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Center for Real Estate

Quarterly & Urban Development Journal

• 4th Quarter 2009



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Editor's Urban Development Journal: **Greening The Ratings: Weed LEED & SEED**

Professor Will Macht, Editor



Sustainable economic and environmental development ratings need revision on the basis of cost-benefit analysis.

While it is gratifying that so many in the development community now seek to develop sustainably, far too few are reaching beyond the superficial indicia of green building. Too many simply seek an award of approval without understanding the limitations and contradictions inherent in the standards by which the awards are measured. The most dominant standards for measuring sustainability, the Leadership in Energy and Environmental Design (LEED) standards, promulgated by the U.S. Green Building Council, as well as the

Portland-based Green Building Initiative's (GBI) Green Globes, are fraught with inconsistent goals and unbalanced priorities.

There are several basic problems impeding a large-scale shift to sustainable development:

1. The standards for measuring sustainability are often internally inconsistent.
2. There is no correlation between point scores and economic costs and benefits.
3. Different rating systems are largely incompatible.
4. Sustainability is about long-term benefits, while developers' timelines are short-term.
5. Mixed-uses maximize sustainability, but single-use zoning is still predominant.

1. The standards for measuring sustainability are often internally inconsistent.

Review some contradictions within the LEED standards.

Within a new LEED v 3.0, 110-point scale (formerly 69 points), the Sustainable Sites SS Credit #2 now awards up to five points for development density and community connectivity (formerly it was a single point). Then it further restricts their value by requiring that the site be one that was previously developed, have more than 60,000 square feet per acre, or at least 10 units per acre, plus be within one-half mile of at least ten "Basic Services" defined to include such things as a grocery, pharmacy, bank, library, school, day care center, post office and a park.

And at least eight of those services must already be in operation while the other two must be operational within one year. While highly desirable, these restrictions act as disincentives for suburban developers to attempt to develop mixed-use projects.

But the mixed-use density objective is inconsistent with the open space one. The section on Sustainable Sites (SS Credit #5.2) provides a credit for maximizing open space. And it exacerbates that conflict with the density objective by requiring that as much as 50 percent of the site be in open space, or at least 25 percent more than the local zoning ordinance. The anomaly is that the requirements of the sustainable sites section actually discourage density and encourage sprawl, which by its very nature is not sustainable. It would likely be easier for a developer to get credit for a suburban site with



copious open space than for a dense urban project. Yet the suburban site would generate vastly more vehicle miles traveled (VMT) which certainly does more harm to the environment.

Then the same sustainable sites section grants two points for parking capacity (SS Credit #4.4) and the easiest way to obtain that credit is for a developer to provide no new parking. Or a developer could provide parking for fewer than five percent of the full-time equivalent occupants of the building, and then also allocate at least five percent of that parking for carpools and vanpools.

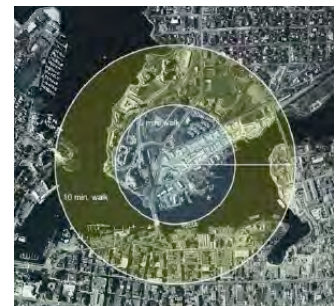


This parking provision conveys a misunderstanding of the relationship between parking and density. The way to increase density is not to limit the absolute number of parking spaces, but rather to maximize the size of development that a number of parking spaces can support. That is done through reducing the relative shared parking ratio between the number of parking spaces and the number of mixed-uses, square feet and units that the parking supports.

Furthermore, to allocate any spaces for a specific class of users, as SS Credit 4.4 does, removes them from a shared parking pool and increases their inefficiency, which is presumably precisely opposite of the intention of the LEED framers. Environmental planners too often do not recognize that greater density of parking leads to greater density of uses, provided uses are mixed and the spaces are not allocated. At \$40,000 to \$50,000 per space, no rational developer wants to build any more parking than is absolutely necessary. Developers make money selling units or office or retail space, not on selling parking. Therefore, planners and developers share an interest in making parking efficient, a fact many planners simply fail to recognize.

2. There is no correlation between point scores and economic costs and benefits.

To take the sustainable sites category again, a developer can earn one point by not developing in a flood plain, prime farmland, habitat of endangered species or other sensitive sites. [SS Credit #1]. That may have zero cost. But to earn points for density, [SS Credit #2] a developer might need to spend hundreds of thousands, or even millions, of dollars to buy a previously developed site and



to develop it with more than 60,000 square feet per acre. And to earn the one point Brownfield Site credit [SS Credit #3], a developer could spend millions of dollars remediating the brownfield. The LEED brownfield point is 0.9 percent of the total and Green Globes allocates only 2 percent, better but still minimal. A developer might ask why invest the extra dollars to earn the difficult point when one can invest little or nothing for the easy one? This disparity is counter-productive.

Or again in the sustainable sites category, a developer could earn one point for the Heat Island Effect credit [SS Credit #7.2] by using a white roof, or lowering the foot-candle power of exterior lighting to earn the Light Pollution Reduction credit (SS Credit #8). These are marginal costs on a totally different scale of investment than the density or brownfield credits.



Or compare the brownfield credit costs to earn one point with another standard in the sustainable sites category that credits one point for the provision of bicycle racks for five percent of a building's occupants, with a shower in

the building [SS Credit #4.2]. Green Globes awards three points for development in a commercial zone, where property will be significantly more costly, but also three points for development within a quarter mile from a bicycle path, where it will likely be far cheaper. To equate those provisions imbalances priorities between costs and benefits, not only in the strict economic sense, but also with respect to energy and environmental benefits.

In the Water Efficiency category, a developer can earn two LEED points for installing drought-resistant plants that need no irrigation. [WE Credit #1.2] Or the developer could earn two LEED points by treating 50 percent of the sewage wastewater onsite to tertiary standards [WE Credit #2]. LEED loses credibility equating the point scores for these items. The former is very low cost and of marginal benefit. The latter is very high cost and renders substantial benefits. Where is the cost/benefit analysis to justify the priorities in these ratings?

In the Energy category, a developer could increase energy cost savings by 12 percent and earn a single credit [EA Credit #1]. Or one could hire an energy commissioning agent early in the design process and earn double, two points [EA Credit #3]. Or one could earn three points by installing an energy consumption metering device system for one year, [EA Credit #5], something one would have thought would be a pre-requisite for earning any credits. There appears to be no correlation between costs and benefits in this priority system.

One could earn two points by providing at least 35 percent of the building's electricity from renewable sources for two years [EA Credit #6] or earn the same two points by installing onsite renewable energy solar panels that produce only three percent of the building's energy. The wide disparity in renewable energy production and costs required to earn the same two points belies the internal consistency of the standards themselves with respect to costs and benefits.

In the Materials & Resources category, a developer could maintain 55 percent of the walls, floors and roof of a building and earn only a single point. [MR Credit #1.1] Or the developer could take the easy route and also earn one point by simply reusing five percent of the materials. [MR Credit #3.1]. Or s/he could not preserve or reuse any structure or materials at all but simply earn one credit by buying any materials with 10 percent recycled content. [MR Credit #4.1]



Just using concrete can earn one point, since it almost always is extracted or manufactured within 500 miles [805 km] of the site. [MR Credit #5.1] Or the developer could earn one point by using cotton insulation or wheat-board office partitions. [MR Credit #6]. Upon what basis can the USGBC conclude that each of these techniques is of equal value?



In the environmental quality category, a developer could earn one point for installing carbon dioxide meters tied to the HVAC system, [EQ Credit #1] or by day-lighting 75 percent of the floor area, [EQ Credit #8.1], or for providing operable windows, [EQ Credit #6.2], or by buying task lighting. [EQ Credit #6.1] What is the basis upon which these items are determined to be of equal value, either environmentally or economically?

LEED awards one point for hiring a LEED-accredited professional consultant [ID Credit #2] — the same one point score earned for spending millions of dollars to remediate a brownfield. The lack of priorities in scoring points, the failure to incorporate cost/benefit analyses into its awards, and the neglect of economic values and benefits, undermines LEED's seemingly widespread acceptance by the development community.

3. Different rating systems are largely incompatible.

Despite its prevalence in the United States, the LEED rating system promulgated by the U.S. Green Building Council, a Washington, D.C.-based non-profit corporation, is not the only rating system. The federal Environmental Protection Agency (EPA) and the U.S. Department of Energy have formulated the Energy Star rating system.

Unlike LEED, only 32 percent of which is devoted to energy conservation, Energy Star is 100 percent based on energy efficiency. Its ratings are awarded relative to energy consumption based on a database of peer buildings that are similar with respect to size, use, occupancy, hours of operation and location. To achieve an Energy Star rating, a building must reach a benchmark that makes it more efficient than 75 percent of its peers. So only the top quartile of buildings may display an Energy Star. Licensed engineers must certify the accuracy of the energy consumption information submitted. Energy Star focuses more on existing buildings, whereas LEED concentrates more on new buildings, and architects have more familiarity with LEED.

Essentially the main compatibility between the LEED and Energy Star systems is that in the LEED ratings for existing buildings, named LEED-EB, a building must achieve an Energy Star rating of at least 69, meaning that it is more energy efficient than 69 percent of its peers. Otherwise, these rating systems are not compatible or competitive.

The only directly competitive system, more or less, is the Green Globes system, based on a 1,000-point scale, versus the 110-point LEED-NC scale. The categories, while somewhat similar, are weighted differently.

Credits	LEED	LEED	LEED	LEED	Green	Green
	v 2.2	v 2.2	v 3.0-2009	v 3.0-2009	Globes	Globes
	Points	Percentage	Points	Percentage	Points	Percentage
Sustainable Sites	14	20%	26	24%	120	12%
Water Efficiency	5	7%	10	9%	130	13%
Energy & Atmosphere	17	25%	35	32%	300	30%
Materials & Resources	13	19%	14	13%	145	14.5%
Indoor Environment	15	22%	15	14%	160	16%
Innovation & Design	5	7%	6	5%	-	-
Regional Priorities	0	0%	4	3%	-	-
Project Management	-	-	-	-	100	10%
Emissions	-	-	-	-	45	4.5%
Totals	69	100%	110	100%	1,000	100%

The Green Building Initiative (GBI) that sponsors Green Globes had its genesis in Toronto in 1996 by the Canadian Standards Association. Now, the American National Standards Institute (ANSI) has accredited the GBI as a standards developer. The ANSI process is consensus-based and involves a committee of users, producers, interested parties and non-governmental organizations. Green Globes is an online-based interactive system where point scores are known as the design proceeds, unlike LEED whose results are not known until the project is completed, commissioned and certified. Green Globes does require third-party verification. Because its categories, credits and points are different from LEED's, making cost-effective comparisons and judgments is difficult. But it does not appear that cost/benefit analysis is endemic to standards setting of either ratings system.



4. Sustainability is about long-term benefits while developers' timelines are short-term.

One of the major impediments to wide-scale adoption of green building has little to do with the rating systems but much more to do with the timelines of developers, which have become shorter and shorter due to the:

- securitization of real estate markets,
- rise of merchant developers,
- conversion of private developers to traded real estate investment trusts (REITs), and
- proliferation of hedge funds operating in the real estate sector.

The Wall Street virus of its short-term attention span on quarterly earnings reports has spread to developers as well as to lenders, especially as secondary mortgage markets morphed into derivatives with mortgage pools, sliced and diced into more arcane tranches, leading to the implosion of those markets during the last year.

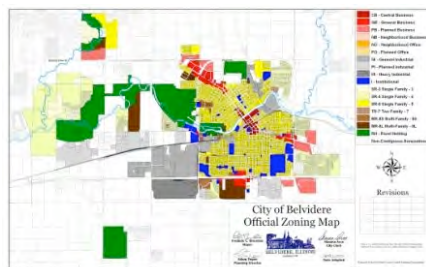
There was a time when visionary developers thought in terms of quarter centuries, not three-month quarters. When John D. Rockefeller, Jr. built Rockefeller Center, it was to hold, not to be sold. The great real estate fortunes of John Jacob Astor, Henry Huntington and Henry Flagler, the Durst, Shorenstein and Ashforth families, and many others, were built on the premise of building for the long term. Such a family will be very concerned about building using solid materials and quality systems that have longer lives and lower operating expenses over extended periods.

But a merchant developer, who will flip a building upon completion, if not before, will not absorb short-term pain for long-term gain that would accrue to future owners. And as residential markets have been overtaken by condominiums, where the developer, who enjoys none of the savings in energy operating expenses, but rather sells upon completion, will spend little time and money on building well unless there is a short-term premium upon sale. With a glut of condominiums on the market as a result the national binge on short-term credit, that is very unlikely to happen anytime soon.

Unfortunately, build and hold has been a strategy few developers have been either willing or able to follow. If the business of development is the creation of value, which it is, green building creates long-term values, especially as energy prices rise. And with those rising energy prices, buildings that are not green will become functionally obsolescent, analogous to the way that energy-consuming sports utility vehicles (SUVs) have witnessed values that have depreciated more quickly than in previous years. So the risks of not building green will rise.

5. Mixed-uses maximize sustainability, but single-use zoning is still predominant.

While some shortsighted private developers have been slow to adopt green building, public planners are often locked into outmoded land use planning models. The United States is still, for the most part, ossified in single-use zoning — the very antithesis of green building and vital mixed-use urbanity. While many planners decry cars and seek universal mass transit, and LEED planners award credits for projects without cars, the very single-use zones in which the lion's share of new buildings are constructed actually create demand for the very cars they abhor. Shared parking is impossible without mixed uses,

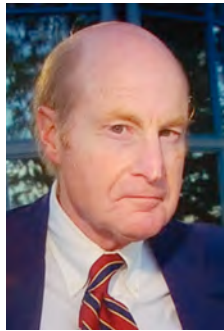


yet in very few areas can a developer build a mixture of uses as of right. And when s/he can, different building codes apply separately to each use, thereby raising costs.

In many ways, single-use zoning is a 20th Century solution leading to the sprawled land-use patterns that exacerbate climate change and segregate society by income, class, age, infirmity, and formerly by race. What is needed is a 21st Century solution based on universal mixed-use land use patterns. The provisions of single-use zoning are in turn aggravated by outmoded concepts of maximum lot coverage, minimum setback requirements, maximum floor area ratios and maximum heights that help to ensure sprawling land-use patterns.

Rather than be complacent with LEED, or Green Globes, one can suggest that if the ratings were adjusted to become balanced by cost/benefit analyses, like the SEED ratings proposed, vastly more developers would buy into the ratings system and save enormous amounts of energy, while they satisfy pent-up demand for green buildings, which can lead to premiums for green building sales, occupancy and rent.

Moreover, developers and building owners who do not build green will likely see their buildings experience functional obsolescence and declining values. To achieve more universal adoption of its rating system, the U.S. Green Building Council, and GBI's Green Globes, should weed and overhaul its LEED and Green Globes ratings and truly plant a SEED for widespread green building.

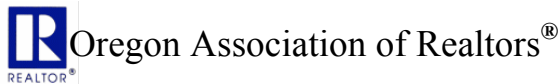


Respectfully yours,

William P. Macht

Professor Will Macht
Editor, Center for Real Estate Quarterly
Associate Director, Center for Real Estate

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Deleveraging Commercial Real Estate: Equity Investment Market Dynamics

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Tom Wolfe's 1998 novel, *A Man in Full*, portrays the fictional fall from grace of a formerly acclaimed real estate developer, Charlie Croker. In one of its more famous chapters, Croker is summoned to a breakfast meeting that quickly turns into an unpleasant grilling at the hands of his lender. The scene evokes the often-uncomfortable images that surround the archetypical commercial real estate loan workout, but more importantly it demonstrates the strong dynamics of the two-party relationship of lender and borrower. During the real estate crash of the late 1980s and early 1990s, borrowers and their lenders often had similar uncomfortable interactions. But these interactions frequently led to a productive working out of problematic investments, resetting expectations of both the equity investors and the debt lenders. In conjunction with the policies of the Resolution Trust Corporation (RTC)¹, these workouts were a critical component to the resolution of the troubled assets of institutions not subject to insolvency in a market characterized by massive overbuilding and a major national recession.

The nature and source of commercial real estate debt and equity capital changed through the course of the current cycle. Today, the relationship between borrower and lender has been diluted by a myriad of participants in any given real estate investment – including Commercial

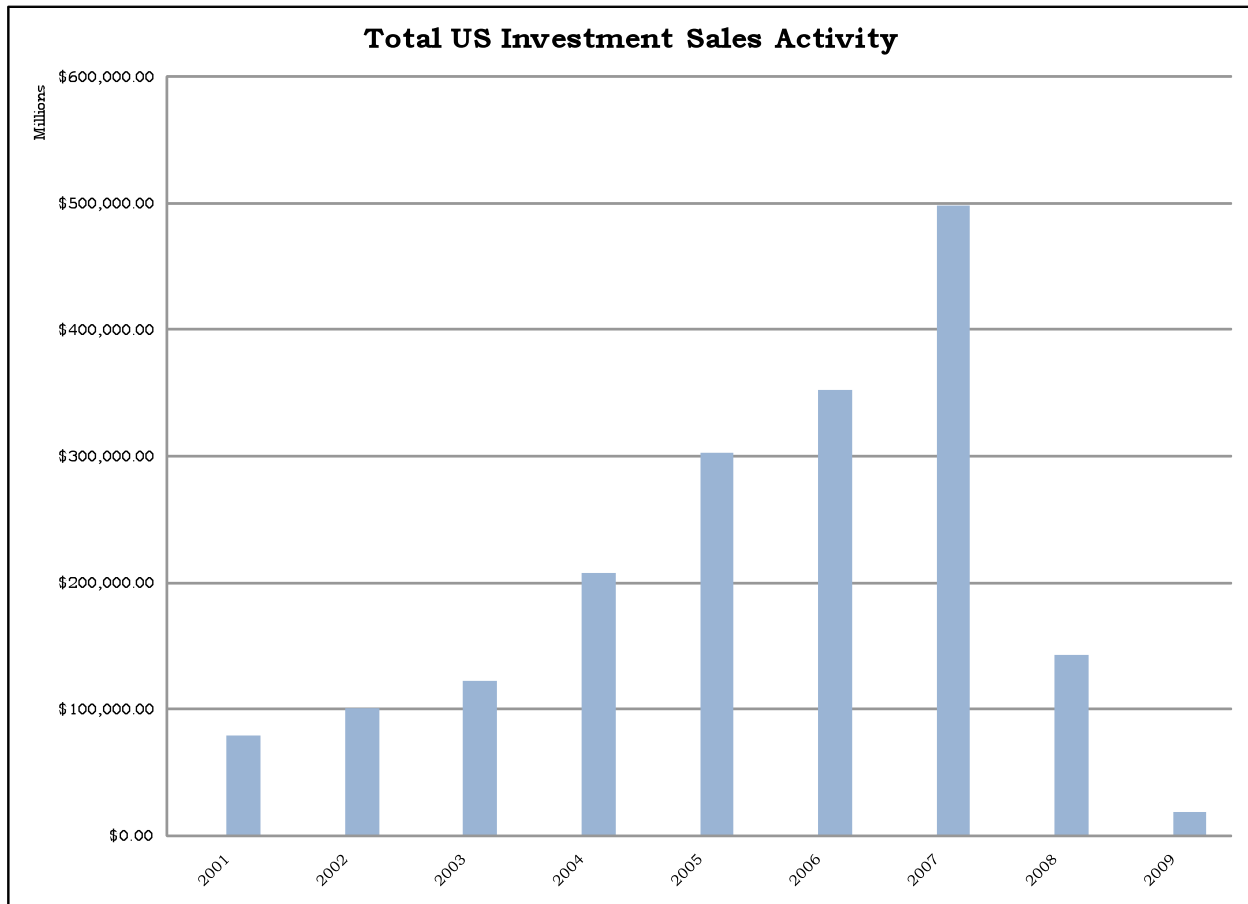
¹ The Resolution Trust Corporation was the U.S. Government-owned asset management company charged with liquidating assets of savings and loan institutions declared insolvent by the Federal Office of Thrift Supervision.

Mortgage-Backed Securities (CMBS) bondholders, large loan syndication participants, junior and mezzanine lenders, preferred equity and institutional equity investors and entrepreneurial investment sponsors. This dilution seemingly has led to an environment where no single participant can take the first step towards truly resolving troubled real estate investments.

Indeed, the commercial real estate investment industry finds itself in one of the worst down-market cycles in decades. Instead of suffering from oversupply issues that were characteristic of the real estate crash of the early 1990s, today's commercial real estate market is reeling from an unprecedented and dramatic tightening in global capital flows and a sudden and substantial slackening in tenant demand across all real estate asset classes. In this article we explore current economic trends that are driving deterioration in commercial property markets, analyze trends in the global capital markets relative to commercial real estate investment and discuss practical strategies that are being employed by market participants in order to maximize commercial real estate value in the context of the deleveraging economy.

Current Market Trends

Many real estate market participants have commented that the current real estate downturn is the worst we have seen in decades, including the savings and loan crisis of the late 1980s. Transaction activity has dropped to minimal levels. Indeed, from 2007 to 2009, the number of commercial real estate transactions fell 92%, representing a drop in dollar volume from \$421 billion in 2007 to \$17 billion in year-to-date 2009.

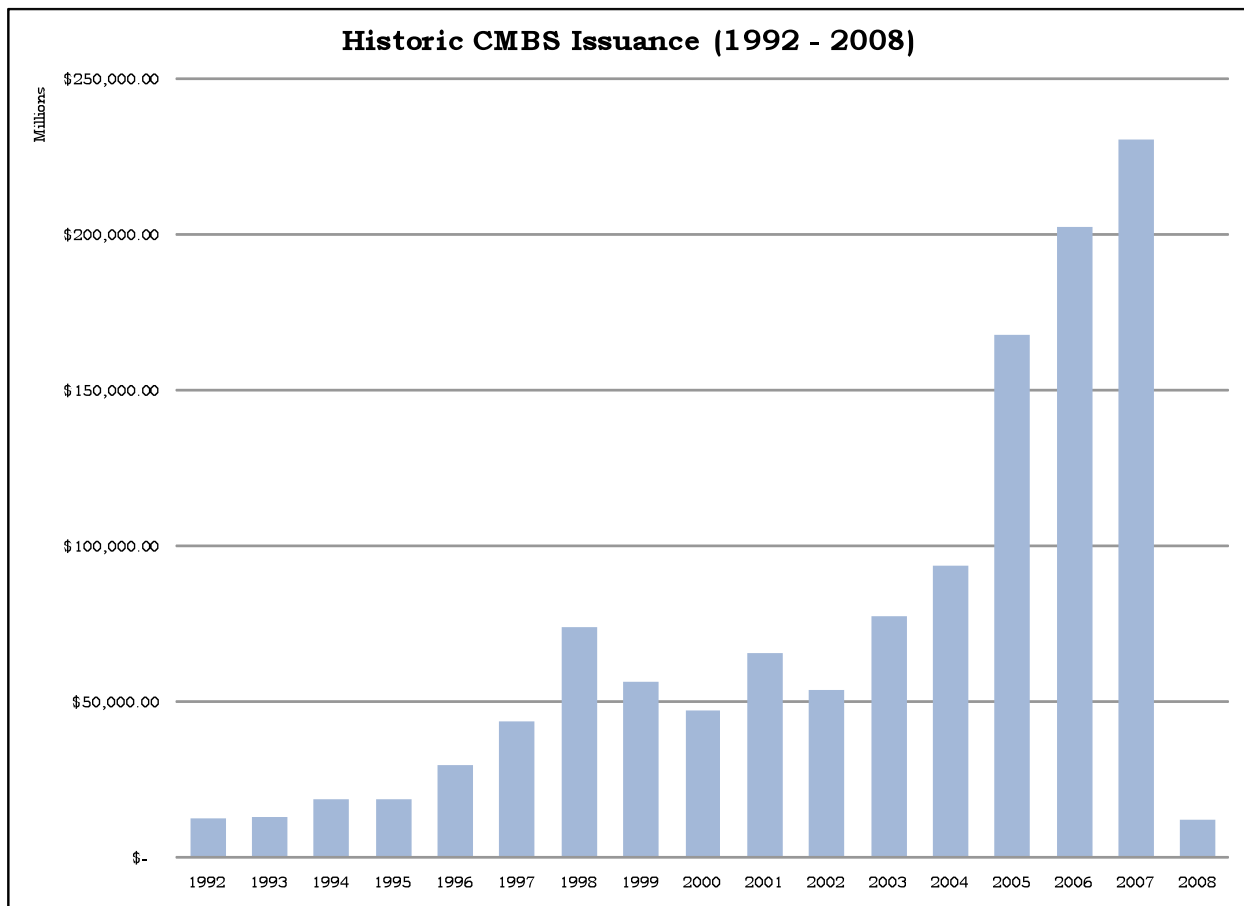


Source: Real Capital Analytics Inc.

With the institutional equity investment market reeling from significant losses, redemption issues and the denominator effect,² transaction activity throughout the commercial real estate sector has ground to a halt. As a consequence of the decline in transaction activity, owners have few data points to reference when valuing a portfolio, and lenders have few data points to guide them in ascertaining exposure risk. The commercial real estate sector as a whole is hard pressed to identify appropriate risk-weighted returns on capital, fair market capitalization rates and, as a result, to determine the appropriate valuation of real estate assets.

What spurred the dramatic decline in transaction activity in the first place? Commercial real estate investment performance began this decade on a strong note. Despite economic hiccups related to the dot-com bust and 2001 national recession, commercial real estate continued to deliver strong returns on investment. Additionally, the growth of the Real Estate Investment Trust (REIT) market, standardization of financial reporting and the globalization of the financial markets led to a continued and long-term influx of capital into real estate as an asset class.

The globalization of the financial markets and a long-term low interest rate environment led to an exponential increase in the issuance of CMBS. Volumes soared, reaching a peak issuance of \$230 billion in 2007. At the same time, institutional investors, ranging from life insurance companies to pension fund advisors, increased their overall allocations to commercial real estate. Real estate, as an asset class, transformed from an alternative or tactical asset class to



Source: Commercial Mortgage Alert

² Commercial real estate sales required by asset value declines in institutional investor asset pools' target-restricted real estate asset allocations.

a crucial, strategic component of a diversified investment portfolio.³ As a result, from 2001 to 2005, annual net investment in U.S. commercial real estate assets increased by 251 percent.

By 2005, increased pressure from the bond-buying community to purchase CMBS led major investment banks to increase the size and frequency of their loan securitizations. This increase could only be accommodated by lax underwriting standards, higher leverage and, ultimately, less attention to detail. First mortgages were often written up to 90 percent of value at historically low interest rates — sometimes interest-only and almost always on a nonrecourse basis. Increasingly, CMBS lenders began underwriting future, unrealized income to capture additional loan volume, exposing CMBS investors to the potential of greater default risk if market fundamentals were ever to slip.

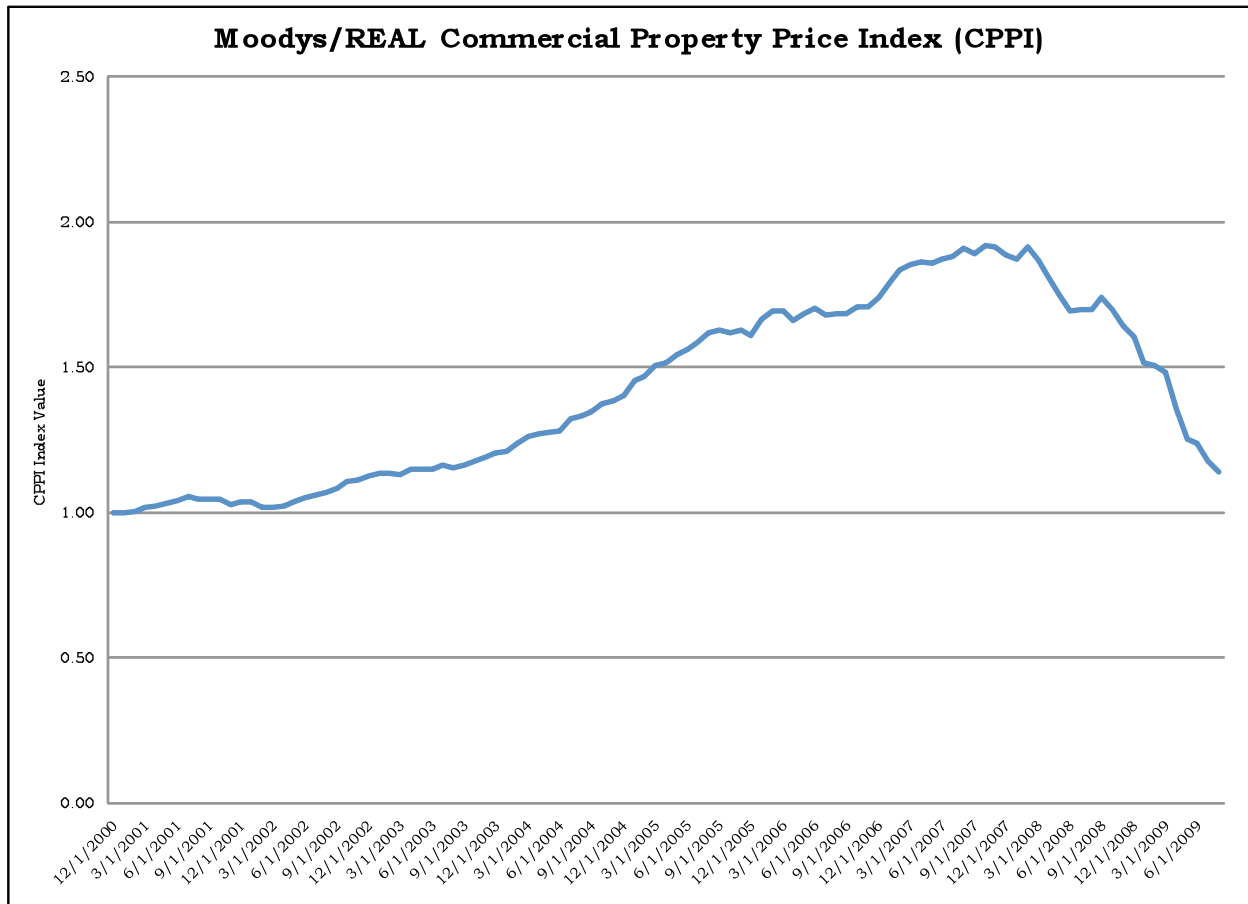
But the spark that triggered the commercial real estate liquidity crisis ultimately came in the form of delinquencies and defaults observed in the Residential Mortgage-Backed Securities (RMBS) market. Bond buyers began to analyze more closely the risks inherent in the aggressive loans in the underlying CMBS bond pools. After evaluating the underwriting of these loans, bond buyers lost confidence that CMBS were risk-rated and priced appropriately. As a result, bond buyers devalued these securities as an investment class, driving CMBS yields to astronomical levels, subsequently leading to rapid inflation of the cost of capital for borrowers. This paralyzed the CMBS market and CMBS issuers were left laden with commercial real estate debt that was immediately mispriced and with no discernable market buyers. Unable to sell this mountain of debt intended for the securitization market, CMBS originators became unintended balance sheet lenders. With no source of new liquidity and no practical means to liquidate their current holdings, these lenders have virtually remained out of the permanent lending market since the credit crunch began in early 2007.

