CROCKER PARTNERS

2011 Q1 Market Update

Transactions – Sale volume of stabilized, core assets located in core submarkets continues to expand at a rapid pace. Real estate as a whole, however, remains bifurcated between core assets and everything else. Interest in core properties is so strong that they are trading at all-time high prices. On the other hand, non-core properties have been trading much less frequently and at huge discounts to prior sales prices (although there has been a noticeable increase in non-core assets being marketed, primarily by large investors and balance sheet lenders who are cleansing their balance sheets of toxic assets). In fact, one of the largest owners of distressed real estate in the country told us that they have begun selling assets at today's distressed pricing because over the past few years their internal valuation write-downs have been so severe that sales at current market value generates a profit.

Our current acquisition pipeline reflects this uptick in activity and consists of thirteen potential acquisitions requiring over $290 million of equity, a substantial increase over last quarter's pipeline of seven potential acquisitions.

Debt & Capital Markets – The availability of debt and equity for acquisitions and refinancing continues to improve. In particular, CMBS originators are aggressively pursuing well-leased, stabilized assets, asking borrowers, "What do we need to do to win your business?" The debt market for non-stabilized assets, however, remains much more challenging and is limited to specialty debt funds that provide debt at reasonable loan-to-value ratios but at much less favorable rates and terms. Capital markets continue to be dislocated with investors focusing on either (i) core assets (whether debt or equity) to achieve single digit returns or (ii) opportunistic investments to achieve returns in excess of 20%, resulting in a vacuum in the value-add space, which targets mid-teens returns.

Real Estate Market Fundamentals – When was the last time you heard a broker say, "this past year was my best ever"? 2007 or 2008? Well, if you were speaking with a commercial leasing broker, it could have been last month. Tenants continue to lock in long-term leases at today's advantageous terms, a trend we see continuing as stressed buildings trade to new owners with ample capital reserves and a desire to poach tenants from buildings with owners who are either unable or unwilling to incur the substantial capital expenses required to retain them. Real estate fundamentals, however, continue to bump along the bottom of the economic cycle with the exception of certain submarkets within the DC Metro and Houston markets in which fundamentals have shown impressive improvement.

Coremania - Act II of a Three Act Play

As you may recall, in our 2010 Q3 report, we described the run-up in pricing in core assets as "coremania." Not only has the market failed to correct, but in certain markets core pricing has reached all-time highs, trading at historically low cap rates driven by the deluge of capital into the core space. Between June 2009 and September 2010, the aggregate redemption queues for core, open-end funds dropped from $10 billion to aggregate <u>deposit</u> queues of over $6 billion. As it turns out, a warning to our readers to "beware the ides of March" would have been prescient since the most expensive Washington, DC office trade ever reportedly closed on March 10th.

For the past three quarters, properties have been trading in DC for significant premiums to the cost to develop a new office building in DC, which ranges between $700/sf and $750/sf. These fully-leased buildings with in-place rents at or just below market rents have been trading at cap rates between 4.5% and 5% (spreads over the 10 Year Treasury are often below 150bp) which is remarkable when comparing those cap rates to the 7.5% target stabilized cap rate for a developer. It appears that these buyers are not concerned with short-term NAV risk but rather focused primarily on cash flow to achieve their target returns. An analysis of these trade metrics has yielded a sobering conclusion: to achieve an all-cash, gross 7% IRR over a 10 year investment period, cash flow assumptions must be "priced to perfection," including near-term rental spikes in excess of 30% (which means that rental rates will exceed those for new construction) and sales prices in excess of the future cost to develop a competing office building.

Epilogue: Why Value-Add Investors Love Coremania

The flood of capital into core assets is one of the factors helping to create the excellent value-add investment environment on the horizon. Clearly, with less money chasing these investment opportunities, pricing will be more favorable and will allow value-add investors to achieve superior risk adjusted returns. Furthermore, there is so much capital currently allocated to the core space (*e.g.*, CalPERS reports that 75% of its new allocations will be core) that it will take years to deploy. This will create a deep market of core buyers to whom today's value-add investors can sell their then stabilized assets at attractive pricing.

About Crocker Partners

Crocker Partners is a private equity fund manager that invests capital in office product located in primary submarkets in the Southeast U.S. and Texas. 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.

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