COLLIERS INTERNATIONAL VALUATION & ADVISORY SERVICES

WEEKLY MARKET RECAP

Week @ A Glance

Macro Economic and Real Estate News

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This past week, the debt and equity markets tried to move forward on the heels of solid earnings news. Seventy-five percent of the 270 companies reporting Q2 earnings thus far have beaten estimates. However, the market looked past the stellar earnings due to anxiety over the looming debt downgrade and turned in five consecutive days of decline for most indices.

During a meeting last week with the banking regulators in Washington, D.C.

I was taken aback by the focus on everything except what happens to the banking system and asset values – like real estate - in the event of a U.S. debt downgrade.

Instead, the focus was on Dodd-Frank rule making (more regulation), commercial real estate stress-testing (more uncertainty), rebuttal of the GAO report on the Federal Reserve's use of its 13(3) emergency funding powers during the financial crisis (more rearview mirror focus), etc. The Board-staff at the Federal Reserve seemed aghast at my inquiry as to what advice was being provided to the banks regarding liquidity, capital requirements, treatment of municipal bond holdings, loan pricing, and extensions of credit in the event of a downgrade or default. I raised the question on Wednesday afternoon after S&P announced it would not issue a rating for two new CMBS issuances by Goldman Sachs and Citi (GSMS 2011-GC4) that were set to close the next day. On Thursday, the FHLB and FHFA were reporting some pricing and credit issuance wrinkles due to the impending U.S. debt downgrade. Also, on Thursday, demands on cash reserves at the respective Federal Reserve District Banks became elevated by companies' building-up cash to insure they could meet their liquidity obligations in the days ahead.

This must have hit a nerve, as Friday the top 20 U.S. banks were invited back to Washington to discuss such issues.

With the President and Treasury refusing to clarify the prioritization of the bills it will pay in August if the debt ceiling is not raised, banks, businesses, cities, states, retirees, the military, federal employees operating essential services (like our transportation ports, and homeland security), and our creditors are left with a great deal of uncertainty as to how they operate come August 2nd. To add insult to injury, **the Treasury expects to issue new debt on Monday, August 1st.**

To our banking colleagues, keep this situation in mind the next time the bank examiners want to criticize your business continuity plan.

What lies ahead for the U.S. next week will be unprecedented for America if its debt rating is downgraded from "AAA," regardless of a last hour agreement to raise the debt ceiling. However, a "AAA" downgrade is not unprecedented for G-10 economies. Canada lost and regained its "AAA" debt rating, and so can the U.S. Other countries (Australia in 1986, Canada in 1992, and Japan in 1998) have weathered "AAA" debt rating downgrades and recovered.

The U.S. may be a more complex downgrade as it is the world's reserve currency, and more of the U.S. debt is held by foreigners than was the case with other countries.

A U.S. debt downgrade from "AAA" is not insurmountable.

Furthermore, a failure to raise the debt ceiling does not mean the U.S. will default on its debt obligations.

HISTORY OF U.S. DEBT: From 1791-August 1, 2011
From $75.5 Million in 1791 to $14.3 Present

FISCAL YEAR	DOLLAR AMOUNT OF U.S. DEBT	MILESTONES
01/01/1791	75,463,476	
01/01/1800	82,976,294	
07/01/1850	63,452,777	
07/01/1861	90,580,873	
07/01/1862	524,176,412	**$100 million**
07/01/1863	1,119,772,139	**$1.0 billion**
07/01/1865	2,680,647,870	
07/01/1882	1,918,312,994	
07/01/1893	1,545,985,686	
07/01/1900	2,136,961,091	
07/01/1918	14,592,161,414	**$10 billion**
07/01/1919	27,390,970,113	
06/30/1930	16,185,309,831	
06/30/1934	27,053,141,414	
06/30/1941	48,961,443,535	
06/28/1946	269,422,099,173	**$100 billion**
06/29/1951	255,221,976,815	
06/30/1963	305,859,632,996	
06/30/1972	427,260,460,940	
06/30/1975	533,189,000,000	
06/30/1976	620,433,000,000	
09/30/1978	771,544,000,000	
09/30/1979	826,519,000,000	
09/30/1980	907,701,000,000	
09/30/1981	997,855,000,000	
09/30/1982	1,142,034,000,000	**$1.0 trillion**
09/30/1986	2,125,302,616,658	
09/28/1990	3,233,313,451,777	
09/30/1992	4,064,620,655,522	
09/30/1996	5,224,810,939,136	
09/30/2002	6,228,235,965,597	
09/30/2005	7,932,709,661,724	
09/30/2008	10,024,724,896,912	**$10 trillion**
07/29/2011	14,300,000,000,000	

Source: U.S. Census Bureau & U.S. Treasury Dept.

