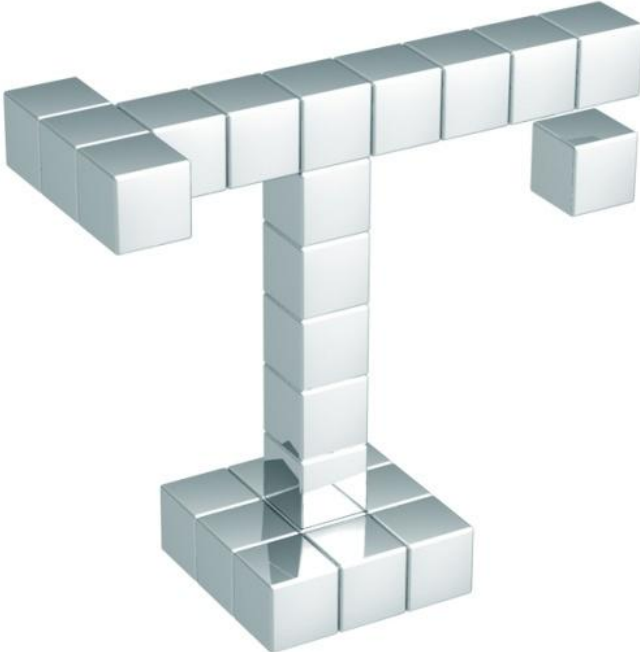




**2009 – ANNUAL REVIEW OF PRIVATE EQUITY
REAL ESTATE TERMS AND CONDITIONS**



INTRODUCTION

SCM Strategic Capital Management AG (“SCM”) is pleased to present you the first annual review of private equity real estate terms and conditions. This study covers the period from 2007 – 2009 and it particularly **highlights the impact of the current crisis on the terms and conditions of fund offerings in 2009**. The report is structured in four sections (1. Description of Sample, 2. Fundraising Environment 2009, 3. Key Findings, and 4. Conclusions and Outlook). It is important to note that the data sources for this research study were the terms and conditions shown in Real Estate Offering Memoranda (“PPM”) and not negotiated terms from Limited Partnership Agreements (“LPA”).

DESCRIPTION OF SAMPLE

SCM's real estate database has continuously grown and includes as per end of 2009 more than 500 funds from almost 400 different private equity real estate fund management firms. The sample used for this research report is composed of funds reviewed in the last 3 years. The composition of the sample experienced three significant changes from 2007 to 2009: 1) Asia and Rest of the World (RoW) lost ground against Europe and the US (its share dropped from 36% in 2007 to 16% in 2009), 2) smaller funds' share (< USD 0.5bn fund size) increased from 50% in 2008 to 68% in 2009 and 3) debt funds' share tripled from 7% in 2008 to 21% in 2009.

SCM Sample Description (2007-2009)

Classification	2007		2008		2009	
Sample size	81 direct closed-end funds (excluding fund-of-funds and open-end funds)		167 direct closed-end funds (excluding fund-of-funds and open-end funds)		81 direct closed-end funds (excluding fund-of-funds and open-end funds)	
Geographic split	North America	36%	North America	34%	North America	53%
	Europe	23%	Europe	23%	Europe	25%
	Asia and RoW	36%	Asia and RoW	32%	Asia and RoW	16%
	Global Funds	5%	Global Funds	11%	Global Funds	6%
Target fund size	< USD 0.5bn	58%	< USD 0.5bn	50%	< USD 0.5bn	68%
	> USD 0.5bn & < USD 1bn	27%	> USD 0.5bn & < USD 1bn	29%	> USD 0.5bn & < USD 1bn	20%
	> USD 1bn	15%	> USD 1bn	21%	> USD 1bn	12%
Fund strategy	Opportunistic	63%	Opportunistic	59%	Opportunistic	62%
	Value-added	31%	Value-added	34%	Value-added	17%
	Private Debt	6%	Private Debt	7%	Private Debt	21%
Fund history	1st time funds	51%	1st time funds	53%	1st time funds	54%
	fund size > predecessor	44%	fund size > predecessor	40%	fund size > predecessor	38%
	fund size ≤ predecessor	5%	fund size ≤ predecessor	7%	fund size ≤ predecessor	8%

