

Appraisal Institute 2009 Summer Conference

Sacramento Region Commercial Real Estate Outlook

Garrick Brown

Vice President, Research

Colliers International

Sacramento Region

garrick.brown@colliers.com

(916) 563-3035



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The Good News!

Signs That Recession Is Easing

- Sales of new single-family homes up 11% in June—largest monthly increase in 8 years (S&P/Case-Shiller)
- Inventory of unsold new homes fell in June to lowest level in more than a decade (S&P/Case-Shiller)
- Median home prices are continuing to fall... but rate is slowing (S&P/Case-Shiller)
- The Conference Board Leading Economic Index increased for the third consecutive month, rising 0.7 percent in June. The six-month change in the index has risen to 2 percent -- up from a decline of 3.1 percent in the preceding six months.

The Good News!

Signs That Recession Is Easing (Continued)

- CEOs more optimistic... most recent Conference Board survey of CEO outlook showed 55% of CEOs expect economic conditions to improve in the next 6 months—up from 17% last quarter. Second largest increase in survey's 23 year history... (Conference Board).
- Unemployment slowing... we continue to shed jobs, but at much slower pace. Continuing claims are going down as well.
- The Conference Board Leading Economic Index increased for the third consecutive month, rising 0.7 percent in June. The six-month change in the index has risen to 2 percent -- up from a decline of 3.1 percent in the preceding six months.

The Bad News...



If the economy is a long train, commercial real estate is the caboose...

The Bad News...



How can the overall economy be improving, while commercial real estate is getting worse?

Think of a very long train going through a valley. Even while the engine is heading out of the valley, the caboose is still heading downward into the valley...

EXCEPT...

The Bad News...



The looming
commercial real
estate
foreclosure
crisis could
derail recovery

**Sacramento
Commercial Real Estate Market
Mid-Year Outlook**

The Coming Storm... CRE Defaults/Foreclosures



A Little Trip Back in Time...



Saving and Loan Crisis Late 1980s/Early 1990s

745 S&L Failures

Contributing Cause of 1990/1991
Recession

Total Cost Estimated at \$160.1
Billion

Total Cost picked up by US
Government Estimated at \$124.6
Billion

*--US GAO 1996/Financial Audit RTC 1994/1995 Financial
Statements*

Back to the Future...



The New Commercial Real Estate Crisis

According to RCA, \$175B already in distressed CRE

Estimated \$1.8 TRILLION in CRE debt coming due by 2012 (includes CMBS)

Estimated \$400 Billion in CRE debt coming due in 2009 alone (includes CMBS)

Estimated \$1.4 TRILLION in CRE Loans coming due by 2014 (no CMBS)

Estimated \$275 Billion in CRE loans (excluding CMBS) coming due this year.

Going Up... Way Up

The New Commercial Real Estate Crisis

According to Fitch Ratings, CMBS defaults rose in July to 3.04%.

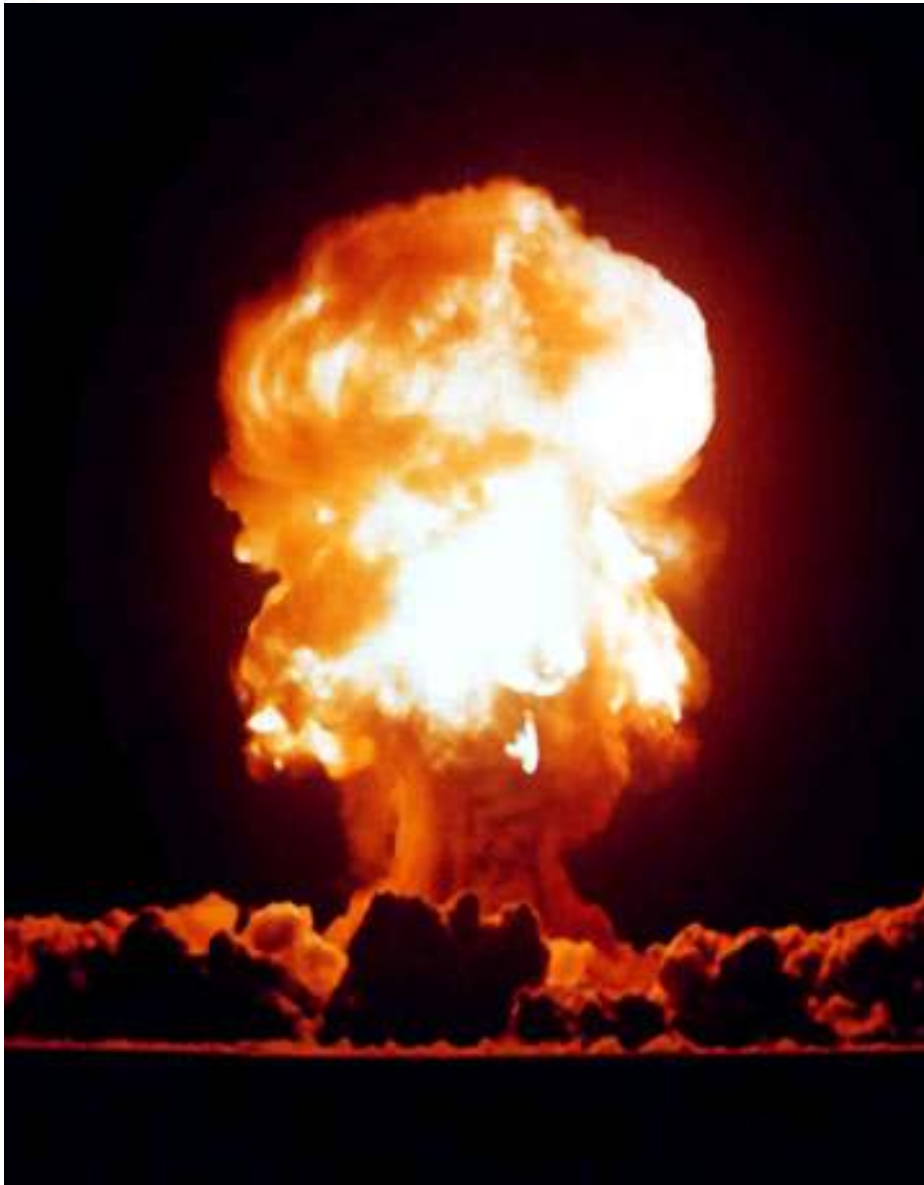
The current rate of increase in CMBS defaults is now over \$2B per month

Fitch forecasts a 6% default rate by 1Q 2010

Barclays predicts a 8% default rate by YE 2009.



How Big Could the Problem Be?



Of the estimated \$1.8 TRILLION in CRE debt coming due by 2012 (includes CMBS), assuming that the rate of default was...

20%	\$360 Billion Problem
30%	\$540 Billion Problem
40%	\$720 Billion Problem

Adjusted for inflation, the approximately \$160B lost in the S&L crisis, would come out to roughly \$250B in today's dollars.

The Next Shoe to Drop

We are already dealing with a number of banks on their distressed assets

Their individual estimates vary, but the consensus number we are hearing from lenders is that they expect 30% of their CRE loans to go bad over the next 24 months...

At least banks can “pretend & extend.” This is not currently an option for CMBS.

A Rolling Loan Gathers No Loss



More banks are opting not to foreclose on distressed assets... to “pretend and extend.”

The Risk? Could compound problem tomorrow...

The Benefit? Could save many loans from going bad.

A Rolling Loan Gathers No Loss



When does Pretend & Extend make sense?

When we advise bank clients, we go through a detailed checklist to determine multiple factors where this makes sense, but ultimately, the biggest factor is the Borrower...

**If a loan is performing
Chances are the lender should find anyway
they can to “Pretend & Extend”**

What Are We Dealing With ...

The New Commercial Real Estate Crisis

CRE values dropped by roughly one third during the S&L Crisis...

They have already dropped by at least that. Estimates from REIS, RCA, Moody's and MIT School of Real Estate are in the 35% to 40% range.

This is BEFORE the full wave of defaults/foreclosures has even hit



How Bad Could it Get?

What, Me Worry?



If aggressive and effective measures are not taken...

The new CRE loan crisis will likely be at least twice as bad as the S&L Crisis and potentially worse...

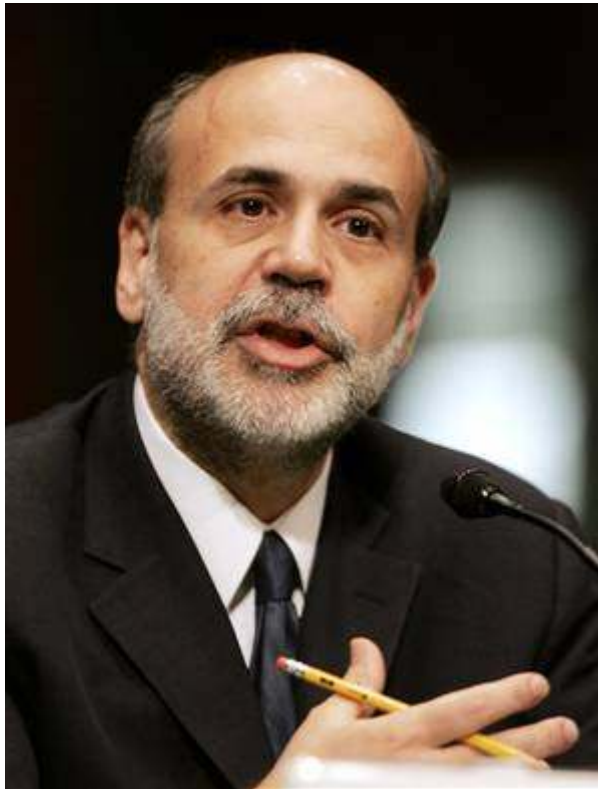
Before it is done CRE values could decline from last peak in the 50 to 80% range...

Hundreds of smaller and regional banks (they will be hit hardest by this) could potentially fail...

Credit markets might freeze back up, creating chain reaction of bankruptcies...

Likely double-dip recession...

Can More Intervention Stem the Tide?



Extension of TALF might provide relief for CMBS loans, but significant improvement won't come until CMBS loans can more easily be re-negotiated.

Can a Bailout Occur if Politicized?

If Not Politicized, it HAS TO happen.

If politicized, who knows?

Impact on Investment Market?

Sales activity already at a crawl while we wait to see where the bottom is. Gap between bids and asking prices is starting to narrow, in favor of bids...

If no relief coming, this process will slow further as opportunistic buyers hold out for even lower fire sale pricing...

If some relief comes, sense of bottom and transactions will come sooner...

Once sense of bottom, flood gates will open... lots of money on the sidelines...

Look for more properties to change hands than what we have seen over last five years combined.



