2008

National Economic and Apartment Market

Overview and Outlook – Client Teleconference
June 17, 2008

TAX CREDIT GROUP
Marcus & Millichap

ECONOMIC and APARTMENT MARKET FUNDAMENTALS

OVERVIEW and OUTLOOK

Housing Continues to Hamper the Economy - Price Trends by Market

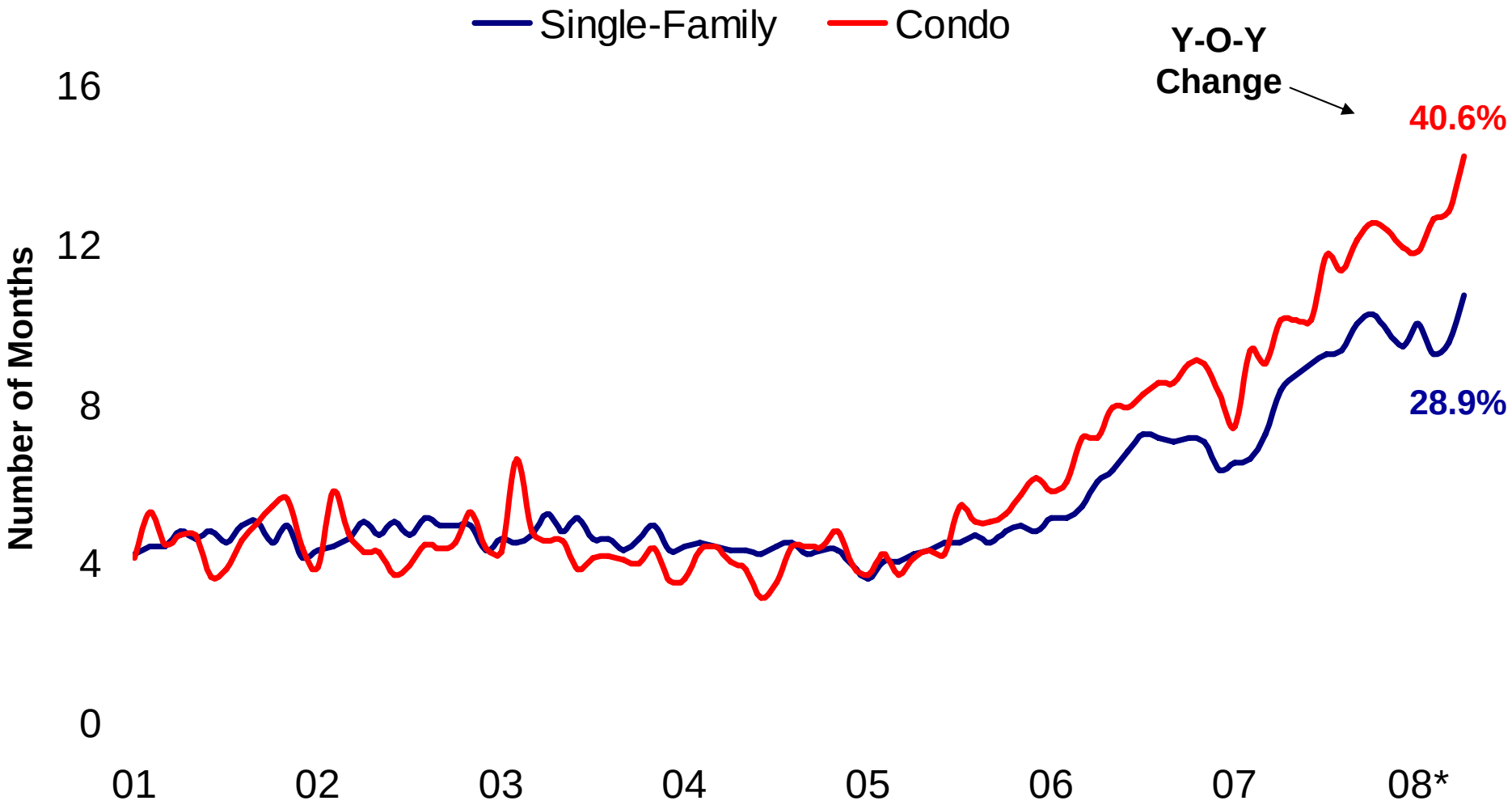
Top 15 Markets	1Q03 – 1Q06	1Q06 – 1Q08
Inland Empire	101%	-27%
Orlando	90%	-11%
Miami	89%	-14%
Las Vegas	85%	-22%
Los Angeles	83%	-18%
Phoenix	82%	-17%
Fort Lauderdale	75%	-16%
West Palm Beach	74%	-15%
Baltimore	69%	1%
Tucson	65%	-11%
Washington, D.C.	64%	-13%
Sacramento	63%	-31%
Orange County	59%	-16%
San Diego	56%	-24%
Seattle	55%	10%
United States	29%	-9%

Bottom 15 Markets	1Q03 – 1Q06	1Q06– 1Q08
Oklahoma City	15%	4%
Boston	14%	-9%
Austin	11%	10%
Houston	10%	4%
Kansas City	10%	-7%
Pittsburgh	9%	4%
Dallas-Ft. Worth	9%	-3%
Denver	8%	-8%
Memphis	6%	-18%
Cincinnati	5%	-7%
Louisville	3%	1%
Columbus	3%	-7%
Indianapolis	3%	-6%
Cleveland	0%	-18%
Detroit	-9%	-11%
United States	29%	-9%

Sources: Marcus & Millichap Research Services, Economy.com, National Association of Realtors

Housing Downturn Yet to Reach Bottom

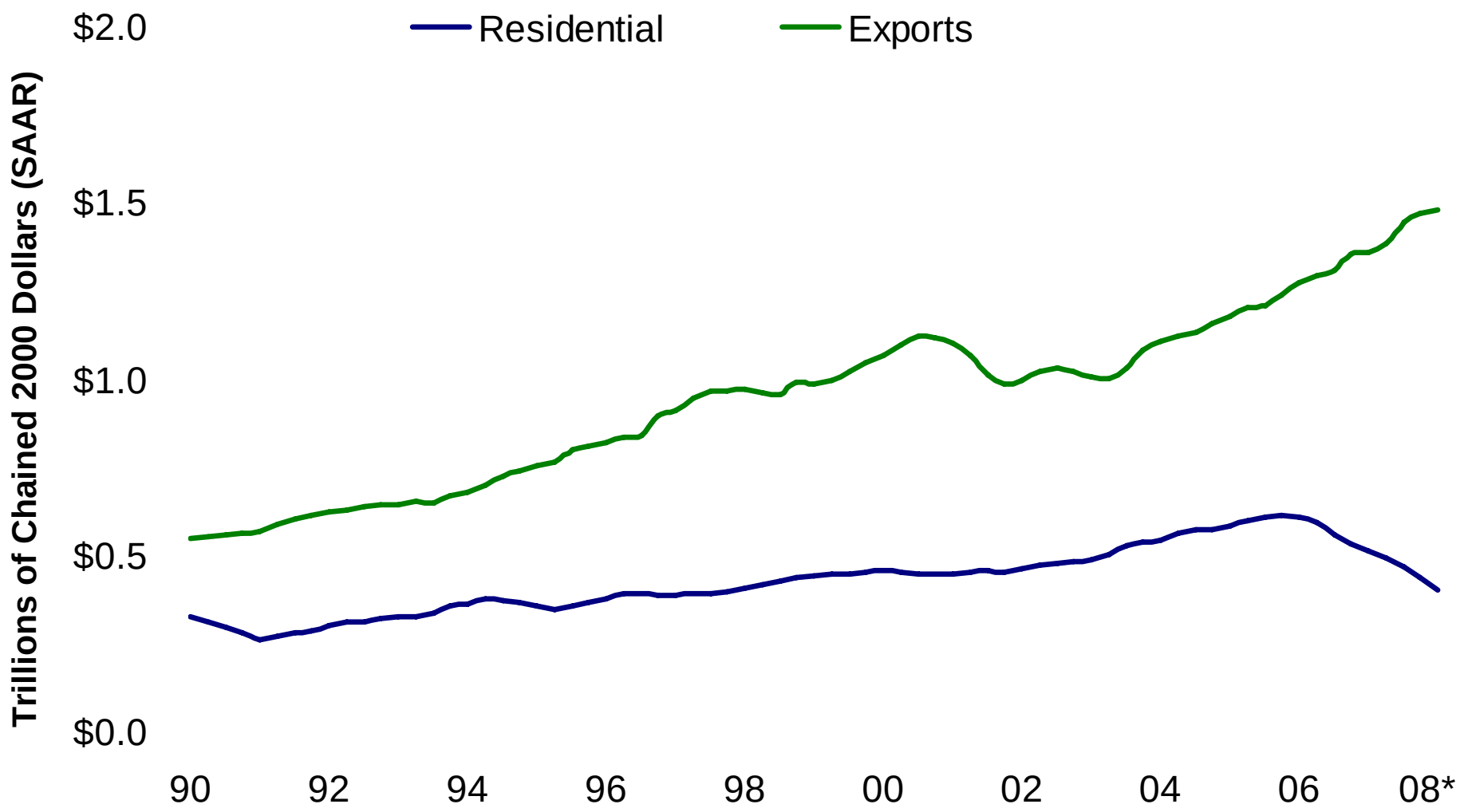
Months Supply of Inventory



* Through April

Sources: Marcus & Millichap Research Services, National Association of REALTORS®

Growth in Exports a Major Contributor to Economic Activity, Housing Offset



* As of 1st Quarter

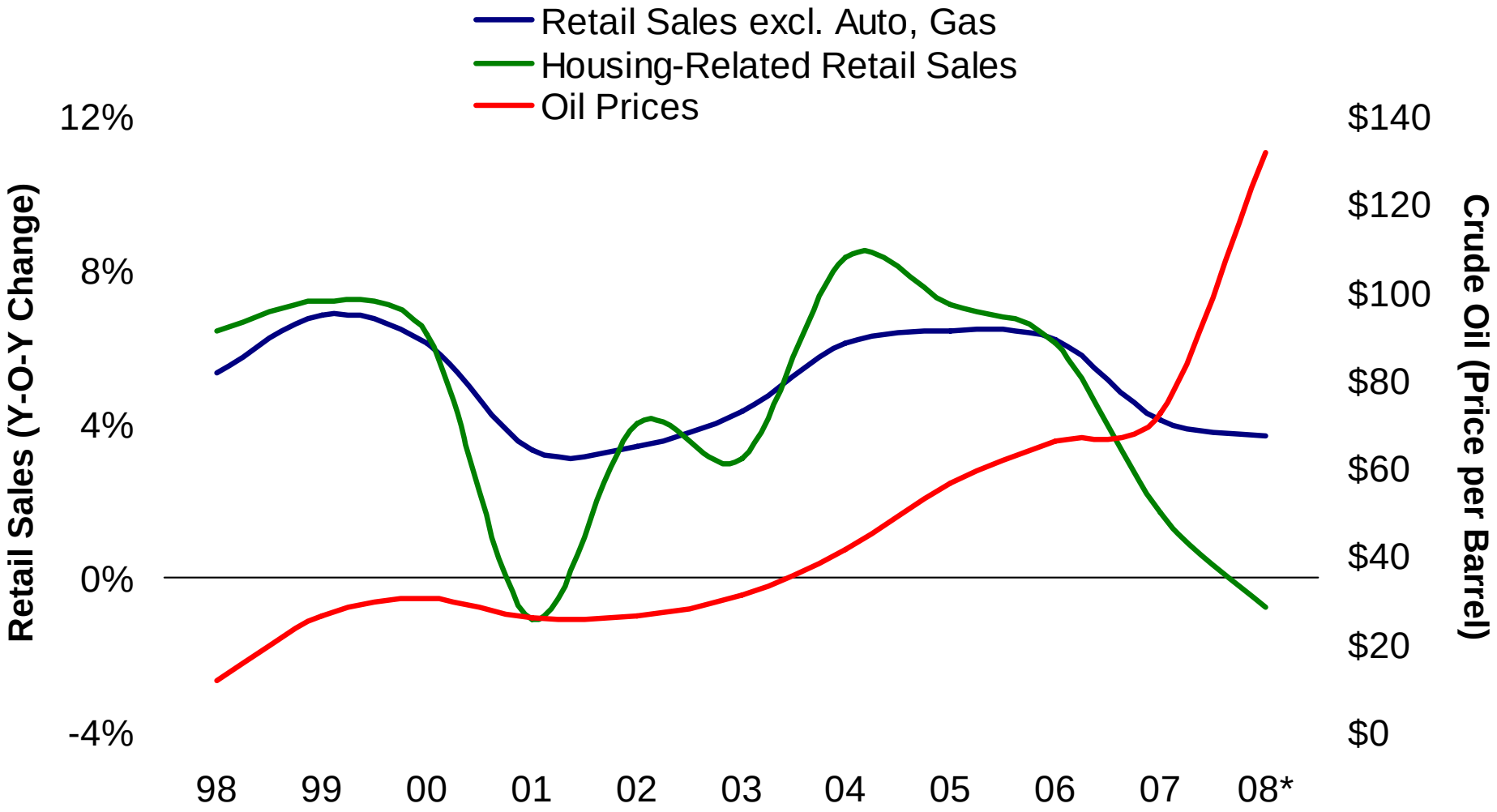
Sources: Marcus & Millichap Research Services, Bureau of Economic Analysis

