

# 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

Now that we have closed the books on the first half of 2011, it's appropriate to look back and ask the obvious question:

### What happened to the momentum that was building in Q1?

At year-end 2010, the outlook for the economy was hopeful. That hope in Q4 2010 turned into optimism in Q1 as a number of key economic indicators were signaling that the economy and commercial real estate were finding a foothold from which to build a recovery. In Q1 2011, it was reported that Q4 2010 GDP was 3.3%, up from -2.0% in 2009. Retail sales for CY 2010 were +6.5%, compared to -6.5% in 2009. Furthermore, consumer confidence had increased to an 8-month high. Contrast that view with the numbers on key economic metrics just reported out as we close the books on Q2 2011:

- **GDP has fallen to less than 2.0% (1.9%),** and consensus forecast is for it to remain in the range of 2.0% to 2.5% in the second-half of 2011.

- **The year-over-year rate of change in retail sales has slowed from +8.0%** in Q1 to +6.0% in Q2.
- **Consumer confidence has succumbed to the worries of rising unemployment (up for the second month in a row to 9.2%) and elevated gasoline prices** (up roughly 25% over summer 2010). In June, consumer confidence declined to an index reading of below 60 - its lowest level since November 2010.

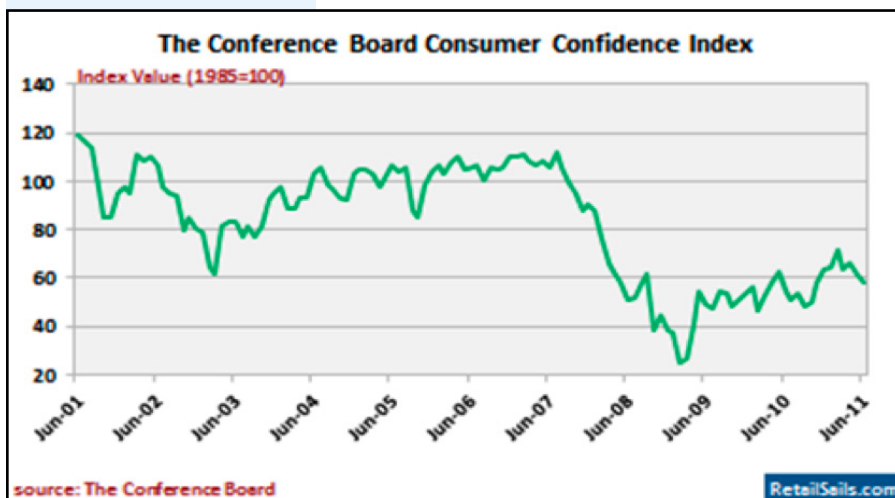
### So what happened to the foothold for recovery in Q1?

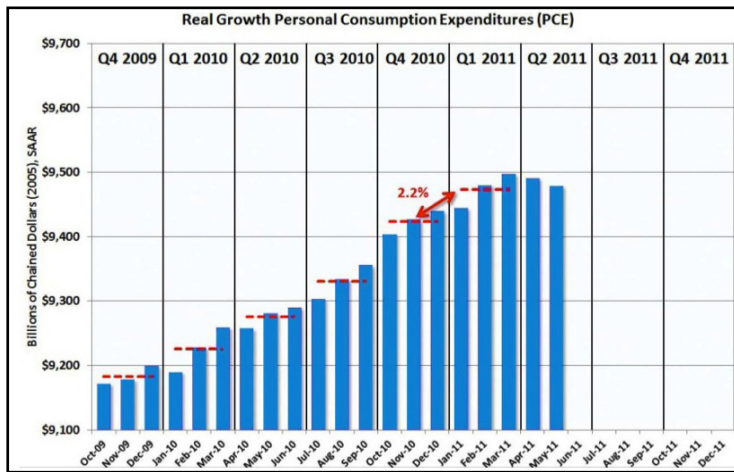
What happened was a series of events ranging from the March earthquake in Japan which disrupted manufacturing supply chains globally, to a steep rise in gasoline prices. Additionally, the downward trend in weekly jobless claims that had fallen below 400,000 has reversed course.

Weekly jobless claims have remained above 400,000 since the week ending April 9th - or 15 consecutive weeks of claims above 400,000.

The U-3 (official unemployment rate) has risen in Q2 2011 to 9.2%. States and local governments struggling to balance their budgets lead all employer categories in job cuts. Financial services have seen the next highest level of cuts.

