



resolution**CAPITAL**  
real estate securities solutions

# RESOLUTION CAPITAL GLOBAL PROPERTY SECURITIES FUND

**JUNE 2011**  
**QUARTERLY INVESTMENT REPORT**



# GLOBAL REAL ESTATE SECURITIES

## Fund Investment Performance

The Resolution Capital Global Property Securities Fund outperformed the UBS Global Investors Index (AUD Hedged Net TR) by 79 basis points for the quarter ending 30 June 2011.

### Period Ending 30 June 2011\*

	Quarter %	1 Year %	2 Year %	Since Inception <sup>#</sup> %
Portfolio	4.79	31.98	32.84	9.32
Benchmark (UBS Global Investors Index)	4.00	32.50	35.74	1.94
Difference	0.79	-0.52	-2.90	7.38

\*Returns are expressed after deducting investment management costs.

<sup>#</sup> 30 September 2008

### Resolution Capital Global Property Securities Fund Unit Price - Class A

	Entry	Exit
30 June 2011	\$0.9770	\$0.9712
31 March 2011	\$1.0527	\$1.0465

## Market Performance

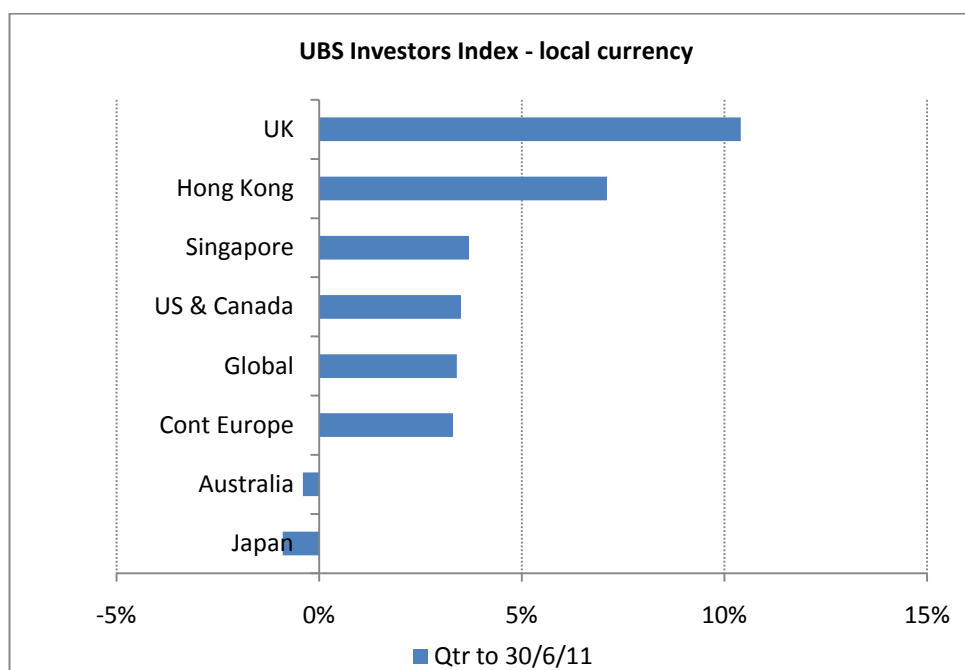
### Market Overview

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

## Commentary

The UBS Global Investors Accumulation Index (Hedged) produced a total return of +4.0% for the quarter ended 30 June 2011. The listed real estate sector outperformed general equities with the MSCI World (A\$ hedged) index returning -1.4% for the quarter. For the year ended 30 June 2011 the index produced a total return of 32.5%, outperforming global equities which returned 19.3%.

In local currency terms the top performing regions for the quarter were the United Kingdom (+10.4% total return) and Hong Kong (+7.1%) while Japan (-0.9%) and Australia (-0.4%) were the weakest.

