



resolution**CAPITAL**
real estate securities solutions

RESOLUTION CAPITAL CORE PLUS PROPERTY SECURITIES FUND

JUNE 2011
QUARTERLY INVESTMENT REPORT



AUSTRALIAN REAL ESTATE SECURITIES

Fund Investment Performance

The Resolution Capital Core Plus Property Securities Fund underperformed the S&P/ASX 300 AREIT Accumulation Index by 22 basis points for the quarter ending 30 June 2011.

Period Ending 30 June 2011*

	Quarter %	1Year %	2Years % p.a.	Since Inception [#] % p.a.
Fund	-0.71	6.19	12.90	-6.58
Benchmark	-0.49	5.87	12.87	-9.94
Difference	-0.22	0.32	0.03	3.36

*Returns are expressed after deducting investment management costs.

[#] 30 September 2008

Resolution Capital Core Plus Property Securities Fund Unit Price

	Entry	Exit
30 June 2011	\$0.6806	\$0.6766
31 March 2011	\$0.7375	\$0.7331

Market Performance

Market Overview

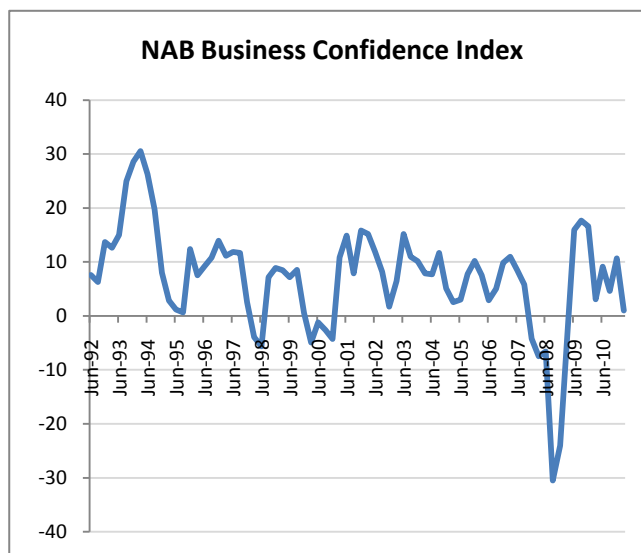
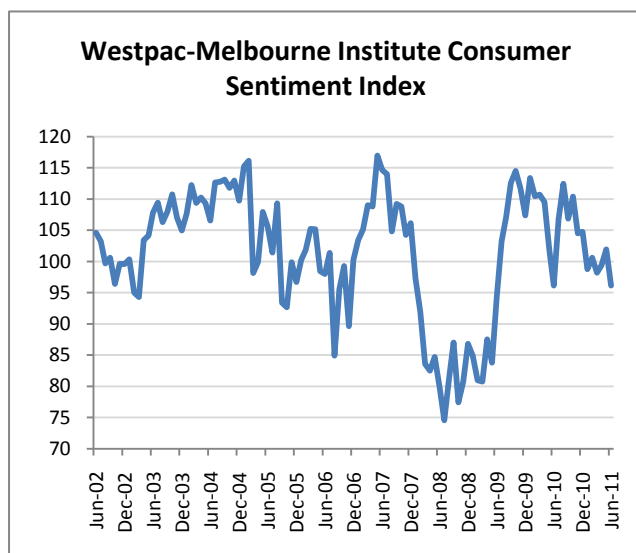
	30 Jun 2011	31 Mar 2011	Quarterly Total Return
S&P/ASX 300 (GICS) A-REIT Accumulation Index	19,794	19,891	-0.49%
S&P/ASX 300 Index	34,122	35,640	-4.28%
UBS Global Investors Index AUD (Unhedged)	965	959	0.56%
UBS Global Investors Index AUD (Hedged)	1,306	1,256	4.00%
10 Year Bonds	5.21%	5.50%	
90 Day Bills	4.96%	4.89%	
AUD/USD	\$1.072	\$1.03	4.08%

