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Defying the Real Estate Crunch

Chaos in the capital markets is making it harder to do commercial real estate deals, but Denver's market fundamentals remain strong, industry experts say. Vacancy rates remain low in the office, industrial and retail markets. Rents are continuing to rise in office and industrial but dropped slightly for retail. Meanwhile, new construction continues at a rapid clip — though experts say it's largely because the financing was secured before the credit markets tightened. Nationally, the commercial real estate market is starting to falter. Over the past five years, commercial real estate values rose 90 percent. But from August to September, prices dropped 1.2 percent, according to Moody's Investors Service. But investors still found Denver a great place to park their money, setting another record for sales this year, with an estimated \$6.2 billion in deals done in all product types, up from nearly \$6 billion last year. "Last year, it was a culmination of more and more capital chasing lower and lower yields, more flexible loan programs and available funds," said Ethan Reed, marketing and research manager for CB Richard Ellis. "We probably won't hit another record level in 2008." That's at least partly because the credit crunch resulting from subprime loans gone bad has taken its toll. "What the credit crunch has done is made every deal harder," said Byron Koste, director of the real estate center at the University of Colorado at Boulder. "If you need credit, whether it's to borrow money to build a house or a high-rise, it's harder. Those markets have definitely tightened. There will be much more due diligence than there has been." Bill Tresham, chief operating officer of Chicago-based Callahan Capital Partners, said Denver is better insulated from the credit crunch than other markets because it does not have a lot of mortgage companies and investment banks leasing space. While Callahan is moving forward with its plans to build the Tabor II office tower, financing the project will be different than initially envisioned, Tresham said. When Callahan first announced its plans for the downtown high-rise, it intended to put in 30 percent equity. Now, the equity piece could be as much as 50 percent. "There is construction financing available," said Tresham, who does not yet have any preleasing for the building. "The question is on what terms and conditions." Nearly 2 million square feet of office space is under construction, and a number of other projects, including Tabor II, are in the planning stages, according to a report by CB Richard Ellis. Construction at 1900 16th St. illustrates how building continues at a rapid clip in Denver, although experts say it's largely because financing was secured for such projects before the credit crisis set in. (John Prieto, The Denver Post) of construction occurring downtown, but deliveries metrowide in the next couple of years should not reach a level that's detrimental to overall vacancy," CB analyst Kate Waggoner said. Developer Grant McCargo of Urban Villages LLC said that while construction on the Sugar3 building only started this year, the project has been in the works for seven years. He doesn't intend to sell the 10-story retail, office and apartment building, so he's not worried about the investment market. He also said the credit crunch should help his apartment leasing. "Our timing turned out to be brilliant," he said. "The apartment market is doing very well." During the third quarter, the vacancy rate for office space metrowide dropped to 12.9 percent as 545,192 square feet of office space was absorbed, according to a report by CB Richard Ellis. Average rents metro wide increased to \$19.71 per square foot. The average for the third quarter last year was \$17.49. The downtown office market is the strongest, with an 8.9 percent vacancy rate and average rents of \$25.64 per square foot. Last year, during the third quarter, downtown rents averaged \$21.09. The

industrial sector also fared well for the quarter, with the vacancy rate dropping to 6.4 percent and lease rates increasing to \$6.04 per square foot, compared with \$5.66 last year. While it's not in horrible shape, the retail sector's vacancy rate increased to 5.9 percent, and rents dropped to \$15.83. During the second quarter, they were \$15.97. But in the third quarter last year, average lease rates were \$15.68 per square foot. Sales of office buildings for the year so far are \$3.3 billion, close to the 2006 record of \$3.5 billion. "We have not really seen a decrease in interest from out-of-state investors," said Adam Christofferson, vice president and regional manager of Marcus & Millichap. "Denver is still looked at as an emerging market and a good long-term play." The majority of out-of-state buyers across all property types are institutional investors, but more than half of the apartment properties sold to private investors, according to an analysis by Marcus & Millichap Research Services and Real Capital Analytics. Funds purchased 43 percent of the office properties sold during the last year. But a high level of interest doesn't make doing deals easier. The credit crunch's widespread impact on the housing market has spilled over into commercial real estate because much of the lending was securitized, said Ed Boxer, principal of Essex Financial Group. "That section of the lending world, as opposed to the portfolio lenders, has pulled way back," Boxer said. "Part of it is because the subprime problem affected investors in general and has spooked investors away from buying any type of securitized product." Boxer said that when he underwrites a loan request, the lenders come back with loan terms that are less favorable than what he requested. "Nobody wants to lend money unless it's extremely cautious, and they get paid for it," he said. **(Denver Post)**

