

Market Perspective

Executive Summary

- Asia is projected to see 2006 annual GDP growth of 7.7%, supported by growing exports (especially intraregional), booming investments and private consumption.
- Positive economic and business prospects, increasing headcounts and corporate capital expenditure budgets are likely to sustain the uptrend in office markets in terms of rents and prices.
- Consumer spending remained steady, buoyed by robust economic performance, an improved labor market and intraregional tourism. International retailers are likely to expand in existing or new markets, resulting in further demand for retail space.
- Asia's residential market performance was mixed in 3Q06. Interest rate rises softened affordability in Japan and Korea. In China, measures to cool residential prices affected market sentiment. Hong Kong showed resilience in terms of transaction volume. Singapore's investor demand for prime residential units stayed strong, and the outlook is robust.
- The outlook of the industrial property market remains bright, supported by strong exports, which grew by 8% per year from 2000 to 2004.
- In 3Q06, the Asian REIT market saw new listings in Japan, Malaysia and Singapore, and the total market capitalization of Asian REITs reached US\$51.9 billion.
- Five commercial mortgage-backed securities issues are still in the 2006 pipeline, four from Japan and one from China, totaling US\$1.52 billion.

Introduction

Asia's economies continued to see robust growth in the third quarter, supported by growing exports (especially intraregional),

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booming investments and private consumption. Inflationary pressure has become evident compared with the start of the year, partly due to high oil prices and partly to strong domestic consumption, especially in emerging markets such as China and India. On the other hand, the U.S. Federal Reserve paused the federal-funds rate increase at its meetings in August and September, which could mitigate the upward pressure on Asian interest rates. The region is projected to see 2006 annual GDP growth of 7.7%, higher than 2005's 7.4% growth.

In China, the government reported that fixed-asset investment, a major indicator of economic growth, fell 5.9 percentage points from July to 21.5% in August. Moderation in investments has also reduced the demand for bank loans. In July and August, Chinese banks lent 177 billion yuan (US\$22.4 billion) on average per month, half the average monthly new loans in the first six months of the year. The bank loan reduction also resulted from the 27-bps interest rate rise to 6.12% in August. In 3Q, the central bank also raised the amount of cash that banks must hold in reserve by another 0.5 percentage points to 8.5% to freeze liquidity of up to 160 billion yuan (US\$20.2 billion), another measure to rein in investment and lending. These macro-economic measures are likely to moderate China's GDP growth in the third and fourth quarters, compared with the 10.2% growth in 2005 and 10.9% in the first half of 2006. It is projected that 2006 annual GDP growth will be about 10%, while inflation will be about 2%.

Market sentiment toward Japan's economy improved in the third quarter, as reflected by the latest Bank of Japan (BOJ) *tankan* survey, which showed that large enterprises were more optimistic about the economy in September than in June. The optimism was also reflected in the labor market, where the unemployment rate hovered at 4.1% in August, lower than June's 4.2%. In July, the BOJ raised the interest rate by 25 bps, which ended its five-year zero interest rate policy. The market expects the central bank to increase interest rates before the end of the year, especially when inflation has been rising and reached 0.9% in August, the highest level since March 1998.

South Korea's economy saw mixed signals in the third quarter, and indicators point to a slowdown for the rest of the year. On the one hand, industrial output growth accelerated to 10.6% year-on-year (y-o-y) in August, up from the 4.3% growth in July. Factories were running at an average of 80.7% of full capacity in August, up from 76.8% in July. Labor also remained stable in the quarter, with the unemployment rate at 3.5% at the end of August. On the other hand, the central bank's consumer sentiment index fell in the July-October period to a seven-quarter low, and there were concerns that the potential economic slowdown could dampen consumer spending. High global oil prices and a series of labor strikes have likely exacerbated consumer sentiment. In August, the central bank raised the benchmark interest rate by 25 bps to 4.5%, or 125 bps since October 2005, which has moderated the demand for bank loans. In 3Q, won-denominated loans from the four leading commercial banks grew by only 3.2% quarter-on-quarter (q-o-q), compared with 6% growth in the preceding quarter.

