



# COMMERCIAL REAL ESTATE OUTLOOK

June 2007

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## Office Sector Investment at Record Pace Fundamentals Improving...

### OVERVIEW

With a sales transaction volume of over \$157 billion in the first four months of 2007, the year is starting out with a bang. More than 60% of this transaction volume is from trades within the office sector. In April alone, more than \$14 billion of the former Equity Office Properties' portfolio was spun off by the Blackstone Group.

The \$157 billion transaction volume is significant, when compared to previous years. In all of 2006, nearly \$307 billion of real estate traded hands and nearly \$268 billion in 2005. An ever-increasing sales volume goes hand-in-hand with rising per square foot prices and falling cap rates when examined over the last few years.

**NAR FORECAST:** The flow of capital (both equity and debt) will continue to be strong throughout 2007. Large portfolio transactions and privatizations of Real Estate Investment Trusts (REITs) could make 2007 a major year for investment transactions. Concerns by regulators about risky levels of lending in commercial real estate by some banks, could have an impact on capital flow, but should not deter large institutional investors, investment banks and foreign investors from seeking price appreciation and income-streams from commercial real estate investments.

**The Office Sector:** New supply now impacting rent growth in some markets...

On a national basis rent growth in 2006 was a respectable 5.6% over the previous year. While newly constructed office buildings can command a higher gross rent, the space being vacated in older buildings often has to be marketed aggressively with generous tenant improvement packages, which often cut effective rent growth.

**NAR FORECAST:** With the level of new supply expected to be twice what it was just two years ago, it is not surprising that rent growth is less than in previous years. Almost 78 million square feet of new space will be added to the nation's office market by the end of 2007. It is anticipated the overall vacancy rate will hover around the 12.5% to 13.5% range into 2008 as this new space and the older space vacated by tenants "moving-up" is leased-up.

**The Industrial Market:** Port locations – both traditional and inland- are the biggest factor in current industrial demand ...

Industrial fundamentals clearly indicate that this sector is holding its own. The vast majority of leasing activity and absorption is occurring in California and South Florida.

## 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

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## Fundamentals Improve for all Sectors Except Retail...

### COMMERCIAL LEADING INDICATOR (CLI)

#### FIRST QUARTER COMMERCIAL REAL ESTATE INDEX RISES AGAIN, BUT DECELERATING

WASHINGTON (May 21, 2007)  
– The Commercial Leading Indicator for Brokerage Activity, a forward-looking index for the commercial real estate market, rose slightly in the first quarter to the highest level on record but the rate of growth has decelerated over the past year, according to the National Association of Realtors®.

The Commercial Leading Indicator for Brokerage Activity increased 0.2 percent to an index of 120.3 in the first quarter from a reading of 120.1 in the fourth quarter, and is 0.8 percent higher than the first quarter of 2006 when it stood at 119.3. NAR's track of the index dates back to 1990.

Lawrence Yun, NAR senior economist, said the index has risen for eight consecutive quarters but factors in its components are mixed. "Rising industrial production, a rise in the REIT price index, growth in commercial jobs, rising income and gains in wholesale sales contributed to the rise in our leading indicator," he said.

(continued on page 5)

Inland ports, like Tucson, Las Vegas and Albuquerque, are also seeing increased demand for warehouse and distribution space. Flex space is also gaining hold in many tight office markets.

**NAR FORECAST:** Warehousing and distribution space will continue to drive the U.S. industrial market. The demand for manufacturing facilities will trail this sector. With tight office markets, some office users will continue to consider flex space – space that could be used for light industrial/office purposes. The industrial vacancy rate will remain under 10% into 2007.

#### **The Retail Market: Let's go shopping mate!!**

One of the most noticeable trends so far this year has been the increased appetite for retail investments by institutions and foreign investors, especially the Australians. These two investor groups have actually accounted for 60% of all retail property transactions (over \$5.0 million in value) in the first four months of the year.

**NAR FORECAST:** Real Estate Investment Trusts (REITs) once were a major player when it came to retail real estate acquisitions. With many public REITs going private, foreign investors and institutional equity funds will assume the dominate role in retail real estate investments.

#### **The Multi-Family Market: Reverse condo conversions occurring in many markets...**

Condo conversions were a major trend in multi-family housing, beginning in 2003, but they have slowly died out. During the hot housing market, many multi-family rental buildings/complexes were purchased with the idea of converting them into condominiums. In many markets where projects began as condominiums, they are now being advertised as rentals. It is the condo conversion process in reverse. This is happening in Washington, DC, Northern Virginia and a number of other markets where condominium construction has been rampant and the demand for condo sales is just not meeting developers' expectations.

**NAR FORECAST:** The vacancy rate for the multi-family housing will remain in the 5.5%-to-5.9% range for most of 2007. In markets where condo construction was rampant, expect to see a portion of these condo projects converted to rental accommodations if and where regulations and demand warrant such changes.

JUNE 2007 ECONOMIC FORECAST

<i>Major Indicators</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>	<i>2008 III</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Real GDP Annual Percentage Growth Rate	2.5	0.6	2.5	2.6	2.9	3.0	3.0	3.2	3.3	2.0	3.0
Non-Farm Employment Annual Percentage Growth Rate	1.5	1.5	1.3	1.2	1.1	1.0	1.3	1.3	1.9	1.4	1.2
Consumer Prices Annual Percentage Growth Rate	-2.1	3.8	4.3	2.4	2.2	2.3	2.0	2.4	3.2	2.5	2.4
Real Disposable Income Annual Percentage Growth Rate	6.4	4.7	-1.7	2.2	2.7	3.6	2.7	2.8	2.6	2.8	2.6
Consumer Confidence Index	107	110	107	108	107	109	109	110	106	108	110
Unemployment Percent	4.5	4.5	4.5	4.7	4.8	4.8	4.8	4.7	4.6	4.6	4.8
<i>Interest Rates (%)</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>	<i>2008 III</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Fed Funds Rate	5.2	5.3	5.3	5.3	5.3	5.0	4.8	4.8	5.0	5.3	4.9
3-Month T-Bill Rate	4.9	5.0	5.0	5.0	4.9	4.7	4.5	4.5	4.7	5.0	4.6
Prime Rate	8.3	8.3	8.3	8.3	8.3	8.0	7.8	7.8	8.0	8.3	7.9
Corporate Aaa Bond Yield	5.4	5.4	5.7	5.8	5.8	5.8	5.8	5.9	5.6	5.7	5.9
10-Year Gov't Bond	4.6	4.7	4.8	5.0	5.0	5.0	5.0	5.0	4.8	4.9	5.0
30-Year Gov't Bond	4.7	4.8	4.9	5.1	5.1	5.1	5.1	5.1	4.9	5.0	5.1

