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Griffin Realty Advisors Economic and Real Estate Update



On a daily basis, there are numerous media reports regarding the state of the economy which would make one believe Chicken Little is back in town and "the sky is falling." While there is reason for concern, the situation is not as dire as many are reporting. Truth be told, money managers, economist and investment strategist all say the economy will rebound in the second half of the year. More specifically, Chris Probyn, chief economist for State Street Global Advisors in Boston says, "A moderate recovery is expected in the second half (of 2009) based upon aggressive federal policy and reaction to it" and James Swanson, chief investment strategist for MFS Investment Management believes "daylight comes this summer as lower mortgage rates, government stimulus actions and housing availability kick in" and finally Dennis Lockhart, president of the Atlanta Federal Reserve Bank says "I believe financial markets will have stabilized sufficiently to support a recovery, so I am looking for an improving economy in the second half (of 2009)". They can't all be wrong. And they are not. The massive intervention by the Federal Reserve and the global central banks is starting to take affect and the frozen credit markets are beginning to thaw. Most economist agree that GDP will begin to rebound by the 2nd quarter of 2009 and the chance of unemployment reaching double digits is remote. So all signs point to economic improvement beginning in the second half of 2009.

We believe the same holds true for the real estate capital markets. The capital markets are currently in a holding pattern because of the lack of available credit and the inability to determine current market values due to minimal transaction volumes. In 2009 there is approximately \$160 billion in commercial real estate debt maturing which will force owners who are unable to obtain adequate

leverage to sell assets at distressed prices. This, along with the natural thaw of the credit markets which is occurring, will jump start the capital markets back into gear by the last half of 2009. According to Stuart A. Schweitzer, global markets strategist for JP Morgan Asset Management, "The spark to watch for will be investors beginning to buy distressed assets in sufficient quantity for their prices to rise, boosting capital ratios of financial counterparties and encouraging lending to resume."

For investors sitting on the sidelines flush with cash, there will be bargains galore. Bernard Haddigan, 28 year real estate veteran with Marcus & Millichap Real Estate Investment Services believes "the next three to five years are going to be the best buying opportunity that any of us have seen in our careers."

The following information outlines, in more detail, the major economic factors having an effect on the economy and the real estate markets along with our thoughts regarding timing of recovery.

Gross Domestic Product (GDP)

The decrease in real GDP in the third quarter of .5% primarily reflected negative contributions from personal consumption expenditures, residential fixed investments and equipment and software. The residential sector will continue to have a negative effect until inventory levels normalize and restraints on mortgage credit begin to see relief. Business expenditures are also expected to be held back due to weaker sales outlooks and tighter credit conditions. Along with these factors, export growth began trending downward in the 3rd quarter due to the weak growth globally.

Because consumer spending represents approximately 70% of GDP, it warrants a closer look. Personal consumption fell by 3.7%. The greatest decline came in durable goods, which sank by a 14.1% in the 3rd quarter.



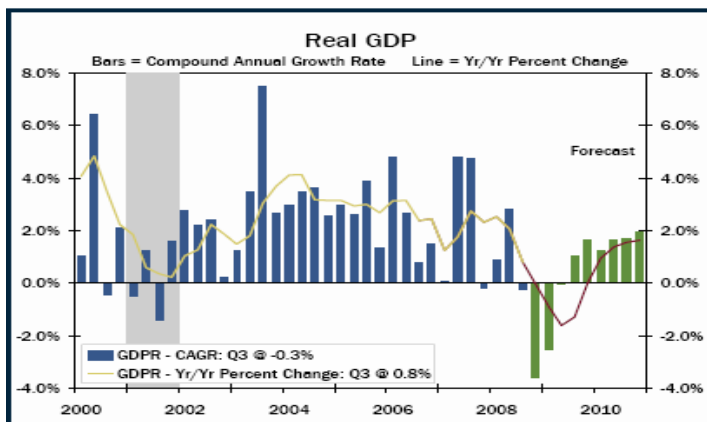
Economic Update

One of the major catalysts for this decline is the drop in auto sales to 10.5 million cars in October from 12.5 million in September. This decline represents a 34% decrease in sales on a year ago basis and is at its lowest since the early 1980s.

