RED CAPITAL GROUP®

Market Overview

Oakland, California

Multifamily Housing Update **December 2008**

EXECUTIVE SUMMARY

Employment trends in the Oakland metropolitan area deteriorated in the third quarter, a product of weaker conditions in the construction, retail trade, business services and government sectors. The foregoing industries combined for attrition of 11,700 jobs, calculated on a year-over-year basis, representing a -2.2% rate of decline. This compares to an aggregate loss of 2,600 (-0.5%) jobs in 2Q08. As a result, total quarterly metro losses accelerated to a 19,800-job, -1.9% rate from the 11,200-job, -1.1% pace recorded in the second quarter.

Job cuts in the foundation skilled services sectors were of particular concern. Business services firms trimmed headcounts by 1,100 workers, the sharpest cuts in five years. Much of the impetus derived from weaker trends in the professional, scientific and technical services category, where firms reduced payrolls by 1,000 (-2.4%) jobs in September relative to same month of 2007. Job losses in the finance sector also continued apace as firms shed workers at a 4,400-job, -7.6% y-o-y rate. With the impact of the Wells/Wachovia merger still largely to be manifested, banking trends could regress further.

Indeed, **RED CAPITAL Research** expect 2009 to be an extremely difficult year for the East Bay economy. The group's econometric payroll model forecasts accelerating losses in 4Q08, rising to a 28,800-job, -2.7% rate, giving rise to a calendar year loss of 16,100 (-1.5%) jobs. The rate of attrition is projected to peak in 1Q09 (-39,400) before slowing gradually through year end. Nevertheless, y-o-y job losses at rates exceeding 25,000 are likely to persist throughout 2009, yielding a full-year setback totaling 34,000 (-3.3%) jobs.

Conditions in the apartment market remained remarkably firm under the circumstances. Owners managed to net lease 193 units against no supply, pushing average occupancy 0.13% higher to about 95.9%, according to Reis. Demand was especially robust in the North Alameda submarket that includes Oakland, Berkeley and Alameda. Tenants net leased 124 units, raising the submarket occupancy rate 50 basis points to a nine-month high 94.5%.

Rent trends more fully reflected the depressed economic conditions. Owners managed sequential effective rent hikes averaging only $12 (0.8%) to $1,318, the smallest advance posted in nearly four years. San Ramon and West Contra Costa properties accounted for the lion's share of the advance, registering 1.5% and 3.7% increases, respectively. By contrast, rent growth in North Alameda and Fremont averaged an anemic 0.1%, as owners sacrificed revenue to build occupancy levels in the face of rapid job losses by urban office workers.

Reis foresee weaker conditions through 2010. The service expects occupancy to fall 20 bps by year-end and a further 50 bps by YE2010. Supply estimated at 1,653 units in 2009, the largest vintage harvested since 2000, will be largely responsible. By way of effective rent, Reis foresee advances averaging 2.2% and 3.4% in 2009 and 2010, respectively, low by metro standards but above the comparable forecasts for the **RED 50** (1.7%/2.8%) markets.

Third quarter property sales were slower, consistent with the national trend. RCR counted 6 trades of apartments valued at $5mm or more totaling $68mm. This compares to 13 sales for gross proceeds of $232mm in 3Q07.

A degree of cap rate decompression was evident. Class-B properties exchanged hands at initial yields in the mid–5% to low-6% area, 100 to 150 bps wider than earlier in the year. **RCR** are of the mind that Oakland represents attractive relative value at this level and thereby upwardly revise the metro to a ***"cautious accumulate"*** rating from ***opportunistic.***

SNAP SHOT

	Y-o-y change	Projected YE2008
Vacancy (4.1% - 3Q08)	Down 50 bps	Up 20 bps
Effective Rents ($1,318 - 3Q08)	Up 4.7%	Up 3.9%
Cap Rate (5.8% - 3Q08)	Up 50 bps	Neutral
Employment (1,027.2m - 3Q08)	Down 19.8m	Down 16.1m