Commentary

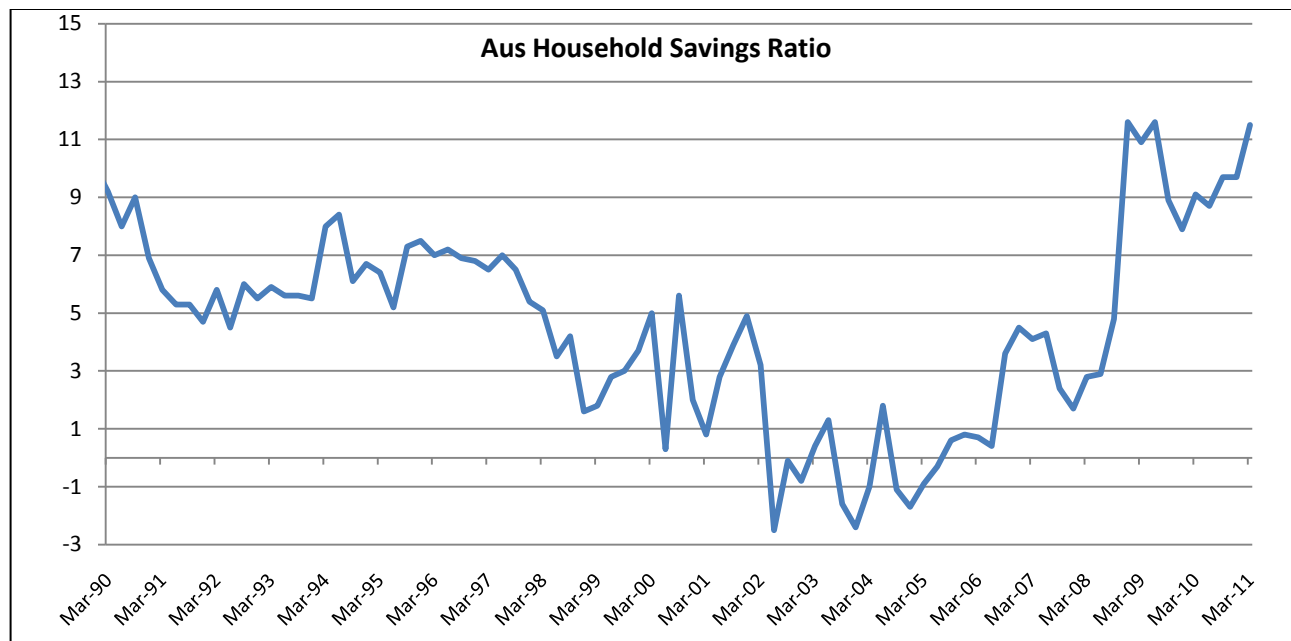
The S&P/ASX Property Accumulation Index produced a total return of -0.5% for the quarter ended 30 June 2011. Poor performance of the two largest index stocks, Westfield Group (-7.3% total return) and Stockland Trust Group (-4.9%), overshadowed reasonable returns from many of the other, smaller, index constituents. As a general rule, concerns about the health of retail spending and the residential market weighed on the performance of the larger vehicles which seem to be the funding source of a switch into office sector REITs (+8.1%), the sector's remaining industrial property play Goodman Group (+5.8% total return) and those with a major exposure to both these sectors such as Dexus Property Group (+6.5%).

It also is worth highlighting that REITs undertaking share buy-back programs also performed strongly: Charter Hall Retail (+6.6% total return) and Challenger Diversified (+16.4%). Excluding the moribund Centro Properties Group (-36.2% total return), Charter Hall Group suffered the worst return (-8.7%) as a consequence of uncertainty arising over its management of Charter Hall Office, more on that later.

Outside the resources sector, it is widely recognised that the Australian economy is fragile. Relatively high real interest rates (as a consequence of the Reserve Bank's determination to dampen the excesses caused by the resource sector's growing pains), an elevated A\$ and economic disruptions caused by natural disasters such as the Queensland floods, are weighing on corporate and consumer confidence. Consumers are now saving at record levels in an effort to reign in their high personal debt levels.



In this context, the prospect of improved tenant demand remains unpersuasive. Rent growth in many parts of the Australian commercial real estate market is growing at no more than inflation. Pressure on rents in retail property, the backbone of the A-REIT market, continues to mount in light of the more frugal, “etail” savvy consumer which is placing pressure on retailer profitability.



Source: ABS, Bloomberg

Given underlying real estate portfolios of A-REITs are heavily weighted toward non-resource sector economies of NSW and, to a lesser extent, Victoria and SE Queensland, the short term A-REIT operating earnings (ie rental) outlook appears tepid.

