

Sunnier Days Ahead?



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The U.S. Commercial Property Market Today

- ▶ Transaction market coming back to life
- ▶ Yield compression continues for “flight to quality” core properties
- ▶ Deterioration in property market fundamentals slowing rapidly but NOI will not bottom for 12-18 months
- ▶ \$1.5 trillion of loan maturities (or defaults) still expected over the next few years
- ▶ “Extend and pretend” coming to an end?
- ▶ “Weak hand” owners unable to hang on much longer

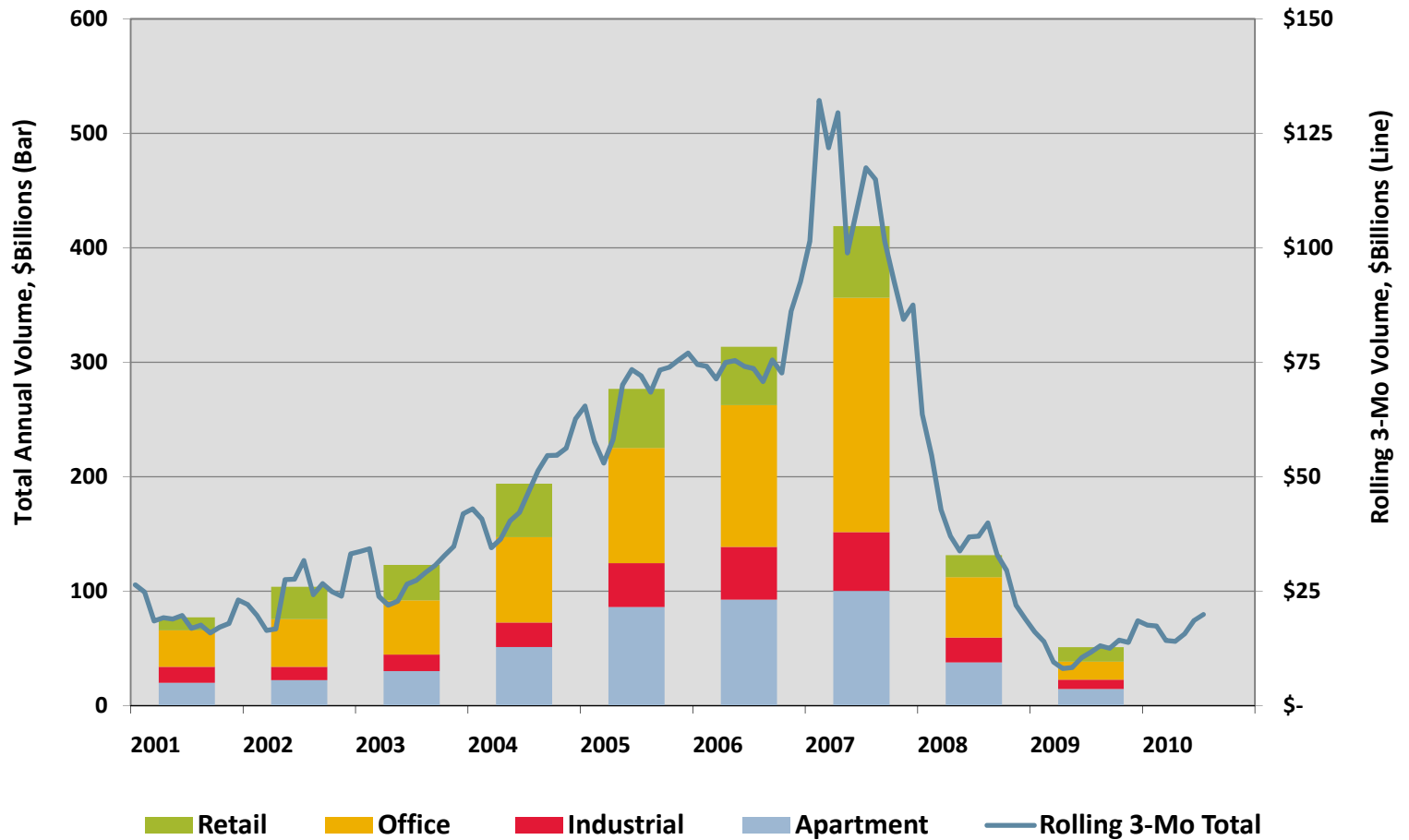
Transaction Market Improving From Low Levels

Transaction volume rising from depths of early 2009 but still at lowest levels of past decade

\$45.7 billion YTD through July 2010

Four markets account for 30% of all trades:
NYC, DC, LA and Chicago

TOTAL TRANSACTION VOLUME

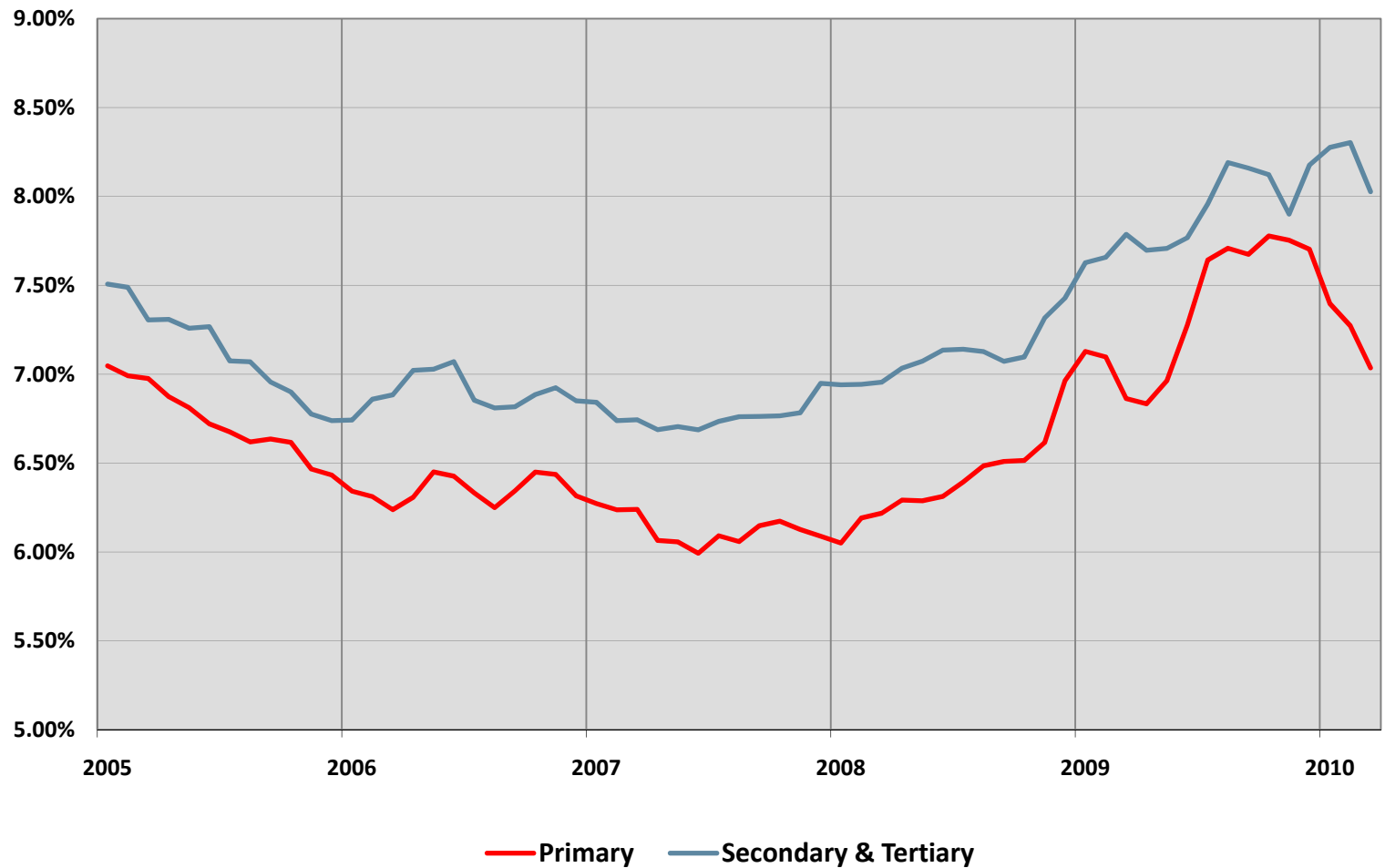


Source: Real Capital Analytics

Core Pricing Responds to a World Without Yield

Investor demand for high quality yield growing as rates stay low and spreads narrow

