

EXECUTIVE SUMMARY

National Economic Trends

- Real GDP growth slowed to 3.3% in 2006, largely attributable to a weaker housing market, slower wage growth and rising tax burdens and interest rates. In 1Q07 GDP growth slipped to 0.7%, the slowest quarter recorded in more than four years.
- The outlook for domestic economic conditions is relatively positive. National City Bank economist Dr. Richard DeKaser (*USA Today Economist of the Year, 2007*) forecasts GDP growth of 2.2% in 2007 and 3.1% in 2008.
- Although inflation remains a primary concern for Fed policy makers, recent data suggest that inflationary pressures are under control. Therefore, the next move of the Fed Funds rate is more likely to be a decrease. Nevertheless, a change in Fed policy is not imminent.

Mid-Atlantic Economic Trends

- The region posted moderate economic growth in the first quarter 2007, adding jobs at a 137,000 (1.1%) year-over-year pace, slower than the last year, when Delaware, D.C., Maryland, Pennsylvania and Virginia created a total of 155,900 (1.2%) jobs.
- The skilled services sectors continued to post strong results. Robust hiring in the education and health care service sectors translated into a 2.5% annual growth rate during the first five months of 2007. Rapid expansion also was reported in the professional service industries. Business service firms hired a seasonally adjusted 24,700 workers by the end of May, translating to a 2.6% year-over-year advance. Establishments turned increasingly to employment services to obtain labor with scarce computer and customer service skills. Contract employment expanded at a 6.3% annual rate during the first five months of the year.
- Conditions were softer in the goods producing industries. Hiring by construction companies fell from 19,200 workers last year to 1,800 in the twelve months ended in May. Factory attrition proceeded at an 18,800-job over-the-year pace in May. Firmer conditions in the commercial real estate market and surprisingly strong orders reported by capital goods producing companies in May should contribute to more constructive trends in the second half of the year.
- Home prices were firm in the first quarter, with each state in the Mid-Atlantic Region and the District of Columbia registering positive year-over-year and one-quarter appreciation, according to the Office of Federal Housing Enterprise Oversight. Sales were generally slower in the first quarter, contributing to longer required marketing periods. The Philadelphia Federal Reserve Bank reported that some observers anticipate price appreciation below the rate of inflation for several years.
- Single-family building permit issue was down 22.8% year-over-year through May. Virginia and Maryland posted the largest percentage declines. Multifamily permitting advanced 2.1%, however, evidencing a shift of developer interest toward rental options.
- RED CAPITAL's econometric payroll forecast model foresees slower job growth through 2008. After producing 155,900 jobs in 2006, the model projects 2007 regional net job creation in a range of 97,000 to 129,000, with a mid-point of 113,000 (0.9%). The model forecasts slower going next year, within a 52,000 to 114,000-job confidence interval. The 2008 point estimate is 83,000 (0.6%).

Total Return Analysis

- Investments in the Maryland suburbs of Washington promise the highest total returns in the RED 50. Optimistic Reis rent growth forecasts and an attractive generic cap rate combine to produce 10.5% projected 5-year holding period returns. Assets located in the District and Baltimore offer attractive risk-adjusted returns by virtue of the low degree of rent and occupancy volatility recorded in these markets. Conversely, high prices and low cap rates limit potential returns in Northern Virginia and Philadelphia, wherein RED estimate most-probable generic returns of 5.8% and 5.0%, respectively, well below the 7.4% RED 50 median.

Investment Rankings

- Suburban Maryland's high expected returns and attractive investment profile elevate it to one of the top 5 acquisition markets in the RED 50, earning it an "Accumulate" ranking. Baltimore also merits an "Accumulate" rating by virtue of its exemplary stability and RED 50 best Risk-adjusted Index (RAI). Conversely, the District is ranked as "Opportunistic" due to mediocre RAI and expected return metrics, and Northern Virginia and Philadelphia are considered "Holds" owing to low expected total returns.