Global Real Estate Securities Commentary

August 2009

The month of August offered a trend reversal in performance from previous months, with the economies of developing countries losing momentum and the developed economies performing more strongly. Although a global economic recovery seems to be under way, current market enthusiasm appears to go beyond the economic data that have been observed. Following growth in valuation ratios, higher profits will have to be observed in order to justify the recent market vigour.

North America

The FTSE EPRA/NAREIT North America index continued to forge ahead, providing a 13.7% return in August. This surge, prompted by positive quarterly results, enabled the index to reach its highest level since the sharp drop of November 2008. Beyond the quarterly results, the sector seems to be carried by the loosening of credit conditions for real estate companies. A number of firms have resorted to bank credit or bonds. For example, Simon Property, the company with the highest capitalization in the index, financed itself in February at a 10% rate for five years in unsecured debt, whereas today the same credit conditions are offered at rates of 6.0% to 6.5%.

The narrowing of credit spreads is very important for real estate securities because it lowers financing costs, especially for heavily leveraged companies. We are seeing a trend emerging in the last few weeks, with REITs that face a higher refinancing risk becoming highly sought after in the market.

We are also observing a sense of confidence in the worldwide economic recovery, even though U.S. consumers are only timidly involved at this stage. We think North American real estate fundamentals are generally well reflected in share prices at present. Where direct real estate is concerned, we are seeing a growing number of transactions at encouraging capitalization rates, suggesting that investors perceive rents to be stabilizing.

FTSE EPRA/NAREIT North America Index Performance

	$US	Local Currency
United-States	14.18%	14.18%
Canada	9.32%	11.05%

Source: Bloomberg

Europe

For August, the FTSE EPRA/NAREIT Europe index rose 16.9%. The stock market recovery is continuing to push up the listed real estate sector in Europe. Countries that traditionally benefit in a recovery continue to record performances that are up substantially, while the more defensive markets have risen more moderately.

The month was marked by two major rumours concerning British Land. The first one involved an offer for the company by a group of foreign investors. We give little credence to this rumour. Another rumour, which we believe to be more credible, concerns the sale of 50% of their Broadgate asset. This sale would reduce leverage but does not seem to realize the asset's full value since the sale would occur at a price reflecting a market trough.

In operational terms, results continue to show some stability, with rent decreases offset by lower interest rates on debt. However, pressure continues to be felt on new leases, with the balance of power leaning toward tenants. For example, a recent 20-year lease in London came with a six-year rent-free period, meaning the effective rent is 50% below the top of the cycle. This type of transaction could lower income for many years, with leases being renewed at sharp discounts.

FTSE EPRA/NAREIT Europe Index Performance

	$US	Local Currency
United Kingdom	17.35%	19.37%
France	16.93%	15.52%
Netherlands	15.80%	14.40%

Source: Bloomberg

Asia-Pacific

The Asian index fell 0.7% in August. The great favourites since early in the year, Hong Kong and China, lost considerable ground to the developed economies, especially Australia. Fundamental data remain positive and Asian real estate companies continue to have access to new capital.

Hong Kong/China

After a spectacular performance since early 2009, real estate securities in Hong Kong and China underwent a sharp correction in August. Although the macroeconomic recovery remains intact, investors are increasingly fearful of restrictive government policies on price increases in the residential sector. A slowdown in the volume of loans issued by Chinese banks has also had a negative impact on stock performance.

Singapore

The market fell 1.1% in August, with the month marked by low trading volumes on the Singapore stock exchange. The retail sales sector stood out positively due to a higher consumer confidence level. Investors will be keeping a close eye on movements in the volumes and selling prices of residential units this fall, which are likely to influence the performance of real estate securities.

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Japan

Japan slightly outperformed the Asian index in August, with a 4.0% performance. Japan's Democratic Party had its first election victory in 54 years, guided by Yukio Hatoyama. Japanese policies, which historically have been quite static, could benefit from a fresh breeze. The strong performance by small-caps has been recurrent this year and continued in August, both among J-REITs and among Japanese developers.

Australia

Australia performed strongly in August, with a rise of 16.6% in local currency and 15.0% in U.S. dollars. This performance was the best in the Asia-Pacific region. Recent economic data, mostly above expectations, were the main cause of this regional outperformance. Retail sales remained strong, with second-quarter growth exceeding forecasts (2%, after inflation, compared to a 1.3% consensus). House prices rose 4.2%, quarter over quarter, while construction permit applications were up by a surprising 7.7%. Despite these encouraging numbers, the Australian central bank kept its rate at 3%, but its tone is now tending toward a potential increase by late 2009. The unemployment rate stayed at 5.8% (compared to a consensus figure of 6%).

