The Quarterly

Trust Report

Multi-Employer Property Trust

INSIDE:

SECOND QUARTER | JULY 2008 | VOLUME 23, NUMBER 2

The Multi-Employer Property Trust closed the second quarter of 2008 with a unit value of **$7,961.99,** up **0.61 percent** (net of fees) from the previous quarter. For the trailing four quarters, MEPT's net return is **7.51 percent. MEPT outperformed all real estate industry benchmarks for the second quarter.**

Despite a weakening US economy, commercial real estate fundamentals generally held steady in the second quarter. Quarter over quarter, there was a marginal 22 basis point increase in the national office vacancy rate to 11.7 percent, and a 30 basis point increase in the national industrial vacancy rate to 8.7 percent. At the same time, new supply remained constrained by credit availability, escalating construction costs, and uncertainty about the economy. The strong market conditions of the last several quarters and limited new supply have cushioned the impact of the economic downturn.

However, it is expected that the sluggish economy will have a negative effect on commercial real estate in the latter half of 2008. Even so, the impact will vary greatly by market and by property type with coastal markets and certain asset classes, such as multi-family, faring relatively well.

The loss of 438,000 jobs in the first six months of 2008 is now causing weaker demand for office and industrial space, especially in markets dominated by the financial services and housing-related industries. In light of current economic conditions, tenants are delaying leasing decisions when possible. Companies have become cost conscious and are electing to renew or extend leases rather than commit to new space. Furthermore, to compete for tenants, landlords have begun to offer concessions. All of these trends are putting downward pressure on effective rental rates. As a result, rent growth will not be as strong as previously assumed, leading to lower-than-expected property income. To offset slower income growth, real estate investors will seek higher investment yields that will likely lead to rising capitalization rates *(initial expected yields on investments based on purchase price).*

In the second quarter, there was an extremely low volume of sale transactions. The volume of office sales was down by 67 percent, and industrial property sales fell by 50 percent compared to a year ago, according to Real Capital Analytics. A significant bid/ask spread has emerged between buyers and sellers: buyers are very cautious about pricing due to the prospect of declining values and are tentative about the stricter lending environment; sellers with high-quality assets, on the other hand, are unwilling to accept lower prices. **The lack of transaction activity makes it increasingly difficult to ascertain current property pricing.** However, the current market favors patient investors who have access to cash, a long-term investment horizon, and experience with repositioning distressed assets.

News Briefs

IN APRIL, MEPT COMMITTED $27.8 MILLION TO BURLINGTON 100, a Class A office building development in suburban Boston. The site is located in the Burlington Centre Office Park, a current MEPT asset, and near a regional mall, restaurants, and other tenant amenities. MEPT will seek LEED Silver certification for the three-story, 106,887 square foot building. Construction on the asset is set to begin in the third quarter after demolition of an existing structure on the site, and completion is scheduled for mid 2009.


Ardea Rendering

DURING THE SECOND QUARTER, MEPT COMMITTED TO PURCHASE THE ARDEA FOR $145.3 MILLION. Ardea, a former condominium project in the final stages of development in Portland, OR, was negatively impacted by the for-sale housing downturn. MEPT was able to acquire the project at a discount to replacement cost and plans to reposition the property as a LEED Gold certified rental project. The development, a transit-oriented site with proximity to Portland's MAX light-rail network, will have lower-floor units available for rent in August, with the remainder of the building ready for occupancy in December 2008. It will be comprised of two towers with 323 units, 15,947 square feet of retail and 396 underground parking spaces.

IN MAY, MEPT COMMITTED $19.4 MILLION to a 578,967 square foot, to-be-built bulk distribution facility in Gateway Commerce Center, the premier warehouse/distribution park in the St. Louis area. This project, Phase 2 of MEPT's Gateway Commerce Center III, is an expansion on 26.7 acres. Proctor and Gamble has signed a lease to occupy both Phases 1 and 2, and, at completion by year-end 2008, will occupy over 1.1 million square feet. MEPT has built or acquired over 2.5 million square feet in the park, and the Fund controls additional developable land.


