



# Market Commentary

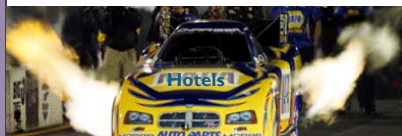
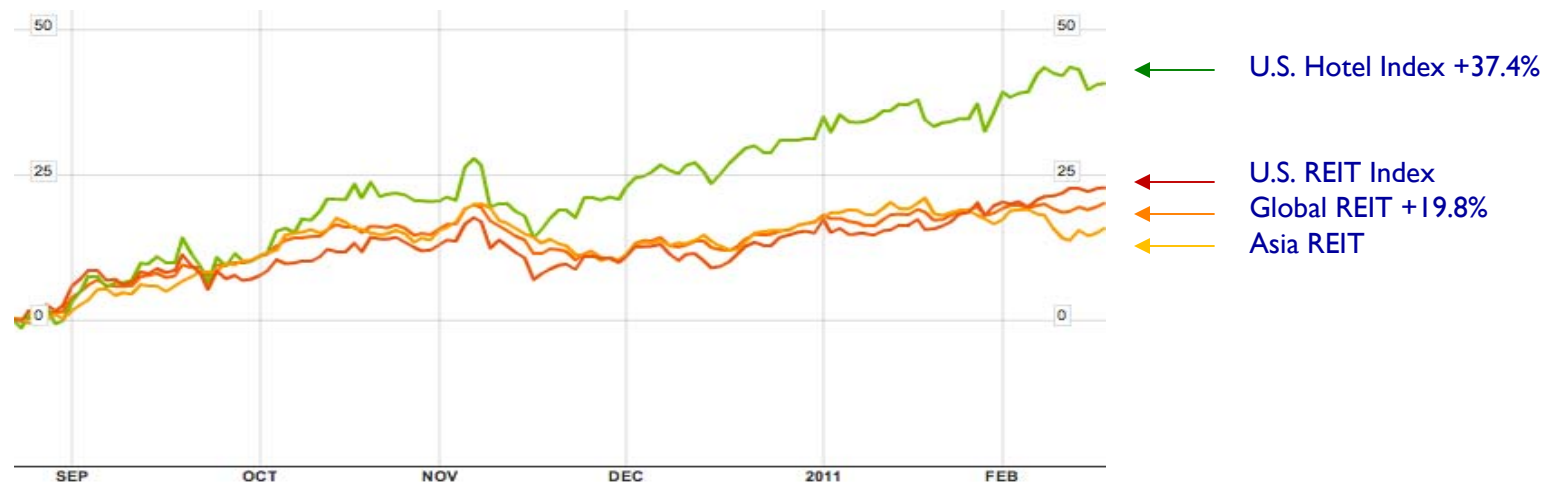
February 18, 2011

HIGHER on fundamentals, +2.32% YTD Feb 16. This pace for +19% in 2011 seems too optimistic. The Global REIT index climbed again after a great year '09 and '10 as global economic conditions improved, securities and direct property values performed well. U.S. and Hotels performed best, Asia's more interesting. We have been overweight U.S. and hotels for much of 2010 adding income securities in December to dampen potential volatility. The U.S. REIT index was +27.95% for 2010 while the European RE index was up 8.42%. Hotel occupancy rates and performance has recovered well in 2010 globally. Hotel RevPAR in NYC for late December was +2.6%, Boston +12.9%. RevPAR in Europe (in EUR) for November was +15.4% year over year and pricing power seems to be intensifying in major cities globally.

Cap rates and RE dividends are thin but 6-7% dividends are still available in liquid securities, CBD has vastly outperformed suburban. Since we discussed the Buy opportunity in March 2009, the Global RE index is up over 100% and broader markets are above levels pre-credit crisis. There continues to be a dearth of Direct Property opportunities for Private Equity RE Funds in top global markets. Buyers will be forced beyond top markets.

Global RE index +20.40% for year 2010 **+2.83 % YTD Feb 17**, with Hotel Sector outperforming

