2008 ECONOMIC FORECAST

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2008 is not the easiest year in California's history to forecast. In fact, it may be one of the most difficult. The major problem lies in the myriad of conflicting statistics and indexes at the international, national, state, and local levels.

But after reviewing literally dozens of forecasts by highly learned academics and scholars, I think that I am going to go out on a limb and take a very contrarian view of 2008. Most of the forecasts I have reviewed anticipate no start of an economic recovery until late 2008 or early 2009, especially in California. My crystal ball has a slightly more optimistic scenario.

The National Economy

Let's first review where we are on the national economic scene:

- Due to the weak U.S dollar, our goods are amazing bargains and the world is taking advantage of the situation. The result is a massive boom in exporting, particularly to Third World countries that are desperately trying to become Second World countries and need our goods to do so because they don't have the resources to create them themselves.

- As a result of expanding exports, the gross domestic product continues to expand at a rate that is within the range of normalcy for the U.S.

- Our military spending continues at a very high pace, due primarily to our continued involvement in Iraq and Afghanistan. That money creates thousands of jobs in industries that produce goods for the military and they are virtually all U.S.-based jobs.

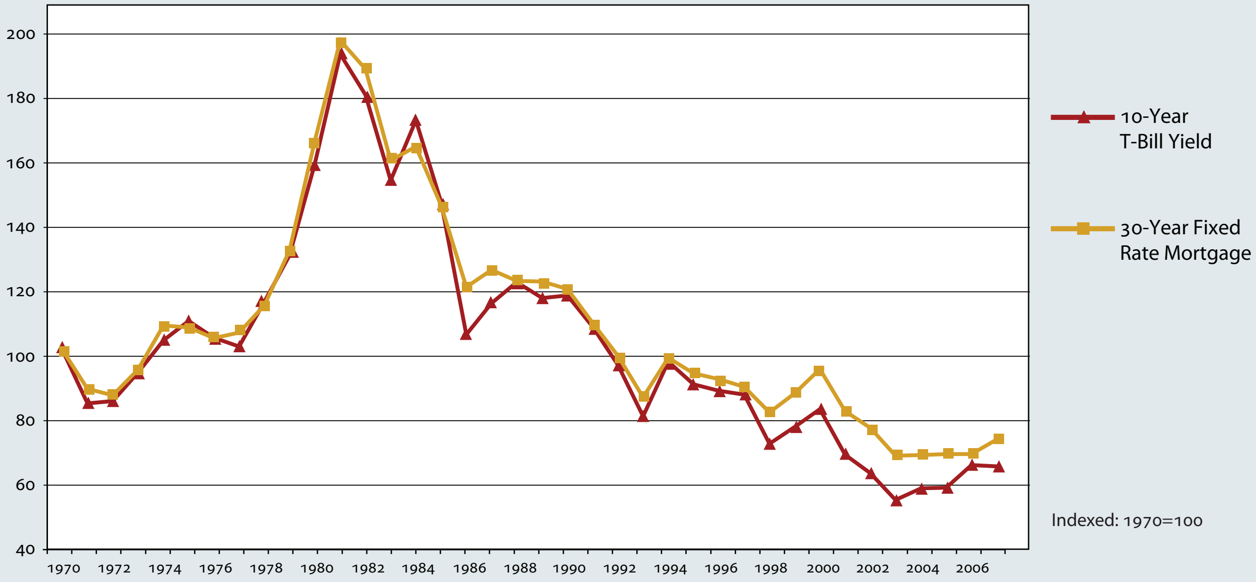
- We have now proven that gas at $3-plus per gallon has had only a negligible effect on the growth of the economy.

- Automobile sales continue at a high pace and create tens of thousands of jobs in the U.S. — and while most of them in firms that are not U.S.-owned, the paychecks stay here.

- And we are going into an election year. That means that the party in office at the White House will do as much as humanly possible to generate economic strength in order to retain the presidency and pick up Congressional seats.

- The most important thing that the D.C. crowd can do is to reduce interest rates. The last sitting president who tried for a second term during a period of high interest rates was President Carter. Presidents since then have taken note of that situation.

