



January 19, 2009

Hello everyone. I hope you have survived (somewhat intact) the upheaval of the last few months, and hopefully you were able to have an enjoyable holiday season and new years.

Our 2008 year end market reports have been completed. For legal reasons, I can no longer post the official report, but I would be happy to email it to anyone who would like to receive it. If you are interested, please simply email me and I will forward to you immediately. We again have both a Baltimore Metro area report and a national report. We use data provided by a company called Costar to compile this information, and it has proven to be quite good.

On to my thoughts....

There are several things that have run through my mind fairly consistently over the second half of the year, but certainly within the last four months of the year. In no particular order, these were:

1. Can I just get one thing to go right?
2. Where did everyone go?
3. Uuuuugggggghhhh!

Please understand that these are noted tongue-in-cheek, but they do represent a decently accurate summary of the commercial market. While we were able to see and even discuss the tightening credit market and general economic slowdown that has come to the forefront of everyone's minds, we were not able to grasp the magnitude, breadth, and severity of these factors across all asset classes (for gallow's humor, we sold a co-investment project in June due to fears of the tightening credit market at a significant gain and then personally plowed the profits directly into the stock market.) This economic downturn has affected all areas of commercial real estate, including its most fundamental issue, demand for space.

I want to start my commentary with what I was just mentioning (demand for space) because it is the most fundamental driver of everything and anything that happens in commercial real estate. Companies use space, whether warehouse, office, retail, flex, or any other type to conduct trade, store goods, or sell items. As those levels of activity decline, the demand for space gets reduced. It can be seen in several other indicators including employment and stock price. In fact, real estate demand for space ties much closer to equity levels than to debt levels.

As most people are keenly aware, the equity markets were historically volatile in the second half of 2008. Since companies use their equity to start or expand projects, this volatility created a situation where companies could not know their cost of capital. Without knowing your cost of capital, it becomes impossible to judge whether a project should start or end, expand or contract. The net effect is that companies simply do... nothing. They wait until there is some sense of stability, even at a lower valuation, so that a rational decision can be made. This is what was seen in the second half of the year – a complete removal of all but the most needy of demand. This removal spanned across nearly all asset types from office to retail to warehouse. All of this can be seen in the statistical figures for the second half of the year.

YEAR END 2008 COMMENTARY



Vacancy in the Baltimore office market jumped to 12.2% from 11.7% at the end of June. Vacancy in the Baltimore Warehouse market actually dropped over the second half of the year from 11.3% to 11.0% on the back of several large deals done in the early 3rd quarter. The Baltimore retail market maintained a 4.8% vacancy throughout the second half, however, at the end of fourth quarter, and additional 4% of the market was available for sublease. One other note, whereas in July I had thought that we would see a statistical turn in the second half of 2009, I now think that such a recovery in demand could well be into 2010.

All of this slackening of demand has had a tremendously significant impact on asset valuations. This has come on top of the tighter credit markets that we have experienced. In effect, we are seeing buyers of commercial real estate reevaluate the risk that is attached to such an investment. Whereas pricing two years ago gave almost no consideration to the possibility of vacancy, we are now seeing pricing which reflects longer lease up times at higher installation costs and lower projected revenues. This has created a huge disparity between the perceived values of buyers and the perceived values of sellers. In such an environment, the outcome has been a complete lack of asset trades.

On a national basis, we have seen stabilized properties sell at higher capitalization rate to compensate buyers for both higher credit costs and the risks associated with the tenant's businesses. We have seen a rise of anywhere from 100 – 250 basis points within the investment market since the beginning of 2008. As I have previously stated:

I believe we are going to see 6 – 18 months of very low activity. It takes a while for market players, especially sellers, to wrap their arms, heads, and hearts around the new market realities. Keep in mind that while we are often talking about "institutions", "developers", "entrepreneurs", "businesspeople", etc., we are still talking about people. Most people, if they are told that something is suddenly not worth as much as they believed a few months earlier will simply hold on to that asset. The institutional asset manager does not want to admit that their underwriting was wrong or that they failed to see a change coming in the market. The individual owner will typically believe the market value will return shortly (in the same way many homeowners are having difficulty dealing with the new market pricing.) Once the psychological shock wears off, I think we will see the market return to normal. Assets with stable income will once again sell for a reasonable rate of return based on the riskiness of the cash flow. Vacant or value-added opportunities will go back to selling for a discount to compensate for the added risk.

For 2008, AGM was able to notch some significant deals including:

- Disposition of a co-investment asset at an 8% capitalization rate, giving the equity partners were able to realize a 43.4% annualized compounded return.
- Leasing of new corporate and regional headquarters for GSE Systems (35,000 square feet) and Geosyntec Consultants (17,000 square feet).
- Sale of a two building office complex in Woodlawn, Maryland at the end of the year at a 10% capitalization rate.

We are hopeful that the economic mood will shift for all parties of the economy in 2009, and we hope to be able to serve of clients in any way possible.

As always, please let me know if I or anyone at AGM can be of assistance. Have a great 2009!