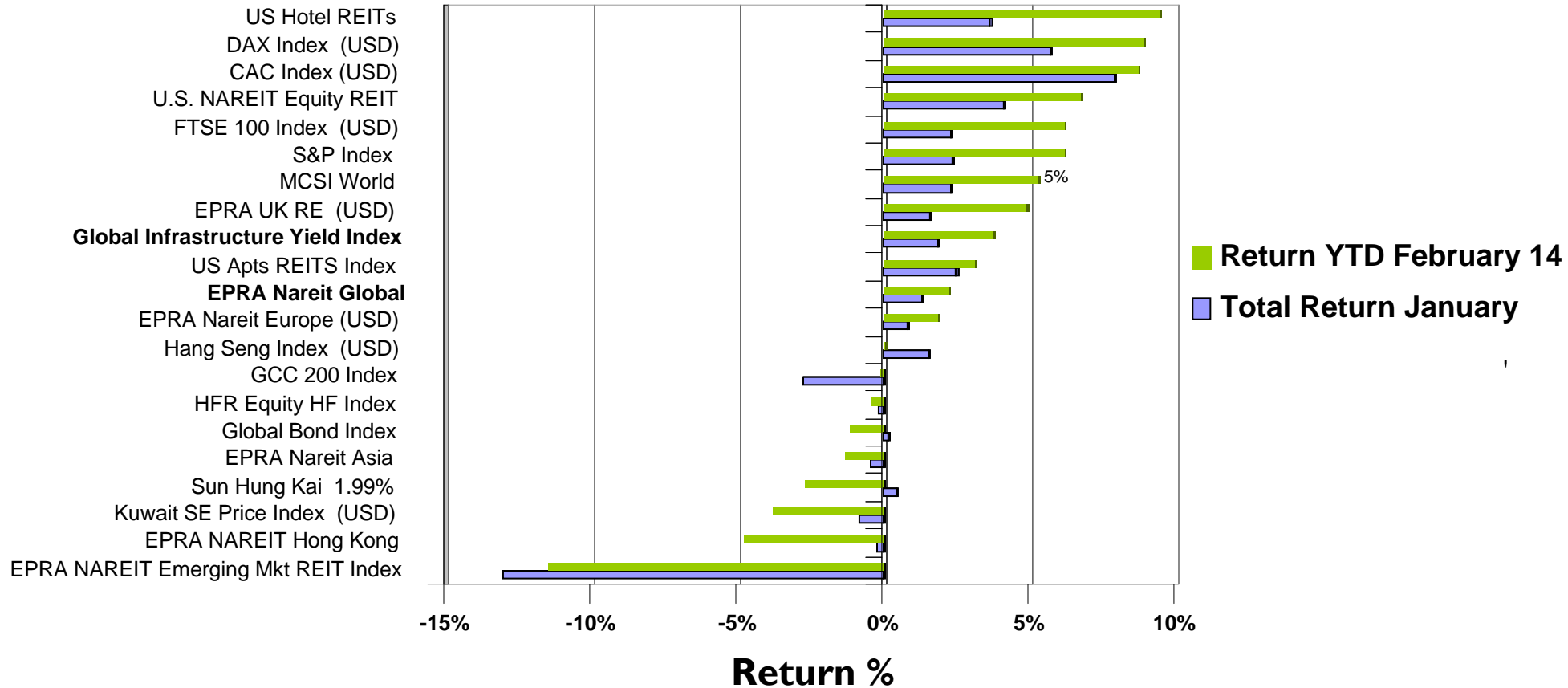
**Global RE Indexes 6 mo to Feb 17 2011**  
**% Return**



Hotel REITS  
 Rapid improvement

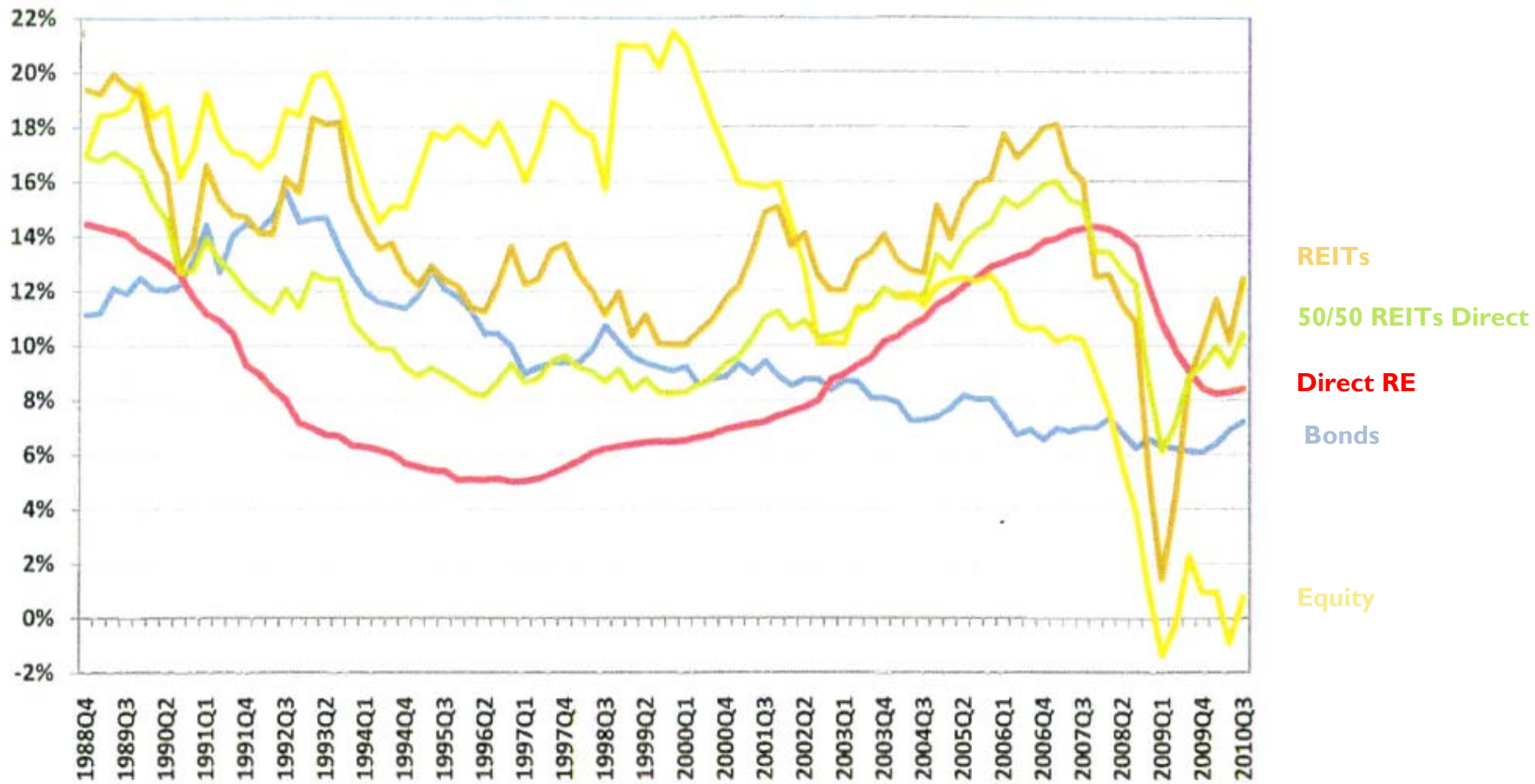
# Good news... RE securities up nicely in '11

