

April 19, 2010

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Office Report: Will it be Heaven in 2011?

When it comes to recovery in the nation's office market, don't expect much change to the upside until 2011, according to a new report from Marcus & Millichap. The firm's 2010 National Office Property Report tracks 44 major markets across the U.S. based on a series of 12-month forward-looking supply and demand indicators. Here's the bottom line: the Marcus & Millichap index projects that vacancies will climb and rents fall in all of those markets this year. But the worst of it should be coming to an end. "Vacancies are still rising, but the pace has slowed, and the remainder of 2010 should mark the peak for this cycle, with a gradual recovery in 2011," says Alan Pontius, managing director of the firm's National Office and Industrial Properties Group. "The expiration of leases signed during the height of the last expansion period will drag on NOIs for the next few years but should be somewhat offset by a release of pent-up demand through above-average job growth between 2011 and 2013." According to the index, the top 10 U.S. office markets in 2010 look like this:

Washington, D.C.
Philadelphia
Los Angeles
Houston
Boston
New York City
Portland
Kansas City
Chicago
Seattle

Here are the key highlights of the report:

- Washington, D.C., retained the top spot of the NOPI in 2010, fueled by healthy job gains and the greatest positive net absorption of any market in the ranking. Philadelphia (#2) also maintained its position from a year ago due to a second consecutive year of modest supply growth and an increase in office-using employment.
- Markets with high concentrations of banking and finance-related jobs generally improved in this year's ranking, led by New York City (#6), which rose two spots. San Francisco (#15) and Charlotte (#16) climbed four and two positions, respectively.
- With a few notable exceptions, demand for office space remains unlikely to pick up considerably this year, even as employers expand payrolls. Reflecting the shallow anticipated absorption, markets that avoided significant speculative development and retained lower vacancy rates throughout the recession, such as Los Angeles (#3), Boston (#5) and Portland (#7), ranked highly in the index.
- The recession claimed 8.4 million jobs, including more than 4.8 million positions in 2009. Employers will rehire cautiously in 2010, creating 1 million jobs, with office-using industries accounting for approximately one-third of the total.
- Government stimulus, healthy trade activity and stabilization of the housing market point to gross domestic product (GDP) growth of 2.5% to 3.0% in 2010. Another year of below-trend personal consumption, which accounts for more than 70% of economic activity, dampens the likelihood of a significant near-term rebound in GDP.

- The second half of 2010 will mark an important turning point for the U.S. economy, as real growth drivers, not government stimulus and incentive programs, will need to take over as primary drivers of expansion.
- New supply will not significantly affect property fundamentals in many markets, as completions will total 30 million sq. ft., down from 45 million sq. ft. in 2009. Despite limited construction and the resumption of office-using job creation, vacancy will rise 100 basis points to 18% in 2010. Leases on roughly 13% of occupied space are due to expire in 2010, and owners with rollover risk further softening of NOIs if tenants scale back space needs to reflect current staffing.
- National asking rents will fall 3.5% this year, following a 4.7% dip in 2009, while effective rents will decrease 5.2%, after plunging 8.9% last year. Headwinds to NOIs will persist for several years.
- Substantial rent declines will occur in some prominent CBDs, such as Midtown in New York City and the Financial District in San Francisco. Rents in these areas spiked from 2005 to 2007 but continue to recede as many owners employ discounts and concessions rather than realize a loss of revenues from vacant space.
- Lenders will continue quoting all-in rates instead of spreads over Treasuries, limiting fluctuations in borrowing costs. All-in rates for new five-year mortgages currently range from 6.5% to 7.0%. On average, LTVs are 60% to 65%.
- Tight lending among traditional sources of mortgage debt will result in a growing number of IPOs this year. Many REITs will tap the stock market to pay down existing debt or raise capital for acquisitions.
- CMBS holds promise for improved liquidity in the office sector this year, with several lenders ramping up conduit lending operations; however, the securitization market will not resume its role as a primary source of financing in the near future.
- With banks offering modifications and extensions of up to three years on average, distressed deals may make headlines but will not account for a significant share of investment activity. Buyer motivation will shift in 2010 from trying to time the market's bottom and acquire assets for pennies on the dollar to a more thoughtful evaluation of short- and long-term opportunities.
- Following a 50% decline last year, investment activity is expected to accelerate in 2010, but transaction volume will lag the peak levels of a few years ago.
- Medical office assets posted comparatively stable occupancy and rents through the recession, stimulating investment demand and limiting price declines. Cap rates for medical office properties have inched up an average of just 100 basis points since 2007, while the median price has dropped 12%, compared with a 25% fall for traditional office properties. Medical office buildings comprised nearly half of all sales activity in many secondary and tertiary markets last year. **(National Real Estate Investor/Ben Johnson)**

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Fed Chief Bernanke Sees Recovery Staying Moderate

