

REAL ESTATE OUTLOOK

June 2008

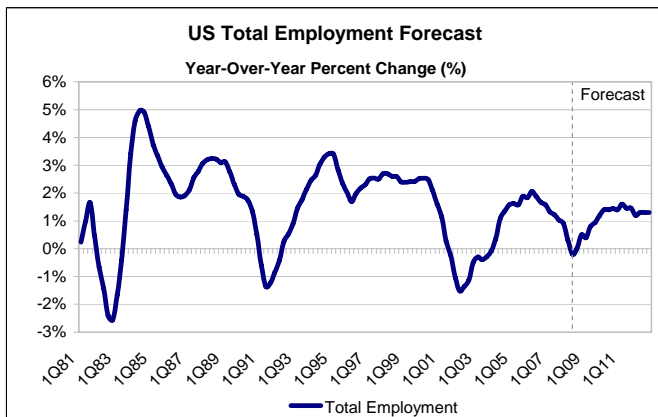
In this newsletter, and on a quarterly basis in the future, we will discuss the current outlook for the US economy, capital markets and four primary property types. In other months we will continue to cover topical items of interest to real estate investors.

US Economic Outlook

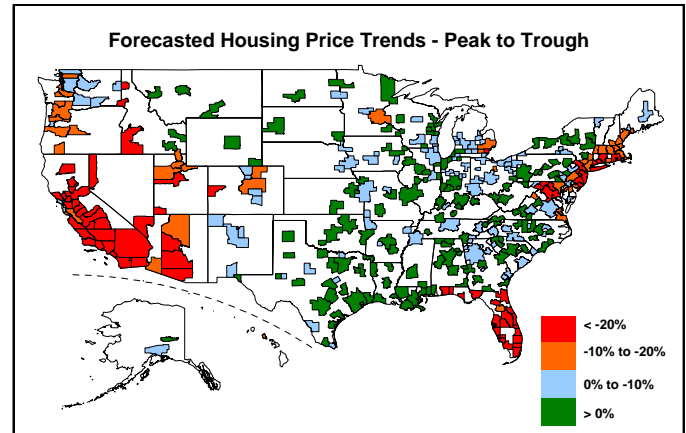
US economic growth remains weak, with the first quarter 2008 advance estimate of GDP rising only 0.6% for the second consecutive quarter. Several factors are weighing on economic growth, most notably the housing correction, the credit markets and inflation. Even though the Fed has initiated aggressive monetary and fiscal measures – cutting the federal funds rate to 2.25% and implementing a \$150 billion tax rebate stimulus plan – the US economy is expected to remain soft through much of 2009, with economic recovery occurring by 2010.

The job market reflects current economic weakness, with four consecutive months of negative employment for a total job loss of 260,000, a 0.2% decline, as of April 2008.

- Housing related segments of the economy are generally the softest, with construction job losses totaling a 6.8% loss over the past 3 months
- Job losses have expanded to non-housing related sectors of the economy, including the information, transportation and professional & business service sectors
- Solid job gains, at nearly an 8% annual rate, continue in the natural resources and mining sectors, as high commodity prices entice expansion
- Strong demographic trends support job growth in education, health services, leisure and government



Source: Economy.com, ARA Research



Source: Economy.com, ARA Research

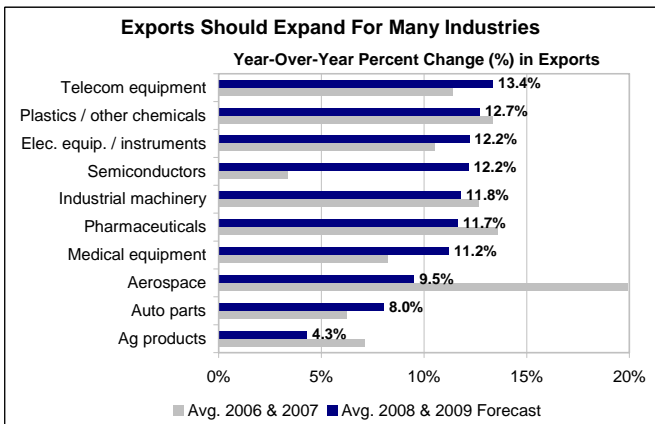
The US housing market remains on shaky ground with home sales at a standstill and foreclosures at an all-time high. According to the S&P/Case-Shiller® National Home Price Index, housing prices are down 12.7% on a year-over-year basis as of February 2008. Indicating further weakness in the market, owner occupied housing vacancy is at 2.8%, an all-time high and nearly twice the long-term average vacancy of 1.5%. Markets which experienced the greatest run up in prices – such as Florida, California and Nevada – are expected to see the largest declines in housing prices going forward. In these markets, values are forecast to decline by 30% from peak to trough.

