

US Real Estate Capital Market Commentary: May 4, 2009

"Pain is temporary. Quitting is forever." -Lance Armstrong

Overview

The measure of "temporary" is relative, but the amount of pain moving through the economy and financial system has been absolute. The US credit markets have been in a recession since early 2007. The US equity markets entered into a recession in early October 2007. The US economy moved into a recession in December 2007. As one measure of investors' pain, the S&P 500 is down nearly 40% from its peak in May 2008; peak-to-trough movement on the S&P 500 is off nearly 53%.

The US property markets seem to have finally entered into a recession (as measured by declining rental and occupancy rates) in the last two quarters. Property market fundamentals always lag the broader markets, but the lag in this recession has been longer than normal. As a result, we believe investors have priced a broad-based severe and prolonged property recession into the value of various commercial real estate-linked securities. At the risk of being Pollyannaish, we believe these expectations may not match reality. Cadence Capital believes now is the time to begin investing in commercial real estate, not the time to quit.

REIT Equity: The US REIT sector has finally moved into a period of de-levering/re-equitization.

REIT equity values (as measured by the MSCI REIT Index or "RMZ") have fallen more than 60% from a high-water mark of 1,226 in February 2007. This price decline has been driven largely by investor concerns about the outlook for property fundamentals and uncertainty surrounding debt refinancing requirements. The RMZ recently closed at 443.10, a healthy rebound off its multi-year low of 287.87 on March 6, 2009.

While many have characterized this period of collapsing equity values as "de-levering", it has technically been a period of devaluation with the expectation of recapitalization/re-equitization. However, we are now entering a period of de-leveraging. REITs are issuing common equity (at deeply dilutive prices) and applying the proceeds to meet refinancing needs or to buy-back debt outstanding bond issues. Thirteen REITs have issued equity since mid-March, raising over \$5.1 billion in fresh equity. Investors clearly recognize value at these price levels as the RMZ is up nearly 30% since this period of re-equitization began.

Cadence Capital believes REIT equity price volatility will continue throughout 2009, but the RMZ will end the year in positive territory. Individual company valuations will begin to reflect investor perception of "survivability" through this recession.

REIT Preferred equity: The best entry-point into commercial real estate-linked securities.

Preferred equity is clearly a hybrid component of capital, exhibiting many attributes of debt but none of the corresponding control provisions. As a result, investors tend to shy away from preferred equity leaving REIT managers to utilize the deeper mortgage and unsecured bond markets. The REIT preferred equity is relatively shallow with roughly \$13 billion of securities outstanding (including \$1.4 billion issued by mortgage and hospitality REITs) and is currently trading at an estimated 11.0% dividend yield. This compares favorably to the common stock dividend for these same companies of roughly 8.0%.

The proper investment analysis for preferred stock entails estimating the enterprise value of the issuer, determining the directionality of the issuer's credit profile then estimating the appropriate risk premium for this tranche of capital. Cadence Capital believes preferred stock currently represents the best risk-adjusted return.

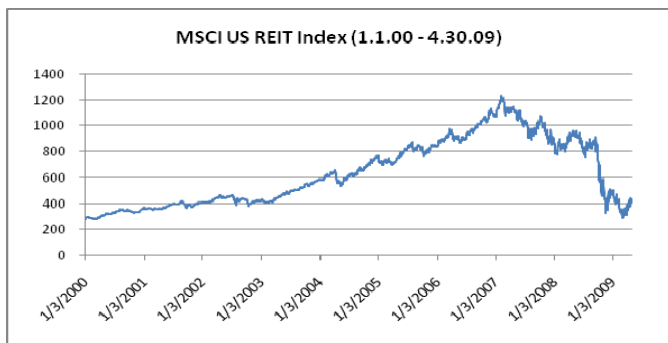
CMBS: A four-letter word with unknown nuggets of value.

To say investor demand for CMBS is dead would be an understatement. New-issue CMBS volume totaled just \$12 billion in 2008 as compared to over \$200 billion in each of the prior two years. AAA tranches (as measured by the Markit CMBX indices) have seen a slight increase in investor interest since the FDIC said the Public-Private Investment Program ("PPIP") and TALF funding would be used to support both residential and commercial mortgage-backed bond purchases; AAA tranches are currently trading in the low 70's, off their lows of the mid-50's. However, all other credit classes continue to trade below 30.

