CORNERSTONE

U.S. RESEARCH quarterly

Summer / Fall 2012

The U.S. Economy

- After a strong and hopeful start to the year, the economy retrenched in the second quarter. Real GDP growth fell to an annualized rate of 1.7% in Q2 as uncertainty about the global economy, the U.S. fiscal situation, and post-election policies (tax, regulation, health care) weighed on the minds of consumers and businesses.

- Consumer confidence and retail sales have weakened in the third quarter as election rhetoric and gas prices have increased and job gains have slowed. Despite continued strength in the technology, energy and healthcare sectors, total private sector employment was up only 103,000 in August and 141,000 in July.

- The lack of improvement on the job front led the Federal Reserve to announce a third round of "quantitative easing," an unprecedented open-ended mortgage backed securities purchase program ($40 billion per month) to continue until the labor market shows "substantial signs of improvement." The Fed also extended its guidance on near zero short term rates from 2014 to 2015.

- By targeting the mortgage market, the Fed aims to boost a housing market that is coming off the bottom and transitioning from being a drag on to a driver of economic growth. House prices are stabilizing or increasing, albeit with still wide metro variations, and the NAHB/Wells Fargo Index of builder confidence has increased for five consecutive months to its highest value since June 2006.

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Real Estate Investment Markets

- Commercial property sales activity totaled nearly $110 billion in the first half of the year (as per Real Capital Analytics), roughly on par with 2011. Volume increased in secondary and tertiary markets. Sales softened in July, totaling $14.7 billion, down 20% year over year, with the slow down more a reflection of fewer properties being offered for sale than lack of buyer interest.

- Cap rates and yields have held relatively flat in recent months, although spreads to 10 year Treasuries have widened. This is reflected in the Moody's/RCA Commercial Property Price Index (CPPI) that is up 7.1% over the past year through July and only 0.5% over the past three months.

Real Estate Benchmark Returns

- NCREIF Property Index (NPI) total returns were 2.68% (1.45% income + 1.23% appreciation) in 2Q12, down slightly from 2.59% in Q1. The NPI was up 12.04% over the past year. PREA Consensus Forecasts show NPI return expectations of 9.9% for 2012 and 8.2%/ year on average over 2012-2016.

- 2Q12 NCREIF Open-End Diversified Core Equity (ODCE) Index returns were 2.58% (1.34% income, 1.23% appreciation), down from 2.82% in Q1. As of Q2, the ODCE Index was up 12.42% year over year and had average annual returns of 8.39% over the past 3 years.

- NAREIT Equity REIT Total Return Index was up 3.71% in Q2 and 4.71% in Q3 (through 9/16). The REIT index is up 20.4% year to date versus an 18% gain for the S&P 500.

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U.S. Economy & Real Estate Trends

Four years after the collapse of Lehman Brothers at the height of the Great Financial Crisis the U.S. economy has made significant strides but is plodding along at too slow a pace to provide the substantial, broad-based and sustained improvement in the labor market required to shift it into higher gear. More than three years past the official end date of the recession the unemployment rate remains above 8%, and recent headline-grabbing declines are more the result of discouraged workers leaving the labor force than new hiring. Employers remain hesitant to add to payroll because of economic uncertainty at home and abroad, and this is not likely to begin to change until mid-2013, after the U.S. Federal election and more of the Eurozone debt situation plays out. Another part of the labor slack story is housing. The sector that has historically led the economy out of recession but couldn't this time, is now starting to contribute with the potential benefits of a QE3 tailwind. While challenges remain, on the whole the housing sector is beginning to show signs of marked improvement in recent months with sales, starts, and builder confidence up and inventory and months on the market down.

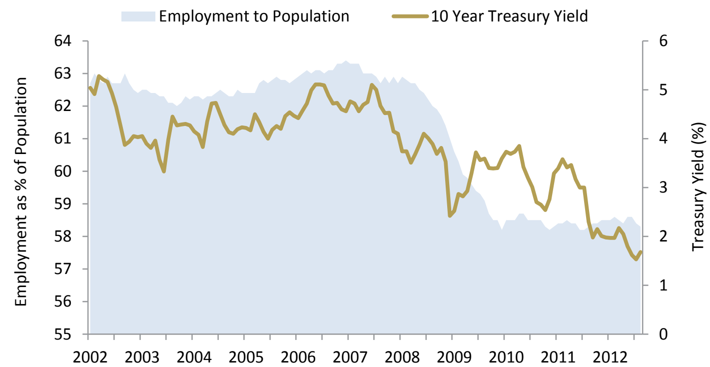
Despite a near term slow growth scenario, real estate space market fundamentals are improving at a modest pace as even sluggish employment gains is enough to maintain or improve occupancies in the face of limited new supply. While investor appetite for stabilized core real estate remains strong in the face of global uncertainty and historically low Treasury yields, investor attention is shifting beyond apartments and CBD office into other property sectors and markets, especially those that have seen robust job growth.

