

# 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 a Bearish two weeks we've just concluded. Starting with the disappointing employment reports from Challenger, ADP, and the BLS July 6th through July 8th, and concluding this past week with the worsening sovereign-debt crisis, it might feel like the Bull has become extinct. The following recent events are just a brief synopsis of what has bombarded American businesses and consumers over the past two weeks:

- On July 9th, the first state government shutdown occurred since the onset of this state and municipal debt crisis - which commenced with the bankruptcy of Vallejo, California in May 2008. The shutdown of the state of Minnesota is a microcosm of what to expect at a federal level come midnight August 4th. July 4th may remain the date we celebrate our freedom, but if we default on our debt, August 4, 2011 could become the day we remember for the loss of our economic independence. Minnesota has laid-off 22,000 state workers, halted approximately 100 road projects, barricaded 66 state parks and all Interstate rest stops, and ceased funding to all but vital services. **What are vital services?** The courts are now working to define this as the state feels its way through the reality of a shut down. What services will be funded by Treasury Secretary Geithner? Congress and the President don't have the answers to these questions. **Will the General Services Administration (GSA) make rent payments to property owners leasing space in some 12,000 properties?** What about Amtrak service in the Northeast, or operations at hospitals dependent on federal Medicaid and Medicare payments? What happens to our military and their families at home if their pay is disrupted? We are two weeks from a potential default on our debt and a possible government shutdown. No leader in Washington

can answer these basic operational questions. **To our banking colleagues: would that kind of business disruption plan be acceptable to your primary regulator?** If you thought things were tough in 2009 when banks wouldn't lend to each other, wait until you see what happens if the U.S. defaults on its debt.

**A debt default by the U.S. is economic suicide.** Chairman Bernanke can forget QE3 after August 4th, because our fiat currency will finally be regarded as worthless and the "promise to pay" will have been broken. Maybe Chairman Bernanke needs to take a crash course on the history of fiat currencies. A great article to begin with is: *How International Monetary Trends Affect Real Estate Values*, by John Lifflander.

- **On July 11th**, we learned why throwing more dollars at education, or banks and entitlement programs for that matter, produces poor results in the absence of controls. The nationally covered Atlanta public schools cheating scandal could be anywhere in the U.S. where such controls are absent. The sad part of this scandal is the economic damage is immeasurable. First, there is a lost decade of children who have been moved through their formative years without preparation for higher education and a demanding job market. Second, there is the economic toll on metropolitan Atlanta on two fronts: the damaged reputation that will undoubtedly discourage corporations from wanting to remain based in an MSA with such a dysfunctional education system; and the "guilty by association" damage done to the larger surrounding suburban school system. Atlanta is a donut-hole of about 700,000 people in a nearly 6.0 million person CBSA. **Atlanta city public schools constitute less than 10% of the student population in metropolitan Atlanta, but they have tarnished the whole region.**

The Atlanta public school cheating scandal is another microcosm of the break down in so many of our institutions and systems of government that elevate the importance of this debt ceiling debate in Washington. Our elected officials at the federal, state, and municipal levels have let us down. If we do not now hold them accountable, we will have only ourselves to blame. Economic recovery cannot take root with this kind of waste and corruption. Private industry wouldn't be able to make quarterly payrolls and produce earnings if it conducted business in such a way. So why do we accept these failing grades from government leaders?

- **On July 11th**, we also bid farewell to the space shuttle program with the final launch of Atlantis. One of our Colliers colleagues, Todd Jones, MAI and Executive Managing Director of Property Tax Services, attended the last shuttle launch and spent time before and afterward talking with "Space-Coast" clients as well as many to-be-unemployed NASA scientists and mission specialists.

*"A tremendous brain-drain is about to occur in this country from Florida's space-coast and the Johnson Space Center in Houston", concluded Todd Jones regarding the final launch.*

This "best in math and science" that we have to offer are being recruited in mass to Asia and Europe. Reflecting upon all the programs and ventures that our federal government has undertaken, there is none to have yielded as much economically and technologically as the space program. Every major item or device in our daily lives – cell phones, computers, microwave ovens etc. – has its roots in the U.S. space program.

Just as it is a disgrace that we have a 25% unemployment rate for returning veterans from Iraq and Afghanistan, it's equally disgraceful that we are allowing this to occur.

*To the thousands of men and women who have served in our space program - thank you!*

- **Finally, this past weekend**, Angelinos prepared for "Carmageddon" as Interstate 405 was closed in Los Angeles for reconstruction. What could have been a more appropriate news story to cap two weeks of such *Bearish* news than "Carmageddon?" The preceding stories were selected to answer the question:

#### **What has happened to consumer confidence?**

Over the course of the past two weeks, we've received new readings on confidence levels for

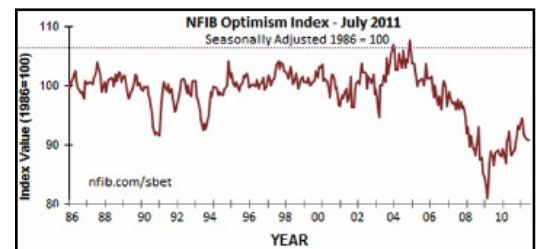
businesses and consumers.

These new readings by the Conference Board, University of Michigan, and the National Federation of Independent Businesses (NFIB) have plummeted.