FUNDRAISING ENVIRONMENT 2009

If one called the fundraising environment for private equity funds “a challenge” or “difficult” in 2009, the environment for real estate fundraising experienced a major downturn. This was particularly caused by the retreat of US investors (primarily pension funds and endowments) who had always been amongst the largest capital allocators to real estate funds. Given the losses they experienced from such holdings, the over-exposure and liquidity constraints they had to deal with, an important investor base of such funds disappeared almost overnight. Another group of large investors, Sovereign Wealth Funds (“SWF”), either stopped making new investments as well or they moved away from blind pool structures. The investor base which continued investing was just not large enough to fill the gap which these investors left behind.

As a result, none of the funds which started their fundraising in 2009 reported a significant first close yet and therefore, Limited Partners as well as managers still lack reliable indications how post-Lehman terms and conditions may look like.

The few fund managers which announced a significant first or final close in 2009 already started their fundraising in 2008 and raised most of the capital pre-Lehman (at “old” terms and conditions), i.e. late close investors more or less had the choice between accepting the terms or not making a commitment.

What does it all mean for this terms and conditions study 2009? Managers which launched their real estate funds in 2009 certainly understood that they could not just copy paste the terms and conditions from their last funds, which were raised in a different market environment. But since the real estate fundraising market came to a complete standstill in 2009, the managers were not exactly clear what terms Limited Partners would accept and they did also not want to give up all negotiating power already in the PPM. As a result, managers changed some of their terms and conditions already in the PPM while other terms were left unchanged for negotiations later in the process. Therefore, SCM does not consider the terms and conditions in 2009 PPMs anything close to current market practice but relies on the trends observed during negotiating processes, which are discussed in this report.

KEY FINDINGS

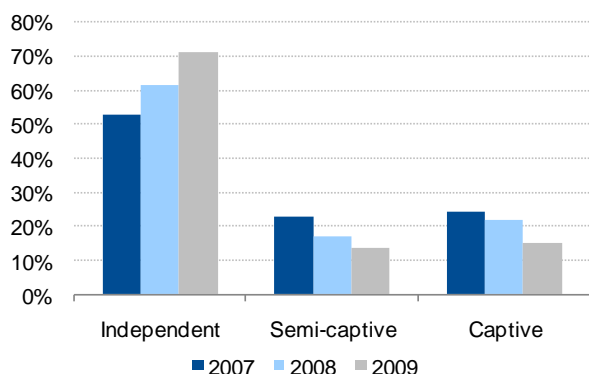
Alignment of Interests: Ownership, GP-Commitment, Carry, Hurdle, Waterfall

An interesting observation in the 2009 study was the decreasing number of fund offerings from semi-captive and captive managers (Chart A), a consequence of the financial crisis. Some sponsors of real estate funds disappeared from the landscape (e.g. Lehman) or they were just not in a position anymore to act as sponsors of such investment pools (e.g. Investment Banks). As a result, offerings from independent fund managers accounted for more than 70% in 2009 (+ 10% vs. 2008 / + 20% vs. 2007). This situation is probably not going to change in the foreseeable future. That being said,

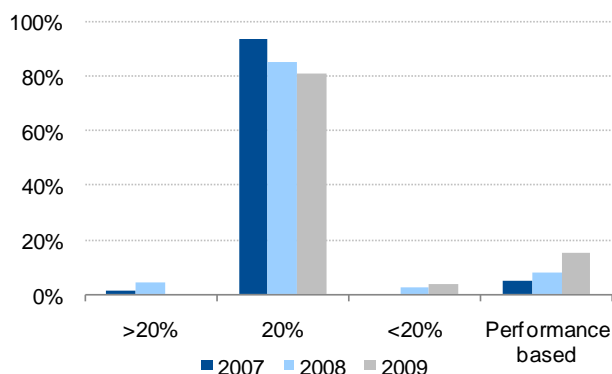
almost 30% of all real estate funds were still managed by captive or semi-captive teams.