Delaying projects underway, cutting non-essential services (similar to what Minnesota has done in the last 30 days), deferring payments to federal employee pension plans, etc., are all actions the Treasury can take to avoid any debt default. These kinds of budget juggling actions are what individuals and businesses have been doing for the past three years to manage cash-flow.

U.S. Treasury, welcome to the real world where you can't just write as many checks as you can print – 80 million checks per month at last count.

The Treasury secretary and President both recognize they have the ability to calm the markets and layout a plan prioritizing payments, but they have failed to plan for managing August's cash-flow assuming Congress fails to increase in the debt ceiling. We have a systemic spending crisis in the U.S. that permeates all levels of government – federal, state, and local.

Maybe a refusal to raise the debt ceiling is an effective way to gain the attention of our elected officials before we go the way of previous empires and world "fiat currency" economies summarized in a piece I recommended to you in the June 27th – July 1st edition of the *Weekly Market Recap entitled:"How International Monetary Trends affect Real Estate Values"* - by John Lifflander.

Before examining the *Bullish, Bearish and Bewildering* news of the past week, let's make sure we have a solid foundation on the debt numbers for the start of August. The table to the left and subsequent tables have been prepared using the latest data from the Federal Reserve, U.S. Treasury, and the U.S. Census Bureau and Bureau of Economic Affairs (BEA). Let's begin with the history of how long it took us to reach $14.3 trillion dollars in debt, and conclude with a tally on what each American actually owes in terms of incurred and obligated debt – things such as unfunded pension obligations.

What is alarming from this chronology of U.S. debt between 1791 (commencement of fiscal year budgeting) and Mid-2011 is:

- The U.S. debt started off slow, but has risen more in the last five years than the 214 years between 1791 and 2005.
- It took 72 years to incur our first $1.0 billion of debt in 1863.
- Fifty-five years then transpired before the next milestone of $10.0 billion in debt was surpassed in 1918.
- The cost of WW I and WW II ran the national debt up to the next milestone of $100 billion by the end of 1945.
- It then took an oil, housing, savings, and loan crisis in the 1970s to push the U.S. debt above $1.0 trillion in 1981.

- In the 1980s and 1990s, the U.S. racked up another trillion dollars of debt every 3-5 years until we surpassed $10 trillion in 2008.
- The financial crisis and Washington class of 2008 have added 40% to the national debt in less than 3 years.

TOTAL U.S. DEBT: All Sources (Federal, State, Municipal, & Consumer)

DEBT CATEGORY	U.S. TOTAL	PER CAPITA $ AMT
Mid-2011 Incurred U.S Debt	14,300,000,000,000	$46,567
GAO Committed/Unfunded Debt	64,000,000,000,000	$208,410
Subtotal:	**78,300,000,000,000**	**$254,977**
All 50 States Incurred Debt	1,004,000,000,000	$3,269
All 50 States Unfunded Pension Debt	3,137,000,000,000	$10,215
Subtotal:	**4,141,000,000,000**	**$13,485**
Total Consumer Debt (auto and credit cards)	2,400,000,000,000	$7,815
Total Home Mortgage Debt (source: BEA)	10,300,000,000,000	$33,541
Subtotal:	**12,7000,000,000,000**	**$41,356**
Total U.S. Debt (Gov. & Consumer)	**98,141,000,000,000**	**$319,587**

Source: BEA, Federal Reserve, Treasury Dept., U.S. Census Bureau, & PEW Ctr.

If this trajectory is not sufficient evidence that the U.S. has a spending problem, then maybe the following tally on what each American owes will be convincing.

The total U.S. debt burden for every man, woman and child is approximately $320,000 – or approximately $100,000 more than the median price for a new home at mid-2011.

That amount of debt would require a monthly debt payment of $1,720 from each American - assuming a 30-year amortization period at an interest rate of 5.0%. For the average American household, that monthly debt payment would exceed $3,900 (after tax) or 94% of the U.S. median household income reported by the 2010 U.S. Census.

In other words, U.S. debt is approaching 100% of GDP - and 100% of household income if we were to amortize all sources of debt over a 30 year period at a 5.0% interest rate. For this reason, a larger tax burden cannot be imposed; the problem is one of excess spending.

THE SCORE BOARD

WEEK ENDING	BULLS	BEARS	BEWILDERED
July 29	2	5	3
July 22	3	4	5
July 15	5	7	5
July 8	2	4	3
4-Week Avg.	3.0	5.0	4.0

THE U.S. ECONOMY MAY BE SLIPPING FROM "SLOW GROWTH WHILE WE CUT BIG DEBT" TO "NO GROWTH WHILE GOVERNMENT CAN'T ACT."

