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## ECONOMIC & REAL ESTATE OVERVIEW

2<sup>ND</sup> QUARTER 2010

### Contents

Employment .....	2
Gross Domestic Product (GDP).....	4
Institute for Supply Management Index .	5
Construction Spending.....	6
Korpacz Real Estate Investor Survey .....	8
Cap Rates vs. Sales .....	10
Commercial Property Sales Analysis ....	11
Distressed Commercial Properties .....	13
NCREIF Property Index .....	14
U.S. REIT IPOs on the Rise .....	16
FTSE NAREIT U.S. Real Estate Index.....	18
Commercial Lending Increases .....	19
CMBS Market.....	20
Hotel Properties on the Rebound.....	23
Property Forecast.....	24

### Introduction

During the first half of 2010, the U.S. economy continued its gradual improvement despite talks about a double dip recession resulting from the slowing of government incentives. The ending of tax incentives for first-time homebuyers resulted in home sales declining 32.7% in May. The pullback in stock market, sovereign debt concerns in Europe and the gulf oil spill have led to increased concerns about the economy. Generally, second quarter activity was disappointing for the majority of economic indicators and nonfarm payrolls fell in June; GDP was also recently revised downward for the first quarter of 2010. On the positive, retail sales have recently rebounded as retailers began to increase discounting and The Institute for Supply Management (ISM) surveys continue to indicate economic growth.

Although market activity is slowly beginning to rise, excess space, negative absorption, flat rents and increasing delinquency rates for commercial mortgage backed securities (CMBS) continue to plague the commercial real estate market. One exception appears to be the apartment sector, where several markets have reported increasing rents, tightening space and a recovery within the sector. As commercial banks rid their balance sheets of troubled assets, the number of distressed properties continues to rise. Experts believe commercial real estate conditions will still remain sluggish for the remainder of the year although increased investor activity and moderating cap rates provide hope for the future.

The following summarizes key issues related to the current economic conditions:

- **Positive GDP Growth.** U.S. gross domestic product (GDP) grew at a 2.7% annual pace during the first quarter of 2010, following a 5.6% increase in the previous quarter.
- **Unemployment Rate Falls.** The unemployment rate declined to 9.5% in May from 9.7% a month earlier. However, 125,000 jobs were lost during May, adding to pessimism about the health of the economic recovery.
- **Construction Spending Decreases.** Total construction spending declined 0.2% in May with the April figure revised lower to 2.3%.
- **Durable Goods Orders Rise.** New orders for big-ticket manufactured goods decreased 1.1% in May as demand for commercial aircraft dropped off. This represented the first decline in six months, following April's strong 3.0% increase. Excluding the transportation sector, orders increased 0.9%.
- **New Home Sales Decline.** New home sales decreased 32.7% in May and fell to a 300,000-unit pace from a downwardly revised rate of 446,000 in April. The sharp decline in new home sales in May likely reflects the expiration of the homebuyers' tax credit.

Real Estate Solutions

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*Introduction (continued)*

- **Leading Indicators Up.** The Leading Economic Index (LEI) increased 0.4% in May, and April's small decline was revised to no change. The financial components made the largest positive contributions to the index this month, more than offsetting the substantial negative contributions from stock prices and building permits. Five of the ten indicators that make up The Conference Board LEI for the U.S. increased in May.
- **Retail Sales Slip.** After seven consecutive monthly gains, retail sales declined 1.2% in May. The decrease was primarily due to a sharp drop in purchases of building materials.
- **Consumer Prices Stable.** The CPI declined 0.2% in May for the second consecutive month. Energy prices fell 2.9% in May, offsetting gains in virtually all of the other major indexes.
- **Business Inventories Stable.** Business inventories across the supply chain increased 0.4% in April, a slower pace than during the prior two months.
- **Wholesale Inventories Rise.** In April, wholesale inventories increased 0.4%. This represented a slight slowdown from March's upwardly revised 0.7% gain.
- **Personal Income Edges Up.** Following an upwardly revised 0.5% increase in April, personal income increased by 0.4% in May. Economists had expected a 0.5% increase during the latest month.
- **Industrial Production.** U.S. factory output increased for the 11th consecutive month in May, primarily resulting from gains in manufacturing and utilities.

## Employment

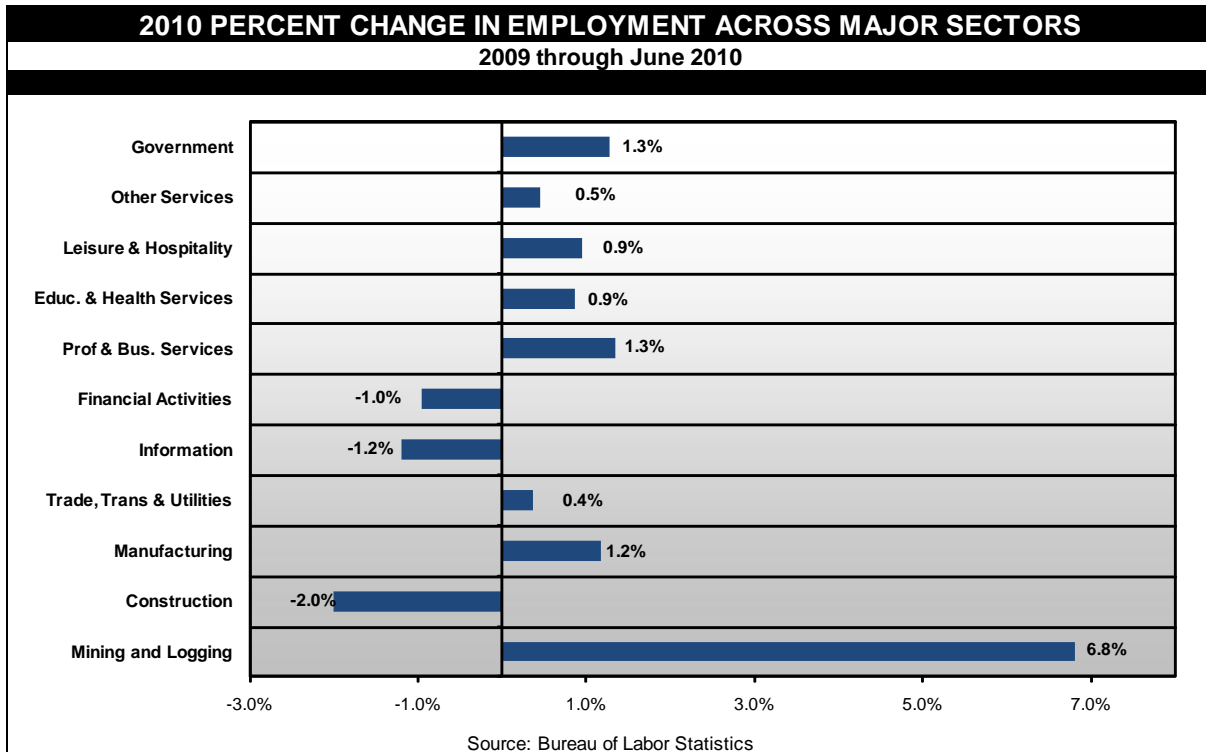
For the first time in 2010, the U.S. economy shed jobs in June as 225,000 government workers that were hired for the 2010 census in recent months lost their temporary jobs. In total, nonfarm payrolls fell by 125,000 in June. If the loss of census jobs were removed, job growth of 100,000 was recorded during June. Other sectors losing jobs included financial activities (15,000) and construction (22,000).

Gains were widespread across various sectors of the economy. During June, professional and business services added 46,000 jobs, leisure and hospitality gained 37,000 positions and health care saw a 9,300 increase. Smaller increases were recorded within the manufacturing (9,000), mining (5,000) and education (5,100) sectors.

UNITED STATES NON-FARM EMPLOYMENT BY INDUSTRY							
Historic & Current Figures							
INDUSTRY	Jun-10 Employment	Total Percent	2009 Employment	Total Percent	2008 Employment	Total Percent	% Change May-10 - 2009
Mining and Logging	725	0.6%	676	0.5%	768	0.6%	7.2%
Construction	5,582	4.3%	5,696	4.4%	6,704	5.0%	-2.0%
Manufacturing	11,670	8.9%	11,534	8.9%	12,822	9.5%	1.2%
Trade, Trans & Utilities	24,744	19.0%	24,653	19.0%	25,619	19.1%	0.4%
Information	2,715	2.1%	2,748	2.1%	2,908	2.2%	-1.2%
Financial Activities	7,584	5.8%	7,657	5.9%	8,000	6.0%	-1.0%
Prof & Bus. Services	16,709	12.8%	16,488	12.7%	17,220	12.8%	1.3%
Educ. & Health Services	19,519	14.9%	19,350	14.9%	19,033	14.2%	0.9%
Leisure & Hospitality	13,114	10.0%	12,991	10.0%	13,248	9.9%	0.9%
Other Services	5,338	4.1%	5,314	4.1%	5,445	4.1%	0.5%
Government	22,770	17.4%	22,481	17.3%	22,561	16.8%	1.3%
<b>Total Nonfarm</b>	<b>130,570</b>	<b>100.0%</b>	<b>129,588</b>	<b>100.0%</b>	<b>134,328</b>	<b>100.0%</b>	<b>0.8%</b>

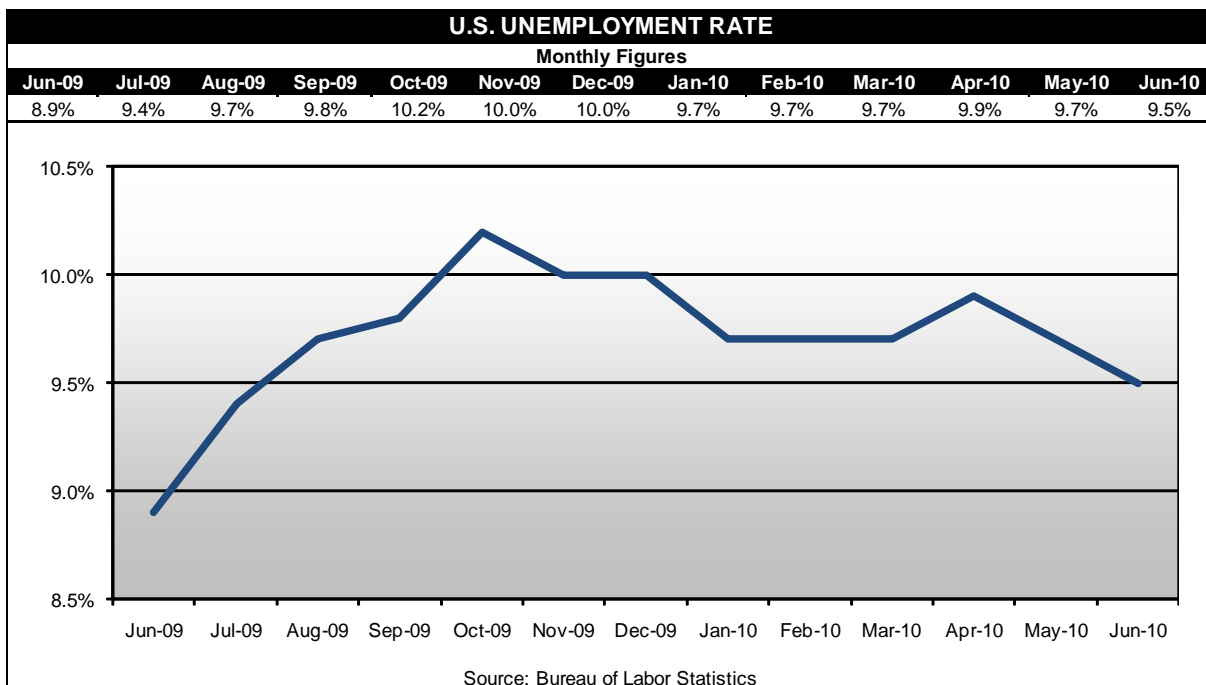
Source: Bureau of Labor Statistics

Employment (continued)



The change in employment through June 2010 showed only three sectors, Financial Activities, Information and Construction, recording losses in employment since 2009. Private-sector payrolls increased by 83,000 in June, below analyst expectations. Despite a reduction of jobs during June, the unemployment rate dipped to 9.5%; this marked the third consecutive monthly decline within the unemployment rate

Below is a graph depicting unemployment since May 2009:



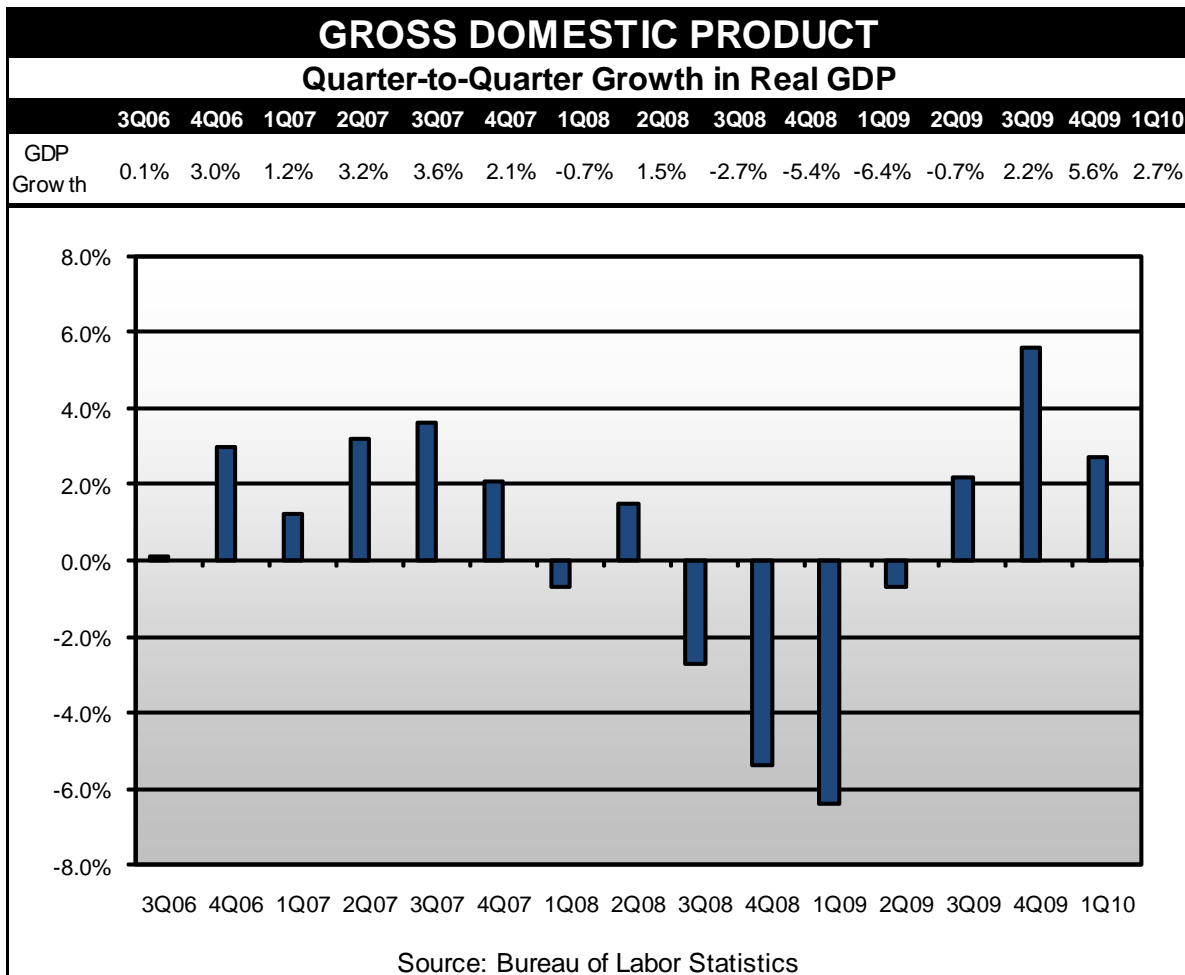
## Gross Domestic Product (GDP)

The GDP growth rate is considered the most important indicator of economic health. When the GDP is growing, the expectation is that business, jobs and personal income will also grow. On the contrary, if GDP is contracting, then expectations are that businesses will hold off investing in new purchases and hiring new employees as they wait to see if the economy will improve. A negative GDP growth rate is indicative of a recession.

The Commerce Department reported that U.S. GDP growth was revised downward to 2.7% during the first quarter of 2010, primarily due to downward adjustments of growth in consumer spending and imports. Initially, a 3.2% growth rate was reported for the first quarter of 2010. However, the increase marked the third consecutive quarterly gain. The increase in real GDP primarily reflects positive contributions from private inventory investment, exports, personal consumption expenditures (PCE), and nonresidential fixed investment. Also helping the GDP was that spending by consumers increased by the fastest pace in three years. Deceleration in real GDP growth in the first quarter was caused by a slowdown in private inventory investment, a downturn in residential fixed investment and larger decreases in state and local government spending.

Wells Fargo Securities forecasts GDP to slow to 2.0 percent during the second half of 2010. The predicted slowdown is primarily attributed to the ending of various stimulus programs and the winding down of inventory restocking. In addition, the Gulf oil spill and European financial crisis are likely to negatively impact domestic economic activity.

The following chart summarizes GDP growth on a quarterly basis since 2Q 2006:



## Institute for Supply Management (ISM) Manufacturing Index

The ISM, a national survey of purchasing managers, is calculated based on a weighted average of the following five sub-indexes: new orders (30%), production (25%), employment (20%), deliveries (15%), and inventories (10%). Economic activity in the manufacturing sector expanded in May for the tenth consecutive month, driven by new orders and production. However, the ISM index fell in May with slower improvement in production and inventories. The employment index increased 1.3 percentage points since April, consistent with continued job gains in manufacturing. Sectors adding jobs included electrical equipment, fabricated metals, transportation and paper. Sixteen of the 18 manufacturing industries reported growth in May; only the petroleum and coal products industry reported contraction. The prices paid index ticked down to 77.5 in May from 78.0 in April, suggesting price pressures increased for an 11th straight month but at a slightly slower pace.

### MANUFACTURING AT A GLANCE - MAY 2010

Index	Series Index May	Series Index April	Percent Point Change	Direction	Rate of Change	Trend* (months)
Purchasing Managers' Index	59.7	60.4	-0.7	Growing	Slower	10
New Orders	65.7	65.7	0.0	Growing	Same	11
Production	66.6	66.9	-0.3	Growing	Slower	12
Employment	59.8	58.5	1.3	Growing	Faster	6
Supplier Deliveries	61.0	61.3	-0.3	Slowing	Slower	12
Inventories	45.6	49.4	-3.8	Contracting	Faster	2
Customer Inventories	32.0	33.0	-1.0	Too Low	Faster	14
Prices	77.5	78.0	-0.5	Increasing	Slower	11
Backlog of Orders	59.5	57.5	2.0	Growing	Faster	5
Exports	62.0	61.0	1.0	Growing	Faster	11
Imports	56.5	58.0	-1.5	Growing	Slower	9

Source: Institute for Supply Management

\*Number of months moving in current direction

- **Purchasing Managers' Index (PMI).** A reading above 50.0% indicates that the manufacturing economy is generally expanding; below 50.0% indicates that it is generally contracting. Manufacturing continued to grow in May. However, the PMI declined to 59.7%, a decrease of 0.7 percentage points since April 2010.
- **New Orders Index.** A New Orders Index above 48.8%, over time, is generally consistent with an increase in the Census Bureau's series on manufacturing orders. The New Orders Index increased for the 11th consecutive month in May. Fifteen industries reported growth in new orders in May.
- **Production Index.** An index above 50.4%, over time, is generally consistent with an increase in the Federal Reserve Board's industrial production figures. Fifteen industries reported growth in production in May.
- **Employment Index.** An Employment Index above 49.7%, over time, is generally consistent with an increase in manufacturing employment. Twelve of the eighteen manufacturing industries reported growth in May.
- **Supplier Deliveries Index.** A reading above 50% indicates slower deliveries, with twelve industries reporting slower supplier deliveries in May.
- **Inventories Index.** An Inventories Index greater than 42.6%, over time, is generally consistent with expansion in the Bureau of Economic Analysis' (BEA) figures on overall manufacturing inventories. Manufacturers' inventories expanded in May for the second consecutive month following 46 months of contraction.

## Construction Spending

After increasing for three consecutive months, construction spending in the United States declined in May due to weakness within the multifamily and home improvement sectors. The Commerce Department reported that construction spending decreased 0.2% in May to a seasonally adjusted annual rate of \$841.9 billion. The government also revised the April increase down to 2.3%, less than previously estimated. However, single-family construction increased 0.8% during May despite the expiration of the contract signing deadline for the homebuyers' tax credit. During the first five months of 2010, construction spending amounted to \$314.2 billion, 12.0% below the \$356.9 billion for the same period in 2009.

Weakness persisted in the private nonresidential sector as construction spending declined 0.1% in May and is now down 15.2% over the past year. On the positive, residential construction was at a seasonally adjusted annual rate of \$270.8 billion in May; this represented an 11.9% increase during the past 12 months.

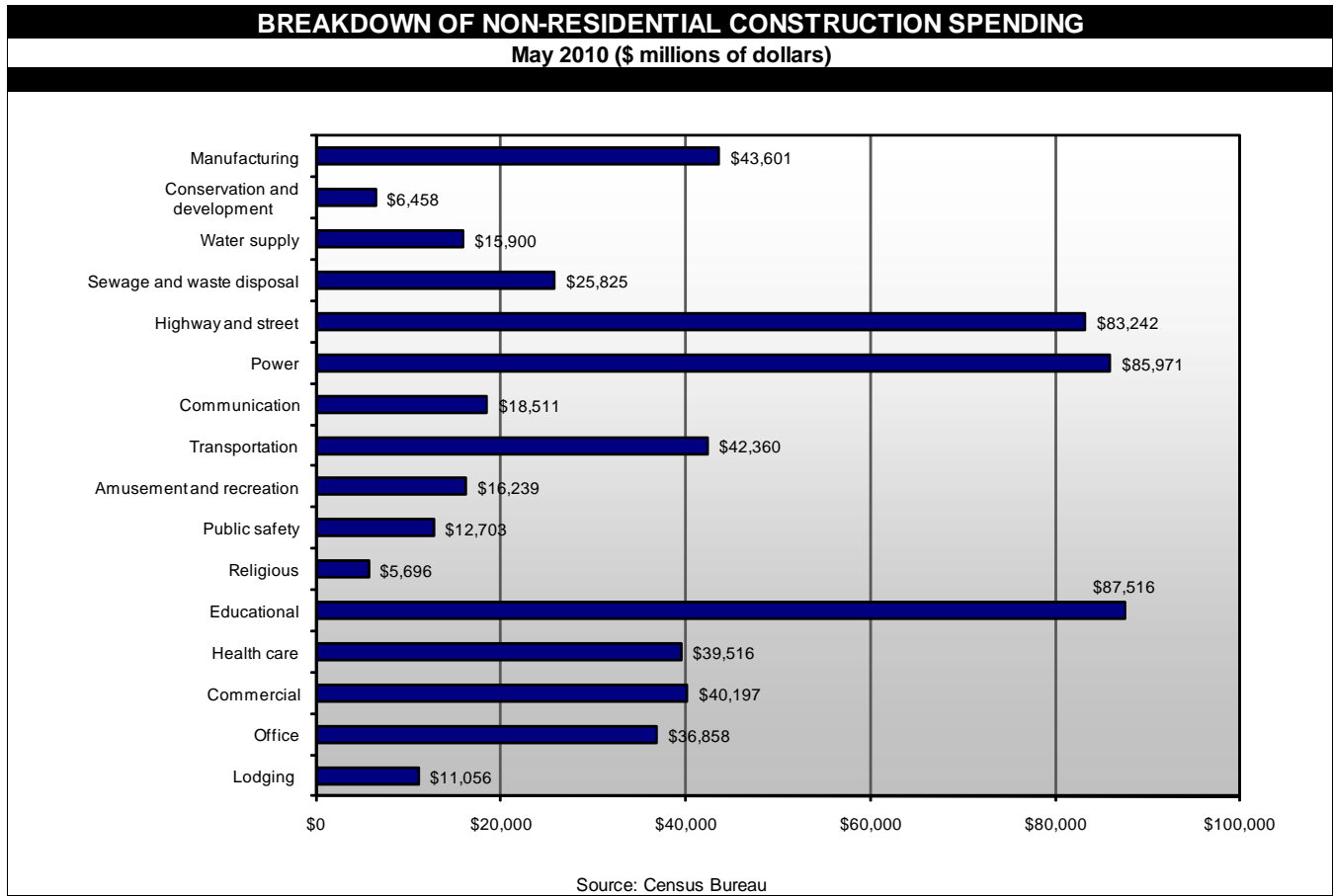
Of total construction spending, private construction accounted for 64% of total expenditures, while 36% were public. Non-residential spending comprised 68% of total expenditures compared to 32% for non-residential projects. Within the non-residential sector, the largest declines in spending were within the lodging (-62.1%), office (-33.8%), commercial (-31.8%) and manufacturing (-31.4%) sectors during the past 12 months. On the positive, gains in total construction spending occurred within the transportation, conservation and development, highway and street, water supply, and sewage and waste disposal sectors during the same time frame.