The U.S. economy should continue to recover at a moderate pace this year, but it will take time to restore all the jobs lost during the recession, Federal Reserve Chairman Ben Bernanke said Wednesday. In his latest assessment of the economy, Bernanke told a congressional committee that the pace of the recovery this year will depend on whether consumers spend and companies invest enough to make up for fading government support. "On balance, the incoming data suggest that growth in private final demand will be sufficient to promote a moderate economic recovery in

coming quarters," Bernanke told the Joint Economic Committee. The U.S. economy is slowly emerging from its worst recession since the 1930s Great Depression that followed the Wall Street crash. Although recent reports have shown some pickup in the jobs market, the economy continues to be hampered by high unemployment and a weak housing sector. The slow pace of growth is keeping prices under wraps, allowing the Fed to maintain interest rates close to zero to bolster the recovery. In response to a lawmaker's question, Bernanke repeated the Fed's pledge to keep interest rates at a record low for an "extended period" to continue aiding the recovery. He reiterated what Fed officials said in their latest policy meeting March 16, which is that "extended period" depends on how the economy develops and isn't dependent on a time frame. Some investors Tuesday speculated Bernanke could signal that the Fed may be moving closer to raising rates because of the improving economy. "We strongly believe that the current policy language has legs, long legs," said Larry Meyer, a former Fed board governor, adding he doesn't expect rates to rise until well into 2011. **(Denver Post)**

Colorado Jobless Rate Hits 7.9 Percent

Colorado's unemployment rate climbed by two-tenths of a percentage point to 7.9 percent as employers shed 1,600 jobs during March, the state reported Friday. "While results for March are mixed, the Colorado job market continues to stabilize," said Donald Mares, executive director of the Colorado Department of Labor and Employment. "Improving conditions are encouraging Coloradans to return to the labor force, contributing to the increase in the unemployment rate." The Department of Labor and Employment reported the elimination of 1,600 jobs over a month's time brought Colorado's nonfarm wage and salary jobs down to 2.2 million. The civilian labor force — which includes those old enough to work but aren't institutionalized — increased by 8,400 to 2.65 million in March. The number of Coloradans unsuccessfully looking for a job rose by 6,700 to 209,800. The federal Bureau of Labor Statistics reported the national employment rate remained at 9.7 percent for the third consecutive month. Of the 24 states with higher month-over-month jobless rates, the bureau deemed four to have statistically significant increases. Those states were Colorado, Montana, Nebraska and Virginia, all at two-tenths of a percentage point. Of Colorado's 11 major industry sectors, only three added jobs since February. The financial activities sector grew by 200 jobs. Professional and business services added 1,600 positions. The government sector grew by 2,300 people, which was tied to increased hiring for the 2010 Census. **(Denver Business Journal)**

More Upbeat ULI Summit Finds Big Finance Players 'Back on Offense

Major conferences can be telling barometers of the commercial real estate industry's mood. Only a year ago, the atmosphere at the Urban Land Institute's spring summit in Atlanta was dour, even fearful, recalled Patrick Phillips, the organization's CEO. This week, ULI's spring conference in Boston revealed an unmistakable change. "There's more of a forward-looking attitude and more of an upbeat attitude," Phillips told CPE Thursday afternoon. "When you look around here in Boston, what you're seeing are the survivors." Those survivors expressed a sense of confidence that the worst of the crisis is finally over. "We're back from the edge of a cliff," said ING chairman & CEO Stephen Furnary during a finance and investment panel discussion

on Wednesday afternoon. Among other gains, commercial real estate assets will again start to register increases in net operating income, Furnary predicted. Some financial heavyweights also took the opportunity to alert the assembled real estate professionals that they are back in the game. Frank Cohen, senior managing director at Blackstone Real Estate Advisors, said during Wednesday's finance panel that the firm was participating in joint ventures with REITs as well as investing in B-notes and CMBS. "I think we are very much in the mode now of back on offense," Cohen said. Private equity can have an essential role to play in re-energizing the market. A borrower who needs a loan valued at 100 percent or more of an asset's value for refinancing may be able to secure a loan for only 70 percent of value. In those cases, private equity can supply the rest of the capital stack, he explained. Cohen also predicted that REITs "will be the first to develop because they don't need the construction loans." Speaking for one of those REITs, ProLogis CEO Walter Rakowich told the audience that a build-to-suit project provides his company with better returns today than acquisitions. Much of the industrial giant's development portfolio is outside of the United States as overseas clients expand or upgrade their assets. However, Rakowich also noted that that development is attractive for ProLogis in part because acquisition is so unattractive: "We're not seeing terrific buys on the industrial side." A sense that the industry's prospects are improving but mixed also emerged in the economic outlook that preceded Wednesday's capital markets discussion. The recovery is now spreading from the central part of the country to the Southeast, except for Florida, and the industrial upper Midwest, reported Augustine Faucher, director of macroeconomics for Moody's Economy.com. The national unemployment rate will reach an estimated 10.2 percent by the end of the year, although some of the increase will result because formerly discouraged workers will be counted in unemployment figures when they resume the job hunt. Business and professional services will generate most of the job gains.

(Commercial Property News)

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	.25
3 MONTH LIBOR	.31	.26	1.11
PRIME RATE	3.25	3.25	3.25
10 YEAR TREASURY	3.79	3.64	2.83
30 YEAR TREASURY	4.67	4.57	3.71