



ANNUAL REPORT ON INVESTMENTS WITH DAVENPORT PARTNERS

September 2007

Dear Investor:

This investor letter will serve as a brief annual report and look-back on our various investments.

In 2007 to date, we have sold two properties, 180 Newport Center in Newport Beach and Sixth Street Center in Ontario, and made a co investment in a shopping center in Maui. We have two properties in contract and several other deals in the Letter of Intent stage. In the following pages we provide you with a brief update on some of our projects of which you may be an Investor.

One of the biggest news stories in the real estate world this year was the sale of Equity Office Properties to the Blackstone Group (NYSE: BX). Locally, Equity Office owned 6 million sf of office space throughout Orange County (3.9 million sf of which were former Spieker Properties buildings which we sold to Equity Office in 2001). Blackstone promptly flipped the entire OC portfolio to Maguire Properties (NYSE: MPG). Maguire then turned around and put several packages of buildings on the market to sell.

In one package were four Airport Area low to mid rise offices buildings comprising 534,000 sf, in which Davenport Partners bid aggressively (so we thought!) at \$300/sf. Apparently not quite aggressively enough though, for the ultimate winner of the bid, was just a little higher than us, at \$425/sf. (In whole dollars their bid was \$67 million higher than ours - oh well...)

A conundrum in the leasing market? Orange County office asking rates are at an all time high, partly as a result of many new high rises coming on line this year and next, each carrying very high asking rates. At the same time, the Sub Prime Mortgage Lender implosion has led to many locally headquartered companies such as New Century, Impac, and Ameriquet to have massive layoffs. The result is a tremendous amount of sub lease space on the market. Nobody is fessing up yet, but the probable result is a tenant's market for leasing office space in the near future.

Impac Mortgage Holdings occupied a building at 1401 Dove Street in Newport Beach. Because they were growing so fast (buying mortgages), they committed to lease a new office building that was under construction on Jamboree Boulevard (next to the Google Building). The Impac Building on Dove Street - soon to be vacant - was sold for about \$350/sf to a home builder. Impac's stock (IMH) has gone from above \$20/share to \$1.75/share in the last year and they are now trying to sublease space. The home builder just put the 1401 Dove Street building back on the market for sale and it is still totally vacant. What do you think - will it sell for more or less than the home builder paid for it less than one year ago??

Deal friction: We signed a Letter of Intent to purchase the Sprint building in Honolulu in September of 2005. We signed the purchase agreement in May of 2006. We picked our lender in June. The lender's appraiser submitted their appraisal in late July. We finally closed the deal August 31, 2006. The time that went into this \$13 million dollar acquisition was incalculable, and the cost of fees, consultants, due diligence, lender costs, etc was nearly \$500,000. Instead one could get exposure to Sprint and Hawaiian real estate by going online and buying a block of Sprint stock and buying blocks of Alexander & Baldwin or HRPT Properties stock (both Hawaiian property owners) with the click of a mouse and at a cost of \$9.95 per trade. We love real estate and we love to do deals and build and rehab and lease and manage properties. That's what we do and we enjoy it every day. But sometimes we have to question the process.

We are moving into turbulent times in commercial real estate. The housing market is in the tank, the subprime mortgage implosion, foreclosures are up, election year politics, potential tax hikes on hedge fund carried interest profits and now a banking and credit crisis. It is bound to affect the commercial real estate market. But how much and in what way? You are thinking, prices will go down, of course.

Investor Letter
September, 2007

Fed Chairman Bernanke has a little problem: we are in housing and banking crisis, the economy is supposed to be growing but there is little job growth, and the Federal Government has a huge and growing deficit. We may be facing a serious recession. What is his solution? Lower interest rates and flood the money supply, and push for a weaker dollar to get job growth and inflation. Job growth keeps people employed so they can pay the mortgage. Inflation raises their pay check so they can make the higher monthly payments on the ARMs. Inflation also lowers the real value of the deficit. A weaker dollar results in more exports. More exports results in more production in the US, which means more US jobs. The weaker dollar also means more expensive imports which results in importing more inflation.

And the implications for real estate: foreclosures stabilize and housing goes flat. Commercial real estate rents go up with inflation and jobs driven demand for space. Foreigners with their strong currencies go on a buying spree and cannot get enough of what now appears to be cheap US commercial real estate.

Are you now thinking maybe prices will go up?

We don't know the answer, of course, so we will just keep looking for good deals.

We appreciate your interest and support.

Please feel free to contact us anytime at (949) 640-5100 with any questions concerning your investment, the property or the real estate markets, or your interest in other real estate investments.

Sincerely,

Davenport Partners

Enclosure