RED CAPITAL GROUP®

Market Overview

Portland, Oregon

Multifamily Housing Update — **March 2010**

EXECUTIVE SUMMARY

Oregon is leading the nation in "green" energy development and sustainable practices, and federal stimulus dollars lately have fueled faster growth in the sector. In the long term, steps taken today will pay dividends. But for the time being, Oregon will have to rely on its traditional strong suits like semiconductor fabrication, retail trade and freight transportation to power the economy out of its deep recession.

Fortunately, the news on these fronts are promising. Worldwide computer chip sales increased 47% year-over-year in January, propelled by improved demand for mobile phones, PCs and capital goods. Global trade also rose sharply, sending freight tonnage shipped through the Port of Portland up 11% during the same period. Simultaneously, the consumer spending freeze began to thaw, helping Portland-based Nordstrom to post sharply higher 4Q09 sales and profits.

Weak payroll trends persisted through year-end 2009, but the outlines of a developing recovery became clearer. By the numbers, metro payrolls fell at a 51,800-job, -5.0% annual pace in 4Q. Although considerably weaker than the national average, the performance represented a meaningful improvement from 3Q's devastating 60,900-job, -5.9% setback. Sequential quarter gains largely were attributable to more stable conditions in virtually every major payroll category rather than any measurable growth.

Seasonally-adjusted data painted a similar picture. These figures showed Portland losing -2,200 jobs in December and -6,800 jobs in 4Q09, down from a loss of -5,400 in 3Q. Peak to trough, metro payrolls declined by 71,700 jobs or -6.9% of total payrolls.

RED Research expect improvement in 2010 and 2011, but not a return to the robust growth observed from 2005 to 2007. Our econometric model forecasts attrition of 17,500 jobs this year, and creation of about 3,100 in 2011.

Apartment demand was constructive under the circumstances, as tenants net leased a seasonally strong 436 units in 4Q09, the highest fourth quarter result recorded since 2000. Supply of 494 units was counterbalancing, however, holding metro occupancy at a 93.1% average. Vancouver and Northeast Portland submarkets recorded 50 and 60 basis point sequential quarter occupancy increases, while the supply-rich Northwest and East Gresham submarkets suffered respective 160 and 110 bps declines.

Weak rent trends persisted: effective rent fell -0.9% sequentially to a $757 average. Save for a supply-driven 3.4% gain in the Northwest submarket, rents would have tumbled -1.4%, ranking as the 5th weakest performance recorded among the **RED 50**.

Reis expect market performance to decay at a slower pace in 2010. By year end, the service predicts metro occupancy will decline 20 bps to 92.9%, and rents will slip another $3 (-0.4%) to $754. Reis expect conditions to improve significantly thereafter though, especially with respect to rent, which is projected to rise 2.1% annually through 2014, considerably faster than the 1.8% **RED 50** average.

Investors demonstrated a hearty appetite for Portland properties, closing six trades from October to February totaling $116mm. The bellwether was a $65mm acquisition by a Texas fund of a new repurposed condo tower in the University District. The investment should yield about 8.0% when the property is fully leased. Cap rates were observed in the 6% to 7% range for stabilized institutional-quality product. Using a 6.8% generic yield, **RCR** calculate a 7.0% expected total return, ranking 19th in the **RED 50.**

SNAP SHOT

	Y-o-Y change	Projected 2010
Vacancy (6.9% - 4Q09)	▲ 1.7%	▲ 0.2%
Effective Rents ($757 - 4Q09)	▼ 0.8%	▼ 0.4%
Cap Rate (6.5% - 4Q09)	▲ 10 bps	↔
Employment (980.9m - 4Q09)	▼ 52m	▼ 17.5m

