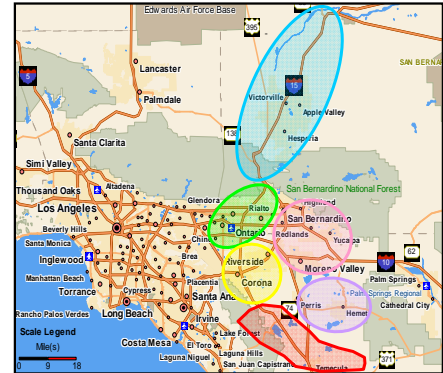


Inland Empire Housing Market Outlook 2010

December 2009

THE
CONCORD
GROUP

The following outlines The Concord Group's ("TCG") outlook on the Inland Empire housing market for 2010. TCG's conclusions draw from both demographic and employment driven demand assessments, as well as various tools for evaluating supply levels and absorption velocity in the six Inland Empire submarkets that capture the majority of new housing activity: Southwest Riverside (outlined in red on the map to the right), Northwest Riverside (yellow), Central Riverside (lavender), West San Bernardino (green), the I-10 Corridor (pink) and Victor Valley (turquoise). Housing market recovery timing drives immediate acquisition, planning and disposition decisions. Our conclusions are derived within the context of our ongoing analyses in the region for developers, builders, capital sources and public agencies.



Executive Summary

The following summarizes TCG's key conclusions regarding the outlook for the Inland Empire housing market:

- Current employment of 1.15 million, peak-to-trough projected loss of 10.0% (127,000 jobs), return to growth in 2011 adding 30,000 jobs per year
- New home sales volume down 22.4% year-over-year, third quarter new home sales up 4.4% over second quarter
- Resale volume up 15.0% year-over-year, with significant distressed property sales
- New home prices down 13% year-over-year with 3% of this decline in the most recent quarter (3Q09)
- Finished lot-to-home price ratios up to 40% in prime locations (Corona, Eastvale, Temecula) as public builders bid up prices targeting offerings in the range of 25 to 75 finished lots, 15% to 20% lot-to-home ratios in outlying secondary markets (Central Riverside, I-10 Corridor)
- TCG projects an Inland Empire housing market recovery, defined as sustainable homes sales levels per project and low single-digit home price appreciation, in 3Q 2012 with demand for new finished lots 12 months prior (3Q 2011); immediate re-entitlement and repositioning opportunities available in close-in Inland Empire submarkets

How We Got Here

By virtue of its location and accessibility, the Inland Empire – particularly those submarkets located in its western half (Southwest Riverside, Northwest Riverside and West San Bernardino) – has traditionally represented the first outlet for residential growth in the coastal counties of Southern California. Expansionary pressure within Orange and Los Angeles Counties drove residents west along Interstate 10 and State Routes 91 and 60, into the now mature cities of Corona, Riverside and Ontario, while pressures within North San Diego County drove residents north along Interstate 15 to Temecula and Murrieta. In the early days of Southern California's population boom, all these areas were bedroom communities to the coastal employment nodes; they offered limited local employment and few services beyond those specifically targeted to a residential audience. Affordable, spacious homes on generous lots and new, well-regarded schools drove potential homebuyers to justify the tradeoffs of increased commuting time and lack of cultural and recreational amenities.

The continued expansion of the coastal counties has fundamentally altered the perception and character of the Inland Empire over the past ten years. The area's existence as a collection of affordable bedroom communities was increasingly compromised by the tremendous price pressures of the real estate run-up of the late 1990s and early 2000s, while commuting to coastal areas became less attractive due to freeway congestion. Businesses, especially those dependent on blue-collar labor and a low cost/rent basis for facilities, began to migrate east in an effort to preserve their labor pools. Such expansion of land uses proved effective only in the short term; the pressures of price growth continued to diversify the economy of the submarket at a pace no one could have predicted at the onset.

Professional employment began to transition to the Inland Empire shortly after blue collar labor, bringing with it a demand for upscale housing, services and amenities. As commuting was increasingly less viable, professional service and business firms began to migrate east as well, seeking to preserve their labor base much as manufacturing, warehousing and construction firms had done in years past. Movement of these firms brought a new, executive market segment to the area – business owners and managers following their firms east. With this group came demand for even more upscale accommodations. While this transition is still taking place, as evidenced by the large projected increase in the employment share of professional and business services, the Inland Empire has effectively evolved into a fully diversified, self-sustaining economy.

The rapid rise in prices and expansion of the professional classes has served to create further outward pressure, again primarily focused on the middle market and affordable segments. Those submarkets located in the Inland Empire's eastern half (I-10 Corridor, Central Riverside and the Victor Valley) are now benefitting from this growth, and over time will likely continue to evolve in a similar manner to the Inland Empire's western submarkets.

