Principal® Real Estate Investors

RESEARCH | RESOURCES | RESULTS

Principal U.S. Property Account

RESULTS

Above:
Meadows Marketplace
Houston, TX

On the cover:
Capitol Plaza
Washington, D.C.

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PROFILE

Background

Since 1982, the Principal U.S. Property Separate Account (the Account)[1] has been made available to clients as an open-end, commingled real estate account established by Principal Life Insurance Company. The Account is a diversified real estate equity account consisting primarily of high quality, well-leased real estate properties in the multifamily, industrial, office, retail and hotel sectors. The Account is available only to qualified retirement plans. The Account is an insurance company separate account sponsored by Principal Life Insurance Company and managed by Principal Real Estate Investors.

Philosophy

The Account is a core real estate account designed to have a low to moderate risk profile compared to other funds comprising the National Council of Real Estate Investment Fiduciaries (NCREIF) Fund Index – Open-End Diversified Core Equity (NFI-ODCE). This risk profile has two components: 1) a low to moderate real estate property risk profile; and 2) a low to moderate risk portfolio level operating profile. Low to moderate real estate property risk is accomplished by investing primarily in well-leased properties on an unleveraged basis. Low to moderate portfolio level risk is accomplished by operating with limited portfolio level obligations and a well diversified portfolio.

Objectives

The Account has two primary objectives:

1) to invest in a well-diversified real estate portfolio that reflects the overall performance of the U.S. commercial real estate market, and

2) to provide clients with private real estate returns that, over a market cycle, meet or exceed:

- the open-end fund component of the NCREIF Property Index at the property level, and
- the NFI-ODCE Equal Weight at the portfolio level.

[1] The Principal U.S. Property Separate Account is an open-end, commingled real estate account available to retirement plans meeting the requirements for qualification under Section 401(a) of the Internal Revenue Code of 1986 ("Code"), as amended, and governmental retirement plans meeting the requirements of Section 457g of the Code. The Account is an insurance company separate account sponsored by Principal Life Insurance Company and managed by Principal Real Estate Investors.

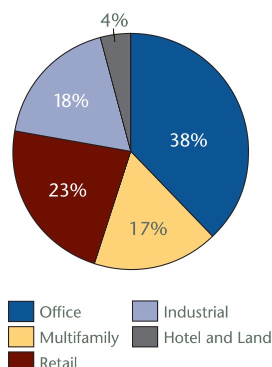
The Account is a diversified real estate equity account consisting primarily of high quality, well-leased real estate properties in the multifamily, industrial, office, retail and hotel sectors.

Watermark I
Cambridge, MA

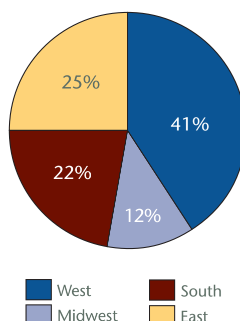
DIVERSIFIED

PORTFOLIO HIGHLIGHTS

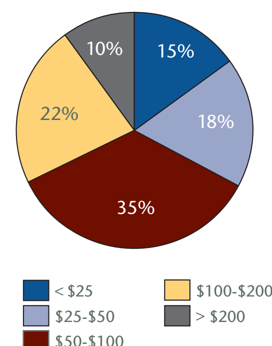
SECTOR WEIGHTINGS



GEOGRAPHIC WEIGHTINGS



PROPERTY SIZE
(in Millions)



KEY STATISTICS | *December 31, 2011*			
Inception Date	January 1982	Cash to Gross Assets	5.5%
Gross Asset Value	$5,046 million	Leverage Ratio[1]	21.8%
Net Asset Value	$3,755 million	Portfolio Occupancy[2]	90.7%
Number of Investments	117	Institutional Investors > $5m	89
Number of Markets	39	2011 Client Contributions	$771.2 million
Size	30.4 million SF	2011 Client Distributions	$518.0 million

SECTOR	CURRENT ALLOCATION	NFI-ODCE ALLOCATION	TARGET ALLOCATION
Office	38%	37%	35 - 45%
Multifamily	17%	23%	15 - 25%
Retail	23%	18%	15 - 25%
Industrial	18%	18%	15 - 25%
Hotel, Land and Other	4%	4%	0 - 5%

PERFORMANCE	GROSS PORTFOLIO[3]	PORTFOLIO BENCHMARK[4]	NET PORTFOLIO[5]	PROPERTY[6]	PROPERTY BENCHMARK[7]
1 Year	16.67%	15.96%	15.34%	14.93%	14.87%
3 Year	-1.80%	-2.25%	-2.92%	0.56%	2.42%
5 Year	-0.95%	-0.57%	-2.08%	1.17%	2.61%
10 Year	5.70%	5.79%	4.51%	6.89%	7.45%
Since Inception	7.14%	6.75%	5.99%	7.79%	7.12%

[1] Account's share of total debt (both property and portfolio) divided by Account's share of total gross assets

[2] Occupancy excludes value-added assets which are acquired at less than 85% occupancy, are under development or are condominium units available for sale. Occupancy for the total portfolio is 87%.

[3] Gross portfolio returns include leverage. Actual client returns will be reduced by investment management fees and other expenses that may be incurred in the management of the portfolio. The highest standard institutional investment management fee (annualized) for the Account is 1.15% on account values. Actual investment management fees incurred by clients may vary and are collected daily which produces a compounding effect on the total rate of return net of management fees and other expenses. Investment management fees are subject to change.

[4] Gross portfolio performance is benchmarked against the National Council of Real Estate Investment Fiduciaries (NCREIF) Fund Index – Open-end Diversified Core Equity (NFI-ODCE) Equal Weight.

[5] Net portfolio returns are shown after deduction for portfolio expenses including an investment management fee, which is 1.15% annually from July 1, 2002 through the present. Net portfolio returns prior to July 1, 2002 are calculated to reflect deduction of blended annualized investment management fees of 1.15% and 1.05% in the periods in which those amounts were charged.

[6] Property returns are unlevered, before fees and calculated in accordance with NCREIF property return methodology.

[7] Property performance is benchmarked against the Open-end Fund component of the NCREIF Property Index.

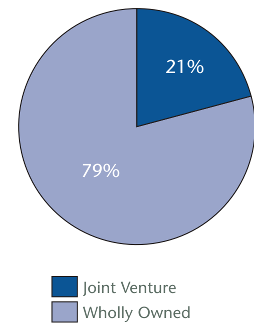
TEN LARGEST INVESTMENTS

INVESTMENT NAME	METROPOLITAN AREA	SECTOR	OCCUPANCY	% OF GROSS REAL ESTATE ASSETS
1370 Avenue of the Americas	New York	Office	87.3%	5.5%
112 @ 12th Street	Seattle	Office	93.5%	4.3%
Burbank Empire Center	Los Angeles	Retail	100.0%	4.0%
Capitol Plaza	Washington, D.C.	Office	97.6%	3.2%
Watermark I	Cambridge	Multifamily/Retail	96.1%	3.1%
J.W. Marriott Resort and Spa	San Antonio	Hotel	41.4%[1]	2.8%
Portales Corporate Center	Phoenix	Office	91.3%	2.3%
Charles Park	Cambridge	Office	93.0%	2.3%
Hazard Center	San Diego	Office/Retail	96.8%	2.2%
420 West 42nd Street	New York	Multifamily	98.8%	2.1%

RETURNS

	1 YEAR	3 YEAR	5 YEAR	10 YEAR
PORTFOLIO RETURNS[2]				
Income	5.92%	6.29%	5.66%	5.95%
Appreciation	10.28%	-7.73%	-6.34%	-0.24%
TOTAL RETURN	**16.67%**	**-1.80%**	**-0.95%**	**5.70%**
PROPERTY RETURNS[3]				
Income	5.94%	6.11%	5.63%	6.06%
Appreciation	8.61%	-5.30%	-4.28%	0.79%
TOTAL RETURN	**14.93%**	**0.56%**	**1.17%**	**6.89%**

STRUCTURE

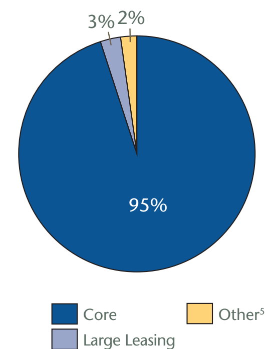


ONE YEAR PERFORMANCE

	OFFICE	INDUSTRIAL	RETAIL	MULTIFAMILY
PROPERTY SECTOR[3,4]				
Income	6.03%	5.86%	6.56%	5.85%
Appreciation	5.38%	12.35%	7.40%	13.23%
TOTAL RETURN	**11.65%**	**18.74%**	**14.33%**	**19.64%**

	EAST	MIDWEST	SOUTH	WEST
GEOGRAPHIC REGION[3]				
Income	5.06%	6.59%	5.78%	6.35%
Appreciation	6.70%	4.26%	8.86%	10.91%
TOTAL RETURN	**11.99%**	**11.05%**	**15.01%**	**17.76%**

LIFE CYCLE



[1] Occupancy for the year averaged 66.2%.

[2] Gross portfolio returns are levered and pre-fee.

[3] Property returns are unlevered, before fees and calculated in accordance with NCREIF property return methodology.

[4] Hotel performance was as follows: 5.13% Income, 6.18% Appreciation and 11.52% Total.

[5] Includes land and individual condominium units for sale.

PORTFOLIO MANAGER COMMENTARY

The Account enjoyed another positive year in 2011 on many fronts. Continued cap rate compression aided property returns, leverage was accretive to performance and strong leasing activity contributed to same-property income growth in the portfolio. While the Federal Open Market Committee has essentially telegraphed continued low interest rates into 2014, we expect that future appreciation will be achieved more through income growth than further cap rate compression, reinforcing our commitment to leasing and tenant retention efforts throughout the portfolio.

The Account generated a total return of 16.7% in 2011, comprised of 5.9% income and 10.3% appreciation. This compares favorably with the Equal Weight NFI-ODCE benchmark return of 16.0%. One-year and three-year income and total returns for the Account exceed the portfolio benchmark.

Despite market volatility driven primarily by another flare up of European sovereign debt concerns in late summer 2011, all four real estate quadrants ended the year with positive performance.

Despite market volatility driven primarily by another flare up of European sovereign debt concerns in late summer 2011, all four real estate quadrants ended the year with positive performance. Domestic REITs remained volatile throughout the year, with monthly performance ranging from –10.9% to 14.4%, yet ended the year with an annual return of 8.7%. The other real estate public market, CMBS, was also subject to market-induced volatility, but ended the year with positive performance throughout the debt tranches.

Commercial mortgage spreads and rates declined in 2011, resulting in appreciation for investors in private mortgages. And private equity real estate enjoyed its second consecutive year of positive returns, with the NCREIF Property Index appreciating 7.8%, now up 15.4% from the trough reached in the first quarter of 2010.

Both commercial real estate space markets and capital markets improved in 2011, aided by a backdrop of slow, but positive, economic and employment activity. U.S. GDP rose a disappointing 1.7% in 2011, slower than historical post-recession growth rates. The unemployment rate dropped from 9.1% to 8.5% during 2011, partially the result of the net addition of 1.82 million jobs, as the 2.09 million jobs created in the private sector were partially offset by public sector job losses. Economic growth and employment gains helped reduce vacancy rates for all property types throughout the year. While space market strength in the multifamily sector continued to lead the other property types with a 5.1% year-end vacancy rate, slight progress was achieved in vacancy rates during 2011 for industrial (down 0.6% to 13.1%), office (down 0.4% to 16.7%) and retail (down 0.1% to 11.4%). Data from Real Capital Analytics shows continued momentum for property transactions in 2011, with total transaction activity of $218.5 billion (albeit with some slowdown in momentum in the second half of the year), up from $134 billion in 2010, but well below the 2007 peak of $524 billion.

J.W. Marriott
San Antonio, TX

Three properties were acquired for the Account in 2011 totaling $262 million, the largest of which was the $152 million acquisition of a stabilized office building in Washington, D.C. Owned property dispositions totaled $52 million during the year in six transactions. In addition, two forward commitment properties were sold for $496 million, including Hess Tower in Houston for $442.5 million, which set a per square foot record for an office building sale in that city at $524 per square foot.

The surge in global market volatility at mid-year 2011 resulted in an increase in investor risk aversion across most asset classes, including commercial real estate, for much of the second half of the year. As a result, real estate equity capital continued to favor lower risk properties and funds through year-end. Attractively priced debt capital added to the momentum for core properties, as portfolio lenders also prefer to make loans on high quality properties with a stable income stream. While the agencies (Freddie Mac and Fannie Mae) frequently offer the lowest cost of debt capital for multifamily, many life companies have significant allocations for senior secured mortgages and are offering very competitive pricing spreads on loans up to 60% loan-to-value on core properties. Investors and funds seeking higher debt returns are filling the mezzanine lending space with ample capital to leverage stabilized properties to 75%-80% loan-to-value.

The financing strategy for the Account is to remain in the 20-25% total portfolio loan-to-value range. In addition, with historically low borrowing rates, the Account's primary strategy is focused on fixed rate, intermediate to long-term borrowing on select core holdings, although floating rate debt is also being used in select situations to maximize flexibility. Finally, all of the financing activity for the Account is completed with careful consideration to property and fund level ALM (asset-liability matching). The Account's weighted average cost of debt capital was 4.37% at the end of 2011. With the opportunity in 2012 to refinance five fixed rate loans totaling $146 million with a weighted average interest rate of 6.6%, we expect to be able to further reduce the portfolio weighted average cost of debt capital to even more attractive levels.

PERFORMANCE

With future appreciation likely dependent primarily on net income growth, we remain focused on optimizing property level operations and results.

PORTFOLIO MANAGER COMMENTARY *continued*

With future appreciation likely dependent primarily on net income growth, we remain focused on optimizing property level operations and results. Principal Real Estate Investors' asset management team continued to find tenants in an otherwise less-than-robust tenant demand market in 2011, with 844,000 square feet of positive net absorption occurring in the Account. Retaining existing tenants is another factor essential to income stability and growth and the tenant retention rate for the Account was 71% in 2011. While elevated vacancy rates at this stage of the recovery cycle make it challenging to generate strong rent growth, our asset managers are highly focused on both effective management of expenses and generating as much landlord pricing power as possible. These combined efforts resulted in same-property net operating income (NOI) growth of 4.0% for the portfolio in 2011. A continued emphasis in these areas will be key for continued growth in net operating income and property appreciation in 2012 and beyond.

The core nature of the Account means that the predominant focus will be on optimizing the returns on existing stabilized properties and acquiring additional core properties. However, as other investors continue to drive prices higher through competitive bids on the most highly sought after core properties in primary markets, the Account will continue to focus its incremental investment activity on acquisition of properties on an off-market basis or situations in which there is limited bidding competition. In addition, we feel that attractive risk-adjusted returns can be generated through alternative "means to an end" strategies that result in a selective accumulation of quality core properties in a manner other than just direct acquisition of existing core properties through a fully marketed competitive bid process. For example, there may be attractive relative value opportunities in the area of "lease-to-core" (whereby an investor buys an otherwise high quality property that is currently not well leased, but then proceeds to lease the property to a stabilized, core status). Given Principal Real Estate Investors' strong leasing capabilities and demonstrated success of achieving positive net absorption, "lease-to-core" will likely be a strategy we will employ on a selective basis in 2012. Another area that appears attractive on a risk-adjusted basis is "build-to-core" apartment development in which an investor constructs, leases and holds the stabilized apartment project in a portfolio. Given the firm's successful history of real estate development, we expect to make limited and highly selective investments in this strategy in 2012.

