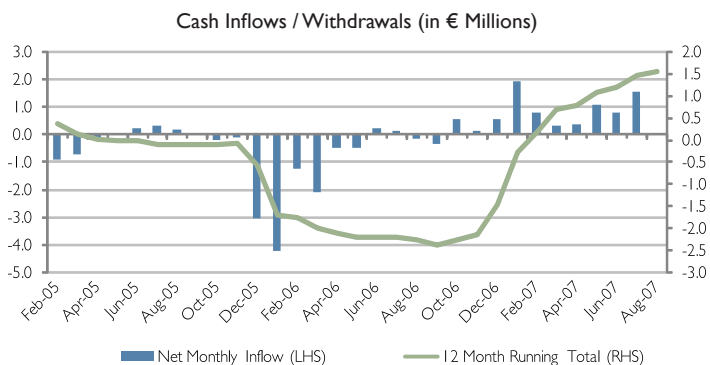


German Funds Make a Comeback; UK Property Companies Regroup

GERMAN OPEN-END FUNDS RE-ENTER THE MARKET

German open-end funds (GOEFs) have made a strong return to the market this year as investors regain confidence in the real estate sector. Net cash inflows to GOEFs reached €6.9 billion over the first eight months of 2007, in contrast to domestic bond and equity funds, which saw net withdrawals of €11.2 billion and €15.8 billion, respectively. GOEFs completed €3.9 billion in European cross-border purchases in the first half of 2007, representing a three-fold increase over the same period last year. With the majority of portfolio restructurings and sell-offs behind them, GOEFs have become active buyers, albeit with new target geographies. As funds look to diversify further into Europe, investment focus has shifted away from the large office markets of London, Paris and Stockholm to the less developed markets of central and eastern Europe.

It is expected that higher lending margins and lower loan-to-value ratios will continue to squeeze out highly leveraged investors and transfer the competitive advantage to GOEFs, who typically borrow only a small portion of the purchase price of an asset.



Sources: CBRE Market Index, Financial Times, Property Week, BVI.

UK PROPERTY COMPANIES UNDERTAKE STRATEGIC REVIEWS

Stock prices of UK property companies continued to fall in the third quarter. The retreat from real estate within the public markets has driven the prices of some companies down 20%-30% from their winter peaks, with REITs now trading at discounts of up to 34% from NAV. Global fears that the property cycle is peaking have also resulted in a slowdown in the direct market, which has seen 85 commercial property transactions executed in the UK this month, down from an average of 125 per month in the previous half-year.

In response to this market malaise, several UK property companies are undergoing internal business reviews so as to position themselves for a continued downturn. Land Securities is reported to be considering a break up of its London office portfolio, retail business and £1 billion outsourcing arm Trillium, while British Land has begun a £250 million share buyback program and has been trying to sell a majority stake in its £1.7 billion Meadowhall shopping centre. SEGRO continues to increase its exposure to development and recycle capital in the UK, whilst growing its portfolio in continental Europe.

Another strategy being considered by property companies – particularly sector specialists – is one already adopted by groups such as Grainger and UNITE, who have developed an investment management capability by spin-

ning off portfolios of their stabilised properties into funds. This allows them to redeploy the released capital for investment in higher return strategies while receiving a stable income from asset management fees.

Sources: Financial Times, RICS, M3 Capital Partners.

UK SHOPPING CENTRES FOCUS ON RENTAL GROWTH

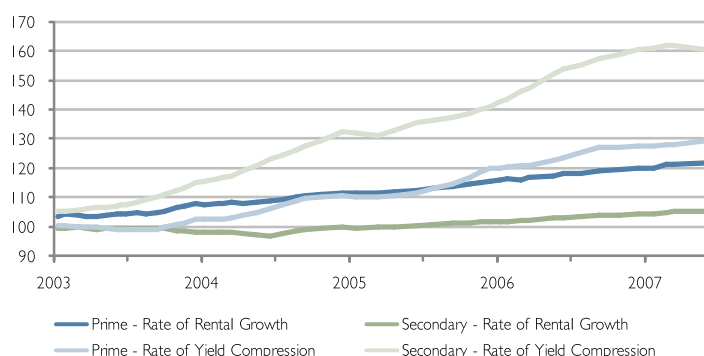
Capital values of shopping centres located in secondary markets in the UK increased by 9.8% per annum between June 2002 and June 2007, significantly higher than the 5.6% annual rise for assets located in prime markets. However, annual rental growth over the same period was 3.7% in the prime locations but only 1.1% in the secondary markets, clearly demonstrating the impact of yield compression on the latter.

Demand for shopping centres in secondary locations has been largely driven by debt-backed buyers, and as such, yields in those markets have begun to rise as a correction within the sector takes place. The market is once again recognising the risk inherent in secondary locations. As such, the yield differentiation versus assets in more desirable locations has reverted back to historic levels of more than 100 basis points.

As the rising cost of borrowing has impacted market pricing, investors have begun to focus on rental growth as the primary driver of value. As a result, and in light of increasing selectivity by tenants, products of an unsuitable size, configuration or location are expected to underperform.

A number of large transactions have taken place during 2007, including the formation of the Westfield UK Shopping Centre Fund, Liberty International's sale of a 40% stake in the MetroCentre (Gateshead), and Hamner's sale of a 50% stake in West Quay (Southampton). It would appear that demand remains robust for prime UK shopping centres where rental growth projections can be underwritten. This is particularly the case from overseas institutional investors who have had to wait until property companies were able to reduce their CGT liabilities on centres held for many years before they were willing to transfer ownership positions to third-party capital. It is anticipated that investor interest will continue to focus on desirable locations as well as strategies conceived toward urban revitalisation and providing retail amenities.

Prime vs Secondary Locations for Shopping Centres
Yield Compression and Rental Growth
2003-2007



Sources: Colliers CRE, CBRE, IPD, Jones Lang LaSalle.

M3 CAPITAL PARTNERS IS A GLOBAL INVESTMENT BANKING AND ADVISORY FIRM SPECIALISING IN RAISING PRIVATE EQUITY FOR REAL ESTATE OPERATING COMPANIES AND FUNDS, AND DELIVERING STRATEGIC FINANCIAL ADVISORY SERVICES TO ITS CLIENTS.

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