AVERAGE CAP RATE (%)



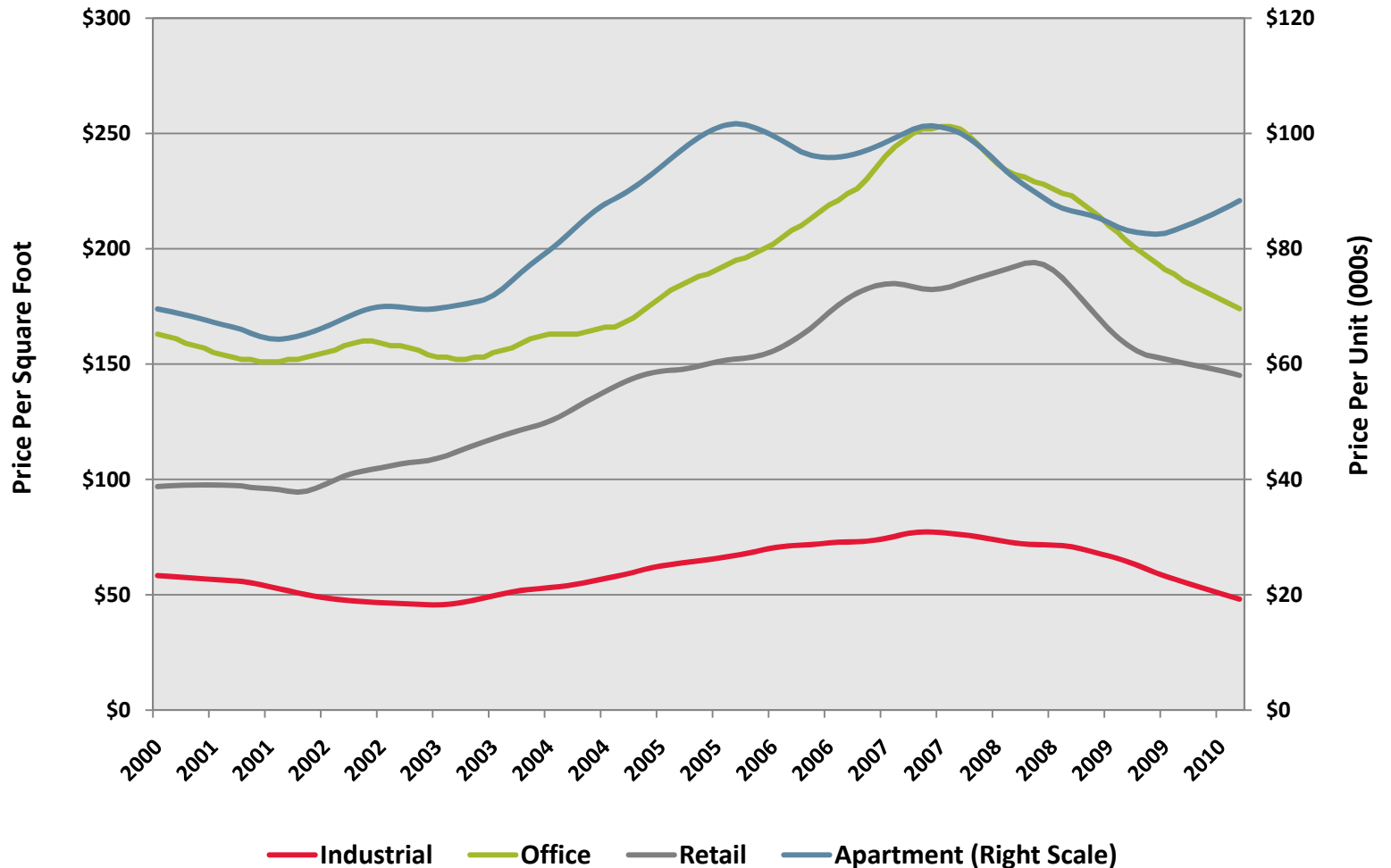
Source: Real Capital Analytics

Lower Cap Rates But Low Price Per Pound Too

Price per pound continues to trend down

Recent small increase in apartments reflecting favorable GSE financing and core buyer demand

PRICE PER FOOT/UNIT FOR PROPERTIES THAT TRADED



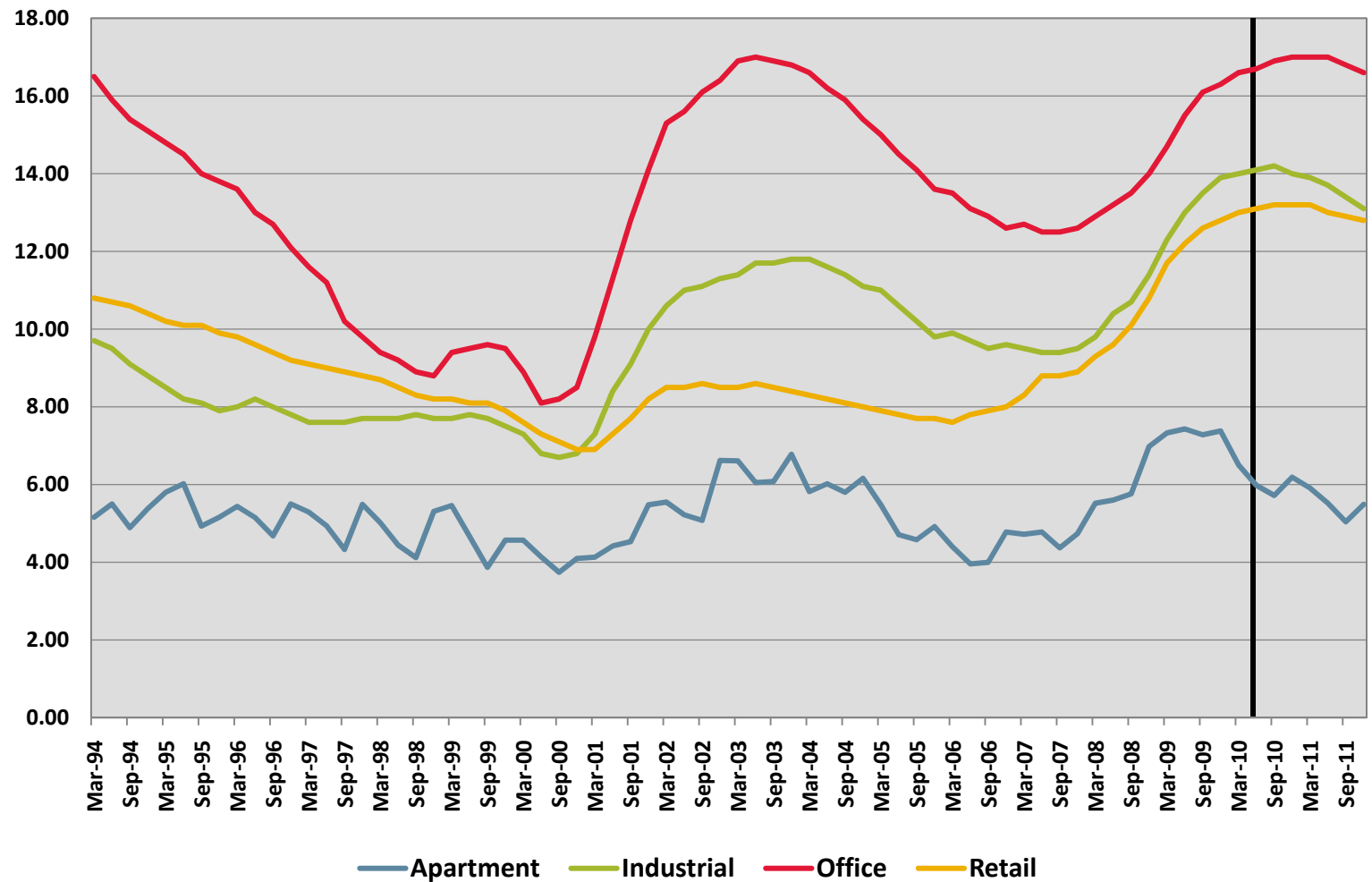
Source: Real Capital Analytics

Vacancy Rates Peaking

Hotel occupancy rates also bottoming now at all time low

Operating fundamentals stabilizing but NOI decline continues for some time

VACANCY RATE BY PROPERTY TYPE



Source: CBRE-EA (Torto Wheaton Research)

