

## Chasing the Blind Pools

### REIT INDEX POSTS BEST QUARTER SINCE 1995 INCEPTION

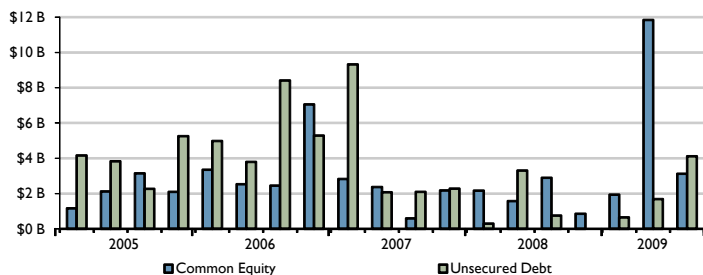
Following on last quarter's rebound, the overall public equity markets enjoyed strong gains in the third quarter of 2009. REITs were most impressive, however, as the RMS index posted a 34.6% total return – the largest quarterly gain since its inception in 1995. This record performance was propelled by the continued recapitalization of the public REIT sector. Year to date, REITs returned 17.9% versus 17.0% for the S&P 500 index.

	2004	2005	2006	2007	2008	YTD	3Q 2009
MSCI US REIT (RMS)	31.5%	12.1%	35.9%	-16.8%	-38.0%	17.9%	34.6%
S&P 500	9.0%	3.0%	13.6%	3.5%	-38.5%	17.0%	15.0%
NASDAQ	8.6%	1.4%	9.5%	9.8%	-40.5%	34.6%	15.7%

Source: Bloomberg.

### PUBLIC MARKETS CONTINUE SECTOR RECAPITALIZATION

In the third quarter, equity REITs issued \$3.1 billion of common equity, following on last quarter's robust \$11.6 billion. In August, the REIT public debt market opened further, enticing equity REITs to issue \$4.1 billion in unsecured notes during the quarter, exceeding the total debt issuance over the prior four quarters combined by over \$1 billion. This further strengthens REIT balance sheets and broadens their access to capital.



Sources: Bloomberg.

### BLIND POOL EQUITY REITs JOIN THE IPO QUEUE

The initial public offering ("IPO") market opened its window, albeit briefly, in the third quarter for newly formed commercial mortgage REITs, highlighted by Starwood Property Trust's (STWD) upsized \$932 million offering. Starwood's IPO was followed by CreXus Investment's (CXs) \$200 million, Colony Financial's (CLNY) \$288 million, and Apollo Commercial Real Estate Finance's (ARI) \$200 million. Of note, the size of the latter three IPOs was reduced significantly while multiple other proposed offerings were postponed or pulled.

The mortgage REIT IPO "mini-boom," along with the significant year-to-date equity REIT secondary offerings and stagnant private capital flows, has led to increased speculation over the timing of the next phase of equity REIT IPOs. To date, equity REIT IPO filings have largely been concentrated in the lodging sector, including proposed blind pool offerings by Chesapeake Lodging Trust, Pebblebrook Hotel Trust, and Chatham Lodging Trust. A blind pool industrial REIT, Terreno Realty Corp., recently joined the queue.

It remains to be seen whether the public markets would be willing to allocate new equity to management teams without existing balance sheet assets – but who are looking to capitalize on unidentified future acquisition opportunities – an investment strategy that the private equity market remains reluctant to pursue.

Source: Company filings.

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### BUT WHY IPO IF YOU CAN "SPAC UP THE TRUCK"?

While the IPO queue grows, one veteran management team has already formed a new blind pool REIT by accessing existing public equity via a special purpose acquisition company ("SPAC"). In early August, NRDC Acquisition Corp. (NAQ) – a SPAC or "blank check" company that completed its \$414 million IPO in October 2007 – announced plans to convert into a retail REIT focused on acquiring necessity-based shopping centers. The new management team is led by Stuart Tanz, the former Chairman and CEO of Pan Pacific Retail Properties which was sold to Kimco Realty Corp. (KIM) for \$4.1 billion in November 2006. Shareholders approved the plan in late October, and the company has been renamed Retail Opportunity Investments Corp. (ROIC).

Similarly, in early November, Global Brands Acquisition Corp. (GQN) – a SPAC that completed its \$288 million IPO in December 2007 – announced its intention to convert into a necessity-based retail REIT. The new management team would be led by retail real estate veteran William Gerrity, pending shareholder approval. Ultimately, the proposed REIT did not receive a critical mass of new shareholders, and the sponsors elected to terminate the process in early December in advance of its special meeting of shareholders.

The SPAC-to-REIT conversion is an opportunistic angle for experienced management teams to tap the public markets for "blind pool" capital. With cash-rich balance sheets and without legacy issues, these newly formed REITs would be well positioned in a capital-constrained market.

Source: Company filings.

### PRIVATE TRANSACTIONS FOCUSED ON ASSET SPIN OUTS

Although private equity capital flows remain muted, there has been an uptick in the formation of institutional joint ventures involving asset "spin outs," or the recapitalization of existing balance sheet assets. Spin-out joint ventures generate liquidity for operators while allowing them to maintain control over assets and collect management fees; they also serve to communicate a price point to the market for the company's assets. The Macerich Company (MAC) has been particularly active through the formation of three distinct spin-out joint ventures, encompassing over \$1.6 billion in aggregate of existing regional malls and generating \$434 million in cash proceeds to apply toward the company's deleveraging objective. The acquisition joint venture between Cedar Shopping Centers (CDR) and RioCan (TSX: REI.UN), seeded with \$270 million of spin-out assets, was part of a larger strategic investment by RioCan that included an approximate 15% equity stake in Cedar.

The increased institutional joint venture activity is an encouraging sign of life for private equity capital flows. Notably, the majority of the transactions involved investment managers as direct institutional investors largely remain on the sidelines. Nevertheless, the demonstrated ability / willingness of these operators and investors to find common ground on asset pricing (and structure) is a positive sign for private market liquidity.

Operator	Investor	Size	Sector	JV Type
Glimcher	Blackstone	\$320 M	Retail Mall	Existing Asset
Regency	USAA	\$134 M	Shopping Center	Existing Asset
Veingarten	Jamestown	\$160 M	Shopping Center	Existing Asset
Cedar	RioCan	\$270 M	Shopping Center	Seeded Acquisition
U-Store-It	Heitman	\$102 M	Self Storage	Existing Asset
Macerich	Heitman	\$669 M	Retail Mall	Existing Asset
Macerich	GI Partners	\$337 M	Retail Mall	Existing Asset
UDR	Kuwait Finance House	\$450 M	Multifamily	Acquisition
Macerich	Cadillac Fairview	\$652 M	Retail Mall	Existing Asset
Extra Space	Harrison Street	\$131 M	Self Storage	Existing Asset

Source: Company filings, M3 Capital Partners.