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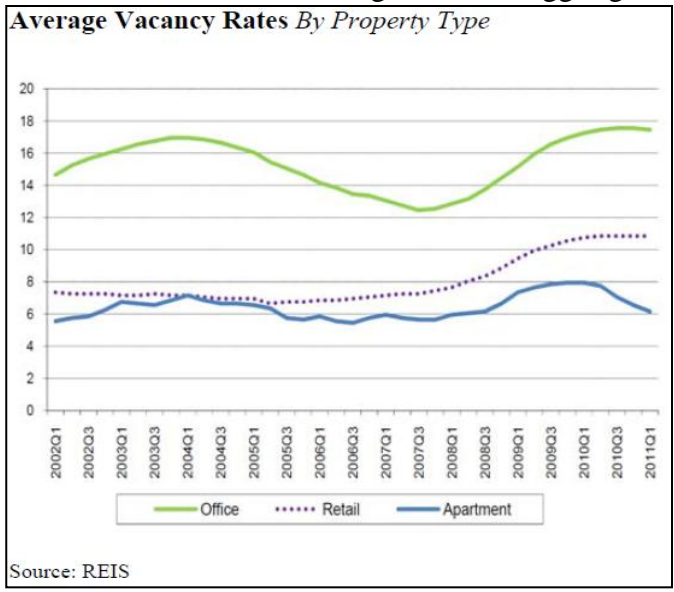
Summary

During the second quarter of 2011 the housing and commercial real estate (“CRE”) markets continued to move in opposite directions. The U.S. housing market experienced a double-dip with respect to prices, while the CRE market for top-quality, trophy assets continued its march to near peak levels. High single-digit unemployment will continue to be a drag on any sort of housing recovery, while still historically low interest rates provide cheap capital for institutional real estate investors to continue pushing valuations upward in their search of higher yields relative to alternative investments. The prognosis of an economic slowdown in the second half of 2011 resulting from high unemployment and a decline in consumer confidence will only make the housing recovery worse, and has a very good possibility of spilling over into the CRE market. Although most observers believe CRE fundamentals will continue to recover throughout 2011, the recovery will be more modest than 2010 and will ultimately mirror the economy at large.

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Commercial Real Estate – National

Commercial real estate fundamentals continued to strengthen in the second quarter of 2011, albeit at a much slower pace than during the last quarter of 2010. The moderate recovery has been consistent with global economic trends, which softened in the first half of the year as a result of spikes in oil prices, the Japanese earthquake, and severe weather and flooding in parts of the U.S. While the economy continues to face the challenges of a struggling housing market, anemic job growth, and state and



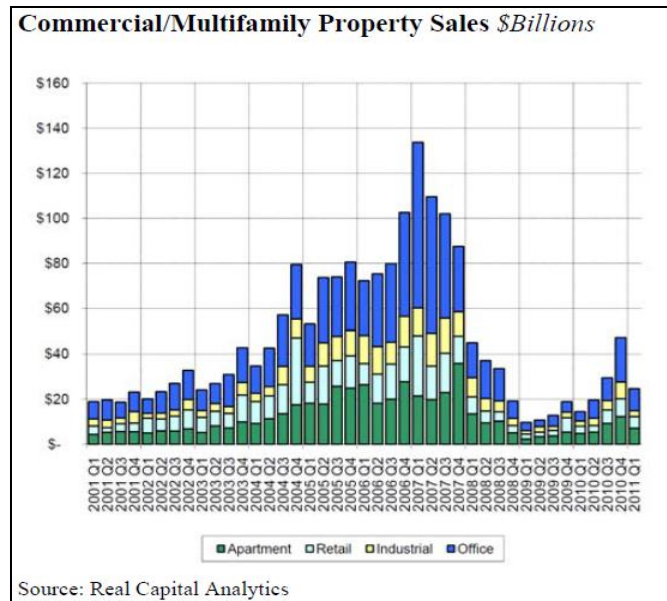
federal budget constraints, economic growth is expected to pick up in the second half of the year as energy prices ease and global supply chains restock inventory. As the economy gathers steam, CRE market fundamentals should improve as well.