While Hong Kong's economy expanded by 6.6% y-o-y in the first half of 2006, it is expected to moderate in the second half, as the global economy will probably see slower growth. As such, the government projected 2006 annual GDP growth to be about 5%, lower than last year's 7.3% but still higher than Hong Kong's long-term average growth of about 4% per year. Private-sector

economists projected 2006 annual GDP growth to be about 6.3% on average. For the third quarter, total exports grew by 10.7% and 9.9% y-o-y, respectively, in July and August, better than in the second quarter. The labor market remained stable, with the unemployment rate hovering around 5% at the end of August.

Singapore's advance estimates show that GDP in 3Q06 grew by 7.1% y-o-y, lower than the second quarter's 8.0% growth. Growth in the manufacturing sector moderated to 10% in the third quarter, from 12.2% in the previous quarter, as biomedical manufacturing, electronics and chemicals experienced some growth moderation. The services-producing industries expanded by 6.6% in 3Q06, only slightly lower than the 6.9% expansion in the preceding quarter. The construction sector was estimated to have expanded by 1.0%, higher than the 0.3% growth previously. Based on the Monetary Authority of Singapore's survey of professional forecasters in September, 2006 annual GDP was revised up to 7.1%, more than the 6.7% growth forecast in June, as more growth is expected in all sectors.

Malaysia's economic growth momentum in 3Q06 is likely to be similar to the second quarter, which saw GDP expand by 5.9% y-o-y, supported by robust domestic demand and strong investment in the public and private sectors. Trade statistics in the third quarter were also encouraging – exports expanded by 16.0% y-o-y in July, the fastest growth since March 2005. The Malaysian government expects 2006 annual GDP growth to be 5.8% and 6.0% in 2007. Private consumption is projected to account for about half of 2007's GDP. The government also announced the reduction of the corporate tax – from the current 28% to 27% in 2007 and 26% in 2008. The government's development expenditure will also rise 24% y-o-y to RM44.5 billion, with RM27.5 billion for construction and infrastructure.

Capital Markets

In the third quarter, the Asian REIT market saw new listings in Japan, Malaysia and Singapore. At the end of September, the total market capitalization of Asian REITs reached US\$51.9 billion, of which J-REITs accounted for 63.5%.

Japan had 39 REITs at the end of September, with a total market cap of about US\$33 billion, up from US\$30 billion three months ago. In the third quarter, three new J-REITs were listed, and in the first nine months of 2006 there were 11 J-REIT listings, compared with 13 for the whole of 2005. The average dividend yield of J-REITs was 3.86% at the end of September, similar to the second quarter, representing a positive spread of 218 bps over the 10-year Japanese government bond yield of 1.68%.

Hong Kong had four listed REITs at the end of September, unchanged from the previous quarter. The total market cap of HK-REITs was estimated to be about US\$6.5 billion, and the average dividend yield was 4.6% at the end of September, 70 bps above the 10-year Exchange Funds bond yield of 3.9%, which has leveled off from 4.8% in June. The proposed listings of Sunlight REIT by Henderson Land and Sun Millennium REIT by Sun Hung Kai Properties, which were postponed in May, did not take place in the third quarter either, probably because of rising interest rate concerns. It is expected that the listings will occur when interest rates' upward pressure in Hong Kong starts to taper off. Besides the two potential listings, it was reported that

Regal Hotels International Holdings may list a hotel REIT, comprising five hotels in Hong Kong, with a total net asset value of about HK\$10 billion.

In Singapore, three new REITs were listed in the third quarter: Fraser Centrepoint Trust (retail malls); CDL Hospitality Trust (hotels); and Cambridge Industrial REIT. At the end of September, there were 13 listed S-REITs, with a total market cap of about US\$11.1 billion. The average dividend yield was 4.0%, down from 5.6% in June due to share price increases in the third quarter. The 4.0% was 80 bps above the 10-year government bond yield of 3.2%.

In Malaysia, Al-‘Aqar KPJ REIT was listed in 3Q06, the fifth listed M-REIT. This healthcare REIT was set up by KPJ Healthcare and comprises six hospitals, with a total asset value of RM481 million. Al-‘Aqar KPJ REIT issued 340 million units at 95 sen each, of which KPJ Healthcare holds 160 million units, or 47%. The projected 2006 dividend yield for retail investors is about 7.6%, slightly higher than M-REITs’ average dividend yield of 7.1%, which is 294 bps over the 10-year Malaysian government bond yield of 4.16%. The total market cap of M-REITs at the end of September was US\$573 million. It is noteworthy that during the 2007 budget announcement in September, the government decided to lower the REIT distribution tax to 20% for foreign institutional investors from 28% previously.