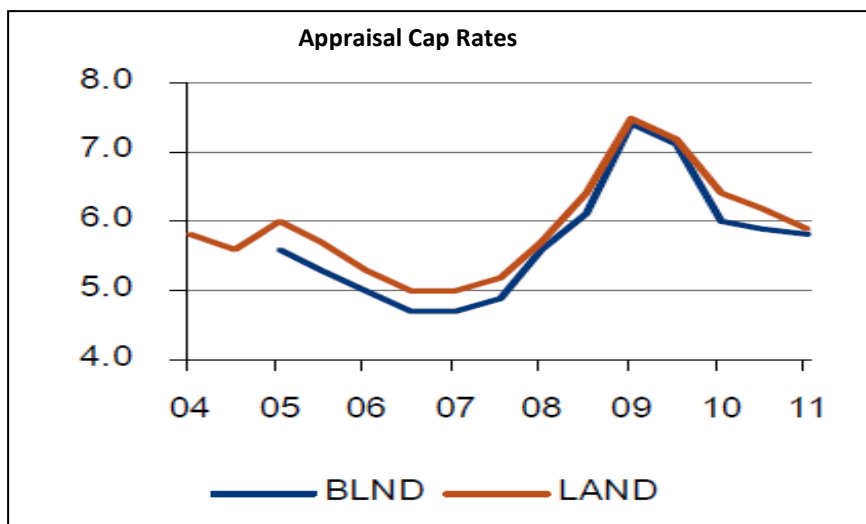


## UK

In the March quarter, UK REIT's performed strongly on the back of financial results, particularly those of Land Securities (LAND), British Land (BLND) and Great Portland (GPOR). All reported strong property revaluation increases particularly in London office with LAND reporting a 19.5% increase in Net Asset Value (NAV) and BLND reporting a 12.5% increase in NAV. Meanwhile, Derwent London (DLN) provided solid commentary for the three months ended 31 March 2011 reporting good progress on the leasing front and the sale of £105m worth of properties at a 35% premium to book value.

BLND also confirmed that it had agreed terms with Aon to pre-lease approximately 30% of its Leadenhall office development, one of the four major office towers currently under construction in the City of London.

UK property revaluation increases were driven by a combination of rent growth and a firming of cap rates, particularly for property located in London. The latter reflects increasing investor appetite for prime assets in major global cities where there are few if any distressed sellers and buyers are becoming increasingly anxious to deploy their capital.

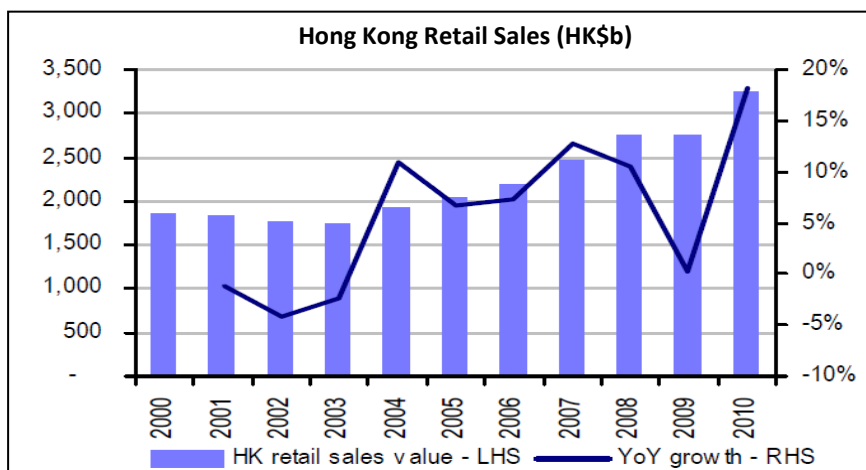


Source: BofA Merrill Lynch

Our holdings in Land Securities and Derwent London contributed positively to performance and are well positioned to capture the promising outlook for London office markets which is in stark contrast to the gloom that prevailed in 2009 when some questioned London’s future as a key financial centre.

### Hong Kong / China

Listed Hong Kong real estate landlords generally outperformed the developers (non-index) as the latter were weighed down by on-going concerns about over-heating residential markets. Retail landlords in particular benefited from strong sales growth, as mainland Chinese shoppers continue to pour into Hong Kong. Our exposure to Link REIT (823) benefited from this trend, albeit its offer is targeted more at the domestic market. Our non-index holding in Sun Hung Kai (16) detracted from performance, somewhat offset however by our holding in mainland China focussed office developer SoHo China (410) which is one of the few mainland developers immune from the government’s residential policy interference.



