

March 22, 2010

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

PwC Report: Investor Sentiment Improves but Challenges Persist in 2010

Commercial real estate investors reveal a sense of hopefulness and improved sentiment with regard to the industry as the U.S. economy shows some encouraging signs of improvement, according to the first quarter 2010 findings of PricewaterhouseCoopers' Korpacz Real Estate Investor Survey™, released today. The report notes that investors find it easier to envision a commercial real estate market recovery today than at any point during the past 24 months. At the same time, however, investors acknowledge that challenges and concerns still exist. According to the survey, overall capitalization (cap) rates, a key measure of expectations of property income and value, have started to stabilize and even slightly decline in certain markets and for quality assets. This trend may help to stabilize values since weak fundamentals are still a drag on value appreciation. Over the next six months, survey participants forecast overall cap rates to hold steady in 19 of the survey's 30 markets. Last quarter, just two markets had such a forecast from survey participants. "Following the onset of the recession and the credit crisis, underlying fundamentals were deteriorating and overall cap rates were expanding simultaneously and quickly, causing values to plummet," said Susan Smith, director, real estate advisory practice, PricewaterhouseCoopers, and editor-in-chief of the survey. "The worst seems to be over, according to survey participants, as investors suggest that the bottom is near, if not here, particularly for better-positioned markets and assets." In the survey's national and regional apartment markets, the low end of the range for overall cap rates decreased 75 basis points this quarter to 5 percent, pushing the averages down 18 and 50 basis points, respectively, due mainly to the numerous bidders showing up to buy quality assets in good markets. At the same time, average marketing times are down in these two survey markets, further signaling restored confidence among many investors. Surveyed investors comment that owners and lenders are finally coming to grips with what assets are truly worth. As a result, the report finds that while 2010 is expected to be a slow year for sales activity by historical comparison, there could be marked improvement from 2009, as banks appear more willing to lend although underwriting remains very conservative and more equity is needed to secure debt. "There is a tremendous amount of capital seeking real estate opportunities, and now is still a great time to buy. Many investors in our survey still anticipate incurable deleveraging issues on the part of both lenders and owners to provide opportunities to acquire quality assets at below-peak pricing, and there's strong competition among buyers for such deals, as investors indicate increasing activity with both the number of bids and good offers," added Smith. According to the report, looming debt maturities remain a top-of-mind issue among surveyed investors, who believe the out-of-balance loans coming due over the near term will present major hurdles for owners and lenders. "The industry keeps looking to lending institutions and special servicers of commercial mortgage-backed securities to provide forced sales, but some investors surveyed cite that more distressed selling will likely come from borrowers, who are more comfortable with where the market is now and will accept a loss in order to move on," Smith commented. While occupancy and rental rates have deteriorated significantly during the past 24 months, surveyed investors anticipate vacancy rates to continue to increase in the coming year but not as steeply as the prior year. In addition, they foresee rental rates continuing to decline in most markets, but to lesser degrees, as property visits and tenant interest show slight improvements across the country. Consequently, many survey investors continue to use low, and in certain markets

negative, market rent change rate assumptions in the initial years of cash flow analyses. While the majority of the 30 surveyed markets report negative average initial-year market rent change rates this quarter, the expected declines are milder in comparison to the prior quarter. As weak tenant demand lingers, investors surveyed indicate an increasing need to offer prospective tenants free rent during lease negotiations. Overall, just over 91 percent of surveyed investors reported the use of free rent. Last year, this survey figure was 84 percent. Office markets where survey investors report the highest levels of free rent over an average seven-year term include Phoenix (up to 24 months), Atlanta and Chicago (up to 18 months), and Dallas (up to 15 months). Lower levels are noted for San Diego (up to 6 months) and Los Angeles and Denver (up to 7 months). Surveyed investors project that the apartment sector will continue to lead the recovery as value losses have been almost fully recognized, and some multifamily assets are actually showing slight value increases. The warehouse sector remains weak, according to survey participants, due to an overall lack of demand for goods, while the office and retail sectors continue to struggle as both economy and employment challenges persist.
(PricewaterhouseCoopers)

...