South Korea had seven REITs at the end of September, unchanged from the preceding quarter. Total market cap by the end of 3Q was about US\$732 million, and the average dividend yield was about 8.5%, 389 bps above the five-year Treasury bond yield of 4.61%.

In the debt market, the pause in the U.S. federal-funds rate increase in 3Q06 re-ignited market expectations that interest rates may have reached the peak of the cycle. In Asia, benchmark interest rates in China and South Korea rose by 27 bps and 25 bps, respectively, in the third quarter. After five years of a zero interest rate policy, Japan’s interest rate rose by 25 bps in July.

Five commercial mortgage-backed securities (CMBS) issues are still in this year’s pipeline, totaling US\$1.52 billion, based on data from *Commercial Mortgage Alert*. Four of the CMBS originated in Japan (US\$1.4 billion) and the remaining one in China (US\$125 million).

Property Markets

Office

In the third quarter, demand for office space in Tokyo remained broadly based, especially from banks, business services, manufacturing companies and foreign multinational corporations. More than 95% of new completions in 2006 were committed at the end of September. As a result, occupiers are now faced with a limited supply of space at significantly higher rental costs. Average grade-A vacancy at the end of September was about 0.6%, slightly lower than 0.7% one quarter ago. The average grade-A effective rent rose by 7.1% in 3Q but was still 33% below the peak in December 1990. In the first nine months of 2006, average grade-A office rent rose by 35.1%. Going forward, as supply continues to tighten, Tokyo’s office rents are poised to see further upside for the rest of the year.

In Hong Kong, tenant expansions and relocations both continued to underpin the grade-A office leasing market, but at a slower rate. In the CBD areas, the tightening supply of quality space and the rising rental environment have triggered relocations to non-prime buildings in the CBD or to decentralized areas, where large amounts of contiguous vacant space can still be found at a relatively cheaper cost. In Central, average vacancy fell to about 4% at the end of September, from 4.4% three months ago. Decentralized areas such as Hong Kong East also saw vacancy decline to about 3% at quarter-end, from 3.4% in the preceding quarter. Grade-A office rents in Central rose by about 7.5% on average in 3Q and 23.5% in the first nine months of the year, lower than the 64.5% increase for the same period last year. Going forward, the rental growth pace will likely see some moderation, which is in line with the expected economic slowdown in Hong Kong.

In Beijing, grade-A office rents remained firm in the third quarter, supported by the finance and banking sectors, which accounted for one-fifth of the leasing transactions in the first half of the year. When the banking sector is deregulated at the end of 2006, foreign banks will be allowed to provide financial services to local residents. This bodes well for the Beijing office market, as there will be more demand from new and existing financial institutions. Grade-A vacancy fell to about 14.5% at the end of September, from 17% a quarter ago. Going forward, more new supply is expected in the fourth quarter and 2007, which could temporarily outpace new demand and create upward pressure on vacancy. However, as new and existing financial institutions look for more space in 2007, the vacancy rate is projected to begin to decrease toward the end of next year. In Shanghai, all the key office sub-markets saw rental increases in the third quarter, especially Pudong, where office effective rents rose by 10.4% on average. In the property investment sales market, prices in Beijing and Shanghai saw positive growth in 3Q. Anecdotal evidence suggests that some investors have adjusted their investment strategies to focus on commercial properties, in light of a series of government measures, most of which were aimed at cooling the residential market.

In the third quarter, Singapore's office market continued to see further escalation of rents, underpinned by robust demand and the tightening of available office space. Grade-A office vacancy declined further to 0.7% by the end of September, from 2.7% in the preceding quarter. The latest average vacancy is the lowest since 2000, during the dot-com boom, when vacancy was 1.2%. More broad-based demand from financial institutions, banks and other multinational corporations, instead of just the IT sector, supports the current office market boom. As a result of strong demand, grade-A office rents rose by almost 12% on average in the third quarter. In the first nine months of 2006, they rose by 28% on average, and for the whole year, rental growth is expected to be about 45%. As current supply continues to tighten, the absence of suitable premises could restrict new entrants and business expansions, thereby moderating the growth of new demand. New supply of grade-A office space will experience a significant rise in 2009, when the first phase of the Marina Bay Financial Center is completed, releasing about 1.5 million square feet into the market. Grade-A office rents over the next few years are therefore poised to see further upside.

