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cutting through complexity

Commercial Real Estate survey: Executives move forward in slow market

Will look to increase efficiencies and cut costs

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KPMG's industry outlook surveys

KPMG LLP, the audit, tax and advisory firm, surveyed top-level executives in the commercial real estate industry during the second quarter of 2012.

Participants were asked about business conditions in their sector, the most significant revenue growth areas, and factors that would impede or support recovery in real estate. These responses were compared to the findings of a similar survey conducted among commercial real estate executives in the second quarter of 2011.

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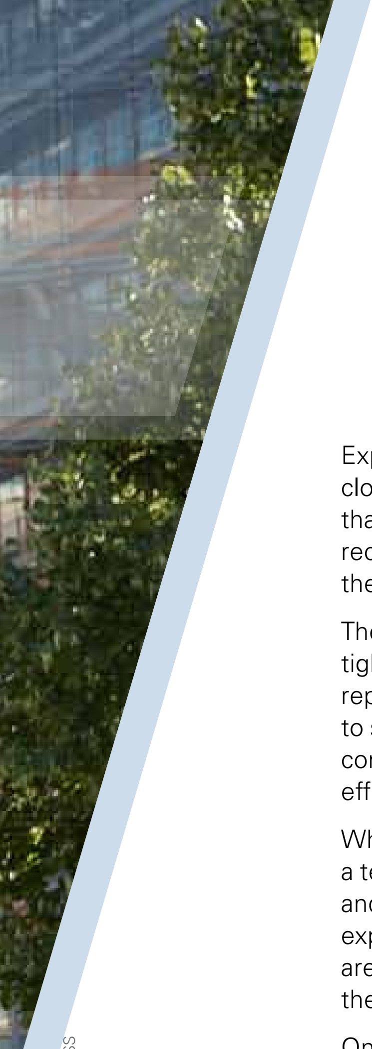


Expectations by commercial real estate executives for a modest but continuing sector recovery are closely aligned with their expectations for the U.S. economy as a whole. This optimism is more subdued than last year's assessments, when a larger portion of respondents hoped for a robust or even full recovery within a year or two. In 2012, it appears the real estate industry recognizes the full extent of the downturn, and expectations have been adjusted accordingly.

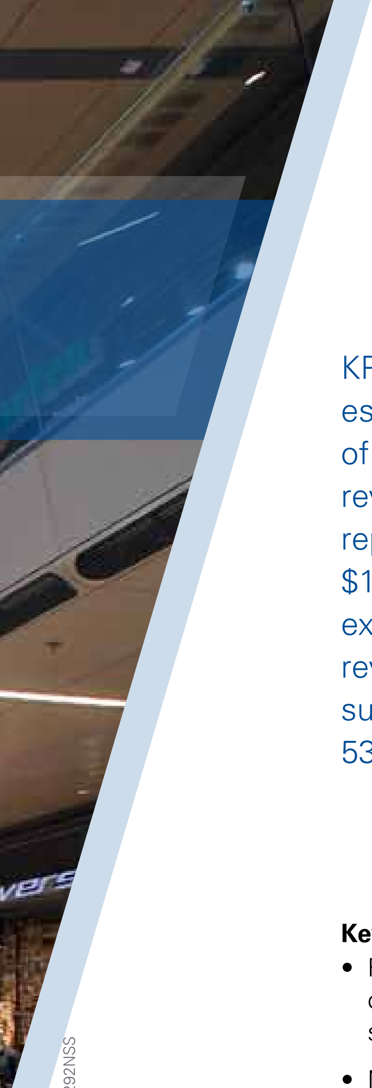
The industry still faces significant barriers to growth, including pricing pressures, sluggish demand, tight credit markets, and regulatory uncertainty. However, real estate executives in this year's survey report that their companies are undertaking a number of well-considered and strategic initiatives to squeeze out unnecessary costs, improve efficiencies, and focus on organic growth to enhance their competitive posture. Moreover, they plan on ramping up their investments in IT in support of improving efficiencies, especially in the area of regulatory reporting.

While increasing operational efficiencies and reducing costs will be a primary focus, there is also a tempered optimism exhibited by executives as industry fundamentals continue to slowly improve and bright spots emerge. One such bright spot will be in the area of multifamily development, which is expected to see a significant spike in activity in 2013. In addition, modest gains in hiring and revenue are expected to continue over the next year, further signaling positive momentum building within the industry.

On behalf of KPMG, I would like to thank those executives who participated in this survey. I hope the findings are useful to you in addressing market challenges and opportunities. I also welcome the chance to discuss this study and its implications for your business in the year ahead.

Greg Williams
National Sector Leader, Building, Construction & Real Estate
KPMG LLP

Key findings from KPMG's 2012 Real Estate industry outlook survey



KPMG's survey reflects the responses of nearly 80 senior real estate executives from large, U.S.-based companies. The majority of respondents (55 percent) work for companies with annual revenue between $100 million and $1 billion, while 36 percent represent companies with annual revenue between $1 billion and $10 billion, and 7 percent work for companies with annual revenue exceeding $10 billion. Another 2 percent work for companies with revenue below $100 million. Forty-seven percent of the executives surveyed work for companies that are publicly held, while 53 percent are privately held.

