NAI CAPITAL

Market Perspective | Spring 2010

NAI Capital

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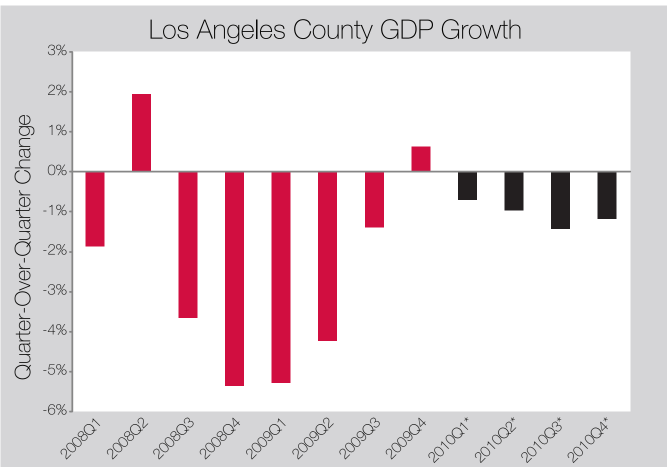
California Lutheran University

NAI Capital is pleased to provide the following economic outlook to our clients. We understand the importance of timely, accurate data when making significant financial decisions. As such, we have taken every measure to verify the data contained in this report. We hope that the information contained in this report is helpful to you.

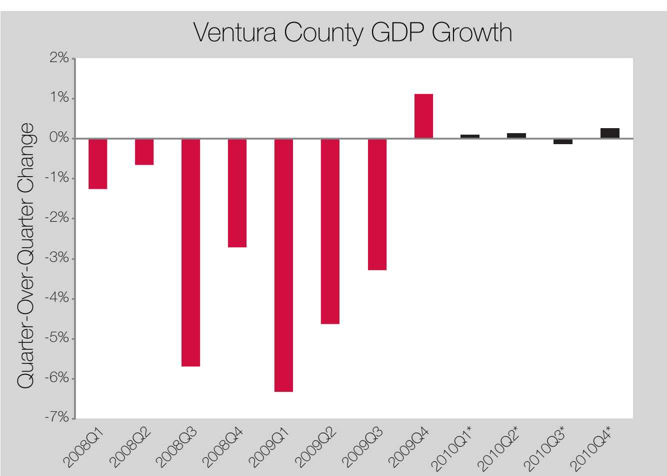
Economic Trends

Economic conditions in the Los Angeles Basin remain weak. Los Angeles County, the basin's largest county, managed to eke out a small, .63 percent, increase in economic output during the fourth quarter of 2009. This was the first increase in five quarters. The same was true of Ventura County where economic output increased 1.11 percent in Q4 2009. The increase in output snapped Ventura County's seven quarter decline.

Unfortunately, the gains in Los Angeles County are not likely to be repeated. Significant weaknesses remain. In particular, the city of Los Angeles faces a $530 million budget deficit in the coming year. According to the Mayor's office, 2,800 jobs could be lost.



* Projected
Source: CERF



* Projected
Source: CERF

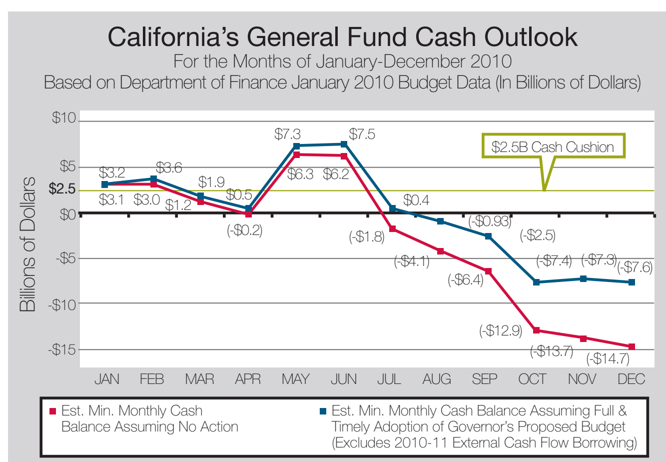
A second area of concern is the recently announced increases in electricity rates. To be fair, the city council rejected the Mayor's proposed increases. However, it seems likely that some increase is coming. It may not be as large as the Mayor and DWP would like but the odds favor a rate hike in the coming year. Increasing costs to businesses and consumers during a period of weak economic activity is surely not a remedy to stimulate growth.

The coming year looks a bit brighter for Ventura County. It appears that the worst is over. The County's economic output is expected to increase slightly in 2010. The increase will not be large by any measure but after seven quarters of decline any increase is welcome news.

More broadly, California's budget problems may negatively impact the Los Angeles Basin. Several higher educational institutions in the Basin have instituted furloughs. Others have instituted pay freezes. The same is true for many government sector jobs as well as K-12 education. Further budget cuts from the State are likely to be met by layoffs. Most of the fat has been trimmed.

As an indication of how severe California's budget crises is, the State's Controllers Office estimates that California could run out of cash as early as July 2010. There are essentially three ways the State can prevent this. First, California could borrow more money. This option seems unlikely given the State's poor credit rating and the associated high costs of borrowing. Second, taxes could be raised. Again, this seems unlikely. Voters in California have little appetite for more taxes. Finally, California can reduce expenses. While difficult, this appears to be the most likely solution. Reduced expenses mean fewer government services and more layoffs.

One of the most severe problems facing the Basin is unemployment. The bad news is February 2010 unemployment rates, the latest month for which we have data, are higher than February 2009 numbers. The good news is unemployment rates, while remaining tragically high, fell in February for each county, in part at least because of workers leaving the workforce.



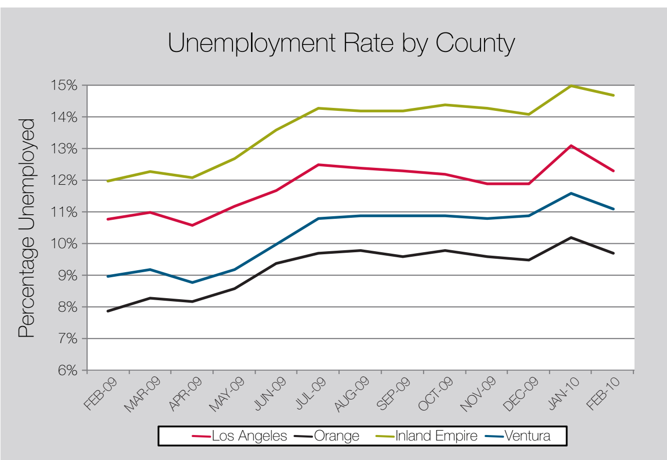
Source: California Controller's Office

A one month decline is not indicative of a trend. Given the issues outlined above, there is some concern that this trend will not continue. With that said, it is important to recognize that any decrease in unemployment should be perceived as a positive sign. Even small decreases mean that employment opportunities are increasing.

Unemployment rates in the Los Angeles basin (Los Angeles, Orange, Riverside, San Bernardino, and Ventura counties) exhibited a similar pattern in February 2010. The Inland Empire, Riverside and San Bernardino counties, continues to have the highest unemployment rate, 14.7 percent. Orange County has the lowest unemployment rate, 9.7 percent, in the Basin.

As the unemployment rate increases so does the number of unemployed persons. From February 2009 to February 2010 the number of unemployed persons in the Los Angeles Basin increased 20.7 percent. While this is high, it is significantly better than last year's change when the Basin's unemployed rose 80.5 percent.

The slowdown in the growth of unemployed persons can be viewed with cautious optimism. It suggests that the labor market is approaching the bottom. Unfortunately, the labor market is likely to drag along the bottom for some time, as the economy searches for solid footing. Based on the forecast above, this is likely to take some time. We do not expect improvements in the labor market during 2010.



Source: California Employment Development Department

Change in Unemployed Persons				
	Feb 10 - Feb 09		Feb 09 - Feb 08	
	Number	Percent Change	Number	Percent Change
Los Angeles	66,700	12.5%	245,400	85.4%
Orange	34,200	27.0%	58,100	84.6%
Inland Empire	45,000	20.9%	96,500	81.3%
Ventura	8,800	22.5%	16,200	70.7%
Total/Average	**154,700**	**20.7%**	**416,200**	**80.5%**

Source: California Employment Development Department

All industries within the Los Angeles basin, save two, have lost jobs over the past twelve months. Education and Health Services and Information Services were the only industries that gained jobs from February 2009 to February 2010. Given the state of the residential and commercial real estate markets it is no surprise that the construction industry lost the most jobs in percentage terms.