Source: NAR

COMMERCIAL FORECAST - JUNE 2007

<b>OFFICE</b>	<b>2006 III</b>	<b>2006 IV</b>	<b>2007 I</b>	<b>2007 II</b>	<b>2007 III</b>	<b>2007 IV</b>	<b>2008 I</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Vacancy Rate	12.9%	12.6%	12.7%	13.0%	13.1%	13.3%	13.3%	13.6%	12.6%	13.3%
Net Absorption ('000 sq. ft.)	18,821	23,925	6,653	14,291	13,153	10,192	12,904	88,834	76,426	44,289
Office Employment (thousands)	16,633	16,704	16,759	16,824	16,903	16,993	17,090	16,358	16,704	16,993
Completions ('000 sq. ft.)	12,003	13,600	11,343	28,191	19,223	17,980	14,069	38,200	47,700	76,737
Inventory (millions sq. ft.)	3,296	3,310	3,321	3,349	3,369	3,386	3,401	3,262	3,310	3,386
Rent Growth	2.1%	1.4%	2.0%	0.8%	0.8%	0.5%	0.7%	5.2%	5.6%	4.1%
<b>INDUSTRIAL</b>	<b>2006 III</b>	<b>2006 IV</b>	<b>2007 I</b>	<b>2007 II</b>	<b>2007 III</b>	<b>2007 IV</b>	<b>2008 I</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Vacancy Rate	9.5%	9.4%	9.3%	9.2%	9.2%	9.3%	9.2%	9.8%	9.4%	9.3%
Net Absorption ('000 sq. ft.)	55,806	54,906	31,706	46,919	43,467	40,771	45,707	282,767	202,836	162,862
Industrial Employment (thousands)	10,237	10,231	10,240	10,253	10,271	10,294	10,325	10,184	10,231	10,294
Completions ('000 sq. ft.)	34,985	48,186	24,579	43,911	43,911	53,560	38,581	149,866	168,070	165,961
Inventory (millions sq. ft.)	12,075	12,123	12,148	12,192	12,236	12,289	12,328	11,955	12,123	12,289
Rent Growth	0.4%	0.5%	0.9%	0.6%	0.8%	0.7%	0.8%	2.9%	1.4%	3.0%
<b>RETAIL</b>	<b>2006 III</b>	<b>2006 IV</b>	<b>2007 I</b>	<b>2007 II</b>	<b>2007 III</b>	<b>2007 IV</b>	<b>2008 I</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Vacancy Rate	8.0%	8.1%	8.4%	8.8%	8.8%	8.6%	8.6%	7.2%	8.1%	8.6%
Net Absorption ('000 sq. ft.)	7,165	6,711	802	4,686	5,270	4,978	4,834	32,846	10,611	15,745
Completions ('000 sq. ft.)	6,403	10,087	6,010	11,366	6,556	2,202	4,835	25,094	28,462	26,134
Inventory (millions sq. ft.)	1,540	1,550	1,556	1,568	1,574	1,576	1,581	1,522	1,550	1,576
Rent Growth	1.0%	1.0%	1.2%	0.5%	0.4%	0.4%	0.4%	2.9%	4.1%	2.4%

Source: NAR/TWR

COMMERCIAL FORECAST – JUNE 2007

<i>MULTI-FAMILY</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>2008 I</i>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Vacancy Rate	4.6%	5.9%	5.7%	5.6%	5.4%	5.8%	5.7%	6.2%	5.9%	5.8%
Net Absorption (Units)	50,754	(59,683)	69,214	67,317	81,889	(5,745)	64,591	350,358	229,316	212,316
Completions (Units)	56,844	57,478	52,554	55,448	56,038	55,084	57,320	203,343	221,866	223,890
Inventory (Units in Millions)	13.7	13.7	13.8	13.8	13.9	13.9	14.0	13.6	13.8	14.0
Rent Growth	1.1%	0.8%	0.7%	0.7%	0.8%	0.9%	1.0%	2.9%	4.1%	2.1%

Source: NAR/TWR

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

“On the other hand, deteriorating economic conditions have been a drag, specifically, a marked decline in durable goods shipments, a decline in return on commercial investment and an increase in the number of people filing for unemployment insurance.”

The small net rise in NAR’s index means net absorption of space in the industrial and office sectors should be fairly steady over the next six to nine months, with slightly higher completions of overall office, warehouse, retail and lodging structures.

Net absorption in the office and industrial sectors in the third quarter of 2007 is expected to be 10 million to 20 million square feet, with about \$335 billion to \$345 billion in new completed commercial construction activity, compared with \$323 billion of new construction recorded in the first quarter of this year.

“Deceleration in the growth of our leading index means we’re entering a more stable period for commercial real estate sectors,” Yun said.

Commercial real estate practitioners can anticipate leasing and sales activity in the third quarter of this year to be approximately 0.8 percent higher than the third 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 include 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.

More than 120,000 NAR members offer commercial services, and 68,000 of those are currently members of the REALTORS® Commercial Alliance, NAR’s commercial division.

## Demand for New Office Property is Changing Fundamentals...

### LOWEST OFFICE VACANCY Q2/2007 FORECAST

1) New York, NY	6.3%
2) Ventura County, CA	7.9%
3) Honolulu, HI	8.9%
4) Orange County, CA	9.1%
5) Los Angeles, CA	9.4%
6) Miami, FL	9.7%
7) Seattle, WA	10.0%
8) Washington, DC	10.3%
9) Long Island, NY	10.3%
10) San Francisco, CA	10.5%
11) Orlando, FL	10.5%
12) Ft. Lauderdale, FL	10.9%
13) W. Palm Beach, FL	11.5%
14) Tucson, AZ	11.6%
15) San Jose, CA	11.7%
<b>US National Avg.</b>	<b>13.0%</b>

Source: NAR/TWR

Pent-up demand for quality office space has been fueling new construction in many markets. While new construction is most often characterized by a healthy office market, if the demand is not sufficient, vacated older office buildings will not be immediately back-filled with tenants.

