Home Properties (HME)

'08 Not Looking So Great

February 25, 2008 ■ Recent Price $46.97 ■ DJIA 12,570 ■ RMZ 865

I. Overview

As part of HME's 4Q07 earnings, the company provided '08 same-unit guidance that lags that provided by its apartment REIT peers. HME's "organic" revenue growth estimate sits well below the apartment REIT average primarily because of inferior submarket locations and asset quality, which calls into question whether HME's portfolio is really as defensive as advertised. The company's '08 capital plan calls for a greater level of acquisitions than stock buybacks, a questionable capital allocation decision given the available arbitrage. Recent operating results were weaker than expected, as revenue growth came in well below the apartment REIT average and bested only CPT and CLP.

II. '08 Outlook Lags Peers

HME reported disappointing 4Q results that fell short of both our same-unit growth and FFO/sh expectations. Revenue growth came in 50bps below the apartment REIT average and bested only the Sunbelt-dominated portfolios of CPT and CLP, while same-unit NOI growth was better than only AIV. More importantly, HME's same-unit revenue growth outlook for '08, which it also provided as part of 4Q earnings, fell short of our forecast (3.8% vs 4.2%).

It is important to note that a significant portion of HME's corporate strategy entails "buying" rent growth by investing excess capital to upgrade its properties within its same-unit portfolio. After adjusting for both excess capital expenditures and incremental utility reimbursement revenue, HME's '08 "organic" revenue outlook (2.2%) sits even further below our estimate and the apartment REIT average (3.5%), questioning whether HME's portfolio is really as defensive as suggested. To be fair, other apartment REITs receive a boost to revenue from utility reimbursements, but the magnitude of their respective revenue benefit is much less significant. The growth in HME's level of reimbursements not only affects revenue, but also causes higher than average same-unit expense growth (4.5%), of which an estimated 50 basis points is the result of utility costs that will be reimbursed by tenants. That said, the remaining expense growth of 4% is still well above the 3-3.5% for most of its peers and our prior estimate of 3.25%.

While management acknowledged it is facing economic and market-specific headwinds, the implementation of a revenue management system (LRO) should help same-unit results. Apartment REITs that have previously implemented LRO have indicated a benefit of 100-150 basis points to reported revenue growth; HME's '08 outlook does not include an LRO-related boost given the uncertainty of the benefit. Markets expected to lead the way in '08 include Philadelphia, Baltimore, Washington, D.C. and Florida (2 assets), while Maine and Boston are expected to be bottom performers.

III. Acquiring Stock…and Assets?

HME's '08 anticipated investments include $50 million of share repurchases (1.1M shares at the current price), as well as $150 million of potential acquisitions at an expected nominal cap rate of 6.25%. With its stock trading at an implied cap rate north of 7%, a more aggressive share repurchase strategy would appear to represent a better risk-adjusted use of the company's capital. HME acquired $60M worth of shares (2.6% of shares/units outstanding) during 2H07 and indicated that it will continue to consider share repurchases should it exceed its disposition target for '08 ($180M) or if potential acquisitions do not meet its internal return hurdles.

IV. Roadblock Highlights Development Risk

HME's burgeoning development platform was dealt a body blow during 4Q as its centerpiece project, the proposed Falkland Chase high-rise development project in Silver Spring, MD, may have to be shelved as it is currently encountering legislative obstacles (see our note, "*Centerpiece Development Hits Major Roadblock*, dated December 13, 2007). HME has

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spent significant time and capital entering the development business and this setback highlights one of the risks to which developers are exposed, especially those with limited experience. While not a significant loss financially (capitalized costs to date total $1.2 million or $.03/sh), a cancellation of this development project will make it more difficult for HME to gain credibility for its development platform going forward.

V. NAV / FFO Update

Combining 4Q operating results with a slower NOI growth outlook for '08, results in a 1% ($0.50/sh) decline in our NAV estimate to $48.50/sh, as well as a 3% decline in our '08 FFO estimate to $3.37/sh (was $3.46). Our revised '08 estimate sits below the Street's consensus estimate of $3.41/sh, but within HME's '08 FFO guidance of $3.31-$3.47/sh.

HME's portfolio is valued at an economic cap rate of 5.8% after a $1,300/unit cap ex reserve, or a nominal (pre cap-ex reserve) cap rate of 6.9%.

