ING Clarion Real Estate Securities

GLOBAL REAL ESTATE SECURITIES

Market Commentary

Equity markets, including property companies, slumped in January as investors for the first time in months looked at the glass as being half empty instead of half full as investors digested a mix of disappointing macro-economic data, tightening measures in China and perhaps a slippage of confidence that global governments can smoothly engineer the framework for a sustained economic recovery. Listed property companies were down 5% for the month with little difference in returns among the North American, European and Asia-Pacific regions. Within the Asia-Pacific region, Hong Kong property companies were notably hit the hardest, down more than 10%, on concerns emanating from a clear message from Beijing that liquidity levels will be reduced. Negative performance in Hong Kong was somewhat offset by modestly positive returns in Japan, which appears to be benefiting from an investor rotation to valuation levels that are comparatively reasonable.

Index Performance ($ USD)	1 Month	YTD	1 Year	3 Year	5 Year	10 Year
S&P Developed Property Index	-5.0%	-5.0%	49.1%	-15.4%	1.4%	9.2%
Returns by Region						
Asia Pacific	-5.1%	-5.1%	45.8%	-11.1%	3.6%	6.7%
Europe	-4.9%	-4.9%	55.7%	-21.8%	-2.4%	9.5%
North America	-5.1%	-5.1%	49.8%	-16.6%	0.7%	10.3%

Source: S&P Developed Property Index, as of January 31, 2010.

Economic news is three steps forward, two steps back. Macro-economic news has been mixed but we believe net positive. Economic headwinds began early in the month as U.S. non-farm payrolls missed consensus numbers and reminded investors that the path to sustained economic recovery will have setbacks along the way. Later in the month, the Chinese central government announced monetary tightening measures which raised concerns that the Chinese economy might be overheating and that further measures will follow. More specifically, the People's Bank of China announced that it would raise the required reserve ratios by 50 basis points to 16.0%. On the positive side, U.S. annualized 4Q09 GDP growth surprised to the upside late in month at a rate of 5.7% versus 4.7% expected, demonstrating the mixed nature of macro-economic indicators. Separately, U.S. consumer confidence was shown to have improved in January. While headwinds this year have been somewhat anticipated, including an interest rate environment which may eventually move higher in response to an economic recovery, we are not dissuaded from the view that the outlook for real estate securities is improving. Economic recovery ultimately translates to improved real estate demand and is positive for owners and operators of real estate, including listed property companies.

Back to basics for listed property companies. Following the significant dislocation and subsequent recovery of the capital markets over the past eighteen months, 2010 promises to be a year where property company management teams can get back to focusing on improving earnings. While this primarily means focusing on asset management activities which drive "internal" growth, this also means adding value through "external" growth by recycling capital via selective acquisitions/dispositions and marginal development activities. Internal growth is driven by mundane but critical property management activities including those related to tenant retention, such as structuring leasing commissions/tenant improvements and managing maintenance capital expenditures in an efficient manner. External growth consists of taking advantage of acquisitions when the opportunity presents itself and possibly funding it by pruning mature or non-core properties from the company portfolio. It also might include selectively looking at development activities, which at this point in the recovery are likely to be an expansion or renovation rather than a new project. Listed property management teams can get back to the routine tasks of running a real estate company as balance sheets have largely been repaired and the deleveraging process largely completed. History suggests that the listed company management teams will capably handle the challenges of 2010.

Commercial real estate debt markets appear to be deleveraging with speed and some degree of transparency. It appears increasingly likely that there will not be massive dislocation in the commercial real estate market driven by real estate loan expirations. Instead, as property values firm, it is likely that commercial real estate loan expirations will be handled via an orderly process. There will be losses, some significant, but massive dislocation is unlikely.

