

Investment Market Report

OAHU - HONOLULU | 2009 - 2010

“The combination of the inability to secure refinancing and the weakened economy will boost defaults and foreclosure activity.”

- Mark Bratton (R) CCIM
Vice President

MARKET INDICATORS

	YEAR END		
	2008	2009	2010
SALES VOLUME	▼	▼	▲
SALES COUNTS	▼	▼	▲
CAP RATE	▲	▲	▲

HIGHLIGHTS

Total 2009 \$IM+
Commercial Investment
Transactions:

113

Total 2009 \$IM+
Commercial Investment
Sales Volume:

\$627 Million

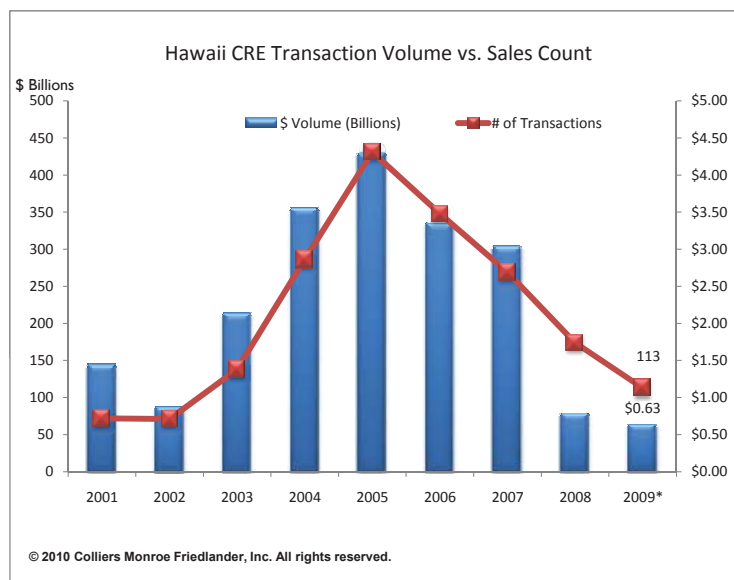
Loan Defaults Loom Over Horizon

Hawaii's commercial real estate investment market encountered difficult market conditions as the combination of the lack of financing capacity, poor market conditions, and the faltering economy drove transaction activity to levels not seen since the aftermath of the Japanese bubble period in the early 1990s. Total transaction volume fell to \$627.5 million, 20.4% below 2008 totals and more than 85% below the record \$4.3 billion level established in 2005.

Hawaii has experienced a significant change in the investment market over the past 18 months. At mid-year 2007, nearly every property type was coveted as money flowed from off-shore capital sources to purchase or

develop properties. At one point, there was more than 7 million square feet of proposed commercial development being planned. At its zenith, vacancy rates had trended downward for nearly five years and rents have escalated. Each property sector fell into the expansion phase of the real estate cycle.

Today, each property type has entered the recession phase of the real estate cycle. Tenant demand has slowed, rents have reversed direction and many proposed developments were shelved. However, it appears that the downturn in the property cycle was shallower than that felt on the U.S. mainland. There are already signs that several property sectors will emerge from the recessionary phase of the cycle.



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Financial Crisis Impact

Many of the properties which traded hands and were purchased with short-term debt at the height of the market (from 2004 through 2007), now face challenges securing refinancing. Tightened underwriting loan term requirements of lower loan-to-value ratios, more stringent debt coverage ratios, and intense scrutiny of rent rolls and income statements have placed nearly every real estate transaction under the proverbial microscope.

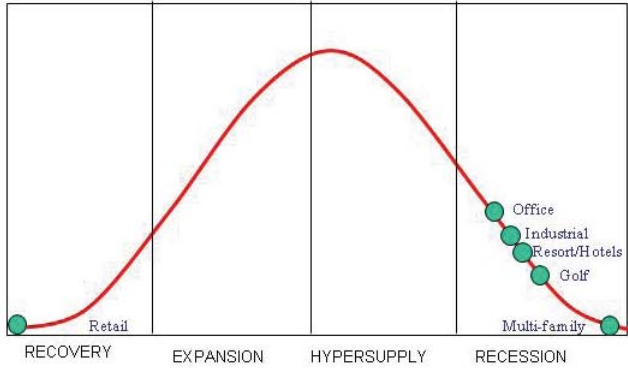
As with all investments, there is a continuum that is based on risk versus return. Despite the limited number of transactions, all indications lead us to believe that capitalization rates that had sunk to the 5.0% to 6.0% range two years ago for prime properties are following mainland US trends and are on the rise. Recently sold shopping centers and suburban office buildings have traded within an 8.0% to 8.5% cap rate range. This 200 basis point increase over the past 18 to 24 months shows the rapid change in the market. Land sales for development deals have come to a standstill as financing for these projects appears to have evaporated as lenders become increasingly risk averse.

