

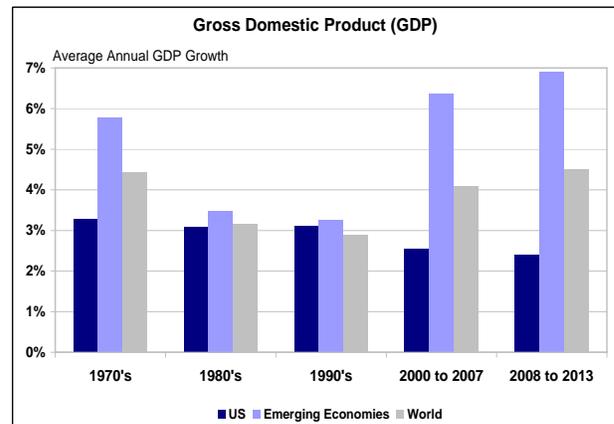
Oil & Real Estate: An In-Depth Analysis

Executive Summary

- The current high price of oil is not expected to be permanent but is more likely cyclical and prices should peak in 2009. High prices eventually slow demand and justify increased exploration and production, but it may take several years before this results in the price of oil falling to premium support levels.
- With respect to usage, the industrial sector is generally the most energy intensive. However, the multi-family and retail sectors are likely to be the most impacted by higher oil prices due to higher operating costs, increased tenant turnover costs, and reduced demand from a slowing economy.
- Rising energy costs suggest that location is more important than ever. Office buildings located in public transit dominant CBDs should see more demand growth than suburban office markets lacking public transit access. Multi-family located near major employment centers should see increased demand. Warehouse distribution centers in locations that minimize transportation, labor and rent costs, should also see increased demand.
- Pricing for older less efficient buildings is most at risk, as higher operating costs are likely to cut into their net rents more than at newer more-efficient buildings.

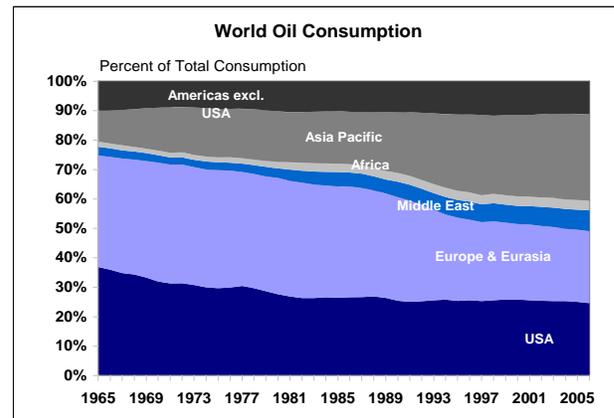
Is Global Oil Demand High?

In the past decade, there has been strong, global economic growth that has been particularly energy intensive and concentrated in emerging economies. Global annual GDP growth averaged 3.9% over the past decade, a level not seen since the 1970's. Since 2000, growth in emerging economies has taken-off, averaging 6.4% annual growth versus 2.5% for more developed economies. While the US currently accounts for 21.3% and the EU for 22.7% of global GDP, emerging economies account for two-thirds of the remainder. Of the emerging economies, China is in the lead, accounting for 10.8% of world economic growth in 2007.



Source: IMF, ARA Research

Strong global economic growth has led to strong global energy demand growth, even in the face of rising prices. As of 2007, world oil consumption averaged 85.8 million barrels per day, a 12% increase over the past decade. Much of this growth in demand has come from Asia – China in particular. By 1999, Asia became the largest oil consuming region in the world. As of 2006, Asia accounted for nearly 30% of global demand, with China alone accounting for 9% of total global demand.



Source: BP, ARA Research

Why Haven't Higher Prices Reduced Demand?

The price of crude oil has skyrocketed to over \$140 per barrel. While price increases usually cause demand to fall, this has not been the recent case during the last decade. Although demand fell in the Organization for Economic Cooperation and Development (OECD), demand grew in the emerging economies. According to International Energy Agency (IEA) data, OECD demand – currently accounting for 57% of global demand – contracted 0.5% in 2007, versus an annual average of 0.5% growth over the past decade. In contrast, non-OECD demand – currently accounting for 43% of global demand – grew 3.7% in 2007, well above the annual average growth of 2.8% over the past ten years. While oil demand in the OECD is less energy intensive and concentrated in gasoline consumption for transportation, demand in emerging economies is fueled by energy intensive industrial production and concentrated in distillates such as diesel. Since 2003, electricity shortages in China have forced factories to install diesel powered generators. In addition, while oil demand in the free markets of the OECD is sensitive to price increases, many emerging economies with the strongest economic growth – such as China, Saudi Arabia, Russia and India – subsidize domestic oil prices and, as such, demand is not affected by price. For this reason, global demand has not been dampened by recent price increases.

