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Small Banks Quickly Shed Commercial Real Estate Risk

Under pressure from federal regulators and weighed down by an unhealthy exposure to commercial real estate, small banks — or those in the \$1 billion to \$100 billion asset range — are making haste to clean up their balance sheets, according to Oakland, Calif.-based Foresight Analytics, a unit of Trepp LLC. In the fourth quarter alone, the nation's small banks cut the total outstanding balance of commercial real estate construction and land loans by about 13%, while large banks with assets of \$100 billion or more only trimmed back by about 4%, says Matt Anderson, managing director for Foresight. The contrast in the outstanding balance of construction and land loans is even greater when comparing the fourth quarter of 2008 to the fourth quarter of 2009. Small banks held \$121.7 billion and \$83.4 billion respectively, a 31.5% decline over one year. "Given that there's not much in the way of other financing out there right now, to the extent that they're shedding exposure, it's more through selling off the loans to someone else or potentially through foreclosures," says Anderson. The buyers of this debt have generally been private equity players that want to expand into commercial real estate, particularly if there's a discount involved. However, Anderson points out that many small banks claim the haircuts on the sales haven't been as severe as they had originally anticipated. "Given that the volume of non-performing loans has continued to grow, I'm guessing the ones that are selling are the ones where the bank isn't having to take as big of a loss," he says. "They're choosing which ones to sell and they're picking the ones that can get somewhat better pricing." The loans selected for disposition, in fact, may even be performing loans or "less bad" non-performing loans. For example, the discount on a loan for a piece of land far from an urban center and the discount on a loan for a project already under way in an urban setting is vastly different. Over the past year, small banks have gained the reputation for not only being over-weighted in construction loans and mortgages but for holding loans of a lower quality than their larger bank brethren. In February, the Congressional Oversight Panel, established by Congress in 2008 to oversee expenditures of the \$700 billion Troubled Asset Relief Program, said that of the approximately 8,100 banks in the U.S., 2,988 are small banks that are dangerously exposed to commercial real estate. In addition to the lack of diversification, these community and mid-sized banks also hold high concentrations of the riskiest and least sought-after loans, including transition properties and construction loans in secondary or tertiary markets, according to the panel. The one plus, many small banks contend, is that on the mortgage side of the business they have a significant exposure to owner-occupied properties, which have performed better than income-producing properties. "It's better but not problem free," says Anderson. Owner-occupied properties made up 43% of total loans outstanding for small banks at the end of the fourth quarter, and had a delinquency rate of 4.8%. That compares with 57% of loans backing income-producing properties, which had a delinquency rate of 6% over the same period. Despite paring back their commercial real estate exposure, small banks are unlikely to be making room on their balance sheets for new commercial real estate loans. "[They are] cleaning up the risk and not planning on coming back anytime soon," says Anderson. With \$1.4 trillion in commercial real estate debt maturing over the next five years and no obvious source of funding to soak it up, Anderson does not foresee any major improvement for commercial real estate lending in the near term, even if commercial mortgage-backed securities issuance continues to recover at a healthy pace. "Even if it doesn't end incredibly badly for everyone, at best [the commercial

real estate industry] is essentially treading water.” **(National Real Estate Investor/Sibley Fleming)**

How Should We Interpret the March Jobs Report?

