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Florida Region Report

FIRST QUARTER 2008

EXECUTIVE SUMMARY

National Economic Trends

- The U.S. economy averted recession in the first quarter of 2008, recording a seasonally-adjusted annualized growth rate of 1.0%. On a year-over-year basis, real GDP was up 2.55%, an improvement from the 2.46% metric posted in 4Q07.
- Weak consumer spending growth and plummeting fixed investment in residential real estate contributed to the below trend GDP report. Personal consumption grew only 1.1%, the lowest metric posted since 2001, reflecting efforts by households to reconstruct balance sheets damaged by declining home prices and excessive consumer debt. Home construction also contributed to the slowdown: the value of residential construction dropped -24.6%, better than the -25.2% decline recorded in 4Q07.
- The collapse of the sub-prime mortgage market continued to put downward pressure on home prices. The median price of a U.S. home fell -7.7% year-over-year in 1Q08, according to the National Association of Realtors, the worst performance ever in this series. Value depreciation was severe in West Region markets in which use of sub-prime products was common, especially Sacramento (-29.2%); Inland Empire (-27.7%) and Las Vegas (-20.2%).
- Evidence that the economic downturn may be near bottom emerged by mid-spring. Payroll employment in April declined only 20,000 jobs, following losses totaling 240,000 (seasonally-adjusted) jobs during the previous three months. Stock prices rebounded, rising about 10% from March lows by mid-May. Credit market stress also appeared to ease, as indicated by a reduction in the spread between Libor and Treasury rates from 200 bps in March to 100 in May, and a recovery of financial stock prices.
- National City Bank economist Dr. Richard DeKaser was steadfast in his forecast for economic recovery in the second half 2008. DeKaser expects GDP growth to accelerate to 1.9% in 2H08 and 2.0% in 2009. Payroll growth will rebound to a 0.2% pace in 4Q.

Florida Economic and Housing Trends

- Housing market conditions continued to deteriorate in 2008. According to OFHEO, Florida home prices fell 8.2% year-over-year in 1Q08, the third worst performance among the 50 states and the District of Columbia. In addition, RealtyTrac report that one out of every 211 homes was in foreclosure in June, ranking fourth behind Nevada (1 out of 122), California (1 out of 192) and Arizona (1 out of 201).
- Headline job trends were equally dismal. A net of -39,600 (-0.5%) positions were eliminated year-over-year in 1Q08. The trend worsened as -88,400 (-1.1%) jobs were cut in May. **RED CAPITAL Research** expect average monthly payrolls to decline by -52,000 (-0.6%) this year. Conditions should improve in 2009, however, when we forecast creation of 74,000 (0.9%) jobs.
- Real gross state product growth is likely to turn negative this year. The 0.5% rate of payroll growth last year corresponded to essentially no change in gross state output. Negative payroll trends this year portend a contraction.

Total Return Analysis

- Only one Florida market demonstrates above average risk adjusted returns; Jacksonville (2.99 RAI). The remaining five markets fall short of the 2.82 **RED** 50 mean, owing to lower rates of expected return and higher degrees of NOI growth volatility. Ranked by expected total returns, all Florida markets fall short of the 6.2% **RED** 50 average. Jacksonville (5.2%) comes closest to meeting this threshold.
- The low total returns are a product of relatively "rich" asset prices and pessimistic Reis forecasts for rent and occupancy trends. Cap rates for the highest quality assets remained relatively stable at sub-5% levels but cheaper yields may be available for Class B assets.

Investment Rankings

- Based on the NCREIF metro cap rate series, it is difficult to justify acquisition of multifamily assets in any of the major Florida markets. We recommend that investors delay purchases in Jacksonville, Tampa and Orlando until prices moderate. In Southeast Florida, Miami and Fort Lauderdale assets appear too rich to warrant acquisitions. Conversely, a pricing correction may be underway in West Palm Beach. Therefore, investors should prospect for metro assets ***opportunistically***.

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