The Score Board

"THE BEARS PREVAIL"

The absence of a debt ceiling resolution has taken its toll on the economy in the past four weeks. This uncertainty is manifesting itself in declining consumer confidence, GDP, and hiring by businesses. The economic data this past week confirmed: The U.S. economy may be slipping from "slow growth while we cut big debt" to "no growth while government can't act."

Despite stellar earnings by 75% of the 270 companies reporting earnings thus far for Q2, the "Advanced Estimate" of GDP fell to just 1.3% for Q2, 2011, Durable Goods orders fell 2.1%, and the Institute for Supply Management business barometer fell to 58.8 in July. A reading at or below 50 signals recession. However, the Federal Reserve's Beige Book is sticking to a *Bewildering* story that says in its summary statement:

- Economic activity continues to grow, although at a more moderate pace;
- Consumer spending is increasing;

THE QUOTE OF THE WEEK

"The U.S. is not a triple-A credit and is running a fiscal doomsday machine. The problem is not the ceiling, but the debt."
—CNBC Interview (Gennine Kelly) with David Stockman former federal budget director under President Reagan

This quote reiterates two key points that appear to get pushed to the background amidst the rhetoric:

- Regardless of an agreement to increase the debt ceiling prior to Tuesday August 2nd, the U.S. debt rating is likely to still be downgraded by year-end.
- A debt rating downgrade is still likely because our spending and debt are at unsustainable levels. This observation is reinforced by the history of our debt from 1791 to 2011 at the beginning of this recap.

In the weeks ahead, the market should not be surprised if a downgrade to the U.S. debt rating still follows. If Congress does not put forth a credible, long-term plan to bring spending under control, the market will respond accordingly.

- Activity in nonfinancial service sectors is improving;
- Manufacturing activity continues to expand and the near-term outlook remains positive.

Keep in mind that the Federal Reserve's Beige Book – formally known as the Summary of Current Economic Conditions - is largely a collection of anecdotal statements from select business and banking contacts in the respective 12 reserve districts. It's not a statistically valid survey. The value of these observations varies by district. If you want some meat-on-the-bone insights with something substantive, refer to the St. Louis, Kansas City, and Minneapolis reserve district sections of the Beige Book.

These three districts provide what those in the real estate industry would refer to as "submarket detail," and they quantify with statistics the depth of their verification for each economic observation.

STATISTIC(S) & HEADLINE FOR THE WEEK JULY 25-29:

The Statistic(s) of the Week

After this past week's bombarding of debt statistics, like most Americans, you may be numb from the numbers. The statistics that dominated headlines and news leads were:

- Apple has more cash on hand than the U.S. Treasury;
- GDP falls to 1.3% in Q2;
- Weekly Jobless Claims continue to stay above 400,000 on a trailing four-week basis; and
- Gold rises to a new high of $1,631 per ounce.

What you may not have seen communicated amidst the "millionaires and billionaires" and "job producers" rhetoric was the statistic assembled for you in the prologue to this week's recap:

The total U.S. debt obligation exceeds $98 trillion, or $319,587 for every man, woman, and child in America. That figure is approximately $100,000 greater than the median price of a new home in the U.S. and it factors into federal, state, municipal, mortgage, and consumer debt.

The Headline(s) of the Week

Late Wednesday July 27th, S&P announced:

It would not be issuing ratings for two new CMBS issuances by Goldman Sachs and Citi that were to close on Thursday July 28th.

The move by a major rating agency to refuse issuance of a rating the day before a transaction is to close, and after completing all underwriting, is rare - and without precedent in the CMBS 2.0 era.

This action escaped the kind of attention it normally might have garnered had it not been for the focus on the debt ceiling debate. For those engaged in commercial real estate finance and the CMBS market,

This event is likely the headline that will define securitization in 2H2011.

Discussion with Wall Street and regulatory colleagues directly or indirectly impacted by these and other issuances, in the pipeline through August, noted the following:

- This action casts a cloud over all new CMBS issuance as it was not clear in the S&P statement to withhold a rating for the Goldman Sachs and Citi GSMS 2011-GC4 deals, whether the decision was deal-specific or something systemic to all new issuance. It is believed that the action is a more systemic review of DSCR calculations.
- It's unclear whether S&P's decision will impact just CMBS 2.0 issuance or whether any change in DSCR calculations will also be applied retrospectively to legacy outstanding CMBS ratings. Those investors holding CMBS 1.0 issuance will likely be impacted.
- Due to this S&P announcement, and other issues with new deal placement, the size of the warehouse pipeline is expected to be reduced. It's expected that originators will be re-negotiating loan coupons with borrowers. As a result of increased coupons, some loans might become non-eligible for conduits (due to the inability to meet DSCR thresholds) and some borrowers could decide to pull back. The prospects for CMBS issuance to reach the beginning of the year expectations of $50 billion continue to decline.