The slowing housing market means that households are under substantial debt burdens, with household debt service accounting for over 14% of disposable income as of the fourth quarter of 2007, up from 12.3% in 2000. Household debt in delinquency or default has skyrocketed to over \$700 billion – more than double the average level seen since 2000.

Household Debt in Delinquency or Default (in Billions)						
	30 days	30-60 days	60-90 days	90-120 days	Default	Total
1Q00	\$70.9	\$21.6	\$10.2	\$23.4	\$51.5	\$177.6
1Q08	\$218.0	\$99.0	\$61.0	\$136.0	\$197.0	\$711.0

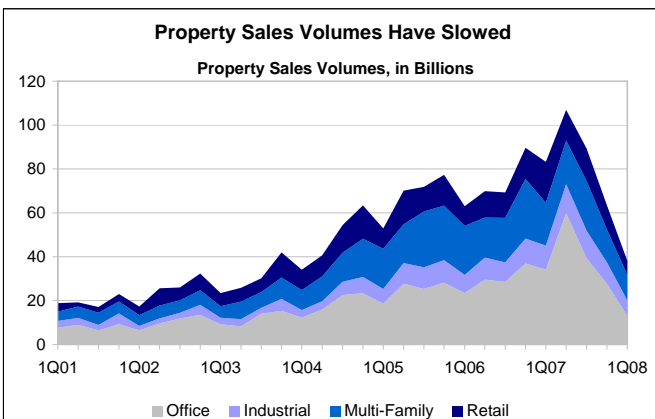
Source: Economy.com, ARA Research

In contrast, debt burdens for non-financial businesses are at all-time lows. Thanks to low interest rates, interest costs account for only 12.1% of total costs as of the fourth quarter of 2007, versus an average of over 22% since 1980. In addition, with the US Dollar at historical lows and growth in emerging economies at nearly three times the US rate, many export industries are benefiting.



Source: Economy.com, ARA Research

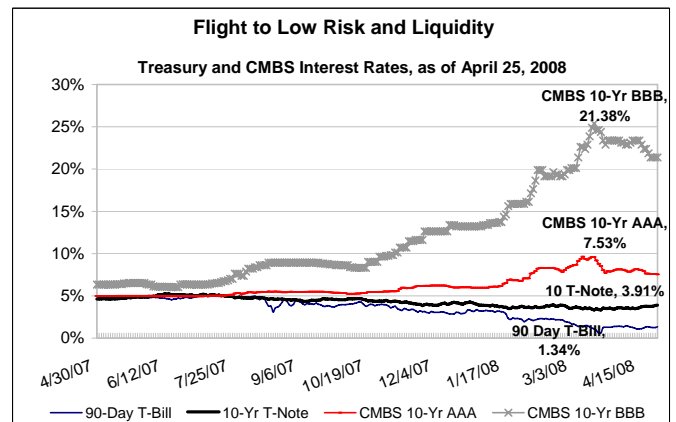
While the weak US Dollar and strong global growth benefit US export related businesses, both add to the global inflation risk by causing record high energy and food prices worldwide. Several emerging economies have high inflation, with year-over-year annual inflation as of March 2008 at: 6.7% in India, 8.3% in China and 13% in Russia, while annual inflation for the US was 4.0%, well above the US average of 3.0% since 1922. With higher inflation and the dollar at historic lows, there is a risk that foreigners may demand higher premiums to hold dollar assets.



