Inland Empire Housing Market Outlook

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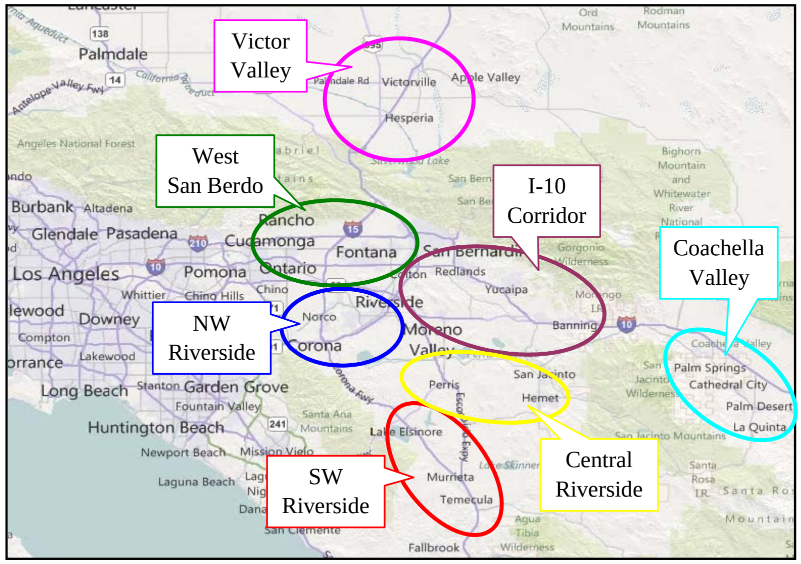
THE CONCORD GROUP

The following outlines The Concord Group's ("TCG") outlook on the Inland Empire housing market. 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 seven Inland Empire submarkets that capture the majority of new housing activity: Southwest Riverside, Northwest Riverside, Central Riverside, West San Bernardino, the I-10 Corridor, Victor Valley and Coachella Valley. 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.

Figure A: Submarket Map



Executive Summary

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

- Current employment of 1.04 million ("MM"), peak-to-current loss of 13.2% (167,000 jobs).
- Employment losses slowing, following peak quarterly loss of 24,000 jobs in 2Q09 to 9,000 in 2Q10. Consensus forecasts project moderate growth in 2011, with more robust generation of 30,000 jobs in 2012 and beyond.
- Annualized new closing volume bottomed in 1Q10 before generating a small 1% gain in 2Q10, aided by the federal and state stimulus. Same quarter volume was up 5% (2Q10 vs. 2Q09).
- Following seven consecutive quarters of resale gains (aided by significant volume of distressed sales), annualized volume has leveled, stabilizing at year 2003 vintage.
- New home prices are up 3% year-over-year, with no change over the past quarter.
- Finished lot-to-home price ratios up to 40% in prime locations (Corona, Eastvale, Temecula) as public builders bid up prices in 2Q10; 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 4Q12 with demand for new finished lots 12 months prior (4Q11); 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 commute time and lack of cultural / recreational amenities.

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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.

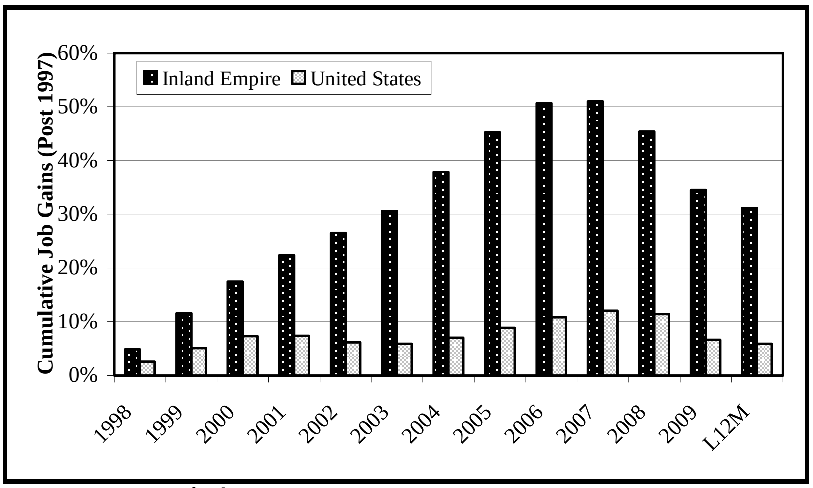
Professional employment began to transition to the Inland Empire shortly after blue collar labor, bringing with it a demand for upscale housing, services and amenities. As commuting was increasingly less viable, professional service and business firms began to migrate east as well, seeking to preserve 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

