

2002 Economic Forecast



2001 brought a pause to the longest economic expansion in US history. Growth, which averaged 5.2% in the first half of 2000, fell to only 0.7% in the second quarter of 2001.

The Federal Reserve aggressively lowered interest rates to ward off an impending recession, beginning with an unexpected rate cut between the December 2000 and January 2001 meetings. This was followed with additional rate cuts culminating in a 25 basis point reduction at the June meeting that brought the overnight rate to 3.9%, down from 5.9% the first week in January.

Despite the softening economy and layoffs across a broad range of industries (large companies alone announced almost 656,000 through July), unemployment remained low and inflation accelerated. The severe labor shortage that has characterized the business environment in recent years kept upward pressure on wages, with labor costs up 5.2% in the first quarter. Health insurance costs soared, as the managed care industry focused on profitability rather than market share, and energy prices spiked to record highs. The consumer price index rose 3.4% in 2000 and increased another 3.4% through June of 2001. As a result, long-term interest rates did not decline as short rates fell. The 30-year conventional mortgage rate averaged 7.1% in June, essentially unchanged from where it began the year. The premium of junk bonds to Treasuries averaged more than 800 basis points at its peak, more than three times the historic average.

The engine of economic growth moved from business investment spending to consumer spending. Despite plunging consumer confidence, extremely high levels of revolving credit and the first decline in household net worth since the Federal Reserve began tracking that statistic in 1943, the consumer continued to spend in early 2001. However, there were signs of impending problems: December 2000 holiday sales disappointed retailers and high-end discretionary purchases - luxury cars, expensive furniture, meals at fancy restaurants - softened as the year unfolded. If the consumer, who accounts for 70% of economic activity, decides to save or pay down debt rather than spend, the economy will quickly slip into recession.

The “nattering nabobs of negativism,” to quote a politician of a bygone era, are raising their voices to warn of recession as this forecast is being prepared. In opposition, the “positive proponents of prosperity” respond that the worst is already behind us and the expansion is reaccelerating. They cite the improvement in the stock market, particularly outside the technology sector, some recovery in consumer confidence and a strong housing market as evidence that all is well.

In our view, the economy can go either way, not a very useful forecast. There are no serious, fundamental problems that point to a long, deep recession, absent an international financial crisis originating in Japan. Nevertheless, the evidence is mounting that the United States’ decade of unprecedented growth ended in 2001.

Our baseline scenario, to which we attach a 55% probability, calls for a mild recession in 2001. Following two or three quarters of contraction, a new cycle of growth will begin in 2002. The ability of the economy to absorb significant layoffs with only a modest increase in the unemployment rate - a direct result of the fact that 42 million Generation Xers are replacing 75 million Baby Boomers in the workforce - is the primary factor preventing a more serious decline.

Despite a mild recession, inflation will remain a threat in 2002, keeping long-term interest rates higher than otherwise would occur. The Federal Reserve will be less generous with rate cuts later in the year, recognizing that the full impact of the January-June 2001 cuts will not be felt until 2002. With inflation seething just below the surface, it is dangerous to add too much stimulus to a reaccelerating economy.

The tax cut, which will provide about \$40 billion of stimulus in mid-2001, is more likely to be used to reduce debt than to boost spending. With the top 1% of taxpayers paying one-third of all income taxes and the top 10% paying nearly two-thirds, a \$600 check is unlikely to produce a major change in spending patterns.

The alternative scenario, with a 40% probability of occurring, avoids recession over the forecast horizon of the next 18

months. Consumers continue to spend, housing remains strong, energy prices retreat and no serious problems develop among our major trading partners. However, each month that brings more layoffs, declines in industrial output and weakening sales reduces the likelihood that this will occur.

The disaster scenario, with a 5% probability of coming to pass, continues to be serious financial unrest originating in Japan. The Japanese economy remains weak and the economy is burdened with a high level of debt, little appetite on the part of consumers to spend or invest locally and seriously troubled banks. A new government offers the possibility of meaningful reform, but it is too soon to judge what will happen.

Whether 2002 brings a continuation of the 1990s expansion or the start of a new one, the US economy has enjoyed a

phenomenal 20-year run. The 1982-90 expansion was the third longest in our history and the recent expansion that began in 1991, after a short, mild recession, sets a new record each month that it continues. Eventually it will come to an end, and the evidence is growing that this will be sooner rather than later. Fortunately, the age mix of the work force and productivity gains (the lull in the first quarter of 2001 is only temporary) from huge expenditures on technology will quickly have the US economy back on the track of job creation and economic growth.

