RESOLUTION CAPITAL CORE PLUS PROPERTY SECURITIES FUND

JUNE 2010
QUARTERLY INVESTMENT REPORT

AUSTRALIAN REAL ESTATE SECURITIES

Fund Performance

The Resolution Capital Core Plus Property Securities Fund outperformed the S&P/ASX 300 A-REIT Accumulation Index by 8 basis points for quarter ending 30 June 2010.

Period Ending 30 June 2010*

	Quarter %	6 Month%	1 Year %	Since Inception[#] %
Fund	-1.46	-2.36	20.05	-13.18
Benchmark	-1.54	-3.15	20.34	-17.90
Difference	0.08	0.79	-0.29	4.72

*Returns are expressed after deducting investment management costs.
[#] 30 September 2008

Resolution Capital Core Plus Property Securities Fund Unit Price

	Entry	Exit
30 June 2010	0.7010	0.6968
31 March 2010	0.7514	0.7470

Market Performance

Market Overview	30 June 2010	31 March 2010	Quarterly Accumulation Return
S&P/ASX 300 A-REIT Accumulation Index	**18,697**	**18,990**	**-1.54%**
S&P/ASX 300 Index	30,494	34,340	-11.20%
UBS Global Investors Index AUD	888	881	0.79%
UBS Global Investors Index AUD (Hedged)	986	1,036	-4.83%
10 Year Bonds	5.09%	5.76%	
90 Day Bills	4.43%	5.26%	
AUD/USD	$0.845	$0.917	-7.85%

Commentary

A dose of reality during the upwind grind

The S&P/ASX 300 A-REIT Accumulation Index produced a total return of -1.54% for the quarter and a total return of +20.3% for the year ended 30 June 2010.

The fund delivered modestly better performance relative to the benchmark for the quarter.

The dip in the market was triggered by ongoing global macro challenges, notably sovereign risk issues associated with:

- Australian Federal Government's proposed resources super profits tax; and
- Ongoing debt problems in the European Union, which served as a reminder of the longer term issues associated with profligate spending.

In this uncertain environment, A-REITs together with many other international REIT markets outperformed the broad equities markets.

Table 1

REITs vs Equities Quarter End 30 June 2010*	UBS Global Investors	General Equities
US	-3.8%	-11.4%
Continental Europe	-9.6%	-7.9%
UK	-12.3%	-12.3%
Japan	-8.2%	-15.4%
Australia	-1.2%	-11.2%
Singapore	1.2%	-0.7%
Hong Kong	0.5%	-3.5%

*Local currency total returns

Source: UBS

In light of the dearth of property construction activity allaying increasing vacancy concerns (which we have discussed at length in previous reports), the strength of contractually bound income from real estate leases provides an attractive, relatively secure, return profile during a period of uncertainty. Hence it could be argued, with restored balance sheets, global REITs including A-REITs are, for once at least, delivering on the theoretical promise of a defensive role in a diversified portfolio.

Furthermore, there is increased evidence that domestic real estate valuations are at or through the cycle trough. As examples, Colonial First State managed listed funds released updated independent appraisals of their portfolios displaying a stabilisation in valuations. As at 30 June 2010, CFS Retail Fund's portfolios increased in value by 1.6% compared with valuations 6 months prior. The portfolio of its sister fund, Commonwealth Property Office Fund displayed a 1.2% improvement compared with 31 March 2010. Meanwhile, Challenger Diversified's preliminary valuations suggest a 2% uplift for its portfolio.

A value discrepancy is evident between listed REIT prices and appraisal based valuations as measured by discounts to Net Tangible Asset (NTA) and, more intriguingly, the prices at which unlisted wholesale vehicles in Australia have been able to raise capital. Unlike many listed A-REITs, which have undertaken massively discounted capital raisings, we note that the Lend Lease managed APPF Retail Fund not only raised new equity at NAV during the period, its manager Lend Lease disposed some of its units in the vehicle at a 1% premium to the 31 March 2010 valuation. Meanwhile the closest comparable listed vehicle CFS Retail Trust (CFX), which also is externally managed, continues to trade at a 5-10% discount to its appraisal based valuation. This is summarised in Table 2 below. Furthermore, GPT's Wholesale Office Fund raised equity at NTA backing whilst the leading office A-REIT trades at a 15% discount to NTA. Indeed, GPT itself trades at a 15-20% discount to its NTA.