**Manufacturing layoffs, supply-chain disruptions, rising energy costs, elevated weekly jobless claims, and worries about employment have converged to send the consumer back into a savings versus spending mode.**





Personal Consumption Expenditures data for Q2 2011 corroborates this retrenchment in consumer behavior:

With this reversal in key economic metrics, one would expect the deterioration to translate into weak demand and declining prices for commercial real estate. However, just the opposite is occurring for all but retail real estate. **Overall commercial real estate transaction activity is up nearly 70% from this same time in 2010, and the capital markets are on track to more than double the amount of CMBS issuance completed in CY 2010, or \$40 to \$50 billion. What is behind this flood of capital back into commercial real estate?** It's due to institutional capital and REITs with built-up cash reserves and foreign investors anxious to deploy U.S. dollars and rotate into hard assets in an inflationary environment.



## The Score Board

THE BEWILDERED EDGE OUT THE BEARS


So - what has been the "Bulls, Bears & Bewildered" Scoreboard during the first half of 2011; and what direction is the Scoreboard heading toward for the second-half of 2011?

The Scoreboard was introduced at the beginning of Q2 as an enhanced feature to the Weekly Market Recap. The moving average for Q2 was Bullish by a small margin. **The trend, has clearly been a move toward the Bearish and Bewildering as:**

- **Manufacturing slowed** from supply disruptions emanating from the March Sendai, Japan earthquake;
- **Uncertainty of job growth re-emerged** as weekly unemployment claims rose back above 400,000 - and have remained there for the past 15 weeks;
- **Consumer Confidence retrenched** under the weight of higher energy prices, inflation, and rising unemployment.

Let's hope for some "Deficit Cutting" progress from Washington this week, or next week will likely be Bearish, as the U.S. will face an inevitable downgrade of its AAA credit rating. That could trigger an economic seismic event as powerful as the March Sendai, Japan earthquake.

THE SCORE BOARD Q2 2011			
WEEK ENDING	BULLS	BEARS	BEWILDERED
April 1	8	3	2
April 8	Note: There was not a WMR this week.		
April 15	3	8	4
April 22	5	2	2
April 29	6	3	4
May 6	3	2	2
May 13	2	3	2
May 20	4	4	5
May 27	2	5	2
June 3	6	7	3
June 10	5	5	6
June 17	5	4	6
June 24	3	4	3
July 1	4	3	3
Q2 Avg.	4.3	4.1	3.4

 <b>THE SCORE BOARD</b>			
WEEK ENDING	BULLS	BEARS	BEWILDERED
July 22	3	4	<b>5</b>
July 15	5	<b>7</b>	5
July 8	2	<b>4</b>	3
July 1	<b>4</b>	3	3
4- Week Avg.	3.5	<b>4.5</b>	4.0

**STATISTICS & HEADLINES FOR THE WEEK**

This week’s statistic recognizes the result that can be achieved when there is a commitment to quality. Colliers Valuation and Advisory Services is the only national firm that audits its appraisers’ work and ties their compensation to the quality of their reports.

Our peers compensate appraisers primarily upon a production basis that has encouraged a **“fast and cheap”** business model. This model has resulted in a compromised appraisal reliability, which bank regulators have failed to address. Colliers, though, heard this concern from our industry, and two years ago set out to make a watershed change to address appraisal quality head on.

Colliers commenced with an overhaul of the entire business model. It went back to the drawing board in terms of appraiser training, data integrity, templates, and recruitment. The overhaul concluded with the implementation of an audit process that ties compensation to quality over quantity.

**THE GOAL WAS FOR COLLIERS TO BECOME KNOWN AS THE QUALITY PROVIDER OF VALUATION AND ADVISORY SERVICES, VERSUS THE QUANTITY PROVIDER.**

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VALUATION PROFESSIONALS	
MAKING THE TOP GRADE IN JUNE	
LEADING PRODUCERS WITH TOP GRADE IN REPORT QUALITY	
Jonathan Fletcher, MAI	Jeff Shouse
Bobby Hastings, MAI, MRICS	Kurt Smook
Rob Detling, MAI	Jory Wilcox
Richard Mupo, MAI	Robert Steed
Jeremy Snow, MAI	Matthew Mintier
Robert Rickman, MAI	Matt Steffen
Marty J. Shearer, MAI, MRICS	Andrew Thompson
Trisha Guarnieri, MAI, MRICS	John Larson
Bryan Dragoo	Patrick Wilson
Scott Shouse	Jerrey Wilson

This week, twenty of Collier’s appraisers were recognized for maintaining a top grade for their appraisal work in Q2, while also maintaining a top ranking in terms of production. These 20 are more than statistics to our company and our clients.