CONSUMERS AND BUSINESS LEADERS' CONFIDENCE HAS BEEN ADVERSELY IMPACTED BY THE D.C. PARALYSIS OVER MANAGING THE COUNTRY'S FISCAL CRISIS.

YTD 2011 CMBS ISSUANCE: By Type With Pipeline Thru August 2011

ISSUANCE NAME	ISSUANCE TYPE (SINGLE/MULTI)	ISSUANCE TYPE (PRIVATE/GOV.)	ISSUER	ISSUANCE SIZE ($)	ISSUANCE DATE	PRIVATE/ GOV.
WFDB 2011-BXR	SnglAsset/Borr	Private	Wells Fargo	1,000,000,000	8/18/11	Private
FREMF 2011-K14	Conduit	Government	JP Morgan	1,191,595,324	8/10/11	Government
WFRBS 2011-C4	Conduit	Private	Wells Fargo	1,480,697,060	8/9/11	Private
JPMCC 2011-CCHP	SnglAsset/Borr	Private	JP Morgan	425,000,000	8/8/11	Private
COMM 2011-THL	SnglAsset/Borr	Private	Deutsche Bank	975,000,000	7/28/11	Private
GSMS 2011-GC4	Conduit	Private	Goldman, Sachs & Co.	1,476,098,883	7/28/11	Private
BAMLL 2011-FSHN	SnglAsset/Borr	Private	B of A Merrill Lynch	410,000,000	7/14/11	Private
LNSTR 2011-1	Conduit	Private	JP Morgan	359,479,580	6/30/11	Private
FREMF 2011-K702	Conduit	Government	JP Morgan	1,199,030,698	6/29/11	Government
DBUBS 2011-LC2	Conduit	Private	Deutsche Bank	2,143,913,255	6/28/11	Private
JPMCC 2011-C4	Conduit	Private	JP Morgan	1,447,107,234	6/23/11	Private
MSC 2011-C2	Conduit	Private	Morgan Stanley	1,213,951,725	6/22/11	Private
FREMF 2011-KAIV	SnglAsset/Borr	Government	B of A Merrill Lynch	672,342,988	6/9/11	Government
WFRBS 2011-C3	Conduit	Private	Wells Fargo	1,446,013,394	6/9/11	Private
FREMF 2011-K13	Conduit	Government	B of A Merrill Lynch	1,250,189,452	5/26/11	Government
FDIC 2011-C1	Conduit	Government	Wells Fargo	374,286,161	4/29/11	Government
CFCRE 2011-C1	Conduit	Private	Cantor Fitzgerald & Co	633,243,881	4/28/11	Private
FREMF 2011-K12	Conduit	Government	Wells Fargo	1,208,640,464	4/27/11	Government
FREMF 2011-K11	Conduit	Government	Deutsche Bank	1,185,559,783	3/31/11	Government
GSMS 2011-GC3	Conduit	Private	Goldman, Sachs & Co.	1,395,649,099	3/30/11	Private
JPMCC 2011-C3	Conduit	Private	JP Morgan	1,498,807,353	3/18/11	Private
GSMS 2011-ALF	SnglAsset/Borr	Private	Goldman, Sachs & Co.	325,000,000	3/17/11	Private
WFRBS 2011-C2	Conduit	Private	Wells Fargo	1,294,512,851	3/10/11	Private
FREMF 2011-K701	Conduit	Government	Morgan Stanley	1,014,943,804	3/9/11	Government
MSC 2011-C1	Conduit	Private	Morgan Stanley	1,541,988,998	2/28/11	Private
DBUBS 2011-LC1A	Conduit	Private	Deutsche Bank	2,166,212,202	2/25/11	Private
FREMF 2011-K10	Conduit	Government	JP Morgan	1,162,468,621	2/10/11	Government
Total Single Asset	**$3,807,342,988**	**Total Gov/Agency**		**$9,259,057,295**		
Total Conduit	**$26,684,389,822**	**Total Private**		**$21,232,675,515**		
	Total-All Issuance Type			**$30,491,732,810**		

Source: Federal Reserve Bank of New York, TREPP, FDIC, Freddie Mac

The Bulls, The Bears & The Bewildering

Surprise – last week scored *Bearish*.

