

# COLLIERS INTERNATIONAL VALUATION & ADVISORY SERVICES

## WEEKLY MARKET RECAP



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## Macro Economic and Real Estate News

K.C. Conway, MAI, CRE, CIVAS Market Analytics

### What's wrong with this picture?

- **The S&P 500 is on track to turn in its best October performance in more than a quarter century.** Through Friday, October 28th, the S&P 500 had gained 14.12% for the month. It was on track to meet or beat the best ever October for that index which occurred in 1974 when it gained 16.3%. Only Monday, October 31, stood in the way.
- **Approximately 70% of the 315 S&P 500 companies reporting Q3 2011 earnings thus far have beat estimates.** Less than 20% of reporting companies have missed estimates. The average earnings growth rate for the 63% of the S&P 500 is 13.1%.
- **Job growth is positive in nearly 50 U.S. MSAs** and above a growth rate of 2.0% for approximately a dozen MSAs. According to the Department of Labor, job growth in September was geographically dispersed and included MSAs in Arizona, California, Florida, Michigan, Nevada, and Ohio.
- **Retail Sales are up a stellar 1.1%** compared to just 0.3% in August and lower consumer sentiment readings.
- **U.S. home foreclosures are down 34% YOY** to 610,000 in September 2011.
- **The European Union has agreed to a plan** to avoid an economic Armageddon

The answer is that not all is as it appears. It's amazing how the market reacts so quickly to the headline data releases with so little analysis into what is behind the numbers. The market behavior to a single data point release without any analysis would be analogous to an appraiser concluding that all property was worth more because of one sale at a low capitalization rate. At the risk of sounding like the "doom and gloom" report, the age-old adage that **"the devil is in the details"** is true – even more so in times of market volatility.

Market traders wait anxiously at 8:30 a.m. EST most mornings for the latest economic or earnings data release to be reported, and react 30 seconds later. If the data release meets or exceeds expectations, it's off to trading to the upside. If the data item misses expectations, traders rush to sell with no clear understanding of what happened or what to move back into.

This mindset has resulted in the most volatile market in nearly three decades. Conversely, hours – and sometimes days can be spent tearing apart a data release to understand the why behind the numbers, let alone connect the dots to what it means down the road. A good example from the aforementioned is retail sales.

The Department of Commerce reported that September retail sales were up 1.1%, or much better than the forecast +0.3%. When asked what happened, the media's talking heads concluded that consumers must have been telling us one thing in consumer sentiment surveys, and then acting differently. However, digging into the September numbers, it was revealed that the uptick, as reported in the previous edition, was due primarily to **spending on recovery following the plethora of natural disasters this past spring and summer.**

Insurance settlements and checks from the southeast and midwest tornadoes, Mississippi flooding, and Hurricane Irene all factored into the revisions and strong September sales. Home Improvement center sales, furniture sales in the disaster impacted states, and apparel sales (replacing lost or damaged clothing and not just back-to-school outfits) led the categories with increased sales activity (see Department of Commerce Monthly Sales by Category in the previous edition). Understanding this anomaly in the September retail sales data is essential to looking forward and understanding Q4 2011 holiday sales.

### Consumers are not telling us one thing in sentiment surveys and then ratcheting up spending.

In this week's publication, these and other data releases will be dissected in the respective Bulls, Bears and Bewildering sections. What you will see in the final analysis is that:

- The European debt crisis is far from resolved and celebration would be very much premature.
- Foreclosures are still elevated and running twice the 1,000 per day peak during the Great Depression.
- S&P earnings were achieved through more expense curtailment and accounting treatments,

such as Collateral Valuation Adjustments (CVAs). The European debt crisis and impending austerity measures are now impacting companies like 3M. Top-line revenues are not growing. We're not experiencing double-digit earnings of 13.1% from revenue growth.

- Retail Sales are up less than one-half of one percent when backing out insurance settlement spending from spring and summer natural disasters. ICSC retail sales next week will likely affirm that U.S. retailers are seeing flat to modest retail sales growth.



## THE SCORE BOARD

WEEK ENDING	BULLS	BEARS	BEWILDERED
October 28	4	4	3 ★
October 14	4	5 ★	4
October 7	4	5 ★	4
September 30	5	5	5 ★
4-Week Avg.	4.3	4.8 ★	4.0

Note: A Tie Bulls/Bears Score Results in Bewildered



## The Score Board

**RETURN OF THE BEWILDERED. THE BACK AND FORTH VOLLEY BETWEEN BEWILDERING AND BEARISH WILL PERSIST THROUGH Q4 2011 AS BOTH THE U.S. AND EUROPE ADDRESS THEIR DEBT CRISES.**

### STATISTIC(S), QUOTE(S) & HEADLINE(S) FOR THE WEEK

#### The Statistic(s) of the Week

A couple of statistics not widely covered this past week stood out.

- **\$0.02 per acre; and**
- **11.5% versus 10.8%**

The first measure relates to the U.S. purchase of Alaska from Russia. October is the anniversary of the Alaskan purchase from Russia in 1867 for a mere \$7.2 million dollars – or less than \$0.02 per acre. The Alaskan purchase should serve as a reminder to us that all real estate value is relative to the perception by the market. Russia perceived Alaska as a liability and land that was difficult to defend. Rather than risk losing it in a battle with Great Britain, it thought it better to sell it to the U.S.