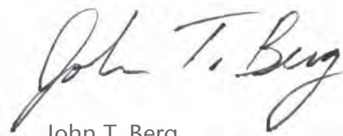
Shoppes at Woolbright
West Palm Beach, FL

In summary, as a core fund with a clear understanding of our place on the risk/return spectrum, we will continue to pursue core acquisition opportunities, especially on an off-market basis. However, as we search for relative value in the marketplace, the supplemental "lease-to-core" and "build-to-core" strategies look to offer interesting opportunities at the intersection of portfolio strategy, our capabilities as a firm and marketplace supply and demand. With just 7% of leases in the portfolio expiring in the next year and improving economic prospects in the U.S., timing may be optimal to engage in a limited amount of this activity in 2012 before a wider swath of market participants erode the return potential by pursuing similar strategies.

The Account's property type weightings were relatively stable during 2011, all ending the year within two percentage points of year-end 2010 levels. The portfolio office weighting increased slightly to 38%, industrial decreased to 18%, multifamily reduced to 17% and retail remained at 23%. After combining the aforementioned "lease-to-core" and "build-to-core" activities with other acquisitions and dispositions in 2012, we expect to end the year with higher portfolio weightings to the office and multifamily sectors than is currently the case. In contrast, we anticipate decreasing the portfolio's weighting to the retail sector and roughly maintaining the current industrial exposure.

The economic recovery in the U.S. may be shifting from uncertain to self-sustaining. To the extent the U.S. economy decouples from the troubles in Europe and China is able to achieve a soft landing, prospects for continued strengthening in job growth and thus increased tenant demand in the U.S. are likely to improve. Capturing this demand via positive net absorption and increased rents in existing properties or through selective acquisitions with lease-up potential will aide in the creation of NOI growth in the portfolio. The Account's objective of generating solid risk-adjusted returns within a core strategy while focusing equally on return generation and risk management remains intact. Owning and effectively managing high quality properties in strategic infill locations remains a hallmark of the Account and the primary path to achieving the objective. We expect 2012 will offer opportunities to both strategically enhance the portfolio and generate tactical alpha.

The resources of Principal Real Estate Investors are fully committed to embracing the opportunities ahead for investors in the Account. Thank you for your continued support and consideration of the Account. We look forward to working with you in the future.



John T. Berg
Portfolio Manager

OPPORTUNITIES

2012 ECONOMIC OUTLOOK

Economic Outlook: A Year of Decoupling?

The ongoing forces of globalization and inherent interdependence of the world's economies have kept virtually all nations vulnerable to what are still elevated levels of systemic risk and whose epicenter continues to be the Eurozone. Yet there are increasing signs of potential decoupling of the U.S. economy from both the most troubled developed nations (from a sovereign risk perspective) and from the economic slowdown in emerging markets. And while the resumption of growth in the U.S. economy is not nearly as strong as it has been during past recoveries, the risk of a double dip recession appears to have eased materially. That trend, along with slowing productivity growth, is beginning to generate more consistent job growth. Of course, the trajectory of both economic and job growth remains constrained by a great deal of policy uncertainty within the United States which (with the exception of monetary policy, whose transparency is improving) is likely to remain unresolved until after the 2012 elections.

While consumer sentiment and small business confidence are showing gradual signs of improvement, such gains are admittedly coming off a rather low base. Further, small business surveys indicate that regulatory policy has become a much more concerning issue relative to past surveys. Despite record cash holdings, businesses remain reluctant to commit resources to major expansion initiatives in the current environment of tax, regulatory and other policy uncertainty. Still, corporate earnings (whose rate of growth is understandably slowing as the recovery matures) remain strong and businesses are expanding. As it becomes more difficult for the business sector to incrementally increase the labor productivity of its existing workforce, additional hiring will likely be in the offing. The jobs market still faces a long road to reach its previous peak, unlike real GDP which has already moved past its prior peak, as shown on the right. But in the absence of a double dip recession, job growth will likely continue to steadily improve given the flattening of labor productivity growth.

There has been some gradual improvement in the Eurozone (helped along by the European Central Bank special long-term refinancing operation for European banks) which has contributed to reduced volatility and improved sentiment in the U.S. But that does not necessarily imply no further flare ups of volatility in 2012. Potential missteps in Europe, including a disorderly default by Greece, a failure to reach agreement on the fiscal union pact, and perhaps most importantly an inability of Spain or Italy to sustainably reduce the bond market's required spreads on their sovereign debt could lead to another round of significant risk aversion across global markets.

Another concern impacting global markets is whether China will indeed achieve a soft landing. At the moment, inflation appears to have subsided sufficiently that Chinese authorities are, if not actually adding stimulus, beginning to dismantle the growth and credit formation constraints that have been in place for the past year (including a significant rise in interest rates over the

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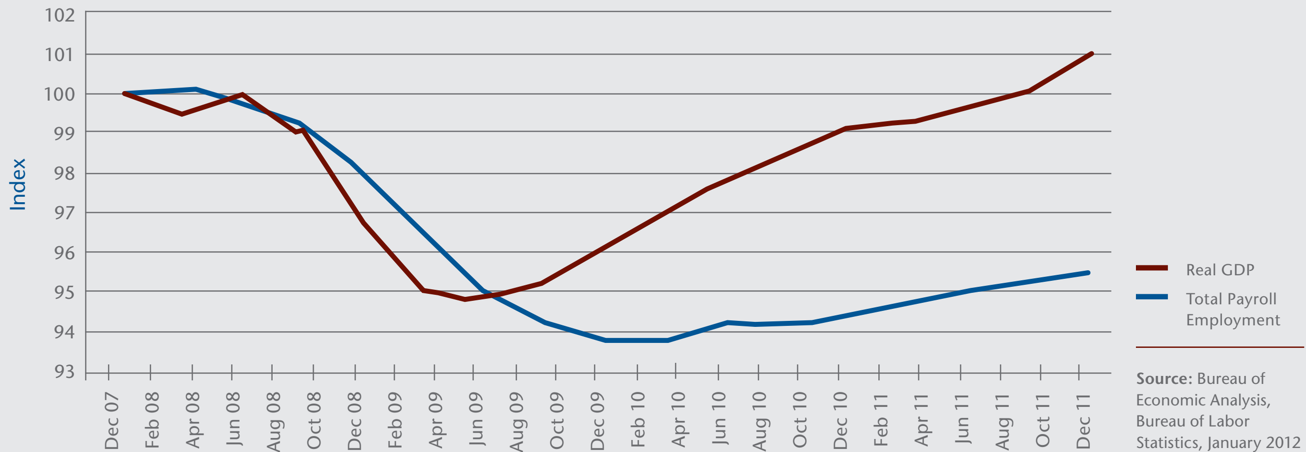
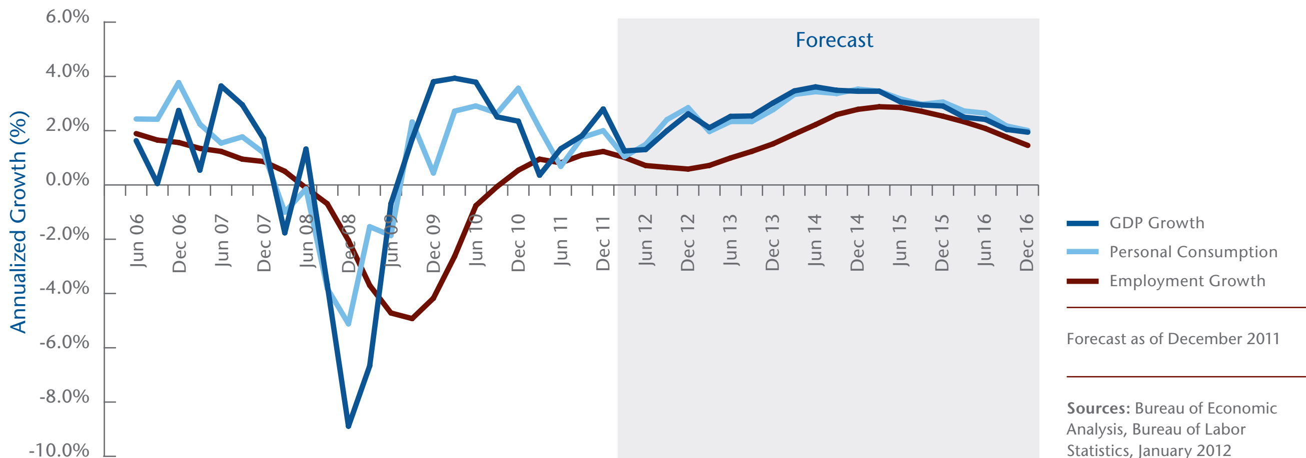


past several quarters that has driven up consumer and corporate borrowing costs). It is likely, however, that China will pause in allowing a continued gradual increase in the value of the renminbi relative to the dollar. That is because China is seeking to increase its export growth, especially given the weakness in Europe and its reduced demand for goods. As a result of reduced demand in some of China's traditional large export markets and import growth resulting from consumer demand in China's emerging middle class, China's trade surplus (both in absolute terms and as a percent of GDP) has been on the decline over the past several months.

All of the above dynamics feed into and influence the outlook for the U.S. economy for 2012 and beyond, including whether the U.S. will be able to decouple somewhat from the slowdown and financial challenges in other economies. Key elements for the coming year include:

- Political uncertainty remains a key risk, with little policy clarity expected until after the 2012 elections (except for monetary policy)
- Monetary policy is becoming more transparent, and the Fed has recently signaled that it expects to continue its very accommodative monetary policy through at least late 2014
- U.S. corporate earnings, while slowing as a result of a less than robust global economy, should continue to grow and, combined with easing levels of labor productivity, allow for relatively consistent private payroll employment growth going forward
- However, a higher than normal level of systemic risk will continue to overhang the global markets, mostly the result of overleveraged governments, especially in Europe. In addition, China and other emerging markets are grappling with the aftermath of high levels of credit formation and capital inflows, inflationary pressures, and whether they can slow their economies without incurring a hard landing
- The risk of a double dip recession in the U.S. in 2012 appears to be easing materially, although disruptive events out of Europe could cause a resurgence in volatility and a subsequent setback in recovery in the U.S. economy or jobs market
- A combination of low Treasury rates (which provide support for real estate cap and borrowing rates) and gradual improvement in space markets as supply (ex-apartments) stays constrained and job growth continues, should allow for continued recovery of commercial real estate property values. However, the pace of appreciation is likely to slow substantially relative to the past several quarters

U.S. ECONOMIC ACTIVITY



2012 ECONOMIC OUTLOOK *continued*

- Headwinds still exist in the U.S. economy, including high energy prices and a still weak housing market. As a result of these factors and an increase in the trade-weighted dollar over the past several months that may challenge the trajectory of exports, U.S. economic growth is likely to remain steady but is not expected to be robust. More specifically, Principal Global Investors expects U.S. real economic growth of about 2.2% in 2012, well below trendline of most historical recoveries. In terms of the jobs market, that level of economic growth would equate to about 1.8–2 million in growth in net payroll employment, most of which will come from the private sector as public sector hiring is expected to remain weak.

Space Markets

Space market fundamentals for all four major property types continued to improve in the fourth quarter of 2011, making it the first year since the onset of the Great Recession in which vacancy rates for all property sectors either held steady or declined. Despite fears that the significant stock market volatility of the second half 2011 might derail net absorption, the office, industrial and multifamily sectors all posted strong quarters of net demand. And while retail net absorption lagged (partially due to limited credit access for small retailers and continued store closings across some chain store brands), tenant demand for all four property types exceeded the amount of new supply delivered to the market.

Despite improved net absorption, year-over-year rental rates remain under pressure with limited instances of sustained landlord pricing power, with the exception of the multifamily sector. In the office, industrial and retail sectors, vacancy rates are still too high in most markets and velocity of net demand not yet strong enough to give most landlords the confidence to hold out for higher rent levels. In contrast, the multifamily sector is already at equilibrium in most markets and the pace of net absorption is sufficiently strong to allow for a restoration of landlord pricing power and thus positive rent growth. Still, with a significant amount of multifamily product currently under construction, the apartment sector is likely currently at or near its peak of pricing power. The delivery of new supply in late 2012 and beyond, along with slowing trajectory of net absorption as the foreclosure-driven transition of households from single family homes to apartments begins to slow, will likely begin to push multifamily vacancy rates upwards albeit in a gradual manner.

Valley Center
Seattle, WA

Despite improved net absorption, year-over-year rental rates remain under pressure with limited instances of sustained landlord pricing power, with the exception of the multifamily sector.

In terms of the market outlook for total returns for the various property types, respondents to the Pension Real Estate Association (PREA) Consensus Survey of the NCREIF Property Index forecast that apartment total returns will continue to outperform all other property types in both 2012 and 2013, despite having the lowest current income component of the property types. This reflects respondents' expectation that while apartment appreciation will slow, it is nevertheless expected by respondents to generate approximately double or triple the rate of appreciation of the other property types over that time frame. However, while apartments should continue to benefit from reasonably strong landlord pricing power and low absolute vacancy rates despite new supply coming on line, the magnitude of further appreciation in multifamily in light of already low cap rates and potential policy changes that could increase rental competition from vacant single family homes remains uncertain.

Respondents to the PREA survey also project that core retail will be the second highest total rate of return performer over the next two years, slightly outpacing office and industrial. That may be a function of expectations that regional malls will continue to perform well, and that investor demand for grocery anchored centers and other properties with long term leases should remain attractive to investors seeking lower volatility. However, the retail sector also faces some headwinds in terms of retailer consolidation, ongoing credit problems for some retailers, and increasing competition from internet retail sales. The retail investment outlook therefore varies depending upon the type of retail format, but as consumer spending comes back (on the heels of continued job growth), both discretionary spending and spending on durable goods (due to pent up demand) should continue to grow.

EXPECTATIONS

2012 ECONOMIC OUTLOOK *continued*

As regards office, little new supply is underway and so the key dynamic is the level of tenant demand, which translates into the strength of white collar job growth. Corporate America has record levels of cash, but whether that cash will be primarily used to buy back stock or for expansion activities that ultimately result in increased job growth remains to be seen. Still, as the job market improves further, office absorption should continue to expand and with it a gradual move back towards office equilibrium. Still, a large volume of office buildings in the distressed debt arena (including office loans in CMBS special servicing) may limit the upside of office (especially lower quality or commodity office space) as buyers of challenged office buildings offer aggressive rents in order to retain existing tenants or steal tenants from weaker competitors. Still, the relative value equation looks appealing for well located, quality office properties that can be purchased at a reasonable discount to replacement costs which, in the hands of well capitalized buyers, can be transitioned through a lease-to-core strategy by taking tenant market share away from competitors.