Will Demand Always Remain This High?

As emerging economies eventually slow, growing wealth and improved standards of living represent permanent new demand. As a result, global demand is expected to remain higher than previous levels, even if global economic growth slows. For 2008, the IEA estimates global oil demand should total 86.8 million barrels per day, a 1.2% increase from 2007. As emerging economies grapple with the high cost of subsidizing domestic energy costs and the inflationary effect of these policies, many of these countries, such as India, Indonesia and Taiwan, have recently scaled back oil subsidies. As more countries follow suit, demand could plummet.

How Much Oil is Being Produced?

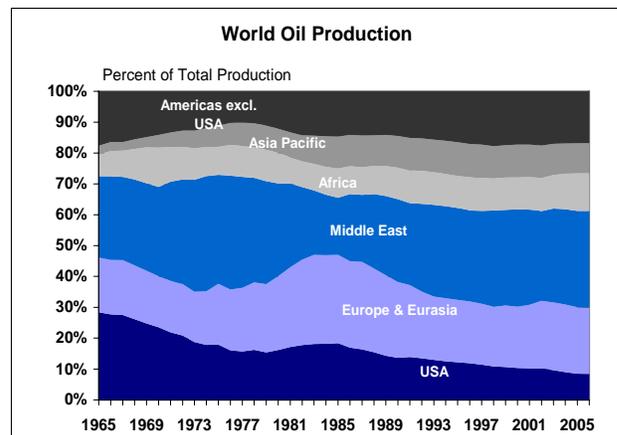
Since 1998, world oil production has grown nearly 16.3% and currently averages 85.6 million barrels per day. According to BP data, the Middle East accounted for over 31% of global production, followed by Europe/Eurasia at 21.5% as of 2006. Over the past decade, the areas of production have changed, with production falling 3.4% in North America and remaining flat in South and Central America, while increasing 30.7% in Africa and nearly 23.8% in Europe and Eurasia, due to Russia and former Soviet Union countries. Production in the Middle East – still the largest producing region – grew 11.2%.

Are We Running Out of Oil?

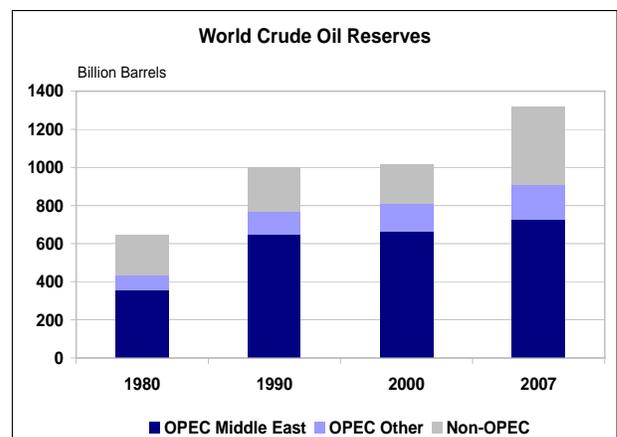
There is no scarcity of oil. Since 1980, global proven reserves have doubled to 1.3 trillion barrels as of 2007 due to OPEC gains in the 1980's and non-OPEC gains in the 2000's.

Why Isn't More Oil Being Produced?

The past decade has seen significant supply disruptions across the globe that have hampered production growth and strained capacity. With little excess capacity and consumption dependent on the supply of imported oil, the divide between oil consuming and producing nations has been accentuated. As a result, the loss of a major supplier has been able to cause global shortages and even small supply disruptions have been able to cause significant price increases. Further, the mismatch between refinery products demanded in the emerging economies versus current refining capacity has impacted pricing in the entire oil market.



Source: BP, ARA Research



Source: EIA, ARA Research

Why is the Price of Oil so High?

From a 30-year low price of \$12.72 per barrel in 1998, light sweet West Texas Intermediate crude oil (WTI) has climbed to an average high of \$133.88 in June 2008, first breaking through \$40 resistance in 2004 due to the war in Iraq and increasing sharply since the beginning of 2008. There are several reasons why the price of oil is so high:

Weak US Dollar: Oil is denominated in dollars. If the value of the dollar drops, the price of oil will rise by an offsetting amount. The weighted average exchange value of the dollar has declined 37% since reaching a 16-year high in 2002 and is currently at all-time lows.

