

November 13, 2006

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

### **New Report: Occupancy Growth Hits a Wall**

Landlords are savoring some well-deserved occupancy gains. They may need to enjoy them while they last. An Oct. 27 research report from Property & Portfolio Research (PPR) predicts that vacancies in all classes of real estate (except office) will register above current levels by 2011. This shouldn't be misread as dire news, however. Tight occupancy will allow most landlords to hike rents, and the tightest markets can absorb plenty of new development. Boston-based PPR doubts that vacancy will continue dropping at the pace that it has been during the past few quarters. Between mid year and the end of September, for example, office vacancy dropped by 0.2% to 16% in the steepest decline of any property type. But PPR expects office vacancies to fall by just 0.1% between the end of September 2006 and the end of September 2007. That's a meager drop, too: The previous twelve-month period saw office vacancies decline by 0.9%. "The office market has done pretty well with what most economists are calling mediocre job growth in recent months," says Bob Bach, director of national research at Oak Brook, Ill.-based Grubb & Ellis. Bach doesn't expect office vacancy to drop quite as dramatically next year as it has in 2006. The apartment market will also be challenged to bring vacancy down over the next 11 months. Apartment vacancies are only expected to drop by 0.2% to 5.5% by the end of September 2007. Like the office market, apartment vacancies fell sharply between September 2005 and 2006 (try 0.7%). "We've really seen a shift over the past 12 months as more people have gravitated towards renting an apartment versus owning a home," says Mark Obrinsky, chief economist at Washington, D.C.-based apartment trade association National Multi-Housing Council. His bullish outlook hinges on solid economic growth in 2007, plus declines in single-family home values. While apartment and office are following similar paths over the next year, the office sector is poised to thin vacancy further within the next five years. PPR projects that the office market recovery will resume after next year, pushing vacancies down by 1.3% between early 2007 and the 2011. For the near term, PPR expects some markets to outshine the herd. Sixteen markets should see a vacancy decline of roughly one percentage point between now and the end of September 2007. The leaders, in order, will be New Orleans office, Raleigh retail followed by San Jose office, in third place. Some of these markets are in bad shape now, however. The New Orleans' office market was 26.5% vacant at the end of September. San Jose, where the technology bust is still being felt, is grappling with 20% vacancy. And Raleigh's retail market is coping with the after-effects of a construction boom that's thankfully come to an end. "While the occupancy recovery is largely over in many markets, rent growth projections are still healthy," reads the report. "Upcoming rent growth in the apartment and office markets will outpace that of the past year. The picture is not so rosy for retail and warehouse markets, where rent growth is slowing, but still-decent growth is projected in the near term."

**(National Real Estate Investor/Parke Chapman)**

## Major Dilemma for Office REITs: Buy or Build

Private investors have come to dominate office investment sales, and for one very good reason: the added purchasing power of high leverage. Unlike public office REITs, whose shareholders have less of a stomach for debt-drenched portfolio deals, private players can pile on leverage and, in many cases, outbid their listed competitors. During the second quarter, for example, private equity funds closed on \$5.25 billion in office deals. They also had more than \$20 billion in office properties under contract, reports Real Capital Analytics. By contrast, public REITs booked only \$1 billion in acquisitions during that period, a slight drop from the first quarter. As a result, public REITs are relying increasingly on development to build their portfolios. That approach is not without risk, of course, as soaring construction and land costs have made it painfully expensive to assemble sites and build on them. It's still cheaper to buy than build office in most markets, considering the high replacement cost, but that gap is narrowing. "The only growth mode that's open to office REITs is development," says Doug Poutasse, investment strategist at Boston-based pension fund advisor AEW Capital, citing Boston Properties (NYSE: BXP) as an example. "There's just so much leveraged private money out there that it's very hard to compete for existing buildings." Even on the development side, however, the public REITs may be outgunned. Nearly half of all office sites sold over the past 18 months were bought on behalf of private investors. One of the most active developers among office REITs is Atlanta-based Cousins Properties (NYSE: CUZ). The company, which builds apartment, retail and industrial properties, built several of Atlanta's largest office towers in the 1990s, and is still active. It's now developing a 520,000 sq. ft. skyscraper in the Buckhead section of Atlanta, part of the sprawling mixed-use project known as Terminus. The 27-story Terminus 100 tower will be completed next spring. The space is already 60% pre-leased. "Most of the office buildings that we develop are due to some special circumstance," says Tom Bell, CEO of Cousins Properties. "If a tenant wants 300,000 sq. ft. in a market, we may build a larger building and take the risk on the remaining space." Even so, Bell agrees that it's challenging to buy existing properties. He describes the amount of private capital that's looking to find a home in the office market as "astounding." While the veteran corporate executive says that he's shocked at the volume of capital that's sidelined, Bell doesn't expect this logjam to break up anytime soon. That should keep demand cooking for office properties, he says. "I would guess that pension funds will allocate more into the real estate market," says Bell. "And I'd also guess that other capital sources continue to press into the market, too." **(National Real Estate Investor/Parke Chapman)**

...

