

# Global Real Estate Securities Valuation Summary and Outlook

30 JUNE 2010



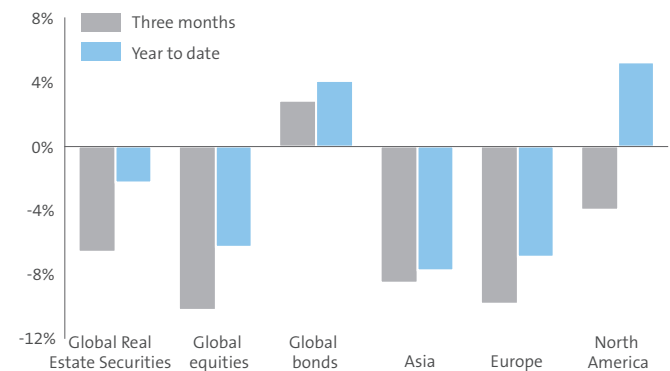
Capital markets continued to move ahead as the second quarter commenced. However, uncertainty regarding U.S. economic indicators and global events clouded investor sentiment in May and June. Negative headwinds included the sovereign debt issues in southern Europe, fears for China's economy, ongoing amendments to the proposed financial regulation bill in the United States (U.S.) as well as the escalating clean-up and cost of B.P.'s oil spill in the Gulf of Mexico.

Global real estate securities were impacted by weaker broader market sentiment during the second quarter and there was a flight to quality as investors reduced risk. However, despite a cautious short-term outlook, it is worth noting that the longer-term sentiment towards global real estate securities remains optimistic.

## Regional market activity and performance

Global real estate securities as measured by the FTSE EPRA/NAREIT Developed Index, were down 6.6% for the three months, while global equities were down 10.2% and global bonds were up 2.9%. (Source: FTSE/EPRA NAREIT Developed Index, European Public Real Estate Association and JP Morgan. Returns for all indices expressed in local currency.)

**Chart 1 – Performance by Region**  
At June 30, 2010



Source: European Public Real Estate Association, FTSE and JP Morgan  
Note: All returns shown in local currency, except Asia which is shown in USD

Real estate securities generally outperformed their broader equity markets over the quarter. This was particularly evident in the U.S. and Australia, where A-REITs were sought after as a defensive investment. Importantly, while macro concerns caused capital markets, including REITs, to sell off, earnings season across the globe demonstrated that underlying real estate fundamentals across many sectors were showing clear signs of improving. Corporate activity continued to feature across all regional markets, including equity and debt issuance.

Transactions occurred at low capitalisation rates with strong demand for high quality assets in markets with high barriers to entry, particularly in the U.S. and the UK. AMP Capital Investors believes office markets with better than expected tenant demand and little immediate supply will continue to be sought after. Indeed, some markets, such as Hong Kong, have surprised the market in terms of rental growth achieved in 2010 to date.

## Moving ahead

Over the course of the second quarter, bond yields became more compressed, investors' appetite for risk dramatically reduced and demand for defensive REIT sectors intensified. As the second half of the year gets underway, AMP Capital Investors believes the cautious mood will continue to influence market movements across the globe. Until investor fears regarding southern Europe and risks of a hard landing for China's economy are alleviated, volatility will continue to hang over capital markets on a month-to-month basis.

Nonetheless, it is important to bear in mind that key fundamentals for real estate securities continued to move ahead for many markets. AMP Capital Investors believes the medium term outlook for global economic recovery and for global REITs is positive. Access to credit markets, improving supply and demand indicators across underlying real estate markets and stabilising asset values are positive for REITs, with many companies now armed with strong balance sheets and trading at attractive levels.

## North America

### Overview and outlook

Real estate securities experienced a strong start to the second quarter, continuing the rally from the preceding months. However, uncertainty regarding U.S. economic indicators and global events clouded investor sentiment in May and June and impacted all capital markets, including REITs. The asset class ended the quarter in negative territory, although it is worth noting REITs outperformed broader equities for the period. As the uncertainty prevailed, defensive REIT sectors were sought after, with healthcare companies outperforming on a relative basis.

Domestic concerns included the proposed financial regulation bill in the U.S. and B.P. oil spill in the Gulf of Mexico. In addition, a number of closely-watched indicators were weaker than expected, in particular housing data, consumer confidence and job growth. Yields on Government bonds also hit lows, with the 10-year Treasury yield below 3% by the close of the quarter.

Importantly, while these data points have resulted in a guarded outlook for the short-term, the longer-term sentiment towards U.S. REITs continues to be optimistic. Improving underlying fundamentals were reported for a number of REIT sectors, particularly for those more sensitive to GDP, such as apartments and hotels. Retail landlords noted that retailers continued to undertake expansion plans, particularly for higher quality malls. In addition, a number of office transactions occurred, reflecting solid pricing metrics and low capitalisation rates.

AMP Capital Investors anticipates lingering uncertainty will result in a level of volatility across capital markets in the short term for North American REITs. While AMP Capital Investors believes the U.S. economic recovery will continue, the pace of recovery appears to be slower than many analysts had hoped, and key indicators for international economies will still have an influence on sentiment. However, the longer-term outlook is positive, as REITs are underpinned by improving direct market fundamentals and attractive valuations. Defensive characteristics are likely to be sought after.