In the industrial sector, global trade has rebounded but is not yet back to pre-recession levels. In addition, the likelihood of a European recession and a slowing China economy (albeit one which Chinese authorities are trying to re-stimulate) mean that warehouse vacancies will likely decline only gradually. Until the U.S. housing market begins to show sustained improvement, the trajectory of retail and wholesale sales of housing-related durable goods will likely remain constrained. Cost-driven consolidation initiatives in the logistics industry have left the warehouse space markets trifurcated, with the weakest demand in medium-sized buildings catering to tenants in the 150,000 to 300,000 sf range. Tenant demand is strongest at the bookends, both for smaller size bays and for very large boxes, keeping pressure on rental rates for a significant portion of the industrial universe. In addition, while new supply is constrained, there are a number of build-to-suits underway, which are essentially the economic equivalent of speculative new construction as older properties are vacated. These are likely some of the factors behind PREA survey respondents' forecasts that industrial appreciation over the next two years will trail the other primary property types. Fortunately, the industrial sector is not burdened with much distressed debt, which may help buoy values. In addition, for those investors with land holdings, industrial build-to-suit and other pre-leased opportunities will create opportunities for build-to-core strategies.

In summary, the 2012 outlook for space market fundamentals is for new supply to be a material risk factor primarily in the apartment sector.

In summary, the 2012 outlook for space market fundamentals is for new supply to be a material risk factor primarily in the apartment sector. In all other property type sectors, the trajectory of the rebound in demand and thus the magnitude of net absorption will be the most critical factor. If the U.S. economy can maintain a consistent growth pattern, vacancy rates for all property types except apartments are likely to decline over the next two years. Conversely, apartments may experience a modest uptick in vacancy rates but even then will likely still be able to boast the lowest absolute vacancy rates of all property types.

Ally Center
Charlotte, NC

440 S Church
HDR

2012 ECONOMIC OUTLOOK *continued*

Capital Markets: Finding Their Way Back

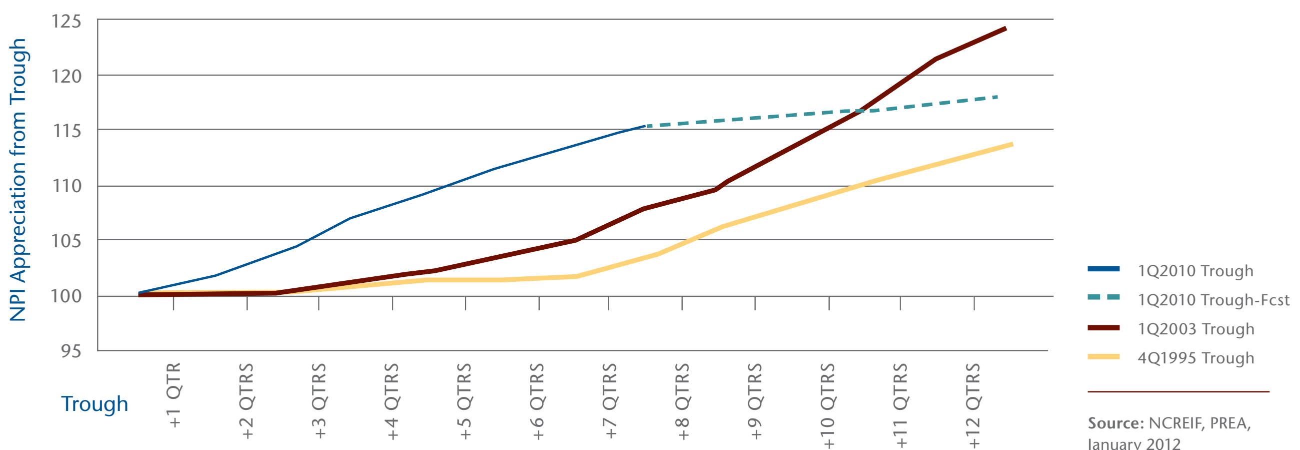
Despite the overall easing in stock market volatility over the past few months, relative value across the four quadrants of real estate continues to take somewhat divergent paths. Publicly traded REITs across most of the globe declined in 2011, although not in the U.S. which (on the back of a strong fourth quarter REIT rally) managed to generate a reasonably strong total return for the third consecutive year. Some of that was due to the high correlation of the REIT market with the broader U.S. stock market, which also rallied in the fourth quarter as volatility eased.

Commercial mortgaged backed securities (CMBS) have also taken advantage of an easing in the broader market volatility, gradually seeing spreads tighten over the past few months, although their rally has not been as strong as in the public REIT sector. Still, spread narrowing has allowed some CMBS issuance shops to resume lending and has led to a moderate pipeline of new CMBS bond issuance beginning to emerge in 2012. Still, unlike the other three quadrants, the CMBS market looks as though it is being priced for the risk of either a recession or extremely slow economic growth, partially because technicals continue to dominate fundamentals in that quadrant.

The private quadrants have undergone some changes as well, including a reduced trajectory of sales transaction volume and tempered pricing aggressiveness in second half 2011. In addition, many portfolio lenders have become slightly more conservative in their lending practices and continue to attempt to hold to rate floors (albeit with mixed results) as long term Treasuries remain near record low levels. Still, despite very low mortgage rates, many life companies see good relative value in senior secured mortgages relative to other fixed income classes.

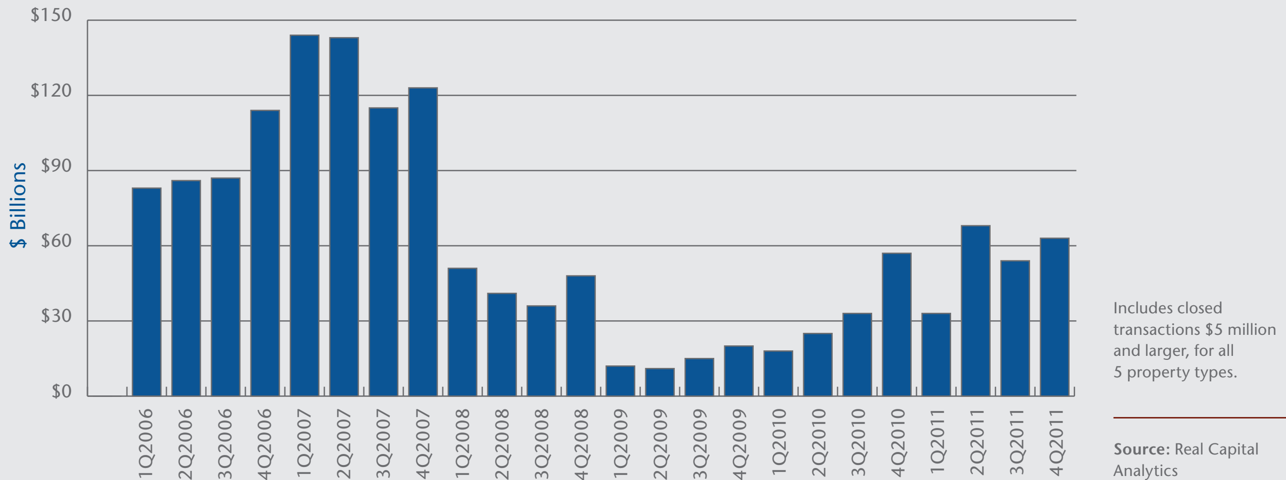
Meanwhile, the private real estate equity quadrant continued to generate appreciation in the second half of 2011, despite the aforementioned volatile markets, slowing sales transactions and some re-trading. However, low Treasury rates, buoyed by the Fed's forecasts that

U.S. – COMPARATIVE NPI APPRECIATION RECOVERY TRAJECTORIES



Source: NCREIF, PREA, January 2012

QUARTERLY TRANSACTION VOLUME



short term rates will remain unchanged for the next three years, lend further support to cap and discount rates. In addition, better economic data coming out of the U.S. (including job growth) and the aforementioned initial elements of potential decoupling are allowing risk aversion to begin to abate, helping partially restore capital flows to commercial real estate.

Core properties have recorded their seventh consecutive quarter of appreciation per data from NCREIF, increasing by a cumulative 15.4% from the trough, but the pace of appreciation unsurprisingly is tapering down. Market expectations are for continued appreciation in 2012, but with a material slowdown. The aforementioned PREA survey of NCREIF estimates generated an expectation of appreciation of core properties of 1.8% and 2.2% in 2012 and 2013, respectively, as shown on the left.

Property sales transactions continue to rebound strongly on a year-over-year basis, but second half 2011's pace of transactions did decelerate slightly, a victim of increased market volatility. While total 2011 transactions reached $218.5 billion, the highest since 2007, the pace of sales activity peaked in second quarter and then declined gradually in the third quarter. Fourth quarter transaction activity rebounded slightly, though it did not reach the level recorded in second quarter. Some of that was also a function of reduced availability of financing, especially given the decline in CMBS lending activity as the year progressed.

PROGRESS

2012 ECONOMIC OUTLOOK *continued*

Most investors continue to focus on core properties, especially high-quality assets in primary markets. However, as space markets improve and prices get driven higher in primary markets, investor strategies have gradually been broadening to include larger secondary markets. In addition, reduced lender emphasis on loan extensions (and thus more resolution-oriented strategies for distressed debt) has resulted in a somewhat greater availability of value-add properties that may offer better relative value on a risk-adjusted basis than core properties. This is especially true for well-capitalized investors that have strong leasing capabilities. In addition, green or sustainable buildings, particularly in the office sector, will be increasingly important in order to maximize tenant bandwidth. The ability to acquire quality value-add assets at relatively steep discounts to reproduction costs can make select value-added opportunities appealing, particularly in sub-markets with a multitude of undercapitalized competitors from which to potentially lure away tenants. In the multifamily sector, low vacancy rates and improved rental levels have made development opportunities increasingly economically feasible, although in some cases stabilized return on costs are quite low, increasing the vulnerability to potential increases in cap rates during the development period.

As the markets head further into 2012, it will be important for space markets to continue their gradual improvement and catch up to the capital market recovery. It is likely that the Fed will keep short rates unchanged over the intermediate term, and in addition will likely try to keep longer Treasury rates low through direct and indirect measures, keeping the forces of asset reflation in place. Given the increased transparency of the Fed, which has suggested that short term rate hikes will not occur until at least 2014, space markets have an opportunity to improve through continued job growth (and limited new supply, ex-apartments) before a removal of ultra-accommodative monetary policy gets underway.

CORE PROPERTIES

Most investors continue to focus on core properties, especially high-quality assets in primary markets.

The Phoenix Apartments
Dallas,TX

ACCOUNT PERFORMANCE

2011 was a year of progress amidst volatility for the Account. Surrounded by unrest in the broader markets and questions regarding the sustainability of recovery, core private equity real estate served as a respite for investors employing a "flight to quality" strategy. Continued investor interest in the asset class and core strategies led to solid return performance, and as such, Account performance was strong on both a nominal and relative basis. Further, Account operations strengthened throughout the year in response to improving debt markets, signs of stabilization in space markets and a continued focus on effective asset management.

Performance of the Account is measured relative to both portfolio level and property level benchmarks. During 2011, the Account outperformed both its portfolio level benchmark, the NCREIF Fund Index – Open-end Diversified Core Equity (NFI-ODCE) Equal Weight and property level benchmark, the open-end fund component of the NCREIF Property Index (NPI). At the portfolio level, the Account outperformed by more than 70 basis points over the one year time period, with approximately 40 basis points of outperformance generated through an above-benchmark income return. Of importance is that although the Account's income return exceeded that of the benchmark, leasing in the Account is slightly lower than that of the NFI-ODCE, with Account occupancy for the total portfolio at 87.2% compared to NFI-ODCE occupancy of 89.0%. This provides the Account with the opportunity to further increase the income return through continued leasing of vacant space in a macroeconomic environment of improving space market fundamentals. Also driving income return outperformance was growth in net operating income. On a year-over-year basis, same-property net operating income (NOI) within the Account increased 4.0% which compares very favorably to a year-over-year NOI decrease of -1.1% for the NFI-ODCE properties. Three year performance of the Account also strengthened considerably on a relative basis, surpassing the benchmark by 45 basis points. Over the five and ten year time periods, Account performance trails that of the benchmark, though the delta over the five year time frame improved throughout the year. At the property level, performance trails that of the benchmark over the three, five and ten year time periods, primarily due to property value declines recorded in late 2008 and 2009.

Of the four primary property sectors, Account assets in the multifamily sector recorded the highest aggregate one year return for the second consecutive year. One year unlevered multifamily performance totaled 19.6%, driven primarily by appreciation of 13.2%. The sector has benefited considerably from marked improvement in space market fundamentals characterized by decreasing vacancy rates and increasing rental rates, in addition to fervent investor demand spurred by ultra-accommodative agency-driven lending. Portfolio multifamily occupancy dipped slightly, from 95.4% at 12/31/2010 to 93.4% at 12/31/2011, which was less a representation of reduced demand and more indicative of the careful balance between increasing rental rates and reducing concessions while maintaining high occupancy levels. Notably, same property multifamily

Account operations strengthened throughout the year in response to improving debt markets, signs of stabilization in space markets and a continued focus on effective asset management.

Cicero
Chicago, IL

NOI increased on a year-over-year basis by 12.7%, with all assets recording an increase save for one well-leased Austin property that recorded a decline of $126,000. The largest dollar increase was recorded at a multifamily property in Cambridge, MA, located in close proximity to the MIT campus. An adjacent parcel is also owned by the Account, on which approval was obtained to commence vertical construction of an additional 144 units beginning spring 2012. This example of the build-to-core strategy is one in which the project will be the first property built in a strong market with limited near-term supply additions.

The industrial sector recorded the second highest aggregate one year returns within the Account, bolstered by recovery in major transportation hubs such as southern California and 2011 net absorption within the sector totaling nearly 900,000 square feet. Annual total property level performance for industrial assets reached 18.7%. Occupancy in the sector increased from 79.1% at 12/31/2010 to 85.0% at 12/31/2011 through continued leasing efforts. Of note was a 504,000 square foot lease signed at a property located in the 7A market of New Jersey. In response to significant leasing over the past two years, NOI for the sector increased on a year-over-year basis by more than $2 million, or 4.7%. The largest dollar increases were generated at the aforementioned 7A property as well as at an asset located in Edison, NJ, and a warehouse facility in the Airport submarket of Atlanta. Only 8% of leases within the sector expire during 2012, providing ample opportunity to continue increasing occupancy and NOI within the sector over the coming year.

Retail assets within the Account posted total performance of 14.8% during 2011, and registered the highest income return of the four sectors at 6.6%. Investor interest in grocery anchored, necessity based formats increased considerably, and nearly 83% of the Account's retail holdings by gross asset value are in neighborhood and community centers. Given the long term leases characteristic of grocery anchored centers, the Account's retail portfolio maintained a strong occupancy position throughout the recession and is well leased today at 94.4% (compared to 93.6% at 12/31/2010). Longer term leases limit some potential for NOI growth, though growth within the sector was positive on a year-over-year basis at 1.4%. The increase was entirely driven by the Account's single power center exposure, an asset located in Los Angeles, CA that is currently 100% leased. Despite very low levels of lease signings throughout the market, the one vacancy at the center generated considerable retailer attention and multiple tenants expressed interest in the space that was ultimately filled with Nordstrom Rack, a significant enhancement to the center. Rollover within the sector in 2012 is very limited, with only 7% of leases expiring over the course of the next year.