## Tabor Center II Finally to be Built

The long-awaited development of Tabor Center II, a high-rise tower that's been planned for years for the corner of 17th and Larimer streets, is closer to reality. The Tabor Center I complex, which opened to great fanfare in the mid-1980s, houses offices, retail and the Westin Tabor Center hotel. A second tower was in the plans, but economic conditions in the past 20 years forced Part II into a holding pattern. Not anymore. "The second tower at Tabor Center is happening. We're working on it diligently," said Joe Cantalamessa, a newly hired broker for CB Richard Ellis (CBRE)

and a long-time employee of Equity Office Properties Trust (EOP), which owns the Tabor Center and the adjacent parcel. Though Cantalamessa switched companies effective Nov. 1, he's still working on the Tabor Center II project with former associates at EOP. CBRE has signed a contract with EOP to handle leasing for the Tabor Center. It most likely will handle pre-leasing for the new office high-rise as detailed plans are fleshed out. "We're looking for tenants," Cantalamessa said. "Behind the scenes we've been working on design and floor plans." For months, industry observers have been speculating that Tabor Center II should be built, what with vacancy rates dropping steadily in downtown office properties, particularly in LoDo. Almost no office buildings have been built in downtown Denver since the mid-1980s. Recently, several spec office projects were announced, with construction slated to begin in the two to three months. Despite the growing momentum, EOP appeared out of the local development business. Last year, the giant real estate firm recruited Jones Lang LaSalle to sell the Tabor II site, which has been a concrete plaza. But there were, evidently, no takers or at least no acceptable offers. EOP took the property off the market. Ironically, today EOP is in the process of selling most of its Denver portfolio, which includes 13 properties downtown and in the Denver Tech Center. It's decided to hold onto two "trophy" buildings, the U.S. Bank Tower and Tabor Center I, as well as the development site. Cantalamessa expects that the new tower, which could add up to 500,000 square feet of office space, will come together soon. "I think realistically, we can commence this project next spring. The site was always prepared for the second building," he said. Creating the design documents and obtaining building approvals could take up to six months. Construction would take between 18 and 24 months, Cantalamessa said. **(Denver Business Journal)**

...

### **Transit-Oriented Development Will Be in Demand**

Denver will see a dramatic shift in who lives near transit stations, according to a study released Monday. The study was done by the Center for Neighborhood Technology, Reconnecting America and Strategic Economics. The three organizations studied 41 regions -- 32 with transit systems in place and nine planning them -- and said demand for housing within walking distance of transit-oriented developments will increase. The study projects that by 2030 some 16 million households will be living in or near transit-oriented developments compared to 6 million today. Denver is expected to see a fivefold increase in demand for housing near transit stops. The city is about to unveil an expanded light-rail system that will connect more suburban communities with downtown. The study examined the growth of what the groups called "transit zones," which are defined as a half-mile radius around transit stations. With just 24 transit zones now, Denver is expected to have 87 by 2030. If supply meets demand, the survey's authors said, the number of households in the city's transit zones will balloon to 155,076 in 2030 from 17,881 in 2000. Living in transit zones is ideal for lower-income workers who don't have the additional money needed to drive and park a car in the city. But a demographic shift under way in Denver could crowd out the poor from neighborhoods with easy access to mass transit. The study said 6,557 people lived in a transit zone in 2000 had household income of less than \$20,000, which comprised the largest percentage of residents by income. But by 2030, residents making \$75,000 or more -- estimated at 40,826 -- will be in the majority. Those earning less than \$20,000 are projected to

be only 30,803 of the households. The household type is expected to shift as well, from singles and their roommates to married couples. **(Denver Business Journal)**

...

