



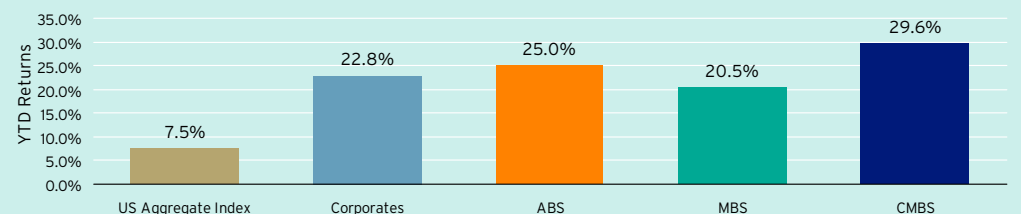
Market Commentary

Real Estate Debt Performance Indicators FIRST QUARTER 2010

After 18 months of no new issuance, first new CMBS transaction was brought to market.

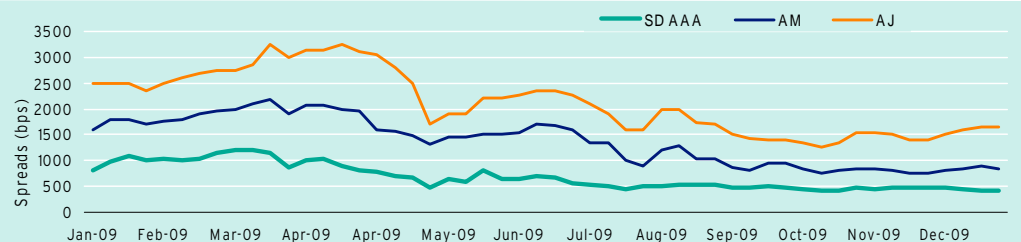
- Rebounding from a relatively weak November, legacy CMBS finished the year with the best absolute performance for 2009 compared to other major fixed income indices. Senior AAA CMBS spreads which started the year at approximately 1,000 basis points were quoted at 410 at the end of the fourth quarter, or a 590 basis point improvement. Although the sector did witness a recovery in security pricing, the deterioration of CMBS fundamentals continues on an upward trajectory and is likely not to stabilize until the beginning of 2011. For senior securities, the in-place credit enhancement should provide a level of insulation from deteriorating fundamentals and is one reason, along with a return to liquidity in the overall credit markets, for the increase in prices for this part of the capital structure.
- Considering the positive impact that Legacy TALF has had on senior security prices, the upcoming March 2010 program conclusion has the possibility of producing a technical weakening in spreads. If this occurs, many market participants believe it will be short-lived as even at current pricing, CMBS still provides a relative yield pick-up to most other fixed income sectors. Additionally, with requested TALF financings running between \$1 to \$2 billion per month, many investors have already been purchasing securities at market pricing without the use of leverage to achieve a higher return threshold.
- After nearly 18 months of no new issuance in the CMBS sector, the fourth quarter saw three new transactions brought to market. The first deal was a \$400 million single-borrower transaction sponsored by Developers Diversified Realty (DDR) and was backed by only one loan secured by 28 retail properties. Even though pricing moved inside of initial guidance, it was reported that only 24% of investors requested TALF loans with the remaining allocations going to unleveraged buyers. With the strong initial demand for the DDR transaction, the two following single-borrower transactions came to market without TALF support and generally received positive demand.

Excess Returns versus Treasuries



Source: Barclays Capital as of December 31, 2009

CMBS AAA Spread Timeline



Source: Morgan Stanley as of December 31, 2009.

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Commercial Mortgage Performance

The CMBS delinquency rate ended 2009 at 5.62% which was a 437 basis point increase from the end of 2008. For December, the 40 basis point increase in new delinquencies was in-line with that of the past few months. Moving through 2010, delinquencies are still expected to increase for all property types as a result of the fundamental lag of commercial real estate to the overall economy. Certainly, specific property types with shorter term leases such as the lodging and multifamily sectors should exhibit a faster recovery once stabilization has been reached but this is likely not to occur until 2011. Looking back at the last recession in 2002, delinquency rates continued to remain elevated through 2004 but lodging delinquency rates, which initially rose very quickly, also were able to improve at a much faster pace than most other sectors.

Delinquency rate ends 2009 at the highest point of the year.

Unlike the last period of fundamental distress in 2002-2004, the current environment is expected to also include a significant portion of balloon maturity defaults in addition to the increasing term delinquencies. Already, non-performing balloon maturities are contributing 33 basis points to the delinquency rate, a figure which should continue to increase considering the valuation declines which have occurred in conjunction with the high amounts of financing provided during 2005-2007.

The multifamily sector ended the year with the highest overall delinquency rate but in recent months has showed some signs of flattening. Even with this trend, this figure could move dramatically higher in the first quarter of 2010 with the impending default of the Stuyvesant/Peter Cooper property which alone would increase the rate by 275 basis points.

CMBS Delinquency by Property Type

Property Type	Percent of Balance Outstanding	Delinquencies Q3 - 09	Delinquencies Q4-09
Retail	30.9	4.49	5.48
Multifamily	15.8	7.65	9.65
Office	30.7	2.76	3.46
Hotel	8.0	6.36	9.51
Industrial	5.1	3.08	4.02
Mixed Use	4.2	4.02	5.50
Senior Housing	0.2	10.81	4.00
Manufactured Housing	1.7	3.01	3.93
Self Storage	1.9	3.01	2.45
Warehouse	0.0	0.00	0.00
Co-op Housing	0.4	0.39	0.39
Other	1.0	2.27	1.76
Totals	100.0	4.42	5.62

Source: Invesco Real Estate using data from Citigroup and Trepp as of December 2009.

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Return of the New Issuance Conduits?

In contrast to the REIT unsecured markets, the new issuance CMBS market has so far been slow to return to any meaningful volumes. This phenomenon has primarily been driven by the relatively high risk premiums required by security investors and the impact this has on acceptable loan terms by the eventual borrowers. As was previously referenced, the three transactions which were brought to market during the fourth quarter all involved a single borrower and had a relatively simple structure in hopes of increasing investor demand.

As for expected new issuance volumes in 2010, most market participants believe \$10 to \$15 billion is achievable. It is likely that the majority of transactions will continue to be either single-borrower or large loans with the first true multi-borrower deal not expected until the end of the year. Deal sizes are expected to be much smaller than what occurred between 2005-2007, expecting to average \$400 to \$500 million. Over the next few years, domestic CMBS new issuance still has the possibility of again reaching volumes north of \$100 billion but continued spread stability and a reversal of real estate fundamentals is likely necessary for these levels to be reached.

Of the conduit programs that are currently in the market offering financing quotes, all are noted as being very selective on asset quality and are seemingly hesitant to offer financing for unanchored retail or lodging properties. The following provides a sample range of conduit terms offered from four originators:

Conduit Financing Terms:

- Collateral: Stabilized
- Loan Size: \$10 to \$75 million
- Loan Term: 5 to 10 years
- Maximum Loan-to-Value: 60% to 75%
- Minimum Debt Service Coverage: 1.25x to 1.35x
- Minimum Debt Yield: 11% to 12%
- Coupon: 6.75% to 7.75%

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