Following a 10-year period between 1997 and 2007 in which the Inland Empire gained an average of 43,000 jobs annually (4.2% per year), the region has since shed 13% of its base compared, more than twice the level of U.S. decline (6%). Especially hard hit are the Construction and Manufacturing industries, accounting for 36% and 22% of net job losses, respectively. Despite the recent losses, the Inland Empire continues to outperform the nation long-term, with post 1997 employment gains that are five times the US average (Figure B). Moving forward, employment stabilization is projected in 2011, to be followed by more robust job growth of 30,000 per year in 2012 and beyond.

Figure B: Cumulative Percentage Job Gain (1997+)



Source: US Bureau of Labor Statistics

Figure C: Submarket Capture of Households & Closings

Submarket	Households 2010	Households Growth '10-'15	New Home Closings 2005	New Home Closings L4Q
Northwest Riverside	16%	16%	13%	17%
Coachella Valley	12%	16%	15%	12%
I-10 Corridor	19%	15%	12%	14%
West San Bernardino	21%	14%	10%	18%
Central Riverside	10%	13%	18%	16%
Southwest Riverside	8%	12%	17%	14%
Victor Valley	9%	10%	12%	8%
Other	5%	4%	2%	1%

Source: Claritas; DataQuick

The Inland Empire is home to approximately 4.25 million people in 1.31 million households. This base is expected to grow by nearly 30,000 households annually (2.2%/year) over the next five years. Future growth is projected to be evenly distributed across the Inland Empire submarkets, ranging from a 10% to 16% market share for the Victor Valley and Northwest Riverside, respectively.

The most affluent submarkets are employment driven, possessing an established job core while also benefiting from close proximity to LA, Orange County and San Diego office nodes. Southwest Riverside, West San Bernardino and Northwest Riverside garner median incomes above the regional average, while the exurban, bedroom communities of I-10 Corridor, Victor Valley and Central Riverside fall below the median.

Home Sales

New home closings picked up in the second quarter, buoyed by the federal and state stimulus as well as the seasonal peak spring/summer homebuying period. Year over year volume change was positive, up 5% from 2Q09 levels. Annualized new home volumes picked up in 2Q10 vs. 1Q10 as well, ending a 13 quarter continuous decline, rising 1% to a level of 7,500. Nevertheless, current new home closing volumes remain nearly 80% below peak 2005 levels and 70% below more stabilized 2002/2003 levels.

Figure D: New & Resale Closings

	New Home Closings (A)			2Q10			
	2005 to Trough		Trough to	New Home Closings (Q)		Resale Closings (Q)	
Submarket	**% Chg.**	**Trough**	**Current**	**Y/Y Chg.**	**Q/Q Chg.**	**Y/Y Chg.**	**Q/Q Chg.**
Inland Empire	**-79%**	**1Q10**	**1%**	**5%**	**43%**	**-8%**	**20%**
West San Bernardino	-57%	2Q09	22%	53%	46%	-11%	20%
Northwest Riverside	-66%	1Q10	7%	26%	107%	-8%	22%
I-10 Corridor	-67%	1Q10	0%	1%	88%	-15%	16%
Central Riverside	-76%	3Q09	4%	-3%	21%	-20%	15%
Southwest Riverside	-77%	1Q10	0%	0%	70%	-1%	21%
Coachella Valley	-78%	2Q10	0%	-14%	8%	10%	25%
Victor Valley	-81%	2Q10	0%	-28%	7%	-19%	23%
Other	-88%	2Q10	0%	-50%	-44%	10%	23%

Source: DataQuick

At the submarket level, early signs of recovery are most evident in the close-in job focused markets of West San Bernardino and Northwest Riverside, each of which has generated positive volume gains since late 2009 / early 2010 (up 22% and 7%, respectively). The worst performers continue to be the exurb submarkets such as the Coachella and Victor Valleys, each of which has suffered through a volume loss of 80%+ from peak and continue to see declining activity.

