



Re: Principal U.S. Property Separate Account

The global financial system is in a period of volatility arguably without precedent. In recent weeks, the global credit crisis has intensified, and this credit crisis has compounded already-challenging conditions in the real estate market. One of the effects of these market conditions has been a sharp slowdown in transaction activity in the private real estate market. As a result of these and other factors described below, Principal Life Insurance Company (Principal Life) has determined that it is in the best interest of all investors in the Principal U.S. Property Separate Account (the "Separate Account") to implement a client redemption queue effective immediately.

In accordance with the provisions of your group annuity contract issued by Principal Life, we are giving you notice that Principal Life has applied a limitation which will delay the payment of withdrawal requests and provide for payment of such requests on a pro rata basis (a "Queue") as cash becomes available for distribution, as determined by Principal Life. As mentioned above, this process is effective immediately and is being made in the interest of all investors in the Separate Account.

Overview

Previously Principal Life has generally processed withdrawal requests, also referred to as redemptions, on a daily basis. This was possible because sufficient cash was available (from investor subscriptions, rents, property sales, etc.). However, capital market volatility, a significant reduction in debt capital for transactions and reduced investor demand for core real estate vehicles have changed the cash flow profile of the Separate Account. After careful consideration of the ongoing cash and liquidity needs of the Separate Account, Principal Life has decided to implement a Queue. Withdrawal requests will be paid as cash becomes distributable, on a pro rata basis. Further details are provided in a subsequent section of this letter.

The purpose of including this provision in the Separate Account agreement at the outset, and in applying this provision now, is to allow the Separate Account to continue to be managed appropriately for the benefit of investors who remain invested in the Separate Account as well as being fair to investors wishing to redeem part/all of their investment. The Separate Account will continue to be managed according to all pre-set portfolio diversification and leverage ranges, in compliance with relevant legal and financing obligations, and in a manner consistent with the strategic objectives of a core ongoing commercial real estate portfolio. We cannot project how long it will be necessary to maintain the Queue, but will provide quarterly update information regarding the Separate Account.

The balance of this letter describes the rationale for the decision to implement a Queue and provides further details on how the Queue will be managed.

Rationale

Transaction volume for private market equity real estate has fallen sharply as a result of an abrupt pullback in financing availability. This has resulted in wide bid-ask spreads and a market in which it is challenging to consummate transactions.

The Principal U.S. Property Separate Account has not been immune to the significant downshift in investor demand for core private real estate equity strategies. Year-to-date client contributions have been more than offset by redemption requests received from investors that are rebalancing their portfolios. The implementation of the Queue does not change our strategy of seeking to achieve good risk-adjusted returns through investment in core commercial real estate. While we may use capital sourced from property sales along with new client contributions and borrowings as appropriate to satisfy outstanding amounts in the Queue, all use of capital (including from property sales and financing decisions) will be strategic and will be made in the best interest of all investors.

Method of Operation of the Queue

The Queue is effective immediately. Some of the key aspects of how it will operate are provided below:

- All withdrawal requests from this Separate Account are subject to the Queue and will be delayed or processed in a series of payments until all withdrawal transaction requests have been met. However certain benefit related transactions including death, disability and certain retirement benefits under the group annuity contracts will be processed in the ordinary course of business outside of the Queue
- With respect to withdrawal requests, there is one Queue for all investors. No investor receives priority over another investor in the Queue.
- When a determination is made by Principal Life that cash is available for distribution to investors in the Queue, distributions will be made on a pro rata basis. For example, if there is \$10 million of withdrawal requests outstanding in the Queue and there is \$1 million of cash to distribute, each investor in the Queue will receive one-tenth of their requested amount as part of that distribution (without regard to the timing of the withdrawal requests). Principal Life reserves the right to satisfy de minimus amounts in full. Currently, de minimis means transaction not exceeding \$100. Principal Life will evaluate this standard over time.
- Distributions will be made based on unit values as of the date of the distribution, rather than on the date of the withdrawal request. Unit values can move up or down between the date of the withdrawal request and the date(s) of distribution.
- Investors should submit a withdrawal request in the same manner as before. However, instead of receiving a distribution on the date requested, distributions will be made as cash is available to distribute.

Conclusion

The Queue exists for the protection of the investors in the Separate Account. While applying the Queue will temporarily result in a delay in payments to investors making withdrawal requests, it enables us to continue to operate the Separate Account for the benefit of all investors.

Notwithstanding the current volatility in the U.S. economy and real estate markets, we believe the core, low-risk strategy and high asset quality of the Separate Account can provide investors with attractive risk-adjusted returns over a full market cycle. We maintain our dual focus on return generation and risk management, with the interests of all investors at the forefront of our management of the Separate Account. We will keep you informed regarding the Separate Account and we very much appreciate your continued support.

In the meantime, please feel free to contact your relationship manager or me if you have any questions.

Sincerely,
John T. Berg, Portfolio Manager