The access to a pool of capital from a sponsor was in SCM's view the reason why still 20% (2008: 35%) of all real estate funds received a high GP commitment of > 5% in 2009 (Chart B), although a clear downward trend was observed. GP commitments in real estate generally tend to be (slightly) higher than in private equity (at least in SCM's samples) which may be surprising. Reasons could in SCM's view be the managers' origins (several managers have grown from a family office to a "fund management company" but still receive backing from the family) or some managers' diversified real estate operating platforms that generate excess fees (e.g. from property management or development businesses).

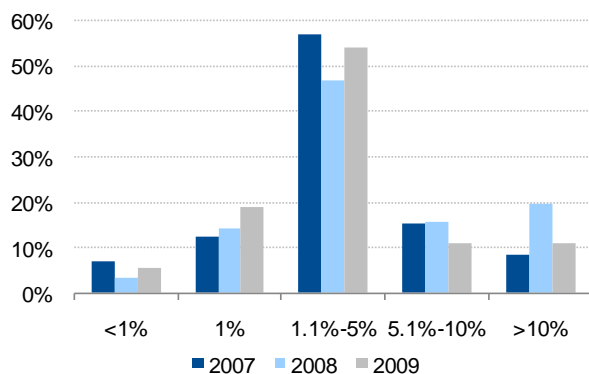
(A) Ownership Structure



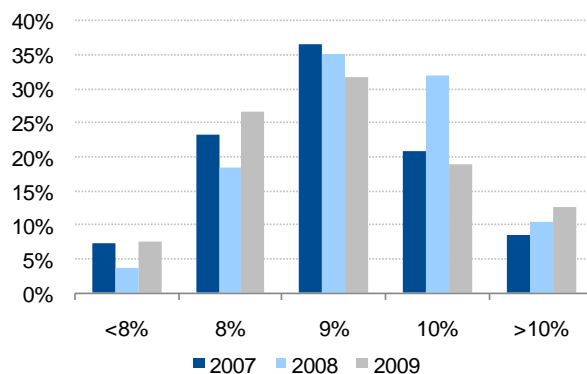
(C) Carried Interest



(B) GP-Commitment



(D) Hurdle Rate



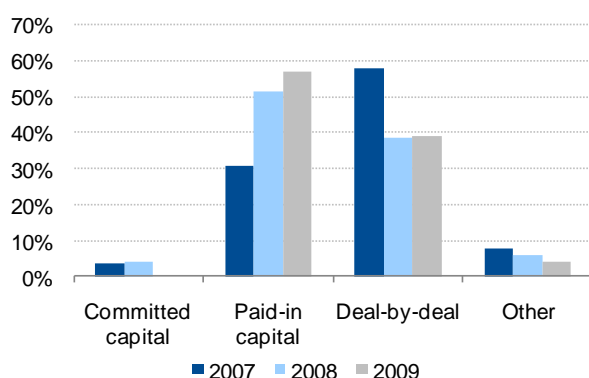
The carried interest of the vast majority of all real estate funds (Chart C) stood at 20%. An increasing number of managers tried to push through a performance based step-up carried interest (e.g. 20% carried interest if an 8% hurdle rate (preferred return) is achieved and a 25% carried interest if a 15% hurdle rate is achieved). Such performance based mechanism has in SCM's view no chance of success if the hurdle rate stays at around 8%. In the standard 20% carried interest model, hurdle rates of 8% or 9% were the norm (Chart D).

One of the most important changes in this terms and conditions study relate to the waterfall, which became more LP friendly. A deal-by-deal carried interest which reached a market share of almost 60% in 2007 was replaced by a fund-as-a-whole carried interest as best market practice in 2008. In 2009, this trend continued and almost 60% of all funds have to return the paid-in capital to Limited Partners (plus a preferred return) before the managers would be entitled to receive carried interest distributions (Chart E).