30-Year Fixed-Rate Mortgage Versus 10-Year T-Bill Yield



Source: Market Pointe Realty Advisors

- As of this writing, interest rates are going down. Interest rates generally follow the path of inflation and inflation is declining as well. The 10-year T-bill provides the basis for the 30-year fixed rate conforming loan (currently loans under $417,000). As I write this, the 10-year T-bill is less than 4.0 percent. Typically, the lender market adds 1.2-1.4 percent to that amount and that is the 30-year rate. On that basis, home loans should be down in the 5.50-5.75 percent range.

- Recently, the spread between the 10-year T-bill and the 30-year fixed loan has widened, but we see a trend toward a narrowing of the gap. On the graph on the previous page, look at how the two factors fit together.

The homebuilding and resale market have been in a funk, particularly in the high-growth states. Most of the states in the nation never participated in the recent bout of insanity. The wildness of the market was limited, for the most part, to the Sunbelt superstates (California, Arizona, Nevada, and Florida), and one or two others.

The California Economy and Housing Market

Let's look now at California, the perpetual Golden State. The economic basics of the state remain strong. The population this year will grow by more than 400,000 persons. In this decade, we will most probably add 5 million persons to the population. That's almost like adding an entire Bay Area in one decade.

Population=Consumption. These 5 million persons eat, drink, buy clothes and cars, and have a never-ending need for housing. California needs about 240,000 new housing units each year to keep up with demand. Now we know the industry is capable of providing that enormous number, but that political/environmental conditions rarely allow the industry to meet that goal.

In 2007, as a result of numerous factors, it is likely that the California homebuilding industry output will be about 116,000 units, just 60 percent of the past five-year average. Single-family permits are expected to total approximately 71,000 units, along with 45,000 multifamily units.

The massive decline in residential construction was a function of "irrational exuberance" by the market in 2003-2005 — the rapid run-up in land prices due to the shortage of readily buildable lots, the decline in interest rates, ready availability of loans to owners and investors, and a generally strong economy. The expansion of the construction industry (and its multitude of related industries) provided much of the economic vitality in the state during the past several years.

Historic and Projected Single-Family & Multifamily Units Permitted

State of California, 2002-2008f

Project Type	2002	2003	2004	2005	2006	2007e	2008f
Single-Family	123,865	138,762	151,417	155,322	108,021	70,850	81,700
Multifamily	43,896	56,920	61,543	53,650	56,259	45,400	46,700
Total	**167,761**	**195,682**	**212,960**	**208,972**	**164,280**	**116,250**	**128,400**
% Single-Family	**73.8%**	**70.9%**	**71.1%**	**74.3%**	**65.8%**	**60.9%**	**63.6%**

Source: *Historic: Construction Industry Research Board*
Projected: California Building Industry Association

Single-family market — modest turnaround

In 2008, in California, we foresee a modest turnaround in the housing market. In the single-family market, we anticipate a modest improvement in sales in those markets that are highly urban, such as San Diego, Orange County, and the Bay Area.

In those areas, where lots are not abundant, we forecast a 10-15 percent increase in sales in 2008, with prices holding steady. Unsold inventory will remain exceptionally low, by design, and homes will be offered most often on a non-contingent basis. In other words, homebuilders in those areas will be building almost on a custom basis. That most certainly is not the M.O. of the major public builders, but if they want to remain in the state, they will have to adapt to its quirky markets.

In the areas where lots are in ample supply, like Riverside, San Bernardino, the San Joaquin Valley, and the Sacramento area, there will be a major change in the homebuilding mentality. Lots, for the most part, have declined substantially in value. They will be written down to more practical value levels. As a result, homebuilders will be able to build substantially smaller homes and sell them for substantially lower prices. In Riverside and San Bernardino Counties, for instance, we see new smaller houses being offered for $100,000 or more less than in the last round of development.

As a result of these massive shifts in home pricing in these areas, and reduced interest rates, home sales should increase substantially by the third quarter of 2008. As a result, I believe total new-home sales will accelerate in the second half of the year, leading to a 2008 single-family total of more than 80,000 units.

