

# ING Clarion Real Estate Securities

## GLOBAL REAL ESTATE SECURITIES

### Market Commentary

Global property companies generated a negative total return during the month of June, thus extending weak performance which began in May as investors over this time period increasingly looked at the economic glass as "half empty." Performance was hampered by macro-economic concerns which bring into question the trajectory of the economic rebound, which is now over a year in the making. Specific worries include the European sovereign debt crisis and associated tepid response by the European Central Bank (ECB), disappointing economic numbers out of the U.S. including employment and home sales, and concerns regarding the ultimate effect of the increased reach of politicians into the private sector via regulatory announcements or legislation. These combined concerns have caused a general ratcheting down of expectations regarding global economic growth looking forward. While forward growth remains positive, investors have come to learn that patience will be required with this recovery.

Index Performance (\$ USD)	1 Month	YTD	1 Year	3 Year	5 Year	10 Year
<b>S&amp;P Developed Property Index</b>	-1.85%	-3.89%	25.25%	-13.88%	-0.01%	8.68%
<b>Returns by Region</b>						
<b>Asia Pacific</b>	0.65%	-6.11%	9.67%	-13.35%	3.44%	7.00%
<b>Europe</b>	0.79%	-18.07%	13.72%	-24.01%	-6.16%	7.22%
<b>North America</b>	-5.11%	5.42%	54.51%	-9.60%	-0.18%	10.10%

Source: S&P Developed Property Index as of June 30, 2010.

**Macro-economic headwinds increase.** Economic news over the quarter has reminded investors that the deleveraging process begun over a year ago will continue to weigh on the pace and strength of the economic recovery. Europe has been the focus of much attention as concerns have shifted from the relatively small economy of Greece to the larger one of Spain, which has a banking system that remains extended and potentially vulnerable to refinancing risk over the near term. Investors worry that credit issues in "peripheral" European countries could spark a wider credit crisis and that the ECB will not be sufficiently proactive in providing a safety net should this occur. This is despite the successful repayment of €442 billion of one-year loans extended by the ECB to European banks which came due July 1, €242 billion of which was refinanced with a three-month term. In the U.S., economic statistics of late have been below consensus expectations and indicate that the pace of economic recovery is slowing. In its third and final reading of 1Q 2010 U.S. GDP, the Commerce Department reported that gross domestic product grew by 2.7%, less than the previously estimated reading of 3.0% and well below the 5.6% growth rate in the previous quarter (4Q09). The final reading registered lower primarily due to slower than originally reported consumer spending activity, which although healthy at 3.0% was below original expectations for 3.5% growth. Sales of existing homes were down 2.2% in May after two consecutive monthly increases and despite support from the federal government tax-incentive program. Non-farm payrolls in May and June also disappointed on the realization that many of the jobs added were via temporary census workers as private sector hires remain anemic and that a lower unemployment rate of 9.5% (from 9.7% in May) is largely the result of workers leaving the workforce rather than becoming employed. The Asia-Pacific region by contrast has demonstrated robust economic growth, notably in Singapore, but remains subject to a potentially decelerating Chinese economy as the government in Beijing attempts to cool demand, including residential property demand. China's official manufacturing PMI in June came in at 52.1, lower than the May reading of 53.9 and below market expectations of 53, providing a reminder that Chinese economic growth may indeed be slowing at a sharper than expected pace.

**Political meddling increasingly weighs on the economic recovery.** Compounding economic concerns are related regulatory actions which might further constrain growth. Political rhetoric and legislation in each of the major regions of the world have increased as of late, perhaps redefining the regulatory environment and calling into question the extent to which government will be involved with the private