While easy access to credit was a major factor in rising values and today's current lack of debt capital, conversely, it is a major contributor to the current cycle of falling asset values. In fact, according to a recent RREEF research report, during this decade market participants became increasingly reliant upon the availability of inexpensive debt capital in order to meet ever-increasing return thresholds demanded by the global investment community. By the end of 2008, the global commercial real estate debt market accounted for about 58 percent of the \$12 trillion real estate investable universe.⁴

After the collapse of the CMBS lending market, commercial real estate investors could no longer achieve their yield requirements at market pricing. In fact, yield requirements have widened, driving up capitalization rates and driving down values.

³ David J. Blum and Scott Urdang, "Repricing Risk in the U.S. Commercial Real Estate Market," *PREA Quarterly* Winter 2008: 32-35.

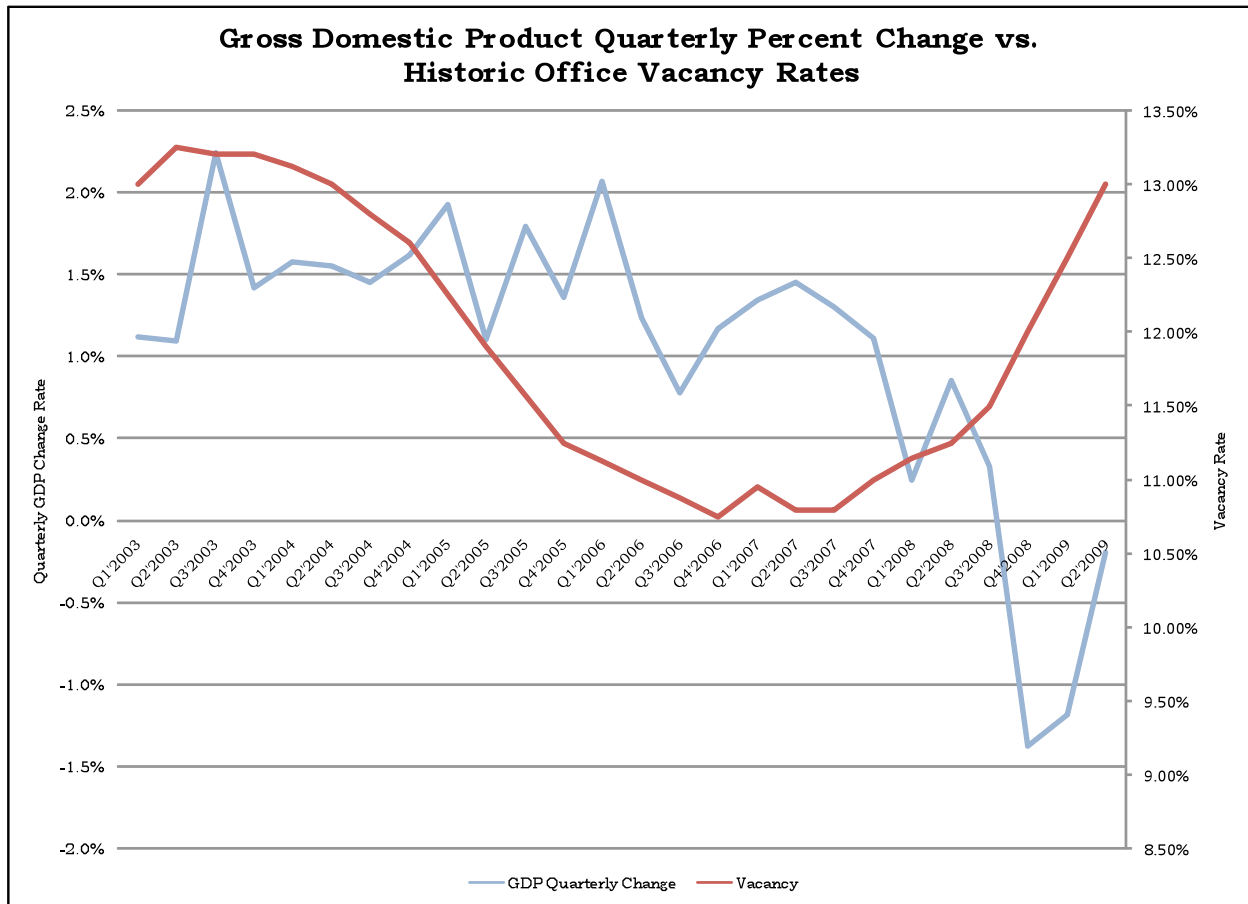
⁴ *Global Commercial Real Estate Debt: Deleveraging Into Distress* (RREEF Research, June 2009).



Source: Moody's Investors Service

Today, observable commercial real estate pricing is dropping quickly and steeply. Prices have already come down 40 percent from their peak in October 2007, according to the Moody's/REAL Commercial Property Price Index, based on repeat sales, from Real Capital Analytics. Equity investors, and in many cases lenders, who entered the market from 2005 to 2007, now find that their initial capital investment is significantly in excess of current market value. For equity investors, this precipitous drop in market pricing has effectively wiped out any prospect of a return on their original investments. For lenders, the current environment means facing the very real prospects of a loss of loan principal.

What is especially troubling is that the commercial real estate market may not yet have hit bottom. In addition to marked value declines driven by the repricing of risk, the fundamental drivers of commercial real estate value are also deteriorating. A sizeable reduction in the national workforce has reduced consumer spending, decreased the demand for retail, office and industrial space, and has led to a decline, and potentially negative growth, in household formation, a driver of housing demand. On October 20, 2009, the Wall Street Journal argued that "the U.S. has shed 7.2 million jobs since the recession began in December 2007, the deepest contraction since the Great Depression. Even if the job market started spitting out jobs as fast as it did during the 1990s boom, adding 2.15 million private-sector jobs a year, the U.S. wouldn't get back to a 5% unemployment rate until late 2017."



Source: Federal Reserve Bank of St. Louis and CoStar Realty Information, Inc.

In the long run, it may be owners of commercial real estate who suffer most. Today, owners are facing a market environment where rents are declining, vacancies and concessions are increasing, and operating expenses such as property tax and utilities continue to rise. The extended duration nature of commercial leases suggests that these reductions in revenue will continue to drag down values over the long term and implies further negative consequences for investors who acquired commercial real estate assets during the peak period and relied on lease-up and rent growth for their exits.

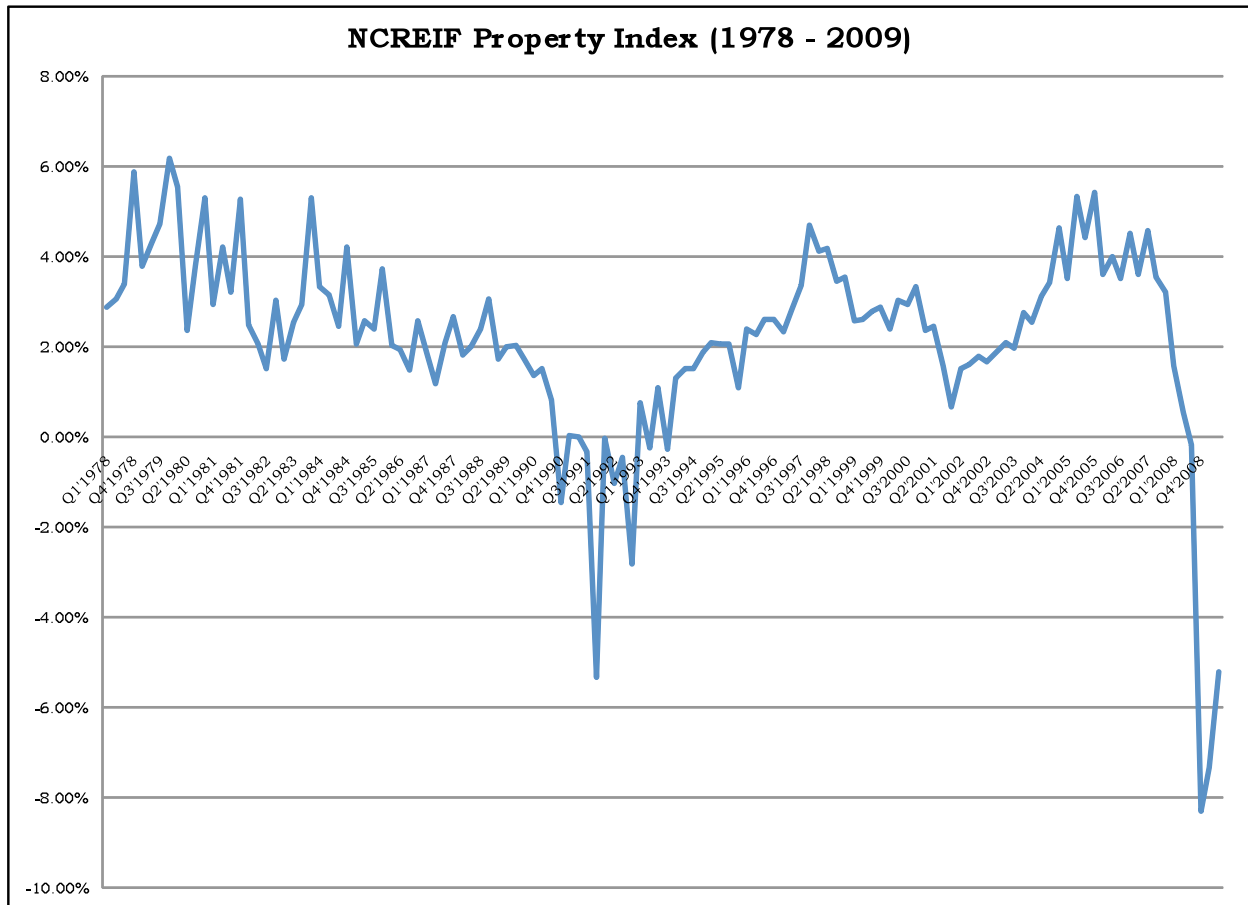
Equity Market Implications

It appears that the equity markets have been much quicker to recognize and address their losses in commercial real estate assets than the debt markets. This can be attributed to the ubiquitous structure of the closed-end equity investment funds as a finite pool of capital directed towards certain investment classes or strategies. The fund losses are still distressing and in some cases total, but due to the nature of these investment vehicles, losses can be compartmentalized to a specific fund with broad brush blame attributed to the investment vintage, rather than to fund management itself.

The National Council of Real Estate Fiduciaries (NCREIF), a non-partisan institutional real estate investment industry organization, has published the NCREIF Property Index (NPI) on a quarterly basis since 1978. The NPI reflects the composite total rate-of-return measure of investment performance for a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. All properties in the NPI have

been acquired, at least in part, on behalf of tax-exempt institutional investors – the great majority being pension funds.

The NPI quarter-to-quarter return, which is plotted below, represents an estimate of the quarterly Internal Rate of Return (IRR) as if a property was purchased at the beginning of the quarter and sold at the end of the quarter with the investor receiving all net cash flow (net operating income minus capital expenditures) during the quarter. The index illustrates the depth of losses that institutional investors have realized during the current cycle.



For many investors, this poor investment performance has translated into the total loss of investment equity in certain property holdings. The proliferation of non-recourse debt, which financed most of the deals of this vintage, provides little incentive to continue to dedicate resources to these assets, once investors have abandoned any hope of equity recovery. As a result, experienced fund managers have been able to triage the worst investments through an orderly forfeiture of properties in a series of high profile, deed-in-lieu of foreclosure arrangements with their lenders. Therefore, the larger established owners of commercial real estate, while dramatically impacted by the market downturn, may not find these losses to be fatal. Hines, Maguire, and California Public Employees' Retirement System (CalPERS) have all handed property back to their lenders. In August 2009, the Wall Street Journal highlighted a local example, when the joint venture partnership capitalized by the California Public Employees' Retirement System walked away from its ownership position in Portland, Oregon's KOIN Tower, relinquishing control of the property to its lender, New York Life Insurance Co.

With KOIN Tower, CalPERS stepped away from \$39 million of pension fund equity it had invested as recently as 2007. When faced with the need to commit additional capital to carry the deal through the current recession, CalPERS, acting as fiduciary to its pension policy holders, determined that it had simply overpaid for the property to the extent that the recovery of any of its investment equity was highly unlikely. CalPERS facilitated an orderly return of the property to its lender determining it would not be prudent to throw good money after what it perceived to be bad and writing its equity investment down to nothing.

Fund managers have realized tremendous losses in commercial real estate investments. These losses typically stop at the fund level and do not necessarily represent systemic risk to the fund manager, particularly given the non-recourse nature of the debt provided at original acquisition. In fact, sophisticated commercial real estate equity fund managers have been able to maintain investor confidence by directing blame for problem investments on market issues rather than operational issues. The larger fund managers have generally been able to develop a compelling investment premise and raise additional capital with which to reenter the market with new strategies to capitalize on opportunities available in the current market.

With so many deals gone bad, distressed opportunities are now appealing to investors as many are lured by what is viewed as a historic buying opportunity. Meanwhile, equity investment managers are raising new capital, or repurposing existing funds to make such new investments. Real Estate Alert's annual review of high-yield real estate funds⁵ identified a growing number of distressed property and high-yield debt funds. The review surveys closed-end real estate funds of at least \$50 million of equity, targeting a return greater than 10%. The increasing supply of distressed opportunities, and a credit constrained investment environment, has led to a change in the reported investment strategies of a larger portion of these funds. Increasingly, funds that categorized themselves as either opportunity or value-added funds, representing almost 75% of investment equity by allocation, report targeting distressed properties and underperforming or defaulted loans. In addition, during a period of time when more than 50 planned funds were either withdrawn from the market or ceased fund raising activities altogether, high-yield debt funds have increased from 54 such reported funds in 2008 to 73 funds in 2009 and are expected to account for 16 percent of the total equity being raised in the marketplace. Real estate is a leveraged asset class, and until such time as traditional real estate lenders return to extending credit to refinance maturing loans or to buy transitional properties, the market clearly anticipates that this void will be partially addressed in the equity markets.

The Real Estate Alert survey also provides insight into investor expectations. Many institutional investors are not sanguine on the prospect of complete return of their capital for investments made in 2006 and 2007. It is estimated that over \$106 billion worth of properties may be categorized as distressed or potentially troubled with the most significant volume of distressed asset sales expected to be greatest in 2011.⁶

Investors are aware that large fortunes have been made in the worst of economic times, and are preparing to take advantage of distress. These same investors are not necessarily condemning their fund managers, as long they are demonstrating an aptitude for capable asset management of their troubled holdings.

When Lehman Brothers filed for bankruptcy in September 2008 it directly held real estate loans and assets estimated at \$43 billion. On May 2, 2009 the front page of the New York

⁵ Real Estate Alert, March 18, 2009.

⁶ Ron Zuzack, Chief Operating Officer, Real Estate Equity, BlackRock, "Institutional View of the Real Estate Market", May 27, 2009. (Presentation).

Times business section profiled Mark Walsh, the former head of Lehman Brother’s global real estate group who was largely credited (or blamed) with Lehman’s aggressive foray into real estate investment and lending. The article portrayed Mr. Walsh as a once admired financier who recklessly burdened Lehman with increasingly risky real estate deals, culminating with the \$22 billion purchase in May 2007 of the Archstone-Smith Trust, a publicly traded company that held approximately 360 upscale apartment buildings across the country.

In June 2009, Mr. Walsh and a group of former Lehman employees were back at work at Lehman Brothers managing the private-equity portfolio.⁷ Like Mr. Walsh, numerous fund managers throughout the industry are gearing up to take advantage of this pending distress, and in some instances, looking to profit among the ashes of their own ruins.

Debt Market Implications

In order to understand the current real estate debt market environment, we must appreciate the current position of financial institutions. The willingness of debt investors to lend depends upon their own liquidity and the nature of their businesses. The majority of life insurance company real estate loans were issued at ten-year terms, providing for amortization. Maturing debts for these institutions have greater debt-service-coverage ratios and loan-to-value ratios, mitigating refinancing risk.

Depository banks traditionally have lent for three- to five-year terms. As a result, many of the real estate loans coming due in the next two years will be of recent vintage with difficult declining valuation issues. Market pricing declines of 40 percent means that the subordinated investment equity has been eliminated and lenders are experiencing the prospect of principal losses on any asset originated at over 60% loan-to-value. Over the last several years, banks more commonly underwrote loans at 80% - 90% of value, meaning that today’s values have migrated well through the investment equity and into the lender’s position. Banks are forced to go it alone.

Debt Shortfall Matrix						
New Loan LTV at Refinance						
		70.00%	65.00%	60.00%	55.00%	50.00%
Property Value Decline	0.00%	(5.00)	(10.00)	(15.00)	(20.00)	(25.00)
	-5.00%	(8.50)	(13.25)	(18.00)	(22.75)	(27.50)
	-10.00%	(12.00)	(16.50)	(21.00)	(25.50)	(30.00)
	-15.00%	(15.50)	(19.75)	(24.00)	(28.25)	(32.50)
	-20.00%	(19.00)	(23.00)	(27.00)	(31.00)	(35.00)
	-25.00%	(22.50)	(26.25)	(30.00)	(33.75)	(37.50)
	-30.00%	(26.00)	(29.50)	(33.00)	(36.50)	(40.00)
	-35.00%	(29.50)	(32.75)	(36.00)	(39.25)	(42.50)
	-40.00%	(33.00)	(36.00)	(39.00)	(42.00)	(45.00)
	-45.00%	(36.50)	(39.25)	(42.00)	(44.75)	(47.50)
-50.00%	(40.00)	(42.50)	(45.00)	(47.50)	(50.00)	

Note: The matrix above illustrates debt shortfall of an assumed initial loan based on \$100 property value, 75% LTV.
Source: Prudential Real Estate Investors

⁷ Peter Lattman and Anton Troianovski, “Lehman Property Boss Returns,” *Wall Street Journal* June 17, 2009.

The table presented on the prior page, adapted from a Prudential Real Estate Investors equity research report⁸, presents the potential maturity default risk to real estate owners, and their lenders, as a result of a combination of declines in underlying property values and the new underwriting standards.

It must be remembered that banks, unlike equity investment funds, are not single-purpose entities formed to direct debt capital into specific real estate investments. Depository banks have a fiduciary responsibility to their depositors, and must at all times maintain sufficient capital reserves to account for credit risk related to assets (such as loans) and other off-balance sheet exposures. When a banking institution cannot maintain sufficient capital relative to loan-loss exposure, it is deemed inadequately capitalized and is shut and sold by its regulator.

When a bank writes down the principal value of a debt investment, it must raise capital reserves to offset the write-off. Given the substantial amount of exposure to continued losses related to commercial real estate debt investments, banks are finding it difficult to attract private capital, particularly when banks are competing with new equity opportunities targeting higher yielding opportunities devoid of the drag and uncertainty of underperforming or non-performing legacy assets.

As a result, banks are accessing capital infusions almost exclusively through the government's Troubled Asset Relief Program (TARP) and, if at all possible, very expensive equity issues under unfavorable terms. GMAC is reportedly seeking a third round of federal assistance and demonstrates the difficulty lending institutions are having attracting private capital. After the government published its banking stress tests in May, Bank of America and Wells Fargo succeeded in raising tens of billions of dollars from private sources. However, they do not represent the majority of banks that have been unable to raise any capital.⁹

Raising capital as a bank with a deteriorating loan portfolio is an impossibility. As of October 24, 2009, regulators have shut 106 banks this year, the largest number since the savings and loan crisis. Those banks that can raise capital find it extremely costly. Last month, West Coast Bancorp in Lake Oswego was able to raise \$155 million from investors. In order to do so, the bank significantly diluted current investors selling new investors stock representing an 83 percent ownership interest at a price less than 20 percent of the bank's September 30 book value.¹⁰ Deals such as these illustrate the need for liquidity by smaller banking institutions to stave off uncertainties surrounding the economy and the performance of their loan portfolios.

Despite access to TARP funds, which are meant to offset additional loan loss reserves, it is widely believed that lenders are not writing down their commercial real estate debt investments to today's market levels. Many lenders are "pretending and extending", in the parlance of market participants, executing loan extensions and renegotiating with their borrowers, in exchange for partial pay-downs and marginal increases to their interest rates. Lenders hope to be able to weather the current market long enough to recover the full debt investment value by the extended maturity date. In the interim, the loan can be booked to the balance sheet as a performing loan garnering the preferential reserve treatment warranted such assets.

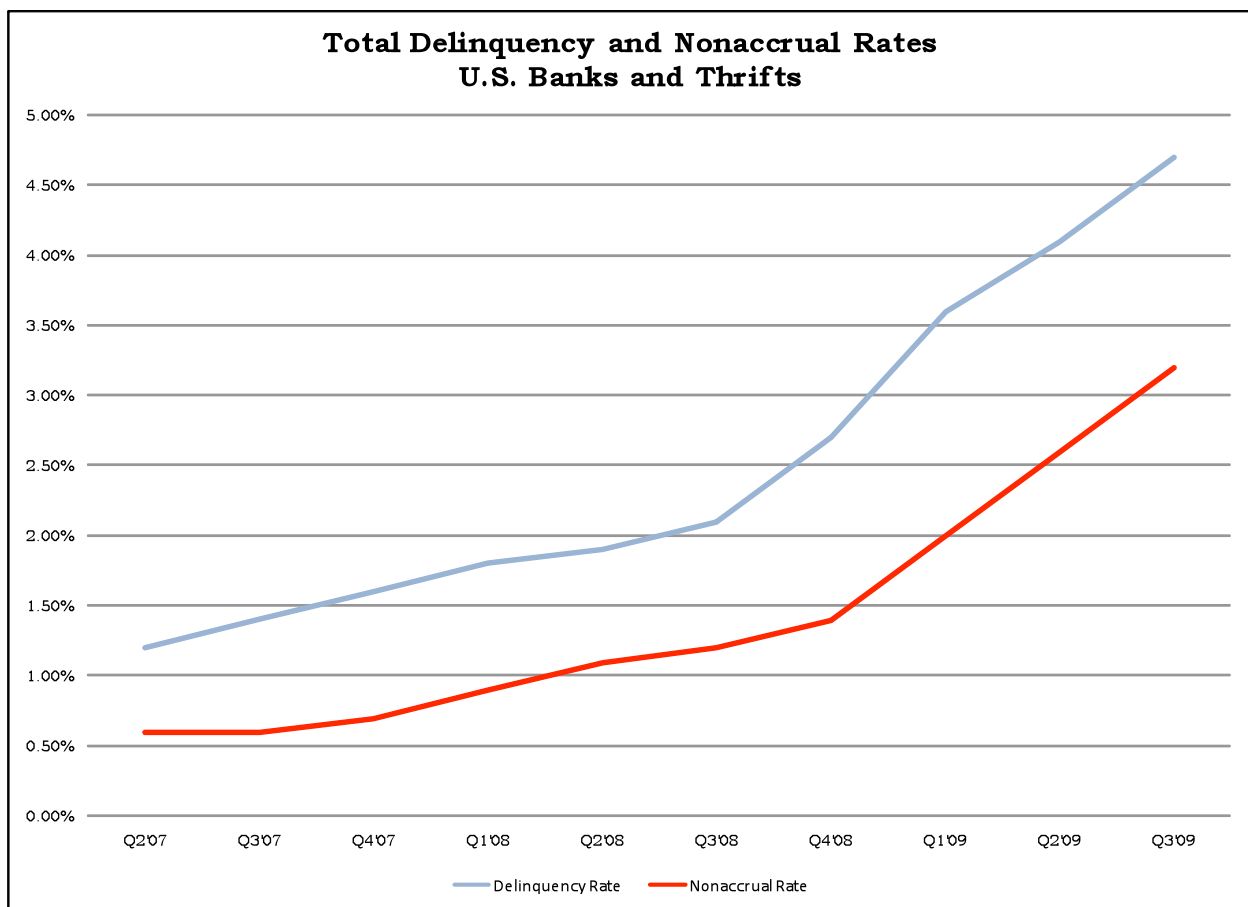
⁸ Life After Debt: Coming to Grips with the Funding Gap (Prudential Real Estate Investors, September 2009).

⁹ Colin Barr, "GMAC grabs for another lifeline," Fortune Magazine October 28, 2009.

¹⁰ Jeff Manning, "New investors take most of Oregon's West Coast Bancorp," The Oregonian October 29, 2009.

The implication of these practices is that banking capital for new lending will be tied up for the foreseeable future, at best, until the banks' investments are repaid. At worst, these institutions are temporarily forestalling failure. Similar to what happened to Japan in the 1990s, deals may be perpetually extended by lenders as equity investors focus on capital preservation in lieu of capital investment. Transactions, new construction and development outside of the public sector could slow to a crawl and the commercial real estate industry overall could continue to experience tremendous downsizing.

The valuation declines to date, coupled with significant impairment in commercial real estate investment asset performance, have led to substantial increases in defaults and non-accrual rates on depository banks' loan portfolios. As the chart below illustrates, commercial mortgage loan delinquency rates have risen sharply (2.10 percent to 4.70 percent) from the third quarter of 2008 to third quarter 2009.



Source: Foresight Analytics LLC

Current Strategies

The similarity of the current credit crisis, compared to the last banking crisis, remains in that carelessness in lending practices resulted in massive balances of commercial real estate debt that cannot be repaid. However, the nature of workouts has changed. The recourse nature of the loans during the S&L crisis of the late 1980s and early 1990s certainly played a factor, in that recourse provided for a certain alignment of interests between borrowers and their lenders. Lenders were willing to work with borrowers given that they deemed recourse provisions would provide an additional measure of credit support. In turn, borrowers were adequately

incentivized to work for the lender's principal recovery. However, at that time, banking essentially remained a two party system of lenders and borrowers. Today, there are typically numerous tranches of debt holders, each with its own distinct agenda. It is this change in that fundamental structure which, by far, has had the largest impact on workout strategies.

In fact, it was the proliferation of CMBS debt issuances that irrevocably changed this dynamic. Today's commercial real estate debt structures are easily comprised of multiple securitized layers of credits. The combination of these tranching and securitized structures, subordinate debt holders, mezzanine lenders, and preferred equity participants means more passive players who cannot as easily be brought to cooperate like banks and borrowers in a recourse, two party system. As described by one real estate professional, "there are more chairs in the conference rooms and less alignment of interests." The organizational issues within bank groups can be harder to resolve, and upon which to reach consensus, than even the substantive real estate matters.

All of this has been exacerbated by the complete and rapid meltdown of value that led to most of these lenders being overwhelmed, from the standpoint of management capacity, as they were never staffed to handle an active asset management role. Given that the structure of the commercial real estate capital markets' environment has dramatically been transformed from the two-party system of the 1990s, and that banks are ill-equipped from a management standpoint to deal with the immeasurable wave of troubled deals that we face in today's market, the flexibility to structure creative solutions, such as direct debt-for-equity swaps, simply does not exist.

Still, some market participants have found that certain strategies exist to deal with the current market crisis. The appropriate strategy to implement generally depends upon whether the subject asset is a performing cash flowing asset or if it is a non-cash flowing project still under development, or in a state of transition.

In an effort to stave off maturity defaults, lenders have been receptive to working with borrowers who own properties with in-place cash flow, in an effort to give the borrowers more time to create additional value at the property level, or for the hope of a broader market recovery. Ultimately, if cash flow is apparent and sustainable, banks are much more apt to extend loans, renegotiate interest rates to manageable levels, or otherwise redirect cash flow for the benefit of the property. Sam Zell noted in a recent interview that today "we have a scenario of pretend and extend. If an owner has no equity, just an option – a hope certificate – why would he sell unless he was under complete distress? He'll extend as long as he can keep paying the debt service and the lender will leave him in place."¹¹

We also note that balance sheet lenders are able to be much more flexible than lenders who securitized and sold their loans. However, even special servicers who manage loans within commercial mortgage-backed securities pools have some degree of flexibility. A commercial real estate owner we spoke with described a recent restructuring of a CMBS financing, where its lender eliminated certain lender-required impounds (maximizing cash flow available to cover future debt service), and reduced the interest rate in exchange for an interest accrual account and the investment of borrower held cash reserves.

In general, most lenders, balance sheet and securitized alike, are generally reticent to extend for a period of greater than a 24-month extension on the primary term. However, extensions subject to an asset performance test are also commonly reported elements of successful

¹¹ Zoe Hughes, "To Zell and back," Private Equity Real Estate November 2009.

restructure transactions. Even within the rigid structure of commercial mortgage-backed securities lending, there is room for flexibility.

For non-cash flowing properties, such as development projects still under construction or partially completed asset repositions, lenders face a significant challenge. In many cases, these loans have recently, or are about to, run out of money in their respective debt service reserves. In many of these variable rate financings, lenders funded considerable carrying costs, including reserves to fund future capital expenditures and debt service expenses, with the expectation that by the maturity of these financings, asset values would far exceed the outstanding loan principal balances.

