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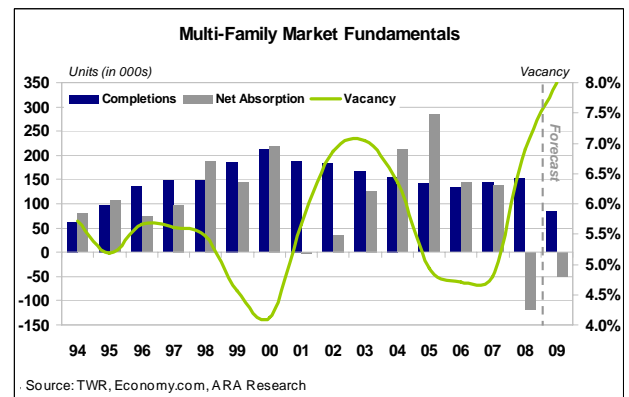
The Multi-Family Property Sector

January 2009

This month, we provide an overall picture of the multi-family sector, as well as contrast markets that have strong fundamentals for rental properties with other weaker markets. Finally, we will examine how capital market trends affect potential multi-family investment opportunities in 2009.

Multi-Family Demand Market Overview

The multi-family sector has historically experienced lower vacancy rates than other property sectors, with rates averaging 5.1% since 1994 vs. 9.0% for industrial and just over 12% for office and retail over the same period. Despite this track record, the multi-family sector recorded its worst annual performance in 2008, with vacancy up 2.1% in the past year to 6.9% and demand 1.1% lower, its largest ever decline on record.



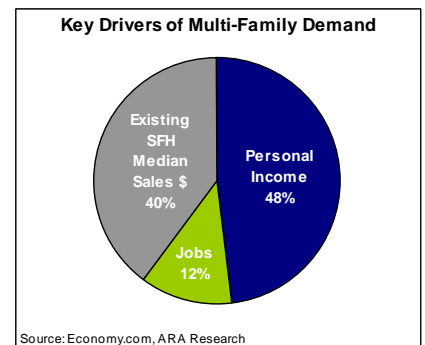
Multi-Family Demand

The near-term demand for multi-family properties is driven primarily by three main factors including:

- changes in total personal income;
- changes in the median sales price of existing single family-homes; and
- changes in employment levels.

All of these factors are positively correlated with multi-family demand, meaning that when any of these factors rise, the demand for rental multi-family housing also tends to increase. The opposite is also true – when any of these fall, demand falls as well.

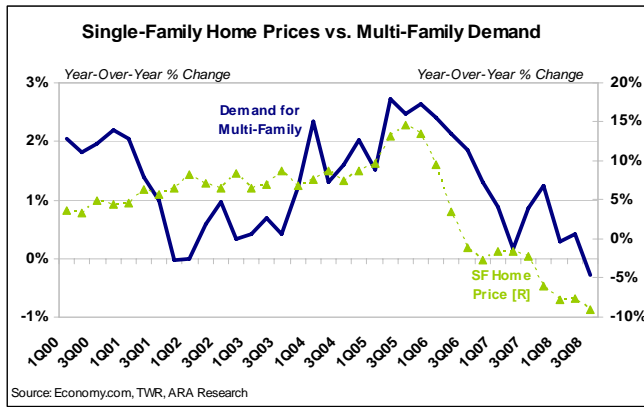
For example, in 2005 when housing prices, personal incomes and employment were increasing, demand for rental multi-family housing grew by 2.7%, more than double its long-term average of 1.2%. However, once home prices started to fall, the demand for apartments followed suit. In this case, falling home prices indicated weakness in the economy and resulted in increased



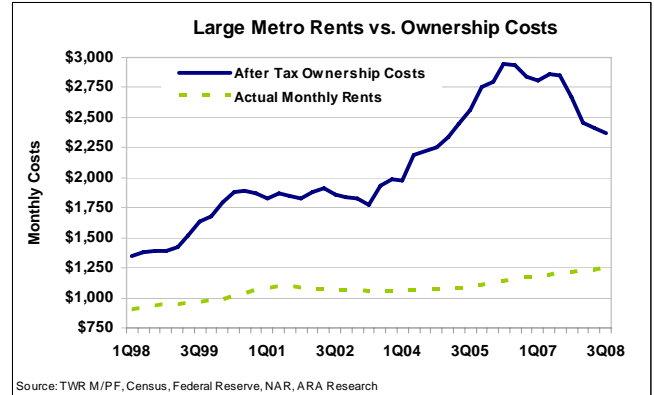
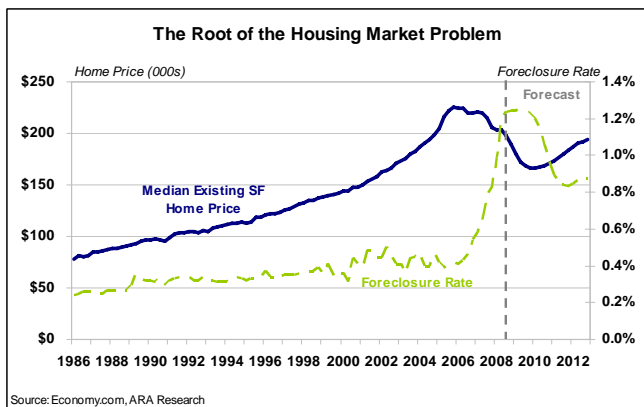
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competition from single-family homes and condominiums, which were added to the rental market. The net result was that this “shadow” supply of rental homes took away some individuals who might otherwise have rented an institutional-quality apartment. Therefore, while the rise in foreclosures and tightening loan underwriting standards have contributed to a 1% rise in the propensity to rent, increased competition from non-institutional quality rental properties and other demand losses, such as doubling up, have more than offset this gain, resulting in falling demand.