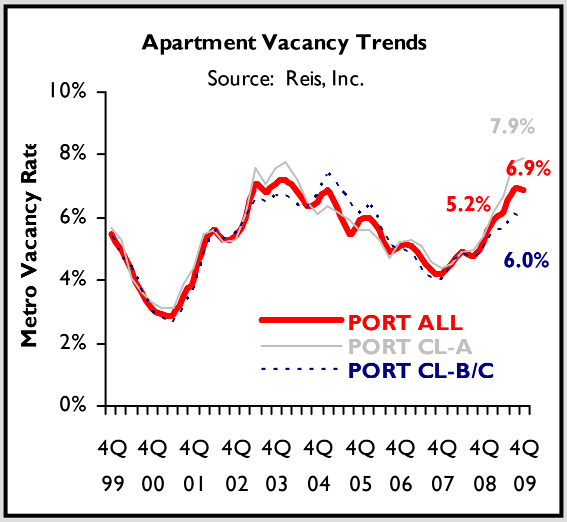
KEY POINTS

- The pace of job losses decelerated in 4Q, declining to the 51,800-job, -5.0% year-on-year rate from 3Q's sharp 60,900-job retreat.
- **RED Research** expect job losses to persist through 1Q11, contributing to a 17,500-job decline in 2010, and a small gain next year.
- Owners discounted rents aggressively in 4Q to attract tenants. Reis data indicate that sequential quarter same store rents dropped 1.4%, while public REIT disclosure suggest that the decline was –2% to –3%.
- The pricing strategy met with success as a net of 436 tenants signed leases in the period. Move-ins were overbalanced by supply, however, and occupancy fell another 20 basis points sequentially and 170 bps year-over-year to 93.1%.
- Same store NOI declined -8% to -10% in 2009, moderately better than the U.S. norm.
- Investors snapped up six institutional quality apartment properties in the October—February period for total proceeds of $116mm. Cap rates were mostly in the 6% to 7% range, consistent with recently observed West Coast metro trends.

VACANCY TRENDS

- Occupancy rates fell to the lowest level in six years in the fourth quarter, declining 20 basis points from September to 93.1%.
- Owners net leased 436 units in the quarter, divided nearly equally between class-A and class-B/C quality product. Delivery of 323 class-A units was overbalancing, reducing class occupancy 10 basis points to 92.1%. Conversely, class-B/C occupancy was firm at 94.0%.
- Supply pressures sent occupancy in the Northwest and East Gresham submarkets tumbling. Average rates fell 160 and 110 bps sequentially from September. Conversely, rates in Northeast and Vancouver submarkets recovered 60 and 50 bps to 92% and 94%, respectively.
- M/PF reported a 92.9% year-end metro occupancy rate.

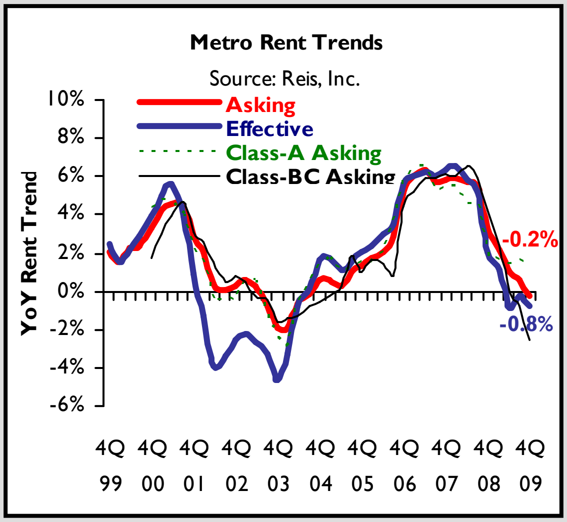
RANK: 21th out of 50



RENT TRENDS

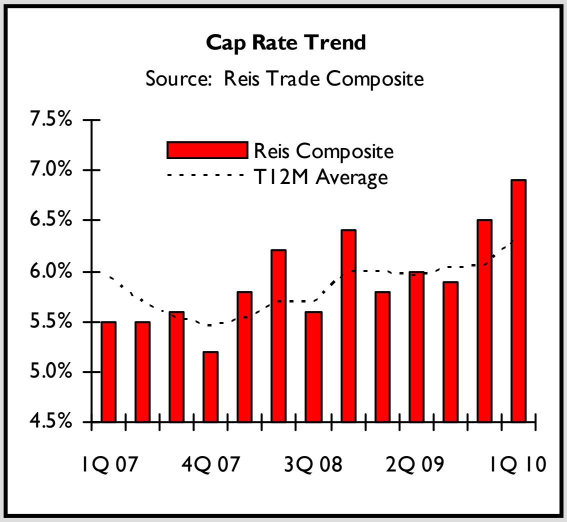
- Reis report that metro effective rents declined $7 (-0.9%) sequentially to $754 in 4Q09, producing a –0.8% decline for the year. Excluding the effect of a luxury high-rise delivered in the West End, average effective rents would have declined about -1.4% sequentially.
- M/PF report that effective rents fell about –2% sequentially and –6% year-over-year. Disclosure from two public REIT with significant Portland holdings show sequential loses of -2.3% and -3.3%, and year-on-year declines of -3.6% and -4.1%, respectively.
- Reis data lead **RCR** to estimate that same-store NOI fell –8.2% in 2009. Two public REIT reported declines of –6.6% and –10.3%.
- Reis believe that rents will decrease by another $3 or -0.4% in 2010.