The March employment report released by the U.S. Bureau of Labor Statistics may have fallen somewhat short of Wall Street’s expectations, but the 162,000 gain in nonfarm payrolls provides indisputable evidence that the economy is on the mend. The leisure and hospitality sector, for example, added 22,000 jobs in March, while retailers added nearly 15,000 jobs. That’s encouraging news for commercial real estate. Tempering the optimism are a few factors. The growth in payrolls in March includes the hiring of 48,000 temporary workers to conduct the decennial census. Most compelling is that the government’s broader measure of unemployment — which takes into account people who have stopped looking or who can’t find full-time jobs — shows an unemployment rate of 16.9%. In addition, some 6.5 million workers have been unemployed for 27 weeks or longer. NREI asked two notable real estate economists to offer their views on the March jobs report. Victor Calanog, director of research at New York-based real estate researcher Reis: “The last few months have consistently implied that the hemorrhage of job losses has slowed. Although March experienced a net gain in nonfarm payrolls, skeptics like pointing out that the largest gains were in temporary hiring, up 40,200, and that finance and information industries posted losses of 21,000 and 12,000, respectively. “However, economic stabilization often progresses in fits and starts, and we should expect to see more of the checkered results like the March figures show, with some employment categories posting gains and some posting losses. “Expect a roller-coaster ride over the next few months as the hiring by the U.S. Census Bureau ramps up, and then lets go of temporary workers as processing work winds down. We should also expect a slow journey back to previous employment level peaks. As of February, we’re back to employment levels last seen in August 1999. “Even if the economy adds a healthy 200,000 jobs per month, it will still take three and a half years to regain the 8.4 million jobs we lost since December 2007. However, as of March 2010 we’ve taken the first step by actually posting net gains.” Bob Bach, chief economist at Chicago-based Grubb & Ellis: “Private-sector employers were responsible for 123,000 of the 162,000 net new payroll jobs in March. It was the best showing for nonfarm payroll in three years, according to the Bureau of Labor Statistics. “The manufacturing sector is alive and well. The Institute for Supply Management’s purchasing managers’ index increased to 59.6 in March. That’s the highest level since July 2004. The index has remained above the expansionary threshold of 50 for the past eight months. These and other recent indicators suggest that the recovery is gaining some momentum. “I don’t agree with critics who say that job growth is slow to ramp up. The labor market did not hit bottom for 21 months after the 2001 recession ended. Assuming the 2007-09 recession ended last June (a pretty early assumption), and assuming the labor market hit bottom in February, that is a span of eight months. You can argue that this recession has had a much worse impact on the labor market, and you would be right. But as to how quickly the labor market is bouncing back, this time could be quicker than the last.” **(National Real Estate Investor/Matt Valley)**

Buyer's Viewpoint for Office Complex Centers on Spec Suites

A local investor purchased a pair of small-tenant office buildings off Broadway and West Mineral Avenue for \$4.65 million, or \$50 per square foot, and will build out spec suites in an effort to draw new tenants. F&C Holdings LLC bought the Viewpoint buildings at 7901 and 7921 SouthPark Plaza in Littleton from McMorgan & Co., a San Francisco pension fund adviser. "The property is in absolutely terrific shape," said F&C Holdings' Jeff Roemer. "The seller kept great care of it, and there is very little deferred maintenance. The exterior is basically brand-new." The interior also has been well cared for, he said. "It's just a little outdated. Our plan is to go in there and upgrade the lobbies, corridors, restrooms and create ready suites for future tenants." Built in 1982, Viewpoint I and II total 93,021 sf and are situated on 6.02 acres of land. The buildings were 62 percent leased at the time of the sale. Alstom Power, Edward Jones, ARES Corp. and ABB Power join a number of small, local tenants in the buildings. "I think the buyer made a very good acquisition of the second best buildings in that submarket at a great discount to replacement cost," said Cushman & Wakefield of Colorado Inc. broker Patrick Devereaux. "They've got great glass lines, good floor plates, good views," Devereaux said of the buildings, which he considers second only to their biggest competitor, the Kellogg Building. Each of the Viewpoint buildings has a conference room for Tenant use. There is a shared fitness facility, and the property has new landscaping and parking lots. "The historical occupancy in those buildings has been fairly high," said Roemer. "They are well-known buildings within that submarket." The two-story configuration makes the buildings easy for tenants to get in and out, as opposed to a multistory building, he said. Fuller Real Estate brokers Dan Miller, Brad Rice and R.C. Myles are marketing the available suites, which will range from 1,500 to 5,500 sf. "They know that market well and know what demand typically is," said Roemer, adding F&C decided to build out spec suites because the market caters to smaller tenants, which "need to see the space before they make a decision." Devereaux and Cushman & Wakefield of Colorado Inc. broker Gene Pride represented McMorgan & Co. In the sale of the property. A local bank provided a loan for the acquisition. F&C Holdings acquires welllocated, value-add commercial properties with a history of strong performance, Roemer said. It owns approximately 350,000 sf of office space in the Denver market, including the Capitol Center, a midrise office building a block north of the Colorado Capitol, and Dry Creek Office Village in Centennial. **(Colorado Real Estate Journal)**