Source: RCA, ARA Research

Real Estate Capital Markets

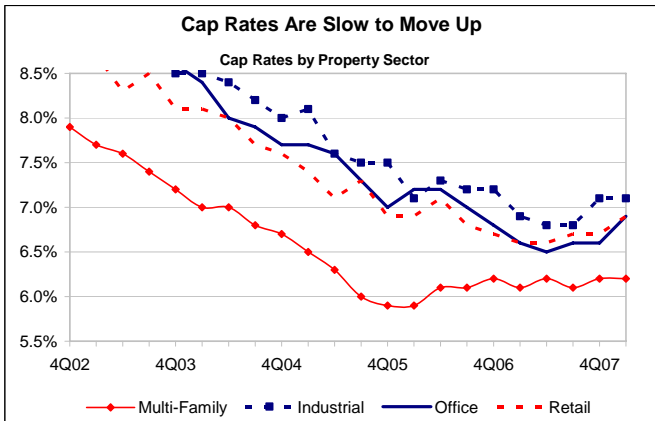
During the summer of 2007, financial markets experienced considerable turmoil due to a “credit crunch” triggered by delinquencies in the sub-prime market. Problems then spread from residential mortgages to the entire debt market, leading to a re-pricing of all forms of risk and ultimately to the collapse of investment bank Bear Stearns. With constrained capital flows to commercial real estate, year-to-date institutional real estate sales have fallen to only \$38 billion as of the first quarter of 2008 – one-third the level achieved at the peak nearly one year ago. In fact, nearly half of the commercial real estate deals brought to market have failed to close due to a mismatch in pricing expectations of buyers and sellers. In addition, public market financing has been constrained, with only \$11 billion of public equity and debt raised in the first quarter of 2008, or about one-tenth the amount raised during the market peak just a few quarters ago.



Source: Lehman, US Treasury, ARA Research

The capital markets have experienced significant volatility since July, evidenced by large swings in stock, bond and CMBS pricing levels, with a significant re-pricing of high-risk debt overall. Risk spreads relative to the 10-Year Treasury Note have increased, with the interest rate for BBB-rated (CMBS) increasing from the 6% range to over 20% as of April 2008.

With this re-pricing of risk, we expect real estate cap rates to increase. Since 2003, NCREIF reported transaction cap rates have fallen from over 8% in 2002 to a low of 5.4% in the second quarter of 2007. While cap rates have increased since then to average nearly 5.7%, this represents only a 1.9% premium over treasuries, compared to a 2.7% historical average. This suggests that cap rates could rise by an additional 0.8%, which equates to about a 10% to 15% decline in prices for commercial real estate as a whole.

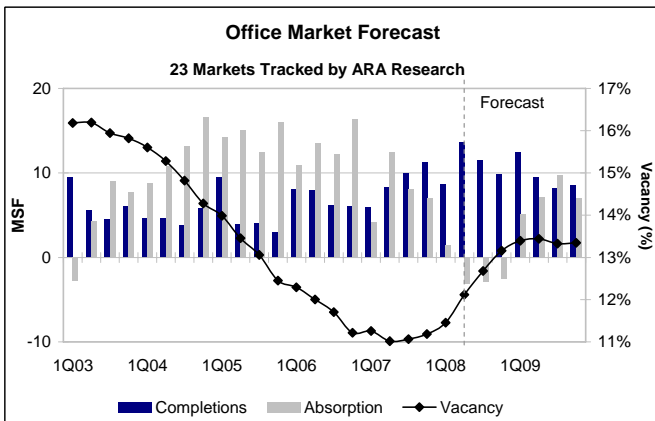


Source: RCA, ARA Research

Since the market takes time to adjust to turning points, we expect cap rates to return to more normal spreads relative to the 10-Year Treasury over the next year.

US Office Market Trends

Due to slowing demand, vacancy climbed 30 basis points to 11.5% in the first quarter of 2008 for the 23 office markets tracked by the ARA Research team. Office employment growth slowed dramatically over the last quarter and is expected to remain weak through the end of 2008. Consequently, seven million square feet (MSF) of negative net absorption is forecasted for 2008, compared to an annual average of 55 MSF over the past four years. At the same time, construction deliveries are expected to total 44 MSF for 2008 – 55% above the annual average of the last four years.