Demand for space in CRE properties is outpacing the low level of new space coming online, and is beginning to eat into commercial real estate vacancies. Average vacancy rates declined for apartment and office properties in the first quarter and were flat for retail properties (see graph to the left). The drop in average apartment vacancy rates – driven by the continued drop in the homeownership rate

– was the most pronounced, falling from 8.0% in Q1 2010 and 6.6% in Q4 2010 to 6.2% in Q1 2011. Office vacancy rates fell from 17.6% in Q4 2010 to 17.5% in Q1 2011, but are up from last year’s Q1 rate of 17.3%. Retail vacancy rates were flat at 10.9% in the first quarter, where they have been for the past year. Eventually the decline in the vacancy rate should translate into higher rental rates, but outside of apartment units, most observers don’t expect to see any significant increase in rental rates until 2012.

According to Marcus & Millichap, the dollar volume of \$20 million-plus transactions has jumped 160%, compared to a 35% jump in the \$1 million to \$20 million segment. Public and private REITs, pension funds, and large national private investors remain active buyers, especially REITs who have raised tremendous amounts of capital during the past year. REITs and private funds reported raising \$35.48 billion from investors in the second quarter for real estate related deals and refinancing. The amount of capital raised brings the total inflow for the first 6 months of 2011 to more than \$66.45 billion representing approximately 1,075 funds and firms. It took more than nine months to raise the same amount last year.

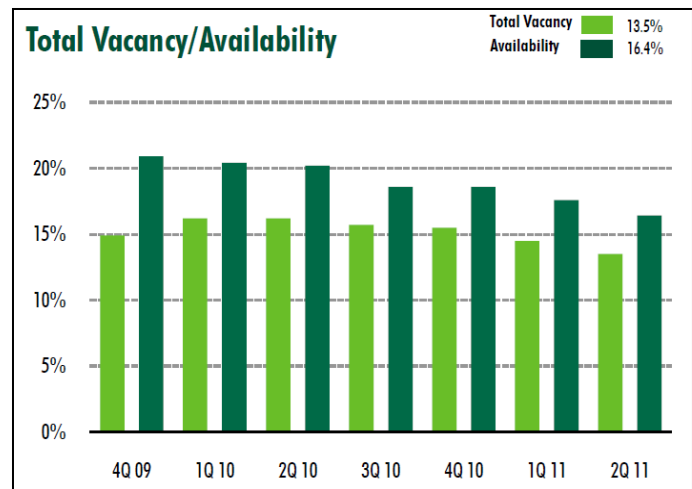
Overall sales volume is on track to increase by 20% to 30% over 2010 to \$245 billion (see graph to the right). This is similar to 2003/2004 levels, which is a good benchmark for a normal trading environment. The increased level of activity is fueled by low interest rates, improved availability of financing, a sense that pricing has generally bottomed, and expectations that a moderate economic recovery will endure beyond the current slowdown. In addition, little new supply is coming online in most product types over the next two to three years, and competitive overall yields relative to alternative investments, with the exception of ultra-low cap rate trophy assets, should support continued investor demand for commercial real estate.



Commercial Real Estate – Local

The year 2010 proved to be a strong recovery year for the San Francisco Bay Area commercial real estate market, and halfway through 2011 growth has continued with occupancy gains and rent increases in many areas. However, while the recent positive signs in the Bay Area are encouraging, nearly all of the recent growth has come from large technology companies with a strong presence in the area. Until we see a significant improvement in the overall economy and across a larger section of industries, leasing activity and rent increases are expected to continue at a more moderate pace and in selective submarkets like San Francisco South of Market, Palo Alto and Mountain View.

