12th District Real Estate Conditions

May 2013

Federal Reserve Bank of San Francisco: Banking Supervision & Regulation

Special points of interest:

Commercial:

- Like last year, demand from high tech is driving office improvement
- In industrial space, warehouse is the star
- Multi-housing rent growth is slow as supply growth accelerates
- Retail is challenged, but conditions in affluent markets are improving
- Las Vegas and Sacramento are among the weakest markets in all sectors

Residential:

- Residential conditions are looking very favorable

Executive Summary

12th District* real estate (RE) markets are in the expansion phase of the RE cycle with different sectors at different stages of expansion.

Office sector improvement has been strong in technology-heavy markets but modest in others. Downtown markets have generally outperformed suburban markets, although this trend is starting to change as high costs push tenants to the suburbs.

The industrial sector has seen growth in warehouse properties but manufacturing and R&D properties are notably weaker.

Multi-housing continues to be notably stronger than the other sectors. Vacancy rates have fallen for three years and improvement is slowing as the sector nears the latter stage of expansion.

Retail is plodding along hindered by structural challenges that may be less an issue in more affluent markets.

The residential sector made significant gains in 2012. Prices have increased in almost all markets, sales have been on an upward trajectory, and anecdotal evidence of multiple offers and bidding wars is plentiful.

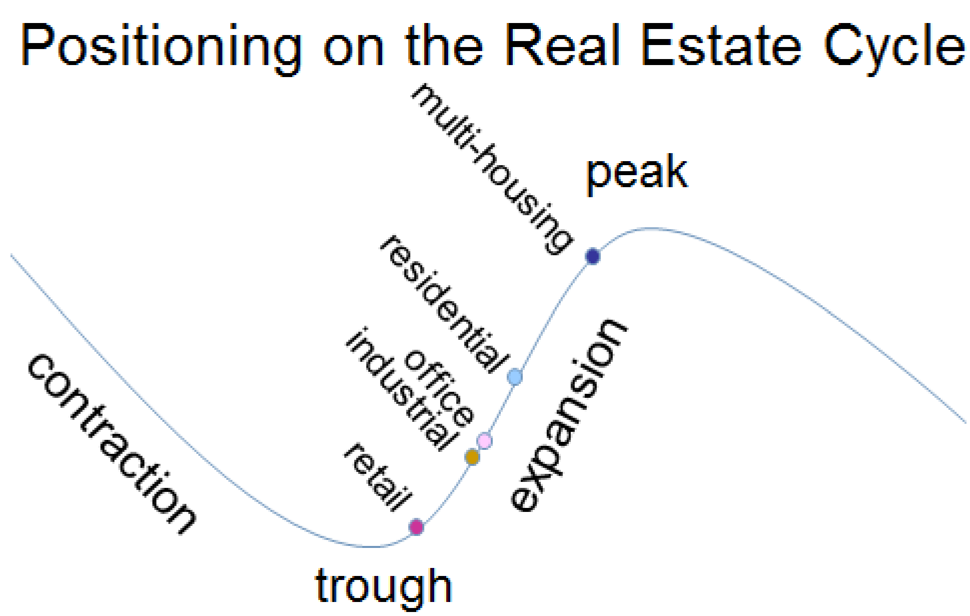
About this Report

This report provides a high level overview of RE market conditions in the 12th District.

The findings are based largely on the Vitality Scores produced by the Federal Reserve Bank of San Francisco's (FRBSF) Commercial Real Estate (CRE) and Residential Real Estate (RRE) Market Vitality Models. These models compare several variables against their long-term history to calculate a Vitality Score for each metropolitan statistical area (MSA) and property type. For more on the models, see pages two and ten.

*The 12th Federal Reserve District consists of Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington

Inside this issue:



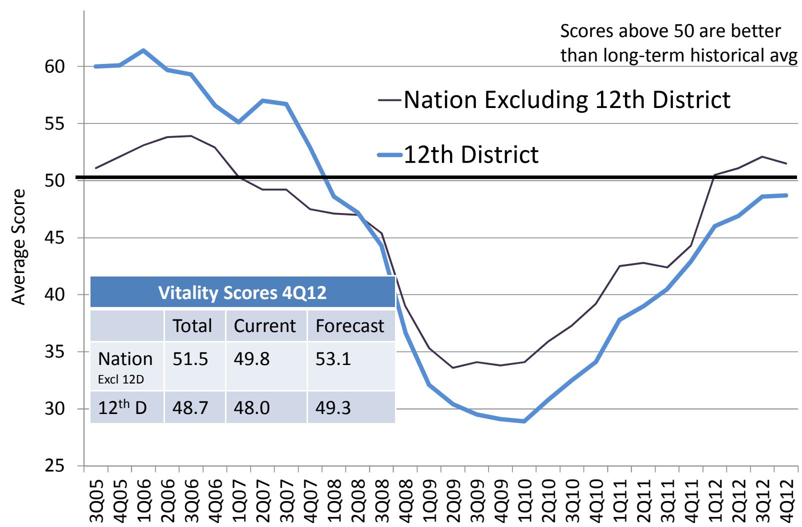
Office Sector Analysis

Average District Vitality Scores from the CRE Vitality Model have been improving since the trough in 1Q10, but they continue to trail the Nation. While tech-centric markets are driving improvement in the average District score, the rest of the Nation is benefiting from strong growth in the energy sector.

San Francisco remains at the top of nationwide rankings, as strong tech job growth pushed down vacancy rates below historical averages and accelerated rent growth. But on the whole, District markets have been surpassed by markets benefiting from the energy boom. Weakness in the aerospace/defense and finance industries as well as the vestiges of the housing crash weigh on many District markets.

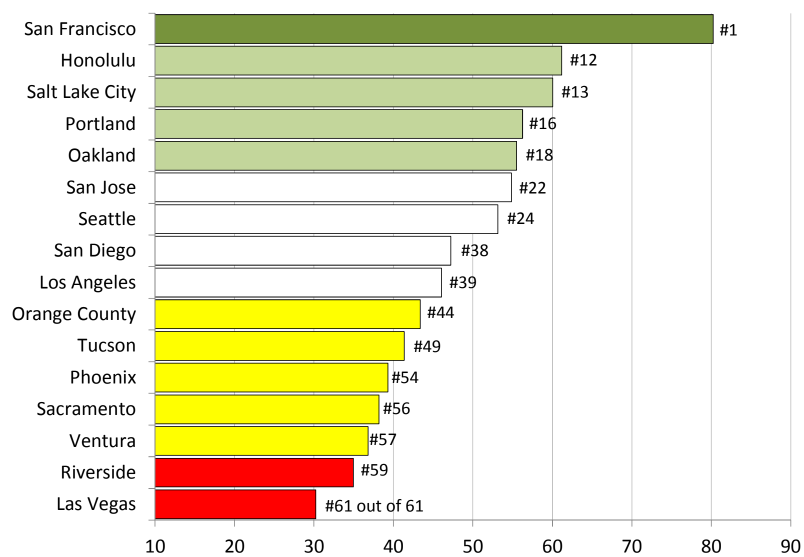
The office sector is also in the midst of a general trend toward densification. The focus on reducing office space per worker is most noticeable in finance and business services. Companies in these fields disproportionately occupy expensive space, in prime locations. Revenue pressures have many of these companies looking to trim occupancy expenses. Markets with concentrations in finance and business services could see weaker absorption rates if strong job growth does not offset these trends.