More Oil Imports: As a result of shifts in sources of supply,

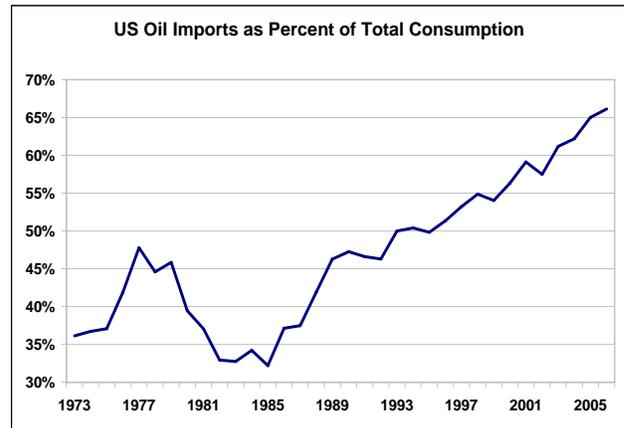
energy importing regions are importing more energy and exporting regions are exporting more energy. As of 2006, the US imported 66% of its oil, while China imported 52%, Europe 86% and Japan 100% of its oil. This scenario increases the risk of price spikes if producing nations increase their own consumption or experience political unrest.

Supply Disruptions: Due to supply disruptions, world production in 2007 was 0.2% below world consumption levels. As most consider the price elasticity of oil around 10%, a 0.2% supply shortfall should increase prices by 2%. Supply disruptions and uncertainty due to war and political unrest since 2002 have also caused the risk premium for oil to increase.

- In 2002, Venezuela's national oil strike shut down oil fields, resulting in a 12% drop in oil production by 2003.
- The 2003 Iraq invasion and aftermath – considered the largest oil supply disruption since WWII – resulted in a 24% drop in oil production and overall higher risk in the Middle East.
- In 2005, Hurricane Katrina disrupted US oil and natural gas production, impacting 10% of US oil refining capacity. While 60 million barrels of oil were released from global reserves and US fuel standards were temporarily relaxed, US refinery throughputs fell 1.65% in 2005 versus an average annual growth of 0.44% over the past decade.
- In 2006, Venezuela seized oil fields and forced the remaining private oil companies to sign new operating agreements, causing production to decline 50% from its peak.
- Since 2003, threats and violence in Nigeria have caused oil installations to shut down operations periodically, and the rebels' 2006 declaration of total war on foreign oil companies resulted in cutting oil exports by 20%.
- Between August 2006 and June 2007, the Prudhoe Bay pipeline has been closed intermittently for repairs, affecting 8% of the US oil supply.
- In April 2008, striking refinery workers in Scotland caused the complete shutdown of a pipeline carrying 700,000 barrels of oil and 80 million cubic meters of gas per day. It took several days to return to full capacity.

Surplus Capacity: In 2005, OPEC surplus capacity declined to a low of only one million barrels per day. In a world that consumes over 80 million barrels per day, this has added a significant risk premium to the price of crude oil. Looking ahead, surplus capacity is expected to increase to 3.5 million barrels per day by 2009, as new production comes online.

Demand for Distillates versus Gasoline: Emerging economies account for a large portion of global demand in the form of oil distillates. Due to a shortage of conversion units that allow refineries to extract higher yields from heavy crude, demand



Source: BP, Economy.com, ARA Research

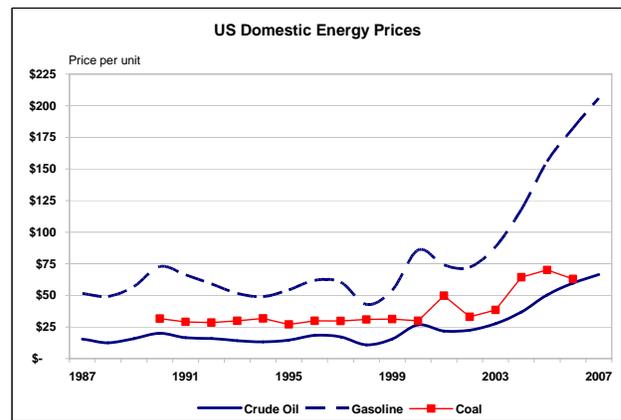
for heavy crude has fallen while demand for light crude has risen. This shortage of refining capacity puts additional pressure on light crude oil prices and makes the market more sensitive to any light crude supply disruptions.

Oil Subsidies: Emerging economies subsidize the cost of oil for their domestic consumers, and this demand is not dampened by higher prices. As increased demand in these economies hits higher prices, there is no price ceiling.

