

December 7, 2009

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Commercial Real Estate: The Danger of Fighting the Last War

John B. Levy & Co. warns commercial real estate investors against making decisions in today's market based on the recession of the early 1990s. As embattled industries seek ways to regain their equilibrium in today's struggling economy, more than a few investors in the commercial real estate sector have turned their attention to the recession of the early 1990s, thinking that today's market is a repeat of what happened nearly two decades ago. According to "Fighting the Last War," the latest podcast produced by John B. Levy & Co. (see right rail under NREI Interactive Products), the market of 2009 is dramatically different from the foreclose-and-dispose days of 1990, 1991 and 1992. Because of this, commercial real estate investors who make decisions today based on the last war are pursuing a dangerous strategy. "A lot of people in the commercial real estate industry believe we're seeing a repetition of the early '90s," says John Levy, founder of John B. Levy & Co. "They're waiting for the proverbial blood in the streets . . . a return to the days when the RTC bought, foreclosed on and sold assets by the pound. I hate to say it, but that's not where we are today." For Levy, the difference between then and now is dramatic. While the collapse of one sector of the banking system (the savings and loan industry) in the early 1990s left investors in a state of shock and awe, today's recession has been marked by the near meltdown of the entire banking system. Over the past couple years investors have seen AIG, a AAA-rated company, on the brink of bankruptcy. They watched the rescue of Fannie Mae and Freddie Mac and witnessed the fall of Lehman Brothers and Bear Stearns. Today's recession is global and severe, and it has touched not only commercial real estate, but investments and companies across the board. "Some people point to real estate and say 'that's what caused today's recession,'" says Levy, "but that's not completely true. Single-family real estate? Yes, but not commercial. We're somewhat like a snake going through a dip. The economy may be heading up, but commercial real estate is at the tail of this recession, and it's quite possible for it to still be going down before heading up." With leverage down and promising to stay that way indefinitely, the market clearly needs more equity. But where that comes from is a crucial concern. Levy thinks institutions will eventually provide equity once they recognize that the pricing they are now getting has reached the bottom or is trending up. In the meantime, equity will likely come from high net worth individuals and family offices, even endowments, because these sources have a longer-term view of real estate. The economy in general and commercial real estate in particular will also reflect the impact of a new policy statement from the FDIC. Whether that impact is positive or negative depends on one's perspective. On the positive side, banks will not have to establish extreme reserves for bad loans. But on the negative side, investors will not see real estate priced as it was in the RTC days of the early 1990s because there is no pressure to liquidate assets. "With no pressure to liquidate assets, it might take a long time to get back to equilibrium pricing," says Levy. "Is this good news? Probably because a collapse in real estate equity values won't benefit anyone. But if you're waiting for blood-in-the-street pricing, it could be bad news." **(National Real Estate Investor)**

Wealthy Investors Plan to Buy More Real Estate, Barclays Says

Individuals with more than \$800,000 to invest plan to increase their property holdings because they foresee better long-term returns than from stocks and bonds, according to a Barclays Plc global survey. Twice as many people plan to raise their investment in commercial and residential property as intend to reduce it, the Barclays Wealth unit said in an e-mailed statement today. The richer the individual, the greater the proportion of wealth is placed in real estate, the survey found. "I was surprised how big a share of their wealth property represents," Mike Dicks, the London-based head of research at Barclays Wealth, said in an interview. "It's not what I would tell grandma. None of our data suggests that would be a good allocation." The global recession pushed down commercial and residential real estate prices in every region except Asia. The value of U.S. shops, offices and warehouses fell 21 percent in the first three quarters of this year, following a 12 percent decline in 2008. Belief that properties are now undervalued was the second most common reason cited for increasing investment. Real estate investment among wealthy individuals is set to rise to 30 percent of the average portfolio for the next few years from 28 percent now, according to the survey. That excludes properties used as a principal residence. Most rich people, other than the extremely wealthy, should have no more than 10 percent of their assets in property, said Dicks. "An emotional attachment to bricks and mortar," can mean that rich investors are often unwilling to sell real estate at short notice and may be less rigorous in measuring its performance as an asset, according to the report. Investors from Canada and the Persian Gulf were the most likely to increase their property allocations, with an average rise of 4 percent, the report said. Spain was the only country in the survey where more individuals said they would reduce the proportion of real estate investment, said the wealth management division of London-based Barclays. About 60 percent of rich individuals in that country have more than half their assets in property. Almost 30 percent of British and Indian investors have more than half their wealth tied up in real estate. About 40 percent of the total respondents worth more than 30 million pounds (\$49 million) have a similar allocation, Barclays Wealth said. Three out of four investors surveyed said residential property is looking attractive and two-thirds are keen to explore investing in commercial real estate, the survey said. About 75 percent said they feel hampered by borrowing costs. The U.S. was the most attractive real estate market for investors outside their home country, the survey showed. The country was seen as having the highest potential for return on investment. Barclays Wealth surveyed 2,000 people. Forty percent were worth 500,000 pounds to 1 million pounds. An additional 40 percent were worth between 1 million pounds and 10 million pounds. Ten percent had assets of as much as 30 million pounds and the rest were wealthier than that. **(Bloomberg)**

