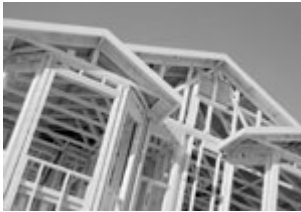


PortReal, LLC // serving institutional investors
Residential market update // 3rd Quarter, 2008



www.portreal.com

Parachutes, anyone?

Prices of investor grade homes continued their free-fall this past quarter. From April to July, investor grade prices dropped 4.9%, or 18% annualized.

Since investor grade homes are already at the low end of the market (15th percentile price by definition), this category can't compress much further in the many markets where asking price is far below the replacement cost.

Prices dropped faster in the last quarter than in the previous quarter, suggesting the roller-coaster ride is re-energizing. There may be small consolation in the fact that median quality and luxury home prices are not dropping as fast as investor grade housing.

	Last year⁽¹⁾ 4/07-4/08	Last quarter⁽²⁾ 1/08-4/08	Current quarter⁽²⁾ 4/08-7/01
For Sale asking prices ⁽³⁾ INVESTOR GRADE / Starter Home (15th percentile)	-7.2%	-2.3%	-4.9%
For Sale asking prices ⁽³⁾ MEDIAN	-3.8%	0.1%	-2.6%
For Sale asking prices ⁽³⁾ LUXURY (75th percentile)	-2.8%	2.0%	-1.1%
Transacted prices OFHEO ⁽⁴⁾	-2.5%	-1.3%	Na

Notes:

(1) annual data; (2) quarterly data; (3) US average weighted by number of listings in each metro area

(4) data reflect changes in weighted-average prices, weighted by metro population

Source: online realtor listings, including Realtor.com; OFHEO; Census

A few quarters ago, sellers were cutting the margin between “asking” and “selling” prices as they became less optimistic and less patient with slow absorption. But sustained reductions in asking price reflect the reality of lower market valuation. Values are down due to lower demand, constrained credit, and competition from homes in foreclosure and bankruptcy, selling for cents on the dollar. The fire sales running in parallel to the retail “for sale” market also results in higher-quality homes now coming onto the market priced as “starter” homes.

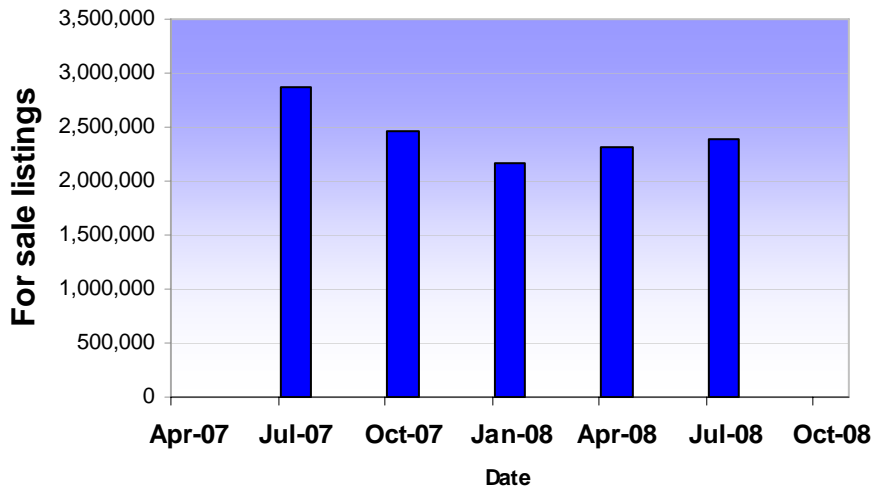
The national average starter home (investor grade) is now priced at \$144,000, while average rent for a three-bedroom apartment is about \$1250 (these figures are population-weighted averages

for the 379 cities that we track). Buyers looking for long-term housing—and who can get financing—should find that buying a home at these low prices is not just an affordable alternative to renting, but may potentially offer them a great value in terms of home quality.