Source: TWR, ARA Research

Office Construction – Because the credit crunch occurred while vacancy was tight but before a significant wave of construction would normally begin, some projects have been halted. As a result, the office sector should be less

impacted by oversupply and should recover more quickly than in past cycles. Vacancy is expected to peak in the mid-13% range in 2009 – 250 basis points less than the previous vacancy peak in 2003 – and gradually fall to the 12% range by 2012, as construction slows and demand gradually picks up.

Office Rent – Gross rents grew 9.8% in 2007 and 0.9% during the first quarter of 2008. Due to the sluggish economy, rent growth is expected to slow dramatically, with average annual rent growth forecasted at 2% to 4% through 2012.

Office Sector Trends – Due to higher construction levels, suburban vacancy should increase more than CBD vacancy. In 2009, suburban vacancy is expected to rise 2.4% to 15.6% in 2009, while CBD vacancy is expected to rise only 1.1% to 9.7%. Consequently, CBD office markets are expected to achieve greater near-term rent growth than the suburbs.

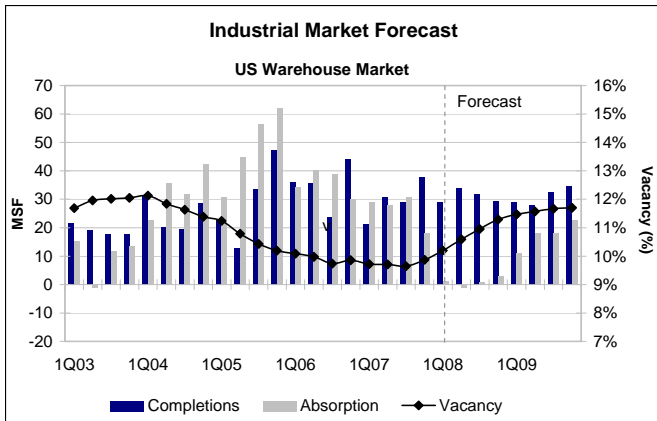
Office: Market Vacancy Forecast					
	1Q08	1Q10		1Q08	1Q10
New York	4.4%	5.3%	Portland	12.5%	13.1%
San Francisco	8.6%	9.1%	San Jose	13.5%	17.1%
Long Island	9.7%	11.3%	Fort Lauderdale	13.6%	16.8%
Seattle	9.8%	12.8%	Denver	14.8%	15.4%
Los Angeles	10.6%	12.4%	San Diego	14.9%	16.9%
Washington DC	10.6%	13.4%	Chicago	15.0%	15.4%
Boston	10.7%	12.5%	Minneapolis	15.2%	14.3%
Nashville	11.0%	17.6%	Oakland	15.5%	13.7%
Houston	11.5%	14.6%	Austin	15.8%	20.1%
Avg. of Markets	11.5%	13.1%	Orange County	16.1%	14.9%
Miami	11.7%	20.4%	Atlanta	16.5%	17.9%
Riverside	12.3%	13.8%	Northern NJ	17.2%	17.1%

Source: TWR, ARA Research

US Industrial Market Trends

Due to a dramatic slowing of demand, US industrial warehouse vacancy increased 30 basis points to 10.2% in the first quarter of 2008. Looking ahead, demand is expected to remain weak, totaling only 4 MSF of positive net absorption in 2008 before picking up to 70 MSF in 2009. At the same time, construction deliveries are expected to be heavy through 2008, with 124 MSF scheduled by the end of the year.

Industrial Construction – Because industrial warehouse space requires little time to build, construction is responsive to changes in demand, and the sector should be less impacted by oversupply during the current economic slowdown. Vacancy should remain stable, peaking near 12% in 2009 before falling to the 11% range by 2012 as demand gradually picks up.