Nondurable goods spending fared better but only in relative terms with a decline of 6.4%. A major factor in this decline is the reduction in petroleum consumption which was down 16.7%.

In our view, there are two underlying factors causing the recent GDP decline to be more rapid. 1) The credit crunch has been exacerbated by a significant amount of consumer/business panic. Because we believe the markets have priced in the risk of a prolonged slump in earnings and efforts are under way to stabilize consumer confidence, we do not anticipate a prolonged decline in GDP once the credit market is stabilized. 2) Another contributing factor we view as having a short term affect is the decline in GDP related to petroleum. The import declines are attributed to a supply/demand imbalance promulgated by the surge in oil prices to \$150 a barrel during the summer which significantly reduced consumer consumption and pricing causing the price per barrel to drop to approximately \$40/barrel as of mid-January 2009. We expect this miss-match to correct itself in the near term through the normal business cycle and will not have a long term negative impact on GDP growth.

Most economists agree with the Federal Reserve's estimate of a 3%-4% annual rate of decline in the fourth quarter of 2008 and stabilization by early to mid-2009. They envision stabilized growth each quarter thereafter resulting in a flat 2009 and a return to a normalized rate of potential growth in 2010 as the restraints on households and business spending from the financial market tensions have eased and the contraction in the housing market is expected to come to an end.



Source: Wachovia Economic Watch

Unemployment

According to the Bureau of Labor Statistics, the unemployment rate rose to 7.2% in December which represents a 2.6 million person increase in unemployment since the beginning of the recession in December of 2007. As the list of firms announcing earnings dissapoint-

ments has increased, so has the pace of layoff announcements. To date, the downturn has been broad based with only a handful of sectors avoiding layoffs, including healthcare, educational services, commodity-producing industries and government. But, according to Economy.com, labor market conditions will deteriorate further in the coming months.

Stuart Hoffman, chief economist with PNC Financial expects unemployment to rise to at least 8.5% before the recession ends. The majority of researchers, including the Department of Labor and Employment, agree with Mr. Hoffman's assessment and believe the likelihood of double digit unemployment is remote. Most also agree that unemployment will peak by the end of 2009 or early 2010.

Consumer Confidence

According to Economy.com, the United States' net worth has fallen close to \$11 trillion since peaking a year ago; of that, \$4 trillion results from the decline in house prices, while the rest is due to the decline in stock prices. Given these dramatic declines and the rapid increase in unemployment during 2008, it is no wonder consumer confidence in December is at its lowest level since the Consumer Confidence Survey began more than 40 years ago.

While consumer outlook continues to be bleak, consumers appear to be shifting from the initial panic and are becoming comfortable with the idea that they must adjust spending habits away from a "consumption at any price" philosophy to a "consumption in moderation or limited to necessity." The initial panic also rallied a realization of consumers' need to de-leverage and increase savings which is apparent in the 1.3% savings level increase in September of 2008. It will take time for the American and global economy to adjust to this this new mantra but it will occur over time.

Consumer confidence will also strengthen as the markets begin to react to the government's recent policy actions including rate reductions, coordinated interest rate cuts by central banks, extraordinary liquidity measures, and official steps to strengthen financial systems.

Housing

There are 4 sides to the housing equation: pricing, sales volume, inventory and availability of credit.

Pricing

The financial shocks in late 2008 have appeared to dash any hopes for a quick recovery in the housing market, where the precipitous declines in sales and prices have only worsened. Of the sales that closed in October, nearly half were the result of sales after a foreclosure. Sellers were forced to lower prices again sending home values down at a record pace. Home prices across the United States declined 16.6 percent in the third quarter of 2008 from the July-to-September period a year ago, according to the Case-Shiller Home Price Index. This decline represents the largest quarter-to-quarter decline in prices since the survey began in 1988. Prices have returned to levels not seen since 2004. Indeed, the only silver lining to the significant price declines is that they signal the recovery process, while painful and slow, is under way.