### **Brewing Ideas for Duffy's Building**

Once the Duffy's building at 1635 Court Place sells, the new owner plans to honor the agreements tenants have with current owners Ken and Frank Lombardi. "They've done business the old-fashioned style, which is on a handshake," said Bill Lucas, vice president of Brookfield Properties Corp., which has the building under contract in a deal that is expected to close by the end of the year. The building houses Duffy's Shamrock, Denver's iconic downtown bar; Pizzeria Colore; the Santa Fe Cookie Co.; Beta-Chron Inc. jeweler; and a barbershop. It also has five floors of office space. Publicly traded Brookfield plans to put terms of existing agreements into letters rather than negotiate formal leases, Lucas said. "It's a little more formal," he said. "We have to have a little more of a paper trail." Brookfield owns the adjacent 56-story Republic Plaza. The acquisition will give it control of the entire block. The Lombardis approached Brookfield about selling the property after others had indicated interest in purchasing it. "It's a good piece of the pie to have," said Lucas, who declined to disclose terms of the deal. Brookfield has not determined what it will do with the property. Among the options being considered is a 1,000-car parking garage with street-level retail. "Others have had ideas about doing office buildings and residential lofts," Lucas said. The group developing the Downtown Denver Area Plan is assessing downtown's parking needs as part of the planning process. "We certainly recognize that parking needs are not going away in downtown, despite the increase in transit," said John Desmond, vice president of urban planning and environment for Downtown Denver Partnership Inc. "To the extent we can have well-designed structured parking as opposed to surface- lot parking, it is a good thing, especially if that parking is in a structure that has ground-floor retail." The Lombardis essentially cleaned up the block when they purchased the property in 1974. At the time, businesses operating in the building included a strip club, an X-rated bookstore and a "flophouse" hotel, Ken Lombardi said. Brookfield is North America's second-largest public commercial real estate company with a portfolio comprising 104 commercial properties totaling 74 million square feet in the downtown cores of New York, Boston, Washington, D.C., Los Angeles, Houston, Toronto, Calgary and Ottawa. **(Denver Post)**

...

### **Metro Denver's Top Industries**

From energy to aerospace, to bioscience, information technology - software, and financial services, Metro Denver offers a healthy blend of viable industries and the nation's second most highly educated workforce. Metro Denver's five industry clusters targeted for RECRUITMENT efforts include:

- **Aerospace:** Colorado boasts the third largest space economy in the U.S. The state's aerospace industry has critical mass with 54,000 workers, including

24,700 private employees and 29,300 military personnel. The state is home to four military commands, six major space contractors, and 300 aerospace companies and suppliers.

- **Bioscience:** Metro Denver has 4,700 biotechnology and pharmaceuticals workers plus 7,300 workers in medical device and instrument production. The industry is supported by 11 local higher education institutions with bioscience programs and numerous bioscience research assets. The industry is also enhanced by the opportunities to bring together academic, research, and corporate biotechnology institutions at the \$4.7 billion Fitzsimons Bioscience Campus.
- **Energy:** The inter-relationship between fossil energy, renewable energy, and energy research provides unique growth opportunities for this industry that currently employs over 22,900 people. The National Renewable Energy Laboratory (NREL), located in Golden, is the primary national laboratory for renewable energy and energy efficiency research and development. The integration of energy technology and the state's rich energy resource base place Metro Denver at the forefront of energy development.
- **Financial Services:** Metro Denver is one of the few areas outside of the northeast with a substantial financial services industry in three key market segments: banking and finance, investments, and insurance. A variety of trade associations and service firms supports the diverse financial services industry base of 9,000 companies and 90,000 employees in Metro Denver.
- **Information Technology - Software:** Colorado has the most high-tech workers per capita in the nation for the seventh straight year according to the latest AeA Cyberstates report. A strong entrepreneurial spirit fuels this industry, employing nearly 44,000 workers in 3,400 companies.

Metro Denver's four industry clusters targeted for RETENTION efforts include:

- **Aviation:** Denver International Airport, three general aviation reliever airports, and top aircraft manufacturing companies create a solid foundation for 14,200 workers directly employed by air transportation companies in Metro Denver.
- **Beverage Production:** With 5,500 employees involved in the production of beer and other beverages, Metro Denver has the fourth highest beverage industry employment concentration out of the 50 largest metro areas.
- **Broadcasting and Telecommunications:** Although telecom still faces challenges in the short-term, the long-term opportunities for this industry that employs over 43,400 workers in Metro Denver is positive.
- **Information Technology - Hardware:** Metro Denver is a leader in the magnetic and tape storage industry with over 9,700 employees in numerous pioneering companies. **(Metro Denver Economic Development Corp.)**

	<b>CURRENT</b>	<b>1 MONTH PRIOR</b>	<b>1 YEAR PRIOR</b>
<b>FED FUNDS RATE</b>	5.25	5.25	4.00
<b>3 MONTH LIBOR</b>	5.37	5.37	4.33
<b>PRIME RATE</b>	8.25	8.25	7.00
<b>10 YEAR TREASURY</b>	4.64	4.62	4.56
<b>30 YEAR TREASURY</b>	4.73	4.77	4.75

