Foundation Report: London Office Market

February 3, 2009 ■ FTSE 100: 4,164 ■ FTSE 350: 1,437 ■ RMZ: 421 ■ U.K. 10-YR GILT: 3.75%

This report describes the history and characteristics of the London office market, examines the near-term outlook, and provides a brief overview of the major listed companies that have sizable positions in the market. The report does not include company-specific investment recommendations. We plan to initiate company research in the near future.

Overview: The London office market has suffered since mid-'07 when credit dried up and the financial services sector began to show signs of strain. Since the peak, values have decreased by approximately 40% and effective rents have declined by about 30%. The market will likely weaken further as demand deteriorates and a flood of supply comes online.

Market Composition: The London office market, which is about half the size of Manhattan's market and twice as large as Washington D.C.'s, is comprised of five primary submarkets. The two main submarkets, the City of London and West End, account for 75% of total stock. The West End has recently generated superior rental growth due to higher barriers to supply, a lack of substitutes, and a more resilient tenant base.

London vs. Manhattan: Comparisons are frequently made between London and Manhattan due to their statures as global financial cities. Barriers to supply are much lower in London. Whereas completions totaling 9% of stock will come online in London between '08 and '11, Manhattan faces completions totaling only about 1% of stock. The London economy is also more tied to the finance industry than Manhattan's, making the U.K. capital more susceptible to prolonged cyclical swings. The combination of lower space demand and higher supply in London should cause office owners there to experience greater pain over the next few years.

Outlook for London Office Market Fundamentals: Like other global financial centers, London is in the middle stages of a major recession. The severity of the current downturn in office fundamentals will likely be at least as bad as past major market downturns (i.e. the mid-'70s and early-'90s). Our forecasts assume, from peak levels in mid-'07 to a trough in '10, approximately 85,000 Central London job losses (9.5% of the total employment in finance, banking, and insurance), a 750 basis point increase in market vacancy (to 10.5%), and a 45% decline in effective rents (to £32/s.f. in the City and £64/s.f. in the West End). It is likely that same-market NOI growth will be negative in the City and West End during '09 and '10. A recovery is expected in '11 as the current development pipeline is absorbed and the financial services industry continues to recover.

London Office Market Valuation: London office properties appear overpriced in the private (i.e. "open") market. Based on current initial yields and expected rent growth, we estimate that unleveraged total return expectations (IRRs) for City and West End office properties are in the mid-7s and low-8s, respectively. These return expectations appear inadequate as compared with the returns available in low investment grade debt. Unless corporate bond yields decline relative to London office IRRs, private-market office values may fall by another 20%. This would factor in a typical severe "20-year flood" in commercial real estate pricing (i.e. a peak-to-trough drop of 50% or more). Values could fall even further if the U.K. economy suffers the "50-100 year flood" that many economists fear.

REIT share prices appear to be incorporating a more severe decline in property values than our base case estimate. Investors are concerned not only about the potential further drop in private-market values, but also the possibility that REITs will engage in dilutive transactions (equity offerings or asset sales).

Selected Listed Property Companies: Five major U.K. REITs have sizable London office portfolios. The REITs generally own prime properties and have considerable development exposure. Land Securities (LAND) and British Land (BLND) have the largest operating portfolios and two of the largest development pipelines in the Central London office market. Both of these companies are diversified with less than half of their total property portfolios invested in offices. Derwent London (DLN) and Great Portland Estates (GPOR) are nearly pure-plays in the London office market, whereas Hammerson (HMSO) primarily owns retail assets and has a position in the City.

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22 Grosvenor Square - 3rd Floor ■ London, W1K 6LF
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Note: Values used in this report are based on company-published information. Green Street will publish proprietary estimates when initiating company research in the future. The USD/GBP exchange rate used in this report is £1/$1.43. Most market data is based on 4Q08 estimates by CBRE. Rent figures quoted are prime unless stated otherwise.

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I. Overview

This report describes the history and characteristics of the London office market, examines the near-term outlook, and provides a brief overview of the major listed companies that have sizable positions in the market. The report does not include company-specific investment recommendations. We plan to initiate company research in the near future.

The London office market has suffered since mid-'07 when credit dried up and the financial services sector began to show signs of strain. Since the peak, values have decreased by approximately 40% and effective rents have declined by about 30%. The market will likely weaken further as financial services jobs are lost and a flood of supply saturates the market.

The report is targeted to all investors, but makes references that are intended to be particularly useful for those based in the U.S. Basic terminology, lease terms, valuation, and supply/demand conditions are quite different in the U.K. For further details on terminology differences, please refer to Appendix D of this report and our forthcoming foundation report comparing U.K. and U.S. property market terminology.

A. Market Composition

The London office market totals 210 million s.f. and is comprised of five primary submarkets. The two main submarkets, the City of London and West End, account for 75% of total stock. Due to several factors, the West End has generated superior rental growth in recent periods (see pages 9-12):

- **Higher Barriers to Supply:** The local authority responsible for granting planning permissions in the West End is hostile towards development and has designated 75% of the submarket as a conservation zone, thereby restricting development. Furthermore, offices compete with residential and retail projects for land sites whereas office development accounts for all projects in the City.

- **Less Competition:** Unlike the West End, the City faces competition from the new, low-cost business centers in Canary Wharf and Southbank. The larger financial services firms that have historically been City tenants favor large floorplates as opposed to location. The drastic expansion in supply within Canary Wharf and Southbank has kept a lid on rent growth in the City.

- **A More Resilient Tenant Base:** Whereas the City's main tenants are larger financial services firms, the West End has a mix of occupiers (notably smaller business services firms). Since business services employment has grown twice as quickly as banking and insurance over the last 20 years, demand in the West End has outstripped the City. The diversified tenant base also makes the West End more resilient during a financial crisis.

B. London vs. Manhattan

Important similarities and differences between the London and Manhattan office markets include (pages 13-14):

- **Lower Supply Barriers:** While London and Manhattan are both urbanized, the barriers to supply appear to be much lower in London. Whereas completions totaling 9% of stock will come online in London between '08 and '11, Manhattan faces completions totaling about 1% of stock. **This is particularly a problem in the City, which faces completions totaling 12% of stock through '11. The West End is also confronted with a wave of supply and faces completions totaling 5% of stock, comparable to expected completions as a percentage of stock for the entire U.S. office market.**

- **More Financial Services Dependent:** The London economy is more tied to the finance industry than Manhattan, making the U.K. capital more susceptible to prolonged cyclical swings. **The financial services contraction, coupled with a worse supply outlook, suggest that London office owners will experience greater pain over the next few years.**

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- **Similar Occupancy Costs per Worker:** The London office market has more than double the rent per s.f. as Manhattan, but twice the worker density. Thus, while London occupancy costs per s.f. are the priciest in the world at nearly £100/s.f., the cost differential per worker is modest.

- **Superior Lease Structure:** London office landlords benefit from a favorable lease structure that provides significant downside protection. Leases require tenants to pay for building maintenance and repairs, contain 5-year upward only rent reviews (every five years, leases are marked-to-market if the market exceeds in-place rent), and are long at 10-15 years. The beneficial lease structure is a key reason why nominal cap rates and required IRRs have historically been lower in London. However, U.K. landlords do not receive fixed annual rent increases (i.e. "rent bumps"), which are a fairly standard practice in U.S. office leases.

C. Outlook for London Office Market Fundamentals

Like other global financial centers, London is in the middle stages of a major recession. Since the peak in mid-to-late '07, effective rents have fallen by roughly 30% and vacancy has increased by 230 basis points to 5.3%. With significant supply coming online and the economy in a tailspin, London office owners will experience the most pain since the early '90s downturn.

- **Oversupply (pages 15-18):**
  - A wave of speculative development will weigh on the London office market over the next few years. **Developers accepted lower target development yields as cap rates compressed. With valuation yields now rapidly expanding, most development has become value destructive (see page 17).**

- **Lackluster Demand (pages 23-24):**
  - The main demand driver for London office space is financial services employment growth. Over the last few years, as financial services activity was robust, London experienced rapid economic growth and rents soared to all-time highs. However, with the financial industry in tatters and the global economy mired in recession, significant headwinds have emerged.
  - We expect that nearly 10% of total jobs in banking, finance, and insurance (85,000) will be lost across Central London. This outlook indicates a drop in employment that will far exceed the last cycle, but will be roughly equal to losses from the early-'90s.
  - We also estimate that take-up (a measure of gross leasing activity in the market) will fall to its lowest level since '91.

- **Occupancy and Rents to Fall (pages 25-26):**
  - The mixture of rising supply and mounting job losses will significantly increase vacancy. We estimate that Central London vacancy will expand by 750 basis points from the peak to 10.5%, approaching the trough level hit in the early-'00s downturn.
  - Rents are also set to decline as the growth generated over the last few years evaporates. We estimate that the City and West End will suffer roughly 45% effective rent declines from the peak (i.e. to £32/s.f. in the City and £64/s.f. in the West End) as demand dwindles and the market is saturated with supply.
  - **The combination of rising vacancy and falling rents will have a material impact on NOI growth. It is likely that NOI growth will be negative in the City and West End during '09 and '10. A recovery is expected in '11 as the current development pipeline is absorbed and the financial services industry continues to recover.**

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D. London Office Market Valuation

Although values have already declined by approximately 40%, London office buildings still appear overpriced in the private market (pages 27-28). During the upcycle, net initial yields compressed to historic lows as the cost of debt diminished and investors used aggressive underwriting assumptions. This “low-return world” began to unwind in mid-’07 as liquidity dried up and concerns about fundamentals took center stage. **Since the peak, net initial yields in the City and West End appear to have increased by about 300 basis points, one of the largest expansions in their history. Despite the sizable movement to date, values will likely continue to decline.**

Based on our current estimates regarding near-term NOI growth and net initial yields, the unlevered IRRs that a buyer of an office building can expect are roughly 7.6% for the City and 8.0% for the West End. Compared to yields on low investment grade debt (9%) and other investments with similar risk profiles, this indicates an inadequate return to real estate equity holders. Unless corporate bond yields decline relative to London office IRRs, private (i.e. “open”) market office values may fall by another 20%. This would factor in a typical severe “20-year flood” in commercial real estate pricing (i.e. a peak-to-trough drop of 50% or more). Values could fall even further if the U.K. economy suffers the “50-100 year flood” that many economists fear.

REIT share prices appear to be incorporating a more severe decline in property values than our base case estimate. Investors are concerned not only about the potential further drop in private-market values, but also the possibility that REITs will engage in dilutive transactions (equity offerings or asset sales).

E. Selected Listed Property Companies

Five U.K. REITs have sizable London office portfolios. The REITs generally own prime properties and have considerable development exposure. See pages 29-31 for additional overview comments and Appendix E for company-specific details.

- **Land Securities (LAND); (London Office: £4.2B pro-rata value; 44% of total assets)**
  - Largest Central London office landlord with roughly 5% market share.
  - Builds geographic clusters. Portfolio is concentrated around Victoria Station (West End), Cheapside (City), and New Street Square (Midtown).
  - Active developer that has mostly well-timed completions during the recent cycle.
  - Largest developer in the West End, but with respectable pre-leasing (47%) across its pipeline.
  - Mix of prime and secondary assets; focuses on redeveloping older assets into new prime destinations (i.e. Cardinal Place, One Wood Street).
  - Delayed construction of 20 Fenchurch (aka “Walkie Talkie”) in mid-’08 due to concerns about the City.

- **British Land (BLND); (London Office: £3.4B pro-rata value; 32% of total assets)**
  - Owns two large, prime office estates: Broadgate (3.6 million s.f.; City) and Regent’s Place (1 million s.f.; West End). Both assets serve as key hubs for the financial services industry in London.
  - Historically more of an investor than developer. Made well-timed decision to reduce London office investment property exposure over the last few years (notably selling many properties at the peak, including 175 Bishopsgate and CityPoint).
  - Largest current developer in the City. Several projects from the earlier part of the cycle were timed well (Plantation Place and Willis Building) and generated large development profits. However, half of the company’s recent pipeline completes during ’08-’09.
  - Largest development project (Leadenhall Building) was postponed in mid-’08 due to concerns about the market.

- **Derwent London (DLN); (London Office: £2.2B pro-rata value; 94% of total assets)**
  - London office sharpshooter concentrated in value-oriented West End submarkets (Fitzrovia, Victoria, Soho, and Covent Garden).
  - Relatively large current pipeline (12% of operating asset value), but with the highest pre-leasing percentage (57%) of the REIT peer group.

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- **Hammerson (HMSO); (London Office: £0.9B pro-rata value; 16% of total assets)**
  - Primary focus is retail.
  - Concentrates on developing and recycling capital in the City to capitalize on market swings.
  - Historical development track record has been good although the REIT is having trouble leasing the two projects currently in the pipeline.
  - Recently placed its marquee London office asset on the market (Bishops Square).
  - Owns two large land sites in the City/Hackney (adjacent to Bishops Square and Broadgate).

- **Great Portland Estates (GPOR); (London Office: £0.8 pro-rata value; 72% of total assets)**
  - Focused on the West End (specifically the North of Oxford Street submarket).
  - Portfolio is a mix of office and retail assets that have "growth potential" (i.e. low rents that can be improved through repositioning or redevelopment).
  - Added development capability in '02. The development program has generally been well-timed with the majority of projects completed near the market's peak, generating large profits (Met Building and Sackville Street). While there are only a few developments in progress, the REIT's future pipeline is expansive.

Steven Frankel
Senior Associate

John Lutzius
Managing Director

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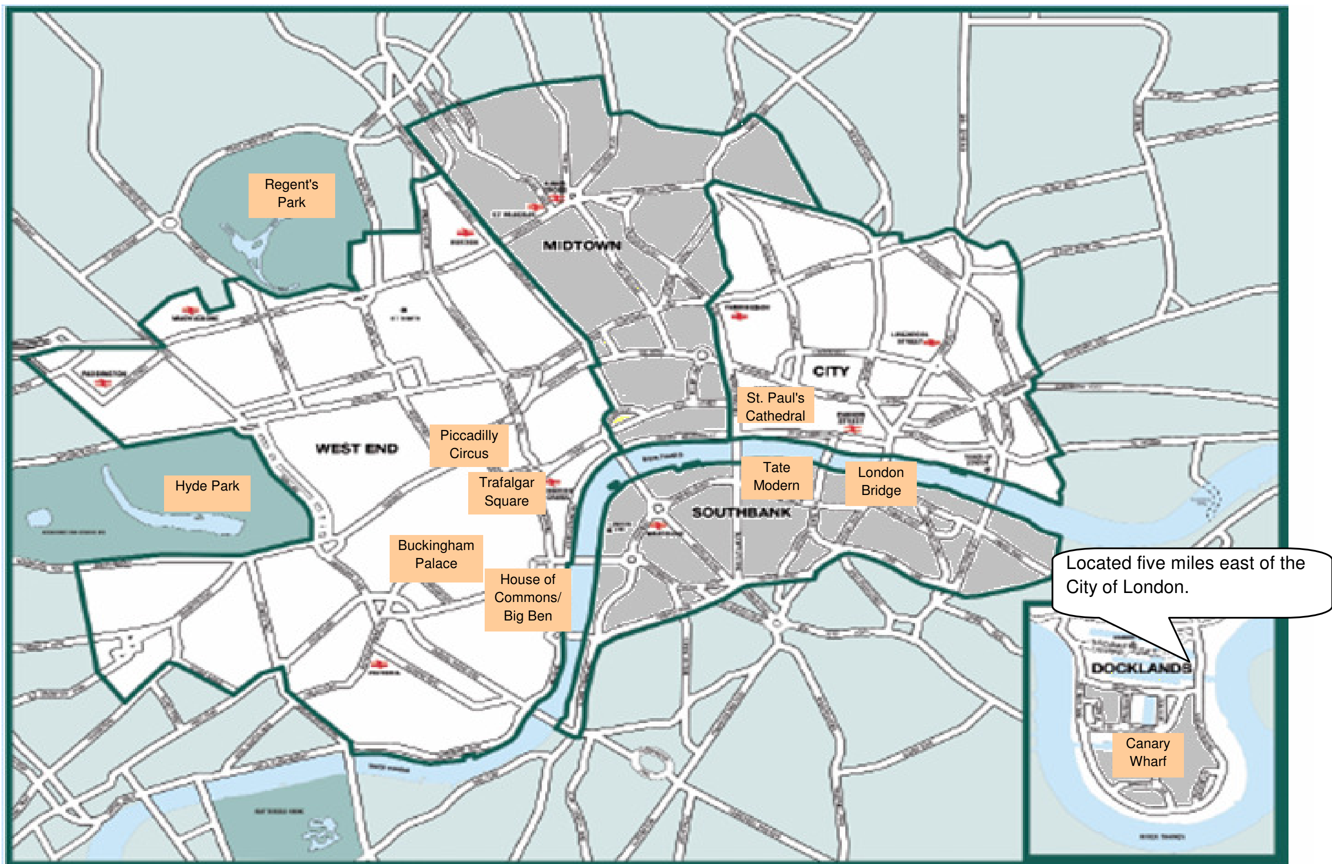
II. The Basics

The London office market totals 210 million s.f. The five key submarkets are:

- **The West End (40% of s.f.):** Wide variety of tenants (from hedge funds, to advertising firms, to government). Older low-to-mid-rise buildings with small floor plates. Both prestigious and modest submarkets.
- **The City (33%)**: Traditional center of finance. Buildings are mid-to-high-rise, with a wide variety of ages and floor plates.
- **Midtown (11%)**: High concentration of legal firms and other service firms. Mixed building ages and floorplates.
- **Southbank (8%)**: Value option for service firms and government. Former industrial area that has attracted several new high-quality developments in recent years.
- **Canary Wharf (aka Docklands, 8%)**: Primarily financial service tenants, especially large, international banks and investment banks that require large trading floors. High-quality, high-rise buildings with large, modern floor plates.

Map of Central London



Source: CBRE and Green Street Advisors.

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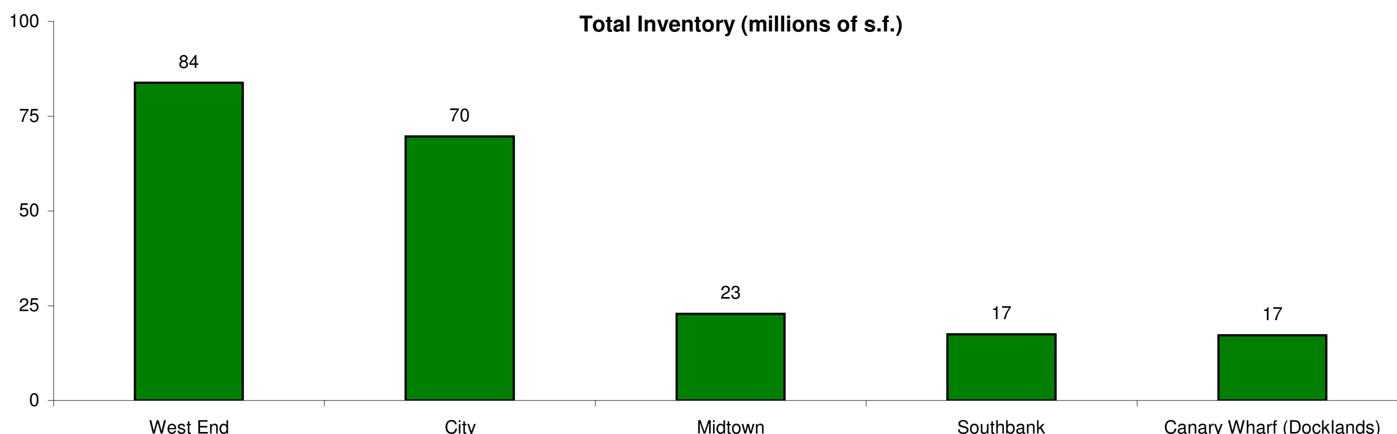
II. The Basics (cont'd)

Central London's two main markets account for nearly 75% of total space: the West End and the City of London. Midtown, Southbank, and Canary Wharf (Docklands) are relatively newer office markets and in aggregate have slightly less stock than the City.



Source: CBRE

London Market	U.S. Near-Equivalent	Key Similarities and Differences
West End	Midtown Manhattan	These office markets are supply constrained, contain most of their city's cultural attractions, and are where office developers compete with alternative uses (hotel, residential) for sites. Like Midtown Manhattan, the West End is the choice location for business services firms and specialist finance companies (hedge funds, private equity firms). Unlike Midtown, the West End is predominantly comprised of low-rise buildings. The best areas of the West End enjoy rents and values per s.f. that are well in-excess of any U.S. market.
City of London	Downtown Manhattan	Both markets are the historical headquarters for financial services firms and home to the local stock exchanges. In contrast to Downtown Manhattan, there is not much residential space in the City of London, which is more of a "9-5" location.
Canary Wharf and Southbank	Jersey City	Canary Wharf and Jersey City are newer satellite office locations. Both are in close proximity to the historical financial center and offer cheaper rents. The main difference is that Canary Wharf has successfully competed with the City of London for "front office" tenants, whereas Jersey City is primarily home to "back office" operations.

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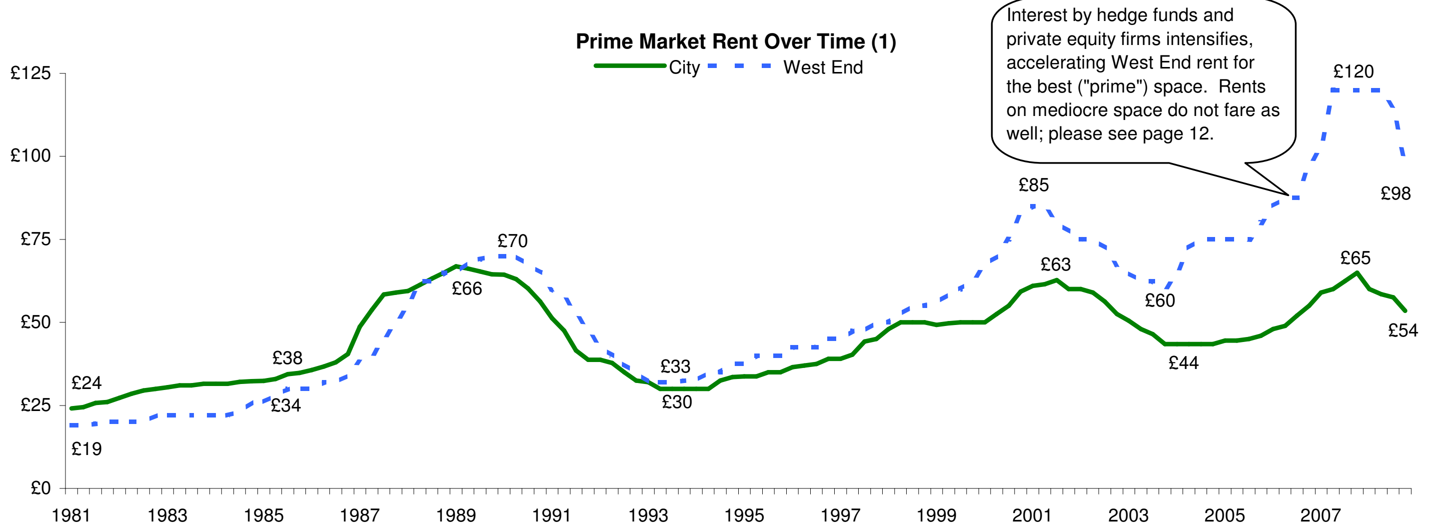
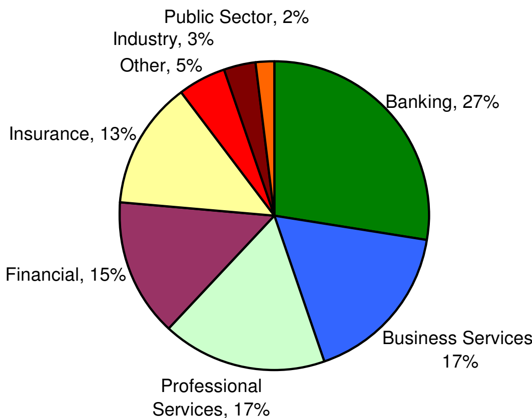
III. The City vs. West End

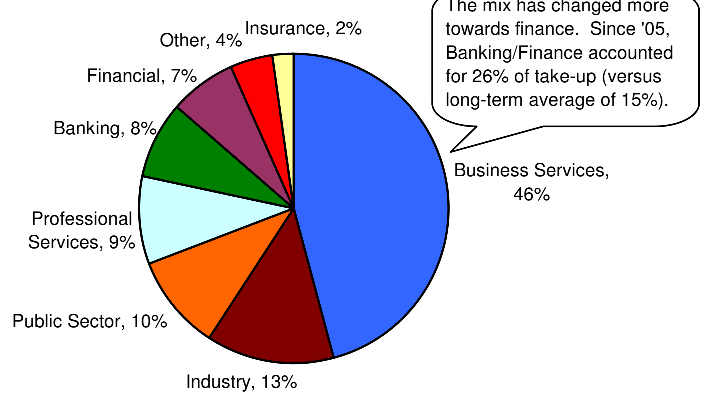
The West End is the most expensive London office market. After commanding similar rents as recently as '98, West End prime rents are now double those of the City. Higher barriers to new supply, more resilient demand from a diverse group of tenants, and a lack of substitutes should enable the West End to remain the priciest London office location.



