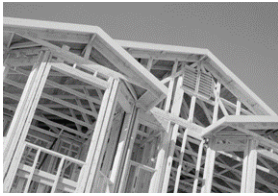


PortReal, LLC // serving institutional investors
Residential market update // 2nd Quarter, 2008



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PFFT ! – the sound of deflating expectations

Starter-home house prices dropping fastest, luxury turning around

Sellers are letting the hot air out of inflated expectations. Asking prices of For Sale listings dropped by 7-9% nationwide in the last year. That's a massive drop compared to figures reported by OFHEO's House Price Index. Hardest hit is Investor Grade housing, while prices in the luxury segment may be turning around

	Last Year(1) Q406 - Q407	Last quarter(2) Q307 - Q407	Current quarter(2) Q407 - Q108
For Sale asking prices STARTER HOME / Investment grade (15th percentile)	-9.1%	-6.8%	-1.5%
For Sale asking prices Median	-8.3%	-4.3%	0.3%
For Sale asking prices LUXURY (75th percentile)	-7.7%	-3.3%	1.7%
OFHEO transacted prices	0.1%	-0.4%	na

(1) annual rates; (2) quarterly rates Source: online realtor listings, including Realtor.com; OFHEO

Crashing noises in the desert

California inventory at US norms while prices plunge

We do not see California inventories surging even though prices are plunging.

The ratio of for-sale listings per capita is near national levels. Most California cities have about 1 listing per 100 people, vs. the national weighted average of 0.9 listings/100. There are a few exceptions, such as Madera at 3.5 per 100, Napa at 3.3 per 100.

While the price collapse may be slowing in some markets, California is still dropping like a hot potato. OFHEO reports prices dropping about 5-15% in the previous year.

We believe OFHEO understates the magnitude of the correction. Asking prices of entry-level properties dropped by 15-30% in 2007 in some areas (such as Merced, Modesto, Salinas) and dropped an additional 15-20% just in the last quarter.

The beatings will continue until morale improves **Florida inventories high**

Florida is competing with California for "fastest value lost".

But Florida has one thing over California: bulging inventories.

Florida's inventories range 1 to 5 listings/100, topping out at 19/100 (Punta Gorda) and 7/100 (Sebastian-Vero Beach). These are among the highest For Sale inventories in the nation.

Not good to be an over-achiever.

Florida cities experienced double-digit price collapses in 2007, and the first quarter of this year generally reflects a continuation of that momentum across most metro areas. We feel that OFHEO understates value loss: also true in Florida.

How low can they go?

Detroit has lowest priced starter-home prices

We have been anticipating a rebound in the rust belt and the Midwest due to already extremely low property prices.

The Investor Grade (starter home) benchmark price in Detroit-Livonia-Dearborn is currently under \$26,000. This is the lowest Investor Grade price of any of the 379 metro areas we cover. The national median Investor Grade price is \$155,000.

While Detroit has high inventories (2.3 listings/100), they are not at the top of the range (3+ listings/capita, see Florida, above).

Asking prices are also now falling at a slower rate.

Perhaps investors are starting to buy into this market?

Good news

Investment affordability moving up and expanding

Falling prices are making more markets affordable again. This is especially good for buy-and-hold investors who rely on rental income to cover costs.

	Jan 2007	Jan 2008	Mar 2008
Percent of cities affordable to investors	34.5%	38.4%	56.1%
Median level of affordability	22.2%	13.2%	-3.3%
"+"=overpriced	(overpriced)	(overpriced)	(affordable)
"-" = affordable			

The table below summarizes rankings from 379 metro areas that we cover. Affordability is the measure of market pricing vs. an investor's "most you can afford" price.

	MOST AFFORDABLE Metro areas	Price, \$ Investor Grade	Rent 3BR(1)			LEAST AFFORDABLE Metro areaS	Price, \$ Investor Grade	Rent 3BR(1)
1	MI: Detroit-Livonia-Dearborn	\$ 25,963	\$ 1,018		1	OR: Bend	252,500	\$1,112
2	MI: Warren-Troy-Farmington Hills	\$ 29,900	\$ 1,040		2	CA: San Luis Obispo-Paso Robles	365,000	\$ 1,617
3	WV: Weirton-Steubenville	\$ 32,000	\$ 713		3	WA: Wenatchee	199,900	\$ 960
4	IN: Muncie	\$ 39,900	\$ 856		4	NJ: Newark-Union	249,000	\$ 1,434
5	IN: Kokomo	\$ 44,900	\$ 872		5	WA: Bremerton-Silverdale	245,000	\$ 1,201
6	IN: Anderson	\$ 44,000	\$ 863		6	NY: Kingston	199,999	\$ 1,214
7	OH: Cleveland-Elyria-Mentor	\$ 49,500	\$ 1,004		7	MT: Missoula	190,000	\$ 970
8	WV: Wheeling	\$ 40,000	\$ 712		8	WA: Seattle-Bellevue-Everett	275,000	\$ 1,395
9	IN: Terre Haute	\$ 40,000	\$ 739		9	NJ: Ocean City	199,000	\$ 1,218
10	IL: Danville	\$ 34,000	\$ 722		10	NM: Farmington	167,700	\$ 811

Getting out of the jungle

Where next for opportunities?

We offer little encouragement for investors who think the recent freefall has finished the job of rationalizing prices. We believe markets are still over-priced compared to historical rates of appreciation and/or compared to our affordability benchmark.

For the speculator focused on appreciation, some markets (such as Naples-Marco Island, FL) may have bottomed out, but higher inventories may keep prices down for a while.

Key questions for investors:

- Where is potential downside risk the least?
- Where is potential upside gain the highest?

Avoiding 'least affordable' markets is a good start. But finding upside gain is harder. 'Most affordable' doesn't guarantee a lack of risk. In some cases, high affordability is the result of collapsed housing prices caused by fundamental problems in that market. These problems can also spoil vacancy rates, renter quality, and operating costs.

We use price stability, scarcity (inventory levels), and per capita income growth in conjunction with affordability to improve the odds of picking markets that are fundamentally healthy. This blended filter identifies the Midwest, Gulf Coast, and mid-Atlantic as potential opportunity areas for the buy-and-hold investor. For example, Pennsylvania (e.g.: Pittsburgh), Texas (e.g.: Beaumont-Port Arthur) and Louisiana (e.g.: Alexandria), may offer investment opportunities.

Definitions

Investor Grade is a starter-home property ready and suitable for renting or resale.

We benchmark **Investor Grade** pricing using the 15th percentile price point in the market.

Investor Grade housing shapes supply/demand for the overall housing market by defining a clearing price for investors.

Our PortReal's **Affordability** benchmark is the ratio of the **Investor Grade** price to a "most you can afford" price based on rental income.

If rent cover ownership costs, then the market is affordable.

In the current real estate cycle, **Affordability** is a weathervane for future pricing, correctly predicting price change ~70% of the time.

PortReal news

PortReal publishes research and investment ratings for residential real estate for investors. PortReal was recently cited in a Morgan Stanley analysts' report covering residential REITs. We provide custom services and are piloting China, India residential research.

Disclaimer: Investors should not rely on our data to make specific investment decisions. Economic and market conditions differ greatly by location and property. Our analysis ranks metro areas using standardized assumptions across geographies. Investors must perform their own analysis of vacancy, rents, operating costs, and other factors before making investments.

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