Absorption tends to languish when there is demand for quality space and new construction rises to meet such a demand, but the older space remains vacant. Atlanta is a case in point.

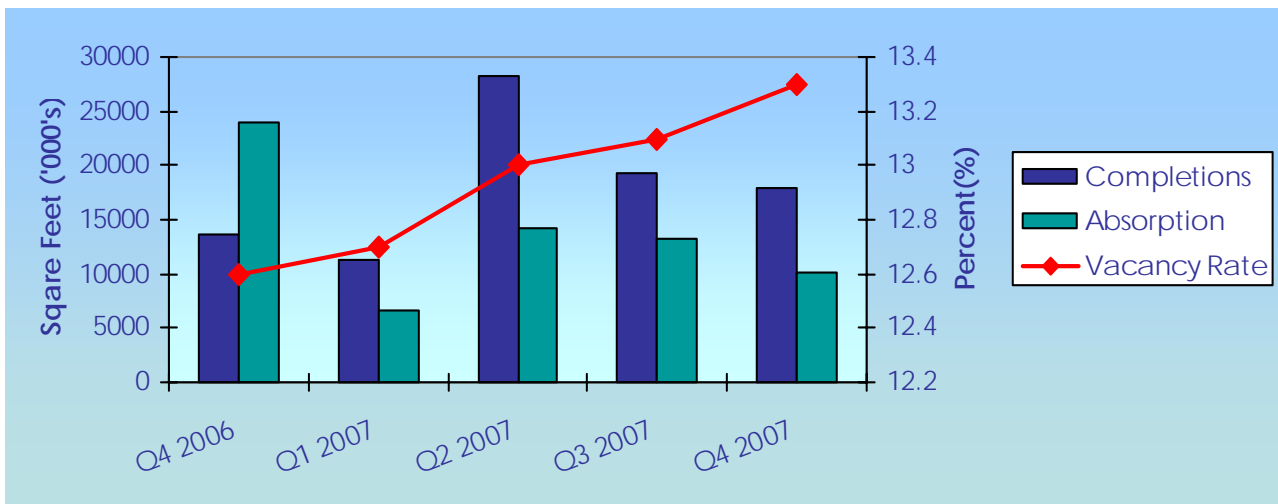
Our office space forecast for the second quarter calls for the national average vacancy rate to increase slightly to 13.0% from the 12.7% recorded in the first quarter of the year. Of the 51 primary office markets tracked in this report, two-thirds experienced a decline in available space.

Markets with the lowest available office space include one of the nation's largest - New York City (6.3%) and one of the smallest - Ventura County (7.9%). Highest office vacancy rates can be found in Dallas (22.0%) and Detroit (20.9%).

New supply also has an impact on rent growth. Again it goes back to the back-filling of old space. While new Class A office space may be commanding high net effective rental rates, vacated space is often offered at below-market rates, which moderates overall rent growth, or in some cases results in a slowing of rent growth. It is expected that rent growth for all of 2007 will be 4.1%, slower than 5.6% and 5.2% in 2006 and 2005, respectively.

The greatest rent growth is happening where supply is limited, but also in markets experiencing declines in vacancy over previous quarters - Raleigh and Fort Lauderdale, for example.

### OFFICE FUNDAMENTALS



Source: NAR/Torto Wheaton Research

## Record Office Transactions Continue With EOP & Blackstone Sales...

### OFFICE INVESTMENT PRICING TRENDS Q1/2007 SELECTED MARKETS

#### Mid-Atlantic

Washington, DC.....\$416/psf  
Northern Virginia....\$313/psf  
DC/MD.....\$231/psf

#### Midwest

Chicago, IL.....\$228/psf  
Cleveland, OH.....\$142/psf  
Minneapolis, MN....\$131/psf

#### Northeast

Manhattan, NY.....\$711/psf  
Stamford, CT.....\$305/psf  
Boston, MA.....\$302/psf

#### Southeast

Palm Beach, FL.....\$242/psf  
Miami, FL.....\$230/psf  
Atlanta, GA.....\$182/psf

#### Southwest

Austin, TX.....\$264/psf  
Phoenix, AZ.....\$210/psf  
Denver, CO.....\$187/psf

#### West

San Francisco, CA...\$435/psf  
San Diego, CA.....\$319/psf  
Seattle, WA.....\$315/psf

Source: Real Capital Analytics,  
May 2007

Records continue to break in office investment transaction volume. In the first four months of 2007, a record \$95 billion worth of office building traded hands nationally. This includes a \$39 billion Equity Office Properties (EOP) deal and a number of spin-offs by the purchaser - Blackstone. One market where the Blackstone sales had a noticeable impact was Orange County, Calif., where spin-offs of EOP office properties to the Australian Macquarie Properties brought the quarterly total to \$2.0 billion, more than \$1.5 billion higher than last quarter.

So far this year, Equity Funds have accounted for 53% of all office buildings purchased, with private developers accounting for 16% of transactions. While it is rare for equity funds to account for such a large percentage of transactions, the demand for office buildings as an investment vehicle is also strong within other buyer groups.

Cap rates continue to fall and average prices continue on an upward trajectory. At the end of April, average cap rates for office sales transactions in Central Business District areas were around 5.5% and 7.0% for suburban buildings.