Historic and Projected Single-Family Units Permitted

State of California, 2002-2008f

REGION	2002	2003	2004	2005	2006	2007e	2008f
Central Coast	4,279	4,998	4,797	4,248	3,132	2,000	2,200
Non Metro	8,374	10,017	12,569	14,318	9,022	6,000	6,500
Sacramento Valley	18,762	18,184	18,680	15,629	8,797	7,500	8,000
San Francisco Bay Area	14,164	14,947	14,885	14,686	10,528	9,000	10,000
San Joaquin Valley	21,899	27,080	29,594	34,676	23,106	15,000	17,000
Southern California	56,387	63,536	70,892	71,765	53,436	31,350	38,000
Total SF California	123,865	138,762	151,417	155,322	108,021	70,850	81,700
SOUTHERN CALIFORNIA							
County	**2002**	**2003**	**2004**	**2005**	**2006**	**2007e**	**2008f**
Los Angeles	8,217	10,217	11,752	11,911	10,097	7,500	8,500
Orange	6,423	5,565	4,395	4,058	3,735	2,100	3,000
Riverside	20,591	25,137	29,478	29,994	20,692	10,500	13,000
San Bernardino	9,179	10,820	13,991	15,305	12,599	7,000	8,500
San Diego	9,749	9,455	9,555	7,904	4,753	3,500	4,000
Ventura	2,228	2,342	1,721	2,593	1,560	750	1,000
Total SF So Cal	**56,387**	**63,536**	**70,892**	**71,765**	**53,436**	**31,350**	**38,000**
So Cal as % of CA	**45.5%**	**45.8%**	**46.8%**	**46.2%**	**49.5%**	**44.7%**	**46.5%**

Source: *Historic: Construction Industry Research Board*
Projected: California Building Industry Association

Multifamily market — townhomes, apartments lead

On the multi-family side, there are four products that comprise most of the California multi-family market — mid/high-rise construction, wood frame vertical construction (usually four levels over two levels of parking), townhomes/plexes, and rental product.

In 2008, mid/high-rise condominium construction is expected to be negligible throughout the state. There are numerous projects recently completed or nearing completion, but scant few projects in the early stages of development. We anticipate the next round of mid/high-rise development will begin delivering product in 2010-2011.

Woodframe vertical condominium construction has also almost come to a halt throughout the state. The costs of construction (though lower now than in the past three years), combined with the cost of subterranean parking, drive up the cost of this product type above that which is acceptable to the market. Unfortunately, a substantial number of sites for this product type were acquired in the halcyon years of 2003-2005 at bloated prices by condominium builders and now the numbers make no sense.

Many of these low-rise sites are being sold to apartment developers for luxury rental apartments throughout California as the rental market is strong and the national apartment builders are flush with cash and can tolerate entry cap rates of 3-4 percent.

Townhomes represent strong sales opportunities in the pricier single-family markets and act as surrogates for the detached home. The highest levels of acceptability will be in the urban area of the coastal cities. In the less urban areas, townhomes, given new lower land prices, will be produced for the entry-level market and accepted in substantial numbers.

Historic and Projected Multifamily Units Permitted
State of California, 2002-2008f

REGION	2002	2003	2004	2005	2006	2007e	2008f
Central Coast	1,718	1,526	1,175	1,012	727	1,500	1,000
Non Metro	1,026	1,830	2,487	1,565	1,336	1,300	1,200
Sacramento Valley	4,616	4,605	3,587	2,863	3,530	1,300	2,500
San Francisco Bay Area	8,409	13,222	12,187	12,215	13,780	10,000	11,000
San Joaquin Valley	1,605	3,699	4,137	4,315	3,282	4,000	3,000
Southern California	26,522	32,038	37,970	31,680	33,604	27,300	28,000
Total Mf California	43,896	56,920	61,543	53,650	56,259	45,400	46,700
SOUTHERN CALIFORNIA							
County	**2002**	**2003**	**2004**	**2005**	**2006**	**2007e**	**2008f**
Los Angeles	11,147	11,096	15,183	13,736	16,251	13,000	14,000
Orange	5,597	3,746	4,927	3,148	4,636	5,000	5,000
Riverside	2,073	5,224	4,748	4,140	4,519	2,500	2,500
San Bernardino	1,437	1,820	4,479	1,379	1,273	2,000	1,500
San Diego	5,989	8,859	7,751	7,354	6,024	3,800	4,000
Ventura	279	1,293	882	1,923	901	1,000	1,000
Total Mf So Cal	**26,522**	**32,038**	**37,970**	**31,680**	**33,604**	**27,300**	**28,000**
So Cal as % of CA	**60.4%**	**56.3%**	**61.7%**	**59.1%**	**59.7%**	**60.1%**	**60.0%**

