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## Griffin Realty Advisors 2008 Market Outlook



There are a number of factors contributing to the overwhelming concern surrounding the condition of the global economy and the risk that the United States is headed towards or is already in a recession. These concerns are very valid given the number of dislocations in the debt markets particularly with year-to-date CMBS issuance down 92%, volatility in the LIBOR rate and the 10-year Treasury note seeing its largest weekly decline in four years. In addition, the housing crisis continues with further value losses of 25%-40% expected. Finally, year-to-date job losses topped 250,000 for the first quarter along with the unemployment rate creeping up to 5% and the GNP growth in the first quarter remaining positive but only at .6%.

The Federal Reserve has taken a number of steps including the recent (5/01/08) 25 basis point drop in the federal funds rate pushing it down to 2 percent. This was the Federal Reserve's seventh straight rate cut and many believe it to be the end of the rate cut campaign for the near term due to growing concern of increased inflation. The Federal Reserve has also made \$150 billion in short term loans available to commercial banks to provide cash to strained banks so they will continue lending to customers. The stimulus package approved by Congress should be in the hands of most consumers at this point and is expected to stimulate consumer spending over the next few months.

Unfortunately, Commercial real estate is just like most other commerce and it cannot remain unaffected by these economic woes. For the most part, real estate fundamentals remain strong therefore the affects of the downturn should be mitigated significantly reducing the risk of

current market conditions creating a commercial real estate downturn like the one seen the early 1990's.

Because of liquidity and delinquency concerns created by the credit and housing markets, lending requirements have become extremely stringent. Lenders are offering less leverage and requiring higher debt service coverage and are rigorously examining borrower business plans, credit and sponsorship before providing loans.

As debt across the board becomes scarce and consequently more expensive, the cap rates necessary to attract investors to commercial real estate investments are increasing. Distressed asset sales are also on the rise due to owners' inability to meet lender requirements.

Despite the softening of the economy and the turmoil in the capital markets, investors continue to have confidence in the U.S. commercial real estate industry. *A survey of more than 1,000 private and institutional real estate investors reveals that 62% of the respondents plan to increase allocations in real estate during 2008 and only 7% of real estate investors plan to decrease their investments in 2008.* The fact that the majority of investors are planning to increase real estate holdings and that the percent is higher than last year is a strong validation that they are able to separate capital market issues from commercial real estate fundamentals.

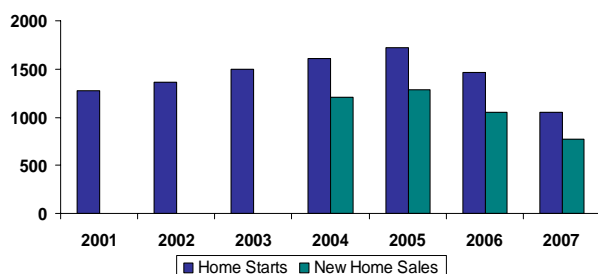
Given the tighter financing environment, lower leverage buyers and cash investors will be better positioned for buying opportunities. The Griffin Realty Fund falls into this category and is poised to take advantage of some of the best buying opportunities we've seen in years.

# Overall Economic Outlook

## Housing Market Struggles Continue

As mentioned, the struggles in the housing industry continue. Housing starts were down over 28% in 2007 and the deterioration has continued into 2008 with a decline of approximately 8% thru March of 2008. 2007 also saw a 26% decline in home sales. Thru March 2008, sales declined approximately 13%. Throughout 2008 home sale inventory has remained relatively consistent at 9.9 months of inventory.

New Home Starts and Sales



Source: U.S. Census Bureau

The S&P/Case-Shiller® Home Price Indices measures the residential housing market, tracking changes in the value of the residential real estate market in 20 metropolitan regions across the United States. In February of 2008, the index revealed that the drop in house prices had accelerated to a 9.1% annual rate which is enough to erase more than \$2 trillion in household wealth causing more homeowners to experience negative equity and giving way to additional increases in delinquency and foreclosure rates.