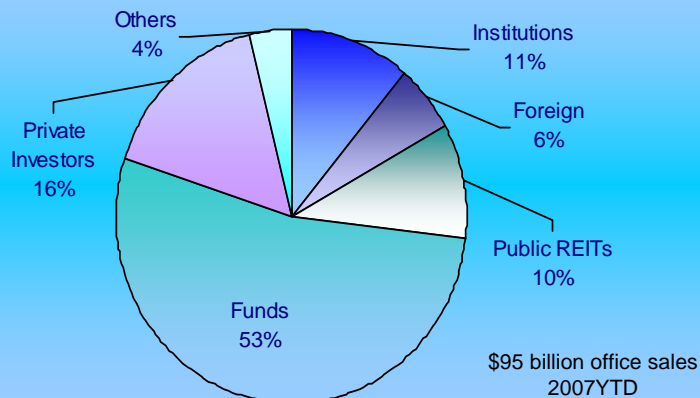
Compare this with the 8.5% cap rate seen at the beginning of 2004. Average pricing for office buildings is just over \$250/psf, up from the \$160/psf recorded at the beginning of 2004.

Institutional investors returned to the office market in a significant way in 2005 and continue to acquire office buildings in major markets. So far this year, institutional investors have spent over \$14 billion on office building acquisitions, with the most active buyers being Morgan Stanley, Hines Interests and Prudential Real Estate Investors. The most active equity fund has been Blackstone and its acquisition of EOP.

Over the last 12 months, the Northeast and the West have accounted for almost 70% of the \$172 billion office sales volume. Office markets with the highest sales volume over the last year months include Manhattan at \$41 billion, Chicago at \$13 billion, Northern Virginia at \$12 billion and San Francisco at \$11 billion.

Price appreciation is a strong motivation for investment decisions. For the first quarter of 2007, at 5.42%, office properties had the best appreciation rate of all the commercial real estate sectors.

Office Investors by Transaction Volume 2007 YTD



Source: Real Capital Analytics, May 2007

Office Region	Average Cap Rate	Average Price (\$/Sq. Ft.)
Mid-Atlantic	6.8%	\$281
Midwest	7.5%	\$171
Northeast	6.3%	\$438
Southeast	7.2%	\$164
Southwest	7.2%	\$158
West	6.6%	\$305

Source: Real Capital Analytics, May 2007

## Strong Industrial Property Demand Results in New Supply Which is Snapped-Up...

### LOWEST INDUSTRIAL VACANCY Q2/2007 FORECAST

1) Los Angeles, CA	4.4%
2) Orange County, CA	4.9%
3) San Francisco, CA	5.1%
4) Tampa, FL	5.2%
5) Albuquerque, NM	5.2%
6) Portland, OR	5.3%
7) Tucson, AZ	5.4%
8) Las Vegas, NV	5.6%
9) Miami, FL	5.7%
10) Salt Lake City, UT	5.8%
11) Ventura County, CA	6.2%
12) Orlando, FL	6.3%
13) Seattle, WA	6.4%
14) Long Island, NY	6.6%
15) Ft. Lauderdale, FL	6.8%
<b>USA National Avg.</b>	<b>9.2%</b>

Source: NAR/TWR

The booming trade situation continues to bolster the demand for warehouse/distribution space across the country. However, coastal industrial markets are benefiting the most from this trend, followed by major inland ports and distribution hubs. Our estimated industrial vacancy rate for the second quarter of 2007 is 9.2%, down from the 9.3% recorded last quarter.

To meet the need for state-of-the-art distribution centers, the level of build-to-suit industrial product has been significant over the last few years and 2007 is no exception. Our forecast calls for over 165 million square feet of new supply to be added to the national market with 162 million square feet of absorption. Unlike other sectors, there is an obsolescence factor to be considered with industrial buildings. In addition many older industrial buildings are converted to other uses in some markets – residential lofts and high-end retail facilities have been created in some “rust belt” markets.

Markets with the lowest amount of available industrial space include those around the busy ports of Los Angeles and Long Beach. With vacancy rates under 5.0%, both Los Angeles and Orange County have virtually no available industrial space. Nearly all of the industrial markets listed in the chart to the left are benefiting from increased trade. In many cases, older industrial properties considered to be obsolete are being converted to other commercial or residential uses.

With the slowdown in the automotive sector, it is not surprising to discover that Detroit has the highest industrial vacancy rate at 15.9%. The Atlanta market, which is seeing significant new construction, but not a similar rise in demand has a vacancy rate just above the 12% range.

In terms of industrial rent growth, 2007 is expected to rebound to levels seen in 2005 after a lackluster performance in 2006. Industrial rent growth is expected to be 3.0% this year, with significantly higher growth in Miami, Salt Lake City and Seattle – all markets with below-average vacancy rates.

### Industrial Fundamentals



Source: NAR/Torto Wheaton Research

**INDUSTRIAL INVESTMENT  
PRICING TRENDS Q1/2007  
SELECTED MARKETS**

Mid-Atlantic

DC/VA Suburbs...\$127/psf  
Washington, DC....\$125/psf  
DC/MD Suburbs..\$93/psf

Midwest

Detroit, MI .....\$65/psf  
Minneapolis, MN....\$58/psf  
Chicago, IL.....\$55/psf

Northeast

Manhattan, NY.....\$488/psf  
NYC Boroughs.....\$154/psf  
Stamford, CT.....\$75/psf

Southeast

Palm Beach, FL.....\$124/psf  
Ft. Lauderdale, FL...\$93/psf  
Tampa, FL.....\$91/psf

Southwest

Austin, TX.....\$119/psf  
Phoenix, AZ.....\$95/psf  
Houston, TX.....\$76/psf

West

San Jose, CA.....\$169/psf  
San Diego, CA.....\$140/psf  
Las Vegas, NV.....\$136/psf

Source: Real Capital Analytics,  
May 2007

**Price Appreciation for Industrial Properties  
Remains Strong...**

While a sales volume of nearly \$12 billion for industrial properties during the first four months of 2007 pales when compared to the \$95 billion worth of office properties traded, the volume is only down 13% from the same period last year.

Price appreciation for industrial properties trails office properties slightly at 4.5% for the first quarter of 2007. While cap rates continue to fall, pricing has been fluctuating since 2004. The average cap rate for industrial properties is resting just above 7%, while pricing is slowly edging back to the average of \$75/psf last summer. Pricing is currently averaging \$70/psf on a national basis.

Prices have risen most in coastal markets and particularly near port facilities. Pricing for flex space is also increasing in markets where there is significant demand for office properties, and flex industrial buildings are seen as a viable investment opportunity.

