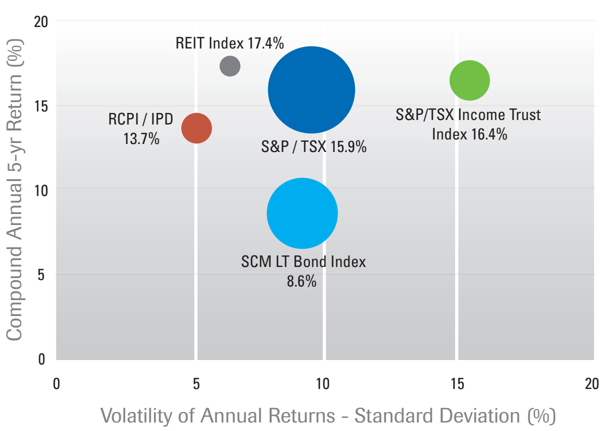
investment summary

> In the twelve months to September 2007, unlevered real estate returns measured by ICREIM/IPD Canadian Property Index grew 18.6%, only a very slight moderation from the 18.8% gain the year before. Capital appreciation of 11.5% accounted for most of this return and while strengthening NOI growth played a role, cap rate compression remained the major force in driving up appraisal values. With values rising, ICREIM/IPD income yields continued to be squeezed in the third quarter of 2007, narrowing to 6.4%.

The domination of "super-sized" capital growth in real estate's recent total return profile is largely a cyclical phenomenon. Over the past 20 years, more than 80% of real estate's average total return of 9.5% was attributed to the yield on income. In contrast, capital appreciation, which because of its cyclicality also tends to be far more volatile than the income yield component, historically averaged just 1-2% depending on property type. This comparatively larger (and therefore more stable) contribution from the income return has been a major reason for real estate's low volatility relative to other investment classes, and accordingly, one of its major appeals.

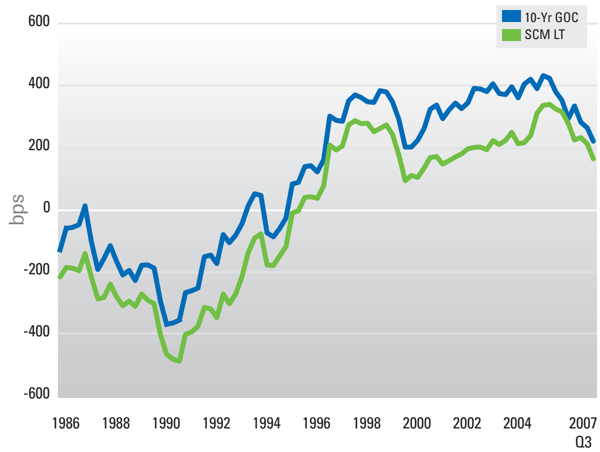
ASSET CLASS RETURNS vs. VOLATILITY (Q4|02 - Q3|07)



Source: IPD, RBC Capital Markets

Due to the continued compression of property yields, spreads over risk-free fixed income alternative investments continued to narrow over much of 2007. By the third quarter of 2007, the IPD income yield spread to Government of Canada 10 year bonds and the TSX Long-term bond index were approximately 192bps and 141bps, respectively. Although these spreads are significantly lower than historical averages (the 10 year historical average spread on Government of Canada 10 year bonds was 300bps) they remain within positive territory. This is a distinctively different situation than the late 1980's when these spreads were decidedly negative.

IPD INCOME YIELD SPREADS OVER 10YR. BOND & THE SCM LT BOND INDEX



Source: IPD, Bank of Canada

A WALL OF CAPITAL HAS CHASED REAL ESTATE

As mentioned earlier, a substantial proportion of Canadian real estate value and return increases during the past five years can be attributed to a reduction in capitalization rates. This was still the case over the twelve months to September 2007 as cap rates in Canada declined a further 25-50 bps. Illustrating the magnitude of capital that has been chasing real estate, CBRE estimates that transactions over $1 million exceeded $13 billion during the first half of this year, which is roughly on par with the momentous flows seen in 2006 when transactions hit a record $24.2 billion (up from $19.7 billion in 2005). Note that this figure does include land and hotels. Over this period, office transactions have dominated given their relative availability. A number of high profile industrial portfolios also changed hands including the purchase of HCI portfolio by Dundee REIT for an estimated $230 million.

