DIVIDEND CAPITAL RESEARCH

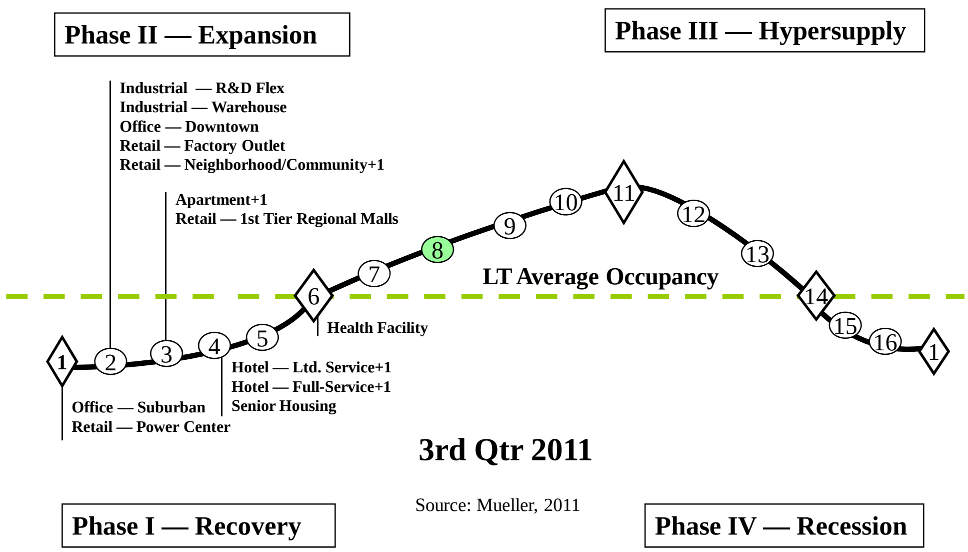
Cycle Monitor — *Real Estate Market Cycles*

Third Quarter 2011 Analysis
November 2011

Physical Market Cycle Analysis of All Five Major Property Types in More Than 50 MSAs.
Job growth continued to move along at a slow 100,000 increase per month. U.S. consumers continue to take a wait-and-see attitude as the Greek debt crisis and other world events do not provide a positive outlook for the future. "Occupy Wall Street" protestors seem to be a sign of the times, as they are vocal about not liking the situation, but do not have any useful ideas for improvement. Governments seem to be in a similar stalemate. Despite these problems, all five property types showed minor increases in occupancy levels and rents grew for all except hotel.

Office occupancies **improved** 0.2% in 3Q11, and rents grew 0.3% for the quarter and were up 0.5% annually.
Industrial occupancies **improved** 0.4% in 3Q11, and rents grew 0.2% for the quarter but were down 0.9% annually.
Apartment occupancies **improved** 0.1% in 3Q11 and rents grew 0.6% for the quarter and 3.6% annually.
Retail occupancy **improved** 0.5% in 3Q11, and rents grew 0.1% for the quarter and 1.7% annually.
Hotel occupancies **improved** 0.3% in 3Q11, while RevPAR fell 2.7% for the quarter, but grew 6.1% annually.

National Property Type Cycle Locations



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All relevant disclosures and certifications appear on page 9 of this report.

