

REAL ESTATE INVESTMENTS

WINTER 2009



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CEO's Real Estate Perspective

By Richard Myers, Chief Executive Officer

Last year's worldwide economic slowdown signaled both harder times ahead for certain real estate properties, as well as lucrative return potential for others. Our acquisitions team fielded a steady stream of new investment opportunities but witnessed a change in the types of investments submitted. We believe that this change in types of investments will continue in the current year, including:

- **More mezzanine loans and preferred equity investments** – These are basically high interest rate loans. Historically, these opportunities have represented less than 5% of our offerings, but with the national credit crunch, we expect this percentage to increase as developers/sponsors work to close gaps in their project funding.
- **“Distressed” properties** – Pick up the *Wall Street Journal* on any day and its likely to include a story about a “distressed” asset. In such cases, highly-motivated, cash-strapped property owners have to quickly sell their properties at low prices to meet cash requirements.
- **Fewer development deals** – Until 2008, the majority of projects we reviewed were development deals. In recent months, though, these have all but dried up due to the reduced capacity of banks to provide loans. However, development projects that do receive financing in this environment are expected to be highly attractive and offer significant competitive advantages.
- **Capital calls/additional fundings on existing investments** – RCP currently manages over 110 active investments. Some of these will likely require additional funding this year due to the credit crunch and weak market demand. Capital calls can help these projects withstand extended downturns in the economy. They also allow developers/sponsors to pursue value-added strategies that may enhance future performance (e.g. increasing tenant improvement allowances to spur leasing). When such investments are required, RCP strives to structure the fundings in such a way that will help original investors preserve their equity and make a good return, while offering incentives for new investors to participate in the offerings.

Overall, we expect to have more “market power” as investors than anytime in the last 20 years. RCP will press through the current economic crisis and continue to manage and find quality real estate investments. If you would like to discuss these trends further, I invite you to contact me directly at 817.479.1402 or rmyers@rcpinvestments.com.

Risk Adjusted Returns

By Isaac Gregory, Senior Vice-President, Capital Markets and
Rory Maguire, Executive Vice-President, Real Estate

There is a wealth of information available to help you evaluate traditional investments like stocks, bonds and mutual funds. Key measures like price-to-earnings ratio, historical returns and standard deviation are widely available. When it comes to balancing risk against returns in your investment portfolio, real estate investments can be harder to evaluate given that standardized data is not as prevalent.

There are, however, several factors that can help you judge the overall risk of a real estate investment, including the developer/sponsor, market, construction (or execution) risk, financing and entitlements. While not every real estate investment will have significant exposure to all of these, there is usually some combination of the above to consider. RCP focuses intensively on these criteria when considering an investment opportunity. In most cases, the higher the risks, the higher the expected return. For instance, let us assume that you evaluate risk on a scale of one to five, with five being the highest level. You might expect an investment that ranks a five in every category to triple your money in one year. Conversely, an investment that ranks a one in every category might be comparable to investing in a AAA bond and, thus, offer a much lower return.

In terms of the developer/sponsor, RCP looks for partners with a successful track record. We carefully add new partners and routinely invest with our existing network of proven developers/sponsors. We require our partners to provide detailed information on their experience and previous project performance.

Next, regarding market risk, RCP feels that geographic diversification is fundamental to reducing concerns in this area. For instance, homebuilders in California or residential condominium developers in southern Florida have seen the worst effects of the current recession due to highly specialized development in only one region.

Construction (or execution) risk can not be completely eliminated by a successful track record of development. Construction costs have seen significant increases in the last several years, and even the most highly qualified teams have seen cost overruns affect their project. As such, to mitigate this issue for development projects, RCP will often require that a guaranteed maximum price

construction contract be in place prior to funding.

Financing and entitlement risk tend to be more objective in nature. RCP often requires the developer to acquire the necessary financing and government approvals before our equity is contributed.

In addition to considering these five risks when targeting a return, investors must also understand the structure of the investment they are contemplating. Financial tools, such as lookbacks and hurdles, can help minimize downside risk and boost returns in the event a project takes longer to sell than expected. They also help align the interests of the investor with the developer to maximize the project's success. In many circumstances, the structure of an investment is a good measure of a project's risks. For example, a developer that is purchasing an existing building that is 100% leased with excellent cash flow is likely to be offered less onerous financial terms than a developer building a speculative office building in an average market.

Ultimately, as an investor, there are many factors to consider beyond just the projected return and projected holding period. To make wise decisions, you should understand that every project has its own level of risk and selecting deals solely based on high potential returns could subject you to a substantial amount of overexposure in a given risk category. The fundamentals of each project should be considered and diversification techniques should be used in your real estate portfolio, just as you would in other investments to help minimize risk.

Sourcing New Real Estate Investment Opportunities

By Rory Maguire, Executive Vice-President, Real Estate

RCP presents approximately 25 to 35 investment opportunities to its clients each year. While there are numerous opportunities available across the country, finding deals that meet RCP's stringent risk and return criteria can be challenging. Because the process between receiving a potential opportunity and presenting it to our clients is highly involved, I would like to give you an insider's look into what happens before a new opportunity is presented to you, the investor or prospective investor.