- **Conference Board:** The Conference Board's *Consumer Confidence Index®*, which declined in May, decreased again in June. The Index now stands at 58.5 (1985=100), down from 61.7 in May.

- **University of Michigan:** This recognized measure of consumer confidence also fell in July to its lowest level in more than two years. The University of Michigan's Consumer Sentiment Index decreased to 63.8, the weakest reading since March 2009.

- **NFIB:** NFIB's monthly Small-Business Optimism Index dropped again in June, settling at 90.8, and is solidly in recession territory according to the NFIB.



What is *Bewildering* about this decline in confidence is that it has come as energy prices have retreated, IPO activity has risen to its highest level since 2007, and REITS have produced enviable double-digit 1H2011 returns. Simultaneous with this Weekly Market Recap, the Colliers International Valuation and Advisory Services' quarterly national overviews for multifamily, office, retail, and industrial real estate have been updated for Q2 2011. From these updated property type overviews, it's clear capital is returning to commercial real estate - and fundamentals are markedly better than 6, 12, or 18 months ago for all but retail real estate. Therefore, the question arises from the news, data releases, and refreshed analyses of property conditions:

#### **What is the latest Bulls, Bears and Bewildered score?**

*Until Congress resolves the uncertainty of the U.S. defaulting on its debt obligations, the market is likely to remain volatile and defer major decisions.*



# The Score Board

THE BEARS DOMINATE FOR A 2ND WEEK

**The score for past two weeks, as well as the 4-week moving average, has moved from Bewildering to Bearish.** Until Congress resolves the uncertainty of the U.S. defaulting on its debt obligations, the market is likely to remain volatile and defer major decisions. The June job numbers have clearly rattled the market, as well as business and consumer confidence.

Earnings from Q2 will likely do little to move the market from its *Bearish* outlook as the consequences of a sovereign debt crisis weigh more heavily on domestic and international capital piled up on the sidelines. The prescription needed to move the *Bulls, Bears and Bewildered* score back to *Bullish* territory is:

- 1 part deficit reduction plan.
- 1 part job growth without government stimulus.
- 1 part regulatory roll-back.
- 1 part change of attitude from “It’s evil to earn a reward for taking a risk” to rewarding economic risk undertaken by capital.
- 1 part resolution of European Union sovereign debt crisis. Why should we care about Europe? No other economic relationship in the world is as integrated as the transatlantic economy. The E.U. and the U.S. economies account together for about half the entire world GDP. The transatlantic relationship also defines the shape of the global economy as a whole.

# Economic Calendar

JULY 18 – JULY 22


The week ahead is not likely to produce any good news from new economic data releases. The forthcoming data is primarily focused on housing starts and the *FHFA Home Price Index*. The market will be focused on earnings releases for Q2 2011, and progress by Congress in resolving the impending U.S. debt default on August 4th. There are some sleeper items to be monitoring, though:

• Leadership changes in the regulatory regime: Sheila Bair left the FDIC’s Seidman Center July 8th, and the FDIC is under new leadership. June was the slowest month of bank closings in two years (4 closings) due to the transition. June’s four closings followed a spike in April (13 closings). Some key questions to be answered in 2H2011 include:

- Will the FDIC pursue more securitization of assets from failed banks like it did in May, or will it extend more life to the 888 banks on its watch-list due to a \$1 billion negative balance in the FDIC Deposit Insurance Fund as of end of Q1 2011?
- Will Tom Curry get confirmed as the new head of the OCC?** How will a community banker change the direction of the OCC as it incorporates the OTS?
- What happens to the behemoth Consumer Finance Protection Bureau** now that Congress didn’t take a recess and President Obama was denied his chance of making Elizabeth Warren a recess appointment? The CFPB’s duties commence this month as it takes over consumer regulation from the FED in August. Is the CFPB ready? Are the banks ready for the new sheriff?

• **Who will fill the giant shoes of the retiring Kansas City FED President - Tom Hoenig?** He has been the champion voice of reason and fiscal responsibility. Will the Kansas City FED elevate its First Vice President Esther George – a solid pick who understands community banking and has the same independent spirit of outgoing Tom Hoenig - to the top job? Or will the Board of Governors force Kansas City to elevate another Janet Yellen type to the top job?

*Together, the E.U. and the U.S. economies account together for about half the entire world GDP - and for nearly a third of the world trade flows.*

 <b>THE SCORE BOARD</b>			
	BULLS	BEARS	BEWILDERED
Week of July 15	5	7	5
Week of July 8	2	4	3
Week of July 1	4	3	3
Week of June 24	3	4	3
<b>4-Week Moving Average</b>	3.5	4.5	3.5

THE STATISTIC OF THE WEEK

**Approximately \$2 of every \$10 that went into Americans' wallets in 2010 were payments from the government.**

—Moody's Analytics

**By the end of 2011, Moody's Analytics estimates \$37 Billion will be reversed-out from the nation's pocketbooks as funding from the stimulus programs ends.**

THE HEADLINE OF THE WEEK

**How many lawmakers does it take to save a light bulb?**

—Associated Press

**This week's headline comes to us complements of the Associated Press in a July 12th story addressing a group of Congressmen pushing legislation that would overturn measures in the 2007 energy act requiring efficiency upgrades in to the old-fashioned incandescent light bulbs. At a time when we face 9.2 percent % systemic unemployment, a sovereign debt crisis, and a looming deadline for the U.S. to extend its debt ceiling, we have legislators focused on reversing legislation that will reduce energy consumption, versus legislation that will reduce government spending. Where are the priorities of our elected officials?**

Governor Yellen's duty as the FED's newest Governor was to draft the new "gag" orders on participants in the FOMC process. So much for more transparency. Chairman Bernanke now has "spin control" on all FOMC meetings via his new briefings - and the cover of Governor Yellen's "gag" orders on FOMC members. At least the FED still has a few good men left in the likes of a Jim Bullard (President of St. Louis FED), Jeff Lacher (President of Richmond FED), Richard Fisher (President of Dallas FED) and Sandra Pianalto (President of Cleveland FED).