In Seoul, the average vacancy of grade-A office space fell to 2.5% at the end of September, from 2.9% in the previous quarter and 4.1% at the start of 2006. Demand came from domestic financial services companies and multinational corporations. Grade-A office rents rose by 0.4%

on average in 3Q and by 2.3% in the first nine months of the year. Going forward, the organic growth of companies (headcount increases) and corporate “office upgraders” will sustain demand for grade-A office space. Rents are likely to see further growth as vacancy continues to stay at current low levels, although the mixed economic outlook could moderate the growth pace.

In Kuala Lumpur, grade-A office rents in the Kuala Lumpur City Center edged up slightly in the third quarter, supported by demand from local occupiers and multinational corporations to establish call centers and shared service centers for their global operations. The supply of grade-A office space is tightening steadily, and vacancy continues to moderate. Going forward, the limited supply of new grade-A office space for the rest of 2006 and 2007 bodes well for office rents. Vacancies in the decentralized areas are also expected to decline, as space in new buildings starts to be absorbed.

Residential

Japan’s nationwide housing starts fell by 7.5% y-o-y in July but rose by 1.8% in August. The ratio between new condominium units contracted and units marketed in July and August was 79.1% on average, lower than the 85.6% for the same period a year ago. Units sold in July and August totaled 8,230, lower than the 10,657 units sold in the same period last year. The average new condominium price rose by 7.6% month-on-month in July but fell by 18.0% in August, as sentiment was probably affected by the 25-bps interest rate increase in July and the possibility of future rises. Going forward, while any interest rate increase could influence demand for new condominium units, the underlying economic growth momentum will probably mitigate the impact.

More government measures to cool residential prices and to curb speculative activities somewhat dampened China’s residential market sentiment in the third quarter. In July, the central bank raised the bank reserve ratio from 8% to 8.5% to freeze liquidity of up to 160 billion yuan, thus tightened the mortgage loan supply. The central bank also raised the interest rate to 6.12% in August, from 5.85%, the second rate increase after April this year. The central government declared that it would send senior inspectors nationwide to see if banks were implementing the measures to cool housing prices, an indication that the central authorities were seriously concerned about the overheated market and were attempting to bring the market back to a more sustainable growth pace. Anecdotal evidence shows that potential buyers have adopted a wait-and-see attitude in view of the measures and have held back their purchases. Transaction volume has moderated and is likely to remain subdued in the short term, which would cap any further price growth going forward.

In Hong Kong, although monthly residential sales and purchase agreements fell in July month-on-month, the number rebounded in August and improved further in September, as potential buyers expected the interest rate cycle in Hong Kong to flatten after the U.S. federal-funds rate was held unchanged in August and September. The total number of sales and purchase agreements in the third quarter rose by 2.0% q-o-q, while total consideration rose by 1.1% q-o-q. In the primary market, pent-up demand was seen after developers adjusted the pricing of new launches so that they were more in line with those in the secondary market. Positive sentiment is likely to continue in the fourth quarter, as the interest rate is expected to remain flat

and the labor market continues to see improvement. The prime residential leasing market saw a brief slowdown in the latter part of the third quarter, as some expatriates completed their house-hunting activities in June and July and went on vacation in August.

In Seoul, while the housing price index saw month-on-month increases throughout 3Q, the quarterly growth pace slowed to 1.8% q-o-q versus 3.9% in the second quarter. The housing market slowdown was also reflected by weakened demand for mortgage loans, which grew by 11.8% and 10.9% y-o-y in July and August, respectively, lower than the growth rates of 11.9% and 12.4% for the same period last year. The central bank's 25-bps interest rate increase in August, the fifth since October 2005, has also created more uncertainty in the residential market, which potential buyers responded to by postponing their buying decisions.