Office Vitality Score History (Averages Across Markets)



Vitality Scores 4Q12			
	Total	Current	Forecast
Nation Excl 12D	51.5	49.8	53.1
12th D	48.7	48.0	49.3

Office: Vitality Score & National Rank



About the Commercial Real Estate Market Vitality Model

FRBSF's model uses five historic variables:

1) *property value change (relative to 5-year avg.),*
2) *employment growth (2-years),*
3) *vacancy /availability rate,*
4) *stock growth (2-years),*
5) *rent growth (relative to 5-year avg.),*

and five forecast variables (all looking out one year based on CBRE-EA forecasts):

1) *property value change,*
2) *vacancy/availability rate,*
3) *completion rate,*
4) *absorption rate,*
5) *rent growth.*

The most recent results for each variable are percentile ranked against a long history of results for that variable. These ten percentiles are then averaged to produce a Vitality Score. The scores fall into one of five ranges.

0-35	*red - weak*
35-45	*yellow - vulnerable*
45-55	*white - neutral (the long-term historical average is 50)*
55-65	*light green - strong*
65-100	*dark green - very strong*

Data Source: CBRE Econometric Advisors Outlook,
CRE Market Vitality Model: FRBSF

Link (FRB staff only):
http://bsr.sf.frb.org/RE/commercial/market-analysis/CRE-market-vitality-model.html

YOY Changes in Office Vitality Scores	
Market	4Q11 to 4Q12
San Francisco	15.36
Oakland	11.49
Sacramento	9.11
Ventura	8.88
Phoenix	8.82
Los Angeles	7.92
Portland	7.89
San Diego	7.4
San Jose	5.92
Honolulu	5.67
Orange County	3.87
Las Vegas	2.99
Tucson	2.71
Seattle	1.25
Salt Lake City	-2.07
Riverside	-4.24

Vitality Scores for office properties are up in most District markets year over year (YOY).

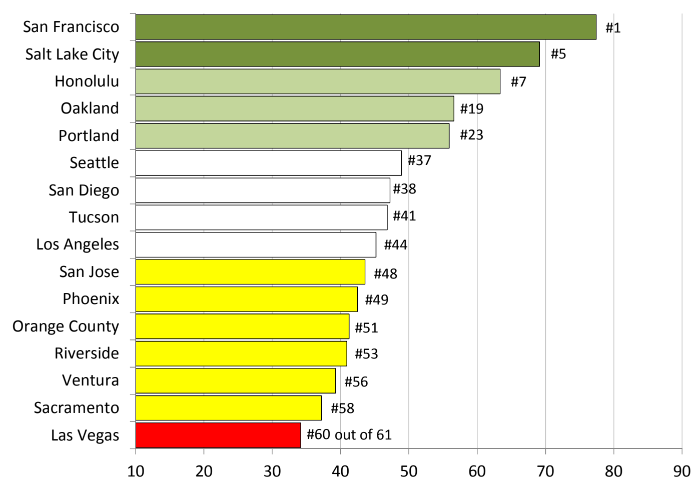
The strength in the San Francisco office market has spilled over into Oakland with both markets posting the largest YOY improvements in the District.

Riverside was one of two District markets where office sector scores fell in 2012. Riverside is struggling with a decline in office jobs, rents remaining well below levels from a few years ago, and stubbornly high vacancy rates. Additionally, the appraisal-based CBRE price index used in the Vitality Model suggests that property values have fallen, and will continue to fall.

Salt Lake City, which had the largest YOY score increases last year, saw its score fall as a result of new supply added in 2012.

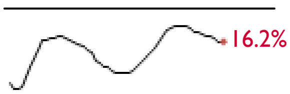
Looking at just the forecast components of the Vitality Model, the chart below shows that San Francisco should remain the top U.S. office market, with Salt Lake City and Honolulu not far behind. San Jose drops considerably in the rankings as a significant volume of construction is underway and expected to outpace demand over the next year. Other lagging markets have weak forecast demand in addition to soft or negative employment growth.

Office: Forecast Vitality Score & National Rank

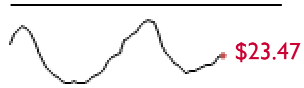


12th District Aggregates**

1Q00 Vacancy 1Q13

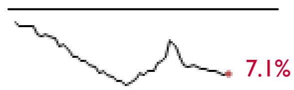


1Q00 Rent 1Q13



National Average***

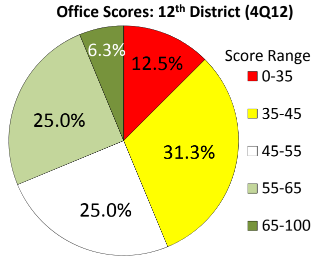
1Q01 Cap Rate 1Q13



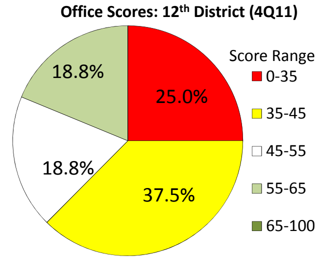
Sources: **CBRE-EA vacancy/availability, CBRE-EA rent index, ***Real Capital Analytics cap rates

The percentage of District office markets with Vitality Scores in the Red zone (0-35) dropped sharply to 12.5%. The percentage of markets in either Red or Yellow (0-45) fell from 63% to 44% over the past year.

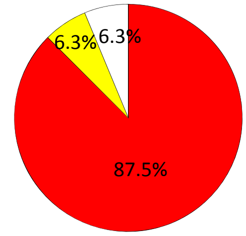
Office Scores: 12th District (4Q12)



Office Scores: 12th District (4Q11)



Office Scores: 12D at trough (1Q10)



12th District Real Estate Conditions

Industrial Sector Analysis

The District's and Nation's industrial sectors continue to rebound off of 1Q10 lows at approximately the same moderate pace.

