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Commercial Property Prices Still Gaining

Commercial real estate prices were up more than 5% nationally at the end of March from the same time last year, according to Standard & Poor's March GRA Commercial Real Estate Indices. The S&P/GRA indices look at commercial real estate prices from 10 different perspectives, including nationally, by geographic regions, and by property type. Nationally, commercial real estate prices gained 5.1% through the end of March from the previous period a year ago, but were down 0.1% from February 2008 levels, according to S&P. For comparison purposes, the national index peaked at 14.5% in June 2006. S&P's index values are based on a three-month rolling average transaction price per sq. ft. on closed transactions. "Overall, the results for commercial real estate were modest for the month," says David Blitzer, chairman of the index committee at S&P. "The Western regions significantly outperformed their Eastern counterparts this month. The region that showed the most weakness in March was the Northeast, down 1.4%. On the positive side, the Pacific West returned 1.7% for the March/February period and has the highest return over the past year." Three of five regions showed positive monthly returns. The Midwest was up 0.7%, and the Desert Mountain West region gained 1.0%. Besides the Northeast, the Mid-Atlantic South was down 0.1%, compared with February 2008. S&P attributes the decline in the Northeast to price changes in the New York and Boston multifamily, office, retail and warehouse sectors. This was offset somewhat by price gains in Washington, Baltimore and Philadelphia multifamily, office and retail properties. Gains in the Pacific West were largely the result of price changes in the Los Angeles, Orange County, Riverside, San Bernardino and San Diego multifamily, office, warehouse and retail property sectors. Breaking down the performance for different property types, Blitzer says, "In the property sector warehouse was the star performer during the March/February period, up 0.9%. The other three property sectors reported small positive returns. Confirming that a turnaround may be taking place following a weak 2007, apartments are showing the highest one-year return since March 2007, up 7.7%." The multifamily sector peaked in August 2006 at 16.6%, S&P reports, and declined as much as 3.5% in June 2007, with the March 2008 return of 7.7% showing a recovery. Multifamily properties have held steady since February. Fundamentals in the sector are holding up across most major metropolitan areas, taking into account slowdown in job growth, falling home prices and rising affordability of home purchases. However, growth in rents has started to slow even though apartment vacancy rates in most markets remain below normal long-term levels. Another factor supporting multifamily fundamentals is that permits issued for multifamily construction have continued to drop over the last 12 months. In March 2008, taking into account five-unit plus communities, the annual number of permits issued totaled 274,000 units, down more than 26% compared to the 371,000 issued in March 2007. The warehouse sector benefited in March due to price gains in the Pacific West region, the Mid-Atlantic South, some parts of the Northeast, and in Chicago. This was offset somewhat by downward trends in Washington, Baltimore, Philadelphia and some parts of the Midwest. Office properties were up 0.1% in March from the previous month, and retail properties gained 0.3%. **(National Real Estate Investor/Poonkulali Thangavelu)**

