

Yeskey Real Estate Consulting & Investments



## October Surprises, Fall Update: More Surprises for the end of 2012

Updated Oct 15, 2012

September 15, 2012

“Keeping Clients & Investors Ahead of the Market”

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## Fall 2012 Surprises.... Outline

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Updated Oct 15, 2012

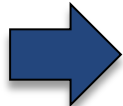
## Fall 2012 Surprises.... Introduction

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- **Our mission is to take a forward look at macro/micro economic and investment trends to provide clients and investors with the cutting-edge thought leadership and intellectual capital needed to stay ahead of the market. We passionately believe in the importance of truly independent fact-based research, which is in short supply today.**
- **This report is the most recent in a series, issued periodically over the past 15 years. In addition to our macro analysis, we also analyze micro issues on a special request basis (e.g. specific regulatory/accounting issues impacting CRE, tax reform, etc.).**
- **This is an annual report similar to last years October Surprise report which carries on our tradition of publishing an annual Top Ten report with the current context focusing on the last six months of activity in the market.**
- **Examples of previous reports include; “Top Ten Preview” – Jan 2012, “Fall Update – October Surprise 2011”, “The Good, Bad and Ugly – Predictions for the Second Half of 2011”, “Top Ten Issues in Real Estate Capital Markets” – annual.**
- **Please see [www.YeskeyRealEstate.com](http://www.YeskeyRealEstate.com) for more details.**

## Fall 2012 Surprises.... Executive Summary

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### **Big Surprise**

1. **Government Intervention** – suddenly, a rebirth of specific Govt. actions has occurred!
2. **Capital Markets** – also, a surprising up surge through Mid-Sept. despite election rhetoric.



### **No Surprise**

1. **The Economy** – Performing as predicted (mature 1-2%) within a global slow down.
2. **Commercial Real Estate** – Also performing as predicted; outperforming many investments.



### **Next Surprise**

1. **Capital Markets 2.0** – Watch out for the fall “dip” based on poor earnings and election uncertainty.
2. **Tax Reform** – Coming in 2013 whether you like it or not, especially on capital gains & loopholes.

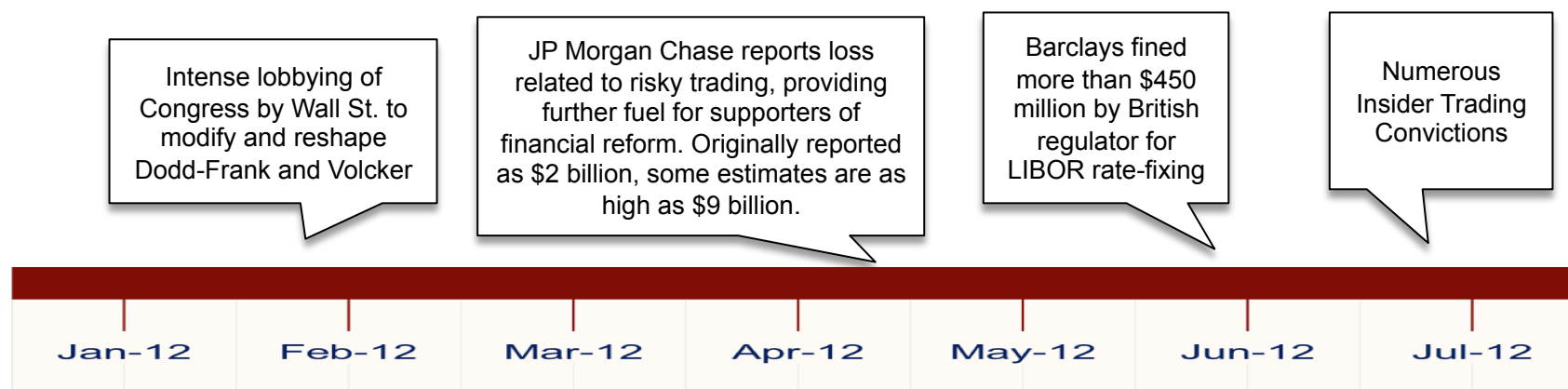
## Fall 2012 Surprises.... Executive Summary