Ultimately, multi-family housing has to be competitive with all other types of housing, including home ownership. While generally the difference in the after-tax cost of owning vs. renting is fairly stable at approximately 100% to 120% of renting costs, this ratio peaked at 154% of rental costs in 2005. This relatively large gap between ownership and renting costs contributed to high rates of multi-family net absorption. However, now with home prices down and rents up, we have seen a downward adjustment in the ratio reverting back to a more “normal” 117% of renting costs. Due to this adjustment in relative pricing, investors are likely to see renters with an increasing ability to leave rental housing for home ownership, especially in markets where the difference in costs between the two is minimal.

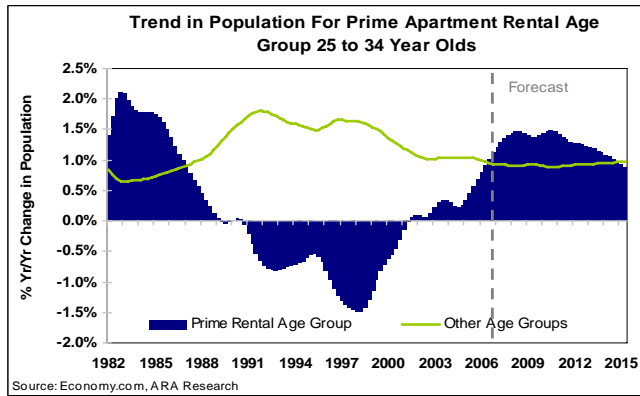


After Tax Ratio of Home Ownership vs. Renting Costs			
MSA	After Tax Ratio	MSA	After Tax Ratio
San Jose	186	Chicago	115
Oakland	181	Fort Lauderdale	115
Northern NJ	160	Phoenix	113
San Francisco	151	Dallas	107
Seattle	146	Boston	107
Orange County	144	Denver	106
Portland	141	Los Angeles	105
San Diego	129	Riverside	105
West Palm Beach	128	Houston	104
Miami	120	Long Island	102
Washington DC	119	Minneapolis	95
Austin	116	Nashville	94
		Atlanta	84

Source: Economy.com, NAR, ARA Research
After Tax Ratio is the after tax cost of homeownership/cost of renting.

Multi-Family Demographics

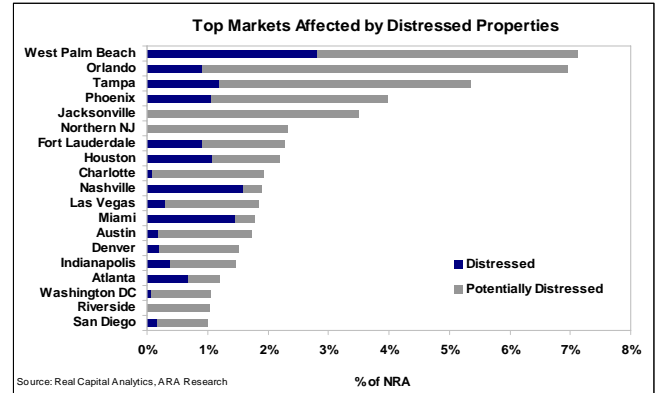
On a long-term basis, multi-family demand is a function of demographics and this trend has been favorable due to the emergence of the “echo-boom” generation (children of baby-boomers). An analysis of demographic trends shows that, while the prime rental age group of those 25 to 34 years old declined for most of the 1990’s, this age group is poised to experience a strong 1.3% annual rate of growth through 2015. The echo-boom generation, driving record college demand now, is staged to drive strong growth in the demand for rental apartments. Growth in this age segment is expected to be 40% higher than the general population, and, given that this population segment already has driven increased demand for high-end student housing, we expect this trend to transfer eventually to the demand for multi-family housing as well.



