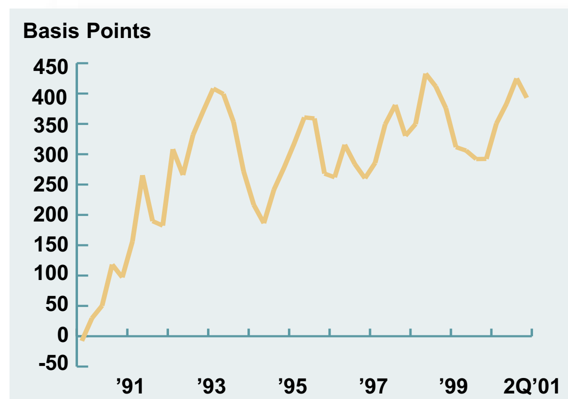
2

Attractive risk-return profile.

The enduring 300- to 400-basis-point spread between real estate yields and 10-year Treasuries offers investors an excellent risk cushion. "Real estate is a bargain except for the fear about the economy."

EXHIBIT 1-1

Spreads Between Real Estate Yields and 10-Year Treasuries



Sources: ACLI, Federal Reserve Bank, Rosen Consulting Group

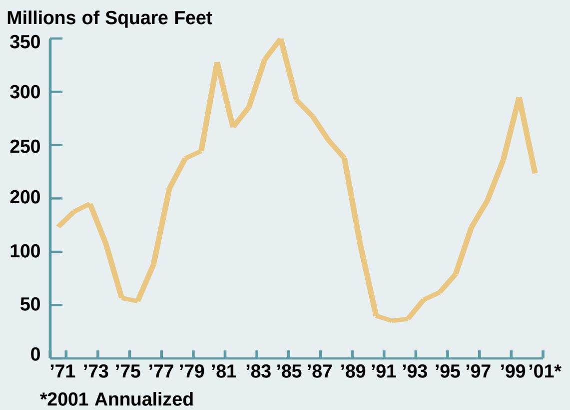
3

Supply is under relative control.

Don't be fooled: commercial construction has been ample—two-thirds of the previous prodigious peak in the mid-'80s. But lenders have been careful to restrain developers—especially in downtown office and hotel markets. Some high-flying telecom and tech office markets may have overindulged given the demand implosion, and certain suburban areas have softened, but they're the exceptions. Retail, in general, suffers a continuing glut of stores—what else is new? New residential projects are absorbed by renters as fast as they come on the market, and industrial never gets radically overbuilt. With the economy shifting into lower gear, developers realize

EXHIBIT 1-2

Office Construction



Source: FW Dodge

that 2002 won't be their year. Financing sources have pulled back, citing the greater risk. "We needed a recession to make sure construction stayed under control," says an interviewee. "It was getting going again, so it was time to be brought up short. Long run, this is good."

4

Lease structures offer protection.

Office rents may decline off spikes and drop to replacement cost levels; but lease structures lock in credit tenants through the downturns, and tenants with older leases set to roll over will still face new rents at levels well above what they had been paying. Even though "the excess has been taken out of the market," net operating incomes can still grow. "Real estate provides stability—high-credit leases bridge the gap of uncertainty."

5

Low interest rates help protect values.

Alan Greenspan's welcomed largesse—steadily dropping interest rates—shores up capital values. Most owners are far from distressed, benefiting from the option to refinance at highly attractive spreads to healthy property yields. Cash-strapped investors forcing buildings onto the market at bargain pricing are few and far between, and delinquency rates have stayed down.

In short, most real estate markets are operating from relative strength, not weakness, as the economic outlook turns gloomier. "My guess is that real estate is positioned better than the other asset classes, with better cash flows and market fundamentals," concludes an interviewee hopefully.

INCREASING RISK

Declining demand for space from a wounded U.S. economy, aggravated by developing economic malaise around the world and anxiety about U.S. reprisals to terrorist incursions, haunt *Emerging Trends* forecasts for 2002.

Setbacks at home—reduced business profits, the short-circuiting of the New Economy growth engine, record levels of consumer and corporate debt, massive wealth obliteration from stock market declines, and the devastating aftershocks of September 11—all spell further trouble in the form of rising unemployment, reduced business and tourist travel, and lagging consumer confidence.