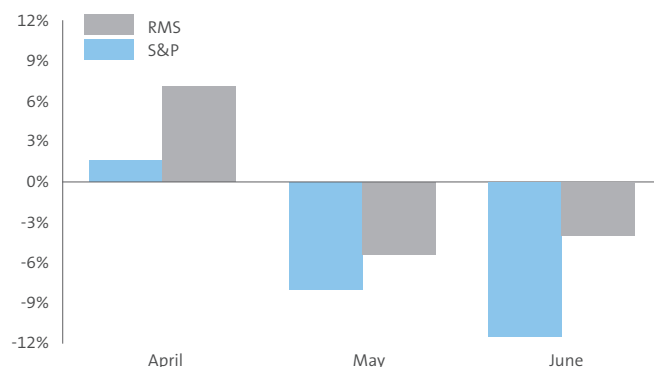
### Market activity and performance

U.S. REITs (as measured by the MSCI US REIT Total Return Index (RMS)) were down 4.0% over the three months, faring significantly better than the S&P 500 Total Return Index (S&P), which was down 11.4%.

The RMS was up 7.1% in April, following positive performance from the previous quarter, and led by economically-sensitive sectors such as hotels, apartments and CBD office. The ongoing sovereign debt issues in European markets had an impact on capital market sentiment, with Greece calling for assistance from the European Union. Nevertheless, investor confidence was upheld by continued evidence of broad global economic recovery.

Chart 2 – US REITs vs S&P

At June 30, 2010



Source: MSCI Barra, S&P

However, REITs sold off in May and June as the negative macro headwinds strengthened. The combination of the sovereign debt issues in southern Europe and fears of contagion in Ireland and Portugal, political tension between North and South Korea, monetary policy tightening in China, the escalating clean-up and cost of B.P.'s oil spill in the Gulf of Mexico as well as ongoing amendments to the proposed financial regulation bill in the U.S. was intense. Against the broader market backdrop, there was a flight to quality and investors generally favoured stability over growth.

Apartment companies outperformed as investors perceived potential for strong growth with the pace of improving fundamentals increasing. As a result, sector valuations became relatively stretched. Investors sought companies with high quality portfolios, exposure to Californian markets as well as those names with top-line growth potential.

Hotel companies were a standout in April however were down significantly in May and June, in line with a high sensitivity to economic concerns. This was despite strong RevPAR data and demand. Marriott announced a positive revision to 2010 RevPAR guidance of 3% to 6% (compared to 0% to -3%), which was a boost to the sector's outlook. The revision was based on increasing occupancy levels, particularly in key business markets, which suggested pricing power will also improve as the year progresses.

### Key themes

Earnings season for the first quarter of 2010 commenced, with expectations for solid results at an overall level. In particular, sectors characterised by shorter-term leases and economically-sensitive businesses were anticipated to report positive earnings results. Sectors less levered to the economic recovery were expected to report comparatively weak results, such as suburban office and industrial.

Office companies performed in line with investors favouring Californian names as a number of significant leasing deals were announced on the West Coast. Despite the general preference for defensive sectors, apartments were sought after for most of the quarter, partially driven by some companies expecting double-digit NOI (Net Operating Income) growth for the next two to three years.

Industrial companies lagged other REIT sectors. As the two largest companies in the sector, ProLogis and AMB Corporation, have substantial exposure to Europe, investors were uncertain regarding the potential impact from the sovereign debt issues in that region. Regional malls and shopping centres were also laggards. However, leasing activity for 'big box' and 'junior box' space appeared to pick up, boding well for companies with exposure to this type of retail offering.

Hotel companies reported improving fundamentals and investors responded positively, although the sector was dragged down by the broader market in May and June. Concerns surrounding European economies led to fears for how this could impact travel to and from the region, while political unrest in Thailand also had some impact on companies with international portfolios. Marriott reported RevPAR of 9% for the month of May for its North American portfolio, which included positive rate growth for the first time in almost two years. The company also reported second quarter RevPAR growth of 7% for its global portfolio. At a national industry conference, a number of hotel management teams expressed bullish outlooks for the medium term. This was underpinned by stronger than expected demand in 2010 and the anticipated additional benefit of limited supply in 2011 and 2012. Nevertheless, by the close of the quarter, sector valuations were stretched, with the positive outlook already priced-in.

In corporate activity, a number of hotel companies issued equity. Strategic Hotels and Resorts (BEE) completed an equity offering, raising \$330 million. The issue had been broadly expected for some time, with the proceeds used to repay down debt. DiamondRock Hospitality Company (DRH) issued \$185 million in equity, using the proceeds to acquire two assets; a Hilton hotel in Minneapolis and the mortgage underlying a hotel in foreclosure in Chicago, the Allerton Hotel.

Chatham Lodging Trust raised \$150 million via an initial public offering (IPO). The REIT acquired six hotel assets, operated by Hilton, and indicated the remainder of the proceeds from the IPO would fund future acquisitions. Three IPOs have occurred in the hotel sector since December 2009, raising a total of \$710 million; Chatham Lodging Trust, Chesapeake Lodging Trust and Pebblebrook Hotel Trust. Another hotel company filed its intention for an IPO. The Clearview Hotel Trust will aim to raise \$375 million. Underlying the float will be a portfolio of 14 U.S. assets and the company will be run by Mr. Jon Kline, the former President of Sunstone REIT.

Healthcare was one of the strongest REIT performers in May and June, as investors sought the defensive nature of its cash flows, and resulting in expensive sector valuations on a relative basis. Healthcare management teams were generally optimistic at the NAREIT (National Association of Real Estate Investment Trusts) conference, anticipating transaction activity to increase over the next 12 months.

