



COMMERCIAL REAL ESTATE OUTLOOK

September 2007

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Commercial real estate does not necessarily follow the same cycle as residential...

OVERVIEW

The prevailing talk on Wall Street and in the media of late, has been about the troubles with subprime mortgages, the credit crunch and doomsday scenarios that could impact commercial real estate.

What most people fail to realize is that the current situation impacting residential real estate is not the same for commercial real estate. For example, there has not been the same level of overbuilding in commercial as there was in residential. Secondly, most investment in commercial real estate entails some degree of equity, with 100% financing a rarity. The portfolios of commercial real estate investors tend to be more diverse than those of residential investors, so the sources of capital are much more varied. Panic and over-reaction could limit or curtail the availability of capital needed by private investors, but overall the situation does not appear to have had a devastating impact on commercial real estate.

A record \$257 billion in commercial real estate transaction volume has occurred so far into 2007. In all of 2006, \$306.8 billion worth of commercial real estate traded hands, compared with \$267.6 billion in 2005. Both surpassed the \$150 billion that traded hands in 2004. So far, commercial real estate is still fulfilling the appetite of investors.

NAR FORECAST: Pricing for some commercial real estate has been at record levels and cap rates have been at historic lows. Normalization may finally be occurring, but the definition of "normal" is still up for debate.

The Office Sector: The sector of choice for most investors, especially with improving fundamentals....

The office sector, for the most part, has not experienced a significant amount of overbuilding. The cost of steel and other factors have helped to keep the level of speculative new construction to a minimum in most markets. While there has been new office space added, most has been on a build-to-suit or pre-leases basis. As a result the vacancy rate has not shifted significantly from the 12% mark this year.

NAR FORECAST: The demand for office space will be strong as we move into 2008, which will result in the vacancy rate declining somewhat. In some markets the demand for space will be met with new construction and there is the possibility that the older vacated space may be vacant for a period of time...the classic lag effect.

The Industrial Market: Rebirth of the technology sector fuels demand for flex space ...

While the main driver for the national industrial market continues to be the need for warehouse and distribution space, there has been a marked increase in the demand for flex space, especially in technology markets

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

Investors may start looking at income more than appreciation now...

COMMERCIAL LEADING INDICATOR (CLI)

COMMERCIAL REAL ESTATE INDEX CONTINUES RISE IN SECOND QUARTER

A forward-looking index for the commercial real estate market recorded its ninth consecutive improvement in the second quarter.

The NATIONAL ASSOCIATION OF REALTORS® Commercial Leading Indicator for Brokerage Activity rose 0.5 percent to an index of 120.7 in the second quarter, the highest on record. This is 1.1 percent higher than the second quarter of 2006 when it stood at 119.7. NAR's track of the index dates back to 1990.

Lawrence Yun, NAR senior economist, said the commercial sectors are benefiting most from rises in industrial production, shipments of durable goods and wholesale trade. "Despite some signs of slower overall economic expansion, the rise in the index means net absorption of space in the industrial and office sectors is likely to expand over the next six to nine months," he said. "In addition, an improvement in returns on investment implies healthy rent increases for commercial property owners."

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like San Jose, Portland and Phoenix. Like the office sector, new supply has been build on a build-to-suit or pre-lease basis. Building obsolesce continues to be a factor for distribution facilities.

NAR FORECAST: With building obsolesce and site remediation an issue in some markets, industrial users and tenants have been, and will continue to explore alternative locations in secondary and tertiary markets. In some of these markets development land is clean, cheap and incentives are offered to lure industrial users. With tightening availability in many primary markets, industrial tenants and users may increase interest in secondary and tertiary markets.

The Retail Market: Developers have finally got the message...

The one thing that has been holding back the recovery in retail real estate more than any other factor has been the level of new supply. The vast majority of new retail space coming-on-stream has been in non-regional malls. As in previous quarters the Australians have been one of the most active investors in retail real estate.

NAR FORECAST: Major investors in retail real estate are not as impacted by a tightening of capital, institutional and foreign investors are somewhat immune when it comes to sources of capital. However, the credit crunch could impact fundamentals if consumers cut back on their expenditures. The most current retail sales numbers do not point to a significant drop in sales for major retailers, but it is early yet.

The Multi-Family Market: Can't sell your home or unwilling to take a price cut...

Anecdotal evidence points to the fact that an influx of single-family homes offered for rent is impacting the multi-family market. A slowing housing market is forcing some owners to rent, if a sale is realistically not in the cards. The availability of single-family homes (for rent) cuts into the demand for multi-family housing. In addition, the slowing housing market is resulting in a number of condominium projects being converted to rental units. This is happening in many markets like Washington, DC and several markets in Florida.

NAR FORECAST: While the increase in single-family homes coming onto the rental market is noticeable, there also is a hesitance by some potential first-time home buyers to make the leap to homeownership at the current time. This hesitancy is bolstering multi-family fundamentals, but the market is cyclical and the lure of homeownership will eventually return.