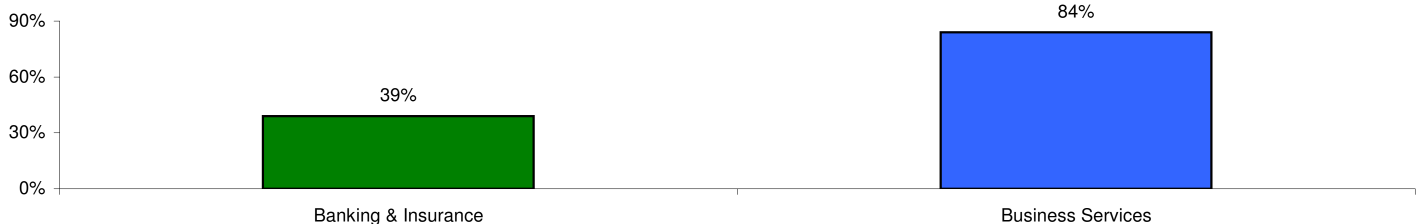
(1) Quoted as "net rent" in the U.S. "Prime rent" refers to rent for the best space in a given submarket.
Source: CBRE

Whereas take-up (gross leasing activity) in the City stems from banking, finance, and insurance (plus affiliated professional services), the West End has a diverse mix of tenants and is predominantly comprised of business services firms (a diverse category in its own right). Since business services employment has grown more than twice as fast as banking and insurance employment, demand in the West End has outstripped the City. Furthermore, having a diversified tenant mix probably makes the West End more resilient during times of financial crisis.





Source: CBRE. Data after 2Q07 is excluded from this analysis since the categories materially changed.



Source: Experian (CBRE).

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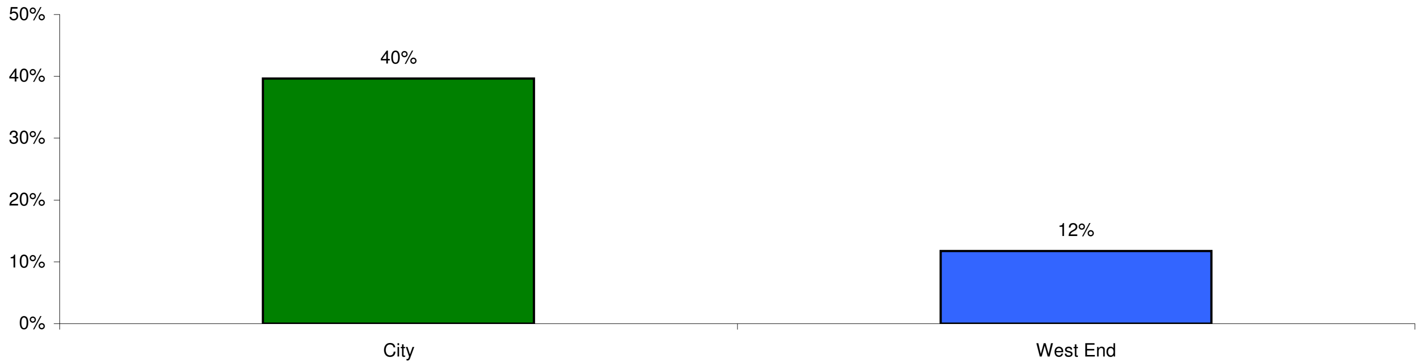
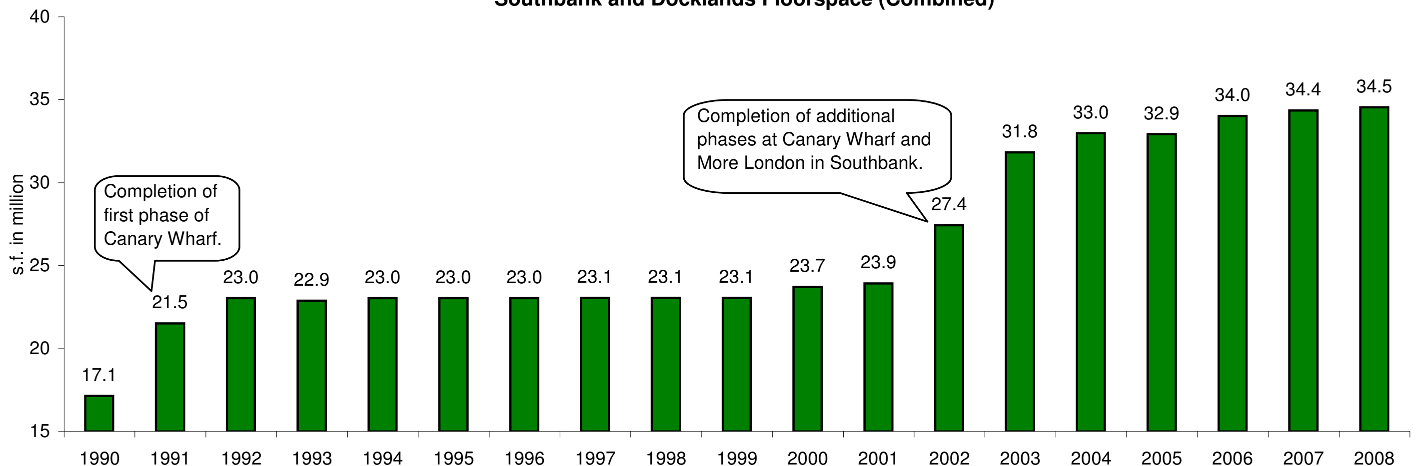
III. The City vs. West End (cont'd)

Supply has increased by 40% in the City over the last 25 years, while the West End remained much more constrained. Two factors explain why less development occurs in the West End. First, the Westminster borough council (which controls planning in the market) is wary about office development. The council has designated 75% of the West End (11,000 buildings; the main core) as a conservation area, which restricts development. Second, offices compete with residential and retail projects for land sites (whereas office development constitutes nearly all projects in the City). This is particularly the case in the West End core where land sites are scarce and office is often not the highest and best use. As a result, office development is mostly confined to the West End fringe (Victoria, Paddington, Euston). In contrast, supply has grown much faster in the City due to more lax planning restrictions.



Source: CBRE, City of Westminster Supplementary Planning Guidance, and Green Street Advisors.

Furthermore, Canary Wharf and the Southbank have emerged as new business centers to cater to the large financial services firms that have historically resided in the City. Development has added nearly 20 million s.f. (30% of City stock) to these emerging markets over the past 20 years, which has kept market conditions from becoming too tight in the City.



Source: CBRE

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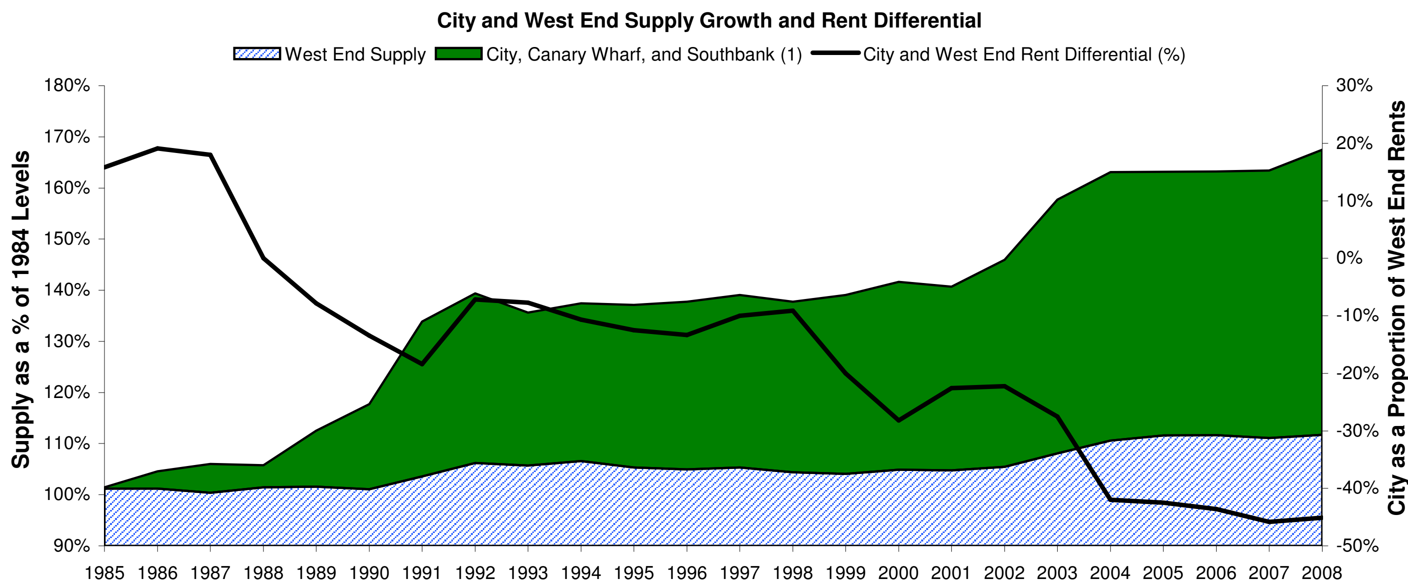
III. The City vs. West End (cont'd)

The confluence of these supply and demand factors has caused the submarkets to register divergent rent growth profiles. Since 1985, rent growth in the West End has generally outperformed the City, leading to the widest rent differential between the two submarkets in London's history. With a bloated supply pipeline coming online in the City over the next few years, the rent differential will likely remain high between the City and West End.



(1) Stock for Canary Wharf and Southbank are unavailable prior to 1990 and 1985, respectively. As a result, some assumptions were used to derive estimates of historical supply growth.
Source: CBRE and Green Street Advisors.

West End's Achilles Heel

The main source of the astronomical rent growth in prime areas of the West End over the last few years has been the demand from private equity firms and hedge funds. As these sectors generated torrid returns and growth in assets under management, firms accumulated office blocks in the most sought after areas of Mayfair and St. James's. Given the high barriers to supply in the core West End, this incremental demand subsumed available supply, resulting in an expansion in rents to unparalleled heights. These firms were also price inelastic since the higher rents remained insignificant relative to income. At the peak of the cycle (mid-'07), alternative investment firms comprised roughly 60% of the top leasing deals in the market. Rents were pushed out so much that some traditional Mayfair occupiers (including property surveyors and agents) were priced out of the market and moved to the City.

The recent financial turmoil caused steep losses for most hedge funds. Due to sub-par returns and an increased preference for risk aversion, many institutions have requested redemptions. Some industry observers project that 30% of the world's hedge funds will shut down over the next few years and that numerous others will shrink in size. While private equity funds typically have longer lock-up periods for redemptions, they have started to also hunker down and cut expansion plans.

The demand spigot is firmly turned off, which will cause pronounced downward pressure on West End prime rent. Take-up activity was particularly muted during the fourth quarter, registering a roughly 40% decline versus the year ago period. However, there is a floor for how low West End rents can fall since it is such a desirable submarket where tenants would move if rents fell enough. This is particularly true for the core West End where hedge fund interest had been concentrated.

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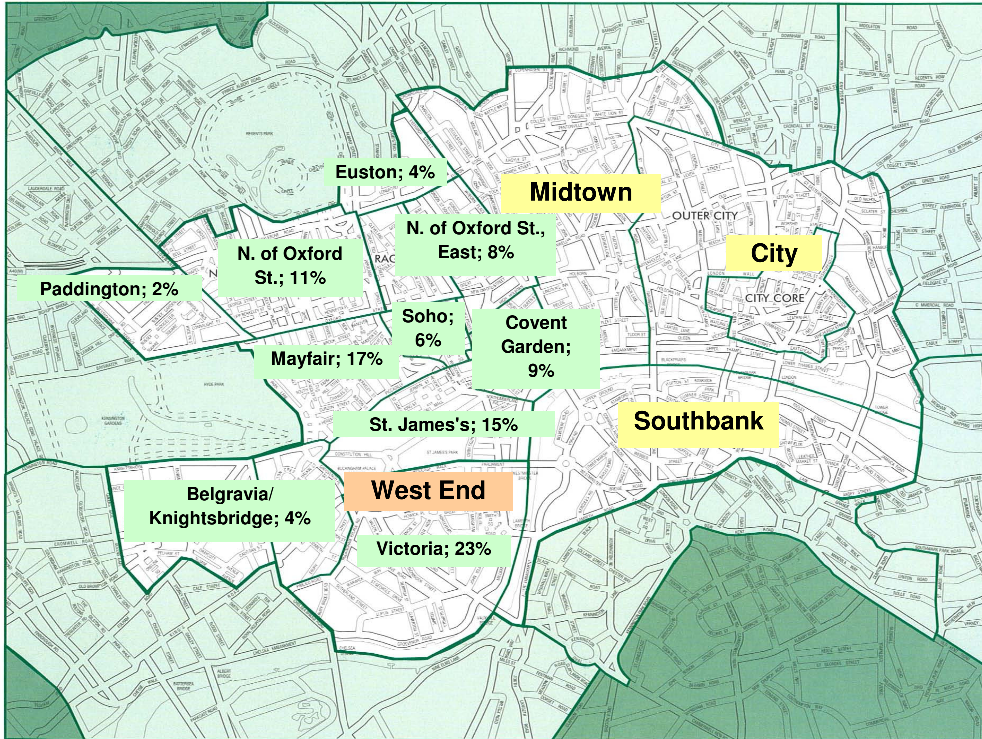
III. The City vs. West End (cont'd)

The West End is comprised of several submarkets which have varying drivers and characteristics. While the super-prime areas of Mayfair and St. James's receive much media attention due to their astronomical rents, over two-thirds of aggregate West End space is located outside these areas. The largest individual submarket is Victoria, which has nearly 25% of total stock.

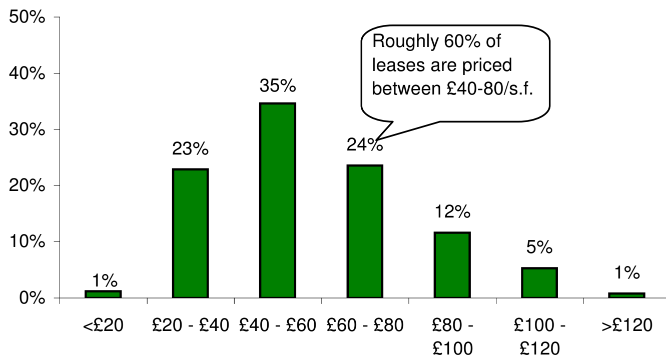
Submarkets (as a % of Total West End Stock)



Source: CBRE.

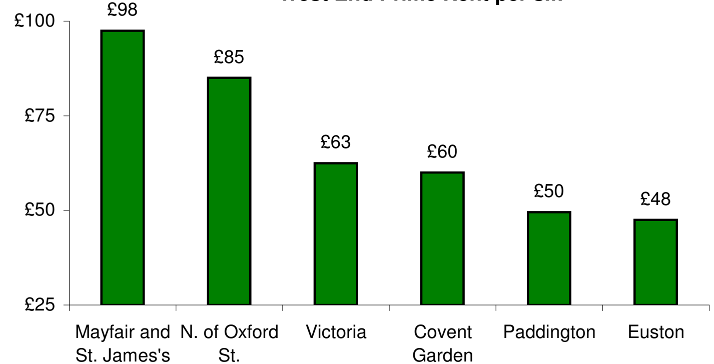
Rents vary across, and within, submarkets. While prime rents are £98/s.f., rents average £54/s.f. across the entire West End (comparable to prime City office space). There is a demarcation between good and mediocre submarkets, which is a function of tenant clustering. Whereas hedge funds and private equity firms favor Mayfair and St. James's, the government has a large base in Victoria. There is also a wide rent range within submarkets since only a few buildings are deemed "prime."

Distribution of West End Rents per s.f. (1)



(1) Proportion of leases signed between 1Q07 and 4Q08.
Source: CBRE.

West End Prime Rent per s.f.



Source: CBRE.

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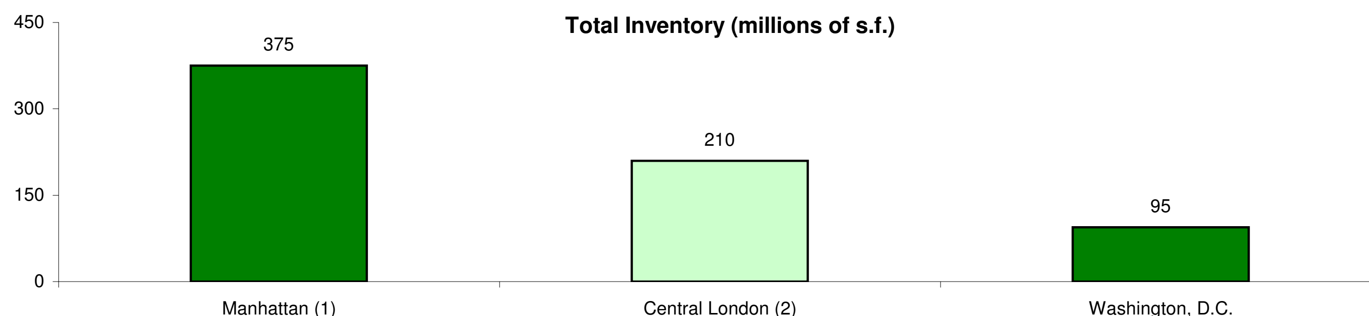
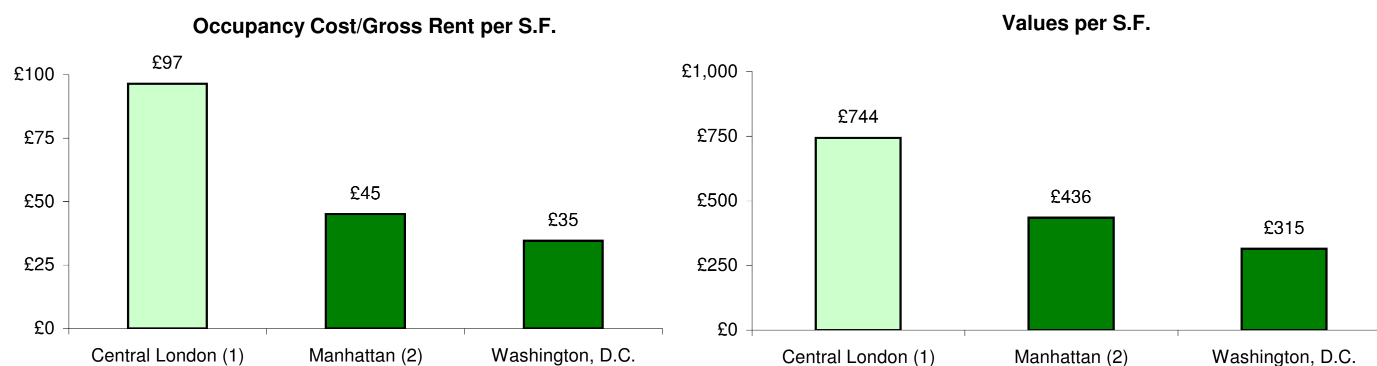
IV. London in a Global Context

London is a global city, home to more than 100 of Europe's 500 largest companies and 550 international banks. One-quarter of the world's largest financial companies also have their European headquarters in the U.K. capital. In addition to being the engine for the European financial markets, London drives the U.K., accounting for roughly one-sixth of the country's GDP. Despite its importance in the global financial industry, the London office market is only roughly half the size of Manhattan's office market.



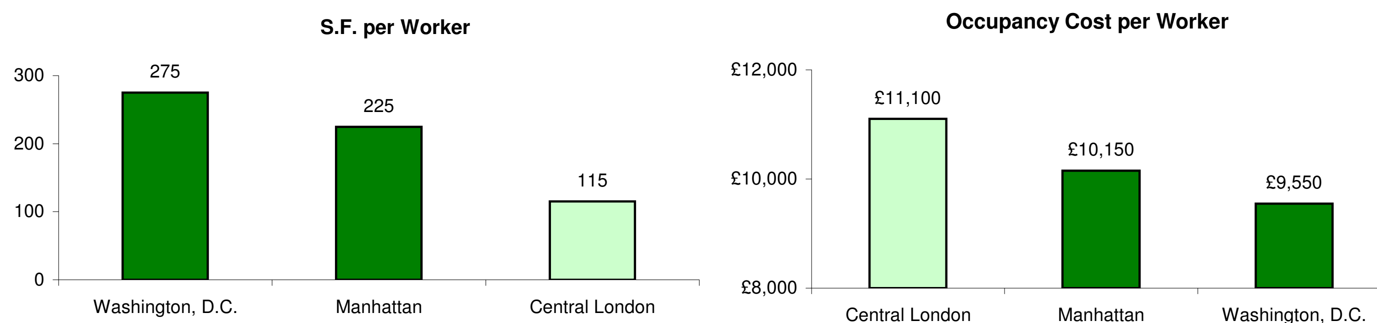
(1) Average from various market reports. Manhattan includes Midtown and Downtown.
(2) Central London includes West End, City of London, Midtown, Southbank, and Canary Wharf (Docklands).
Source: CBRE, Greater London Authority, REIS, and Green Street Advisors.

London is one of the world's most expensive office locations with occupancy costs for class-A space averaging £97/s.f., more than double the average for class-A space in Manhattan. Average values per s.f. also dwarf Manhattan or Washington, D.C. at roughly £750/s.f. ($1,000/s.f.).



(1) Incorporates estimate of £25/s.f. for tenants' service charge. Weighted average value per s.f. based on estimates of £600/s.f. for City and £1200/s.f. for the West End.
(2) Weighted average of Midtown and Downtown. Weighted average value per s.f. based on estimates of $695/s.f. for Midtown and $360/s.f. for Downtown.
Source: CBRE, Real Capital Analytics, REIS, and Green Street Advisors.

However, employees in London occupy half the space of workers in Manhattan or Washington, D.C., which distorts the perceived cost differentials. Occupancy cost per worker in London is only slightly greater than Manhattan.



Source: DTZ, Staubach, and Green Street Advisors.

