



THE LINNEMAN LETTER

Volume 10, Issue 2

Summer 2010

For Real Estate, It Is All About The Economy

With the supply of new space at a virtual standstill in every market and for every property type, real estate's near-term future is all about the strength and timing of the economic recovery. It is now clear that the recession ended around July 2009. The final scorecard brands the recent panic-induced super recession as "the worst" recession of the last 40 years, narrowly edging out the super recessions of 1973-1975 and 1980-1982.

The good news is that all 15 metrics in our analysis reached bottom, primarily in 2009, and have started

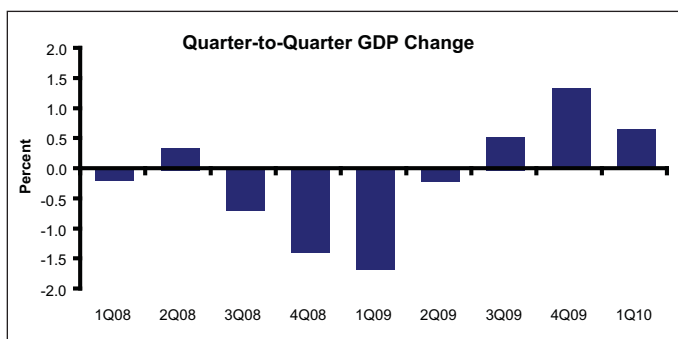


figure 1

U.S. Super-Recessions Over the Past 40 Years

	Nov 1973- Mar 1975	Jan 1980- Nov 1982	Dec 2007- May 2010
Duration in Months	17	35	30
Change in GDP (%)	-3.5%	-2.8%	-3.7%
Change in Payroll Employment (%)	-1.6%	-2.2%	-6.2%
Change in Real Household Net Worth (%)	-10.0%	0.0%	-25.7%
Change in Auto Sales (%)	-30.4%	-36.7%	-40.1%
Change in Industrial Output (%)	-15.0%	-10.3%	-16.9%
Change in Real Sales by Retail Stores (%)	-9.5%	-11.6%	-12.4%
Change in Construction Contracts for C&I Buildings (%)	-52.2%	-50.5%	-78.2%
Percent Real Return in S&P 500	-39.9%	-25.0%	-46.8%
Change in Real Median Home Price (%)	-4.0%	-14.0%	-15.3%
Change in Real After Tax Profit (%)	-30.4%	-24.1%	-22.9%
Lowest Consumer Confidence Level (Monthly)	57.6	51.7	55.3
Change in Housing Starts	-30.5%	-44.4%	-55.3%
Highest Inflation Rate (Monthly)	12.2%	14.6%	5.4%
Highest Unemployment Rate (Monthly)	8.6%	10.8%	10.1%

figure 2

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“Worst Ever” U.S. Recession

	Dec 2007 - May 2010		
	Worst Point		Current
	Period	Level	
Duration in Months	current	30	30
GDP (Real \$ billions)	Apr-09	\$12,888	\$13,217
Payroll Employment (thousands)	Feb-10	129,641	130,570
Real Household Net Worth (Real \$ billions)	1Q09	\$48,522	\$54,176
Auto Sales (vehicles)	Feb-09	387,800	464,800
Industrial Output Index	Jun-09	94.4	101.4
Real Sales by Retail Stores (Real \$ millions)	Dec-08	\$291,380	\$311,577
Construction Contracts for C&I Buildings (SF millions)	Nov-09	21	23
S&P 500 Index	Feb-09	735	1,042
Real Median Home Price (Real \$)	Apr-10	\$198,400	\$198,400
Real After Tax Profit (Real \$ billions)	4Q09	\$900	\$1,129
Consumer Confidence Level	Nov-08	55.3	67.4
Housing Starts	Jan-09	360,000	593,000
Inflation Rate	Sep-09	5.4%	2.2%
Highest Unemployment Rate	Oct-09	10.1%	9.7%

figure 3

to regain ground. It should be noted that in figure 3, it appears that the April median home price is the lowest point of the recession. However, we believe that the true home price trough (based on Census data) occurred in March 2009 (-10.4% from December 2007), because home prices grew steadily over the next 11 months through March 2010. The April 2010 reading is merely a reflection of builders re-entering the market, but with smaller, lower-cost homes. Gone are the days of the super-sized McMansions (at least for now).

Real GDP has grown by 2.6% since the second quarter of 2009, and is only 1.3% off of the second-quarter 2008 peak. In fact, by the end of July 2010, real GDP will be at its previous peak. Most importantly, a robust job recovery is underway, with 982,000 jobs added from the December 2009 low point through May 2010. And while the private sector only added 41,000 jobs in May, this was due to the fact

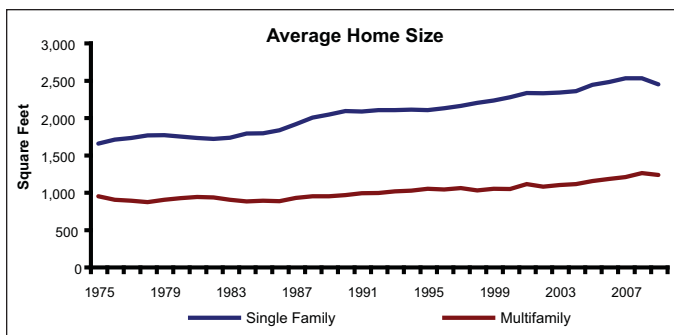


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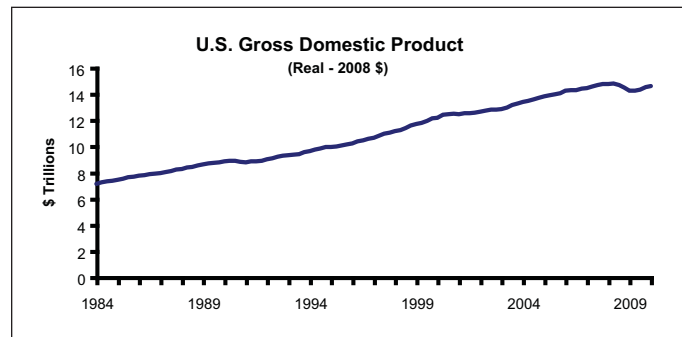


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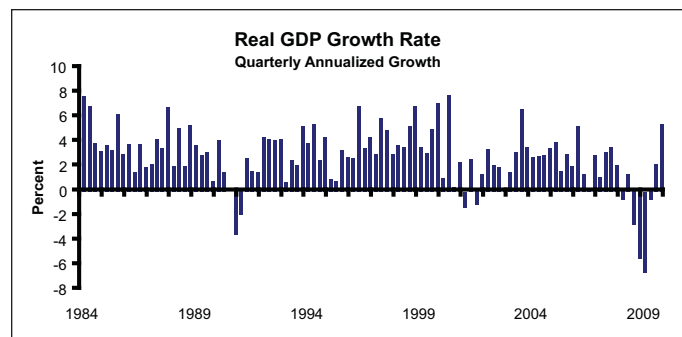


figure 6

that Census hiring “crowded out” some 200,000-300,000 private hires. After all, what marginal worker chooses a private sector job at \$12 per hour when the Census offers \$18-20 per hour for less demanding work? The result is that the U.S. economy has already added back nearly 1 million of the 8.36 million jobs shed during the recession.

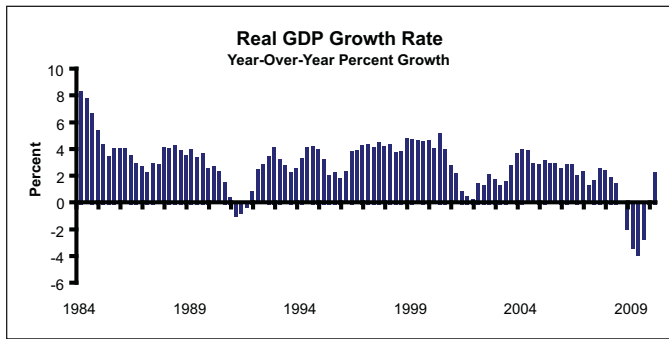


figure 7

Real GDP (2008 \$) was nearly \$14.8 trillion in the second quarter of 2008, falling by a total of 3.8% (\$566 billion) over the next 12 months. However, over the last three quarters, real GDP has rebounded to \$14.6 trillion. In other words, about the same GDP is being produced by about 7.4 million fewer workers, representing a 5.5% productivity increase in 18 months. Remember that the U.S. population has grown 1.5% over that time period, so on a per capita basis, real GDP is worse by about 2-3%. And not only is per capita GDP lower, but it has become more unevenly spread. In particular, many lower-skilled employees and certain geographic areas and industries have been hit much harder than others. Of course, the one sector that has largely been immune to any pain is government employment, particularly at the federal government. In that politically sacred sector, few were laid off and everyone received pay increases. In fact, while the taxpayers suffered, government employees fattened up during the Great Recession.

Global real GDP continues its strong rebound, fueled by positive first-quarter annualized growth in China (11.9%), India (8.6%), Canada (6.0%), Japan (4.8%), Italy (2.0%), Germany (0.8%), and France (0.4%). Notable exceptions include Chile (-6.0%), Greece (-3.2%), and Mexico (-1.2%).

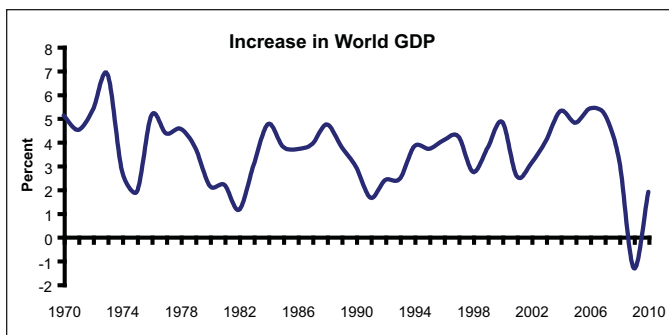


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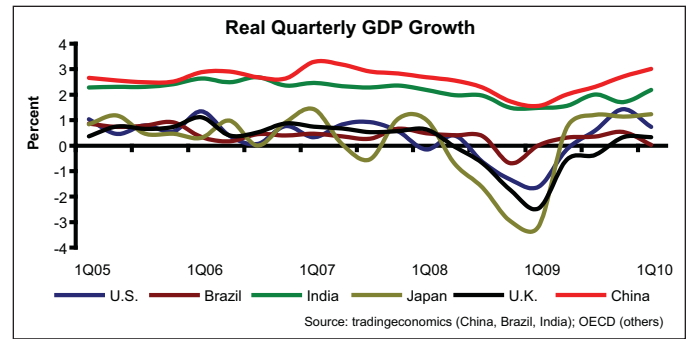


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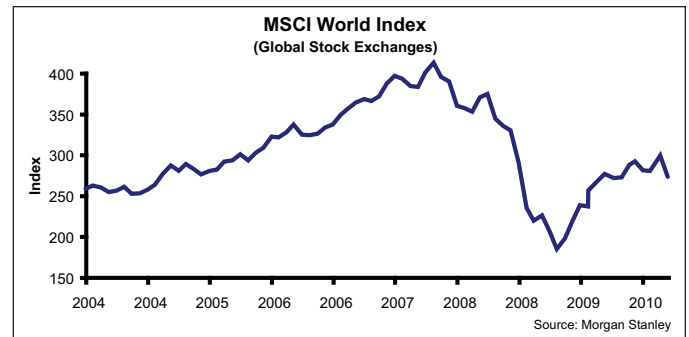


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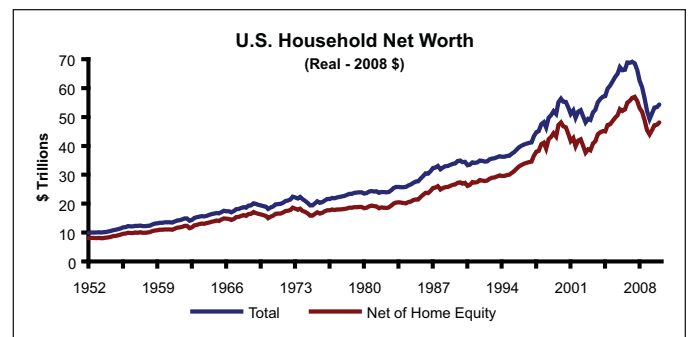


figure 11

Real U.S. household wealth, which bottomed in the first quarter of 2009 at \$51.8 trillion (2008 \$), has since climbed \$2.2 trillion (4.3%) through the first quarter of 2010, a year-over-year growth rate of 10.4%. Real tangible assets, including real estate and consumer durables, declined by \$605 billion (2.7%) over the last year, and by \$6 billion (0.3%) in the first quarter, while financial assets (including deposits, credit market instruments, and equities) increased by \$5.5 trillion (13.8%) year-over-year and \$1.03 billion (2.3%) quarter-over-quarter.

