



COMMERCIAL REAL ESTATE OUTLOOK

June 2006

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Commercial Real Estate – bright spot in national economy

Overview

With the housing market slowing, a bright spot in the real estate industry is on the commercial side. Fundamentals are improving as vacancy rates decline and rent growth gains traction.

However, there are some clouds in the silver lining. Increasing energy costs, rising interest rates, high construction costs and a slowing housing sector can negatively impact the buoyancy in the commercial market.

The rising cost of oil can increase the cost of running a commercial building, as well as depress consumer spending. Rising interest rates may make it difficult to find capital to fund transactions. High construction costs may make “build-to-suit deals” unfeasible. At the same time, these high costs limit the level of new speculative commercial development. The slowdown in the housing market and the resulting decline in household equity could dampen retail sales and thus stymie the need for more retail space.

NAR FORECAST: The overall economy will remain strong, with GDP in the 2.5% to 3.4% range into 2007. Unemployment will remain under 5.0% as job growth numbers become sustainable. Interest rates will not increase to a point where the economy becomes stifled.

Institutional investors return to the office sector...

One sign of the health in the office sector is the increase in office building acquisitions by pension funds and other large institutional investors. This trend has been particularly noticeable in the first quarter of this year. From 2001 to 2004, institutions were actively divesting themselves of their office property holdings. Last year institutions began active acquisitions, and in the first quarter of 2006 have invested almost \$10 billion, or 66% of all office building sales so far this year.

NAR FORECAST: Improving fundamentals will make the office sector an attractive investment vehicle for even more institutional investors. With a vacancy rate under 13% and a slow-down in new speculative construction, the office market will offer respectable returns for investors.

Demand for distribution/warehouse space fuels industrial market...

Trade with China is one key reason for the strong demand for warehouse and distribution space in the United States. Southern California and Florida are just two of the regions benefiting from increased trade and the ever-increasing volume of goods passing through major port facilities.

MARKET SECTOR

▼	Office Vacancy
▲	Office Net Absorption
▲	Office New Completions
▲	Office Rent Growth
▼	Industrial Vacancy
▲	Industrial Net Absorption
▲	Industrial New Completions
▲	Industrial Rent Growth
▼	Retail Vacancy
▲	Retail Net Absorption
▲	Retail New Completions
▲	Retail Rent Growth
▼	Multi-Family Vacancy
▼	Multi-Family Net Absorption
▲	Multi-Family New Completions
▲	Multi-Family Rent Growth

New supply in the pipeline is a cause for concern in some markets...

COMMERCIAL LEADING INDICATOR FOR BROKERAGE ACTIVITY (CLI)

During the first quarter of 2006, the Commercial Leading Indicator Index for Brokerage Activity was 118.9, rising 0.8 percent from an upwardly revised reading of 118.0 in the fourth quarter; the index is 2.7 percent higher than the first quarter of 2005 when it stood at 115.7. The first-quarter index marked four straight quarters of growth, with improvement seen in 10 of the last 11 quarters. An increase in commercial brokerage activity can be expected over the next six to nine months. The commercial leading indicator affirms a national trend for additional strengthening in commercial real estate sectors with absorption of space outpacing the level of new space coming on line.

The Commercial Leading Indicator for Brokerage Activity is a tool to assess market behavior in the major commercial real estate sectors. The index incorporates 13 variables that reflect future commercial real estate activity, weighted appropriately to produce a single indicator of future market performance, and is designed to provide early signals of turning points between expansions and slowdowns in commercial real estate.

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Industrial production is up and this should also increase the demand for manufacturing space across the country.

NAR FORECAST: Industrial space located at or near traditional and inland ports will continue to be in great demand. "Build-to-suit" activity will increase to meet the specific needs of tenants/users involved in the distribution business. Absorption of industrial space will continue to be strong and vacancy rates will rest around the 9.5% level by the end of 2006.

