

The logo for Resolution Capital features a dark red, trapezoidal shape in the upper right corner. Below it, the word "resolution" is written in a lowercase, sans-serif font, and "CAPITAL" is written in a larger, uppercase, sans-serif font. Underneath the company name, the tagline "real estate securities solutions" is written in a smaller, lowercase, sans-serif font.

resolution**CAPITAL**  
real estate securities solutions

# **RESOLUTION CAPITAL GLOBAL PROPERTY SECURITIES FUND**

**SEPTEMBER 2011**  
**QUARTERLY INVESTMENT REPORT**



## GLOBAL REAL ESTATE SECURITIES

### Fund Investment Performance

The Resolution Capital Global Property Securities Fund underperformed the UBS Global Investors Index (AUD Hedged Net TR) by 236 basis points for the quarter ending 30 September 2011.

#### Period Ending 30 September 2011\*

	Quarter %	1 Year %	3 Year %	Since Inception <sup>#</sup> %
Portfolio	-16.88	-3.64	2.03	2.02
Benchmark (UBS Global Investors Index)	-14.52	0.00	-3.41	-3.41
Difference	-2.36	-3.64	5.44	5.43

\*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 September 2011	\$0.8121	\$0.8073
30 June 2011	\$0.9770	\$0.9712

## Market Performance

### Market Overview

	30 Sep 2011	30 Jun 2011	Quarterly Accumulation Return
<b>UBS Global Investors Index AUD (Hedged)</b>	<b>1,116</b>	<b>1,306</b>	<b>-14.52%</b>
UBS Global Investors Index AUD (Unhedged)	886	965	-8.18%
S&P/ASX 300 (GICS) Australia Property	18,182	19,794	-8.14%
S&P/ASX 300 Index	30,147	34,122	-11.64%
10 Year Bonds	4.25%	5.21%	
90 Day Bills	4.86%	4.96%	
AUD/USD	\$0.97	\$1.072	-9.51%

## Commentary

The UBS Global Investors Accumulation Index (hedged) produced a total return of -14.5% for the quarter ended 30 September 2011. During the quarter, the global macro environment darkened considerably, driven by regional events and signs of decelerating economic growth. As the quarter progressed, listed real estate securities markets declined due to concerns about capital market events and the impact that slower economic activity could have on tenant demand.

### Macro Events Mattered

It is apparent that June and July marked an inflection point where the global macro landscape shifted away from hopes of accelerating growth toward fears of economic contraction and a re-pricing of risk. The debt crisis in Greece remained unresolved with broader implications for the Euro region; the US federal long term credit rating was downgraded for the first time ever; and China's economy, a major contributor to growth over the past few years, continued to moderate with implications for the pace of economic activity throughout Asia and other parts of the world.

During the quarter, the crisis in Greece threatened to spread throughout Europe via financial institutions that faced considerable losses on their loans and other investments in Greece. It has become clear that European banks must recapitalise following value diminution of assets on their balance sheets. As a result, lending activity is being curtailed throughout the region, credit spreads have widened and debt capital has become less available.

Global markets were dealt a body blow in July and August from the fractious debate over the US deficit and the subsequent downgrade of the US government's long term credit rating by Standard and Poor's. This downgrade triggered a sell-off in every major market index around the world while market volatility spiked to levels not seen since the darkest days of the GFC.

### United States

In the third quarter, the US REITs produced a total return of -14.2% with performance worsening as the quarter progressed. Fears of a double dip recession emerged with worse than expected non-farm payroll figures, a sharp drop in consumer sentiment and a downward revision to historic GDP figures adding to the deteriorating tone.

The property market became bifurcated and investment activity slowed as the quarter progressed. Financing became more difficult to obtain and this became an acute problem for secondary assets and markets. Core property in prime markets continued to trade at low capitalisation rates. In Manhattan and Washington DC, multi-family REIT UDR Inc (UDR) deepened its footprint with several acquisitions at sub 5% cap rates. Also in Manhattan, office REIT SL Green (SLG) entered into a joint venture to acquire a US\$416m retail and multifamily portfolio on the East Side at a cap rate in the low 4% range. Finally, two high end malls were sold during the quarter when General Growth Properties (GGP) and the Canadian Pension Plan jointly acquired Plaza Frontenac in St. Louis, while Simon Property (SPG) acquired the remaining interests in King of Prussia Mall near Philadelphia. High end malls with tenant sales in excess of US\$500 per square foot continue to be well bid in the market.