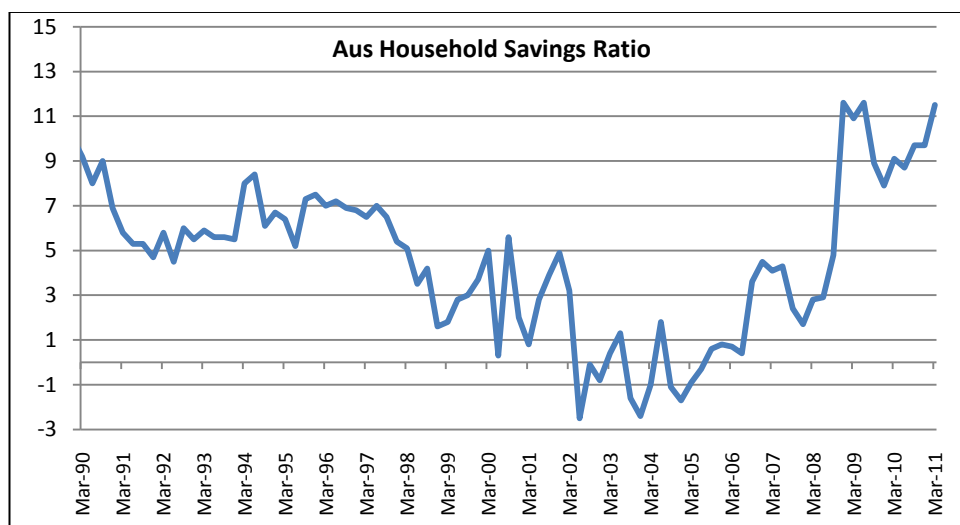
Source: UBS, CEIC

## Australia

Australia was impacted by the poor performance of the two largest index stocks, Westfield Group (-7.3% total return) and Stockland Trust Group (-4.9%), which overshadowed reasonable returns from many of the other, smaller, index constituents. 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 is worth highlighting those 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 (-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.



Source: ABS, Bloomberg

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. Online shopping is made even more attractive for the Australian consumer by the appreciation of the Australian dollar.

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 (i.e. rental) outlook appears tepid.

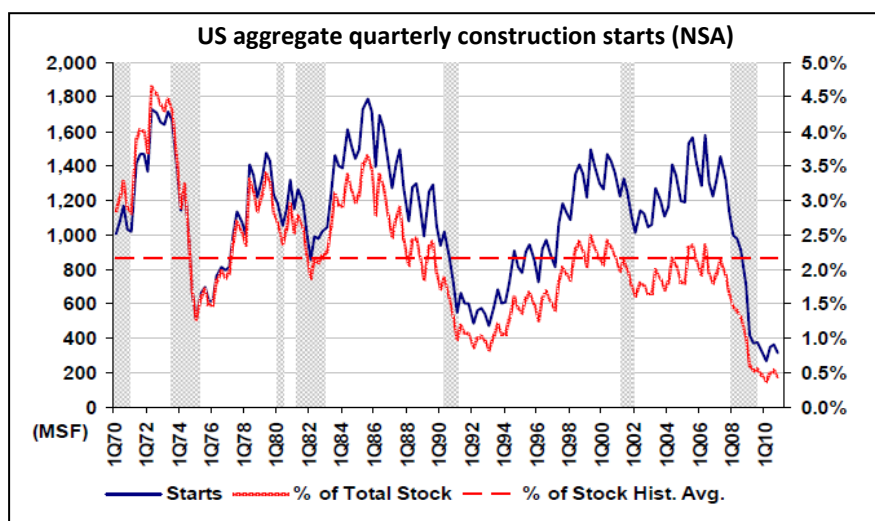
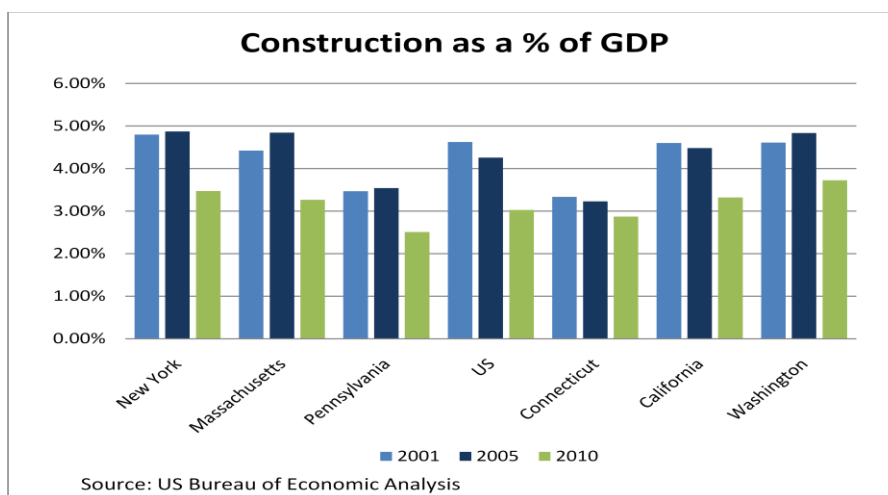
Hence, after taking into account the state of the economy, and the often excessive trust management expenses (which is not taken account of in calculating the NTA), the ongoing discount to Net Tangible Assets for many A-REITs is probably justified, particularly in light of the sector's questionable long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