Key findings from the real estate sector include the following:

- Fifty-one percent of survey respondents believe that the multifamily sector will see a significant amount of development beginning in 2013. Fourteen percent anticipate that the industrial sector will experience significant development during this time.
- Nearly half (46 percent) of the real estate executives surveyed expect to spend the majority of their time and energy over the next two years on increasing operational efficiencies and reducing costs versus other initiatives.
- The top three areas where executives plan to increase spending over the next year include technology (52 percent), business acquisition (37 percent), and employee compensation and training (32 percent).
- More than two-thirds (72 percent) of respondents said improving real estate fundamentals will be the biggest growth driver over the next one to three years, representing a 22 percentage point increase in this category as compared to last year's survey.
- Executives cite pricing pressures (35 percent), lack of customer demand (25 percent), access to and managing capital (24 percent), and regulatory and legislative pressures (21 percent) as the most significant barriers to growth.
- Fifty-six percent of real estate executives surveyed said their company's revenue has increased over the last year, while 67 percent anticipate continued revenue growth a year from now.
- Forty-seven percent of survey respondents reported adding U.S. employees over the last 12 months, and 58 percent expect to add more over the next year. Meanwhile, 23 percent noted that their company's U.S. headcount has already returned to prerecession levels.
- More than half (58 percent) of the executives surveyed expect some improvement in economic conditions over the next year. However, 63 percent have pushed back their expectations for a full U.S. economic recovery until 2014 or later.

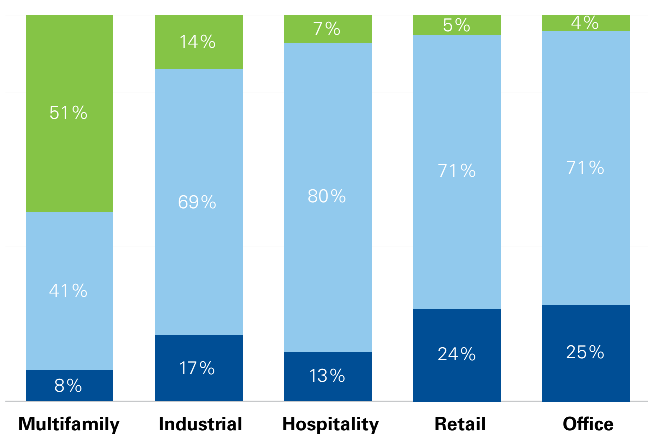
A tempered outlook for the year ahead

According to this year's survey, the commercial real estate market continues to make strides in the right direction despite a lackluster economy. While progress is slow going, bright spots are emerging, including some real estate asset classes that are expected to improve in 2013. However, persistent slow growth and pricing pressures will likely result in more executives seeking to increase efficiencies and reduce costs over the next year. At the same time, executives say they will concentrate efforts on pursuing growth opportunities, relying on a return of real estate fundamentals to boost revenue over the next three years. Overall, modest gains in revenue and hiring are expected to continue, but sector executives are less optimistic longer-term, pushing back their predictions for substantial economic recovery until 2014 or later. This is a much deflated view from last year's survey when the majority of those surveyed believed in the possibility of a complete economic recovery by the end of 2013.

Future development

Executives expect to see continued development over the next year, especially in the multifamily sector, where more than 50 percent believe there will be significant development beginning in 2013.

Expected areas of development starting in 2013

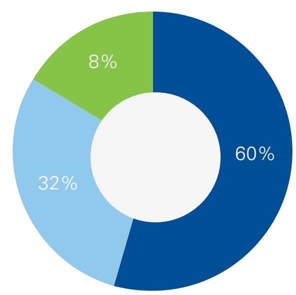


Key

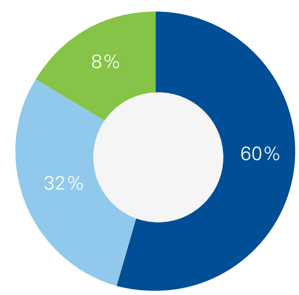
- None
- Some
- Significant amount

A closer look at key fundamentals

Comparing key economic fundamentals, such as unemployment, job growth, cost of living, etc., in their primary markets today versus expectations for 2013, 60 percent of executives anticipate that these dynamics will improve in 2013. Interestingly, when asked specifically about real estate fundamentals, their responses reflected the same perspective. Sixty percent of respondents believe real estate fundamentals, such as vacancy, occupancy, rental rates, deal velocity, etc., in their primary markets will improve in 2013.



Key *economic* fundamentals outlook 2012 (2Q)



Key *real estate* fundamentals outlook 2012 (2Q)

