

RCLCO

The Cycle



ULI Multi-Family Gold Council

Wednesday, November 6, 2013

11:00 AM – 11:45 AM

Charles Hewlett, Managing Director, RCLCO

The Cycle – where we are now, how do you know and what is your strategy going to be given where we think we are?

Discussion Topics:

- Where do you think we are on the cycle?
- When do you think the market will peak next?
- What are you doing to inform your “company view” of where you are, and where you are headed?
- How are you planning on adjusting your strategy in response to changing market conditions?
- What are some of the lessons learned from the last downturn, and how has that altered your strategy going forward?

Moderator:

- Charlie Hewlett – RCLCO

Panel:

- Bill Roberts – GID
- Roger Pratt – Prudential
- Matt Birenbaum – AVB
- Jay Hiemenz – Alliance



Position your company to not just survive, but thrive...

No better time to act than when things are going well...

Truly strategic companies:

- a) Process to monitor markets; and**
- b) Set of actions “cycle strategies” in advance**



IF HISTORY IS ANY GUIDE...

Since WW II = 11 cycles

- Average trough-to-peak = 5-6 years
- Shortest trough-to-peak = 12 months (1981-82)
- Longest = 120 months (1991-2001)
- Average = 58.4 months

1970-2009 = 7 cycles

- Average trough-to-peak = 71.0 months
- Average peak-to-peak = 81.7 months

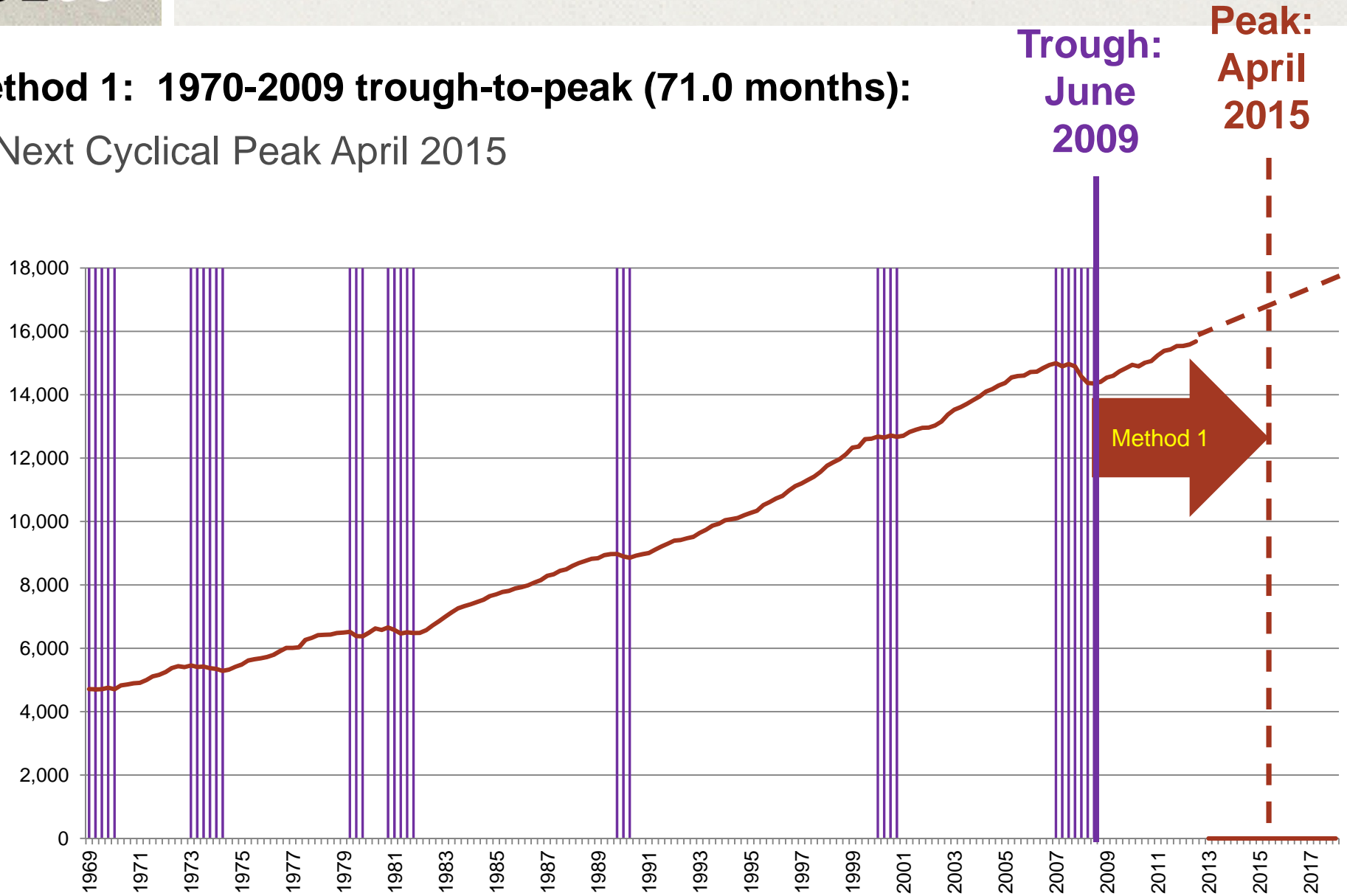
Source: National Bureau of Economic Research (NBER)

<u>BUSINESS CYCLE REFERENCE DATES</u>		<u>DURATION IN MONTHS</u>			
Peak	Trough	Contraction	Expansion	Cycle	
<i>Quarterly dates are in parentheses</i>		<i>Peak to Trough</i>	<i>Previous Trough to this Peak</i>	<i>Trough from Previous Trough</i>	<i>Peak from Previous Peak</i>
June 1857(II)	December 1858 (IV)	18	30	48	--
October 1860(III)	June 1861 (III)	8	22	30	40
April 1865(I)	December 1867 (I)	32	46	78	54
June 1869(II)	December 1870 (IV)	18	18	36	50
October 1873(III)	March 1879 (I)	65	34	99	52
March 1882(I)	May 1885 (II)	38	36	74	101
March 1887(II)	April 1888 (I)	13	22	35	60
July 1890(III)	May 1891 (II)	10	27	37	40
January 1893(I)	June 1894 (II)	17	20	37	30
December 1895(IV)	June 1897 (II)	18	18	36	35
June 1899(III)	December 1900 (IV)	18	24	42	42
September 1902(IV)	August 1904 (III)	23	21	44	39
May 1907(II)	June 1908 (II)	13	33	46	56
January 1910(I)	January 1912 (IV)	24	19	43	32
January 1913(I)	December 1914 (IV)	23	12	35	36
August 1918(III)	March 1919 (I)	7	44	51	67
January 1920(I)	July 1921 (III)	18	10	28	17
May 1923(II)	July 1924 (III)	14	22	36	40
October 1926(III)	November 1927 (IV)	13	27	40	41
August 1929(III)	March 1933 (I)	43	21	64	34
May 1937(II)	June 1938 (II)	13	50	63	93
February 1945(I)	October 1945 (IV)	8	80	88	93
November 1948(IV)	October 1949 (IV)	11	37	48	45
July 1953(II)	May 1954 (II)	10	45	55	56
August 1957(III)	April 1958 (II)	8	39	47	49
April 1960(II)	February 1961 (I)	10	24	34	32
December 1969(IV)	November 1970 (IV)	11	106	117	116
November 1973(IV)	March 1975 (I)	16	36	52	47
January 1980(I)	July 1980 (III)	6	58	64	74
July 1981(III)	November 1982 (IV)	16	12	28	18
July 1990(III)	March 1991 (I)	8	92	100	108
March 2001 (I)	November 2001 (IV)	8	120	128	128
December 2007 (IV)	June 2009 (II)	18	73	91	81
Average, all cycle: Months					
1854-2009 (33 cycles)		17.5	38.7	56.2	56.4
1854-1919 (16 cycles)		21.6	26.6	48.2	48.9
1919-1945 (6 cycles)		18.2	35.0	53.2	53.0
1945-2009 (11 cycles)		11.1	58.4	69.5	68.5
1970-2009 (7 cycles)		11.9	71.0	82.9	81.7

NEXT CYCLICAL PEAK?

