

Commercial Real Estate Update and Outlook

10 November 2009

Introduction

- A slow but sustained economic recovery is underway
- An end to supportive government policies is a critical uncertainty and risk
- Property fundamentals to remain weak through 2010
- Commercial real estate debt has yet to meaningfully surface
- The REITs rally does not necessarily signal a US CRE recovery
 - Reflected an unwinding of bankruptcy risk along with an improvement in lending markets
 - Also, prices are now above MS price target of 480

Section 1

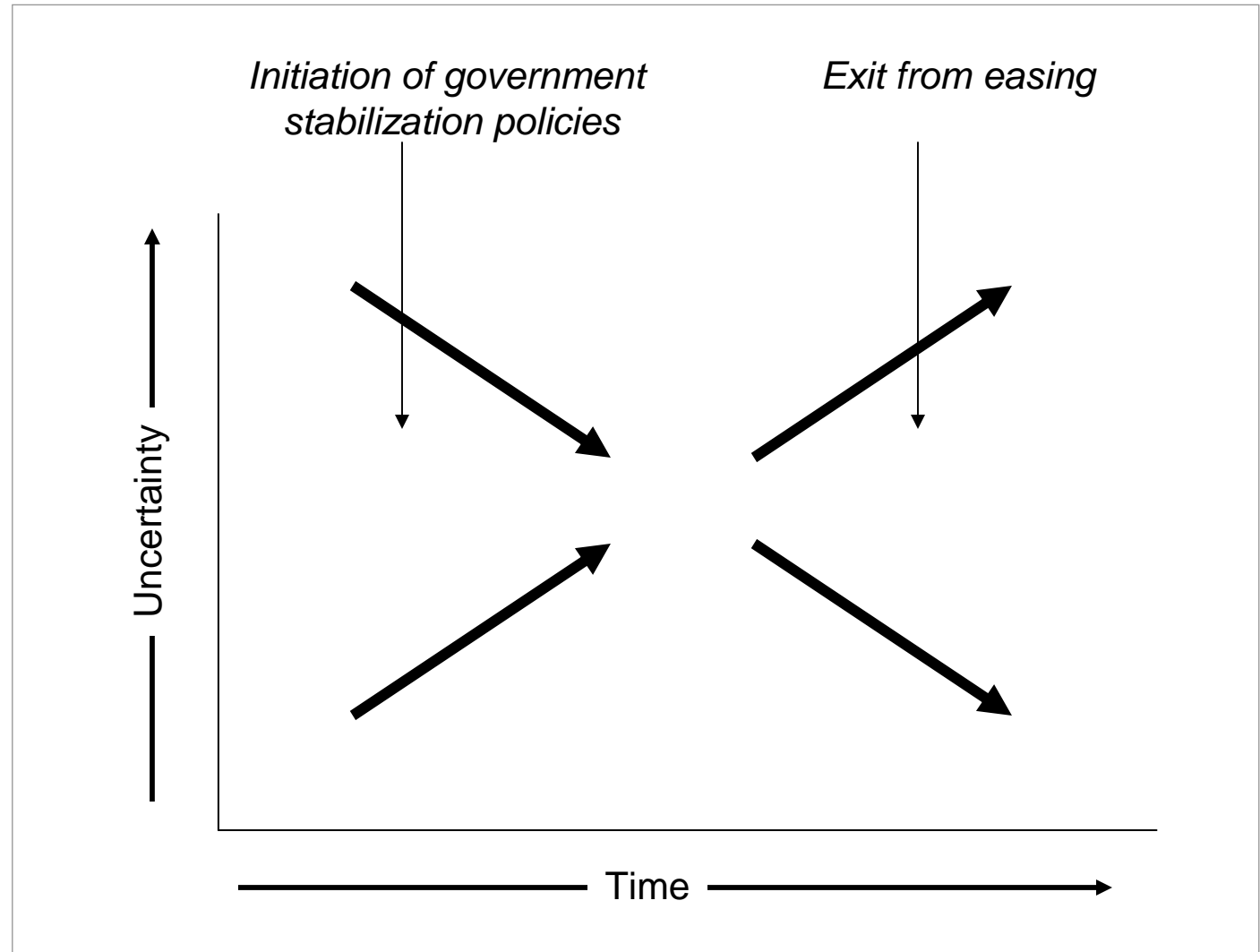
Economy

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A Framework for the Recovery Outlook

Timing the exit

- Fed waiting for clear broad based economic expansion
- Look for Fed commentary to lead action
- May provide specific commentary before steps are taken
- Will be open about uncertainties and risks



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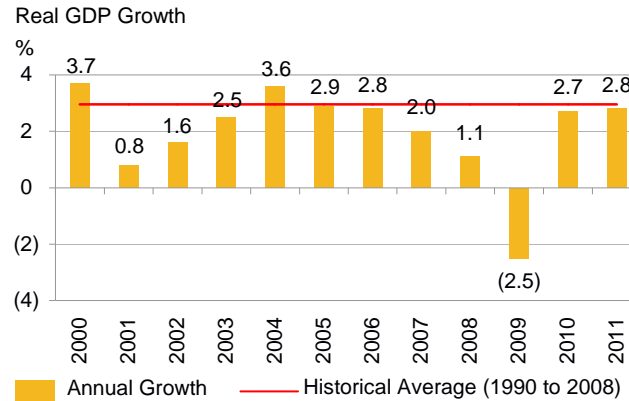
What Shape of Economic Recovery

Shape	Description	Rationale
V	Sharp downturn, followed by sharp recovery	Rapid crashes can be followed by strong recoveries
Square Root	Sharp recovery, but followed by slower sustained growth	As above, but macro headwinds weigh on expansion
U	Protracted recovery	Recovery will be impaired by need to remedy macro headwinds (e.g., savings rate, consumption, etc.)
L	Sharp downturn followed by no recovery	Minimal private sector impetus for recovery, macro headwinds prevail
W	Double dip recession followed by recovery	Government-led recovery, but resumption of private sector expansion lags
Lightning Bolt	Double dip recession not followed by recovery	Macro headwinds need to be unwound before growth occurs

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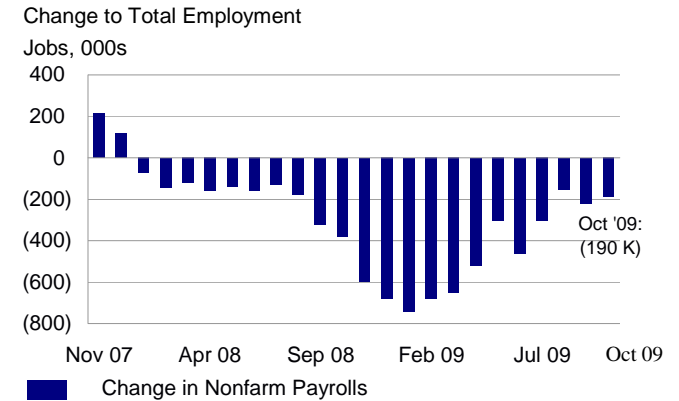
Tracking the Shape of Recovery

Economic Growth



Source: Moody's, BEA, Morgan Stanley projection, as of October 2, 2009

Monthly Job Losses Slowing



Source: Moody's Economy.com, Bureau of Labor Statistics, as of September 30, 2009