Table 2

Listed v Unlisted Pricing Comparison

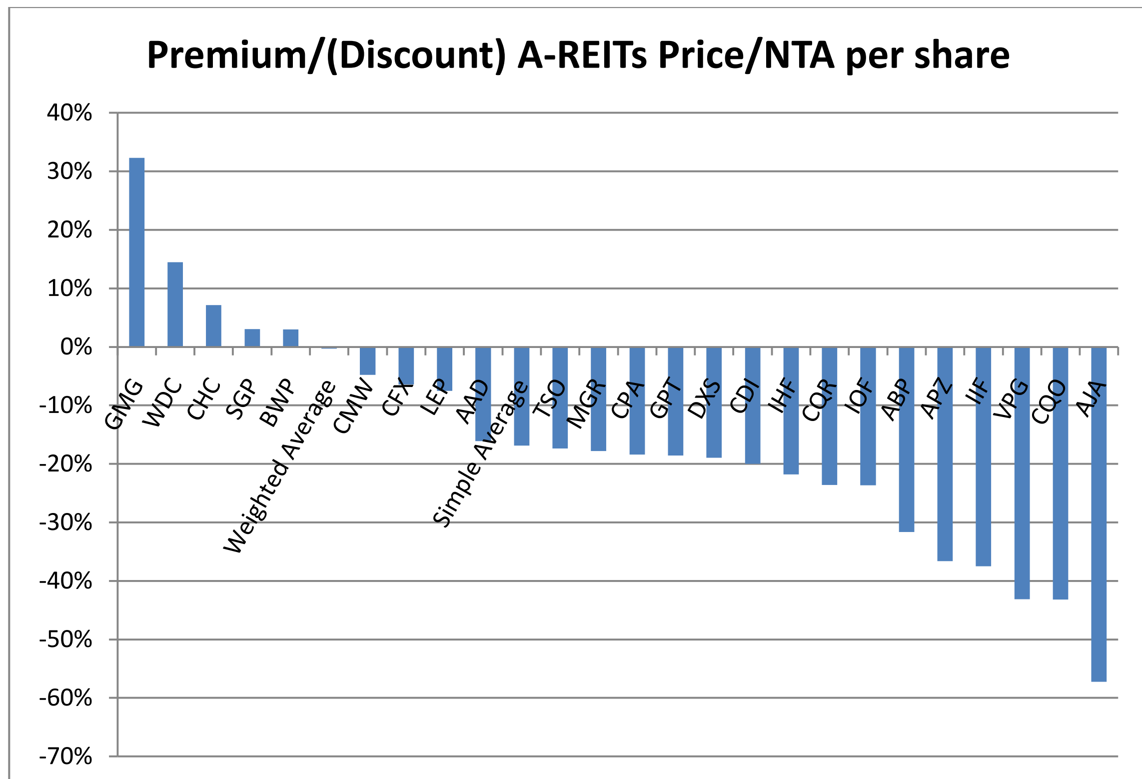
	CFX (listed)	APPF Retail (unlisted)
Independent Valuation Cap Rate	6.57%	6.59%
Current NTA per unit	$2.02	$1,634
Unit Price 30 June 2010	$1.89	$1,634
Price to NTA	-6.40%	0%

Source: Company Reports

As highlighted Graph 1, as at 30 June 2010, only five A-REITs were trading at a premium to NTA backing. Four of these are internally managed and two, Goodman Group (GMG) and Charter Hall Group (CHC), have substantial funds management platforms which the market applies valuation multiples that suggest strong fee and development earnings growth. Westfield (WDC), which is trading at the second largest premium to NTA, has arguably the best overall real estate portfolio and long term management track record of the A-REIT sector. On a simple average basis, the

sector is trading at a 20% discount to NTA while on a weighted average basis the sector trades at NTA.

Graph 1



Source: Company Reports
Prices at 30 June 2010

Focusing on a point in time NTA per share and trading discount/premium is a dangerous exercise. It fails to reflect the nature of the assets, balance sheet risk and management's track record in adding or destroying value, which includes capital as well as property asset management.

Indeed, the track record of the office focused A-REITs provide a fascinating but ultimately disturbing picture. In general, and there are notable exceptions, the office REITs are trading at a significant discount to appraised based NTA.

We attribute the discounts to two major factors:

a. The nature of commercial office buildings which provide significant periodic capital to attract tenants in what is a cyclical, commodity asset class which suggests the market disagrees with independent valuers.

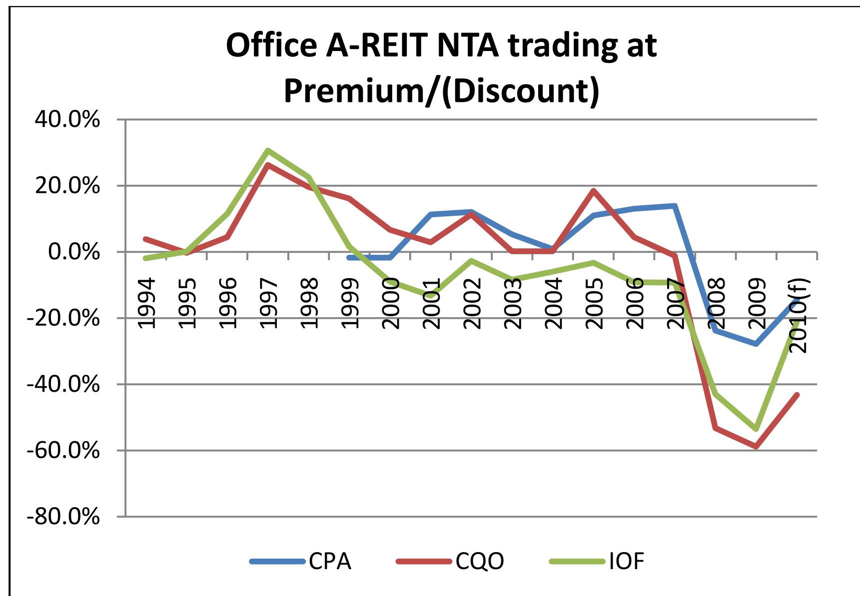
b. The appalling capital management (at least partly attributable to external management) within the group involving imprudent growth strategies that over-levered over-valued assets and, as a consequence, was forced to raise equity and/or sell assets at fire sale prices.