RANK: 13th out of 50



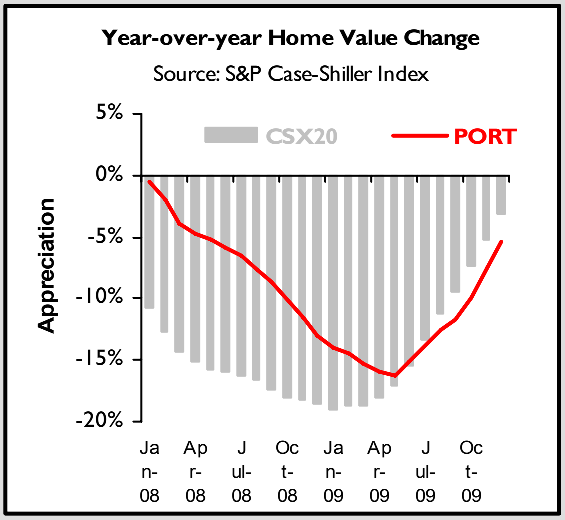
PROPERTY MARKET & CAP RATE TRENDS

- Cap rates continued to drift higher in the fourth quarter. Average cap rates gravitated to the mid– to high-6% area, about 50 basis points above the 12-month moving average.
- An active Texas-based investor completed the bellwether trade in December. The fund and its REIT partner acquired a 40% occupied, 2009-construction high-rise near the University of Portland at a price equating to $184,659 per unit. The property also contains street-level retail space. **RCR** estimate that the investment will yield about 8% at current rents when stabilized occupancy is achieved.
- Based on recent trades, **RCR** are of the mind that generic Portland apartment properties generate about 6.8% initial yields. Using this cap rate and Reis 5-year rent and occupancy forecasts, we estimate that a typical property will generate a 7.0% total return, eclipsing the 6.8% **RED 50** average, and a 2.42 risk-adjusted index, also above average.



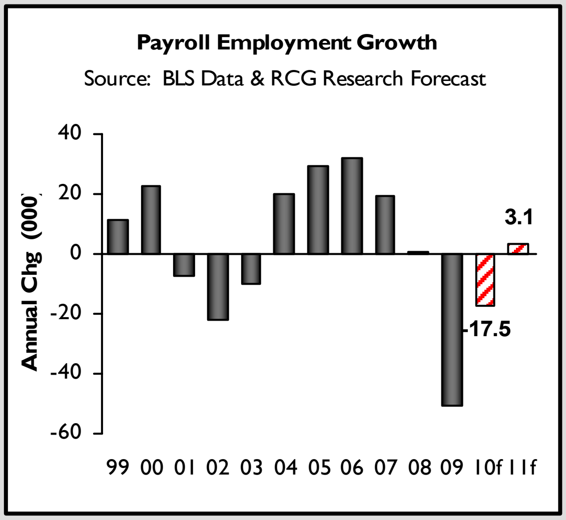
NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class	Date of Transaction	Total Price (in millions)	Price per unit	Estimated Cap Rate
Orchard Park (Salem)	B	23-Dec-2009	$10.5	$46,875	9.4% (quoted)
Hallwood (Beaverton)	B	31-Jan-2010	$5.6	$73,684	**6.0% / 6.9% p.f.**
Cyan / PDX (University District)	A+	15-Dec-2009	$65.0	$184,659	8.0% p.f.
Discovery Park (Vancouver)	B	24-Nov-2009	$15.2	$72,226	6.0%



