Little Relief Through Early 2009; Private Equity Adjusts

STOCKS CONTINUE RETREAT, REITs ENDURE STEEP LOSSES

Equity markets continued to decline into 2009 as global economic concerns plagued the overall market. REITs were hit especially hard, dropping 32.7% in 1Q 2009. The S&P 500 saw significant declines as well, falling 11.7% and marking the second straight quarter of double-digit losses. The NASDAQ fared better, dropping just 3.1% during the quarter. Over the last two quarters REITs suffered considerably worse than the S&P 500 and NASDAQ, falling 59.0% compared to 31.6% and 26.9%, respectively.

	2003	2004	2005	2006	2007	2008	1Q 2009
MSCI US REIT (RMS)	36.7%	31.5%	12.1%	35.9%	-16.8%	-38.0%	-32.7%
S&P 500	26.4%	9.0%	3.0%	13.6%	3.5%	-38.5%	-11.7%
NASDAQ	50.0%	8.6%	1.4%	9.5%	9.8%	-40.5%	-3.1%

Source: Bloomberg.

MINIMAL PUBLIC DEBT ISSUANCE... BUT SIGNS OF LIFE?

Unsecured debt issuance in 1Q 2009 was 81% lower than the quarterly average since 2005. BBB REIT spreads continued to increase during the first quarter, expanding by 250 bps to reach double-digit levels above the 10-year Treasury (average spread over 1,125 bps for the quarter). However, in a potential watershed event, Simon Property Group (SPG) issued $650 million of unsecured 10-year notes in March, marking the first unsecured debt issuance by a REIT since 3Q 2008. The notes were priced to yield 10.35% to maturity, a spread of approximately 770 bps over the 10-year Treasury.

Debt Financings ($M)

	2005 Debt	2005 Treasury 10-Yr[1]	2006 Debt	2006 Treasury 10-Yr[1]	2007 Debt	2007 Treasury 10-Yr[1]	2008 Debt	2008 Treasury 10-Yr[1]	2009 Debt	2009 Treasury 10-Yr[1]
1Q	$ 4,139	4.43%	$ 5,375	4.65%	$ 9,320	4.59%	$ 295	3.73%	$ 650	2.64%
2Q	3,832	4.10%	3,800	5.11%	2,070	4.66%	3,300	3.80%		
3Q	2,179	4.16%	8,580	4.87%	2,100	4.63%	748	3.94%		
4Q	5,052	4.52%	5,290	4.57%	2,275	4.51%	0	N/A		
Year	$15,202		$23,045		$15,765		$ 4,343		$ 650	

[1] Average interest rate for 10-year U.S. Treasuries at time of debt offering for the applicable period.
Sources: NAREIT, Bloomberg, M3 Capital Partners.

MARKET DISTRESS IMPACTS REAL ESTATE PRIVATE EQUITY

The credit crunch is dramatically reshaping the real estate private equity landscape. As transaction activity has halted and values have fallen, numerous limited partners (LPs) and general partners (GPs) of real estate private equity funds have begun exploring strategic alternatives to address liquidity and / or personnel issues. Common themes among LPs and GPs include:

- Significant markdowns of existing investment values, particularly for funds with higher leverage
- LPs reluctant to fund capital calls due to liquidity constraints
- Substantial financial distress and / or the loss of key personnel for select fund GPs as long-term financial incentives evaporate
- GP management teams disenfranchised within larger financial institutions
- LPs encouraging GPs to slow down the pace of investment and to minimize capital calls, threatening relationship for noncompliance
- LPs / GPs working through refinancing issues on near term debt maturities

As a result, select LPs are contemplating the sale of fund interests in the secondary market. Additionally, LPs are increasingly engaged and proactive in overseeing fund performance, and select GP management teams are actively seeking new platforms.

COMMON EQUITY ISSUANCE PICKS UP

Despite turmoil in the public markets, equity issuance in 1Q 2009 increased significantly from the previous quarter as REITs raised capital to strengthen balance sheets and address near-term debt maturities. The $1.9 billion raised in 1Q 2009 marks a 126% increase over the equity issuance in the previous quarter but a 21% decrease from the average quarterly public issuance volume since 2005. The market saw a flurry of additional issuance in April and May as share prices rebounded and the re-equitization of the REIT space accelerated. For the fifth consecutive quarter, there were no major REIT IPOs.

Common Equity Raised ($M)

	2005	2006	2007	2008	2009
1Q	$ 1,166	$ 3,655	$ 2,830	$ 2,170	$ 1,942
2Q	2,123	2,590	2,462	1,571	
3Q	3,363	2,449	594	2,754	
4Q	2,100	7,050	2,180	858	
Year	$ 8,752	$ 15,744	$ 8,066	$ 7,353	$ 1,942

Sources: NAREIT, press releases, M3 Capital Partners.

M&A ACTIVITY VISIBLE BUT LIGHT IN THE FIRST QUARTER

Few M&A transactions of note were announced in 1Q 2009. Macquarie Countrywide Trust (MCW) agreed to sell 30 U.S. shopping centers to Inland Real Estate Acquisitions for $427 million, with 7 properties closed at announcement and others to be closed subject to debt assumption. MGM Mirage sold the Treasure Island Hotel and Casino in Las Vegas to Ruffin Acquisitions for $600 million in cash proceeds and a $175 million secured note. Developers Diversified Realty (DDR) announced the sale of a minority stake in the company to the Otto family of Germany. DDR agreed to issue 30 million shares for $112.5 million plus 10 million warrants to purchase additional DDR stock. Upon closing, the Otto family will be DDR's largest individual shareholder, owning approximately 20% of common shares outstanding.

Acquirer	Target	Annc. Date	Size	Sector
Inland Real Estate	Macquarie Countrywide Trust	27 Jan	$ 427 M	Retail
Otto Family	Developers Diversified Realty	23 Feb	$ 113 M	Retail
Ruffin Acquisitions	MGM Mirage	20 Mar	$ 775 M	Hotel

Sources: Press releases, M3 Capital Partners.

FEW DOMESTIC JVs IN TURBULENT MARKET

Formation of institutional joint ventures remained slow during 1Q 2009. Among the most notable was the registration of two new private REITs, CNL Macquarie Global Growth Trust, Inc. and CNL Macquarie Global Income Trust, Inc. Both REITs will be externally managed by a newly formed joint venture between CNL Financial Group and Macquarie Group Limited and will target multiple commercial property sectors globally. In another announcement, Lane Co. partnered with Lubert-Adler on a $250 million venture focused on acquiring multifamily properties in the southeastern and southwestern United States.

Operator	Sector	Size	Venture Type	Institutional Investor
CNL / Macquarie	Diversified, Global	$ 1,500 M	Acquisition / Development / Redevelopment	CNL Macquarie Global Growth Trust
CNL / Macquarie	Diversified, Global	$ 1,500 M	Core Acquisition	CNL Macquarie Global Income Trust
Lane Co.	Multifamily	$ 250 M	Acquisition	Lubert-Adler

Sources: Press releases, M3 Capital Partners.

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