

February 23, 2009

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To The Rescue: Real Estate Has More Questions Than Answers on Bailout

Stan Ross, chairman of the USC Lusk Center for Real Estate, said government intervention alone won't help free up frozen capital markets. Debate over how, or even whether, the Obama administration's economic recovery plan will help restore liquidity to troubled commercial real estate markets has been a spectator sport at industry events this year. Over the last week, some of the key elements of the plan have begun to take shape. The construction industry gives an enthusiastic thumbs up to the massive \$787 billion economic stimulus package. Property professionals gave a nod of approval to the administration's \$75 billion plan this week to stem residential foreclosures and decision to provide \$200 billion each to shore up mortgage finance giants Fannie Mae and Freddie Mac. Many questions remain, however, among executives interviewed by CoStar Group about proposals by the Treasury Department and Federal Reserve to launch a public/private investment fund of up to \$1 trillion to buy toxic assets from financial institutions -- and a related plan to kick-start stalled secondary loan markets by providing up to \$1 trillion more in financing for investors to buy securities backed by assets such as consumer credit card debt, auto loans, student loans -- and most recently, commercial mortgage loans. Treasury Secretary Timothy Geithner last week announced that the Term Asset-Backed Loan Facility, better known as TALF, will be expanded to allow the purchase of highly rated commercial mortgage-backed securities (CMBS) to collateralize new commercial loans. The Treasury and Federal Reserve also left the door open to including residential mortgage-backed securities and assets backed by corporate debt in TALF. The previous version of TALF focused on easing debt from consumer credit cards, auto loans, student loans and small business loans. Under the new approach, the Treasury and Fed would dramatically expand the TALF credit facilities to cover newly issued triple-A-rated CMBS. The mortgage-backed securities could be swapped for more secure Treasuries and moved off bank balance sheets, freeing up capacity for financial institutions to make fresh loans. Following a record year in 2007, the CMBS market quickly turned stale as the credit crisis spread around the globe. Banks and other institutions sharply curtailed lending and refinancing and tightened credit standards. Highly leveraged commercial borrowers now face hundreds of billions in maturing debt -- \$171 billion coming due this year alone, according to the Mortgage Bankers Association -- with few options to refinance. Executives generally applaud the Treasury moves as a first step toward restoring liquidity. But they also note that the devil's in the details, and the plan contains few details, even though Federal Reserve Chairman Ben Bernanke recently said the TALF program could be deployed any day now. Some of the most pressing and common questions: With little or no transaction activity, how will the government establish pricing for the new TALF securities? The program currently covers only newly issued securities, so what will happen to existing debt, including the lower tranches that make up as much as 90% of the capital stack in many deals? What will the Treasury do with toxic real estate assets, and will the government get involved in modifying existing commercial mortgages? "We're all waiting to see how it unfolds," said Kenneth Spears, senior vice president with New York-based real estate banking firm Savills LLC, who has been helping the firm ramp up its distressed debt practice. "The details are few about what's going to happen, and I think that's what people are most concerned about." Like the earlier Troubled Asset Relief Program (TARP), TALF doesn't spell out whether distressed commercial property will be taken off the market and transferred into a 'bad bank' program, Spears said. "It