Americans didn't regard the purchase favorably and viewed Alaska as barren land that was worthless. Today, 25% of America's oil and over 50% of its seafood come from Alaska. The name Alaska is derived from the Aleut word alyeska, which means great land. Sometimes, value is disguised and needs to be unlocked, and other times the value is staring us in the face in something as simple as its name.

As we focus on how far housing and commercial real estate prices have fallen in the past four years, and regulators tell banks how little value resides in their real estate holdings, maybe we need to recall the Alaskan purchase for some perspective.

The second item relates to the average annual return on U.S. government bonds compared to U.S. equities. According to Jeremy Siegel, a finance professor at the University of Pennsylvania's Wharton School of Business in Philadelphia, stocks had risen more than bonds over every 30-year period from 1861 until now. The biggest bond gains in almost a decade have pushed returns on treasuries above stocks over the past 30 years, the first time that has happened since before the Civil War.

Fixed-income investments advanced 6.25%, almost triple the 2.18% rise in the Standard & Poor's 500 Index through last week, according to Bank of America Merrill Lynch indexes. Debt markets are on track to return 7.63% this year, the most since 2002. Long-term government bonds have gained 11.5% a year on average over the past three decades, beating the 10.8% increase in the S&P 500.

**ALL REAL ESTATE VALUE IS RELATIVE TO THE PERCEPTION BY THE MARKET.**

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## CONGRESS' INABILITY TO UNDERSTAND THE MEANING OF AUSTERITY PUTS OUR ECONOMY AT RISK.

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What is the takeaway from the latter statistic of the week? With interest rates at less than 25 basis points for 2-year treasuries – and less than 2.0% for 10-year treasuries – maybe now is the time to take your profits from the bond market with the FED being such an active buyer. There isn't a lot of room for rates to go much lower and bond yields to improve. This realization, along with fears of a dual U.S. and European recession, may also explain why capital is flooding back into U.S. real estate. Where can you find 6%+ cash on cash yields today secured by a tangible asset that is trading substantially below its replacement cost?

### The Quote(s) of the Week

**“The U.S. needs to be careful of what the Italians call the malocchio and what the Greeks call 'mati'—the evil eye. A deal is not a deal until the deal is done.”**

*—Charles Dallara (former U.S. assistant Treasury Secretary involved in the Greek bailout negotiations) in an October 28th interview to “The Kudlow Report.”*

This quote came from an interview by Larry Kudlow with a former U.S. assistant Treasury Secretary seated at the table in which the so-called “E.U. plan with Greece” was reached last week. As events unfold – and we learn whether Greece and its citizenry will go along with the plan – Charles Dallara made two very revealing points regarding the EU plan that we in the U.S. don't fully appreciate any more than we did the TARP plan. Those two points are:

- If the E.U. plan with Greece does fall apart, and it might, Europe will be coming to us. It will start with the banks, which finance 80% to 90% of the global trade, and since most of the trade is dollar-denominated, it will continue to the U.S. government. Congress' inability to understand the meaning of austerity puts our economy at risk.
- Because Europe lacks fiscal unity, there is no deal until it is done and in place. Premature celebration of a plan before all the details are

worked out and understood could be ripe with perils.

### The Headline(s) of the Week

#### Want to Be the 1%? There's an App for That

*—CNBC -Cindy Perman - Oct 27, 2011*

There is a solution to the Occupy Wall Street (OSW) protestors that may be as easy as downloading an iPad app. Now the 99% can experience what it's like to be the 1%, one of the wealthiest people in America – without having to move, take out student loans and complete school, risk capital or get a job or ever pay taxes.

Spur of the Moment Games is about to launch their debut mobile app called “Clear the Park, where you get to play the role of an executive who “clears the park” of protesters by throwing things at them from your office or luring them away with prizes. If you win, you get that gorgeous park view back for when you're kicking back in the corner office. If the protesters win, they may engage in acts that or turn your office into something not so corporate. This attention-grabbing headline and story leads one to ponder:

#### Maybe device applications (“apps”) are the solution to all our global problems.

Instead of real war, we could just have an app for battling terrorism. Instead of housing and financial crises with home foreclosures and bank failures, we could just have an app to simulate the crisis and spare us all from the absurdity of legislation and regulation like Dodd-Frank. With the cost of regulatory compliance in the U.S. now zapping an estimated 15% of our GDP, maybe Congress and policy makers need to look to the development of apps to solve our problems. We could start with an app to simulate the consequences of the U.S. not meeting its budget cut obligations by the end of this month. On second thought, we do have such a simulation at hand. It is called the E.U. debt crisis. As goes Europe, so goes the U.S. given the entanglement of our economies and financial systems.

## The Bulls, The Bears & The Bewildering



On the surface, there was a fair amount of Bullish news. The announcement late last week that the E.U. had reached an agreement on

resolving a Greek debt default was preceded by news that:

- **Foreclosures fell 34%** compared to September 2010;
- Of the 315 S&P companies reporting Q3 earnings, **71% have beat expectations**;

## STATE REVENUE FORECASTS IN 45 OF 50 STATES ARE AT LEAST 10% OFF FY 2011 BUDGETS.

- The “advance estimate” on Q3 GDP was 2.5% - or nearly double that of Q2 (take it with a grain of salt as the “Advance Estimates” are notoriously inaccurate); and
- MSA level job growth as reported by the BLS for September was surprisingly broad based and not just concentrated in a few states or one region of the U.S.