## Economic Growth Slowing

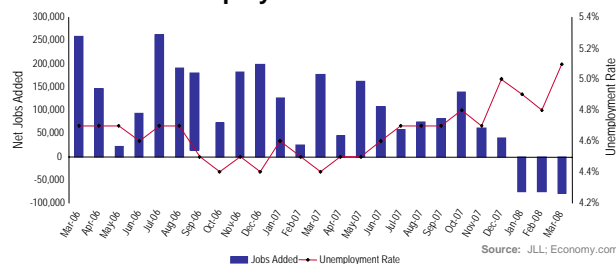
The economy is still expanding albeit at a much slower rate as evidenced by the 4th quarter 2007 growth rate of only .6%. The majority of economists are predicting that this trend will continue for the first half of 2008 with growth expectations below 1%.

This is not surprising given the daunting variety of negative factors affecting the household sector including rising gas prices, energy and food costs, slowing employment growth, household wealth declining due to falling prices of homes and equities and the significant reduction in availability of consumer credit.

## Losing Ground in the Job Market

The year-over-year growth rate of overall employment fell to .06% well below the 1% rate that has, in the past, been a recession indicator. In the first quarter of 2008, total employment declined by 232,000 jobs. The good news is the job loss in April slowed to only 20,000 and current unemployment levels are at a low rate of 5% and are projected to increase approximately 1% over the next 18 months.

## Unemployment and Job Loss



Source: JLL, Economy.com

## Credit Tightening

Reductions in credit availability have limited the beneficial impact of easier monetary policy. The Federal Reserve Loan Officer's Survey indicates that many banks have tightened their lending standards across all categories of bank loans – commercial and industrial loans, commercial real estate loans, mortgage loans and consumer loans.

## The Offset of Exports

The good news is that the global economy is still strong and the weak dollar continues to support export growth. Net exports are expected to continue to rise during 2008, although somewhat slower than in 2007 since economic expansion abroad is also slowing somewhat. According to the Mortgage Banker's Association, over the past eight quarters, the increase in real net exports has offset more than 90% of the drag on real GDP growth stemming directly from the decline in residential investments. By the second half of this year, the rise in net exports is expected to more than offset the decline in residential investment.

## U.S. vs. Global Markets

Finally, it is clear that the financial markets have experienced a difficult 8 months since August, 2007 when the first signs of the sub prime problems began to appear. No one knows when the market will return to normal but there is some good news. In April, 2008, the U.S. stock market gained 4.5% which was the largest gain in a year. Although the U.S. Stock Market still reflected a loss of 3.4% year to date through April, it has fared better than many foreign exchanges through the same period.

Country	Index	Change Through 4/30/2008
US	Dow Jones Avg.	-3.4%
UK	FTSE 100	-5.7%
Hong Kong	Hang Seng	-7.4%
Japan	Nikkei	-9.5%
France	CAC 40	-11.0%
Australia	S&P/ASX 200	-12.0%
Germany	DAX	-14.0%
India	Sensex 30	-15.0%
China	Shanghai Comp.	-30.0%

Many U.S. investors who have considered foreign markets a preferred investment arena over the past few years are having to re-evaluate current investment strategies in light of the slowing world economy, decline in the value of the U.S. dollar and increase in value opportunities in the United States.

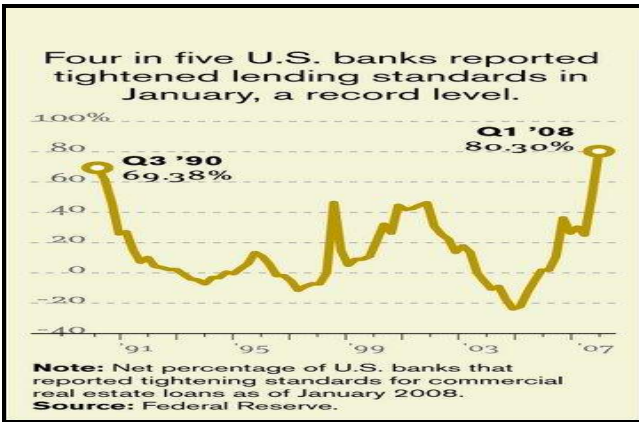
# Measure of the Commercial Real Estate Downturn

## How Far Down is it Headed?

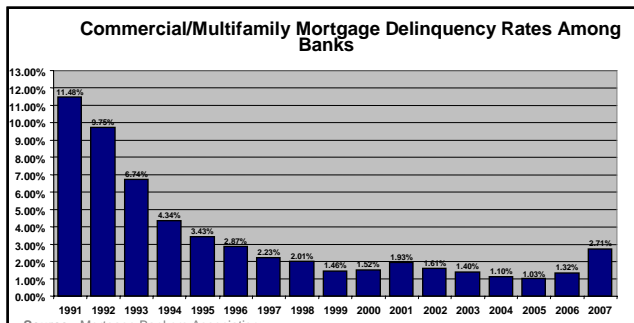
Given the current market declines, there are 2 questions on most people's minds: 1) Will the commercial real estate downturn be as significant as the residential real estate decline? and 2) Will the current commercial real estate decline be as detrimental as the downturn in the early 90's?