Graphs 2 and 3 demonstrate our argument.

Graph 2 highlights the price to NTA of three of the largest office A-REITs – ING Office Fund (IOF), Charter Hall Office (CQO) and Commonwealth Office Fund (CPA). After trading at or a premium to

NTA for many of the years since each vehicles IPOs to 2007, these vehicles now trade at discounts of 10% to 40% to stated NTA suggesting they offer tremendous value.

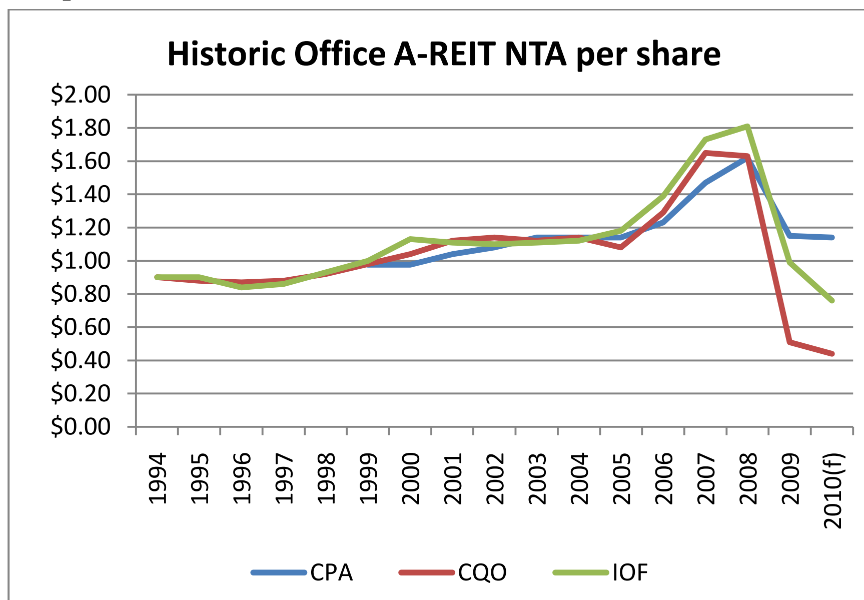
Graph 2



Source: Company Reports

However, critically, Graph 3 illustrates the value destruction that a number of managers have inflicted on unit holders, with stated NTA per unit falling by over 50% for one vehicle, Charter Hall Office (previously Macquarie Office) from the levels of a decade earlier. Consistent with our theory, CPA has had the best performance of the group and trades at the lowest discount to NTA having consistently maintained lower leverage than its peers.

Graph 3



Source: Company Reports

Indeed the track record of this sector provides a stark reminder that not all real estate or REITs are created equal. This is borne out in Table 3 which illustrates the long term performance of office

REITs. At the risk of labouring the point, why should these stocks trade at a premium when management is capable of such disastrous long term wealth destruction?

Table 3

Australian Office REITs						
	Listing Date	IPO Price	30/06/10 Price	IPO DPU	Peak DPU	Current DPU
CQO (MOF/LUO	1993	$1.00	$0.25	10.0c	11.2c	3.0c
IOF (Prime/AJO)	1994	$1.00	$0.58	10.5c	10.8c	3.9c
CPA	1999	$1.00	$0.93	7.8c	9.7c	5.3c
Record Realty	2002	$1.00	Bust	3.4c	11c	N/A
TSO	2004	$2.00	$0.38	18.6c	18.6c	0.0c
RNY	2005	$1.00	$0.12	7.9c	7.9c	0.0c
WOT*	2003	$0.50	$0.825	6.7	6.7c	6.7c
Rubicon America	2004	$1.00	Bust	13.0c	13.0c	N/A
Rubicon Europe	2005	$1.00	Bust	9.8c	9.8c	N/A
Rubicon Japan	2006	$1.00	Bust	8.5c	8.5c	N/A
Multiplex Europe	2007	$1.00	$0.135	8.6c	8.6c	0.3c
Multiplex Prime#	2006	$600	$1.04	$46.50	$46.50	$0.00

#IPO price and DPU adjusted for the 1000:1 share consolidation completed in June 2010
*Partially Paid Units
Source: Resolution Capital

It is for these reasons that many A-REITs trade at discounts to assessed NTA – being punished for poor long term performance and inability to explain why it will be different in the future. Importantly, it highlights why investors should rightly be cautious about investing in a generic basket of listed REITs as a surrogate for what is perceived to be a lower volatile investment category. These management practices and strategies of many A-REIT not only destroy value, they reduce the likelihood that stock will trade at fair value so that investors can have confidence that they can realise their investments in an orderly market at close to a fair price.

Thanks to the financial crisis which exposed the flawed practices, the strategies of many of these vehicles are still being refined. While there are signs of promise, and deep value is arguably evident, problems remain and, in some cases, these problems are equally deeply entrenched. We suspect the motives for REIT management that continually fail their shareholders include selfishness (particularly those externally managed REITs remunerated by gross asset value), self-preservation (to limit takeover attractiveness) and incompetence.