After years of healthy job growth, which is the primary requirement for commercial real estate market expansion, Hawaii's employment market was plagued with layoffs, furloughs and job sharing strategies. Rising vacancy rates, weakening tenant demand and declining consumer confidence resulted in negative net absorption and softening rental rates. As market fundamentals started to deteriorate, properties faced with toughened loan criteria found margins shrink as property values sagged. At this point, properties that are unable to meet their lender's required loan-to-value ratios could technically be placed into a default situation.

Foreclosures Mount

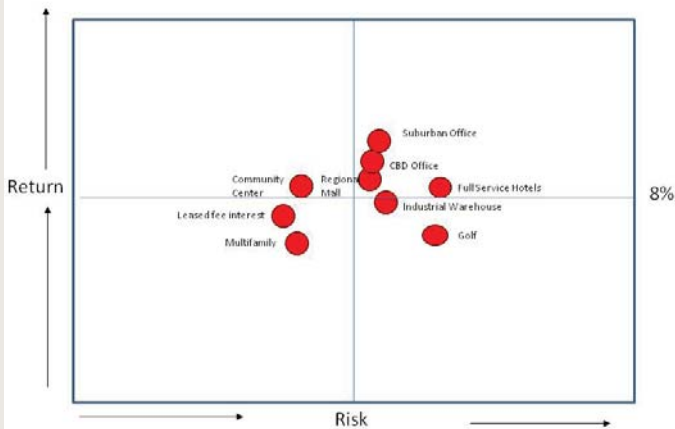
Many property owners that capitalized on cheap available funding during the market's peak, found themselves over-leveraged a few years later. Unable to meet their debt obligations to pay back the mortgage, foreclosures appear inevitable. For lenders, many are not interested in taking a property back. The need to place capital reserves aside to cover a foreclosed property can be onerous. Many small regional banks on the mainland have failed as capital reserve requirements for bad commercial real estate loans resulted in the Federal Deposit Insurance Company closing a number of banks.

Real Estate Cycle



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Risk vs. Return



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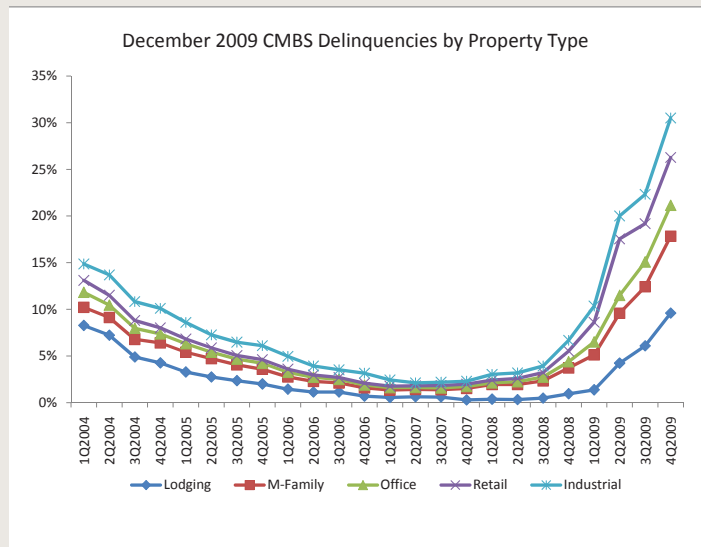
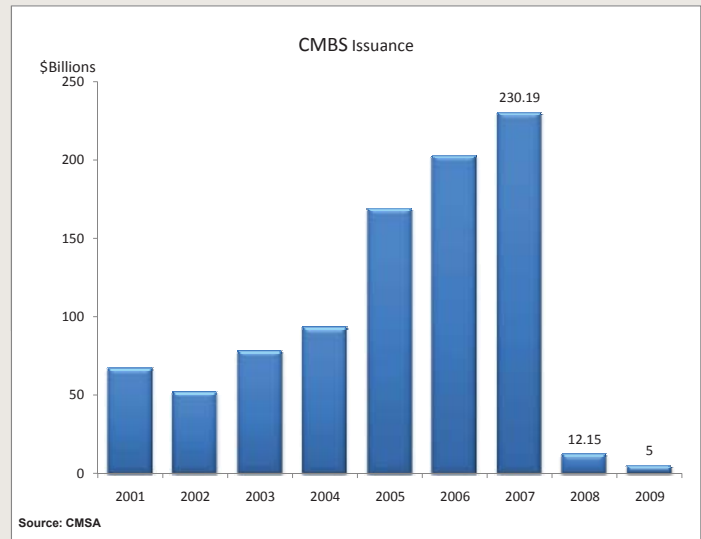
Banks are attempting to avoid this increased capital requirement situation by extending the term of many of these expiring loans. “Pretend and Extend” has become the vernacular used to describe the popular banking strategy to avoid assuming bad loans, or taking back properties in foreclosure. In some cases it is a matter of survival, in others it’s the “hope and pray” mentality that the market improves during the renewed term of the mortgage.

