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Commercial Real Estate Prices Could Require a Decade to Rebound

Even though commercial real estate sales are picking up for trophy properties in cities like Washington, D.C. and New York, a sobering new report by global investment management firm PIMCO cautions that investors should be wary as they enter the recovering market. National price indexes are misleading when transactions are limited, the report says, and the prices fail to reflect uncertainty about property valuations. The difficulty of transferring commercial real estate risk out of the banking system makes a stable recovery unlikely, author John Murray, commercial real estate portfolio manager at PIMCO, and his team conclude. "Many commercial real estate assets likely will not return to 2007 prices until the end of this decade," the report warns. Still, there are positive signs in the market. "Capital is clearly returning to commercial real estate, helping to stem the value decline," the report states. And high levels of bidding activity in some metro areas are generating optimism. However, the transactions and capital flows have been concentrated in trophy properties and in assets for which below-market financing is available. "This has provided a false sense of clarity on the real level of property values. A significant volume of weaker and distressed assets has yet to be liquidated and this foreshadows further pressure on values. Against this backdrop, we caution against the presumptions that a rapid broad-based recovery is under way," PIMCO says in the report released Tuesday. The Newport Beach, Calif.-based investment firm conducted research in 10 metro areas across the country, meeting with commercial real estate lenders, special servicers, real estate owners and developers, investment sales advisers, leasing brokers, and other industry specialists. The authors concluded that changes in the structure of capital markets, including securitization, since the commercial real estate crisis of the early 1990s, will lengthen the deleveraging process and suppress a recovery. Capital has returned to the most liquid sectors of commercial real estate first, through real estate investment trusts (REITs) and commercial mortgage-backed securities (CMBS). REITs were able to raise more than \$24 billion in equity and to issue \$10 billion in debt in 2009, according to PIMCO. From the first quarter of 2009 to the first quarter of 2010, as capital flowed into REITs and CMBS, REIT prices rose more than 96% and super senior CMBS tranche spreads tightened by nearly 70%. Meanwhile, on the debt side, insurance companies have been actively looking to finance quality properties, and former Wall Street investment conduit groups are reforming and several private debt vehicles are raising capital, according to PIMCO. However, the commercial real estate market shares most of the sins of its residential cousin, namely weak loan underwriting, excessive leverage and the absence of risk management from both banks and rating agencies, the report notes. Market reports on industry fundamentals such as vacancy rates and rental rates are misleading, the researchers said after their interviews with leasing brokers and property owners. Some current reports do not fully depict the extent of concessions landlords are offering to attract and retain tenants, according to the report. On a larger, economic scale, issues such as limited gross domestic product growth in the U.S., high unemployment and potential re-regulation will force the market to re-evaluate the assumptions it has used to price commercial real estate. These trends severely affect the outlook for rents, vacancies and capitalization rates, highlighting the downside risks that remain in commercial real estate, the investment firm says. Significant challenges lie ahead for commercial real estate, including the uncertainty related to valuations, which will affect the prospects for recovery, PIMCO says. Because of the complexities that have

evolved in the capital markets over the past decade, approaches to analyzing and investing in the recovering market will need to depart significantly from those of previous cycles, according to Murray and the PIMCO researchers. "Investors therefore should proceed with caution when examining the complex opportunities that are surfacing." **(National Real Estate Investor/Denise Kalette)**

Jump in Jobless Claims Raises Concerns for Economy

The number of people filing new claims for jobless benefits jumped last week after three straight declines, another sign that the pace of layoffs has not slowed. Initial claims for jobless benefits rose by 12,000 to a seasonally adjusted 472,000, the Labor Department said Thursday. It was the highest level in a month and overshadowed a report that showed consumer prices remain essentially flat. The rise in jobless claims highlighted concerns about the economic rebound — especially after a report earlier this week said home construction plunged in May after government tax credits expired. If layoffs persist, there's a concern that the June employment numbers may show a decline in private-sector jobs after five straight months of gains, said Jennifer Lee, an economist with BMO Capital Markets. First-time jobless claims have hovered near 450,000 since the beginning of the year after falling steadily in the second half of 2009. That has raised concerns that hiring is lackluster and could slow the recovery. A separate Labor report said consumer prices fell for the second straight month. The 0.2 percent drop in the Consumer Price Index was pulled down by falling energy prices — notably a 5.2 percent drop in gasoline prices. But core consumer prices, which strip out volatile energy and food, edged up 0.1 percent in May after being flat in April. Core prices are up 0.9 percent over the past year — below the Fed's inflation target. Additionally, the Commerce Department said Thursday that the most broad measure of U.S. trade rose during the first quarter to the highest point in more than a year. Much of the widening deficit was because of higher prices on imported oil during the first three months of the year. Those prices have since come down. And a private research group said its gauge of future economic activity rose 0.4 percent in May, signaling slow growth in the U.S. economy through the fall. Turmoil in stock markets and a troubled housing market weighed on the Conference Board's leading economic index, while measures related to interest rates and an increasing amount of money in the economy tugged it higher. **(Denver Post)**

