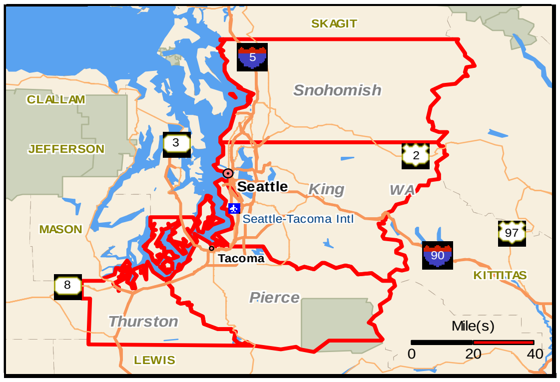
Puget Sound Housing Market Outlook 2010

December 2009

THE CONCORD GROUP

The following outlines The Concord Group's ("TCG") outlook on the Puget Sound housing market for 2010. TCG's conclusions draw from demographic and employment driven demand assessments and various tools for evaluating supply levels and absorption velocity. The outlook covers the four Puget Sound area counties capturing the majority of new housing activity: King, Snohomish, Pierce and Thurston. 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, capital sources and public agencies.



Executive Summary

The following summarizes TCG's key conclusions regarding the housing market outlook for the Puget Sound:

- Current employment of 1.8 million, peak-to-trough projected loss of 3.5% (65,000 jobs), return to growth in 2011 adding 35,000 jobs per year
- New home sales volume down 24% year-over-year, but last six months flat suggesting stabilization
- Same product new home prices down 13% year-over-year, 4% of this decline last quarter (3Q09)
- Finished lot to home price ratios range from 25% to 30% ($105-135K+/lot) in prime locations (Eastside) to 15% to 20% ($40-60K/lot) in outlying secondary markets (Pierce, Thurston), representing declines of 50% or more versus peak values
- TCG projects housing market recovery, defined as sustainable homes sales levels per project and low single-digit home price appreciation, in 1Q 2012 with demand for new finished lots in 1Q 2011(12 months prior) and immediate re-entitlement and repositioning opportunities in 1Q 2010

Economic / Demographic Drivers

The Puget Sound is home to 3.6 million people in 1.4 million households. This base is expected to grow by over 18,000 households annually (1.3%/year) over the next five years. On a nominal basis, King County is projected to contribute nearly 43% of this annual growth (7,800 households, or 1.0% annually), but Snohomish, Pierce and Thurston Counties will continue to capture more than their fair share with annual growth rates from 1.5% to 1.8%. The median household income in the region is above the national average at $64,000, with King and Snohomish County incomes approximately $66,000 and Pierce and Thurston Counties approximately $58,000.

The region is known for its concentration of high-tech and aerospace jobs and is home to eight Fortune 500 companies including Costco, Microsoft, Amazon.com, Paccar, Weyerhaeuser, Starbucks, Nordstrom and Expeditors International. While these companies continue to drive the regional economy, the current recession has led to contractions. The Boeing Company, which moved their corporate headquarters from Seattle to Chicago in 2001, continues to employ over 70,000 people locally. However, they recently announced that they would be locating a new 3,800-person plant in South Carolina rather than Washington to supplement their 787 production due to substantial financial incentives and non-unionized labor.

Microsoft, for the first time in company history, made substantial layoffs of nearly 6,000 employees this year of from their workforce of 91,000 total. But with cash reserves of nearly $50 billion, the recent successful launch of Windows 7 and an immediate push to begin development of Windows 8, Microsoft will continue to be an economic boon for the region.

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The Puget Sound has a current employment base of 1.8 million. The total projected peak-to-trough job loss for the region is around 3.5%, or 65,000 jobs (see Figure A). King County, home to the City of Seattle and Eastside employment nodes, is the economic engine of the region accounting for 65% of total jobs and 77% of the projected total job loss this cycle. By contrast, Thurston County is home to the state capital (Olympia) and has a current employment base of around 100,000 but is only projecting a 1.1% loss (1,100 jobs) due to its government concentration. Employment growth is projected to return to the region in 2011 adding approximately 35,000 jobs per year through 2014, thereby returning to peak employment by year end 2012.

Figure A: Employment Trends (000)

				Peak-Trough Loss	
County	**2000**	**2008**	**2009**	**%**	**Nominal**
Snohomish	214	260	251	-3.5%	(9)
King	1,189	1,217	1,169	-3.9%	(48)
Pierce	244	281	274	-2.5%	(7)
Thurston	85	103	102	-1.0%	(1)
Puget Sound	**1,732**	**1,861**	**1,796**	**-3.5%**	**(65)**

Source: Global Insight

Home Sales

Recent quarter data suggests volume declines are nearing bottom in the Puget Sound with significantly reduced rates of deterioration in both the new and resale home sectors. While annual (4Q08-3Q09) new home sales volume is down nearly 25% year-over-year (YOY), nearly all of this decline was in the first half of the year (down 42%) with the second half of the year showing stabilization (down 2%).

Resale activity mimics this trend with a 30% YOY decline, but a single-digit volume contraction in the most recent quarter. Resale activity is anticipated to be boosted in the near-term by values inherent in distressed properties and government incentives, a trend that has been realized in various markets nationally that were quicker to fall into recession. The trend is beginning to come to fruition as sales of foreclosed homes accounted for 25% of total resale volume in 2009 versus less than 2% in 2007.

