



COMMERCIAL REAL ESTATE OUTLOOK

MARCH 2008



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Dramatic declines in investment activity mask respectable fundamentals...

OVERVIEW

While investment in commercial real estate has decreased to levels not seen in four years, fundamentals (vacancy, rent growth, absorption) have remained relatively buoyant. There have not been any great spikes in vacancy rates nor have that many markets experienced negative rent growth. Under normal circumstances, full or near-to full occupancy coupled with positive rent growth would be ample incentive for investor interest. Where is the disconnect?

Many analysts have assumed that capital does not exist and that banks or other sources of equity have put a halt to lending for commercial real estate. This is not the case. The decline in investment activity actually has more to do with a lack of confidence by investors and lenders who are leery about current conditions and are taking a "wait and see" attitude. More than anything else, the decline in confidence levels is due to investor concerns and reticence about the current and future state of the economy.

Despite these concerns, a record \$427.2 billion worth of commercial real estate traded hands in 2007. However, the vast majority of this volume occurred in the months prior to August, when the credit crunch began to impact commercial real estate.

NAR FORECAST: Until such time as confidence levels return to normal and investors and lenders are willing to take measured levels of risk, investment in commercial real estate in 2008 will most likely remain as much as 40% below transaction levels seen last year.

The Office Sector: Lag factor applies when new office space is added to a market....

Even when new office space is added to a market, either on a build-to-suit basis or with a significant pre-lease in place, there is often a lag period to backfill space vacated by tenants moving into newly constructed space. Concerns about the overall economy are also causing some tenants to put their expansion /relocations plans on hold.

NAR FORECAST: There will always be some level of demand for new office space. Every market has tenants who have a need /desire for top-of-line office space. The challenge is leasing space in older office buildings in a timely and cost-effective manner. The level of new supply in 2008 will be greater than in 2006 or 2007. As a result the vacancy rate is forecast to increase to 13.3%.

The Industrial Market: Activity still robust in port and distribution hubs unlike manufacturing centers...

Thirty-seven percent (37%) of the investment volume in industrial real estate in 2007 involved properties in the West Region of the country, with Southern California dominating.

Concerns about the economy play a pivotal role in commercial investment/leasing decision making...

COMMERCIAL LEADING INDICATOR (CLI)

FOURTH QUARTER COMMERCIAL REAL ESTATE INDEX EASES

WASHINGTON (February 20, 2008) – Commercial real estate market activity is expected to decline moderately with fewer business opportunities for commercial practitioners in the months ahead, according to a forward-looking index for the commercial real estate sectors published by the National Association of Realtors®. The Commercial Leading Indicator for Brokerage Activity¹ slipped 0.4 percent to an index of 120.1 in the fourth quarter from a reading of 120.6 in the third quarter, but remains 0.1 above the fourth quarter of 2006 when it stood at 119.9.

This is the second straight quarterly dip after reaching a record of 120.7 in the second quarter of 2007. The index showed nine consecutive quarterly gains prior to these declines; NAR's track of the index dates back to 1990.

Lawrence Yun, NAR chief economist, said the latest index suggests reduced business opportunities for commercial real estate practitioners in the months ahead. "The decline in the index implies that commercial activity, as measured by net absorption and the completion of new commercial buildings, is likely to contract moderately over the next six to nine months, which is consistent with an expectation for slower overall economic expansion in upcoming quarters," Yun said.

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NAR FORECAST: International trade continues to play a pivotal role in industrial real estate dynamics. In 2007, Los Angeles outpaced almost every other primary industrial market in terms of investment transactions. In addition, Los Angeles and neighboring Orange County boast some of the lowest industrial vacancy rates. Could the presence of two major ports be the reason for such healthy fundamentals?

The Retail Market: New supply finally being held in check, but secondary and tertiary markets could be growing...

One aspect of the retail market often overlooked is that retail development often follows population growth. Tracking only primary markets may not give a full picture of market conditions since it omits many new retail centers in secondary and tertiary markets. One telling sign of such activity in these markets can be seen in investment data from 2007. In the Southeast Region alone, 35% of the retail transaction volume last year occurred in secondary and tertiary markets.

