RED CAPITAL RESEARC

Florida Regional Report

SECOND QUARTER 2007

EXECUTIVE SUMMARY

National Economic Trends

- Following four quarters of below trend economic growth, second quarter GDP increased at a 4.0% real rate, fueled by improved export sales; stronger corporate investment in plant, equipment and software; and faster inventory growth.
- The outlook for the economy dimmed during the summer months, as sequential payroll employment growth decelerated in July and turned negative in August. Growing job losses in the construction and manufacturing sectors were largely responsible. On a year-over-year basis, payroll employment was up 1.1% in August, the lowest annual comparison recorded in 40 months.
- Although signs of a slowdown were unmistakable, the probability of recession remains low. Indeed, the outlook for the economy is for moderate, slightly below trend growth through 2008. On September 7, National City Corporation chief economist Dr. Richard DeKaser forecasted GDP growth at an annual rate of 2.1% in second half of 2007, rising to 2.6% in 2008.
- In respect to non-farm payroll job creation, Dr. DeKaser projected growth at a seasonally-adjusted annual rate of 0.7% for 2H07, and 0.9% for 2008. Should this come to pass, 2008 will represent the weakest domestic job market since 2003.
- A record number of homes listed for sale and turmoil in the mortgage market exerted downward pressure on housing prices. Median home prices fell 1.5% (NAR) in the twelve months ended in June, and industry analysts expect further declines in the 2H07. High-cost coastal metros where the employment of jumbo loans and other non-conforming note structures is ubiquitous may experience above average depreciation. Prices in some markets could decline by 5% to 10% by the end of 2008.

Florida Economic Trends

- Coming off two years of exceptional population and economic growth, Florida trends were rather ordinary in the first half. After adding 207,200 (2.7%) non-farm payroll jobs in 2006, June Florida payrolls were up only 109,300 (1.4%) jobs year-over-year. A dramatic slowdown in housing construction was largely responsible, leading to the attrition of 14,200 seasonally-adjusted construction jobs from January to June. The sector added 24,200 jobs in the comparable period of 2006.
- Population growth slowed materially in 2006, as a combination of high housing costs; skyrocketing homeowners insurance rates; a growing real estate tax burden and hurricane anxiety diminished the appeal of relocating to the state. This and a rising supply of new and existing homes for sale contributed to weaker housing prices in most Florida metro markets. OFHEO report that the average value of a Florida home fell 0.8% in 2Q07, the largest sequential quarter decrease in fifteen years. Supply pressure from new condominium construction will exert further downward price pressure on state markets in 2008.
- **RED** CAPITAL Research forecast net creation of 120,000 (1.5%) payroll jobs in 2007. RCR expect slower job growth in 2008, with net gains ranging from 51,000 to 114,000 jobs, with point estimate of 83,000 (1.0%). The RCR econometric model forecasts nominal GSP growth of only 2.4% in 2007 and 2.7% in 2008, each materially slower than the U.S. average.

Total Return Analysis

- RCR estimate that the most probable five-year holding period return of Florida metro apartment investments based on recent acquisition cap rates and Reis rent and occupancy forecasts is 6.5%. This compares to a 7.1% non-Florida metro median return.

Investment Rankings

- **RED** CAPITAL Research assign "***Opportunistic***" investment ratings to each of the six covered Florida metro markets. In most cases, this represents a downgrade from our previous quarterly report. Generally, an opportunistic rating indicates that market fundamentals are relatively strong, but that current cap rates are too low to justify an aggressive acquisition effort. Over the long-term, Florida investments should deliver attractive total returns. In light of the current unsettled nature of the housing market and the implications of shadow supply on occupancy and rent trends, however, an upward cap rate adjustment is appropriate. We assert that current conditions warrant cap rates about 50 basis points above those typically observed in 2Q07 trades.