Medical Properties Trust issued \$240 million in equity, using the proceeds to pay down debt and management also indicated potential for acquisitions in 2010. Speculation surfaced regarding the possibility of an IPO for Hospital Corp of America; a hospital owner/operator which was privatised in 2006 at \$33 billion, representing the largest privatisation in the U.S. at that time. Although no formal announcements were made, analysts speculated whether this could hint at a trend for IPOs across the healthcare sector in 2010, with many operators currently private.

Healthcare operator, Sun Healthcare announced it planned to form a new REIT from its real estate assets during the fourth quarter of 2010. The company owns 93 skilled nursing assets and also manages a number of other assets for other external owners. Ventas announced the acquisition of Lillibridge Healthcare Services, a medical building company with assets across the U.S., for between \$300 million and \$400 million. The transaction was well received due to the increased diversification across Ventas' portfolio.

Canadian REITs modestly outperformed U.S. REITs over the quarter, underpinned by a resilient economy and higher yields on a relative basis.

## Direct real estate markets

Following on from the first quarter, earnings season confirmed underlying direct real estate market fundamentals were beginning to improve across many sectors.

Transaction activity demonstrated solid pricing metrics and low capitalisation rates, particularly in the office sector. SL Green purchased 600 Lexington Avenue in New York at a price of \$636 per square foot, reflecting a capitalisation rate of approximately 5.0%. SL Green also acquired 125 Park Avenue in New York for \$330 million. RXR Realty, a private company, was reported to be in exclusive discussions to acquire 340 Madison Avenue, New York at a price of \$770 per square foot. These transactions indicated the ongoing recovery in prices for well-located CBD office assets, particularly in New York City. In other activity, KBS Realty Advisors acquired 300 North LaSalle Street, Chicago for \$625 million, or \$480 per square foot, representing the city's largest single real estate transaction since 2004.

## Europe

### Overview and outlook

European real estate securities were dragged down by the sovereign debt issues and fear of contagion in southern Europe. However, real estate companies fared better than the broader equity market, and regained some ground in June. In May, Greece called on assistance from the European Central Bank and was downgraded by rating agency, Standard and Poor's. Similar concerns for other countries in the region, including Ireland and Portugal as well as contagion from exposure to Greece by major European banks worried investors further. In the UK, the general election in May failed to deliver an outright majority for either of the two main parties and a coalition Government was formed between the Conservatives and Liberal Democrats. The coalition announced that its main priority was to reduce the deficit in order to protect the credit rating of the UK, which pleased investors.

First quarter earnings results were generally impressive in the UK, with management teams reporting a marked uplift in Net Asset Values (NAV) on the back of continued investor demand for well-let assets with long lease terms.

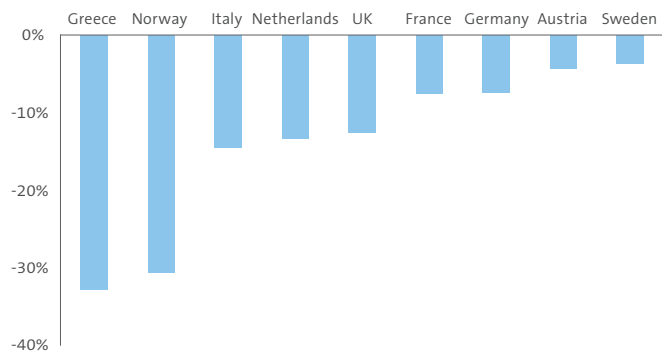
AMP Capital Investors believes lingering challenges of banking and sovereign issues in the region will be a key influence on the third quarter. A number of countries have announced an intention to cut budget deficits; however, this is likely to generate higher taxes and spending cuts. Therefore, AMP Capital Investors believes the economic growth outlook is subdued for the medium term. GDP growth is also likely to be hindered as governments begin to rein in spending and conclude stimulus programs as their economies emerge from recession.

The banking system in the region remains under significant pressure and this will affect the real estate sector as banks are highly exposed and may release further stock to the market. As economic growth is likely to remain muted, meaningful asset price appreciation and rental growth are unlikely, according to AMP Capital Investors. Markets characterised by high barriers to entry and relatively stable economies, such as Switzerland and London's office market, will continue to be sought after in this environment.

### Market activity and performance

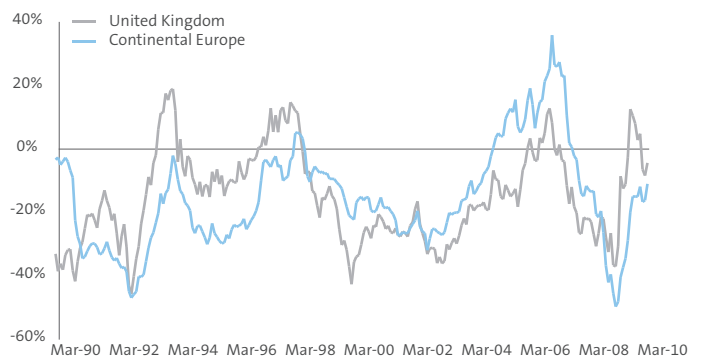
The EPRA European Index (Europe) was up 1.6% while the EPRA UK Index (UK) was down 4.6% over the quarter. The EPRA European Index Ex-UK was up 3.5%. (Source: European Public Real Estate Association. Returns expressed in local currency.) By the close of the period, investors looked to the Continent for better value and the UK underperformed on a relative basis. Notably, European real estate securities reversed some of the heavy losses incurred over the last three months since the sovereign debt crisis emerged. Both markets continued to trade at a discount to NAV.

