

United States Housing Outlook

When Will Markets Recover?

January 2009

The following analysis outlines The Concord Group's ("TCG") forecast for the U.S. housing market and represents the first in a series of articles concerning market risk and opportunity. TCG's conclusions draw from both demographic and employment driven demand assessments and various tools for evaluating supply levels and absorption velocity. The timing of the housing market recovery drives immediate acquisition, planning and disposition decisions.

Executive Summary

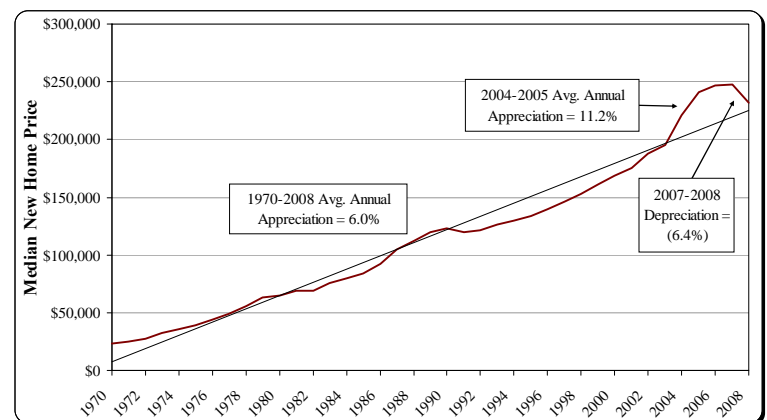
TCG analyzed the state of the market and needs for recovery. Below are key findings and conclusions:

- National new home sales volumes down 61% and same product pricing down 21% from peak;
- Sales levels below structural demand – macroeconomic, credit, employment and consumer confidence recovery needed to underpin sales;
- 1.975MM available new units nationally, including standing, available lots and recently built foreclosures;
- Price drops have brought affordability in line with 20-year ratios in most markets; oversupply and poor macroeconomic conditions will likely lead to additional 5% to 10% overcorrection;
- Long-term structural annual US new home demand of 895K units, but not likely reached until 2011;
- National market will turn in 2010 with absorption increases and significant land sales;
- Full recovery defined as one per week new home sales per project and low single digit price appreciation – TCG forecasts 2Q 2011 nationally with specific markets outlined below;
- Submarket fundamentals often diverge from region and can present opportunities in challenged markets;
- Potential for Obama administration stimulus and bank restructuring plans to provide near-term market improvement;
- Land/lot development opportunities precede recovery by 12 to 18 months;
- Opportunities for re-entitlement, land planning and product development are best addressed immediately;
- Strategic analysis must focus on specific regional and submarket supply and demand conditions.

History and Overview

The period between 2001 and 2008 can broadly be categorized as a boom, a bubble and a bust. Since 1970, United States new homes price appreciated 6% annually, on average. In 2004 and 2005, average new home prices grew by over 11% annually. New home sales volume grew approximately 40% between 2001 and 2005.

Figure A: Historical U.S. New Home Prices (1970-2008)



Sources: U.S. Census Bureau; The Concord Group

Several factors drove the housing boom, including:

- 2.1 jobs nationally for every single-family building permit between 1970 and 1999, far outpacing the equilibrium of 1.5 jobs per permit;
- Changes in capital gains tax law in 1997 limiting tax exposure to homes sold after significant appreciation;
- Tech bust in the early 2000s and the movement of funds from equities to real estate investment;
- Baby boom generation reaching peak-buying ages;
- Generation Y's high homeownership propensity compared to that of previous generations;
- Interest rates at historical lows.

The above, coupled with momentum and loose lending standards, led from boom to bubble. Volumes were not supported by household growth and prices were detached from affordability metrics as buyers were attracted by both seemingly limitless appreciation and nontraditional lending practices. Builders responded to the demand by delivering large numbers of units in key growth markets like Florida, Phoenix, the Inland Empire (CA) and Las Vegas.

As with any bubble, minor demand shocks translated into system-wide depreciation and deceleration below historically supportable levels. While structural demand supports significant velocity increases, macro-economic disruptions to U.S. output, credit markets, employment and consumer confidence will dampen near-term recovery. The various stimulus plans proposed by the new Obama administration combined with the usual turn in the business cycle when prices become extremely attractive will likely drive 2010 sales growth.