ACCOUNT PERFORMANCE *continued*

Finally, the office sector generated the lowest return of the four primary property sectors, though maintained double-digit one year property level performance at 11.6%. The office sector space markets are poised to benefit from additional recovery in the jobs market, though some markets have already registered considerable improvement including New York, Washington, D.C. and San Francisco. At the beginning of 2011, over one million square feet of office leases within the Account were scheduled to expire during the year. Despite this, net absorption within the sector totaled just -33,000 square feet, demonstrating considerable leasing success throughout the year. As regards the four largest lease rollovers, the current tenant was either retained in all or part of the space, or the space was re-leased by year end. The largest lease signed in the sector was a 163,000 square foot lease signed at Charles Park in Cambridge, MA. The asset, one of the ten largest holdings by gross market value within the Account, was 66% leased at 06/30/2011. As of 12/31/2011 and including the new lease, the asset is 93% leased. Despite considerable leasing success, market rental rates today are, in most cases, well below those of leases signed in 2006 and 2007. As such, NOI within the sector is down year over year by -14.3%. The largest contributors to NOI declines include those assets for which there was considerable rollover in 2010 and 2011, though much of the space has since been re-leased. In 2012, 8% of leases expire, presenting an opportunity for renewed NOI growth and increased occupancy.

The year was a positive one for the Account's single hotel investment. Average occupancy for 2011 increased over that recorded in 2010, the hotel's first year of operation. The average daily rate, or ADR, and NOI also increased in 2011.

In addition to property performance, the leverage strategy of the Account remained a primary focus throughout 2011. Leverage was again accretive to total returns, and the positive impact of leverage was further enhanced by the Account's low cost of debt capital.

OPERATIONAL METRICS

PROPERTY SECTOR	OCCUPANCY	OCCUPANCY EXCLUDING VALUE-ADDED PROPERTIES[1]	NET ABSORPTION[2]	YEAR 1 CAP RATE[3]	DISCOUNT RATE (IRR)[3]
Office	84%	86%	(33,002)	5.5%	8.1%
Retail	94%	95%	49,232	6.6%	8.0%
Industrial	85%	92%	897,689	6.0%	8.0%
Multifamily	93%	93%	(69,713)	5.5%	7.3%
TOTAL	**87%**	**91%**	**844,206**	**5.9%**	**8.0%**

[1] Value-added assets include those that are acquired at less than 85% occupancy, are under development or are individual condominium units for sale.

[2] Net absorption reflects change in occupied square feet since the end of the previous year.

[3] Excludes value-added assets.

LEASE EXPIRATION SCHEDULE (FOR THE YEARS ENDING)

	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Office	8%	14%	13%	13%	12%
Industrial	8%	5%	14%	12%	14%
Retail	7%	9%	5%	9%	11%
Total	**7%**	**10%**	**10%**	**11%**	**11%**

SAME-PROPERTY NET OPERATING INCOME (IN $M)

Actual ending 12/31/2010	$249.5
Actual ending 12/31/2011	$259.4
GROWTH	**4.0%**

LEVERAGE INFORMATION	INTEREST RATE	% OF TOTAL DEBT
Fixed Interest Rate Obligations	5.05%	76%
Floating Interest Rate Obligations	2.16%	24%
TOTAL OBLIGATIONS	**4.37%**	**100%**
Secured Obligations	4.37%	83%
Unsecured Obligations	4.39%	17%
TOTAL OBLIGATIONS	**4.37%**	**100%**

At 12/31/2010, the Account's weighted average cost of debt capital totaled 4.55%. This was reduced throughout the course of 2011 to 4.37% with the addition of two new property loans related to acquisition activity totaling $119.0 million and refinancing activity of three loans totaling $148.9 million. Looking to 2012, six property level loans will mature throughout the course of the year totaling $248.8 million. The interest rates on the five fixed rate notes are above current market rates and range from 5.54% to 7.47%. Refinance considerations will include the strategic value of the property to the portfolio and asset-liability matching at both the property and portfolio level. However, given low borrowing spreads available from lenders and the relatively flat yield curve, pursuing fixed rate loans with longer terms is consistent with strategic initiatives. Of the maturities noted, $105.9 million in refinancings are in final stages of negotiation with lending institutions. The refinancing activity of 2012 is anticipated to materially lower the Account's already accretive cost of debt capital.

IMPACT OF MARKING DEBT TO MARKET	
1 YEAR	-0.6%
3 YEARS	-0.4%
5 YEARS	-0.1%
10 YEARS	-0.1%

DEBT MATURITY SCHEDULE[1]

YEAR	DOLLAR AMOUNT ($M)	% OF DEBT MATURING
2012	$248.8	21.7%
2013	$130.2	11.4%
2014	$187.6	16.4%
2015	$136.6	11.9%
2016	$128.7	11.3%
2017+	$312.4	27.3%

[1] Debt maturity schedule is calculated using the principal balance of all outstanding notes, includes the Account's share of non-consolidated joint venture debt and excludes the line of credit. The line of credit had no outstanding balance at 12/31/2011.

Finally, sustainable investment strategies continue to be of great importance to the Account. As green mandates increase in their importance to prospective tenants, LEED and Energy Star Certification contribute value through expense savings, enhanced leasing opportunities and tenant retention. As of 12/31/2010, seven assets in the Account were LEED or LEED EB certified. As demonstration of the Account's continued commitment to sustainable investment, today there are 12 assets in the Account that are LEED or LEED EB certified, including the recently acquired Ally Center. One of the assets certified during 2011 recorded a decline in energy consumption from peak of nearly 14%, resulting in expected energy cost savings of $250,000 over three years. Multiple other assets within the Account are registered for various levels of LEED or Energy Star certification where those efforts are economically feasible and consistent with our fiduciary responsibility to investors.

LEASING

2011 TRANSACTION ACTIVITY

The market for private equity commercial real estate transactions continued to improve during 2011, with both dollar volume and number of sales increasing materially from 2010 totals. According to Real Capital Analytics, nearly $219 billion of real estate was sold during the year, a 63% increase from 2010. Moreover, the number of transactions closed increased from approximately 5,600 in 2010 to nearly 9,300 in 2011. Transaction volume at these levels demonstrates considerable improvement in the market for private equity real estate, though closings remain well below the levels recorded pre-recession. The macroeconomic volatility of the second half of 2011 is also evident, as the pace of closings slowed in the third quarter. Despite heightened risk aversion and some retrenchment in pricing by investors, fourth quarter activity rebounded slightly. Given favorable conditions in the debt markets including low interest rates, replenished lending coffers, and several billion dollars of committed capital waiting to invest in core equity real estate, 2012 transaction volume is likely to rebound further.

Account transaction activity during 2011 was centered on the strategic themes set forth at the beginning of the year: active pursuit of acquisition opportunities; maintenance of a high quality, infill portfolio; increase net operating income; and selectively increase risk tolerance within a core context through execution of lease-to-core and build-to-core investments. Principal Real Estate Investors strives to maintain strong relationships with both national and local market contacts in order to drive transaction volume and source new acquisition opportunities. As a result of that network and the firm's efforts, three of the four acquisitions closed in 2011 were the result of a direct negotiation whereby the transaction was not fully marketed by the seller. In total, acquisition activity was nearly $262 million. The following details each property's key highlights:

2011 Acquisitions

- **Capitol Plaza,** an office asset located in Washington, D.C., was acquired during the third quarter. The asset was built in 2007 and is 98% leased, primarily to government credit tenants with an average lease duration of 8.2 years. As is consistent with Account initiatives, the building is currently registered for and proceeding toward LEED EB Gold certification.
- **Ally Center,** an office asset located in Charlotte, NC, was acquired during the fourth quarter. The asset was built in 2009 and is currently 60% leased, presenting a lease-to-core opportunity in a strengthening, well diversified market.
- Through the forward commitment program, the note for **Shoppes at Woolbright,** a retail center built in 2008 and located in West Palm Beach, FL, was acquired during the fourth quarter. The center, currently 83% leased, is anchored by Publix and located on a primary arterial road within the trade area.
- **Discovery Tower II,** a land parcel in downtown Houston, TX, was acquired through the Account's forward commitment program in conjunction with the sale of Hess Tower during the fourth quarter.

Hess Tower
Houston, TX

2011 TRANSACTION ACTIVITY *continued*

The disposition strategy of the Account was also executed through employment of the aforementioned strategic themes, with a continued focus on reducing exposure to secondary markets and suburban, commodity properties. As such, six transactions were closed at a net sales price (purchase price less closing costs) of $52.4 million. Additional details are included below:

2011 Dispositions

- **Chelmsford,** an industrial asset located outside of Boston, MA, was sold to execute the disposition strategy of reducing exposure to lower-quality, suburban assets.
- The Account's remaining building at **Enterprise Distribution Center** in Rialto, CA, was sold to mitigate exposure to a full building vacancy in a weak submarket.
- **Riverport Distribution Center and Louisville Distribution Center,** industrial properties located in Louisville, KY, were sold to exit Class B properties in a secondary market.
- In a partial sale, ownership of **Lakeside at Lyons,** two office buildings located in Ft. Lauderdale, FL, was transferred to the lender as the cashflow from the asset did not cover the interest payments due to the lender and the market value of the asset was substantially lower than the debt balance.
- Partial sale activity also included the ongoing sale of remaining retail and storage units located at **170 King**, a multifamily and retail asset located in San Francisco, CA.

Additional transaction activity during the year included the sale of two forward commitments. Both assets were built in partnership with a local developer and sold at stabilization. Additional details are included below:

- **Legacy Circle** was sold during the first quarter for $53.6 million. The office building, built in 2009 and located in Dallas, TX, was sold to limit exposure to suburban office assets and to capitalize on market pricing that significantly exceeded the cost to build the asset.
- **Hess Tower,** an office asset built in 2010 and located in downtown Houston, was sold in the fourth quarter. The asset, 100% leased to Hess Corporation, was sold at completion of the property's business plan for $442.5 million or $524 per square foot, setting a new high price per square foot record for an office building in the city.

As of December 31, 2011, four land holdings remain within the Account's forward commitment program, all of which are representative of the Account's current strategy and long term goals as relates to property sectors and market exposure.

FORWARD COMMITMENTS

PROJECT	SECTOR	METROPOLITAN AREA	MAXIMUM LOAN AMOUNT($M)	USPSA LOAN BALANCE ($M)
15th and Island	Land	San Diego, CA	$17.1	$15.1
Stevens Creek	Land	San Jose, CA	$40.3	$34.5
Everett Riverfront	Land	Seattle, WA	$17.3	$15.0
Guasti	Land	Riverside, CA	$49.5	$42.5
TOTAL FORWARD COMMITMENTS			**$124.2**	**$107.1**

TRANSACTIONS

ACQUISITIONS

PROPERTY	SECTOR	METROPOLITAN AREA	SIZE	PRICE ($M)
Capitol Plaza	Office	Washington, D.C.	291,838 sf	$151.8
Ally Center	Office	Charlotte, NC	368,523 sf	$60.5
Discovery Tower II	Land	Houston, TX	0.45 acres	$0.0
Shoppes at Woolbright	Retail	West Palm Beach, FL	146,759 sf	$49.4
				$261.7

DISPOSITIONS

PROPERTY	SECTOR	METROPOLITAN AREA	SIZE	PRICE ($M)
Chelmsford	Industrial	Boston, MA	98,048 sf	$9.7
Lakeside at Lyons[1]	Office	Ft. Lauderdale, FL	41,127 sf	$5.7
Enterprise Distribution Center	Industrial	Riverside, CA	370,335 sf	$17.6
Riverport	Industrial	Louisville, KY	216,000 sf	$7.7
Louisville Distribution Center	Industrial	Louisville, KY	317,900 sf	$11.4
170 King Street[1]	Residential	San Francisco, CA	1 unit	$0.3
				$52.4

FORWARD COMMITMENT DISPOSITIONS

PROPERTY	SECTOR	METROPOLITAN AREA	SIZE	PRICE ($M)
Legacy Circle	Office	Dallas	214,110 sf	$53.6
Hess Tower[1]	Office	Houston	844,763 sf	$442.5
				$496.1

[1] Partial sale

Looking ahead, the transaction strategy for the Account is based upon the following overarching sector-specific themes:

- **Office:** Given little new supply in the pipeline, labor productivity peaking and modest levels of recession-to-date employment growth, the sector is well-positioned to benefit from future economic expansion. As corporations turn to hiring in an effort to increase output, office using employment is expected to rebound. As such, the Account is currently positioned to benefit from improvement in office market fundamentals, with a strategic overweighting to the sector.
- **Retail:** As the economic expansion gains further traction and consumer spending trends upward, the transaction strategy for the retail sector will include targeting a continued overweighting to necessity-based retail formats. These formats, such as grocery anchored neighborhood and community centers, are particularly attractive for investment given potential headwinds for the consumer including increasing commodity prices that may reduce disposable income.
- **Multifamily:** The transaction strategy for the Account includes increasing its weighting to the multifamily sector, with careful consideration for landlord pricing power, which may be peaking in some markets. The current fervor for the sector has resulted in aggressive pricing given low yield requirements by some investors. As such, new properties for the Account are likely to be accessed through build-to-core strategies, executed in markets where there is little new supply underway given barriers to entry and where new development in which the Account participates can be first to market.
- **Industrial:** The Account's transaction strategy within the industrial sector includes maintaining its neutral weight position relative to the NFI-ODCE. The sector is likely to benefit from sustained improvement in the economy, especially as regards job growth that will drive continued consumer spending and demand for goods. As such, the strategy will focus on the warehouse sub-sector and overweighting exposure within major transportation hubs.