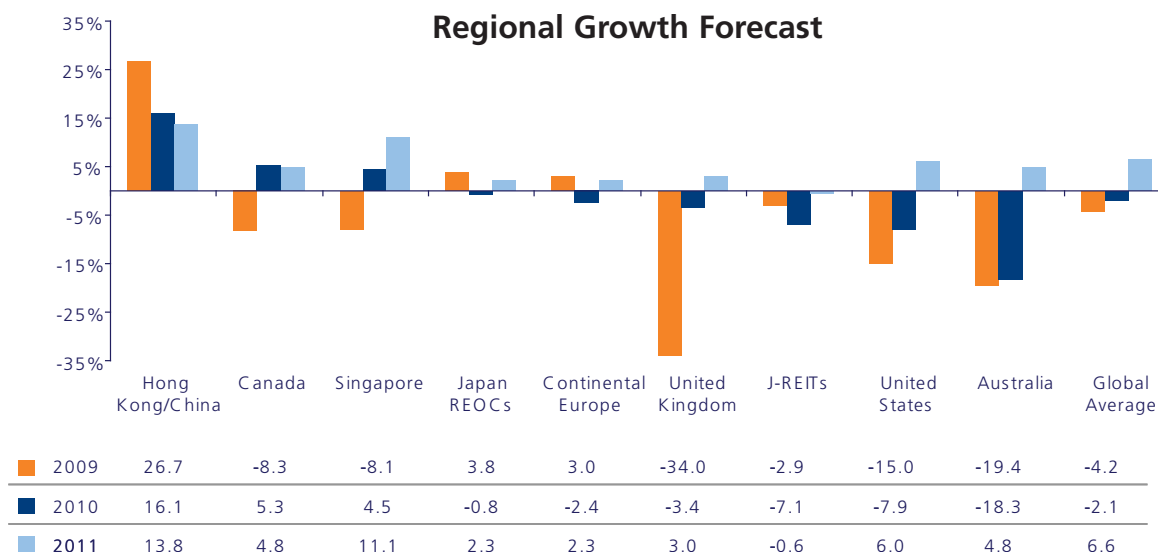
sector during the next economic cycle. In Europe, which has received much of the attention, the European Union and the International Monetary Fund announced on May 10 an emergency rescue package of up to €750 billion ostensibly to keep Greece's debt crisis from spreading through the euro zone, but in principle available to any euro zone country in need. Questions remain regarding whether this action is sufficient to solve the problem of significant debt coming due over the coming year. In the U.S., banking reform legislation was passed by the Senate and now needs to be merged with a bill passed by the House last December. With prospective passage imminent, the bill would increase capital requirements among financial institutions and more closely regulate derivative and mortgage products. In China, the central government continues to remind its provinces that housing prices remain too high. The announcement of potential property taxes, perhaps first in Shanghai and Chongqing, plus the acceleration of the collection of Land Appreciation Taxes, which are payments made by developers to the government, are intended to slow growth in property prices. This follows a raft of announcements made in mid-April which increased down payment requirements for mortgages and otherwise narrowed the definition of how many mortgages a family can obtain, as the government attempts to rein in lending to the property sector. In Australia, the proposed Henry Tax would tax the "super-profits" of the resource companies beginning in mid-2012, although a compromise is expected from the new prime minister of Australia who appears to be more accommodative. Japan has also installed a new prime minister as voters in Japan, too, increasingly voice frustration partly because of their government's inability to effectively address economic challenges.

**One silver lining is low policy rates for the foreseeable future.** One positive outcome of soft economic news is increased clarity that central bank policy will remain generally accommodative. The Federal Reserve maintained its all-time low interest rates in its June meeting and restated its intention to keep rates very low for an "extended period". Fed leaders left the Federal Funds rate in a range of 0% to 0.25%, where it has been since December 2008. The Bank of England and ECB have also kept policy rates on hold, although some of the healthier Scandinavian countries have raised rates during 2Q10 (Norway by 25 basis points to 2.0% and Sweden by 25 basis points to 0.5%). The recent upward bias to policy rates in the Asia-Pacific region ex-Japan has paused as the Reserve Bank of Australia kept rates on hold in its June meeting after having increased rates by an aggregate 150 basis points over the past nine months. A delicate balance remains between Western markets (plus Japan) which are attempting to nurse growth back to a self-sustaining pace and Asian markets, which are attempting to cool economic growth in a globally dynamic market with economic regions that are increasingly interdependent.

**Property fundamentals begin to reflect improving underlying markets.** From a bottom-up standpoint, property fundamentals are gradually improving. With the second quarter earnings season upon us, themes thus far this year include: (1) improving operating numbers which are either "less bad" than comparable numbers or even positive; (2) improving expectations; (3) yield compression, albeit decelerating; and (4) continued capital raising, both equity and debt. Evidence of a rebound in property fundamentals differs by property type, lease length and geography but there is little doubt that the marginal trend is one of improvement looking forward. Among listed property companies globally, occupancy rates are generally in the 90's, market rents are generally bottoming/improving, balance sheets are healthy with an average loan-to-value of 40% (versus mid-50% range at the nadir of the credit crisis), transactions volumes are increasing and confidence is growing.