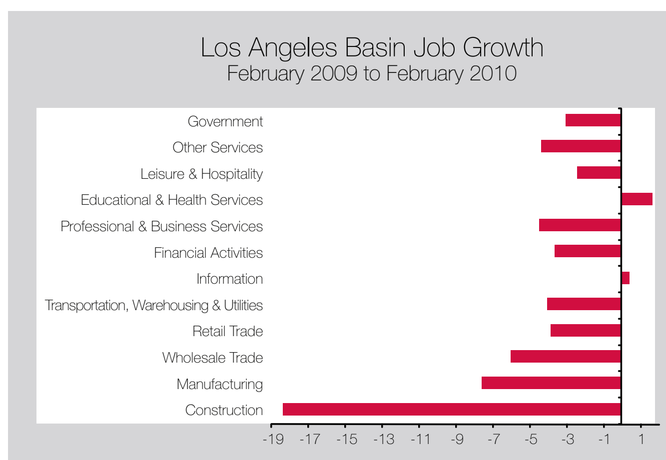
The increase in Education and Health Services was due to an increase in Health Services that was partially offset by declines in Education. The State's budget problems are impacting employment at all levels of education. Given the troubles mentioned above, it is likely that more Education jobs will be lost in 2010.

The increase in Health Services is primarily due to an aging population. As individuals age they tend to demand more health services. As baby boomers continue to age we expect more employment opportunities in this sector.

To date job losses in the Government sector have been small. However, given California's budget problems we expect this to change in 2010. As we discussed above, budget cuts are the most likely tool Sacramento will use to cut next years' budget deficit. This implies that government employment will decline, because salaries are a very large component of government costs. The lost jobs are likely to occur throughout California and will affect a wide variety of government services.

Problems in the labor market continue to negatively impact the housing market. Consumers concerned about future employment are not likely to purchase a home. Those who have lost their jobs are cutting back on everyday expenses in order to keep their mortgages current. Regardless of employment status, home owners who owe more than their home is worth are walking away in record numbers, and the trend seems to be accelerating.

Notices of default and foreclosures remain extremely high relative to their historic norms. On a positive note, foreclosures have fallen from their 2008 peak. Unfortunately, the same is not true of notices of default. There were more notices of default in 2009

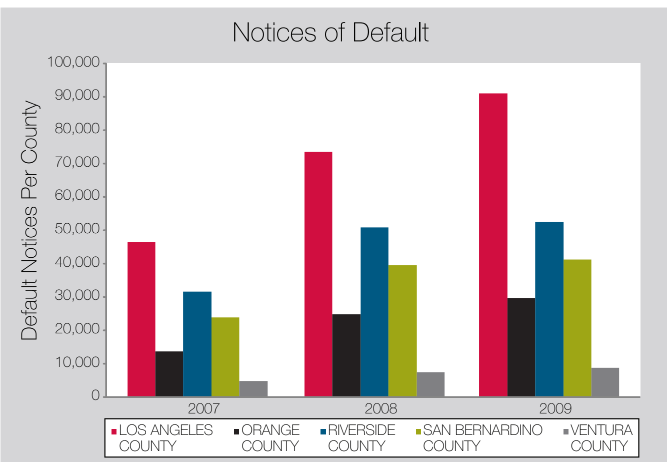


Source: California Employment Development Department than in 2008. The increase in notices of default suggests that foreclosures may rise in 2010.

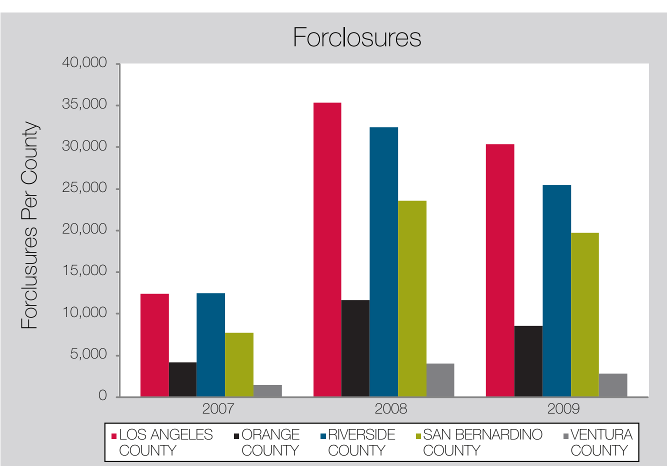
The historically high level of both notices of default and foreclosures, increasing notices of default, and weak labor markets suggest that the Basin's residential real estate market remains weak. It may be some time before we see some relief in the residential real estate market.

Not all of the economic data is bad. In fact, two of the largest sectors in the Los Angeles Basin are showing signs of improvement. After months of decline, shipments through the Port of Long Beach have recently increased. More importantly, the largest increase occurred in February, the last month for which we have data. These increases suggest that world trade is beginning to improve and further support data that suggest that manufacturing is improving.

This bodes well for the Basin. The Port and related industries employ a significant number of local residents. A rebounding manufacturing sector will also help the area's economy.



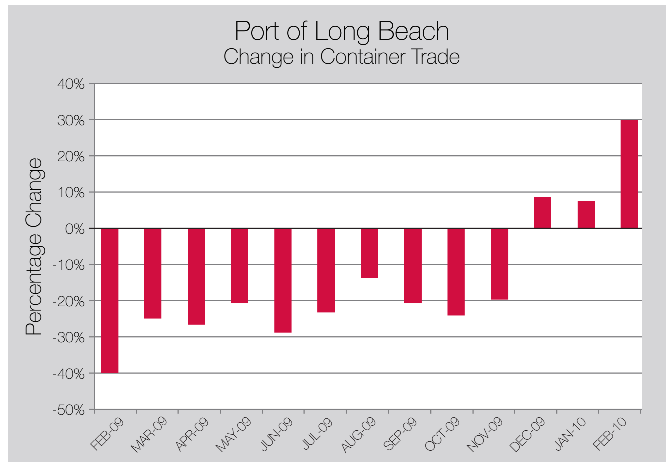
Source: DataQuick



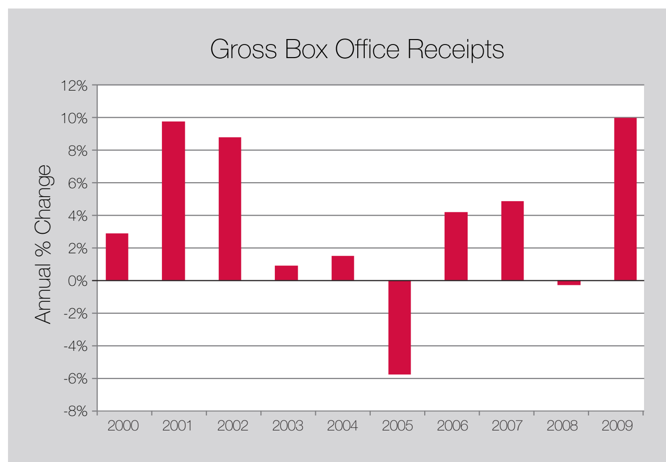
Source: DataQuick

Although, we must note that manufacturing's share of the Basin's economy is shrinking. Nonetheless, any improvement in manufacturing will be welcome.

Finally, the entertainment industry had a banner year in 2009 as measured by gross receipts. After declining in 2008, box office receipts rose 10 percent in 2009. Increases in both ticket sales and prices were responsible for the growth in gross receipts. For the year, ticket sales increased 5.3 percent while the average price for a movie increased from $7.18 to $7.50.



Source: Port of Long Beach



Source: Box Office Mojo

Retail Market

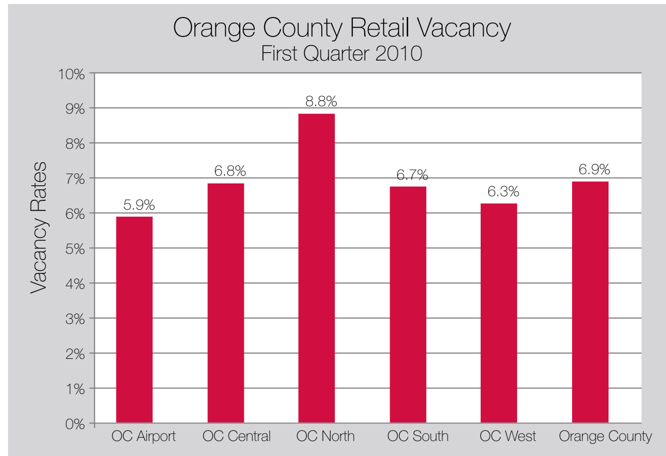
The decline in consumer spending has negatively impacted the retail market. Retail sales in California have declined for eight consecutive quarters and are likely to decline in 2010. High unemployment, overleveraged consumers, increased internet sales, and stagnant wages will all combine to keep local retail sales subdued in the coming year.

The continuing decline will have numerous impacts. The two most concerning are the impact on local government budgets and the impact on the retail segment of the commercial market. Declining retail sales translated into fewer receipts for local governments. Financially strapped local governments will find it harder to balance their budgets in 2010.

