



Government Takeover of Agency Lenders Amounts to Another Break for Economy - Significant Headwinds Remain

The government's takeover of Fannie Mae and Freddie Mac, which combined back or hold \$5.2 trillion of U.S. residential mortgage debt - or roughly one-half of the total - is a critical step in reducing financial market uncertainty. The Treasury Department's seizure of the mortgage giants will result in losses for the companies' shareholders and U.S. taxpayers in the near term, though it greatly reduces mortgage- and housing-related risks to the overall economy and the global financial system. The government's actions will provide greater availability of mortgage debt, put downward pressure on residential mortgage rates and essentially elevate the status of securities issued by the government-sponsored enterprises (GSEs) to U.S. Treasury debt.

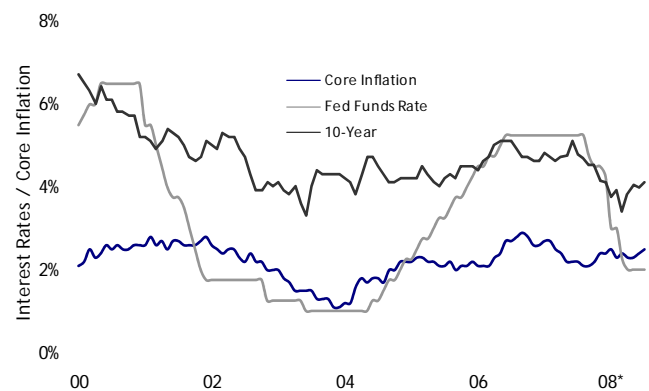
The government will provide immediate liquidity to Fannie Mae and Freddie Mac to help offset mortgage-related losses and will purchase at least \$5 billion of mortgage-backed securities issued by the companies. The initial plan places the firms under a conservatorship, which transfers control of the companies to the Federal Housing Finance Agency (FHFA).

Despite inflation concerns, the Fed held interest rates stable at its last two meetings, providing time for the economy to heal. The headline rate of inflation reached 0.8 percent in July, pushing the year-over-year increase to 5.6 percent, the highest figure since 1991; however, commodity prices declined considerably in August, which should translate into reduced consumer price growth. Furthermore, the Fed is betting that the weak employment market will

continue to ease wage pressures and that the slowing economy will restrict consumer demand, taking additional pressure off inflation in the coming months.

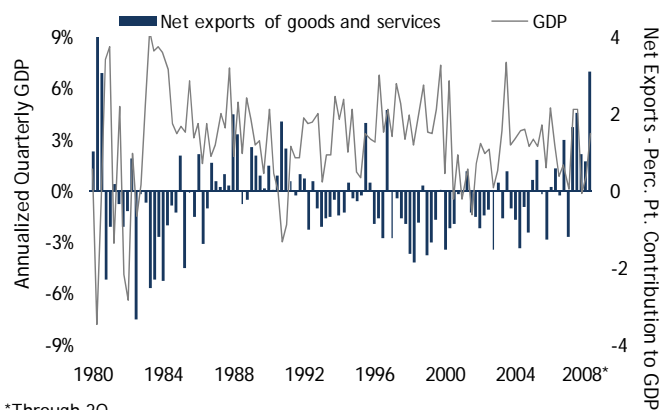
The economy was weaker than thought in late 2007 but was propped up by stimuli in the first half of 2008. Annualized GDP growth came in at an estimated 3.3 percent in the second quarter, boosted by net exports, which contributed 3.1 percentage points to GDP growth - the greatest contribution since 1980. The dollar has firmed against major foreign currencies in recent weeks, and the slower global economy is expected to reduce demand for U.S. goods and services,

Interest Rates Low, Inflation Risks Elevated



*Inflation as of July, interest rates as of September 4th
Sources: Marcus & Millichap Research Services, Federal Reserve