In comparison, cap rates were considerably wider for secondary assets. Equity One sold a lower quality shopping centre portfolio containing 36 assets to Blackstone Group at a reported 7.5% cap rate. Also, after quietly trying to sell some assets, GGP announced its plan to spin off 30 lower quality properties into a new REIT, Rouse Properties, via a special taxable dividend later this year. Meanwhile Westfield's (WDC) intention to sell some of its lower quality US malls appears to have stalled as buyers and lenders focus on prime assets.

Commercial real estate pricing was adversely impacted by the sudden halt in the CMBS market. In mid-July, CMBS issuance activity stopped immediately following S&P's withdrawal of its rating of a large CMBS deal, virtually at the closing table. Transactions that were in process did not proceed and lenders were left warehousing loan inventory that they could not sell. Consequently, secured debt origination ground to a halt and spreads widened for even the best borrowers. The impact was far greater on secondary assets, which were more reliant on CMBS financing, than on core properties, which still could attract capital from balance sheet lenders, principally life insurers. By the end of September the CMBS market began to revive and several deals priced, albeit at higher spreads, including the one that had been pulled in July.

The hotel sector suffered the most immediate impact to values, declining 27.3% during the quarter. This negatively impacted fund performance due to its hotel exposure. After a prolific first half of the year, hotel REITs stopped acquiring. Acquisition agreements in process were re-priced or broken. Hyatt Hotels was able to re-price its US\$802m acquisition of 24 limited service hotels from LodgeWorks; Host Hotels terminated its planned acquisition of the St. Regis Monarch Beach; and Cerberus Capital and Chatham Lodging Trust sought to terminate their joint venture to purchase the Innkeepers USA Trust portfolio citing material changes.

## Europe

Europe was caught in the crosshairs of the Greek crisis which threatened the European financial community. Listed property stocks produced a total return of -18.2% on the Continent and -21.2% in the UK during the quarter as mounting fears of contagion and economic contraction gripped the region. Consumer sentiment was down, job layoffs began to rise and investment capital receded.

Two planned corporate transactions in the third quarter illustrate the challenges in the region. In July, Fonciere des Regions (FdR) announced the acquisition of a significant stake in Fonciere Paris France (FPF), a smaller Paris office focused company. FdR agreed to acquire the remaining interest in FPF, with a closing expected later this year. In September, however, the transaction was terminated due to adverse market conditions. Then in August, Dutch based Nieuwe Steen Investments (NSI) was forced to postpone to October a vote on its proposed merger with VastNed O/I when it became clear that it would not receive adequate shareholder approval at the EGM.

## Asia

The listed real estate sector in Hong Kong produced a total return of -25.3% in the third quarter, the worst performing market globally. Hong Kong was buffeted on three fronts – a global office market slowdown, slowing residential sales, and moderation of activity in China.

We believe a pricing anomaly is emerging in Hong Kong, and that quality companies have become oversold. At current share price levels, we believe certain Hong Kong landlords, such as Hysan, represent outstanding value.

Hong Kong retail remains the strongest sector on the back of strong sales from mainland Chinese tourists. RMB appreciation has made Hong Kong shopping very attractive and retail sales have been growing at a double digit pace over the past few years.

The residential market in Hong Kong has stalled in terms of transaction volumes following the austerity measures implemented by the Hong Kong government since 2010. On the positive side, supply levels remain subdued despite government attempts to release more land, and leverage levels are not extreme. We note however that affordability has deteriorated due to elevated prices and mortgage rates rising as banks face funding pressures. Auctions of residential land sites have also slowed, following several sales that priced below expected levels.

As one of Hong Kong's dominant residential developers, our holding in Sun Hung Kai Properties (16) detracted from performance despite reporting strong full year results to 30 June 2011 and increasing its dividend by 24%. We believe the dividend increase reflects the strength of the recurring earnings stream from the company's investment portfolio in Hong Kong and China.