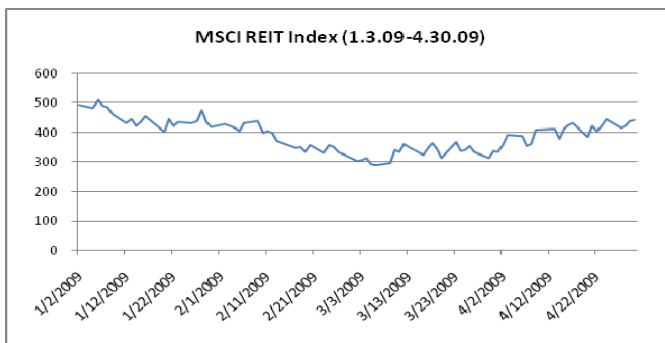
Cadence Capital believes AAA-tranches will likely see sporadic investor demand and could reward the diligent (and patient!) investor with significant risk-adjustment yields over the next 12 – 18 months. Cadence Capital does not expect material investor interest in the non-AAA tranches until real estate fundamentals show signs of improvement and credit losses become more quantifiable.

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MSCI US REIT Index

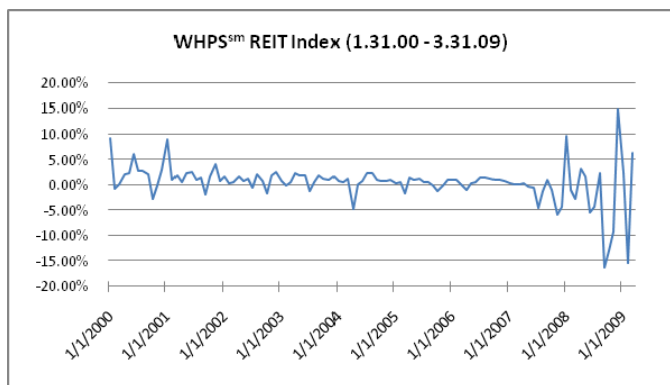


Source: MSCI, Cadence Capital Group, LLC

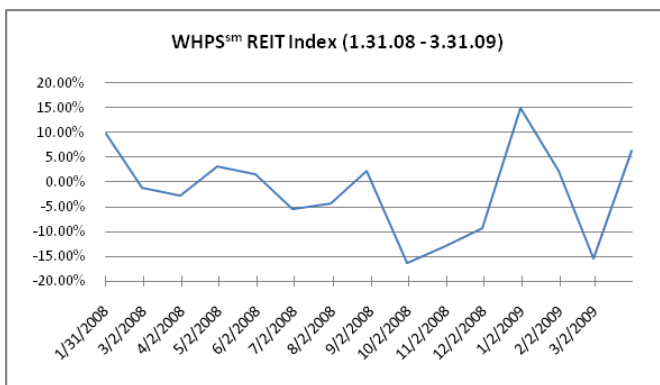


Source: MSCI, Cadence Capital Group, LLC

WHPSsm REIT Index

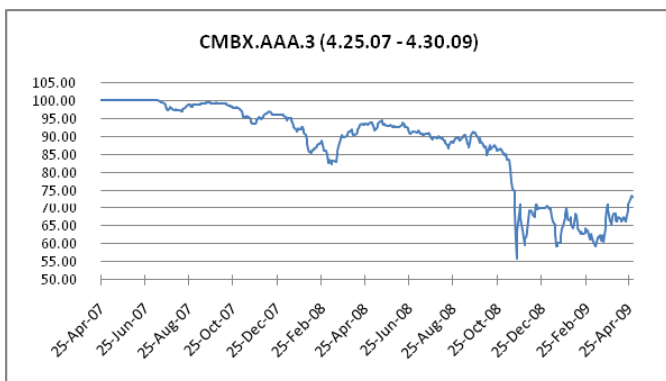


Source: Wachovia Capital Markets, LLC, Cadence Capital Group, LLC

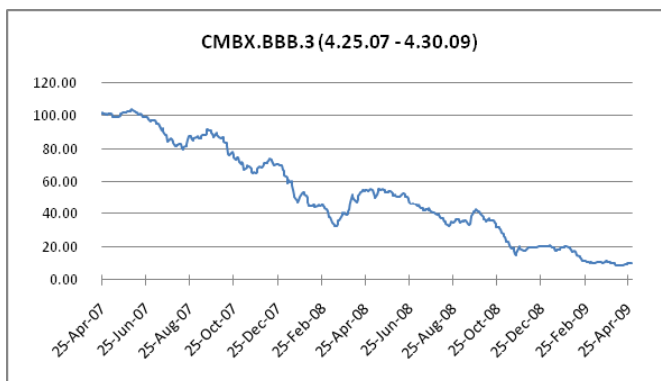


Source: Wachovia Capital Markets, LLC, Cadence Capital Group, LLC

CMBX pricing



Source: Markit, Macquarie Capital (USA), Cadence Capital Group, LLC



Source: Markit, Macquarie Capital (USA), Cadence Capital Group, LLC

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