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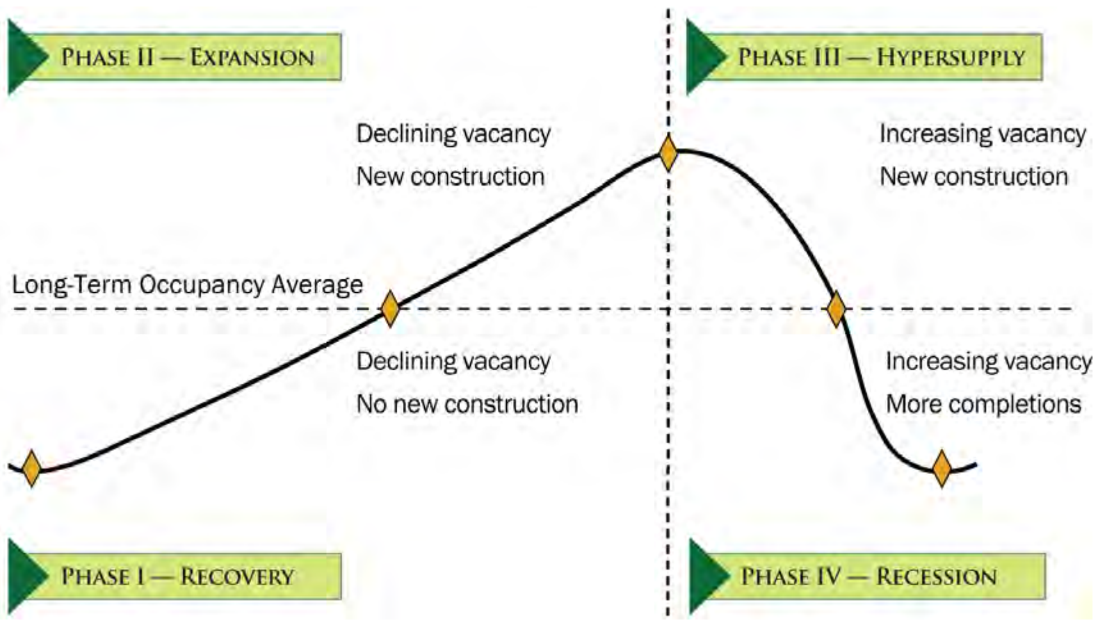
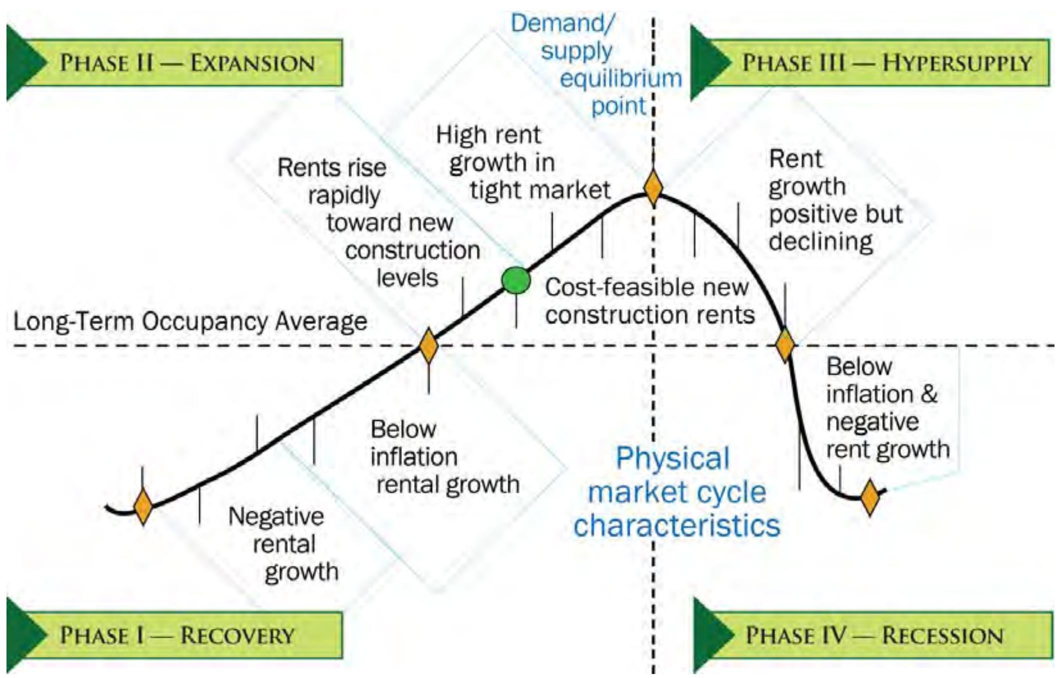
The cycle monitor analyzes occupancy movements in five property types in more than 50 Metropolitan Statistical Areas (MSAs). Market cycle analysis should enhance investment-decision capabilities for investors and operators. The five property type cycle charts summarize almost 300 individual models that analyze occupancy levels and rental growth rates to provide the foundation for long-term investment success. Real estate markets are cyclical due to the lagged relationship between demand and supply for physical space. The long-term occupancy average is different for each market and each property type. ***Long-term occupancy average*** is a key factor in determining rental growth rates — a key factor that affects real estate returns.