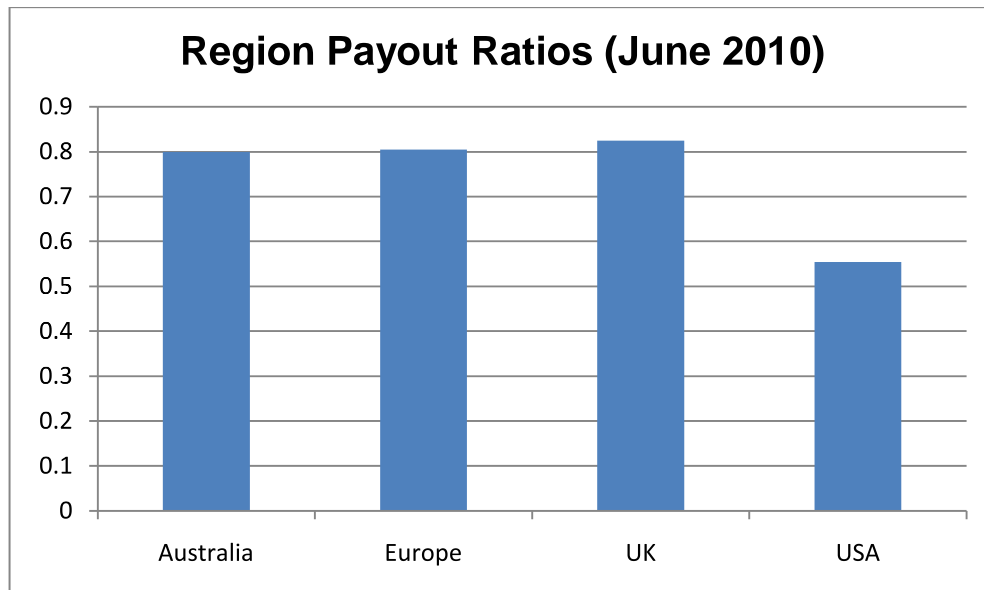
It is substantially for these reasons we urge clients to consider our global strategy which focuses on select, quality real estate platforms.

The dividend yield of A-REITs also was a topic of market discussion during the quarter with the low payout ratio fingered for holding back investor appetite. It is foolhardy to suggest that dividends determine REIT value. Indeed it is clearly the opposite. Combined with the restoration of balance sheets (see Appendix I), A-REIT dividend payout ratios have been cut from 101% of pre-depreciation earnings levels to now circa 80% which provide a buffer against any further economic shocks and potential to grow as economies recover. Hence, whilst the income yield is nominally low, the quality of dividends is relatively high. At 30 June 2010, we estimate the A-REIT dividend

yield of the sector is circa 6%, the dividend payout ratio equating to 80%. The retained portion can be applied to ongoing capital needs of the properties to maintain their functionality and attractiveness to occupants (much like a strata unit block's sinking fund).

Graph 4 highlights the A-REIT payout ratio now is broadly consistent with other international securitised real estate markets. Investors should be confident that the current dividend level is, barring a major economic downturn, maintainable so that they can reasonably budget for a reliable income stream well into the future.

Graph 4



Source: RCL

In conjunction with improved balance sheet capital ratios (i.e. leverage) and mindful of A-REIT taxation payout requirements, we continue to assert that A-REIT payout ratios are broadly appropriate. That said, in some exceptional cases we acknowledge the payout should in fact be raised as we have low confidence in management's ability to responsibly re-invest the retained capital. Nevertheless, the temptation will be there for some to increase the payout, perhaps with the help of financial engineering, if management believe doing so will hood-wink the market into giving them a lower cost of capital. More often than not, this lower cost of capital is transitory, as it will be exploited to raise equity to acquire more assets that, in many cases, detract from the value of the existing portfolio. This will probably be the case in externally managed vehicles where the manager is remunerated on the size of the vehicle as well as a mechanism to defend against takeover.

We acknowledge quality among the listed as well as unlisted vehicles globally is inconsistent and there are several vehicles in both camps which continue to flounder due to incompetent management, lower quality real estate and inappropriate financial leverage.

Issues with the disjointed/inconsistent Australian pricing environment may be brought further under the spotlight through one Australian real estate fund manager's proposal to allow unit holders in its hybrid property securities funds (containing listed and unlisted investments) to "convert" some or all of their currently frozen unlisted units into listed securities to trade on the

ASX. The move is designed to act as a temporary liquidity solution until “the Funds return to appropriate liquidity levels”. We note that the unlisted component of these funds includes investments in separate vehicles also managed by the hybrid manager. We draw a number of observations from this proposal:

- the unlisted appraised based component is probably overvalued
- the move would allow the manager to cement FUM during downturns and ratchet up assets following future periods of net new investor demand
- raises questions about the sensibility of cross investing in other vehicles sponsored by the manager due to conflicts of interest

We view the twin valuation outcome proposed by the manager as farcical – those that convert must value at the listed price, those that don’t retain the appraised valuations applied to the unlisted component.

In all likelihood the move will be akin to the experiment called Redeemable Listed Property Trusts in the early 1990’s, frozen unlisted property trusts which sought a managed pricing option in a listed environment but quickly and simply became listed property trusts.