With regards to the various Australian sectors, heavily influenced by a growing economy, a major trend was the outperformance of stocks in the residential and industrial sectors. In contrast, those in the office space sector were underperformers following disappointing annual results.

FTSE EPRA/NAREIT Asia-Pacific Index Performance

	$US	Local Currency
Japan	3.97%	1.31%
Hong Kong	-11.94%	-11.93%
Australia	16.55%	14.95%
Singapore	-1.05%	-1.12%

Source: Bloomberg

EMERGING MARKETS

The FTSE EPRA/NAREIT Emerging Markets index rose 4.1% in August. Real estate companies should be able to continue their growth in the second part of the year due to easier access to debt and equity financing. Demand in the residential market is sustained and higher selling prices are probable in the short term in a number of markets. This could be beneficial for developers if demand remains strong since their margins should improve. In the long term, the outlook remains positive for emerging countries, which are benefiting from expansionist monetary policies and robust domestic consumption.

Mexico

The Mexican economy contracted sharply in the first half of the year and the country's unemployment rate is rising. The central bank, however, seems to expect some economic improvement, as reflected in its decision to keep rates unchanged. Residential companies continue to sell more houses and have higher revenues (with 7% to 10% annual revenue growth being forecast). The largest residential developers should emerge financially stronger, with higher market shares. Some smaller developers have had to reduce their production of houses because of a shortage of financing and their inability to remain profitable in the current context.

Brazil

The Brazilian economy seems to be coming out of the worldwide economic slowdown without having suffered too much. The job market is improving, with the unemployment rate down in the last few months. In the residential market, the latest quarterly results have been solid, with a strong recovery in sales volumes in part from inventories and a recovery in the level of project launches. Clearly, the government program aimed at supporting the residential sector is bearing fruit. Companies that own shopping centres are benefiting from a context of low interest rates and from strong domestic consumption.

South Africa

South African real estate companies have reported their August financial results. Most companies published good growth levels despite a more difficult economic context. These companies' profitability was certainly affected by a lower rental occupation rate, but this occupation rate remains high compared to many other countries around the world. In this sense, South African real estate companies are highly resilient, with growth in per-share distribution levels of about 7%. It should be noted that the central bank lowered interest rates by 50 basis points in August, down to the 7% level, in order to stimulate the economy.

FTSE EPRA/NAREIT Emerging Markets Index Performance

	$US
Americas	11.33%
EMEA	3.05%
Asia-Pacific	-0.16%

Source: Bloomberg

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INVESTMENT STRATEGY

The China/Hong Kong region compared to the United States:
The U.S. market presents its share of challenges, having experienced a spectacular drop in value over the last 12 months followed by just an equally impressive recovery. The stabilization of credit conditions is probably fully discounted at present in the valuation of U.S. REITs. However, it should not be forgotten that the U.S. job market is showing no sign of recovery. Moreover, coming refinancing in the commercial real estate sector, as well as the approaching maturities of some issues of structured debt products, continue to present a real risk.

On the one hand, the China/Hong Kong region has experienced a decline in the listed real estate sector over the last few weeks. The region thus offers good investment opportunities at present, and we believe these opportunities could be more numerous in the coming weeks, forming a contrast with the U.S. market and creating geographic arbitrage opportunities, among others.

A major risk lies in the potential strength of the U.S. dollar, which historically has tended to outperform other currencies in contexts of high volatility. Also, the U.S. dollar could benefit from a general perception that the improvement in the economic situation reflected in the data is sustainable in the short and medium terms and/or that the data give reason to believe the recession is ending.

Focusing on value in a market that is potentially losing momentum:
Creating value through stock selection is becoming more important in a market that could be losing momentum. In this regard, we perceive opportunities in two relatively small regions in our index: Singapore and Australia. These countries both benefit from Asian growth fed by Chinese expansion. Moreover, in Australia, the region's macroeconomic solidity strengthens our optimism concerning current levels of valuation.

Japan, in our opinion, presents investment opportunities in development companies, despite the difficult economic situations, with the valuation of stocks discounting an economic situation that is worse than what has been observed.

More opportunities should be coming up … soon:
The market continues to benefit from the economic recovery. We continue, though, to hold the view, like the consensus, that the world's economic growth potential has probably declined in the last 12 to 24 months, especially in the United States. We thus aim to gain some advantage from the solidity of the Chinese financial situation compared to that of the United States. We also believe that the listed real estate sector will soon provide opportunities to reduce our cash level, which went up in early August.

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