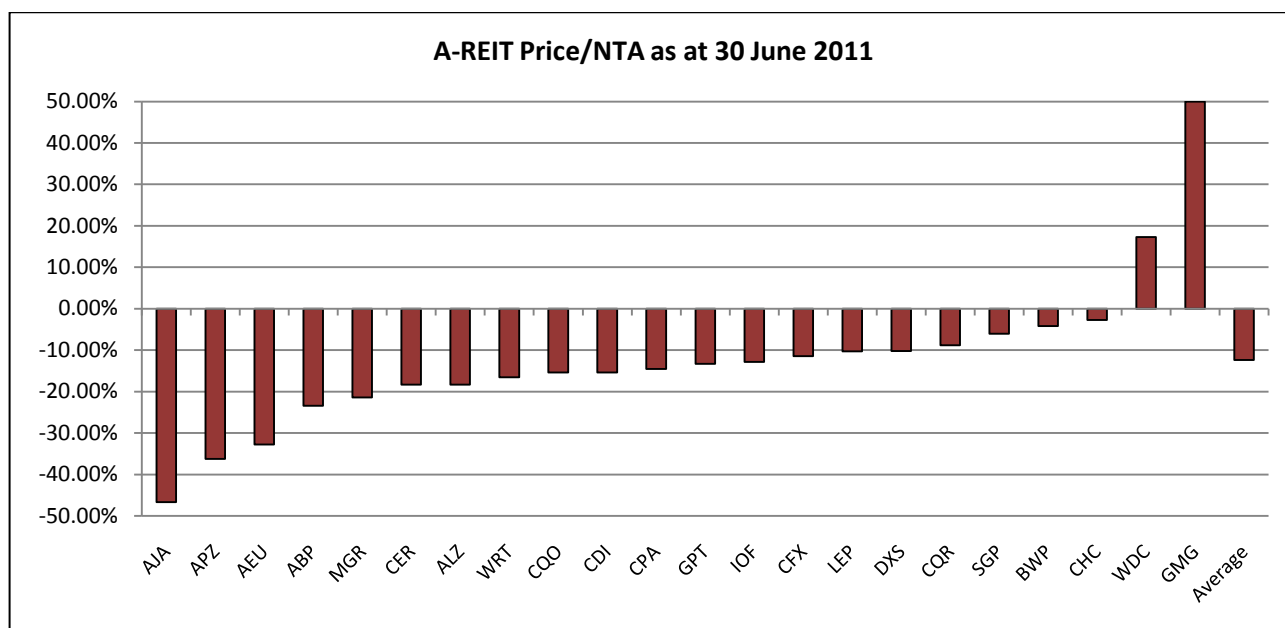
Hence, after taking into account the state of the economy, often excessive trust management expenses (which is not taken account of in calculating the NTA), the ongoing discount to Net Tangible Assets for many A-REITs is probably justified, particularly in light of the sector’s questionable long term track record (which we have discussed in previous quarterlies ad nauseam).

In light of these factors, A-REIT equity capital raisings have slowed to a trickle. Proposed new listings have struggled to gain investor interest. During the June quarter 360 Capital Industrial Property Trust (previously the unlisted Becton Industrial Property Trust) attempted to raise equity as part of its plan to list but has “postponed” the raising awaiting better market conditions. We do not believe the externally managed, low quality, industrial REIT warrants support in its current form.

Despite macro headwinds, we believe the strength of many A-REIT capital structures is becoming increasingly apparent. Sector borrowings are at a reasonable level. Most have suspended DRPs opting instead for reduced distribution pay-out ratios. A-REITs now are self sustaining without need for additional capital: debt or equity.

Significantly rather than expanding, A-REITs are shrinking their capital base. The number of A-REITs undertaking share buy-backs is growing. As an example, having divested most of its non-core assets and continuing to trade at a discount to Net Tangible Assets (NTA), GPT management announced that a buy back will be carried out at levels accretive to operating earnings and the NTA. GPT will buy back up to 5% of its securities beginning in July 2011. Meanwhile, Charter Hall Office has announced plans to make a special distribution from the proceeds of the intended disposal of its US assets. Post 30 June, Commonwealth Property Office (CPA) indicated it will pay a special distribution from the proceeds of sale of some of its Perth office buildings.

