

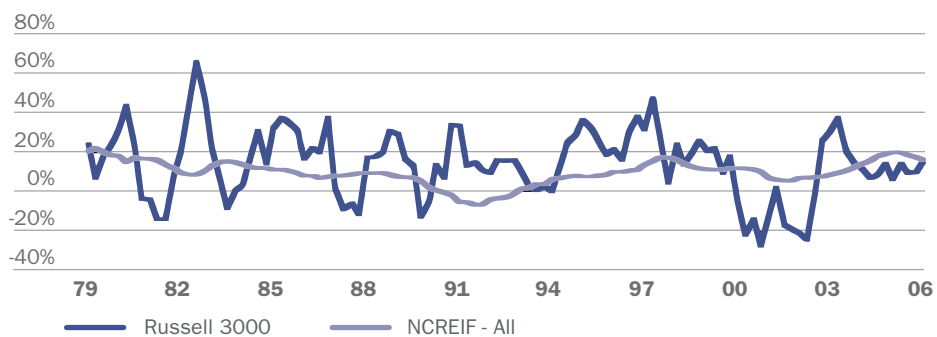
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COMMERCIAL REAL ESTATE'S DAY IN THE SUN

Commercial real estate has become a favored asset class for investors since the stock market correction in 2000 elevated real estate's attractiveness versus stocks. Commercial real estate performance has been especially strong since the beginning of 2004, with total returns averaging over 16% per year for the last three years. In contrast, the Russell 3000 stock index returned 11% per year for the same period.

STOCK VS. REAL ESTATE TOTAL RETURNS



Sources: Russell 3000 Index; NCREIF

During today's discussion, we will focus on the following aspects of the commercial real estate environment:

- Why has commercial real estate become a favored asset class for investors in recent years?
- What access do investors have to commercial real estate?
- What is the outlook for the commercial real estate investing environment for 2007 and what are the factors that influence this outlook?

Commercial real estate investments typically do not offer returns that outperform stocks. Since the inception of commercial real estate performance tracking in 1978, total returns have averaged just over 10%. At the same time, however, the risk associated with commercial real estate investment is estimated to be lower than stock market risk by roughly half.¹

Commercial real estate investments are typically defined to include downtown and suburban office buildings, warehouses, factory buildings, research and development facilities, shopping centers, and apartments. Hotels are included as well but constitute a very small part of the commercial real estate investment universe. In recent years, more esoteric property types are offering investment opportunities; examples include self-storage, senior housing, and mixed-used developments that combine more traditional property types into "lifestyle" centers or contrived "downtowns."

Vehicles for investing in commercial real estate take a variety of forms. Investors can buy properties directly and either manage them or contract out management to specialized property management firms. A more popular option is comprised of open-end and closed-end real estate funds managed by professional real estate advisors. Open-end funds allow investors to move money in and out; property portfolios for such funds are actively managed and the funds have no finite term. Closed-end funds do not offer liquidity for investors and property portfolios are generally fixed. Closed-end funds usually have a finite life ending with the sale of the properties and distribution of proceeds.

Commercial real estate investors can also buy REIT stocks. These are companies that exist for the purpose of owning and operating real estate. The dividends paid by REITs are derived from the cash flow of their real estate and in this way, owning REITs is similar to owning real estate. However, since REITs are stocks that are priced minute-to-minute in public stocks markets, their value is much more volatile than the value of direct properties which are valued in periodic appraisals. As a result, in an investment portfolio, REITs behave more like stocks than real estate.

Individual investors do not have the same access to commercial real estate investments as institutions. Of course, individuals can invest in small neighborhood properties and sometimes enjoy very attractive returns. But properties of this type are not "institutional quality" and carry with them very high concentration risk because of the absence of diversification. The alternative for individuals is to purchase REITs with their stock-like characteristics. High net wealth individuals have more choices including access to open-end and closed-end real estate funds designed for them, as well as access to REITs. **TIAA-CREF participants have a unique opportunity in that they can invest in our Real Estate Account. The Account, which offers liquidity on demand, is an open-end vehicle containing commercial real estate and offering return and risk characteristics that are usually available to only institutions and high net wealth investors.**

In California, the TIAA Real Estate Account is available through IRAs, but not all employer sponsored plans. Please contact us to determine if your institution's plan can accept investments into the account.

OUTLOOK

After the strong investment returns produced by commercial real estate in recent years, investors are asking how much longer can it last? In order to address that question, we regularly monitor a stylized set of factors that influence real estate investment returns.

¹ Source: TIAA-CREF calculations using the NCREIF real estate index and the Russell 3000 equity index.

First, real estate returns are affected by fundamental supply and demand conditions in each local market and for each property type. These conditions determine rents. If an excessive amount of office space is built in downtown Philadelphia, rents will decline as landlords compete for tenants. Vacancy rate data is a useful source of insight into real estate market fundamentals. In addition, we monitor construction plans and the pace of employment growth in local markets throughout the country to inform our judgment of near-term improvement or decay in market fundamentals. The performance of the overall U.S. economy is part of the “local” market analysis through its effect on employment growth. Few localities escape the ups and downs of the national business cycle.

Since the end of the recession in 2001, real estate market fundamentals have been improving across office, industrial and retail property types. Vacancy rates have been edging down and new construction has been well-behaved. Office properties were the last to recover and enjoyed strong improvement last year. By the end of the year, evidence of a slowing in the pace of improvement became evident. This suggests that investment performance next year will be weaker than the stellar 16%+ total return generated in 2006.

Second, real estate returns are affected by financial markets through the effects of interest rates, risk pricing, and performance of other investment classes. Interest rates, as embodied in Treasury yields, affect real estate by setting a floor for required property returns. A developer will not build and an investor will not buy a property that is not expected to return more than the riskless Treasury rate. With interest rates expected to change very little this year, there should be little effect on real estate for good or ill from this factor.

Risk pricing refers to how willing investors are to assume risk at various rates of return. Risk pricing has become very aggressive in the last three years. Investors are paying higher and higher prices for assets and getting lower and lower return for taking risks. This squeeze has helped to boost real estate values and sellers of real estate have reaped huge gains. This situation is a vulnerability going forward because at some point investors will become more cautious.

Finally, performance of other investment classes has been very positive for real estate since 2000. After the stock market correction, investors were wary of stocks for quite some time. Institutional investors’ attention turned to so-called “alternative” assets that include real estate, hedge funds, and private equity, while individuals focused on their homes and second homes. Looking ahead, the relative performance across asset types in 2006 does not point to any threat to real estate’s relative attractiveness in the near term.

Altogether, we expect real estate to remain an attractive investment in 2007 relative to other assets types. Real estate fundamentals and the financial environment are expected to remain positive through the year but not without risk. These factors point to positive returns but weaker returns than the 16%+ recorded for 2006.

You should consider the investment objectives, risks, charges and expenses carefully before investing. Please go to www.tiaa-cref.org or call (877) 518-9161 for a prospectus that contains this and other information. Please read the prospectus carefully before investing.

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