**Global REITs +2.83% YTD February 17**



# A look at Synchronicity and allocations...

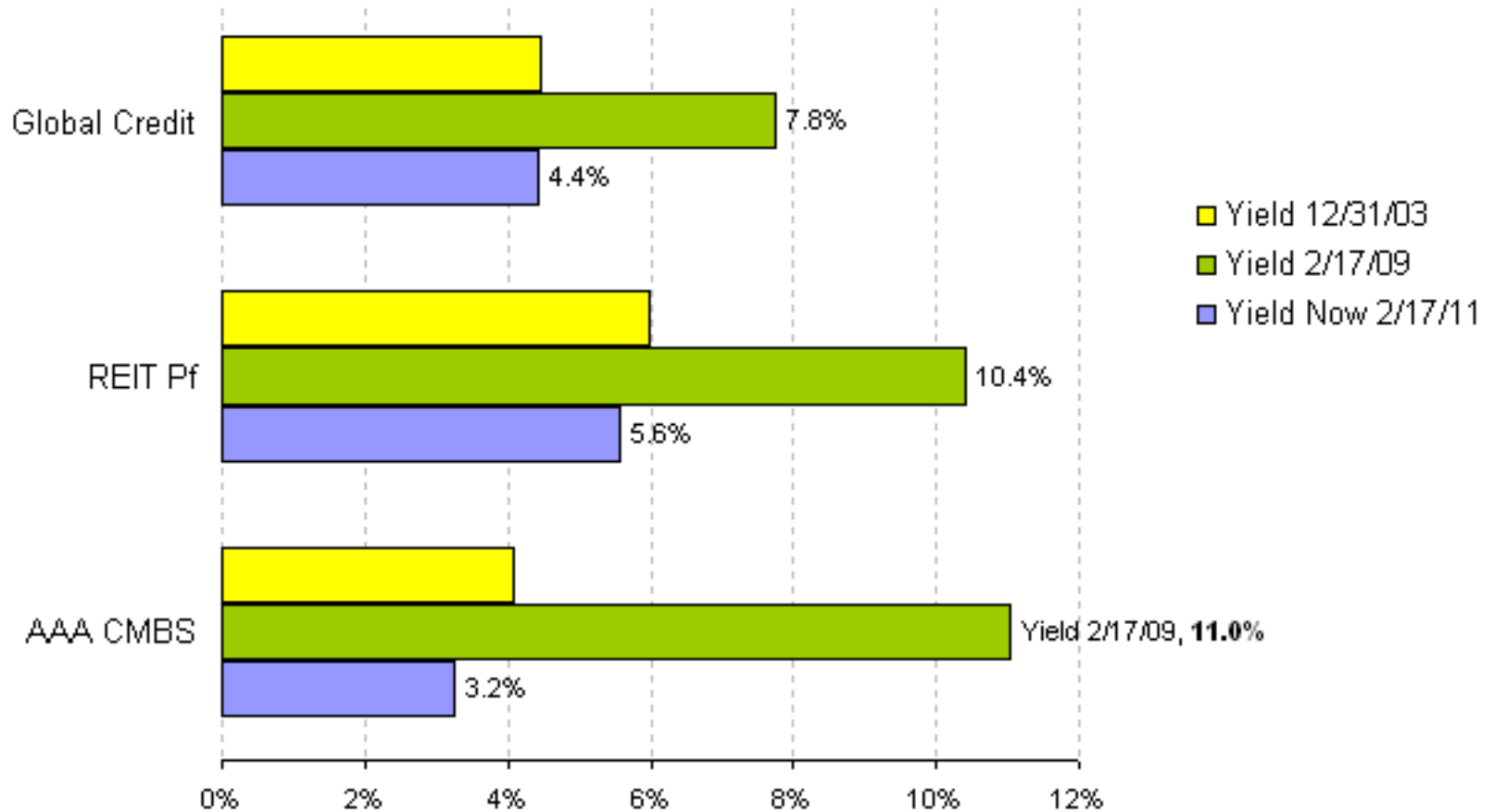
## Target return assessment



10 year Rolling Returns for Various Asset Classes

# Structured Finance is the foundation for Credit supply to Real Estate

Spreads have improved, Significant investor demand for Yield now

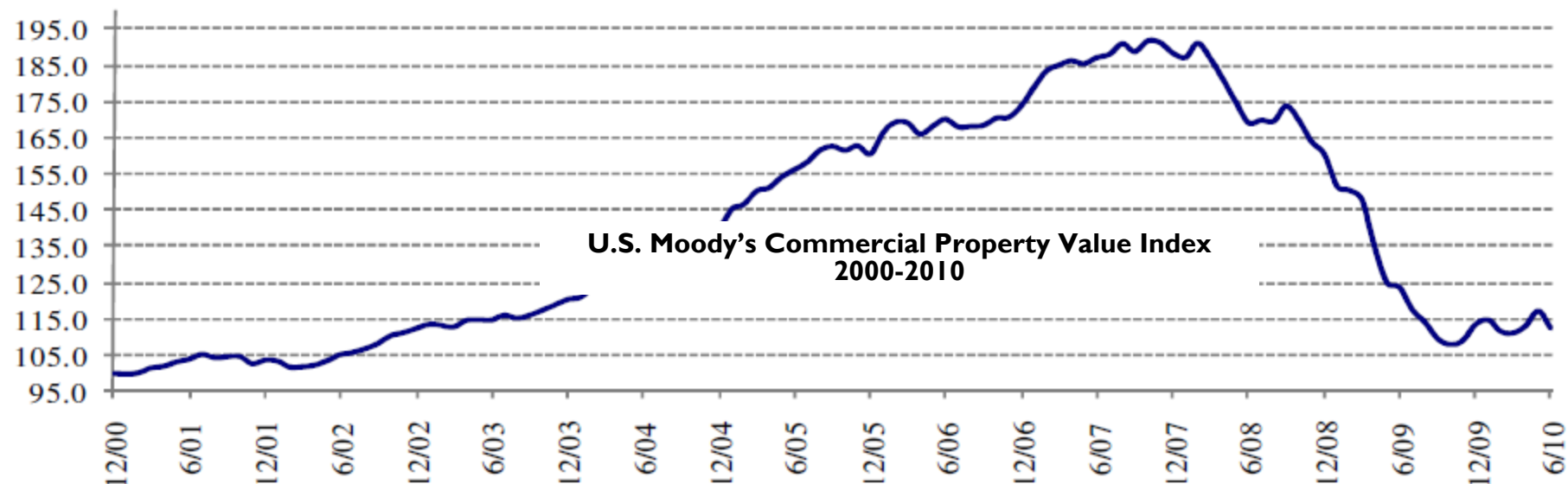


Yielding securities tighter, but 6% is available

# Global REIT returns...

**+116.5% from 3/31/09 to 1/31/11**

**not so strong for Direct Property Values, -24.3%**



**U.S. CAP Rates for CBD Office Bldgs  
No bargains like in 2009**