The second quarter of 2011 proved to be one of the most active quarters for the Bay Area office market in San Francisco and along the Peninsula. As a result of growing tenant demand and market activity, available space dropped to the lowest amount witnessed since Q3 2008. According to CB Richard Ellis, vacancy fell 100 basis points to 13.5% in the second quarter. At the same time, the availability rate decreased 120 basis points to 16.4% (see graph to the right). Available options for large users are becoming increasingly scarce since many of the available large blocks of space (20,000 SF and larger) have been absorbed in recent quarters. With quality office space becoming harder to find, it is expected that downward pressure on vacancy will continue throughout the rest of this year.



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Research and Development (“R&D”) performed relatively well during the quarter as well. R&D properties saw a notable decrease in vacancy rates across the market, with a 210 basis point drop from first quarter to 17.0%. This marks the third consecutive quarter of decreased vacancy rates and continues to indicate a recovery in the R&D market. The largest amount of activity occurred in the Palo Alto and Mountain View submarkets. Although the demand for office and R&D product has been on a steady climb, recent demand for the industrial and retail product types have not been as strong. Vacancy rates dipped only 10 basis points during the quarter to 7.9% for industrial, while retail fared a little better with the vacancy rate decreasing 50 basis points to end at 5.9%.

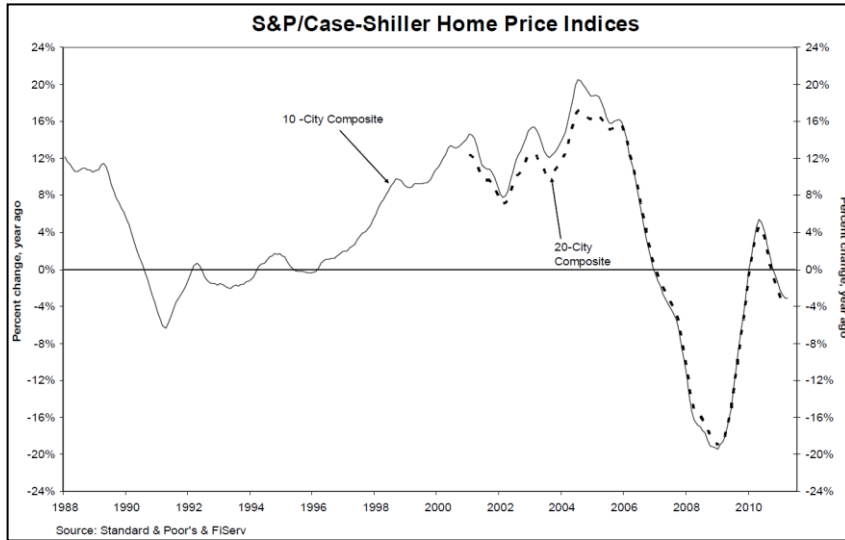
Some notable Bay Area CRE deals during the second quarter were:

- Los Angeles based Kilroy Realty Trust is in contract to buy three San Francisco office properties, adding another 500,000 SF to its rapidly expanding 1.8 million SF portfolio. It has now invested more than \$600 million in the Bay Area in less than 18 months.
- Google agreed to lease nine buildings containing 630,000 SF in Mountain View, and plans to build as much as 595,000 SF of new space on 9.4 acres of land leased for 54 years from the City of Mountain View.
- Apple announced its intention to develop a massive 4-story office building in Cupertino to house 13,000 employees by 2015.
- Microsoft agreed to lease 237,000 square feet at Moffett Towers in Sunnyvale.
- Alexandria Real Estate Equities purchased 409 and 499 Illinois Street in San Francisco for \$290 million.

Overall, the second quarter of 2011 reflects positive fundamentals returning to the Bay Area CRE market. As demand increases and the supply of available product remains limited, it is expected that many tenants will look to lock in rates as vacancies trend down. As hiring in the technology sector continues, the Bay Area is well positioned to see positive absorption for the remainder of the year and into 2012.

