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SURVIVAL MODE: Rising Cap Rates Add to Real Estate Investors' Worries

The steady rise in capitalization rates from the sale of commercial property shows little sign of abating, adding to the anxiety of real estate investors who don't expect any of the major property sectors to rebound until well into next year. As investment risk has increased, actual cap rates have risen nationally over the last five quarters and continue to rise across most markets and property types, according to a preview analysis of CoStar COMPs data gathered so far in 2009. The continued cap rate expansion also dovetails with the results of the first-quarter Korpacz Real Estate Investor Survey, a widely watched report issued by PricewaterhouseCoopers this week. More than 100 institutional and private investors surveyed for the Korpacz report predicted that cap rates will rise by an average of nearly 50 basis points over the next six months across virtually all property categories and most metro markets. The largest projected gainers are power centers (74.4 bp) suburban office (65.6 bp) and regional malls (65 bp), with their generally lower barriers to market entry. Although cap rates appear to have dropped in the Houston and Washington, D.C. office markets in the first quarter, Korpacz respondents expect them to rise a whopping 118 points and 25 points, respectively, over the next six months. "The ongoing problems tied to both the U.S. economic recession and the financial crisis are making it very difficult for investors to sidestep value losses across all property types," said Susan Smith, director in the PricewaterhouseCoopers real estate sector services group and editor of the survey. "It's clear that many investors are more in survival mode than in acquisition mode, even though buying opportunities are expected to increase in the coming months." The 100-page survey provides a window into the thought processes of the investors in REITs, pension funds, private equity firms and insurance and mortgage companies on the economy, property valuation, cap rates and property-level performance of national and local markets. Survey authors said with few financing options and receding tenant demand, investors and real estate companies have shifted into a mode of managing and protecting their existing assets, with landlords cutting costs and rushing to sign or renew tenants -- in many cases offering sweet incentives and concessions such as free rent. The result is lower revenue and higher overall cap rates reported for the few investment sales that are being completed. "Tenants are in the driver's seat, and landlords are in survival mode, trying to preserve revenue streams in one of the harshest ownership environments ever encountered," said Tim Conlon, partner and U.S. real estate sector leader for PricewaterhouseCoopers. "It will be survival of the fittest going forward, with owners who are able to remain financially strong being better positioned to capitalize on the buying opportunities that are to come." Although sales have been weak, survey respondents expect buying opportunities to pick up in coming months as distressed assets from commercial loan defaults hit the market in larger numbers. Both private equity and institutional investors are preparing by disposing of certain assets, revving up potential joint partnerships, retiring debt and scrubbing their balance sheets, according to survey feedback. However, a huge impediment is that, with the capital markets in disarray and few comparable transactions upon which to build a foundation, buyers and sellers can't agree on pricing. In fact, one widely watched transaction-based index published at the MIT Center for Real Estate couldn't even produce a retail index for the fourth quarter due to the dearth of transactions. The overall sample size for various other property markets was "scarily low," acknowledged David Geltner, director of research at the MIT Center for Real Estate. Of the data collected for other

commercial property sectors, overall prices of property sold by major institutional investors fell by a record 10.6% in the fourth quarter of 2008 and 15% for the year, in line with similar analyses by CoStar Group, Inc. and other data providers. The market uncertainty is perhaps best reflected in the confusion over cap rates. Most analysts agree there are just too few transactions to draw many conclusions. Respondents to the Korpacz survey reported that overall cap rates have increased for most major markets and product types over the last during the quarter, a trend bolstered by an analysis of CoStar COMPs transaction data for office, industrial and multifamily sales over the last five quarters: In fourth-quarter 2007, 180 closed transactions of Class A office sales of more than \$5 million were recorded, trading at an average actual cap rate of 6.1% nationally. By the last three months of 2008, the average cap rate spiked to 7.6% on just 80 transactions, including a jump of more than 100 basis points between the third and fourth quarters. With sales results for the quarter still being collected, CoStar had recorded 42 closed transactions at an average actual cap rate of 7.9% as of March 18. Investors closed 279 sales of Class A and B warehouse and distribution property in the fourth quarter of 2007 at an average cap rate of 7.1%. The number of transactions dropped sharply in fourth-quarter 2008, with the cap rate rising 100 bp. First-quarter 2009 is continuing to trend toward a sharp drop in transactions, with the cap rate edging up another 50 bp to a preliminary 8.6% as of March 18. In the apartment sector, a look at sales totaling \$5 million or more shows that 629 Class A properties exchanged hands in fourth-quarter 2007 at an average actual cap rate of 5.9%. For the same period a year later, 355 transactions sold and the average cap rate rose 90 basis point to 6.8%, thanks to a 50-bp jump between the third and fourth quarters. Though deal volume appears to be again dropping sharply in the first quarter, the cap rate for closed transactions was holding steady at 6.8% in the quarter to date -- the only major property category to hold the line on cap rate expansion. Another interesting result in the PricewaterhouseCoopers survey was the average amount of free rent offered by office landlords. Compared to a year ago, the average has increased sharply in several major metro office markets, including Boston, where average free rent increased from 2.15 to 6 months; Manhattan, where it grew from 4 ½ to six months; and in San Francisco, where it jumped from 3 ½ to six months. Warehouse landlords also have stepped up concessions significantly as tenants have melted away. In the CBD office market, tenant concessions don't yet appear to be creating a lot of leasing activity, with many survey respondents reporting that deal flow is frozen. "Tenants have the upper hand, but many of them are afraid to make critical near-term decisions because of the recession," noted one investor surveyed for the Korpacz report. Subtle signs of weakness emerged in early 2008 as demand for suburban space waned, said an investor. "By the latter part of 2008 tenants were no longer nine deep at the door and calls from prospective tenants began to dwindle." A suburban office market respondent opined that "fundamentals will remain under pressure as demand weakens and more companies are forced to return space to the market," with the problems lingering for at least two more years. **(CoStar)**