Method 1: 1970-2009 trough-to-peak (71.0 months):

- Next Cyclical Peak April 2015

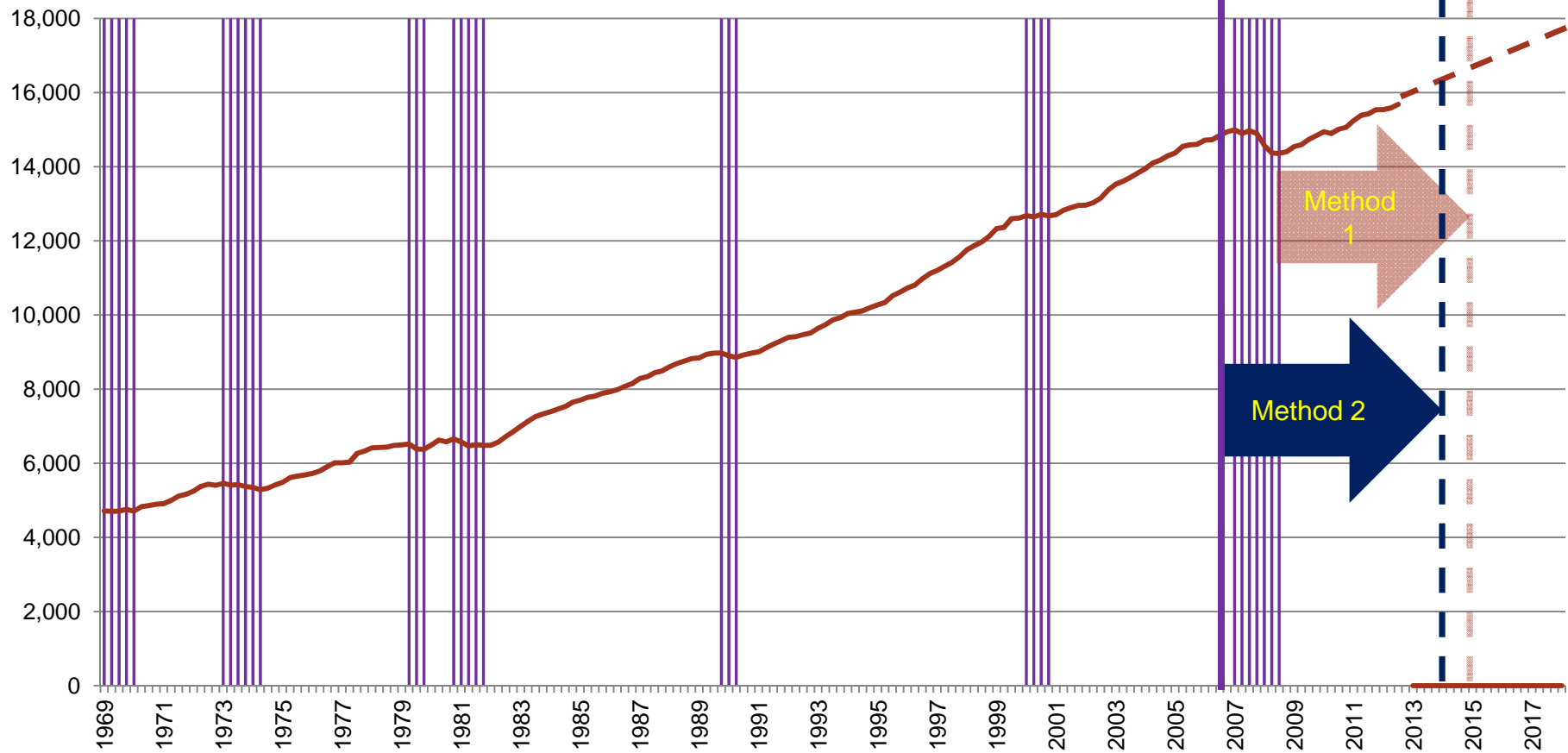


NEXT CYCLICAL PEAK?

Method 2: 1970-2009 peak-to-peak (81.7 months):