The specter of rising global violence unsettles capital markets everywhere. Japan looks like a "basket case," volatile Asian economies suffer from enduring mountains of debt, and Latin American leaders—Brazil and Argentina—always seem to be reeling. Europe, meanwhile, sputters—despite all the promise from common currency and economic union. In this stew of afflictions, all regions seem to be marching in lockstep—in an uncertain direction. "The world's gotten smaller; the U.S. economy is no longer insulated," and U.S. borders are no longer secure from attack. Can federal pump priming, increased defense spending, effective action against terrorism, Bush tax cuts, and still-lower interest rates help ensure a rebound? They can't hurt, but the odds for a quick recovery early in 2002 get longer.

“Real estate provides stability—high-credit leases bridge the gap of uncertainty.”

TECH-WRECK CONTAGION

Expect the real estate markets to suffer through a two-stage demand decline before hitting bottom:

STAGE ONE of the tech wreck spewed a record level of sublease space into the markets, causing heavy concentrations of telecommunications businesses, e-business startups, and Internet wannabes to go belly up. “It was the NASDAQ phenomenon—all the growth industries expanded more rapidly than they should have and then reality set in.” Damage was not immediately widespread, but it stopped “unsustainable” rent growth in its tracks, sending rates that few players had taken seriously into a decline. Among the hard-hit areas were high-tech magnets like San Francisco, Seattle, and Austin; some suburban markets in Northern Virginia, Denver, Atlanta, and Boston; and pockets in Manhattan and outside Chicago. Regions without heavy New Economy activity—Southern California, South Florida—barely noticed a ripple. Stage one’s impact, generally felt by fall 2001, amounted to a sanity check and market true-up.

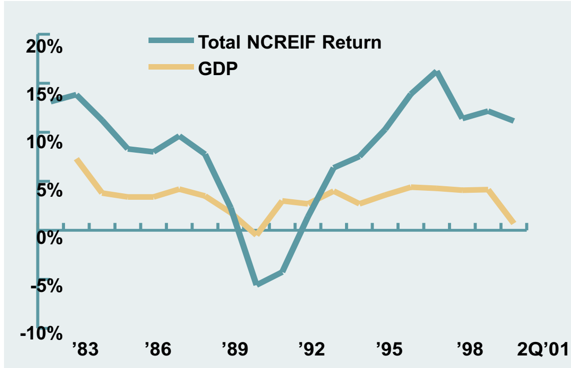
STAGE TWO will be felt into 2002 and will determine the depth of the real estate market downturn. After the economy’s growth engine stalled, financial markets turned south and overall corporate profits started to lean sideways. Companies were somewhat restrained about inevitable layoffs and budget cuts, keeping unemployment low—but the terrorist shockwave precipitated more downsizings and belt-tightening. “Watch the economy. Real estate will be following right behind.”

The greater the demand erosion in stage two, the greater the negative impact on growth in net operating income and the potential for value declines as vacancies rise and rents stagnate or drop further. But given their relative balance entering the downturn, the office, industrial, and apartment markets shouldn’t fall too far out of equilibrium. In a macabre twist, New York area office markets benefit from the destruction of the World Trade Center—space is at a premium. However, some companies could be forced out of the market altogether. Demographic trends—a population increase spurred by healthy immigration and impressive Echo Boom household formation prospects—portend a solid recovery in demand. And new supply will be restrained, helping to spur a more immediate upturn from bottom.

Don’t expect anything approaching the early-’90s bust. This downturn should look more like a dip. But don’t anticipate a rebound anything like the late-’90s boom, either.

EXHIBIT 1-3

Real Estate vs. Economy



Sources: U.S. Department of Commerce, NCREIF, Rosen Consulting Group

RESTARTING DEMAND DRIVERS

1

A more restrained cycle ruled by income.

The *Emerging Trends* consensus sees markets showing signs of recovery during the second half of 2002, “with marked improvement” into 2003, but it also anticipates slower growth than in the "bullish" 1995-2000 period. Markets should quickly move back into relative supply-demand balance with measured growth in returns, dominated by income. "In the private equity markets, that translates into a nice cash return and some appreciation with fairly small downside risk—but not a lot of upside," says a leading analyst. "People were turning up their noses at 10% returns. For the future they'll be quite nice."

"We won't be in a get-rich-quick business anymore," says a deal broker. "The market is accepting this reality and focusing on income and credit."

To achieve returns above 10%-12%, equity investors will need to employ debt strategies. "Careful use of leverage will be more important than it has been for a long time," says a transactions executive.

2

Reversion to the mean will limit opportunity funds.