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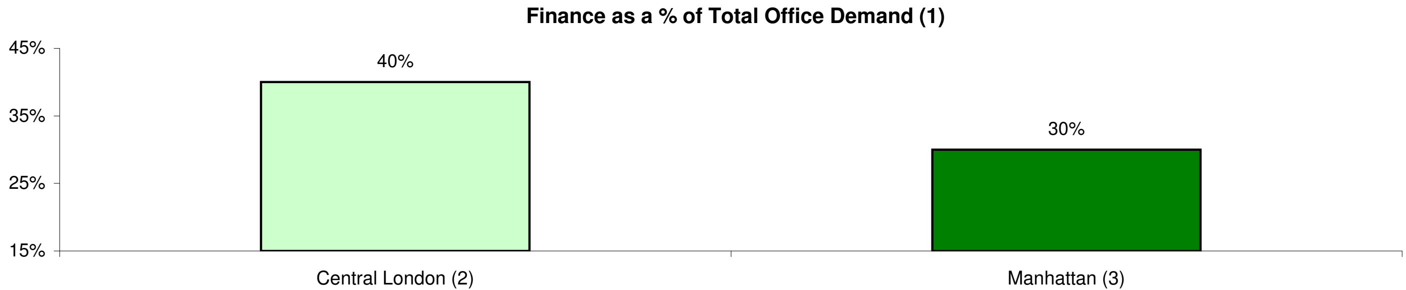
IV. London in a Global Context (cont'd)

The health of the London office market and economy is more tied to the finance industry than its American counterparts. Whereas an estimated 40% of Central London's total office demand is attributable to banking, finance, and insurance, the comparable percentage in Manhattan is slightly lower at 30%.

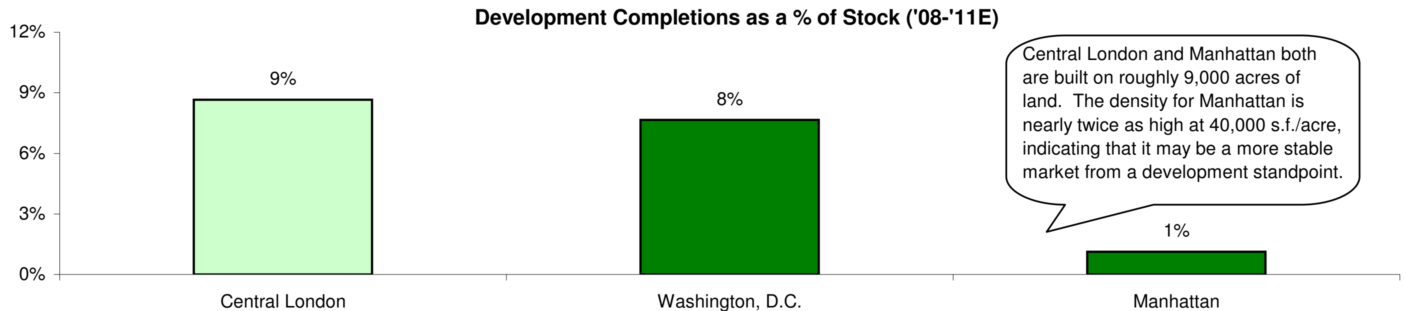
Finance as a % of Total Office Demand (1)



(1) "Finance" corresponds to demand from banking, finance, and insurance.
(2) Estimate based on historical take-up (gross leasing activity) and employment statistics.
(3) Estimate based on discussions with market participants and U.S. office REIT disclosures.
Source: CBRE, City Research Focus, Colliers, Office of National Statistics, and Green Street Advisors.

The barriers to supply are materially lower in London as evidenced by the wave of new supply that will soon come online. Between '08 and '11, supply will increase by nearly 9% in London, equaling the combined amount of completions as a percentage of stock in Manhattan and Washington D.C. This new supply results in a more dour outlook for same-market NOI growth in London over the next three years as illustrated on p. 27.

Development Completions as a % of Stock ('08-'11E)



Source: CBRE, REIS, Green Street Advisors.

The Landlord Magna Carta

Landlords in London benefit from a favorable lease structure including limited capital expenditures, long leases, and upward only rent reviews.

	Key Differences	Implications
Fully Repairing and Insuring (FRI) Leases	The typical lease structure in the U.K. where a tenant must return a property in the same condition as when first leased. After the lease term, the landlord collects a payment to cover repairs. Landlords also have a more hands-off approach to building services.	Capex requirements are lower for landlords in the U.K. and tenants must handle maintenance for their space.
Lease Length	Leases are typically longer in the U.K. (10-15 years) versus the U.S. (avg. 7-10 years).	Longer U.K. leases provide protection in economic downturns.
Upward Only Rent Reviews	In the U.K., rents are reviewed every five years and are marked to the higher of market rent or the tenants' current rent. This differs from the U.S. which typically has 2% annual rent bumps.	In a downturn, U.K. leases will likely post less growth than U.S. leases. In a rising market, U.K. leases provide a call option on rent spikes.

Source: The Glossary of Property Terms, company disclosures, and Green Street Advisors.

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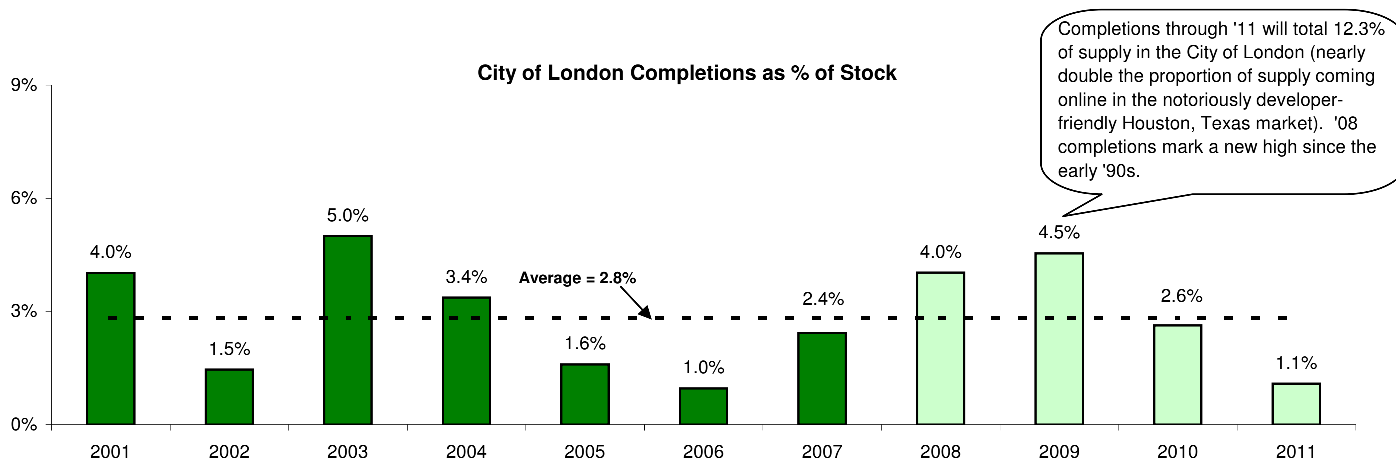
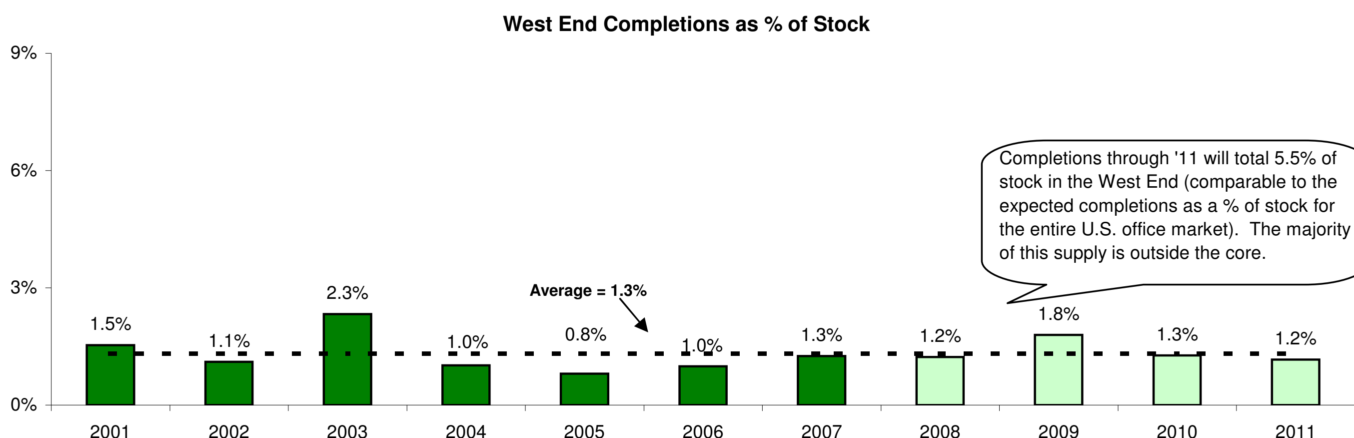
V. The Development Picture

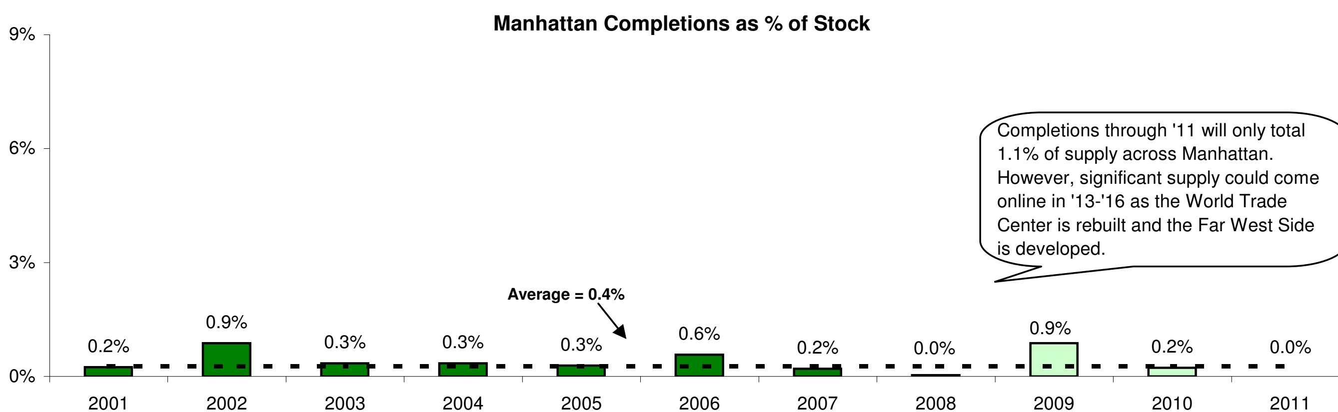
A flood of speculative development is being delivered in Central London. The City of London will be particularly impacted with completions between '08 and '11 totaling more than 12% of existing stock. A slowdown in the financial services industry severely increases the risks associated with these large development deliveries. Development in the West End is much more modest, while Manhattan is even more constrained.



Source: CBRE and Green Street Advisors.



Source: CBRE and Green Street Advisors.



Source: REIS.

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The Office Planning Yo-Yo

The City market is characterized by periods of significant over-supply and under-supply, which are in part reflections of public policy. Historically, when the Tories (Conservatives) controlled Parliament, development was encouraged; when Labour ruled, development was hindered. This has changed in recent times as development has been pushed down to the borough-council level.

Post WWII — Central London in ill-repair with nearly one-third of office stock destroyed. Development remains stymied, however, due to a restrictive tax policy and requirement of building permits (which were often not granted).

1954 — Conservatives repeal the development tax and building permit requirement, initiating a ten-year building boom. Starts increase ten-fold as builders line up to construct space.

1964 — Fearful that Central London was becoming too congested, the "Brown Ban" is enacted. Building permits are required for any development exceeding 2,500 s.f. which effectively shuts off supply.

1971-1974 — A newly-elected conservative government lifts building permit requirements and removes property lending restrictions, resulting in a mini-development boom. However, Labour returns to power in '74 and ratifies a rent freeze and reinstates the development tax, turning off the tap again. The rent freeze was particularly harsh given distressed property conditions and high inflation.

1979 — Conservatives return to power. Prime Minister Thatcher creates the London Docklands Development Corporation (LDDC) to rebuild the Docklands (Canary Wharf) and development authorization is decentralized to London borough councils.

Mid-1980s — City relaxes development restrictions due to concerns that Canary Wharf would displace it as the epicenter of finance. One of the largest building booms ensues with supply increasing by roughly one-third in the City.

2000 — London elects its first mayor (Ken Livingstone) who is responsible for setting planning guidelines across London. Livingstone narrows the width of St. Paul's viewing corridors (specially protected views of the Cathedral from eight distinct vantage points) and encourages skyscraper development.

2008 — Boris Johnson elected mayor. Johnson has made known his disapproval of tall buildings and it is thought he may widen viewing corridors, which would put a damper on development. However, the mayor is considered "pro-business" and it is unclear what changes will be implemented. Separately, a change in empty rates (property tax) policy exacerbates the pain of vacant development space.

Source: Marriott, Oliver. The Property Boom; *Harris, Robert.* Property and the Office Economy; *and Fainstein, Susan.* The City Builders: Property Development in New York and London, 1980–2000.

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V. The Development Picture (cont'd)

Cost basis and timing are the most crucial elements in determining the profitability of a development project. Given the large lead time for construction (about three years), projects completed over the next few years will generally have higher land bases than developments that were delivered at the midpoint of the recent cycle. The economics of development have quickly turned negative as rents have contracted, lease-up has slowed, and valuation yields have expanded. However, developers acquiring land today for delivery during the next cycle may be positioned to generate a "normal" profit.

City Development Cost and Yields
£ values are per sq. ft.

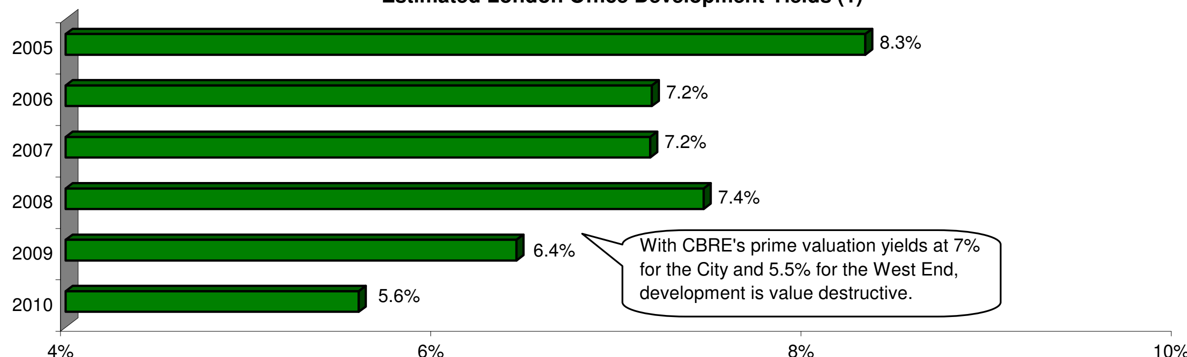
	Current Office Cycle			Next Cycle	
	Mid	Late	% Change	Early	
Development Cost					
Land (1)	£175	£275	57%	£150	
Shell (2)	305	350	15%	265	
Soft costs & financing (3)	130	150	15%	105	
Total Development Cost	**£610**	**£775**	**27%**	**£520**	(5)
Rent					
Face Rent	£57	£45	-21%	£52	(6)
Rent free discount:					
Lease length in yrs	15	15		15	
Months free	20	36		28	(6)
Discount %	11%	20%	80%	16%	
Effective Rent	**£51**	**£36**	**-29%**	**£44**	
Development Yield (4)	8.1%	4.9%	-39%	8.1%	
Valuation Yield	5.0%	7.0%	40%	7.0%	
Property Value	**£963**	**£489**	**-49%**	**£596**	
Profit	**58%**	**-37%**		**15%**	

This analysis excludes the cost of empty rates. Addition of this expense would make the profit margin worse (particularly for "Late").

(1) Based on discussion with industry participants; "Next Cycle" assumes 45% drop from "Late".
(2) Based on discussion with industry participants; "Next Cycle" assumes 25% drop in cost (including a decline in contractor profit margin).
(3) Based on discussion with industry participants; "Next Cycle" assumes 30% drop from "Late" (due to less construction costs to finance).
(4) Development yield is calculated by dividing face rent by the sum of "Total Development Cost" and Free Rent.
(5) Look-forward replacement estimate assuming an attractive land basis.
(6) Rent and free-rent period required for "normal" development profit of 15% assuming current valuation yield.
Source: Green Street Advisors.

Real estate developers accepted lower target development yields as cap rates compressed. With cap rates now rapidly rising, '09 and '10 deliveries will likely incur losses.

Estimated London Office Development Yields (1)



(1) Year corresponds to delivery date. The yields are the equally weighted average of a sample of REIT development projects. The REITs provide different levels of disclosure. The yield is calculated by dividing projected face rent by total development costs (land, shell, soft costs, and free rent). This analysis also assumes that properties are 95% leased at stabilization (unless a project is a build-to-suit).
Source: Company disclosure and Green Street Advisors.

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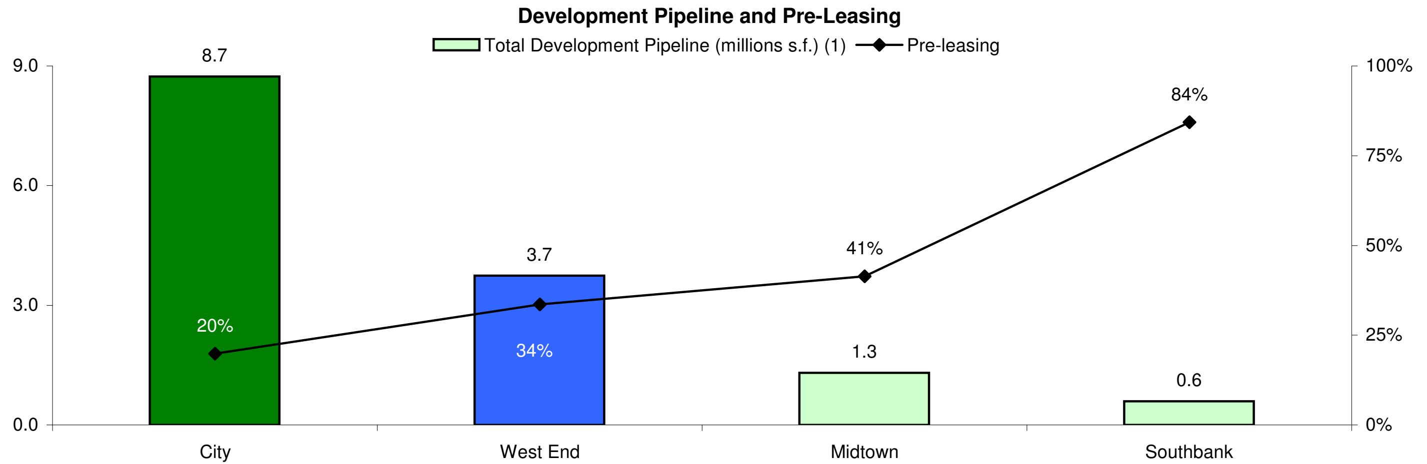
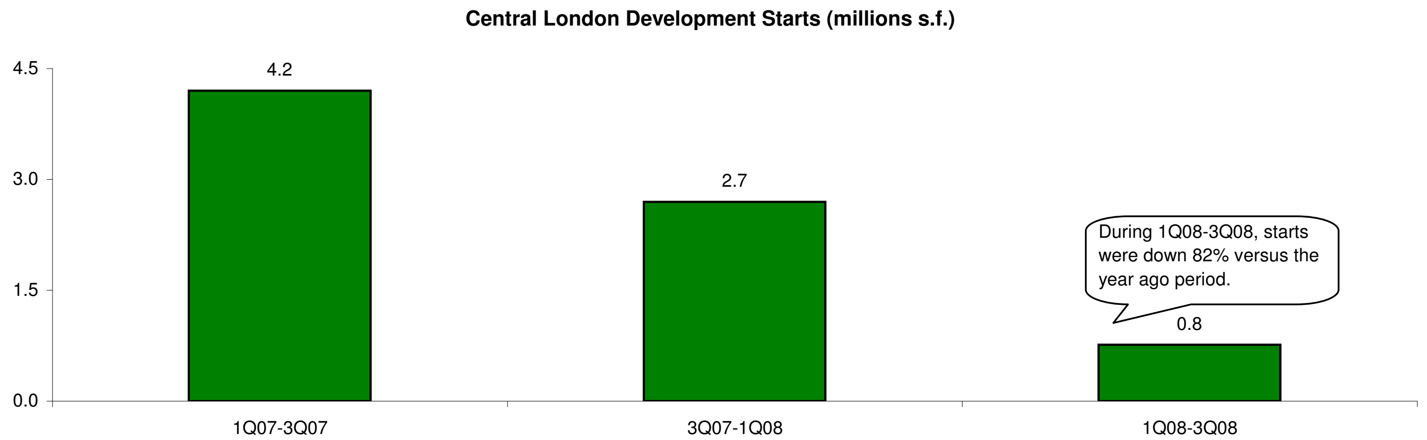
V. The Development Picture (cont'd)

The majority of developments in London were started on a speculative basis (0% pre-let) and pre-leasing to date has been sub-par as the economic slowdown has negatively impacted tenants' expansion plans. This has particularly been the case in the City where the bulk of development activity is taking place and pre-leasing is a mere 20%.



(1) Includes developments in process and completed developments still in lease-up as of 3Q08.
Source: Drivers Jonas and Green Street Advisors.

One important piece of good news is that the development tap has slowed from a flood to a trickle. While starts totaled nearly 800,000 s.f. during the six months ending September 30th, most speculative starts were in the West End where demand remains stronger. With starts grinding to a halt, the market has a chance to recover in '11/'12.



Source: Drivers Jonas.

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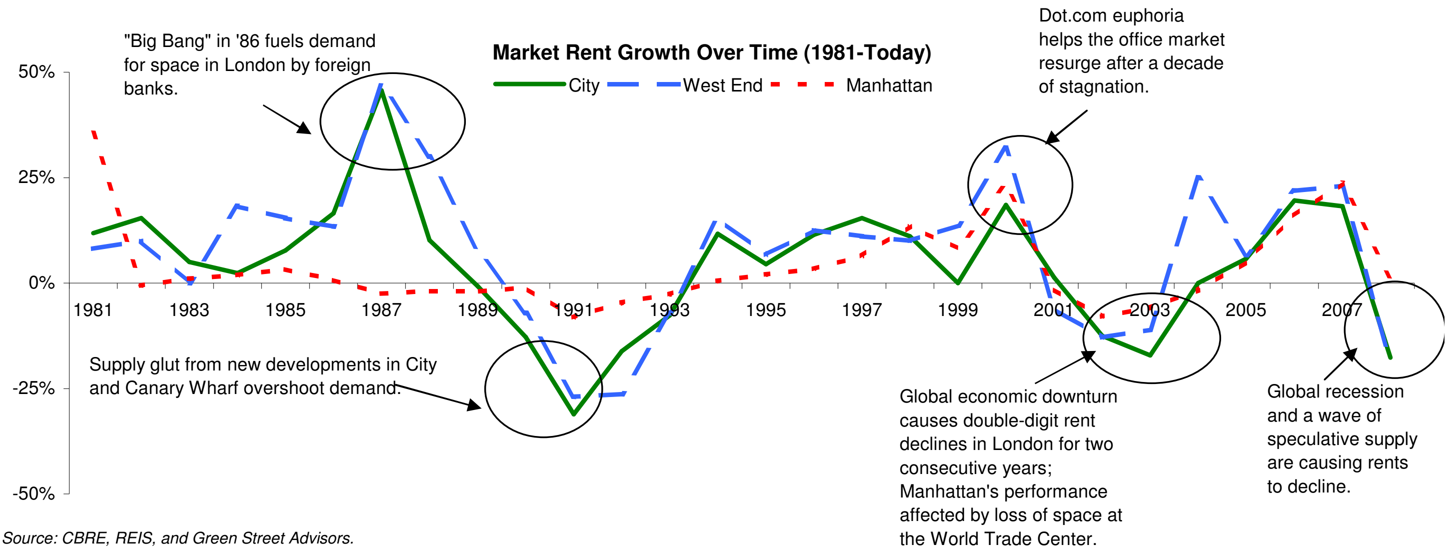
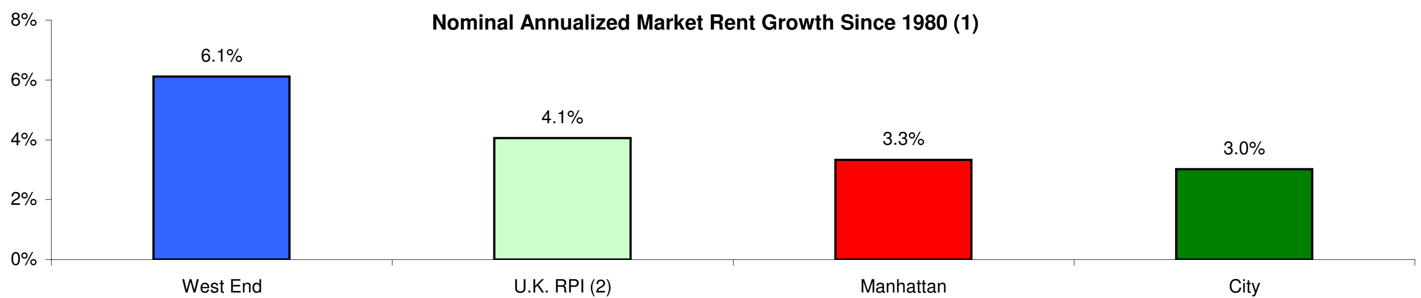
VI. A Volatile History

London office rent growth has wildly fluctuated over the last three decades. Much of this is due to the capital's reliance on the financial services sector, which is prone to prolonged swings. With a more diverse tenant base and fewer building booms during this same time period, Manhattan has better weathered recent downturns.