Somebody take it...please!

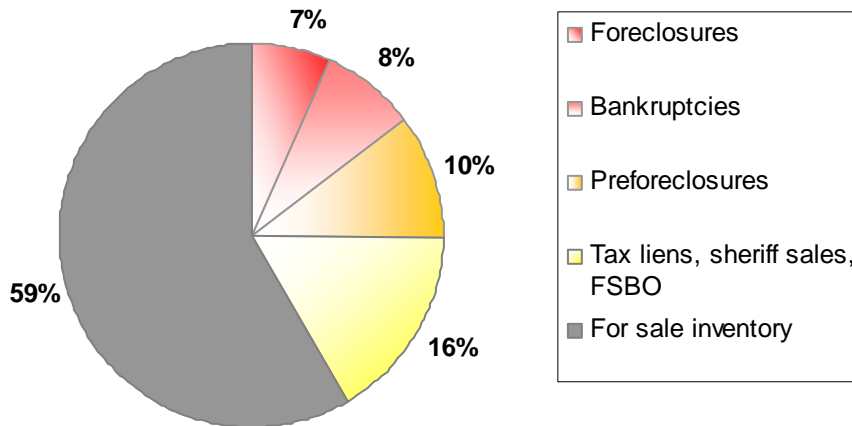
For homebuyers, the price may be right if they keep their home for a while. But sellers face continued risk that demand will be low. “For Sale” listings are rising after a brief decline. Slower absorption is due to buyer fears and competing inventory in the distressed housing market.

"For Sale" listings for 379 US metro areas rising



Distressed homes (bankruptcies, foreclosures and pre-foreclosures, sheriff's sales, and liens) and FSBO (for sale by owner) now exceed 40% of inventory on the market. This creates tremendous pressure on retail pricing, especially in markets with even higher percentages of distressed housing.

US foreclosures, bankruptcies, other distressed sales, & FSBO >40% of listings

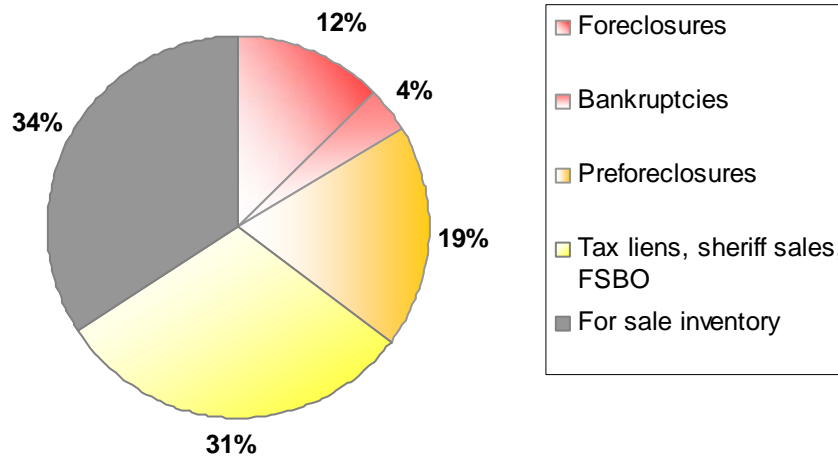


California...letting it all hang out

Distressed housing and FSBO make up two-thirds of California inventory (vs. 40% nationally), and prices are still in freefall. On the positive side, "for sale" inventories are relatively low and improving affordability (lower cost to buy vs. cost to rent) may stabilize prices.

