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Tanking Real Estate Values Take Toll on Pension Funds

Public pension funds are under enormous pressure to claw back a seemingly endless decline in the value of their real estate investments. The extent of the damage is revealed in the release of a few of the larger fund's annual reports. The nation's largest pension fund, the California Public Employees Retirement System (CalPERS), has reported a litany of recent troubles. The bellwether institutional investor reported that the value of total assets under management at the end of June was \$180.9 billion, down from \$237 billion a year earlier, or a drop of 23.6%. Real estate values accounted for the biggest chunk of the decline, falling 35.8% during the period, followed by private equity with a 31.4% decline. In July, CalPERS' joint venture with Houston-based Hines defaulted on a \$152 million mortgage secured by three office buildings in Emeryville, Calif. The buildings, totaling 814,000 sq. ft., are part of the 1.2 million sq. ft. Watergate office complex. A fourth building on the site is owned by a separate entity, Hines REIT, and is not part of the default. NOP Watergate LLC, the joint venture that defaulted on the buildings, paid \$335 million for the buildings and a separate restaurant in late 2006, at what most observers consider to be the height of the market. Now it is surrendering the property to the lender, Pacific National Bank. It is unclear what strategy the bank intends to pursue. In another stinging and unprecedented move, New York-based rating agency Moody's Investors Service placed its AAA-rating on CalPERS under review. Despite its multitude of travails, CalPERS is certainly not alone in the falling values department. The California State Teachers' Retirement System (CalSTRS), another institutional bellwether, reported that its total asset values fell by 25% in the fiscal year ended June 30, to \$118.8 billion. The value of CalSTRS' real estate assets fell by an astounding 43% during the year, due largely to the fund taking a large write-down on its assets for 2008 rather than spread out the pain over a few years. "We're now in the position to turn around our real estate returns with new, creative strategies, including acquiring high-quality assets from distressed sellers at attractive discounts", says chief investment officer Christopher Ailman. Farther east, the Ohio Public Employees Retirement System saw its total assets grow by 3% to \$50.2 billion year-to-date through June 30, but real estate was a big drag on its results. The fund's real estate assets, which account for about 8% of the fund's total assets, dropped 12.2% during the same period to approximately \$4.2 billion. The decline was beat only by the drop in private equity holdings, which declined 18.22% for the year. Optimism is growing that a turnaround is on the doorstep. In recent months, the stock market has recovered much of losses notched over the past year. In early August, New York-based rating agency Standard & Poor's issued an encouraging report on the recovery of stock prices for publicly traded real estate firms. In the second quarter, the S&P property and REIT indices saw sharp rises, following a drop of nearly 20% in the first quarter. But many industry experts believe that more pain is ahead. According to Robert White, president of New York-based researcher Real Capital Analytics, some \$2.2 trillion of properties acquired or refinanced after June 2004 have lost value since their transaction date. Given that prices have declined 25% on properties purchased or refinanced from 2006 through 2008, "the equity in \$1.3 trillion of properties is at great risk, if not already wiped out," says White. Both institutional and private owners alike see no signs of an immediate rebound in the property sales market to help stem the tide of dwindling values. Commercial property sales through the first six months of 2009 amounted to only 7% of the volume reached at the peak of the frothy sale market in the first half of 2007,

according to Real Capital Analytics. But White also notes that the number of office property sales in June was 24% higher than in May. "The jump in activity in June may be an early signal that buyers are returning, lured by lower prices," he says. Still, June was one of the worst months to date for new distress, with \$13.6 billion worth of properties falling into default, foreclosure or bankruptcy. According to White, by the end of June the total value of distressed commercial properties nationwide was nearly \$115 billion. **(National Real Estate Investor/Ben Johnson)**

Economists Say the Recession Is Ending; When Colorado Will Recover Is Open to Debate