U.S. Forecast Economic Performance

	2011	2012*	2013*
Gross Domestic Product	1.7%	2.1%	2.2%
Employment Change	1.2%	1.4%	1.4%
Unemployment Rate	8.5%	8.2%	8.0%
Inflation (CPI)	3.1%	2.0%	2.2%
Housing Starts (000s units)	610	745	850
Retail Sales Growth (ex Auto ex Gas)	5.8%	4.7%	5.0%
10 Year Treasury Yield	2.8%	1.8%	1.9%
1 Month LIBOR	0.2%	0.2%	0.2%

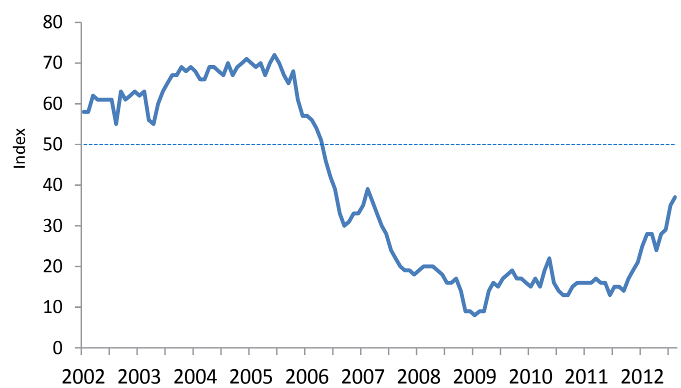
**forecast*

Labor market slack to keep Fed focus on low interest rates



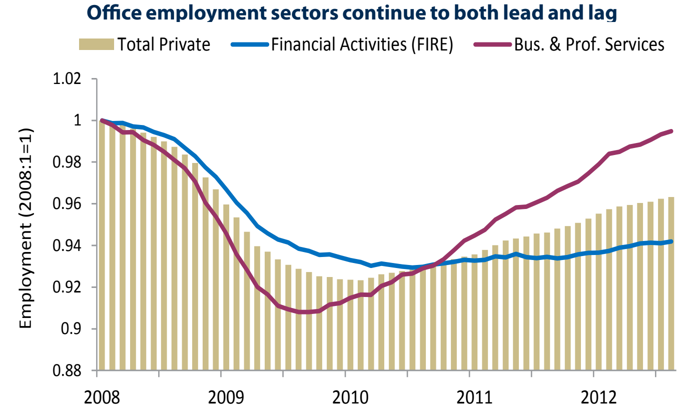
Source: Cornerstone, BLS, Federal Reserve

Improving builder confidence points to broadening recovery
(NAHB/Wells Fargo Housing Market Index)



Source: Cornerstone, National Association of Home Builders (NAHB)

Office employment sectors continue to both lead and lag



Source: Cornerstone, Federal Reserve, BLS

Office: Vacancy ↓30 bps to 15.7% in Q2[2]

After a pause in Q1 the office sector regained momentum in Q2 with 45 of 62 major markets reporting occupancy gains and suburban submarkets (↓40 bps to 17.4%) outperforming downtown (↓20 bps to 12.6%). While the resilient business/professional service sector has recovered to pre-recession levels, recovery in financial services employment is lagging far behind. Seattle, San Diego, Boston, and Charlotte all saw significant decreases in vacancy. Supply growth is dormant, with limited multitenant construction concentrated in New York, Washington, Boston, and Houston.

Apartment: Vacancy ↓ below long run average to 4.8% in Q2[2]

Strong demand and tight occupancy set the stage for further rent gains. Most markets saw vacancy fall, with Austin, Atlanta, Newark, and San Diego notable exceptions. Newark, Minneapolis, Bay Area metros, Boston, and Miami are amongst the tightest. Development is picking up but units under construction represent less than a 1% addition to inventory and an estimated 30% of new units are concentrated in four markets: New York, Dallas, Washington DC, and Austin. The most active markets relative to current inventory (2%+ new supply under construction) include Raleigh, Austin, Salt Lake City and San Jose.