**Chart 3 – European REITs Quarterly Performance by Country At June 30, 2010**



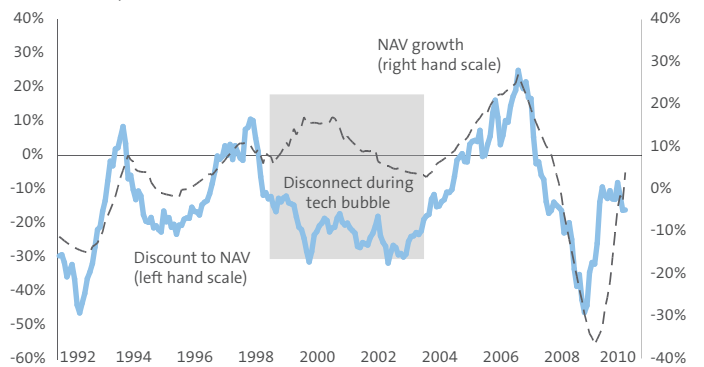
Source: European Real Estate Association  
Note: Returns shown in local currency

**Chart 4 – European REITs Discount/Premium to Net Asset Value At June 30, 2010**



Source: Morgan Stanley

**Chart 5 – European REITs Net Asset Value Valuation and Net Asset Value Growth At June 30, 2010**



Source: Morgan Stanley

In the UK, the new coalition Government announced a series of austerity measures in an emergency budget on June 22. The aim of the budget was to broadly eradicate the structural deficit by the end of the current Parliament (2015), through spending cuts as well as a number of tax increases. The news was generally well received by the market as investors had previously been concerned by deficit levels at similar levels to those of Greece and Spain. In announcing these measures, the new government confirmed it was doing what it could to underpin the AAA rating of UK sovereign debt. Gilt markets rallied on the news of a new age of financial prudence from the UK Government and AMP Capital Investors anticipates the resultant effect on real estate will likely be positive as Gilt Yields (Risk Free Rate) will remain low making other investments, such as real estate look more attractive.

Evidence emerged demonstrating that the capacity of UK banks to finance new transactions was hampered by the amount of real estate on their balance sheets. These assets are unlikely to be sold due to the negative valuation evidence it could create. On the Continent, more costly debt finance as well as uncertainty due to the sovereign debt crisis also meant few transactions transpired.

## Key themes

Despite the uncertainty hanging over the region, a level of corporate activity pushed ahead. Italian real estate company, Beni Stabili announced a private placement of shares equal to 7.0% of total share capital and a convertible bond issue of €225 million. The equity issue was related to adoption of SIIQ status, similar to REIT legislation, by the end of 2010. Although the equity and debt issues were likely to be modestly dilutive to NAV, achievement of SIIQ status and resolution of upcoming financing issues were viewed as positives by institutional investors. The company is considered to be relatively low-beta within Europe and owns a high quality and well-leased portfolio.

German residential company, GSW announced its intention to float via an IPO in the second quarter of 2010. The privately-held company, with a portfolio was valued at €2.6 billion, had indicated its intention to float in 2009. Also in Germany, fund manager, Commerz Real was reported to be in the process of acquiring Bonarka City Center in Krakov, the largest urban shopping centre in southern Poland for approximately €500 million and a 7% yield.

UK Industrial REIT, Segro acquired 50% of the British Airways APP portfolio for £111.3 million, which implied a £466.6 million valuation for the property at 100% ownership. The net initial yield was 6.0%. The 3.5 million square foot portfolio had a total vacancy rate of 6.8% and average lease length (to expiry) of 13.4 years. Market reaction to the transaction was muted as the announcement coincided with the company's first quarter Interim Management Statement (IMS) which revealed a continued challenging operating environment.

A slew of results from UK real estate companies were announced, including British Land, Big Yellow Group, Land Securities and Great Portland. Management teams generally reported a marked uplift in NAV. Great Portland noted meaningful additions to its development pipeline at attractive entry points, while British Land reported significant asset value uplifts, driven by its high grade portfolio. Management teams commented that leasing markets were showing tentative signs of improvement, particularly London. Both companies benefited from operating in markets characterised by higher barriers to entry which necessarily limits supply.

Management teams of British Land and Land Securities articulated a more aggressive development strategy in the medium term. British Land announced three new schemes which will cost approximately £475 million and said it was considering starting the 610k square foot Leadenhall scheme in London. Land Securities announced it was seeking to commence a 1.3 million square foot London development. Both companies emphasised a positive disposition to the under-supplied central London office market.

The De Montfort Commercial Real Estate lending survey in the UK showed that over one fifth (about £50 billion) of commercial property loans was in breach or default in the first quarter. New lending had decreased and margins were high. More than 71% of outstanding loans (£161 billion) are due to mature over the next five years. On the positive, publicly-listed real estate companies remain well-capitalised and are unlikely to need further equity. Furthermore, these companies have high Interest Coverage Ratios (ICR) and Loan-To-Value (LTV) covenants and extended maturity profiles.

In addition, UK banks including RBS (West Register) and Lloyds (Tennyson) assembled teams to manage the loan books and this was considered likely to result in professional execution of impaired assets. AMP Capital Investors does not anticipate the market will see a large quantity of stock released to the market, which will help protect asset valuation levels.

