

June 16, 2008

A Denver Based Commercial Real Estate Investment and Management Company
Contact Ken Gillis at 303-407-8715

Institutions Struggle with Denominator Effect

Just when many institutional investors have committed larger pools of money to the commercial real estate sector for the first time in years, those same investors are potentially facing the very real need to sell off a portion of their commercial real estate portfolios in order to maintain pre-set target investment allocation levels. This quandary is known as the "denominator effect." As the value of different asset classes — stocks and bonds for example — falls, the value of allocations to other assets, including commercial real estate, rises above allocation targets, triggering needed adjustments, i.e. sales. But the sales market for real estate assets has come to a virtual standstill as investors wait for the gap between buyer and seller pricing expectations to narrow. While waiting, some pension fund advisors have begun telling clients to cut back on future funding to commercial real estate. Recently the City and County of San Francisco Employees' Retirement System (SFER) reduced its target allocation to real estate by 73%, from \$750 million to only \$200 million in its next fiscal year beginning in July. SFER's advisor, the Townsend Group, also recommended that the fund invest only in non-core assets. "By all accounts, large sums of equity capital from foreign and domestic sources remain available [to invest in commercial real estate] but appear content to sit on the sidelines for now," according to a recent research report from Parsippany, N.J.-based Prudential Real Estate Investors. The report also notes that core funds are seeing more withdrawals as more pension funds grapple with over-allocations to real estate caused by the sharp downturn in the equity and bond markets over the past year. "It's been a long time since core funds had queues of investors trying to get out, but the risk that many of the large open-end commingled funds will be in such a position by year-end has increased." According to New York-based researcher Real Capital Analytics, institutions have slowed their acquisition pace dramatically in 2008, with only \$4.9 billion in office building transactions in April, down 80% from a year ago. And if history is any indicator, pension funds and others will lag any upturn in the markets. "Institutional investors are notoriously slow to react and are usually followers as opposed to leaders," says Robert White, president of Real Capital Analytics. That was the case in 2003 and 2004, when institutions stayed out of the market as more opportunistic investors waded in. "Like everyone else, they want greater clarity of where the economy is going. They really didn't start to become active in a big way until 2005 and 2006, well into the bull run," says White. That experience looks to have taken hold in the present market environment. "At this point, investors are wary of becoming buyers too soon rather than responding to any urgency over concern that they will miss the upside," says Sam Chandan, chief economist and senior vice president at New York-based Reis. The recent sale of the General Motors Building in Midtown Manhattan for an estimated \$2.9 billion has given some sellers a tiny sliver of hope, but most observers don't believe it was a seminal event that will uncork an explosion in deal making. "No doubt the sale is a good sign, especially at that price, but I don't think it's going to be a strong signal to the market since it is such a special, one-of-a-kind property," says White. Chandan agrees. "There are few conclusions that can be drawn from its sale — the roster of participants to the transaction or the structure of the financing that are directly relevant for more common properties available for sale." As White puts it, "There was a lot of ego in that deal, not necessarily economics." **(National Real Estate Investor/Ben Johnson)**

REIT Week Attendees Expect Tough Times Ahead

The U.S. commercial property market will avoid the massive troubles crippling the single-family housing sector but will face hard times in the coming year, according to presenters at NAREIT's annual REIT Week conference that took place in New York City from June 4 to June 6. Coming out of ICSC's RECon show in Las Vegas in May, retail REIT executives said retailers were worried about sluggish consumer spending and continued to scale back store openings. Few, however, have asked for outright rent relief. Overall, the market environment seems to be more stable than everyone feared, leading to predictions that the industry will weather a long, but mild recession. Rising food and gas prices currently present the biggest challenge for shopping center operators, according to Milton Cooper, chairman and CEO of Kimco Realty Corp., a New Hyde Park, N.Y.-based shopping center REIT with a 120-million-square-foot portfolio. With gas costing more than \$4 a gallon, U.S. consumers are cutting back on everything but the essentials. Even luxury retailers have started to feel the impact, said John Bucksbaum, chairman and CEO of General Growth Properties, Inc., a Chicago-based regional mall REIT with a 180-million-square-foot portfolio. "In the past couple of years, everybody wanted to trade up," Bucksbaum said describing the trend of middle-income consumers dabbling in the luxury sector. "Today, so many of those people are scaling back. It's all at the margins, but it makes a big difference to the retailers." Despite the hit to consumers, most REIT executives reported that leasing activity during the RECon show remained healthy, though below last year's robust levels. The retailers holding on right now include discounters, warehouse clubs and supermarkets, which are benefiting from inflation on food prices, according to Cooper. On the flip side, restaurants are hurting, said Craig Macnab, chairman and CEO of National Retail Properties, Inc., an Orlando-based REIT that owns approximately 10.6 million square feet in single-tenant retail assets. This lackluster environment will likely last for another year or so, according to Kenneth Rosen, professor of real estate and urban economics at the University of California-Berkeley, who estimates the economy has entered a recession, but thinks there's a 50 percent it will remain mild. The wild card, however, is the price of oil. If that jumps significantly, all bets are off. Despite the broader economic challenges, commercial real estate fundamentals remain solid in part because developers have scaled back on new projects, limiting the amount of new supply. That will provide a buffer against the kind of precipitous price declines experienced in the residential sector, Rosen said. However, there will at least be a modest drop in prices this year, he predicted. In the past 12 months, cap rates on A-class retail assets have increased between 25 basis points and 50 basis points to approximately 6.5 percent, according to Kenneth Bernstein, president and CEO of Acadia Realty Trust, a White Plains, N.Y.-based shopping center REIT with an 8-million-square-foot portfolio. Cap rates on class-B and class-C assets have moved up 100 basis points, meanwhile, and may still go higher. As a result of the slowdown in leasing and the difficulty of obtaining construction financing, most of the REITs are taking a more measured approach to new development—Acadia, for example, expects to have a five-year turnaround for its new projects, instead of the usual three-year plan. But the majority of REIT executives expect that they will be able to get through the current downturn unscathed. "I am optimistic about the long range, we just have to be patient," said Cooper. "I am very hopeful and optimistic that the market will change next year. Whoever is elected president, there will likely be an increase in taxes,