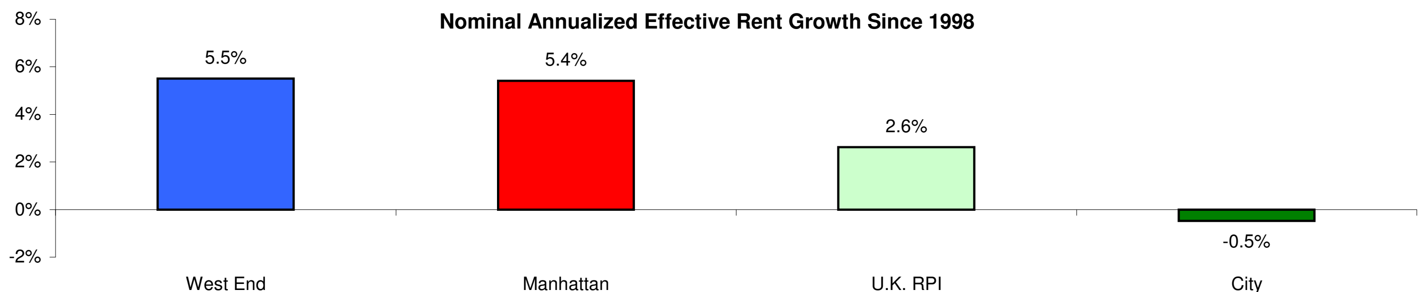
Source: CBRE, REIS, and Green Street Advisors.

OVER THE LAST 28 YEARS, rent growth in London has kept pace with inflation. However, the majority of this growth came in the mid-1980s as the Big Bang and tight supply led to a few years of astronomical rent growth.



(1) Effective rent data not available until the 1990s.
(2) RPI is retail price inflation, the most commonly used metric of inflation in the U.K.
Source: CBRE, Office of National Statistics, REIS, and Green Street Advisors.

OVER THE LAST 10 YEARS (a period for which effective rent data is available), the West End has generated the highest effective rent growth as hedge funds and private equity firms flocked to the market. Effective rents in Manhattan also grew in excess of inflation by a wide margin. Large additions to supply and the emergence of the Southbank and Canary Wharf have caused rent growth in the City to be negative. The lack of supply barriers in the City should cause the submarket to continue to underperform.



Source: CBRE, Office of National Statistics, REIS, and Green Street Advisors.

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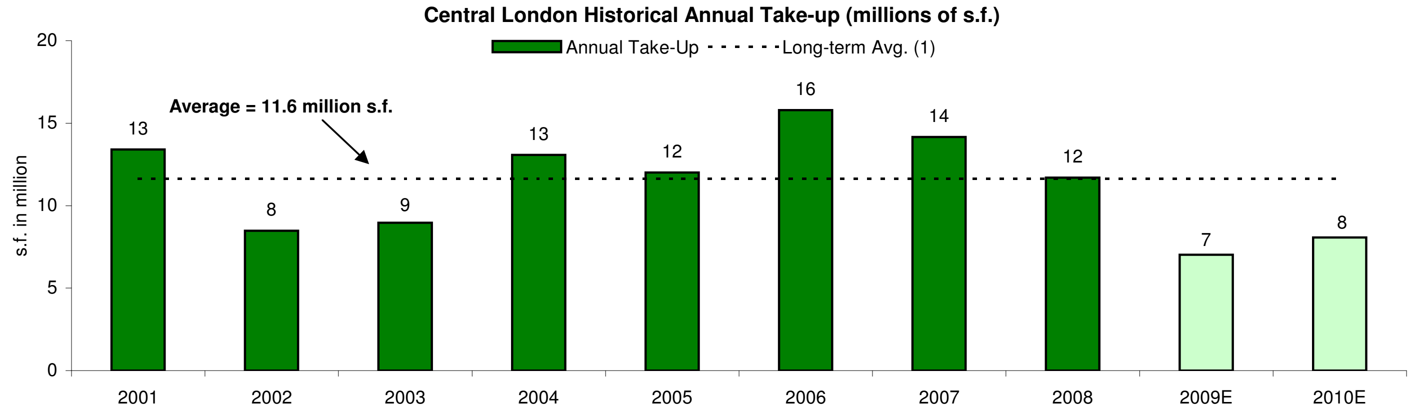
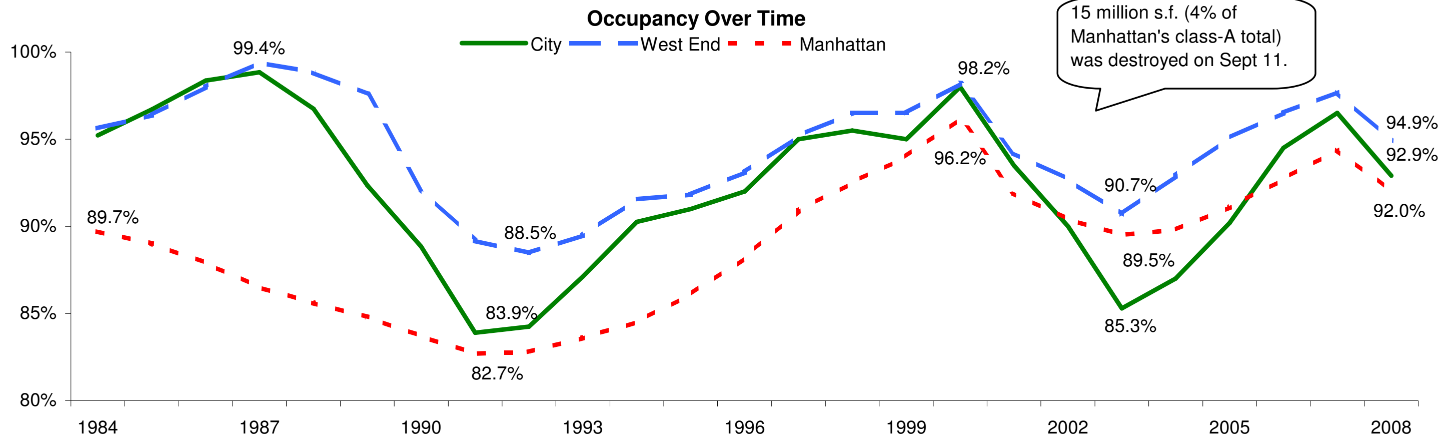
VI. A Volatile History (cont'd)

Take-up* measures overall leasing activity in the market and is a leading indicator of occupancy. Like rent growth, it has ebbed-and-flowed. Central London take-up has started to moderate, particularly in the City, where financial services firms are cutting staff. With the credit crisis wreaking havoc, take-up is slated to decline to the lowest levels since the early '90s.



* Take-up measures gross leasing activity. The preferred measure of net absorption is not available for the London market.
(1) Annual average take-up (1990-2008).
Source: CBRE and Green Street Advisors estimates.

Occupancy remains high by historical standards in both London and Manhattan, but will decline as take-up moderates and large amounts of supply come online. Since London and Manhattan have similar economies (growth generally depends on the health of the financial services industry), occupancy tends to move in tandem across the Atlantic. Peaks form during periods of ebullient financial services profitability whereas valleys are accentuated by active development periods. The destruction of 15 million s.f. of class-A space on 9/11 played a key role in keeping Manhattan's occupancy tight.



Source: CBRE and REIS.

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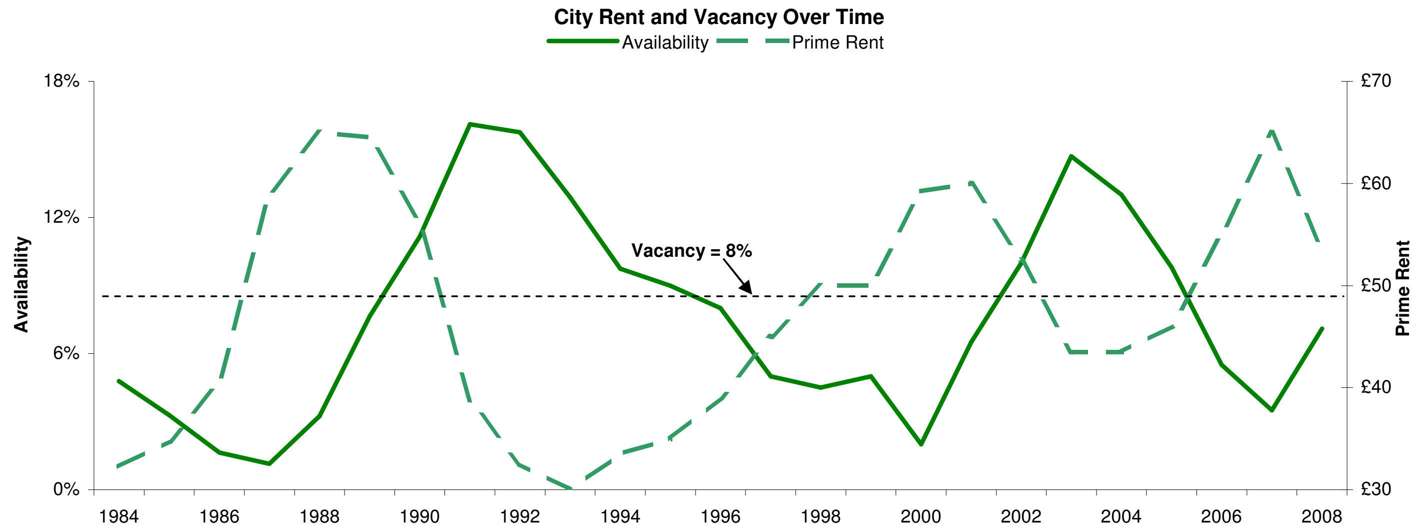
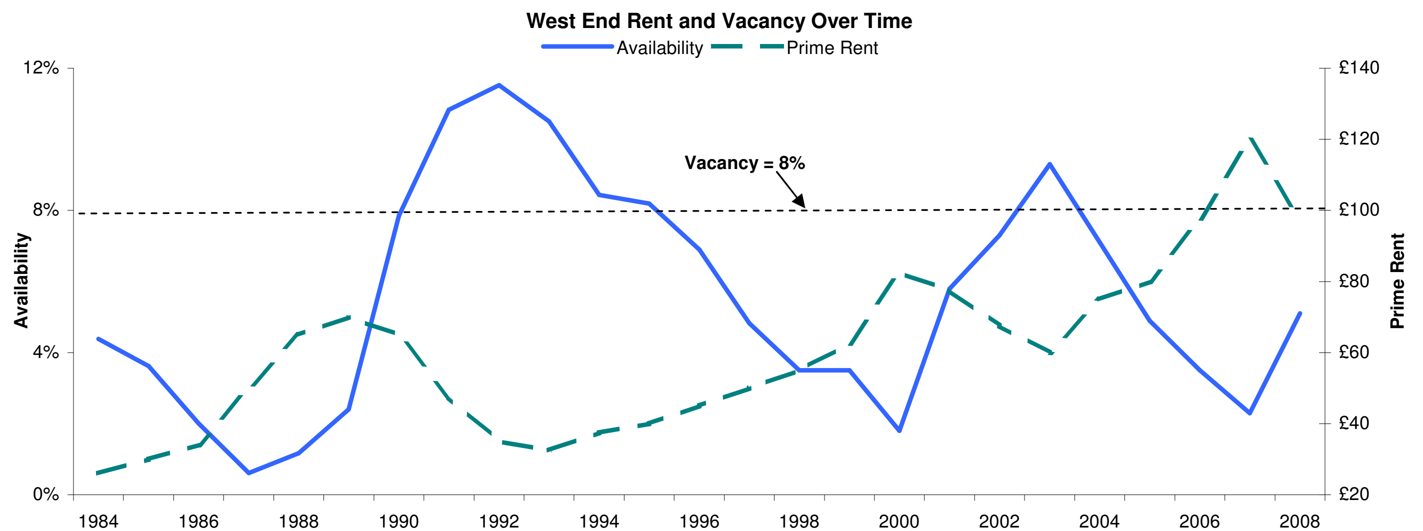
VI. A Volatile History (cont'd)

A rent "tipping point" is reached once vacancy rises towards the 8% level. Around this mark, rents significantly contract as vacancy increases. Over time, the City and West End have demonstrated similar behavior. Rent changes can occur before the 8% threshold is crossed if a large pipeline is nearing completion and demand factors are weak (as was the case in the early-'90s and today).



Source: CBRE.



Source: CBRE.

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VII. Near-Term Outlook Is Poor

The London office market has a history of cyclical swings and is currently in the middle stages of a major recession. It is possible that fundamentals will not be as dour as the early-'90s since supply growth is not as acute and rents did not grow as much prior to the downturn. However, since property yields compressed excessively during the bull market, value corrections could be larger. If Green Street's estimates for the length and depth of the downturn are reached, London office values could fall by an additional 20% (i.e. a cumulative peak-to-trough fall of roughly 55%).

Economic Backdrop	1974-1976	1989-1993	2001-2004	2007-2010 (1)
Length of Downturn (Peak to Trough)	2 years	4 years	3 years	3 years
Source	Banking Collapse, Commodity Bubble	Overbuilding, Recession	Tech Bubble, Terrorism	Credit Crunch, Overpaying
Job Losses - London (2)	N/A	(90,000)	(52,400)	(85,000)
Job Gains Prior to Peak - London	N/A	N/A	173,500	119,800
Trough Year GDP Growth	-1.4%	-1.4%	2.1%	-2.8%
Peak Interest Rate (5-year Swap)	N/A	11.6%	6.0%	6.2%

(1) Green Street estimate.
(2) London includes Camden, City of London, Islington, Kensington and Chelsea, Lambeth, Southwark, Tower Hamlets, and Westminster. Job loss estimate for the early '90 provided by The City Builders: Property Development in New York and London, 1980–2000.
Source: Office of National Statistics (Annual Business Inquiry and Annual Population Survey), Bloomberg, Fainstein, Susan.The City Builders: Property Development in New York and London, 1980–2000, and Green Street Advisors.

City of London	1974-1976	1989-1993	2001-2004	2007-2010 (1)
Supply Growth	N/A	29%	14%	12%
Rent Growth Preceding Downturn (3)	221%	112%	95%	85%
Occupancy Change (bps)	N/A	(1275 bps)	(1275 bps)	(1000 bps)
Rent Change (3)	-38%	-55%	-47%	-46%
Increase (Decrease) in Prime Yield (bps) (4)	200 bps	200 bps	(50 bps)	325 bps
Prime Yield at Peak	4.00%	4.50%	6.50%	4.25%
Capital Growth Before Decline	N/A	51%	26%	43%
Capital Value Decline (5)	-50%	-54%	-9%	-58%

Additional Capital Value Decline to Reach Scenario	**-22%**
Implied Additional Decrease in NAV (6)	**-44%**

West End	1974-1976	1989-1993	2001-2004	2007-2010 (1)
Supply Growth	N/A	9%	6%	6%
Rent Growth Preceding Downturn (3)	186%	169%	205%	117%
Occupancy Change (bps)	N/A	(1100 bps)	(750 bps)	(500 bps)
Rent Change (3)	-44%	-54%	-33%	-42%
Increase (Decrease) in Prime Yield (bps) (4)	N/A	175 bps	(50 bps)	275 bps
Prime Yield at Peak	N/A	4.75%	6.00%	3.50%
Capital Growth Before Decline	N/A	91%	47%	75%
Capital Value Decline (5)	-50%	-49%	-9%	-53%

Additional Capital Value Decline to Reach Scenario	**-21%**
Implied Additional Decrease in NAV (6)	**-42%**

(3) Market rent changes are used for the '70 and early '90s cycles, effective rents thereafter. Because the upswing in rents before the '70s and early '90s downturns lasted more than a decade, rent growth before the downturn in these periods reflects five-year rent growth.
(4) Cap rate compression helped buoy values during the early '00s downturn.
(5) '70s value decline is an approximation from Property and the Office Economy *and* The Secondary Banking Crisis, 1973-75. Through December '08, IPD estimates indicated that values have decreased by roughly 40% in the City and 35% in the West End since the '07 peak. However, Green Street estimates that current net initial yields are roughly 7.5% in the City and 6.5% in the West End. These yields imply an additional decline in values that has not yet been incorporated by IPD. As a result, we forecast that the value declines since the peak in the City and West End have so far been 45% and 40%, respectively.
(6) Assumes 50% leverage.
Source: CBRE, IPD, Harris, Robert. Property and the Office Economy, *Reid, Margaret.* The Secondary Banking Crisis, 1973-75,*and Green Street Advisors.*

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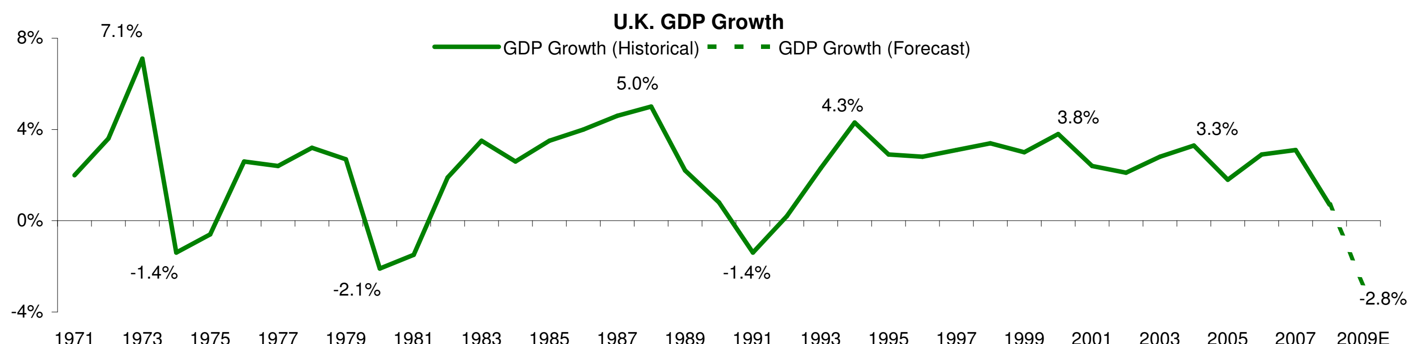
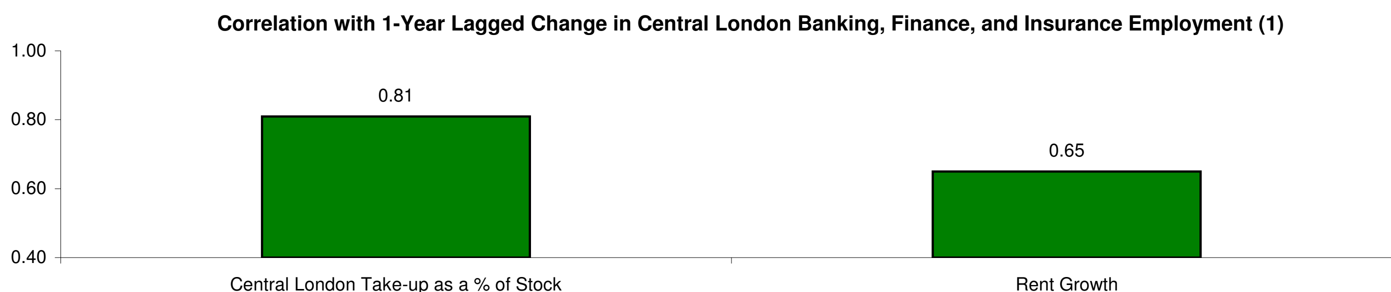
VII. Near-Term Outlook Is Poor (cont'd)

The U.K. economy is falling into a recession that could be worse than the early-'80s or '90s as the financial crisis unwinds and consumer spending hits a wall. Against the weakening economic backdrop, companies have had to "right size" their operations by cancelling expansion plans and downsizing. This is particularly the case in London, the hub of the European financial services industry.



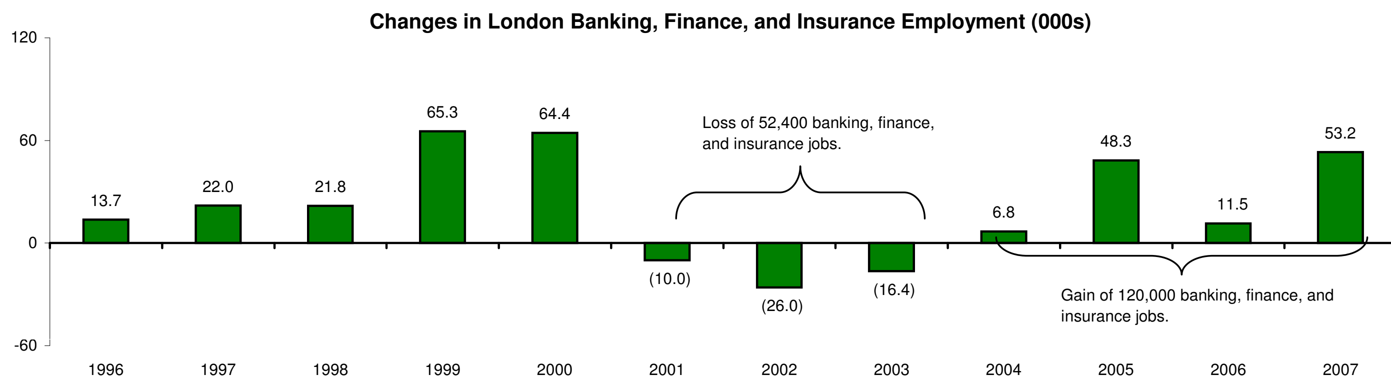
Source: Office of National Statistics (historical) and Financial Times (forecast).

With GDP set to fall, financial services employment will contract significantly. Since financial services employment growth is a key demand driver, the London office market will suffer accordingly. Over the past 12 years, take-up and rent growth have exhibited strong correlations with lagged banking, finance, and insurance employment growth. Given London's reliance on these industries (45% of total employment), the correlations are not surprising.