Total durable goods orders in April 2010 represent a 21% increase, compared to the March 2009 low. Monthly automobile and light truck sales, which hit a low of 761,900 vehicles in February 2009, then rose to nearly 1.8 million

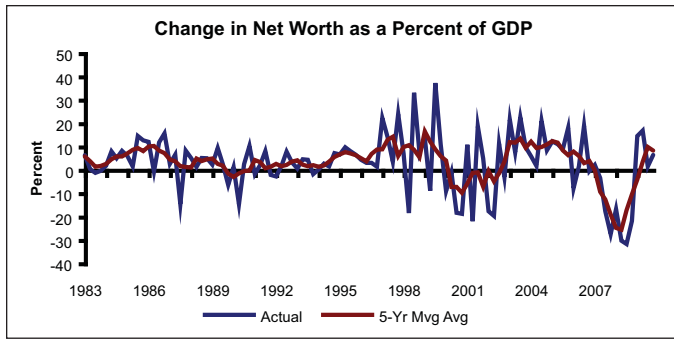


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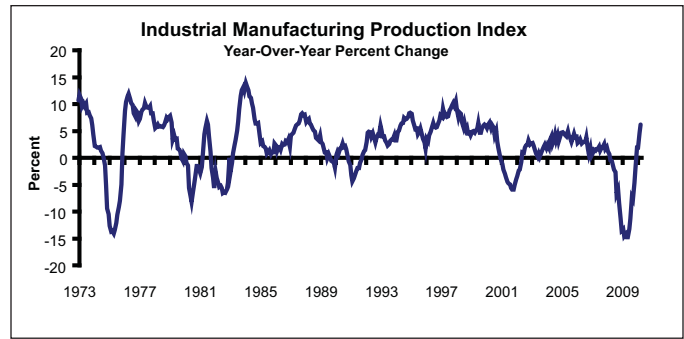


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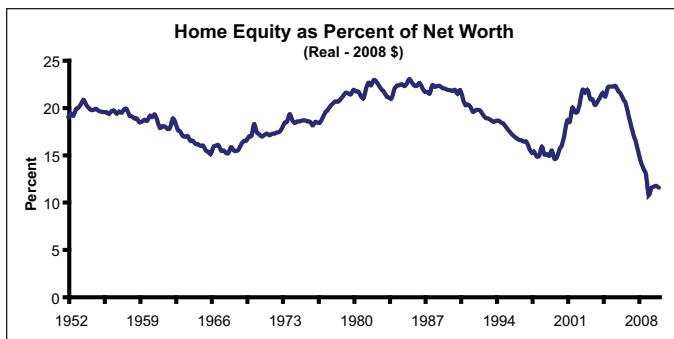


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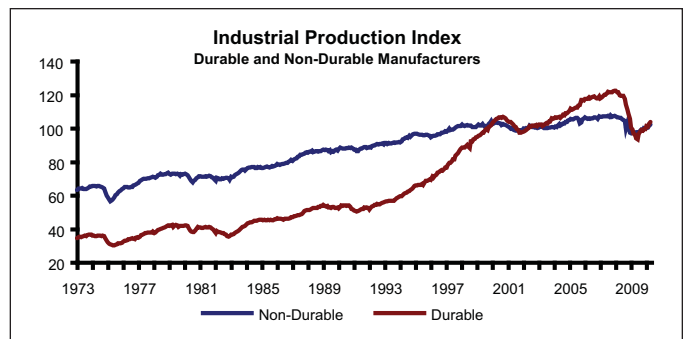


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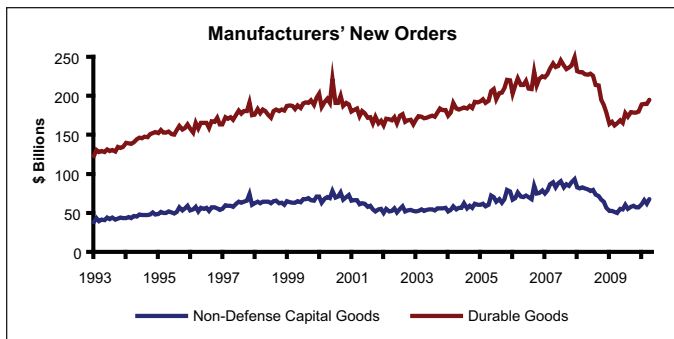


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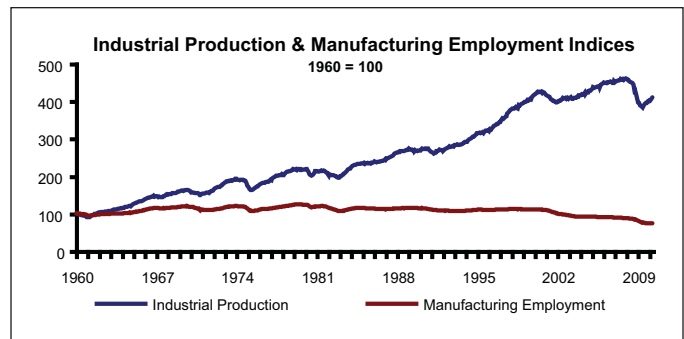


figure 17

vehicles in August 2009 (due in part to the Cash-for-Clunkers program), and stood at 967,900 in May 2010.

During the recession, manufacturing declined dramatically, with durable goods production down by as much as 23.8% (December 2007 to June 2009), and non-durables down 9.7% (December 2007 to January 2009). These declines in manufacturing production have reversed course, with the durable goods production index rising from the low of 92.9 in June 2009, to 103.4 as of April 2010, leaving it 15% off of the peak. Non-durables have risen by 5.4% since January 2009 and are off the previous peak by 5% as of April 2010.

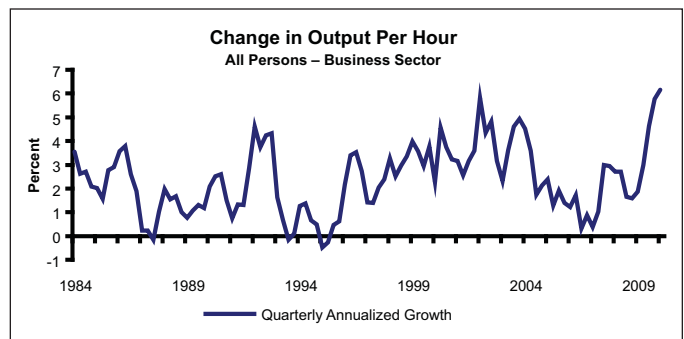


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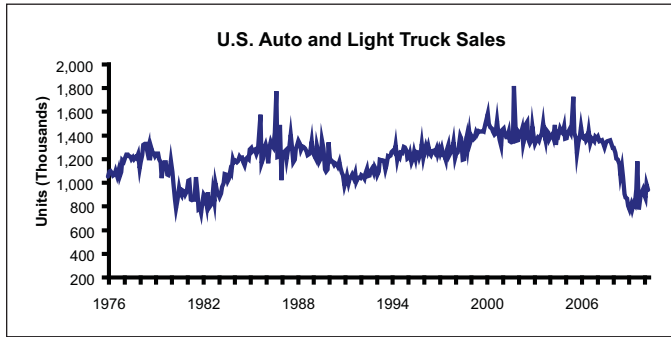


figure 19

The auto and light truck production index rebounded from a low of 3.7 in January 2009, to 7.9 in April 2010. While it is still below the 40-year average of 10.7, this is a robust rebound. From the low of April 2009 through May 2010, total vehicle sales increased by 12.6% on a real dollar basis, and by 26.5% on a unit basis. Even GM registered profits in the first quarter of 2010 – the first time in three years. Within the various vehicle categories, monthly auto sales increased by 19.9%, from 387,800 vehicles in February 2009 to 464,800 units sold in May 2010. During the same period, monthly unit sales of light trucks grew by 129,000 vehicles (34%), while heavy truck unit sales were relatively flat.

The energy production index hit a low of 102.8 in July 2009, but increased by 10.6% by January 2010. As of May 2010, it was back to 108.7, still a 5.7% increase over the low point.

Consumer confidence has rebounded strongly, from an extreme cyclical low. It reached a pre-recession peak of 96.9 in January of 2007, before plunging to a low of 56.3 in February 2009. It then rose to 74.4 in January 2010, but stood at 72.7 in April. We expect it to return to a normalized level of 90-95 in early 2011.

The improvement in consumer confidence is mirrored in the business community, where the S&P 500 closing

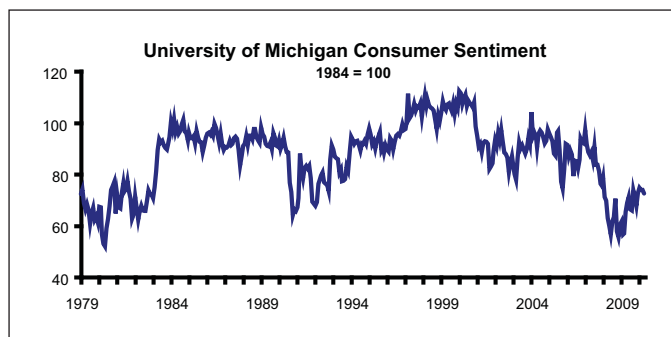


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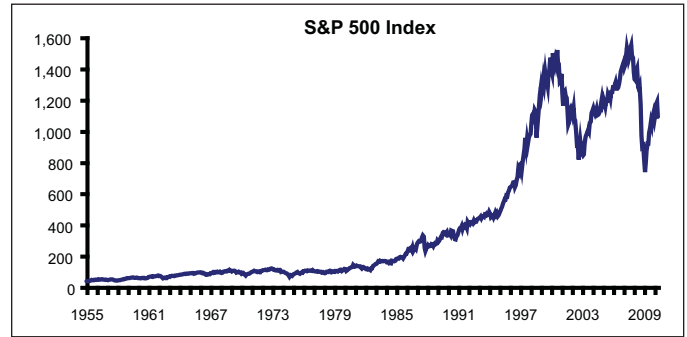


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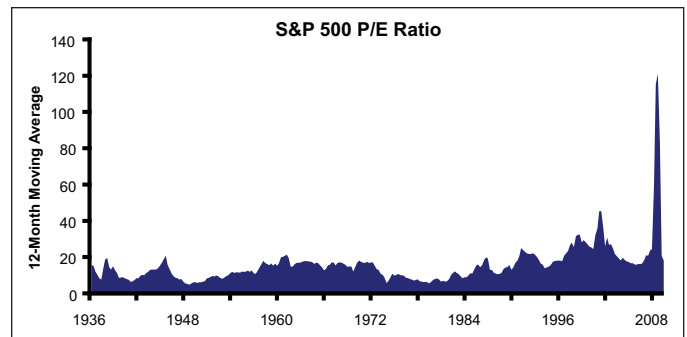