Current New Home Market Conditions

1. Sales Rate

The national new home market is at historically low levels driven by oversupply, affordability and credit issues. Last 12 months (“LTM”) single-family new home sales volume through November 2008 was 505,000, down 61% from the 2005 peak of 1.28MM sales. The severe sales deceleration has led to housing oversupply. Builders, distressed homeowners and banks have employed price cuts to drive absorption, in many cases with suboptimal results.

2. Supply

Builders overbuilt to meet the artificially high demand. TCG estimates 1.975MM units of new home supply are currently available in the U.S., representing three to four years of inventory at current run rates. Historically, supply has not exceeded one to two years. Competitive supply is defined as standing inventory, lots in actively marketed new home communities and recently built foreclosures.

The oversupply is not limited to new homes. The Census Bureau’s monthly American Housing Survey estimates 4.2MM resale units are available, representing 5.4% of total housing stock, 61% higher than the long-term average of 3.3%. These units create continued downward price pressure until absorbed by the market.

3. Prices

Same-product prices have fallen 17% year over year from November 2007 to November 2008, with an overall drop from peak nearing 21%. This metric is a more accurate barometer than the 6% non-mix-adjusted U.S. median new home price drop as reported by the Census and other sources. The mix of sales has skewed home prices higher – toward better performing higher-priced product – despite same product price drops.

Homebuilders have been pricing product at or below the resale market, contrary to the 10-15% premium historically achieved under normal market conditions. In most acute situations, builders have priced slightly above the foreclosure market or simply withdrawn (“mothballed”) communities in markets with high foreclosure inventory and consequently steep price depreciation. As delinquency rates continue to rise – 6.9% of all loans outstanding as of Q3 2008 were delinquent, up 25% from last year – real estate owned (“REO”) sales will limit builders’ abilities to rapidly regain these price drops.

Approximately 18.5% of 2008 resale transactions were bank-owned properties, reaching as high as 84% in high-growth markets now facing the sharpest corrections. The high volume of these distressed sales has contributed to heavy depreciation, further eroding buyer confidence.

Figure B: 2008 REO Sales in the U.S. and Selected Markets

| Market | REO Sales | % Resale Volume |
|---------------|-----------|-----------------|
| United States | 910,800 | 18.5% |
| Seattle | 2,300 | 7.1% |
| Charlotte | 2,600 | 12.0% |
| Boston | 4,200 | 13.7% |
| Orlando | 4,300 | 14.0% |
| Dallas | 11,100 | 18.1% |
| DC/Baltimore | 19,200 | 20.3% |
| Tampa | 11,300 | 23.7% |
| S.F. Bay Area | 16,500 | 27.5% |
| Orange County | 6,100 | 27.6% |
| Los Angeles | 21,300 | 42.0% |
| Phoenix | 22,600 | 42.6% |
| Las Vegas | 20,800 | 74.0% |
| Sacramento | 23,600 | 77.4% |
| Inland Empire | 40,800 | 84.0% |

Sources: Dataquick; RealtyTrac; NAR;
The Concord Group

4. Regional Conditions

The highest-growth markets of the last cycle’s price upswing have experienced the sharpest declines in sales and pricing. Markets, including the Inland Empire, Las Vegas, Phoenix and a number of Florida markets have been characterized by same-product price declines over 30% from peak. These same product figures are deeper than frequently reported prices due to sales mix issues that have skewed median prices upward.

Figure C: New home Sales and Price Trends in Selected Markets (sorted by same-product price change from peak)