200 Fifth Avenue

AT THE END OF THE SECOND QUARTER, MEPT COMMITTED TO A $165 MILLION MEZZANINE DEBT INVESTMENT to finance the redevelopment of 200 Fifth Avenue in New York City. The former International Toy Center, in the Madison Square Park/Flatiron district, is being redeveloped into a state-of-the-art, multi-tenant, LEED-Certified, Class A office building with ground level retail space. The 14-story building is 40 percent pre-leased and will have 762,221 square feet of office, 55,476 square feet of retail, and additional storage space. As a lender in this project, MEPT will retain certain rights to the repayment of capital at the end of the three-year loan, and expects to earn an attractive return on investment. In the unlikely event of default, MEPT would have rights to foreclose on interests in the property ownership. *(For more, see In-Depth Article: Mezzanine Debt Financing.)*

DURING THE QUARTER, MEPT ENHANCED ITS GLOBAL LEADERSHIP POSITION IN RESPONSIBLE PROPERTY INVESTING (RPI) by participating in the United Nations Annual Principles for Responsible Investment (PRI) Meeting in Seoul, Korea. Preston Sargent, EVP and MEPT Portfolio Manager at Kennedy Associates Real Estate Counsel (Kennedy), made a presentation, and Headley Butler, SVP at Landon Butler & Company, accepted and signed the UN PRI on behalf of MEPT. Additionally, in London, Kennedy was named one of nine global winners in the inaugural ULI Sustainable Cities Award competition, in recognition of Kennedy's commitment to RPI, particularly its work relating to MEPT's portfolio.

Second Quarter Results

Net Return, Second Quarter:
0.61%

Net Return, 7/1/07–6/30/08:
7.51%

Net Asset Value:
$7.16 billion

PERFORMANCE

FUND OVERVIEW

Inception Date	April 1, 1982	Average Age of Properties	10.2 years
Assets Held	190	Markets	25
Number of Buildings	517	Net Asset Value	$7.16 billion
Total Operating Square Footage	39.8 million	Unit Value	$7,961.99
Operating Portfolio Occupancy	92.0%	Participating Plans	335

TOTAL RETURN: After reviewing MEPT's year-to-date performance and evaluating the outlook for the economy and real estate market conditions, **MEPT's Policy Board has restated the Fund's return target for 2008 and now expects the Fund to achieve a total return of 2.5 to 3.5 percent (net of fees) for 2008 versus 8 to 10 percent return (net of fees), as originally projected in January 2008.**

INCOME RETURN: MEPT's 2008 projected Net Operating Income (NOI) for its 40 million square foot operating portfolio will be approximately 3.6 percent lower than first projected due to market dynamics. Although leasing volume in MEPT's portfolio has remained active with 189 lease transactions executed in the first six months, velocity across MEPT markets is beginning to slow and rental revenue from new leases will be earned later than projected. Also, rental rate growth is expected to moderate and not achieve prior growth rate assumptions.

Additionally, the Fund's income growth will be negatively impacted by other factors affected by economic and market conditions, including the timing and completion of in-process assets and new acquisitions, less-than-expected interest earned on a lower cash balance, higher-than-projected debt expense, and interest rate fluctuations.

At the same time, MEPT's portfolio is well positioned to weather the impact of the slowing economy due to its current high level of occupancy of 92 percent, market rents that exceed rents of near-term rolling tenants, continued leasing transaction volume, manageable rollover in the next six quarters, and strong historical tenant retention.

APPRECIATION RETURN: Lower projected NOI coupled with real estate market conditions that include rising operating costs, minimal transaction activity, fears about a weakening economy, a shallow pool of investors, and a tightening of available credit, will put downward pressure on real estate values nationwide. In MEPT's portfolio, there are certain assets that are expected to experience value increases due to leasing activity, continued strength in their markets, and investor interest but, overall, MEPT's Policy Board believes that the Fund will experience net depreciation as valuation assumptions further reflect current market conditions.