The good news is that the answer to both of these questions is no. The residential downturn is expected to be far more significant than the anticipated downturn in the commercial real estate arena. Commercial real estate is projected to decline 15%-25% (*which is good for buyers and bad for owners*) while residential housing prices have already seen a significant decline, Credit Suisse is projecting home prices to fall an additional 25% - 40% in some regions before bottoming out. As for a comparison to the early 1990's, there are a number of factors that allude to the fact that the current commercial real estate downturn will be far less severe.

To begin with, banks began tightening credit standards in mid-2007 and the trend has continued into 2008. To date, credit standards are currently more stringent than they were in the early 1990's.

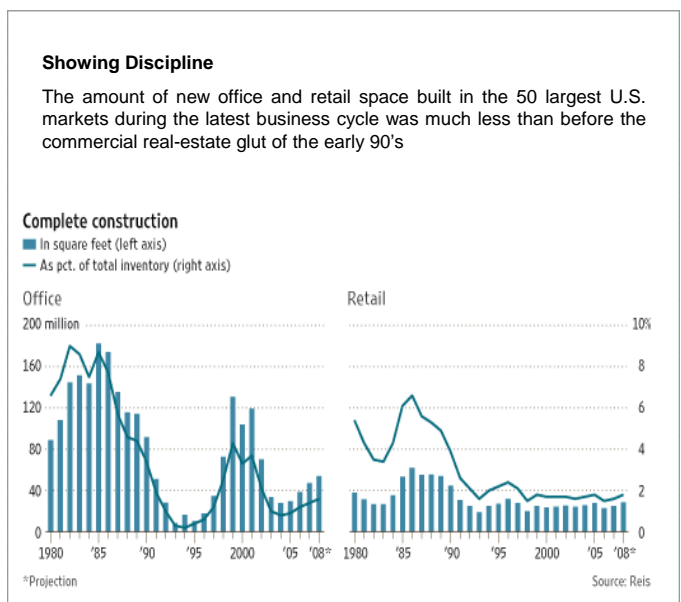


In line with the credit standards is the fact that current delinquency rates are far lower than rates in the early 1990's. Given the tightening of credit standards mentioned above, it is very unlikely that delinquency levels will reach the levels of the earlier downturn.



Delinquencies are one of many factors that can lead to a bank failure. *The last time the FDIC was hit hard with failures was during the 1990-1991 recession, when 502 banks failed in three years. Current estimates are that only 100-200 banks will fail over the next 12-24 months.*

Finally, and probably most important is the fact that most real estate sectors showed discipline in delivering new product mainly due to the high construction cost and because the commercial real estate market only began to recover from the last recession in 2004.



In 1986, Moody's gave the nation's office sector a score of 13 out of 100 on a scale it uses to project the sectors health, meaning supply far outweighed demand. Today the national average score of the office sector is 52. It appears we are really struggling with a battle of perception vs. reality. The reality is:

- Current credit standards are more stringent than in the early 1990's
- Current and projected delinquency rates are far lower than in the early 1990's
- Bank failures are estimated at less than half of the number of failures that occurred in the early 1990's
- The majority of commercial real estate sectors have been diligent in not over developing as was done in the early 1990's.

Based on this reality, the risk of a downturn consistent with the early 1990's is very low but the benefit of favorable buying opportunities consistent with the early 1990's is very likely.