Net Exports Make Greatest Contribution to GDP Since 1980



*Through 2Q
Sources: Marcus & Millichap Research Services, BEA

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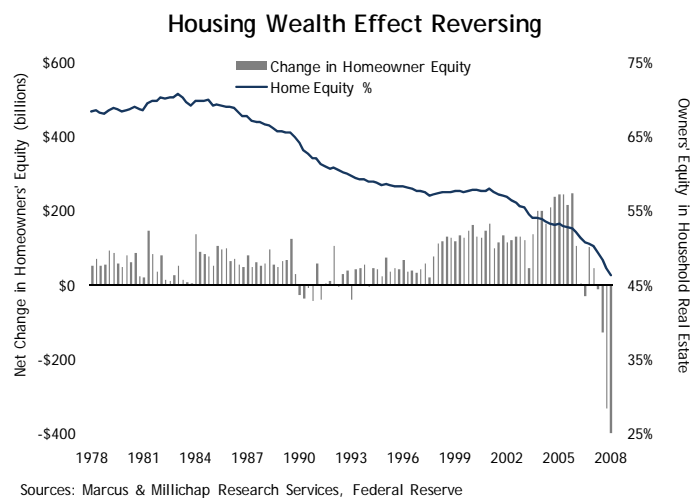
ultimately limiting the impact of net exports on overall expansion in the latter part of this year. Personal consumption expenditures also contributed to growth, adding 1.2 percentage points to the second quarter figure, boosted by tax rebate checks, which were spent more quickly than many had anticipated. Business investment in structures also added modestly to economic expansion last quarter. The housing market, on the other hand, has yet to reach bottom, subtracting 0.6 percentage points from growth during the quarter, while reduced business inventories were a far greater drag, deducting 1.4 percentage points from the overall growth figure.

The recent plunge in oil prices was a much-needed break for the economy; prices should continue to trend down, albeit at a more moderate pace, assuming supply-shocks are avoided. The spike in oil prices earlier this year was attributable largely to the weak U.S. dollar and investor speculation. Domestic oil demand has slipped in recent years; however, global demand, particularly among emerging economies, remains at high levels, which could prevent prices from declining substantially.

Job losses are likely to continue but are still below trend, as companies remained cautious during the most recent period of expansion. U.S. employment has declined by 605,000 jobs to date in 2008, led by losses in trade, transportation and utilities, construction and manufacturing, while the unemployment rate has ticked up 110 basis points to 6.1 percent. There are some bright spots, however, including the educational and health services and government sectors. With high gas prices putting pressure on truck/SUV sales, domestic automakers will continue cutting back; however, manufacturing may get a boost from business spending later in the year, as companies take advantage of tax incentives offered as part of the stimulus package.

Housing and energy prices remain the economic wildcards. Existing single-family home sales increased in July due to transactions involving foreclosures; however, sales are still down 12.4 percent from 12 months ago, while condo sales have fallen almost 19 percent over the same period. For-sale inventory of houses and condos combined is at 11.2 months of supply, compared to 9.5 months one year ago, and 4.5 months of supply at the market's peak. While energy prices have declined from peak levels, they remain elevated and will continue to act as a drag on household budgets and corporate profit margins. Adding to the economic headwinds is the fact that a large share of the \$100 billion in economic stimulus checks has already been spent, minimizing the chances of any significant positive impact on consumer spending in the latter half of this year.

The U.S. housing market will continue to weigh down the economy in the near term. In addition to subtracting from GDP growth, housing market woes have also negatively affected household wealth, leading to deteriorating consumer confidence and reduced retail spending. During the first quarter, U.S. household wealth declined by \$1.7 trillion, of which \$400 billion was



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attributable to declining home equity. It is estimated that every \$1 loss in household wealth translates to a \$0.06 decline in consumer spending; therefore, the first quarter loss alone exceeds the total tax rebate checks issued as part of the economic stimulus package. Furthermore, an estimated 9 million households are currently upside-down on their mortgages. If otherwise financially able homeowners walk away from their loans en masse, home price corrections could continue over the next several quarters.

Bank failures are creating a new wave of uncertainty in the marketplace, spurring government action to shore up confidence. The Fed has extended its emergency lending facilities to ease tight credit conditions, but many institutions will remain hesitant to lend until they can better assess the damage to their balance sheets. Once lenders are able to stabilize their positions and confidence in the banking industry is restored, this negative feedback loop should be replaced by a mild self-sustaining recovery.

Credit remains tight as most banks are focused on regaining liquidity and addressing writedowns; however, several regional and local banks that had lost considerable market share in recent years are stepping up to the plate. On average, balance-sheet lenders are pricing loans for retail properties at 255 to 300 basis points over the 10-year Treasury, with maximum leverage of approximately 65 to 75 percent.