Although this delaying tactic is often chided as postponing the inevitable, historic precedence has already been established. During the Japanese bubble era, the Japanese bought luxury hotels, commercial properties and residential developments and homes in Hawaii without abandon. After the bubble burst, Japanese banks held onto their underperforming loans for nearly a decade before reconsidering their strategy and selling at tremendous discounts. The question is whether this will be the case for lenders during this down cycle. Depreciating property values of 30% to 50% are being recorded for prime properties in U.S. mainland metropolitan markets such as San Francisco, New York and Los Angeles.

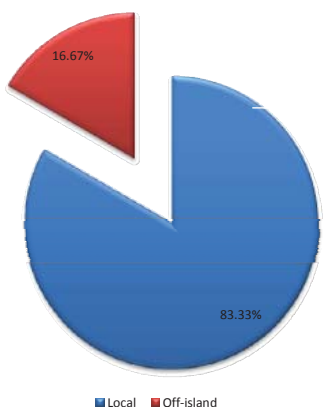
Hawaii’s commercial real estate market appears to have weathered the downturn with fewer casualties than those of major West Coast metropolitan markets. Despite weakening market conditions and the drop in transaction activity, the freefall in property values and dramatic upward swings in vacancy rates has not materialized. The jury is still out as to whether a more serious downturn will occur here. Although Hawaii has historically lagged behind mainland markets, the impact of this current recession was simultaneously felt with the rest of the nation.

CMBS Market Dramatic Rise and Fall

Commercial mortgage-backed securities or “CMBS” served a principal role in the rise and downfall of the real estate industry. The securitization of both residential and commercial mortgage, created a glut of financing capital available for reinvestment. The issuance of CMBS rose to a high of \$230 billion in 2007 only to drop to a miniscule \$5 billion in 2009. It is this glut of loans that are facing term maturities that resulted in a dramatic rise in CMBS loan delinquencies and defaults. At the end of December 2009, CMBS 60-day past due delinquencies had risen 18-fold from a miniscule 0.24% ratio reported during the first quarter of 2007 to 4.49% at the end of the fourth quarter of 2009.

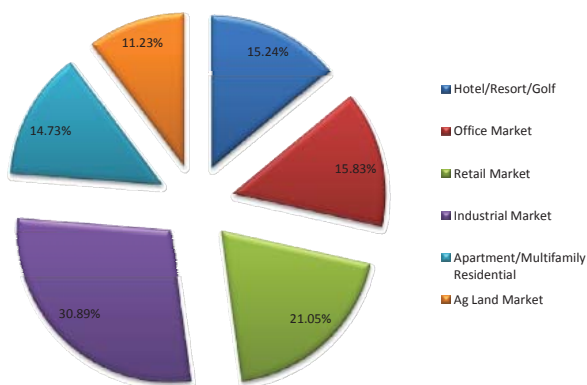


Local vs. Off Island Transaction Percentage



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Percent of Sales Volume by Property Type



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Transaction Activity Reviewed

Of the 113 commercial real estate transactions recorded for 2009, only 16 transactions exceeded \$10 million in sales price and constituted roughly 56% of the total sales volume. The lack of large transactions is directly related to the difficulties in securing acquisition financing. Of the transactions that did close, many had seller financing or were all cash deals. The average transaction size was \$5.6 million and more than 85% of the total sales volume were sales to local buyers.

Historically, Hawaii's transaction activity had been dominated by luxury hotels, which often constituted the majority of the sales volume for the year. Typically, hotel/resort/golf property sales generated more than 50% of the deals done for the year. For 2009, the dearth of hotel acquisitions resulted in a decade low of \$79.3 million or 13% of the total sales volume. It becomes even more dramatic if you removed the Kapalua Plantation Golf Course \$49 million transaction from the list of resort sales.