US ECONOMIC INDICATORS

| | 2000 | 2001 ^e | 2002 ^f | 99/00 | 00/01 ^e | 01/02 ^f |
|--|-----------|-------------------|-------------------|--------|--------------------|--------------------|
| Gross Domestic Product (billions) | \$9,963.1 | \$10,291.9 | \$10,806.5 | 7.1% | 3.3% | 5.0% |
| Real GDP (billions of 1992 dollars) | \$9,318.5 | \$9,430.3 | \$9,694.4 | 5.0% | 1.2% | 2.8% |
| Unemployment Rate | 4.0% | 4.5% | 4.6% | n/a | n/a | n/a |
| Private Housing Starts (million units) | 1.57 | 1.59 | 1.50 | (4.3)% | 1.3% | (5.7)% |
| Auto/Truck Sales (million units) | 17.8 | 16.4 | 16.3 | 2.3% | (7.9)% | (0.6)% |
| Consumer Price Index (1982-84=100) | 172.2 | 178.4 | 185.2 | 3.4% | 3.6% | 3.8% |
| 90-Day Treasury Bill Rate | 5.8% | 4.0% | 4.1% | n/a | n/a | n/a |
| 10-Year Treasury Note | 6.0% | 5.3% | 5.5% | n/a | n/a | n/a |
| 30-Year Conventional Mortgage Rate | 8.1% | 7.2% | 7.4% | n/a | n/a | n/a |

n/a = not applicable *e* = estimate *f* = forecast

The Year in Review

Despite a slowing national economy and mounting layoffs in the technology sector, the Colorado economy remained healthy through mid-2001. Growth rates did not match the phenomenal pace of the 1990s – between 1992 and 1999 growth in output averaged 6.6% annually, the fourth highest in the nation – but was strong enough to keep retail sales growing and unemployment low.

Four Colorado cities ranked among the best places in the nation to do business in 2000, according to the Milken Institute: Boulder (#4), Denver (#22), Colorado Springs (#26) and Fort Collins (#31). Nevertheless, there are signs of incipient problems. During the first quarter of 2001, personal bankruptcies in the state reached 4,162, up 21%. Business bankruptcies, unaffected by an expected legislative change, rose 34% to 134.

Job growth averaged 3.2% through June of 2001, after a strong 3.9% in 2000. The unemployment rate remained low at mid-year, only 2.9%.

Retail sales growth slowed from its sizzling 11.5% pace in 2000, up 6.0% through May. Inflation in the Denver metropolitan area (CPI-U) reflected the strong economy, averaging 4.0% in 2000 relative to 3.4% nationally. Through June of 2001, local inflation reached 5.4%, well ahead of the nation's 3.4% pace.

Personal income rose 10.8% in 2000, outperforming the other 49 states. California was the only other state to enjoy double-digit growth. When adjusted for the state's rapid population growth, per capita personal income reached \$32,949, the seventh highest in the nation. This amounted to a 4.4% increase, a small gain in inflation-adjusted terms.

As data from the 2000 Census become available, the strength of a decade of economic growth is confirmed. In April of 2000, Colorado had more than 4.3 million residents, up 30.6% from the 1990 Census, the third fastest growing state in the nation. The six-county Denver metropolitan area, home to more than half of the state's residents, grew 29.9%.

Colorado's rapid population growth has fueled a boom in new construction that rivals the one accompanying the westward migration of the Baby Boom in the 1970s and early 1980s. Housing permits soared 10.7% in 2000, led by a 47% surge in multifamily permits. Through June of 2001, permits increased another 14.2%, with both single-family and multifamily gains. The value of nonresidential contracts fell by 14.2% to \$3.2 billion, and then remained flat through the first half of 2001.

The Engines of Growth

Regional growth is driven by industries that bring new dollars into the economy, what economists call basic industry. These differ by region and are a primary component of the variation in regional growth rates. In Colorado, these basic industries include agriculture, mining, tourism and advanced technology.

Agriculture: Although small in terms of employment (less than 2% of Colorado jobs), agriculture is a major contributor to the state's economy. There are 29,000 farms (defined as an operation with annual sales of more than \$1,000) covering 31.6 million acres. The state ranks first in the production of proso millet and second in summer potatoes and carrots. It is one of the top five states in silage sorghum, sunflowers, winter wheat, sweet corn, lettuce, spinach, sheep and lambs, cattle on feed, fed cattle marketings and market sheep and lambs.

The state's agricultural output in 1999 was valued at \$5.2 billion, producing net farm income of \$922 million. Livestock accounted for 57% of the total. Direct government payments resulting from extremely low crop prices provided 21% of net cash income, well below the 87% in Iowa, 69% in Kansas and 61% in Nebraska.