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Quick Facts: Government Takeover of Fannie Mae and Freddie Mac

Responding to increased risks to global financial markets and the broader economy from the mortgage crisis, the U.S. government seized control of mortgage giants Fannie Mae and Freddie Mac. Fannie Mae and Freddie Mac hold or back \$5.2 trillion in residential mortgage debt, or roughly half the total outstanding.

The government's takeover provides assurance to GSE bondholders by essentially elevating the status of agency mortgage-backed securities to U.S. Treasury debt. The collapse of one or both of the companies would have had devastating effects on the mortgage and housing market, in addition to the broader economy and global financial system. Major holders of U.S. agency mortgage-backed securities include foreign central banks, led by China and Japan. In the weeks leading up to the takeover, Fannie Mae and Freddie Mac announced massive losses due to rapidly rising residential foreclosures. Despite the "implied government guarantee" of agency-issued debt, major investors in agency mortgage-backed securities were growing wary of the securities and began to pare back holdings. The loss of confidence in the GSEs became increasingly evident as their stock prices plunged.

The Treasury Department's takeover of Fannie Mae and Freddie Mac is comprised of multiple actions that combined should restore confidence in the mortgage giants, inject immediate liquidity into the mortgage market and help curtail the housing downturn.

- *The companies' operations are now under the control of a government conservatorship led by the Federal Housing Finance Agency. Longer-term plans for Fannie Mae and Freddie Mac remain uncertain, though once stabilized and restructured to minimize risk to the broader economy, the government may re-privatize the firms.*
- *Immediate liquidity injections will enable the agencies to function more effectively in issuing new debt. The U.S. Treasury has established the Government Sponsored Enterprise Credit Facility to provide an estimated \$200 billion in liquidity to Fannie Mae, Freddie Mac and Federal Home Loan Banks on an as-needed basis through the end of 2009.*
- *The total cost of the bailout remains to be seen, though the plan is intended to minimize losses to U.S. taxpayers and holds the potential to produce gains. In exchange for guaranteeing GSE-issued mortgage debt, the Treasury Department receives \$2 billion in preferred stock. Under the new agreement, common and existing preferred shareholders will be subject to losses ahead of the government. While there are financial institutions vulnerable to significant losses under this plan, the numbers are limited and the banking agencies will assist with capital restoration plans if requested.*
- *To reduce housing and capital markets uncertainty, and to ensure adequate availability of affordable home mortgage debt, the U.S. Treasury will purchase GSE mortgage-backed securities and allow the GSEs to expand their portfolios moderately in the near term. After 2009, the size of their portfolios will be reduced by 10 percent per year to minimize risk.*

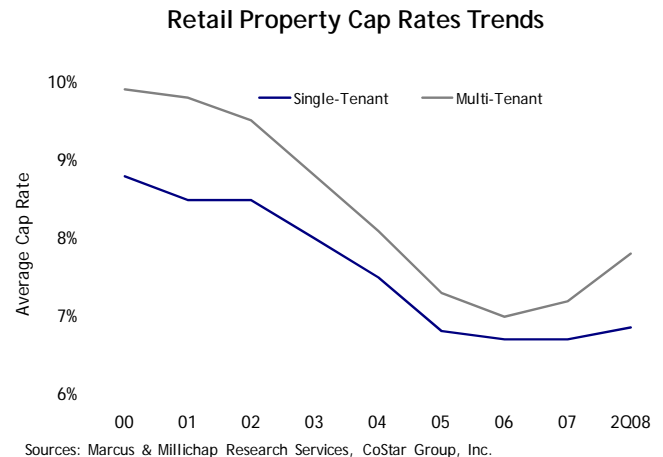
The government's move is not seen as the cure to housing market ills, but it is expected to propel the process of re-establishing credibility. Most importantly, it reduces uncertainty in a critical component of global capital markets. Since the takeover announcement, the 30-year fixed mortgage rate has declined 45 basis points. In addition, a recent Fannie Mae auction of \$7 billion in notes was met with strong demand, with more than \$9 billion in orders. It is important to note that the multi-family sector has been a bright spot for the agencies, and indicators point to continue funding of transactions. Apartment spreads have remained relatively unchanged since the takeover announcement.



Economic Stimulus Checks Temporarily Offset Drag of Higher Energy Costs and Job Losses on Retail Sales

Retail vacancy rose 50 basis points during the second quarter to 10.7 percent, bringing the year-to-date increase to 100 basis points. Approximately 32 million square feet of new retail space was delivered, contributing to the increase in vacancy.