**• Release of the much awaited Government Accountability Office (GAO) audit of the Federal Reserve** called for in the Dodd-Frank legislation. If last week's hearings between Congress, the Appraisal Subcommittee, the Appraisal Foundation and the Appraisal Institute are any indication of what is to come, **the GAO audit report may make the top 10 on the NY Times reading list.** If ever there

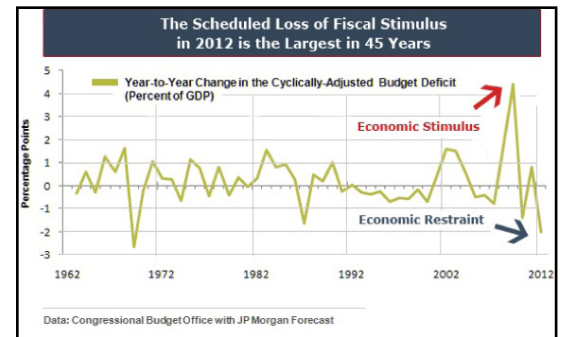
were an argument for Congress to revisit the whole Appraisal Foundation and Appraisal Subcommittee structure, it was handed to them by the atrocious performance of Jim Park – Executive Director of the Appraisal Subcommittee this past week. The Appraisal Institute did a commendable job highlighting the failings of the Appraisal Subcommittee, Appraisal Foundation and this new Recognized Appraisal Practices Board created in 2010

**• QE3 by the Federal Reserve:** The Federal Reserve is very concerned about the latest economic and employment readings. It has thrown everything it knows at this financial crisis and recession, yet employment has failed to respond. The Great Depression holds few lessons for how to handle a sovereign debt crisis. **The Federal Reserve is just now coming around to the realization that round two of this recession may be combating a sovereign debt crisis.** The financial crisis may look easy by comparison.

STATISTICS & HEADLINES FOR THE WEEK JULY 5-JULY 15

The statistics that stood out this past week all relate to the economic impact from stimulus in 2010, and the resulting economic impact from the end of stimulus by the end of 2011. The question to ask - compared to prior stimulus programs during periods of recession - is: **Did we get much bang for the buck from the debt we incurred for our children to pay off?**

1. Approximately \$2 of every \$10 that went into American wallets in 2010 were payments from the government such as jobless benefits, food stamps, Social Security and disability, according to a just published analysis by Moody's Analytics.
2. By the end of 2011, Moody's Analytics estimates \$37 billion will be reversed-out from the nation's pocketbooks as funding from the stimulus programs end. In states hit hard by the downturn, such as Florida and Michigan, residents derived even more income from the government.



**3. When 2012 begins, the economy is scheduled to lose more than \$300 billion in federal support, as stimulus programs expire.** Policy changes will result in the most severe fiscal tightening in more than 40 years, subtracting an estimated 1.5 percentage points from GDP growth in 2012, according to an analysis by J.P. Morgan.

EXPIRING STIMULUS PROGRAMS & THEIR IMPACT ON 2012 GDP		
Program	Lost Stimulus (\$B)	GDP Impact (% of GDP)
Payroll Taxes	-\$110	-0.5%
Unemployment Insurance	-\$50	-0.3%
Accelerated Depreciation	-\$25	0.0%
State & Local Transfers	-\$50	-0.2%
Infrastructure & Other	-\$75	-0.5%
<b>Total</b>	<b>-\$310</b>	<b>-1.5%</b>

SOURCE: J.P. Morgan

# The Bulls, The Bears & The Bewildering

## THE QUOTE OF THE WEEK

**“Home sales may remain lackluster - to put it nicely - but apartment rentals are booming.”**

—Rusty Pulliam, Pulliam Properties

**Rusty Pulliam, CEO of Pulliam Properties, regarding the market response to a recently repositioned condo to rental project in Ashville, NC. Pulliam's perspective is not atypical. Multifamily real estate has seen vacancy rates drop in the last twelve months to the 6.0% range, and rents rise approximately 3.0% in just the first-half of 2011. Later in this recap, more details will be provided as to why multifamily real estate is the shining-star among commercial real estate property types.**

As previously noted in the introduction to this week's market recap, the latest news is quite *Bearish*. Rather than dwell on all that made us want to go into economic hibernation, this week's *Bulls, Bears & Bewildered* discussion focuses on the state of the core commercial real estate property types. The highlights from the just produced national property overviews will be presented as either a *Bullish, Bearish, or Bewildering* by property type. Within the *Bulls, Bears & Bewildering* discussions, the detail tables from the consumer confidence, employment, inflation, and manufacturing data releases will still be presented - just without much commentary. How many ways do we need to say it's *Bearish*? If you wish to receive a full copy of these in-depth property analyses, please refer to the sales and marketing contact info at the end of this *Weekly Market Recap* to receive all four Q2 property type overviews.

by both JP Morgan and Wells Fargo which included non-core property types (self storage and RV parks) in secondary markets.

