

THE U.S. ECONOMY—THIRD QUARTER 2011 UPDATE

RESEARCH NEWSLETTER

Since the close of the Second Quarter 2011, uncertainty surrounding the government's ability to deal with the budget deficit coupled with Standard & Poors' subsequent downgrade of the U.S. government's credit rating, has contributed to significant volatility in the U.S. stock market. The fear of an anemic economic recovery is now being priced into the capital markets, reinforced by a series of second quarter economic data highlighting reduced growth at levels lower than earlier in 2011. Elevated energy prices, the earthquake in Japan and slowing government stimulus spending have all had downward pressure on growth expectations. While private real estate markets have yet to show any significant reduction in activity, a slow economy will ultimately impact the real estate market.

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Chairman & CEO

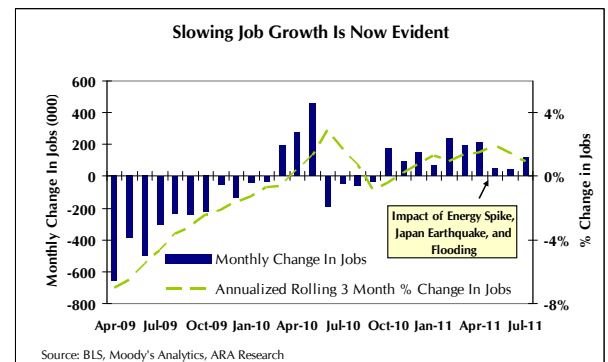
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THE NATIONAL JOB MARKET

Through July of 2011, the year-to-date job growth totaled 930,000 jobs, a 1.2% annual rate. However, over the past three months (May, June, July), the rate of growth has slowed to half the year-to-date rate, a pace not conducive of a significant decline in the unemployment rate. While this slowing may be short-term in nature, the added impact of the U.S. credit downgrade and the correction in the stock market has now increased the possibility of a double-dip recession.

Within the job market, growth that has occurred in 2011 has been largely in business and professional services, technology, and energy, as well as in demographically-driven health care and leisure. In contrast, government employment and related government spending has lagged. In early August, Congress and the President agreed to a revised debt ceiling bill that included \$2.4 trillion in spending cuts over the next ten years, with no increase in taxes.

Although details of how the bill will be implemented have yet to be worked out, the message of a smaller government is clear, with cuts in spending for defense, health care and other discretionary areas likely to put further pressure on an already fragile recovery. In local markets, employment growth trends vary significantly, from 3.5 - 4.0% in technology markets like San Jose and energy markets like Houston to declines in Los Angeles, Washington, D.C., and New York.



Employment Trends By Major Metro

	Current Employment % of Past Peak	YTD % Annual Rate Of Job Growth
San Jose	-5.1%	4.0%
Houston	-1.1%	3.7%
Seattle	-5.8%	3.2%
Dallas	-2.1%	2.7%
Portland	-6.4%	2.5%
Boston	-2.0%	2.5%
Austin	0.0%	2.1%
San Diego	-5.8%	2.0%
South FL	-8.9%	1.8%
San Francisco	-7.7%	0.9%
Phoenix	-11.7%	0.9%
Chicago	-6.3%	0.8%
Denver	-5.2%	0.5%
Orange County CA	-10.8%	0.5%
Atlanta	-8.7%	0.3%
New York	-2.9%	-0.1%
Washington	-1.2%	-0.3%
Los Angeles	-8.7%	-0.5%
U.S.	-5.1%	1.2%