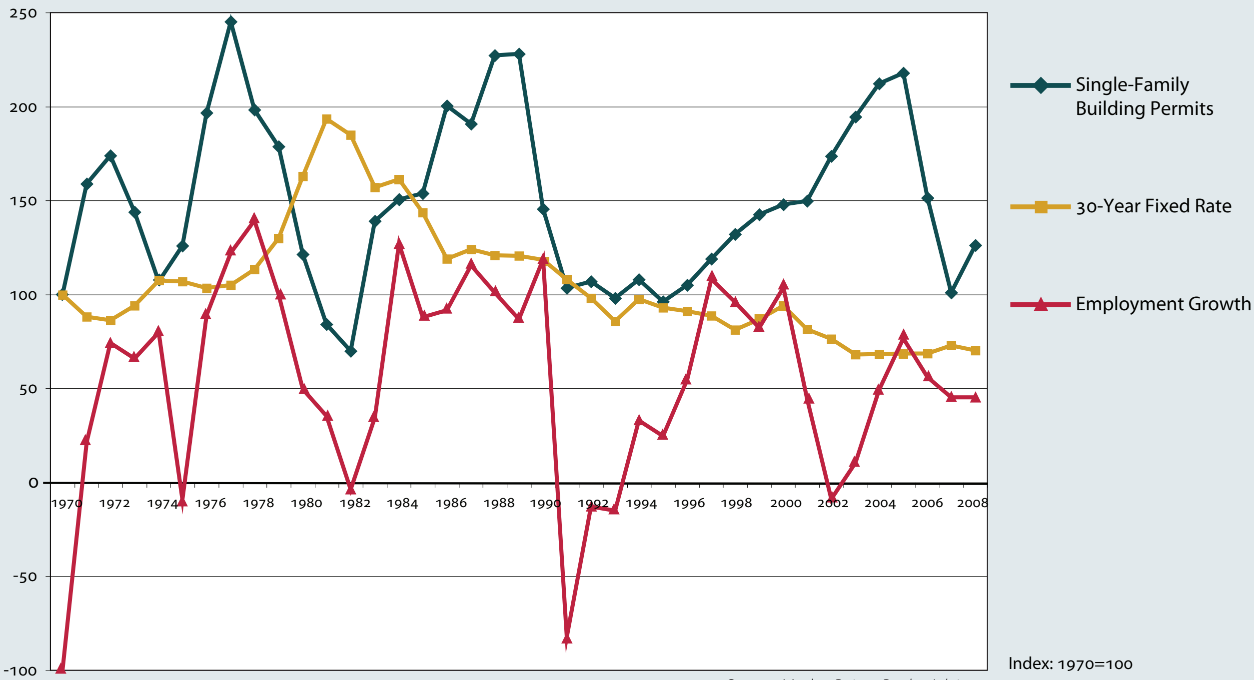
Source: *Historic: Construction Industry Research Board*
Projected: California Building Industry Association

We project that in 2008, multifamily units will total 46,700, slightly higher than in 2007, primarily as a result of extensive apartment construction.

Homebuilding typically leads the way to economic recovery. On the graph shown below, note that homebuilding precedes employment growth and leads the way toward economic recovery. Inevitably, declining interest rates accompany this economic trend. Please also note that interest rates have been on a cascading trend since the Reagan administrations.

It is this table that leads to the conclusion that the California economy will have a soft landing in 2008 and begin its return to normalcy by mid-2008. We project that new-jobs gains will be in the 210,000-246,000 range.

California Economy



Source: Market Pointe Realty Advisors

Regional Perspectives

The Central Coast

Employment growth in the Central Coast has been uneven during the past several years, generally ranging from no new jobs to more than 7,000 new jobs in 2005. In 2006, new jobs totaled 2,083 and slightly less than that in 2007. We project 2,000-3,000 new jobs produced there in 2008.

The area between Santa Barbara and Santa Cruz had averaged 4,581 single-family units permitted in the 2002 through 2005 period. By 2007, that number had been more than halved, falling to 2,000 units. The continual job gains indicate that the demand for new housing exists, but is largely untapped. We anticipate that the single-family market will gradually recover in 2008, finishing the year with 2,200 units.