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 corporate governance issues, 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.

Our exposure to Australia continued to detract from performance. We could be accused of having home-market bias and arguably hold too many names. We continue to review our positions however we believe our exposures have strong financial footings and are generally well placed relative to the exuberance evident in other REIT markets such as the US.

## USA

Despite concerns about its compounding debt load and stubbornly high unemployment, the US economy is expected to grow roughly in line with its 20 year average GDP growth rate (circa 2.5%) in the next 6 to 12 months, notwithstanding expectations for a soft June quarter 2011. This expected growth should be underpinned by a recovery in the construction industry (a major employer with a significant multiplier effect) from multi-decade lows. Since 2007, US construction activity as a proportion of GDP contracted by an average 8.2% per annum which we believe is unlikely to be sustained due to improving supply demand dynamics in the real estate industry.



Signs of a pick-up in development activity are emerging including the resumption of development by Boston Properties (BXP) of their one million square foot office project at 250 West 55<sup>th</sup> Street, in midtown Manhattan. The 39-story office tower commenced development in 2007 but was suspended in 2009. Construction is now set to resume later this year triggered by law firm Morrison & Foerster signing a lease for 180,000 square feet. Completion is scheduled for 2014.

Meanwhile on the demand-side, publisher Conde Naste is reported to be moving from midtown to downtown Manhattan, leasing one million square feet at 1 World Trade Center. Located on the site of the former World Trade Center, the building will be the tallest in America and is being developed by the Port Authority of New York and New Jersey. Conde Naste is regarded as somewhat of a trend-setter amongst New York tenants, having pioneered a move to its current Times Square office when that location was not regarded as appealing to large scale users. The move could signal a shift in the broader appeal of lower Manhattan and is also indicative of limited options for large space users in midtown given the lack of development in recent years.

Avalon Bay (AVB) along with other multi-family REITs have also been moving to satisfy the looming shortage of multi-family residential accommodation in key cities such as New York, San Francisco and Boston by kick-starting development activity.

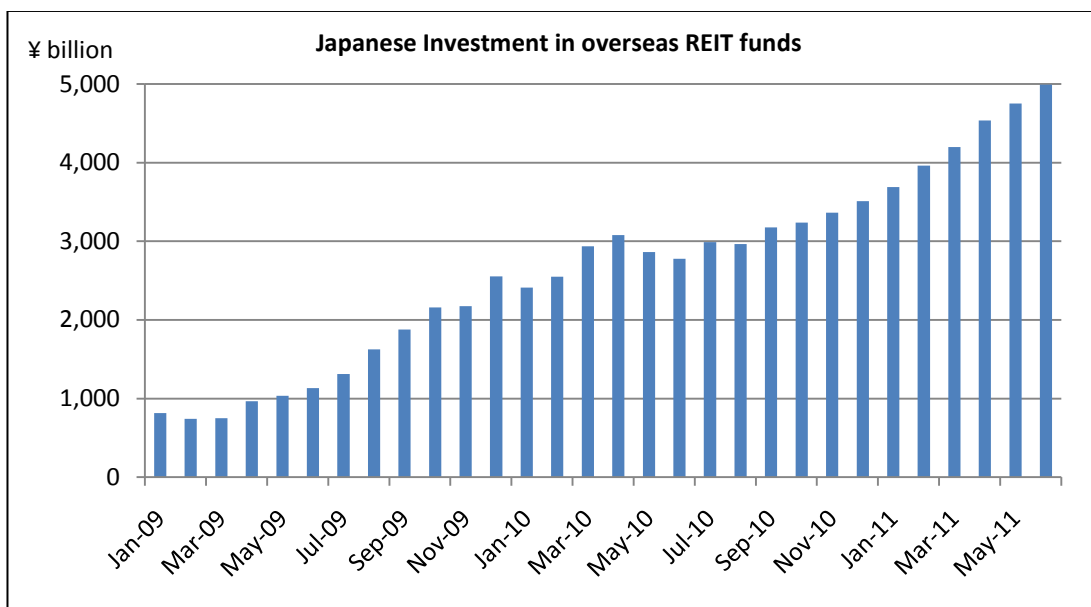
The US Federal Reserve appears content to keep interest rates lower for longer. As we have stated previously, these conditions (low construction and low interest rates) are positive for real estate markets. While a job-less recovery is not without perils, the diversified nature of the US economy and the potential pick-up in construction and employment bodes well for a sustainable and robust recovery. The handling of the government's debt burden appears to be the greatest challenge in predicting the speed and breadth of such recovery. Furthermore we continue to watch for signs of inflation which could cause the Fed to review interest rate settings.