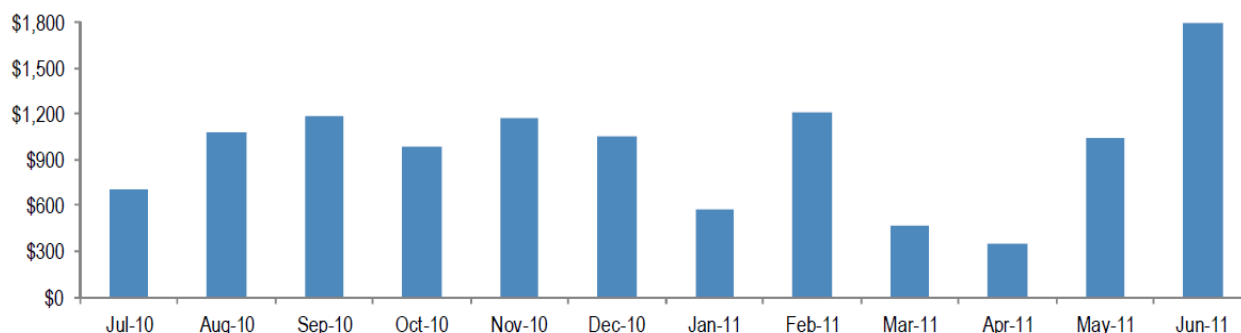
We believe the sale of additional assets is critical to further equity reduction initiatives. We believe levering up makes little sense, the prospect of increasing debt finance remains problematic. Alternate forms of debt finance are slowly emerging - of particular note was CQR's four year funding commitment from superannuation fund manager, UniSuper. The superannuation industry has typically shied away from providing secured property financing and while this is an encouraging sign, the market nevertheless remains heavily reliant on short duration, covenant heavy, bank debt. Hence, in our opinion the buy-backs must be funded by additional asset sales.



Source: Resolution Capital. WDC, WRT, GPT and ABP adjusted for Ex-Dividends post 30 June.

If management is unable to sell assets at or above recent valuations it demonstrates these vehicles should not be trading at NTA as the valuations (independent and directors) would evidently be wrong. With the volume of physical property transactions recovering in 2010, transactions during the most recent quarter were somewhat patchy but have nevertheless supported the valuations used by A-REITs (key transactions were the 50% interest in Northland shopping centre in Melbourne and Brisbane's Waterfront Place office tower on cap rates between 6.25% and 7.5%). Despite the patchiness seen in 2011, the broadly held view is that investor demand for Australian commercial real estate, domestic and offshore, remains strong.

Figure 6: FY11 Monthly Major Australian Transactional Activity (\$30m+)



Source: Australian Press Reports (AFR, Property Review), Knight Frank, J.P. Morgan.

From a headline perspective asset sales will allow management to re-invest the freed-up capital in the remaining “core” portfolio at discounts to valuations and potentially boost earnings (depending on yields achieved).

Fundamentally, management should be focused on using the process as an opportunity to further refine their portfolio and investment strategies. In order to compete with unlisted vehicles as well as other investment classes, REITs have to become more than a collection of assets. What is the compelling investment case? We see evidence of these strategies unfolding in various forms:

- Westfield’s plan to sell malls in second tier US cities and focus on major markets (albeit part of WDC long term portfolio refinement approach).
- Stockland’s 3-R (retail, residential, retirement) strategy.
- Goodman’s focus on modern logistics and capital partnering model.

Whilst the wisdom and success of these strategies is far from assured, when combined with more disciplined capital management we believe any strategy is better than the scattergun accumulation of assets that was widely the case up to 2007.

Thus many A-REITs have moved from asset accumulation to capital recycling and improved return on capital which, as we have discussed, may mean capital contraction which we view as a positive.