KEY POINTS

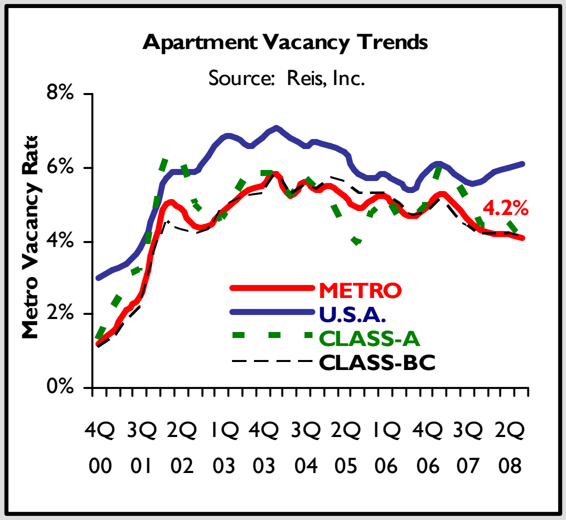
- The weak housing market and global recession exerted increasing downward pressure on the East Bay economy. Firms engaged in construction, finance, retail trade and professional services cut headcounts at accelerating rates, causing metro payrolls to fall at a 19,800-job, -1.9% rate in 3Q, down from a 11,200-job, -1.1% loss posted in 2Q.
- **RCR** expect 2009 to be a particularly difficult year for the metro economy. The firm's econometric model forecasts a net loss of 34,000 (-3.3%) jobs, which would be the metro's worst ever one-year performance.
- Multifamily market performance was constructive under the circumstances. Tenants absorbed a net of 193 units, lifting average occupancy 10 basis points to 94.9%.
- Effective rents increased by an average of $12 to $1,318. The posted 0.9% and 4.7% sequential and y-o-y advances ranked 11th and 9th, respectively, among the **RED 50**.
- The median prices of Alameda and Contra Costa County homes sold in November fell -37% and -50% y-o-y, respectively, to the lowest levels recorded in eight years.

VACANCY TRENDS

- A solid lease performance in 3Q08 was paced by strong tenant demand for apartments located in Berkeley, Oakland and Alameda. Properties in the North Alameda submarket absorbed 124 units, back-filling 816 units delivered in 1H08, thereby raising submarket occupancy 50 basis points to 94.5%. Largely due to this performance, metro occupancy improved 10 bps to 95.9%.
- Class-A properties chalked down 195 net absorptions, lowering average vacancy 40 bps to 4.1%. Class-B/C communities lost 2 net tenants, leaving average vacancy unchanged also at a 4.1% rate.
- Another national real estate data service reported San Francisco/ Oakland occupancy averaging 95.6%, down 15 bps year-over-year.

RANK: 7th out of 50

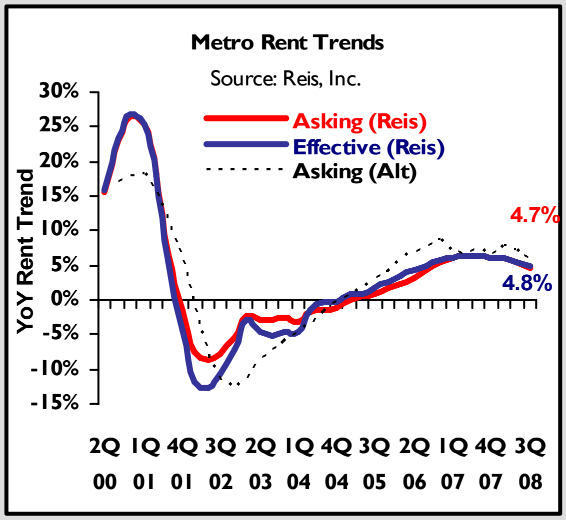
COMMENT: Occupancy is expected to outperform the RED 50 through 2012.



RENT TRENDS

- After recording seven consecutive quarters of year-over-year rent growth of 5% or greater, Oakland trends began to moderate in 3Q08. Asking rents increased by an average of $13 (0.9%) to $1,385, and effective rents rose $12 (0.9%) to $1,318. These data produced y-o-y gains of 4.7% and 4.8%, respectively, ranked **RED 50** 10th and 9th.
- Third quarter results were boosted by strong sequential quarter gains recorded in the West Contra Costa and San Ramon submarkets. Effective rents rose $50 (3.7%) and $20 (1.5%) sequentially. By contrast, rents were essentially flat in North Alameda and Fremont.
- An alternative source reported 4.4% y-o-y asking rent growth in 3Q.
- Reis forecast 3.8% average rent growth through 2012, 100 bps above the **RED 50** average.