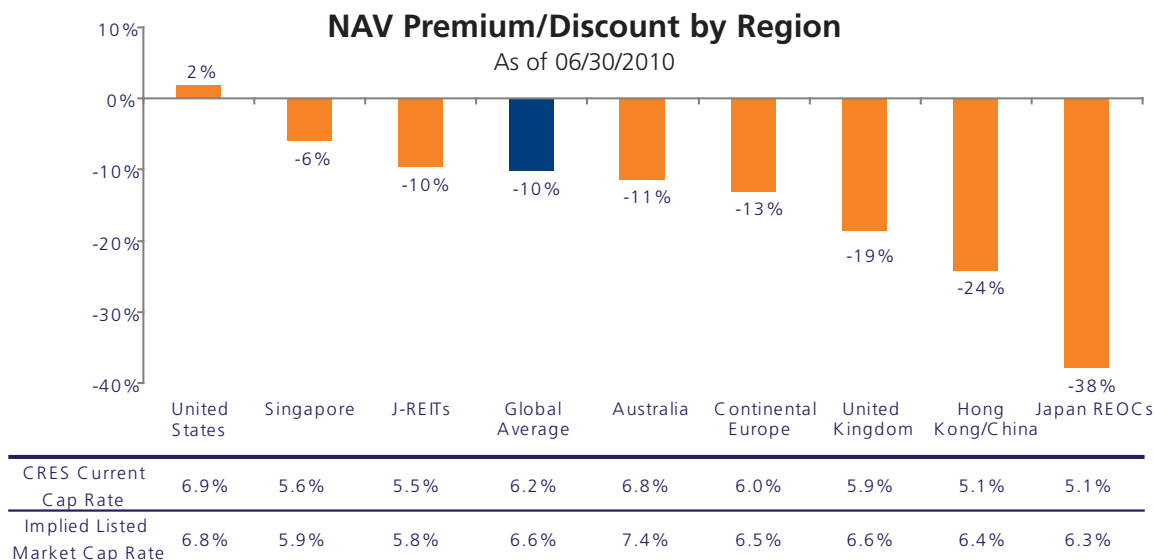
**Capital markets remain wide open.** Property companies globally have raised approximately \$100 billion in equity and debt capital over the past year and a half. During the quarter, a number of unsecured debt deals were completed in the U.S. such as Boston Properties' \$700 million issuance of 5.625% senior unsecured notes due in 2020 and Healthcare REIT's \$300 million of 6.125% senior notes also due in 2020. In Europe, French shopping center company Klepierre raised €700 million through a 7-year bond offering at a coupon of 4.0%, a 125 basis point spread above the swap rate. Equity raises include Macerich's \$1.2 billion raise of equity in the largest U.S. REIT follow-on ever as the deal size doubled from its original size as the result of high demand. Pan-European shopping center company Corio completed a €600 million equity issuance to help it fund acquisitions. U.S. REITs saw an IPO during the month of June as Hudson Pacific Properties went public with proceeds of \$210 million. Hudson Pacific is an owner and operator of six office assets primarily located in Southern California, as well as two media and entertainment campuses located in Hollywood, CA. Capital markets remain supportive of capital formation, which remains critical to the listed sector.

**Earnings suggest improving economic conditions.** Despite the travails of recent macro-economic worries, we continue to see a rebound of property company earnings as we look out to 2011. While patience is clearly required, our most recent projections show a mid single-digit growth in cash flow per share in 2010/2011:



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**Valuations have been “re-set” to an attractive discount.** The recent sell-off has improved the valuation of listed companies relative to what we believe the underlying real estate value to be, or NAV. While debate has continued regarding appropriate multiples and NAV relationships of real estate companies coming out of a recessionary environment using trough earnings, it clearly has become easier to make a case for listed property valuations following the recent correction. We estimate global property companies are trading at an average 10% discount to NAV on a weighted average basis. In the U.S., we estimate property companies are trading in-line with NAV.



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We believe yield compression to have largely run its course from trough levels, although current yields should generally hold as capital returns to the property sector and as property fundamentals continue to improve, however gradual. While the returns looking forward for a listed strategy likely cannot maintain the sharp pace of the last year, we believe the sell-off during 2Q10 supports positive expectations for property companies on the back of gradually improving economic conditions and an associated improvement in property fundamentals.

