Principal U.S. Property Separate Account

Redemption Queue Update Memorandum

Update on the Client Redemption Queue in the Principal U.S. Property Separate Account

On September 26, 2008, Principal Life Insurance Company implemented a client redemption queue (the Queue) for the Principal U.S. Property Separate Account (the Account). The Queue was implemented in the interest of all investors in the Account in the face of challenging conditions in the real estate market compounded by the global credit crisis. Investor withdrawal queues are not uncommon in the marketplace and most US core open-end private equity real estate funds had a client withdrawal queue at the end of 2008.

Since the implementation of the Queue, the fundamentals of the real estate market have further deteriorated and the continuing global credit crisis has made it particularly difficult to sell properties at fair prices. Given these conditions, no distribution has yet been made to investors in the Queue. As of February 1, 2009, the outstanding amount in the Queue was $936.9 million (19.2% of the Account NAV).

We believe it is highly unlikely that a distribution to investors in the Queue will be made prior to the third quarter of 2009, and any distributions thereafter will depend largely on the ability to sell properties at fair prices. It is likely that multiple distributions over some period of time will be necessary in order to fully satisfy the Queue given its current size and the level and timing of property sales. We will continue to manage the Account for the benefit of investors who remain invested as well as the orderly generation of cash to redeem investor interests in the Queue.

The balance of this letter provides more detail on developments since implementation of the Queue, their impact on the Account and the current status of the Queue.

Economic and Market Update

Since the Queue was implemented, the economic and market factors that had caused its implementation have worsened significantly. The US economy has deteriorated further, as have real estate supply and demand fundamentals. The result has been a fall in real estate values, causing a decrease in Account unit values. In addition, the continuing global financial crisis has crippled transactions in private market real estate, as both equity and debt capital have become scarce. This has materially impacted the cash flows of the Account.

Real Estate Values

Real estate values are falling for two primary reasons – demand is falling for both space (by tenants) and property ownership (by investors). The recession is causing tenants to pull back their space needs, negatively impacting occupancy and rent levels. This has resulted in lower cash flow projections for properties. The trend toward risk aversion is causing investors to require higher rates of return for many asset classes, including real estate. Concurrently, many investors have found that their allocations to real estate have risen above their policy level, as a result of the relative outperformance of real estate versus other asset classes (often referred to as the “denominator effect”). This combination of reduced demand for real estate by both tenants and investors has negatively impacted values and may continue to do so.

Account Cash Flows

The Account has three primary sources of cash – rents from tenants, investor contributions and proceeds from property sales. The rental stream has been relatively steady, although there is the potential that some tenants may be negatively impacted by the recession which would cause a decline in cash flow. Investor contributions have slowed materially over the past year as investor

demand for real estate has declined. With the combination of decreased demand for property ownership by investors and the global financial crisis, the property transaction market has been extremely challenging. Transaction dollar volume in the U.S. equity real estate market was down approximately 75% in 2008 compared to 2007. This has adversely impacted the ability to sell Account assets. The Account successfully sold $390 million of property in 2008, including $115m of property in the 4th quarter. However, over $500 million of additional property was marketed for sale but did not transact. This contrasts with prior years in which nearly all property for sale ultimately sold.

The cash derived from rents from tenants, investor contributions and proceeds from property sales is used for ongoing property and portfolio level cash needs, interest payments on debt, acquisition obligations (the Account has commitments totaling around $800m over the next few years, all of which were committed to prior to 2nd quarter 2008) and retirement of debt[1].

Since the implementation of the Queue, it has been necessary to use any remaining cash (after ongoing property and portfolio level cash needs, interest payments and meeting acquisition obligations) to pay down Account debt. This has been done in order to maintain compliance with debt limitations that apply to the Account and to plan for future maturities on existing debt. In the fourth quarter of 2008, $196 million of debt was paid off. Compliance with debt covenants and meeting debt maturities as they come due are essential to operating the Account in the best interest of all investors.

Current Position

As we begin 2009, over $1 billion of Account property is earmarked for sale, some of which has property-level debt. Depending on how much of this property transacts, we may have the ability to make a distribution to investors in the Queue. However, we will first use proceeds to protect the existing investments in the portfolio, maintain compliance with all of our debt covenants, meet debt maturities as they come due and fund additional Account obligations.

We hope this update is useful and provides some insight into the management of the Account during this challenging time. We will continue to manage the Account in the best interest of all investors and will strive to provide timely communication regarding investment performance, liability management, Queue status and disposition pipeline. The Annual Report will be available shortly, which will provide detailed information on activities over the year, assets and liabilities.

Thank you for your investment in the Principal U.S. Property Account.

Principal® Global Investors

The Principal U.S. Property Separate Account is available through a group annuity contract with Principal Life Insurance Company, member of the Principal Financial Group® (The Principal®), Des Moines, 50392.

Principal Real Estate Investors is the sub-advisor of the Principal U.S. Property Separate Account and is an affiliate of Principal Global Investors.

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[1] The Account has both property-level and Account-level debt obligations. Certain of the Account-level debt obligations are structured with debt covenants – such as loan-to-value and debt service coverage ratios. These covenants are negotiated up front and provide the lender(s) with protection generally related to the amount of risk-taking in which the Account can engage. By both parties agreeing to these debt covenants, the lender is protected from certain risks and the Account can borrow at a lower interest rate. The Account is also required to operate within its stated investment guidelines, which include a 33% limit on total debt obligations.