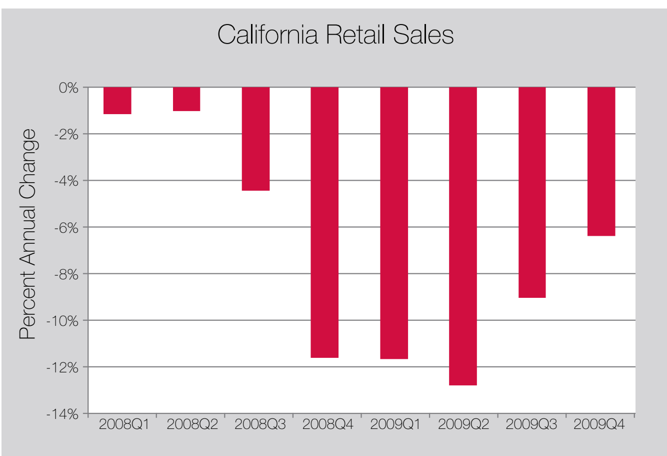
Overall demand for retail space is likely to be limited in the near future, due to declining retail sales. Discount retailers are one exception. In difficult economic times discount retailers tend to outperform traditional and upscale retailers as consumers substitute away from high priced items. Thus, we expect to see some strength in this segment.

Problems in the retail segment are likely to persist throughout 2009 and into 2010. Over-leveraged balance sheets, stagnant wages and job security concerns will entice consumers to save rather than spend. Consumer debt will also play a role. In these trying economic times consumers are opting to paying down debt rather than spending their disposable income.

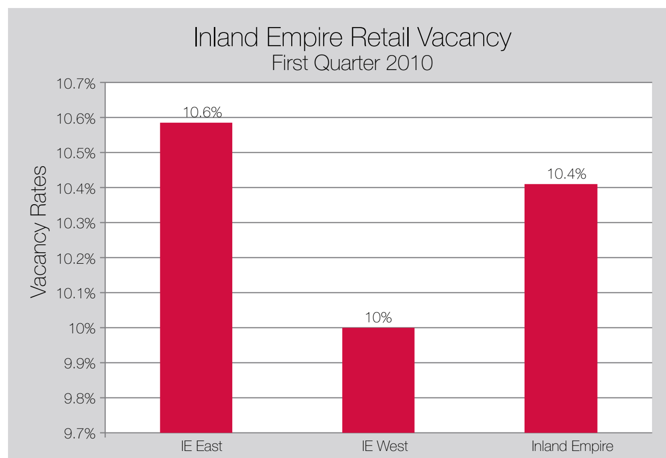
Relative to a year ago, retail vacancy rates are up. For the Basin



Source: CoStar



Source: CERF



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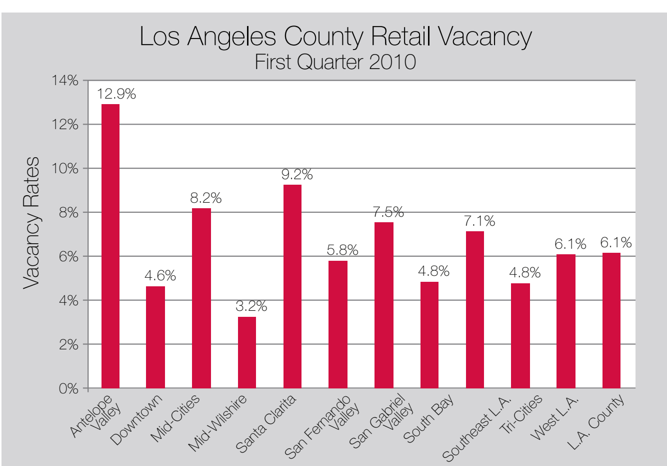

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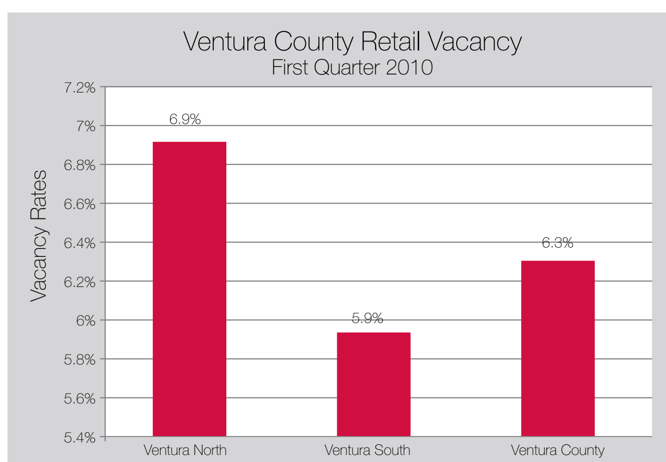
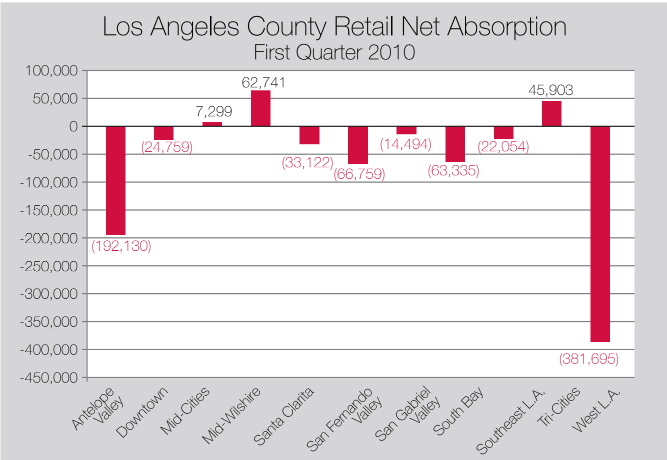


Source: CoStar

as a whole, vacancy rates have increased 1.4 percent from the first quarter of 2009. Orange County experienced the largest increase, 2 percent, while the increase in Ventura County was below 1 percent.

Net absorption for the Basin was negative. In the first quarter of 2010, nearly 1,000,000 square feet of net retail space was returned to the market. The lone bright spot was the Inland Empire, which experienced a positive net absorption.

Increasing vacancy rates and negative net absorption combined to reduce lease rates. On average lease rates declined $.11 per square foot per month in Q1 2010 compared to a year ago. Orange County experienced the largest decline as rates fell $.24 per square foot per month. On a positive note, retail lease rates did not decline in Los Angeles County.



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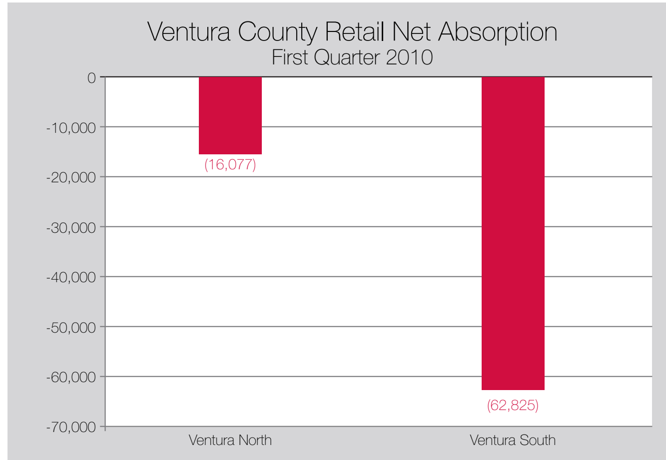

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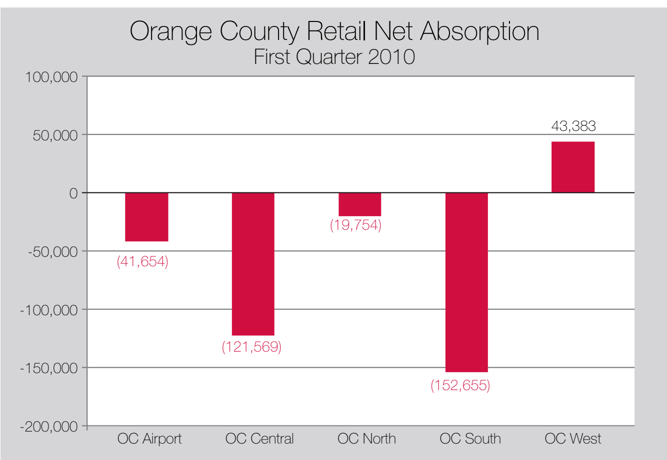

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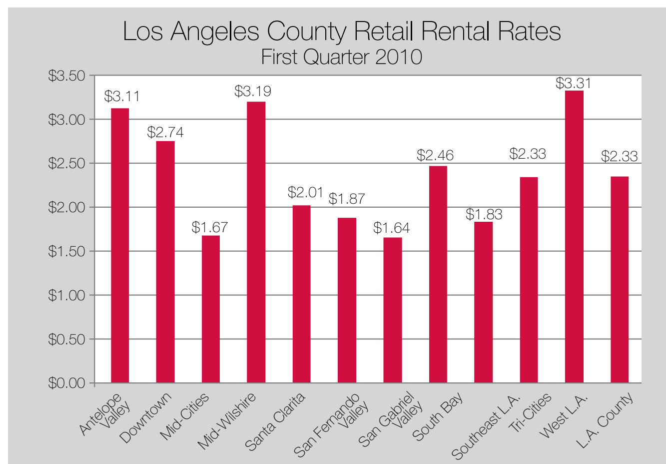