Review of Leading Indicators

	Latest Data Point	Trailing 3 Mo Avg.	as of	Economy Scenarios (Shading Reflects Current Point)			
				Deep Recession	Recession	Flat Growth	Expansion
Monthly Job Growth	(263,000)	(256,000)	Sep, '09	< (300,000)	(300,000) to (50,000)	(50,000) to 50,000	50,000+
Unemployment Rate	9.8	9.6	Sep, '09	> 7.0	6.0 to 7.0	5.0 to 6.0	< 5.0
Unemployment Claims	551,000	560,000	Sep, '09	> 500,000	400,000 to 500,000	350,000 to 400,000	< 350,000
Consumer Confidence	53	52	Sep, '09	< 65	65 to 75	75 to 85	> 85
Industrial Production Growth	(10.7)	(12.1)	Aug, '09	< (3.0)	(3.0) to 0.0	0.0 to 1.0	> 1.0
Manufacturing Index	53	51	Sep, '09	< 42	42 to 48	48 to 55	> 55
Credit Spreads ⁽¹⁾	284	318	Sep, '09	> 300	300 to 225	225 to 175	< 175

Source: Moody's Economy.com, BLS, U.S. ETA, The Conference Board, Federal Reserve, Institute for Supply Management, MSREI Strategy as of October 5, 2009

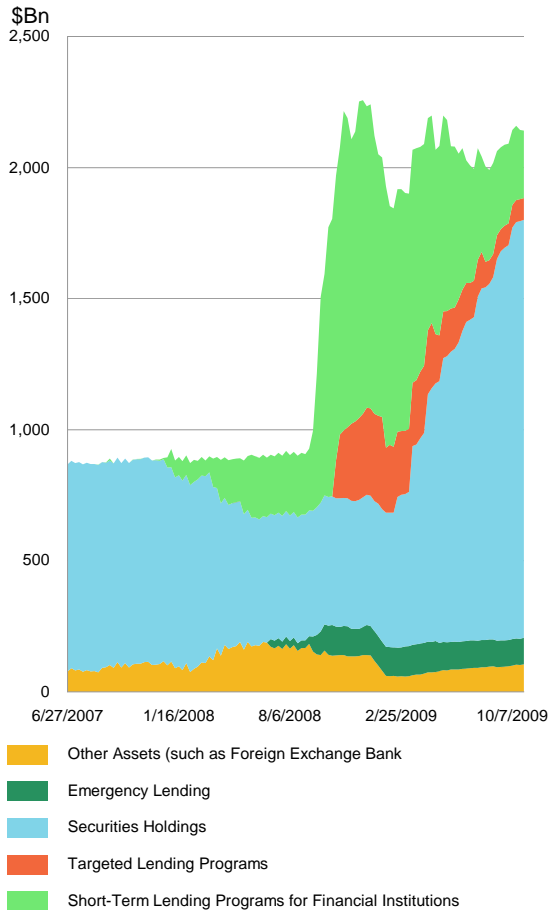
Notes

1. Baa Corporate spread to US 10 year Treasury yield

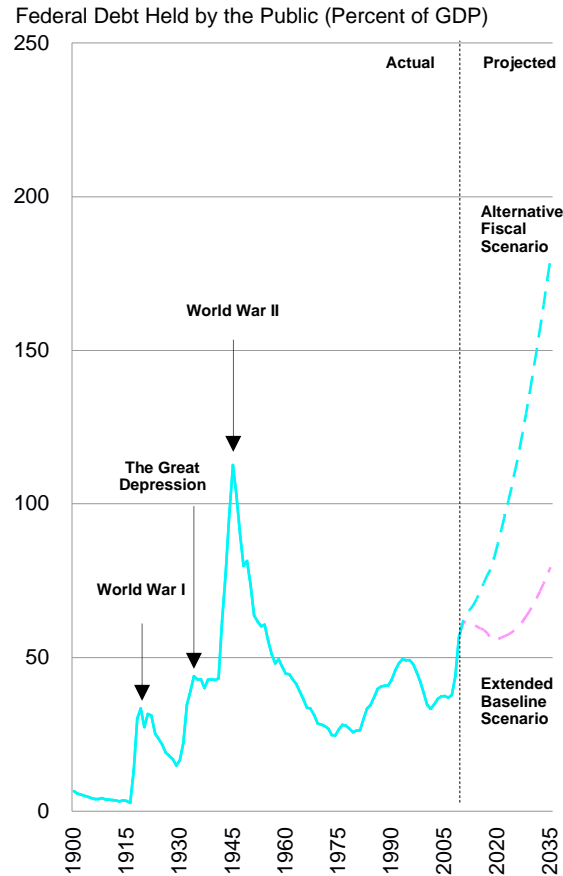
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Significant Government Intervention

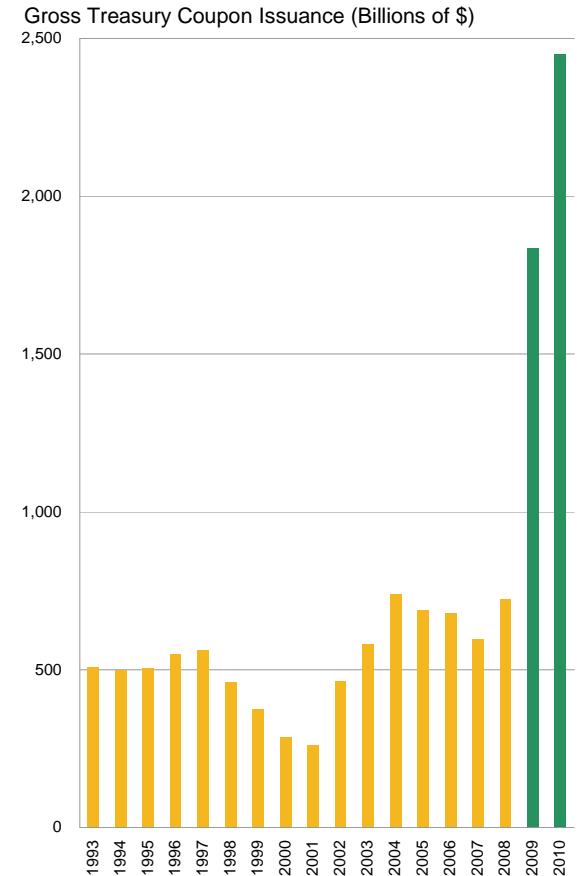
Fed's Balance Sheet Will Continue to Grow for Now