Unfortunately, for many of these transactions those debt service reserves have evaporated, asset values have not increased (and in many cases have decreased) and the lender is left with significant problems. The most extreme example was Corus Bank, which extended loans primarily to condominium and speculative office and retail developers. Corus Bank, which held \$8 billion in assets, \$6.6 billion in deposits, and 70 branches as of August 2009, was determined to be undercapitalized relative to its portfolio of deteriorating construction and commercial real estate loans. The bank was seized by its regulators on September 11, 2009.¹²

In these situations, lenders have to make a decision either to take back the property or commit additional capital to see the project through to completion. In a two-party system, lenders had the ability to be flexible and restructure the debt in order to enable the borrower to achieve project completion, in some cases even subordinating their debt to the developers to encourage additional equity contributions. In today's market, lenders have limited flexibility as they must align their work outs with the interests not only of the borrower but also of various other debt holders, both senior and subordinate. Still, there have been several recent situations whereby subordinate debt holders have agreed to acknowledge that their position has been wiped out and approve more creative workouts led by senior debt holders in exchange for a hope note, or the promise of an equity-like return on their subordinate unpaid balance, in the event that the workout leads to a positive return on investment at the deal level.

Clearly, in certain cases lenders and borrowers are able to reach consensus on a workout plan that enables the borrower to complete his or her business plan. However, this is much more difficult in the multi-party system prevalent in today's market, with each lender in the capital stack vying to maximize its recapture of invested capital. The resolution of property issues often falls secondary to the difficulties inherent in the debt structure.

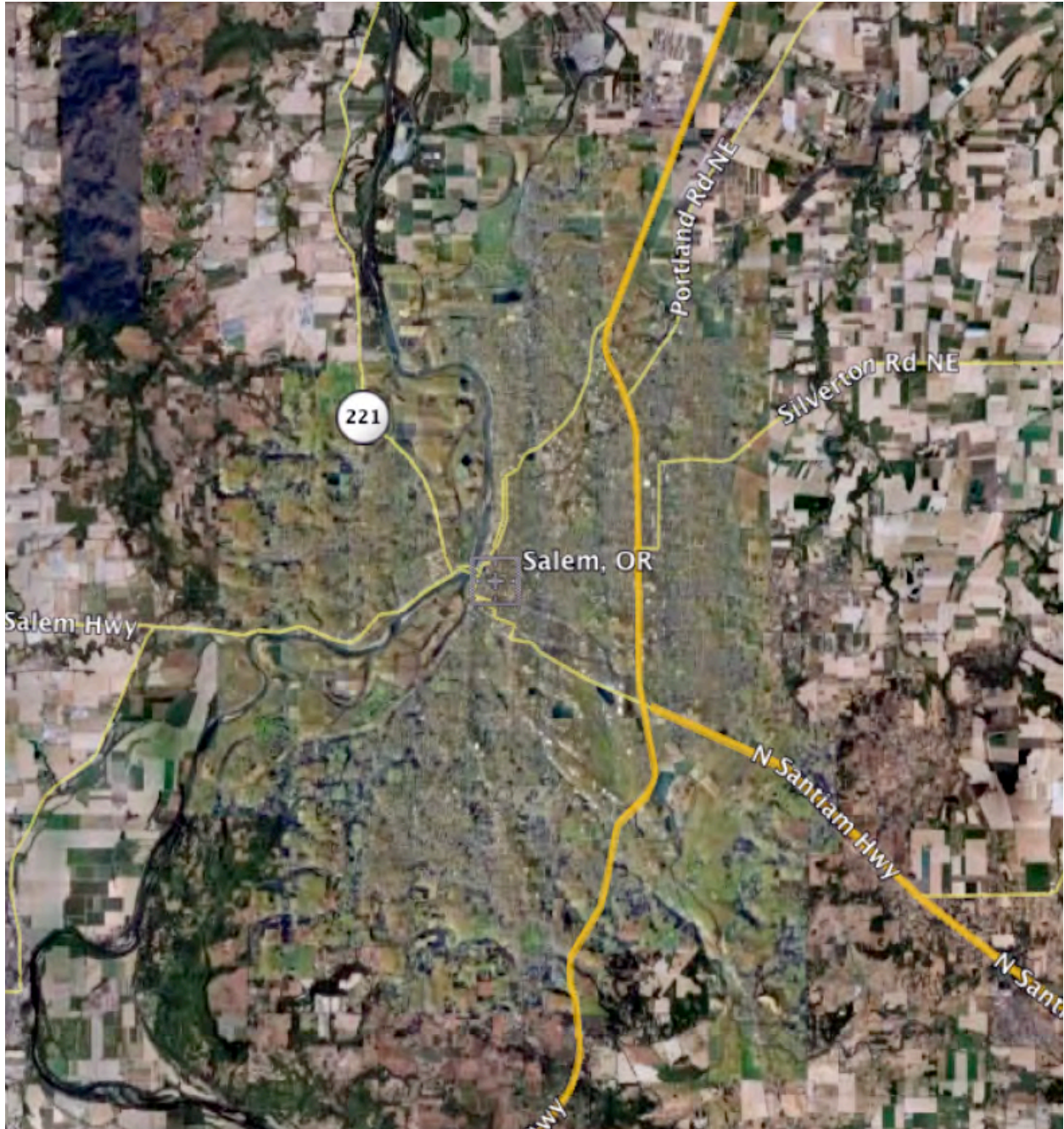
As we face the most significant real estate crash since the early 1990s, and one broader in scope, it is instructive to look back at lessons from the past to gain insight into recovery. However, there has been a fundamental shift in the structure of the global financial system generally, and specifically commercial real estate capital markets during this past decade. These changes have rendered many of the tools utilized during the last real estate implosion almost useless, and have necessitated that we conceive new strategies to emerge from the uncharted waters of the current crisis.

This article represents the views of the authors only, and does not necessarily represent the views or professional advice of ScanlanKemperBard Companies or KPMG LLP.

¹² Nick Timiraos and Jessica Holzer, "Corus Bank Is the Latest to Be Seized by Regulators," Wall Street Journal September 12, 2009.

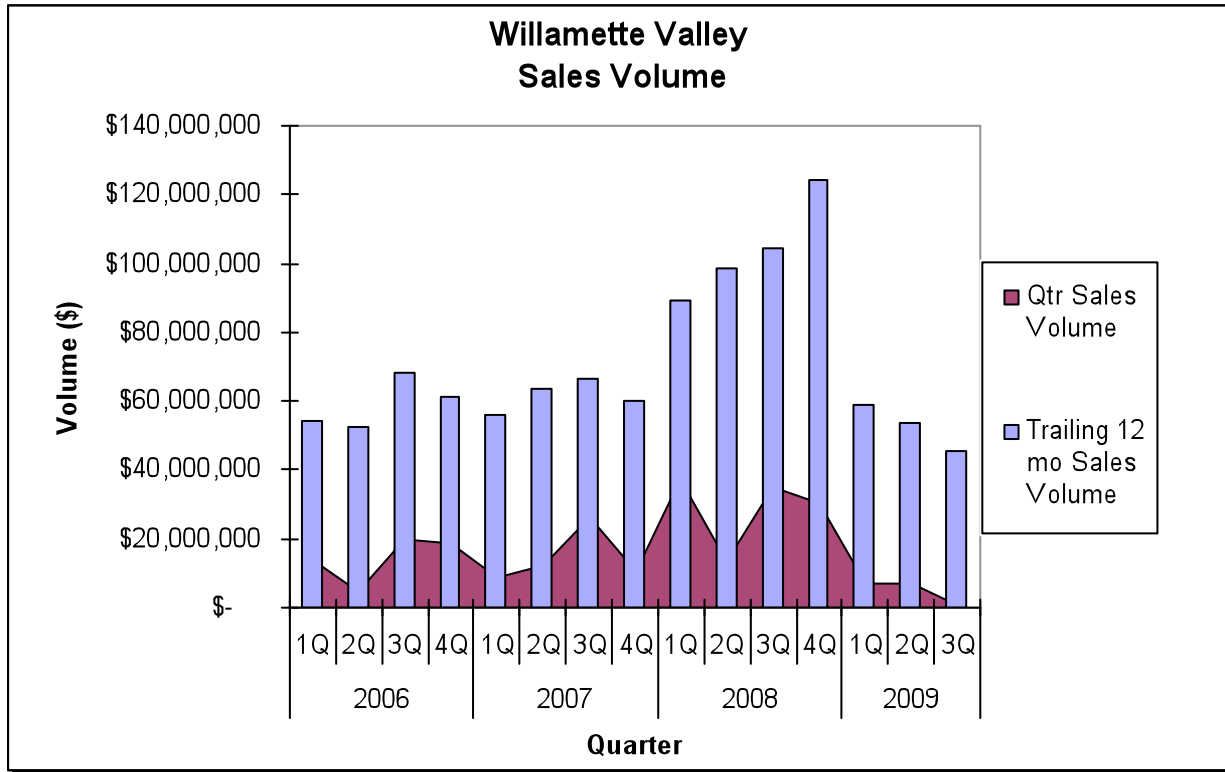
Salem Multifamily Report

Jamie Martinson, Senior Advisor, Sperry Van Ness Commercial Advisors [Multifamily]



Over the last 12 months, the Willamette Valley (WV) has quickly joined the rest of the nation in the grip of the economic recession. My annual forecast in February highlighted that 2009 was likely to be a back to basics year. I said then that landlords must stay ahead of market conditions as the recession continues and especially keep a close eye on proposed state and

local government job cuts during the current legislative session. The unemployment rate then was 9 percent but rose to 11.2 percent by August 2009. I noted earlier that the unemployment rate threatened continued low vacancy in the market and suggested that sales would occur as investors realized the underlying strength of the Willamette Valley market. Since that time, the Willamette multifamily market has seen a steep decline in occupancy rates and transaction volume and the reemergence of rent concessions as the national recession has deepened. The



current operating conditions, coupled with the tightening of the credit market, have brought the multifamily investment market to a near standstill.

Transactions

The year-to-date numbers for the WV multifamily sales market are in line with national trends. According to Real Capital Analytics (REAL), nationally, multifamily investment-sales volume of properties >\$5 million declined 79 percent over the first half of 2009 as compared to the prior year. In the WV, multifamily investment sales volume of properties >5 units declined 72 percent during the same period as sales of only 275 units for \$14,109,000 were closed. This is the lowest transaction volume since the first two quarters of 2005 yielded closings on 301 units for \$14,258,000.

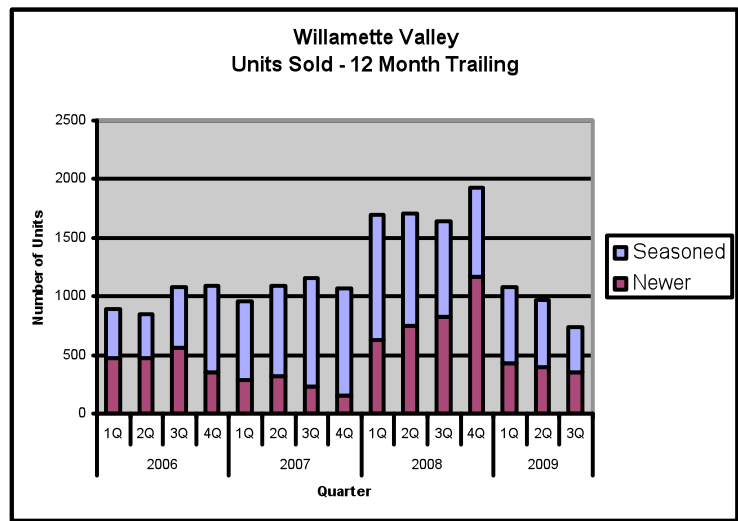
The 12-month trailing sales volume for the WV fell to \$45,312,900, off from \$103,304,300 one year ago (Figure 1). The number of transactions dropped from 36 to 20, and units sold decreased from 1,640 to 734 in the same time period. As sales volume has decreased, listing volume has picked up due in large part to properties sitting with little activity or interest.

Currently in the WV, LoopNet, RMLS, and the Willamette Valley MLS have 109 >5 unit multifamily properties listed for sale. Of those 109 multifamily projects on the market, only 17 are listed with capitalization rates greater than 7.0, and several of those have cap rates based on proforma financials. Year to date, Oregon has only seen three transactions with properties

greater than 100 units in size. Two of those traded at a reported 7.6 cap rate: Pacific Crest in Tigard and McKenzie Meadow in Springfield. It is likely that one year ago these projects would have traded in the 6.25-6.75 percent cap rate range.

Due in part to the disparity between asking CAP rate and selling CAP rate, the number of properties on the market and the average length of time a property is on the market is increasing. This increase in supply has had some impact on the price paid per unit, although with so few transactions in the WV it is difficult to compare sales today with past activity.

According to REAL, properties purchased between 2005 and 2008 have suffered price drops of more than 20 percent, with multifamily properties purchased at the market's peak in 3Q 2007 dropping 32.2 percent peak to trough. The 12-month trailing price paid in the WV for seasoned units peaked in 3Q 2008 at \$59,991; that average price paid fell to \$42,434 in 2Q 2009. For new units, the price peaked with the national market in 3Q 2007 at \$81,106, fell sharply to \$63,832 in 2Q 2008, and has since recovered to \$72,672.



Notable WV sales in 2Q 2009 include: Hollywood Park Apartments in Salem, 52 units built in 1979, at \$42,308/unit; Typres Gardens in Newberg, 20 units built in 1973 at \$42,500/unit and at a 7.6 percent cap.



Vacancy/Concessions

In her most recent Apartment Survey, Shirley Layne, an appraiser at Powell Valuation Inc, states that Salem/Keizer “vacancy has more than doubled from 2.95 percent to 6.17 percent since the fall 2008 survey, and concessions or inducements to occupy are being offered at almost every apartment complex.” Concessions have reentered the market with one-month free rent fairly standard on a 12-month lease in addition to move-in fee waivers. The waiver of move-in fees may also be in response to Oregon SB 771-B as landlords prepare for new limits on allowable fees which will begin January 1, 2010.

The outlook for a reduction of vacancy rates is not optimistic as long as unemployment rates remain high, especially for those workers under 29 years of age. Nationally, 78 percent of households under age 25, and 63 percent of households under age 29 are renters. According to Dr. Sam Chandin, President and Chief Economist Real Estate Econometrics,

“Among the current challenges for multifamily investors and operators, the absence of new jobs for recent graduates and other young people has resulted in a sharper increase in the unemployment rate for these groups. But without jobs and the resulting income streams, the members [of that demographic group] demonstrate a lower propensity to form new households. Some move home after college; others double-up. In both cases, a keystone of rental demand softens, resulting in lower apartment occupancy and rental rates.”

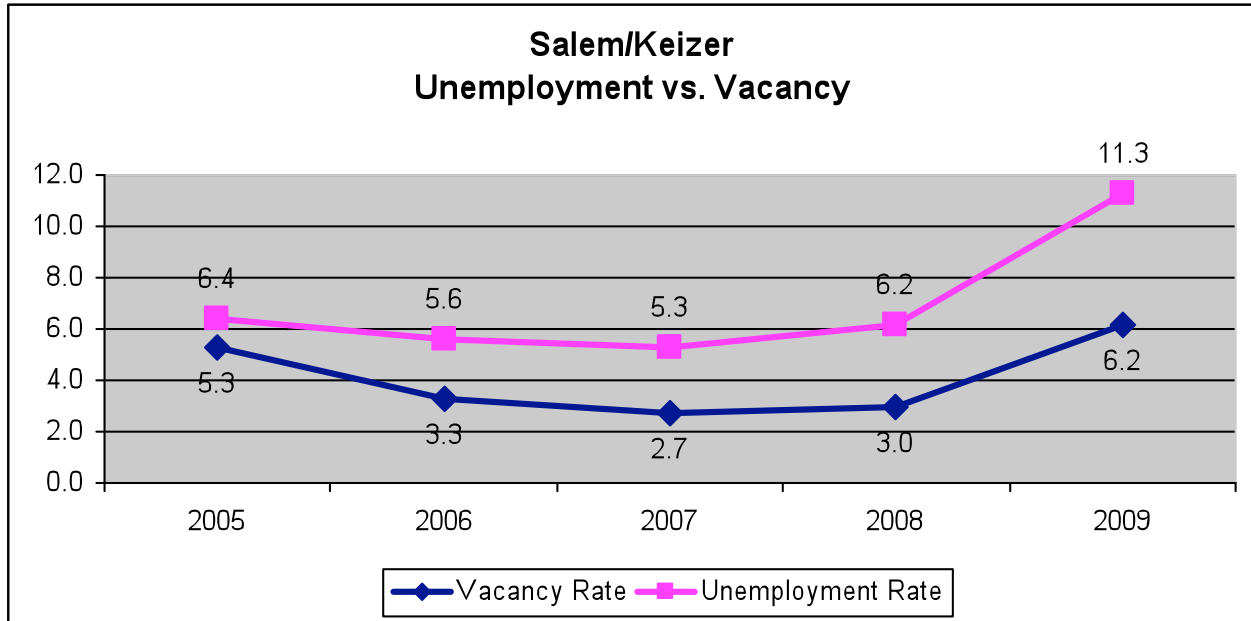


Chart data provided by Shirley Layne, Powell Valuation Inc

As clearly demonstrated in the chart above, there is a high degree of correlation between unemployment rates and vacancy rates. The greatest concentration of vacancies in newer projects is in two-bedroom, two-bathroom units (exceeding 8 percent vacancy), while two-bedroom, one-bathroom units have the highest rate in seasoned properties (exceeding 5 percent vacancy). This is telling for the overall market in that these unit types represent the greatest number of total units in their respective categories. Non-stabilized projects completed in 2008 and 2009 are reporting 20-50 percent vacancy rates and are finding it difficult to obtain permanent financing.

There is speculation that much vacancy is due to renters moving into homeownership. One should hesitate to place much weight on that theory. Although interest rates remain low and there is the first time home buyer tax credit available for purchases through December 1, 2009, potential homebuyers need to be employed, need to have a downpayment saved and need to qualify in today’s new lending environment. The barriers to entry as a homebuyer are much higher today than at the market’s peak in 2007.

As vacancies have escalated, market rents have flattened with little change from 2008. Two-bedroom, one-bathroom rents in seasoned properties range from \$464 in East Salem to \$659 in Keizer. Two-bedroom, two-bathroom rents in newer properties range from \$678 in East Salem to \$765 in Southeast Salem. Projects in a rent up period offer two-bedroom floor plans from \$725 at Santiam Village in East Salem to \$875 at Hawks Point in Keizer. Concessions have not dramatically affected rent collection year-to-date, but watch for a greater impact on economic rent collection (i.e. gross rent, less vacancy, less concessions) in 2010.

Summary

Economic headlines have been anticipating the bottoming out of the recession. However, for the next 12 to 36 months, the bottom will be rocky for multifamily investors as anticipated:

- by the acceleration of delinquency rates in the collateralized mortgage-backed securities (CMBS) universe;
- by the resetting of partial interest-only loans;
- by the failure of pro forma loans to stabilize;
- by the threat of loans reaching maturity, then not qualifying for a large enough refinancing to retire existing debt; and
- by vacancy rates continuing to climb to match high unemployment rates during a projected long, jobless recovery from the current recession.

Capitalization rates will continue to rise as nonperforming assets reach the market and income will suffer due to pressure on rents from concessions and ongoing vacancy. Finally, apartment sales will continue to lag due to the difficulty of obtaining financing and the remaining gap between buyer and seller expectations of value.

Salem Retail Report

Jennifer Martin, CCIM, Senior Advisor, Sperry Van Ness Commercial Advisors



Nationally, we have been in a recession for at least 19 months. While most experts expect that the national economy will bottom out by the end of 2009, Oregon usually lags other parts of the nation in entering and exiting recessionary periods. The retail sector is also victim to this trend, as most industry analysts forecast another one to two years before a full recovery of the retail sector.

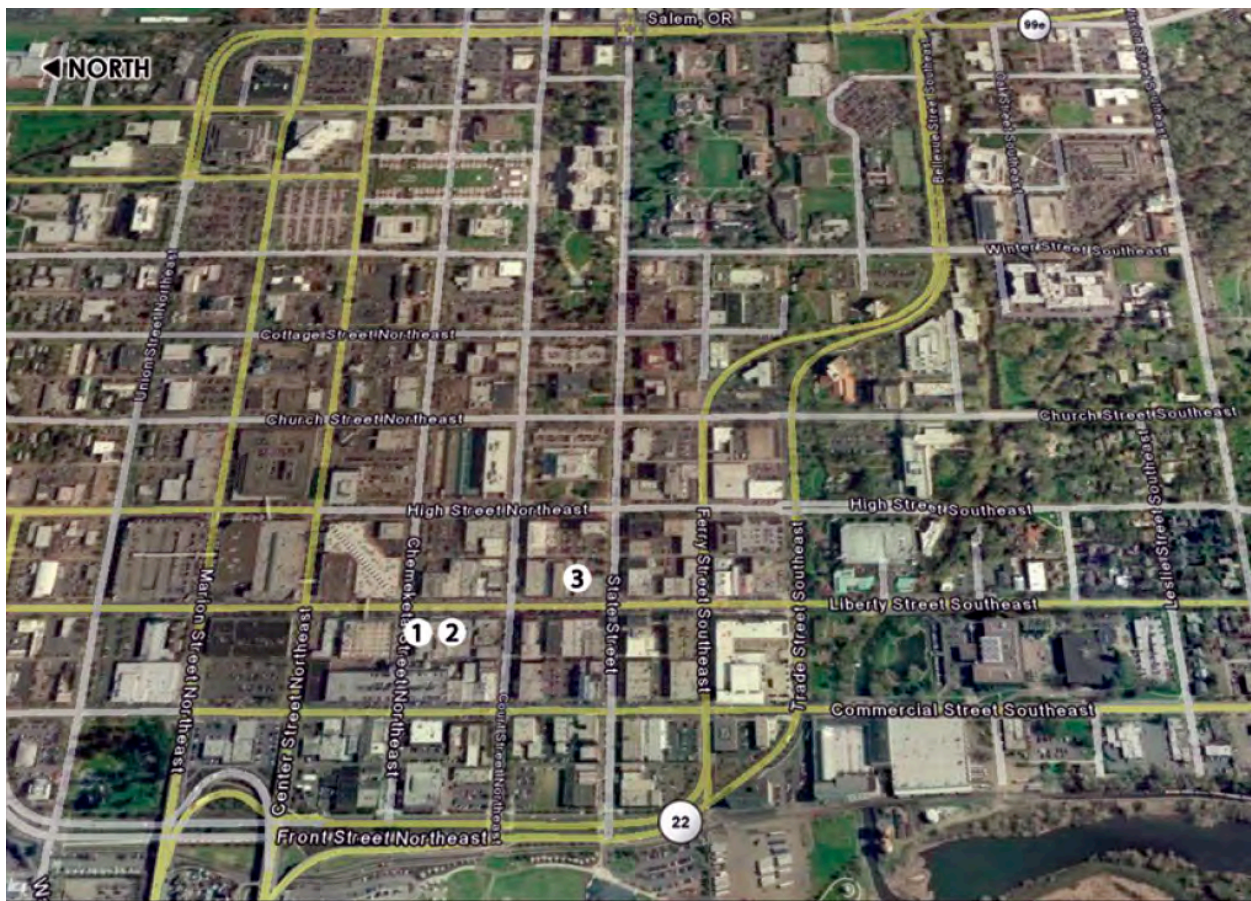
Consumers are spending their incomes on essential goods and services while increasing their savings rates, but industry observers contend that they will spend money on discretionary items if they perceive value. Therefore, discount retailers and drugstore chain sales are faring well in this economy up 4.1 percent and 1.3 percent respectively year over year from July 2008-July 2009, while luxury apparel sales are down 12.5 percent for the same period, according to Peter Sharpe, president of commercial developer Cadillac-Fairview Corporation and chair of the International Council of Shopping Centers [ICSC].

Lower food prices are exacerbating the lack of sales growth. Nationally, 2,800 chain stores have closed during the first six months of 2009, compared to 3,200 during the first six months of 2008 according to ICSC research. ICSC experts predict an overall sales growth rate in retail of 0.3% during 2009, and a 3.5% growth in 2010.

Locally, retailers are feeling the pinch of less consumer spending. Reports of sales declines by local retail and restaurant owners in the Salem/Keizer market are fairly standard. Expansion has come to a halt as most retail owners' focus has turned to sustaining current operations and analyzing efficiency to ensure they can ride out this recession. This lack of consumer spending, and inward focus of owners has negatively affected local retail vacancy rates.

Overall, the Salem/Keizer retail vacancy rate was 15.07 percent at the end of 2008, based on a survey size of almost 4,000,000 square feet, not including regional malls Salem Center and Lancaster Mall, each containing approximately 650,000 square feet. The Salem vacancy rate was far above a healthy industry rate of 8-10 percent. At the end of the second quarter, 2009, that rate had risen to 18.27 percent. This represents a negative absorption of over 120,000 square feet. The closures of Circuit City (30,763 square feet) and local furniture retailer Home and Dining Collections (30,000 square feet) caused most of this decline.

There are ten mid- and large-box retail spaces (over 20,000 square feet) available in the Salem/Keizer area. Reports by Donahue Schriber, owners of Keizer Station, indicate that the releasing of the former Wickes and Party Depot spaces is likely to occur in the near term. Additionally, Dick's Sporting Goods is going to backfill the Joe's [formerly G.I. Joe's] location on Lancaster Drive. Unfortunately, there are few retailers in the marketplace who have the size requirements to fill many of the 20-40,000 square foot vacancies.



1. Liberty Plaza
2. Former Andersons Sporting Goods
3. Metropolitan

On a sector-by-sector basis, no one in the local marketplace is immune from decreased spending by consumers and lack of expansion by retailers. The CBD has a current vacancy rate of almost 20 percent, led largely by the lack of absorption of the recently remodeled former Anderson's Sporting Goods and the Metropolitan Building. Ongoing vacancy at Liberty Plaza also negatively affects the vacancy rate.

In South Salem, the vacancy rate is up about 1.5 percent from year-end to a current level of 15.8 percent. The closing of a stationery store and the addition of a new retail/office mixed-use project called Candalaria Crossing, which has only reached approximately 30 percent occupancy are the main causes of the increase. The addition of the recently relocated St. Vincent dePaul Thrift Store from South Salem to Lancaster Drive further hampers occupancies and increases vacancies in the South Salem area.

In West Salem, the retail service area is relatively small so the large vacancy at Oak Hills (Safeway) on Edgewater is the main reason for the above-market vacancy of 17 percent. Owners are currently remodeling and analyzing several tenants interested in some or all of the vacant space.

In the East Salem retail area, the vacancy is up to 19.4 percent from year-end's 17 percent. The continuing vacancy of five large retail spaces is the reason the vacancy is so high.

In the North Salem/Keizer sector, the vacancy rate of almost 19 percent can almost solely be attributed to the vacancies at Keizer Station. There are numerous smaller vacancies along River Road, most of which have been available for more than a year.

Over the past six months, very few retail lease deals have been consummated as compared to the leasing velocity of the marketplace during 2006 and 2007. There are a number of start-up types of businesses or first-time retail business owners analyzing the marketplace. Healthy retailers looking to out-position their struggling competition are also prevalent in the marketplace.

However, deals are taking much longer to complete due to a variety of reasons. First, tenants who rely heavily on national news reports believe they can obtain lease rates and terms that would put most landlords out of business. Tenants fail to understand the relationship between what they can (or will) pay and a landlord's access to capital. Conversely, landlords in some cases are failing to realize that qualified tenants are difficult to find in this economy and that it may be a smart decision to leave a few dollars on the table to ensure a stabilized future income stream.

Unfortunately, lack of capital reserves, and/or lack of access to capital by both landlords and tenants, is also affecting deal volume. Start-up capital for inventory and working capital is not plentiful, and landlords do not typically have reserves for tenant improvements because they came to rely on financing for those costs during the time when lenders were happily providing funds for those uses.

The Salem/Keizer market is not unique in its struggle to right the retail ship. In order to do so, a number of market perceptions need to be corrected. First, landlord and tenant expectations need to come in line with a new normal commercial real estate market condition. Comparing the quality of space and the lease rates of 18-36 months ago to justify today's asking rates will only delay recovery. Furthermore, tenants need to realize that landlords need to make a profit, albeit smaller than the profit realized just a short time ago. The capital markets also need to improve so that both qualified landlords and tenants can access needed capital for successful ventures.

Big Box Reuse

April Chastain, RMLS Fellow & Certificate of Real Estate Development Student

The current recession poses new opportunities as well as challenges. With the retail market contracting, there are a number of big box stores that have become vacant. According to third quarter reports by Norris Beggs & Simpson, Portland currently has an 8 percent overall retail vacancy, which equals 3,481,017 SF of vacant retail space. A number of retailers have gone bankrupt during this recession, two of which have completely liquidated their assets and closed their doors, Linens-n-Things and Joe's Sports & Outdoors.

Portland has its share of big box stores, although the situation here is a little different than those faced by other cities in the nation. Empty boxes may present an opportunity for national chains to enter the market, according to an article in the Portland Business Journal¹. In January of 2009, when it was written, there were 11 empty big box stores in the area, "including four former Linen's N' Things stores, three Shoe Pavilions, two Levitz Furniture stores, a Mervyns and a Wickes furniture store". More vacancies were expected. Some have found temporary fillers, such as Linens N' Things on SE 82nd, allowing The Spirit of Halloween store to occupy part of the building. The article says that Portland has too many smaller big boxes, defined as 100,000 SF and below, which do not attract national chains that typically require retail spaces of 150,000 SF and larger.