Economic/Demographic Drivers

The Inland Empire (exclusive of the Coachella Valley) is home to approximately 3.4 million people in 1.0 million households. This base is expected to grow by over 25,000 households annually (2.4%/year) over the next five years. On a nominal basis, the I-10-Corridor and West San Bernardino submarkets are projected to contribute nearly 40% of this annual growth (9,700 households, or 1.8% annually), but the Southwest Riverside, Victor Valley and Central Riverside submarkets will continue to capture more than their fair share, with annual growth rates of 4.0%, 3.1% and 3.0%, respectively. The median household income in the region is approximately \$60,000; Southwest Riverside is the most affluent area (\$75,700) with West San Bernardino (\$66,500) and Northwest Riverside (\$65,900) both above the Inland Empire average. Figure A below provides more detail on selected demographic characteristics by submarket.

Figure A: Demographic Characteristics

Market	Households				Median Household Income			
	2009	2014	Annual Change		2009	2014	Annual Change	
			#	%			#	%
Southwest Riverside	101,350	123,022	4,334	4.0%	\$75,719	\$85,769	\$2,010	2.5%
Northwest Riverside	193,015	215,313	4,460	2.2%	\$65,927	\$73,573	\$1,529	2.2%
West San Bernardino	260,164	283,399	4,647	1.7%	\$66,505	\$74,294	\$1,558	2.2%
I-10 Corridor	245,437	270,626	5,038	2.0%	\$50,816	\$57,401	\$1,317	2.5%
Central Riverside	122,007	141,136	3,826	3.0%	\$45,884	\$52,134	\$1,250	2.6%
Victor Valley	99,523	116,006	3,297	3.1%	\$51,734	\$58,290	\$1,311	2.4%
I.E. Total/Wtd Average (1)	1,021,496	1,149,502	25,601	2.4%	\$59,638	\$67,074	\$1,487	2.4%

(1) Weighted by total households

Source: Claritas; The Concord Group

The Inland Empire region (defined here as Riverside and San Bernardino Counties) has a current employment base of approximately 1.15 million, with an unemployment rate at a historical high of 14.6%. After averaging more than 30,000 jobs added annually from 1991 through 2007, the area lost nearly 50,000 jobs in 2008, equivalent to a 3.8% decline. Total employment is projected to hit bottom in 2010, with total peak-to-trough job losses of 10.0%, or 127,000 jobs. Consensus forecasts project job creation to begin picking up in late 2010 into 2011, with recovery to pre-recession employment levels by 2014. The Trade, Transportation & Utilities and Government sectors constitute the largest share of employment in the Inland Empire at 24.0% and 18.8%, respectively. The Professional & Business Services sector has significantly increased its share of employment over the last 20 years, rising from 8.3% percent of all jobs in 1990 to 11.2% today.

Home Sales

Recent quarter data indicates demand may be returning to more normalized levels across the region with reduced rates of deterioration in both the new and resale home sectors. While new home sales continue to decline – last twelve month sales decreased on a year-over-year basis from approximately 7,250 sales to 5,600 (22.4%) – the rate of decline is lower than second quarter results, and third quarter sales grew 4.4% over second quarter performance.

Resale activity has continued to strengthen throughout the middle of 2009 as buyers are enticed by values inherent in distressed properties and government incentives. Although third quarter resale volume was down 2.9% from the second quarter, total resales actually increased 15.0% over the same quarter last year (from approximately 17,400 sales in 3Q 2008 to 20,050 in 3Q 2009).

At the submarket level, resale trends are generally consistent with metro data – volumes down on a quarter-over-quarter basis, but up on a year-over-year basis in most areas. New home data, however, demonstrates submarket variability, particularly on a quarter-over-quarter basis. Figure B highlights home sales data by submarket.

Figure B: Home Sale Volume Change

Market	Resale				New			
	Q/Q Change		Y/Y Change		Q/Q Change		Y/Y Change	
	Q2 '09	Q3 '09	Q2 '09	Q3 '09	Q2 '09	Q3 '09	Q2 '09	Q3 '09
Southwest Riverside	15.4%	2.2%	17.2%	-4.3%	32.8%	-9.7%	-7.3%	-29.3%
Northwest Riverside	14.8%	-4.7%	42.5%	0.2%	48.6%	-7.2%	-25.1%	-24.0%
West San Bernardino	24.9%	-0.1%	76.7%	22.5%	-0.9%	36.2%	-39.3%	3.6%
I-10 Corridor	14.5%	-0.4%	84.6%	20.8%	40.2%	18.4%	-35.4%	-31.5%
Central Riverside	26.6%	-10.2%	76.9%	14.2%	53.4%	-19.3%	-35.6%	-25.0%
Victor Valley	32.1%	-4.0%	106.8%	54.1%	53.8%	10.6%	-61.4%	-42.1%
I.E. Wtd Average (1)	20.9%	-2.9%	65.0%	15.0%	35.7%	4.4%	-31.8%	-22.4%
I.E. Straight Average	21.4%	-2.9%	67.5%	17.9%	38.0%	4.8%	-34.0%	-24.7%