Aggregate NOI Bottoms in 2011/2012

Real estate is a lagging sector

NOI bottoms 12-36 months after GDP and jobs

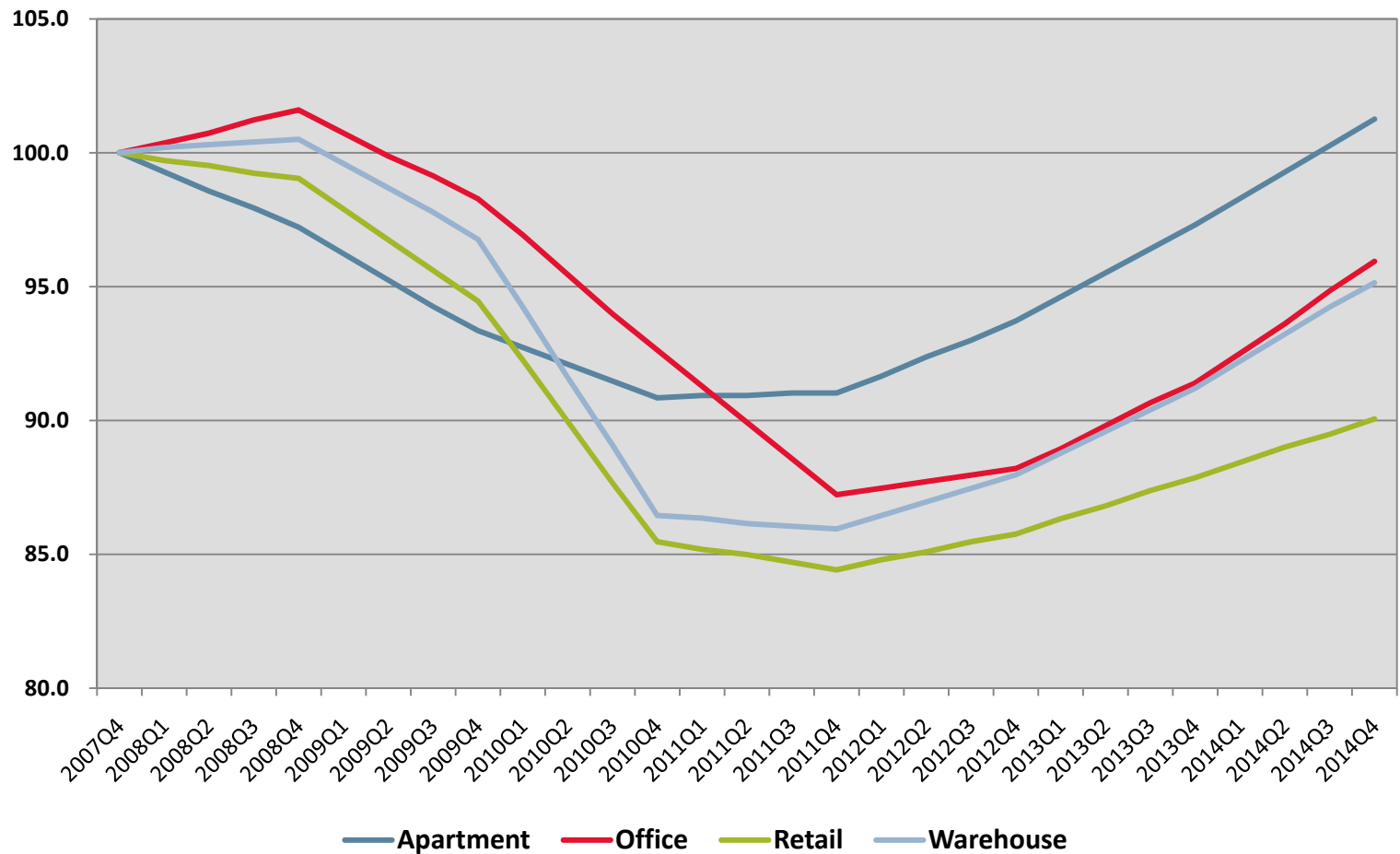
Jobs trail GDP

Occupancy trails jobs

Rents trail Occupancy

NOI trails Rent

PEAK-TO-TROUGH DECLINE IN PROPERTY NOI
INDEX 2007 Q4 = 100



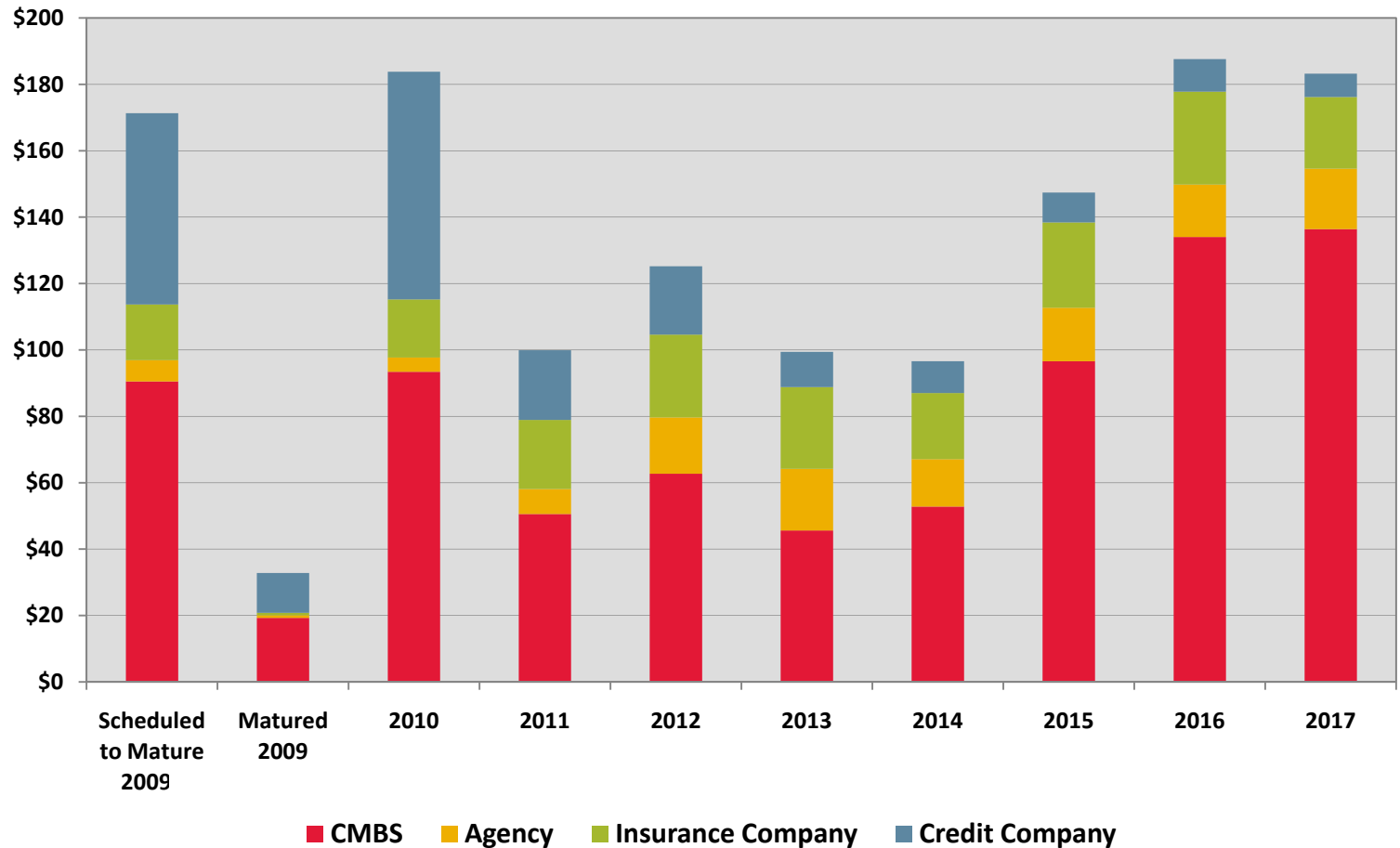
Source: P&PR

Deferred & Maturing Loans Hitting Right Now

Very few loans scheduled to mature in 2009 were resolved

Becoming more difficult to extend

NON-BANK LOANS, \$ BILLIONS

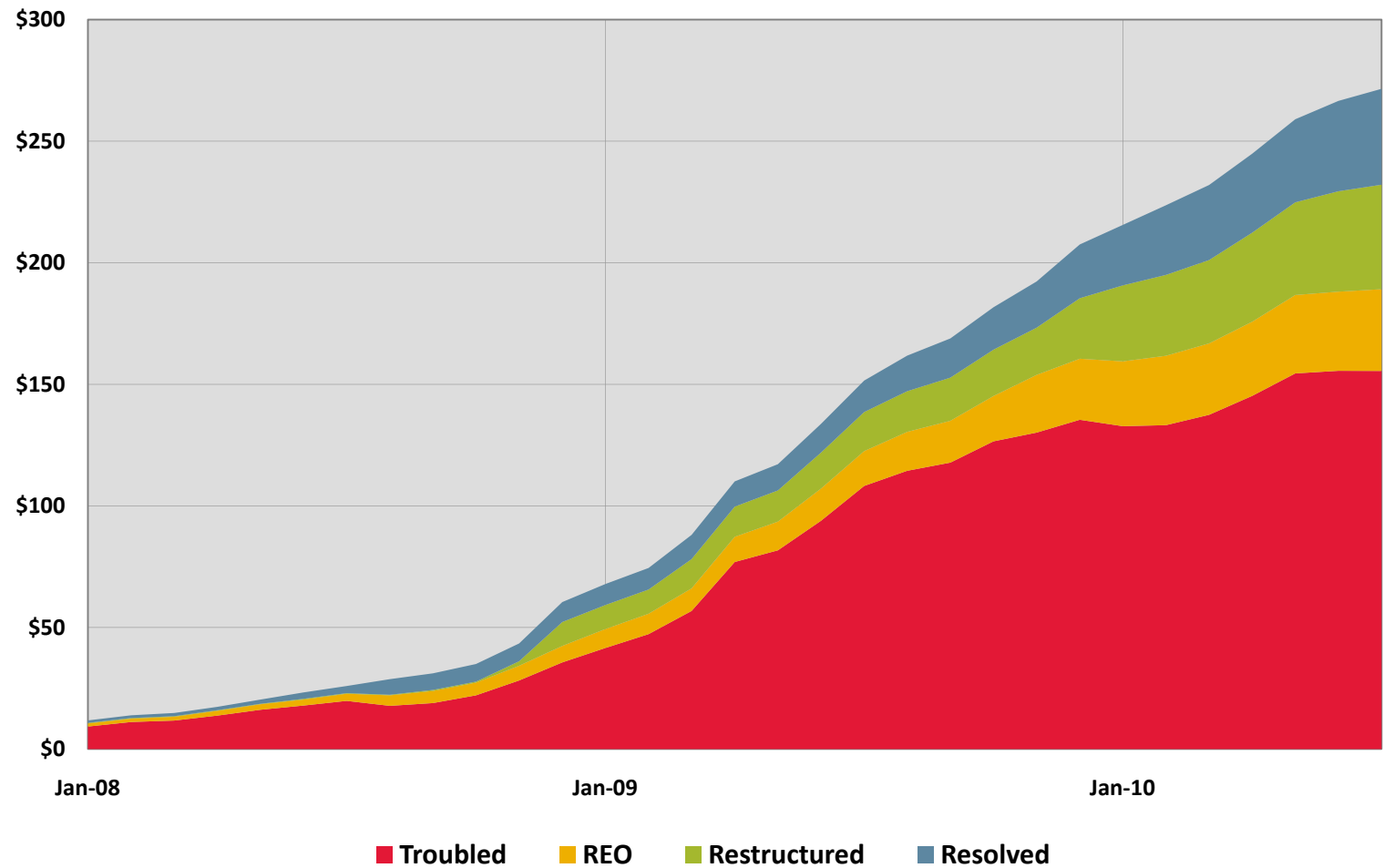


Source: Mortgage Bankers Association

Very Little Resolved So Far

Resolution of troubled assets accelerating but long way to go

TRBOULED ASSETS (\$ BILLIONS)



Source: Real Capital Analytics

The End of “Extend and Pretend”?

