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REAL ESTATE ADVISORS

RELATIVE VALUE US REAL ESTATE INVESTING

November 2008

The Market Observed

- As anticipated we are starting to see the first signs of loan delinquencies within recent issue Commercial Mortgage Backed Securities (CMBS). Two of the three largest loans (a lifestyle center and hotel) in a recent 2008 vintage (loans originated in 2007) deal (JPM 2008-C2) appear to be having difficulties and in recent weeks transferred to "special servicing", (read "workouts"). As this story has broken (*Bloomberg 20 Nov*) it has become a big headline news item for the CMBS market, and CMBS spreads have widened in sympathy.

- Paulson & Co, one of the few hedge funds that correctly picked the collapse of the sub prime market (and made billions accordingly), is reported (*Financial Times 17 Nov*) as having told clients they have started buying real estate backed debt securities.

- CMBS spreads are at all time wide levels to Swaps. Benchmark CMBS AAA securities currently trading at 1,200 to 1,400 bps makes the rest of the corporate spread markets look very rich with high grade corporate spreads at an average of approximately 445 bps. Indeed, current AAA CMBS spreads imply loss severities that are more than 10 times higher than the worst loss severities ever experienced in the commercial mortgage market, and they also imply an approximate 50% reduction in property values.

- Equity real estate transaction volumes remain at historical lows with lenders showing a degree of restraint in calling in loans and thus forcing sales. Transaction volumes will likely remain stagnant through the first half of 2009, if, as expected commercial mortgage capital remains in short supply as it is today.

Manager Actions

- **The downside risk to equity real estate remains very high – avoid.**

- **We are preserving new capital for opportunities that will emerge in 2009**

- **When new capital is deployed we will likely be very selectively acquiring high credit investments secured against high quality income producing real estate assets, (currently in 30% subordination AAA CMBS).**

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Our portfolio orientation is represented as follows.

Investment Sectors	Fundamentals		Technicals [1]		Risk Adjusted Returns	Accretive [2]	Action
Public Debt (Real Estate Fixed Interest Securities)							
Investment Grade CMBS - seasoned	Good	▼	Fair	▲	Good	Yes	🟡
Investment Grade CMBS - recent vintage	Poor	▼	Good		Poor	Yes	🔴
Private Debt							
Whole Loans	Good	▶	Good	▲	Good	No	🔴
Below Investment Grade CMBS - seasoned	Fair	▼	Poor		Good	Yes	🟡
Below Investment Grade CMBS - recent vintage	Poor	▼	Fair		Poor	Yes	🔴
Mezzanine Loans [3]	Good	▶	Fair	▲	Good	Yes	🟢
Public Equity (Real Estate Equity Securities)							
REIT Common Stock-Equity	Fair	▼	Good		Poor	No	🔴
REIT Common Stock- Commerical Mortgage	Poor	▼	Good		Fair	Yes	🔴
REIT Preferred Stock - Equity	Fair	▼	Poor		Good	Yes	🟡
REIT Preferred Stock - Commercial Mortgage	Poor	▼	Poor		Fair	Yes	🔴
Private Equity							
Direct Ownership	Fair	▼	Fair		Poor	No	🔴
Preferred Equity	Fair	▶	Good	▲	Good	Yes	🟢

🟢 Overweight   🔴 No Allocation   🟡 Selective

Technicals [1] Refer to key non fundamental factors such as capital flows, ability to acquire suitable product etc.

November 2008 - Structured Debt / Equity Opportunities

Attributes	Investment Grade CMBS	B-Notes	Mezzanine	Preferred Equity	Joint Venture Equity	Distressed Debt
Investment Size (millions)	**$1 to $10**	$1 to $50	**$1 to $50**	$1 to $50	$1 to $50	$1 to $50
Loan-to-Value	**50% to 75%**	65% to 85%	**65% to 90%**	65% to 95%	65% to 95%	0% to 95%
Debt Coverage	**1.30X +**	.70X to 1.20X	**.70X to 1.20X**	1.05X to 1.20X	N / AP	0.0X to 1.20X
Term	**1 to 10 years**	1 to 10 years	**1 to 10 years**	1 to 10 years	1 to 5 years	1 to 10 years
Structure	**Fixed**	Fixed & Floating	**Fixed & Floating**	Fixed	Promote	Fixed & Floating
Amortization	**Interest Only**	I.O. / Amort.	**I.O. / Amort.**	Interest Only	N / AP	I.O. / Amort.
Current Yield	**10% to 20%**	8% to 12%	**5% to 12%**	12% +	Varies with Cash Flow	0% +
IRR	**14% - 50%+**	12% - 20%	**12% - 25%**	15% - 30%	15% - 30%+	15% - 30%+

Investment Grade CMBS

Opportunity: Acquire Investment Grade CMBS at spreads / yields that are several times higher than historical levels.