VALUE OF CONSTRUCTION PUT IN PLACE - SEASONALLY ADJUSTED ANNUAL RATE							
(millions of dollars)							
	Apr-10	Mar-10	Feb-10	Jan-10	Apr-09	Percent change	
						May 2010 from -	Apr-10
<b>Total Construction</b>	<b>\$841,888</b>	<b>\$843,308</b>	<b>\$824,023</b>	<b>\$815,797</b>	<b>\$915,372</b>	<b>-0.2%</b>	<b>-8.0%</b>
<b>Residential</b>	<b>\$270,239</b>	<b>\$271,306</b>	<b>\$258,293</b>	<b>\$257,485</b>	<b>\$241,574</b>	<b>-0.4%</b>	<b>11.9%</b>
<b>Nonresidential</b>	<b>\$571,650</b>	<b>\$572,003</b>	<b>\$565,730</b>	<b>\$558,312</b>	<b>\$673,798</b>	<b>-0.1%</b>	<b>-15.2%</b>
Lodging	\$11,056	\$11,504	\$12,234	\$13,274	\$29,134	-3.9%	-62.1%
Office	\$36,858	\$37,438	\$39,464	\$41,229	\$55,706	-1.5%	-33.8%
Commercial	\$40,197	\$40,302	\$41,771	\$43,185	\$58,974	-0.3%	-31.8%
Health care	\$39,516	\$39,449	\$40,747	\$38,499	\$46,263	0.2%	-14.6%
Educational	\$87,516	\$88,641	\$88,992	\$90,953	\$107,525	-1.3%	-18.6%
Religious	\$5,696	\$5,466	\$5,690	\$5,653	\$5,974	4.2%	-4.7%
Public safety	\$12,703	\$12,852	\$13,099	\$12,843	\$14,848	-1.2%	-14.4%
Amusement and recreation	\$16,239	\$16,655	\$16,055	\$15,661	\$19,733	-2.5%	-17.7%
Transportation	\$42,360	\$43,347	\$42,616	\$39,228	\$37,234	-2.3%	13.8%
Communication	\$18,511	\$18,216	\$16,602	\$18,879	\$19,874	1.6%	-6.9%
Power	\$85,971	\$85,957	\$78,528	\$77,264	\$91,150	0.0%	-5.7%
Highway and street	\$83,242	\$81,059	\$79,123	\$75,835	\$78,855	2.7%	5.6%
Sewage and waste disposal	\$25,825	\$25,239	\$24,647	\$23,259	\$24,573	2.3%	5.1%
Water supply	\$15,900	\$15,070	\$14,530	\$13,662	\$15,142	5.5%	5.0%
Conservation and development	\$6,458	\$6,419	\$6,102	\$5,669	\$5,251	0.6%	23.0%
Manufacturing	\$43,601	\$44,389	\$45,532	\$43,219	\$63,563	-1.8%	-31.4%

Source: Census Bureau

*Construction Spending (continued)*

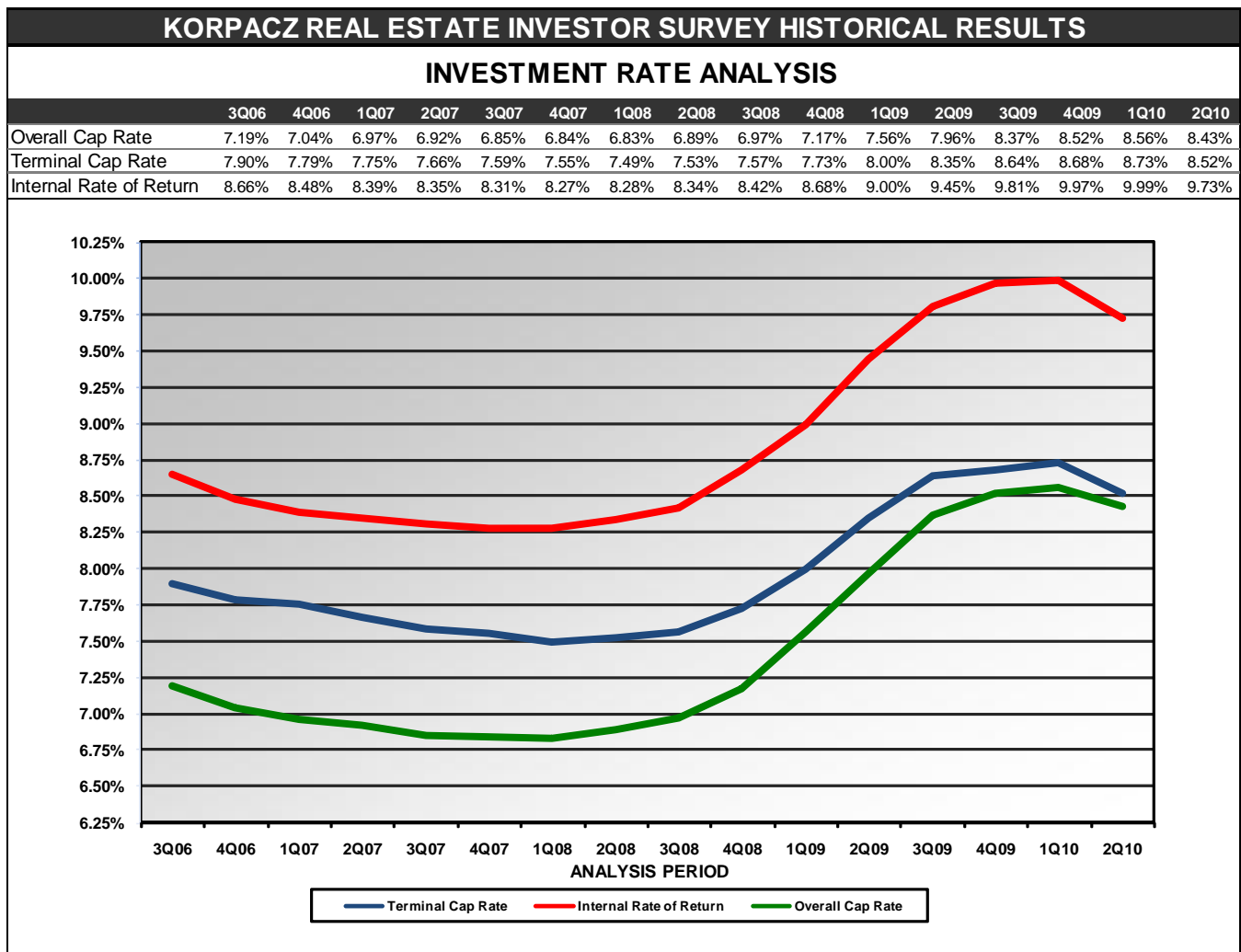
Below is a further breakdown of non-residential construction spending, which totaled a seasonally adjusted annual rate of \$571.9 billion during May 2010.



## Korpacz Real Estate Investor Survey

- More than 100 institutional and private investors surveyed for the Korpacz Real Estate Survey reported that overall cap rates (OARs) have declined in 17 of the survey's 30 tracked markets during the second quarter of 2010. Cap rate reduction continued to occur for better-positioned assets within prime locations and with stable rent rolls. Since 1Q10, the average decrease was 13 basis points across nearly all major property types. OARs are predicted to decline or hold steady over the next six months across almost all property categories and metro markets.
- After nine consecutive quarterly increases, terminal cap rates declined during 2Q10. The average decrease was 21 basis points (BPS) across nearly all major property types. This compares to a 73 BPS rise for terminal cap rates between 1Q09 and 1Q10.
- Discount rates (IRR) have decreased across nearly all surveyed markets and product types during 2Q10 after 10 consecutive quarterly increases. The average decline was 26 BPS across nearly all major property types since 1Q10. This compares to a 99 BPS rise for discount rates between 1Q09 and 1Q10.

Simple averages of the capitalization, terminal capitalization and discount rates are presented in the following table for the following property types: flex/R&D, warehouse, central business district (CBD) office, suburban office, apartment, strip center, regional malls and power centers.



*Korpacz Real Estate Investor Survey (continued)***2Q10 Survey Highlights**

- Commercial real estate investors reveal a sense of optimism and improved sentiment with regard to the industry as the U.S. economy shows some encouraging signs of improvement. The report notes that investors find it easier to envision a commercial real estate market recovery today than at any point during the past 2 years.
- Surveyed investors indicated the lack of buying opportunities on the market for institutional-grade offerings. This is partly the cause for the still sluggish sales activity during 2010. Investors are concerned with the unknown speed and strength of the recovery.
- OARs declined within nearly all major property types during 2Q10; the largest decreases were recorded within the regional mall (41 BPS), CBD-office (20 BPS) and suburban-office (19 BPS) sectors. Sectors where OAR's increased included power center (15 BPS) and flex/R&D (2 BPS). Since 2Q09, OARs across all property sectors increased an average of 47 BPS.
- As of 2Q10, flex/R&D properties had the highest average OARs at 9.38%, followed by suburban-office (8.60%) and warehouse (8.60%). The lowest average OARs were recorded within apartment (7.68%), regional mall (7.93%) and CBD-office (8.15%) sectors. The simple average OAR across all sectors was 8.56%.
- Terminal cap rates declined across all property types during 2Q10; the largest decline was recorded within the regional mall (23 BPS) sector. Since 2Q09, terminal cap rates across all property sectors increased an average of 17 BPS.
- As of 2Q10, flex/R&D properties had the highest terminal capitalization rate at 9.16%, followed by suburban-office (8.77%) and power center (8.65%). The lowest terminal capitalization rates were recorded within the apartment (7.84%) and CBD-office (8.20%) sectors. The simple average terminal capitalization rate across all sectors was 8.52%.
- IRRs declined across all major property types during 2Q10; the largest decreases were recorded within the regional mall (66 BPS) and CBD-office (30 BPS) sectors. Since 2Q09, IRRs across all property sectors increased an average of 28 BPS.
- As of 2Q10, flex/R&D properties had the highest IRR at 10.05%, followed by regional mall (10.04%) and power center (9.90%). The lowest IRRs were recorded within the CBD-office (9.28%) and warehouse (9.35%) sectors. The simple average IRR across all sectors was 9.73%.

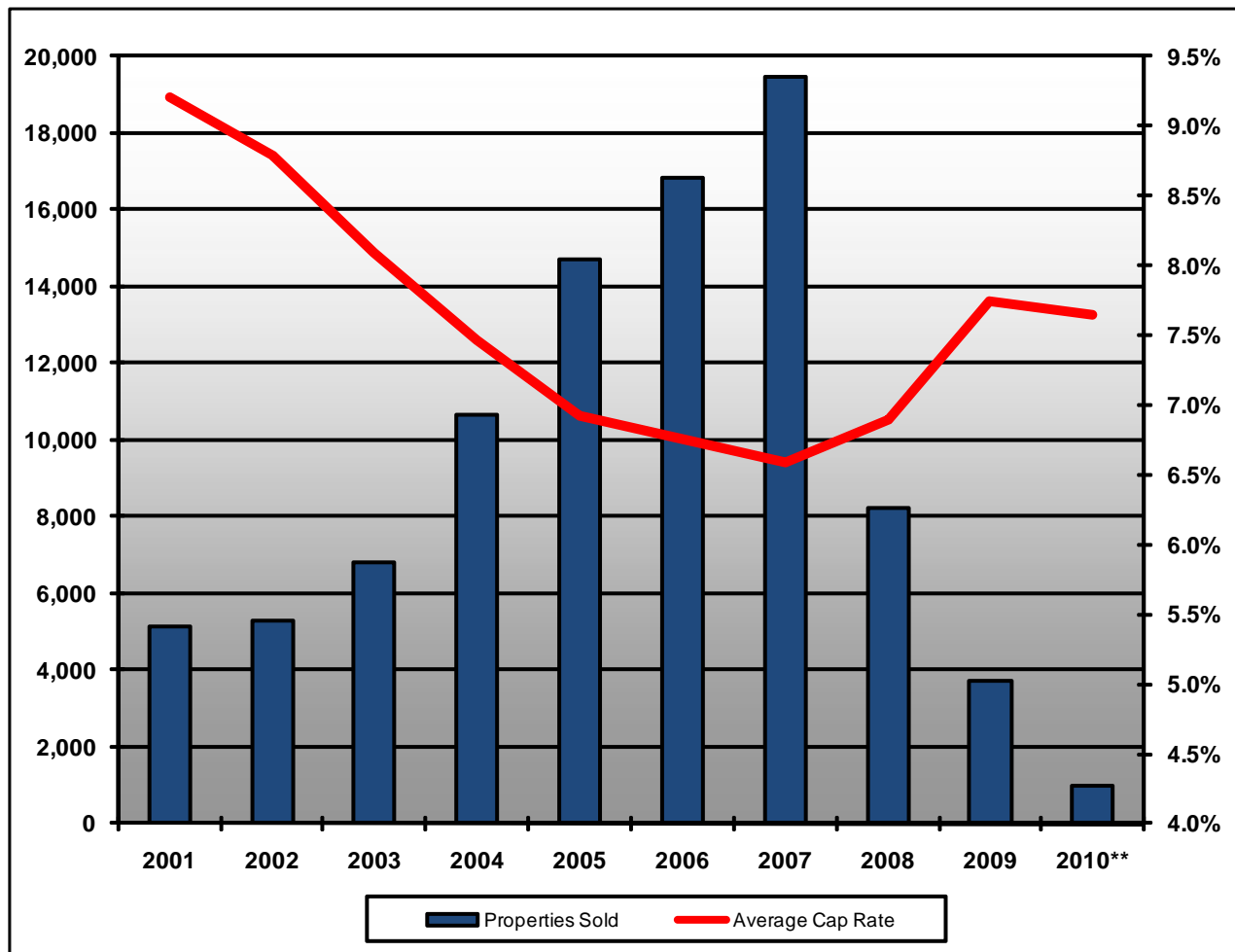
## Cap Rates vs. Sales

A weak economy and credit crunch continues to limit sales activity in 2010, characterized by few transactions and a sharp decline in buying by foreign and institutional investors. After a two year ascent where overall cap rates nearly reached 8.0% during 4Q09, OARs have moderated through the first four months of 2010. Real Capital Analytics (RCA) reported that nearly 1,000 properties sold through April 2010, lagging the 2009 quarterly average by approximately 20.0%. OAR's within the various sectors were as follows: 8.9% for warehouse; 8.5% for strip centers; 8.4% for flex; 8.3% for suburban office; 8.0% for regional malls; 7.3% for garden apartments; 7.1% for CBD office; and 5.3% for mid/high-rise apartments.