Economic and Real Estate Update

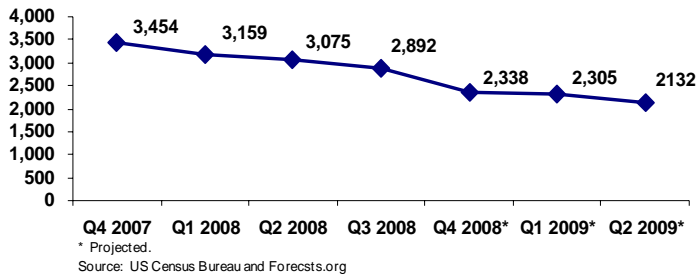
Sales Volume

In November of 2008, pending sales of existing homes dropped to a seven year low. Buyers have been reluctant to enter the market for several reasons; from widespread expectations that prices will fall further to a scarcity of mortgages being made available by lenders. Economists are cautiously hopeful that president-elect Barack Obama's proposed massive spending plan, together with steps by the Treasury and Federal Reserve to lower mortgage rates will support the housing sector in the second half of this year.

Inventory

In general, 6 months of home inventory is considered a buyers market. Given the fact that current inventory levels are at approximately 11 months, it is easy to understand the very negative impact this oversupply is having on the current housing market. While the drastic decline in housing starts over the past 18 months has had a negative effect on the overall economy as it relates to jobs and GDP, it is beneficial to the efforts needed to bring the housing market back to equilibrium.

Housing Starts



Unfortunately, it is going to take both a decline in the generation of new inventory and a decline in the pricing of existing inventory to finally stabilize this industry.

Availability to Finance

Because mortgage lenders have lost the vehicle to package and sell home loans (the MBS market), they are applying far more scrutiny on the credit quality of potential home buyers causing these potential borrowers to find it impossible to get a loan at any price. Sensing this increasingly dire situation, the Federal Reserve announced a pair of programs in November of 2008 aimed at helping Americans obtain the money needed to make large purchases, like a home. According to the Federal Reserve, the action is being taken to reduce the cost and increase the availability of credit for the purchase of houses. Initial reaction from economists at JP Morgan is that the action will measurably improve conditions in the mortgage markets and will have beneficial effects on housing and the broader economy. Thirty-year fixed mortgage rates have been declining since the announcement of these programs.

General Real Estate Outlook

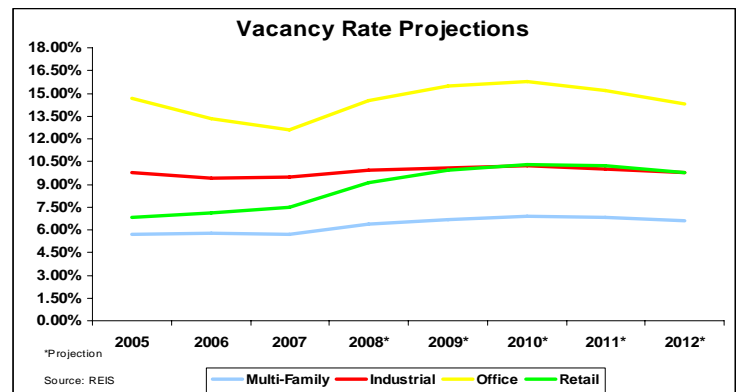
The commercial real estate industry is taking a double hit from the country's current economic woes. First, the now global credit crisis has placed a deep freeze on the availability of leverage for commercial real estate transactions which brought the capital markets to a screeching halt in 2008. Second, the weakening

economy which has resulted in higher unemployment, declining GDP and exports and waning consumer confidence is beginning to have a negative impact on real estate fundamentals.