A deeper analysis of these Bullish indicators reveals that the good news is just skin deep. As we now know, the E.U. debt deal with Greece is wrought with problems. The three most entangling problems are:

- How does the E.U. write-down the Greek debt and not trigger a default that has very material implications in the CDO market?
- Where does the E.U. get the \$170 billion Euros to fund the European Financial Stability Facility that will recapitalize the E.U. banks?
- Will the other PIGS countries (Portugal, Ireland, and Spain), and Italy, pursue a similar agreement to restructure and charge off a material portion of their debt and can that contagion be avoided?

### Earnings

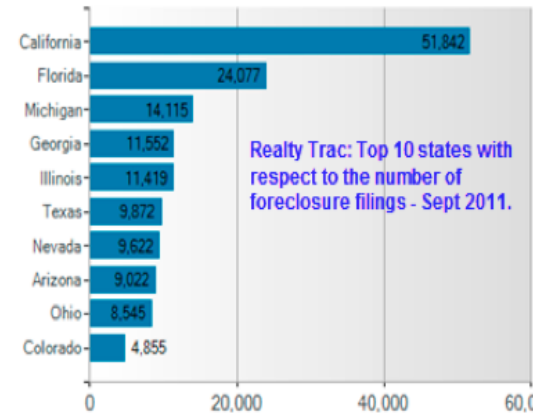
With respect to earnings, there are a lot of chinks in the armor. Top-line revenues are not growing. Companies with greater exposure to Europe (like 3M) than emerging markets are reporting declining sales and offering less encouraging forward guidance for Q4 2011. Cost curtailment and accounting adjustments (such as CVAs – Collateral Value Adjustments) accounted for a material portion of earnings.

### Foreclosures

Although foreclosures are down 34% from September 2011, they’re still running at levels that approximate 2,000 per day – or double the peak rate during the Great Depression. The comparisons to a year ago are also skewed by the fact that moratoriums and backlogged courts in judicial foreclosure states have slowed the foreclosure process. With banks not holding well in excess of 1.0 million foreclosed homes on their books and another 600,000 occurring every quarter, the foreclosure story is far from Bullish. A more appropriate characterization would be less bad. The new Home Affordable Modification Program (HAMP) for homeowners with negative equity that have been current on their mortgages may be the most encouraging development that could really begin to moderate the pace of foreclosures in 2012. The key provision that escapes many is that banks will be released from their “reps and warranties”

under this new program for refinancing underwater homeowners. This feature is just the incentive banks need to re-engage as the FHFA has demonstrated an inclination to send every bank originated mortgage that becomes delinquent back to the banks for some kind of “rep and warrant” infraction.

**Overall, 1 in every 213 mortgages is in foreclosure.** Although California, Florida and Georgia remain among the top 5 states in terms of the number of foreclosure filings, Texas has moved up to number 6.



### GDP

GDP has been a volatile number through 2011 due to revisions, disruptions to auto manufacturing, and the evolving European and U.S. debt crises. Q1 GDP has been final revised down to just 0.4%. Q2 GDP has been revised down to 1.3%, and the initial advance reading on Q3 GDP came in above estimate at 2.5%.

Assuming the Q3 advance estimate holds up to the scrutiny of revisions (not typical), the average GDP for the first three quarters of 2011 will be just 1.4%. Recognizing that advance estimates of GDP are notoriously inaccurate - and are typically revised downward in subsequent months - and that corporate guidance for Q4 has been consistently negative by the S&P 500 companies reporting Q3 earnings, Q4 GDP is likely to be well below Q3’s advance estimate of 2.5%.

The announced job cuts by financial, retail and service industries have yet to take effect - and state governments face more budget cuts at year-end 2011. State revenue forecasts in 45 of 50 states are at least 10% off FY 2011 budgets. Mid-Fiscal Year budget revisions are ahead in early 2012. In summary, the Bullish economic data is not as Bullish as it may appear. Dig deep into the data and connect the dots to understand the why when data releases materially exceed forecast or go contrary to other indicators.



The Bearish economic indicators of the past week tell us a lot about what is going on beneath the surface. For example, weekly jobless claims continue to bounce around just above 400,000, but the state detail in the weekly claims reports is beginning to show a concerning trend:

**The number of states indicating a rise in weekly claims is increasing. No longer is it just a few states with increases offset by a few with decreases.**

The number of states reporting an increase of at least 1,000 claims has increased with each new weekly report in September and October. The latest report for the week ending October 15th shows that only 1 state reported a decrease in claims of at least 1,000.

**On the other hand, 22 states reported an increase of claims of more than 1,000.**

That figure is double the number of states reporting increases since June when states were implementing deep cuts to implement new FY 2011 budgets. Aside from the weekly claims 4-week moving average, pay attention to the state detail provided in the weekly claims report. The insight into which industries are contracting - as well as the number of states cutting jobs - is most valuable. The latest data shows continued job loss in services, retail, construction, trade and transportation, as well as non-auto related manufacturing.