There are Basically Two Types of REITs Today



Bankrupt

Or...
Raising
Warchests in
Preparation
for the
Fire Sale



REITs Looking to Raise Cash Through IPOs

25 Registrations with SEC in just the last 6 weeks

Brookfield Properties--\$900M/\$4B total besides IPO

Boston Properties--\$850M

Simon--\$650M

Regency Centers--\$400M

Colony Financial--\$500M

Thompson National Properties--\$1B

PennyMac Mortgage Investment Trust--\$335M

Dividend Capital Total Realty Trust--\$540M

Apollo Management subsidiary--\$600M

Alliance Bernstein--\$500M

HCP--\$441M

Federal Realty Investment Trust--\$250M

the list goes on...

Many are raising cash to pay down debt, but most are also positioning themselves for acquisition sprees

Sacramento Commercial Real Estate Market Mid-Year Outlook

Recession/Recovery Timeline—Assuming CRE Relief

1/2008 – 9/2008	10/2008 – 4/2009	5/2009 – 9/2009	10/2009 – 12/2009	2010	2011	2012	2013
Moderate Recession	Great Recession	Moderate Recession	Mild Recession	Slow Recovery Possibility of Double Dip Recession	Slow Recovery Worst of residential foreclosures over	Increasing Growth	Increasing Growth Residential Housing Begins Growth
Negative job growth	Employment freefall	Continued job losses	Continued job losses	March 2009 Peak unemployment	Low job growth	Low job growth	Increasing job growth
	Industrial vacancy begins uptick	Industrial vacancy continues uptick	Industrial vacancy continues uptick CRE foreclosure surge	Industrial vacancy peaks 3 rd Qtr— begins to rebound CRE foreclosure surge	Market Stabilization/ Slow growth for industrial CRE foreclosure surge	Increasing growth CRE foreclosure surge over	Increasing Growth

Sacramento Commercial Real Estate Market Mid-Year Outlook

Recession/Recovery Timeline—Assuming NO CRE Relief

1/2008 – 9/2008	10/2008 – 4/2009	5/2009 – 9/2009	10/2009 – 12/2009	2010	2011	2012	2013
Moderate Recession	Great Recession	Moderate Recession	Mild Recession	Double Dip Recession by End of Year	Still possible recession Worst of residential foreclosures over	Increasing Growth	Increasing Growth Residential Housing Begins Growth
Negative job growth	Employment freefall	Continued job losses	Continued job losses	Job Losses stabilize in Spring—Picks up again final half of year	Job losses stabilizing by first half of year	Low job growth	Increasing job growth
	Industrial vacancy begins uptick	Industrial vacancy continues uptick	Industrial vacancy continues uptick CRE foreclosure surge	CRE foreclosures surging	Market Stabilization/ CRE foreclosure surge	Increasing growth/Slow growth for office and industrial CRE foreclosures diminishing	Increasing Growth Retail stabilizing

Sacramento Commercial Real Estate Market Mid-Year Outlook

CRE Property Types—Strongest to Weakest



Multifamily
Industrial
Office
Retail



Sacramento Commercial Real Estate Market Mid-Year Outlook

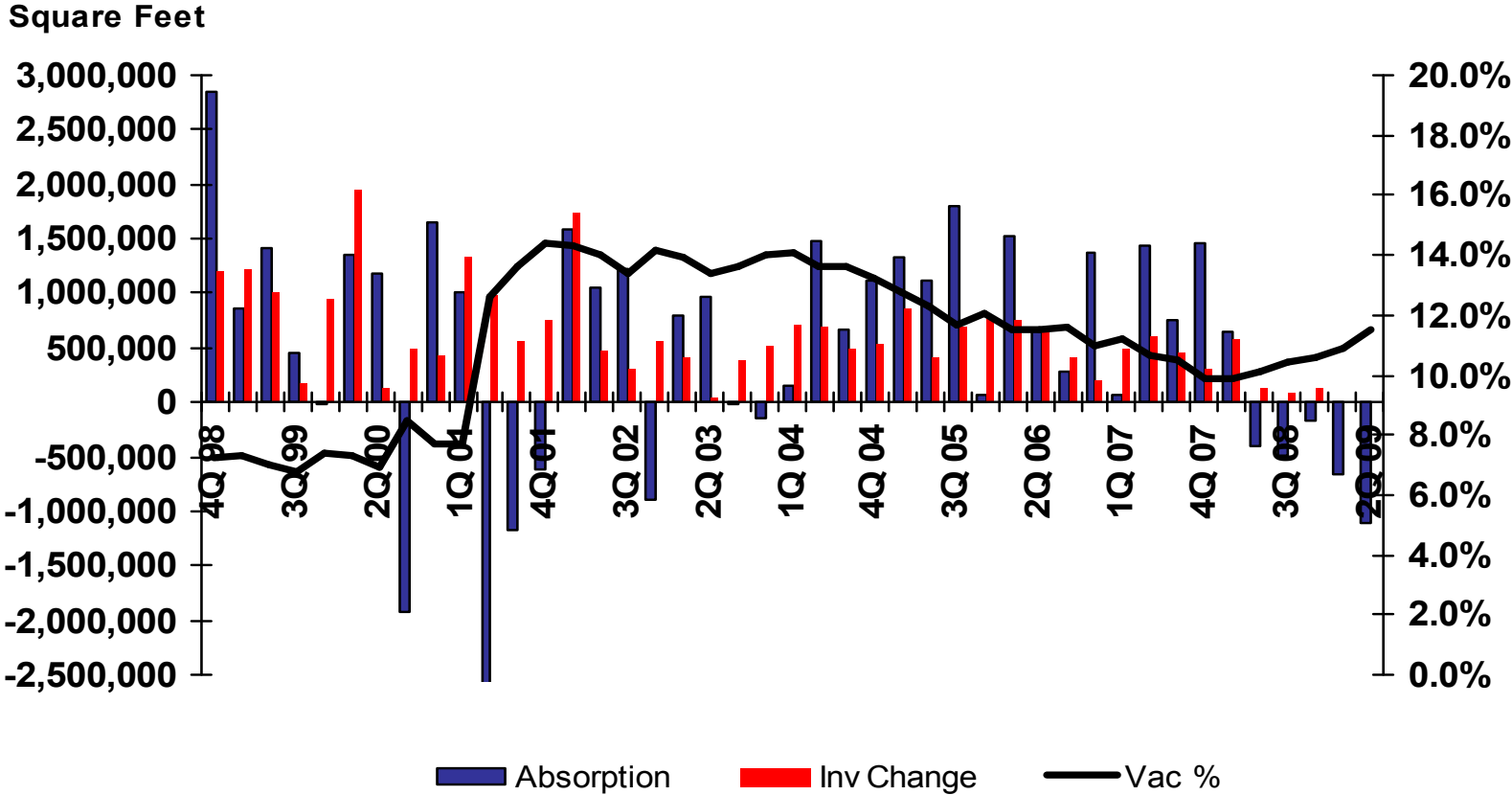


Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook



Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Change in Inventory, Net Absorption & Vacancy



Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Real Estate Roundup

- Vacancy up from 10.9% to 11.5%.
- Over 1.1M SF negative net absorption in 2nd Qtr.
- Second consecutive quarter with no new deliveries-market first.
- Rental rates continuing to drop, concessions on rise... Deal activity remains suppressed—mostly short-term renewals. Tenants market for those ready to pull trigger.
- Construction related users and suppliers continuing to go dark.
- Shadow market of occupied space where rent is not being paid is growing... State of CA IOUs only adding to problem... some submarkets with 10 – 11% vacancy may have another 10% of space that is occupied but not paying rent.