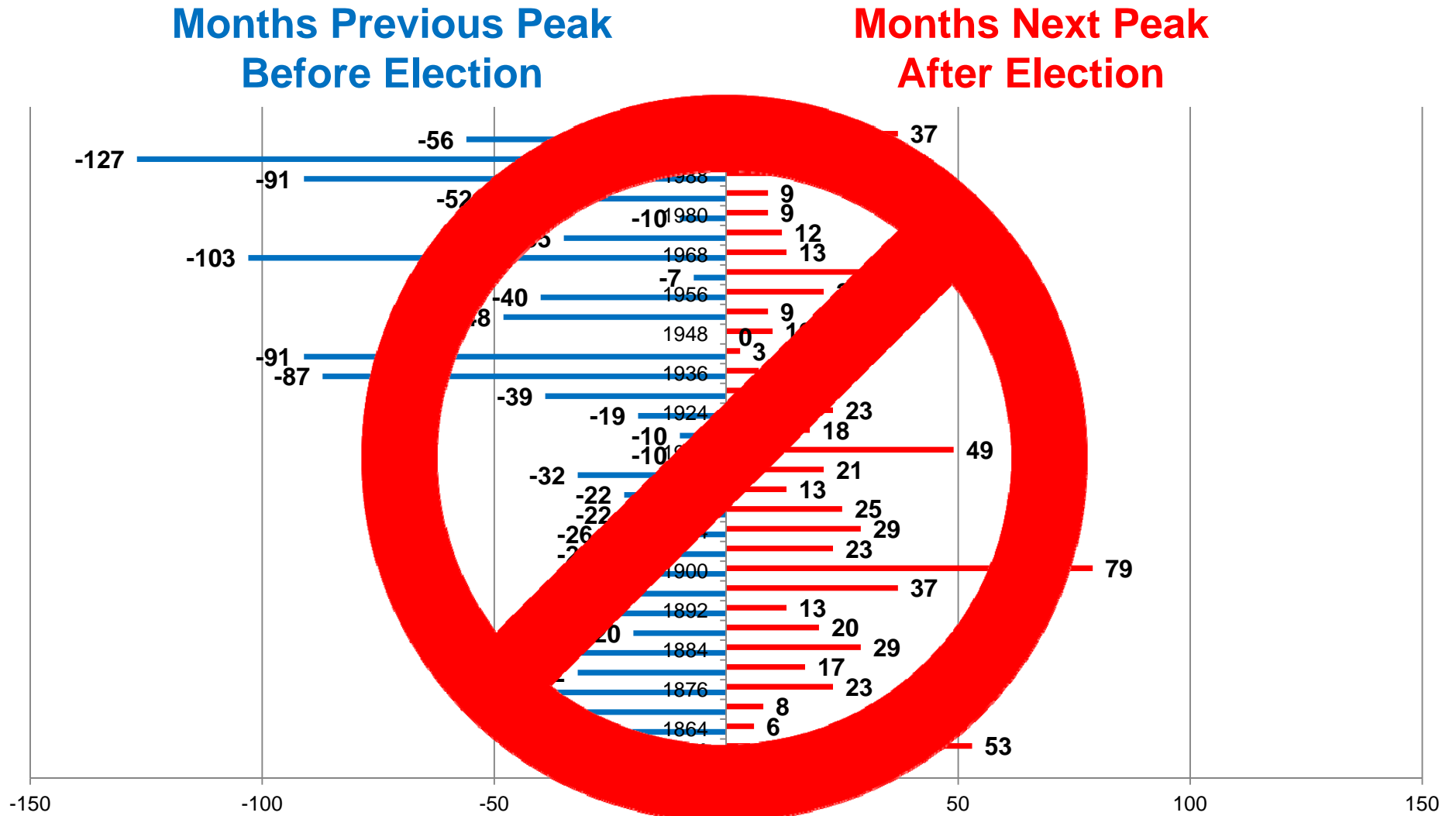
- Next Cyclical Peak August 2014

Peak: December 2007
Peak: August 2014



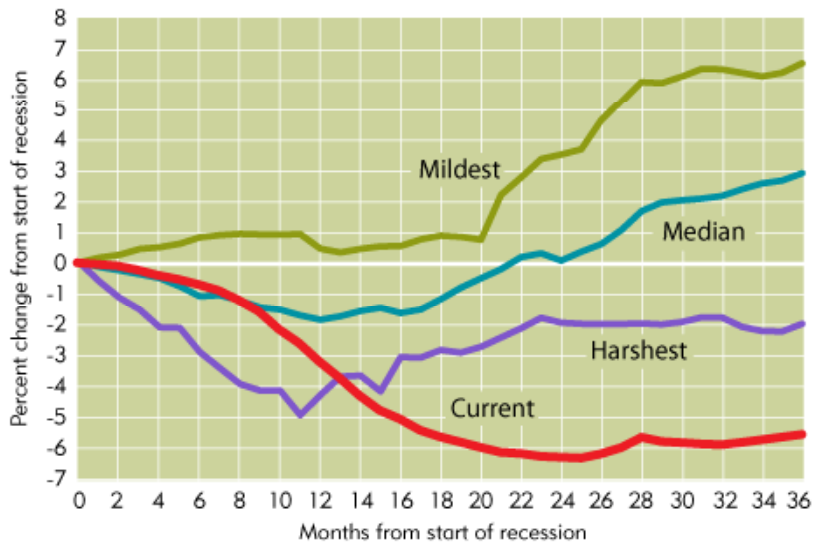
ELECTION CYCLE – CONVENTIONAL WISDOM?

The next peak will occur after the 2016 election cycle...



GREAT RECESSION – ENDED JUNE 2009?

Change in U.S. Employment through 36 Months: 2007 – 2009 Recession vs. Summary of 10 Postwar Recessions

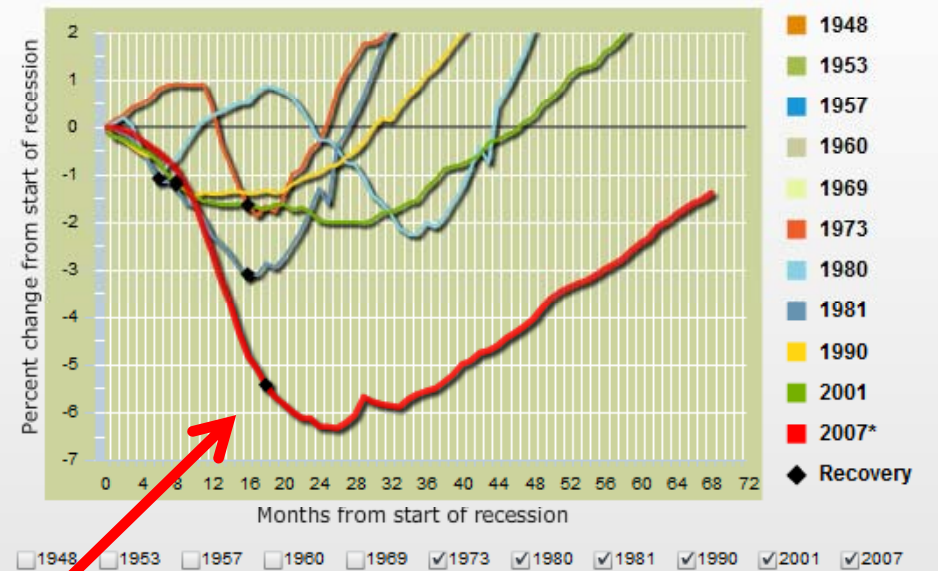


Updated March 4, 2011

*Mildest, median, and harshesht lines reflect the smallest, median, and largest declines as of each month; they do not reflect specific individual recessions.

Source: Federal Reserve Bank of Minneapolis

Change in U.S. Employment: Recessions



Updated September 6, 2013

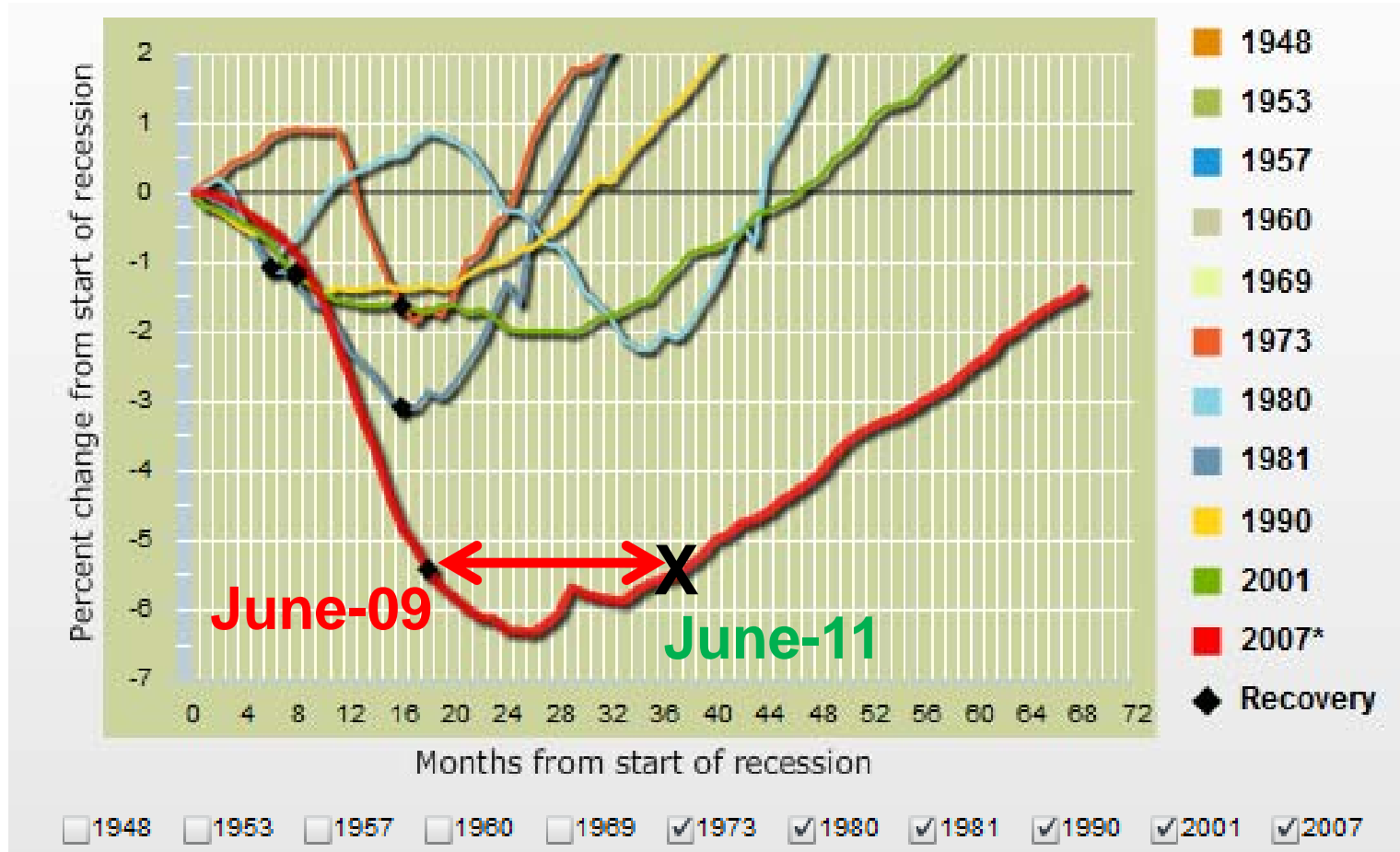
*Start of the recovery for the 2007 recession is June 2009.