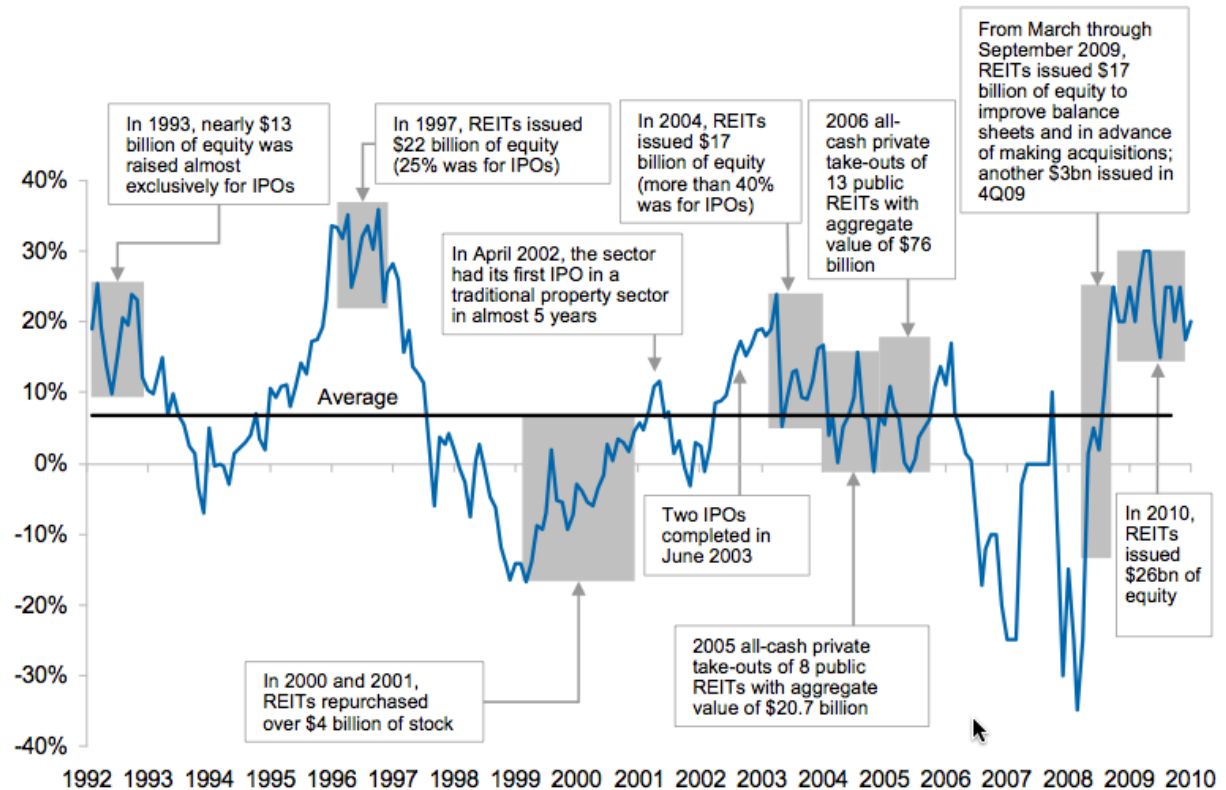
\*Source: Moodys, RCA

# U.S. REITs near peak premium to NAV... Apt Reits now 5% Cap\*\* as global investors buy the yield and stability

**U. S. REIT Premium (Discount) to NAV\*  
1992-2010**

**Premium (Discount) to NAV\***

<b>U.S. REITs</b>	<b>+20%</b>
<b>Europe ex-UK</b>	<b>+7%</b>
<b>UK</b>	<b>-7%</b>
<b>JREOC</b>	<b>-21%</b>
<b>JREITs</b>	<b>+10%</b>
<b>China REOC</b>	<b>-22%</b>
<b>Hong Kong REITs</b>	<b>0%</b>
<b>Hong Kong REOC</b>	<b>-18%</b>