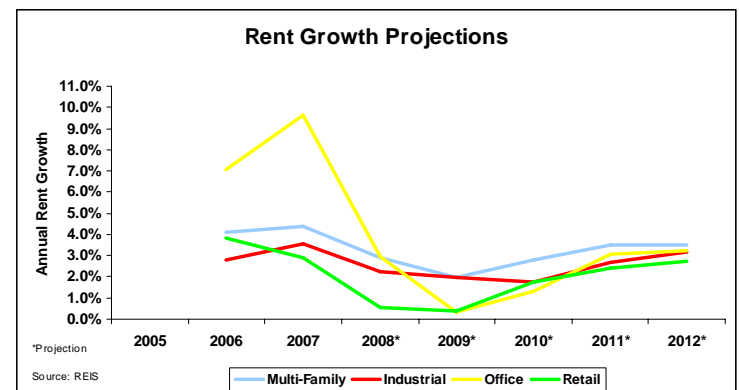
Even though the commercial real estate market is likely to experience a correction, experts believe the market is well-positioned to absorb a slowing economy. According to Arthur Jones, a senior economist with CBRE Torto Wheaton, "We are fortunate in this economic cycle, as opposed to 2001 or 1990, that there hasn't been any overdevelopment to speak of so the corrections that we're going to see are not going to be as severe or sharp or as painful as what we had in 2001."

Although fundamentals for all property types are expected to continue to weaken into the first half of 2009, retail and office properties are expected to be the hardest hit because they are experiencing the most significant degree of downturn in demand and tenant related issues.

According to 3rd quarter 2008 projections from REIS, retail vacancy rates are not expected to increase by more than 350 basis points off the 2005 vacancy low. Even at its high, REIS projects retail vacancy to cap out in 2010 at 10.2%. Given the negative performance of retailers in the 4th quarter of 2008, we expect vacancies to cap out higher than current REIS projections.



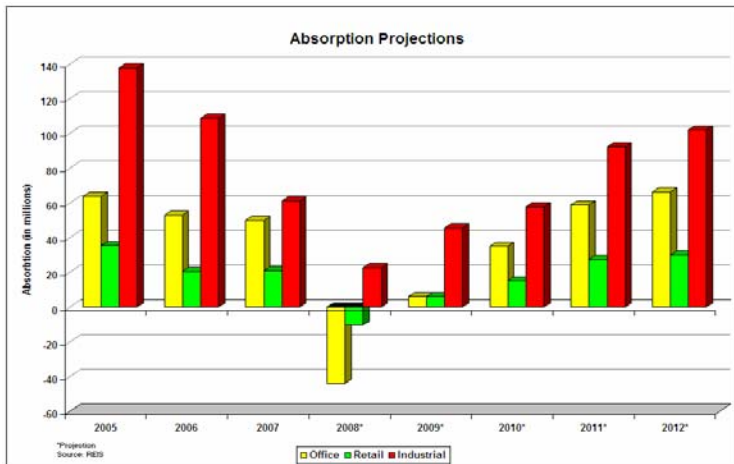
REIS third quarter 2008 asking rent projections do not anticipate declines in asking rents, however, they do reflect minimal growth in 2009 and 2010 and reflect annual rent growth being restored to normalized levels by 2011 and 2012. Our research indicates that asking rents are should remain constant during 2009, however rent concessions provided are likely to increase for the first half of 2009 having a detrimental affect on asking rents.





Real Estate Update

And finally, absorption projections by REIS do reflect negative expectations in 2008 and lower than historical absorption returning to stabilized levels in 2011-2012.



Truth be told, for investors who are standing on the sidelines waiting to get into the real estate game, 2009 is going to be the beginning of great investment opportunities.

Credit Markets

The commercial real estate debt capital markets made a sudden shift in 2008 from highly accommodative to highly risk adverse making borrowing both more difficult and more expensive. The near shutdown of the commercial mortgage-backed securities (CMBS) market has taken a huge chunk of capital off of the table for borrowers. In today's market, issuers don't want to make new loans unless they can sell the resulting bonds to investors but investors don't want to buy bonds until the spreads have settled down, thus the standstill. As of November 2008, there was only \$12.1 billion in U.S. issuance, a fraction of the \$181.1 billion in issuance for 2007. Many believe a modified form of this market will return over time as the markets calm because it is a critical source of financing for commercial real estate.

The other significant lending source is bank financing which is seeing the tightest credit standards since the early 1990's. These stringent lending requirements are placing significant restrictions on investors versatility and ability to acquire or refinance assets.