This activity will likely slow in Q3 as banks have been rushing to complete new issuances in advance of the Federal Reserve's final capital rules regarding risk retention (anticipated in August). Another sign of the demand for CMBS was Prudential's recent announcement that:

*“Prudential Mortgage Capital Co. and the Perella Weinberg Partners affiliate Asset Based Value strategy have formed a joint venture to originate commercial mortgages for future securitization.”*

According to the companies, the joint venture will originate loans through Prudential Mortgage Capital Co.'s platform. The loans will then be warehoused and securitized by the joint venture and serviced by Prudential Asset Resources. The joint venture is initially targeting \$1.0 billion a per year in fixed-rate mortgages for stabilized commercial properties across all asset classes.

*“Participation in the re-emerging CMBS market is critical to maintaining our leadership position in the commercial mortgage arena,” stated David Twardock, president of Prudential Mortgage Capital Co. in the press release announcing the venture.*

Other *Bullish* news of the past week included REIT profits. U.S. real estate investment trusts (REITs) outperformed the broader equity market in the second quarter and the first half of this year, according to new data from the National Association of Real Estate Investment Trusts (NAREIT). According to NAREIT, the U.S. REIT industry's total equity market capitalization was \$455 billion at June 30, up 17% from \$389 billion at Dec. 31, 2010. The average daily dollar trading volume was up more than one-third to \$4.6 billion in June, compared with \$3.4 billion in December 2010.

***Among the larger REIT market sectors, apartments led with a 14.11% total return in the first half of this year, while the office sector was up 12.5%, the industrial sector was up 11.03% and the retail sector was up 10.34%***

## MULTIFAMILY METRICS Q1 2011: VACANCY FALLS 6% & RENTS INCREASE 0.4%

Market	FIRST QUARTER 2011			CHANGE FROM PREVIOUS QUARTER		
	Asking Rent	Vacancy	Rent Change	Vacancy Basis Pt Change	Inventory Growth	
Southwest	\$775	8.4%	0.5%	-50	0.0%	
S. Atlantic	\$946	7.0%	0.4%	-40	0.0%	
West	\$1,185	5.3%	0.3%	-50	0.0%	
Northeast	\$1,504	4.2%	0.4%	-30	0.1%	
Midwest	\$847	6.0%	0.4%	-30	0.0%	
<b>United States</b>	<b>\$1,047</b>	<b>6.2%</b>	<b>0.4%</b>	<b>-40</b>	<b>0.0%</b>	

SOURCE: REIS®



### THE BULLS

Despite the headlines, there has been some *Bullish* news. Initial Public Offering (IPO) activity is at its highest level since 2007 as cash looks for places to go to work. Google is just the latest IPO coming to market. In addition to increased IPO activity, Commercial Mortgage Backed Security (CMBS) activity has picked up. Approximately \$4.5 billion in new issuance is in the pipeline. This new activity is on the heels of an active month in May with profile deals

## National Property Type Overviews – Q2 2011

Among the core commercial property types, apartments are the shining star and office is experiencing the greatest dollar volume of capital inflows. While the strong performance of multifamily real estate may not be a surprise, some of the details behind multifamily and office property performance may have escaped your attention. The following are highlights from the updated Q2 national overviews for these two property types.

### Multifamily

- **Multifamily real estate is outperforming all commercial property types.** Apartments are the only income producing property type experiencing both single-digit vacancy rates and rental rate growth.

- **Rent growth is strongest in markets located in growth restricted areas,** such as coastal California, Austin, Boston, and Washington D.C. Year-to-date 2011, Class A and B+ apartment rents are up in excess of 3.0%. Rent growth is also occurring in cities where employment has stabilized and the economy has started to expand, such as Charlotte, Dallas, Denver, Miami, and Raleigh.

- **Apartment demand is being fueled by demographics.** College graduates entering the workforce, as well as young professionals, are increasingly opting to rent versus own for several reasons, including the desire to reside in an urban setting without costly commutes.

- **Constrained mortgage credit and new supply are also factors in the Bullish story** for multifamily real estate. According to Dodge Pipeline, new multifamily completions have fallen from approximately 54,000 units in Q4 2008 to less than 7,000 units estimated for Q2 2011. The 75 most active apartment markets in the U.S. will deliver less than 4,000 units in Q2 2011, compared to an average of 28,000 units per quarter in 2008.

- **Investment capital is back.** This combination of rent growth and constrained new supply is attracting investment capital back to multifamily real estate. The best statistic corroborating the return of capital to multifamily is that 80 of the most active 100 apartment property investors pre-2008 have returned to the market with the purchase of at least one property.

- **The other key risk to monitor is** whether capitalization rates will once again become compressed to levels that encourage the kind of overbuilding and over-leverage that occurred between 2002 and 2004.

### Office

- **Office was the second best performing commercial property type in the first half of 2011** - even with an elevated vacancy rate above 15%.

- **Capital is flooding back into office properties** as investors look to rotate out of cash, U.S. Treasuries, and fixed-income investments. All are vulnerable to value erosion during inflation.

