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## Warning Sign for Office Market?

It's tough to argue that the health of the nation's 7 billion sq. ft. office market is anything but robust. Demand is strong and vacancy rates have fallen. Lofty construction costs have tamped down new supply and asking rents shot up at their fastest rate in six years during the third quarter. But a host of economic risks, ranging from weak job growth to ripple effects from a housing slowdown, could impact the office market in coming months. The shift may already be upon us: Take third-quarter job growth, which many economists viewed as mediocre -- non-farm payrolls increased by just 51,000 in September after rising by 188,000 in August. The consensus prediction among 23 economists polled by Dow Jones Newswires was that payrolls would jump by 125,000 in September. While recessions are notoriously difficult to predict, some troubling signs have emerged in recent months. One quirky example is the Federal Reserve's "beige book" report from September. This closely watched survey, essentially a roundup of regional economic reports, used the word "weak" 50 times. The July report only featured 40 references to "weak." What's telling is that the January 2001 report used the word 53 times and that was two months before the last recession officially began. One real estate economist believes that the office market is slowly feeling the effects of weaker job growth. Leasing demand answers to job growth. So will this be a gradual slowdown or a flat-out recession? The Conference Board, a global research and business membership organization, reported on Tuesday that several economic indicators suggest slower growth --but not a recession -- on the horizon. Within the past three months, the Conference Board's index of leading economic indicators has turned down relative to its level six months ago. That's significant because it marks the first time that the index has fallen since the current economic expansion began in 2003. "While this signal is not particularly alarming, since the downturn is still rather modest, it does suggest that the economic cycle is more mature than is generally presumed," says Gail Fosler, executive vice president and chief economist at the Conference Board. "Everybody is watching the job numbers and the housing market very carefully," says Bob Bach, national director of market research at Oak Brook, Ill.-based Grubb & Ellis. "It's also getting harder to deny that growth has pulled back a bit given the recent job numbers." Sam Chandan, chief economist of research firm Reis, points to a more troubling sign of a slowdown: Net absorption fell from 16 million sq. ft. nationally in the second quarter to 10.7 million sq. ft. during the third quarter. That means tenants are taking on less space and demand is cooling. "The fourth quarter could be a real turning point for the office market," says Chandan. "And the consensus is that 2007 will bring slower growth than 2006, which may go down as a banner year for the office market." And what about a severe slowdown in the housing market? History offers some guidance: If the housing market were to reprise its last major downturn in 1991, Bach projects that roughly 716,000 payroll jobs would be lost. That total represents 42% of all net additions to non-farm payrolls by all sectors between August 2005 and August 2006. More than 90,000 of these jobs would be in housing-related service sectors that tend to occupy office space. The upshot is that such a severe slowdown could generate negative net absorption approaching 16 million sq. ft. over the next four quarters. But, Bach adds, that is a "worst-case scenario." It's important to note that most of the bearish economic forecasts in recent weeks have all touched upon a housing slump. Last week, for

example, International Strategy & Investment economist Nancy Lazar said this in the Wall Street Journal: "I'm very worried about housing and the potential negative impact on overall economic activity...the big question for me is how will that impact consumer spending?" **(National Real Estate Investor/Parke Chapman)**

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### **Fed Reports Resilience in Economy**