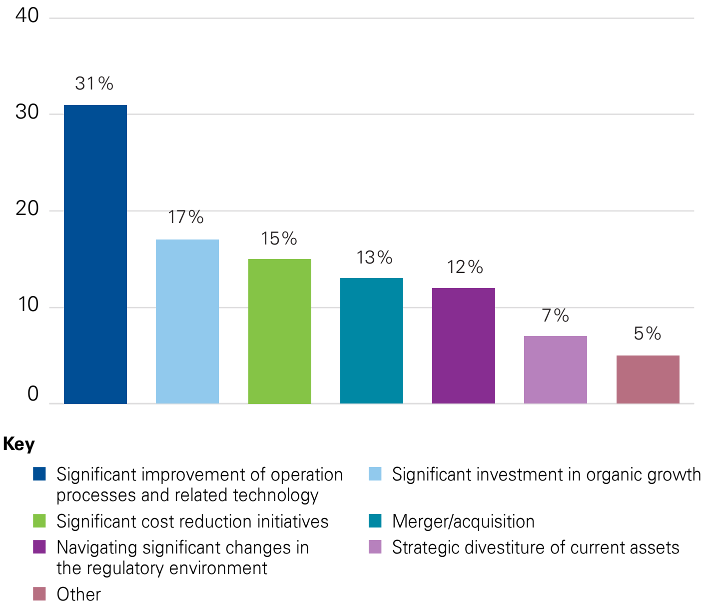
Key

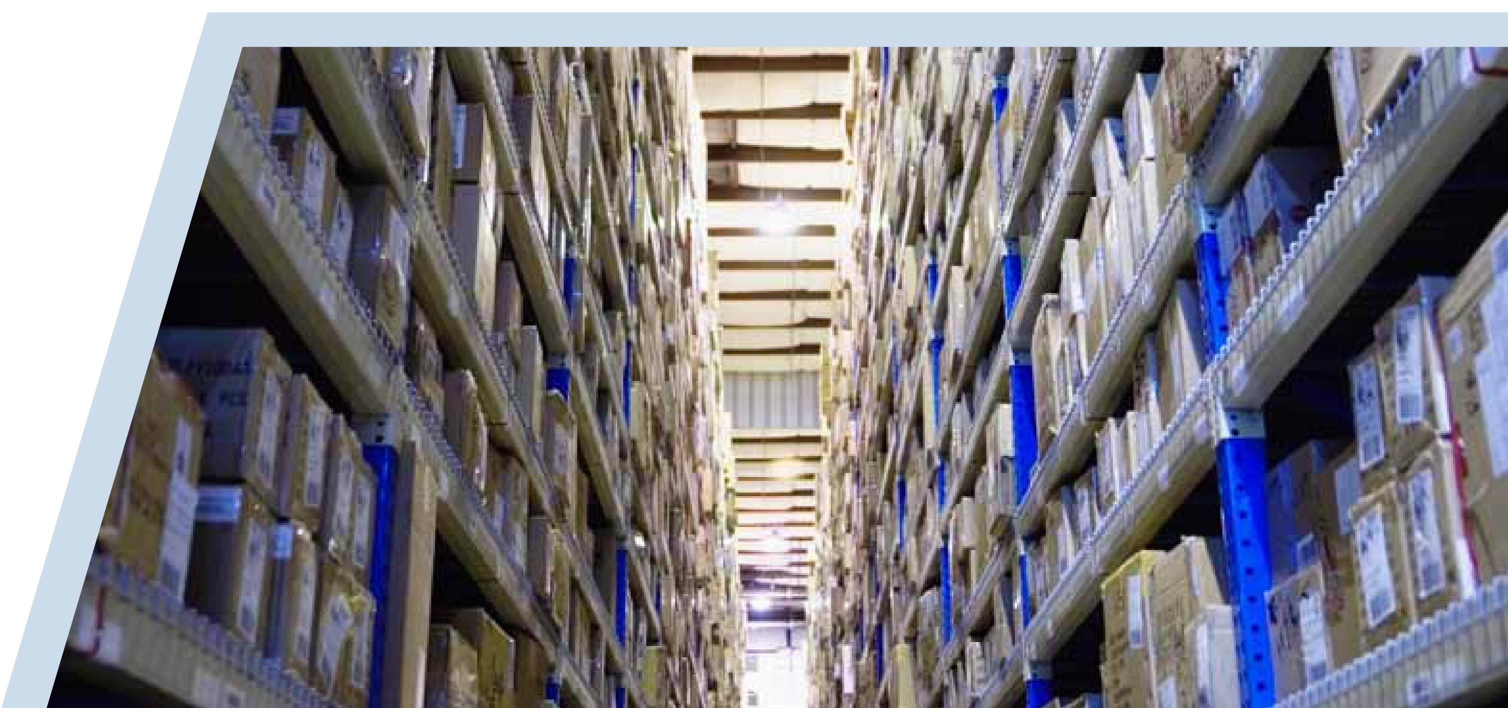
- Better in 2013 versus today
- About the same in 2013 versus today
- Worse in 2013 versus today

Initiatives garnering attention

When asked about the top initiative on the minds of management over the next two years, 31 percent of executives cite the need to significantly improve operational processes and related technology, followed by investing in organic growth (17 percent) and cost-cutting initiatives (15 percent).

Top management initiative over the next two years

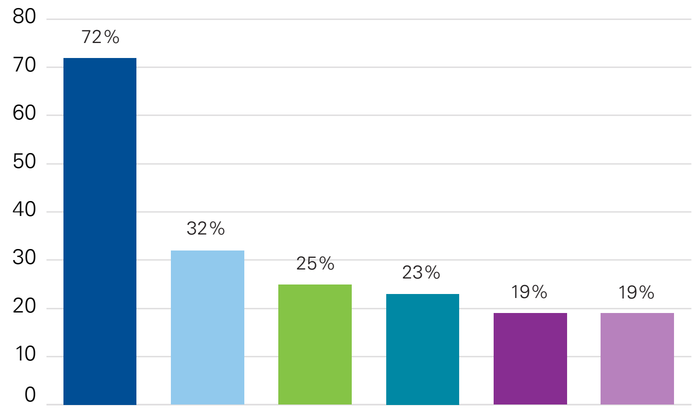




In pursuit of growth and opportunities

Improving real estate fundamentals will be a key revenue driver over the next three years, according to 72 percent of survey respondents. Respondents also see acquisitions (32 percent) and geographic expansion (25 percent) as potential drivers of revenue growth moving forward.