Residential Real Estate - National

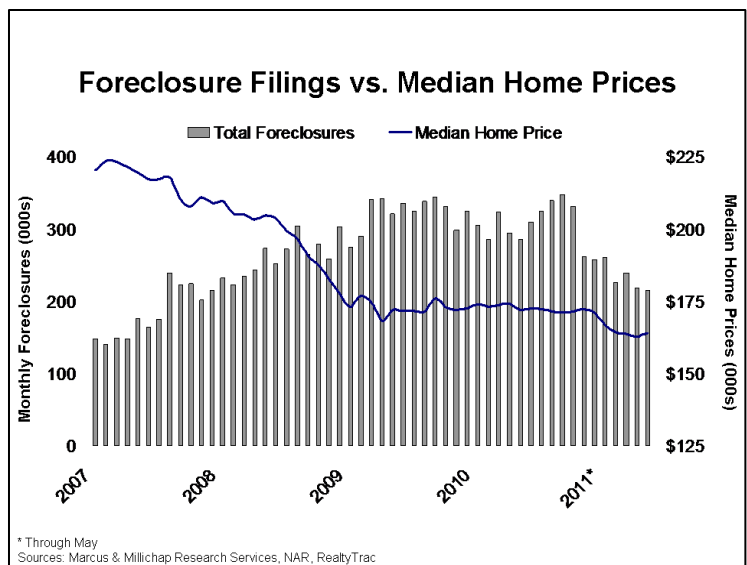
The U.S. housing market has fallen into a double-dip slump after last year's stimulus-driven stabilization and will continue to weigh on the pace of economic recovery through the rest of this year.



After climbing in early 2010, home prices have reached a new eight-year low. According to data from the S&P Case-Shiller Index (see graph to the left), prices are down by 3.5% year-over-year, and by 32% from their peak in 2006. Sales activity is also down, by 12.9% year-over-year, albeit from a high level in 2010 that was stimulated by a home-buyer tax credit. The nation's home-ownership rate has dropped from a peak of 69% in 2006 to 66.4% today.

Foreclosure activity remains high, despite a drop of 35% in the past year and 45% since the peak in Q1 2009 for homes either owned by banks or in some stage of foreclosure, according to data from Marcus & Millichap, RealtyTrac, and the National Association of Realtors (see graph below). While the number of distressed sales is down, so is the number of total sales, keeping the percentage that is distressed at 28%, down from 42% a year ago. With distressed properties typically selling at a 20% discount, easing foreclosure activity should help alleviate further pressure on prices. However, it appears the distressed sale factor will remain throughout 2012 placing a damper on new home sales.

As the saying goes, it is darkest before dawn and we are making progress on clearing the inventory of distressed loans and foreclosed homes from the market. Inevitably the national housing market will improve, but that will not happen until job growth returns to healthier levels, consumer sentiment remains positive, and the economy expands beyond its current levels. Unfortunately that could take well into the second half of 2012 or even 2013. The hopes of a V-shaped recovery in the housing market have long since faded away, and have been replaced with more realistic expectations of a long, gradual and sometimes bumpy improvement.



Residential Real Estate – Local

Overall, the Bay Area and Santa Cruz County housing markets fell sharply in May from year-ago levels, which had been pumped up artificially by homebuyer tax credits. Move-up buying and new-home sales were especially weak in May, while the share of sales involving distressed properties, cash buyers and investors remained far above normal. According to the California Association of Realtors, year-over-year percentage change was negative for all except two counties, Napa and San Mateo (see graph below). The hardest hit county was Santa Cruz with a 16.7% decline in prices from one year ago. DataQuick indicated a total of 6,988 new and resale houses and condos sold in the nine-county Bay Area and Santa Cruz County last month. That was up 2.9% from 6,789 in April but down 15.4% from 8,264 in May 2010. Last month's year-over-year drop was the sharpest since sales fell 22.8% last October according to DataQuick.