Most retailers have reduced expansion plans this year and continue to shutter underperforming stores, with approximately 2,830 closures announced during the first half of the year. Apparel stores accounted for 35 percent of the closure announcements in the first six months of this year, followed by home entertainment chains at 29 percent. Closure announcements by food and beverage establishments, such as Starbucks, accounted for another 6 percent of the total during the first half. The shift in closure announcements is dramatic when compared to the latter half of 2007, when the bulk of closures were directly related to the housing downturn, with furniture/home furnishings stores and home entertainment stores each accounting for more than one-third of the 1,525 closures announced.



Retail sales picked up steam in the second quarter thanks to economic stimulus checks. Year-over-year, retail sales (less autos and gas) were up 3.6 percent as of June, compared to 1.8 percent three months earlier. Wholesale clubs and discount chains are faring best, due in part to discount pricing on gasoline, with same-store sales up 9.5 percent and 2.3 percent, respectively, at the end of the second quarter. Apparel and furniture chains, along with department stores, continued to post declining sales.

Tighter financing and an expanding expectations gap between buyers and sellers have resulted in a dropoff in dollar volume, particularly among deals involving larger properties and portfolios; however, there are plenty of reasonably priced core retail properties attracting multiple buyers, which account for the bulk of velocity. One of the larger deals this year involves Centro Properties Group, which is facing challenges refinancing some of its U.S. shopping center holdings acquired just prior to the onset of the credit crunch. Centro recently agreed to sell 29 of its higher-quality U.S. assets for \$714 million; the deal should ease some of the pressure on the company's balance sheets. The reported sale price reflects a 10 percent discount from the original acquisition price in 2006, which is moderate considering the escalation in perceived risk in the retail sector over the past 12 to 18 months and the company's weakened negotiating position.

The \$1 million to \$10 million segment has been impacted the least by the credit crunch, as many private investors continue to focus on high-quality single-tenant assets, which tend to fall into this price range. Overall, single-tenant retail properties are pricing at cap rates of 6.9 percent, approximately 20

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basis points greater than the average in 2007, while multi-tenant cap rates are closer to 7.8 percent, which is more than 50 basis points higher.

Forecast:

Completions are forecast to drop by only 10 million square feet, to a total of 130 million square feet in 2008. Due to only a moderate reduction in new supply this year, rising closures among smaller and regional retailers and difficulty re-tenanting dark space, vacancy is forecast to rise by at least an additional 50 basis points during the latter half of 2008 to the low-11 percent range. Big-box retailers account for a large share of new construction in the pipeline, and once these projects are delivered we expect to see a major dropoff in new supply entering the market.

Financing for retail transactions is still available, but lenders will continue to proceed with caution, closely monitoring local market fundamentals and tenants' credit quality. Cap rates will continue to diverge for retail properties based on quality and location. Investors' aversion to risk is apparent when reviewing cap rates for value-add deals, which have increased 70 basis points or more over the past year, compared to high-quality stabilized assets, which have registered less significant increases of 40 to 50 basis points.

Continued reductions in development will allow for improvement once the housing market settles and the economy regains traction. Markets with above-average for-sale housing inventories today, such as Phoenix, Orlando, Tampa and South Florida, are also those that offer some of the strongest long-term demographic and economic outlooks.

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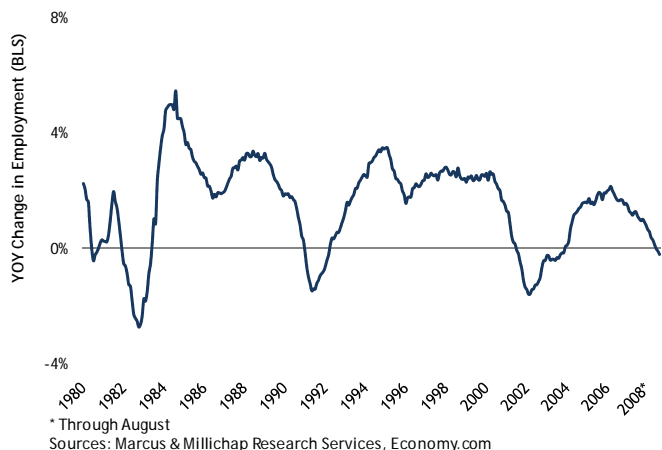
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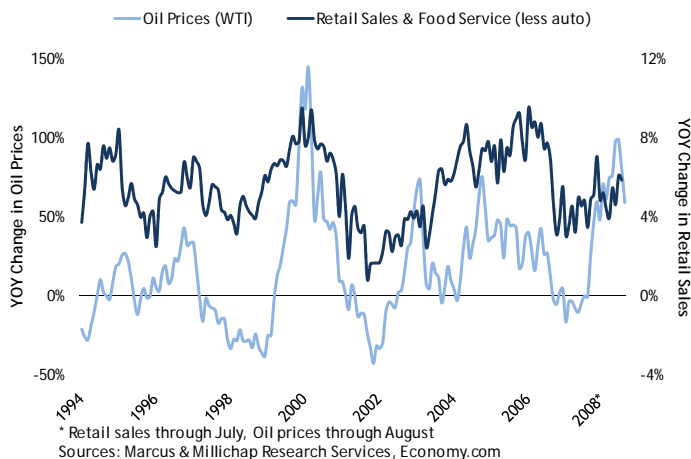