- ▶ Falling NOI forcing more properties into inadequate coverage
- ▶ Debt service coverage reserves burning off at accelerating rate
- ▶ Capital events (TI’s, leasing commissions) not being funded by “weak hand” owners
- ▶ Higher recovery rates giving lenders more courage to act
- ▶ What will the banks do? How long will the government let them defer the problem?



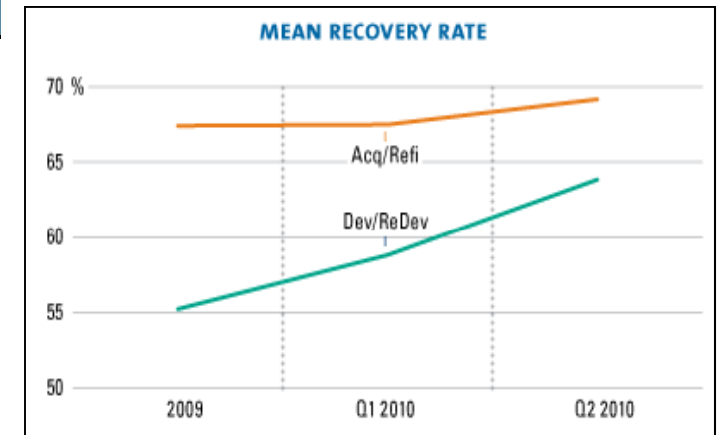
Great Variation by Lender

Across all lenders, 64% recovery rate on 2009 defaulted loans

Recovery rates improving during 2010 – particularly on development loans

RECOVERY RATES ON 2009 DEFAULTS

	Development Loans	Acquisition and Re-Fi Loans
CMBS		62%
Insurance Companies		79%
Regional/Local Banks	55%	73%
National Banks	53%	70%
Private Investors	32%	68%
Foreign Banks	60%	65%
Non-Bank Financial	58%	68%