The Long-Term Debt Outlook is Dire in any Scenario



Treasury Supply Will Continue to Skyrocket



Source US Treasury, Morgan Stanley Research

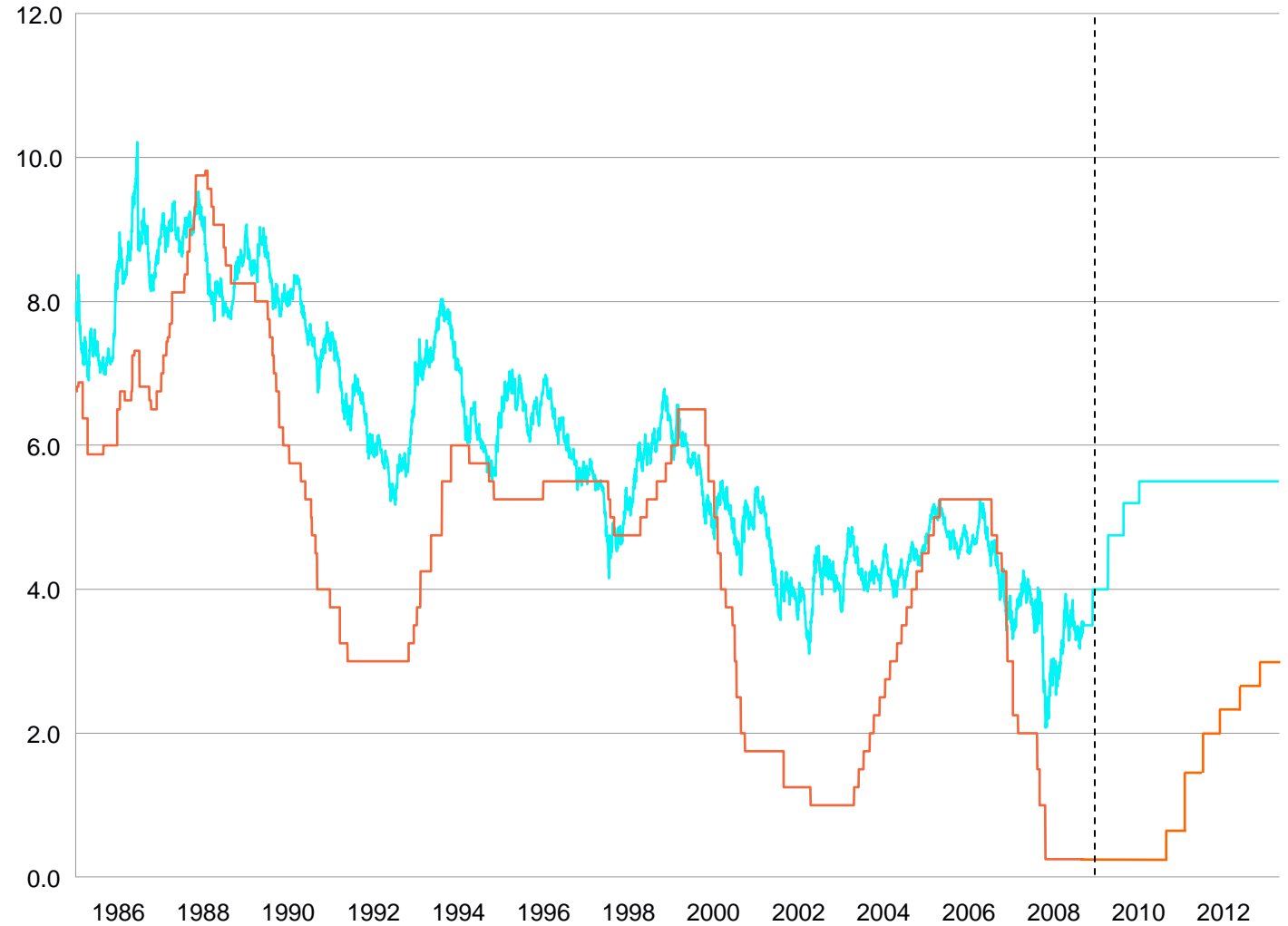
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Interest Rates

U.S. Federal Funds Target Rate and 10-Year Treasury Yield ⁽¹⁾

1986 – 2012E

%



— 10-Year Treasury Yield — Federal Funds Target Rate

Source Factset

Notes

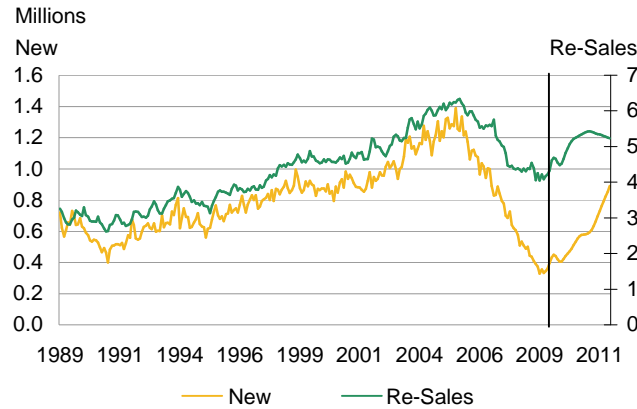
1. 2010-2012 figures use Morgan Stanley estimates

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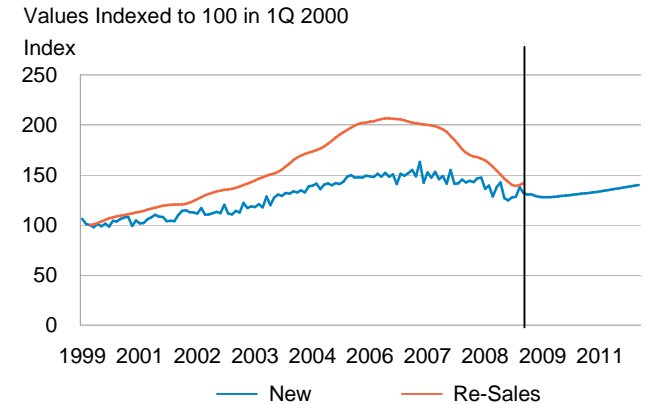
U.S. Housing Market May Be Reaching The Bottom

- Homebuilding construction activity is in “complete freefall.” Overall residential investment in Q2 dropped by 25%. New homebuilding activity was off 50% year-on-year
- Affordability is currently at record highs, and spurred by expectations of higher mortgage rates to come, bargain-hunting buyers are back
 - Inventory of new homes for sale has dropped from over 12 months’ worth to around 7 months