(1) Includes auxiliary industries. A long-term and consistent time series only including financial intermediation jobs is unavailable.
Source: Green Street Advisors.

Job losses are expected to pile up as many investment banks have either left the market or announced significant staff reductions. Published estimates have expanded to 55,000 to 65,000 layoffs during this downturn. The midpoint of this range (60,000) would slightly exceed the '01-'03 losses.



Source: Office of National Statistics (Annual Business Inquiry).

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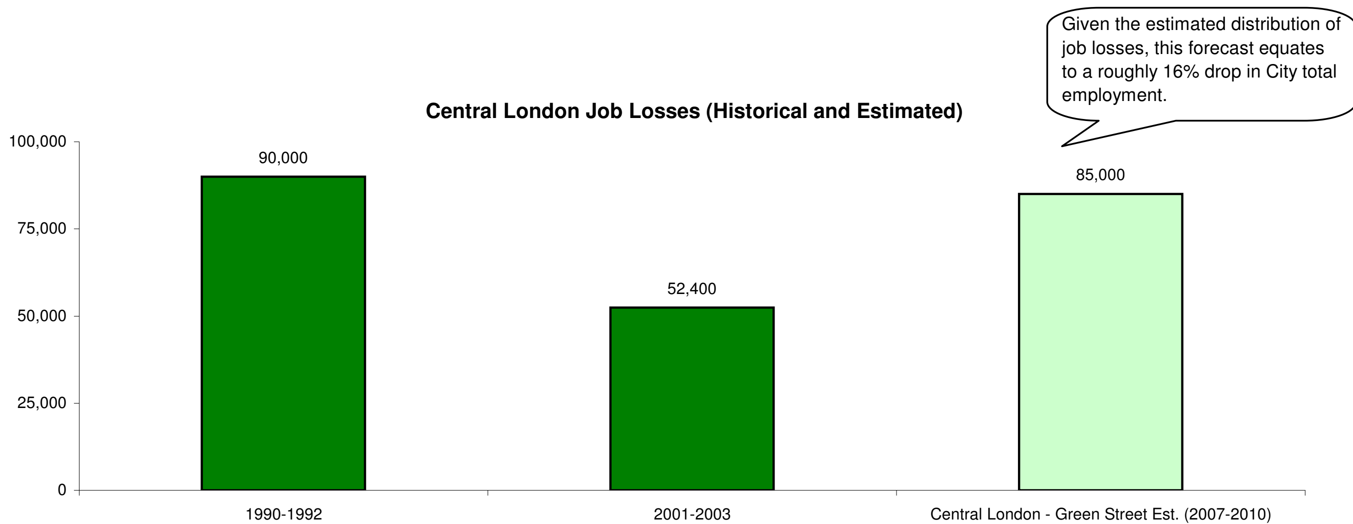
VII. Near-Term Outlook Is Poor (cont'd)

Our base case forecast is that roughly 85,000 jobs will be lost across Central London. This outlook indicates a drop in employment that will exceed the last cycle by about 60%, but will be roughly equal to losses from the early-'90s.

Central London Finance, Banking, and Insurance Employment (1)	Amount	% of Total Jobs
Total Jobs in Central London ('00)	818,300	
Job Gains ('97-'00)	173,529	26.0%
Job Losses ('01'-03)	(52,400)	-6.4%
Total Jobs in Central London ('07)	885,700	
Job Gains ('04'-07)	119,800	15.5%
Expected Job Losses ('07-'10)	**(85,000)**	**-9.5%**

(1) Central London is defined as Camden, City of London, Islington, Kensington and Chelsea, Lambeth, Southwark, Tower Hamlets, and Westminster.
Source: Office of National Statistics (Annual Business Inquiry) and Green Street Advisors.



Source: Office of National Statistics, Fainstein, Susan. The City Builders: Property Development in New York and London, 1980–2000, *and Green Street Advisors.*

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VII. Near-Term Outlook Is Poor (cont'd)

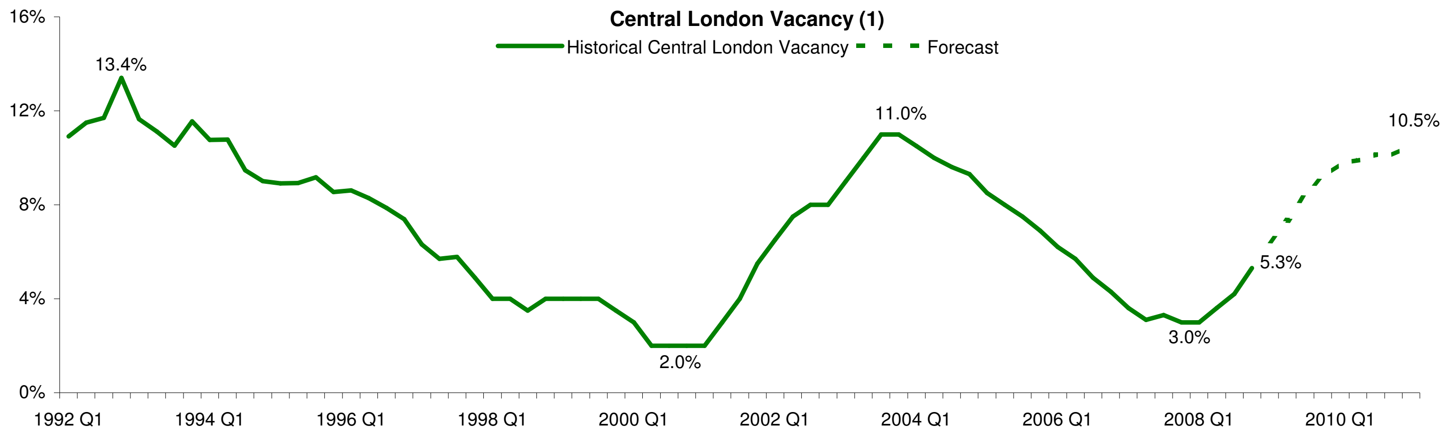
By itself, the loss of 85,000 jobs could cause vacancy to rise by about 275 basis points. In addition, a rising tide of development projects remains mostly unlet. The combination of these two factors could cause vacancy to rise by 750 basis points to 10.5%, which is slightly below the peak from the early '00s downturn due to less supply growth this time.

Current Vacancy = 5.3%
Estimated vacancy with job losses and developments:

Central London Job Losses (1)

Density per Worker (s.f.)	60,000	70,000	85,000	90,000	100,000
100	9.6%	9.9%	10.3%	10.5%	10.7%
115	9.7%	10.0%	**10.5%**	10.7%	11.0%
125	9.8%	10.1%	10.7%	10.8%	11.2%
150	9.9%	10.4%	11.0%	11.2%	11.6%

(1) Full-cycle net job losses. Assumes 60% of space vacated from job losses returns to market.



(1) Data prior to '98 is weighted average of vacancy in the City and West End. Includes sublet space.
Source: CBRE and Green Street Advisors.

Effective rents have started to decline across Central London as free rent periods have significantly increased. The West End has held up better than the City due to less new supply. As more developments come online and jobs are cut, effective and face rents will decline further in both markets.

City of London	Peak (4Q07)	Today (4Q08)	% Change
Prime Market Rent (psf/yr)	£65.00	£53.50	-18%
Free Rent Period (1)	1.0	2.1	113%
Effective Rent (psf/yr)	£58.46	£40.54	-31%
Effective Rent as % of Market	90%	76%	

(1) Years on a 10 year lease.

West End	Peak (3Q07)	Today (4Q08)	% Change
Prime Market Rent (psf/yr)	£120.00	£97.50	-19%
Free Rent Period (1)	0.5	1.3	150%
Effective Rent (psf/yr)	£117.00	£87.75	-25%
Effective Rent as % of Market	98%	90%	

(1) Years on a 10 year lease.
Source: CBRE

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VII. Near-Term Outlook Is Poor (cont'd)

A negative near-term outlook for London results in a forecast of increased vacancy and reduced rents. However, London office leases are long (10-15 years) and in-place rents remain well-below peak levels. As a result, same-market NOI has some downside protection. The West End should outperform the City since it has higher embedded NOI growth (i.e. the amount that NOI would increase if all leases could be instantly marked to market), faces less development completions, and has no sizable release valve. For additional insights regarding these forecasts, please see Appendix C.

(1) These forecasts are utilized in our market-by-market estimates of same-property NOI growth and IRRs.
Source: Green Street Advisors.

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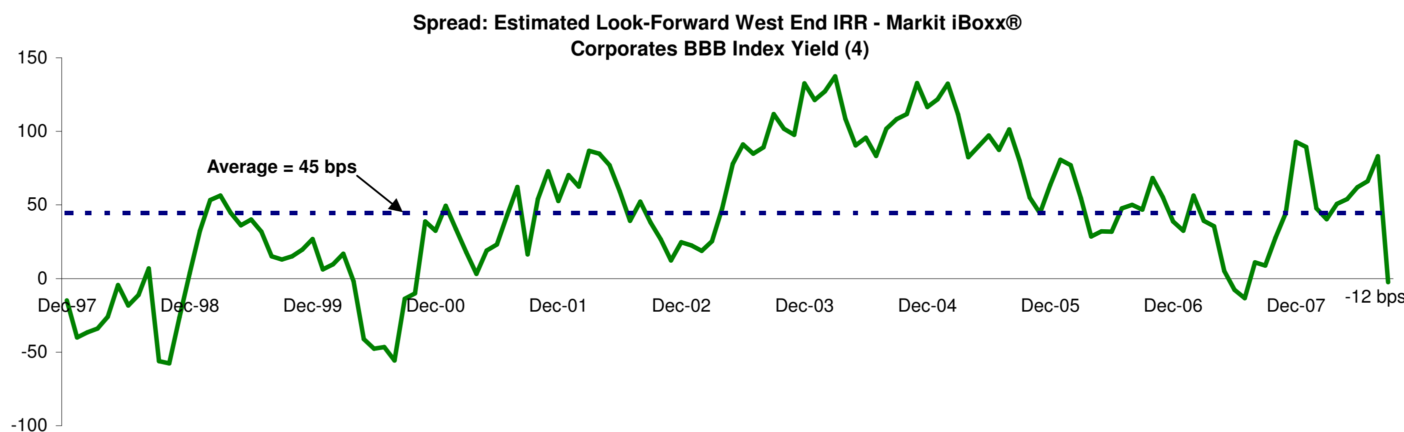
VIII. Private Market Pricing

The total returns that office owners are likely to achieve at current private-market (i.e. open-market) pricing can be assessed by combining the initial yield and growth forecasts shown below.

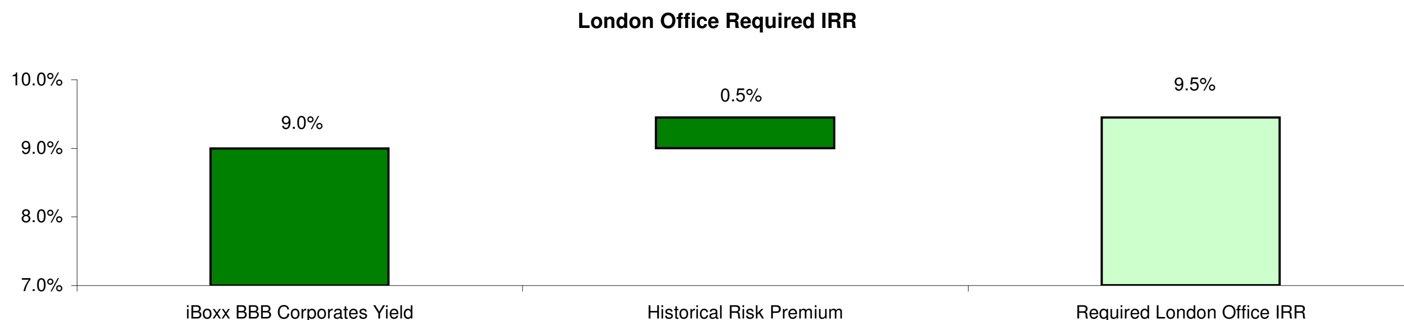
Sector	Initial Yield (1)	Nominal Cap Rate	Economic Cap Rate (2)	Projected Same-Market NOI Growth (3) '09	'10	'11	'12	'13	Long Term
West End	6.5%	6.5%	**5.7%**	-7.1%	-2.6%	0.5%	1.1%	2.8%	2.7%
City of London	7.5%	7.5%	**6.6%**	-11.2%	-2.7%	0.6%	0.2%	2.1%	1.2%
Midtown Manhattan	6.9%	7.3%	**6.1%**	1.8%	2.8%	3.6%	4.3%	5.3%	2.3%
Downtown Manhattan	7.5%	7.9%	**7.0%**	-3.3%	-1.6%	1.6%	4.3%	-0.4%	2.0%

(1) Net initial yield for West End and the City represents an estimate for the average initial yield for a hypothetical market portfolio based on pricing outlined in Appendix B. To derive a Manhattan net initial yield, we add purchasers' costs (5.75% of property value) to the denominator of the nominal cap rate. The NOI/net rent margin in London is estimated to be 94%.
(2) For London, capital expenditures are estimated to be 12% of NOI, which is below the 15% reserve used for Manhattan. Capital expenditures in the U.K. should be lower than the U.S. since landlords have a more favorable leasing structure (fully repairing and insuring) that distributes more costs to tenants.
(3) Projected Same-Market NOI growth forecasts are for markets as a whole. REIT portfolios will likely outperform these estimates since they generally have above-average properties and have limited near-term expiries. For London, projected NOI growth is on an effective basis (i.e. face rent minus free rent). Long-term growth starts with inflation and subtracts an adjustment based on how a market's long-term rent growth fared versus inflation. While historical rent growth for the West End equaled inflation, the relationship was assisted in part by the aggressive expansion of hedge funds the last few years. Consequently, our long-term NOI growth forecast is based on the inflation implied in the 30 year gilt market minus 50 basis points. Although historical rent growth in the City trailed inflation by 130 basis points, this number was fueled by the supernormal growth from the Big Bang in the early 1980s. As a result, the long-term growth used for the City is implied inflation minus 200 basis points. Long-term growth for the West End is higher than Midtown since inflation expectations are higher in the U.K. (3.2% versus 2.5% in the U.S.).
Source: Green Street Advisors, IPD, Bloomberg.

Historically, required IRRs for London office market investors have been about 45 basis points higher than the iBoxx Corporates BBB index yield. With the iBoxx currently yielding about 9%, investors likely require IRRs in the 9.5% range.



(4) The estimated look-forward West End IRR is the sum of the West End economic cap rate and long-term growth rate. Historical West End economic cap rates are estimated by adjusting the time series of monthly CBRE prime yields by the steps mentioned in footnotes 1 and 2 on the top of this page. Long-term growth rates at various points in time are found by subtracting 50 basis points from the implied inflation in the 30 year gilt market (see footnote 3). The spread shown is the resulting difference between the estimated look-forward IRR and the iBoxx Corporates BBB index yield. Data since September '08 has been excluded from this analysis since the prime yield has trailed pricing. The spread between the historical estimated look-forward City IRR and the iBoxx Corporates yield has been negative over time, indicating that investors have expected better growth than is reasonable (and was achieved). Since the required return for an investment in the City would likely be at least equal to that for the West End, we use the West End's risk premium for all of Central London.



Source: Markit (Markit iBoxx is a registered trade mark of International Index Company Limited), CBRE, and Green Street Advisors.

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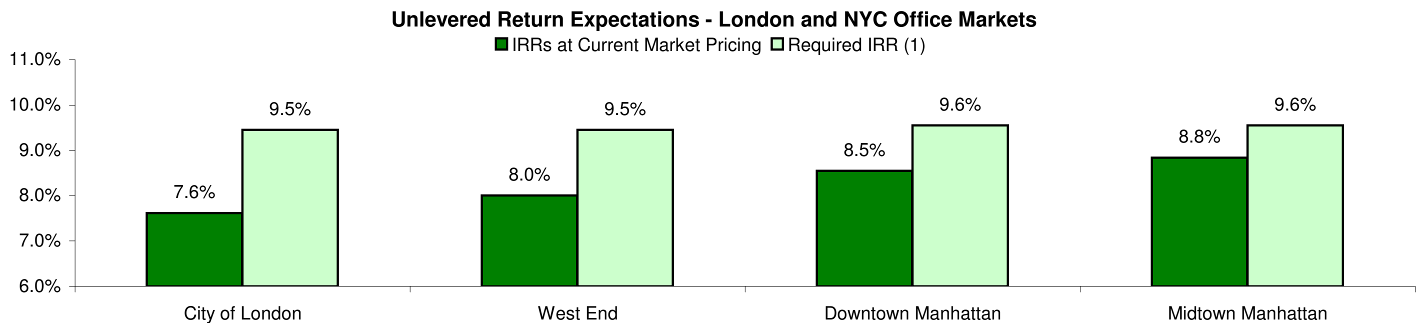
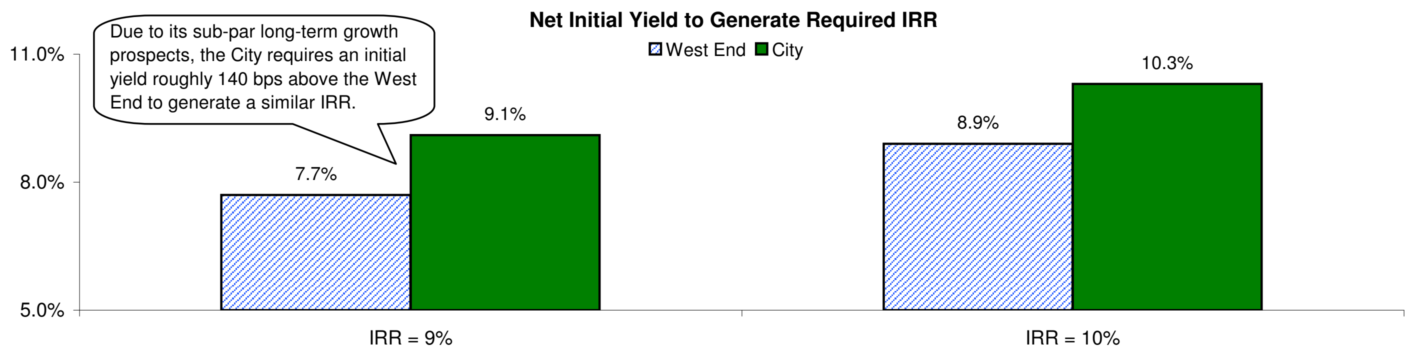
VIII. Private Market Pricing

London is priced to deliver unlevered returns (IRRs) slightly lower than Manhattan's office markets. However, as is true in Manhattan, the current return expectation premium (expected IRR minus the hurdle rate) is negative, suggesting that private market values may fall further. A roughly 20% decline in private-market London office values is needed for the historical relationship between unlevered IRRs and the cost of debt to revert to its long-term average.



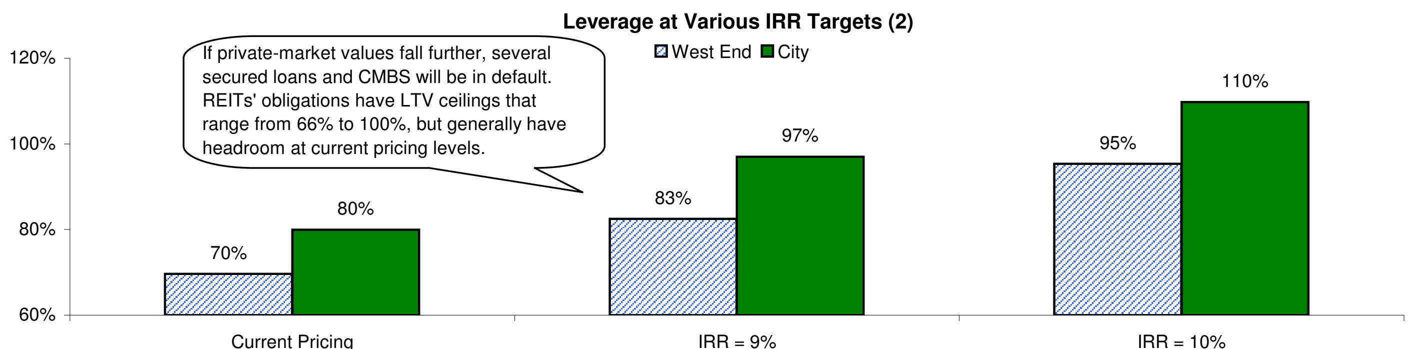
(1) Required IRRs differ by country. The historical average return premium for U.S. office real estate since 1986 is 155 basis points over mortgage rates. With mortgages currently priced at about 8%, the required IRR is roughly 9.6% for U.S. office. The required IRR for the U.K. is explained on the previous page. One of the reasons for the lower required IRR for London is the more favorable lease structure (see page 14).
Source: Green Street Advisors.

Given that near double-digit yields are available on moderate-risk corporate bonds, it seems fair to require at least a similar return from real estate. Target IRRs for institutions have increased substantially since the frothy days of the peak in '06/'07. Since it is unlikely that target IRRs are at 8% today given the plethora of investment opportunities in the credit market, London real estate appears modestly overpriced in the private market.



Source: Green Street Advisors.

As net initial yields expand, leverage steadily increases for current office owners. Like in the U.S., there is a high probability that distress will occur in the U.K. since loans signed in the '06/'07 timeframe are likely approaching a level where the property value is about equal to the loan amount. As a result, real estate values may fall further than the 20% needed to get the historical relationship between IRRs and corporate borrowing costs to normal, leading to opportunities for well-capitalized buyers.



(2) Assumes that loan-to-value was 50% for a secured loan signed in December '06.
Source: Green Street Advisors.

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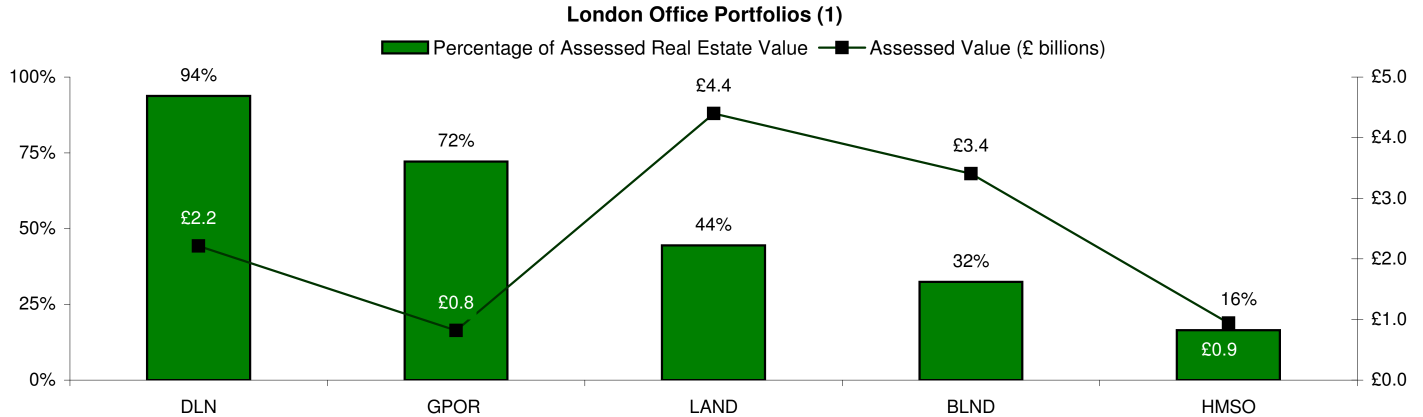
IX. Major U.K. REITs in London

Five U.K. REITs have sizable London office portfolios. The companies mostly own high-quality assets in the City and secondary West End submarkets. Their aggregate share of London office assets is £12 billion. Only two REITs are pure-plays: Derwent London (DLN) and Great Portland Estates (GPOR). Land Securities (LAND), British Land (BLND), and Hammerson (HMSO) are diversified, but have two of the three largest REIT-owned portfolios.