Figure E: Foreclosure Activities

	Foreclosure Activities	
Submarket	**Quarter Change**	**Num. per Household**
Inland Empire	**-6%**	**102**
West San Bernardino	-14%	115
Northwest Riverside	0%	114
I-10 Corridor	-3%	110
Coachella Valley	-5%	103
Southwest Riverside	-4%	92
Central Riverside	1%	84
Other	-8%	81
Victor Valley	-12%	75

Source: RealtyTrac; Claritas

Following seven consecutive quarters of growth in annualized resale activity, buoyed by high levels of distressed inventory, sales volume leveled off the past two quarters, down 4% vs. 4Q09. The current annualized pace of 76,000 closings is on par with year 2003 levels.

Foreclosure activity continues to place downward pressure on the new home market. While foreclosures are down 6% quarter to quarter (August vs. May 2010), just under one in every 100 households received a notice of default or foreclosure filing in the month of August. Foreclosure activity is most evident in Central Riverside and the Victor Valley, each with one foreclosure activity per every 84 and 75 households, respectively, in August 2010.

New Home Prices

Following 11 consecutive quarters of new home price decline, during which the median fell 37%, prices have rebounded over the last several quarters, up 6% since 3Q09. However, the majority of price increase was generated in 1Q10, with prices holding steady in the most recent quarter. 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 price recovery is projected to lag behind 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 2011 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 – the current pressure to acquire 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. Notable public builder transactions are also underway for developments consisting of both finished and paper (mapped) lots requiring further entitlements.

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 4Q 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, a dampened economic outlook for 2011, poor consumer sentiment and the high level of foreclosures will prevent demand from reaching intrinsic growth levels until 2012. In the interim, current moderated levels of velocity are projected to be maintained over the next six to nine months, followed by an increase in Spring 2011, assuming employment projection accuracy and credit market relief.

Figure F: Unsold Inventory

Submarket	Years of Inventory (Run-Rate) L4Q	Years of Inventory (Run-Rate) '02-'03
Inland Empire	**4.7**	**1.3**
West San Bernardino	1.6	0.6
Southwest Riverside	2.5	0.5
Northwest Riverside	2.7	0.8
Other	4.3	1.6
I-10 Corridor	4.9	1.6
Central Riverside	7.1	3.1
Victor Valley	10.6	4.3
Coachella Valley	12.1	3.2

Source: TCG; HanleyWood; DataQuick

Demand for new finished lots is projected to precede housing recovery by 12 months (4Q11). As such, re-entitlement and repositioning strategies will need to commence an additional 12 to 24 months prior to lot recovery ("immediately" in select submarkets) in order to prepare for lot deliveries in late 2011 and home sales in late 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.

Figure G: Submarket Recovery

Submarket	Comments	Market Recovery Timing: New Homes	Market Recovery Timing: Finished Lots	Market Recovery Timing: Re-Entitle/ Reposition
Inland Empire		**4Q12**	**4Q11**	**Immediate**
Out-Performers				
West San Bernardino	• Increasing sales activity • Submarket with greatest supply constraints • Proximity to major transportation corridors • Employment center of San Bernardino County	1Q12	1Q11	Immediate
Southwest Riverside	• Access to three employment centers - Riverside, SD and OC • Relative affluent demographic profile • Manageable over-supply	1Q12	1Q11	Immediate
Northwest Riverside	• Increasing sales activity • Employment center of Riverside County • Sell-out of active projects imminent (35% of inventory in stalled projects)	2Q12	2Q11	Immediate
Under-Performers				
I-10 Corridor	• Access to I-10 and Hwy. 60 convenient for commute to Ontario/Riverside emp. • Significant over-supply, but only moderate foreclosure activity (in line w/ IE)	1Q13	1Q12	1Q11
Central Riverside	• Affordability driven market - lowest median income in IE • Exurb with no growth constraints • Bounded by more desirable suburbs to the north (NW Riv) and south (SW Riv)	3Q13	3Q12	3Q11
Victor Valley	• Highest rate of foreclosure activity • Significant over-supply concerns combined with largest drop in sales activity	1Q14	1Q13	1Q12
Coachella Valley	• Significant inventory concerns • Depressed recreation / second home market	2Q15	2Q14	2Q13

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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