

# TRUST REPORT

## || MULTI-EMPLOYER PROPERTY TRUST

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- MEPT Hosts Fifth Annual Real Estate Conference
- David Keto Joins NewTower Trust Company as Chief Operating Officer

SECOND QUARTER | JULY 2010 | VOLUME 25, NUMBER 2



**MULTI-EMPLOYER PROPERTY TRUST** closed the second quarter of 2010 with a unit value of **\$5,107.96, up 3.22 percent** (net of fees) from the previous quarter. For the trailing four quarters, MEPT's net return is **negative 7.13 percent**.

In the second quarter, investors were cautious as the U.S. economy transitioned from a Federal-stimulus driven recovery to a self-sustaining growth cycle. **In addition, uncertainty about the resilience of the global economy and conflicting economic and financial indicators will likely result in heightened volatility in the near term.**

Indeed, fears about a double-dip recession surfaced during the quarter. However, the U.S. has never gone into recession without first experiencing negative year-over-year growth in both real retail sales and the S&P 500, and at this time, neither indicator is negative. The debt and equity markets experienced declines during the second quarter in response to unease that Greece and other Euro-zone countries would be unable to service their outstanding debt and as a result, would dampen the pace of a global economic recovery. By the end of the quarter, these concerns remained, but were waning.

One positive signal over the past two quarters has been employment growth. Total non-farm employment has grown in five of the last seven months with 882,000 jobs gained and private sector job growth has been positive in six of the last seven months with the addition of 585,000 jobs. Nevertheless, approximately 8 million jobs were estimated to have been lost across all sectors during the recession, so continued improvement will be needed to have a meaningful impact on the broader economy.

**In commercial real estate capital markets, conditions continued to improve in the second quarter.** Traditional lenders remained eager to lend, but were challenged to find good opportunities. At the same time, property sales increased during the quarter, with total volume reaching \$20.6 billion for the three months ended June 30, 2010. Overall, activity in the first half of 2010 was 67 percent higher than the first half of 2009. The accelerating pace of equity flowing into commercial real estate for well-located, well-leased assets halted a rise in capitalization rates<sup>1</sup>. Sales and pricing of high-quality assets in the most desirable markets, such as Washington, DC, actually resulted in cap rate declines.

**While pricing has improved noticeably, market fundamentals for commercial real estate will likely remain challenged for the remainder of 2010 as vacancy rates remain well above long-term equilibrium rates.** However, increases in vacancy across all property types in the second quarter of 2010 were the smallest increases over the past two years. Vacancy for apartments, a sector which began to recover two quarters ago, actually declined in the second quarter. In MEPT's target markets, vacancy rates remained flat or fell slightly during the quarter. Based on recent leasing interest across major markets, it appears that tenants may be returning to the market to lease space and take advantage of current conditions since further economic improvement may mean rental rate growth and fewer landlord concessions in the near future.

(<sup>1</sup>A capitalization rate is an approximation of expected current income determined by dividing net operating income by the purchase price.)

## NEWS BRIEFS

**DURING THE SECOND QUARTER, MEPT SOLD 303 SECOND STREET IN SAN FRANCISCO FOR GROSS PROCEEDS OF \$237 MILLION.** The two-tower, Class A, 732,000 square-foot office property located in San Francisco's South Financial District was acquired by MEPT in 2005. Since purchasing the asset, MEPT worked diligently to market space in the building, leasing over 550,000 square feet over the last five years and achieving a 94 percent occupancy rate at the time of sale. Additionally, MEPT applied its Responsible Property Investing (RPI) principles and retrofitted the building with numerous energy-efficient features, earning 303 Second Street an ENERGY STAR label, LEED Gold-EBO&M certification and several BOMA of San Francisco Earth Awards. Given the limited potential for additional value creation from rent growth or new leases, 303 Second Street was targeted for sale. The sale of the property also allows MEPT to execute certain investment objectives and reduce its allocation to the office sector and the West region. After receiving a number of offers that exceeded the listed sale price, MEPT sold 303 Second Street to Kilroy Realty Corporation, a California-based REIT.