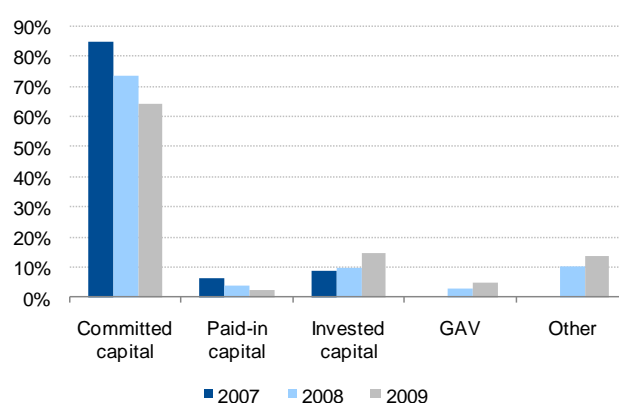
Management Fees

The management fee base (Chart F) during the commitment period was in more than 60% of all offerings the committed capital (and invested capital post-investment period). However, an increasing number of funds (2009: 15%) charged management fees on invested capital right from the beginning which obviously lowers the amount of fees charged during the commitment period. This being said, this model creates a conflict as managers are incentivized to deploy their funds' capital more quickly in order to maximize their fee income. Overall, SCM has a clear preference for a lower management fee rate than a change in the management fee base. But a reduction of management fee rates could not be observed yet in 2009 because no meaningful fundraising was completed during the year. SCM has, however, evidence from most recent partnership negotiations that Limited Partners are pushing managers hard to lower their fee rates.

(E) Waterfall



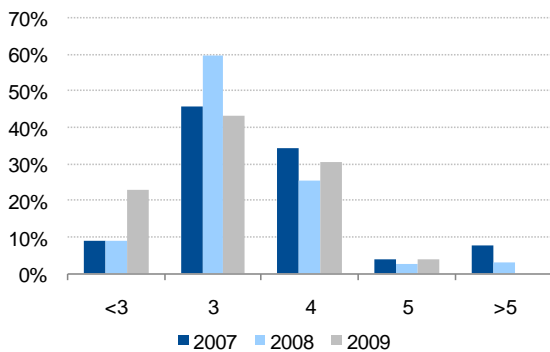
(F) Management Fee Basis (Investment Period)



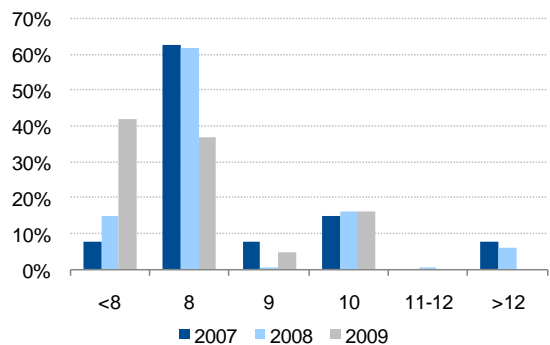
Length of Investment Period / Investment Term

Investment periods and fund terms of classic estate funds are normally 3-4 years and 8 years respectively. However, the sample shows in 2009 outliers in both, investment period (more than 20% < 3 years) and fund term (40% < 8 years). This is mainly related to an increased number of private debt fund offerings in 2009 which generally have a shorter life. Out of the 18 private debt funds reviewed in 2009, 56% had a fund term below 8 years and 39% had an investment period below 3 years.

(G) Length of Investment Period



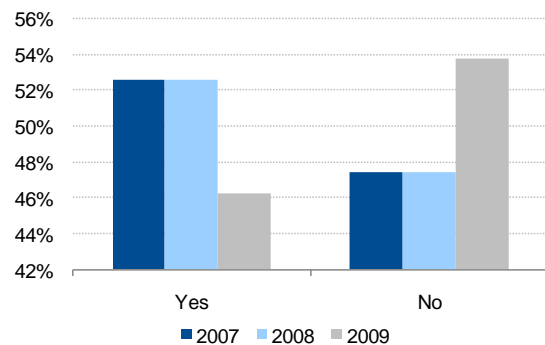
(H) Fund Term



Use of Placement Agents

While in the past slightly more than 50% of all managers used a placement agent, this **percentage dropped below 50% in 2009**. This may come as a surprise as in a difficult fundraising environment one would expect managers to flee into the arms of placement agents. SCM believes that this development is less a result of fewer managers trying to engage placement agents but rather the placement agents' decision not to accept mandates, which in their view will never come to a successful end. For this purpose some placement agents changed their model from a pure success fee to a mix of retainer and success fee. While such model improves the placement agents' position, managers will probably be more reluctant to award mandates to placement agents where the fundraising success and duration seems questionable.