Since that article was written, Joe's Sports & Outdoors was liquidated and closed, although Dick's Sporting Goods has leased three of the vacant stores throughout the metropolitan area. According to Norris, Beggs & Simpson, the third quarter retail vacancy moved up a whole percentage point over last quarter with 365,818 SF of newly vacated space. Of the submarkets in the Portland metropolitan region, Vancouver has the highest vacancy at 11.6 percent, which equals 1,000,518 SF of vacant retail space. The Southwest, which includes Washington Square, has 859,908 SF available with an 8.4 percent vacancy rate. The Southeast/East Clackamas submarket has the lowest vacancy rate at 4.3 percent and 228,127 SF of vacant retail space.

Julia Christensen's book, *Big Box Reuse*, published in 2008 by MIT, suggests some possible solutions to the glut of vacant retail big box stores. Christensen's interest in big box reuse and research for the book began before the Great Recession. Substantially more big-box stores may now be vacant without other tenants available to re-rent the buildings. However, the book does offer some insight into the challenges facing communities as they search for ways out of the recession. From interviews on NPR to a scathing review by Martin Zimmerman in *Urban Land*, the book is at least sparking conversation about what to do with unwanted big box stores, a conversation that may be provoking communities to try to prevent them in the first place, rather than have to deal with their short-lived



¹ <http://portland.bizjournals.com/portland/stories/2009/01/05/story1.html#>

utility, lack of architectural inspiration, and negative environmental impacts. That aside, Christensen illustrates some intriguing reuses for big box stores across the nation. She chronicles several, civic and community uses, including several schools that have been adapted to fit into the vacant buildings.

Christensen's website² makes use of an interactive map to provide insight into several of the places she visited in the course of writing her book. It includes three schools, several apartments, a library, a justice center, a medical center and even a Spam Museum. She admires the creativity of people trying to decide what to do with these buildings. She also notes that most of these vacant buildings are not abandoned because the retailer goes bankrupt, but rather simply because it builds a bigger, better box nearby, frequently within a mile.



In Kentucky a group of four doctors privately renovated a Wal-Mart into The Central Kentucky Comprehensive Medical Center. The \$4 million dollar renovation provides 44,000 SF of space, which is home to 88 examination rooms, a chiropractic suite, a wellness center, a physical therapy center with small pool and an indoor walking track, among a variety of other services and amenities.



Christensen's website also shows the Sugar Creek Charter School in Charlotte, NC, which is housed in an old K-Mart that is being renovated in stages. The school moved into half of the site in 2000 and plans to add a gym, cafeteria and more classrooms, as time and money allow. The layout of the hallways of the new school can be seen following the aisle layout of the old K-Mart to take advantage of the original wiring. The school added skylights to let natural light into the building.

²<http://www.bigboxreuse.com/>

A local example of a retail facility converting to another use can be found in Vancouver. Mastro Properties³ based in Seattle, renovated a 200,000-square-foot shopping center into an office plaza, which it leased to several state agencies, the U.S. Postal Service, Health Experience A.C. and Columbia Credit Union. In 2004, Mastro Properties sold the Town Plaza Business Center in Vancouver to Tower Mall LLC for \$27 million.



Christensen's book explores Wal-Mart's business model, which relies on vacating the first round of stores after building a bigger store nearby, because it is cheaper to build a new store than to close and lose sales during renovation. A chart from the book shows that Wal-Mart built 1,980 supercenters between 1995 and 2006. The number of discount stores decreased from 1,990 to 1,209 in that same time period.

Another way Wal-Mart has been influencing retail vacancy is through the use of non-competition clauses in the original leases that do not allow other retailers, expressly including K-Marts, to reuse the buildings. The old buildings then remain as real estate placeholders staving off the competition. This has led many communities to invest in institutional reuses. Since libraries, schools and community centers do not compete with retailers, they can take over the lease of the property without violating the non-competition clause. Christensen decries the ethical implications of building these big boxes in the first place, since they pose large environmental impacts during construction, cannot function without cars and must create huge parking lots. However, reusing the big-box buildings, while not advancing smart growth principles of compact development, is considered by her to be greener than simply demolishing them to build others. The problem, she contends, lies in the underlying infrastructure and business models that promote sprawling suburban development.

In a June 2009 Urban Land magazine article, Jeffrey Spivak⁴ starts from the premise that "communities would prefer not to get stuck with empty big boxes in the first place." He notes that many communities are taking preventive measures to try to promote a different building model by imposing regulation such as:

- Setting a size limit on retail buildings;
- Establishing stricter design standards, and

³ "Mastro sells Vancouver office plaza," Portland Business Journal, January 19, 2004.

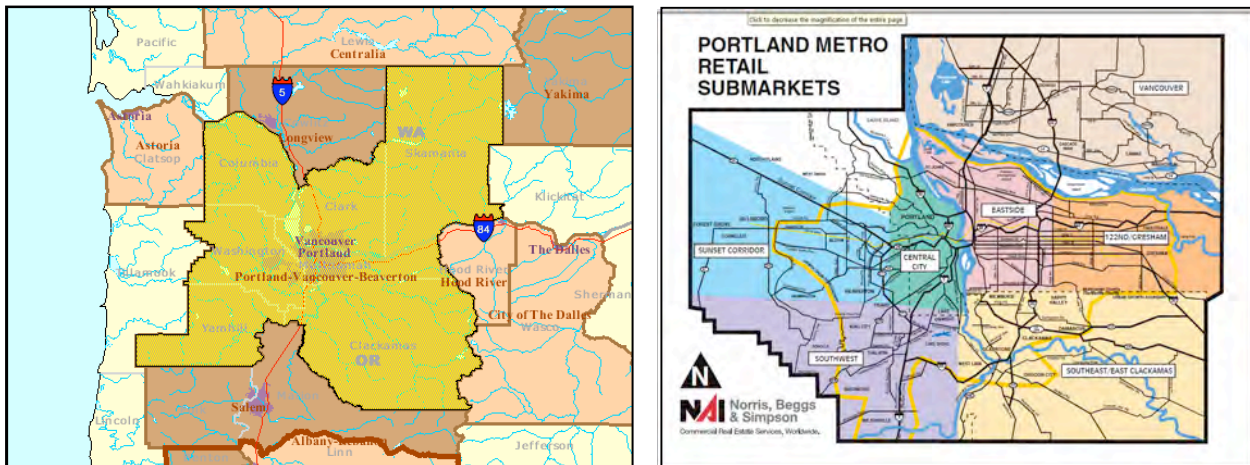
⁴ "Reusing Big Boxes," Urban Land, June 2009. P.56 et. seq.

- Requiring a demolition bond to provide money for razing a big box if it remains vacant for a prescribed period.

Another book, “Retrofitting Suburbia,” by Ellen Dunham-Jones and June Williamson⁵, notes a retail trend in the United States as a result of overbuilding retail space as part of the leapfrogging pattern of development that has occurred as cities have spread farther from their cores. They note that in 1986 there were 15 square feet of retail space per person, increasing 20 percent to 20 square feet per person in 2003. Canada averages 13 square feet per person, Australia 6.5 square feet and Sweden (the highest in Europe) boasts a mere three square feet per person.

The Portland metropolitan area currently has a total inventory of 43,654,248 SF of retail space, although 3,481,017 square feet of it currently sit vacant, according to a report by Norris Beggs & Simpson. According to the American Community Survey, the projected population for 2008 for the Portland Metropolitan Statistical Area (Portland-Vancouver-Beaverton) was 2,209,114.

Assuming that the two measurements cover approximately the same area, Portland would have 19.8 square feet of total retail space per person, approximately the same as the national average in 2003. See the following maps for comparison. It seems that the census area encompasses more of the surrounding rural area than the retail submarket map, which would suggest that the actual ratio of retail space per person is even larger, although the residents counted in the Portland Metropolitan Statistical Area probably shop to some extent within the retail area shown.



How will the consolidation of retail space as a result of the Great Recession, the demise of many big box retailers and the paucity of retailers to occupy the vacated space, particularly in the 25,000 to 100,000 square foot range impact the reuse of these vacant retail spaces? Inevitably retailers will consolidate, as retail likes to be near retail. It seems that the quicker this happens the better off retailers will be. Of course there will be winners and losers. Retail areas that lose tenants could consider their options: non-retail tenants or land banking for future redevelopment.

Schools, hospitals, and clinics have minimal funds if any for expansion right now. In fact the Portland Public Schools District has already consolidated some schools and may consolidate others. The current healthcare debate may bring opportunities, depending on what legislation, if any comes out of Congress. Other options to fill vacant retail spaces include: industrial incubators, fitness centers, daycare centers, senior centers and government offices. If healthcare in general shifts toward preventive services and general health maintenance, then

⁵ “Repurpose-Driven Life,” The New York Times, June, 2009

there may be a greater need for wellness and community centers promoting exercise programs. Remote retail locations might even be considered for low-security detention facilities.

Metropolitan and local governments could implement policies that encourage retail consolidation near transit centers and along transit lines, and allow for a greater mix of uses, encouraging more office and residential within commercial zones. The UGB in Portland and other Oregon cities will probably cause more redevelopment and re-use to occur than in other states, since development opportunities and parcels will be more limited. Communities could also look to purchase the land, assemble larger pieces and plan to redevelop it in the future when the time is right and needs are more apparent and economically feasible.

Retail Market Analysis

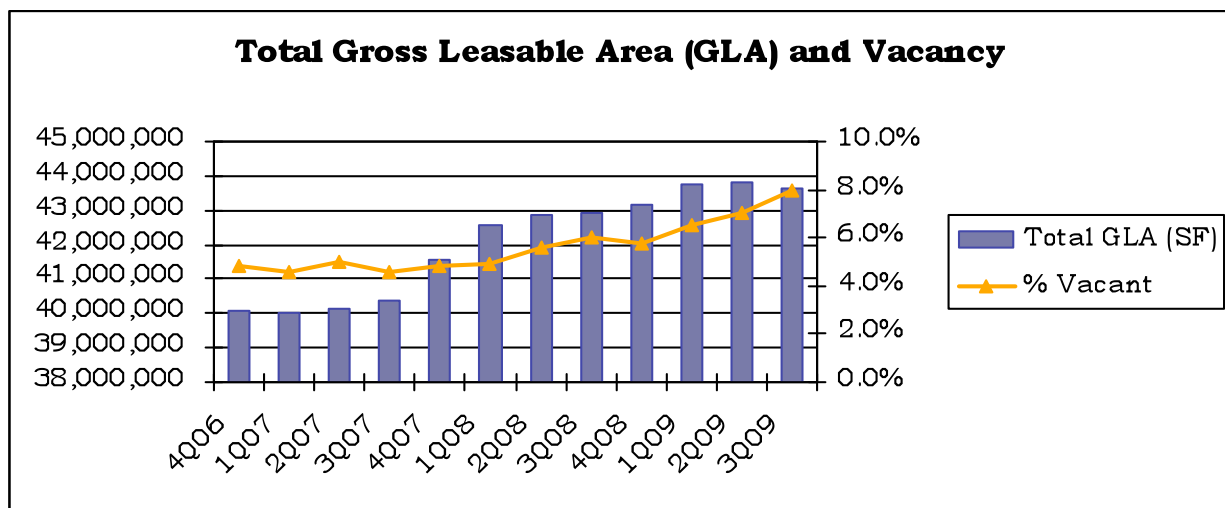
By April Chastain, Certificate of Real Estate Development Graduate Student & RMLS Fellow

Norris, Beggs & Simpson reports an increase in metro-wide retail vacancy, reaching 8 percent this quarter. Joe's Sports & Outdoors played a large part in that vacancy, although Dick's Sporting Goods has leased three of the buildings vacated by Joe's. A new Winco under construction at Bowyer Marketplace in Clark County is expected to be delivered in June 2010. Costco is also planning a new 154,701 SF building in Clark County on Northeast 192nd.

NBS reports downtown/central city vacancy reaching 9.8% with 250,765 square feet of retail space available for lease. That is topped only by Vancouver with an 11.6% vacancy rate and over 1,000,578 available for lease and another 107,800 square feet under construction.

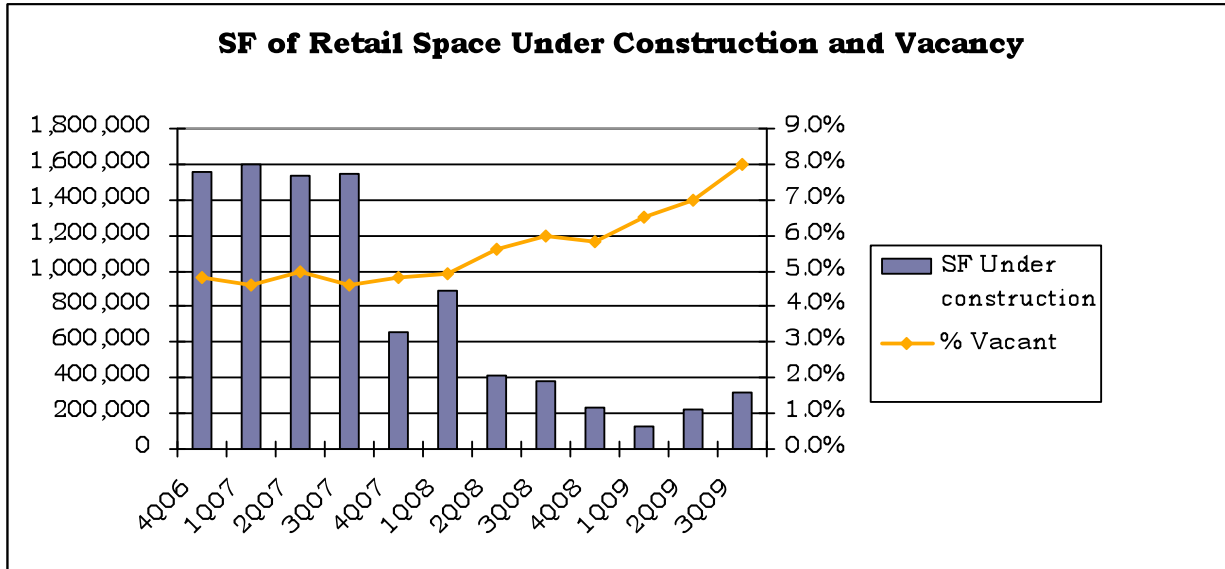
Lloyd Center was to be sold for \$192 million, or \$137 per square foot, which would have included the \$127.5 million mortgage, according to the DJC¹. It would have been purchased by Merlone Geier Partners, based in California, from Glimcher Realty Trust of Columbus, Ohio. However, Merlone Geier terminated the sale agreement, which it could do at its sole discretion before September 30, 2009. CoStar reports that Glimcher acquired Lloyd Center from SI-Lloyd Associates for \$167 million, when it was 85% occupied and tenant sales were about \$325 per square foot. At the end of 2008, Glimcher, reported 94.7% occupancy at Lloyd Center and \$379 per square foot in tenant sales.

General Growth Properties, which owns Pioneer Place, Clackamas Town Center, Salem Center, Rogue Valley Mall in Medford, and Gateway Mall in Springfield filed for chapter 11 bankruptcy in April. The decision to pursue reorganization under chapter 11 came after unsuccessful efforts to refinance or extend maturing debt outside of chapter 11.

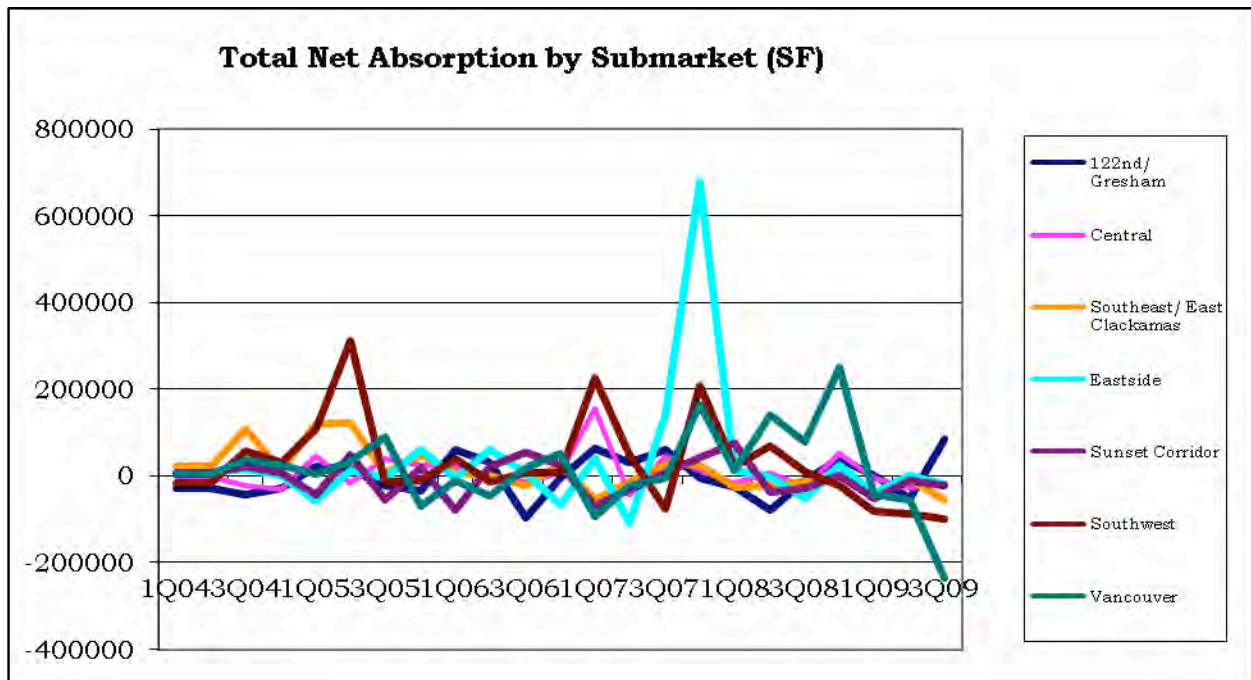


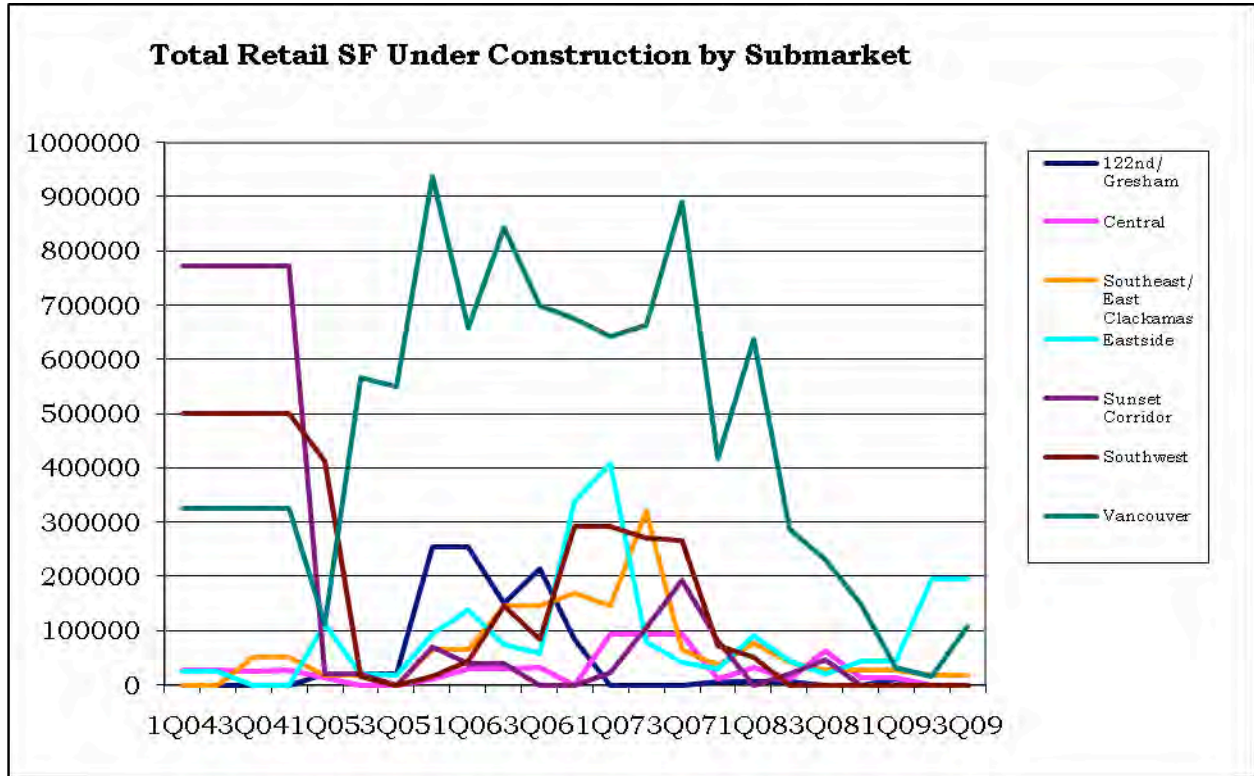
Source: Norris, Beggs & Simpson Retail office report - Third quarter 2009

¹ "Lloyd Center sold for \$192M", Daily Journal of Commerce, September 15, 2009.



Source: Norris, Beggs & Simpson Retail office report - Third quarter 2009





Source: Norris, Beggs & Simpson Retail office report - Third quarter 2009

According to the DJC² several downtown restaurants have closed recently, leaving vacancies that are expected to remain so for some time. They tend to be 4,000 to 10,000 SF, sizes which might attract national chains, but few national chains are currently expanding. See the following map for vacancies as of September, 2009.

Name	SF Available
McCormick & Schmick's Seafood	9,400
Kincaid's Fish, Steak and Chophouse	8,000
Stanford's at RiverPlace	7,030
Newport Seafood Grill	3,800
Pinnacle Pavilion	4,410
Palomino Restaurant	7,800
R Palate	1,975
Harrison Restaurant (Tondero)	8,700
Jax Restaurant	3,250

[See aerial photograph on the next page.]

² "Dining dip leaves space", DJC, September 11, 2009.

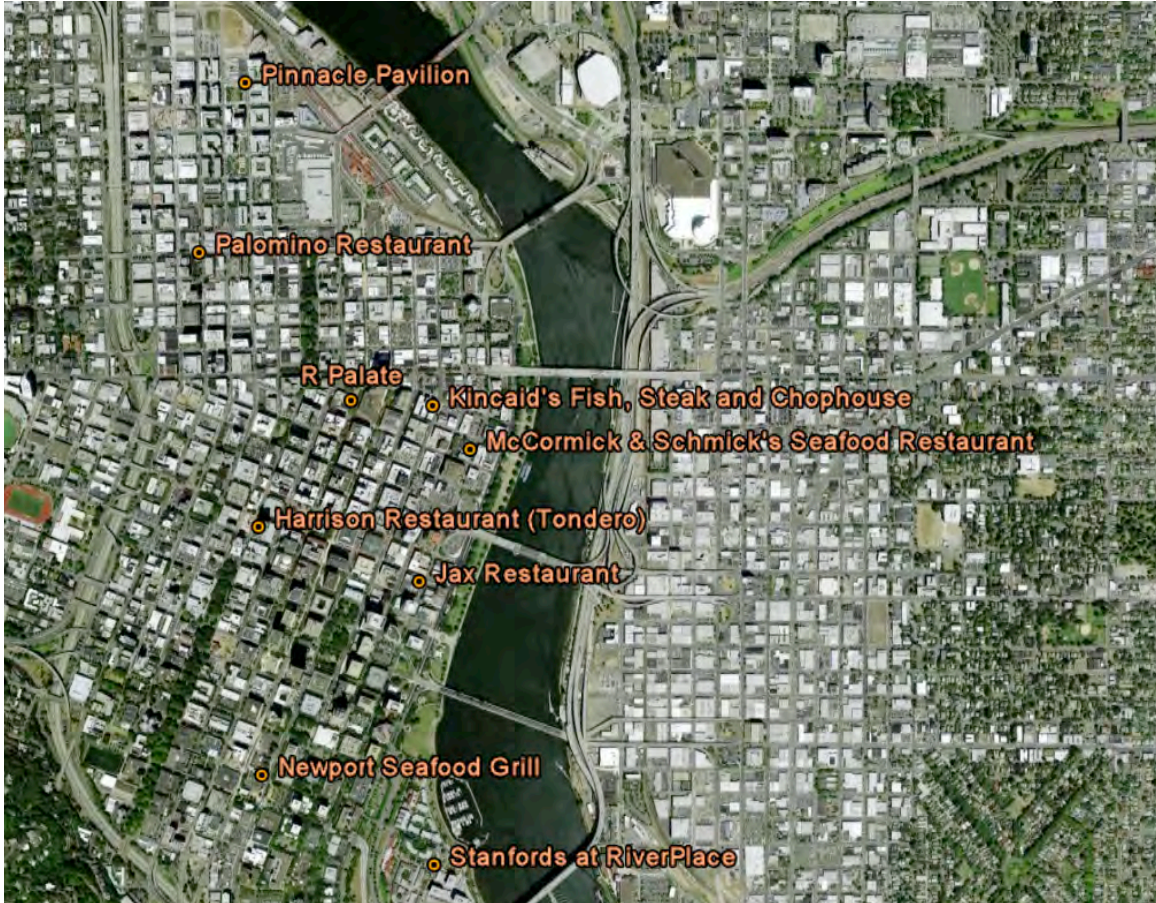


Figure 1. Restaurant Vacancies as of September 11, 2009.

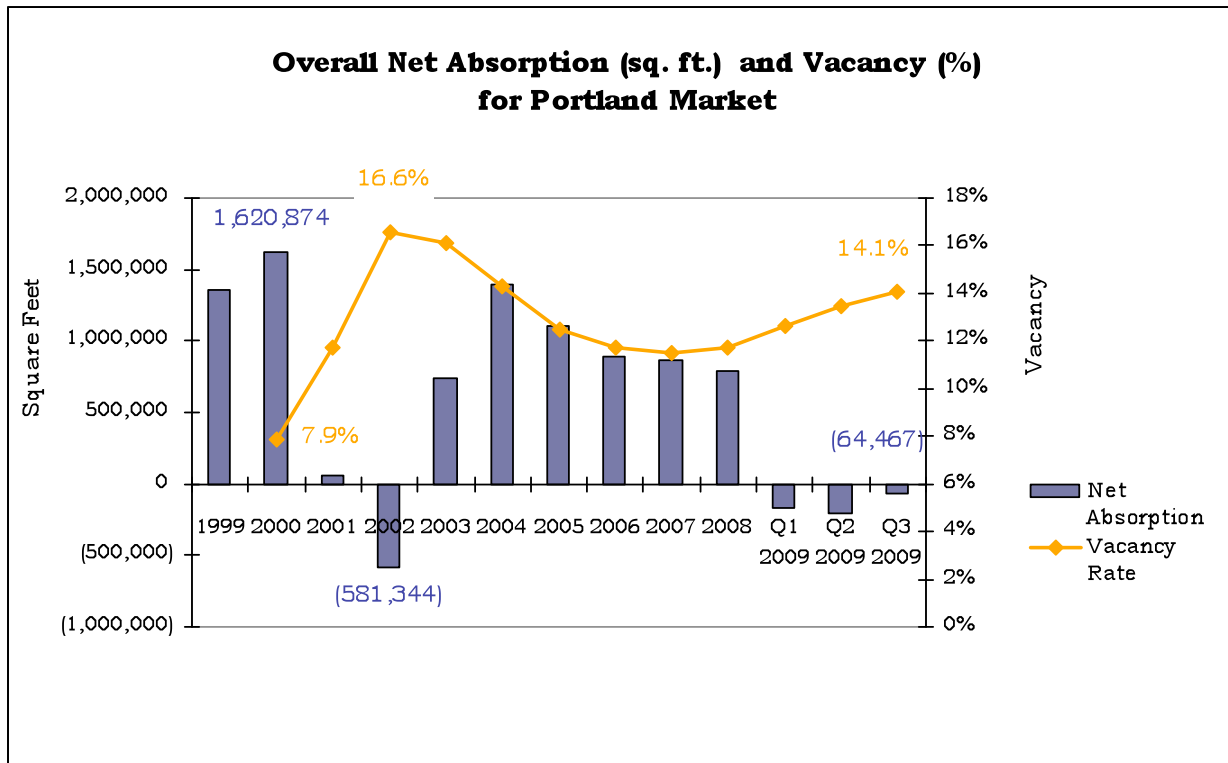
Office Market Analysis

April Chastain, RMLS Fellow & Certificate of Real Estate Development Student

Portland Office Market

The office market has worsened this quarter over last. The CBD is feeling the impacts with Laika Animation studios leaving 83,676 SF in the Leland James building and Daimler trying to sublease 100,000 SF in Montgomery Park, as reported by Norris Beggs & Simpson. CB Richard Ellis [CBRE] believes that the commercial real estate market has not yet hit bottom and will not start to recuperate until the unemployment rate decreases. It notes that the Oregon's unemployment rate continues to fluctuate: 12.1% in the second quarter 11.1% in July, 11.6% in August. This time a year ago an estimated 67,900 people were unemployed compared to 139,900 currently unemployed. However, CBRE also states that the office market this quarter experienced only 290,562 SF of negative net absorption, which is a 44% improvement over last quarter's 522,785 SF of negative net absorption.

Analysis by Grubb & Ellis predicts that the office market is near the bottom with a slowing in the decline. It also notes that effective rental rates declined by more than 10 percent. Analysis by Colliers International predicts a "slow and prolonged recovery in the second half of next year and into 2011" for the commercial real estate market due to lack of job growth, although other economic indicators show signs of improvement.



