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US Real Estate Capital Market Commentary: August 13, 2009

"Investors make money on the buy, traders make money on the sell" -anonymous

Overview

The economy has started to shows signs of a tepid recovery, giving the bulls an opportunity to take control of the capital markets; the DOW, S&P and Treasuries have all rallied during the past month, causing many market observers to wonder if investors have gotten a little ahead of themselves. While corporate earnings have been favorable, reflecting both recent cost-cutting efforts and overly-dire analysts' earnings expectations, downside economic risks stemming from changing consumer spending patterns and a very weak labor market continue to haunt the markets.

The REIT sector has also benefited from the sunny investor temperament, with the FTSE NAREIT equity index rising over 80% (price-only) from its trough in early March and just over 10% (price-only) year-to-date through August 10. However, investors need to be more cautious at current price levels and should expect a divergence in individual stock performance through year-end. Investors should not expect all REIT securities to universally increase in value and should begin to differentiate between management teams, investment strategies and balance sheet flexibility. There should also be a renewed interested in evaluating property fundamentals to ascertain the directionality of future cash flow generation.

<u>Cadence Capital believes REITs will deliver a mid-teens total return in 2009 but cautions that individual company valuations will begin to reflect investor perception of "managerial alpha".</u>

The "risk spectrum" approach to value: a better investment selector?

While most investors pursue an investment strategy focused primarily in one of the so-called "four-quadrants" of real estate capital, such as "public equity" versus "private equity", there are a growing number of investors pursuing a "risk spectrum" approach to real estate securities investing. Strategies that focus primarily in one of these quadrants of real estate capital can potentially lead to the mispricing of risk by not taking into consideration the nuances associated with individual capital structures and securities.

Investors first need to estimate the value of the underlying real estate collateral and then evaluate the various risks associated with every investable component of the company's capital structure, ranging from secured and unsecured debt to preferred and common equity. These risks should then be appropriately priced based on the investor's risk appetite and compared to the current market price of that risk in order to determine the best risk/reward trade-off.

The final result of this process should be a well-diversified, appropriately-priced portfolio, which balances risk rather than a homogenous collection of assets valued with inconsistent methodologies. That's not to say that this portfolio will definitively sustain fewer losses over time, but it will allow for a meaningful determination of "alpha" so as to better reward investment out-performance.

<u>Cadence Capital believes a risk spectrum approach to securities investing, when coupled with a realistic property valuation, can yield a well-balanced portfolio that will outperform classically oriented "four-quadrant" strategies.</u>

Government-backed alphabet soup support CMBS AAA pricing…but mortgage performance is a lagging indicator

TARP, TALF, PIPP are piquing investor interest but no amount of government support will adequately revive the CMBS market. While there has been a more pronounced price movement (as measured by the CMBS) in AAA classes due to PIPP, the non-AAA classes have also seen healthy gains.

Delinquency rates within CMBS pools appear to be catching up with investor perception, increasing to 3.51% at the end of June 2009, up from 0.48% a year earlier. *Realpoint Research* recently put forth two forecasts for yearend 2009 delinquency rates, ranging from 6.6% to just over 9.0%. If these forecasts are accurate, perhaps some of the distressed debt capital that has been raised during the past year will finally get to chase investment opportunities.

Investors are rightfully cautious about the overhang from legacy mortgage inventory, uncertainty surrounding structural concerns and the unknown direction of increased regulations and stricter accounting guidelines. <u>Cadence Capital believes investors need to see delinquency rates stabilize and structural issues properly addressed before non-government supported CMBS issuance returns in any meaningful fashion.</u>

See page 3 for important disclosures

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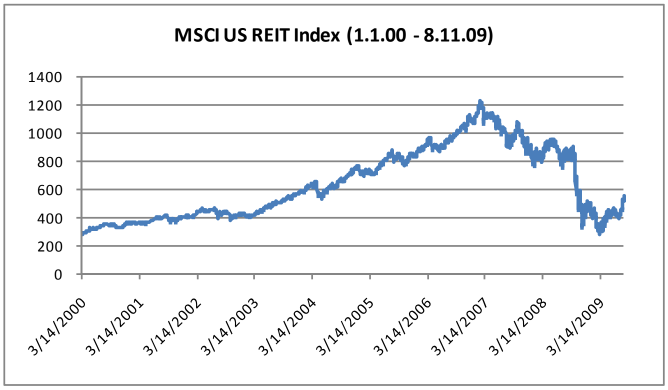
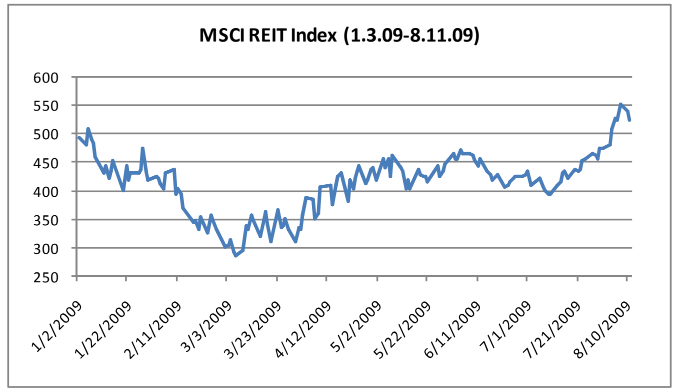
MSCI US REIT Index

