

# Global Real Estate Securities Commentary

July 2009

The FTSE EPRA/NAREIT Index continued climbing in July, rising 10.0%. This continuation of the recovery can be explained in part by the announcement of corporate financial results that matched or exceeded expectations in several areas and by continued improvements in access to financing. Higher residential sales volumes in parts of Asia and in some emerging countries reflect increased household confidence and the impact of government stimulus measures. Also in July, some central banks decided to pause before adjusting their interest rates, with the aim of letting the effects of various economic stimulus programs announced by governments begin to take hold.

## North America

The FTSE EPRA/NAREIT North America Index rose 10.7% in July. This was a two-phase performance. First, there was a sharp drop of more than 10% early in the month, due in particular to news of economic stagnation and little visible prospect of the residential real estate crisis being resolved. Later in the month, REITs took off following the publication of positive quarterly corporate results. Some short sellers saw a need to cover their positions following these better-than-expected financial results and with easier credit access at more favourable interest rates. This quick, sharp upward movement was also fed by renewed interest in the financial sector.

The sustained market rise calls corporate valuation metrics into question. On the one hand, investors are showing interest in this asset class, as indicated by the positive fund flows, but on the other hand fundamental industry data continue to deteriorate. Some investors are highly optimistic and seem to lend greater importance to the results that companies will be capable of generating in the medium term (after 2011), once the crisis is over.

U.S. buying habits are probably in mutation for a cycle that could last a few years. Some of the major themes to consider in the coming years relate to better household budget management and higher savings rates among Americans.

Financial results from real estate companies that operate in the retail sector are finally showing encouraging signs from the economic slowdown. The residential sector continues to be affected by substantial housing supply and the low availability of credit at the household level.

In a context of rapidly rising capital flows toward the REIT sector in the United States, especially from Asian markets, it is important to do a relative valuation of each security in relation to those in the same sector in other regions of the portfolio.

FTSE EPRA/NAREIT North America Index Performance

	US\$	Local Currency
United-States	10.39%	10.39%
Canada	13.61%	5.76%

Source: Bloomberg

## Europe

In July, the FTSE EPRA/NAREIT Europe Index rose 12.0%. The stock market recovery gave a fresh boost to the listed real estate sector in Europe. Countries that traditionally gain from a recovery rose substantially and the more defensive markets rose more modestly, playing the role that is expected in a volatile market.

The month's most notable event was SEGRO's final offer for Brixton and SEGRO's raising of funds to finance this acquisition. The stabilization of real estate values could lead other players to look into purchases and benefit from what may be the imminent bottom of the cycle. However, enthusiasm for asset purchases could be cooled by declining rent levels.

With regards to operating results, first-half figures generally match or exceed expectations. Weakness in rents was more than offset by lower short-term borrowing costs. Longer-term leases help absorb the effect of sharply falling market rents, but any market recovery may take time to be felt in cash flow terms because of above-market rents (over-renting).

FTSE EPRA/NAREIT Europe Index Performance

	US\$	Local Currency
United Kingdom	11.97%	11.23%
France	16.56%	15.32%
Netherlands	10.63%	9.45%

Source: Bloomberg

## Asia-Pacific

Real estate securities in the Asian region performed positively for the fifth month in a row. After a pause in June, prices resumed rising notably in Hong Kong and Singapore.

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## Hong Kong/China

The sustained rise in the selling prices of residential units in Hong Kong was the month's top item. Whereas most analysts expected this rise in selling prices to slow down, it kept speeding up, reaching 20% year to date. The availability of mortgage credit, along with favourable interest rates, continues to arouse interest among buyers.

## Singapore

As in June, REITs performed better than developers in July. Investors seem reassured by visible signs of income and profits from REIT vehicles that still provide excellent dividends (6% to 12%). The gradual improvement in the country's economic situation also has helped this strong performance.

## Japan

Japan's real estate fundamentals remain relatively weak, with vacancy rates rising above 7% in the Tokyo office sector. Moreover, with a difficult job market, the government is forced to become more involved in boosting this important sector of the economy. An investment fund financed by the private and public sectors will be set up late in the summer to facilitate the refinancing of JREITs.

## Australia

Positive economic news abounded during the month, especially in the residential market. Surprises came from rises in construction permit applications (up 9.3% for the month) and housing price indices (up 4.2% in the quarter). Stocks reacted positively to this news. Some companies also reached partnership agreements and/or sold significant assets. Fears related to future refinancing are thus gradually declining across the sector.

FTSE EPRA/NAREIT Asia-Pacific Performance

	US\$	Local Currency
Japan	3.13%	1.75%
Hong Kong	14.65%	14.65%
Australia	5.30%	2.40%
Singapore	9.45%	9.05%

Source: Bloomberg

## Emerging Markets

The FTSE EPRA/NAREIT Emerging Markets Index rose 15.1% in July, with this area seeing major inflows of funds in the last two weeks of the month. A major theme in emerging markets

has been the capacity of consumers to continue buying. In some countries, retail sales are up, and higher volumes have been seen in the sale of residential properties. However, the sharp rise in stock markets in the last four months reflects greater investor optimism in the market. The short-term risk is that companies will be unable to generate results that match expectations. It is also likely that some central banks will decide to take a pause before adjusting their interest rates to observe the impact of the measures announced by governments in recent months to stimulate the economy.

## Mexico

Mexico's economic position relies heavily on the economic situation in the United States. The improvement in fundamentals in the U.S. is positive for Mexico and its currency. Despite a tougher fiscal context in Mexico, it is interesting to see that Moody's has reaffirmed the credit rating of the country's debt, with a stable outlook. Real estate companies announced their second-quarter results in July. These results matched company forecasts of 7% to 10% revenue growth this year. This shows the resilience of demand in the residential market for low-income households due to government programs.

## Malaysia

The residential market has regained strength in recent months, due mainly to a recovery in household confidence and to promotional offers by developers to reduce costs related to buying a property. Some developers are more confident regarding demand and are increasing the number of project launches. Developers are likely to reduce their marketing and promotional efforts in the coming months; this could have a positive impact on margins and profits if demand for homes remains strong. It should be noted that encouraging signs from the residential market and greater appetite for risk seem to be leading some investors to turn toward small cap companies to find buying opportunities.

## India

Real estate companies in India ended the month with a positive yield in July despite disappointment following the government's budget announcement early in the month. This budget emphasized GDP growth through government spending, creating a negative impact on the budget deficit and raising questions about the government's ability to finance this deficit without having a significant effect on interest rates in India. Sales volumes in the residential market are encouraging and continue to show greater strength than in recent months after developers lowered property prices. With the aim of regaining some of the lost ground, it is possible that some developers may return to raising the prices of their properties, and this could have an impact on affordability.

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FTSE EPRA/NAREIT Emerging Markets Performance

	US\$
Americas	27.26%
EMEA	6.99%
Asia-Pacific	8.87%

Source: Bloomberg

## Investment Strategy

Markets clearly appear to be stabilizing, due to a number of worldwide factors: fundamental macroeconomic data that are positive (or at least less negative than expected), relatively solid financial performances from listed companies, and much more optimistic investor expectations in a context of monetary and fiscal policies that remain expansionist.

Following the enthusiasm during the last months, the current price levels command investors to remain cautious. Indeed, although the recovery seems tangible and remains our medium-term scenario, we are reviewing our cash levels and paying close attention to valuations in relation to growth prospects of underlying companies.

In spite of China/Hong Kong's region being in a strong position in comparison to other large developed markets (i.e. U.S. and U.K.), valuations seem less attractive. In our view, Singapore, Japan and Australia offer very attractive investment opportunities.

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