YIELD

	SECOND QUARTER 2008	TRAILING FOUR QUARTERS (COMPOUNDED)
NET	**0.61%**	**7.51%**
INCOME	0.99%	4.16%
APPRECIATION	-0.38%	3.24%
GROSS	**0.82%**	**8.42%**
INCOME	1.20%	5.06%
APPRECIATION	-0.38%	3.24%

NEW PARTICIPANTS

Carpenters Pension Fund of West Virginia

Cumberland, Maryland & Vicinity Building & Construction Employees' Pension Trust Fund

PROJECTS COMMITTED

200 Fifth Avenue, *New York, NY*

Ardea, *Portland, OR*

Burlington 100, *Boston, MA*

Gateway Commerce Center III, Phase 2, *St. Louis, MO*

DETERMINING PORTFOLIO VALUE IN A TURBULENT MARKET

INTERVIEW WITH BRENT PALMER, EXECUTIVE VICE PRESIDENT AND CHIEF VALUATION OFFICER, NEWTOWER TRUST COMPANY

THE REFORECAST OF MEPT'S 2008 TARGET RETURN WAS DRIVEN largely by the fact that MEPT's portfolio will recognize more depreciation in 2008 than originally estimated. Brent Palmer, Executive Vice President and Chief Valuation Officer of NewTower Trust Company and a Member of the Appraisal Institute (MAI), a professional designation he has held for over 20 years, explains why the current market environment will impact MEPT real estate valuations for the foreseeable future:

For an open-end fund like MEPT, with a large, modern, well-diversified portfolio that is 92 percent leased to credit-worthy tenants, why are property values expected to decline?

Brent Palmer: In the past few years —2005 through 2007—there was an unprecedented level of transaction volume and record prices, driven primarily by a flood of equity and debt capital into commercial real estate. At the same time, real estate market fundamentals were also strong; however, both highly levered and other marketplace participants used rental rate growth assumptions significantly higher than inflation together with historically low yield rates to support negotiated pricing. This approach reflected a posture that US economic and market rent growth would continue for an extended period of time; however, that outlook has clearly changed—economic growth is weaker than expected and previous rent growth assumptions are not being realized. In addition, yield rates are edging upward to reflect increased economic risk and reduced rent growth expectations in the near term. The combination of these events is causing downward pressures on values, resulting in modest levels of depreciation.

Furthermore, the valuation process is primarily based upon sale transactions, market and property-level operating characteristics, and capital markets activity. While fundamentals at the property and/or market level may be healthy, other factors including debt and equity availability and required investment returns continue to play a significant role. Most observers are already well aware of the capital markets environment that has resulted in a near standstill of sales activity—some sources are reporting year-to-date transactions activity down by over 60 percent from last year. This significantly reduced volume also makes it particularly difficult for valuation professionals who need to locate and analyze comparable transactions for use in the appraisal process.

What does this mean for MEPT values?

BP: The NewTower valuation team's role is to report current market value for each asset in the MEPT portfolio—with "current" being the definitive term. It is our fiduciary responsibility to make sure that investors who are either buying or selling units in MEPT each quarter are paying or receiving a price that represents current and accurate market value estimates.

Regarding market rent, MEPT continues its focus on using realistic growth assumptions as it has in the past; however, now, not all 2008 projections are expected to be fully realized, as leasing velocity has slowed and prospective tenants are pushing new or expanded occupancy requirements into future quarters. In addition, increasing yield rates reflecting rising market and property-type risk are making it even more difficult to identify comparable data for use in current appraisals and interim valuations. Still, it is critically important that all relevant market data and analysis be utilized in the quarterly valuation process to ensure accuracy.

What are some of the key data points that appraisers use to determine property value and to ensure appropriate trends and fundamentals are represented? How do appraisers develop and determine their assumptions?

BP: By relying on industry data, market trend and transaction reports, and through interviews with industry professionals and participants, appraisers collect, analyze, and interpret trends, sales data, statistics, and other information regarding specific properties when developing their opinion of value. Each resulting appraisal also contains in-depth economic, property, and valuation analysis that includes multiple approaches (replacement cost, sales comparison, and income capitalization) to value.

Consistent with professional and federal valuation standards, MAI-designated appraisers balance all relevant data, analysis and judgment when interpreting what historic, current and forecasted market trends indicate for the asset being appraised. While scientific approaches or methodologies are employed in the valuation process, the resulting opinion is also dependent on the practitioner's expertise and judgment.