Most are not optimistic that access to capital will improve significantly anytime soon and expect the cost of capital to continue to increase which will push capitalization rates upward. For most investors, spreads have increased 250 to 300 basis points. Although those higher spreads have been offset somewhat by a drop in the 10-year Treasury and LIBOR, the net result, for most, remains a higher cost of capital. The spike reflects the recent surge in investor fears and lack of inter-bank lending and should ease as the markets settle. However, spreads are unlikely to return to 100 basis points above Treasuries which was common 18 months ago.

With limited access to leverage, owners with maturing debt are finding it much more difficult to refinance causing them to seek out more expensive capital or "gap equity" to fund the difference created by the reduced amount of debt

available. Currently debt ratios are approximately 55%-60% of value compared to 80%-90% a year ago. The need for "gap equity" is increasing dramatically with approximately \$580 billion of commercial real estate coming due over the next three years, \$160 billion of which matures in 2009.

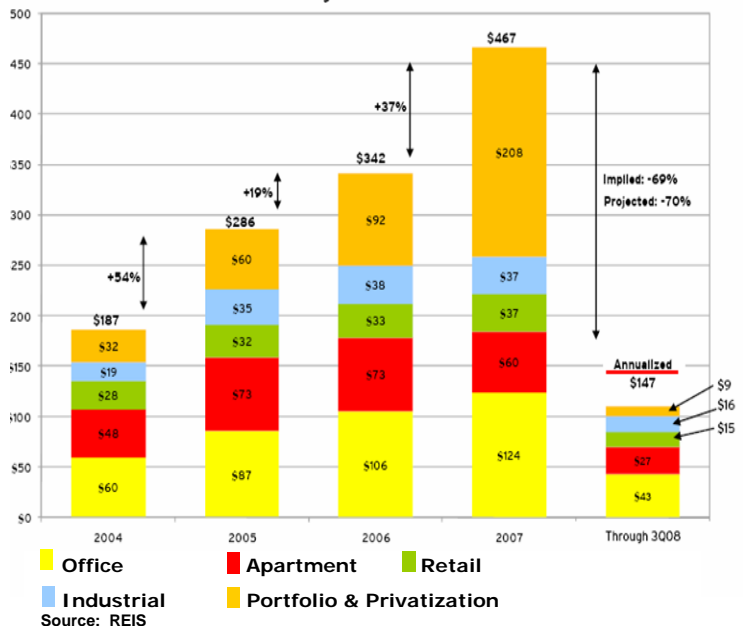
There are already signs that the unraveling has begun. General Growth Properties, the nation's second-largest shopping mall owner, has warned that it might have to file bankruptcy if it can't restructure or postpone payment on \$27 billion of debt as large installments come due in the coming months. Also in November, ProLogis, the nations' largest industrial REIT, decided to sell their interest in their Asian funds and cutting its 2009 dividend by more than half to help pay down debt and bolster its balance sheet.

For investors with available cash, the anticipated increase in distressed asset sales will create the best buying opportunities the market has seen since the early 1990's.

Capital Markets

This disruption in the capital markets has brought about a significant decline in transaction activity and has sidelined a number of investors that, in the past, used high levels of leverage to acquire assets. According to REIS, 2008 sales transactions are projected to decline by approximately 70%.

Dollar Volume of Arms-Length Transactions



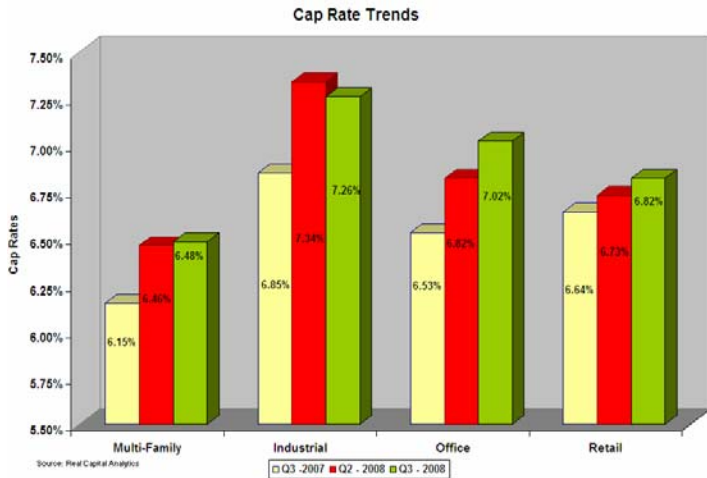
The lack of transactions is reeking havoc on the industry's ability to determine current market value. In a year where the gap between buyers and sellers has been wide, the lack of market pricing has made it difficult for sellers and buyers to know what is a fair price. With the recent increase in distressed deals, sellers are beginning to acquiesce on pricing and the gap is starting to narrow with a downward pricing trend. According to the brokerage firm Grubb & Ellis, this narrowing will help increase asset volume as much as 15% in 2009 with volumes projected to reach as much as 30% over current levels by the last half of 2009.



