

Irrational Expectations

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The U.S. economy is clearly losing momentum. Real GDP is on pace to grow at a rate that is less than 2% for the first half of 2011, down from 2.9% in 2010. Part of the deceleration is due to temporary disruptions related to the disaster in Japan and costlier fuel and food, but not all of it. *(continued on page 2)*

Baseline Forecast:

	2010				2011				2012			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	2010	2011	2012	
US Economy												
Real GDP (a)	1.7	2.6	3.1	1.9	1.6	2.0	3.4	2.8	2.9	2.2	2.8	
Nonfarm Employment (b)	635	(73)	245	422	254	305	458	533	940*	1,439	2,100	
Office-using Employment (b)	77	31	122	148	53	64	96	112	307*	361	441	
Unemployment Rate	9.6	9.6	9.6	8.9	9.1	9.2	9.0	8.9	9.6	9.1	8.6	
Retail Sales (a)	6.3	3.7	12.5	10.5	1.0	5.5	9.0	4.3	6.4	6.5	5.0	
CPI Inflation (a)	(0.5)	1.4	2.6	5.2	4.3	2.0	1.9	2.2	1.7	3.3	2.6	
CCI	58	51	57	67	63	61	65	71	54	64	75	
Fed Funds Rate	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.6	
10-year Gov't Bond	3.5	2.8	2.9	3.5	3.2	3.3	3.6	3.8	3.2	3.4	3.9	
ISM Manufacturing Index	57.6	55.2	57.9	61.1	55.0	51.0	54.0	56.0	57.3	55.3	56.0	
West Texas Intermediate	78	76	85	94	106	101	100	101	79	100	98	
Office Sector												
Net Absorption (c)	6.0	6.8	9.7	7.5	6.7	7.7	13.8	15.0	18.9	35.7	44.0	
Vacancy	16.9%	16.9%	16.8%	16.5%	16.0%	15.9%	15.7%	15.5%	16.8%	16.0%	15.3%	
New Deliveries (c)	10.9	4.5	4.7	6.4	--	--	--	--	20.1	18.9	30.4	
Asking Rents	\$21.41	\$21.31	\$21.31	\$21.36	\$21.35	\$21.41	\$21.41	\$21.45	\$21.36	\$21.38	\$21.52	
Investment Sales (d)	\$8.9	\$10.2	\$19.4	\$9.7	\$14.2	\$8.8	\$15.1	\$13.0	\$42.6	\$47.8	\$62.0	
Industrial Sector												
Net Absorption (c)	7.0	1.7	11.4	24.7	14.0	9.1	6.7	9.6	(9.0)	54.5	72.0	
Vacancy	9.9%	9.8%	9.7%	9.5%	9.5%	9.5%	9.4%	9.4%	9.8%	9.5%	9.1%	
New Deliveries (c)	5.1	4.0	1.3	5.8	--	--	--	--	15.0	15.4	38.8	
Asking Rents	\$5.18	\$5.15	\$5.10	\$5.08	\$5.10	\$5.11	\$5.15	\$5.15	\$5.15	\$5.13	\$5.24	
Investment Sales (d)	\$3.2	\$4.1	\$7.4	\$2.7	\$4.0	\$2.7	\$6.4	\$6.5	\$17.0	\$15.8	\$24.1	
Retail Sector**												
Net Absorption (c)	(1.9)	0.6	0.4	0.7	0.9	1.3	1.8	1.5	(3.2)	4.7	8.2	
Vacancy	10.9%	10.9%	10.9%	10.9%	11.0%	11.1%	11.1%	11.2%	10.9%	11.0%	11.5%	
New Deliveries (c)	0.7	1.8	0.7	0.1	--	--	--	--	4.4	8.7	18.3	
Asking Rents	\$19.01	\$19.01	\$18.99	\$18.98	\$18.97	\$18.97	\$18.96	\$18.97	\$18.99	\$18.97	\$18.98	
Investment Sales (d)	\$2.7	\$5.9	\$7.2	\$5.6	\$6.8	\$4.0	\$4.3	\$5.3	\$19.9	\$20.7	\$24.0	
Apartment Sector**												
Net Absorption (e)	47.9	95.6	58.6	44.1	47.1	45.7	48.8	59.0	228.5	185.7	164.0	
Vacancy	7.8%	7.1%	6.6%	6.6%	5.8%	5.5%	5.1%	4.7%	6.6%	5.8%	4.3%	
New Deliveries (c)	30.9	24.1	13.1	6.0	--	--	--	--	96.1	41.5	88.7	
Asking Rents	\$1,032	\$1,037	\$1,043	\$1,047	\$1,053	\$1,068	\$1,080	\$1,090	\$1,043	\$1,062	\$1,120	
Investment Sales (d)	\$5.4	\$9.3	\$12.0	\$7.6	\$8.9	\$9.2	\$11.8	\$12.0	\$31.4	\$37.5	\$48.0	