Speculative Investments: While futures speculation can account for some near-term price increases and increased volatility, speculation itself does not affect the physical market price over the long term. Since commodity contracts are tied to the physical market at expiration – on a monthly basis in the case of crude oil. Speculative positions are an inefficient costly way to stockpile commodities over a longer period of time. However, if producers who do control the physical market are actively speculating in the futures market, their actions could influence prices over a longer period of time. Even then, however, as there are two sides to each transaction, any price manipulation eventually reverses.

Are There Plans to Produce More Oil?

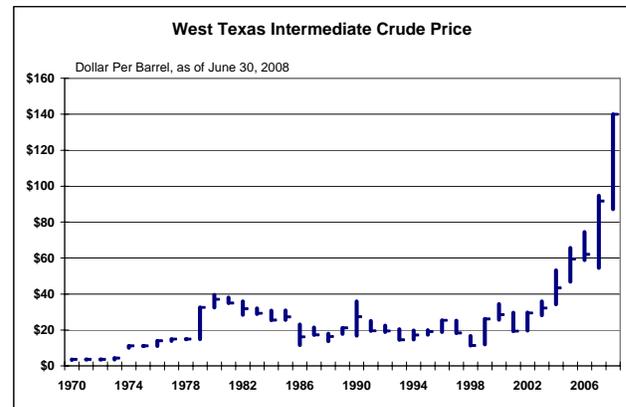
Over the next few years, global oil production is expected to increase. OPEC countries are currently investing \$120 billion in over 100 projects. Of this, Saudi Arabia alone is spending \$50 billion to raise capacity to 12.5 million barrels per day by the end of 2009, while new refineries will add almost 8 million barrels per day of new capacity by 2010. Kuwait is spending \$51 billion to upgrade operations over the next five years and looks to increase production from 2.7 million barrels per day to 4 million bpd by 2020. In the US, active rigs have increased to an average of 1,800 in 2008, a 284% increase from an all-time low of only 635 in 1999, when the price of oil was near a long-term low.



Source: Economy.com, ARA Research

How Does the Price of Oil Affect Other Fuels?

The prices of all fuels are interrelated. Studies have shown that if the price of crude oil increases, the prices for petroleum products – gasoline, diesel, residential fuel oil, jet fuel, etc. – will rise more quickly than crude prices but that the magnitude of increases eventually equalize due to competition. On the other hand, if the price of crude oil declines, prices for petroleum products do not decline as quickly. Another study also found that the prices of other energy sources – coal, natural gas, electricity – respond symmetrically to changes in petroleum product prices, meaning these prices increase or decrease in the same relation to petroleum product price increases or decreases.



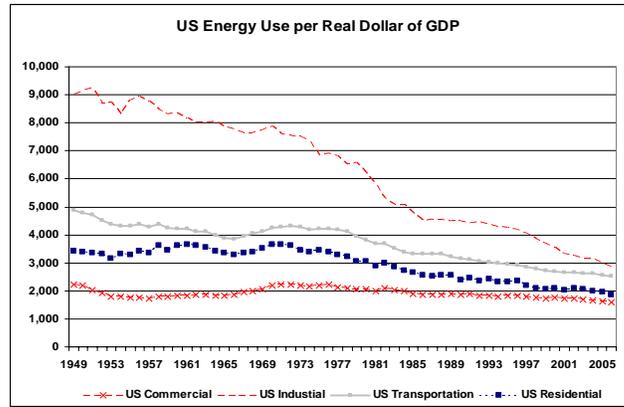
Source: Economy.com, EIA, ARA Research

Will the Price of Oil Eventually Fall?

Yes. Spikes in oil prices are not permanent but cyclical, occurring on a roughly 29-year cycle, based data going back to 1861. High oil prices eventually justify increased exploration and production and tame demand, but these adjustments often take several years. In the 1970's, oil broke through resistance in 1974 and increased for seven years. Thereafter, oil trended downward for eight years to reach a new support level. In the current price spike, oil broke through \$40 resistance in 2004 and has increased for five years so far. Based on historical market cycles, oil prices could peak in 2009. Thereafter, it may take several years for prices to fall to new support levels. As a result, we believe higher oil prices will be with us for an extended period of time, but the price of oil will eventually fall from current levels.

How Does the Price of Oil Affect the US Economy?

The best estimate of the oil price to GDP relationship is a -0.055 cumulative decrease in GDP over a two-year period, regardless of whether the price increase is sustained. In addition, oil price shocks particularly affect the economy when it is in a low growth phase. With respect to labor, oil price shocks can cause a reallocation of up to 11% of the workforce – usually to similar industries, as seen in the shocks of the 1970's. In industries where wages cannot be lowered, there is increased unemployment. In addition, oil price increases, due to the inflationary effect, depress real wages for all workers but raise the relative wage of skilled workers. Finally, an oil price increase has a much stronger impact on the economy if it occurs as a shock after a period of low price volatility.