Real Estate Update

Pricing and Cap Rates

Real estate pricing has been very difficult during 2008 as discussed, However, based on limited sales activity to date, capitalization rates have increased with premiums of up to 50 basis points, depending on the asset class.



There is a consensus that commercial real estate prices will decline further from current levels. Goldman Sachs and JPMorgan Chase & Co. estimate that the average capitalization rate will ultimately rise to the historical average of 9.5% indicating an additional 225-300 basis point increase.

Another value measure is the Moody's/REAL Commercial Property Price Indices (CPPI) which is a periodic same-property round trip investment price change index of the U.S. commercial investment property. In September of 2008 the index reflected a decline in prices of approximately 9.4% below the peak in October 2007. By property type the declines were: multifamily-7.2%, industrial-10.1%, office-8.3% and retail-9.9%.

And it is no surprise given current market conditions that these trends are expected to continue into 2010. According to the Emerging Trends, a joint report by PricewaterhouseCoopers and the Urban Land Institute, commercial property values could drop 15% to 20% from the peak realized in 2007 with the potential for more severe losses for lesser quality commercial properties in secondary markets.

The silver lining to all of this is the fact that investors with available capital will have the opportunity to be selective in buying opportunities because they will be abundant.

Sector Analysis

Office properties are typically the most volatile of the four major sectors as real estate moves through its economic cycle. Owners will not be able to escape value corrections and flattening rents but long term leases and limited development activity should help buffer owners from these risk, especially in the CBD markets.

Secondary and tertiary markets are seeing greater erosion in demand and have incurred a larger percent of the speculative projects with deliveries continuing in 2009.

These markets are also more susceptible to value loss with the flight to quality.

With the goal of reducing operating costs in mind, we expect tenants in the office sector to begin trending towards space efficiency and higher green building standards.

Multi-family fundamentals remain solid even though nine consecutive months of unemployment and the growing shadow supply of single-family and condominium homes is creating a drag on apartment occupancy and rental rates. This is a trend that will likely continue into 2009. But given the burgeoning Generation Y (young adult) population and restrictive mortgage lending trends, multi-family values should hold up better than other sectors.

Looking forward, we anticipate the multi-family sector's growth to trend towards urban centers with strong transportation availability. We foresee most new developments being multi-use to meet the growing desire for in town, convenient living.

Retail markets are expected to be hit the hardest due to pullback in retailer expansion on the heels of a building boom that has left some developers scrambling to fill space.

Even with renewed economic growth expected in 2010, retail sales growth will be modest as consumers adjust to their reduced wealth in the post-housing bubble period.

We expect well located strip centers anchored by top super-market chains to continue to draw "necessity shoppers" and weather the storm with relative ease. Adversely, we believe lifestyle centers with a greater focus on "discretionary products" will continue to struggle and experience the greatest number of store closings in the coming year.

Industrial properties are now reflecting the broader economic slowdown due to connections with troubled sectors, namely housing production, import flows and consumer spending. Despite dipping short-term prospects attributable to the economic slowdown, premier coastal markets will continue to shoulder increasing import/export activity in the global marketplace and will continue to thrive. Large-bay warehouse product in peripheral locations along with multi-tenant product in housing-bubble markets will likely be the hardest hit in terms of occupancy and rent declines over the next two years and could take much longer to stabilize and recover.