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ConocoPhillips: Helipad, Hotel, Child-Care Center Planned

In addition to offices, training and research facilities, ConocoPhillips' new 2.5 million-square-foot Louisville campus could have at least one helipad, a child-care center and landscaping designed to "demonstrate (the energy company's) corporate sustainability mission," according to the company's preliminary site plan made available for viewing Monday. The preliminary plan submitted to the city of Louisville provides some of the first specific size, scope and use details for the 432-acre site that has been a focal point of Colorado economic development and business

discussions for the past two years. Some information from the site plan was disclosed late Friday, but a look through the plans on Monday revealed additional details on the phasing of the construction, amenities on the site and suggestions for road improvements to accommodate expected increases in traffic. ConocoPhillips' Louisville campus will be constructed in three phases over the next 23 years. The first phase, planned for completion by 2013, will include 1.6 million square feet of offices, research space, a learning center and 120 hotel rooms. Included in the first phase are the development of pedestrian plazas and walkways; private, non-commercial recreational and social facilities; parking lots and structures; hotel facilities; a child-care center; cafeterias, cafes and food service offerings; internal roads; at least one helipad and the need for 183 employees in "support services." The second phase, planned for 2018, would include additional research space, and the third and final phase would consist of up to 750,000 square feet of additional office and research space. City Manager Malcolm Fleming said Monday that he expects the city review process to take about a year, adding that ConocoPhillips could break ground in late 2010 or early 2011. The facilities are expected to be clustered in the center of the 432-acre plat and could take up 120 acres, less than one-third of the area. Louisville Mayor Chuck Sisk said he was pleased that ConocoPhillips officials appear to be following through with previous statements to have the majority of the campus be open space and prairie land. "One of the most important things, from our standpoint, was certainly the compactness," he said. The majority of the landscaping will consist of a restored short-grass prairie landscape with native ornamental grasses and wildflowers, according to the site plan. The primary entrance areas to the campus will be developed to showcase an "extensive private common open space with landscape, grading and irrigation to demonstrate corporate sustainability mission," officials said. The campus also is expected to generate about 10,500 vehicle trips per day by 2013 and 17,500 vehicle trips per day at build-out, according to a preliminary traffic impact submitted by ConocoPhillips. As a result of the demand, officials suggest that by 2035, roads such as 96th Street, Dillon Road, McCaslin Boulevard and the Northwest Parkway should be widened. The site plan did not include details such as the work-force figures, the type of research to be conducted or physical descriptions of the buildings. ConocoPhillips officials have said they plan to employ up to 7,000 people on the site within a 25- to 30-year span. ConocoPhillips' plans to house a training center for its global work force and a research center for energy technologies have already spurred comparisons to when IBM Corp. located a campus in Boulder. "I would expect (ConocoPhillips) would be generating spinoffs and attracting companies -- that want to work with them -- to the area," said Frances Draper, executive director of the Boulder Economic Council. **(Daily Camera)**

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Economy Improves Modestly Across U.S., Fed Reports