Like the office sector, equity funds have been the among the most active buyers of industrial real estate across the

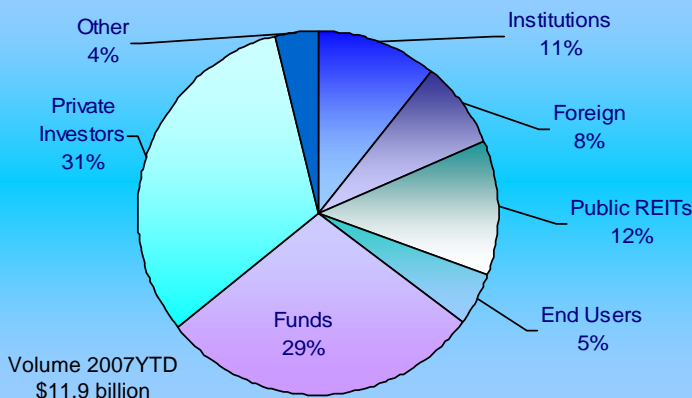
Country, with almost 30% of the sales volume recorded so far this year.

Southern California has dominated the industrial investment scene recently and this appears to be continuing into 2007, with Chicago, Atlanta and the Baltimore/Washington DC corridor also experiencing investor demand. Institutional investors have been particularly fond of these markets.

The most active buyers of industrial real estate so far this year have included First Industrial Realty Trust, GE Capital and RREEF. Private investors, many using the 1031 exchange process, have been most active in Phoenix and Houston.

On a regional basis, institutional investors have been most active in the West and Southeast (particularly Florida). REITs have preferred the Mid-Atlantic and Midwest industrial markets. There has also been a lot of capital flowing from private sector investors – particularly into California, Nevada and Florida.

**Industrial Investors by Transaction Volume 2007 YTD**



Source: Real Capital Analytics, May 2007

Industrial Region	Average Cap Rate	Average Price (\$/Sq. Ft.)
Mid-Atlantic	7.4%	\$62
Midwest	7.8%	\$49
Northeast	7.1%	\$75
Southeast	7.3%	\$53
Southwest	7.3%	\$69
West	6.7%	\$104

Source: Real Capital Analytics, May 2007

## New Retail Construction Finally Hits the Brakes

### LOWEST RETAIL VACANCY Q2/2007 FORECAST

1) San Francisco, CA	2.6%
2) Orange County, CA	3.4%
3) Miami, FL	3.7%
4) San Jose, CA	4.0%
5) Las Vegas, NV	5.0%
6) Washington, DC	5.4%
7) Ventura County, CA	5.7%
8) San Diego, CA	5.7%
9) Long Island, NY	5.7%
10) Seattle, WA	6.0%
11) Nashville, TN	6.2%
12) Jacksonville, FL	6.3%
13) Oakland, CA	6.4%
14) Los Angeles, CA	6.6%
15) Minneapolis, MN	6.9%
<b>USA National Avg.</b>	<b>8.8%</b>

Source: NAR/TWR

While the Conference Board's Index of Consumer Confidence bounced back in May to 108 from a six-month low of 106.3 seen in April, the slowing housing market and higher gas prices are keeping same-store retail sales flat. In the second quarter of this year, the retail vacancy rate is expected to jump to its highest level (8.8%) in two years. With fewer new retail projects due to come-on-stream in the third and fourth quarters, the vacancy rate is expected to decline slightly and end up at 8.6% by December 2007.

Those retail markets with a vacancy rate under 5.0% are located in California, with the exception of Miami. The highest retail vacancy rates tend to be in the Midwest in markets like Cleveland (14.6%), and Indianapolis (14.0%). Retailers generally look for areas where there is population growth, hence the strong demand for retail space in the West and Southeast.

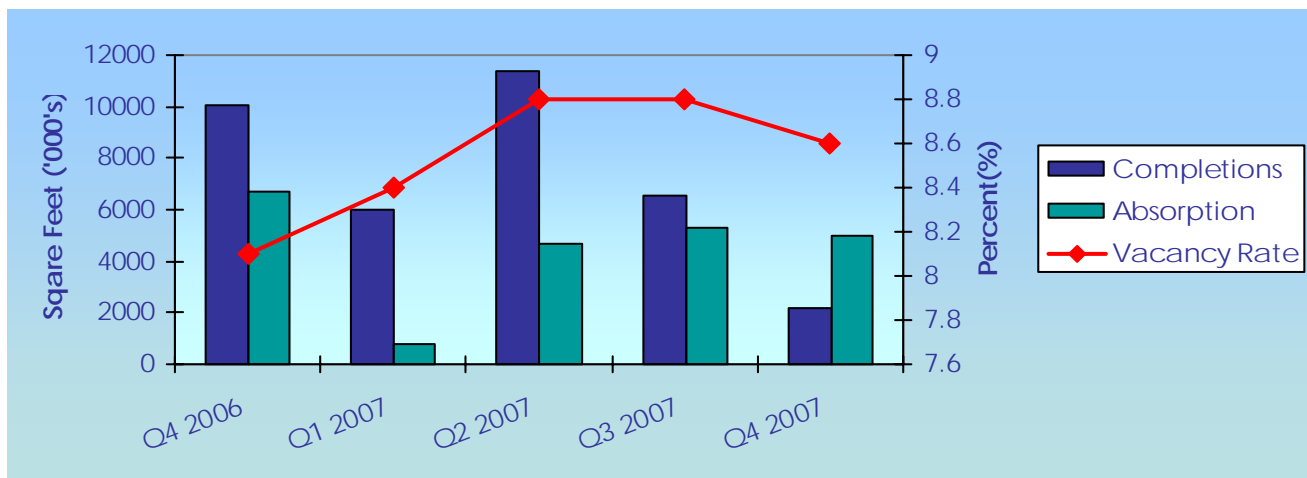
So far this year, there have not been any major retail mergers/consolidations on the scale of the May Department Store/Federated deal last year that caused the vacancy rate in regional shopping centers to jump due to store rationalization.

Retail rent growth is expected to be sluggish – in the 0.4% to 0.5% range for the remaining quarterly periods. Overall rent growth for the year should come in at 2.4% to 2.6%. Low levels of demand in many markets, primarily the Midwest, are keeping overall rent growth flat. Again, it should be expected that the markets with the greatest rent growth are those with the tightest availability.