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2007 Was Year of the Big Conduit Deal

A whopping \$188.6 billion, or 83%, of the \$228.3 billion of the year's domestic CMBS issuance was comprised of conduit transactions. Given the hefty investor appetite and loan-origination activity, transactions ballooned in size to an average \$3.3 billion in 2007 from \$2.6 billion in 2006. Of the \$188.6 billion in conduit loans, \$109 billion require only interest payments for their entire terms. **(LoopNews)**

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Report: US Transactions Could Drop up to 40%

US annual real estate investment volume hit a record high of \$375 billion in 2007, but experts say not to expect a repeat for 2008. The volume for 2008 is expected to decrease to 40% from 2007 numbers, according to the 2007 year-end report by Jones Lang LaSalle's capital markets research group. Jones Lang LaSalle is predicting investment volume of between \$225 billion and \$260 billion for this year. The volume of transactions in 2007 was a 4% increase over the volume in 2006, which was approximately \$360 billion. While 2008 figures are expected to be below 2006 and 2007 numbers, 2008 volume is still expected to be more than the average annual volumes of 2002 through 2006, which ranged from \$215 billion to \$220 billion, says Noble Carpenter, managing director of Jones Lang LaSalle's Capital Markets Group. The volume will seem "sluggish" but "it is still a very healthy transaction pace," he says. The decrease in transaction volume for 2008 is due to "primarily the credit crunch and the uncertainty around the economy," Carpenter

says. "We think there will be a lot of caution in the market." Additionally, there will not be as much financing available as there had been in previous years, he adds. There are currently more than \$50 billion in five-year, full-term, interest-only loans. "They will be very difficult properties to refinance because the underwriting done at the time was very aggressive," he says. Only a small number are expected to go into foreclosure and there should not be a large impact on the commercial real estate market, according to Carpenter. But, he adds, it is hard to determine what the psychological impact will be, and it is possible that there could be a large psychological impact if there are one or two "high profile" foreclosures. Real estate fundamentals remain strong in most markets and the subprime mortgage turmoil is expected to subside by the end of the year. "We think this will work itself through in 2008," he says. "Optimistically, we would love it to be done by the end of the first quarter. Realistically, it will likely occur in the second half of 2008." There is expected to be a decline in high-leverage and entrepreneurial buyers, but an increase in institutional, international and low-leverage buyers, Carpenter predicts. The volume in primary markets may remain the same, but there could be a sharp decline in transactions in secondary and tertiary markets, he says. **(Globest.com)**

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Office Market to Remain Strong in '08