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IBM's Bid to Acquire Sun Might Cost Jobs

Boulder's largest private-sector employer, IBM Corp., reportedly is in talks to purchase Sun Microsystems Inc., Broomfield's biggest, in a move that has analysts pondering corporate culture clashes and possible job losses. Several published reports Wednesday citing unnamed sources said IBM is offering at least \$6.5 billion

in cash to acquire longtime rival Sun. Neither company commented on the reports. Analysts said a combination of Armonk, N.Y.- based IBM and Santa Clara, Calif.- based Sun likely would produce job cuts. IBM employs about 3,400 at its campus in north Boulder. Sun Microsystems has an estimated 2,500 workers at its facility in Broomfield's Interlocken business park. "It's certainly always a concern when you have a merger or an acquisition and there is duplication in job functions," said Don Dunshee, president and chief executive of the Broomfield Economic Development Corp. "We'd hate to see any adjustments to their employment numbers." IBM would benefit from acquiring Sun's large share in the computer-server market and gaining access to Sun's customer base in finance, telecommunications and government, analysts said. But the deal would create strange bedfellows, said University of Colorado economist Gary Horvath. "You've got a West Coast company and an East Coast company with distinctly different corporate cultures," he said. Former Sun chief executive Scott McNealy "has been quite an IBM basher over the years," said technology analyst Frank Gillett of Forrester Research in Cambridge, Mass. "It would be very curious to see them combine." Gillett said Sun is known for having "a lot of cool technology but not much recognition in the market for it." Reports of IBM's possible purchase sent Sun shares soaring \$3.92 Wednesday to \$8.89, a gain of 79 percent. IBM was down 96 cents, or 1 percent, to \$91.95. Until Wednesday, Sun's stock had fallen about 70 percent over the past year as restructuring efforts and thousands of layoffs failed to prevent two straight quarterly losses with prospects for a third, according to analysts' estimates. Sun said in November that it would cut up to 6,000 jobs, 18 percent of its global workforce, after terminating 7,000 positions in the previous three years. Sun does not disclose regional employment totals, but economists have estimated that its Colorado workforce has dropped from about 3,500 in 2007 to 2,500 now. **(Denver Post)**

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Labor Department: Denver-Area Unemployment at 7.4% in January

Unemployment in the Denver area stood at 7.4 percent in January, up from 6.3 percent in December and 4.8 percent in January 2008, according to a report Thursday by the U.S. Department of Labor. There were 103,000 people normally part of the nonfarm workforce who were without jobs in the Denver-Aurora-Broomfield area in January, versus 88,600 in December and 65,800 the previous January, the Labor Department's Bureau of Labor Statistics said in its monthly "Metropolitan Area Employment and Unemployment" report. The figures are preliminary and not seasonally adjusted. The Denver-area nonfarm labor force was little changed over the 12 months covered in the BLS report. It totaled 1,390,600 in January, slightly under the 1,396,500 total in December and just over the January 2008 tally of 1,381,900. The report treated the Boulder area separately from metro Denver. It said unemployment in the Boulder area was 5.8 percent in January, versus 4.9 percent in December and 4 percent in January 2008. In Fort Collins-Loveland, the January jobless rate was 6.2 percent. Across Colorado, urban-area unemployment ranged in January from a high of 8.6 percent in Pueblo to Boulder's low of 5.8 percent, BLS said. Nationwide, January unemployment was higher than it was a year earlier in all but one of the 372 U.S. urban areas covered by the BLS report. Fourteen cities saw jobless rates of 15 percent or more, with El Centro, Calif., ranking No. 1 with a 24.2 percent jobless rate. The average unemployment rate for those 372 cities in January was 8.5 percent, versus 5.4 percent a year earlier, BLS said. As for Colorado's statewide unemployment and labor force, the state's

Department of Labor and Employment reported March 11 that Colorado's unemployment rate rose to 6.6 percent in January, up from 5.8 percent in December and 4.3 percent in January 2008. It said Colorado also lost 64,100 nonfarm payroll jobs between December and January, a larger-than-usual decline led by weakness in construction and professional and business services, officials said. Colorado's estimated number of nonfarm jobs declined by 42,000 in January 2009 from the same month a year earlier, or 1.8 percent, since last January to a current 2,272,600, officials said. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	2.25
3 MONTH LIBOR	1.22	1.25	2.61
PRIME RATE	3.25	3.25	5.25
10 YEAR TREASURY	2.65	2.75	3.33
30 YEAR TREASURY	3.65	3.55	4.16