Growth Sectors Outweighed Contraction – Through 2007

U.S. Employment Sectors	2007 Second Half Absolute Change	Percent Change
Education & Health Services	287,000	1.6%
Leisure & Hospitality	184,000	1.4%
Professional & Business Services	185,000	1.0%
Trade, Transport & Utilities	80,000	0.3%
Other Services	4,000	0.1%
Total Gain	740,000	
Financial Activities	-32,000	-0.4%
Information Services	-15,000	-0.5%
Manufacturing	-120,000	-0.9%
Construction	-131,000	-1.7%
Total Loss	-298,000	

Sources: Marcus & Millichap Research Services, BLS, Economy.com

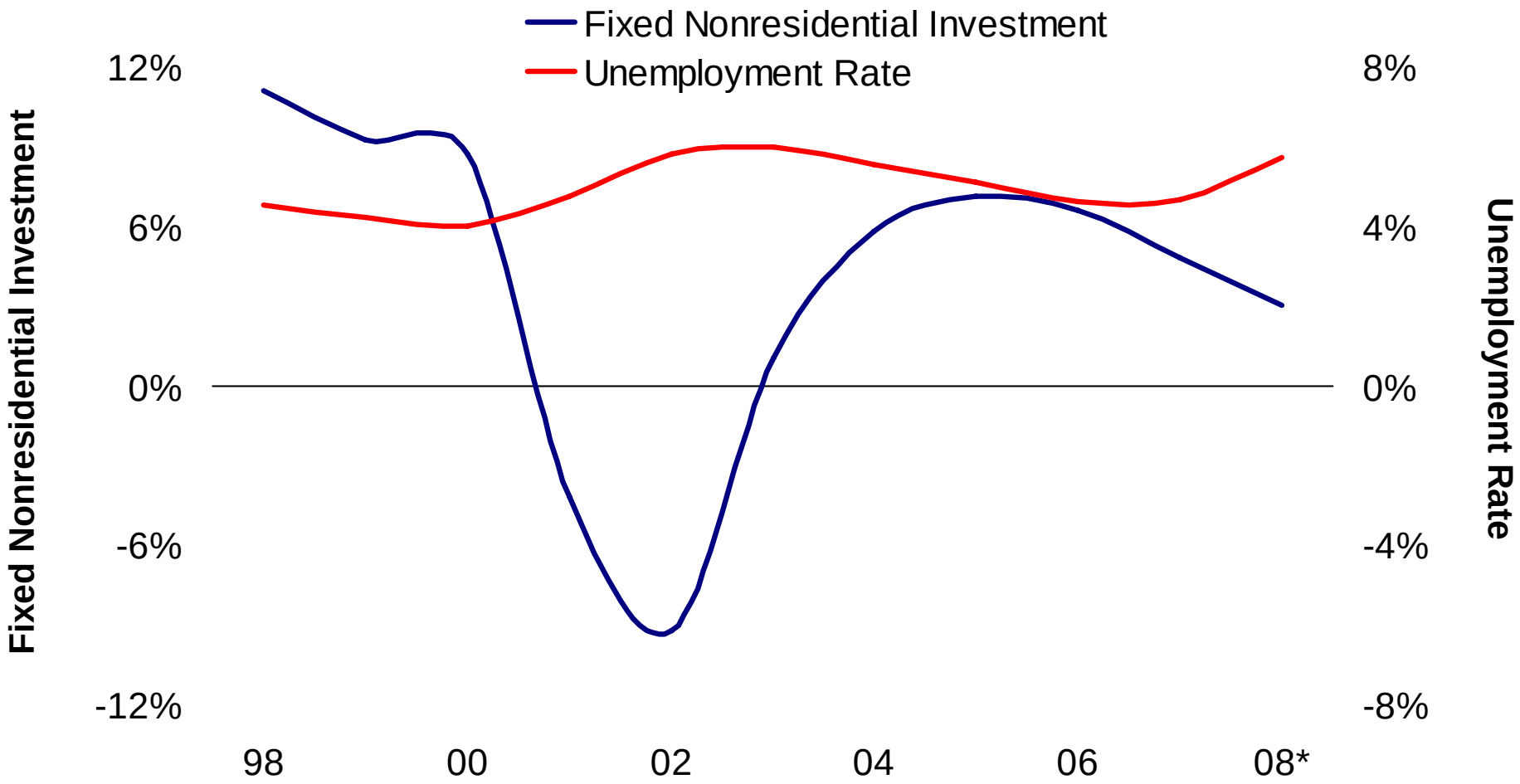
Cash from Home Refinancing
No Longer Shielding Retail Sales from High Energy Prices



* Retail Sales exclude Auto and Gas (Y-O-Y as of May), Oil Prices as of June 10th

Sources: Marcus & Millichap Research Services, Economy.com

Corporate Investment Stalling Despite Healthy Balance Sheets, Unemployment Rising



* Forecast

Sources: Marcus & Millichap Research Services, BLS, Economy.com

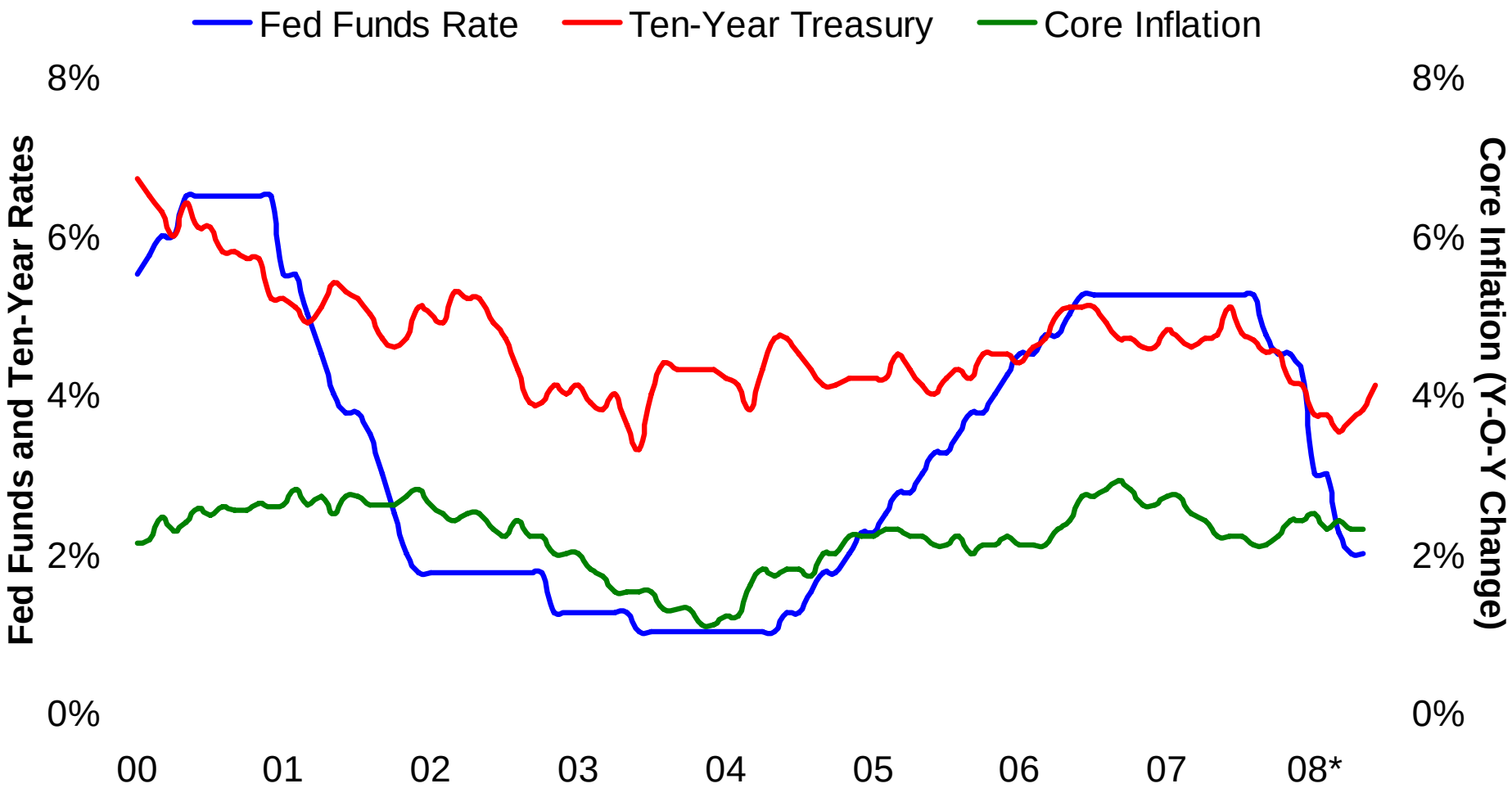
Economy Stalled, Taking Toll on Employment

United States Employment Sectors	YTD 2008* Absolute Change	Percent Change
Education & Health Services	256,000	1.4%
Government	73,000	0.3%
Leisure & Hospitality	65,000	0.5%
Other Services	30,000	0.5%
Natural Resources & Mining	15,000	2.0%
Total Gain	439,000	
Information Services	-14,000	-0.5%
Financial Activities	-21,000	-0.3%
Professional & Business Services	-124,000	-0.7%
Trade, Transportation & Utilities	-193,000	-0.7%
Manufacturing	-203,000	-1.5%
Construction	-208,000	-2.8%
Total Loss	-763,000	

* Through May

Sources: Marcus & Millichap Research Services, BLS, Economy.com

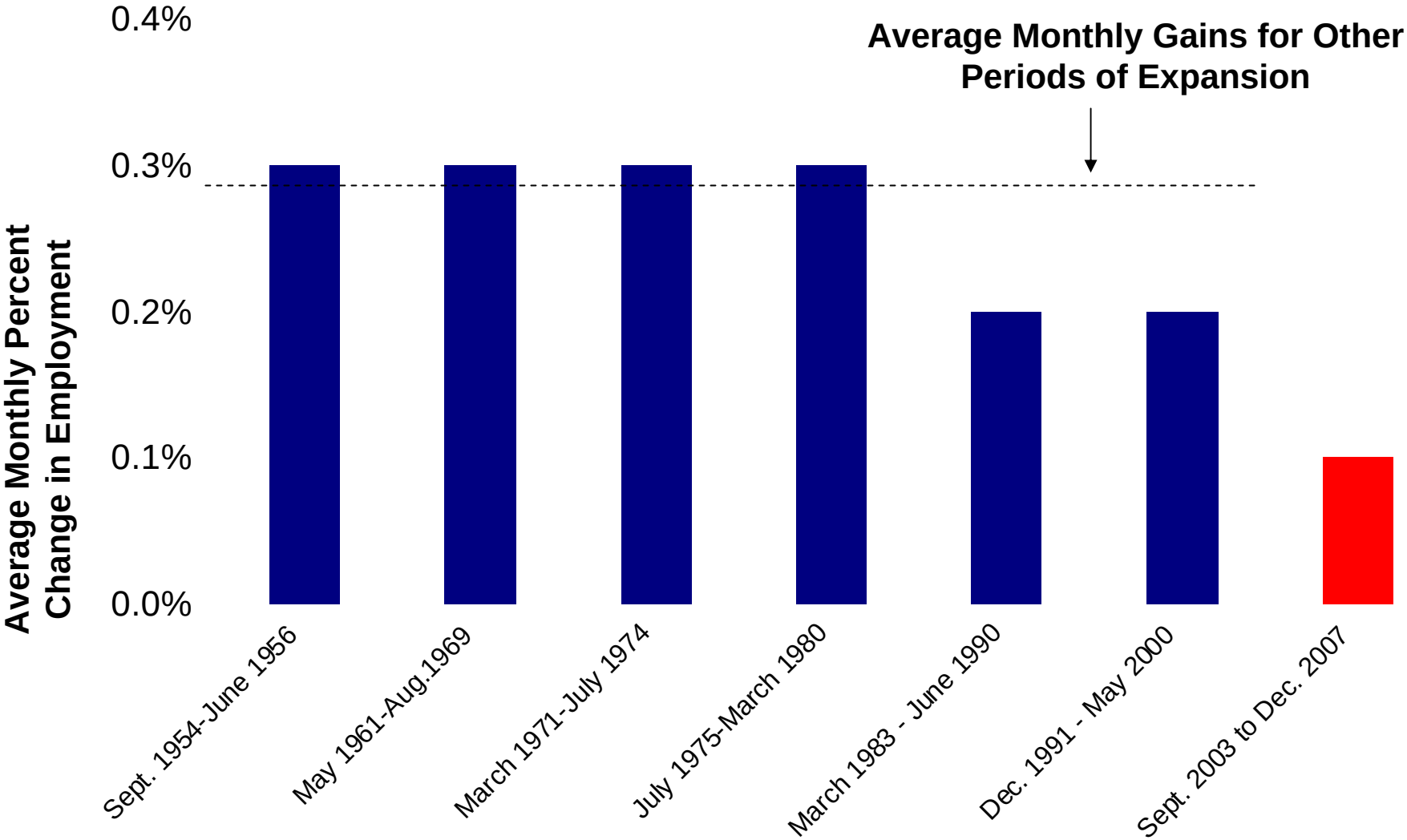
Better Late than Never: The Fed Finally Aggressive On Rates, Liquidity – Inflation a Major Concern