Maybe the sputtering housing market will not be that big of a drag on the economy after all. Falling gas prices are leaving Americans with more money to spend, and inflation has become less of a threat in recent weeks, according to a report released yesterday by the Federal Reserve. Wall Street reveled at the news. Stock prices — already buoyed by a series of strong corporate earnings announcements from companies like McDonald's and Costco — surged even higher after the Fed's report, the beige book, came out yesterday afternoon. The benchmark Standard & Poor's 500-stock index jumped to its highest close in more than five and a half years. The Dow Jones industrial average, which last week broke a record high that had stood since 2000, climbed past 11,900 to close fewer than 53 points short of 12,000. The Nasdaq composite gained more than a point and a half. A separate report showing that the nation's trade deficit reached a record high in August was apparently an afterthought for investors. The Commerce Department said that on a seasonally adjusted basis, Americans imported \$69.9 billion more than they exported, up 2.7 percent from a \$68 billion deficit in July. That increase was in large part a result of near record petroleum prices. While the beige book was hardly a glowing picture of the nation's economy, it did strike a generally optimistic tone. It described a "widespread cooling" in residential housing but noted that growth in commercial real estate activity was picking up some of the slack. And there were a handful of areas where residential home sales "showed signs of resilience," the report said. Manhattan, Houston and Sioux Falls, S.D., were among these pockets of strength. "It seems like things are still stable," said Marisa DiNatale of Moody's Economy.com. "There may be moderating growth, but it's certainly not a drastic slowdown." Other potential problem spots in the economy — rising prices and slower consumer spending — do not appear to be much of a problem at all in many areas of the country, the report said. Consumers spent freely, taking vacations and shopping for back-to-school items. Wage growth was described as generally "modest." And there were few signs of pressure from higher prices as the cost of gasoline dropped. Economists said falling fuel prices should be reflected in the next trade deficit report. Energy costs were the major reason for the widening trade gap in August, with the deficit in petroleum-related products accounting for nearly all of the \$1.9 billion increase. The amount Americans spent on foreign-made household appliances and electronics also rose. "The trade balance should improve significantly soon," Dmitry Fleming, an economist with ING, said in a research note. "August, however, was never going to be the starting point, with the lagged effects of higher oil prices." The growing trade imbalance with China was another major factor in the ballooning trade deficit. The unadjusted trade deficit for August was \$79 billion. Nearly a third of that, \$22 billion, represented the gap in trade between the United States and China. The numbers defied expectations. Economists who were surveyed before the numbers came out predicted that the overall deficit would fall in August, but it rose, seasonally adjusted, by \$1.9 billion from July. When the gap hit a record in July,

economists said they believed that the numbers were nearing a peak. But as energy prices remained high this summer, the deficit continued to swell. Still, many economists said yesterday that they now believed that the turning point was near. "This is probably as bad as it gets," wrote Paul Ashworth, senior United States economist with the economics research firm Capital Economics. Yesterday, the Chinese reported their own trade numbers, which showed a surplus of \$15.3 billion for September. China's trade surplus hit a record \$18.8 billion in August. While American reliance on foreign goods is showing no signs of weakening, exports also remained strong. After declining in July, exports grew in August by 2.3 percent, to \$122.4 billion. But that rate of growth was not strong enough to offset the rise in imports, which reached \$192.3 billion in August. That was an increase of 2.4 percent. Peter Kretzmer, senior economist with Bank of America, said such strong import growth was a sign the economy would expand at a faster rate in the final months of the year. "We've been surprised by how strong import growth is," he said. "This strong domestic demand may be a bit of a harbinger of a strong domestic economy going into the fourth quarter." **(New York Times)**

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### **DIA Use Up, Up, Up**

A record number of passengers used Denver International Airport in August, the 16th month in a row of monthly passenger records. More than 4.3 million passengers used DIA in August, up 5.1 percent from the 4.1 million travelers at DIA in August 2005. For the year through August, DIA passenger traffic has been up 9.6 percent with nearly 32.4 million passengers total. That's up from 29.5 million travelers in the same period a year ago. DIA said it is on track to set another record for passenger traffic this year. Last year, 43.4 million passengers used the airport. A 9.6 percent increase for 2006 would total more than 47 million. DIA was built for 50 million travelers annually in its first phase, and the airport is updating its master plan considering additions to the airport in the next 15 years. **(Denver Post)**

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### **Buyers Bargain on Building's 'Basement'**

The former Honeywell Center in Inverness Business Park sold to an investment group that saw a bargain in the basement. Equity West Investment Partners, Inverness Properties and Somera Capital Management teamed up to buy the 134,691-square-foot building at 304 Inverness Way S. with plans to restore the lower level, which has been used as storage, to data center space. They also will invest approximately \$500,000 in the Class B building to raise it by a letter grade. "We're going to redevelop the property and really change its image in the marketplace," said Equity West principal David Naus. The upgrade, which will be completed by the end of the year, will encompass the lobby, common areas, corridors and elevators of the building, which Naus said is "fundamentally solid" and "very well located" real estate. **(Denver Business Journal)**

	<b>CURRENT</b>	<b>1 MONTH PRIOR</b>	<b>1 YEAR PRIOR</b>
<b>FED FUNDS RATE</b>	5.25	5.25	3.75
<b>3 MONTH LIBOR</b>	5.37	5.39	4.15
<b>PRIME RATE</b>	8.25	8.25	6.75
<b>10 YEAR TREASURY</b>	4.78	4.80	4.39
<b>30 YEAR TREASURY</b>	4.91	4.95	4.60