- **Average cap rates have compressed** from an 8%-9% range in 2009 and 2010, to a low to mid 7% range due to competition for Class A properties in core MSAs and select secondary markets like Denver and Houston.

- **The demand is strongest for leased-up properties located in Central Business Districts (CBDs) with quality rent roll profiles** (credit quality tenants with limited tenant-turnover risk during the next 5 years). Institutional capital remains leery of value-enhancement and suburban office properties where vacancies are near 20%.

- **REITS and hedge funds in search of profit yields are beginning to venture into the non-core markets,** but remain focused on properties located in the CBDs.

- **Surprisingly, four office markets have set either leasing or pricing records in Q2 2011:**

- New York - Manhattan set a leasing record in May with 4.32 million square feet of net leasing resulting in an overall NY CBD vacancy rate below 10% for the first time since spring 2009;

- Boston - recent sales of Class A office buildings in Boston's CBD ranged from \$600 to \$650/SF. The price of admission to own a Class A office building in the Boston CBD appears to be \$600 per square foot; and

- Denver - two buildings, one CBD and one suburban, have recently sold at prices that set two-decade highs for Denver office building prices.

- According to Dodge Pipeline, there are approximately 50.685 million square feet of office space currently under construction in the U.S. totaling \$13.5 billion in construction costs (or an average of \$266/SF). Seventy-three percent of this \$13.5 billion in new office construction is concentrated in just 25 projects totaling 23.4 million square feet. The largest 25 projects are located in core markets in the Northeast and Mid-Atlantic (northern Virginia and Washington D.C.).

*Multifamily real estate is outperforming all commercial property types. Apartments are the only income producing property type experiencing both single-digit vacancy rates and rental rate growth.*



**THE BEARS**

The primary *Bearish* news of the past two weeks went well beyond our perennial employment and housing bears to:

- Declining business and consumer confidence;
- Declining retail expansion (lowest rate in 40 years);
- Lingering concerns over inflation despite a retreat in energy prices;
- Growing concern of an impending sovereign debt crisis.

Retail is the one commercial property type clearly in *Bearish* territory. Before examining what ails retail real estate, let's run through the economic data releases that have rattled the market of late:

**Housing**

RealtyTrac released its latest ranking of the 10 states with the highest foreclosure rates. The good news for California, Florida, and Michigan is they are no longer among the two worst states. The bad news is that they still rank among the 10 worst states at numbers 3, 7, and 6 respectively. Nevada and Arizona hold the number one and two spots for most foreclosures when analyzed on a per household basis.

U.S. STATES WITH THE HIGHEST FORECLOSURE RATES - JUNE 2011					
Rank	State	Rate per Households	Properties With Filings (June)	Change from May 2011	Change from June 2010
1	Nevada	1/114	10,007	-9.35%	-22.06%
2	Arizona	1/205	13,447	2.48%	-6.77%
3	California	1/248	54,087	4.20%	-21.74%
4	Utah	1/294	3,237	24.02%	-9.81%
5	Idaho	1/344	1,861	33.59%	-16.51%
6	Michigan	1/352	12,919	-11.60%	-24.54%
7	Florida	1/372	23,769	-23.85%	-53.89%
8	Georgia	1/418	9,715	-7.50%	-19.29%
9	Illinois	1/480	11,014	4.16%	-25.24%
10	Colorado	1/498	4,357	4.06%	-5.10%

Link to "States With Highest Foreclosures" <http://www.cnbc.com/id/29655038?slide=7>  
 SOURCE: REALTY TRAC

**Manufacturing**

Manufacturing in the New York region contracted for a second straight month in July as orders shrank at a faster pace. This decline in the *Empire State Manufacturing Index* is another sign

the manufacturing industry may be at risk of stalling. It suggests the decline in manufacturing extends beyond the supply disruptions from the Sendai earthquake. Mounting inventories and a slowdown in consumer spending indicate a pickup in manufacturing may depend more upon the strength of exports and demand for business equipment. *The Empire State Index* is considered a key bell-weather for U.S. manufacturing because New York ranks third among all states for manufacturing behind Texas and California. New York and New Jersey – which are included in the Empire State Index – account for 7.5% of U.S. manufacturing, or more than Illinois, Michigan, or Ohio.

Item	NAICS-Based Product Code Groupings				Total	
	Manufactured Commodities		Mfg & Non-Mfg Commodities		April	Year-to-Date
	April	Year-to-Date	April	Year-to-Date		
U.S. Total	91,399.2	347,682.3	100.0	123,786.9	474,896.2	
Foreign Trade Zone	2,462.8	9,047.7		2,6	11,114.4	
1 Texas	16,571.8	60,239.3	17.3	21,496.3	79,351.6	
2 California	8,442.8	32,783.5	9.4	12,883.1	50,346.2	
3 New York	3,906.6	16,695.6	4.8	6,618.9	27,408.1	
4 Florida	3,753.8	14,076.4	4.0	5,457.3	20,331.2	
5 Illinois	4,393.7	15,826.0	4.6	5,484.3	20,222.9	
6 Washington	3,475.2	13,412.4	3.9	5,084.4	19,535.1	
7 Louisiana	2,989.1	11,390.9	3.3	4,469.1	19,456.9	
8 Michigan	3,713.4	14,172.5	4.1	4,322.7	16,392.5	
9 Ohio	3,338.1	13,057.4	3.8	3,771.4	14,661.3	
10 Pennsylvania	2,613.2	9,863.2	2.8	3,502.7	13,104.9	
11 New Jersey	2,481.2	8,871.3	2.6	3,289.6	12,146.5	
12 Georgia	2,229.6	9,107.2	2.6	2,762.8	11,096.8	
13 Indiana	2,597.0	9,781.8	2.8	2,893.7	10,663.0	
14 Tennessee	1,820.7	7,369.6	2.1	2,477.9	9,832.1	
15 North Carolina	1,929.1	7,411.4	2.1	2,335.2	8,870.6	