### REAL CAPITAL ANALYTICS HISTORICAL RESULTS

#### AVERAGE CAP RATES vs. PROPERTIES SOLD\*

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010**
Average Cap Rate	9.2%	8.8%	8.1%	7.5%	6.9%	6.8%	6.6%	6.9%	7.7%	7.7%
Properties Sold	5,142	5,277	6,831	10,651	14,725	16,852	19,465	8,246	3,743	996



\* Based on independent reports of properties and portfolios \$5 million and greater. Data believed to be accurate but not guaranteed.

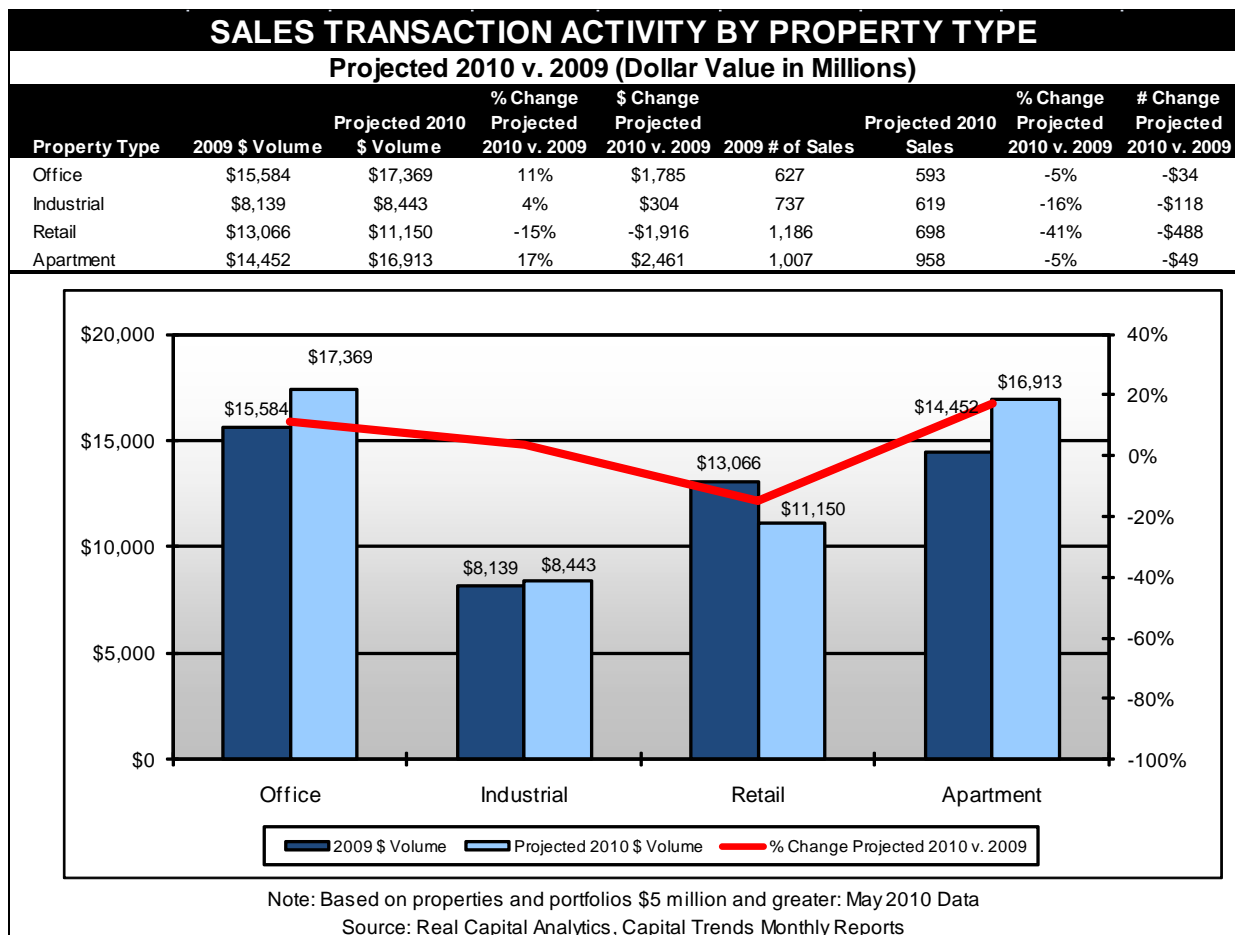
\*\* Data is through May, 2010

## Commercial Property Sales Analysis

Based on sales data recorded through May 2010 from Real Capital Analytics, commercial property sales activity is projected to total \$53.9 billion in 2010, a 5.0% increase from 2009 totals. However, this total is still considerably lower than historical averages. Although tight credit continues to limit commercial real estate sales in the United States, the capital markets appear to be slowly rebounding.

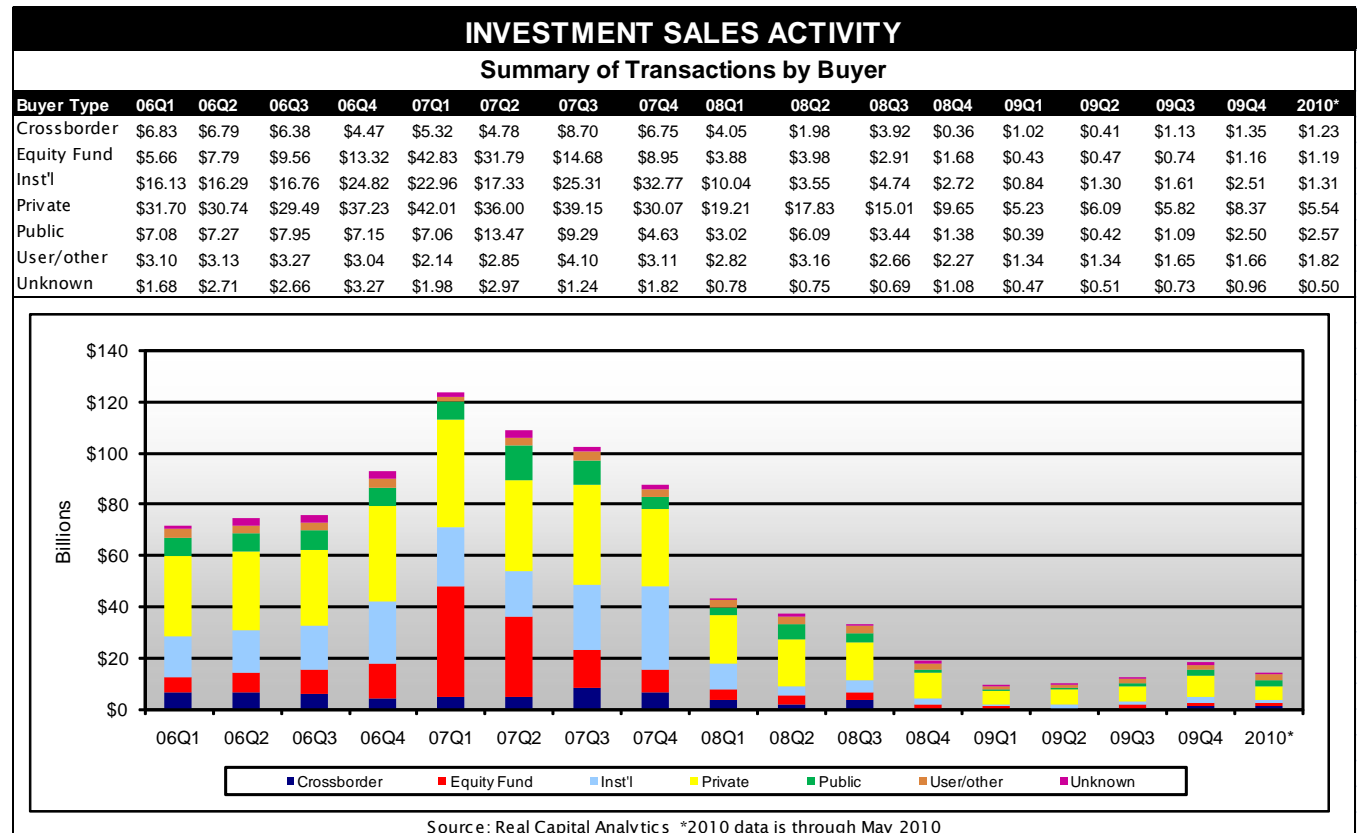
- Office:** Based on sales through May 2010, the office market is projected to record nearly \$17.4 billion in sales transactions during the year. This would represent 11.0% increase from 2009 levels, but is still off by more than 60.0% from 2008 totals. Suburban properties have traded more than CBD properties.
- Industrial:** The industrial market is projected to record \$8.4 billion in sales activity during 2010. This represents a projected gain of 4.0% from 2009 levels. Warehouse properties comprised 53.0% of total activity during the first five months of 2010.
- Retail:** Based on projected figures, the retail market is projected to record the only decline of the four property types during 2010. Projected sales, totaling \$11.2 billion, are forecasted to lag 2009 totals by 15%. Sales of strip centers have slightly lagged mall properties.
- Apartment:** Projected sales of apartment properties are expected to increase 17.0% to \$16.9 billion during 2010, the best for any property type. Sales of mid- and high-rise apartments are projected to double while a slight decline in garden apartments is expected during 2010.

Sales transaction activity by property type is summarized in the table below:



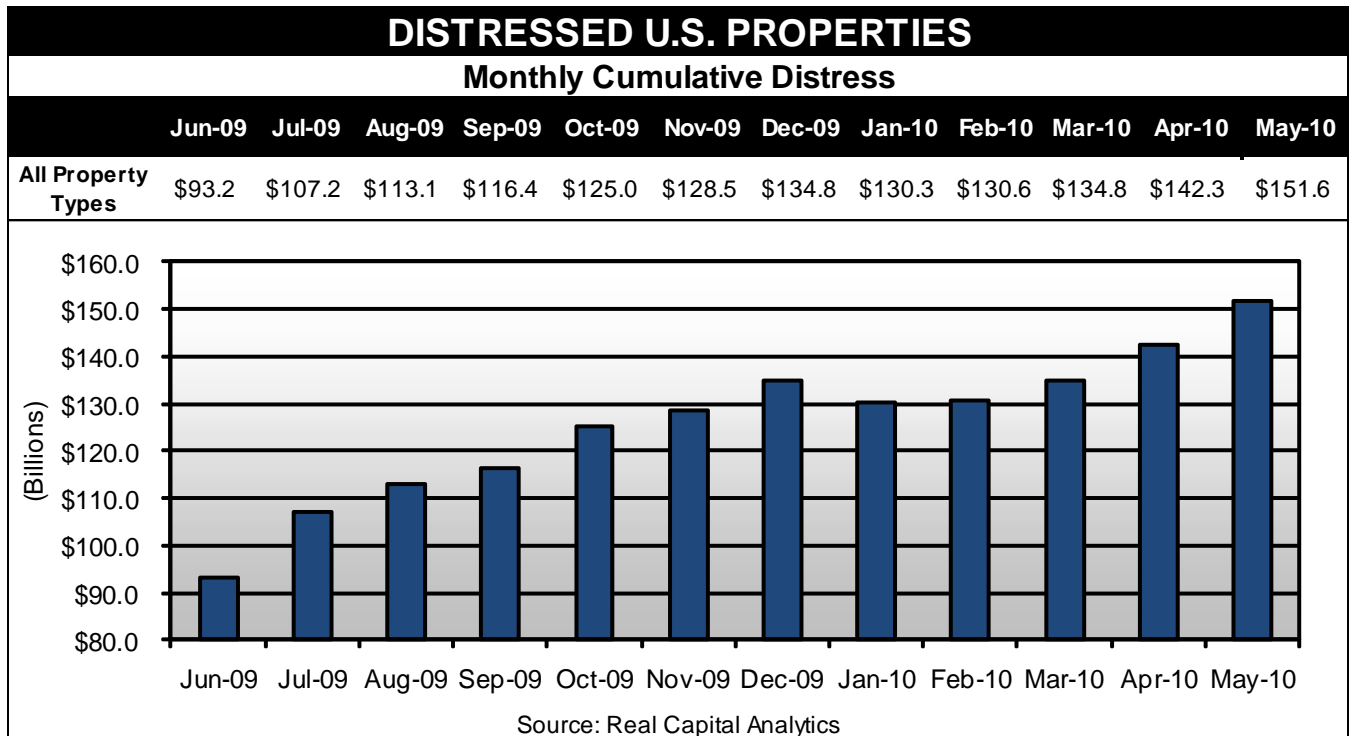
*Commercial Property Sales Analysis (continued)*

In addition to the preceding data, we have also analyzed historical sales activity by buyer type. Despite declining through the first five months of 2010, the private sector accounted for roughly 39.0% of total investment sales activity. The public sector accounted for roughly 18.0% of sales transactions, up from 13.0% recorded in 4Q09. After peaking during the first half of 2007, acquisitions by equity funds have considerably declined. Likewise, institutional players have greatly lessened their acquisition of investment assets. Combined these two buyer types accounted for nearly 18.0% of total assets acquired during the first five months of 2010. Looking ahead, it is forecasted that activity will slowly rebound as more investors enter the market and the flow of credit begins to open.