The composition of real estate purchasers in Canada has been relatively diverse. However REITs, flush with capital raised in equity markets over the past few years, emerged as the most active buyer during the twelve months to September 2007, accounting for slightly more than 30% of all purchases. They were followed by pension funds, who accounted for close to 20% of all transactions during the same period.

LEVERAGE HAS BEEN A POWERFUL TOOL

The ample liquidity available in the credit markets over the past few years has helped to facilitate a dramatic rise in the use of leverage in this investment cycle. Highly leveraged buyers have had a significant advantage over the past few years when bidding for properties. Pension funds have also continued to increase their use of debt in order to meet their actuarial requirements in a low cap rate environment and have become increasingly competitive bidders even when competing against highly-leveraged buyers.

Private equity funds, in particular, are one such group that tends to utilize a significant amount of leverage (debt levels of 60-80%) to make acquisitions. The rise of private equity funds has been most dramatic in the U.S., where they accounted for nearly 40% of all real estate transactions in the first half of 2007 compared to just 3% in 2004 (Note that much of this 2007 figure is skewed by the Blackstone Group-Equity Office Properties Trust transaction).

In Canada, however, the universe of private equity funds sponsored by Canadian partners has been smaller compared to the U.S. or globally. This partly reflects the relative structure of the Canadian real estate investment market, which is dominated by a handful of large and sophisticated institutional investors.

CAP RATES POISED TO RISE OVER 2008

The 2007 credit crunch marks a major turning point for the ample liquidity and attractively priced debt that has partly driven real estate investment activity and suppressed cap rates. Tighter credit conditions suggest that the flow of debt-fueled real estate transactions is expected to slow going forward and some motivated sellers may be forced to lower prices. As a result, we expect that cap rates for institutional quality properties will move up by approximately 25-50bps through the course of 2008.

Risk re-pricing by lenders and tighter underwriting standards suggest that cap rates for lower-tier properties primarily in what are perceived to be riskier markets and submarkets will rise by 50-150bps during this time period.

With regard to institutional capital flows, it is important to note that a number of Canada's largest pension funds have begun to close in on their targeted real estate allocations. For example, Canada's 10 largest pension funds already had 8.3% of their total assets invested in real estate by the end of 2006 compared to about 6% in 2001. The significant increase over this time frame is primarily because of the "numerator effect" – that is, both acquisitions and capital appreciation allowed real estate assets to rise faster than the total investment holdings of these pension funds.

One implication of this is that after years of exceptional performance and rising asset values, commercial property in Canada may not simply draw capital from these larger pension funds purely because of its relative attractiveness versus other asset classes. Instead, these investors are apt to remain attracted to the asset class but mostly on the basis of building and/or enhancing a strategic allocation to it.

Once risk pricing is firmly re-established, this strategic focus may involve the pursuit of lower-tier properties or submarkets that offer higher yields. But it may also involve the pursuit of alternative real estate investments such as hotels or senior's housing as well as investments in other illiquid assets such as infrastructure. While some of these latter investments afford many of the larger pension funds with enhanced yields and greater diversification benefits, it also allows them to deploy significant amounts of capital in a single transaction – a prospect that is increasingly difficult to do with Canadian property given its relative scarcity.

On the other hand, the allocation to real estate by smaller pension funds (i.e., those with total assets below $1 billion) amounted to just 4% as of the end of 2006. This is effectively unchanged from the previous year largely because of the "denominator effect" – that is, total net assets grew faster than their holdings of real estate. Since, real estate values have risen appreciably over the last few years this suggests that that these smaller pensions have not been investing in real estate by as much as their larger peers. For this reason, we expect that these smaller pensions funds especially those with defined benefit obligations and without any real estate holdings at all, will be competitive bidders of core properties going forward.