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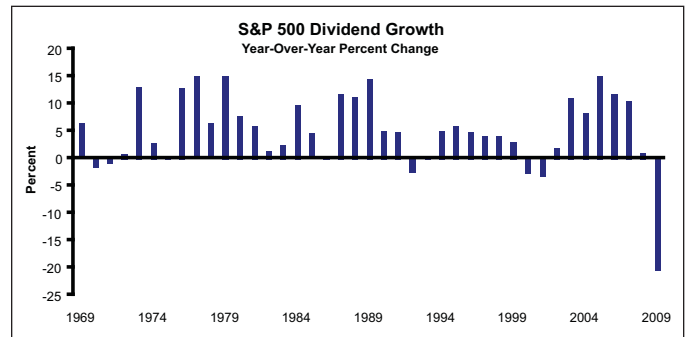


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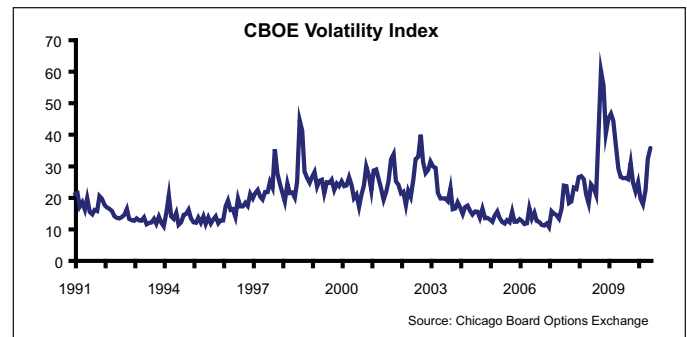


figure 24

rose from a low of 676.5 in March 2009 to a high of 1,217 in late April 2010. As of mid-June, the market gave back some of that momentum due to jitters from European sovereign debt problems, but the S&P 500 held steady at 1,120.

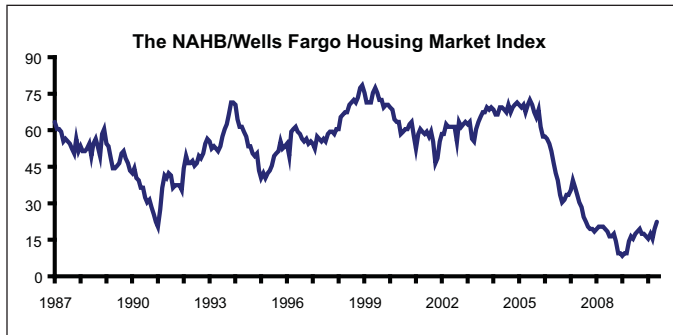


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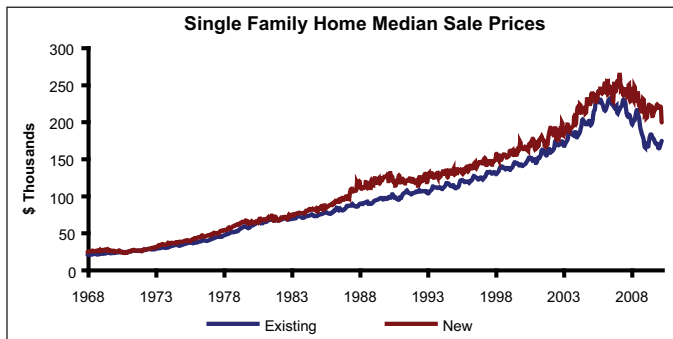


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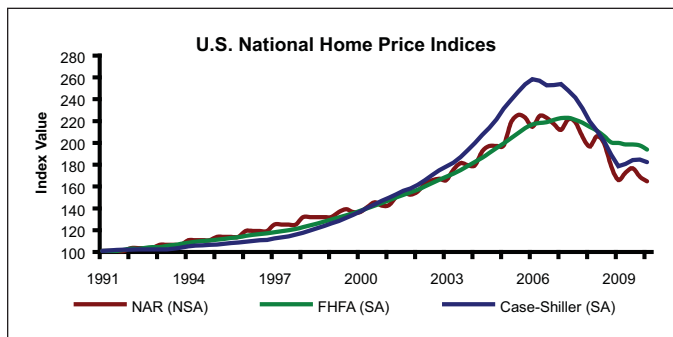


figure 27

In many single-family housing markets, we are witnessing much improved supply-demand dynamics. Home prices in almost every metro have hit bottom and risen since early last year. Rising prices mean that more demand than supply is pushing prices up. This will lead to improved confidence in housing as an asset. Further, as the U.S. continues to add population, these people have to be

housed, either in multifamily or single-family homes. In the next two years, they will be housed in smaller single-family units than in the last decade. Thus, an upswing is underway, though the upward path will be bumpy.

Result of 100 bp Increase in Unemployment of...		
	Adults	Teens
	<i>(Change in Dependent Variable, bps)</i>	
Consumer Spending		
Total	-110	Not significant
Durable Goods	-298	Not significant
Non-Durable Goods	-87	Not significant
Autos	Not significant	-160
Housing	-119	Not significant
Consumer Confidence	-2,330	-220

figure 28

As the unemployment rate stabilizes and then declines, we expect noticeable pickups in durable goods and home sales to continue. Our research indicates that a 100-basis point (bp) decline in the unemployment rate leads to increases in sales of durable goods and housing of 298 bps and 119 bps, respectively. While automobile sales are not significantly correlated with changes in the adult unemployment rate, a 100-bp decline in the teen unemployment rate will lead to an increase of 160 bps (1.6%) in auto sales.

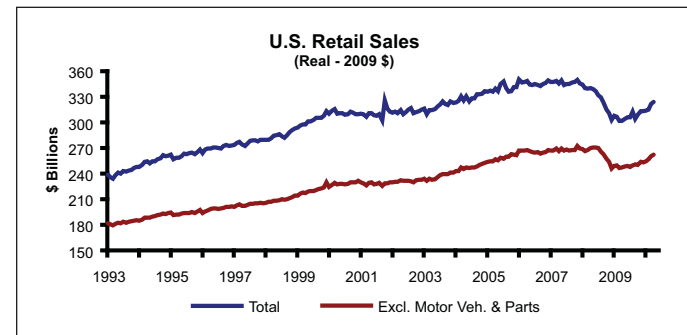


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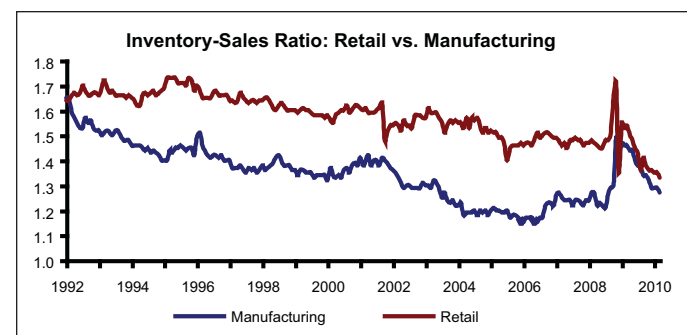


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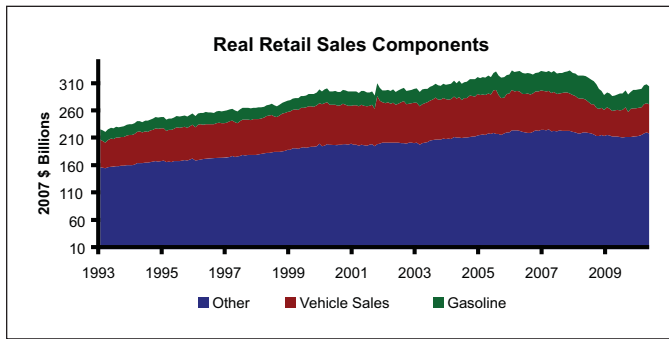


figure 31

Total real retail sales in the U.S. bottomed in March 2009 at about \$300.6 billion, and have since risen (excluding a small decline in September) by 6.1% to \$319 billion in May 2010. We anticipate a continued strong rebound into 2011 as job growth occurs.

Same-store retail sales have seen a broad-based recovery in the last several months through the first half of 2010. Rebounding from the Northeast’s historic snowfalls during February, consumers spent more money thereafter, with March year-over-year same-store sales rising

among the largest retailers: Costco (10%); Nordstrom (16.8%); and TJX (12%). However, these figures must be interpreted in the context of the cyclically low levels to which sales had fallen. Most retailers are still well below their 2007 and 2008 monthly net sales highs.

Between June 2009 and May 2010, seasonally adjusted real retail sales grew by 4.7% (4.1% excluding auto and auto parts). Stores that sell building materials, garden equipment, and supplies experienced a 1.6% increase over the same period. Furniture and home furnishing stores rose by 4.1%, health and personal care stores by 1.7%, and restaurants and bars by 2%. Gas stations rose by 10.2%, while electronics and appliance stores (3.3%), sporting goods, hobby, book, and music stores (2.6%), and grocery and liquor stores (1.3%) also exhibited positive growth between June 2009 and May 2010. Department stores were the only exception to the trend, dropping 2.5% over the same period. Certain category sales were only reported through April 2010 as we go to print. All of those retail segments, including electronic shopping and mail order (11.7%), jewelry stores (6.2%), warehouse clubs and superstores (3.2%),

	Department Stores											
	Macy's			JC Penney			Nordstrom			Saks		
	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth
Aug-09	1.54	-8.5%	-8.1%	1.43	-5.6%	-7.9%	0.54	-3.0%	-7.6%	0.16	-18.1%	-19.6%
Sep-09	2.04	-2.4%	-2.3%	1.44	-0.6%	-1.4%	0.72	0.3%	-2.4%	0.24	-10.2%	-11.6%
Oct-09	1.69	-1.3%	-0.8%	1.31	-3.5%	-4.5%	0.61	14.7%	6.5%	0.22	1.8%	0.7%
Nov-09	2.17	-6.3%	-6.1%	1.72	-5.2%	-5.9%	0.75	5.9%	2.2%	0.25	-25.1%	-26.1%
Dec-09	4.42	0.7%	1.0%	2.89	-2.4%	-3.8%	1.25	10.8%	7.4%	0.39	11.1%	9.9%
Jan-10	1.26	3.5%	3.4%	0.94	-4.4%	-4.6%	0.54	16.0%	14.0%	0.16	8.0%	7.0%
Feb-10	1.64	4.1%	3.7%	1.18	1.5%	1.2%	0.54	14.4%	10.3%	0.17	3.1%	2.0%
Mar-10	2.14	11.0%	10.8%	1.53	5.0%	5.4%	0.82	20.9%	16.8%	0.24	13.6%	12.7%
Apr-10	1.74	2.8%	1.1%	1.22	-3.7%	-3.3%	0.64	13.3%	7.5%	0.25	3.4%	3.2%
May-10	1.79	2.6%	1.4%	1.23	-2.1%	-1.8%	0.71	7.8%	3.7%	0.18	6.9%	5.8%

figure 32

	Discounters								
	Costco			Target			Wal-Mart		
	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over-Year % Growth	YOY Same Store Sales % Growth
Aug-09	5.40	-0.2%	-2.0%	4.86	0.1%	-2.9%	98.67	1.1%	-0.8%
Sep-09	6.85	2.7%	1.0%	5.39	1.4%	-1.7%			
Oct-09	5.68	7.2%	5.0%	4.54	2.9%	-0.1%			
Nov-09	6.04	8.8%	6.0%	5.69	1.5%	-1.5%	112.83	4.6%	-1.2%
Dec-09	8.26	11.5%	9.0%	9.74	5.0%	1.8%			
Jan-10	5.62	10.4%	8.0%	4.29	3.6%	0.5%			
Feb-10	5.61	10.9%	9.0%	4.64	6.0%	2.4%	99.10	6.0%	-0.5%
Mar-10	7.14	11.7%	10.0%	6.23	12.5%	10.3%			
Apr-10	5.83	12.5%	11.0%	4.29	-3.5%	-5.9%			
May-10	6.09	11.3%	9.0%	4.62	3.7%	1.3%			

figure 33

and clothing and shoe stores (5%), posted positive growth between June 2009 and May 2010.