303 SECOND STREET

**IN JUNE, DAVID KETO JOINED NEWTOWER TRUST COMPANY AS CHIEF OPERATING OFFICER.**



DAVID KETO

In his new role, Mr. Keto will work closely with NewTower's President and CEO, Patrick Mayberry, in the general management of the bank, including business and operations management, organizational and human resource development, investment management, and external relations. Mr. Keto will also serve as a member of the Trust Real Estate Investment Committee. Mr. Keto has nearly thirty years of experience in real estate investment, finance, law, and economic development. Prior to joining NewTower, he was COO for the AFL-CIO Investment Trust Corporation (ITC), a financial services company providing marketing and other investment-related services for clients including the AFL-CIO Building Investment Trust. His prior experience also includes serving as Undersecretary in the Executive Office of Economic Affairs for Massachusetts, as Special Counsel at the Boston Redevelopment Authority and as a real estate attorney.

**IN MAY, MEPT SOLD TWO OFFICE ASSETS, COLUMBIA CENTER I AND II, IN DETROIT FOR TOTAL GROSS PROCEEDS OF \$59 MILLION.** MEPT purchased Columbia Center I and an adjacent parcel of land in 1998. In 2000, MEPT completed construction of Columbia Center II, creating over 616,000 job hours in the local community. At the time of sale, Columbia Center I was 84 percent leased and Columbia Center II was 97 percent leased. While the two office assets, totaling 506,598 square feet, have maintained above-average occupancy, the decision was made to market the properties for sale due to depressed real estate market conditions in the Detroit area. Additionally, the sale provided an opportunity to further reduce the Fund's allocation to the office sector and the Midwest region. The developer and minority partner of the project, Michigan-based Kirco Development Corporation, purchased the assets.

## SECOND QUARTER RESULTS

Net Return,  
Second Quarter  
**3.22%**

Net Return,  
7/1/09 – 6/30/10  
**-7.13%**

Net Asset Value  
**\$3.78 billion**



# PERFORMANCE

## SECOND QUARTER COMMENTARY

IN THE SECOND QUARTER, MEPT produced a total gross return of 3.47 percent, composed of 1.45 percent income and 2.01 percent of appreciation. Year-to-date, MEPT's performance has resulted in a total gross return of 3.35 percent, composed of 3.01 percent income and 0.33 percent appreciation. **The management team believes that MEPT is on course to achieve a projected total return, gross of fees, for 2010 of 7 percent to 9 percent, composed of 6 percent to 6.5 percent gross income return, and 1 percent to 3 percent appreciation.**

**Appreciation Return:** The moderate but improving economic recovery is providing appraisers with more certainty regarding the outlook and stability of commercial real estate markets. Furthermore, the increased volume of transaction activity is providing appraisers with comparable transactions to analyze and consider. As a result, they are recognizing modest recovery and rent growth for certain property types and assets in certain markets, but continue to assume risk associated with lease rollover. **In the second quarter, 100 assets in the MEPT portfolio had appreciation or no change in value and 36 assets had depreciation.** Yield rate assumptions in MEPT valuations, quarter over quarter, decreased by approximately 8 basis points. MEPT's performance, as well as commercial real estate trends, reflects that values have begun to recover. The management team anticipates continued improvement and appreciation in the portfolio in 2010.

**Income Return:** There is downward pressure on income since rental rates have declined, and in some markets and property types, concessions are necessary to compete effectively for tenants. **The current environment underscores the importance of MEPT's focused active asset management program.** MEPT's portfolio is expected to generate approximately \$200 million in net income in 2010. To maintain the stable income stream generated by the 34 million square foot operating portfolio, asset managers are protecting occupancy through active leasing and renewals and managing expected rollover by holding discussions with tenants 12-24 months in advance of lease expirations. In addition, asset managers continue

to employ comprehensive risk mitigation procedures such as assessing and monitoring the creditworthiness of all existing and prospective tenants and avoiding an overweight to any one industry. Furthermore, MEPT is maximizing net income by focusing on expense management, including energy-efficient measures.