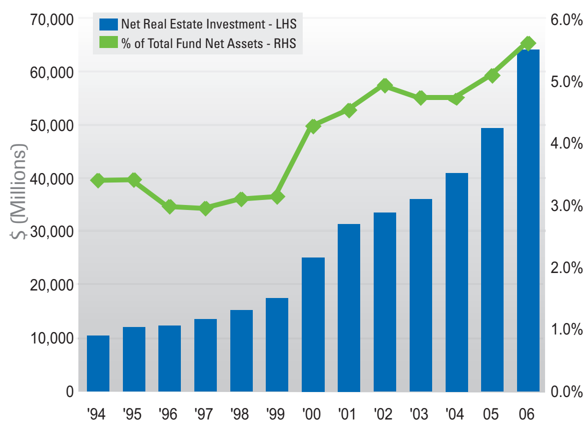
NATIONAL INVESTMENT TRANSACTIONS SUMMARY ($ Billions)

	Total	Office	Retail	Industrial	Multi-Res.	Hotel	Land
2007 (1st Half)	13.1	3.8	2.2	2.2	2.3	0.2	2.4
2006	25.0	4.4	3.9	7.2	3.5	2.1	3.9
2005	19.6	5.4	4.1	4.1	3.0	0.8	2.4
2004	17.3	4.1	4.0	3.4	2.9	0.3	2.5
2003	13.1	2.8	2.8	2.6	2.5	0.3	2.1
2002	14.8	3.6	2.8	3.0	3.1	0.2	2.1
2001	13.1	4.7	1.9	2.3	2.3	0.1	1.8

Note: Sales over 1 million

Source: CBRE

PENSION FUND INVESTMENT IN REAL ESTATE



Source: CPF Directory, annual reports

2006 (END OF YEAR) CANADIAN PENSION FUND INVESTMENT IN CANADA WITH CPP

Fund Size (Net Assets)	Fund Assets ($MM)	RE Equity ($MM)	%RE
BREAKDOWN OF CANADIAN PENSION FUND INVESTMENT			
Funds with Real Estate			
Top 10 Funds with Real Estate	646,887	53,639	8.3
Other Funds > $1 B	233,913	9,380	4.0
$100 MM to $1 B	20,959	1,190	5.7
$0 to $100 MM	1,557	97	6.2
Funds with Real Estate	903,317	64,306	7.1
Funds without Real Estate	249,913	0	0.0
All Funds	1,153,230	64,306	5.6

Source: Canadian Pension Fund Directory, Benefits Canada, Annual Reports
Note: as of Dec. 2006 or most recent annual report

public equity

> Canadian REITs had outperformed the broad S&P/TSX Composite Index on a total return basis up until the spring of 2007. However, a global retreat in REIT prices occurred by mid 2007 as long term bond yields began to moderately rise. In Canada, the REIT sector's lagging performance may have also been partly attributed to negative fund flows into the income trust sector as small investors (via dedicated mutual funds etc.) continued to negatively react to the October 31, 2006 federal government proposal to tax income trusts. Indeed, from January to July of 2007, RBC estimates that overall fund flows into the sector amounted to -$1.5 billion compared to net inflows of +$1.2 billion during the same period in 2006.

By the end of November 2007, the lagging performance of the Canadian REIT sector had intensified with a year to date return of -4% versus +6% for the S&P/TSX Composite Index. A principal reason for the lagging performance of REITs, both in Canada and the U.S. is due to negative market sentiment related to anything “real estate.” Indeed, the deterioration of the U.S. subprime mortgage market, related commercial paper problems and increasing concerns over the effects of rising U.S. mortgage defaults have not only been responsible for the general underperformance of most financial stocks in the wake of the credit crunch but also a factor in holding back REIT prices. Consistent with this “guilt by association” but also because of earlier miss-pricing, U.S. REITs have underperformed Canadian REITs so far in 2007 with a November to date total return of -15% (U.S. dollar terms).