* Core Inflation through May, Ten-Year/Fed Funds through June 10th

Sources: Marcus & Millichap Research Services, Economy.com, Federal Reserve

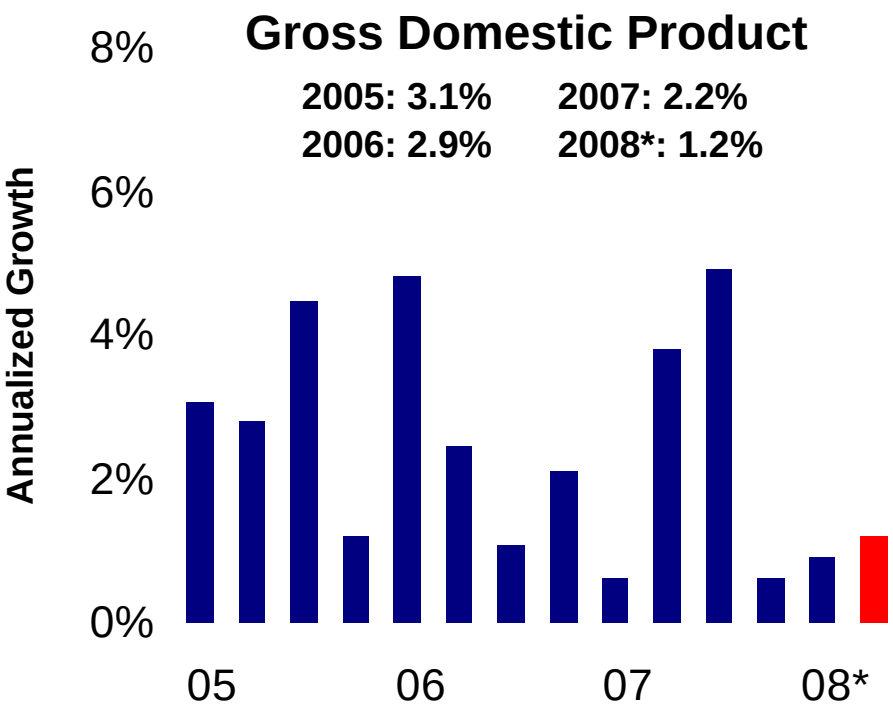
Employment Growth Was Lowest in Last Expansion and Should Result in Fewer Job Losses

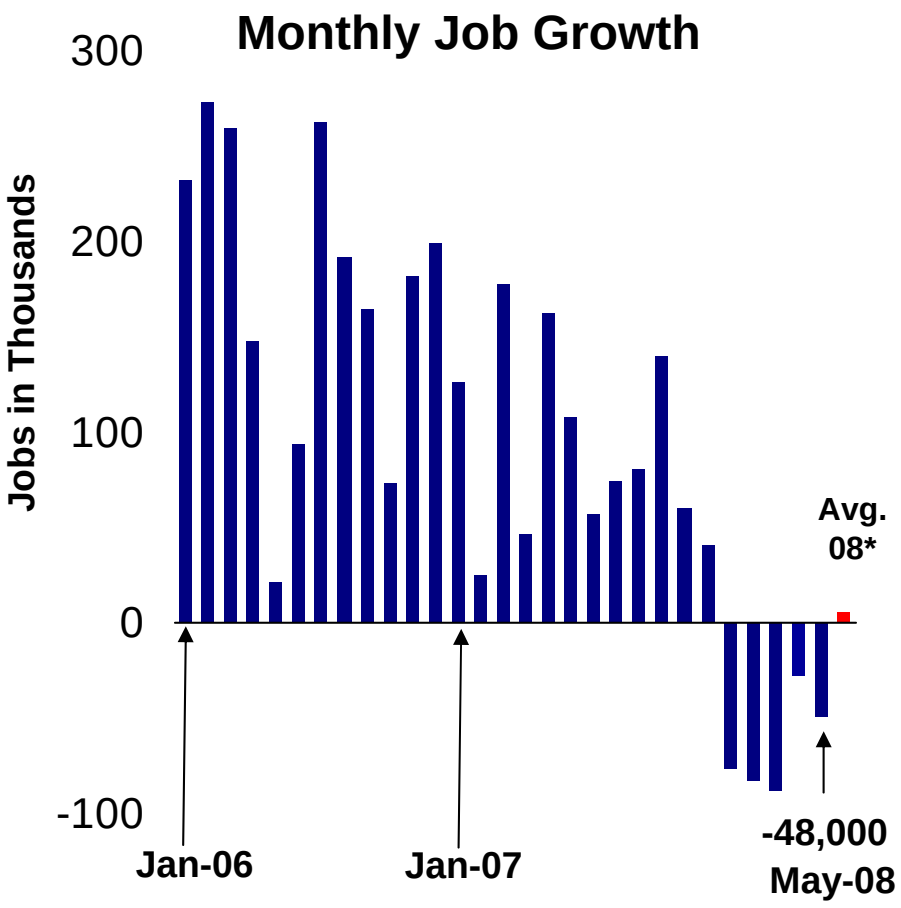


Sources: Marcus & Millichap Research Services, Economy.com

Technical Recession Unlikely – No Driver of Rebound in the Short-Term

Risk Levels Elevated (Housing, Energy, Credit)





* Forecast

Note: Technical Recession Defined as Two Consecutive Quarters of GDP Contraction

Sources: Marcus & Millichap Research Services, Economy.com

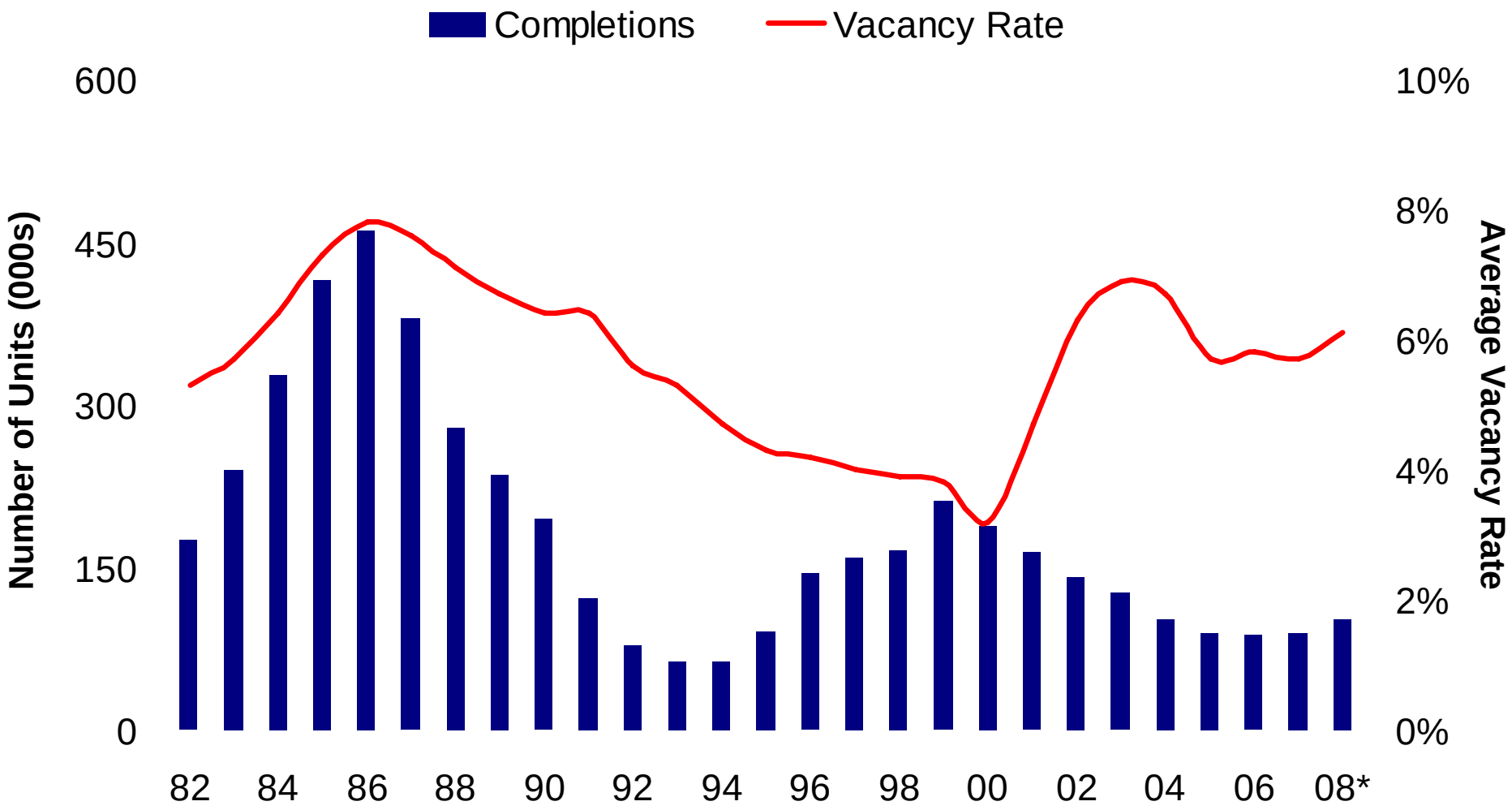
Most and Least Improved Employment Markets Y-O-Y April 2008

Top 15 Markets	YOY Abs. Change	YOY % Change
Houston	71,500	2.8%
Austin	20,100	2.7%
San Antonio	19,100	2.3%
Dallas/Ft. Worth	66,800	2.3%
San Francisco	21,700	2.2%
Charlotte	16,900	2.0%
Seattle/Tacoma	34,000	2.0%
Denver	22,000	1.8%
San Jose	12,200	1.3%
Portland	13,700	1.3%
Atlanta	28,900	1.2%
Washington, D.C.	28,100	0.9%
New York	48,000	0.9%
Indianapolis	8,000	0.9%
Columbus	7,000	0.8%
United States	462,000	0.3%

Bottom 15 Markets	YOY Abs. Change	YOY % Change
Los Angeles	-1,000	0.0%
Jacksonville	-700	-0.1%
Phoenix	-2,900	-0.2%
Milwaukee	-1,800	-0.2%
Las Vegas	-3,400	-0.4%
St. Louis	-5,000	-0.4%
Cleveland	-4,900	-0.5%
Miami	-5,500	-0.5%
Oakland-East Bay	-6,600	-0.6%
Tampa	-13,000	-1.0%
Fort Lauderdale	-8,700	-1.1%
West Palm Beach	-7,000	-1.2%
Orange County	-19,400	-1.3%
Inland Empire	-16,800	-1.3%
Detroit	-51,000	-2.6%
United States	462,000	0.3%