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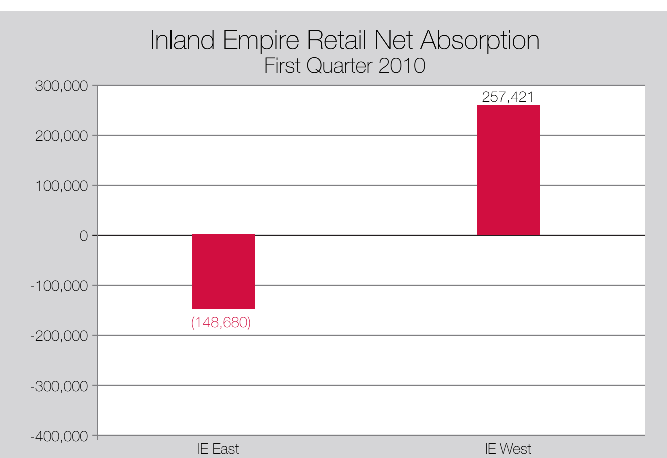

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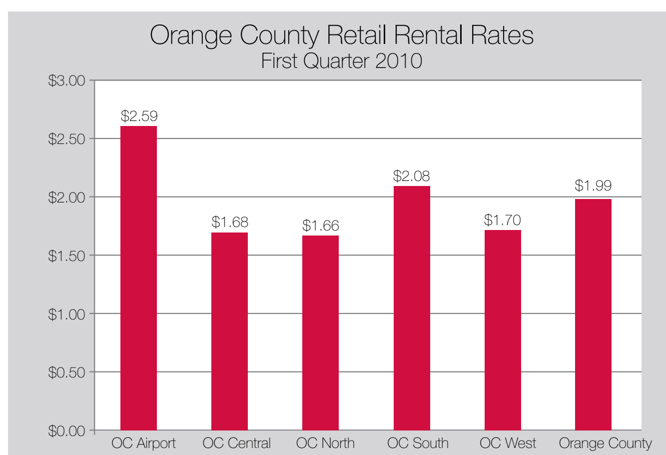

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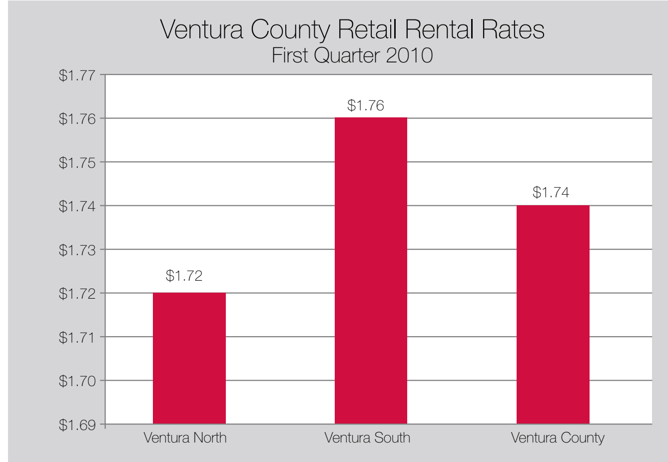


Source: CoStar

Los Angeles Basin Retail Market ■ First Quarter 2010

	Vacancy Rate				Average Asking Rental Rate[1]		
	2010	2009	Difference	Net Absorption (SF)	2010	2009	Difference
Antelope Valley	12.9%	9.0%	3.9%	(192,130)	$3.11	$2.12	$0.99
Downtown	4.6%	3.9%	0.7%	(24,759)	$2.74	$1.90	$0.85
Mid Cities	8.2%	8.1%	0.1%	7,299	$1.67	$1.68	($0.01)
Mid Wilshire	3.2%	2.8%	0.5%	62,741	$3.19	$3.54	($0.36)
Santa Clarita	9.2%	7.3%	1.9%	(33,122)	$2.01	$2.48	($0.47)
San Fernando Valley	5.8%	5.0%	0.8%	(66,759)	$1.87	$2.28	($0.41)
San Gabriel Valley	7.5%	6.4%	1.2%	(14,494)	$1.64	$1.82	($0.18)
South Bay	4.8%	4.2%	0.6%	(63,335)	$2.46	$1.92	$0.53
Southeast LA	7.1%	6.0%	1.1%	(22,054)	$1.83	$1.95	($0.12)
Tri Cities	4.8%	4.6%	0.1%	45,903	$2.33	$2.48	($0.15)
West LA	6.1%	3.2%	2.8%	(381,695)	$3.31	$3.56	($0.25)
Los Angeles County	6.1%	5.1%	1.0%	(682,405)	$2.33	$2.33	$0.00
OC Airport	5.9%	4.0%	1.9%	(41,654)	$2.59	$2.44	$0.14
OC Central	6.8%	5.3%	1.5%	(121,569)	$1.68	$2.09	($0.41)
OC North	8.8%	6.6%	2.2%	(19,754)	$1.66	$1.75	($0.09)
OC South	6.7%	4.5%	2.3%	(152,655)	$2.08	$2.56	($0.48)
OC West	6.3%	4.4%	1.9%	43,383	$1.70	$2.27	($0.57)
Orange County	6.9%	4.9%	2.0%	(292,249)	$1.99	$2.24	($0.24)
IE East	10.6%	8.4%	2.2%	(148,680)	$1.51	$1.60	($0.09)
IE West	10.0%	9.2%	0.8%	257,421	$1.73	$2.07	($0.35)
Inland Empire	10.4%	8.6%	1.8%	108,741	$1.57	$1.74	($0.17)
Ventura North	6.9%	6.0%	0.9%	(16,077)	$1.72	$1.79	($0.07)
Ventura South	5.9%	5.4%	0.5%	(62,825)	$1.76	$2.02	($0.26)
Ventura County	6.3%	5.6%	0.7%	(78,902)	$1.74	$1.93	($0.19)
Total LA Basin	**7.4%**	**6.1%**	**1.4%**	**(944,815)**	**$2.02**	**$2.13**	**($0.11)**

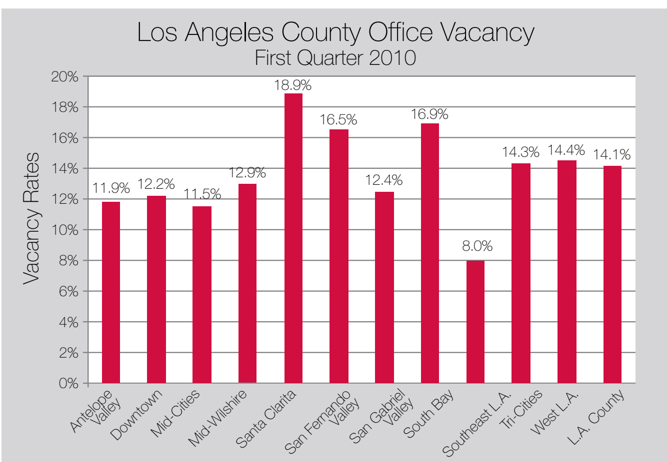
[1]Per SF per month, NNN. Total is weighted by available space.
Data is for all Class A, B and C buildings 20,000 SF or larger. Excludes owner-occupied.
Source: CoStar

Office Market

Conditions in the office market remain weak. Poor economic conditions have forced many companies to cut back or completely eliminate expansion plans. Corporate bankruptcies, downsizing and consolidation are taking their toll on the office market. Current economic conditions have negatively altered the risk-reward profile for many companies. The risk of expansion has increased while the reward has fallen.

Rather than looking for new space most companies are trying to reduce the amount of space they lease. There are two reasons for this. First, as layoffs grow the need for space is reduced. Secondly, organizations are looking for ways to reduce expenses. Consolidating operations is one way to accomplish this goal.

The end result of all this is high vacancy rates. The average vacancy rate in the Los Angeles Basin is 16.1 percent. This represents a two percentage point increase from the first quarter of 2009. Orange County and the Inland Empire have the highest vacancy rates in the Basin. Vacancy rates in these counties are just below 20 percent. As a sign of the weaknesses in the office market we note that every region within the Los Angeles Basin has a vacancy rate above 10 percent.