NAR FORECAST: Population growth will continue to be a key determinant in the development, leasing and acquisition of retail real estate. As secondary and tertiary markets grow, it will become necessary to track commercial real estate activity in these markets as well as monitor the impact of such growth on older existing retail centers. In addition, uncertainty resulting from the slumping housing market and recession fears will cause consumers to hold back on some expenditures even with a tax rebate.

The Multi-Family Market: Risk-averse institutional investors are attracted to multi-family ...

Of the almost \$100 billion worth of multi-family properties that traded hands last year, 40% was through acquisitions from institutional investors (pension funds, life insurance companies, etc). Private investors accounted for another 40% of the transaction volume in this sector. Most other investment groups reduced, some dramatically, their market share in this type of real estate.

NAR FORECAST: Could institutional investors be hedging their bets on a protracted recovery in the housing sector and therefore a consistent demand for multi-family rental accommodations? Many analysts see an end to the housing crisis this year. This sector bears close watching.

CLI & SIOR INDEX: A record drop in commercial real estate activity is seen in both indexes...

Both NAR's Commercial Leading Indicator (CLI) and the SIOR Index point to a slowdown in commercial real estate activity. The SIOR Index, which is compiled from anecdotal survey responses from SIOR members, suggests declines in both the office and industrial markets with a particular decline in both the Northeast and South regions. The CLI also declined in the last quarter, indicating that there will likely be a slight-to-modest decline in real estate transaction activity.

MARCH 2008 ECONOMIC FORECAST

Major Indicators	2007 III	2007 IV	2008 I	2008 II	2008 III	2008 IV	2009 I	2009 II	<u>2007</u>	<u>2008</u>	<u>2009</u>
Real GDP Annual Percentage Growth Rate	4.9	0.6	0.1	0.9	2.0	2.3	2.6	2.5	2.2	1.5	2.4
Non-Farm Employment Annual Percentage Growth Rate	0.8	0.8	(0.1)	0.4	0.6	1.2	0.8	0.6	1.1	0.5	0.8
Consumer Prices Annual Percentage Growth Rate	2.8	5.0	3.9	2.1	1.4	1.7	1.0	1.8	2.9	3.2	1.5
Real Disposable Income Annual Percentage Growth Rate	4.0	(0.3)	1.5	1.4	2.0	2.4	4.6	3.2	3.0	1.4	3.1
Consumer Confidence Index	107	106	84	80	84	86	86	89	103	84	91
Unemployment Percent	4.7	4.8	5.1	5.3	5.5	5.6	5.5	5.6	4.6	5.4	5.5
Interest Rates (%)	2007 III	2007 IV	2008 I	2008 II	2008 III	2008 IV	2009 I	2009 II	<u>2007</u>	<u>2008</u>	<u>2009</u>
Fed Funds Rate	5.1	4.5	3.1	2.5	2.5	2.5	3.0	3.2	5.0	3.0	3.6
3-Month T-Bill Rate	4.3	3.4	2.7	2.7	2.8	2.9	3.2	3.4	4.4	2.8	3.5
Prime Rate	8.2	7.5	6.1	5.5	5.5	5.5	6.0	6.2	8.1	6.0	6.6
Corporate Aaa Bond Yield	5.8	5.5	5.1	5.2	5.3	5.4	5.5	5.6	5.6	5.2	5.7
10-Year Gov't Bond	4.7	4.3	3.7	3.8	3.9	4.0	4.1	4.3	4.6	3.9	4.5
30-Year Gov't Bond	4.9	4.6	4.0	4.1	4.2	4.3	4.4	4.6	4.8	4.3	4.8