which will be good for the dollar. And there will be a push to make America less dependent on oil." **(Retail Traffic)**

Art Helps Make Dingy Ex-Qwest site 'First-Class'

Artwork by German artist Reinger John adorns the entrance of the former Qwest Building at 1001 17th Street. It is composed of a "flying glass sculpture" and a stained-glass mosaic. Miller Global turned a once-dingy high-rise into a sleek, energy-efficient building. Quiznos will be the anchor tenant for the 20-story building, which is one-third leased. Other tenants include Newfield Energy, FTI Consulting and TD Ameritrade. When Micky "Myron" Miller's company bought the dark and dingy former Qwest headquarters building at 17th and Arapahoe streets in 2006, he thought he would install a waterfall. But his architect, Michael Barber, told him every new suburban department store has a waterfall, so he nixed the idea. "I thought we should do something spectacular," Barber said Wednesday. Eventually, Miller was sold on a German artist after finding that Barber's firm had a relationship with Franz Mayer Studio, which created the stained glass windows in the Cathedral of the Immaculate Conception at 1530 Logan St. The official opening was Wednesday night for the 20-story, 645,000-square-foot building at 1001 17th St. A third of it is leased, with Quiznos serving not only as its anchor tenant but with plans to build its flagship sandwich store in a new glass "jewel box" of retail space along 17th Street. "We got the idea of this box from the Apple store on Fifth Avenue in New York," said Paul Hogan, executive vice president of Miller Global. "I guarantee you this will be like no other Quiznos." The entryway artwork, created by German artist Reinger John, is in two pieces - a "flying glass sculpture" suspended more than 20 feet above the top of the escalators and a stained-glass mosaic with 73,472 individual pieces of colored glass. "When you take a first-class renovation like this and couple it with quality art, it really helps define what makes a great city," said Mayor John Hickenlooper. Jim Miller, Micky's son and president of Miller Global, compares it with the the new breed of energy-efficient buildings downtown still under construction. "We're really the only choice if you want a new energy-efficient building of this quality," he said. Other tenants include Newfield Energy, 51,000 square feet; FTI Consulting, 18,000 square feet; and TD Ameritrade, about 5,000 square feet, said Nick Pavlakovich, who is leasing it with fellow Cushman & Wakefield Broker Matt Gautreau. **(Rocky Mountain News)**

Corridor Sees Surge in Proposed Hotels

At least 10 hotels – including some trendy new brands – are proposed for the U.S. Highway 36 corridor. NYLO, Indigo and Hyatt Place hotels have been announced, along with a more traditional full-service Marriott. A number of select-service, extended-stay brands also are in the works. While the corridor is due for some new construction, it's unlikely all the hotels will be built, however, according to Larry Kaplan of HREC Investment Advisors, a national hotel brokerage firm with offices in Denver. "There are always hotels that are proposed that never get built," said Kaplan, noting the current lending climate will make financing new projects difficult. Also, hotel developers are known for announcing new projects to stave off competition, he said. **(Colorado Real Estate Journal)**

Fontius Renamed for New Anchor Sage

Developer Evan Makovsky announced Tuesday that he is renaming the historic Steel building, better known as the Fontius building, on the 16th Street Mall as the Sage building. The four-story building at 1575 Welton St. is being renamed for its anchor tenant, Denver-based Sage Hospitality. Sage, which develops and manages hotels across the country, is taking all the space above the ground retail — the second, third and fourth floors — for a total of 33,000 square feet. That is 10,000 square feet more than it leases in Writer Square, said Walter Isenberg, CEO of Sage, which employs 120 people in its corporate office and more than 400 in hotels in the area. In addition, American National Bank, owned by investor Donald Sturm, is leasing 4,500 square feet in the building. **(Rocky Mountain News)**

...

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	2.00	2.00	5.25
3 MONTH LIBOR	2.81	2.68	5.36
PRIME RATE	5.00	5.00	8.25
10 YEAR TREASURY	4.27	3.92	5.21
30 YEAR TREASURY	4.79	4.61	5.30