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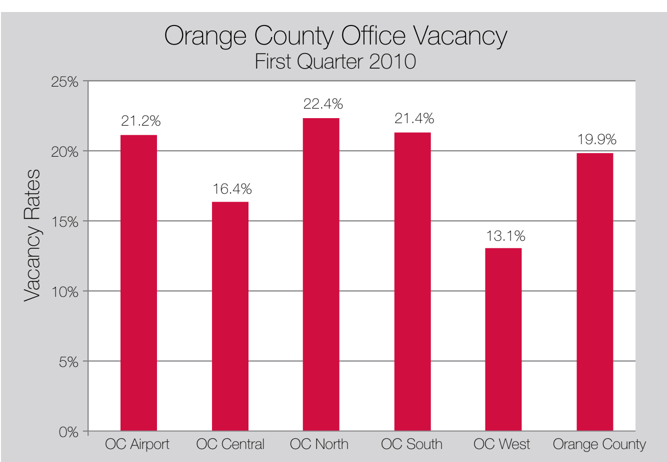
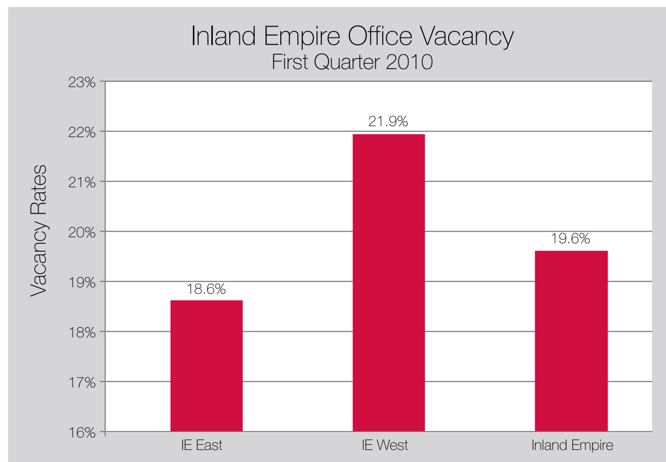


Source: CoStar

Despite the all the bad news, there is one positive sign. Office vacancy rates in the Inland Empire fell 0.5 percentage points compared to the first quarter of 2009. Premier space offered at the lowest lease rates in the Basin is bringing tenants to the Inland Empire.

The lack of demand for office space has forced landlords to reduce lease rates. Compared to the first quarter of 2009, average lease rates have fallen $.18 per square foot per month in the Los Angeles Basin. Orange County, home to numerous bankrupt mortgage companies, experienced the largest decline in lease rates. The average asking lease rate for office space in the Los Angeles Basin is now around $2.30 per square foot per month.

Given the weak economic conditions, net absorption during the first quarter of 2010 was negative. Nearly 2 million square feet of space was returned to the market. The lone bright spot was the Inland Empire. Demand in this market appears to be strengthening as net absorption was positive. As mentioned above, most of the demand stems from low lease rates.



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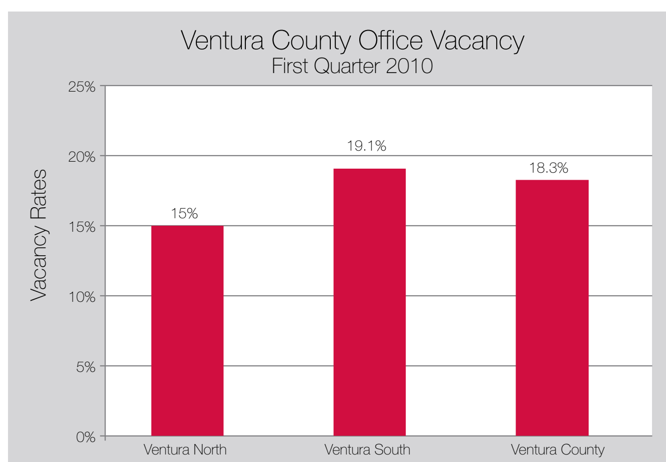

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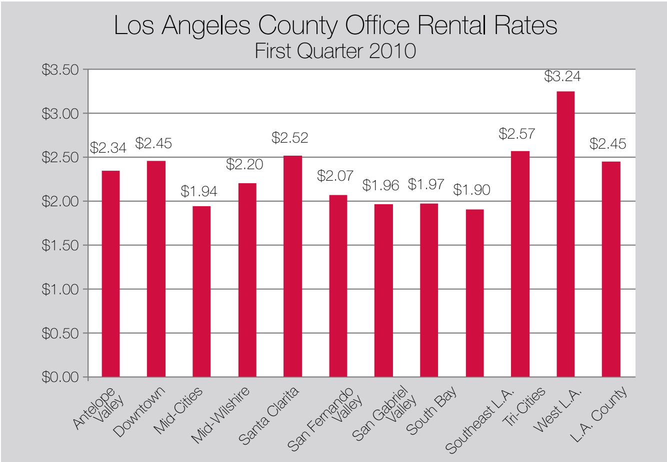

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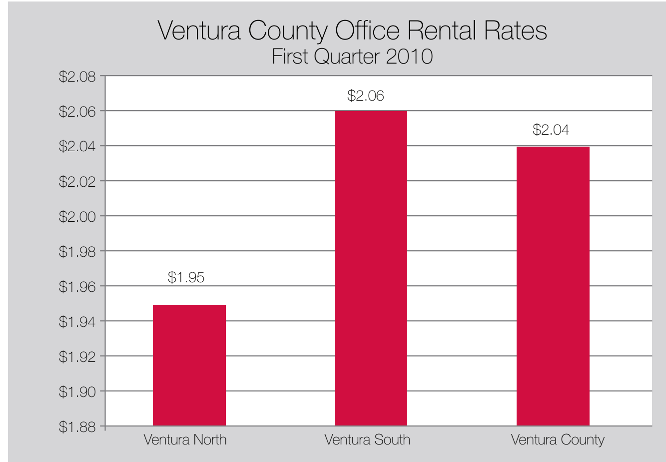

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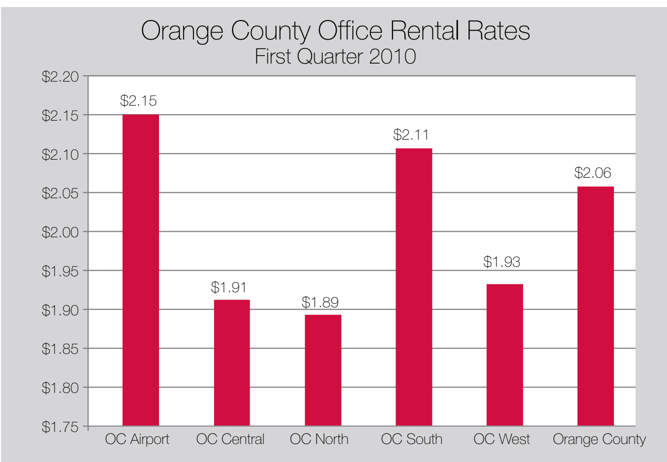

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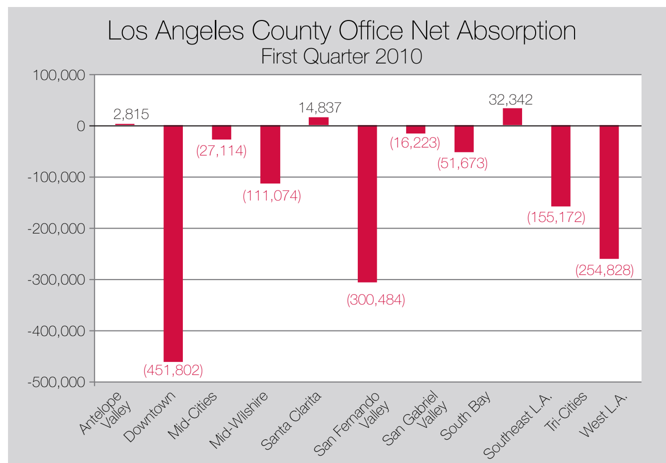

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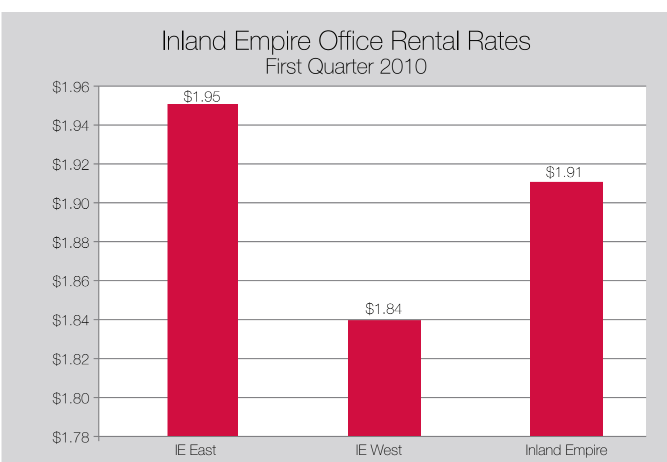