(a) - Annualized Growth Rate, Quarter-over-Quarter
(b) - Thousands, SA, Quarterly Chg.

(c) - Millions square feet
(d) - Quarterly Sum, Billions

(e) -Thousands
*December 2010 over Dec 2009

**Reis & RCA Historical data; Cassidy Turley Forecasts

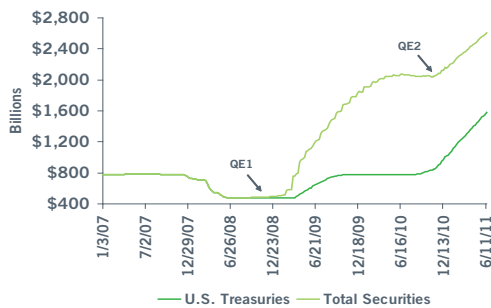
The recent slowdown also reflects the challenges that often come with a balance-sheet recovery. For the past several months, the massive amount of unpaid debt (both public and private) has been overshadowed by the last round of quantitative easing (QE2) and the tailwinds of several rounds of fiscal stimulus. The government aid drove stock values to soaring levels and helped generate healthier GDP, but it also created irrational expectations as to how this recovery would evolve. Now that the government support is fading, the unresolved problems are rising to the surface. Among them are the over 1.7 million homes still in foreclosure, nearly \$500 billion of distressed real estate assets (\$300B residential, \$184B commercial) that need to be addressed, and a severe lack of confidence that this recovery is sustainable.

Nevertheless, the U.S. economy is on much stronger footing than it was a year ago. Indeed, there are still many encouraging signs that suggest the recovery for the economy, and for the property markets, will continue. Most notably, oil prices have begun to fall, exports remain robust, equity markets and CMBS markets have rallied, banks are flush with cash and businesses remain extremely profitable. Still, until the debt-overhang works its way out of the system, the U.S. economy will continue to grow in fits and starts, but assuming nothing else goes wrong, it will not retrench. Likewise, the property markets will lose some of the pep they displayed over the last 12 months, but the trajectory will generally remain positive.

Living Without Quantitative Easing

Unlike last November 2010, when the Fed decided to move forward with QE2 – printing money to buy government securities - the U.S. economy is currently in a much stronger position to continue expanding on its own. Since QE2 was implemented on November 10th of last year, the U.S. economy has added 1.2 million jobs (500,000 of them office-using), has transformed from a deflationary scenario to a tame inflationary scenario, and has seen business exports rebound to pre-recession levels. Moreover, had it not been for the temporary disruptions that occurred in the first part of the year, there would likely be no discussion of a possible double-dip recession. The tsunami in Japan clearly sent shocks to supply chains around the world, causing industrial production for motor vehicles to fall sharply, particularly in April. The turmoil in the Middle East and North Africa caused gasoline prices to rise from \$2.75 per gallon in May of 2010 to \$3.90 one year later. Every \$1 increase in gasoline prices causes U.S. consumers to spend an extra \$134 billion on fuel, and over 50% of that revenue goes to overseas producers rather than into U.S. coffers (to, for instance, help pay down the federal deficit). The good news: gasoline prices have fallen 30 cents per gallon since mid-May.