It appears, in fact, that private equity markets may be headed into a period of normalization, reverting to the mean after the torrid bust-and-boom '90s. In the 1970s and '80s, real estate was sold as a bond-plus return diversifier and a great inflation hedge, based on its traditional performance. The past decade has arguably been an anomaly, spawned by the immense space-market dislocation of the late '80s, followed by the tech bubble. Overall investor expectations were further skewed by sky's-the-limit run-ups in the stock market. "Now real estate will be back to the 1950s—slow, steady, and predictable." In other words, core-style returns.

The back-to-cash-flow-basics outlook could frustrate opportunity investors in domestic markets. 2002 may be their last best chance to cash in for a while—albeit off a measure of disequilibrium. The bigger the market fallout, the better for them. "Investors don't believe they can get 20% returns anymore," says a portfolio manager of an enhanced-return fund seeking high-teens performance.

"You'll still hear 20% from the marketers because it sells, and the investment banks can make a lot more on fees at a 20% return than in the teens," warns a former Wall Streeter. "But the only way you're going to get such a high return is through a lot of risky leverage and a lot of luck."

By all accounts, major opportunity funds have been waiting on the sidelines "with a ton of commitments," ready to pounce on distressed sellers in the market downturn. "Our investors are saying 'don't rush, things will get cheaper,'" says one portfolio manager, who has banked over $1 billion in a war chest and still talks the 20% game. But he admits to looking for pop from fringe investment categories like senior housing and higher-risk overseas regions, as well as the more obvious candidates in tech-wreck-hammered office markets.

Appetites for future opportunistic investing may be dictated by what happens to funds in the process of cashing out properties and returning proceeds to investors. "Pension plan sponsors want their dollars back before they invest again in another round." Heavily leveraged funds could be in for trouble, especially if they bought at close to market peaks. At minimum, the 20% hurdle will be more difficult to vault in today's teetering markets than it would have been in 2000, when markets were just leveling off. Widened bid-ask spreads caused by rising uncertainty in 2001 derailed transactions markets, especially in the office sector. Then the terrorist rampage gridlocked deals. Some opportunity managers have bought time by refinancing investments to return some equity. "No one wants to leave money on the table. The general partners want their promote—they need to sell; it's not the best time. There's been a little bit of coming to Jesus."

“People were turning up their noses at 10% returns. For the future, they’ll be quite nice.”

Steady cash flows, relative equilibrium, low interest rates, slower growth. All add up to getting better risk-adjusted returns from core strategies than from seeking big rewards in opportunity funds. Twenty percent anyone?

3

REITs face a bumpy ride.

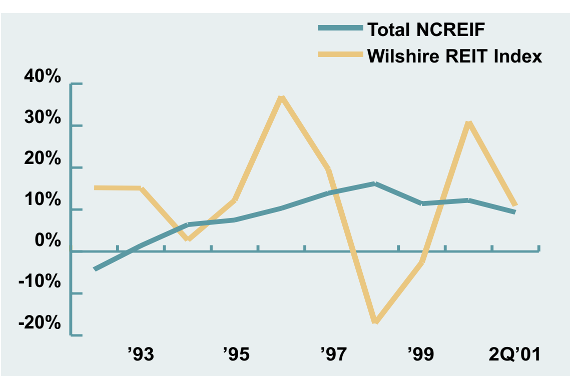
Impressive REIT yields and the stocks’ low correlation to other equities have turned real estate securities into an excellent defensive play in the otherwise floundering 2001 stock market. REITs also operate “quite independently” (i.e., they’re more volatile) from the private real estate markets, allowing investors “to use two different real estate approaches for asset diversification.”

The same economic fallout confronting private real estate investors will compromise REIT earnings growth into 2002—total returns could drop into the high single-digits after a nice two-year run-up. Will these stocks lose their allure if the stock market stages a rally? “It wouldn’t be shocking to see a correction,” says a well-known stock picker.

While dividends have been “delightful,” the stock group has experienced price volatility during the past decade. Analysts tapped REITs as growth stocks (1996-97), then savaged them after realizing they behaved more like utilities (1998-99). More recently, their dividend-oriented returns have been a welcome safe haven for mutual fund managers, and stock prices have been bid back up close to underlying values—they’re not cheap buys. Long-term investors should realize bond-plus returns akin to or slightly better than those from private equity real estate—but the ups and downs will call for patience. 2002 could be an especially bumpy year for the group, and market timers need to be careful.