At the submarket level, resale trends are consistent with metro data – volumes down around 30% YOY with the first half of the year bearing the brunt of the drop. New home data, however, demonstrates submarket variability. Figure B highlights YOY, first half (1H: 4Q08-1Q09 versus 4Q07-1Q08) and second half (2H: 2Q09-3Q09 versus 2Q08-3Q08) data.

Figure B: New Home Sales Volume Change

	4Q08-3Q09	New Home Sales - YOY Change		
County	**New Sales**	**Annual**	**1H**	**2H**
Snohomish	2,084	-10%	-36%	21%
King	3,061	-30%	-44%	-13%
Pierce	1,255	-28%	-48%	0%
Thurston	806	-22%	-34%	-8%
Puget Sound	**7,206**	**-24%**	**-42%**	**-2%**

Source: Hanley-Wood

Overall, regional submarket performance is consistent with trends reported in most markets throughout the nation: the outlying areas that drove new home sales volumes during the boom (e.g., suburban Pierce County) continue to show signs of weakness while inner areas proximate to employment centers with balanced supply/demand metrics boast the most positive outlook (e.g., Eastside, western Snohomish County).

Prices

TCG analysis shows new home prices depreciated YOY at a rate of 13% with 4% of this decline occurring during 3Q 2009. The price decline is captured as a "same product" metric, which adjusts for product and location based on our ongoing direct field research on actively selling new home communities. Results from this recent quarter illustrate new home price depreciation lagging volume declines, with a bottoming out expected in the near term as volumes stabilize. A potential risk factor remains the oversupply of condominiums and the resulting downward pressure on apartment rents and values. Declining rents may cause a further drag on home prices as ownership affordability is undermined by increasingly attractive rents.

The 13% annual decline is on par with other major markets across the U.S. through mid-2009. On a regional level, Puget Sound prices are expected to hold up better peak-to-trough than other Western markets such as Las Vegas, Phoenix, Sacramento and the Inland Empire given a more modest run-up to peak values and stronger economic fundamentals.

Land Market

Significant oversupply issues, severely diminished demand and eroding home prices have had an amplified effect on the Puget Sound land market. Very few, if any, land buyers targeting large-scale acquisitions remain active. Large public home builders are taking down finished lots in limited quantities, generally no more than 10 to 20 at a time. In some instances, rolling option take-down schedules are being negotiated with conservative assumptions and minimal down payments. Buyers are targeting finished lot-to-home price ratios ranging from 25% to 30% in the most attractive locations (e.g., prime Eastside) to 15% to 20% in outlying secondary markets (e.g., Snohomish, Pierce, Thurston). Figure C illustrates these ranges and the implied lot values based on average new home prices. Buyers also suggest a bulk discount of 20% to 40% to these values would be necessary to entice interest on larger transactions (greater than 12-18 month selling period) to further hedge absorption risk. These ratios represent declines of 50% or more versus peak values. Given the abundance of currently available inventory – nearly 25,000 units total in actively selling 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 Snohomish and King Counties.

Figure C: Finished Lot Values (000)

County	New Home Price	Finished Lot Ratio		Finished Lot Value	
Snohomish	$336	18% -	24%	$60 -	$81
King	$443	24% -	30%	$106 -	$133
Pierce	$295	15% -	20%	$44 -	$59
Thurston	$274	15% -	20%	$41 -	$55
Puget Sound	**$369**	**18% -**	**25%**	**$66 -**	**$92**

Source: The Concord Group market surveys

Market Recovery

TCG defines market recovery as three to four sales per month per subdivision (i.e., sustainable sales rates) with low single-digit new home price appreciation. TCG projects an overall Puget Sound housing market recovery by 1Q 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 and poor consumer sentiment will prevent demand from reaching intrinsic growth levels until 2011. In the interim, some velocity increase is expected in 2010 assuming employment projection accuracy and credit market relief.

Demand for new finished lots is projected to precede housing recovery by 12 months (1Q 2011). As such, re-entitlement and repositioning strategies will need to commence an additional 12 months prior to lot recovery (1Q 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 across the region, TCG projections vary by county. The table below provides county-specific commentary and projected recovery timing.

County	Comments	Market Recovery Timing: New Homes	Market Recovery Timing: Finished Lots	Market Recovery Timing: Re-Entitle/ Reposition
Snohomish	• Manageable oversupply issues and strong new home buyer demographic profile (high growth, high income)	4Q 2011	4Q 2010	4Q 2009
King	• Economic engine of the region • Bogged down by oversupply and distress in "edge" communities and downtown Seattle condominiums • Established Eastside suburbs display relative stability due to strong fundamentals of employment and affluence	2Q 2012	2Q 2011	2Q 2010
Pierce	• Most significant oversupply issues • Competitive concerns given price declines in closer-in areas, likely to induce further price erosion prior to volume recovery	2Q 2012	2Q 2011	2Q 2010
Thurston	• Limited market depth with minimal volume • Oversupply issues likely to linger until market works through excess supply	2Q 2012	2Q 2011	2Q 2010

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 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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