With winter wheat production down about 14% and a decline in the number and size of cattle, prices are rising. Retail beef prices are already at record levels. Corn prices are flat and soybean prices are declining. Guaranteed minimum prices for grain mean the taxpayer, not the farmer, will absorb the lower prices. Vegetable prices are up, but apple, peaches and potatoes are down.

The outlook for farm income in Colorado in 2002 is a mixed bag, but the important livestock industry can expect a good year. Global competition, with high quality and low cost of production, will continue to force many crop producers to rely on government subsidies rather than market prices to remain in business. How long the American taxpayer is willing to continue this support will determine the future of the minority of Colorado farmers raising program crops.

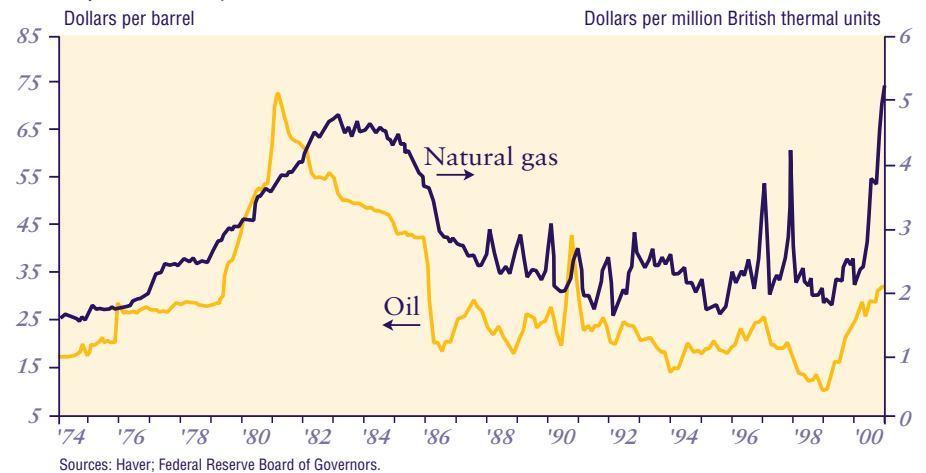
Mining: The mining sector accounts for 0.6% of Colorado's employment base, down from 3.4% at its peak in 1981. Of the 12,800 mining jobs in 2000, 56% were in oil and gas extraction. Coal mining accounted for another 16%.

The combination of \$11 per cubic foot natural gas in January, record gasoline prices this spring and widely publicized power outages in California has revived the Mountain West's dormant energy industry. More rigs are active than at any time since the mid-1980s, drilling primarily for natural gas. Colorado, the nation's sixth largest natural gas producer, is on pace to issue 2,500 drilling permits in 2000, a state record. The Colorado Oil and Gas Commission estimates there are 235 trillion cubic feet of gas reserves in the region.

Natural gas prices reached an inflation adjusted high early this year, but oil prices are below their 1981 peak. OPEC, which cut production three times in the first seven months of 2001 as crude oil prices sagged from \$37 a barrel in November 1999 to \$23 in July 2001, appears to be targeting a price of about \$25 a barrel.

Despite the focus on oil and gas, coal generates 52% of the electricity in the US, up sharply in the last ten years. Nuclear production accounts for 20%, while natural gas is the fuel for 16%. About half of the coal produced in the US comes from the West, primarily Wyoming, and all of the growth in domestic production has occurred in the western US. The energy crisis in California is directly attributable to a 23% surge in demand since 1992, matched by only a 6% increase in new capacity. The solution is simple: build more generators. There are numerous proposals under consideration to do this, most fired by natural gas. However, about 16% will be coal fired.

Inflation Adjusted Natural Gas and Oil Prices



Colorado will be impacted in several ways by the resurgence in the energy industry. Employment, growing for the first time since 1981, will continue to increase. Drilling activity outside of Colorado will be managed from Denver offices, as was true in the 1980s, although the impact will be much less. Severance taxes imposed on energy and mineral production doubled in fiscal 2000-01, to more than \$67 million.

Tourism: We often forget that selling services brings new dollars into the state in the same way that selling food, minerals or widgets does. Tourism is one of Colorado's most important basic industries. In 2000, it generated 24.7 million visitors (98% of whom spent at least one night in the state) who spent \$6.9 billion, according to Longwoods International.

Just over 80% of Colorado's visitors came on overnight pleasure trips last year, down 5% from 1999. This was offset by an 8% increase in business travel. Colorado's share of overnight pleasure trips has declined steadily over the last ten years, from 2.7% in 1992 to 1.7% in 2000.