DEMOGRAPHICS & HOUSING MARKET

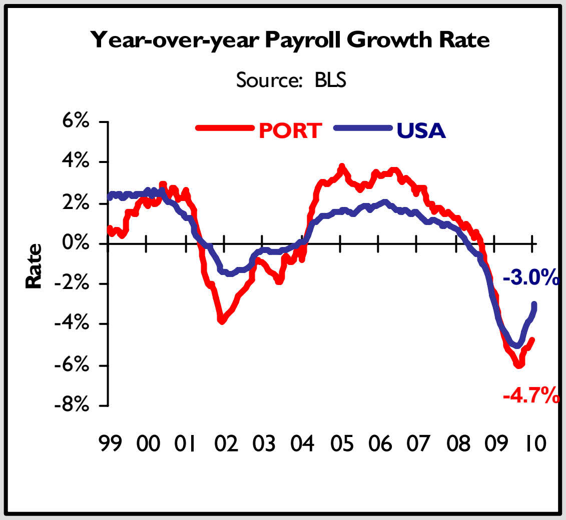
- The N.A.R. report that the median price of a Portland MSA home sold in 4Q09 was $239,400, down -9.5% from 2008 and –2.1% from 3Q09. Typical US homes, by comparison, fell -4.0% and -3.0%, respectively.
- S&P Case-Shiller report that Portland home values declined –0.3% November to December, in line with the performance of the firm's 20-metro index (CSX20). Year-on-year, Portland property values declined by an average of -5.4%, moderately trailing the –3.1% decline recorded by the CSX20 index (see the chart to the left).
- DQ News report that 4Q09 median metro county home prices plunged -7.5% (Multnomah) to -10.4% (Clark, WA) year-over-year.
- One of every 44 Portland households received one or more notices of foreclosure last year, up 87% from 2008. The foreclosure rate was 61st highest among the 203 largest U.S. metro areas.



EMPLOYMENT TRENDS

Fourth Quarter 2009 Non-Seasonally-adjusted

- Payroll job losses moderated in the fourth quarter, declining from 3Q's devastating 60,900 year-over-year rate to a 51,800-job pace.
- Quarter-to-quarter improvement was attributable to decelerating losses in nearly every NAICS super-sector. No notable gain was recorded in any category, however; only health care services advanced.
- Year-over-year payroll losses recorded in December slowed to 48,700 (-4.7%) jobs. This was the smallest y-o-y setback posted since March but represented a significant underperformance relative to the –3.0% US average nevertheless.
- The unemployment rate in December was 10.6%, 100 basis points lower than the August peak but up 20 bps from September.

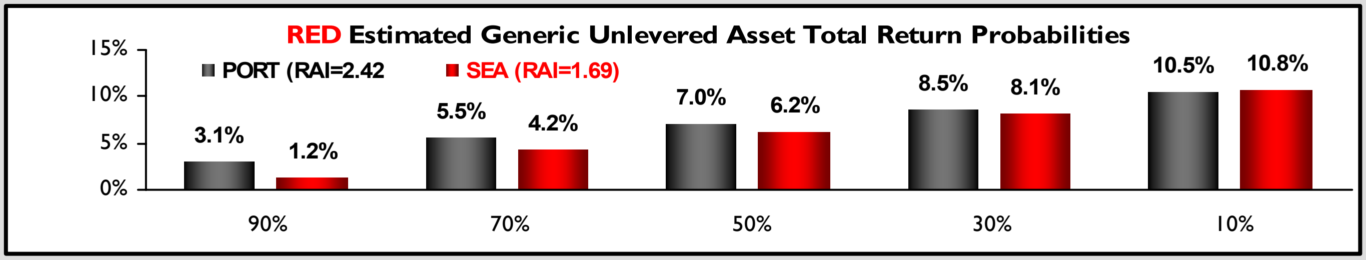


Fourth Quarter 2009 Seasonally-adjusted

- Peak to trough, Portland lost 71,700 jobs expressed on a seasonally-adjusted basis, representing -6.8% of the payroll job base.
- Payrolls fell 6,800 jobs in 4Q09 expressed on a seasonally adjusted basis, down from a 5,400-job retreat in the prior three-month period.
- The fourth quarter loss was largely attributable to attrition of 3,400 jobs in November. Losses in December diminished to 2,200 jobs.
- Pursuant to its annual re-benchmarking exercise, the BLS sharply lowered its estimates of 2009 state of Oregon employment levels. A similar revision is likely for the Portland series as well.