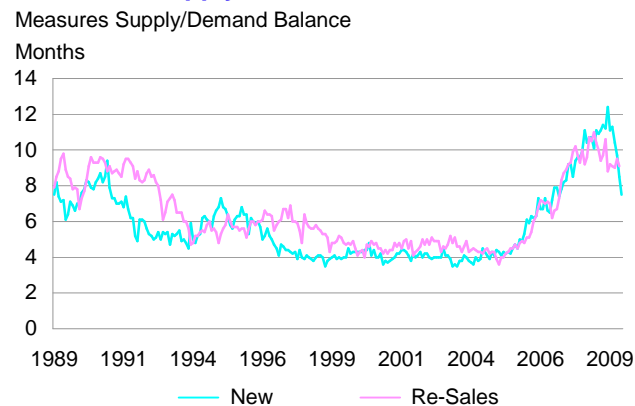
Sales



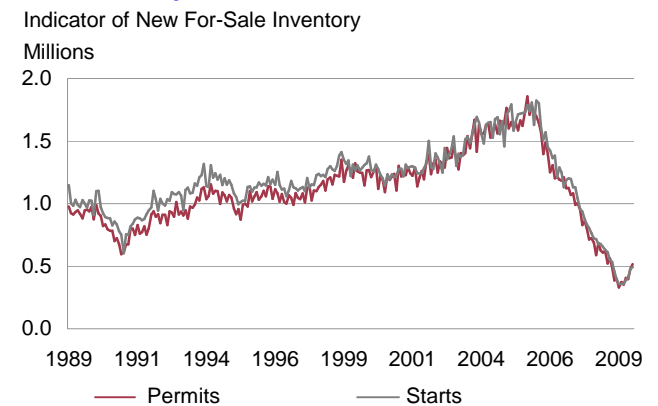
Home Prices



Months of Supply



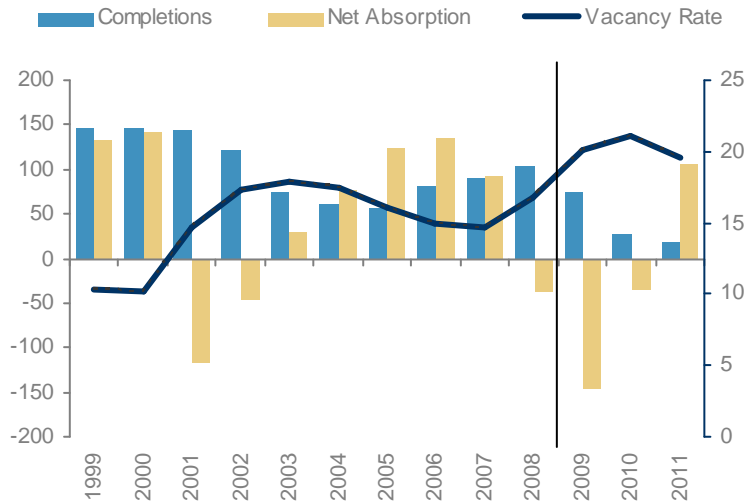
New Development



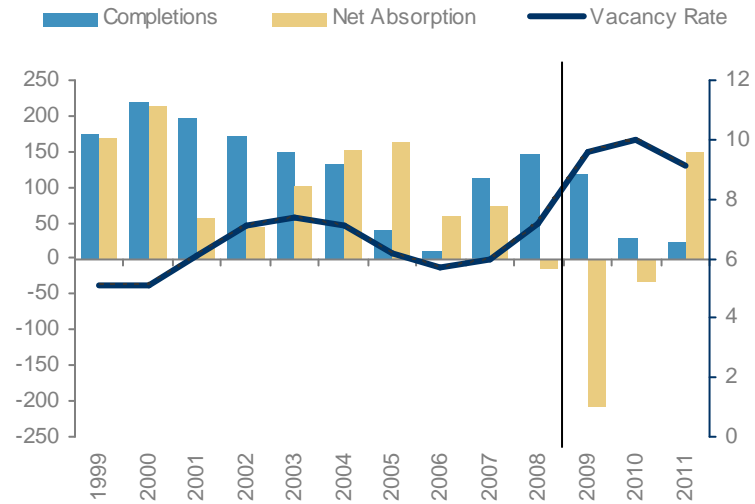
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Property Fundamentals Outlook

Office



Apartment



Rent Growth



Rent Growth



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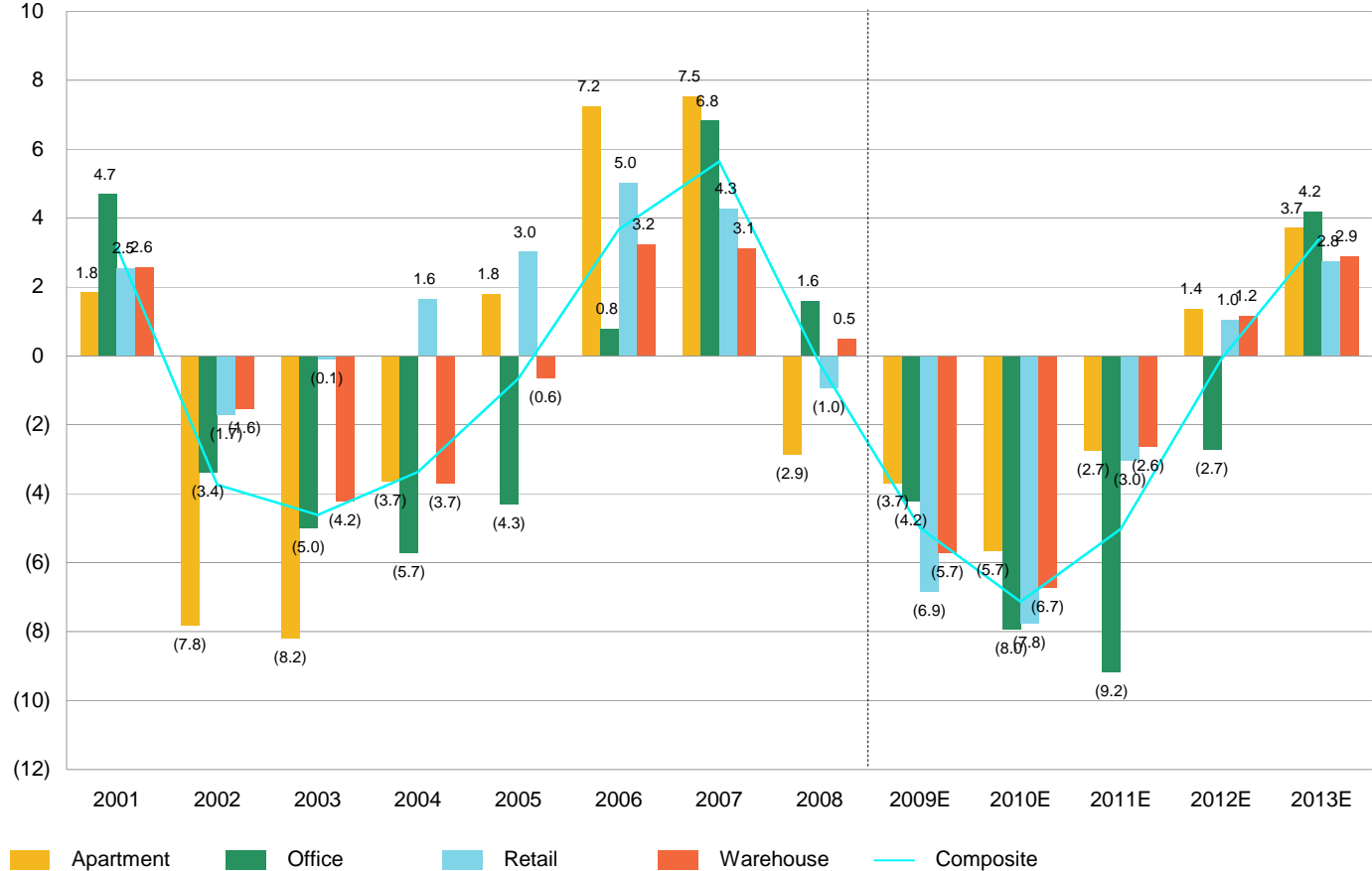
Income Forecasts

- NOIs will decline further this cycle than in the post-dot-com correction of the early 2000s
- The apartment sector, with short lease terms, could correct soonest
- Positive growth is expected to resume in 2012 or 2013

U.S. NOI Growth

By Sector

%



Source PPR, MSREI Strategy

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Table Of Vacancy Rates And Rent Changes By Market