Metro Denver's office market continued to show "signs of strength" in 2007, according to a new report by Jones Lang LaSalle's Denver office. That market also should fare relatively well in 2008, the analysis predicts. This year was marked by high-profile acquisitions and large lease renewals, according to Mark Lucas, Denver market director for Chicago-based Jones Lang LaSalle (NYSE: JLL). Metro Denver saw its biggest real estate transaction ever in March of this year, when Callahan Capital Partners LLC acquired five downtown-Denver office buildings from The Blackstone Group LP for \$770 million. The deal coincided with Blackstone's purchase of Equity Office Properties of Chicago for \$41 billion. CB Richard Ellis Inc.'s Denver office represented Blackstone in the transaction. Other significant sales included LBA Realty Inc.'s purchase of Denver Place North & South Towers from Amerimar Enterprises Inc. for \$200 million, and Walton Street Capital LLC's purchase of the Park Central building from Beacon Capital Partners Inc. for \$135 million. All those buildings are in downtown Denver. "As national investors set their 2008 target markets for capital replacement, Denver remains on most investors' hot list," Lucas said in a statement. "Revenue growth, supply discipline and a diverse economy are the drivers." Other office market highlights for 2007, and the report's predictions for '08, include: Building owners enjoyed lower vacancy rates and increasing rents this year. Metro Denver's 90 million square feet of investment-grade office stock had more than 1.6 million square feet of absorption this year, including sublease space. The overall vacancy rate dropped to 13 percent from 15 percent at the end of 2006. Average asking rental rates for all types of office buildings increased 13 percent to \$21.99. Top-tier, Class A buildings in the central business district are asking \$40 per square foot for premium space. Energy companies drove large lease renewals in metro Denver this year; the renewals were in downtown Denver buildings. EnCana Oil & Gas Inc. renewed its lease and expanded its space in Republic Plaza to 453,000 square feet. Anadarko Petroleum Corp. expanded its presence in Granite Tower to 221,000 square feet. "Tenants within the energy industry continue to expand and have a strong presence within Denver, showcasing a trend that is not likely to slow

through 2008," Lucas said. Other major downtown Denver office transactions included Wells Fargo & Co.'s expansion to 400,000 square feet at Wells Fargo Center, and the Internal Revenue Service's 157,000-square-foot lease at 1999 Broadway. In the southeastern suburbs, Dex Media will consolidate multiple locations at a 160,000-square-foot build-to-suit at Panorama Corporate Center. Transit-oriented development (TOD) continued to have a major effect on the local office market this year, particularly along light-rail corridors in lower downtown Denver and the southeastern suburbs. New downtown TOD projects include Opus Northwest LLC's 1400 Wewatta and 1401 Wynkoop buildings, with a total of 317,862 square feet. Hines Interests LP continued construction on its 285,217-square-foot building at 1515 Wynkoop St. The 656,334-square-foot 1001 17th Street building continued its renovation. In the southeastern suburbs, work started on Lincoln Station, Bellevue Station, Parkside Office Plaza and Maroon V. **(Denver Business Journal)**

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U.S. Economy: Job Growth at Weakest Pace Since 2003

Hiring in the U.S. slowed more than forecast in December and unemployment jumped to a two-year high, raising the odds that the Federal Reserve will cut interest rates by half a point this month to ward off a recession. Payrolls rose by 18,000, capping the worst year for job creation since 2003, the Labor Department said today in Washington. The jobless rate increased to 5 percent from 4.7 percent in November, while the Institute for Supply Management said growth in U.S. service industries cooled last month. Treasuries rallied, the dollar fell and stocks slid after the jobs report indicated more damage to the economy from the housing slump and reduced access to credit. The figures may also strengthen calls for President George W. Bush to stimulate the economy during his final year in office. "It's time for the Fed to step up to the plate and let the public know how they're going to play this," said Maury Harris, chief economist at UBS Securities LLC in New York. "This is a very vulnerable economy right now." Excluding a gain in government jobs, payrolls fell last month for the first time since July 2003, hurt by losses in manufacturing, construction and the retail industry. "This tells you that the strains from credit problems and so forth that have been developing the last six months are starting to bite and they're biting in a way that now finally draws consumption into question," said Neal Soss, chief economist at Credit Suisse Group Inc. in New York. Yields on benchmark 10-year Treasury notes fell to 3.86 percent at 3:14 p.m. in New York from 3.89 percent late yesterday. The dollar dropped 0.2 percent to \$1.4772 per euro and the Standard & Poor's 500 Index lost 2.2 percent to 1,415.7. Shares of retailers, homebuilders and automakers in the S&P 500 are down 5.8 percent so far in 2008. The group fell 14 percent last year, trailing only financial companies, which lost 21 percent. Edward Lazear, chairman of the White House Council of Economic Advisers, said the Bush administration will consider measures to stoke the economy. "We have pushed economic growth policies throughout this administration and we're not going to stop doing that now," Lazear said in a Bloomberg Television interview in Washington. "If there are necessary steps that need to be taken, the president will be considering those over the next few weeks." The ISM index of non-manufacturing businesses, which make up almost 90 percent of the economy, fell to 53.9 from 54.1 the prior month, the Tempe, Arizona-based ISM said. Readings above