EXHIBIT 1-4

Equity Real Estate Performance vs. REITs



Sources: NCREIF, Wilshire Associates, Rosen Consulting Group

If REIT stock prices can stay close to perceived net asset values, watch for the larger, well-capitalized companies to issue new stock and resume some accretive buying in the market downturn, helping to lower cap rates and restart the transaction markets.

Predicted REIT consolidation continues, and oligopolies of two or three major companies are dominating public market activity in each of the large property sectors. These stocks are the best bets. The addition of Equity Office to the S&P 500 provides a boost, helping mainstream the overall stock group, which had not been eligible for the index previously.

For the larger REIT companies, buying certain attractive cash-flowing assets may help performance on the margins. “But the bigger you are the harder it is for acquisitions, even package deals, to be accretive,” says a prominent REIT executive.

“We’ve got to become more like Corporate America—focused on earnings per share, and not so much on funds from operations,” says another interviewee. That means reducing dependence on asset performance for returns, and enhancing management fees and operations revenues. “We’ve got to operate more like other public companies, and less like a collection of assets. Stock investors want earnings growth, not hard assets.”

Smaller companies—especially those in fringe categories like health care, self-storage, and manufactured homes—don’t hold great investment potential. The overall stock group remains a tiny category on Wall Street ($150 billion), though it commands a sizable $260 billion in equity real estate when leverage is added. The group's thin market cap (equal to the California Public Employees Retirement System's total assets under management) keeps larger institutional investors from taking positions that will achieve real diversification benefits without liquidity problems cropping up. The size handicap won't go away.

4

Debt investors appear buffered.

Sustained health of the huge debt markets—four times the size of real estate equity—should be the paramount concern for real estate investors. Mortgage lenders and CMBS investors appear relatively insulated from major discomfort in a 2002 market downturn. "We're in the best shape ever entering a recession." Even if delinquency rates increase from their preexisting miniscule levels, "there will be no blanket pain and no widespread defaults."

General market equilibrium and the low-interest-rate environment buffer most owners from distress, let alone delinquency or default. Cash-flowing projects keep debt service coming.

"Some banks may have made a few bad loans on development projects, but in a portfolio context it will be no big deal," predicts a CMBS manager. "We're at the top of the cycle. The economy is faltering but we are well below the historic average of delinquencies (2%). Even if the average ratchets up to 2%, you'll still get outsized returns in your portfolio."

At greater risk may be some CMBS portfolios with heavy positions of loans underwritten "too aggressively" in the pre-1998 period. Hotel investments will also face pressure. Since the fall 1998 panic, ratings agencies have improved their oversight of issuers, and B-piece buyers have been unsparingly rejecting questionable loans from offerings. The loan pools have been well diversified and borrowers have laid out significant equity. "The odds of a B-piece failing in this market are still fairly long," says a conduit executive. Unrated buyers would be more vulnerable. "Worst case for unrated buyers investing over the past three years is they're even up."

Construction lenders, meanwhile, have been careful—demanding developer equity and recourse structures. Loans on bigger projects have required significant preleasing: 50% or more. "When banks do deals these days the terms are stiff." Some smaller, spec suburban-office projects in fringe markets may be in jeopardy, but a raft of mega-defaults, like the havoc ten years ago, isn't in the cards.

5

No mercy.

For troubled borrowers of securitized loans, the old days of wheedle-and-beg are history. "Borrowers will have no luxury in the workout environment." Not only will borrower defaults show up on the Internet, but special servicers will show no mercy in following loan documents to "whack" the deadbeats. "The buddy-buddy times are over," says a CMBS investor. "Special servicers have their obligation to the trust holding the loans, not the future business relationship with the borrower." This added discipline should "help stabilize the capital markets" if the environment gets rough.

6

Mezz debt warnings.

Almost universally, interviewees red-flagged mezzanine debt (subordinate higher-risk, higher-interest positions) as a problem waiting to surface. "There's ample mezz debt money out there; the problem is too many people raising money and putting it out." What's more, these are "inexperienced, younger Wall Street types, who've not yet dealt with the problem markets." "Three guys and a Bloomberg can start a mezz debt fund. It's the loose end of the debt markets."

THE TECH EFFECT REVISITED

Don't get trapped into thinking that the demise of many New Economy stocks means technology's impact on real estate investing is about to fade away.

Realize that overbuilding of fiber optic capacity and the failure to create profitable Web mousetraps are mere stumbles in the ongoing revolution of technological change.