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Re/Max HQ Building Gets Buyer

Re/Max International Inc.'s 14-story headquarters building in the Denver Tech Center is under contract for purchase by HRPT Properties Trust, according to local real estate brokers. Brokers said the purchase price is more than \$300 per square foot. In 2009, the HRPT bought the 666,650-square-foot Seventeenth Street Plaza office building in downtown Denver for \$134.3 million, or \$201.38 per square foot, in one of the area's largest commercial real estate deals of the year. The seller was JP Morgan Chase & Company of New York. Re/Max spokesman Shaun White declined comment about the deal, and HRPT spokespeople did not return a phone call and email asking for comment. The 240,000-square-foot Re/Max office building is at 5075 S. Syracuse St. in Denver, and was completed in 2007 at a cost of about \$65 million. The property won "Office Project of the Year" that year from the Denver

Metro Commercial Association of Realtors. The building includes a five-level parking structure. **(Denver Business Journal)**

United Launch Alliance to Stay in Centennial Area at Expanded HQ Campus

United Launch Alliance LLC will expand its headquarters campus to 2,000 employees working in a trio of buildings in its Centennial neighborhood starting late this year. The space rocket company decided not to build its own campus from scratch because it found enough high-quality office space literally just down the street from its existing headquarters at prices that made sense, said CEO Michael Gass. "The market enabled conditions for facilities that were either vacant or were coming vacant," Gass said, and they were coming available at a time when ULA wanted to consolidate its three south Denver metro area locations. ULA will move into a trio of new office buildings encompassing 466,000 square feet. Two of the buildings are off Panorama Drive, and the company has an option for a portion of a third Panorama building. One of ULA's new buildings will be Waterview IV, in the Waterview office buildings off East Nichols Avenue and South Chester Street. The company currently has 1,700 local employees split between its headquarters off East Mineral Road just west of Interstate 25, rocket-building space it subleases at Lockheed Martin Space Systems' Waterton Canyon campus in the Jefferson County foothills, and another building off South Park Way in Littleton. Another 300 subcontractors and federal government employees work at its headquarters, too. The drive to consolidate in one neighborhood made sense — employees had to factor in 40-minute drives if their work spread them between the different locations, Gass said. ULA will bring the workers into its new Centennial offices by the end of 2011. The company was formed in 2007 from the merger of The Boeing Co. and Lockheed Martin rocketry divisions. It's the main space-launch contractor for federal government satellites and space probes. Centennial mayor Cathy Noon praised ULA's headquarters choice and said the city will benefit from having even more ULA workers shopping and living there. "As a city, we're very pleased to have ULA call us home," she said. "It's good to have another startup figure out Centennial is a great place to be in business." The ULA's new Panorama Corporate Center offices are in an island of unincorporated Arapahoe County land surrounded by office and retail properties in Centennial city limits. The Waterview IV building, a couple blocks south, is within Centennial city limits. That makes ULA eligible for up to \$400,000 in city sales and use tax rebates on remodeling purchases and furnishings spent in the move. Noon noted that ULA's corporate colors, blue and yellow, are also the colors of the city and retail giant IKEA, which will break ground on its first Colorado store next month on land between the new ULA headquarters buildings. ULA could renew the lease on the 160,000-square-foot office building on East Mineral Road it currently uses for headquarters, if ULA wins some new contracts its bidding on. Winning the work could mean hiring more people. ULA employs nearly 4,000 people nationwide, with other major locations at Cape Canaveral, Fla., and Vandenberg Air Force Base in California, and at its Delta rocket assembly plant in Decatur, Ala. **(Denver Business Journal)**

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	.25
3 MONTH LIBOR	.30	.26	1.13
PRIME RATE	3.25	3.25	3.25
10 YEAR TREASURY	3.90	3.72	2.92
30 YEAR TREASURY	4.74	4.69	3.75