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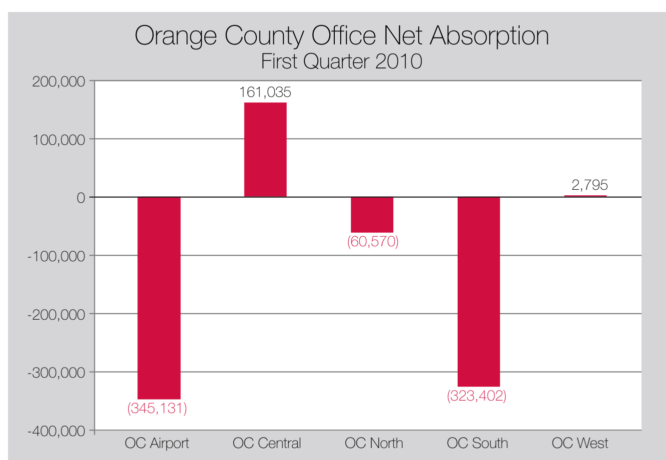

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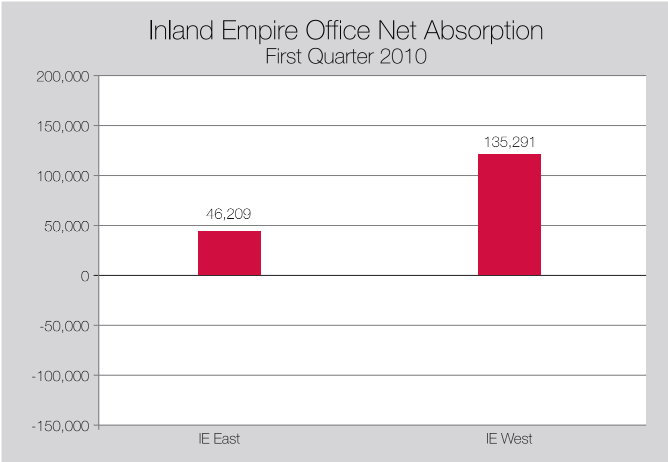

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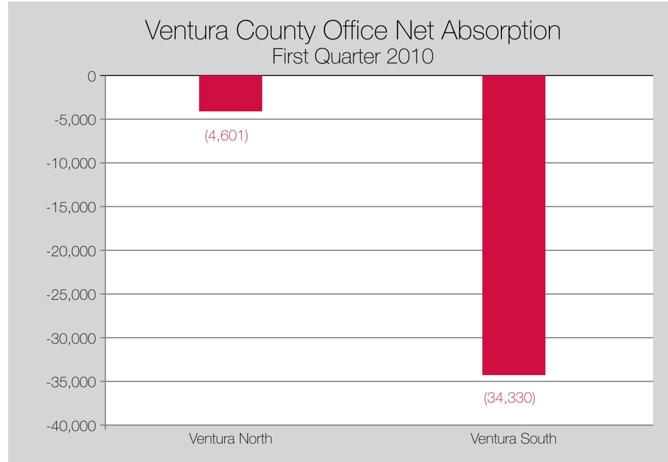


Source: CoStar

Los Angeles Basin Office Market ■ First Quarter 2010

	Vacancy Rate				Average Asking Rental Rate[1]		
	2010	2009	Difference	Net Absorption (SF)	2010	2009	Difference
Antelope Valley	11.9%	14.3%	-2.4%	2,815	$2.34	$2.37	($0.03)
Downtown	12.2%	11.7%	0.5%	(451,802)	$2.45	$2.56	($0.11)
Mid Cities	11.5%	8.0%	3.5%	(27,114)	$1.94	$2.02	($0.08)
Mid Wilshire	12.9%	9.9%	3.0%	(111,074)	$2.20	$2.60	($0.40)
Santa Clarita	18.9%	18.0%	0.8%	14,837	$2.52	$2.62	($0.11)
San Fernando Valley	16.5%	13.4%	3.1%	(300,484)	$2.07	$2.28	($0.22)
San Gabriel Valley	12.4%	11.7%	0.7%	(16,223)	$1.96	$2.02	($0.06)
South Bay	16.9%	16.0%	0.9%	(51,673)	$1.97	$2.00	($0.03)
Southeast LA	8.0%	9.1%	-1.1%	32,342	$1.90	$2.00	($0.09)
Tri Cities	14.3%	10.2%	4.1%	(155,172)	$2.57	$2.73	($0.17)
West LA	14.4%	11.8%	2.6%	(254,828)	$3.24	$3.56	($0.31)
Los Angeles County	14.1%	12.2%	2.0%	(1,318,376)	$2.45	$2.63	($0.18)
OC Airport	21.2%	18.1%	3.1%	(345,131)	$2.15	$2.40	($0.25)
OC Central	16.4%	15.9%	0.5%	161,035	$1.91	$2.02	($0.10)
OC North	22.4%	15.0%	7.4%	(60,570)	$1.89	$2.12	($0.23)
OC South	21.4%	16.4%	4.9%	(323,402)	$2.11	$2.31	($0.20)
OC West	13.1%	11.0%	2.1%	2,795	$1.93	$2.15	($0.22)
Orange County	19.9%	16.6%	3.2%	(565,273)	$2.06	$2.27	($0.21)
IE East	18.6%	18.6%	0.0%	46,209	$1.95	$2.02	($0.08)
IE West	21.9%	23.7%	-1.8%	135,291	$1.84	$2.02	($0.18)
Inland Empire	19.6%	20.1%	-0.5%	181,500	$1.91	$2.02	($0.11)
Ventura North	15.0%	15.1%	-0.1%	(4,601)	$1.95	$1.95	($0.00)
Ventura South	19.1%	18.9%	0.2%	(34,330)	$2.06	$2.24	($0.19)
Ventura County	18.3%	18.1%	0.1%	(38,931)	$2.04	$2.18	($0.15)
Total LA Basin	**16.1%**	**14.1%**	**2.0%**	**(1,741,080)**	**$2.30**	**$2.48**	**($0.18)**

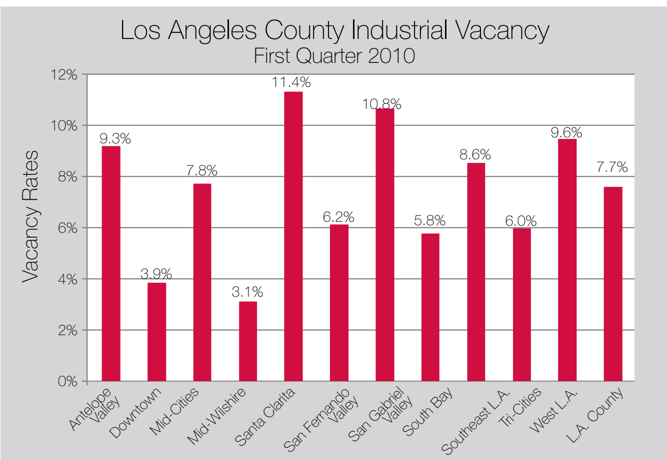
[1]Per SF per month, NNN. Total is weighted by available space.
Data is for all Class A, B and C buildings 20,000 SF or larger. Excludes owner-occupied.
Source: CoStar

Industrial Market

Much like the other markets, industrial real estate remains weak. Fortunately, there is good news regarding this segment. The Institute for Supply Management's (ISM) factory index, a broad measure of manufacturing activity in the U.S., rose in March 2010. This is the eighth consecutive month the index has risen. As of March 2010 the index stood at 59.6, (a reading below 50 indicates contraction), suggesting that the manufacturing sector is improving.

While this news is encouraging, it will take time for the increased activity to be felt in the industrial real estate market. After the devastating recession, business will expand cautiously. We expect it will take at least six to nine months before we see improvements in the industrial market. Until then the industrial market will likely remain weak. We expect vacancy rates to increase and lease rates to decrease throughout 2010.

Vacancy rates for industrial space are increasing in the Basin. The average vacancy rate in the Basin is 10.6 percent. This is 1.6 percentage points higher than last year's number. Only Los Angeles and Ventura County's have vacancy rates below 10 percent. At 14.8 percent the Inland Empire has the highest vacancy rate.