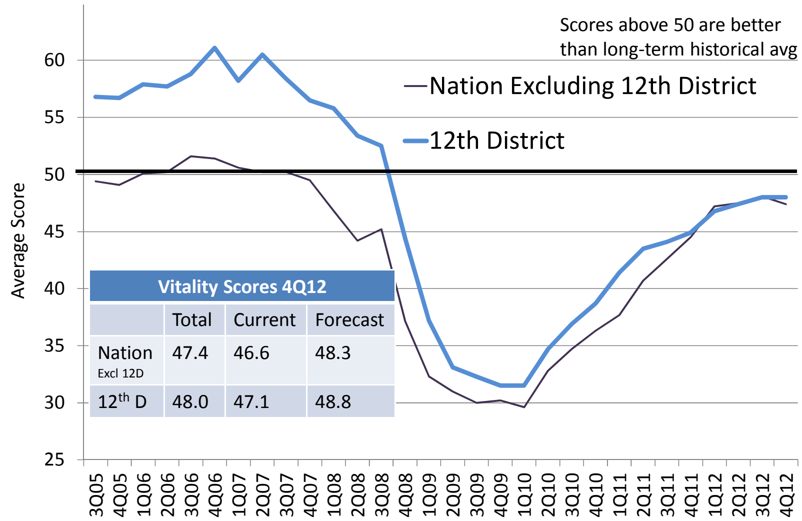
The average District MSA Vitality Score is still below 50 (the long-term historical average) as rent growth remains poor, property values are depressed, and availability rates remain high.

At the market level, Seattle displaced Salt Lake City as the District's best performing market. Manufacturing and distribution employment growth was above 6% YOY in both markets, but Seattle has higher forecast rent growth and property values.

Near the bottom, Las Vegas, Phoenix, Sacramento, and Tucson are struggling with high availability rates, depressed property values, and weak rent growth.

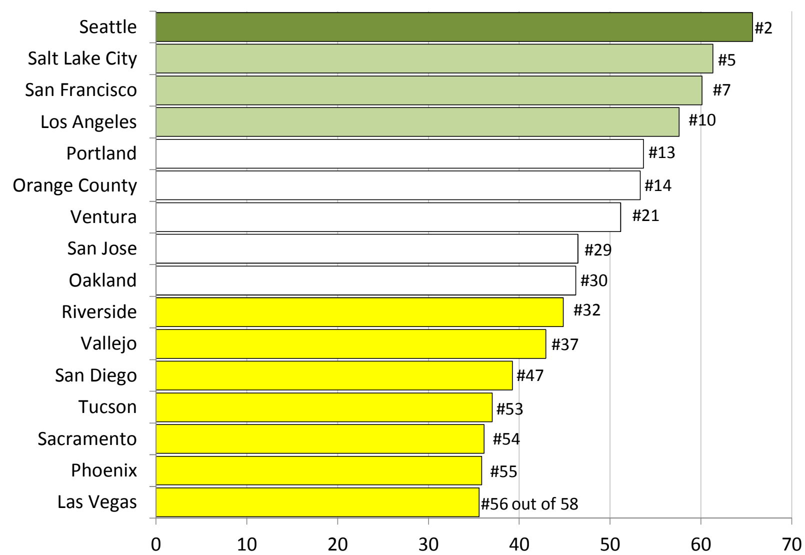
Once the economy begins to grow more rapidly, the District is poised for stronger performance than the rest of the Nation. The trade imbalance with Asia favors District warehouse properties because U.S. imports require more space than exports. Imports are largely consumer goods (e.g. electronics, apparel) while U.S. exports are largely capital goods (e.g. aircraft, industrial machines) that are not warehoused before export. Warehouse has been the healthiest subsector among industrial property types, and the District has more warehouse distribution space relative to manufacturing.

Industrial Vitality Score History (Average Across Markets)



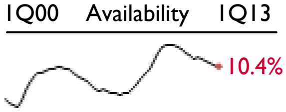
Vitality Scores 4Q12			
	Total	Current	Forecast
Nation Excl 12D	47.4	46.6	48.3
12th D	48.0	47.1	48.8

Industrial: Vitality Score & National Rank



12th District Aggregates**

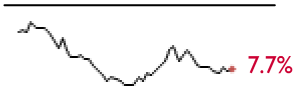
1Q00 Availability 1Q13



1Q00 Rent 1Q13

National Average***

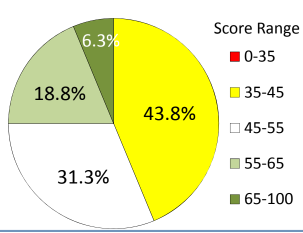
1Q01 Cap Rate 1Q13



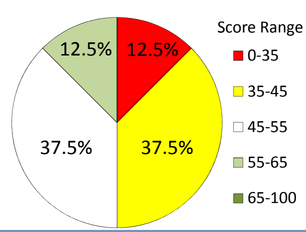
Sources: **CBRE-EA vacancy/availability, CBRE-EA rent index, ***Real Capital Analytics cap rates

The percentage of District MSAs with Vitality Scores in the Red or weakest range (0-35) has fallen to zero from a high of 81.3%.

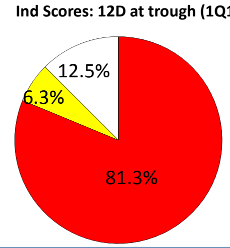
Industrial Scores: 12th District (4Q12)



Industrial Scores: 12th District (4Q11)



Ind Scores: 12D at trough (1Q10)

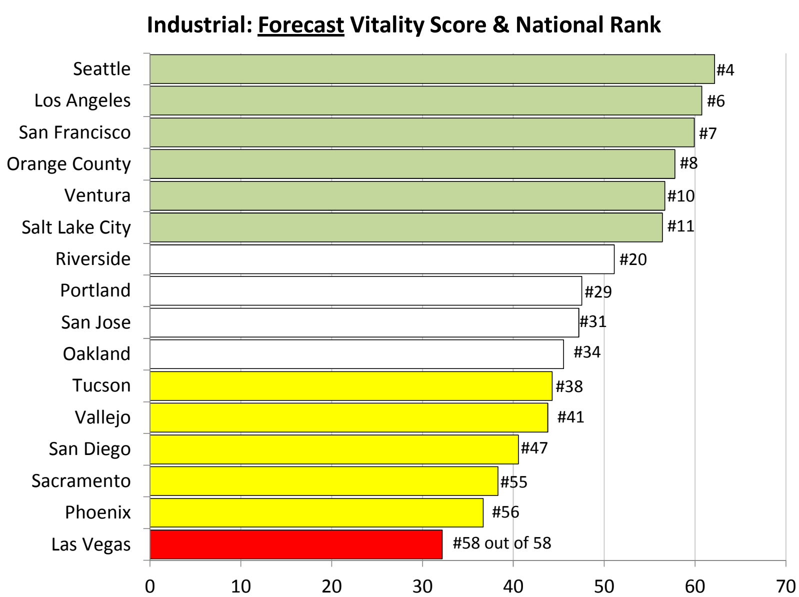


YOY Changes in Industrial Vitality Scores

Market	4Q11 to 4Q12
Seattle	**14.21**
San Francisco	**10.34**
Vallejo	**7.59**
Las Vegas	**5.41**
Sacramento	4.99
Oakland	4.97
Ventura	2.8
Riverside	2.78
Orange County	1.21
San Jose	0.89
Los Angeles	0.77
Tucson	-0.08
Portland	-0.15
San Diego	-1.38
Phoenix	-1.69
Salt Lake City	-3.55