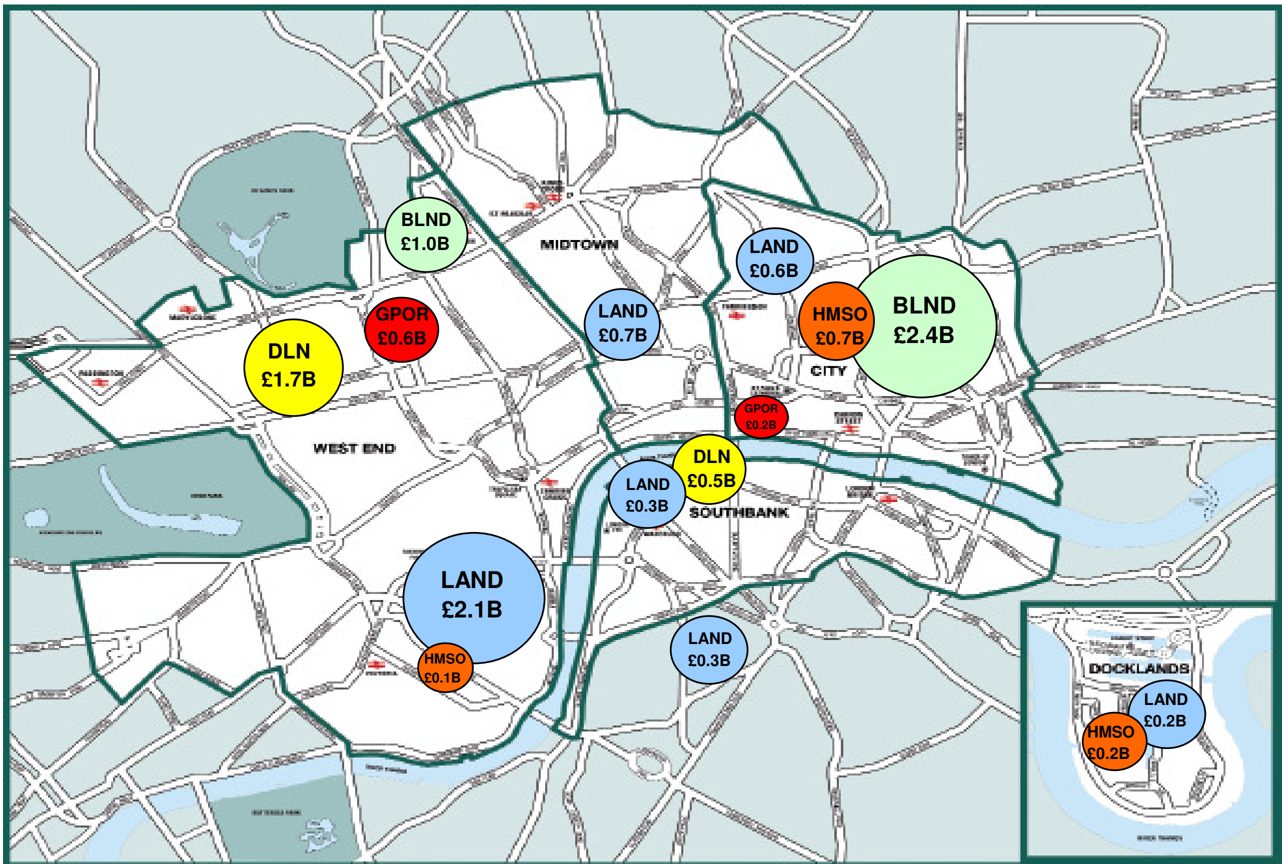
London Office Portfolios (1)



(1) Excludes development properties.
Source: Company disclosure.

The REIT portfolios are mostly located in the West End and City. While LAND, GPOR, and DLN focus on the West End, BLND and HMSO are primarily concentrated in the City.

U.K. REIT London Office Portfolios (1)



(1) Excludes development properties. Development is shown on the following page.
Source: CBRE and Company disclosures.

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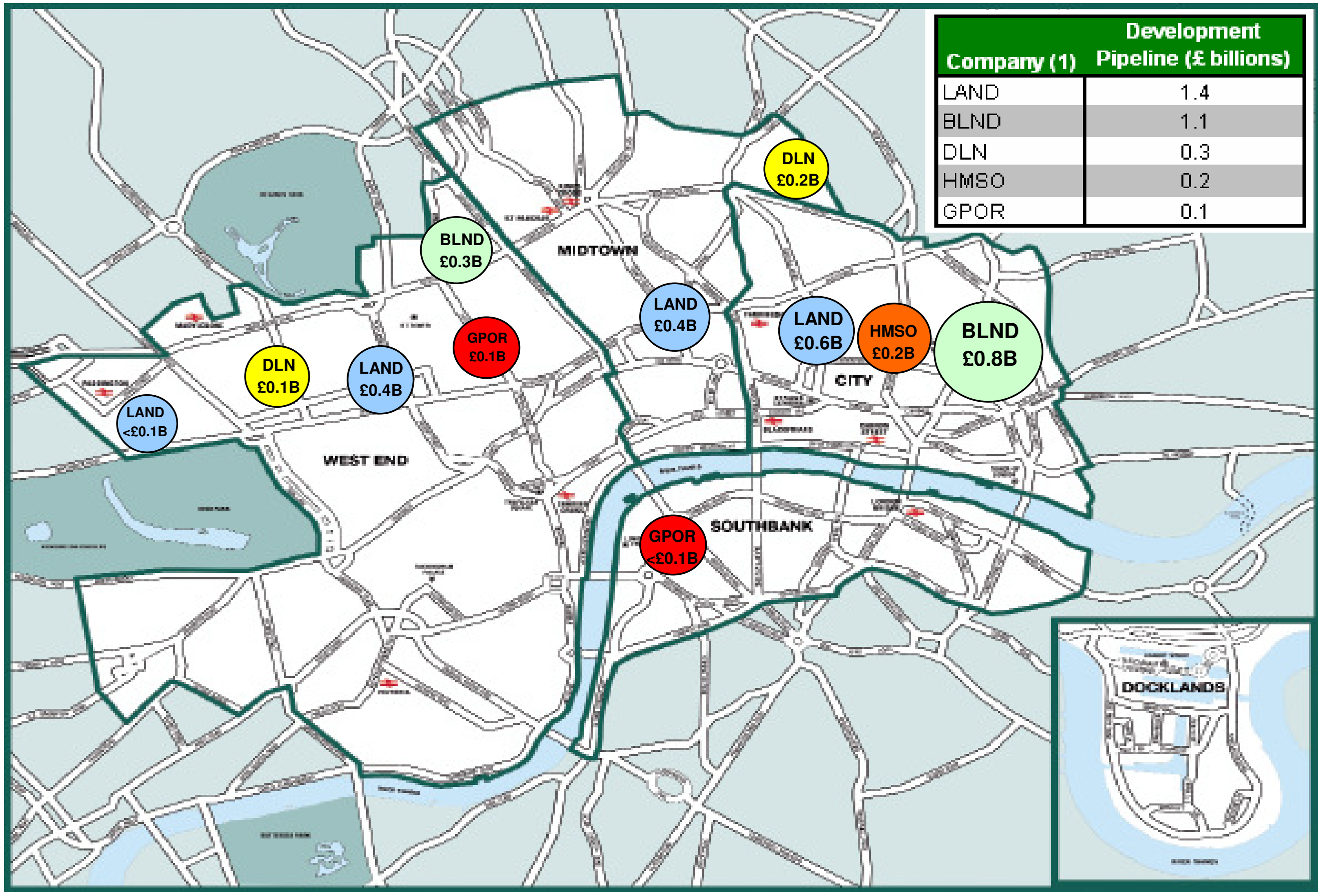
IX. Major U.K. REITs in London (cont'd)

The U.K. REITs are active developers and generally focus this activity where their existing portfolios are located. Whereas BLND and HMSO's development projects are mostly in the City, DLN, GPOR, and LAND have concentrations across the various London office markets.

U.K. REIT In-Process Development (Total Expected Cost)

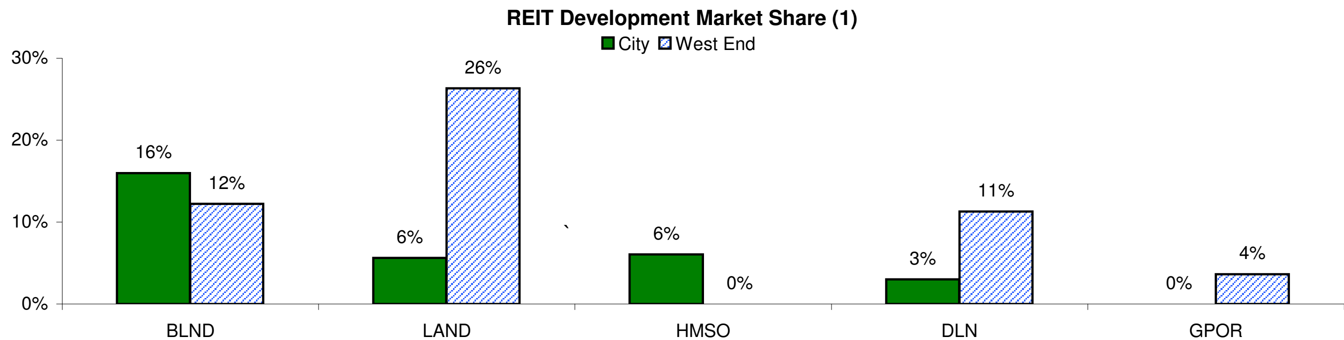


Company (1)	Development Pipeline (£ billions)
LAND	1.4
BLND	1.1
DLN	0.3
HMSO	0.2
GPOR	0.1

(1) Company-level snapshots highlighting REITs' development pipelines can be found at the end of this report.
Source: Company disclosure and CBRE.

BLND has the highest market share of total development under construction and available for lease in the City, the market facing the greatest headwinds. While LAND's development pipeline is spread throughout London, it is the largest developer in the West End.

REIT Development Market Share (1)



(1) Includes recently completed developments.
Source: Company disclosure and Drivers Jonas.

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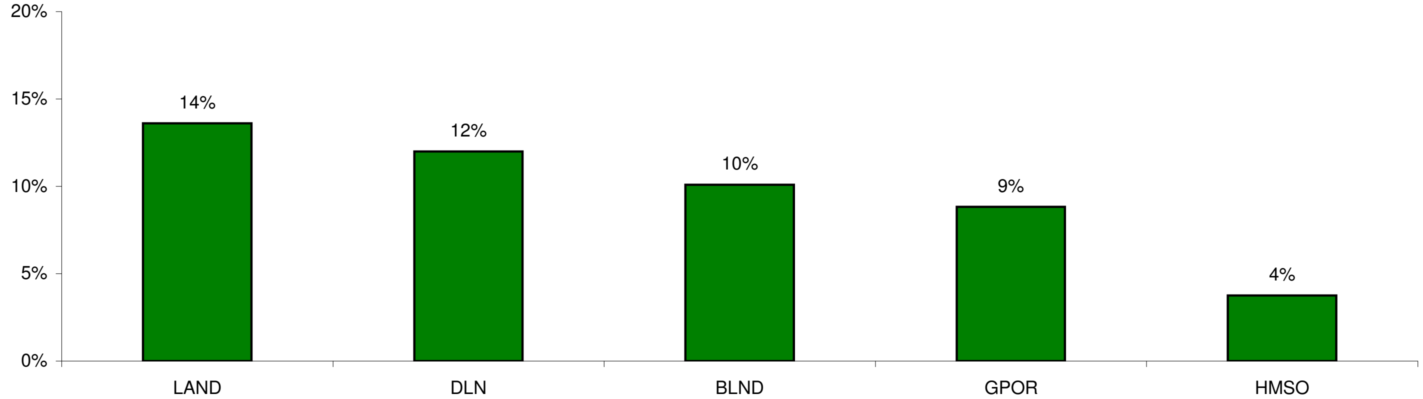
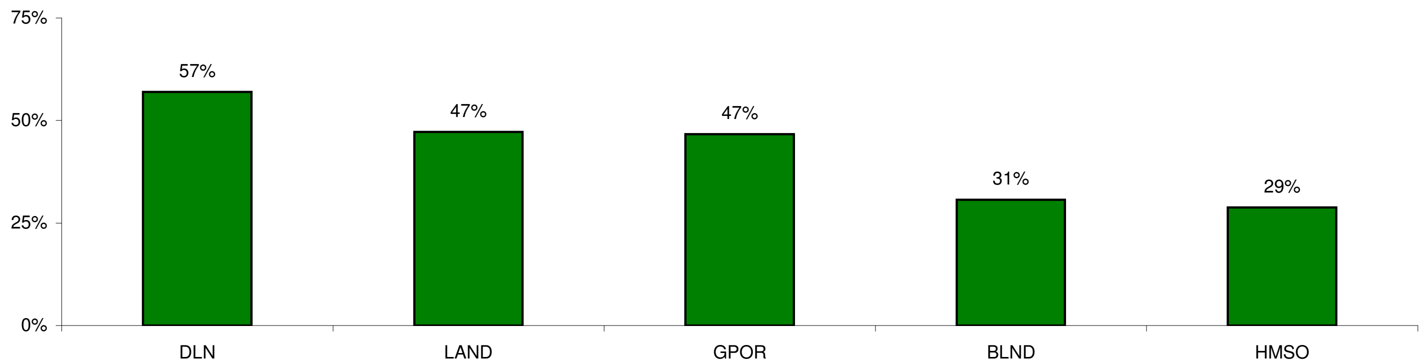
IX. Major U.K. REITs in London (cont'd)

Softening fundamentals have changed the economics of development. Promising projects have become potential sources of value destruction now that potential development yields have fallen and exit cap rates have risen. The deteriorating outlook has caused some REITs to postpone projects. Nevertheless, REITs still have a material exposure to London development activity.



(1) Includes retail portions of mixed-use projects and recently completed developments. For example, for BLND the costs of 201 Bishopsgate and the Broadgate Tower are included in the numerator of this ratio but the assessed value for these projects is excluded from the denominator. The denominator for this ratio includes all of a REIT's investment properties (office, retail, and other sectors).
Source: Company disclosure and Green Street Advisors.

Pre-leasing can greatly mitigate development risk and is typically correlated with submarket health. Despite having the two largest development pipelines as a percentage of assets, DLN and LAND have large concentrations in the West End and the highest pre-leasing of the group. While BLND and HMSO have successfully leased up developments over the last few years, low pre-leasing in their current pipelines is a source of concern.



(1) Includes retail portions of mixed-use projects and recently completed developments.
Source: Company disclosure and Green Street Advisors.

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The development of Canary Wharf permanently changed the landscape of London. During the mid-'80s, office space in the City of London lacked large floorplates and the technological infrastructure needed to support large financial trading operations. Believing that financial services firms would be willing to move to a fringe location that offered modern amenities at rents roughly 50% below prime space in the City, Olympia and York (O&Y) took over the project to build Canary Wharf - located 5 miles east of Central London. While Canary Wharf today is nearly fully occupied and considered an extension of the City, in the late-'80s, firms were reluctant to move to the location. In response to Canary Wharf's construction, the City relaxed development restrictions. Competitive supply emerging in the City, combined with a property recession, resulted in Canary Wharf initially becoming one of the largest busts in real estate history. However, the project emerged as a success after the market recovered and transportation linked it to Central London. Today, Canary Wharf is home to roughly 15 million s.f., and many A-list financial firms have space at the estate.

Year	Event
1981	The Local Government Planning Act of 1980 establishes the London Docklands Development Corporation (LDDC) to regenerate the Docklands, an eight square mile area comprised of dilapidated docks in East London. The LDDC offers developers a 10-year exemption from development land tax, tax deductions on capital expenditures, and relaxed planning guidelines. Residential developers are attracted by the incentives and build 24,000 housing units over the next seven years. Due to the fringe location and lack of transportation infrastructure, office developers avoid the site.
1987	Travelstead (the initial developer) is unable to attract financial backing from Morgan Stanley or CSFB. O&Y saves the project by committing to build 4.6 million s.f. by '92 and 7 million s.f. afterwards. Morgan Stanley and CSFB commit to lease 1 million s.f. if another 1 million s.f. of pre-lets are secured. O&Y decides to only focus on front-office tenants.
1990	O&Y barely gets the 1 million s.f. of pre-lets needed to keep Morgan Stanley and CSFB at Canary Wharf. However, leasing incentives are immense (TIs of £100/s.f. were provided to American Express versus annual face rents of £30/s.f. O&Y also bought out leases of several tenants to convince them to move to Canary Wharf).
1991	First phase of Canary Wharf is completed for $4 billion. The complex opens 55% leased (versus 80% occupancy in City). Due to a lack of infrastructure, the site is nearly inaccessible. The Daily Telegraph is the only U.K. firm with space at the estate.
1992	O&Y goes bankrupt. Only 14% of space is actually occupied at the estate (versus 57% leased). Administrators do not allow large TI packages to be granted to Amex and others, resulting in 530,000 s.f. returning to market.
1995	The London office market recovers. Paul Reichmann (former head of O&Y) forms a consortium (Canary Wharf Group) to buy Canary Wharf. Occupancy reaches 80%. Barclays and other U.K. financial tenants finally lease space. Plans are made to add more buildings.
1999-2000	The Jubilee Tube Line reaches Canary Wharf, connecting the estate to Central London. Rents approach 70% of City levels. Canary Wharf Group listed. During '00, Canary Wharf Group overtakes LAND as the largest U.K. property company by market cap and joins the FTSE 100.
2003-2004	Canary Wharf Group up for sale after news spreads that nearly 1 million s.f. could be put back to the company by tenants. Battle for control ensues. Songbird Estates (Morgan Stanley-backed consortium) wins majority stake (62%) of Canary Wharf Group in May '04. In June '04, Songbird (SBDB) becomes listed on the AIM exchange.
2008	Today, Canary Wharf totals roughly 15 million s.f. and 20,000 people live within walking distance. Capacity remains for 12 million s.f. to be added to the estate, which Canary Wharf Group plans to add as conditions improve and pre-lets are secured. A Crossrail station is also slated for the estate, which will improve connectivity between Canary Wharf and the City, Heathrow, and East London.

Sources: Bianco, Anthony. The Reichmanns: Family, Faith, Fortune, and the Empire of Olympia & York, Harris, Robert. Property and the Office Economy, Songbird Estates.

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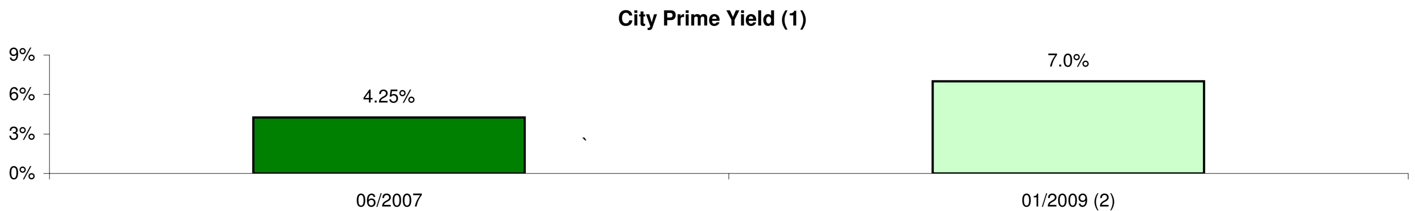
Appendix B: Recent Transactions - City

No major City transactions have closed since August. Valuers believe that prime yields have increased to 7%, as of the beginning of January.

City Prime Yield (1)



(1) Prime yield measures the investment yield for a prime property in the City and assumes that the asset is fully-leased with in-place rents at ERV (current market rental levels).
(2) Reflects prime yield for City buildings with lot size exceeding £50m.
Source: CBRE.

We estimate that current net initial yields for prime space in the City of London are approximately 7.5% (300 basis point increase from the peak in mid-'07). Net initial yields have increased by roughly 150 basis points since September as the financial and credit markets have reeled.

Date	Property	Market	Price (millions)	Value / S.F.	Net Initial Yield	Year Built / Renovated	Comments
TBD	1 Fleet Place	City	£74	£435	7.75%	1992	Expected to close soon. Fleet Place is located on the City fringe (near Midtown). Was offered for £100m in March '08. The location and a motivated seller (L&G) likely influenced pricing.
Failed	88 Wood Street	City	£180	£727	6.59%	1998	88 Wood Street failed to close twice last Fall. Initially offered for £200m in June, a sale of the building was expected to close at £190m in August, only to fall apart. A second deal at £180m unwound in October. 88 Wood Street is off the prime pitch, has a distressed seller, and has questions surrounding a tenant, which will make it trade at a higher yield than prime City space.
Failed	Milton Gate Building (Moor Lane)	City	£150	£750	6.25%	2007	Offered in May for £172m (5.5% yield). Signa Deutschland had won the bidding war only to pull out in early October due to an inability to secure financing.
08/2008	Moorhouse	City	£230	£757	6.50%	2004	Prime London office asset near Bank. Was initially offered for £300m in June. Fully occupied with an average unexpired lease term of 9 years. Buyer is DEKA, a German fund.
05/2008	Willis Building	City	£400	£860	5.70% Proforma Yield	2008	Fully occupied by Willis Group. Prime tower building (other buildings discussed are mid-rise). KIA paid a healthy price for the trophy asset in an off-market transaction. As part of the deal, BLND (seller) will cover the rent free period through '12 (a £60m cost).

Source: Property Week, CBRE, Colliers, Knight Frank, Company disclosure, and Green Street Advisors.

At the peak, net initial yields for prime City buildings were in the 4.5% range. Most of these acquisitions were underwritten with the assumption that rents would increase steadily for another few years. Instead, office fundamentals weakened and purchasers are now significantly underwater.

Date	Property	Market	Price (millions)	Value / S.F.	Net Initial Yield	Year Built / Renovated	Comments
06/2007	250 Bishopsgate	City	£230	£929	3.50%	1998	RBS' City HQ (lease expires in 2035). Evans Randall (seller) bought the building in mid-'05 for £184m. Net initial yield is the lowest ever in the City.
05/2007	175 Bishopsgate (One Exchange Square)	City	£406	£1,057	4.60%	1991	Fully occupied by EBRD (15 years left on lease). BLND's first sale of any land or property at Broadgate. Sold above the offer price.
04/2007	CityPoint	City	£650	£919	4.85%	1967/2000	The largest London office building purchase until Metrovacesa paid £1 billion for the HSBC building. Price paid was 23% more than seller had paid for building 14 months earlier.
02/2007	30 St. Mary Axe (Gherkin)	City	£630	£1,260	4.50%	2004	Sale-leaseback transaction with Swiss Re, who will lease half of the building through 2031. Buyer group expected to push rents from £60/s.f. range to £75/s.f. by '08 and securitize equity stakes via funds. Deal was 85% LTV.

Source: Property Week, Jones Lang LaSalle, CBRE, Company disclosure, Estates Gazette, and Green Street Advisors.

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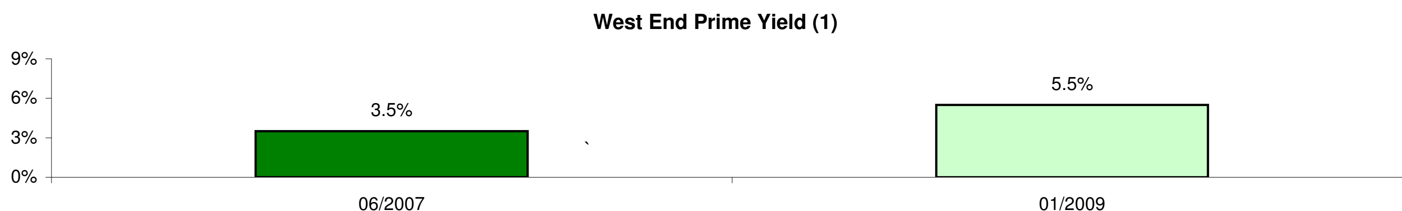
As with the City, there have not been any major West End transactions that have closed in several months. Valuers believe that prime yields have expanded to 5.5% as of the beginning of January.