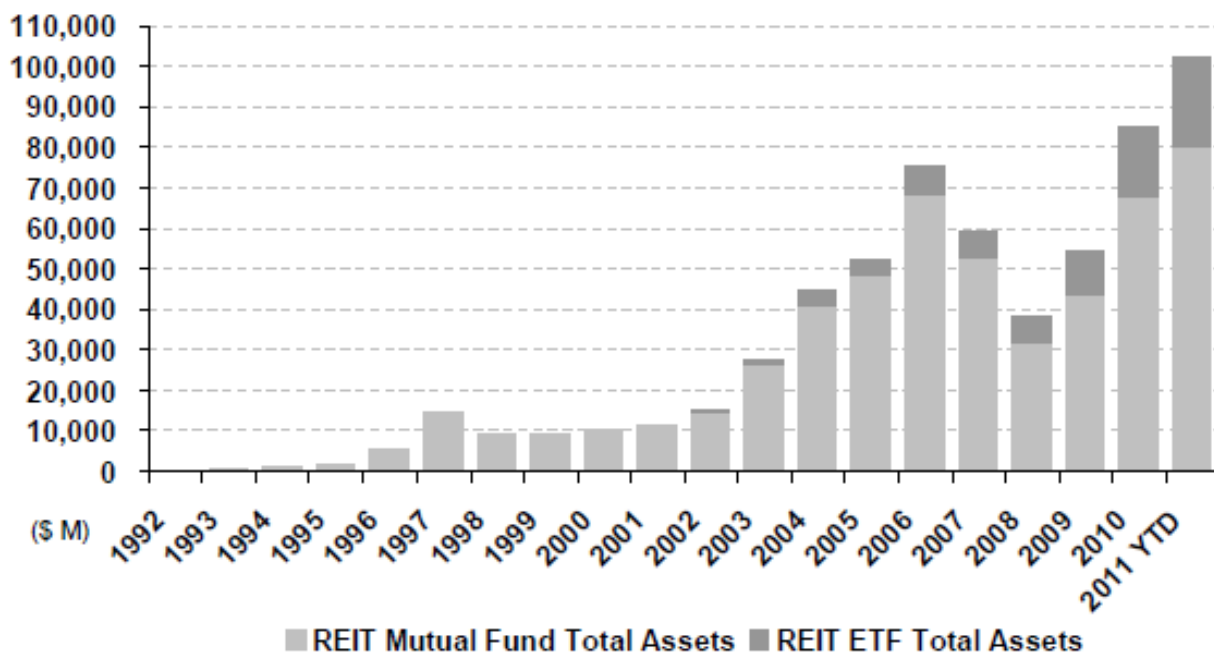
As well as potentially improving returns to long-term unitholders, we see short term market benefits of the buy-backs and special dividends. Significantly, it will alleviate some of the selling pressure being exerted by the decline of the biggest owners and cheerleaders of the sector, the A-REIT Property Securities Funds (PSFs) which funnelled copious amounts of equity into the sector up until 2007. By our estimates PSFs constitute approximately 30% of the sector’s equity ownership but the recent rate of outflow from these traditional supporters appears greater than money entering from global REIT funds, general equities investors and private individuals. These dedicated funds are experiencing outflows as a consequence of many factors specific to the “product” and the sector: Too volatile, insufficient dividend yield, a high A\$, agency risk/poor corporate governance, insufficient and ineffective diversification, poor returns, high interest rates, a preference for global REITs and attractive valuations in other parts of the equities market. These and other factors have combined to act as a drain on the local REITs, in turn creating a vicious cycle and reinforcing the crisis of confidence.

Indeed, despite M&A activity over the past 9-12 months (ING Industrial, Challenger Kennedix Japan, Valad Property Group, M-REIT) money still appears to be deserting the sector, mostly via the PSFs.

This view was reinforced by our recent discussions with asset consultants around the world which highlighted that many investors and their advisors are unsure how to categorise the listed REIT sector: real estate or equities? At the moment it is in the too hard basket with most preferring unlisted real estate despite recognising the inherent dangers of illiquidity whilst most in the equities market continue to side-step the REIT “leper colony” in favour of what we are sure must be high quality Australian equities.