Source: BLS, Moody's Analytics, ARA Research



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REAL ESTATE CAPITAL MARKETS

Returns

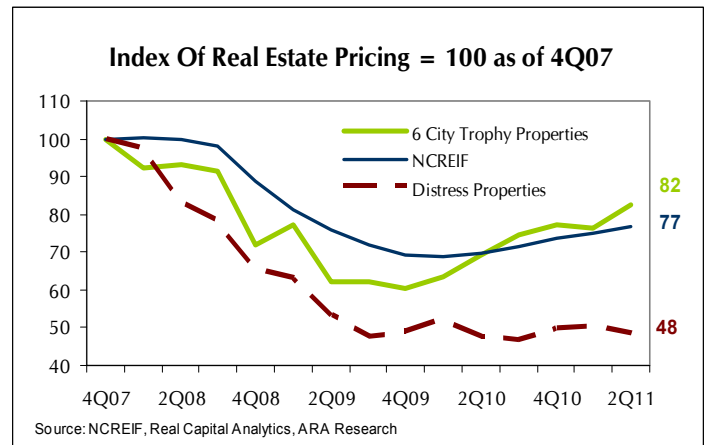
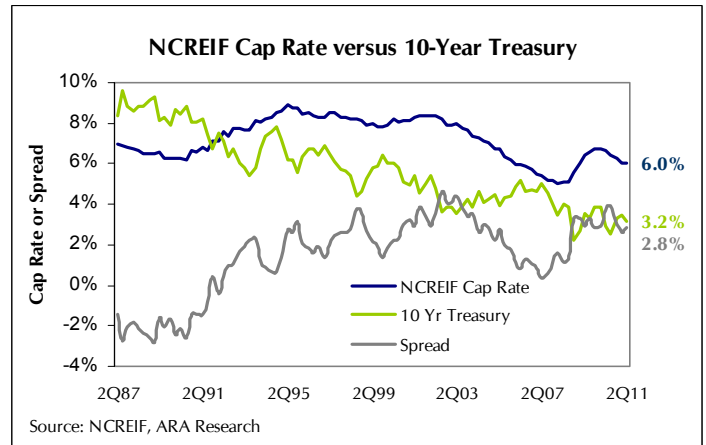
During the past year, core real estate returns have been strong and have performed well above long-term expectations. With historically low interest rates on Treasuries likely to remain in place through 2013, cash yields on real estate should remain attractive to investors. Within the property sectors, multi-family has been the top performer over the past one to three year period for both the public and private sectors, although the expected returns on all four main property types has been converging over the past year.

Cap Rates

Cap rates continue to compress, with the National Council of Real Estate Investment Fiduciaries (NCREIF) reporting an average 6.0% four-quarter trailing cap rate versus an ultra low 10-year Treasury yield of 2.0% touched briefly on August 18th. A relatively high spread between cap rates and Treasury rates at 4.0%, compared to a long-term average spread of 2.4%, could lead to further compression in the month ahead if the 10-year Treasury yield stays at this level.

Prices

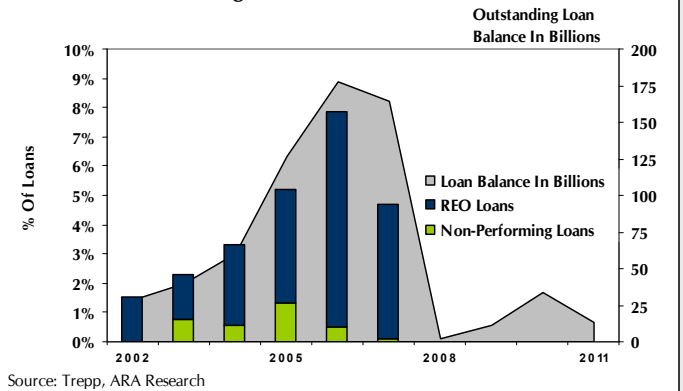
Real estate prices have been driven largely by investors' desire for lower-risk core properties, or, if they are investing in distressed properties, a significant discount to perceived value. Because of the recent stock market correction, we expect these trends to continue.



REAL ESTATE CAPITAL MARKETS HIGHLIGHT

Refinancing risk on commercial mortgage-backed security (CMBS) loans, as well as the performance of the sector in general, has resulted in structural changes in how real estate is financed. In particular, nearly 8% of the 2006 CMBS loans are now either classified as Real-Estate Owned (REO) or non-performing, representing \$14 billion of distressed asset value. While lenders are likely to collect some of this loan capital upon sale, the depth of loss has fundamentally altered CMBS volume to a fraction of past volume. Additionally, the shock of property value declines is still impacting the debt market, as loan repayments are exceeding new money for most providers of real estate debt.

CMBS Non-Performing Loans versus Balances



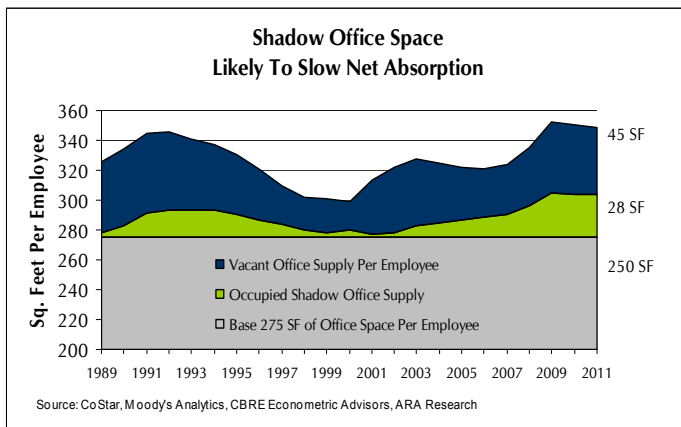
However, indicating a potential turning point in debt capital to real estate, life insurance company debt flows have turned positive (\$10 billion annual rate) for the first time since 2008. More significant growth in debt capital is likely to eventually occur, although this will take time as increased construction activity is needed to achieve significantly stronger debt capital flows to real estate.