Colorado's 2000-2001 ski season reversed two years of declining skier days, up 5.8% to 11.5 million visitors. Nationally, skier days increased 9.8% to 57.3 million visits. Colorado's best season was 1997-98, with 12 million skier days.

However, high gasoline prices and a softer economy impacted summer tourism, despite a 38% increase in requests for the state's vacation guide and a national survey that showed only 18% of Americans intended to curtail vacation plans. Colorado Springs reported a 10% drop in hotel occupancy through mid-summer and 3 to 7% declines in attraction visits. Hotel occupancy rates were off by more than four percentage points in Denver through June, while attraction attendance was relatively flat.

Travel is a discretionary expenditure and, until the US economy rebounds and consumers feel more confident, tourism will remain soft. Business travel is sensitive to declining corporate profits and high-end restaurants in metro Denver are already reporting fewer business customers.

Technology/Telecommunications: Colorado had 180,866 advanced technology workers in 2000, earning an average annual salary of \$66,378, almost double that of the average private sector employee. An American Electronics Association study pointed out that Colorado has the highest concentration of technology workers in the country, 97 per 1,000 private sector employees, and was the fourth fastest growing state in terms of technology job creation from 1994-2000 with a 72% gain. Major advanced technology employers in Colorado include Qwest Communications, Level 3, IBM, Storage Technology and Sun Microsystems. The April 30 issue of *Newsweek* listed Denver as one of the top ten high-tech cities in the country, with 87,000 jobs and 5,500 high-tech companies.

The naïve belief that technology is different, somehow insulated from the worst of the business cycle, has proved false. Cisco, Intel, Oracle, Sun, Ericsson, Motorola – the list goes on and on of the big firms that have reported losses and slashed jobs. Investment in information technology fell at an annual rate of 19% in the second quarter of 2000, after 20% annual increases over the previous decade. Even these data substantially understate the investment in information technology that occurred. The quantity of computing power purchased with one dollar in 1987 cost only an inflation-adjusted nickel in 2000!

Tens of thousands of technology/telecom jobs have disappeared in 2001, including thousands in Colorado. Despite this fact,

companies are still hiring technical workers and Colorado firms report an inability to fill some types of jobs. Large employers nationwide plan to hire 900,000 technical workers in 2001, down from 1.6 million last year, according to an Information Technology Association study.

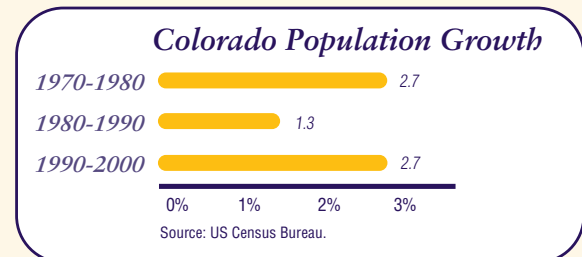
One offshoot of the growth in the advanced technology industry in Colorado has been the increasing importance of the international sector. Of the state's \$6.6 billion in exports in 2000, advanced technology accounted for \$4.1 billion or 62%. This was up from \$1.3 billion only three years earlier. In the first quarter of 2001, exports rose 8.2% led by data processing machines, electronic integrated circuits, components for office machines, scientific measuring instruments, medical instruments and photographic plates and film.

The long-term outlook for Colorado's technology/telecom industry is good. Once businesses have adjusted to the over investment that occurred in the 1990s and technology firms reconfigure themselves for slower rates of growth, expansion will resume. With our relatively young, highly educated labor force and excellent quality of life, Colorado will be a major competitor for these jobs.

Population

The decennial population census, completed in April 2000, confirmed what Coloradans already knew: the state grew much more rapidly during the decade of the 1990s than official estimates had indicated. Between 1990 and 2000, the state added 1,006,780 residents, 80% of them along the Front Range, home to Colorado's ten largest counties. This brought the state's population to 4,301,261.

The acceleration in population growth, from 14% in the 1980s to 30.6% in the 1990s, was the second strongest in the nation, behind Idaho. Nevada, Wyoming, Utah and Montana are other Mountain



Region states that experienced large growth acceleration. California and Florida, on the other hand, ranked 49th and 50th, with sharp decelerations in population growth.

Douglas County was the fastest growing county in the country in the 1990s, with population expanding by 191%. This put it far ahead of second place Forsyth County, Georgia, up 123%. Douglas County surpassed Mesa County as Colorado's tenth largest. Seven other Colorado counties ranked among the 20 fastest growing, including Elbert (3rd, up 106%), Park (5th, up 102%), Eagle (10th, up 90%) and Summit (15th, up 83%). In contrast, San Juan County in southwest Colorado saw its population shrink 25%.

