REAL ESTATE TRIUMPH CORPORATION

TRIUMPH NEWS

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TEFLON ECONOMY?

By Paul J. Ruff, President
Triumph Real Estate Corporation

- **DEVELOPMENT**
- **INVESTMENT**
- **BROKERAGE**
- **MANAGEMENT**
- **CONSTRUCTION**

I recently attended the annual economic briefing by noted economist Dr. Sung Won Sohn of Wells Fargo. Dr. Sohn firmly asserted that "there will be no recession" but that a return to the growth of a year ago will be slow, due to "structural problems, over-capacity in technology, high debt, and the poverty effect of the stock market." When addressing Denver in particular, he predicted continued strength, pointing to the diversity of the economic base, a pent-up demand for labor that is quickly absorbing layoffs, and continued strong in-migration and labeled it as a "Teflon Economy."

Meanwhile, the most dramatic and visible impact of the slowdown in GDP growth over the past year in the real estate market has been the increase in the availability of office sublease space available in the market. This massive spike in office vacancy (combined direct and sublease space), coupled with diminished demand for space overall has most developers and lenders very concerned, even though most of them are still receiving rental payments on the space.

The primary reason for concern is that sublease space competes for the new lower level of demand with the vacant space available directly from landlords, often fiercely.

Concessions such as free rent, generous tenant finish allowances, and moving allowances are on the rise, along with leasing commissions and broker "bonuses," as landlords work to fill the vacancy they do have in this competitive environment.

It's already hard enough to make money in office buildings. While the vacancy rates metro-wide were very low coming into this slowdown, and most new construction was hitting 70-80% lease-up targets upon completion, it's that last 20% that spells profit. Not to mention the fact that the cost to lease that last chunk of space has just gone up considerably.

With all due respect to Dr. Sohn, this may, in fact, become a problem. According to CoStar Realty Information, since the fourth quarter of 2000 the amount of sublease space on the market has increased by 152%, led by overextended technology companies. In real numbers, it is an increase from 1.47 million square feet to over 3.7 million square feet of available sublease space. This has brought the overall vacancy rate to 12.64%, up from just 10.5% at year-end. This is not horrible overall but the breakdown shows major weakness in certain key pockets- the vacancy rate is 17% in the Southeast Metro area, and over 21% in the US 36- Boulder-Corridor market. Further,

DENVER OFFICE MARKET

QUARTER	EXISTING RBA	DIRECT VACANT SF	VACANCY RATE %	W/ SUBLET VACANT SF	VACANCY W/ SUBLET %	RENTAL SF OCCUP	RATE
CURRENT	127,488,665	12,388,854	9.72%	16,108,206	12.64%	111,380,459	$16.91
END 1ST QTR 2001	126,295,756	11,717,401	9.28%	14,331,025	11.35%	111,964,731	$16.42
END 4TH QTR 2000	125,659,978	11,822,885	9.41%	13,300,111	10.58%	112,359,867	$16.39
END 3RD QTR 2000	123,590,494	11,287,800	9.13%	12,444,219	10.07%	111,146,275	$16.21
END 2ND QTR 2000	121,883,683	11,431,577	9.38%	12,497,152	10.25%	109,386,531	$16.08
END 1ST QTR 2000	120,413,068	11,659,461	9.68%	12,631,757	10.49%	107,781,311	$16.06
END 4TH QTR 1999	119,633,181	12,135,005	10.14%	13,148,789	10.99%	106,484,392	$16.10
END 3RD QTR 1999	117,995,095	11,782,790	9.99%	12,869,786	10.91%	105,125,309	$15.99

given the time it takes to get a new development out of the ground, new speculative projects started back when things were still rosy are now ready to dump more space into the competitive fray. If demand does not pick up soon and begin to reverse the vacancy trend, even office investors with an average amount of leverage will be faced with difficulty making mortgage payments.

Predicting demand is the tough part. *The Wall Street Journal* recently offered insight from a survey of office space users and retailers. The survey, reported in the May 14, 2001 issue, revealed that even though users of office space generally believed their business fortunes would turn around by mid-year, very few of them intended to lease more space during 2001. These tenants expect to lease an additional 0.6% of office space over the next 12 months, a much slower growth rate than the 2% or so of demand-growth forecast earlier this year. In a startling contrast, a majority of retailers surveyed- which was supposed to be the weakest sector- had plans to expand and open new markets this year, despite the recent instability of consumer confidence numbers. Retailers plan to lease an additional 3.7% of space, a much faster rate than the 0.6% previously forecast for that sector.

While some economists are eager to suggest we have seen the worst of this downturn and that it will not affect Denver profoundly, others point to the large numbers of layoffs occurring here (over 14,000 since January 1st, according to the *Denver Post*, 7/1/01) and around the country and posit that it must get worse before it gets better. Our analysis leans toward the latter opinion, however we have a keen eye turned toward the moment the bottom is evident, which will no doubt create some excellent investment and development opportunities. We further believe that the first and best opportunities will come in the office sector.

As predicted in our last newsletter, the cost to purchase office assets is falling and the going-in returns are rising as a result of the increase in risk and cost of lease-up. Vacancy will create problems for current owners, who will need to cut their losses or dump under-performing assets. Then, once the crystal ball on the economy does become clear and demand starts to climb back, it will be good times for those who have a few pennies put away in their piggy bank and the resources to turn around vacancy.

For now, it is time for investors to be highly selective with their opportunities, and be very confident in their risk analysis. The Triumph Team pulls together some of the top talent in the industry in Development, Brokerage & Marketing, Construction, and Asset & Property Management. Please contact us for more information on the market, our services, or for a thorough assessment of any opportunities you may be considering.

TRIUMPH REAL ESTATE
6860 S. YOSEMITE CT.
SUITE 1400
ENGLEWOOD, CO 80112
303.858.0922 **PH**
303.858.0921 **FAX**