(1) Weighted by last twelve months home sales

Source: DataQuick; Hanley Wood; The Concord Group

Interestingly, regional submarket performance is somewhat inconsistent with trends reported in most markets throughout the nation, as the outlying areas that drove home sales volume during the boom (i.e. Victor Valley, I-10 Corridor, etc.) are outperforming the more “close-in” locations (i.e. Southwest and Northwest Riverside), particularly on a resale basis. However, given the high level of distressed properties in the outlying submarkets, much of the dramatic increase in resale volume is attributable to the significant impact of foreclosure sales. On a new home basis, year-over-year sales in the second quarter were much stronger in the “close-in” locations than other areas, and although this trend deviated somewhat in the third quarter, the inner areas more proximate to employment centers with balanced supply/demand metrics boast the most positive outlook.

Prices

TCG analysis shows new home prices depreciated year-over-year at a rate of 13% with 3% of this decline occurring during 3Q 2009. Results from this recent quarter illustrate slowing new home price depreciation. The 13% annual decline is generally in-line with other major markets across the U.S. through middle 2009. A potential risk factor remains the large supply of newly built (since 2002) foreclosures that compete with new construction and bring downward pressure on apartment rents and values. As a result, Inland Empire new home prices are expected to fare slightly worse peak-to-trough than other Western markets such as the Bay Area, Orange County, Seattle and San Diego.

Land Market

Builder demand for finished lots has increased significantly over the past quarter in prime locations such as the Southwest and Northwest Riverside submarkets. Public builders with substantial capital are targeting properties consisting of 25 to 75 finished lots, planning for home closings in 2010 while limiting their risk exposure. With builders underwriting to smaller net margins (sub-8% in many cases) and projecting some price appreciation, buyers are targeting finished lot-to-home price ratios as high as 40% in the most attractive locations (i.e. Corona, Eastvale, Temecula, etc.). In areas such as Central Riverside and the I-10 Corridor, rolling option take-down schedules are being negotiated with conservative assumptions and minimal down payments, and finished lot-to-home ratios in these secondary locations typically range from 15% to 20%. Given the abundance of currently available inventory – nearly 35,000 units total in actively selling and stalled communities, competitive foreclosures built since 2002 and finished lots – today’s market for paper lots is minimal. Recently though, private capital groups have begun to evaluate paper lot positions in the “A” locations within the western Inland Empire submarkets.

Market Recovery

TCG defines market recovery as three to four new home sales per month per subdivision, with low single-digit home price appreciation. TCG projects an overall Inland Empire housing market recovery by 3Q 2012. New housing demand functions as the lever to the recovery and, positive for future market health, regional underlying long-term demographic demand fundamentals for new for-sale housing are strong. Critically, however, economic struggles, poor consumer sentiment and the high level of foreclosures will prevent demand from reaching intrinsic growth levels until 2011. In the interim, some velocity increase is expected in late 2010 assuming employment projection accuracy and credit market relief.

Demand for new finished lots is projected to precede housing recovery by 12 months (3Q 2011). As such, re-entitlement and repositioning strategies will need to commence an additional 12 months prior to lot recovery (3Q 2010) in order to prepare for lot deliveries in 2011 and home sales in 2012. When assessing paper lot acquisitions and/or asset management strategies, rezoning or re-entitlement options should be carefully considered. Based on TCG'S experience, reducing density, infrastructure costs (on and off-site) and/or home sizes (and therefore nominal cost and sales price) are key strategies to target buyer preferences and to maximize absorption potential in today's market.

Given the variety of economic and supply/demand conditions found throughout the region, TCG projections vary by submarket. The table below provides submarket-specific commentary and projected recovery timing.

Submarket	Comments	Market Recovery Timing		
		New Homes	Finished Lots	Re-entitle/Reposition
Southwest Riverside	<ul style="list-style-type: none"> Manageable oversupply issues Strong demographic profile Access to SD, Riverside and OC employment 	4Q 2011	4Q 2010	Immediate
Northwest Riverside	<ul style="list-style-type: none"> Riverside/Corona are primary regional economic engines Sell-out of active projects imminent Significant public builder interest for finished lots 	1Q 2012	1Q 2011	Immediate
West San Bernardino	<ul style="list-style-type: none"> Desirable location Proximity to major transportation corridors Ontario employment center Upscale community amenities 	2Q 2012	2Q 2011	2Q 2010
I-10 Corridor	<ul style="list-style-type: none"> Significant supply concerns with active and planned residential developments 	1Q 2013	1Q 2012	1Q 2011
Central Riverside	<ul style="list-style-type: none"> "Edge" location with limited employment and community amenities 	2Q 2013	2Q 2012	2Q 2011
Victor Valley	<ul style="list-style-type: none"> Bogged down by oversupply High level of distressed properties Removed from major employment centers 	2Q 2013	2Q 2012	2Q 2011

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 professional consulting staff completes hundreds of 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, builder 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.

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