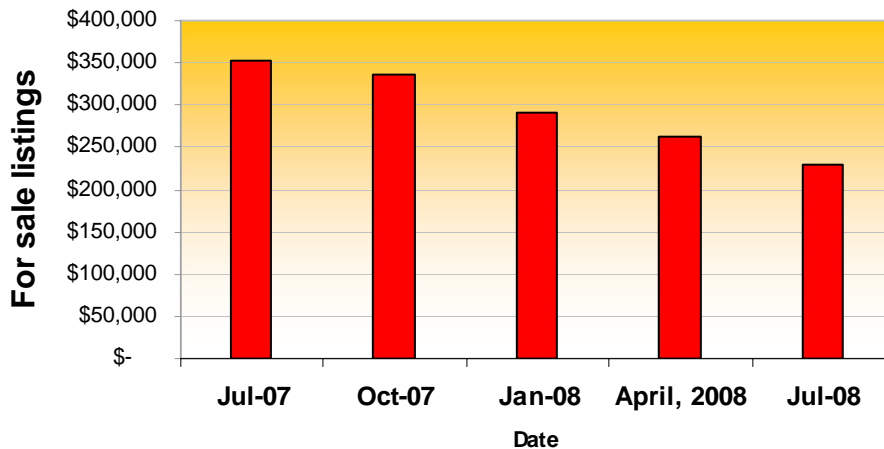
Retail "For Sale" inventories are relatively low in California by national standards, and may even be falling. However, retail inventories are overshadowed by the high volume of distressed inventories. Most large California cities have distressed inventories at 60% to 80% of total, resulting in housing inventories that exceed national averages.

California foreclosures, bankruptcies, other distressed sales, & FSBO 66% of listings



At the same time, California housing prices are still in freefall. Compared to US averages, entry-level housing prices still have room to drop, though affordability (cost-to-own vs. cost-to-rent) may start to support price stability as investors enter the market to buy rentals.

35% drop in average entry-level house price for top 28 California cities

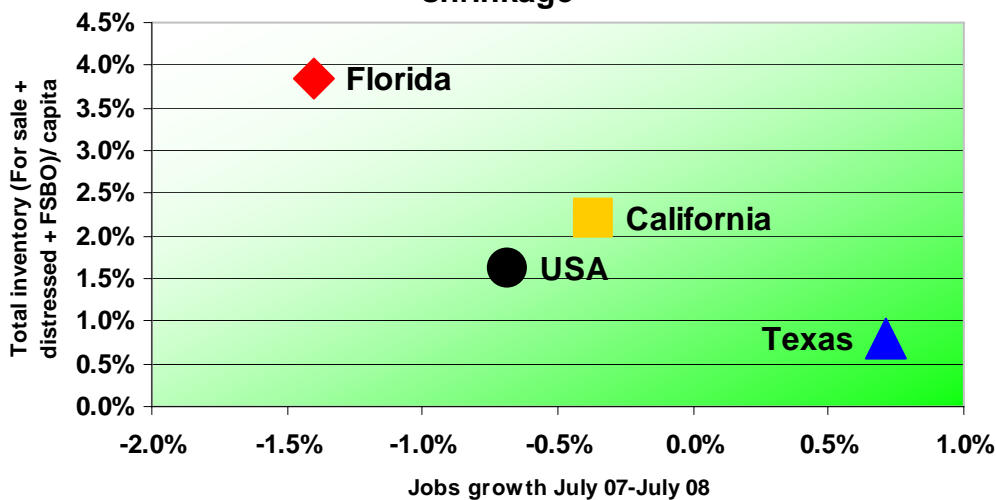


If you're going to invest in California, be sure to wear flowers in your hair, because there is only one city we rate highly: San Francisco. Using four metrics (inventories, affordability, price statistics, and job trends), San Francisco is sitting on the dock by the bay watching the rest of California go up in smoke. We put San Francisco in the top 35 best places to buy investor housing this quarter.

Florida: still smells like swamp gas

The good news about California is that it's not nearly as bad as Florida. Overall, Florida has higher inventories and a weaker jobs outlook. In particular, Punta Gorda has very high inventories, and some markets have not experienced enough correction to deflate the bubble. Only Gainesville appears to have inventories (For Sale+distressed+FSBO) comparable to national norms. Get fresh air and stay out of Florida.

Florida suffering from high inventories and job shrinkage



Detroit: a good deal?