Vacancy Forecast

	Cycle Low	Latest	Increase So Far	Cycle Peak	Incremental Increase
California					
San Francisco	8.6	12.9	430	12.9	0
San Jose	12.2	25.5	1,330	26.0	50
Oakland	14.2	15.3	110	17.4	210
Sacramento	14.5	20.5	600	27.1	660
Los Angeles	9.7	15.2	550	19.1	390
Orange County	7.7	19.5	1,180	20.4	90
Riverside	7.6	23.4	1,580	24.3	90
San Diego	10.7	20.5	980	21.3	80
Mountain / Pacific					
Denver	14.2	18.1	390	21.4	330
Phoenix	11.8	25.8	1,400	28.6	280
Portland	12.4	15.2	280	19.1	390
Seattle	8.8	16.3	750	21.9	560
Other Major Markets					
New York	5.7	9.7	400	12.4	270
Washington, DC	8.9	14.7	580	17.2	250
Dallas	20.3	21.8	150	24.5	270
Atlanta	16.5	19.9	340	23.4	350
Chicago	14.9	18.5	360	20.7	220
Nation	12.4	16.1	370	18.8	270

Section 2

Real Estate Investing

REAL ESTATE INVESTING

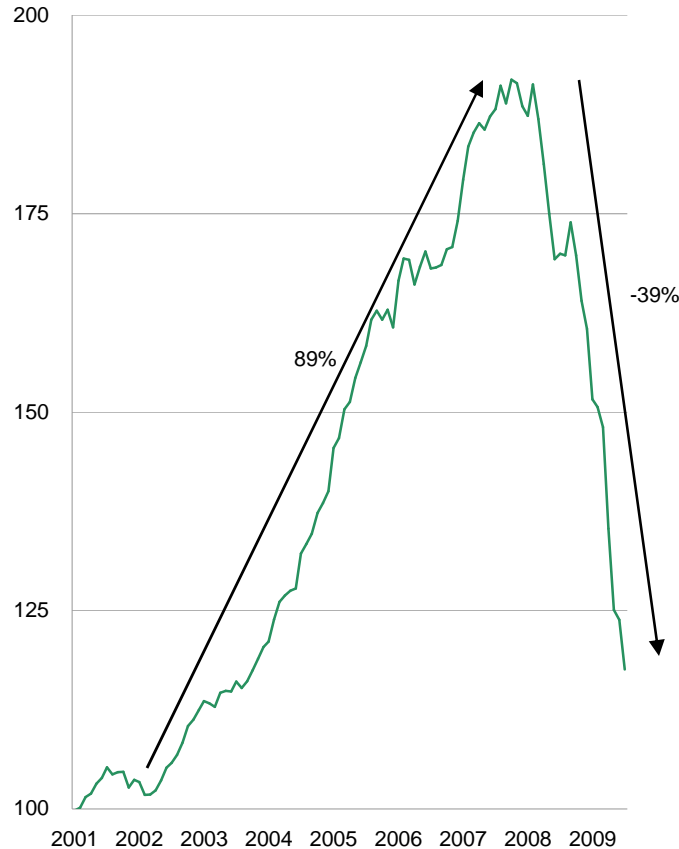
Tracking Commercial Real Estate Price Trends

Commercial Real Estate Projected for a +/-40% Peak-to-Trough Decline

- Benchmark returns have already declined 39% through July according to Moody's Commercial Property Price Index (CPPI)
- Derivative markets estimate a +/-45% peak-to-trough price adjustment
 - down by 30%+ already
 - further value writedowns remaining