Department store results have generally lagged the discounters. For example, Macy's registered year-over-year monthly net and same-store sales growth of 2.6% and 1.4% in May 2010. JC Penney reported year-over-year same-store sales declines of -3.3% and -1.8% in April and May. Nordstrom was the best performer, with net sales moving in line with the discounters.

While Costco experienced negative year-over-year net and same-store growth for each of June, July, and August 2009, it turned in impressive positive growth from October 2009 through May 2010. Quality-discounter Target also posted positive year-over-year net sales growth into 2010. Its same-store sales growth lagged, not turning positive until December 2009. Since then, Target has registered consistent monthly growth, with the latest year-over-year performance of 1.3% in May 2010.

Wal-Mart generates an astronomical \$100 billion in net sales each quarter, give or take a few billion. To make

the comparison to other retailers even more ambiguous, the 800-pound gorilla ended its fiscal "4Q 2010" in January 2010. Over the last year, Wal-Mart's net sales are up 4.6%.

Teen apparel companies like Abercrombie & Fitch and American Eagle Outfitters had a rough 2009, but both have reported strong year-over-year net and same-store sales growth thus far in 2010.

In the apparel category, TJX (TJ Maxx, Marshall's, Home Goods) and Kohl's posted positive year-over-year monthly net and same-store sales growth for the 11 months to May 2010, with only one exception for Kohl's in April. Both companies sell a range of products in addition to apparel (home decor, toys, books, etc.) and trend toward discounting name-brand products. The Gap posted respectable positive growth over the trailing eight months through May, with only one exception in April.

Since its low of 65.1% in June 2009, manufacturing capacity utilization has since risen 570 bps to 70.8% in April 2010. This is compared to a 20-year average of 79%, which is where it stood in 2007.

	Teen Apparel					
	Abercrombie & Fitch			American Eagle Outfitters		
	Net Sales (\$ Billions)	Year-over- Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over- Year % Growth	YOY Same Store Sales % Growth
Aug-09	0.31	-22.6%	-29.0%	0.31	-3.8%	-7.0%
Sep-09	0.25	-9.9%	-18.0%	0.25	-7.3%	0.0%
Oct-09	0.20	-5.5%	-15.0%	0.20	-4.7%	-5.0%
Nov-09	0.25	-8.1%	-17.0%	0.27	-0.8%	-2.0%
Dec-09	0.48	-10.5%	-19.0%	0.54	9.2%	7.0%
Jan-10	0.22	16.3%	8.0%	0.16	17.7%	10.0%
Feb-10	0.20	15.6%	5.0%	0.19	6.1%	6.0%
Mar-10	0.28	19.1%	5.0%	0.28	15.4%	15.0%
Apr-10	0.21	7.6%	-7.0%	0.19	-1.0%	-6.0%
May-10	0.20	10.4%	-3.0%	0.19	-1.5%	-3.0%

figure 34

	Apparel								
	TJX			Gap			Kohl's		
	Net Sales (\$ Billions)	Year-over- Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over- Year % Growth	YOY Same Store Sales % Growth	Net Sales (\$ Billions)	Year-over- Year % Growth	YOY Same Store Sales % Growth
Aug-09	1.57	6.1%	5.0%	1.12	-1.8%	-3.0%	1.32	4.8%	0.2%
Sep-09	1.98	8.2%	7.0%	1.33	-0.8%	-1.0%	1.46	9.6%	5.5%
Oct-09	1.70	14.9%	10.0%	1.14	5.6%	4.0%	1.27	5.0%	1.4%
Nov-09	1.84	15.0%	8.0%	1.42	2.2%	0.0%	1.87	7.1%	3.3%
Dec-09	2.87	20.9%	14.0%	2.02	4.7%	2.0%	3.01	8.8%	4.7%
Jan-10	1.27	19.8%	12.0%	0.80	5.4%	5.0%	0.80	10.8%	6.5%
Feb-10	1.42	16.4%	10.0%	0.84	5.4%	3.0%	1.08	7.8%	3.7%
Mar-10	2.03	18.7%	12.0%	1.45	12.4%	11.0%	1.81	26.4%	22.5%
Apr-10	1.60	10.0%	4.0%	1.05	0.0%	-3.0%	1.14	-5.0%	-7.7%
May-10	1.60	8.0%	4.0%	1.05	2.0%	1.0%	1.34	6.6%	3.5%

figure 35

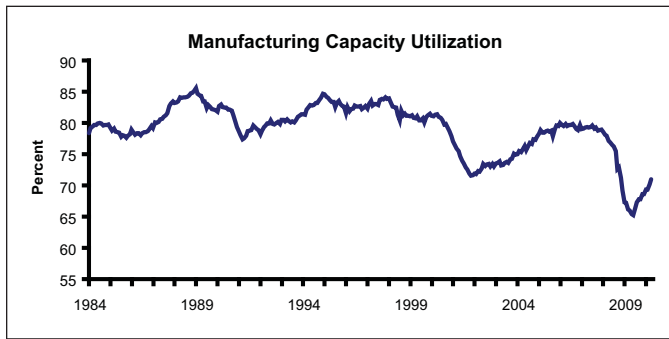


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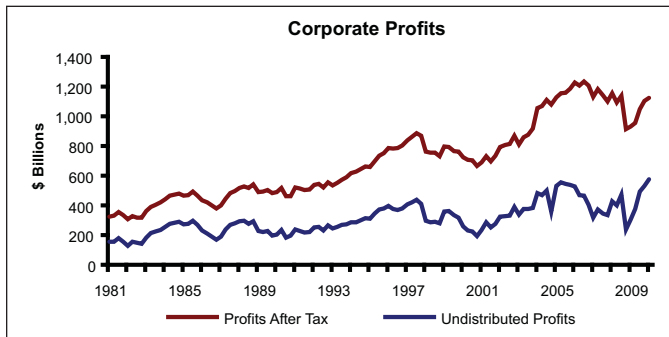


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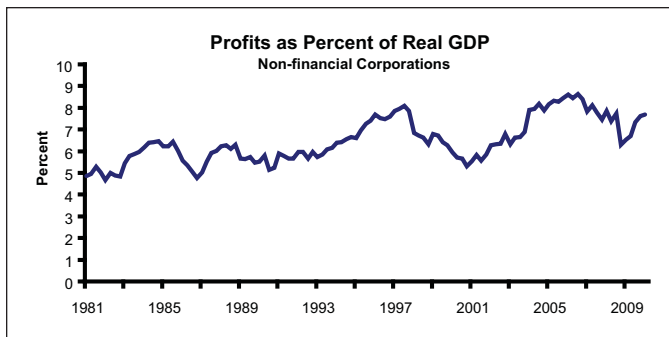


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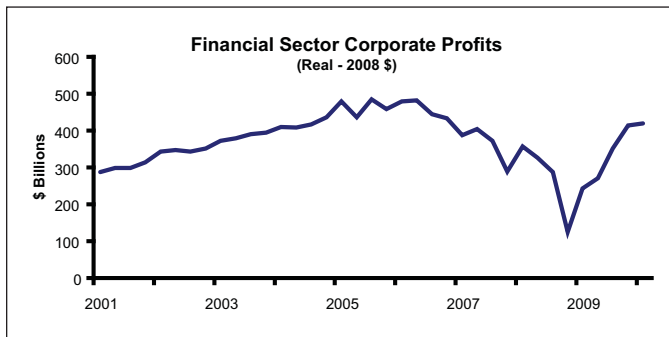
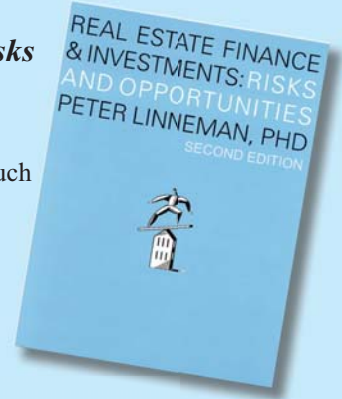


figure 39

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*Albert Behler
President, Paramount Group Inc.*

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*Dean Adler
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On an annualized basis, real after-tax corporate profits in the first quarter of 2010 rose by \$210 billion, compared to the fourth quarter of 2008. This 23% increase in after-tax profits has resulted in a 145% spike in undistributed profits, substantially reversing the \$187 billion decline (-17%) that occurred during 2008. By the first quarter of 2010, financial service profits had rebounded by 245% from their fourth-quarter 2008 low. This rebound in corporate profits is the most powerful driver of future job growth.

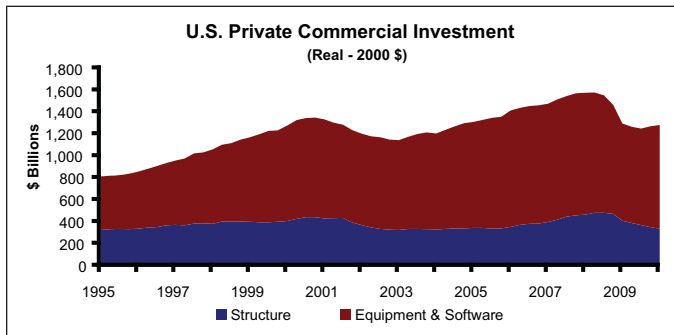


figure 40

From its peak in the second quarter of 2008 through the third quarter of 2009, U.S. private commercial investment fell by over 20%. It has since rebounded by 2.7%, primarily due to improved corporate profits. Specifically, private commercial investment in equipment and software has increased by 7.6%. However, investment in private commercial structures continues to fall, due to the excess supply of real estate associated with the loss of 8.4 million jobs.

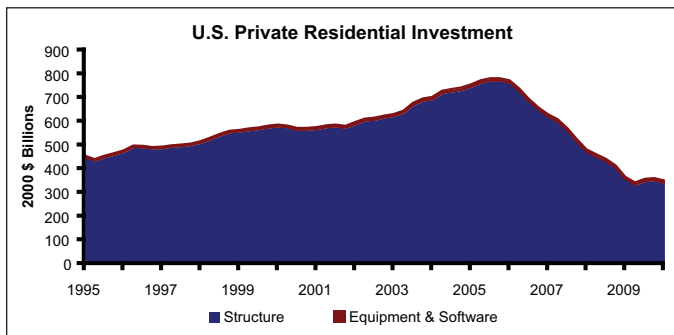


figure 41

Private residential investment is up modestly by \$8.6 billion (2.5%) from its low in the second quarter of 2009, driven by the increase in seasonally-adjusted annual single-family home starts, from an all-time low of 360,000, to 593,000 as of April 2010.