Seattle and San Francisco were the two District markets with double-digit YOY industrial sector improvement. An improving economy and continuing expansion of Pacific trade have benefited these and other port markets.

Among the markets where conditions deteriorated, San Diego stands out as more of a concern. Recent job losses, high availability rates, declining rents and property values, all suggest that the San Diego industrial sector has yet to participate in the expansion.



The forecast variables in the Vitality Model suggest that among the current laggards, Las Vegas will see no improvement in 2013, and may see property values continue to fall significantly. Phoenix, Sacramento, and San Diego will remain about the same, although Phoenix could surprise to the upside if projected new supply is absorbed quicker than forecast. Tucson is forecast to improve the most due to higher expected rent growth, although it's a relatively small industrial market that can have quick swings in key metrics.

12th District Real Estate Conditions

Multi-Housing Sector Analysis

The multi-housing sector remained the strongest performer in 2012 but in the second half of the year average scores fell slightly for both the Nation and the District. Multi-housing is now in the latter part of the expansion phase of the real estate cycle.

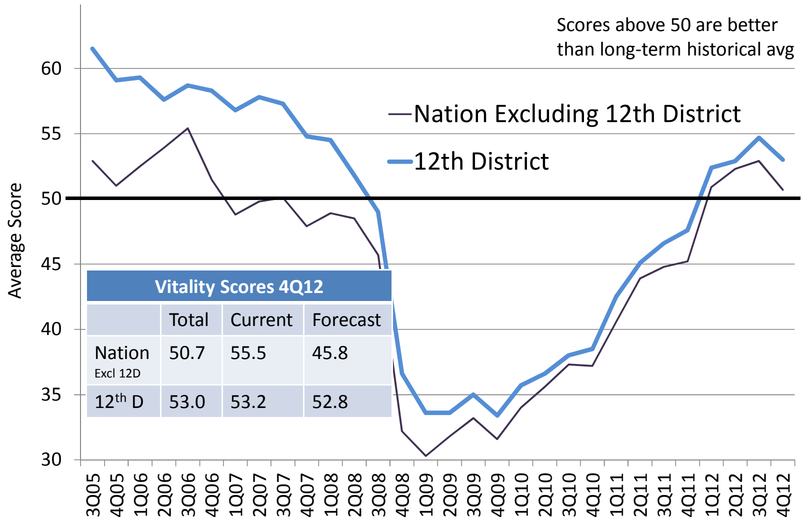
The slowdown is due to higher forecast vacancy rates, as well as more recent and forecast supply. Rents however, will continue to increase, although at a slower pace, given historically low vacancy rates.

Despite this slowdown, the District is forecast to significantly outperform the rest of the Nation, due to historically higher population and employment growth.

The Bay Area takes the top two spots in the national multi-housing rankings. Employment growth has been stronger in technology sectors and the Bay Area. The area remains a popular place to move for younger transplants who are more likely to be renters. There are also more building constraints that suppress both the supply of multi-housing units and affordable single family homes.

Although multi-housing construction activity is surging in most of the District, it is only returning to long-term construction levels. This will continue to slow rent growth, but should otherwise be manageable. San Jose is probably most at risk because it is adding a substantial number of new apartment units over the next year. But barring a market correction, even this level of construction (2.6% in 2013) should be manageable given the market's strong employment and population pull.

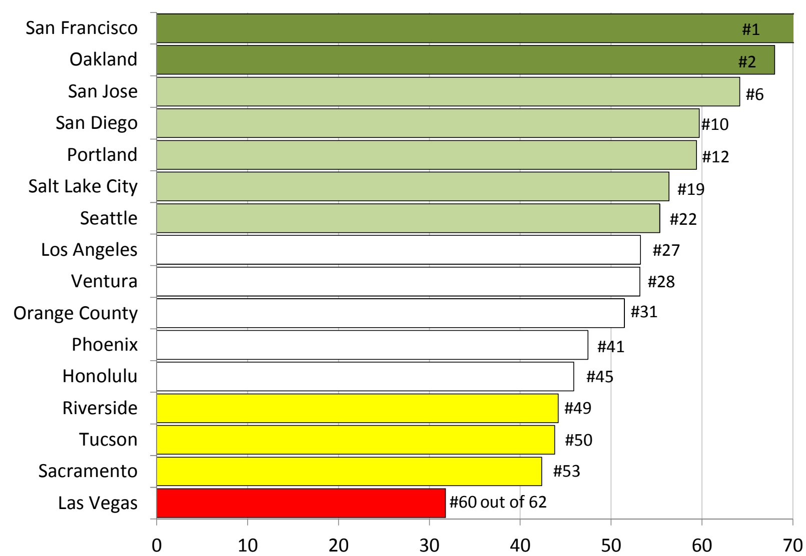
Multi-Housing Vitality Score History (Average Across Markets)



Vitality Scores 4Q12

	Total	Current	Forecast
Nation Excl 12D	50.7	55.5	45.8
12th D	53.0	53.2	52.8

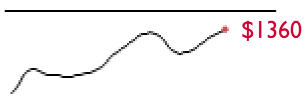
Multi-Housing: Vitality Score & National Rank



12th District Aggregates**

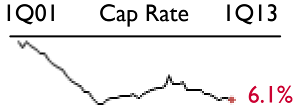
1Q00 Vacancy 1Q13

1Q00 Rent 1Q13



National Average***

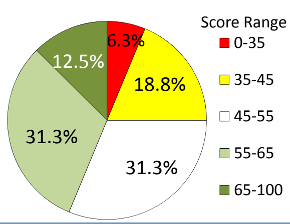
1Q01 Cap Rate 1Q13



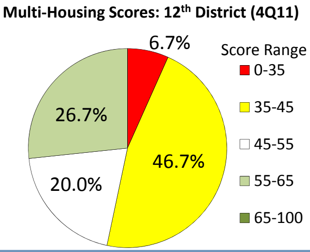
Sources: **CBRE-EA vacancy/availability, CBRE-EA rent index, ***Real Capital Analytics cap rates

Forty-four percent of District markets are in the strong (55-65) or very strong (>65) Vitality Score range.