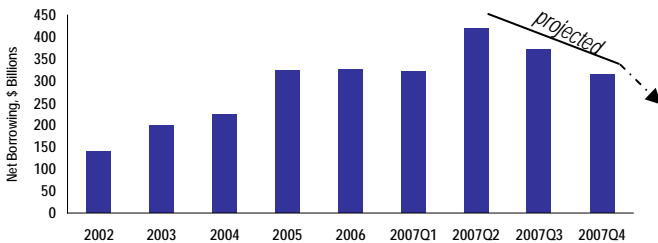
# Financial Outlook

## Availability of Credit

In 2007 net income for FDIC insured banks dropped over 25%. Over the next 3 years, 100-200 Banks are expected to fail. These failures are expected to hit smaller banks with weak profits and deteriorating capital bases. There are currently 76 banks on the FDIC's "problem institutions". These are just a few of the many signs that financial institutions were hit hard in 2007 and are struggling to maintain strength in their balance sheets.

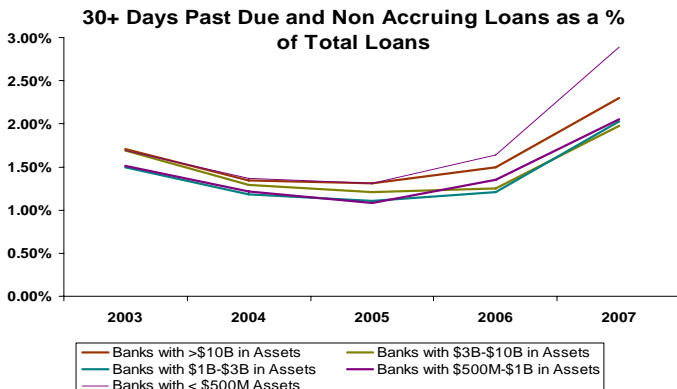
In a time when the Federal Reserve is taking steps to provide liquidity to banks in an attempt to increase the quantity of available credit, lenders remain reluctant to provide credit, especially real estate credit, because the risks are perceived to be very high.

### Net Borrowing, Commercial and Multifamily Mortgages



\* Quarterly 2007 data are seasonally adjusted rates  
Source: Jones Lang LaSalle, Federal Reserve

This sentiment is not completely unwarranted. According to the Federal Reserve, delinquencies in commercial real estate surged in the 4th quarter of 2007 to 2.71%, the highest level since the fourth quarter of 1996, and more than double the 1.32% of the prior year.



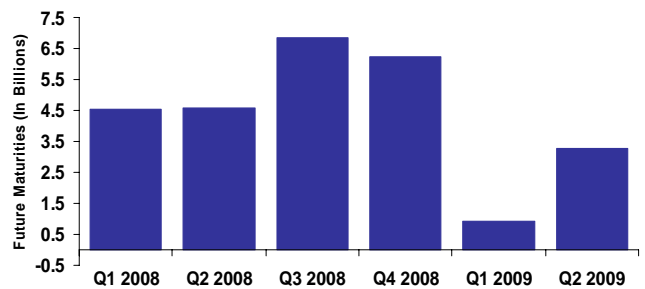
Source: Federal Reserve

The expected growth in delinquent and non accruing loans will continue to deteriorate financial institutions' balance sheets and increase the number of distress sales available in the market.

Commercial real estate values have already declined 10%-15% and another 5%-10% decline is expected over the remainder of 2008. For both the lender and the real estate owner, these declines will have a very negative affect. Value declines may cause borrowers to go into default if they can no longer meet certain loan covenants such as loan to value (LTV) or debt coverage requirements. The inability of borrowers to satisfy these covenants will require banks to increase loan loss reserves, weakening the financial strength of the lending institution. In the worst case scenario of foreclosure, banks will be required to take back and manage assets, which is very costly and not efficient given property management is not a primary function of lending institutions or they will seek out buyers with capital and a proven track record of closing on REO transactions.

Another dilemma created by the loss in value and more stringent lending requirements is the increased inability of the real estate owner to refinance debt as it matures. Through mid-2009, there are over \$26 billion of loans maturing that may require refinancing.

### Potential Refinancings



Fixed-Rate Conduit/Fusion Deals  
Source: Wachovia Capital Markets, LLC, Intex Solutions, Inc., Trepp, LLC.