Market Cycle Quadrants



Source: Mueller, Real Estate Finance, 1995.

Rental growth rates can be characterized in different parts of the market cycle, as shown below.

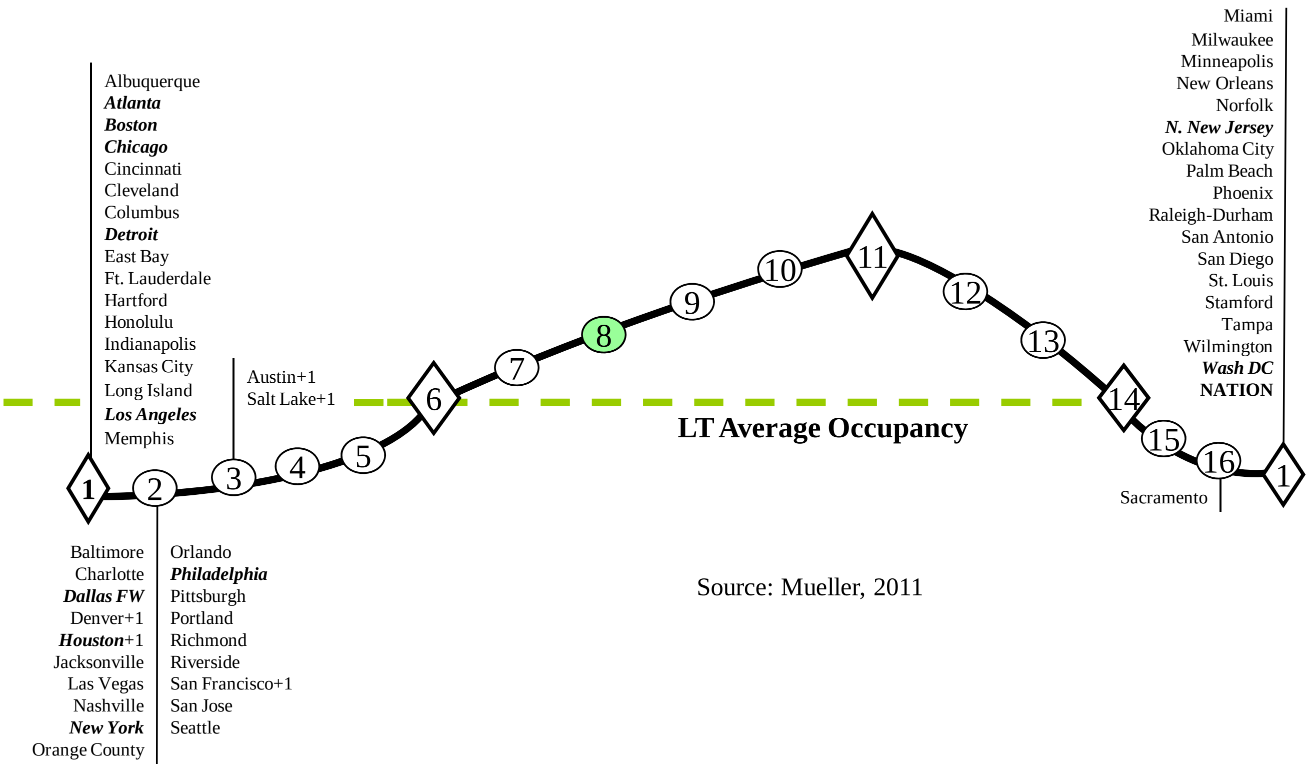


Source: Mueller, Real Estate Finance, 1995.

OFFICE

The national office market occupancy level improved 0.2% for 3Q11 and was up 0.5% year-over-year. While 21 of 54 markets are off the bottom point #1, the national average is still at the bottom point #1. CBD office continues to perform better than suburban space at an average higher occupancy level of 4.0%. Absorption continued at an almost 12 million square foot national pace in 3Q11, the same as 2Q11. With only slightly less than 2 million square feet of new space delivered and sub-lease space offered dropping to normal long-term levels, the trends are a slow positive for future office occupancy increases. Austin and Salt Lake are now the best markets in the country moving to point #3 on the cycle, where rental growth should be positive. We expect to see supply constrained markets like Boston, DC, New York and San Francisco move up next. Rents were up 0.3% for 3Q11, driven mostly by Class-A downtown leasing and were up 0.5% year-over-year.