Source: Grubb & Ellis, Co., Office Quarterly Report, Second Quarter 2009 Statistics

OFFICE Q3-09¹	CB Richard Ellis	Cushman & Wakefield	Grubb & Ellis	Norris, Beggs & Simpson	Median
Market-Wide Vacancy	15%	15.9%	14%	17%	15.7%
Previous Quarter	14%	14.9%	14%	16%	14.6%
Third Quarter 2008	10.7%	11.9%	11.6%	13.4%	11.8%
Third Quarter 2007	10.9%	11.5%	11.7%	13.0%	11.6%
CBD and Downtown Vacancy	10.0%	11.7%	9.8%	11.1%	10.6%
Previous Quarter	8.9%	10.9%	8.5%	10.3%	9.6%
Third Quarter 2008	7.6%	8.5%	7.6%	9.0%	8.1%
Third Quarter 2007	8.2%	9.2%	8.3%	10.3%	8.8%
CBD Class A Vacancy	6.3%	9.0%	6.2%	6.7%	6.5%
Previous Quarter	5.4%	8.6%	6.1%	6.3%	6.2%
Third Quarter 2008	4.6%	5.6%	4.8%	5.6%	5.2%
Third Quarter 2007	5.0%	5.9%	5.2%	5.9%	5.6%
CBD Class A Asking Rents	N/A	\$25.79	\$25.86	N/A	\$25.83
Previous Quarter	N/A	\$26.20	\$24.68	N/A	\$25.44
Third Quarter 2008	\$26.91	\$26.61	\$26.48	N/A	\$26.61
Third Quarter 2007	\$24.17	\$25.27	\$25.14	N/A	\$25.14
Suburban Vacancy	20.3%	19.9%	17.4%	20.2%	20.1%
Previous Quarter	19.3%	18.7%	18.1%	19.1%	18.9%
Third Quarter 2008	13.6%	15.3%	14.0%	15.6%	14.7%
Third Quarter 2007	13.4%	13.7%	13.8%	14.9%	13.8%
Suburban Class A Vacancy	N/A	22.6%	20.6%	22.6%	22.6%
Previous Quarter	N/A	20.3%	19.5%	N/A	19.9%
Third Quarter 2008	N/A	15.8%	15.6%	N/A	15.7%
Third Quarter 2007	N/A	13.7%	10.5%	N/A	12.1%
Suburban Class A Asking Rents	N/A	\$24.04	\$23.84	N/A	\$23.94
Previous Quarter	N/A	\$23.59	\$23.65	N/A	\$23.62
Third Quarter 2008	N/A	\$24.46	\$24.11	N/A	\$24.29
Third Quarter 2007	N/A	\$23.79	\$24.34	N/A	\$24.07

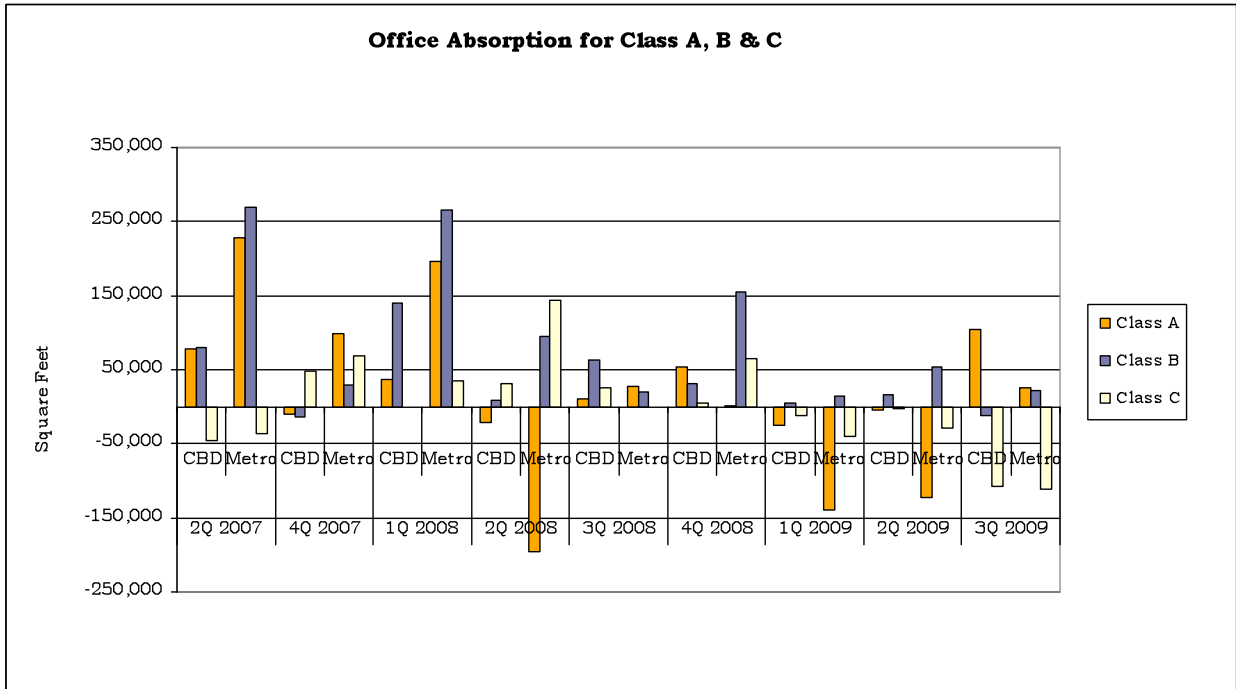
Source: CB Richard Ellis, Cushman & Wakefield, Grubb & Ellis, Norris, Beggs & Simpson Quarterly Reports and Statistical Reports, First Quarter 2009.

According to this summary chart the CBD Class A vacancy rate remains fairly stable and is much lower than the overall CBD vacancy rate which has now crossed the 10% mark. The Suburban Class A market, on the other hand, has higher vacancy rates than the overall suburban market, probably due to the impacts of employment declines in the financial sector in the Kruse Way corridor and possibly a shift toward a more central location by stable companies that are taking advantage of the downturn to lock in leases in prime locations. Both the CBD and the suburban submarkets have seen declines in rent since the third quarter of 2008, but have increased over the previous quarter.

¹ Vacancy rates above include subleases except those reported by CBRE, and NBS, which report direct vacancies. CBD figures include close-in neighborhoods, except Class A figures reported by CBRE. All rents are full service. All other suburban figures include Vancouver.



Source: Grubb & Ellis, Co., Office Quarterly Report, Third Quarter 2009 Statistics



Source: Grubb & Ellis, Co., Office Quarterly Report, Third Quarter 2009 Statistics

CBD Trends

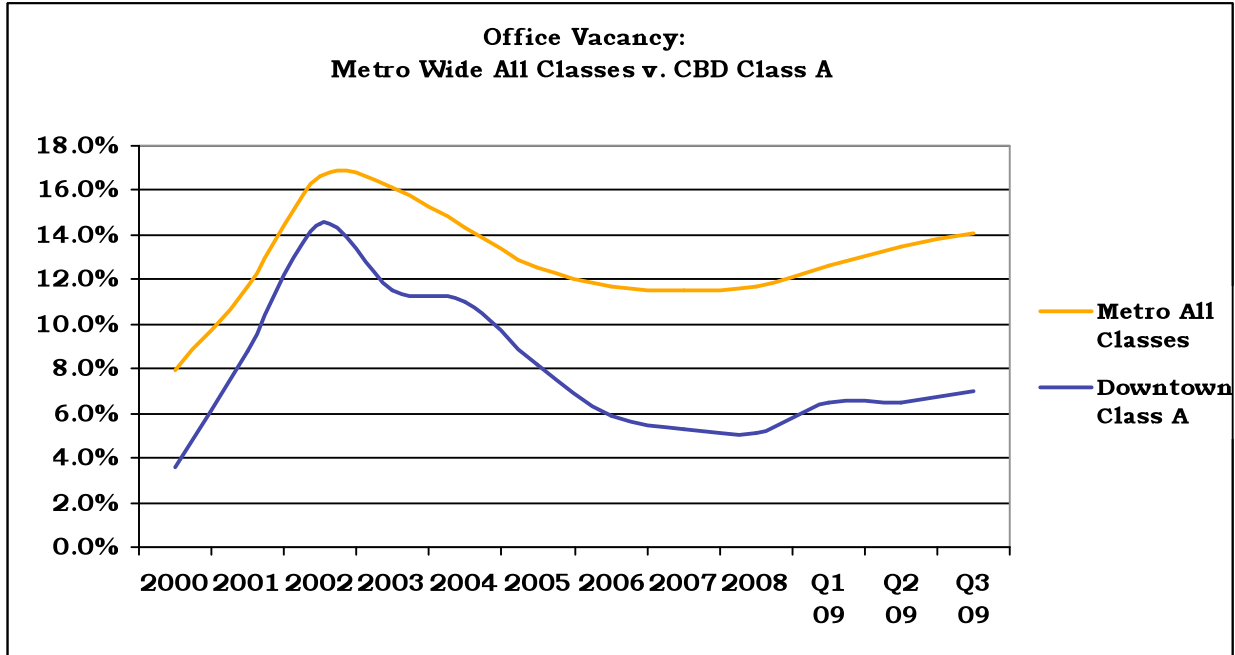
CBD Class A is only 6.68% vacant, according to Norris Beggs & Simpson, with the KOIN center gaining two new tenants, ECONorthwest and Willis of Oregon. An August article in the Wall Street Journal² explains the recent plight of the KOIN Center. Calpers and CommonWealth Partners LLC, joint owners of the office portion of the building, defaulted on the mortgage and were sued by the mortgage providers New York Life Insurance Co. Calpers has decided to walk away from its investment, which was purchased at the peak in 2007 for \$109 million, not including the upper 11 floors of condominiums. The troubles are due to insufficient cash flow caused by higher than expected vacancies. The last straw may have come when the law firm Ater Wynne LLP vacated 50,000 SF in the building relocating to the Pearl.



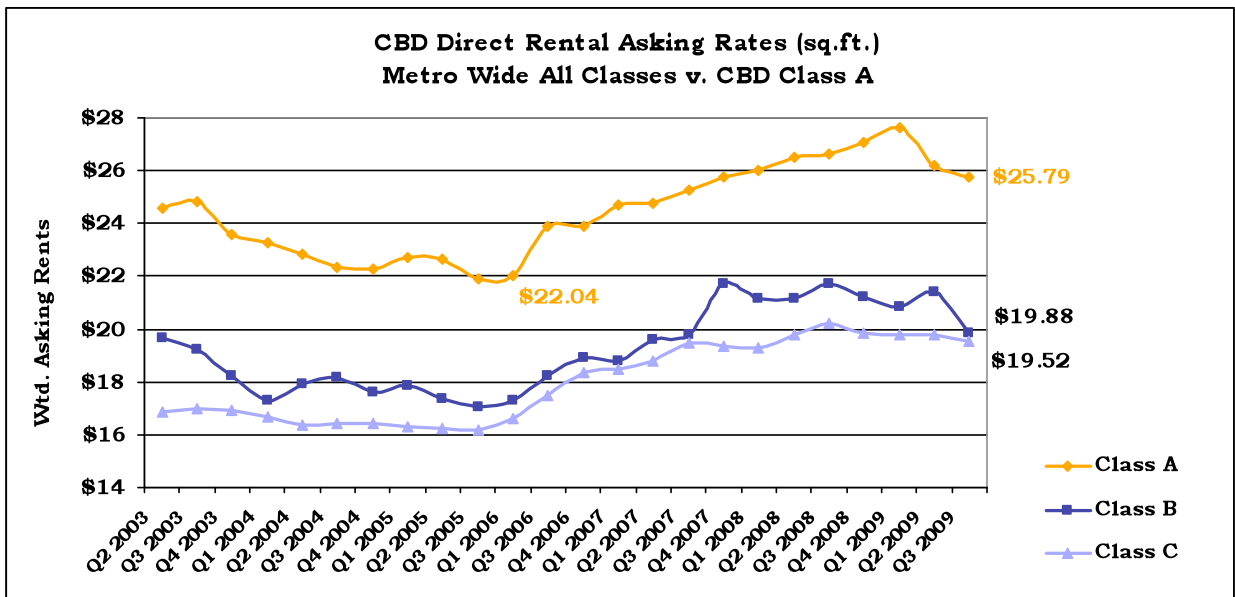
CB Richard Ellis notes that this is the first time since the third quarter of 2006 that the overall downtown submarkets have gone over a 10% vacancy rate. It also notes that overall asking rates in the CBD remain steady at \$22.40/SF. The summary chart above shows a median asking rental rate of \$25.83 for Class A in the CBD. Grubb & Ellis notes that 29,000 SF of sublease space was taken off the market this quarter bringing the year-to-date total to 277,996 SF of available sublease space in the CBD. It also reports that the CBD accounted for 97% of the region's office space currently under construction but is not likely to see new projects anytime soon.

Grubb & Ellis report an opportunity for the CBD to absorb some of this new construction by the General Services Administration (GSA), which is actively looking for space, generally needs larger spaces, and tends to locate downtown in LEED-certified buildings. Colliers International confirms this trend reporting that the GSA signed a lease for 37,000 SF of the 62,000 SF currently under construction in the Overton Building in the Pearl, which should be delivered next summer. Collier's also reports that Shorenstein is actively negotiating with the federal government for lease of its new First & Main office building, which will soon add 348,000 SF to the market.

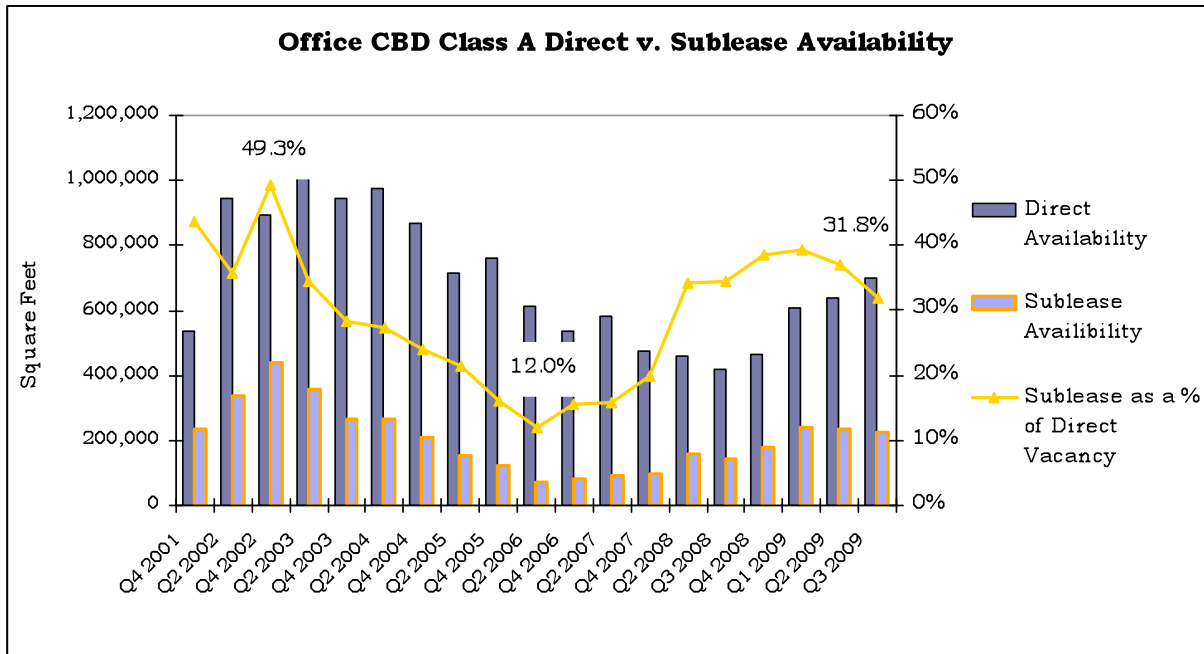
² "Calpers Takes Another Property Hit", Wall Street Journal, August 19, 2009.



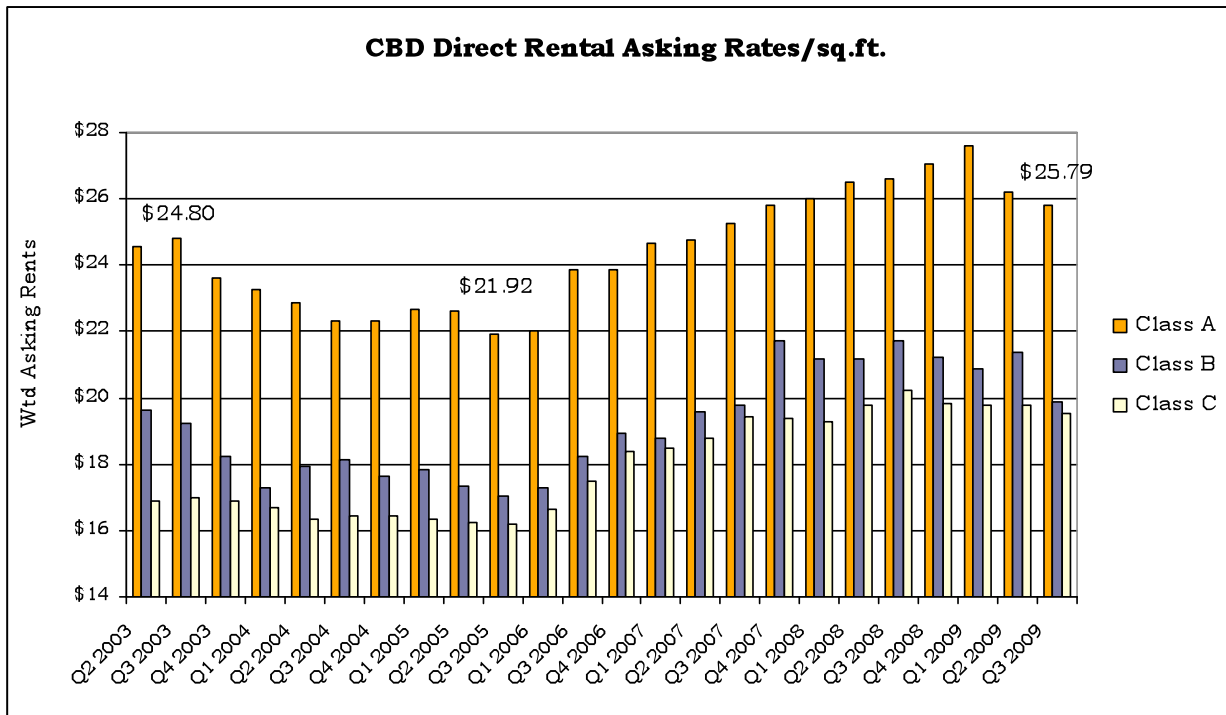
*Source: Grubb & Ellis, Co., Office Quarterly Report, Third Quarter 2009 Statistics



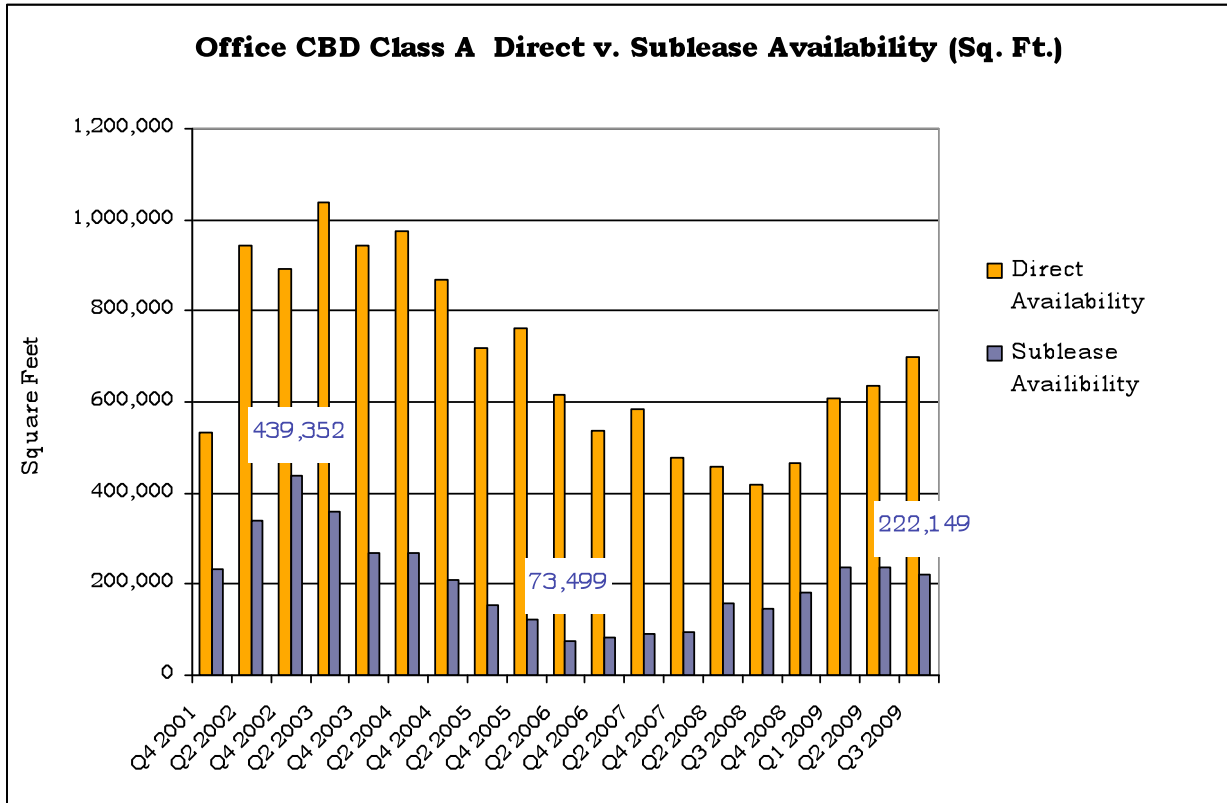
Source: Cushman & Wakefield, Portland Third Quarter 2009, Overall Office Summary.



Source: Cushman & Wakefield, Portland Third Quarter 2009, Overall Office Summary



Source: Cushman & Wakefield, Portland Third Quarter 2009, Overall Office Summary.



Source: Cushman & Wakefield, Portland Third Quarter 2009, Overall Office Summary.

Suburbs:

Vacancy in the suburbs continues to increase, rising to 20.1% median rate as shown in the brokerage report summary. CBRE notes that the suburban submarkets have not seen 20% vacancy since the end of 2001, with average asking rates continuing to decline. Norris Beggs & Simpson notes that the delivery of 92,754 SF of Class A office space at Cascade Station I, which remains entirely vacant, increased the vacancy of the North/Northeast submarket by nearly nine percentage points. The west side continues to show the greatest vacancy with Hillsboro at nearly 30%, according to CBRE.

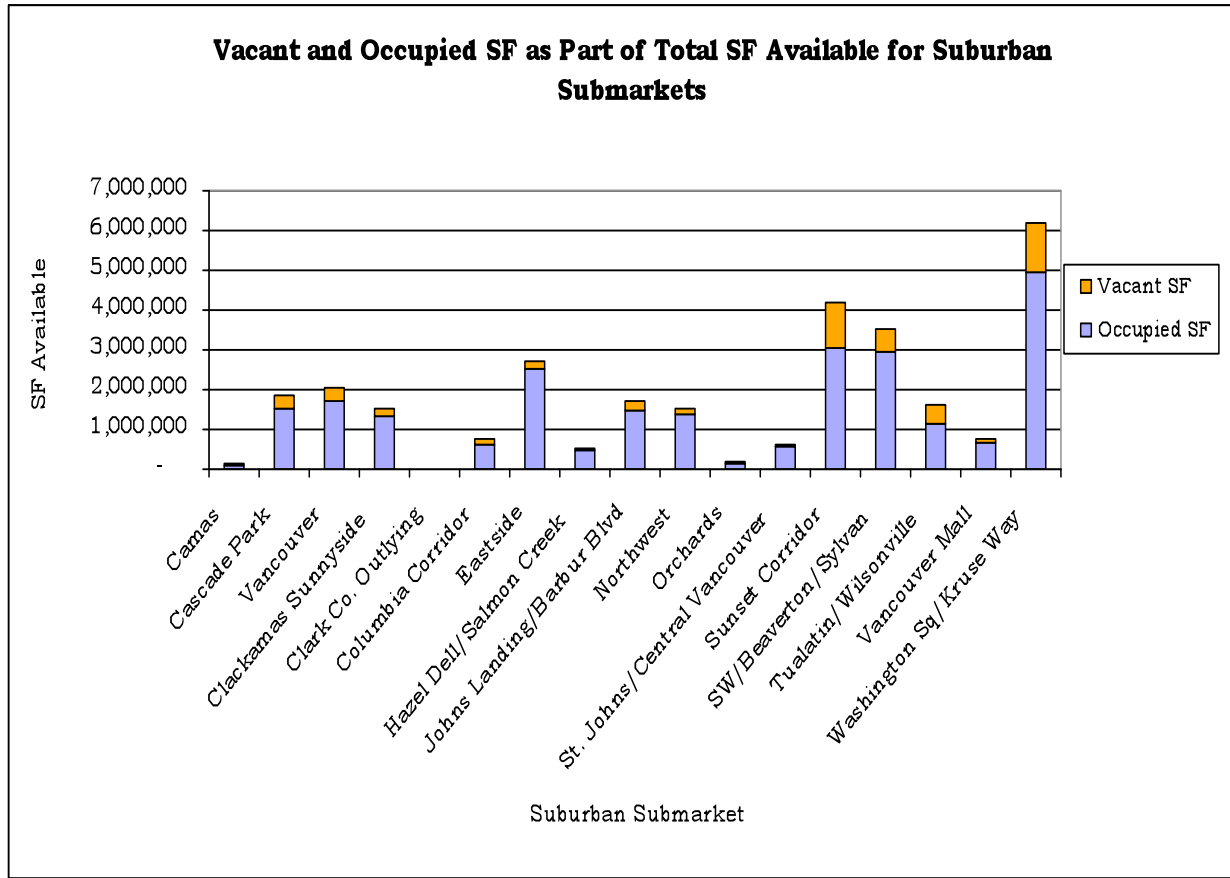
Grubb & Ellis reports high vacancy in the Sunset Corridor and expects that the Kruse Way corridor will continue to see vacancy increase as tenants who have signed leases move to other areas. According to Grubb & Ellis, the Tualatin/Wilsonville submarket still ranks the highest in percentage of vacancy, but the amount of vacant space is only a third of the amount of vacant space found in the fifth ranked Washington Square/Kruse Way submarket. Beaverton saw a 6% decline in vacancy since last quarter.

Suburban Office Submarkets Ranked by Highest Percent of Vacancy		
Submarket	Rank	Vacancy Rate
Camas	3	25%
Cascade Park	7	16.9%
Vancouver	10	14.7%
Clackamas Sunnyside	13	10.40%
Clark Co. Outlying	11	14.1%
Columbia Corridor	4	23.1%
Eastside	16	7.4%
Hazel Dell/Salmon Creek	17	6.2%
Johns Landing/Barbur Blvd	9	14.8%
Northwest	15	7.5%
Orchards	6	20.3%
St. Johns/Central Vancouver	12	10.8%
Sunset Corridor	2	27.4%
SW/Beaverton/Sylvan	8	15.8%
Tualatin/Wilsonville	1	27.9%
Vancouver Mall	14	9.90%
Washington Sq/Kruse Way	5	20.6%

Source: Grubb & Ellis, Co., Office Quarterly Report, Third Quarter 2009 Statistics

Total Vacancy for Select Suburban Submarkets									
Submarket	Current Market Size (Sq. Ft.)	2Q 08 Vacancy	3Q 08 Vacancy	4Q 08 Vacancy	1Q 09 Vacancy	2Q 09 Vacancy	3Q 09 Vacancy	% change from last quarter	Current Vacancy (sqft)
Washington Square/ Kruse Way	6,205,488	13.8%	13.5%	14.7%	16.3%	19.6%	20.6%	5.1%	1,275,337
Sunset Corridor	4,195,633	21.2%	22.3%	22.3%	25.3%	25.6%	27.4%	7.0%	1,149,184
Beaverton	3,509,988	17.2%	16.9%	15.4%	16.5%	16.8%	15.8%	-6.0%	555,926
Eastside	2,736,015	6.7%	8.2%	8.2%	7.6%	7.4%	7.4%	0.0%	213,621
Johns Landing/Barber Blvd.	1,704,248	13.3%	14.2%	13.1%	13.9%	14.5%	14.8%	2.1%	251,537
Tualatin/Wilsonville	1,600,875	21.9%	28.7%	27.3%	26.1%	26.9%	27.9%	3.7%	446,483

*Source: Grubb & Ellis, Co., Office Quarterly Report, Third Quarter 2009 Statistics



*Source: Grubb & Ellis, Co., Office Quarterly Report, Third Quarter 2009 Statistics

Major Lease Transactions Q3 2009

Lessee	Property	Submarket	Size (SF)
Wells Fargo (renewal)	Montgomery Park	Portland	128,032
Cascade Education LLC (renewal)	8909 Building	Portland	47,033
Genesis Financial Solutions	Creekside Corporate Park	Central 217	27,862
Nationwide Mutual Insurance	847 NE 19th Ave	Lloyd District	24,405
Hampton Management (renewal)	9600 Building	Portland	24,056
InFocus	Triangle Corporate Park	Tigard	17,267
Elynx Ltd.	Creekside Corporate Park	Central 217	12,705

Source: CB Richard Ellis, MarketView Third Quarter 2009 Office Report, Norris, Beggs and Simpson, "Market Summaries 3Q09", Cushman and Wakefield, "MarketBeat 3Q09", Grubb & Ellis, "Office Trends Report 3Q09"

Hotel Market Analysis

By April Chastain, Certificate of Real Estate Development Graduate Student & RMLS Fellow

According to the Daily Journal of Commerce (DJC)¹, the occupancy rate of Portland's hotels has fallen 12 percent in 2009. So far this year, the overall occupancy rate stands at 63 percent. The hotel market supply expanded by more than 979 rooms downtown alone during the boom with the addition of several new hotels: the 173-room Hotel Modera, the 331-room Nines, the 256-room Courtyard by Marriott, the 140-room Fifty, the 79-room Ace Hotel plus suburban hotels like the 136-room Aloft Hotel at Cascade Station to name a few. Nationally, revenue per available room (RevPAR) is down 18.3 percent.