Biggest drivers of company's revenue growth: Next 1–3 years



Key

- Improving real estate fundamentals
- Acquisitions
- Geographic expansion
- New services
- Better/cheaper access to capital
- More aggressive leasing

Multiple responses allowed.

Meanwhile, pricing pressures (35 percent) and a lack of customer demand (25 percent) were seen by respondents as the most significant growth barriers facing their industry over the next year.

Barriers to growth

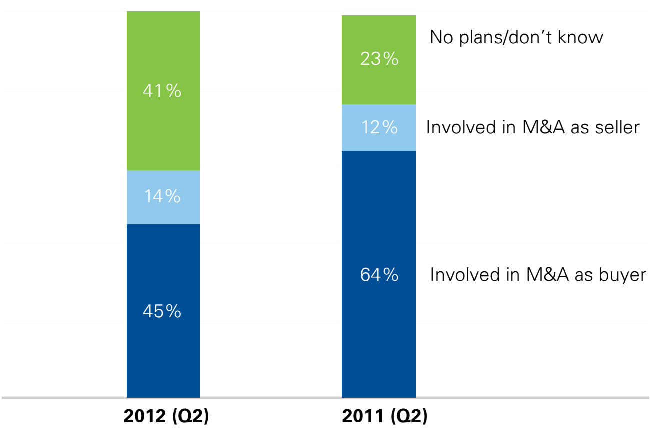
Pricing pressures	35%
Lack of customer demand	25%
Access to and managing capital	24%
Regulatory and legislative pressures	21%
U.S. dollar strength	16%
Lack of qualified workforce	15%
Energy prices	13%
Increased taxation	13%
Risk management issues	8%
Labor costs	8%
Inflation	7%
Volatile commodity/input prices	7%
Staying on top of emerging technologies	5%
Foreign competition	3%
Exchange rate fluctuations	3%
Other	9%

Multiple responses allowed.

M&A activity

Survey results signaled less enthusiasm toward mergers and acquisition strategies within the sector. When asked about the likelihood of their company being involved in a merger or acquisition during the next two years, 45 percent of real estate executives in 2012 say they will be involved in an M&A transaction as a buyer, down from 64 percent a year ago. Meanwhile, 41 percent said their company has no plans or are unsure if they will be involved in M&A activity, as compared to just 23 percent in 2011.

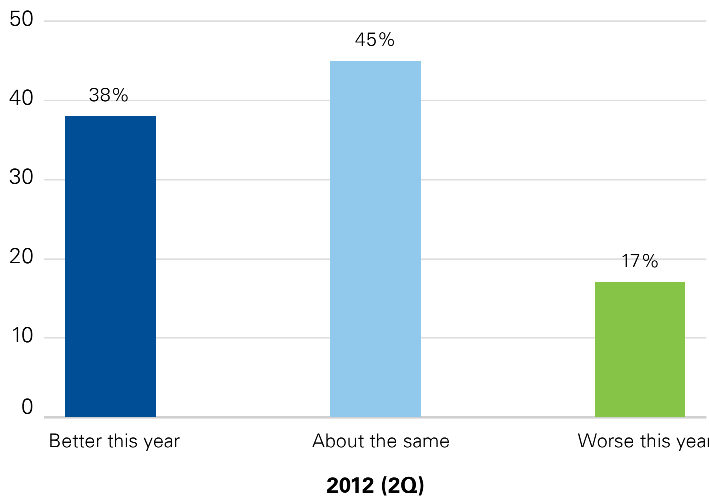
Likelihood of M&A activity



Investment opportunities

Forty-five percent of respondents say the environment for investment opportunities has remained relatively the same as the previous year, while 38 percent believe it has improved during this time.

Marketplace for investment opportunities



Real estate executives in this year's survey view distressed assets as the biggest investment opportunity over the next 12 months.

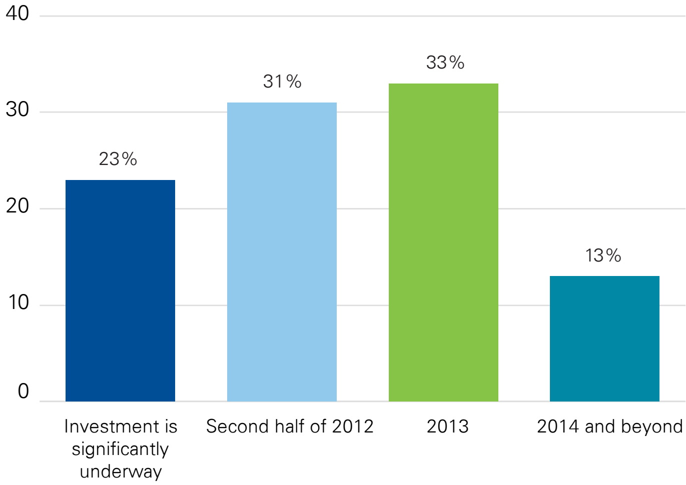
Assets most likely to acquire over next 12 months

	Biggest Opportunity	2nd Biggest Opportunity	3rd Biggest Opportunity
Distressed assets	36%	23%	12%
Development opportunities	28%	17%	35%
Class A assets in secondary/tertiary markets	23%	20%	32%
Class B/C assets	8%	36%	18%
Other	5%	4%	3%
Total	**100%**	**100%**	**100%**

Capital spending and investing

More than half of executives (52 percent) indicate they have significant cash on the balance sheet and are ready to start spending. In fact, 23 percent of that population acknowledges that investment already is significantly underway, but a plurality (33 percent) said they expect to invest it in 2013.