The highest gross retail rent is being paid in Los Angeles and surrounding markets like Riverside and Orange County, all with gross rents over \$30.00/psf. Retailers looking for the markets with the lowest gross retail rent can look in Cincinnati, Salt Lake City and Oklahoma City, where rental rates are below \$12.00/psf.

Some of the best same-store sales numbers are occurring at high-end retailers like, Neiman Marcus, Nordstrom and Saks. Clearly those who shop at these locations are not concerned with the price of gas or other current economic dilemmas.

### Retail Fundamentals



Source: NAR/Torto Wheaton Research

**RETAIL INVESTMENT  
PRICING TRENDS Q1/2007  
SELECTED MARKETS**

Mid-Atlantic

Washington, DC.....\$387/psf  
DC/VA Suburbs.....\$191/psf  
DC/MD Suburbs.....\$189/psf

Midwest

Minneapolis, MN.....\$404/psf  
Chicago, IL.....\$189/psf  
Cincinnati, OH.....\$177/psf

Northeast

Manhattan, NY.....\$1,198/psf  
NYC Boroughs.....\$465/psf  
Westchester, NY.....\$256/psf

Southeast

Miami, FL.....\$242/psf  
W. Palm Beach, FL.....\$176/psf  
Jacksonville, FL.....\$175/psf

Southwest

Phoenix, AZ.....\$191/psf  
Denver, CO.....\$185/psf  
Austin, TX.....\$163/psf

West

San Francisco, CA.....\$428/psf  
Los Angeles, CA.....\$324/psf  
San Diego, CA.....\$282/psf

Source: Real Capital Analytics,  
May 2007

So far this year, institutional investors, as well as, foreign investors account for 60% of all retail properties sold nationwide. Australian firms, Centro Properties Group and Macquarie have spent almost \$13 billion to acquire 1,500 retail properties over the last 12 months. On the institutional side, TIAA-CREF have bought 312 retail properties, spending \$6.7 billion over the last 12 months. In April, Australian firm Centro acquired New Plan Realty Trust for \$6.2 billion.

Retail sales volume more than doubled in the first four months of 2007 compared to the same period last year. Year-to-date retail property sales volume was \$27.7 billion compared with the \$12.5 billion from last year. The reason for the upswing in sales transactions this year has been mainly through portfolio acquisitions. In addition, a number of large retail properties have been included in this number. For example, over the last 12 months Triple Five, bought-out their partners at the Mall of America in Minneapolis. This is the reason the average price per square foot for Minneapolis is very high at \$404/ psf foot.

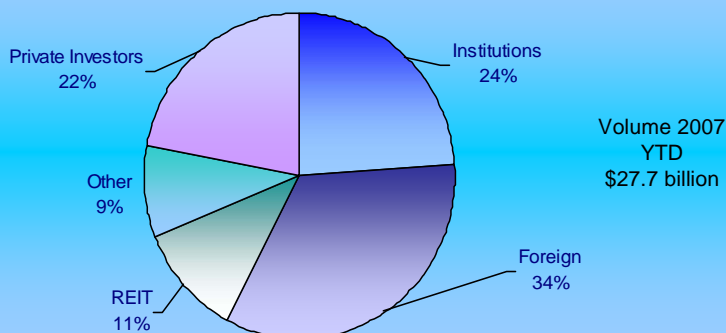
**U.S. Retail Real Estate  
Appeals to Australians...**

Cap rates on retail real estate have remained relatively flat so far this year as have prices for retail real estate. Cap rates on retail properties are currently resting at around 6.7%, down from 8.2% in the first quarter of 2004. Pricing for retail property is around \$175/psf, which is up from \$130/psf three years ago.

New retail acquisitions by institutional investors have been heavily concentrated in Southeast, with Atlanta and several of the main markets in Florida on their radar screen. Foreign investors, particularly the Australians, have been most active in Southern California and Chicago, and to a lesser extent in Houston and Austin.

Unlike most of the other sectors, REITs have been actively acquiring retail properties, with a particular interest in the Northeast and Mid-Atlantic areas. Over the last 12 months, the active retail REITs have included Developers Diversified, with the acquisition of 305 properties and Kimco Realty, which spent \$4.9 billion to acquire 152 retail centers.

Retail Investors by Transaction Volume 2007 YTD



Source: Real Capital Analytics, May 2007

Retail Region	Average Cap Rate	Average Price (\$/Sq. Ft.)
Mid-Atlantic	6.8%	\$155
Midwest	7.6%	\$148
Northeast	6.6%	\$238
Southeast	7.1%	\$144
Southwest	6.9%	\$139
West	6.4%	\$214

Source: Real Capital Analytics, May 2007

## “Reverse Condo Conversions” A New Trend in a Slow Market ...

### LOWEST MULTI-FAMILY VACANCY FORECAST Q2/2007

1) N. New Jersey	2.3%
2) Pittsburgh, PA	2.3%
3) Salt Lake City, UT	2.6%
4) San Jose, CA	2.6%
5) San Francisco, CA	2.6%
6) Norfolk VA	2.7%
7) Miami, FL	3.1%
8) Los Angeles, CA	3.2%
9) Portland, OR	3.2%
10) Orange County, CA	3.4%
11) Minneapolis, MN	3.5%
12) Seattle, WA	3.6%
13) Washington, DC	3.6%
14) Baltimore, MD	3.8%
15) Boston, MA	3.8%
<b>US National Avg.</b>	<b>5.6%</b>

Source: NAR/TWR

One “sign of the times” seen in many markets is newly constructed condominium projects sporting “for lease” signs. Could this be a mistake? In Washington, DC, where cranes can be seen in every direction, newly constructed buildings that were originally intended for sales are now being advertised “for rent.”