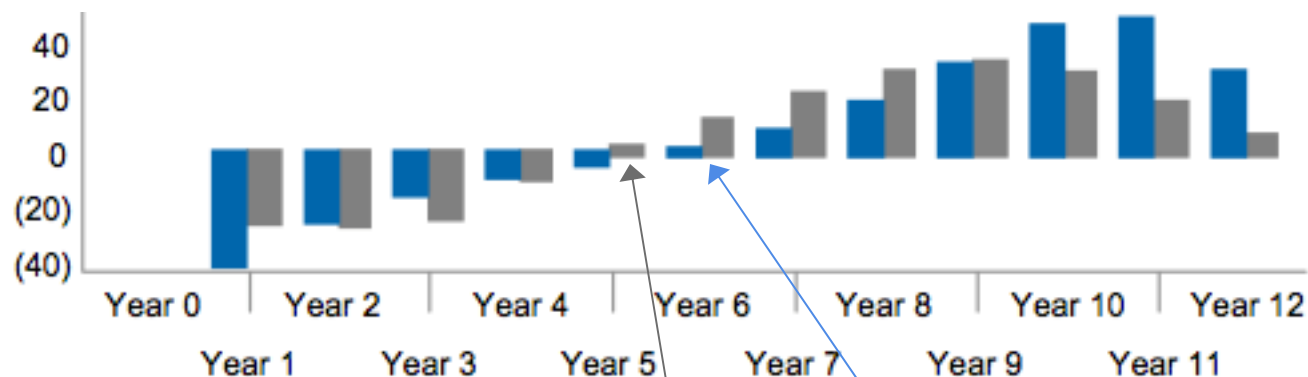
\*Source: Green Street, Morgan Stanley 2/10

\*\* CSFB Covered

# RE and Infrastructure: decisions today constrain decisions tomorrow

## Private Equity blind pools, Direct, or Public...

**J- Curve Views**  
Private Equity RE and LBO funds\*



Solutions to recent breakdown in the “Yale” model:

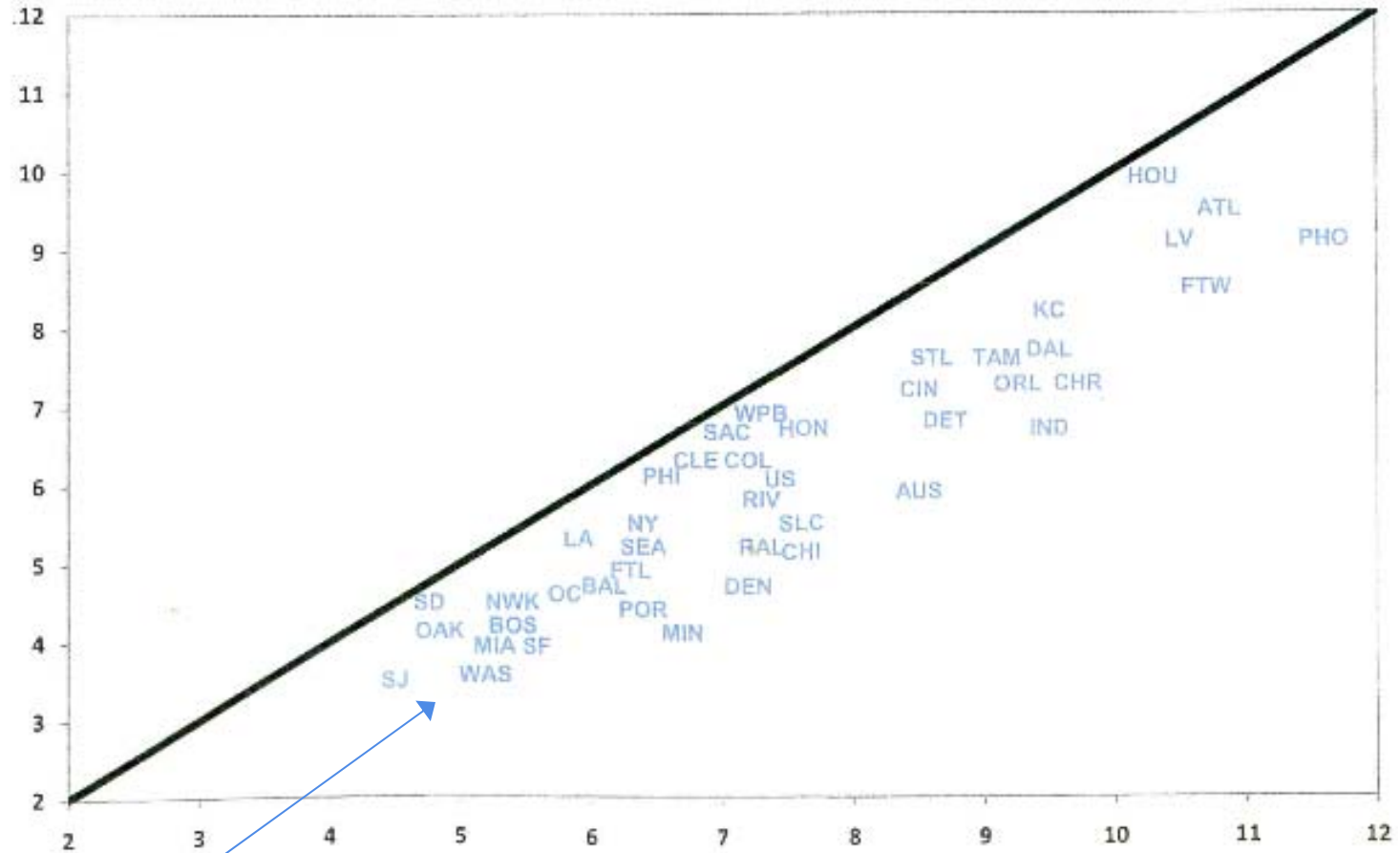
- fund changes
- public allocation
- direct
- co-invest
- CIO/CFO partnership