#### STATES WITH A DECREASE & INCREASE OF MORE THAN 1,000

STATE	CHANGE	STATE SUPPLIED COMMENT
<b>STATES WITH A DECREASE OF MORE THAN 1,000</b>		
WI	-1,536	No comment.
<b>STATES WITH AN INCREASE OF MORE THAN 1,000</b>		
KS	+1,012	No comment.
NJ	+1,014	Layoffs in the service, retail, & construction industries.
KY	+1,071	No comment.
TN	+1,093	Layoffs in the service & manufacturing industries.
CO	+1,147	No comment.
MA	+1,326	Layoffs in the manufacturing & services industry.
MI	+1,475	No comment.
IL	+1,479	Layoffs in the construction, service, & trade industries.
AR	+1,571	Layoffs in the healthcare industries.
AK	+1,723	No comment.
AZ	+1,723	No comment.
IN	+1,813	Layoffs in the manufacturing industry.
MO	+1,822	Layoffs in the manufacturing & services industries.
AL	+1,941	Layoffs in the transportation and service industries.
OH	+2,462	Layoffs in the automobile industry.
FL	+2,507	Layoffs in agriculture, construction, manufacturing, trade, retail.

#### Architectural Billings Index

According to the American Institute of Architects, the Architecture Billings Index (ABI) reversed direction in September and dropped 4.5 points to 46.9. Regional index averages in September were 51 for the Midwest, 46.7 for the West, 47.3 for the South and 50.8 for the Northeast. The index is an economic indicator of construction activity that shows a nine- to 12-month lag time between architecture billings and non-residential construction spending. The key take-away from the September report that puts new construction activity into perspective was stated quite candidly by American Institute of Architects (AIA) Chief Economist Kermit Baker in the press release for the September report:

"It appears that the positive conditions seen last month were more of an aberration," said Baker.

"The economy is weak enough at present that design activity is bouncing around more than usual; one strong month can be followed by a weak one. The economy needs to be stronger to generate sustained growth in design activity."

#### Housing

The news was not encouraging at all. Both pending sales and new mortgage applications were down again. Increasingly, buyers are falling out of contract for one of three reasons: the mortgage underwriting process has become so onerous and lengthy that buyers give up after 6 months; increasing anxiety about the economy and employment; and declining home prices from a perpetual flow of foreclosures.

**Pending sales of existing U.S. homes dropped for a third successive month during September.**

The National Association of Realtors (NAR) Pending Home Sales Index, based on contracts signed in September, was down 4.6% to 84.5. The September index fell in every region of the country from August levels.

**According to the Mortgage Bankers Association, mortgage applications plunged 14.9% last week.**

The MBA reports that its seasonally adjusted Purchase Index decreased 8.8% from one week earlier and is at its lowest level since December 1996. Both conventional and government purchase activity declined last week, with the Conventional Purchase Index decreasing 11% and the Government Purchase Index decreasing 5.9% from the previous week.

**Inflation**

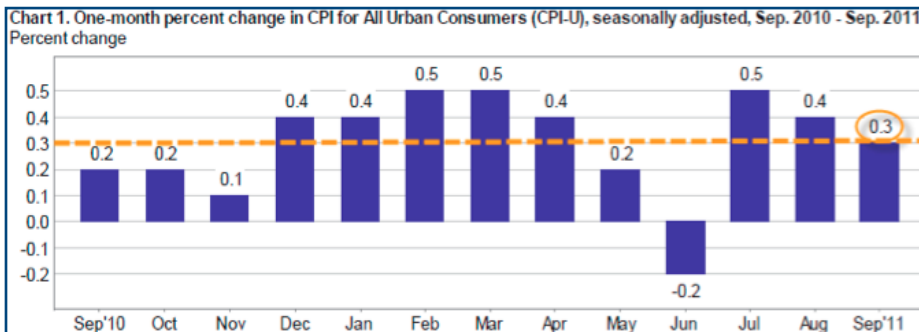
As the FED and European central bankers stress over asset price deflation, commodity inflation is the concern for businesses and consumers. Both the PPI and CPI showed commodity and raw materials inflation is alive and well. This development caused a number of economists and industry analysts to dust off the 1970s term “stagflation” – inflation with no job or economic growth. It is the worst of all kinds of inflation as consumers are squeezed between the reality of lower wages and higher prices, and businesses are squeezed between higher raw material costs and resistance to price increases from customers that elect to go without.

**PPI – Produced Price Index**

The Producer Price Index for finished goods rose 0.8% in September. Finished goods prices were unchanged in August and increased 0.2% in July. At the earlier stages of processing, prices received by manufacturers of intermediate goods moved up 0.6% in September, and the crude goods index advanced 2.8%. The real concern from the September PPI, was:

**On an unadjusted basis, prices for finished goods climbed 6.9% for the 12 months ended September 2011.**

Month	Finished goods					Intermediate goods	Crude goods
	Total	Foods	Energy	Except foods and energy	Change in finished goods from 12 months ago (unadj.)		
<b>2010</b>							
Sept.....	0.3	0.9	0.0	0.2	3.9	0.4	0.6
Oct.....	0.6	0.5	3.0	-0.3	4.3	1.0	4.8
Nov.....	0.5	0.8	1.6	0.0	3.4 <sup>f</sup>	0.9	1.4
Dec.....	0.9	0.8	2.5	0.2	3.8	1.1	6.9
<b>2011</b>							
Jan.....	1.0	0.4	2.8	0.5	3.6	1.6	3.5
Feb.....	1.5	3.5	2.9	0.2	5.4	1.9	3.1
Mar.....	0.7	-0.4	2.8	0.3	5.6	1.4	-0.8
Apr.....	0.8	0.5	2.2	0.3	6.6	1.4	3.9
May <sup>1</sup> .....	0.1	-1.2	1.1	0.1	7.1	0.6	-4.3
June <sup>1</sup> .....	-0.1	0.7	-2.0	0.3	7.0	0.0	-0.5
July.....	0.2	0.6	-0.6	0.4	7.2	0.2	-1.2
Aug.....	0.0	1.1	-1.0	0.1	6.5	-0.5	0.2
Sept.....	0.8	0.6	2.3	0.2	6.9	0.6	2.8



**CPI – Consumer Price Index**

The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.3% in September on a seasonally adjusted basis. Over the last 12 months, the all items index increased 3.9% before seasonal adjustment.