SCHEDULE OF INVESTMENTS

PROPERTY	SECTOR	SF/UNITS/ACRES	STRUCTURE	METROPOLITAN AREA	ACQUISITION DATE	GAV (12/31/11)
J.W. Marriott Resort and Spa	Hotel	1,002	Joint Venture	San Antonio, TX	07/31/07	$131,220,909
Bensenville Warehouse	Industrial	202,880	Wholly Owned	Chicago, IL	11/07/88	$9,570,000
Elmhurst Business Park	Industrial	294,954	Wholly Owned	Oakland, CA	12/29/94	$21,400,000
Ontario Distribution Center	Industrial	317,070	Wholly Owned	Riverside, CA	03/04/97	$22,000,000
Secaucus Seaview	Industrial	146,426	Wholly Owned	New York, NY	04/02/97	$13,400,000
Carver Business Center	Industrial	272,460	Wholly Owned	Phoenix, AZ	08/26/97	$17,550,000
Freeport Southwest	Industrial	60,040	Wholly Owned	Houston, TX	09/02/97	$3,300,000
Intercontinental Distribution Center	Industrial	127,257	Wholly Owned	Houston, TX	09/02/97	$6,400,000
Stone Lake 6	Industrial	108,000	Wholly Owned	Austin, TX	05/22/98	$12,900,000
Woodridge Centre	Industrial	100,972	Wholly Owned	Chicago, IL	08/19/98	$7,600,000
3351 Philadelphia	Industrial	203,408	Wholly Owned	Riverside, CA	02/10/99	$12,200,000
Chantilly Distribution Center	Industrial	159,655	Wholly Owned	Washington, D.C.	03/31/99	$14,400,000
Denver Business Center	Industrial	152,841	Wholly Owned	Denver, CO	06/21/99	$7,400,000
NW Distribution Center	Industrial	389,966	Wholly Owned	Houston, TX	07/15/99	$16,900,000
Airport Distribution Center	Industrial	406,989	Wholly Owned	Atlanta, GA	01/05/01	$20,300,000
Secaucus	Industrial	68,439	Wholly Owned	New York, NY	05/02/00	$5,800,000
Fullerton Business Center	Industrial	180,918	Wholly Owned	Santa Ana, CA	02/24/05	$14,100,000
Jurupa Business Park	Industrial	1,077,990	Wholly Owned	Riverside, CA	12/01/02	$76,500,000
Pointe West Commerce Center	Industrial	169,033	Wholly Owned	Fort Lauderdale, FL	12/18/01	$18,400,000
Port 95 Business Plaza	Industrial	99,753	Wholly Owned	Fort Lauderdale, FL	12/18/01	$11,200,000
Valley Centre Corporate Park	Industrial	1,084,409	Wholly Owned	Seattle, WA	01/31/02	$77,800,000
26 Englehard Drive	Industrial	324,540	Wholly Owned	Edison, NJ	12/13/02	$13,000,000
West Winton Industrial Center	Industrial	220,213	Wholly Owned	Oakland, CA	12/06/02	$14,800,000
O'Hare Business Center	Industrial	127,642	Joint Venture	Chicago, IL	11/21/03	$6,300,000
Vapor Industrial	Industrial	414,561	Wholly Owned	Chicago, IL	11/22/05	$30,800,000
Medley Logistics Center	Industrial	300,000	Wholly Owned	Miami, FL	11/20/03	$24,700,000
Fife Commerce Center	Industrial	798,950	Joint Venture	Tacoma, WA	07/27/04	$55,100,000
University Crossing	Industrial	455,870	Wholly Owned	Chicago, IL	01/16/07	$18,300,000
Smithway Commerce Center	Industrial	329,267	Wholly Owned	Los Angeles, CA	10/19/04	$32,700,000
Bedford Park	Industrial	341,144	Wholly Owned	Chicago, IL	10/09/07	$14,300,000

PROPERTY	SECTOR	SF/UNITS/ACRES	STRUCTURE	METROPOLITAN AREA	ACQUISITION DATE	GAV (12/31/11)
Costco Way	Industrial	1,223,320	Wholly Owned	Edison, NJ	06/27/07	$25,800,000
West Manor Way	Industrial	905,000	Wholly Owned	Trenton, NJ	10/23/07	$36,200,000
O'Brien Drive	Industrial	70,125	Joint Venture	San Francisco, CA	01/10/07	$15,600,000
Technology Park	Industrial	224,110	Joint Venture	Detroit, MI	01/29/07	$7,300,000
Melrose Park	Industrial	139,331	Wholly Owned	Chicago, IL	04/02/10	$7,300,000
Cicero	Industrial	113,948	Wholly Owned	Chicago, IL	10/28/09	$8,200,000
1500 Rahway	Industrial	326,741	Joint Venture	Edison, NJ	12/20/07	$25,700,000
1980 U.S. Highway 1	Industrial	247,830	Joint Venture	Edison, NJ	10/01/07	$13,800,000
Boynton Commerce Center	Industrial	295,576	Wholly Owned	West Palm Beach, FL	10/25/07	$22,000,000
Lyons Technology Center	Industrial	232,887	Wholly Owned	Fort Lauderdale, FL	04/23/08	$20,600,000
Airspace I, II, III	Industrial	779,426	Wholly Owned	Louisville, KY-IN	12/13/07	$29,200,000
Amber Glen	Industrial/ Office/Land	580,549	Wholly Owned	Portland, OR	11/15/04	$63,900,000
Hacienda Business Park	Industrial/ Office/Retail	380,372	Joint Venture	Oakland, CA	06/27/07	$56,200,000
Quarry Oaks	Land	10.01 ACRES	Wholly Owned	Austin, TX	06/27/03	$720,000
Discovery Tower II	Land	0.45 ACRES	Joint Venture	Houston, TX	12/22/11	$4,000,000
Oak Grove Shoppes	Land	1 ACRE	Joint Venture	Orlando, FL	05/26/06	$200,000
Lindenhurst Village Green	Land	55 ACRES	Wholly Owned	Lake County, IL	10/16/09	$6,900,000
Watermark II	Land	1.10 ACRES	Wholly Owned	Cambridge, MA	09/03/10	$7,920,000
Henderson Lofts	Land	16.25 ACRES	Wholly Owned	Las Vegas, NV	12/03/08	$2,520,000
Riverside Station	Land	11 ACRES	Joint Venture	Washington, D.C.	07/30/07	$7,450,000
100 East Las Olas	Land	0.89 ACRE	Joint Venture	Fort Lauderdale, FL	10/04/07	$5,000,000
Santa Trinita	Land	4.56 ACRES	Wholly Owned	San Jose, CA	10/15/09	$7,100,000
The Trestles Apartments	Multifamily	188	Wholly Owned	Houston, TX	03/30/01	$19,000,000
The Phoenix Apartments	Multifamily	449	Wholly Owned	Dallas, TX	07/17/01	$56,200,000
170 King Street	Multifamily	1	Joint Venture	San Francisco, CA	07/08/03	$450,000
Watermark I	Multifamily	321	Joint Venture	Cambridge, MA	11/06/03	$148,500,000
420 West 42nd Street	Multifamily	264	Wholly Owned	New York, NY	11/12/03	$101,000,000
Tanglewood Apartments	Multifamily	838	Wholly Owned	Chicago, IL	09/25/03	$64,700,000
Market Center West	Multifamily	221	Joint Venture	Baltimore, MD	02/15/06	$33,900,000
Ravello Apartments	Multifamily	290	Wholly Owned	Dallas, TX	03/29/06	$62,600,000

SCHEDULE OF INVESTMENTS *continued*

PROPERTY	SECTOR	SF/UNITS/ACRES	STRUCTURE	METROPOLITAN AREA	ACQUISITION DATE	GAV (12/31/11)
San Portella	Multifamily	308	Joint Venture	Phoenix, AZ	06/21/06	$45,100,000
West Campus Phase I	Multifamily	482	Joint Venture	Austin, TX	08/21/07	$54,400,000
West Campus Phase II	Multifamily	970	Wholly Owned	Austin, TX	09/15/09	$92,900,000
Hardin House	Multifamily	228	Joint Venture	Austin, TX	01/17/07	$23,100,000
Channel Point Apartments	Multifamily	212	Wholly Owned	Los Angeles, CA	10/01/07	$56,500,000
Premier Lofts	Multifamily	250	Wholly Owned	Denver, CO	01/03/02	$55,800,000
EpiCenter	Multifamily /Retail	134,681/130	Wholly Owned	Seattle, WA	04/01/06	$38,200,000
The Signature Center	Office	257,686	Wholly Owned	Oakland, CA	08/24/95	$37,300,000
Cascades	Office	168,006	Wholly Owned	Columbus, OH	10/30/97	$6,800,000
Honeywell	Office	40,429	Wholly Owned	Columbus, OH	06/30/98	$2,300,000
Stonelake 1-5	Office	123,761	Wholly Owned	Austin, TX	07/10/98	$15,000,000
Freeport Parkway	Office	151,200	Wholly Owned	Dallas, TX	12/29/99	$14,300,000
Metroplex	Office	104,903	Wholly Owned	Santa Ana, CA	06/02/05	$18,500,000
Lincoln Plaza	Office	148,503	Wholly Owned	Seattle, WA	06/24/05	$44,700,000
Union Tower	Office	332,608	Wholly Owned	Chicago, IL	11/22/02	$55,000,000
Quarry Oaks	Office	292,417	Wholly Owned	Austin, TX	07/03/03	$68,300,000
Charles Park	Office	369,371	Wholly Owned	Cambridge, MA	02/16/05	$108,700,000
Ally Center	Office	368,523	Joint Venture	Charlotte, NC	10/03/11	$60,800,000
112th at 12th Street	Office	480,267	Wholly Owned	Seattle, WA	06/29/04	$203,100,000
Papago Buttes	Office	511,081	Wholly Owned	Phoenix, AZ	11/18/04	$90,400,000
20 Greenway Plaza	Office	430,236	Wholly Owned	Houston, TX	09/19/05	$62,600,000
Campbell Mithun Tower	Office	729,638	Wholly Owned	Minneapolis, MN	09/14/05	$85,300,000
90 Mountainview	Office	183,644	Wholly Owned	Phoenix, AZ	06/07/06	$32,900,000
One DTC	Office	238,848	Wholly Owned	Denver, CO	07/26/07	$40,900,000
Crescent V	Office	89,895	Wholly Owned	Denver, CO	07/26/07	$12,800,000
Crescent VI	Office	134,741	Wholly Owned	Denver, CO	07/26/07	$19,500,000
Spring Mall Office Building	Office	114,008	Joint Venture	Washington, D.C.	11/16/07	$19,800,000
150 Spear Street	Office	262,319	Wholly Owned	San Francisco, CA	12/11/07	$95,100,000
Portales Corporate Center	Office	453,444	Wholly Owned	Phoenix, AZ	03/06/08	$111,500,000
1370 Avenue of the Americas	Office	338,880	Wholly Owned	New York, NY	03/23/06	$259,800,000

PROPERTY	SECTOR	SF/UNITS/ACRES	STRUCTURE	METROPOLITAN AREA	ACQUISITION DATE	GAV (12/31/11)
Capitol Plaza	Office	291,838	Wholly Owned	Washington, D.C.	07/08/11	$152,300,000
Fountainhead	Office/ Land	476,172	Wholly Owned	Phoenix, AZ	06/29/05	$57,500,000
Hazard Center	Office/ Retail	405,608	Wholly Owned	San Diego, CA	09/04/03	$104,600,000
North Avenue Collection	Office/ Retail	199,683	Wholly Owned	Chicago, IL	12/29/04	$63,100,000
Grand Hunt Center	Retail	133,360	Wholly Owned	Lake County, IL	12/15/94	$16,900,000
Peninsula Center	Retail	296,027	Wholly Owned	Los Angeles, CA	06/30/00	$81,000,000
Southdale Square	Retail	116,024	Wholly Owned	Minneapolis, MN	12/19/00	$28,100,000
Old Town Square	Retail	87,123	Wholly Owned	Chicago, IL	11/15/01	$29,100,000
Fischer Market Place	Retail	233,308	Wholly Owned	Minneapolis, MN	09/29/03	$36,300,000
Plaza Paseo	Retail	147,832	Joint Venture	San Diego, CA	12/30/03	$72,800,000
Stony Island	Retail	159,785	Wholly Owned	Chicago, IL	12/17/04	$23,600,000
Cherry Hills	Retail	202,195	Wholly Owned	Denver, CO	06/17/04	$39,100,000
Bell Tower Shops	Retail	325,697	Joint Venture	Cape Coral, FL	08/17/04	$70,300,000
The Marketplace at Vernon Hills	Retail	191,418	Wholly Owned	Lake County, IL	09/13/05	$26,600,000
Burbank Empire Center	Retail	618,562	Wholly Owned	Los Angeles, CA	12/22/05	$189,800,000
Meadows Marketplace	Retail	251,944	Joint Venture	Houston, TX	08/29/06	$53,200,000
Lake Worth Marketplace	Retail	197,332	Wholly Owned	Fort Worth, TX	10/11/07	$29,000,000
Backlick Center	Retail	47,977	Joint Venture	Washington, D.C.	11/16/07	$18,000,000
Sacramento Shopping Center	Retail	84,466	Joint Venture	Washington, D.C.	11/16/07	$14,400,000
Sterling Plaza Center	Retail	153,311	Joint Venture	Washington, D.C.	11/16/07	$29,700,000
Sterling Plaza II	Retail	22,480	Joint Venture	Washington, D.C.	11/16/07	$4,500,000
West Springfield Shopping Center	Retail	83,733	Joint Venture	Washington, D.C.	11/16/07	$30,000,000
Fischer Market Place	Retail	20,388	Wholly Owned	Minneapolis, MN	10/16/07	$5,000,000
Shoppes at Woolbright	Retail	146,759	Wholly Owned	West Palm Beach, FL	12/27/11	$49,558,723
Pinewood Square Shopping Center	Retail	182,140	Wholly Owned	West Palm Beach, FL	06/16/05	$46,700,000
Lantana Square	Retail	113,565	Wholly Owned	West Palm Beach, FL	03/17/06	$23,300,000
Southport Shopping Center	Retail	146,833	Wholly Owned	Fort Lauderdale, FL	01/22/03	$40,600,000

$4,756,759,632

INDEPENDENT AUDITORS' REPORT

TO THE CONTRACTHOLDERS OF
PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
DES MOINES, IOWA

We have audited the accompanying consolidated statements of assets and liabilities of Principal Life Insurance Company U.S. Property Separate Account (the "Account"), including the consolidated schedules of investments, as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Account's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Account's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Account as of December 31, 2011 and 2010, the results of its operations, changes in its net assets, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, the financial statements consist substantially of assets and liabilities whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on independent appraisals or internally prepared valuations.

Deloitte & Touche LLP

Des Moines, Iowa
March 1, 2012

AUDITED FINANCIAL STATEMENTS

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES
AS OF DECEMBER 31, 2011 AND 2010

	2011	2010
ASSETS:		
Investments — at fair value:		
Real estate (cost: 2011 — $4,781,664,311; 2010 — $4,550,391,976)	$ 4,575,980,000	$ 3,984,110,000
Real estate joint ventures (cost: 2011 — $51,196,816; 2010 — $51,700,315)	31,252,765	27,496,341
Mortgage loan receivable (cost: 2011 — $49,379,835; 2010 — $0)	49,558,723	-
Short-term investments (cost: 2011 — $262,259,578; 2010 — $17,666,114)	262,259,578	17,666,114
Total investments (cost: 2011 — $5,144,500,540; 2010 — $4,619,758,405)	4,919,051,066	4,029,272,455
Cash	14,605,362	18,266,500
Accrued investment income and other assets	44,091,229	37,388,989
Deposits on investment commitments	68,052,740	70,302,740
Unrealized gain on investment commitments	-	56,820,353
Total assets	5,045,800,397	4,212,051,037
LIABILITIES:		
Line of credit — at fair value (cost: 2011 — $0; 2010 — $50,000,000)	-	50,000,000
Debt — at fair value (cost: 2011 — $1,041,781,482; 2010 — $938,135,040)	1,036,821,087	921,062,040
Accounts payable and accrued expenses	71,264,209	83,394,213
Accrued property taxes	20,743,877	21,572,614
Security deposits	14,251,628	13,389,294
Unrealized loss on investment commitments	79,890,158	64,351,596
Total liabilities	1,222,970,959	1,153,769,757
NET ASSETS:		
U.S. Property Separate Account	3,755,393,314	3,014,371,214
Noncontrolling interests	67,436,124	43,910,066
Net assets	$ 3,822,829,438	$ 3,058,281,280

See notes to consolidated financial statements.