Office Market Cycle Analysis
3rd Quarter, 2011



Source: Mueller, 2011

Note: The 11-largest office markets make up 50% of the total square footage of office space we monitor. Thus, the 11-largest office markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

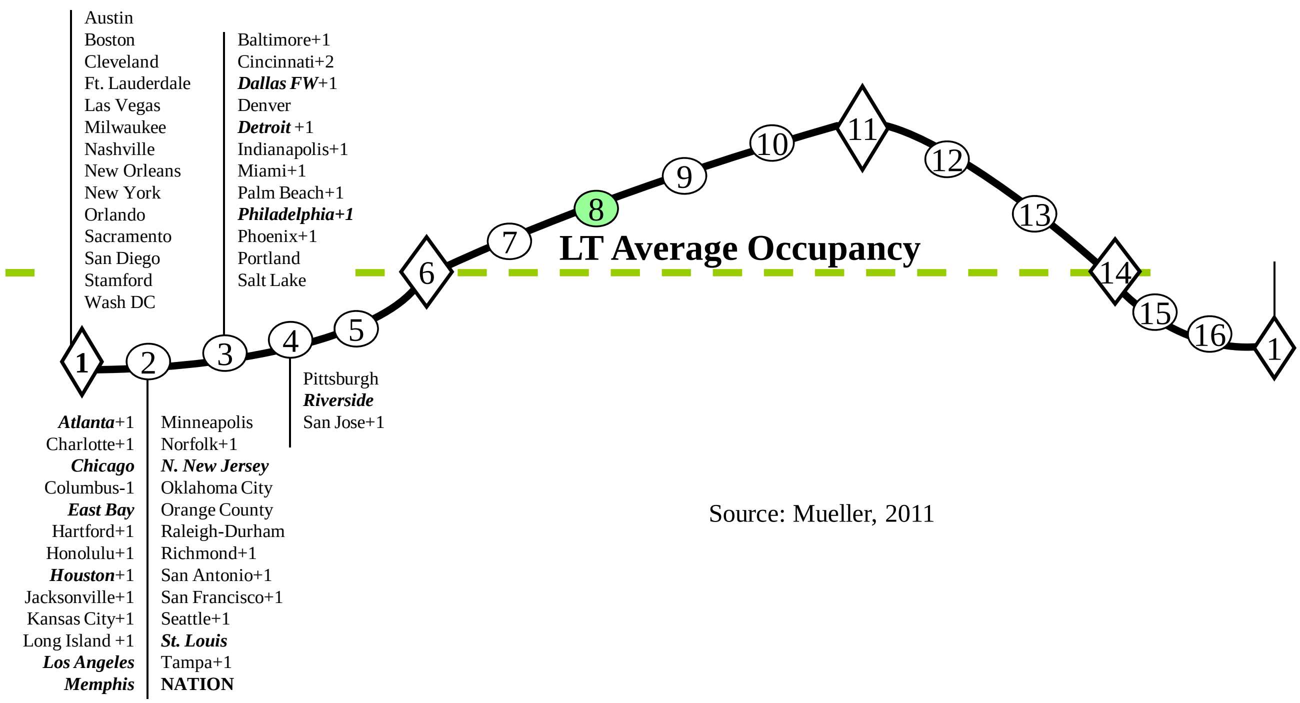
Markets that have moved since the previous quarter are now shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, i.e., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

INDUSTRIAL

Industrial occupancies improved 0.4% in 3Q11, which resulted in a 1.0% increase year-over-year. Demand for industrial space continued at a modest pace in 3Q11. August saw a drop in the ISM manufacturing indicator numbers, but the index continues to stay above 50 which indicates expansion. In addition, the TEUs coming through ports saw small percentage declines in the summer months, but demand for port space continued to improve — especially in California ports, which are the largest in the country. The industrial national average rents increased 0.2% in 3Q11, but rents were down 0.9% year-over-year.