Source: Energy Information Administration, Economy.com, ARA Research

Over the past fifty years, the US economy has evolved from energy intensive economic growth to less energy intensive economic growth due to the change from a manufacturing to a service economy, as well as the move towards greater energy efficiency in buildings and transportation. While economic growth in the US and other OECD countries is less energy dependent, high energy prices still affect advanced economies. On a short-term basis, demand is inelastic but on a long-term basis if high prices are sustained demand becomes elastic.

How Does the Price of Oil Affect the Monetary Policy?

Oil price shocks specifically impact interest rates. While oil shocks cannot be contained by monetary policy, price shocks eventually force changes in interest rates. As of the first quarter of 2008, US inflation was 4.2%. If this rate holds, the Fed will not be able to maintain the Fed Funds at 2.0% for long without further fueling inflation. On the other hand, raising rates should negatively impact the vulnerable housing and credit markets. The Fed is handcuffed and with the current Fed Fund rate below inflation, oil prices should continue to go up.

What Happened in Past Oil Shocks?

The US has experienced two previous oil price shocks over the past thirty years: one in the early 1970's and one in the late 1970's. In the early 1970's, the US faced an environment of rising global economic growth, energy demand and inflation, with the Middle East dominating world oil supply, much like what we are experiencing today. Unable to negotiate higher oil prices from the US to offset inflation costs after the dollar went off the gold standard, OPEC used the western world's support of Israel in the Yom Kippur War as a justification to stage an oil embargo in 1973. As the US no longer had spare production capacity due to the previous removal of production limits, there was no way to limit price increases and prices increased 250% by 1974. While price increases would normally spur increased US exploration and production, the US imposed price controls on domestically produced oil in order to stem inflation and lessen the recession. While this policy did help lessen the recession, US oil producers had little incentive to increase US exploration and production, and consumers were not driven to lower consumption through increased energy efficiency. Oil imports surged from 36% of total consumption in 1973 to nearly 48% by 1977.

With the US increasingly dependent on imported oil, the Iranian Revolution and the Iraq-Iran War in 1979 and 1980 caused crude oil prices to more than double by 1981. This time, however, there was no US policy intervention. As a result, price increases caused several reactions: increased energy efficiency in residences, industrial processes and automobiles, as well as the off-shoring of industrial production. While demand fell due to a global recession, oil exploration and production outside of OPEC increased, with US oil production actually climbing 32%. Further, the US reduced oil imports to a low of 32% of US consumption by 1985. While the global recession was temporary, increased energy efficiency and industrial offshoring remained in place. As a result, lower oil demand per real GDP was permanent. In fact, demand in the US and other advanced economies would never again respond to lower prices with increased consumption of oil.

How Does the High Price of Oil Affect Real Estate?

As the price of oil has increased over the past decade, there has been an increased awareness and interest in energy efficiency, some pressure on operating costs, but no significant impact on demand or value for real estate. However, due to the recent spike in oil prices, we are likely to see greater impacts, as not only the overall price but also the magnitude of price increases are realized. In general, energy prices affect real estate in three basic ways:

1. Overall Demand for Real Estate
2. Income
3. Value

Because the price run-up in oil has lasted so long, and is not expected to dissipate quickly, demand for energy efficiency should increase. To the extent that operating costs can be passed on to end-users, income should be less impacted, but values for older less-efficient buildings in less prime locations could see value declines.

1. Overall Demand: Demand for real estate is correlated to employment growth. High energy prices eventually dampen economic growth and increase unemployment. As employment growth contracts, demand for real estate falls. In our analysis of oil price versus employment growth, we have found that when the price of oil increases over 50% in one year, employment contracts an average 0.1% in the following year. In contrast, when the price of oil decreases over 20% in one year, employment grows an average 2.5% in the following year.

2. Income: Real estate income is affected by the value of rent growth in relation to operating costs. As energy prices are interrelated with inflation levels, energy prices affect both rents and costs. If both rise with inflation, income will not be affected. However, if only costs increase by inflation, income will fall behind. While this can impact all property sectors, it is especially problematic for the retail and multi-family sectors, as these sectors have higher operating expenses and often have high tenant turnover. As of the first quarter of 2008, year-over-year CPI increased 4.2%, while rent growth increased 7% for office, 2.9% for industrial, 3.1% for multi-family and 0.6% for retail over the same time period. Adjusting for inflation, industrial, multi-family and retail rents were actually negative. Whether rents can be pushed remains to be seen.