AUDITED FINANCIAL STATEMENTS

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
CONSOLIDATED SCHEDULES OF INVESTMENTS
AS OF DECEMBER 31, 2011 AND 2010

	Fair Value 2011	Fair Value 2010
REAL ESTATE — 93.1% in 2011 and 98.9% in 2010		
United States:		
Office — 36.8% in 2011 and 36.6% in 2010		
One Twelfth at Twelfth, Bellevue, WA	$ 203,100,000	$ 183,300,000
1370 Avenue of the Americas, New York, NY	259,800,000	247,200,000
Other office	1,344,700,000	1,042,880,000
Total office (cost: 2011 — $2,105,659,470; 2010 — $1,856,574,012)	1,807,600,000	1,473,380,000
Retail — 20.8% in 2011 and 23.3% in 2010		
Burbank Empire Center, Burbank, CA	189,800,000	161,800,000
Other retail	832,200,000	778,400,000
Total retail (cost: 2011 — $1,003,159,763; 2010 — $991,159,754)	1,022,000,000	940,200,000
Industrial — 17.4% in 2011 and 19.7% in 2010 (cost: 2011 — $857,015,022; 2010 — $893,932,792)	855,820,000	794,630,000
Multifamily — 16.7% in 2011 and 17.9% in 2010 (cost: 2011 — $710,254,279; 2010 — $704,223,363)	821,850,000	720,940,000
Land — 1.4% in 2011 and 2010 (cost: 2011 — $105,575,777; 2010 — $104,502,055)	68,710,000	54,960,000
Total real estate (cost: 2011 — $4,781,664,311; 2010 — $4,550,391,976)	4,575,980,000	3,984,110,000
REAL ESTATE JOINT VENTURES — 0.6% in 2011 and 0.7% in 2010		
United States:		
Hotel — 0.6% in 2011 and 2010 (cost: 2011 — $51,196,816; 2010 — $50,000,000)	31,252,765	24,996,341
Retail — 0.0% in 2011 and 0.1% in 2010 (cost: 2011 — $0; 2010 — $1,700,315)	-	2,500,000
Total real estate joint ventures (cost: 2011 — $51,196,816; 2010 — $51,700,315)	31,252,765	27,496,341
MORTGAGE LOAN RECEIVABLE — 1.0% in 2011 and 0.0% in 2010		
United States:		
Retail (cost: 2011 — $49,379,835; 2010 — $0)	49,558,723	-
SHORT-TERM INVESTMENTS — 5.3% in 2011 and 0.4% in 2010		
Principal Life Insurance Company Money Market		
Separate Account — 4.3% in 2011 and 0.3% in 2010 (cost: 2011 — $210,659,667; 2010 — $12,496,114)*	210,659,667	12,496,114
Short-Term Investment Trust Government & Agency Portfolio — 1.0% in 2011 and 0.1% in 2010 (cost: 2011 — $51,170,000; 2010 — $5,170,000)	51,170,000	5,170,000
United States Treasury Bills — 0.0% in 2011 and 2010 (cost: 2011 — $429,911; 2010 — $0)	429,911	-
Total short-term investments (cost: 2011 — $262,259,578; 2010 — $17,666,114)	262,259,578	17,666,114
TOTAL INVESTMENTS — 100% (cost: 2011 — $5,144,500,540; 2010 — $4,619,758,405)	$ 4,919,051,066	$ 4,029,272,455

* Principal Life Insurance Company is an affiliate of the Account.

See notes to consolidated financial statements.

AUDITED FINANCIAL STATEMENTS

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
INVESTMENT INCOME (LOSS):		
Revenue from real estate	$ 428,849,335	$ 461,569,981
Equity in income (loss) of real estate joint ventures	4,388,380	(1,156,821)
Interest income on short-term investments	593,532	156,874
Total investment income	433,831,247	460,570,034
EXPENSES:		
Real estate expenses and taxes	182,275,794	190,801,299
Interest expense	50,115,353	51,023,676
Investment management fees	35,764,450	34,404,250
Professional and other fees	4,598,596	6,563,138
Total expenses	272,754,193	282,792,363
NET INVESTMENT INCOME	161,077,054	177,777,671
REALIZED AND UNREALIZED GAIN (LOSS):		
Realized gain (loss) from sales	71,766,174	(276,715,456)
Less previously recorded unrealized loss (gain) on sales	(47,468,134)	312,189,824
Net gain recognized from sales	24,298,040	35,474,368
Unrealized gain on investments, investment commitments, and debt	325,641,208	257,052,996
Net realized and unrealized gain	349,939,248	292,527,364
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	511,016,302	470,305,035
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS ATTRIBUTABLE TO NONCONTROLLING INTERESTS	23,163,672	14,990,504
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS ATTRIBUTABLE TO U.S. PROPERTY SEPARATE ACCOUNT	$ 487,852,630	$ 455,314,531
AMOUNTS ATTRIBUTABLE TO U.S. PROPERTY SEPARATE ACCOUNT:		
Net investment income	$ 158,284,933	$ 174,841,349
Net realized and unrealized gain	329,567,697	280,473,182
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS ATTRIBUTABLE TO U.S. PROPERTY SEPARATE ACCOUNT	$ 487,852,630	$ 455,314,531

See notes to consolidated financial statements.

AUDITED FINANCIAL STATEMENTS

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	U.S. Property Separate Account	Noncontrolling Interests	Total
NET ASSETS — January 1, 2010	$ 3,416,624,550	$ 33,299,751	$ 3,449,924,301
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS:			
Net investment income	174,841,349	2,936,322	177,777,671
Net realized and unrealized gain	280,473,182	12,054,182	292,527,364
Net increase in net assets resulting from operations	455,314,531	14,990,504	470,305,035
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM CAPITAL TRANSACTIONS:			
Contributions	304,872,426	1,373,411	306,245,837
Distributions	(1,162,440,293)	(5,753,600)	(1,168,193,893)
Net decrease in net assets resulting from capital transactions	(857,567,867)	(4,380,189)	(861,948,056)
NET INCREASE (DECREASE) IN NET ASSETS	(402,253,336)	10,610,315	(391,643,021)
NET ASSETS — December 31, 2010	3,014,371,214	43,910,066	3,058,281,280
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS:			
Net investment income	158,284,933	2,792,121	161,077,054
Net realized and unrealized gain	329,567,697	20,371,551	349,939,248
Net increase in net assets resulting from operations	487,852,630	23,163,672	511,016,302
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM CAPITAL TRANSACTIONS:			
Contributions	771,181,400	2,991,156	774,172,556
Distributions	(518,011,930)	(2,628,770)	(520,640,700)
Net increase in net assets resulting from capital transactions	253,169,470	362,386	253,531,856
NET INCREASE IN NET ASSETS	741,022,100	23,526,058	764,548,158
NET ASSETS — December 31, 2011	$ 3,755,393,314	$ 67,436,124	$ 3,822,829,438

See notes to consolidated financial statements.

AUDITED FINANCIAL STATEMENTS

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net increase in net assets resulting from operations	$ 511,016,302	$ 470,305,035
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities:		
Net realized and unrealized gain	(349,939,248)	(292,527,364)
Equity in loss (income) of real estate joint ventures	(4,388,380)	1,156,821
Changes in:		
Accrued investment income and other assets	(3,291,137)	5,415,608
Accounts payable and accrued expenses	(1,416,228)	(22,664,952)
Accrued property taxes	(828,737)	(3,445,183)
Security deposits	862,334	(818,184)
Total adjustments	(359,001,396)	(312,883,254)
Net cash provided by operating activities	152,014,906	157,421,781
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from real estate investment sales	46,717,636	677,773,826
Purchases of real estate investments and improvements	(283,824,254)	(92,087,413)
Distributions from real estate joint ventures	2,500,000	5,942,276
Purchase of mortgage loan receivable	(49,379,835)	-
Net change in short-term investments	(244,593,464)	(17,666,114)
Net change in escrows and other restricted assets	2,160,763	(161,713)
Proceeds from investment commitment sales	77,962,158	-
Refund of deposits on investment commitments	27,797,598	-
Deposits on investment commitments	(25,547,598)	(13,504,194)
Net cash provided by (used in) investing activities	(446,206,996)	560,296,668
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of financing costs	(1,544,306)	(4,730,847)
Borrowings on line of credit	145,000,000	722,000,000
Repayments on line of credit	(195,000,000)	(672,000,000)
Proceeds from borrowings and issuance of debt	240,058,396	311,065,000
Repayments of debt	(130,694,621)	(308,644,139)
Contractholder contributions	767,153,982	304,872,426
Contractholder distributions	(534,804,885)	(1,139,574,829)
Noncontrolling interests contributions	2,991,156	1,373,411
Noncontrolling interests distributions	(2,628,770)	(5,753,600)
Net cash provided by (used in) financing activities	290,530,952	(791,392,578)
NET DECREASE IN CASH	(3,661,138)	(73,674,129)
CASH:		
Beginning of year	18,266,500	91,940,629
End of year	$ 14,605,362	$ 18,266,500
SUPPLEMENTAL DISCLOSURE OF CASH PAID FOR INTEREST	$ 50,174,822	$ 51,937,858

(Continued)

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

The Account had accrued but unpaid purchases of real estate improvements of $46,415,857 and $40,336,820 as of December 31, 2011 and 2010, respectively.

In connection with real estate investment sales or similar transactions (i.e. foreclosures, deed in lieu) in 2011 and 2010, the buyers or other parties to the transaction assumed $5,717,333 and $112,298,000, respectively, of debt from the Account.

The Account processed contribution and distribution requests from contractholders of $4,027,418 and $4,981,136, respectively, on December 31, 2011. The Account processed distribution requests from contractholders of $22,865,464 on December 31, 2010. These contribution and distribution amounts are included in accrued investment income and other assets and accounts payable and accrued expenses in the consolidated statements of assets and liabilities, respectively.

See notes to consolidated financial statements.

(Concluded)

AUDITED FINANCIAL STATEMENTS

PRINCIPAL LIFE INSURANCE COMPANY U.S. PROPERTY SEPARATE ACCOUNT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

1. ORGANIZATION

Principal Life Insurance Company U.S. Property Separate Account (the "Account") is an open-end, commingled real estate account and a separate account of Principal Life Insurance Company ("Principal Life") established in 1982 in accordance with the provisions of the State of Iowa insurance laws. Pursuant to such laws, the net assets of the Account are not chargeable with liabilities arising out of any business of Principal Life. Participation in the Account is available through the purchase of certain group contracts and policies issued by Principal Life. The investment advisor is Principal Real Estate Investors, LLC (PrinREI), a wholly-owned subsidiary of Principal Life. The Account is a diversified real estate equity account consisting primarily of high quality, well-leased real estate properties in the multifamily, industrial, office, retail and hotel sectors.

Principal Life has the ability to apply a contractual limitation which delays the payment of withdrawal requests (a "Withdrawal Limitation"). If the Withdrawal Limitation were applied, withdrawal requests included within the Withdrawal Limitation would be paid on a pro rata basis as cash becomes available for distribution, as determined by Principal Life.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The accompanying consolidated financial statements of the Account have been presented in conformity with accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements of the Account include the accounts of its wholly-owned and controlled real estate investments. All intercompany transactions are eliminated in the consolidation.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

The real estate and capital markets are cyclical in nature. Real estate investment and debt values are affected by, among other things, the availability of capital, occupancy rates, rental rates, interest rates, and inflation rates. As a result, determining such values involves many assumptions. Amounts ultimately realized may vary significantly from the fair values presented.

Risks and Uncertainties — The Account invests in commercial real estate properties located throughout the United States that are bought and sold in private market transactions. The Account's estimates of fair value are based on the best information available to management as of the date of the valuation. Certain market conditions that impact commercial real estate transaction markets may impact the availability of observable inputs. Should market conditions or management's assumptions change, the Account may record realized and unrealized losses or gains in future periods.

Concentration of Credit Risk — The Account invests its cash primarily in deposit accounts and short-term investments, including money market funds, with financial institutions. At times, cash balances at financial institutions may exceed the federally insured amounts. The Account believes it mitigates credit risk by depositing cash in or investing through major financial institutions. In addition, in the normal course of business, the Account extends credit to its tenants, which consist of local, regional, and national-based tenants. The Account does not believe this represents a material risk of loss with respect to its financial position.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *continued*

Real Estate — Real estate investments are carried at fair value. Properties owned are initially recorded at the purchase price plus closing costs. Development costs and major renovations are capitalized as a component of cost, and routine maintenance and repairs are charged to expense as incurred. Real estate costs include the cost of acquired property, including all tangible and intangible assets. Tangible assets include the value of all land, building, and tenant improvements at the time of acquisition. Intangible assets include the value of any above and below market leases, in-place leases, and tenant relationships at the time of acquisition. Real estate costs also include leasing or similar costs paid to third parties to obtain tenants. The cost of real estate investments presented in the accompanying consolidated statements of assets and liabilities includes approximately $115,300,000 and $98,000,000 of leasing costs as of December 31, 2011 and 2010, respectively. The Account does not record depreciation or amortization on real estate as fair value estimates take into consideration the effect of physical depreciation.

Real Estate Joint Ventures — Investment in real estate joint ventures is comprised of joint ventures over which the Account does not have majority control, but over which it has significant influence. The investments are included in the accompanying consolidated statements of assets and liabilities at the Account's ratable share of the fair value of the underlying net assets of the joint ventures, adjusted for the terms of the joint venture agreements. Equity in income (loss) of real estate joint ventures represents the Account's share of the current year's joint venture income (loss) as provided for under the terms of the joint venture agreements and is included in net investment income in the accompanying consolidated statements of operations. The Account's ratable share of the change in the fair value of the joint ventures is reported in realized and unrealized gain (loss) in the accompanying consolidated statements of operations. Contributions to and distributions from the joint ventures are recorded when remitted and received by the Account, respectively.

Mortgage Loan Receivable — Investment in mortgage loan receivable is carried at fair value, equivalent to the lesser of the fair value of the underlying real estate asset or contractual cash flows discounted using current interest rates at which similar advances would be made with similar terms.

Short-Term Investments — Short-term investments are comprised of money market funds and U.S. Treasury obligations and are recorded at fair value.

Cash — Cash includes cash on hand and demand deposit accounts.

Accrued Investment Income and Other Assets — Accrued investment income and other assets consists of the following: (i) escrows and other restricted assets including real estate tax, real estate improvement, and insurance escrows that are required as part of debt agreements, and security and utility deposits ($13,847,001 and $16,007,764 as of December 31, 2011 and 2010, respectively), (ii) tenant receivables, and (iii) prepaid expenses. These amounts are recorded at cost, which approximates fair value.

Debt — With the adoption of the fair value option, and at the election of Account management, debt is carried at fair value.