In Singapore, the prime residential market remained buoyant in the third quarter, driven mostly by foreign purchasers and local high-net-worth individuals. At the same time, developers have been seeking choice residential development sites, especially for high-end and "lifestyle" projects in prime districts. As a result, land prices reached a new benchmark in prime districts in the third quarter, which even surpassed those before the 1997 Asian crisis. However, this does not imply that a property bubble exists, as property speculation in new projects in prime areas does not appear to be rampant. In the primary market, between 1,800 and 2,000 new units were launched in the quarter, while a similar number were sold. The government's flash estimate shows that island-wide private residential prices in 3Q06 increased by about 2.5% from the previous quarter, the fastest quarterly rise since 1Q00. Prices for luxury properties have risen by about 5.5% in 3Q06 and 18.4% in the first nine months of the year, far better than the 2.2% increase in the same period last year. Going forward, the prime residential market will continue to attract interest among investors, both local and foreign, and prices are likely to see further upside.

Retail

Total retail sales in China rose by 13.7% and 13.8% y-o-y, respectively, in July and August, similar to 2Q growth levels. For the first eight months of this year, total retail sales increased by 13.5% y-o-y to 4.85 trillion yuan (US\$614 billion), supported by robust domestic consumption on the back of strong economic growth.

Beijing's total retail sales rose by 11.1% and 13.8% y-o-y in July and August, respectively, reflecting robust consumer confidence. For the first eight months of the year, total disposable income per urban resident was 13,356 yuan, 14.1% higher than the same period last year. Key demand drivers of the retail leasing market in Beijing in 3Q continued to be retailers from the food and beverage, cosmetics, jewelry and watch sectors. Prime retail rents in Beijing remained stable. Going forward, retail space demand in Beijing will be healthy, underpinned by expansion plans among foreign and local retailers, in light of the robust economy and the upcoming Olympics. In Shanghai, total retail sales rose by almost 13% y-o-y each for July and August. For the first eight months of this year, total disposable income per urban resident rose by 10.7% y-o-y to 13,976 yuan. Prime retail rents rose by 5.7% y-o-y in the third quarter, more than the 4.8% increase previously.

Retail sales in Hong Kong expanded by 7.1% and 8.3% y-o-y in July and August, respectively, as improving employment conditions, the sustained rise in household income and the pause in U.S. interest-rate hikes boosted consumer confidence. Tourist arrivals totaled 2.35 million in August, up 11.2% y-o-y. In the first eight months, tourist arrivals exceeded 16.74 million, up 10.4% y-o-y. Prime retail rents rose by an average of 2.8% in the third quarter and by 6.7% in the first nine months. Average vacancy hovered around 1.5% in the third quarter and is likely to be the same at year's end, as new supply is projected to be limited.

Weakened retail sales and consumer market confidence clouded South Korea's retail property market in 3Q06. The retail sales index fell by 0.5% month-on-month in July and by 0.3% in August. The government's consumer confidence index also weakened, hurt by high oil prices and a series of labor strikes. Consumer sentiment was also dampened by the 25-bps interest-rate increase in August. The soft market sentiment is likely to persist for the rest of the year, and retailers will probably wait and see before they consider aggressive expansions again. New demand for retail space is therefore likely to be somewhat slow going forward.

The Great Singapore Sale (GSS), which started May 26 and ended July 23, helped Singapore's retail market in 3Q. According to MasterCard Worldwide, its cardholders' spending during the eight-week GSS surpassed last year's amount by 25%. Substantial tourist arrivals in July, which totaled 913,000, partly contributed to the success. Robust consumer spending in the third quarter was also reflected by the 4.6% y-o-y increase in the retail sales index in July. Prime retail rents in both Orchard Road and suburban areas rose slightly in the quarter, supported by retailer demand. At the same time, precommitment rates for new shopping centers in the final quarter of 2006 range from 70% to 90%. Developers have also become more confident about the Republic's retail market, judging by their responses to recent government land sales of commercial sites, which saw record prices. Going forward, demand for retail space is expected to remain firm, and the upward pressure on rents will likely persist.

In Kuala Lumpur, prime retail rents in the City Center area remained stable in the third quarter. Prime retail vacancy hovered around 12% at the end of September, much lower than the nationwide average of about 20%. Under the Ninth Malaysia Plan (2006-2010), tourist arrivals will likely reach 24.6 million by 2010, from 17.5 million expected this year. The government intends to promote the nation as an international shopping destination, and tourist revenue is expected to rise to about RM59.4 billion by 2010.