The uncertainty of the debt ceiling overshadowed what should have been a *Bullish* week from the standpoint of earnings. We debated trading-out the *Bewildered* category in the Scoreboard for "troubled" after the news on GDP, manufacturing, and housing. The market is less bewildered about the volatility in the economic data and has become troubled enough by it to idle plans to hire, expand, or add capital equipment. Consumers and business leaders' confidence has been adversely impacted by the D.C. paralysis over managing the country's fiscal crisis. It should therefore be no surprise that the market forecast is being revised for Q3 from:

"Slow growth while we cut big government debt" to "No growth while government can't act." Before delving further into the *Bulls, Bears & Bewildered* news of the past week, remember to contact Colliers about your interest in subscription to the Weekly Market Recap. This is the final complementary edition to be distributed to those of you on a trial-basis. Effective August 1st, the WMR will be distributed on a subscription only basis. There are two levels of subscription offered: one for individuals and an enterprise level for businesses. Please contact either Daniel Briggs or KC Conway for subscription details. Sales and Marketing contact information may be found on the last page of this publication.

Q2 2011 EARNINGS BY SECTOR

S&P 500 SECTORS	EARNINGS %
Energy	+ 12.14%
Healthcare	+ 10.65%
Cons. Discretionary	+ 6.54%
Cons. Staples	+5.86
Utilities	+5.52%
Industrials	+3.42%
Materials	+2.57%
Tech	+0.63%
Financials	-8.48%

IT'S AMAZING HOW RETAIL IS INNOVATING DESPITE A TOUGH CONSUMER ENVIRONMENT. THIS INNOVATION IS EVIDENCE THAT EVEN IN THE WORST OF TIMES THERE IS OPPORTUNITY.

THE BULLS

The *Bullish* news of this past week was a continuation of the Q2 earnings story. The week before last, 75% of the 88 S&P 500 companies reporting earnings beat estimates. That trend continued with 182 more companies reporting last week. In aggregate, 202 of the 270 companies to report earnings for Q2 2011 have surpassed earnings estimates. Energy and healthcare sectors continue to lead, and financials continue to drag, turning in the worst performance of all S&P 500 sectors.

The other noteworthy *Bullish* item of the week was that business continues to evolve and innovate despite the headwinds from Washington. A good example is Wal-Mart, which introduced its new "Wal-Mart Express" concept store in Chicago. The Express store is a hybrid discount dollar and drug store designed to offer both convenience and discount dollar-store type merchandise in a new package to gain back market share lost to both discount dollar stores and drug stores. It's amazing how retail is innovating despite a tough consumer environment. This innovation is evidence that even in the worst of times there is opportunity.

An extension of this retail innovation is a developing trend with respect to shop space leasing in Class B/C retail centers. The presumption thus far in this recession is that the Class A centers would stay leased up because of the draw by anchor tenants, and that Class B/C centers would struggle to maintain or rebuild occupancy. Just the opposite is occurring. One example is dollar discount stores. Increasingly, tenants like Dollar Tree are leaving the Class-A, grocer-anchored centers and relocating to nearby Class B/C centers that have lost a grocer, hardware store, or drug store. The rent differential is substantial (40%-60%), and allows the discount dollar store to operate at a much lower cost without any loss in sales, given the established identity in the neighborhood and similar arterial visibility. Because retailers have seen gross sales decline 25-50%, their occupancy costs must also decline in order for the store to remain profitable. Where Class A shopping center owners refuse to adjust rents down to reflect an occupancy to gross sales ratio in the 10%-15% range, shop-space tenants are relocating to nearby Class B/C centers where that kind of ratio can be achieved.

Ironically, we may be seeing the revitalization of Class B/C retail due to declining sales and consumer spending. This trend has material value implications for both Class A and Class B/C retail centers. Contact a Colliers retail specialist for assistance in translating this trend for a particular market or property.