QE2 Coming to an End



Source: Federal Reserve Balance Sheet

U.S. Economy in a Stronger Position to Grow

	Before QE2*	After QE2**
Employment (mil.)	129.8	131.0
Office Employment (mil.)	27.0	27.5
DJIA	10,159	12,579
CPI Inflation (AR%)	-2.5%	2.0%
Exports (bil.)	\$196	\$219
10-Yr Treasury Yield	2.5%	3.0%

*Low Point Pre-QE2 Summer/Fall 2010

**Most Recent Monthly Data Point

Source: Federal Reserve Board

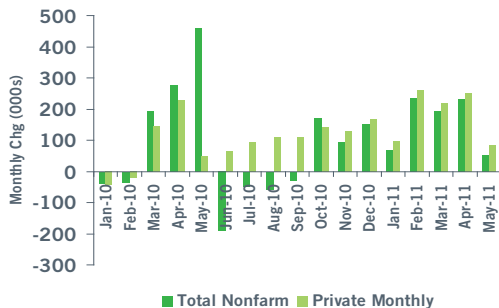
Still, it will take something big to speed up the current trajectory in the economy. Fortunately, something big might be in the works. All of the technology surrounding social media/mobile technology (e.g., video-servicing, internet calling, entertainment apps, and data science) provides tangible signs that a major economic engine might be forming. Numerous businesses, such as Google, LinkedIn, Twitter, YouTube, Apple, Zynga as well as many start-ups, are already putting in large requirements for additional office space, particularly in California markets. Office rents in Silicon Valley and San Francisco are soaring. It is too early to gauge how much net demand this area of the technology sector will ultimately generate, but some believe it is in embryonic stages of the next major boom.

Labor Markets Slowing

For commercial real estate, the most worrisome trends are those reflected in the latest labor market data. The economy produced just 54,000 new non-farm payroll jobs in May. Job creation had been growing at an average of 160,000 new jobs per month since October of 2010. Moreover, trends in jobless claims data suggest the employment situation will remain weak. The number of unemployment insurance claims has been hovering around 420,000 in both May and June. Typically, when jobless claims are between 400,000 and 450,000, the U.S. economy is creating less than 50,000 total nonfarm jobs per month.

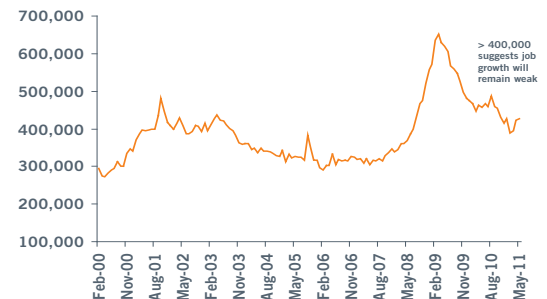
Businesses are proving to be impressively profitable with fewer people on the payroll. Yes, real GDP is now back to pre-recession levels, but the economy is producing that level of output with 7 million fewer people on payrolls. Longer-term, there are signs that hiring will accelerate. Worker output per hour is declining, suggesting that businesses are nearing a tipping point where they will soon need to add to payrolls to keep pace with growing demand. In addition, businesses and banks are flush with cash, and corporate profits have never been higher. As businesses become less skittish about the recovery, they will soon need to reinvest more aggressively to grow profit margins, and hiring productive people will increase profits. Given the recent economic slowdown, U.S. job growth will disappoint in 2011, with less than 100,000 new jobs being created per month for the remainder of the year (June-Dec). By 2012, the relationship between strong corporate profits and employment will finally translate into stronger job creation. The U.S. economy will add 175,000 jobs per month in 2012. To be clear, this pace of hiring will be healthier, but not robust, and unemployment will remain above 8.5%.