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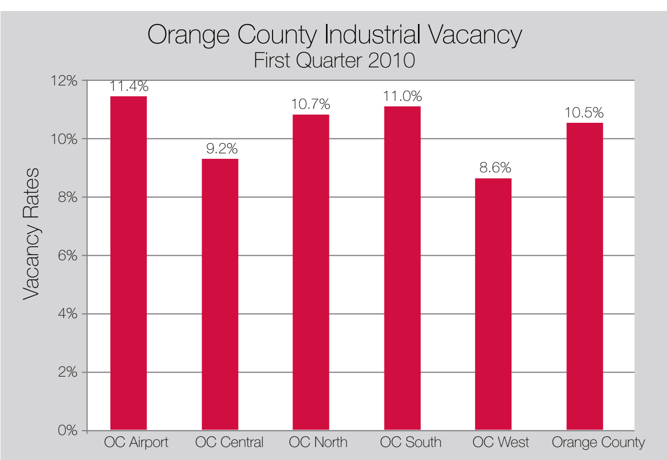
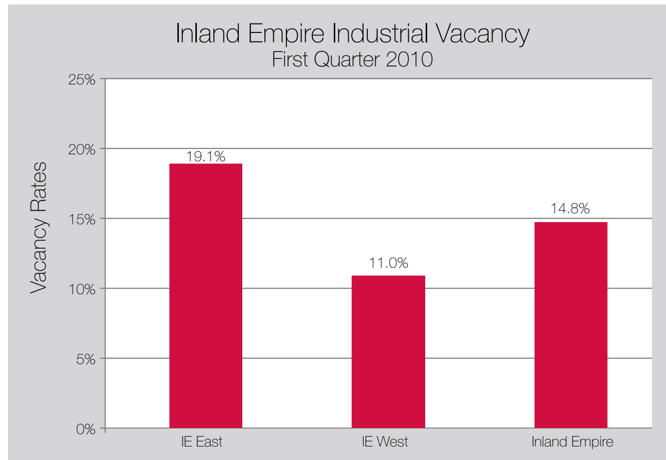


Source: CoStar

Ventura County has the lowest rate, 7.1 percent.

Net absorption for industrial space was negative for the first quarter of 2010. Just over 5 million square feet of space was returned to the market. Similar to the office market, demand for industrial space in the Inland Empire appears to be strengthening. In this particular market, net absorption was positive.

As with the other markets, lease rates for industrial space have fallen. Weak market conditions have forced landlords to reduce rates in an effort to lure or keep tenants. We expect this trend to continue but at a much slower pace. Lease rates are expected to fall slightly in 2010. However, as manufacturing in the Los Angeles Basin improves so will the industrial market.



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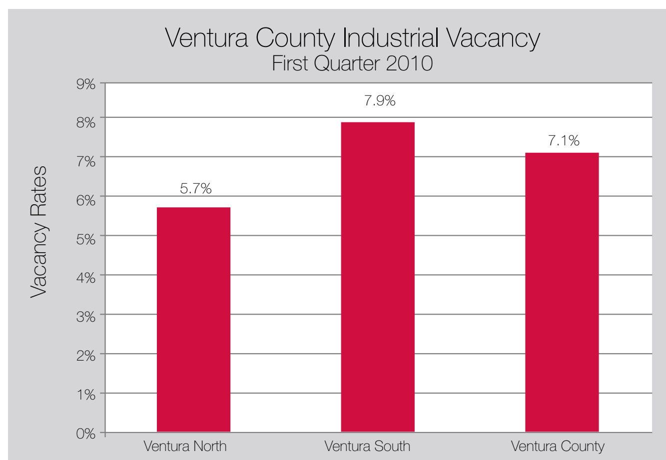

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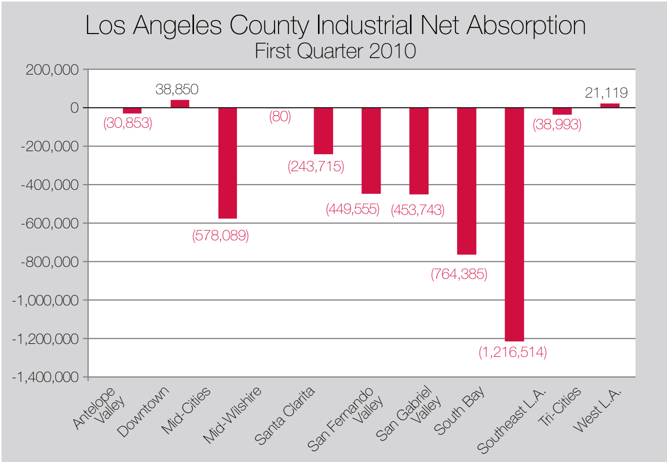

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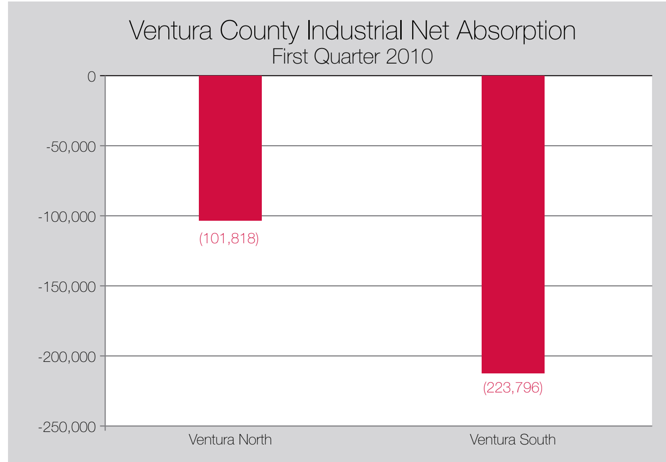

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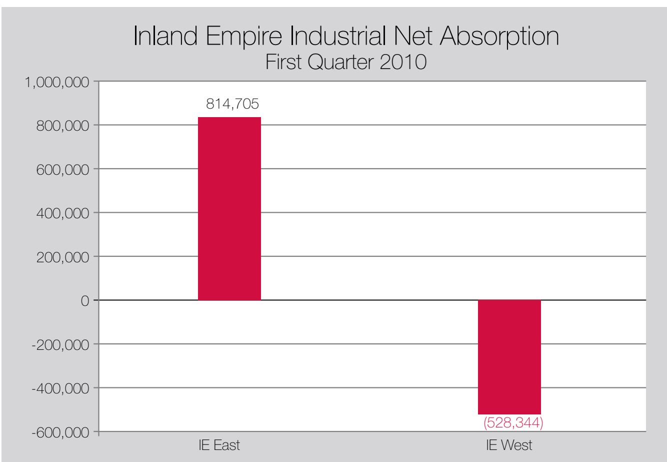

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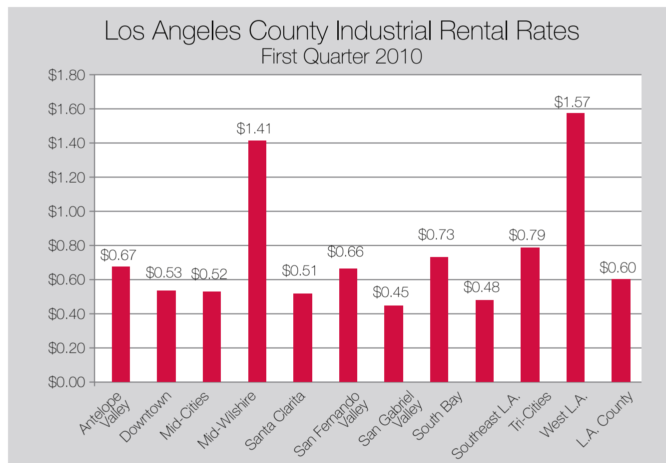

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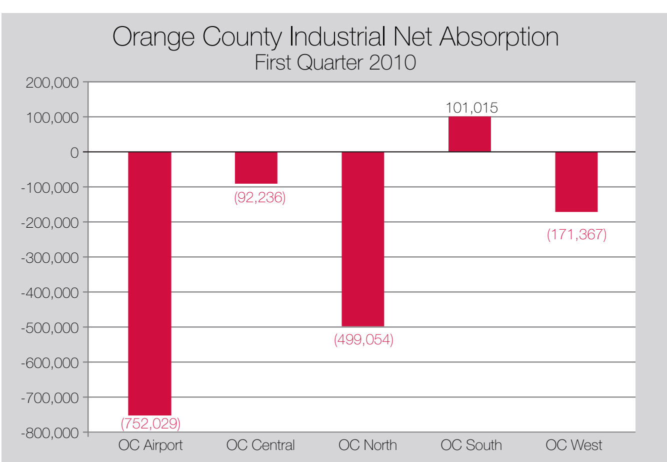

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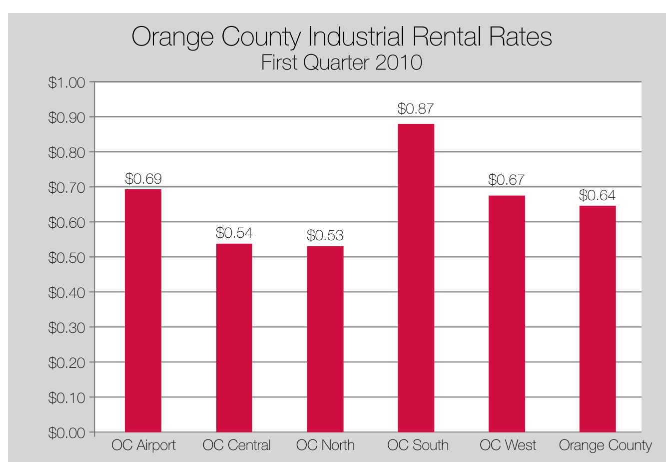