Source: Federal Reserve Bank of Minneapolis

June-09

ACTUAL RECOVERY AFTER SEVERAL MONTHS OF POSITIVE JOB GROWTH = JUNE 2011

Change in U.S. Employment: Recessions



Updated September 6, 2013

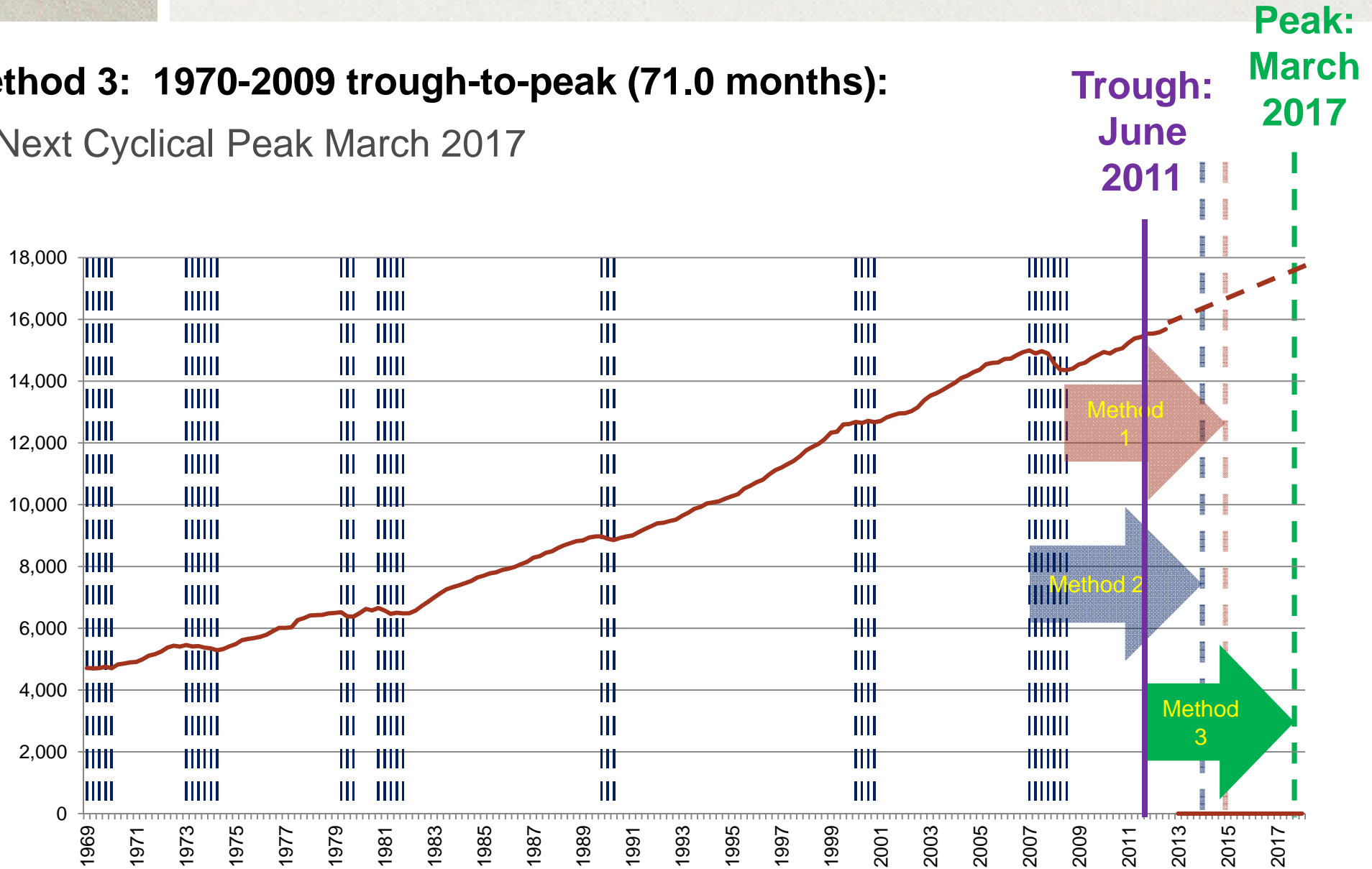
*Start of the recovery for the 2007 recession is June 2009.

Source: Federal Reserve Bank of Minneapolis

NEXT CYCLICAL PEAK?

Method 3: 1970-2009 trough-to-peak (71.0 months):

- Next Cyclical Peak March 2017

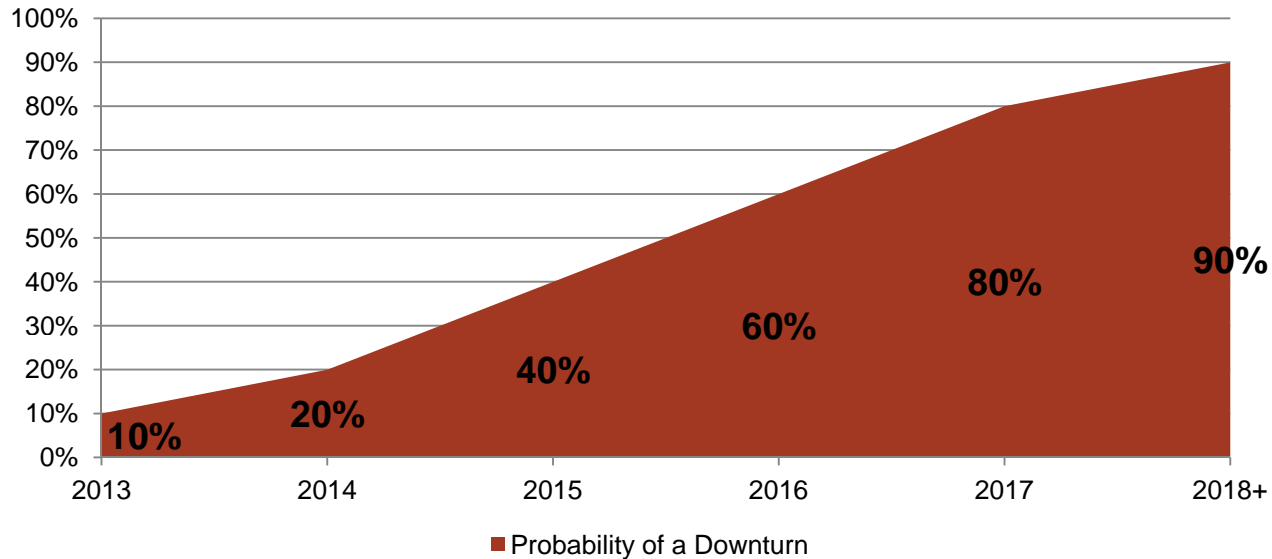


So now we have narrowed it down .

- The next cyclical peak will occur on a Thursday sometime between August 2014 and March 2017.
- You're welcome.