Hence the US economy is at a challenging phase. There is reason for optimism as well as trepidation. US REIT's have been viewed as a good bet in these conditions. However we believe US REIT prices are excessive on many measures – relative to equities and “price per pound” in particular. Many of its major constituents are at or approaching all-time high stock prices and are factoring in a continuation of favourable conditions for some time. We believe the sector is vulnerable to the inevitable unexpected events which periodically test the market and change the dynamics which impact real estate and the economy. Our portfolio remains focussed on stocks with exposure to the most robust dynamics – particularly New York office (SL Green), highly productive malls and outlet centres (Simon Property Group) and high barrier to entry residential areas (Home Properties).

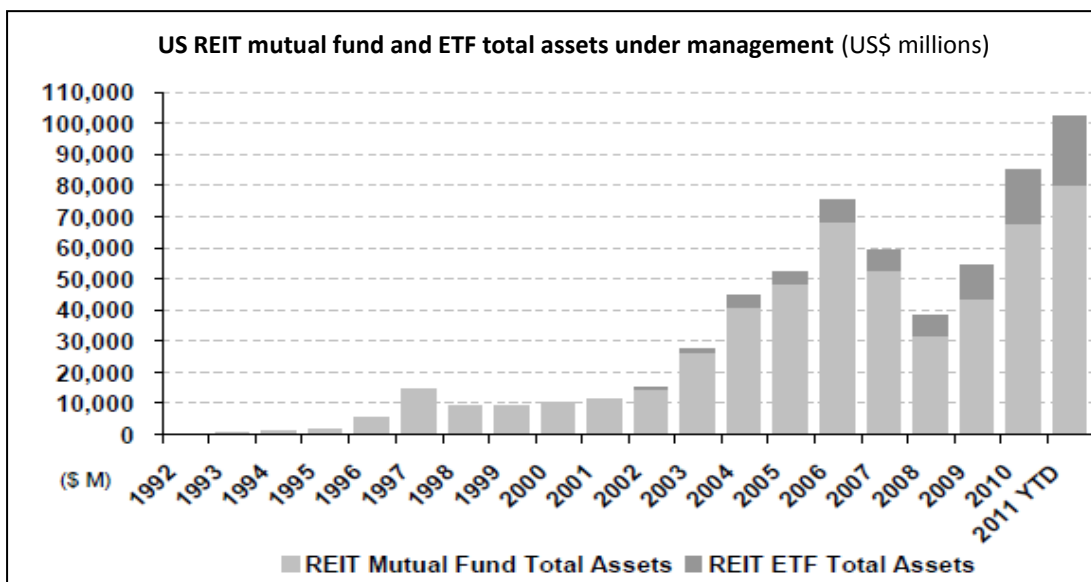
## **Capital flows**

Our recent discussions with asset consultants around the world highlighted that many investors and their advisors are unsure how to categorise the listed REIT sector: real estate or equities? At the moment many are putting it in the too hard basket and preferring unlisted real estate despite recognising the inherent dangers of illiquidity.