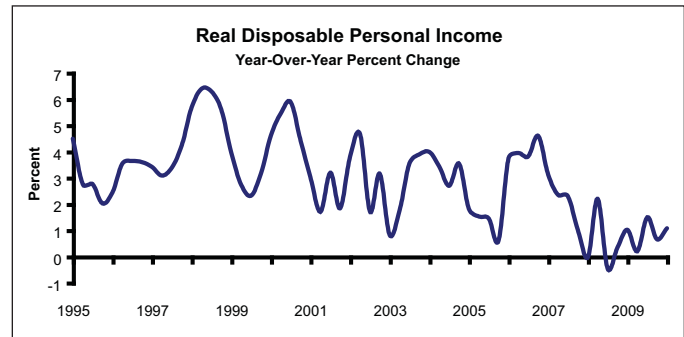


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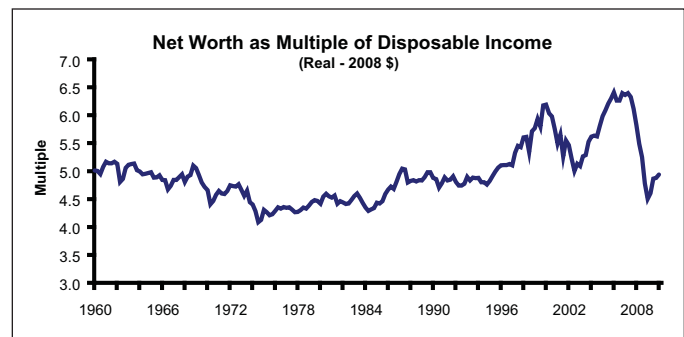


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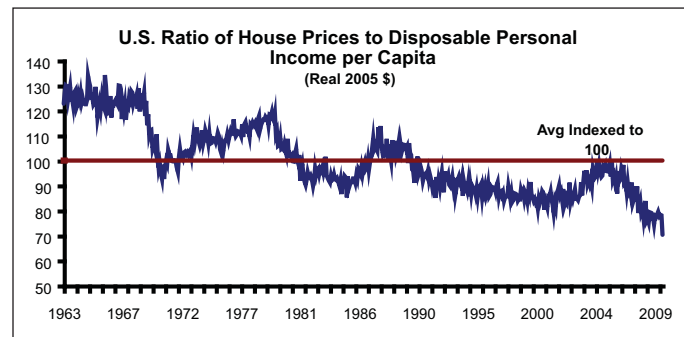


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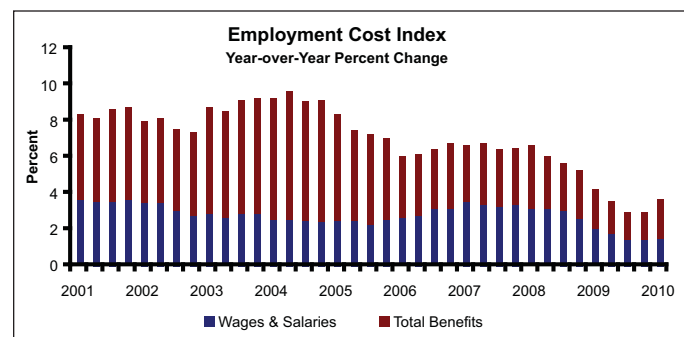


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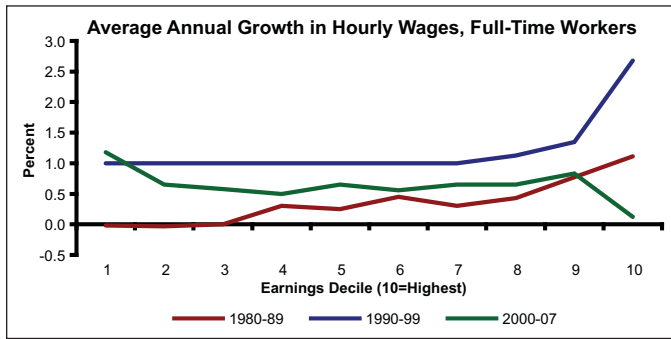


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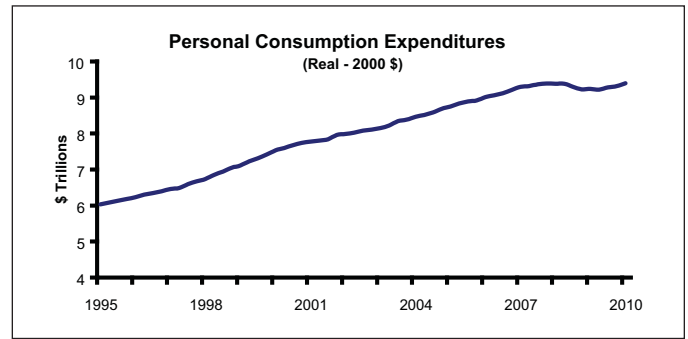


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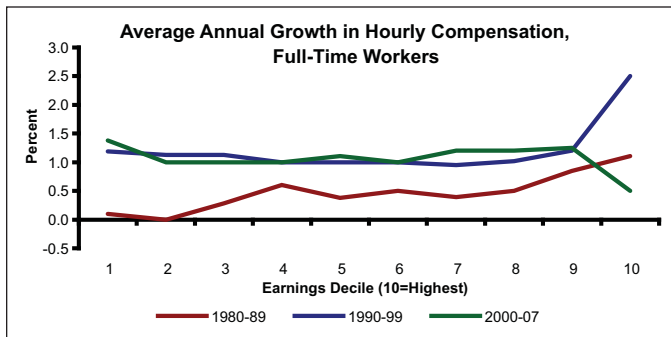


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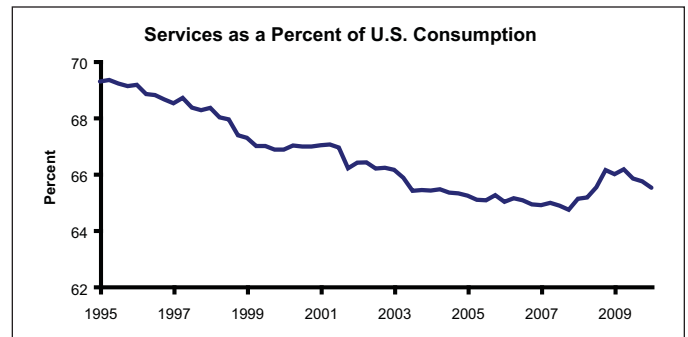


figure 50

Share of Full-Time Workers' Compensation Gains Absorbed by Benefits			
Earnings Decile (10=Highest)	1980-89	1990-99	2000-7
1	100.0%	29.5%	29.1%
2	100.0%	22.2%	44.6%
3	87.0%	24.2%	48.9%
4	52.7%	20.5%	59.6%
5	61.8%	17.2%	53.6%
6	41.7%	18.3%	54.5%
7	46.9%	12.1%	50.2%
8	35.5%	9.5%	49.7%
9	29.0%	7.8%	43.8%
10	20.8%	6.9%	78.0%

Source: Estimates by Watson Wyatt Worldwide

figure 48

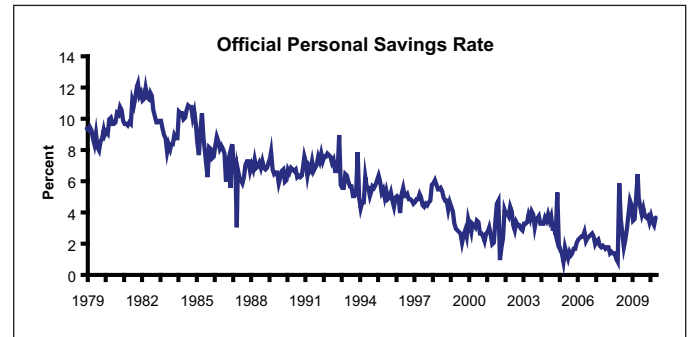


figure 51

Real disposable personal income rose by almost 1.1% year-over-year through the first quarter of 2010. Real wage and salary income declined by 6.6% during the recession, but has subsequently risen by 1.2% as of April 2010. In 2009, consecutive quarter-over-quarter changes in real wage and salary income were -3.1%, -0.4%, -1.9%, and -0.9%, with 0.4% registered in the first quarter of 2010.

Real personal consumption expenditures were up by 1.7% year-over-year through the first quarter of 2010, and by 0.9% quarter-over-quarter. Real housing expenditures rose by 0.9% over the last four quarters, while auto

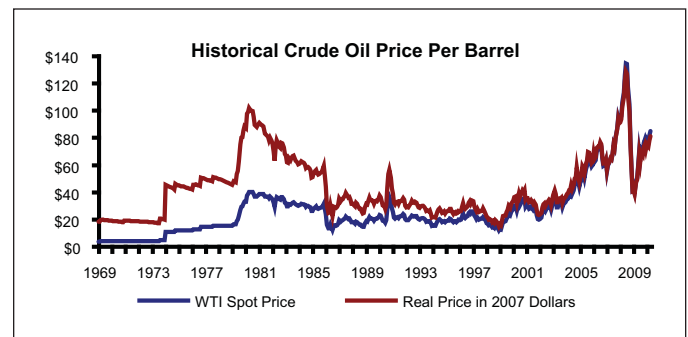


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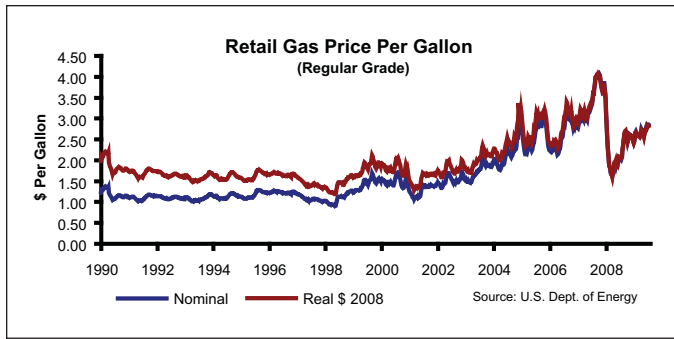


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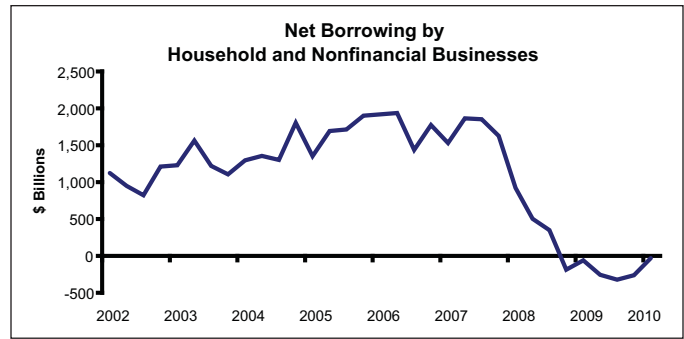


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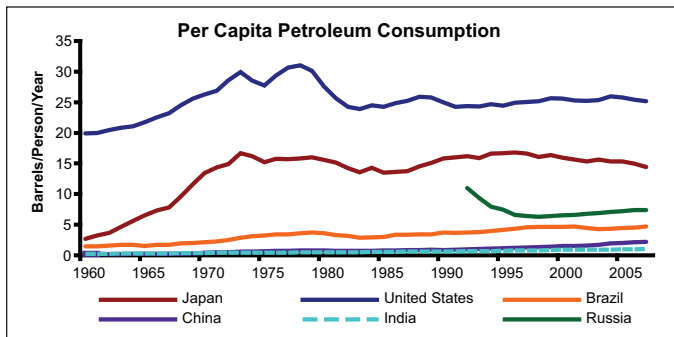


