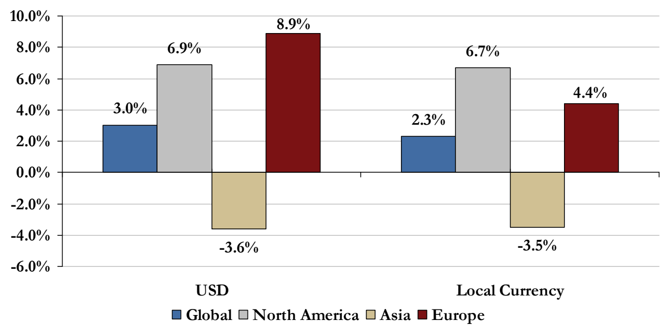
MARKET PERFORMANCE SNAPSHOT

FTSE EPRA/NAREIT Developed Index

First Quarter 2011 Total Returns



North America: Canada posted a 10.4% return led by RioCan Real Estate Investment, the country's largest public real estate company, which was up 17.4%. US increased 6.3% despite the expectation of the end of QE II.

Asia: The devastating Japan earthquake on March 11 clearly impacted the Asia-Pacific region. Japanese real estate companies, which represent almost 9% of the index, fell 11.7%. Large-cap Japanese developers and companies with retail exposures were the most affected.

Europe: The impending bailout of Portugal provides a temporary respite to the financial crisis and the fears of it spreading to Spain. Inmobiliaria Colonial, Spain's only index constituent, rose 53.9%. Also of note, while the region was the best performer, over half of the return was due to currency gains.

OBSERVATIONS FROM THE FIELD

Adelante's global effort demands extensive field research throughout the year. In the following sections, we share our impressions and experiences from the markets we have visited recently.

North America

Boston Residential Market – Luis Sanchez

In March I took a trip to Boston to meet with the local management teams of various REITs with a presence in the market, tour a small sampling of assets and meet with various brokers and private market participants.

Within the Apartment sector, I met with and toured assets owned by AvalonBay Communities, Equity Residential and UDR, Inc. My meetings confirmed the overall view that the Apartment sector continues to benefit from limited new supply, a declining home ownership rate and favorable demographic trends. The Boston metro is expected to be one of the better performing apartment markets in 2011. Owners I met with are achieving rental increases of 6% to 7% on renewals within the urban infill submarkets, while rents on new leases for vacated units were achieving increases in rents of 3% to 5% over the expiring rent. The convergence of the level of increase being achieved on both new and renewal rents is a positive sign for the overall health of the apartment market.

While in Boston, I also had the opportunity to meet with Peter Donovan, the head of CBRE's National Multifamily Investment Sales division. Peter indicated that the transaction market is continuing to recover. Total sales activity for apartments in 2010 of approximately $31.6 billion was more than double the $14.7 billion achieved in 2009. While still well below the levels of $90 billion plus achieved in 2006 and 2007 near the market peak, the continued improvement in volume is a sign of healthy investor demand given both the improved operating fundamentals for apartments and the attractive financing that is available for buyers. Volumes in 2011 could increase by as much as 30% to 40% over 2010, putting overall activity above $40 billion. The biggest constraint on volume may be the imbalance between capital looking to be invested and the limited quantity of quality apartment assets on the market, as sellers are more reluctant to sell assets ahead of what is believed to be a two to three year window of very favorable operating fundamentals.

Asia

Build It and They Will Come – Eric Thaller

Following on the heels of Michael's trips to China over the last couple years, I made my way there at the end of March, spending two weeks in Beijing, Chongqing, Hong Kong and Shanghai. I met with a number of company management teams, toured properties, both finished and unfinished, and spent some time simply interacting with the locals. The physical landscape of the cities is amazing, with buildings seemingly jumping out of the ground everywhere. However it is the complex maze of political, social and economic dynamics that are most fascinating.

I visited Vanke's Beijing Hills development about 2 miles from the central business district and I can assure you this was not like Beverly Hills as suggested. According to the sales agent, Phase I began selling at an average sales price ("ASP") of 31k RMB/m² in December 2009. Just a year later, similar units were priced about 35% higher at around 42k RMB/m² (USD 604/sq foot). In Chongqing prices are considerably less but also showed unsustainable increases. Agile's International Garden 1,200 Unit Phase I had an ASP of 8,800 RMB/m² (USD 127/sf) in June 2010. Phase II and III, with around 2,000 units in total, are currently being built and expected to be released at an ASP of 13 – 15,000 RMB/m² (USD 187 – 216/sf) in September of this year. Tales of price increases of this magnitude were common.

Apartments in Beijing

In isolation the price levels don't mean much. However, if one takes into consideration the current rents, the prices do not make a lot of economic sense. Rental yields seemed to range between 1% and 2% in Beijing and Shanghai and are slightly higher in Chongqing. Financed buyers are paying interest in the 6% to 7% range. Further, the quoted yield was based solely on the sales price, ignoring the costs to finish and furnish the unit (upwards of 40% of the unit cost), pay building management dues or purchase a parking space. For cash buyers, the carrying costs are not overwhelming, but the government is experimenting with property tax in Chongqing and Shanghai, so that might change too. You might ask what gives?