Multi-Family Supply

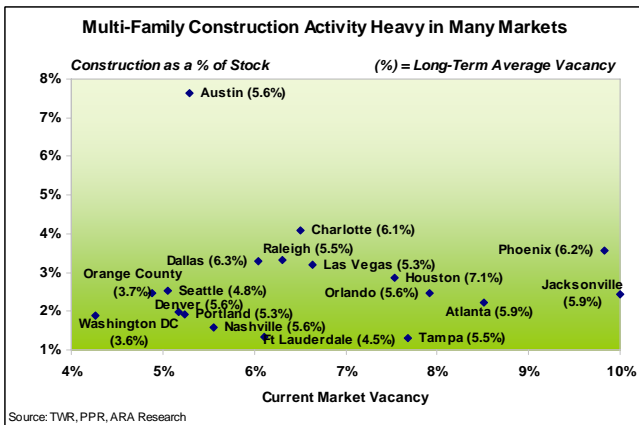
Unlike the volatile cycle of other property sectors, the construction of rental multi-family units has been fairly steady, averaging more than 37,000 new apartment deliveries each quarter since 1994, including 41,000 units in the third quarter of 2008. The lower level of construction volatility can be accounted for by the stability of demographic trends that drive demand. Additionally, as rental rates for apartments have generally been at levels needed to support new construction, there are rarely periods of slow activity, as is typical for the other property sectors.

average growth. In contrast, markets that have been deeply affected by turmoil in the housing sector, such as Phoenix and Jacksonville, have sizeable amounts of construction activity underway. This will put investors at a higher risk than in markets such as Washington DC or Denver that have significantly lower levels of new construction.



Target Market Strategy

Taking into account the supply and demand factors previously mentioned, American has identified markets with strong fundamentals for potential investments in multi-family properties. On the demand side, we focus on home prices, the gap between owning a home and renting an apartment, personal income growth and job growth. On the supply-side, we look at vacancy, construction activity and the amount of units currently or potentially in distress. Of the 39 markets included in this analysis, those at the top of the list for the most part have stronger supply fundamentals such as lower vacancy rates and/or lower levels of construction. For example, in Baltimore, the demand fundamentals are slightly stronger than average while its supply fundamentals are among the most favorable. In contrast, Phoenix, Southern California, Las Vegas and South Florida are all ranked as below average performers. These metros have been severely impacted by the housing collapse in terms of falling home prices and lost jobs, and therefore have much weaker demand drivers. Despite its heavy levels of construction, Austin appears toward the top of the list as it has the strongest demand fundamentals — home prices have barely moved from peak levels, home ownership is expensive relative to the cost of renting, and the forecasts for growth in personal income and employment exceed those of other markets.



Analysis of the multi-family supply pipeline in 2008 shows 210,000 units under construction, representing 1.5% of the existing inventory, slightly exceeding the historical average of 1.3%. The level varies by market: for example, Austin's current construction activity represents more than 7.6% of its existing inventory and is the highest level among all of the metros. However, Austin's current vacancy of 5.3% is slightly below its long-term average of 5.6%, indicating that this market is in a better position to absorb the new deliveries than others, especially given its history of above-

In addition to metro-level target market analysis, at the property level, highly-desired locations near major

employment centers are desirable. Studies have shown that while homeowners are willing to travel great distances to work, renters, in contrast, are not so inclined. Additionally, markets with good schools, above average home values and low crime rates are the most in-demand, as our studies have shown a strong housing market is needed to support a strong rental apartment market. Finally, Class A product is optimal, as these properties tend to have higher occupancy rates and less market risk in slow economic times.

Capital Markets

No analysis of the multi-family sector would be complete without considering the capital markets. In general, multi-family has been a favored market segment relative to other property types, with the current 6.5% average cap rate well below that of other property types, now averaging 7.3% on new offerings. Additionally, the sector has benefited from available debt capital via Freddie Mac and Fannie Mae,

which has helped support a slightly better sales volume, only half of 2007 volume, compared to a 72% reduction for the other major property types. However as multi-family has enjoyed these benefits, the risk to current pricing levels may be higher than other property sectors. For example, the futures market is currently showing that NCREIF Property Index returns for the multi-family sector are likely to trail other property sectors by about 1%, as investors feel the cap rate difference between multi-family and other sectors is likely to narrow. Because of this pricing risk, American has established a slight underweight position to the multi-family sector and has weighted our exposure more to the metros likely to outperform.

Capital Market Metrics		Other Property Sectors	Difference
	Multi-Family		
New Offering Cap Rate	6.5%	7.3%	-0.8%
% Yr/Yr Change in Sales	-51.0%	-72.0%	21.0%
Two Year Futures Market Return Forecast	-10.6%	-9.3%	-1.3%

Source: Real Capital Analytics, Markit, ARA Research

Conclusion

Those considering investments in the multi-family sector should understand that the near-term pricing risk in this sector may be above average. However, investors should be well rewarded in the long-run by looking for strong demand indicators such as rising housing prices and job growth, combined with controlled supply indicators as is typically displayed by below average vacancy rates, with little to no distressed property activity and minimal construction activity. Longer term demographic trends suggests that the demand for multi-family housing could grow at a rate 40% faster than the overall economy through 2015.

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