Chinese residential developers also suffered steep share price declines during the quarter as sales volumes declined, price discounting began and funding pressures emerged. The fund has no exposure to the pure mainland residential developers.

Japan real estate stocks outperformed in the third quarter with a total return of -7.5%. The externally managed J-REIT sector continued to benefit from the Bank of Japan asset purchasing program.

## Australia

The Australian listed property sector was one of the best performing markets in the third quarter with a total return of -8.0%. The market's relative, albeit negative, performance was fostered more by the absence of macro crises than by buoyant property fundamentals. A tepid office leasing environment and growing concerns about retail sales and the possible effects of e-tail cannibalisation on bricks and mortar locations continued to weigh on the stocks.

During the quarter, there were several corporate capital events which supported interest in the Australia listed property sector.

Charter Hall Office REIT (CQO) announced it would exit the US market and sell its assets to Beacon Capital Partners for gross proceeds of US\$1.71 billion. After adjusting for capital expenditure, selling fees and transfer costs the net price equated to a 6% discount to book value. The news was initially treated with disappointment as market expectations were for the sale to have achieved a premium to book value. However the stock rebounded later in the quarter when a Macquarie Group led consortium put forward a highly conditional proposal to acquire the remaining Australian assets of CQO. While the approach was dismissed by the independent directors as being inadequate based on an indicative bid price approximately 9% below pro-forma book value, it did signal international investor interest in

Australian real estate at a price representing a narrower discount than the 15% to 20% gap at which many AREIT's had been trading.

In addition to the aforementioned bid for CQO, Valad Property Group agreed to be acquired by Blackstone for A\$806m (or A\$1.80 per unit). This followed Blackstone's purchase of Centro's (CNP) US shopping center assets for A\$8.5b earlier in 2011.

Several Australian property companies announced share buybacks including GPT, Charter Hall Retail, Stockland and Investa Office. These announcements look to be little more than window dressing given the limited amount of capital actually committed.

Westfield's price continued to decline, falling 7.5% during the quarter, despite a falling Australian dollar and the completion of its £1.8 billion Stratford City retail centre on the northeast side of London. Westfield pre-sold a 50% interest in the asset last November crystallising a 20% profit on development costs. Earlier in the quarter, the company announced that it was entering the Brazil market via acquiring a 50% interest in Almeida Junior Shopping Centers which owns a portfolio of five properties in the southern state of Santa Catarina. Westfield also announced that it intended to expand into continental Europe by forming a joint venture to develop a €1.0-1.25 billion mall in Milan.

## Capital Raisings

Given the macro uncertainties that enveloped global markets and the negative performance experienced by the listed property sector, there were very few capital raisings in the third quarter.

Several IPOs were delayed, including Axis Global Islamic REIT (a shariah compliant fund that was to own industrial properties in Asia and had expected to be listed in Malaysia), Morgan Properties Trust (suburban apartments in the New York-Washington corridor of the US) and O'Donnell Strategic Industrial REIT (US warehouses).

There were four equity raisings in the US during the third quarter of meaningful size. All involved companies taking advantage of highly priced equity values that traded at or above NAV. In three instances, UDR, Home Properties (HME) and Equity Lifestyle (ELS), the companies involved raised equity to fund specific acquisitions. In contrast Avalon Bay (AVB) raised US\$630m in late August opportunistically to further improve its already lightly leveraged balance sheet. We applaud management teams that recognise when their equity is priced at a premium and act to capture that value.

## Conclusion

In the third quarter, REITs were rocked by economic issues potentially affecting tenant demand. Real estate, along with many other asset classes, was impacted by broad, trans-regional macroeconomic issues including sovereign credit ratings, retreating lending markets and slowing economic activity. With few exceptions, we note that real estate supply-side dynamics remain healthy in most markets; new construction is limited and vacancy rates are below historic averages. The sell-off experienced in global real estate markets is mostly attributable to uncertain tenant demand. We do not expect a sharp rent reversion to occur in any major property market over the coming quarters. With the view that market fundamentals will remain in equilibrium for an extended period of time, we maintain our constructive view of global REITs.

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