**Increases in energy and food indexes were the main cause of the seasonally adjusted all items increase.**

The gasoline index continued to rise, and indexes for electricity and natural gas increased as well. Broad increases in food indexes also continued in September, with the food at home index rising 0.6% for the third month in a row and no major grocery store food group indexes declining.



**THE BEWILDERING**

Europe has to top the Bewildering list - and it will likely remain unclear for weeks and months to come. Why? In the U.S., we fail to appreciate:

- The European Union may have monetary union, but it lacks fiscal union. Monetary policy and discipline is next to impossible without fiscal union and the ability to impose spending boundaries. We think we have this fiscal union in the U.S., but it will be put to the test in 2012 as our own State and municipal crises bloom. Will the fiscally sound states accept measures to rescue the debt-ridden states? The chaos that ensued in Wisconsin this past spring, in Washington D.C. this past July, and now the Occupy Wall Street movement should all serve as wake-up calls to us that our “fiscal unity” is fragile. The Tea Party movement from two years ago and the Occupy Wall Street movement this fall underscore the frustration over our own fiscal disharmony.
- The history of Europe and fear of concentrating economic power in Germany.
- How the debt crisis is resolved has huge implications on the CDO market and whether restructure is a default. CDO losses to E.U. and U.S. financial institutions impacts capital and viability. MF Global is just the tip of the iceberg if resolution of the Greek and broader E.U. debt crisis is determined to be a default.
- Finally, where will the EFSF find the \$170 billion euros will to recapitalize the European bank?

Will it come from China with strings attached? Will FED Chairman Bernanke institute a new acronym plan to place European debt on the FED's balance sheet under the guise of "exigent circumstances" like it did under TARP? Will Australia, Canada or other nations partake in the \$170 billion euros EFSF recapitalization plan? A lot has to be resolved.

**U.S. Bank Failure Outlook**

The FDIC just updated its forecast for the number of bank failures and outlook for losses to the FDIC fund and concluded:

**Fewer failures and less loss to the FDIC fund.**

According to an October 11th FDIC report, bank failures are now estimated to cost the Deposit Insurance Fund \$19 billion through 2015, compared to the estimated \$23 billion in losses in 2010 alone.

ABA Chief Economist James Chessen remarked that "the banking industry is rapidly returning to health and the losses once expected were overstated."

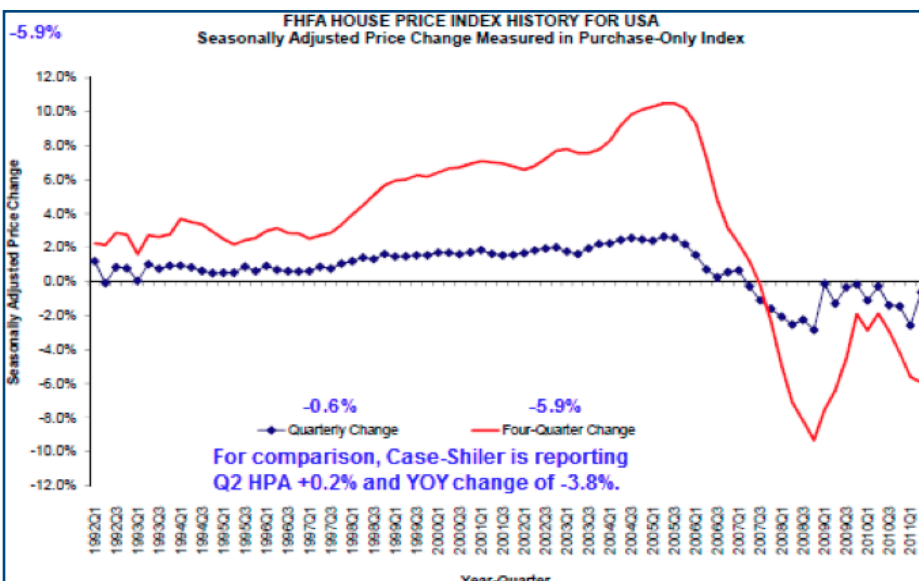
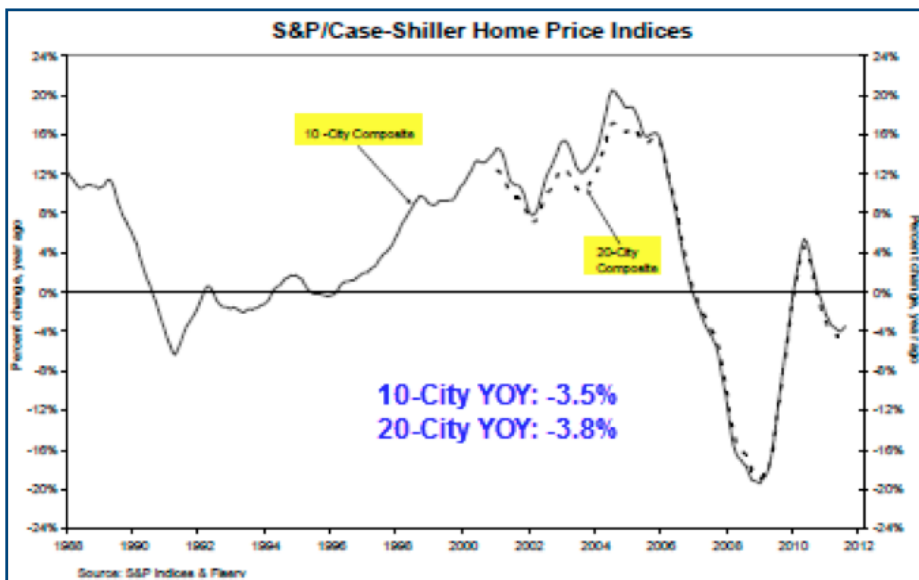
We've had fewer bank failures and losses to the FDIC fund because of "extend and pretend" strategies like the 2009 CRE Loan Workout Guidance and cosmetic bank stress testing that allowed banks to release their commercial real estate loan losses into earnings over the past 4 quarters. Now that both those jigs are up and banks face higher capital requirements, more regulation, less profitable operations due to the Durbin amendment in Dodd-Frank, and more mortgage litigation and put-backs from the FHFA, do you honestly think we are going to see fewer bank failures and losses to the FDIC fund? We have had 87 bank failures thus far in 2011. That compares to 410 since the start of the 2008-2009 financial crisis, and 2,369 in the 8-year S&L crisis. Nearly 900 banks remain on the FDIC watch list and our 7,500 U.S. community banks have yet to develop a new business model without real estate lending constituting approximately half of its revenue base. Fitch Ratings just cited:

**Continued uncertainty on economic conditions and litigation tied to mortgage risks as its reasons for placing U.S. banks on review for possible downgrades.**

The U.S. banking system is under more duress from regulation and litigation than at any point during this 4-year financial crisis. It's most bewildering that the FDIC would suggest the U.S. banking industry is "rapidly returning to health" and will experience fewer bank failures ahead and 20% less losses to the FDIC fund. It's unclear what economic or bank earnings data they are looking at, but industry observers, rating agencies, and the weekly flow of bank failures every Friday suggest the contrary.

**Housing – Home Prices and Foreclosures**

Case-Shiller home price appreciation data seems to suggest things are moderating, and only MSAs like Atlanta are still seeing declines in home prices. Its latest data release shows home price up 0.2% for its 10- and 20-city composites in August versus July. However, the broader and more reliable FHFA home price data shows just the opposite. The FHFA reports home prices from paired sales of home purchases using Freddie of Fannie Mae financing across all 360 U.S. MSAs fell another 0.6% in Q3 and are down another 5.9% YOY. The respective HPA tables from both sources show the conflicting perspectives.



With the flow of foreclosures continuing at a pace in excess of 600,000 for Q3 2011 and absence of job growth close to the 200,000 level needed to absorb new workers and erode the 16.5% U-6 Total Unemployment rate, it seems more than likely that the FHFA report of home prices still falling is more accurate. Except for education center markets (Austin, Boston, Denver, Raleigh, etc.) where intellectual property manufacturing is returning, as well as some midwest agricultural and energy states, home prices are still declining in 85% of U.S. MSAs.

### Foreclosures

The foreclosure data further corroborates the home price findings by FHFA. According to RealtyTrac, foreclosures rose another 1% in Q3 2011 as lenders resume foreclosures in the absence of any settlement agreement among the state attorneys general. Nationwide, one in every 213 housing units received a foreclosure filing during the third quarter, which included default notices, auctions and bank repossessions. Although the YOY foreclosure filings are down, keep in mind that moratoriums and court backlogs in judicial foreclosure states the past 12 months slowed the process. Notices of Default (NODs) are a better leading indicator to monitor. In California, for example, Notices of Default reversed course in the third quarter, increasing more than 25% from the second quarter, when filings hit a three-year low. How banks respond to the flow of mortgage put-backs by the FHFA, resolve their documentation hurdles in judicial foreclosure states, decide to participate in this latest HAMP plan for underwater homeowners current on their mortgage payments, absence of a settlement agreement with the state attorneys general and their capital squeeze by regulators will dictate the direction of foreclosures in 1H2012. Job growth would help as well. Absent job growth, reversal of higher capital requirements for banks, and FHFA stemming the flow of mortgage put-backs to banks, foreclosures are likely to remain elevated at levels that suppress any home price appreciation from getting a foothold.

In summary, Europe, banks, and housing will likely be in the Bewildering category for the balance of 2011 and into 1H 2012. Regardless of what European leaders convey about the progress in resolving the E.U. debt crisis, the latest accounting gimmicks employed by banks to create the appearance of earnings (Q4 2010 to Q3 2011 drawing down loan loss reserves – and now Collateral Value Adjustments to

revalue debt in a low interest rate environment), or what Advance government data says about home prices and foreclosures, the market is learning that it is prudent to let all information age – like wine – before partaking. Premature reaction to breaking news and updated data releases is proving to be most distasteful.

## ECONOMIC CALENDAR

OCTOBER 31 – NOVEMBER 4

Although we have just come through a period of two weeks loaded with earnings and economic data, next week is a biggie with an FOMC meeting, G-20 meeting, and jobs report. We are just about through Q3 earnings and all eyes are on the U.S. and European debt crisis.