Other Liabilities — Accounts payable and accrued expenses, accrued property taxes, and security deposits are recorded at cost, which approximates fair value.

Noncontrolling Interests — The Account has entered into joint development relationships with other external investors to acquire and develop real estate properties. The Account is the majority owner in such projects and has control over decision making. Accordingly, the underlying assets and liabilities of the projects are consolidated into the Account's financial statements, with the external investors' net share of net assets reflected as noncontrolling interests. Certain external investors earn additional equity if the estimated rate of return of the real estate property that they are invested in exceeds a contractually determined rate. This additional equity allocation is accrued or reversed at the same time that the underlying real estate property appreciates or depreciates, respectively.

Revenue Recognition — Rental income is recognized as income when earned in accordance with the terms of the respective leases. Reimbursements from tenants for common area costs are recognized monthly based on an estimate of annual costs, subject to periodic adjustments to reflect actual costs.

Income Taxes — According to current provisions of the Internal Revenue Code pertaining to tax qualified separate accounts, no income taxes are attributable to the activities of the Account. As a result, income taxes are not reflected in the accompanying consolidated financial statements.

Recent Accounting Pronouncements — In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements,* which, among other things, amends Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures,* to require entities to separately present purchases, sales, issuances, and settlements in their reconciliation of Level 3 fair value measurements (i.e. to present such items on a gross basis rather than on a net basis). The adoption of ASU 2010-06 impacted 2011 disclosures only.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* This guidance expands the qualitative and quantitative fair value disclosure requirements for Level 3 fair value measurements. The new guidance is effective for reporting periods beginning after December 15, 2011. The Account is currently evaluating the impact of this guidance on its consolidated financial statement disclosures.

3. FAIR VALUE MEASUREMENTS

In determining fair value, the Account uses various valuation approaches. ASC 820, *Fair Value Measurements and Disclosures,* establishes a fair value measurement framework, provides a single definition of fair value, and requires expanded disclosure summarizing fair value measurements. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability.

The standard establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable input be used when available. Observable inputs are inputs that the market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Account. Unobservable inputs are inputs that reflect the Account's judgments about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is measured in three levels based on the reliability of inputs:

Level 1 — Valuations based on quoted prices in active markets for identical assets or liabilities that the Account has the ability to access.

Level 2 — Valuations based on quoted prices in less active, dealer, or broker markets. Fair values are primarily obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 — Valuations derived from other valuation methodologies, including pricing models, discounted cash flow models, and similar techniques, and not based on market, exchange, dealer, or broker-traded transactions. Level 3 valuations incorporate certain assumptions and projections that are not observable in the market and significant professional judgment in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

3. FAIR VALUE MEASUREMENTS *continued*

The following is a description of the valuation techniques used for investments measured at fair value:

Real Estate — Real estate values are based upon independent appraisals or internally prepared valuations. An independent consultant (the "Valuation Consultant") selected by PrinREI oversees and administers the appraisal process for the Account. Real estate investments are stated at fair value as determined by the Valuation Consultant and approved by Account management. Appraisals are performed for each investment annually by independent third party MAI certified appraisers with all appraisals being performed in accordance with the Uniform Standard of Professional Appraisal Practice. Thereafter, values are updated daily by the Valuation Consultant based on changes in factors such as occupancy levels, lease rates, overall market conditions, and capital improvements. Determination of fair value involves subjective judgment because the actual fair value of real estate can be determined only by negotiation between the parties in a sales transaction.

The values of real estate investments have been estimated giving consideration to one or more of the following valuation approaches: (i) income, (ii) cost, and (iii) sales comparison. The income approach estimates an income stream for a property (typically 10 years) and discounts this income plus a reversion (presumed sale) into a present value at a risk adjusted rate. Significant inputs to the income approach include discount rates, terminal capitalization rates, and rent information, including current and projected rental and expense growth rates, all of which are derived from underlying lease contracts and market transactions, as well as other industry and market data. The cost approach estimates the replacement cost of the building less physical depreciation plus the land value. Generally, this approach provides a check on the value derived using the income approach. The sales comparison approach compares recent transactions to the appraised property. Adjustments are made for dissimilarities which typically provide a range of value. Generally, the income approach carries the most weight in the value reconciliation.

The values of real estate investments undergoing development have been prepared giving consideration to costs incurred to date and key development risk factors, including entitlement risk, construction risk, leasing/sales risk, operation expense risk, credit risk, capital market risk, pricing risk, event risk, and valuation risk. The fair value of investments undergoing development includes the timely recognition of estimated entrepreneurial profit after consideration of the items identified above.

The values of real estate investments do not reflect transaction sale costs, which may be incurred upon disposition of the real estate investments.

The Account's real estate investments are generally classified within Level 3 of the valuation hierarchy.

Real Estate Joint Ventures — Real estate joint ventures are stated at the fair value of the Account's ownership interests of the underlying entity. The Account's ownership interests are valued based on the fair value of the underlying assets and liabilities including the underlying real estate and any related debt, which are both valued consistently with the Account's wholly-owned real estate investments and debt, and other factors, such as ownership percentage, ownership rights, and distribution provisions. Upon the disposition of all real estate investments by an investee entity, the Account will continue to state its equity in the remaining net assets of the investee entity during the wind down period, if any, that occurs prior to the dissolution of the investee entity. The Account's real estate joint ventures are generally classified within Level 3 of the valuation hierarchy.

Mortgage Loan Receivable — The fair value of the mortgage loan receivable held by the Account has been determined by giving consideration to one or more of the following criteria as appropriate: (i) interest rates for loans of comparable quality and maturity, (ii) the anticipated equity return a market participant would accept with similar risk and terms, and (iii) the value of the underlying collateral. The Account's mortgage loan receivable is classified within Level 3 of the valuation hierarchy.

Short-Term Investments — Short-term investments are comprised of money market funds and U.S. Treasury obligations and are valued at fair value. The fair value is based on significant observable inputs obtained from transactions in the same securities. Short-term investments are generally classified within Level 2 of the valuation hierarchy.

The Principal Life Insurance Company Money Market Separate Account ("MM Separate Account") is recorded at fair value, which represents the net asset value of shares held by the Account at year end. The primary investment objective of the MM Separate Account, which is managed by Principal Global Investors, LLC, an affiliate of the Account, is to obtain the maximum current income consistent with the preservation of capital and the maintenance of liquidity by investing in high-grade short-term debt securities. The MM Separate Account's investment portfolio will primarily contain investment grade money market instruments such as U.S. government obligations, U.S. government agency obligations, commercial paper, bank certificates of deposit, bankers acceptances, and repurchase agreements with commercial banks or investment bankers secured by obligations of the U.S. Treasury, U.S. government agency obligations, commercial paper, and bank certificates of deposit. The MM Separate Account may also invest in an underlying mutual fund or other type of investment that maintains the investments previously described.

The Account does not have any commitments to fund the MM Separate Account. In general, contributions, payments, and transfers to or from the MM Separate Account may occur on any business day. Principal Life has reserved the right to temporarily or permanently terminate the ability of all contractholders to make contributions or transfers to this MM Separate Account. Payments and withdrawals are normally processed within seven days after Principal Life receives the request; however, Principal Life reserves the right to defer payment or transfers from the MM Separate Account with a maximum delay of 180 days, unless a longer delay is approved by the New York Insurance Department. If the total amount of withdrawal requests exceeds the limits specified in the contract, Principal Life reserves the right to make these payments in installments, using the procedure specified in the contract. This procedure spreads out the payments over a period of months which should limit the harm caused by such withdrawals to the other contractholders with an interest in the MM Separate Account. Payments or transfers which are deferred or paid in installments will be made using the applicable unit value for the valuation date immediately preceding the date payment or transfer of each installment is to be made.

Unrealized Gain/Loss on Investment Commitments — The fair value of commitments to purchase real estate investments is recognized when the value of payments the Account is contractually obligated to make is above or below the value at which a market participant would assume the commitment and is determined based on the fair value of the underlying real estate, estimated using similar valuation approaches for real estate as described above. The Account's commitments to purchase real estate investments are generally classified within Level 3 of the valuation hierarchy.

Line of Credit and Debt — The fair value of the line of credit and debt instruments are determined by discounting the future contractual cash flows to the present value using market interest rates. The market interest rate used to discount the future contractual cash flows is determined by giving consideration to one or more of the following criteria as appropriate: (i) interest rates for loans of comparable quality and maturity, (ii) the anticipated equity return a market participant would accept with similar risk and terms, and (iii) the value of the underlying collateral. Significant inputs to debt valuation include the market interest rate, anticipated equity returns, and future contractual cash flows. The Account's line of credit and debt are generally classified within Level 3 of the valuation hierarchy.

AUDITED FINANCIAL STATEMENTS

3. FAIR VALUE MEASUREMENTS *continued*

The following tables set forth by level within the fair value hierarchy a summary of the Account's assets and liabilities measured at fair value on a recurring basis at December 31, 2011 and 2010.

	2011			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets:				
Investments:				
Real estate	$ -	$ -	$ 4,575,980,000	$ 4,575,980,000
Real estate joint ventures	-	-	31,252,765	31,252,765
Mortgage loan receivable	-	-	49,558,723	49,558,723
Short-term investments	-	262,259,578	-	262,259,578
Total investments	$ -	$ 262,259,578	$ 4,656,791,488	$ 4,919,051,066
Liabilities:				
Debt:				
Mortgage notes payable — fixed rate	$ -	$ -	$ 679,581,098	$ 679,581,098
Mortgage notes payable — variable rate	-	-	95,900,343	95,900,343
Assessment bonds — variable rate	-	-	58,290,104	58,290,104
Unsecured notes payable — fixed rate	-	-	203,049,542	203,049,542
Total debt	-	-	1,036,821,087	1,036,821,087
Unrealized loss on investment commitments	-	-	79,890,158	79,890,158
Total liabilities	$ -	$ -	$ 1,116,711,245	$ 1,116,711,245

AUDITED FINANCIAL STATEMENTS

	2010			
Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Investments:				
Real estate	$ -	$ -	$ 3,984,110,000	$ 3,984,110,000
Real estate joint ventures	-	-	27,496,341	27,496,341
Short-term investments	-	17,666,114	-	17,666,114
Total investments	-	17,666,114	4,011,606,341	4,029,272,455
Unrealized gain on investment commitments	-	-	56,820,353	56,820,353
Total assets	$ -	$ 17,666,114	$ 4,068,426,694	$ 4,086,092,808
Liabilities:				
Line of credit — variable rate	$ -	$ -	$ 50,000,000	$ 50,000,000
Debt:				
Mortgage notes payable — fixed rate	-	-	638,106,830	638,106,830
Construction note payable — variable rate	-	-	27,835,330	27,835,330
Assessment bonds — variable rate	-	-	54,819,619	54,819,619
Unsecured notes payable — fixed rate	-	-	200,300,261	200,300,261
Total debt	-	-	921,062,040	921,062,040
Unrealized loss on investment commitments	-	-	64,351,596	64,351,596
Total liabilities	$ -	$ -	$ 1,035,413,636	$ 1,035,413,636

3. FAIR VALUE MEASUREMENTS *continued*

The following is a reconciliation of the beginning and ending balances for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the years ended December 31, 2011 and 2010. For the years ended December 31, 2011 and 2010, there were no significant transfers in or out of Levels 1, 2, or 3.

	Real Estate	Real Estate Joint Venture
Beginning balance — January 1, 2011	$ 3,984,110,000	$ 27,496,341
Realized and unrealized gain (loss)	354,401,678	1,868,044
Real estate acquisitions	212,912,333	-
Real estate improvements	76,990,958	-
Real estate dispositions	(46,717,636)	-
Equity in income of joint venture	-	4,388,380
Joint venture distributions	-	(2,500,000)
Mortgage loan acquisition	-	-
Investment commitment dispositions	-	-
Borrowings on line of credit	-	-
Repayments on line of credit	-	-
Proceeds from borrowings and issuance of debt	-	-
Repayments of debt	-	-
Real estate and debt foreclosed	(5,717,333)	-
Ending balance — December 31, 2011	$ 4,575,980,000	$ 31,252,765
Amount of unrealized gain (loss) reported in the statement of operations attributable to assets and liabilities held at end of year	$ 351,245,443	$ 1,868,044

	Real Estate
Beginning balance — January 1, 2010	$ 4,413,709,000
Realized and unrealized gain (loss)	259,932,248
Purchases, issuances, settlements, and sales	(689,531,248)
Ending balance — December 31, 2010	$ 3,984,110,000

AUDITED FINANCIAL STATEMENTS

2011				
Mortgage Loan Receivable	Unrealized Gain on Investment Commitments	Line of Credit	Debt	Unrealized Loss on Investment Commitments
$ -	$ 56,820,353	$ (50,000,000)	$ (921,062,040)	$ (64,351,596)
178,888	21,141,805	-	(12,112,605)	(15,538,562)
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
49,379,835	-	-	-	-
-	(77,962,158)	-	-	-
-	-	(145,000,000)	-	-
-	-	195,000,000	-	-
-	-	-	(240,058,396)	-
-	-	-	130,694,621	-
-	-	-	5,717,333	-
$ 49,558,723	$ -	$ -	$ (1,036,821,087)	$ (79,890,158)
$ 178,888	$ -	$ -	$ (9,298,761)	$ (15,538,562)

2010				
Real Estate Joint Venture	Unrealized Gain on Investment Commitments	Line of Credit	Debt	Unrealized Loss on Investment Commitments
$ 34,817,723	$ -	$ -	$ (1,018,678,937)	$ (64,763,581)
(222,285)	56,820,353	-	(12,260,241)	(11,742,711)
(7,099,097)	-	(50,000,000)	109,877,138	12,154,696
$ 27,496,341	$ 56,820,353	$ (50,000,000)	$ (921,062,040)	$ (64,351,596)

4. INVESTMENT MANAGEMENT FEES

Principal Life charges the Account an investment management fee (based upon its net assets), with such fees computed and deducted daily. These fees totaled $35,764,450 and $34,404,250 in 2011 and 2010, respectively. The Account owed Principal Life investment management fees of $210,444 and $756,506 as of December 31, 2011 and 2010, respectively. The fees owed are included in accounts payable and accrued expenses in the accompanying consolidated statements of assets and liabilities.

5. INVESTMENT COMMITMENTS

As of December 31, 2011, the Account had outstanding commitments to purchase four properties for approximately $124,200,000. The Account has made deposits of $68,052,740 on these projects as of December 31, 2011. It is anticipated that the Account will acquire these properties between 2012 and 2013.

6. LINE OF CREDIT

The Account maintains an unsecured line of credit. Maximum availability under the line of credit was $300,000,000 as of December 31, 2011 and 2010 (reduced to $296,750,000 and $296,375,000, respectively, by the letters of credit described below). There were borrowings outstanding on the line of credit of $0 and $50,000,000 at December 31, 2011 and 2010, respectively. Interest on outstanding borrowings accrues at LIBOR plus the applicable margin, which can range from 2.00% to 2.25%, and is based on the aggregate debt limitation ratio, as defined (all-in interest rate of 2.30% and 2.27% at December 31, 2011 and 2010, respectively). Interest is payable on a monthly basis. Additionally, the Account pays a quarterly commitment fee ranging from 0.30% to 0.40% per year, based on the aggregate debt limitation ratio, as defined. The line of credit matures on October 4, 2013.