As is true across the country, Colorado's population became more diverse in the 1990s. The Census shows that 17.1% of the state's residents are Hispanic, up from 12.9% in 1990. The African American population declined slightly to 3.8%, while Asian/Pacific Islanders comprised 2.3% and Native Americans 1.0% of Colorado residents. The state's foreign-born population grew more rapidly than the nation's, up 80%, between 1990 and 1999.

The median age in the state rose to 34.3 years, up substantially from 32.5 in 1990 but below the national median of 35.3. Aging Baby Boomers (45-54) were the most rapidly growing segment of the population, up 82.4%. The 25-34 year-old cohort grew only 8.5%, the explanation for the state's labor shortage.

The price Coloradans pay for the economic prosperity of the last decade is increased traffic congestion and commute time. Americans spend \$78 billion a year in wasted time and gasoline because of overcrowded roads. Denver holds the dubious distinction of ranking seventh in wasted time – 45 hours a year. Colorado Springs ranks 46th (20 hours) and Boulder ranks 66th (5 hours). Colorado Springs has the worst traffic of any small city (less than 500,000) in the US, according to a Texas Transportation Institute study.

Population growth in Colorado mirrors job growth, with a lag of about 12 months. As the economy slows and jobs are less plentiful, immigration to the state will slow. Population growth

will fall to 2.1% in 2002, as Colorado experiences a net gain of 57,000 residents from other states.

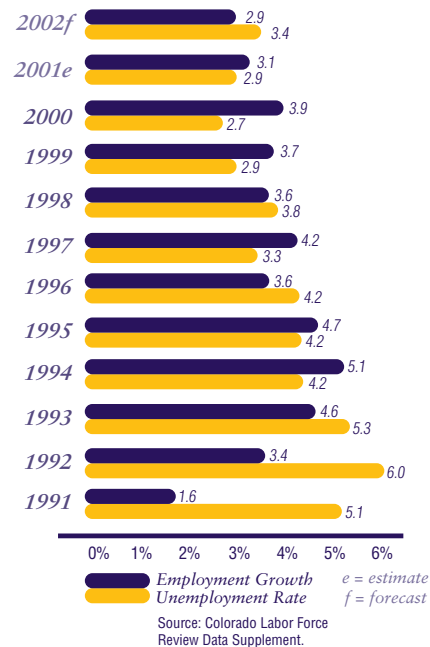
Employment

Job growth remains the best indicator of economic vitality and by this measure the Colorado economy is healthy. The state added 694,000 jobs between 1990 and 2000, a 3.9% annual average increase relative to the 2.7% annual gain in population. Unemployment is nonexistent, at 2.9% in June, despite more than 17,000 reported layoffs through July.

Job growth peaked in 1994 at 5.1%, but remained a solid 3.2% through June of 2001. The number of unemployed rose slightly, to 82,500, from 79,400 a year earlier. The unemployment rate reached a seasonally adjusted low of 2.5% several times in 2000 and 2001, and was only 2.9% at mid-year, well below the nation's 4.5%. At the peak of Colorado's deep recession in 1987 and 1988, the unemployment rate soared to 8.8%.

At the beginning of the year, there were 35,000 positions "available for hire" in the metro Denver area, according to the US Department of Labor, at an average wage of \$12.70 an hour (\$26,414 annually). About three quarters of these positions were in the service and retail sectors, with 37% requiring post-secondary education. At the same time, the

Colorado Employment Growth & Unemployment Rate



Colorado Department of Labor reported that 31,600 individuals were unemployed. Clearly there is a mismatch between jobs available and people seeking work.

This conclusion is borne out by the fact that, despite thousands of layoffs in the technology and telecommunications industries, companies still report that they are unable to fill many jobs. A survey of Colorado companies showed that 73% planned to hire information technology workers in the second quarter, while the quarterly Manpower survey found that 47% of Colorado Springs companies planned to expand their work force in the third quarter. The down side is that, despite continued hiring, demand for technology workers nationally has fallen by 44%.

Job growth, which will slow to an estimated 3.1% in 2001, will slow further to 2.9% in 2002. The unemployment rate will inch up to 3.4% as companies facing higher costs and declining profits economize on expensive labor.

Income and Retail Sales

Colorado not only had the highest rate of personal income growth in the nation in 2000 at 10.8%, it continued to be one of the wealthiest states. Per capita personal income of \$32,949 was 111% of the national average. This ranked Colorado seventh among the 50 states, up from 12th in 1980 and 19th in 1990. The Denver primary metropolitan statistical area boasted a per capita income of \$36,058 in 1999 (most recent data available), the 16th wealthiest city in the country.

