RED CAPITAL RESEARC

California Region Report

SECOND QUARTER 200

EXECUTIVE SUMMARY

National Economic Trends

- U.S. economic conditions remained exceptionally weak in June as payroll job losses and jobless rolls continued to grow. The nation's employed payroll workforce declined at a 5.7 million job, -4.2% rate, while the ranks of the unemployed increased to 15.1 million persons, the highest total ever recorded in the Bureau of Labor Statistics data series dating to 1948.
- Although conditions in the labor market remain dire, gross domestic product data suggest that the 2007—2009 Great Recession is approaching its final months. Total U.S. output fell only 0.7% in 2Q09, expressed on a seasonally-adjusted annual basis, much slower than the –6.4% rate of decline reported in 1Q. The quarter-to-quarter improvement primarily was attributable to slower rates of decline in fixed investment, exports and government spending.
- PNC Financial Services Group economists believe that GDP growth in the U.S. will be positive in 3Q09, rising 2.5%- 3.0% on a seasonally-adjusted annual rate basis. Faster personal consumption and private inventory investments will fuel the advance. With respect to employment, the group project a small net loss (-0.2%) in 2010, and a constructive 1.7% advance in 2011.

California Region Economic Trends

- The state's economy remained weak as California establishments cut a seasonally-adjusted -189,700 positions from payrolls in the second quarter, following a -252,300-job decrease in the previous quarter. Moreover, the seasonally-adjusted unemployment rate rose from 8.7% in December to 11.6% in June.
- On an annual basis, the pace of payroll job loss accelerated from -563,800 (-3.7%) in 1Q09 to -733,100 (-4.8%) in 2Q09, partially due to faster attrition among manufacturing firms. Production staffs declined -90,800 year-over-year in 1Q09 and -120,400 in 2Q09. Professional, scientific and technical business service providers also trimmed staffs more aggressively, cutting -35,700 jobs year-over-year in 2Q09.
- The Business Forecasting Center at the University of the Pacific and the Anderson Forecast Center at UCLA predict that job trends will remain weak through 2010. Specifically, the former forecasts that payroll employment will fall -0.7% next year, before rising 2.2% in 2011. **RED CAPITAL Research** forecast a similar -146,300 (-1.0%) job decrease next year, but a less robust 238,700 (1.7%) job gain in 2011. Moreover, the Anderson Forecast group notes that the state's unemployment rate will likely remain above 10.0% heading into 2011.

Total Return Analysis

- Two of the eight California metros generated above average year-over-year NOI growth in the **RED** 50. At -4.7%, San Diego ranked 11th in the **RED** 50 and the -7.6% decrease in Oakland was moderately better than the -7.8% group average.
- San Diego boasts the highest expected return in California (7.1%) and in the **RED** 50, owing to optimistic Reis forecasts for rent and occupancy trends. Conversely, San Jose and San Francisco registered the state's lowest measures of both total and risk-adjusted returns. The remaining markets generated similar return profiles as expected returns ranged from 4.7% to 6.8% and risk-adjusted returns varied from 1.17 to 3.02.