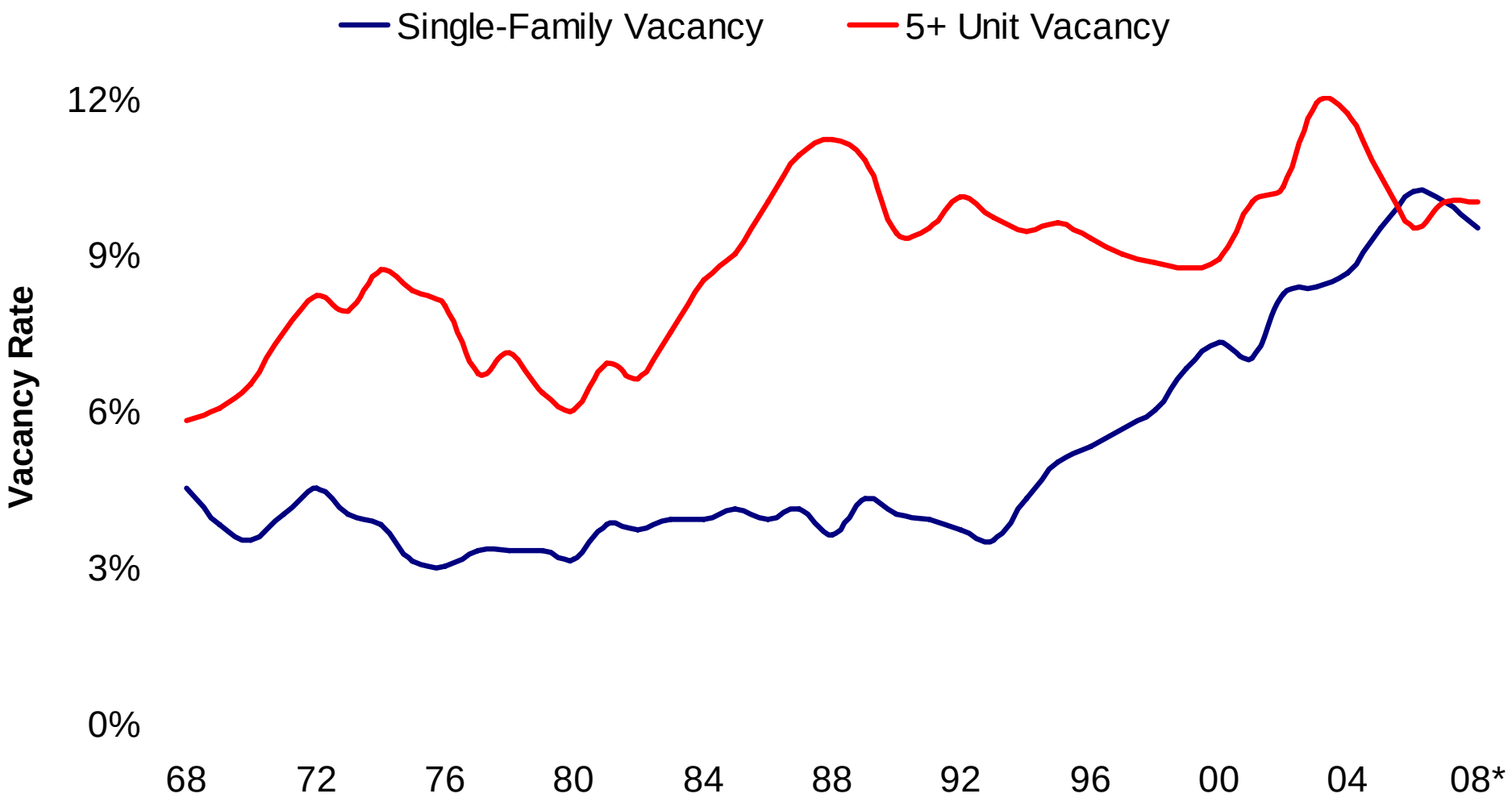
Sources: Marcus & Millichap Research Services, Economy.com

Apartment Vacancies Rising Moderately Due to Weak Employment, "Shadow" Market Competition



* Forecast
Sources: Marcus & Millichap Research Services, Reis

Single-Family and Condo Rentals Are Competing with Apartments – Particularly in Over-Built Markets



* Forecast

Sources: Marcus & Millichap Research Services, Equity Residential, U.S. Census Bureau

Apartment Vacancy Ranking
Top 15 and Bottom 15 Markets: Y-O-Y 1Q 2008

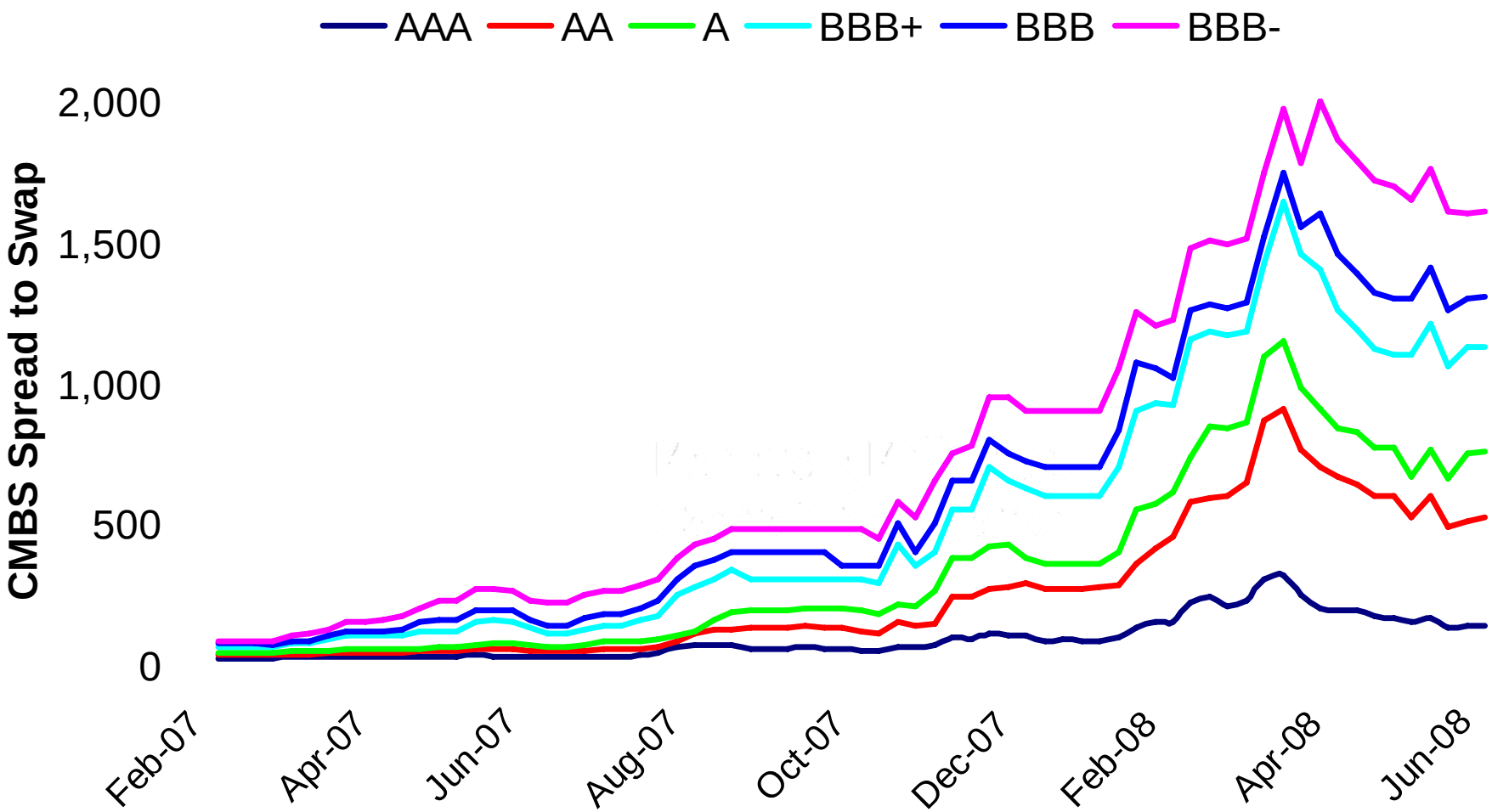
Top 15 Markets	1Q 08 Vacancy	Bps Change
Denver	6.4%	(170)
Cincinnati	7.1%	(160)
Indianapolis	8.1%	(140)
Oakland-East Bay	4.4%	(110)
St. Louis	6.9%	(100)
Cleveland	5.4%	(100)
Columbus	6.8%	(100)
Milwaukee	3.8%	(80)
Oklahoma City	8.2%	(80)
San Francisco	4.1%	(80)
Austin	6.8%	(80)
Detroit	6.4%	(80)
San Antonio	6.9%	(80)
Dallas-Fort Worth	6.3%	(70)
Seattle-Tacoma	4.5%	(60)
United States	**5.9%**	**-10**

Bottom 15 Markets	1Q 08 Vacancy	Bps Change
Northern New Jersey	3.6%	20
Los Angeles	3.8%	40
Miami	4.3%	40
Orange County	4.0%	40
Washington, D.C.	5.4%	60
Tucson	6.2%	70
Inland Empire	6.5%	120
Palm Beach	8.0%	140
Las Vegas	6.5%	150
Houston	9.3%	150
Phoenix	8.7%	160
Tampa	7.4%	160
Ft. Lauderdale	5.7%	190
Orlando	7.8%	220
Jacksonville	10.4%	340
United States	**5.9%**	**-10**