## Direct real estate markets

Transaction activity continued to occur in the UK as the quarter began, with some analysts speculating that recent yield compression was motivating owners to bring assets to the market. However, the pace slowed as macro uncertainty gained pace. On the Continent uncertainty around the sovereign crisis had a noticeable dampening effect on transactions, including those investors with available funds.

Data from real estate agencies indicated that over £3 billion worth of London real estate assets were being marketed. Examples included reports that Hermes Real Estate and Blackrock's UK property fund had placed Tower 42, a 250,000 square foot London office building, on the market. There was speculation on a price tag of around £300 million and a yield of 6.0%. Several bidders competed for Drapers Garden in London City; being sold by a consortium comprising Morgan Stanley Real Estate Funds, Canary Wharf Group and Exemplar Properties. Bids of approximately £240 million were received for the 300,000 square foot property, reflecting a yield of around 5.25%. No formal announcements have yet been made.

UK REIT, Land Securities purchased, the O2 Centre, London, a 300,000 square foot retail property, for £126 million, reflecting a 6.0% yield. Middle Eastern investors were prominent in London acquiring key sites in Knightsbridge, Stratford and Oxford Street. Land Securities sold a development known as Park House on Oxford Street to Barwa, a Qatari-based investor for £250 million for the site, all the construction costs as well as a profit share on completion (£33 million based on current ERVs, with a £50 million cap). This was considered a positive result for Land Securities and demonstrates that certain segments of the market remain in strong demand.

Despite this activity, the capacity of banks to finance new transactions is hampered by the amount of real estate currently on their balance sheets and therefore the outlook remains mixed. While not related directly to this issue, Deka reportedly pulled out of £400 million worth of commercial property investments in the City of London. Deka had agreed to buy Canary Wharf's and Exemplar's 292,000 square foot Drapers Gardens and Evans Randall's 201,000 square foot Milton Gate.

Tenant demand was unabated in the first quarter across London's office markets, with more than two million square feet leased, including leases signed by Nomura, Macquarie and Blackrock. As development remains limited, rental levels are likely to improve as anticipated. Morgan Stanley released a report suggesting rental levels could increase by 10% in 2010 and a further 8% in 2011.

# Asia

## Overview and outlook

The volatility experienced in North American and European markets was mirrored in Asia over the three months. Of particular concern were the monetary tightening policies in China. Analysts' opinions on whether these policies would result in a hard or soft landing for the Chinese economy were mixed. As in other international markets, investors rotated out of riskier asset classes and sought defensive characteristics. Notably, in Australia, this saw a general preference for real estate securities, signalling that the asset class' perception as a defensive investment had been restored.

Earnings season generally produced solid results. Interestingly, the outlook for the majority of companies in Hong Kong, Japan and Singapore was particularly positive for those with a higher percentage of their profits from rental income streams rather than development activity.

AMP Capital Investors believes broad market uncertainty will continue to drive investor sentiment, and therefore a level of volatility will remain over the third quarter. While the conservative mood will affect market movements in the short term, the improving fundamentals across most real estate sectors in the region are likely to present opportunities to acquire blue-chip companies at attractive valuations. Notably, as liquidity and bank lending remains more readily available than in 2009, a number of recapitalised real estate companies are back on the acquisition trail.

Consolidation across Japanese REITs is likely to continue and AMP Capital Investors believes this will be a positive in the longer term, as it should result in the creation of stronger companies with better sponsors. AMP Capital Investors believes office markets with better than expected tenant demand and little immediate supply will continue to be sought after. Indeed, some markets, such as Hong Kong, have surprised the market in terms of rental growth achieved in 2010 to date.

The overall outlook for the A-REIT market in the coming 12 months is positive, according to AMP Capital Investors, with companies well positioned to build upon improving real estate fundamentals, driven by strong economic metrics and a demand for prime quality assets that will further support capital values. A-REITs with exposure to international assets are likely to remain in strong demand, particularly as real estate fundamentals appear to be bottoming globally and little value is attributed to this component of their business by many investors. The current high cost of capital means accretive acquisitions will remain difficult; although, a number of A-REITs are openly seeking to acquire assets over the next six months. It is worth noting that the likelihood of good quality assets being acquired remains low, as investors, both public and private, are unlikely to dispose of their best assets at a low point in the cycle.

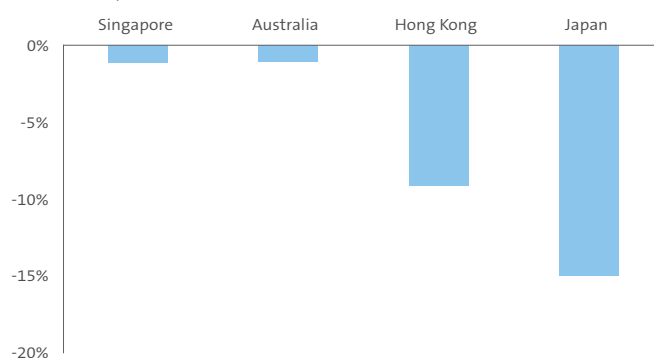
## Market activity and performance

The FTSE/EPRA NAREIT Asia Index was down 9.4% for the three months. Singapore was the strongest performer, down 2.57%, while Japan was the worst performer, down 10.66%. (Source: European Public Real Estate Association. Returns expressed in U.S. dollars.) Real estate securities underperformed their broader equity markets in China, Hong Kong and Singapore. Investors sought refuge in lower beta names and repositioned their portfolios away from Hong Kong and Chinese developers due to weak sentiment from falling volumes and prices on the back of tightening monetary policies.