PE LBO CF positive

PE Real Estate Funds CF positive

# Direct RE has performed well...

occupancy improving, but growth? Look at infrastructure



Vacancy Q4 2010 lower than Q4 2009 all major markets

Strategia favorite has been... DC

# Trade Flows up Sharply from 2009...

## look at Industrial RE sector and Hotels



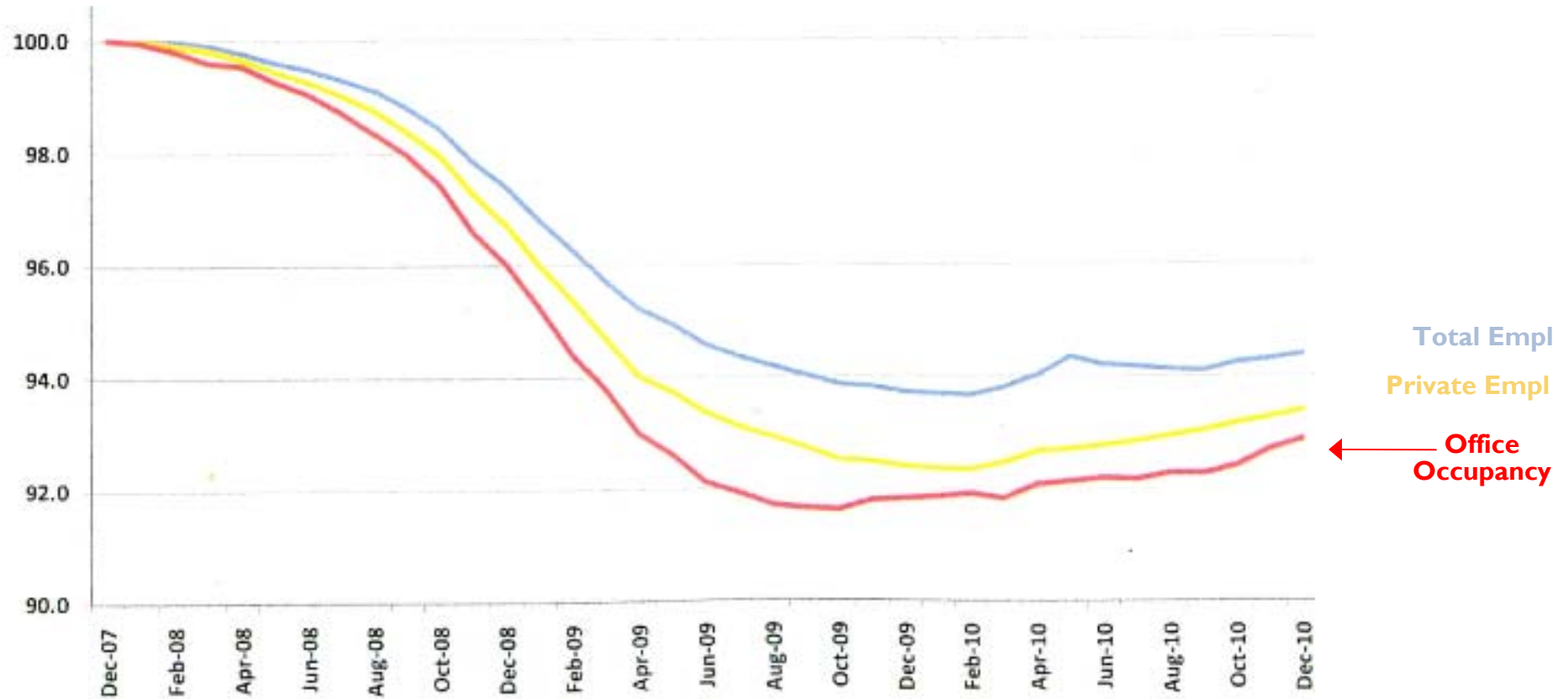
YOY real change in Exports/Import of Goods

Exports

Imports

# Employment “flat-lining” from 2009...

## look at Healthcare real estate sector



Employment and Office occupancy since 2007 “peak”