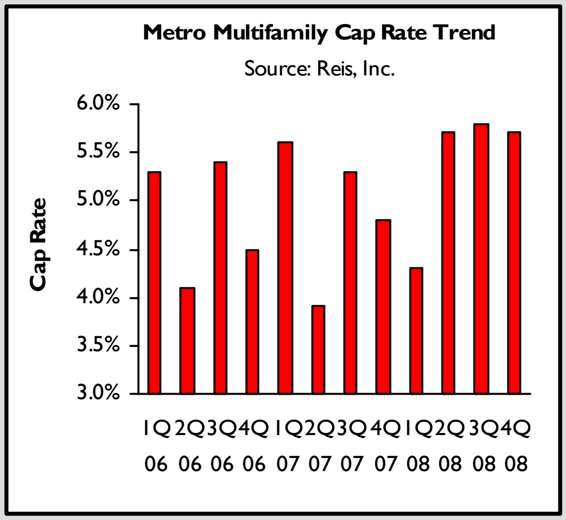
RANK: 9th out of 50



PROPERTY MARKET & CAP RATE TRENDS

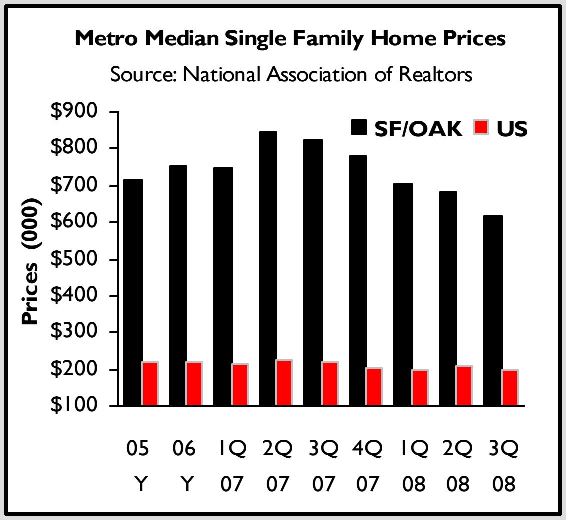
- Sales of East Bay properties declined in 3Q, reflecting rising investor concerns over the economy and a more difficult financing environment. **RCR** identified 6 sales totaling $68mm of proceeds closed from July to September, a sharp decline from 14 trades for $232mm in the comparable period of 2007.
- A review of estimated initial property yields suggest that acquisition cap rates increased substantially from earlier levels. Typical 30-year old class-B assets were capitalized at 5.4% to 6.2%, roughly 100 to 150 higher than rates typical of the spring.
- The sale of a Fremont property closed in early December. The $21.5 million transaction was capitalized at an estimated 6.0% rate.

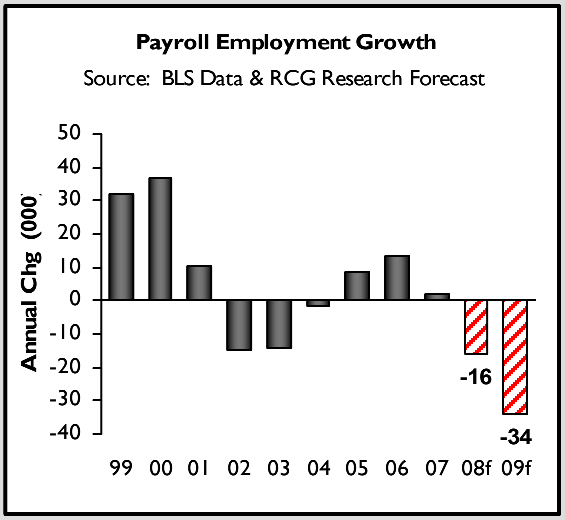
COMMENT: RCR find metro fundamentals compelling. Formerly a sticking point, pricing now appears more advantageous. *Accumulate with caution.*