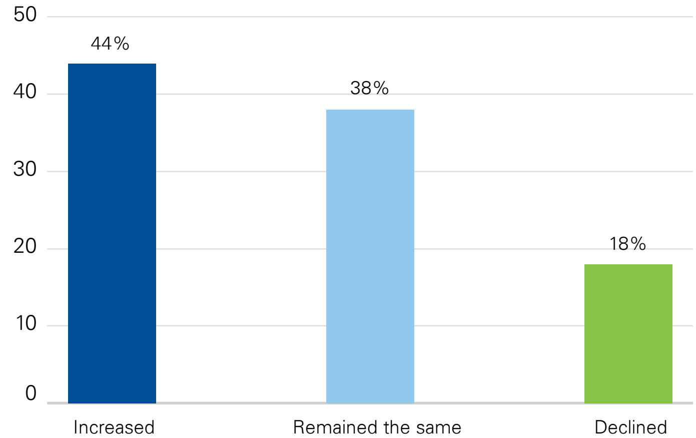
Investment time frame



Cash position

Compared to a year ago, 44 percent of the executives surveyed note that their company's balance sheet cash position has increased, while 38 percent say it has stayed the same.

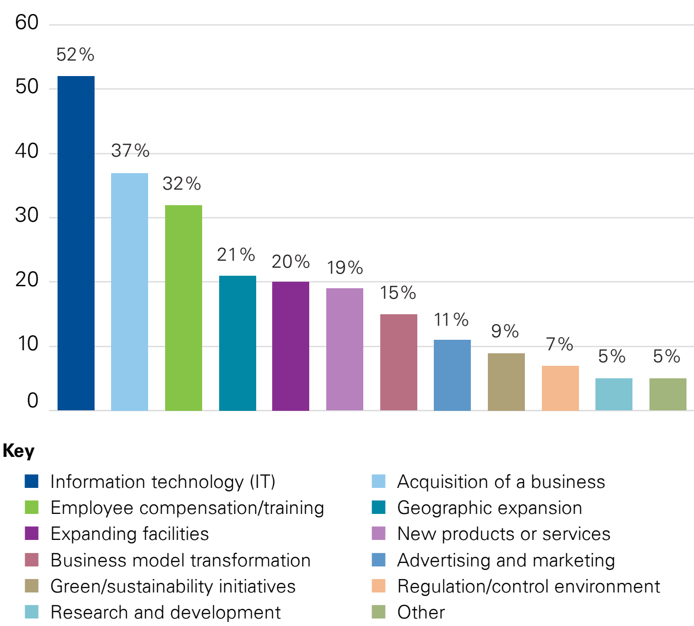
Cash position



Capital spending

Forty-six percent of survey respondents predict their company's capital spending will increase, while 35 percent expect it to stay the same over the next year. Much of this spending will be in the areas of information technology (52 percent), business acquisition (37 percent), and employee compensation and training (32 percent).

Increased areas of capital spending over the next year

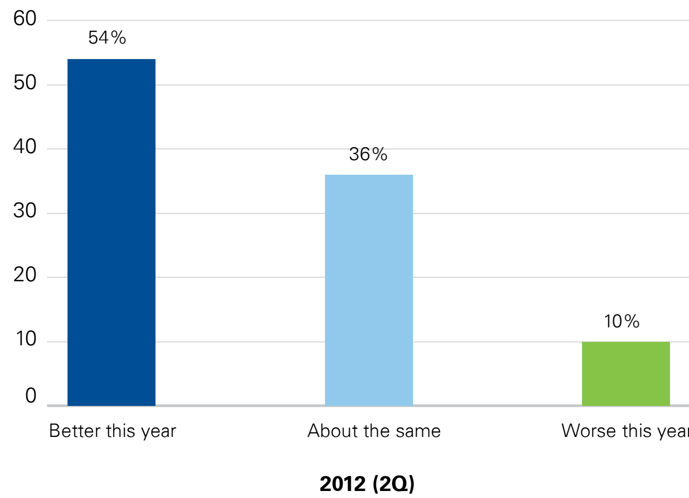


Multiple responses allowed.

Availability of debt

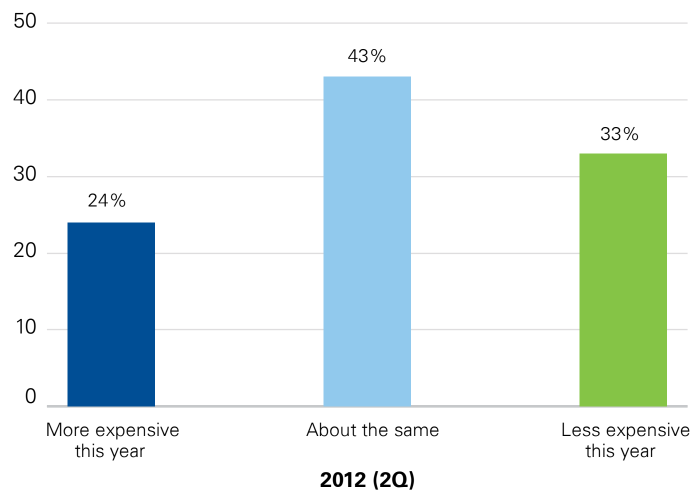
The commercial real estate industry has continued to see improved access to debt financing, with 54 percent of executives rating their company's current access better than this time last year. Meanwhile, 10 percent report that their access is worse this year compared to the same period in 2011.