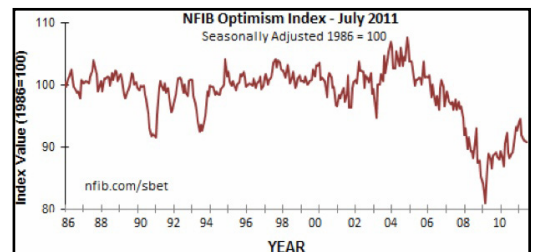
**NFIB – Small Business Index**

NFIB's monthly Small Business Optimism Index dropped for the fourth consecutive month, settling at 90.8 in recession territory. Small business owners are registering a vote of no-confidence in the federal government.

*Between the deluge of new regulations and a Washington policy agenda that is largely ignorant of Main Street needs, stubbornly low consumer spending, and grave concern among small firms about the federal budget, there is not much to be optimistic about as a small-business owner. Who can blame the prevalence of pessimism when administration officials are telling Congress that small businesses need to pay more in taxes to support government spending programs?*

-NFIB Chief Economist William Dunkelberg

Earnings trends for small businesses remained distressingly negative in June. According to the July report, 69% of the owners view the current period as a poor time to expand.



**Employment**

Whether it is job cuts, weekly jobless claims, or the Labor Department’s monthly jobs report, employment is clearly not re-establishing at levels sufficient to reduce the 9.2% unemployment rate. A few interesting things to note from the respective jobs reports are:

- Jobless claims remain elevated above the 400,000 claims level, and the states reporting increases of more than 1,000 claims note the materiality of state and local government cuts.

**Table A. Monthly and 12-month percent changes in selected stage-of-processing price indexes, seasonally adjusted**

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>							
June.....	-0.3	-2.4	0.2	0.1	2.7	-0.7	-3.0
July.....	0.1	0.7	-1.0	0.2	4.1	-0.4	1.5
Aug.....	0.6	-0.1	2.5	0.1	3.3	0.6	3.3
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	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. <sup>1</sup> .....	1.5	3.5	2.9	0.2	5.4	1.9	3.1
Mar. <sup>1</sup> .....	0.9	0.1	3.0	0.3	5.8	1.2	-1.0
Apr.....	0.8	0.3	2.5	0.3	6.8	1.3	4.0
May.....	0.2	-1.4	1.5	0.2	7.3	0.9	-4.1
June.....	-0.4	0.6	-2.8	0.3	7.0	0.0	-0.6

• **Planned job cuts have returned to the landscape**, and bell-weather industries are shedding jobs according to June’s Challenger, Gray & Christmas employment report, which tracks corporate hiring and layoffs in a monthly survey. **The government sector is the most active in trimming staff**, the Challenger report noted. The public sector accounted for 77,591 of the total cuts.

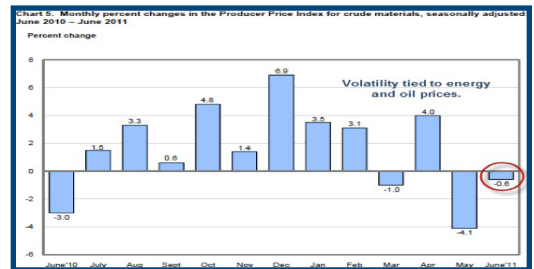
The aerospace and defense industry, which is heavily exposed to government spending, has seen a considerable spike in downsizing this year as well. In the first half of 2011, the sector saw a 241% increase in job cuts over the previous year, from 6,121 to 20,851, according to the report. Financial services companies are also cutting staff, with 11,734 laid off in the first six months of 2011, up 18.5%.

**Inflation**

On the surface, the latest PPI and CPI readings suggest that some relief is occurring on the inflation front from the retreat in oil prices to below \$100 per barrel. However, the threat of inflation has far from dissipated. The prices for finished-goods are up 7.0% over the trailing twelve months.

Although prices for intermediate and finished-goods declined in Q2 due to contracting energy prices, the prices for crude materials remain volatile. As can be noted from the previous table, food was the Finished-Goods category with the most increase in four months. Inflation risk remains elevated, and would likely worsen in the event of a U.S. default on its debt.

With respect to CPI, the trend at first glance is moderating inflation. However, closer examination shows that the annual rate of increase in prices for all items over the trailing twelve months is 3.6% – well above the FED’s targeted 2.0% rate. And, despite the recent decline in gasoline prices, fuel prices are still up a staggering 35.6% from a year ago. The slightest disruption in supply – from say a hurricane in the Gulf of Mexico, or a further decline in the dollar from a sovereign debt crisis – would likely send oil and energy prices back above \$100 per barrel. Inflation and interest rate risk should remain at the top of all risk managers’ lists of threats to businesses.