Going forward, we believe the industrial sector will begin shifting from building large warehouses in major markets to developing multiple, smaller warehouses in secondary markets focusing more on "just-in-time" inventory in order to increase efficiency. This approach should also reduce investor risk.

While 2009 will offer numerous challenges in the real estate market, investors with available capital will have a great year because of the numerous buying opportunities that will arise due to the current market conditions. These investors will have the ability to be patient and selective in asset acquisition.



Appendix A

Economic Crisis

Timeline

- Feb. 2007** HSBC is the first major bank to announce larger than anticipated losses from rising defaults of sub prime mortgages.
- April 2007** New Century Financial, one of the nation's largest sub prime lenders files for bankruptcy.
- June 2007** Two of Bear Stern's hedge funds run into losses and are forced to dump assets, with the trouble spreading to major Wall Street firms such as Merrill Lynch, JPMorgan Chase, Citigroup and Goldman Sachs which had loaned the firm money.
- Sept. 2007** The Fed starts cutting interest rates. The Central Bank will make 7 straight cuts before pausing. It also agrees to start loaning money directly to Wall Street firms, rather than only commercial banks, and to accept troubled mortgage-backed securities as collateral.
- March 2008** JP Morgan Chase Co. acquires troubled Bear Sterns in a deal engineered by the Federal Reserve.
- July 2008** The FDIC takes over IndyMac, one of the leading lenders of home loans to people who did not provide proof of income. FDIC warns more bank failures lay ahead.
- Sept. 6, 2008** Treasury Secretary Henry Paulson announces a takeover of Fannie Mae and Freddie Mac. The Treasury Department agrees to provide up to \$200 billion in loans.
- Sept. 14, 2008** Lehman Brothers files for Chapter 11.
- Sept. 15, 2008** Bank of America agrees to acquire Merrill Lynch.
- Sept. 16, 2008** Government announced it would stage an \$85 billion bailout of AIG and take an 80% stake in the company.
- Sept. 18, 2008** Fed and other central banks around the world invest \$180 billion in global markets.
- Sept. 19, 2008** The Treasury agrees to insure up to \$50 billion in money market fund investments guaranteeing that the funds' value would not fall below \$1 a share.
- Sept. 25, 2008** Washington Mutual collapses making it the biggest bank failure in history. The FDIC quickly orchestrates a purchase by JP Morgan Chase.
- Sept. 29, 2008** The Dow plunges 777 points, its largest one-day point drop.
- Oct. 3, 2008** Just hours after the Labor Department reports the biggest drop in jobs in more than five years, the \$700 billion bailout is voted into law. Just four days after Citigroup said it would pay \$2.2 billion for Wachovia's banking assets, Wachovia and Wells Fargo announce plans to merge.
- Oct. 6, 2008** The Fed says it will make \$600 billion available to banks through its Term Auction lending facility, doubling the availability.
- Oct. 7, 2008** Fed announces a new commercial paper program.
- Oct. 8, 2008** Fed cuts key fund rate .5%
- Oct. 9, 2008** GM and Ford are downgraded to negative
- Oct. 11, 2008** Wells Fargo gets government approval to purchase Wachovia.
- Oct. 11, 2008** President announces a plan for the treasury to directly purchase \$250 billion in equity shares from banks.
- Oct. 30, 2008** Real GDP decline of .3% announced.
- Nov. 12, 2008** Treasury Secretary Paulson says the \$700 billion rescue funds will not be used to purchase illiquid mortgage-related but that the administration will use for capital injections into businesses.
- Nov. 23, 2008** Treasury Secretary Paulson announces bailout of Citigroup. The deal includes \$20 billion of fresh capital and government guarantee against a portion of any losses incurred on \$306 billion of troubled assets. In return, the government will receive \$7 billion in preferred stock and warrants for approximately 254 million shares of common stock.
- Nov. 25, 2008** Treasury Secretary Paulson announces 2 programs totaling \$800 billion to free up consumer and home mortgage credit.
- Nov. 28, 2008** NBER announces 12/07 was the beginning of the US recession.