Notably, Australian REITs significantly outperformed general equities, as investors regarded listed real estate exposure as more risk adverse, a traditional characteristic the asset class appeared to regain. The S&P/ ASX Property 200 Accumulation Index was down 1.3% for the three months, compared to the S&P/ ASX 200 Accumulation Index, which was down 11.1%. (Source: UBS.) A key driver for outperformance in the second quarter was the defensive trade, with both general equity investors and offshore investors viewing the Australian REIT market as a safe haven.

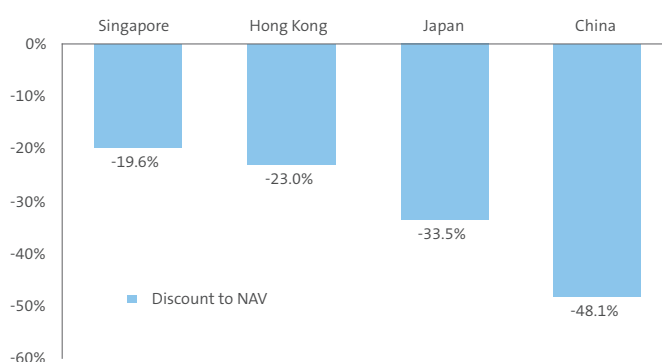
By the close of the quarter, real estate securities across the region were trading at a discount to NAV.

**Chart 6 – Asian REITs Quarterly Performance by Country At June 30, 2010**



Source: European Real Estate Association  
Note: Returns shown in local currency

**Chart 7 – Asian REITs Discount to Net Asset Value At June 30, 2010**



Source: EPRA

Consumer and business confidence in Australia were impacted by the combination of past interest rate hikes, broad global market uncertainty as well as debate over a proposed tax on mining and resources companies. As broadly anticipated, the Reserve Bank of Australia (RBA) increased interest rates by 25 basis points in April and again in May, now sitting at 4.50%. The central bank made no changes in June; however, stating it was monitoring the risks emanating from the European sovereign debt issues and the potential slow down in China. First quarter GDP growth was moderately slower compared to the previous period, however the pace is anticipated to resume in the second quarter. This should be driven by solid retail sales growth in March and April, a lagged rise in building approvals likely to flow through to stronger housing construction and business investment remaining on track.

In China, government measures as well as financial stress in southern Europe and an associated fall in demand for exports worried investors. Leading indicators such as the Purchasing Managers Index (PMI) began to exhibit signs of moderation. However, it is worth noting that despite this, the reading remained at a level that suggested China's economy was still in expansion mode.

The People's Bank of China (PBoC) announced the Renminbi exchange rate would cease to be marked against the U.S. dollar and return to the pre-crisis arrangement although no timeframe was articulated. In the statement, PBoC did not announce a one-off revaluation of the Renminbi (RMB) and emphasised that "the basis for large-scale appreciation of the RMB exchange rate does not exist." AMP Capital Investors anticipates appreciation of the RMB will be a gradual process, especially in light of global macro uncertainty, and that interest rate movements will be limited over the next quarter.

Hong Kong's economy recorded GDP growth of 8.2% for the first quarter (year-on-year), marking a second consecutive quarter of positive year-on-year growth. Importantly, the jobs market appeared to stabilise, with the unemployment rate remaining unchanged, at 4.4%, from February to April. Improvements also flowed through from trade data and domestic consumption.

In Japan, the June Tankan survey of business sentiment by the Bank of Japan (BoJ) better than expected, amid appreciation of the Yen and the decline in stock markets. The survey reported a widespread improvement in business conditions and the majority of firms surveyed expected sustained improvements over the next six months, on the back of robust medium-term demand from emerging economies, including China and emerging Asian countries. As the Japanese government has previously expressed a determination to fight deflation and the sovereign debt issues in Europe have led to some short-term uncertainty, market consensus does not anticipate the BoJ will increase interest rates over the next 12 months. Nevertheless, the BoJ will need to implement further measures to avoid deflation and there are limited options, including the possibility of depreciating the Yen. An option which is available to the BoJ is an extension and expansion of its quantitative easing measures, including increasing its purchase of Japanese Government Bonds.

Singapore also recorded strong economic growth over the first quarter, of 32.1%, which was significantly better than consensus expectations, and market analysts believe the second quarter will generate a similarly positive result. This is due to solid

manufacturing output growth, led by a considerable increase in pharmaceutical output. The majority of analysts now anticipate the Singaporean government will upgrade its full year GDP growth forecast to 10% to 12%, from 7% to 9%. In an effort to manage inflation, in April the Monetary Authority of Singapore announced a one-off re-centring of its exchange rate policy band, shifting the policy from zero appreciation to modest and gradual appreciation.

## Key themes

Monetary tightening, aimed at cooling real estate prices, dominated China and Hong Kong over the three months and impacted global equity markets. Nonetheless, corporate activity continued across Asian real estate companies.

Media articles reported that the final proposal for the trial program of REITs in China was submitted to the State Council for final approval. The proposal was jointly initiated by four Shanghai-based A-share listed developers. According to the media reports, the proposed REIT vehicle will comprise debt securities and will not be publicly listed. Investors will likely receive coupon payments which are tied into the rental income of the properties. No specific timeframe was mentioned for the official launch.