### Big Surprise

1. **Government Intervention – suddenly, a rebirth of specific Govt. actions has occurred!**
  - In March, widely held belief was that new regulations (Dodd-Frank, Volcker, etc. ) would be gradually watered down/repealed. Anti-Interventionists heavily influencing mood against more regulation.
  - Major surprise is that the pendulum has swung sharply to the side favoring more government action, partly as a result of financial scandals involving JP Morgan, Libor, anti-money laundering, PE fees, Inside trading, and a call to break up the big banks.
  - The momentum of Govt. Agencies, particularly SEC, FDIC, State Agencies and European Regulators, have provided specific regulatory and legal actions that crystallized this push back and increased regulatory action.

### Timeline of Recent Events Involving Financial Regulation



## Fall 2012 Surprises.... Executive Summary

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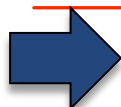
### Big Surprise

#### 1. Government Intervention – suddenly, a rebirth of specific Govt. actions has occurred!

Update October 15 –

- Several court cases defeating specific Dodd-Frank rule-making around derivatives trading have occurred.
- SEC was heavily defeated on increasing transparency for Money Market funds.
- Recent election rhetoric highlighting and debating government intervention levels have increased.
- JP Morgan (Bear Sterns) has been sued by the NYS Attorney General about mortgage fraud .

## Fall 2012 Surprises.... Executive Summary



### Big Surprise

#### 2. Capital Markets – also, surprisingly surge up through Mid-Sept. despite election rhetoric.

- The other big surprise is the capital markets have surged recently, and have so far avoided a repeat of the extreme market volatility that happened in August/September of 2011.
- This has occurred despite ongoing painful European debt issues and recession issues, slowing China growth, election rhetoric, weak investor and consumer confidence, etc. etc.
- In 2012 stocks showed first quarter surge and second weakness like 2011 but 2012 is different with third quarter surging again. Surprise!

#### Comparative Returns, YTD 2011 & 2012

	6/30/11	9/30/11	10/14/11	12/30/11	1/31/12	3/30/12	6/29/12	8/31/12	9/28/12
DAX (DE)	6.68%	-20.42%	-13.70%	-14.69%	9.50%	17.78%	8.78%	18.18%	<b>22.34%</b>
NASDAQ Composite	4.55%	-8.95%	0.56%	-1.80%	8.01%	18.67%	12.66%	17.73%	<b>19.62%</b>
Gold 1oz Spot	7.11%	15.26%	19.39%	14.30%	7.96%	8.59%	4.41%	7.67%	<b>16.00%</b>
S&P 500	5.01%	-10.04%	-2.63%	0.00%	4.36%	12.00%	8.31%	11.85%	<b>14.56%</b>
Russell 2000	5.59%	-17.80%	-9.08%	-5.45%	7.00%	12.06%	7.77%	9.61%	<b>13.03%</b>
DJ All REITs (US)	7.03%	-9.54%	-6.58%	2.34%	5.50%	8.60%	11.43%	14.30%	<b>12.76%</b>
DJ All Equity REITs (US)	7.85%	-9.17%	-5.70%	4.10%	5.42%	9.07%	11.80%	14.33%	<b>12.59%</b>
DJIA (US)	7.23%	-5.74%	0.58%	5.53%	3.40%	8.14%	5.42%	7.15%	<b>9.98%</b>
Nikkei 225 (JP)	-4.04%	-14.94%	-14.48%	-17.34%	4.11%	19.26%	6.52%	4.55%	<b>4.91%</b>
Barclays Aggregate Bond	2.70%	6.83%	5.90%	8.08%	0.72%	0.13%	2.11%	3.49%	<b>3.77%</b>

## Fall 2012 Surprises.... Executive Summary



### Big Surprise

2. Capital Markets – also, surprisingly surge up through Mid-Sept. despite election rhetoric.

Update October 15 –

- Some rollback 1-2%; beginning of a dip – 3-5% - no correction yet – some snapback
- Capital markets holding, so far.
- Europe down, Asia down, US Holding, Housing Up, REITs holding
- Significant uncertainty and nervousness effecting investor confidence
- US Economy still regarded as one of the strongest in the world despite 1-2% growth.