In 2010, MEPT will incur unanticipated legal fees and other costs related to certain repairs and construction defects at two MEPT properties which will impact performance. At one MEPT office building in Washington, DC, 1717 Rhode Island Avenue, it became necessary to reface the original brick façade due to faulty installation, despite numerous repairs. However, the

building remains in operation during the construction work and MEPT is in litigation to recover the costs. Secondly, MEPT has incurred legal expenses and anticipates a loss of income in 2010 due to the decision in the second quarter to vacate and dismantle The McGuire, a 272-unit multi-family asset in Seattle. Engineering experts involved in the investigation and repair

of the building determined in the second quarter of 2010 that construction defects were financially impractical to repair. As noted in the fourth quarter 2009 Trust Report, the value of The McGuire was written down to zero at the end of 2009 due to pending repairs and related costs, and MEPT is currently pursuing legal action and insurance claims in order to achieve financial recovery of all costs and damages.

**Balance Sheet Strength: MEPT maintains a strong balance sheet with moderate leverage in order to ensure that the Fund has the flexibility to structure and execute transactions, the stability and capital needed to own, operate, and lease properties, as well as the liquidity to meet the Fund's investment commitments, with sufficient cash to honor investor withdrawal requests.**

Through dispositions in 2010, MEPT has continued to identify and sell assets that have downside risks that outweigh their long-term upside potential. As a result, MEPT has generated approximately \$350 million in net proceeds from sales year-to-date, which will be redeployed through the Fund's acquisitions program.

**MEPT is very well positioned for the next real estate cycle since the Fund has no redemption queue**

YIELD		
	SECOND QUARTER 2010	TRAILING FOUR QUARTERS (COMPOUNDED)
NET	3.22%	-7.13%
INCOME	1.21%	5.25%
APPRECIATION	2.01%	-11.91%
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GROSS	3.47%	-6.27%
INCOME	1.45%	6.20%
APPRECIATION	2.01%	-11.91%

# PORTFOLIO SPOTLIGHT

## FUND OVERVIEW

Inception Date	<b>April 1, 1982</b>	Average Age of Properties	<b>11.1 years</b>
Assets Held	<b>137</b>	Markets	<b>24</b>
Number of Buildings	<b>305</b>	Net Asset Value	<b>\$3.78 billion</b>
Total Operating Square Footage	<b>34.3 million</b>	Unit Value	<b>\$5,107.96</b>
Operating Occupancy	<b>87.6%</b>	Participating Plans	<b>320</b>

IN THE FIRST SIX MONTHS OF 2010 — a particularly challenging leasing environment—MEPT’s asset management team completed 145 lease transactions including 45 new leases, 80 renewals, and 20 expansions. **Gross leasing activity totals more than 3.8 million square feet, year-to-date.**

The occupancy rate in the portfolio at June 30, 2010 was 87.6 percent, which dropped slightly from the end of the first quarter due to three large lease terminations in the MEPT portfolio that resulted from one office tenant moving to space with a substantially lower rent, a tenant that declared bankruptcy but paid MEPT a \$1.1 million termination fee, and a tenant with an expiring lease which made a corporate decision to consolidate multiple offices into existing leased space. At the same time, MEPT signed several large leases during the quarter including a 374,126 square foot lease renewal with Jones Distribution, a 326,543 square foot lease renewal with Sport Chalet, Inc., a 108,680 square foot lease renewal with ASEV Display Labs, a 89,578 square foot new lease with Amerimax Home Products, and a 58,143 square foot new lease with the U.S. Health and Human Services Agency.

**The Asset Management team is continually focused on retaining existing tenants. MEPT’s controllable net retention for the trailing four quarters ending June 30, 2010 was 86.5 percent.** This reflects the Asset Management team’s commitment to maintain high occupancy in the portfolio by retaining tenants, relocating existing tenants to other MEPT assets or removing specific tenants to accommodate new leases that provide more favorable economics.

The Asset Management team’s stringent controls and focus on mitigating lease payment risk resulted in tenant account receivable delinquencies and write-offs far below the industry best practice of two percent of total revenue. MEPT’s rate at June 30, 2010 was 0.54 percent of total revenue.