Current access to debt financing compared to last year



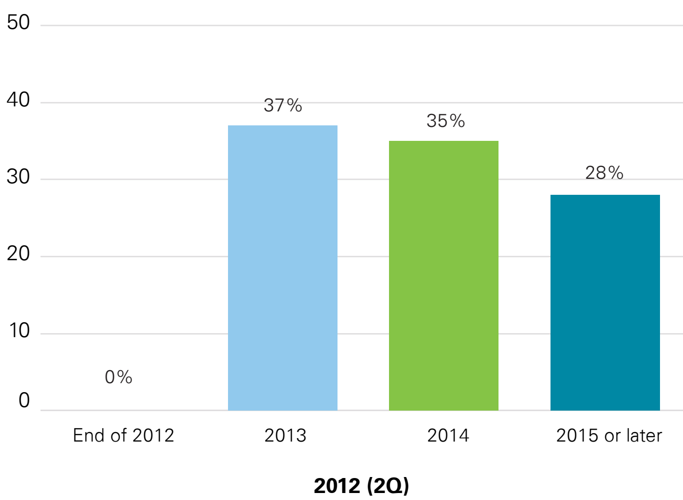
At the same time, 33 percent of executives report that the cost of debt financing was less expensive than the previous year, while 43 percent believe it has remained the same.

Cost of debt financing today versus 2011



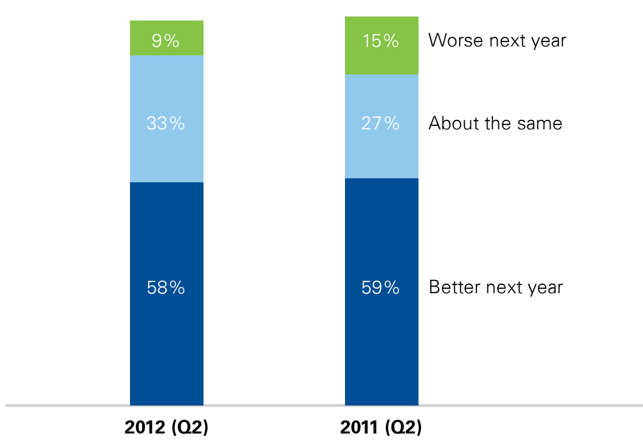
Hope for recovery remains on the horizon

Hopes for a full U.S. economic recovery seem to have been pushed back, according to the real estate executives surveyed. The majority (63 percent) believe that it will not actually occur until 2014–2015 or beyond. This differs from last year's results, in which 31 percent of survey respondents expected a full recovery in 2012 (the following year), while 57 percent anticipated it would happen in 2013 or later.



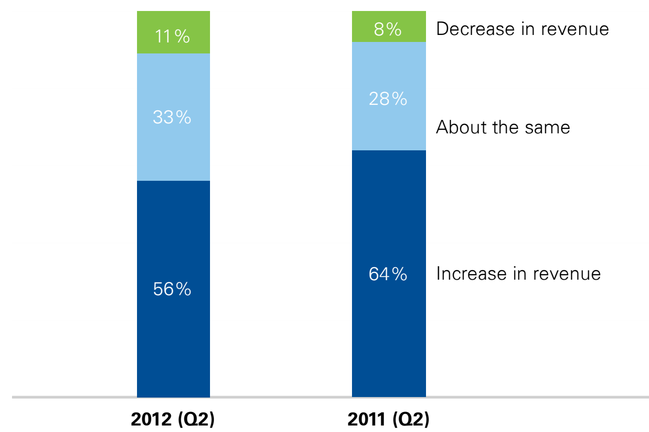
Business conditions

More than half (58 percent) of sector executives believe that the economy will improve over the next year, while only 33 percent expect conditions to stay the same. This is similar to last year's results, in which 59 percent and 27 percent, respectively, answered the same question.

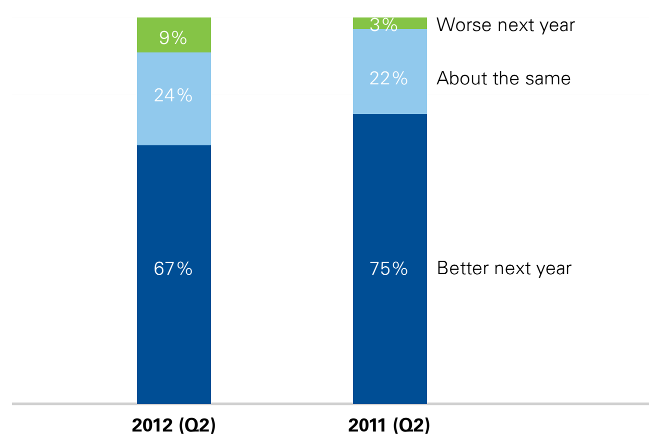


Revenue

A small majority (56 percent) of survey respondents report generally modest revenue increases over the last year, which represents a slight dip from 64 percent who reported a revenue increase in 2011.