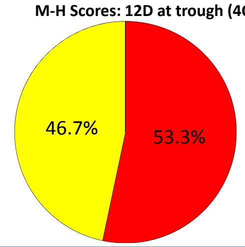
Multi-Housing Scores: 12th District (4Q12)



Multi-Housing Scores: 12th District (4Q11)



M-H Scores: 12D at trough (4Q09)

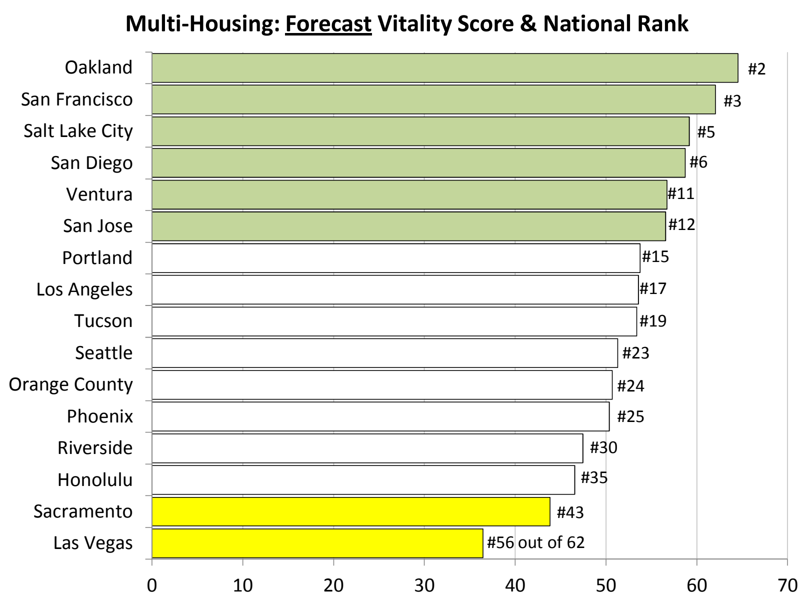


YOY Changes in Multi-Housing Vitality Scores	
Market	4Q11 to 4Q12
Salt Lake City	13.67
San Francisco	9.11
Orange County	8.3
Phoenix	7.38
Honolulu	6.11
Riverside	5.29
San Diego	5.03
Tucson	4.59
Oakland	4.41
Seattle	4.38
Los Angeles	3.48
Portland	3.22
Las Vegas	3.02
Sacramento	1.85
San Jose	0.27

Seven out of fifteen District markets improved significantly YOY (up >5 Vitality Score points). This compares to 12 of 15 last year.

A favorable factor for the multi-housing sector in the District is the rent or buy decision. Despite nationwide improvements in home affordability, it is still cheaper to rent than buy in most District markets. Furthermore, as home prices rose in 2012, the savings from renting increased. According to a recent report from CBRE-EA, San Jose is approximately 72% cheaper, Seattle (40%), San Diego (38%), Portland (26%), Tucson (22%), San Francisco (21%), Los Angeles (3.0%), and Phoenix (1.8%).****

**** CBRE-EA Multi-Housing Overview& Outlook 4Q12



Higher absorption rates than the rest of the Nation should keep District markets near the top of the national rankings over the next year.

Multi-housing construction in Seattle, San Francisco, and San Jose is forecast to slow rent growth in these markets more than others, but other fundamentals will still be favorable.

Las Vegas and Sacramento remain near the bottom of forecast rankings with declining property values, and for Las Vegas, vacancy rates that are double the District average.

12th District Real Estate Conditions

Retail Sector Analysis

The retail sector is in the early stages of a real estate cycle expansion. District conditions, on average, are stronger than the Nation, but the sector faces structural challenges even as economic conditions and consumer sentiment generally trend up.

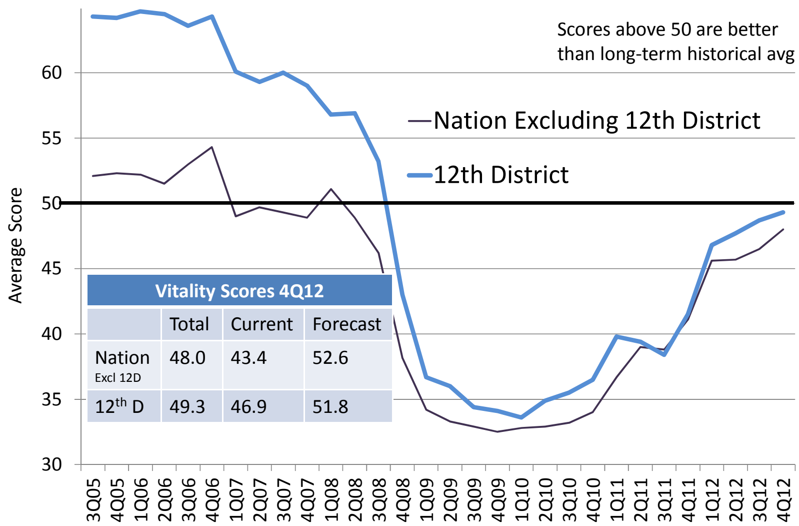
The most daunting and persistent challenge to brick and mortar retail is on-line shopping. E-retail is taking an increasing share of retail dollars. While larger malls have a social component that keeps them relevant and e-retailers have been less successful taking market share from grocery stores, big box retailers and non-grocery store anchored neighborhood community centers are struggling to compete. Proposals to tax internet sales would bring parity on this issue, but ultimately the cost advantage of not having to pay for expensive brick and mortar retail space will continue to favor on-line shopping (see insert on page 9).

There are also metrics that suggest the U.S. is over-retailed. According to the Harvard Design School Guide to Shopping, the U.S. has significantly more retail space per person than any other country.

At the MSA level, more affluent markets, where consumers have more disposable income, are at the top of the rankings. In the 12th District, this includes: San Francisco, San Jose, Honolulu, and Orange County.

The retail analysis is largely based on neighborhood and community centers.