(I) Use of Placement Agents



CONCLUSIONS AND OUTLOOK

This study revealed a few important changes in the real estate fund terms and conditions in 2009, the most LP-friendly probably being the change from a “deal-by-deal” to a “fund-as-a-whole” waterfall. Because 2009 was a particularly weak fundraising environment with very few negotiated terms and conditions, the whole degree of pressure on the terms and conditions will only be visible once more funds have completed a full fundraising cycle under the new market conditions. Like in the past, Limited Partners will have different foci in the negotiations of terms and conditions but they will probably have a common understanding of the goal that should be achieved: lower fees (and more transparency), better alignment of interest and stronger corporate governance. **Therefore, SCM expects that the following terms and conditions will be amongst the ones where managers will experience most pressure from Limited Partners:**

Commercial Terms / Alignment of Interest

Preferred return: The trend to higher preferred returns in the range of 10% to 12% will in SCM’s view continue.

Carried interest: Performance based carried interest models (step-up mechanism) will in SCM’s view not find great acceptance amongst Limited Partners.

Management fees / other fee income: Paying high fees was justified by high returns. But going forward, managers will experience tremendous pressure from Limited Partners to

lower the fund management costs (e.g. netting of fee income (e.g. transaction fees) against management fees, reduction of management fee base rates in general, full disclosure of property management fees, etc.).

GP-Commitment: SCM expects different forms of GP-commitments to come under increased scrutiny as Limited Partners want to see the investment teams deploy their own capital to the funds they manage. The cross-subsidization of the GP-commitment from fund management fees, property management fees or even from other businesses of the parent company raises questions about the alignment of interest (e.g. “fee machine”, time allocation of key professionals, etc.). This will certainly be an interesting topic to watch as it questions some real estate managers’ business models (in particular the operation of broad real estate platforms including fund management, property management, development business, leasing agent business, etc.) and would certainly affect certain terms and conditions (e.g. lower GP commitments).

Cross-collateralization of assets: Cross-collateralization of assets allowed managers to secure favorable terms for credit lines on a fund level. While attractive at first sight, some managers clearly underestimated the downside risks of such financing structures in a bear market environment. One might question whether the cross-collateralization of assets has much to do with prudent management and SCM has the view that within a blind-pool fund concept, property transactions should be financed on a standalone basis going forward.

Fund Governance

Removal for cause / no-fault removal: The right to remove a manager for cause or no-fault is certainly amongst the strongest rights an investor can have. As a consequence, managers tried to resist any change requests in favor of Limited Partners or they requested high compensation in case a removal event was triggered. Given the importance of such rights, SCM believes that Limited Partners will try to shift power from managers to Limited Partners (e.g. managers shall give up all future carried interest or management fee payments if a removal for cause event was triggered).

Key man event: While most old fund documentations included a key man provision, SCM believes that Limited Partners are keen to make such provisions more effective.

Role and power of advisory board: SCM believes that the Advisory Board will have a more important role governing funds going

forward, which would require very clear formulations of advisory board involvement in all potential situations that could arise during the lifetime of a closed-end fund. But the new role will also put an obligation on Limited Partners to appoint experienced investment professionals to the boards and not to view advisory boards as classrooms for junior professionals.

Overall, SCM believes that the next few years will represent very tough fundraising markets and therefore, most managers that intend to raise new blind-pool funds will have to make significant concessions on the terms and conditions of their offerings if they want to have a realistic chance to close a fund. Therefore, SCM looks forward to interesting and demanding rounds of negotiations with managers, with the hope that going forward the pendulum of power does not anymore shift too much in either direction.

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