Hotel: Occupancy ↑ 61%; RevPAR ↑ 8% through Q2[3]

Despite a slowing global economy, business travel remains robust and the hospitality sector is maintaining steady occupancy and room rate growth, with a fairly bullish outlook. Full service sectors are all achieving occupancy in excess of 70% and strong rate growth. Top performing markets are New York, Oahu, Miami, San Francisco and Los Angeles. Dallas and Washington D.C. stand out as posting slight declines in average room rate over the first half.

Industrial: Vacancy ↓20 bps to 13.2% in Q2[2]

2Q was the ninth consecutive quarter of modest improvement with more metros (34 of 52) reporting tighter leasing conditions. Indianapolis, Detroit, Chicago, Miami, Seattle, Riverside County, and Phoenix all saw significant occupancy gains, though vacancy remains high in many of these markets. Atlanta, Austin, Boston, Philadelphia and Tampa lost ground. Supply growth is virtually nonexistent nationally, with Nashville, Riverside, Phoenix, Memphis, and Portland exceptions that are seeing modest additions to supply.

Retail: Neighborhood/Community availability ↓ 10 bps[2]

Shopping center availability improved slightly to 13% in Q2, but is essentially unchanged over the past three years. Retail chains remain reluctant to expand until consumer spending and confidence begin to show real traction. After an extended period of fairly impressive retail sales gains, consumers have trimmed their spending in recent months and retail sales growth (excluding gasoline and autos) has stalled, suggesting that prospects for a broad-based recovery, beyond infill grocery anchored centers and major malls, will be further delayed.

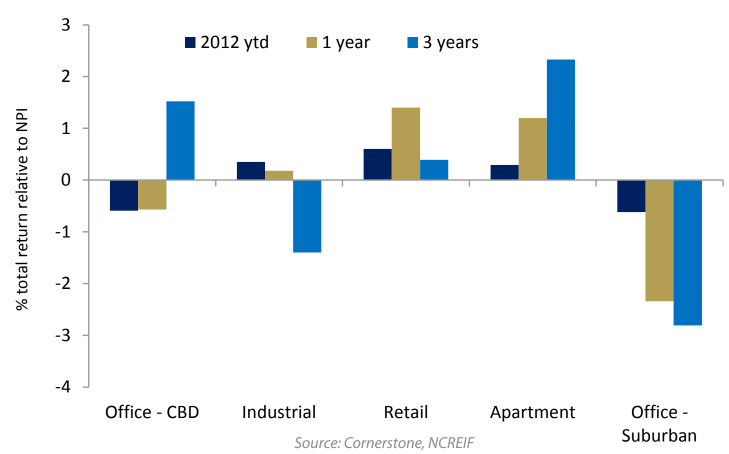
Capital Market Highlights

Despite slowing GDP growth, U.S. institutional real estate has turned in another solid performance so far this year, benefiting from incredibly low interest rates and elevated stock market volatility ("macro push" factors) and slowly improving leasing fundamentals. NCREIF Property Index (NPI) total returns were 5.34% year to date and 12.04% on a one year basis through 2Q12. We expect investor interest to remain strong and that NPI returns will slow marginally but finish the year in double digits once again. The spread between the implied average NPI cap rate and 10 year Treasury yield is high by historical standards and widened significantly in the second quarter as Treasuries fell to new lows (chart on back page). With the adoption of QE3 extending the Fed's window for keeping downward pressure on interest rates, and the fact that the end date is both open and conditioned on solid improvement in employment (and hence leasing markets), there is a strong case for continued modest value gains and possibly some room for further cap rate compression at the overall market level.

Aggregate index figures hide wide variation in property performance across sectors and metros that have important implications for investment strategies today. The strong recovery in institutional property values over the past three years was driven primarily by the CBD office and apartment sectors (chart below), and primarily high quality assets in major Gateway markets. Suburban office and industrial have lagged behind, as have most secondary and tertiary markets and most properties with leasing risk. At this point in the economic and financial market cycles the divergence of performance across sectors is narrowing, with year to date returns more closely aligned than one and three year returns. As more investors look to real estate with an offensive (growth) as opposed to defensive (current income) strategy, capital is increasingly focused on opportunities in sectors beyond class A CBD office and apartments in major markets to other property sectors and locations, and towards assets with leasing risk and/or capital needs that offer experienced operators the potential to create value.