**Expect returns of +5% to +15%.** As put forth at the beginning of the year, we expect total returns will be in the +5% to +15% range in 2010, driven by steady and growing dividends yielding approximately 4% combined with mid single-digit earning growth looking out to 2011. Given that first half returns were negative, this suggests that second half returns could be even better than the range provided. The backdrop as we stand mid-year 2010 is significantly better than six months and even a year ago, but still remains fragile. We expect real estate fundamentals to continue to improve during the year but acknowledge that patience will be required. Though occupancies and rents will take time to improve, with increasing demand and low levels of new construction, fundamentals should inevitably firm going into 2011. In a world of sluggish economic growth, the cash component of total return via the dividend yield we believe will be increasingly appreciated. Current yield via the dividend remains a hallmark of investing in the REIT sector.

Our outlook by region is attached, where we remain positive on regions and property types which are more responsive to improving economic conditions. We are maintaining the outlook we have held since the beginning of the year despite recent market setbacks which we believe are temporary in nature.

## ASIA-PACIFIC REGION

### Australia (10% of index)

- Macroeconomic :** GDP growth is projected to be in the 3% range in 2010 (versus 1% in 2009) as Australia demonstrates continued economic resilience as one of the few major economies to avoid recession during the credit crisis. Unemployment levels have improved with the unemployment rate for May 2010 at 5.2% versus 5.7% one year ago. Australia should continue to benefit from its natural resources trade, particularly with China. Policy rates, raised by 150 bps since October 2009 and now at 4.5%, are expected to increase throughout 2010 in response to a strengthening economy, although the Reserve Bank may take a more cautious stance over the near term.
- Property Markets :** We favor office and industrial property types, which are at a turning point in fundamentals. Office is becoming more attractive as evidence grows that rents are bottoming, after an approximate one-third peak-to-trough correction in prime rents in Sydney and 10% in Melbourne. Industrial landlords should benefit from limited new supply and higher than average growth of Australian and Asian economies. Residential has rebounded strongly in 2010, though faces headwinds of higher mortgage rates. Retail fundamentals remain steady but with arguably less upside than other major property types.
- Valuation :** Valuations are attractive at an 11% discount to NAV versus a long-term average of a modest premium to NAV. Dividend yield on average is now 5.7% which exceeds the 10-year bond yield of 5.1%. The yield spread to the 10-year bond compares favorably to the long-term average of +90 bps, which reflects a more conservative payout policy adopted by many companies.
- Other :** The Australian REITs have undergone a dramatic recalibration of business models, balance sheets and dividend policies in 2008/2009 and are now positioned for upside in 2010 as the companies return to business models which balance growth, both internal and external (acquisitions/development), with capital recycling that ultimately improves shareholder value.
- Total Return :** We expect a total return of 10-15% over the next 12 months, consisting of a dividend yield of 5-6%, with expanding multiples as the NAV discount closes and the anticipation of positive earnings growth looking out 1-2 years.

### Hong Kong (14% of index)

- Macroeconomic :** Hong Kong's GDP growth forecast for 2010 remains unchanged from last quarter (in the 6% range) as Asia responds to improving economic conditions globally via increased exports as well as robust domestic demand. Economic growth out of mainland China is underpinned by fiscal and monetary factors, reviving exports and latent domestic demand. The Renminbi will strengthen against major currencies in a modest and controlled fashion.
- Property Markets :** Property values in Hong Kong, both commercial and residential, continue to rebound from a 20-30% peak-to-trough drop in value. Residential values have surpassed the pre-Lehman peak, and are now improving at a much slower pace, while office rents and values began turning the corner during the first half of 2010. As such, we increasingly favor office over residential and continue to favor retail based on resilient demand from mainland Chinese tourists. We are cautious on property markets in China as the result of increased regulatory risk out of Beijing. Measures intended to cool the housing market have been given sharper teeth of late as the government attempts to balance affordability with the need for more housing.
- Valuation :** Stocks were up significantly in 2009 and now trade at a 24% discount to our estimate NAV, compared to a long-term average discount in the 18% range. Earnings growth among the property companies remains highly dependent on development profits and is expected to be in the 16% range in 2010 which is higher than the 15% expectation six months ago.
- Other :** The Central Government in Beijing plays an active role in either catalyzing or cooling the property sector, which will bring volatility to an otherwise healthy demand/supply relationship.
- Total Return :** We expect projected earnings growth in the 16% range and dividend yields in the 2-3% range.

