ING Clarion Real Estate Securities

GLOBAL REAL ESTATE SECURITIES

Market Commentary

Global property companies rallied in July as sentiment regarding the global economic outlook improved, based partly on encouraging results of the European bank stress tests, whose uncertain outcome had previously weighed on the market. European property companies as a result rebounded sharply with a total return of +14.5%, followed by property companies in North America +9.7% and the Asia-Pacific region +6.7%. Year-to-date, returns for global listed property stocks are once again in positive territory.

Index Performance ($ USD)	1 Month	YTD	1 Year	3 Year	5 Year	10 Year
S&P Developed Property Index	9.1%	4.9%	24.8%	-9.8%	0.8%	9.2%
Returns by Region						
Asia Pacific	6.7%	0.1%	8.3%	-10.9%	4.0%	7.6%
Europe	14.5%	-6.2%	16.9%	-18.7%	-3.8%	8.6%
North America	9.7%	15.6%	53.0%	-4.2%	0.3%	10.22

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

Macro economic news continues to grab the headlines. The most significant financial news for the month was the result of the European bank stress tests, released on July 23, to which equity markets reacted positively despite criticism that the tests were not stringent enough. Only seven of the 91 banks tested failed. Still, the tests appeared to soothe investors, reassured by, if nothing else, the improved disclosure of the banks' finances. Other factors also supported the position that European economic conditions may be better than once feared. Spain, Greece and Ireland successfully tapped the bond markets in July for an aggregate €9.42 billion: Spain raised €5.97 billion (12- and 18-month bills), Greece €1.95 billion (13-week bills), and Ireland €1.5 billion (six- and 10-year bonds). A relaxation of the capital requirements in combination with the postponement of the introduction of Basel 3 (a new and stricter set of accountancy rules limiting balance sheet flexibility of the banks) also helped sentiment. The U.K. reported consensus-beating GDP data for the second quarter, with output jumping 1.1% quarter-on-quarter versus market expectations of 0.6%. This was the strongest growth rate in four years. Construction rose 6.6%, manufacturing rose 1.6% and services output rose 0.9% (all quarter-on-quarter). We expect that capitalization levels of European banks will continue to be under scrutiny, particularly those in Spain and some in Germany.

In the U.S., marginal economic news, while not horrible, highlighted the downside risks to the ongoing fragile economic recovery. The June jobs number was underwhelming, consumer confidence was at a five-month low and disappointing housing numbers followed the expiration of the homebuyer tax credit in April. U.S. 2Q10 GDP came in at 2.4% annualized versus 3.7% the previous quarter, short of consensus expectations of 2.5%. Federal Reserve officials offered a slightly more dour outlook on the U.S. economy in its late June meeting. Fed officials stated that the economy, as measured by GDP, will grow between 3.0% to 3.5% in 2010, a downward revision from its previous estimate of 3.2% to 3.7%.

By contrast, economic growth in the Asia-Pacific region ex-Japan remains robust. Singapore reported 2Q10 GDP which was +19% year-over-year versus consensus expectations of +17%. As a result of this reading, the Monetary Authority of Singapore has increased its full-year 2010 GDP forecast from 7% to 9% to between 13% to 15%. Along with 2Q10 GDP growth in China at 10.3% year-on-year, the Singapore numbers continue to provide sharp contrast to Western economies which hope to sustain still fragile economic recoveries. Taken as a whole, with slow growth Western economies offset by higher growth Asian and emerging market economies, we believe the case for a continued global economic recovery to remain intact.

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Second quarter earnings reports are encouraging. Earnings reporting season is well underway as: (1) operating numbers reflect continued improvement of property fundamentals; (2) real estate companies continue to access both debt and equity capital at competitive costs and generally with ease; (3) transaction volumes continue to pick-up, albeit well off pre-crisis peak levels; and (4) listed property companies continue to be net buyers for the third consecutive quarter and property transaction yields are stabilizing, leading us to expect that future total returns now depend on sustainable and improving underlying fundamentals.

U.S. REIT earnings highlights. Second quarter earnings season is well underway as more than 50% of the companies reported results during July. A vast majority of companies in each of the major property types met or exceeded consensus expectations and demonstrated improving real estate fundamentals, with the exception of the industrial companies. In the office sector, Boston Properties beat consensus expectations reporting same-property net operating income (NOI) of -4.4% year-over-year (which is an improvement from the -6% decline in 1Q10), portfolio occupancy up 10 basis points to 93% and cash re-leasing spreads of +40% versus +14% during 1Q10 and -13% in 4Q09. National apartment company Equity Residential also beat consensus expectations with year-over-year same-property NOI of -2.9% versus -5.6% in 1Q10 and -6.3% in 4Q09, which also demonstrates sequential operational improvement. Management revised full-year same-property guidance by approximately 3%. Simon Property Group, the largest owner of malls in the U.S., reported 2Q10 FFO of $1.38/sh versus $1.34 consensus, due primarily to better than expected core fundamentals as same-property NOI was +1.9%, driven by an 80 basis point improvement in occupancy to 93.1%. Simon's liquidity profile remains among the strongest of U.S. REITs, with $2.6 billion of cash and over $3 billion of availability on its line of credit. Lodging REIT bellwether Host Hotels marginally beat consensus expectations on improving fundamentals as revenue per available room projections for the year were revised up to a range of +4% to 5.5% from a previous range of +1% to 4% range. The industrial property type has proved to be the only disappointing major property type thus far, as national owner/operator AMB Property lowered guidance for the year (despite meeting consensus numbers for the quarter) on weak leasing prospects both for the core portfolio as well as on the lease-up of its $1 billion development portfolio. AMB's report serves as a reminder that economic recovery as reflected in property company earnings does not necessarily travel in a straight line.