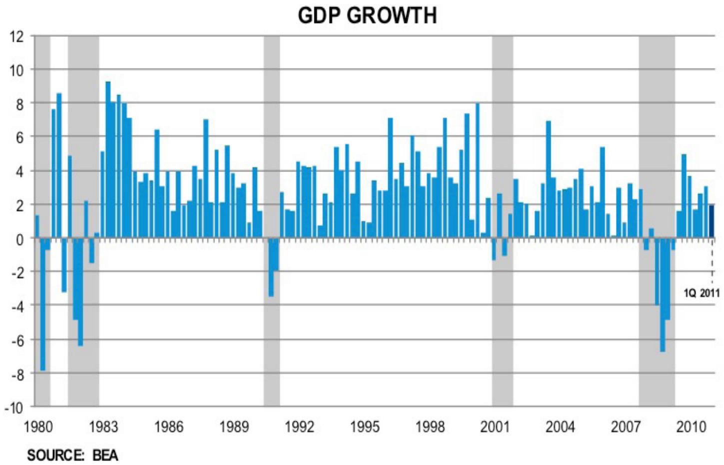
THE BEARS

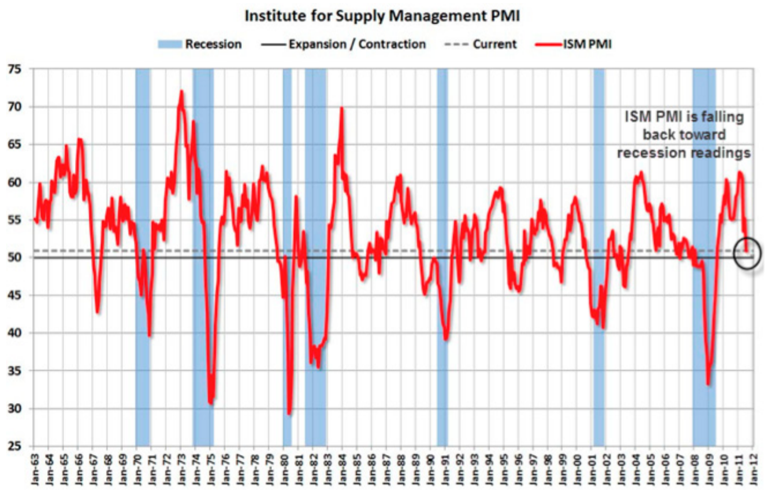
The *Bearish* news of the past week was symptomatic of what follows three months of pounding away at business and consumer confidence. Q2 GDP collapsed nearly one-third to an "advance reading" of just 1.3% from a disappointing 1.9% reading in Q1. Durable goods fell 2.1%. Pending home sales declined as cancelations quadrupled to 16% from a normal monthly rate of 4% according to the National Association of Realtors.

Three more banks failed Friday July 29th, and manufacturing is now slowing beyond the supply disruptions emanating from the Japan earthquake last March. The ISM reported its business barometer fell to 58.8 in July from 61.1 the prior month. Figures at or below a reading of 50 signal recession.The key details and data charts from these *Bearish* metrics follow.

GDP

Friday's report on GDP was market moving from two perspectives. First, the "advance estimate" on Q2 GDP was well below expectations at just 1.3% and the previously reported 1.9% for Q1. Secondly, the revised estimate of Q1 GDP plummeted to just 0.4%. The revisions are part of the government's annual updates derived from broader, more complete surveys. Data back to 2003 was subject to revisions, and some components were updated for the entire history of the series, according to the Bureau of Economic Analysis. Both the revisions and advance estimate for Q2 GDP suggest economic recovery is much weaker than previously thought, and that the U.S. economy could slip back into recession by Q4, based on the latest readings for manufacturing, employment, and consumer spending. The probability of a "double-dip" recession by year-end 2011 is more likely than not, especially with the end of stimulus spending, more state budget cuts ahead, and the likelihood that any deficit ceiling legislation will entail at least $1.0 trillion in federal spending cuts.





Employment

UNEMPLOYMENT INSURANCE DATA FOR REGULAR STATE PROGRAMS					
WEEK ENDING	ADVANCE JULY 23	JULY 16	CHANGE	JULY 9	PRIOR YEAR
Initial Claims (SA)	398,000	422,000	-24,000	408,000	457,000
Initial Claims (NSA)	366,578	470,081	-103,503	473,963	413,679
4 WK Moving Avg. (SA)	413,750	422,250	-8,500	424,000	455,750

Although weekly jobless claims fell below 400,000 for the first time in many weeks, the 4-week moving average remains elevated above 400,000 claims. One week of decline does not constitute a trend. The state-by-state comments suggest the decline was attributable to fewer cuts by state government - which had previously cut in June and early July as 40 of 50 states commenced new fiscal year budgets. The July jobs report next Friday will provide some clarity as to whether last week was a dip from fewer state government layoffs, or the beginning of some hiring post the Japan earthquake supply disruptions.

STATES WITH A DECREASE OF MORE THAN 1,000		
STATE	CHANGE	STATE SUPPLIED COMMENT
NY	-17,377	Fewer layoffs in the education related services.
MN	-10,352	Fewer furloughs in state government.
MI	-7,039	Fewer layoffs in the automobile industry.
OH	-5,037	Fewer layoffs in the automobile industry.
PA	-3,347	Fewer layoffs in the education related services.
IN	-1,806	No Comment.
CT	-1,169	No Comment.
AZ	-1,104	No Comment.