| Market | New Home Sales Volume | | | Average New Home Price | | | | Same Product Price | |
|-------------------|-----------------------|---------|--------|------------------------|-----------|--------|--------|--------------------|--------|
| | Peak | LTM (1) | Δ Peak | Peak | LTM (1) | Δ Peak | Y/Y Δ | Δ Peak | Y/Y Δ |
| United States (2) | 1,283,000 | 505,000 | -60.6% | \$313,600 | \$296,600 | -5.4% | -3.7% | -21.0% | -16.6% |
| Dallas | 43,100 | 19,200 | -55.5% | 233,000 | 224,400 | -3.7% | 1.0% | -4.6% | -3.0% |
| Charlotte | 22,400 | 16,100 | -28.1% | 314,700 | 313,700 | -0.3% | 8.0% | -5.8% | -4.4% |
| Seattle | 15,200 | 6,100 | -59.9% | 420,700 | 411,100 | -2.3% | -2.3% | -11.4% | -10.2% |
| Boston | 2,800 | 700 | -75.0% | 467,600 (3) | 450,300 | -3.7% | -2.5% | -12.8% | -6.0% |
| S.F. Bay Area | 16,700 | 8,000 | -52.1% | 738,500 | 658,300 | -10.9% | -6.1% | -21.0% | -16.0% |
| Orange County | 5,900 | 2,100 | -64.4% | 834,800 | 706,000 | -15.4% | -15.4% | -21.0% | -13.7% |
| DC/Baltimore | 33,900 | 9,300 | -72.6% | 504,600 | 410,000 | -18.7% | -11.4% | -26.3% | -18.7% |
| Tampa | 46,400 | 16,200 | -65.1% | 304,300 | 272,500 | -10.5% | -4.2% | -30.5% | -19.8% |
| Sacramento | 14,200 | 4,900 | -65.5% | 451,000 | 358,200 | -20.6% | -14.1% | -31.0% | -19.1% |
| Orlando | 52,900 | 18,000 | -66.0% | 255,000 | 231,500 | -9.2% | -8.8% | -33.0% | -15.0% |
| Inland Empire | 34,100 | 8,000 | -76.5% | 492,000 | 405,600 | -17.6% | -16.0% | -34.0% | -17.0% |
| Los Angeles | 11,000 | 3,700 | -66.4% | 608,600 | 594,300 | -2.3% | 3.4% | -34.4% | -27.9% |
| Las Vegas | 45,000 | 7,100 | -84.2% | 449,000 | 327,000 | -27.2% | -26.0% | -39.3% | -31.7% |
| Phoenix | 55,400 | 15,600 | -71.8% | 290,400 | 253,600 | -12.7% | -9.5% | -40.6% | -32.7% |

(1) LTM end varies by market from September 2008 to November 2008

(2) U.S. Census Bureau/HUD covers only single family home sales

(3) Boston home prices reflect total average price of new and existing home sales

Sources: U.S. Census Bureau/HUD; HanleyWood; DataQuick; MetroStudy; S&P/Case-Shiller; The Concord Group

As sales have dropped, inventories have risen to between three and six years of supply at current run rates. With sales rates 38% below 20 year averages, these overhangs depict an overly negative picture, but a medium-term demand rebound will reduce supply.

Figure D: Competitive Inventory in the U.S. and Selected Markets

| Market | Competitive Inventory |
|---------------|-----------------------|
| United States | 1,975,000 |
| Boston | 3,900 |
| Orange County | 10,500 |
| Los Angeles | 16,900 |
| Sacramento | 20,200 |
| Seattle | 22,800 |
| S.F. Bay Area | 30,600 |
| Charlotte | 35,200 |
| Inland Empire | 46,700 |
| Las Vegas | 47,900 |
| Tampa | 49,400 |
| Dallas | 63,100 |
| Orlando | 67,400 |
| DC/Baltimore | 68,300 |
| Phoenix | 86,600 |

Sources: U.S. Census Bureau/HUD; HanleyWood; MetroStudy; RealtyTrac; The Concord Group

Markets with high second home composition have elevated inventory given prominent slowing in second home absorption. In markets such as Las Vegas, Orlando and Phoenix, new home inventory must be analyzed assuming some second home demand and potential economic multipliers from tourism and hospitality.

5. Signs of Recovery

Recent sales volumes in national and major metropolitan markets have not indicated the start of a recovery. New home sales change from second quarter 2008 to third quarter 2008 is negative. Resale volumes in certain markets have increased due to high foreclosure activity, showing potential underlying demand at affordable levels.