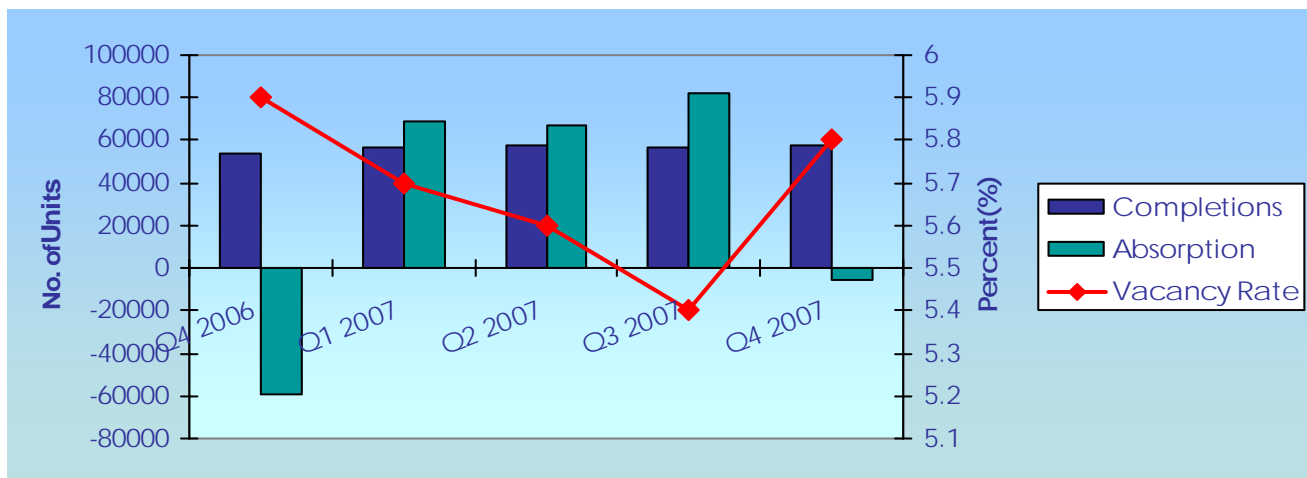
Developers in many markets have decided to either sell their condo project to a multi-family investor as a whole or rent the units themselves and generate income rather than try to sell the units individually in a sluggish market. Buildings now nearing completion have most likely secured financing and have business plans based on pro formas with different market price assumptions.

While the vacancy rate of 5.6% is low, it is expected to climb slightly to 5.8% by the end of the year. The level of demand for multi-family housing is strong, but the level of new supply almost matches leasing activity, which is keeping absorption low. New supply includes those condo projects that are being converted to rental accommodations.

More than half of the multi-family markets tracked in this report have a vacancy rate below the national average of 5.6%. The demand for rental accommodations is strong in markets where the cost of housing is still out of reach for many households or where there is a significant level of permanent or transient population growth. Pittsburgh is an anomaly in this market, other than to say that the level of new supply in that market is not keeping pace with demand.

The markets with the highest rents are clustered in California, with the highest average rent for a “typical” unit in San Francisco at \$1,714/month. San Jose and Los Angeles follow at \$1,521/month and \$1,521/month, respectively. Outside of California, the highest rents can be found in Boston at \$1,325/month for a typical rental unit in that marketplace. It should be noted that a typical apartment in one market may differ significantly from a typical rental unit in another. For example a typical apartment in Kansas City may consist of two bedrooms and one bath, whereas in New York City a typical multi-family unit is more likely to be a studio or one-bedroom.

### Multi-Family Fundamentals



Source: NAR/Torto Wheaton Research

**MULTI-FAMILY INVESTMENT  
PRICING TRENDS Q1/2007  
SELECTED MARKETS**

Mid-Atlantic

Washington, DC...\$214,700/unit  
DC/VA Suburb.....\$177,900/unit  
Baltimore, MD.....\$105,300/unit

Midwest

Chicago, IL.....\$118,600/unit  
Minneapolis, MN...\$100,000/unit  
Cincinnati, OH.....\$63,400/unit

Northeast

Manhattan, NY.....\$389,700/unit  
Stamford, CT.....\$177,600/unit  
Boston, MA.....\$169,600/unit

Southeast

Miami, FL.....\$143,400/unit  
W. Palm Beach, FL.....\$134,900/unit  
Ft. Lauderdale, FL.....\$122,800/unit

Southwest

Denver, CO.....\$99,700/unit  
Phoenix, AZ.....\$97,000/unit  
Austin, TX.....\$75,300/unit

West

San Francisco, CA.....\$256,200/unit  
Orange Co., CA.....\$199,800/unit  
Oakland, CA.....\$197,100/unit

Source: Real Capital Analytics,  
May 2007

## Investors “Cool” on Multi-family Investments ...

The sale of multi-family properties in the first four months of this year was down by 25% compared with the same time last year. A total of \$23.2 billion worth of multi-family properties changed hands from the beginning of January through the end of April. The vast majority (49%) of acquisitions have been made by private investors this year.

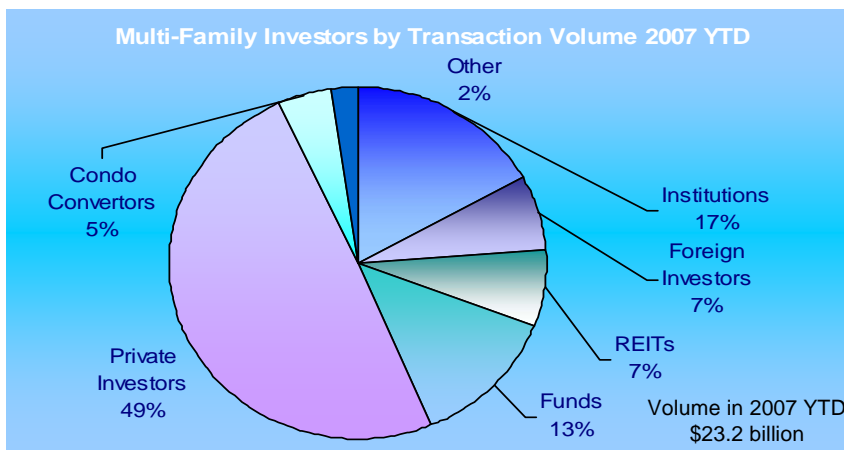
Condo converters have represented just 5% of multi-family sales volume this year. Compare this with all of 2005 and 2004 when respectively converters represented 35% and 26% of all multi-family sales volume. At this point, the only places where condo conversions are occurring to any appreciable extent are in some Florida markets and in Las Vegas.