Sacramento

Commercial Real Estate Market--Industrial

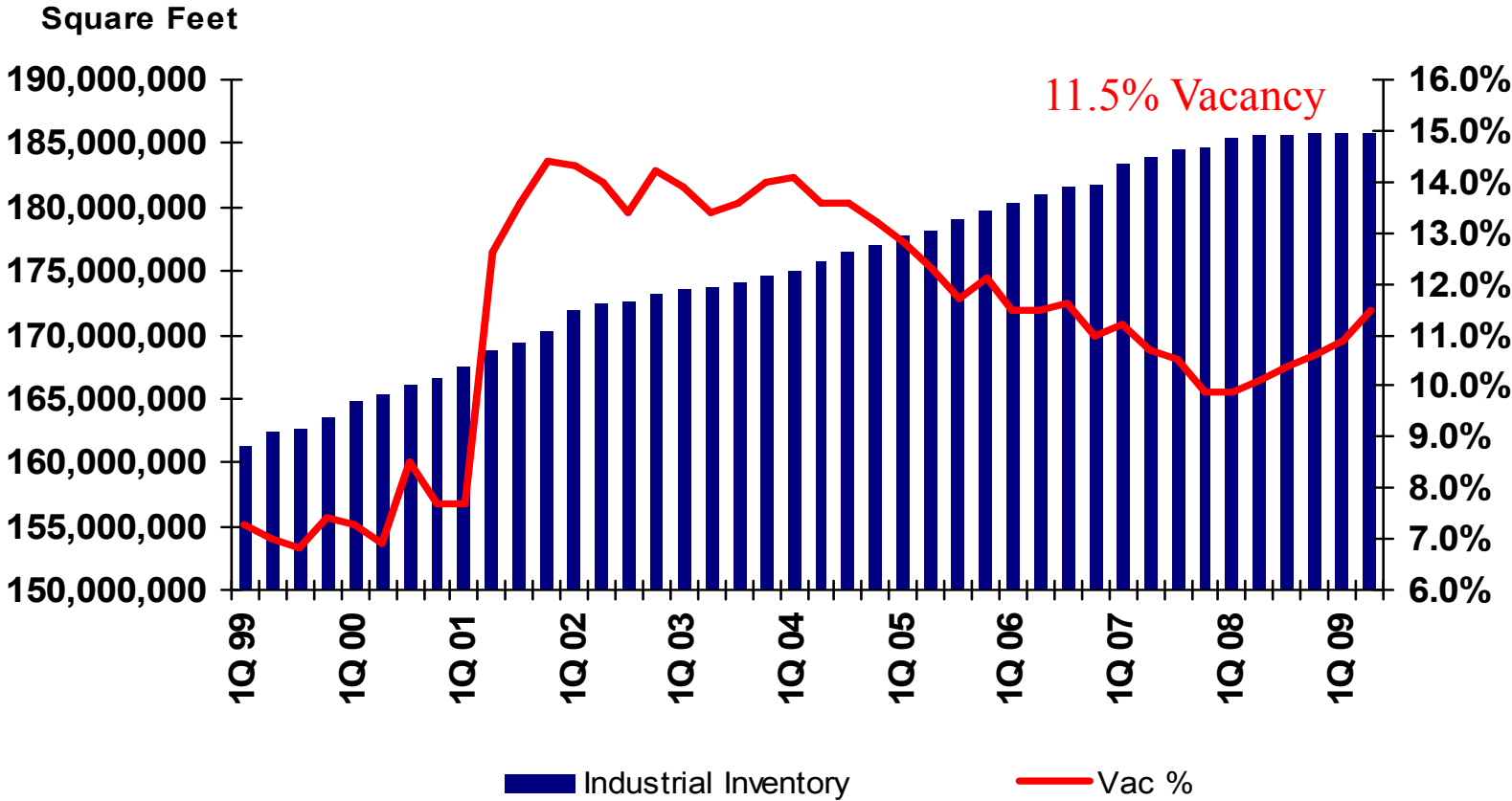
Mid-Year Outlook

Top 2009 Industrial Leases YTD

Building	Submarket	Type	SF Transacted	Tenant	Notes
2935 Ramco Street	West Sacramento	Wrhs	444,600	Safeway	Renewal
1685 E Tide Court	Davis/Woodland	Wrhs	151,200	E&E Trading	Renewal
8670 Younger Creek Dr	Power Inn	Wrhs	101,256	Continental Warehouse	Renewal
1660 Tide Court	Davis/Woodland	Wrhs	91,445	Amerimax Building Products	Renewal
1751 Aviation Blvd	Roseville/Rocklin	Wrhs	77,165	X2 Motorsports	New Deal 6/1/09 Move-in
3062 Prospect Park Drive	Sunrise/Hwy 50	Flex	44,740	EDS	Renewal
1341 N Market Blvd	Natomas/Northgate	Wrhs	36,000	Dayton Phoenix	New Deal 6/1/09 Move-in
700 Santa Anita Dr	Davis/Woodland	Wrhs	35,500	Continental Supply	Renewal
3200 Reed Ave	West Sacramento	Wrhs	32,000	Valley Relocation & Storage	New Deal 10/1/09 Move-in
1460 Tanforan Ave	Davis/Woodland	Wrhs	32,000	NorCal Indoor Sports	New Deal 7/1/09 Move-in
3885 Seaport Blvd	West Sacramento	Wrhs	29,128	Mission Foods	1/1/09 Move-in

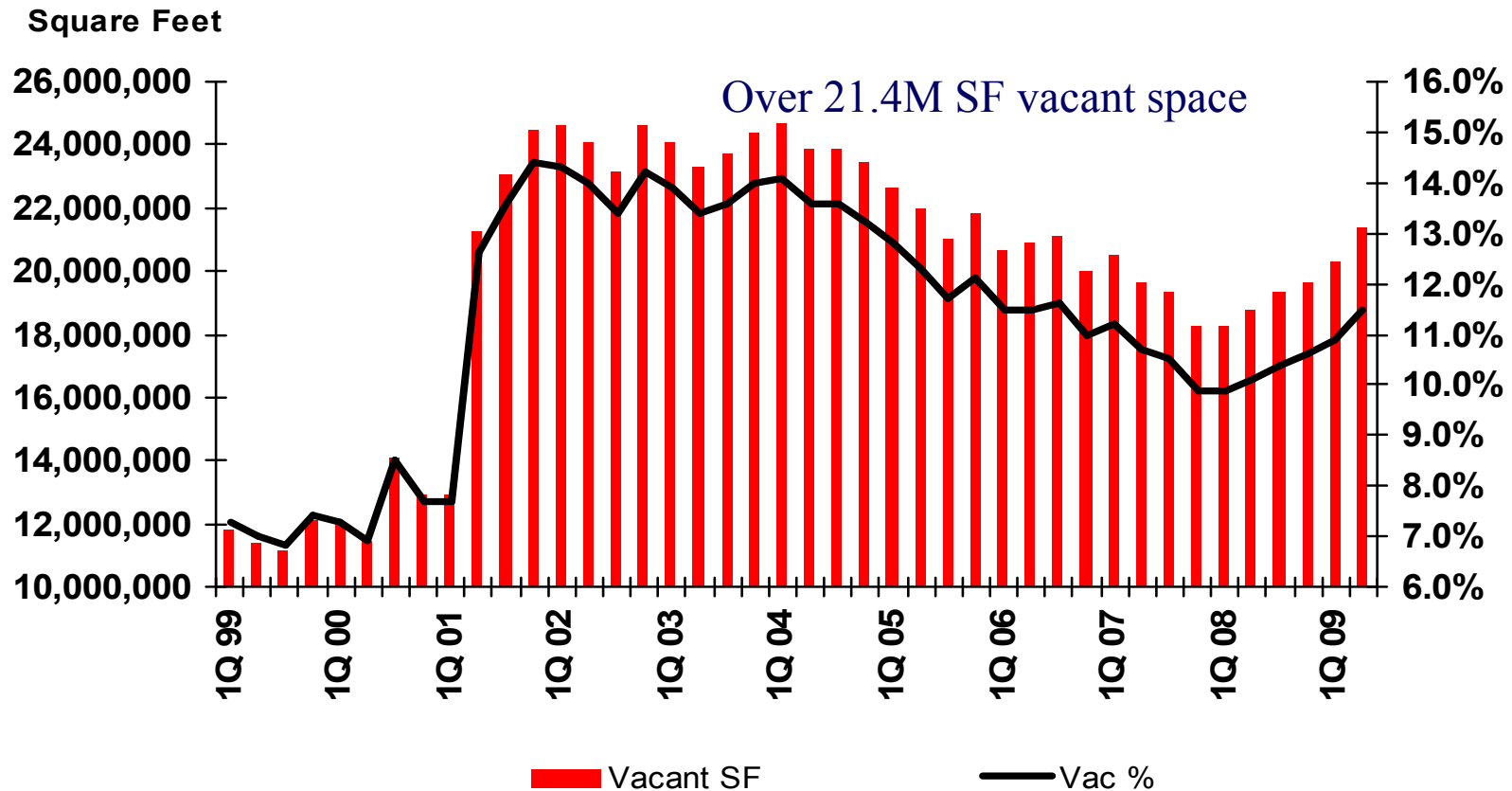
Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Inventory (Total SF) & Vacancy



Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Vacant SF/Vacancy Rate



Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

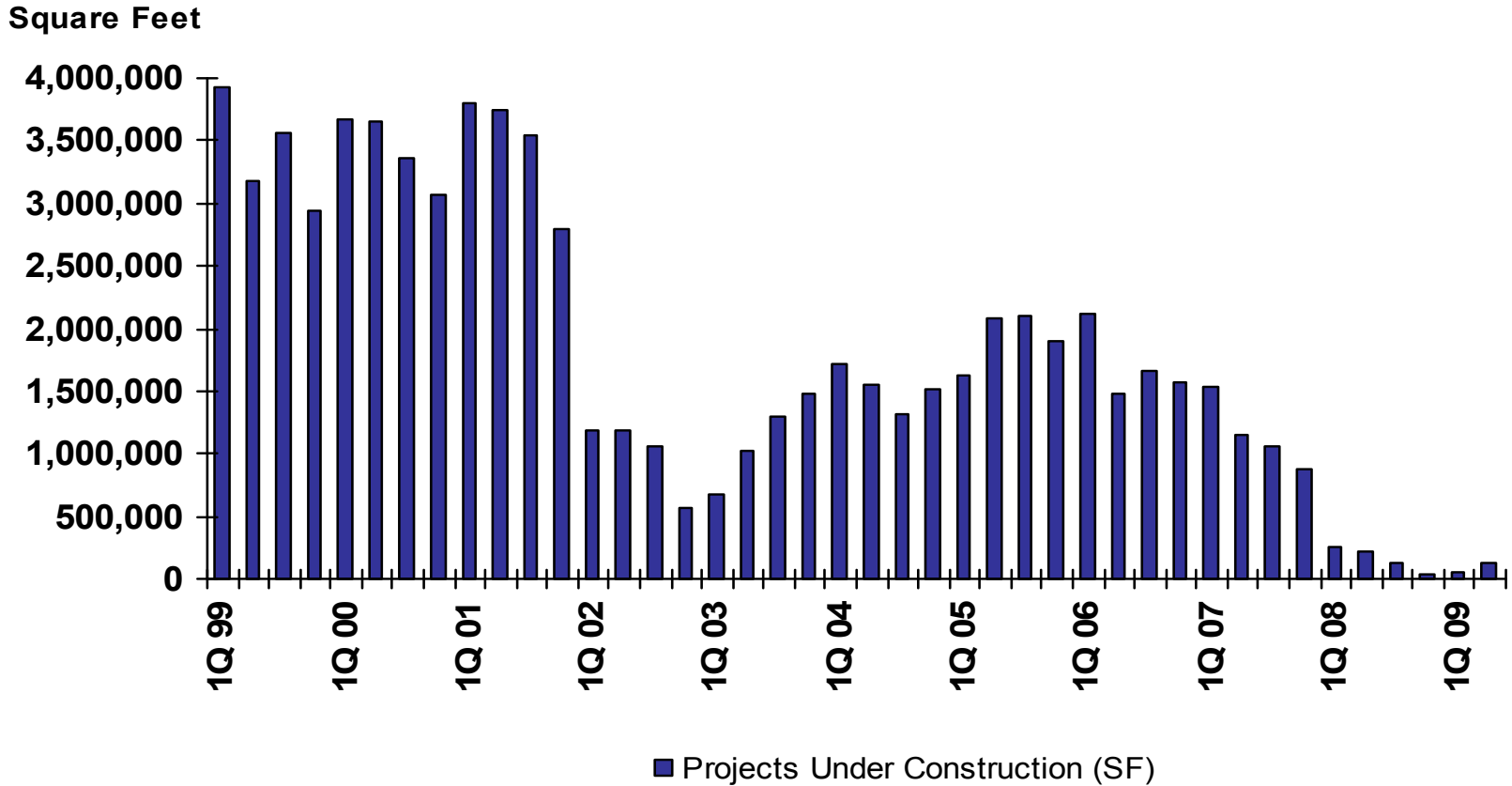


No New Deliveries Two Quarters Running New Market Record

- Empty construction pipeline will play a major role in industrial rebound being more robust than other local property types.
- We don't see industrial development picking up substantially for at least 18 months.
- **SALE PRICES ARE BELOW REPLACEMENT COST FOR MOST CRE PROPERTY TYPES**

Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

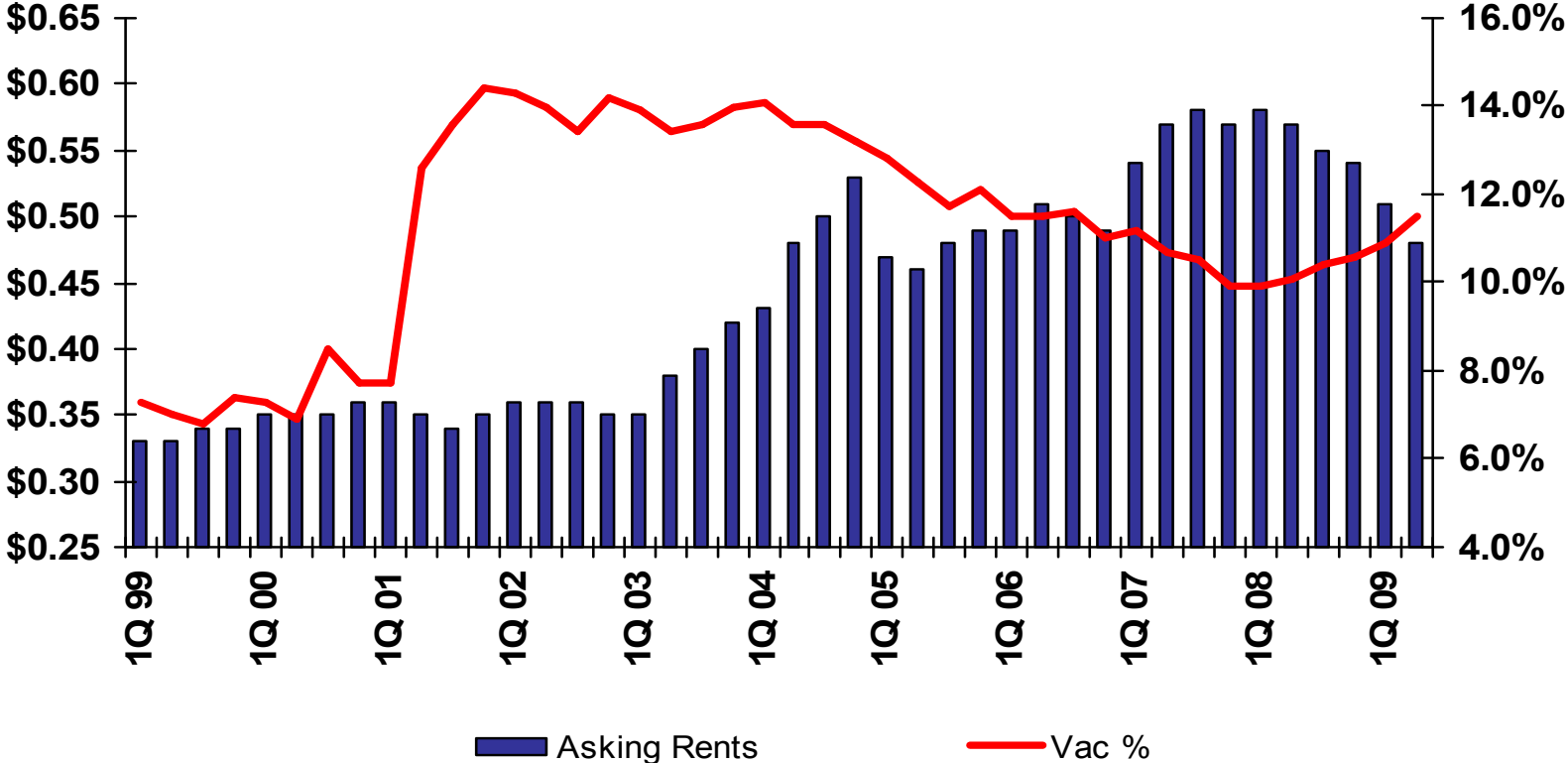
Construction Pipeline



Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Asking Rents Vs. Vacancy

Asking Rents
(Monthly NNN)



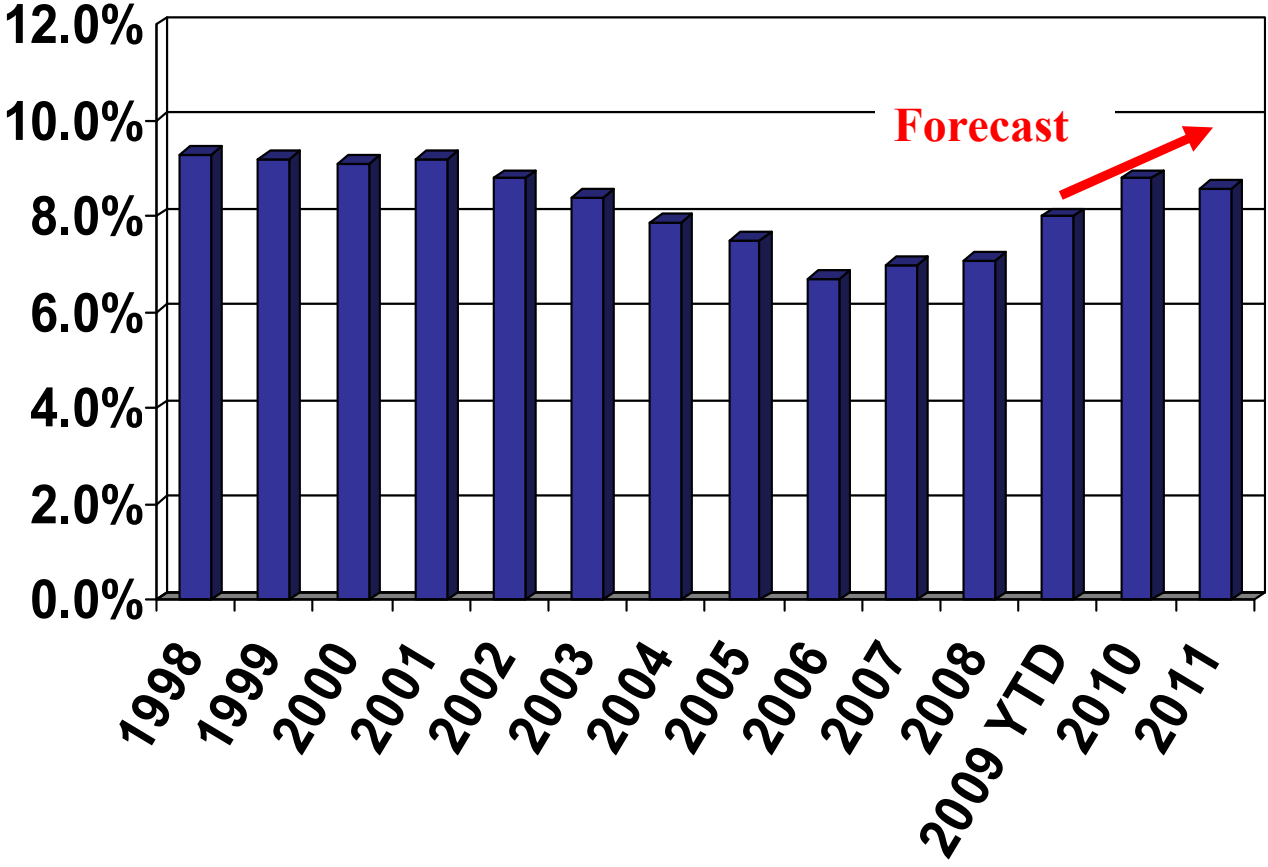
Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Investment Outlook

- Owner/user sales continue to outpace investment opportunity. Approx 220 sales so far this year, less than 25% of these were investment transactions.
- Slow sales activity continues... gap remains between bids and asking rates... momentum on buyer's side.
- Pricing will be heavily impacted by distressed properties.
- Cap rates continue to rise—now 8% average for metro—will peak in the 9% range next year.
- Defaults on the rise... foreclosures on the way... distressed property sales will take centerstage over next 6 to 18 months.
- Vulture funds waiting on sidelines for deals. Stronger REITS building warchests for acquisition. Expect surge in activity in next 12 months. Expect major changes in ownership of CRE.

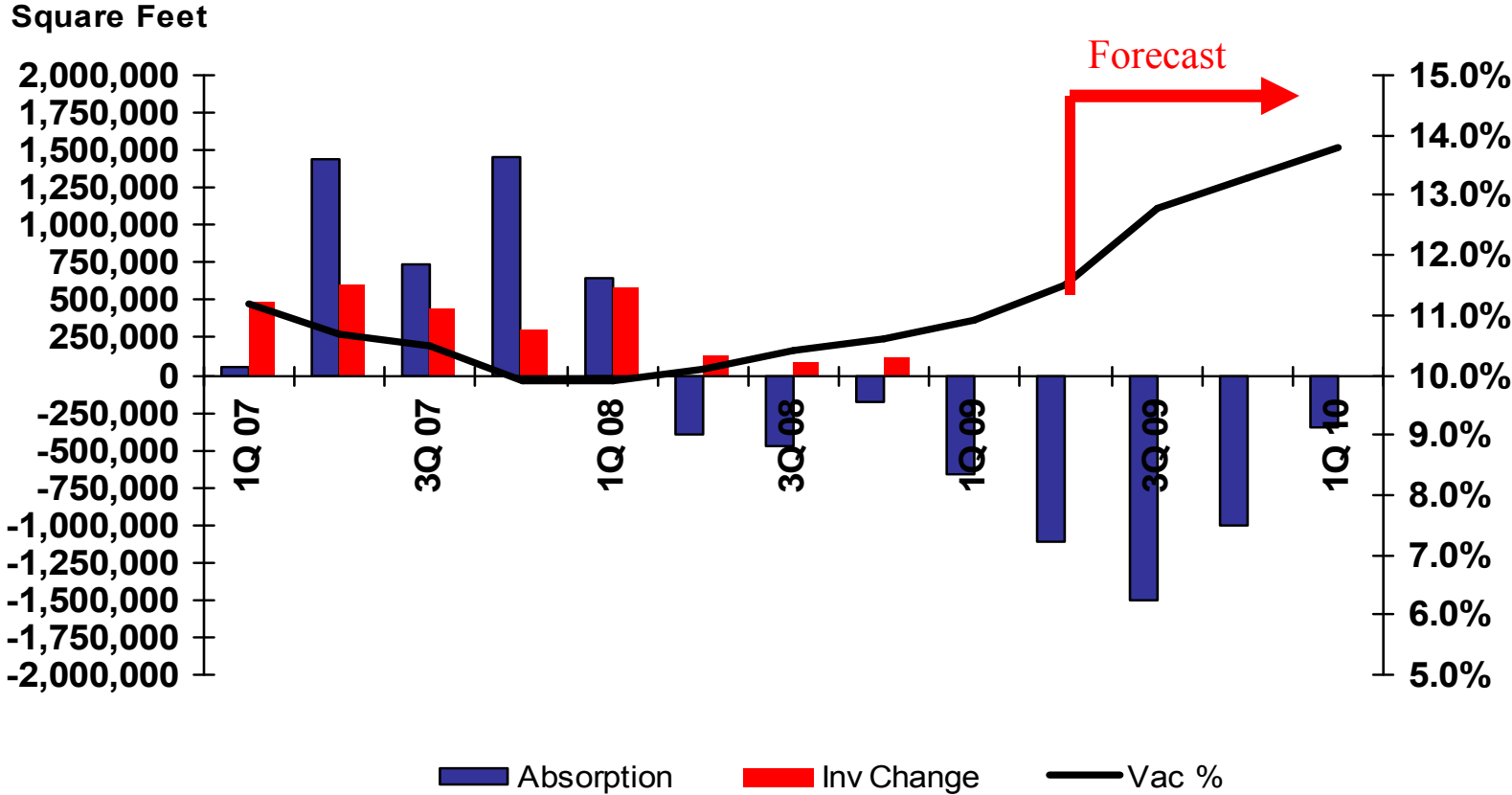
Sacramento Commercial Real Estate Market--Industrial Average Cap Rates

Mid-Year Outlook



In 2009/2010 expect to see a few deals with caps as high as 10% or 11%. There are already a number of listings advertising 9%+ caps. This will be a factor in bringing the region's average cap rate close to the 9% mark by 2010.

Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook 2009/2010 Forecast



Sacramento Commercial Real Estate Market--Industrial Mid-Year Outlook

Looking Ahead

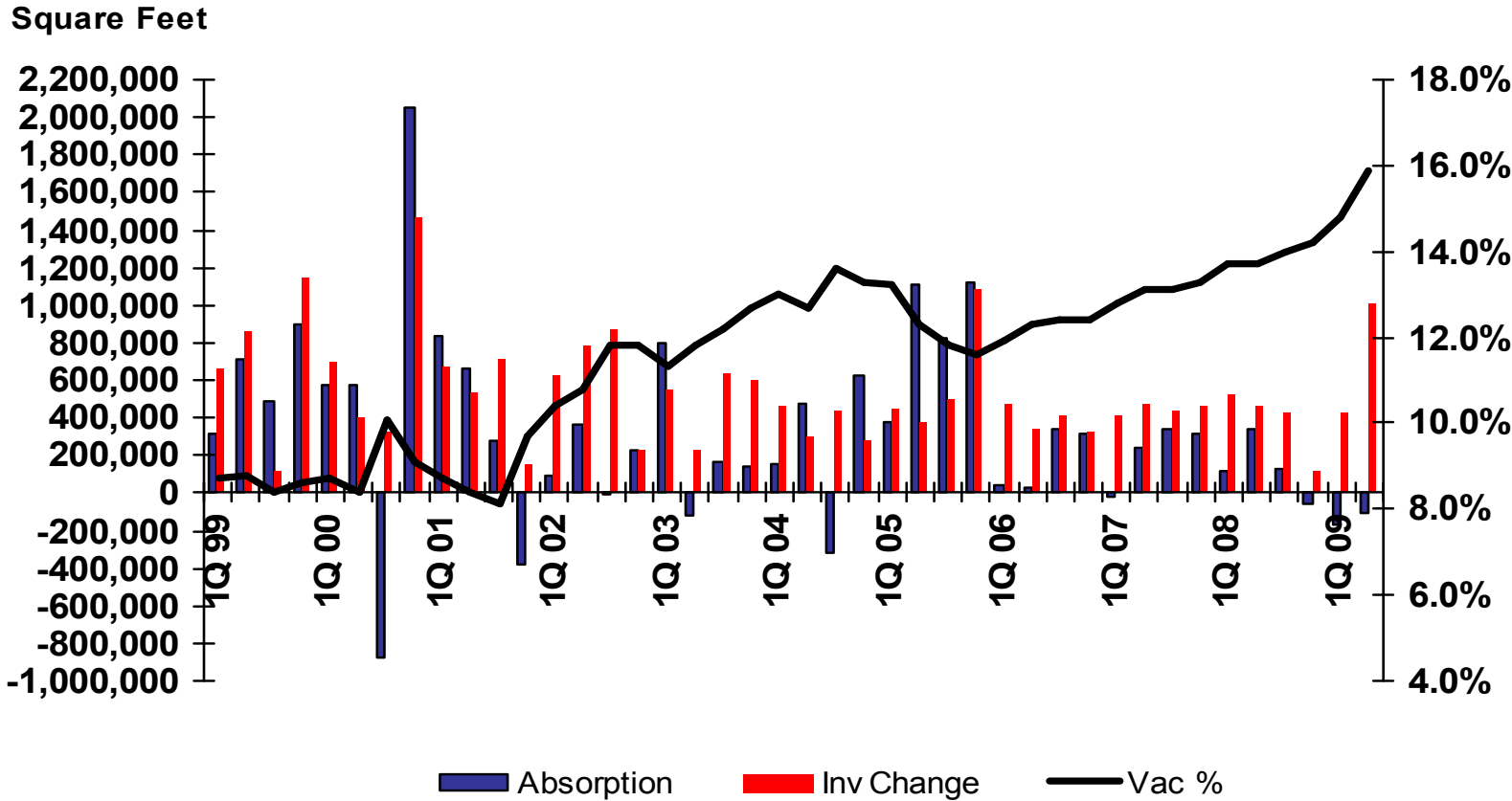
- Negative net absorption through remainder of the year.
- Vacancy will continue to increase heading into early 2010, likely by another 20 bps.
- Zero construction levels likely with us another 18 months... will play positive role in market recovery.
- Continued strong downward pressure on rental rates.
- Distressed property sales will take centerstage as commercial foreclosures surge.
- Industrial rebound will begin second half 2010... industrial properties will be better positioned than other CRE thanks to low vacancy heading into storm and no construction.

**Sacramento
Commercial Real Estate Market--Office
Mid-Year Outlook**



Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Change in Inventory, Net Absorption & Vacancy



Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Real Estate Roundup

- Vacancy up from 14.8% to 15.9%.
- -105,000 sf Net Absorption in 2nd Qtr
 - Delivery of 400,000 sf CalSTRS Building—almost—but not quite enough to keep us in the black.
- Over one million sf new space delivered in 2nd Qtr.
- Strong pressure remains on rental rates, but held their own in 2nd Qtr, after falling previous five quarters. Free rent and TI allowances up.
- Deal activity remains suppressed—mostly short-term renewals.
- Few expansion leases... most are under 5,000 sf in size and are from legal, accounting or medical users.

Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Real Estate Roundup

- Shadow Space Looming
 - Occupied, but unused space, will increasingly be returned to the marketplace
 - Combined actual & shadow vacancy could be as high as 40% in Roseville, as high as 25% in other suburban markets
 - How much is returned will depend on user sense of economic recovery—the longer this drags out, the more space will be returned



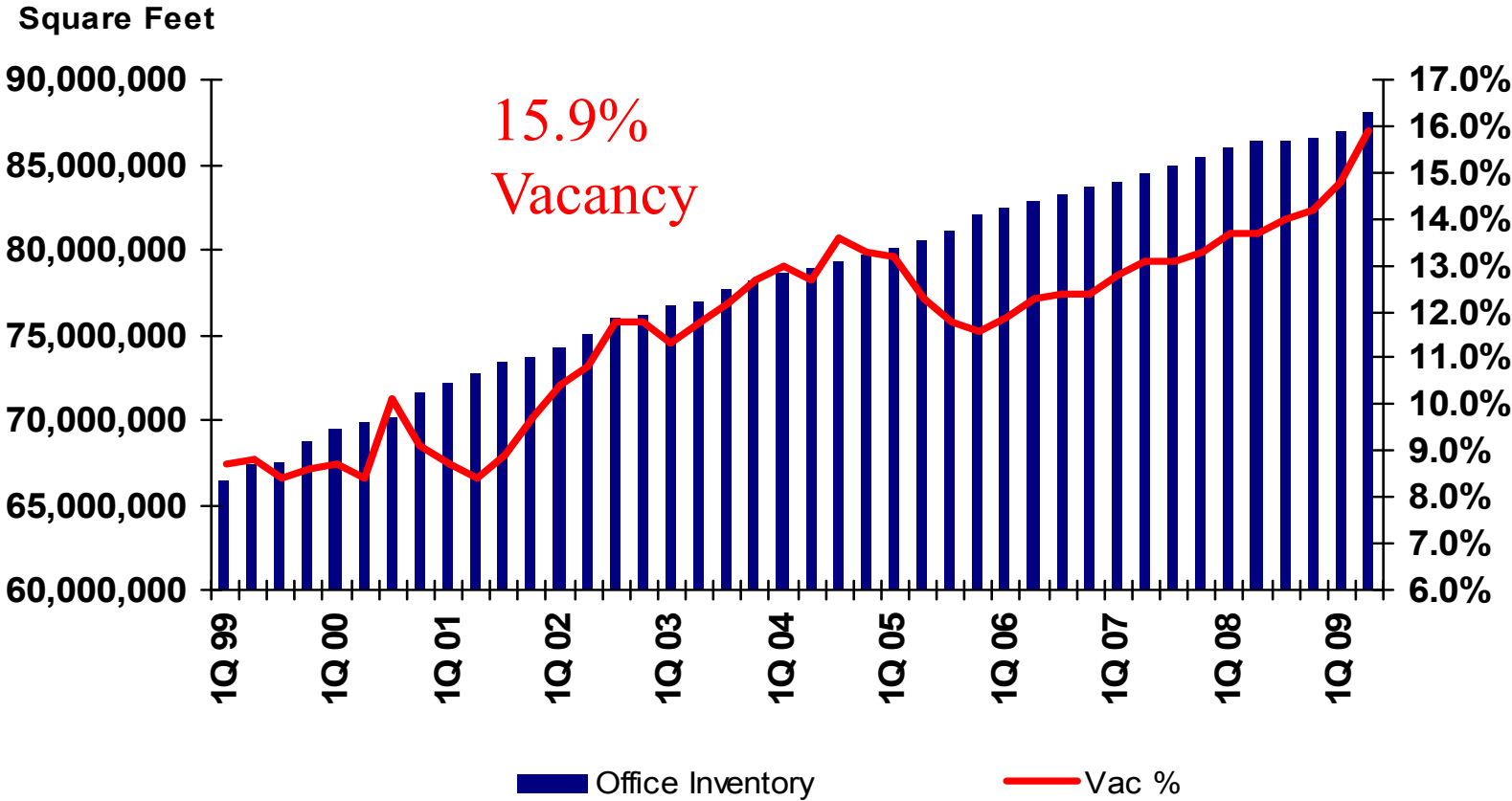
Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Top 2009 Office Leases YTD

Building	Submarket	Class	SF Transacted	Tenant	Notes
3215 Prospect Park Drive	Highway 50	Class C	101,400	EDS	Renewal
2235 Iron Point Road	Folsom	Class B	96,400	Numonyx	New Deal 12/1/09 Move-in
2870 Kilgore Road	Highway 50	Class B	75,626	Volcano	Renewal
11000 White Rock Road	Highway 50	Class A	53,742	Wachovia Education Finance	Renewal
2485 Natomas Park Drive	South Natomas	Class A	51,980	Cb2m Hill Co	Renewal
2005 Evergreen Street	Point West	Class C	37,960	State of CA DMV	New Deal 6/1/09 Move-in
10877 White Rock Road	Highway 50	Class A	36,626	Allstate	Sublease 6/1/09 Move-in
500 Capitol Mall	Downtown	Class A	34,680	Bank of the West	New Deal
2825 Watt Ave	Watt Ave	Class C	34,587	Kaiser Permanente	Renewal