**THE QUOTE OF THE WEEK**

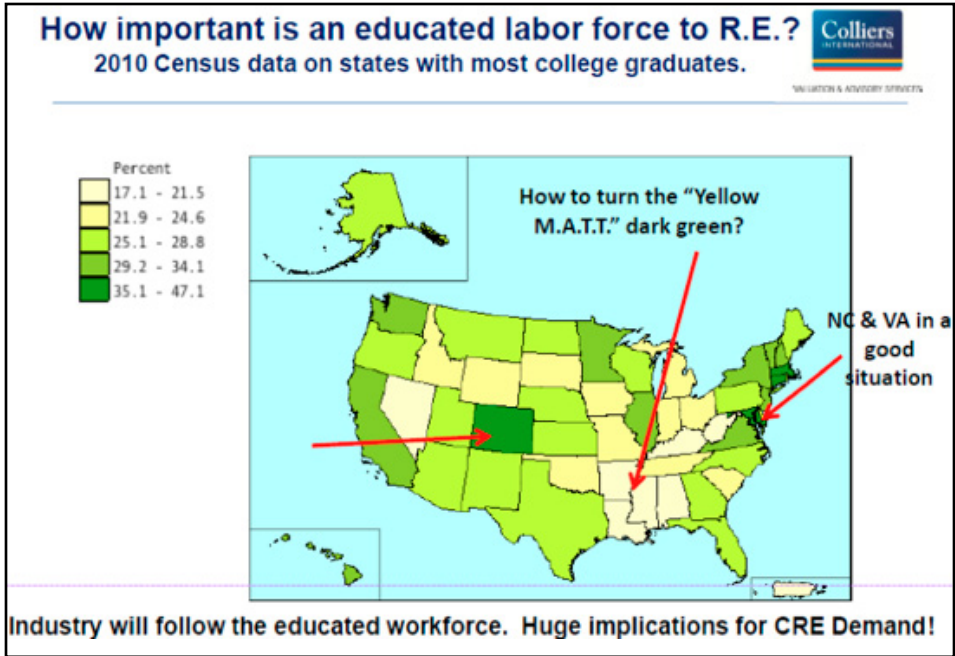
**“There is no Chinese law that says I can’t decorate my shop the way I want to decorate it.”** - By an un-named owner of an unauthorized Apple store discovered this past week in Kunming, China.

The quote and discovery re-ignited the concern by American companies about the lack of intellectual property right protection in China. The quote of the week epitomizes the systemic disregard for intellectual property rights in China whereby an exact replica of an Apple store is rationalized as decorative interpretation. The consequence for China not respecting intellectual property rights is that manufacturing will migrate back to the U.S. or to another low-cost wage country that does respect intellectual property rights.

Please refer to back to earlier Analytics presentations from this year which highlight how education centers – such as Boston, Raleigh, Denver and certain Texas MSAs – are experiencing a rise in net office and industrial absorption fueled by technology companies moving research, computer design, and product manufacturing back to the U.S. in proximity to education centers where skilled labor is readily available.

Intellectual property manufacturing is returning to the U.S. as a result of intellectual property theft being experienced by American companies that moved manufacturing to China.

The following is a slide which highlights education centers in the U.S. that are benefiting from this trend. The dark green colored states represent the areas with the highest concentration of college-educated residents:



**THE HEADLINE(S) OF THE WEEK**

After this past week’s lack of progress by Congress in addressing our looming debt crisis, it was tempting to retain last week’s headline:

**How Many Lawmakers Does It Take to Save a Light Bulb?**

As you may recall, that headline related to Congress’ focus on overturning measures in the 2007 Energy Act requiring efficiency upgrades in the old-fashioned incandescent light bulbs, versus focusing on legislation that would reduce government spending. The quote elevated the question of legislative priorities as we face a sovereign debt crisis.

However, the headline selected for this week comes from a feature story by Chris Morris of CNBC on what would replace the U.S. dollar as the international reserve currency should the U.S. default on its debt obligations.

Both headlines are related in that they elevate awareness of what is at stake if the U.S. defaults on its debt come August 2nd.

The headline for this week is: What Is Bitcoin?

A “Bitcoin” is a form of digital currency that has been evolving over the past two years to become a global currency not backed or controlled by any government or central bank. Although its origin has sinister roots associated with illegal drug trade, its evolution demonstrates how quickly the world markets could move to replace the U.S. dollar as the international reserve currency from which all commodities are priced.

“Bitcoins” are not cash; rather they are a virtual currency. Users exchange online credits for goods and services from select retailers, contractors, and online trading houses. Rather than going through a bank or financial institution, these credits - called tokens - are exchanged directly from person to person, or person to merchant.

When a transaction occurs, the “Bitcoin” is automatically sent from the buyer to the seller through an encrypted method that’s designed to ensure “Bitcoins” can’t be hacked or artificially created. Usage is growing at a pace eerily reminiscent of the growth of another digital company that has challenged the banking system known as PayPal.