Cap rates and pricing for multi-family properties have been relatively flat so far this year. Cap rates have been in the 6.0% range, down from 7.3% three years ago. Pricing in 2007 is averaging \$120,000/unit nationally. In 2004 the average unit price hovered in the \$75,000-to-\$80,000 range.

Institutional investors in multi-family properties have taken over the lead role in multi-family acquisitions now that condo converters have gone by the wayside. Institutions appear to favor the Northeast, Phoenix, Dallas, Atlanta and Chicago, where population growth and demand seem to constant. A number of REIT privatizations and a major acquisition in New York City (Stuytown) brought the total sales volume by institutions to record levels last year – over \$23.2 billion.

One of the most noteworthy trends in multi-family investment has been the rise in out-of-state buyers. Traditionally, investors in this sector have concentrated acquisition efforts in their local markets. However, with 1031 exchanges and higher yields in other markets, multi-family investors have been branching out. Out-of-state buyers have been concentrating their acquisitions in Phoenix, Atlanta and to a lesser extent, Austin Houston and Denver.

There are a number of multi-family properties under contract, so 2007 could be good year both from a yield and from an overall sales volume point of view.



Source: Real Capital Analytics, May 2007

Multi-Family Region	Average Cap Rate	Average Price (\$/Unit)
Mid-Atlantic	6.1%	\$107,800
Midwest	7.1%	\$70,400
Northeast	5.5%	\$216,100
Southeast	6.6%	\$80,800
Southwest	6.5%	\$74,100
West	5.5%	\$145,500

Source: Real Capital Analytics, May 2007

METRO FORECAST SUMMARY Q2/2007

	Office Vacancy Rate	Industrial Vacancy Rate	Retail Vacancy Rate	Multi-Family Vacancy Rate
Albuquerque, NM	14.9%	5.2%	9.2%	4.1%
Atlanta, GA	18.3%	12.1%	8.3%	6.4%
Austin, TX	14.0%	9.6%	11.4%	4.5%
Baltimore, MD	12.8%	13.6%	8.4%	3.8%
Boston, MA	12.2%	15.4%	8.2%	3.8%
Charlotte, NC	12.3%	9.7%	10.0%	4.5%
Chicago, IL	15.8%	11.6%	12.2%	3.9%
Cincinnati, OH	20.2%	8.7%	13.8%	5.8%
Cleveland, OH	18.4%	9.8%	14.6%	5.7%
Columbus, OH	18.4%	13.5%	12.6%	5.3%
Dallas, TX	22.0%	11.2%	12.2%	5.3%
Denver, CO	14.7%	9.1%	11.6%	4.8%
Detroit, MI	20.9%	15.9%	13.7%	5.4%
Fort Lauderdale, FL	10.9%	6.8%	7.4%	3.9%
Fort Worth, TX	12.5%	9.0%	14.1%	6.9%
Hartford, CT	15.8%	10.3%	—	—
Honolulu, HI	8.9%	—	7.0%	5.1%
Houston, TX	12.6%	7.0%	13.5%	6.8%
Indianapolis, IN	16.9%	9.9%	14.0%	6.6%
Jacksonville, FL	17.0%	7.2%	6.3%	7.4%
Kansas City, MO	17.0%	8.6%	12.9%	4.7%
Las Vegas, NV	18.1%	5.6%	5.0%	4.9%
Long Island, NY	10.3%	6.6%	5.7%	—
Los Angeles, CA	9.4%	4.4%	6.6%	3.2%
Miami, FL	9.7%	5.7%	3.7%	2.9%
Minneapolis, MN	14.6%	6.1%	6.9%	3.5%
Nashville, TN	12.0%	8.5%	6.2%	4.3%
New York, NY	6.3%	8.1%	8.7%	5.6%
Northern New Jersey (Newark)	14.2%	7.1%	—	2.3%
Oakland, CA	15.3%	9.6%	6.4%	4.1%

Source: NAR/TWR

METRO FORECAST SUMMARY Q2/2007

	Office Vacancy Rate	Industrial Vacancy Rate	Retail Vacancy Rate	Multi-Family Vacancy Rate
Orange County, CA	9.1%	4.9%	3.4%	3.4%
Orlando, FL	10.5%	6.3%	7.6%	4.4%
Philadelphia, PA	12.9%	10.6%	9.0%	4.6%
Phoenix, AZ	15.8%	9.3%	7.4%	5.9%
Pittsburgh, PA	16.7%	—	—	2.3%
Portland, OR	13.0%	5.3%	8.5%	3.2%
Raleigh, NC	13.4%	—	—	4.9%
Riverside, CA	11.2%	7.3%	7.8%	4.7%
Sacramento, CA	15.0%	11.9%	7.8%	5.0%
Salt Lake City, UT	11.7%	5.8%	8.2%	2.6%
San Diego, CA	16.4%	9.4%	5.7%	4.0%
San Francisco, CA	10.5%	5.1%	2.6%	2.6%
San Jose, CA	11.7%	10.2%	4.0%	2.6%
Seattle, WA	10.0%	6.4%	6.0%	3.6%
Stamford, CT	12.8%	11.2%	—	—
St. Louis, MO	16.2%	10.1%	11.6%	6.1%
Tampa, FL	12.8%	5.2%	8.3%	4.9%
Tucson, AZ	11.6%	5.4%	9.1%	4.5%
Ventura, CA	7.9%	6.2%	5.7%	—
Washington, DC	10.3%	11.3%	5.4%	3.6%
West Palm Beach, FL	11.5%	7.0%	9.4%	5.7%
National Averages	13.0%	9.2%	8.8%	5.6%

Source: NAR/TWR

N.B. Not all markets are represented in chart above.

## NAR Research...

NAR Research also provides analysis of monthly economic indicators, such as GDP and employment data that clearly impact commercial markets over time.

If you have questions or comments regarding this report or any other commercial real estate research, contact Scott MacIntosh, NAR's Senior Economist-Commercial/Investment Real Estate, at (202) 383-1188 or [smacintosh@realtors.org](mailto:smacintosh@realtors.org)

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