Source: Real Capital Analytics

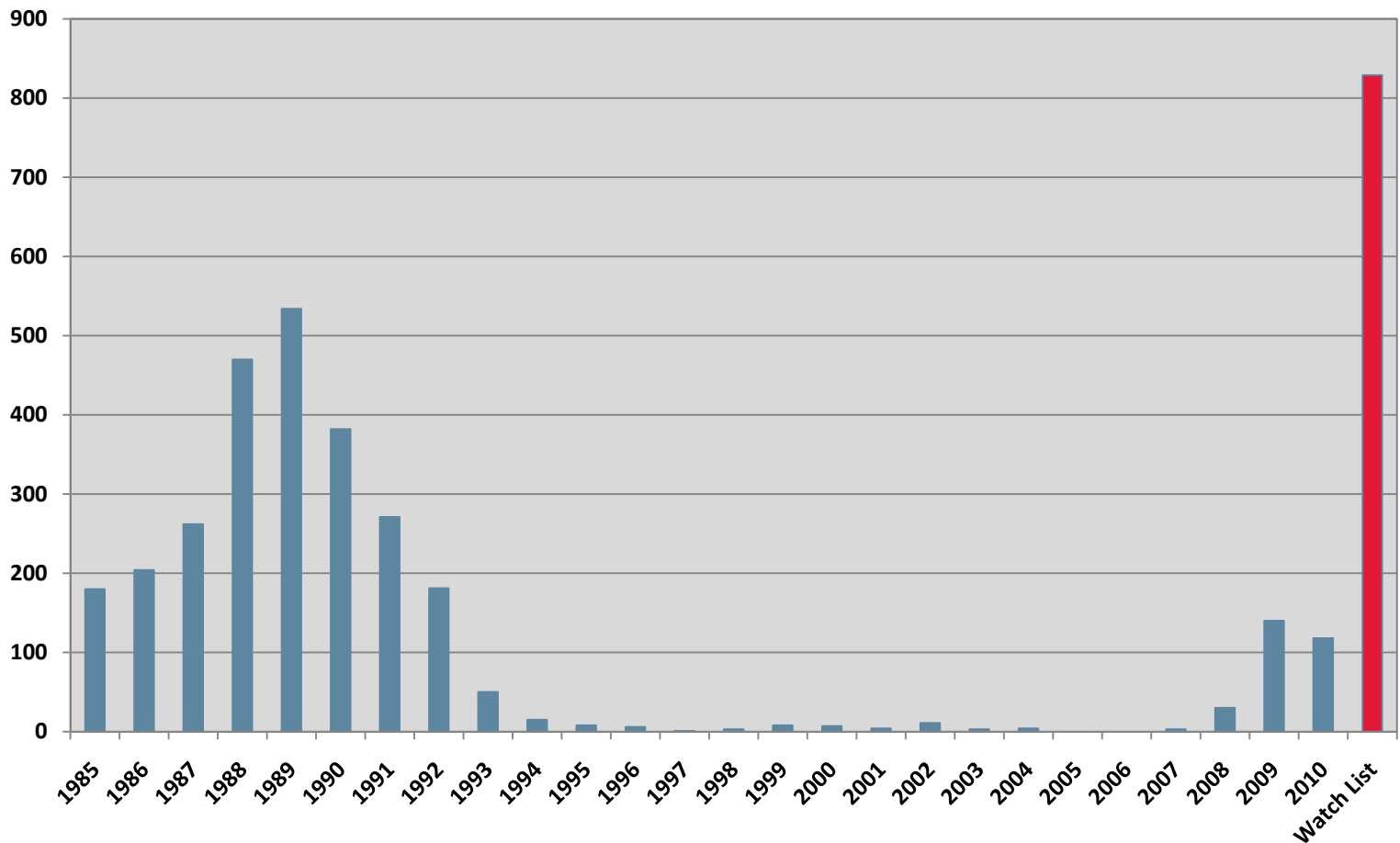
Weak Hands #1: The Banks

More than 800 banks on the FDIC "watch list"

FDIC reports nearly 3,000 banks with commercial real estate exposure > 300% of capital

Largest banks are now willing to work with fresh equity investors, smaller banks still in denial