Commercial Property Price Index

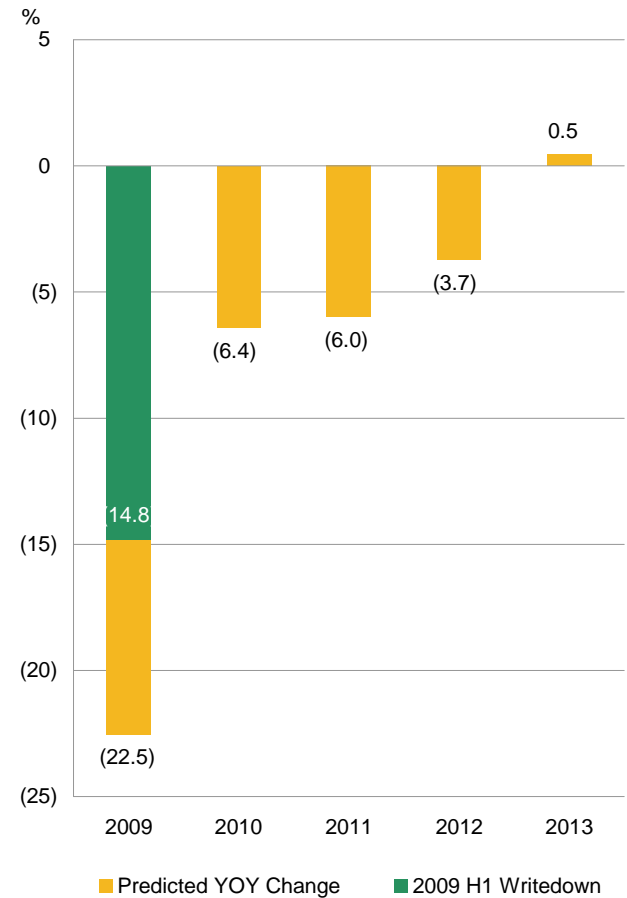
Repeat Sales Price Index
Index



Source Moody's, RCA, MIT, data through July 31 2009

Futures Market Predictions for CRE Returns

Predicted NCREIF Capital Value Change, from Dec 31 2008



Source Markit.com, NCREIF, Morgan Stanley, as of September 28 2009

Source DTZ Research

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REIT Market Performance

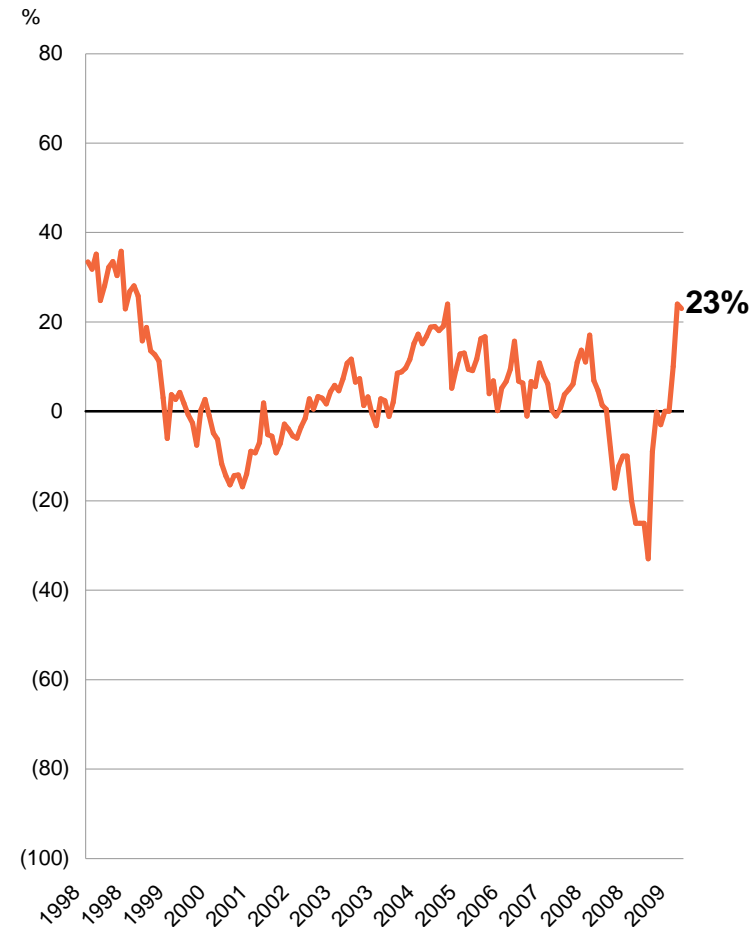
RMZ Share Price

Indexed to 100



Source Factset

Premium/(Discount) to NAV Analysis

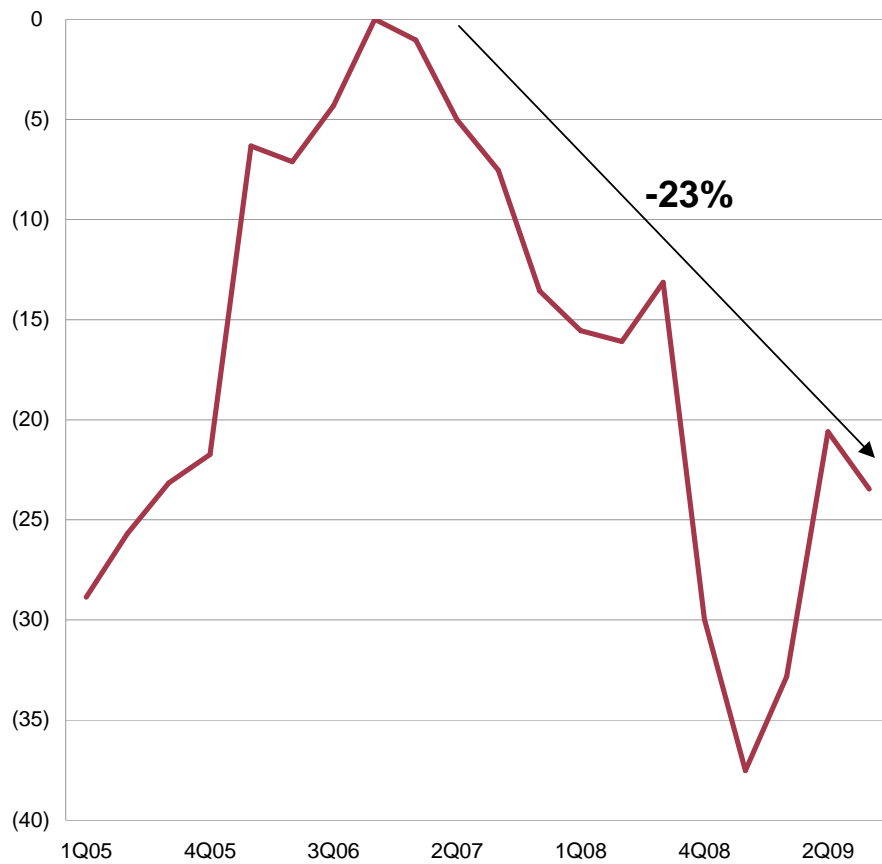


Sources Morgan Stanley Research

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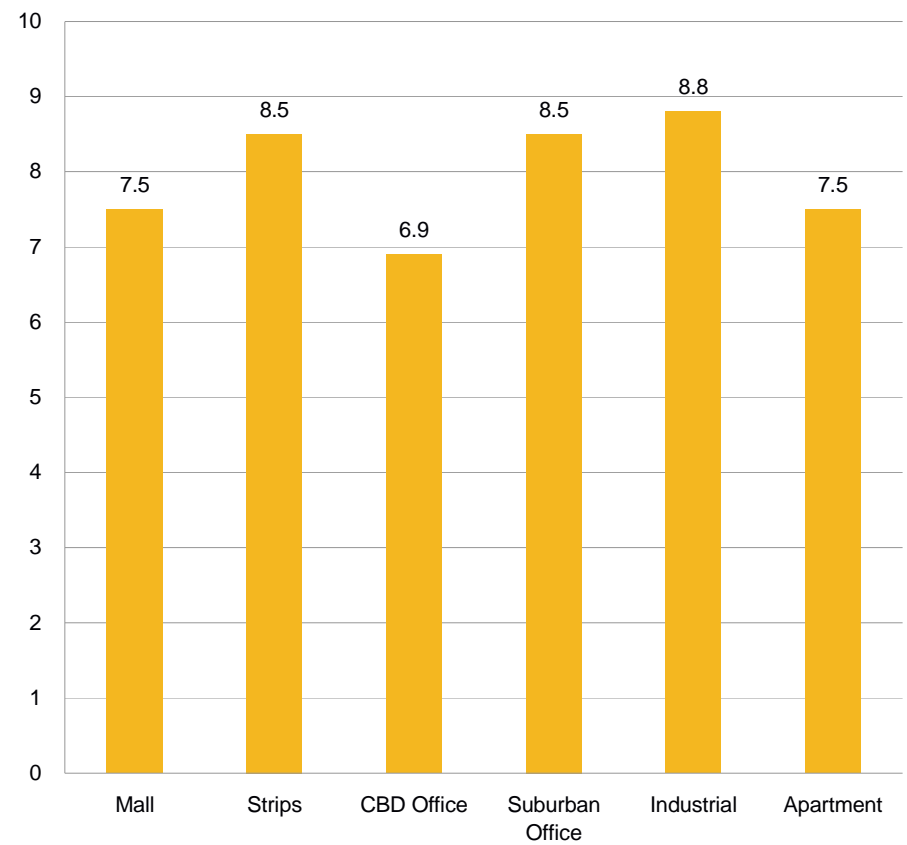
REIT Pricing Metrics for Transaction Markets

