



2010 Q4 Market Update

Overview: Deal volume continues to improve. Owners and lenders have begun to remove impaired assets from their balance sheets. Debt markets continue to strengthen with CMBS originators leading the pack on well-leased, stabilized assets and specialty debt funds are providing capital for more challenged properties. Leasing volume remains healthy as tenants continue to lock in long-term leases at today's advantageous terms. Our current acquisition pipeline consists of seven potential acquisitions, which would require over \$150 million of equity, and for the first time in over three years Crocker Partners acquired an asset, the Lakes on Post Oak ("LOPO"), a 1.2 million SF, 88% leased, Class A office project located in the Galleria submarket in Houston. This transaction represents a re-acquisition of this project, which we sold in 2005. We purchased it in a joint venture with an affiliate of Five Mile Capital Partners for \$177 million (\$147/SF) or a 7.3% cap rate (at closing, in-place rents were only 75% of current market rents), which equates to a 55% discount to replacement cost. Since closing, we have entered into leases and LOIs totaling 54,308 SF at effective rents which are \$2.16 higher than our pro forma rents and which will bring occupancy to 92.9% and increase our cap rate to 8.1%.

"They Don't Ring a Bell at the Top or Bottom of the Market":

We do not time the market; rather, we rely on our disciplined and consistent investment strategy which utilizes strict underwriting standards honed over twenty years. We buy when our underwriting evinces that we will achieve attractive risk adjusted returns to our investors and we sell when a successful bid would require us to use underwriting assumptions that are "priced to perfection." For instance, in late 2005 we sold our prior company, a publically-traded REIT, because each time we underwrote a potential acquisition we were unable to get near the sale price and it became apparent that there was a bubble in commercial real estate. As a result, under our management, shareholders achieved a 21% IRR and 2.8x equity multiple on a company that was only 40% leveraged. In retrospect, we sold about a year too early, but we would rather be a year too early than a year too late. The following ten principles guide our investment process:

1. Exit Cap Rates Must be Consistent with Long-Term, Stabilized Cap Rates
2. Sale Price Must be Consistent with Prior Trades in Normalized Capital Markets
3. Purchase and Sale Prices Must be Significant Discounts to Replacement Cost
4. Sale Price Must Allow the Next Buyer to Generate an Appropriate Risk Adjusted Return
5. Rent Recovery May Not Exceed Prior Peak Rents
6. Stabilized Rent May Not Exceed Historical Discounts to Replacement Cost Rent for Comparable Buildings

7. Leasing Velocity May Not Exceed Historical Absorption Rates of Comparable Properties
8. Required Returns Must Reflect the Risk of the Return Distribution Between Cash Flow and Reversion
9. Financing Must Accommodate Downside Scenarios
10. Stabilized Occupancy Rates May Not Exceed Historical Normalized Occupancy Levels in Comparable Buildings

Asset Sales: We witnessed an enormous increase in transaction volume in 2010; however, until Q4, most trades consisted of stabilized, core assets located in core submarkets. Real estate has been bifurcated between core assets in core submarkets and everything else. The former have been trading at historically low cap rates and are awash in debt at attractive terms, while the latter has seen few if any trades. In Q4, however, non-core assets began to trade due to the confluence of a healthier debt market and a significant improvement in lender balance sheets that allowed them to take write-downs on toxic assets. With support from the U.S. Government, troubled assets are being liquidated in an orderly fashion, allowing the bid-ask spread to compress to a level that permits banks to sell while remaining solvent and buyers to acquire assets at attractive risk adjusted returns. Our acquisition of LOPO is a good example of the bifurcation of the market. At first glance, one would think this stabilized asset, located in one of the stronger submarkets in the US, would fall into the core category and, as value-add investors, it would have been priced out of our range. It failed, however, to garner interest from core, institutional investors because of substantial tenant rollover in 2014.

Debt Markets: Lenders continue to pursue loans on well-leased assets. On our acquisition of LOPO, we were able to secure a 10-year, \$117mm loan (66% LTV) at a fixed interest rate of 5.68% which the next buyer may assume for a nominal transfer fee. Although we anticipate only holding the asset for five years, the ten-year debt provides ample time to relet the project should the anchor tenant vacate. Moreover, if we sell in five years, this debt will likely provide upside over our pro forma returns since odds are that the interest rate will be accretive. The availability of debt for poorly leased assets (*i.e.*, under 80% leased) also improved last quarter, mainly due to specialty debt funds which will provide debt at reasonable LTVs but at rates and terms much less favorable than those for debt secured by stabilized assets.

Real Estate Market Fundamentals: Real estate fundamentals continue to bump along the bottom of the economic cycle. In a couple of our target submarkets (most notably suburban DC and Houston), fundamentals have begun to improve with positive net absorption and rental rate growth. Leasing volume has remained strong as tenants rush to lock in new leases or renewals at favorable terms. It appears that most of our leasing markets will remain weak for at least the next 20 months, as office using employment slowly backfills the vacant and "grey" space (*i.e.*, space that is currently rented but is held for future expansion purposes).