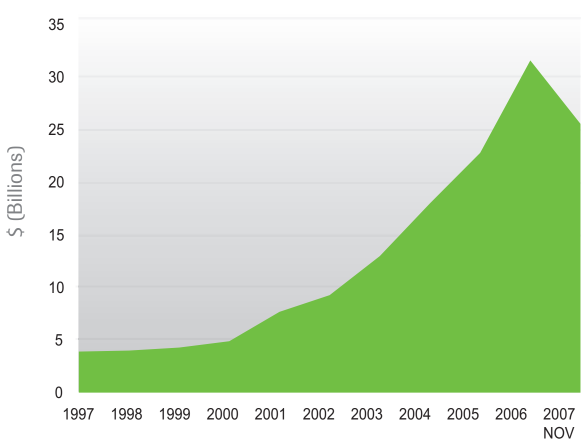
While small investors may have broadly stayed clear of the Canadian REIT sector in 2007, private equity and institutional investors remained drawn to it, principally via M&A activity. From January to October of 2007, RBC estimates that privatization activity took out approximately $7.4 billion from the REIT sector. Many of these transactions have been in the seniors and hospitality sector (Retirement Residences, Sunrise Seniors Living and CHIP REITs) but the sale of Dundee REIT's eastern Canadian industrial portfolio to GE Real Estate, which amounted to approximately $1.4 billion, is also factored in.

Due to this M&A activity, but also because of lower unit prices, total equity market capitalization of TSX-listed REITs (net of acquisitions) declined by about $4.5 billion or 15.9% over the eleven months to November 2007. The accelerated wave of M&A activity in Canada over the last two years ultimately contributed to a significant premium attached to underlying valuations in the REIT sector. Indeed, RBC estimates that the price to NAV (net asset value) premium in the sector peaked at a +16% level as of the end of February. However, recent price declines in the sector have now caused price-to-NAV ratios to fall back into discount territory, the first time since 2001.

This raises the interesting question of whether these valuation adjustments are simply the public markets way of suggesting that the strong investment cycle that real estate enjoyed over the last four years may be at an end or that REITs have now become bigger targets for additional takeouts. We think the answer will be the latter. Recent sharp price declines against a backdrop of healthy space market fundamentals may well be over done especially in light of the fear that has currently gripped public financial markets.

It is also worth noting that recent changes in the capital markets suggest that cash buyers of real estate will have a greater influence on the market compared to the recent past. As such, high quality REITs that can successfully raise equity should be in good shape going forward, albeit, changes to their implied yields suggest that this group may not be able to pay as much for assets as they once could. However, we believe that lower quality REITs that have difficulty attaining financing for new, potentially accretive deals or re-financing existing assets will face greater challenges going forward and will therefore be the biggest target of potential privatization efforts.

CANADIAN REITs (BY MARKET CAP)



Source: RBC Capital Markets

REITs PRIVATIZED (2005 -2007)

	MARKET CAPITALIZATION ($ Millions)	
O&Y REIT*	2,000	2005
TGS North American REIT	960	2006
Summit REIT	2,100	2007 YTD
Retirement Residences REIT	800	2007 YTD
Sunrise Senior Living REIT	1,000	2007 YTD
Alexis Nihon REIT	500	2007 YTD
Dundee REIT**	1,400	2007 YTD
Legacy Hotel REIT	1,600	2007 YTD
CHIP REIT (pending)	1,200	2007-Q4
IPC US REIT (pending)	600	2007-Q4
TOTAL	12,160	
2007 YTD Total (MM)	7,400	