Indexed Office Price / Ft



Source Morgan Stanley, as of 3 November 2009

Implied Cap Rate

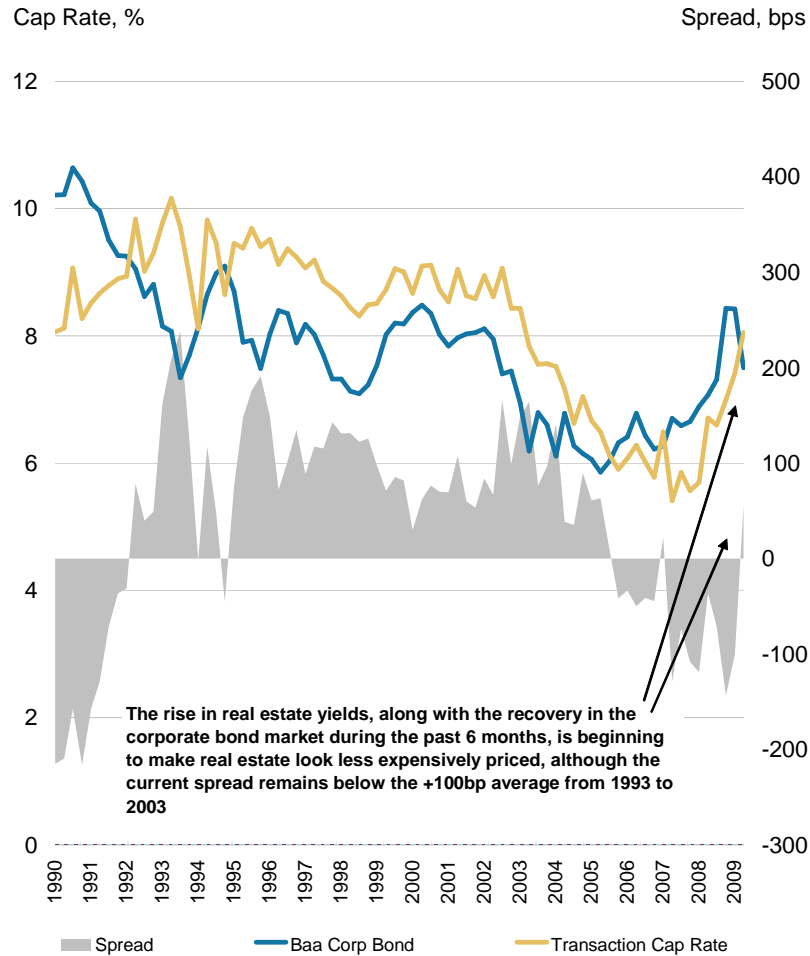


Source Morgan Stanley, as of 3 November 2009

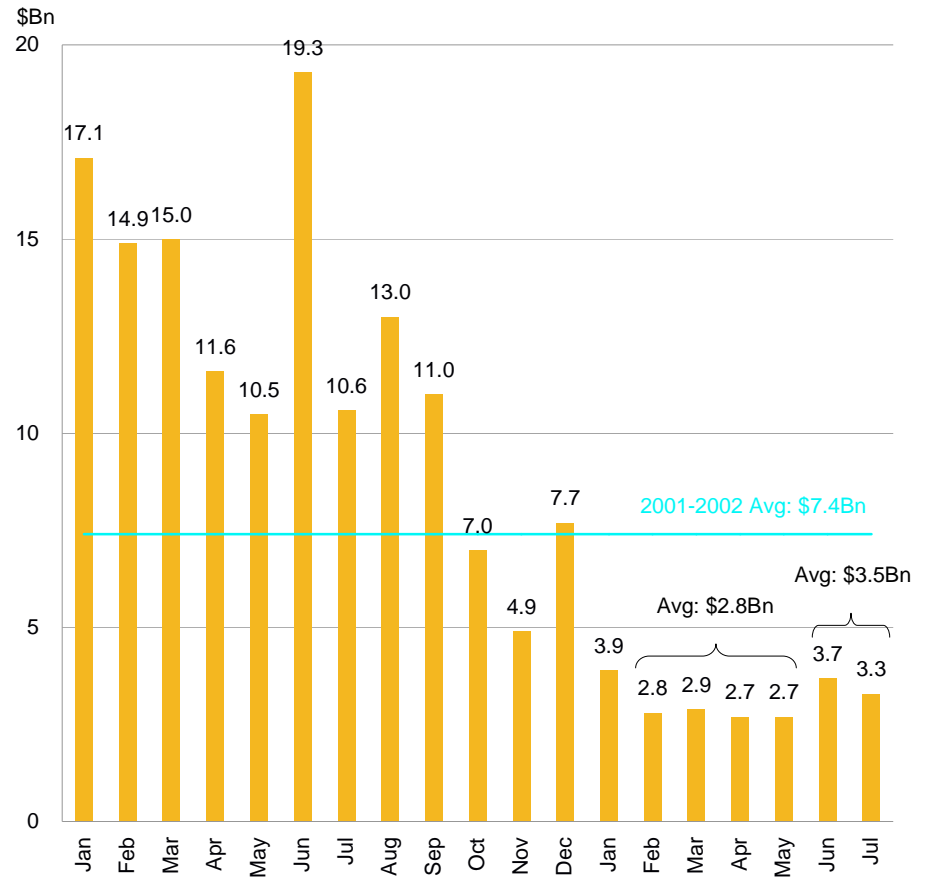
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Transaction Markets Have Bottomed, Set to Accelerate

Cap Rate Spread, 1990 – 2009



Monthly Deal Volume



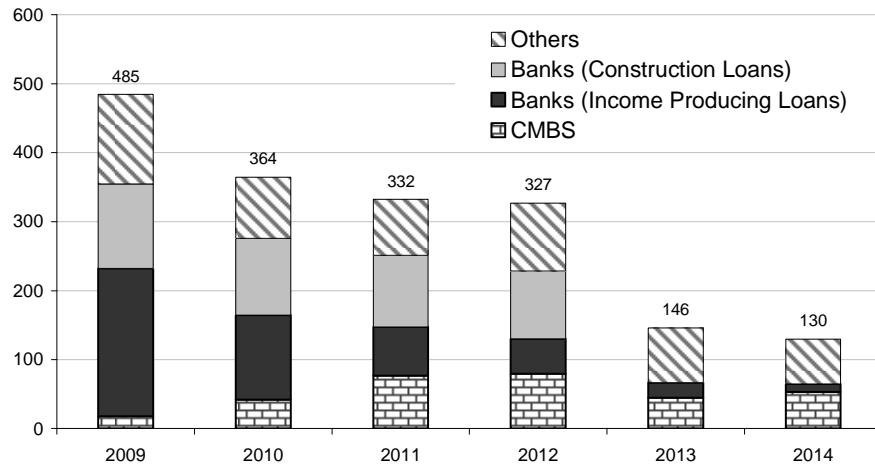
Source Real Capital Analytics through June, Morgan Stanley Research

Source: NCREIF, Morgan Stanley Research

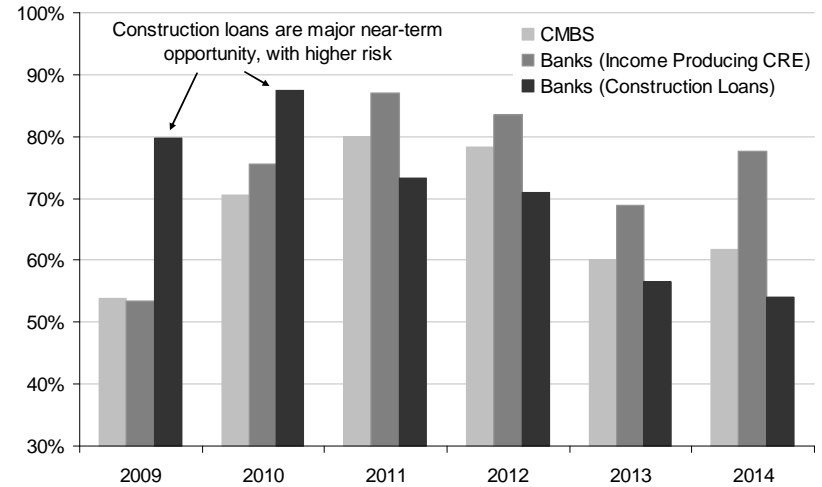
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Commercial Real Estate Debt