### Comparative Returns, YTD 2012

	Date	Prior Peak	9/28/12	10/02/12	10/12/12
DAX (DE)	9/14/12	25.66%	22.34%	23.86%	22.62%
NASDAQ Composite	9/14/12	22.22%	19.62%	19.76%	16.85%
Gold 1oz Spot	9/21/12	16.56%	16.00%	15.96%	15.40%
S&P 500	9/14/12	16.55%	14.56%	14.96%	13.60%
Russell 2000	9/14/12	16.71%	13.03%	13.44%	11.09%
DJ All REITs (US)	9/14/12	18.29%	12.76%	12.54%	11.90%
DJ All Equity REITs (US)	9/14/12	18.36%	12.59%	12.18%	12.13%
DJIA (US)	9/20/12	11.29%	9.98%	10.35%	9.10%
Nikkei 225 (JP)	9/19/12	9.19%	4.91%	3.91%	0.93%
Barclays Aggregate Bond	9/26/12	3.69%	3.77%	3.82%	3.85%



## Fall 2012 Surprises.... Executive Summary



### No Surprise

#### 1. The Economy – Performing as predicted (mature 1-2%) within a global slow down.

- The economy appears to be on a steady course of low and slow growth, with few surprises in the first and second half of 2012.
- The one surprising element is that despite GDP growth in the range of 1-2 percent, the U.S. is actually outperforming most of the other major industrialized economies. E.g.: Europe and Japan
- Government spending has been decreasing, despite hype to the contrary, and this has reduced one potential source for GDP growth.
- Major missing element of GDP growth is the lack of new business investment focused on domestic employment, not inventory adjustments.