Separately, the difficulty in securing “distressed” real estate is an ongoing theme within the real estate sector globally. The combination of low interest rates and relatively high occupancy means that many highly leveraged borrowers are able to service their debt. No doubt many lenders view it as better that, although highly leveraged, professional owners should continue to operate the assets. Managing real estate is not the primary business of banks and financial institutions and certainly not, if history is any guide, a core competency. Apart from avoiding liquidity issues associated with loan defaults, banks have been able to reap higher returns in the form of penalty fees and interest rates typically extracted from “extend and pretend” arrangements.

US REIT Simon Property Group’s (SPG) futile efforts to acquire General Growth Properties (GGP) highlights the challenges in securing quality real estate. As a reminder, GGP owns a significant portfolio of malls and shopping centres in the US and became one of the world’s largest real estate bankruptcies when it entered Chapter 11 (a form of bankruptcy in the US that allows an organisation the ability to restructure itself) in April 2009. Despite having arguably the highest, and we believe a generously priced bid, SPG’s offer for GGP was thwarted reportedly on the grounds of uncertainty as there were concerns that regulatory anti-trust (i.e. competition) issues could jeopardise the deal. The Brookfield supported recapitalisation was considered preferable. Perhaps the Bucksbaum family’s (which is a major stakeholder in GGP) determination not to be taken over by the Simon family’s REIT also may have played a vital part in the process.

The anti-trust issue came as a surprise to many, ourselves included, as there had been a belief that real estate is exempt from this sphere/issue, on the grounds that it is a large and diverse market difficult for any participant to dominate. Whilst acquiring GGP would cement Simon as the largest single owner of malls in the US, and arguably dominant in some cities, it still would own less than 50% of the malls in America and a fraction of the overall retail space if other types of shopping centres are included, not to mention the advent of internet retailing.

This issue has precedents in other countries. In Australia, a market with much lower retail space per capita, Westfield is believed to have run into obstacles in this area following its takeover of AMP Retail Trust in 2003, forcing it to pass up ownership and/or management of certain assets. Furthermore, post 30 June Unibail has had difficulty closing a transaction to add to its Polish shopping centre portfolio for similar reasons. In the case of Simon's bid for GGP, whilst nothing was officially decreed by US regulators, it is certainly a significant milestone for US mall landlords.

Combined with the lack of buying opportunities, the constrained supply conditions and improved prospects for global economic growth is encouraging a number of A-REITs with the financial capacity to increase their development pipelines: Westfield, Goodman, Stockland and GPT Group prominent on this list. The development equation is arguably marginal but is assisted by a trend of firming cap rates, declining construction costs and stabilised rents showing signs of improvement.

Whilst real estate equity capital raisings slowed to a trickle in many regions, including Australia, the steady stream of US REIT secondary capital raisings continued during the quarter. Macerich undertook the largest US REIT secondary offering when it raised US$1.23 billion equity in April – surprisingly modest when one considers raisings of this magnitude or greater were not uncommon in Australia over the past decade.

Meanwhile, securitised real estate Initial Public Offerings (IPOs), particularly of any scale, remain difficult to execute. The decision to withdraw the Swire Hong Kong real estate spin-off during the quarter is evidence of widespread investor reluctance to support new vehicles at unrealistic vendor expectations, particularly as the listed market has had plenty to choose from existing vehicles with many issuing at deep discounts.

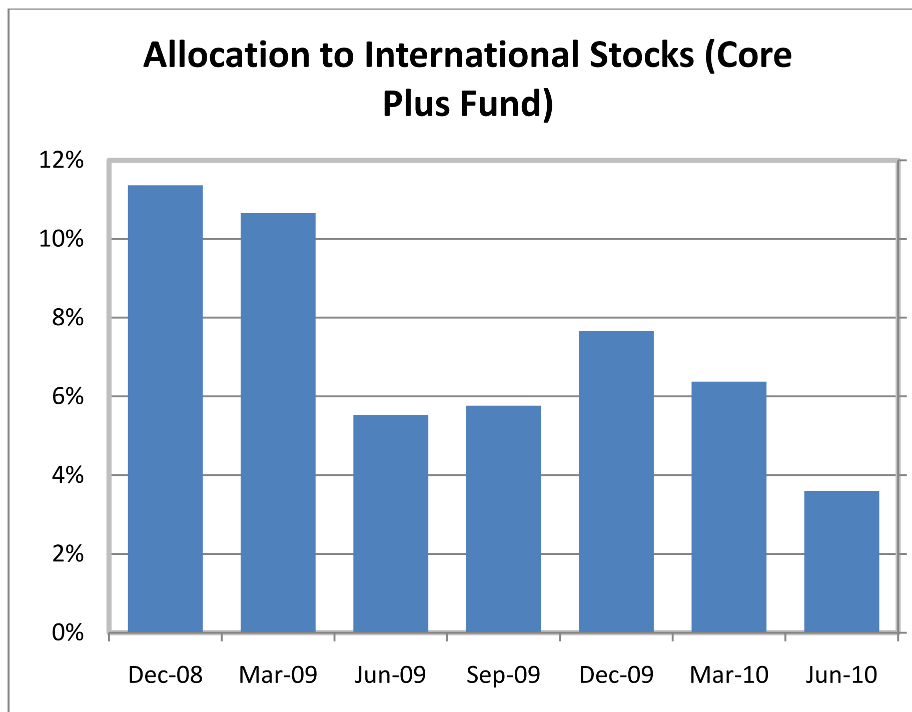
In light of the difficulty in securing assets or launching sizeable IPOs, we expect corporate activity will focus on mergers, particularly of smaller vehicles which do not have the economies of scale to properly resource themselves and have no access to competitive capital – Mirvac's bid for Westpac Office Trust during the quarter and earlier takeover of M-REIT indicative of this trend.