I certainly don't believe prices will continue to increase forever, but I did come to appreciate the differences between the investment markets here and there. As Professor Jun of Cheung Kong Graduate School of Business pointed out during our conversation, the Chinese have limited investment opportunities elsewhere. Real interest rates are negative as bank interest rates are around 4%, while inflation is running at the 5% level. Equity trading volumes are exploding, but stocks have only compounded at an annual rate of around 7% over the last ten years while exhibiting extreme volatility. Fixed income is not an option, as the bond market is not developed, and investment outside of China is highly restricted, except for the government and SOEs (state owned enterprises) of course.

Thus property is the primary investment vehicle for the Chinese and it is deeply engrained in the culture. Virtually every local I spoke with talked about the desire to own a home and I heard a number of men say that they didn't expect to be able to find a wife until they owned a home. Savings rates are very high and the family plays a large role in assisting a child or couple with home purchase. The use of leverage is vastly different than in the United States. Between 30% and 60% of buyers are paying all cash and the remainder are putting down at least 30%.

The Central Government has taken a number of steps to reduce speculation in housing. In addition to increasing the bank reserve requirements, the Central Government has limited the number of homes one can purchase, instituted higher down payment requirements and asked local governments to provide residential price targets. This seems to have done little to curb investor appetite and price appreciation is clearly the main motivation for investment, at least in Tier 1 cities.

The Central Government probably won't stop its tightening measures until they see housing prices increase less than inflation. This is a noble goal, but the end game remains unclear. Professor Jing thought that home prices could decline significantly without triggering panic because consumers are less leveraged. He may ultimately be right, but history is not littered with successful tales of government-engineered soft landings.

Europe

What's in a Name? – Daniel Kwon

The Gherkin. Walkie-Talkie. The Cheesegrater.

Londoners have developed a quaint habit of nicknaming iconic buildings as they rise, or hope to rise, above the city's skyline. It is a testament to the subtlety of British wit but also speaks of the peculiarities of the buildings themselves, and to the short memories of the developers.

30 St. Mary's Axe, aka The Gherkin, started it all. For those unfamiliar with the building, it is an oblong-shaped (hence the pickle reference) glass building in the City of London. Built over a two-year period from 2001-2003, The Gherkin has won several prestigious architectural awards for its innovative structure and creative design. It also happens to be the model for inefficient design (63% leasable space), inflated costs, and aggressive rental growth assumptions.

That said, three years after delivery, the building was sold at a record price of GBP 630 million and a reported yield of 4.5%. The developers came out of this project looking, as the Brits like to say, "absolutely brilliant" especially since 24 months later, Lehman failed.

During my recent trip to London, I couldn't help but feel an eerie similarity as I met with UK REIT management teams. They spoke enthusiastically about beginning construction on 30 Fenchurch Street (Walkie-Talkie) and 122 Ledenhall (The Cheesegrater) even though the required rental value necessary was GBP 60/sf and the market is at low GBP 50s/sf. The designs of both buildings, as their nicknames suggest, are clearly atypical.

The CEO of a German Office REIT offered me his thoughts on the London market. "It is a lack of control of the architects," he told me. His company prefers "shoeboxes" that maximize density and provide companies a way to increase productivity per square foot. Left unstated was also the minimized need of a creative architect.

The City of London lacks any real barriers to entry. Zoning permits are more relaxed than in the West End and as long as one has the capital and doesn't block the sightlines of St. Paul's Cathedral, it is relatively easy to develop an iconic building in one of the world's premier financial centers. While I have nothing against interesting architecture and, in fact, feel that these buildings create a global identity for cities, I have a difficult time believing that it is the best capital allocation decision for listed real estate companies whose primary interest is to create shareholder value.

Artist's rendition of The Cheesegrater; The Gherkin in the foreground

The uniqueness of the design can increase development costs by upwards of 30%. And while not as extreme as The Gherkin, the inefficient floor plates of these two REIT-financed developments, reduce the leasable square footage of the asset. As a result, the rents that company management must receive in order to achieve an acceptable return are much higher. These management teams are hoping that either 1) tenant demand will drive up city rents to and hopefully above their return requirements or 2) the "greater fool", aka cap rate compression, will come and pay them a lofty premium for their iconic building. Certainly, one can see the risks in these assumptions.

As a counter example, Brookfield Properties and Great Portland have joint-ventured on a "shoebox" development also in the City of London, not far south from The Cheesegrater scheme. From a design standpoint, it will be something quite easily overlooked on a landscape shot of the skyline – tall, rectangular, plain. However, in terms of floor-space efficiency, it will be over 85% efficient. The required rents, GBP 48/sf.

While I am certain to admire the Walkie-Talkie or The Cheesegrater when delivered, as an investor, I would prefer not to own them.

The Shoebox will do just fine.