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CEO's Real Estate Perspective

By Richard Myers, Chief Executive Officer

From time to time, a client will ask us how we manage our active partnerships. With over 100 partnerships in our current portfolio and another 15 to 25 partnerships added each year, it is easy to see why this question would arise.

As an investor, I think you would be pleased to know that RCP hires experienced professionals for our Real Estate group. We were pleased to bring on Steve Saxon—a 17-year veteran of the real estate industry—to lead the team this past December. Steve and his group spend numerous hours managing our partnerships. In fact, the amount of time devoted to asset management has particularly increased of late due to the national "credit crunch" impacting commercial real estate.

The developers/sponsors that we invest with are generally responsible for the day-to-day operations and management of each investment. However, our Real Estate group is also closely involved with each investment in the following ways:

- Ensuring the developer/sponsor honors the terms of the partnership agreement.
- Reviewing project cost budgets, operating budgets and partnership financials.
- Monitoring construction progress, plans, and timelines for new developments.
- Reviewing the partnership business plan and recommending improvements.
- Completing regular site visits.
- Analyzing local market conditions on an ongoing basis.
- Verifying capital shortfalls and helping to raise additional funds as needed.
- Approving new financing terms or helping to negotiate new terms with lenders.
- Reviewing the property marketing plan and suggesting enhancements.
- Approving the property sales price and terms of sale.

While it would take a few more pages to list every aspect of our asset management process, I hope this brief list gives you an idea of our level of participation with each of your investments. Furthermore, in addition to the Real Estate group, you will often find other key members at RCP lending their expertise and assistance to help with the ongoing management of our partnerships, including myself and the Capital Markets group.

RCP's goal is to protect your investments, as well as to provide you with frequent communication about these efforts. We offer regular investment updates via our website, occasional reports/letters and weekly investor conference calls. With each of these, we try to summarize the most relevant issues affecting your investments. Of course, if you would like more information about specific investments or a personalized portfolio review, please contact your Capital Markets advisor.

We look forward to continuing to serve you.

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Recent Company News

RCP is diligently expanding its investment offerings and client services through the careful expansion of the company and the hiring of talented employees. Listed below are a few initiatives RCP has undertaken this year.

- **Capital Markets Group:** *John Raggio* joined the New York office as Senior Vice President of the Capital Markets group. He is using his extensive experience in real estate finance to grow the company's capital raising efforts in the Northeast and to identify new potential developers/sponsors. In addition, Capital Markets also welcomed *Ben Phillips* as Vice President. Ben will be responsible for managing and developing relationships with high net worth individuals in the Dallas/Fort Worth area. He comes to RCP with vast experience in commercial and industrial real estate.
- **Real Estate Group:** The Real Estate group welcomed back *Keith Caldwell*, a former MBA summer intern, as an Investment Manager. Keith is responsible for underwriting and ongoing asset management. The group is also hosting three MBA summer interns—one each from the University of Chicago, Northwestern University and Texas A&M University. The interns are actively involved in all aspects of RCP's acquisitions, underwriting and asset management functions.
- **International Initiatives:** In an effort to better service its international investors and to expand capital raising efforts outside the U.S., RCP recently hired London-based *Jonathan Newell* and *Pierre-Olivier Baudot* as Managing Directors in the Capital Markets group. Each has an impressive background with experience in real estate finance, investment banking and consulting.

Market Sector Overview: Hotels

By Blake Lugash, Vice President, Real Estate

While the hotel sector has faced challenges amidst the economic recession, it is beginning to show signs of stabilization, and we expect a possible recovery after mid-2010. Investment activity and opportunities are expected to strengthen as distressed assets become available for sale and supply remains constricted due to a lack of financing available for new development.

Hotel Operating Performance: PKF Hospitality Research believes that the large majority of declines in revenue per available room ("RevPAR") will pass by the third

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Should You Still Invest in Real Estate Today?

By Isaac Gregory, Senior Vice President, Capital Markets

I would guess that, in the midst of the worst market downturn since the Great Depression and one of the worst economies seen in over 20 years, you might be feeling a little uneasy about all of your investments, including your RCP holdings. This is natural, but one thing to remember is that focusing on time tested investment fundamentals like "buy low, sell high" has long-term benefits. Let me give you an example from my days as a financial advisor.