Multi-family production has not been a major part of the new housing market in the Central Coast region, rarely topping more than 1,500 units and more often not even 1,000 units. We project 1,000 new multi-family units in 2008 in the Central Coast, somewhat lower than 2007's 1,500 units.

The Sacramento Valley

In the "normal" years of 2002-2004, Sacramento added12,000-14,000 jobs annually. Then, as a result of the housing acceleration and general industrial health in the area, the job count in 2005-2006 reached the 20,000 level. In 2007, as a result of the housing market decline, the average gain was approximately 15,000 jobs. We anticipate that 2008 will produce between 14,000 and 16,000 jobs.

The Sacramento metropolitan area has had a particularly severe decline in single-family permits. In the 2002-2005 period, the area's single-family permits averaged almost 18,000 units annually. The fall from that total came rapidly, declining to almost half that total in both 2006 and 2007. Most of the blame appears to be the rapid rise in prices in an area that has long been accustomed to moderate-priced homes. We project a gradual recovery in 2008 with 8,000 new single-family homes permitted and a far larger part of them at the lower end of the price scale.

Sacramento has traditionally been a market where single-family permits dominated with multifamily permits accounting for just 20 percent of the new housing output, and most of that in the form of apartments. We see a continuation of that trend in 2008, with apartments constituting most of the multifamily permits and totaling 2,500 units.

The San Francisco Bay Area

The San Francisco Bay Area has experienced a major job comeback in the past three years. In 2002 and 2003, as a result of the dot.com bust, the area lost almost 300,000 jobs. Gradually struggling back, the area has gained increasing numbers of jobs since then. In both 2006 and 2007, the area gained more than 60,000 jobs. A third of the new jobs have been in the Silicon Valley, the area that, by itself, lost almost 200,000 jobs in the dot.com bust. In 2008, we anticipate that the Bay Area will gain more than 60,000 new jobs and will maintain an unemployment rate of below 5.0 percent.

Single-family homebuilding did not decline as severely in the Bay Area as in many other parts of the state. In the 2002-2005 period, average production was in the 15,000-unit range. In 2007, that total declined to the 9,000 level, but we foresee it climbing to the 10,000 level in 2008.

The Bay Area has long been a bulwark of multi-family housing, typically accounting for almost half of all housing production. The high price of housing, combined with the traditional urbanization of the area, has led to an urban scene with a strong combination of vertical and townhome construction, both for-sale and rental.

The Bay Area traditionally produces 12,000-13,000 multifamily units annually. In 2007, however, that total declined to the 9,000 level, mostly as a result of a decline in vertical construction. We project a mild upturn in multifamily production in 2008, with the total rising to 11,000 units as a result of a renewal of lower-density attached housing in the suburbs.

San Joaquin Valley

Typically, the San Joaquin Valley produced 12,000-15,000 jobs in the 2002-2004 period with most industries showing modest gains. Then, in 2005, there was a remarkable wave of new homebuilding and buying unrelated to new-job creation. As a result of that homebuilding binge, new-job gains increased to more than 40,000 in 2005 and 31,000 in 2006. For instance, in Kern County, 25 percent of all new jobs in 2004-2005 were in construction, compared to 5 percent in prior years. In 2007, employment growth has gradually returned to a more normal level, adding more than 15,000 jobs. Most of those job gains are support jobs servicing the rapidly expanded inventory of housing. In 2008, we project 18,000-20,000 new jobs.

Single-family home production in the region peaked in 2005 with almost 35,000 new single-family homes produced, compared to a more normal 21,000-25,000 output. By 2006, the total had declined to 23,000 units and in 2007 declined once more to the 15,000-unit level. We project that the homebuilding business will improve modestly in 2008 as smaller homes are once again produced. We project 17,000 units of single-family housing for 2008 in the San Joaquin Valley.

Multifamily production has traditionally been negligible in the San Joaquin Valley, typically accounting for no more than 10 percent of output. We see no change in that picture and project 3,000 units of multifamily units permitted in 2008.

Southern California

Los Angeles County

For reasons we do not pretend to understand, job growth tends to be erratic in Los Angeles County. In 2005, the county gained 27,000 jobs and then jumped to 69,000 jobs in 2006 and now it appears that in 2007, the total will be in the 40,000-plus range. In 2008, we project gains in the 40,000- to 50,000-unit range as construction makes a comeback and the key media industries and import/export trade continue to expand.