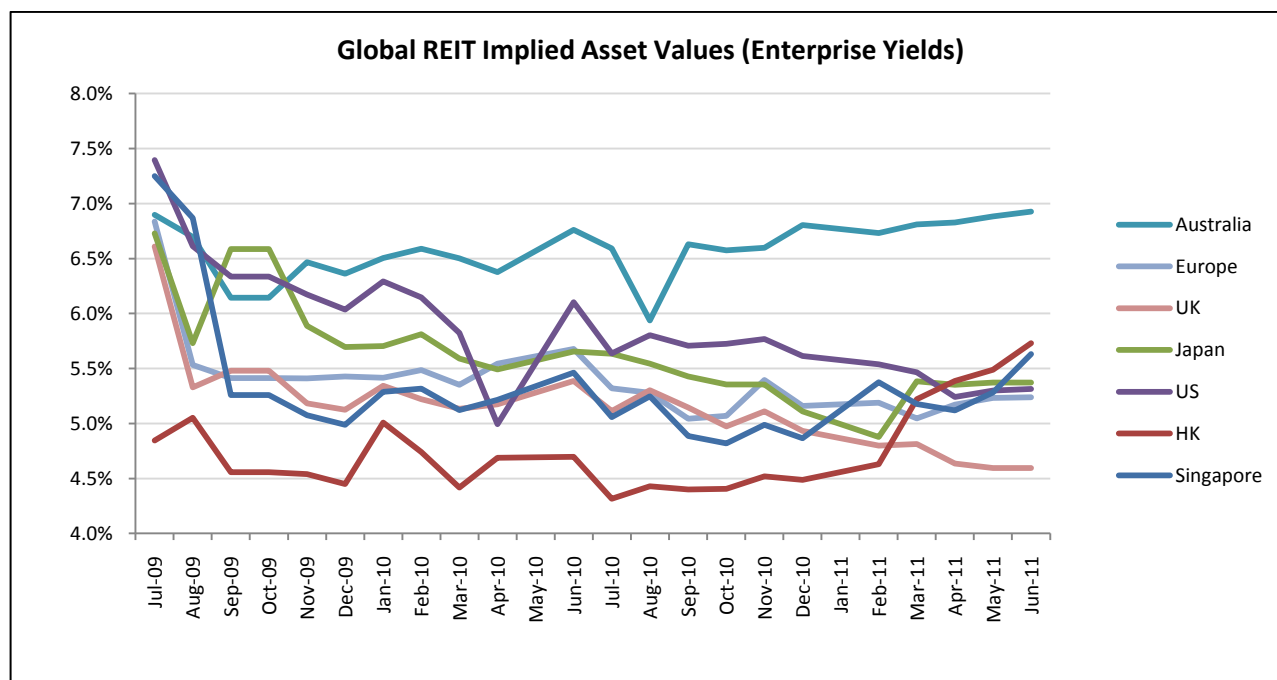
This view however, isn’t necessarily shared with investors everywhere as evidenced by strong inflows by US investors into US and global REIT funds.

Figure 6. REIT Mutual Fund and ETF Total Assets Under Management (\$ millions)



Source: AMG and Citi Investment Research and Analysis

Perhaps a turnaround in Australian interest rate expectations might rekindle interest in A-REITs but they are unlikely to return to widespread favour for some time at least. As we highlighted in mid-2010, due to the demise of the A-REIT PSFs as well as agency issues (ie corporate governance), the sector's cost of capital is likely to be relatively high for some time - the valuation differential of A-REITs to global peers is stark and cannot be explained by interest rates alone.



Source: Resolution Capital

The extent of this valuation anomaly, combined with the improved A-REIT capital structures, has driven our decision to hold minimal offshore REIT exposure in our Core Plus strategy. We constantly question the wisdom of this decision given the strength of macro headwinds beating down on the local market.

As well as capital management initiatives, to us the most significant issues for A-REITs centred once again on corporate governance surrounding the battle for control of Charter Hall Office Fund, IOF and a court finding on ASIC's action against Centro directors. The developments serve to remind investors of some of the flaws in A-REITs, real or perceived, reinforcing the crisis of confidence.

Centro – shock horror - Directors are responsible!

Following the Federal Court's decision in June 2011 that Centro's Directors had failed in their responsibilities under the Corporations Act in relation to the accuracy of Centro's 2007 financial statements, media commentary focused on the potential repercussions for corporate directors, namely the ability attract independent directors.

From what we understand, Centro's Directors argued that they had relied on experts, such as their accounting firm, for advice on information surrounding the classification of short and long term liabilities. We view the Court's decision as one of common sense, classification of short term versus long term debt is a basic test of accounting of which any reasonable Director should have an understanding. If the accounts and business were too complex that Directors relied on external "experts" it could be argued the Board was not in control of the affairs of the company. Given the rapid growth of Centro and its complex ownership and highly levered capital structure, the risk of collapse should have been apparent to experienced and qualified Directors such as those who accepted the role as Directors of a publicly listed company.

If directors are incapable of interpreting the accounts they should resign or reign in management. If they fail to do either, they must accept the consequences of failing to honour their fiduciary duty. If they cannot deal with this maybe the public would be better not having these type of companies in the first place.

ING Office – the Code remains the same but let's hope performance doesn't

Management of ING Office Fund passed from ING to Investa Property Group (IPG) during the period, the vehicle re-named Investa Office Fund, retaining the code "IOF". Previously ASX listed, IPG was taken private by Morgan Stanley's real estate funds in 2007.