Although bank and institutional debt is becoming less difficult and expensive to secure, securitised debt markets, particularly commercial mortgage backed securities (CMBS), continue to be restrained by structural and ownership complexities and the uncertainties over how the 2011-13 maturities bulge will play out in terms of default rates and refinance options. Whilst real estate values have at least stabilised and the outlook for rent cash flows appears improved, there are some unresolved poorly conceived loans which will result in some significant losses/casualties. Sam Zell, the noted US real estate grave dancer, recently argued that "dilution is the solution", meaning these stakeholders must accept their position is untenable without significant new capital which values the assets more realistically.

Turning to the Fund's international holdings, as Graph 5 illustrates, we have continued to reduce offshore exposure for a number of reasons:

- A-REITs have now restored balance sheets and recalibrated dividends
- The sector has been rid of a number of lower quality operators
- The outlook for the Australian economy and real estate is relatively robust
- A-REITs are trading below our assessed NAVs

Graph 5



Source: Resolution Capital

We maintain positions in stocks such as Hong Kong listed Link REIT which continues to blithely charge through the global economic crisis seemingly unaffected. Link's 2010 annual result, released in June, was once again notable for strong rental growth and cost containment supported by a rock solid balance sheet. We inspected a number of Link properties in May and continue to see the potential of this portfolio to deliver stable growth to investors thanks to the quality the rental cash flows (derived largely from necessity based retail in high foot traffic locations) and strength of the balance sheet.

The biggest challenge for Link appears to be management resolve to deal with the stresses of managing tenant relationships in what was, less than 5 years ago, a public sector administered portfolio with high expenses, low rents (indeed in some cases rents weren't collected) and poorly maintained properties. In May, George Kwok Lung Hongchoy was appointed Link's new CEO having previously served as CFO. The appointment follows the March 2010 resignation of the COO and CEO, both Australian nationals, in what was partly attributed to vitriolic tenant pressure in opposing management efforts to raise rents, remix and improve the quality of the retail offer.

We lightened the portfolio's position in Link during the quarter primarily due to tax considerations surrounding Australia's Foreign Investment Fund (FIF) tax regime, Link's recent price performance softening the blow of reducing exposure to this stellar performer which we continue to believe represents rare value within the sector.

Excluding the US, REITs in markets consumed by debt issues were among the worst performers during the June 2010 quarter, particularly those in the UK, Continental Europe as well as Japan where political instability has also weighed heavily of investor confidence.

Within this region, we remain committed to our exposure to French listed Unibail (pronounced "oonibuy") Rodamco. Unibail's portfolio and management are of exceptional quality, its balance sheet strong, fundamentals which have not greatly altered because of the weak macro environment

in some parts of Europe. Indeed the French consumer, to whom the majority of Unibail's shopping centre portfolio is directed, remains lowly indebted.

The UK stocks we favour have long term leases, (in most cases over 7 years with upward only rent reviews) combined with development opportunities that the market is putting little or no value on. Somewhat surprisingly the London office market, to which we have exposure principally through Land Securities, is experiencing moderate vacancy rates (7-10%) and evidence of improving letting demand and, consequently, rents. Indeed, as highlighted in the previous quarterly, supply is starting to emerge which is designed to exploit a bulge in lease expiries in 2013-2015 many of which will take place in functionally obsolete properties.

Government interference in real estate markets is an emerging global issue. The risk is that real estate will be viewed as:

a. An easy target by virtue of its immobility from which to extract additional tax revenues. Evidence of the emerging threat could be seen in a number of recent tax changes including:

    - NZ – removed depreciation allowances on buildings
    - France – introduced levies on real estate associated with the funding of additional infrastructure spending in urban areas

   Perhaps highlighting the vulnerability of real estate, it is interesting to observe that the proposed resource super profit tax was ultimately defeated by the resources industry threatening to invest in other markets.

b. A means to stimulate construction activity which inevitably leads to an oversupply and the next property bubble.

In an example of reverse stimulus, China experienced its own government's intervention during the quarter designed to curb excessive speculative demand in the residential property market. The cooling measures were mostly aimed at limiting the ability of people to buy a second residential property. Again the reaction of market participants to the Chinese changes makes an interesting contrast to that experienced in Australia to the resources tax.

On the road

We spent time, as per usual, inspecting properties and searching for new ideas. This included:

Las Vegas ICSC

This year RCL had two people attending the International Council of Shopping Centre's (ICSC) global retail real estate conference in Las Vegas. Attendance for the conference rebounded from 30,000 last year to 50,000 this year, though it is still well below boom years. Clearly the mood of the retailers has improved from early 2009 and with positive sales growth and an opportune leasing environment, retailers are looking for expansion to drive top line sales growth. While demand has returned it is only for the best properties and even as the landlords bargaining position has improved retailers still have the upper hand. With the supply pipeline switched off demand is focussed on existing properties. New format roll-outs have become smaller and retailers are even considering floor plates which aren't perfect, but do offer the right location and reduced rents. Some reported that unlike previous years, tenants attended with the intention of doing deals to facilitate opening stores this year in recognition of improving trading conditions and more attractive rent levels.