Agricultural land has risen in popularity as Hawaii's climate is conducive for genetically engineered seed crop usage. Firms such as Monsanto and Syngenta are scouring the islands for the correct topography and soil conditions for potential expansion plans. However, sales declined by more than 75% in 2009 to \$38 million from 2008 levels when more than \$155 million of prime agricultural land was sold.

Capitalization rates are projected to continue to rise as properties begin to devalue. Market fundamentals point to a protracted slowing economy. Hawaii may have skirted the worst of the real estate bubble and our recovery is likely to be shallow. The real estate market's recovery is projected

Year End 2009 Oahu Investment Market Statistics

	Number of Transactions	Sales Volume	Colliers Estimated Cap Rate	Korpacz National	Real Capital Analytics	Integra Realty Resources	Emerging Trends/ULI
Apartment/Multifamily	19	\$84,815,301	5.8% to 6.5%	7.84%	7.00%	7.80%	7.60%
Hotel/Resort	7	\$87,765,034	8.7% to 9.8%	---	---	---	---
Agricultural Land	7	\$64,665,213	---	---	---	---	---
Industrial	35	\$177,903,857	6.9% to 8.7%	8.46%	8.30%	8.70%	8.30%
Office	21	\$91,154,113	8.7% to 9.8%	8.11%	8.00%	8.60%	8.03%
Retail Malls	24	\$121,220,128	8.4% to 9.25%	8.41%	7.70%	8.50%	8.40%
Totals	113	\$627,523,646	---	---	---	---	---

Source: Korpacz USA, Emerging Trends 2009, Real Capital Analytics, Colliers Monroe Friedlander, Inc.

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to start in mainland cities as cap rates trend towards 10%. Hawaii will lag this national trend as mainland industrial and retail sectors begin to improve.

Notable Transaction Highlights:

- The \$49 million purchase of the Kapalua Plantation Golf Course on Maui by Ty Management Company from Maui Land and Pineapple topped the list of most notable sales transactions for 2009. In an affect to stave off creditors, Maui Land and Pineapple was in need of a capital infusion to keep operations going. Unfortunately, even with the sale of their prized PGA golf course, the company entered into bankruptcy.
- The purchase of the Pacific Guardian Tower by Maruito USA for nearly \$38 million raised some eyebrows as this was the first major commercial real estate investment in Hawaii by a Japanese company in quite awhile. Not since the Japanese bubble in the early 1990s have Japanese considered prime Hawaii properties for purchase.
- The former Moana Vista condominium development site which fell into foreclosure proceedings by KC Rainbow II was purchased by San Diego-based Oliver McMillan for \$37 million. This purchase price included a \$29.5 million lien with Hawaiian Dredging Construction Company, Inc. The intent is to complete the high-rise condominium project with revised unit types and pricing to attract a broader range of buyers.

Hawaii Hotels Are Not Expected To Fully Recover Until 2012



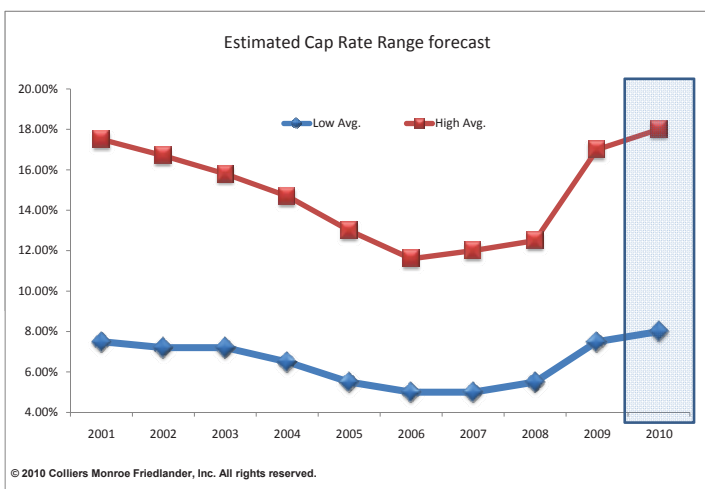
MARK BRATTON (R) CCIM
Vice President

Hawaii's hotels have been battered by a "double whammy" as occupancy and room rates are both down. This downward trend started in 2008 with the loss of a significant amount of airlift to Hawaii. Since Hawaii's biggest market for vacationers come from California, the severity of the recession in California has contributed to the fastest and most severe downturn in the history of Hawaii's tourism. This resulted in a 20% decline in 2009 in revenue per available room ("RevPAR") in Hawaii compared to the overall U.S. market seeing a 17.5% decline in RevPAR. That is a tough nut to swallow if you recently (2005-2007) purchased a hotel with great expectations and cheap money.