### Contribution to Percent Change in GDP

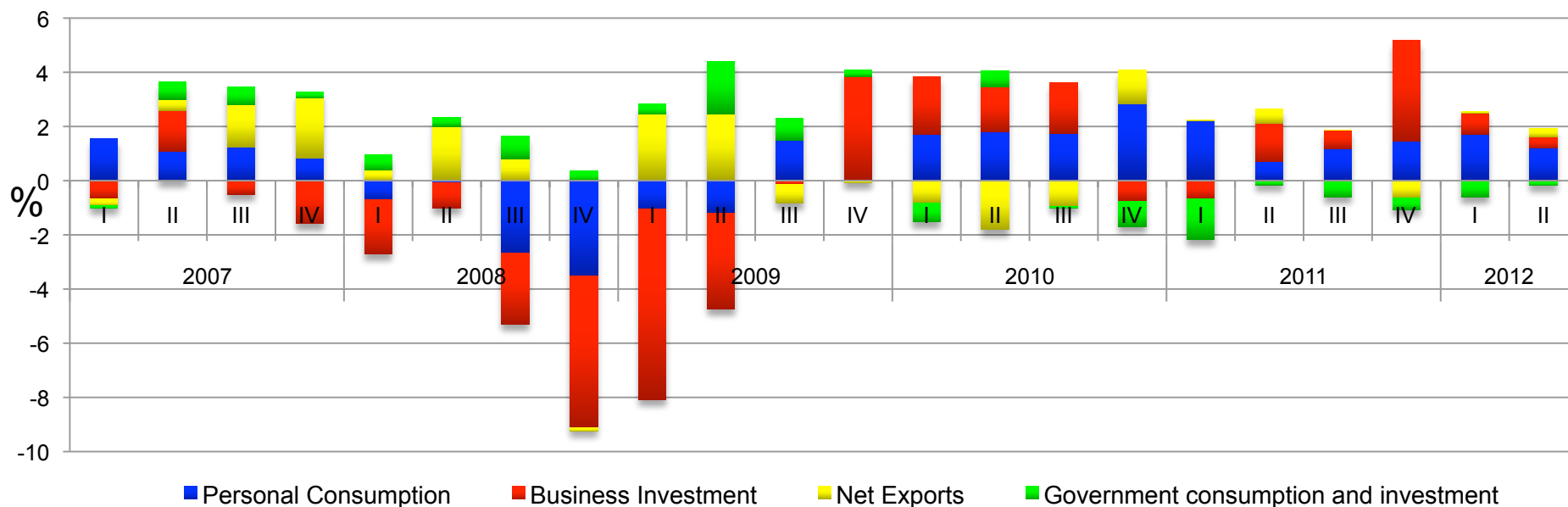


Chart Source: BEA

## Fall 2012 Surprises.... Executive Summary



### No Surprise

#### 1. The Economy – Performing as predicted (mature 1-2%) within a global slow down.

Update October 15 -

- A growing trend -- Unhealthy and unsustainable consumer spending above 70% of GDP.
- Most importantly, business Investment is just too low particularly to encourage domestic employment and exporting.
- Historically, Government spending appears to be on track considering the last 40 years.
- A new grand strategy is needed to drive future growth.

	1970s	1980s	1990s	2000s	2010-2011
Avg. Annual GDP	3.3%	3.1%	3.2%	1.7%	2.1%
Personal Spending	62%	64%	67%	70%	71%
Business Spending	17%	17%	15%	16%	12%
Govt. Spending	21%	21%	19%	19%	21%
Net Exports	0%	-2%	-1%	-5%	-4%
DJI Decade Return*	4.8%	228.3%	317.6%	-9.3%	17.16%** / 27.82%***

Table Source: BEA, Dow Jones, \*Price Only Returns

\*\*end of 2011 / \*\*\* till 10/12/12

## Fall 2012 Surprises.... Executive Summary



### No Surprise

#### 2. Commercial Real Estate – Also performing as predicted; outperforming many investments.

- It's no surprise that CRE (NCREIF, REITs, Global REITs) continues to rebound and to outperform other alternative asset classes.
- REITs still relatively strong, performing in 12-13% range; NCREIF returns strong above 12%
- Historically spreads are at all time highs, 400-600bps above 10-Year treasuries.