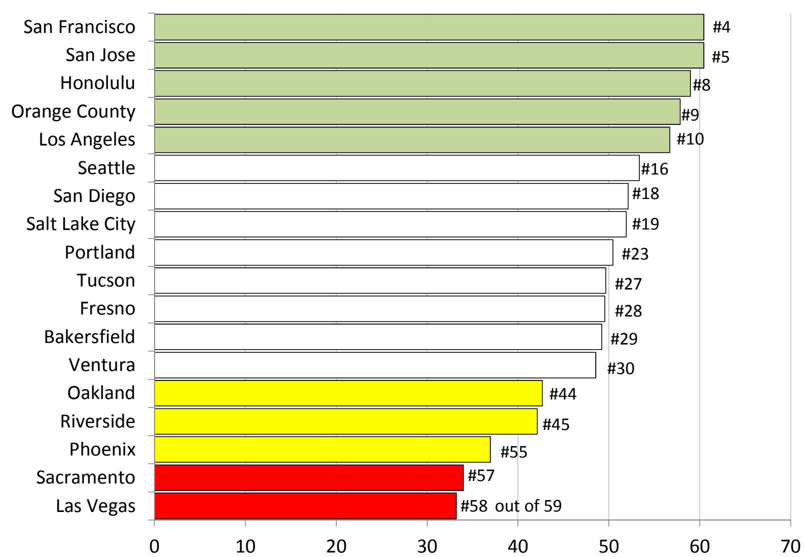
Retail Vitality Score History (Average Across Markets)



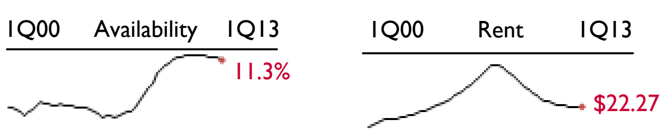
Vitality Scores 4Q12

	Total	Current	Forecast
Nation Excl 12D	48.0	43.4	52.6
12th D	49.3	46.9	51.8

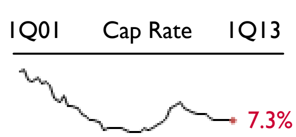
Retail: Vitality Score & National Rank



12th District Aggregates**



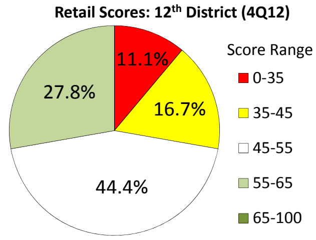
National Average***



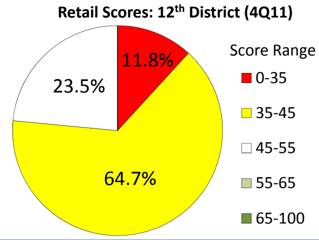
Sources: **CBRE-EA vacancy/availability, CBRE-EA rent index, ***Real Capital Analytics cap rates

The percentage of markets with Vitality Scores in the Red, or weakest range (0-35) has fallen just slightly in the past year.

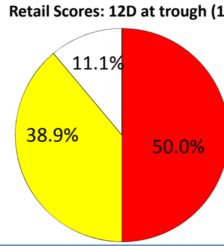
Retail Scores: 12th District (4Q12)



Retail Scores: 12th District (4Q11)



Retail Scores: 12D at trough (1Q10)

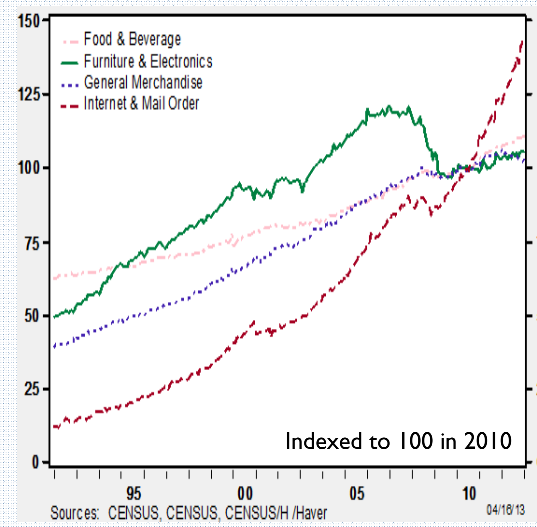


YOY Changes in Retail Vitality Scores	
Market	**4Q11 to 4Q12**
Fresno	13.94
Bakersfield	11.48
Salt Lake City	11.4
Tucson	11.12
Orange County	10.56
San Francisco	9.05
Seattle	8.6
San Jose	8.27
San Diego	7.68
Phoenix	6.92
Los Angeles	6.64
Portland	6.06
Ventura	5.72
Las Vegas	3.92
Riverside	3.72
Oakland	1.28
Sacramento	-1.88

Given the structural challenges faced by the retail sector YOY improvement in Vitality Scores is quite impressive. Most District markets improved by at least five points. Increasing or at least stabilizing rents were a common thread among these markets.

However, last year, retail was at the trough of the real estate cycle and the magnitude of the moves off the bottom will be more difficult to repeat this year.

The monthly dollar value of internet sales has surpassed that of food & beverage stores, furniture & electronics stores, and general merchandise stores.

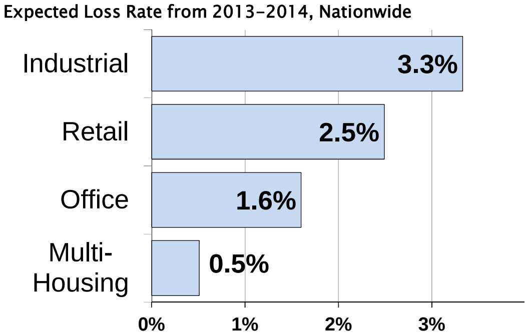


CRE Credit Risk - Commercial Mortgage Metrics Model Results

Moody's Commercial Mortgage Metrics (CMM) model suggests that nationally, expected loss rates on CRE loans over the next two years will be fairly moderate. In general, loans originated near the market peak (i.e., 2008) are expected to have relatively high loss rates, while newer originated loans are likely to have low loss rates. The CMM model suggests that the highest losses will be on industrial properties (3.3% for a prototypical loan originated in 2008) and the lowest for multi-housing (0.5%). Geographically, District markets hardest hit by the housing meltdown, like Las Vegas, Riverside, and Sacramento have high expected loss rates, while the more tech-oriented markets like the SF Bay Area, Salt Lake City and Portland are less at risk.

Mortgage Risk Indicator:
2-Year Expected Loss Rate
on a Typical CRE Loan Originated in 2008

Expected Loss Rate from 2013-2014, Nationwide



Greatest Credit Risk	2-Year Expected Loss Rates
Las Vegas -- Retail	20%
Las Vegas – Industrial	18%
Ventura – Office	16%
Las Vegas – Office	14%
Riverside – Office	10%
Sacramento – Industrial	9%

Least Credit Risk	2-Year Expected Loss Rates
SLC – Multi-Housing	0.3%
San Fran – Multi-Housing	0.4%
Oakland – Multi-Housing	0.5%
Portland – Multi-Housing	
San Diego – Multi-Housing	0.6%
San Francisco – Office	

Source: Moody's Commercial Mortgage Metrics. Assumes 7-Year fixed rate loan originated in 2008 amortizing over 25 years with original Loan to Value and Debt Service Coverage ratios of 70% and 1.2x respectively; baseline forecast from CBRE-EA. Expected loss rates combine term and maturity risk.