Hawaii has had a significant number of high profile hotels in distress, including major brand name and iconic properties including, but not limited to: The Ilikai Hotel, the former W Hotel Diamond Head, Maui Prince, Fairmont Orchid, ResortQuest Kauai and the Hilton Kauai. The hotel real estate market came to a grinding halt in 2009 when only 3 properties actually traded hands. There are currently four hotels on the market for sale, two being quietly marketed and 11 indicated as distressed or in the foreclosure process. This is similar to what mainland U.S. markets are experiencing with few properties selling as values have plunged.

It is hopeful that we have reached the bottom in this market segment as occupancy is projected to climb again. In addition, RevPAR is forecasted to increase annually over the next four years.

There are glimmers of hope. High net worth individuals and families, sovereign related groups and other investors from the Asia-Pacific region are more actively targeting Hawaii investments. Investors from China, Vietnam, South Korea, Singapore, the Philippines and Japan, to name a few, are putting out feelers. Recovery will be slow but sure and we believe we have bounced off the bottom. Overall recovery on the visitor side will begin in 2010; however it will be an extended recovery of two to three years. RevPAR will not likely see the same numbers experienced in 2006/2007 until 2012.



Financial Market Stress Impact: Heartache and Opportunity



**NANETTE
MACAPANPAN (S)**
Research Consultant/
Project Manager

The rigors of obtaining financing in a capital-restrained market and adhering to existing loan covenants has led to financial heartaches for some property owners and attractive buying opportunities for lenders and capable investors. Hawaii's \$12 billion exposure to securitized funding has kept its commercial real estate market in tune with the mainland US when it comes to troubled assets. The once common high leveraging of properties has resulted in financial difficulties for property owners in every property sector in Hawaii. Poor

economic conditions have hampered occupancy and rental revenue causing a decline in property cash flow and value, making it difficult for some property owners to cover mortgage payments.

The Hotel and Resort sector was most severely impacted by the financial crisis combined with a slowing visitor industry. Hotels from the economy-class Hawaiiana Hotel in Waikiki to the luxury-class Fairmont Orchid have been affected and foreclosed on by property lenders or land owners. The Makena Resort, which sold for \$575 million in 2007, is currently in foreclosure after the owners failed to make payments on a \$192 million mortgage.

On the retail front, General Growth Properties, Inc. ("GGP"), the owner of Ala Moana Center and Victoria Ward properties, filed for Chapter 11 bankruptcy in April

2009. The result of its inability to refinance mortgages as they matured. Prior to restructuring their debt, GGP offered Ward Properties for sale in an effort to raise capital. Another distressed retail property is the 74,000 square foot King Kalakaua Plaza in Waikiki which lost its only tenant, Niketown, in late 2009. Lehman Brothers took the asset back but was unsuccessful in trying to sell the property.

On a positive note, the financial crisis has led to favorable opportunities for well-capitalized investors and lenders. Several of the distressed properties have been taken back or purchased at a discount by property lenders. Other opportunistic investors have switched from buying properties to buying notes on distressed properties with the hopes of the taking the property back and selling for a favorable return once market conditions strengthen.

For example, the former 66-acre Hawaii Raceway Park site in West Oahu fell into default and I-Star Financial, the primary note holder initiated foreclosure proceedings. A&B Properties purchased the distressed note from I-Star Financial last summer.

It is highly likely that 2010 will yield more financially distressed properties for Hawaii and the US. With an estimated \$1.4 trillion in commercial debt in the US due to mature by 2013, there is sure to be more financial heartache for property owners and more opportunistic plays for savvy investors.

Hawaii Distressed Properties in 2009

Property	Property Type	Status
Resort Quest Kauai	Hotel	Foreclosure complete. Lender-owned.
Fairmont Orchid	Hotel	Foreclosure complete. Lender-owned.
Makena Resort	Hotel	In foreclosure.
W Honolulu Diamond Head	Hotel	Resolved: Sold to Unity House
The Ilikai	Hotel	Foreclosure complete. Lender-owned.
Kapolei Trade Center	Industrial	Foreclosure complete. Lender-owned.
Former Raceway Park Site	Industrial Land	Foreclosure complete. Lender-owned.
Moana Vista	Residential	Resolved: Sold to Oliver McMillan
Coconut Grove	Retail	Foreclosure complete. Lender-owned.
King Kalakaua Plaza	Retail	Foreclosure complete. Lender-owned.
Ala Moana	Retail/Office	Owner bankrupt. Loans restructured.
Victoria Ward Properties	Retail/Office/Industrial	Owner bankrupt. Loans restructured.