I had a client, let's call him John. John had a fairly large portfolio invested with me and was one of my top clients. In 2006, the real estate portion of his portfolio grew by over 30% in that year alone, while his fixed assets/bonds only gained a modest 4%. Toward the end of 2006, John expressed a desire to increase his real estate allocation based on this performance. My advice was to "buy low, sell high" in rebalancing his portfolio, meaning that we would sell some of his real estate assets and re-invest those gains into other asset classes that were underperforming.

In theory, the practice makes sense but acting on this age-old investment philosophy takes a considerable amount of self discipline and confidence in not only yourself but the markets in which you are investing. It was a tough decision for John but at the end of 2007 he understood the advice when his real estate holdings lost almost 15% in value while his fixed assets/bonds increased by over 7%.

Now consider that real estate has been one of the worst performing asset classes over the last two years. The last time that occurred was 1991-1992, which was followed by a phenomenal 15-year (1992-2007) bull run marked by a cumulative increase of over 169%¹.

Our goal at RCP is to help you take some of the emotion out of your investment decisions and to present you with facts so that you can make informed decisions. While we at RCP are not in the business of predicting the bottom or top of the real estate market, we are clearly seeing excellent opportunities that appear to confirm the theory of "buy low, sell high." Now might be an opportune time to revisit your asset allocation, either on your own or with your investment professional, and consider whether it is a good time for you to "buy low".

¹National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index. (December 2008).

What Makes a Distressed Deal?

By Steve Saxon, Executive Vice President, Real Estate

In one sense, every deal on the market today is distressed. The banks are making very few new loans, most of the equity is still on the sidelines waiting for the economy to recover, and most properties are not performing as well as they have in the past few years. In this environment, owners do not want to sell a property unless there is no other option. The buyers understand this, and therefore, they know that any property for sale is, by definition, “distressed.”

A distressed asset almost always involves debt, and any one of several scenarios may apply to the situation. The debt may be at maturity and there is no refinancing available, or the property may not be generating enough cash to service the debt and is therefore in default. In either case, the owner negotiates with the bank to pay as little as possible to retain control over the property.

Unfortunately, the banks are under pressure from the regulators to reduce their real estate exposure and increase their capital, which can limit their flexibility with the owner. At the same time, the banks are reluctant to foreclose on the property, which results in adding the full amount of the loan to the bank’s loss reserve. When you combine declining values, stringent regulators, borrowers with limited capabilities, and banks trying to preserve capital, you clearly end up with a distressed situation. The prudent buyer must know when to step into the middle of a distressed situation, how to satisfy each party and come out with a quality deal.

A distressed situation can also arise from a quality asset with a financially strapped owner. Generally, the asset is performing well but is owned by a person or entity that is under financial stress and must liquidate its position in the subject asset. This is a much easier acquisition than the distressed asset scenario but may not result in as good a bargain. In other words, it may allow you to acquire a solid asset at a good price but without as much upside potential.

RCP’s Acquisitions group is seeing a large number of distressed deals across the country and is constantly evaluating these situations to find investment opportunities for our investors. Examples of such opportunities include the firm’s recent offerings for Reliant Corporate Center (Houston, Texas), Northwest Crossing (Dallas, Texas), Carnegie Hill (New York, New York) and Johns Creek Medical (Forsythe County, Georgia).

Did You Know?

Leasing Basics

By Josh Clary, Vice President, Investment Management

The type of lease used in commercial real estate varies depending on the property type, location, and building age. The three most commonly used are: triple net (NNN), expense stop, and gross.

The *triple net lease* puts responsibility for all property expenses (e.g. taxes, insurance, maintenance, and operating expenses) on the tenant. The tenant will typically reimburse the landlord for these expenses in the form of “additional rent.” Landlords favor NNN leases because the tenant bears the risk of increased property expenses.

An *expense stop lease* includes a specific amount of property expenses, known as an “expense stop” in the rent. If actual property expenses exceed the expense stop, the tenant is responsible for the difference, known as the “pass through cost.” This lease type also favors the landlord because the tenant bears the risk of increased expenses.

A *gross lease* is a lease in which the landlord pays all property expenses and no pass through costs are assessed to the tenant. Tenants favor this lease because the landlord absorbs the cost for all property expenses. Small tenants that want consistent rent payments also prefer this type of lease.

Most leases include a *base rent*—the minimum amount a tenant will pay over the life of the lease. It is common for the first year’s lease rate to be equal to the base rent with specified annual increases (e.g. 3%) thereafter to help account for inflation.

Leases may also include provisions such as a *tenant improvement allowance*. The landlord provides this allowance so that the tenant can make his space suitable for move-in and occupancy. It is often spent on items such as drywall, ceiling tiles, lighting fixtures and office furniture.

