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Mid-Atlantic / Northeast Regional Report

FOURTH QUARTER 2007

EXECUTIVE SUMMARY

National Economic Trends

- The pace of economic expansion was considerably weaker in the fourth quarter 2007. Real gross domestic product advanced at a 0.6% seasonally-adjusted annual rate, significantly below trend and comprehensively slower than the 4.9% surge recorded in the third quarter. The housing downturn was largely to blame: residential fixed investment fell 25.2%, as developers cut production in order to stem a sharp rise in unsold home inventories. Personal consumption advanced at a 1.9% rate, down from 2.8% in 3Q07, and import levels fell 1.9% on sluggish domestic demand. The decline in spending was felt most acutely at retailers exposed to the housing industry, especially building supply, home furnishings and department stores, which registered declining sales year-over-year. Even export growth, which ignited the economy in the third quarter, decelerated significantly, dropping from a 19.1% burst in 3Q07 to a more modest 4.8% advance.

- January and February payroll data suggest that the economy continued to decelerate in 2008 and raised the prospect that GDP growth will be negative in the first quarter. Establishments trimmed 22,000 and 63,000 jobs, respectively, in January and February, the first seasonally adjusted losses recorded since August 2003. On a year-over-year basis, payroll employment rose 0.6% in February, the slowest annual comparison observed in 48 months. New orders for manufactured goods fell 2.5% in January, following a 2.0% increase in December. This decline was primarily attributable to reduced demand for cars, trucks and other transportation equipment, which fell 13.0% following a 10.1% gain posted in December.

- National City Bank economist Dr. Richard DeKaser forecasts GDP growth to decelerate to 1.9% in 2008 but rebound to 2.5% in 2009. Similarly, the rate of payroll growth is expected to fall to 0.6% this year, and accelerate to 1.1% in 2009.

Mid-Atlantic / Northeast Region Economic Trends

- The pace of job growth slowed to 207,000 (0.8%) year-over-year in 4Q07, down from 283,000 (1.1%) in the same period of 2006. The slowdown was partially attributable to reduced hiring by construction and business service firms. Combined, the sectors accounted for 107,900 new jobs in 4Q06 and 67,400 in 4Q07. Weakness in the financial sector also contributed. After posting a 11,100 year-over-year job advance in 4Q06, establishments lost 8,500 workers in 4Q07.

- While the region exhibited slower growth in 2007, New York and the District of Columbia posted accelerated trends. In aggregate, New York payrolls increased 81,400 (1.0%) in 2006 and 119,200 (1.4%) in 2007. Similarly, DC employers added 5,400 (0.8%) workers in 2006 and 7,200 (1.0%) in 2007. Job growth fell only slightly in Massachusetts, down from 33,900 (1.1%) to 31,700 (1.0%). In Pennsylvania, job creation slowed from 53,900 (0.9%) to 39,700 (0.7%) and in Maryland the pace fell from 33,700 (1.3%) to 20,600 (0.8%). Payrolls in Virginia rose 62,100 (1.7%) in 2006 before decelerating to 34,200 (0.9%) last year.

- **RED CAPITAL Research** (**RCR**) expect payroll growth to continue to slow but remain positive in 2008, assuming a modest expansion domestically. Our econometric model suggests that 148,000 (0.6%) jobs will be created this year with another 164,000 (0.7%) jobs in store for 2009. The confidence intervals range from 98,000 (0.4%) to 198,000 (0.8%) this year and from 100,000 (0.4%) to 299,000 (0.9%) next year.

Total Return Analysis and Investment Rankings

- The two markets in the Northeast, Boston and New York, are traditionally among the favorites of institutional and international investors. But low cap rates in New York and sluggish rent trends in Boston may alter investor sentiment, albeit to a small degree. Our analysis of projected total returns on generic metro investment suggests that acquirers should seek assets in secondary barrier-protected markets as some of the primary markets are over-bought. With this in mind, we assign a rating of ***Hold*** to Boston and New York. The same goes for Northern Virginia assets. Market fundamentals and projected total returns do not support acquisition at this time.

- Baltimore earns an ***Accumulate*** ranking based on historic stability and a comparatively optimistic fundamental forecast from Reis. The expected rate of total return is about average but risk-adjusted returns rank among the top three of the **RED** 50. Similar to Boston and New York, assets in the District of Columbia are priced to perfection, leaving investors exposed to a high degree of risk if market fundamentals dip and cap rates rise. For investors looking for an inroad to the DC market, we suggest ground-up ***development***. For stability, we suggest investigating Philadelphia assets, but do so ***opportunistically*** as cap rates in certain submarkets are low. Suburban MD merits an ***Accumulate*** rating, boasting a top 10 measure of expected and risk-adjusted returns.