Sources: Marcus & Millichap Research Services, Reis

CAPITAL MARKETS OVERVIEW and OUTLOOK

Commercial Mortgage-Backed Securities (CMBS) Spreads

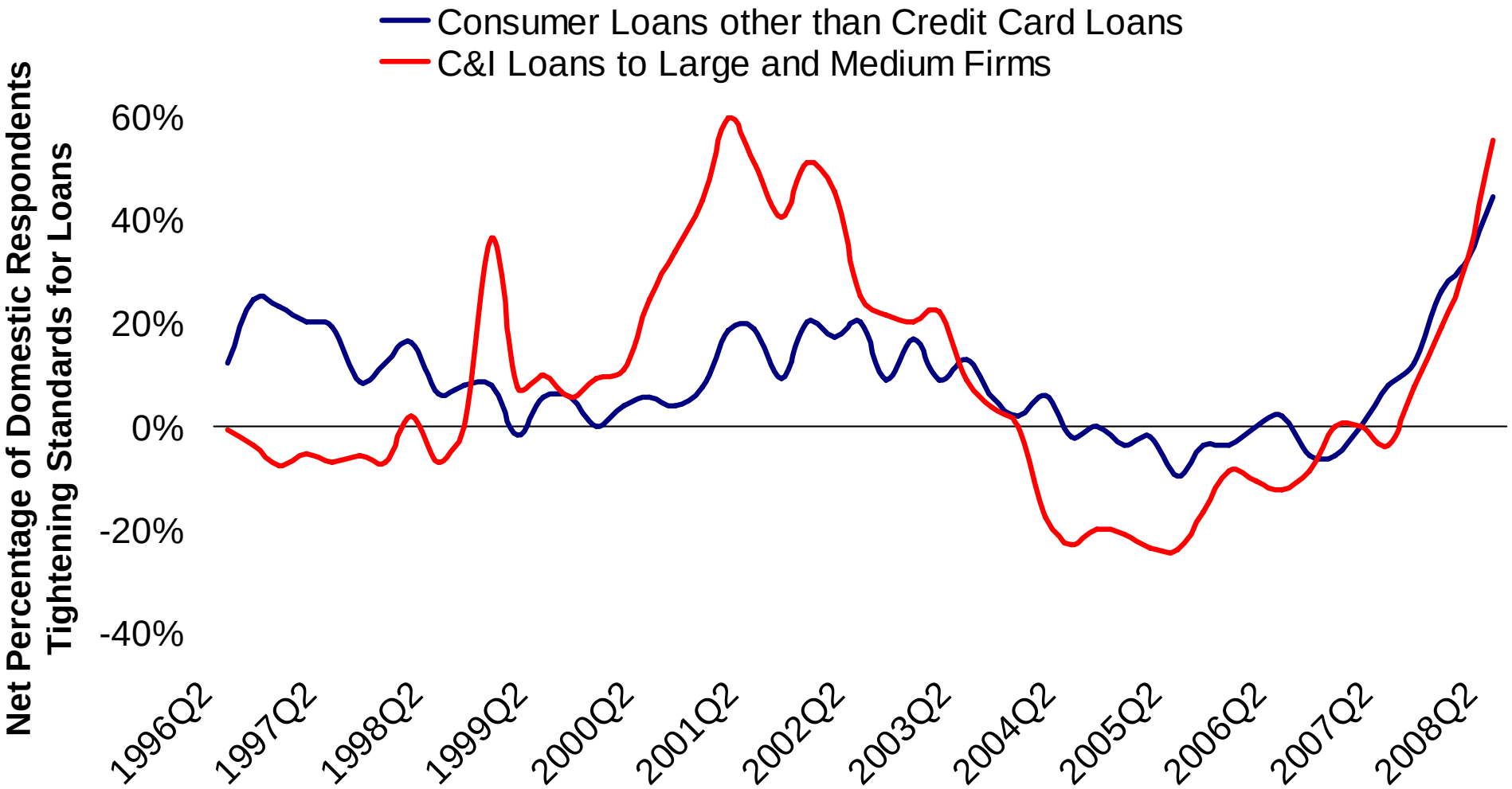


Sources: Marcus & Millichap Research Services, Wachovia

Good News

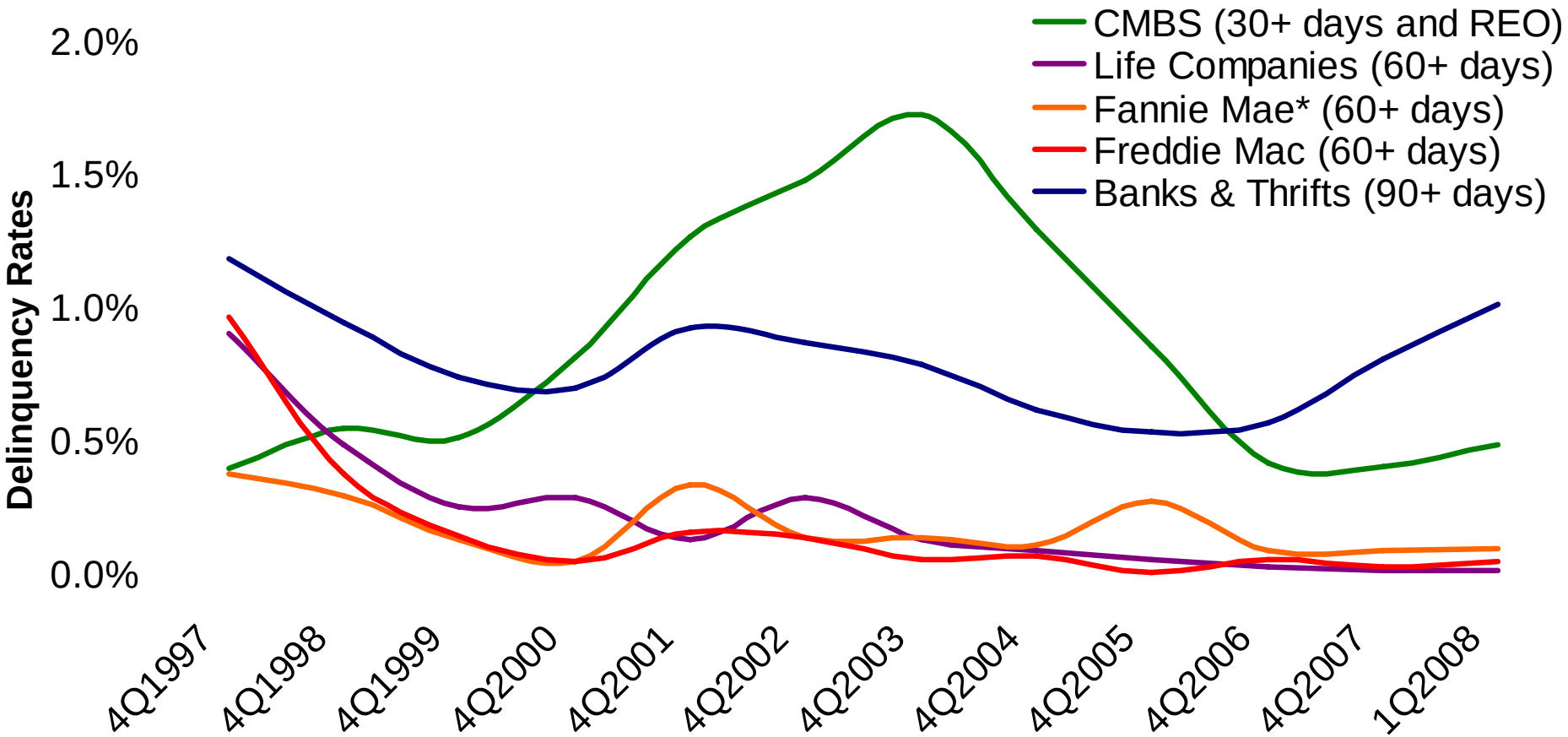
- **UBS, Lehman and other Wall Street banks have raised capital.**
- **Last 3 deals issued by Citi, LB, UBS and JP were all received well by buyers.**
- **Black Rock acquires $20 billion of UBS sub-prime debt securities for $15 billion.**
- **According to Fitch, 3,345 CMBS fixed-rate loans with a balance of $21.4 billion have successfully refinanced since August when the credit crunch began.**
- **We have already survived over 10 months of credit market turmoil.**

Credit Standards Have Tightened Across the Board



Sources: Marcus & Millichap Research Services, Federal Reserve Board

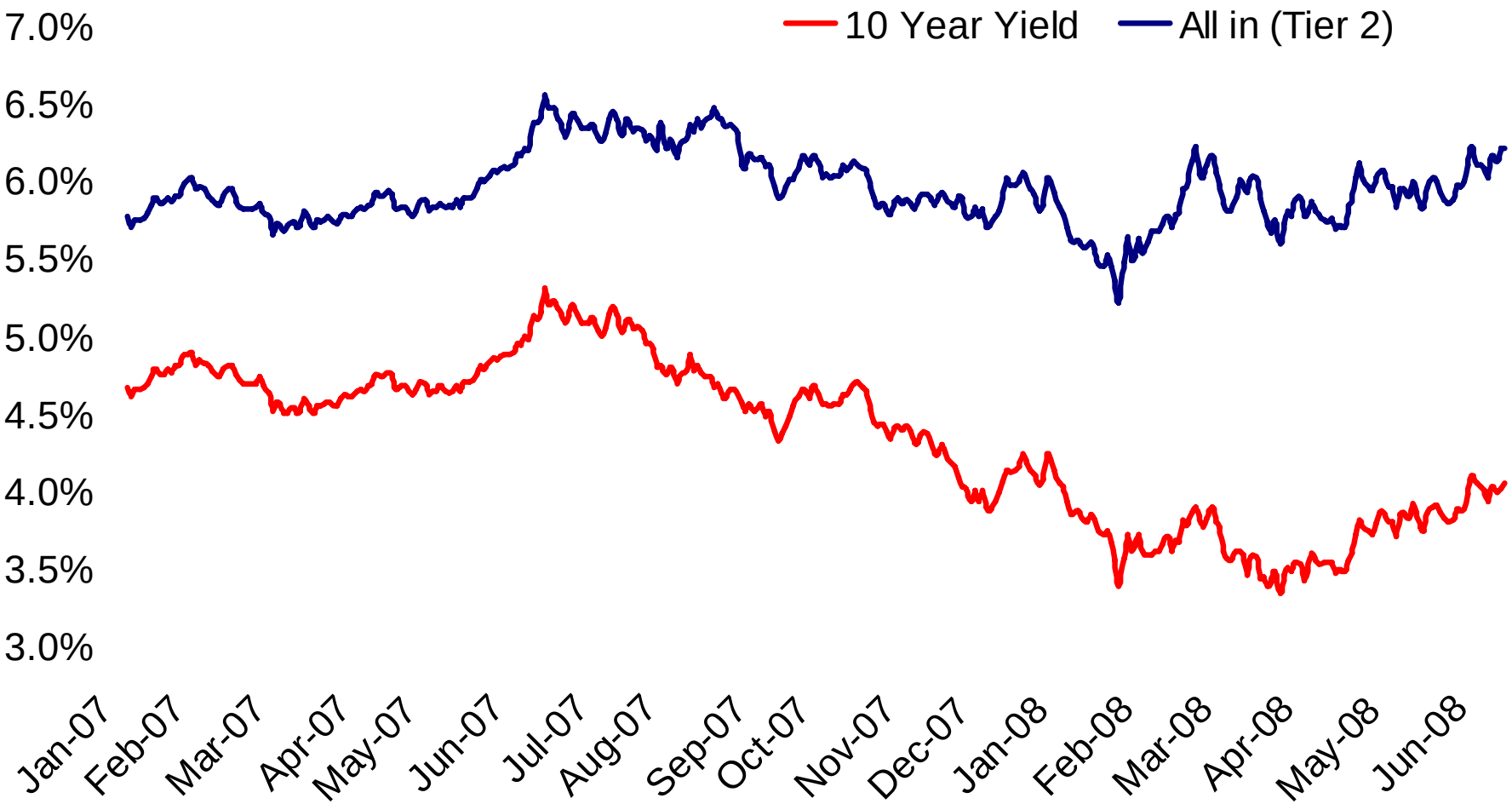
Commercial/Multifamily Mortgage Delinquency Rates by Group



Delinquency rates at the end of each period

Sources: Marcus & Millichap Research Services, Federal Reserve Board

10-Year Treasury Yield and All-In Apartment Mortgage Rates

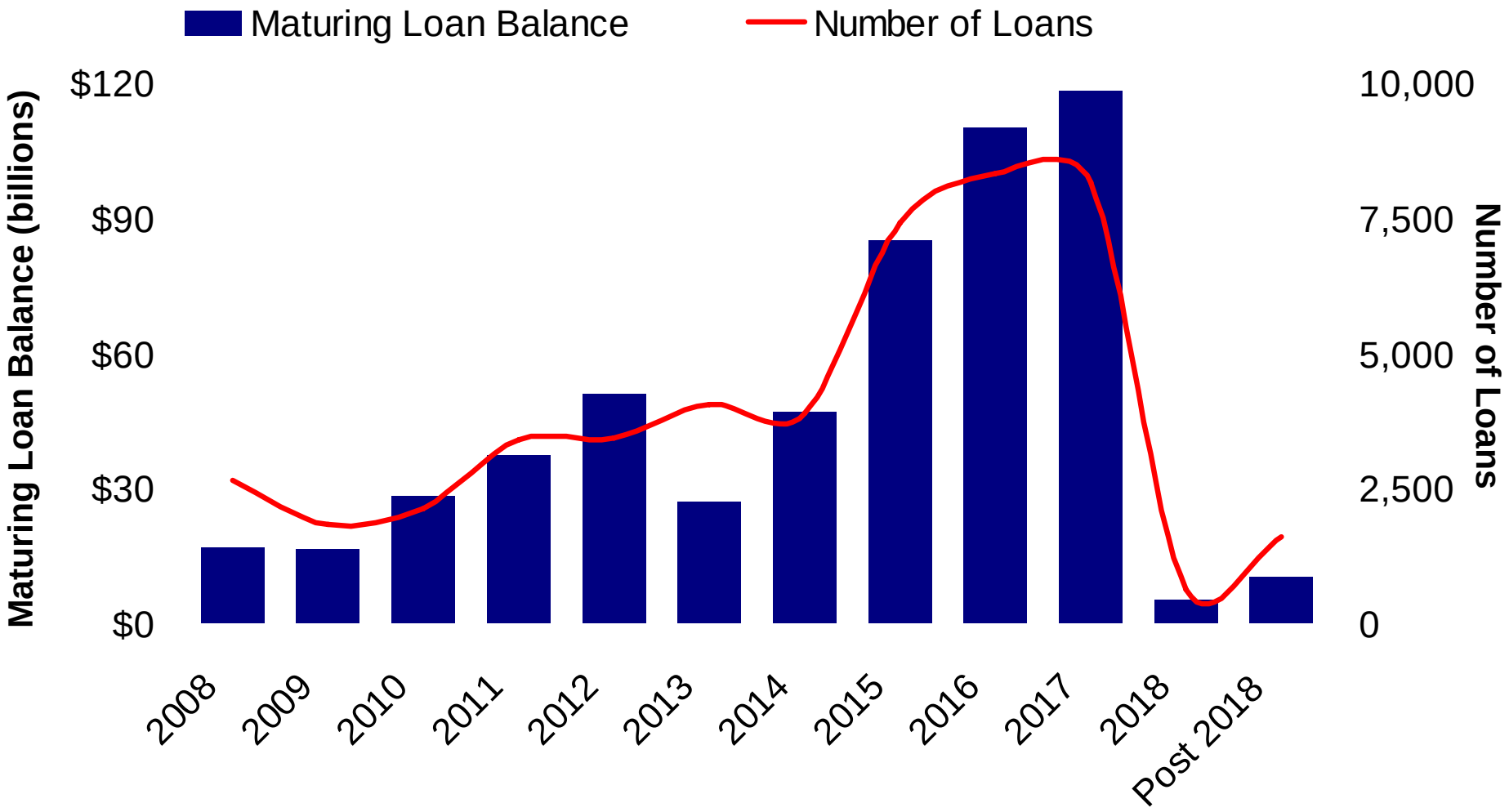


As of June 10, 2008

Sources: Marcus & Millichap Research Services, Federal Reserve Board

Maturing Commercial Loan Volume Unlikely to Create Distressed Environment In the Short-Term

S&P CMBS Fixed-Rate Final Maturities



Sources: Marcus & Millichap Research Services, Standard & Poors

What Does the Future Hold?