This view however, isn't necessarily shared with investors everywhere as evidenced by strong inflows by Japanese and US investors into US and global REIT funds. In particular, Japanese investors have poured into offshore REIT funds in the last 12 months chasing higher yields, diversification away from the post-quake local economy and perhaps in anticipation of a weakening Yen. We understand that some REIT funds are offering Japanese investors guaranteed yields well over 10% which are manufactured via currency and derivative instruments or are paid out of capital. The volume and speed of such flows is of some concern to us, not just from the impact of a sudden reversal, but also the possible tarnished reputation of the industry if such ‘manufactured’ products implode.



Source: Daiwa Research



Source: Citi Investment Research and Analysis

## External Conflicts

The quarter was notable for highlighting the conflicts involved in externally managed vehicles with two such vehicles being challenged by activist shareholders.

ProLogis European Properties (PEPR), a Euronext listed satellite fund of ProLogis (PLD) faced a takeover-bid by a disgruntled existing shareholder, Dutch pension fund manager Algemene Pensioen Groep NV (APG), in a consortium led by Australian-based Goodman Group (GMG). The consortium's offer of €6.00 per share was a premium of approximately 20% to PEPR's prior closing price of €5.00, and in-line with the most recent appraised NAV. The proposal was nevertheless rejected by ProLogis, in part because the offer imposed a number of conditions including the transfer of management rights from ProLogis to Goodman. Subsequently, ProLogis raised its ownership in PEPR from 33.1% to 38% and launched a tender offer to acquire all of PEPR's ordinary and convertible preferred units initially at €6.10 and later increased to €6.20. At the end of the offer period, PLD owned 89.6% of the ordinary units and 94.6% of the preferred units. This was below the threshold required to squeeze-out the remaining shareholders.

Meanwhile, hedge fund shareholders agitated for a change of manager for Australian listed Charter Hall Office Fund (CQO), a listed satellite fund of Charter Hall Group (CHC). The hedge funds have called a meeting to replace CHC with Moss Capital as manager. In response CHC has increased its stake in CQO to approximately 13.3% and is reviewing the corporate governance and fee structures of its listed funds.

The battle over the future direction and management of CQO negatively impacted the manager, CHC, the later producing a total return of -8.7% for the quarter. 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, the hedge funds have picked at the soft underbelly of the AREIT 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.

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.

## **M&A**

In addition to the aforementioned shareholder agitation, there were a number of take-over bids for smaller real estate vehicles during the quarter.

Blackstone Real Estate Partners entered into a Scheme Implementation Deed to acquire Australian listed property fund manager and developer Valad Property Group (VPG). The offer price of A\$1.80 per unit in cash represents a 56% premium over the closing price of 27 April and a 22% discount to the Dec 2010 NTA.

London listed developer Minerva PLC (MNR) agreed terms with a consortium consisting of funds advised by AREA Property Partners and Delancey Real Estate Asset Management for a recommended cash offer to acquire all the issued shares in MNR. The bid values MNR at 120.5 pence a share which represents a 26.8% premium to MNR's 19 May 2011 closing price of 95 pence.

In Singapore, Allgreen Properties (AG) received a privatisation offer from its largest shareholder, the Kuok Group led Brookvale Investments (which already owns approximately 55.7%) for S\$2.5bn, or 0.96x its latest NAV representing a 20% premium to Allgreens highest traded price in the last three years.

## Capital Raisings/IPOs

Most IPO's during the quarter had been previously deferred and re-priced.

German housing firm GSW Immobilien (GIB) successfully completed a €468m IPO after pulling an earlier attempt in 2010 amidst the sovereign debt crisis. The offer was eventually priced at €19 per share and advanced 13% on its first trading day to close at €21.50.

Also in Germany, Prime Office REIT (PMO) completed its IPO at €6.20 after re-pricing earlier attempts to list at over €7.00 per share. It was not apparent to us that management was optimising value for the existing unitholders in the predecessor unlisted funds. The stock closed its first day of trading at €6.77 but subsequent to quarter end has traded below its issue price.

In Singapore, Mapletree Commercial Trust (MCT) closed on its S\$1bn IPO after a delay in March due to Japan's earthquake disaster, with a final offering price of S\$0.88 per share, slightly above the midpoint of its pricing range (S\$0.84-0.91). MCT closed the quarter just below its issue price at S\$0.865 per share. Another postponed Singaporean IPO, Perennial China Retail Trust (PCRT), completed its S\$785 million IPO. Perennial China is a unit of Perennial Real Estate that was founded by former CapitaMall Trust CEO Pua Seck Guan. The stock ended the quarter approximately 12% below its IPO price of S\$0.70.