VI. Recommendation

While HME's portfolio is better positioned for same-unit growth than it was just a few years ago, its growth prospects still lag in comparison to those apartment REITs that also focus on high-barrier markets, owing mostly to the inferior submarket locations and asset quality of HME. HME currently trades at the smallest discount to NAV in the apartment REIT sector, in part because it is often touted as a defensive play within the sector. However, it's '08 revenue guidance (after adjusting for revenue-enhancing cap-ex) suggests that it may not be as defensive as some believe.

Our NAV-based Pricing Model concludes that HME should trade at an 8% NAV discount, which is smaller than the 18% discount at which the average multifamily REIT currently trades. When applied to our NAV estimate of $48.50/sh, a warranted price of about $44.50/sh is indicated.

At the current valuation, we maintain our SELL recommendation on the shares of HME.

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GREEN STREET ADVISORS

NAV Analysis - Home Properties (HME) — 4Q07

last revised: February 24, 2008

NAV $48.50

Operating Value of Real Estate

Reported Property Results	
Rental revenue and other income	$127,626
Expenses	($54,749)
Reported NOI	**$72,877**
Margin	*57.1%*
Adjustments:	
Acquisitions	$182
Unrealized benefit of revenue enh. cap-ex incurred	$263
Other	$0
NOI including adjustments	$73,322
Annualized NOI	$293,289
Annualized forward growth rate	5.15%
Forward twelve-month NOI	**$302,607**
Capitalized Real Estate Value:	
Cap Ex reserve per unit	$1,300
Cap Ex as % of NOI	16.1%
Cap Ex reserve	($48,745)
Adjusted NOI	$253,862
Economic cap rate	5.80%
Nominal cap rate	6.91%
Value	
Value of operating communities	**$4,376,928**
Number of apartment units	37,496
Value per apartment unit	**$116,731**

Debt Summary / Ratio Analysis

	$Amount	%Total Assets
Leverage (w/out prfds.)	$2,265,616	50.2%
Leverage (w/ prfds.)	2,265,616	50.2%
Variable	31,185	0.7%
Short Term Debt (<2yrs.)	135,576	3.0%
Current assets	80,185	1.8%
Current liabilities	215,588	4.8%
CA-CL/TA	(135,403)	-3.0%
G&A	23,500	0.52%
CIP and Land (including PV value creat	54,069	1.2%
Other Assets (property services busine:	620	0.0%
	#Shares	# Total
Insider ownership	1,395,496	3.0%
Insider ownership (w/ options)	2,340,920	5.0%
	$/Share	# Options
Options (all)	$40.24	2,348,014
Recent Share Price	$47.06	
Implied Value/Unit and Nom Cap Rate	$115,046	7.01%

M-T-M Summary	
Fixed rate debt	$2,158,104
Average rate	5.61%
Average time unitl maturity (years)	7.53
Treasury yield on wghtd avg debt maturity	3.34%
Unsecured spread over similar maturity	2.30%
Mark-to-market adjustment	**($3,685)**
Increase per share	($0.08)
Increase as a % of NAV	-0.2%

Adjusted Current Value Balance Sheet (000s)

		as of 12/31/2007
Assets		
Capitalized RE value		$4,376,928
Property services		620
CIP		16,570
Land held for Development		37,499
PV Value Creation CIP		0
PV Value Creation Development Pipeline		0
Cash & equivalents		17,218
Restricted cash		31,005
Prepaids		15,560
Deferred charges		12,371
Other assets		4,031
Other assets held for sale		0
Total Assets		**$4,511,802**
Liabilities		
Line of credit		$2,500
Mortgage Debt		1,958,104
Convertible Debt		200,000
Variable mortgage		28,685
Accounts payable		18,616
Accrued expenses and other liabilities		27,586
Security deposits		22,826
Accrued interest		10,984
Mark-to-market adjustment - Fixed rate debt		(3,685)
Total Liabilities		**$2,265,616**
Preferred Stock		**$0**
Shareholders' Equity		**$2,246,185**
Shares and OP Units outstanding		46,048
Conversion of Options (Treasury Method)		340
Conversion of Preferred Shares & Units		N/A
Shares Outstanding		46,388
Net Asset Value (NAV)		**$48.42**
Δ from last published estimate of:	$49.00	-1.02%