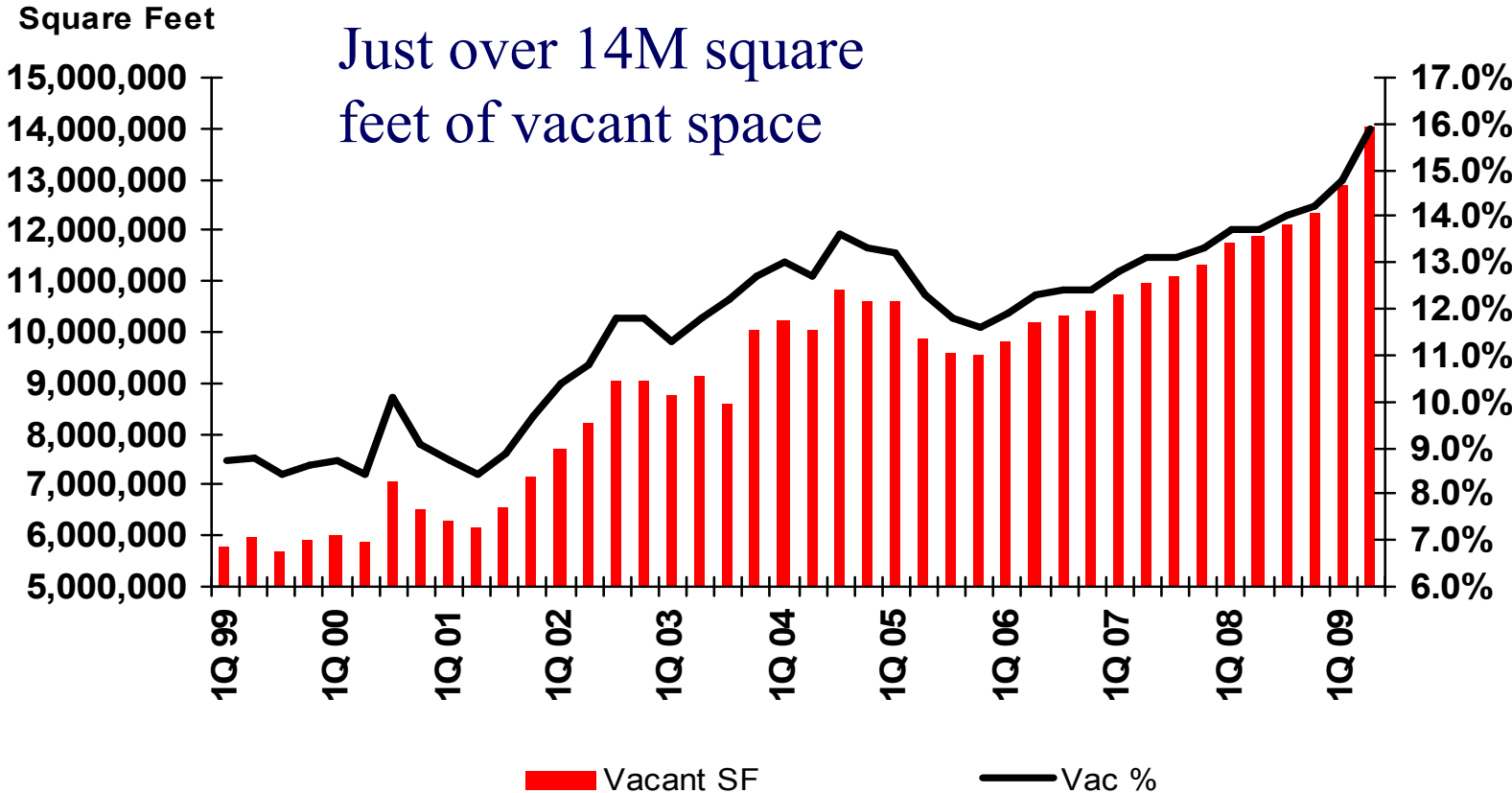
Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Inventory (Total SF) & Vacancy



Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Vacant SF/Vacancy Rate



Sacramento Commercial Real Estate Market--Office Mid-Year Outlook



Occupancy Growth from Major Deliveries Outpaced Occupancy Losses Elsewhere

- 500 Capitol Mall
 - Downtown Class A
 - 433,500 square feet
 - 284,000 square feet remains available (accounted for almost 150,000 sf occupancy growth upon delivery)
- 100 Waterfront Place CalSTRS HQ
 - West Sacramento Class A
 - 400,000 square feet
 - Completely occupied

Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Construction Pipeline



Sacramento Commercial Real Estate Market--Office Mid-Year Outlook



Remaining Construction in Pipeline Having Lease-Up Issues

- Gateway Tower East
 - South Natomas Class A
 - 319,200 square feet
 - 319,200 square feet remains available
 - Delivery 3rd Qtr 2009

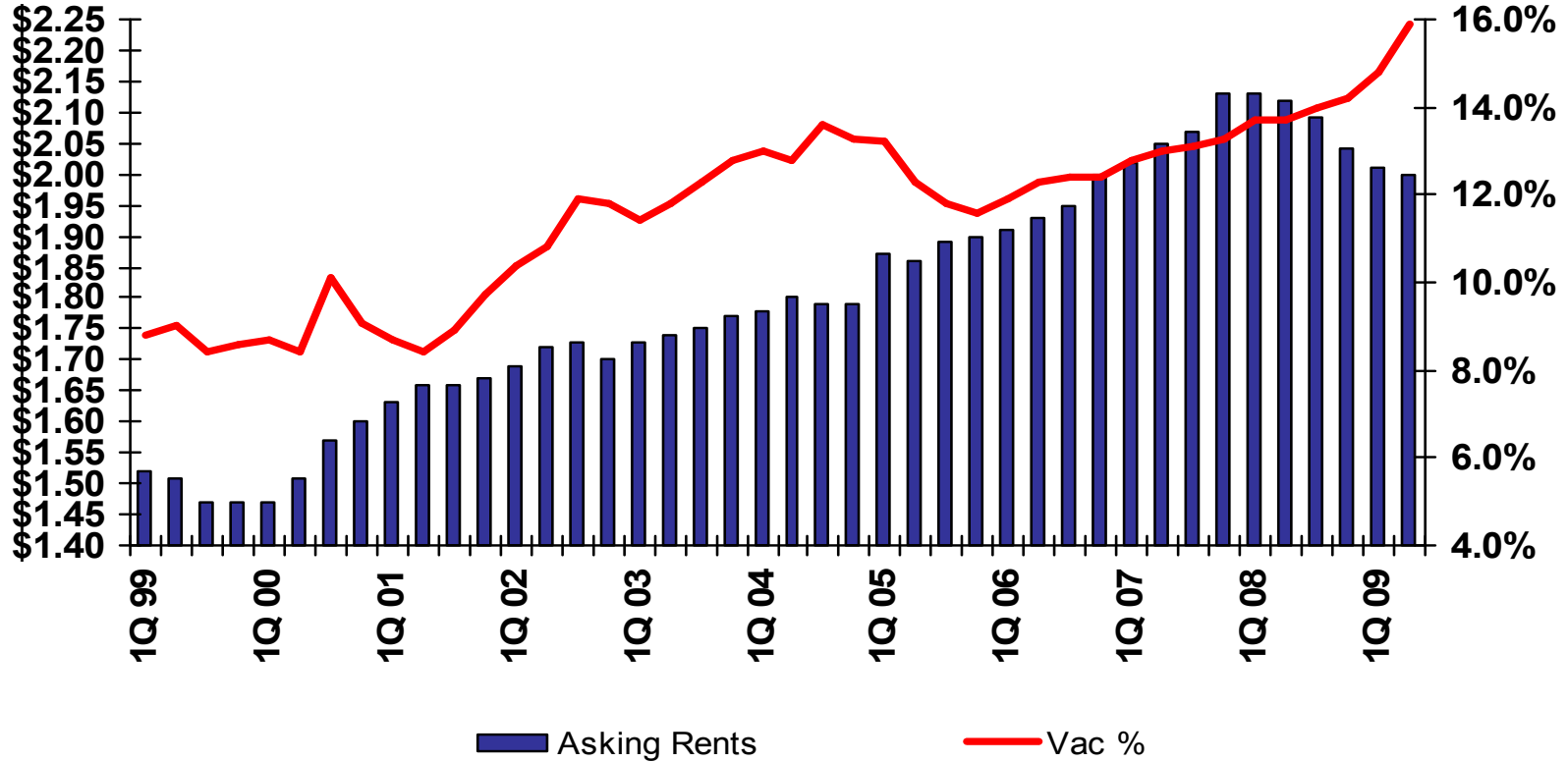
Riverpoint North Corporate Center

- South Natomas Class A
- 108,516 square feet
- 108,516 square feet remains available
- Delivery 1st Qtr 2010

Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Asking Rent
(Monthly Full Service)