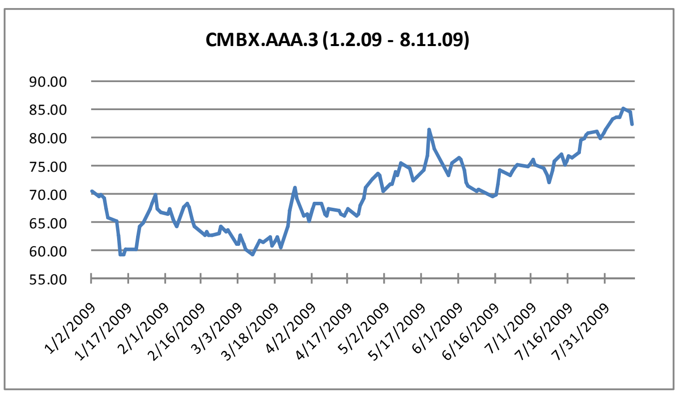


Source: MSCI, Cadence Capital Group, LLC

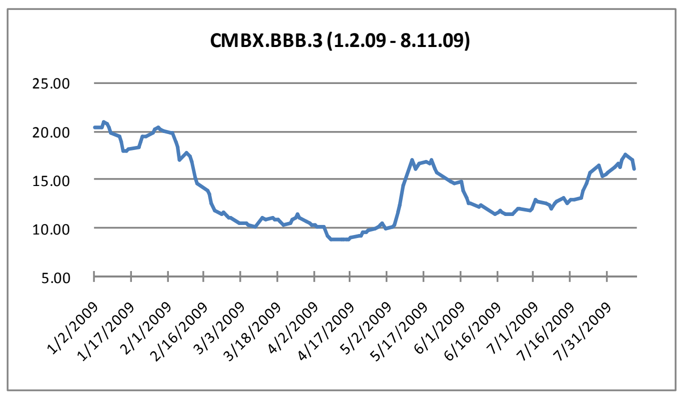


Source: MSCI, Cadence Capital Group, LLC

CMBX pricing (year-to-date)

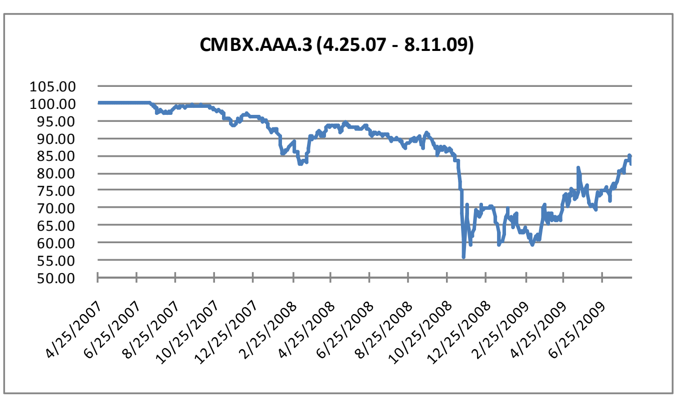


Source: Markit, Macquarie Capital (USA), Cadence Capital Group, LLC



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

CMBX pricing (historical)



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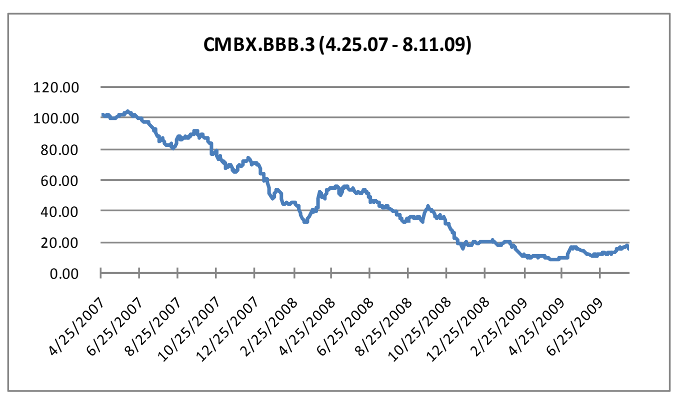

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