50 signal growth. Economists surveyed by Bloomberg News had forecast a gain of 70,000 in payrolls, according to the median estimate, from an originally reported gain of 94,000 for November. The November job increase was revised up to 115,000 today. The December job gain puts the total payroll increase for 2007 at 1.33 million, the fewest in four years. The unemployment rate for 2007 averaged 4.6 percent. The last time the jobless rate rose more in a single month was April 1995. "It's not a done deal, but if we're going to have a recession, it's too late to do anything about it," said Stuart Schweitzer, global markets strategist at JPMorgan Wealth & Asset Management in New York. "The Fed can't prevent a recession if one's in the making, and we're pretty close." Traders increased bets the Fed will lower its benchmark rate by a half-point to 3.75 percent at the next meeting, on Jan. 29-30. The odds of such a move rose to 42 percent today from 34 percent yesterday and zero at the start of the week, futures prices show. Today's figures were even worse than a private survey yesterday that indicated a cooling job market. Companies hired 40,000 workers in December, according to data compiled by ADP Employer Services. The figures include only private employment and don't take into account hiring by government agencies. Service industries, which include banks, insurance companies and restaurants, added 93,000 workers last month after gaining 160,000 jobs in November. Retail employment declined by 24,300 after increasing 32,000 in November. Factory payrolls decreased by 31,000 after falling 13,000 a month earlier. Economists had forecast a drop of 15,000 in manufacturing employment. Builders reduced payrolls by 49,000 after cutting 37,000 jobs in November. Government payrolls increased by 31,000 during the month, indicating private payrolls declined by 13,000. Residential construction started dropping at the start of 2006, weakening job growth as builders, mortgage companies and manufacturers reduced staff. The collapse of the subprime mortgage market in July and August hastened firings at financial companies. National City Corp., Ohio's largest bank, said this week it would eliminate another 900 jobs, bringing total cuts to 3,400, or about 10 percent of its workforce, in one year. The housing market "corrected with a high degree of suddenness," Chief Executive Officer Peter Raskind said in an interview on Jan. 2. Manufacturers are also cutting back as sales of building materials, appliances and furniture weaken, reflecting a 34 percent slump in combined new and existing home sales from their July 2005 peak. Factories have already slowed. ISM's manufacturing index for last month fell to 47.7, the lowest since April 2003, the purchasers group said this week. Today's report showed hourly wages rose 7 cents, or 0.4 percent, on average to \$17.71 in December and were up 3.7 percent from a year earlier. Economists had expected a 0.3 percent increase for the month and 3.6 percent for the 12-month period. Average weekly hours worked by production workers were unchanged at 33.8. Average weekly earnings rose to \$598.60 last month from \$596.23 the prior month. The world's largest economy grew at a 1 percent pace in the fourth quarter after expanding at a 4.9 percent rate the previous three months that was the strongest since 2003, according to the median estimate of economists surveyed last month. Growth for all 2008 was projected at 2.3 percent. **(Bloomberg)**

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	4.25	4.50	5.25
3 MONTH LIBOR	4.52	5.25	5.32
PRIME RATE	7.25	7.50	8.25
10 YEAR TREASURY	3.88	3.96	4.60
30 YEAR TREASURY	4.36	4.45	4.71