## PERFORMANCE *(continued from previous page)*

and is not under pressure to service debt, has no near-term debt maturities, no forward commitments, manageable lease rollover, and an asset management team focused on preserving operating income. At June 30, 2010, MEPT’s third-party leverage was 17.9 percent of gross assets—relatively low compared to the open-end fund universe. During the first and

second quarters, MEPT took measures to reduce the Fund’s exposure to floating rate debt to mitigate the risk of inflation and rising interest rates, and to further extend debt maturities. MEPT replaced a total of \$400 million of debt, comprised of a floating-rate line of credit and a callable revolving loan with a \$400 million, fixed-rate, secured term loan MetLife facility.

## IN APPRECIATION AND RECOGNITION OF OUR 25 YEAR PARTNERSHIP, MEPT SALUTES

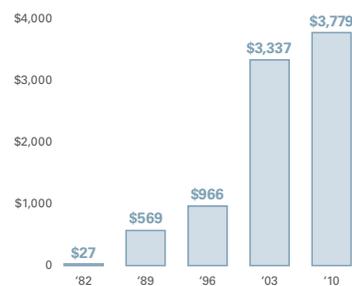
Laborers’ Pension Fund

## PROJECTS SOLD

Columbia Center I and II  
*Detroit, MI*

303 Second Street  
*San Francisco, CA*

**NET ASSET VALUE GROWTH**  
*June 30, 1982 – June 30, 2010*  
Based on Market Value (\$Millions)



Values shown are for June 30 in each year. Date of inception April 1, 1982.

**UNIT VALUE GROWTH**  
*June 30, 1982 – June 30, 2010*  
Based on Market Value



Values shown are for June 30 in each year. Date of inception April 1, 1982.

# MEPT Hosts Fifth Annual Real Estate Conference

ON JUNE 2, 2010, THE MEPT management team was joined by participating pension plans, investment consultants, appraisers, members of the MEPT Advisory Board and industry experts at the Fifth Annual MEPT Real Estate Conference held at the Liberty Hotel in Boston. **The conference, titled “Passage to Recovery”, addressed timely questions about the sustainability of the current economic recovery, the health of real estate capital markets, reaching a “bottom” in commercial real estate, and identifying the most attractive property types and markets for investment. The conference also examined the growing importance of Responsible Property Investing (RPI) for institutional investors**

Dr. Linneman and Mr. Poutasse launched the conference with a discussion titled “Is There Light at the End of This Very Dark Tunnel?” Through a lively discussion filled with personal anecdotes, they examined the impacts of the recession, highlighting where we have been in the last two years and how long it might take the economy to get back to “normal”. Dr. Linneman analyzed the impact of the recession on the U.S. economy, in particular, the loss of over 8 million jobs and the resulting surge in the U.S. unemployment rate over the last year. He noted that while the U.S. has slowly begun to add jobs back into the economy in the past few months, the U.S. will likely not fully recover until the end of 2012 or the beginning of 2013. Furthermore, while the national unemployment rate will decline, Dr. Linneman forecast that it will not go back to pre-recession levels, but rather settle around 8 percent.

Mr. Poutasse discussed the potential for inflation in the coming years. He noted that while the government has been careful not to raise interest rates over the last few quarters in order to aid

the recovery, the Federal Reserve will likely begin to raise interest rates in late 2011 or early 2012, resulting in some inflation. However, he expects the resulting inflation will be manageable and will be more welcomed than the possibility of deflation.

In their panel discussion, Ken Riggs, Mark Gibson and Robert White reviewed and analyzed capital markets flows into and out of commercial real estate over the last few years, the volume of real estate transactions, and the pricing of assets. Mr. Gibson noted that the largest sources of capital for commercial real estate transactions over the past year have been private cash buyers, foreign buyers, and institutional buyers, including real estate funds. While the banking industry has not yet been a major source of capital, Mr. Gibson forecasted that banks will come back into the commercial real estate market in the latter half of 2010. Consequently, Mr. Gibson expects there will be around \$100 to \$125 billion in commercial real estate transactions in 2010 versus only \$50 billion in 2009.