Industrial Market Cycle Analysis

3rd Quarter, 2011

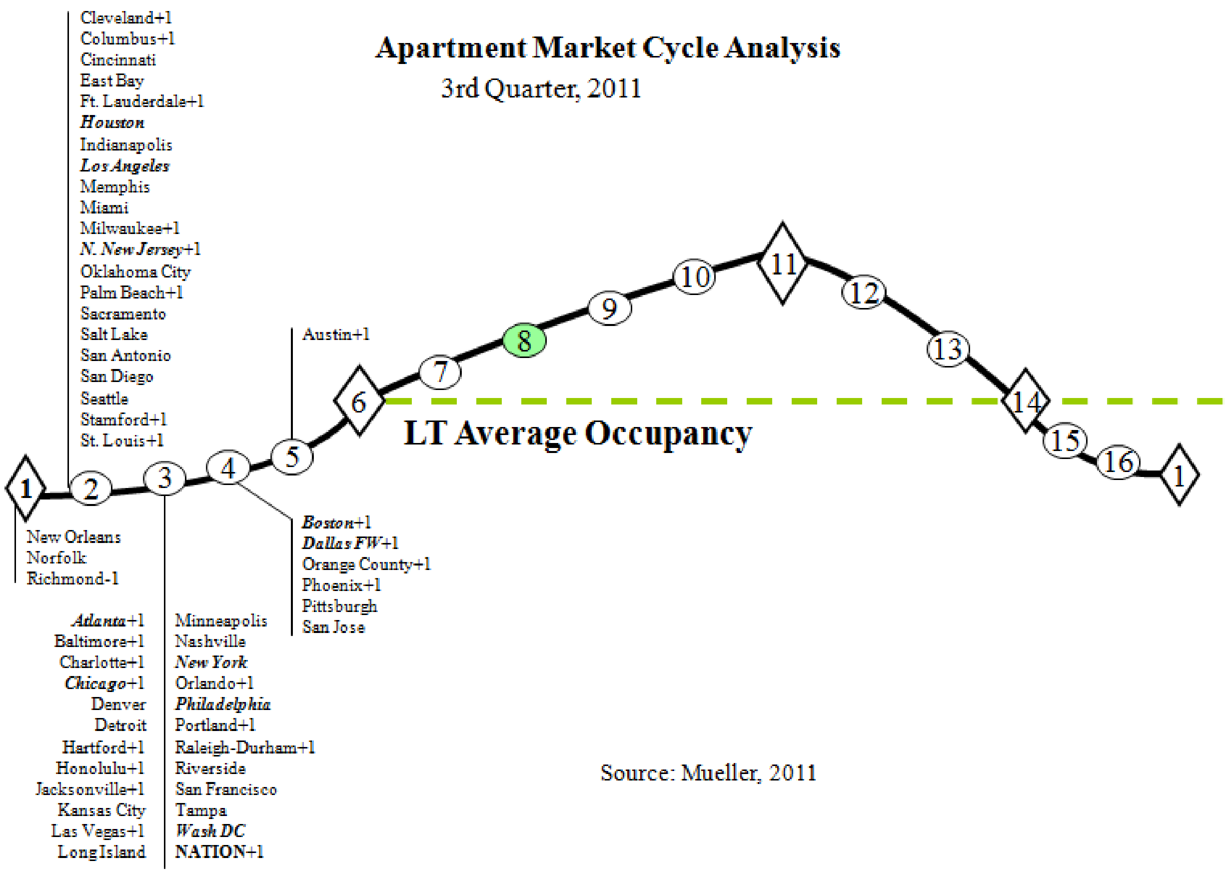


Note: The 12-largest industrial markets make up 50% of the total square footage of industrial space we monitor. Thus, the 12-largest industrial markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

APARTMENT

The national apartment occupancy average increased 0.1% in 3Q11 and was up 0.6% year-over-year. The continuing new job creation at an average pace of 100,000 per month is pushing demand for apartments. There is a great deal of new apartment starts in the pipeline as it is the one property type where construction and permanent financing is readily available. This future new supply is concerning to many researchers and investors, as the potential to over supply the market is high, should the economy turn down. Average national apartment rents improved 0.6% in 3Q11 and were up 3.6% year-over-year.