The impact of the new supply, coupled with reduced travel due to the Great Recession, has exacted a toll on hotel owners and operators. According to the DJC², Hilton has made plans to close the downtown Hilton Hotel for over four weeks, one week in November, one week in December and two weeks in January, in order to cut costs. Hotwire.com³ ranked Portland's hotel market as experiencing the fifth largest decline nationally in hotel prices. As of the first week in September, room rates are down 20% compared with last year, to an average three-star rate of only \$57 per night. Due to these problems in the hotel market, local firms are concerned that distressed hotels may be purchased by so-called vulture investment firms.

The depth of the recession in the hotel market, coupled with its accelerating costs and required public subsidies, have stymied plans to develop a 600-room Westin headquarters hotel at the Oregon Convention Center⁴. The hotel was to have been part of a plan to bolster events at the Oregon Convention Center (OCC) on land acquired by the PDC to the east of the OCC on N.E. Martin Luther King Jr. Blvd. The 23-story, \$200+ million project would have been paid for in part by funds from the Portland Metro Visitors Development Fund, funded by hotel room taxes. The Portland Mayor, Metro president and Multnomah County Chair decided in September not to extend a development agreement with the hotel's developers.



The CoStar Group⁵ reports that some hotel chains are looking to raise money in order to acquire properties in distress. Hyatt Hotels Corp. and DiamondRock Hospitality Co. are both making moves to raise capital in order to add hotels to their portfolio. Hotel executives

¹ "Portland hotels: plenty of rooms available", Daily Journal of Commerce, October 7, 2009.

² "Union: Downtown Hilton plans shutdown", DJC, September 1, 2009.

³ "Hotel rates falling fast in Portland", Portland Business Journal, September 23, 2009

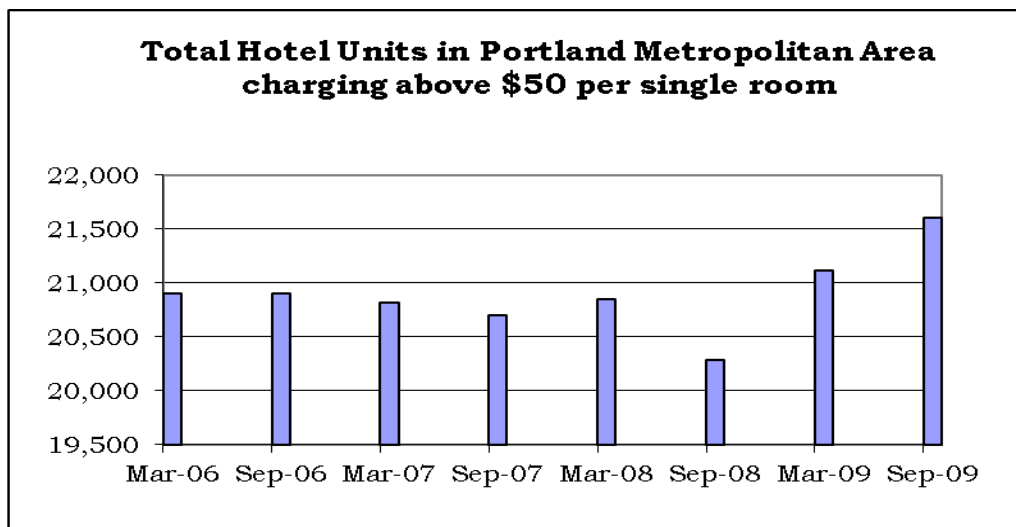
⁴ "Falling demand sinks HQ hotel", DJC, September 21, 2009.

⁵ "Hotels: Don't Buy Them Now, But Start Looking", CoStar Group, October 21, 2009.

interviewed for the article expect to see more transactions in 2010, with over \$30 billion of hotel collateralized mortgage-backed securities' (CMBS) debt coming due through 2014 and with \$8 billion already unable to meet debt service.

Local hotels may have some relief from the weak market as attendees of the upcoming supercomputing convention in November will reportedly be accommodated at 31 different hotels in the area.

A preliminary report by The Dundon Company shows an increase of four hotels in the Portland Metropolitan Area since March. One hotel was deleted due to a decrease in price. Three hotels are currently under construction and four more are in the planning stages. Since March of 2009, 92 hotels are quoting a higher nightly rate with an average increase of \$14.33. Sixty-three hotels are quoting a lower corporate rate averaging \$10.66 less per night. Eighteen hotels maintain the same rate, for a total of 176 hotels in the area that charge a corporate rate of more than \$50 per night.



Source: "Portland Hotel Survey, March 2009", The Dundon Company, LLC

September, 2009	Number of Hotels	Total Rooms Available	Rooms Under Construction	Rooms Planned for Development	Rooms Closed for renovation	Rooms Added/ Deleted
Suburban Westside	46	4,941	-	366	-	124
Downtown	31	5,510	-	66	-	256
Suburban Eastside*	40	3,914	-	-	-	-25
Int'l Airport	26	3,407	370	-	-	-
Vancouver WA	22	2,139	-	-	-	132
Rose Quarter/Lloyd Center	12	1,693	-	-	-	-
Metropolitan Total	176	21,604	370	432	0	487

Source: "Portland Hotel Survey, September 2009", The Dundon Company, LLC

*Suburban Eastside, 25 rooms deleted due to drop in price

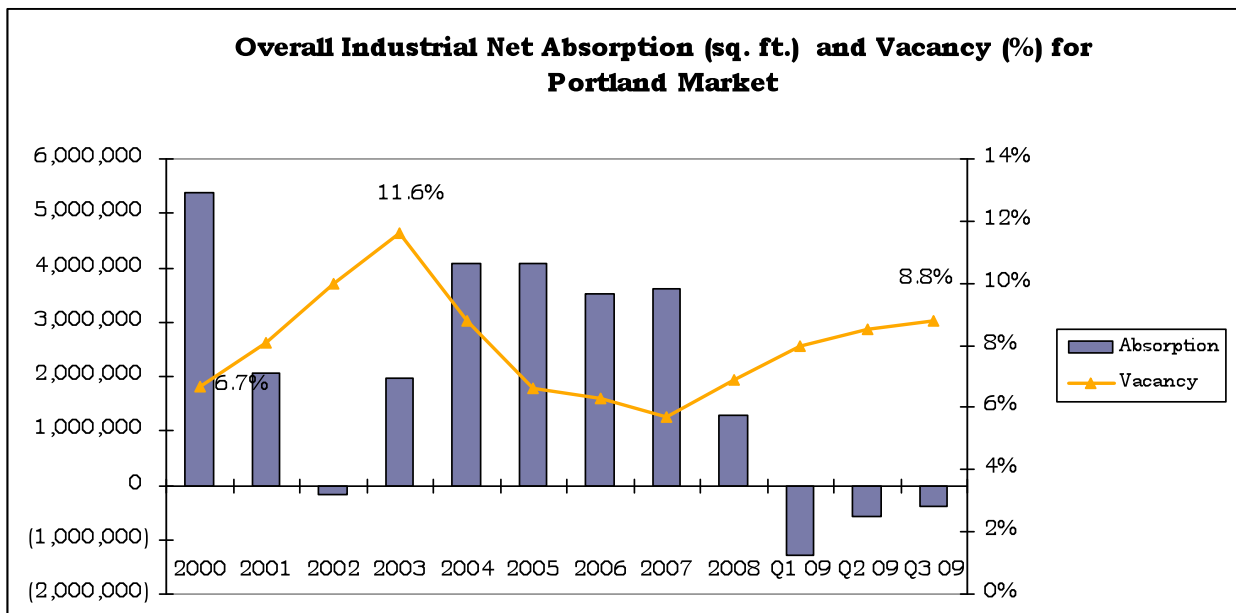
Suburban Westside: Beaverton, Sunset Corridor, Hillsboro, Lake Oswego, Tualatin, Tigard, & Wilsonville.
 Downtown Portland includes Downtown, John's Landing, Uptown and Northwest Industrial
 Suburban Eastside includes Jantzen Beach, Gresham, Troutdale, Clackamas, Oregon City and Milwaukie
 Source: "Portland Hotel Survey, March 2009", The Dundon Company, LLC

Portland Industrial Market

April Chastain, RMLS Fellow & Certificate of Real Estate Development Student

The industrial sector remains depressed. Colliers International reports a vacancy rate of 8.3% and a negative net absorption of 776,352 SF. It expects vacancy to continue to increase, reaching the 12-13% rate by mid-to-late 2010. As in the office sector, stagnant job growth will hinder recovery. Colliers also predicts potential distress for landlords who have taken significant rental reductions, at 20-30% below pro forma rental projections, in order to secure and retain tenants. This may lead to reduced building values and loan repayment troubles in the future. However, this also indicates that the market may be bottoming out.

Some positive news came when Daimler Trucks North America announced that it would not leave its Swan Island location as it procured a government contract for military vehicles, preserving about 650 jobs. CB Richard Ellis notes that if awarded a DOE grant, ReVolt Technology will locate its US headquarters in Portland hiring up to 250 employees in the development of rechargeable zinc batteries for electric vehicles. It also notes that construction and manufacturing gained jobs in August, while vacancy has remained nearly flat at 8.1%. Norris Beggs & Simpson on the other hand, reports overall vacancies rising a percentage point to 14.94% this quarter, with the Southwest 217 vacancy nearly doubling to 24.98%.



Source: Grubb & Ellis Co., Industrial Quarterly Report, Third Quarter 2009

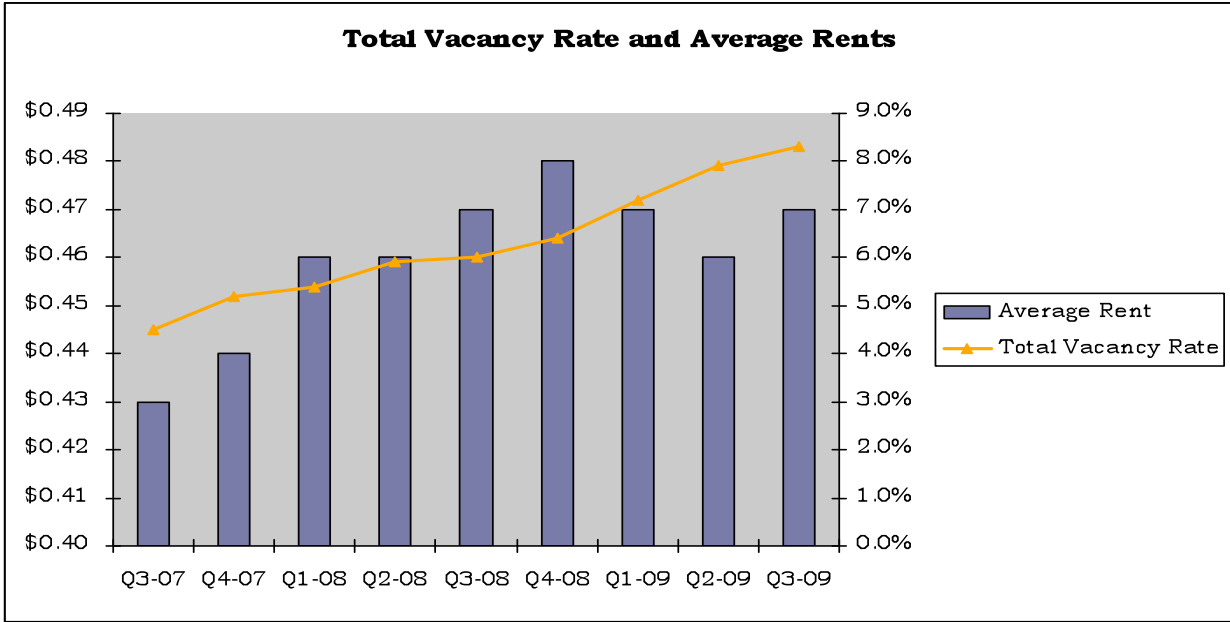
New construction in 2009 has delivered 511,003 SF according to CB Richard Ellis, nearly 85% of which is vacant. The remaining 461,500 SF currently under construction will be occupied upon delivery by FedEx and General Pacific. Norris Beggs & Simpson reports another 150,000 SF under construction within three smaller buildings in the Southwest I-5 submarket.

CB Richard Ellis reports that shell rates contracted, except in inventory restricted areas such as Vancouver and the Southeast where they remain steady. Case Holland's 246,228 SF lease and HD Supply Utilities' new lease at Clackamas Station resulted in positive net absorption this quarter for the Northeast and Southeast submarkets.

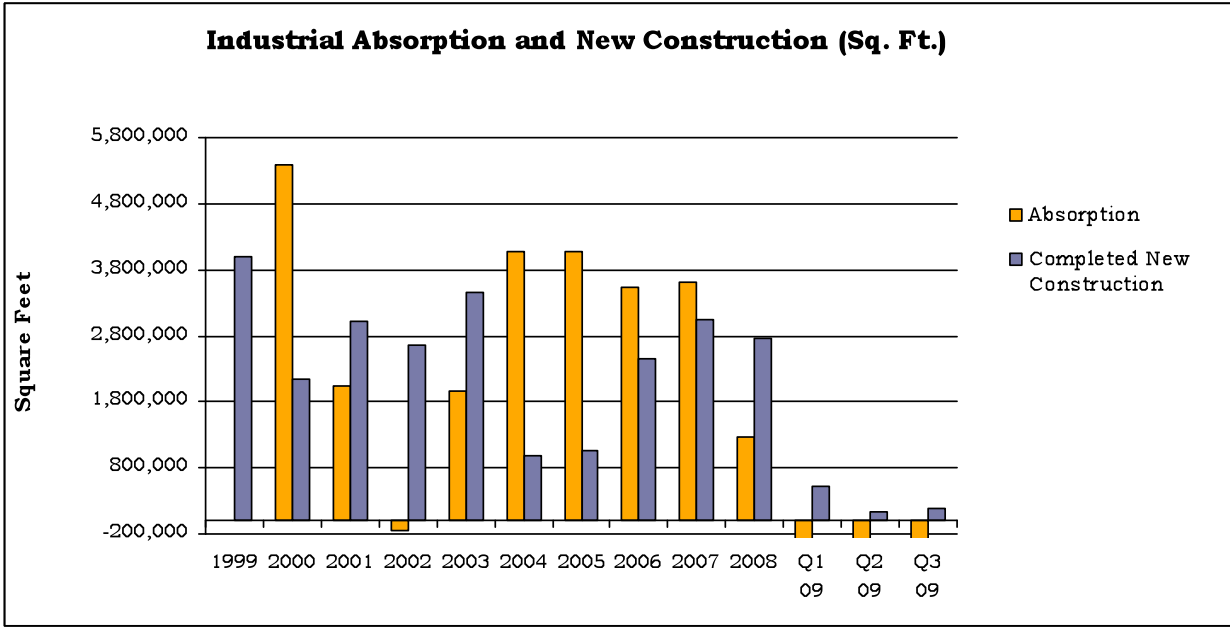
Cushman & Wakefield report that Shin-Etsu, a Japanese solar and computer chip manufacturer bought the Hewlett Packard campus in Vancouver. HP will lease back part of the site.

INDUSTRIAL Q3-09	CB Richard Ellis	Cushman & Wakefield	Grubb & Ellis	Norris, Beggs & Simpson	Median
Market-wide Vacancy	8.1%	8.3%	8.8%	14.9%	8.6%
Previous Quarter	8.1%	8.0%	8.5%	N/A	8.1%
Third Quarter 2008	6.1%	6.7%	6.6%	N/A	6.6%
Third Quarter 2007	4.9%	5.0%	5.3%	N/A	5.0%
Warehouse/Distribution	14.0%	8.8%	8.9%	N/A	8.9%
Previous Quarter	14.6%	7.7%	8.6%	N/A	8.6%
Third Quarter 2008	11.97	5.8%	6.7%	N/A	6.7%
Third Quarter 2007	N/A	4.3%	4.8%	N/A	4.6%
R&D/Flex Vacancy	15.1%	10.0%	8.4%	15.7%	12.5%
Previous Quarter	14.9%	9.6%	7.9%	N/A	9.6%
Third Quarter 2008	12.73	9.5%	6.3%	N/A	9.5%
Third Quarter 2007	N/A	9.2%	7.0%	N/A	8.1%
Asking Monthly Shell Rates	\$0.39	N/A	\$0.43	N/A	\$0.41
Previous Quarter	\$0.40	N/A	\$0.41	N/A	\$0.41
Third Quarter 2008	\$0.39	N/A	\$0.42	N/A	\$0.41
Third Quarter 2007	\$0.37	N/A	\$0.41	N/A	\$0.39
Asking Monthly Flex Rates	N/A	N/A	\$0.79	N/A	\$0.79
Previous Quarter	\$0.85-\$1.05	N/A	\$0.80	N/A	\$0.80
Third Quarter 2008	\$0.85-\$1.05	N/A	\$0.85	N/A	\$0.85
Third Quarter 2007	\$0.85-\$1.05	N/A	\$0.83	N/A	\$0.83

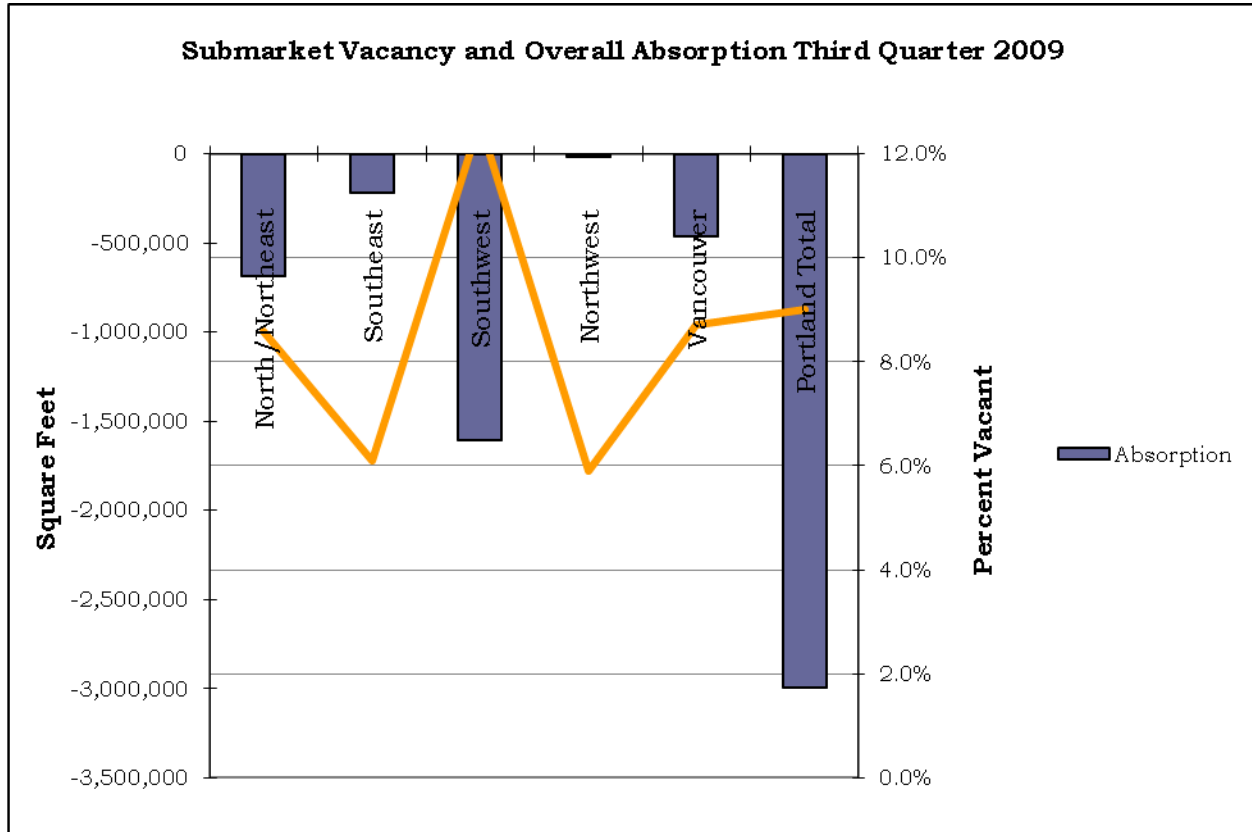
Source: Grubb & Ellis, Cushman and Wakefield, Norris, Beggs & Simpson, Quarterly Reports



Source: Colliers International, "The Knowledge Report", Industrial, Third Quarter 2009.



*Source: Grubb & Ellis Co., Industrial Quarterly Report, Third Quarter 2009



Major Lease Transactions Q3 09

Industrial

Tenant	Property	(Sq. Ft.)	Submarket
Case New Holland	ProLogis Park PDX	246,228	Portland
Bunzl Distribution (renewal)	Jennifer Distribution Center	127,420	Clackamas
Aaron Rents (renewal)	Rivergate Warehouse	97,625	Portland
Quantum Resource Recovery	Waterfront Business Center	92,500	Portland
Biamp Systems Corporation	Nimbus Corporate Center	70,944	Beaverton
Oregon Electric Construction	1709 SE Third Ave	46,154	Southeast
Total		680,871	

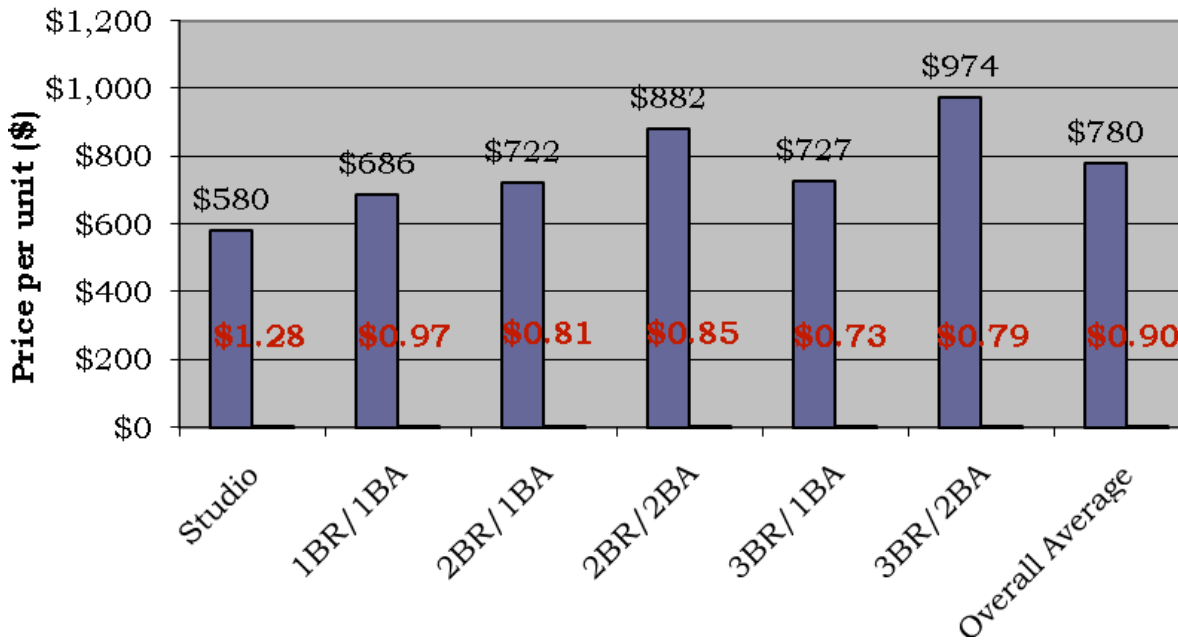
*Source: NAI Norris Beggs & Simpson, CB Richard Ellis, and Cushman & Wakefield, Industrial Quarterly Reports, Third Quarter 2009, and the Portland Business Journal

Portland Apartment Market

**Scott Aster, Oregon Association of Realtors [OAR] Fellow
& Certificate of Real Estate Development Student**

According to Norris, Beggs & Simpson's Third Quarter 2009 Multifamily Report, the overall multifamily vacancy rate has decreased in the third quarter to 4.62% from 5.03% in the second quarter but is still up from 3.76% this time last year. The average rents for the quarter are \$686 (\$0.97/SF) for a 1BR/1BA, \$720 (\$0.81/SF) for a 2BR/1BA, \$876 (\$0.85) for a 2BR/2BA and \$974 (\$0.79) for a 3 BR/2BA. These numbers are up slightly from the previous quarter. Average 2BR/2BA new units rent for \$1,219 per unit, an increase of \$19 over last quarter. Seasoned 2 BR/2BA units rent for an average \$826 per unit, which is an increase of only \$2 over last quarter.

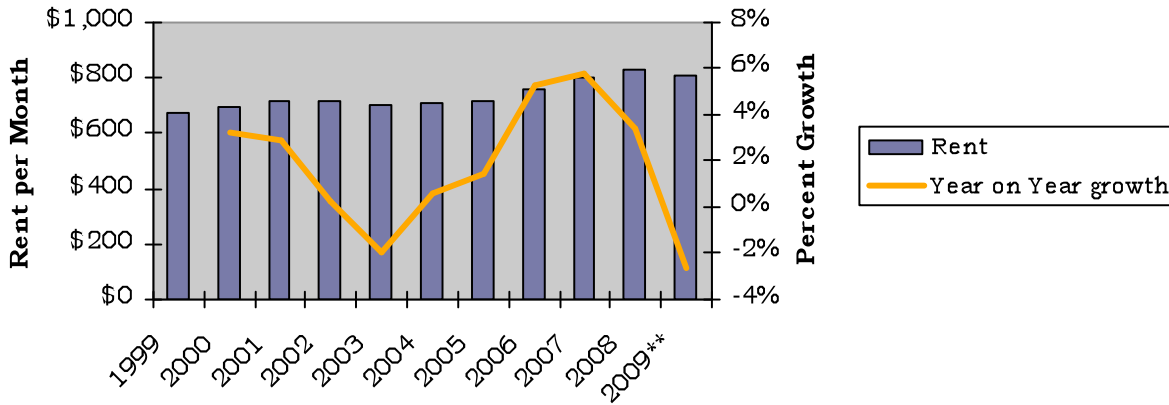
Metro-Wide Average Rents Third Quarter 2009



Source: Norris, Beggs & Simpson "Portland Area Multifamily Report Third Quarter, 2009,
*Price per square foot shown in red

The higher vacancy issue appears to be a lagging indicator within this recession as the economy's slow recovery does not appear to be improving occupancy rates. September vacancy numbers reflect 5-7% vacancies across the Portland market, with high areas at 10% and low areas at 3%. Concessions remain commonplace though rental rates have stabilized somewhat. The primary cause of the high vacancies is the economic downturn's strong negative effect on renter affordability.

Average Historical Rents & Rent Growth



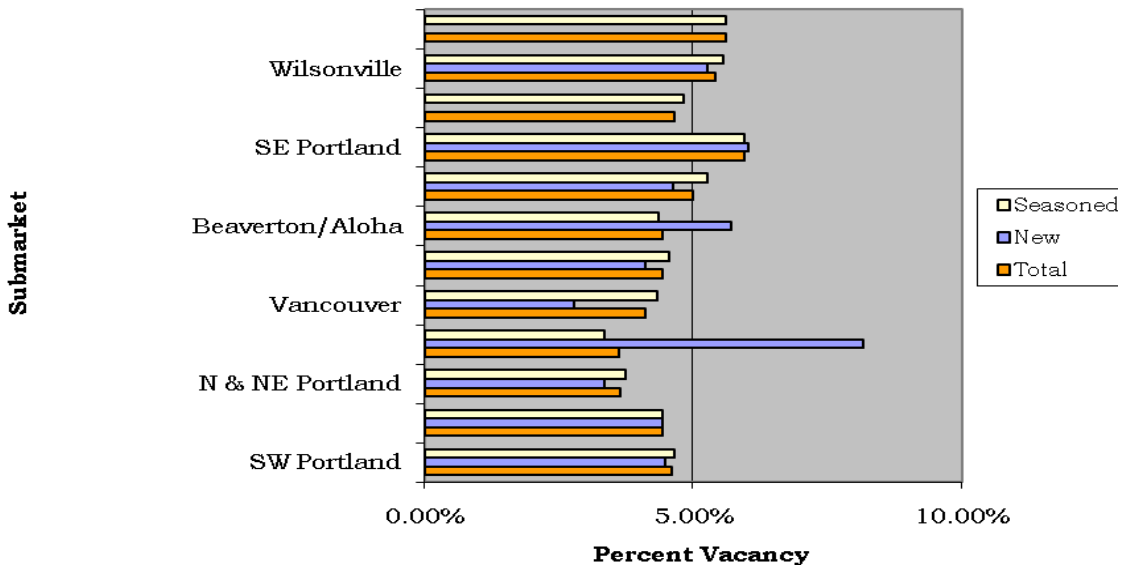
*Based on 1BR rate

**2009 estimated.

Source: Brokers, Gary Winkler & Beth DuPont, Colliers multifamily investment, "Portland Multifamily Private Capital News, Year End 2008"

The SE Portland submarket shows the highest total vacancy rate at 5.94%, while Lake Oswego/West Linn has the lowest submarket vacancy at 3.61%. However, Lake Oswego has the highest new unit vacancy at 8.16% while Vancouver has the lowest new unit vacancy at 2.78%.

Third Quarter 2009 Submarket Vacancy



Source: Norris, Beggs & Simpson "Portland Area Multifamily Report Third Quarter, 2009"

According to Colliers International, the high local unemployment rates are having a strong negative impact on vacancies, as shown in the charts below. The rise in the unemployment rate from 6.2% in 2008 to 11.3% in 2009 suggests that vacancy rates might continue to rise until unemployment levels stabilize and decline.

