

Real estate markets continue to adjust to a recessionary economy that began the end of 2007. With a 6.3 percent decline in 4thQ GDP, the economy has stretched into the longest recession since 1933. Labor markets continue to be stressed with the recession costing over 5.1 million jobs and economists forecasting that the current unemployment rate of 8.5% (a 25 yr high) will rise to 10% by the end of 2009. The Conference Board Leading Economic Index (LEI) for the U.S., a private-sector's measure of future economic activity, decreased 0.3 percent in March, and the index has not risen in the past nine months. The anticipation of further declines in GDP, jobs and leading indicators continues to add uncertainty to the real estate markets.

Real estate property in all markets for all property types continue to be negatively impacted by an economy under severe stress. Property fundamentals that depend on economic strength for stability are falling in step with the downturn in the economy. Lower demand is resulting in negative absorption, increasing vacancies and falling revenues. Current property revenues have fallen below recent historical highs. Investor expectations of higher revenue growth have now been replaced with an expectation that future revenues will continue to decline until the economy begins to show signs of stability. Decreased investor expectations for property returns, combined with significant uncertainty in the capital markets and all aspects of the economy, have driven capitalization rates higher and values lower. The wide gap between buyer and seller expectations has limited real estate transactions, making it more difficult to estimate recent value declines. However, limited sales along with discussions with investors, brokers, appraisers and other real estate participants suggest that capitalization rates have increased over 50-200 bps, with values decreasing 15-40%+ since the market peaked in 2007. Well positioned investment grade Class A properties in primary markets have performed better than Class B properties in secondary or tertiary locations. Overall, it is anticipated that capitalization rates and values will continue their respective upward and downward trends through 2009.

Property fundamentals deteriorated in the 1stQ 09 for office, apartment, retail and hotel properties. Office vacancies rose 70 bps according to Torto Wheaton Research (TWR), increasing to 14.7% as job losses mount and demand for office space diminished. Apartment vacancies increased 40 bps to 7.3%. Apartment markets hardest hit, such as Phoenix, experienced increases over 400 bps. Retail property fundamentals are under extreme pressure as consumer spending is reduced to historical lows. Costar reported that retail vacancy hit 7.2% in the 1st Q, the highest level since tracking started in 2000. Rental rates experienced a decline of 0.5% over year-end 2008 but a 0.5% increase over 1st Q08. Industrial availability according to TWR increased 80 bps to 12.2%, the highest vacancy level since tracking began in 1989. The industrial property net rent market index showed rents down 5.9% in the 1stQ 09, to \$6.08 from \$6.46 a year ago. The PKF-Hospitality March 2009 national forecast calls for hotel RevPar to be down 13.7% for 2009 as businesses re-think travel expenses and consumers reconsider leisure travel. Hotel profits are expected to decline by 30.1% as a result.

An economy entrenched in recession with no clear exit weighs heavily on a commercial real estate market that is closely tied to the performance of the economy. Commercial real estate values and property fundamentals are expected to be negatively impacted until that economy shows signs of life and investors can project with reasonable certainty that jobs, GDP growth, and consumer confidence are once again viable.

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