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### **Economist: Washington's Fixes Have Become the Problem**

Uncertainties over taxes and access to credit are driving U.S. businesses to hoard cash rather than lead the economy into recovery by spending and hiring, according to a prominent real estate researcher. The private sector has squirreled away trillions of dollars that could revitalize the economy, but businesses are reluctant to part with cash they may need for operating capital in the absence of credit, and to pay higher tax bills at all levels of government, according to Dr. Mark Dotzour, chief economist at the Real Estate Center at Texas A&M University. "We are used to thinking of the federal government as the solution to these problems for economic growth and they have rapidly become the source of the problem because of the uncertainty that they have created for business people," says Dotzour, who was one of several presenters at a symposium hosted by the CCIM Central Texas chapter on Feb. 23 in Austin. What uncertainty? Taxes, for one. Early proposals to raise the capital gains tax from the current 15% to 24% have been scaled back to 20%, but even that hike would reduce initial returns on investments in commercial real estate, Dotzour says. That threat of a bigger tax hit will influence many potential buyers to postpone acquisitions until a definite rate is set and can be factored into purchase prices. Similar worries about higher income tax rates, increasing energy costs as a result of cap and trade legislation, and health-care reform proposals that leave members of the medical and insurance industries guessing as to what their incomes will be next year are collectively weighing on the minds of business owners and would-be entrepreneurs. Just as tight credit and tax hikes by the Hoover administration exacerbated a recession to create the Great Depression in the 1930s, which Dotzour dubs "the Hoover maneuver," a lack of credit and potential tax hikes will stifle business growth as the nation struggles to climb out of the current downturn. Washington's response to the recession with stimulus dollars has served to prop up ailing financial institutions and state governments without doing enough to correct underlying problems that brought on the credit crunch and banking crisis, Dotzour contends. By allowing banks to extend loans that are covering their debt service payments but that are underwater, meaning the value of the asset has fallen below the remaining loan balance, the federal government is postponing the inevitable write-downs — and bank failures — that must occur in order for surviving banks with healthy balance sheets to resume lending to small businesses. Dotzour says redefining fair market value to reflect an owner's asking price, rather than what a willing buyer would pay for a real estate asset, has allowed banks to avoid write-downs on loans that would otherwise be deemed underwater. He compares the practice of extending bad loans at U.S. banks to the Japanese government's allowing banks to keep bad real estate loans on their books, which mired bank balance sheets and crippled that nation's economic growth for more than a decade beginning in the 1990s. "Now let's try the Hoover maneuver and the Japanese thing all in one year," Dotzour says. "This is a cocktail for disaster." Others at the conference took a more reserved view of the government's approach to bad real estate loans. In a presentation on the capital markets, Phil Capron, president of Austin-based real estate investment firm Falcon Southwest agreed that the federal government is "supporting the fiction of minimal loan problems." By allowing banks to extend underwater loans, however, government regulators are enabling banks to write off bad debts a little each year and work through their problems without much pressure to speed up the process, Capron told the group. An even greater source of uncertainty is the looming fiscal crisis for state and local governments that have

relied on federal stimulus dollars to help balance their 2010 budgets rather than cut programs and staffing, says Dotzour. With major indexes showing commercial real estate values down by 40% or more from their peaks in 2007, tax appraisal rolls must soon realize a massive decline in the tax base that funds everything from state government to school districts. "That is the biggest threat to a double-dip recession," Dotzour says. "Government entities from the states on down are going to have to lay people off to balance their budgets." On the positive side, consumers have reigned in their debt balances and discretionary spending, corporate profits and shareholder earnings are increasing and businesses have right-sized their spending, Dotzour says. "The only component of the economy that hasn't right-sized yet is government at the state, city, county and federal level," he says. "That's going to have to happen." Dotzour's contention that federal regulators aren't doing enough to force banks to write down bad real estate loans and revalue commercial real estate collateral struck a chord with Tim Hendricks, senior vice president in the Austin office of Atlanta-based Cousins Properties Inc. (NYSE: CUZ). Hendricks says the creation of the Resolution Trust Corp. (RTC) in the 1980s enabled the banking sector to deal with bad real estate loans and resume lending in an environment of corrected real estate values. "At some point there has to be a re-adjustment in the market," says Hendricks, who was among the more than 200 real estate professionals at the Austin gathering. "The RTC dealt with flushing through those buildings and we're going to need to do something similar to that this time around. That feds are going to have to make that happen and make the banks work through their problems." **(National Real Estate Investor/Matt Hudgins)**

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### **Rising Jobless Claims Threaten Economic Rebound**