## Distressed Commercial Properties

As the economy worsened, Real Capital Analytics began to track distressed real estate assets in 2008. Real Capital Analytics' definition of distressed encompasses properties that are in default of their mortgages, including ones taken over by lenders, owned by a troubled or bankrupt entity or have a major tenant in bankruptcy; it also includes properties whose debt has been restructured and those taken over by the holders of junior debt. During the past 12 months, the total volume of distressed assets has increased by roughly 63%. As of May 2010, roughly \$152 billion of distressed real estate is on the market. After a relatively stable period between December 2009 and March 2010, nearly \$17 billion of distressed properties were added during April and May of 2010.



As the supply of distressed assets has risen during the past few years, a larger percentage of distressed assets have comprised total sales activity across the major asset classes. In 2007, only 0.20% of sales activity involved distressed assets. This total significantly increased to 3.42% in 2008, primarily resulting from more than \$4.5 billion of distressed assets changing ownership within the office and apartment sectors. One year later, nearly 11.0% of sales transactions involved troubled properties, led by a surge within the struggling hotel sector. This trend has continued into 2010, with significant distressed assets trading within the apartment sector.

<b>U.S. Distressed Sales as a Percentage of Total Sales</b>				
	2007 Distressed Sale %	2008 Distressed Sale %	2009 Distressed Sale %	2010* Distressed Sale %
<b>Main Type</b>				
Apartment	0.42%	3.18%	13.79%	22.27%
Hotel	0.22%	0.86%	20.19%	22.79%
Industrial	0.21%	1.27%	4.20%	7.19%
Office	0.12%	6.26%	13.28%	10.12%
Retail	0.11%	0.23%	6.14%	11.72%
<b>Totals</b>	<b>0.20%</b>	<b>3.42%</b>	<b>10.74%</b>	<b>14.83%</b>

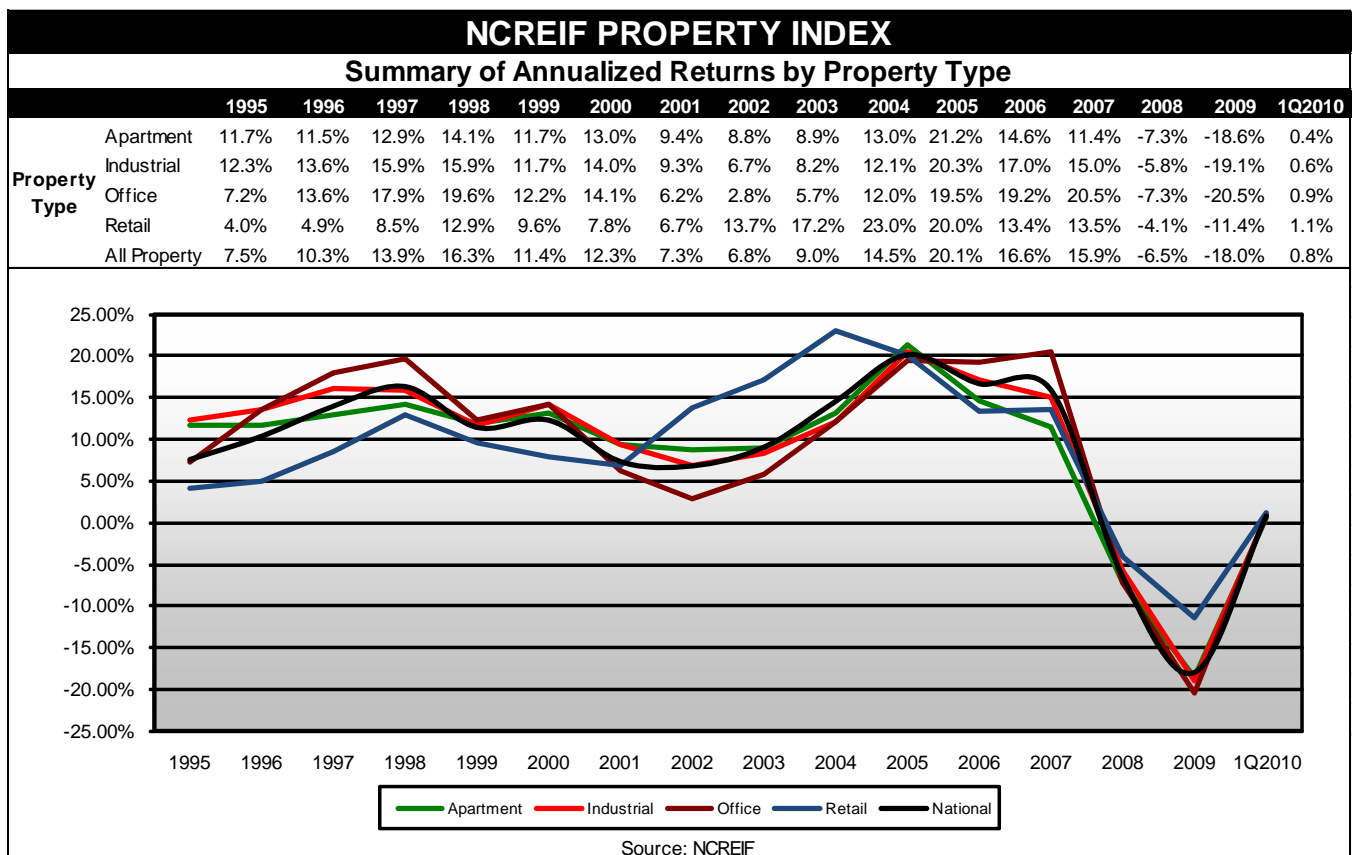
Source: Real Capital Analytics \*Data through May, 2010

## National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index

The NCREIF Property Index (NPI) is a quarterly time series composite total rate of return measure of investment performance of a large pool of individual commercial real estate properties acquired in the private market for investment purposes only. Properties in the NPI are accounted for using market value accounting standards, not historical cost. NCREIF requires that properties included in the NPI be valued at least quarterly, either internally or externally, using standard commercial real estate appraisal methodology. Each property must be independently appraised a minimum of once every three years. Because the NPI is a measure of private market real estate performance, the capital value component of return is predominately the product of property appraisals. As such, the NPI is often referred to as an “appraisal based” index. When entering the NPI, properties must be 60% occupied; investment returns are reported on a non-leveraged basis and properties must be owned/controlled by a qualified tax-exempt institutional investor or its designated agent. Properties exit the NPI when assets are sold or otherwise leave the database. All historical data remains in the database and in the Index. The Index represents investment returns from a single class of investor.

### NCREIF Property Index Annualized Returns by Property Type

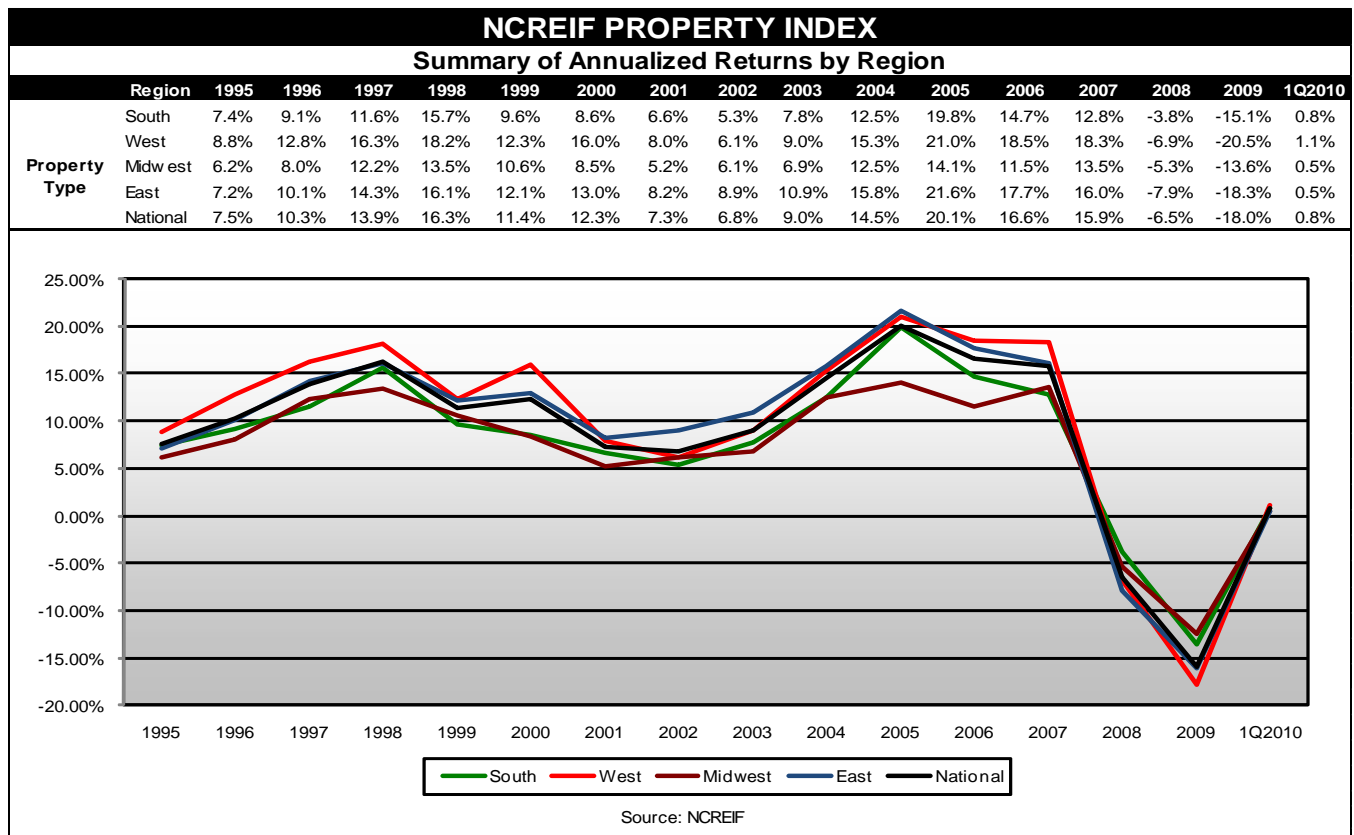
After declining 18.0% during 2009, the NPI rebounded during the first quarter of 2010 to post a 0.8% gain. The retail sector led in gains at 1.1%, followed by the office sector (0.9%). As the nation’s real estate market enjoyed prosperity from 1996 to 2000, fueled by the technology boom and healthy stock market, the NPI enjoyed five consecutive years of double digit growth. A cool-down during the next three recessionary years brought the NPI moving average down from 12.8% to 7.7%. Beginning in 2004, a record run in real estate growth allowed the index to achieve a four-year moving average of 16.8% annualized gains through 2007 and breaking the 20.0% threshold in 2005. Prior to the last two years of decline, the four property types averaged annualized returns of 13.1% between 1997 and 2007.



*NCREIF Property Index (continued)*

**NPI Annualized Returns by United States Region**

After posting positive returns for 15 consecutive years beginning in 1993, the NPI Index turned negative in 2008 due to the economic downturn, which has continued throughout 2009. However, the NPI Index turned positive during the first quarter of 2010 when annualized returns across all property sectors increased by the largest amount in the West (1.1%) and the South (0.8%). Between 1999 and 2009, average annualized returns registered 8.1% across all regions with the greatest rate of return occurring in the East (8.9%) and West (8.08%). Returns in the South (7.2%) and Midwest (6.4%) lagged behind the national average. The greatest periods of growth occurred between 1996–2000 and 2004–2007 when economic expansion resulted in robust years for the real estate industry.



## U.S. REIT IPOs on the Rise

Industry data show that U.S. REIT IPOs are on the rise as nine REIT IPOs were executed in 2009 and six more so far in 2010. Combined, these offerings raised more than \$4.1 billion. The offering type that has generated the most recent attention has been from “blind-pool” REITS, which have no current assets but seek to raise capital in order to take advantage of distressed asset values. The six REIT IPOs completed in 2010 as are follows:

- Chesapeake Lodging Trust is a self-advised hotel company organized to take advantage of current and future lodging-related investment opportunities.
- Piedmont Office Realty Trust is a fully integrated, self-administered and self-managed REIT specializing in the acquisition, ownership, management, development and disposition of primarily high-end buildings located in major United States office markets.
- Terreno Realty Corporation focuses on acquiring industrial real estate located in the Los Angeles, Northern New Jersey, New York City, San Francisco Bay, Seattle, Miami and Washington D.C./Baltimore regions.
- Chatham Lodging Trust is a self-advised hotel investment company seeking to invest in premium-branded upscale extended-stay, upscale select-service, and full-service hotels.
- Excel Trust, Inc. is a retail focused real estate investment trust that targets value oriented community and power centers, grocery anchored neighborhood centers and freestanding retail properties.
- Hudson Pacific Properties is a full-service, vertically integrated real estate company focused on owning, operating and acquiring high-quality office properties and state-of-the-art media and entertainment properties in select growth markets primarily in Northern and Southern California.

Despite the influx of new IPOs, several new issuances have been reduced in size, have had their price range cut or have been postponed or canceled. Welsh Property Trust Inc., an owner of industrial and office properties, was forced to abandon plans for a \$350 million IPO in early June. In May, warehouse operator Americold Realty Trust postponed the largest U.S. initial public offering of 2010, which had been valued at \$660 million. During the same week, Madison Square Capital Inc., a New York-based firm that invests in adjustable-rate mortgage securities guaranteed by U.S. government agencies using borrowed money, also postponed its \$150 million offering.