Manufacturing

Manufacturing has slowed beyond the disruptions from the March Sendai, Japan earthquake. The latest July reading from the ISM PMI indicates that multiple sectors beyond auto manufacturing are slowing and that manufacturing activity is dangerously close to recession readings at or below 50.

Bank Failures

Three more banks failed Friday, July 29th. The three banks were located in Indiana, South Carolina, and Virginia. This brings the number of U.S. bank failures to 61 so far in 2011, preceded by 157 in 2010, 140 in 2009, and 25 in 2008.

The failed banks were:

- Richmond, Virginia-based Virginia Business Bank, with total assets of about $95.8 million and total deposits of about $85.0 million as of March 31, 2011.
- Columbia, South Carolina-based Bank Meridian, N.A., with about $239.8 million in total assets and $215.5 million in total deposits as of March 31, 2011.
- Evansville, Indiana-based Integra Bank, National Association, with about $2.2 billion in total assets and $1.9 billion in total deposits as of March 31, 2011.

The FDIC continues to insure 7,575 financial institutions, of which nearly 900 are on its "watch list" for failure.

Pending Home Sales Decline

Early in Q2, the *Weekly Market Recap* for the week April 25-29 cautioned about misinterpreting rising pending home sales as an indication of a housing recovery. It was noted that the rise in pending home sales was attributable to more onerous mortgage underwriting that created, a backlog of mortgage applications and delaying closings. It was suggested that pending home sales could fall in the summer if the mortgage underwriting delays persisted and consumers lost confidence in their jobs or the economy. This past week we observed such a decline in pending home sales. Cancelations quadrupled their normal monthly rate of 4% to 16% as prospective homebuyers became rattled by the news on employment, GDP and, home prices.

THE BEWILDERED

The WMR for the week ending July 22nd scored *Bewildering* as the lead sentiment. This past week, not even stellar earnings could move the market from anything but a *Bearish* outlook. The chaos in Washington D.C. over the debt ceiling, declining durable goods orders, falling consumer sentiment, and an alarming report on GDP sent the market into a retrench mode during all five trading days. Gold shot up to a new record of $1,631 per ounce, and silver prices rose back above $40 per ounce, as forecast by the WMR when silver prices declined in early May. Despite the *Bewildering* losing out to the Bears this past week, there was plenty to be *Bewildered* about.

THE FEDERAL RESERVE REMAINS DISCONNECTED FROM THE REAL ECONOMY WHEN IT MAKES ASSERTIONS THAT "ECONOMIC ACTIVITY CONTINUES TO GROW."

Treasury Yields below 3.0%

Treasury yields staying below 3.0% during the entire week was absolutely amazing. How can the U.S. dollar decline and the U.S. debt be so elevated that the world stood on the brink of a sovereign debt crisis, yet the U.S. Treasury be regarded as so secure as to command such a low yield?

S&Ps refusal to issue ratings on new CMBS

S&P's unprecedented move to refuse issuance of a rating on two CMBS issuances the day before the transaction closed was my top pick for *Bewildering*. The implications for new issuance the remainder of 2011 is huge. What's going on with DSCR calculations at the rating agencies after 20 years of calculating them is most troubling.

Finally, the Federal Reserve's Beige Book, or Summary of Economic Conditions, rounded out the *Bewildering* news of the week. The Federal Reserve remains disconnected from the real economy when it makes assertions that "Economic activity continues to grow," "Consumer spending is increasing," and "Manufacturing activity continues to expand and the near-term outlook remains positive" when durable goods orders decline 2.1%, the ISM PMI declines to within a few points of recession territory, and GDP collapses to 1.3%. Furthermore, the Federal Reserve's visible absence during this past week – except at the annual Jackson Hole, Wyoming boondoggle - when banks looked for guidance on managing liquidity, lending activity, and valuation of assets was market rattling. When the secretary of the Treasury is unable to devise a plan of payments in the event the debt ceiling is not raised, and the chairman of the Federal Reserve waits until Friday to engage banks in liquidity and credit discussions, the market loses confidence in the U.S. central bank.

An absence of leadership in Congress, the Federal Reserve, Treasury, and the White House was the most Bewildering item of the week.

Given the absence of leadership at so many levels, it is tempting to re-label the Scoreboard the *Bulls, Bears and Troubled*.