Retail sales growth in Colorado has been extremely strong, even as consumer confidence falters. In 2000, sales soared 11.5%, to \$90.5 billion. Holiday sales, flat nationally, increased 10.4% in Colorado during the important November/December period. Overall, sales growth remained solid through May of 2001, up 6.0%.

At mid-year, there were signs that consumers were spending more cautiously. High-end retailers in metro Denver reported that sales of luxury goods had slowed and consumers were shopping longer and looking for value. Sales at retailers

frequented by tourists in metro Denver were off 4.3% through June and there were reports of the unexpected closing of a number of small boutiques. Nationally, banks reported they were tightening standards on credit card loans, as consumers continued to borrow to maintain spending levels.

Household net worth, an important influence on consumers' willingness to spend, fell 2% in 2000, the first decline in 55 years of record keeping. A plunging stock market was the primary culprit. Although stock ownership rose from 32% of US households in 1989 to 49% ten years later, most Americans hold relatively few shares. The richest 10% of US households own about 80% of shares, a ratio that has remained relatively constant.

Personal income growth remains strong in 2002, boosted by higher inflation and a growing population. Retail sales will rebound in the second half of the year as the recovery gets underway, up 7.9% to \$104 billion.

Inflation and the Cost of Living

More rapid inflation, along with increasing congestion and longer commute times, is the price Coloradans pay for the rapid growth they have enjoyed during the last decade. Since 1992, Colorado inflation, as measured by the consumer price index for all urban consumers in the Denver-Boulder metropolitan region, has exceeded the national average. Over this period, prices locally rose 33%, compared to 22.7% for the US as a whole.

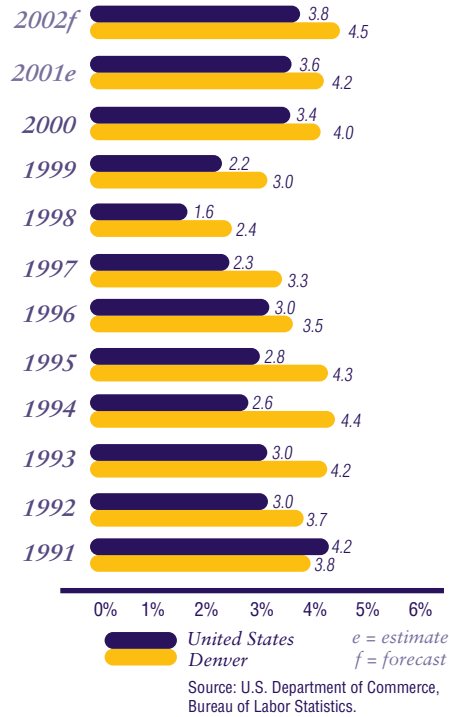
Not surprisingly, Denver is a relatively expensive place to live. At the end of last year, the cost of living in Denver was 110.4% of the national average, in large part because the cost of housing was 32% higher. (The cost of living is based on a middle-income family of four with two cars living in a 2,200 square foot, four-bedroom home.) Denver is still a cost effective place to do business relative to cities in California, however. In San Jose, living costs were 185% of the national average, thanks to housing that was 3.5 times more expensive. In Denver, housing comprises 41% of a family's living expenses, in San Jose 67%.

Other Front Range cities enjoy a much lower cost of living. Colorado Springs hovers just below the national average, while Pueblo, Greeley and Fort Collins are substantially lower.

A mild recession in Colorado will do little to alleviate the upward pressure on housing prices, the largest component of Colorado's consumer price index. Inflation will average 4.5% in 2002, above the national rate for the 11th consecutive year.

United States vs. Denver Inflation

(1982-84=100)



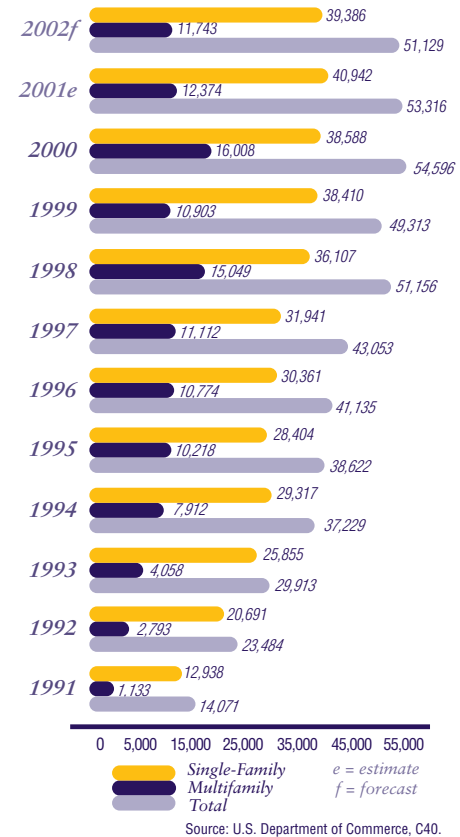
and financial institutions anxious to lend. Cranes on the skyline and new homes and shopping centers under construction add to the sense that all is well. Unfortunately, when growth slows, layoffs mount, property values fall and confidence plummets. This means that real estate and construction are disproportionately important to the health of Colorado's economy.