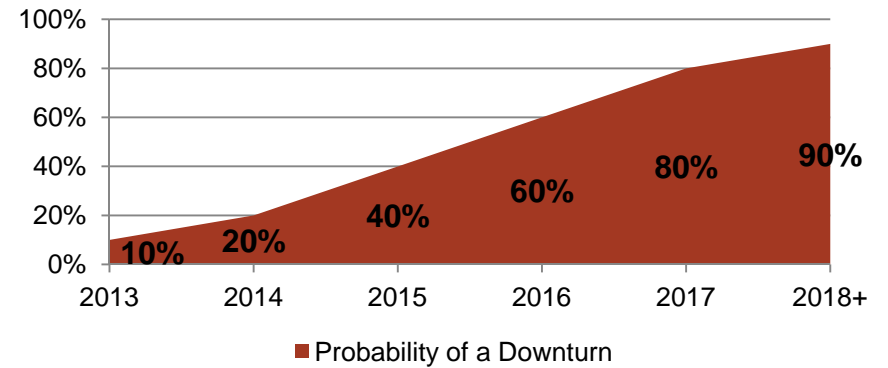


Better to talk in terms of probability:

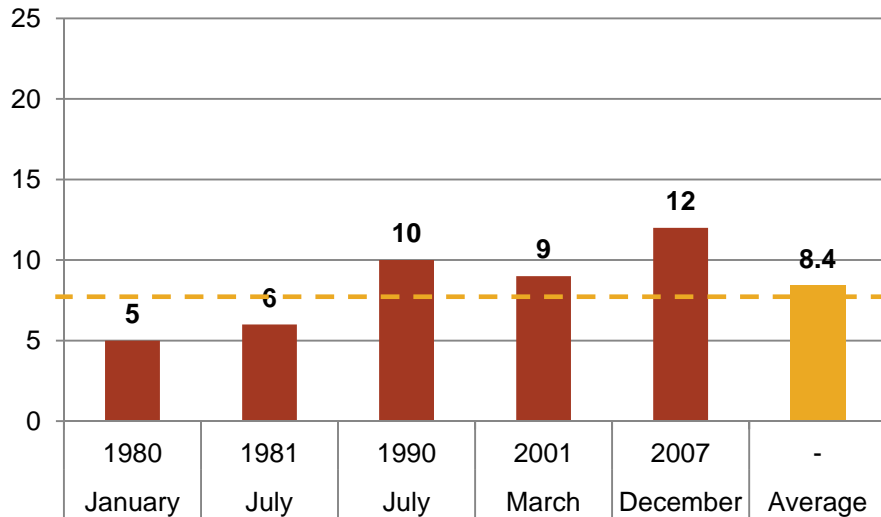


So how will you “know” when the market turns?

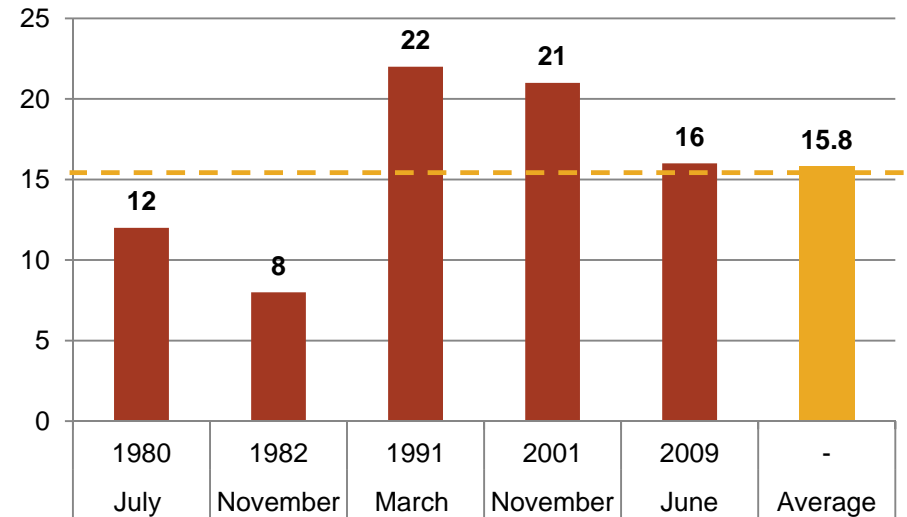
- NBER?



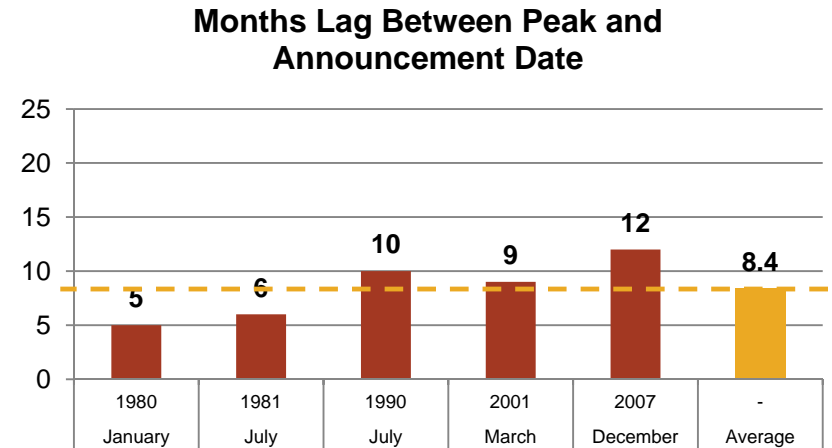
Months Lag Between Peak and Announcement Date



Months Lag Between Trough and Announcement Date



- **Good news:** Don't have to wait for NBER—typically three to six months you typically “know” that the markets have shifted from one phase to the next.
- **Bad news:** By then, it may be too late to do anything about it.
- Companies that wait to prepare and deploy cycle strategies until it is clear have probably waited too long.
- Better course of action is to have predetermined cycle strategies in place that change the posture of the company in a graduated manner.
- Think DEFCON levels, not light switch.