Developers Seal Deals Downtown

Two local developers known for their adaptive reuse projects -- Charlie Woolley and Evan Makovsky -- recently purchased buildings in downtown Denver. Woolley, head of the Denver-based St. Charles Town Co., bought the 13-story, 60,000-square-foot 1800 Glenarm office building at that address for \$6 million in late May, according to Denver County real estate records. The developer plans to convert the building, at a cost of \$15 million, to office condominiums. Denver developer Eric Osborn previously hoped to reconfigure the property, with seller Fleisher Smyth Brokaw LLC of Denver, as a high-end residential condo project called Mondrian City Homes. Makovsky, best known for redeveloping the blighted former Fontius building on downtown Denver's 16th Street Mall, just purchased the building at 1411-1417 Market St. from Denver car salesman and investor Socrates Sclavenitis for nearly \$3 million, according to Denver County real estate records. The developer acquired the property as Shi'kor LLC. Calls to Makovsky to find out what he plans to do with the property weren't returned. St. Charles Town Co. acquired the 1800 Glenarm building from Fleisher Smyth Brokaw, as Glenarm Residences LLC, and plans to convert the property to roughly 25 for-sale office condos with 4,500 square feet of first-floor retail space. A bank the developer declined to name is expected to occupy the retail space. Prices for the units haven't yet been determined. The building also will get more exterior glass, new skin and an updated, modern look, according to Matt Holberton, St. Charles' managing director. St. Charles has experience with downtown Denver office condos, as owner of The Equitable Building office condos on 17th Street. Woolley was in Europe this week, and unavailable for comment. "For all practical purposes, this will be a new building that will give people the chance to own space at a time when the market is a little unsettled," said David Leuthold, vice president of commercial marketing services at St. Charles. Eric Osborn, who formerly was the developer of the nearby \$100 million One Lincoln Park condo project, said in 2007 that he and Fleisher Smyth Brokaw were working to convert 1800 Glenarm to high-end condos that would complement One Lincoln Park. The Mondrian City Homes units were to range from 2,200 to 4,200 square feet in size, and sell for more than \$1 million each. Osborn hoped to start construction in 2007 and finish the project this year. Osborn continues to be an investor in the 32-story, 177-unit One Lincoln Park, but resigned as developer in February when he was indicted on two counts of felony theft of \$255,000. The developer pleaded not guilty to those charges in May. The two-story Market Street building Makovsky bought, located at the corner of Market and 14th streets, includes an Old Chicago Pizza restaurant. The building was completed in 1919, and includes 13,500 square feet of space, according to Denver County property tax records. Makovsky recently leased the top three floors of the four-story old Fontius Shoe Co. building to Denver-based hotel management company Sage Hospitality Resources LLC for its new corporate headquarters. Sage plans to move its 120 headquarters employees to the building in the first quarter of 2009. Makovsky also plans to redevelop a block behind the Fontius building, now called the Sage Building, as a transit-oriented residential and commercial project. **(Denver Business Journal)**

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Equity Capital Remains on the Sideline

Real estate equity capital remains voluminous but the lack of debt financing, a mismatch between capital and available product, and desire to see a proven market

bottom are contributing to dramatically lower transaction volumes in 2008. That was the message from a panel of experts assembled to discuss the state of commercial real estate equity capital markets in an event hosted by the Real Estate Investment Advisory Council. Still, the panel members expect the market to begin improving as these factors inevitably turn around, possibly in 2009. The June meeting at the Westin Buckhead was moderated by Dale Taysom, a managing director of Prudential Real Estate Investors. Panelists included Neill Faucett, managing principal of Lubert-Adler Real Estate Funds; Bob DeWitt, president and CEO of The General Investment & Development Cos.; Seth Weintrob, a managing director with Morgan Stanley; and Ewoud Swaak, president of Westplan Investors. The panel noted that equity capital earmarked for United States' commercial real estate investment remains very deep and demands greater returns than in recent years. At the same time, mortgage money for acquisitions is pricier and less available, so more of the purchase price must be funded by comparatively expensive equity. That math has led to falling buyer bid prices for available properties and given rise to the current "bid-ask spread," the gap between willing seller and buyer valuations. With no common ground on pricing, transaction volumes have slowed. Weintrob of Morgan Stanley noted that industry analysts have offered estimates of pricing contractions of 5% to 25%. Assuming prices might ultimately fall 10% to 15%, he says, the market may be half way there at present. Cap rate increases have accounted for the initial declines, but net operating income underperformance will be the next driver, according to Weintrob. This is particularly the case with some high-profile office investments where rents were expected to dramatically increase before leases reset. Instead, far lower rent growth is now expected. Another driver is the changing investment motivations of equity providers, according to the panel. Whereas low-risk, low-yield core capital was abundant in recent years, the equity sector targeting higher yield distressed investments is experiencing the greatest investor growth today. DeWitt noted General Investment & Development Cos.' long-term agreement to purchase apartments with core money on behalf of CalPERS. Those properties, he said, routinely trade at around an 8% internal rate of return (IRR). He added that the risk/reward of taking investment chances in this market argues for conservative underwriting, and thus his company has not purchased any apartments so far in 2008. The "denominator effect" partly explains the conservative investment stance of pension funds today, says DeWitt. Declines in the stock market and other asset classes have brought real estate allocations back in line without need to buy additional properties. While the core marketplace has gone quiet, sponsors looking to acquire properties at artificially low, distressed prices have raised numerous funds. By taking advantage of perceived market dislocations, distressed investors are expecting 20% or better IRRs from their investments, according to the panel. Lenders are the anticipated source of most distressed product, which can be real estate owned (REO), loans in default or close to default, or even healthy loans of ailing lenders. Lubert-Adler is looking for opportunities in all these areas, according to Neill Faucett. So far, for-sale residential land has accounted for most of the distressed investment opportunities and land pricing has not yet hit its bottom, according to the panel. Faucett said that some reports suggest as many as 65% of land acquisition-development loans could ultimately go bad. This will cause significant distress to some regional and local lenders where these loans make up 10% or more of balance sheets, and underlying bank capital is highly leveraged. The panel also noted that Class-A property investments should outperform Class B and C properties, so understanding the different performance profiles of each asset class is important. The desire to witness the bottoming of asset pricing before jumping in