A slowing housing market coupled with a decline in condo conversion activity is improving the multi-family housing markets. Rising interest rates are boosting the number of renter households as affordability becomes an issue. In 2005, condo conversions – turning a multi-family rental building or complex into condominium units – accounted for 34% of the \$87 billion worth of all multi-family properties that traded hands that year.

NAR FORECAST: Unlike 2005, when condo conversion activity accounted for a major portion of all multi-family sales transactions, 2006 will see a marked decline in this type of activity--by as much as 10%. As the Fed continues to boost interest rates, people will stay in rental apartments. The vacancy rate for multi-family real estate is likely to end up at 5.7% by the end of 2006.

The level of new supply in the retail sector continues to be a problem in some markets. While new construction is generally considered to have a positive impact on a community, there is however, the case of what to do with the vacant retail left behind. When a strip center loses its anchor, this can often have devastating effects on the remaining tenants.

NAR FORECAST: On a national level, retail will hold its own. With absorption matching new supply, it is not anticipated that vacancy rates will shift significantly from the current 7.5% over then next few years.

With revenue per available room (RevPAR) at its highest level since 9/11, hotels are once again in favor by investors and lenders alike. Solid fundamentals are resulting in burgeoning demand and increased new development. In 2005, slightly more than 950 hotel properties changed hands. So far this year, 660 hotels have traded.

NAR FORECAST: 2006 will be a record year in terms of the number of hotel properties trading hands. Investor appetite will continue to be strong. One concern is the number of new rooms in the pipeline. A total of 31,500 new rooms are planned for completion in 2007, a staggering 27,000 more than have opened or are slated to open in 2006.

JUNE 2006 ECONOMIC FORECAST

<i>Major Indicators</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>
Real GDP Annual Percentage Growth Rate	5.3	2.5	2.9	3.5	3.3	3.4	3.7	3.4	3.5	3.4	3.3
Non-Farm Employment Annual Percentage Growth Rate	1.7	1.3	1.1	1.0	0.9	1.1	1.5	1.4	1.5	1.4	1.1
Consumer Prices Annual Percentage Growth Rate	2.2	3.0	2.6	1.7	1.6	1.8	2.0	2.3	3.4	3.1	2.0
Real Disposable Income Annual Percentage Growth Rate	2.1	5.4	4.1	5.1	5.1	3.7	3.7	3.0	1.4	3.1	4.4
Consumer Confidence Index	106	107	107	106	105	105	106	107	100	107	106
Unemployment Percent	4.7	4.7	4.8	4.9	5.0	5.1	5.0	5.0	5.1	4.8	5.0
<i>Interest Rates (%)</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>
Fed Funds Rate	4.5	4.9	5.0	5.0	5.0	5.0	4.8	4.8	3.2	4.8	4.9
3-Month T-Bill Rate	4.4	4.7	4.8	4.8	4.8	4.8	4.5	4.5	3.1	4.7	4.8
Prime Rate	7.4	7.9	8.0	8.0	8.0	8.0	7.9	7.7	6.2	7.8	7.9
Corporate Aaa Bond Yield	5.4	5.9	6.1	6.1	6.2	6.3	6.2	6.3	5.2	5.9	6.3
10-Year Gov't Bond	4.6	5.1	5.2	5.2	5.3	5.3	5.2	5.2	4.3	5.0	5.3
30-Year Gov't Bond	4.6	5.2	5.5	5.5	5.5	5.4	5.5	5.5	4.6	5.2	5.5