**Monday** Chicago PMI update – Auto manufacturing and raw materials going into auto production will influence this reading. U.S. auto sales are Bullish as consumers have to replace an aging fleet (which now exceeds 10 years) and struggle to find inventory given shortages of Japanese models and used cars.

**Tuesday** Motor Vehicle Sales (likely to remain at or above 13 million unit level with favorable earnings by Auto Nation – largest U.S. auto retailer), followed by a new ISM Manufacturing report and the start of the November FOMC meeting (a yawner as the FED will not change interest rates and prays over Europe).

**Wednesday** The ADP and Challenger-Gray employment reports may impact the FED Chairman's press conference following the FOMC meeting. The market will want to know how private payrolls are holding up and if job cuts are still elevated. Don't be lulled into a false sense of security here as state and municipal job cuts lie ahead at year end and the wave of announced financial service job cuts have yet to be counted into any of this employment data.

**Thursday** Weekly Jobless Claims – They aren't going below 400,000 on a 4-week moving average; pay attention to the detail provided by states. Are more or less states experiencing increases in claims and in what sectors? The bigger news will come from Europe with the start of the G-20 meetings. What will be the latest drama surrounding Greece?

**Friday** The monthly jobs report from the BLS. Auto manufacturing and seasonal holiday hiring by retailers could result in a number above expectations. It is doubtful we will see job creation anything close to the 175,000 to 200,000 level we need to whittle away at the U-6 16.5% Total Unemployment rate.

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*THE U.S. BANKING SYSTEM IS UNDER MORE DURESS FROM REGULATION AND LITIGATION THAN AT ANY POINT DURING THIS 4-YEAR FINANCIAL CRISIS.*

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## DISCUSSION ITEM

After nearly two straight weeks of travel, speaking to a wide range of audiences and industry groups from coast-to-coast this week's Discussion Item shares some of what we've been hearing and learning. Without divulging names, companies or industry groups, the following is a summary of noteworthy items from a wide variety of market participants, including, but not limited to, appraisers, accountants, bankers, brokers, lawyers, property tax professionals, regulatory authorities, and domestic and international clients:

- Commercial real estate investors are having one of their best years in a decade. Despite a dearth of capital from banks and CMBS, deals are getting done with lots of life company and out-of-U.S. capital. There is plenty of capital out there for tenanted commercial real estate.
- Property tax appeals are getting tougher and more litigious as states and municipalities struggle with declining revenues and rising costs. Assessors are using unprecedented tactics to preserve property tax revenue, and judges are sympathetic to the fiscal crisis faced by states. Don't anticipate an easy appeal process or expect immediate or retroactive relief.
- Cap rate compression that was slow coming to industrial real estate is now underway. The recent AREA/Adler portfolio transaction in suburban Washington D.C. at a 6.1% capitalization rate is proof positive of the compression. Colliers International Valuation and Advisory Services has also documented some recent and pending transactions that are at sub-6.0% capitalization rates. As the search for multifamily investments has driven cap rates down to sub-4.0% levels in even some secondary and overbuilt primary markets, investors are looking to industrial for yield and diversity.
- International capital flowing into the U.S. to invest in commercial real estate is not abating. Boston, coastal California, Denver, southern Florida, primary Texas MSAs, North and South Carolina and Washington D.C. are on the preferred shopping list. Why? Dwindling new construction, re-emergence of job growth, and prices still well below replacement cost are three of the most common reasons cited in Q&A discussions following events and presentations.
- Loan sales are increasing by banks. Banks are increasingly inclined to sell distressed

loans than pursue foreclosures and REO sales as a means of cleaning up their commercial real estate concentrations. Loan portfolios are being constructed in ways that don't just include a dump of all that is non-performing. This trend is also occurring in bank acquisitions. BB&T's recent acquisition of a pool of loans from BankAtlantic is a good example that will be discussed further in the next edition. The clearing process we have been waiting for via foreclosures may be underway through loan sales as banks race to raise capital in anticipation of new Dodd-Frank, G-20 and Basel II requirements over the next 12-36 months.

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*COMMERCIAL REAL ESTATE INVESTORS ARE HAVING ONE OF THEIR BEST YEARS IN A DECADE. DESPITE A DEARTH OF CAPITAL DEALS ARE GETTING DONE WITH LOTS OF LIFE COMPANY AND OUT-OF-U.S. CAPITAL.*

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# KEY ECONOMIC FINANCE RATES

## GROSS DOMESTIC PRODUCT

### United States

Q3 2011 +2.5% (Advanced)  
 Prior Qtr. +1.3% (Final)  
 CY 2010 +2.9%

### Hong Kong

Q2 2011 +0.5%  
 Prior Qtr. +2.8%  
 Recent High +6.3% Q3 2003  
 Recent Low -3.6% Q1 2009  
 Historic Avg. +1.0% 1990-2011

### Germany

Q2 2011 +0.1%  
 Prior Qtr. +1.3%  
 Recent High +2.1% Q3 2010  
 Recent Low -3.7% Q1 2009  
 Historic Avg. +0.3% 1991-2011