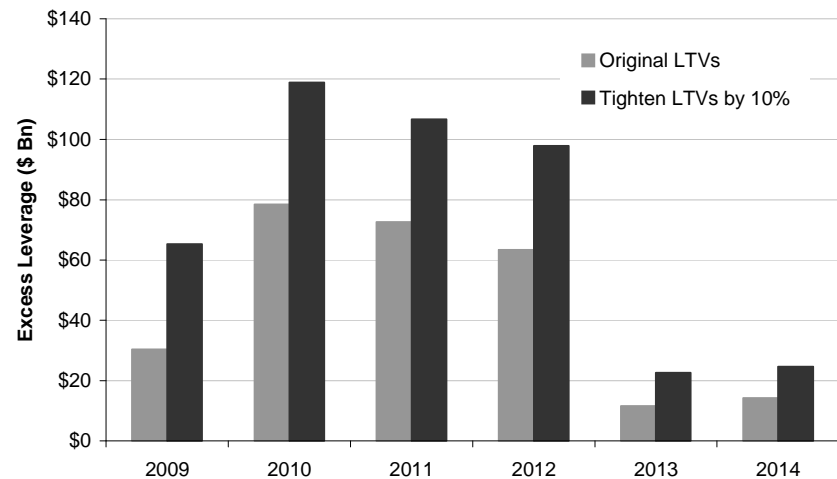
Debt Maturity Schedule (\$Bn)



Estimated Loan-to-Value Ratios at Maturity



Excess CRE Leverage at Maturity (\$Bn)

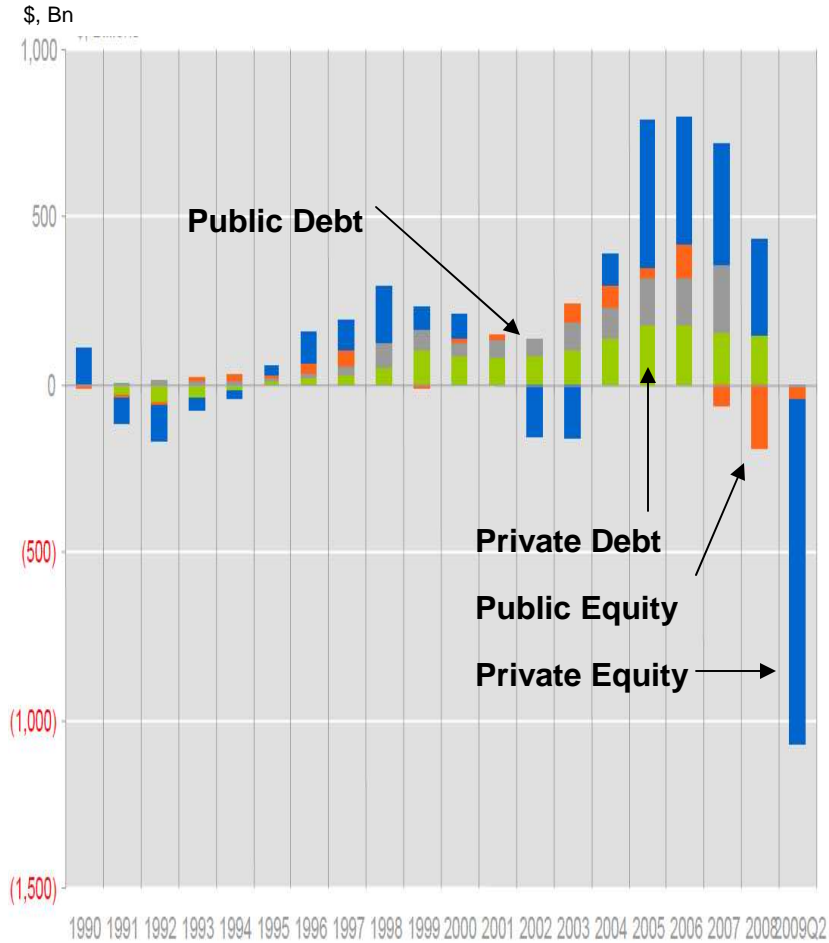


Source: Federal Reserve, FDIC, FFIEC, MBA, Trepp, Morgan Stanley Research

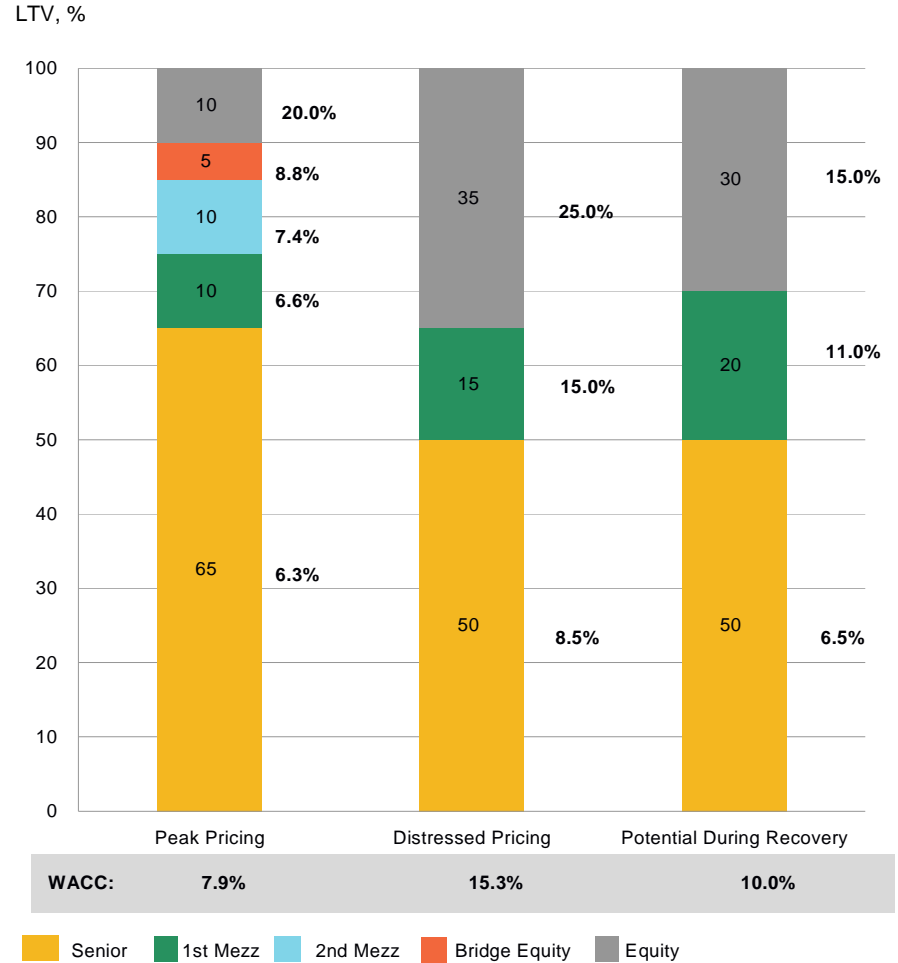
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Real Estate Capital Flows and Pricing

Real Estate Capital Flows



Capital Stack for Opportunistic Buyers



Takeaways

- Recession has ended, although macro risks remain
 - The Fed will take a clear approach to ending government support programs
 - Meaningful job growth will be slow to resume
- Commercial real estate lags economic cycles, further challenges ahead
 - CRE property fundamentals weak through 2010
 - Transaction market still very impaired for those who want to deploy capital
 - REIT pricing has come very far, but is now above NAV
 - The capital gap is sizable