

While the broader economy experienced a setback during the quarter, the commercial real estate market remained resilient.

In the second quarter of 2011, commercial real estate continued to experience positive returns off a bottom established in late 2009 and early-2010. Property fundamentals continued to strengthen, albeit at a more moderate pace. These trends were reflected in the NFI-ODCE's and NAREIT Equity's 2Q11 total returns of 4.6% and 2.9%, respectively, which represented the sixth consecutive quarter of positive returns for the NFI-ODCE.

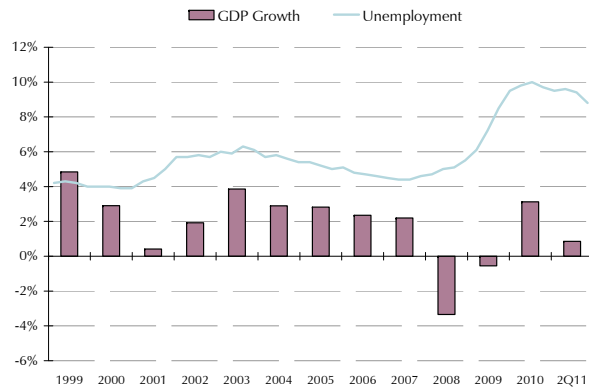
Overall, it was a strong quarter for commercial real estate, but heightened economic uncertainty at its end had not yet filtered through to the real estate markets. With moderately stronger economic growth projected for the remainder of 2011 and 2012, commercial real estate demand fundamentals were expected to benefit from limited new development activity and declining vacancy rates. This should support rent increases and allow NOI growth to gain traction. Additionally, greater lending activity, an improved transaction market and a gradual improvement in market fundamentals resulted in relatively stable borrowing costs and capitalization rates. Still, a stark divide between core and non-core pricing remains.

Overall real estate market summary

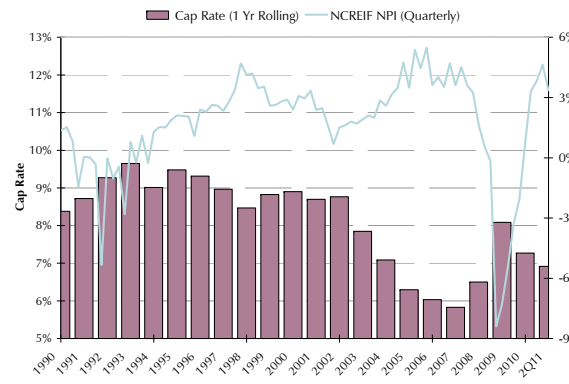
- Market volatility persisted throughout 2Q11 due to the U.S. debt-ceiling debate and European debt default concerns, and as the U.S. economy registered disappointing real GDP growth of just 1.3%. This volatility aside, market sentiment continued to improve for commercial real estate and capital flows into the sector continued due to the attractive yield characteristics. Prequin reported 18 funds raised a total of \$11.2 billion during 2Q11 for private equity real estate investments, reflecting a 26% increase over the prior quarter and a 58% increase over 4Q10.
- Even as the debt markets remained challenged, Treasury yields tightened further during 2Q11 as investors expect the 10-year Treasury yield to remain low for the foreseeable future. Debt is still available for real estate transactions, but the divide between rates for well-leased stabilized assets and more distressed assets remains. Many lenders have begun reversing their work-out strategies, abandoning loan modification and extension strategies as they are increasingly focused on liquidation and recapitalization.
- Transaction volume continued to accelerate during 2Q11 as Real Capital Analytics reported U.S. transaction volumes of \$55 billion, exceeding 2Q10 volume by 117%. The Moodys/REAL CPPI reported overall pricing in the U.S. for all property types declined by 6.7% from the year-earlier period, as \$76 billion of properties were listed for sale during 2Q11, up 79% from 2Q10. A clear divergence in pricing continues to persist between rising or flat prices in primary markets and declining prices in all others.
- Three of the four primary property types reported vacancy rate declines during 2Q11, with only the retail vacancy rate increasing, albeit slightly. Accordingly, the NCREIF Property Index returned 3.9% during the quarter, led by the office and industrial sectors, which each gained 4.5%. Apartments continued to strengthen, returning 4.2% as the vacancy rate tightened to just 5.4%. Even with the slight uptick in retail vacancies, the sector returned 2.5% during 2Q11.
- The FTSE EPRA/NAREIT Global REIT Index increased 2.5% during 2Q11 and posted a year-to-date return of 4.6%. During the quarter, European listed REITs led the recovery with an increase of 7.2%, followed by North America returning 3.2% and the Middle East/Africa returning 2.4%. Asia/Australia posted the only negative return during the quarter at -0.2%, and the decline now brings the region's dividend yield in-line with the North American region at 3.4%. Additionally, US REITs continued to attract fresh capital, raising approximately \$10 billion of equity during 2Q11.