Forecast

- The **RCR** econometric payroll model projects continuous year-over-year payroll losses through 1Q11. Annually, the model foresees a 17,500-job payroll decline in 2010, followed by a slim 3,100-job advance in 2011.

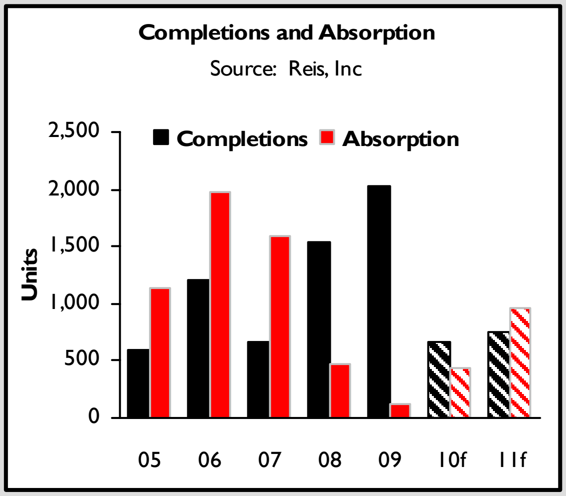


SUBMARKET TRENDS

Submarket	Effective Rent			Physical Vacancy		
	4Q08	4Q09	Change	4Q08	4Q09	Change
Northwest Portland	$992	$1,115	12.4%	7.9%	14.2%	630 bps
Tigard / Oswego / Wilsonville	$771	$736	-4.6%	5.2%	6.1%	90 bps
Beaverton	$752	$721	-4.1%	5.1%	6.0%	90 bps
Milwaukie / Oregon	$706	$675	-4.4%	4.1%	5.8%	170 bps
East Gresham	$685	$667	-2.6%	4.0%	5.9%	190 bps
Vancouver	$722	$716	-0.8%	5.3%	6.0%	70 bps
Northeast Portland	$827	$808	-2.3%	5.7%	8.0%	230 bps
Metro	**$763**	**$757**	**-0.8%**	**5.2%**	**6.9%**	**170 bps**

SUPPLY TRENDS

- Nine major apartment projects containing 2,034 units were completed in 2009. Five that encompass 1,574 total units are located in the Northwest submarket. No other submarket added more than 239 units during the period.
- Projects under construction dwindled to only three at this writing. Each is located in the Northwest submarket. A six-story 151-unit infill project in the Bridge Port Brewing neighborhood is expected to be completed in May. A 274-unit, five-story LEED-certified mid-rise in the South Waterfront section is tipped for a July debut. Pre-leasing rents range from $920 to $3,120 or about $1.50 to $2.00 per square foot. Finally, a 238-unit suburban-style four-story project near Oak Hills was putting on its finishing touches at the time of this report. Some units already were occupied at rents ranging from $800 to $1,395 or roughly $1.00 to $1.20 per square foot.
- Developers have a host of projects on the shelf; 17 projects encompassing 1,767 units were in the planning stage as of February. The largest concentrations are located in the Northeast Portland, Vancouver and East Gresham submarkets. Fortunately, only one project is located in Northwest Portland:
- A significant portion of recent competitive supply has come in the form of repurposed condos. The Portland market may not have seen the last of this phenomenon. Presently, 12 major condo projects with 1,475 units are planned, including four in the over-supplied Northwest Portland submarket. The potential for one or more of these properties to explicitly enter the rental market is considerable.



- Tenants occupied about 25 units of a 22-story, 273-unit tower in the P.D. two months after the project was complete. Rents averaged roughly $2,015 per month.
- About 75 units of a repurposed 188-unit, six-story North Portland neighborhood condo project were rented after being on the market about 9 months. Rents averaged $953.
- A 16-floor, 231-unit LEED-certified high-rise in the North P.D. was nearly 97% occupied in December after leasing about 18 months. Rents at this project averaged nearly $2,700.

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

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

RED CAPITAL GROUP
Two Miranova Place
Columbus, OH 43215
www.redcapitalgroup.com
800.837.5100