Economic Mixed Bag: No Inflation but Little Hiring

The picture of an economy growing modestly without producing inflation yet struggling to create jobs emerged from government reports Thursday. The number of newly laid-off workers requesting jobless benefits fell slightly last week for the third straight time. But initial claims remain above levels that would signal net job gains. New claims for unemployment aid fell 5,000 to a seasonally adjusted 457,000, the Labor Department said. That nearly matched analysts' estimates of 455,000, according to Thomson Reuters. The four-week average of jobless claims, which smooths out volatility, dropped to 471,250. Still, the average has risen by 30,000 since the start of this year. That's raised concerns among economists that persistent unemployment could weaken the recovery. The average number of weekly jobless claims remains above the 400,000-to-425,000 level that many economists say it must fall below before widespread new hiring is likely. Initial jobless claims are considered a gauge of the pace of layoffs and an indication of companies' willingness to hire. High unemployment has persisted even though the economy grew in the second half of last year. In a separate report, the department said consumer prices were flat in February. A rise in food prices was offset by a drop in gasoline and other energy costs. Excluding the volatile food and energy categories, the core Consumer Price Index edged up just 0.1 percent last month, matching economists' estimates. The report adds to evidence that the weak economy has all but erased inflation. That allows the Federal Reserve to continue its efforts to revive the economy by keeping the short-term interest rate it controls at a record low near zero. In another report, a private research group said its gauge of future economic activity rose just 0.1 percent in February, suggesting slow growth this summer. The gain in the Conference Board's index of leading economic indicators was the smallest in 11 months. The index is intended to forecast economic activity in the next three to six months based on a variety of economic data. Also, the current account trade deficit widened in the fourth quarter, the Commerce Department said, reflecting an improving economy. Imports of oil, autos and other products outpaced gains in U.S. exports. But the trade gap for all of 2009 fell to its lowest point in eight years. Economists say they think the deficit will widen

during 2010, though not to the record heights seen before the recession. A weaker dollar is expected to boost U.S. exports. A weaker dollar makes U.S. goods cheaper overseas and foreign goods costlier for U.S. consumers. The current account is the broadest gauge of trade because it includes not only trade in goods and services but also investment flows between countries. It measures how much the country must borrow from foreigners. In the Labor Department report, the number of people continuing to claim unemployment benefits rose slightly to 4.58 million. That was similar to what economists expected. But it doesn't include millions of people who are receiving extended benefits for up to 73 extra weeks, on top of the 26 weeks customarily provided by the states. More than 6 million people were on the extended benefit rolls for the week that ended Feb. 27, the latest data available. That is about 300,000 more than in the previous week. The total number of people receiving benefits now tops 11.2 million. Over the past two months, "this measure has gone nowhere but up," Dan Greenhaus, chief economic strategist at Miller Tabak, wrote in a note to clients. "We believe it will moderate through the spring, but the larger story, that people are simply not finding jobs, remains in place." The nation's gross domestic product, the broadest measure of output, rose 5.9 percent in the fourth quarter, the fastest pace in six years. But much of that growth reflected a one-time gain from companies restocking their inventories. Many economists expect the growth rate to drop to about 3 percent in the current January-to-March quarter. The unemployment rate was 9.7 percent in February, the same as the previous month, down from a peak of 10.1 percent last October. Still, the Federal Reserve and most private economists expect it to remain well above 9 percent throughout this year. The Fed said Tuesday that "the labor market is stabilizing." That's an improvement from its previous diagnosis in January, when it said its deterioration "is abating." Among states, North Carolina had the largest increase in claims, with 5,100. It attributed the increase to layoffs in the construction, apparel and industrial machinery industries. Illinois, Oregon, Ohio and Alabama had the next-largest increases. The state data lags one week behind the initial claims figures. New York had the largest drop in claims, with 10,929. It cited fewer layoffs in transportation and services. California, Connecticut, Kentucky and West Virginia also reported declines. (AP)

...