12th District Real Estate Conditions

Residential Sector Analysis

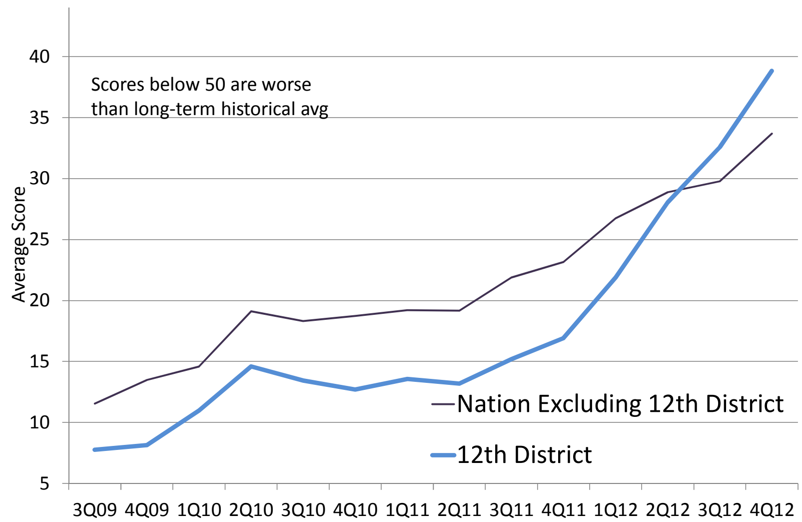
Residential real estate saw significant improvement in 2012 as job growth edged up, inventories became tighter, and housing prices jumped. The improvement was even stronger in District markets where average Residential RE Market Vitality scores surpassed the Nation.

Almost all District markets had positive job growth in 2012, but the strongest job growth was in Utah and Coastal California markets. Inland California markets had modest job growth and double-digit unemployment rates. Despite this, many of these markets posted YOY price increases. But the biggest YOY price increases were in Arizona, while the smallest were in the Pacific Northwest. Unemployment rates were highest in California and lowest in Utah.

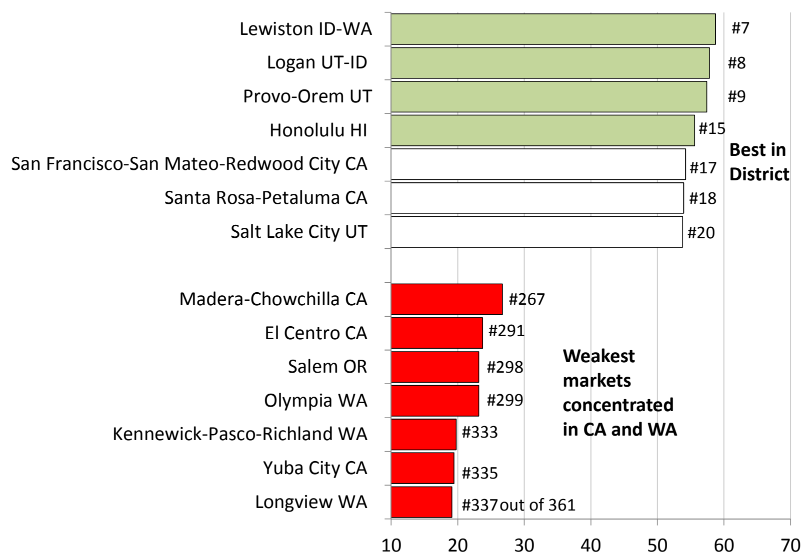
Vitality Scores reflect these trends, with Utah having some of the strongest markets. Logan UT scored 57.8 out of 100 and ranked 8th in the Nation. Provo ranked 9th and Salt Lake City 20th.

Although they are out of the single digits, the District still has 27 markets (40%) considered very weak. Most of these markets are concentrated in Inland California, Washington and Oregon.

Residential Vitality Score History (Average Across Markets)



Residential: Vitality Score & National Rank (select markets)



About the Residential Real Estate Market Vitality Model

FRBSF's model uses four variables:
1) unemployment rate,
2) one-year job growth rate,
3) one-year home price change,
4) five-year home price change (home price changes derived from CoreLogic MSA level House Price Index).

The results for each variable are percentile ranked against a long history of results for that variable. These four percentiles are then averaged to produce a Vitality Score. The scores fall into one of five ranges.

0-35	*red - very weak*
35-45	*yellow - weak*
45-55	*white - neutral*
55-65	*light green - strong*
65-100	*dark green - very strong*

Data Source: CoreLogic, Haver Analytics, Bureau of Labor Statistics

Link (FRB staff only):
http://bsr.sf.frb.org/RE/residential/residential.html

Different indices take slightly different measures of home price changes. But from December 2011 to December 2012, all key national home price indices point in the same direction:

+9.2% Radar Logic (Nov)
+8.3% CoreLogic
+6.8% S&P Case-Shiller
+5.8% LPS
+5.5% FHFA
+5.4% FNC
+5.4% Zillow
+4.9% Clear Capital

Residential fundamentals deteriorated YOY in only one out of sixty-seven District markets (Kennewick-Pasco-Richland WA). Other markets that had marginal improvement were concentrated in the Pacific Northwest and Inland California. The reasons for lack of improvement vary from negative job growth and falling prices (Kennewick WA), to double-digit unemployment (El Centro CA, Yuba City CA), and to generally stagnant conditions (Longview WA, Bremerton WA).

Markets with the most improvement generally had double-digit price gains. Even Modesto, a very weak market, with 15% unemployment and only 1% job growth, had a 12% YOY price gain. Driving the price gains despite weak job growth are a lack of supply, low interest rates, and investors taking advantage of buying opportunities.