We still like Detroit as a potential region for investment. Total inventories are about twice the national level (comparable to much of California but better than most of Florida) but "For sale" inventories are coming down. Entry level housing is a bargain at \$26,000. It's still the lowest entry level price in the 379 markets we cover, but it may have bottomed out as buyers realize that it just can't go any lower. Jobs have shrunk by 5%, so future value will depend on whether the economy stabilizes and whether housing production stalls long enough to cause a shortage. But at these prices, it's worth looking into.

Affordability top 10 / bottom 10

More markets becoming affordable as prices decline. This is especially good for buy-and-hold investors who rely on rental income to cover costs.

We rate affordability based on an investor's ability to break even investing in property and putting it out to rent. We compare the "most you can afford" based on expected rental income vs. "lowest price available on the market today". Assuming prevailing rents can be collected, the following table shows where the best bets are. Of course, investors must perform their own due diligence at a local level.

Top 10 (best) affordability			Bottom 10 (worst) affordability		
Metro area	Price, Investor Grade	Rent 3BR(1)	Metro area	Price, Investor Grade	Rent 3BR(1)
MI: Detroit-Livonia-Dearborn	\$26,000	\$1,032	WA: Wenatchee	\$199,950	\$958
MI: Warren-Troy-Farmington Hills	\$29,900	\$1,055	WA: Bremerton-Silverdale	\$248,000	\$1,202
IN: Muncie	\$39,900	\$935	CA: San Luis Obispo-Paso Robles	\$359,900	\$1,661
AR: Pine Bluff	\$36,000	\$760	OR: Bend	\$235,000	\$1,139
MI: Bay City	\$39,900	\$842	WA: Mount Vernon-Anacortes	\$249,900	\$1,229
IN: Kokomo	\$44,900	\$897	NJ: Newark-Union	\$239,900	\$1,404
IN: Anderson	\$44,900	\$880	WA: Tacoma	\$224,990	\$1,202
WV: Wheeling	\$40,000	\$742	CO: Grand Junction	\$186,500	\$923
WV: Weirton-Steubenville	\$40,000	\$736	MT: Missoula	\$184,900	\$980
IN: South Bend-Mishawaka	\$49,900	\$913	WA: Seattle-Bellevue-Everett	\$270,000	\$1,411

Getting out of the jungle

We use 4 criteria to assess markets for investors and home-buyers: (1) housing supply vs. demand (essentially absorption), (2) pricing trends, (3) rent-vs.-buy cannibalization, and (4) fundamental economics of the region. We use four proxies for these criteria: housing inventory/capita, statistical evaluation of appreciation rates, affordability of buying vs. renting, and jobs growth in the area. These criteria identify cities that appear to be poised for growth in demand and pricing.

Major centers of creativity, financial and political power are well-positioned: San Francisco, Washington, DC, New York City, and Boston. We also continue to like the mid-Atlantic: selected cities in Virginia, West Virginia, Pennsylvania, Ohio and New York. We like Texas in general, and McAllen, Fort Worth in particular. We were favorable regarding the Gulf Coast last quarter, but deals may be harder to find as prices have edged up. There are a number of cities in the Plains (North Dakota and Nebraska) that appear to be stable candidates poised for growth.

In addition to California and Florida, cited above, there are a handful of cities that we feel are weak on all counts. One such city is Bend, Oregon. Bend isn't awful in any one way, but it fails to meet minimum requirements across our four criteria.

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.

Our measure of **Affordability** can be a weathervane for imminent price trends.

PortReal news

Our third quarter Market Report has just been released, and is available from our website, or through EBSCO, Research and Markets, and Alacra.

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.

Sources: Census, OFHEO, Bureau of Labor Statistics, and online listings and foreclosure data (including Realtor.com and Foreclosure.com).

For more information, contact:

Peter Benda, President

PortReal, LLC

P.O. Box 6061 / Glen Allen, Virginia 23058 / 804-360-2701 / www.PortReal.com

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