High Levels of Bad Loans Afflict Banks

Another sign pointing to the deteriorating condition of Colorado financial institutions has emerged: The number of banks saddled with high levels of delinquent loans has jumped from 13 three years ago to 70 today. That means nearly 36 percent of the 195 state banks tracked by Bauer Financial Inc. have nonperforming loans representing 3 percent or more of their average assets. That figure is sharply higher than the U.S. rate of 29 percent, said Karen Dorway, director of research at Bauer Financial. The report is the second dire assessment of Colorado bank quality this month. Data posted recently by the Federal Deposit Insurance Corp. show a third of the state's banks lost money last year. Bank experts say the trends reflect a need for closer supervision of banks. Yet the state is approaching its 17th straight month without a full-time banking commissioner to oversee regulation of banks. "This is dramatic," said Fred Gibson, deputy inspector general for the FDIC, which aids the state with bank inspections. "It's cause for concern — something that would give rise to consideration of whether these banks need a higher level of scrutiny." Showing the heaviest concentration of nonperforming loans — 90 days or more overdue — by

the end of 2009 was Pueblo Bank and Trust, with 18 percent of its assets, followed by Park State Bank & Trust of Woodland Park and FirstTier of Louisville, each with 13 percent. Those banks and at least three others with the highest levels of distressed loans have faced enforcement actions by regulators in recent months directing them to improve their credit practices, particularly in the handling of loans for commercial real estate, a market hit hard by the recession. Bill Tandy, president of Pueblo Bank and Trust, said his bank has buffered the impact of soured loans by raising more capital — it has at least \$40 million — to absorb potential losses. "We rank at the top nationally for raising capital," Tandy said. "There's a lot of banks out there trying to raise capital but can't. They may have better numbers for nonperforming loans but way less capital than we do. We're being extremely aggressive in charging off loans and recovering them." Tandy also said regulators did not provide enough tough oversight before the recession hit. "They were patting us on the back and telling us what great guys we are," Tandy said. "Now that the times are not so good, we're idiots. It should be the other way around." "It is imperative the state get a qualified, competent banking supervisor who can get this thing turned around before the house burns down," said Lynne Turner, former chief accountant for the Securities and Exchange Commission. State officials said a commissioner will be hired "shortly." **(Denver Post)**

Vectra Bank's Small Business Index for Colorado Up a 5th Month

"Colorado small business owners have a lot to look forward to in 2010," said Jeff Thredgold, Vectra Bank corporate economist, said in a statement. The 85.9 reading for last month follows a revised index of 83.6 in January, 74.5 in December 2009, 73.1 in November, 72.2 in October and 70.9 in September 2009. The last time the index was higher was in October 2008, at a revised 87.3. "The new year is demonstrating significant improvement over the old one, and that is being reflected in the [index]," Thredgold said. "For one thing, the U.S. economy is growing again at a solid pace, which is helping to prop up the Colorado economy," Thredgold said. "Personal income in the state is also expected to improve significantly in 2010 versus 2009." Despite a small uptick in Colorado unemployment, to 7.4 percent in January from 7.3 percent a month earlier, "Colorado's job picture continues to look up," Thredgold said. "Even though the state is down 100,000 jobs in the last 12 months, revised figures show that last August was the low point in Colorado employment. Year-over-year job losses totaled 134,600 at that point." He also cited "an extremely low interest rate environment." The Vectra Bank Colorado Small Business Index measures business conditions from the viewpoint of the Colorado small business owner or manager. A higher index number is associated with more favorable business conditions for Colorado's small businesses. The index uses 100 for calendar year 1997 as its base year. **(Denver Business Journal)**

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	.25
3 MONTH LIBOR	.28	.25	1.23
PRIME RATE	3.25	3.25	3.25
10 YEAR TREASURY	3.70	3.72	2.60
30 YEAR TREASURY	4.58	4.70	3.63