### Japan (13% of index)

- Macroeconomic :** GDP growth has been raised to nearly 3% in 2010 (from 2.1% last quarter). The Bank of Japan continues to fight deflationary forces with low interest rates and quantitative easing. The Bank of Japan will keep policy rates low for the foreseeable future at the current 0.10%.
- Property Markets :** Tokyo remains the strongest property submarket in Japan at the expense of regional cities. This is a relative concept though as commercial property demand has remained weak. Office vacancy rates in Central Tokyo, as surveyed by consultancy Miki Shoji, are at historical highs (just shy of 9% range) but are expected to peak in the coming year. Above average supply is expected in the Tokyo office market during 2011-2012, which is an upcoming risk factor for the office market. Tokyo remains among the world's largest office markets. Residential fundamentals remain strong, supported by market price correction and expanded tax-relief on residential transactions introduced by the government.
- Valuation :** Japanese property companies are trading at an approximate 28% discount to NAV, which is in-line with the historical average discount. With office markets projected to reach an inflection point in 2010, we would expect property companies to eventually outperform but with no immediate catalyst, we are currently cautious on the stocks. The average dividend yield for the REOCs is 1.4% versus the yield on the 10-year bond of 1.1%. J-REIT dividend yields average 5.8%. Both are well above long-term average relationships to the yield on the 10-year bond.
- Other :** Property companies, especially the J-REITs, need to raise equity to reduce leverage levels and position themselves for external growth. Internal growth remains tepid as office mark-to-market rents are flat to negative. More J-REIT M&A transactions are expected as smaller companies seek to strengthen corporate credit by merger or via replacing the corporate sponsor.
- Total Return :** We project a 5-10% total return for real estate companies over the next 12 months, consisting primarily of capital appreciation for the operating companies and of dividend yield for the J-REITs.

### Singapore (6% of index)

- Macroeconomic :** Singapore's economy is expected to grow strongly in 2010 to a projected 9.7%, with the growth rate being raised significantly from an estimated 6.8% in the previous quarter.
- Property Markets :** Residential outperformed office in 2009 as office rents declined over 40% versus residential values increased in the 5-10% range. With a bottoming of office rents currently underway, we are increasingly positive on office as rents approach an inflection point. New office supply in 2010 and beyond remains a concern although new casinos plus increased visibility to the pre-leasing of Marina Bay Financial Center should mitigate some of the supply overhang.
- Valuation :** Singapore property companies trade at a 6% discount to NAV after significantly outperforming in 2009. The average dividend yield for the REOCs is 1.9% versus a yield on the 10-year bond of 2.4%, which is above the historical spread. The average dividend yield for S-REITs is 6.4%, which is also above the historical spread.
- Other :** Singapore property companies include pan-Asian platforms, which offer better long-term growth prospects than companies focused on Singapore proper.
- Total Return :** We expect S-REITs to generate a 5-10% total return over the next 12 months, anchored by the dividend yield. Operating company performance will depend on continued earnings growth, which has increasing headwinds. We expect a 0-5% total return for the operating companies as earnings multiples contract.

## Europe

### Continental Europe (10% of index)

- Macroeconomic :** Economic growth in the euro zone remains unchanged from the previous quarter at a projected 1-2% range in 2010. The ECB is expected to maintain accommodative fiscal policies for the foreseeable future, particularly in light of sovereign debt concerns among a number of Southern European countries.
- Property Markets :** By property type, we prefer retail and industrial over office and residential. By geography, we prefer Western and Northern Europe over Eastern and Southern Europe. We believe slower economic growth in peripheral European countries, a weaker Euro and a softening of the commercial property lending climate will ultimately negatively impact demand for commercial real estate in the eurozone.
- Valuation :** Valuations show a 13% discount to our estimate of NAV. The average dividend yield of 6.3% compares favorably to the yield on the 10-year bond of 2.6%. This spread in yield is significantly above the long-term average of -120 bps. Despite valuations that are more attractive than six months ago, we believe it's too early to add to property companies based in the euro zone.
- Other :** We prefer companies with strong balance sheets that have access to equity and debt markets, with firepower for potential acquisitions as a source of earnings growth.
- Total Return :** We expect a 5-10% total return over the next 12 months consisting of a dividend yield in the 6% range, constant multiples and flat to modestly positive earnings growth in 2011.