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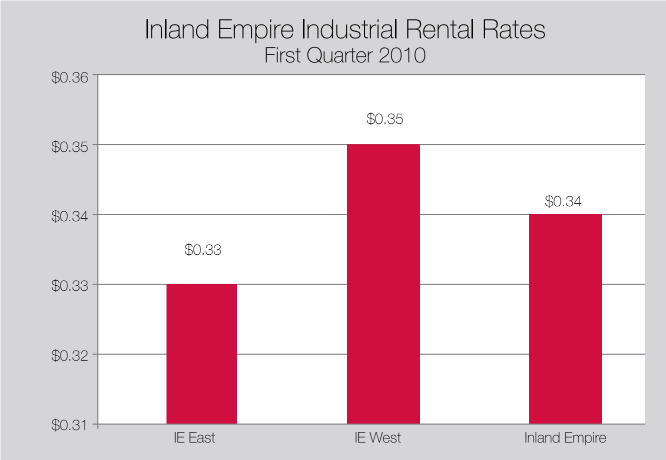

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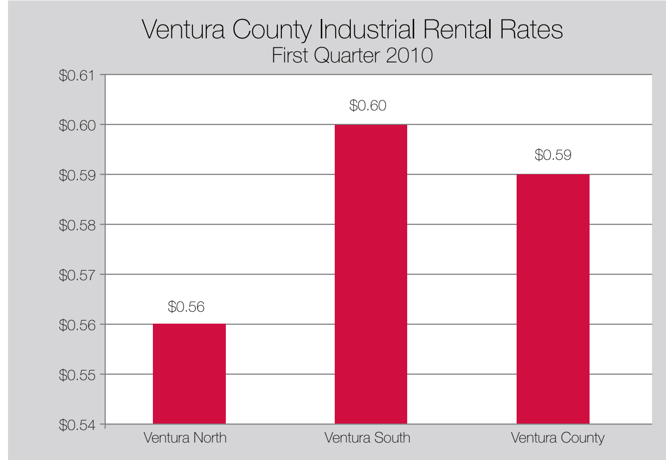


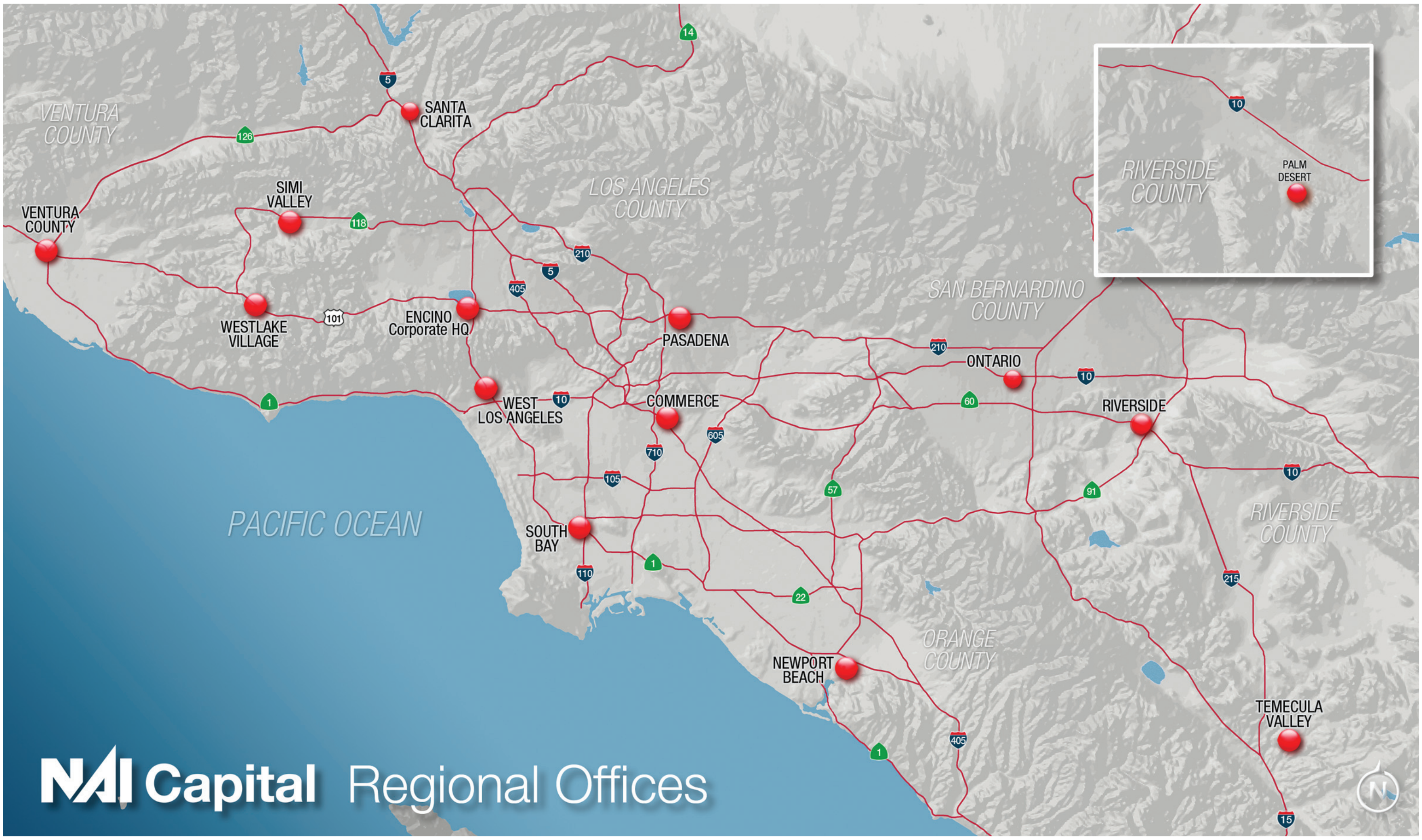
Source: CoStar

Los Angeles Basin Industrial Market ■ First Quarter 2010

	Vacancy Rate				Average Asking Rental Rate[1]		
	2010	2009	Difference	Net Absorption (SF)	2010	2009	Difference
Antelope Valley	9.3%	8.3%	1.0%	(30,853)	$0.67	$0.69	($0.02)
Downtown	3.9%	3.9%	0.0%	38,850	$0.53	$0.67	($0.13)
Mid Cities	7.8%	5.7%	2.1%	(578,089)	$0.52	$0.62	($0.09)
Mid Wilshire	3.1%	1.1%	2.0%	(80)	$1.41	$2.01	($0.61)
Santa Clarita	11.4%	8.1%	3.3%	(243,715)	$0.51	$0.63	($0.12)
San Fernando Valley	6.2%	4.1%	2.1%	(449,555)	$0.66	$0.67	($0.01)
San Gabriel Valley	10.8%	10.3%	0.4%	(453,743)	$0.45	$0.51	($0.07)
South Bay	5.8%	4.0%	1.8%	(764,385)	$0.73	$0.71	$0.02
Southeast LA	8.6%	4.8%	3.8%	(1,216,514)	$0.48	$0.55	($0.07)
Tri Cities	6.0%	4.7%	1.3%	(38,993)	$0.79	$0.81	($0.02)
West LA	9.6%	8.5%	1.1%	21,119	$1.57	$1.56	$0.01
Los Angeles County	7.7%	5.7%	2.0%	(3,715,958)	$0.60	$0.65	($0.06)
OC Airport	11.4%	7.6%	3.8%	(752,029)	$0.69	$0.85	($0.16)
OC Central	9.2%	7.4%	1.8%	(92,236)	$0.54	$0.61	($0.07)
OC North	10.7%	6.7%	4.1%	(499,054)	$0.53	$0.59	($0.07)
OC South	11.0%	8.9%	2.1%	101,015	$0.87	$1.02	($0.15)
OC West	8.6%	3.9%	4.7%	(171,367)	$0.67	$0.82	($0.14)
Orange County	10.5%	7.2%	3.3%	(1,413,671)	$0.64	$0.76	($0.11)
IE East	19.1%	18.6%	0.4%	814,705	$0.33	$0.40	($0.07)
IE West	11.0%	10.8%	0.2%	(528,344)	$0.35	$0.43	($0.08)
Inland Empire	14.8%	14.6%	0.3%	286,361	$0.34	$0.41	($0.07)
Ventura North	5.7%	4.3%	1.4%	(101,816)	$0.56	$0.63	($0.07)
Ventura South	7.9%	4.9%	3.0%	(223,796)	$0.60	$0.60	$0.00
Ventura County	7.1%	4.7%	2.4%	(325,612)	$0.59	$0.61	($0.02)
Total LA Basin	**10.6%**	**8.9%**	**1.6%**	**(5,168,880)**	**$0.51**	**$0.58**	**($0.07)**

[1]Per SF per month, NNN. Total is weighted by available space.
Data is for all Class A, B and C buildings 20,000 SF or larger. Excludes owner-occupied.
Source: CoStar

Regional Offices



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