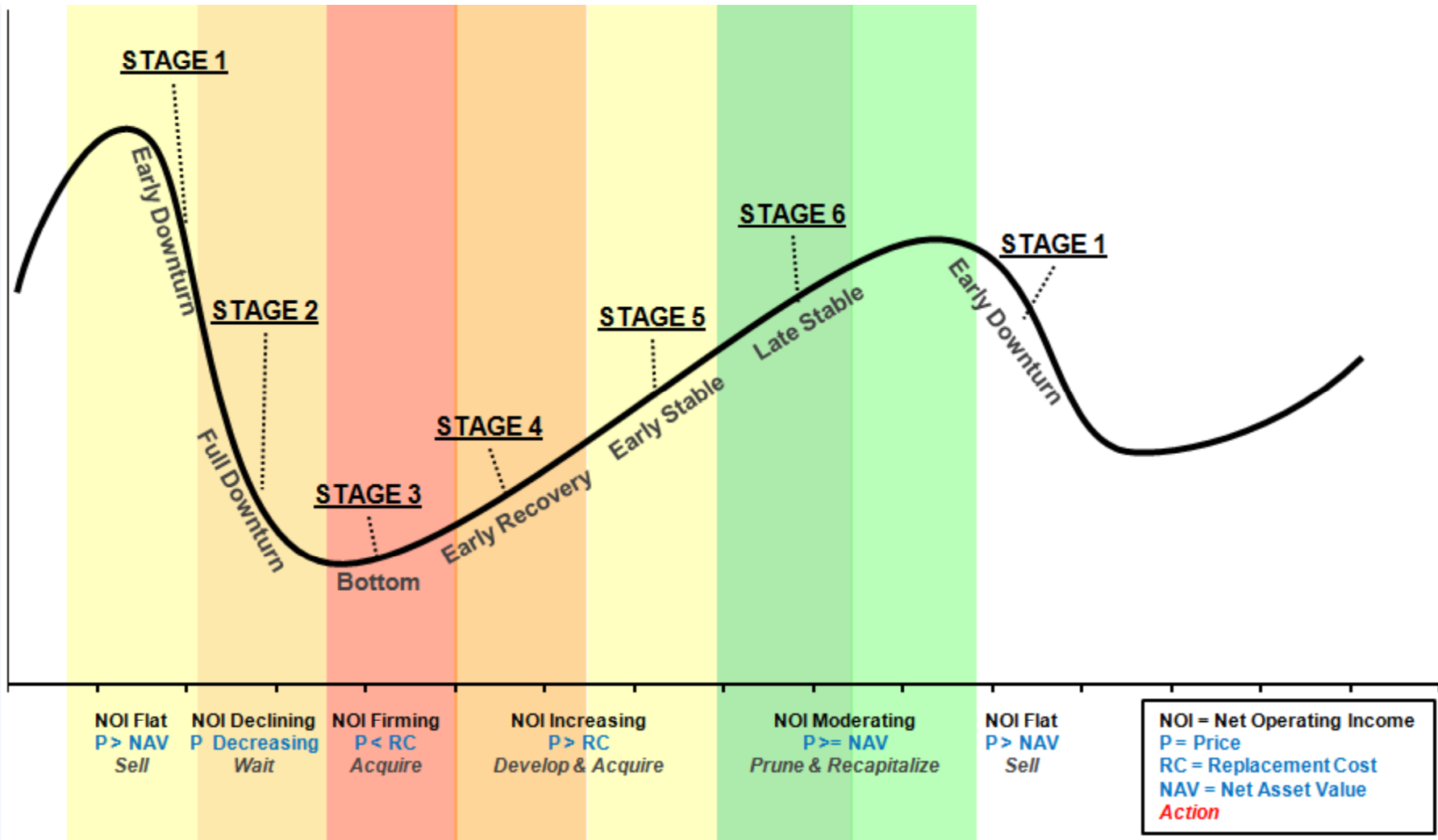


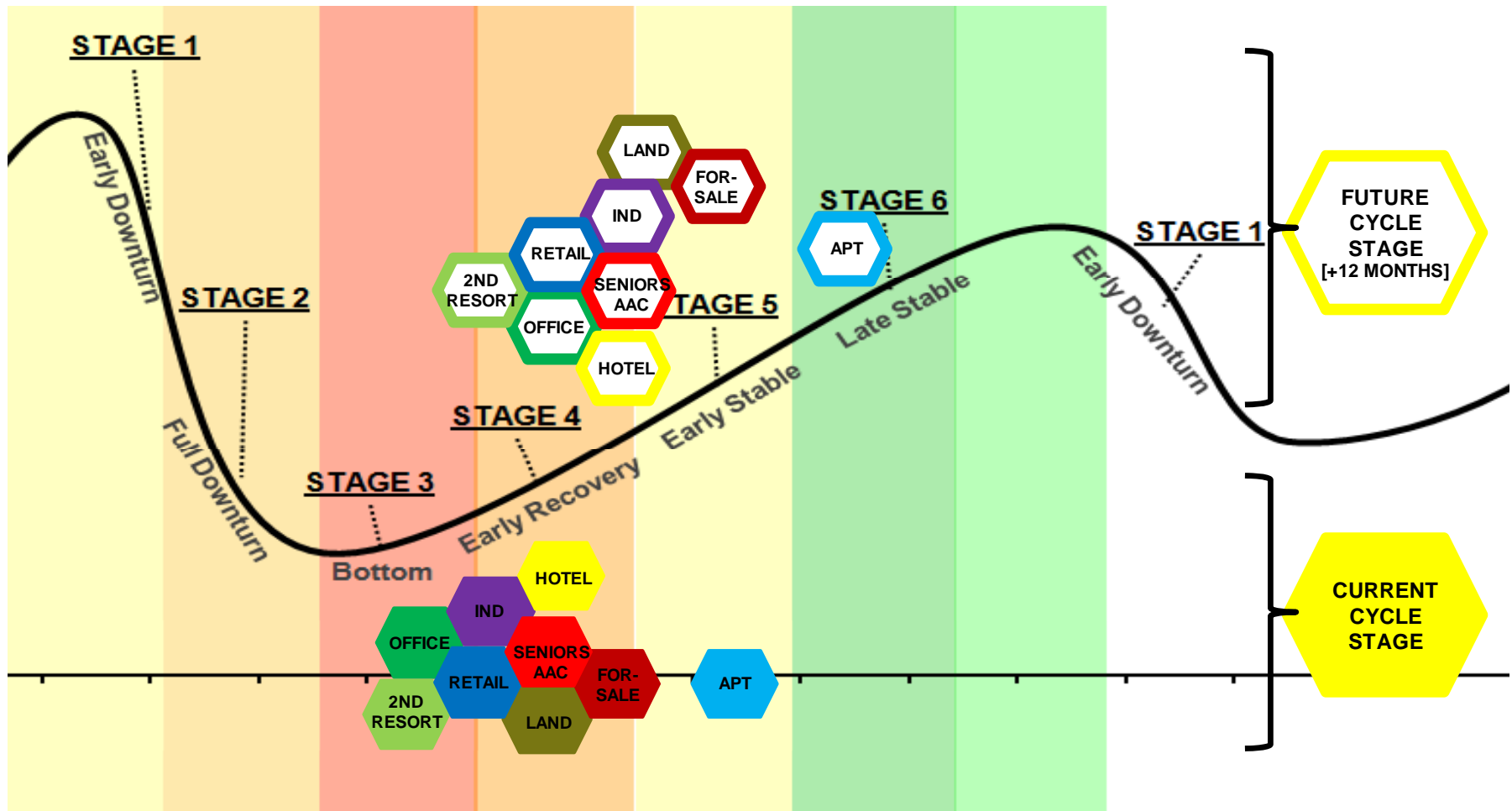
LAMINATE IT – DON'T WING IT

- **Develop strategies for dealing with a number of possible outcomes and probabilities.**
- **Key questions at this point in the cycle:**
 - How well prepared am I for a slight hesitation or mild economic slowdown?
 - What about a more severe (and by its very nature) unanticipated downturn?
 - What economic and real estate market indicators should I be tracking to help gain perspective on where my market(s) are heading?
 - What predetermined cycle strategies should I have on my play sheet ready to deploy at the right moment, instead of deciding in the heat of battle?



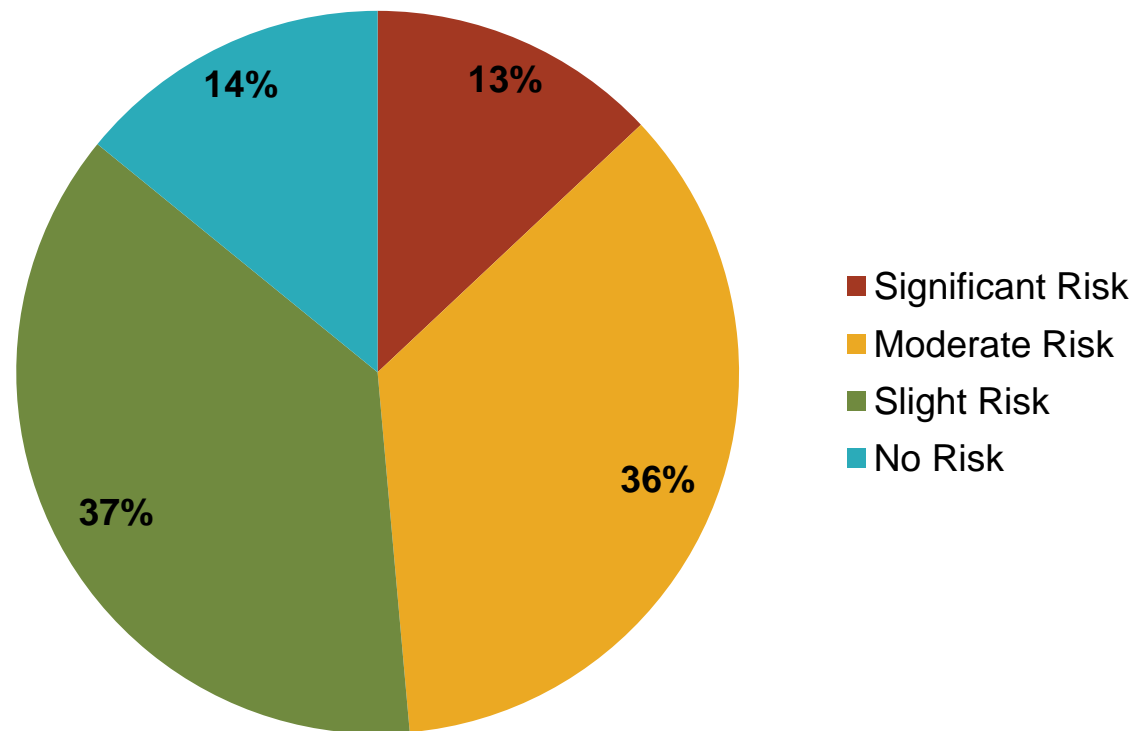
REAL ESTATE CYCLE STAGES





- Varies by market.
- While not the majority, more responded apartments in early downturn (12%) vs. early recovery (8%).

