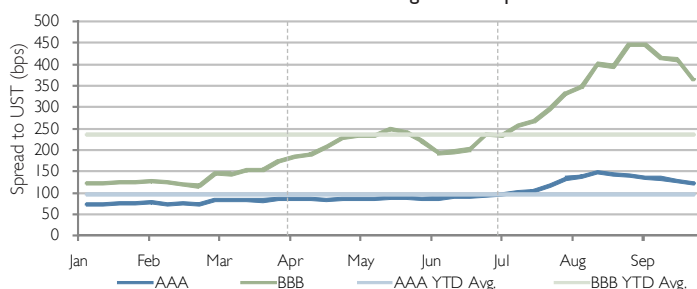


Lending Conditions Dampen Markets; REIT Shares Rebound Late

CMBS SPREADS UP SHARPLY ON INVESTMENT-GRADE DEBT

During 3Q 2007, CMBS pricing continued to widen, with dramatic changes in spreads on investment-grade debt. This movement highlights the impact of the credit market crisis ignited by the US subprime debacle. Although spreads began their increase during 2Q 2007, investment-grade CMBS loans were hit much harder during 3Q 2007. Spreads peaked in mid- to late-August, advancing from the start of the quarter by 57% and 88% for AAA and BBB rated CMBS, respectively, before moderating somewhat in September. The widespread debt market dislocation evidenced by these spreads stalled potential transactions throughout the US real estate capital markets and a catalyst for its recovery remains elusive.

2007 Investment Grade Average CMBS Spreads



Source: Bloomberg, Morgan Stanley CMBS Indices.

M&A ACTIVITY STALLS AFTER EARLY BLOCKBUSTER DEAL

The third quarter saw just one publicly traded REIT merger transaction in the US, Liberty Property Trust's \$900 million acquisition of Republic Property Trust. This dearth of transactions reflects the difficulties facing dealmakers amid tumultuous debt market conditions. Beyond publicly traded REITs, two other notable real estate M&A transactions occurred during the quarter: The Blackstone Group acquired Hilton Hotels Corporation for \$26.0 billion, and Behringer Harvard acquired IPC US REIT.

Acquirer	Target	Ann. Date	Size	Sector
The Blackstone Group	Hilton Hotels Corporation	July 3	\$26.0 B	Hotel
Behringer Harvard REIT	IPC US REIT (Canadian)	August 14	\$1.4 B	Office
Liberty Property Trust	Republic Property Trust	July 24	\$900 M	Office

Sources: NAREIT, M3 Capital Partners, press releases.

DEBT ISSUANCE REMAINS SLOW

In 3Q 2007, REITs raised \$2.1 billion of unsecured debt, a slight increase of \$30 million, or 1.4%, compared with the second quarter. Even with this increase, debt issuance activity remained extremely slow compared with both 3Q 2006 and the quarterly average since 2003, declining 75.5% and 49.1%, respectively. Volume was constrained by the shockwaves that swept through most global debt markets during the summer, following the upheaval in US subprime debt.

Debt Financings (\$M)

	2003	10-Yr	2004	10-Yr	2005	10-Yr	2006	10-Yr	2007	10-Yr
	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹	Debt Treasury ¹
1Q	\$4,107	3.93%	\$5,575	3.84%	\$4,139	4.43%	\$5,375	4.65%	\$9,320	4.59%
2Q	2,155	3.60%	2,264	4.59%	3,832	4.10%	3,800	5.11%	2,070	4.66%
3Q	990	4.08%	4,746	4.35%	2,179	4.16%	8,580	4.87%	2,100	4.63%
4Q	2,432	4.26%	4,371	4.07%	5,052	4.52%	5,290	4.57%		
Year	\$9,684		\$16,956		\$15,202		\$23,045		\$13,490	

¹ Average interest rate for 10-year US Treasuries at time of debt offerings for the applicable period.

Sources: NAREIT, M3 Capital Partners.