Although “Bitcoins” are a bit harder to utilize in day-to-day life, an increasing number of establishments are accepting them. These include some New York City restaurants, hotels such as the Howard Johnson Hotel and Conference Center in California near Disneyland, and even some small businesses located inland – e.g. Sugar, an Oklahoma City wedding cake shop. The number of vendors that accept “Bitcoins” is increasing regularly—and includes both online and physical vendors. In his feature, Chris Morris concludes by asking: “What’s the point of “Bitcoins?”

The response to the question posed to “Bitcoin” creators is something our leaders in D.C., the Treasury Department and Federal Reserve - should take to heart this week:

“Bitcoin’s creators like to position the currency as an alternative to the U.S. dollar and Euro. They hope to revolutionize the world of finance just as the Web has proven to be a paradigm shift in the publishing world.”

## The Bulls, The Bears & The Bewildering

As previously noted in the first-half of 2011 review, the outlook trend from the Scoreboard has clearly been a move toward the Bearish and Bewildering. This shift in outlook from Bullish to Bearish stands out more clearly from analysis of weeks which were Bullish, Bearish or Bewildering over the past 14 weeks. All but one of the Bullish weeks occurred in the first four weeks of Q2; and all but one of the Bearish weeks occurred in the later part of Q2. This past week, the Bewildered edged out the Bears by a score of 5 to 4 due to the uncertainty of the U.S. debt crisis. The Scoreboard has been Bullish only one week since the first week of May.

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. Effective August 1st, the WMR will be distributed on a subscription 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 as follows for subscription details:

- K.C. Conway, MAI, CRE and Executive Managing Director of Real Estate Analytics for Colliers.  
KC.Conway@Colliers.com
- Daniel Briggs, Analyst, Sales and Marketing, Real Estate Analytics  
Daniel.Briggs@Colliers.com



### THE BULLS

Until we get past the uncertainty of the U.S. debt crisis and receive new readings on employment, inflation, and consumer confidence in August, the Bullish news is likely to be limited to earnings from the remaining 412 companies comprising the S&P 500 that have yet to report for Q2, IPO activity, and market response to new CMBS issuance.

The most encouraging and Bullish news is that U.S. corporate earnings are turning in stellar results despite the headwinds of commodity inflation and looming sovereign debt crisis.

### Q2 2011 Earnings: All sectors but Financials have Increased in 1H2011

#### S&P 500 Sectors

Energy	+12.14%
Healthcare	+10.65%
Cons. Discretionary	+6.54%
Cons. Staples	+5.86%
Utilities	+5.52%
Industrials	+3.42%
Materials	+2.57%
Tech	+2.29%
Telecom	+0.63%
Financials	-8.48%

#### Financials This Year

Bank of America	-27.15%
Morgan Stanley	-25.17%
Comerica	-24.10%
Goldman Sachs	-23.62%
Citigroup	-21.44%
Fifth Third Bank	-19.48%
Bank of New York Mellon	-18.37%
SunTrust Banks	-18.53%
Regions Financial	-17.28%
Barclays	-16.65%
Wells Fargo	-14.31%
Royal Bank of Scotland	-13.80%
Credit Suisse	-12.72%
KeyCorp	-12.03%

Corporate earnings suggest that a recovery could regain footing if much of the uncertainty surrounding the debt crisis, taxes, healthcare costs, and regulation were cleared out of the way. Approximately 28% of the S&P 500 companies have reported Q2 2011 earnings, and 75% of the 88 companies reporting thus far have announced earnings that beat estimates.

Excluding the financial sector, all sectors of the S&P 500 are up for the first half of 2011.

In addition to strong earnings being reported by three-quarters of all reporting companies, IPO (Initial Public Offering) activity is healthy. With 81 U.S. IPOs priced year-to-date, exceeding the 74 deals completed for the same period of 2010, the U.S. IPO market is starting to gather steam, nearing 2007's levels when 123 IPOs debuted from January through the end of July.

Last month the IPO market was led by new offerings for LinkedIn and Russia's online search engine Yandex. This month the activity continued with the real estate online-marketplace company Zillow, and the fashion-trendy headphone and electronics accessories maker Skullcandy. The following table profiles the top 10 biggest U.S. IPO's pops and drops in the first day of trading since the beginning of this year.