The line of credit includes a $100,000,000 letter of credit sub facility at December 31, 2011 and 2010. At December 31, 2011 and 2010, there were letters of credit issued of $3,250,000 and $3,625,000, respectively. Interest on outstanding borrowings accrues at LIBOR plus the applicable margin, as defined above (all-in interest rate of 2.30% and 2.27% at December 31, 2011 and 2010, respectively). Additionally, the Account pays a commitment fee of 0.125% plus the applicable margin, as defined above, based on the unused amount of the letters of credit issued. The letters of credit expire in October 2012.

The line of credit agreement contains financial and non-financial covenants, including requirements regarding net assets, leverage ratio, debt service coverage ratio and unencumbered assets. The Account was in compliance with all covenants as of December 31, 2011.

7. DEBT

Mortgage Notes Payable — Contractual obligations on mortgage notes payable totaled $771,002,896 as of December 31, 2011. These obligations consisted of $673,701,014 in fixed rate mortgage notes and $97,301,882 in variable rate mortgage notes with interest rates ranging from 2.00% to 7.97% and 2.55% to 3.05%, respectively, as of December 31, 2011. These mortgage notes mature between 2012 and 2034. Contractual obligations on mortgage notes payable totaled $638,274,149 as of December 31, 2010. These obligations consisted of fixed rate mortgage notes with interest rates ranging from 2.00% to 7.97% as of December 31, 2010. The mortgage notes are collateralized by the underlying real estate assets which have an estimated fair value of $1,229,000,000 as of December 31, 2011.

Construction Note Payable — Contractual obligations on the construction note payable totaled $27,943,886 as of December 31, 2010. This construction note had a variable interest rate (1.54% at December 31, 2010). This construction note was refinanced as a mortgage note payable in 2011.

Assessment Bonds — Assessment bonds consist of amounts owed to the City of Pleasanton, California, and the City of New York, New York. The assessment bonds owed to the City of Pleasanton were paid in full in 2011. Contractual obligations on these assessments totaled $70,778,586 and $71,917,005 as of December 31, 2011 and 2010, respectively. The assessment bonds remaining mature in 2032 and bear a variable interest rate (1.29% at December 31, 2011). The interest rates ranged between 0% and 0.30% at December 31, 2010. The assessment bonds are recorded as liens on the underlying real estate asset which has an estimated fair value of $101,000,000 as of December 31, 2011.

Unsecured Notes Payable — Contractual obligations on unsecured notes payable totaled $200,000,000 as of December 31, 2011 and 2010. There are two notes outstanding for $100,000,000, one of which matures in 2013, and the other in 2015. Each note bears a fixed interest rate of 4.13% or 4.65% and interest is payable on a semi-annual basis. The note agreements contain financial and non-financial covenants, including requirements regarding net assets, leverage ratio, debt service coverage ratio and unencumbered assets. The Account was in compliance with all covenants as of December 31, 2011.

As of December 31, 2011, aggregate contractual maturities of debt were as follows:

Years Ending December 31,	
2012	$ 150,247,539
2013	134,893,514
2014	191,233,507
2015	138,571,823
2016	126,697,773
Thereafter	300,137,326
Contractual maturities of debt	1,041,781,482
Debt fair value adjustment	(4,960,395)
	$ 1,036,821,087

8. TENANT LEASES

The Account leases space to tenants under operating lease agreements. These agreements include renewal options and expire at various dates. At December 31, 2011, future minimum base rentals under non-cancelable leases having an original term of more than one year are as follows:

Years Ending December 31,	
2012	$ 313,100,803
2013	297,096,117
2014	263,940,415
2015	230,020,772
2016	188,885,083
Thereafter	795,854,994
	$ 2,088,898,184

The above future minimum base rental payments exclude multifamily lease agreements that accounted for approximately 16.4% and 17.3% of the Account's revenue from real estate for the years ended December 31, 2011 and 2010, respectively. Revenue from real estate included approximately $69,723,000 and $73,595,000 for expenses recovered from tenants for common area and other reimbursable costs for the years ended December 31, 2011 and 2010, respectively.

9. REAL ESTATE JOINT VENTURES

The Account invested in two real estate joint ventures, a hotel and conference center and a retail property, in which it does not have control, but over which it has significant influence. The Account has a 33% ownership interest in the hotel and conference center joint venture. The Account had a 10% ownership interest retail property joint venture. The retail property joint venture sold the underlying real estate asset in December 2010 and the Account's interest was liquidated in 2011.

The following is a condensed and combined summary of the financial position and operating results of the Account's joint venture investments as of December 31, 2011 and 2010, and for the years then ended. The joint ventures record their assets and liabilities at fair value.

	2011	2010
Statements of assets and liabilities:		
Real estate	$ 430,000,000	$ 405,100,000
Other assets	37,588,108	32,279,746
Debt	(302,933,769)	(281,413,097)
Other liabilities	(37,355,434)	(48,474,595)
Net assets	$ 127,298,905	$ 107,492,054
Account's share of net assets	$ 31,252,765	$ 27,496,341
Statements of operations:		
Revenue from real estate	$ 114,375,172	$ 94,031,093
Expenses	(101,077,049)	(96,716,827)
Net loss recognized from real estate investment sale	-	(2,940,791)
Unrealized gain (loss) on real estate and debt	6,905,536	(447,920)
Net income (loss)	$ 20,203,659	$ (6,074,445)
Account's share of net income (loss)	$ 6,256,424	$ (1,379,106)

10. SUBSEQUENT EVENTS

The Account evaluated subsequent events through March 1, 2012, the date the accompanying consolidated financial statements were available to be issued.

The Account paid the investment management fees owed to Principal Life of $210,444 on January 3, 2012.

The contribution and distribution requests processed on December 31, 2011 of $4,027,418 and $4,981,136, respectively, were received by the Account and distributed to contractholders on January 3, 2012, respectively.

As of December 31, 2011, the Account had an outstanding commitment to sell one property for $45,100,000. This property was sold on February 1, 2012.

11. FINANCIAL HIGHLIGHTS

Participation in the Account is available through the purchase of certain group contracts and policies issued by Principal Life resulting in various rate classes. The information below details the per share operating performance for the 2011 and 2010 rate classes of the Account and is based on the terms, including fees charged, of the specific underlying group annuity contract, the participating plan, and the services provided.

	Rate Class A		Rate Class B		Rate Class C		Rate Class D	
Per Share Operating Performance	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Net asset value — beginning of year	$ 497.20	$ 428.87	$ 22.95	$ 19.76	$ 245.58	$ 214.71	$ 22.29	$ 19.26
Original issuance of shares in class	-	-	-	-	-	-	-	-
Income from investment operations:								
Net investment income	24.30	24.58	1.18	1.18	8.32	9.14	1.05	1.07
Net realized and unrealized gain	51.97	43.75	2.40	2.01	25.55	21.73	2.33	1.96
Total income from investment operations	76.27	68.33	3.58	3.19	33.87	30.87	3.38	3.03
Net asset value — end of year	$ 573.47	$ 497.20	$ 26.53	$ 22.95	$ 279.45	$ 245.58	$ 25.67	$ 22.29
Total return**	15.34 %	15.93 %	15.57 %	16.17 %	13.79 %	14.38 %	15.17 %	15.76 %

	Rate Class E		Rate Class F		Rate Class G		Rate Class H	
Per Share Operating Performance	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Net asset value — beginning of year	$ 513.46	$ 441.56	$ 422.18	$ 366.31	$ 22.23	$ 19.20	$ 455.98	$ 394.49
Original issuance of shares in class	-	-	-	-	-	-	-	-
Income from investment operations:								
Net investment income	26.82	26.76	17.86	18.62	1.05	1.07	20.75	21.31
Net realized and unrealized gain	53.71	45.14	44.03	37.25	2.32	1.96	47.61	40.18
Total income from investment operations	80.53	71.90	61.89	55.87	3.37	3.03	68.36	61.49
Net asset value — end of year	$ 593.99	$ 513.46	$ 484.07	$ 422.18	$ 25.60	$ 22.23	$ 524.34	$ 455.98
Total return**	15.68 %	16.28 %	14.66 %	15.25 %	15.17 %	15.76 %	14.99 %	15.59 %

(Continued)

AUDITED FINANCIAL STATEMENTS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

11. FINANCIAL HIGHLIGHTS *continued*

	Rate Class I		Rate Class J		Rate Class K		Rate Class L	
Per Share Operating Performance	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Net asset value — beginning of year	$473.90	$409.66	$483.06	$ 417.09	$404.05	$ 351.04	$ 438.11	$ 379.45
Original issuance of shares in class	-	-	-	-	-	-	-	-
Income from investment operations:								
Net investment income	22.00	22.49	23.07	23.44	16.51	17.34	19.41	20.04
Net realized and unrealized gain	49.48	41.75	50.47	42.53	42.13	35.67	45.72	38.62
Total income from investment operations	71.48	64.24	73.54	65.97	58.64	53.01	65.13	58.66
Net asset value — end of year	$ 545.38	$ 473.90	$ 556.60	$ 483.06	$ 462.69	$ 404.05	$ 503.24	$ 438.11
Total return**	15.08 %	15.68 %	15.22 %	15.82 %	14.51 %	15.10 %	14.87 %	15.46 %

	Rate Class M		Rate Class N		Rate Class O*		Rate Class P	
Per Share Operating Performance	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Net asset value — beginning of year	$ 22.86	$ 19.69	$ 22.66	$ 19.54	$ 22.83	$ 19.66	$ 511.75	$ 440.97
Original issuance of shares in class	-	-	-	-	-	-	-	-
Income from investment operations:								
Net investment income	1.16	1.16	1.13	1.13	0.62	1.16	25.58	25.76
Net realized and unrealized gain	2.38	2.01	2.36	1.99	1.44	2.01	53.50	45.02
Total income from investment operations	3.54	3.17	3.49	3.12	2.06	3.17	79.08	70.78
Net asset value — end of year	$ 26.40	$22.86	$ 26.15	$ 22.66	$ 24.89	$ 22.83	$ 590.83	$ 511.75
Total return**	15.51 %	16.11 %	15.40 %	15.99 %	9.03 %	16.11 %	15.45 %	16.05 %

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	Rate Class Q		Rate Class R		Rate Class S		Rate Class T***	
Per Share Operating Performance	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Net asset value — beginning of year	$ 520.57	$448.35	$ 545.03	$468.71	$ 6.86	$ 5.91	$ -	$ -
Original issuance of shares in class	-	-	-	-	-	-	24.89	-
Income from investment operations:								
Net investment income	26.32	26.44	28.47	28.42	0.33	0.35	0.57	-
Net realized and unrealized gain	54.43	45.78	57.02	47.90	0.72	0.60	0.94	-
Total income from investment operations	80.75	72.22	85.49	76.32	1.05	0.95	1.51	-
Net asset value — end of year	$ 601.32	$ 520.57	$ 630.52	$ 545.03	$ 7.91	$ 6.86	$ 26.40	$ -
Total return**	15.51 %	16.11 %	15.68 %	16.28 %	15.40 %	15.99 %	6.05 %	0.00 %

The 2010 rate classes shown above were previously presented under different names and correspond as follows:

2011	2010	2011	2010
Rate Class A	R6	Rate Class K	R1
Rate Class B	PGI>$25 Million	Rate Class L	R3
Rate Class C	Provider	Rate Class M	PGI>$10<=$25 Million
Rate Class D	SIP< $25 Mil., no comm.	Rate Class N	PGI<=$10 Million
Rate Class E	Classic	Rate Class O	Rate Level 52
Rate Class F	R2	Rate Class P	I3
Rate Class G	Retirement Accum. Contract	Rate Class Q	I4
Rate Class H	Signature	Rate Class R	I5
Rate Class I	R4	Rate Class S	RIS Investment Only 1
Rate Class J	R5		

The change in rate class name presented had no impact on previously disclosed financial highlights by class or the underlying terms of each rate class based on the group annuity contract or participating plan.

FUND LEVEL SUPPLEMENTAL DATA	2011	2010
Net assets attributable to U.S. Property Separate Account, end of year	$ 3,755,393,314	$ 3,014,371,214
Ratio to average net assets:		
Fund level expenses	1.20 %	1.40 %
Net investment income	4.73 %	5.61 %

(Concluded)

* Rate Class O was eliminated effective June 30,2011. Contractholders in this share class were transferred to Rate Class M.

** Total return for newly issued share classes is from the inception date and for eliminated share classes is to the elimination date.

*** Rate Class T had an inception date of July 1, 2011.

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Certain information contained in this report constitutes "forward-looking statements" that can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "estimate," "intend," "continue," or "believe" or the negatives thereof or other variations thereon or comparable terminology. Furthermore, any projections or other estimates in this presentation are "forward-looking statements" and are based upon certain assumptions that may change. Due to various risks and uncertainties, actual events or results or the actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Moreover, actual events are difficult to project and often depend upon factors that are beyond the control of Principal Real Estate Investors and its affiliates. All expressions of opinion and predictions in this report are subject to change without notice.

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This investment is subject to investment and liquidity risk and other risks inherent in real estate such as those associated with general local economic conditions. Payment of principal and earnings may be delayed.

National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors – the great majority being pension funds. As such, all properties are held in a fiduciary environment. The universe includes wholly owned and joint venture investments; operating properties only — no development projects; and only investment-grade, non-agricultural, income-producing properties in the apartment, hotel, industrial, office, and retail sectors.

The NCREIF Property Index is a private real estate market proxy that is based on property level returns (after property level expenses). The Open-End Fund Component of the NCREIF Property Index is a subcomponent of the NCREIF Property Index that employs all characteristics of the Index, however, only includes property level performance of open-end funds.

NFI-ODCE is a capitalization-weighted, gross of fee, time-weighted return index with an inception date of December 31, 1977. Supplemental data is also provided, such as equal-weight and net of fee returns, for informational purposes and additional analysis. Open-end Funds are generally defined as infinite-life vehicles consisting of multiple investors who have the ability to enter or exit the fund on a periodic basis, subject to contribution and/or redemption requests, thereby providing a degree of potential investment liquidity. The term Diversified Core Equity style typically reflects lower risk investment strategies utilizing low leverage and generally represented by equity ownership positions in stable U.S. operating properties. The NFIODCE, like the NCREIF Property Index and other stock and bond indices, is a capitalization-weighted index based on each fund's Net Invested Capital, which is defined as Beginning Market Value Net Assets (BMV), adjusted for Weighted Cash Flows (WCF) during the period. To the extent WCF are not available; which may be the case for older liquidated funds, BMV is used. Indices are typically capitalization-weighted, as they better represent the universe and the performance of the overall marketplace. Total Return of any capitalization-weighted Index is, therefore, more influenced by the larger funds (based on Net Invested Capital) included in the Index. Additional information, such as the equally-weighted NFI-ODCE, is also presented to show what the results would be if all funds were treated equally, regardless of size. This presentation is typically used for statistical purposes and peer-to-peer comparisons.

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