PUBLIC EQUITY MARKETS SLOW, REITS RECOVER

Growth in the public equity markets continued, albeit at a slower pace than in the second quarter, as the S&P and NASDAQ finished up 1.6% and 3.8%, respectively. Meanwhile, the MSCI US REIT Index recovered somewhat from a dismal second quarter performance by posting a 2.4% gain in the third quarter. Exceptional growth late in the quarter produced this overall gain for REITs, as the MSCI US REIT Index increased by almost 14% in the last six weeks. Year-to-date, the public equity markets have posted strong returns, with the S&P and NASDAQ up 7.6% and 11.8%, respectively, while public REITs have declined 4.2%, still trying to recover from several months of weak performance earlier in the year.

	2003	2004	2005	2006	1Q 2007	2Q 2007	3Q 2007
MSCI US REIT	36.7%	31.5%	12.1%	35.9%	3.4%	-9.6%	2.4%
S&P 500	26.4%	9.0%	3.0%	13.6%	0.2%	5.8%	1.6%
NASDAQ	50.0%	8.6%	1.4%	9.5%	0.3%	7.5%	3.8%

Source: Bloomberg.

COMMON EQUITY ISSUANCE STALLS

REITs raised only \$594 million of public common equity during the third quarter, the lowest quarterly level since 1Q 2003. This result also marked a decrease of more than 75% compared with the amount of common equity raised during both the previous quarter and the same quarter a year ago. Common equity issuance volume during 3Q 2007 was less than 23% of the average quarterly public issuance volume since 2003. While there were no IPOs in the first three quarters of 2007, DuPont Fabros Technology made its debut in October. This precipitous drop in public equity issuance by REITs has been driven by the rapid decline in REIT share prices between February 7 and August 15, when the MSCI US REIT Index fell more than 25%.

Common Equity Raised (\$M)

	2003	2004	2005	2006	2007
1Q	\$123	\$3,913	\$1,166	\$3,655	\$2,830
2Q	2,502	1,706	2,123	2,590	2,462
3Q	2,767	2,810	3,363	2,449	594
4Q	1,731	3,244	2,100	7,050	
Year	\$7,123	\$11,673	\$8,752	\$15,744	\$5,886

Sources: NAREIT, M3 Capital Partners.

WASHINGTON, DC FOCUS HEADLINES JV ACTIVITY

Several notable co-investment ventures were formed during 3Q 2007. Two of the larger ventures involve investment activity in the greater metro area of Washington, DC. The JBG Companies formed a venture with MacFarlane Partners and a fund managed by Morgan Stanley Real Estate to develop or renovate a 93-asset portfolio including office, retail, hotel and multifamily projects; JBG expects the JV to be roughly \$10 billion upon stabilization. Liberty Property Trust formed a \$2.2 billion venture with the New York State Common Retirement Fund to assemble a portfolio of office properties in northern Virginia and the District of Columbia, seeded with \$900 million of office assets from its purchase of Republic Property Trust.

Operator	Institutional Investor	Size	Sector	Venture Type
The JBG Companies	MacFarlane Partners/ Morgan Stanley	\$3.7 B	Diversified	Development/ Redevelopment
Liberty Property Trust	New York State Common Retirement Fund	\$2.2 B	Office	Existing Asset/ Acq./Dev.
Lexington Properties Trust	Inland American Real Estate Trust	\$1.4 B	Diversified	Existing Asset/ Acquisition
Shriram Properties (India)	Walton Street Capital/ Starwood Capital Group Global	\$1.2 B	Integrated Township	Development

Sources: The Wall Street Journal, SEC filings, M3 Capital Partners, press releases.

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CHICAGO
One North Wacker Drive
Chicago, Illinois 60606
Telephone +1 312 499 8500
Facsimile +1 312 499 8585

LONDON
Equitable House
47 King William Street
London, England EC4R 9AF
Telephone +44 (0) 20 7280 3600
Facsimile +44 (0) 20 7280 3601

NEW YORK
630 Fifth Avenue, 32nd Floor
New York, New York 10111
Telephone +1 212 582 7210
Facsimile +1 212 582 7211