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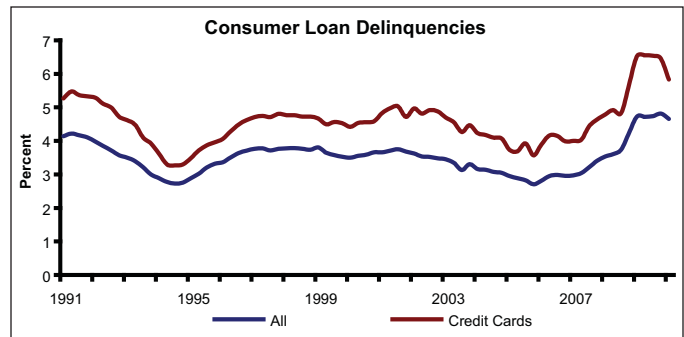


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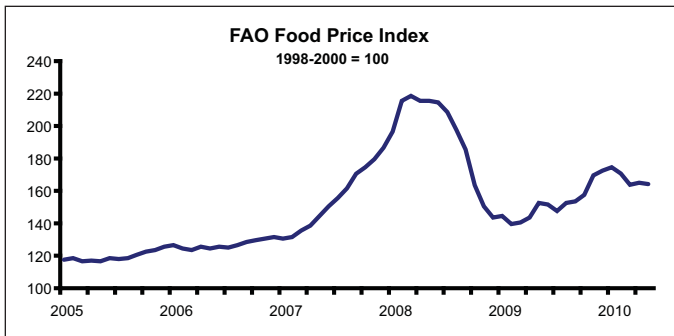


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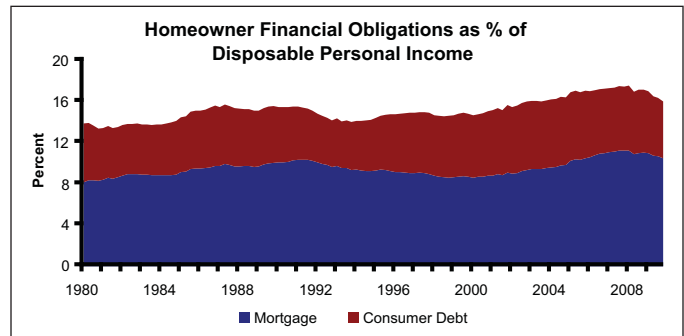


figure 58

expenditures grew by 1.5% over the same period and real personal expenditures on gasoline dropped by 0.6%. Service consumption rose by 1.0%, with medical expenditures increasing by 2.2% year-over-year through the first quarter of 2010. Quarter-over-quarter results for the first quarter 2010 were: total personal expenditures (0.9%); housing (0.4%); gasoline (0.4%); auto (-0.1%); service (0.5%); and medical (0.6%).

Consumer credit has fallen by roughly 3.8% over the past year through the first quarter of 2010, as consumers have reduced the use of credit, and have paid down some debt.

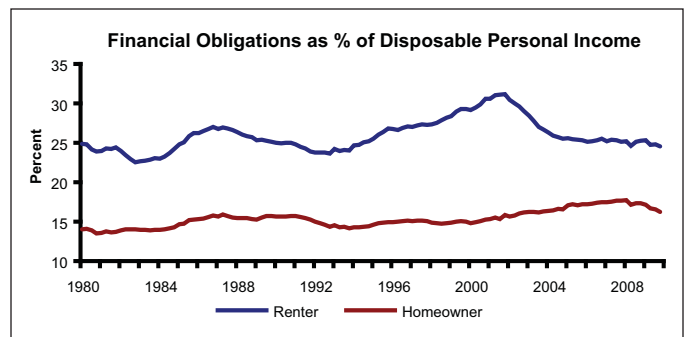


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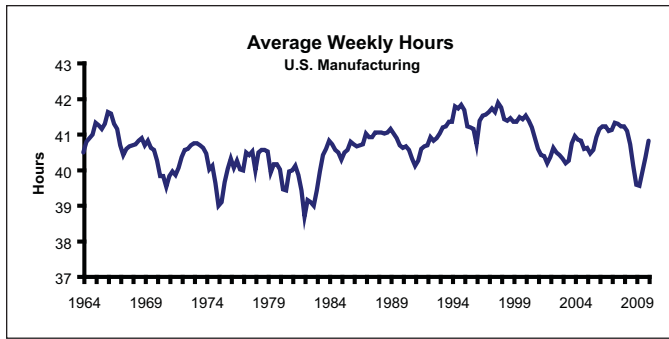


figure 60

It is noteworthy that almost every major economic indicator has risen from its respective low point: average weekly manufacturing hours worked (3.2%); average weekly overtime hours (46%); new orders received by manufacturers for durable (16.3%) and non-defense goods (18.1%); single-family housing starts (64.7%); industrial production (7.4%); non-durable (2.8%) and durable (12.3%) goods consumption; and industrial inventories (3.1%). Taken together, these factors indicate that a broad cyclical economic recovery is underway and will continue for the next four years. In six months, we have gone from being fearful to far greedier. We are certainly not in a period of raw greed yet, but greed is back.

Greed is going to win again and win big. During the good times, it is important to maintain sufficient reserves. Although we are entering a phase when greed is replacing fear, always remember that it will, in turn, be followed by fear replacing greed. The cycle may take 5-7 years, but it will no doubt re-occur. And when fear wins, diversification does not do much for anyone, because investors bail out of almost everything. Maintaining low debt levels is the best defense against the eventual return of fear.

But What About Jobs?

Through August 2008, we were in a typical recession concentrated in housing, autos, and a financial sector that financed the overexpansion of these sectors. Then the government caused a complete panic-induced collapse, which resulted in the needless loss of at least 6.2 million jobs. The needless job losses are underscored by the fact that only 4.6 million (about 55%) of the total 8.4 million lost jobs

Historically, about six quarters of prolonged profit growth are needed before companies hire aggressively.

since year-end 2007 were in manufacturing (including autos), construction, or finance.

Historically, about six quarters of prolonged profit growth are needed before companies hire aggressively. A robust job recovery is underway, with profitable employers finally replacing employees who died, retired, took extended maternity leave, or went back to school. Unfortunately, many small firms were needlessly destroyed as the government artificially channeled scarce capital to large, politically-connected firms. As we have said repeatedly, “too big to fail” is code for “too small to succeed.”

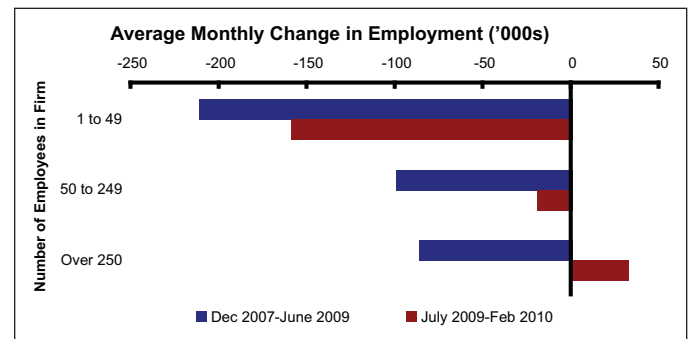


figure 61

An improving job market is evidenced by: a 1.5% increase in the number of weekly hours worked since June 2009; a 12% decline in “marginally attached” workers from 2.5 million in February 2010 to 2.2 million in May; a year-over-year increase in Temporary Help Service workers; and an increase in the number of employees quitting (because they now have improved options). Marginally attached workers include those who want a job, have searched for work during the prior 12 months, and were available to take a job, but had not looked for work in the past four weeks. Declining levels are an indication that more people are either getting jobs or are actively

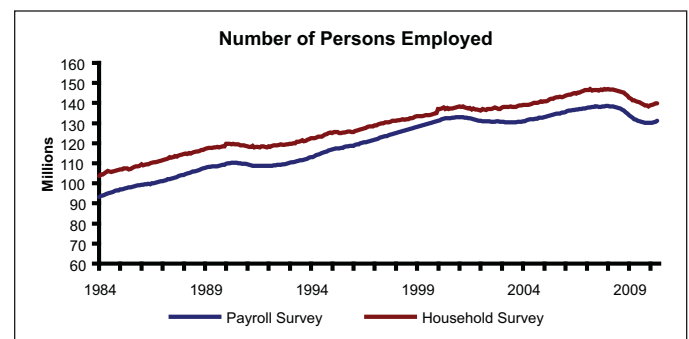


figure 62

looking. The increased use of temp workers reflects a rebounding workforce, as temp workers are a flexible means of increasing employment in the early stages of a recovery. Temporary help services increased employment by 175,000 jobs over the first five months of 2010.

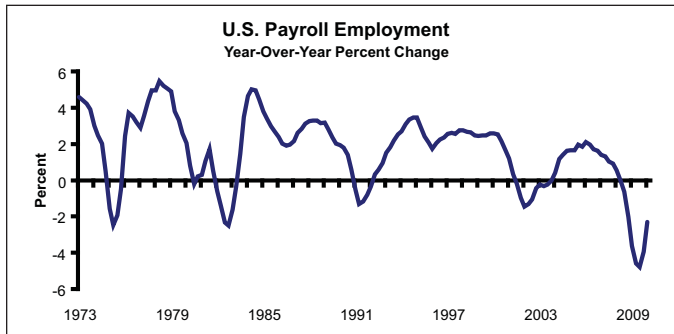


figure 63

Based on the Payroll Survey, total employment peaked in December 2007 with nearly 138 million jobs, and bottomed two years later with 8.36 million fewer jobs. Since year-end 2009, we have gained back 982,000 jobs through May. In comparison, the Household Survey, from which unemployment statistics are calculated, indicates that employment peaked in November 2007 at just under 146.5 million jobs, bottomed in December 2009 at almost 8.7 million lower, and has since grown by over 1.6 million. Of those lost jobs, 5.2 million were concentrated among males older than 19, and only 1.9 million among women older than 19. This reflects the high concentration of males in manufacturing, construction, and finance, while women are disproportionately employed in the less adversely impacted government, healthcare, and education sectors.

We anticipate that the next three years will continue to see average job growth of 250,000 per month, for a 3-year job increase of at least 9,000,000 jobs by early 2013. This robust recovery will be due primarily to the restocking of jobs vacated during the panic, rather than a net employment expansion. While this robust job growth may seem overly optimistic, it is important to remember that our forecast would leave us with almost the same

We anticipate that the next three years will continue to see average job growth of 250,000 per month, for a 3-year job increase of at least 9,000,000 jobs by early 2013.

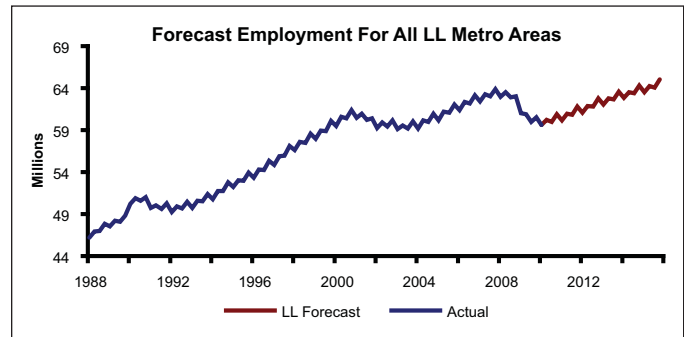


figure 64

number of jobs in mid-2013 as existed at the beginning of September 2008, in spite of a population that will have grown by 15 million people. In fact, employment today is at the same level as in September 1999, despite the fact that population has grown by more than 25 million people. If we have a robust recovery, adding 9 million jobs over the next three years, we will still have an anemic unemployment rate of 7%. Hence, we expect a robust rebound to mediocrity.

... our forecast would leave us with almost the same number of jobs in mid-2013 as existed at the beginning of September 2008, in spite of a population that will have grown by 15 million people.