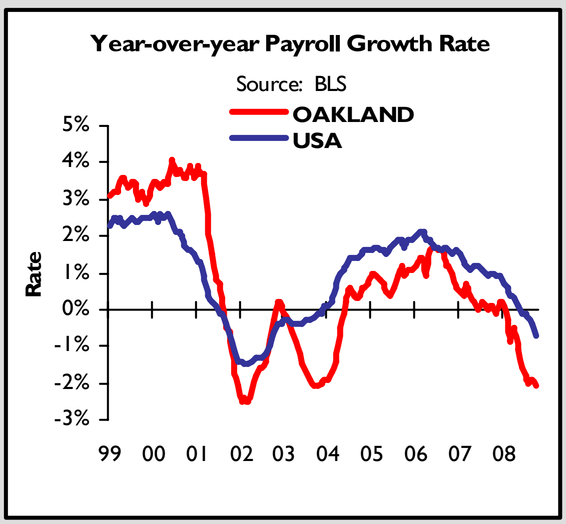


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class	Date of Transaction	Total Price (in millions)	Price per unit	Estimated Cap Rate
Dorchester House (Hayward)	BC	Aug-2008	$7.1	$104,412	5.9%
Carrington Apts (Fremont)	BC	Dec-2008	$21.5	$142,384	6.0%
White Terrace (W Contra Costa)	BC	Aug-2008	$5.8	$111,538	6.2%
Camden Village (Hayward)	BC	Aug-2008	$34.5	$176,026	5.4%







DEMOGRAPHICS & HOUSING MARKET

- Alameda County population increased 12,536 (0.9%) in 2007, the largest gain since 2000; lower domestic out-migration was a key factor.
- Home foreclosure rates in Oakland MSA are among the highest in the nation. RealtyTrac.com reports that 1.64% of metro households were undergoing foreclosure in 3Q08, 10th highest in the country.
- Foreclosure sales dominate the for-sale housing market. Largely for this reason, November median home prices fell to eight-year lows in Alameda and Contra Costa Counties. Medians fell to $365,500 and $265,500, respectively, representing -37% and -50% y-o-y declines.
- The once thriving condo market is now moribund. As many as 2,000 vacant units are offered for sale in Oakland and Emeryville and more are under construction. With prices down by a third or more some developers are likely to repurpose for-sale units as rentals.

EMPLOYMENT TRENDS

Third Quarter 2008

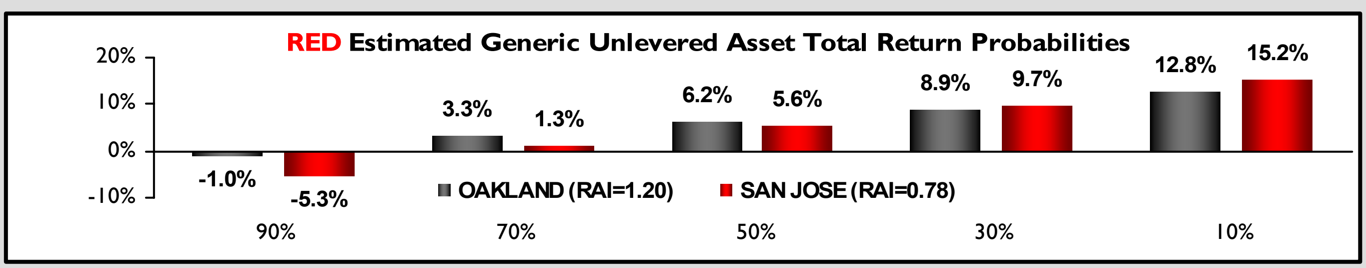
- Payroll trends deteriorated in the third quarter. After hemorrhaging at an 11,200-job, -1.1% rate in 2Q08, losses accelerated to 19,800 (-1.9%) in 3Q08.
- Government belt tightening was a prominent reason for the decay. Agencies cut budgets to the bone after tax revenues plummeted. After hiring at a net 4,100-job pace in 2Q08, public entities trimmed 600 jobs from payrolls in 3Q. Faster attrition also was observed in the retail, construction and business service sectors. The foregoing industries reduced headcounts at an 11,000-job, -3.2% annual rate, compared to a 6,700-job deficit recorded in 2Q08.
- Severe job cuts in the financial services industry persisted. BLS data show an annual decline of 5,000 (-8.6%) job in the third quarter. Conditions may deteriorate further as the operations of the Wells Fargo and Wachovia corporations are merged and rationalized.
- The petrochemical industry was a rare bright spot. Payrolls increased by 400 jobs in 3Q08, representing a 5.3% annual rate of growth.