Layoffs are no longer dropping as they were in the final months of last year, reinforcing fears that the jobs crisis will weigh down consumer spending and the economic rebound. Severe weather contributed to a rise in jobless claims last week. But other economic data add to evidence that the recovery remains weak and uneven. An example is orders for big-ticket manufactured goods, excluding airplanes and other transportation equipment. Those orders dropped 0.6 percent in January, the government said Thursday. Earlier in the week, it was announced that new-home sales fell in January to their lowest pace on record. And consumer confidence plunged in February. Mark Vitner, senior economist at Wells Fargo, said the weak reports point to an economy struggling to wean itself from government stimulus programs such as homebuyer tax credits and other supports. "Going forward, growth is going to be much more dependent on the private sector," Vitner said. In its report Thursday on jobless claims, the Labor Department said first-time claims for unemployment benefits rose 22,000 to a seasonally adjusted 496,000. Wall Street analysts polled by Thomson Reuters had expected a drop to 455,000. The rise occurred mostly because state agencies last week processed a backlog of claims caused by snowstorms the previous week. Still, the four-week average of jobless claims, which smooths out volatility, rose 6,000 to 473,750. The average had fallen sharply over the summer and fall from its peak last spring of about 650,000. **(Denver Post)**

## Commercial Sales Jump

The number of commercial real-estate sales rose sharply in December, triggering fresh debate about whether the sector has reached bottom. Property sales, a gauge of market health, rose 75% in December from the prior month, according to Real Capital Analytics. The end of the year traditionally sees an increase in volume. But the recent increase is significant even after adjusting for that, says Neal Elkin, president of REAL, a research firm that analyzed the data. The Moody's/REAL All Commercial Property Price Indices, or CPPI, which track values, measured a 4.1% increase in December. This followed an increase of 1% in November, which was the first time since 2007 that there were two consecutive months of rising values. But Moody's and REAL agreed that it is too soon to conclude that the market has hit bottom. "It makes me feel very confident that the dramatic violent price movement that we saw in the first part of 2009 is over," says Mr. Elkin of REAL. "But I would never be so bold to say that we are going straight up from here." There were 716 transactions in December, according to the CPPI. That compares with more than 1,600 deals in December 2007. Sales activity has been in the doldrums for months because of a dearth of financings and sellers' unwillingness to put property on the block when prices are down sharply from a few years ago. That means competition can be fierce when prime buildings are put up for sale. Earlier this month, an institutional real-estate fund run by J.P. Morgan Asset Management bid on a large \$100 million-plus rental-apartment property in Washington. Seventeen other buyers submitted offers, says Kevin Faxon, head of U.S. Real Estate for J.P. Morgan Asset Management. "We are actively in the market seeking to acquire properties," Mr. Faxon says. "We are not on the sidelines. We're not taking a view that prices are going to be cheaper tomorrow than they are today." Also, some healthy properties are still commanding decent prices. In Boston, a nearly 200,000-square-foot office and retail property called One Brigham Circle is in contract to sell for \$97 million to AEW Capital Management, according to a person with knowledge of the deal. Brokers for Cushman & Wakefield are representing the seller, the Rappaport family's New Boston Fund. The cap rate, an industry term for the buyer's nonleveraged yield on the property at current net rents, is less than 6.5%, a return that is comparable to property prices in 2005 and 2006, according to local brokers. The building is fully leased. The conflicting market signals come at a time when the commercial real-estate sector faces significant challenges. The economic fundamentals, such as anemic hiring, mean that office rents are likely to continue falling while vacancies continue to rise. Meanwhile, apartment rents also are low, driven down by record low home prices and increased supply from investors stuck with unsold properties who have put them on the rental market. In addition, many top-of-the-market real-estate deals are still expected to go bad, like Peter Cooper Village and Stuyvesant Town, a sprawling Manhattan residential complex that is in default on \$4.4 billion in debt. Market bulls agree that the sector continues to perform badly. But they argue it is doing better than people thought it would. Therefore, real-estate assets are undervalued and prices are going up, they say. "No one believed me that values were going to go up so soon," says Dan Fasulo, head of research for Real Capital Analytics. "But there's enough anecdotal evidence now that we've come well up off the bottom already." **(Wall Street Journal)**

	<b>CURRENT</b>	<b>1 MONTH PRIOR</b>	<b>1 YEAR PRIOR</b>
<b>FED FUNDS RATE</b>	.25	.25	.25
<b>3 MONTH LIBOR</b>	.25	.25	1.26
<b>PRIME RATE</b>	3.25	3.25	3.25
<b>10 YEAR TREASURY</b>	3.61	3.65	2.99
<b>30 YEAR TREASURY</b>	4.55	4.56	3.65