1. Commercial delinquencies expected to increase to a still-low 2 to 3%.
2. Treasuries will increase moderately over the next 6 to 12 months.
3. Credit markets stabilizing but vulnerable to additional shocks.
4. Spreads coming in as markets stabilize.
5. Underwriting will continue to be more conservative:
    a. I/O available, but loan dollars will not be based on I/O payments
    b. Well-grounded revenue, realistic uncollectible allowances
    c. Use of trailing 12-month operating expenses updated to market
    d. Debt Service Coverage Ratios - 1.25 most common
    e. More focus on sponsorship
6. Market normalizing with LTV of 60% to 70%:
    a. Commercial Banks – 70%
    b. Agency Lender – 70%
    c. Life Companies – 60%

APARTMENT INVESTMENT TRENDS and STRATEGIES

Why Has The Apartment Market Been So Strong in the 2000s?

- Low interest rates and spreads
- Apartments deemed a preferred product class and resulting capital flows
- Alternative investments have not been as favorable
- Investors were anticipating improving demographics and fundamentals
- Move towards “dynamic” vs. “static” underwriting and valuation techniques

Why Has The Apartment Market Been So Strong in the 2000s?

And a new reason…

- **Supply and demand of apartments is stable and favors increasing rents and appreciation**
  - **Development sites scarce and expensive**
  - **Construction costs high and volatile**
  - **"Nimby"ism reduces approved sites, lengthens the approval process and increases impact fees**
  - **required density and higher costs**

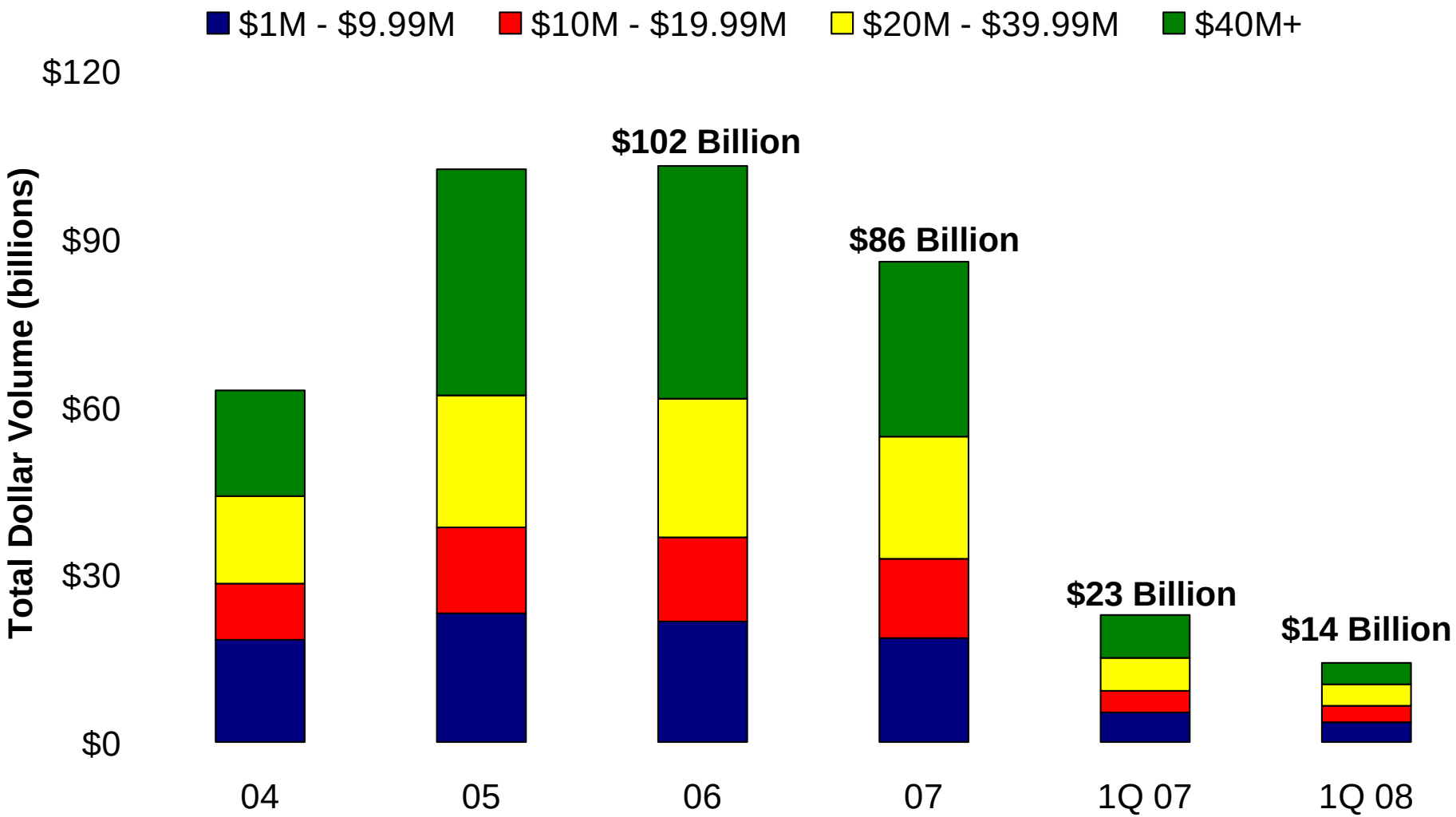
State of the Apartment Industry

Apartment fundamentals are solid:

- **The national occupancy rate is 94%**
- **Supply: 100,000 market-rate units (1% stock)**
- **Effective rent growth: 3.0% to 3.5%**
- **Homeownership rate reversing**

Apartment Investment Trends

Sales Volume by Price Category



Excludes Archstone Privatization

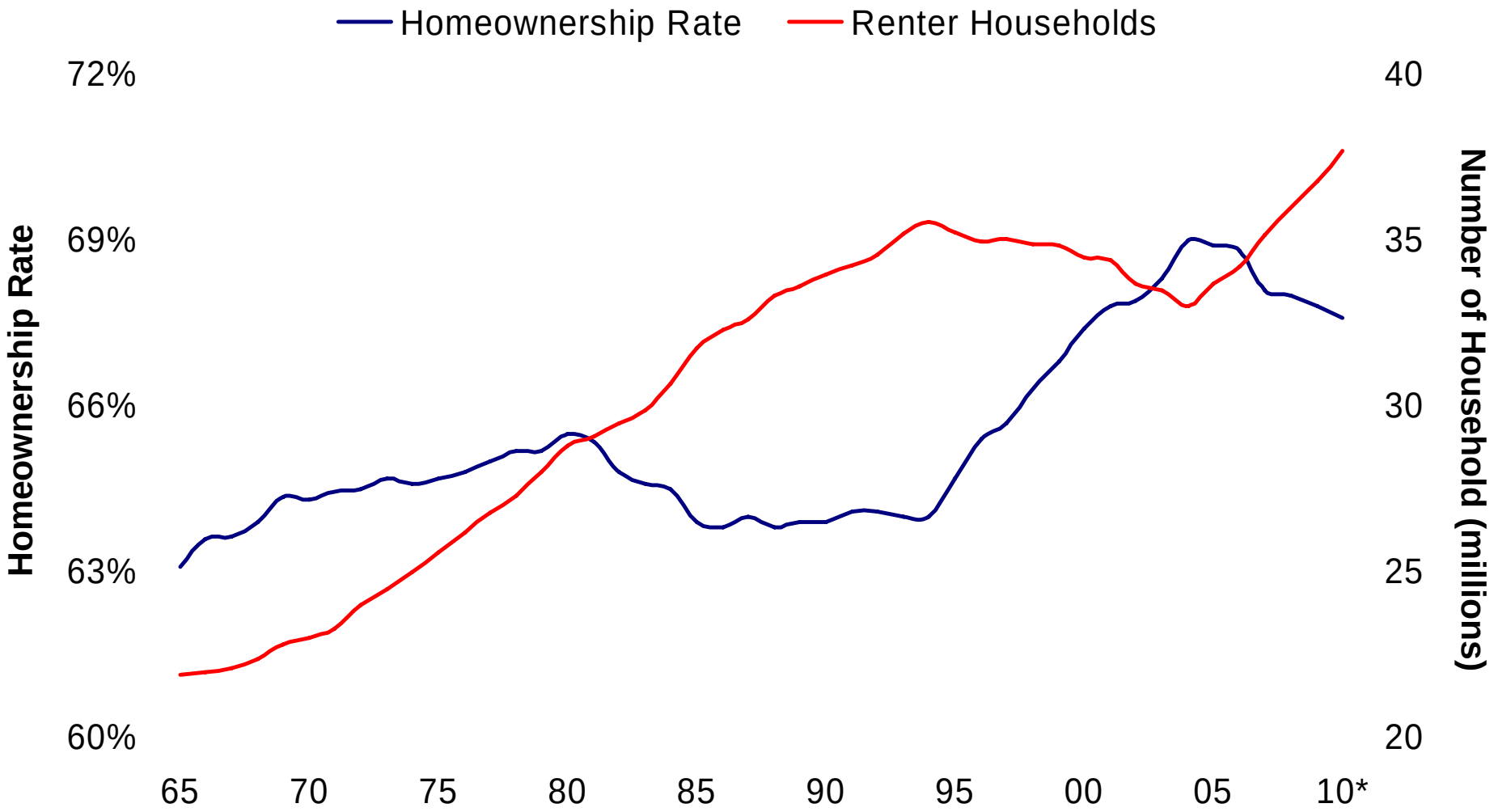
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics

Why The Disconnect …

In a typical recession…

- **Supply exceeds demand and there is usually a development overhang**
- **Occupancies are decreasing**
- **Asking rents are decreasing or concessions are wide-spread**
- **Effective rents are decreasing**