## Australia

As investors generally shunned risk and growth for safety, Australian real estate securities were sought after as a defensive investment. The trade was driven by the combination of global and domestic macro uncertainty.

Following unprecedented equity issuance of in excess of AU\$20 billion in 2008/09, the vast majority of A-REITs are now well-capitalised with strong balance sheets and conservative dividend pay-out ratios. While the scale of equity issued resulted in limited earning growth potential across the asset class in 2010-2011, the risk to earnings is now considered to be low, particularly compared to general equities.

Another positive is the increased transparency of earnings profiles and better alignment with the underlying real estate assets relative to pre the financial downturn in 2008. Practices which were previously common across A-REITs, such as over-distributing above cash earnings, synthetic capital and income hedging gains and 100% debt funding maintenance capital expenditure, have largely been eliminated.

Importantly, early indications of asset value appreciation emerged for the first time since the market peak of 2007, with quarterly valuations for a select number of A-REITs witnessing positive growth, and driven by marginal rental growth and capitalisation rate compression.

## China

The Chinese government's measures to temper real estate prices and limit speculative activity played a key role in escalating investor uncertainty across the globe during the second quarter. AMP Capital Investors believes further measures, such as a real estate tax, could be likely, which would particularly affect Beijing and Shanghai, where investors are most active.

In summary, the new policies were:

- The minimum down payments for first home larger than 90 square metres was increased to 30% from 20%
- The down-payment for second homes was lifted to 50%, from 40%, and interest rates may not be lower than 110% (from 85%) of benchmark rates, i.e. bank mortgage rates on second homes must be at a minimum of 1.1 times the central bank's benchmark interest rate. Banks previously had flexibility in the rates they charged
- No lending to third home buyers in areas of rapid price increases
- No lending to non-local buyers unable to deliver the past year tax return or social security tax return
- No lending to developers involved in land hoarding or delayed launches
- Prices of units available for pre-sale must be published within 10 days of receiving government approval

The immediate effect of these measures was a fall in sales volumes as many buyers delayed making decisions. The new restrictions and slowing sales could result in a lack of liquidity for developers, with some already cutting prices in an attempt to increase volumes. AMP Capital Investors believes developers may supplement liquidity shortfalls through debt or equity issuances.

It is worth noting that prices have not yet fallen as significantly as the government's new measures aimed to do and AMP Capital Investors believes prices will have to fall further in order to entice prospective buyers back into the market.

## Hong Kong

The Hong Kong government introduced new policies to prevent excessive real estate prices and to eliminate allegedly misleading sales strategies by developers. As a result, new launches were delayed by developers and market sentiment was dampened temporarily. In May, three land auctions fell short of the market's expectations. The first land auction in the government's 2010-2011 financial year, a Tung Chung residential site was auctioned at HK\$3.42 billion to Nan Fung, a private developer. The land price came at lower than market consensus ranging from HK\$3.7 billion to HK\$5 billion, with few developers actively bidding. However, the second site, a high-end residential development at the Peak, received a better response although was still below expectations.

## Japan

Mergers and acquisitions as well as sponsor changes continued to dominate J-REITs. Two diversified REITs; United Urban, under Marubeni's sponsorship, and Nippon Commercial, sponsored by Pacific Holdings (now in bankruptcy), announced an intention to formally merge on December 1, 2010. United Urban will be the surviving entity and the merged portfolio will have a total asset size of approximately Y460 billion, representing the fourth largest REIT in Japan. Like its predecessors, United Urban will use the negative goodwill from the merger to reposition the merged entity's portfolio and improve the REIT's overall financial stability. The negative goodwill can be distributed to maintain dividends, to offset any potential earnings dilution from divestments or to offset losses from divestment. In another merger, Crescendo, a J-REIT investing in office and residential properties, and Japan Single Residence, a residential J-REIT, will merge in October 2010. Crescendo, sponsored by Heiwa Real Estate, will be the surviving entity and the total asset size will be approximately Y149 billion.

Japanese real estate companies also continued to reposition their portfolios to offset weaker rental income by acquiring higher-yielding assets and a number of REITs with relatively high dividends issued equity to fund these acquisitions. Mori Trust Sogo, a diversified REIT focusing on large office buildings in central Tokyo, raised Y40.2 billion through a public offering to pay down its debt from the acquisition of Tokyo Shiodome Building (Y11 billion) – a large mixed-use building with Net Operating Income (NOI) yield of 4.5%. Frontier Real Estate, a retail REIT used the proceeds of Y19.5 billion from a public offering to acquire two retail properties from its sponsor Mitsui Fudosan, for an aggregate price of Y28.8 billion at an overall 5.3% NOI yield. Advance Residence, a residential J-REIT merged with Nippon Residential Investment during the first quarter, issued equity of Y28.2 billion for acquisitions and debt repayment. REITs that can demonstrate they can undertake accretive acquisitions and increase dividends will outperform over the remainder of 2010, in AMP Capital Investors' view.

## Singapore

Following on from the recapitalisation activity in 2009, the majority of Singaporean REITs are focusing on asset enhancement initiatives and new acquisitions in 2010. Corporate activity has also begun to emerge.

Representing the first IPO in two years, Cache Logistics Trust, a pure play industrial REIT, successfully raised S\$417 million. The REIT closed its first day of trading up 8.5%, attracting investors with a high yield of 8.8%. By the close of the quarter, the company was up 11.4% from its listing price of S\$0.88 per share.