NUMBER OF FAILED BANKS



Source: FDIC, As of July 2010

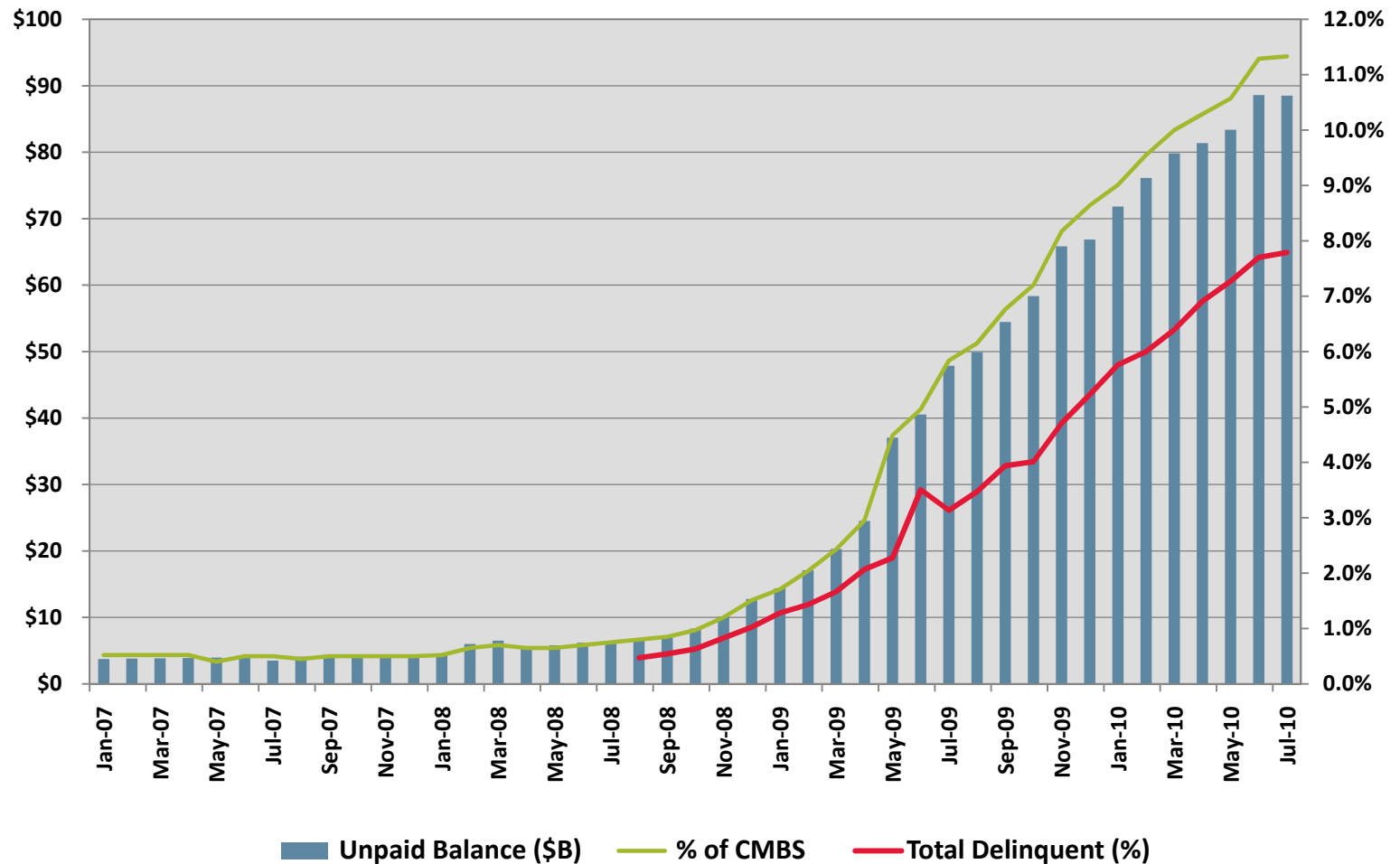
Weak Hands #2: The Servicers

More than 10% of CMBS loans now in special servicing

Small loans are less profitable to service

Servicers need to clear “shelf space” for future defaults

CONDUIT LOANS IN SPECIAL SERVICING



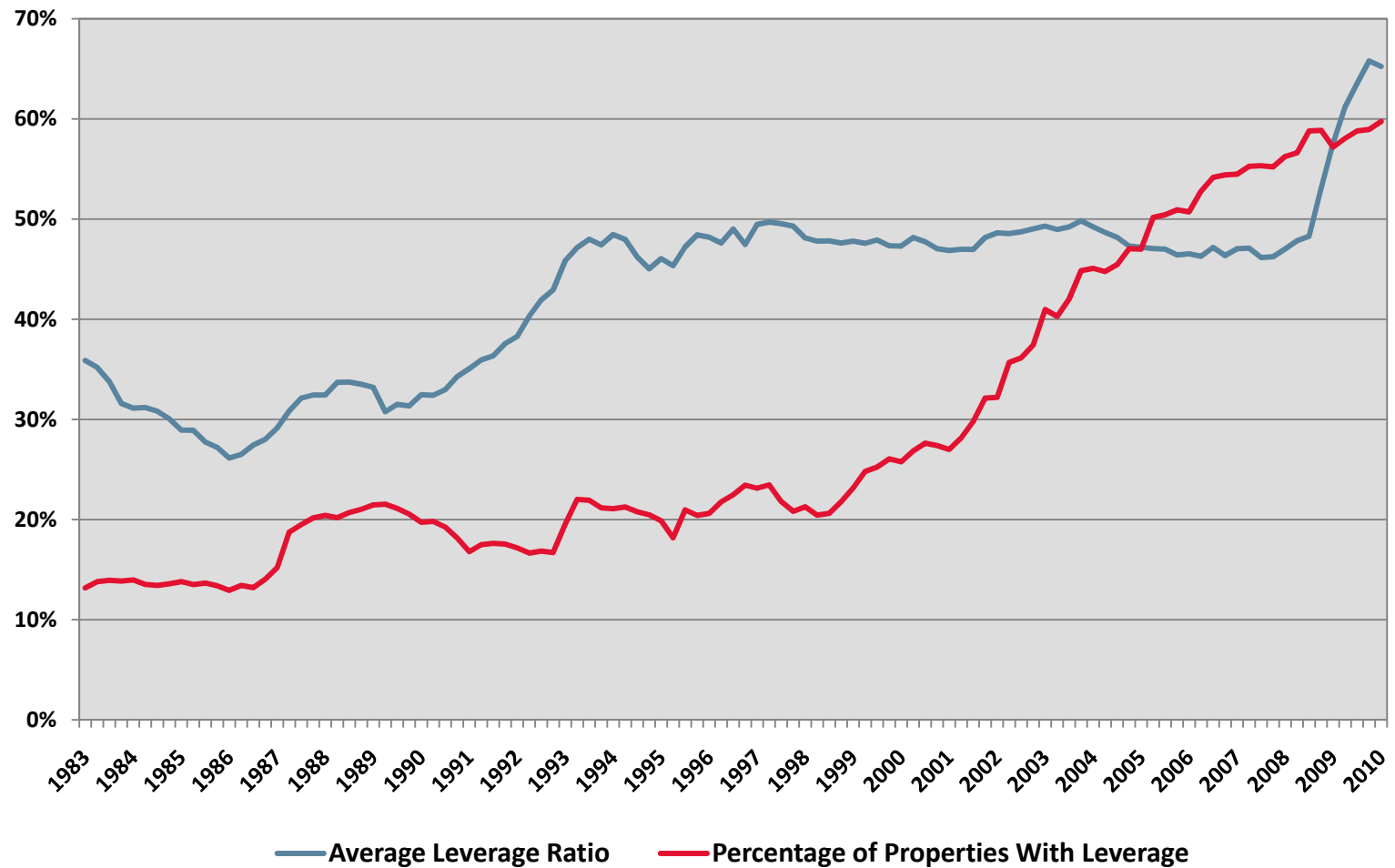
Source: Realpoint LLC

Institutional De-Leveraging Ahead?

60% of all NCREIF properties are leveraged with 65% LTV

For apartments, 75% are leveraged and average leverage ratio is 75%

AVERAGE LEVERAGE RATIO FOR PROPERTIES WITH LEVERAGE



Source: NCREIF

AEW Real Estate Market Outlook

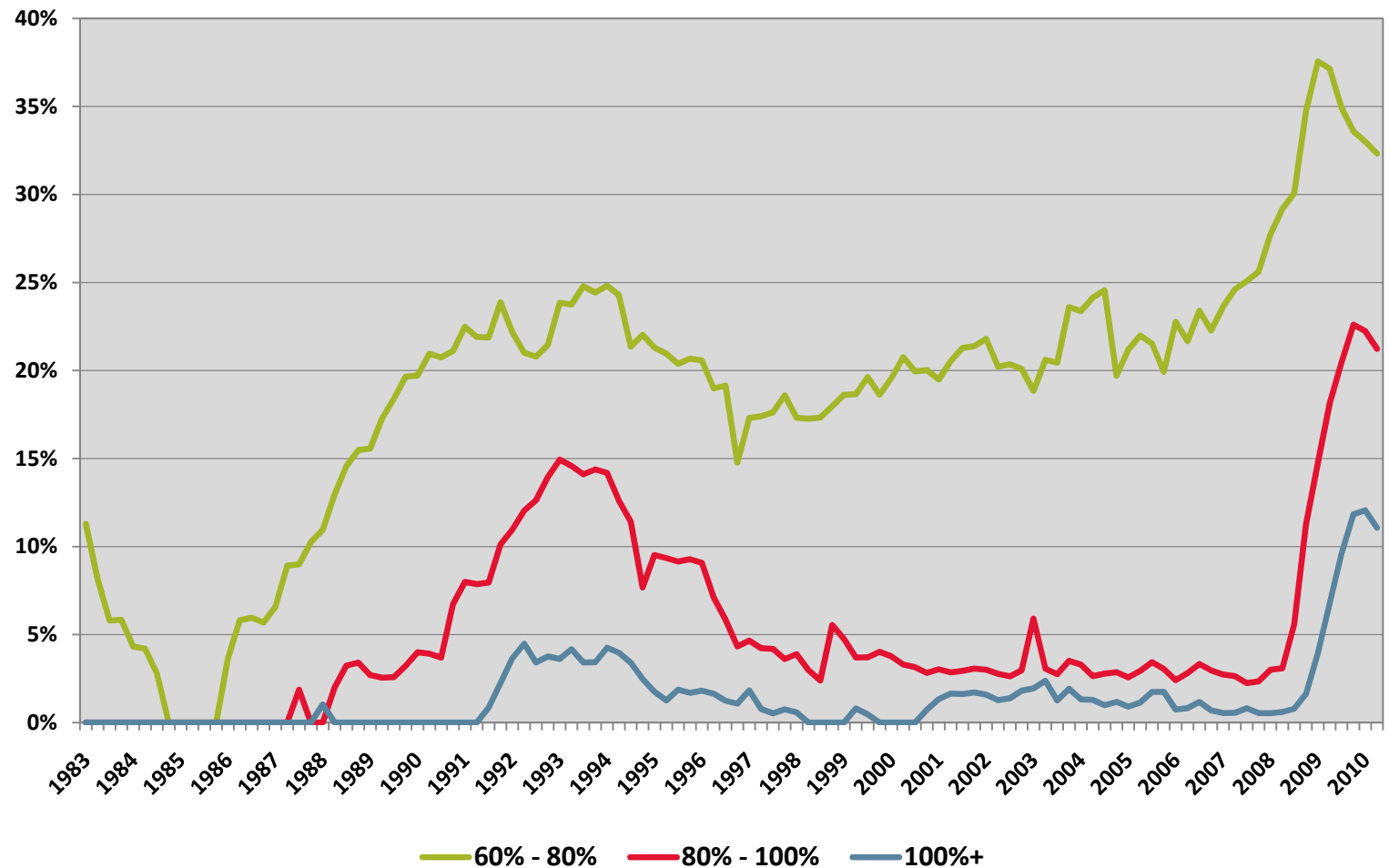
Will They Give the Properties Back?