Source: CoStar, TWR, ARA Research

Industrial Rent – Net rents were up 3.6% in 2007 and up 0.2% in the first quarter of 2008. Due to the slowing economy, rent growth should be flat in 2008 and average between 2% to 4% annual growth through 2012.

Industrial Sector Trends – Rising fuel and labor prices have caused some firms to do the following:

- Minimize truck transport by increasing rail and port transport
- Move from large consolidated distribution facilities to a greater number of smaller, regional distribution centers
- Due to congestion and high labor costs at seaports and popular coastal distribution areas, some firms have moved to inland areas of high population growth in order to reduce costs and minimize delays, as well as capture local demand.

Industrial Warehouse: Market Vacancy Forecast					
	1Q08	4Q09		1Q08	4Q09
Orange County	4.8%	5.4%	Denver	9.8%	9.2%
Los Angeles	5.7%	6.3%	San Diego	10.0%	11.5%
San Francisco	6.0%	4.1%	Avg. of Markets	10.2%	11.7%
Portland	6.4%	6.6%	Austin	10.7%	9.8%
Houston	6.7%	7.0%	Dallas	10.9%	11.7%
Seattle	6.7%	7.5%	Phoenix	10.9%	13.1%
Tampa	7.0%	9.0%	Washington DC	11.1%	11.8%
San Jose	7.4%	6.3%	Riverside	11.1%	14.6%
Miami	7.8%	10.3%	Philadelphia	11.3%	11.5%
Long Island	7.8%	7.9%	Indianapolis	12.0%	12.5%
Fort Lauderdale	8.0%	10.8%	Chicago	12.6%	15.6%
Oakland	8.0%	7.4%	Nashville	13.5%	17.8%
W. Palm Beach	8.8%	10.6%	Baltimore	13.6%	14.9%
Cincinnati	8.8%	11.1%	Atlanta	14.4%	14.5%
Northern NJ	9.4%	9.9%	Boston	14.9%	15.9%
Fort Worth	9.7%	10.6%	Memphis	19.1%	22.1%

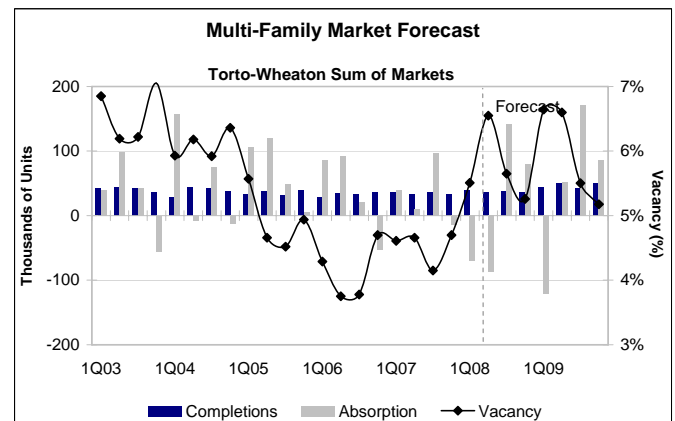
Source: CoStar, TWR, ARA Research

The downside of locating warehouses near large, densely populated regions with a growing consumer base, however, is that many of these metros areas have been the

hardest hit by the soft housing market. While the housing boom had previously encouraged homeowners to increase spending, falling home prices and sales volumes have dampened consumer spending growth, slowing demand for distribution space in these locations. Due to slowing in consumer spending, business inventories and slowing of imports (due to the weak US Dollar), warehouse demand is down from the past couple of years.

US Multi-Family Market Trends

US multi-family vacancy ended the first quarter of 2008 at 5.5%, up 90 basis points from the previous quarter. Due to the softening of the economy as well as increased supply, current vacancy is off a seven-year low of 3.75%, achieved in the second quarter of 2006. Absorption totaled 132,000 units in 2007, considerably lower than the 212,000 unit average demand achieved nationally from 2004 to 2006. Due to falling home prices and slowing job growth, absorption is expected to further slow and be near zero for all of 2008. At the same time, construction deliveries are expected to increase, with 151,000 units scheduled to be delivered in 2008, a 9% increase over 2007 levels. This is however, in line with the historical annual average of 150,000 unit completions since 1994. As a result, we expect US multi-family vacancy to climb over 6% through 2009.