We remain uneasy about this situation. Investa has outlined its intention to (at least partially) internalise IOF management but without nominating a price up front, we fear the worst. Whilst we have high regard for the senior management team at IPG, we believe the corporate imperative of Morgan Stanley's heavily leveraged fund will threaten what is best for IOF unitholders. We are concerned that the vehicle will be subject to related party transactions.

For the record we voted in favour of the change of control. Having spoken with management and independent directors at length and other interested parties it seemed we had little feasible alternative, a disappointing state of affairs (but at least there were no poison pills inserted).

We have maintained a significant exposure to IOF during the past couple of years as we believe the portfolio represents reasonable value and we are hopeful that a constructive outcome in relation to the future management structure of the vehicle can be achieved. We are placing significant faith in the independent directors and senior management of Investa to do the right thing and honour their fiduciary duty to investors, if need be at the expense of their investment banking masters.

Charter Hall Office - CQ-dOh!

The battle over the future direction and management of Charter Hall Office (CQO) continued during the quarter.

Uncertainty created by the brouhaha negatively impacted the manager, Charter Hall Group (CHC), the stock producing a total return of -8.7% for the quarter, the worst of any index stock. We believe whilst it is highly unlikely CHC will lose management of CQO, the battle will reduce CHC's returns outlook and put in question its judgement of buying the Macquarie real estate platform in 2010.

In choosing to attack Charter Hall Office (CQO), the hedge funds have picked at the soft underbelly of the sector relating to corporate governance of externally managed listed vehicles. We doubt their intentions are altruistic nor entirely consistent with the long term aspirations of other unitholders.

Nevertheless, we recognise they may well be an important agent for change, the hedge funds have succeeded in highlighting some of the entrenched corporate governance issues and that, not only must you be clean, you must be seen to be clean. Managing closed end listed vehicles is fraught with challenges and conflicts. This is a difficult situation for the incumbent management and for independent directors. Indeed given the inherent conflicts one would question why any person in their right mind would want to be an independent director of an externally managed listed REIT.

....So what to do?

It is hard for management to successfully and faithfully serve two masters: REIT investors and the owners of the management entity. The hurdles in fixing the deeply entrenched problems within externally managed listed vehicles, perceived and/or real, appear overwhelming. Unless these externally managed vehicles enshrine the absence of poison pills, disciplined acquisition and capital management policies (a challenging task in a dynamic and periodically volatile world), investors will remain uncertain as to what is the future direction and nature of these vehicles. Hence, these vehicles are susceptible to trading at a significant discount to underlying worth for extended periods of time.

Outlook

According to our research forecasts, at 30 June 2011 the prospective earnings yield of the A-REIT index is 7.5% whilst the dividend yield promises a 6.5% income yield.

The outlook for the Australian economy and A-REITs remains challenging. Post 30 June the leading department store operator David Jones highlighted a recent "unprecedented" deterioration in trading conditions. Whilst in most cases property leases provide income security at least until lease expiry, given retail property represents the majority of the A-REIT sector's investments, sentiment toward the sector is likely to remain nervous.

While A-REIT balance sheets and payout ratios are in the best shape they have been in over a decade, we continue to highlight the limitations of the sector: namely the lack of effective diversification and agency management issues. We believe that select global REITs provide superior diversification including exposure to leading, aligned, management and high quality real estate markets with liquidity which should in turn generate superior long term risk adjusted returns.

For those committed to maintaining a discrete exposure to A-REITs it is important to look beyond the cyclical macro factors influencing A-REITs and focus on factors within management's control.

We expect corporate governance and capital management initiatives will be an important determinant of intra sector performance over the next 12-18 months.

The potential for M&A activity is increasing but as the CQO situation demonstrates there are significant barriers to effecting a change of control or direction. Investors must be more critical and reject conflicts that are difficult to control, which is generally the case with closed end externally managed listed funds. This is the time for independent directors and executives to prove their worth or step aside. If not, the sector will once again be condemned to its past.

Assuming satisfactory sale prices can be achieved, this may be an ideal time for REIT managers to cull their portfolio and focus on better locations whilst reducing overheads and, dare we say it, even finding other income streams to improve return of equity whilst maintaining low leverage. Rather than being bigger and a mere collection of assets, REITs need to be better. This will enable them to demonstrate a real point of difference and compete more effectively with equities and unlisted real estate.