Over the last few years, the ratio of income to appreciation for core real estate was inverted, with recent NCREIF performance demonstrating a significant reversal. What factors will help establish ratios similar to the historical norm of 80 percent income and 20 percent appreciation?

BP: Clearly, the economy and market participants play key roles and, as long as the economy is uncertain, businesses will continue to closely scrutinize all operating expenses, including occupancy costs, which will impact leasing velocity, rental rates, and investment-driven yield requirements. In addition, the valuation profession must closely monitor sales activity and rent growth trends to accurately estimate "current" market value. The financial industry needs to re-establish its footing so the lending pendulum can swing back into balance, thereby paving the way for traditional capital sources to re-enter the market.

Significant Demand for Mezzanine Debt Financing

The 2007 disruption of the credit markets forced many traditional lenders out of the market. Prior to last summer, banks and investment banks had become increasingly aggressive in competing for real estate financing business—and as real estate values soared, the loans available became abundant and cheaper for borrowers. These lenders were willing to take on more risk than before, providing up to 100 percent of a transaction's value, and investors who historically provided mezzanine debt *(debt that is supplementary financing to equity and senior debt)* were priced out of the market.

Now, with the repricing of risk premiums for loans, the potential for declining real estate values, and stricter underwriting requirements, banks and investment banks have retreated and are only willing to finance up to 60 percent of the value of a project. This has left a significant gap in a property's capital structure, forcing buyers to look for other sources of capital to complete the financing of a property. Additionally, the traditional lenders, once responsible for financing 60 percent of all deals, now account for just 9 percent of financings, according to Real Capital Analytics.

Given the current market conditions, there is significant demand for mezzanine debt capital providers to finance the gap in the capital stack between the first mortgage lenders and equity owners, or the component of the capital structure between 55 percent to 75 percent of the value. **Since mezzanine debt has many appealing investment characteristics, including a very attractive risk/return balance in this market, many traditional real estate equity investors are looking closely at the opportunity to fill the gap in real estate financing as an alternative to traditional equity investments, with the benefit of higher returns.**

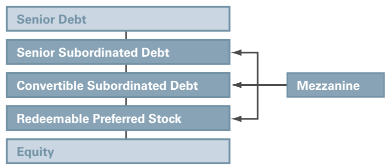
Mezzanine debt can play a role in financing real estate at any stage of a property's lifecycle from development to stabilization. Also, there are many ways mezzanine debt can be structured and may take the form of a straight loan, a bridge loan, a participating note, or preferred equity. Mezzanine financing can also contain a convertible feature that can allow a lender to realize gains associated with a project's performance. Additionally, in the event of a default, mezzanine lenders can foreclose on the underlying property, subject to the senior loan provisions.

Mezzanine debt investments are attractive since they can offer the yield of an equity investment with many of the protections of a creditor position. Borrowers are typically required to compensate mezzanine lenders with higher interest rates as a protection for the risk associated with its location in the capital structure, subordinate to the senior debt or first loan, but superior to the property owner's equity.

Mezzanine investing risks are similar to other real estate investments, but can incorporate both equity and debt characteristics depending on how the mezzanine debt is structured. The key issues for the mezzanine lender include market risk, underwriting risk, financial/interest rate risk, and deal structuring risk. Other risks may include detrimental value changes, property management quality, and construction risk.

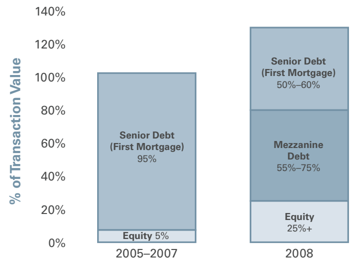
For years, Kennedy's Acquisition team has applied rigorous risk analysis to every acquisition it considers for MEPT. **Since the risk issues are similar and the underwriting of a mezzanine loan incorporates a thorough understanding of the underlying real estate, MEPT has expanded its investment universe to include mezzanine debt. By identifying select mezzanine investment opportunities, MEPT is taking advantage of the dislocation in the debt market and seeking "mezz" debt investments that fit with the Fund's overall investment strategy.** In the second quarter, MEPT committed to its first mezzanine debt investment to provide up to $165 million in financing to a mixed-use redevelopment project at 200 Fifth Avenue in New York (See "News Briefs").