Asking Rents Vs. Vacancy

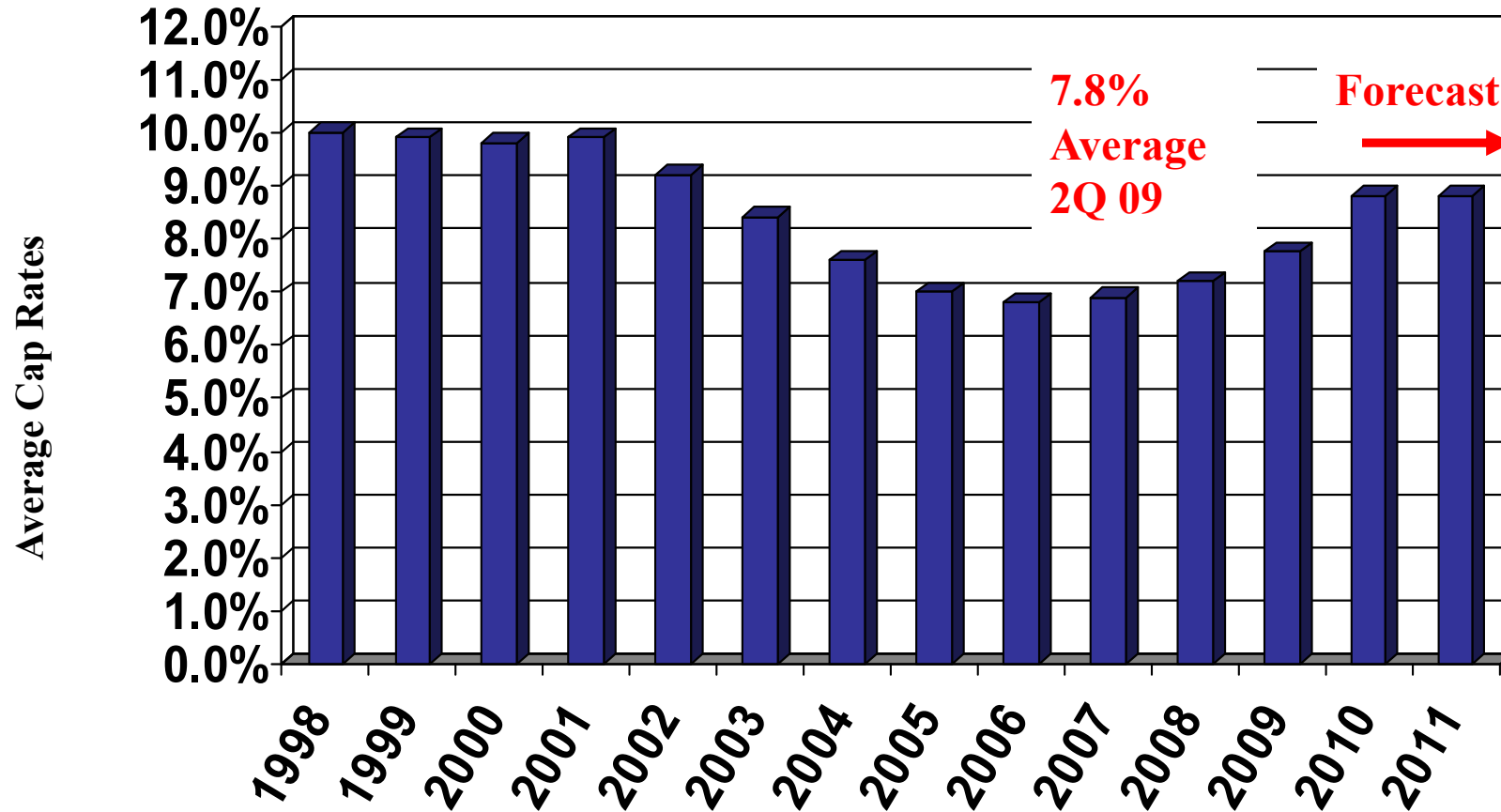


Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Investment Outlook

- Slow sales activity continues... gap remains between bids and asking rates... momentum on buyer's side.
- Pricing will be heavily impacted by distressed properties.
- Cap rates continue to rise—now just below 8% average for metro—will peak in the 9% range next year.
- Defaults on the rise... foreclosures on the way... distressed property sales will take centerstage over next 6 to 18 months.
- Vulture funds waiting on sidelines for deals. Stronger REITS building warchests for acquisition. Expect surge in activity in next 12 months. Expect major changes in ownership of CRE.

Sacramento Commercial Real Estate Market--Office Mid-Year Outlook



In 2009/2010 expect to see a few deals with caps as high as 10% or 11%. This will be a factor in bringing the region's average cap rate close to the 9% mark by 2010.

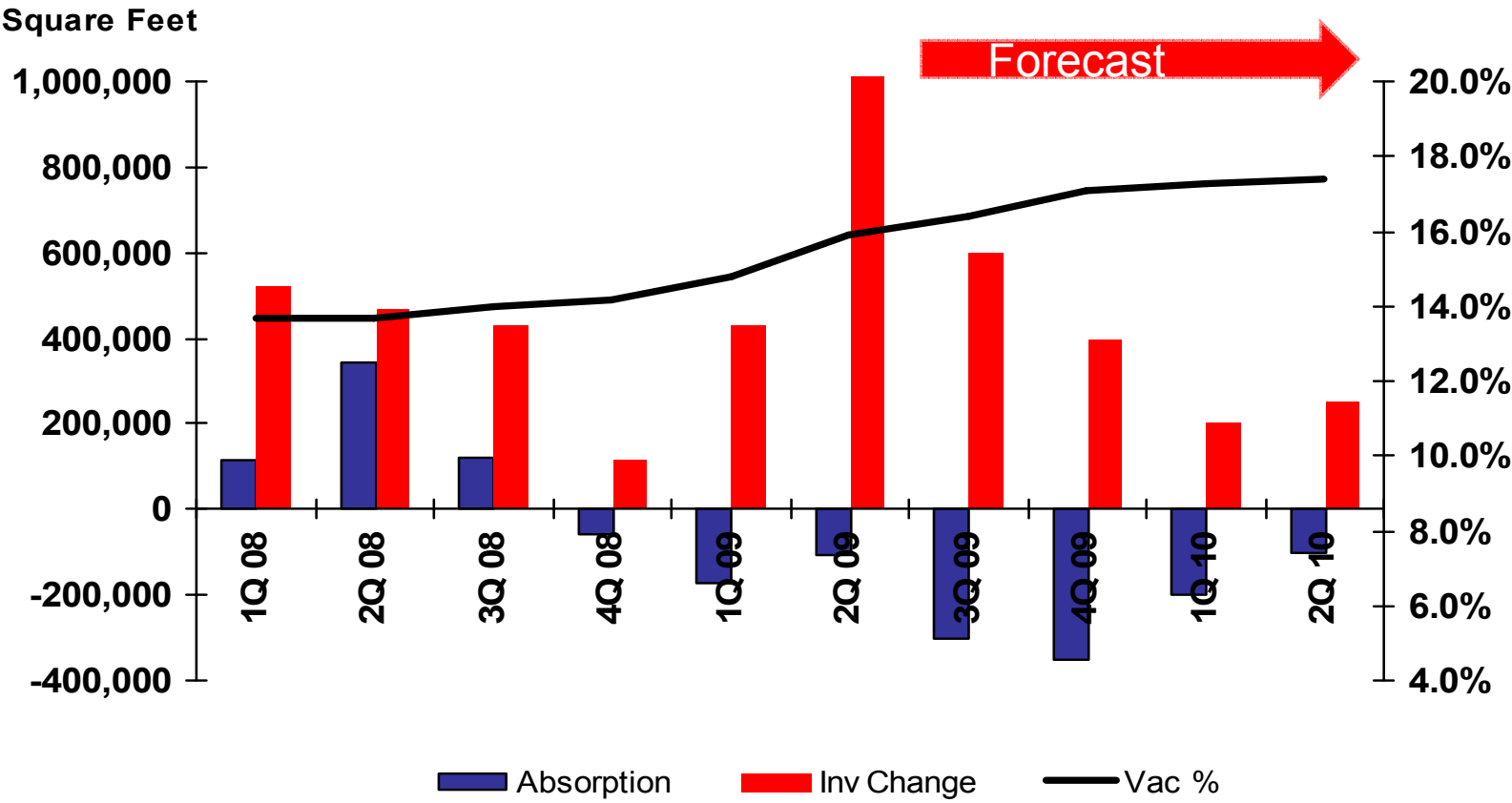
Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Looking Ahead

- Negative net absorption through remainder of the year.
- Between space being returned to marketplace and delivery of vacant new space, look for an additional 1M sf of vacant space by end of 4Q.
- Vacancy will continue to increase heading into early 2010, likely by another 15 to 20 bps.
- Construction pipeline will continue to decrease sharply.
- Continued strong downward pressure on rental rates—particularly for Class B suburban properties.
- Distressed property sales will take centerstage as commercial foreclosures surge.
- Pricing to drop by as much as 40% from peak as investment activity becomes dominated by distressed property sales. Average cap rate will top 9% mark by 2010.

Sacramento Commercial Real Estate Market--Office Mid-Year Outlook

Change in Inventory, Net Absorption & Vacancy



Sacramento Commercial Real Estate Market--Retail Mid-Year Outlook



What is the New “Normal”?



By end of 2nd Qtr Personal Savings Rate was up to 6.9% in June

Was 2.5% at mid-year 2008

Was negative at peak of last cycle

Consumers saving, not spending

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Wealth Effect Replaced by Fear Factor



Consumer confidence to remain low until employment stabilizes

No wage growth in sight to boost spending

Downshifted consumer spending will remain necessity-based until sense that recession is over

Return to 2001-2006 spending patterns not likely

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Retailer BKs



Pain shifting to larger national retailers

Deep pockets running empty

Ability to refinance debt will loom large over retail world... if credit markets seize up again, say goodbye to many chains

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Saved... For Now



Rite Aid refinanced \$1.9 B in debt coming due...

Will live to fight another day...

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Who is on the Watch Lists?

Abercrombie & Fitch

Aldo Shoes

AMC Entertainment

Ann Taylor

Arby's Restaurant Group

Barney's New York

BCBG

Belk

Blockbuster

Bon-Ton

Borders

Brookstone

Cache

Center Cut Hospitality

Christopher & Banks

Claire's Stores

Coldwater Creek

El Pollo Loco

Express

Foot Locker

Fossil

Guitar Center

Harry & David

J Crew

The logo for Colliers International, featuring the company name in white serif font on a dark blue square background, with a white border and a horizontal bar of yellow, blue, and red stripes below it.

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Who is on the Watch Lists? (cont.)

Krispy Kreme

Limited Brands

Loehmann's

Mattress Holdings

Michael's

Modell's

Movico

National Amusements

Office Depot

Office Max

Oriental Trading Co

OSI Restaurants

Pacific Sunwear

Perkins/Marie Callender's

Rare Restaurant Group

Roundy's Supermarkets

Sagittarius Restaurants

Sbarro

Saks Fifth Avenue

Sears

Signet Jewelry

The Limited

Whole Foods

Zales

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Hot

- **Discount**
- **Aeropostale**
- **Nordstrom Rack**
- **WalMart**
- **McCafe**
- **Off-Price Apparel**
- **Pop-Ups/Kiosks**
- **7-11**