3. Value: In general, commercial real estate is considered a good long-term hedge for inflation because it is a real asset. In an expanding economy, the price of real estate increases to reflect growth in replacement costs. However, if demand drops significantly due to a recession or if net income falls behind inflation for a sustained period of time, land prices could decrease and real estate values could fall. Further, real estate values should be impacted by location, building type and energy efficiency as energy prices remain elevated. As the supply of older inefficient and poorly located buildings on the market increases, the spread between Class A and Class B properties should increase even as all values decline.

Which Metros Will Become More Competitive?

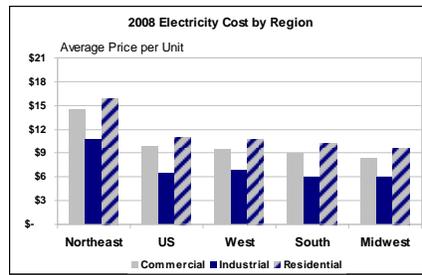
Metros vary across a wide variety of metrics important to business operations, including: business costs, job growth, educational attainment, and population. The attractiveness of one metro versus another usually is not reliant on only one metric, such as fuel cost, but rather is derived from a mixture of attributes which make one metro more competitive relative to another for a particular business sector. Forbes ranked US metros according to various metrics to determine the best areas for doing business. While we do not consider this a comprehensive study, it is interesting to note that the top metros in each category do not overlap. This means that industries relying on low business costs should not be located in metros with a highly educated workforce, and vice versa. For the most part, businesses are already located in the most rational location for their type of operation and, thus, higher fuel prices – which affect all metros – should not drastically change these competitive rankings.

Ranking of Best Metros for Business					
	Cost of Doing Business	Job Growth	Educational Attainment	Population	Overall Rank
1	Albuquerque	Cape Coral	Boulder	New York	Albuquerque
2	Lexington	Naples	Bethesda	Los Angeles	Raleigh
3	Hickory	Port St Lucie	Ann Arbor	Chicago	Houston
4	Oklahoma City	Las Vegas	Cambridge	Houston	Boise
5	Tulsa	McAllen	San Francisco	Atlanta	Knoxville
6	Fort Smith	Riverside	Durham	Washington DC	Phoenix
7	Clarksville	Fayetteville	Fort Collins	Riverside	Nashville
8	Portland	Ocala	Washington DC	Philadelphia	Durham
9	Louisville	Deltona	Bridgeport	Dallas	Fayetteville
10	Cedar Rapids	West Palm Beach	San Jose	Phoenix	Indianapolis

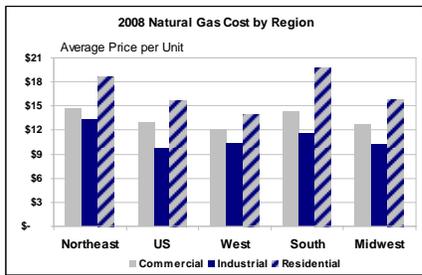
Source: Forbes, ARA Research

Don't Metros Vary According to Fuel Cost and Usage?

With respect to primary fuels, there are regional differences in the average cost of energy. In general, the Northeast has the highest fuel costs for all property sectors, while the Midwest has the lowest. Because higher energy costs generally impact all metros equally regardless of relative differences in costs, the attractiveness



Source: Energy Information Administration, ARA Research



of one metro over another should not be dramatically changed by the current rise in fuel costs. However, to the extent that higher energy costs cause certain marginally affordable metros to become unaffordable for certain cost sensitive operations or too expensive for large portions of the population, higher energy prices could cause some businesses to cease, move or offshore operations.

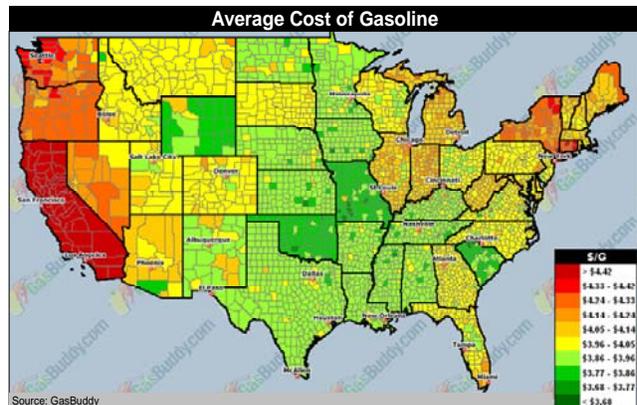
What about Higher Transportation Costs?