European company reports mixed. Outside the U.S., 2Q10 releases have been a mix of earnings releases (e.g., Continental Europe plus Asia) and portfolio updates in the form of interim statements and/or revaluations with no earnings numbers (e.g., U.K. and Australia). Reported numbers have generally been in-line to better than expected, with a few exceptions. In Continental Europe, Unibail attracted most of the attention following its announcement of a €20/sh special dividend to be paid in October (the "super-dividend" equates to a 13% yield on current share price). The super-dividend is not the first time Unibail management has been willing to return cash to shareholders (it did so in January 2005 with a €23/sh dividend) as it attempts to remain lean in an operational environment which is generating modestly positive earnings this year, as reflected in part by the +1.8% like-for-like rental growth achieved during 1H10 and leasing spreads which have decelerated to +16.5% for 1H10 versus +21% in 2009. Unibail's pro-forma leverage will be 40% (debt-to-total assets) which gives the company capacity for acquisitions off a smaller asset base.

On the other hand, fellow pan-European retail company Klepierre disappointed investors by revising earnings expectations for the year to be slightly negative. Like-for-like rental growth came out at -0.7% for 1H10 and occupancy declined to 97% at 1H10 from 97.3% at FY09 and 97.5% in 1H09, which shows the challenges of growing an otherwise well-leased portfolio. Disappointing leasing results came from significant negative rental revisons on assets in Spain and Eastern Europe, which continue to be tough markets from an operational point of view. French office companies generally produced disappointing earnings, too, as their in-place portfolios remain over-rented in the 10% to 15% range, and the Paris office rental market is not yet improving.

In the U.K., Land Securities announced in its interim statement the start of its first large retail development in recent times at Trinity Leeds, predicated in part on pre-leasing levels approaching 50%. West End office specialist Great Portland reported a portfolio valuation uplift of +4.6% since March, demonstrating what is likely the tail end of the benefit of yield compression over the past year as values will increasingly depend on improving trends in top-line rental income. IPD, a U.K. property market benchmarking firm, said capital growth in June was +0.5%, taking the quarter to +1.9%, the lowest since the rebound began (now +15% from its low).

Asian company results reflect regional strength. Earnings releases in the Asia-Pacific region reflect real estate markets which remain robust with occupancies generally in the mid-90% range and earnings which are in-line or better than expectations. Hong Kong Land, which serves as a proxy for office markets in both Hong Kong and Singapore, reported earnings at the high end of market expectations largely as the result of the completion of two large projects in Singapore — Marina Bay Residences and Waterfall Gardens. Rental revenue was +2.6% year-over-year with office occupancy at 95.8% and retail 100% occupied. Separately, the dominant Tokyo development companies (Mitsubishi Estate, Mitsui Fudosan and Sumitomo Realty) all reported quarterly results with no surprises and confirmation that the residential business (condominium sales) remains in better condition than the office market. Portfolio office occupancy rates for Mitsubishi Estate and Mitsui Fudosan, which are the two dominant Tokyo-focused property companies, nonetheless remain north of 95%, notably above the market average of 91% occupancy. Miki Shoji data for July shows office vacancy rates for Tokyo's five central wards to have improved by 10 basis points to 9.1%, which marks the first improvement since January 2008. The primary challenge for Tokyo office companies continues to be rental growth as re-leasing spreads remain challenged. The improvement in the Miki Shoji July vacancy numbers provides hope that vacancies have bottomed. However, we believe such a bottom will be slow in the making given lackluster demand and new supply concerns in 2011 and 2012.

Transaction pace continues to pick up. Not far beneath the surface of economic and real estate worries is a level of transaction activity which suggests many investors see the world more optimistically. In London, which has been among the most active major markets globally over the past 6 to 12 months, Cushman & Wakefield reports that £2.78 billion was transacted in the second quarter across the West End, City and Docklands, which is a 94% increase year-on-year. This brings the total transacted this year to £4.45 billion and a further £1.1 billion is under offer and expected to close in the third quarter. The weak pound, improving rental prospects, improved sentiment and significant capital looking to invest in property have all contributed to the increase in transaction volumes. CBRE reports that €23.5 billion of transactions were completed in Europe during the second quarter, versus €20.3 billion in the first quarter. This increase was in spite of a challenging period, including a sovereign debt crisis and austerity measures. CBRE comments that the "flight to quality" has intensified as 62% of total investment occurred in the U.K., France and Germany. An example is the reported sale of London City office skyscraper Tower 42 to Chinese Estate Group for £300 million or a 6.8% yield (with the caveat that the building is over-rented, requires capex and has a significant number of lease expiries over the coming years). Tower 42 is thought to have attracted bids from over a dozen investors. In the U.S., southern California office landlord Douglas Emmett, Inc. announced that it has acquired Bishop Square, an office project containing approximately 960,000 sf located in Honolulu, Hawaii for a contract price ($232 million/ $242/sf) or a nominal yield estimated to be at a 7% range. Charter Hall Office Trust, an Australian REIT, announced the disposal of a non-core asset, the City Central office building in Milan for €118.5 million at a yield of 6.4%.

Continuing positive outlook for returns. The rebound in July provides some comfort that global property companies remain on track to provide positive total returns for the year, anchored by an approximate 4% dividend yield. With economic improvement seemingly taking one step back for each two steps forward, patience will be required. Real estate fundamentals will, as always, reflect improving economic conditions on a lagged basis as a result of the underlying lease structures. We continue to believe listed property companies to be well-positioned to grow cash flow per share on a sustained basis in the current economic environment and are trading at reasonable valuations.