Rocky Mountain
Property Management INC CRMC®

446 E. 4th St.
Loveland, CO 80537
(970) 669-0842 (voice)
(970) 669-4942 (fax)
www.RMPM.com

March 16, 2009

Dear Investors:

If you are wondering what is going to happen in the real estate market in Colorado and nationwide, I can tell you only one thing: it is not an easy thing to understand or find solutions for that are certain. How we got to the point where lawmakers believe that the best course of action is to pump $700 BILLION dollars into what is being called a bailout is incredibly complex, and since it did not happen overnight, the move out of the severity of the problem will not happen overnight, either. Right now it feels like we're trying to control the weather ... the more we do to "seed clouds," the more natural cycles remind us that nature will take its course. In the 1600's Sir Isaac Newton theorized that for every action, there is an equal and opposite reaction. Physics and economics are not that far removed from one another.

Right now, fingers are getting pointed in so many directions, it is hard to tell what to believe. Follow the fingers and you will hear news reports that the problem is foreclosures that caused banks to default, that unscrupulous lenders enticed unsuspecting buyers into horrible adjustable rate mortgages, and that these sub-prime mortgages were packaged and sold on Wall Street to hide the risk. The simple fact is that all of these issues are likely contributing factors, but not one is a single event factor. It is my opinion that it is a complex mix of actions and reactions that led us to where we stand today ... just as in Newton's laws of physics.

Like you, I am searching to understand how we got here and where our national economy is going. At the end of September, Jodi and I attended a professional conference for property managers and listened to an economist speak, and since that time, I have also had many, many conversations with investors and professionals from many different fields of endeavor. Also, I've spent a lot of time investigating historical cycles in real estate and economics because I know that you trust our firm and are looking to us to lead. We do not take your trust lightly. In fact, it is the basis on which any business or personal relationship is founded, and further, trust is TRULY what is lacking today in all facets of the economy.

Here are some thoughts on what is going on and why:

1. In the 1990's economic expansion was prevalent. It is my opinion that this was mostly due to the opening of new international markets on the Pacific rim and formerly communist European countries. Life was good and we watched as economic prosperity caused property values to triple (or more depending upon region). In the late 90's, economists actually thought that America had found a way to control and manipulate the economy and would never have to face anything more than some recessional "self corrections." We were seeding clouds.

2. In 2000, the stock market ... far sooner than what most people attribute to economic difficulty arising from the September 11, 2001 bombing ... fell sharply, and the federal reserve began employing tactics to prolong the furious economic expansion. They lowered interest rates and freed up currency. By this time, though, in the real estate sector, there were more homes being built than people to fill them. It is my opinion that by this time, we were already out of equilibrium. But then hindsight is 20/20. On September 10, 2001, we sent a letter to investors that we had data to back up changes coming in the rental market. You know what happened the next day.

3. Investors who have been with our firm for many years will recall that in 2001-2005, we were incredulous to report that tenant residents were converting from one- or two-bedroom apartments to home ownership and that applicants we would not rent to because of risky applications were actually buying homes. Historically, tenants have moved from smaller quarters to larger quarters, eventually a single family home, and then to home ownership. To circumvent what I call the "housing food chain" and leap to ownership was an anomaly that happened too frequently to be just those few that were hearty savers.

4. The lure of home ownership has always been there. It is an American Dream. So as interest rates declined, it was only natural that so many converted from tenancy to home ownership, in many cases before they were ready. The ease of borrowing money meant people could buy at a cost less than renting. So investment properties experienced declines in rents. This isn't rocket science, it is the same Economics 101 course that you and I took in college. We had built more homes than there were people to fill them up. Supply up, demand down, prices down for lack of competition.

5. By keeping interest rates low, the federal reserve tried to prolong the boom while population grew (demand) to fill up the inventory (supply). But by employing the very effort of infusing cash flow and avoiding inflation, the economy was being synthetically manipulated.

6. Talk to any Realtor you know, and ask them if the re-sale home market declined because the ease of access to low interest rate by builders kept builders building. This ultimately kept new home sales up from 2004-2007 while resale homes sat on the market longer and longer. Many people bought new rather than resale homes, and resale home prices started to decline. And why not? New home buyers were now getting up to $30,000 purchase incentives from builders, it was a great deal as our society made bets (based on purchase decisions) that the good times would continue to roll. After all, we had a history of economic expansion.

7. Life in the investment property segment of real estate was a challenge. Rents were down $50/month for 1 bedroom apartments to $200/month for nice single family homes here in Loveland, and our market was much more stable in growth and decline than other areas.

By the end of 2005, we were feeling 12-13% vacancy rates with depressed prices. All the while the East and West coasts were still appreciating. You might also recall that in 2006, Colorado was #1 in the nation in number of foreclosures, and Weld County was #1 in the country.

8. Then in late Spring, 2006 our local vacancy rate dropped from 12-13% to 8%, we had hope! Knowing that a few months of stability as exhibited by lower vacancy rates does not make a trend, we conservatively waited to see if there was truly a difference or if we were imagining things! In late summer, 2006, we actually started raising (albeit it conservatively and carefully) rents. Modest increases started at just $10-$15/month. We did it because we have also lived through some spicy times when appreciation was phenomenal, but it was tough to raise rents $75-$100/month without causing vacancies, so we wanted to be careful that we didn't wait too long and get behind what seemed like more palatable increases.