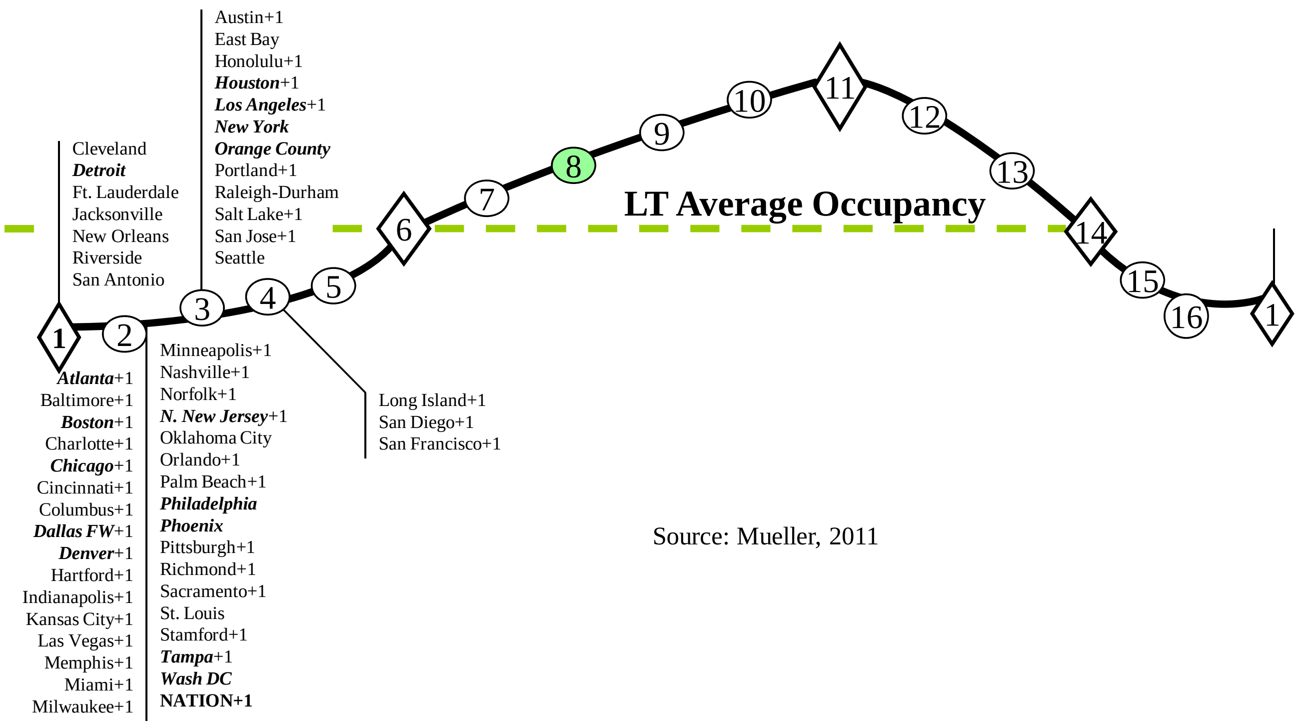
Note: The 10-largest apartment markets make up 50% of the total square footage of multifamily space we monitor. Thus, the 10-largest apartment markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

RETAIL

Retail occupancies improved 0.5% in 3Q11 and were up 1.7% year-over-year. Consumer confidence declined during 3Q11 and people are hanging on to cash instead of spending as they wait for better economic news. Retail is becoming an industry of haves and have-nots as A-quality malls (especially in high-income trade areas) and grocery-anchored centers do well while big box and general retail centers continue to suffer. Some vacated big boxes are now being filled, but at very low rents. Tenants are still in the driver's seat as rents were down 0.1% in 3Q11 and were down 1.7% year-over-year.