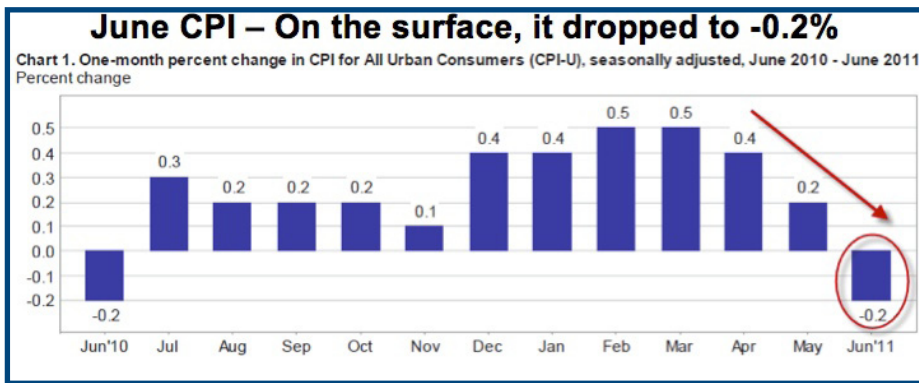


**Retail Real Estate**

Of the major property types, retail real estate is the only one with a Bearish outlook. Not only is this outlook attributable to retail’s closer linkage with the consumer and housing, but retail also has the greatest supply and demand imbalance. In Q1 2011, the trend was improving for retail real estate as:

- Q4 2010 GDP was 3.3%, up from -2.0% in 2009;
- Retail sales for CY 2010 were up 6.5%, compared to being down 6.5% in 2009; and
- Consumer confidence had increased to an 8-month high, according to the Conference Board.

So what happened? A series of events ranging from the March earthquake in Sendai, Japan which disrupted manufacturing supply chains globally, to a steep rise in oil and gasoline prices. Additionally, the downward trend in weekly jobless claims that had fallen below the 400,000 threshold level has reversed course.



The following are noteworthy excerpts from the just updated Q2 national overview for retail real estate.

- Vacancy elevated above 10%, declining rents, less than 1% job growth, and 27.86 million square feet of new retail center space still underway are not metrics that are conducive to attracting capital or encouraging retailers to expand.

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The following are noteworthy excerpts from the just updated Q2 national overview for retail real estate that help explain the Bearish outlook for 2H2011.

- **Unlike multifamily and office real estate, the supply and demand imbalances in retail are**

**more substantial.** Vacancy elevated above 10%, declining rents, less than 1% job growth, and 27.86 million square feet of new retail center space still underway are not metrics that are conducive to attracting capital or encouraging retailers to expand

- **The decline in retail space underway has not slowed as dramatically as completions.** Space still underway has slowed approximately 50% from Q4 2008 compared with an 80% reduction in completions. This observation should not be too surprising as the natural instinct by developers and lenders in a recession is to slow the pace of development in hopes the market will come back. The interest-reserve in construction loans is sufficient to carry the project over a longer construction period. As a result, it's not uncommon during periods like this to see completions slow more dramatically than projects underway.

- **Two-thirds of the remaining retail construction is dispersed in second-tier and tertiary markets.** Unlike other commercial real estate property types where the construction underway is primarily concentrated in the top 20 to 50 MSAs, retail construction underway is more widely dispersed.

- **Overbuilt MSAs with significant housing and labor imbalances,** like Atlanta, Chicago, Dallas, and Houston, are among the list of the 20 markets with the most remaining retail construction still underway.

- **The additions to supply are much less of a problem in "education center" markets where job growth is re-establishing, such as Boston, Raleigh and Denver,** than they are for distressed housing markets with elevated unemployment, like Atlanta, Chicago, Milwaukee and Sacramento - and the interior regions of California (Central Valley and Inland Empire).

- **Investors are not yet willing to tackle value-enhancement retail given the volume of new construction and lack of expansion by national retailers.** For these less liquid markets, cap rate derivation will require use of techniques such as "Band-of-Investment" or "Mortgage-Equity."

*The FDIC's list of problem institutions now contains the highest number (888) since 1993 when the number reached 928 during the S & L crisis.*



## THE BEWILDERED

The *Bewildering* news of the past two weeks ranges from the sub 3.0% yield on 10-Year Treasuries with a looming U.S. debt default, to the slowing pace of bank failures as the list of problem banks expands. **The FDIC's list of problem institutions now contains the highest number (888) since 1993 when the number reached 928 during the S & L crisis.** Is the declining failure rate of banks - despite a growing list of problem banks - related in any way to the \$1.0 billion negative balance in the FDIC Deposit Insurance Fund at the end of Q1, 2011? With delinquency rates and mortgage maturities still rising, it's more likely the banking environment will remain challenging. The lack of Congressional inquiry into regime change at the FDIC and OCC as our banks face more daunting regulatory challenges is beyond *Bewildering*. **Congressional interest in light bulbs versus our bank regulatory agencies is scary.** Given this backdrop, this last news item is a good way to wrap-up the *Bewildering* news of the week.

### Bankers fight back against regulators

According to an article in the July 11th edition of *American Banker*, "overzealous examiners and frustrated community bankers have taken matters into their own hands by pressing a House panel to pass legislation that would force regulators to be more lenient." **Under a bill proposed by Rep. Bill Posey, R-Fl., banks would be allowed to treat non-accrual loans as accrual for capital purposes if they are current, amortizing, not paid from an interest reserve account and have not been more than 30-days delinquent within six months.** Community bankers said the legislation, which obviously does not have the support of regulators and faces an uphill battle in Congress, is necessary because examiners are going overboard in declassifying loans and forcing bankers to hold higher capital than necessary. But regulators warned the legislation was dangerous, saying it undermined examiners' ability to ensure the safety and soundness of banks.