Mezzanine Debt Financing



Source: FitchRatings

Components of Capital Stack



NewTower Holds Second Annual Real Estate Conference

NewTower Trust Company held its second annual MEPT Real Estate Conference in Washington, DC, at The Madison hotel on June 4, 2008. There were over 100 attendees including US and Canadian pension plan trustees, representatives of MEPT participating plans, members of the MEPT Advisory Board, members of the MEPT management team, and individuals from strategic MEPT service providers, including many appraisal firms.

The conference featured industry leaders addressing current topical issues impacting real estate markets as well as forecasts for future development and investment. Conference sessions included presentations on the macro economy, real estate trends pertaining to risk, pricing, capital sources (debt vs. equity), and a case study on Responsible Property Investing (RPI). *(continued on back)*

Management Fee—The Trustee of MEPT charges an annual investment management fee based on the net assets of the Fund. The current annual MEPT fee is approximately 0.855%. The fee is determined as follows: 1.25% on the first $1 billion of MEPT total net assets, 1.0% on the second $1 billion of MEPT total net assets, and 0.75% on MEPT total net assets above $2 billion. Cash balances in excess of 7.5% of Property Trust net assets are excluded from the above fee calculation and will be subject to an annual fee of 0.15%. Therefore, the fee decreases as MEPT grows. There are no charges for entry or exit, and the Trustee charges no additional investment management fees to its investors.

In-Depth Report *(continued from inside)*

Featured speakers included:

- Joseph Gyourko, Professor of Real Estate and Finance, and Director of the Zell/Lurie Real Estate Center at Wharton
- Bruce Becker, AIA, AICP, President, Becker & Becker
- Robert White, Jr., President, Real Capital Analytics
- Mark Gibson, Executive Managing Director, Holliday Fenoglio Fowler L.P.
- Kenneth Riggs, President and CEO, Real Estate Research Corporation

Major themes that were discussed included:

- **The economy:** Professor Gyourko concluded that minimal to modest growth is expected in 2008, and that lingering issues in the residential market and energy pricing will continue to have a ripple effect for much of the year.
- **Real estate transaction activity:** Mr. White showed data that revealed real estate transactions are stalling because the bid/ask spread on listings is widening. He noted there is a flight to quality (Class A, income-producing properties in stable or growth oriented markets) as many investors are only pursuing the best investments.
- **Real estate financing:** Mr. Gibson discussed the current real estate financing market, and how traditional lenders have become highly selective in order to reduce the amount of leverage on their balance sheets. As a result, construction loans are only available for best-in-class projects with mezzanine loans being sought to fill the gap.
- **Real estate fundamentals:** Mr. Riggs highlighted that now, more than ever, the primary focus of portfolio managers will be on optimizing property operations and leasing activity, as these are key factors in enhancing returns.
- **Off-shore investors:** Mr. Gibson noted that there has been a marked increase in capital flowing into US real estate due to the weak dollar, stable real estate markets, and the expectation of stronger US economic growth relative to other global economies.
- **Uncertainty abounds:** The meeting wrapped up with a panel discussion in which the presenters agreed that market anxiety is driving current conditions.

It was a thought-provoking forum with active and open discussion regarding the critical issues facing real estate investors today. NewTower has already commenced scheduling the 2009 conference.

The *Trust Report* is published by Multi-Employer Property Trust (MEPT), a commingled open-end real estate equity fund that invests in a diversified portfolio of institutional-quality real estate assets and 100% union-built new construction properties in major metropolitan markets around the country. MEPT's primary investment strategy is to create top-quality, income producing assets through development, rehabilitation or acquisition and repositioning of under-valued assets. MEPT's investor base is diverse and is composed of Taft-Hartley, public employee and corporate pension plans.

For more information, please contact Landon Butler & Company, LP at 202-737-7300, or through the Web site, **www.mept.com**.

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