Over the 12 months ending with July 2001, sales of single-family homes in metro Denver rose 5.2%, while condominium/town-home sales were up 8.3%. The median price of a single-family home, at \$219,000, was 9.6% above July 2000. Median price is a better indicator of the strength of the market than average price (\$265,255), which is distorted by the mix of homes changing hands.

The number of homes in metro Denver valued at a million dollars or more skyrocketed 150% between 1999 and 2001, and in Cherry Hills Village the median home price is \$900,000, the 50th most expensive in the nation according to *Worth* magazine. Aspen is the third most expensive, with a median price of \$2.3 million.

At mid-year, there are signs of impending trouble in the residential resale market. The inventory of houses for sale was 39% higher than a year earlier, according to the Denver Board

Colorado Housing Permits



Real Estate and Construction

Real estate values and new construction are extremely important to a small, rapidly growing economy such as Colorado's. Employment growth attracts immigrants, who require places to live, shop and work. In 2000, 7.3% of Colorado's workforce was in construction, a full percentage point higher than at the peak of the last construction boom in the early 1980s.

Not only does the construction industry create high paying jobs, but during a construction boom property values soar and the resulting wealth makes consumers willing and able to spend

of Realtors, and homes are staying on the market longer. In the past, this has been an early indicator of a downturn in new construction.

Housing construction increased 14.2% through June, as single-family permits rose 9.1% and multifamily increased 29.6%. This came on top of a 46.8% gain in multifamily activity in 2000. With the multifamily inventory up 70.4% in July, problems appear inevitable in this sector.

The overall apartment vacancy rate in metro Denver hit a ten-year high in June, at 5.7%. Last quarter it was 4.5% and a year ago it was 4.9%. The average rent, \$818.40 per month, was up 8.8% from a year ago. More than 3,300 apartments were completed in the first half of 2001 and that will reach 8,000 by year-end, according to CB Richard Ellis. The biggest problems are in the more expensive apartments, as has been the case for several quarters. North Douglas County, with an average rent of \$1,142, had the region's highest vacancy rate, 9.4%, down from 11.4% in the first quarter.

The value of nonresidential construction contracts was flat through June, at \$1.7 billion. Retail contracts soared 39% and there were huge gains in manufacturing, educational and science and miscellaneous.

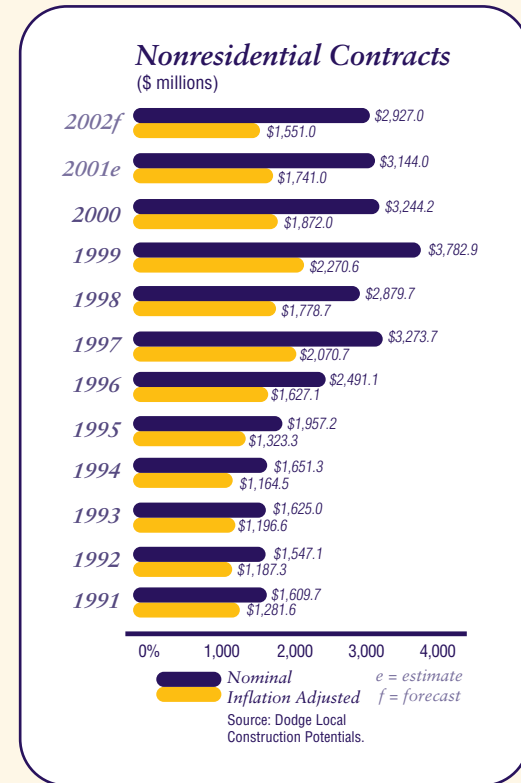
The industrial vacancy rate rose from 5.5% at the end of 2000 to 6.98% at mid-year, according to Frederick Ross Research. Absorption was negative at the same time that two million square feet of new space entered the market. Rental rates were flat to down.

Vacancies in the retail sector climbed sharply, to 8.1% from 5.7%. Absorption was a negative 1.5 million square feet and more than two million square feet is on pace to be completed before year-end. Another 5.6 million square feet will come into the market in 2002 and early 2003. Rental rates declined.