"The misplaced zeal and arbitrary demands of examiners are having a chilling effect on credit," said James McKillop, president of Independent Banker's Bank of Florida, who testified on behalf of the Independent Community Bankers of

America. "Good loan opportunities are passed over for fear of examiner write-downs and the resulting loss of income and capital."

Regulators warned the legislation was dangerous, saying it undermined examiners' ability to ensure the safety of banks. **"This proposed legislation would result in an understatement of problem loans on banks' balance sheets and an overstatement of regulatory capital,"** George French, deputy director of the Federal Deposit Insurance Corp.'s division of risk management supervision, said in written testimony. **I have just three observations:**

1. Where was the regulatory community's concern for "an understatement of problem loans on banks' balance sheets" when CRE concentrations skyrocketed 2005-2007, and when interest reserves were used to keep loans classified as current 2007-2009?
2. With the regulatory regime allowing banks to dump loan loss reserves into earnings the past few quarters, when did regulators become so concerned about an "overstatement of capital?"
3. Where was Sheila Bair's voice on this matter before leaving the building July 8th, and where is the acting Chairman of the FDIC on this issue?

### Industrial Real Estate

Of the four core real estate property types, industrial real estate is more closely aligned with the *Bewildered* category due to the transformation that is occurring within the manufacturing and warehousing industries. The following are noteworthy excerpts from the just updated Q2 national overview for industrial real estate that help explain the *Bewildered* outlook for 2H2011.

- Manufacturing activity has been expanding in the U.S. for nearly two years. Historically, expansion in manufacturing leads to a robust recovery in industrial real estate. Such a robust recovery has not yet developed on a widespread basis for industrial real estate.
- One major reason is that new supply outpaced demand during all but three of the last ten years (2004, 2005, and 2006). Beyond this supply and demand imbalance, the demand determinants for warehouse space have changed due to the evolution of global trade, advances in supply-chain management, and changes in the "path-of-goods" movement across the U.S.

*"The misplaced zeal and arbitrary demands of examiners are having a chilling effect on credit," said James McKillop, president of Independent Banker's Bank of Florida, who testified on behalf of the Independent Community Bankers of America.*

# KEY ECONOMIC & FINANCE RATES

## US UNEMPLOYMENT (JUNE):

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

## JOBLESS CLAIMS: (JULY)

Initial (July 9th)	405,000
Initial (Prior Wk)	427,000
4-Wk Average	423,250

## HOME FORECLOSURES:

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

## GROSS DOMESTIC PRODUCT:

Q1 2011(3rd Est.)	+1.9%
Q4 2010	+2.8%
Q3 2010	+2.6%
CY 2010	+2.9%

## TREASURY RATES (JULY 15):

2-Year Tr	0.35%
10-Year Tr	2.91%

## LIBOR

6-Month	0.41%
3-Month	0.25%
1-year	0.74%
PRIME % (US)	3.25%
(Fed FOMC Mtg Aug 9th)	

## MORTGAGE RATES (JULY 15):

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 July 15)	\$1,590
Gold (high: 5/4/11)	\$1,541
Gold (5-yr low: 1/06)	\$ 540

Oil (WTI) July 15' 11	\$97.24
Oil (High) Jun 13' 08	\$135.00
Oil (Low) Jan 09/ 09	\$ 40.83

- Demand for warehouse space varies widely because of these changes. Warehouse space can no longer be examined or valued based on simplistic historic metrics, such as ceiling height, number of docks, type of construction, or price per square foot. **The storage that occurred in warehouses is now in containers being shipped.**

Technology in warehouses with such features as modern racking systems become more important in the demand and rent equation than the number of docks. The net result is the location and physical features that were important determinants of industrial real estate demand 10 or 20 years ago have changed substantially.

- This change explains why the recovery in industrial real estate has not been as broad-based and why the investment behavior is concentrated in markets like Southern California, Northern California, Portland, Houston, Chicago, Miami, Atlanta, and Memphis. These are the markets with well-developed intermodal transportation systems.

- More than any other property type, industrial/warehouse may be undergoing the most change in terms of demand drivers and physical attributes. There is no longer such thing as a generic bulk-warehouse. **Functional and economic obsolescence are impacting industrial property more than any other property type.**

## DISCUSSION ITEM:

This week's discussion item is two questions:

1. **Have you taken a fresh look at the market conditions for the respective core property types in the past 30 days** to understand the balance between supply and demand, investor behavior and changing demand determinants?
2. **How will U.S. property values change if the U.S. defaults on its debt obligations August 4th?**

If the U.S. Treasury was the basis for deriving a risk-free rate in building up a capitalization rate, what will be the new risk-free rate?

Will investors flood capital into hard assets, like real estate, or will the market lock-up like it did during the 2009 financial crisis?

## 512 offices in 61 countries on 6 continents

United States: 125  
Canada: 38  
Latin America: 18  
Asia Pacific: 214  
EMEA: 117

- \$1.5 billion in annual revenue
- 979 million square feet under management
- Over 12,500 professionals

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