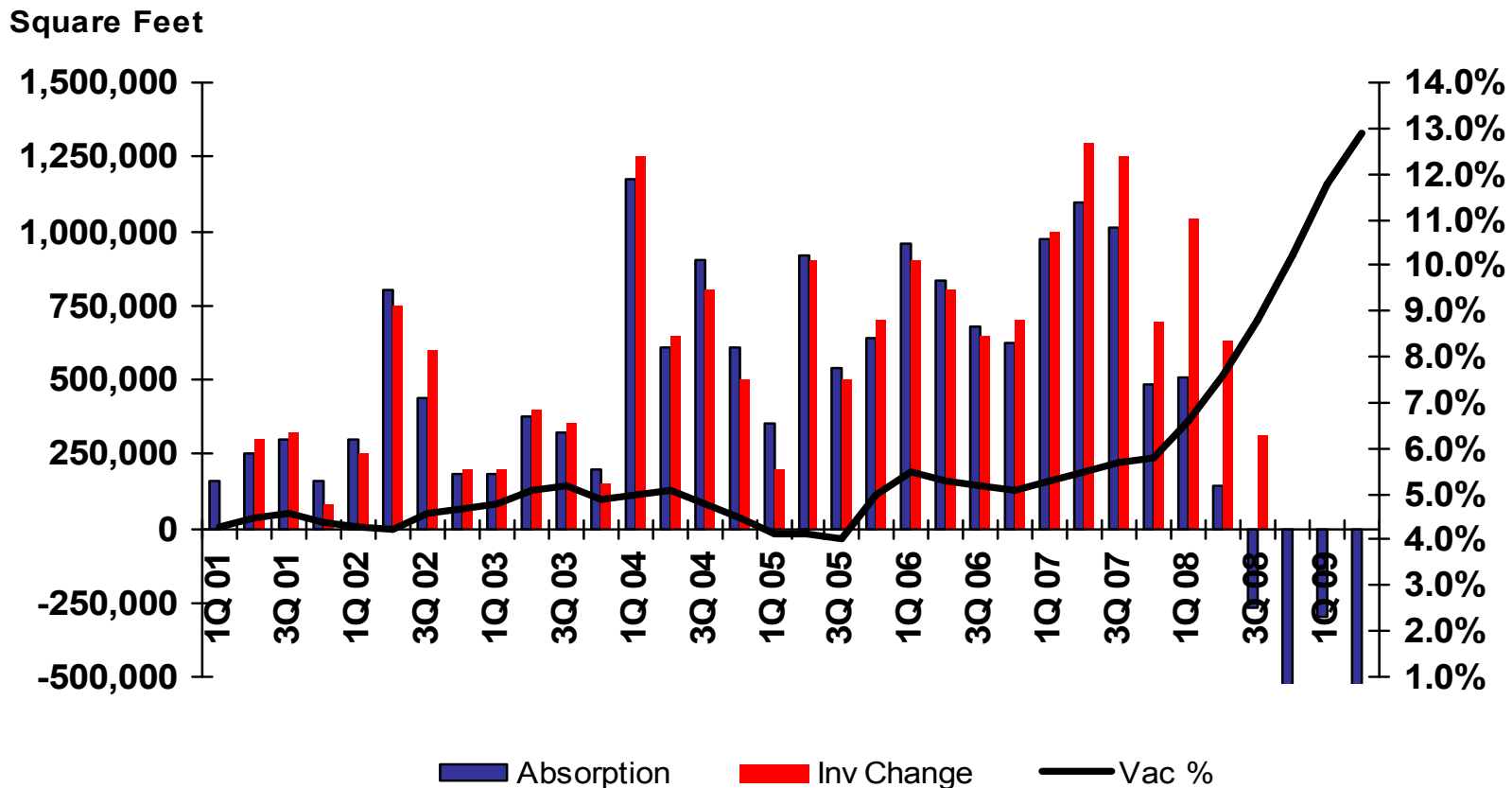
Not

- **Luxury**
- **Abercrombie & Fitch**
- **Nordstrom**
- **Whole Foods**
- **Starbucks**
- **Designer Label Apparel**
- **Big Box**
- **Convenience Stores
(except 7-11)**

Sacramento Retail Market

2nd Qtr 2009

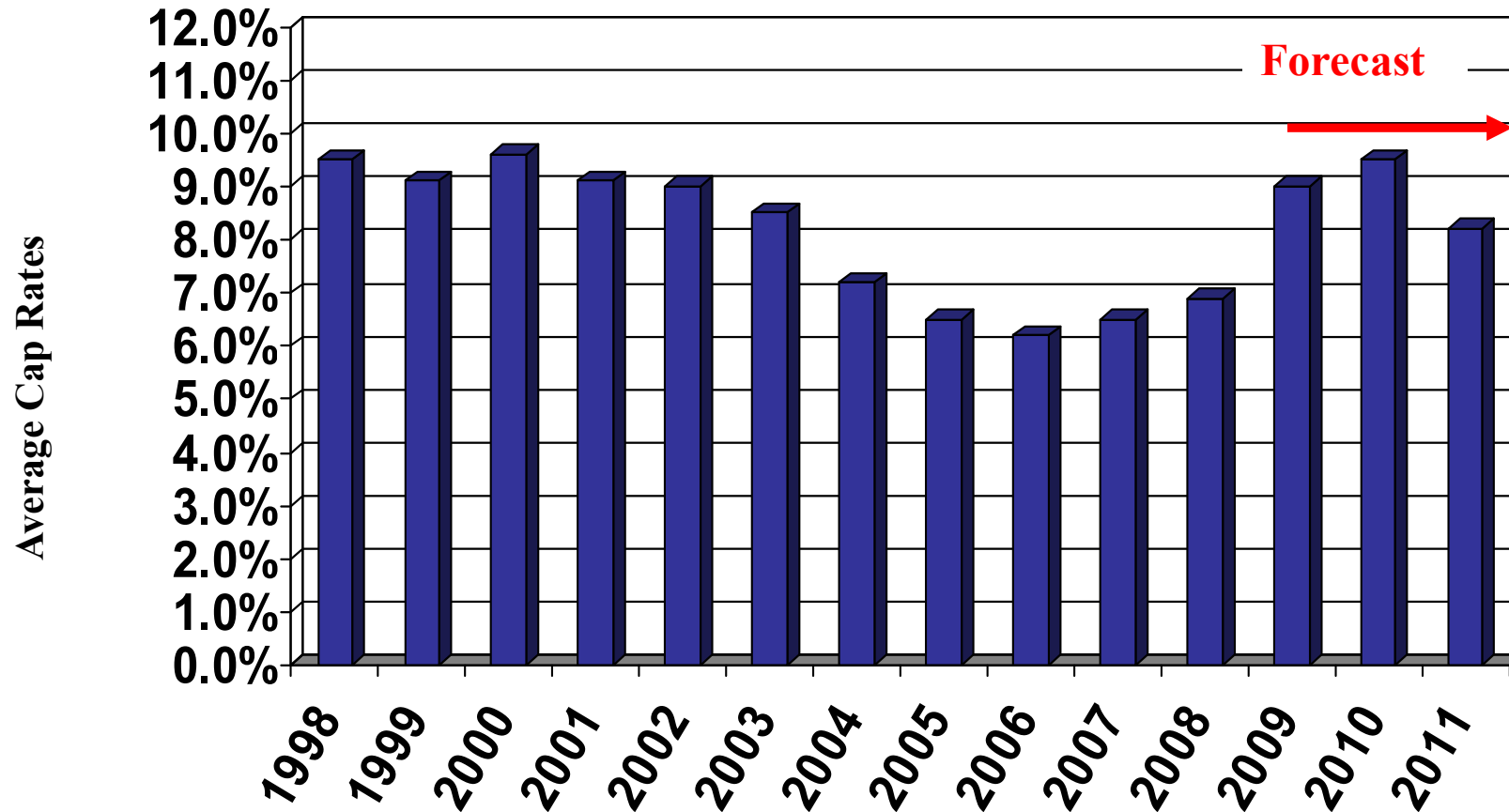
Change in Inventory, Net Absorption & Vacancy



Source: Colliers International Research Department

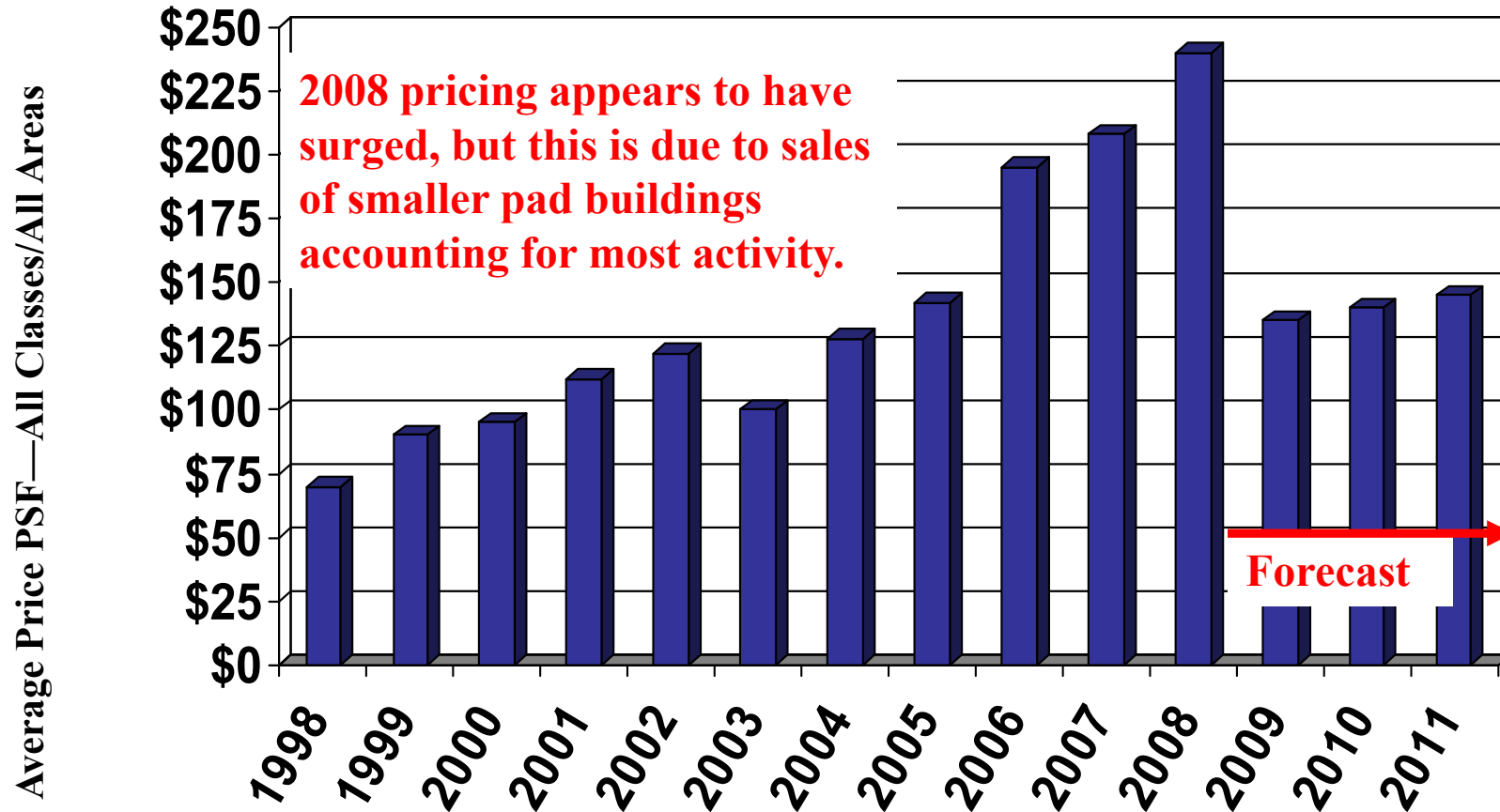


Sacramento Retail Market Shopping Center Investment Sales Average Cap Rates



In 2009 expect to see a few deals with caps as high as 10% or 11%. This will be a factor in bringing the region's average cap rate to the 9% mark.

Sacramento Retail Market Shopping Center Investment Sales Average Price PSF—All Classes/All Areas



These averages include all classes of shopping center product, from Regional/Power to Strip Centers or multi-tenant pad buildings. As such, these numbers are best utilized for benchmarking purposes.

Sacramento Commercial Real Estate Market--Retail Mid-Year Outlook

Looking Ahead

- Positive net absorption thanks to Forever 21 & Kohl's backfilling vacant Mervyn's & Gottschalks space and partial delivery of Folsom Palladio...
- Positive growth trend will be short-lived.
- Retail in general will be in contraction for AT LEAST two more years, probably three, maybe four.
- Necessity retailers and discount concepts will continue to do well, while the rest of the retail world will suffer.

It Will Get Better...

Garrick Brown

Director of Research

Colliers International

Sacramento Region

garrick.brown@colliers.com

(916) 563-3035



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