Compelling Attributes:

- CMBS spreads have widened under largely technical pressure, and while delinquencies are beginning to rise, they remain at historically low levels. For example spreads on 30% subordination AAA CMBS are approaching 1,400 basis points. These levels compare to the peak of the CMBS market in January, 2007 when spreads on these bonds were approximately 25 basis points. Spread widening much more pronounced on lower rated CMBS classes.
- Upside potential. For example if spreads compress 200 bps on a bond with 5 year duration, it results in a 10% gain at the time of sale. Given the remarkable spread widening that has taken place, 200 bps appears achievable over the term of these investments;
- Good liquidity, albeit at distressed prices;
- Secured by first mortgages;
- Lower (safer) position in the capital structure.

Challenges:

- Must be very selective in terms of credit, as later vintages contain poorly underwritten loans with low subordination;
- Investors must be able to withstand market volatility on monthly valuations.

B-notes

Opportunity: Acquire subordinate first mortgage positions originated by CMBS conduit lenders, typically at a discount to the outstanding principal balance.

Compelling Attributes:

- Assets are priced to sell, due to seller balance sheet pressure;
- Secured by a first mortgage;
- Lower position in the capital structure relative to other high yield debt opportunities.

Challenges:

- Limited to CMBS conduits for supply and B-notes are no longer being manufactured. As such, the remaining supply is typically very low quality.

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Mezzanine Debt

Opportunity: Originate and / or acquire mezzanine loans which are secured by an assignment of partnership interests. With first mortgage loan proceeds effectively capped at 65% LTV or less, borrowers increasingly require mezzanine debt to acquire properties, buy-out partners, fund capital improvements or refinance existing debt.

Compelling Attributes:

- Relative to the prior 12 to 18 months, mezzanine debt is now required for a safer position in the capital structure, with returns that are higher than recent history.
- Larger slices of the capital structure enable capital to be deployed more quickly.

Challenges:

- In many cases, the existing senior loan documents do not permit mezzanine debt or approvals are complicated and time consuming. As such, preferred equity is in many cases the only alternative. This is not typically an issue with property acquisitions.

Preferred Equity

Opportunity: Equity investments structured similar to mezzanine loans with a preference on property cash flow to pay a preferred return. The majority of existing and new senior debt prohibits secondary financing, including mezzanine loans. However via a direct transfer of partnership interests, property owners can look to preferred equity investments to unlock equity.

Compelling Attributes:

- Investments are in mostly stable assets with higher returns than typical core to core plus equity investments.
- Larger slices of the capital structure enable capital to be deployed more quickly.
- Fewer players in this space rendering the market less competitive.

Challenges:

- Deals are relatively complicated – documentation is less boiler plate;
- Typically requires servicer approval from existing first mortgagee. Not an issue with property acquisitions.

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Joint Venture Equity

Opportunity: Joint venture equity investments which provide capital to sector and market specialists to lease-up and or reposition assets.

Compelling Attributes:

- Provides access to attractive opportunities, typically under the radar of larger opportunity funds.

Challenges:

- Deals are relatively complicated – documentation is less boiler plate;
- Typically requires servicer approval from existing first mortgagee. Not an issue with property acquisitions.
- Typically value-add opportunities which are difficult to underwrite headed into a weaker economy.
- The near term opportunity in this sector is extremely limited and perhaps nonexistent until the economy recovers and real estate fundamentals follow suit.

Distressed Debt

Opportunity: Acquire sub and non-performing commercial mortgages at significant discounts to outstanding principal balances.

Compelling Attributes:

- Purchase prices typically range from 20% to 60% of the outstanding principal balance which provides more flexibility to arrive at a resolution or dispose of the asset and therefore achieve higher returns (more upside potential).

Challenges:

- Timing, cost and resolution of the loan is somewhat hard to predict. Requires purchase prices at substantial discounts to par.
- Some loans may not provide any interim cash flow.

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