SEPTEMBER 2007 ECONOMIC FORECAST

<i>Major Indicators</i>	<i>2007 I</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>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Real GDP Annual Percentage Growth Rate	0.6	4.0	2.3	2.1	2.8	3.0	3.0	3.2	2.9	2.0	2.7
Non-Farm Employment Annual Percentage Growth Rate	1.5	1.3	0.4	1.0	0.8	1.2	1.3	1.8	1.9	1.3	1.0
Consumer Prices Annual Percentage Growth Rate	3.8	6.0	2.2	2.2	2.1	2.0	2.0	1.6	3.2	2.8	2.3
Real Disposable Income Annual Percentage Growth Rate	5.4	0.1	5.3	3.2	3.7	2.9	3.1	3.4	3.1	3.6	3.3
Consumer Confidence Index	110	107	106	107	108	108	109	110	106	108	109
Unemployment Percent	4.5	4.5	4.6	4.8	4.8	4.9	5.0	4.9	4.6	4.6	4.9
<i>Interest Rates (%)</i>	<i>2007 I</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>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Fed Funds Rate	5.3	5.3	5.2	4.8	4.8	4.8	4.8	4.8	5.0	5.1	4.8
3-Month T-Bill Rate	5.0	4.7	4.6	4.3	4.3	4.3	4.4	4.4	4.7	4.7	4.4
Prime Rate	8.3	8.3	8.2	7.8	7.8	7.8	7.8	7.8	8.0	8.1	7.8
Corporate Aaa Bond Yield	5.4	5.6	5.7	5.7	5.8	5.9	6.1	6.2	5.6	5.6	6.0
10-Year Gov't Bond	4.7	4.8	4.5	4.5	4.6	4.7	4.9	5.0	4.8	4.6	4.8
30-Year Gov't Bond	4.8	5.0	4.7	4.7	4.8	4.9	5.0	5.2	4.9	4.8	5.0

Source: NAR

COMMERCIAL FORECAST - SEPTEMBER 2007

OFFICE	2006 IV	2007 I	2007 II	2007 III	2007 IV	2008 I	2008 II	2006	2007	2008
Vacancy Rate	12.5%	12.7%	12.4%	12.7%	12.9%	12.9%	12.7%	12.5%	12.9%	12.4%
Net Absorption ('000 sq. ft.)	23,688	6,449	21,197	15,310	12,918	14,972	14,410	77,975	53,781	65,101
Office Employment (thousands)	16,707	16,792	16,884	16,947	17,030	17,127	17,239	16,707	17,030	17,476
Completions ('000 sq. ft.)	13,425	10,931	14,639	28,771	21,210	17,282	11,790	49,419	75,551	55,157
Inventory (millions sq. ft.)	3,314	3,325	3,339	3,369	3,390	3,407	3,419	3,314	3,390	3,445
Rent Growth	0.8%	4.3%	0.3%	1.0%	0.5%	0.8%	0.7%	5.2%	6.1%	3.1%
INDUSTRIAL	2006 IV	2007 I	2007 II	2007 III	2007 IV	2008 I	2008 II	2006	2007	2008
Vacancy Rate	9.5%	9.3%	9.4%	9.4%	9.6%	9.6%	9.5%	9.4%	9.6%	9.4%
Net Absorption ('000 sq. ft.)	54,906	31,706	30,389	35,771	27,093	37,063	41,305	202,836	124,960	165,614
Industrial Employment (thousands)	10,231	10,240	10,253	10,271	10,294	10,325	10,363	10,231	10,294	10,435
Completions ('000 sq. ft.)	48,186	24,579	43,911	43,911	53,560	38,581	38,080	168,070	165,961	159,852
Inventory (millions sq. ft.)	12,123	12,148	12,192	12,236	12,289	12,328	12,366	12,123	12,289	12,449
Rent Growth	0.5%	0.9%	1.4%	0.8%	0.9%	0.9%	0.9%	1.4%	3.9%	3.7%
RETAIL	2006 IV	2007 I	2007 II	2007 III	2007 IV	2008 I	2008 II	2006	2007	2008
Vacancy Rate	8.1%	8.4%	8.8%	9.1%	9.3%	9.1%	9.0%	8.1%	9.3%	8.9%
Net Absorption ('000 sq. ft.)	7,115	3,062	(337)	4,791	4,569	4,283	4,532	10,724	12,085	19,026
Completions ('000 sq. ft.)	10,324	8,630	7,449	10,257	8,156	1,935	4,261	28,686	34,492	15,335
Inventory (millions sq. ft.)	1,551	1,559	1,567	1,577	1,585	1,587	1,591	1,551	1,585	1,600
Rent Growth	1.0%	1.6%	0.2%	0.7%	0.4%	0.4%	0.3%	3.9%	2.9%	1.0%

Source: NAR/TWR

COMMERCIAL FORECAST – SEPTEMBER 2007

<i>MULTI-FAMILY</i>	<i>2006 IV</i>	<i>2007 I</i>	<i>2007 II</i>	<i>2007 III</i>	<i>2007 IV</i>	<i>2008 I</i>	<i>2008 II</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Vacancy Rate	5.9%	5.7%	5.7%	5.4%	5.9%	5.7%	5.5%	5.9%	5.9%	5.6%
Net Absorption (Units)	(57,981)	70,763	41,290	97,016	84	69,526	80,551	229,428	209,153	234,398
Completions (Units)	54,902	57,798	58,384	57,436	57,314	56,275	54,573	224,170	226,997	228,554
Inventory (Units in Millions)	13.8	13.8	13.9	14.0	14.0	14.1	14.1	13.8	14.0	14.2
Rent Growth	0.8%	0.7%	0.7%	0.7%	0.8%	0.8%	0.9%	4.1%	2.9%	3.8%

Source: NAR/TWR

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

Positive movements in the index components more than offset a fall in the National Association of Real Estate Investment Trusts price index. The net gain in NAR's index also indicates modestly higher completions of overall office, warehouse, retail and lodging structures.

"In short, the latest data suggests improved business opportunities for commercial real estate practitioners in the months ahead," Yun said.

Net absorption in the office and industrial sectors in the fourth quarter of 2007 is expected to be 30 million to 40 million square feet, with about \$365 billion to \$375 billion in new completed commercial construction activity, compared with \$343 billion of new construction reported in the second quarter of this year.²

The rise in the commercial leading indicator also implies that commercial real estate practitioners could expect leasing and sales activity in the fourth quarter of this year to be about 1.1 percent higher than the fourth quarter of 2006. 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 REIT (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.