In Hong Kong, the first Yuan denominated IPO outside of mainland China, Hui Xian REIT (87001) was priced at RMB5.24 per unit (the low end of the indicative range), raising total proceeds of RMB10.48b. Hui Xian REIT consists of a single asset, Beijing Oriental Plaza, which was the flagship asset of Cheung Kong Holdings. The REIT will be externally managed by CITIC Securities Group, the Cheung Kong Group and the ARA Group. The vehicle ended the quarter trading at RMB4.83, some 8% below the IPO price.

In Australia, 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 vehicle warrants support in its current form.

In the US ProLogis raised US\$1 billion via a placement at \$33.50 per share. The newly merged entity is targeting a BBB credit rating and had announced its intention to de-lever via a combination of non-core asset sales and a possible equity raising at the time of the merger with AMB. The tender offer for ProLogis Europe (referred to earlier in our report) and an acceleration in its development activity triggered the capital raise.

While we undertook extensive reviews, we did not participate in any of these offerings.

## Travel

In June RCL travelled to Poland to better understand the rapidly evolving shopping centre industry which has become an increasing focus for many of the larger European shopping landlords (one AREIT, Charter Hall Retail, also has investments in Poland). The shopping centre industry is remarkably immature in Poland, the oldest western-style shopping centre is only 12 years old, and as a result the country remains under-retailed when compared to many of its European peers. In addition, Poland's economic growth has been a shining light in Europe, being the only EU economy that did not see negative GDP growth during the GFC, partly a result of having the ability to devalue its currency while at the same time being the biggest beneficiary of EU spending. These factors have combined to see developers from all over Europe and the UK enter Poland often by buying cheap land in tertiary locations that are expected to benefit from massive amounts of infrastructure

spending (by 2013 €28bn is expected to have been spent on infrastructure and environmental projects by the European Regional Development Fund). This strategy is fraught with risk as leasing up will likely prove difficult in light of the supply conditions.

Unibail has adopted a different strategy in Poland, in that it has a portfolio of four of the most prime mall assets in Poland's wealthiest city, Warsaw. These shopping centres are remarkably productive for a country which has a relatively low income per capita, almost 30% more productive than your average centre in Germany.

While on the Continent we met with a number of European companies and continue to find it challenging to identify new investment opportunities, in significant part due to what we perceive to be poor strategies and execution. In a throw-back to pre financial crisis conditions, many are focussed once again on acquisitions despite remaining relatively highly levered. Our meetings with Unibail management once again reinforced the strength of their management team and the quality of their portfolio. Unibail is steadily selling its smaller centres and focusing on its 'fortress' malls where it constantly tries to improve the tenant mix.

In the US RCL attended the annual International Council of Shopping Centres (ICSC) global retail conference. While attendance was up and the mood more optimistic than the previous two years the talk was more about the strong firming of investment cap rates than strong tenant demand. Demand from tenants is still focussed on the better centres and while large national retailers are selectively expanding, the smaller 'mom and pop' operators, which are more prevalent in the strip centre arena, are still having a tough time.

We visited Canadian multifamily REIT Boardwalk (BEI) in its hometown Calgary. The high oil price is triggering huge capital expenditure programs to explore the oil fields which should bode well for multi-family demand. Furthermore demand is underpinned by the affordability of rental properties compared to buying. The assets we visited presented well and we saw an apartment complex which had been converted into supported living for limited cost.

Our visit to Canada revealed other interesting opportunities. While one REIT in particular ticks many boxes, pricing unfortunately wasn't one of them. Therefore, we will keep track of this company and if a more attractive entry point becomes available we might add this company to our portfolio.

In Asia we visited China and Hong Kong. The larger Chinese residential developers appear to be well positioned to gain market share from smaller players, and have the benefit of having a diversity of product mix and locations – including exposure to second tier cities that have not felt the full force of policy measures aimed at cooling house prices in the bigger first tier cities.

## Conclusion

Headlines are filled with macro concerns including the European sovereign debt crisis, US political wrangling over the debt ceiling and disruptions caused by recent natural disasters. Real estate remains susceptible to the risks of a jobless recovery and policy measures to address fiscal imbalances. However in broad terms, listed real estate balance sheets are robust, the global economy is not in decline whilst low interest rates and low construction continue to underpin real estate markets in most parts of the world.