The conference reinforced our views that the rental growth outlook for prime properties is far superior to the weaker properties; some of the latter will find it difficult to replace (anchor) tenants and reduced rents is a given. Furthermore, malls and outlets are faring better than strip centres; "mom and pop" operators in the latter are still having difficulty obtaining credit and strip centres have seen much higher supply growth the last decade than malls. Outlets remain one of the few areas where there is retailer demand and development makes economic sense.

We also note that many retail landlords will need to adjust reported tenant sales because of the distortion created by the success of Apple's Ipad. Once again Apple's success highlights how vitally important real estate is in reaching and serving customers despite the supposed convenience of the internet.

NAREIT - Chicago

Four of our team travelled to NAREIT to take the pulse on the US REIT market.

NAREIT highlighted the industry is in a good financial position and now relies on evidence of sustained economic growth to drive tenant demand. When viewing the prospects of the REIT industry, US REIT managers have re-established their traditional posture of seeing the glass as half full (as opposed to a fearing a broken glass in late 2008/early 2009). Almost all were heartened by improving tenant leasing conditions, albeit we still have the sense that the fact that things have stopped deteriorating has provided grounds for a relief rally – tenants still do not appear to be expanding at a rate which will see a return to any material rent growth in the immediate future – multi-family the clear exception.

Whilst in the US we inspected a number of properties owned by REITs as well as some of its unlisted competitors, most notable those of multi-family owner Archstone which we would not be surprised to see a return to public hands at some point over the next 3 years.

Brazil

Having undertaken extensive desk-top research, in May two members of our team travelled to Brazil to meet with a number of Brazilian property companies and see for ourselves the opportunities that exist for real estate in this emerging economy. Despite being endowed with rich and diverse natural resources, Brazil has often failed to take advantage of its potential and its history has been riddled with political instability and hyperinflation. However, after seemingly exhausting all other options, Brazil embarked on a number of sensible economic reforms in the 1990's and the election of Luis Inácio Lula da Silva in 2002 have cemented the foundation upon which Brazil has emerged strongly from the global financial crisis.

Investors have taken note, and foreign investment in Brazil has escalated rapidly. A number of foreign property investors have entered the market, US REITs prominent, often through joint ventures with established local firms, and in the past five years some of these vehicles have listed on the Brazilian stock exchange, the BM&F BOVESPA. The opportunities for these companies are many:

- Brazilian real estate has highly fragmented ownership (mostly by families) and typically these properties have suffered underinvestment and have been poorly managed, creating many opportunities to acquire and add value.
- The rising middle class (with over half the population under 25 years old) is growing rapidly and consumer credit is taking off.
- Brazil remains under retailed compared to most other developed or developing markets including Mexico and Chile.
- Development of retail assets can deliver strong returns of 12-14% in the first year, with rents accelerating strongly post completion.
- For retail property investors, there are a number of landlord friendly aspects to the lease structure in Brazil, such as double rent being paid in the month of December every year. In addition anchor tenants (who in other countries typically pay little to no rent) take up less space while also paying more rent, meaning retail assets are generally more productive.
- Credit is becoming increasingly available to investors to fund development and acquisitions.

Challenges also exist, particularly as they relate to government underinvestment in infrastructure and education, two issues which persistently arose in discussions and were also very evident when travelling through the country. Poor infrastructure and education (which lag behind emerging markets such as China) threaten to limit economic growth and also fuel inflation. Other issues such as violent crime, which is still rampant in parts of the country, and corruption, also threaten further investment in the country. Furthermore, early indications are that Rio de Janeiro is not well advanced on preparations for the World Cup and Olympics in 2014 and 2016, respectively. For most Brazilian property companies, development is a large component of future growth, and there is the risk that construction costs (which are never fixed in Brazil) will skyrocket as the government scrambles to prepare for these events, potentially impacting development returns for investors.

Overall the opportunities in Brazil look compelling, particularly when compared with many Western economies with debt burdens and declining populations. Reassuringly, the political debate in the lead up to the presidential election in October has been relatively moderate, with both sides acknowledging the positive impacts that the liberalisation of its economy has delivered over the past decade. For many Brazilians the memories of hyperinflation remain strongly entrenched, and while short term challenges remain, there is widespread acknowledgement that Brazil is, finally, heading in the right direction.

Asia Pacific Real Estate Association (APREA) Conference - Singapore

As part of a tour visiting property and management in Hong Kong and Singapore, we attended the annual APREA conference in Singapore. The ongoing strength of the Chinese economy has underpinned confidence in the region. It was also evident that Hong Kong and Singapore are benefiting from the uncertain tax/regulatory environment in US/UK which is evident in the expansion of global banks in these markets.

