

### 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 0.9%. On a year-over-year basis, real GDP was up 2.53%, 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 1.0%, the lowest metric posted since 1991, 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 -26.7%, the largest one-quarter decline posted since 1981.
- 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 2.2% in 2009. Payroll growth will rebound to a 0.3% pace in 4Q.

#### *Mid-Atlantic / Northeast Region Economic Trends*

- Job growth in the states that constitute the Mid-Atlantic and Northeast regions decelerated from a 208,800 (0.7%) year-over-year pace in 4Q07 to 191,700 (0.7%) in 1Q08. The strongest trends were noted in Maryland and the District of Columbia as both posted growth rates of 1.0% or greater. New York and Massachusetts fell just shy of this standard, rising at 0.9% and 0.8% rates, respectively. The slowest increases were registered in Virginia (0.5%), Pennsylvania (0.4%) and New Jersey (0.3%).
- In total, **RED** expect payroll growth in the region to slow from 255,400 (0.9%) last year to 75,000 (0.3%) in 2008, and 71,000 (0.2%) in 2009. The slowdown is largely attributable to reduced hiring among skilled service providers and increased attrition in the banking sector.

#### *Total Return Analysis*

- Generic metro asset total returns vary greatly throughout the region. New York and Boston exhibit high historic volatility and low initial yields which produce low expected and risk-adjusted returns. On the other end of the spectrum, Baltimore, Suburban Maryland and Philadelphia boast low historic volatility and relatively attractive acquisition cap rates. As a result, these markets deliver above average measures of risk-adjusted returns. Owing to low projected rent growth, Philadelphia assets possess a below average expected rate of total return. The total return profiles for Northern Virginia and the District of Columbia are similar as Reis forecast comparable rent growth and occupancy trends for the two markets. On the other hand, higher purchase yields in Northern Virginia result in a more attractive expected rate of return relative to the District.

#### *Investment Rankings*

- Our highest rankings were awarded to Baltimore and Suburban Maryland. Both earned *Accumulate* honors based on above average expected returns and excellent risk-adjusted returns. **RED CAPITAL Research** appreciate the virtues of institutional favorites Boston and New York, but cap rates were too low to make an unconditioned "buy" recommendation. Therefore, we assign *Opportunistic* ratings until prices moderate. We held much the same view of Philadelphia and Northern Virginia. The former boasts a high degree of stability but low potential returns. Northern Virginia offers an average expected rate of return but buyers must assume an above average risk profile. Finally, assets in the District of Columbia are too rich for underlying fundamentals. Buyers should proceed with caution and current owners are compelled to consider *monetizing unrealized gains*.