Mr. White confirmed Mr. Gibson’s findings noting that there had already been over \$20 billion in sales in the first quarter of 2010 and he expects sales to increase throughout the year. Mr. Riggs added that the majority of the recent transactions had been in the multi-family and office sectors, although he expects transaction activity in the retail sector to follow soon. Mr. White added that surprisingly, hotels

have been trading because that asset class appears to be the property type of choice for many REITs.

Mr. White noted that while many people had assumed there would be a flood of distressed assets on the market, this had not materialized. Many banks and other lending institutions are choosing to work with the property owners instead of foreclosing. In fact, only 15 percent of transactions in the first quarter of 2010 were distressed asset sales.

## THE CONFERENCE FEATURED NATIONALLY RECOGNIZED SPEAKERS, INCLUDING:

**Dr. Peter Linneman**, Principal of Linneman Associates and the Albert Sussman Professor of Real Estate Finance, and Public Policy at the Wharton School of Business at the University of Pennsylvania

**Douglas Poutasse**, Executive Director, National Council of Real Estate Investment Fiduciaries (NCREIF)

**Robert White, Jr.**, President, Real Capital Analytics

**Mark Gibson**, Executive Managing Director, Holliday Fenoglio Fowler, LP

**Kenneth P. Riggs, Jr.**, President & CEO, Real Estate Research Corporation

**Dr. David Wood**, Director, Initiative for Responsible Investment at the Harvard Kennedy School of Government

**A large and growing pool of money has accumulated to purchase quality assets in top-tier markets.** Mr. Gibson commented that with this surplus of available capital and a limited amount of Class A assets in the best markets, pricing for high quality assets has been trending upwards. Indeed, for certain assets, such as well-located apartments, the volume of available capital has driven cap rates down. In addition, some buyers are purchasing quality assets in secondary markets in order to put capital to work. **Mr. Riggs noted that there is a bifurcation in terms of pricing and capitalization rates between the best quality assets and lesser quality assets and**

*(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 0.95%. 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)*

**that the flood of capital has helped stop the rise in capitalization rates and the decline in values.**

Dr. Wood examined the recent focus on Responsible Property Investing (RPI) by institutional investors in commercial real estate.

**Dr. Wood explained that RPI concentrates on the “environmental, social and corporate governance issues that can affect the performance of investment portfolios.”**

At the same time, RPI principles may better align investors with the broader objectives of society. Dr. Wood discussed how by analyzing investment managers by RPI criteria, institutional investors are gaining important insight into the quality of management and also mitigating financial, political, physical and social risk in their investment portfolios.

Furthermore, some institutional investors—particularly in Europe and Australia—value long-term benefits that are harder to quantify. These institutional investors have found that their investments can address and influence climate change, resource scarcity, urbanization and consumer preferences, allowing the interests of investors and the society to converge over time.

To close the afternoon’s discussions, senior

members of the MEPT management team including Pat Mayberry, Preston Sargent, John Parker, Shobi Khan and Paul Zemla, representing NewTower Trust Company, Kennedy Associates, and Bentall discussed the future outlook for commercial real estate and the transaction environment. **The panelists agreed that although there may be more vacancy anticipated in certain markets and property types in the near future, commercial real estate had reached an inflection point and a recovery and realized appreciation should materialize over the next 12–18 months.**

As a part of that recovery, all agreed there would be new construction on the horizon. Based on supply and demand fundamentals, these seasoned investment professionals expect that development of multi-family assets in certain coastal markets is likely to be the first new construction activity. Additionally, the panelists noted that they expect rental rate growth to resume in all property types, with the multi-family sector leading the way. As a result, the MEPT team agreed that real estate values would improve and revert back to more appropriate levels.

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](http://www.mept.com).

MEPT engaged a printer for the production of this report that is 100% wind powered, uses a waterless printing process and employs qualified union craftsmen. This report was printed with 100% environmentally friendly soy-based ink. The paper used in this publication was manufactured with a minimum of 50% total recycled fiber, including a minimum of 25% post-consumer waste, and is Forest Stewardship Council certified for chain-of-custody.