To begin with, deals come to RCP from many avenues: through the existing relationships of our executive management and real estate teams, developers, bankers, bro-

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kers, and current investors. RCP professionals also attend conferences and other networking functions to continue broadening this base of relationships.

A key factor in sourcing new investment opportunities is to know where to look. Each year, we identify the markets that we feel will have strong employment growth. More jobs mean more people, which stimulates the need for commercial, retail, residential and other real estate uses. Other key factors we consider are high barriers to entry, household income, and density. We also receive input from people that are in tune with real estate activity in various local markets.

In a typical week, our Acquisitions department receives an average of 20 new investment opportunities. In general, we can pass on 60-70% of these investments within thirty minutes of review as they do not meet the initial criteria related to our five major risk categories. These categories include developer, market, entitlement, financing, and construction risks. As an example, an experienced developer may submit a package for a to-be-built, 100% preleased office building with a construction loan in place and complete construction plans. The internal rate of return for the development pencils out to 25% over a three-year hold. This could potentially be a good project unless the location is in a market that is not diverse enough to provide alternative exit strategies if the tenants underperform and move-out.

The 300 to 400 properties that pass the initial 30-minute screening are then reviewed in more depth. Financial projections and assumptions are explored, comparables in the market are examined, competitive advantages are analyzed, and all risk categories are scrutinized. A formal presentation containing the key aspects, advantages, and risks of each deal is then presented to our Investment Committee. Made up of representatives from our Executive Management, Capital Markets and Real Estate teams, the Investment Committee vets each property before deciding whether to present it to our clients. The Executive Management team, alone, has a combined real estate background of more than 100 years, which speaks to the different experiences and perspectives that are presented during these meetings.

In the end, less than 10% of all deals presented to the Investment Committee receive final approval to be offered to our clients. Once approved, the Investment Management group continues to perform more thorough due diligence up until the scheduled closing day when the project is transitioned to asset management.

Did You Know?

Adding Value Through Entitlements

By Peter Aberg, Executive Vice-President, Capital Markets

Entitlements are just one of the factors RCP underwrites when considering a new investment opportunity. Entitlements, such as land use permits and zoning, are typically regulated by local and state governments and essentially grant a landowner rights to develop a parcel of land for a specific use. While the process for seeking new entitlements or changing existing entitlements can be time-consuming and costly, especially depending on the location and intended use for the property, the process can result in clear “added value” for a project.

Prior to purchasing land or starting construction on a new project, a developer will have to determine what entitlements are in place and what entitlements are needed to execute his intended business plan. A prudent developer will seek out opportunities to change entitlements where the political climate and surrounding land use or overall land plan would “likely” support these changes. For example, in talking with city officials, a developer may find that because a property’s existing entitlements are inconsistent with the future land use plan adopted by the city planning department, the ability to add value through a zoning change may be fairly easy. However, even under unfavorable circumstances, a developer may have the political skill and vision to convince local authorities to approve entitlements, such as “up-zoning” land from a low density use to a higher-use such as commercial or mixed-use zoning.

A developer or landowner willing to pursue entitlements can benefit from substantial increases in land value, particularly in cities where the entitlement process can be quite lengthy, such as in California and the East Coast. A developer that purchases 10 acres of undeveloped, unentitled land based on a “raw land valuation” and spends two years entitling the property to allow for a higher use (such as office or retail) may create additional value worth three to five times his original land cost basis. Furthermore, a developer that obtains entitlements early on may also increase the attractiveness of his site to future end-users (e.g. McDonald’s) or developers (e.g. apartment developer) by reducing the time before the end-user can begin construction on his project, particularly if surrounding undeveloped properties do not have the same entitlements in place.

Update on Schedule K-1 Tax Forms

By Terry Boone, Executive Vice-President, Investor Services

As we approach tax season, RCP is very sensitive to the needs of our clients and their tax preparers. We plan to provide Schedule K-1 tax forms for each of your investments by the first week of April. As a reminder, we will send the K-1's for your investment entity once we have received all of the related K-1's rather than sending each K-1 as it is received. We do this based on investor feedback that indicated it was easier to keep track of K-1's received if they were delivered all together rather than piecemeal.

We are very aware of how important it is to deliver the K-1 forms on a timely basis and continuously strive to make improvements to our K-1 process each year. We send necessary documentation to our accounting firms throughout the year and stay in constant contact with our developers on the status of tax return and K-1 filings. In addition, in each of our partnership agreements with the developers/sponsors, we are now including strict penalties for delayed delivery of K-1's to incentivize our project partners to provide timely information.

As mentioned earlier, you should expect to receive your K-1 forms by early April. We will notify you as quickly as possible in the event that we anticipate any delays. In the meantime, please feel free to contact your Capital Markets advisor at 817.479.1400 with any further questions.

Investor Conference Calls

We encourage you to join us on our weekly project update calls to receive the latest information on your investments. The calls are held on Saturday mornings at 10 a.m. CST and generally last no more than 25 minutes. A brief schedule of upcoming calls is listed below.

February 21	Medical District Urban Living I-20 Spur Clear Lake
February 28	Hometown Apartments Riverside Western Center
March 7	Carpenter Business Center North Academy Silverleaf

A complete listing of our call schedule and recordings of previous conference calls are available on our website under the Investor Conference Call section.



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