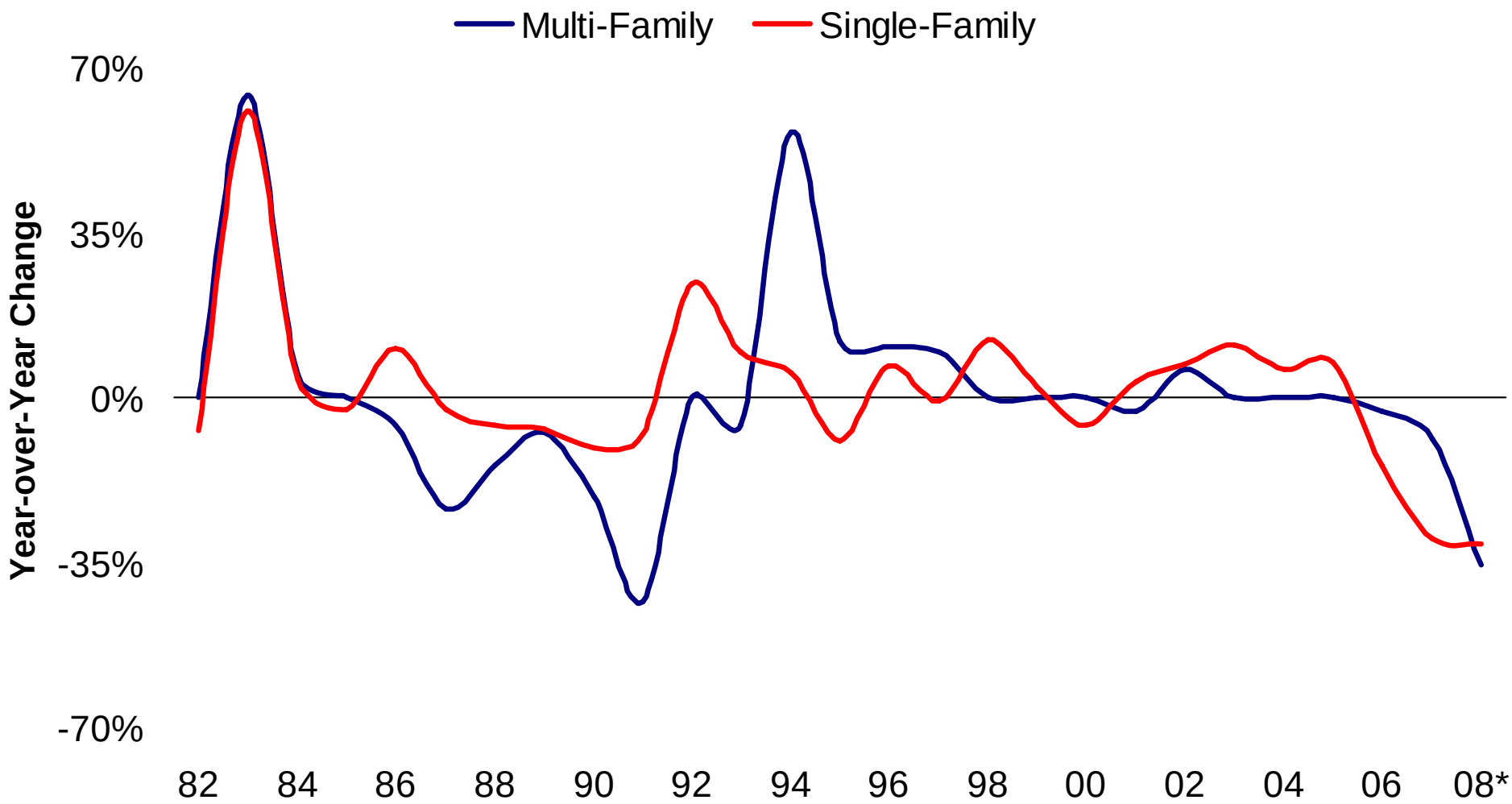
Reversal in Home Ownership Rate Points to Increase in Renter Households



* Forecast

Sources: Marcus & Millichap Research Services, U.S. Census Bureau, TWR

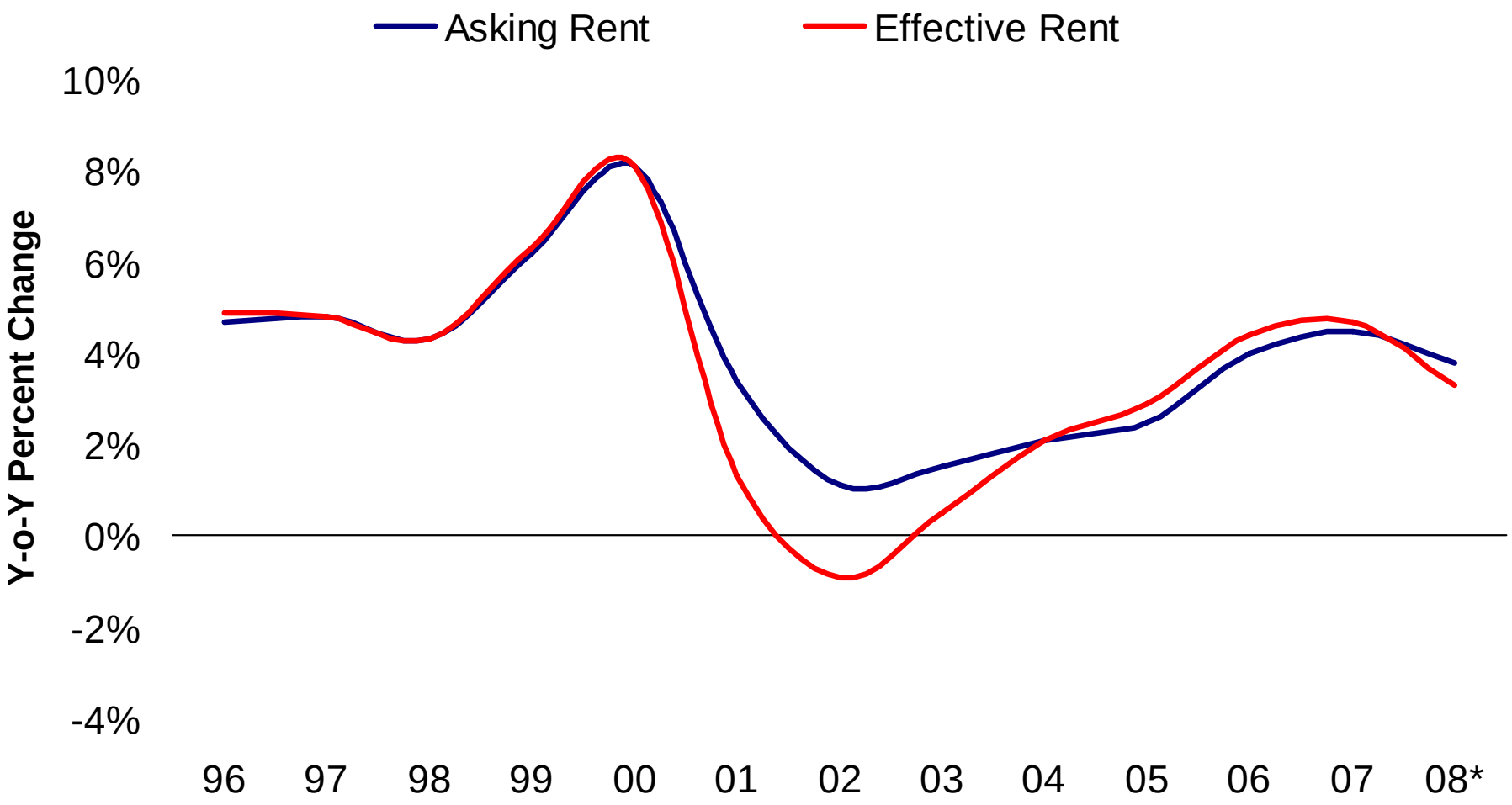
Construction Starts Declining



* Forecast

Sources: Marcus & Millichap Research Services, Economy.com

Apartment Rent Growth Slowing After a Strong Recovery Period



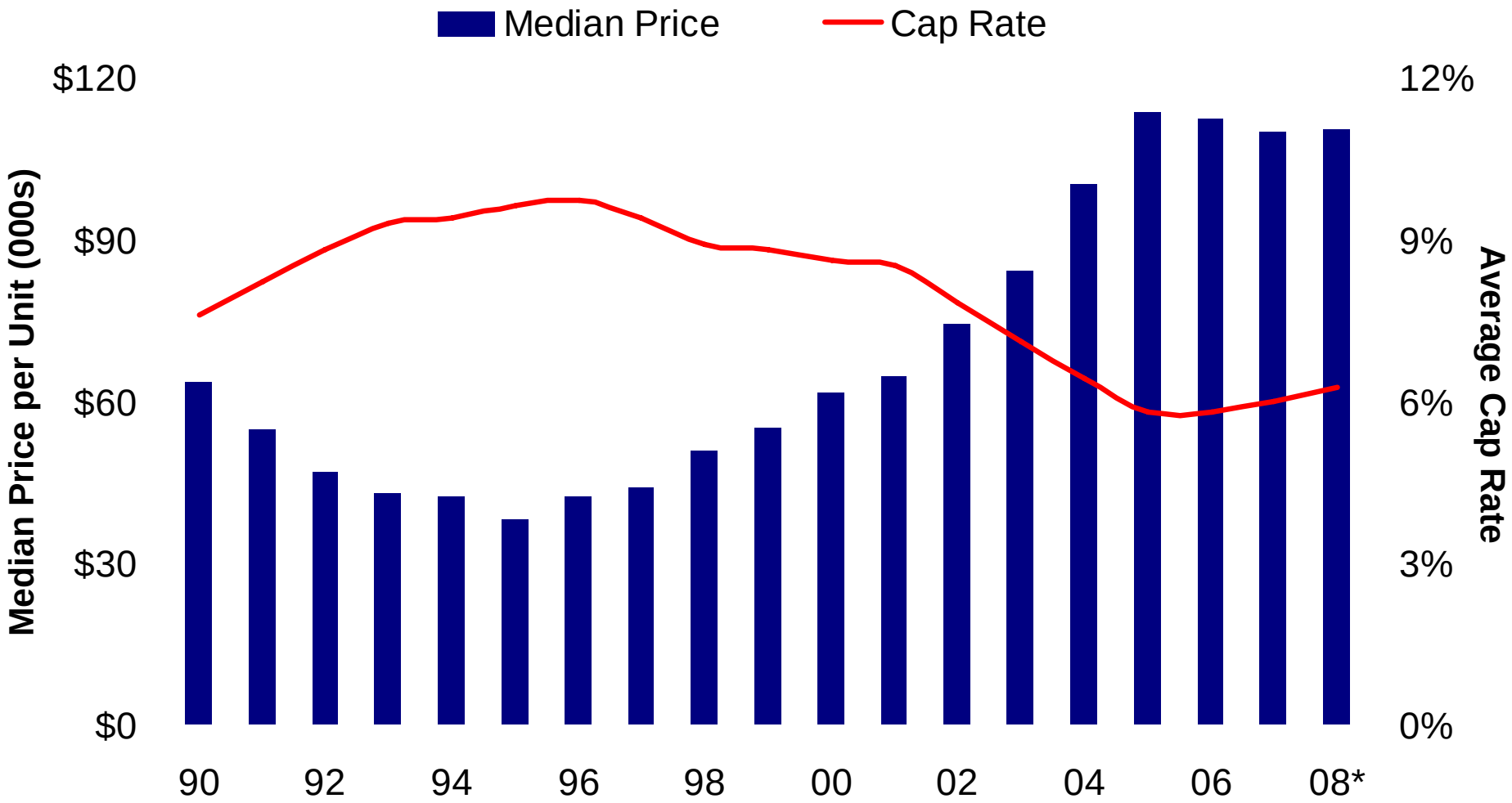
* Forecast
Sources: Marcus & Millichap Research Services, Reis

Recession ... Or Recalibration?

What's going on…

- **Many investors are on the sidelines**
- **Most sellers are not willing to accept substantially lower prices**
- **Therefore … Sales velocity has decreased**

Apartment Investment Trends
Pricing and Cap Rates



* 1st Quarter
Sales $1 million and greater
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

Recession ... Or Recalibration?

What's being recalibrated …

- **Lender underwriting standards**
  - **Attitudes re: interest-only loans**
  - **Attitudes re: growth rates in models**
  - **Attitudes re: reversion cap rates**
  - **Attitudes re: debt coverage ratios**
  - **Attitudes re: loan-to-value ratios**
- **Equity yields**
- **Some equity providers are being distracted in the "short run"**

Recession ... Or Recalibration?

What's going on …

- **There is a difference between:**
  - **Justifiable re-pricing**
  - **Opportunistic re-pricing**
- **The stress in the market is being recast as negativity by those who have a vested interest in an over-correction**

Recession ... Or Recalibration?