Metros vary by transportation costs. Transportation costs are generally higher in more sprawling areas than more densely populated areas, although costs are mitigated in densely populated metros with public transportation. However, overall household expenditures are usually lower where densities are lower because housing costs – a much larger cost – are usually less in these metros. Within the US, 76% of public transit demand is concentrated in seven metros, with half of US demand in New York and Chicago. To the extent that higher cost metros have public transportation available, these metros should remain attractive for businesses and residents. Within metros, exurban locations should become less economically feasible, especially for lower income residents, while infill locations close to public transportation should become more desirable.



Source: The Public Purpose, ARA Research

With respect to transportation fuels, there are regional differences in the average cost of gasoline and diesel. On a national basis, the West Coast has the highest gasoline costs while the Midwest has the lowest. Sprawling metros in high fuel cost regions – such as Los Angeles, Riverside and San Diego – should see the greatest impact in rising fuel costs, while metros with public transportation in the higher fuel cost regions – such as San Francisco and New York, or sprawling metros in moderately high fuel cost regions – such as Atlanta or Washington – should be less impacted.



Source: GasBuddy

Will People Move to Save on Energy Costs?

From a residential perspective, metros also vary according to the total cost of living. According to the ACCRA Cost of Living Index, the goods and services and housing comprise 64% of the total living costs, while fuel cost related utilities and transportation account for only 19% of total costs. This means that people are on average three times more sensitive to housing costs than energy costs. According to this study, the most inexpensive metros tend to be located in the South and Midwest, while the most expensive metros are located along the coasts. As most working residents are tied to their job's location, moving to a less expensive metro is usually not feasible. While some areas, such as California, may offer residents minimal fuel primary costs due to a milder climate, transportation fuel costs are some of the highest in the nation and the overall total cost of living remains quite high.

Most & Least Expensive Metros by Component							
Top 5 Bottom 5	Total Cost of Living	Misc. Goods & Services (35%)	Housing (29%)	Grocery (13%)	Utilities (10%)	Transportation (9%)	Health Care (4%)
1	New York City	New York City	New York City	Honolulu	New York City	Honolulu	Juneau
2	San Francisco	Juneau	San Francisco	Juneau	Boston	San Francisco	New York City
3	Honolulu	San Francisco	Los Angeles	San Francisco	Honolulu	San Diego	Boston
4	Los Angeles	Honolulu	Honolulu	New York City	Juneau	Juneau	San Francisco
5	San Diego	Philadelphia	San Diego	Los Angeles	Buffalo	New York City	Seattle
41	Springfield	Buffalo	Charlotte	Oklahoma City	Charlotte	El Paso	Des Moines
42	Topeka	Jacksonville	Dallas	Topeka	Eugene	Des Moines	Milwaukee
43	Oklahoma City	Omaha	Topeka	Des Moines	Jacksonville	Memphis	Topeka
44	El Paso	Springfield	El Paso	Jackson	San Antonio	Jackson	Jackson
45	Memphis	El Paso	Memphis	San Antonio	Colorado Springs	San Antonio	Montgomery

Source: ACCRA Cost of Living Index (1Q05), ARA Research

How Do Higher Fuel Costs Affect the Industrial Sector?

According to a KPMG study, operating costs can vary by type of operation and location along six broad categories. Within the industrial sector, labor and facility costs account for the majority of location sensitive costs, but transportation and primary fuel costs can account for up to 25% of these variable costs. Because of transportation and energy intensive operations, the industrial sector is the most fuel sensitive property sector. As costs have increased for truck and air transport, rail and port transport now have cost advantages. As a result, the industrial sector, more than any other property sector, could see relocations in order to reduce transportation costs. Over time we expect warehouse and distribution demand to increase in locations with superior rail (i.e. Chicago) and port (i.e. Houston) access, as well as a shift from fewer big facilities to an increased number of smaller facilities in order to reduce trucking distances. With fuel prices expected to remain high for some time, locations which offer an excellent transportation network, low overall costs, and access to a strong local industrial base and large consumer base will remain attractive.

Location Sensitive Costs	
Industrial Sector	Percent of Total
Labor	58% - 74%
Facilities	8% - 19%
Transportation	1% - 15%
Electricity/Natural Gas	2% - 10%
Telecommunications	0% - 1%
Taxes	6% - 11%

Source: KPMG, ARA Research

How Do Higher Fuel Costs Affect the Office Sector?