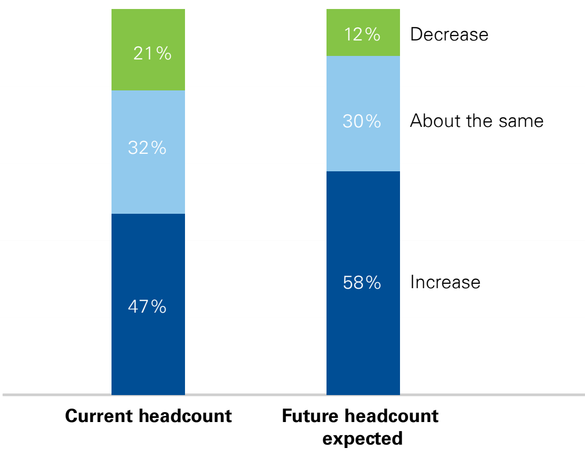


When asked to describe their revenue expectations a year from now, 67 percent of executives predict that revenue will increase, down from 75 percent the previous year. Meanwhile, 24 percent believe revenue will stay flat over the next year as compared to 22 percent in 2011.



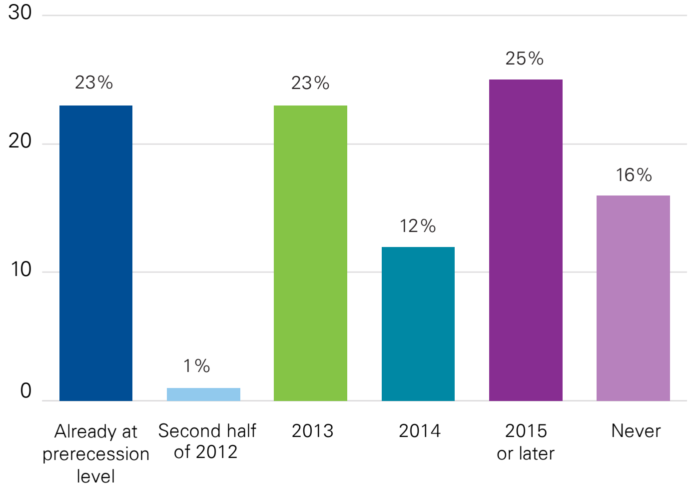
Headcount

Real estate executives added more U.S. employees over the last year, with 47 percent of respondents reporting an increase in headcount, while 32 percent reported no change. Executives have higher expectations for the year ahead, with 58 percent predicting an increase in hiring and 30 percent expecting headcount to stay the same.



Interestingly, 23 percent of survey respondents said that their U.S. headcount has already reached prerecession levels, but 16 percent believe it will never return to those levels.

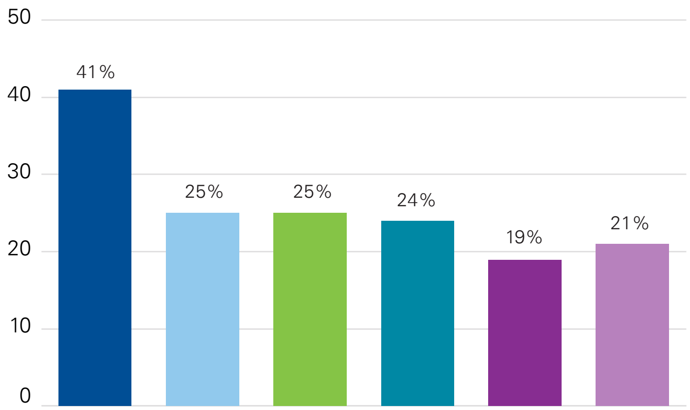
Headcount: Return to prerecession levels



Risk and regulatory challenges

Evolving regulation and changing marketplace dynamics are encouraging more companies to implement strong internal risk frameworks. Asked to identify any challenges preventing the adoption of a formal risk policy, 41 percent of survey respondents cited culture and behavior as a key challenge, while 25 percent believe that process integration or operational efficiency pose significant obstacles.

Challenges preventing the adoption of a formal risk policy



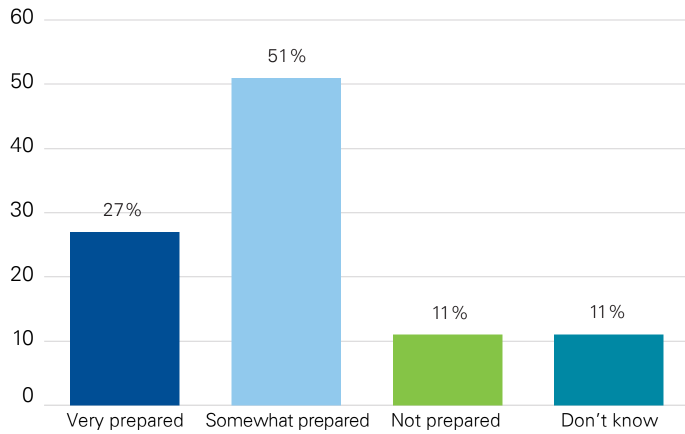
Key

- Culture and behavior
- Process integration/efficiency of operations
- Governance framework
- Clearly defined roles and responsibilities
- Shared resources across the organization
- Don't know

Multiple responses allowed.

Despite obvious challenges, 51 percent of respondents believe their company is somewhat prepared to seize opportunities as a result of public policy and regulatory reform. Notably, 27 percent report being very prepared.