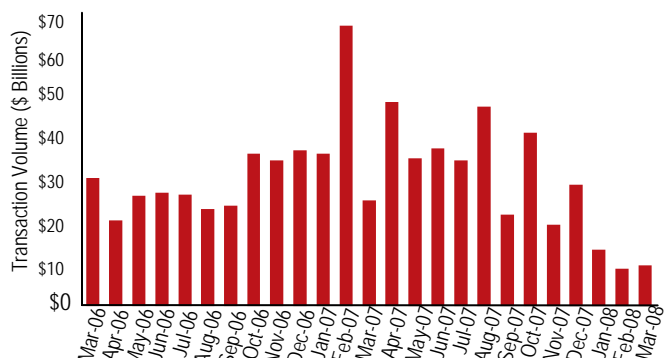
This is not all bad news. For investors with available cash, like Griffin Realty Fund, the anticipated increase in distressed asset sales will create some of the best buying opportunities the market has seen since the early 1990's.

# Commercial Real Estate Outlook

## Capital Markets

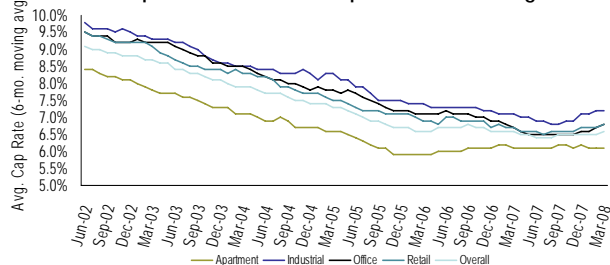
The commercial real estate debt capital markets shifted suddenly from highly accommodative to highly risk-averse making borrowing both more difficult and more expensive. This disruption in the capital markets has brought about a significant decline in transaction activity since mid 2007 and has sidelined a number of investors that, in the past, used high levels of leverage to acquire assets. It has also brought the era of cap rate compression officially to a close with cap rates already increasing an average of 75-100 basis (notably less in a select few top-tier markets).

Overall Volume Set to Drop by up to Two-Thirds in 2008



\* Properties of at Least \$5 Million  
Source: Jones Lang LaSalle, Real Capital Analytics

Upward Pressure on Cap Rates is Mounting



\* Properties of at Least \$5 Million  
Source: Jones Lang LaSalle, Real Capital Analytics

## Real Estate Fundamentals

The good news is, the drastic slowing in the capital markets is not due to a significant deterioration in the current operating performance of real estate assets. Real estate fundamentals maintained a strong rate of improvement through 2006, with all five primary property types experiencing their strongest rent growth in 5 years.

While improvement in property fundamentals has slowed in 2007 and has deteriorated in a few markets, the overall outlook for operating performance is positive. Notwithstanding, increased investor caution and selectivity is warranted given the recent turmoil in the capital markets and current economic uncertainty.

U.S. Property Sector Relative Performance

Sector	Market Score 2008/2009	% US Metros w/Decline or Watch Scores	Annual Change in Effective Revenue			Current Vacancy
			2007	2008 F	2009 F	
Apartment	Stable	15%	4.6%	2.2%	2.0%	5.9%
Industrial	Stable	17%	3.0%	0.6%	1.8%	8.8%
Office	Growth	22%	11.6%	3.1%	2.0%	12.7%
Retail (Strip Centers)	Stable	21%	2.0%	1.0%	1.1%	7.6%
Hotel	Stable	NA	5%-7%	2%-4%	0%-2%	36.80%

Source: REIS, Inc., Torto Wheaton Research, Smith Travel Research, Real Capital Analytics, Inc. and Wachovia Capital Markets, LLC.

**Multi-Family:** The multi-family market remains strong despite exposure to the distressed condo and single family markets. Rental rates are expected to slow but occupancy levels should benefit from strong demographic trends and increased residential foreclosures.

**Industrial:** Exports are expected to remain strong, which will help this sector maintain healthy occupancy and rental rates particularly in coastal locations.

**Office:** The office market has experienced robust rental rate growth and low vacancy rates over the past few years which began slowing in 2007, a trend that is expected to continue for the next 12-24 months. Because of the slowing economy employers are being forced to make more efficient use of floor space and delay expansion plans.

**Retail:** Rental vacancy rates have increased in 2007 due to deteriorating absorption rates and an over supply of inventory. If the consumer economic strains of increasing inflation, job loss and the housing market continue, this sector's struggles will persist.

**Hospitality:** The hotel industry continued its strong performance in 2007, however occupancy and growth in average daily rates (ADR) have begun to moderate as new supply is beginning to outpace demand.