Labor Markets Losing Momentum



Source: BLS

Jobless Claims Remain Elevated



Source: BLS

Property Markets

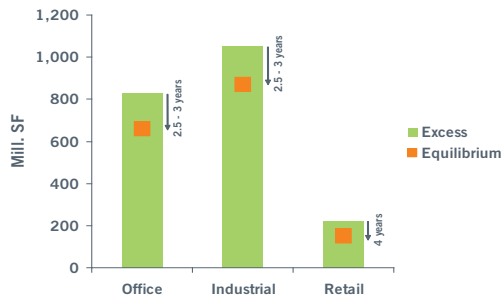
Commercial real estate hit bottom in the first quarter of 2010 and has been steadily improving ever since. Demand metrics for office, apartment, and industrial have all registered several quarters of increased occupancy. The retail sector is lagging, but Class A centers are now seeing stronger demand across nearly all markets. The multifamily sector is the clear stand-out. Vacancy in apartment buildings is now back to pre-recession levels, and in many markets vacancy is at its lowest level in a decade.

The flight to quality continues. In all areas of leasing and investment sales, and in all markets, Class A space is outperforming Class B by a wide margin. Owners of Class A assets have been largely surprised by the quick demand/rent/price turnaround; owners of lower quality assets are wondering if the recovery will ever help their *proformas*. The spread in rents between Class A and Class B space is at an all-time high.

Outside of the apartment sector, there is still a large overhang of empty space. The office sector has an excess supply of 158 million square feet (msf), the industrial sector has an excess supply of 132 msf, and the retail sector has an excess supply of 69 msf. Based

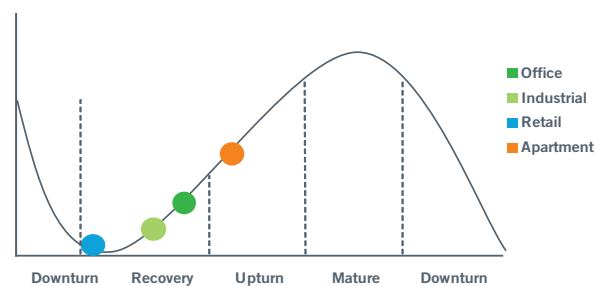
on historical levels of demand, these sectors are 2-3 years away from full recovery, with retail lagging behind the other two product types. Given the numerous space options, U.S. rents will generally remain flat at least through 2012. Even under an optimistic scenario, rent growth in 2012 will fall well below the historical annual average rate of 3%.