Figure E: Quarterly Sales Performance for the U.S. and Selected Markets

| Market | Q/Q Sales Volume Change (1) | | | |
|---------------|-----------------------------|------|---------|------|
| | New Homes | | Resales | |
| | Q/Q | Y/Y | Q/Q | Y/Y |
| United States | -19% | -36% | 1% | -8% |
| Boston | -28% | -60% | 7% | -12% |
| Charlotte | -4% | -46% | 8% | -37% |
| Dallas | -9% | -29% | 8% | 14% |
| DC/Baltimore | -40% | -76% | -3% | -25% |
| Inland Empire | -29% | -51% | 31% | 102% |
| Las Vegas | -27% | -56% | 26% | 66% |
| Los Angeles | -23% | -40% | 19% | 15% |
| Orange County | -24% | 0% | 20% | 1% |
| Orlando | -13% | -52% | 9% | -8% |
| Phoenix | -1% | -44% | 34% | -4% |
| Sacramento | -33% | -38% | 18% | 91% |
| S.F. Bay Area | -30% | -30% | 21% | 25% |
| Seattle | -39% | -44% | -6% | -36% |
| Tampa | 5% | -47% | 23% | -13% |

(1) Quarter end varies by market from September 2008 to November 2008

Sources: NAR; Dataquick; HanleyWood; U.S. Census Bureau/HUD; MetroStudy; The Concord Group

TCG Market Outlook

The following are TCG’s overall conclusions for the U.S. housing market.

- Demographic growth of 1.3MM households annually creates strong long-term demand;
- Annual demand of 895,000 new housing units, back to 1997-2002 norms;
- New home sales volume levels bottom in 2009;
- Peak to trough housing-market same-product price correction of 25-30%, reaching nadir by the end of 2009; same product has already dropped 21%;
- Minimal price appreciation through 2010; Moderate, single digit growth in 2011 and beyond;

TCG used the following methodology to predict key recovery milestones:

1. Forecasted annual new home demand;
2. Assessed current inventory levels by several methods:
 - a. Competitive new home supply, including standing inventory and available lots in active communities and recently-built foreclosures;
 - b. New home sales vs. new home starts;
 - c. Household creation vs. new home starts;
 - d. Supply outlook vs. demand projections; and
3. Forecasted price drops required to reach normalized affordability levels.

1. Recovery Definitions

TCG’s forecast identifies two key recovery milestones:

A. Land Market Recovery: When competitive supply reaches 12 months, the normal cycle of finished purchases by builders will likely restart. Builders, gaining confidence from increasing absorptions and manageable overhang, will begin acquisitions for future development. This land buying will signal a key inflection point.

B. Housing Market Recovery: TCG defines housing market recovery as one sale per week per project combined with single digit price appreciation. While overall absorptions will recover earlier (even with supply overhangs), price appreciation will not likely begin until inventory levels are six months or less. Assuming additions of some months of supply from additional competitive foreclosures especially from Alt-A resets and selected planned and proposed projects, TCG pegs this recovery to when the currently available supply balance is eliminated.

2. New Home Demand Projections

New home demand will drive market recovery. TCG’s estimates are based on published employment forecasts, structural household growth, turnover and obsolescence. TCG also utilizes conservative financing assumptions to adjust for the tightened credit market. Within this framework, TCG projects long-term annual new home demand potential in the United States to be 895,000 units per year. This projection is based on 1.1% annual household growth rate over the next five years, or 1.3MM new households, qualifying for percent-own, percent-buy-new and income ratios. This demand projection is in line with total new home sales performance in the early 2000’s.

For milestone forecasts, TCG used a “blended” demand number, assuming the current run rate for the next 12 months followed by a “recovery” rate below structural demand levels. The blended run rate assumes macroeconomic and credit issues will keep demand at current levels in the near term. However, since intrinsic household growth would support significantly more sales and some positive credit market impact is likely from various relief programs, 2010 sales are expected to move toward structurally supportable levels. Figure F depicts various U.S. new home demand measures.

Figure F: U.S. New Home Demand Measures

| Source | Demand Measure |
|----------------------|----------------|
| TCG Demand (1) | 895K |
| 10-Yr Avg. SFD Sales | 954K |
| 20-Yr Avg. SFD Sales | 815K |
| LTM SFD Sales (2) | 505K |
| 2008e SFD Sales (2) | 503K |

Sources: U.S. Census Bureau/HUD; Claritas; TCG

(1) Includes single-family and attached new homes; historically 10-12% of total sales (per NAR)

(2) Total new home sales including attached product approximately 550K to 575K

3. Current Inventory and Recovery Forecast

Recovery milestones depend on supply levels. TCG analyzed current inventory levels using the following methodologies:

1. Estimated units remaining nationally in active projects. Total unsold units equals 1.975MM;
2. Assessed 20-year historical new home starts versus new home sales as an indicator of over or under-building. Total supply equals 2.0MM units (starts minus sales);
3. Analyzed medium term historical household creation versus new home starts as indicator of housing unit demand. Total inventory of 2.2MM new units (new households minus starts).