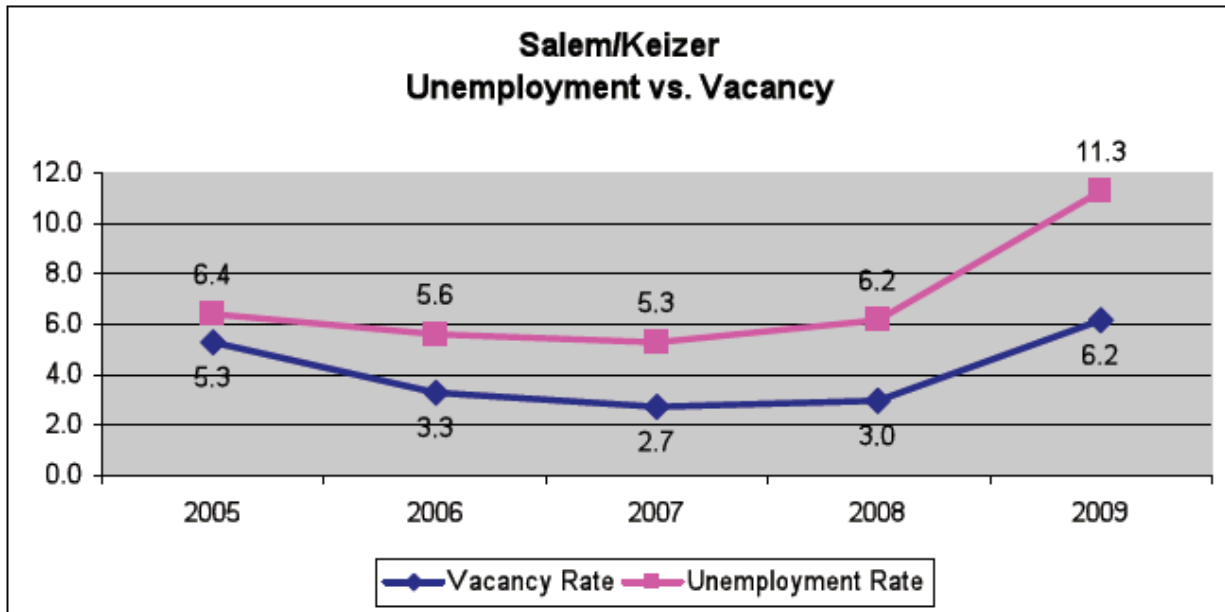
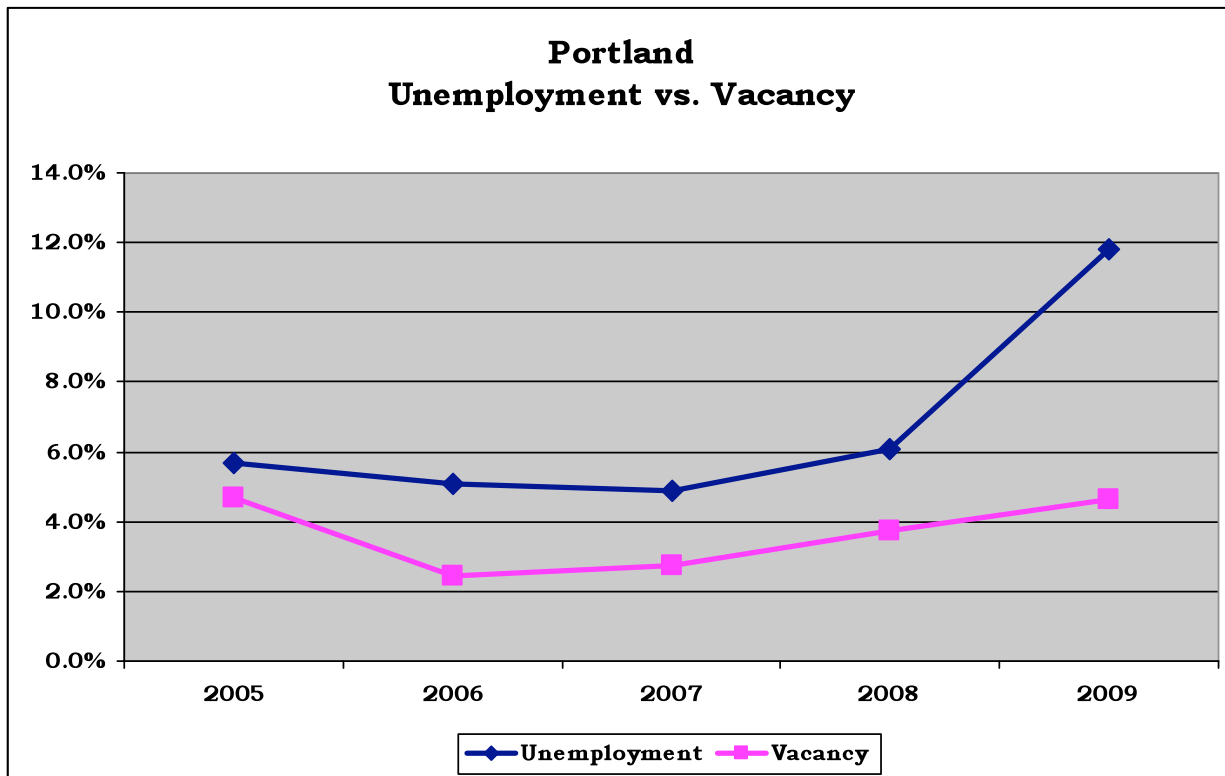


Chart data provided by Shirley Layne, Powell Valuation Inc



Source: Norris, Beggs & Simpson "Portland Area Multifamily Report Third Quarter (2009, 2008, 2007, 2006, 2005), U.S. Bureau of Labor Statistics (Aug 2009, 2008, 2007, 2006, 2005)

Vacancies are up not necessarily because residents are moving from Portland but also due to tenants doubling up, moving in with family, or moving into single-family rental homes. According to Mark Barry, condominium conversions are also having an impact on vacancy rates. He estimates a current 2.5 to 3.5 years of inventory in the condominium market.

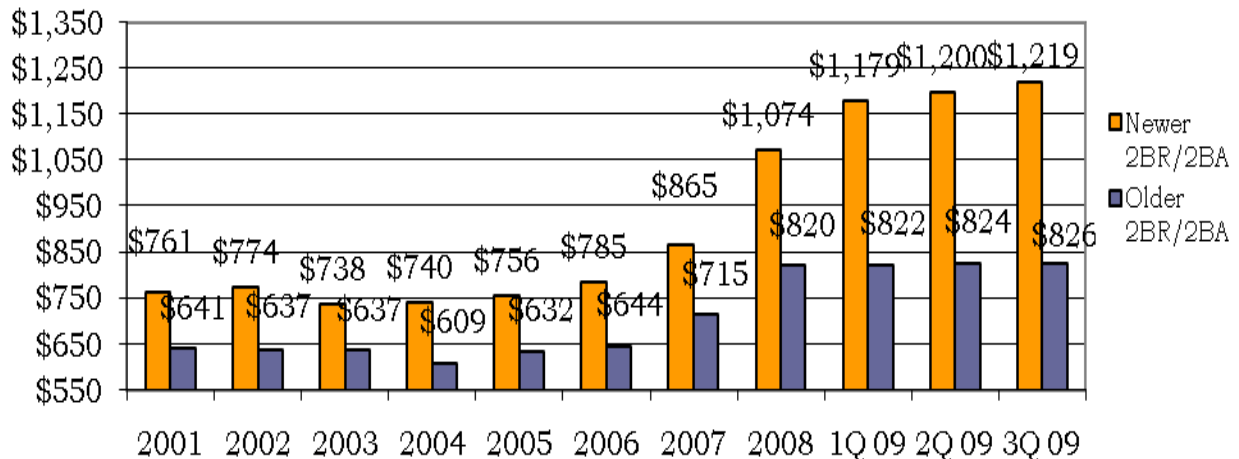
The threat of fleeing tenants has caused some landlords to offer lower rents, one or two months worth of free rent concessions as well as free parking. Colliers International states in its midyear report that, “some new buildings even guarantee that if a tenant loses his/her job, they can end their lease agreement without penalties, early termination fees or adverse impact on credit.” The widespread discounting produces net effective rents, including parking and rent concessions in select buildings throughout the metro area, ranging from 5.6% to 16.8% lower.

One of the driving factors behind the vacancy issue is affordability. According to Colliers International, the middle income work force that drives demand for multifamily rental housing earns between 50% and 80% of median family income (MFI). The 2009 MFI for a single person in Portland is \$49,000. Assuming rents are a 30% of gross income, the individual could afford a monthly rent of between \$613 and \$980. Options are very limited within this price range in the Portland area as studios and one-bedrooms are between \$710 and \$740 and higher range luxury options are in excess of \$1,000.

	2009 MFI	Single Person
50% MFI	Gross Income	\$24,500
	Affordability	\$613
60% MFI	Gross Income	\$29,400
	Affordability	\$735
80% MFI	Gross Income	\$39,200
	Affordability	\$980
100% MFI	Gross Income	\$49,000
	Affordability	\$1,225

Source: Colliers, "Portland Multifamily Private Capital News, 3rd Quarter 2009"

Average Portland Metro Rents



Source: Norris, Beggs & Simpson "Portland Area Multifamily Report Third Quarter, 2009"

Norris, Beggs & Simpson’s list of major apartment sale transactions indicates a drastic decline in apartment sales over the previous year. The sum of the purchase prices from the list of the seven major sale transactions in NBS’s Third Quarter 2008 Report amounts to \$249,523,900. This year’s list totals only \$9,879,123, or 4% of the previous year’s total. Thus major apartment sales were few and far between in the third quarter of 2009. Similarly, multifamily land sales for future development have also dried up. However, as NBS indicates in its report, it expects sales to accelerate once the availability of financing increases.

Two transactions, as reported by the Portland Business Journal¹, took place after the quarter ended. Nevins Adams Lewbell Schell purchased The Colonnade, a 268-unit complex at 20311 NW Colonnade Drive, Hillsboro for \$21.42 million (\$79,925/unit). The same company also purchased the Park at Mill Plain, a 352-unit complex at 206 NE 126th Ave, Vancouver, for \$23 million (\$65,340/unit).

MAJOR SALE TRANSACTIONS					
Buyer	Building	Price	Units	Price/Unit	Submarket
NW DPL V, LLC	Emerson Apartments	\$2,659,123	26	\$102,274	North/NE Portland
Kelly and Linda Finerty	Yorktown Gardens Apartments	\$1,660,000	30	\$55,333	Gresham/Troutdale
Fircrest Investment, LLC	19511 NE Halsey Street	\$1,450,000	27	\$53,704	North/NE Portland
Dash Investments, LLC	The Meadows	\$1,250,000	22	\$56,818	Beaverton/Aloha
Bill and Georgia Pappas	View North Apartments	\$1,075,000	20	\$53,750	North/NE Portland
5625 SE Gladstone, LLC	Triangle Terrace	\$1,035,000	14	\$73,929	Southeast Portland
Park Place Partners, LLC	220-244 NE 143rd Avenue	\$750,000	13	\$57,692	North/NE Portland

¹ “California firm buys apartment complexes for \$48M”, Portland Business Journal October 16, 2009

Housing Market Analysis

By Scott Aster, Oregon Association of Realtors [OAR] Fellow
& Certificate of Real Estate Development Graduate Student

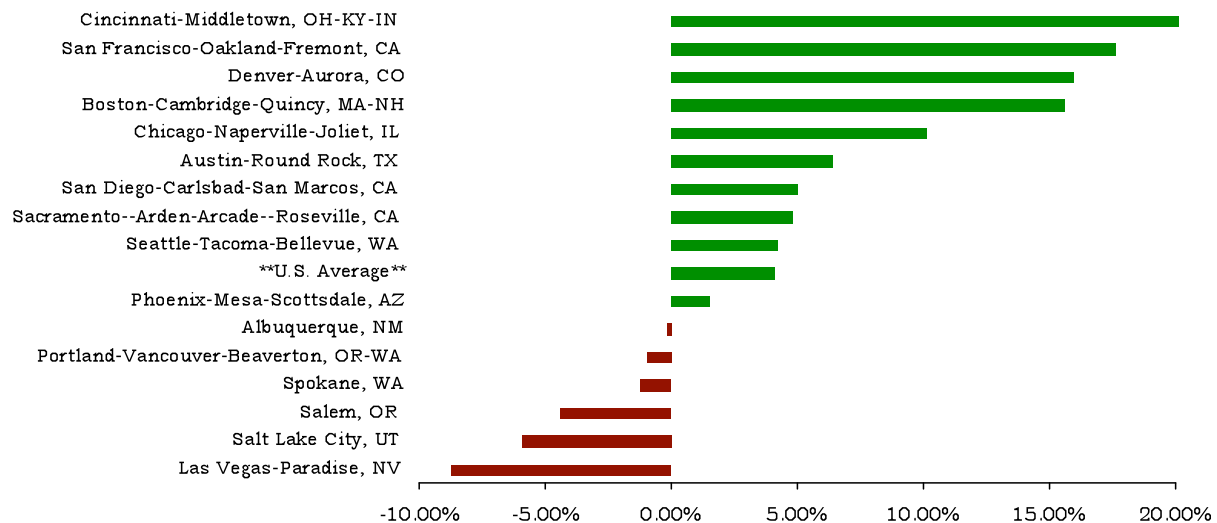
Median Home Values of Existing Detached Homes

	U.S.	West	Portland Metro Area
August 2008 Median Sales Price	\$ 201,900	\$ 254,900	\$ 290,000
August 2009 Median Sales Price	\$ 177,500	\$ 225,600	\$ 260,000
% Change in Median Sales Price	-12.1%	-11.5%	-10.3%
% Change in Number of Sales Aug 2008-2009	2.5%	7.1%	27.3%

Source: National Association of Realtors (August 2009) and RMLS (August 2009)

Once again the housing market statistics reflect a decrease in value from the prior year. Median home prices were down 12.1% annually in August, and 11.5% for the western part of the nation. According to May's Standard & Poor's Case-Shiller index, the metro areas with the greatest annual depreciation rates are Las Vegas (-31%), Phoenix (-28%), Detroit (-25%), and Miami (-21%). However, prices are still substantially higher than they were before the housing bubble. For Portland, the index based on a home valued at \$100,000 in 2000 stood at \$150,060 at the end of July 2009. The number of building permits issued was down 33% nationally, with a reduction of 38% in Oregon.

Median Sales Prices of Existing Single Family Homes By Metropolitan Area



Source: <http://www.realtor.org/Research.nsf/Pages/MetroPrice>

Building Permits Issued

Year to Date (all data in thousands)

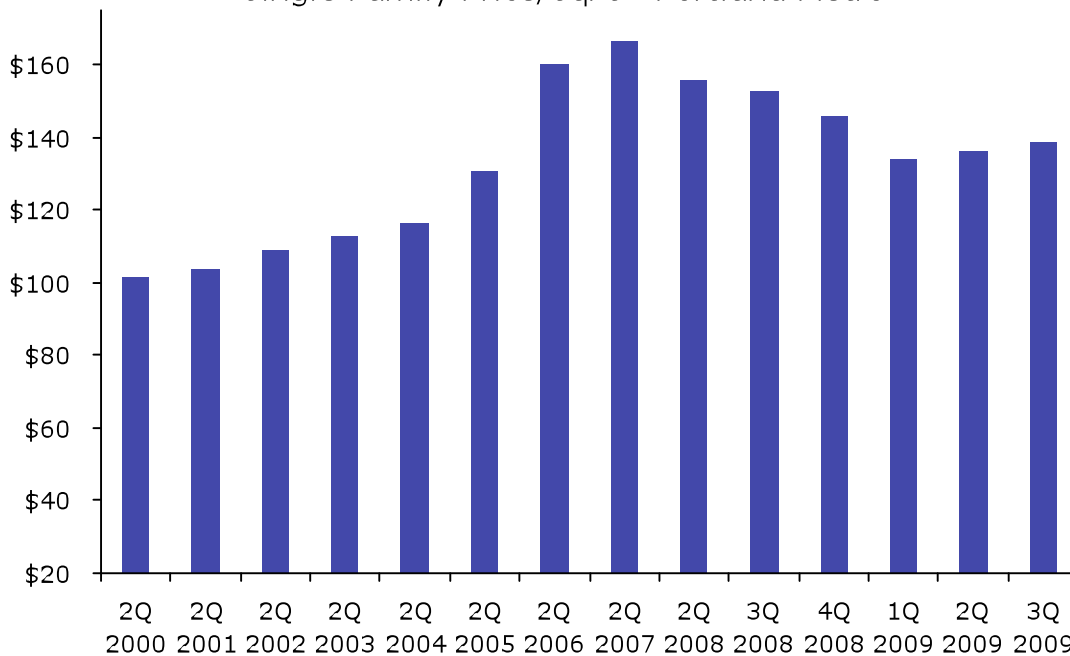
	SINGLE-FAMILY			MULTIFAMILY		
	Aug-09	Aug-08	PCT CHG	Aug-09	Aug-08	PCT CHG
UNITED STATES	291.3	435.3	-33%	92.5	245.2	-62%
OREGON	3.84	6.19	-38%	1.46	3.41	-57%
Bend OR	0.24	0.52	-54%	0.03	0.08	-67%
Corvallis OR	0.03	0.03	-4%	-	-	-
Eugene-Springfield OR	0.30	0.48	-38%	0.08	0.12	-30%
Medford OR	0.21	0.31	-30%	0.01	0.05	-89%
Portland-Vancouver-Beaverton OR-WA	1.98	3.34	-41%	0.59	2.94	-80%
Salem OR	0.24	0.42	-44%	0.10	0.21	-50%

Source: National Association of Home Builders (August 2009)

Portland

The number of Portland metropolitan area home sales increased by 25% over the second quarter, as buyers closed purchases on 4,191 existing homes. This is an increase of 14% over the previous year. Median prices for the third quarter were at \$258,000, a 1% increase over the previous quarter, but an 11% reduction annually. Prices are still being marked down, with average sales taking place at 91.68% of the original list price, 1.96% less than the previous year. Sellers in the Portland area, on average, have their homes on the market for 72 days before closing, reflecting a one-week increase from 2008. Price per-square-foot values increased slightly again to \$139, a 2% increase from the previous quarter. However, this reflects a 9% decrease annually.

Single Family Price/SqFt - Portland Metro



Median Sales Price & Number of Homes Sales Per Quarter - Existing Detached Homes

Portland Metro (Excluding Clark County)



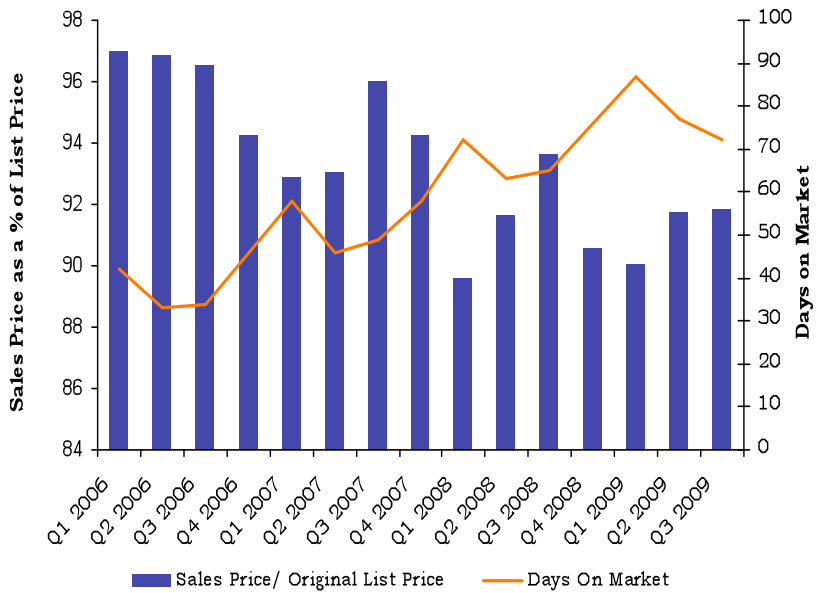
8-Year outlook for Median Sales Price & Number of transactions

2nd Quarter Median Price: \$258,000
 Quarterly % Change: 0.95%
 Annual % Change: -11.00%

Number of Transactions: 4,191
 Quarterly % Change: 25.40%
 Annual % Change: 14.13%

Sale Price/Original List Price & Average Days on Market - Existing Detached Homes

Portland Metro (Excluding Clark County)



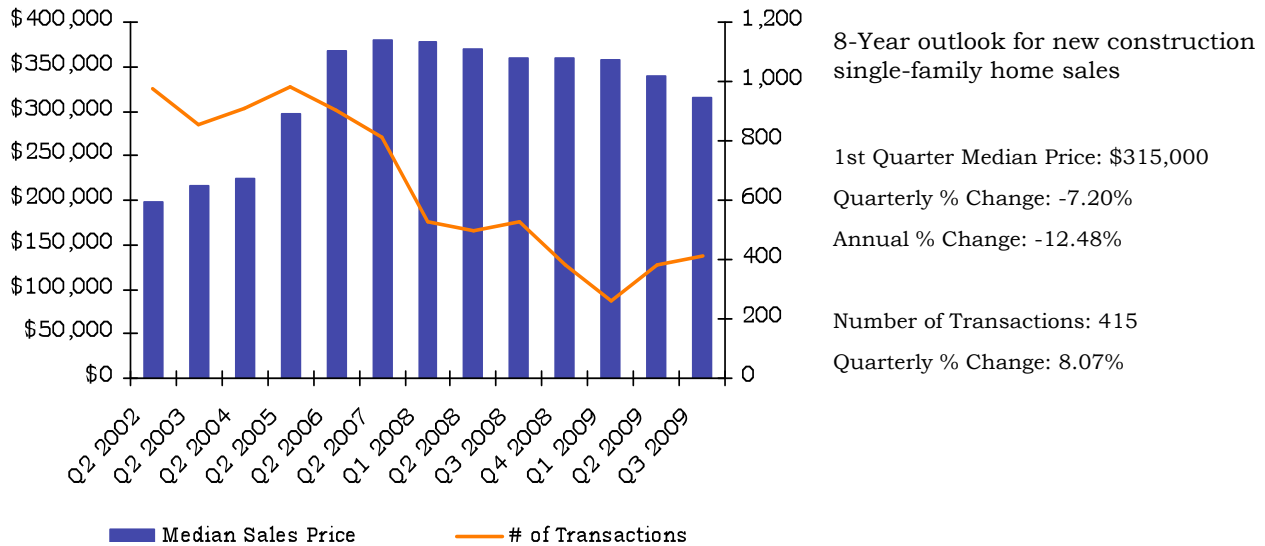
8-Year outlook for Average DOM and Sales Price/Original List Price ratio

1st Quarter Sale/Original ratio: 91.68
 Quarterly % Change: -.076%
 Annual % Change: -2.09%

Days on Market: 72
 Quarterly % Change: -6.50%
 Annual % Change: 10.77%

Median Sales Price & Number of Transactions – New Detached Homes

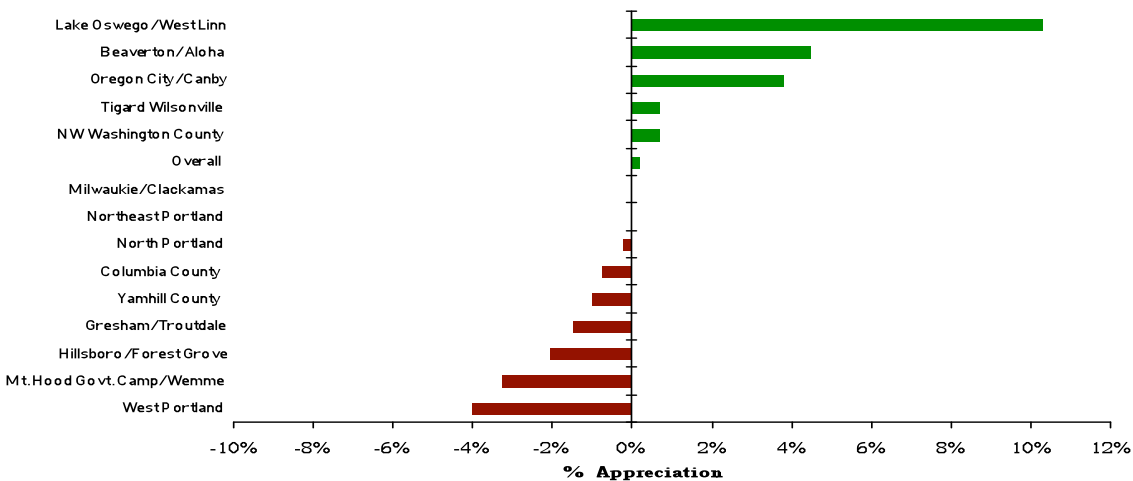
Portland Metro (Excluding Clark County)



On a note of optimism, six of the submarkets listed below experienced quarterly price appreciation while one remained unchanged. The other submarkets experienced a decline in value. Lake Oswego/West Linn home prices increased the most at 10.28% followed by Beaverton/Aloha at 4.49% and Oregon City/Canby at 3.82%.

Conversely, the Southeast Portland area experienced the highest depreciation rate at (-5.17%), followed by West Portland at (-4.00%). However, annual results are negative for all but two Portland area submarkets. Columbia County (3.5%) and Mt. Hood Government Camp/Wemme (1.4%) are the only two submarkets that experienced an increase in value from the previous year. Conversely Southeast (-15.1%) and Northeast Portland (-13.3%) home values depreciated the most from 2008.

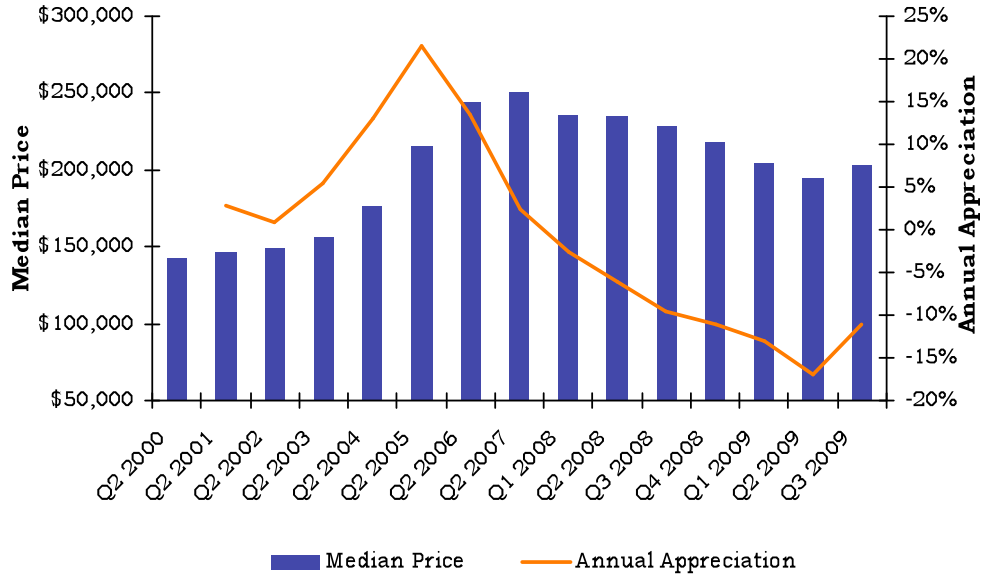
Appreciation Rates of Existing Detached Homes - Portland Sub-Market
Q2 2009- Q3 2009



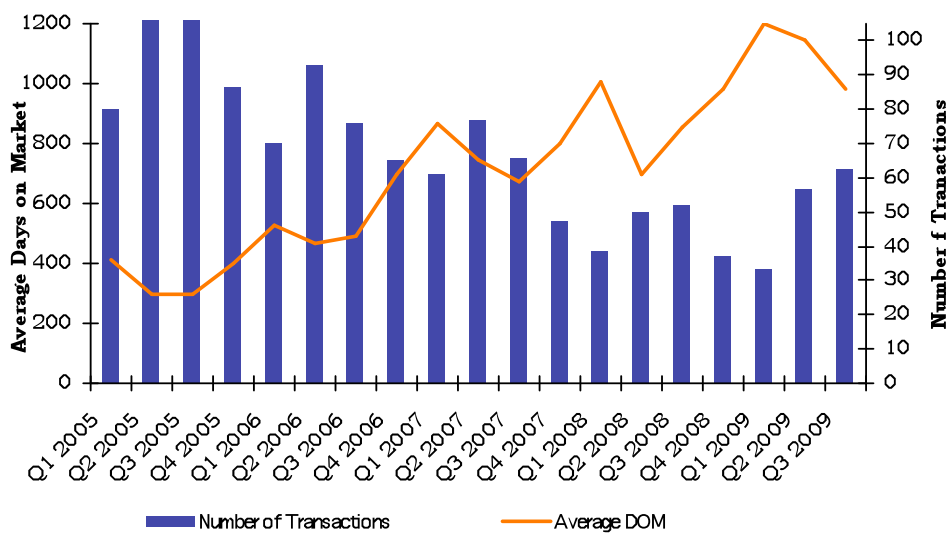
Vancouver

After declining over the previous six quarters, Vancouver’s home values finally experienced a quarterly increase. Vancouver’s median home price was \$203,825 resulting in an increase from the previous quarter (4.5%) but a decrease from the previous year (-11%) in home values. On another positive note, the number of home sales increased to 714, up 10% quarterly and 21% annually. However, the number of days on the market is up to 86, a 15% increase from 2008.