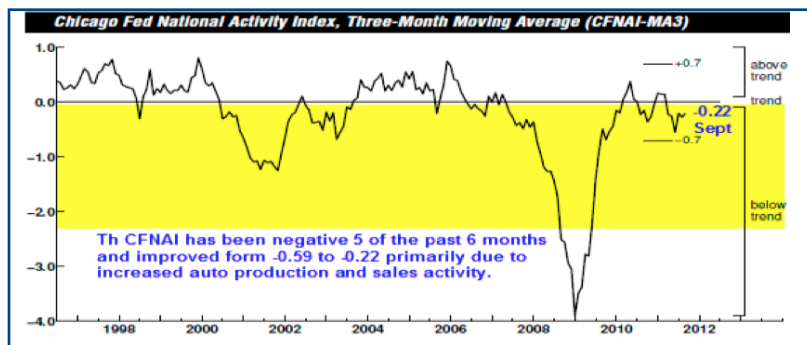


## CMBS DELINQUENCY RATES

PROP. TYPES	OCT 10	SEP 10	AUG 10	3 MO.	6 MO.	1 YR.
Industrial	6.27	6.48	6.56	6.04	5.41	3.18
Lodging	14.92	19.33	18.92	18.41	17.16	8.67
Multifamily	14.63	14.43	14.53	14.00	13.06	7.66
Office	6.68	6.62	6.57	6.35	5.37	3.08
Retail	7.17	7.13	6.76	6.90	6.44	4.53
<b>Overall</b>	<b>8.58</b>	<b>9.05</b>	<b>8.92</b>	<b>8.71</b>	<b>8.00</b>	<b>4.80</b>

## CHICAGO FED NATIONAL ACTIVITY INDEX (CFNAI)

Current Period -0.22% Sep 2011  
 Year Ago +0.27% Sep 2010  
 Prior Month -0.59% Aug 2011  
 May 2011 -0.37%  
 April 2011 -0.85%  
 March 2011 +0.41%  
 February 2011 -0.26%



## NATIONAL RESTAURANT PERFORMANCE INDEX

Current Period 100.1 Sep 2011  
 Prior Period 99.4 Aug 2011  
 Trend Volatile  
 Key Note < 100 = contraction



## PRODUCER \$ (PPI-FIN GOODS)

Sep. 2011 +0.8%  
 August 2011 +0.0%  
 July 2011 0.2%  
 June -0.4%

## CONSUMER PRICE INDEX

September +0.3%  
 August +0.4%  
 July +0.5%  
 June -0.2%

## U.S. UNEMPLOYMENT

U-3 (Official) 9.1%  
 U-6 (Total) 16.1%

## JOBLESS CLAIMS

Initial (10/1) 406,000  
 Initial (Prior) 404,000  
 4-Wk Average 406,500

## TREASURY RATES

2-yr (-1bps) +0.20%  
 10-yr (+4bps) +2.23%

# CIVAS MARKET ANALYTICS

## Products & Services

- Weekly Market Recap
- National Market Overviews
- Economic Spotlight
- CRE Stress Testing
- Market Presentations
- Consulting & Advising



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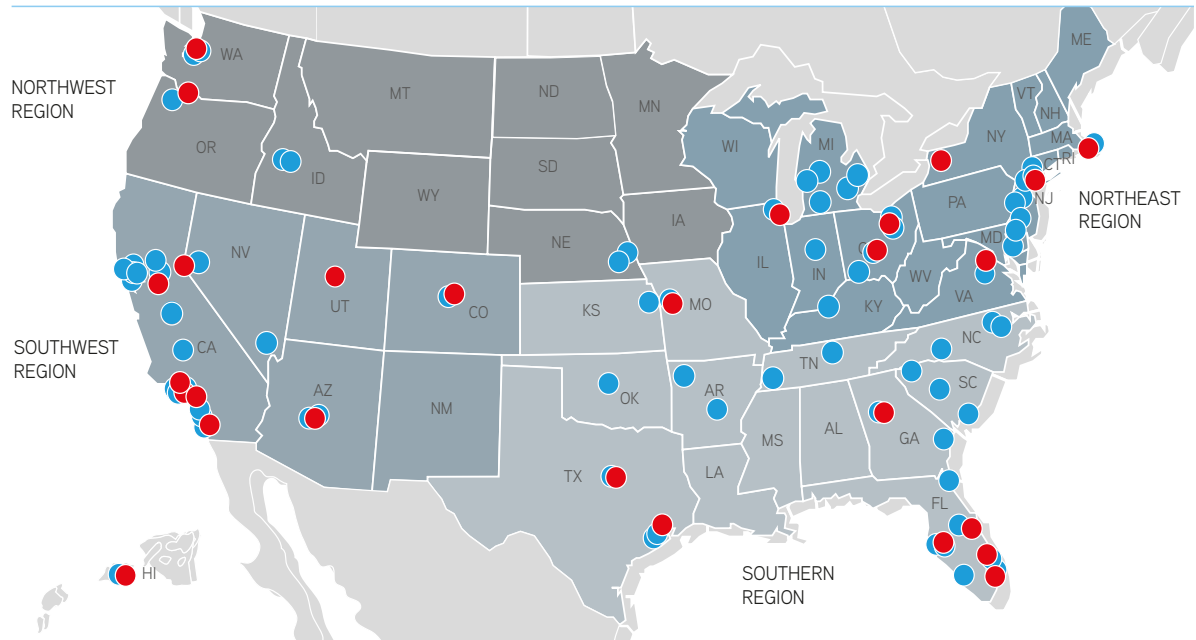
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