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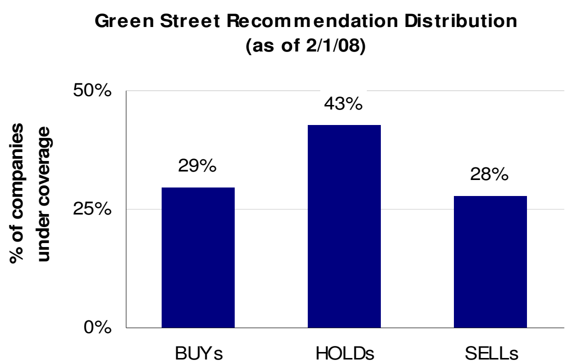
At any given time, Green Street publishes roughly the same number of "BUY" recommendations that it does "SELL" recommendations.



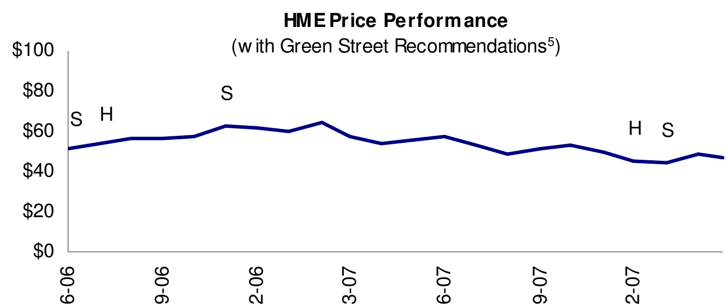
Green Street's "BUYs" have historically achieved far higher total returns than its "HOLDs", which, in turn, have outperformed its "SELLs".[1, 2]

Total Return of Green Street's Recommendations

Year	Buy	Hold	Sell	NAREIT Eqty[4]
2008 YTD[3]	5.1%	6.6%	6.1%	-1.0%
2007	-6.5%	-22.3%	-27.6%	-15.7%
2006	45.4%	29.9%	18.4%	35.1%
2005	26.3%	18.3%	-1.9%	12.2%
2004	42.3%	28.4%	15.6%	31.6%
2003	42.7%	37.2%	20.9%	37.1%
2002	17.7%	2.6%	1.9%	3.8%
2001	35.7%	19.1%	11.9%	13.9%
2000	53.6%	29.3%	4.4%	26.4%
1999	14.2%	-9.2%	-20.2%	-4.6%
1998	-0.6%	-15.1%	-16.4%	-17.5%
1997	37.1%	14.2%	5.8%	20.3%
1996	47.3%	30.2%	17.5%	35.3%
1995	23.6%	14.3%	-0.4%	15.3%
1994	20.5%	-0.7%	-9.3%	3.2%
1993[3]	29.4%	5.4%	6.7%	12.4%
Total Return[3]	**3866.0%**	**385.2%**	**18.5%**	**483.5%**
Annualized	**27.8%**	**11.1%**	**1.1%**	**12.5%**

Year Ended December 31:

The chart below shows HME's price performance over the last three years, along with Green Street's recommendations during that time.



1) Historical results through January 3, 2005 were independently verified by Ernst & Young, LLP. E&Y did not verify stated results subsequent to January 3, 2005. Past performance results cannot be used to predict future performance. For a complete explanation of study, see 5/9/03 report "How are We Doing?".
2) Company inclusion in the calculation of total return has been based on whether the companies were listed in the primary exhibit of Green Street's "Real Estate Securities Monthly", pg. 13-16. Beginning with May 2000, Gaming C-Corps and Hotel C-Corps, with the exception of Starwood Hotels and Homestead Village, are not included in the primary exhibit and therefore not included in the calculation of total return. Beginning with March 2003, all Hotel companies are excluded.
3) Study uses recommendations given in Green Street's "Real Estate Securities Monthly" from January 29, 1993 through February 1, 2008.
4) Not directly comparable to Green Street's performance indices because NAREIT includes more companies and uses market-cap weightings. Green Street's returns are equally-weighted averages.
5) Green Street has only three recommendations: BUY ("B"), HOLD ("H") and SELL ("S"). The firm does not consistently publish price targets and therefore price targets are not included in this graph.

Green Street will furnish upon request available investment information regarding the recommendation