



MEMORANDUM

DATE: July 15, 2009

TO: All PCA Clients

FROM: PCA Real Estate Group

RE: Real Estate Market Commentary

During the past six months, the commercial real estate markets have continued to decline significantly.

Fundamentals continue to deteriorate as job losses, the immediate reaction to recessionary pressures, led to reductions in space needs and therefore higher vacancies and lower effective rents. The dramatic change in consumer confidence levels and spending habits during the past twelve months has translated into unprecedented retail bankruptcies and store closings in spite of long term leases which had previously given comfort to investors in shopping centers and mixed use properties.

Our previous estimates of gross asset value deterioration of 25-30% compared to values in Q3 2008, which many felt was too severe a forecast at the time, have unfortunately been borne out in the property appraisal numbers we have seen during the first and second quarters of this year. The most widely observed benchmark of commercial properties held by institutional owners, the NCREIF Index, has seen a 19.2% decline in value during the 12 months ending March 31, 2009—we think it continues to lag the actual state of the market.

We see no near term expectation of a change in the direction of results. Notwithstanding the recent rally in the REIT sector, both in share price and the ability to issue new, albeit highly dilutive, new equity to solve near term maturities, PCA continues to be pessimistic regarding the values of existing holdings because of lack of demand for additional space. This concern is heightened for those properties with opportunistic and value-added risk characteristics, as the level of leverage associated with these assets proves to be unsupportable, endangering all of the equity invested.

Of course, as with every investment crisis, new opportunity is created within the uncertainty and chaos. We believe that because of the disruption to normal market practices, there will be some



extraordinary opportunities to purchase investment grade assets, in both debt and equity forms, for the patient investor with a strong stomach. PCA seeks to identify those managers who have the capital, access, alignment and lack of legacy issues and may thus be suitable partners for our clients going forward.

Our view of the time to expect reversal of these debilitating trends in value and rent is uncertain, at best. The single key factor is debt. The crucial questions are: When (not if) will the first mortgage production for commercial properties begin to return; what will be acceptable underwriting criteria for clearing mortgage trades expeditiously and with reasonable certainty; and, what will the government finally decide is its method for dealing with the underwater mountains of existing debt that cannot be re-financed at anything close to par? The market will be shaped by these interlocked decisions, as well as the rules and regulations which will be developed in order to provide the market with certainty of execution and enforcement. Without more clarity on this front, we think the current stasis will continue.

We have recently had high level discussions with one of the leading managers in the real estate world, who drifted too far from its core competency, and as a result, is in the unimagined position of losing 100% of the equity invested in a very significant core plus-value added commingled fund. This would have been unthinkable three years ago, and now the world of investment analysis and counsel includes the best practices for a pre-packaged bankruptcy for a real estate fund.

PCA's real estate clients are focused on three areas:

1. re-examining the role of property within the overall asset allocation, and identifying the appropriate levels of risk to undertake therein in light of the client's obligations;
2. preserving and protecting their existing property assets to the highest degree possible, including evaluating and changing the investment managers when necessary, and
3. identifying attractive opportunities for investment as they emerge.