Another provision is the *rent abatement*, which is free or reduced rent for a period of time. In today’s commercial real estate market—a combination of a contracting economy and oversupply of vacant space—it is common for landlords to offer concessions such as rent abatement to entice tenants to sign (and even renew) a lease.

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Second Quarter Project Updates

The second quarter updates are now available on the RCP website. Please review these updates for the latest news regarding your investments. You can also learn more about your investments by listening to recordings of previous investor update calls which are also on the website.

2009 Investment Summary

Despite challenges in the real estate market, we continue to see real estate as a viable option for diversifying investment portfolios. Through the end of July, RCP and its investors provided approximately \$17.2 million for eight investments, which included RCP's first New York project (a high-end residential development on the Upper East Side) and a high-tech sports facility in the burgeoning North Texas suburb of Frisco.

Our Investment Committee works diligently to scrutinize investment opportunities and identify those that potentially offer substantial protections for investors' capital. In addition to securing a favorable capital stack position for some of the year's investments, RCP also selected opportunities that provided favorable terms such as internal rate of return hurdles, equity guarantees and strong barriers to entry.

RCP expects to see a steady stream of real estate opportunities and anticipates offering another 7-10 investments through the end of the year.

Investment Summary (January-July 2009)			
Partnership	Property Type	Closing Date	Investment Amount
I-20 Spur (Capital Call) Terrell, Texas	Land	January	\$129,148
Hometown (Capital Call) North Richland Hills, Texas	Apartments	January	\$580,595
Frisco Sports Village Frisco, Texas	Special Use	March	\$2,581,680
Reliant Corporate Center Houston, Texas	Office	March	\$4,015,600
Dallas Rehabilitation Hospital Dallas, Texas	Medical	May	\$4,868,989
Northwest Crossing Dallas, Texas	Office	July	\$1,331,114
Carnegie Hill New York, New York	Residential	July	\$2,382,813
Village First Lien Colleyville, Texas	Real Estate Loan	July	\$1,285,129
Total Equity Invested			\$17,175,068

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Finally, regarding *lease terms*, different market types call for different strategies when negotiating lease terms. For example, in today's market it may be beneficial for landlords to sign tenants to shorter leases since leasing rates have fallen significantly from the market peak. By doing so, landlords have the opportunity to re-lease their property at higher rates when the market rebounds. Other factors, such as when the landlord plans to sell the property, may also be considered when negotiating a lease term.

Market Sector Overview continued from page 2

quarter of 2009². These declines, which stem from declining average daily rates ("ADR") and hotel occupancies, have been steepest among full-service business hotels located in large cities. The typical U.S. hotel should continue to generate positive net operating income through the economic cycle as managers and operators work to cut costs.

Investment and Transaction Activity: As with the broader commercial real estate market, sales and transaction activity has softened. During a recent presentation in Chicago regarding "Opportunities and Challenges in a Distressed Hotel Industry," DLA Piper and Jones Lang LaSalle Hotels reported that global hotel transaction volume was down 82% in 2008—a casualty of buyers being unable to obtain financing and a considerable bid-ask spread in the market³. In recent months, however, various brokers have reported an uptick in listing activity and buyer interest, leading to expectations for an increase in transactions by the end of 2009. The deals that are closing have principally been under \$35 million and have been bought by U.S. equity investors such as hotel operating companies and high net worth individuals.⁴ Asian buyers are also re-emerging as their currency strengthens.⁵

Outlook: Similar transactions with favorable purchasing terms are expected to pick up in the next year as distressed assets are forced into sale. Michael Cahill, CEO of Hospitality Real Estate Counseling and co-chairman of the Lodging Industry Investment Council, is confident that buyers will begin seeing bargain investment opportunities. As he states, "The greatest hotel buying opportunity of our lifetime will be the next 12-18 months. The key is having all equity to close without mortgage financing."⁶

²PKF Hospitality Research. (June 2009). *Hotel Horizons*.

³Jones Lang LaSalle. (January 26, 2009). *Slowdown in global movement of capital as cross-border investment is curtailed*. [Press Release].

⁴Murray, B. (May 7, 2009). Global Hotel Transactions Hit 7-Year Low in Q1, but Change is Afoot. *Commercial Property Executive*.

⁵HotelWorld Network. (May 5, 2009). Global hotel transactions: Has the market hit bottom?

⁶Butler, J. (May 25, 2009). Is It Time to Buy Hotels? *Hospitality Net*.

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