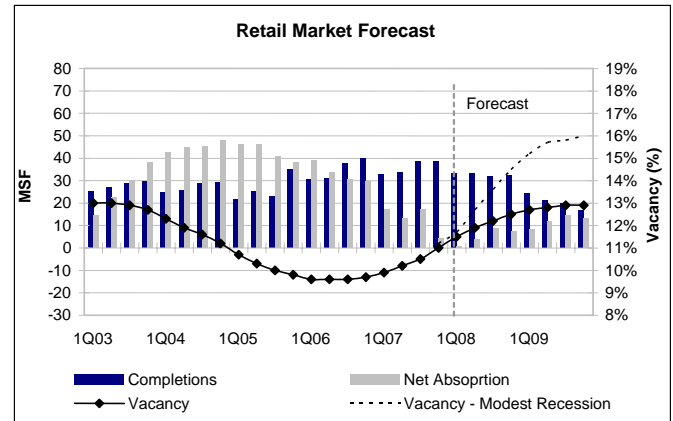


Source: TWR, ARA Research

Multi-Family Construction – In addition to the “shadow supply” of for-sale housing, a “wave” of construction completions in 2009 is expected to impact the multi-family market. As a result, vacancy is expected to peak around 6.6% in 2009 and gradually fall to the mid 5% range by 2012, as units are absorbed and demand gradually picks up.

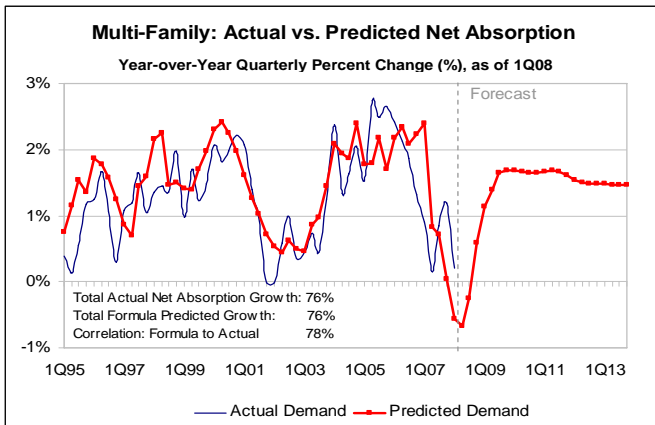
Multi-Family Rent – US multi-family rents grew 3.3% in 2007, with no nationally achieved growth in the first quarter of 2008. Due to the slowing economy and rising vacancy, rents are expected to slow dramatically with 0% to 2% growth expected in 2008 and average annual growth of 2% to 4% expected through 2012.

Multi-Family Sector Trends – The health of the for-sale housing market directly impacts the multi-family sector. According to American’s research, multi-family demand is positively correlated to housing price trends. With S&P/Case-Shiller® reporting national housing prices declining nearly 13% from one year ago as of February 2008, we expect multi-family demand to be negatively impacted as well. Falling home prices indicate general weakness in the economy but also an increase in the housing supply which competes directly with multi-family properties. Until the for-sale housing market recovers, we expect further softness in the multi-family sector on a national level.



Source: PPR, ARA Research

Retail Construction – Over 136 MSF of new retail space is expected to be delivered in 2008, bringing the new construction total over the last three years to over 400 MSF – the largest three-year increase in retail construction in twenty years. Due to weakening demand for retail space, construction is expected to slow considerably in 2009 to the 70 MSF range or nearly half of the total expected for 2008.