TCG projected U.S. and selected metropolitan recovery dates in Figure G below. As mentioned above, the competitive inventory figure combines currently available new homes/lots and recently completed foreclosures considered probable to compete with new inventory offered by builders. This overhang results from 50 to 60% drops in sales volumes from peak and drives prices downward. This outlook may be overly negative for high second home volume markets such as Las Vegas, Orlando and Phoenix given conservative second home demand forecast and elevated levels of such product remaining in supply.

Figure G: Projected Recovery Dates for the U.S. and Selected Markets

| Market | Blended Mo. Supply (1) | Recovery | | Market Rating (2) |
|---------------|------------------------|----------|---------|-------------------|
| | | Land | Housing | |
| United States | 32 | 2Q 10 | 2Q 11 | 2 |
| Charlotte | 25 | 4Q 09 | 4Q 10 | 2 |
| Tampa | 28 | 1Q 10 | 1Q 11 | 2 |
| Dallas | 29 | 2Q 10 | 2Q 11 | 2 |
| Seattle | 30 | 2Q 10 | 2Q 11 | 3 |
| Boston | 30 | 2Q 10 | 2Q 11 | 3 |
| S.F. Bay Area | 32 | 2Q 10 | 2Q 11 | 3 |
| Orange County | 33 | 3Q 10 | 3Q 11 | 3 |
| Orlando (3) | 33 | 3Q 10 | 3Q 11 | 3 |
| Sacramento | 35 | 4Q 10 | 4Q 11 | 3 |
| Los Angeles | 36 | 4Q 10 | 4Q 11 | 4 |
| Inland Empire | 37 | 4Q 10 | 4Q 11 | 4 |
| DC/Baltimore | 37 | 4Q 10 | 4Q 11 | 4 |
| Phoenix (3) | 43 | 3Q 11 | 3Q 12 | 5 |
| Las Vegas (3) | 44 | 3Q 11 | 3Q 12 | 5 |

(1) Blended sales rate takes into account a minimum of 12 months at LTM run rate, followed by near-term recovery rate, and projected annual demand rate thereafter; months of supply is current as of Nov. 2008 and rounded to the nearest month

(2) Rating is based on a 5-point scale: 1 = <24 months recovery, 2 = 24-30 months, 3 = 30-36 months, 4 = 36-42 months, 5 = 42+ months

(3) Indicates high volume second home market. Recovery projections may be conservative

Sources: HanleyWood; Claritas; MetroStudy; RealtyTrac; DataQuick; U.S. Census Bureau/HUD; The Concord Group

Some analysts conservatively assess the state of the housing market using the LTM run-rate of 503K single-family new home sales. At this pace, it will take 47 months, or over four years, to eliminate the 1.975MM units of competitive new home inventory. The inventory volume assumes minimal new product releases between today and the recovery date. At this pace, U.S. market recovery is projected by 2013. TCG views this downside case as unlikely based on underlying demographic trends.

4. New Home Price Forecast

Nationwide affordability has returned to long-term levels; however, certain regions still require price drops to meet historical norms. The income to housing ratio ranged from 22% to 25% between 1998 and 2003. After 2003, however, the ratio increased from 24% to near 30%, a 25% increase over the supportable average. The 20-year average affordability is 26%. In certain markets, this ratio reached over 40%.

Figure H: Long-Term Affordability Driven U.S. Home Price

| Assumptions | Values |
|-------------------------------|-----------|
| 2008 Avg. HH Income: | \$67,918 |
| 2008 Avg. New Home Price: | \$293,304 |
| Down Payment: | 20% |
| 30-Yr Mortgage Rate: | 6.5% |
| Associated Points: | 0.6 |
| Income/Housing Ratio: | 26.6% |
| 20 Yr Avg. Affordability: | 26.2% |
| Supportable Home Price | |
| Given 20-Yr Affordability: | \$289,000 |
| % Change from Current: | -1.5% |
| 1998-2003 Avg. Affordability: | 24.2% |
| Supportable Home Price | |
| Given '98-03 Affordability: | \$267,000 |
| % Change from Current: | -9.0% |

Sources: U.S. Census Bureau/HUD; The Concord Group

TCG projects an additional U.S. new home price decline of 5% to 10% before market bottom through the end of 2009. Though current prices are in-line with historical affordability levels, the combination of builders overcorrecting to move inventory, distressed/REO home sales, tougher lending standards and poor buyer sentiment will contribute to reduced non-distressed sales volumes and thus prompt sellers to continue to cut prices.