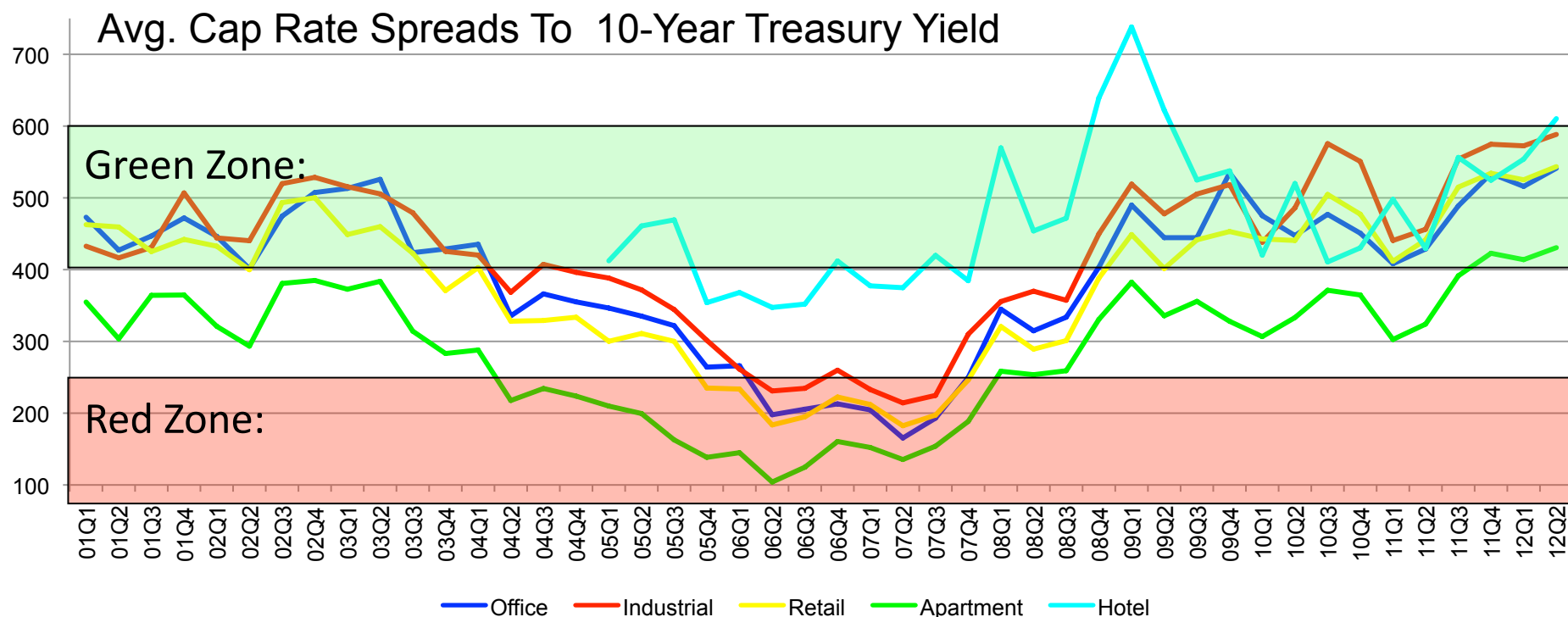


Chart Source: RCA

## Fall 2012 Surprises.... Executive Summary



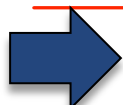
### Next Surprise

1. **Capital Markets 2.0 – Watch out for the fall dip based on poor earnings and election uncertainty.**
  - CRE Remains a very attractive investment when compared against either stocks, bonds or alternatives.
  - REITs, especially, continue to outperform many sectors of the market.

As of 6/30/2012	1-Year	3-Year	5-Year	10-Year
U.S. Venture Capital Index	6.00	12.67	4.85	5.28
U.S. Private Equity Index	6.19	16.62	6.01	12.85
FTSE/NAREIT All REITS	12.65	31.02	2.19	9.62
FTSE/NAREIT Equity REITS	12.48	32.40	2.60	10.32
NCREIF Prop Index	9.11	7.86	1.97	8.00
Barclays Capital Gov't/Credit Bond	8.78	7.34	6.90	5.79
Dow Jones Industrials Average	6.63	18.25	2.00	6.01
Nasdaq Composite*	5.82	16.95	2.43	7.21
Russell 2000	-2.08	17.80	0.54	7.00
S&P 500	5.45	16.40	0.22	5.33

Table Source: Cambridge Associates, NAREIT, \*Price Only Return

## Fall 2012 Surprises.... Executive Summary



### Next Surprise

#### 2. Tax Reform – Coming in 2013 whether you like it or not, especially on capital gains & loopholes.

- The next surprise here is that reforming the tax code is an issue of the Presidential election but action is clearly put off till 2013.
- What is certain is that this is an issue that needs to be fixed after the election, and no matter who wins there will be change.
- Tax reform needs to be focused on new long term business investment that promotes domestic employment.

Barack Obama	Mitt Romney
Wants to extend temporarily all the Bush-era tax rates for households earning up to \$250,000 per year	Wants to extend temporarily all the Bush-era tax rates that expire at the end of the year.
Proposes limiting deductions to 28% for the wealthiest	Proposes to cut income tax rates by 20 per cent
Plans to cut the corporate tax rate from 35 to 28 per cent	Plans to cut the corporate tax rate from 35 to 25 per cent
Want to raise tax on investment income for the rich, from 15 to 20 per cent for capital gains and 15 to 39.6 per cent for dividends	Wants to maintain taxes on investment income – capital gains and dividends at 15 per cent for the wealthy and reduce it to zero for the middle class.
Would impose a 3.8 per cent surtax on investment income for the rich to fund Medicare.	Says he will repeal the 2012 health law, scrapping the 3.8 per cent surtax on investment income