Retail Market Vital Signs

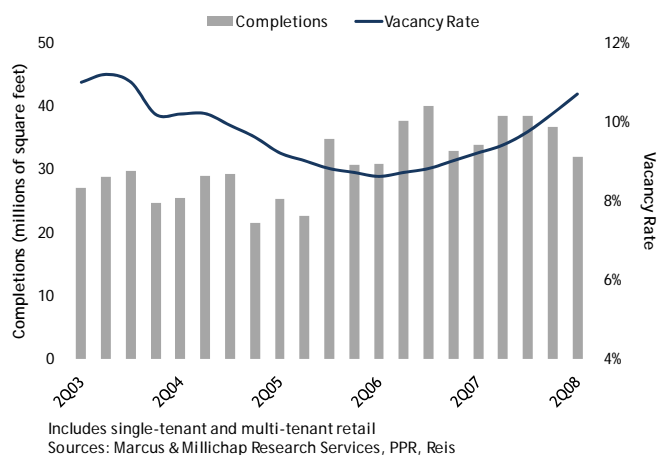
Total Non-Farm Employment Growth



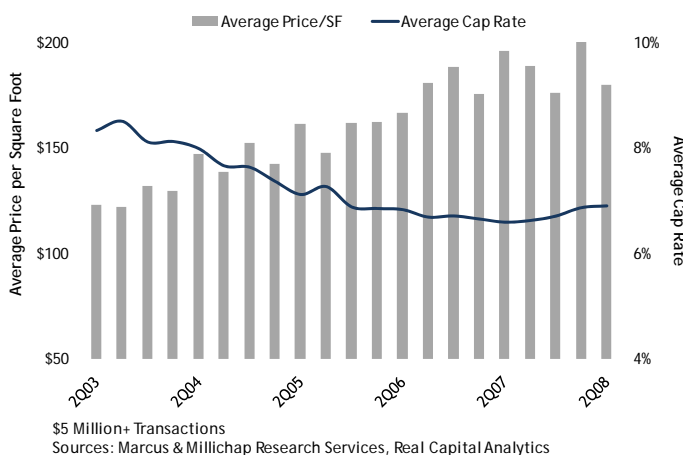
Retail Sales and Oil Prices



Total Retail Supply and Demand Trends



Retail Price and Cap Rate Trends



2Q 2007 to 2Q 2008 Change in Retail Vacancy

Top 10 Markets (Ranked by Change in Vacancy)

Metro	2Q 2008	YOY Chg (bps)
Charlotte	8.3	-20
San Francisco	4.1	-10
Oklahoma City	10.8	-10
Philadelphia	6.9	30
Denver	8.2	30
Baltimore	5.8	40
New Haven-Fairfield County	8.1	40
Boston	5.8	50
Columbus	11.7	50
Kansas City	11.7	50
US Metro Average	10.7	150

Bottom 10 Markets (Ranked by Change in Vacancy)

Metro	2Q 2008	YOY Chg (bps)
Jacksonville	9.6	200
Sacramento	10.1	200
Salt Lake City	10.0	210
Chicago	9.5	210
Fort Lauderdale	6.8	230
Milwaukee	11.8	230
Orlando	9.5	230
Riverside-San Bernardino	13.7	250
San Antonio	14.3	270
West Palm Beach	8.9	280
US Metro Average	10.7	150

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