Excess Supply



Source: Cassidy Turley

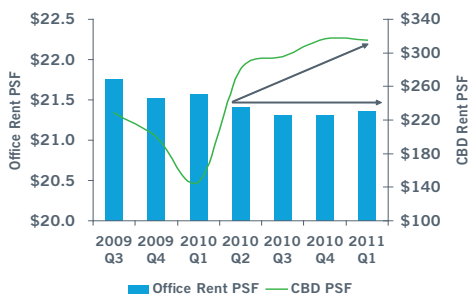
U.S. Property Market Cycle



Source: Cassidy Turley

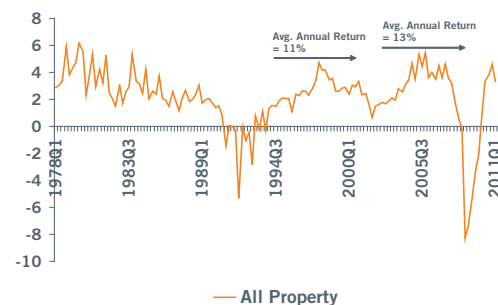
The investment sales market remains robust, but there is a growing disconnect between transaction level pricing and leasing fundamentals. For example, average price per square foot for office sales in 2011 (to date) has risen 21% since 2009. Meanwhile, vacancy has increased 200 basis points over that same period and rents have fallen 5%. The gap between fundamentals and pricing is even wider for prime product in top tier markets. For instance, rent growth remains soft in markets such as New York City and Washington D.C., but that has not stopped sales prices -- as measured by price per square foot -- from blowing past replacement costs. Investors continue to place a premium on stabilized assets in quality markets, but there are also signs that demand is spreading to this same product in secondary and tertiary markets. Although leasing still has a ways to go, the sharp rise in values indicates that investors are confident that fundamentals will continue to improve, rents will rise, and future cash flows will provide solid, if not attractive returns. If history is any guide, this strategy has worked well before. Investors who bought in the immediate years following the 1990 and 2001 recessions, and sold 5-7 years later, made unleveraged average annual returns of 11% and 13%, respectively.

Disconnect Between Values & Fundamentals



Source: Real Capital Analytics

NCREIF Property Index Returns



Source: Moody's, Cassidy Turley

Expect a slow recovery

The safe bet is that the property market recovery will slow for the remainder of 2011, but will re-accelerate in 2012. Real GDP will generally remain below potential for the next 18 months, and net job growth will disappoint. Nevertheless, the gains in employment that we do get will be enough to keep vacancy eroding across most product types. Unemployment will remain elevated, sticking very close to 9% through most of 2012.

Again, it will take something big to change the current economic trajectory. Maybe the spark will come from the re-emerging technology sector, maybe it will come from something else. It is hard to forecast when that next big thing will surface and propel economic growth to a higher path, but in the U.S., it always does...eventually.

Optimistic Scenario:

	2010				2011				2012			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	2010	2011	2012	
US Economy												
Real GDP (a)	1.7	2.6	3.1	1.9	2.4	4.1	4.5	4.2	2.9	3.0	4.0	
Nonfarm Employment (b)	635	(73)	245	422	421	505	580	700	940*	1,928	2,500	
Office-using Employment (b)	77	31	122	148	88.4	106	122	147	307*	464	525	
Unemployment Rate	9.6	9.6	9.6	8.9	9.0	9.0	8.8	8.7	9.6	8.9	8.4	
Retail Sales (a)	6.3	3.7	12.5	10.5	1.0	7.2	9.2	5.5	6.4	7.0	6.8	
CPI Inflation (a)	(0.5)	1.4	2.6	5.2	4.3	2.0	2.4	2.6	1.7	3.5	3.3	
CCI	58.2	50.9	57.1	66.9	67.0	70.0	71.0	73.0	54.5	69.0	80.0	
Fed Funds Rate	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.7	
10-year Gov't Bond	3.5	2.8	2.9	3.5	3.2	3.5	3.8	4.1	3.2	3.6	4.3	
ISM Manufacturing Index	57.6	55.2	57.9	61.13	55.0	57.0	59.0	60.0	57.3	58.0	59.0	
West Texas Intermediate	78	76	85	94	106	102	102	104	79	101	104	
Office Sector												
Net Absorption (c)	6.0	6.8	9.7	7.5	10.6	13.5	15.6	17.4	18.9	47.2	62.0	
Vacancy	16.9%	16.9%	16.8%	16.5%	15.9%	15.7%	15.4%	15.2%	16.8%	15.9%	14.7%	
New Deliveries (c)	10.9	4.5	4.7	6.4	--	--	--	--	20.1	20.9	30.4	
Asking Rents	\$21.41	\$21.31	\$21.31	\$21.36	\$21.37	\$21.41	\$21.50	\$21.55	\$21.36	\$21.41	\$21.70	
Investment Sales (d)	\$8.9	\$10.2	\$19.4	\$9.7	\$15.5	\$16.0	\$18.0	\$11.8	\$42.6	\$59.2	\$75.0	
Industrial Sector												
Net Absorption (c)	7.0	1.7	11.4	24.7	16.2	14.0	18.0	17.9	(9.0)	72.9	73.0	
Vacancy	9.9%	9.8%	9.7%	9.5%	9.5%	9.4%	9.3%	9.2%	9.8%	9.4%	8.9%	
New Deliveries (c)	5.1	4.0	1.3	5.8	--	--	--	--	15.0	15.4	38.8	
Asking Rents	\$5.18	\$5.15	\$5.10	\$5.08	\$5.11	\$5.13	\$5.20	\$5.22	\$5.15	\$5.13	\$5.26	
Investment Sales (d)	\$3.2	\$4.1	\$7.4	\$2.7	\$4.5	\$4.8	\$6.5	\$8.5	\$17.0	\$18.5	\$32.0	
Retail Sector**												
Net Absorption (c)	(1.9)	0.6	0.4	0.7	1.5	2.1	2.0	2.1	(3.2)	6.3	11.6	
Vacancy	10.9%	10.9%	10.9%	10.9%	11.0%	11.1%	11.1%	11.2%	10.9%	11.1%	11.3%	
New Deliveries (c)	0.7	1.8	0.7	0.1	--	--	--	--	4.4	8.7	18.3	
Asking Rents	\$19.01	\$19.01	\$18.99	\$18.98	\$18.99	\$19.05	\$19.07	\$19.10	\$18.99	\$19.02	\$19.15	
Investment Sales (d)	\$2.7	\$5.9	\$7.2	\$5.6	\$7.0	\$8.0	\$8.4	\$11.0	\$19.9	\$29.0	\$45.0	
Apartment Sector**												
Net Absorption (e)	47.9	95.6	58.6	44.1	49.2	50.1	51.0	54.0	228.5	194.4	175.0	
Vacancy	7.8%	7.1%	6.6%	6.6%	5.8%	5.4%	5.0%	4.7%	6.6%	5.7%	4.1%	
New Deliveries (c)	30.9	24.1	13.1	6.0	--	--	--	--	96.1	41.5	88.7	
Asking Rents	\$1,032	\$1,037	\$1,043	\$1,047	\$1,063	\$1,080	\$1,088	\$1,095	\$1,043	\$1,070	\$1,130	
Investment Sales (d)	\$5.4	\$9.3	\$12.0	\$7.6	\$9.5	\$9.8	\$11.0	\$11.4	\$31.4	\$37.9	\$51.0	

(a) - Annualized Growth Rate, Quarter-over-Quarter
(b) - Thousands, SA, Quarterly Chg.

(c) - Millions square feet
(d) - Quarterly Sum, Billions

(e) -Thousands
*December 2010 over Dec 2009

**Reis & RCA Historical data; Cassidy Turley Forecasts

Pessimistic Scenario:

	2010				2011				2012			
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US Economy												
Real GDP (a)	1.7	2.6	3.1	1.9	0.9	1.1	1.5	2.0	2.9	1.4	2.2	
Nonfarm Employment (b)	635	(73)	245	422	154	200	354	405	940*	1,130	1,418	
Office-using Employment (b)	77	31	122	148	32	42	74	85	307*	296	298	
Unemployment Rate	9.6	9.6	9.6	8.9	9.1	9.3	9.2	9.2	9.6	9.1	9.0	
Retail Sales (a)	6.3	3.7	12.5	10.5	1.0	3.0	2.8	4.0	6.4	4.3	4.1	
CPI Inflation (a)	(0.5)	1.4	2.6	5.2	4.3	1.4	1.5	1.6	1.7	3.1	1.9	
CCI	58.2	50.9	57.1	66.9	63.4	59.0	60.0	61	54.5	62	65.0	
Fed Funds Rate	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
10-year Gov't Bond	3.5	2.8	2.9	3.5	3.2	3.1	2.9	2.9	3.2	3.2	3.3	
ISM Manufacturing Index	57.6	55.2	57.9	61.1	55.0	52.0	49.0	51.0	57.3	54.3	53.0	
West Texas Intermediate	78	76	85	94	103	99	94	95	79	98	95	
Office Sector												
Net Absorption (c)	6.0	6.8	9.7	7.5	2.4	4.1	6.4	10.8	18.9	20.4	25.8	
Vacancy	16.9%	16.9%	16.8%	16.5%	16.1%	16.0%	15.9%	15.9%	16.8%	16.1%	15.1%	
New Deliveries (c)	10.9	4.5	4.7	6.4	--	--	--	--	20.1	20.9	30.4	
Asking Rents	\$21.41	\$21.31	\$21.31	\$21.36	\$21.34	\$21.34	\$21.35	\$21.36	\$21.36	\$21.35	\$21.40	
Investment Sales (d)	\$8.9	\$10.2	\$19.4	\$9.7	\$10.0	\$7.5	\$9.7	\$8.5	\$42.6	\$36.9	\$41.3	
Industrial Sector												
Net Absorption (c)	7.0	1.7	11.4	24.7	5.1	1.3	-2.2	0.5	(9.0)	28.9	24.0	
Vacancy	9.9%	9.8%	9.7%	9.5%	9.6%	9.6%	9.7%	9.8%	9.8%	9.6%	9.8%	
New Deliveries (c)	5.1	4.0	1.3	5.8	--	--	--	--	15.0	15.4	38.8	
Asking Rents	\$5.18	\$5.15	\$5.10	\$5.08	\$5.08	\$5.08	\$5.07	\$5.08	\$5.15	\$5.08	\$5.11	
Investment Sales (d)	\$3.2	\$4.1	\$7.4	\$2.7	\$2.7	\$2.0	\$6.0	\$3.5	\$17.0	\$13.4	\$15.8	
Retail Sector**												
Net Absorption (c)	(1.9)	0.6	0.4	0.7	0.5	0.8	1.0	1.3	(3.2)	3.0	4.4	
Vacancy	10.9%	10.9%	10.9%	10.9%	11.0%	11.1%	11.2%	11.3%	10.9%	11.2%	11.8%	
New Deliveries (c)	0.7	1.8	0.7	0.1	--	--	--	--	4.4	8.7	18.3	
Asking Rents	\$19.01	\$19.01	\$18.99	\$18.98	\$18.96	\$18.96	\$18.95	\$18.94	\$18.99	\$18.96	\$18.96	
Investment Sales (d)	\$2.7	\$5.9	\$7.2	\$5.6	\$4.8	\$2.5	\$4.0	\$4.5	\$19.9	\$16.9	\$17.5	
Apartment Sector**												
Net Absorption (e)	47.9	95.6	58.6	44.1	32.0	24.0	28.5	34.6	228.5	128.6	114.0	
Vacancy	7.8%	7.1%	6.6%	6.6%	6.0%	5.9%	5.7%	5.5%	6.6%	6.0%	5.4%	
New Deliveries (c)	30.9	24.1	13.1	6.0	--	--	--	--	96.1	41.5	88.7	
Asking Rents	\$1,032	\$1,037	\$1,043	\$1,047	\$1,049	\$1,059	\$1,073	\$1,080	\$1,043	\$1,057	\$1,090	
Investment Sales (d)	\$5.4	\$9.3	\$12.0	\$7.6	\$7.5	\$7.5	\$9.0	\$7.3	\$31.4	\$31.6	\$34.0	

(a) - Annualized Growth Rate, Quarter-over-Quarter
(b) - Thousands, SA, Quarterly Chg.

(c) - Millions square feet
(d) - Quarterly Sum, Billions

(e) -Thousands
*December 2010 over Dec 2009

**Reis & RCA Historical data; Cassidy Turley Forecasts

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