The trade-off between owning and renting in the United States has also returned to near historical norms. Due to low interest rates and the relative affordability of loans over the past cycle, the run-up in for-sale home prices was not matched by a similar increase in the relative cost of owning. During the 2005/2006 peak, average owner costs (not assuming tax benefits) were 187% of average rental costs, a level significantly lower than that of the late 1980's/early 1990's and on par with the 20-year trend.

Certain locations in California, Florida and the Northeast remain above historical affordability levels and could see additional drops of 10% or more in for-sale product. Most high-growth markets with affordability challenges during the recent cycle's peak have already dropped 20% to 40% on a same product basis. The Inland Empire and Sacramento have dropped 30 to 35%; Las Vegas and Phoenix have same product price drops of over 35%; and major Florida markets (Miami, Orlando and Tampa) have dropped between 30% and 40%. The sharpest price drops correlate highly with significant investor speculation and second home markets.

5. Acquisition and Investment Opportunities

The current economic recession is creating opportunities for investment in the housing market. TCG is bullish about the long-term opportunities for new housing in the United States given the high demographic growth for an industrialized nation, governmental support for ownership and consumer preferences.

Depending on the region, the high volume of distressed assets, continued reduction in bid/ask spreads and possible overcorrection of home prices will allow for favorable deal conditions. These opportunities are predicated on liquidity in the capital markets. TCG employs a conservative valuation strategy that analyzes both liquidation and going concern assessments, with valuation driving off recovery dates that assume limited finished lot and no raw-land sales prior to recovery. In cases where the discounted cash flow value is above the market liquidation value, TCG identifies a possible favorable investment.

Specific submarkets present opportunities despite challenges to the greater region. For example, prior recovery cycles have demonstrated that absorption and pricing in master planned communities outperform stand alone development. Locations with proximity to quality schools, accessible leisure and entertainment options and diversity of jobs will also outperform recover timeframes. Submarket-level analyses will identify opportunities and constraints that diverge from the regional average.

Regions with strong long-term growth fundamentals and diversified economic bases will emerge earliest, whereas the outlying commuter markets will lag. Development of quality new housing in core employment centers is expected to be an opportunity, particularly if entitlement risks reduce competitive supply. Meeting the needs of baby boomers, including the nascent trend of their transition to urban areas, should remain a focus. In the near term, discretionary purchases for retirement and recreational purposes will continue to decelerate, though TCG supports the long-term opportunity of these assets assuming supportable pricing and appropriate location, product and amenities.

Assuming healthy market fundamentals, the release of new, exciting product has contributed to turning the market towards the end of past down cycles. However, market and consumer preferences should be studied before the release of aggressively innovative product concepts. Promoted in many cases by government wishes and inflated land values, the rush to higher density housing in outward suburban locales through the upswing of this last cycle is an example of a possibly risky proposition.

About The Concord Group

The Concord Group is a leading real estate strategy firm with offices in Newport Beach, San Francisco and Boston. TCG's 40 consultants complete over 350 assignments annually in the U.S., Europe, Asia and Latin America. Our services include market and consumer analyses, transaction due diligence and asset valuation. Recent private equity assignments have included multiple analyses of distressed assets of commercial banks and new acquisitions for next-cycle development. We also continue to assist developer and financial clients on value maximization of owned-assets. We cover all property types (commercial, residential and land), in all metro areas and work under tight due diligence deadlines.

Limiting Conditions

The Concord Group, LLC utilized best efforts to ensure that the data contained in this report reflect accurate and timely information and are reliable. This report is based on estimates, assumptions and other information developed by The Concord Group, LLC from its independent research effort, secondary sources and general knowledge of the industry. No responsibility is assumed for inaccuracies in this report. This report is based on information that to our knowledge was current as of the date of this report and The Concord Group, LLC has not undertaken any update of its research effort since such date. This report or any portion thereof may not be reproduced or redistributed by any person for any purpose without the consent of The Concord Group, LLC.