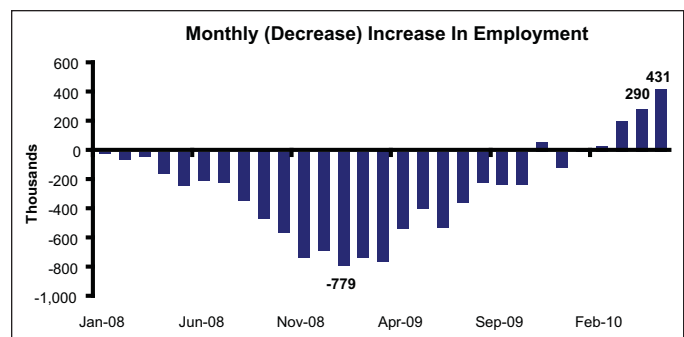


figure 65

The key for the real estate sector is job growth, as a recovery without jobs does not fill buildings. Total non-farm payroll employment has grown every month in 2010 through the first five months of the year, with May registering 431,000 new jobs. In comparing sectoral job losses from December 2007 through each sector's respective trough, it is apparent that the pain was disproportionately distributed. While manufacturing

Payroll Survey Employment (000's)								
Industry	Dec-07	Trough Date	Trough	May-10	Peak to Trough		Trough to Present	
					Change	% Change	Change	% Change
Manufacturing	13,726	Nov-09	11,552	11,660	-2,174	-15.8%	108	0.9%
Trade, Trans, & Utilities	26,709	Dec-09	24,653	24,727	-2,056	-7.7%	74	0.3%
Construction	7,491	Feb-10	5,585	5,591	-1,906	-25.4%	6	0.1%
Prof & Business Svcs	18,051	Sep-09	16,349	16,663	-1,702	-9.4%	314	1.9%
Leisure and Hosp	13,535	Dec-09	12,991	13,086	-544	-4.0%	95	0.7%
Information	3,023	Mar-10	2,728	2,728	-295	-9.8%	0	0.0%
Other Services	5,514	Feb-10	5,310	5,334	-204	-3.7%	24	0.5%
Mining and Logging	739	Oct-09	669	720	-70	-9.5%	51	7.6%
Government	22,377	Dec-07	22,377	22,968	0	0.0%	591	2.6%

figure 66

(-15.8%) and construction (-25.4%) hemorrhaged jobs during the recession, losses in some industries were more muted. On an absolute basis from peak to respective trough, manufacturing (-2.2 million), trade, transportation, and utilities (-2.1 million), construction (-1.9 million), and professional and business services (-1.7 million) lost the most jobs. Manufacturing and trade, transportation, and utilities turned the corner in the fourth quarter of 2009, while construction did not reverse course until late in the first quarter of 2010.

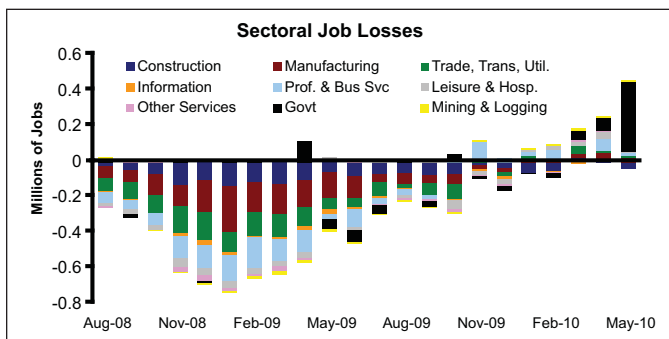


figure 67

The obvious winner was the government sector, which effectively did not shed any jobs at all. The other relatively strong sectors (healthcare, information technology, education, and pharmaceuticals) experienced demand growth during the recession, yet still shed jobs, largely via hiring freezes. That is, job losses in those sectors were due more to the lack of replacements for employees who died, retired, or went on extended maternity leave. As profits have rebounded over the last 18 months, and the panic has subsided somewhat, these sectors have lifted hiring freezes and begun replacing those who left.

According to the March 2010 Job Openings and Labor Turnover Survey, just 40.8% of industries are

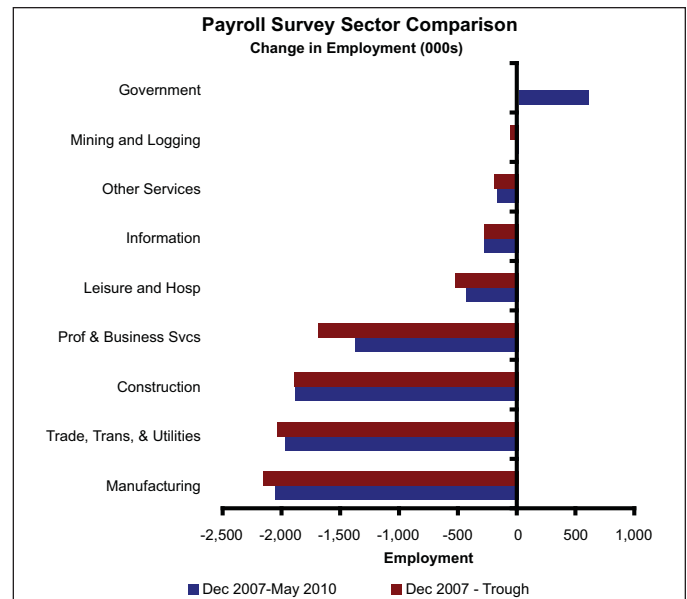


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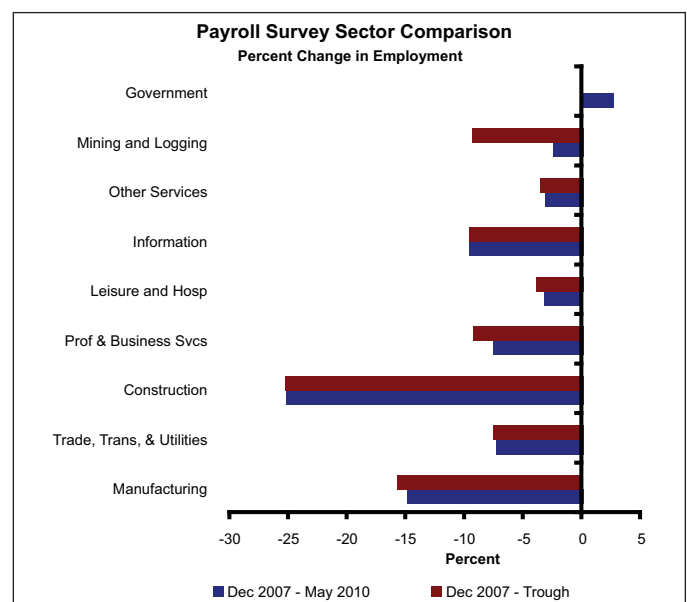


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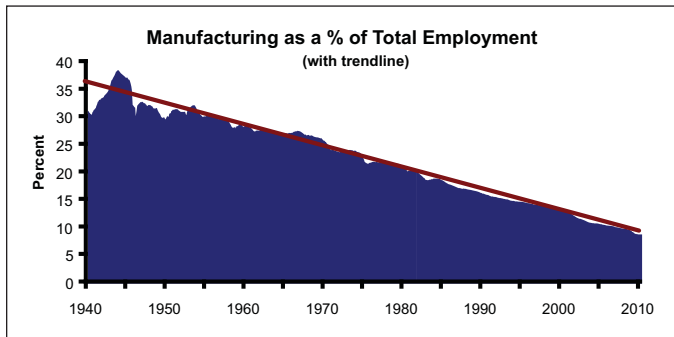


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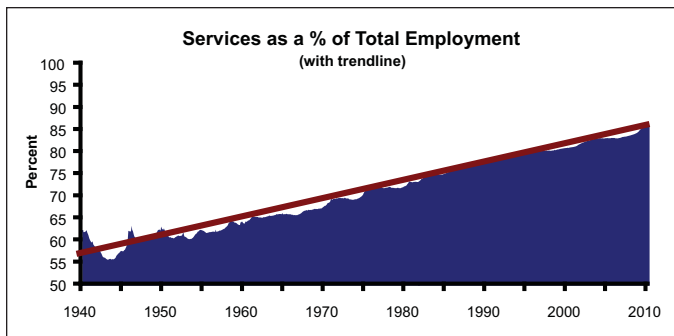


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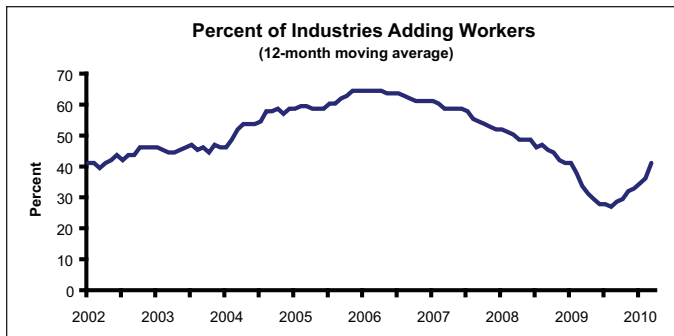


figure 72

adding workers on a 12-month moving average basis, versus the 9-year average of 49%. This is massively improved from 27.5% eight months ago. Comparing payroll employment from the December 2007 peak through May 2010, it is clear that most sectors have posted very modest gains from their respective troughs, though are still significantly below their peaks. The notable exception is the government sector, which registered an increase of 591,000 jobs between December 2007 and May 2010. On an absolute basis, the biggest job losses during this period were: manufacturing (2.1 million); trade, transportation, and utilities (2 million); construction (1.9 million); and professional and business services (1.4

million). On a percentage basis, construction (-25.4%) and manufacturing (-15.1%) were the worst performers.

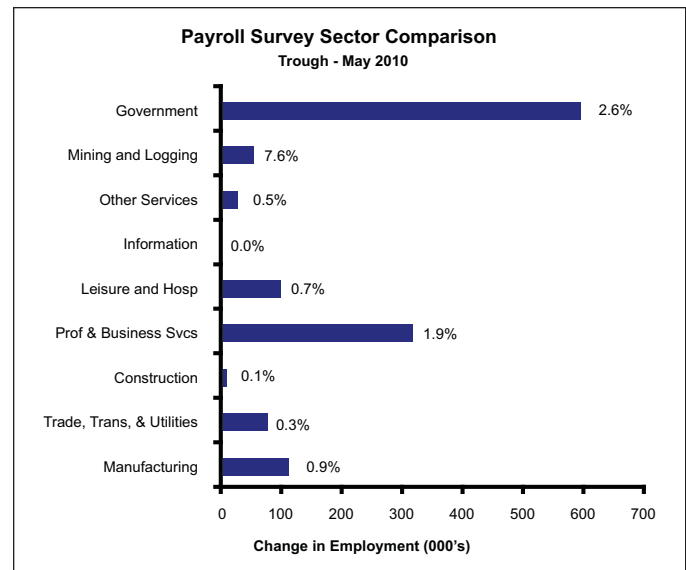


figure 73

The good news is that all major industries except the information sector have registered employment gains from their respective troughs. Aside from the government sector (591,000), the largest absolute job increases were in professional and business services (314,000), manufacturing (108,000), leisure and hospitality (95,000), and trade, transportation, and utilities (74,000). On a percentage basis, the largest gains were made in mining and logging (7.6%), government (2.6%), professional and business services (1.9%), and manufacturing (0.9%).