**Median Price and Annual Appreciation
Existing Detached Homes
Vancouver**

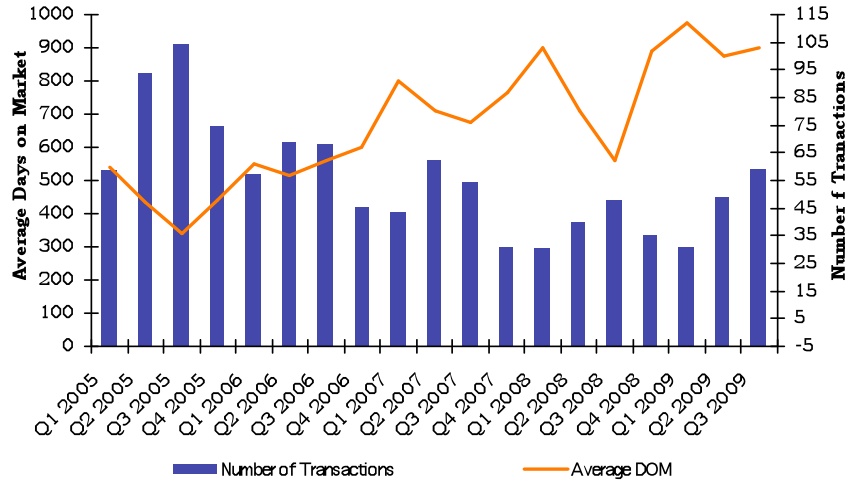


**Average Days on Market and Number of Transactions
Existing Detached Homes
Vancouver**



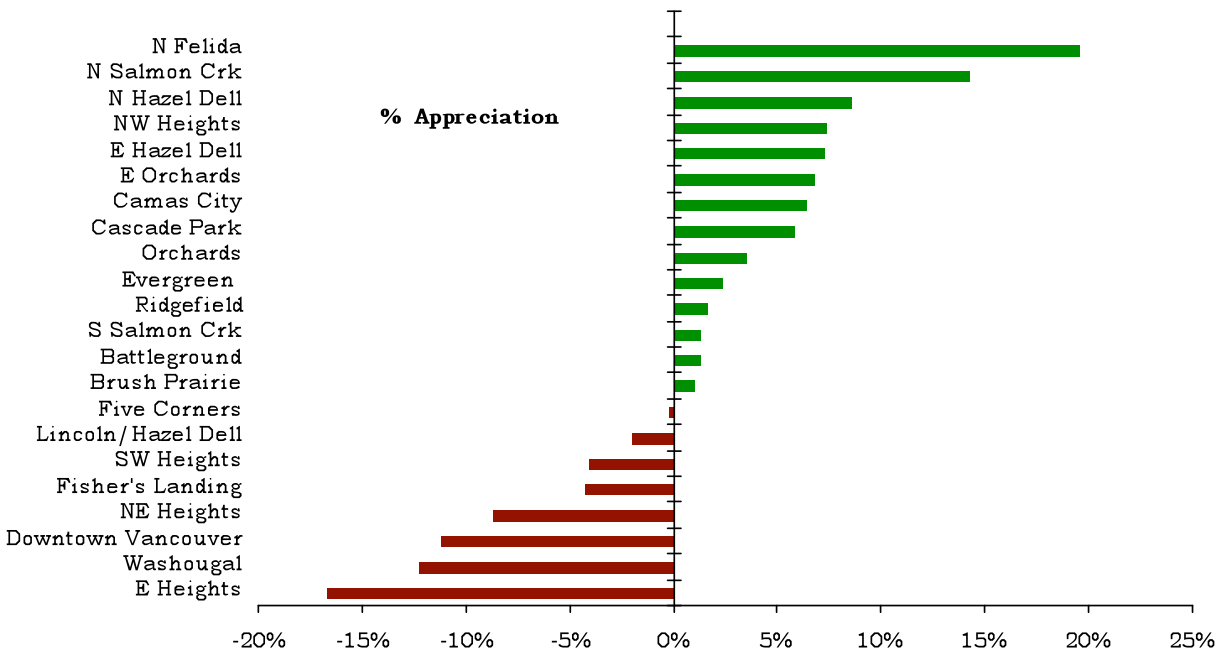
In the suburbs of Clark County, home prices have dropped to \$240,750 a 2% drop from the previous quarter's median price of \$245,000. An annual comparison indicates that home prices are down 10% from 2008. Similar to Vancouver, the number of home transactions in the Clark County suburbs is up 19% for the quarter and 22% annually. But the number of days on the market has increased 66% annually and is up to 103.

**Average Days on Market and Number of Transactions
Existing Detached Homes
Clark County (excluding Vancouver)**



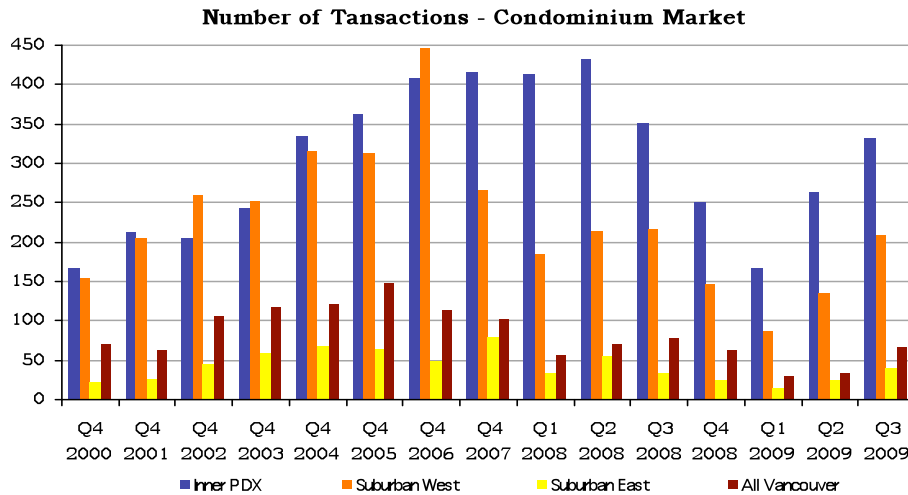
Most Vancouver/Clark County submarkets experienced price appreciation for the quarter. North Felida home values increased the most (20%) followed by North Salmon Creek (14%). Conversely, the East Heights area had the highest depreciation rate at (-17%) followed by Washougal (-12%) and Downtown Vancouver (-11%).

**Appreciation Rates of Existing Detached Homes
Vancouver and Clark County Sub Market - Q2 2009 - Q3 2009**

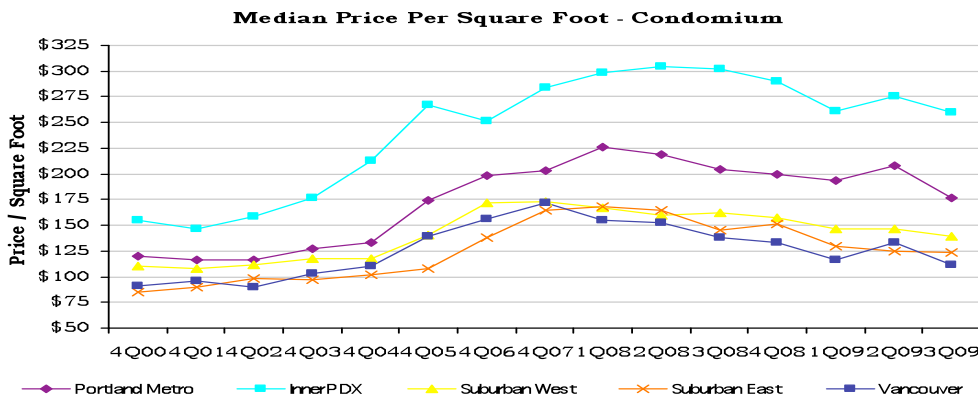


Condominium and Attached Market¹

The number of condominium sales in the Portland metropolitan market is up significantly from the previous quarter but is still down from 2008. Across the metropolitan area, the number of sales is up 38% for the quarter while the number of Vancouver sales increased 89%. The Portland metropolitan area’s price per square foot is at \$177, a decrease of 15% quarterly and 13% annually. The median price per Portland condominium unit is \$188,700 down 6% from the second quarter. Vancouver, at a price per square foot of \$111, is down 17% for the quarter and 20% for the year. Vancouver’s median price per condominium is up to \$126,950 a decrease of 18% for the quarter.

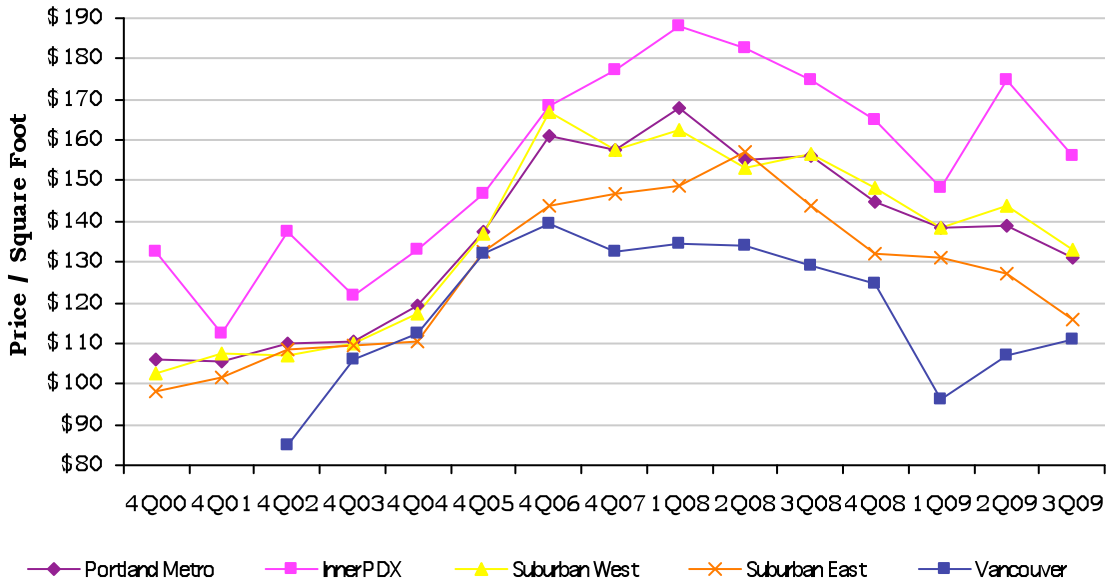


Results for single-family attached housing are up for the quarter as well as annually. The number of attached home sales in the Portland metropolitan area increased 37% from the second quarter to 398. The number of sales of attached homes is up 13% annually with a median price of \$195,000. The Vancouver area saw both quarterly (1%) and annual (24%) increases as the number of attached homes sold increased to 77. For Portland, price-per-square-foot numbers (\$131) are down 6% from the second quarter and 16% annually. Vancouver, at \$111 per square foot, saw a quarterly increase of 4% but an annual decrease of 14%. The median price for attached homes in Vancouver was \$169,900.

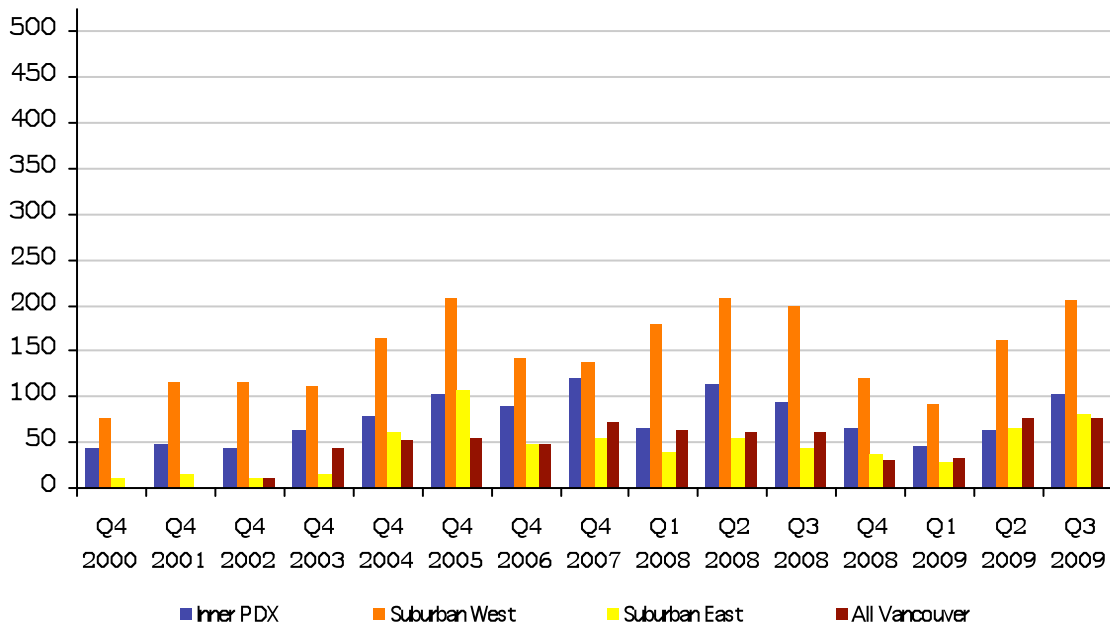


¹ RMLS defines attached as “an element of the residence construction is shared with another property. Condominiums are excluded. Condominiums are defined as an attached or stand-alone residence for which the owner has title to the space inside the unit and shares common spaces with other unit owners in accordance with specific legal guidelines.

Median Price Per Square Foot - Attached

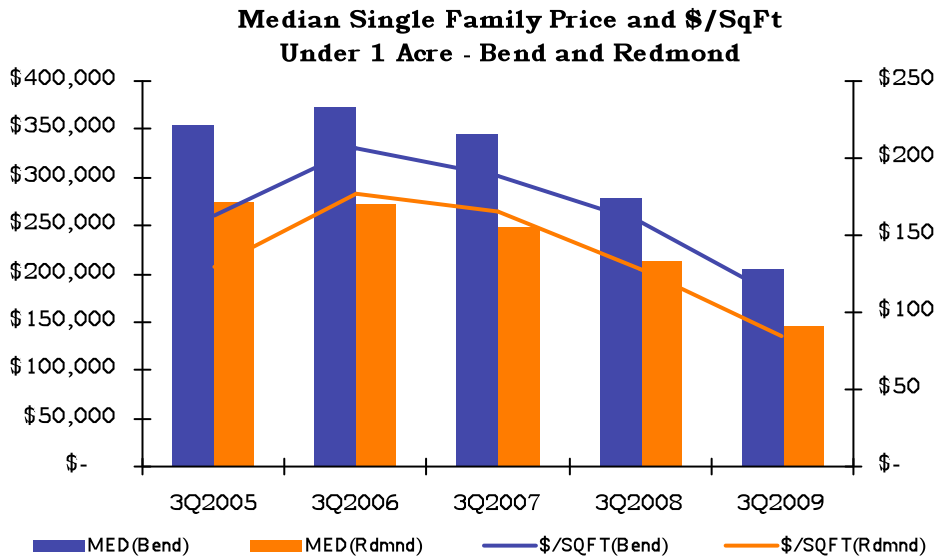
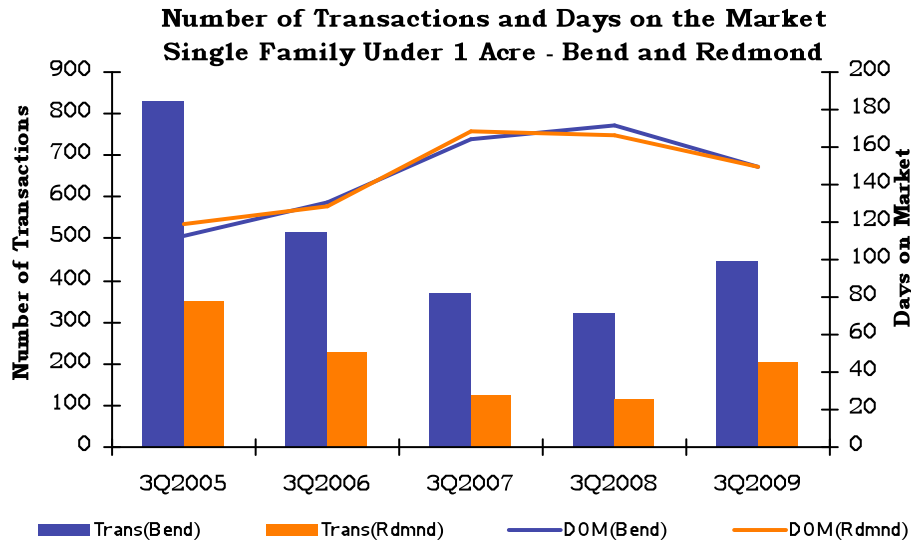


Number of Transactions - Attached Single Family



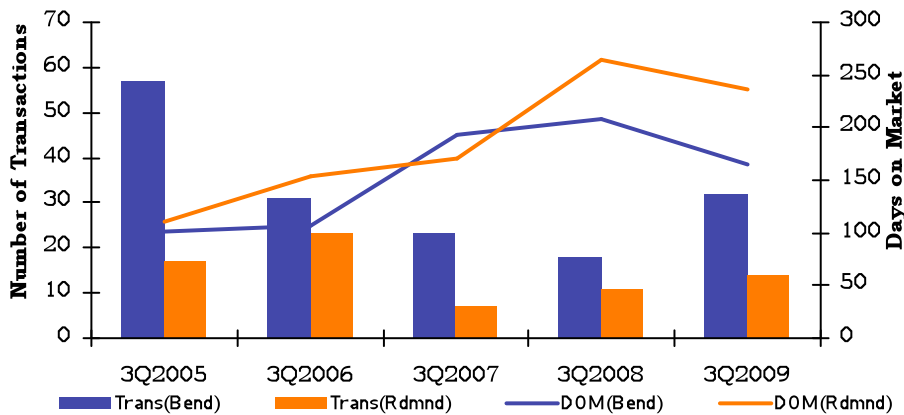
Central Oregon

Both Bend and Redmond experienced a slight increase from the previous year with respect to the number of homes sold. Bend home sales are up 37% to 443 while Redmond's increased 79% to 204. The number of days on the market declined to 149 for Bend and 149 for Redmond as well. However, the median home prices declined significantly for both Central Oregon submarkets. Bend home prices plummeted (-27%) to \$205,000 while Redmond prices slipped (-32%) to \$145,000. Price-per-square-foot numbers also declined significantly for Bend and Redmond at \$109 and \$85.

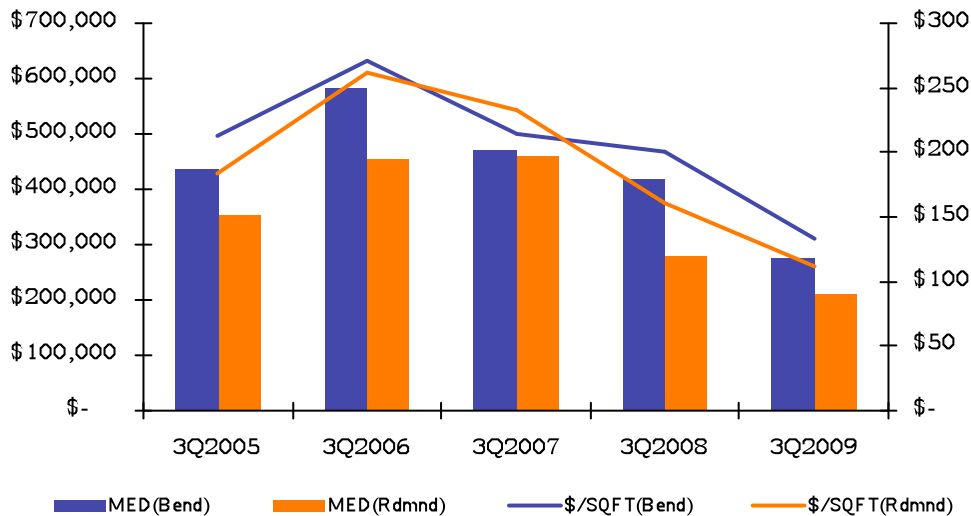


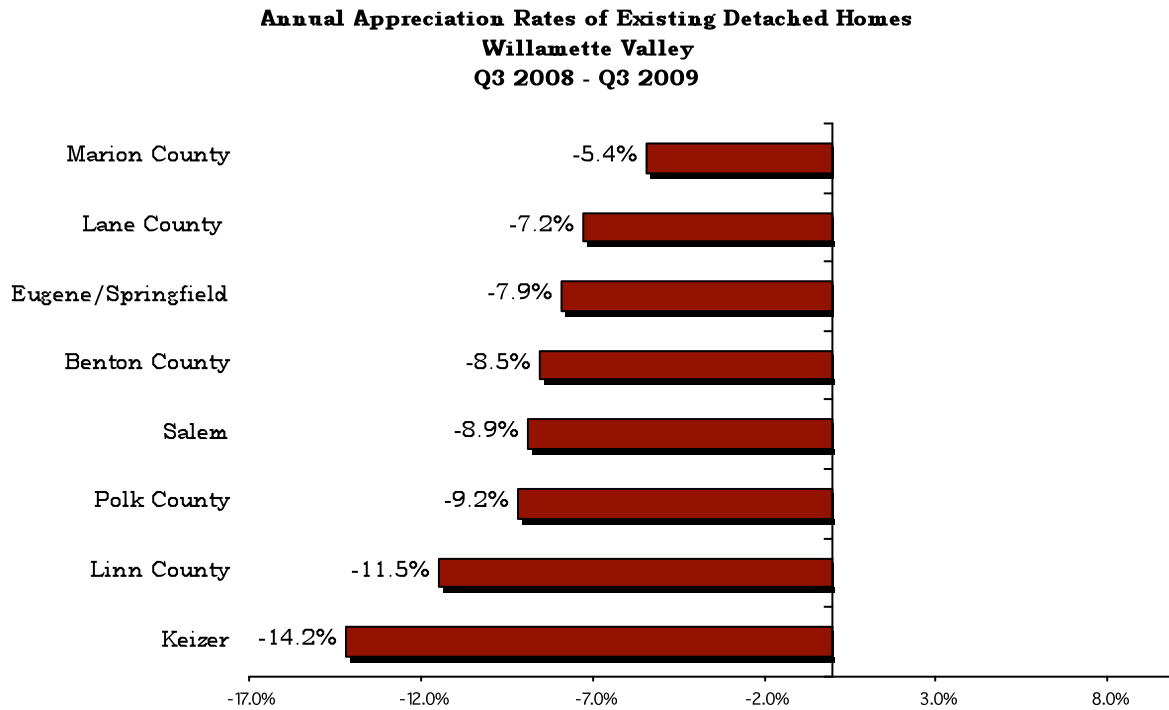
As it is commonly reported in Central Oregon’s reports, the housing stock is separated by lot size – properties under one acre and those between one and five acres. Price per square foot is provided to control for lot size between both categories. Third quarter statistics are mostly negative for Central Oregon homes on acreage. Bend transactions increased 78% from 2008 while Redmond experienced an increase of 27%. However, Bend home prices plummeted (-35%) to \$273,690 while Redmond prices slipped (-24%) to \$212,000. Price per square foot is down -34% to \$133 for Bend and -30% to \$112 for Redmond. The number of days on the market decreased for both areas as Bend is at 165 and Redmond is at 237.

**Number of Transactions and Days on the Market
Single Family 1-5 Acres -Bend and Redmond**



**Median Single Family Price and \$/SqFt
1-5 Acres - Bend and Redmond**



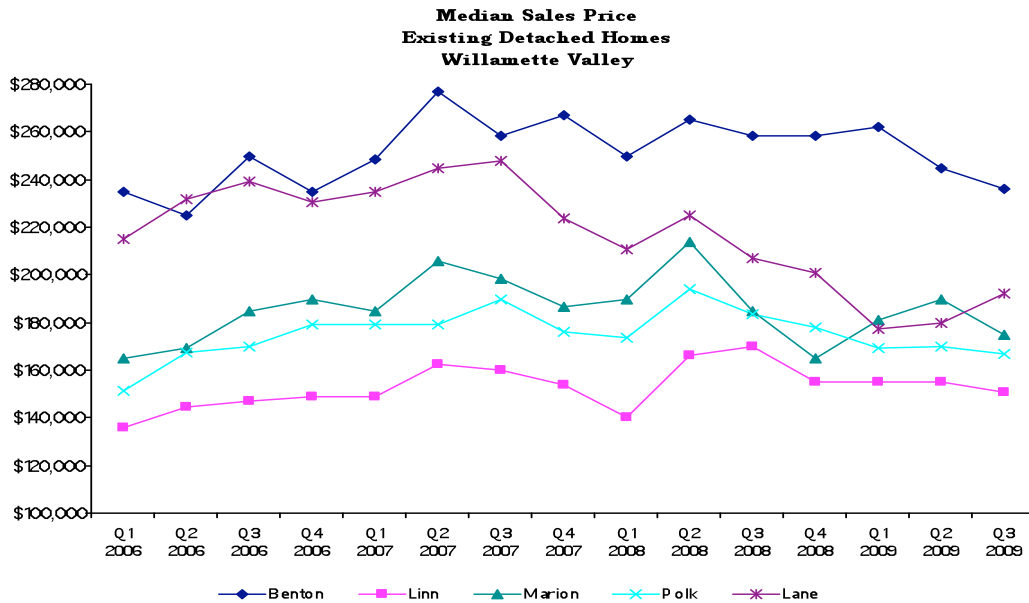
Willamette Valley


All Willamette Valley submarkets experienced annual depreciation on existing home prices.

Keizer suffered the worst quarter in the valley with declining prices of (-14.2%) followed closely by Linn County at (-11.5%).

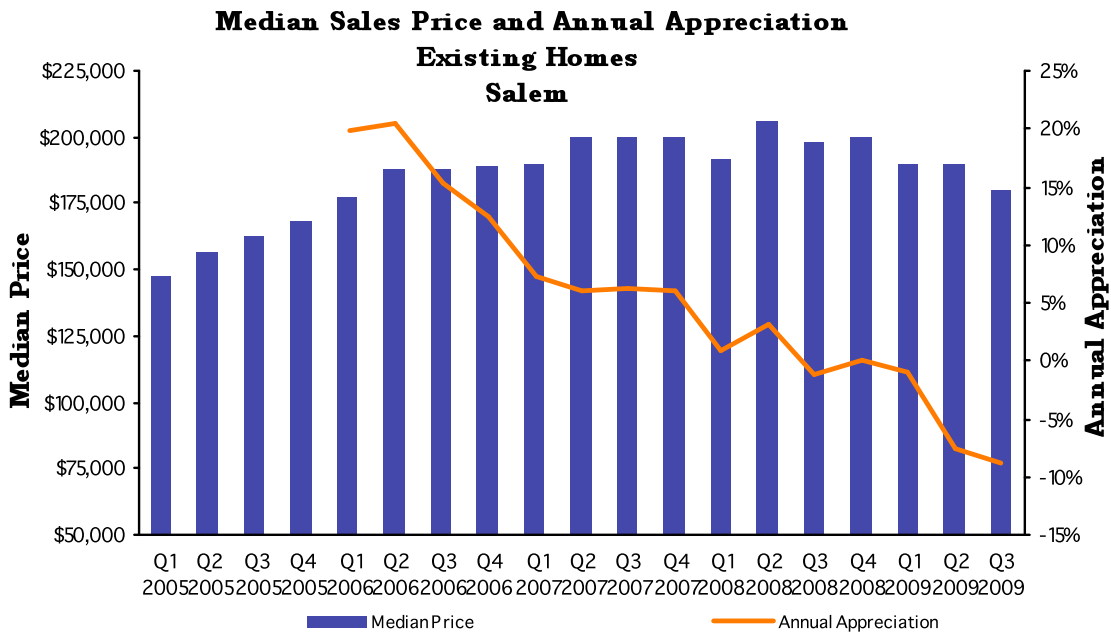
Marion County was the stronger submarket but still suffered a (-5.4%) depreciation rate. On a positive note, the number of transactions over the past year also increased for all of these areas with Benton County increasing the most (56%).

The number of days on the market decreased for all of these submarkets with the exception of Linn County.

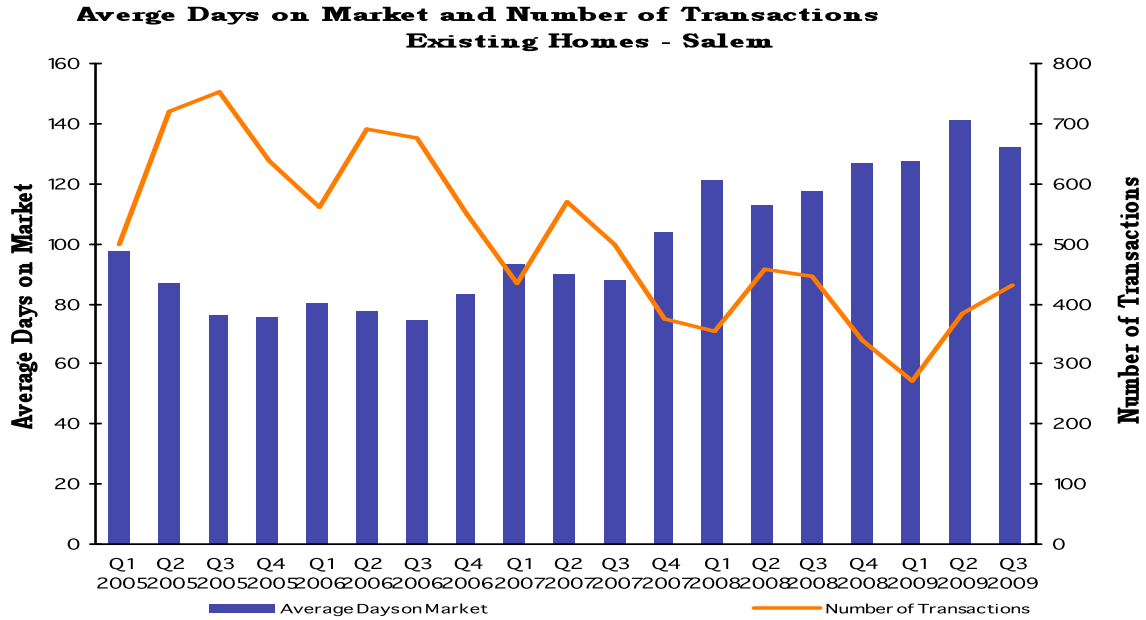


Salem

Salem’s housing market continues to suffer annual depreciation of home prices, fewer home transactions, and a greater number of days on the market. Prices declined (-9%) from the previous year to \$179,900. Meanwhile, the number of average days on the market increased to 132, approximately four and a half months. The number of transactions declined (-16%) from the previous year to 431.



Eugene/Springfield



The Eugene/Springfield area experienced declining home prices relative to the third quarter of 2008. However, the number of transactions rose 6% annually to 579. The median price was down 8% to \$215,000. Sellers currently have had their houses on the market for 79 days before closing and are realizing 92.67% of their original listing price on the sale.