Single-family production in Los Angeles County is relatively limited by a paucity of buildable land. Typically, single-family units permitted total 10,000-12,000, but declined to the 7,500 level in 2007. We project a modest growth in 2008, with single-family units totaling 8,500 — mostly in the far northwest reaches of the county.

Multifamily production normally accounts for 60 percent of Los Angeles County production and we see that trend repeating itself in 2008. In a typical year, multifamily production is in the 11,000- to 15,000-unit range and was at the lower end of that range in 2007. In 2008, we project an increase to 14,000 units as several major projects break ground in downtown Los Angeles and the near-in suburbs.

Ventura County

The Ventura County job base had been steadily growing this decade, with job gains of around 7,000 in 2005 and 2006. In 2007, however, with two of its major employers facing difficulties, along with the near demise of the homebuilding market, job gains ground to a near halt. In 2007, jobs gains barely reached 2,000. In 2008, we see a modest improvement, perhaps reaching the 2,500-3,000 level.

Ventura has traditionally been the smallest of the single-family homebuilding markets in Southern California, traditionally producing 2,000-2,500 units. In 2006 and 2007, production took a most dramatic nose-dive, with only 1,560 units permitted in 2006 and fewer than 1,000 in 2007. We foresee a modest improvement in 2008 with production in the 1,000-unit range.

Multifamily housing production has always been modest in Ventura County with most years averaging fewer than 1,000 units. 2007 is no exception, with production in the 1,000-unit range. We project a similar picture for 2008.

Orange County

From 2003-2006, Orange County typically gained 25,000-33,000 jobs annually. In 2007, there has been a dramatically decline in that picture, with approximately 10,000 new jobs created. Part of that decline relates to the fall-off of the housing industry, both new and resale. In 2008, we project gains in the 10,000-12,000 job range.

Single-family housing production continues to ebb in Orange County as the price of land is high and the supply constrained. 2007 marked the sixth continuous year of decline in single-family production, hitting a modern low of 2,100 units. In 2008, we project a mild recovery, reaching the 3,000-unit level.

Multifamily production in Orange County tends to be in the 3,000-5,000-unit range annually. The stability relates in part to a continuing supply of rental housing in the most urban areas, and, of late, a burst of vertical construction in Irvine, Santa Ana, and Anaheim. In 2008, we project a production in the 5,000-unit range.

Riverside/San Bernardino Counties (The Inland Empire)

The employment base of the Inland Empire continues to expand, despite the massive slowdown in residential construction. In both 2004 and 2005, the Inland Empire added 60,000 jobs, 40 percent of all new jobs in Southern California. In 2006, job generation slowed to 48,000 and in 2007 approximately 40,000. We project a further modest decline in job creation to between 30,000 and 40,000 jobs in 2008.The job generation is due to continuing population growth and basic job gains in northwest Riverside County and San Bernardino County.

During 2002-2005, single-family production averaged 37,000 homes in the Inland Empire. In 2007, the total declined to 17,000 units. Multi-family units peaked in 2004 with 9,227 units only to decline to half that total in 2007.

In 2008, we foresee a turnaround in the single-family market as developers bring to market decidedly smaller homes at lower prices. We project that single-family home production will rise to 21,000 units. The multifamily permit activity will remain in the same 4,000-unit realm as 2007 with a major part of that production in rental housing.

San Diego County

During the 2004-2006 period, new job gains in San Diego County ranged from 18,000-21,000 with unemployment levels well below 5.0 percent. In 2007, job gains faltered, falling to the 10,000 level. We anticipate a slight improvement in 2008, with total job gains of 10,000-12,000.

Single-family production has been cascading downward since 2002 as the county's lot supply dwindles. In 2002, single-family production totaled 9,749 units and in 2007 did not reach 4,000 units. In 2008, we project single-family permits to be in the 4,000-5,000 range, largely because of the replacement of the 1,500 homes destroyed in recent fires.

Multifamily housing production has been declining since 2003, when 8,859 units were permitted (exclusive of condominium conversions). In 2007, multifamily unit production fell below the 4,000 level as vertical construction subsided. In 2008, we do anticipate more than 4,000 multi-family units to be constructed, largely the result of apartment developers acquiring sites once destined for condominium development.

Research Economist: Michael Colby; Peer Review: Russell Valone