Retail Market Cycle Analysis
3rd Quarter, 2011



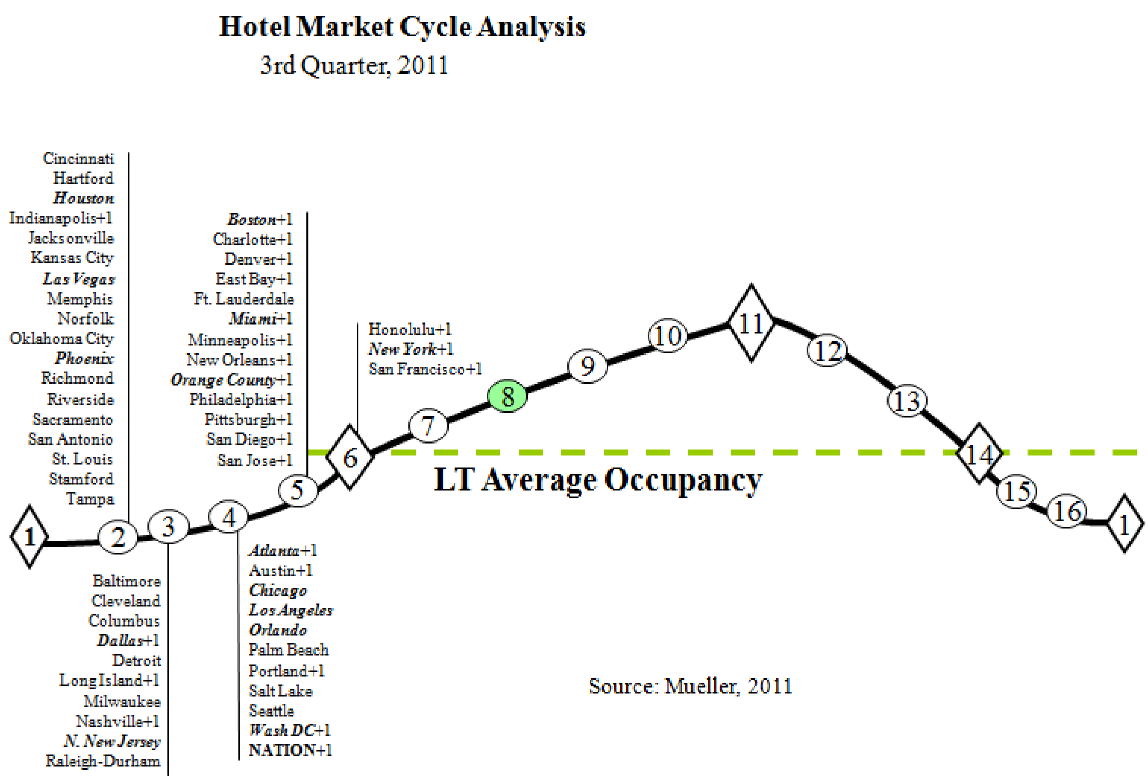
Source: Mueller, 2011

Note: The 15-largest retail markets make up 50% of the total square footage of retail space we monitor. Thus, the 15-largest retail markets are in ***bold italic*** type to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

HOTEL

Hotel occupancies improved an average of 0.3% in 3Q11 and were up 2.9% year-over-year. Occupancies improved enough in 23 of our 54 markets to move them forward one position and the national average has again moved forward to point #4 on the cycle graph — better than halfway through the recovery phase. Many annual business conferences have been breaking attendance records. National average Hotel RevPAR was down 2.7% in 3Q11 as hotels dropped rates to attract summer leisure travelers, but was up 6.1% year-over-year.



Note: The 14-largest hotel markets make up 50% of the total square footage of hotel space that we monitor. Thus, the 14-largest hotel markets are in boldface italics to help distinguish how the weighted national average is affected.

Markets that have moved since the previous quarter are shown with a + or - symbol next to the market name and the number of positions the market has moved is also shown, e.g., +1, +2 or -1, -2. Markets do not always go through smooth forward-cycle movements and can regress, or move backward in their cycle position when occupancy levels reverse their usual direction. This can happen when the marginal rate of change in demand increases (or declines) faster than originally estimated or if supply growth is stronger (or weaker) than originally estimated.