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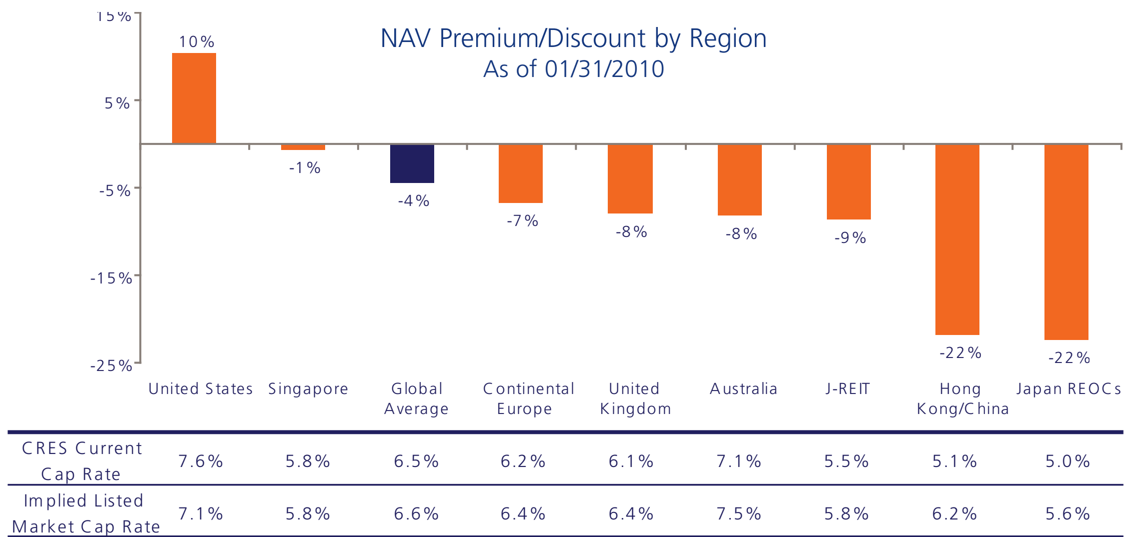
What can go right… An example of a reorganization which is moving quickly and in an orderly process is the General Growth Properties bankruptcy. General Growth Properties is one of the largest owner/operators of regional malls in the U.S. and declared bankruptcy nearly a year ago as a result of being unable to refinance significant debt maturities, despite remaining current on debt service payments and an underlying occupancy rate which never dipped below 90%. It now looks like General Growth Properties will be able to recapitalize with secured lenders getting par and maybe even unsecured lenders getting par – whereas six to nine months ago it looked like the creditors controlling the break-up of the company expected to take substantial losses/write-offs. In an environment where massive dislocation is not expected to occur, the appeal of REITs with high-quality portfolios, good management, transparency and liquidity is enhanced.

…and what can go wrong. Separately, in a high profile private transaction which demonstrates what can go wrong, but for political reasons and not fundamental reasons, Tishman Speyer's handing back of the keys to their creditors for the $5.4 billion ($6.3 billion including the interest reserve) Stuyvesant Town/Peter Cooper Village investment deal, which was completed in 2006, demonstrates an example of overpaying for real estate based on optimistic assumptions. A key assumption was the ability to increase rents to current market levels. This has not materialized, largely the result of political pressure. Courts have prevented rent control from being removed from rents that remain materially below market rates, thus making this real estate deal unique as the result of New York City politics. As a result, NOI on the asset is only up approximately 20% from the date of acquisition versus the approximate 200% by 2011 underwritten by the buyers. While equity investors have lost $1.9 billion on the deal which was bought near the peak, with mezzanine investors soon likely to follow, all eyes are on a deal which is going to result in material losses for stakeholders. Of note is that the fate of the deal has little direct impact on U.S. REITs beyond SL Green Realty, which has fully written down its $200 million mezzanine investment. While the ultimate resolution of this reorganization remains to be seen, the visibility and speed with which it has moved thus far brings with it the hope of a somewhat orderly reorganization, which in hindsight was an extremely over-priced asset at acquisition given inherent political risk.

Real estate values are moving up. Perhaps underappreciated by many investors is that real estate capital values have moved up over the past six months. With values that we believe troughed approximately six to nine months ago, we now estimate cap rates are 6.5% on a weighted average global basis. Real estate values are moving up as a result of the combination of an improved access to capital, an improved cost of capital and more visibility to underwriting assumptions. In terms of expected returns, the overall risk premium has materially decreased over the past six to nine months as a result of the above. This in turn has resulted in decreased Internal Rates of Return required by investors. With cash flows generated from property bottoming out, investors can underwrite property values using current yields which are materially lower than during the depth of the credit crisis. At the end of January, we estimate that listed property companies are trading at an approximate 4% discount to the underlying real estate value.



	United States	Singapore	Global Average	Continental Europe	United Kingdom	Australia	J-REIT	Hong Kong/China	Japan REOCs
CRES Current Cap Rate	7.6%	5.8%	6.5%	6.2%	6.1%	7.1%	5.5%	5.1%	5.0%
Implied Listed Market Cap Rate	7.1%	5.8%	6.6%	6.4%	6.4%	7.5%	5.8%	6.2%	5.6%

*Information is the opinion of ING CRES as of 01/31/10 which is subject to change and is not intended to be a forecast of future events, a guarantee of future results, or investment advice. Forecasts and any factors discussed are not necessarily indicative of future investment performance.

We reiterate our total return expectations for 2010 to be in the +5% to +15% range as improving fundamentals and valuations based on an improving economy more than offset headwinds which are typical at this point in the economic and property cycle. History suggests that listed property companies do well coming out of a recessionary environment and we believe this time to be no different from past recoveries.

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The S&P Developed Property Index is unmanaged and constructed to include all developed market property companies with an available market capitalization of at least US $100 million and derive more than 60% of their revenue from property-related activities. Investors cannot invest directly in an index.

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REAL ESTATE INVESTMENT MANAGEMENT

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