

Executive Summary

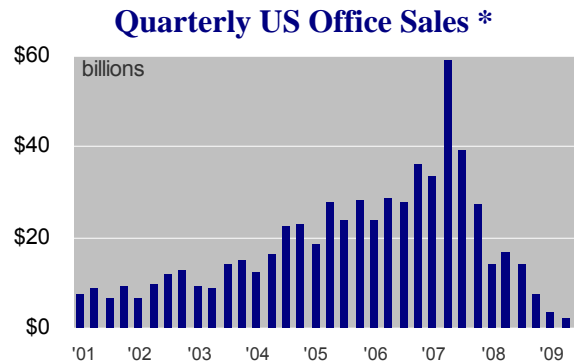
- **Capital Markets** – No improvement during the second quarter.
- **Debt Markets** – Remain frozen with cautious lenders issuing only a few new loans.
- **Sale Transactions** – Almost non-existent.
- **Property Values** – Continue to slide and are now between 30% and 50% off 2007 peak values.
- **Real Estate Market Fundamentals** – Vacancy rates are rapidly approaching historic highs and effective rents are plummeting. The next 24 months will see continued weakening.
- **Investment Opportunity** – These events are creating the best atmosphere since the early 1990's to invest in commercial office product.

Capital Market Fundamentals

Debt is Scarce & Expensive – Banks and many traditional lenders are reeling from massive losses resulting from the housing and consumer credit crisis. In an effort to preserve capital to protect against future losses relating to the impending realization of the collapse of commercial property values, these lenders are making few, if any, loans. To the extent loans are issued, lenders are only doing so in top tier markets, limiting proceeds to 50%-65% LTV, charging interest rates above 8%, requiring amortization, and underwriting stressed NOI to a minimum of 14% of principal balance. Compounding this problem is the virtual disappearance of the CMBS market. Most lender activity is limited to “amending and extending” existing loans as they approach maturity. Since most borrowers cannot refinance their debt and lenders are unable to recognize the market value of their debt without risking insolvency, this strategy benefits both parties. This “accommodation” can only work for so long. As lenders’ reserves increase, so will their ability to absorb losses making them less willing to extend loans, especially with respect to loans collateralized by properties that are unable to satisfy debt service due to continued deterioration of NOI.

There are No Trades – During the first five months of 2009, only \$4.9B of office buildings traded hands (\$538MM of which were located within our primary investment markets and of that only \$143MM was

located in markets outside of the DC Metro area). That compares to \$19.9B in 2008, \$42.5B in 2007, and \$33.6B in 2006. In almost all cases, the bid-ask spread is enormous and most marketed properties have been pulled by disappointed sellers. The atmosphere has changed so radically from the 2007 heyday that many brokers now require a “break-up” fee in the event an owner pulls an asset. The few trades that have occurred



demonstrate significant increases in capitalization rates and indicate that values have declined between 30% and 50% from 2007 peak values. Originally, we assumed it would be the high-leveraged buyers that would be the first owners forced to capitulate and sell to the market; as it turns out, those owners are not sellers today for two reasons: (i) they are obtaining “amend and extend” options from their existing lenders and (ii) with little remaining equity, non-recourse debt, and property-level management fee income, they are not motivated to sell. Surprisingly, the sellers appear to be large institutions and funds that need to raise capital to fulfill their capital commitments, satisfy their redemptions, and/or to maintain their leverage limitation covenants.

Real Estate Fundamentals

Weak & Getting Weaker – Real estate fundamentals have plummeted. Certain submarkets, when including sublet space, have vacancy rates approaching 30%. A few submarkets will be severely impacted by developments currently under construction (e.g., downtown Miami may become 40% vacant by 2011 and Buckhead in Atlanta may become 30% vacant by 2010). Although it appears from current economic indicators that most of the layoffs of office-using employees have occurred, we expect continued softening in the commercial office real estate market due to the

significant amount of “dark space”¹ that we foresee coming back to the market over the next 36 months. Even when tenants choose not to give back dark space, market demand will still be impacted since those tenants will not require additional space until they have back-filled the dark space.

Long-Term Trough – Effective rents have already declined by as much as 30%, driven primarily by increases in concessions in the form of free rent and additional tenant improvement allowances. We expect further declines in real estate fundamentals throughout 2010 including continued increases in vacancy rates. We do not foresee rent recovery in many of our markets until 2014 and some markets may not return to 2007 rents until 2016.

Recent Fund Activity

Discipline – Since the initial closing of our current fund in July 2007, we have not purchased any assets other than a minor participation in a B note. The fund consists solely of legacy assets purchased by the partners on their personal balance sheets in off-market transactions and contributed at cost to the fund upon its formation.

Lender Focus – Since many owners have lost most if not all of their equity, we have spent much of the past 18 months focused on trying to purchase notes from lenders to execute a loan-to-own investment strategy. At first, lenders did not acknowledge that there were any issues with their loans. Their attitude, however, changed drastically about six months ago at which time lenders began to aggressively discuss selling their notes. We originally planned to purchase notes at a discount based on our valuation of the collateral, but had to adjust our strategy when it became apparent that the lenders would not recognize such large write downs. Now, we are proposing to restructure the debt so as to reduce the recognition of loss through the creation of a joint venture with the lender. We would act as the asset manager and contribute preferred equity for capital expenses (including tenant improvements and leasing commissions) so that the lender would not be required to

¹ “Dark space” is leased but is not being used due to downsizing or consolidation. Since many of these tenants are good credit, they do not immediately default on their lease obligations; rather, they opt not to renew their leases or may give back the space upon expiration.

* Quarterly US Office Sale chart sourced from Real Capital Analytics July '09 Capital Trends Monthly.

reserve any future capital. This structure would prevent the collateral from wasting as the current borrower has no available capital for these expenses.

Investment Opportunities

By Whom & When Will Selling Begin – The fourth quarter may see a modest uptick in transaction volume, which may set the long-awaited pricing “floor”. Sellers will consist of large funds that need to raise capital for redemptions or other capital requirements and property owners that are willing to take year-end write downs to clean up their balance sheets. Transaction volume should increase throughout 2010 as lenders, who will have by then appreciably narrowed the spreads between their book values and market values, will bring REO properties and distressed debt to market.

Opportunities – Despite the low transaction volume, the dearth of equity (and more importantly debt) coupled with weak real estate market fundamentals should keep pricing at historic lows for several years. Properly underwritten and managed value-add real estate investments made between 2010 and 2014 should achieve opportunistic level returns (which we define as a minimum 20% leveraged IRR and a 2.0x multiple). **Not since the early 1990’s has there been such an attractive investment environment in which to achieve outsized returns with moderate risk.**

About Crocker Partners

Crocker Partners is a private equity fund manager that invests capital in office product located in primary submarkets along the East Coast of the United States. We are currently investing capital on behalf of Crocker Partners IV, a closed-end fund focusing on value-add and opportunistic office investments located within the Southeast U.S.



Our investors include some of the largest and most respected institutional investors in the world.