THE ECONOMIC CALENDAR FOR THE WEEK AHEAD: AUGUST 1–5

Congress can't resist an encore performance and will likely keep the debt ceiling drama going well into the week. A last minute compromise will twist and turn in the wind as the market gets buffeted like a flight through a summer thunderstorm. At some point, the rating agencies wane of the inaction and just downgrade the U.S. debt rating. This threat is increasingly understood by the market and will overshadow the remainig earnings news for Q2 and all economic news next week except one item – Friday's jobs report. The Challenger jobs cut, ADP private employment hiring, and Monster online job listings reports will hardly garner attention amidst the ongoing debt ceiling rhetoric. However, Friday's jobs report is report card time. If unemployment rises further from 9.2% , and total job creation remains below 100,000 jobs, "katy bar the door." The rating agencies will be forced to downgrade the U.S. debt rating from "AAA" as David Stockman suggested in the quote of the week.

Focus on just two items in the week ahead:

1. The details of any debt ceiling compromise. If the legislation is a feeble attempt to reign in spending and delay our own austerity measures, the market will vote quickly via the major market indices.

2. Friday's BLS jobs report for July. Another shocker that will trigger a U.S. debt downgrade is likely ahead. I fear another abyssmal jobs report will signal that like Greece, the U.S. lacks the growth to pay its way back to creditworthiness. Keep the following statistic in mind for the week ahead: $319,587

Remember that is the per capita figure for all U.S. debt – federal, state, municipal, consumer and mortgage. For my household, our share of U.S. debt is a mere $1.6 million.

KEY ECONOMIC & FINANCE RATES

US UNEMPLOYMENT (JUNE):

U-3 (official rate)	9.2%
U-6 (total rate)	15.8%

Note: Next Report is Aug 5

JOBLESS CLAIMS: (JULY)

Initial (July 16th)	398,000
Initial (Prior Wk)	422,000
4-Wk Average	413,750

HOME FORECLOSURES:

CY 2011	1,100,000
CY 2010	1,005,000
CY 2009	918,000
Dec 2010	69,847

Note: Decrease from the previous week.

GROSS DOMESTIC PRODUCT:

Q2 2011(Advanced)	+1.3%
Q1 2011 (Revised)	+0.4%
Q4 2010	+2.8%
Q3 2010	+2.6%
CY 2010	+2.9%

TREASURY RATES (JULY 29):

2-Year Tr	0.36%
10-Year Tr	2.80%

LIBOR

6-Month	0.42%
3-Month	0.25%
1-year	0.74%
PRIME % (US)	3.25%

(Fed FOMC Mtg Aug 9th)

MORTGAGE RATES (JULY 29):

30-yr Fixed	4.78% (up 3 basis points)
15-yr Fixed	4.01% (up 1 basis point)

CONSUMER PRICE INDEX:

June 2011	-0.2%
May 2011	+0.2%
April 2011	+0.4%
Mar 2011	+0.5%

CMBS DELINQUENCY:

(Source: TREPP)

9.37% - June 2011	down 23 bps
9.60% - May 2011	down 5 bps
9.65% - Apr 2011	up 23 bps
9.42% - Mar 2011	up 3 bps
9.39% - Feb 2011	up 5 bps
9.34% - Jan 2011	up 32 bps

COMMODITIES:

Gold ($/oz June 22)	$1,631
Gold (high: 5/4/11)	$1,541
Oil (WTI) July 15' 11	$95.70
Oil (High) Jun 13' 08	$135.00

DISCUSSION ITEM

Because I fear the U.S. is likely to see a downgrading of its triple-A debt rating despite an increase to the U.S. debt ceiling, banks, businesses, and real estate professionals should be actively engaged in discussions as to what happens to credit, liquidity, and asset values when a country's debt rating is downgraded. We have modern-day examples involving Australia, Canada, and Japan that all suggest a credit downgrade is not economically insurmountable. Therefore, the discussion item for the week is:

How will U.S. property values change if the U.S. debt rating is downgraded from triple-A?

As appraisers, the consequences of a U.S. debt downgrade are now no longer a "hypothetical condition." The market is beginning to price into credit the cost of a lower debt rating. How will cap rates change? What is the new "risk-free" rate, and should appraisers and clients be re-engaging in discussion over the Scope of Work in a post debt downgrade environment?

To our regulatory colleagues, will banks be required to reappraise all collateral as a U.S. debt downgrade will clearly be a "material change" in market conditions?

To our banking colleagues, have you engaged your primary regulator in a discussion as to your ALLL and appraisal requirements in the event of a U.S. debt downgrade? What happens to the value of your municipal bond holdings?

To both our banking and regulatory colleagues, some interagency guidance might be advised.

To our professional associations at the Appraisal Institute, Counselors of Real Estate, and Royal Institute of Chartered Surveyors, a conference call with members or in conjunction with the upcoming August Appraisal Institute conference might be appropriate to explore answers to these questions.

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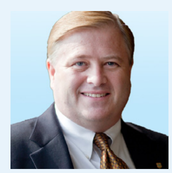

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