"The 'Great Recession' is no more. It's over, finished, kaput!" declared Jeff Thredgold, an economist with Vectra Bank Colorado. Thredgold serves on three national forecasting groups, and all predict economic growth will return this quarter and continue into next year. But local economists differ on whether Colorado's downturn will also end this quarter, with some cautioning that job losses will continue far into 2010. "Although the state went into the recession later than the nation, we are forecasting it to come out at roughly the same time," said Tim Sheesley, chief economist with Xcel Energy. Richard Wobbekind, associate dean at the University of Colorado Leeds School of Business, said Colorado is well-positioned to ride the draft of a U.S. recovery and maybe even vault ahead. He points to a strong technology sector, heavy federal stimulus spending and a housing market that has less mending to do. "People expect this to be a technology-led recovery," he said. "If it is, we have technology." But others say Colorado will need more time, given heavy job losses and the hit the energy sector has taken. Record-high energy prices last summer helped stave economic contraction for energy-producing states such as Colorado, which didn't see job declines start until July. The U.S. recession started in December 2007. Those declines accelerated with a fury after the credit crisis deepened in September. The state has lost more than 100,000 jobs in the past year, according to payroll reports. "You just don't bounce back immediately," said Thredgold, who doesn't expect meaningful signs of growth for Colorado until the first half of 2010. Natalie Mullis, chief economist for the state's legislative council, is also skeptical the "crawling" pace of U.S. growth will be enough to lift Colorado. "The uptick is primarily related to firms' needs to rebuild their inventory after having depleted them over the last few quarters," Mullis said. But Colorado has a fairly small manufacturing presence, so it may not do much for the state, she said. The brunt of the deepening collapse in commercial real estate is yet to come, and credit still remains tight, leaving Mullis less certain of how Colorado will fare. Sheesley agrees that energy development is way down, but he expects health and educational services and retail trade boosted by tourism to increase next year. There have been several developments that provide a glimmer of hope for the state economy. Only the National Bureau of Economic Research, a private nonprofit, can declare an official end to the U.S. recession. But it will likely take several more months for the confirming data to come in. Economists have raced to lift their forecasts for the third quarter after U.S. GDP shrunk a smaller-than-expected 1 percent in the second quarter. Rising confidence, heavy federal stimulus spending and a need to restore depleted inventories could end four quarters of decline in economic output, the longest stretch on record since 1947. But the cross-currents remain strong and numerous. Consumer spending, which represents about 70 percent of economic

activity, fell 0.4 percent in June and was down in the second quarter. Rising job losses could set off another wave of foreclosures. And the impact of collapsing prices and rising loan defaults in commercial real estate are still out there. Even if Colorado's economic output starts rising again, continued job cuts will mean it doesn't feel like a recovery. Moody's website, Economy.com, predicts Colorado will lose 3,000 jobs next year, enough to rank it fifth-best among states, Wobbekind said. **(Denver Post)**

Mid-Year Economic Forecast: Colorado "Last In, First Out" of Recession

In December 2007, the U.S. economy entered the most severe recession in decades. A number of instabilities contributed to the downturn, but a global pattern of inflated housing trends and financial market failures was a key factor. U.S. job losses between December 2007 and June 2009 totaled nearly 6.5 million, which is also the vast majority of jobs created since the 2001 recession. Because so many jobs have been lost, the U.S. labor market could take several years to recover once employment growth resumes. Colorado employers did not begin significant and sustained layoffs until September 2008, almost a full year after the nation officially entered recession. Layoffs spiked quickly, however, and unemployment rose dramatically. While the state's labor and housing markets have suffered some of the largest downturns in decades, Colorado is still in a comparatively better economic position than many states nationwide. According to a recent forecast by Moody's Economy.com, Colorado, Idaho, Texas, Oregon, and Washington will be the first states to recover in late 2009. While each state's economy is unique, the five states have generally better household credit ratings, milder housing downturns, and concentrations of business in energy, technology, and other industries that should benefit from pent-up demand. "Because of Colorado's diverse economy, we expect we'll be 'last in, first out' of the recession," stated Tom Clark, executive vice president of the Metro Denver Economic Development Corporation. "Plus, Metro Denver is on the radar for international and national company relocations and expansions that could further stabilize our labor market." Like Colorado's economy, the Metro Denver economy is weathering some of the most difficult labor, housing, and financial market conditions reported in decades. Still, the regional economy has several advantages that should support a stronger and earlier recovery than many metropolitan areas are likely to experience. First, Metro Denver's housing market has been more stable than other markets nationwide. Foreclosure rates have improved in the region's most-affected counties, and the region's home price declines are consistently smaller than declines reported for other metropolitan areas. In fact, foreclosures through the first five months of 2009 fell 13.3 percent from the same months in 2008. Notably, the counties which reported the most foreclosures in 2006 and 2007 – Adams County, Arapahoe County, and the City and County of Denver – have reported some of the largest declines in foreclosures so far this year. Metro Denver commercial real estate markets are also in a better position than markets elsewhere, partly because of sustained business interest and partly because of more restrained development prior to the downturn. These and other factors including a well-educated workforce and high quality of life continue to attract businesses to Metro Denver, even during recession. The Metro Denver economy still has room for improvement, particularly as consumers and businesses remain cautious and governments work through a damaging combination of lower sales, property, and income taxes. Even so, improvements in the Metro Denver economy –

particularly in housing – will become more apparent through the second half of 2009.
(Metro Denver EDC)

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	2.00
3 MONTH LIBOR	.43	.51	2.81
PRIME RATE	3.25	3.25	5.00
10 YEAR TREASURY	3.55	3.62	3.88
30 YEAR TREASURY	4.41	4.48	4.52