October 2008

- Job losses continued to accelerate in October. Metro payrolls were 22,500 jobs below the comparable level in October 2007, a -2.1% decline. The comparison was the weakest recorded since April 2002.
- The unemployment rate increased 40 basis points from September to 7.2%. In October 2007, Oakland unemployment stood at 4.9%.

Forecast

- **RED CAPITAL Research** expect conditions in the East Bay to continue to retrogress through the second quarter 2009. Our econometric model produces a 4Q08 forecast of 28,800 (-2.7%) y-o-y job losses. Over-the-year losses should peak in 1Q09 at the 39,400-level but remain at recessionary levels through year end. FY2009 job cuts should total about 34,000 (-3.3%) jobs.

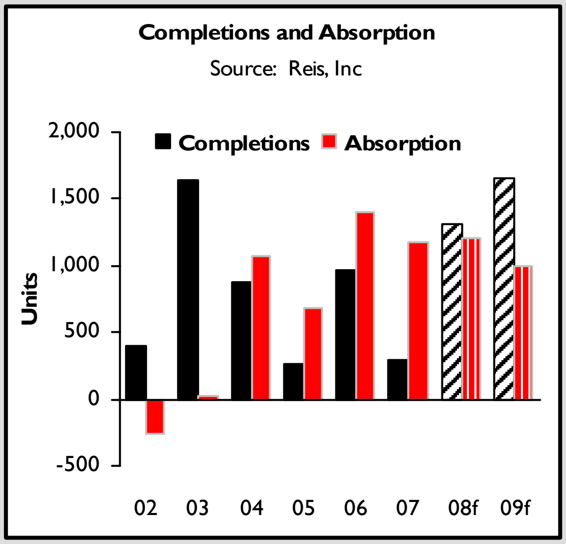


SUBMARKET TRENDS

Submarket	Effective Rent 3Q07	Effective Rent 3Q08	Effective Rent Change	Physical Vacancy 3Q07	Physical Vacancy 3Q08	Physical Vacancy Change
North Alameda County	$1,293	$1,351	4.5%	5.7%	5.5%	-20 bps
Fremont / Newark / Union	$1,334	$1,383	3.7%	3.6%	3.0%	-60 bps
East Alameda County	$1,439	$1,501	4.3%	4.4%	5.0%	60 bps
West Contra Costa County	$1,274	$1,369	7.5%	6.7%	4.1%	-260 bps
Concord / Martinez	$1,122	$1,187	5.8%	4.1%	3.7%	-40 bps
San Ramon / Walnut Creek	$1,333	$1,390	4.3%	3.4%	3.5%	10 bps
East Contra Costa County	$1,089	$1,138	4.5%	5.8%	4.6%	-120 bps
San Leandro / Hayward	$1,153	$1,194	3.6%	3.7%	3.5%	-20 bps
Metro	**$1,258**	**$1,318**	**4.8%**	**4.6%**	**4.1%**	**-50 bps**

SUPPLY TRENDS

- Reis expect two projects to enter lease up in the fourth quarter: a 55-unit garden project in a new lifestyle center in Danville and a luxury townhome development near the BART station in Dublin.
- A total of 1,653 units are expected to be completed in 2009. This estimate is likely to prove to be too high. At this writing, construction is underway on fewer than 900 apartments; delivery of all these units in 2009 is by no means certain. Indeed, an alternative data source forecasts new supply of only 603 units in 2009, a figure that appears better supported by activity on the ground.
- On the other hand, at least 1,000 condos and townhomes will be delivered in 2009, exacerbating the surplus of for-sale real estate now flooding the market. Developers are likely to face increased pressure to place unsold units into the rental pool, a strategy that has proven relatively successful to date.
- **A luxury mid-rise on the Emeryville waterfront that debuted in winter 2007/08 was reported to be more than 94% occupied in September at rents averaging $2,415.**



RED CAPITAL GROUP
Two Miranova Place
Columbus, OH 43215

Daniel J. Hogan
Director of Research
djhogan@redcapitalgroup.com
614-857-1416

William T. Hinga
Business Development
wthinga@redcapitalgroup.com
614-857-1499

www.redcapitalgroup.com
800.837.5100

Columbus, OH_Boston, MA_Charlotte, NC_Chicago, IL
Denver, CO_Fredericksburg, TX_Irving, TX_Jupiter, FL_Linwood, NJ_Nashville, TN
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