CapitaMalls Asia listed its Malaysian REIT, CapitaMalls Malaysia Trust, shortly after the quarter end, raising RM860 million (S\$370 million) and becoming Malaysia's largest listed 'pure-play' retail REIT. The initial portfolio comprised three retail assets, Gurney Plaza in Penang, Sungei Wang Plaza in Kuala Lumpur, and the Mines in Selangor. CapitaMalls Asia retained a 41.74% stake in the REIT.

Additional IPO activity is likely throughout the remainder of the year in Singapore. Mapletree Investments, a fully-owned real estate subsidiary of Temasek Holdings, announced plans to list two trusts that will own a combined total of approximately S\$5 billion to S\$6 billion in assets. Rumours emerged that one of the new vehicles will be an industrial-focused REIT, and will comprise the former JTC assets acquired by Mapletree in 2007. If successful, this would rival Singapore's current largest industrial REIT, Ascendas REIT.

## Direct real estate markets

### Australia

Fundamentals across Australia's direct property markets generally continued to improve. AMP Capital Investors believes asset values have essentially bottomed, with the exception of lower quality real estate assets. In AMP Capital Investors' view, asset valuations are likely to move ahead over the next six months and into 2011, with two vehicles reporting positive movements in first quarter earnings results. The spread between primary and secondary real estate valuations may widen further in the coming 12 months as demand is unlikely to be matched by supply.

The scarcity of capital and soft effective rental levels in the last 18 months has resulted in historically low supply levels across Australia's major markets. Therefore as tension between landlords and tenants returns to the leasing market towards the end of this year and into 2011, AMP Capital Investors anticipates strong rental growth will occur and asset valuation growth. Sustained improvements in employment data should also support recovery across real estate fundamentals, particularly demand in the office sector as well as retail sales, which saw a moderation as government financial stimulus ended.

### Hong Kong

Hong Kong's office market was a standout during the three months. According to real estate agency, Knight Frank, rental increases outpaced prices over the first quarter of 2010; up 15% in Premium Central, 6% in Causeway Bay, and 4% for Tsimshatsui and Mongkok. As an example, the Bank of America leased three floors in IFC One at HK\$120 per square foot per month. This implied an approximate increase of 30% compared to the previous year.

Solid leasing activity led to the total vacancy for higher quality office space falling below 5%, similar to levels during the second half of 2008. Real estate brokers anticipate Central office rentals will rise another 15% to 20% over the next 12 months, with vacancy rates likely to drop below 3%.

Capitalisation rates remained low, with Ryoden selling its office property, Manulife Tower in North Point for HK\$2.3 billion (or HK\$6,389 per square foot). Based on current rentals of HK\$20 per square foot per month for the entire property, the transaction price reflected 3.8% yield, compared to market historical average of 5.5% yield.

### Japan

Japan's the National Tax Agency (NTA) announced the Rosenka<sup>1</sup> land price for January 2010, showing the latest land price was down 8.0% year-on-year on a nationwide basis (previously down 5.5% year-on-year), down 9.7% in Greater Tokyo, down 8.3% in Greater Osaka, and down 7.6% year-on-year in Greater Nagoya.

Despite the land price survey results, AMP Capital Investors believes capitalisation rates have stabilised. According to the Japan Real Estate Institute's investor survey for April 2010, anticipated yields for A-class buildings in Tokyo's Marunouchi and Otemachi districts were unchanged from September 2009 levels at 4.5% and 4.2% respectively. The survey's capitalisation rate implied investors are discounting for a 15% fall in prices. The 5% to 10% drop in rental levels suggests investors are discounting for 20% to 25% declines. While this survey only measures expectations, it was in line with anecdotal evidence recently disclosed by J-REITs.

Investor appetite has noticeably increased in 2010, with the value of all transactions occurring during the first quarter of 2010 at approximately ¥250 billion. Notably, this equates to 90% of the total value transacted across the entire 2009 calendar year. Increased demand has been driven by improved equity raising conditions, an increase in purchases made utilising debt, and an inflow of capital from offshore investors. AMP Capital Investors believes transaction activity will continue to feature over the remaining six months of 2010.

### Singapore

The Singaporean government released an aggressive land sales programme for the second half of 2010, which doubled the total number of units released during the first half of the year. The expected supply of at least 14,300 units in 2010 is virtually double the record supply of 8,500 units pushed into the market by the government back in 1997. Nevertheless, AMP Capital Investors believes investors anticipated the government's move, as sales volumes and prices continued to move ahead in the second quarter despite the cooling measures implemented earlier this year.

The record supply over the remainder of the year aims to slow buyer momentum and, in turn, limit developers' ability to price projects aggressively. However, AMP Capital Investors does not expect new apartment prices to decline until the first half of 2011, as developers presently launching projects acquired land at relatively higher prices and will want to achieve healthy margins. Therefore, it is likely that sales volumes will moderate and prices will remain stagnant.

Fundamentals for Singapore's office sector are likely to improve in the near term. The majority of supply coming on stream by the end of 2010 is pre-committed and rentals appear to have reached a bottom. Therefore, AMP Capital Investors anticipates the rate of decline in rental levels will slow over the remainder of this year, particularly for higher quality office buildings. Tenant enquiries have begun to pick up and are likely to improve on the back of economic growth.

1. Rosenka is the benchmark land price used by the NTA to calculate inheritance tax for residential land, and is derived as approximately 80% of the Koji Chika, the land price survey by the Ministry of Land, Infrastructure, Transport and Tourism, the latest of which was announced in March.

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## Contact us

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