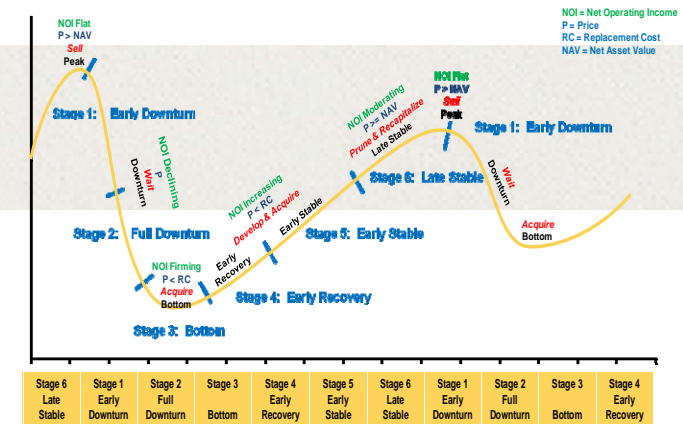
What is the risk of an apartment bubble in your market?



STAGE 5 – EARLY STABLE

At this stage in the cycle:

- This is the closest to equilibrium in the real estate markets.
- NOI increasing.
- Prices are increasing and close to matching or exceeding replacement costs.
- Because it takes time to gear up and deliver new projects, there remains pent-up demand and forward momentum in the marketplace.



Strategies for this stage of the cycle:

- Developers continue to start new projects per their investment/yield matrix.
- However, this is the time to become more selective on land acquisitions that may take time to bring to market.
- Asset acquisitions should be slowed relative to the previous Early Recovery stage by virtue of increasing hurdle rates to eliminate marginal deals.
- Continue to manufacture and deploy capital to execute the pipeline of deals.

Don't stop, but sharpen the ax:

- Growth often exceeds organizational capacity—time to improve processes and efficiency.

STAGE 6 – LATE STABLE

At this stage in the cycle:

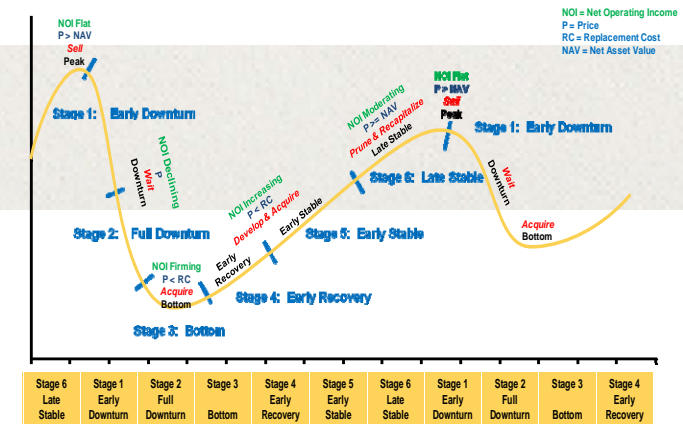
- NOI moderating.
- Prices typically exceed asset values.

Strategies for this stage of the cycle:

- Other than long-term holders, this is the time to sell.
- Dispose of marginal deals, or assets not wanted after the peak.
- Tighten underwriting criteria and raise hurdle rates for new deals.
- Refinance your portfolio with flexible, low-cost debt.
- Manage growth with flexible/outsourced overhead to avoid painful cuts in the downturn.
- ID capital or create a war chest to take advantage of dislocations in the coming downturn.

Toughest call to make:

- Selling into what feels like a continuing expansionary market.
- At peak, market turns in an instant from sellers' to buyers' market.
- After peak, hard to sell assets you wanted to, at prices you had hoped for.



STAGE 1 – EARLY DOWNTURN

At this stage in the cycle:

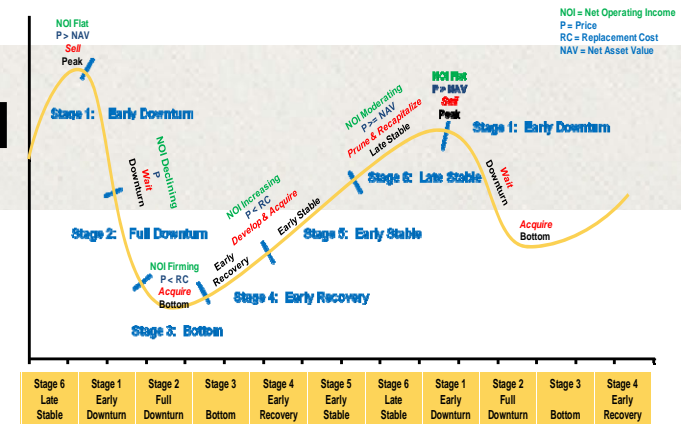
- Prices, NOI, and asset values are falling.
- Credit, when available, on less attractive terms.

Strategies for this stage of the cycle:

- Developers curtail starts and mothball deals, where possible.
- Acquirers try to defer, retread and many walk on deposits.
- Savvy players line up capital for opportunistic buys in the Stage 3 Bottom phase.
- Pare down overhead—work hard to keep the “keepers.”
- Reevaluate strategic activities that may have made sense in the early expansionary phase.
- Generally, the focus is to prepare the company to weather the downturn.

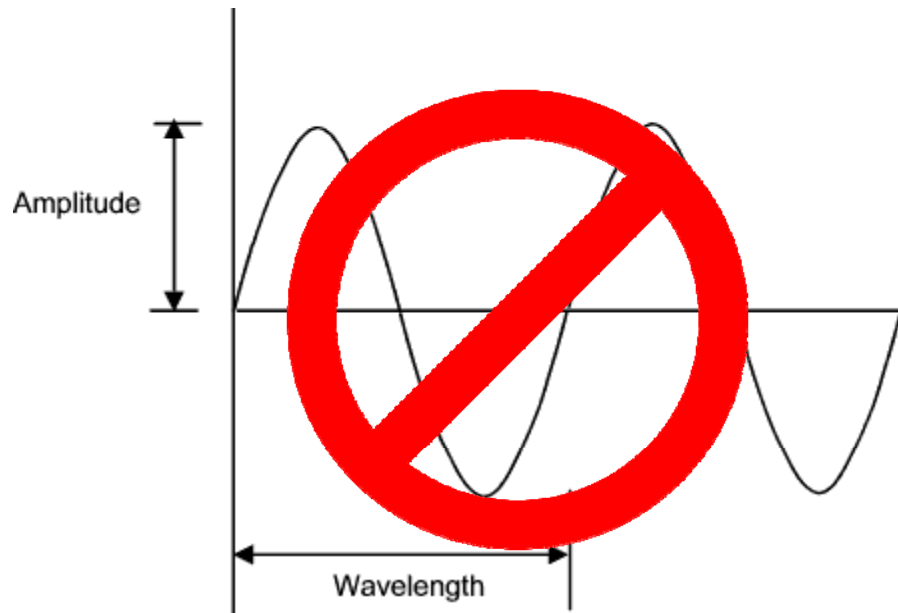
Many are ill prepared:

- Companies that wait until this stage to begin deploying cycle strategies are ill prepared.
- Critical to deploy staged actions in the previous phases to avoid creating opportunities for others in the downturn!