Table Source: Financial Times, September, 11, 2011 article by James Politi

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## Dennis Yeskey

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### Professional Highlights

Dennis has recently formed Yeskey Consulting, a firm which specializes in real estate consulting and investments. Prior to that, for fifteen years Dennis served as National Director of the Real Estate Capital Markets practice for Deloitte & Touche. He also built the New York-based Real Estate Services practice from the bottom up and was the Group Managing Partner for Investment Services, which included real estate, investment companies, PEI firms, hedge funds and insurance companies. While under his leadership, these practices achieved an annual growth of more than 25% with a staff of more than 1,000 professionals. Prior to Deloitte, from the mid-1980s to the mid-1990s, Dennis developed and led a successful real estate practice as a partner at Kenneth Leventhal & Company, the premier real estate restructuring firm in the United States at the time. He began his career at A.T. Kearney and PricewaterhouseCoopers, along with working at two engineering firms which specialized in solving difficult design and construction issues.

### Client Experience

His financial advisory clients include Apollo, The Blackstone Group, Goldman Sachs, O'Connor Capital Partners, GE Capital, Starwood Capital, TIAA-CREF, New York Life, Turner Construction, and the New York Common Fund as well as investors such as JMB, VMS, Bank of Tokyo, Brookfield, Confederation Life, Deutsche Bank, ING, KKR, Lazard Frères, Lehman Brothers, Lend Lease, Morgan Stanley, The Paramount Group, Sentinel, and Malkin Properties.

Over the course of his distinguished 40-year career, Dennis has been involved in dozens of high-profile workouts, restructurings, and reorganizations, including Travelers Life Insurance Company, Rockefeller Center, Mutual Benefit, Prudential Financial, DeBartolo, Bally's, The Trump Organization, Olympia & York (O&Y), Wheeling Pittsburgh Steel Corporation, E-II Holdings, and Mellon Bank. He has also worked with several government agencies in dealing with troubled assets, such as the US Resolution Trust Corporation, the FDIC, and the US Post Office, as well as with Japanese and UK government entities as well.

### Affiliations

Dennis holds an MBA in finance from Columbia University. He also holds both bachelor's and master's degrees in civil engineering from the University of Pittsburgh's Swanson School of Engineering. He is an active member of The Real Estate Roundtable and the Urban Land Institute, for which he became ULI Foundation Governor in 2008. He is a sought-out speaker for industry events and is frequently quoted as an authority in the general business and real estate media. Supporting this role, he continues to perform leading edge research in the capital markets arena, including publishing his annual "Top Ten Real Estate Issues" report which he has done for the past fifteen years.



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**Peter Culliney**

Pete Culliney has 20 years experience making better information easier to use for colleagues and clients by developing new products while enhancing and expanding services that help smooth the transition from data to knowledge. Prior to his work with Yeskey Real Estate, Pete was with Real Capital Analytics, where he led the research teams that expanded that firms research scope from covering the US to covering the world and from tracking just buy/sell transactions to tracking troubled assets as well as laying the groundwork for covering property debt markets. In addition to his work in real estate and capital markets, early in his career Pete worked extensively in the insurance, technology and communications fields.

A librarian by training, Pete knows the primary goal is to try to understand as fully as possible what the client wishes to learn from the project. what new knowledge is sought and how it is hoped to use this knowledge. We then seek out the data and information needed to achieve those aims.

**David Garcia**

David's focus is on synthesizing primary and secondary research into actionable analysis to help clients solve business challenges, develop new opportunities, and stay ahead of evolving issues. He has extensive experience researching, writing, and developing customized report and presentation deliverables on companies, industries, and trends in a variety of topics. In all instances, he strives to produce work that cuts through information overload and stays relevant to bottom line results.

In addition to his work with Yeskey Real Estate, David has been providing research, analysis, and project management services to Fortune 500 clients for two decades, via his work for Smith Barney, General Atlantic Partners, ORC International (formerly Find/SVP and Guideline Research), and Deloitte. Over that span, he has developed specialty expertise in a variety of industries, including commercial real estate, homebuilding, home improvement retail, industrial distribution, investment banking, asset management, and distressed debt, among others.

**About Check : Research**

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