YOY Changes in Residential Vitality Scores (Least Improved MSAs)

Market	4Q11 - 4Q12	4Q12 Score
Kennewick-Pasco-Rich WA	-2.2	19.8
Olympia WA	2.9	23.2
El Centro CA	5.4	23.8
Yuba City CA	5.5	19.4
Wenatchee-East Wenatc WA	7.7	32.8
Hanford-Corcoran CA	9.7	32.8
Salem OR	11.2	23.2
Longview WA	11.6	19.1
Ogden-Clearfield UT	12.8	39.2
Bakersfield-Delano CA	13.9	34.2
Bend OR	13.9	37.3
Portland-Vancouver-Hillsboro OR-WA	14.1	33.6
Bremerton-Silverdale WA	14.9	28.0
Corvallis OR	15.2	34.4
Salinas CA	15.9	39.0
St. George UT	16.7	44.6
Yakima WA	16.9	29.6

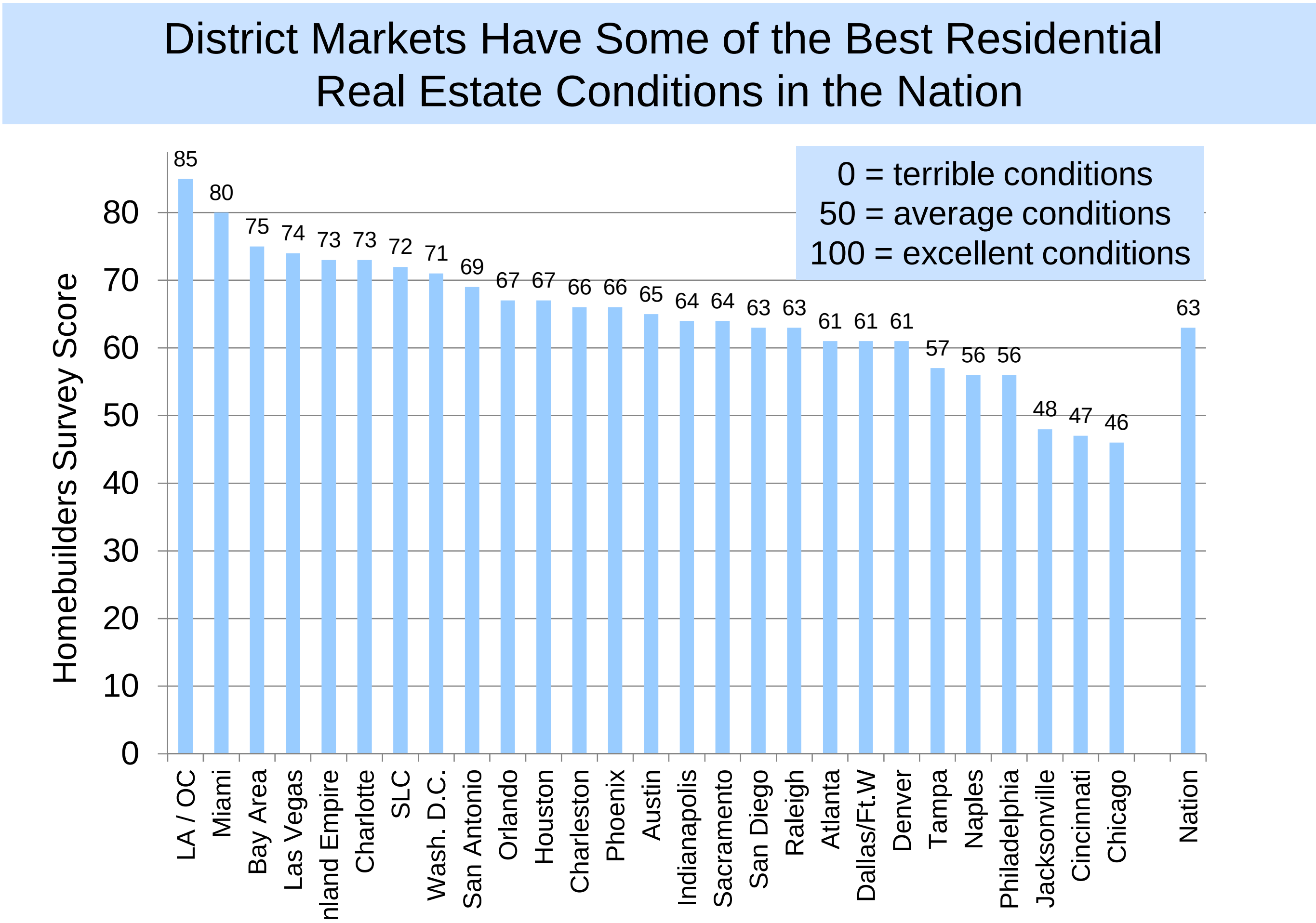
Rising home prices are giving prospective buyers confidence to make the purchase decision and a sense of urgency. Reports of multiple offers on existing homes are in the news again.

For some sellers, prices have not yet returned to levels where they would be motivated to sell. This has contributed to a shortage of existing homes for sale, and pushed some buyers to new homes. Homebuilders are reporting pricing power thanks to the pent-up demand that has been unlocked over the last year. Their backorder books are growing and in Salt Lake City hopeful buyers camped out in order to secure prime home lots from a builder.

YOY Changes in Residential Vitality Scores (Most Improved MSAs)

Market	4Q11 - 4Q12	4Q12 Score
Santa Rosa-Petaluma CA	45.8	54.0
Lewiston ID-WA	40.5	58.7
Idaho Falls ID	34.2	51.2
Prescott AZ	33.6	42.8
San Luis Obispo-Paso Robles CA	33.0	42.8
Honolulu HI	32.8	55.6
Flagstaff AZ	31.4	42.8
Oakland-Fre-Hayward CA	31.3	43.3
Sacramento--Arden-Arcade--Roseville CA	30.7	38.6
Pocatello ID	29.9	48.5
Santa Barbara-St Maria-Goleta CA	29.3	48.3
Tacoma WA	29.1	42.5
San Francisco-San Mateo-Redwood City CA	28.8	54.3
Modesto CA	28.8	33.6
Stockton CA	28.7	41.6
Reno-Sparks NV	28.1	37.1
Bellingham WA	27.7	48.3

12th District Real Estate Conditions



Source: Zelman & Associates March 2013 Homebuilding Survey. Results based on foot traffic, pricing power etc..

Indicative of the upturn in residential real estate conditions is a 1Q2013 survey of builders' opinions on conditions in their markets. District markets lead the survey results. Los Angeles/Orange County had the best conditions in the Nation. The Bay Area was close behind. Surprisingly, builders in Las Vegas feel conditions there merit the fourth highest score in the Nation.

Prices in Las Vegas surged 15% YOY, but job growth was only 1% and the unemployment rate was 10.5%. According to RealtyTrac, Nevada foreclosure starts in February 2013 increased 334% YOY to a 17-month high, keeping the state's foreclosure rate as the second highest nationwide for the fifth month in a row. One in every 320 Nevada housing units had a foreclosure filing in February, more than twice the national average. But the positives builders point to are a 26% increase in traffic, increasing absorptions, and falling cancellations.

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