	Median Price of Existing Single-Family Homes				Sales		
	11-May	11-APR	10-May	MTM% CHG	YTY% CHG	MTM% CHG	YTY% CHG
Alameda	\$465,550	\$452,140	\$507,210	3.00%	-8.20%	0.50%	-14.70%
Contra-Costa	\$602,860	\$553,160	\$653,300	9.00%	-7.70%	6.60%	-3.20%
Marin	\$807,140	\$726,060	\$838,940	11.20%	-3.80%	20.30%	-9.00%
Napa	\$377,270	\$306,820	\$367,390	23.00%	2.70%	8.30%	10.30%
San Francisco	\$641,670	\$636,900	\$697,030	0.70%	-7.90%	-0.70%	-5.30%
San Mateo	\$810,000	\$720,000	\$740,000	12.50%	9.50%	16.30%	0.70%
Santa Clara	\$600,000	\$585,000	\$630,000	2.60%	-4.80%	-3.30%	-21.60%
Santa Cruz	\$437,500	\$448,500	\$525,000	-2.50%	-16.70%	-0.70%	-16.00%
Solano	\$191,850	\$189,120	\$224,120	1.40%	-14.40%	5.80%	-11.30%
Sonoma	\$353,750	\$332,650	\$368,310	6.30%	-4.00%	0.00%	-14.40%

After a lackluster month in April for Marin County, sales and prices for single-family homes rose in May. Sales were up 20.3% compared to April, but were down 9% year-over-year. The median price for single-family, re-sale homes rose 11.2%, although year-over-year was down

3.8%. San Francisco county prices and sales were relatively flat from April to May, increasing 0.7% and decreasing 0.7%, respectively. However, year-over-year changes were down 7.9% for prices and 5.3% for sales. Santa Cruz County fared much worse, with prices and sales decreasing 16.7% and 16% from a year ago, respectively.

In Marin County, sellers are receiving multi-offers, but bidding appears to be restrained close to the listing price. There's not a lot of inventory for sale in the Marin market, which helps explain why multi-offers are being received. Pricing is as important as ever, and having a listing that "isn't priced right" is resulting in an extended stay on the market for those homes. Given the negative headline news about the national housing market, people still want to feel like they're getting a good deal which means there isn't a lot of pricing power for would-be sellers.

There are always bright spots and exceptions within a large regional housing market, and selling activity continued on its hot streak throughout the month of May for parts of San Francisco, North Santa Clara and South San Mateo Counties. The South Beach, Mission, Potrero Hill, and SOMA neighborhoods in San Francisco are experiencing strong demand with inventory significantly tightening in recent months. Buyers are benefiting from a strong technology and bio-science employment base, and are seeking locations close to Cal-Train or easy access to the 101 and 280 highways. In the Mission Bay neighborhood, new residential development has resumed with builders seeking deposits on newly constructed condominiums that won't be delivered for another 12 months. Only time will tell if the San Francisco housing market has enough legs to support speculative development.

In the cities of Palo Alto, Los Altos, and Menlo Park, closed and pending home sales numbers remain high and days on market stands steady with an average of just 29 days on market. The average home price for these three areas was \$1.8 million, which stands in sharp contrast to the average price of \$525,000 and \$605,000 for Santa Clara and San Mateo Counties, respectively. As we mentioned in last month's commentary, the Silicon Valley's financial fervor is fueling yet another real estate boom. Billions of dollars in fresh venture capital is being invested, tech IPOs are hitting the stock market weekly, and the newly minted millionaires are looking to buy a house.

Conclusion

The double-dip in the national housing market doesn't seem to be impacting the commercial real estate market for core, class-A trophy properties in major metropolitan markets. The low interest rate environment currently characterizing the US economy has made CRE an attractive asset class relative to other investments, but for how long remains the \$25,000 question. As long as job growth and the residential housing market remain weak, the Fed has indicated its intent on supporting the US economy with continuous monetary stimulus. Only until underlying economic fundamentals demonstrate sustained improvement will there be more visibility for future growth in the investment real estate market and the return of increasing home prices nationwide.

Sincerely,

Carlos Valdivia
Real Estate Investment Advisor