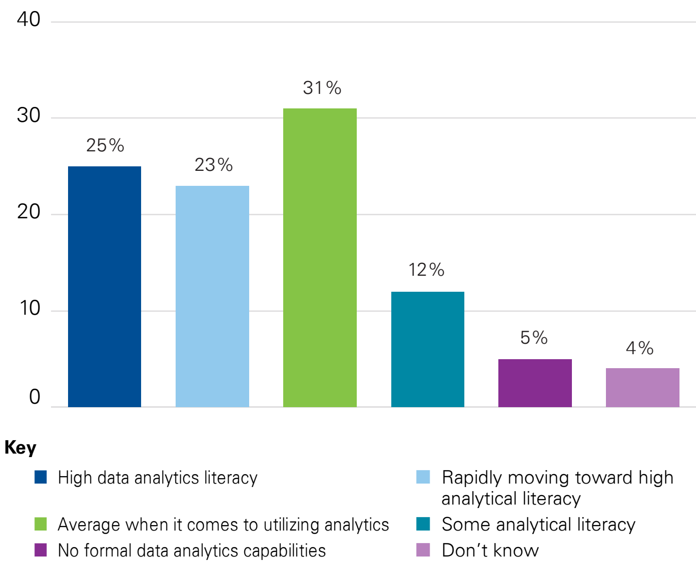
Ability to seize opportunities from regulatory change

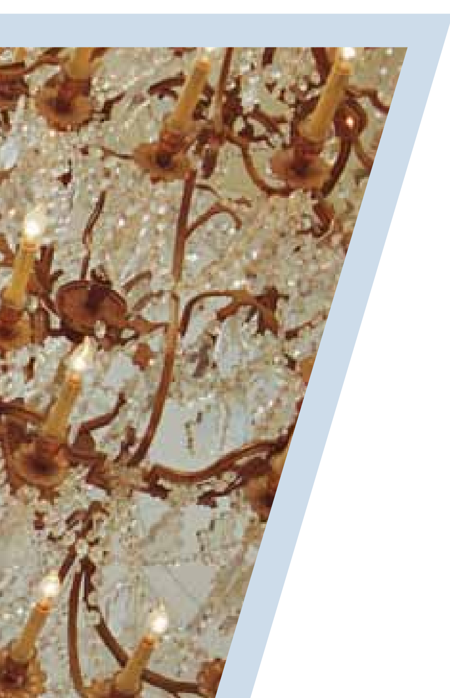


Data analytics and digital marketing channels

When asked to describe their organization's maturity regarding usage of data analytics, 31 percent of executives rate the data analytics literacy of their company as average, while nearly as many—25 percent—rate their data analytics literacy as high.

Data analytics literacy of company





Exploring digital marketing channels

Commercial real estate executives plan to use digital, social, and mobile technologies in a variety of ways over the next 12 months. In fact, 43 percent have plans to use social media for external brand promotion, 35 percent will use it to gain customer insight, and 33 percent will deploy it for recruiting purposes over the next year.

Digital marketing strategies planned for year ahead

Social media for external brand promotion	43%
Social media for customer insight	35%
Social media for recruiting	33%
Customer-facing mobile applications	31%
Mobile-specific customer-facing web sites	25%
Mobile-specific enterprise web sites (i.e., mobile intranets)	24%
Social media for two-way customer engagement	23%
Enterprise mobile applications	23%
Location-based marketing using mobile technology	21%
Social media for enterprise collaboration/knowledge sharing	20%
Creation and distribution of digital media internal messages using video	20%
Creation and distribution of digital media marketing messages using video (including company-specific external video channels)	19%
Social media for customer crowd sourcing	19%
Social media for enterprise crowd sourcing	11%
Social media for enterprise risk management	7%
Mobile-commerce technologies including near-field communication-enabled payments and mobile wallets	4%

Multiple responses allowed.

Conclusion

The commercial real estate industry is slowly but steadily coming back from the most difficult market contraction in a lifetime. Real estate executives are cautiously optimistic, even though this optimism is tempered by a realistic assessment of the many challenges still facing real estate companies. Pricing pressures and mounting regulations continue to pose significant hurdles.

At the same time, future trends point toward a more efficient, cost-effective industry characterized by innovative processes, new technologies, improved employee compensation, and a measured approach to growth based on organic development and carefully chosen acquisitions. The encouraging signs are clear. More than half of the respondents expect the economy to continue to improve. Fifty-eight percent expect to add headcount over the next year—up from 53 percent in last year's survey. In addition, 87 percent of the companies reporting significant cash on hand expect to make strategic investments, either this year or next.

If one statistic captures the attitude of the industry in 2012, it might be this one: 72 percent of respondents said that improving real estate fundamentals will be the biggest growth driver over the next one to three years, an increase of 22 percentage points compared to last year. With a careful focus on costs, markets, and the bottom line, the real estate industry will likely be well positioned to maintain a path toward full recovery in the years ahead.

KPMG LLP's Building, Construction & Real Estate professionals provide strategic insights and relevant guidance wherever our clients operate. We provide services on a local and national level with a network of 1,500 dedicated professionals in the United States and through the global network of KPMG International member firms, comprising more than 3,000 professionals in 77 countries. This network of member firms enables us to serve a broad array of building, construction, and real estate enterprises worldwide, providing extensive international coordination and a thorough understanding of global markets and their attendant risks and opportunities. In the United States, we advise owners, managers, developers, lenders, intermediaries, construction and engineering firms, and investors in effectively executing complex transactions ranging from acquisitions and dispositions, to securitization of real estate assets for individual properties and portfolios, to entity-level mergers and acquisitions, and to interpretation of and compliance with a broad range of regulations and standards. KPMG member firms provide the right resources to meet our clients' needs, regardless of geography.

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