FUNDAMENTALS TRENDS AND FORECAST

Office

Second Quarter 2011 office net absorption totaled 7.1 MSF in the 23 major markets tracked by American, with 25 MSF of positive net absorption over the past year. Our office net absorption forecast is at 25 to 30 MSF for 2011 (1.0% to 1.4% demand growth), with vacancy falling by up to 100 basis points to the low 14% range by year-end. Growth in office demand is likely to be constrained due to the high level of “shadow supply” (leased but unoccupied spaces), which currently stands at a near record of 28 SF per employee nationally, double the long-term trend.

Despite the improvement in occupancy, office rent trends remain relatively flat, with some reduction in rent concessions helping to raise effective rents in some markets, such as New York, San Francisco and Chicago. Since office rents are on average 15% below the long-term trend and there is little new construction, rent growth should accelerate once more significant job growth resumes.



Industrial

Net absorption of 21 to 25 MSF has been recorded for three consecutive quarters in the industrial sector, a vast improvement over the 204 MSF of cumulative negative net absorption from 2008 to 3Q10.

We expect industrial net absorption to grow at a 1.0% annual rate in 2011 (80 MSF), with more significant growth needing improved job-growth trends. Industrial rents have been fairly flat, although port-related locations and some big box segments in metros such as Los Angeles (CA), Riverside (CA), Newark (NJ) and Miami (FL), have generally experienced positive rent trends. Warehouse completions should be minimal at approximately 10 MSF nationally, the

lowest since at least 1989, and down 90% from long-term averages. The vast majority of new warehouse projects under construction are substantially leased build-to-suit properties. This limited level of construction should allow for occupancy and rent gains, when significant job growth resumes.

Retail

The combination of high energy prices and increased internet sales had a dampening impact on overall retail demand in the first half of 2011. Demand recorded only 0.5% growth (40 MSF) during the first two quarters, which is only half of what was experienced by the office and industrial sectors year to date. However, new construction has been minimal, which has helped push vacancy down by 0.4% since the 2010 market peak to 7.2% as of 2Q11. Additionally, ideally-located shopping centers, focused on needs-based retail with top-tier tenants, have tended to outperform market averages with retail rents overall remaining fairly stable.

Another key retail trend has been the split in retail sales trends between upper-income consumers, who have jobs and are not highly impacted by rising costs for food and other essentials, versus lower-income shoppers, who struggle with stubbornly high unemployment and rising costs. Because of this trend, retail stores located in higher-income areas, such as those targeted by American, are inclined to report stronger retail sales and occupancy trends despite the soft economy.

Multi-family

Vacancy in the multi-family sector fell 100 basis points over the past year to 6.0% and effective rents have increased by 5.0% over the same period, including a 1.4% gain in the past quarter. Multi-family completions are expected to hit a market-cycle low point in 2011, followed by an increase starting in 2012. This forecasted increase would bring new supply back to a level in line with demand growth. Since multi-family rents are closer to the long-term trend compared to other property types, and new construction is starting to resume, rent upside within this sector is lower than that of the other major property types. However, until significant construction resumes, solid rent growth is likely to be focused on metros with stronger housing markets, limited housing affordability and strong job growth, or some combination of these factors. For example, San Jose is the top rent growth market for multi-family rents at 13.0%, while it is also the top job growth market at 4.0% and it is home to one of the least affordable housing markets.

CURRENT STRATEGY

Given the uncertain economy, the highest returns in real estate are likely to result from active management and defensive investments intended to protect against downside risk. Our investment strategy is focused on investing in properties with a more stable pattern and that tend to perform well in all points in the market cycle, which is typically focused on submarkets that have a long-run history of above average occupancy rates. Additionally, properties purchased in today's market at a discount to replacement cost are also likely to stage the greatest increase in value when the economy eventually recovers.

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