As we go to print, the latest available MSA employment data are through April 2010. We examined each MSA's respective employment peak versus where it stood in February and April 2010. According to both the Payroll and Household Surveys, none of the markets in our analysis have reached their peak employment levels. However, all markets except Northern/Central New Jersey (-0.3% on the Payroll Survey and -0.6% on the Household Survey) and Seattle (-1% on the Household Survey) posted positive employment growth from February through April 2010. For the Payroll Survey, the largest 3-month percentage gains were seen in Baltimore (3.6%), Austin (2.7%), Washington, D.C. (2.3%), Indianapolis (2.3%), and St. Louis (2.2%). Is it any surprise that three of the top five performers are government seats? Similarly, the markets with the top 3-month percentage growth based on the Household

	Changes in MSA Employment			
	Payroll Survey		Household Survey	
	% Change Feb-April '10	% Change Peak to Present	% Change Feb-April '10	% Change Peak to Present
Baltimore	3.6	-5.1	2.4	-7.2
Austin	2.7	-5.0	2.2	-5.1
Washington, D.C.	2.3	-2.1	1.8	-2.9
Indianapolis	2.3	-7.7	2.1	-9.7
St. Louis	2.2	-5.8	1.8	-7.5
Long Island	2.2	-13.8	2.5	-10.0
Kansas City	2.0	-5.3	0.8	-7.0
Las Vegas	2.0	-7.3	2.3	-5.6
Boston	1.9	-5.3	0.8	-4.4
Cincinnati	1.9	-5.8	0.5	-5.3
Houston	1.8	-8.6	0.4	-9.3
Minneapolis	1.8	-7.9	1.9	-2.3
Charlotte	1.7	-8.2	2.9	-5.9
U.S.	1.6	-6.5	1.5	-5.4
New York City	1.6	-6.5	2.1	-4.7
Chicago	1.5	-9.0	1.8	-7.3
Fairfield County	1.5	-7.4	0.6	-5.5
Dallas/Fort Worth	1.4	-4.6	1.0	-2.5
Atlanta	1.2	-8.6	1.3	-8.2
Phoenix	1.2	-11.7	1.5	-2.6
Detroit	1.2	-24.8	2.0	-19.0
Raleigh-Durham	1.1	-4.6	2.4	-3.1
Denver	1.1	-7.4	2.1	-5.9
Cleveland	1.1	-8.0	2.1	-5.7
Nashville	1.0	-7.4	2.6	-1.4
Columbus	1.0	-1.3	1.4	3.4
Portland	0.9	-4.8	1.2	-0.1
Seattle	0.9	-9.2	-1.0	-6.5
Orange County	0.8	-11.7	0.9	-8.2
Riverside-San Bernardino	0.7	-13.7	1.0	-9.9
San Diego	0.7	-8.2	0.8	-4.8
Philadelphia	0.6	-4.0	0.8	1.1
San Jose	0.6	-8.8	0.8	-19.2
Westchester County	0.6	-9.3	1.5	-5.0
Orlando	0.6	-9.9	1.9	-7.1
Sacramento	0.6	-10.5	0.6	-6.8
Tampa	0.4	-11.1	1.6	-7.5
San Francisco	0.3	-9.0	0.4	-11.1
Los Angeles	0.3	-9.6	0.5	-7.9
West Palm Beach	0.3	-13.3	1.5	-9.4
Miami	0.2	-9.6	0.9	-1.6
Ft. Lauderdale	0.0	-12.8	1.4	-8.8
Northern/Central NJ	-0.3	-14.9	-0.6	-6.0
Metro (excl LI)				

figure 74

Survey include Charlotte (2.9%), Nashville (2.6%), St. Louis (2.5%), Long Island (2.5%), Baltimore, and Raleigh-Durham (each with 2.4%).

Based on the Payroll Survey, only Washington, D.C. and Columbus employment levels are fewer than 300 bps off of December 2007 employment. Markets that are 500 bps or fewer away from their respective peaks include Austin (-500 bps), Dallas-Fort Worth (-460 bps), and Philadelphia (-400 bps). At the other end of the spectrum, the markets farthest from pre-recession levels are Detroit (2,480 bps), Northern/Central N.J. (-1,490 bps), and West Palm Beach (-1,330 bps). The Household Survey also indicates that Portland (-10 bps), Philadelphia (-110 bps), Miami (-160 bps), Minneapolis, (-230 bps), Dallas-Fort Worth (-250 bps), Phoenix (-260 bps), Washington, D.C. (-290 bps), and Nashville

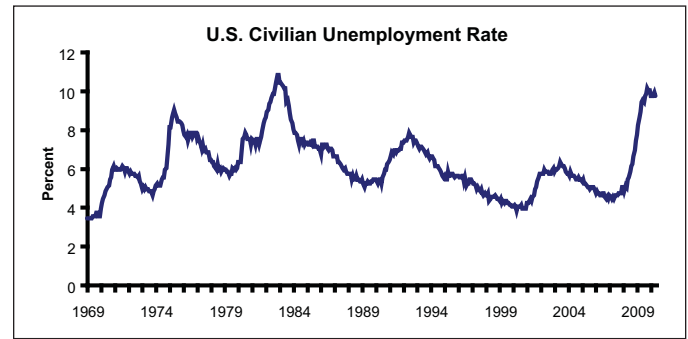


figure 75

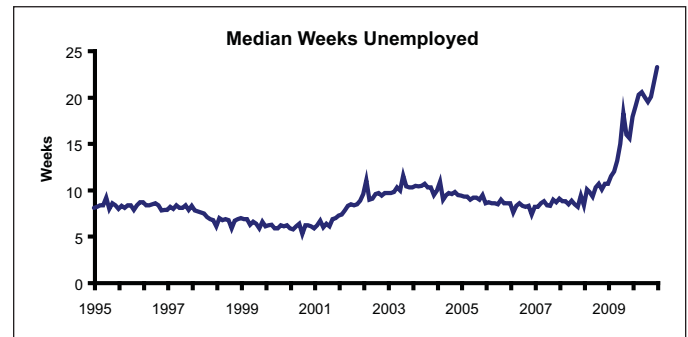


figure 76

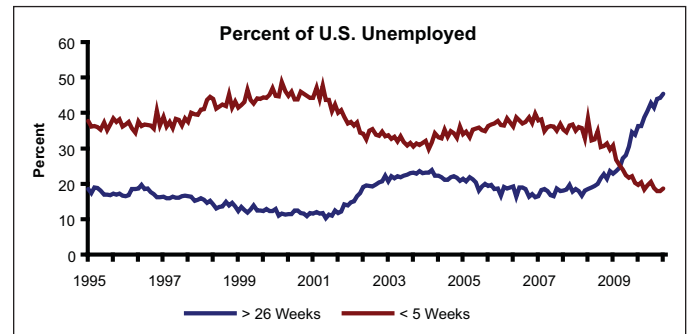


figure 77

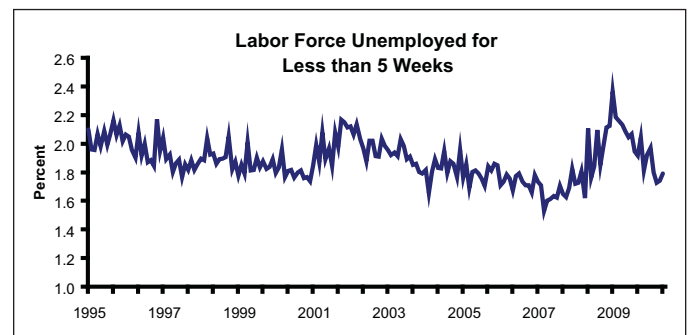


figure 78

(-240 bps) are all fewer than 300 bps away from their respective December 2007 levels.

At 9.7%, the May 2010 unemployment rate declined by 40 bps compared to its peak of 10.1% in October 2009. The median unemployment duration stands at 23.2 weeks, with the percent unemployed more than 27 weeks rising from a low of 17.5% in December 2007 to 45.2% in May 2010. At the same time, short-term (five weeks or less) unemployment spells are at 18.4%, compared to 36.5% at the beginning of the recession. Except for a short-lived improvement in February 2010, the longer-duration unemployment statistic has been weakening steadily since early 2008. However, the percent unemployed for fewer than five weeks showed the first sign of improvement with an increase in May 2010.

This recession was extraordinarily male-centric, with 9.8% of males over the age of 20 unemployed, versus 8.1% of females. In late 2007, the unemployment rates for males and females over the age of 20 were 4.5% and 4.6%, respectively. At their peaks, the adult male unemployment rate was 10.6% in October 2009, and the adult female unemployment rate was 8.2% in April 2010.

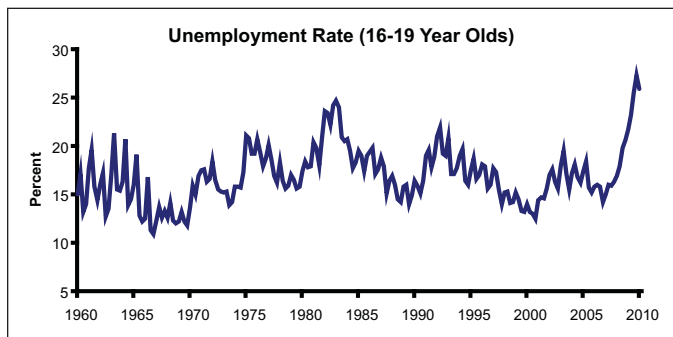


figure 79

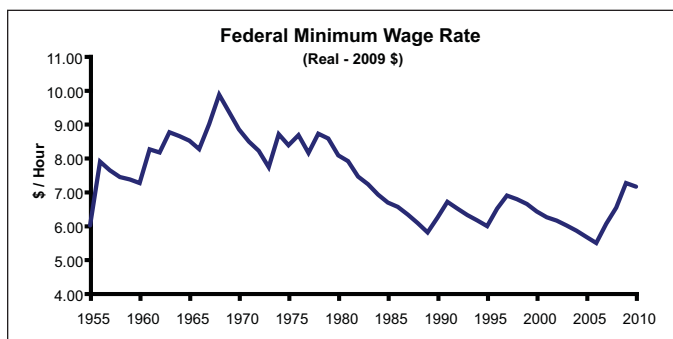


figure 80

Teens were crushed by the recession. As a result of the minimum wage increase, teen workers accounted for about 18% of the nearly 8.7 million jobs lost from the Household Survey peak. Their unemployment rate rose from 16.9% at the end of 2007 to 26.5% in May 2010. Although today's level is below the October 2009 peak of 27.6%, it represents an increase over April 2010. Today's 960-bp increase over the pre-recession level stands in stark contrast to the 200-300-bp increase that normally occurs for teens during a recession. This dramatic increase is similar to that of the 1973-1975 recession, which also coincided with a precipitous increase in the minimum wage. If there is a bright side to this disastrous teen unemployment profile, it is that teens are not as important as adults in terms of family income generation. However, their re-employment is critical for the multifamily rental market, as absent jobs, these youths remain at home, rather than rent apartments.

A Robust Job Recovery Is Underway

As noted earlier, we believe that 3-3.5 million jobs will be formed in each of the next three years. In fact, this is roughly the rate at which jobs have been added since March 2010. However, this rate of job creation must be viewed in the context of the nearly 8.4 million jobs lost during the recently concluded recession, and the 1.8 million jobs normally added annually to the U.S. economy.

We believe that just as the standard economic models failed to predict outsized job losses, they are similarly incapable of predicting an outsized recovery. This pattern characterized the super recessions of 1973-1975 and 1980-1982. In both cases, the extent of the recession was seriously under-predicted by economic models, as was the robustness of the recovery. This is because these models are based on centrality and momentum, making it almost impossible to predict extreme ups and downs, even though notable ups tend to be followed by notable downs (and vice versa).

We project that for the next three years, we can add 3.3 million jobs each year, consisting of the normal 1.8 million new jobs associated with the additional 3 million people entering the economy, plus 1.5 million of the 8.4 million lost jobs being recovered. Stated differently, if we re-create 1.5 million of the lost 8.4 million jobs each year, in addition to population-driven job growth, for the next three years, we will have restored only 4.5 million of the 8.4 million lost jobs. This is hardly a rapid return