# Real Estate has done well in China...bubble situation?

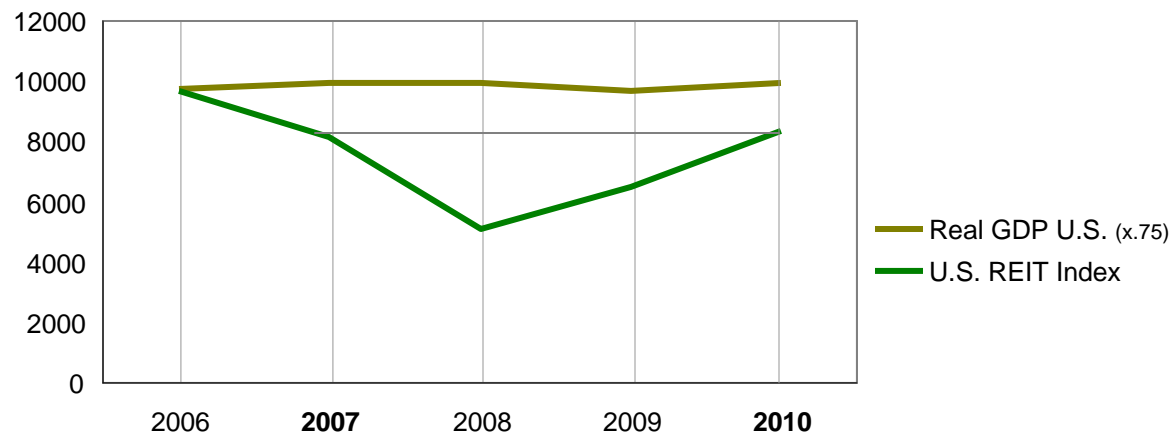
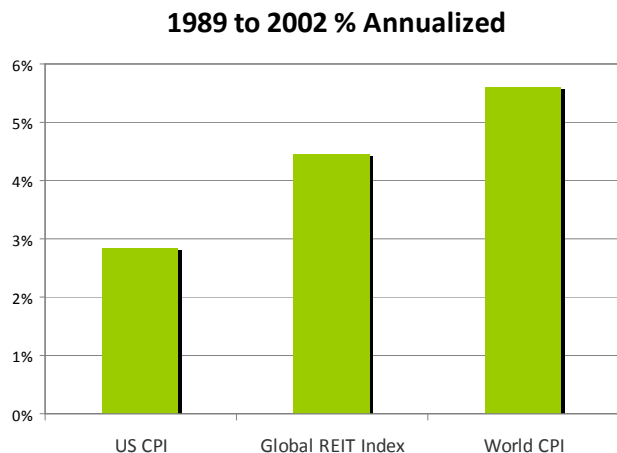
Recently, Hong Kong property stocks fell after a report showed China's non-food consumer prices rose in January by the most in more than 6 years and the State Information Center said the nation may increase interest rates again. China's CPI rose 4.9% in January (yoy) which missed estimates of 5.4%. This however is a large increase and is leading some investors to believe that as China continues to tighten to counter inflation, they will burst property values.

Interestingly, the resilience of the mainland Chinese and Hong Kong property markets suggests that the impact of the well-publicized measures taken by the Chinese government to try and cool developments in the real estate sector has been limited. In mainland China, both tenant demand and rental expectations posted strongly positive net balance scores, +57 and +67, respectively, while in Hong Kong, rental expectations rose to +88 from +70 last quarter. The Hong Kong government has become more concerned about combating asset inflation and speculation in the residential sector yet the current upward cycle is being led by solid end-user demand. In the year ahead, capital values are expected to remain firm on the back of low interest rates, high liquidity, supply shortage and a forecast of positive GDP growth 5% to 6% in 2011.

HK remains the 3<sup>rd</sup> most expensive overall residential market in the world; Home prices increased 20% in 2010. In January alone, overall **rents were up 11.5%** (yoy) and the Real Estate agency forecasts another 11%% increase in rents are to come in 2011. The HK property market seems like an ample investment opportunity. Demand is strong and property investments are inflation protected. With inflation, rents and demand rising and a measured supply, investors expect to make high returns in the Asian RE markets. There is as much talk about both an Asian property bubble and high potential returns. The heating up of the Asian market poses a great risk. If the Chinese are not able to cool their property market, we expect that there is a tipping point in the future. It is a matter of timing.

We however expect that the real estate market will grow in 2011, and see 2012 to be a cooler growth year with a potential of a bubble bursting.

# A Macro look...



**Inflation? RE and Infrastructure do well**

**Economy: GDP above '07  
REIT double dip" unlikely**

Country	Real GDP YoY	Unemployment
China	9.6%	
Brazil	8.8%	
India	8.8%	
Indonesia	5.8%	
Canada	4.1%	7.9%
Germany	3.7%	7.5%
United States	3.1%	9.6%
United Kingdom	2.8%	7.7%
Japan	2.4%	5.0%
Eurozone	1.9%	10.1%
France	1.7%	10.0%

**Economies ok, credit crisis over, but other concerns have risen**

# Real Estate returns before and after...

## Forensic look at a large Office property acquired by a non-U.S. Investor

	August 2007	2010	Gain (loss)	
NOI	\$ 34,850,000	\$ 30,668,000	-12%	← NOI slightly lower, -12% 2007 to 2010
Vacancy	15%	30%		
Net Op Income per sf	\$ 21	\$ 18	-12%	
Size sf	1,700,000	1,700,000		
Cap rate vs original cost	4.1%	3.6%	-12%	← CAP Rate widened slightly to 6.6%
Cap vs "current" value		6.6%		
Price/sf	\$ 500	\$ 272		Mezz investor lost 40%
Value	\$ 850,000,000	\$ 462,317,073	-46%	
NOI drop		(4,182,000)		Equity Gone 100% Loss if 70% debt
Price multiple vs NOI	24	15		
Loss if were "all cash" investo	-46%			
Actual Loss to Mezz Lender	-41%			
new Mezz price/LTV		82%		