>10% of leveraged NCREIF properties currently valued below the debt

One-third of leveraged properties have debt above 80% of value

Two-thirds of leveraged properties have debt above 60% of value

AVERAGE LEVERAGE RATIO FOR PROPERTIES WITH LEVERAGE



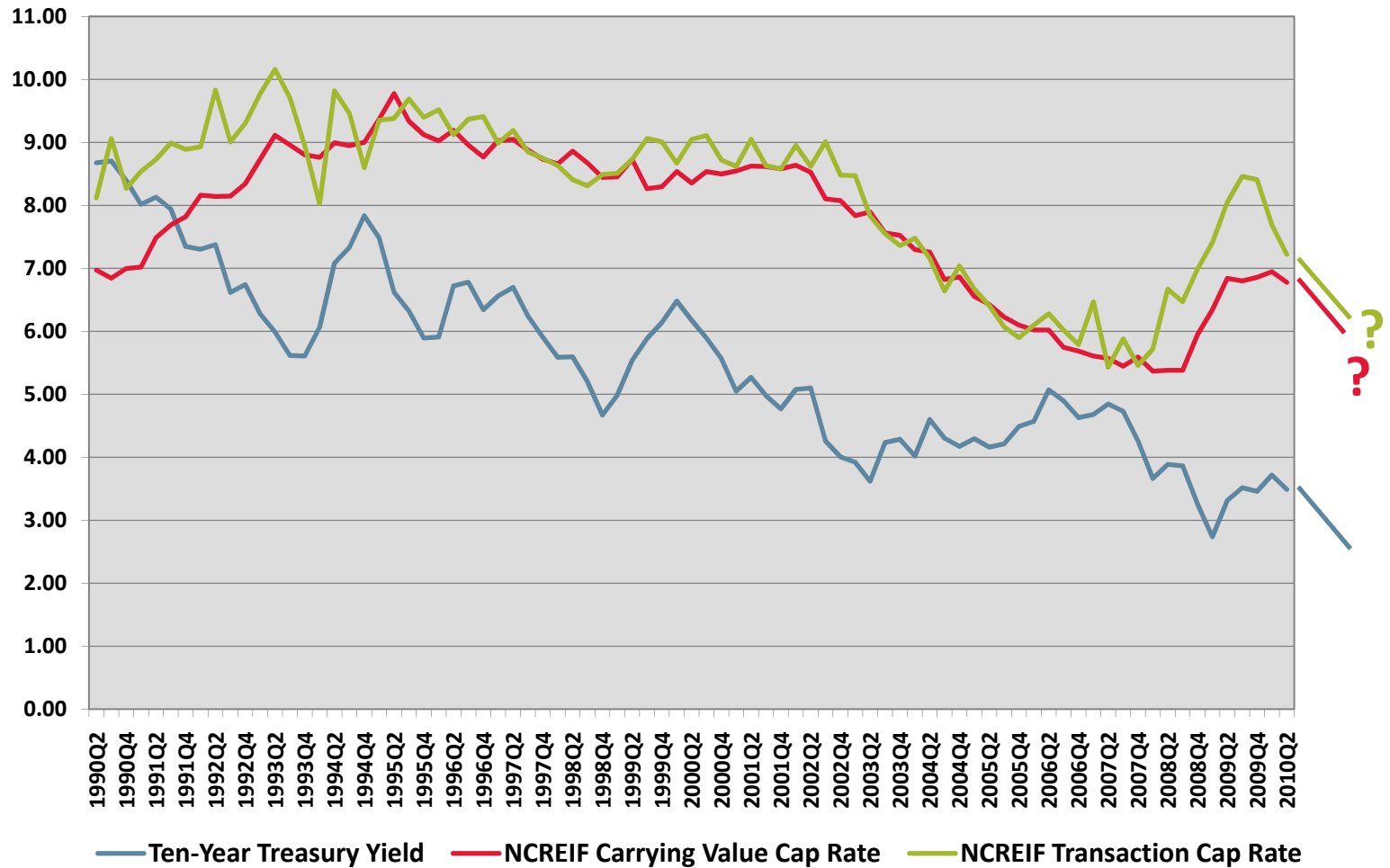
Source: NCREIF

AEW Real Estate Market Outlook

Will Yield Compression Save the Day?

Cap rate spreads to Treasuries near all-time highs

CAP RATES AND YIELDS (%)

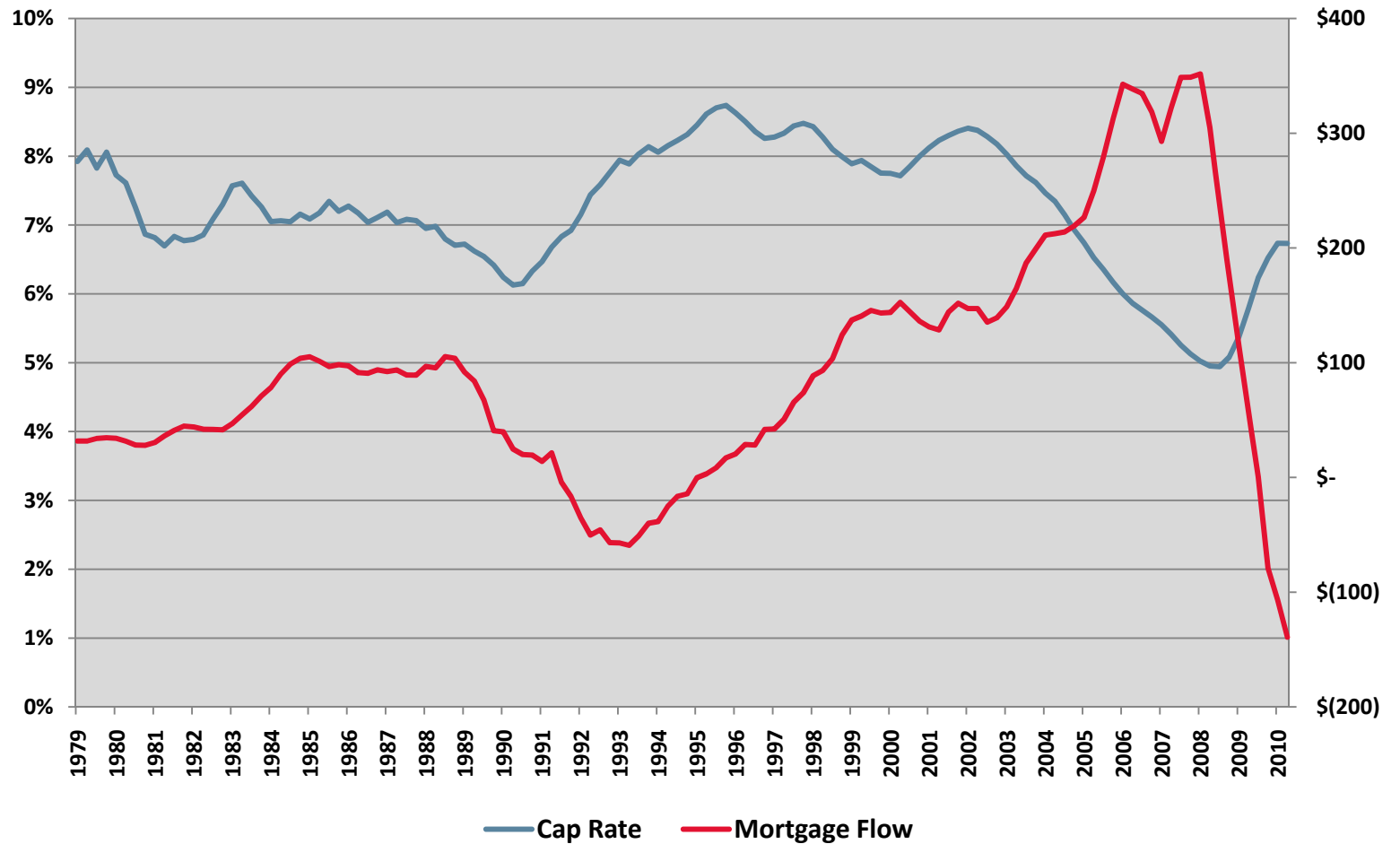


Source: BLS, Moody's Economy.com, NCREIF

Real estate
prices driven
by availability
of financing

Will Yield Compression Save the Day?