Finally, the other Bullish news is that, commercial real estate transaction activity has continued to build. Approximately \$4.5 billion of new CMBS issuance is in the pipeline, special servicers continue to liquidate foreclosed CMBS assets at nearly \$1.0 billion per month, and foreign entities disposing of U.S. real estate loans – like Anglo Irish Bank Corp – are finding strong demand. Several banks, including Deutsche Bank AG, Goldman Sachs Group Inc., J.P. Morgan Chase & Co. and Wells Fargo & Co., are weighing bids for parts of nationalized Irish lender Anglo Irish Bank Corp.'s U.S. real-estate portfolio. The interest in the bank's real-estate loans, which have a book value of about \$9.5 billion, is a sign of Wall Street's rising appetite for commercial property. If the Anglo Irish sale is successful, other foreign banks are expected to look to unwind their U.S. commercial real-estate portfolios. Colliers has analyzed the Anglo Irish Bank portfolio. Pat Craig, MAI and director of Colliers Northeast valuation services can be contacted for assistance with similar portfolio advisory needs:

Patrick Craig, MAI - Northeast Regional Managing Director for Valuation Advisory Services Patrick.Craig@Colliers.com

#### Top 10 IPOs 1st Day Returns

Company	Ticker	Offer Date	Offer Price	Close Price (1st Day)	1st Day Return (%)
Qihoo 360 Technology Co	QIHU	29-Mar-2011	14.5	34.00	134.5%
LinkedIn Corp.	LNKD	18-May-2011	45	94.25	109.4%
Zipcar, Inc.	ZIP	13-Apr-2011	18	28.00	55.6%
Yandex NV	YNDX	24-May-2011	25	38.84	55.4%
HomeAway, Inc.	AWAY	28-Jun-2011	27	40.21	48.9%
Cornerstone OnDemand	CSOD	16-Mar-2011	13	19.07	46.7%
Epocrates, Inc.	EPOC	01-Feb-2011	16	21.96	37.3%
Phoenix New Media Ltd.	FENG	11-May-2011	11	14.75	34.1%
Demand Media, Inc.	DMD	25-Jan-2011	17	22.65	33.2%
Velti Plc	VELT	27-Jan-2011	12	15.58	29.8%

#### Bottom 10 IPOs 1st Day Returns

Company	Ticker	Offer Date	Offer Price	Close Price (1st Day)	1st Day Return (%)
FriendFinder Networks, Inc.	FFN	11-May-2011	10	7.85	-21.5%
NetQin Mobile Inc.	NQ	04-May-2011	11.5	9.30	-19.1%
Sequans Communications SA	SGNS	14-Apr-2011	10	8.25	-17.5%
Boingo Wireless, Inc.	WIFI	03-May-2011	13.5	12.10	-10.4%
Mission NewEnergy Ltd.	MNEL	20-Apr-2011	9	8.07	-10.3%
AcelRx Pharmaceuticals	ACRX	11-Feb-2011	5	4.55	-9.0%
Taomee Holdings Ltd.	TAOM	10-Jun-2011	9	8.23	-8.6%
Box Ships, Inc.	TEU	14-Apr-2011	12	11.00	-8.3%
TMS International Corp.	TMS	13-Apr-2011	13	12.00	-7.7%
Trunkbow International Hldgs	TBOW	02-Feb-2011	5	4.74	-5.2%



THE BEARS

#### Housing

At the onset of Q2, the dominant Bears each week were housing and inflation. Subsequently, inflation has moderated in the latest CPI data as oil prices retrenched back below \$100 per barrel, and:

Housing has bifurcated into two markets. There is a recovering and active rental housing market; and there is a for-sale housing market that will likely remain in the doldrums for years to come.

This past week the news on housing reflected this bifurcation. Although single-family starts increased according to the U.S. Census Bureau and HUD, most of the increase in single-family starts and permits came in the Midwest and South as rebuilding from the spring tornadoes commenced; and the balance of the 80,000-unit increase came from new rental housing. In fact, more than half the total increase in starts (41,000 units) was from rental units.

Single-family starts are within 2,000 units from June 2010, compared to multifamily starts, which are double the level a year ago.

In the commentary provided by the states as to the reason for the increase, the most common responses were: layoffs in education (MN, NY, PA, TN). layoffs attributed to state government (MN, NV, TN, WI), and layoffs in manufacturing, especially automobile (MI, OH, IN and AL).

**Table 3. New Privately-Owned Housing Units Started**  
 [Thousands of units. Detail may not add to total because of rounding]

June Housing Starts Period S-Family & M-Family	United States			
	Total	In structures with --		
		1 unit	2 to 4 units	5 units or more
2010: June	539	491	(5)	83
July	550	429	(5)	102
August	606	427	(5)	165
September	597	447	(5)	144
October	539	434	(5)	93
November	551	454	(5)	82
December	526	421	(5)	97
2011: January	636	437	(5)	187
February	518	388	(5)	112
March	593	418	(5)	164
April (r)	549	411	(5)	124
May (r)	549	414	(5)	129
June (p)	629	453	(5)	170

**Banking**

The Bearish news on banking came from two fronts this past week. It commenced with bank earnings.