talks about new issuance, new securities and transactions based on new lending, but it does not address the billions in old collateral that is sitting on people's books and has not been written down, which is creating the current stagnation in the marketplace," Spears said. There's also no mention of what will happen to sub-AAA or non-rated assets. "If you're going to do just the top 10% to 30% of the debt, what's going to happen to the bottom pieces of the stack? They're looking to the private market, I guess, to buy those assets," Spears said. Stan Ross, chairman of the USC Lusk Center for Real Estate, said TALF and the other rescue plans are not the best way to mount a frontal attack on commercial market illiquidity. "In military terms, those bills are like attacking from the flanks; they're focused primarily on financial institutions and housing. But those attacks have their place and they will inject some liquidity into the system. Combined with a little push and pressure on the banks and extensions on conventional loans, they will give breathing room for the market to return." Spears noted that the earlier TARP program was supposed to pump capital into banks, which would then ramp up lending. But the Treasury reported this week that major banks actually reduced overall lending while collecting nearly \$200 billion in TARP bailout funds. "The government is going to have to get involved and loosen up those bad assets, or transfer them to another structure, whether it's a bad bank or an ownership participation structure shared with the government," Spears said. "Just letting the assets sit there for the duration is probably not the answer because it's not going to free up lending." Robert Toothaker, chairman of the National Association of Realtors' Commercial Alliance, noted that while much remains to be done, the TALF plan is a good start. "There is no secondary market for commercial mortgages, so it is important to encourage lenders and investors whose activity will be essential in refinancing the performing commercial real estate loans in the marketplace, many of which are due to reset soon," Toothaker said. Jeffrey DeBoer, CEO of the Real Estate Roundtable, called Geithner's announcement last week "an extremely positive step toward reconnecting the credit markets for the huge commercial real estate sector" that would attract essential private capital and help avert a potential commercial foreclosure disaster. "With hundreds of billions of commercial real estate mortgages maturing this year alone and no functioning credit market, many people are concerned that borrowers will technically default," DeBoer said. "Left unchecked, this could have extremely negative implications for local communities, jobs, and investors." "How and when the slide in property values is abated depends a great deal on policy actions in Washington, and we should pay careful attention to the details to make sure we get this crucial part of the plan right and the program can reach its full potential. Additional steps may be necessary, but the essential foundation for restoring a credit market is now being laid," DeBoer said. USC's Ross said TALF and other rescue programs may restore some liquidity and take pressure off borrowers with short-term loans coming due, but they won't by themselves bring investors back to the marketplace. The TALF program, if fleshed out to the market's satisfaction, could start a trickle of liquidity that might accelerate into a healthy current. But for that to happen, the government will likely have to allow commercial mortgage debt holders to modify the interest rate, terms and conditions of existing loans and keep them out of nonperforming status, similar to Obama's plan to avert home foreclosures. After a year or two, conventional liquidity will flow again. "We're already starting to see some money chasing yields again," Ross said. "How long are investors going to be willing to park their money in Treasuries at zero percent?" "We need to know the rules -- that's critical," Ross said. "Specifically, we need to know [the Treasury's] position on non triple-A bonds. That market has to be told whether we're taking

prisoners, or whether it's going to be shot." Added Spears: "Until you address the transfer pricing issues, the fair market accounting issues and how you get [bad debt] off the books, I'm not so sure the markets will open up and normalize very quickly." Construction of public infrastructure and buildings will get a significant boost under the \$787 billion stimulus bill passed by Congress last week and signed into law by President Obama on Tuesday. The 1,071-page American Recovery and Reinvestment Act includes more than \$135 billion for public projects ranging from highways, housing and high-speed rail to facilities for federal agencies, the military and government research. Industry trade groups, including the Associated General Contractors of America, claim the government infusion will preserve nearly 2 million jobs in construction and related fields over the next two years. An analysis by AGC Chief Economist Ken Simonson concluded the funding would create or save 650,000 construction jobs and 300,000 positions in related fields such as equipment and material supply, with additional 970,000 jobs in the broader economy created or supported by the investments. Included in the package is \$27.5 billion for highway and bridge construction, nearly \$18 billion for transit and rail, including \$8 billion for high-speed rail projects, nearly \$30 billion in building infrastructure, including major investment in federal GSA building, military construction and Veteran's Administration facilities; public housing, and health, science and research facilities. Energy and technology initiatives will get another \$30 billion, including \$11 billion for the nation's electrical grids, \$7.2 billion for wireless and broadband expansion, \$5 billion for weatherizing and retrofitting homes and public buildings and \$6.3 billion in state and local energy grants. Most energy efficiency measures are aimed at residential and public buildings, although commercial landlords can apply for the state and local grants. The stimulus package lands as evidence continues to mount that a rebound in the larger construction industry won't happen any time soon. The Architecture Billings Index (ABI) released Wednesday dropped to an all-time low in January of 33.3, down from December's modest uptick of 34.1. The index is a leading economic indicator of construction activity, reflecting a nine- to 12-month lag time between architecture billings and construction spending. A score above 50 is required to show growth in billings -- a benchmark not reached in more than a year. "Now that the stimulus bill has passed and includes funding for construction projects, as well as for municipalities to raise bonds, business conditions could improve," said Kermit Baker, chief economist for the American Institute of Architects, which publishes the index. "That said, until we can get a clearer sense of credit lines being made available by banks, it will be hard to gauge when a lot of projects that have been put on hold can get back online." The stimulus will have a positive impact for construction businesses across the country, insists Stephen Sandherr, chief executive officer of the Associated General Contractors of America. "When you get beyond the politics and the policy, the fact remains these investments will put people to work, save businesses, and help rebuild aging infrastructure." Simonson noted that the \$135 billion for construction would increase personal earnings nationwide by \$75 billion and add \$230 billion to GDP. "Beyond the immediate benefits, the new infrastructure projects will make businesses more efficient, commuting more reliable and our economy more prosperous for years to come," Simonson said. (CoStar)