was a repeated theme among the panelists. Some funds require periodic reappraisals, and panelists like DeWitt said clients are reluctant to incur a downward revaluation on new investments. The more conservative approach, he says, is to wait until the recovery is well underway. The panel also noted some bright spots. Faucett highlighted the positive impact on real estate investments of metro Atlanta's 150,000 net population gains annually and future job growth predictions. Taysom and Weintrob related experiences from recent trips to the Middle East to raise investment capital. Both expect more equity to flow into U.S. real estate from that region as Middle Eastern investors are willing to de-link U.S. subprime mortgage fallout from performance prospects of commercial real estate. DeWitt pointed to the ailing single-family marketplace as one of several factors that will increase resident demand for apartments, setting the stage for property income increases. Swaak of Westplan Investors said that in-town luxury apartment development had represented the bulk of his company's investments to date, although he recently raised a fund targeting distressed land. Swaak, who places Dutch private and institutional capital into U.S. investments, indicated that his investors continue to endorse U.S. real estate. All the panelists viewed apartments as the best performing property sector in the current market. Still, Taysom said that Prudential has been active purchasing mezzanine positions versus the outright property ownership because his company is able to obtain projected mid- to high teen IRRs while remaining at comparatively safer positions in the capital stack. The incongruous nature of the risk-adjusted returns appears a temporary phenomenon. Once the available logjam of distressed commercial mortgage paper and mezzanine positions clears the market, says Taysom, and mortgage lenders return from the sidelines, capital flows and return expectations should normalize and investment activity among the "four food groups" — office, apartments, retail, industrial — should begin improving. The panel said to look for that stabilization and recovery to begin sometime next year. **(National Real Estate Investor)**

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Retail Real Estate Expected to Remain Strong

Metro Denver's retail real estate market should remain "fairly healthy," with absorption of vacant space and higher rents, for the rest of 2008, according to a report released Wednesday by Marcus & Millichap Real Estate Investment Services Inc. The report attributes the forecast to strong metro-area demographic trends and weakening supply-side pressure. Employers project an increase of 13,000 jobs, or a 1 percent gain, for the entire year. "Investors with long-term strategies may find properties in the expanding northeast submarket, as well as new developments along planned FasTracks lines," Adam Christofferson, regional manager for Marcus & Millichap's Denver office, said in a statement. Looking at retail real estate, the commercial real estate brokerage expects the following:

- Asking rents to increase 1.6 percent to \$17.44 per square foot on average.
- A 0.8 percent uptick in effective rents to \$15.46 per square foot on average. "Effective rent" is the rent actually paid by tenants to landlords.
- Year-end vacancy rate of 8.1 percent.
- A 2 percent jump in the inventory of retail space, with the addition of 2.5 million square feet. **(Denver Business Journal)**

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	2.00	2.00	5.25
3 MONTH LIBOR	2.79	2.64	5.36
PRIME RATE	5.00	5.00	8.25
10 YEAR TREASURY	3.99	4.01	5.11
30 YEAR TREASURY	4.53	4.69	5.20