The economy expanded or improved "modestly" across the U.S. from October to mid-November as consumer spending rose in most Federal Reserve districts, the central bank said Wednesday. Eight regions "indicated some pickup in activity or improvement in conditions," while the other four said conditions were little changed or mixed, the Fed said in its Beige Book business survey, published two weeks before officials meet to set monetary policy. The labor and commercial-real-estate markets remained "weak," the report said. Policymakers last month repeated their pledge to keep interest rates low for an "extended period" to bring down unemployment that is

forecast to remain above 10 percent even as the economy emerges from recession. A government report Friday is likely to show that companies reduced payrolls for a 23rd straight month, according to a Bloomberg survey of economists. "Economic conditions have generally improved modestly since the last report," the Fed said. "Financial institutions generally reported steady to weaker loan demand, continued tight credit standards, and steady or deteriorating loan quality." The Beige Book reflects information collected through Nov. 20 and summarized by staffers at the New York Fed. The four districts that didn't report an improved economy were Atlanta, Cleveland, Philadelphia and Richmond, Va. Fed Chairman Ben Bernanke will testify today before the Senate Banking Committee in a confirmation hearing for a second term that would begin Feb. 1. "This report is a little more upbeat than the previous one," said former Fed governor Lyle Gramley, who is now a senior economic adviser with New York-based Soleil Securities Corp. "Most districts are seeing the economy pick up just a little." The world's largest economy grew at a 2.8 percent annual pace in the third quarter, the first expansion after four quarters of contraction and the fastest rate in two years. **(Denver Post)**

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Goss Business Index Bullish on Colorado, But Sees Slow Job Growth

A monthly indicator of expected business activity in Colorado was well into positive-growth territory in November for a second month, economist Ernie Goss said Tuesday in his monthly Business Conditions Index report. Even so, Goss -- director of the Goss Institute for Economic Research -- said he expects the state to add jobs at only "a snail's pace" in early 2010. Goss' monthly business index for Colorado -- based on a survey of supply managers in the state -- rose to 70.3 in November from 65.5 in October. That followed negative readings of 48.7 in September and 47.5 in August. The index ranges between 0 and 100. An index greater than 50 indicates expectations of an expanding economy over the next three to six months; 50 is "growth neutral." Colorado's index has been below 50 every month since September 2008 except for July's tepid 51.1 reading, according to Goss' data. The index fell to 38 in April. "A weaker U.S. dollar, making Colorado goods cheaper abroad, and a rebounding global economy will underpin the state's economy in the months ahead," Goss said in a statement. Exports "will be especially important for the state's computer and electronic component manufacturing sector," he said. But the rosy growth outlook will not translate into rapid hiring, Goss added. "Over the past year, Colorado has lost 10.4 percent of its manufacturing jobs, or almost 15,000 of its manufacturing base," he said. "... I expect the state to add jobs, albeit at a snail's pace, in the first quarter of 2010." Goss said that the Colorado index for November broke down this way (with indexes for recent months given):

- New orders: 68.9 (64.4 in October, 48.3 in September, 51.1 in August, 57.3 in July).
- Production/sales: 65.7 (56.1 in October, 49.2 in September, 50.7 in August, 56.3 in July).
- Delivery lead time: 65.4 (42.6 in October, 50.1 in September, 47.9 in August, 53.5 in July).

- Inventories: 73.7 (45.7 in October, 44.7 in September, 39.4 in August, 42.3 in July).
- Employment: 77.7 (45.9 in October, 51.3 in September, 46.5 in August, 46.2 in July).

Goss separately released a three-state composite index that includes Colorado, Utah and Wyoming. Across the three-state region, the Business Conditions Index stood at 55.4 in November, up from 51.6 in October, 48.5 in September, 47 in August, 51.5 in July, 41.4 in June and 38.9 in May. "While new orders and sales have been growing and are likely to continue to expand, that growth is likely to be volatile by historical standards with marginal improvements in the region's job market," Goss said of the regional index. The Goss Institute uses the same methodology for its survey as the Institute for Supply Management, formerly the Purchasing Management Association, in its national survey of its members. Goss also is Jack A. McAllister Chair in Regional Economics at Creighton University in Omaha. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	1.00
3 MONTH LIBOR	.26	.28	2.19
PRIME RATE	3.25	3.25	4.00
10 YEAR TREASURY	3.48	3.52	2.55
30 YEAR TREASURY	4.40	4.39	3.06