The financials are the only sector in the S&P 500 that show a negative return year-to-date.

**WORST PERFORMING U.S. BANKS IN 1H2011**

Financials This Year	
Bank of America	-27.15%
Morgan Stanley	-25.17%
Comerica	-24.10%
Goldman Sachs	-23.62%
Citigroup	-21.44%
Fifth Third Bank	-19.48%
Bank of New York Mellon	-18.37%
SunTrust Banks	-18.53%
Regions Financial	-17.28%
Barclays	-16.65%
Wells Fargo	-14.31%
Royal Bank of Scotland	-13.80%
Credit Suisse	-12.72%
KeyCorp	-12.03%

**Employment**

Stepping to the forefront again as dominant Bears are employment and banking. The more Bearish news, though, remains in the area of employment. The weekly jobless claims data released each Thursday continue to disappoint the market. For fifteen consecutive weeks, jobless claims have remained elevated above the threshold 400,000 claims level. This past Thursday, claims rose another 10,000.

**UNEMPLOYMENT INSURANCE DATA FOR REGULAR STATE PROGRAMS**

WEEK ENDING	Advance July 16	July 9	Change	July 2	Prior Year <sup>1</sup>
Initial Claims (SA)	418,000	408,000	+10,000	427,000	466,000
Initial Claims (NSA)	464,865	473,887	-9,022	425,640	502,065
4-Wk Moving Average (SA)	421,250	424,000	-2,750	427,000	459,500

Of greater concern is the increase in the number of states reporting an increase of more than 1,000 claims from the prior week and the commentary provided by the respective states.

For the week ending July 16th, fifteen states reported increases in claims of more than 1,000 over the prior week. That number is the highest level reported in Q2; and it's the second highest level to date in 2011.

The mortgage foreclosure mess and resulting settlements - like Bank of America's - are paralyzing the banking industry. Banks continue to bleed whatever remaining loan loss allowance they can into earnings, but the market has seen though this scheme and is looking for loan and revenue growth. Neither is present, and bank balance sheets are contracting, as lenders remain uncertain as to the thousands of rules still to be written and implemented from Dodd-Frank. The biggies, like the Risk Retention Rule, and who will be deemed a "SIFI" - Systemically Important Financial Institution - are looming over the market. If banks don't know their cost of capital or the regulatory rules ahead, they just are not going to lend. Without capital, businesses won't expand and consumers won't spend.

**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.

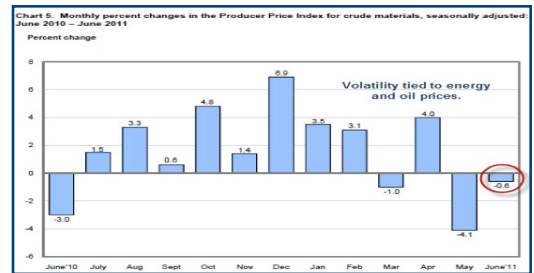
The aerospace and defense industry, which is heavily exposed to government spending, has seen a considerable spike in downsizing this year as well. In the first half of 2011, the sector saw a 241% increase in job cuts over the previous year, from 6,121 to 20,851, according to the report. Financial services 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.

### GAO Audit of the Federal Reserve

Adding insult to injury on the banking front this week was the Government Accounting Office's (GAO) release of a report called for under the Dodd-Frank legislation on the Federal Reserve's management of its 13(3) emergency lending powers during the financial crisis. The audit concluded:

**The Federal Reserve has one set of standards for the banks it supervises in how they conduct business, and yet an entirely different set of standards for themselves.**

Specific noteworthy comments from the released audit include:

- **GAO Audit Reveals Fed Played Fast and Loose with Loan Rules.**
- **Inadequate explanation of loans:** The Federal Reserve evoked emergency powers to make loans to Wall Street firms without bothering to adequately explain the legal grounds for those loans. To our bank colleagues, how long do you think your financial institution would remain functioning without a "cease and desist order" if it were to make loans to its preferred customers and depositors without any grounds for making such a loan?
- **Stall tactics persist at the Federal Reserve:** Nearly three years after emergency loans were made, the Fed still hasn't provided a satisfying answer to the GAO for why it made loans to the London-based broker-dealer subsidiaries of Merrill Lynch, Goldman Sachs, Morgan Stanley, and Citigroup, as well as the U.S. broker-dealer subsidiaries of Merrill Lynch, Goldman Sachs, and Morgan Stanley. The Federal Reserve Board has yet to provide documentation explaining why these extensions were provided specifically to affiliates of these primary dealers.
- **"Exigent Circumstances" is an abused citation:** The Fed made emergency loans anyway, citing its powers under Section 13(3) of the Federal Reserve Act to extend loans in "exigent circumstances," but it never explained exactly why it decided these loans qualified under this provision. To the lay reader, this citation of "exigent circumstances" is the equivalent of a toddler's response to why it misbehaved being: "because."
- **"Exigent Circumstances" was used to justify all Federal Reserve Lending to banks after mid 2008:** Beginning with the rescue of Bear Stearns, the Federal Reserve began to use its 13(3) emergency lending authority more frequently. The provision allows the Federal Reserve to lend to "any individual, partnership or corporation in unusual and exigent circumstances" when the borrower "is unable to secure adequate credit accommodations from other banking institutions." It may be an important authority for the Federal Reserve to have in its tool-bag, but it appears to have been abused.
- **The Federal Reserve does not document:** The GAO goes on to explain in its audit findings that when it asked for documentation about the presence of "exigent circumstances," it was told the Fed had never documented its views. Again, to our banking colleagues, how do you feel about your primary regulator requiring you to document lending practices but then not documenting its own lending practices with the use of taxpayer funds?
- **The Good News part of this GAO audit and finding:** The Dodd-Frank Act includes new requirements for the Federal Reserve to report to Congress on any loan authorized under Section 13(3). Those reports must include not just the amounts, terms, and borrowers, but the justification for the assistance.

**Next time just declaring "exigent circumstances" won't be good enough.**

**Bank Failures:** The other Bearish news of the week concerning banking was more bank failures under the watch of a new interim FDIC chairman and an expansion of the bank watch list.

**This past week, three more banks failed, bringing the 2011 tally to 58.**

Two of the banks were in Florida, and one was located in Colorado. The 56th, 57th and 58th bank failures were:

- **#58: Bank of Choice** – Greeley, CO: Bank of Choice was the 58th FDIC-insured institution to fail in 2011, and the fifth in Colorado. Bank Midwest, National Association - Kansas City, MO, assumes All of the Deposits of Bank of Choice, Greeley, CO.

As of March 31, 2011, Bank of Choice had approximately \$1.07 billion in total assets and \$924.9 million in total deposits. The FDIC estimates that the cost to the Deposit Insurance Fund (DIF) will be \$213.6 million.

- #56 and #57: Southshore Community Bank - Apollo Beach, FL and Landmark Bank of Florida - Sarasota, FL, became the 56th and 57th bank failures of 2011. American Momentum Bank - Tampa, FL, acquired all of the deposits of both failed institutions. Southshore Community Bank had approximately \$46.3 million in total assets and \$45.3 million in total deposits; and Landmark Bank of Florida had total assets of \$275.0 million and total deposits of \$246.7 million. The FDIC estimates the cost to the Deposit Insurance Fund (DIF) for Southshore Community Bank will be \$8.3 million, and \$34.4 million for Landmark Bank of Florida.

The prospect for more bank failures grows as the watch list expands to approximately 900 financial institutions. The states with at least 20 institutions on the list are provided as follows, and are based on FDIC notices through May 2011.

Mid 2011 Bank Watch List States with Most Banks on the List	
State	# of Banks on the "Watch List"
1 - Illinois	81
2 - Florida	73
3 - Minnesota	68
4 - California	67
5 - Georgia	62
6 - Texas	52
7 - Wisconsin	41
8 - Kansas	36
9 - Colorado	29
10 - Missouri	29
11 - Alabama	27
12 - Tennessee	26
13 - Ohio	23
14 - Washington	23
15 - Michigan	20
15 - South Caroli	20



**THE BEWILDERED**

The Bewildered prevailed in this week's Scoreboard, narrowly edging out the Bearish news of the week by a score of 5 to 4. The items that were Bewildering ranged from the perennial reconciliation of a 10-Yr Treasury yield below 3.0% to our looming debt crisis, to rising housing starts in light of such abysmal home sale and home price appreciation data. Other items that seem perplexing are:

- The trickle of bank failures despite a rise in the number of problem banks and deteriorating earnings among the financial sector of the S&P. Approximately 900 banks on the FDIC watch list, contracting bank balance sheets, double-digit declines in year-to-date stock prices for the nation's top banks, and a draining of loan loss reserves into earnings with unresolved housing, mortgage and commercial losses is just not reconcilable to loan growth or a healthy banking system.
- The reported earnings of some of the nation's largest restaurant companies in light of both declining consumer confidence and a decline in the National Restaurant Performance Index back into contraction territory is Bewildering.



BJ's, Buffalo Wild Wings, Chipotle Mexican Grill, Dominos, and McDonalds all turned in stellar earnings and same store sales growth figures for Q2. How are restaurant earnings like these possible when unemployment is rising, consumer confidence is falling, and the National Restaurant Performance Index has fallen back in to contraction territory? The answer is that these are all fast food restaurants where the consumer is spending down with its limited dining-out dollars. Mid-priced and upscale dining establishments are not reporting similar results.