Source: NAR

COMMERCIAL FORECAST - MARCH 2008

COMMERCIAL REAL ESTATE

OUTLOOK

<i>OFFICE</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2008 I</i>	<i>2008 II</i>	<i>2008 III</i>	<i>2008 IV</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Vacancy Rate	12.4%	12.5%	12.5%	12.7%	13.0%	13.2%	13.3%	12.6%	12.5%	13.3%
Net Absorption ('000 sq. ft.)	21,202	14,766	15,414	9,179	8,690	9,468	11,193	81,183	57,265	38,530
Office Employment (thousands)	16,795	16,826	16,875	16,915	16,950	16,997	17,066	16,648	16,875	17,066
Completions ('000 sq. ft.)	14,732	16,476	19,781	17,380	23,442	17,338	16,252	51,606	61,102	74,412
Inventory (millions sq. ft.)	3,362	3,378	3,398	3,416	3,439	3,456	3,472	3,326	3,398	3,472
Rent Growth	1.2%	3.5%	1.3%	1.0%	0.9%	0.8%	0.8%	5.2%	8.0%	3.5%
<i>INDUSTRIAL</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2008 I</i>	<i>2008 II</i>	<i>2008 III</i>	<i>2008 IV</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Vacancy Rate	9.3%	9.2%	9.4%	9.5%	9.6%	9.6%	9.6%	9.4%	9.4%	9.6%
Net Absorption ('000 sq. ft.)	35,402	29,390	19,733	32,899	33,299	33,035	35,429	205,365	120,231	134,662
Industrial Employment (thousands)	10,236	10,238	10,238	10,244	10,252	10,255	10,261	10,235	10,238	10,261
Completions ('000 sq. ft.)	35,695	28,033	40,330	52,874	46,020	36,627	38,520	173,979	126,765	174,041
Inventory (millions sq. ft.)	12,330	12,358	12,399	12,451	12,497	12,534	12,573	12,233	12,399	12,573
Rent Growth	1.2%	0.8%	0.7%	0.6%	0.8%	0.9%	0.9%	1.4%	3.6%	3.3%
<i>RETAIL</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2008 I</i>	<i>2008 II</i>	<i>2008 III</i>	<i>2008 IV</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Vacancy Rate	9.0%	8.8%	9.2%	9.1%	9.1%	8.9%	8.8%	8.0%	9.2%	8.8%
Net Absorption ('000 sq. ft.)	(169)	9,199	(621)	6,756	6,368	6,000	5,636	10,526	11,081	24,760
Completions ('000 sq. ft.)	8,002	7,454	5,807	6,269	6,300	3,094	4,659	28,455	29,733	20,322
Inventory (millions sq. ft.)	1,566	1,574	1,580	1,586	1,592	1,595	1,600	1,550	1,580	1,600
Rent Growth	0.8%	0.8%	0.8%	0.4%	0.3%	0.3%	0.3%	3.9%	3.2%	1.4%

Source: NAR/TWR

<i>MULTI-FAMILY</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2008 I</i>	<i>2008 II</i>	<i>2008 III</i>	<i>2008 IV</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Vacancy Rate	5.7%	5.7%	5.1%	5.4%	5.3%	5.1%	4.8%	5.9%	5.4%	5.1%
Net Absorption (Units)	70,705	41,348	111,734	10,612	71,751	82,375	91,707	229,452	234,399	245,786
Completions (Units)	57,798	58,384	57,436	57,314	56,275	54,573	53,999	224,170	230,932	216,880
Inventory (Units in Millions)	13.8	13.9	14.0	14.0	14.1	14.1	14.2	13.8	14.0	14.2
Rent Growth	0.7%	0.7%	0.8%	0.9%	1.0%	1.3%	1.4%	4.1%	3.1%	5.3%

Source: NAR/TWR

COMMERCIAL LEADING INDICATOR (CLI) (continued from Page 2)

Rising unemployment insurance claims and falling durable goods shipments were the key factors in lowering the CLI, but a weaker rate of return on investment as measured by the NAREIT Price Index was also a factor. The only positive contributors to the index were growth in wholesale and retail trade, and rising personal income. The latest data imply that investment in private non-residential structures, which rose a solid 13.2 percent in 2007 according to a preliminary GDP estimate, could show only minimal growth or even decline in 2008. REALTORS® who specialize in office and industrial properties indicate in a separate survey² that they anticipate a measurably lower level of business activity in the upcoming quarters.

The Commercial Leading Indicator implies weakening activity for commercial leasing and building sales activity. Commercial practitioners can anticipate a weaker, though positive, net absorption in the office and industrial sectors later in the year with fewer new commercial buildings reaching the market.

The Commercial Leading Indicator 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. The 13 series in the index are industrial production, the NAREIT (National Association of Real Estate Investment Trust) price index, NCREIF (National Council of Real Estate Investment Fiduciaries) total return, personal income minus transfer payments, jobs in financial activities, jobs in professional business service, jobs in temporary help, jobs in retail trade, jobs in wholesale trade, initial claims for unemployment insurance, manufacturers' durable goods shipment, wholesale merchant sales, and retail sales and food service.