2009 - 2010 REIT IPOs								
Company Name	Ticker Symbol	Property Sector	Chairman	IPO Date	Shares (millions)	Offering Price	Total Raised (millions)*	
Cypress Sharpbridge Investments, Inc.	CYS	Mortgage	Kevin E. Grant	6/1/2009	9.10	\$11.00	\$115.12	
Government Properties Income Trust	GOV	Office	Barry M. Portnoy	6/1/2009	10.00	\$20.00	\$230.00	
Invesco Mortgage Capital	IVR	Mortgage	Neil Williams	6/26/2009	8.50	\$20.00	\$365.50	
PennyMac Mortgage Investment Trust	PMT	Mortgage	Stanford L. Kurland	7/29/2009	14.71	\$20.00	\$338.25	
Starwood Property Trust, Inc.	STWD	Mortgage	Barry S. Sternlicht	8/11/2009	40.50	\$20.00	\$415.63	
CreXus Investment Corp.	CXS	Mortgage	Patrick Corcora	9/16/2009	13.33	\$15.00	\$230.00	
Colony Financial	CLNY	Mortgage	Thomas J. Barrack	9/23/2009	12.50	\$20.00	\$287.50	
Apollo Commercial Real Estate Finance	ARI	Mortgage	Henry R. Silverman	9/23/2009	10.00	\$20.00	\$230.00	
Pebblebrook Hotel Trust	PEB	Lodging	Jon E. Bortz	12/8/2009	17.50	\$20.00	\$402.50	
Chesapeake Lodging Trust	CHSP	Lodging	James Francis	1/21/2010	7.50	\$20.00	\$172.50	
Piedmont Office Realty Trust	PDM	Office	Wayne Woody	2/10/2010	12.00	\$14.50	\$200.10	
Terreno Realty Corp.	TRNO	Industrial	Blake Baird	2/10/2010	8.75	\$20.00	\$201.25	
Chatham Lodging Trust	CLDT	Lodging	Jeffrey Fisher	4/15/2010	8.63	\$20.00	\$172.50	
Excel Trust, Inc.	EXL	Retail	Gary Sabin	4/22/2010	15.00	\$14.00	\$210.00	
Hudson Pacific Properties	HPP	Office	Victor Coleman	6/24/2010	12.80	\$17.00	\$237.60	

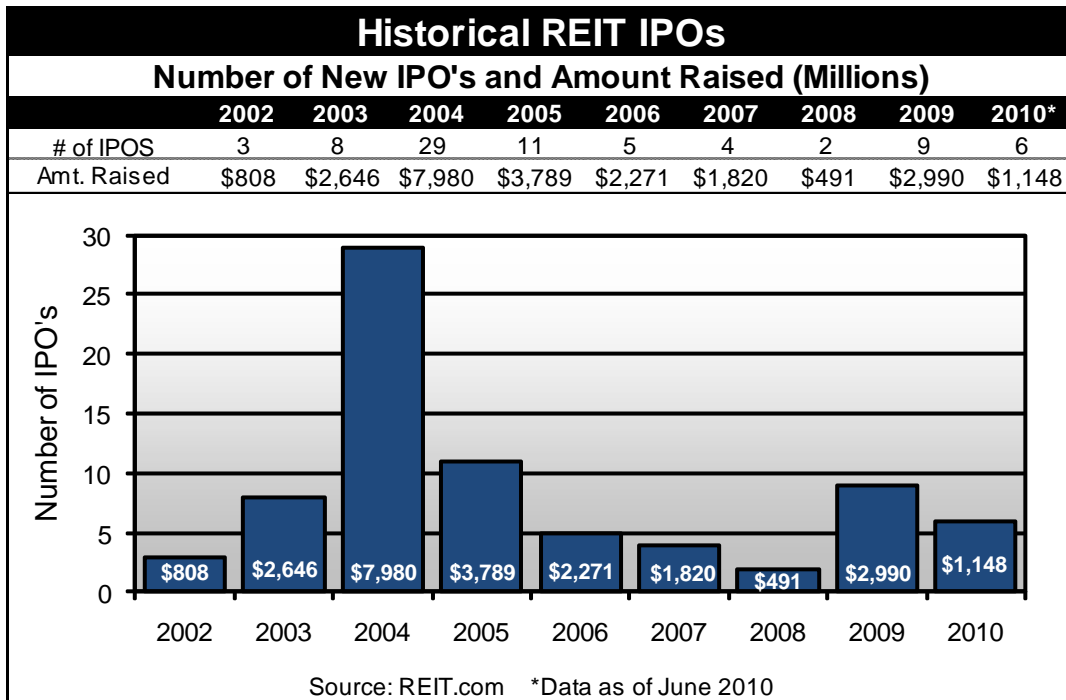
Source: REIT.com \*includes greenshoes

*U.S. REIT IPOs on the Rise (continued)*

According to Deloitte, the lingering capital market challenges for private owners and the strong performance of listed REITs are helping to fuel the IPO pipeline.

Thomson Reuters reports that upwards of 12 property real estate investment trust IPOs are in the pipeline as more U.S. commercial property companies seek to go public to refinance billions of dollars of mortgage debt. The largest commercial real estate IPOs in the pipeline are aiming to raise upwards of \$575 million.

The following table depicts the number of new REIT IPOs and total dollar value raised since 2002:



## FTSE National Association of REITS (NAREIT) U.S. Real Estate Index

Comprised of 111 REITS, The Financial Times of London and the London Stock Exchange (FTSE) NAREIT U.S. Real Estate index continued its positive growth through the second quarter of 2010. A 4.1% growth rate was achieved during the past three months. The largest advances among REITS during the quarter were recorded within the apartment (15.9%) and regional mall (7.6%) sectors. During the past one-year period, the Equity REIT Index posted a 55.9% increase as investors seeking high yields were active buyers of real-estate stocks. Historically, health care, self storage and free-standing retail REITS have experienced the largest compound annual returns.

Investment Performance by Property Sector and Subsector								
Property Sector/Subsector	Number of REITS	Total Return (%)			Compound Annual Total Returns			
		M-T-D	Q-T-D	Y-T-D	1-Year	3-Year	5-Year	10-Year
<b>Equity REIT Index</b>	111	3.1%	4.1%	14.5%	55.9%	-10.3%	2.2%	10.7%
<b>Industrial/Office</b>	29	2.6%	-0.7%	6.3%	54.6%	-17.9%	-2.3%	6.7%
Industrial	8	2.2%	-6.3%	-3.1%	40.3%	-30.6%	-11.8%	3.1%
Office	15	2.8%	1.9%	10.9%	66.0%	-12.0%	2.2%	8.5%
Mixed	6	2.7%	-2.7%	3.1%	34.8%	-15.4%	-2.6%	6.2%
<b>Retail</b>	26	3.4%	3.8%	15.9%	56.8%	-16.5%	-2.8%	12.1%
Shopping Centers	16	3.2%	-0.7%	13.2%	35.2%	-19.5%	-4.5%	10.0%
Regional Malls	6	3.9%	7.6%	17.7%	78.9%	-17.6%	-3.6%	13.3%
Free Standing	4	1.7%	2.1%	16.6%	47.3%	6.2%	9.2%	16.6%
<b>Residential</b>	16	3.0%	15.1%	26.4%	75.3%	-3.9%	7.6%	11.6%
Apartments	14	5.0%	15.9%	27.1%	76.5%	-4.1%	7.8%	11.8%
Manufactured Homes	2	2.6%	0.4%	12.4%	53.4%	1.1%	3.7%	7.3%
<b>Diversified</b>	7	2.2%	3.6%	14.1%	62.9%	-10.4%	1.5%	10.8%
<b>Lodging/Resorts</b>	11	4.8%	2.2%	24.8%	63.3%	-16.9%	-2.2%	5.3%
<b>Health Care</b>	12	2.4%	0.9%	7.8%	45.5%	6.4%	11.4%	20.1%
<b>Self Storage</b>	4	0.8%	3.8%	15.9%	50.6%	1.9%	10.3%	17.8%
<b>Specialty</b>	6	6.7%	5.3%	14.6%	31.9%	3.5%	10.2%	6.0%

Source: FTSE® Group and National Association of Real Estate Investments Trusts®. Data as of June, 2010

Below is a listing of the largest REITS by market cap within the FTSE NAREIT U.S. Real Estate Index.

REIT	Symbol	Property Subsector	Market Cap*
Simon Property Group, Inc.	SPG	Retail	24.7
Public Storage	PSA	Self Storage	15.6
Vornado Realty Trust	VNO	Diversified	14.1
Equity Residential	EQR	Residential	12.4
Boston Properties Inc.	BXP	Office	10.6
Host Hotels & Resorts Inc.	HST	Lodging/Resorts	9.8
HCP Inc.	HCP	Health Care	9.4
AvalonBay Communities Inc.	AVB	Residential	8.3
Ventas Inc.	VTR	Health Care	7.5
Kimco Realty Corporation	KIM	Retail	5.9

\*Values as of June 23, 2010 in billions of dollars

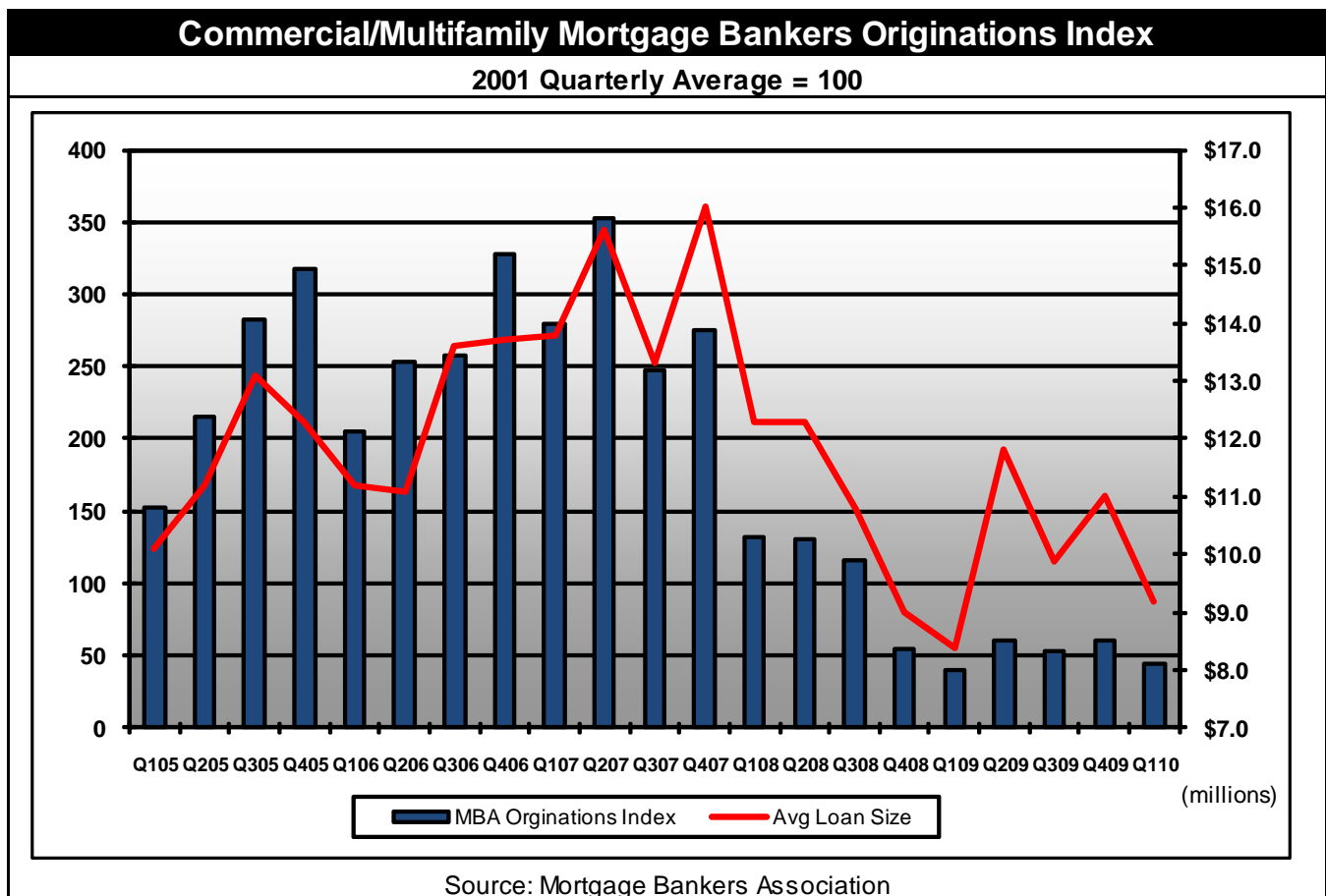
## Commercial Lending Increases

According to the Mortgage Bankers Association’s (MBA) Quarterly Survey of Commercial/Multifamily Mortgage Bankers Originations, first quarter 2010 commercial and multifamily mortgage loan originations were 12.0% higher than during the same period last year and 26.0% lower than during the fourth quarter of 2009. Since 1Q09, lending increased within the retail and office sectors while lending slowed within the multifamily, industrial, hotel and health care sectors. The overall increase in commercial/multifamily lending activity during the first quarter versus 1Q 2009 was driven by increases in originations for office and retail properties. Jamie Woodwell, MBA’s Vice President of Commercial Real Estate Research, indicated that based on surveys from the Federal Reserve Board and discussions with lenders, there appears to be increasing capital available for commercial mortgages, but only limited demand for new mortgages from commercial and multifamily property investors.