Dispersion in NCREIF Property Sector Returns Diminishing

(Property Sector Return Spreads to Aggregate Index, through 2Q12)



Source: Cornerstone, NCREIF

Capital Markets

Market Return Comparison

Total Returns	Q2 2012	1-year	3-year	5-year	10-year
NCREIF Property Index	2.7%	12.0%	8.8%	2.5%	8.3%
FTSE NAREIT-Equity Index [7]	3.7%	12.9%	32.4%	2.6%	10.3%
BofAML US Corp/Gov't Bond Aggregate Index [6]	2.6%	8.7%	7.4%	6.9%	5.8%
MSCI EAFE Gross USD Index [6]	-6.9%	-13.4%	6.4%	-5.6%	5.6%
Russell 2000 Index [6]	-3.5%	-2.1%	17.8%	0.5%	7.0%
S&P 500 Index	-2.8%	5.5%	16.4%	0.2%	5.3%

Market Yields and Rates

Market Yields and Rates	Q2 2012	Q1 2012	1-year
10-year Treasury Yield [5]	1.9%	2.0%	2.1%
LIBOR - 3 month [5]	0.5%	0.5%	0.4%
Merrill Lynch Gov't/Corp Bond Yield [6]	1.9%	1.9%	2.0%
NCREIF Potential Distribution (12-mo trailing) [1,4]	3.9%	4.0%	4.0%
FTSE/NAREIT-Equity Dividend Yield (12-mo forward) [7]	3.5%	3.6%	3.6%

private

Real Estate Performance Summary

Real Estate Performance Summary [4]	Q2 2012	1-year	3-year	5-year	10-year
Apartment	2.8%	13.2%	11.1%	2.9%	8.2%
Hotel	2.1%	8.0%	5.1%	-0.2%	6.8%
Industrial	2.9%	12.2%	7.4%	1.7%	7.6%
Office	2.3%	10.5%	7.8%	1.7%	7.4%
Retail	3.0%	13.4%	9.2%	4.3%	10.8%
NCREIF Property Index	2.7%	12.0%	8.8%	2.5%	8.3%

public

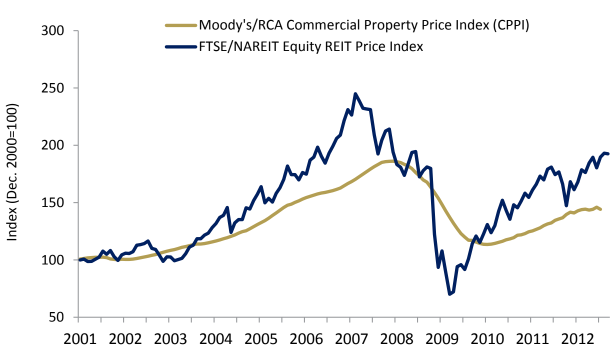
NAREIT Sector Index Total Returns [7]	Q2 2012	1-year	3-year	5-year	10-year
Office/Industrial	1.2%	2.4%	26.5%	-4.6%	5.6%
Retail	5.8%	23.2%	37.8%	1.3%	11.6%
Residential	0.9%	10.7%	40.6%	7.4%	12.3%
Lodging	-0.6%	-1.0%	28.8%	-6.8%	3.6%
Healthcare	10.2%	20.9%	29.6%	14.4%	15.2%
Diversified	1.3%	2.2%	29.1%	-0.1%	9.1%
FTSE/NAREIT Equity Index	3.7%	12.9%	32.4%	2.6%	10.3%

Real Estate Pricing

Endnotes and Data Sources

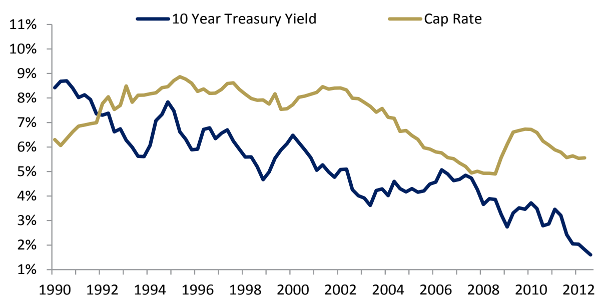
1 Cornerstone Research
2 CBRE Econometric Advisors
3 Smith Travel Global
4 NCREIF
5 Moody's Economy.com
6 Ibbotson
7 NAREIT

Property and Equity REIT Price Indices



Source: Moody's Investor Services, NAREIT.

NCREIF Appraisal Cap Rate and 10 Yr Treasury Yield



Source: Federal Reserve Board, NCREIF.