Industrial

The Bank of Japan's 3Q06 *tankan* survey showed that manufacturers' optimism was the highest in two years, buoyed by the economic recovery. Demand for logistics centers in Tokyo remained strong in 3Q's robust economic environment. On the other hand, tenant resistance to current rental levels could be seen, especially among the cost-conscious occupiers who dominate Tokyo's mid- to large-scale logistics property market. Investor demand for logistics properties remained strong in the third quarter. These properties have emerged as another asset class for which both foreign and domestic capital is likely to compete. It is estimated that there are 21 large multitenant distribution centers in Tokyo, totaling about 5.4 million square feet, with average vacancy of about 8.6%.

China's sales of industrial products rose by about 26% y-o-y in both July and August, similar to the same period last year. In Beijing, the expansion plans of major foreign and local logistics players supported demand for logistics centers and services, in light of the boom in the retailing sector and the 2008 Olympics. In Shanghai, the rising needs of high-tech manufacturing enterprises and logistics end-users, who view Shanghai as a key economic, business and financial activity hub, continue to support leasing absorption of industrial facilities.

Hong Kong's exports rose by 9.9% and 10.7% y-o-y in July and August, respectively. For the first eight months of 2006, the value of total export goods rose 9% over the same period last year. Starting on July 1, 2006, the number of products eligible for zero tariffs under CEPA's (Closer Economic Partnership Arrangement) regulations on origin rose to 1,407. This zero-tariff preference is likely to rejuvenate Hong Kong's position as the manufacturing location for certain kinds of products, thus creating additional demand for both factory and warehouse space. Average industrial rent rose by about 1.1% for the two months ending in August, compared with June. Total warehouse stock is about 36.6 million square feet, and average vacancy is about 3%.

In Singapore, total manufacturing output expanded by 12.4% y-o-y for the two months ending with August. For the first eight months, growth was slightly more than 15%. In the high-tech industrial sector, rents grew by about 5.4% on average in the third quarter. Future demand for high-tech space is likely to rise, supported by the government's goal of developing the high-tech industry further. Rents for quality factories and warehouses generally remained firm in the quarter, as demand from manufacturers is expected to be sustainable, backed by the robust economy. Total high-tech industrial space is about 11.9 million square feet, and average vacancy hovered around 9%.

Conclusion

Asia's economic momentum remained stable in the first nine months of the year and is likely to continue through the final three months. Central banks are likely to take their cue from the pause in the U.S. federal-funds rate and pace any future rate increases carefully to alleviate any adverse impact on private consumption. The pause in the interest-rate uptrend should mitigate any upward inflationary pressure in the short term.

Positive economic and business prospects, increases in headcounts and higher corporate capital expenditure budgets, especially those of large office-space users such as financial institutions and banks, are likely to sustain the upturn in the region's office markets in terms of rents and prices. This will translate into a rising need for additional office space, particularly grade-A, which is seeing limited new supply.

Consumer spending in the region remained steady in the first nine months, buoyed by robust economic performance, an improved labor market and intraregional tourism. China is leading the pack via the increasing affluence of its population. The recovery of the Japanese economy is also supporting domestic consumption. To capitalize on the region's growing population and spending power, international retailers are likely to expand in existing or new markets, resulting in further demand for retail space.

The region's residential markets continued to show mixed performance in the third quarter. Interest-rate increases in the quarter softened affordability in Japan and Korea, as reflected by the decline in sales and weakened demand for mortgage loans. In China, market sentiment reacted to both the interest-rate uptrend and the government's monetary measures to cool residential prices. On the other hand, Hong Kong's residential market showed some resilience in August and September in terms of transaction volume, as the market expected the interest rate to flatten. In Singapore, demand for prime residential units from investors remained strong in the third quarter, and the outlook continues to be robust, supported by the city-state's economic and political stability, and the government's pro-business policy.

The outlook for the region's industrial property market remains bright, supported by robust exports, which grew by 8% per year between 2000 and 2004, twice the worldwide export growth rate of 4% per annum, according to the latest statistics from the World Trade Organization. Demand for industrial properties in the region has been strengthening, particularly in the logistics segment. Asia's status as the global manufacturing hub, enhanced by its improving infrastructure, will underpin future demand for quality industrial space. And more investors are likely to add the asset class to their global portfolios to improve diversification.

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