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Colorado's Apartment Vacancy Rate Rises to 8%

The statewide apartment vacancy rate in the fourth quarter of 2008 increased to 8 percent, driven by increases in vacancies in Greeley, Grand Junction, Loveland and

metro Denver, according to a report released today by the Colorado Division of Housing. That is a 21 percent increase from 6.6 percent a year earlier. Vacancies also rose from 2008's third-quarter vacancy rate of 6.6 percent, although vacancies are generally expected to rise from the third quarter to the fourth for seasonal reasons. Rates were stable in Pueblo, where vacancies increased from 7.1 percent during the fourth quarter of 2007 to 7.2 percent during the fourth quarter of 2008. Only Colorado Springs and Fort Collins experienced falling vacancies during the fourth quarter, with Colorado Springs falling from 10.8 percent to 10.4 percent year over year. Fort Collins vacancies fell from 4.4 percent to 4.2 percent during the same period. The fourth-quarter survey measures only vacancies in metropolitan areas of the state. Metro Denver's vacancy rate, reported in a separate report earlier this quarter, rose 30 percent from 6.1 percent during the fourth quarter of 2007 to 7.9 percent during the fourth quarter of 2008. Increases were smaller in northern Colorado, where Greeley vacancies advanced from 7.2 percent to 8.1 percent year over year, and Loveland vacancies rose from 5.6 percent to 6.1 percent during the same period. In general, a vacancy rate of 5 percent is considered an "equilibrium rate." Rates below 5 percent indicate a tight market. "The trend in recent quarters has been toward rising vacancies due to softness in the housing market and in the overall economy," said Kathi Williams, director of the Colorado Division of Housing. "Looking at the nation as a whole, Colorado is certainly one of the stronger multifamily markets, but we're not immune from the national economy." In spite of falling vacancy rates in much of the state, average rents continued to increase throughout the fourth quarter of 2008. Average rents increased in all areas surveyed except Loveland and Greeley. The most substantial rental increases were found in Grand Junction and Pueblo, where average rents jumped 10 percent in each area from the fourth quarter of 2007 to the fourth quarter of 2008. Year over year, Grand Junction rents increased to \$666.22 from \$603.22, while Pueblo average rents increased to \$518.26 from \$470.65. Loveland rents fell from \$862.32 to \$850.92 from the fourth quarter of 2007 to the fourth quarter of 2008. Greeley rents were more stable, falling from \$631.19 to \$628.77 during the same period. "In most places where you see significant rental increases, with the exception of Grand Junction, you'll find that the average is being driven up by recent new construction," said University of Denver business professor Gordon Von Stroh, who wrote the report. "New units command higher rents, and it is not necessarily the case that there is much rent growth in older units." **(Rocky Mountain News)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	3.00
3 MONTH LIBOR	1.25	1.12	3.08
PRIME RATE	3.25	3.25	6.00
10 YEAR TREASURY	2.78	2.53	3.78
30 YEAR TREASURY	3.56	3.15	4.55