Colorado Unemployment Rate Stays at 8% in May; 1,100 More Working

Colorado's unemployment rate remained at 8 percent in May, and 1,100 more residents found jobs during the month, the Colorado Department of Labor and Employment reported Friday. Unemployment also stood at 8 percent in May in the Denver metro area. Donald Mares, the department's executive director, noted that temporary Census hiring "is providing a brief boost in Colorado jobs. ... The labor market remains weak." The 1,100 increase in working Coloradans from April to May brought the statewide employment total to 2,456,900. But the civilian labor force grew by 1,600 in May to 2,670,700, about 500 more than the rise in employment, so the number of unemployed grew to 213,800. Still, that's a slight improvement over the May 2009 jobless rate of 8.2 percent and the total of 225,000 unemployed a year ago, according to the state's data. However, 46,500 fewer Coloradans were working in May 2010 than in May 2009, when employment stood at 2,503,400. The

monthly unemployment rate is seasonally adjusted to account for normal seasonal job fluctuations. The national unemployment rate for May is 9.7 percent. In the Denver-Aurora-Broomfield metro area, the unemployment rate stood at 8 percent in May, the labor department reports. The local jobless rate was 7.9 percent in April and 8.5 percent in May 2009, seasonally adjusted. In metro Denver, there were 109,600 unemployed in May, up 400 from April but down 10,400 from May 2009. There were 1,255,600 employed workers in the area in May, down 12,700 from April and down 31,500 from May 2009, the state reports. The metro area's labor force was 1,365,200 in May, down 12,300 from April and down 41,900 from May 2009. Statewide, the rise in the workforce is partly due to previously discouraged unemployed workers resuming their job hunt and is seen as a sign of rising optimism about the economy. Unemployed workers who haven't been actively looking for a new job are not considered part of the labor force and therefore are not counted as unemployed until they resume their search. May employment across Colorado was boosted by the addition of 7,600 temporary Census jobs out of a total increase in government employment of 7,800 jobs, the labor department reported. The Census Bureau has hired workers nationwide to help it knock on the doors of residents who didn't submit their Census forms on time. Also, Colorado construction employment was up by 1,500 jobs in May over April, and "other services" jobs rose by 800. On the other hand, Colorado jobs in the category of trade, transportation and utilities dropped by 1,600 in May from April levels, while financial activities positions declined by 1,100, information jobs dropped by 1,000. Other job category declines in May: leisure and hospitality (down 700), manufacturing (down 500), and professional and business services (down 300). Year over year, jobs have increased in only three of 11 industry sectors in Colorado: Government (up 11,000), education and health services (up 3,800) and other services (up 1,000 jobs). All other sectors declined between May 2009 and May 2010, led by construction (down 19,200); trade, transportation and utilities (down 10,200); manufacturing (down 6,900); and leisure and hospitality (down 6,400). **(Denver Business Journal)**

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Denver Business Tenants Take Advantage of Office-Space Bargains, Concessions in Q2

Tenants leasing office space in metro Denver continued to capitalize on the availability of space, bargain rental rates and "generous" concessions in the second quarter, according to a PricewaterhouseCoopers LLP report Friday. On the other hand, sales of office buildings during the period were "modest," and the few deals that closed were for high-quality properties, said PwC's "Korpacz Real Estate Investor Survey." The supply of office properties up for sale nationally outweighs demand by purchasers, except among top-quality, institutional-grade buildings. There also has been an uptick nationally in availability of financing for buying top-grade properties. The Korpacz report includes national data on retail and industrial space as well as apartment properties, but only offers information by market on office space. PwC surveyed real estate investors nationwide on their thoughts about 30 U.S. markets, including metro Denver, for the study. Most respondents (67 percent) believe conditions in the Denver-area office investment market "currently favor buyers," while the rest think conditions are equally good for both buyers and sellers, the report said. Putting a price on for-sale office properties remains challenging, the report said, because some sellers are pricing their lesser-quality buildings based on what higher-quality properties have sold for. Major second-quarter office sales in

metro Denver included HRPT Properties Trust (NYSE: HRP) of Newton, Mass., buying Re/Max International Inc.'s 235,575-square-foot headquarters building at the Denver Tech Center for \$75 million, or \$318 per square foot. Re/Max was the seller, and now is a tenant in the building. HRPT will change its name to Commonwealth REIT (NYSE: CWH) July 1. Looking at the country as a whole, the PwC report found that capitalization, or "cap," rates dropped in 17 of the survey's 30 markets in the second quarter. The decrease in cap rates, which are a key measure of investors' expectations regarding a property's value and the income it will produce, shows investors see less risk now. That's especially so for "prime properties in better markets," the survey said. In metro Denver, the Q2 average cap rate increased to 8.4 percent in the second quarter from 7.79 percent in 2009's second period, the report said. Capitalization rate is the rate of return on a real estate investment property, based on anticipated income. It's calculated by dividing property income, less costs, by a property's total value. Metro Denver's largest office lease of the period was United Launch Alliance LLC's huge April lease of 450,000 square feet at multiple buildings in Centennial and adjacent unincorporated Arapahoe County. The deal will consolidate some 2,000 ULA employees over the next 18 months — and removes a couple of large blocks of available office space from the southeast suburban submarket. Downtown Denver also has some significant leases in the period, including Los Angeles-based AECOM Technology Corp.'s (NYSE: ACM) consolidating its metro-area operation in nearly 70,000 square feet at Manville Plaza. To get lease deals done, metro-area landlords are offering as many as 10 months of free rent — though the average is five months — the report said. Tenant improvement allowances have increased to \$10 per square foot on average. (Denver Business Journal)

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	.25
3 MONTH LIBOR	.54	.46	.61
PRIME RATE	3.25	3.25	3.25
10 YEAR TREASURY	3.24	3.37	3.83
30 YEAR TREASURY	4.15	4.24	4.60