The result …

- **Lenders, equity providers and buyers want to believe that apartment prices have decreased**
- **If you add up the changes in their proposed metrics … values would have to drop 15% - 25%.**
- **Meanwhile … fundamentals are stable to improving in most markets**

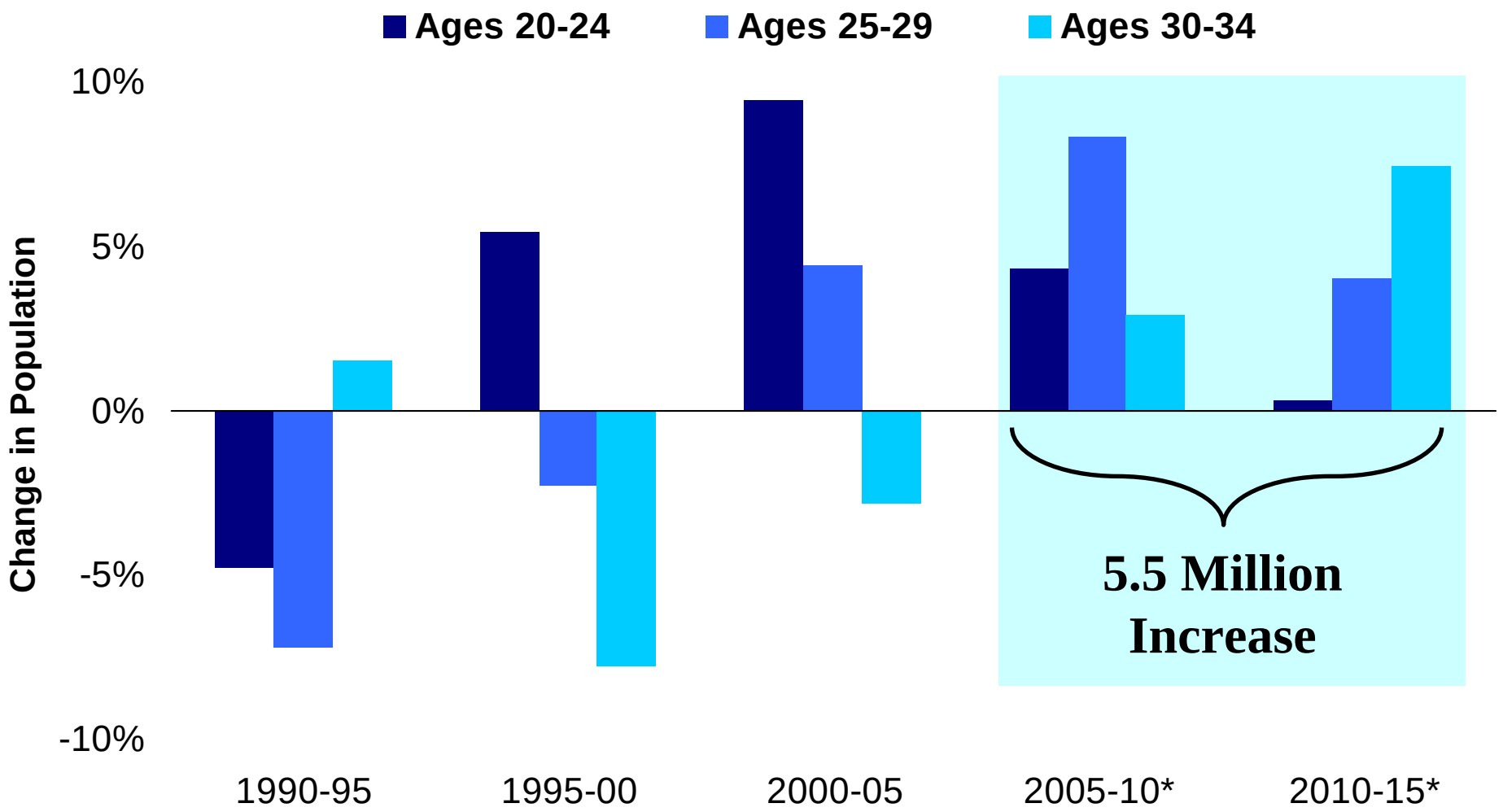
Apartment Cap Rate Adjustment Matrix

	Class “A”	Class “B”	Class “C”
Primary	.25 (0 to 50 bps)	.35 (25 to 50 bps)	.50 (25 to 75 bps)
Secondary	.35 (25 to 50 bps)	.50 (25 to 75 bps)	.75 (50 to 100 bps)
Tertiary	.75 (50 to 100 bps)	1.00 (75 to 125 bps)	1.25 (100 to 150 bps)

How Long Will This Last?

- **In a normal recession:**
  - **1 to 2 years to dig out to neutral**
  - **Another year to engage the growth engine**
- **In a period of recalibration …**
  - **At worst, less time than a recession**
  - **At best … 6 to 9 months**
- **Hard to predict … but it will be quicker than the negative rhetoric suggests**

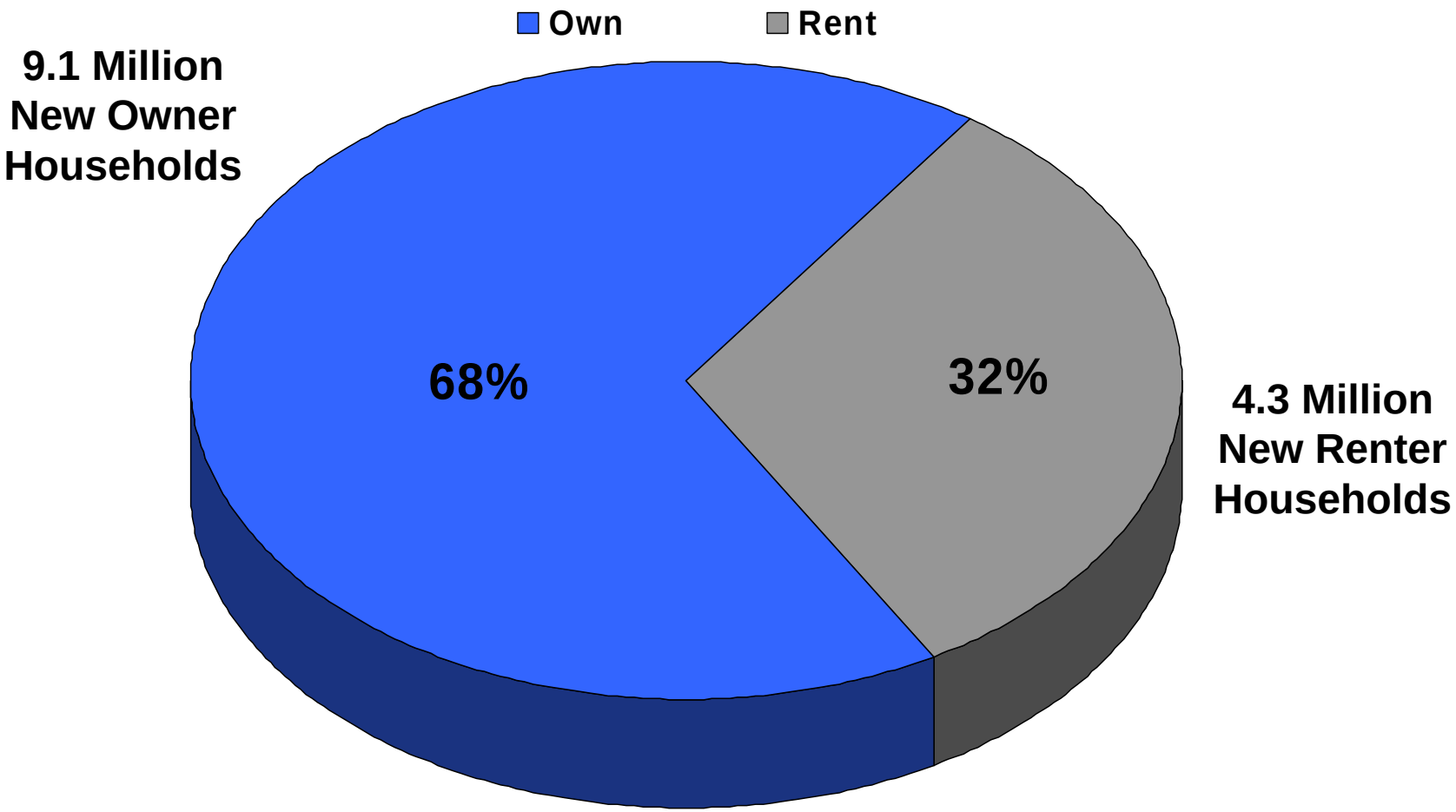
Echo Boomer Demand Supports Appreciation



* Forecast

Sources: Marcus & Millichap Research Services, Economy.com

Household Growth Points to Strong Rental Demand 2005 – 2015 Projections

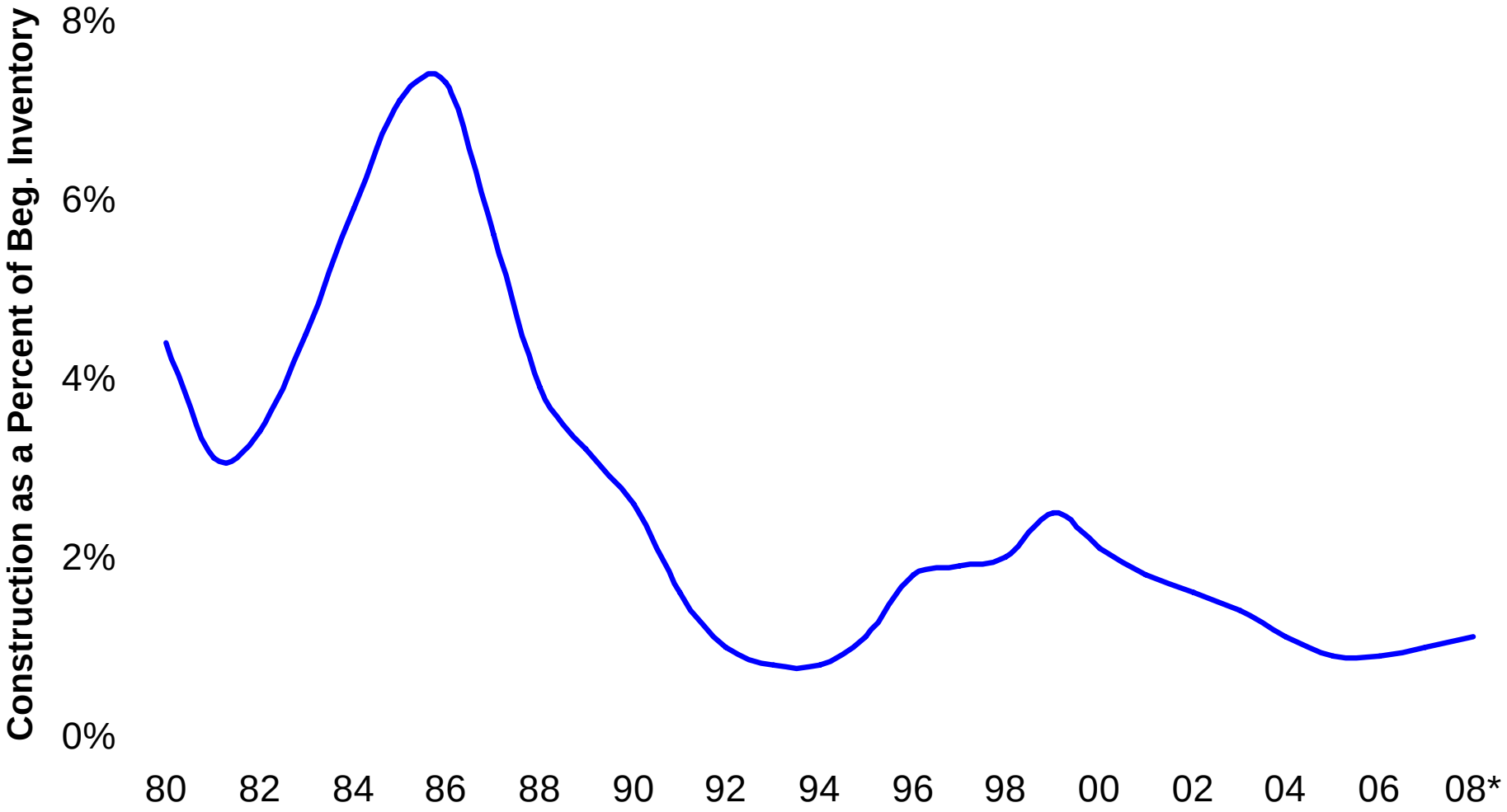


13.4 Million Net New Households

Sources: Marcus & Millichap Research Services, Economy.com, Harvard University

New Supply Has Become Much More Constrained

Apartment Construction as a Percent of Beginning Inventory



* Forecast

Sources: Marcus & Millichap Research Services, Reis

Marcus & Millichap's NMHG Remains Bullish on U.S. Apartments

- High levels of future demand
- Supply more difficult and expensive to deliver
- Unlikely the industry will meet demand
- Current rents in most markets do not justify development
- Significant future pressure on rents
- U.S. apartments will be dramatically more valuable in 2013 than 2008