Property Council of Australia Leaders Summit - Canberra

In Australia we attended the Property Council's Leaders Summit. It was valuable to hear senior politicians from both sides of the spectrum uniformly optimistic about the prospects for the Australian economy thanks largely to our proximity to Asia and vast minerals reserves. That said it was disappointing to hear discussion within the real estate industry largely moderated by investment bankers on how the industry could grow, not how investors could be rewarded. Fair to say it was a product expo rather than investment summit.

Outlook

In the short to medium term, the confidence and focus of investors is likely to be periodically tested by the varying rate of the recovery of corporate earnings, restoration of public sector finances and consequent effect on interest rates and inflation. Our position is to recognise that economic fortunes rise and fall, but well managed well located real estate remains relatively constant.

The fundamentals of the REIT sector have arguably not been as strong for quite some time: construction supply is low, REIT balance sheets are strong and, whilst dividend yields are historically low in nominal terms, dividends are at the very least sustainable thanks to a more responsible payout ratio.

Based on current prices we believe that if management act competently (e.g. focus on asset management and recycling capital rather than growing assets), long term total returns will be at least adequate. Nevertheless, the quality of management in the A-REIT sector is variable and the concentration issue is a high risk factor.

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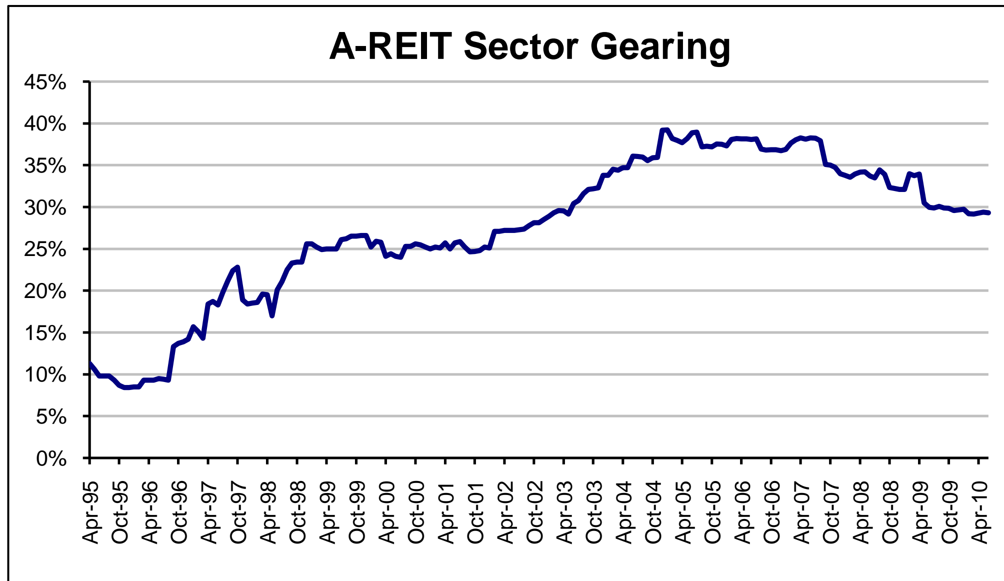
Appendix I – Miscellaneous

As highlighted in the chart below, A-REITs have restored balance sheets albeit largely through delusionary equity raisings.



Source: UBS

US REIT Returns Have Been Competitive

Index	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 YTD	Average
REITs (*)	35.9%	18.6%	-16.9%	-4.6%	26.8%	12.8%	3.6%	36.6%	31.5%	12.1%	35.9%	-16.8%	-38.0%	28.6%	5.7%	11.5%
S&P 500	23.0%	33.4%	28.6%	21.0%	-9.1%	-11.9%	-22.1%	28.3%	10.9%	4.9%	15.8%	5.5%	-37.0%	23.5%	-7.9%	7.1%
NASDAQ	23.0%	22.2%	40.2%	86.1%	-39.2%	-20.8%	-31.5%	50.3%	8.6%	1.4%	9.5%	9.8%	-40.5%	43.9%	-7.4%	10.4%
Russell 2000	16.5%	22.4%	-2.5%	21.3%	-3.0%	2.5%	-20.3%	43.7%	18.3%	4.6%	18.4%	-1.6%	-34.8%	25.2%	-3.3%	7.2%
Russell 2000 Value Index	21.4%	31.8%	-6.5%	-1.5%	22.8%	14.0%	-11.3%	42.7%	22.2%	4.7%	23.5%	-9.8%	-35.9%	17.7%	-3.3%	8.8%
S&P Small Cap 600	21.3%	25.6%	-1.3%	12.4%	11.8%	6.6%	-15.3%	39.0%	22.6%	7.7%	15.1%	-0.3%	-31.1%	23.8%	-2.1%	9.0%
S&P Mid Cap 400	19.2%	32.2%	19.1%	14.7%	17.5%	-60.0%	-15.4%	35.6%	16.5%	12.6%	10.3%	8.0%	-36.2%	35.0%	-2.6%	7.1%
S&P Utility Index	3.1%	24.8%	14.7%	-8.9%	59.5%	-30.4%	-33.0%	26.2%	24.3%	7.7%	21.0%	19.4%	-29.0%	6.8%	-9.5%	6.4%

Source: BofA Merrill Lynch Global Research; (*) Morgan Stanley REIT Index - ticker RMS; priced as of 07/01/10