WAVE IS A BETTER ANALOGY

- Acknowledge you don't have 20-20 forward vision—there is no perfect algorithm.
- Repeat—you will never really know—but it is critical to have a point of view.
- Tremendous benefit = conscious consensus among those charged with executing the company's strategy & avoiding the natural human tendency towards denial.



- **ID set of indicators:**

- Specific to industry
- Specific to market
- Internal company
- External market
- Quantitative
- Qualitative

- **Convene Cycle Committee:**

- Annual, quarterly, monthly
- Declare “Stage”
- Consider Cycle Actions

INDICATOR	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
	Early Downturn	Full Downturn	Bottom	Early Recovery	Early Stable	Late Stable
Local/Micro Market Indicators						
Purchase of unentitled land	No one	No one	No one	Few	Many	New Players
Level of Mezz financing	None	None	None	Limited	Significant	Most Deals
Availability of capital	None	Opportunity	Land Bank	Institutional	Everyone	Too Much
Secondary players/developers and/or sites	None	None	None	Few	Some	Many
Land Leases	None	None	None	Few	Some	Many
Qualitative assessment of competitive landscape	Limited	None	Limited	Moderate	Significant	Too Much
Market Indicators/Stats:						
	Declining rapidly below trends	Far below trends	Below trend	Growing, but below trend	At or slightly above trend	Far above trend
# starts/permits	"	"	"	"	"	"
Job-permit/job absorption ratio	"	"	"	"	"	"
Job growth	"	"	"	"	"	"
Homeownership rate trends	"	"	"	"	"	"
Rental rate & occupancy trends	"	"	"	"	"	"
Demand/supply equilibrium	"	"	"	"	"	"
Cap rates	"	"	"	"	"	"
Land pricing	"	"	"	"	"	"
Concessions	Increasing	Increasing rapidly	Firming	Declining rapidly	Declining	Gone
NOI trends	Declining	Declining rapidly	Firming	Growing rapidly	Growing	Flat
Price to Replacement Cost	P declining rapidly	P < RC	P >=RC	P > RC	P > RC	P > RC
Residential/Condo activity	None	None	None	Limited	Moderate	Significant
Pro Forma Indicators						
Development Pro Forma IRRs	n/a	25%+	25%+	20-25%	15-20%	<15%
Going In/Out Cap Rate Spread (bps)	240+	200+	200+	150+	100-150+	<100
Loan to Cost Construction	n/a	<50%	50%	0.6	65-75%	80-100%

Discussion Topics:

- Where do you think we are on the cycle?
- When do you think the market will peak next?
- What are you doing to inform your “company view” of where you are, and where you are headed?
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Charles Hewlett, Managing Director, RCLCO

Since our founding in 1967, RCLCO has been at the leading edge of real estate trends and issues, offering strategic guidance that is always market-driven, analytically based, and financially sound. Our real estate advisors help clients make the best possible decisions about property and portfolio investment, development, management, design, and corporate strategy issues. We assist our clients with everything from market, economic, financial, and impact analyses to organizational strategic planning and litigation support. We are real estate experts, consultants, advisors, analysts, and strategists offering solutions from project inception to disposition and all points in between.

RCLCO has expertise in five major areas: Strategic Planning and Litigation Support, Urban Real Estate, Community and Resort, Public Strategies, and Institutional Investment.

Our multidisciplinary team combines real world experience with the analytical underpinnings of the firm's thousands of consulting engagements to develop and implement strategic plans that strengthen our client's position in a market or sector, add value to a property or portfolio, mitigate price erosion, and strengthen a client's position in the case of an acquisition, disposition, or legal case.

Each day, our consultants apply the knowledge gained from our body of work along with the insights from our proprietary research, which includes trends analysis, consumer research, project/portfolio performance metrics, real estate forecasts, etc. Our foremost goal is to add value to our clients' real estate activities at every point in the market cycle. We constantly refine our concepts and methods in order to identify the best means for helping our clients gain a competitive advantage in the marketplace. Furthermore, our extensive network of clients, colleagues, professionals, and public officials, in the United States and abroad, provides us with a unique and comprehensive outlook on the industry—not to mention unmatched access to the best minds in real estate.

Year Opened

1967

Office Locations

Washington, D.C. (HQ)

Los Angeles, CA

Orlando, FL

Austin, TX

Affiliations

Urban Land Institute

Pension Real Estate Association

International Economic Development
Council

National Multifamily Housing Council

Society for College and University
Planning

American Planning Association

Core Values

Adding Value to Our Clients

Achieving Excellence and Innovation

Enjoying Our Work

Promote Economic, Social, &
Environmental Sustainability**Advisory Groups**

Community and Resort Advisory

Institutional Advisory

Strategic Planning & Litigation Support

Public Strategies

Urban Real Estate Advisory

ADVISORY GROUPS: CENTERS OF KNOWLEDGE AND EXCELLENCE

Community and Resort Advisory

- Master-Planned Communities
- Single-Family, Townhomes
- Active Adult Communities
- Independent, Assisted Living, CCRC
- Second Home Communities
- Conservation Communities
- Beach, Mountain, Lake Resorts
- Casino, Marina

Strategic Planning

- Capital Formation Strategies
- Corporate, Business Unit, Portfolio, or Asset Level Strategies
- Performance Audit
- Litigation Support Services

Institutional Advisory

- Portfolio Strategy
- Sector Strategy
- Manager Selection
- Asset Management & Monitoring

Public Strategies

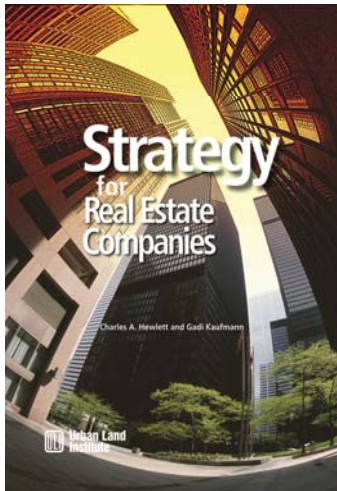
- Local, State, and Federal Government
- Regional Planning Organizations
- Redevelopment Authorities
- Transit Agencies
- Chambers of Commerce
- Economic Development Organizations
- Business Improvement Districts

Urban Real Estate Advisory

- Apartments, Condominiums
- Office
- Retail
- R&D/Industrial
- Mixed-Use
- Lifestyle/Entertainment Centers
- University/Medical Campus

Strategy Planning Services

- Corporate, business unit, portfolio, or asset level strategies
- Enterprise risk management (ERM) strategies
- Growth, profitability, consumer-, product-, and place-based strategies
- Capital formation strategies
- Organization strategies
- Succession Planning
- Performance audits and benchmarks



Representative Clients

The Artery Group
 Arizona State Retirement System
 Associated Estates
 ATAPCO Properties
 Avalon Bay Communities
 Avatar Properties
 Balboa Land Investments
 Berkshire Property Advisors
 The Brick Companies
 Bonita Bay Properties
 The Bozzuto Group
 Clark Realty Capital
 Combined Properties
 Cohen Financial
 Continental Realty Corporation
 Crescent Resources, LLC
 Crosland
 Dell Webb Corporation
 Dominion Resources
 East West Partners
 Etkin Equities
 Fairfield Residential Company
 Forest City
 Haus Panama
 H.G. Fenton Company
 Hershey Trust
 Howard Hughes Co.
 Kettler
 Koger Equity, Inc.
 Mill Creek Residential Trust
 Mischer Investments
 National Multi Housing Council
 Newland Communities
 Paradigm Properties
 Penzance Company
 Revolution/Miraval Resorts
 Stanley Martin Company
 Stuart Properties
 Summit Properties
 Trammell Crow Residential
 Transwestern
 Teachers of Texas
 Tejon Ranch Company
 The Urban Land Institute
 Washington Properties
 Watson Land Company

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