### THE ECONOMIC CALENDAR FOR THE WEEK AHEAD: JULY 25 – JULY 29

The week ahead will likely be defined by volatility as the U.S. approaches "D-Debt" doomsday. Monday, the Treasury will hold its next to last set of Treasury Bill auctions before the August 2nd debt ceiling deadline. How the market reacts to these T-Bill sales will be an important bell-weather for what lies ahead with respect to interest rates.

On Tuesday, we will get updated readings on consumer confidence, new home sales and home prices from S&P/Case-Shiller. As the week progresses, the news on durable goods (Wednesday), farm prices, and GDP (Friday) could be muted by what transpires in Washington with respect to the debt crisis. In between, corporate earnings progress with readings from the likes of Amazon, AutoNation, Boeing, etc.

The major automobile, consumer staple, transportation, and shipping companies comprising the S&P 500 will give us insight into:

- Global demand for U.S. goods;
- Inflation pressures (Vietnam is now reporting inflation running at the rate of 22% – fueled by energy, food, and construction material cost increases.);
- GDP growth for the second-half of 2011.

This past week, GE told us that its GE Capital unit was lending and past the worst of its loan and credit problems. Let's hope they don't get deemed a "SIFI" by the FED in 2H2011. Bell-weather Caterpillar confirmed that inflation is still a problem with rising input costs. Finally,

the banks told us: The U.S. banking system is not in the best of shape to weather another recession or a sovereign debt crisis that could potentially despoil the credit rating of 7,000 municipal bonds.

### DISCUSSION ITEM

This week's discussion item is an expanded version of last week's: How will U.S. property values change if the U.S. defaults on its debt obligations August 2nd? Keep in mind the logistics of what happens if the debt ceiling is not raised; and a serious attempt made by the U.S. Congress at getting our own fiscal house in order:

- The U.S. issues approximately 80 million checks a month. What will get paid? Treasury has not revealed a plan and in Wisconsin, we have observed the courts having to determine what is deemed a "vital service."
- 40% of every dollar for these 80 million checks is borrowed money from Treasury-Bill auctions each month. What happens if we can't auction our debt?
- The U.S. annual deficit has grown by 40% in just the past 2 years. How are we different than Greece?
- The U.S. dollar is fiat currency – it's not backed by any item of intrinsic value. The only thing giving the U.S. dollar value is our unbroken promise to pay.

Commodity prices priced in U.S. dollars will undoubtedly rise sharply on a U.S. debt default. What will oil prices rise to? Will OPEC even sell U.S. oil given the volume of Treasury debt they hold if we default?

- An estimated 7,000 municipal bond credit ratings are inextricably linked to the U.S. Treasury bond yield. A default by the U.S. on its debt obligations will more than fulfill the doomsday municipal bond crisis forecast by Meredith Whitney in the fall of 2010.
- An increase in the debt ceiling limit without a meaningful attempt at deficit spending reduction will likely result in a downgrade of the U.S. debt rating by the rating agencies.

# KEY ECONOMIC & FINANCE RATES

## US UNEMPLOYMENT (JUNE):

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

## JOBLESS CLAIMS: (JULY)

Initial (July 16th)	418,000
Initial (Prior Wk)	408,000
4-Wk Average	421,250

## 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(Final) New on Fri.	+1.9%
Q4 2010	+2.8%
Q3 2010	+2.6%
CY 2010	+2.9%

## TREASURY RATES (JULY 15):

2-Year Tr	0.39%
10-Year Tr	2.96%

## 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 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)	\$1,601
Gold (high: 5/4/11)	\$1,541
Gold (5-yr low: 1/06)	\$ 540

Oil (WTI) July 15' 11	\$99.87
Oil (High) Jun 13' 08	\$135.00
Oil (Low) Jan 09/ 09	\$ 40.83

This debate in Washington is not just about raising the debt-ceiling limit. It's more about whether the U.S. can rein in its deficit spending any more than Greece, Portugal, Ireland or Spain.

If the U.S. Treasury has been the basis for deriving a risk-free rate in building up a cap rate, what will be the new risk-free rate - and impact on cap rates for U.S. real estate?

As appraisers, the events of this week will have a profound impact on the valuation of U.S. real estate. Have we prepared?

### Should a special assumption and limiting condition be added to our appraisals this week?

What will happen to the demand for U.S. real estate and the metrics used to value it in the event of a U.S. debt default on August 2nd?

To our baking 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 this week might be appropriate to explore answers to these questions.

## 512 offices in 61 countries on 6 continents

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

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