2Q11 Real Estate Industry Analysis

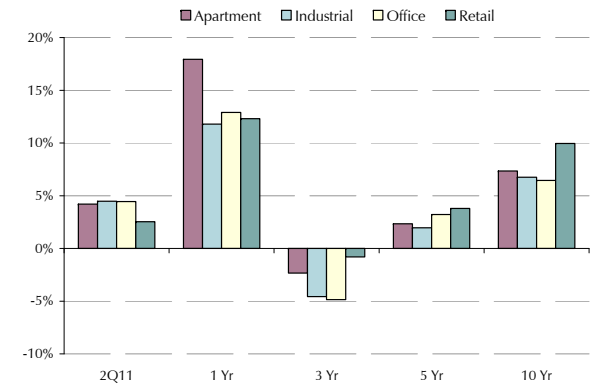
Economic Information¹



Cap Rates vs. Returns²



Property Type Returns²



The economic expansion continued to slow during the second quarter as real GDP growth expanded by a disappointing 1.3% and the jobless rate increased to over 9% again. While part of the slowdown can be traced to transitory shocks such as the Middle East uprisings and Japan's earthquakes, weakness can also be attributed to the anxiety being felt by businesses over the depth and breadth of the recovery.

These factors continue to limit new development activity, and vacancy rates for all property types are projected to decline further, causing rents to increase, and allowing NOI growth to gain traction.

As liquidity and operating fundamentals gradually improve, and capitalization rates compress, the commercial real estate market has experienced a significant recovery from its 2009 lows.

The NPI total return increased for the sixth consecutive quarter, reflecting a TTM return of 17%. Average cap rates, as measured by NCREIF, also continued to compress, however, the relative strength and the rising values appear to be led by core assets with durable in-place income. The recovery in the more distressed markets and assets will likely begin to improve as their operating fundamentals recover.

For the second quarter of 2011, operating fundamentals improved slightly as vacancy rates declined for all property types except retail. Year-over-year effective rent growth, on the other hand, only improved for apartment and office properties.

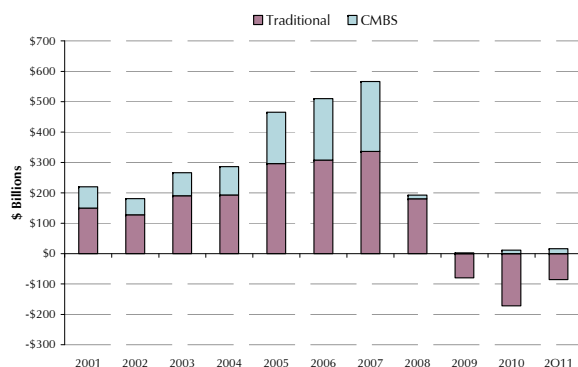
These mixed operating improvements generated positive earnings growth for apartments while the property returns for the other three sectors were primarily driven by improved buyer sentiment as capitalization rates continued to compress.

¹ Source: US Bureau of Labor Statistics and US Bureau of Commerce.

² Source: NCREIF Property Index.

2Q11 Real Estate Industry Analysis

Debt Capital Flows¹



Bank lending for traditional commercial and multifamily real estate fell by about \$294 billion from the peak in 2008 through 2Q11 as total traditional mortgages outstanding stood at \$3.1 trillion.

The large decrease was mostly the result of tightening in the commercial real estate credit markets and a CMBS market that had dried up. However, through 2Q11, traditional lending activity declines have moderated and new CMBS issuance of \$16.0 billion through 2Q11 has already surpassed all of 2010's issuance.

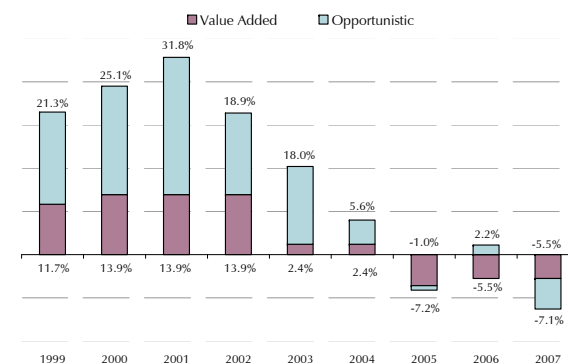
Trailing Period Returns²

As of June 30, 2011	1 Year	5 Years	10 Years
Core	20.8%	0.2%	5.8%
Value-Added	21.6	-4.9	4.5
Opportunistic	26.9	-0.4	9.9
Domestic REITs	34.1	2.6	10.7
S&P 500 Index	30.7	2.9	2.7

Private market real estate underperformed the S&P 500 during the TTM of 2Q11, as private real estate growth historically lags the broader equity markets. REITs, on the other hand, reflected the strong appetite for real estate in the public markets, outperforming the broader equity markets in both the short-term and the long-term period.

Within private real estate strategies, core performance has moderated as opportunistic strategies have benefitted from their aggressive posture and outperformed the other strategies in both the short-term and the long-term period.

Vintage Year IRRs³



Closed-end real estate partnerships generally require five to seven years to "mature." Until that time, investments held at cost and fees tend to suppress the underlying return generated by these funds.

Funds that were raised in the beginning of the decade experienced significant performance gains, benefitting from inexpensive debt, increasing economic activity, and property dispositions in high valuation markets.

More recent funds had been impacted by the GFC, but recent appreciation for real estate has moderated unrealized losses in recent quarters.

¹ Source: Federal Reserve Flow of Funds and Commercial Mortgage Alert.

² Source: NCREIF and The Townsend Group, NAREIT Equity Index, and S&P 500 Index.

³ Opportunistic vintage years are portrayed individually. However, value-added vintage years are grouped together during some periods by the NCREIF-Townsend Index.