Source: ARA Research

Retail: Market Vacancy Forecast					
	1Q08	1Q10		1Q08	1Q10
New York	2.3%	4.0%	Boston	11.1%	12.7%
Long Island	2.5%	3.8%	Raleigh	11.4%	13.4%
San Diego	3.5%	3.9%	Avg. of Markets	11.5%	12.9%
Orange County	4.1%	4.6%	W. Palm Beach	11.8%	13.9%
Oakland	4.2%	5.1%	Northern NJ	12.0%	13.8%
Fort Lauderdale	4.8%	6.4%	Houston	13.3%	15.1%
San Francisco	5.2%	5.9%	Minneapolis	13.5%	12.7%
Phoenix	5.6%	9.9%	Riverside	14.4%	14.1%
Washington DC	6.3%	6.8%	Dallas - FW	15.6%	17.1%
Miami	7.4%	8.7%	Las Vegas	16.8%	18.5%
Portland	7.5%	8.6%	Atlanta	17.1%	19.9%
Los Angeles	8.6%	9.6%	Cincinnati	18.0%	20.8%
Philadelphia	9.1%	10.1%	Denver	18.6%	18.5%
Seattle	9.2%	10.5%	Charlotte	19.0%	21.0%
Baltimore	9.3%	10.3%	Nashville	19.6%	20.8%
Chicago	10.1%	11.2%	Austin	21.2%	22.3%

Source: PPR, ARA Research

US Retail Market Trends

US retail vacancy stands at 11.4% as of the first quarter of 2008, up 60 basis points from the previous quarter and up 150 basis points over the past year. National retail net absorption totaled 61 MSF over the past year, which is less than 40% of the 161 MSF of annual demand the retail sector averaged from 2004 to 2006. Demand is expected to slow further, with only 4 MSF of positive net absorption forecasted for 2008. Looking ahead, near-term supply is expected to outpace demand. Consequently, retail vacancy is forecasted to peak near 13% in 2009 before falling to the 12% range by 2012, as demand gradually picks up.

Retail Rent – Gross retail rents are up 1.7% for 2007, but have declined 0.3% in the first quarter of 2008. Due to an increase in supply as well as a slowdown in consumer spending, minimal rent growth is expected, with a 1% decline expected in 2008 and less than inflationary rent growth expected annually through 2012.

Retail Sector Trends – With US home prices falling, the extraction of home equity has slowed. Supporting this view, home equity extracted via equity loans has been cut to half the two-year average at \$419 billion in the fourth quarter of 2007. As a result, consumer spending has slowed considerably. Total retail sales grew by only 3.8%

for the first quarter of 2008 versus a long-term average of 4.9%, with over half of the current increase in retail sales accounted for by fuel consumption. Looking ahead, the total retail sales figure is expected to grow in the 2% range through 2012. In contrast, grocery sales grew by 6.6% in the first quarter, largely due to food inflation costs, but also to a renewed budget consciousness on the part of the consumer. Until the housing market turns positive and commodity price increases level-off, we expect further weakness in the retail sector, with strong growth in the grocery sector on a national level.

Key Indicators			
Interest Rates	5/22/2007	4/22/2008	5/21/2008
10-Year Treasury Yield	4.8%	3.7%	3.9%
CMBS AAA Yield	5.2%	6.7%	6.2%
CMBS BBB Yield	6.7%	20.5%	17.9%
Cap Rates	1Q2007	4Q2007	1Q2008
Office	6.6%	6.6%	6.9%
Industrial	6.9%	7.1%	7.1%
Multi-Family	6.1%	6.2%	6.2%
Retail	6.6%	6.7%	6.9%
12 Mo Private Real Estate Returns	1Q2007	4Q2007	1Q2008
NCREIF - All Properties	16.6%	15.9%	13.6%
Office	19.9%	20.5%	17.5%
Industrial	16.8%	14.9%	13.0%
Multi-Family	13.9%	11.4%	9.6%
Retail	13.1%	13.5%	11.6%
Vacancy	1Q2007	4Q2007	1Q2008
Office	12.7%	12.6%	12.9%
Industrial	9.7%	9.9%	10.2%
Multi-Family	4.6%	4.6%	5.5%
Retail	9.9%	11.0%	11.5%
Employment	Apr. 2007	Mar. 2008	Apr. 2008
Unemployment	4.5%	5.1%	5.0%
Total Employment Monthly %	0.0%	-0.1%	0.0%
Total Employment Yr/Yr	1.2%	0.4%	0.3%

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