FALCON

REAL ESTATE INVESTMENT MANAGEMENT, LTD.

Advisory Services for Investors in US Real Estate

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US Commercial Real Estate Market Rebounds Strongly

The US commercial real estate market had a very good year in 2013. Total transactions are estimated by the CoStar Group to have totaled over $370 billion last year, up 18% from the previous year. This was the highest total since 2007 when $490 billion in sales were recorded. These totals include office, industrial, retail, hospitality and land.

In Falcon Real Estate's view, many of the uncertainties that the real estate market faced at the beginning of 2013 have been resolved and 2014 now appears on track to be another excellent year. All indications point to continued and accelerating growth in the US economy, with most estimates pointing to growth of over 3% by the second half of the year. The Federal Reserve Board has recognized this strength, reporting that eight of the twelve geographic districts in the US reported significantly faster economic growth as 2013 came to a close. As a result, the Fed has begun the long awaited 'taper' — reducing its $85 billion per month quantitative easing program by $10 billion each month, leading to its elimination later in the year. The Fed clearly feels that the growing strength of the US economy permits it to reduce the stimulus programs that dated back to the recession.

There are many factors that have led to the economic resurgence in the United States, but one of the most important has been the virtual revolution in the oil and natural gas industry. As fracking has become more widespread, the output of petroleum products has soared and the US may soon become an exporter of oil and liquefied natural gas. With natural gas prices having fallen to extraordinarily low levels, production costs in the US have followed, giving US manufacturers a competitive edge, and actually causing some producers to bring production back to the US from overseas.

As the economic recovery spreads throughout the US, the strength in the commercial real estate market has followed that recovery, as it always does. The markets in New York, Washington, San Francisco and Chicago have been doing quite well, but the booming Texas economy and the growth being experienced in many parts of the country has also sparked investor demand in such markets as Houston, Denver, Phoenix, Miami and Atlanta. Falcon is now seeing a great many attractive investment opportunities in these markets and others throughout the entire US.

US Economy

The general consensus among forecasters is that the US economy will lead the way again in 2014 with growth of about 3%. This compares with growth projections of about 1% for the euro zone, and a little under 1% for Japan. And each of the BRIC countries — Brazil, Russia, India and China — all of which were previously experiencing high rates of economic growth, are now facing slowdowns or other problems unique to each of them. The US economy is clearly benefiting from the stimulus programs enacted during the 2008/9 recession, but more significant benefits are being realized from the energy revolution brought about by the use of fracking in the oil and gas industry. This has not only created jobs directly in that industry, but has lowered costs throughout the economy leading to a drop in the unemployment rate to 6.7% in December, its lowest rate since prior to the recession.

Another major cloud that hung over the US economy has been the Federal budget deficit. This led to the so-called sequester, an act passed by Congress that placed an absolute cap on Government expenditures. Despite all the bad publicity about it, the sequester, together with a recovering economy, has caused the budget deficit to plunge 50%, from $1.4 trillion in

2009 to an estimated $744 billion in 2014. And Congress has now been able to pass a budget covering the next two fiscal years, removing this uncertainty from the economic picture.

Commercial Real Estate Market

Reflecting the strength of the US economy and rising demand for space in offices and industrial buildings, pricing in the commercial real estate market continued on a steady upward trajectory as 2013 came to a close. One of the broadest measures of pricing for US commercial properties, the CoStar Group's US Composite Index, rose by 7.8% during the past year. Space absorption in 2013 proceeded at the fastest pace since 2007, with tenants occupying an additional 380 million square feet of office, retail and industrial space throughout the U.S. The investment grade, or top tier segment of the market, continued to dominate in space absorption. However, there has been some indication that the recovery is accelerating in the secondary and tertiary markets.

The commercial real estate market is, of course, being aided by the availability of adequate credit at very low interest rates. Investors should recognize that the ability to buy investment grade properties at attractive capitalization rates and finance those purchases with very low, fixed rate mortgages will not last forever. We are continuing to see excellent properties in prime markets that can be bought on a 6% cap rate with financing of 5%, leading to a current income return of 7% to 8%. As the economy continues to grow, it is inevitable that the Fed will let interest rates move up and this type of opportunity will disappear.

Attractive Markets

Falcon is seeing attractive investment opportunities in a great many markets in the United States. We always look at the underlying fundamentals of a geographic market and its longer-term growth prospects before recommending a specific property in that market. Some of the markets that we are considering today include the following:

1. Dade County, Florida – Miami is a global magnet for international business and the epicenter of the South Florida market, which is home to 5.6 million people. The Miami-Dade County office market experienced significant improvement during 2013, with nearly 2 million square feet of positive absorption since 2012, pushing vacancy down to the current 16.8% from a high of 19.2% in 2011. A specific property we are considering in Miami is the Waterford Center, which we believe can be purchased for approximately $26 million, equal to a 6.7% initial capitalization rate to provide a 7.3% ten-year average cash yield and a 12.5% IRR.

2. Wall Street Market, New York City – Downtown New York has undergone the most extraordinary transformation of any CBD in the country. The area has been energized with new infrastructure, transportation, parks, schools, and hotels. The Downtown labor pool has continued to attract new tenants catering to media, publishing, technology, health-care and education, such as Condé Nast and Harper Collins. These new tenants will join the financial giants that are already headquartered Downtown including Goldman Sachs, AIG, American Express, and Merrill Lynch. We are analyzing a joint venture for the purchase of a 50% interest in a property in this market — 77 Water Street, a 26-story, Class A office building that is currently 100% net leased to Goldman Sachs. We believe that a $100 million investment in this property could be made on a 7.5% capitalization rate to provide an average 10-year IRR of 8.6%.

3. Northern New Jersey – The warehouse/industrial market in Northern New Jersey is the third largest in the nation with a total of 744 million square feet of space. The specific property we are considering in this market is a data center, and the New Jersey/New York data center market ranks as the largest data center market in the world. Data center proximity to Manhattan is a "must" for New York City's financial institutions and media firms from a technical standpoint as well as for access to the area's robust electric and fiber sources and human capital. The property we are recommending is 755 Secaucus Road, which is 100% leased to Equinix for another 22 years through September 2036. This location is irreplaceable given its proximity to Manhattan, mass transit and the surrounding transportation infrastructure. We believe that this property can be purchased for about $63 million, equal to a 6.2% capitalization rate. At this price the investment will provide a pre-tax average yield of 7% and an IRR of 7.5%.

Additional information can be obtained on these properties and others by contacting Kenneth Lorman – klorman@falconreal.com.

Conclusion

Ten years ago, Falcon was recommending investments in China and in the growing countries of Latin America where we thought that the commercial real estate markets were relatively attractive. Today, we see no economy or commercial real estate market in any country in the world as attractive as those of the United States.