Regionally REIT valuations in the US appear to be full compared to Asian and Australian stocks that have felt the brunt of government and central bank cooling measures. Rising inflation is likely to be positive for commodity real estate such as office and industrial given that rents are often inflation linked and rising costs make it more expensive to build new competing space.

We continue to believe that urbanisation to larger cities is a trend that will positively impact real estate markets in those cities not just in developing economies such as China but also in developed economies around the globe. We remain focussed on REITs positioned to benefit from these long-term drivers.

### Vale Peter Hartigan

Finally, Resolution Capital mourns the loss of Peter Hartigan who passed away on 7 June 2011. Peter was a co-founder and Director of Resolution Capital. Peter was an integral part of the team since 1995 and we 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 council to many in the industry. Peter is survived by his wife Patricia and son Pierce.

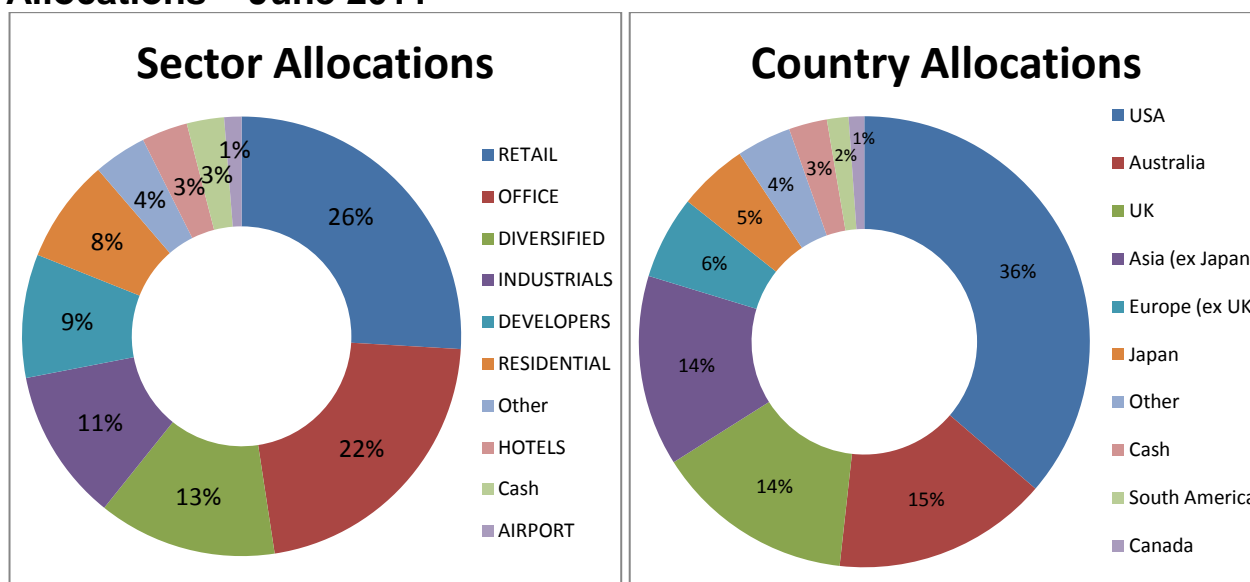
## Portfolio Top 10 Stocks

### Top 10 Portfolio Holdings\* – June 2011

Stock	Sector	Country
Global Logistic Properties Ltd	Industrials	Singapore
Goodman Group	Industrials	Australia
Home Properties Inc.	Residential	USA
Land Securities	Diversified	UK
Mitsubishi Estate	Developers	Japan
Simon Property Group	Retail	USA
SL Green Realty	Office	USA
Sun Hung Kai Properties Ltd	Developers	Hong Kong
Unibail - Rodamco	Retail	France
Westfield Group	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](mailto:andrew.parsons@resolutioncapital.com.au)

### Marco Colantonio

Portfolio Manager

Direct Line: 02 8258 9155

Email: [marco.colantonio@resolutioncapital.com.au](mailto:marco.colantonio@resolutioncapital.com.au)

### Jan de Vos

Portfolio Manager

Direct Line: 02 8258 9109

Email: [jan.devos@resolutioncapital.com.au](mailto:jan.devos@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

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