

### EXECUTIVE SUMMARY

#### National Economic Trends

- The U.S. economy averted recession in the first quarter of 2008, recording a second consecutive seasonally-adjusted annualized growth rate of 0.6%. On a year-over-year basis, real GDP was up 2.46%, the lowest rate of growth reported since 2Q07.
- 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 2.7% in 2H08 and 2.5% in 2009. Payroll growth will rebound to a 0.8% pace in 4Q.

#### Southeast Economic Trends

- First quarter payroll growth in the four-state Southeast Region continued the steady deceleration first observed in 1Q07. Georgia, North Carolina, Tennessee and Virginia establishments created 124,200 (0.8%) jobs year-over-year in 1Q, down from 153,600 (1.0%) in 4Q07; 199,500 (1.4%) in 3Q07; and 245,700 (1.7%) in 1H07.
- The housing slump was largely responsible. Construction employment declined year-over-year in March and April, the first net job losses in this sector observed since 2003. Slower demand for mortgage credit also gave rise to losses in the financial services sector. Finance employers reduced payrolls by an average of 9,400 jobs (-1.2%) year-over-year in March and April.
- **RCR** expect region payrolls to rise an average 89,000 (0.8%) jobs in 2008, before rebounding to a 151,000-job, 1.0% add in 2009.

#### Total Return Analysis

- Mean Southeast Region total returns fall slightly below the **RED 50** average across the probability spectrum, limiting its investment appeal. One exception to this rule is Charlotte whose expected total return metric (6.9%) exceeds the group average by 70 basis points. Moreover, Charlotte's expected returns best the **RED 50** norm in every probability category, distinguishing it from regional peers. Charlotte falls short of the **RED 50** average with respect to risk-adjusted returns, however; only Norfolk among region metros tops the **RED 50** mean risk-adjusted index (RAI).

#### Investment Rankings

- Norfolk has long been among **RCR's** favorite markets, earning consistent "**Accumulate**" investment ratings. But Reis forecast a dramatic slowdown of rent growth and a pending supply-driven decline of average occupancy. Although we are not entirely in agreement with Reis on this count, we downgrade the Hampton Roads to "**Opportunistic**." Charlotte generates above average total returns, but high degrees of occupancy and rent growth volatility reduce risk-adjusted returns to a below-average level. Like Norfolk, Nashville also exhibits excellent NOI stability but offers below-average total returns. Therefore, **RCR** cannot recommend an active buying program at current prices in these markets, leading us to maintain our "**Opportunistic**" ratings for each. Raleigh is characterized by a robust economy and improving fundamentals, but the supply outlook and high historic volatility limit its appeal. Likewise, Atlanta remains supply-challenged and unable to find sufficient rent traction to support the observed low cap rate pricing regime. Atlanta assets appear rich to prospective NOI growth. We rate both Raleigh and Atlanta as "**Holds**."