West End Prime Yield (1)



(1) Prime yield measures the investment yield for a prime property in the West End and assumes that the asset is fully-leased with in-place rents at ERV (current market rental levels).
Source: CBRE

Given the diversity of submarkets, net initial yields vary across the market. Whereas yields on prime buildings in the core (Mayfair/St. James's) are likely in the 6% range, net initial yields appear to be closer to 6.75% in other submarkets.

Date	Property	Market	Price (millions)	Value / S.F.	Net Initial Yield	Year Built / Renovated	Comments
TBD	40 Portman Square	N. of Oxford Street	£140	£1,400	6.75%	2008	Recently completed development that is pre-leased to Och-Ziff and BC Partners at above market rents (£108/s.f.). The low growth potential likely explains the higher than market yield being offered for the asset.
TBD	Portman House	Mayfair	£175	£1,268	6.00%	2001	LAND is hoping to sell the building to recycle cash. The building is well-located and is a mix of office (100k s.f.) and retail (38k s.f.). If the building trades near a 6% initial yield, average initial yields in the West End are likely at least 6.5%.
TBD	30 Berkeley Square	Mayfair	N/A	N/A	5.75%	N/A	In early November, 30 Berkeley Square was reportedly offered at a 5.75% yield.
08/2008	5 Savile Row	Mayfair	£40	£1,262	5.67%	2006	First building sold from ING out of its U.K. portfolio. ING had bought the building from GE for £51.4m (4.3% net initial yield). Fortress has an office in the recently renovated building. The sales price was indicative of ING needing to offload the asset to satisfy redemptions.
08/2008	63 St. James's Street	St. James's	£38	£1,681	4.90%	N/A	Below-average yield since Brockton (the seller) will provide the buyer with a rent guarantee over the next nine months.
06/2008	69-70 Pall Mall	St. James's	£22	£917	5.00%	2001	Property let to HSBC until '18. In-place rent low at £46/s.f.
06/2008	3-5 Burlington Gardens	Mayfair	£75	£1,667	4.20%	N/A	Prime Mayfair building. Sold by Hermes, who had bought the building in '04 for £45m.
04/2008	Clive House	Victoria	£65	£765	5.20%	2005	Land Securities was hoping to get £81m (4% initial yield) when it marketed the building in Dec '07.

Source: Property Week, CBRE, Colliers, Knight Frank, Company disclosure, Estates Gazette, and Green Street Advisors.

Notable peak market transactions in the West End occurred mostly in secondary locations. Yields in these submarkets were in the low-4% range. It is likely that net initial yields were in the 3.5% range in Mayfair/St. James's.

Date	Property	Market	Price (millions)	Value / S.F.	Net Initial Yield	Year Built / Renovated	Comments
10/2007	Met Building, Tottenham Court Road	N. of Oxford Street, East	£107	£930	4.10%	2005	GPOR sold this recently redeveloped building. It had bought the building in '03 for £16m and spent £24m on renovations.
06/2007	1-11 Hay Hill	Mayfair	£90	£2,000	N/A	N/A	Bought for redevelopment angle. No initial yield provided on transaction.
05/2007	Central Cross, Tottenham Court Road	Fitzrovia	£215	£924	4.25%	N/A	Sold as a site with development potential. Central Cross was the largest asset the seller had bought from Prupim in a '05 portfolio transaction.
05/2007	1A Page Street	Victoria	£81	£685	3.69%	N/A	Property is HQ for Dept of Environment, Food, and Rural Affairs. Initially offered for £70m.

Source: Property Week, CBRE, Colliers, Knight Frank, Company disclosure, Estates Gazette, and Green Street Advisors.

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Appendix C: City of London Forecast Details

City of London Office Market Asking and Effective Rents Assumptions

	2008A	2009E	2010E	2011E	2012E	2013E
Asking Rent per s.f.	£53.50	£43.50	£43.50	£45.00	£48.50	£55.00
Market Rent Growth (%)	-17.7%	-18.7%	0.0%	3.4%	7.8%	13.4%
Rent Free Period Discount (%)	24.2%	27.8%	24.2%	19.4%	15.8%	14.6%
Effective Rent per s.f. (1)	£40.50	£31.50	£33.00	£36.25	£40.75	£47.00
Effective Rent Growth (%)	-30.7%	-22.5%	5.0%	10.0%	12.5%	15.0%

(1) Amortizes free rent over the full term of the lease.

Source: Green Street Advisors.

City of London Office Market Vacancy Forecast Assumptions

2009	
Development Completions (millions s.f.)	Pre-Leasing (%)
3.30	10.6%
Demolition of Space	0.8%
Total Stock (millions s.f.)	72.67
Job Gains	(30,240)
S.F. Gained (milllions)	(2.09)
City Vacancy	**13.0%**

2010	
Development Completions (millions s.f.)	Pre-Leasing (%)
2.00	35.0%
Demolition of Space	1.0%
Total Stock (millions s.f.)	73.93
Job Gains	0
S.F. Gained (milllions)	0.00
City Vacancy	**13.6%**

2011	
Development Completions (millions s.f.)	Pre-Leasing (%)
0.85	45.9%
Demolition of Space	1.2%
Total Stock (millions s.f.)	73.88
Job Gains	10,000
S.F. Gained (milllions)	1.15
City Vacancy	**11.4%**

2012	
Development Completions (millions s.f.)	Pre-Leasing (%)
0.60	0.0%
Demolition of Space	1.5%
Total Stock (millions s.f.)	73.36
Job Gains	15,000
S.F. Gained (milllions)	1.73
City Vacancy	**8.5%**

2013	
Development Completions (millions s.f.)	Pre-Leasing (%)
2.52	0.0%
Demolition of Space	2.0%
Total Stock (millions s.f.)	74.37
Job Gains	25,000
S.F. Gained (milllions)	2.88
City Vacancy	**5.9%**

Source: Green Street Advisors.

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Appendix C: West End Forecast Details

West End Office Market Asking and Effective Rents Assumptions

	2008A	2009E	2010E	2011E	2012E	2013E
Asking Rent per s.f.	£97.50	£80.00	£80.00	£82.50	£92.50	£105.00
Market Rent Growth (%)	-18.8%	-17.9%	0.0%	3.1%	12.1%	13.5%
Rent Free Period Discount (%)	10.0%	19.9%	17.9%	12.5%	10.2%	7.1%
Effective Rent per s.f. (1)	£87.75	£64.00	£65.75	£72.25	£83.00	£97.50
Effective Rent Growth (%)	-23.0%	-27.0%	2.5%	10.0%	15.0%	17.5%

(1) Amortizes free rent over the full term of the lease.

Source: Green Street Advisors.

West End Office Market Vacancy Forecast Assumptions

2009	
Development Completions (millions s.f.)	Pre-Leasing (%)
1.52	15.1%
Demolition of Space	0.5%
Total Stock (millions s.f.)	84.90
Job Gains	(12,600)
S.F. Gained (milllions)	(0.87)
West End Vacancy	**7.1%**

2010	
Development Completions (millions s.f.)	Pre-Leasing (%)
1.10	22.7%
Demolition of Space	0.8%
Total Stock (millions s.f.)	85.36
Job Gains	0
S.F. Gained (milllions)	0.00
West End Vacancy	**7.3%**

2011	
Development Completions (millions s.f.)	Pre-Leasing (%)
1.02	0.0%
Demolition of Space	1.0%
Total Stock (millions s.f.)	85.51
Job Gains	3,000
S.F. Gained (milllions)	0.35
West End Vacancy	**7.1%**

2012	
Development Completions (millions s.f.)	Pre-Leasing (%)
0.85	0.0%
Demolition of Space	1.2%
Total Stock (millions s.f.)	85.33
Job Gains	6,000
S.F. Gained (milllions)	0.69
West End Vacancy	**6.1%**

2013	
Development Completions (millions s.f.)	Pre-Leasing (%)
1.16	0.0%
Demolition of Space	1.2%
Total Stock (millions s.f.)	85.45
Job Gains	12,000
S.F. Gained (milllions)	1.38
West End Vacancy	**4.6%**

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Appendix D: Glossary and Bibliography

The following terms and sources were used in this report.

Term	Definition
Effective Rent	Headline Rent paid by a tenant adjusted for Free Rent and other landlord concessions. The adjustments are generally made on a straight-line basis, amortized to the earlier of the life of the lease or first break.
Embedded NOI Growth	The hypothetical percentage increase in Net Operating Income that would result from marking a property or portfolio's leases to current market levels, assuming no increase in expenses and no change in occupancy.
Estimated Rental Value (ERV)	Total potential market rent for a property at current market rental levels. Most common practice is to assume 100% occupancy.
Free Rent	Rent holiday at the beginning of a lease, granted by the landlord to induce a tenant to complete a lease deal. Generally measured in months.
Leasing Commissions	Fees paid by a landlord to an agent that has helped secured a lease from a tenant. In the U.K., leasing agents are typically paid 10% of first year's rent as a commission.
Net Initial Yield	Annualized net rent (rental income minus ground lease payments) generated by the property expressed as a percentage of the property's value. The denominator is grossed up by 5.75% which represents purchasers costs.
Operating Portfolio	Real estate owned by REITs (excluding properties in development). In the U.K., this is referred to as a company's "investment portfolio."
Prime Rent	Market rent for the most expensive leases signed in a submarket. There are typically only a handful of leases signed at prime rent levels.
Prime Yield	Hypothetical yield for a top-quality, freehold interest in a large, relatively new property located in a prime location, and fully leased at current market rent to a good-quality tenant under a long lease.
Take-up	Gross leasing activity. This is the closest term to net absorption in the U.K.
Tenant Improvement Package	Also known as TIs. Costs to improve space to be occupied by a tenant.

Source: Green Street Advisors.

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E. Company Snapshots

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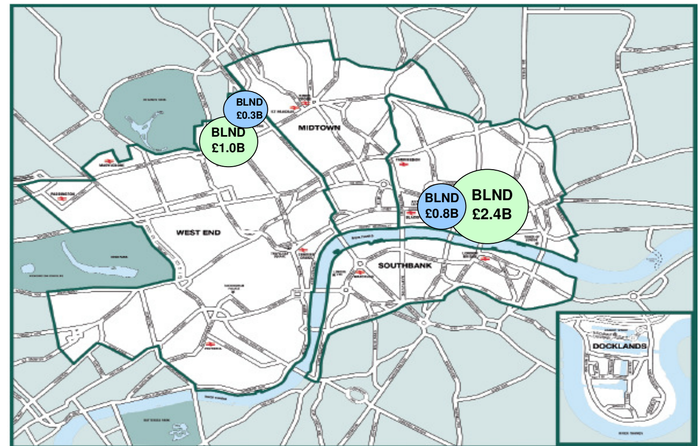
GREEN STREET ADVISORS

British Land (BLND) - London Office Portfolio

last revised: Tuesday, February 03, 2009

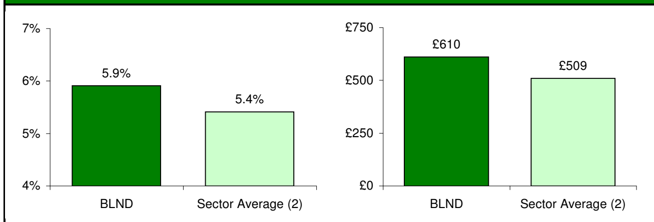


Company Overview

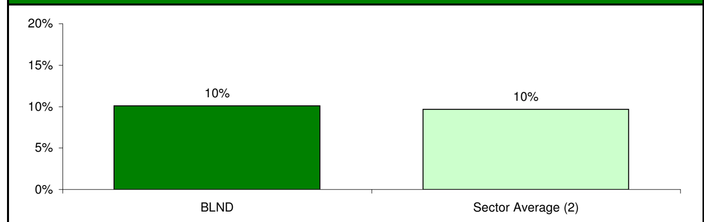
BLND is a diversified property company and the second largest U.K. REIT. Roughly one-third of its pro-rata assets are London offices. The London portfolio is primarily comprised of two prime estates: Broadgate (3.6 million s.f.; City) and Regent's Place (1 million s.f.; West End). BLND focuses on maintaining occupancy in its portfolio and securing tenants on long-term leases. The bulk of its development expenditure is also focused on the City.

Portfolio by Value (1)

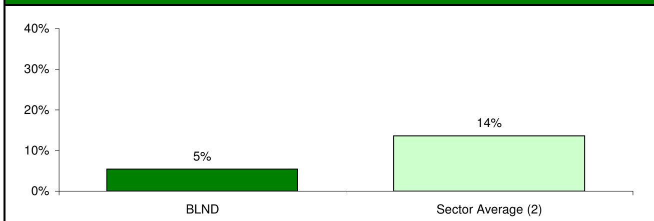
Net Initial Yield and Value per S.F. - London Office



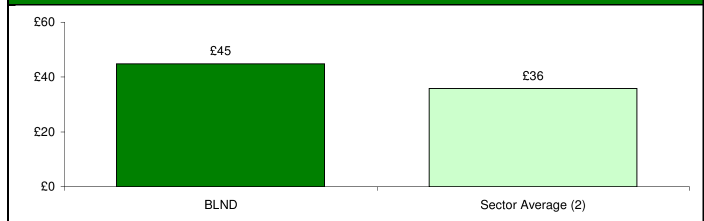
London Office Development Pipeline as % of Operating Asset Value (3)



Embedded NOI Growth - London Office



Average London Office Portfolio Rent



Notable London Office Investment Properties

Property	Location	Size (s.f.)	Quality	Assessed Value (£000s)	% of Total	Value / S.F.	Rent/S.F.	ERV/S.F.	Net Initial Yield (4)	Occupancy
Broadgate	City	3,581,000	Prime	£2,383,000	70%	£665	£47	£49	6.2%	98%
Regent's Place	Euston (WE)	1,000,000	Prime	£661,000	19%	£661	£39	N/A	5.4%	99%
Other Offices	Mostly WE	1,000,000	Mixed	£363,000	11%	£363	N/A	N/A	N/A	100%
Total Portfolio		**5,581,000**		**£3,407,000**	**100%**	**£610**	**£45**	**£47**	**5.9%**	**99%**

London Office Development Properties

Property	Location	Size (s.f.)	Completion Date	Projected Cost (£000s)	% of Total	Cost / S.F.	ERV/S.F.	Estimated Development Yield (5)	Pre-Leasing
201 Bishopsgate	City	419,000	1Q08	£186,000	17%	£444	£50	10.6%	88%
Broadgate Tower	City	400,000	3Q08	£252,000	23%	£630	£55	8.2%	44%
Ropemaker	City	586,000	3Q09	£377,000	35%	£643	£52	6.5%	0%
Osnaburgh Street	Euston (WE)	370,000	3Q09	£276,000	25%	£746	£55	6.3%	0%
Total Development Pipeline		**1,775,000**		**£1,091,000**	**100%**	**£615**	**£53**	**7.5%**	**31%**

(1) Composition of investment properties. Excludes in-process or completed developments.
(2) Sector average is an equally-weighted average of comparable figures from the London office portfolios of BLND, DLN, GPOR, HMSO, and LAND.
(3) Estimated total development costs of the London development pipeline divided by pro-rata investment property value. Recently completed but pre-stabilized properties (less than 95% let) are excluded from investment property value and included in the numerator.
(4) REITs use various types of valuation yields. For these snapshots, net initial yield is defined as annualized net rents for London office properties divided by the assessed value of investment properties grossed up for purchasers' costs (if a development is completed, but is less than 95% let, it is excluded from investment property value).
(5) Incorporates estimates for free rent packages as an additional cost. An estimate of 95% stabilized occupancy is also used for this analysis (unless a project has higher pre-leasing). Since REITs quote development yields in different ways, it is likely that the estimated yields are different from company estimates.

Source: Company disclosures and Green Street Advisors.

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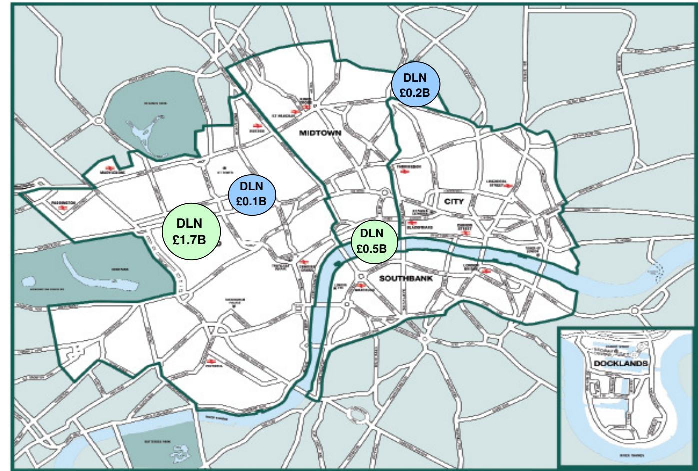
Derwent London (DLN) - London Office Portfolio

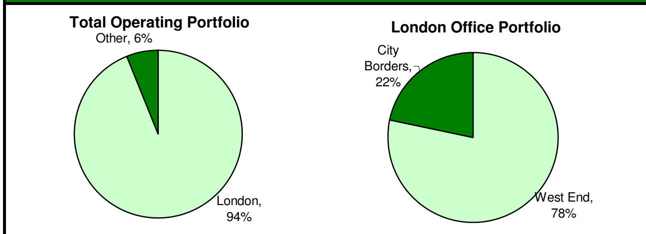
last revised: Tuesday, February 03, 2009

Company Overview

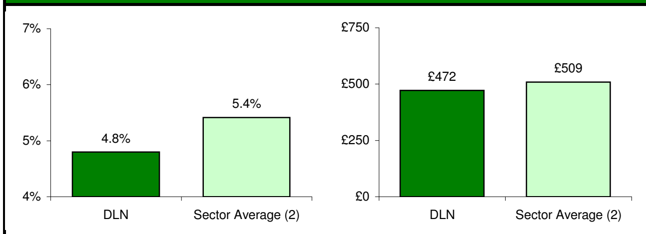
DLN is a London office sharpshooter that is principally concentrated in the West End. The portfolio is primarily in Fitzrovia, Victoria, Soho, and Covent Garden, the West End's more "value-oriented" office submarkets. Current developments center on Islington, Fitzrovia, and Noho.



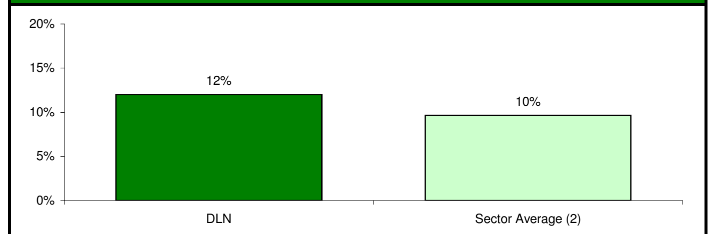
Portfolio by Value (1)



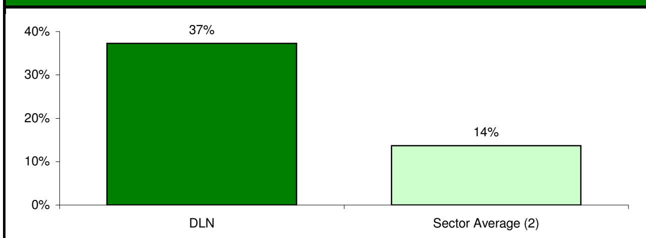
Net Initial Yield and Value per S.F. - London Office



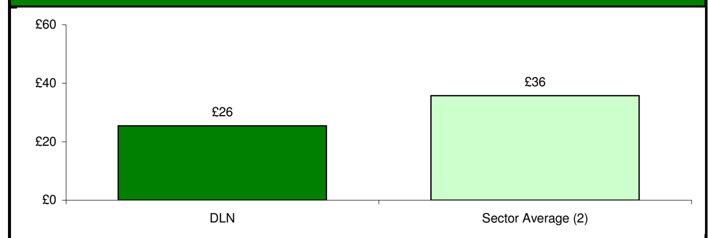
London Office Development Pipeline as % of Operating Asset Value (3)



Embedded NOI Growth - London Office



Average London Office Portfolio Rent



London Office Investment Properties

Property	Location	Size (s.f.)	Quality	Assessed Value (£000s)	% of Total	Value / S.F.	Rent/S.F.	ERV/S.F.	Net Initial Yield (4)	Occupancy
West End	West End	3,246,000	N/A	£1,699,400	77%	£524	£27	£38	4.5%	N/A
City Borders	Outside City	1,350,000	N/A	£510,600	23%	£378	£24	£27	5.7%	N/A
Total Portfolio		**4,596,000**		**£2,210,000**	**100%**	**£472**	**£26**	**£35**	**4.8%**	**96%**

London Office Development Properties

Property	Location	Size (s.f.)	Completion Date	Projected Cost (£000s)	% of Total	Cost / S.F.	ERV/S.F.	Estimated Development Yield (5)	Pre-Leasing
16-19 Gresse Street	Noho	59,000	2Q09	£50,000	19%	£847	£54	5.4%	0%
Arup III	Fitzrovia	85,000	4Q09	£63,000	24%	£741	£42	5.7%	100%
Angel Building	Islington	263,000	2Q10	£152,000	57%	£578	£42	6.1%	53%
Total In-Process Development		**407,000**		**£265,000**	**100%**	**£651**	**£44**	**5.9%**	**57%**

(1) Composition of investment properties. Excludes in-process or completed developments.
(2) Sector average is an equally-weighted average of comparable figures from the London office portfolios of BLND, DLN, GPOR, HMSO, and LAND.
(3) Estimated total development costs of the London development pipeline divided by pro-rata investment property value. Recently completed but pre-stabilized properties (less than 95% let) are excluded from investment property value and included in the numerator.
(4) REITs use various types of valuation yields. For these snapshots, net initial yield is defined as annualized net rents for London office properties divided by the assessed value of investment properties grossed up for purchasers' costs (if a development is completed, but is less than 95% let, it is excluded from investment property value).
(5) Incorporates estimates for free rent packages as an additional cost. An estimate of 95% stabilized occupancy is also used for this analysis (unless a project has higher pre-leasing). Since REITs quote development yields in different ways, it is likely that the estimated yields are different from company estimates.