### United Kingdom (5% of index)

- Macroeconomic :** GDP growth forecasts for 2010 are unchanged in the 1% range for 2010. The Bank of England has moved aggressively in lowering policy rates, now at a post-war low of 0.5% and is expected to err on the side of keeping rates low until economic recovery proves to be sustained. The proposed 2010 budget introduces austerity measures which combine spending cuts with higher taxes including a higher capital gains tax, which should temper forward-looking economic growth.
- Property Markets :** Sentiment has turned in London from extremely negative a year ago to more constructive. Yields have compressed by approximately 190 bps from the trough and year ago and the IPD index (the bellwether private market index) has now been positive for over six months. Rents continue to be soft but appear to be bottoming. We prefer office and industrial over retail and residential.
- Valuation :** The property companies are trading at a 19% discount to our estimate of NAV, which is modestly cheaper than the long-term average and represents reasonable value for this stage of the cycle. The average dividend yield of approximately 4.8% compares favorably to a yield on the 10-year bond of 3.3%. This spread is significantly above the long-term average spread of -250 bps, which reflects in part the adoption of the REIT structure in the U.K. three years ago.
- Other :** The U.K. property market is characterized by long leases (10-15 years) which remain favorable to the landlord, a tight planning regime and a high proportion of long-term fixed rate debt which effectively matches assets with liabilities. U.K. property companies have largely adapted to the REIT structure, now in place since early 2007, and are increasingly offering attractive yields in addition to prospective capital appreciation.
- Total Return :** We expect a 10-15% total return over the next 12 months consisting of dividend yields in the 4-5% range, expanding earnings multiples and positive earnings growth looking out 1-2 years.

## North America

### Canada (3% of index)

- Macroeconomic :** With projected 2010 GDP growth raised to 4% (from 3.4% last quarter), the economic rebound in Canada looks stronger than its southern neighbor, despite a downturn that was more shallow than in the U.S. The Bank of Canada has begun to modestly tighten policy rates by recently raising it by 25 bps.
- Property Markets :** Western Canada remains dependent on the commodity market and vicissitudes of commodity prices. Toronto remains stable. Apartment rents remain regulated in most provinces and, therefore, provide a degree of predictability.
- Valuation :** Property companies trade at a 2% premium to NAV which is in-line with the long-term average. An average dividend yield of 6.2% is well above the 3.1% yield on the 10-year bond and above the historical spread. Dividend yields are well above the global average and remain attractive for an investor seeking income.
- Other :** Regulatory announcements are being refined to leave REIT business models largely intact, although hotel and healthcare REITs will have to make structural changes by 2011.
- Total Return :** We expect a total return of 7-12% over the next 12 months consisting of a dividend yield in the 6% range, constant to modestly contracting earnings multiples and flat to modestly positive earnings growth looking out one year plus.

### United States (40% of index)

- Macroeconomic :** GDP growth forecasts for 2010 remain unchanged in the 2-3% range as the economy continues to improve. The Fed is expected to maintain an accommodative monetary policy with a target Fed Funds rate of nearly zero (0-0.25%). The U.S. economy is projected to rebound at a more sluggish rate than from previous recessions but nonetheless will continue to expand over the coming quarters.
- Property Markets :** We prefer cyclical property types including apartments, lodging, industrial and regional malls. These tend to be property types with shorter lease lengths. We avoid property types which are slower to respond to economic improvement including office and healthcare.
- Valuation :** The 2% premium at which U.S. REITs trade is consistent with where U.S. REITs have traded at this point in the property cycle (off trough valuations and earnings). U.S. REITs currently have an average dividend yield of 4.1% versus a yield on the 10-year Treasury of 3.0%. This spread between dividend yield and the yield on the 10-year Treasury is in-line with the long-term average of +100 bps.
- Other :** U.S. REITs have successfully repositioned balance sheets with over \$30 billion of equity raised over the past year and a half and over \$20 billion raised in unsecured debt. Companies are generally well-positioned to take advantage of potential acquisitions.
- Total Return :** We expect a total return of 7-12% over the next 12 months consisting of a dividend yield in the 4% range, constant to modestly contracting earnings multiples and mid single-digit positive earnings growth looking out 1-2 years.

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The FTSE EPRA/NAREIT Developed Index is unmanaged and constructed to include all European and North American companies with greater than 10% weight in regional index if included and Asian companies with greater than 30% weight in regional index if included. All companies included in the FTSE EPRA/NAREIT Index must derive more than 75% of their EBITDA from property-related activities. Investors cannot invest directly in an index.  
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