Reports of problems in the office market began to surface early in the year. During the first quarter, stories emerged on huge increases in sublease space. The *Denver Business Journal* reported a 50% increase in the first quarter. Participants in

the *Rocky Mountain News'* real estate roundtable in April all fretted about the amount of space reentering the market. Greg Morris at Fuller and Company coined the phrase "phantom vacancy," when you have 11 employees occupy 100,000 square feet of space in a company that will be bankrupt in a few months. This is in addition to the space already on the sublease market.

We seem to have done it again: gotten caught up in the "two pine trees and a fountain" euphoria that promises my project will be successful because it is somehow different from the one sitting empty across the street. Frederick Ross reports that the office vacancy rate rose four percentage points to 12.8% in the first half of 2001, with negative absorption of 1.3 million square feet and only half of the 2.4 million square feet of new supply leased. Sublease space doubled, to 3.4 million square feet. The value of new office contracts was down 33% through June, so perhaps construction will halt before the problems become as severe as they did in the 1980s. In the technology corridor along US 36, the *Denver Business Journal* reported a mid-year vacancy rate of 40%.



The Road Ahead

Despite obvious signs that economic growth is decelerating, *Demographics Daily* reported that, at mid-year, Colorado is the economically strongest state in the nation and Denver has the healthiest economy of any metropolitan area in the US. While the state will remain attractive on a relative basis, growth will continue to slow in 2001 and early 2002. The extent of the problem is closely tied to how quickly new construction slows and real estate markets come back into equilibrium.

Population growth in 2002 will average 2.1%, as net migration slows to 57,000 new residents. Job gains will drop below 3% for the first time since 1991, averaging 2.9%. For the first time in four years, the unemployment rate will creep above 3% to 3.4%, still an indication of tight labor markets.

Personal income growth will average 8.2% and retail sales growth will increase to 7.9%. A recovering economy in the second half of 2002 will encourage consumers to spend a bit more freely. Part of these gains will be due to inflation, which will increase to 4.5%, the highest rate in more than ten years.

The crystal ball is cloudiest when we turn to the construction outlook. The signs are clear at mid-year that developers and builders need to pull back on both the residential and nonresidential fronts. If the past is a good predictor of future behavior, this will not occur as quickly as it should. Housing permits will fall 4.1% in 2002, after a 2.3% decline in 2001. The biggest problems will occur in the multifamily market, where overbuilding will continue through most of 2001. The value of nonresidential contracts will decline 6.9%, after dropping 3.1% in 2001.

By the second half of the year, growth will resume and the Colorado economy will be poised for another lengthy expansion. The downturn will be far milder than that experienced in the 1980s, absent an international financial crisis or an unwillingness to limit construction before vacancy rates soar and values plummet.

Additional information on the Colorado economy is available on Dr. Adams' web site at www.ColoradoEconomy.com.

COLORADO ECONOMIC INDICATORS

| | 2000 | 2001 ^e | 2002 ^f | 99/00 | 00/01 ^e | 01/02 ^f |
|--|-----------|-------------------|-------------------|---------|--------------------|--------------------|
| Population (thousands) | 4,319 | 4,418 | 4,511 | 2.7% | 2.3% | 2.1% |
| Net Migration | 58,000 | 61,000 | 57,000 | n/a | n/a | n/a |
| Nonagricultural Wage and Salary Employment (thousands) | 2,214.8 | 2,283.5 | 2,349.7 | 3.9% | 3.1% | 2.9% |
| Unemployment Rate | 2.7% | 2.9% | 3.4% | n/a | n/a | n/a |
| Personal Income (billions) | \$141.7 | \$152.7 | \$165.3 | 10.8% | 7.8% | 8.2% |
| Per Capita Personal Income | \$32,949 | \$34,563 | \$36,644 | 4.4% | 5.3% | 5.8% |
| Retail Sales (billions) | \$90.5 | \$96.4 | \$104.0 | 11.5% | 6.5% | 7.9% |
| Housing Permits (number of units) | 54,596 | 53,316 | 51,129 | 10.7% | (2.3)% | (4.1)% |
| Nonresidential Building Contracts (millions) | \$3,244.2 | \$3,144 | \$2,927 | (14.2)% | (3.1)% | (6.9)% |
| Denver-Boulder Consumer Price Index CPI-U (1982-84=100) | 173.3 | 180.6 | 188.7 | 4.0% | 4.2% | 4.5% |

n/a = not applicable e = estimate f = forecast

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Permission is granted to reprint from this Forecast with credit to U.S. Bank's Rocky Mountain Chief Economist Dr. Tucker Hart Adams.

Information

For more information on the economy, contact Dr. Tucker Hart Adams at (303) 585-5060.

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