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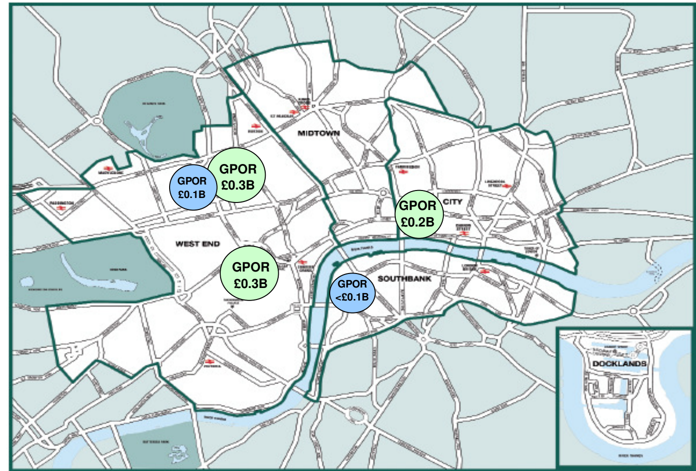
Great Portland Estates (GPOR) - London Office Portfolio

GREEN STREET ADVISORS

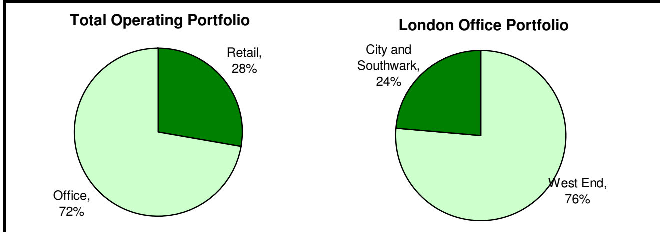
last revised: Tuesday, February 03, 2009

Company Overview

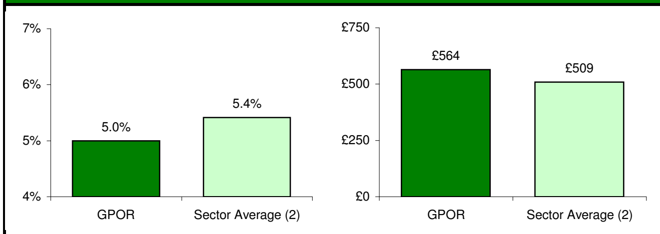
GPOR is a Central London property company. It is mostly concentrated in the North of Oxford Street submarket of the West End. GPOR has office and retail assets and focuses on properties that have "growth potential" (i.e. have low rents and can be improved through repositioning). While there are only a few developments currently in-process, the REIT has an expansive long-term pipeline where it plans to nearly double the size of its current operating portfolio.



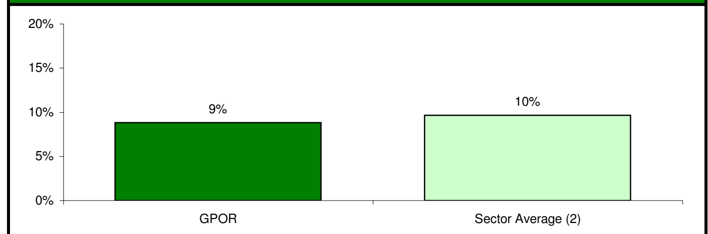
Portfolio by Value (1)



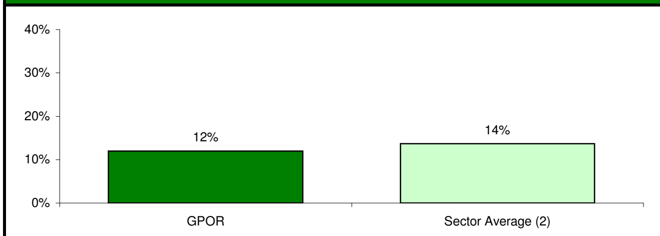
Net Initial Yield and Value per S.F. - London Office



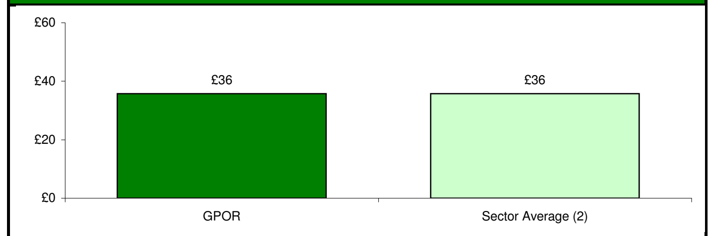
London Office Development Pipeline as % of Operating Asset Value (3)



Embedded NOI Growth - London Office



Average London Office Portfolio Rent



London Office Investment Properties

Property	Location	Size (s.f.) (4)	Quality	Assessed Value (£000s)	% of Total	Value / S.F.	Avg Office Rent/S.F.	Avg Office ERV/S.F.	Net Initial Yield (5)	Occupancy
North of Oxford Street	West End	525,000	N/A	£338,000	41%	£644	£40	£42	4.6%	N/A
Rest of West End	West End	405,000	N/A	£289,000	35%	£714	£40	£48	5.0%	N/A
City and Southwark	London	525,000	N/A	£193,300	24%	£368	£28	£31	6.2%	N/A
Total Portfolio		**1,455,000**		**£820,300**	**100%**	**£564**	**£36**	**£40**	**5.0%**	**93%**

London Office Development Properties

Property	Location	Size (s.f.)	Completion Date	Projected Cost (£000s)	% of Total	Cost / S.F.	ERV/S.F.	Estimated Development Yield (6)	Pre-Leasing
45 Foley Street	West End	20,000	2Q08	£14,800	15%	£740	£50	5.7%	48%
Wells & More	West End	94,000	1Q09	£65,500	65%	£697	£47	5.6%	65%
46/58 Bermondsey Street	Southbank	37,000	1Q09	£20,000	20%	£541	£41	6.2%	0%
Total In-Process Development		**151,000**		**£100,300**	**100%**	**£664**	**£46**	**5.7%**	**47%**

(1) Composition of investment properties. Excludes in-process or completed developments.
(2) Sector average is an equally-weighted average of comparable figures from the London office portfolios of BLND, DLN, GPOR, HMSO, and LAND.
(3) Estimated total development costs of the London development pipeline divided by pro-rata investment property value. Recently completed but pre-stabilized properties (less than 95% let) are excluded from investment property value and included in the numerator.
(4) GPOR does not disclose s.f. nor break out the s.f. of its portfolio by region. Amounts shown for s.f., values, and values/s.f. are on a pro-rata basis and based on a back-of-envelope calculation using data found in the company's accounts.
(5) REITs use various types of valuation yields. For these snapshots, net initial yield is defined as annualized net rents for London office properties divided by the assessed value of investment properties grossed up for purchasers' costs (if a development is completed, but is less than 95% let, it is excluded from investment property value).
(6) Incorporates estimates for free rent packages as an additional cost. An estimate of 95% stabilized occupancy is also used for this analysis (unless a project has higher pre-leasing). Since REITs quote development yields in different ways, it is likely that the estimated yields are different from company estimates.
Source: Company disclosures and Green Street Advisors.

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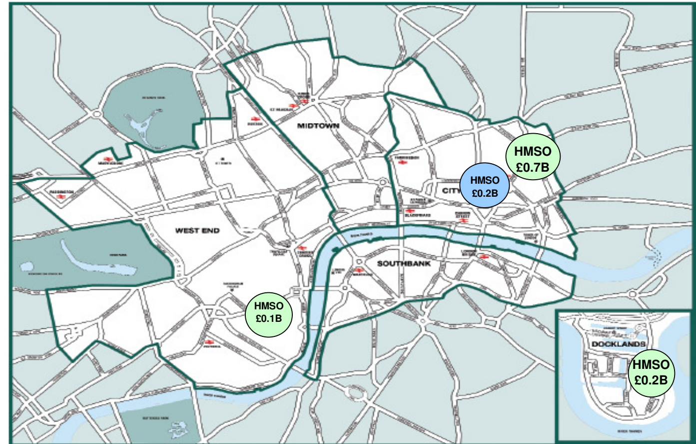
GREEN STREET ADVISORS

Hammerson (HMSO) - London Office Portfolio

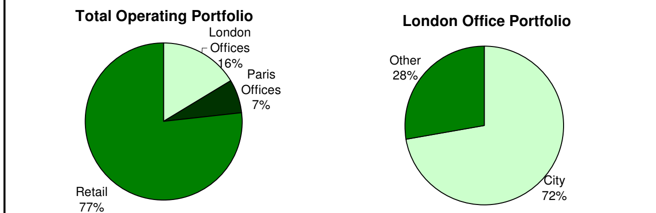
last revised: Tuesday, February 03, 2009

Company Overview

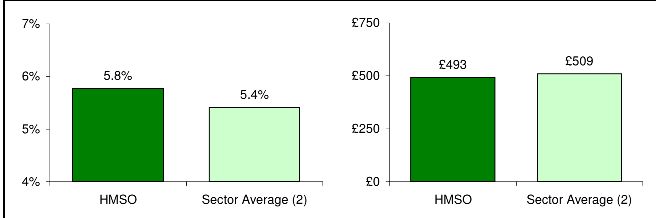
HMSO is the fourth largest U.K. REIT and primarily focuses on retail properties. It also has a concentration in the London office market. HMSO sees itself as a market-timer that develops City office buildings and crystallizes value by selling the leased-up properties at cyclical peaks. Office exposure is typically less than 30% of the portfolio at any given time.



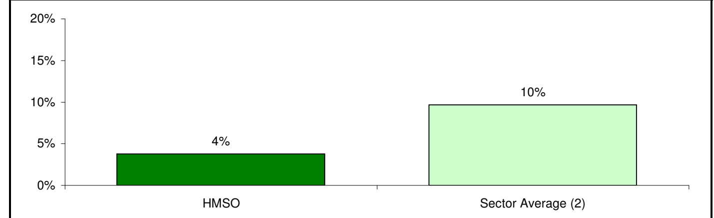
Portfolio by Value (1)



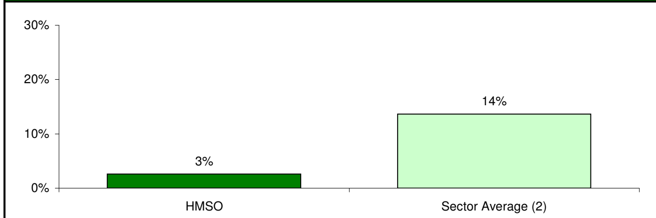
Net Initial Yield and Value per S.F. - London Office



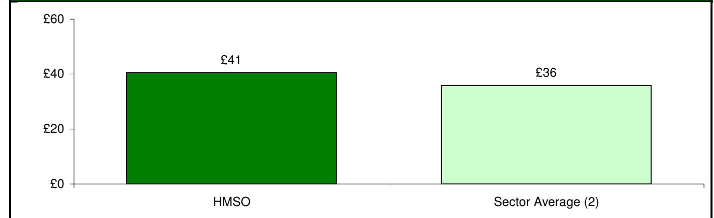
London Office Development Pipeline as % of Operating Asset Value (3)



Embedded NOI Growth - London Office



Average London Office Portfolio Rent



Notable London Office Investment Properties

Property	Location	Size (s.f.)	Quality	Assessed Value (£000s)	% of Total	Value / S.F.	Rent/S.F.	ERV/S.F.	Net Initial Yield (4)	Occupancy
Bishops Square	City	816,000	Prime	£560,000	60%	£686	£44	N/A	6.1%	100%
99 Bishopsgate	City	338,000	Prime	N/A	N/A	N/A	£54	N/A	N/A	100%
Stockley House	Victoria (WE)	70,000	Prime	N/A	N/A	N/A	£44	N/A	N/A	100%
10 Grosvenor Street (50%)	Mayfair (WE)	64,000	Prime	N/A	N/A	N/A	£64	N/A	N/A	100%
Exchange Tower	Docklands	485,000	Prime	N/A	N/A	N/A	£23	N/A	N/A	99%
Total Portfolio		**1,907,000**		**£941,000**	**100%**	**£493**	**£41**	**£42**	**5.8%**	**100%**

London Office Development Properties

Property	Location	Size (s.f.)	Completion Date	Projected Cost (£000s) (5)	% of Total	Cost / S.F.	ERV/S.F.	Estimated Development Yield (6)	Pre-Leasing
125 Old Broad Street (50%)	City	333,000	July '08	£91,000	42%	£547	£54	7.6%	48%
60 Threadneedle Street	City	222,000	January '09	£125,000	58%	£563	£50	6.9%	0%
Total In-Process Development		**555,000**		**£216,000**	**100%**	**£553**	**£52**	**7.2%**	**29%**

(1) Composition of investment properties. Excludes in-process or completed developments.
(2) Sector average is an equally-weighted average of comparable figures from the London office portfolios of BLND, DLN, GPOR, HMSO, and LAND.
(3) Estimated total development costs of the London development pipeline divided by pro-rata investment property value. Recently completed but pre-stabilized properties (less than 95% let) are excluded from investment property value and included in the numerator.
(4) REITs use various types of valuation yields. For these snapshots, net initial yield is defined as annualized net rents for London office properties divided by the assessed value of investment properties grossed up for purchasers' costs (if a development is completed, but is less than 95% let, it is excluded from investment property value).
(5) Refers to actual development costs (not incorporating a profit on sale of 50% stake in 125 Old Broad Street).
(6) Incorporates estimates for free rent packages as an additional cost. An estimate of 95% stabilized occupancy is also used for this analysis (unless a project has higher pre-leasing). Since REITs quote development yields in different ways, it is likely that the estimated yields are different from company estimates.

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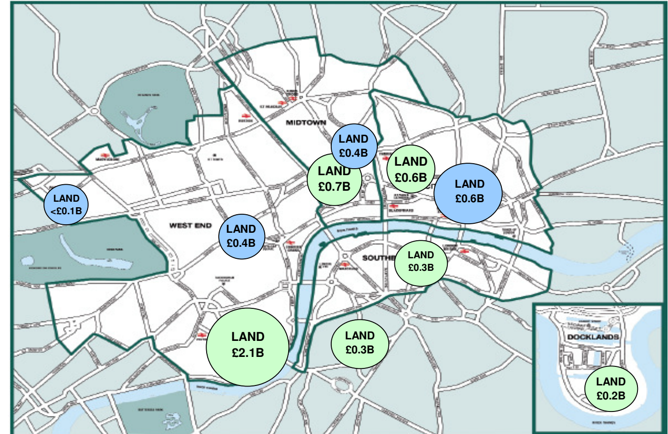
Land Securities (LAND) - London Office Portfolio

GREEN STREET ADVISORS

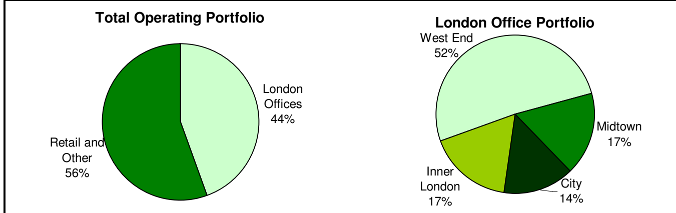
last revised: Tuesday, February 03, 2009

Company Overview

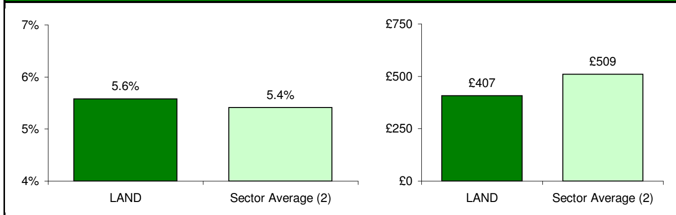
LAND is a diversified property company that has two main property divisions: Retail (55% of total pro-rata asset value) and London (45%). It is also the largest U.K. REIT and has the greatest market share of London office space (5%). LAND's London office portfolio builds geographic "clusters" which establishes the company as a neighborhood sharpshooter. Assets are primarily concentrated around Victoria Station (West End), Cheapside (City), and New Street Square (Midtown).



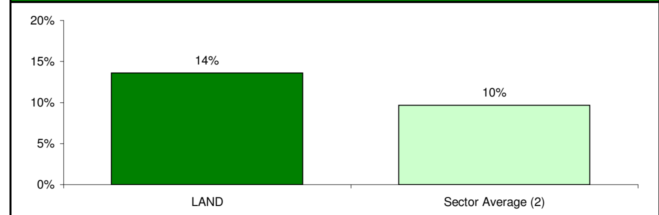
Portfolio by Value (1)



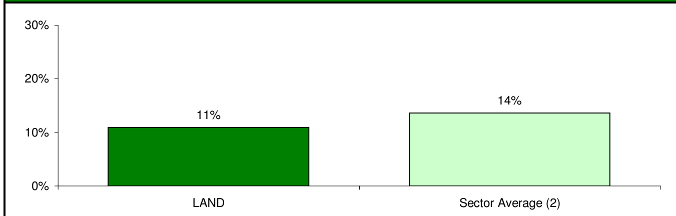
Net Initial Yield and Value per S.F. - London Office



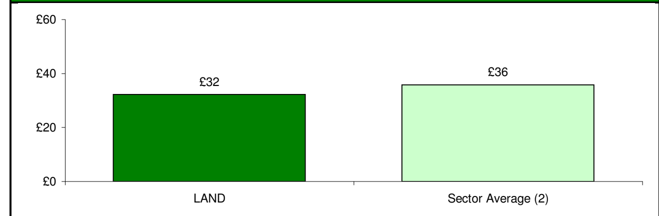
London Office Development Pipeline as % of Operating Asset Value (3)



Embedded NOI Growth - London Office



Average London Office Portfolio Rent



Notable London Office Investment Properties

Property	Location	Size (s.f.)	Quality	Assessed Value (£000s)	% of Total	Value / S.F.	Rent/S.F.	ERV/S.F.	Net Initial Yield (4)	Occupancy
Cardinal Place	Victoria (WE)	669,935	Prime	N/A	N/A	N/A	N/A	£67	N/A	100%
50 Queen Anne's Gate	Victoria (WE)	324,424	Prime	N/A	N/A	N/A	N/A	£40	N/A	100%
Bankside 2&3	Southbank	412,538	Prime	N/A	N/A	N/A	N/A	£44	N/A	100%
Thomas More Square (50%)	Tower Hill	561,865	Prime	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Times Square (95%)	City	377,996	Prime	N/A	N/A	N/A	N/A	N/A	N/A	N/A
One Wood Street	City	178,939	Prime	N/A	N/A	N/A	N/A	£49	N/A	100%
Westminster City Hall	Victoria (WE)	169,532	Secondary	N/A	N/A	N/A	N/A	N/A	N/A	100%
Total Portfolio		**10,793,436**		**£4,397,400**	**100%**	**£407**	**£32**	**£36**	**5.6%**	**98%**

London Office Development Properties

Property	Location	Size (s.f.)	Completion Date	Projected Cost (£000s)	% of Total	Cost / S.F.	ERV/S.F.	Estimated Development Yield (5)	Pre-Leasing
New Street Square	Midtown	703,099	May '08	£381,000	27%	£542	£48	7.5%	91%
Dashwood House	City	159,521	October '08	£112,000	8%	£702	£56	5.6%	5%
30 Eastbourne Terrace	Paddington (WE)	48,115	May '09	£35,000	2%	£727	£42	5.0%	0%
One New Change	City	546,161	September '10	£531,000	37%	£972	£60	5.4%	30%
Park House	Mayfair (WE)	253,705	December '11	£369,000	26%	£1,454	£106	6.3%	0%
Total Development Pipeline		**1,710,601**		**£1,428,000**	**100%**	**£835**	**£61**	**6.2%**	**47%**

(1) Composition of investment properties. Excludes in-process or completed developments.
(2) Sector average is an equally-weighted average of comparable figures from the London office portfolios of BLND, DLN, GPOR, HMSO, and LAND.
(3) Estimated total development costs of the London development pipeline divided by pro-rata investment property value. Recently completed but pre-stabilized properties (less than 95% let) are excluded from investment property value and included in the numerator.
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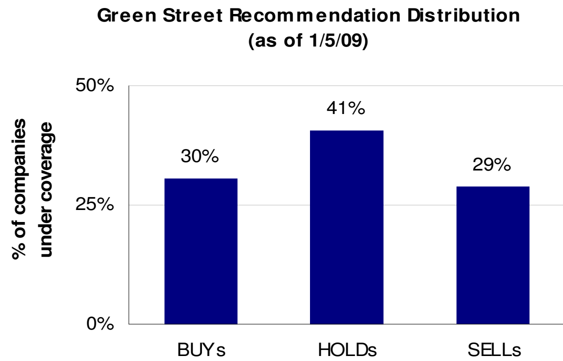

Green Street's "BUYs" have historically achieved far higher total returns than its "HOLDs", which, in turn, have outperformed its "SELLs".[1, 2]

Total Return of Green Street's Recommendations

Year Ended December 31:

Year	Buy	Hold	Sell	NAREIT Eqty[4]
2008	-27.8%	-30.7%	-53.2%	-37.7%
2007	-6.5%	-22.3%	-27.6%	-15.7%
2006	45.4%	29.9%	18.4%	35.1%
2005	26.3%	18.3%	-1.9%	12.2%
2004	42.3%	28.4%	15.6%	31.6%
2003	42.7%	37.2%	20.9%	37.1%
2002	17.7%	2.6%	1.9%	3.8%
2001	35.7%	19.1%	11.9%	13.9%
2000	53.6%	29.3%	4.4%	26.4%
1999	14.2%	-9.2%	-20.2%	-4.6%
1998	-0.6%	-15.1%	-16.4%	-17.5%
1997	37.1%	14.2%	5.8%	20.3%
1996	47.3%	30.2%	17.5%	35.3%
1995	23.6%	14.3%	-0.4%	15.3%
1994	20.5%	-0.7%	-9.3%	3.2%
1993[3]	29.4%	5.4%	6.7%	12.4%
Total Return[3]	**2625.6%**	**215.4%**	**-47.8%**	**267.1%**
Annualized	**23.1%**	**7.5%**	**-4.0%**	**8.5%**

1) Historical results through January 3, 2005 were independently verified by Ernst & Young, LLP. E&Y did not verify stated results subsequent to January 3, 2005. Past performance results cannot be used to predict future performance. For a complete explanation of study, see 5/9/03 report "How are We Doing?".
2) Company inclusion in the calculation of total return has been based on whether the companies were listed in the primary exhibit of Green Street's "Real Estate Securities Monthly", pg. 11-14. Beginning with May 2000, Gaming C-Corps and Hotel C-Corps, with the exception of Starwood Hotels and Homestead Village, are not included in the primary exhibit and therefore not included in the calculation of total return. Beginning with March 2003, all Hotel companies are excluded.
3) Study uses recommendations given in Green Street's "Real Estate Securities Monthly" from January 29, 1993 through January 5, 2009.
4) Not directly comparable to Green Street's performance indices because NAREIT includes more companies and uses market-cap weightings. Green Street's returns are equally-weighted averages.

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Green Street Advisors - European Team*

European Research (London) +44 (0)20 7290 6540	
John Lutzius, Managing Director	jlutzius@greenst.eu.com
Hemant Kotak, Associate**	hkotak@greenst.eu.com
Charles Boissier, Associate**	cboissier@greenst.eu.com

European Research (Newport Beach) +1 (949) 640 8780	
Cedrik Lachance, Senior Analyst	clachance@greenst.com
Steve Frankel, Senior Associate	sfrankel@greenst.com
Scott Kohnen, Senior Associate**	skohnen@greenst.com
Alexandra Coupe, Associate	acoupe@greenst.com

European Trading (London) +44 (0)20 7290 6555	
Lynn Lewis, Managing Director	lynnlewis@greenst.eu.com
Richard Martin, Vice President & Trading Manager	rmartin@greenst.eu.com
Zubeen Khan, Trading Associate	zkhan@greenst.eu.com

Institutional & Subscription Sales	
Institutional Sales (Dallas) +1 (214) 855 5905	
Anthony Scalia, Vice President & Institutional Sales Manager	ascalia@greenst.com
Tim Joy, Vice President, Institutional Sales	tjoy@greenst.com
Scott Bell, Vice President, Institutional Sales	sbell@greenst.com
Murrie Holland, Institutional Sales	mholland@greenst.com
Subscription Sales (Newport Beach) +1 (949) 640 8780	
Damon Scott, Director, Marketing	dscott@greenst.com

Administration (London) +44 (0)20 7290 6540	
Robin Russel, Operations Manager	rrussel@greenst.eu.com
Natascha Collinson, Office Manager	ncollinson@greenst.eu.com

London
22 Grosvenor Square, 3rd Floor
London, W1K 6LF, UK
Main: +44(0)20 7290 6540
Trading: +44(0)20 7290 6555

Newport Beach
567 San Nicolas Drive, Suite 200
Newport Beach, California 92660, USA
+1 (949) 640 8780

Dallas
600 North Pearl Street, Suite 2310
Dallas, Texas 75201, USA
Trading: +1 (214) 749 4730
Sales: +1 (214) 855 5905

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