Market Sector Overview

Office - For the Honolulu office sector, vacancy rates jumped by nearly 200 basis points over the past year from 8.5% to 10.3% as rental rates posted their first decline in more than six years. If it were not for the relocation of the Internal Revenue Service and Immigration and Naturalization Service to private sector office buildings, negative net absorption could have easily eclipsed 300,000 square feet. With this increase in vacancy, the market transitioned from a landlords market to one that is in equilibrium.

Industrial - The industrial market posted its third consecutive year of negative net absorption with 210,641 square feet registered for 2009. Vacancy rates rose to its highest levels in a decade as rents fell in dramatic fashion. The direct weighted average asking rent dropped from \$1.24 psf/mo to \$0.99 psf/mo, a 20% decline. Industrial condominiums, which had been in fashion in 2007, fell out of favor as securing acquisition capital proved to be troublesome for business owners seeking to purchase a condominium. As a result, these vacant condo units, are now being down marketed for lease prices at \$0.90 psf/mo, from their original asking prices of \$1.50 psf/mo or more.

Retail - Honolulu's retail market proved more resilient than other sectors as two projects delivered completed phases to the market. Both Kapolei Commons and Pearl City Gateway boosted absorption of nearly 400,000 square feet. Vacancy rates stabilized near 3.5%, well below harder hit markets such as Phoenix, Las Vegas or Miami. For the first time in six years, average asking rents fell by 4.7% from \$3.72 psf/mo to \$3.54 psf/mo. The weakened travel sector took its toll on resort retailers as the drop in retail sales corresponded to the decline in air passenger arrivals.

Hotel - Last year's 4.5% decline in air passenger arrivals coupled with the 11.7% decline in tourism expenditures reflected the difficulties hoteliers faced. Hotel occupancy rates weakened from 71.4% for November 2008 to 66.6% for November 2009. Average daily room rates for the state's hotels fell by 13% as RevPAR dropped by 18.9% as reported by Hospitality Advisors, LLC latest hotel occupancy report.

2009 Notable Transactions

Property Type	Location	Buyer	Sales Price	Transaction Date
Agriculture Land	Haleakala Ranch	Monsanto	\$20,000,000	12/19/2009
Agriculture Land	West Oahu Ag Land	Gil Olson Joint Venture	\$11,172,863	9/30/2009
Agriculture Land	West Maui Land	SMC Mahana LLC	\$10,000,000	9/23/2009
Commercial Bldgs	1470-1488 Kapiolani Blvd	Walgreens	\$15,050,000	6/1/2009
Commercial Land	Kona Land	Kaiser Foundation Health Plan	\$11,300,000	3/13/2009
Commercial Land	4390 Nuhou St	Property Development Centers (Safeway)	\$11,000,000	4/30/2009
Golf/Resort/Hotel	Queen Kapiolani Hotel (leasehold)	YHB QK Hotel LLC	\$10,820,000	10/16/2009
Golf/Resort/Hotel	W Hotel (leasehold)	Unity House	\$8,505,000	12/24/2009
Golf/Resort/Hotel	Kapalua Golf Course	Ty Management Corp	\$49,800,000	3/27/2009
Golf/Resort/Hotel	Mililani Golf Course	YHB Mililani GC	\$5,040,000	10/15/2009
Industrial Warehouse	Weyerhaeuser Bldg	Thanh Lam, et al	\$20,000,000	5/29/2009
Industrial Warehouse	C&N Grocers Building	Hanua Associates LLC	\$19,200,000	11/16/2009
Industrial Warehouse	Pearl City Industrial Park	Fergus & Company	\$13,040,000	6/23/2009
Industrial Warehouse	94-1489 Moaniani St	A&B Properties, Inc.	\$12,310,400	3/4/2009
Office Building	Pacific Guardian Tower	Maruito USA	\$37,895,600	10/26/2009
Residential Development	Former Moana Vista	Oliver McMillan	\$36,317,701	10/21/2009
Retail	Waipio Shopping Center	A&B Properties, Inc.	\$30,850,000	9/4/2009

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