# If Private Equity funds are chasing too few deals with **TOO MUCH** Capital,

## why not add **Income?** + **Liquidity**

Strategia bought for client, 6.7% cash flow in Q4  
TRR 12/9 to 2/18 +18.9%

*Good time also to add a Real Asset allocation to more global infrastructure*

*Bids are propping up prices for core and distressed assets*

*a “Core” buyer paid 5.7% CAP just because he could borrow at 4.7%, not now*

*an “Opportunity” fund bought a bldg with a 4% Cap expecting to increase rent rates*

*Distressed investing **was** Great in 2009....*

*"The question is whether this opportunity still exists going **forward**" - NEPC May 2010*

**" Lack of supply is causing almost a feeding frenzy.**

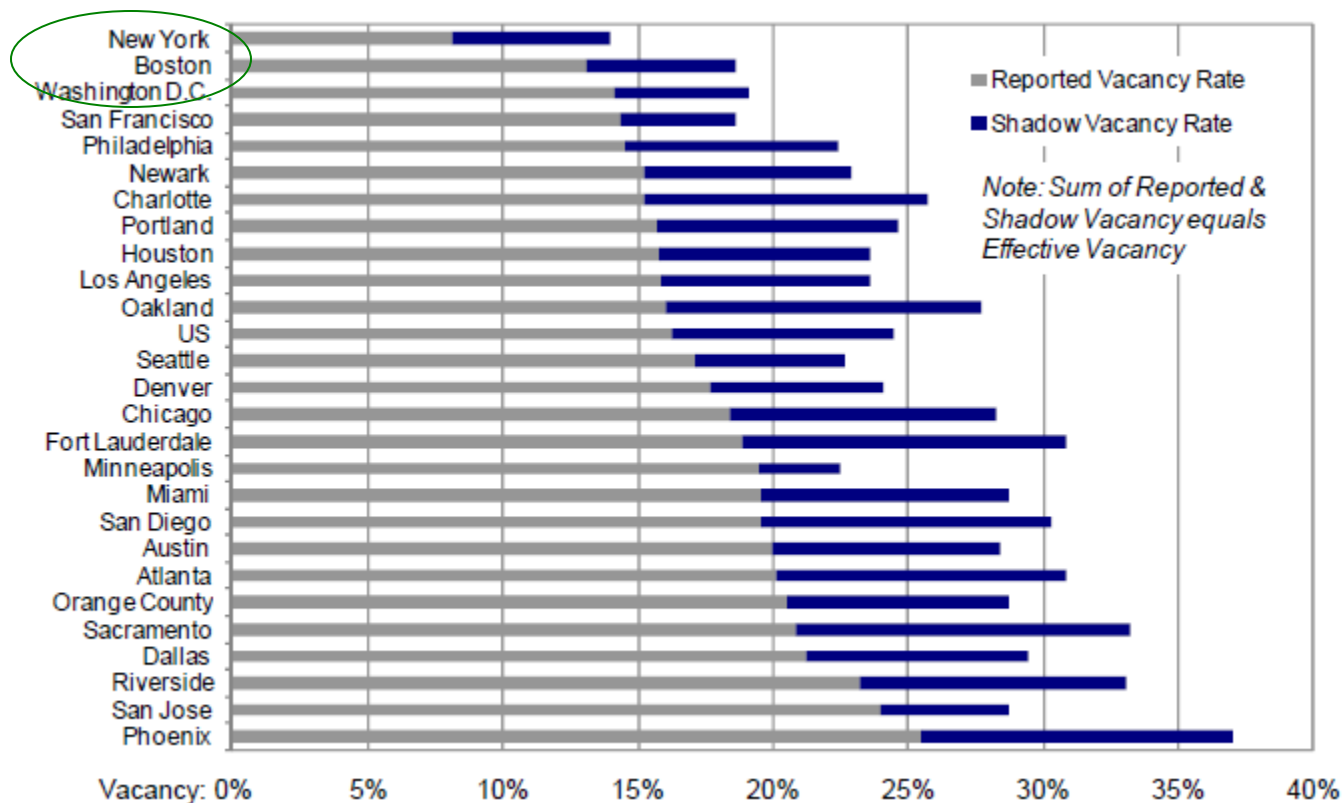
*People have real estate funds that are not on an*

*infinite time line – they need to put capital to work.” -Kava of Goldman Sachs*

**In 2009 we remarked... "now is the time"**

**to buy 100% occupied bldgs in NY, DC (our favorite based on risk/reward), Boston**

**DC Cap Rates have compressed from 8% to 6% Avg US Cap 6.3% values up sharply. EVERY major U.S. mkt has increased occ vs '09**



## **Good News:**

**Global Economy is ok, “double dip” to 2009 values is probably Impossible**

**Investor appetite for “current” Cashflow plus asset/ liability mgt may support valuations**

**If the “bubble” of bonds continues to burst, capital will flow to RE and Infrastructure**

**Rent is improving and demand for infrastructure is growing**

**Strategia’s largest allocation TRR +29.42% annualized 3/31/2008 to 1/31/2011**

## **Caution:**

**Top Market RE values are up sharply, monetary and fiscal uncertainty is growing**

**The resolution of over-leverage has in large part, occurred via foreclosures.**

**Interest Rates have risen sharply, Inflation will “squeeze” NOI, add to political risks**

We welcome Client questions and would like to discuss current opportunities.

Harry Milne

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