9. In 2006, we also witnessed a few foreclosures. Our firm manages community associations, so we are close enough to see trends in rentals and in home ownership. While we were raising rents, a few people in our communities were undergoing foreclosures – roughly 19 foreclosures in the 2,000 homes in our community associations which didn't seem like a trend until the end of the year when the foreclosure laws changed and another 12 were filed.

10. Thus far in 2008, we have had 57 foreclosures filed in the 3,000 homes in our community associations and 3 foreclosures by rental property owners on our rental side. Not what you hear in the media, right? In the first 4 months of 2008, $380 billion in adjustable rate mortgages adjusted, and some of the worst ones had 6% adjustments which caused mortgage payments to increase $500/month!

11. I will offer the opinion that foreclosures are only PART of the issue. When foreclosures started happening, it was truly the neon sign that everyone who could (and some who shouldn't) had already become homeowners and the stream of purchasers had dwindled to a trickle ... yet there was still an abundant supply of homes available and we were still building at a feverish pace. I believe that the oversupply of homes is the larger factor in our present economic state, and nature took over and property values declined. When property values declined, banks had to adjust their balance sheets to reflect the true value of their lending portfolio. PLUS, the banks can only lend up to an amount calculated from their balance sheet assets, so when values declined, they found that they had lent too much. When they loaned out too much, they had to stop lending until they were back in compliance with ratios which dried up credit. In many areas in Florida, the upper mid-West and California, home values have depreciated 15-25% just this year.

12. For banks, the fastest way to get their balance sheets shored up is to stop lending to short term users which is usually businesses. So credit lines were frozen and they set higher or longer holds on deposits. I was talking with one of our investors recently about this. He is an insurance agent who collects premiums from policyholders, deposits them into his agency's trust account and then the national agency sweeps money each night from his trust account to the national company's account. His banker informed him that only a portion of his deposit could be swept until the checks had fully cleared because whether or not the banks his policyholders had written checks on would clear because banks had holds on deposit themselves OR could be written on banks that were near or at insolvency.

13. In October, Congress voted to infuse $700 billion into the economy through bank bailouts. But again, the "bailout" is not necessarily caused by banks and Wall Street being unscrupulous. Yes, there certainly seem to be some buttheads out there doing stupid things, but this emergency legislation was intended to infuse money into the banking system to free up credit. This was critical, especially because if businesses cannot get loans to run, people lose jobs. If people lose jobs, they can't pay mortgages OR RENT, and if people can't pay mortgages there are more foreclosures, and if people can't pay rent, there are more foreclosures. This is not the first time the federal government has loaned money to private industry and banks. This same type of measure has been used to with railroads, airlines, savings and loan institutions, automakers, etc. Believe it or not, when the government buys up stock, they usually make a profit when selling it later after that sector of the market has stabilized.

14. International markets have had similar issues, and our US economy is really quite global. It will be critical not just for the US to take action, but other countries as well. So while everything I have written here is breaking things down as best as I can to understand and convey them, even more complexities exist when we consider the balance of trade. Another factor that will have a reverberating effect will be that the many of the failed mortgages are backed by some type of mortgage insurance, and there is an insurance feature on those mortgages bundled and sold on Wall Street. No one knows how deep the rabbit hole of credit default swaps goes because they are unregulated.

15. We now know that Barack Obama will be the next president of the United States. Up until the election a month ago, that unknown factor

In summary, our economy did not get into this position over night, and it will take time to rebound. Right now, Wall Street still has huge upward and downward variances and it "boings" up and down like a rubber band until it settles in at the right number to reflect true stock values.

I cannot tell you for certain what will happen over the next few months. If the federal government and federal reserve can stabilize the credit systems in a timely manner, then you and I will go about our daily business and keep working to feed our families and live indoors. But stabilizing the credit market is absolutely critical. I believe that will end the stock market freefall. I would also expect the Christmas retail season to be dismal as consumers tighten their belts for the long haul, and that will have an impact on the economy as well. I would predict that it will be at least mid-year next year before we really know where the bottom was.

Colorado is very fortunate. Our housing appreciation bubble did not grow too far out of equilibrium. In fact, property values have been mostly flat for 4 years now which is better than depreciation! The rent prices declined but have rebounded substantially in just 2 years. As long we get credit stabilized so people stay employed, we should be fine in the rental segment of real estate. Up to this point, we have not seen an increase in people moving due to job loss (there are always a few), but we have not yet felt the impact of the stock market fall. I believe that January and February rent cycles will tell us whether my prediction above is realistic or not.

Once again, thank you for allowing us to be of service. Please contact me with any questions at all, and most importantly, thank you for your trust. We do not take your trust lightly, and everyone in our company will to continue to work hard to keep your rental portfolio stable!

Sincerely,

ROCKY MOUNTAIN PROPERTY MANAGEMENT, INC.

Susan Albern
President