**CAP RATES (%) AND THE NET FLOW OF CAPITAL IN COMMERCIAL & MULTIFAMILY MORTGAGES
(4 QUARTER MOVING AVERAGES)**



Source: NCREIF, Federal Reserve (Flow of Funds)

What are Institutional Investors Doing?

- ▶ 83% of North America institutional investors report that they are currently below their target allocation
- ▶ 51% report that they are likely to commit new capital to real estate over the next 12 months
- ▶ 63% targeting core/core plus strategies
- ▶ Why core? 49% cite low risk, 40% cite stable income
- ▶ Average time to reach final close on a private equity real estate fund:
 - 9.8 months in 2006
 - 19.7 months in 2009

Investment Environment Today

CORE

Buy expensive durable income and hope inflation and yields stay very low

VALUE-ADDED

Buy cheap vacancy in anticipation of strong recovery in demand—if you buy vacancy, how cheap is cheap enough?

OPPORTUNISTIC

Work with owners or lenders to re-cap existing high quality assets (broken capital structures, not broken assets)

Brigham Circle

REPRESENTATIVE CORE TRANSACTION



PROPERTY TYPE	Office
LOCATION	Boston, Massachusetts
PROPERTY SIZE	199,488 square feet
YEAR BUILT	2003
ACQUISITION DATE	March 2010
CURRENT VALUE	\$96.8 million (\$485/sf)

INVESTMENT ATTRIBUTES

- Four-story office/retail mixed-use development
- Office component consisting of 124,774 sf is 100% occupied by Partners HealthCare through 2018
- Retail component totals 74,714 sf consisting of Stop&Shop supermarket, Walgreens and other neighborhood related stores
- Centrally located in Longwood Medical area, a dense urban section of Boston surrounded by medical institutes, colleges/universities and a large residential neighborhood

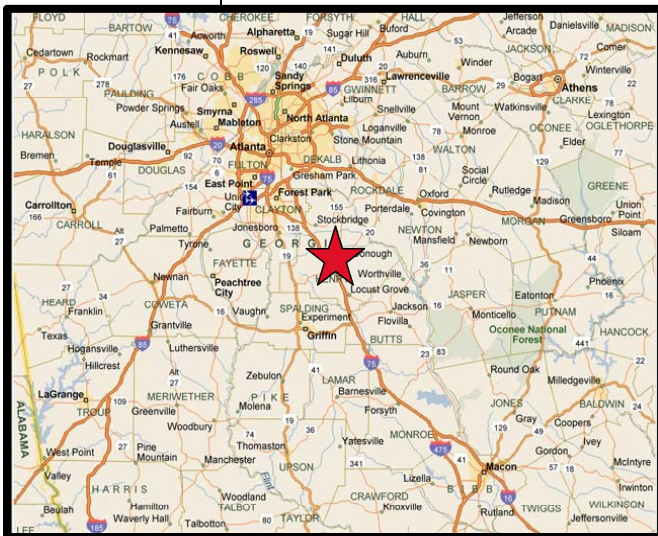
INVESTMENT STRATEGY

- Hold for the long-term and benefit from strong economic drivers (education and healthcare) and above average NOI growth

As of June 30, 2010. Although this transactions represent the types that we may pursue in the future, no representation is made that similar opportunities will be available. There are no assurances that the investment will meet its objectives.

Liberty Industrial Center

REPRESENTATIVE VALUE-ADDED TRANSACTION



PROPERTY TYPE

Industrial

LOCATION

Atlanta, Georgia

PROPERTY SIZE

851,349 square feet

YEAR BUILT/RENOVATED

2006

ACQUISITION DATE

February 2010

CURRENT VALUE

\$15.6 million

INVESTMENT ATTRIBUTES

- Well- located, state-of-the-art, Class A industrial building located in an improving industrial market.
- Investment basis is approximately 60% of cost and substantially lower than competitive existing buildings.
- Low investment basis provides flexibility in leasing space as well as downside protection.

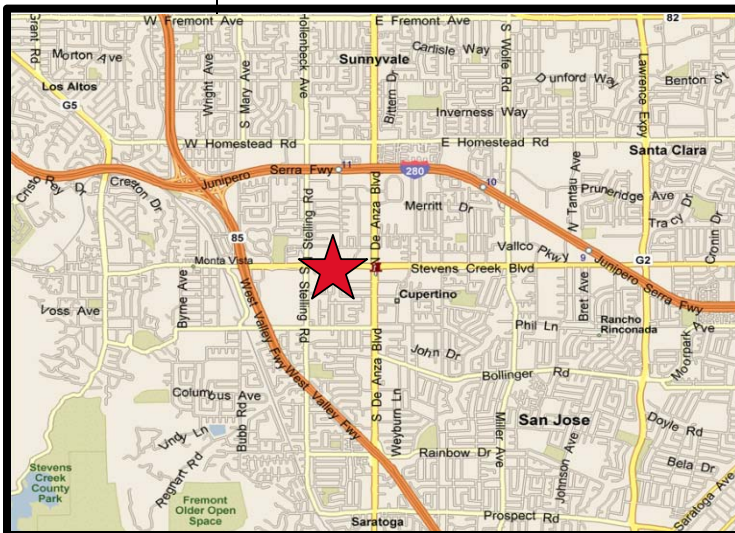
INVESTMENT STRATEGY

- Acquire new Class A industrial building at a significant (40%) discount to replacement cost.
- Lease up vacant space over 30 month period at current market rents.

As of June 30, 2010. Although this transactions represent the types that we may pursue in the future, no representation is made that similar opportunities will be available. There are no assurances that the investment will meet its objectives.

Cypress Hotel

REPRESENTATIVE OPPORTUNISTIC TRANSACTION



PROPERTY TYPE

Hotel

LOCATION

Cupertino, California/Silicon Valley

PROPERTY SIZE

224 rooms

YEAR BUILT

2002

ACQUISITION DATE

April 2010

CURRENT VALUE

INVESTMENT ATTRIBUTES

- Acquire high-quality, well located hotel at substantial discount to replacement cost through the discounted acquisition of a mortgage loan and simultaneous transfer through friendly deed-in-lieu
- First-class hotel located in in Cupertino in close proximity to numerous corporate demand generators including Apple Computer, HP, Cap Gemini and Trend Micro.
- Hotel should generate 10+% current unlevered return if hotel rates return to 2006/2007 levels

INVESTMENT STRATEGY

- Take advantage of distressed market conditions and capitalize on the asset's strong position in the submarket in order to benefit from the market recovery

Biographical Information



MICHAEL J. ACTON, CFA

Managing Director

Michael J. Acton, CFA, is Director of Research for AEW Capital Management, L.P. with responsibility for directing the activities of AEW Research, the firm's highly regarded in-house research group. Mike joined the firm in 1990 and has over 24 years of experience as an economic analyst and forecaster. He chairs AEW's Investment Policy Group and is a standing member of the firm's Investment Committee and Management Committee. The resources of AEW Research are an integral part of AEW's investment process and Mike works closely with senior professionals in all areas of the firm to develop investment strategies that match clients' risk/reward objectives with market opportunities. Mike is also a member of the firm's Compliance Committee and Risk Management Committee. Prior to joining AEW, he was with DRI/McGraw-Hill where he managed the Metropolitan Area Forecasting Service. He is a graduate of Bates College (B.A.) and a Chartered Financial Analyst.

Please feel free to contact Mike regarding any of the information contained herein

macton@aew.com
or 617-261-9577