According to a KPMG study, labor is the most important location sensitive operating cost within the office sector, accounting for up to 88% of variable costs. For the office sector, fuel-related costs account for only 1% to 3% of total location-sensitive costs, with electricity the primary fuel source. Due to its minor impact on overall costs, most operations are not electricity cost sensitive and should be less affected by higher fuel costs. However, because labor costs are the largest location sensitive cost, to the extent that higher oil prices and the resulting inflation put pressure on wage increases and the ability to attract workers, metros with lower labor costs could become more attractive to certain cost sensitive service operations. For operations reliant on highly skilled workers located in high cost areas, energy efficient buildings should see increased demand. Finally, as higher fuel costs increase worker transportation costs, businesses located close to transportation or businesses which allow telecommuting should see less wage growth pressure. As a result, locations close to public transportation should grow in demand.

Location Sensitive Costs	
Office Sector	Percent of Total
Labor	79% - 88%
Facilities	4% - 14%
Transportation	0% - 1%
Electricity/Natural Gas	1% - 2%
Telecommunications	1% - 5%
Taxes	2% - 7%

Source: KPMG, ARA Research

How Do Higher Fuel Costs Affect the Retail Sector?

Consumer retail demand is impacted by inflation levels. To the extent that higher fuel costs lead to higher production costs which can be passed on to the consumer, the cost of goods and services increases. While most consumers respond to higher purchase and transportation costs with reduced consumption, consumers in the lowest income groups are most impacted, as a greater portion of outlay is allocated to fuel. In general, consumers trade down by product or by store, reduce the number of shopping trips per week, or shop closer to home.

In addition to reduced consumer demand, retailers must also grapple with higher transportation costs for goods distribution as well as the pass through of increased property level operating costs. National tenants may be able to absorb higher property level operating costs than smaller tenants, but all retail tenants may reconsider locations with higher operating costs, such as enclosed malls with large, climate-controlled common areas. Retailers with local distribution centers should probably fare better as well. Finally, as a result of slower retail sales growth, the retail sector faces increased tenant turnover which impacts property income.

How Do Higher Fuel Costs Affect the Multi-Family Sector?

Demand for multi-family is impacted by employment growth and personal income growth. To the extent that higher oil prices lead to higher inflation and increased unemployment, multi-family demand should be negatively impacted. As higher fuel prices also impact transportation costs, demand for locations close to public transportation or close to employment centers should increase, while demand for locations far from employment centers or public transportation should drop off. In addition to changes in demand levels, the multi-family sector is also impacted by higher operating costs and tenant turnover. Buildings with larger interior common areas, such as high-rises, should see a greater increase in operating costs versus garden-style apartments, and these costs must be passed on through increased rents. In addition, older buildings that have not been retrofitted with energy saving mechanisms, could be harder to rent or sell than newer, more energy efficient buildings. Finally, with greater multi-family tenant turnover, properties are exposed to greater renovation costs which may increase faster than market rents, thus impacting property income.

In the New York City real estate crunch of the late 1980’s, high monthly maintenance charges made some apartments almost impossible to sell. While this might increase demand for newer, more efficient properties, the overall impact is likely a greater incentive for sellers to reduce prices and unload these properties due to an increase in supply.

The following is a general synopsis of the impact of higher fuel costs on real estate demand by property sector:

Impact of High Fuel Costs on Real Estate				
	Industrial Sector	Office Sector	Retail Sector	Multi-Family Sector
Increased Demand	<ul style="list-style-type: none"> ❖ Energy efficiency ❖ Fuel switching ❖ Locations with rail spurs ❖ Near ports, intermodal 	<ul style="list-style-type: none"> ❖ LEED certification ❖ Energy efficiency ❖ Near transit centers, major employment centers 	<ul style="list-style-type: none"> ❖ One stop shopping ❖ Strip & big box centers ❖ Energy efficiency ❖ Near higher income households 	<ul style="list-style-type: none"> ❖ Garden-style ❖ Energy efficiency ❖ Near employment centers, public transit
Decreased Demand	<ul style="list-style-type: none"> ❖ Older, inefficient buildings ❖ Locations far from transport 	<ul style="list-style-type: none"> ❖ Large common areas ❖ Older, inefficient buildings ❖ Remote locations 	<ul style="list-style-type: none"> ❖ Enclosed malls ❖ Older, inefficient centers ❖ Remote locations 	<ul style="list-style-type: none"> ❖ High-rises ❖ Older, inefficient buildings ❖ Remote locations

Source: Forbes, ARA Research

Conclusion

Oil price spikes are cyclical phenomena. While the price of oil should eventually fall from current levels, higher prices most likely will be with us for several years. During this time, we expect higher energy costs to have an impact on real estate values –in particular, the location, type and energy efficiency of a property should become even more important in determining values within each property sector, with highly accessible energy efficient properties gaining favor over remote, inefficient properties. While location should have the greatest impact on value, every step towards greater energy efficiency will not only reduce energy demand permanently, but also redefine future Class A property standards.

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