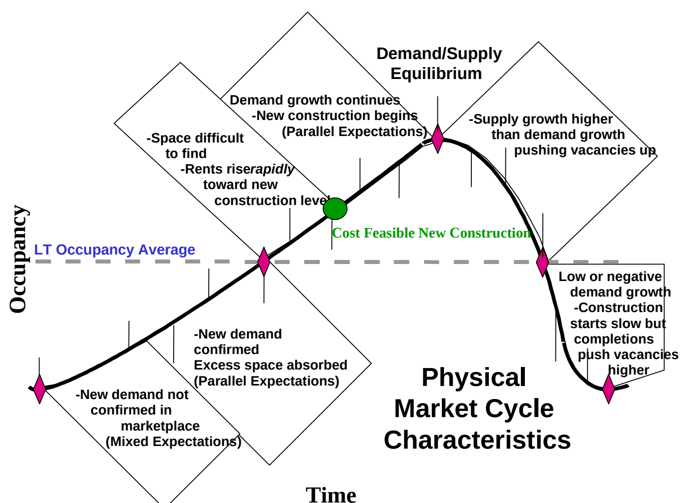
MARKET CYCLE ANALYSIS — Explanation

Supply and demand interaction is important to understand. Starting in Recovery Phase I at the bottom of a cycle (see chart below), the marketplace is in a state of oversupply from previous new construction or negative demand growth. At this bottom point, occupancy is at its trough. Typically, the market bottom occurs when the excess construction from the previous cycle stops. As the cycle bottom is passed, demand growth begins to slowly absorb the existing oversupply and supply growth is nonexistent or very low. As excess space is absorbed, vacancy rates fall allowing rental rates in the market to stabilize and even begin to increase. As this recovery phase continues, positive expectations about the market allow landlords to increase rents at a slow pace (typically at or below inflation). Eventually, each local market reaches its ***long-term occupancy average*** whereby rental ***growth is equal to inflation***.

In Expansion Phase II, demand growth continues at increasing levels, creating a need for additional space. As vacancy rates fall below the ***long-term occupancy average***, signaling that supply is tightening in the marketplace, rents begin to rise rapidly until they reach a cost-feasible level that allows new construction to commence. In this period of tight supply, rapid rental growth can be experienced, which some observers call "rent spikes." (Some developers may also begin speculative construction in anticipation of cost-feasible rents if they are able to obtain financing.) Once cost-feasible rents are achieved in the marketplace, demand growth is still ahead of supply growth — a lag in providing new space due to the time to construct. Long expansionary periods are possible and many historical real estate cycles show that the overall up-cycle is a slow, long-term uphill climb. As long as demand growth rates are higher than supply growth rates, vacancy rates will continue to fall. The cycle peak point is where demand and supply are growing at the same rate ***or equilibrium.*** Before equilibrium, demand grows faster than supply; after equilibrium, supply grows faster than demand.

Hypersupply Phase III of the real estate cycle commences after the peak/equilibrium point #11 — where demand growth equals supply growth. Most real estate participants do not recognize this peak/equilibrium's passing, as occupancy rates are at their highest and well above long-term averages, a strong and tight market. During Phase III, supply growth is higher than demand growth (hypersupply), causing vacancy rates to rise back toward the long-term occupancy average. While there is no painful oversupply during this period, new supply completions compete for tenants in the marketplace. As more space is delivered to the market, rental growth slows. Eventually, market participants realize that the market has turned down and commitments to new construction should slow or stop. If new supply grows faster than demand once the long-term occupancy average is passed, the market falls into Phase IV.

Recession Phase IV begins as the market moves past the long-term occupancy average with high supply growth and low or negative demand growth. The extent of the market down-cycle will be determined by the difference (excess) between the market supply growth and demand growth. Massive oversupply, coupled with negative demand growth (that started when the market passed through long-term occupancy average in 1984), sent most U.S. office markets into the largest down-cycle ever experienced. During Phase IV, landlords realize that they will quickly lose market share if their rental rates are not competitive; they then lower rents to capture tenants, even if only to cover their buildings' fixed expenses. Market liquidity is also low or nonexistent in this phase, as the bid–ask spread in property prices is too wide. The cycle eventually reaches bottom as new construction and completions cease, or as demand growth turns up and begins to grow at rates higher than that of new supply added to the marketplace.



Source: Mueller, Real Estate Finance, 1995

This research currently monitors five property types in more than 50 major markets. We gather data from numerous sources to evaluate and forecast market movements. The market cycle model we developed looks at the interaction of supply and demand to estimate future vacancy and rental rates. Our individual market models are combined to create a national average model for all U.S. markets. This model examines the current cycle locations for each property type and can be used for asset allocation and acquisition decisions.

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