Property Type	Lending Activity since 1Q09
<b>Overall</b>	<b>12.0%</b>
Retail	98.0%
Office	29.0%
Multifamily	-5.0%
Industrial	-28.0%
Hotel	-46.0%
Health Care	-68.0%

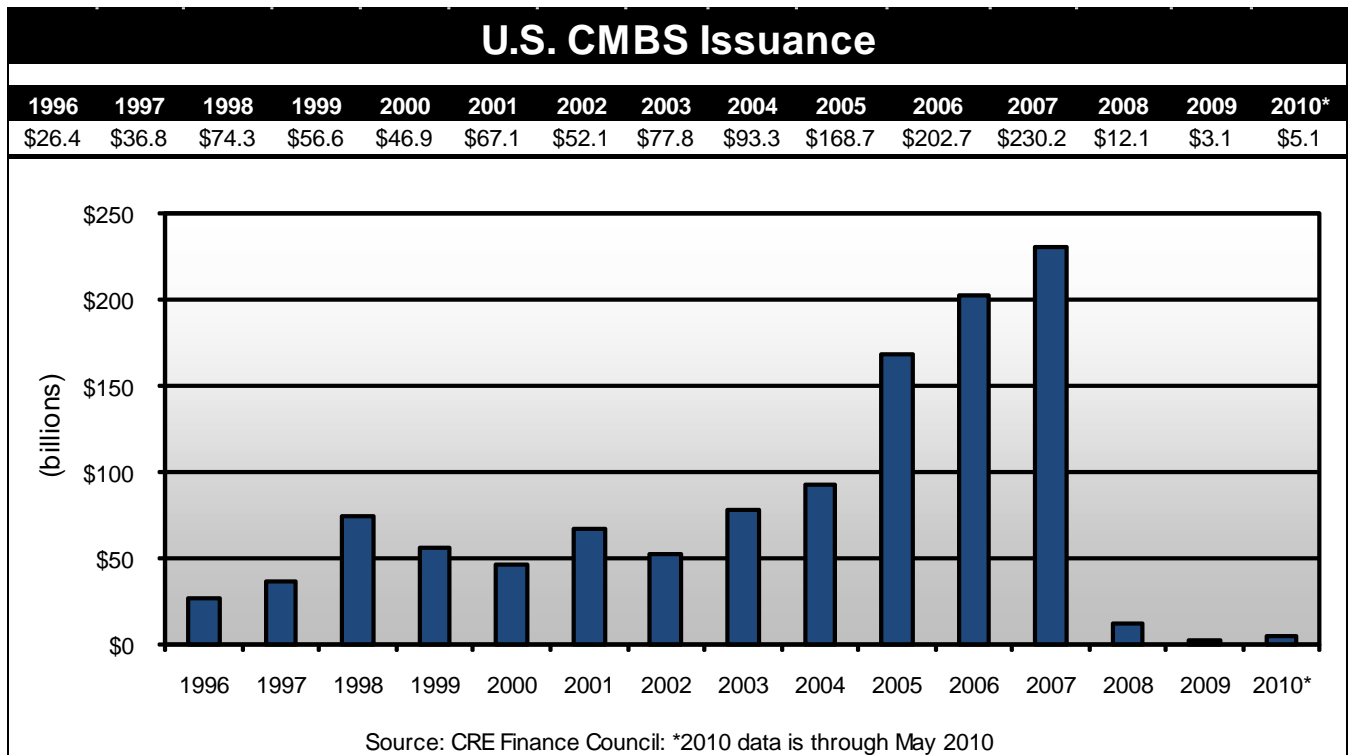
Source: MBA

Below is a graph depicting the frequency of commercial/multifamily loan originations since 2005:



## Commercial Mortgage Backed Securities (CMBS) Market

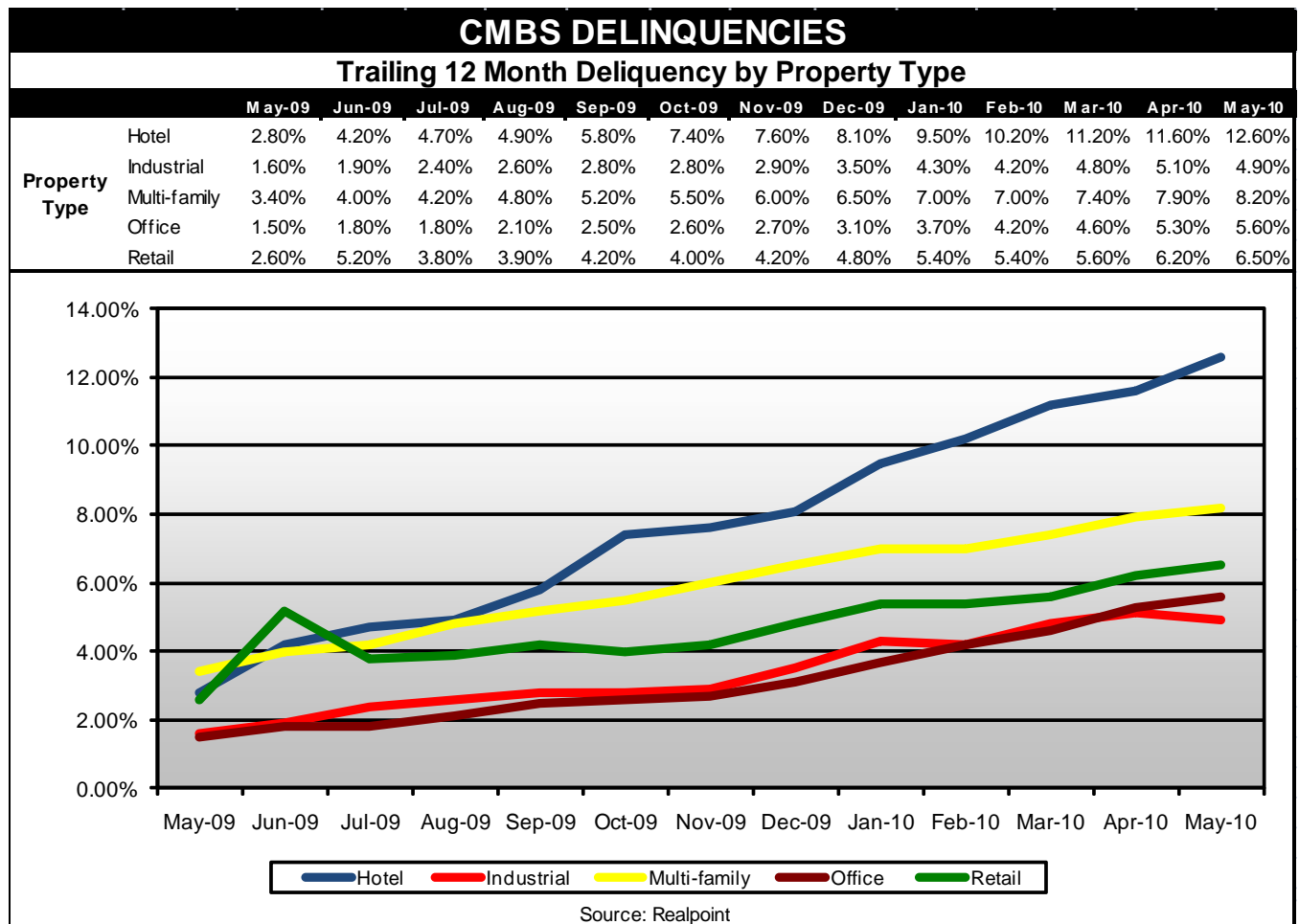
After a six-year period commencing in 2002 where CMBS issuances increased from \$52.1 billion to a peak of \$230.2 billion in 2007, issuances have fallen dramatically. However, the CMBS market appears to be improving with issuances steadily increasing. According to Commercial Mortgage Alert, the United States market recorded \$5.1 billion in CMBS issuances through May 2010 compared to \$3.1 billion of new issuances for 2009. It was reported that several financial institutions are actively working on more CMBS loans. The few deals that have taken place in the CMBS market since last fall have featured a single borrower. Based on activity throughout the first five months of the year, roughly \$12.1 billion of CMBS issuances are forecasted for 2010. This total would be on par with levels posted during 2008.



Difficult economic conditions and limited financing continue to hamper commercial loan performance through May 2010 as delinquencies have trended upward for all property types. Due to aggressive pro-forma underwriting, larger loan vintages between 2005 and 2008 continue to default. According to Realpoint, retail loans topped multi-family loans as the greatest contributor to overall CMBS delinquency for the sixth straight month. As of May, the retail default rate stands at 6.5%. The total delinquency rate for CMBS hotel loans grew to 12.6% in May 2010, up from 11.6% within the prior month. The hotel sector is forecasted to experience a continued increase in delinquency rates as both business and leisure travel still remain slower than historical averages, resulting in greater decreases in occupancy, revenue per available room (REVPAR) and average daily rate (ADR). In May, delinquency rates increased 30 basis points within the multifamily and office sectors. On the positive, delinquency rates fell within the industrial sector during May.

CMBS Market (continued)

Below is a chart depicting the monthly CMBS delinquencies balance during the past year:

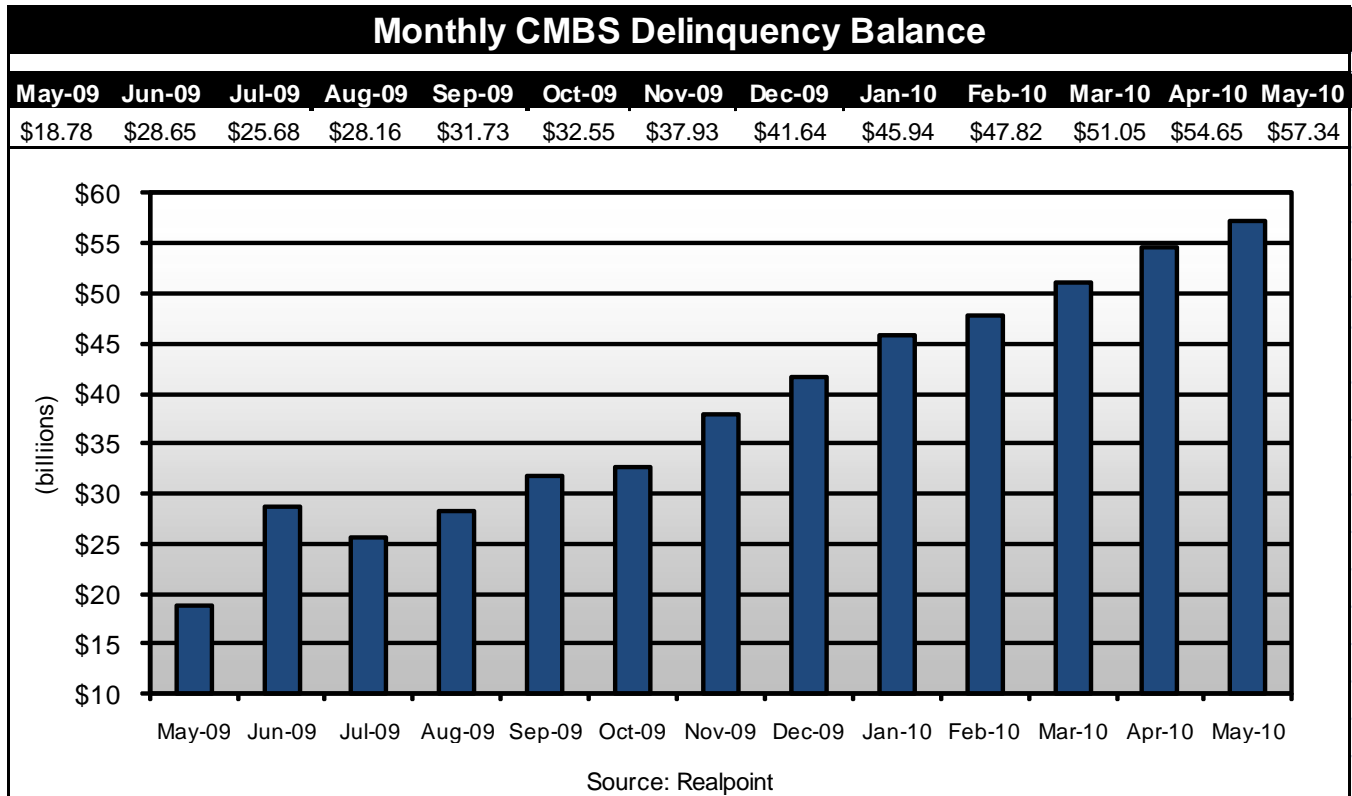


According to Realpoint, the delinquent unpaid balance for CMBS continues to steadily increase after a slight dip in July 2009. After reaching \$57.3 billion in May 2010, the delinquent unpaid balance is up 205.0% from May 2009. The distressed 90+/-day Foreclosure and Real Estate Owned categories grew in aggregate for the 29th straight month. Overall, the total unpaid balance for CMBS pools available for review for the May 2010 remittance was \$788.7 billion. Due to the continued stream of new delinquencies, the \$4.1 billion delinquency of the Extended Stay Hotel loan and a portion of the \$3.0 billion Peter Cooper Village/Stuyvesant Town loan, Realpoint forecasts the delinquent unpaid CMBS balance to continue along its current trend and potentially grow between \$80 and \$90 billion by year-end 2010. Towards the end of May, it was reported that Paulson & Co., Centerbridge Partners LP and Blackstone Group LP won the bankruptcy auction bid for the Extended Stay Hotel chain at \$3.9 billion.