Through the foreseeable future, the Internet, telecom advances, burgeoning broadband transmission, and satellite telemetry, as well as countless other high-tech enterprises, will continue unabatedly to work a dramatic transformation on commerce and lifestyles.

The impacts on real estate have been and will continue to be profound. Here's a scorecard:

1

We've moved into the second inning.

The tech wreck wasn't the end of the ballgame; it was just a passing manifestation of humankind figuring out how to utilize invention. Some companies struck out, certain players went on the disabled list, but the Internet lives and has become an essential tool for many businesses. Its promise remains exponential—people just need to determine how to use it more effectively. That's a matter of time.

2

The flow of property information approaches real time.

This improves decision-making and helps stabilize markets. "Real estate doesn't lag the economy anymore; any effects are felt almost immediately in the markets and people know about them." Transparency has improved markedly. Web sites post new leases, defaults and delinquencies, new vacancies, tenant moves, and transactions. "The knowledge curve is very quick and it's available to everyone. You used to wait six to nine months to figure out what happened; today the information flow acts like a circuit breaker on the markets." Supply and demand are better able to stay in balance, reducing the likelihood of boom-bust cycles and the disequilibrium favored by opportunistic investors. "Everybody is sensitive to the information flow. You won't see the extremes of the 1990s again."

3

Prime locations and flexibility *of space remain primary considerations for tenants.*

No change here. Locations near sources of power, trunk lines, and fiber connections will continue to be favored by companies. Nobody knows what the next tech wave will be, but space must be able to accommodate it. "Having buildings that can handle advanced tech needs gives landlords a definite advantage," said a major downtown developer. "There's not a whole lot of evidence that tenants take full advantage of the capacity, but they figure it may be critical later in their lease term and don't want to be caught short. It's like buying a VCR with 25 features, but all you know how to do when you bring it home is push play."

4

Don't dismiss e-retailing's impact *just yet.*

Most e-retailing ventures went the way of lemmings over the cliff, and most brick stores took large writedowns on their own Web sites when online profits never materialized. E-commerce has captured only about 1% of total sales, but it's made significant inroads in certain commodity merchandise categories—computers (17%), books (11%), and music and video (6%). Clearly, most e-commerce business models just aren't working. "It's been disappointing," says a mall REIT executive. "The reality is it will be a relevant distribution channel, but its adoption rate will be slower and it will be more of an adjunct to existing stores." New technology—maybe broadband, and better delivery and return systems—is destined to boost e-retailing concepts and eventually help cut into market shares of bricks-and-mortar locations. Retailers will use bricks-and-clicks strategies to retain as much market share as possible, and retail real estate owners will eventually get caught holding the bag. Shopping centers won't disappear by any means, but 5% to 10% loss in sales to another distribution channel will hurt, especially in the commodity sectors. It's a matter of time.

5

Just-in-time inventory and shipping systems *have transformed warehouses into distribution centers, concentrated at major regional hubs.*

Storage is out, logistics is in. Over the past decade the use of industrial space has been transformed by technology. The life cycle of older buildings has been telescoped and the growth curve for industrial space inventory has been lowered.

6

The **office is less important** *for conducting business.*

Naysayers say that hoteling doesn't work and hasn't caught on, but they miss the point. Most executives now do more of their work outside the office than ever before, enabled by an increasing variety of handheld e-mail devices, lightweight laptops, cell phones, and fax machines. "I'm as comfortable working at home or in an airport as in my office," says a facilities management executive. "I don't need to be there all the time." If office space is less essential, space per capita can stay low. "It's become embarrassing to have a big office." Secretarial and support staffs have been reduced. Voice mail, e-mail, and computer discs have turned file clerks and personal assistants into endangered species. "The trend to higher density in office space continues." Simply, technology allows companies to reduce their space needs and cut rent outlays.

7

Real estate **ventures into technology** *were a bust.*

If AT&T and MCI Worldcom saw profits die amidst a proliferation of competition and overcapacity, what business did real estate companies—high-tech virgins—have starting up telecom ventures? None. Ditto the landlords who took dot-com stock as lease warrants. "Tenants will need increasingly better communications and information distribution channels, but landlords are not going to make money on it."

8

The new economy will continue to be **an important demand driver.**

"We're just taking a breather," says a portfolio manager. Computer, software, communications, and other high-tech companies, including reconfigured Web firms, will proliferate in the future, filling office and R&D space. But nobody expects another out-of-control, speculative bubble or phantom 5% economic growth rate. Markets with high-tech concentrations are down temporarily, but they should rebound without long-term investor fallout.