Vale Peter Hartigan

Finally, I record that Peter Hartigan passed away on 7 June 2011. Peter was a co-founder and Director of Resolution Capital. I had worked with Peter since 1995 and could not have been more fortunate than to have worked with a thoroughly honourable and conscientious person. Peter understood and practiced a commitment to fiduciary responsibility to his clients and quietly and unassumingly gave guidance and counsel to many in the industry. Peter is survived by his wife Patricia and son Pierce.

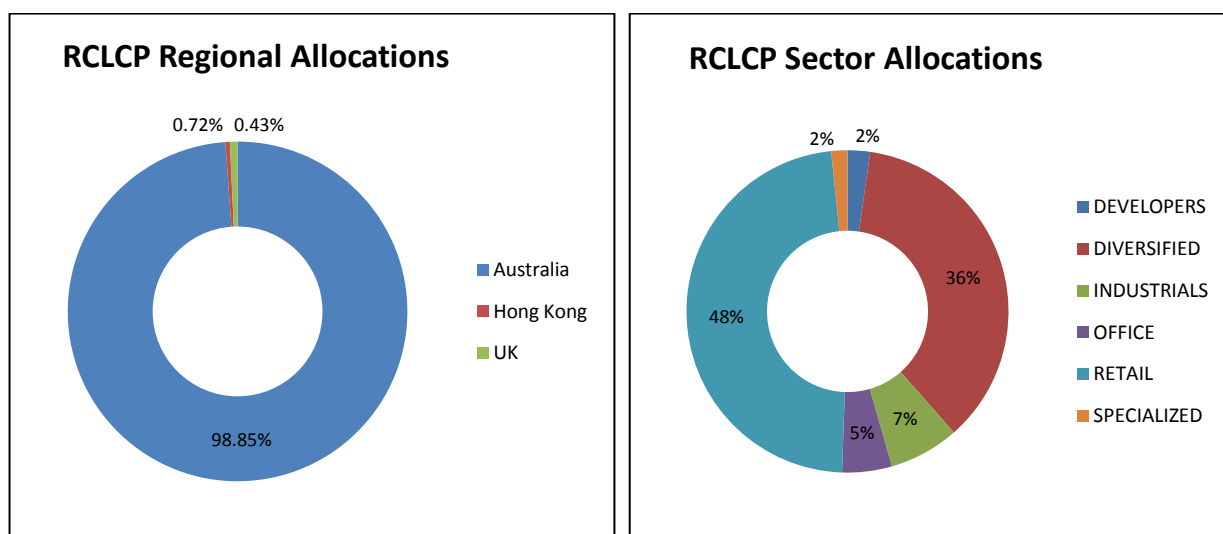
Portfolio Top 10 Stocks

Top 10 Portfolio Holdings* – June 2011

Stock	Sector	Country
CFS Retail Property Trust	Retail	Australia
Charter Hall Retail REIT	Retail	Australia
Goodman Group	Industrials	Australia
Dexus Property Group	Diversified	Australia
GPT Group	Diversified	Australia
ING Office Fund	Office	Australia
Mirvac Group	Diversified	Australia
Stockland	Diversified	Australia
Westfield Group	Retail	Australia
Westfield Retail Trust	Retail	Australia

*In alphabetical order

Allocations – June 2011



Contact Details

Andrew Parsons

Managing Director - Senior Portfolio Manager

Direct Line: 02 8258 9122

Email: andrew.parsons@resolutioncapital.com.au

Marco Colantonio

Portfolio Manager

Direct Line: 02 8258 9155

Email: marco.colantonio@resolutioncapital.com.au

Resolution Capital Limited

Level 38

Australia Square Tower

Sydney NSW 2000

GPO Box 553
Sydney NSW 2001

Tel: 02 8258 9188
Fax: 02 8258 9199

This communication has been prepared for multiple distributions and does not take account of the specific investment objectives of individual recipients and it may not be appropriate in all circumstances. All investments involve risk and persons relying on this information should do so in light of their specific investment objectives and financial situations. Any person considering action on the basis of this communication should seek individual advice relevant to their particular circumstances and investment objectives. Past performance is not a reliable indicator of future performance. Interests in the Fund are issued by WHTM Capital Management Limited, ABN 29 082 494 362, AFSL 238371. WHTM Capital Management Limited believes the information contained in this communication is reliable, however no warranty is given as to its accuracy and persons relying on this information do so at their own risk. Please read the Product Disclosure Statement available at www.resolutioncapital.com.au in its entirety before making an investment decision.