Source: NAR

COMMERCIAL FORECAST

<i>OFFICE</i>	<i>2005 III</i>	<i>2005 IV</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Vacancy Rate	14.1%	13.6%	13.5%	13.2%	12.9%	12.7%	12.4%	13.6%	12.7%	11.6%
Net Absorption ('000 sq. ft.)	20,048	24,459	12,879	17,436	17,800	16,027	15,924	89,479	64,141	60,523
Office Employment (millions)	16,215	16,313	16,408	16,513	16,616	16,715	16,785	16,313	16,715	16,947
Completions ('000 sq. ft.)	8,677	9,667	9,367	9,721	7,250	9,888	7,838	35,976	36,226	30,151
Inventory (millions sq. ft.)	3,278	3,289	3,297	3,307	3,314	3,324	3,332	3,289	3,324	3,354
Rent Growth	1.2%	1.1%	1.3%	1.0%	1.0%	1.0%	1.2%	5.3%	4.4%	5.6%
<i>INDUSTRIAL</i>	<i>2005 III</i>	<i>2005 IV</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Vacancy Rate	10.3%	9.9%	9.9%	9.7%	9.5%	9.5%	9.3%	9.9%	9.5%	9.0%
Net Absorption ('000 sq. ft.)	90,366	97,555	28,279	70,356	61,563	50,794	50,045	290,504	210,992	197,189
Industrial Employment (millions)	10,168	10,191	10,216	10,244	10,268	10,284	10,289	10,191	10,284	10,265
Completions ('000 sq. ft.)	41,712	58,848	38,202	44,637	48,506	50,809	36,427	145,392	182,154	152,077
Inventory (millions sq. ft.)	11,956	12,015	12,053	12,098	12,146	12,197	12,234	12,015	12,197	12,349
Rent Growth	0.7%	0.7%	0.4%	0.5%	0.5%	0.6%	0.6%	2.7%	1.9%	2.9%
<i>RETAIL</i>	<i>2005 III</i>	<i>2005 IV</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Vacancy Rate	7.2%	7.2%	7.7%	7.7%	7.7%	7.6%	7.6%	7.2%	7.7%	7.5%
Net Absorption ('000 sq. ft.)	5,985	8,090	(4,323)	6,855	5,863	5,683	4,944	30,245	14,078	22,706
Completions ('000 sq. ft.)	5,200	6,961	5,034	6,615	5,728	5,794	4,692	23,049	23,171	21,916
Inventory (millions sq. ft.)	1,495	1,502	1,507	1,514	1,520	1,525	1,530	1,502	1,520	1,547
Rent Growth	0.7%	0.7%	(0.7%)	0.3%	0.5%	0.6%	0.5%	2.9%	0.7%	1.8%

Source: NAR/TWR

COMMERCIAL FORECAST

<i>MULTI-FAMILY</i>	<i>2005 III</i>	<i>2005 IV</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Vacancy Rate	5.7%	6.2%	5.5%	5.4%	5.2%	5.7%	5.5%	6.2%	5.7%	5.4%
Net Absorption (Units)	63,046	518	125,643	59,372	81,893	(10,380)	71,825	350,975	256,528	235,635
Completions (Units)	51,092	53,364	54,999	56,844	57,474	52,552	55,451	203,387	221,869	211,852
Inventory (Units in Millions)	13.5	13.6	13.6	13.7	13.7	13.8	13.8	13.6	13.8	14.0
Rent Growth	0.7%	0.9%	1.1%	0.9%	1.1%	1.1%	1.1%	2.9%	4.1%	4.7%
<i>HOSPITALITY</i>	<i>2005 III</i>	<i>2005 IV</i>	<i>2006 I</i>	<i>2006 II</i>	<i>2006 III</i>	<i>2006 IV</i>	<i>2007 I</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Occupancy Rate	71.4%	64.5%	66.1%	71.6%	72.5%	63.4%	65.3%	64.5%	63.4%	63.2%
Revenue per Available Room RevPAR (\$/Room)	\$73.86	\$70.47	\$75.47	\$80.45	\$79.13	\$72.37	\$76.56	\$70.47	\$72.37	\$74.23
Completions (rooms)	93	601	2,385	8,002	9,455	6,540	7,509	5,642	3,852	31,506
Inventory (rooms) (millions)	1.93	1.93	1.93	1.94	1.95	1.96	1.96	1.93	1.93	1.96
Change in RevPAR (year over year)	12.8%	13.1%	12.7%	7.8%	7.1%	2.7%	1.4%	12.3%	7.5%	2.3%

Source: NAR/TWR