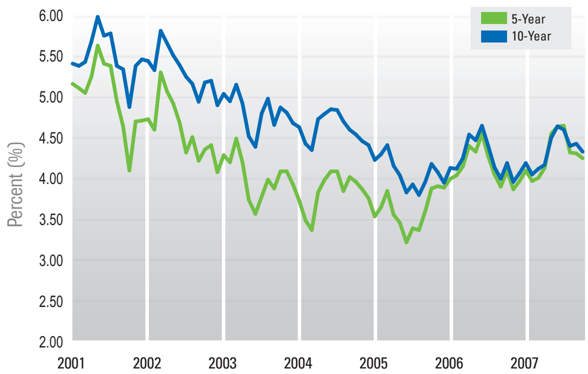
Source: RBC Capital Markets

** estimate of the takeover bid for O&Y REIT, O&Y Prop. Corp. and O&Y Enterprises*
*** indicates partial takeover*

debt market

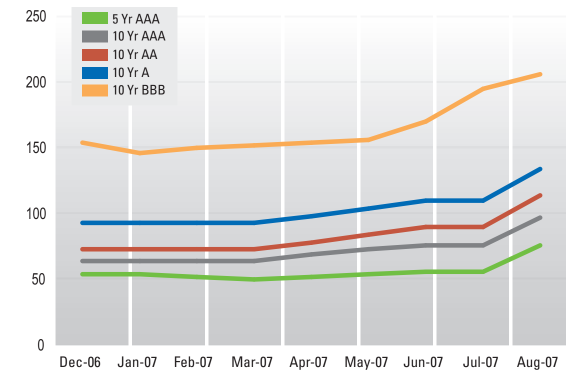
> One of the biggest stories in 2007 was the significant increase in volatility that gripped debt markets. The year began rather quietly but by the spring, higher short term rates and growing concerns about inflation sent long term bond yields up appreciably from their cyclical nadir in the third quarter of 2005. By mid June 2007, the yield on the benchmark 10 year Government of Canada bond had risen to 4.73%, approximately 70bps higher than when the year began.

GOVERNMENT OF CANADA BOND YIELDS



Source: Bank of Canada; last plot October 31, 2007

CMBS SPREADS (bps)



Source: TD Securities

However, debt markets were thrown into a state of disarray in August 2007 as a bursting U.S. housing bubble triggered a rash of U.S. subprime mortgage defaults. Since many of these loans were backed by debt conduits, these securities began to quickly lose value, prompting a substantial financial contagion through integrated global capital markets. A loss of confidence ensued for a broad array of MBSs (mortgage backed securities) and CDOs (collateralized debt obligations) and market participants began reducing their holdings of all risky assets together with large portfolio shifts into safer and more liquid assets such as Government of Canada bonds. Indeed, by the end of November, the benchmark 10 yields fell to just below 4% as a wholesale repricing of implied risk made its way through credit markets.

For commercial real estate investors, the lending environment noticeably changed from the benign environment of the past few years. Not surprisingly, credit became far more costly among conduit orginators given the substantial volatility in pricing within all CMBS tranches. Indeed, in the period between June and September 2007, CMBS spreads had spiked by as much as 50-75pbs. By October of 2007, there were no bids available in any of these products.

The major problem facing the CMBS market is that the inventory of unsecuritized loans warehoused on balance sheets of investment banks are just so large. Many of these loans originated and were priced when underwriting standards were loose and spreads were tight. Until these loans are sold or marked-to-market as some banks have done under significant losses, the volume of CMBS issuance will be constrained well into 2008.

Among portfolio lenders, two camps emerged by the end of 2007. There were those who appeared relatively comfortable with the volumes achieved earlier in the year and were therefore being very selective, offering increasingly bearish quotes in top quality situations to see what might "stick." There were also those who hadn't filled their targets as of press time, although these lenders were few and far between. Ultimately, little competition allowed these lenders to demand wider spreads and better terms. With this relative split in mind, we estimate that as of November 2007, the median portfolio lender increased spreads by 30 - 60 bps for new quality ten year term mortgage investments.

Ultimately, these new debt market realities are likely to reduce borrower demand over the near term, which may actually help to ease some of the upward pressure on spreads as supply and demand find a new equilibrium. However, for now, we expect that debt transaction volumes will begin to slow and/or distress will increase especially for highly leveraged owners who need to refinance in the near term. This is a key reason why we believe that cap rates are likely to move up over 2008.

It is instructive to remember, however, that while the ample liquidity that prevailed prior to the subprime meltdown is not about to return anytime soon, lending in commercial real estate debt markets should improve once the outlook becomes clearer and investors regain confidence in how risk is being priced. As long as space market fundamentals remain healthy, the predictable and transparent contractual cash flows of Canadian commercial real estate should look generally attractive.