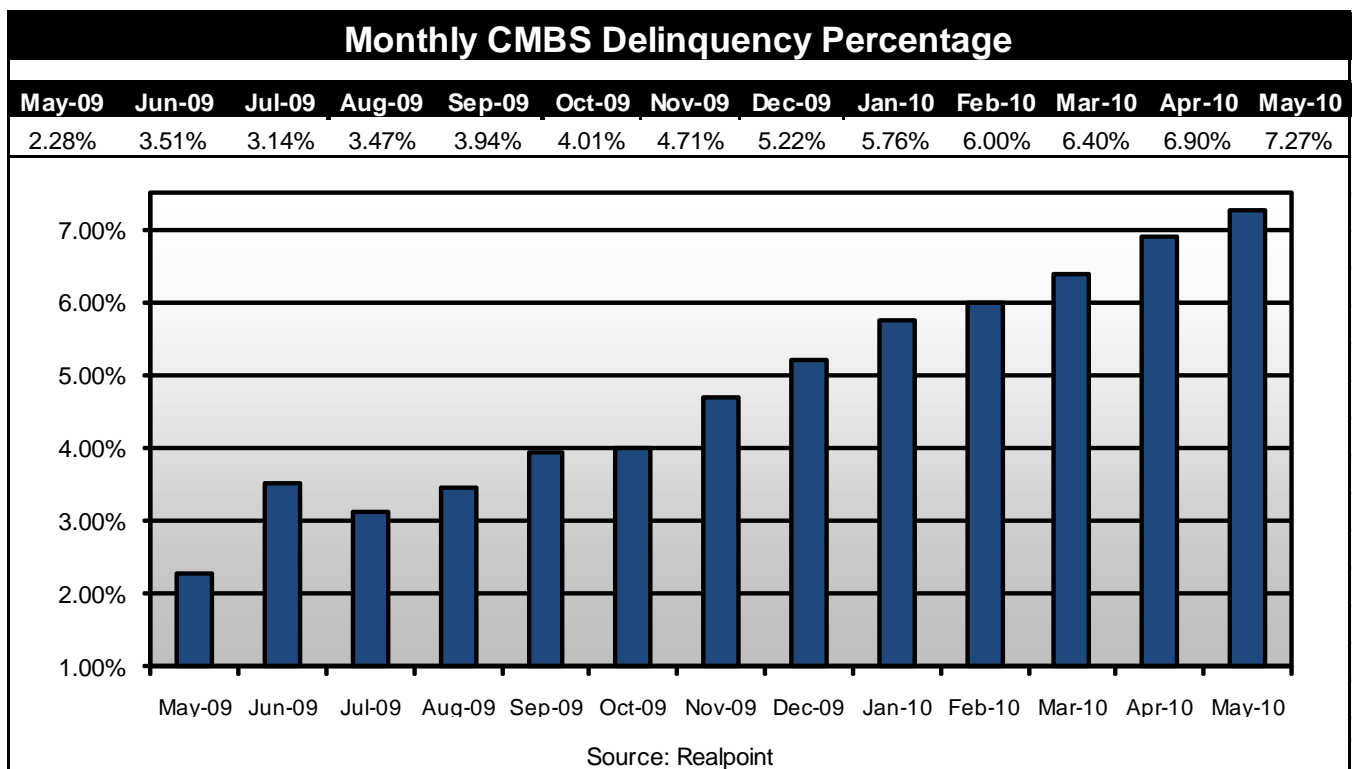
The monthly CMBS delinquency ratio for May 2010 (6.0%) was 37 basis points higher than the April 2010 total. During the past year, the delinquency percentage has jumped roughly 220.0%. Based on an updated trend analysis, Realpoint projects the delinquency percentage to potentially grow between 11% and 12% through year-end 2010. The negative outlook results from several large loans from recent vintage transactions continuing to show signs of stress along with continued balloon maturity defaults from older transactions. Realpoint also indicates that decreasing commercial real estate values and diminished equity in collateral properties may force more struggling borrowers with marginal collateral performance to walk away from properties during the year.

CMBS Market (continued)

Below is a chart depicting the monthly CMBS delinquency balance during the past year:



Below is a chart illustrating the monthly CMBS delinquency percentage during the past year:



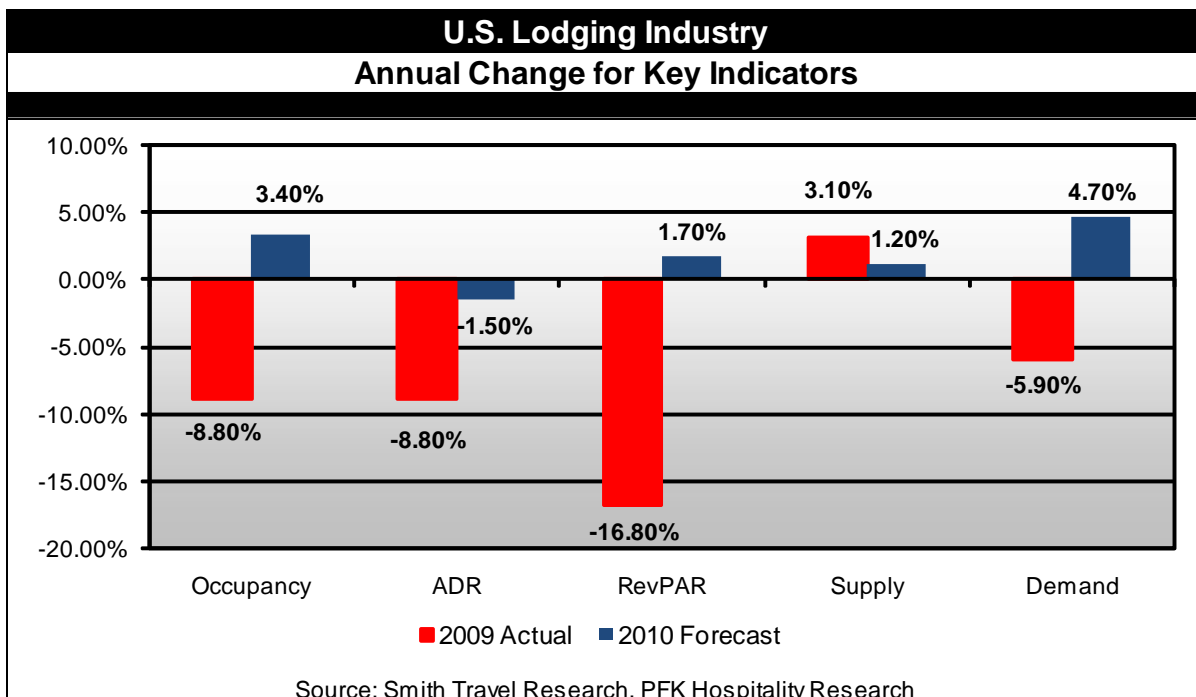
## Hotel Properties on the Rebound

Hotel sales are beginning to rebound after a two-year drought. During the first five months of 2010, Real Capital Analytics reported that 116 hotels changed ownership totaling \$2.7 billion, up from 68 deals totaling \$1.1 billion during the same period last year. Roughly 25.0% of the hotel deals so far this year involved properties with distressed debt. However, transaction volume and values are still far off their highs. Green Street Advisors Inc. estimates hotel values are 35.0% below the highs set in 2007.

According to Smith Travel Research, lodging demand in the first quarter of 2010 increased 5.3% over the first quarter of 2009; this represented the largest quarterly increase in hotel demand since the second quarter of 1989. In May, the U.S. Hotel Industry Leading Indicator or HIL, increased for the fourth consecutive month. It was reported that eight of the nine components that comprise the HIL had a positive contribution during May. These components included: weekly hours in hotels; hotel profitability; international visitors future demand; interest rate spread; new orders for manufactured goods; oil prices; housing activity and national vacation barometer.

Competition for deals has been elevated by a series of factors, including increasing numbers of private funds created to acquire distressed properties, real-estate investment trusts stocked with cash from share sales, and companies recently going public, like Pebblebrook and Chesapeake Lodging Trust. After a flurry of hotel construction in 2008 and 2009, limited construction has enabled existing properties to absorb more occupancy.

PKF Hospitality Research's latest edition of *Hotel Horizons*® forecasts a 1.7% growth in revenue per available room (RevPAR) for 2010. Hoteliers in 49 of the 50 markets (Houston was the exception) covered within the report indicated more rooms were sold in the first quarter of 2010 than a year earlier. However, pricing remained weak as ADR (Average Daily Rate) levels in 49 of the 50 markets experienced a year-over-year drop during the first quarter of 2010. Among the hotel property types, demand growth in 2010 will be strongest for luxury properties, followed closely by upscale hotels. As a result, luxury hotels RevPAR forecast is predicted to be the strongest. In 2011, hotel NOI growth is expected to accelerate dramatically and RevPAR is forecasted to grow 7.8%. The firm forecasts the composition of hotel revenue growth in 2011 should yield strong gains in hotel profits as evidenced by a 4.6% forecasted rise in ADR, combined with a 3.1% anticipated gain in occupied rooms.



## Property Forecast

Market conditions are expected to moderate and improve in 2011, characterized by stabilizing vacancy rates, positive absorption and stronger rent growth. Lawrence Yun, National Association of Realtors (NAR) chief economist, believes the multifamily sector is currently the one bright spot in commercial real estate. Meanwhile, the office, warehouse and retail sectors are still expected to experience the delayed effects of the recession. These sectors should see gradual improvement as job growth escalates and creates additional demand for space, meaning a broader improvement in commercial real estate is not likely until 2011.

NAR/CBRE-Econometric Advisors forecasts the following:

- **Office:** Vacancy rates in the office sector are projected to increase from 16.9% in the first quarter of 2010 to 17.6% in the first quarter of 2011.
- **Industrial:** By the first quarter of 2011, industrial vacancy rates are projected to increase 50 basis points to 14.8%.
- **Retail:** Retail vacancy rates are forecasted to rise 20 basis points to 12.8% during the next 12 months.
- **Multi-Family:** The multi-family sector is forecasted to outperform the three other sectors as vacancy rates are expected to decline 100 basis points to 6.3%.

	Actuals			Forecast			
	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
<b>OFFICE</b>							
Vacancy Rate	16.10%	16.30%	16.90%	17.30%	17.50%	17.60%	17.60%
Net Absorption ('000 sf)	-5,243	-216	-11,099	-8,127	-3,491	-1,915	800
Completions ('000 sf)	16,393	10,854	9,688	6,925	3,224	2,389	3,589
Rent Growth	-0.90%	-1.20%	-0.60%	-0.60%	-0.50%	-0.60%	-0.50%

	Actuals			Forecast			
	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
<b>INDUSTRIAL</b>							
Vacancy Rate	13.50%	13.90%	14.30%	14.60%	14.70%	14.80%	14.80%
Net Absorption ('000 sf)	-53,647	-38,103	-44,729	-30,314	-14,837	-127	15,249
Completions ('000 sf)	14,841	14,761	12,300	5,854	8,244	10,955	10,457
Rent Growth	-1.80%	-2.20%	-1.10%	-1.90%	-1.70%	-1.60%	-1.50%

	Actuals			Forecast			
	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
<b>RETAIL</b>							
Vacancy Rate	12.20%	12.40%	12.60%	12.70%	12.70%	12.70%	12.80%
Net Absorption ('000 sf)	-1,253	-667	-1,017	-413	179	1,166	1,886
Completions ('000 sf)	3,503	2,778	1,267	866	203	179	2,042
Rent Growth	0.00%	-1.20%	-0.70%	-0.40%	-0.30%	-0.10%	-0.10%

	Actuals			Forecast			
	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
<b>MULTI-FAMILY</b>							
Vacancy Rate	7.30%	7.40%	7.30%	6.90%	6.40%	6.70%	6.30%
Net Absorption (Units)	58,362	12,501	27,197	73,959	83,781	-39,244	65,441
Completions (Units)	40,032	29,578	20,917	15,156	12,249	10,994	11,154
Rent Growth	-1.30%	-1.00%	-0.30%	-0.60%	-0.30%	-0.30%	-0.20%

Source: NAR/CBRE-Econometric Advisors

## About FTI Schonbraun McCann Group

FTI Schonbraun McCann Group (SMG) is a global consulting firm dedicated to creating integrated financial, tax and real estate solutions for clients having underlying value in real estate operations and assets. SMG provides an unsurpassed range of advisory services and represents leading public and private real estate entities including owners/developers, financial institutions, investment banks, opportunity funds, insurance companies, hedge funds, and pension advisors who are challenged by today's changing market conditions. FTI Schonbraun McCann Group is the real estate advisory business of FTI Consulting, Inc.

## About FTI Consulting

FTI Consulting, Inc. (NYSE: FCN) is a global business advisory firm dedicated to helping organizations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 3,400 professionals located in most major business centers in the world, we work closely with clients every day to anticipate, illuminate, and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring.

## For Additional Information

### Marc R. Shapiro, MAI, MRICS

Managing Director  
Real Estate Advisory Services  
973-287-5431  
mshapiro@smgllp.com  
marc.shapiro@fticonsulting.com

Prepared and edited by

### Mark E. Field

Senior Consultant  
Real Estate Advisory Services



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